

16 Dec 2022

# Hoa Phat (HPG)

## Is bow's string at full draw?

### 3Q22 results were worse than expectation

HPG posted a loss of VND1,785.7bn in 3Q22 due to the combination of squeezed gross margin of 2.9% (lower ASP and high input cost) and a loss deriving from FX revaluation on the back of USD appreciation. For 9M22, revenue increased 10% yoy to VND115.5tn while net profit was VND10.4tn, -61.4% yoy. In 4Q22F, we forecast HPG to achieve a VND21,729 revenue (-50.4% yoy) and a VND120bn net profit (-98% yoy) under the impact of shrink gross margin (-9.4%p yoy, +9.0%p qoq) and forex loss.

### 2023F industry outlook is still dark

In 2022, the industry has been hit severely by lingering high inflation that dampened the global demand. In 2023F, we see the global demand continues to be hit when the real economy market slows down more significantly. Besides, the domestic issues related to property market need time to be settled down. There are some positive signals from China that partly take away oversupply fears, this may be, however, not enough for the industry growth back on track in 2023F.

### Earnings forecasts are revised down

The sharp downgrade is based on the worse-than-expected 9M22 performance results and poor outlook in 2023F. We revise down our earnings forecast by 66.2-47.8% compared to previous ones over 2022-24F. However, we believe that HPG performance results will grow significantly from 2024F when we see the strong global demand revival and the commence of Dung Quat steel complex will be the main drivers for the growth from 2024F. We forecast core 2022-25F EPS CAGR will be at 22%.

### Maintain HOLD on HPG stock

As we see many headwinds over short term for steel industry and the company, we maintain the HOLD rating for HPG stock and reduce TP from VND51,930 to VND22,100. We see the global recession is the biggest downside risks for HPG, followed by lower-than-expected sales volume. On the other side, better-than-expected sales volume is a potential catalyst for the company. As we see HPG has been stepping in extreme condition, like an arrow at full draw, any improvement in the situation will be more likely to push the company moves toward its new height.

12M rating **HOLD (Maintain)**

12M TP **22,100** from **51,930**

Up/Downside *N.A*

#### Stock Data

VNIndex (15 Dec, pt)	1,055
Stock price (15 Dec, VND)	19,350
Market cap (USD mn)	4,781
Shares outstanding (mn)	5,815
52-Week high/low (VND)	38,674/12,100
6M avg. daily turnover (USD mn)	24.36
Free float / Foreign ownership (%)	54.3/21.2
Major shareholders (%)	
Tran Dinh Long	26.1

#### Performance

	1M	6M	12M
Absolute (%)	54.8	(17.5)	(46.2)
Relative to VNIndex (%p)	38.9	(3.6)	(18.7)

#### Stock price trend



Source: Bloomberg

Yr to	Sales	OP	NP	EPS (adj.)	% chg	EBITDA	PE	EV/EBITDA	PB	ROE	DY
Dec	(VND bn)	(VND bn)	(VND bn)	(VND)	(YoY)	(VND bn)	(x)	(x)	(x)	(%)	(%)
2020A	90,119	17,123	13,450	3,958	46.2	21,899	4.9	4.4	1.1	25.2	2.2
2021A	149,680	37,664	34,478	7,471	88.8	43,751	2.6	2.4	1.0	46.0	2.0
2022F	137,438	16,828	10,594	2,177	(70.9)	23,195	10.7	6.2	1.1	11.0	0.0
2023F	109,274	17,651	13,271	2,409	10.7	24,938	8.5	5.8	1.0	12.3	0.0
2024F	141,177	23,995	17,606	2,961	22.9	32,282	6.4	4.9	0.9	14.6	4.0

Note: Net profit, EPS and ROE are based on figures attributed to controlling interest

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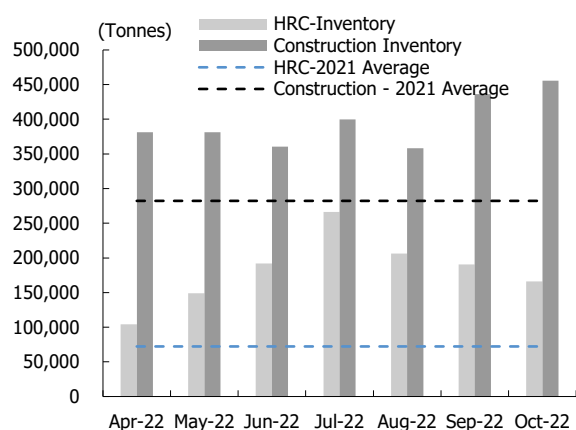
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## Earnings collapsed in 3Q22

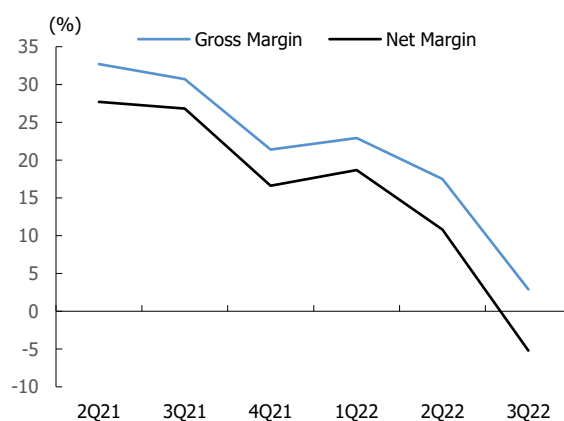
**HPG made a loss in 3Q22 due to high-cost inventories.** HPG surprised the whole market with the 3Q22 performance results when revenue posted at VND34,103.3bn (-11.8% yoy) and net profit posted a loss of VND1,785bn. High-cost inventories eroded most company's profitability when gross margin fell significantly from 17.4% in 2Q22 to 2.9% in 3Q22. High input prices and slow-moving inventory along with lower selling prices were the main reasons for the collapse of gross margin in 3Q22. In addition, HPG had to book inventory provision of VND137bn in 3Q22 (VND575bn in 2Q22) on the back of the decline of input prices. We believe the slow-moving high-cost inventories still affect company performance in 4Q22F at a milder magnitude despite cooling input prices. We forecast HPG will achieve a revenue of VND21,729bn (-51.4% yoy) and a net profit of VND120bn (-98% yoy) based on weak domestic/global demand and the impact of remaining high-cost inventories in 4Q22F.

**Figure 1. Inventories at high level**



Source: Company data, KIS, VSA

**Figure 2. Margins collapsed in 3Q22**



Source: Company data, KIS

### FX revaluation was another reason behind the significant earning drop.

The impact of greenback appreciation also made HPG to book a material forex loss of about VND1,000bn in 3Q22. USDVND appreciated about 3.9% since the beginning of 4Q22F (data collected on 30 Nov). Although the forex can be stable over the remaining days of 4Q22F thanks to the weaker DXY and SBV's policies, we still forecast that HPG still has to book VND240bn forex loss in 4Q22F as the results of stronger USD currency during 4Q22F.

**9M22 results were lower than our forecast due to weaker sales.** Overall, 9M22 business result posted VND115,583bn (+10.1% yoy) and NPAT VND10,443bn (61.8% yoy), fulfilling 65%/32% of our estimation. Blended GM was at 15.2%, (14.8%p yoy) caused by lower selling prices and higher input costs. The financial expense accelerated to VND5,452bn, +113.2% yoy amid higher lending rates and material forex loss.

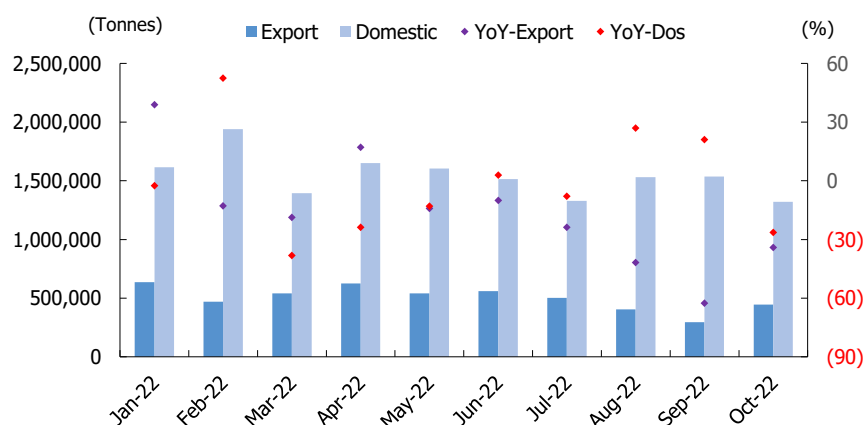
## Domestic and global issues drag down outlook

**It's not a good time for global industry.** 4Q22F and 2023F are not good period of time so far for steel industry in general and HPG in particular. Slow-down global economic growth in 2023F could dampen the steel demand of end-use industries. We see the impact of slowdown of global economy is slowly appearing on companies' performance results over months. In 2023F, we

expect to see a significant decline in performance of most end-steel-use industries. Although we have seen some positive signals from property market in China and expectation about Zero-COVID policy, this may only partly relieve the fear of oversupply from China, which would support global steel prices. From our viewpoint, we see no significant improvement for global steel industry in 2023F amid slowing global economy growth. Global recession along with tepid demand, in our opinion, is the worst scenario for steel industry in 2023F. Obviously, Vietnam steel exporters will be severely hit when global demand is muted.

*Domestic sales volume growth data over last months was not persuasive enough given low-base in 2021.*

**Figure 3. Weak industry sales data for both export and domestic channels**



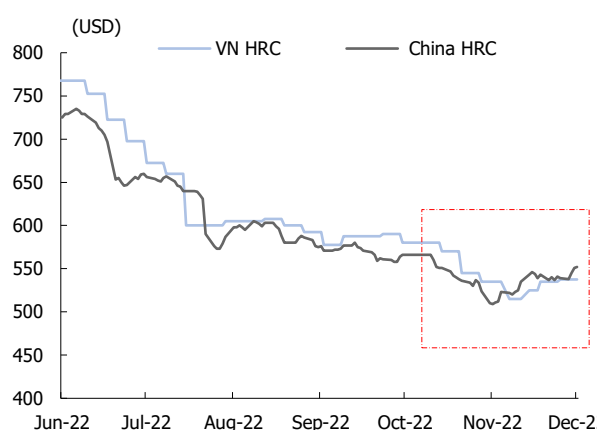
Source: KIS, VSA

**Domestic market is also affected by its own issues.** Property market turbulence could also dampen the domestic demand for steel products. With more than 90% of domestic steel consumption coming from construction sector, stagnant residential market could dent the domestic demand over upcoming months. Evidently, several production cuts have been announced since September:

- + Pomina Steel Corporation announced the shutdown of its BOF.
- + Southern Steel announced the production cut.
- + HPG announced the shutdown plan for 2 out of 3 BF's in Hai Duong and 2 out of 4 BF's in Dung Quat in November and further one more in Dec 2022 if the demand is still weak. As per the company, HPG reduced their BF's production to reduce high-cost inventory and operating costs. Recently, as per management, HPG has expected that the BF's will resume operation in 1Q23F, however, the BF re-operation plan depends on the consumption at that time. The cost for BF shutdown and re-operation will be around VND40-50bn/each and 7 working days for operational resumption.

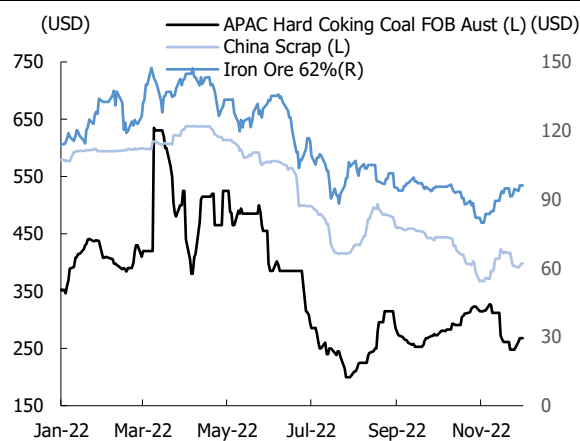
**No exceptions amid darkening outlooks.** As for Hoa Phat Group, the recent improvement in HRC prices thanks to better market sentiment from China could be a good support for company performance in 2023F. Besides, the prices of input materials have remained at a low level, which will help to improve the company margins. In 9M22, USD appreciation affected HPG performance through costlier input materials costs, forex loss, and higher financial expense for both USD-denominated and VND-denominated loans. In 2023F, we see the impact of forex revaluation and input costs will be milder thanks to the SBV's effort in stabilizing USD/VND. However, financial expense will remain elevated as high interest rate in both USD and VND dominated loans.

**Figure 4. HRC price bottomed out thanks to good market sentiment from China**



Source: Bloomberg, KIS

**Figure 5. High input prices will not be the main concern in 2023F**



Source: Bloomberg, KIS

### Sharp earnings downgrade

As the poor outlook discussed above, we revise down our 2022-24F forecast. From our perspective, we suppose that HPG will face the difficulty in 2023F due to the impact of global economy slowdown and back to strong growth phase from 2024F thanks to the significant demand revival and “right on-time” operation of DQSC2. As per company, the DQSC2 is expected to be partly launched from end-2024F, which is quite “delay” compared to initial plan. However, in our opinion, it’s quite understandable and reasonable amid weak global demand and expensive financial expense.

**Squeezed sales on the weak demand outlook.** As discussed, we trim our estimates for 2022F by 23.3% in revenue and 66.2% in NPAT-MI compared to our previous one. We also trim our earnings estimates about 56.1-47.8% for period 2023-24F. The main reason behind the drop in earnings forecast is the significant down in forecasted sales volume (12-41%, depending on each product) due to weak forecasted demand in both domestic and export market in 2022-24F. In the new forecast, we expect to see the weaker sales volume in 2023F and sales volume starts to revive from 2024F.

**Margins to improve in 2023F.** We expect margins to improve to 19.4% in 2023F from 14.7% in 2022F as input price has cooled down despite that ASP can be lower due to (1) weakening demand, (2) lower input prices.

**Steady growth from 2024F.** From 2024F, we expect to see the stronger growth in revenue and NPAT thanks to (1) the stronger demand revival from 2024F and (2) the operation of DQSC2 from end of 2024F.

Regarding short-term debt, we assume that HPG will retain its short-term debt/sales at 36-24% over 2023-25F period to fund its working capital demand. As for long-term debt, we forecast it will remain stable around VND13.4tn before increasing to about VND15.4tn in 2024F to finance DQSC2 capex. As per the company, as end of 3Q22, HPG has a USD-dominated loan with total value at USD129.5mn and already bought a currency swap contract (USD90mn) to hedge the USD appreciation.

As the poor forecasted result in 2022 and 2023F along with huge capex for DQSC2 amid high lending rate, we assume that HPG will not pay any cash dividend for 2022-23F.

Table 1. Earnings revision

	Revised			Previous			Change			Note
	2022F	2023F	2024F	2022F	2023F	2024F	2022F	2023F	2024F	
<b>Revenue</b>	<b>137,438.0</b>	<b>109,274.0</b>	<b>141,177.0</b>	<b>179,232.0</b>	<b>171,671.0</b>	<b>203,104.0</b>	(23.3)	(36.3)	(30.5)	
Steel	130,051.00	100,579.00	128,836.00	165,691.0	154,785.0	184,658.0	(21.5)	(35.0)	(30.2)	
Real Estate	459	1,061	1,622	929	1,561	1,721	(50.6)	(32.0)	(5.8)	
Agriculture	6,928	8,325	10,178	12,612	15,325	16,725	(45.1)	(45.7)	(39.1)	
<b>Gross profit</b>	<b>20,236.7</b>	<b>21,257.0</b>	<b>27,666.0</b>	<b>41,174.0</b>	<b>39,376.0</b>	<b>44,720.0</b>	(50.9)	(46.0)	(38.1)	
GM (%)	14.7	19.5	19.6	23.0	22.9	22.0	(8.3)	(3.4)	(2.4)	Margin will be improved thanks to the input price that cooled down
SG&A expenses	3,408	3,606	3,671	3,585	3,434	4,265	(4.9)	5.0	(13.9)	
Operating profit	16,828.3	17,650.9	23,995.4	37,589.0	35,943.0	40,455.0	(55.2)	(50.9)	(40.7)	
Financial income	2817.5	2185.5	988.2	1255	1202	1422	124.5	81.8	(30.5)	
Financial expenses	7,628	4,917	4,941	3,047	3,090	3,453	150.3	59.1	43.1	We revised up interest expense forecast due to rising lending rates
Net other income	82.5	65.6	42.4	54	52	61	(10.0)	(10.0)	(10.0)	
<b>PBT</b>	<b>12,105.0</b>	<b>14,989.2</b>	<b>20,089.3</b>	<b>35,855.0</b>	<b>34,110.0</b>	<b>38,489.0</b>	<b>52.8</b>	<b>26.2</b>	<b>(30.5)</b>	
<b>NPATMI</b>	<b>10,594.1</b>	<b>13,270.5</b>	<b>17,605.5</b>	<b>33,317.0</b>	<b>30,675.0</b>	<b>34,114.0</b>	<b>(66.2)</b>	<b>(56.1)</b>	<b>(47.8)</b>	
<b>Sales Volume</b>										We revised down sales volume forecast as poor outlook for the industry.
Construction Steel	4,091,500	3,420,000	3,860,000	5,190,000	5,590,500	5,671,000	(21.2)	(38.8)	(31.9)	
Steel Pipes	736,971	730,000	766,500	843,750	928,125	974,531	(12.7)	(21.3)	(21.3)	
Coated Steel	302,933	305,000	400,000	430,000	440,000	440,000	(29.6)	(30.7)	(9.1)	
HRC	2,550,455	2,500,000	3,500,000	3,000,000	3,500,000	6,000,000	(15.0)	(28.6)	(41.7)	

Source: KIS

## Maintain HOLD rating on HPG stock

As we see a dark outlook in 2023F for the whole steel industry, we maintain HOLD rating on HPG stock over 1-year looking forward. However, as for longer term, we still see HPG as a good stock for investment.

We see HPG is stepping into extreme condition, which is compared to a bowstring nearly at its full draw. When all the issues (tension, property crisis, hiking rates etc.) that caused the fall in global steel demand and, then the performance of HPG are reversed or each of them is settled down in turn, we believe HPG performance will be improved significantly. **Therefore, we do recognize the high possibility of stock price re-bounce thanks to good news or improvement in sentiment from the domestic and global markets. However, the risks of global recession and tepid demand, in our opinion, should be seriously considerate.**

We have a HOLD rating for HPG over 1-year looking forward given (1) weak global and domestic demand, and (2) the operation delay of DQCS2. We value HPG at 7.0x 2023F PE (50% weight) combined with DCF valuation (50%) to arrive at a target price of VND22,100. We apply its regional peers' median 2023F PE of 7.6x, which translates into a target 2023F PE multiple of 7x for HPG. We believe HPG should deserve to trade at a discount to median PE of its regional peers given the domestic issues amid global economy slowdowns. In each segment, we apply the same WACC at 16.2%, assuming: 1) a risk-free

rate of 5.5%, 2) a beta of 1.35 and 3) an equity risk premium of 11%. Following the earnings cut, our new TP is cut to VND22,100 (from VND51,930), suggesting 1-year rolling 12MF PE of 9.7x - above 5-year of 8.4x.

**Table 2. DCF method**

Cost of equity	Note	DCF calculation	Value	Note
Beta (x)	1.35	From 1.15	PV of Terminal Value	143,648
Risk-free rate (%)	5.5	From 3.0	<b>Total PV of Operations</b>	180,673
Equity risk premium (%)	11.0	From 10.0	Plus: Cash	20,892
Cost of equity (%)	20.3		Less: Debt	(53,213)
<b>WACC calculation</b>			Less: Minority Interest	(168)
Cost of debt (%)	11.0		Equity Value	148,184
Target debt to capital (%)	39.5		Shares Outstanding, Million	5,815
Tax rate (%)	11.2			
<b>WACC (%)</b>	<b>16.2</b>		<b>DCF target price at end-2023</b>	<b>25,480</b>

**Table 3. PE multiple method**

Metrics	2023F	2024F	Avg.2023-24F
Core EPS (VND)	2,409.1	2,960.7	2,685
Regional median multiple (x)	7.6	N.A	7.6
Discount (%)	7.8	N.A	7.8
Target multiple (x)	7.0	N.A	7.0
<b>Implied value per share (VND)</b>			<b>18,800</b>

**Table 4. Cash flow summary**

	2023F	2024F	2025F	2026F	2027F
<b>EBIT</b>	<b>17,651</b>	<b>23,995</b>	<b>30,467</b>	<b>37,016</b>	<b>44,965</b>
less: tax	(1,679)	(2,431)	(3,199)	(4,035)	(4,346)
add: depreciation	7,287	8,287	9,287	9,847	10,407
less: capex	(23,000)	(25,000)	(25,000)	(14,000)	(14,000)
(increase) / decrease in NWC	4,590	(8,825)	(14,804)	(9,247)	(3,114)
<b>Unlevered free cash flow</b>	<b>5,320</b>	<b>(2,969)</b>	<b>(178)</b>	<b>22,399</b>	<b>36,098</b>
<b>PV of FCF</b>	<b>5,320</b>	<b>(2,553)</b>	<b>(132)</b>	<b>14,392</b>	<b>19,998</b>

**Table 5. Valuation**

Metrics	Implied price	Weight	Weight value
Price/EPS, 1-yr forward at 7.0x	18,800	50%	9,400
DCF	25,480	50%	12,740
<b>HPG's target share price (rounded)</b>			<b>22,100</b>

### Company overview & Glossary

Hoa Phat (HPG) is a leading industrial manufacturing group in Vietnam operating in 5 key businesses: Iron & steel; steel sheet & steel pipe; real estate, agriculture and home appliances.

**Balance sheet**

(VND bn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
Current assets	56,747	94,154	89,506	65,614	69,105
Cash & cash equivalents	21,823	40,708	33,796	20,892	11,848
Accounts & other receivables	6,125	7,662	8,774	8,121	10,811
Inventory	26,287	42,135	43,500	33,760	42,917
Non-current assets	74,764	84,082	105,490	123,713	140,985
Fixed assets	65,562	69,281	69,914	85,628	102,341
Investment assets	6,983	10,573	30,583	32,593	32,603
Others	4,427	7,069	7,538	7,354	8,494
<b>Total assets</b>	<b>131,511</b>	<b>178,236</b>	<b>194,995</b>	<b>189,326</b>	<b>210,090</b>
Advances from customers	1,257	788	1,374	1,093	1,412
Unearned revenue	51	26	26	26	26
Trade payables	10,916	23,729	20,430	14,469	18,659
Others	5,926	5,700	5,857	5,986	6,143
ST debt & due bonds	36,799	43,748	52,748	39,748	40,748
LT debt & bonds	17,343	13,465	13,265	13,465	15,465
<b>Total liabilities</b>	<b>72,292</b>	<b>87,456</b>	<b>93,700</b>	<b>74,787</b>	<b>82,453</b>
Controlling interest	59,071	90,625	101,167	114,371	127,416
Capital stock	33,133	44,729	58,148	58,148	58,148
Capital surplus	3,212	3,212	3,212	3,212	3,212
Other reserves	934	922	932	946	963
Retained earnings	21,792	41,763	38,875	52,066	65,093
Minority interest	149	155	128	168	221
Shareholders' equity	59,220	90,780	101,295	114,539	127,637

**Cash flow**

(VND bn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
C/F from operations	11,587	27,466	10,642	24,293	17,133
Net profit	13,506	34,521	10,568	13,310	17,659
Dep'n & Amort'n	4,776	6,087	6,367	7,287	8,287
Net incr. in W/C	(6,695)	(13,142)	(6,293)	3,696	(8,813)
C/F from investing	(18,495)	(20,404)	(30,001)	(17,832)	(17,044)
Capex	(11,916)	(12,116)	(27,010)	(25,010)	(25,010)
Incr. in investment	(6,579)	(8,288)	(2,991)	7,178	7,966
C/F from financing	16,053.7	1,729.4	8,800.0	(12,800.0)	(1,472.9)
Incr. in equity	3	11	0	0	0
Incr. in debt	17,471	3,423	8,800	(12,800)	3,000
Dividends	(1,420)	(1,704)	0	0	(4,473)
C/F from others	6	(16)	0	0	0
Increase in cash	9,146	8,792	(10,559)	(6,339)	(1,385)

**Income statement**

(VND bn)

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
Sales	90,119	149,680	137,438	109,274	141,177
COGS	71,215	108,571	117,201	88,017	113,511
Gross profit	18,904	41,108	20,237	21,257	27,666
SG&A expenses	1,781	3,444	3,408	3,606	3,671
Operating profit	17,123	37,664	16,828	17,651	23,995
Operating profit (Adj.)	17,123	37,664	16,828	17,651	23,995
Financial income	1,005	3,071	2,818	2,186	988
Interest income	519	1,194	657	613	306
Financial expenses	2,837	3,732	7,628	4,917	4,941
Interest expenses	2,192	2,526	3,961	3,459	3,092
Other non-operating profit	65	48	83	66	42
Gains (Losses) in associates, subsidiaries and JV	2	5	5	5	5
Earnings before tax	15,357	37,057	12,105	14,989	20,089
Income taxes	1,851	2,536	1,537	1,679	2,431
Net profit	13,506	34,521	10,568	13,310	17,659
Net profit (Adj.)	13,114	33,418	12,656	14,009	17,216
Net profit of controlling interest	13,450	34,478	10,594	13,271	17,606
Exceptional items					
FX Gain/(Loss)	-	-	1,725	817	(284)
Other adjustment	-	(466)	400	-	-
EBITDA	21,899	43,751	23,195	24,938	32,282

**Key financial data**

FY-ending Dec.	2020A	2021A	2022F	2023F	2024F
Per-share data (VND, adj.)					
EPS	3,958	7,471	2,177	2,409	2,961
BPS	17,873	20,296	17,420	19,698	21,950
DPS	428	381	0	0	769
Growth (%)					
Sales growth	41.6	66.1	(8.2)	(20.5)	29.2
OP growth	75.7	120.0	(55.3)	4.9	35.9
NP growth (Adj.)	75.4	154.8	(62.1)	10.7	22.9
EPS growth (Adj.)	46.2	88.8	(70.9)	10.7	22.9
EBITDA growth	77.5	99.8	(47.0)	7.5	29.4
Profitability (%)					
OP margin	19.0	25.2	12.2	16.2	17.0
NP margin (Adj.)	14.6	22.3	9.2	12.8	12.2
EBITDA margin	24.3	29.2	16.9	22.8	22.9
ROA	11.6	22.3	5.7	6.9	8.8
ROE	25.2	46.0	11.0	12.3	14.6
Dividend yield	2.2	2.0	0.0	0.0	4.0
Dividend payout ratio	10.8	5.0	0.0	0.0	25.6
Stability					
Net debt (VND bn)	32,319	16,505	32,216	32,321	44,364
Net debt/equity (%)	50.0	20.0	30.0	30.0	30.0
Valuation (x)					
PE	4.9	2.6	10.7	8.5	6.4
PB	1.1	1.0	1.1	1.0	0.9
EV/EBITDA	4.4	2.4	6.2	5.8	4.9

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