

POWER GENERATION COMPANY NO. 3 (GENCO 3) – IPO NOTE

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IPO information

IPO date	Feb 09, 2018
Initial price (VND/share)	24,600
Shares offered (shares)	267,051,900
% of current outstanding shares	12.8%
Structure	Primary
Asset valuation (VNDbn)	92,941
Book Value of Equity after revaluation (VNDbn)	26,108
Chartered Capital (VNDbn)	20,809

Key statistics

Market cap @ initial price (VNDbn)	51,190
EPS (VND)	127
ROE	2.3%
P/E (*)	193.7x
P/B (*)	4.5x

(*) Calculated based on initial price

Expected ownership after IPO

Public	12.84%
Strategic investors	36.0%
ESOP	0.16%
State (EVN)	51.0%

Genco 3 will hold an IPO auction on February 9th, 2018. The company is currently the largest power generation player in the market with a diversified portfolio of multi-source power plants. However, Genco 3 has high leverage and is highly exposed to fluctuations in foreign currency. We expect that the involvement of strategic investors in the company after privatization will improve Genco 3's balance sheet, through restructuring of forex borrowings. We think Genco 3 is more suitable for investors with long term investment horizons and consider PVPower to be a more attractive target in the power generation sector.

IPO scheduled for February 9th, 2018; strong interest from strategic investors.

Genco 3 received approval from the government for its privatization at the end of December 2017, and will carry out an IPO auction on Feb 9th, 2018. The company will offer a 12.84% stake to the public (equivalent to 267.1mn shares) at an initial price of VND24,600/share (19.4x normalized TTM earnings and 193.7x reported TTM earnings). Genco 3 has not yet announced a specific listing date.

Genco 3 plans to issue a total of 1,019.6 million primary shares (equivalent to a 49% stake), thereby reducing state ownership down to 51%. Within the new issuance, 267.1mn shares (12.84% stake) will be offered to the public through an IPO, 749.1mn shares (36% stake) to strategic investors after the IPO ends and 3.4mn shares (0.16%) will be issued through an ESOP program.

There are currently five institutional investors interested in acquiring the entire 36% stake offered to strategic investors. They are power companies that have experience in operating and developing power plants and wish to be involved in Genco 3 management. Moreover, these investors are also willing to acquire any unsold IPO shares.

Genco 3 is currently the largest power generation company in the country with a diversified portfolio of multi-source power plants.

Genco 3 owns 5,450MW of electricity generation capacity directly through ownership of power plants and another 1,724MW of capacity indirectly through subsidiaries and associates. Genco 3 is the largest generation company out of the three entities under EVN, accounting for 16% of nationwide capacity and making up approximately 17% of total electricity output across the country.

80% of the capacity under Genco 3 is located in the South, the largest consumer of electricity out of the three main regions in Vietnam. Given the proximity of this capacity to main consumption hub in the country, EVN prioritizes electricity purchases from power plants under Genco 3 to minimize the transmission losses inherent in transporting power from the North and Central power plants to the power-deficient South. Genco 3 also possesses a portfolio of multi-source power plants: 46% of the capacity under Genco 3 is gas-fired, 43% is coal-fired and 11% is hydropower. This acts as a natural hedge against commodity price fluctuations which change the relative competitiveness of single-source power plants.

Figure 1: Current list of power plants under Genco 3

Name	Capacity (MW)	Ownership %	Commissioning period
<u>Gas-fired thermal power</u>			
Phu My power plants	2,540	100.0	1997-2005
BTP	390	79.6	1992-2002
NT2	750	2.5	2011
<u>Coal-fired thermal power</u>			
Vinh Tan 2	1,244	100.0	2015
Mong Duong 1	1,080	100.0	2015
NBP	100	54.8	1974-1976
<u>Hydropower</u>			
Buon Kuop power plants	586	100.0	2009
VSH	136	30.6	1994
TBC	120	30.0	1971-1975
Se San 3A	108	30.0	2006
Viet-Lao Power JSC	651	0.6	

Source: VNDIRECT

Potential 24.5% increase in capacity in the future through 3 solar power projects and 1 LNG power plant.

Genco 3 has plans in its pipeline to increase its generation capacity in the future. This includes the construction of LNG-fired Long Son power plants (1,200MW for the first phase) and three solar power plants, namely Vinh Tan (35MW), Srepok 3 (50MW) and Ninh Phuoc 7 (Phase 1 of 50MW in total 200MW). This will increase total capacity by up to 1,335MW in the next few years, equivalent to 24.5% of the current capacity across all plants directly owned by Genco 3. Currently, Genco 3 is waiting for approval to begin investing in Vinh Tan solar power plant.

Figure 2: List of new power generation projects in the pipeline

Project	Capacity (MW)	Total investment value (VND bn)	Investment per MW (VND bn)	Timeline
Vinh Tan - Binh Thuan solar	35	1,082	30.9	2018-2020
Srepok 3 solar	50	1,840	36.8	2018-2020
Ninh Phuoc 7 solar	50	1,397	27.9	2019-2021
LNG Long Son #1	1200	24,293	20.2	2020-2025

Source: Genco 3

Among the three solar plants, Srepok 3 requires higher capex per MW due to the advanced technology required to build solar panels afloat on the reservoir of Srepok 3 hydropower plant (falls under the of Buon Kuop power plant series). On the other hand, Ninh Phuoc 7 has relatively low capex per MW thanks to its proximity to Phuoc Thai solar project, which allows it to save costs on building transmission infrastructure to connect to the grid.

The average capex per MW for solar projects by Genco 3 is around VND31.9bn/MW (~US\$1.4mn/MW). We think that this is on the higher side, as the average cost per MW can be reduced to as much as US\$1.2mn/MW using the latest solar technology from Germany and Holland according to Vietnam Climate Innovation Center (VCIC). All of the projects are scheduled to start construction in 2018 and are currently awaiting approval from EVN.

Large amount of foreign currency debt increases exposure to exchange rate risks and has eroded returns on capital

By the end of 3Q2017, Genco 3's total debt was VND66,945bn (~US\$2.97bn), including both long-term and short-term debt. Total amount of borrowings in foreign currency by the end of 3Q2017 was

Figure 3: Breakdown of borrowings in foreign currency at the end of 3Q2017

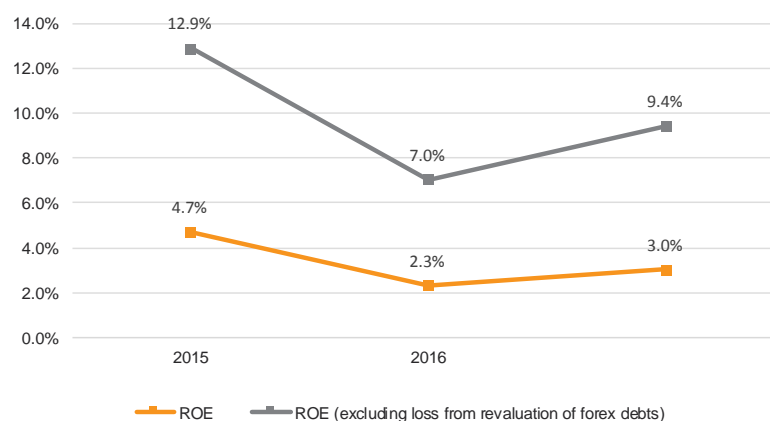
	Total borrowings	Loss/gain per 1% change in exchange rate (in VND)
USD	2,187,089,845	498,312,309,831
JPY	24,427,569,271	47,931,776,414
CNY	569,938,071	18,146,574,114

Source: VNDIRECT

VND56,439bn accounting for 84% of total borrowings and comprising of USD, JPY and CNY loans. The majority of the borrowings were used for the construction of Mong Duong 1 and Vinh Tan 2, which are relatively new power plants that came into operation in 2015.

In 2015, when both new plants came into operation, the company's ROE dropped due to losses on revaluation of foreign currency debt. Excluding the negative impact from exchange rate movements, ROE would have improved from 7.0% in 2015 to 9.4% in 2016. However, since there was a VND537bn loss from revaluation of debt incurred in 2015 and VND725bn in 2016, ROE was only 2.3% in 2015 and 3.0% in 2016. In 9M2017, the company incurred a loss of VND2,369bn from the revaluation of foreign currency borrowings, despite the relative stability of the Vietnamese dong.

Figure 4: ROE of Genco 3 was depressed due to forex debt revaluation losses



Source: VNDIRECT

High leverage will reduce, as proceeds from new share issuance will be used to prepay some of the debt

At the present, Genco 3's debt to equity ratio is relatively high compared to its peers at 5.9x according to our estimation, based on the book value of equity on its balance sheet as of the end of 3Q2017. Genco 3 has planned to use part of the money raised from issuing shares through the IPO to prepay a portion of the debt, thereby reducing its debt/equity ratio.

Genco 3 is allowed to retain only VND10,196bn (US\$451.7mn) of proceeds from the IPO, which is equivalent to the par value of VND10,000 multiplied by the number of shares issued through the IPO, ESOP program and to strategic investors. The difference between the initial IPO price of VND24,600/share and par value will be handed back to EVN to return to the government. In the case that the actual IPO price is higher than the initial reference price, the premium will be divided between Genco 3 and EVN in the ratio of 49:51.

After privatization, Genco 3's leverage will decrease thanks to 2 factors: (1) higher book value of equity as Genco 3 issues additional shares, and (2) reduction in borrowings due to prepayment using proceeds from share issuance.

Assuming all the proceeds retained will be used to prepay debt, Genco 3's borrowings would reduce by 15.2% from VND66,945bn to VND56,749bn, thus allowing its debt/equity to fall to 2.7x, based on the post-issuance book value of equity on its balance sheet. This number is still relatively high compared to regional peers.

An increase in the PPA price for Vinh Tan 2 can benefit Genco 3's topline in the future.

Vinh Tan 2's electricity selling prices based on the power purchase agreement (PPA) with EVN followed Circular 41 at the time of construction, and thus its current price omits some of the cost components that should be included in the PPA price under the latest Circular 56, which replaced Circular 41 in 2014. Therefore, Vinh Tan 2's new PPA will increase by VND145/kWh, which is approximately 11% higher than the current PPA. This will allow Vinh Tan 2 to have an additional VND862.8mn in revenue based on 7bn kWh of electricity output annually with 85% of the total output sold to EVN via the PPA.

Involvement of strategic investors is expected to improve earnings profile. The management expects that EVN will hasten the process of approving a higher PPA price for Vinh Tan 2 after it becomes a joint stock company with the participation of strategic investors. With the new involvement of strategic investors, Genco 3 plans to negotiate with some commercial banks to restructure the existing foreign currency debt by replacing this debt with local currency debt and thereby reducing its exposure to future exchange rate fluctuations.

Valuation

Compared to peers in the region, Genco 3 is relatively expensive with a much lower ROA, ROE and abnormally high PE based on trailing reported earnings and the initial IPO price of VND24,600/share. This is due to the large amount of borrowings in foreign currency that depressed Genco 3's recent earnings. If we strip out the loss from revaluation of foreign currency debt, Genco 3's P/E falls to only 19.4x, which is cheap compared to peers; but we also note that the company deserves to trade at a discount to peers due to its relatively higher earnings volatility, high leverage and low returns on capital. We expect real improvement in financial ratios and earnings profile to occur when Genco 3 delivers what they set out to achieve including (1) prepayment of debt using the proceeds from the IPO, and (2) restructuring of borrowings to reduce exposure to forex movements.

We think Genco 3 is a suitable choice for institutional investors who have a long-term investment horizon, and thus are able to benefit from the above-mentioned improvement in fundamentals expected over the medium-term. However, compared to PVPower, Genco 3 is less attractive in the short run due to its lower return on equity and high earnings volatility.

Figure 5: Peer Comparison

Company	Country	Market					
		Cap (bn US\$)	ROA (%)	ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
Tata Power Co Ltd	India	4.3	1.0	4.8	3.2	42.6	2.0
Adani Transmission Ltd	India	3.7	3.4	14.8	2.9	55.7	7.9
CESC Ltd	India	2.3	1.8	6.5	1.3	21.3	1.5
Torrent Power Ltd	India	2.1	2.1	6.4	1.3	31.4	2.0
Xinjiang Tianfu Energy CO-A	China	1.2	1.7	6.8	1.7	19.2	1.3
Henan Yuneng Holdings CO-A	China	1.0	0.0	0.1	1.3	n/a	1.0
Sichuan Guanggan AAA Public-A	China	0.8	3.2	7.5	0.4	20.3	1.5
Yunnan Wenshan Electric PO-A	China	0.7	8.6	14.0	0.3	19.1	2.6
Guangxi Guidong Electric-A	China	0.7	1.0	5.0	2.8	35.9	1.9
Leshan Electric Power CO-A	China	0.6	2.4	5.3	0.3	55.6	2.8
Sichuan Minjiang Hydro-A	China	0.6	2.4	5.6	0.9	60.4	3.3
Genco 3	Vietnam	2.2 (*)	0.3	2.3 (**)	5.9	193.7 (*)	4.5 (*)
Average		1.5	4.7	13.2	1.6	33.0	2.3
Median		0.8	2.1	6.4	1.3	31.4	1.9

(*): Calculated using the initial price of VND24,600/share. If the loss from revaluation of foreign debt was excluded, the company's TTM P/E would be 19.4

(**): Calculated using the book value of equity on its balance sheet as of the end of 3Q2017

Source: VNDIRECT

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Description:	Excellent	Very Good	Good	N/A	

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Stock Ratings

Definition:

- Add The stock's total return is expected to reach 15% or higher over the next 12 months.
- Hold The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
- Reduce The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings

Definition:

- Overweight An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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