April, 2019

DA NANG RUBBER JSC (HSX: DRC)

Expect a slight earnings growth despite stiff competition

(VND bn)	Q4-FY18	+/- qoq	+/- yoy	FY18	+/- yoy
Net revenue	999	12.2%	-2.7%	3,551	-3.2%
PAT	33	5.3%	4.9%	139	-16.5%
EBIT	54	3.3%	0.3%	-5%	-5.0%
EBIT margin	5.4%	-47.1 bps	16.0 bps	7.3%	-10.0bps

Source: DRC, Rong Viet Securities

FY2018 - The application of EURO 4 emission standard dragged profits down

In 2018, revenue and NPAT of the company reached VND 3,551 billion (-3%YoY) and VND 139 billion (-16% YoY), respectively. DRC saw divergence in sales of two core products. While selling volume of bias tires fell by 21% YoY to 665 thousand units, sales of radial tires grew by 13% YoY to 376 thousand units. The slump in sales of bias tires was due to a 25% decline in selling volume of light truck bias tires as the application of EURO 4 emission standard in early 2018 forced light truck manufacturers to switch from bias tires to radial tires (LTRs). The increase in sales of radial tires was mainly supported by the capacity expansion of radial factory to 600,000 tires per year since July 2018. However, gross profit margin (GPM) of radial tire segment is normally 20 percentage points lower than that of bias products. Hence, the total impact from the increase in radial tire sales and the fall in bias tire sales still resulted in a sharp decline in 2018 NPAT.

FY2019 - Performance is expected to improve slightly

In 1Q 2019, we estimate that revenue and NPAT would reach VND 800 billion (+9% YoY) and VND 22.3 billion (+8% YoY), respectively. The earnings growth would be attributable to radial tire segment as its GPM is anticipated to expand from -3.3% in 1Q 2018 to 1.2% in 1Q 2019.

For 2019 outlook, we expect a trend of switching from bias tires to radial ones in the market. Therefore, we hold the view that selling volume of radial tires would continue to grow, while that of bias tires may decrease slightly. In 2019, we estimate that the company will witness a 6.5% YoY increase in revenue to VND 3,781 billion and a 3.0% YoY growth in NPAT to VND 143 billion, corresponding to an EPS of 1,116 VND.

Valuation and Recommendation:

In the short term, we believe that sales of radial tires have ample room to grow and selling volume of bias tires is likely to remain stable. Regarding 2019 business results, we estimate that NPAT could rise 3.0% YoY to VND 143 billion, corresponding to an EPS of 1,116 VND/share.

*We revise our target price to **VND 23,500/share**, down 2% from the recent valuation, mainly due to the slight decline in gross profit margin of radial tire segment. This target price, coupled with a VND 1,000 cash dividend in the next 12 months, would yield a total return of 15% (calculated based on the closing price on 16 April). Furthermore, we expect that the divestment could be a short-term catalyst for the stock price and the prospect of DRC from 2021 onward would be strong. Therefore, we have an **ACCUMULATE** recommendation on DRC.*

ACCUMULATE +15%

Target price (VND)	23,500
Current market price (VND)	21,350
Cash Dividend (VND)*	1,000

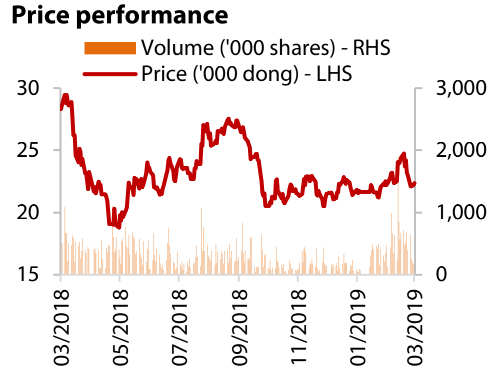
** Expected in the next 12 months*

Stock Info

Sector	Automobile & Parts
Market Cap (VND billion)	2,619
Current Shares O/S	118,792,605
Avg. Daily Volume (in 20 sessions)	578,363
Free float (%)	39
52 weeks High	29,400
52 weeks Low	18,800
Beta	0.68

	FY2018	Current
EPS	1,085	1,085
EPS Growth (%)	-16	-16
Diluted EPS	1,085	1,085
P/E	19.8	19.8
P/B	1.7	1.7
EV/EBITDA	6.5	6.5
Cash dividend yield (%)	5%	5%
ROE (%)	9.1	9.1

Price performance



Major Shareholders (%)	
VINACHEM	50.5
Foreign ownership room (%)	24.9

Vy Nguyen

(084) 028- 6299 2006 – Ext 1528

vy.ntk@vdsc.com.vn

Son Phan

(084) 028- 6299 2006 – Ext 1519

son.pnt@vdsc.com.vn

Exhibit 1: Q4/2018 Results

(VND Bn)	Q4-FY18	Q3-FY18	+/-(qoq)	Q4-FY17	+/-(yoy)
Net revenue	999	890	12.2%	1,027	-2.7%
Gross profit	109	109	0.4%	121	-10.0%
SG&A	48	42	15.2%	61	-21.3%
Operating income	61	67	-8.8%	60	1.5%
EBITDA	569	496	14.8%	355	60.3%
EBIT	54	53	3.3%	54	0.3%
Financial expenses	28	31	-10.3%	18	56.5%
- Interest Expenses	13	14	-6.6%	10	33.0%
Dep. and amortization	515	444	16.1%	301	71.1%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	42	39	6.8%	45	-6.9%
PAT	33	31	5.3%	31	4.9%
(*) Adjusted PAT	33	31	5.3%	31	4.9%

Source: DRC, Rong Viet Securities

Exhibit 2: Q4/2018 Performance Analysis

Particulars	Q4-FY18	Q3-FY18	*+/-(qoq)*	Q4-FY17	*+/-(yoy)*
Profitability Ratios (%)					
Gross Margin	10.9%	12.2%	-128.5 bps	11.8%	-88.5 bps
EBITDA Margin	57.0%	55.7%	125.3 bps	34.6%	2,238.6 bps
EBIT Margin	5.4%	5.9%	-47.1 bps	5.3%	16.0 bps
Net Margin	3.3%	3.5%	-21.6 bps	3.0%	23.5 bps
Adjusted Net Margin	3.3%	3.5%	-21.6 bps	3.0%	23.5 bps
Turnover *(x)					
-Inventories	4.2	3.7	0.5	5.3	-1.1
-Receivables	12.6	10.3	2.3	10.8	1.8
-Payables	11.0	8.5	2.5	11.8	-0.8
Leverage (%)					
Total Debt/ Equity	70%	67%	277.6 bps	59%	1,119.9 bps

Source: Rong Viet Securities

Exhibit 3: Q1/2019 Performance Forecast

Particulars (VND Bn)	Q1-FY19	+/- qoq	+/- yoy
Revenue	799.9	-20.0%	9.0%
Gross profit	88.4	-19.1%	15.9%
EBIT	40.5	-25.6%	14.1%
NPAT	22.3	-31.4%	7.8%

Source: Rong Viet Securities

Updates

We expect a modest improvement in 2019 DRC's earnings

For 2019 outlook, we forecast that revenue would reach VND 3,781 billion (+6.5% YoY), in which heavy truck radial tire segment is a key driver for the growth in revenue of the company.

In terms of heavy truck tires, we expect that in 2019, selling volume of the segment will remain on an upward trend. In particular, despite intense domestic competition from Chinese tires, sales of radial tires is expected to increase strongly by 17% YoY thanks to expansion in export. On the contrary, we forecast that selling volume of heavy truck bias tires would decrease due to the trend of shifting to radial tires. However, the decline may be modest due to low competition in bias tire market and their ability to tackle rough roads in rural areas in Vietnam. As a result, the total impact from the increase in radial tire sales and the decrease in bias tire sales for heavy trucks still will result in a growth in total selling volume of heavy truck tires.

Regarding light truck tires, we believe that sales of the segment, including bias and radial tires, may find it challenging to recover from the low base of 2018. Difficulties from EURO 4 emission standard may continue to affect selling volume of OEM light trucks, which accounts for around 25% total light truck tire sales. Up to now, we see no clear evidence for LTR agreements with key local manufacturers; hence, we anticipate that the company would sell no OEM LTRs in 2019. In addition, sales of bias tires for replacement is forecasted to go down due to the switching to LTRs, but the decline may be small as prices of LTRs are still 12% higher than those of bias tires.

Figure 1: Forecasted selling volume of DRC's core products *(in thousand units)*

Types	2017	2018	2019F	Change YoY	Note
Heavy truck bias tires	168	162	157	-3%	• A moderate short-term shift from bias tires to radial ones • Low competition in bias tire market • Their ability to tackle rough roads in rural areas in Vietnam
Heavy truck radial tires	333	376	439	17%	• Around 60 thousand processing radial tires supplied for an Indian client
Light truck bias tires	664	493	478	-3%	• 12% lower prices compared to LTRs => Slight switch to LTRs
Light truck radial tires (LTRs)		0.7[1]	3		• No OEM deal is expected to sign

Source: DRC, Rong Viet Securities forecasts

Regarding earnings, we forecast that 2019 NPAT of the company would see a 3.0% YoY growth to VND 143 billion thanks to expansion in GPM of bias tire segment. We expect that GPM of bias tires will expand from 22.5% in 2018 to 23.9% in 2019 due to an expected slight decrease in average oil price and stability in average natural rubber price. On the contrary, GPM of radial tires is forecasted to go down to 2.2% (-40bps) in 2019, based on fierce competition from Chinese products and processing contract with an Indian client with low profit margin.

As DRC's key focus, export activities still face risks of increasing competition and falling profit margin

Promoting export may be a temporary way to boost sales in the context of fierce domestic competition. In 2018, US-China trade war magnified competition pressure, which has been intense in the recent years, while capacity utilization rate of DRC's radial factory is just 65%. Therefore, the firm has to boost its export sales through processing contracts, in which India, US and Europe are potential export markets. We believe that despite their relatively low profits margin of these deals, this strategy would still support short term earnings of the firm. In addition, DRC will maintain its current export markets such as Malaysia, Myanmar, and Thailand.

Export to Brazil, accounting for 41% of DRC's export revenue, would remain stable in 2019, before facing risks next year. According to management of the firm, contract of Brazilian partners covered the sale for the whole year of 2019, leading to stability in export of DRC in this year. However, uncertainty remains over whether Brazil's anti-dumping duties on Chinese tires, overdue at the end of 2019, will be extended. Thus the company may face fierce competition from Chinese tires in Brazilian market from next year.

[1] *Sold since October 2018*

State divestment may be an element supporting DRC's stock price in the short term

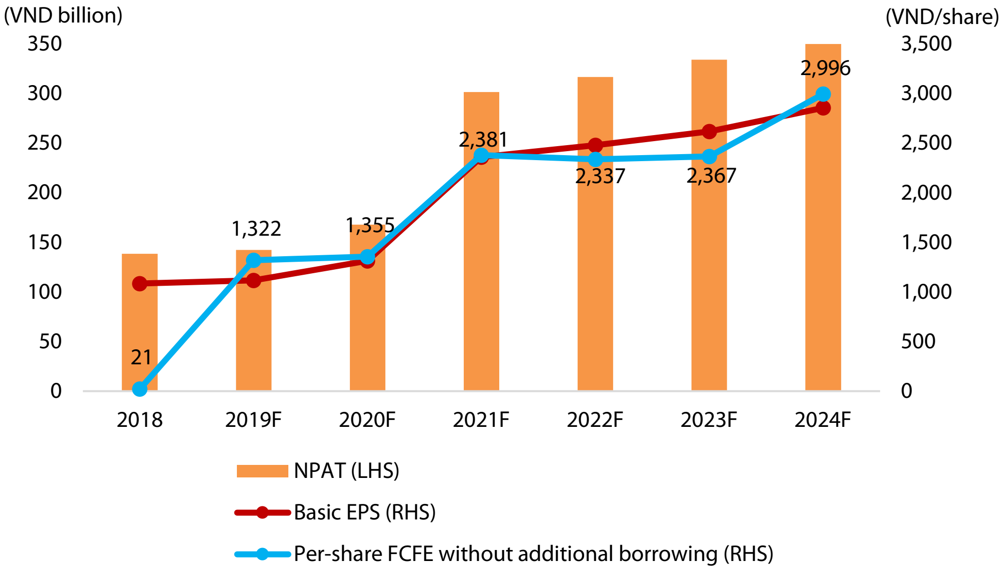
In early 2019, Vinachem submitted documents related to the divestment to the securities committee for approval. We expect that the divestment will occur in late 2Q 2019, becoming a short-term catalyst for the stock price. Regarding potential buyers, some Chinese tire manufacturers have expressed their interest in this deal as they are trying to move their production to Southeast Asia, to avoid high tariffs from US-China trade war.

We expect DRC's prospect from 2021 onward to enhance significantly

*We anticipate an impressive growth in 2021 earnings thanks to a decline in depreciation expense***.** By 2020, equipment of phase 1 of radial factory will be fully depreciated. Hence, from 2021onward, in our estimation, depreciation expense would decline VND 150 billion per year, resulting in a 30% CAGR of earnings in 2018 – 2021 period.

Free cash flow from 2021 would be high, supported by a decline in debt repayments. In fact, DRC has some loans coming due in 2019 - 2020, resulting in lower debt repayment pressure from 2021 onward. Therefore, we believe that total free cash flow to equity (FCFE) from 2021 will expand significantly, enabling the company to pay high cash dividend to shareholders. We also estimate that between 2021 and 2024, per-share FCFE would reach VND 2,400 to VND 3,000, making DRC an attractive stock for dividend yield.

Figure 2: DRC's per-share FCFE and per-share earnings



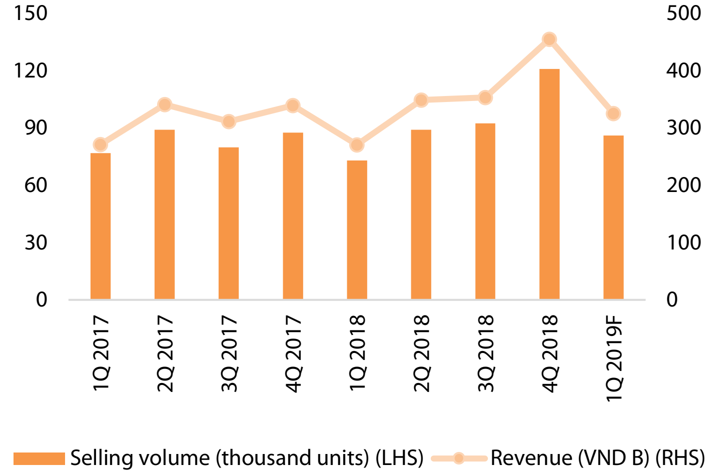
Source: DRC, Rong Viet Securities forecasts

Valuation and Recommendation:

As the leading domestic player in the truck tire manufacturing industry, DRC is still facing fierce competition in the market. In the short term, we believe that sales of radial tires still have ample room to grow thanks to expansion in export and trend of shifting from bias tires to radial ones, while selling volume of bias tires would remain at the low base of 2018. Regarding 2019 business results, we estimate that NPAT could rise 3.0% YoY to VND 143 billion, corresponding to an EPS of 1,116 VND/share.

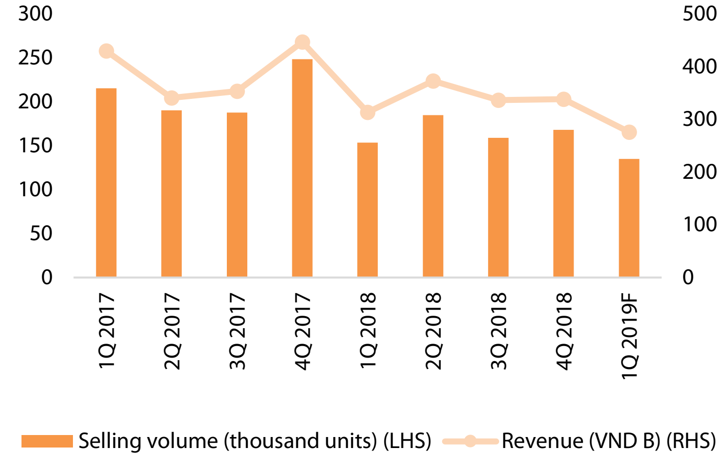
We revise our target price to ***VND 23,500/share****, down 2% from the recent valuation, mainly due to the decline in radial tire segment. This target price, coupled with a VND 1,000 cash dividend in the next 12 months, would yield a total return of 15% (calculated based on the closing price on 16 April). Furthermore, we expect that the divestment could be a short-term catalyst for the stock price and the prospect of DRC from 2021 onward would be strong. Therefore, we have an* ***ACCUMULATE*** *recommendation on DRC.*

Figure 3: Revenue and sales volume of DRC's radial tires by quarter



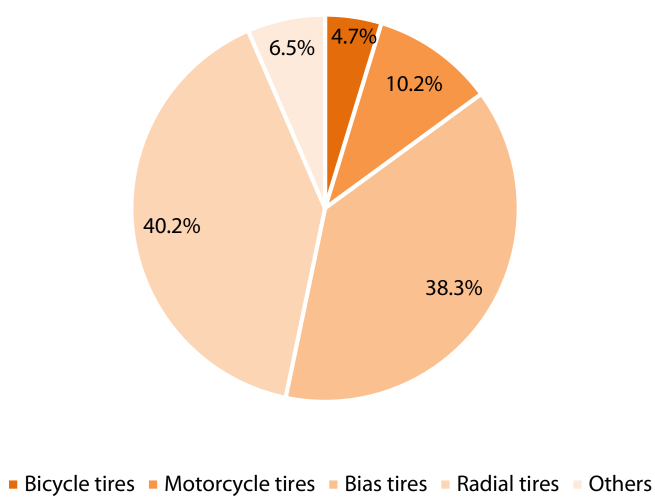
Source: DRC, Rong Viet Securities

Figure 4: Revenue and sales volume of DRC's bias tires by quarter



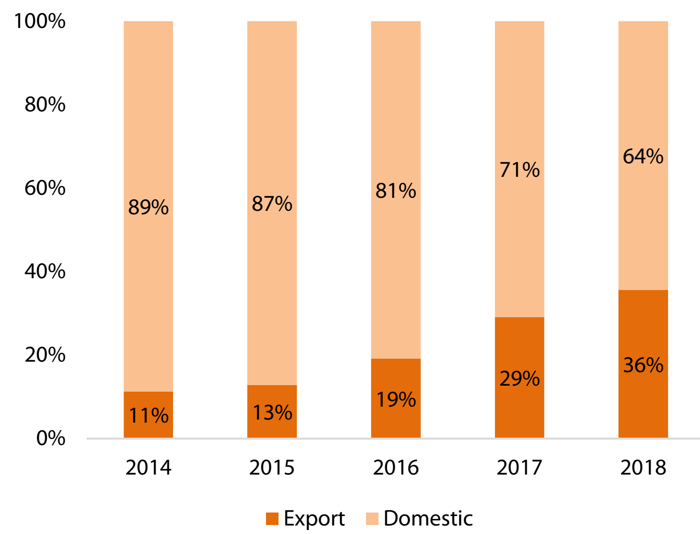
Source: DRC, Rong Viet Securities

Figure 5: Revenue by product in 2018



Source: DRC, Rong Viet Securities

Figure 6: Revenue by market in 2018



Source: DRC, Rong Viet Securities

VND Billion

INCOME STATEMENT	FY2017	FY2018	FY2019F	FY2020F
Revenue	3,669	3,551	3,781	3,945
COGS	3,212	3,124	3,335	3,480
Gross profit	**458**	**427**	**445**	**466**
Selling Expense	118	113	121	118
G&A Expense	66	55	64	67
Finance Income	8	12	10	11
Finance Expense	74	98	100	89
Other profits	0	2	8	8
PBT	**208**	**175**	**178**	**210**
Prov. of Tax	42	36	36	42
Minority's Interest	0	0	0	0
PAT to Equity S/H	**166**	**139**	**143**	**168**
EBIT	273	259	260	280
EBITDA	522	530	534	549

%

FINANCIAL RATIO	FY2017	FY2018	FY2019F	FY2020F
Growth (%)				
Revenue	9	-3	6	4
Operating Income	-50	-5	0	8
EBITDA	-33	2	1	3
PAT	-58	-17	3	18
Total Assets	-1	1	-3	-8
Equity	-3	0	0	1
Profitability (%)				
Gross margin	12	12	12	12
EBITDA margin	14	15	14	14
EBIT margin	7	7	7	7
Net margin	5	4	4	4
ROA	6	5	5	7
ROE	11	9	9	11
Efficiency				(times)
Receivable Turnover	8.9	11.3	9.2	10.5
Inventory Turnover	5.4	3.7	3.9	4.0
Payable Turnover	10.4	9.0	8.7	10.2
Liquidity				(times)
Current	1.3	1.2	1.4	1.7
Quick	0.6	0.4	0.5	0.6
Finance Structure (%)				
Total Debt/Equity	61	62	55	41
Current Debt/Equity	34	46	42	31
Long-term Debt/Equity	27	16	13	10

VND Billion

BALANCE SHEET	FY2017	FY2018	FY2019F	FY2020F
Cash and cash equivalents	67	51	64	84
Short-term investments	0	0	0	0
Accounts receivable	412	315	410	377
Inventories	596	846	865	875
Other current assets	15	35	37	38
Property, plant & equipment	1,635	1,512	1,293	1,074
Acquired intangible assets	15	5	0	0
Long-term investments	4	4	4	4
Other non-current assets	50	66	79	83
Total assets	**2,794**	**2,833**	**2,752**	**2,536**
Accounts payable	310	348	383	341
Short-term borrowings	525	707	634	478
Long-term borrowings	409	245	198	158
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	23	10	12	14
Technology-science, dev. fund	0	0	0	0
Total liabilities	**1,268**	**1,310**	**1,227**	**991**
Common stock and APIC	1,188	1,188	1,188	1,188
Treasury stock (enter as -)	0	0	0	0
Retained earnings	142	113	113	131
Other comprehensive income	21	21	21	21
Inv. and Dev. Fund	176	201	203	205
Total equity	**1,527**	**1,523**	**1,524**	**1,544**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO (*)	FY2017	FY2018	FY2019F	FY2020F
EPS (dong)	1,286	1,085	1,116	1,315
P/E (x)	17.3	18.4	20.0	17.0
BV (dong)	12,853	12,819	12,832	13,001
P/B (x)	1.9	1.7	1.7	1.7
DPS (dong/cp)	1,300	1,200	1,000	1,000
Dividend yield (%)	5.4%	5.6%	4.7%	4.7%

VALUATION MODEL	Price	Weight	Average
FCFE	25,413	50%	12,707
PE	21,490	50%	10,745
Target price (VND)			**23,452**

VALUATION HISTORY	Price	Recommendation	Period
2017/12/26	28,200	Neutral	1-year
2018/09/07	24,300	Reduce	1-year

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 that 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	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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ANALYSIS & INVESTMENT ADVISORY DEPARTMENT

Lam Nguyen
Deputy Manager
lam.ntp@vdsc.com.vn
+ 84 28 6299 2006 (1313)
- Banking
- Market Strategy

Hieu Nguyen
Senior Analyst
hieu.nd@vdsc.com.vn
+ 84 28 6299 2006 (1514)
- Market Strategy
- Pharmaceuticals
- Aviation

Duong Lai
Senior Analyst
duong.ld@vdsc.com.vn
+ 84 28 6299 2006 (1522)
- Real Estate
- Building Materials

Vu Tran
Senior Analyst
vu.thx@vdsc.com.vn
+ 84 28 6299 2006 (1518)
- Oil & Gas
- Fertilizer

Trinh Nguyen
Senior Analyst
trinh.nh@vdsc.com.vn
+ 84 28 6299 2006 (1551)
- Steel
- Technology

Son Phan
Senior Analyst
son.pnt@vdsc.com.vn
+ 84 28 6299 2006 (1519)
- Utilities
- Natural Rubber

Tu Vu
Analyst
tu.va@vdsc.com.vn
+ 84 28 6299 2006 (1511)
- Macroeconomics

Son Tran
Analyst
son.tt@vdsc.com.vn
+ 84 28 6299 2006 (1527)
- Market Strategy
- Retails

Tung Do
Analyst
tung.dt@vdsc.com.vn
+ 84 28 6299 2006 (1521)
- Logistics
- Aviation

Thu Pham
Analyst
thu.pa@vdsc.com.vn
+ 84 28 6299 2006 (1520)
- Industrial Real Estate
- Infrastructure & BOT

Thao Dang
Analyst
thao.dtp@vdsc.com.vn
+ 84 28 6299 2006 (1529)
- Food & Beverage
- Textiles

Tam Pham
Analyst
tam.ptt@vdsc.com.vn
+ 84 28 6299 2006 (1530)
- Insurance
- Fishery

Anh Nguyen
Analyst
anh2.ntt@vdsc.com.vn
+ 84 28 6299 2006 (1531)
- Banking

Vy Nguyen
Analyst
vy.ntk@vdsc.com.vn
+ 84 28 6299 2006 (1528)
- Automobile & Parts

Trinh Le
Analyst
trinh.lx@vdsc.com.vn
+ 84 28 6299 2006 (1536)
- Industrials
- Agricultural Medicine

Hoang Nguyen
Analyst
hoang.nt@vdsc.com.vn
+ 84 28 6299 2006 (1538)
- Macroeconomic

Ha Tran
Assistant
ha.ttn@vdsc.com.vn
+ 84 28 6299 2006 (1526)

Vi Truong
Assistant
vi.ttt@vdsc.com.vn
+ 84 28 6299 2006 (1517)

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