RONG VIET SECURITIES

1QFY16-17 Result Update | Basic materials

March, 2017

HOA SEN GROUP JSC (HSG – HSX)

Robust Core Business

Particulars (VND bn)	Q1-FY16/17	Q4-FY15/16	*+/- qoq*	Q1-FY15/16	*+/- yoy*
Net revenue	5,766.6	4,994.2	15%	3,913.2	47%
PAT	440.0	447.7	-2%	187.2	135%
EBIT	579.7	605.5	-4%	314.3	84%
EBIT margin	10.1%	12.1%	-207bps	8.0%	202bps

Sources: HSG, RongViet Research

FY2015-2016 Performance: A Surging Year for the Market Leader

- Continuously expanding capacity with the encouraged set-up progress.
- Maintaning a record-high gross margin thanks to its pricing power and inventory management amid input price fluctuation.
- Benefiting from the industry growth owing to the influential market shares and the strategy of focusing on domestic sales.
- Huge benefits from trade measures against imports

FY2016-2017 Potential: Anticipating a New Input Price Hike

HSG, who has been known for speedy investments, is going to continue grow its capacity and sales volume strongly by operating various new lines. Having a well-developed retail system makes HSG superior to its competitors in terms of sales to end-users. Besides, the market demand growth can ensure strong consumption for its plants in Central and Northern Vietnam.

HSG possesses a well-perceived brand as well as an influential pricing power. Therefore, the company is capable of easing the burden of the fluctuating material price while at the same time monitoring the market sales price. Moreover, HSG also demonstrates its strong capacity regarding input price forecasts, inventory management and financial health. VND5,000 billion worth of inventory at Q1-end and the recent movements of global steel prices are considered signals for HSG's profitability in the up coming quarters.

Regarding FY16-17 guidance, HSG targets 1.6 million tons for sales volume (+20%), VND23,000 billion for revenue (+29%) and VND1,650 billion for NPAT (+10%), which is considered sensible amid the global steel price's volatile movements.

Valuation and Recommendation: *While input prices are volatile in the global market, HSG has managed to maintain a remarkable production and sales efficiency. Continuing to expand its capacity, the Vietnamese coated steel giant aims at two-digit profit growth in the new financial year. As the mass steel project Ca Na, whose potential is considered promising, has yet to be approved by the government, HSG's cash flows and operating efficiency are not likely to be affected in the medium term. Additionally, HSG's consistent dividend policy of both cash and share can be a factor elevating the market sentiment.*

*We evaluate HSG price at **VND51,700/share**, which is **9.7%** higher than the closing price on March 22nd 2017 and recommend **NEUTRAL** on the stock in the **INTERMEDIATE TERM**. This target price is revised from that in HSG Company Report published on October 29th 2015 because of the domestic steel industry improvements during 2016 and 2017 potential.*

NEUTRAL

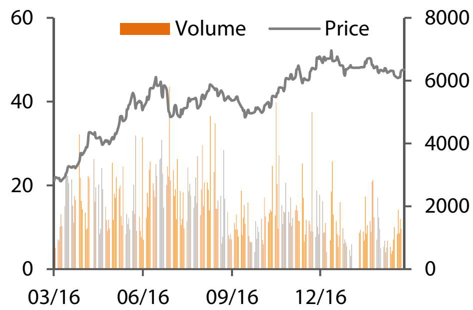
CMP (VND)	47,150
Target Price (VND)	51,700
Investment Period	**Intermediate-term**

Stock Info

Sector	Basic materials
Market Cap (VND B)	9,257
Current Shares O/S	196,540,000
Beta	1.46
Free float (%)	40.0
52 week High	52,198
52 week Low	20,994
Avg. Daily Volume (20 sessions)	1,033,967

	FY15-16	Current
EPS	7,350	9,238
EPS Growth	120 %	101%
Diluted EPS	7,350	9,238
P/E	5.71	5.10
P/B	2.00	2.25
EV/EBITDA	5.02	5.39
Cash dividend	2,500	1,000
ROE	41%	41%

Price performance



Major Shareholders (%)

Hoa Sen Inv Group Ltd	25.69
Hoa Sen Inv & Tourism Ltd	20.61
Le Phuoc Vu	12.97
Tam Thien Tam Co.	7.04
Foreign ownership room (%)	19,41

Trinh Nguyen

(084) 08- 6299 2006 – Ext 1331

trinh.nh@vdsc.com.vn

Exhibit 1: Q1/FY16-17 Results

Particulars (VND bn)	Q1-FY16/17	Q4-FY15/16	+/- (qoq)	Q1-FY15/16	+/- (yoy)
Net Revenues	5,766.6	4,994.2	15.5%	3,913.2	47.4%
Gross profits	1,046.5	1,316.8	-20.5%	649.2	61.2%
SG&AC	509.3	679.8	-25.1%	219.0	132.5%
Operating Income	464.0	546.7	-15.1%	130.7	255.1%
EBITDA	735.7	758.3	-3.0%	444.2	65.6%
EBIT	579.7	605.5	-4.2%	314.3	84.5%
Financial expenses	85.7	97.8	-12.3%	61.4	39.5%
- Interest Expenses	64.7	64.7	0.0%	54.1	19.6%
Dep. and amortization	-156.0	-152.8	2.1%	-129.9	20.1%
Non-recurring Items (*)					
Extraordinary Items (*)	51.0	6.0	752.4%	1.2	4,000.9%
PBT	515.0	540.7	-4.8%	260.1	98.0%
PAT	440.0	447.7	-1.7%	187.2	135.0%
(*) Adjusted PAT	396.4	443.3	-10.6%	186.3	112.8%

Sources: HSG, RongViet Research

Exhibit 2: 1QFY2016-2017 Performance Analysis

Particulars	Q1-FY16/17	Q4-FY15/16	+/- (qoq)	Q1-FY16/17	+/- (yoy)
Profitability Ratios (%)					
Gross Margin	18.1%	26.4%	-822bps	16.6%	156bps
EBITDA Margin	12.8%	15.2%	-243bps	11.4%	141bps
EBIT Margin	10.1%	12.1%	-207bps	8.0%	202bps
Net Margin	7.6%	9.0%	-133bps	4.8%	285bps
Adjusted Net Margin	6.9%	8.9%	-200bps	4.8%	211bps
Turnover *(x)					
-Inventories	3.9	4.0	-0.1	3.6	0.3
-Receivables	15.4	16.3	-0.9	14.7	0.8
-Payables	12.6	11.7	0.9	9.5	3.1
Leverage (%)					
Total Debt/ Equity	204%	196%	776bps	174%	2952bps

Sources: HSG, (*) Annualized turnover

Exhibit 3: Q2-FY16/17Performance Forecast

Particulars (VND bn)	Q2-FY16/17	+/- qoq	+/- yoy
Revenue	6.746	17%	54%
Gross profit	1.298	24%	18%
EBIT	651	12%	11%
NPAT	435	-1%	4%

Sources: HSG, RongViet Research

Updates:

HSG's capacity is going to be expanded by 28% as new lines come online. In particular, two GI/GL lines producing 380,000 tons per year collectively and several welding lines making 250,000 tons of steel pipes per year are going to start operation by April 2017. HSG's total steel capacity will reach 2.9 million tons per year, enabling Hoa Sen Coated Steel to prevail over all of its competitors and helping Hoa Sen Steel Pipe to remain competitive.

HSG benefits from trade policies for coated steel products. The temporary anti-dumping duties on GI/GL imports in September 2016 has taken remarkable effects on the domestic supply side. The improved sales price and the shortage in the market created valuable opportunities for domestic players to boost their sales and profits. HSG's market structure also changed toward the domestic market, which offers higher gross margin than overseas markets. In March 2017, the market is anticipating a final determination of AD duties on GI/GL products as well as a determination on the case of prepainted coated steel, which will then form a completed protection to the domestic coated steel makers.

Plastic pipe products are currently contributing a minor part in HSG's business but promise a strong growth potential. HSG's current plastic pipe capacity is around 76,000 tons per year and will be expanded to 128,000 tons per year thanks to the new line at HSG's plant in Northern Vietnam. This capacity is equal to that of two industry leaders Binh Minh Plastic (BMP-HSX) and Tien Phong Plastic (NTP-HNX). Compared to these two companies, HSG has a huge competitive advantage in terms of cost saving as the company can make use of its own retailing network to carry out agressive discount strategy and retain a substantial gross margin at the same time. HSG has yet to reach full production capacity so this sector contributed less than 5% of both revenue and profits in its consolidated figures. However, considering the strong investments into capacity and marketing similar to the investment for HSG's successful coated steel and steel pipe products in the past, we expect plastic pipes to be a new "ace" in HSG's future product mix. Additionally, the plastic pipe industry has been known for offering superior profitability compared to the coated steel industry. Thus, we predict that plastic pipes will play a much more important role in HSG' growth in the long term.

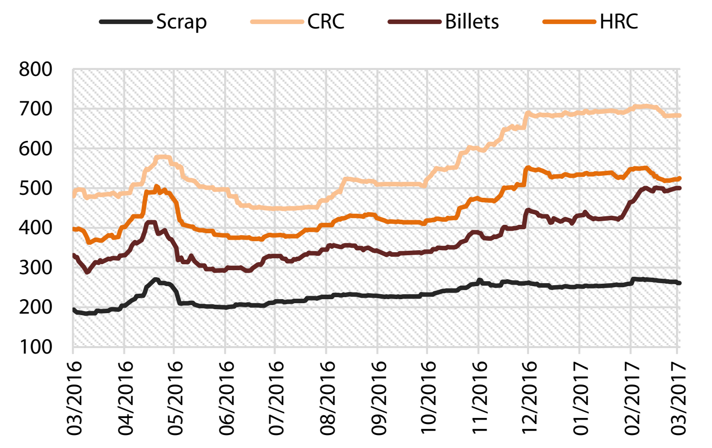
HRC price is in an upward trend influenced by other steel input price hikes. The Chinese steel industry's reforming policy caused the price of coking coal, iron ore and scrap to surge in 2016, which also made steel semi-products such as billets and HRC to increase sharply. Even though China has loosened the restrictions, the lagging reaction along the value chain from raw inputs to semi-products has been the reason for HRC to stay at such high level. Spot HRC in Dalian market (China) is recently observed at USD569 per ton, which increased 35% in a quarter and was double the price one year before. RongViet Research forecasts that HRC is going to remain high and can only cool down in the second half of 2017.

HSG is capable of passing the input price effect to buyers through the retailers, like what it did during Q3/FY15-16 when HRC bounced sharply. Besides, the large amount of raw materials at the latest quarter-end is likely to help HSG stabilise the gross margin and achieve NPAT growth in 1H/FY16-17. In the long run, as profits from input price differences are eliminate from HSG's gross margin, we expect the figure to hover around 16%. This gross margin seems feasible for a down-stream producer with strong market share power and a national-wide retail network.

HSG has paid cash dividends of VND1,000 per share in February and 50% stock dividend is expected to be exercised during Q3/FY16-17.

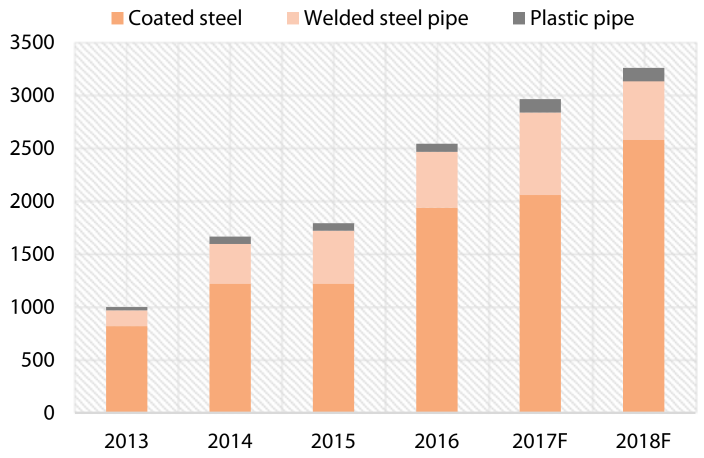
For 2017, RongViet Research forecasts that HSG's sales volume will grow at a similar pace with its capacity growth, at around 28%. ASP is predicted to incline by 14% under certain assumptions concerning input price changes, domestic and global coated steel demand. HSG's gross margin might no longer be as high as 23.4% but decline to 19%, which is still considered superior among industry peers and remarkably higher than HSG in the past itself. Assuming that HSG will set aside 7% of its NPAT for bonus and funds, its FY16-17 EPS is estimated at VND8,256, which means HSG is trading at a forward P/E of 5.5x.

Input Prices (USD per ton)



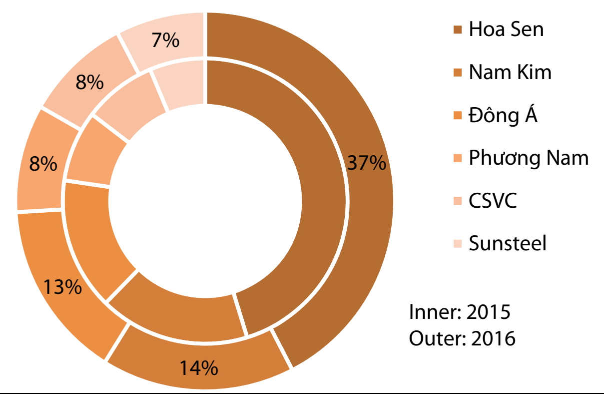
Sources: Bloomberg, RongViet Research

Steel Production Capacity by Segments



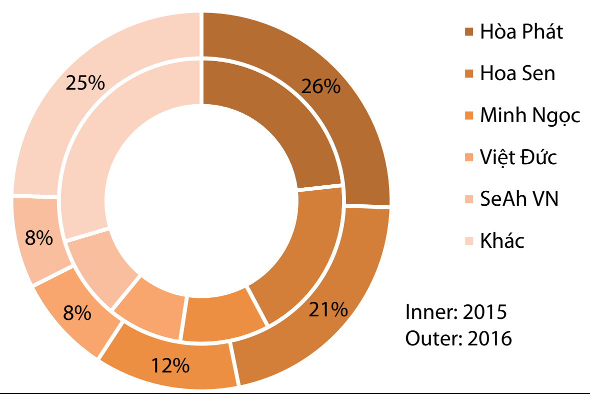
Sources: HSG, RongViet Research

Domestic Coated Steel Market Share



Sources: HSG, VSA, RongViet Research

Domestic Steel Pipe Market Share



Sources: HSG, VSA, RongViet Research

Ca Na Steel Complex: Not Impossible

HSG is planning for a mass project producing up to 6 million tons of steel per year in Ninh Thuan. The project is constructed in 4 phases of which the first phase is scheduled to complete in 2018, producing 1.5 million construction steel and is worth over VND11,000 billion of initial investment. As most recently updated, the project has yet to receive approval from the government.

Assessing the project's feasibility in terms of production and consumption, RongViet Research considers the domestic demand is encouraging capacity expansion particularly in the long steel segments, however Ca Na Steel Complex is likely to put tremendous funding pressures on HSG, whose chartered capital was approximately VND2,000 billion.

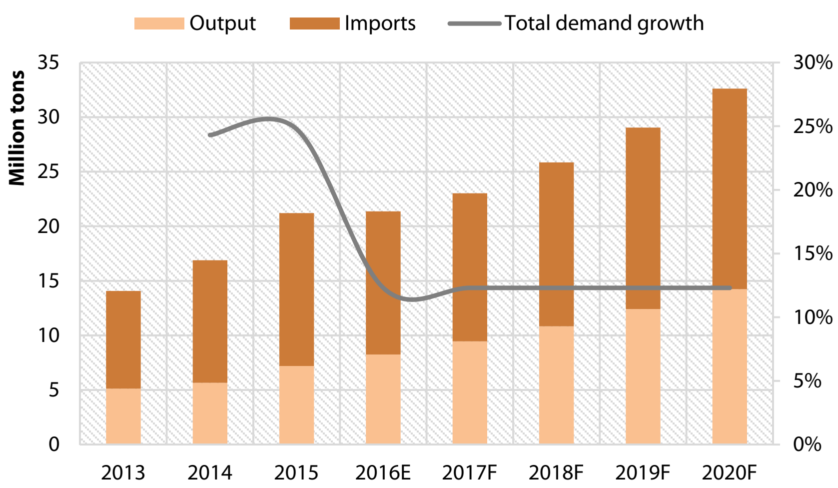
Strengths and Opportunities

As mentioned above, HSG has built itself a well-developed distribution and retail system throughout the whole country as well as several construction material brands recognised by the major public. Ton Hoa Sen (coated steel) and Ong thep Hoa Sen (steel pipes) are familiar names to the market and over 200 retailers ensure HSG's product availability. The company's new brand Ong nhua Hoa Sen (plastic pipes) has enormous advantages and was reported to be growing agressively in terms of market share. Similarly, HSG's long steel products can also make use of the system to rapidly enter the market in a cost-saving manner.

The domestic supply side needs equiping with well-developed production process. Particularly, domestic long steel producers are mostly down-stream which means they are highly dependent on billet imports and retain limited added value. However, the industry still lacks upstream production process and the market still has to import most of the demanded rebar, which made way for China's dumping. HSG' investment might help the industry gradually build an immune system to defend such supply shocks by the neighbour trading partner.

The domestic construction demand is in favour of steel companies. That Vietnam is importing final products such as rebar and wire rods means ample rooms for growth in sales volumes for local steel makers. Due to high transportation cost, domestic companies has significant geographic advantage to take over market shares from the Chinese exporters. Vietnamese steel mills only need to concentrate on developing the production process to lower the costs to directly compete against imports.

Figure: Vietnam's Long Steel Output and Import Forecasts



Source: RongViet Research

Concerning the global steel industry, oversupply also offers an opportunity to acquire machinery at favourable costs. HSG reported that as the world's steel utilisation ratio was hovering around 70%, the exhausted demand for investment in steel production put downward pressure on the price of steel mills. In terms of initial outlay for machinery, investment in steel production can be considered more cost-effective than it was a decade ago. In Vietnam's case, the developing country whose construction demand is growing strongly, the demand potential is encouraging firms to take advantage of the global machinery prices.

Weaknesses and Threats

T**he project's scale is likely to put financing burdens on HSG's gearing**. The company's chartered equity at the end of FY15-16 was nearly VND2,000 billion, which is merely one fifth of phase I's investment value (VND11,150 billion). HSG's plan also says that the company will have to borrow around VND9,000 billion, while at the current borrowing rate of 8-10% p.a. it would be obliged to pay approximately VND700 billion of interest annually.

Another risk is input price fluctuation. Because a large proportion of iron ore, coking coal and scrap are imported, their price movements in the global market are heavily influenced by China, the biggest participant, which as a result is likely to affect the project's operating efficiency. It can be clearly observed that the recent surge of coking coal price caused a serious injury to many steel mills in Japan, Korea and China itself. Moreover, Vietnamese rebar price is not as elastic as that of coated steel, meaning passing through could be difficult in case of input price hikes.

In terms of competition risks, the most significant factor remains China's steel dumping activities. Most Vietnamese steel makers experienced losses or deteriorated profits in 2015 due to dumped rebar and billets from China, as domestic producers lost in the production cost battle. Regarding HSG's new project, the equally developed production method promises a brighter outcome, as Hoa Phat (HPG-HSX) has set an example proving that investing in a decent plant can help survive supply shocks and only that can bring about the long term efficiency. On the other hand, domestic competition could be handled easily because most steel mills are small scale and bear high production costs while lacking distribution capacity especially in Southern Vietnam, which is also HSG's targeted market.

The environment and public relation can also pose a risk to HSG's new project. The recent incidence of Formosa, which is regarded as a marine life disaster and caused the factory to halt production, has drawn attention toward Hoa Sen's plan. It has been known that steel production is not an environmentally friendly industry and pollution is parts and parcels. However, Hoa Phat's steel complex in Pho Noi Industrial Park, Hai Duong has been operating for 10 years and still satisfies Ministry of Natural Resources and Environment's regulations, which embodies the feasibility of running a steel mills without damaging the ecosystem. Not only has HPG never faced PR crisis, they even receive ecosystem services credits from the UN thanks to their energy retrieving method which is different to that of Formosa. HSG states that their new project is going to be equiped with the same technology as Hoa Phat thus will meet the environmental friendliness requirements. Lastly, it can be concluded that this risk may not affect the project's operating efficiency but is likely to influence HSG share price movements.

Forecasts

Based on several assumptions: (1) iron ore price stays slightly above USD60 per ton, (2) coking coal price moves within USD150-160 per ton, (3) VND depreciates 2% per year, outcomes concerning profitability and cash flows were computed. Accordingly, HSG's rebar will be well demanded while the company is able to maintain a gross margin of 15% as the project goes into the stable production phase in year 10. After the equipments are fully depreciated, about VND1,800 billion is added to HSG's cashflow every year. It should also be mentioned that HSG proposed an income tax rate of 10% during the project 70-year life with 0% tax in the first 5 operating year and 5% for the next 9 years. Therefore, the project's NPV is evaluated at VND1,300 billion and its IRR is calculated at 21.1%. It means the project can add VND6,585 to HSG's FCFE valuation per share. However, as the initiation time for Ca Na has yet to be confirme and the market has not started to reflect into the stock price, we put aside the effects of the project in HSG valuation.

Table: 10-year Cash Flow Forecast for Ca Na

(VND million)	2018-2019	2019-2020	2020-2021	2021-2022	2022-2023
PBT	-558,425	142,613	672,976	652,466	597,395
PAT	-558,425	142,613	672,976	652,466	597,395
Depreciation	1,115,000	1,115,000	1,115,000	1,115,000	1,115,000
FCF	556,575	1,257,613	1,787,976	1,767,466	1,712,395
	2023-2024	**2024-2025**	**2025-2026**	**2026-2027**	**2027-2028**
PBT	594,805	649,827	717,094	826,622	937,009
PAT	565,064	617,335	681,239	785,291	890,159
Depreciation	1,115,000	1,115,000	1,115,000	1,115,000	1,115,000
FCF	1,680,064	1,732,335	1,796,239	1,900,291	2,005,159

Source: RongViet Research forecasts

VND billion

INCOME STATEMENT	FY14-15	FY15-16	FY16-17E	FY17-18F
Revenue	17,447	17,886	26,004	30,581
COGS	14,869	13,708	21,063	25,016
Gross profit	**2,578**	**4,178**	**4,941**	**5,565**
Selling Expense	864	884	1,352	1,590
G&A Expense	512	1,006	1,040	1,223
Finance Income	32	38	30	30
Finance Expense	425	274	447	298
Other profits	24	230	25	25
PBT	**832**	**1,921**	**2,157**	**2,509**
Prov. of Tax	179	470	412	377
Minority's Interest	0	0	0	0
PAT to Equity Shareholder	**653**	**1,451**	**1,745**	**2,132**
EBIT	**1,056**	**2,130**	**2,532**	**2,728**
EBITDA	1,538	2,680	3,119	3,422

%

FINANCIAL RATIO	FY14-15	FY15-16	FY16-17E	FY17-18F
Growth				
Revenue	16.4	2.5	45.4	17.6
Operating Income	75.6	90.5	11.4	8.0
EBITDA	45.0	74.2	16.4	9.7
PAT	59.1	122.2	20.3	22.2
Total Assets	-7.5	29.3	27.4	11.8
Equity	22.0	42.1	30.4	30.5
Internal growth rate	19.0	27.3	26.4	26.5
Profitability				
Gross profit/Revenue	14.8	23.4	19.0	18.2
Operating profit/ Revenue	6.9	12.8	9.8	9.0
EBITDA/ Revenue	8.8	15.0	12.0	11.2
Net margin	3.7	8.1	6.7	7.0
ROAA	6.6	13.4	12.6	12.9
ROAE	24.7	41.3	36.7	34.4
Efficiency				
Receivable Turnover	22.1	19.3	22.6	24.1
Inventory Turnover	3.6	3.3	3.5	3.1
Payable Turnover	9.6	8.4	8.3	8.2
Liquidity				
Current	0.9	1.0	1.1	1.4
Solvency				
Total Debt/Equity	222.9	195.9	189.3	147.7
Current Debt/Equity	155.8	105.9	105.4	72.8
Long-term Debt/ Equity	33.4	34.4	31.7	27.5

VND billion

BALANCE SHEET	FY14-15	FY15-16	FY16-17E	FY17-18F
Cash and short-term investment	277	577	585	783
Receivables	755	1,097	1,206	1,327
Inventories	3,544	4,730	7,268	8,632
Other current assets	593	561	617	679
Total Current Asset	**5,169**	**6,965**	**9,677**	**11,421**
Fixed Assets	3,403	4,001	4,178	4,734
Construction in Progress	111	319	810	590
Long-term Investment	38	8	8	8
Other long-term assets	424	621	592	343
Long-term Asset	**4,271**	**5,242**	**5,878**	**5,961**
Total Asset	**9,441**	**12,207**	**15,555**	**17,383**
Payables	760	1,647	2,531	3,006
Current Debt	4,521	4,366	5,669	5,107
Long-term Debt	970	1,419	1,702	1,928
Other long-term liabilities	0	4	0	0
Total Liability	**6,468**	**8,080**	**10,178**	**10,365**
Owner's Equity	**2,902**	**4,124**	**5,377**	**7,018**
Capital	1,008	1,965	1,965	1,965
Retained Earnings	1,453	1,600	2,853	4,494
Funds & Reverses	7	7	7	7
Others	**0**	**0**	**0**	**0**
Total Equity	**2,902**	**4,124**	**5,377**	**7,018**
Minority's Interest	0	0	0	0
TOTAL RESOURCES	**9,370**	**12,203**	**15,555**	**17,383**

VALUATION RATIO	FY14-15	FY15-16	FY16-17E	FY17-18F
EPS (dong)	6,024	6,865	8,256	10,089
P/E (x)	7.6	6.6	5.8	4.7
BV (dong)	28,794	20,981	27,358	35,706
P/B (x)	1.6	2.2	1.7	1.3
DPS (dong/cp)	2,500	1,000	2,500	2,500
Dividend yield (%)	5.5	2.2	5.5	5.5

VALUATION MODEL	*Price*	*Weight*	*Average*
FCFE	47,221	30%	14,166
P/E	53,661	70%	37,563
Target price (dong/share)			**51,700**

VALUATION HISTORY	*Price*	*Recommendation*	*Period*
29/10/2015	33.300	Accumulate	Long term

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RESULT UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective which is to determine the reasonable value of the stock at the time such analyses are performed. Through this report, we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings / Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to10%	-15% to- 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

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Network

Headquarter

Address: Floor 1-2-3-4-5, Viet Dragon Tower, 141 Nguyen Du, Ben Thanh Ward, Dist.1, Tp.HCM

Phone: 84.8 6299 2006   Fax: 84.8 6291 7986

Website: www.vdsc.com.vn

Ha Noi Branch

2C Thai Phien – Hai Ba Trung District – Ha Noi

Nha Trang Branch

50Bis Yersin - Nha Trang

Can Tho Branch

Floor 08, 95-97-99 Vo Van Tan, Ninh Kieu – Can Tho

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