Sector Note

Steel

Light at the end of tunnel

- Most of the listed steel companies recorded better 1Q23 net profit compared to the previous two quarters.
- China HRC steel prices have subdued 9% from the peak in mid-Mar 2023 and are expected to continue falling in the coming months due to weak demand.
- Operating profit of steel companies is expected to be positive in 2Q23. However, 2H23 prospects remain challenging as steel prices drop recently and demand recovers slowly.

The toughest time passed but the best yet to come

We attended the 2023 Annual General Meeting (AGM) of listed steel companies, notably most of their managements have a more positive view of the industry's outlook that 2H22 was the hardest time, but then outlook has gradually improved in 1Q23 and will turn better since 2Q23F. All companies have set FY23F business guidance with positive profit, much more positive than two consecutive quarters of losses in 2H22. However, steel demand will remain weak throughout 2023, making it very challenging for steel companies to complete their full-year business plan.

Positive 1Q23 business results thanks to higher steel selling prices and inventory provision reversal

In 1Q23, steel companies recorded a plunge in business results yoy; however, net profit improved significantly compared to the two previous quarters. We think this trend is mainly due to: (1) the average selling price of Vietnam's construction steel and HRC in 1Q23 was VND15.9m/tonne (-7% yoy/+6% qoq) and US$660/tonne (-20% yoy/ +18% qoq), respectively; (2) the increase in the steel selling price in 1Q23 helped steel companies record an inventory provision reversal; (3) 1Q23 interest expense climbed yoy reflecting the increased cost of debt and (4) the exchange rate was more favorable and steel companies actively reduced foreign currency debts in 1Q23, which helped to narrow their net exchange rate loss compared to 2H22.

The weak housing market still cast a shadow over the recovery prospect of steel makers in 2H23F

Vietnam's steel demand is highly dependent on the residential property industry, which accounts for around 60- 65% of the country's total steel consumption. On April 3, 2023, the Government issued Decree No.10/2023/ND-CP, which will help to ease legal bottlenecks for real estate developers. However, we believe that it is still too early to confirm that the property market will improve in the short term when the actual effectiveness of the implementation of policies is unclear and many bottlenecks have not been completely resolved. Thus, we expect that the domestic property supply will only be able to recover from 2024F when (1) the revised Land Law is adopted to remove legal bottlenecks and (2) banks reducing lending rates and creating more favorable access to capital will support developers and stimulate demand for home buyers. As a result, Vietnam's steel demand won't fully rebound until 2024F.

Figure 1: Listed steel companies all plan to have positive net profit after tax (NPAT) in 2023

Company	Actual business results in 2022 (VND bn)		Business guidance in 2023F (VND bn)		% change (yoy)	
	Revenue	NPAT	Revenue	NPAT	Revenue	NPAT
HPG	142,771	8,444	150,000	8,000	5.1%	-5.3%
HSG (*)	49,711	251	36,000	300	-27.6%	19.5%
SMC	23,182	(652)	20,350	150	-12.2%	NA
NKG	23,128	(125)	20,000	320	-13.5%	NA
TIS	16,832	4	15,826	39	-6.0%	964.4%
VGS	8,491	100	7,000	90	-17.6%	-10.0%
TLH	5,324	8	5,000	100	-6.1%	1150.0%

(*) HSG's 2023 business guidance is according to the financial year 2022-23 with the period from 4Q22-3Q23

Source: VNDIRECTS RESEARCH, COMPANY REPORTS

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Light at the end of tunnel

1Q23 business results

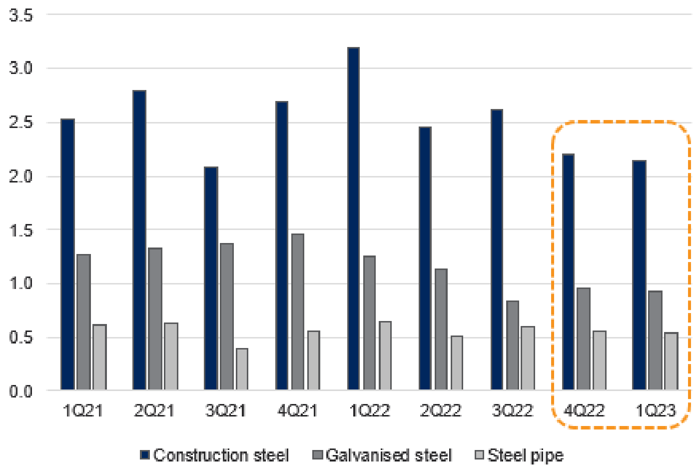
Figure 2: Business guidance in FY23F and actual business results in 1Q23 of listed steel companies

Company	Actual business results in 2022 (VND bn)		Business guidance in 2023F (VND bn)		% change (yoy)		Actual business results in 2H22 (VND bn)		Actual business results in 1Q23 (VND bn)	
	Revenue	NPAT	Revenue	NPAT	Revenue	NPAT	Revenue	NPAT	Revenue	NPAT
HPG	142,771	8,444	150,000	8,000	5.1%	-5.3%	60,653	(3,785)	26,865	383
HSG (*)	49,711	251	36,000	300	-27.6%	19.5%	16,094	(1,567)	6,981	251
SMC	23,182	(652)	20,350	150	-12.2%	NA	9,903	(778)	3,887	21
NKG	23,128	(125)	20,000	320	-13.5%	NA	8,758	(833)	4,380	(49)
TIS	16,832	4	15,826	39	-6.0%	964.4%	9,911	(29)	2,446	(19)
VGS	8,491	100	7,000	90	-17.6%	-10.0%	4,293	23	2,124	14
TLH	5,324	8	5,000	100	-6.1%	1150.0%	2,820	(107)	1,432	6

(*) HSG's 2023 business guidance is according to the financial year 2022-23 with the period from 4Q22-3Q23

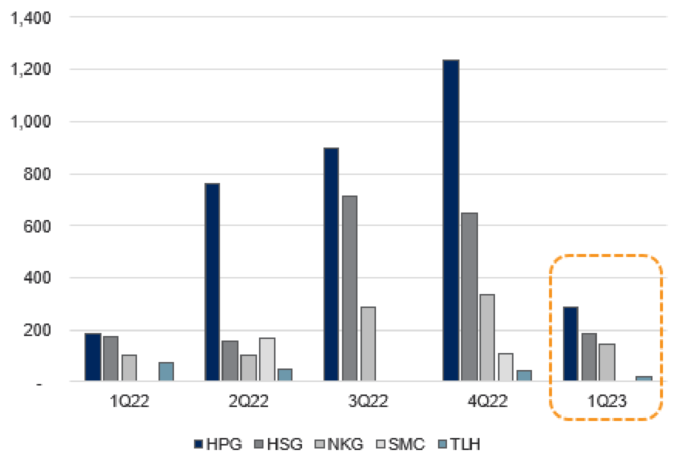
Source: VNDIRECT RESEARCH

Figure 3: Vietnam's steel sales volume was still weak in 1Q23 (m tonnes)



Source: VNDIRECT RESEARCH, VSA

Figure 4: Provision for inventories of listed steel companies in 1Q23 decreased significantly year to date (VND bn)



Source: VNDIRECT RESEARCH, COMPANY REPORTS

In 1Q23, steel companies recorded a plunge in business results yoy, however, net profit improved significantly compared to the two previous quarters. We think this trend is mainly due to:

1) Vietnam's steel volume (including construction steel, steel pipes and galvanised steel) plunged by 29,2% yoy to 3.6m tonnes in 1Q23 from high base 1Q22, according to Vietnam Steel Association (VSA);

2) 1Q23 steel prices plummeted yoy but were still higher than the average of 4Q22, we estimate the average selling price of Vietnam's construction steel and HRC in 1Q23 was VND15.9m/tonne (-7% yoy/+6% qoq) and US$660/tonne (-20% yoy/+18% qoq), respectively;

3) The increase in the steel selling price in 1Q23 helped steel companies record an inventory provision reversal. If we exclude this one-off profit, 6/7 steel companies in our coverage (detailed in Figure 2) will record a net loss.

4) 1Q23 interest expense climbed yoy reflecting the increased cost of debt.

5) The exchange rate was more favorable and steel companies actively reduced foreign currency debts in 1Q23, which helped to narrow their net exchange rate loss compared to 2H22.

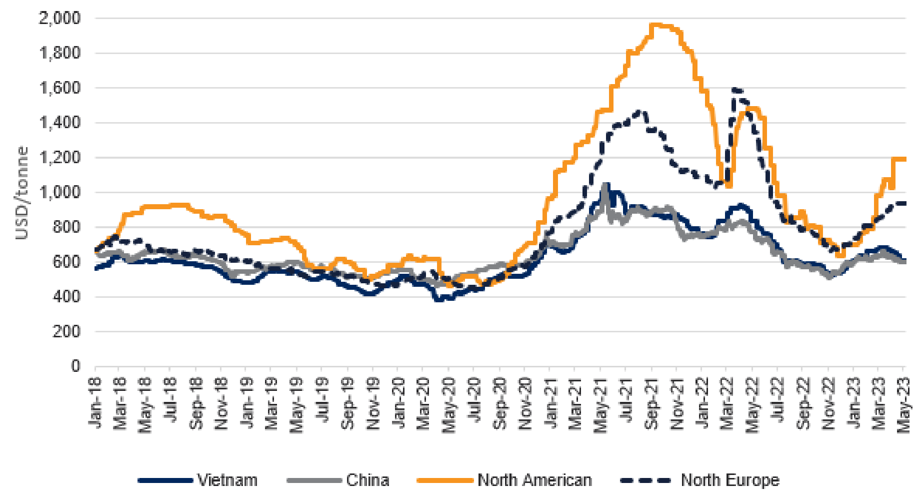
Steel industry outlook 2023

2Q23 gross margin of steel companies will continue to improve qoq, but should still be conservative for the rest of 2023

The selling price of HRC in China & Vietnam has turned down since end-Mar 2023 while the price increase in North America & Northern Europe has also started to cool down

The global price of HRC recorded a significant recovery after China relaxed its dynamic zero-COVID policy since Nov 2022. Market participants expected global steel demand to grow in 2023F thanks to (1) the resumption of economic activities in China to help restore global industrial production and supply chains and (2) China's efforts to promote infrastructure investment and policies to support the property sector gradually taking effect. High expected demand also made steel mills increase utilisation rate and raw materials (iron ore, coke) inventories, leading to steel input prices climbing. Cost-push is also a major factor driving steel prices to jump in 1Q23.

Figure 5: HRC steel prices



Source: VNDIRECTS RESEARCH, BLOOMBERG

However, 1Q23 actual steel demand was not as strong as consensus's expectations. Despite 16 new policy measures announced in Nov 2022, the outlook for China's residential property sector remains subdued, with real estate investment and newly- launched property projects down around 7% and 29% yoy in 1Q23, respectively, based on My Steel data. Strong steel production volume amid weak demand caused China steel prices to decline since the end of Mar 2023.

The S&P Global Eurozone Construction Total Activity Index remained in contractionary territory in early 2023, though with the rate of falls slowing across all three sub-sectors (housing, commercial and infrastructure). The rate of input-cost inflation also appears to have cooled in recent months, though new orders remain weak given the high level of economic uncertainty still present in the market. The European auto industry continues to face challenging conditions in 2023. High energy prices, parts shortages and falling global trade are all impacting manufacturers.

The outlook for US steel demand in 2023 remains positive thanks to (1) CHIPS and Science and Inflation Reduction Acts lend support to domestic manufacturing activity and (2) US$1.2tr Infrastructure and Jobs Act, which includes US$550bn in new federal government investment. However, with the US manufacturing PMI 35 Resources and Energy Quarterly March 2023 falling deep into contractionary territory in early 2023, and new orders slumping, challenges in the near term remain.

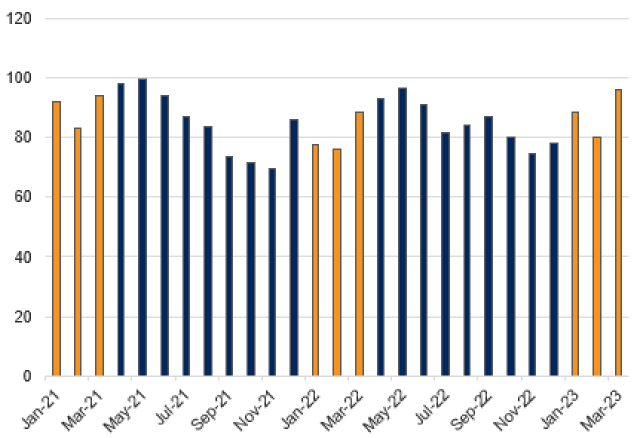
Cost-push and temporary supply shortages due to the earthquake in Turkey - a major steel exporter - was the main reason for the recent sharp increase in steel prices in the US and EU. However, with the prospect of steel demand not having much improvement, we believe that the price increase in these regions will cool down in the coming months.

Selling prices to ease over outlook of slower demand growth and more supply

Spot iron ore prices have rebounded strongly in early 2023 after falling more than 50% in the second half of last year. The higher prices reflect a partial recovery in Chinese steel production (accounting for around 57% of global iron ore demand in 2022), and an anticipated rise in China's steel demand this year — as the economy reopens with the end of the government's dynamic zero-COVID policy in late 2022.

According to data from the World Steel Association (WSA), China's crude steel production reached 262m tonnes in 1Q23, a surge of 6.1% yoy. As of 7 Apr, China's National Development and Reform Commission was still soliciting opinions from major Chinese steel mills on details of the 2023 crude steel output cuts, according to some mill sources. Although the official announcement has not been made yet, many major organizations (including Bloomberg, Reuters, S&P Global) forecasted that China will reduce crude steel production by 2.5% yoy in 2023. That means China's crude steel production and iron ore demand will decline in the remaining months of 2023 to offset 1Q23 growth.

Figure 6: China's crude steel production increased significantly by 6.1% yoy in 1Q23 (m tonnes)



Source: VNDIRECTS RESEARCH, BLOOMBERG

Figure 7: Iron ore price (USD/tonne)

Source: VNDIRECTS RESEARCH, BLOOMBERG

In 2022, China announced its first decline in population, and with real estate constituting as much as 25% of the Chinese economy, weakness in the country's property sector will continue to diminish the country's near-term steel demand. In fact, spot iron ore prices have now turned down 12% from the peak at the end of March 2023. In addition, with the goal of reducing CO2 emissions, China is projected to see a mild decline in total steel production over the outlook, this should see a softer rate growth (0.9% annually) in global iron ore demand in coming years.

On the supply side, the world's two largest producers — Australia and Brazil — are expected to continue to collectively grow export volumes by 3.2% per annum over the outlook period. This follows a ramp up of greenfield projects for major Australian miners, and major expansions planned by Brazilian producers of Vale, CSN and others. New supply from emerging producers in Africa will also contribute to annual growth of around 3% in global trade of iron ore.

According to Australian Department of Industry, Science, Energy and Resources (DISR) estimation, the FY23F average iron ore price is forecasted to reach US$100/tonne (-6.5% yoy), the benchmark iron ore price is projected to average around US$63 per tonne by FY28F.

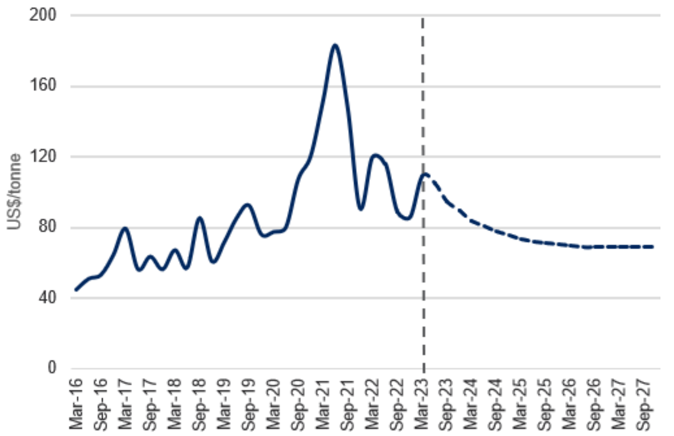
Recent growth in metallurgical coal prices is expected to unwind

Coking coal prices have recently lifted to their highest level since mid-2022, amidst a less pessimistic outlook for China and other major economies.

Prices are expected to ease slowly over the outlook period, with the largest fall expected in 2023 as supply conditions (notably in Australia) improve and normalise. The end of the La Niña cycle should allow waterlogged mines and disrupted terminals and rail to resume full output.

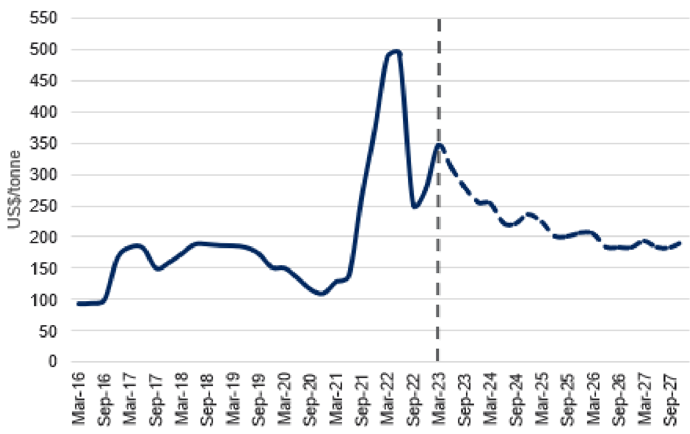
DISR forecasts coking coal to ease from an average of US$299/tonne in FY23F, but is expected to fall by almost a half as supply conditions normalise. Prices are ultimately expected to reach around US$160/tonne by FY28F, representing a shift towards their pre-FY21 level.

Figure 8: Iron ore price outlook, quarterly



Source: DISR FORECASTS

Figure 9: Coking coal price outlook, quarterly



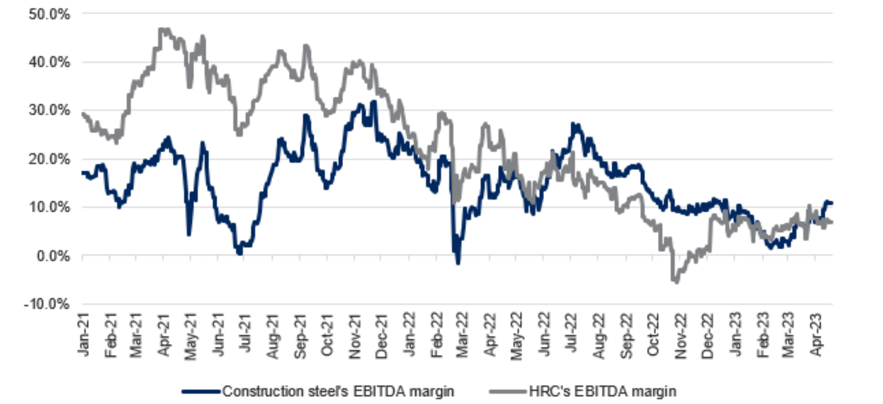
Source: DISR FORECASTS

Steel selling price fell slower than input material prices, helping steel companies' EBITDA margin to improve in Apr 2023

According to spot price (steel, iron ore, coking coal and steel scrap) movements, we estimate that the EBITDA margin of HPG's steel segment in Apr 2023 is 1.5% pts higher than the previous quarter, despite the decline in steel selling prices.

We expect the gross margin of steel companies in 2Q23 will continue to improve compared to the previous quarter. However, the steel demand is forecasted to be still weak in the coming months, profit margin of steel companies may still face many fluctuations, especially the small companies with limited inventory management skills.

Figure 10: Our estimate of HPG's EBITDA margin is based on commodity spot prices

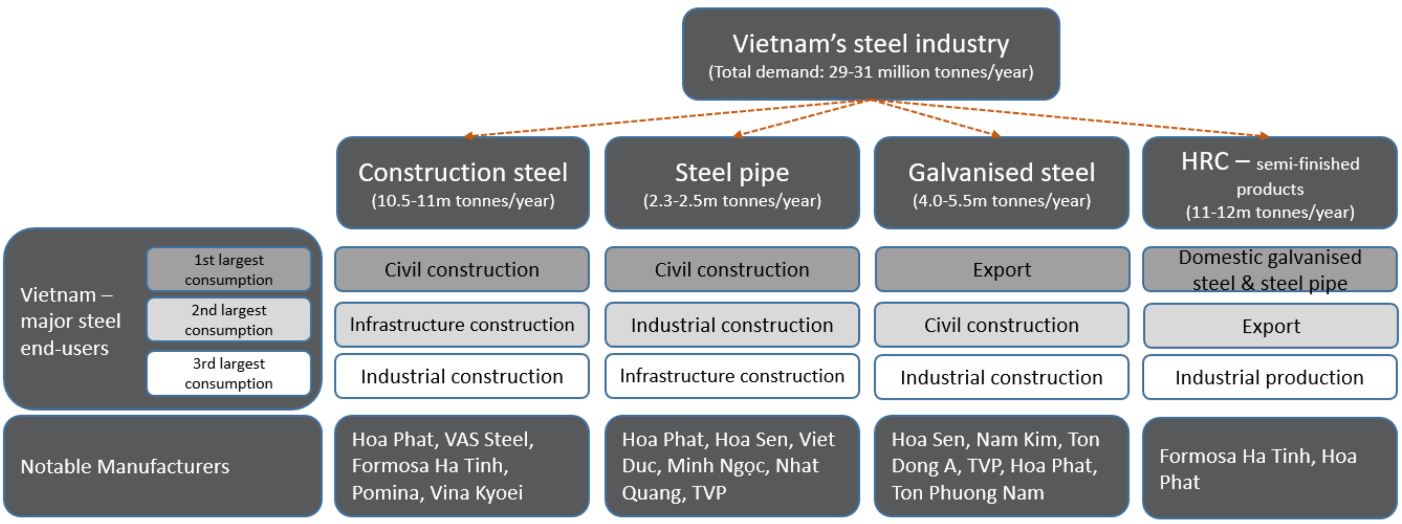


Source: VNDIRECTS RESEARCH, BLOOMBERG

Weak housing market still cast a shadow over the recovery prospect of steel makers in 2H23F

Vietnam's steel demand is highly dependent on the residential property industry, which accounts for around 60- 65% of the country's total steel consumption. Vietnam's residential property market has cooled down since 2Q22 following some tycoon arrests due to corporate bonds issuance violations, limited credit room for property and rising lending rates dent the housing demand.

Figure 11: Vietnam – major steel end-users

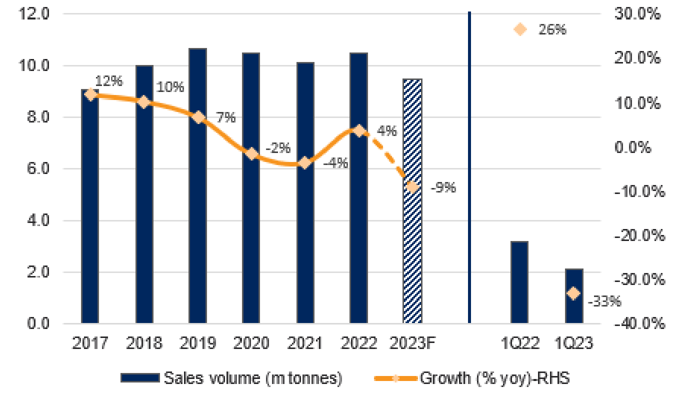


Source: VNDIRECT RESEARCH

Some positive signals for the real estate industry have appeared recently. Many policies to remove difficulties in the real estate market have been issued since the beginning of 2023 such as Decree 08/2023 on corporate bonds, Resolution 33 on some solutions to remove the real estate market's difficulties, Decision 388, and Decree 10, which will help to ease legal bottlenecks. However, we believe that it is still too early to confirm that the property market will recover in the short term when the actual effectiveness of the implementation of policies is unclear, and many bottlenecks have not been completely resolved. We believe that the policies issued above can partially remove the bottleneck, however, more synchronous solutions are needed in terms of both legal processes and access to the capital for the real estate market to recover.

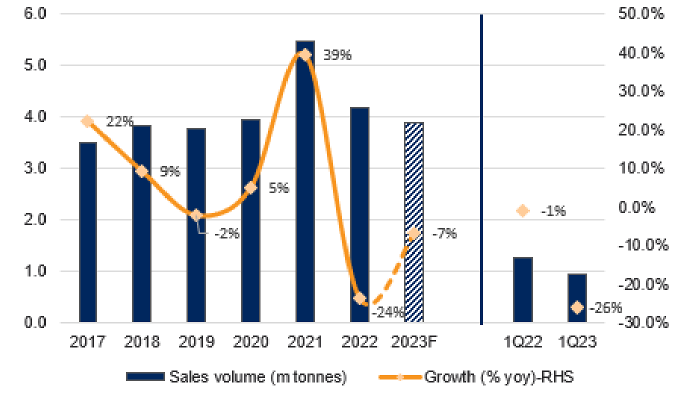
Thus, we expect that the domestic property supply will only be able to recover from 2024F when (1) the revised Land Law is adopted to remove legal bottlenecks and (2) banks reducing lending rates and creating more favorable access to capital will support developers and stimulate demand for home buyers. As a result, Vietnam's steel demand won't fully rebound until 2024F.

Figure 12: Vietnam's construction steel sales volume will decrease by 9% yoy in 2023



Source: VNDIRECT RESEARCH, VSA

Figure 13: Vietnam's galvanised steel sales volume will decrease by 7% yoy in 2023



Source: VNDIRECT RESEARCH, VSA

The prolonged dismal demand of the domestic civil construction sector will have a significant impact on the demand for construction materials in 2023. Although public investment disbursement is expected to accelerate in the coming quarters, we forecast total domestic steel demand to decline single digits in 2023F. In which, we expect Vietnam's construction steel/galvanised steel sales volume to decrease by 9%-7% yoy in 2023F

Investment idea

We attended the 2023 Annual General Meeting (AGM) of listed steel companies, notably most of their managements have a more positive view of the industry's outlook that 2H22 was the hardest time, but then outlook has gradually improved in 1Q23 and will turn better since 2Q23F. All companies have set FY23F business guidance with positive profit, much more positive than two consecutive quarters of losses in 2H22. However, steel demand will remain weak throughout 2023, making it very challenging for steel companies to complete their full-year business plan.

Figure 14: Peer comparison

Company	Ticker	Price	TP	Recom.	Mkt cap	P/E (x)		3-year EPS	P/B (x)		EV/EBITDA (x)		ROE (%)	
		LC$	LC$		US$ m	TTM	FY23F	CAGR (%)	Current	FY23F	TTM	FY23F	TTM	FY23F
Hoa Phat Group JSC	HPG VN	21,750	24,400	Add	5,389	190.5	12.8	48.1	1.3	1.2	13.2	10.1	0.7	10.3
Hoa Sen Group	HSG VN	16,100	na	na	410	na	3.9	177.0	0.9	0.6	7.7	6.1	(9.8)	3.5
Nam Kim Steel JSC	NKG VN	15,200	na	na	171	na	10.7	na	0.8	0.7	16.7	7.3	(11.8)	2.6
Average						*190.5*	*9.2*	*112.5*	*1.0*	*0.8*	*12.6*	*7.8*	*(7.0)*	*5.5*
Median						*190.5*	*10.7*	*112.5*	*0.9*	*0.7*	*13.2*	*7.3*	*(9.8)*	*3.5*

Source: VNDIRECT RESEARCH, BLOOMBERG, DATA AS OF 11 MAY 2023

Figure 15: Investment ideas

No	Ticker	1-year TP (VND/share)	Rating	Comments
1	HPG	24,400	Add	In 1Q23, HPG recorded a turnaround in bottom line to a net profit of VND397bn (-95.2% yoy) from the VND1,992bn net loss in 4Q22. However, if we exclude inventory provision reversals of VND948bn and forex gain of VND69bn, operating profit losses came to VND485bn, broadly in line with our expectation in the previous report (issued Mar 2023). 1Q23 core gross profit came to VND728bn (-92.8% yoy), which is still a recovery versus the core gross loss of VND452bn in 4Q22 thanks to an increase in steel price. In April-May-2023, we see that the demand for construction steel and steel pipes of HPG continues to be weak, amid falling selling prices and a prolonged gloomy property market. Notably, the company currently has plans to reopen its two remaining blast furnaces by 20 May. However, we think that this target will ultimately be subject to market demand – the company is likely to carefully choose the time of resumption to maximize the efficiency of capacities. We expect that HPG will reopen its blast furnaces gradually, maybe later than its initial plan. The price of input materials (iron ore, coking coal) is falling more sharply than the selling price of steel output, which will support HPG's business results in 2Q23. However, weak steel demand will put pressure on HPG's business results in the coming quarters. We like HPG thanks to (1) the leading position in the Southeast Asian steel industry will help HPG to ride on the surge of domestic demand for both civil and transport infrastructure construction; (2) the company's healthy balance sheet with cash-rich will help HPG to grab more market share during the industry downcycle; and (3) DQSC 2 to bring the HPG's crude steel production capacity by 66% from now to 14.6m tonnes per annum from 2025F onwards. Besides, hot rolled coil (HRC) - the main output product of DQSC 2, is still facing a shortage of supply in the domestic market and depends on exports, thus not putting pressure on HPG's steel oversupply in 2025-30F, in our view.
2	HSG	NA	NA	HSG reported a 2Q23 net profit of VND251bn (+7.1% yoy), mostly on inventory provision reversals. If we exclude provision reversals, forex gains/losses and other income, operating losses came to VND255bn in 1Q23, narrowing from the operating loss of VND719bn seen in 1Q23, mainly thanks to the higher qoq selling prices and clearing of high-cost input materials. As a reminder, the Chairman estimated an operating profit of VND50bn for 2Q23 at their AGM, which was held in Mar-23. As a result, this operating loss of VND255bn was a disappointing result, in our view. Cumulatively, HSG reported a net loss of VND429bn in 1H23, and the company will be removed from the margin lending list approved by HSX, likely this month. HSG's management said that the company has total export orders at over 100,000 tonnes, delivering till end-June. HSG targets to sell around 120,000 tonnes per month for the rest of the year, +10% higher than Mar 2023. The recent fall in HRC prices will create further challenges for HSG going forward, although the recovery in export demand plus strong plastic pipe performance could partly offset the selling price decreases.
3	NKG	NA	NA	NKG's 1Q23 results also were disappointing, with an operating profit loss of VND241bn (slightly lower than a loss of VND372bn in 4Q22, and higher than the preliminary loss in the AGM of VND50bn). In comparison to peers, NKG is one of the few steel companies to deliver qoq growth in sales volume in 1Q23 on their proactive strategy of increasing sales activity. However, the company's profit recovery is slower than peers. NKG is the last company still reporting a negative gross profit in 1Q23 mainly due to the highest inventory levels as of end-FY22. Regarding inventory management, as the end of 1Q23, the company reduced its inventory value to around VND6,478bn, (-7.5% ytd), equivalent to 4.6 months of production, which is still at high

				levels. In an effort to reduce operating risk on the back of volatile HRC prices, NKG will continue to cut inventory levels to around 2-3 months of production in the coming months. At the AGM, CEO shared that NKG has successfully signed export contracts with clients till end-June this year. This would secure earnings for 2Q23, with both selling prices and volume improving qoq. The company believes that 1H23 earnings would be positive and NKG will be eligible for the margin lending list issued by HSX in Aug 2023. The recent drops in HRC prices globally will also put pressure on NKG's business results in 2H23F, especially amid weak steel demand.

Source: VNDIRECT RESEARCH

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Stock Ratings	Definition:
Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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