



Da Nang Rubber (DRC) [OUTPERFORM +19.7%]

Update Report

Industry: Tire Manufacturing

Report Date: May 24, 2022

Current Price: VND28,900

Target Price: VND32,900

Last Target Price: VND35,800

Upside to TP: 13.8%

Dividend Yield: 5.9%

TSR: 19.7%

	2021	2022F	2023F	2024F
Rev y/y	20.1%	17.9%	13.0%	8.0%
EPS y/y*	9.2%	27.6%	-7.3%	6.6%
GPM	17.1%	16.4%	15.2%	15.0%
NPM*	6.0%	6.1%	5.0%	4.9%
EV/EBITDA	8.9x	7.9x	6.7x	6.3x
P/Op CF	N.M.	25.1x	9.0x	7.3x
P/E	13.9x	10.9x	11.8x	11.1x

Market Cap: USD149.3mn

Foreign Room: USD63.1mn

ADTV30D: USD2.1mn

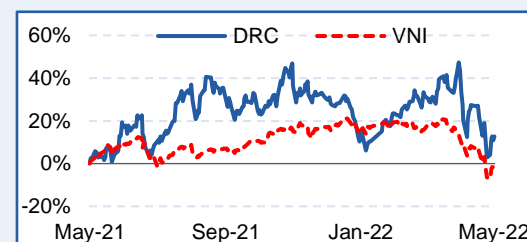
State Ownership: 50.5%

Outstanding Shares: 118.8 mn

Fully Diluted Shares: 118.8 mn

	DRC	Peers	VNI
P/E (ttm)	12.9x	31.9x	13.2x
P/B (curr)	1.9x	1.5x	2.1x
Net D/E	13.6%	-3%	N/A
ROE	16.5%	3.7%	15.8%
ROA	9.7%	2.7%	2.6%

* EPS and NPAT-MI adjusted for bonus & welfare fund (BWF) and FX gains/losses



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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Resilient sale volume, lower gross margin

- We trim our target price (TP) for DRC by 8% to VND32,900/share but maintain our OUTPERFORM rating as the company's share price has tumbled 23% over the past month.
- Our lower TP is mainly driven by our lower aggregate 2022-2028F NPAT-MI forecast (-11.9% vs our previous forecast), which is partly offset by the positive effect of rolling our TP forward to mid-2023 vs YE2022 as previously.
- We cut our 2022F NPAT-MI by 11.4% to VND346bn (USD15mn; +18.7% YoY), which is mainly driven by our (1) lower radial tire sales volume growth assumption (10% vs 16% previously) and (2) lower gross margin assumption for DRC's radial tires. Additionally, our higher selling expenses/sales assumption (5.7% vs 5.1% as previously) weighs on our 2022F NPAT-MI forecast as we expect logistics costs to remain high in 2022F.
- We cut our aggregate 2023-2028F NPAT-MI forecast by 11.9% mainly due to the lower GPM profile for DRC's radial tires and lower radial tire sales volume in this period. In this Update Report, we have not reflected the launch of Dstar products — a radial TBR tire brand that DRC hopes to capture the domestic market. We believe that a successful launch of this product can help DRC to reach the maximum capacity of Phase 3 of its radial tire factory faster than expected.
- Downside risks to our positive view: Higher-than-expected increase in natural rubber prices; intensified competition in the tire market.

Fading competitive advantage in the US to weigh on DRC's radial tire segment. DRC has two main export markets — the US and Brazil. DRC's competitive advantage in the US has been fading as Chinese manufacturers move their production to Southeast Asian countries to avoid high antidumping duties for products originating from China. Management states that DRC has maintained its exports to the US in order to continue its relationships with current clients and underscore its product quality. However, the profitability of exporting to the US is not on par with Brazil — where DRC still enjoys a duty advantage over its competitors. Given that the US still accounted for 35% of DRC's 2021 export revenue, we model a lower GPM profile for DRC's radial tires going forward. For the same reason, we expect a lower radial tire sales volume, which we forecast will reach 67%/77%/88%/92% of DRC's radial tire factory's designed capacity in 2022/2023/2024/2025F vs our previous forecasts of 71%/80%/89%/93%, respectively.

We expect resilient bias tire sales volume in 2022F thanks to (1) DRC's focus on niche product segments (i.e., customized bias tires) in its export markets to avoid direct competition with Chinese products and (2) stronger-than-expected demand for light truck bias tires in the domestic market as economic activity continues to recover as COVID-19 subsides.

SG&A/sales will not fully converge at normal level in 2022F. DRC derived 50% of its revenue from export markets in Q1 2022. As such, we believe high logistics costs due to port congestion in China will continue to put pressure on DRC's selling expenses.

Q1 2022 Recap: Higher input costs weigh on gross margin

Figure 1: Q1 2022 results

VND bn	Q1 2021	Q1 2022	YoY Growth	VCSC comments
Revenue	912	1,284	40.7%	
- Bias truck tires	265	377	42.4%	<p>* Q1 2022 volume jumped 20.2% YoY and was mainly driven by the recovery of bias tire domestic volume (+31.3% YoY) as economic activities in Vietnam began to return to normal conditions in Q1 2022.</p> <p>* ASP increased 18.4% YoY because DRC lifted its product selling price four times in 2021 amid higher input material costs.</p>
- Radial truck tires	468	663	41.5%	<p>* Sale volume surged 29.3% YoY thanks to (1) continued strong demand in export markets — especially in Brazil where DRC is not subject to antidumping tariffs — and (2) DRC's clients stocking up inventory in anticipation of the company's selling price increase in April 2022.</p> <p>* ASP increased 9.4% YoY as the company shared increased logistics costs with clients.</p>
- Others	179	244	36.0%	<p>* Product mix sales volume rose 27.8% YoY, mainly driven by a surge in motorbike tire & tube products (+50.8% YoY) thanks to DRC's efforts to introduce and advertise its products to motorbike repair shops.</p> <p>* However, product mix ASP only edged up 6.5% YoY. We attribute DRC's slower growth in ASP to its efforts to attract local motorbike repair shops as customers.</p>
Gross profit	166	200	20.6%	
SG&A	-80	-111	39.0%	
Operating profit	86	89	3.4%	
Financial expenses	-10	-17	66.6%	
PBT	80	82	2.8%	
NPAT-MI	64	66	3.3%	
GPM %	18.2%	15.6%		* Gross margin was hurt as DRC's elevated selling price failed to fully absorb increased input costs due to the company's relatively weaker market position compared to Chinese manufacturers.
GPM excluding depreciation %	21.0%	17.2%		
GPM bias truck tire %	18.9%	19.3%		
GPM radial tire %	17.8%	13.9%		
SG&A/Sales %	8.8%	8.7%		* SG&A/sales remained high to increased outbound shipping costs as global logistics continued to be snarled by port congestion.
OPM %	9.4%	6.9%		
NPAT margin %	7.0%	5.1%		

Source: Company's financial statements, VCSC

2022F Outlook: Lower radial tire GPM dampens earnings

Figure 2: 2022 forecasts

VND bn	2021	2022F new	2022F new vs 2021	2022F new vs old	VCSC comments
Revenue	4,380	5,163	17.9%	-3.1%	
- Bias truck tires	1,310	1,549	18.3%	0.2%	<p>* We expect bias truck tire ASP to increase 12.2% YoY amid higher input costs.</p> <p>* We slightly trim our bias tire sales volume growth forecast to 5.4% (vs 5.5% in our previous Update Report) due to our lower forecast for heavy truck bias tire sales volume amid the wider adoption of radial tires, which is partly offset by strong light truck bias tire sales volume.</p>
- Radial truck tires	2,305	2,756	19.6%	-5.7%	<p>* We forecast radial tire sales volume to grow 10% YoY even though DRC reached its factory's design capacity of 600,000 units p.a. in 2021. Management stated that the application of high-pressure vulcanization equipment helps to shorten process time by 10%.</p> <p>* However, our sales volume growth is lower than our previous forecast (10.0% vs 16.0% YoY) as the competitive advantage of DRC's products the US market has dwindled as Chinese manufacturers moved to Southeast Asian countries to avoid tariff.</p> <p>* We expect radial tire ASP to increase 8.7% YoY amid higher input costs, which is lower than our expectation for bias truck tires because DRC mainly exports its radial tires (81% of its selling volume in the last 12 months) and has to share the increased logistics costs with its export clients.</p>
- Others	765	858	12.3%	0.0%	
Gross profit	747	848	13.5%	-4.3%	
SG&A	-368	-372	0.9%	5.8%	
Operating profit	379	476	25.7%	-10.9%	
Financial expenses	-51	-77	50.3%	-4.0%	
PBT	364	432	18.5%	-11.4%	
NPAT-MI	291	345	18.7%	-11.4%	
GPM %	17.1%	16.4%		-0.2 pts	
GPM bias truck tire %	18.2%	17.4%		+0.3 pts	* We revise up our bias tire GPM as we observe stronger-than-expected demand recovery after economic activities returned to normal conditions in Q1 2022.
GPM radial tire %	16.1%	15.6%		-0.6 pts	* We cut our radial tire GPM forecast from 16.2% to 15.6% due to DRC's dwindling competitive advantage in the US.
SG&A/Sales %	8.4%	7.2%		+0.6 pts	* We model 2022F SG&A/sales to cool YoY because we do expect any stringent mobility restrictions in Vietnam similar to 2021. However, we expect prolonged high global logistics costs will keep selling expenses/sales at high.
OPM %	8.7%	9.2%		-0.8 pts	
EBITDA margin %	11.0%	10.6%		-0.8 pts	
NPAT margin %	6.6%	6.7%		-0.6 pts	

Source: Company's financial statements, VCSC forecast

Valuation

We value DRC using a DCF valuation method and derive a target price of VND32,900/share, implying a projected total stock return of 19.7%, inclusive of a 5.9% dividend yield. We maintain our explicit forecast period to 2028. We expect DRC to achieve additional radial tire production capacity of 100,000 units p.a. (+17% vs its current maximum capacity of 600,000 units p.a.) thanks to the application of high-pressure vulcanization equipment in 2022F before the full capacity of Phase 3 of its radial tire factory comes online beginning in 2024F, which will raise the capacity to 1,000,000 units p.a. As such, we believe DRC will reach 100% capacity utilization in 2027F and enjoy relatively stable cash flows from 2028F onward.

Figure 3: Valuation summary

VND bn	Valuation method	Weight	Equity value	Target price (VND/share)
DRC	Seven-year DCF	100%	3,905	32,900
Upside to TP				13.8%
Dividend Yield				5.9%
TSR				19.7%
2021 P/E at TP				14.8x
2022F P/E at TP				12.4x
2023F P/E at TP				13.4x

Source: VCSC

Figure 4: DCF valuation summary (VND bn)

Cost of Capital	Previous Report	Revised	FCFF (Seven Year) - VND bn	Value
Beta	1.1	1.1	PV of Free Cash Flows	1,504
Market Risk Premium %	7.0	7.0	PV of Terminal Val (0.5% g)	2,651
Risk Free Rate %	5.5	5.5	PV of FCF and TV	4,155
Cost of Equity %	13.2	13.2	+ Cash & ST investments	524
Cost of Debt %	10.0	10.0	- Debt	-774
Debt %	20.0	20.0	- Minority Interest	0
Equity %	80.0	80.0	Equity Value	3,905
Corporate Tax Rate %	20.0	20.0	Shares (million)	119
WACC %	12.2	12.2	Value per share, VND	32,900

Source: Bloomberg, VCSC

Figure 5: FCF forecasts

VND bn	2022F	2023F	2024F	2025F	2026F	2027F	2028F
EBIT	476	484	523	573	617	649	663
- Tax	-95	-97	-105	-115	-123	-130	-133
+ Depreciation	71	160	160	155	150	150	146
- Capex	-383	-482	-117	-27	-27	-28	-28
- Working cap increase	-280	-100	-30	13	10	-24	0
Free Cash Flow	-211	-35	430	599	626	617	648
Present Value of FCF	-199	-30	323	401	374	328	308
Cumulative PV of FCF	-199	-229	94	495	869	1,197	1,504

Source: VCSC

Figure 6: Sensitivity analysis of our target price (VND) for DRC in relation to DCF's WACC and terminal growth rate, ceteris paribus

		WACC				
		10.2%	11.2%	12.2%	13.2%	14.2%
Terminal Growth	0.0%	40,400	35,700	31,800	28,600	25,800
	0.5%	42,000	37,000	32,900	29,400	26,500
	1.0%	43,800	38,400	(Base case)	30,300	27,200
	1.5%	45,900	40,000	35,200	31,300	28,000
	2.0%	48,100	41,700	36,500	32,300	28,800

Source: VCSC

Peer Comparison

DRC is currently trading at a discount compared to the median TTM P/E of our selected peer group. However, we believe this discount is justified by DRC's weak market position in the bias tire segment.

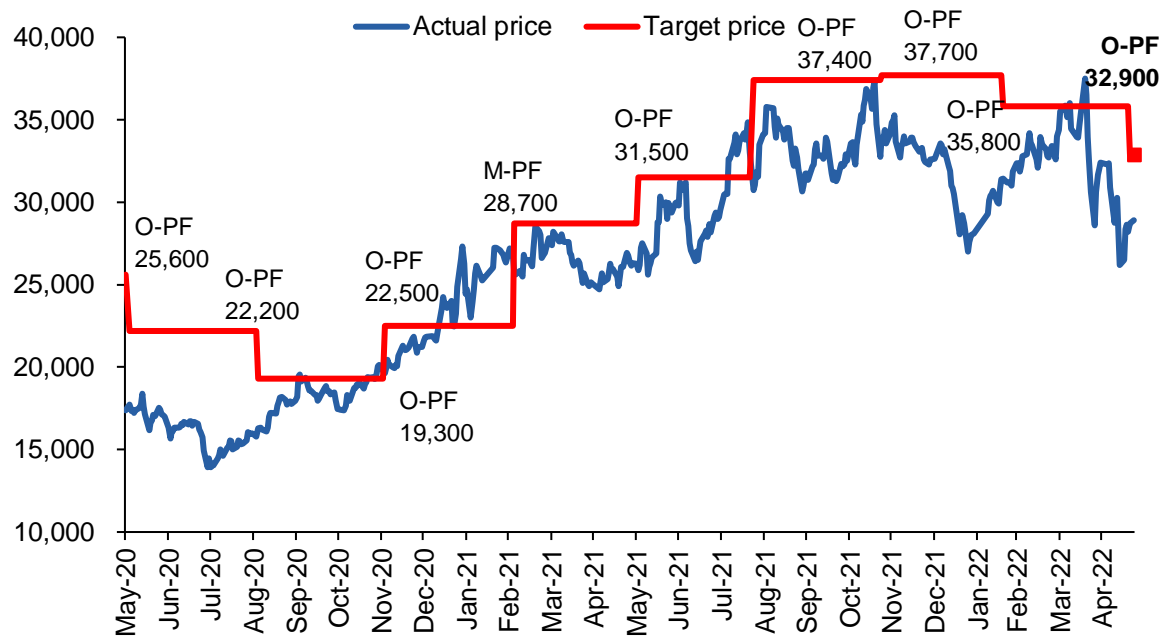
Figure 7: Peer comparison (USD mn)

Company	Country	Mkt cap	TTM Net Sales	Y-o-Y %	TTM NPAT	Y-o-Y %	Net Debt/ Equity	ROE	ROA	TTM P/E (x)	LQ P/B (x)
Tvs Srichakra	India	165	260	-7.7%	10	-10.2%	24.6%	9.4%	4.6%	17.3x	1.6x
Goodyear India	India	267	241	2.6%	18	53.4%	-69.3%	15.5%	10.1%	15.2x	2.5x
Indag Rubber	India	23	22	-1.5%	0	-18.3%	-14.1%	1.0%	0.9%	97.2x	0.9x
ND Rubber Plc	Thailand	29	26	4.6%	1	-47.6%	-3.0%	3.7%	2.7%	31.9x	1.1x
Southern Rubber	Vietnam	81	218	3.4%	2	-59.7%	174.8%	2.9%	0.8%	50.7x	1.5x
Median		81	218	2.6%	2	-18.3%	-3.0%	3.7%	2.7%	31.9x	1.5x
Average		113	154	0.3%	6	-16.5%	22.6%	6.5%	3.8%	42.4x	1.5x
Da Nang Rubber	Vietnam	149	207	26.5%	13	5.4%	13.6%	16.5%	9.7%	12.9x	1.9x

Source: Bloomberg, VCSC. Note: Data obtained as of May 23, 2022. Figures and ratios for DRC are calculated by VCSC.

Recommendation History

Figure 8: Historical VCSC target price vs share price (VND/share)



Source: Bloomberg, VCSC. Note: Historical target prices adjusted for changes in shares outstanding

Financial Statements

P&L (VND bn)	2021A	2022F	2023F	2024F	B/S (VND bn)	2021A	2022F	2023F	2024F
Revenue	4,380	5,163	5,832	6,301	Cash & equivalents	189	90	119	156
COGS	-3,632	-4,315	-4,945	-5,359	ST investment	150	320	320	320
Gross Profit	747	848	888	943	Accounts receivables	127	208	246	277
Sales & Marketing exp	-305	-297	-322	-334	Inventories	788	1,432	1,820	2,017
General & Admin exp	-63	-75	-82	-86	Other current assets	59	67	67	67
Operating Profit	379	476	484	523	Total Current assets	1,311	2,117	2,570	2,837
Financial income	37	27	29	31	Fix assets, gross	3,236	3,252	3,635	4,117
Financial expenses	-51	-77	-118	-134	- Depreciation	-2,172	-2,276	-2,347	-2,506
- o/w interest expense	-9	-37	-73	-85	Fix assets, net	1,064	975	1,289	1,611
Associates	0	0	0	0	LT investment	4	4	4	4
Net other income/(loss)	-1	5	6	6	LT assets other	52	42	40	40
Profit before Tax	364	432	400	427	Total LT assets	1,119	1,022	1,333	1,655
Income Tax	-73	-86	-80	-85	Total Assets	2,430	3,139	3,903	4,491
NPAT before MI	291	345	320	341	Accounts payable	224	408	484	555
Minority Interest	0	0	0	0	Short-term debt	306	572	790	895
NPAT less MI, reported	291	345	320	341	Other ST liabilities	212	383	452	510
NPAT less MI, adj*	246	314	291	311	Total current liabilities	742	1,363	1,726	1,960
EBITDA	483	548	644	683	Long term debt	1	2	238	510
EPS reported, VND	2,449	2,907	2,694	2,873	Other LT liabilities	0	0	0	0
DPS, VND	1,700	2,000	2,000	2,000	Total Liabilities	743	1,365	1,964	2,471
DPS/EPS (%)	82.0%	75.6%	81.6%	76.5%	Preferred Equity	0	0	0	0
*NPAT-MI adjusted for BWF & FX gains/losses					Paid in capital	1,188	1,188	1,188	1,188
					Share premium	0	0	0	0
RATIOS	2021A	2022F	2023F	2024F	Retained earnings	206	242	409	491
Growth					Other equity	293	345	345	345
Revenue growth	20.1%	17.9%	13.0%	8.0%	Minority interest	0	0	0	0
Op profit (EBIT) growth	1.9%	25.7%	1.6%	8.1%	Total equity	1,688	1,774	1,941	2,024
PBT growth	13.6%	18.5%	-7.3%	6.6%	Liabilities & equity	2,430	3,139	3,903	4,491
EPS growth, adjusted	9.2%	27.6%	-7.3%	6.6%					
					Y/E shares out, mn	118.8	118.8	118.8	118.8
Profitability					CASH FLOW (VND bn)	2021A	2022F	2023F	2024F
Gross Profit Margin	17.1%	16.4%	15.2%	15.0%	Beginning Cash Balance	189	90	119	156
Op Profit, (EBIT) Margin	8.7%	9.2%	8.3%	8.3%	Net Income	291	345	320	341
EBITDA Margin	11.0%	10.6%	11.0%	10.8%	Dep, & amortization	104	71	160	160
NPAT-MI Margin	6.6%	6.7%	5.5%	5.4%	Change in Working Cap	-482	-280	-100	-30
ROE	16.8%	18.6%	16.1%	16.4%	Other adjustments	-22	0	0	0
ROA	10.4%	9.8%	7.6%	7.5%	Cash from Operations	-109	137	380	471
Efficiency					Capital Expenditures, net	-9	-383	-482	-117
Days Inventory On Hand	111.5	137.5	141.6	140.7	Investments, net	-163	0	0	0
Days Accts, Receivable	14.0	16.0	16.4	16.7	Cash from Investments	-172	-383	-482	-117
Days Accts, Payable	26.9	34.6	36.9	38.7	Dividends Paid	-119	-178	-238	-238
Cash Conversion Days	98.6	119.0	121.1	118.7	Δ in Share Capital	0	0	0	0
Liquidity					Δ in ST debt	267	218	106	-90
Current Ratio x	1.55	1.49	1.45	1.52	Δ in LT debt	1	237	272	3
Quick Ratio x	0.45	0.40	0.38	0.41	Other financing C/F	33	0	0	0
Cash Ratio x	0.3	0.3	0.2	0.3	Cash from Financing	182	276	140	-324
Debt / Assets	18.3%	26.3%	31.3%	28.7%	Net Change in Cash	-99	29	37	29
Debt / Capital	32.3%	53.0%	69.4%	62.0%	Ending Cash Balance	90	119	156	186
Net Debt / Equity	27.3%	46.8%	61.7%	53.3%					
Interest Coverage x	41.1x	13.0x	6.6x	6.2x					

Source: Company's financial statements, VCSC forecasts

VCSC Rating System

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BUY	If the projected TSR is 20% or higher
OUTPERFORM	If the projected TSR is between 10% and 20%
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