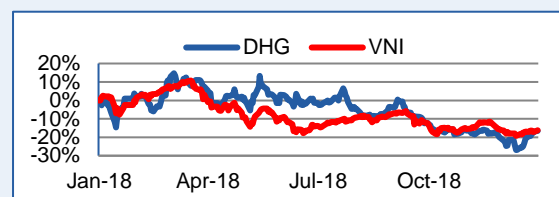


# Hau Giang Pharma (DHG)

# Earnings Flash

<b>Industry:</b>	<b>Pharma</b>		<u>2017</u>	<u>2018</u>
<b>Report Date:</b>	<b>January 21, 2019</b>			
Current Price:	VND84,300	Rev Growth	7.4%	-4.3%
Last Target Price:	VND85,400	EPS Growth	-6.3%	1.7%
Upside:	+1.3%	GPM	43.9%	44.2%
Dividend yield:	+3.6%	NPM	15.8%	16.8%
TSR:	+4.9%	EV/EBITDA	12.2x	12.6x
Rating:	MARKET PERFORM	P/Op CF	19.6x	29.2x
		P/E	19.1x	18.7x



Market Cap:	\$473.0mn		<u>DHG</u>	<u>Peers*</u>	<u>VNI</u>
Foreign Room:	\$241.2mn	P/E (ttm)	18.7x	18.1x	15.9x
ADTV30D:	\$0.4mn	P/B (curr)	3.7x	2.4x	2.4x
State Ownership:	43.0%	Net D/E	-31.1%	-15.3%	N/A
Outstanding Shares:	130.7 mn	ROE	22.1%	11.5%	14.8%
Fully Diluted Shares:	130.7 mn	ROA	15.8%	7.5%	2.4%

\*including foreign and domestic peers

## Company overview

DHG is the largest pharmaceutical company in Vietnam. Its main competitive advantage lies in its market-leading distribution network. DHG mainly produces generic drugs, with antibiotics and painkillers as its major categories.

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## Product mix drives better-than-expected GPM

DHG released 2018 results that included revenue of VND3.9tn (USD174mn, -4% YoY) and NPAT of VND654bn (USD29mn, +2% YoY). In-house product revenue inched up 4% vs 2017, which is broadly in line with our expectation. However, 2018 EBIT surpassed our forecast by 4% mostly thanks to a higher-than-expected GPM for in-house products in Q4 2018. Given this, we see potential slight upside risk to our current 2019/2020 NPAT forecasts of VND619bn/VND646bn (USD26.6mn/USD27.7mn), pending a more extensive review. Having said that, we expect no change to our current MARKET PERFORM rating for DHG at the current share price of VND84,300.

**Q4 2018 in-house product sales stayed flat vs Q4 2017.** This reinforces our conservative view on DHG's volume growth due to intensifying competition in the pharmacy channel and its lack of product differentiation.

**Q4 2018 trading revenue overshot our projection due to the recognition of promotional goods but was non-material to earnings.** We penciled in no trading revenue for Q4 2018 as DHG ceased its third-party trading business in H2 2018 to pave way for its FOL removal. Nonetheless, in Q4 2018, DHG recognized revenue of VND252bn (USD10.8mn), or 6.5% of total 2018 revenue, from promotional goods as part of trading revenue, which generates slim margins.

**Q4 2018 EBIT fell 14% YoY but beat our forecast by 14% thanks to better-than-expected in-house product GPM.** In-house product GPM expanded by 1.8 ppts in Q4 2018 vs 9M 2018 to 54.0% (-1.3 ppts vs Q4 2017). This was in contrast to our expectation that Q4 2018 would contract vs 9M 2018 amid increasing input active ingredient (API) prices. Management attributed such GPM improvement to a better sales mix in Q4 2018 vs 9M 2018, driven by higher-margin categories such as vitamin supplements. Overall, 2018 EBIT declined by 4% YoY due to dwindling in-house product GPM (-2.5 ppts vs 2017 to 52.7%) caused by API price hikes, partly offset by easing SG&A expenses mostly owing to lower staff bonuses as DHG failed its full-year sales target.

**Non-operating income cushioned Q4 2018 PBT.** Net financial income and other income reached VND17.4bn (USD750,000) in Q4 2018 vs a loss of VND12.5bn (USD536,000) in Q4 2017. This was thanks to an increase in interest income on a ballooning cash balance and a provision reversal of VND10.8bn (USD463,000) related to a long-term financial investment. This helped Q4 2018 PBT to slip by only 1% vs Q4 2017 despite a 14% slump in EBIT.

**Disproportionate tax expense allocation in 2017 boosted Q4 2018 NPAT growth of 40% YoY; effective tax rate edged up by 0.3 ppt in 2018.** We note that in Q4 2017, the Tax Authority issued a decision on the calculation of DHG's tax rate, which resulted in a significant upward adjustment in the effective tax rate. In addition, all tax adjustments for FY2017 were made in Q4 2017 alone, i.e., not retrospectively adjusted for 9M 2017. This resulted in a surge in NPAT in Q4 2018 vs Q4 2017. Overall, the effective tax rate reached 11.0% in 2018 vs 10.7% in 2017.

#### DHG's Q4 2018 and full-year 2018 results

VND bn	Q4 2017	Q4 2018	YoY	2017	2018	YoY	% of VCSC's 2018 forecasts
<b>Net revenue</b>	<b>1,354</b>	<b>1,218</b>	<b>-10%</b>	<b>4,064</b>	<b>3,888</b>	<b>-4%</b>	<b>108%</b>
In-house products	962	967	1%	3,055	3,177	4%	101%
Trading and others	392	252	-36%	1,009	711	-30%	155%
<b>Gross profits</b>	<b>564</b>	<b>524</b>	<b>-7%</b>	<b>1,784</b>	<b>1,720</b>	<b>-4%</b>	<b>103%</b>
In-house products	532	522	-2%	1,689	1,676	-1%	103%
Trading and others	33	3	-92%	95	45	-53%	105%
Selling expenses	-243	-234	-3%	-733	-726	-1%	99%
G&A	-85	-87	2%	-318	-287	-10%	110%
<b>Operating profit</b>	<b>236</b>	<b>203</b>	<b>-14%</b>	<b>733</b>	<b>707</b>	<b>-4%</b>	<b>104%</b>
<b>PBT</b>	<b>223</b>	<b>220</b>	<b>-1%</b>	<b>719</b>	<b>732</b>	<b>2%</b>	<b>105%</b>
<b>NPAT</b>	<b>145</b>	<b>204</b>	<b>40%</b>	<b>642</b>	<b>654</b>	<b>2%</b>	<b>106%</b>

Source: DHG and VCSC



## VCSC Rating and Valuation Methodology

**Absolute, long-term (fundamental) rating:** The recommendation is based on implied total return for the stock defined as  $(\text{target price} - \text{current price}) / \text{current price} + \text{dividend yield}$ , and is not related to market performance.

RATING	DEFINITION
BUY	Total stock return including dividends over next 12 months expected to exceed 20%
OUTPERFORM (O-PF)	Total stock return including dividends over next 12 months expected to be positive 10%-20%
MARKET PERFORM (M-PF)	Total stock return including dividends over next 12 months expected to be between negative 10% and positive 10%
UNDERPERFORM (U-PF)	Total stock return including dividends over next 12 months expected to be negative 10%-20%
SELL	Total stock return including dividends over next 12 months expected to be below negative 20%
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