

REE Corporation (REE)

Bright outlook already reflected in share price

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The outlook for the M&E Refrigeration segment is subdued in 1H22 but expected to be brighter from 2H22 onwards

In 1H22, Refrigeration Electrical Engineering (REE) saw a decline in the business performance of the M&E Refrigeration segment from its 1H21 high due to unrealized profits from new projects. We believe the enterprise will turn a profit from these projects in 2H22 after completing construction works. As a leading M&E contractor, REE will likely win the bids for giant airport projects like Terminal T3 of Tan Son Nhat airport and Long Thanh airport, ensuring growth potential of the M&E segment in the medium term, with CAGR estimated at 21.5%/year during the 2022–2026 period.

The real estate and office leasing segment can make a breakthrough from 2023 thanks to E.Town 6

REE's office leasing would maintain stable revenue growth with CAGR of 9.6%/year in 2022–2026, supported by: (1) high occupancy rate (98–100%), (2) rising rents in the medium and long term, and (3) increased leasable area after the launch of E.Town 6 in 2023 with a higher average rent (~USD27/m²/month).

Hydropower will continue to benefit from favorable weather conditions until the end-2022

In 2H22, hydropower plants of REE will continue to benefit from the good hydrological situation of the lakes until the La Nina phenomenon fades away in early 2023 and increased mobilization by EVN. Besides, we expect three wind power projects to continue their stable operation. Also, we are upbeat about REE's solar power development plan under Power Development Plan VIII.

We recommend HOLD for REE stocks with a target price of VND91,100/share

Based on valuation results, business outlook as well as possible risks, we recommend HOLD for REE stocks. The target price is VND91,100/share, 13.0% higher than the closing price on August 12, 2022.

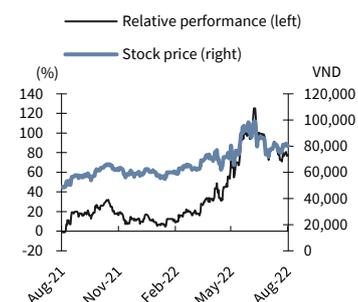
Hold update

Target price	VND91,100
Upside/Downside	13.0%
Current price (Aug 12, 2022)	VND80,600
Consensus target price	VND95,900
Market cap (VNDbn)	28,597

Trading data	
Free float	42.7%
3M avg trading value (VNDbn)	108.44
Foreign ownership	49.0%
Major shareholder	Platinum Victory PTE LTD (31.05%)

Share price performance				
(%)	1M	3M	6M	12M
Absolute	4.8	7.0	35.9	64.3
Relative	-2.3	10.2	63.0	77.6

Forecast earnings & valuation				
FY-end	2020A	2021A	2022F	2023F
Revenue (VNDbn)	5,640	5,810	9,459	10,917
EBIT (VNDbn)	1,239	1,855	3,717	3,777
NPATMI (VNDbn)	1,628	1,855	3,375	3,535
EPS (VND)	5,251	6,003	10,124	9,914
EPS growth (%)	-0.7	14.3	69.0	-2.0
P/E (x)	8.1	12.1	9.0	9.2
EV/EBITDA (x)	12.1	13.0	9.0	8.4
P/B (x)	1.1	1.4	1.6	1.4
ROE (%)	14.0	13.1	18.6	16.9
Dividend yield (%)	4.6	0.4	1.1	1.6



Source: Bloomberg, KB Securities Vietnam

Business performance

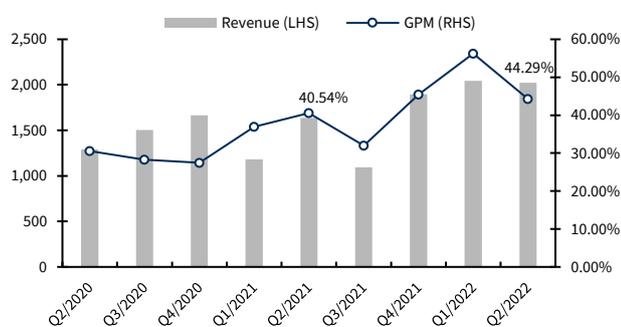
In 2Q22, revenue and NPAT grew by 23.7% YoY and 60.6% YoY, respectively

Gross profit margin remained high thanks to high electricity prices in the CGM and wind power projects

In the second quarter, REE recorded impressive business results with NPAT of VND755 billion (+60.6% YoY) and revenue of VND2,023 billion (+23.7% YoY), driven by the power segment with revenue of VND1,174 billion (+35.5% YoY) or 58% of 2Q22's total revenue. It was attributable to favorable hydrological conditions that boosted hydropower and renewable energy projects, significantly contributing to the revenue growth of the power segment.

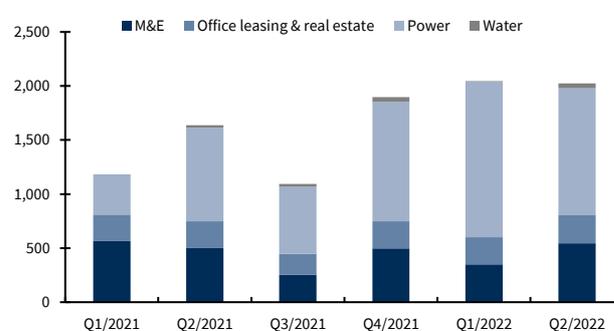
The gross profit margin in the second quarter of 2022 reached 44.3%, down QoQ since earthquakes in the area of Thuong Kon Tum hydropower plant hampered water storage and electricity generation of Vinh Son–Song Chinh Hydropower (VSH). We believe the positive movement of electricity prices in the competitive generation market (CGM) in 1H22 had a profound impact on revenue and the gross profit margin of REE's power segment when: (1) Hydropower has a great competitive advantage over others thanks to the lower average production cost; and (2) surging input costs for coal-fired and gas-fired power plants led to surging electricity prices in the CGM. Besides, the proportion of the power segment to REE's total revenue is increasing. In particular, REE built and started the commercial generation of three wind power projects Tra Vinh, Phu Lac 2, and Loi Hai 2 in October 2021. Furthermore, REE expanded its rooftop solar capacity in 2021 when putting an additional 6.5 MWp of rooftop solar power into operation, bringing the total solar energy capacity to 92.5 MWp. With the contribution from renewable energy and hydropower projects under favorable weather conditions, the gross profit margin usually ranged around 50–65%, leading to a higher proportion of the power segment. Notably, the stable operation of new renewable energy projects will significantly improve REE's gross profit margin in the coming time.

Fig 1. REE – Business results



Source: Refrigeration Electrical Engineering, KB Securities Vietnam

Fig 2. REE – Revenue breakdown (%)



Source: Refrigeration Electrical Engineering, KB Securities Vietnam

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

VND bn	1H2021	1H2022	%YoY	Notes
Revenue (billion VND)	2,819	4,068	44.3%	Revenue increased strongly thanks to contributions from the power segment when CGM price were high and wind power projects operated stably.
M&E	1,065	895	-16.0%	1H2021 is a high base when solar power projects implemented in 2020 are accounted in Q1/2021.
Office leasing & real estate	493	510	3.5%	
Power	1,238	2,613		Favorable hydrological situation has resulted in high generation capacity of hydroelectricity and a high competitive price in the electricity market which has helped increase the average selling price of hydropower. In addition, wind power projects operate stably and fully contribute in 1H2022.
Water	23	51	115.7%	
Gross profit	1,100	2,046	86.1%	
GPM (%)	39.01%	50.30%		Higher gross profit margin thanks to a high proportion of the electricity segment – an operating segment with a high gross margin
SG&A	(177)	(210)		
% SG&A / Revenue	-6.28%	-5.15%		
Profit from operating activities	923	1,837		
Financial income	158	82		In Q1/2021, REE divested from QTP, leading to a sharp increase in financial income.
Financial expenses	(315)	(443)	40.6%	REE began to pay interest on loans to implement newly implemented wind power and solar power projects, leading to a sharp increase in interest expenses.
Profit/loss from JVs	300	406	35.3%	Mainly due to favorable hydrological situation in 1Q2022 leading to higher profits from hydropower companies.
Other net income	3	10		
Profit before tax	768	1,485	93.4%	
Profit after tax	942	1,711	81.6%	
NPM (%)	33.42%	42.05%		
Power output (million MWh)	3,816	4,755	24.6%	Contribution from 3 wind power plants and consolidation of VSH.

Source: Refrigeration Electrical Engineering, KB Securities Vietnam

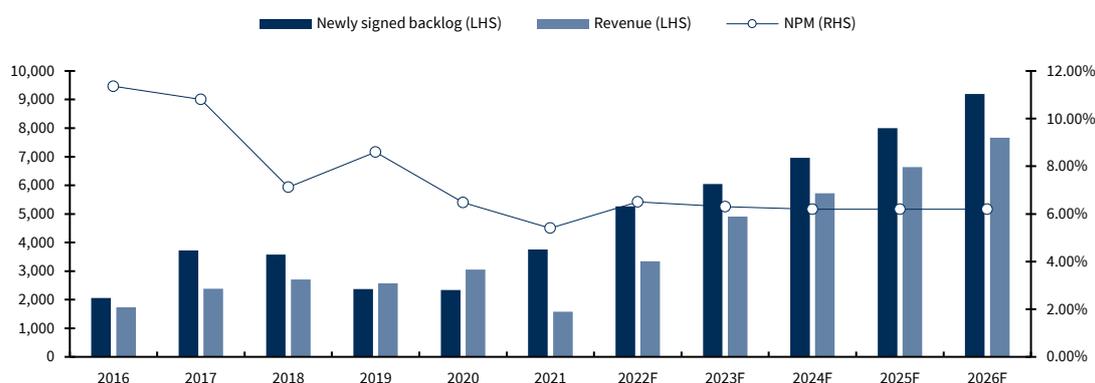
The outlook for the M&E Refrigeration segment is subdued in 1H22 but expected to be brighter from 2H22 onwards

In 1H2022, the M&E segment achieved VND48 billion (-28.4% YoY) in NPAT and VND895 billion (-16% YoY) in revenue. In particular: (1) new projects are in the early stage of implementation; (2) many projects are still under construction, leading to unrealized revenue and profit until receiving acceptance certificates; (3) 1Q2021 results touched a high base thanks to realizing revenue from the solar power projects. In contrast, REE is waiting for approval under Power Development Plan VIII for new projects in 1H2022 and wholesale prices of electricity generated from renewable energies after some time enjoying feed-in tariffs (FITs). Meanwhile, REE's newly signed backlog value remained high at about VND4.7 trillion (+85% YoY) in 1Q2022. In our estimates, 2022F business results will stay unchanged as we expect the company to start realizing revenue from projects completed in 2H2022 after acceptance.

As we mentioned earlier in the prior report, the Vietnamese government is boosting public spending to improve infrastructure. The overloaded infrastructure in the Southern region is hindering the development of the aviation industry, leading to the requirement to broaden airports. As a leading M&E contractor, REE will likely win the bids for giant airport projects like Terminal T3 at Tan Son Nhat airport and Long Thanh airport. We assess REE's revenue in the 2022–2026 period to be at the same high level achieved in the 2016–2017 period when the company carried out the construction work on the Tan Son Nhat airport expansion project.

In addition, the recovery of the real estate market will also boost the M&E segment. According to CBRE estimates, the real estate supply during 2022–2024 will reach 25,000–30,000 units/year against 15,000–20,000 units during 2020–2021. Thus, we forecast REE's newly signed backlog value in 2022 for the M&E segment to be over VND5,200 billion (+40% YoY), bringing in revenue of VND3,705 billion (+104% YoY) compared to the 2021 low. For the period of 2022–2026, we estimate the CAGR of this segment to reach 21.5%/year thanks to the positive prospects.

Fig 3. REE – Business results of the M&E segment



Source: Refrigeration Electrical Engineering, KB Securities Vietnam

Table 2. REE – Airport projects

Project	Construction time	Bidding Package
Noi Bai International Airport	Jun 2000 – Dec 2001	M&E contractor
Lien Khuong Airport	Dec 2007 – Dec 2009	M&E contractor
Tan Son Nhat International Airport	Nov 2004 – Sep 2007	M&E contractor
T2 Terminal Noi Bai International Airport	08/2012 – 12/2014	M&E contractor, ventilation system & BMS installation
T2 Terminal Tan Son Nhat International Airport	Phase 1: May 2015 – Oct 2016 Phase 2: July 2017–August 2018	M&E contractor & station equipment installation
Phase 2: Jul 2017 – Aug 2018	M&E installation and station equipment	
Da Nang International Airport	Apr 2016 – Sep 2017	M&E contractor
Cam Ranh International Airport	Feb 2017 – May 2018	M&E contractor
Van Don International Airport	Nov 2017 – Mar 2019	M&E contractor

Source: Refrigeration Electrical Engineering, KB Securities Vietnam

The real estate and office leasing segment can make a breakthrough from 2023 thanks to E.Town 6

Office leasing brought in NPAT and revenue of VND280 billion (+13.4% YoY) and VND511 billion (+4.5% YoY) thanks to the occupancy rate of over 98%. Remarkably, that figure for E.Town 2, E.Town 5, and E.Town Central achieved above 99%. We expect leasing will continue to recover in 2H2022 and persistently contribute to the revenue growth of REE since the company will not have to reduce rents to aid pandemic-hit customers as it did in 2H2021. In 2H22, NPAT and revenue of this segment should be VND563 billion (+22.2% YoY) and VND1,033 billion (+15.3% YoY), respectively.

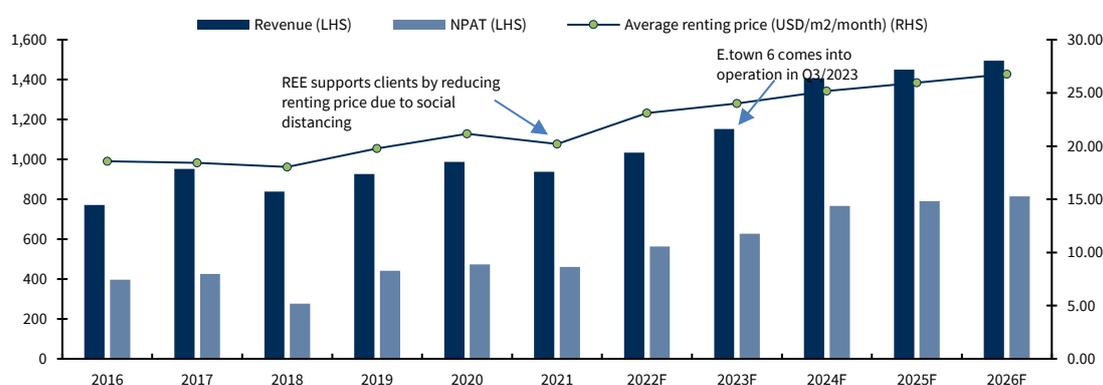
In the coming period, we believe REE's office leasing will maintain stable revenue growth with CAGR of 9.6%/year for the 2022–2026 period:

– **The occupancy rate should average 98–100%:** Currently, REE leases out more than 160,000 m² of Grade B office space. With favorable locations and lower rents than the average, we believe REE's occupancy rate will be reach 98–100%/year in the coming period.

– **Rents tend to rise in the medium and long term:** In our estimates, the rental price of REE's office buildings averaged USD20.2/m²/month last year, 20% lower than the average rent for Grade B office buildings in Ho Chi Minh City as REE lowered the rents to support tenants during lockdowns. However, given the limited supply in the coming time, we expect the average rent of REE's buildings to increase an average of 3.5%/year thanks to favorable locations and the trend of shifting from leasing Grade A to Grade B buildings of domestic enterprises to optimize operating costs.

– **REE will introduce E.Town 6 in 2023 with a higher average rent:** E.Town 6 is a new grade B office building for lease that REE started construction in 2020 and may launch in mid-3Q23. With a total leasable area of 40,000 m², it features 16 floors and seven basements equipped with modern facilities. In our estimates, when REE leases out E.Town 6, its total office space will be 201,000 m², with the expected rent higher than that of the old buildings, at ~USD27/m²/month and the average price increase of about 3%/year. E.Town 6 would annually contribute VND300–320 billion to revenue of REE from 2024.

Fig 4. REE – Business results of the office leasing segment (VNDbn)



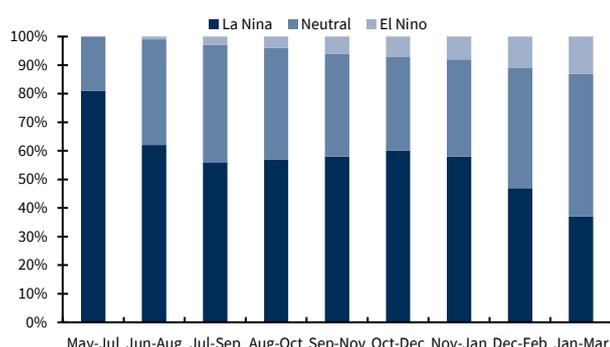
Source: Refrigeration Electrical Engineering, KB Securities Vietnam

Hydropower boomed in 1H2022 and will continue to benefit from favorable weather conditions in 2H2022

During the first half of 2022, REE's power segment, especially hydropower, continued to record remarkable results with NPAT and revenue of VND650 billion (+161.2% YoY) and VND1,816 billion (+131.6% YoY), respectively. It was thanks to: (1) favorable weather conditions that boosted hydropower mobilization, (2) the operation of the Thuong Kon Tum hydropower plant by Vinh Son-Song Hinh Hydropower (VSH), helping REE's output grow impressively, and (3) high electricity prices in the CGM as EVN increased mobilization from sources like gas-fired electricity with high input costs.

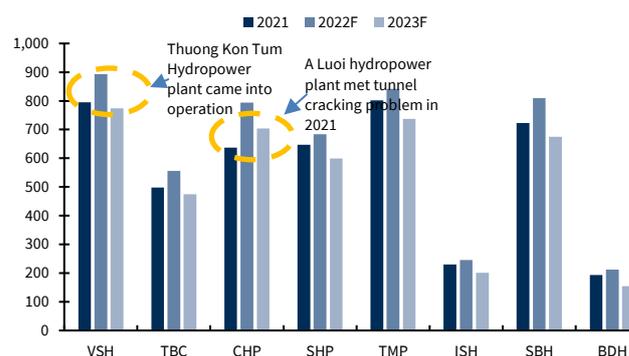
We are optimistic about the prospect of hydropower in 2H2022 because: (1) EVN will likely increase hydropower mobilization during the rainy season in 2H2022 to reduce generation costs for the whole system, and (2) major meteorological organizations in the world anticipated La Nina would last until the end-2022, ensuring enough water for hydropower plants. It is very likely that the La Nina phenomenon will end in early 2023 and the weather will enter the neutral phase, which means less water for hydroelectricity generation.

Fig 5. Global – La Nina, El Nino, neutral weather pattern



Source: IRI, KB Securities Vietnam

Fig 6. REE – Forecast output of hydropower plants (mn kWh)



Source: Refrigeration Electrical Engineering, KB Securities Vietnam

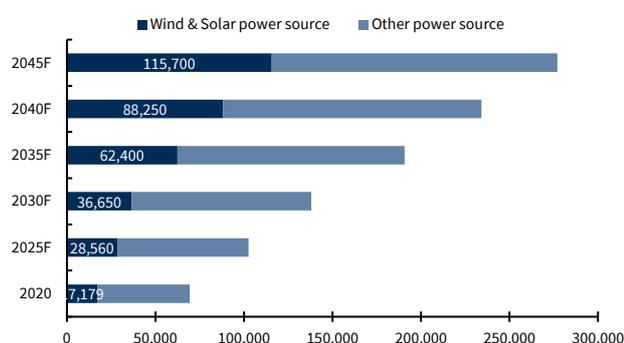
Electricity generation from renewable sources is stagnating in 2022 but will be the growth driver in the long run when National Power Development Plan VIII is approved

The renewable energy segment maintained positive results in 1H2022 with NPAT and revenue reaching VND146 billion (+135.5% YoY) and VND496 billion (+178.7% YoY), respectively. It was attributable to the operation of three new wind power projects (Tra Vinh, Phu Lac 2, and Loi Hai 2) and the development of 26 MWp of rooftop solar power. However, we believe that the 2H2022 results of the renewable electricity generation will level off since: (1) 4Q21 results reached a high base thanks to the operation of wind power projects; (2) wind power projects only operate at their peak efficiency between November and February; and (3) the development of rooftop solar power is behind schedule since National Power Development Plan VIII has not been approved. Therefore, we adjust our forecast for the newly installed capacity of rooftop solar power in 2022 to 70 MWp on the expectation that the government will approve National Power Development Plan VIII in 2H2022, speeding up the installation and commissioning of solar power.

Besides, we take a positive stance toward renewable energy projects of REE, especially solar power, which is the development orientation of REE in the long term, given decreasing investment costs over the years thanks to the popularity of renewable energy worldwide. REE expects the investment cost of upcoming solar power projects to be VND12 billion/MW, which is lower than average in our estimates, contributing to a higher profit margin. We forecast REE's total design capacity of solar power to reach 476.5 MWp by the end-2026 vs. 92.5 MWp by the end-2021.

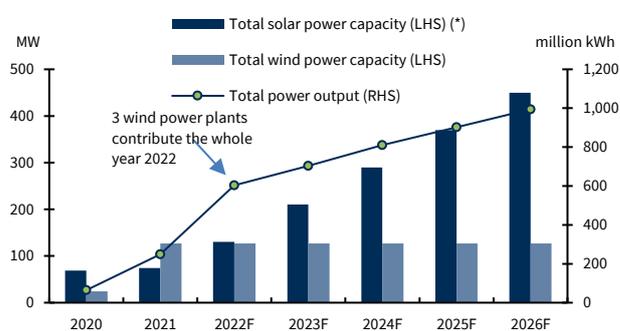
Regarding the wind power segment, we expect REE's three wind power plants to operate stably with high consumption volume in 2022 in the context of surging fuel prices. Besides, we expect REE's wind power plants to be mobilized at about 40–50% of the design capacity in the coming years, given the Government's drastic measures in developing renewable energy projects to achieve the net zero emission target by 2050 as per National Power Development Plan VIII and the rising demand for electric energy consumption for socio-economic development.

Fig 7. Vietnam – Electricity generation from different renewable sources (MW)



Source: Draft of National Power Development Plan VIII, KB Securities Vietnam

Fig 8. REE – Forecast business results of renewable energy



Source: Refrigeration Electrical Engineering, KB Securities Vietnam

(*) 1 MWp ~ 0.8 MW

The outlook for coal-fired power is overshadowed by Vietnam's commitment to the net zero emission target by 2050 under COP26

REE currently owns two coal-fired power plants, Pha Lai Thermal Power Plant (PPC) and Ninh Binh Thermal Power Plant (NBP), with a combined design capacity of 1,140 MW. During the 2016–2020 period, REE held QTP shares of Quang Ninh Thermal Power JSC. However, it divested from QTP from 8.04% to 0.98% in the first half of 2021 and will divest the rest in 2022, aiming towards the net zero emission target that Vietnam has committed under COP26.

After divesting from QTP, Pha Lai Thermal Power (PPC) is the largest coal-fired power plant in which REE holds stakes, with two units and a combined capacity of 1,040 MW. The favorable location of the Pha Lai power plant has facilitated electricity transmission in the North. Nevertheless, the operation after a long period of time (unit 1 started in 1983, and unit 2 began in 2001) led to the deterioration in the power generation systems despite plenty of maintenance overhauls, especially turbines, boilers, and dust filter systems. It resulted in decreased operating efficiency and increased raw material consumption. Furthermore, PPC has had to stop the operation of the S2 unit for remedial works since April 2021, given machine failure. PPC may not complete the repair works until early 3Q22, leading to the continued decrease in PPC's 2022 output. On the other hand, PPC may also need to upgrade the exhaust gas purification system to meet emission standards, leading to rising investment and maintenance costs and dampening profits in the coming period.

In addition, the geopolitical tensions between Russia and Ukraine since the end of February 2022 have continuously pushed the prices of key input materials for the energy industry, namely crude oil and coal prices. To date, the world coal prices have increased substantially for the post-pandemic recovery of the economy worldwide, leading to the coal shortage for Vietnamese power plants amid insufficient domestic supply. As imported coal is mixed with coal bran, the two major domestic coal suppliers, Vietnam National Coal and Mineral Industries Group (TKV) and Dong Bac Corporation, may raise coal prices based on high world coal prices. As a result, it will negatively impact coal power plants in the CGM.

We believe the outlook for coal-fired power will be overshadowed by Vietnam's commitment to the net zero emission target by 2050 under COP26. Meanwhile, the National Power Development Plan VIII has proposed a total coal power capacity of only 36 GW by 2030, about 21 GW lower than the level specified in the National Power Development Plan VII, to protect the environment. Also, thermal power plants must comply with more stringent environmental regulations, which may be a challenge for plants operating for a long duration and with outdated equipment like PPC.

The water segment has constantly contributed to REE's growth

The water segment is one of the businesses constantly contributing to REE's growth with 1H2022 NPAT being VND161 billion (+23.3% YoY) (from associates) on revenue of VND51 billion (+115.9% YoY). We believe that this will be a "cash cow" for REE when: (1) the demand for clean water is increasing in major cities and provinces and (2) water prices are adjusted up annually. According to Ho Chi Minh City's plan, the price of clean water will continue to grow by 4–5% from 2022 after cutting water bills to support poor households and those affected by the COVID-19 pandemic. We believe the water demand will be on the rise in the context of rapid urbanization and new cash flows poured into Ho Chi Minh City to meet the needs of citizens as well as businesses, leading to higher clean water prices over the years. We assume the average price of water will improve by 3%/annum across metropolises. Furthermore, the water supply industry is an essential utility industry, providing clean water for people and businesses, thus having high stability. As a result, this segment will consistently contribute to REE's profit growth so that the enterprise can reinvest in the energy segment, the mainstay of future growth.

Table 3. REE – 2021A–2026E business results of the water segment

	2021A	2022F	2023F	2024F	2025F	2026F
Output (mn m³)	676.6	685.2	692.3	699.5	706.9	714.5
Water supply	258.3	264.8	271.4	278.2	285.1	292.2
Water treatment	418.3	420.5	420.9	421.4	421.8	422.2
Revenue	4,602.0	4,820.6	5,041.8	5,273.9	5,517.3	5,772.7
Net profit contributing to REE	274.0	338.1	353.6	369.9	386.9	404.8

Source: Refrigeration Electrical Engineering, KB Securities Vietnam

Forecast

For 2022F, NPAT and revenue should grow strongly by 41.3% YoY and 48.2% YoY, respectively

In 2022F, we estimate REE's NPAT and revenue at VND3,018 billion (+41% YoY) and VND8,607 billion (+48% YoY) respectively, assuming that:

- The M&E segment should recover from its low base, reaching VND3,705 billion (+104% YoY) in revenue and 6.5% in net profit margin.
- The office leasing segment will also bounce back from the pandemic since REE will not have to reduce rental prices to support tenants.
- VSH is expected to have successfully negotiated the electricity price under the power purchase agreement (PPA) at about VND1,310/kWh for the Thuong Kon Tum plant in 2Q2022. Besides, three wind power projects are expected to stably operate throughout the year, and REE will put an additional 100 MWp of rooftop solar power into operation.

For 2023F, NPAT and revenue should grow strongly by 9.5% YoY and 20.1% YoY, respectively

In 2023F, we estimate REE's NPAT and revenue at VND3,303 billion (+10% YoY) and VND10,333 billion (+20% YoY) respectively, assuming that:

- The M&E segment is expected to achieve revenue growth of 42.5% YoY with a newly signed backlog value of over VND6,000 billion (+15% YoY) and net profit margin flat YoY as a result of fierce competition.
- The office leasing segment achieves revenue growth of 13% YoY thanks to the introduction of E.Town 6 in mid-3Q2022 with an average rent of USD27/m²/month.
- An additional 100 MWp of rooftop solar power will be developed.

Valuation

We recommend HOLD for REE stocks with a target price of VND91,100/share

Based on the SOTP (sum-of-the-parts) valuation method, we recommend HOLD for REE stocks with a target price of VND91,100/share, equivalent to an upside of 13.0% compared to the closing price on August 12, 2022. To be more specific, our valuation for different segments of REE is as follows: power (VND22,939 billion), office leasing (VND9,224 billion), M&E (VND2,409 billion), and water (VND3,719 billion). We apply a conglomerate discount of 10% to reflect the potential risks to REE as a multi-sector corporation. Although we believe REE will maintain positive business results in 2H2022, we are downgrading our recommendation from BUY to HOLD for REE since the share price has partly reflected the market expectations of the company's potential. Nevertheless, investors may grasp opportunities during corrections to accumulate REE stocks, given its bright outlook in the coming period.

REE valuation does not include expansion projects of hydropower plants and new wind power plants

Our valuation for REE does not include expansion projects of REE's subsidiaries and associated companies, namely Thac Ba 2 (18.9 MW), Vinh Son 2 & 3 (110 MW), and new wind power projects until further details about investment plans and the new feed-in-tariff (FIT) regime for renewable energy projects.

Table 4. REE – Target price according to valuation methods (VND/share)

Valuation	Method	Projected NPV	Ownership rate	REE's value
Power				22,939
Hydropower	DCF	35,151	23-50%	13,673
Thermal power	DCF	8,723	24-30%	2,116
Solar power	DCF	2,075	99,99%	2,075
Wind power	DCF	5,519	50-100%	5,019
Power Distribution (DTV)	BV	56	66,29%	56
Office leasing & real estate				9,224
Existing projects	Return on Investment	8,268	100,00%	8,268
Etown 6	DCF	956	100,00%	956
M&E	P/E	2,409	100,00%	2,409
Water	P/E	3,719	20-44%	3,719
Other investment	BV	748		748
Total enterprise value				39,039
(-) Parent company's net debt at 30/06/2022				-2,970
Total Equity value				36,069
Conglomerate discount				10%
Fair value				32,462
No. of outstanding shares (million shares)				356,41
Target price				91,100
Current price (August 12, 2022)				80,600
Upside				13.0%

Source: KB Securities Vietnam

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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

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