

High pressure from steel market and strengthening USD

HPG released operating report for Q3.2022 with key data in below figures:

	3Q.2021	3Q.2022	YoY growth	9M.2021	9M.2022	YoY growth
Net Revenue (VND Bn)	38,918	34,441	-11.5%	105,817	116,559	10.2%
EAT (VND Bn)	10,351	-1,774	-117.2%	27,102	10,474	-61.5%
Construction steel sales volume (mil. Tons)	0.96	1.08	12.5%	2.71	3.40	24%
HRC sales volume (mil. Tons)	0.76	0.62	-18.4%	2.01	2.10	5%

Sources: HPG

Hoa Phat posted a loss in the third quarter of just under 1.8tr VND, the first quarterly loss for the company since listing in November 2007. The poor market conditions, with decreasing steel selling prices and increasing input material costs, created the perfect storm for HPG to post the quarterly loss. According to the company's representative, average selling prices of construction steel and HRC have reduced 3% and 26%, respectively, during Q3.2022 and account for 58% and 36% of HPG's revenues in 9M 2022 based on our calculation as the market faced a reduction in demand on economic weakness and a slowdown in construction activities. On the input side, the coal market has been affected by the Russia - Ukraine conflict, which has pushed coal prices to high levels. Hoa Phat has an inventory cycle of about 3 months, and despite recent easing of coking coal prices, the companies had acquired inventories of high priced coking coal in middle to late Q2.2022 and those coal prices are reflected into COGS of Q3.2022.

The company recorded a 9.3% QoQ reduction in net revenue, in which total sales volume in Q3.2022 decreased 6.5% QoQ and average selling prices decreased 2.99%. Despite the fall in net revenue, the COGS increased by 7.3% QoQ, as according to our calculations, the average cost per ton of goods sold increased by 13,6% QoQ, causing a strong fall in gross margin (down from 18% in Q2.2022 to 3% in Q3.2022). The thin gross margin of HPG in Q3.2022 made the company vulnerable other financial factors such as interest rate and exchange rate movements. The lending rate for HPG, which is pegged to market rates, started to increase in middle of Q3.2022. Although the company has 7.1% lower debt amount at the end of Q3.2022 compared to end of Q2.2022, the increased interest rate caused interest expenses in Q3.2022 to be 17% higher than Q2.2022. As most input materials of HPG are imported from overseas using the US Dollar, the appreciation of the US Dollar had a negative effect on HPG financial cost, in which the loss from currencies exchange was 1,013 Bn.VND in Q3.2022 (+12% QoQ). Selling and administration costs were stable in Q3.2022.

In general, the highly contracted gross margin due to unfavorable market conditions and increased financial costs due to increased interest rates and the appreciation of US Dollar are the main factors that caused the quarterly loss in HPG's operating activities. Although the company has been trying to reduce their debt throughout Q3, the movement of VND lending interest rates and the strength of USD are notable risks for the company in Q4.2022. High input material prices have been recognized in Q3.2022 and we are observing a reduction in coking coal prices since the middle of September, which could signal that the gross margin of HPG in Q4.2022 can be improved. However, we maintain a conservative view for the company in the last quarter of 2022 as there are not yet many signals of an improving construction and real estate market in Q4.2022.

Some bright points of the company's operation

Despite posting the quarterly loss and the difficult market conditions the company is facing, there are some silver linings; the company is still gaining domestic market share from competitors, the market share of HPG in 9M.2022 has increased to 36% (9M.2021 was about 31%).

Two big projects of HPG, the container factory and the Dung Quat expansion were announced to be on progress as originally planned, the company is pushing financial resources for these two projects. The container factory is expected to be finished and will produce commercial products within Q4.2022. The Dung Quat expansion project has completed basic infrastructure construction and could possibly be completed as planned in early 2024.

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