

HOA SEN GROUP (HSG: HOSE)



OUTPERFORM – 1Y Target Price: VND 9,500

Current price: VND 8,450

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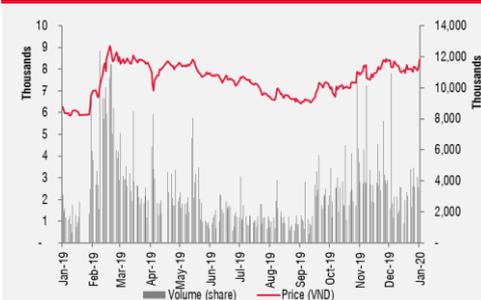
MATERIALS - VIETNAM

Key figures

| | |
|---------------------------|-----------|
| Market cap (USD mn) | 154 |
| Market cap (VND bn) | 3,576 |
| Outstanding shares (mn) | 423 |
| 52W high/low (VND 1,000) | 9.5/5.8 |
| Average 3M volume (share) | 3,895,311 |
| Average 3M value (USD mn) | 1.31 |
| Average 3M value (VND bn) | 30.41 |
| Foreign ownership (%) | 17.77 |
| State ownership (%) | 0 |
| Management ownership (%) | N.a |

Source: SSI Bloomberg

HSG Price & Trading Volume



Source: Bloomberg

Company Snapshot

Hoa Sen Group (HSG) manufactures coated steel sheet (accounting for 56% of FY2015 revenue), hot dip galvanized steel and steel pipe (42%), and plastic pipe (2%).

Among Vietnamese steel companies, HSG possesses the strongest sale network and best-known brand. In 2014, it held 37% steel sheet market share (ranked 1st) and 18% steel pipe market share (ranked 2nd) in Vietnam.

AGM NOTE

Brighter prospects await

- Net profit is targeted to grow by 11% in FY 2020

- Q1 FY2020 net profit attained significant growth at 198% YoY thanks to the stabilization in gross margin

- No major capex in FY 2020

- Maintaining Outperform rating

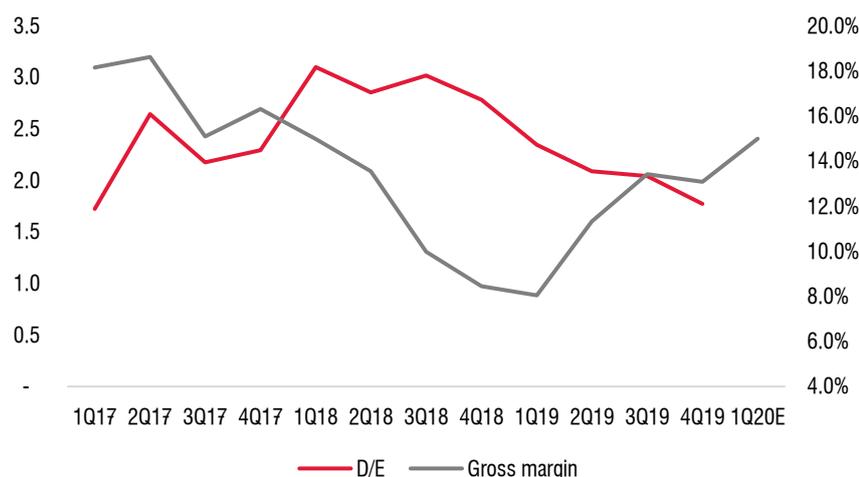
(* Note: All quarters apply to the Company's fiscal year reporting that starts from Oct and ends in Sep. 'Q4' applies to the time period from Jul to Sep.

We have recently attended the HSG FY2020 Annual General Meeting, and here are the key takeaways.

As noted in our previous report, HSG revenue in FY2019 dropped by -18.6% YoY to VND 28.04 tn due to a sales volume decline of -20% YoY. The company maintained its leading 30% market share in galvanized steel up to 11M2019, and held ground on the second-largest 15.4% market share in steel pipes. The market share of HSG for these two product types dropped from 34.3% and 17.3% respectively in 2018.

Net profit of HSG in 2019 continued to decline by -11.7% YoY (after dropping by -69% YoY in FY 2018). If excluding abnormal profit of VND 223 bn from property divestment, net profit in FY 2019 would drop by -55% YoY due to the high base set in Q1 according to FY18. However, the gross margin of the company has shown a stabilization trend in the latest quarters, as the company has switched its focus on profit rather than sales volume after the inventory and debt balance has been reduced to a safer level.

HSG's quarterly gross margin and D/E ratio



Source: HSG, SSI Research

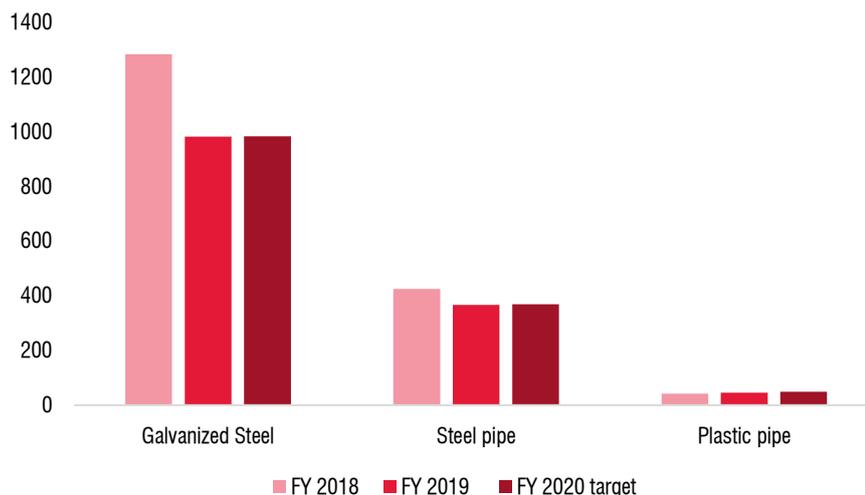
Net profit is targeted to recover in FY 2020

For FY2020, total sales volume and revenue is targeted to go flat at 1.5 mn tons and VND 28 tn respectively. However, the net profit target is set at VND 400 bn, an increase by 11% YoY. Please note that excluding the one-off profit of VND 223 bn from property divestment in FY 2019, the net profit target in 2020 would increase by 116% YoY, with the net margin from the core business improving from 0.7% in FY 2019 to 1.4% in FY 2020.

| | FY2019 | FY2020 Target |
|-------------------------|-----------|---------------|
| Sales volume (tons) | 1,494,560 | 1,500,000 |
| - Main products | 1,393,973 | 1,400,000 |
| - Sub products | 100,587 | 100,000 |
| Sales volume YoY growth | -20.2% | 0.4% |
| - Main products | -20.3% | 0.4% |
| - Sub products | -19.0% | -0.6% |
| Net sales (VND bn) | 28,035 | 28,000 |
| YoY growth | -18.6% | -0.1% |
| Gross profit | 3,199 | 3,400 |
| YoY growth | -19.6% | 6.3% |
| Gross margin | 11.4% | 12.1% |
| Net income (VND bn) | 361 | 400 |
| YoY growth | -11.7% | 10.8% |
| Net margin | 1.3% | 1.6% |

Source: HSG, SSI Research

Sale volume by product ('000 tons)

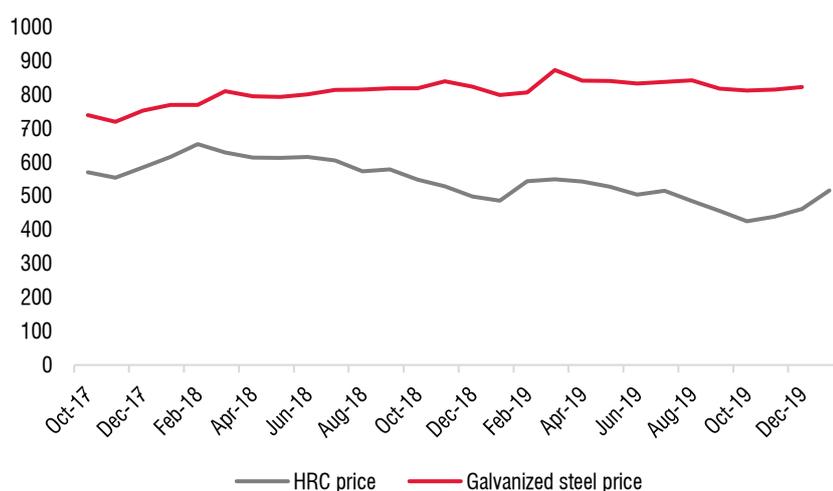


Source: HSG

Q1 FY2020 preliminary earnings results

According to preliminary estimates, although revenue in Q1 FY2020 dropped by -13% YoY to 6.543 tn due to the decrease in the steel price, net profit recovered strongly to VND 181 bn, which mainly came from the core business. Net profit increased by 198% YoY thanks to the normalization in the gross margin, from just 8% in Q1 '19 to nearly 15% in Q1 '20. In the context of HRC price dropping by -16% YoY and -12% QoQ, the company accepted a lower sales volume to keep the sticker price of its various products stable. As a result, the price of galvanized steel dropped by -3% QoQ and 1% YoY respectively, thus helping to expand the core profit margin.

HRC price and HSG's domestic galvanized steel price



Source: HSG

No major capacity expansion in 2020

After 2 years since early FY 2018, HSG has finished restructuring its distribution system by establishing one provincial branch in each province, and has transformed smaller branches into stores under the management of the provincial branch. At the end of 2019, HSG's distribution system included 536 units, consisting of 55 provincial branches, 10 general warehouses, and 471 dependent stores. In 2020, management expects to decelerate distribution system expansion, and instead will focus on optimizing its current system and cost-cutting, especially in financial expense reduction. Management expects to reduce its debt balance by over VND 1.3 tn in FY 2020.

The company also expects to have no significant capacity expansion, as the current capacity utilization rate is under 60%. As a result, we expect capex for 2020 at below VND 500bn.

Dividend plan and management incentive policy: For FY2019, HSG will pay out a 5% stock dividend. The AGM also approved the welfare and bonus fund at 1% of net income for FY19, and up to 4% in FY 2020. The compensation for the BOD in FY2020 is also maintained at the same level in FY 2019 of 1.5% of total net income. In addition, the BOD, BOM, and Chief accountant and subsidiary units will receive a bonus of 3.4% of net income if the company meets their earnings target of VND 400 bn.

Earnings forecast and investment view

We finetune our 2020FY revenue and net profit forecast from VND 28 tn and VND 453 bn to 27.7 tn (-1% YoY) and VND 485 bn (+34% YoY). We assume that sales volume would increase slightly by 2% in FY 2020, whereas the average price dropped by -2.5% compared to a decrease of -6.5% in HRC steel price.

HSG shares are currently trading at P/E and EV/EBITDA 2019 levels of 7.5x and 4.5x respectively. We maintain our Outperform rating for the stock, with a 1-year target of VND 9,500/share based on a composite target PE and EV/EBITDA of 7x and 5x respectively. We think the share price in the coming quarter can be supported by the recovery in HSG earnings compared to the low base witnessed in the first quarters last year.

APPENDIX: ANNUAL FINANCIAL STATEMENTS

| VND Billion | 2018 | 2019 | 2020F | 2021F |
|---------------------------------------|---------------|---------------|---------------|---------------|
| Balance Sheet | | | | |
| + Cash | 492 | 289 | 346 | 347 |
| + Short-term investments | 0 | 76 | 76 | 76 |
| + Account receivables | 2,119 | 1,328 | 1,406 | 1,553 |
| + Inventories | 6,607 | 4,414 | 4,322 | 4,425 |
| + Other current assets | 1,582 | 1,104 | 1,071 | 1,097 |
| Total Current Assets | 10,800 | 7,211 | 7,222 | 7,499 |
| + LT Receivables | 202 | 227 | 0 | 0 |
| + Net Fixed Assets | 8,125 | 8,642 | 7,881 | 7,121 |
| + Investment properties | 0 | 0 | 0 | 0 |
| + LT Assets in progress | 1,513 | 584 | 584 | 584 |
| + LT Investments | 99 | 17 | 17 | 17 |
| + Other LT Assets | 516 | 425 | 390 | 399 |
| Total Long-Term Assets | 10,455 | 9,894 | 8,872 | 8,121 |
| Total Assets | 21,255 | 17,105 | 16,094 | 15,620 |
| + Current Liabilities | 12,638 | 8,647 | 7,732 | 6,631 |
| <i>In which: ST debt</i> | <i>10,880</i> | <i>6,706</i> | <i>5,916</i> | <i>4,821</i> |
| + Non-current Liabilities | 3,466 | 2,990 | 2,418 | 2,475 |
| <i>In which: LT debt</i> | <i>3,462</i> | <i>2,986</i> | <i>2,415</i> | <i>2,472</i> |
| Total Liabilities | 16,103 | 11,637 | 10,150 | 9,106 |
| + Contributed capital | 3,850 | 4,235 | 4,235 | 4,235 |
| + Share premium | 152 | 152 | 152 | 152 |
| + Retained earnings | 1,055 | 1,021 | 1,497 | 2,067 |
| + Other capital/fund | 95 | 61 | 61 | 61 |
| Shareholders' Equity | 5,152 | 5,468 | 5,944 | 6,514 |
| Total Liabilities & Equity | 21,255 | 17,105 | 16,094 | 15,620 |
| Cash Flow | | | | |
| CF from operating activities | 386 | 5,056 | 1,869 | 1,539 |
| CF from investing activities | -2,313 | -661 | -450 | -500 |
| CF from financing activities | 2,096 | -4,596 | -1,362 | -1,038 |
| Net increase in cash | 170 | -201 | 57 | 1 |
| Beginning cash | 292 | 492 | 289 | 346 |
| Ending cash | 459 | 289 | 346 | 347 |
| Liquidity Ratios | | | | |
| Current ratio | 0.85 | 0.83 | 0.93 | 1.13 |
| Acid-test ratio | 0.21 | 0.20 | 0.24 | 0.30 |
| Cash ratio | 0.04 | 0.04 | 0.05 | 0.06 |
| Net debt / EBITDA | 5.38 | 4.88 | 3.38 | 2.81 |
| Interest coverage | 1.65 | 1.62 | 1.86 | 2.17 |
| Days of receivables | 14.8 | 17.6 | 14.2 | 14.4 |
| Days of payables | 27.9 | 17.1 | 19.4 | 19.1 |
| Days of inventory | 93.4 | 81.0 | 66.0 | 64.6 |
| Capital Structure | | | | |
| Equity/Total asset | 0.24 | 0.32 | 0.37 | 0.42 |
| Liabilities/Total Assets | 0.76 | 0.68 | 0.63 | 0.58 |
| Liabilities/Equity | 3.13 | 2.13 | 1.71 | 1.40 |
| Debt/Equity | 2.78 | 1.77 | 1.40 | 1.12 |
| ST Debt/Equity | 2.11 | 1.23 | 1.00 | 0.74 |

| VND Billion | 2018 | 2019 | 2020F | 2021F |
|--|---------------|---------------|---------------|---------------|
| Income Statement | | | | |
| Net Sales | 34,441 | 28,035 | 27,740 | 28,400 |
| COGS | -30,464 | -24,845 | -24,148 | -24,723 |
| Gross Profit | 3,977 | 3,189 | 3,592 | 3,677 |
| Financial Income | 179 | 64 | 50 | 54 |
| Financial Expense | -971 | -803 | -761 | -674 |
| Income from associates | 0 | 0 | 0 | 0 |
| Selling Expense | -2,033 | -1,749 | -1,775 | -1,818 |
| Admin Expense | -679 | -471 | -499 | -511 |
| Income from business operation | 475 | 230 | 607 | 727 |
| Net Other Income | 54 | 230 | 0 | 0 |
| Profit Before Tax | 529 | 460 | 607 | 727 |
| Net Income | 409 | 361 | 485 | 582 |
| NI attributable to shareholders | 409 | 361 | 485 | 582 |
| Minority interest | 0 | 0 | 0 | 0 |
| Key Metrics | | | | |
| Basic EPS (VND) | 947 | 836 | 1,123 | 1,346 |
| BVPS (VND) | 13,288 | 12,895 | 14,018 | 15,365 |
| Dividend (VND/share) | 0 | 1 | 0 | 0 |
| EBIT | 1,341 | 1,205 | 1,315 | 1,347 |
| EBITDA | 2,360 | 2,383 | 2,575 | 2,656 |
| Growth | | | | |
| Sales | 31.7% | -18.6% | -1.1% | 2.4% |
| EBITDA | -16.5% | 1.0% | 8.0% | 3.2% |
| EBIT | -37.0% | -10.1% | 9.1% | 2.5% |
| NI | -69.3% | -11.7% | 34.3% | 19.9% |
| Equity | -0.3% | 6.1% | 8.7% | 9.6% |
| Chartered Capital | 10.0% | 10.0% | 0.0% | 0.0% |
| Total assets | -1.3% | -19.5% | -5.9% | -2.9% |
| Valuation | | | | |
| P/E | 12.1 | 9.7 | 7.5 | 6.3 |
| P/B | 0.9 | 0.6 | 0.6 | 0.5 |
| P/Sales | 0.1 | 0.1 | 0.1 | 0.1 |
| Dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| EV/EBITDA | 7.9 | 4.8 | 4.5 | 3.9 |
| EV/Sales | 0.5 | 0.4 | 0.4 | 0.4 |
| Profitability Ratios | | | | |
| Gross Margin | 11.5% | 11.4% | 12.9% | 12.9% |
| Operating Margin | 3.7% | 3.5% | 4.7% | 4.7% |
| Net Margin | 1.2% | 1.3% | 1.7% | 2.0% |
| Selling exp./Net sales | 5.9% | 6.2% | 6.4% | 6.4% |
| Admin exp./Net sales | 2.0% | 1.7% | 1.8% | 1.8% |
| ROE | 7.9% | 6.8% | 8.5% | 9.3% |
| ROA | 1.9% | 1.9% | 2.9% | 3.7% |
| ROIC | 5.7% | 5.5% | 7.1% | 7.7% |

Source: Company, SSI forecasts

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Outperform: Expected to provide price gains of up to 10 percentage points greater than the market over next 12 months.

Market Perform: Expected to provide price gains similar to the market over next 12 months.

Underperform: Expected to provide price gains of up to 10 percentage points less than the market over next 12 months.

Sell: Expected to provide price gains of at least 10 percentage points less than the market over next 12 months

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