

HOA SEN GROUP (HSG) – AGM NOTE

Market Price VND6,750	Target Price NA	Dividend Yield 0.0%	Rating NOT RATED	Sector BASIC MATERIALS
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Outlook – Short term	Outlook – Long term	Valuation
Not rated	Not rated	Not rated

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We attended the recent FY17/18 (FY-end 31 October) AGM of Hoa Sen Group. Following are our key takeaways on recent business performance and management's restructuring plans:

HSG failed to reach its FY17/18 target of VND1,300 bn in NPAT. Management explained that the sharp decline in HRC (Hot Rolled Coil) input prices and rising expenses hurt HSG's profit margin. As a result, net profit plunged by 69.3% yoy to VND409bn. The company made a loss in the final quarter of FY17/18.

Market share maintained amid a slowdown in flat steel demand and rising competition. In 2018, slower growth in flat steel demand triggered rising competition in both local and overseas markets. HSG continued to expand its retail network to 491 stores to maintain its market share. However, this elevated operating and interest expenses, weighing on profitability.

Restructuring is underway. Burdened with an inefficient retail network, the company has restructured its distribution system to improve efficiency. Accordingly, HSG established 56 major branches in all provinces it has a presence in. These major branches will manage other smaller stores in each province. This move has helped HSG lower its staff headcount and expenses by around 30%, per the company. The company also intends to reduce its inventory levels in order to alleviate short term debt servicing pressures.

The company targets an earnings recovery in FY18/19. Despite a slowdown in flat steel demand, HSG still plans to increase its sales volume by 8.5% yoy. FY18/19 target revenue and net profit are VND31,500bn (-8.5% yoy) and VND500bn (+22.2% yoy), respectively. In our view, FY18/19 earnings will be impacted by the following two key factors: 1) HRC price trend and 2) HSG's ability to cut costs and continue to improve distribution efficiency.

HSG is trading at a TTM P/E of 6.3x, which is nearing its 5-year average P/E of 6.6x, but higher than regional peer average P/E of 5.1x. As we expect the HRC price to decline further, we believe that sentiment on the stock will continue to remain negative over the medium-term.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	26,050
52w low (VND)	5,960
3m Avg daily volume (shares)	
3m Avg daily value (VND mn)	27,482
Market cap (VND bn)	2,575
Outstanding shares (m)	381
Free float (%)	64
TTM P/E (x)	6.3
Current P/B (x)	0.5

Ownership

Hoa Sen Investment Group Ltd.	24.3%
Le Phuoc Vu	11.7%
Beira Limited	4.5%
Others	59.5%

Source: VNDIRECT

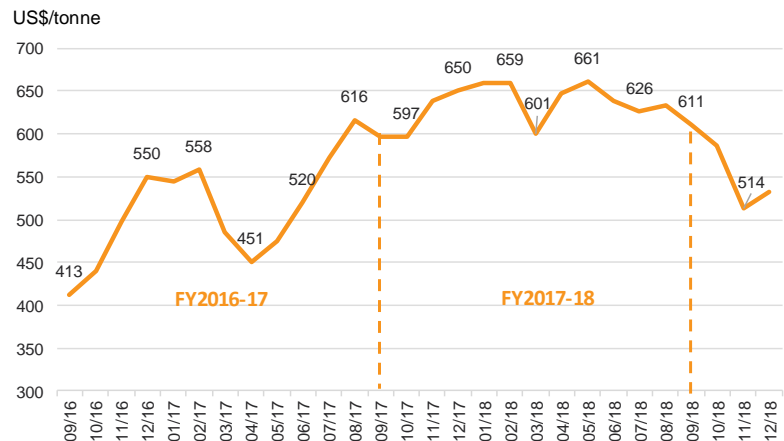
Financial summary (VND)	09-15A	09-16A	09-17A	09-18A
Net revenue (bn)	17,447	17,894	26,149	34,441
Revenue growth		2.6%	46.1%	31.7%
Gross margin	14.8%	23.3%	16.9%	11.5%
EBITDA margin	8.8%	14.9%	10.8%	6.9%
Net profit (bn)	653	1,504	1,332	409
Net profit growth		130.4%	(11.5%)	(69.3%)
Recurring profit growth		130.4%	(11.5%)	(69.3%)
Basic EPS	1,696	3,907	3,459	1,063
Adjusted EPS	1,814	4,181	3,701	1,095
BVPS	28,879	20,996	14,665	13,288
ROAE		42.7%	28.8%	8.0%

Source: VNDIRECT

Continued strong sales growth in FY17/18. The company recorded robust revenue growth of 31.7% yoy in the previous fiscal year thanks to solid volume growth of 12.2% yoy. HSG's finished steel sales volume, reached 1.75m tonnes. This included 1.28m tonnes of galvanised steel (+11.7% yoy) and 425,000 tonnes of steel pipes (+13.3% yoy).

Poor earnings performance. FY17/18 net profit fell sharply to VND409bn (-69.3% yoy). According to the company, the following were the major reasons for the decline in earnings: 1) HSG purchased a large amount of HRC at high prices which led to losses when HRC prices reversed; 2) Fluctuation in exchange rates led to forex losses as the company imports most of its raw material and has a large US\$-denominated debt balance; 3) Galvanised steel imports, mostly from China, put pressure on domestic prices; and 4) rising interest expenses (+68.3% yoy) and SG&A expenses (+17.2% yoy).

Figure 1: HRC prices from 10/2016 to 12/2018



HSG speculated on HRC at the cyclical price peak seen in Jan-Feb and made losses for the rest of the FY17-18 when HRC prices gradually weakened.

Source: VNDIRECT, HSG

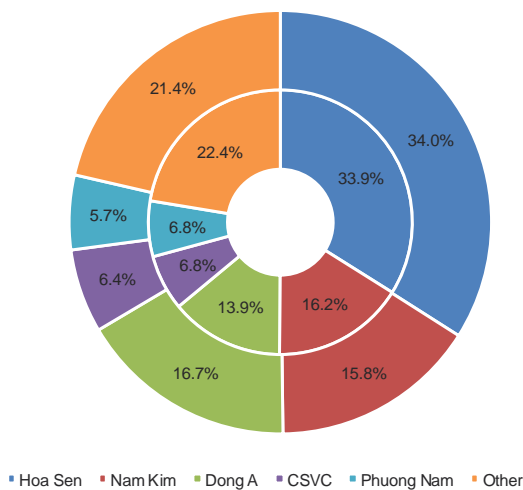
Slowing flat steel demand growth triggered rising competition in both local and overseas markets. According to VSA (Vietnam Steel Association), flat steel demand slowed in 2018. We estimate total flat steel products' consumption (flat steel consumption includes both domestic demand and exports) growth to have dropped from double-digit rates during 2014-17 to only 9.1% yoy in 2018. Exports of flat steel products and domestic consumption are estimated to have touched 2.1m tonnes (+11.1% yoy) and 4.1m tonnes (+8.1% yoy), respectively in 2018. HSG, as a leading producer of galvanised steel and the second largest steel pipe producer in Vietnam, felt the full brunt of the slowdown in demand which was only exacerbated by the company's aggressive capacity expansion in the last five years. According to our estimates, HSG's capacity utilisation rates were only around 48.9% for its steel pipe segment and 55.0% for its galvanised steel segment in 2018. However, it is important to note that HSG still maintained its leading position in the Vietnamese flat steel industry with 34.0% market share for galvanised steel products and 17.5% market share for steel pipe products.

Figure 2: Vietnam's flat steel production and consumption (tonnes, 2013-18E)

	2013	2014	2015	2016	2017	2018E
Production	3,375,000	4,021,000	4,561,000	5,116,000	6,636,000	6,879,000
yoy change (%)		19.1	13.4	12.2	29.7	3.7
Consumption	2,281,000	3,122,000	3,542,000	4,612,000	5,702,000	6,221,000
yoy change (%)		36.9	13.4	30.2	23.6	9.1
Production - Consumption	1,094,000	899,000	1,019,000	504,000	934,000	657,000
Import	752,000	815,000	1,531,000	2,001,000	1,432,000	1,192,000
yoy change (%)		8.3	88.0	30.7	(28.4)	(16.8)
Total inventory change	837,000	544,000	1,514,000	1,110,000	461,000	(267,000)

Source: VNDIRECT, VSA | Flat steel consumption includes both domestic demand and exports | Total Inventory Change = (Domestic Production + Imports) – (Domestic Consumption + Exports) | Calculation based on 11M2018 data

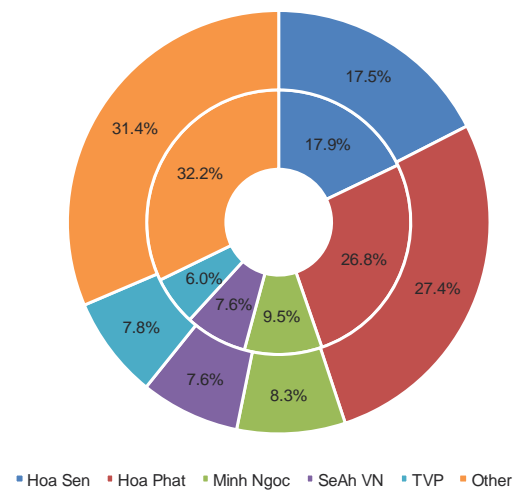
Figure 3: Market share of top 5 galvanised steel producers in Vietnam



Source: VNDIRECT

Note: Inner circle: 2017. Outer circle: 2018.

Figure 4: Market share of top 5 steel pipe producers in Vietnam



Source: VNDIRECT

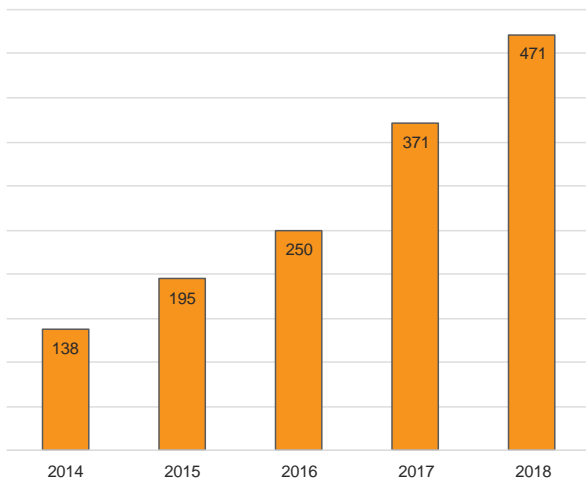
Note: Inner circle: 2017. Outer circle: 2018.

Management will continue restructuring the company's retail network and cutting costs in FY18/19. At end-2018, HSG owned 491 retail stores nationwide, an increase of 120 stores compared to 2017. According to the company, its distribution network will be restructured by establishing 56 major branches in every province it has a presence in. Each provincial branch will manage the other stores in that province. This step could help HSG reduce a large amount of human resources and store-level expenses. In addition, the ERP system, which was fully implemented in FY17/18, is expected to help HSG manage the restructuring process. Currently, HSG's SG&A to sales ratio is much higher than its local peers (7.9% vs. 2-3% for other local peers).

Inventories have fallen from a peak of VND9,884bn as of 31/12/2017 to VND6,604bn (-33.2%) as of 30/09/2018. The company targets to lower its inventories by another VND1,000 -1,500bn in the first quarter of FY18/19 which could help reduce short-term debt, per management.

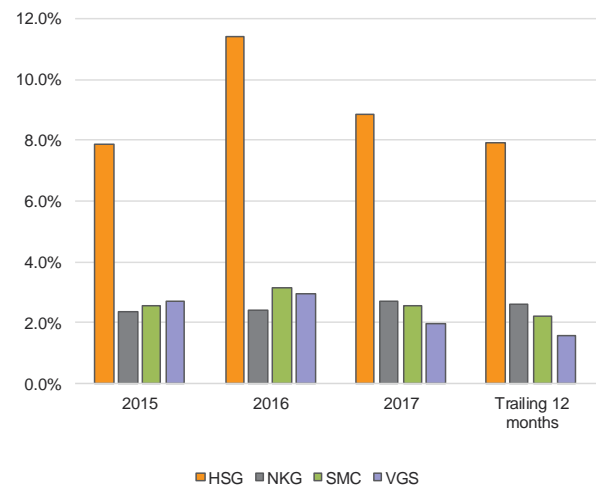
However, as of 30/09/2018, HSG's net debt/equity ratio was 270.7%, much higher than the industry average of 144.1%. Over the course of FY17/18, HSG decreased its employee headcount by 19.0%, reducing salary expenses by 30.0%, per management. The Chairman shared that HSG is going to cut expenses further in FY18/19 as he believes the 2019-20 period will be unpredictable and tough.

Figure 5: HSG's retail network continued to expand in 2018



Source: VNDIRECT, HSG

Figure 6: HSG's SG&A to sales ratio compared to its local peers



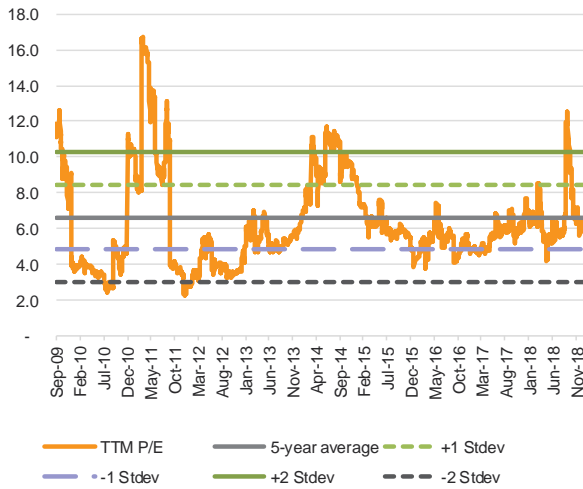
Source: VNDIRECT, FIINPRO

The company targets an earnings recovery in FY18/19. Despite a slowdown in flat steel demand, HSG still plans to increase its sales volume by 8.5% yoy to maintain its market share. FY18/19 target revenue and net profit are VND31,500bn (-8.5% yoy) and VND500bn (+22.2% yoy), respectively. This plan does not include potential abnormal gains from HSG's divestments from its property assets. At the AGM, HSG's shareholders approved a zero cash dividend and 10% stock dividend for FY17/18.

Disappointing earnings results in 1QFY18/19. The company disclosed its 1QFY18/19 results at the AGM with sales volume of 450,000 tonnes (+9.8% yoy). However, both the topline and earnings decreased compared to the same period in the previous year. 1Q revenue and net profit are estimated at VND7,600bn (-3.6% yoy) and VND60bn (-82.0% yoy), respectively. In 1QFY18/19, the average HRC price was US\$531 per tonne (-6.7% yoy and -7.3% qoq). The company's net profit margin is estimated at 0.8% in the first quarter, lower than the FY17/18 net profit margin of 1.2%. With the poor performance in 1QFY18/19, HSG only fulfilled 12.0% of its full year net profit guidance.

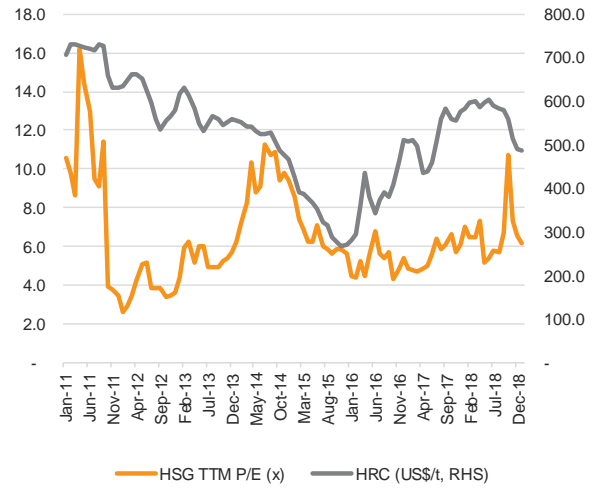
We believe that sentiment on the stock will stay depressed. At the current price, HSG is trading at a TTM P/E of 6.3x, which is nearing its 5-year average P/E of 6.6x, but higher than the regional peer P/E of 5.1x. As we expect HRC prices to decline further, sentiment on the stock is likely to stay depressed.

Figure 7: HSG is trading at its 5-year historical average P/E



Source: VNDIRECT, BLOOMBERG

Figure 8: HSG TTM P/E vs. HRC price



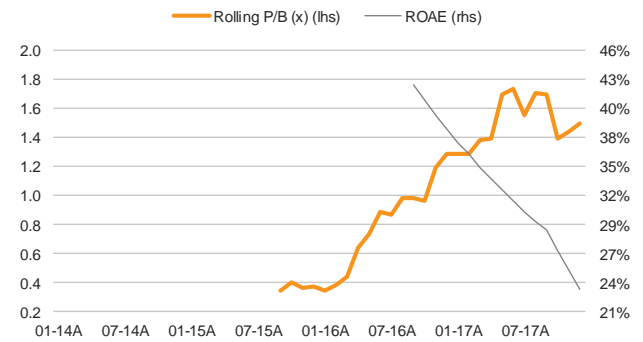
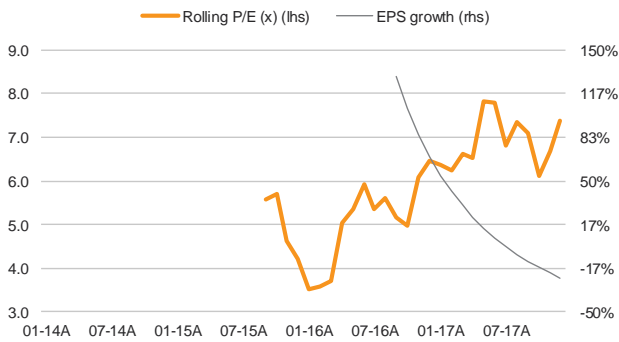
Source: VNDIRECT, BLOOMBERG

Figure 9: HSG's peer comparison

Company	BB Ticker	Country	Recom.	Closing price	Target price	Market cap	ROE (%)		P/BV (x)		P/E (x)		EV/t of sales volume (\$US/tonne)		
				(local curr.)	(local curr.)		(US\$ m)	18E	19F	18E	19F	18E		19F	
JSW Steel	JSTL IN	India	Add	286	337	9,726.3	25.1	19.0	2.0	1.7	8.6	9.3	1.4		
Angang Steel	000898 CH	China	Add	5	6	5,473.0	14.5	10.1	0.7	0.6	4.8	6.3	0.4		
Bluescope Steel	BSL AU	Australia	Add	12	16	4,601.8	15.9	11.3	0.9	0.8	6.2	7.8	1.6		
Maanshan Iron & Steel	600808 CH	China	Add	4	4	3,935.2	23.7	18.1	0.9	0.8	4.2	5.0	0.4		
Steel Authority of India	SAIL IN	India	Add	50	64	2,924.3	7.7	8.6	0.5	0.5	6.8	5.6	0.7		
Jindal Steel & Power	JDSL IN	India	Add	33	90	222.1	12.9	17.3	0.6	0.5	3.5	2.5	0.1		
Nam Kim Steel	NKG VN	Vietnam	Reduce	6,820	6,600	53.5	13.9	12.3	0.4	0.3	3.0	3.2	0.3		
<i>Average</i>															
<i>Median</i>															
Hoa Sen Group	HSG VN	Vietnam	Not rated	6,690	na	111.0	9.0	6.5	0.4	0.4	5.1	7.1	0.5		

Source: VNDIRECT, BLOOMBERG

Valuation



Income statement

(VNDbn)	09-16A	09-17A	09-18A
Net revenue	17,894	26,149	34,441
Cost of sales	(13,717)	(21,731)	(30,464)
Gen & admin expenses	(1,140)	(1,513)	(1,816)
Selling expenses	(901)	(801)	(896)
Operating profit	2,136	2,104	1,266
Operating EBITDA	2,685	2,810	2,285
Depreciation and amortisation	(549)	(705)	(1,020)
Operating EBIT	2,136	2,104	1,266
Interest income	38	54	179
Financial expense	(256)	(589)	(971)
Net other income	(12)	74	54
Income from associates & JVs	0	0	1
Pre-tax profit	1,907	1,643	529
Tax expense	(403)	(311)	(120)
Minority interest	(0)	(0)	(0)
Net profit	1,504	1,332	409
Adj. net profit to ordinary	1,504	1,332	409
Ordinary dividends			
Retained earnings	1,504	1,332	409

Balance sheet

(VNDbn)	09-16A	09-17A	09-18A
Cash and equivalents	577	292	492
Short term investments	0	0	0
Accounts receivables	1,098	1,980	2,119
Inventories	4,822	8,871	6,607
Other current assets	562	1,772	1,582
Total current assets	7,057	12,916	10,800
Fixed assets	4,884	8,094	9,637
Total investments	26	91	99
Other long-term assets	342	490	719
Total assets	12,310	21,591	21,255
Short-term debt	4,366	9,015	10,880
Accounts payable	1,620	3,636	1,067
Other current liabilities	771	930	691
Total current liabilities	6,757	13,581	12,638
Total long-term debt	1,419	2,836	3,462
Other liabilities	4	5	4
Share capital	1,965	3,500	3,850
Retained earnings reserve	1,603	1,447	1,055
Shareholders' equity	4,127	5,133	5,116
Minority interest	3	37	36
Total liabilities & equity	12,310	21,591	21,255

Cash flow statement

(VNDbn)	09-16A	09-17A	09-18A
Pretax profit	1,907	1,643	529
Depreciation & amortisation	549	705	1,020
Tax paid	(378)	(340)	(178)
Other adjustments	(24)	(70)	(185)
Change in working capital	(413)	(4,116)	(688)
Cash flow from operations	1,641	(2,179)	497
Capex	(1,307)	(4,017)	(2,724)
Proceeds from assets sales	5	50	172
Others	8	(27)	159
Other non-current assets changes	0	0	0
Cash flow from investing activities	(1,293)	(3,994)	(2,394)
New share issuance	116	35	0
Shares buyback	(0)	0	(1)
Net borrowings	293	6,066	2,491
Other financing cash flow	(131)	(16)	(43)
Dividends paid	(327)	(196)	(350)
Cash flow from financing activities	(48)	5,889	2,096
Cash and equivalents at beginning of period	277	577	292
Total cash generated	300	(284)	200
Cash and equivalents at the end of period	577	292	492

Key ratios

	09-16A	09-17A	09-18A
Dupont			
Net profit margin	8.4%	5.1%	1.2%
Asset turnover	1.65	1.54	1.61
ROAA	13.8%	7.9%	1.9%
Avg assets/avg equity	3.09	3.66	4.18
ROAE	42.7%	28.8%	8.0%
Efficiency			
Days account receivable	10.5	16.0	17.5
Days inventory	129	149	79
Days creditor	43.2	61.1	12.8
Fixed asset turnover	4.01	4.03	3.88
ROIC	15.2%	7.8%	2.1%
Liquidity			
Current ratio	1.04	0.95	0.85
Quick ratio	0.33	0.30	0.33
Cash ratio	0.09	0.02	0.04
Cash cycle	96	104	84
Growth rate (yoy)			
Revenue growth	2.6%	46.1%	31.7%
Operating profit growth	77.8%	(1.5%)	(39.9%)
Net profit growth	130.4%	(11.5%)	(69.3%)
EPS growth	130.4%	(11.5%)	(69.3%)
Share value			
Basic EPS (VND)	3,907	3,459	1,063
BVPS (VND)	20,996	14,665	13,288

Source: VNDIRECT

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- 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.

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Definition:

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- 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.

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