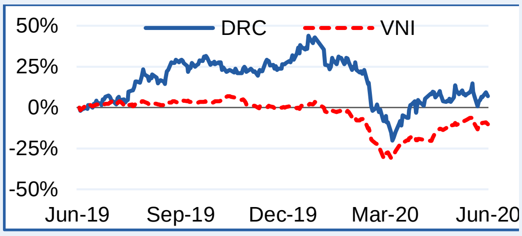
VIET CAPITAL SECURITIES

Da Nang Rubber (DRC) AGM Note

Industry:	**Tire manufacturing**		2019	2020F	2021F	2022F
Report Date:	**June 24, 2020**	Rev y/y	8.6%	-21.9%	22.4%	4.5%
Current Price:	VND19,500	EPS y/y	77.6%	-38.0%	61.3%	24.6%
Current Target Price:	VND22,200	GPM	14.8%	14.4%	15.6%	17.4%
Upside to TP:	13.8%	NPM *	6.0%	4.7%	6.3%	7.5%
Dividend Yield:	5.1%	EV/EBITDA	4.9x	5.6x	7.3x	6.2x
TSR:	19.0%	P/Op CF	6.2x	3.3x	11.3x	6.2x
Rating:	OUTPERFORM	P/E	10.1x	16.4x	10.2x	8.1x



Market Cap:	USD99.4mn		DRC	Peers	VNI
Foreign Room:	USD25.8mn	P/E (ttm)	9.4x	15.0x	14.2x
ADTV30D:	USD200,000	P/B (curr)	1.3x	1.3x	1.9x
State Ownership:	50.5%	Net D/E	38.7%	19.1%	N.A.
Outstanding Shares:	118.8 mn	ROE	17.0%	5.8%	13.6%
Fully Diluted Shares:	118.8 mn	ROA	10.1%	4.8%	2.4%

* Adjusted for Bonus and welfare fund

Company Overview

Da Nang Rubber JSC (DRC) is one of the largest domestic tire producers in Vietnam. The company is a subsidiary of Vietnam National Chemical Group (Vinachem; 50.5% stake in DRC), an SOE that has holdings in the chemical industry. DRC offers a wide range of tires and tube products for trucks, cars, motorbikes and bicycles.

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Headwinds ahead due to pandemic, higher competition

- DRC held its 2020 AGM in Da Nang on June 24, 2020.
- The company released its H1 2020 preliminary results with revenue down 13% YoY to ~VND1.7tn (USD71.6mn) and NPAT-MI falling 15% YoY to ~VND93bn (USD4.0mn) — completing 55% and 48% of our 2020 forecasts, respectively.
- Management guided for 2020 revenue of VND4.4tn/USD188mn (+5.3% YoY; 45% above our forecast) and 2020 PBT of VND280bn/USD12mn (-10.5% YoY; 44% above our forecast). We believe the difference between our forecasts and DRC's guidance is mainly because DRC set its targets in early Q1 2020 when COVID-19 had not yet hit the company's key export markets. Nevertheless, we see potential upside risk to our forecast as we have observed signs of recovery in DRC exports in May and June 2020 — especially in the US market.
- Shareholders approved a final FY2019 cash dividend of VND1,500/share (yield of 7.7%). DRC paid the first interim cash dividend for FY2019 of VND500/share in December 2019. For 2020, DRC's AGM authorized its BOD to decide the dividend payment based on the company's performance in the year.
- Management also shared that Vinachem is no longer considering a stake sell-down in DRC.
- The AGM approved two new BOD members, who are representatives of Vinachem, to replace two members who are nearing retirement.

COVID-19 to negatively impact both the domestic and export markets. In the domestic market, DRC saw sales volume decline starting from mid-March, which was mainly due to (1) lower demand from automobile assemblers in Vietnam and (2) a prolonged drought in Vietnam's Central Highlands. COVID-19 has negatively impacted DRC's key export markets, including the US and Brazil. Moreover, the capacity of tire manufacturers has remained unchanged as they have enough materials to maintain production. This unchanged capacity, coupled with currency depreciations in some of DRC's export markets, has put pressure on selling prices.

EVFTA to have no material impact; DRC is still in process of developing new products for the EU market. DRC's tire products are already eligible for a zero tariff under the EU's generalized scheme of preference from 2018 to 2023; however, the company currently only exports a small amount of products to Eastern European countries because the EU has a high technical barrier regarding the environmental standards of materials. DRC said that it recently became certified for EU standards and is currently in the process of developing new products for the EU market to diversify the company's export markets.

Competition is expected to intensify as Chinese tire manufacturers migrate to Southeast Asia. According to DRC, the company has faced competition from Chinese tire producers with capacities of at least two million tires per year that have migrated to Thailand. Moreover, in Vietnam, an additional capacity of 3.6 million tires per year from two Chinese producers is expected to come online in H2 2020. As a result, DRC is expecting intensified competition in its main export markets — Brazil and the US — which have imposed high taxes for tires manufactured in China.

Antidumping tax investigation can create an opportunity. Currently, the US is investigating passenger car tires from Vietnam, Thailand and South Korea. Although DRC has not exported this product to the US, the company has provided data to prove that it has not received any subsidies from the Government. DRC hopes that the investigation can be continued with light truck radial tires so that higher taxes can be imposed on Chinese producers in Southeast Asia. Therefore, the company is delaying the expansion of its radial factory — which would increase its capacity to 1-1.2 million tires per year — to wait for an advantage once the Chinese producers receive higher tariffs.

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