

Nam Kim Steel (NKG)

Falling steel prices hold back business results

September 13, 2022

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In 2Q22, net revenue increased slightly but NPAT fell sharply

Nam Kim Steel (NKG) posted 2Q22 NPAT of VND201.4 billion (-76.2% YoY) and revenue of VND7,206 billion (+2.7% YoY). Selling, general & administrative (SG&A) expenses increased substantially over last year's corresponding period. The export volume of coated steel products reached 147,217 tons (+13.4% YoY), offsetting weak domestic consumption on depressed demand. Total sales volume during the period went down slightly by 2.6% YoY to 222.4 thousand tons.

A volatile market would darken the outlook for growth of NKG

The price of hot-rolled coil (HRC), NKG's main input, has retreated since May 2022. Vietnamese HRC traded at USD605/ton on the spot market on August 5, prompting NKG to make provisions for inventory devaluation. Selling prices of domestic steel products also decreased in the wake of weak local demand.

NKG may benefit from the energy crisis in the EU

EU steel mills have been forced offline due to soaring energy costs. Currently, the steel demand is dwindling in the bloc. However, if the energy crisis prolongs, it will lead to supply shortage and prompt the EU to look to alternative supplies outside the bloc, thus benefiting NKG.

We recommend HOLD for NKG stocks with a target price of VND24,700

In 2022, we forecast NKG to achieve VND1,203 billion (-45.9% YoY) in NPAT and VND25,342 billion (-10.2% YoY) in revenue. We, therefore, recommend HOLD for NKG stocks with a target price of VND24,700/share, 10% higher than the closing price on September 7, 2022.

Hold initiate

Target price	VND24,700
Upside/Downside	10%
Current price (Sep 7, 2022)	VND 22,550
Consensus target price	VND 24,000
Market cap (VNDtn/USDbn)	5.63/0.24

Forecast earnings & valuation

FY-end	2020A	2021A	2022F	2023F
Net sales (VNDbn)	11,560	28,173	25,309	23,011
Net gain/Loss (VNDbn)	870	4,269	2,427	2,047
NPAT (VNDbn)	295	2,225	1,203	937
EPS (VND)	1,621	10,188	5,508	4,290
EPS growth (%)	528.3%	528.5%	-45.9%	-22.1%
P/E (x)	13.91	2.21	4.09	5.26
P/B (x)	12.90	8.60	7.15	6.30
ROE (%)	9%	39%	14%	12%
Dividend yield (%)	5%	5%	5%	5%

Trading data

Free float	75%
3M avg trading value (VNDbn/USDmn)	200/8.54
Foreign ownership	6.63%
Major shareholder	UNICOH Specialty Chemicals (5.85%)

Share price performance

(%)	1M	3M	6M	12M
Absolute	22	-6	-46	-26
Relative	14	-6	-32	-24



Source: Bloomberg, KB Securities Vietnam

Overview

NKG is an established steel manufacturer in Vietnam

Founded in 2002 with initial charter capital of VND60 billion, NKG is now an established enterprise in the steel industry. The core business of NKG is manufacturing and distributing steel products like hot-dip galvanized steel, color-coated steel, steel pipes, and other industrial products. NKG is in the top 3 most reputable construction material exporters in Vietnam. The company was officially listed on the Ho Chi Minh City Stock Exchange (HOSE) in 2011 and now operates 4 factories with a combined capacity of over 1 million tons/year. NKG's technological equipment is from top steel-manufacturing companies such as SMS (Germany), Drever (Belgium). The input materials are provided by famous corporations like Nippon Steel (Japan), Hyundai Steel (Korea), CSC (Taiwan), Formosa (Vietnam), etc. NKG's distribution network covers Ho Chi Minh City, Dong Nai, and neighboring provinces. Up to now, NKG's products have been available nationwide and exported to more than 50 international markets.

Fig 1. NKG –History of formation and development

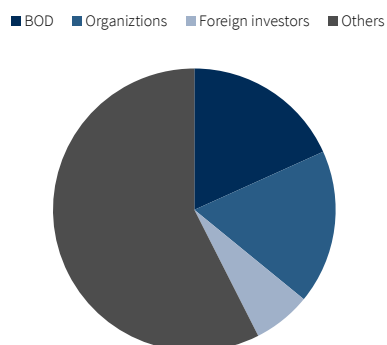


Source: Nam Kim Steel

Shareholder structure

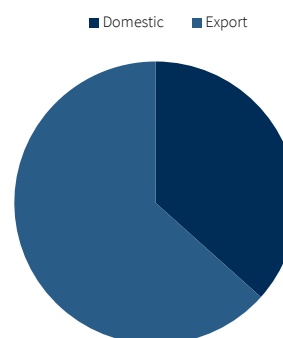
Regarding the shareholder structure, the Board of Directors holds 18.26% of the charter capital, 14.2% of which is by Mr. Ho Minh Quang, Chairman of the board. Other organizations own 17.94%, with the major shareholders being Unicoh Specialty Chemicals Co., Ltd, SMC Trading Investment JSC, Vietnam Enterprise Investments Ltd. Foreign ownership accounts for 6.63% and the rest is held by others.

Fig 2. NKG – Shareholder structure (%)



Source: Nam Kim Steel

Fig 2. NKG – Revenue breakdown (%)

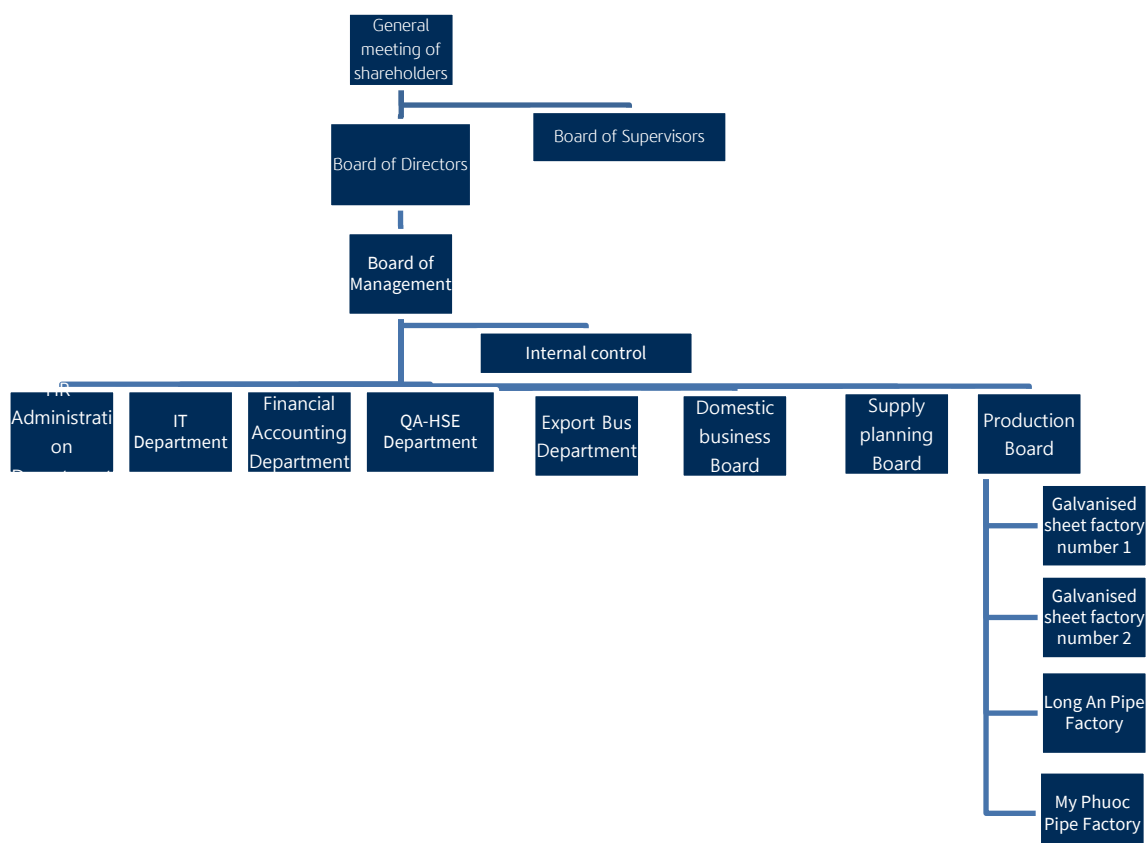


Source: Nam Kim Steel

Revenue breakdown

In 2021, NKG achieved revenue of VND28,206 billion, of which exports accounted for 68% or VND19,200 billion. Domestic sales posted VND900.6 billion. For the time being, NKG is involved in the manufacturing of color coated steel (Naki Color), hot-dip zinc (Naki Zinc), hot-dip zinc-aluminum coated steel (Naki Zincalum), steel pipes, hot-rolled steel sheets in coil, cold-rolled steel sheets in coil and the wholesale trading of various types of steel and iron products.

Fig 4. NKG – Organizational structure



Source: Nam Kim Steel

Business operations

NKG manufactures and distributes coated steel and steel pipes

NKG's main products:

- Hot-dip zinc coated/galvanized steel (Naki Zinc): steel sheets in coil coated with 2 layers of pure zinc (99%), using continuous hot-dip technology through NOF furnace temperature to control mechanical properties which are suitable for different applications.
- Hot-dip zinc-aluminum alloy coated/galvanized steel (Naki Zinalum): steel sheets in coil coated with 2 layers of alloy (55% aluminum, 43.5% zinc, 1.5% Silicon) with corrosion resistance. The coating has good ductility and adhesion, ensuring formability for different applications.
- Pre-painted zinc/zinc-aluminum coated/galvanized steel or color-coated steel (Naki Color): a combination of highclass paint layers to ensure long-term color retention and superior corrosion resistance of zinc-aluminum alloy base steel. The product is manufactured on the modern technological line of SMS Group (Germany).
- Galvanized/Black steel pipes (Naki Pipe): high-quality, meeting international standards.

NKG operates four plants with a combined capacity of more than 1 million tons/year and plans to double the total capacity

Currently, NKG operates two galvanized steel factories with a design capacity of 350,000 tons/year and 650,000 tons/year each. In addition, the enterprise also runs two steel pipe factories with a combined capacity of 270,000 tons/year. NKG recently approved a plan to build a new factory (3 phases) in My Xuan B1-Dai Duong Industrial Park (Ba Ria - Vung Tau), with a total investment of about VND4,500 billion. The factory principally manufactures high-quality products with a capacity estimated at 1.2 million tons, thus raising the total capacity of NKG's five factories to 2.4 million tons.

NKG is ranked second in terms of domestic galvanized steel market share

The production and trading of galvanized steel contribute a sizeable proportion to the total revenue of NKG. According to the Vietnam Steel Association (VSA), NKG ascended from the eighth rank in 2011 (4%) to the fifth in 2012 (6.9%), and the second in 2013 (12%) and 2021 (17.5%) in terms of galvanized steel market share. In the first half of 2022, NKG's market share rose to 18.25%. The company has maintained its growth momentum and upheld its position in the top 3 most reputable construction material exporters in Vietnam.

NKG focuses on its strength of manufacturing and is aggressively expanding its capacity. The firm is one of the leading color-coated steel manufacturers with a large capacity and modern production lines, ensuring domestic and export needs.

NKG's production lines:

- A pickling and oiling line of 900,000 tons/year. Raw materials with a thickness range of 1.5 mm - 5.0 mm and a width range of 750 mm - 1,300 mm are pickled and oiled on modern technology lines of SMS Group (Germany). It is the most and only advanced line in Vietnam equipped with the Acid Regeneration & Recovering Steel Pellets System, which contributes to environmental protection.

- Twin cold rolling mill with 2 stands and the first 6 – HI reversing cold rolling mill CVC in Vietnam which helps not only to double capacity but also to reduce manpower and operation costs to minimum.
- 5 metallic coating lines of up to 1,200,000 tons/year with NOF technology that can produce zinc galvanized steel and pre-painted zinc/zinc-aluminum coated steel complying with various standards.
- 2 advanced color coating lines of 180,000 tons/year which can meet any color matching requirement from the customer, with a warranty period of 15 years.

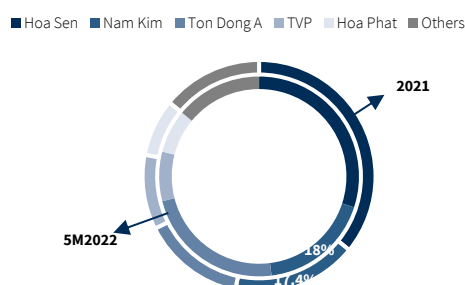
Exports grew strongly in the first half of 2022, offsetting the declining domestic demand

Consumption volume in 2Q22 saw declines. Specifically, consumption of galvanized steel and steel pipes of NKG reached only 222.4 thousand tons (-2.6% YoY) and 37.8 thousand tons (-24% YoY) in 2Q, respectively. In particular, exports of galvanized steel still accounted for a substantial proportion (63.4% of total revenue). NKG's main export markets are Europe (50% of export volume), the US (20% of export volume), and other ASEAN countries. Galvanized steel exports in 2Q22 were up 13.4% over the same period to 173,217 tons. Thus, over the first six months, export volume hit 324,344 tons (+7.8% YoY).

Despite a high contribution of exports, the total consumption of galvanized steel still declined on shrinking domestic demand with only 15,941 tons (-38.7% YoY) consumed nationwide. Steel pipes were only consumed in the local market, reaching 37,824 tons (-24%YoY) in 2Q22. The reason behind weak domestic demand comes from the Government's tightening of capital flows into the real estate market and the slow disbursement of public spending in the first half of the year.

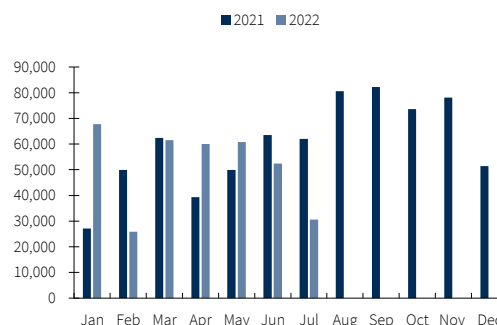
The steel industry has been through a tough time, but NKG's business operation is still better than other peers'. NKG's domestic market share in 1H22 reached 18.25%, up from 17.4% seen in 1H21.

Fig 5. Vietnam – Galvanized steel market share (%)



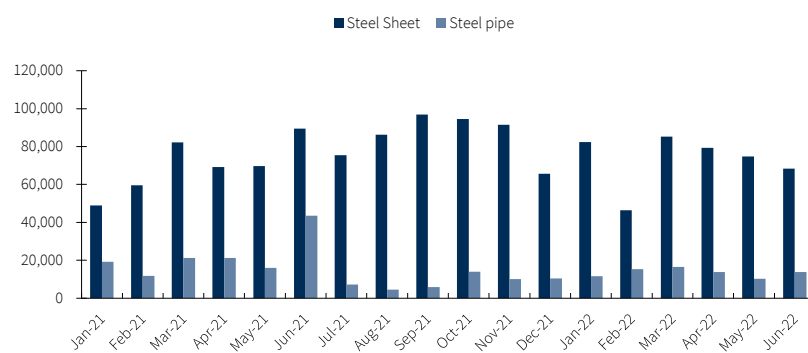
Source: Vietnam Steel Association, KB Securities Vietnam

Fig 6. NKG – Export volume (tons)



Source: Nam Kim Steel, Finpro, KB Securities Vietnam

Fig 7. NKG – Coated steel sheet and steel pipe consumption (tons)



Source: Nam Kim Steel

Business performance & Financial status

In 2021, NKG achieved NPAT of VND2,225 billion and net revenue of VND28,173 billion

In 2021, NKG reached record-high net revenue of VND28,173 billion, up 143.7% YoY. The gross profit margin expanded by 7% to 15.2%. However, selling expenses rose sharply to VND1,398 billion due to high transportation costs arising from supply chain disruptions. NPAT, therefore, reached VND2,225 billion (+654.22% YoY).

In the first half of 2022, NKG's NPAT was VND1,454 billion (+24.6% YoY) on revenue of VND14,437 billion (+20.9% YoY). Gross profit margin hit 12.8%.

In 2Q22, NKG's NPAT recorded VND201 billion (-76.2% YoY) on revenue of VND7.2 trillion (+2.7% YoY)

NKG's 2Q22 revenue reached VND7.2 trillion (+2.7% YoY). The gross profit margin was 12.4% vs. 13.2% in 1Q22. However, NKG reversed the VND300 billion provision expense for the devaluation of inventories in 1Q22. Excluding this amount, the 1Q22 profit margin reached only 9.2%. We believe the improvement in profit margin in 2Q22 compared to the previous quarter (excluding the reversal of provision expense) came from the recovery of coated steel prices in line with higher HRC prices after decreasing steeply from the end of 2021. NKG benefited from hoarding low-priced raw materials. Besides, NKG also receives a number of export orders with two-month forward contracts, so the selling prices are kept at high levels.

2Q22 NPAT posted VND201.4 billion (-76.2% YoY). SG&A expenses of NKG increased sharply, which dampened NKG's earnings.

NKG's total assets have grown significantly since 2020

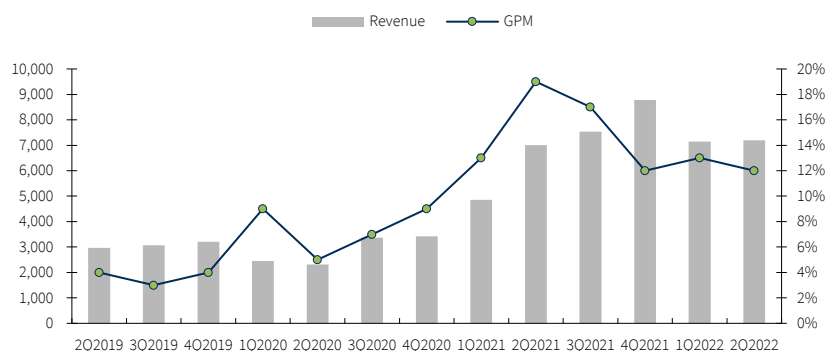
Total assets of NKG grew significantly to VND15,397 billion (+104% YoY) last year. The enterprise's short-term asset structure saw changes compared to 2020 since NKG had to ensure the supply for the export markets amid disrupted supply chains. Accordingly, inventories grew strongly to VND8,701 billion (4-fold YoY), equivalent to 57% of total assets.

As of the end of June 2022, NKG's total assets reached VND16,259 billion, down 1% YTD (year-to-date). In detail, inventories accounted for 51.9% of total assets. Accounts receivable were VND2,061 billion (down 5% compared to 1Q22), equivalent to 16% of total assets.

NKG's debt ratio decreased by 8% compared to the end of 1Q22 to VND4,843 billion. Specifically, short-term debt accounts for the highest proportion in the debt structure. During the first half of the year, the liabilities to total assets (L/A) ratio was 61.9%. However, NKG's debt ratio was only 29.7%, which is safe for the business in our view. NKG's ROE (return on equity) in 2021 reached 38.9%, up strongly against 2020 thanks to a sharp rise in revenue and profit. NKG made the most of HRC's price increase in the second half of 2020 and the first half of 2021.

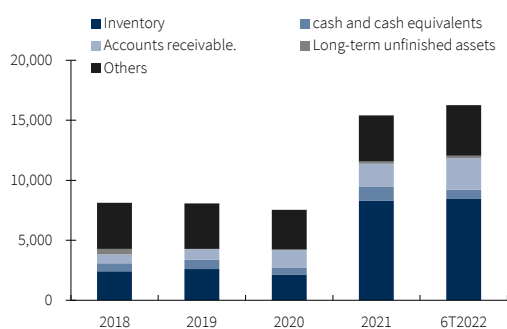
In addition, the risk of provisioning for inventory devaluation will be existential in the context of strong fluctuation in input prices. Currently, the inventory to assets ratio (51.9%) is at a five-year high, higher than Hoa Phat Group's (HPG) (27.7%) and lower than Hoa Sen Group's (HSG) (53%).

Fig 8. NKG – Net revenue, gross profit margin (VNDbn, %)



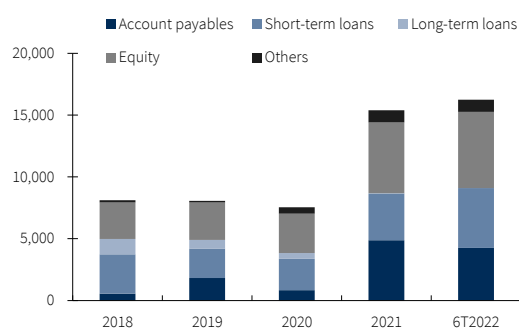
Source: Nam Kim Steel, KB Securities Vietnam

Fig 9. NKG – Asset structure (VNDbn)



Source: Nam Kim Steel, KB Securities Vietnam

Fig 10. NKG – Capital structure (VNDbn)



Source: Nam Kim Steel, KB Securities Vietnam

Table 1. NKG – 1H22 business results

VND bn	1H2021	1H2022	YoY %	Note
Price of input materials				
HRC price (USD/ton)	704.4	825.4	17.1%	HRC price went down from May due to low demand
Consumption				
Steel sheet (ton)	419,151	436,352	4.1%	
Export	304,597	328,344	7.7%	Increase export to EU (50% of export volume) and US (20% of export volume)
Domestic	114,554	108,008	-5%	
Steel pipe (ton)	102,123	81,250	-20.4%	
Revenue	11,862	14,347	20.9%	Revenue growth was largely driven by export with high output prices. High import demand in developed countries
Gross profit	1,916	1,850	-3.5%	
Gross Profit Margin (%)	16.2%	12.8%		Gross profit margin declined due to high competition in the export market and fluctuations in input material prices
Selling expense	417.1	837.2	100.7%	Shipping costs doubled compared to the same period in 2021
% Selling expenses/revenue	0.58%	0.3%		
SG&A expenses	63.39	86.4	36.4%	
% SG&A / revenue	0.5%	0.6%		
Operating profit	1,332	829.8	-37.7%	
Financial Income	54.57	181.5		
Financial expenses	157.84	280.5		
Net other income	10.27	8.5		
Profit before tax	1,342.5	830.2	-38.2%	
Profit after tax	1,166.2	708.3		
NPM (%)				

Source: Nam Kim Steel, KB Securities Vietnam

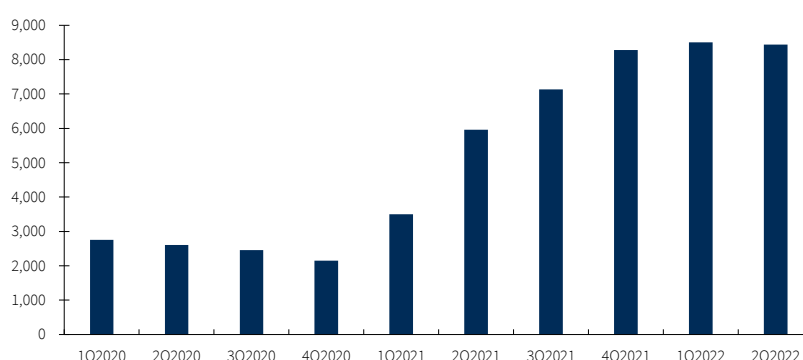
Investment catalysts

NKG is heavily influenced by fluctuations in the steel market

The price of HRC, NKG's main input, has undergone fluctuations. Vietnamese HRC price on the spot market has recorded consecutive declines from its peak of USD925/ton on April 1, 2022 to around USD605/ton. In our estimates, the average HRC price will be around USD800/ton over the next two quarters. However, falling input price has negligible impacts on NKG's business results for the time being since the company still has large inventories of high-priced raw materials. Over the first six months of 2022, NKG's inventory of raw materials reached VND2.25 trillion and of finished products was VND4.5 trillion, both at relatively high levels. The decrease in raw material prices will prompt NKG to make a massive provision for inventory devaluation.

On the other hand, falling HRC prices is pulling down the prices of finished products, in particular, coated steel exported to Europe and the US. Domestic selling prices also decreased in line with the drop in HRC prices on the spot market. HRC peaked and retreated from May 6, 2022, negatively affecting not only NKG but other steel enterprises as well. We forecast the average export price at USD1100/ton and the domestic price at USD900/ton in the second half of 2022. The export prices of steel products are fixed since NKG primarily signs two-month forward contracts. However, the selling prices have been going down since the beginning of May, which means the export prices will not stay as high as those of 2Q22 orders. The gap between the input price (HRC) and the export price is progressively narrowing, putting more pressure on NKG's gross profit margin in the second half of this year. Therefore, dropping HRC prices will cast a shadow over NKG's business results in the short term.

Fig 11. NKG – Inventories (VNDbn)



Source: Nam Kim Steel, KB Securities Vietnam

Competitive pressures increased on trade policies of the US and EU

Vietnam's steel exports will face stiff competition in both the EU and the US. Since early 2022, the US has eased tariff-rate quotas on Japanese, EU and UK steel. Besides, the EU extended safeguard measures on Vietnamese hot-dip galvanized (HDG) steel. Specifically, they are applicable in both 4A and 4B HDG categories from July 1, 2022 to June 30, 2024. The duty-free quota of the group of 'other countries', including Vietnam, is 1.8 million tons between July 1, 2022 and June 30, 2023, up 4% in the following year. The out-of-quota import tax is 25%.

As an enterprise exporting large amounts of galvanized steel products to the US (20% of export volume) and the EU (50% of export volume), the above policies will limit exports of NKG's products to these two markets.

NKG may benefit from the energy crisis in the EU

As per the European Steel Association (EUROFAR), steel consumption in the EU bloc would go down slightly by 2% YoY to 147 million tons, given uncertainties in the second half of 2022 due to the ongoing Russia-Ukraine war, inflation risk, and the deterioration of global outlook.

In terms of supply, the domestic deliveries across EU member states had nearly flat growth in the first quarter of 2022 (+0.2% YoY). July production output of the entire bloc fell by 6.7% YoY. Furthermore, steel plants have been forced offline due to Russia's cut on natural gas flow to Europe, which pushed energy costs higher. As of September 6, 2022, 15 factories had to stop or planned to stop operating. This would continue in the short and medium term if the EU cannot find alternative sources amid tense EU-Russia relations. And even if energy prices stabilize, production output cannot return to pre-crisis levels immediately since it will take a lot of time and costs for businesses to resume arc furnaces after halting for some time.

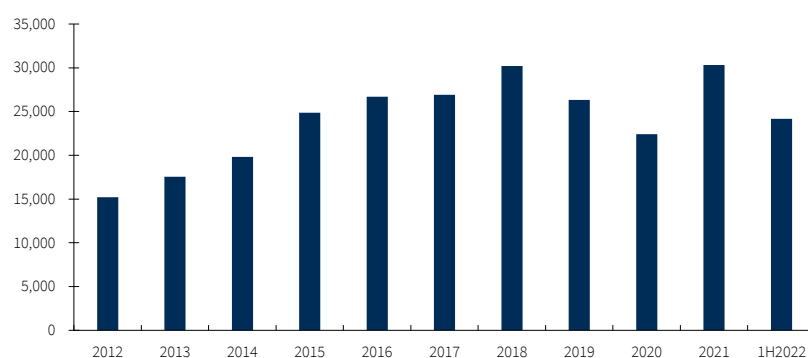
The EU has been boosting steel imports over the past few years. Along with that, the ongoing energy crisis will further contribute to this trend. It would benefit NKG in the coming time since Europe is the enterprise's main export market.

NKG gains a competitive edge over other peers in developed markets thanks to lower production costs

NKG gains a competitive edge over others in developed markets thanks to lower production costs, supported by: (1) trends in clean steel production in major exporters (Turkey, Korea, etc); (2) more relaxed policies for environmental management in Vietnam compared to other developed countries that import steel products like the EU and the US; and (3) the ongoing energy crisis in Europe.

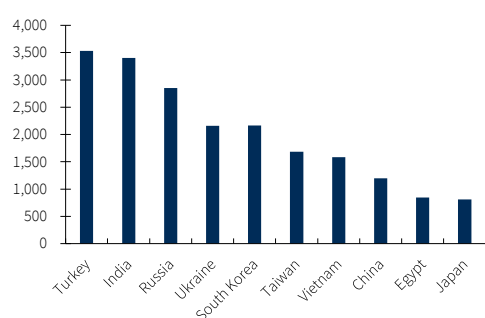
NKG's production capacity continues to improve thanks to a new factory project in My Xuan 1-Dai Duong Industrial Park, specializing in manufacturing high-quality products. The project comprises 3 phases, with the construction expected between 2022-2027 and a capacity of 1.2 million tons/year, ensuring domestic consumption and export volume.

Fig 12. EU – Imports of steel products (thousand tons)



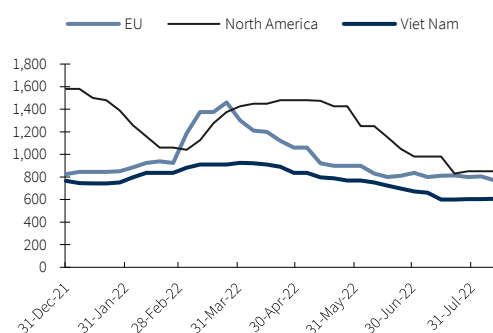
Source: EUROFER, KB Securities Vietnam

Fig 13. EU – Top exporters of flat steel to the EU (thousand tons)



Source: EUROFER, KB Securities Vietnam

Fig 14. Global – HRC prices (USD/ton)



Source: Bloomberg, KB Securities Vietnam

Risks

Fluctuations in prices of input materials and finished products

NKG's revenue and profit very much depend on the prices of input material (HRC) and steel products exported to developed markets such as the US and Europe. Meanwhile, HRC prices and finished product price movements are based on the global commodity market. Besides, the shortage of input materials may also disrupt NKG's operations.

Policies on tariff-rate quotas and safeguard measures

Because export represents the highest proportion, the tariff policies and safeguards of governments in the export markets would detrimentally affect NKG. Recently, the EU extended its safeguard measures on Vietnamese hot-dip galvanized steel. This would trigger challenges in exporting NKG's products to international markets.

The tightening of environmental management policies

As a heavy industry, steel production has a number of impacts on the environment, including air emission, (CO, SO_x, NO_x, PM_{2.5}), wastewater contaminants, hazardous wastes, and solid wastes. As a result, tightening control over waste sources and pushing up the application of environmental management may dampen the business results of NKG.

Forecast & Valuation

2022F business results

We forecast NKG's total consumption volume in 2022 to reach 1 million tons (-7% YoY). Accordingly, NPAT and revenue should be VND1,203 billion (-45.9% YoY) and VND25,309 billion (-10.2% YoY), respectively. The gross profit margin is expected to decline to 9% due to concerns over weak demand, high raw material cost, and decreasing prices of finished products.

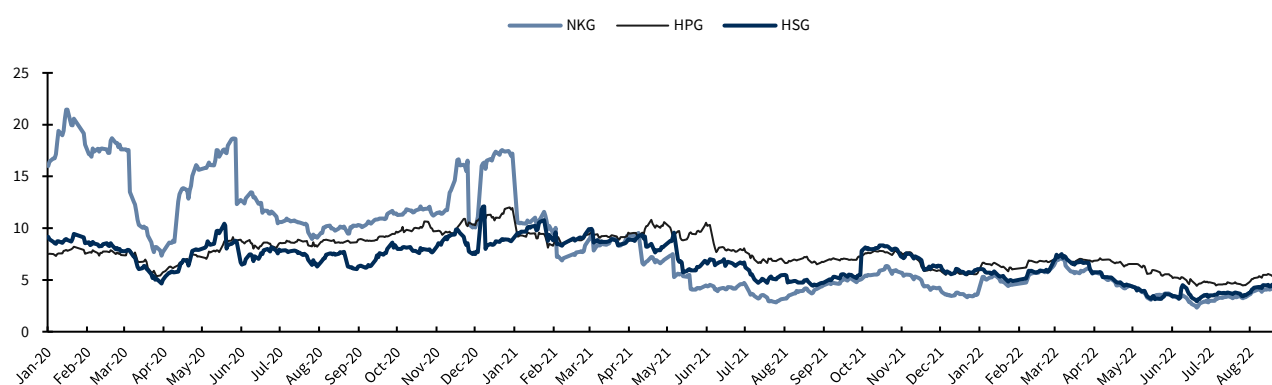
We recommend HOLD for NKG stocks with a target price of VND24,700/share

The outlook for the steel industry is overshadowed by falling selling prices in a depressed market. However, NKG's business operation is still better than other peers. NKG's market share in 1H22 hit 18.25%, up from 17.4% in the same period last year. The enterprise is expected to maintain its competitive advantage and improve production capacity by building a new factory focusing on high-quality products.

Based on two valuation methods P/E and FCFF (free cash flow to the firm) with a weight of 50-50, we recommend HOLD for NKG stocks. The target price is VND24,700/share, equivalent to a total return of 10% compared to the closing price on September 7, 2022.

- According to the P/E method, we adjust NKG's target P/E to 5.5x due to concerns about shrinking demand and low selling prices. 2022F EPS (earnings per share), therefore, is VND4,574. We value NKG stocks at VND25,150/share.
- According to the FCFF method, we value NKG stocks at VND24,360/share.

Fig 15. NKG, HPG, HSG – P/E comparison



Source: Bloomberg, KB Securities Vietnam

NKG – 2019A–2023E financials

VND bn	2019A	2020A	2021A	2022F	2023F
Steel sheet output (tons)	595,987	561,989	929,527	856,352	880,000
Steel pipe output (tons)	82,876	141,744	154,064	151,250	160,000
Net revenue	12,177	11,560	28,173	25,309	23,011
Growth (%)	-17.8%	-5.1%	143.7%	-10.2%	-9.1%
COGS	-11,835	-10,690	-23,904	-22,882	-20,964
Gross profit	342	870	4,269	2,427	2,047
GPM (%)	2.8%	7.5%	15.2%	9.6%	9%
Financial expenses	-275	-281	-398	-276	-252
Selling expenses	-210	-268	-1,398	-633	-575
General and admin expenses	-69	-92	-123	-147	-147

Source: Nam Kim Steel, 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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