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Sector
Note

5 Sep 2023

Construction

Non Rated

Interest burden squeezed revival

Negative earnings growth in 2Q23

Despite a flattish 2Q23 revenue growth of -4.5%yoy (VND39.3tn), earnings growth rattled by 42.1% yoy due to the interest burden coupled with an unfavorable comparison base. Gross profit reduced to VND4.6tn (-17.1%yoy). However, the industry saw some lights at the end of tunnel with a revenue growth +47.1% qoq and an NPAT of 231% qoq. The revenue completion ranged from 15%-25% and average NPAT fulfillment rate was 15% in 1H23.

Gross margin edged down

Costly material thinned industry gross margins, particularly for residential contractors. In contrast, infrastructure builders with BOT projects sustained healthier gross margins. General contractors' gross margins hovered around 9-18%. HBC's gross margins rise to an exceptional 18.5%, +13.5%p yoy while CTD's margin fell to 2.8%, -3.8%p yoy. FCN expanded 8.3%p yoy, reaching 29.9% in 2Q23. Material costs stabilizes since 2Q23, but it could take time for lower input costs to reap the reward.

Financing costs further burdened the net margin

Not only some big players declined net profit in 2Q23, but also suffered loss. PC1 suffered a surprising loss of VND38.1bn PBT. HBC's net profit of VND546bn was attributed to income of asset liquidation. Expensive loans hit further the bottom lines and interest expense of 4 out of 15 companies exceeded gross profit. Contractors were weighted by surging interest expense including C4G (+95 % yoy interest expense growth in 2Q23), PC1 (+59% yoy), TCD (+67% yoy).

The sluggish property market hinders the recovery

The property market only saw a negligible recovery in 2Q23, resulting in residential contractors exposed to default risk of project owners. For infrastructure builders, the benefit from rising public investment spending is yet to be remarkable. Without access to cheaper loans and materials, it is hard to conclude that the construction industry could resume growth momentum in short-term view. We see some light at the end of tunnels when the governments are ramping up to revive the real estate market, and in turn the construction industry could be benefit from in 4Q23F-2024F.

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Negative earnings growth in 2Q23

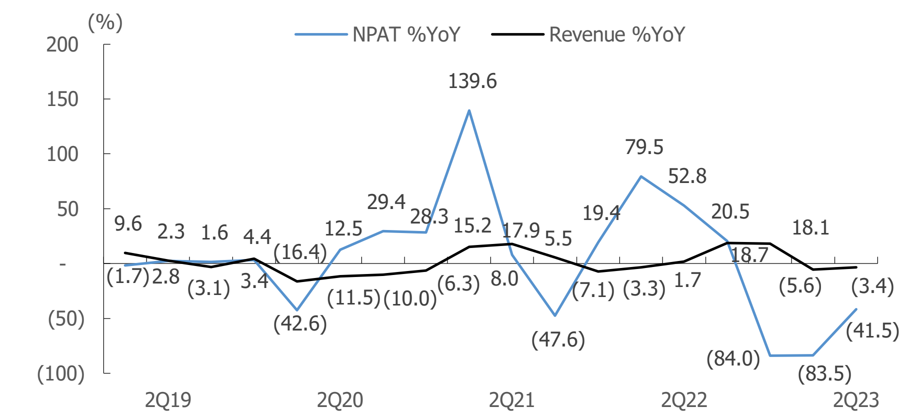
Based on our collection of 130 listed construction companies, the 2Q23 aggregate earnings momentum on all three bourses has yet to recover. Both revenue and NPAT declined by 3.4% /41.5% yoy compared to the reviving 2Q22 base. Expensive input material hindered the industry's gross margin to 12.3% (-2%pt yoy) in 2Q23. However, on the qoq basis, the industry revived with a revenue rise of 49% and NPAT growth of 231%.

Table 1. Aggregated 130 company earnings (VNDbn, %)

	2Q22	1Q23	2Q23	QoQ	YoY
Revenue	41,335	26,809	39,943	49.0	(3.4)
Gross Profit	5,809	3,829	4,910	28.2	(15.5)
Gross Margin	*14.1*	*14.3*	*12.3*	*(2)*	*(1.8)*
NPAT	2,859	501	1,672	231	(41.5)

Source: Fiinpro

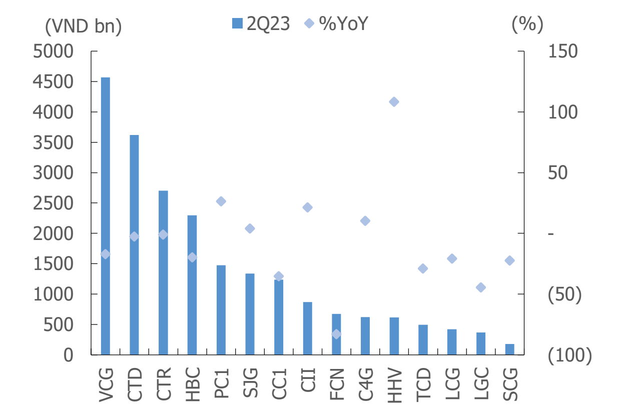
Figure 1. Listed contractors: Revenue and NPAT growth were sluggish



Source: Company data, Fiinpro

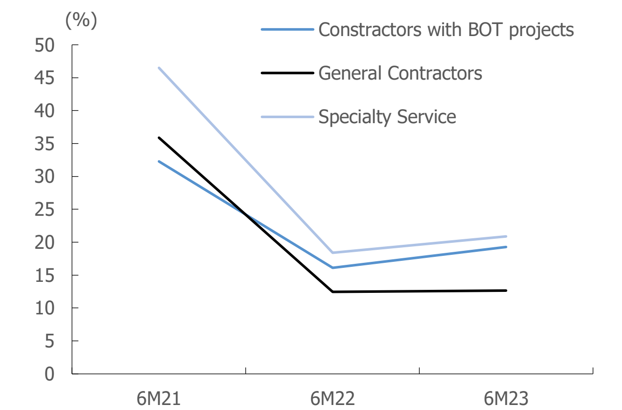
Breaking down aggregated revenue growth, only 4 out of 15 industry leaders grew in 2Q23. VCG topped in terms of revenue (VND4.5tn) and growth (+108% yoy). HHV was the runner-up with 27%yoy (VND627bn). HBC dropped to the second at 45% yoy but marked the third-largest revenue generator with VND2.3tn. The revenue completion ranged from 15%-25% in 1H23, the lowest were the general contractors, seen in SCG with 3% of revenue fulfilment. The industry average NPAT fulfilment rate was 15%, HHV was the outliner with the fulfilment rate of 90%/89%.

Figure 2. VCG led the industry



Source: Company data, Fiinpro

Figure 3. BOT builders improved revenue completion

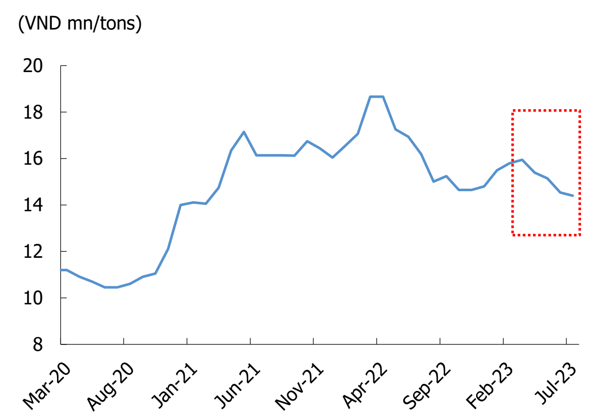


Source: Company data, Fiinpro

Gross margin edged down

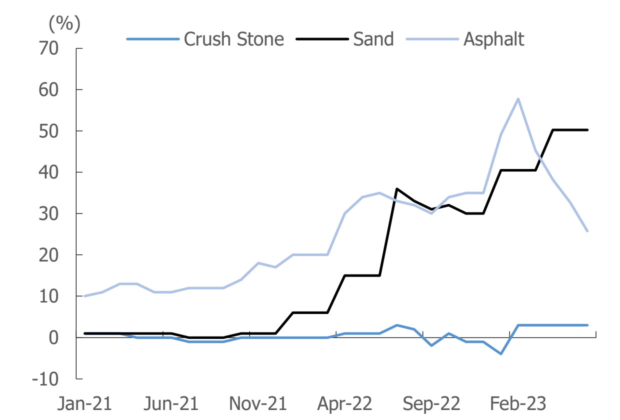
Costlier steel and cement prices put pressure on the cost of goods sold, especially on high-rise building constructors. Though material costs stabilized in 2Q23, the lengthy construction process means that it could take time for the less expensive material to play a part in business performance. In 2Q23, most companies saw their gross margin (GM) edging down compared to 2Q22. The infrastructure builder with BOT projects sustained a healthy profit margin (C4G: 18%, LGC: 55%) thanks to their steady cash flows from toll fees. CII's blended gross margin dropped 20%pts yoy due to a reduction of construction revenue. GM of General Contractors hovered around 9-18% and HBC was an exception at 18.4%, +13.5%p yoy. CTD's gross margin went down to 2.8%, -3.8%p yoy, the lowest among the industry leaders. FCN, a foundation and underground specialist, surprised the market with gross margins expanded 19.7%p yoy to 29.9%, in 2Q23.

Figure 4. Steel price drops since Apr



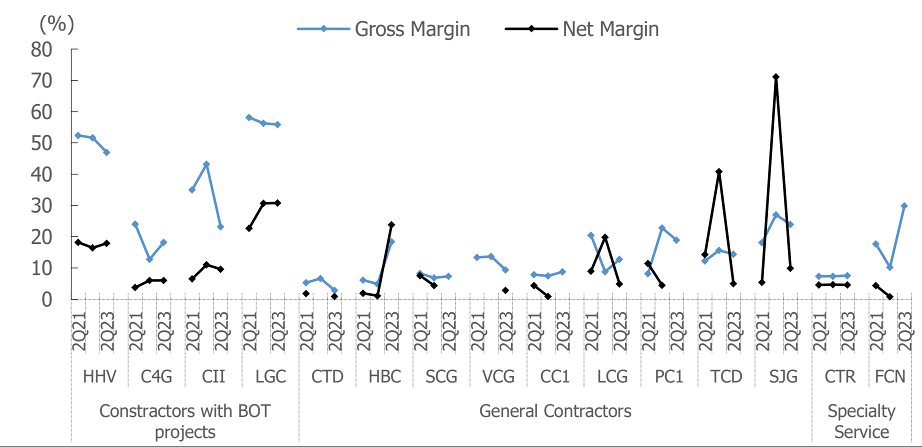
Source: Company data, Fiinpro

Figure 5. The aggregate material index also plateaued in 2Q23 (2020=100%)



Source: Institute of Construction Economics, MoC

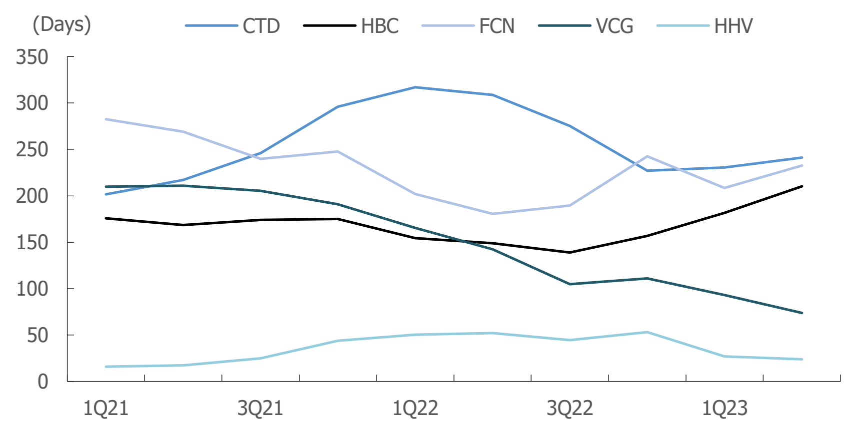
Figure 6. The majority of the companies saw their margins slightly shrinking



Source: Company data, Fiinpro

The cash flow payment from the project owner is essential to the general contractors' operation. Since 2021, many contractors suffered from the developer's default risk for their construction services. In 3Q23, the AR of CTD and HBC ballooned back up to 241/232 days respectively, on par with the 2Q21 heights. Only VCG's AR plunged to 73 days (142 days in 2Q22).

Figure 7. AR days returned to 2Q21 height

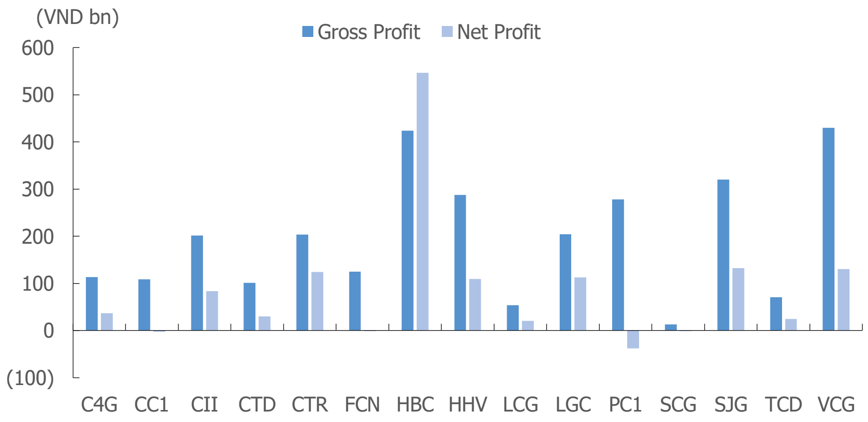


Source: Company data, Fiinpro

Financing costs further squeezed the net margin

The construction industry witnessed a shrinking net profit in 2Q23 and most leaders were subjected to a negative YoY growth. PC1 stood out with a VND38.1bn PBT loss. Only the net profit of 5 out of the 15 companies grew, of which CTD and VCG returned to green territory from the 2Q22 loss. HBC was an outliner with VND546bn (+1110%yoy) thanks to the abnormal income of liquidation of assets.

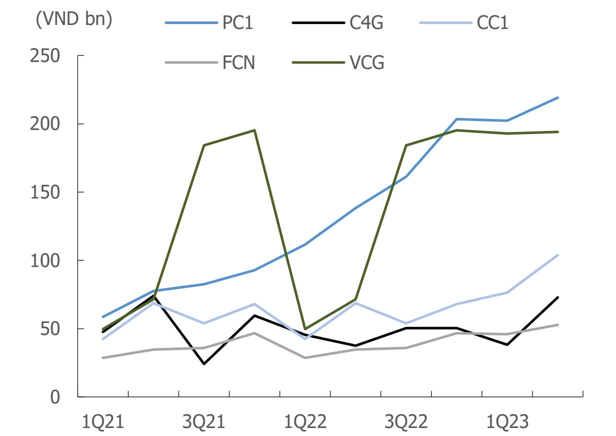
Figure 8. Contractors' 2Q23 Gross Profit and Net Profit



Source: Company data, Fiinpro

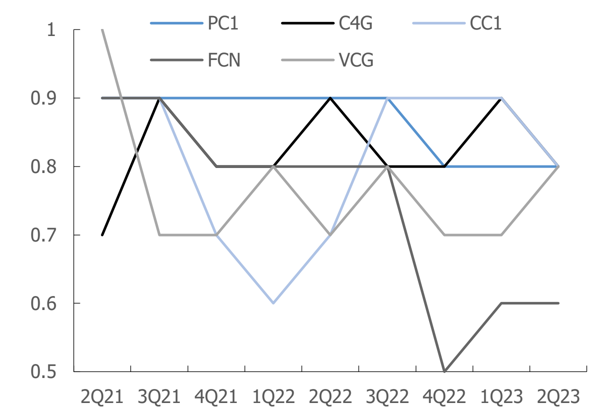
Expensive loans also were a big contributor to the dropping bottom lines and interest expense of 4 out of the 15 exceeded gross profit (SCG's interest expense was 9 times higher than gross profit in 2Q23). Debt expense burden weighting contractors rose strongly including C4G (+95% yoy), PC1 (+59% yoy) and TCD (+67% yoy). Our debt burden analysis (EBT/EBIT) kept downward, indicating that interest expense eroded the profit before tax, especially on FCN, whose gross profit already slid.

Figure 9. Interest expenses kept soaring



Source: Company data, Fiinpro

Figure 10. Interest burden

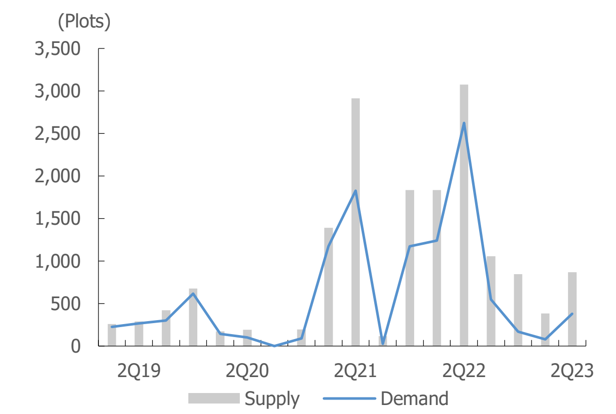


Source: Company data, Fiinpro

The sluggish property market hindered the recovery

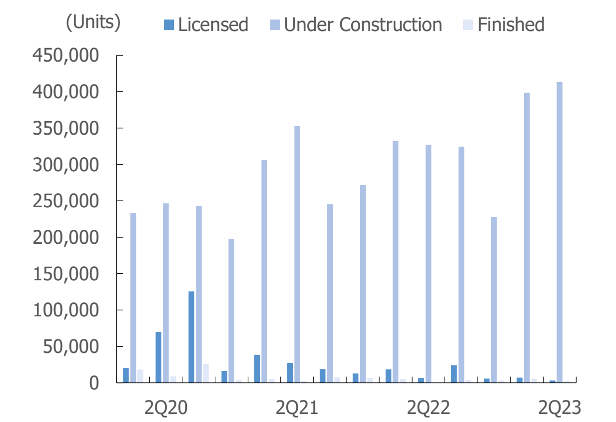
The Real Estate market saw the demand for new housing return in 2Q23 though it was nowhere near the height of 2022. In 2Q23, 867 new foundation plots (+125% qoq, - 71.78% yoy) were made available to the HCMC market and demand was at 378 plots (+384% qoq, - 85.59% yoy). The nationwide supply was still sluggish with only 2,424 new apartment units licensed in 2Q23, and only 3,239 projects completed construction. Over 400,000 apartments were still under construction.

Figure 11. Demand for new foundation plots in HCMC inched upward in 2Q23



Source: DKRA

Figure 12. Demand for new housing projects was weak



Source: MoC

No clear signal of earnings turnaround for the industry in 3Q23. The potential rewards arising from public investment projects are hard to quantify, with mixed pros and cons for the participants of the North-South East Expressway including C4G, CC1, LCG, and HHV. Only infrastructure contractors with access to cheaper sources of aggregate material and affordable loans, we believe the industry net profit margin could improve then.

The high-rise contractors gross margin could see further reduction thanks to remainder of costlier material inventory from late 2022 and 1Q23. Revenue could still not be out of the woods given the project owners' default risks are not diminishing. We see some light at the end of tunnels when the governments are ramping up to revive the real estate market, and in turn the construction industry could be benefit from in 4Q23F-2024F.

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