

# Hoa Phat Group (HPG)

## Coping with bleak demand outlook pressures

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**3Q22 net revenue dropped 11.8% YoY and NPAT recorded a loss of VND1,785 billion**

Hoa Phat Group (HPG) recorded a loss of VND1,785 billion (-117% YoY) in NPAT on net revenue of VND34,440 billion (-11.8% YoY) for 3Q22 due to falling selling prices and high-priced raw material inventory. Rising USD/VND exchange rate also dampened HPG's 3Q22 business results. On the bright side, construction steel consumption hit 1,076,000 tons (+12% YoY) during the period. Notably, steel pipe consumption climbed 62% YoY to 200,000 tons. Meanwhile, hot rolled coil (HRC) consumption only increased slightly, and galvanized steel consumption fell.

**HPG cut inventory and production output in response to weak consumption**

Given decreasing selling prices and high-priced raw material inventory, HPG had to closely manage inventory and may record lower cost of goods sold (COGS) in 4Q22. The steel giant decided to shut down some blast furnaces on sluggish demand. Steel consumption in 4Q22 will continue facing challenges amid a depressed property market and slow public investment disbursement.

**HPG would increase its market share thanks to competitive advantage**

The steel industry is going through a tough time, and most steelmakers suffered profit erosion in 3Q22. HPG, with a high gross profit margin and lower production costs, is expected to increase its market share while other peers would have to reduce output due to falling steel prices and bleak demand outlook pressures.

**We recommend BUY on HPG stocks with a target price of VND15,300/share**

We revise HPG's 2022F NPAT to VND10,236 billion (-70% YoY) on revenue of VND137,883 billion (-7.9% YoY). Based on valuation results, business outlook and possible risks, we recommend BUY on HPG stocks with a target price of VND15,300/share, 15% higher than the closing price on November 16, 2022.

**Buy** maintain

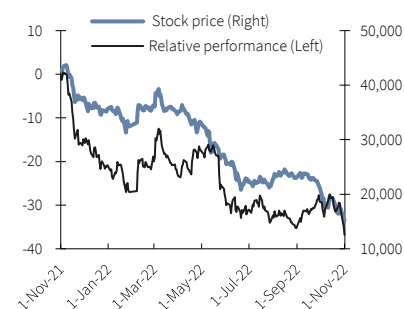
<b>Target price</b>	<b>VND15,300</b>
Upside/Downside	15%
Current price (Nov 16, 2022)	VND13,350
Consensus target price	VND27,143
Market price (VNDtn/USDbn)	87,222/3.5

<b>Trading data</b>	
Free float	55%
3M avg trading value (VNDbn/USDmn)	991/3.1
Foreign ownership	22%

<b>Share price performance</b>				
(%)	<b>1M</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>
<b>Absolute</b>	-30	-36	-52	-64
<b>Relative</b>	-21	-19	-32	-36

### Forecast earnings & valuation

FY-end	2019A	2020A	2021A	2022F
Net revenue (VNDbn)	63,658	90,119	149,680	137,883
Operating income (VNDbn)	9,031	15,289	37,008	11,668
NPAT (VNDbn)	7,578	13,506	10,236	12,436
EPS (VND)	2,700	4,007	7,718	1,760
EPS growth (%)	-32%	49%	89%	-70%
P/E (x)	5.80	3.86	2.03	7.0
P/B (x)	0.88	0.85	0.8	0.7
ROE (%)	17.03%	25.14%	45.97%	10%
Dividend yield (%)	0%	5%	5%	0%



Source: Bloomberg, KB Securities

## Business performance

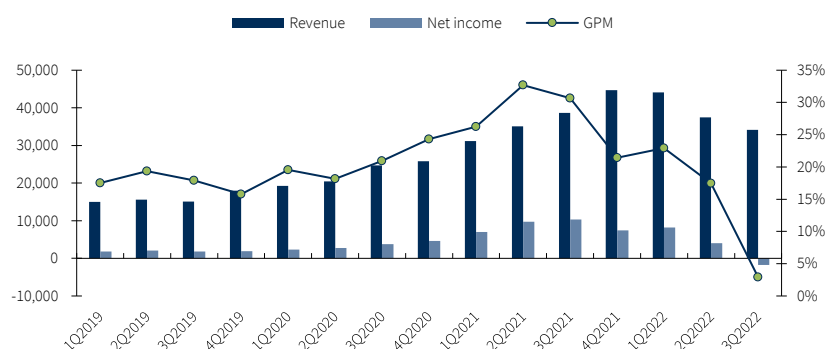
### Increasing exchange rate coupled with falling steel prices delivered a blow on HPG

HPG's 3Q22 revenue reached VND34,103 billion (-11.8% YoY). Gross profit margin was 2.9% (vs. 30.7% in the same period last year) due to lower selling prices and high-priced raw material inventory from the previous quarter. Gross profit posted only VND1 trillion (-91.6% YoY).

HPG recorded an enormous foreign exchange loss on rising USD/VND exchange rate, which sent financial expenses skyrocketing. In its 6M22 financial statements, HPG booked a USD1.2 billion debt and accounts payable of more than VND27 trillion for importing raw materials. HPG may experience further foreign exchange loss in the fourth quarter as the VND will likely continue to depreciate against the USD.

In addition, selling, general and administrative expenses (SG&A) rose sharply in the period, which dented HPG's earnings. 3Q22 NPAT recorded a loss of VND1,785 billion (-117% YoY). Thus, HPG only met almost 42% of its 2022F profit target of VND25,000–30,000 billion by the end of September.

Fig 1. HPG – Net revenue, NPAT, gross profit margin (VNDbn, %)



Source: Hoa Phat Group, KB Securities Vietnam

### Exports supported steel consumption in the third quarter

Between July and September, construction steel consumption touched 1,076 million tons (+12% YoY), primarily thanks to exports. Steel pipe consumption in the period jumped by 62% YoY to 200,000 tons. So far, HPG still upholds its leading position regarding construction steel and steel pipe market share in Vietnam, about 36% and 29% respectively. HRC consumption was 611,000 tons (+1% YoY), and galvanized steel consumption went down to 69,173 tons (-39% YoY). Steel billet exports did not show signs of improvement due to China's dwindling demand and zero-Covid policy.

### HPG's steel consumption dropped sharply in October

The steel giant's production output and sales volume have fallen since July due to declining demand domestically and internationally. Notably, construction steel consumption dropped sharply by 45% to 210,000 tons last month, with exports slumping more than 73%. HPG provided over 57,000 tons of steel pipes (-20%YoY) and 27,000 tons of galvanized steel (-39% YoY) to the market in October. HRC sales picked up 30% to 267,000 tons in October thanks to

exports to Indonesia and Malaysia.

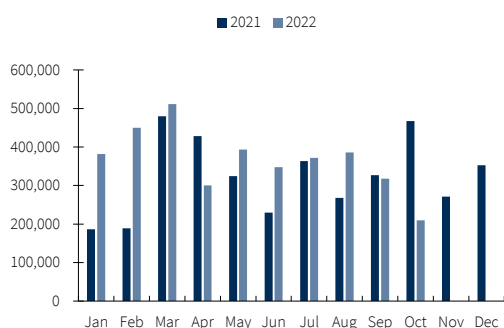
For 10M22, HPG produced 6.6 million tons of crude steel. Sales volume of steel products neared 6.2 million tons (-3% YoY).

### Updates on HPG’s projects

HPG has just launched some new home appliances, notably water purifiers. The giant is now boosting the construction of home appliance production plants in Ha Nam and Ba Ria-Vung Tau provinces.

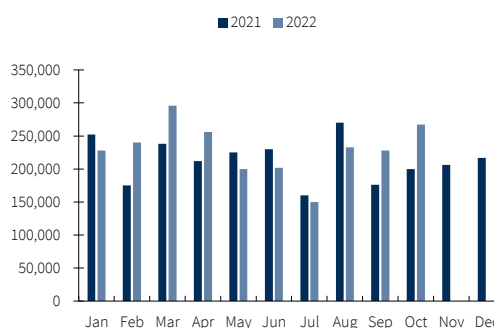
Hoa Phat Dung Quat Iron and Steel Factory Phase 2 is underway. HPG has signed sales contracts for the main items like blast furnace, blowing furnace, rolling line, ... The site was handed over to the firm last month.

Fig 2. HPG – Construction steel consumption (tons)



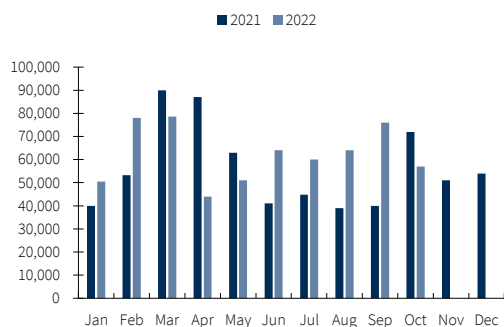
Source: Hoa Phat Group, KB Securities Vietnam

Fig 3. HPG – HRC consumption (tons)



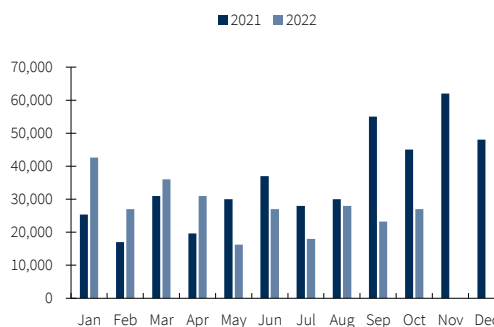
Source: Hoa Phat Group, KB Securities Vietnam

Fig 4. HPG – Steel pipe consumption (tons)



Source: Hoa Phat Group, KB Securities Vietnam

Fig 5. HPG – Galvanized steel consumption (tons)



Source: Hoa Phat Group, KB Securities Vietnam

## Investment catalysts

### Input prices have retreated since early 2022 and remained stable

Iron ore futures on the Singapore Stock Exchange (SGX) on October 31 traded at USD92.59/ton, down 19% compared to early 3Q22. We expect it to range around USD90–100/ton by the end of this year. The forecast comes in the context of subdued demand and slow recovery of production output in China along with the closure of steel mills in Europe due to the energy crunch. This may lead to iron ore oversupply in the near term.

Coking coal futures are currently trading at USD289/ton. Coke prices bounced back after retreating for nearly two months and even dropping to the lowest level of the year at USD200/ton in early August. The recovery can be explained by gas shortages among European countries, causing coal imports to increase and pushing world coal prices higher.

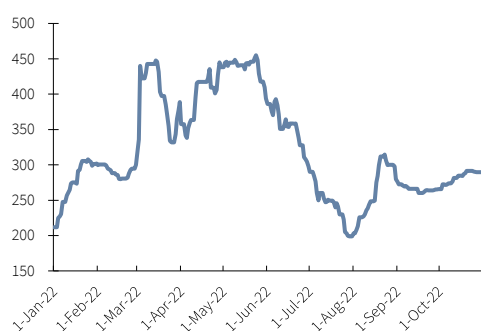
The low volatility of raw material prices helps steel producers like HPG to better control input costs.

### Steel prices may decrease further but will be less volatile

HPG's construction steel prices are now around VND14.5 million/ton after retreating. From May to September, domestic steel prices decreased by VND3.7–3.9 million/ton (–15–16 times). Also, HRC prices were under constant pressure from adjustments. HRC CFR (cost and freight) price in Vietnam on October 31 was USD535/ton, down 20% compared to early 3Q22.

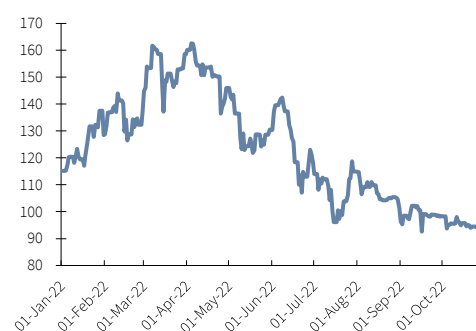
Falling steel prices ate into HPG's 3Q22 revenue. However, steel prices are likely to fall further amid sluggish demand due to a depressed real estate market and slow public investment disbursement. We expect the decline to be modest since steel manufacturers have cut production and inventories since the end of 3Q22. However, inventories at steel enterprises remain high. We forecast construction steel prices to be around VND14 million/ton.

Fig 6. ASX – Coking coal futures (USD/ton)



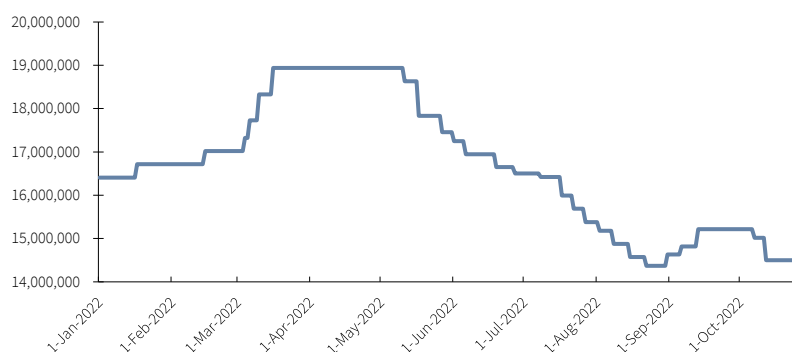
Source: Bloomberg, KB Securities Vietnam

Fig 7. SGX – Iron ore futures (USD/ton)



Source: Bloomberg, KB Securities Vietnam

Fig 8. HPG – Construction steel prices (VND/ton)



Source: Hoa Phat Group, KB Securities Vietnam

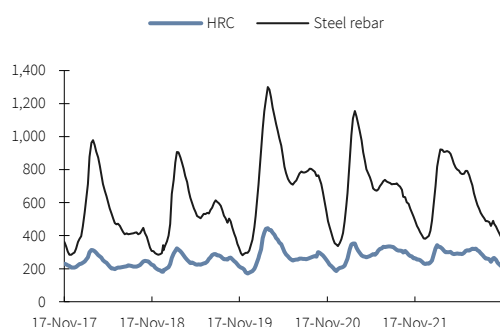
**HPG is under pressure from China's steel market**

China is the world's leading steel producer and consumer. Currently, most steel mills in China have been hit by losses, leading to the shutdown of blast furnaces to switch to maintenance. Steel supply will narrow in the upcoming winter, which will have a negative impact on the global market.

Although HRC and steel rebar inventories have decreased significantly in China, the demand for steel remains weak. The Purchasing Managers' Index (PMI) of the steel industry in this market fell to its 2008 low in July 2022. Despite the subsequent recovery, the index stayed below 50. The steel market outlook will depend heavily on the bounce of China's housing market, which is still suffering from a default crisis. As a result, we assess that HPG's steel exports to this country will continue to face challenges.

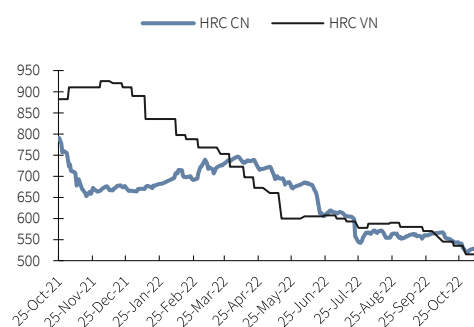
Construction steel prices in China have dropped sharply despite declining output production. Weak demand forced manufacturers to lower selling prices to boost sales and reduce inventories. HRC prices in the country also plunged, thus pulling export prices down and affecting other regional countries, including Vietnam. Domestic HRC CFR price on November 14 was USD515/ton, down 23.4% from early 3Q22. This would hamper HPG's revenue and profit in 4Q22 when construction steel and HRC are its major consumer products.

Fig 9. China – HRC and steel rebar inventory (million tons)



Source: Bloomberg, KB Securities Vietnam

Fig 10. China, Vietnam – HRC prices (USD/ton)



Source: Bloomberg, KB Securities Vietnam

### **Steel consumption will likely face numerous challenges**

The Vietnam Steel Association (VSA) reported that the sales volume of steel products in 3Q22 decreased by nearly 10% YoY. In the first nine months of the year, production and consumption of finished products hit 20.808 million tons (-5.8% YoY) and 19,261 million tons (-1.6% YoY), respectively.

In the short term, the steel industry may continue facing challenges, and the demand recovery would not come anytime soon while inventories remain high. The fourth quarter is seen as the peak construction season, expected to boost the consumption of steel products. However, last month's data show the opposite. A dormant housing market amid slow public investment disbursement is lowering steel demand. This is a big concern for businesses like HPG in the wake of huge inventories despite decreasing from the previous time.

In the long term, we assess that the bounce of the real estate market will reshape the domestic steel industry. Moreover, China's economic reopening and subsequent rising demand will help to promote exports to this market.

### **HPG cut inventory and production output in response to weak consumption**

HPG had to closely manage inventory due to falling steel prices and high-priced raw material inventory, which can help the firm to record lower COGS in 4Q22. HPG's inventory dropped sharply from VND58,317 billion to VND44.779 billion by the end of September, with raw materials making up only 49% (lower than the previous quarters). Days in inventory, therefore, was shortened from 172 to 126 days. It comes in the context of decreasing raw material inventory, helping to lower costs and ease provisioning pressures for HPG.

On the ground of production output in October 2022, we estimate HPG's factories have been operating at 77% of their designed annual capacity. The enterprise sent a document to its partners about the suspension of two blast furnaces at Hoa Phat Dung Quat Iron and Steel Production Complex and two others at Hoa Phat Hai Duong Iron and Steel Production Complex in November 2022. HPG will likely close another one in December.

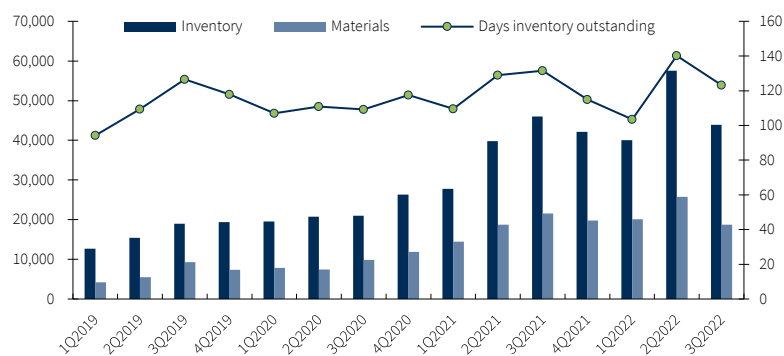
The shutdown of five furnaces in response to falling consumption demand will reduce production capacity by more than 70%. This can be disadvantageous to HPG as it would take 2-3 weeks and cost VND30-50 billion for steel enterprises to put a blast furnace into operation again. However, the firm can carry out maintenance while shutting down those plants. In 2022, HPG plans to conduct maintenance and raise the capacity of HRC plants from 3.5 million tons/year to 4 million tons/year.

### **HPG would increase its market share thanks to competitive advantage**

The steel industry is going through a tough time, and most steelmakers suffered profit erosion in 3Q22. HPG, with a high gross profit margin and lower production costs, is expected to increase its market share while other peers would have to reduce output due to falling steel prices and bleak demand outlook pressures.

However, we believe HPG will capitalize on its competitive advantage to gain more market share. In the first six months of 2022, the firm expanded its market share from 32.6% to 36% for construction steel, from 24.7% to 29% for steel pipes, and the figures kept rising in the third quarter.

Fig 11. HPG – Inventory, raw materials, days in inventory (VNDbn, days)



Source: Hoa Phat Group, KB Securities Vietnam

## Forecast & Valuation

### We revise HPG's 2022F NPAT to VND10,236 billion (-70% YoY)

We revise HPG's 2022F total sales volume to 7.7 million tons (-14% YoY) due to concerns about bleak steel consumption demand in the context of rising inflation, sluggish real estate market, and slow public investment disbursement. Correspondingly, 2022F revenue is VND137,883 billion (-7.9% YoY). However, gross profit margin is adjusted to 14% from 27.5% in 2021 on low selling prices and high input prices. NPAT should be VND10,236 billion (-70% YoY).

### We revise HPG's revenue forecast to VND22,300 billion in 4Q22

The outlook for the steel industry seems subdued. Furthermore, HPG had to close some furnaces to cope with weak steel demand. As a result, we revise HPG's revenue forecast to about VND22,300 billion in 4Q22.

Gross profit margin in 4Q22 is expected to stay low at 8% (up QoQ) since steel prices have dropped substantially from their peak, and the downtrend of material prices is leveling off.

In addition, we believe the risk of exchange rate loss is existential as the VND has shown its depreciation against the USD since early 4Q22. Therefore, HPG's financial expenses may keep growing in the last quarter. Accordingly, NPAT may record a loss of VND208 billion in 4Q22.

### We recommend BUY on HPG stocks with a target price of VND15,300/share

Amid the gloomy outlook of the steel industry, we assess that HPG is still maintaining its competitive advantage and production, therefore gaining more market share.

Based on two valuation methods P/E and EV/EBITDA with a ratio of 50:50, we recommend BUY on HPG stocks. The target price is VND15,300/share, 15% higher than the closing price on November 16, 2022:

- For P/E method, we keep HPG's 2022F target P/E at 7x due to concerns over weak demand, equivalent to VND13,730/share.
- For EV/EBITDA method, we lower 2022F target EV/EBITDA to 5.2x, equivalent to VND16,790/share.

Fig 12. HPG - P/E (x)



Source: Bloomberg, Hoa Phat Group



## HPG – 2020A–2023F financials

Income Statement					Balance Sheet				
(VND billion)	2020A	2021A	2022F	2023F	(VND billion)	2020A	2021A	2022F	2023F
Net sales	90,119	149,680	137,883	95,433	CURRENT ASSETS	56,800	94,155	79,257	46,956
		108,57	118,53	-	Cash and cash equivalents	56,800	94,155	79,257	46,956
Cost of sales	71,214	1	6	80,919	Short-term investments	13,001	22,471	11,220	13,583
<b>Gross Profit</b>	<b>18,904</b>	<b>41,108</b>	<b>19,347</b>	<b>14,514</b>	Accounts receivable	8,822	18,236	18,236	18,236
Financial income	1,005	3,071	3,102	2,273	Inventories	6,125	7,663	8,018	5,565
Financial expenses	-2,837	-3,732	-7,495	-3,340	LONG-TERM ASSETS	26,287	42,134	41,488	30,749
of which: interest expenses	-2,192	-2,526	-2,970	-3,054	Long-term trade receivables	74,711	84,082	103,070	128,464
Gain/(loss) from joint ventures (from 2015)	2	4	4	4	Fixed assets	305	809	809	809
Selling expenses	-1,091	-2,120	-2,326	-1,145	Investment properties	65,562	69,281	68,805	88,176
General and admin expenses	-690	-1,324	-965	-668	Long-term incomplete assets	6,247	9,699	29,458	36,541
Operating profit/(loss)	15,292	37,008	11,668	11,638	Long-term investments	171	7	7	7
Other incomes	654	797	827	797	<b>TOTAL ASSETS</b>	<b>131,511</b>	<b>178,236</b>	<b>182,327</b>	<b>175,420</b>
Other expenses	-589	-748	-662	-748	<b>LIABILITIES</b>	<b>72,292</b>	<b>87,456</b>	<b>82,233</b>	<b>67,044</b>
Net other income/(expenses)	65	48	165	48	Current liabilities	51,975	73,459	66,484	47,866
Income from investments in other entities	0	0	0	0	Trade accounts payable	10,916	23,729	19,485	13,302
<b>Net accounting profit/(loss) before tax</b>	<b>15,357</b>	<b>37,057</b>	<b>11,833</b>	<b>11,686</b>	Advances from customers	36,798	43,748	41,488	30,749
Corporate income tax expenses	-1,849	-2,536	-1,597	-1,169	Short-term unrealized revenue	4,261	5,983	5,511	3,814
<b>Net profit/(loss) after tax</b>	<b>13,506</b>	<b>34,521</b>	<b>10,236</b>	<b>10,517</b>	Short-term borrowings	20,316	13,996	15,749	19,179
<b>Margin ratio</b>	<b>2020A</b>	<b>2021A</b>	<b>2022F</b>	<b>2023F</b>	Long-term liabilities	2,638	0	0	0
Gross profit margin	17.6%	21.0%	14.0%	15.2%	Long-term trade payables	335	532	490	339
EBITDA margin	19.3%	24.3%	13.6%	20.5%	Long-term advances from customers	17,343	13,465	15,259	18,840
EBIT margin	15.3%	19.0%	9%	13%	<b>OWNER'S EQUITY</b>	<b>59,220</b>	<b>90,781</b>	<b>100,095</b>	<b>108,376</b>
Pre-tax profit margin	14.3%	17.0%	8.6%	12.2%	Paid-in capital	33,133	44,729	44,729	44,729
Operating profit margin	14.2%	17.0%	8.5%	12.2%	Share premium	0	0	0	0
Net profit margin	11.9%	15.0%	7.4%	11.0%	Others	934	922	922	922
					Undistributed earnings	21,783	41,763	51,999	60,280
<b>Cash Flow Statement</b>	<b>2020A</b>	<b>2021A</b>	<b>2022F</b>	<b>2023F</b>	<b>Key ratios</b>				
(VND billion)					(x, %, VND)				
Net profit/(loss) before tax	15357	37057	11833	11686	Multiple				
Depreciation and amortization	4776	6077	6948	7879	P/E	3.9	2.0	6.4	6.3
Profit/loss from investing activities	-491	-1661	0	0	P/E diluted	3.7	2.0	6.4	6.3
Interest expense	2192	2526	2970	3054	P/B	0.9	0.8	0.8	0.7
Operating profit/(loss) before changes in Working Capital	21932	44209	20257	22625	P/S	0.6	0.5	0.0	0.1
(Increase)/decrease in receivables	-3374	-3039	-355	2453	P/Tangible Book	0.9	0.8	0.5	0.8
(Increase)/decrease in inventories	-7061	-16949	647	10738	P/Cash Flow	4.4	2.5	7.3	2.8
Increase/(decrease) in payables	4252	9250	-4244	-6184	EV/EBITDA	7.6	4.9	6.0	9.3
(Increase)/decrease in prepaid expenses	-89	-814	0	0	EV/EBIT	1.9	1.5	0.9	0.9
<b>Net cash inflows/(outflows) from operating activities</b>	<b>-4073</b>	<b>-5936</b>	<b>-4498</b>	<b>-3975</b>	<b>Operating performance</b>				
Purchases of fixed assets and other long-term assets	11587	26721	11806	25658	ROE	25%	46%	10%	10%
Proceeds from disposal of fixed assets	-11916	-11621	-26231	-34333	ROA	12%	22%	6%	6%
Loans granted, purchases of debt instruments	34	49	49	49	ROIC	15%	25%	10%	10%
Collection of loans, proceeds from sales of debts instruments	-11971	-41061	0	0	<b>Financial structure</b>				
Investments in other entities	5003	31076	-466	9486	Cash Ratio	0.3	0.3	0.2	0.3
Proceeds from divestment in other entities	0	0	0	0	Quick Ratio	0.4	0.4	0.5	0.6
Dividends and interest received	0	834	0	0	Current Ratio	1.1	1.3	1.2	1.0
<b>Net cash inflows/(outflows) from investing activities</b>	<b>354</b>	<b>1054</b>	<b>1054</b>	<b>1054</b>	LT Debt/Equity	0.3	0.2	0.2	0.2
Proceeds from issue of shares	-18495	-19669	-25593	-23744	LT Debt/Total Assets	0.1	0.1	0.1	0.1
Payments for share returns and repurchases	3	11	0	0	Debt/Equity	0.9	0.6	0.4	0.3
Proceeds from borrowings	0	0	0	0	Debt/Total Assets	0.4	0.3	0.2	0.2
Repayment of borrowings	83074	12507	5313	5313	ST Liabilities/Equity	0.9	0.8	0.7	0.4
		12165	-	-	ST Liabilities/Total Assets	0.4	0.4	0.1	0.1
Finance lease principal payments	-65604	3	-2777	-2627	Total Liabilities/Equity	1.2	1.0	0.8	0.6
Dividends paid	0	0	0	0	Total Liabilities/Total Assets	0.6	0.5	0.5	0.4
Interests, dividends, profits received	-1419	-1693	0	-2236	<b>Activity ratios</b>				
<b>Net cash inflows/(outflows) from financing activities</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	Account Receivable Turnover	27.1	33.6	17.6	14.1
<b>Net increase in cash and cash equivalents</b>	<b>16054</b>	<b>1740</b>	<b>2536</b>	<b>449</b>	Inventory Turnover	3.1	3.2	2.8	2.2
Cash and cash equivalents at the beginning of period	9146	8792	-11252	2364	Account Payable Turnover	5.1	5.8	6.4	5.8
Cash and cash equivalents at the end of period	4545	13696	22471	11220					
Net profit/(loss) before tax	13696	22471	11220	13583					

Source: Hoa Phat Group, KB Securities Vietnam

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## Investment ratings & definitions

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### 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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