

Hoa Phat Group (HPG)

3Q22 results may hit rock bottom

August 22, 2022

Analyst Nguyen Dinh Thuan
thuannd@kbsec.com.vn

HPG's 2Q22 earnings dropped by 58.7% YoY

Hoa Phat Group (HPG) released 2Q22 business results with profit of VND4,023 billion (-58.7% YoY) and revenue of VND37,174 billion (+6% YoY). During the period, the construction steel consumption reached 1,041,000 tons (+6% YoY), primarily driven by exports. This is a positive signal amid the gloomy outlook of the steel industry. However, the consumption of other steel products was humble.

HPG's profit growth in the near term is overshadowed by falling selling prices

Domestic construction steel price has experienced the 13th consecutive adjustment since May 10, 2022, down from VND19 million/ton to VND15 million/ton. Similarly, the prices of coking coal and iron ore contracted by 40% and 30% compared to early April 2022. The high-priced construction materials inventory may dampen the steel giant's profit margin amid falling selling prices. Therefore, we expect HPG's business results to hit rock bottom in 3Q22.

The government should speed up public spending disbursement in the last six months of 2022

Public investment disbursement should be promoted in 2H22 in the context of falling construction materials prices. HPG is among those benefiting from supplying steel products to a slew of key public projects such as the North-South expressways, My Thuan 2 bridge, Tan Son Nhat airport's runway upgrade, etc.

We recommend BUY for HPG stocks with a target price of VND28,500/share

We estimate HPG's 2022F NPAT and revenue to be VND20,623 billion (-40% YoY) and VND154,174 billion (+3% YoY), respectively. On the expectations of lower input costs and the promotion of public investment capital, we recommend BUY for HPG stocks with a target price of VND28,500/share, 19.11% higher than the closing price on August 15, 2022.

Buy maintain

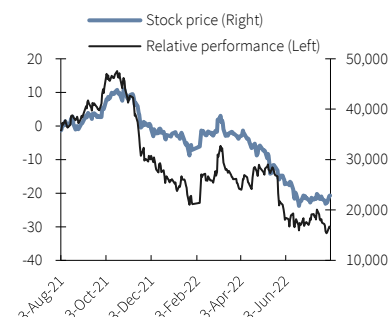
Target price	VND28,500
Upside/Downside	19.11%
Current price (Aug 15, 2022)	VND 24,000
Consensus target price	VND 26,000
Market cap (VNDtn/USDbn)	131/5.7

Trading data	
Free float	55%
3M avg trading value	662/26
Foreign ownership	20.36%

Share price performance				
(%)	1M	3M	6M	12M
Absolute	1	-24	-30	-36
Relative	-1	-22	-13	-29

Forecast earnings & valuation

FY-end	2019A	2020A	2021A	2022F
Net sales (VNDbn)	63,658	90,119	149,680	154,174
Earnings/Loss (VNDbn)	9,031	15,289	37,008	22,090
NPAT (VNDbn)	7,578	13,506	34,521	20,623
EPS (VND)	2,700	4,007	7,718	4,790
EPS growth (%)	-32%	49%	89%	-41%
P/E (x)	20.29	13.67	6.01	6.7
P/B (x)	26.81	25.96	22.54	18.89
ROE (%)	16%	23%	37%	17%
Dividend yield (%)	0%	5%	5%	5%



Source: Bloomberg, KB Securities Vietnam

Business performance

HPG's net sales rose by 6% YoY to VND37,174 billion in 2Q22

In 2Q22, HPG's profit reached VND4,023 billion (-58.7% YoY). Along with that, input costs soared while revenue only increased marginally YoY, dragging gross profit margin down to 18% (vs. 33% in 2Q21 and 22.7% in 1Q22).

Construction steel consumption volume in 2Q22 was driven by exports

HPG's construction steel consumption in 2Q22 reached 1,041,000 tons (+6% YoY), with exports achieving good results thanks to enhancing exports to new markets and maintaining exports to major markets like Canada, Japan, Thailand, and Cambodia. This is a positive signal in the context of dwindling consumption of the whole industry due to the tight control over the real estate credit and stagnating construction amid surging prices of raw materials. Besides, the disbursement of public investment capital in 1H22 was slow.

The consumption of HRC and galvanized steel sheets was humble, reaching 658 thousand tons and 74.2 thousand tons, respectively. Steel billet consumption in 2Q22 was only 114 thousand tons (-43% YoY) since China, HPG's No.1 export market, has consistently imposed new lockdowns to contain the spread of COVID-19. Furthermore, given extensive steel inventories in the world's second largest economy, HPG's exports to China may still face challenges in the time ahead.

In July, consumption of construction steels and steel pipes was 372 thousand tons (+2% YoY, with exports up 82% YoY to 147 thousand tons) and 60 thousand tons (+34% YoY). On the contrary, sales of HRC and galvanized steel sheets decreased YoY. It partially reflects weak domestic demand for steel products.

The steel giant experienced countless difficulties in 2Q22

Given a sharp drop in selling prices of finished products amidst high production costs, the steelmaker had to deduct up to VND575 billion for inventory devaluation. In addition, selling expenses also spiked due to supply chain disruptions and high fuel prices. The appreciation of the USD also impacted HPG's business results as it mainly imports raw materials and has large USD loans. Besides, interest expenses jumped by nearly 20% due to high interest rates, causing financial cost to spike and pulling down NPAT in 2Q22. In the first six months of 2022, NPAT reached only VND12,229 billion on revenue of VND81,480 billion (+22.9% YoY). The gross profit margin was down to 21% against 30% in 1H21, and the after-tax profit margin was 12.2%.

Updates on HPG's projects

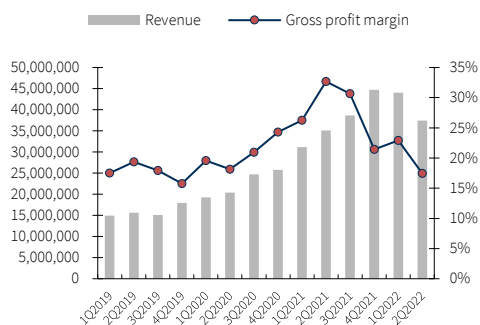
Hoa Phat Container Factory Project Phase 1 in Vung Tau was started construction in April 2021, with a design capacity of 200,000 TEUs/year. The project should be completed in 3Q22 and put into operation in 4Q22. Hoa Phat Dung Quat Iron and Steel Complex Project Phase 2, with a capacity of 5.6 million tons of HRC, is behind schedule due to delayed site clearance. The enterprise is speeding up site clearance to timely complete the project.

Table 1. HPG – 1H21–1H22 business results

VND bn	1H2021	1H2022	YoY %	Notes
Input price				
Coking coal price (USD/ton)	130	467	+259%	Coking coal price has increased abnormally since the beginning of the year, starting from the Russia-Ukraine conflict, peaking in April and showing signs of cooling down. Coking coal's supply is expected to return when rainy season is over in the main exporting countries
Iron Ore 62% Fe (USD/ton)	181	141.4	-21.8%	Iron ore price is expected to decrease in the second half due to the China's lockdown policies, causing steel mills in China to reduce capacity and leading to an oversupply of iron ore.
Consumption				
Construction steel	1,837,000	2,383,754	29.7%	Steel export volume to new export markets was positive while consumption in old markets remained stable.
HRC	1,332,000	1,422,118	6.7%	
Galvanized steel	160,000	179,827	12.3%	
Steel pipe	374,200	366,000	-2.2%	
Steel billet	597,000	194,128	-67%	Output declined due to the fact that HPG mainly exports steel billets to China while this country is in lockdown to control the epidemic, causing low steel demand.
Revenue	66,899	82,118	22.74%	
Gross profit	19,660.1	16,647.9	-15.3%	
GPM (%)	30%	21%		Gross profit margin decreased due to the need to make provision for devaluation of inventories. Moreover, selling expenses increased in the context of supply chain disruption and high gasoline price.
SG&A expenses	(579.5)	(382.5)		
% SG&A / Revenue	0.8%	0.4%		
Operating profit	18,039	13,237		
Financial Income	1,344.6	1,430.8		
Financial expenses	1,588.9	3,143.8	+97%	Financial expenses increased sharply because of HPG's realised foreign exchange loss and unrealised loss from revaluation of monetary items in foreign currencies is large. Besides, interest expenses increased by nearly 20% due to high interest rate.
Net other income	443.7	349.5		
Profit before tax	18,039.6	13,301.4	-26%	
Profit after tax	16,750.7	12,228.9	-26.9%	
NPM (%)	25%	15%		

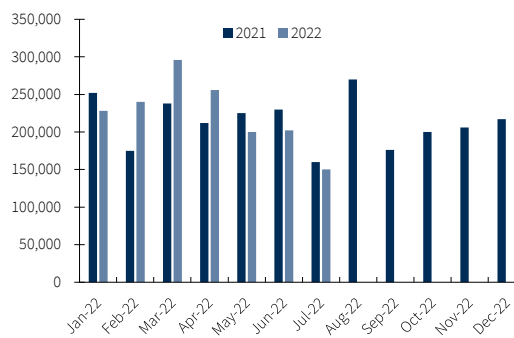
Source: Hoa Phat Group, KB Securities Vietnam

Fig 1. HPG – Business results



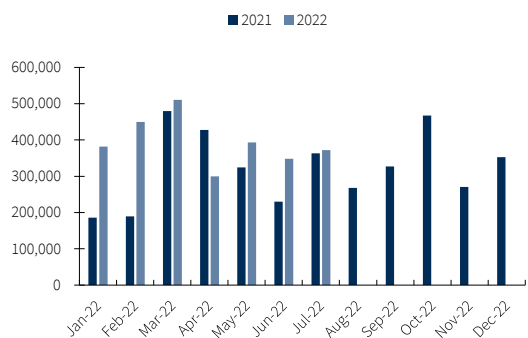
Source: Hoa Phat Group, KB Securities Vietnam

Fig 2. HPG – HRC consumption (tons)



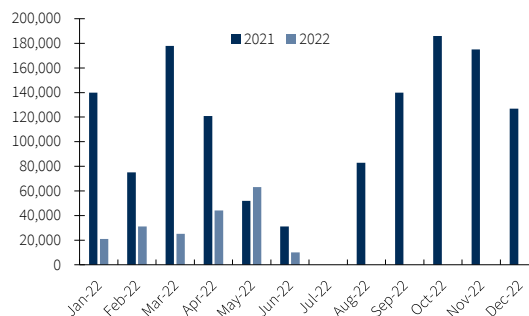
Source: Hoa Phat Group, KB Securities Vietnam

Fig 3. HPG – Construction steel consumption (tons)



Source: Hoa Phat Group, KB Securities Vietnam

Fig 4. HPG – Steel billet consumption (tons)



Source: Hoa Phat Group, KB Securities Vietnam

Investment catalysts

Input material prices are forecast to keep declining

Compared to the beginning of April 2022, the coking coal prices on the Singapore Exchange (SGX) went down 40% to around USD203/ton, and iron ore prices dropped 29% to USD115/ton. We expect the iron ore price to continue to diminish to USD90–100/ton in the second half of the year in the context of the property crisis and expanded Covid lockdowns in China, which led to reduced capacity or shutdown of steel mills in this country. Also, we estimate coke prices will continue to decline to USD200/ton in 3Q22 and USD150/ton in 4Q22 on the expectation that the supply will improve once the stormy season is over in some major exporting countries such as Australia, Queensland. Plummeting input materials costs led to continuous decreases in steel prices. In particular, construction steel prices fell 13 times between May 10, 2022 and August 10, 2022, from VND19 million/ton to VND15 million/ton. Besides, the selling prices of other steel products such as HRC, galvanized steel sheets, and steel pipes were also subject to adjustment. According to the Vietnam Steel Association (VSA), the construction steel prices may keep going down until the end of the third quarter due to dwindling demand.

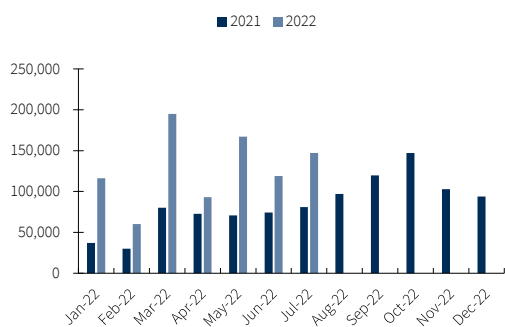
HPG's business results may hit the rock bottom in 3Q22

In our estimates, HPG's profit may hit rock bottom in 3Q22 since: (1) Steel prices are prone to decrease in the year-end period. However, compared to the beginning of the second quarter of this year, steel prices did not drop as much as input materials prices; (2) high-priced construction material inventories may dampen profit margin; and (3) domestic consumption demand will unlikely bounce back during the rainy season in 2H22.

The government should speed up public spending disbursement in the last six months of 2022

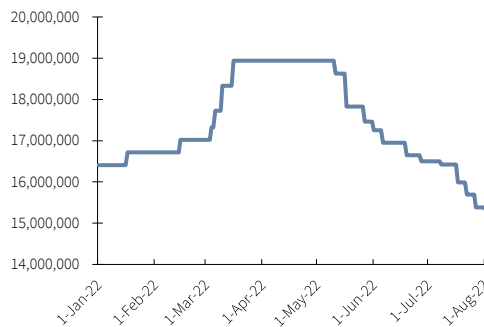
We expect the Government will speed up the disbursement of public spending in the second half of 2022 in the context of low construction material prices. Disbursed public investment in 6M22 and 7M22 reached about 27.75% and 34.47% of the plan, respectively. If the disbursement for the whole year sourced from the State budget fulfills 90% of the yearly target assigned by the Government, the disbursed amount in 2H22 will double that in the first half of the year. Furthermore, HPG is among those benefiting from supplying steel to a series of key public projects such as the North–South expressways, My Thuan 2 bridge, Tan Son Nhat airport's runway upgrade, etc.

Fig 5. HPG – Exports of construction steels (tons)



Source: Hoa Phat Group, KB Securities Vietnam

Fig 6. HPG – Construction steel prices (VND/ton)



Source: Hoa Phat Group, KB Securities Vietnam

Fig 7. Australia – Coking coal futures (USD/ton)



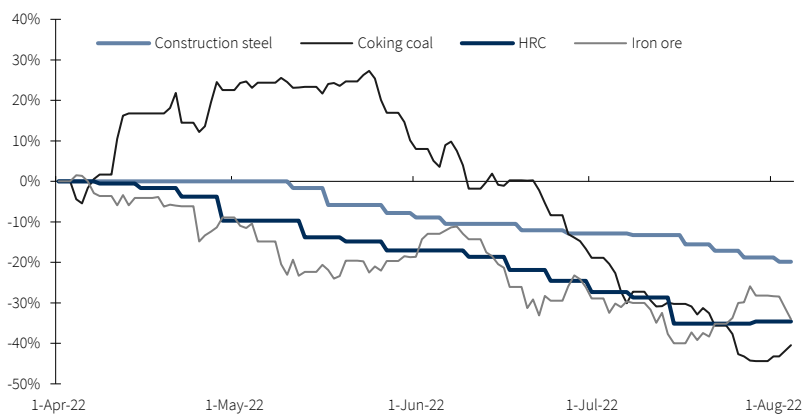
Source: Bloomberg, KB Securities Vietnam

Fig 8. SGX – Iron ore futures (USD/ton)



Source: Bloomberg, KB Securities Vietnam

Fig 9. Global – Price movements of iron ore, coking coal, construction steel, HRC (%)



Source: KB Securities Vietnam

Forecast & Valuation

2022F NPAT is estimated at VND20,623 billion (-40% YoY)

We expect HPG's total steel consumption in 2022 to reach 9,152,000 tons (+3% YoY), equivalent to revenue of VND154,174 billion (+4% YoY). However, the gross profit margin may drop substantially to 17.2% from 27.5% in 2021 due to high input costs and decreasing selling prices. Accordingly, NPAT should be down to VND20,623 billion (-40% YoY).

We recommend BUY for HPG stocks with a target price of VND28,500/share

The steel industry is encountering difficulties caused by falling selling prices and consumption. Given its sustainable competitive advantage, we believe HPG can maintain and improve its market share in the industry. Decreasing input costs and promoted public investment in 2H22 are the key growth drivers for HPG in the coming period.

Based on two valuation methods P/E and EV/EBITDA with a weight of 50:50, we recommend BUY for HPG stocks. The target price is VND28,500/share, 19.11% higher than the closing price on August 15, 2022:

1) P/E method

We adjust HPG's 2022F target P/E to 7x, equaling HPG's 10-year average P/E due to concerns about falling steel prices and dwindling demand. The corresponding valuation is VND27,660/share.

2) EV/EBITDA method

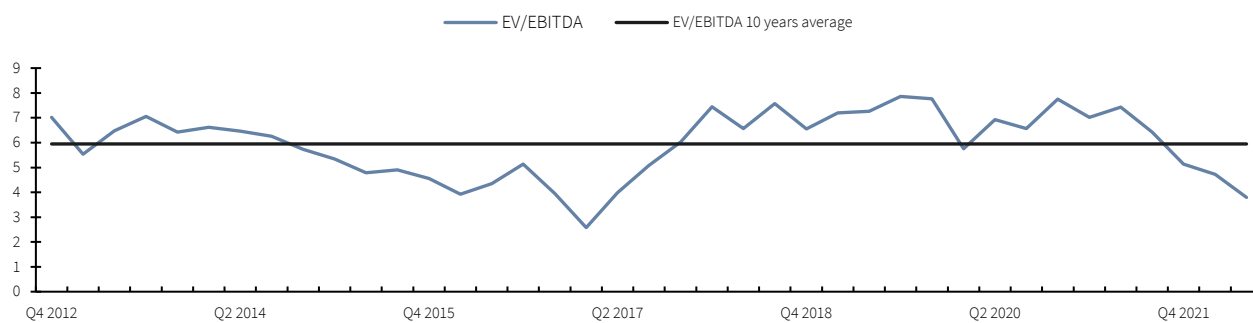
Using this method, we give HPG stocks a fair price of VND29,500/share, corresponding to HPG's 10-year average EV/EBITDA of 5.9x.

Fig 10. HPG – 12M forward P/E (x)



Source: Bloomberg, KB Securities Vietnam

Fig 11. HPG - EV/EBITDA (x)



Source: Bloomberg, KB Securities Vietnam

HPG – 2019A–2022E financials

VND bn	2019A	2020A	2021A	2022F
Construction steel output (tons)	2,773,108	3,400,000	3,880,000	4,600,000
HRC output (tons)	0	681,000	2,560,000	2,722,118
Steel billet output (tons)	0	1,640,000	1,300,000	494,128
Net revenue	63,658	90,119	149,680	154,174
Growth (%)	14%	41,6%	66%	3%
COGS	52,473	71,214	108,571	127,660
Gross profit	11,185	18,905	41,108	26,513
GPM (%)	17.6%	21%	27.5%	17.2%
Financial expenses	1,182	2,824	3,741	3,552
Selling expenses	873	1,094	2,120	1,850
General and admin expenses	569	690	1,324	1,364
Net profit/(loss) after tax	7,578	13,506	34,521	20,623
Growth (%)	-11.9%	78.2%	155.6%	-40%
After-tax profit margin (%)	11.9%	15%	23.1%	13.4%

Source: Hoa Phat Group, KB Securities Vietnam

KB SECURITIES VIETNAM RESEARCH

Nguyen Xuan Binh – Head of Research
binhnx@kbsec.com.vn

Equity

Duong Duc Hieu – Head of Equity Research
hieudd@kbsec.com.vn

Banks, Insurance & Securities

Nguyen Anh Tung – Senior Analyst
tungna@kbsec.com.vn

Nguyen Duc Huy – Analyst
huynd1@kbsec.com.vn

Real Estate, Construction & Materials

Pham Hoang Bao Nga – Senior Analyst
ngaphb@kbsec.com.vn

Nguyen Dinh Thuan – Analyst
thuannd@kbsec.com.vn

Oil & Gas, Utilities

Tieu Phan Thanh Quang – Analyst
quangtpt@kbsec.com.vn

Industrial Real Estate, Logistics

Nguyen Thi Ngoc Anh – Analyst
anhntn@kbsec.com.vn

Retails & Consumers

Pham Phuong Linh – Analyst
linhpp@kbsec.com.vn

Research Division
research@kbsec.com.vn

Macro/Strategy

Tran Duc Anh – Head of Macro & Strategy
anhtd@kbsec.com.vn

Macroeconomics & Banks

Le Hanh Quyen – Analyst
quyenlh@kbsec.com.vn

Strategy, Chemicals

Thai Huu Cong – Analyst
congth@kbsec.com.vn

Strategy, Fishery & Textiles

Tran Thi Phuong Anh – Analyst
anhhttp@kbsec.com.vn

Support team

Nguyen Cam Tho – Assistant
thonc@kbsec.com.vn

Nguyen Thi Huong – Assistant
huongnt3@kbsec.com.vn

KB SECURITIES VIETNAM (KBSV)

Head Office:

Levels G, M, 2 & 7, Sky City Tower, 88 Lang Ha Street, Dong Da District, Hanoi, Vietnam
Tel: (+84) 24 7303 5333 – Fax: (+84) 24 3776 5928

Hanoi Branch:

Level 1, VP Building, 5 Dien Bien Phu, Ba Dinh District, Hanoi, Vietnam
Tel: (+84) 24 7305 3335 – Fax: (+84) 24 3822 3131

Ho Chi Minh Branch:

Level 2, TNR Tower Nguyen Cong Tru, 180-192 Nguyen Cong Tru Street, District 1, HCMC, Vietnam
Tel: (+84) 28 7303 5333 – Fax: (+84) 28 3914 1969

Saigon Branch:

Level 1, Saigon Trade Center, 37 Ton Duc Thang, Ben Nghe Ward, District 1, HCMC, Vietnam
Tel: (+84) 28 7306 3338 – Fax: (+84) 28 3910 1611

CONTACT INFORMATION

Institutional Client Center: (+84) 28 7303 5333 – Ext: 2656
Private Customer Care Center: (+84) 24 7303 5333 – Ext: 2276
Email: ccc@kbsec.com.vn
Website: www.kbsec.com.vn

Investment ratings & definitions

Investment Ratings for Stocks

(based on expectations for absolute price gains over the next 6 months)

Buy:	Hold:	Sell:
+15% or more	+15% to -15%	-15% or more

Investment Ratings for Sectors

(based on expectations for absolute price gains over the next 6 months)

Positive:	Neutral:	Negative:
Outperform the market	Perform in line with the market	Underperform the market

Opinions in this report reflect the professional judgment of the research analyst(s) as of the date hereof and are based on information and data obtained from sources that KBSV considers reliable. KBSV makes no representation that the information and data are accurate or complete and the views presented in this report are subject to change without prior notification. Clients should independently consider their own particular circumstances and objectives and are solely responsible for their investment decisions and we shall not have liability for investments or results thereof. These materials are the copyright of KBSV and may not be reproduced, redistributed or modified without the prior written consent of KBSV. Comments and views in this report are of a general nature and intended for reference only and not authorized for use for any other purpose.