

# Dai Thien Loc (HSX: DTL)

## Initiation

14 April 2011

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**HOLD**

**Target price** 22,600  
**Upside** 10%

Steel

### Key Indicators

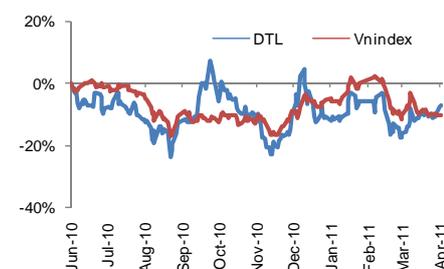
Price @ 13 April 2011	20,600
52-week low	16,700
52-week high	23,000
Average 10 day trading value	142,577
Outstanding shares	48,487,470
Market capitalization (VND bn.)	990
Market capitalization (USD mn.)	48
Foreign ownership	0.8%

Valuation	2009	2010	2011
Restated EPS (VND)	2,759	3,628	3,748
EPS growth (%)	2.7	5.2	3.3
P/E	8.4x	6.0x	5.5x
P/B	1.5x	1.4x	1.1x
ROE (%)	34.7	23.9	22.7
ROIC (%)	13.1	17.2	16.5
Debt/Equity	0.7	1.3	1.4
Dividend yield	n/a	0.15	0.17

*Note: valuation is calculated on fully diluted basis, assuming that the convertible bonds of VND100billion will be converted successfully in 2011 at conversion price of VND16,867 per share.*

Price performance	1M	3M	6M
Absolute %	10.9	5.9	-3.3
Relative %	11.4	11.0	-4.7

### Price performance vs. VNIndex



### Ownership structure

Chairman	33.6%
Management	16.7%
Foreign investors	0.8%
Other investors	48.9%

See important disclosure at the end of this document

## DTL – moving up its value chain

We initiate on Dai Thien Loc (HSX: DTL), a local mid-scale flat steel producer, with a **HOLD** rating given a combination of high prospect of flat steel demand, DTL's capacity expansion and positive earnings on low cost inventory this year. Our target price of VND22,600 which is based on a justified PER of 6.0x, suggests a 10% upside to the current market price of VND20,600.

### Expanded production lines should help produce a wider range of products, fuelling DTL's revenue growth and improving margins

When the new cold rolled coil (CRC) processing lines and additional galvanizing and coating lines go into operation in 2H2011, the company's total capacity will increase fivefold. The company will be able to enhance output on providing a wide range of zinc/aluminium galvanized and colour coated steel products.

We expect margins to improve as the company produces CRC from imported hot rolled coil (HRC) instead of depending on imported CRC. The margin improvement will come from (1) imported price of HRC, typically 10-15% lower than CRC on average (2) import tax savings, current import duty on HRC is 0% cf. 7% on CRC.

### Profitability driven mainly by core business but 50% contributed by steel trading activities

Steel trading still accounts for 50% of the company's total revenue. However, as output increases on expanded capacity we expect lower-margin steel trading to contribute a smaller share of total revenue. In addition, management intends to increase the share of exports-to-revenue from the current 20%. Exports revenue in USD will help partially offset the company's needs for greenback to import raw materials.

### DTL benefits from low cost inventory in this year; remarkable earnings in Q1 2011 could be recorded on strong rise of global HRC prices

The company had VND1,450 billion worth of inventory by the end of 2010. Since then, the average price of global HRC has surged 17% compared to that in 2010 which could translate into significant unrealized gain on its inventory. We estimate the unrealized gain on the difference between the market value and cost of its inventory at about VND130billion. Accordingly, management estimates net income of VND92billion in Q1FY2011 on (1) strong output in Q1FY2011; and (2) low cost inventory in Q1FY2011.

### Alternative energy to enhance cost savings

DTL will use compressed natural gas (CNG) for most of its production which will save 30% compared to using electricity or petrol. Though the energy cost does not account for a large percentage of total production costs, using CNG will save costs and ensure sufficient energy supply for DTL's production.

**Corporate income taxes (CIT) incentives.** The company will pay a CIT of 15% through 2013. Thanks to the strong growth of the flat steel segment and extended capacities in 2011, we believe the company should see top line growth of c.30% with revenue reaching VND2,330 billion. However, large inventory and rising borrowing costs may impede earnings growth which we estimate at c.9% as net income reach VND204 billion. Further, we expect FY2011 EPS growth to drop to c.3% on account of the capital increase from convertible bond.

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## Company description

Established in 2001, Dai Thien Loc (HSX: DTL) is a mid-scale flat steel company specialized in manufacturing and trading of galvanized and colour-coated steel. Management bought its first galvanizing line in 2003 with an annual capacity of 60,000 tons, and has consistently invested in capacity expansion. In 2008, the company expanded into colour-coating with a production line of 45,000 tons per annum. The company has invested in upstream production (cold rolled coil production) and increased capacity of galvanized steel to enhance profit margin and increase product range to meet rapid demand growth.

In 2011, the company will complete five more production lines that will have a total annual capacity of 440,000 tons of cold rolled coil and 270,000 tons of galvanized steel per annum.

At its current galvanized/coated steel production of 12,000 tons/month, DTL is one of the six largest galvanized steel producers. Other key players in this segment include HSG, Sun Steel, Blue Scope, and Phuong Nam Steel Corporation.

### DTL's capacities:

Lines	Current annual capacity (tons)	Additional annual capacity (tons)	Operation	Annual capacity (tons)
Zinc galvanized steel	140,000	-	-	140,000
Color coated steel	45,000	85,000	Expected in 2H2011	150,000
Cold roll coil processing		440,000	Expected in 2H2011	440,000
Zinc-Aluminum galvanized steel		270,000	Expected in 2H2011	270,000

Source: DTL

### 2010 Financial performance

In 2010, the company produced around 90,000 tons and posted VND1,809 billion revenue, recording an annual growth of 18.1% while net profit increased 40.2% YoY to VND176billion. Net margin improved to 10.4% in 2010 from 8.7% in 2009 on account of: (1) the new zinc galvanizing line which began operation in April 2010; and (2) low cost inventories which DTL had built up at the end of 2009, and helped the company maintain healthy growth in 2010. Additionally, average HRC/CRC prices jumped 27% in 2010 compared to the average prices in 2009 which also helped the firm improve its bottom line.

## Earnings Outlook

We are positive on the sales growth of DTL in 2011 thanks to the strong growth of the flat steel segment and extended capacities in 2011 and believe the company should see top line growth of c.30% this year. However, a number of factors may impede net income growth, which we estimate at c.9% YoY:

- (1) Excess inventory may bear the risk of high volatility of steel prices and increase the company's working capital requirements.
- (2) Rising borrowing costs due to high borrowing rates and higher level of borrowing to finance more working capital requirements and investment capital are likely to hurt the company's earnings in FY11. We estimate total interest expenses can rise 200% in 2011. With the current sales/inventory of 1.2x and DTL's management sales forecasts

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of VND2,500 billion in 2011, we estimate that DTL's short term borrowings will increase to above VND1,000 billion in 2011 from VND920 billion as of 31 Dec 2010. The company's remaining capital requirement for its projects in progress is VND300billion will be financed by bank loans or bond issuances. We estimate the long term debt increase to VND400billion from VND114billion as of 31 December 2010.

Key financial indicators	2009A	2010A	2011F
Sales (VND mn.)	1,532	1,809	2,330
Gross profit (VND mn.)	211	357	459
Net profit (VND mn.)	134	188	204
Sales growth (%)	12.7%	18.1%	28.8%
Net profit growth (%)	42.0%	40.2%	8.7%
Restated EPS (VND)	2,759	3,628	3,748
EPS growth (%)	2.7%	5.2%	3.3%
ROE (%)	34.7%	23.9%	22.7%
ROIC	10.0%	10.2%	8.3%
Debt/equity	0.7	1.3	1.4
PE @ market price of VND20,600 per share	8.4	6.0	5.5
PB	1.5	1.4	1.1
Dividend yield	n/a	15%	17%

(\*The calculation is on fully diluted basis, assuming that the convertible bonds of VND100billion will be converted successfully in 2011 at conversion price of VND16,867 per share.

Source: DTL, VCSC

## FY11 EPS will be diluted on capital increase from convertible bond

We assume that VND100billion convertible bonds will be exercised in 2011 as the conversion is still lower than the market prices of the share. So, the equity will be increased by VND59 billion from VND100 billion convertible bonds at a conversion price of VND16,867 per share. Therefore, FY11 EPS is estimated to grow by only 3.3% in 2011.

## Financing activities

For its ongoing projects, DTL has an investment capital requirement of c.VND300 billion which it may finance by issuing convertible bonds or through bank financing.

## Ownership and dividend policies

Low liquidity is of an issue as the stock is tightly held with the chairman, Mr. Nguyen Thanh Nghia and his family members owning 70% interest of DTL. The remaining shares are held by other local institutions and individuals while foreign investors hold a total 0.77% of the company. The 30-day average trading volume is about 140,000 shares per day, equivalent to 0.3% of total listed share amount that was rather low liquidity.

The company provided an attractive c.15% dividend yield with a VND3,000 per share cash dividend in 2010. Management intends to increase the cash dividend to VND3,500 per share in 2011, an impressive c.17% dividend yield at the stock's current market price. We note that the company still needs capital for expansion, and that the high dividend yield

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policy may be a means to attract investors to mobilize funds through a convertible bond issuance later this year. However, the typically high earnings volatility of steel companies may mean that dividend policies will be volatile as well.

## Valuation and risks

The stock is trading at 5.5x FY11E EPS of VND3,748 which represents a 25% discount against the local steel sector PER. The steel industry average PER for FY11E earnings is 7.5x. On account of key challenges explained below, we apply a 20% discount to the sector average to arrive at justified PER of 6.0x for DTL. We initiate on DTL with a **HOLD** rating and a PE-derived target price of VND22,600 which suggests a 10% upside to the current market price of VND20,600.

We applied a 20% discount to the sector average in order to reflect the following key risks:

- (1) Imported CRC or HRC prices volatility. DTL maintained excess inventory which bears risks of higher volatility should steel prices fluctuate.
- (2) Strained borrowing costs in 2011. DTL is likely to increase its level of borrowings to finance higher working capital demand and rising investment capital.
- (3) Slower demand growth may affect DTL's utilization rate as capacity is expanded considerably in 2H2011.

The local flat steel segment will enjoy higher growth in the coming years as it is supported by discretionary consumer spending such as automobiles, machinery and equipments and other industries. However, the rapid expansion of leading players such as HSG, Sun Steel, Blue Scope and Phuong Nam in galvanized steel segment made the galvanized steel segment become more competitive in short term. Therefore, DTL should be well-prepared for the distribution and selling plan after increasing capacity in this year as well as reduce the inventory level to have better working capital management as well as limit the market risks of raw material price volatility.

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## DTL: Summary of Financials

Income (bn VND)	2010	2011F	2012F
<b>Net Revenue</b>	1,809	2,330	2,610
Cost of Goods Sold	(1,454)	(1,871)	(2,114)
<b>Gross Profit</b>	<b>355</b>	<b>459</b>	<b>496</b>
Selling Expenses	(14)	(19)	(21)
Administrative Expenses	(26)	(34)	(38)
<b>Operating Profit</b>	<b>314</b>	<b>406</b>	<b>437</b>
Interest expenses	(80)	(213)	(228)
Other Income	(29)	(16)	(12)
<b>Profit before tax</b>	<b>208</b>	<b>177</b>	<b>197</b>
Corporate Income tax	(20)	27	29
<b>Net Income</b>	<b>188</b>	<b>204</b>	<b>226</b>
<b>EBITDA</b>	<b>325.8</b>	<b>429.8</b>	<b>463.1</b>
Depreciation & Amortization	(9.9)	(23.3)	(26.1)
<b>Growth</b>	<b>2010</b>	<b>2011F</b>	<b>2012F</b>
Revenue growth	18.1%	28.8%	12.0%
EBITDA growth	79.3%	31.9%	7.7%
EBIT growth	80.8%	28.5%	7.5%
Net income growth	40.2%	8.7%	10.9%
EPS growth	5.2%	3.3%	10.9%
Gross margin	19.7%	19.7%	19.0%
Net profit margin	10.4%	8.8%	8.7%
EPS (VND)	3,628	3,748	4,155
BVPS (VND)	16,457	18,377	20,870
<b>Indicators</b>	<b>2010</b>	<b>2011F</b>	<b>2012F</b>
<b>Liquidity Ratios</b>			
Current Ratio	1.5	1.8	1.8
Quick Ratio	0.1	0.2	0.2
<b>Profitability Ratios</b>			
ROE	23.5%	20.4%	19.9%
ROA	9.5%	7.8%	7.7%
ROIC	17.1%	16.6%	15.8%
<b>Efficiency Ratios</b>			
Days Receivables	12	13	13
Days Inventory	364	330	330
Days Payables	23	28	28
<b>Leverage Ratios</b>			
Debt/Equity	1.3	1.4	1.4
Debt/Capital Employed	0.6	0.6	0.6
<b>Valuation</b>	<b>2010</b>	<b>2011F</b>	<b>2012F</b>
At market price of	20,600	20,600	20,600
P/E	5.7	5.5	5.0
P/B	1.3	1.1	1.0
EV/EBITDA	(0.1)	(0.1)	(0.1)
Dividend yield	15%	17%	12%
At target price of	21,900	21,900	21,900
P/E	6.0	5.8	5.3
P/B	1.3	1.2	1.0
EV/EBITDA	0.1	0.1	0.1

Balance (bn VND)	2010	2011F	2012F
Cash & Equivalents	9	116	130
ST Financial Investments	2	2	2
Accounts Receivable	62	81	90
Inventories	1,450	1,691	1,911
Other Current Assets	96	96	96
<b>Current Assets</b>	<b>1,618</b>	<b>1,986</b>	<b>2,229</b>
Fixed Assets (At Cost)	322	602	732
Accumulated Depreciation	(28)	(51)	(77)
LT Investments	-	-	-
Other LT assets	66	66	66
<b>Long-term assets</b>	<b>360</b>	<b>617</b>	<b>721</b>
<b>Total assets</b>	<b>1,978</b>	<b>2,603</b>	<b>2,950</b>
ST Debts	921	889	1,012
Accounts Payables	90	143	162
Other Short-Term Liabilities	55	71	80
<b>Current Liabilities</b>	<b>1,066</b>	<b>1,103</b>	<b>1,254</b>
LT Debts	114	558	620
Other LT Liabilities	0	0	0
<b>Total liabilities</b>	<b>1,180</b>	<b>1,662</b>	<b>1,874</b>
Charter Capital	485	544	544
Capital Surplus	151	151	151
Retained Earnings	162	305	440
Minority Interest	-	-	-
<b>Total Equity</b>	<b>798</b>	<b>1,000</b>	<b>1,136</b>
<b>Total Liabilities &amp; Equity</b>	<b>1,978</b>	<b>2,662</b>	<b>3,010</b>
<b>Cash flow (bn VND)</b>	<b>2010</b>	<b>2011F</b>	<b>2012F</b>
<b>Net Income</b>	176	204	226
Depreciation & Amortization	10	23	26
Other Non-Cash Adjustments	47	-	-
Changes in Non-Cash Capital	(218)	(191)	(202)
<b>Cash From Operating Activities</b>	<b>15</b>	<b>36</b>	<b>50</b>
Disposal of Fixed Assets	-	-	-
Capital Expenditures	(113)	(280)	(130)
Increase (decrease) in Investments	-	-	-
Other Investing Activities	(4)	-	-
<b>Cash From Investing Activities</b>	<b>(117)</b>	<b>(280)</b>	<b>(130)</b>
Dividends Paid	(48)	(61)	(90)
Increase (Decrease) in Capital Stocks	100	-	-
Change in Short-Term Borrowings	-	-	-
Increase (Decrease) in LT Borrowings	58	-	-
Other Financing Activities	(16)	-	-
<b>Cash from Financing Activities</b>	<b>110</b>	<b>351</b>	<b>94</b>
<b>Total Cash Flow</b>	<b>8</b>	<b>108</b>	<b>14</b>

Source: DTL's Unaudited 2010 Financial Statements, VCSC forecast

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