KB Securities VIETNAM

STOCK PITCH REPORT

Da Nang Rubber (DRC)

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Buy

December 28, 2020

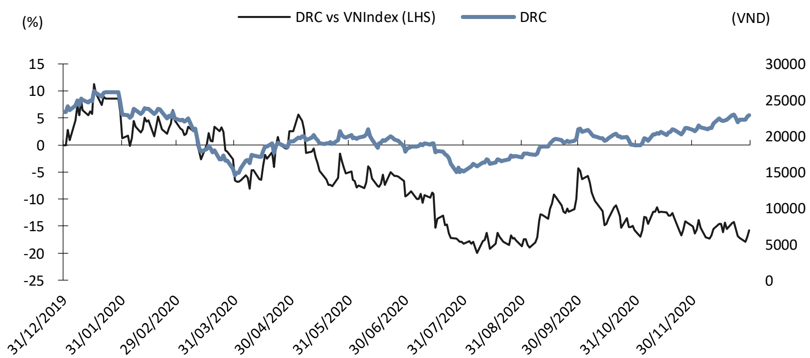
Target price	VND26,800
Upside (%)	17.0
Current price (Dec 28, 2020)	VND10,000
Market cap (VNDbn)	2,720

Trading data	
Free float (%)	46.0
3M avg trading value (VNDbn)	24.0/1.0
Foreign ownership (%)	33.1
Major shareholder	VINACHEM 50.51%

Forecast earnings & valuation

FY-end	2017A	2018A	2019A	2020F
Net sales (VNDbn)	3,669	3,551	3,858	3,695
Earnings/loss (VNDbn)	207	177	312	207
Profit attributable to parent (VNDbn)	166	141	251	242
EPS (VND)	1,398	1,187	2,109	2,038
EPS growth (%)	-60.4%	-15.1%	77.7%	-3.4%
P/E (x)	16.2	19.1	10.8	11.1
P/B (x)	1.8	1.8	1.7	1.6
ROE (%)	10.6%	9.2%	15.9%	14.3%
Dividend yield (%)	5.7%	2.6%	6.6%	6.6%

Fig 1. Share price performance



Source: Bloomberg, KB Securities Vietnam

INVESTMENT VIEWPOINT

We recommend BUYING shares of Da Nang Rubber (DRC), a leading tire manufacturer in Vietnam, with the target price of VND26,800 for 12-month outlook. The company's two main products are radial tires and bias tires.

INVESTMENT CATALYSTS

The post-COVID-19 demand for tires is expected to rebound and grow. After falling due to the impacts of the pandemic, car sales' recovery signs became more pronounced. Besides, the industry outlook has a large growth potential thanks to (1) the overall positive outlook of the global tire industry, (2) the expansion of export markets when FTAs come into effect, and (3) the increase in the rate of localized production.

The depreciation of phase 1 machinery and equipment of radial factories and the reduction in interest expenses will boost DRC profit growth from 2021. The machinery of DRC's phase 1 radial tire production facility was fully depreciated by the end of August 2020, reducing depreciation expenses by VND13.2 billion per month from September 2020. Besides, we believe that DRC will likely pay off its long-term loan in this year.

DRC offers attractive cash dividend payment. We believe that DRC will have a high cash dividend ratio (VND2,000-3,000/share in the 2021-2024) and dividend yield of 8.8-13.2%.

RISKS

There is a risk of increasing input material prices (rubber, black coal and chemicals).
In addition, Chinese tire factories may relocate to Southeast Asian countries to avoid taxes, and the US is likely to impose tariffs on tire products imported from Vietnam.

BUSINESS PERFORMANCE

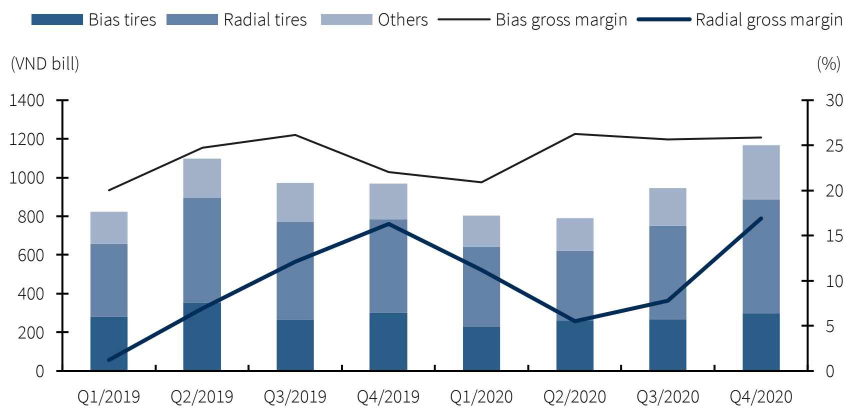
The business performance in the first nine months of 2020 was hit by the pandemic

DRC's 9M20 earnings were VND147.0 billion (-13.4% YoY) on revenue of VND2,538.6 billion (-12.2% YoY), and gross profit margin reached 15%, up slightly compared to 13.9% in 9M20. Subdued performance was mainly because the consumption volume decreased due to low demand during the COVID-19 pandemic and selling expenses rose along with competition.

3Q20 business results recovered significantly compared to the previous quarter

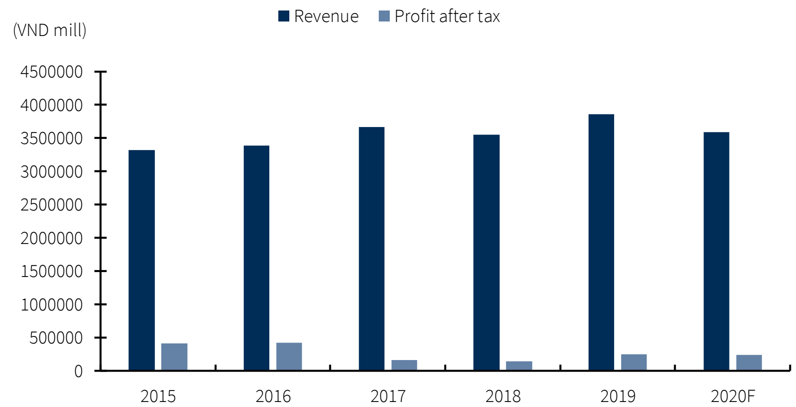
3Q20 earnings reached VND61.6 billion (+28.5% QoQ) on revenue of VND946.7 billion (+20% QoQ), and gross profit margin increased to 15.3% from 15.1% in 2Q. In which, revenue from radial tire segment increased strongly by 33.4% QoQ and bias, motorbike and bicycle tire segments recorded an increase of 3%, 20%, and 27% QoQ respectively.

Fig 2. DRC – Revenue structure (VNDbn, %)



Source: Da Nang Rubber

Fig 3. DRC – 2015-2020F earnings & revenue (VNDmn, %)



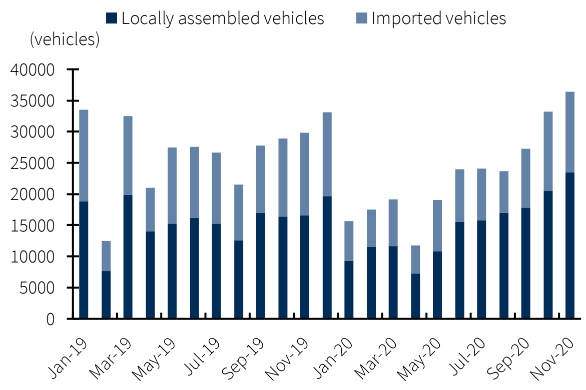
Source: Da Nang Rubber

INVESTMENT CATALYSTS

DRC is a tire manufacturer in Vietnam which provides two main products – radial and bias tires with a capacity of 600,000 tires/year for each line to serve domestic consumption needs and export mainly to the US, Brazil and India. We believe that boosting production of radial tires is the right step for the business when the trend of radicalization in tire production has been spreading globally.

1. The post-COVID-19 demand for tires is expected to rebound and grow

Fig 4. Vietnam – Automobile consumption (units)



Source: VAMA, KB Securities Vietnam

Tire sales gradually improved thanks to a positive recovery in car demand. The Coronavirus outbreak and governments' social distancing protocols had a negative impact on the demand for transportation, causing DRC's revenue to decrease in 9M20. However, both domestic and export markets showed clear signs of recovery. If the pandemic is soon controlled globally given large-scale vaccination, consumption volume should rebound, ensuring DRC's future growth.

— **For the domestic market**, the Vietnam Automobile Manufacturers Association (VAMA) said after a sharp decline in 9M20, the total market sales in October and November increased sharply to 69,613 units (up 18.4% YoY), of which locally assembled cars hit an impressive growth of 33% YoY because: (1) the pandemic is well controlled domestically, helping the demand for automobiles to recover; (2) The Government issued the Decree 70/2020/ND-CP to reduce 50% of the registration fee for domestically manufactured and assembled cars from June 28, 2020 to the end of December 31, 2020; and (3) suppliers actively reduce car prices to stimulate demand and promote the launch of new products with attractive preferential policies.

— **For the export market**, DRC's 3Q20 radial tire exports surged 46.2% QoQ to 104,542 units, accounting for 76.6% of total radial tire consumption. Bias tire exports increased sharply to 43,829 units (+45.7% QoQ) or 27.3% of the total sold bias tires of the company. We expect DRC's product export value to continue to continue its positive growth from 4Q20.

The industry growth prospects are bright. We strongly believe that the domestic tire industry will grow steadily in the long term, especially for car tires thanks to (1) the overall positive outlook of the global tire industry, (2) the expansion of export markets when FTAs come into effect, and (3) the government's priority to localize automobile manufacturing.

— **Car tires, DRC's main product line, can achieve a CAGR of 4.1% in 2020-2025**, increasing to 2,740 million units in 2025 from 2,240 million units in 2020 (according to TechSci Research). In addition, the effective FTAs with a roadmap to reduce import taxes are the driving force for DRC to increase exports and take another piece of the pie in the global tire market, especially the targeted EU potential market.

- **Vietnam's automobile manufacturing industry will develop strongly, and the localization rate will continue to increase** during 2020-2030 with the car consumption growth of 22.6%/year in 2020-2025 and 18.5% in 2025-2035 (according to IPSI). The Prime Minister's master plan on development of the automobile industry in Vietnam with a vision to 2030 considered making the industry to become a leading industry. The total domestically assembled automobiles should account for a larger proportion of the domestic demand, thereby raising the demand for auto parts and accessories. The truck segment is forecast to achieve high output with a CAGR of 12.6% in 2025-2030.

Table 1. Vietnam – Master plant on automobile industry development

	Domestically assembled cars vs domestic demand in 2020	Domestically assembled cars vs domestic demand in 2025F	Domestically assembled cars vs domestic demand in 2030F	Automobile output in 2025F	Automobile output in 2030F
9-passenger cars	7-10%	65%	70%	237,900	451,512
10-passenger cars or larger	45-55%	92%	92%	29,102	51,288
Specialized vehicles	45-55%	18%	20%	2,356	,3846
Trucks	>20%	78%	80%	197,017	356,115

Source: Decision 1168/QD-TTg, KB Securities Vietnam

2. The depreciation of phase 1 machinery and equipment of radial factories and the reduction in interest expenses will boost DRC profit growth from 2021

The machinery of DRC's phase 1 radial tire production facility was fully depreciated by the end of August 2020, reducing depreciation expenses by VND13.2 billion per month from September 2020. Besides, we believe that DRC will likely pay off its long-term loan in this year. This and the increase in consumption volume will be strong growth drivers for DRC from 2021.

However, we strongly believe that DRC will shorten the depreciation period of radial plant machinery in phase 2 from 15 years to seven years as the shortening the period of machinery depreciation in Phase 1 raised depreciation by VND23 billion. Accordingly, we predict that corporate profit in 2021 could increase by more than VND126 billion thanks to the reduction in depreciation from machinery of the radial tire factory in phase 1 and financial interest.

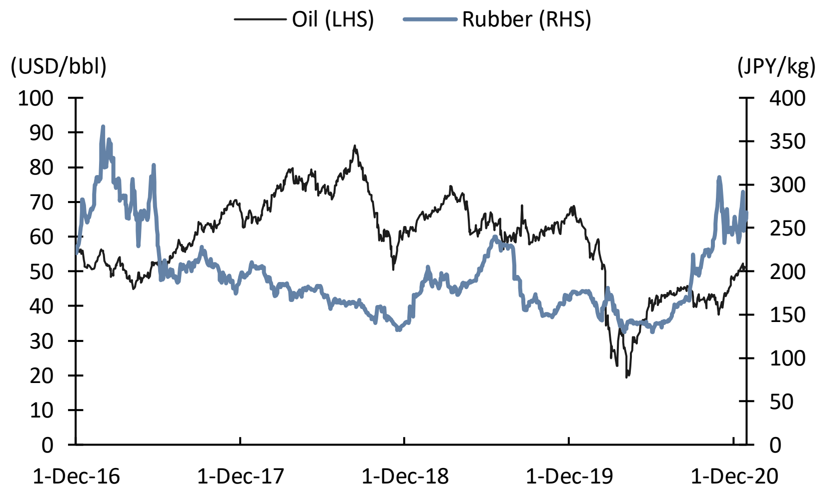
3. DRC offers attractive dividend payment

With a high dividend payout ratio in the past ranging from 70% to 95% in the period 2016-2019 (as the largest shareholder, Vinachem, often requires high cash dividend ratios from affiliates), firm fundamentals, bright profit prospects and no official decision on capacity expansion, we believe that DRC will increase its cash dividend payout in the near future. Cash dividend in the period 2021-2024 should range from VND2,000-3,000 per share, which offers an attractive dividend yield of 8.8%-13.2% compared to the market price.

RISKS

There is a risk of increasing input material prices (rubber, black coal and chemicals). Raw materials account for 75% of DRC's COGS, so fluctuations in raw material prices will have a strong impact on business operations. The price of natural rubber has recorded a sharp increase since July due to the recovery of automobile production, increasing global demand for medical gloves and decreasing supply. Besides, the prices of oil – a raw material for synthetic rubber production also recovered strongly from the bottom of the month when consumption demand recovered, supply gradually returned to the "normal" state when inventories decreased significantly, and the demand is expected to rise further. The prices of black coal and chemicals accounts for about 30% of the cost of raw materials, so the fluctuations in the prices of these two materials also affect DRC's profit.

Fig 5. Global – Rubber and oil prices (USD, JPY)



Source: Bloomberg, KB Securities Vietnam

Chinese tire factories may relocate to Southeast Asian countries to avoid taxes. The outlook of the major export markets including the US and India is positive as these are the countries that are applying high tax rates on Chinese tire products. Brazil's deadline to impose tariffs on car tires imported from China (USD1.12 – 2.29/kg) has just expired since May 4, 2020, but there is a possibility that the tax will continue to be imposed soon. However, the competition in the US and Brazilian markets is becoming more intense with Chinese products being transshipped through ASEAN countries and China's investment in many factories in many ASEAN countries including Thailand, Malaysia and Vietnam with high capacity and low cost. Although DRC maintains the selling prices in the domestic market thanks to long-term customers such as Thaco and Hyundai, it had to lower the prices by 10-15% in export markets to maintain product competitiveness.

Table 2. Vietnam – Big foreign tire producers

Company names	Investment capital	Location	Operated since	Products	Design capacity
Advance Vietnam (China)	USD400 million	Long Giang, Tien Giang	2020	Tires for trucks, agriculture, industry	2,000,000 tires/year
Cooper Tyre & Rubber (US)	USD280 million	KCN Phuoc Đong	2020	All-steel radial tires	2,400,000 tires/year
Sailun (China)	USD 687 million	KCN Phuoc Đong	2013	Semi-steel radial tires	7,800,000 tires/year
Jinyu Vietnam (China)	USD 400 million	Trang Bang, Tay Ninh	2021	Tires for trucks, buses	2,000,000 tires/year
Bridgestone (Japan)	USD 448 million	Đinh Vu, Hai Phong	2014	Car radial tires	16,700,000 tires/year
Kumho (Korea)	USD 200 million	Binh Duong	2008	Tires for travel, SUV, light load	3,150,000 tires/year

Source: Bloomberg, KB Securities Vietnam

The US is likely to impose tariffs on tire products imported from Vietnam. We believe that the sharp increase in the volume of tire products from ASEAN countries originating from China will raise competitive pressure, and price competition may prompt the US government to launch more dumping investigations. Although the US imposes tariffs on passenger and light truck tires, there is almost no significant impact on DRC's exports to the US because the company does not export passenger and light truck tires, but there is still a potential risk if the US expands the scope of investigation if it detects unusual signs.

VALUATION

4Q20F PERFORMANCE

We forecast DRC 4Q20 earnings would reach VND95.1 billion (+17.9 YoY) on revenue of VND1,056.4 billion (+9.2 YoY, +11.6% QoQ) as the consumption demand would recover after the peak of the COVID-19 pandemic to benefit from lower registration fees for locally assembled automobiles before their validity expires and the increase in selling prices following the uptrend of raw material prices. Profit margin should improve as the business actively stockpiles low-priced raw materials and reduces depreciation expenses. Accordingly, full year profit is may be VND242.1 billion (-3.4% YoY), and revenue should be VND3,595.1 billion (-6.8% YoY).

2021F BUSINESS RESULTS

In 2021, net earnings of DCR may reach VND308.4 billion (+27.4% YoY) on revenue of VND4096.4 billion (+13.9% YoY) on the assumptions that radial tire factories operating at 94% capacity and bias tire factories operating at full capacity on higher consumption demand and a 3.5% increase in average tire price thanks to high raw material prices. Gross profit margin should be 16.5% (higher than 2020 forecast of 16.1%) mainly thanks to reducing depreciation expenses and improving production quality. FY21 EPS is VND2,596.

VALUATION

We recommend BUYING DRC shares with the target price of VND26,800, equivalent to an upside of 17% vs the closing price on November 30, 2020, based on the DCF method. DRC shares are currently being traded at FY21 P/E of 8.7x.

In the scenario that the US imposes tariffs against tires originating from Vietnam, including key export products of DRC, the target price of DRC is adjusted down to VND23,000, 0.4% higher than the current price. In that case, we forecast a 50% decrease in revenue from exports to the US due to a drop in selling prices. Accordingly, for the whole year of 2021, DRC's profit is VND257.9 billion and revenue is VND3,471.7 billion, and EPS is VND2,171.

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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