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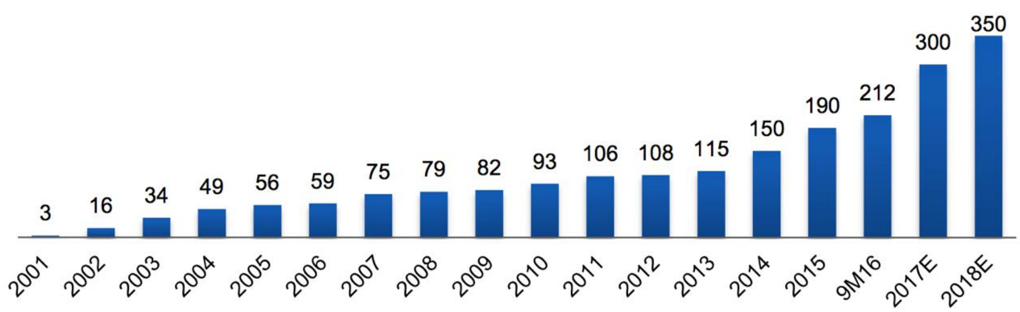
SALE'S NOTE

Hoa Sen Group – HOSE: HSG | **May 17, 2017**

HSG – Outstanding Stock in Material Sector

- Estimated EPS 2017 is 10x, target price is VND70k equivalent to upside 40%.
- Great benefit from new tax imposed to galvanized flat steel and pre-paint galvanized steel sheets support to surge gross margin.
- Increase local market share due to expansion of capacity and distribution channel throughout the country.

HSG was founded in 2001 as galvanized steel retail distributor. After 17 years, HSG became leading company in production and distribution galvanised steel, steel pipe and plastic pipe. The success of HSG could be made by the strategy: buy raw material from 1st sellers and sell final products to end users throughtout nationwide distribution channel.



HSG – Retail Distribution Channel

HSG recored the growth of revenue by 2% only in Y2016 but the net profit increased 130% YoY thanks to discrepancy of cost of raw material and selling price that could make gross margin raised 8.6%. Coming to Y2017, HSG is expected to hit new archievement in term of both market share and net profit.

- **Anti-dumping tax was officially imposed for galvanized flat steel** which was imported from China and Korea and effected from April 17, 2017. In 2106, 50% flat steel's sales volume's of domestic companies was imported even this product has been produced domestically. Thus, the new tariff will limit the imports and create oppotunity for domestic galvanized flat steel such as HSG.
- **Anti-dumping tax on pre-painted galvanized steel sheets** is expected to apply soon. Accordingly, HSG will be greatly benefit because this is the most profitable product which accounted for 26% F2016's revenue. The new tariff of pre-painted steel sheets is evaluated to make greater impact on HSG's revenue and profit than imposing anti-dumping tax for galvanized flat steel. When anti-dumping tax imposed on both galvanized flat steel and pre-painted galvanized steel sheets, imported volume is estimated to reduce about 50%. This will be an opportunity for local supplier such as HSG to boost sales volume.
- **Expand market share to the Central and North of Vietnam**. In Y2016, Hoa Sen Binh Dinh Factory went into operation with total capacity is 24,000 ton/year. Besides, HSG has officially started Ha Nam Factory in March 2016. The factory is planned to release 1st product in begin of 2017 and complete 2nd phase in Sep 2018. Building the factory in North and giving the factory in Central of Vietnam into operation will not only increase total capacity of HSG, also help company to acquire market share of these region, boosting exports to countries such as Cambodia, Laos, Thailand as well. Additionally, HSG plans to open 88 new stores, increases nation-wide distribution channel to 300 stores in 2017. Especially, those stores are wholly-owned and provide products of HSG only. Accordingly, HSG does not need to compete with other supplier in term of sales policy such as discount rate, promotion.
- **The high season of HSG is always H2 of the year.** HSG had reasonable calculation when build new factories in 2016 and expand number of store in 2017. Raising capacity and expanding distribution channel plus benefiting from new tariff, business result of HSG is expected to grow strongly.
- **Hoa Sen – Ca Na Project has been ordered to halt**. This could be good news for investors because of high risk.
  - The total investment of this project is USD500mn and 80% of investment will be lent by the bank under mid-long term loan. That means, HSG has to prepare USD100mn in cash; however at the end of 2016, cash of HSG was around USD25,8mn. Borrowing more loan will increase D/E ratio from 66,5% to 93,8% in 2017 and 112,6% in 2018. This ratio is too high and risky for manufacturing company.
  - Negative impact on environment. Producing steel makes large negative impact on environment and Fomosa Ha Tinh is lesson learned. Even HSG committed to supervise the whole production process to minimize the impact on environment. However, it is not easy to get approval from government.
  - Even HSG is leading company in producing galvanized steel, but the company has no experience in producing long steel with BOF Technology. When diversify to long steel product, HSG is required to upgrade management system and use variety of degital methods. Fail to do this, the whole project will not be effective.
  - Consumption rate of market: when Divergence 1.1 of Hoa Sen Ca Na Project come into operation, they will provide about 1,5 million ton of long-steel, mostly equivalent to estimated

sales volume of Hoa Phat Group in 2016. Hence, it has to take long time for market to consume this capacity.

Grew 255% from VND20k to VND51k in 2016, HSG price was supposed to be at the top. This is why coming to 2017, HSG do not attach high cash flow from investors; especially for foreign investors who inherently not interested in material stock. However, in Vietnam HSG brings a different story related to real estate and public construction. It is possible to say that, construction and galvanized steel are specialized products with high margin. Moreover, demand is always remained higher than local supply and import occupied 50% of total sales. Thus, the new tax scheme would made the great impact on reducing the import from China and Korea. This will be driving force for local manufacturers; especially many of them including HSG expanded capacity at the end of 2016 and ready to compensate for the deficit from import in 2017. With current price is around VND50k, HSG is targeted at VND70k equivalent to 40% upside. This is great opportunity for investors when there are not many companies with strong potential growth, but expect such high price. We highly recommend this is right time to Buy.

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