

Industry: Materials

Recommendations BUY HOA PHAT GROUP JSC (HSX: HPG)

Current price:	50,100	Report writing date:	03/03/2022	Shareholder structure	
The target price:	61,700	Outstanding Shares (Million)	4,473	Tran Dinh Long	26.1%
Dividend yield	N/A	Market capitalization (billion VND)	208,885	Vu Thi Hien	7.3%
Potential for price increase	23%	10 session trading volume	15,965,990	Dragon Capital	4.7%
		Foreign ownership	25.83%	VOF Investment Limited	3.0%

Analyst:

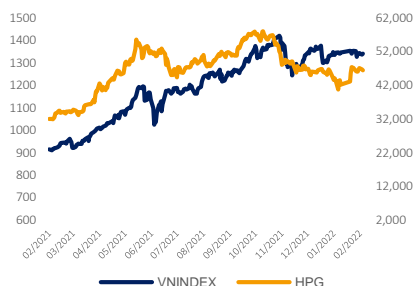
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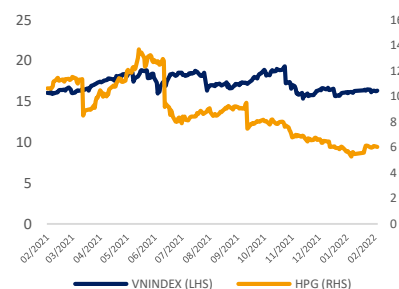
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Recommended price: 55,000 VND
Stop loss price: 46,000 VND

CP price comparison table and VN-Index



P/E and VN index comparison table



Valuation

- BSC recommends **BUY HPG** with **1-year target price of 61,700 VND/share**, equivalent to the upside potential of 23% compared to the price on 03/03/2022 based on a combination of 2 valuation methods P/E = 8.0x and EV/ EBITDA = 6.5x.

Forecasting business results

- BSC forecasts that **HPG's revenue and NPAT** in 2022 will reach **VND145,041 billion (-3.1% YoY)** and **VND36,202 billion (+4.8% YoY)**, **EPS FW = 8,071 VND/share** based on the following assumptions: (i) Total steel sales volume increases by 8.7% yoy, (ii) Adjusted steel price -10% yoy; (iii) Material prices fluctuate in the direction of Ore price -20% yoy and Coal price +10% yoy.

Investment perspective

- We expect that in 2022, HPG's domestic steel consumption will be +9.5% yoy thanks to the policy of accelerating disbursement of public investment in infrastructure; offset export growth falling to +5% yoy due to competitive pressure.
- The closed production process helps HPG maintain the same gross profit margin of the steel segment as in 2021.
- Cheap valuation with PE forward 2022 at 6.2x.

Risk

- Steel selling price fell stronger than forecast;
- Material price fluctuations affect the profit margin of the steel segment.

Business Update

- In 2021, HPG's revenue will reach VND149,680 billion (+66% yoy) and NPAT reached VND34,521 billion (+155% yoy), exceeding 91% of the plan in terms of profit in 2021. Steel segment continues to be the main contributor to business results in 2021, estimated revenue of steel segment is at VND138,471 billion, +81% yoy.
- Steel consumption volume in 2021 will grow by 52% yoy, reaching 8.8 million tons, of which the main contribution comes from finished construction steel with 3.9 million tons (+14% yoy) and HRC 2.6 million tons (x3 times yoy).

	2021	2022F	Peer	VN-Index
PE (x)	5.99	6.21	6.49	17.38
PB (x)	2.28	1.63	2.13	2.78
PS (x)	1.38	1.42	1.31	4.50
ROE (%)	38.0%	28.5%	41.4%	10.3%
ROA (%)	19.4%	16.0%	18.6%	6.3%
EV/ EBITDA (x)	5.90	N/A	7.98	29.29

	2019	2020	2021	2022 F
Net sales	63,658	90,119	149,680	145,041
Gross profit	11,185	18,904	41,108	40,948
NPAT	7,578	13,506	34,521	36,202
EPS	2,726	4,060	7,708	8,071
EPS growth	N/A	48.90%	89.88%	4.71%
Net Debt/Equity	67.2%	68.3%	38.3%	41.7%

BUSINESS UPDATE

HPG's business results in 2021 have impressive growth (Net sales is VND149,680 billion, +66% yoy and NPAT is VND34,521 billion, +156% yoy) mainly contributed by Steel business and production activities. .

Table 1: Summary of business results for 4Q2021 and for the whole year 2021

Billion VND	4Q2021	4Q2020	% yoy	2021	2020	% yoy	Note
Net Revenue	44.711	25.778	seventy three%	149,680	90,119	66%	
<i>Steel</i>	42,598	22,263	91%	140,395	76,334	84%	Net sales of steel segment grew strongly , when both crude steel output +52% yoy and average steel price +43% yoy
<i>Other industrial production</i>	-	618	-100%	-	2.505	-100%	HPG liquidated the entire furniture segment, earning a profit of VND498 billion
<i>Agriculture</i>	1,781	2.718	-34%	7,966	10.553	-25%	Agricultural revenue dropped sharply due to pork price -50% yoy. Supply increased sharply as livestock farmers re-hered and imported pork increased.
<i>Real estate</i>	332	176	89%	1.319	726	82%	Industrial land for lease in Pho Noi A (600ha), Yen My II (231ha), Hoa Mac (203ha) projects. The company also plans to increase the commercial housing land bank in localities across the country.
Gross profit	9,587	6.267	53%	41,108	18,904	117%	
<i>Gross profit margin</i>	21.4%	24.3%		27.5%	21.0%		
SG&A	1220	497	145%	3444	1781	93%	The cost of insurance increased sharply due to the increase in export costs
<i>% SG&A/Net sales</i>	2.7%	1.9%		2.3%	2.0%		
EBIT	8,367	5,770	45%	37.664	17,123	120%	
<i>Interest</i>	630	662	-5%	2.526	2.192	15%	
<i>Financial revenue</i>	857	355	141%	3,071	1.005	206%	Financial revenue increased strongly thanks to short-term financial investment +78% yoy
NPAT	7.419	4.661	59%	34,521	13,506	156%	
<i>Steel</i>	7,327	3,997	83%	33,337	11,110	200%	
<i>Other industrial production</i>	-	67	-100%	-	317	-100%	
<i>Agriculture</i>	(98)	381	-126%	719	1.678	-57%	High cost of goods, plus sudden fighting-Covid costs
<i>Real estate</i>	191	215	-11%	465	401	16%	
Steel consumption (tons)							
<i>Construction steel</i>	1,092,104	913.487	20%	3,889,683	3,400,404	14%	
<i>Steel pipe</i>	177,448	252.762	-30%	675,364	821,840	-18%	
<i>Galvanised</i>	155,710	-	N/A	428,785	-	N/A	
<i>HRC, CRC</i>	629,281	379,147	66%	2,570,419	576.622	346%	
Domestic market share							
<i>Construction steel</i>	36%	31%		36%	32%		The domestic construction steel market share grew, although the industry's output decreased due to the impact of the epidemic
<i>Steel pipe</i>	35%	35%		33%	35%		Continue to lead the market
<i>Galvanized</i>	6%	N/A		6%	N/A		HPG first supplied galvanized steel to the market but has already

					exceeded the design capacity of 400,000 tons/year	
Export share in total consumption						
Construction steel	31%	18%	26%	16%	Export activity grew strongly, +138% yoy, with 2 main product groups being construction steel (steel billet and finished products), and galvanized steel sheet.	
Steel pipe	3%	2%	4%	3%		
Galvanised	78%	N/A	69%	N/A		
Some items in the balance sheet						
Short-term debt			43.748	36.798	19%	
Long-term debt			13.465	17,343	-22%	Dung Quat Phase 1 project is completed and put into full operation in 2021, reducing long-term debt balance
Inventory			42,134	26.287	60%	
Cash, cash equivalents & Short-term investments			40,708	24.825	64%	

Source: HPG, Fiinpro, BSC Research

BUSINESS OUTLOOK 2022

STEEL CONSUMPTION GROWTH CONTINUES

The total recovery of domestic demand helps increase HPG's steel consumption volume, we forecast **+8.7% yoy in 2022**.

The total output growth of the steel industry in 2021 will reach 16.6%, but domestic consumption growth will only reach 5% due to the impact of the epidemic, of which construction steel (-10% yoy) and pipe steel (-16)% yoy) is the most affected. However, the domestic market is still the main consumption market of the steel industry.

Figure 1: The domestic market contributes the most to the total output of the industry

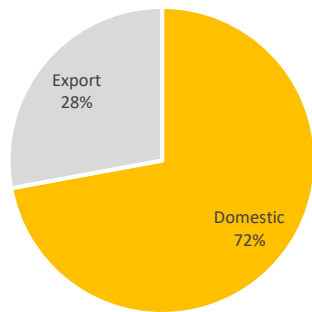


Figure 2: Output of steel products in 2021 (million tons)



Source: GSO, CBRE, BSC Research

We expect domestic steel demand to grow again, estimated at **+13.4% yoy in 2022** thanks to the motivation from the Government's policy to promote disbursement of public investment. In the program on socio-economic recovery and development in 2022 - 2023 with a scale of VND347 trillion just approved by the National Assembly, the capital allocated for infrastructure development is up to VND113 trillion (1.3% GDP), focusing on key traffic projects such as the North-South Expressway in the East, regional connection projects, industrial zones, seaports... **Therefore, We believe that public investment disbursement in 2022 could be +15%-30% yoy, helping to stimulate domestic steel demand.**

Figure 3: Disbursement of public investment is expected to grow strongly in the period 2022-2023 (trillion VND)

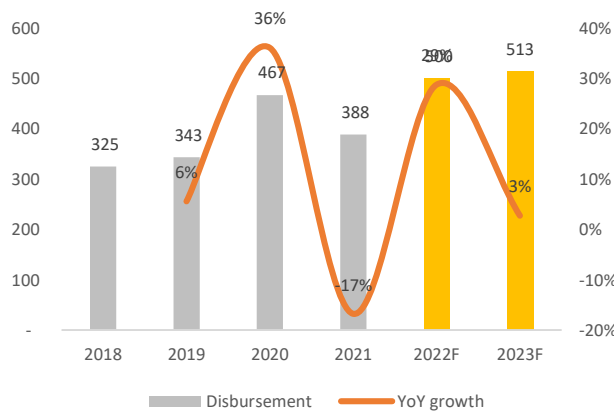
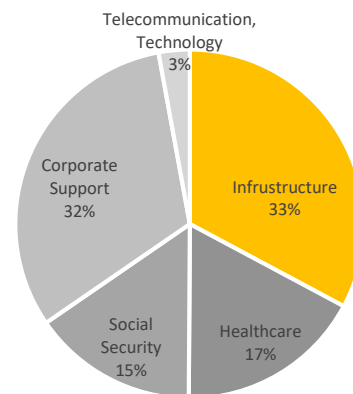


Figure 4: Infrastructure development is the focus of the economic stimulus package of VND 347 trillion



Source: GSO, BSC Research

Meanwhile, steel export activities in 2022 may be more difficult due to increased supply when countries restore production after controlling the epidemic. Increased competitive pressure, especially from China - the world's largest steel producer - made the steel price gap between Vietnam and major import markets narrow. **BSC forecasts steel export volume +5% yoy in 2022, combined domestic and export volume +10% yoy.**

Figure 5: Performance of steel mills in China increased to the highest level in the past 2 years

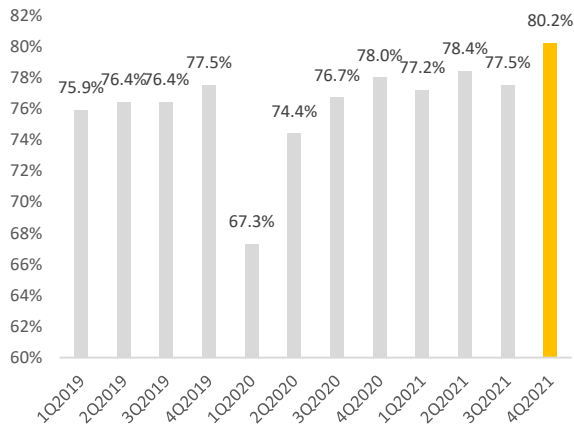
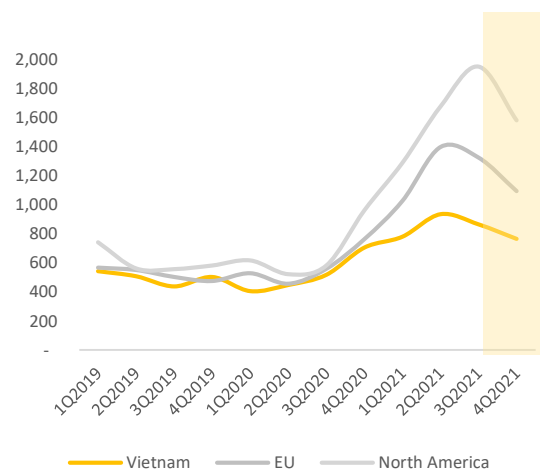


Figure 6: HRC price gap between Vietnam and major import markets narrowed in Q4/2021 (USD/ton)



Source: CNBS, Bloomberg, BSC Research

We believe that HPG is a beneficiary when the domestic market recovers thanks to: (1) the leading domestic market share in the industry (32.5% in construction steel and 24.8% in steel pipes) and (2) the ability to expand the capacity of the factory in Dung Quat Complex by 10%-15% (equivalent to an increase in output of 760,000 tons). BSC forecasts **total domestic steel consumption of HPG +9.5% yoy in 2022.**

Figure 5: Domestic construction steel market share in 2021 will grow despite a decline in industry output

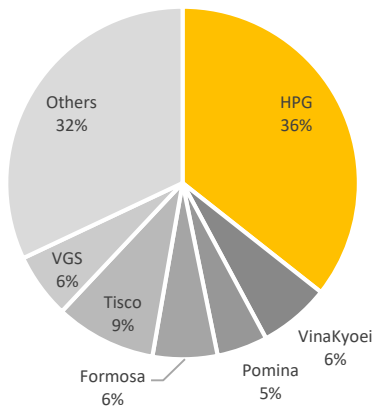
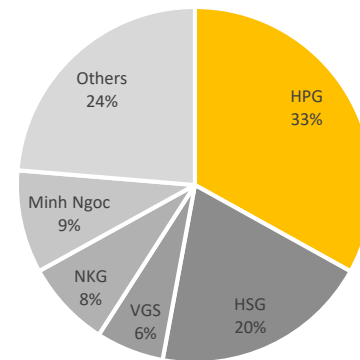


Figure 6: Domestic steel pipe market share -2% yoy but still leading the steel industry



Source: Fiinpro, VSA, BSC Research

HPG's steel exports are forecast to slow down. The export share of HPG's total output will grow in 2021 (from 12% to 18%), of which construction steel exports are the main (75%) and account for 50% of the industry's exports. 70% of HPG's galvanized steel production is consumed in the export market, but has now reached the maximum capacity threshold. **BSC forecasts that HPG's steel export output in 2022 will grow at the same rate as the whole industry, +5% yoy.**

Figure 7 : Construction steel contributes a large proportion to HPG's steel exports (in 2021)

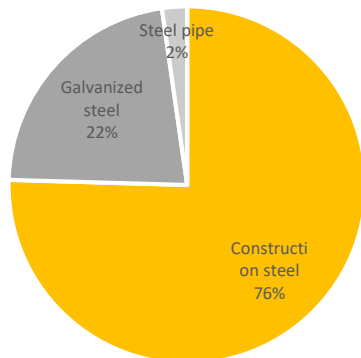
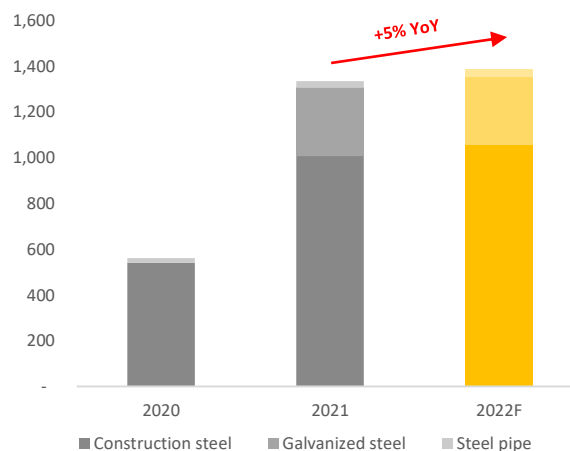


Figure 8: HPG's steel export volume forecast to increase slightly in 2022 (thousand tons)



Source: Fiinpro, VSA , BSC Research

GROSS PROFIT OF STEEL SECTOR MAINTAINS

We believe that owning a closed steel production process and the advantage of large production scale, HPG is able to maintain its profit margin at the same level as in 2021.

BSC forecasts that the average steel price in 2022 will decrease, -10% yoy, based on the following assumptions: (1) iron ore price will continue to plummet -20% yoy and (2) coke price will maintain its upward momentum, +10% yoy.

Iron ore (estimated to account for ~50% of HPG's steel production raw materials cost) : The world iron ore price depends on supply from major exporting countries such as Australia, Brazil and consumption demand from China. Ore prices have begun to fall since Q3/2021 due to concerns about China's plunging property market. However, iron ore prices have rebounded sharply by 25% since the beginning of 2022 thanks to buying power from steel producers in China, as the country has just postponed the deadline for applying emission limits to the steel industry by 5 more. year to 2030, and at the same time, Omicron strains broke out in iron ore exporting countries temporarily disrupting supply.

However, we think the downward trend in ore prices will continue in 2022 as major suppliers such as Fortescue, BHP and Rio Tinto restore mining output to pre-pandemic levels. We expect iron ore price -20% yoy, at around \$120/ton, taking into account the possibility of steel production in China recovering.

Table 2: Summary of iron ore price forecast 62% Fe, China CFR (USD/ton)

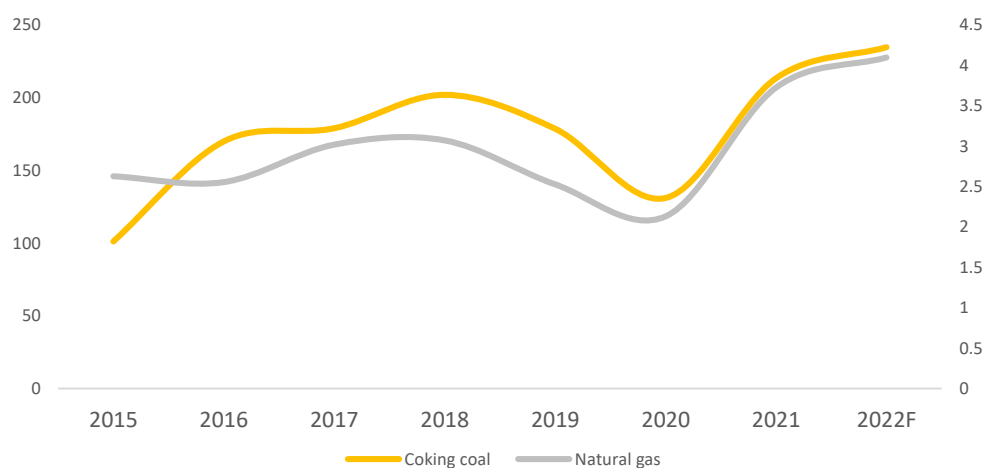
Forecasting party	Q1/2022	Q2/2022	Q3/2022	Q4/2022	Q1/2023	Q2/2023
Capital Economics Ltd	115	102	89	76	68	63
Westpac Banking Corp	134.5	120.5	101	81.5	71	67
Intesa Sanpaolo SpA	100	95	88	85	85	85
Panmure Gordon & Co PLC	120	130	120	-	-	-
Market Risk Advisory Co Ltd	120	115	115	110	110	100
MPS Capital Services Banca per le Imprese SpA	120	100	110	110	-	-
Natixis SA	90	78	82	82	75	75
Commerzbank AG	93	91	90	90	88	88

Australia & New Zealand Banking Group Ltd	124	102	88.2	85.8	85	82
Trung bình	112.9	103.7	98.1	90.0	83.1	80.0
Median	120.0	102.0	90.0	85.4	85.0	82.0

Source: Bloomberg, BSC Research

Coke: Coking coal constitutes about 30% of the steel price, with the main export supply from Australia, Indonesia, Russia, the US, South Africa... and the most consumed by China (50% of world demand). We think the price of coke in 2022 will remain high, +10% yoy because the supply of new mining is limited by commitments to environmental protection, while coal demand in China has increased sharply to solve the current power shortage. The high price of natural gas (a substitute for coal in power generation) following the price of oil is also a factor driving the coal price up.

Figure 9: Natural gas price is forecast to continue to increase in line with oil price, Coal price is forecast to continue to increase



Source: Bloomberg, BSC Research

We believe that possessing a closed steel production process and the advantage of large scale production, HPG is able to maintain profit margin according to our estimate at 25% equivalent to 2021 with the above assumptions.

CHEAP VALUE TO ACCUMULATE

HPG stock is trading at a relatively low valuation (PE = 6.2x) in its trading history due to (1) the market has certain concerns about its 2022 earnings outlook, (2) HPG also entered the phase of large fixed asset investment for Dung Quat 2 project, with an estimated capital of VND85,000 billion, including VND70,000 billion of fixed capital and VND15,000 billion of working capital.

We think a **PE = 6.2x valuation is cheap enough to accumulate** because:

- (1) Net profit remained high thanks to the advantage of large production scale and financial revenue from abundant cash source. HPG has the ability to optimize costs, helping to maintain gross profit margin as we analyzed above. In addition, reduced financial costs thanks to some loans for Dung Quat 1 project being settled and financial revenue from abundant cash will further increase HPG's profit in 2022.
- (2) HPG's financial health in this period is much better than in 2018 when investing in Dung Quat Phase1. Cash and cash equivalents & Short-term financial investment as of December 31, 2021 reached more than VND 40,000 billion, ~57% of the fixed capital of Dung Quat Phase 2 project (at the beginning of Dung Quat Phase 1 construction, only this number is only ~12%).

- (3) We believe that when Dung Quat Phase2 comes into operation from 2024, HPG's total capacity will increase by 5.6 million tons (+70%), focusing on HRC production (currently the total domestic capacity can only meet the demand. 65% of domestic demand) will help revalue HPG stock at a higher PE .

Figure 10: HPG's valuation history by PE



Source: Fiinpro, BSC Research

FORECAST OF BUSINESS RESULTS

BSC forecasts HPG's revenue and net profit in 2022 at VND145,041 billion (-3.1% YoY) and VND36,202 billion (+4.8% YoY), EPS FW = VND8,071/share based on the following assumptions: (i) Total steel consumption +8.7% yoy, (ii) Steel price -10% yoy, (iii) Fluctuation in world raw material prices caused Iron ore price -20% yoy and Coal price. +10% yoy .

VALUATION

We use two methods of P/E and EV/EBITDA (ratio 50:50) with target P/E and EV/EBITDA of 8.0x and 6.5x respectively – equivalent to the average over one period of HPG stock. We recommend **BUY** for HPG stock with a target price of **61,700 VND/share**, equivalent to a **23% upside potential** compared to the closing price on 03/03/2022.

Table 3: Valuation Summary

Valuation method	Proportion	The target price
P/E	50%	64,572
EV/EBITDA	50%	58,814
Summary of valuations		61,700

Source: BSC Research

Figure 11 : HPG's P/E ratio

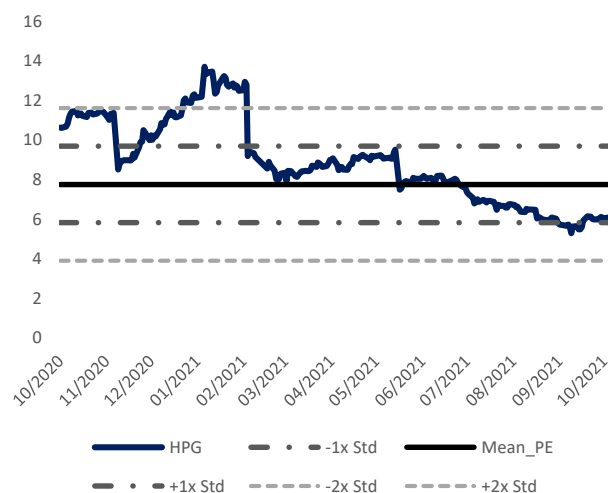
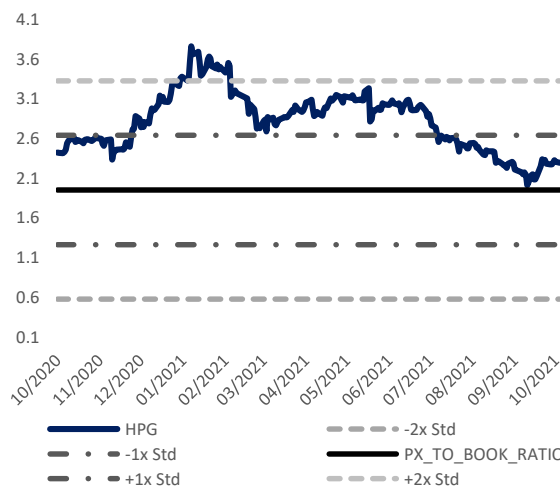


Figure 12: HPG's P/B ratio



Source: Bloomberg , BSC Research

APPENDIX

Income statement (Billion VND)	2019	2020	2021	2022F	Cashflow (Billion VND)	2019	2020	2021	2022F
Net sales	63,658	90,119	149,680	145,041	(Loss)/EBT	9,097	15,357	37,057	38,861
Cost of goods sold	52,473	71,214	108,571	104,093	Depreciation & amortization	3,262	6,575	7,487	6,574
Gross profit	11,185	18,904	41,108	40,948	Change in working capital	(4,644)	(10,345)	(17,077)	(10,077)
Selling expenses	873	1,091	2,120	2,052	CFO	7,715	11,587	27,466	35,359
G&A expenses	569	690	1,324	1,282	Purchase of fixed assets	(20,825)	(11,916)	(12,116)	(33,568)
Gross profit	9,743	17,123	37,664	37,614	Other investments	2,761	(6,580)	(8,288)	(20,158)
Financial revenue	471	1,005	3,071	3,789	CFI	(18,064)	(18,495)	(20,404)	(53,726)
Financial expenses	1,182	2,837	3,732	2,594	Dividend payment	(13)	(1,419)	(1,704)	-
Interest expenses	937	2,192	2,526	2,075	Net borrowing	12,391	17,470	3,423	14,517
Profit from joint ventures	(1)	2	4	4	Other revenues	0	3	11	-
Other profit/loss	66	65	48	48	CFF	12,378	16,054	1,729	14,517
Profit before tax	9,097	15,357	37,057	38,861	C&CE at the beginning of FY	2,516	4,545	13,696	22,471
Corporate income tax	1,518	1,851	2,536	2,659	Net increase/decrease in cash	2,029	9,146	8,792	(3,850)
Profit after tax	7,578	13,506	34,521	36,202	C&CE at the end of FY	4,545	13,690	22,488	18,622
Non-controlling interest	51	56	43	99					
NPAT - Owners	7,527	13,450	34,478	36,103					
EBITDA	12,179	21,657	42,662	43,238					
EPS	2.726	4,060	7,708	8,071					

Balance sheet (Billion VND)	2019	2020	2021	2022F	Ratio (%)	2019	2020	2021	2022F
Cash & Short-term investments	5,919	21,823	40,708	53,750	Liquidity				
Trade account receivables	3,561	6,125	7,662	9,067	Current ratio	1.13	1.09	1.28	1.48
Inventories	19,412	26,287	42,134	42,542	Quick ratio	0.41	0.59	0.71	0.90
Other current assets	1,544	2,513	3,650	3,533					
Total current assets	30,437	56,747	94,154	108,893	Capital structure				
Tangible fixed assets	30,980	65,308	68,744	70,785	Debt/Assets	53%	55%	49%	44%
Intangible fixed assets	269	254	537	520	Debt/Equity	113%	122%	96%	78%
Financial lease	-	-	-	-					
Construction in progress	37,435	6,247	10,018	40,992	Working capital				
Long-term investment	46	171	7	42	Inventory days	117	118	150	150
Other noncurrent assets	2,608	2,784	4,776	4,652	Receivable days	14	13	16	16
Total noncurrent assets	71,339	74,764	84,082	116,991	Payable days	85	71	78	75
Total Assets	101,776	131,511	178,236	225,883	CCC	46	60	53	56
Account payables	7,507	10,916	23,729	21,269					
Short-term loans	16,838	36,798	43,748	46,122	Margin				
Other current liabilities	2,639	4,261	5,983	5,983	Gross margin	18%	21%	27%	28%
Current Liabilities	26,984	51,975	73,459	73,374	NPAT margin	12%	15%	23%	25%
Long-term loans	19,842	17,343	13,465	25,608	ROE	16%	23%	38%	29%
Other noncurrent liabilities	7,163	2,973	532	532	ROA	7%	10%	19%	16%
Noncurrent liabilities	27,005	20,316	13,996	26,139					
Total Liabilities	53,989	72,292	87,456	99,513	Valuation				
Capital	27,611	33,133	44,729	44,729	PE	17.81	11.86	5.62	5.36
Capital surplus	3,212	3,212	3,212	3,212	PB	2.71	2.62	2.13	1.53
Retained earnings	15,877	21,792	41,763	77,866					
Other equity	924	934	922	922	Growth				
Non-controlling interests	163	149	155	201	Revenue growth	14%	42%	66%	-3%
Total Equity	47,787	59,220	90,780	126,929	EBIT Growth	-8%	76%	120%	0%
Total Liabilities & Equity	101,776	131,511	178,236	226,442	EBT growth	-12%	69%	141%	5%
No. of shares (million)	2,761	3,313	4,473	4,473	EPS growth	-32%	49%	90%	5%

Source: HPG, BSC Research

Disclosure

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