

SMC TRADING - INVESTMENT JSC (SMC) – AGM NOTE

Market Price	Target Price	Dividend Yield	Rating	Sector
VND27,000	NA	3.7%	NOT RATED	BASIC MATERIALS

Outlook – Short term

Not rated

Outlook – Long term

Not rated

Valuation

Not rated

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At its 2018 AGM, SMC Trading – Investment JSC (SMC) raised its net profit target from VND200bn to VND250bn based on its new strategic focus on making flat steel products which should enable it to expand margins. Although SMC's current valuation appears to be cheap (2018 forward P/E of 4.7x based on the company's earnings guidance), the company needs time to improve its profitability in the face of stiff competition in the downstream segment of the flat steel market.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	31,000
52w low (VND)	19,604
3m Avg daily volume (shares)	37,189
3m Avg daily value (VNDmn)	860
Market cap (VNDbn)	1,134
Outstanding shares (m)	41.2
Free float (%)	39
TTM P/E (x)	4.3
Current P/B (x)	1.0

Ownership

Hanwa Co., Ltd	20.0%
Nguyen Ngoc Anh	14.1%
Nguyen Thi Ngoc Loan	14.5%
Others	51.4%

Source: VNDIRECT

SMC's expects the flat steel segment to contribute to 50% of its revenue by 2020. SMC deals in two main product categories: construction steel and flat steel. From a purely construction steel commercial trading entity, SMC has gradually turned into a flat steel processing company. The proportion of flat steel products in total sales volume increased from 28.7% in 2012 to 43.7% in 2017. The company aims for its flat steel segment to account for 50% of sales by 2020 and also plans to move into higher value-added activities in the downstream segment of the flat steel market. We laud SMC's efforts to focus on flat steel products in order to improve efficiency and margin stability. However, we think that the company may face some challenges as a late mover in a highly competitive market, facing strong competition from more established players such as HSG, NKG and Dong A Steel. According to management, SMC focuses on a niche market by providing small-sized steel products for home appliances and electronics manufacturers, namely Panasonic, Haier and Clearwater Metal.

Transitioning from a purely commercial trader to a low-value-added manufacturer. SMC is beginning to increasingly focus on value-added products. Sendo, a joint-venture steel pipe factory (SMC owns 75% stake), plans to double its capacity in 2Q18 to 160,000 tonnes per annum. The company will also complete the new coil rolled steel bleaching and plating lines (160,000 tonnes per annum) at the end of 3Q18, ensuring full supply of raw materials for the Sendo steel pipe production factory. The total capex for these two projects is VND140-180bn. The company will fund these projects using the proceeds from the previous private placement to its strategic shareholder Hanwa in May 2017, as well as through divestments of some of its short-term investments.

Financial summary (VND)	12-15A	12-16A	12-17A
Net revenue (bn)	10,046	9,441	12,654
Revenue growth		(6.0%)	34.0%
Gross margin	1.4%	7.7%	5.5%
EBITDA margin	(0.4%)	5.8%	4.0%
Net profit (bn)	(196)	362	270
Net profit growth			(25.4%)
Recurring profit growth			(25.4%)
Basic EPS	(6,642)	12,274	6,431
Adjusted EPS	(6,642)	11,906	6,239
BVPS	12,361	23,588	27,354
ROAE		68.3%	29.3%

Source: VNDIRECT

2018 business outlook still dependent on trading activities. In 2018, SMC targets total sales volume of 1.1 million tonnes (+4.2% yoy). The company expects construction steel volume to decrease slightly to 550,000 tonnes (-3.7% yoy) and for its flat steel volume to increase to 550,000 tonnes (+19.3% yoy). The company's revenue and profit targets have not changed much from last year, as the company plans for its revenue to be stable at VND12,000bn (-5.2% yoy) and for its NPAT to decline slightly to VND250bn (-7.5% yoy). Although the company is making notable strides to raise the sales volume of its own flat steel products, trading activities continue to dominate the sales mix.

Improved revenue mix over the longer-term should be supportive of margins. The contribution of the steel pipe segment is relatively small (~10% of total revenue and 3% of total net profit in 2017), and most of the company's flat steel products carry wafer-thin margins. Over time, however, an increasing share of manufactured steel pipes (gross margin of 7-10%) and traded flat steel products (gross margin of 4-5%) in the revenue mix at the expense of traded construction steel (gross margin of 2-3%) should lift blended margins.

1Q18 earnings declined due to higher input costs. SMC's revenue grew by 15.7% yoy in 1Q18 (~VND3,263.1bn), due to the rise in steel prices. However, its net profit decreased by 30.9% yoy (~VND73.5bn), as cost of goods sold also rose; despite this, SMC was still able to fulfill 29.4% of its profit target for 2018. SMC's gross margin was 5.2% in 1Q18, which was higher than the 4.7% level seen in the previous quarter (4.7%), but still much lower than the same period last year (7.9%). Other income increased significantly from VND1.3bn to VND13.1bn in 1Q18 thanks to the proceeds from the disposal of fixed assets.

The company will pay a further 5% cash dividend and 30% stock dividend for FY17 in May 2018. At the AGM, the company announced its decision to pay a further 5% cash dividend for FY17 (5% cash dividend was paid in Sep 2017). The company will also pay a 30% stock dividend in May 2018. In 2Q18, the company plans to issue shares worth VND4.0bn (at par value), equivalent to about 0.95% of its charter capital to its staff under the ESOP program. The total new share issuance is estimated at 13 million shares, which will expand its charter capital to VND550bn.

A valuation re-rating can only occur if the company successfully transitions from a trader to a manufacturer. Although the current valuation looks cheap, with a 2018 forward P/E of 4.7x based on the company's earnings guidance, SMC's current business is still heavily exposed to the volatility in steel prices and construction cycles. We think the company needs at least 2-3 years to establish a production chain to make the transition from a pure trading company to a steel manufacturer. Moreover, the competition in the downstream segment of the flat steel market is currently very strong and so SMC will face many challenges when competing with other companies that are more experienced and already have well-established production chains in Vietnam.

Income statement

(VNDbn)	12-15A	12-16A	12-17A
Net revenue	10,046	9,441	12,654
Cost of sales	(9,902)	(8,717)	(11,953)
Gen & admin expenses	(102)	(120)	(92)
Selling expenses	(156)	(178)	(234)
Operating profit	(114)	427	375
Operating EBITDA	(73)	483	443
Depreciation and amortisation	(41)	(56)	(67)
Operating EBIT	(114)	427	375
Interest income	53	65	60
Financial expense	(151)	(103)	(103)
Net other income	21	9	(1)
Income from associates & JVs	4	4	2
Pre-tax profit	(188)	402	334
Taxation	(8)	(33)	(58)
Minority interests	(0)	(6)	(6)
Net profit	(196)	362	270
Adj. net profit to ordinary	(196)	362	270
Ordinary dividends			
Retained earnings	(196)	362	270

Balance sheet

(VNDbn)	12-15A	12-16A	12-17A
Cash and equivalents	95	266	398
Short term investments	764	779	83
Accounts receivables	832	1,321	1,659
Inventories	491	1,437	1,672
Other current assets	134	149	214
Total current assets	2,316	3,952	4,026
Fixed assets	493	503	720
Total investments	117	99	203
Other long-term assets	100	97	105
Total assets	3,027	4,651	5,055
Short-term debt	1,782	2,627	1,847
Accounts payable	692	1,007	1,629
Other current liabilities	49	176	291
Total current liabilities	2,523	3,810	3,767
Total long-term debt	109	86	75
Other liabilities	4	4	4
Share capital	295	295	420
Retained earnings reserve	(185)	145	290
Shareholders' equity	365	696	1,149
Minority interests	26	55	61
Total liabilities & equity	3,027	4,651	5,055

Cash flow statement

(VNDbn)	12-15A	12-16A	12-17A
Pretax profit	(188)	402	334
Depreciation & amortisation	41	56	67
Tax paid	(7)	(11)	(77)
Other adjustments	(46)	(35)	(32)
Change in working capital	1,112	(945)	451
Cash flow from operations	911	(532)	743
Capex	(227)	(67)	(301)
Proceeds from assets sales	0	1	0
Others			
Other non-current assets changes	(148)	93	425
Cash flow from investing activities	(375)	27	125
New share issuance	0	0	225
Shares buyback	0	0	0
Net borrowings	(891)	827	(791)
Other financing cash flow	(9)	(9)	(5)
Dividends paid	0	(15)	(51)
Cash flow from financing activities	(900)	803	(621)
Cash and equivalents at beginning of period	459	95	266
Total cash generated	(364)	297	246
Cash and equivalents at the end of period	95	392	512

Key ratios

	12-15A	12-16A	12-17A
Dupont			
Net profit margin	(2.0%)	3.8%	2.1%
Asset turnover		2.46	2.61
ROAA		9.4%	5.6%
Avg assets/avg equity		7.24	5.26
ROAE		68.3%	29.3%
Efficiency			
Days account receivable	28.1	42.2	41.0
Days inventory	18.1	60.3	51.1
Days creditor	25.5	42.3	49.7
Fixed asset turnover		19.0	20.7
ROIC	(8.6%)	10.5%	8.6%
Liquidity			
Current ratio	0.92	1.04	1.07
Quick ratio	0.72	0.66	0.63
Cash ratio	0.34	0.27	0.13
Cash cycle	20.7	60.3	42.4
Growth rate (yoy)			
Revenue growth		(6.0%)	34.0%
Operating profit growth			(12.0%)
Net profit growth			(25.4%)
EPS growth			(47.6%)
Share value			
Basic EPS (VND)	(6,642)	12,274	6,431
BVPS (VND)	12,361	23,588	27,354

Source: VNDIRECT

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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RECOMMENDATION FRAMEWORK

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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