

HOA SEN GROUP (HSG VN)

DOWNGRADE TO SELL – TARGET PRICE VND20,000

Poor results could well continue

HSG's estimated FY2010 results, announced by management at its Sept 18th EGM, are shockingly poor. Volumes at 264k tonnes are 8% lower than planned, revenues at VND4837bn are 3% below plan, and net profit at VND190bn is 63% below plan. Mekong slashes its forecasts for net profit by 42%, 74% and 60% respectively for years 2010-12.

Management blames its VND396bn gross profit shortfall on: (a) expensive inventory versus lower selling prices – VND242bn; (b) power cuts and the unplanned maintenance shutdown of a non-oxidising furnace – VND143bn; and (c) VND11bn due to deviation from expected sales mix.

Financial expenses increased to VND358bn (FY09: 166bn), of which interest expense was VND165bn (FY09: 80bn) and forex loss VND193bn on 8.5% dong devaluation in FY10 (FY09: 86bn on 6.3% devaluation). Short-term and long-term loans increased by 153% and 46% respectively YoY in order to finance sufficient raw material for the expanding output (the latter up 59% YoY in FY10).

As a result, HSG is temporarily delaying its VND850bn Phase II of Hoa Sen Phu My, comprising three production lines of cold rolled coil and one of thin galvanized steel sheet. Other projects such as the hot rolled coil plant and Hoa Sen – Gemadept Port (in Vung Tau) are also put on hold. HSG is sticking with its branch expansion plan with funding of VND633bn till 2015. In order to obtain funding resources, HSG has a new plan to issue bonds worth up to VND1trn, with 40%-50% for Hoa Sen Phu My, 30% for distribution expansion and the remainder for current assets.

Management is confident of re-boosting margins with the two new CRC production lines coming into operation (Jan 2011 and Dec 2011 respectively), and new inventory of 40,000 HRC tonnes (enough for two months of production; HSG currently holds a relatively low 57,000 tonnes in total) recently having been bought at the advantageous price of \$615/ton (versus c. \$700 average for FY10; current price \$620). However, there is no sign as yet of any recovery in steel prices. With the PER for FY2010 and FY2011 at 11.8x and 9.9x respectively (compared to VN industry trailing average of 8.6x, and for example POSCO's 7.8x), we downgrade to Sell (from Buy) at least until we detect a sustained end to monthly losses.

The stock is only off 8% since the earnings shock. It deserves to be off much more than this. Although the management has a reputation for openness, their miss by such a wide margin puts their current informal guidance to analysts into doubt.

(Yrs ending Sept)	2008	2009	2010E	2011F	2012E	2013E	2014E
Sales (VND bn)	2,055	2,831	4,790	6,564	8,794	10,679	12,050
EBITDA (VND bn)	391	452	659	1,079	1,457	1,830	2,040
Net income (VND bn)	198	189	190	262	528	895	1,072
Sales growth (%)	2.0%	37.8%	69.2%	37.0%	34.0%	21.4%	12.8%
ROE (%)	25.8%	21.5%	15.1%	15.4%	26.3%	35.1%	31.9%
ROA (%)	16.7%	15.3%	17.0%	17.9%	21.5%	25.0%	26.1%
EPS (VND)	3,478	3,321	1,896	2,269	4,577	7,756	9,298
BVPS (VND)	14,313	16,594	15,646	15,874	18,951	25,207	33,005
PER (times)	6.47	6.77	11.87	9.92	4.92	2.90	2.42
PBR (times)	1.57	1.36	1.44	1.42	1.19	0.89	0.68

FY2008 shown above is only for the nine months to 30/9/08

Duong Pham

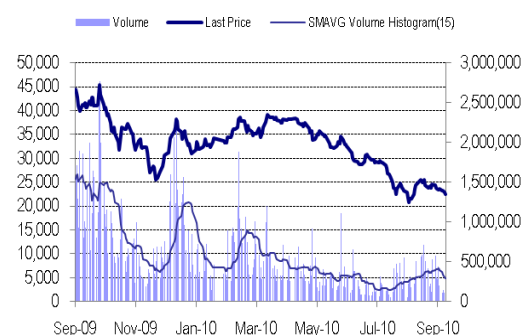
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Company Coverage

Recommendation	SELL			
	HOSE: HSG Steel sector			
Price (VND)	22,500			
Price target (VND)	20,000			
Expected share price return (%)	-11%			
Expected dividend yield (%)	Nil			
Expected total return (%)	-11%			
Stock performance (%)				
	YTD	1m	3m	12m
Abs	-37%	-5%	-25%	-47%
Rel	-28%	-4%	-16%	-32%

Source: Bloomberg



Ownership Structure	30-Sep-10
Chairman	38.71%
Foreigners	17.79%
Others	43.50%

Stock Statistics	30-Sep-10
Bloomberg code	HSG VN
52-week range (VND)	20,700 – 45,400
Shares O/S (m)	100
Mkt cap (VND bn)	2,256
Mkt cap (USD m)	116
Foreign room (%)	31.21%
Est. free float (m)	62
3m avg daily vol (shrs)	259,307
VND/USD	19,500
Index: VNIndex / HNX	454/127

Source: Bloomberg

Financials

HSG FINANCIALS MODEL	Price (VND):	22,500	Target (VND):	24,041	Mkt cap:	2,256,750	SELL		
Analyst	Duong Pham								
(VND mil except where stated)	FY2006	FY2007	FY2008	FY2009	FY2010E	FY2011F	FY2012F	FY2013F	FY2014F
Steel sheet						2,919,928	4,031,368	4,772,328	5,513,288
Steel pipe and HGI						3,471,600	4,762,725	5,906,381	6,536,527
Plastic pipe and others						172,480	172,480	172,480	172,480
Total Net Sales	1,111,197	2,015,691	2,055,045	2,831,419	4,790,028	6,564,008	8,794,093	10,678,709	12,049,815
<i>Sales growth (%)</i>	<i>48.2%</i>	<i>81.4%</i>	<i>2.0%</i>	<i>37.8%</i>	<i>69.2%</i>	<i>37.0%</i>	<i>34.0%</i>	<i>21.4%</i>	<i>12.8%</i>
CoGS ex-dep'n	912,069	1,619,538	1,487,215	2,164,948	3,768,886	4,988,856	6,672,283	8,041,643	9,098,405
Gross profit	185,766	350,755	501,530	555,320	895,735	1,312,802	1,846,760	2,349,316	2,650,959
<i>Gross profit margin (%)</i>	<i>16.7%</i>	<i>17.4%</i>	<i>24.4%</i>	<i>19.6%</i>	<i>18.7%</i>	<i>20.0%</i>	<i>21.0%</i>	<i>22.0%</i>	<i>22.0%</i>
SG&A	58,588	135,337	176,567	214,458	362,126	496,239	664,833	807,310	910,966
<i>SG&A as % of sales</i>	<i>5.3%</i>	<i>6.7%</i>	<i>8.6%</i>	<i>7.6%</i>	<i>7.6%</i>	<i>7.6%</i>	<i>7.6%</i>	<i>7.6%</i>	<i>7.6%</i>
EBITDA	140,539	260,816	391,263	452,013	659,016	1,078,913	1,456,977	1,829,756	2,040,444
<i>EBITDA margin (%)</i>	<i>12.6%</i>	<i>12.9%</i>	<i>19.0%</i>	<i>16.0%</i>	<i>13.8%</i>	<i>16.4%</i>	<i>16.6%</i>	<i>17.1%</i>	<i>16.9%</i>
<i>EBITDA growth rate (%)</i>	<i>204.5%</i>	<i>85.6%</i>	<i>50.0%</i>	<i>15.5%</i>	<i>45.8%</i>	<i>63.7%</i>	<i>35.0%</i>	<i>25.6%</i>	<i>11.5%</i>
Depreciation	13,361	45,399	66,301	111,152	125,407	262,351	275,051	287,751	300,451
Bad debt provs, other costs (net)	0	0	0	0	0	0	0	0	0
Other Income (net)	4,337	(3,775)	(3,277)	11,704	30,000	15,000	-	-	-
Operating profit	131,514	211,642	321,686	352,565	563,609	831,563	1,181,926	1,542,006	1,739,993
<i>Operating profit margin (%)</i>	<i>11.8%</i>	<i>10.5%</i>	<i>15.7%</i>	<i>12.5%</i>	<i>11.8%</i>	<i>12.7%</i>	<i>13.4%</i>	<i>14.4%</i>	<i>14.4%</i>

Finance Income, net	(2,492)	7,565	(29,565)	(71,836)	(193,000)	(214,680)	(252,869)	(258,021)	(246,308)
Net interest expenses	20,131	51,689	79,692	80,339	165,000	333,970	358,332	316,810	231,973
<i>Interest as % of avg net debt</i>	<i>7.0%</i>	<i>8.5%</i>	<i>8.5%</i>	<i>7.5%</i>	<i>14.2%</i>	<i>18.6%</i>	<i>13.5%</i>	<i>10.6%</i>	<i>8.1%</i>
<i>Interest cover (x)</i>	<i>6.5</i>	<i>4.1</i>	<i>4.0</i>	<i>4.4</i>	<i>3.4</i>	<i>2.5</i>	<i>3.3</i>	<i>4.9</i>	<i>7.5</i>
Tax	4,310	16,395	14,058	10,938	15,421	21,218	42,804	72,538	189,257
<i>Effective tax rate (%)</i>	<i>3.96%</i>	<i>9.79%</i>	<i>6.62%</i>	<i>5.46%</i>	<i>7.50%</i>	<i>7.50%</i>	<i>7.50%</i>	<i>7.50%</i>	<i>15.00%</i>
Minorities	0	0	0	0	0	0	0	0	0
Net profit	104,582	151,123	198,371	189,451	190,188	261,694	527,921	894,637	1,072,455
Cash earnings	117,943	196,522	264,672	300,603	315,595	524,045	802,972	1,182,388	1,372,906
Number of shares (m)	25	57	57	57	100	115	115	115	115
EPS (VND)	4,127	2,649	3,478	3,321	1,896	2,269	4,577	7,756	9,298
<i>EPS growth (%)</i>	<i>154.7%</i>	<i>-35.8%</i>	<i>31.3%</i>	<i>-4.5%</i>	<i>-42.9%</i>	<i>19.6%</i>	<i>101.7%</i>	<i>69.5%</i>	<i>19.9%</i>
Cash EPS (VND)	4,654	3,445	4,640	5,270	3,147	4,543	6,961	10,251	11,903
Key cashflow and balance sheet items	FY2006	FY2007	FY2008	FY2009	FY2010E	FY2011F	FY2012F	2013e	2013e
Increase in working capital	-39,984	209,004	-112,643	-29,384	540,231	603,027	1,145,977	947,284	715,563
Capex inc acquisitions	300,325	460,280	215,853	276,481	425,688	978,000	127,000	127,000	127,000
Other cashflow items	0	0	0	0	0	0	0	0	0
Free cash flow	(142,397)	(472,763)	161,463	53,506	(650,324)	(1,056,982)	(470,006)	108,103	530,342
Share issues (m)	133,400	316,985	0	0	432,615	0	0	0	0
Dividends paid	(124,510)	(87,617)	(61,388)	(56,311)	0	0	(173,018)	(173,018)	(173,018)
Increase in net debt	133,507	243,395	-100,075	2,806	217,709	1,056,982	643,023	64,914	-357,325
Net debt, end of year	433,633	784,576	1,095,616	1,049,523	1,267,231	2,324,213	2,967,237	3,032,151	2,674,826
Enterprise value	2,690,383	3,041,326	3,352,366	3,306,273	3,523,981	4,580,963	5,223,987	5,288,901	4,931,576
Shareholders' equity	261,416	723,355	816,390	946,481	1,569,284	1,830,978	2,185,882	2,907,501	3,806,939
BVPS (VND)	10,316	12,682	14,313	16,594	15,646	15,874	18,951	25,207	33,005
<i>Net debt / equity (%)</i>	<i>165.9%</i>	<i>108.5%</i>	<i>134.2%</i>	<i>110.9%</i>	<i>80.8%</i>	<i>126.9%</i>	<i>135.7%</i>	<i>104.3%</i>	<i>70.3%</i>

<i>Net debt / EBITDA (x)</i>	3.1	3.0	2.8	2.3	1.9	2.2	2.0	1.7	1.3
Total assets	818,571	1,698,368	2,160,060	2,438,773	4,193,965	5,100,342	5,873,228	6,466,014	6,856,859

Key return and valuation ratios	FY2006	FY2007	FY2008	FY2009	FY2010E	FY2011F	FY2012F	FY2013F	FY2014F
<i>ROE (%)</i>	52.9%	30.7%	25.8%	21.5%	15.1%	15.4%	26.3%	35.1%	31.9%
<i>ROA (%)</i>	22.1%	16.8%	16.7%	15.3%	17.0%	17.9%	21.5%	25.0%	26.1%
<i>ROIC (%)</i>	12.9%	9.2%	9.4%	7.9%	8.2%	11.2%	14.6%	18.4%	18.8%
<i>WACC (%)</i>	14.5%	15.3%	15.0%	15.3%	14.8%	15.0%	15.1%	15.9%	16.8%
<i>EVA (%)</i>	-1.6%	-6.2%	-5.6%	-7.3%	-6.7%	-3.8%	-0.5%	2.5%	2.0%
<i>PER (x)</i>	5.5	8.5	6.5	6.8	11.9	9.9	4.9	2.9	2.4
<i>EV/EBITDA (x)</i>	19.1	11.7	8.6	7.3	5.3	4.2	3.6	2.9	2.4
<i>EV/FCF (x)</i>	-18.9	-6.4	20.8	61.8	-5.4	-4.3	-11.1	48.9	9.3
<i>PBR (x)</i>	2.2	1.8	1.6	1.4	1.4	1.4	1.2	0.9	0.7
<i>PSR (x)</i>	2.0	1.1	1.1	0.8	0.5	0.3	0.3	0.2	0.2
<i>EV/sales (x)</i>	2.4	1.5	1.6	1.2	0.7	0.7	0.6	0.5	0.4
NOPAT	126,309	190,928	300,398	333,321	521,338	769,195	1,093,282	1,426,355	1,478,994

DCF Financial model	FY2006	FY2007	FY2008	FY2009	FY2010E	FY2011F	FY2012F	FY2013F	FY2014F
FCF	(120,670)	(432,958)	263,489	197,375	(319,174)	(549,481)	95,355	639,822	936,882
Discount factor						1.00	1.15	1.33	1.56
Present value of given year's FCF						(549,481)	82,819	479,669	601,270
PV of FCF 2010-14						614,278			
Terminal growth rate						3%			
PV of terminal value						4,482,911			
DCF valuation per share (VND)						24,041			

Mekong Securities' Rating System

We currently use a three-tier recommendation system for the stocks in our formal coverage: BUY, HOLD, or SELL.

A **BUY** is applied when the expected total return over the next twelve months is at least 10%.

A **HOLD** is applied when the expected total return over the next twelve months ranges between -10% to 10%.

A **SELL** is applied when the expected total return over the next twelve months is -10% or worse.

These benchmarks are subject to change.

Expected Total Return (12 months) = $[(\text{Target Price} - \text{Current Price}) / \text{Current Price}] + \text{Forecast 12-month Dividend Yield}$.

Our Analyst's Methodology

Target price and expected total return

Initially, an analyst derives an expected 12-month target price using multiple valuation methodologies. Different valuation methods have been used, including, but not limited to, discounted free cash-flow and comparative analysis. The selection of methods depends on the industry, the company, the nature of the stock and other circumstances. Company valuations are based on a single or a combination of one of the following valuation methods: 1) **Multiple-based models** (P/E, P/cash flow, EV/sales, EV/EBIT, EV/EBITA, EV/EBITDA), peer-group comparisons, and historical valuation approaches; 2) **Discount models** (DCF, DVMA, DDM); 3) **Break-up value approaches** or asset-based evaluation methods; and 4) **Economic profit approaches** (Residual Income, EVA).

Valuation models are dependent on macroeconomic factors, such as GDP growth, interest rates, exchange rates, raw materials, on other assumptions about the economy, as well as risks inherent to the company under review. Furthermore, market sentiment may affect the valuation of companies. Valuations are also based on expectations that might change rapidly and without notice, depending on developments specific to individual industries.

Once analysts derive a risk-adjusted valuation for a company under review, its current market price is then compared with the target price to calculate an expected gain or loss. The one-year projected dividend yield, if any, is then added to the expected gain or loss to calculate an expected total return.

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