

19 October 2010

BUY

Target price 56,000

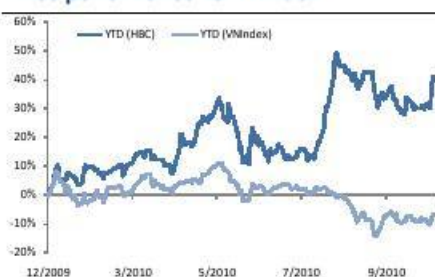
Construction

Key Indicators

Price @ 19/10/2010 (VND)	45,300
Target price (VND)	56,000
Upside to target price	23%
52-week low (VND)	23,700
52-week high (VND)	47,100
Average 10 trading day volume	73,686
Outstanding shares	16,231,003
Market capitalization (VND bn)	735
Market capitalization (USD mn)	39

Valuation	2009	2010F	2011F
EPS (VND)	3,033	6,736	7,410
EPS growth	521%	122%	10%
P/E	14.9x	6.7x	6.1x
P/B	1.3x	1.2x	1.1x
EV/EBITDA	11.3x	5.1x	4.7x
ROE	8%	17%	17%
ROIC	7%	13%	13%
Debt/Equity	57%	76%	75%
Dividend yield	4%	6%	6%

Price performance vs. VnIndex



Ownership structure

BoD and Management	27%
PVFC	6%
Chip Eng Seng	5%
Foreigners	8%
Retail investors	56%
Treasury stock	3%

Analyst

Truong Vinh An, *Senior Associate*

an.truong@vcsc.com.vn

T: +84 8 3914 3588, ext143

An appealing value play

Hoa Binh Construction Company

HBC has paved the way to become one of the leaders in the construction industry, focusing particularly on the residential sector. We initiate on Hoa Binh Construction Company (HBC) with a **BUY** recommendation. Our relative valuation yields a target price of VND56,000 per share which represents a 23% premium over its closing price of VND45,300. HBC is currently trading at an undemanding 6.7x its FY11E earnings, a 27% discount to its industry peers.

Hoa Binh has demonstrated outstanding growth over the last three years, with a CAGR of 97% and 40% for its top and bottom line respectively. Sharp improvements in the company's profitability boost earnings growth and drives HBC's valuation to a record low, widening the discount gap with its peers and VNIndex. Though its share price has outperformed the market by 40% YTD, HBC is still an attractive value play as we believe there is a potential for price gains from multiple appreciation.

By the end of 2010, we estimate that HBC could deliver revenue and net income of VND1,594bn and VND109bn, placing it first among private-sector-originated construction companies and second among listed companies on the HSX.

- HBC made a spectacular recovery from 2009 with significant enhancements in profitability underpinned by changes in internal control and cost management policies.
- HBC is cleaning up its balance sheet by consolidating both property and financial investment portfolios. HBC has a considerable investment portfolio around VND317bn at cost, half the size of its equity and almost as much as its current debt. That said, we expect improving efficiency ratios in the coming years as HBC reduces its exposure to these investments.
- Nevertheless, there are concerns over slow revenue growth in 1H2010. Several client developers requested HBC to reduce its pace in view of sluggishness of the property market which affects their sale and financing capability. We feel that concerns over HBC top and bottom line growth sustainability will remain until the property market improves.

Financial summary and forecast

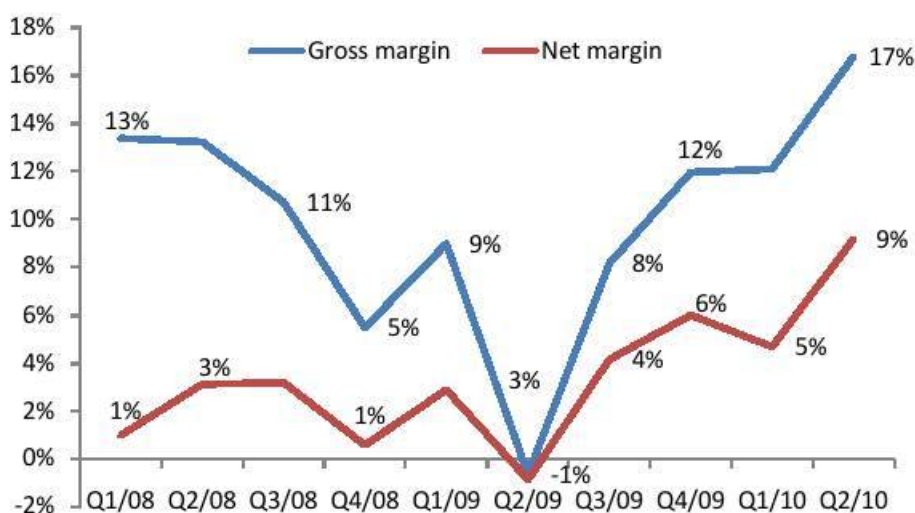
Income (bn VND)	2009	2010F	2011F	Growth	2009	2010F	2011F
Net Revenue	1,763	1,594	1,753	Revenue growth	153%	-10%	10%
Cost of goods sold	1,651	1,357	1,493	EBITDA growth	119%	120%	10%
Sales & operating	45	65	71	EBIT growth	142%	77%	-14%
EBITDA	105	231	254	Net income growth	521%	122%	10%
Depreciation	21	41	45	EPS growth	521%	122%	10%
EBIT	84	190	209	Gross margin	6%	15%	15%
Interest expense	22	41	45	EBITDA/Revenue	6%	14%	14%
Other income	0	2	0	EBIT/Revenue	5%	12%	12%
Profit before tax	63	149	164	EPS (VND)	3,033	6,736	7,410
Corporate income tax	13	39	43	DPS (VND)	2,200	3,000	3,000
Minority interest	1	1	1				
Net income	49	109	120				
Balance (bn VND)	2009	2010F	2011F	Indicators	2009	2010F	2011F
Cash & cash equivalent	184	31	36	Liquidity ratios			
ST financial investment	0	0	0	Current ratio	1.25	1.25	1.25
Accounts receivable	489	852	938	Quick ratio	0.97	1.01	1.01
Inventory	194	175	193				
Other current assets	8	8	8	Profitability ratios			
Current assets	874	1,066	1,174	ROE	8%	17%	17%
				ROA	4%	7%	7%
Long-term receivables	0	0	0	ROIC	7%	13%	13%
Fixed assets	358	432	476				
Investment properties	0	0	0	Efficiency ratios			
Financial investments	90	110	121	Days receivables	101	195	195
Other long-term assets	34	27	30	Days inventory	43	47	47
Long-term assets	482	570	627	Days payables	29	37	37
Total assets	1,356	1,636	1,801				
				Leverage ratios			
Current liabilities	701	887	976	Debt/equity	57%	76%	75%
Long-term liabilities	18	51	56	Debt/Capital employ	50%	65%	65%
Total liabilities	719	939	1,033	Interest coverage	3.8x	3.6x	3.6x
Charter capital	151	167	167	Valuation	2009	2010F	2011F
Paid-in surplus	368	368	368	At target price of	45.3	45.3	45.3
Retained earnings	62	105	175	P/E	14.9x	6.7x	6.1x
Minority interest	56	57	58	P/B	1.3x	1.2x	1.1x
Total owner's equity	581	641	711	EV/EBITDA	11.3x	5.1x	4.7x
Liabilities & Equity	1,356	1,636	1,801	Dividend yield	4%	6%	6%

Source: Company's data, VCSC forecast

Profitability significantly enhanced

After a difficult year in 2009, when its profit margin suffered not only from material price escalation but also losses from real estate business, HBC made a spectacular recovery in 2010, with gross margin improving from an average 6% in 2009 to 12% in the first quarter and 17% in the second quarter of 2010.

Chart 1. Profit margins recovered strongly



Source: HBC's financial statement

As a result of management implementing better cost control measures combined with greater bargaining power with its suppliers and its clients, HBC's net margin increased from the historical average 5% to a new high 9%.

- After several years of horizon expansion, HBC has been able to establish its foothold in the market and build a strong brand name. The company is now focuses on more profitable projects and has increased its bidding price in new tenders.
- The most influential cost control measure was the implementation of a highly efficient purchasing management process, which facilitates the company to find the lowest price supplier, and also reduce "leakage".
- Stronger bargaining power enables HBC to cap material price fluctuation to a maximum level 3% compared to 5% in previous contracts. Therefore, the company is able to pass the more of any increase in material price onto developers, thus protecting profitability from material price volatility.
- HBC is able to negotiate with developers for a higher deposit rate (cash advances) up to 20% of the contract value against 10% previously. HBC uses most of its deposit to reserve steel to buy up to 80% of the steel it will need for any given project. In the absence of feasible steel hedging vehicles, we believe this is a necessary step to control material price volatility and protect its profit margin.

Strengthening balance sheet efficiency

HBC is divesting its non-core investments in properties and financial instruments to focus on its core business. In 2009, HBC liquidated a number of financial investments as well as its investment in Hoa Binh Tower, one of the company's largest property projects.

Table 1. HBC's liquidation of financial and real estate investments

Long-term investments (VND mn)	2008	2009	2H2010
Bond	5,000	5,000	0
Vinashin Petro	12,000	0	0
Hai Dang Investment	25,500	29,285	0
Mạng Viet	300	0	0
Hoa Binh Tower	219,272	0	0
Total	262,072	34,285	0

Though it might take several years, we like management's newly adopted strategy to divest from non-core financial and real estate investment as this will enhance capital efficiency by freeing large amounts of capital currently stuck in properties and financial investments. At cost, the value of their current investment portfolio was VND317bn almost equal to the amount of debt the company had as at Q2-2010.

We believe there is a potential for HBC to considerably improve ROIC in the coming years. Supposing the company was able to liquidate its entire portfolio by the end of 2010, it would be able to increase its ROIC significantly, not to mention benefit from the improvements in profitability resulting from interest expense savings of around VND40bn.

Table 2. HBC's current portfolios of financial/real estate investment

Investment in properties	
Projects	Cost (VND mn)
Thanh Xuan, Q12	20,556
Long Thoi, Nha Be	57,107
Nhon Duc, Nha Be	9,431
Nhi Thanh IZ	120,217
Phuoc Kien Project	4,131
Binh Chieu (JV with TDH)	10,686
Binh An Plaza	21,833
Hoa Binh Phuoc Loc Tho	50,485
Total	294,446

Financial investment	
	VND mn
Golden Lotus Securities	21,268
Nhan Hung JV	498
Others	1,368
Total	23,134

Source: HBC's Q2-2010 financial statement

Core business: increasing construction backlog

The company has a current effective backlog worth VND5,945bn, of which VND1,524bn was acquired in Q3-2010. Given the size of the company this backlog is impressive. It is currently worth approximately 3.7x the company's 2010 expected revenue.

We are aware that management has actively tendered on multiple projects in 2010 and we expect to see more contract announcements by the end of the year.

No	Typical projects	Start date	Expected completion date
1	Phu My Apartment Building	06/06/2007	Q3/2010
2	Hanh Phuc Hospital	14/08/2007	Q3/2010
3	Can Tho Airport	22/05/2008	31/12/2010
4	Keangnam	25/09/2008	31/12/2010
5	CR5 (Phu My Hung)	18/10/2008	Q3/2010
6	CR8 (Phu My Hung)	2011/2008	Q3/2010
7	TDH Truong Tho	29/11/2008	Q3/2010
8	Vincom	01/12/2008	Q3/2010
9	The Manor II - Extension	09/12/2008	Q3/2010
10	RMIT Phase 2	01/01/2009	Q3/2010
11	Phu Quoc Airport	20/01/2009	31/12/2010
12	Phuong Nguyen Hung Apartment	04/02/2009	30/03/2011
13	Tan Hoang Minh Office Building	13/02/2009	31/12/2010
14	Mippec - Basement	02/03/2009	21/08/2009
15	M&C Tower	25/05/2009	23/03/2011
16	Green Hotel (Kien Giang)	12/06/2009	27/07/2010
17	Habico Tower - Infrastructure	03/07/2009	24/05/2011
18	S25 (Phu My Hung)	15/07/2009	27/11/2009
19	Vincom - Completion-90	03/09/2009	15/10/2010
20	Tan Son Nhat Airport - Expansion	01/10/2009	Q3/2010
21	Vincom - Completion - 109	02/10/2009	15/10/2010
22	Mippec	04/10/2009	Change design
23	Sunrise City	15/10/2009	31/01/2011
24	REE Tower	17/10/2009	15/01/2011
25	Ta Hoang Minh Office Building - ME	23/10/2009	12/2010
26	Ha Noi Museum	03/12/2009	30/10/2010
27	Keangnam - Completion	24/12/2009	31/01/2011
28	11D Thi Sach	09/03/2010	08/05/2011
29	Times Square	26/04/2010	25/06/2011
30	Horizon (Fico)	05/06/2010	26/08/2011
31	Novotel Da Nang	06/06/2010	09/11/2010
32	Mippec -PL1-VP	06/06/2010	15/12/2010
33	Lan Phuong MHBR Tower	01/07/2010	01/07/2011
34	FLC Tower - Basement	06/08/2010	15/11/2010

Source: HBC

Valuation attractive with upside

We believe the current valuation is attractive as HBC is being traded at an undemanding 6.7x its FY11E earnings estimated at VND120bn. Our relative valuation yields a target price of VND56,000 per share which represents a 23% premium over its closing price of VND45,300.

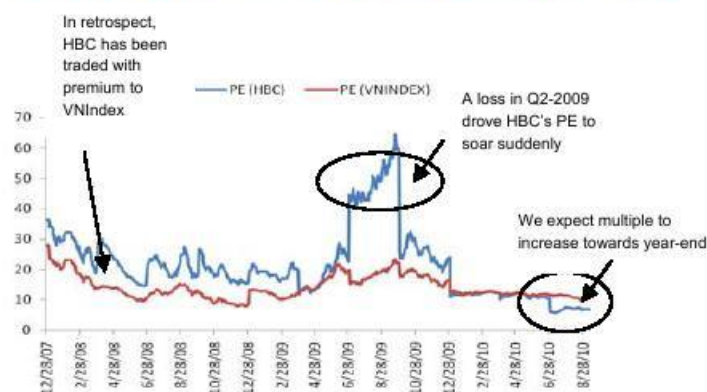
At its current price the stock trades at a 27% discount to its industry peers and provided that the company can deliver strong earnings as forecasted, we think its relative valuation should increase.

Table 3. Construction cross-sectional comparison

Key ratios	CTD	DCC	BCE	L10	SDT	SD9	HBC
Revenue growth yoy	60%	-11%	120%	38%	-36%	5%	-19%
Net profit growth yoy	50%	-48%	68%	77%	-18%	0%	1543%
Gross margin 2009	14%	6%	19%	11%	18%	26%	6%
Gross margin 1H2010	10%	7%	11%	11%	17%	24%	15%
Net margin 2009	12%	5%	15%	5%	11%	18%	3%
Net margin 1H2010	8%	4%	8%	6%	14%	13%	7%
Mkt Cap - VND bn	2,122	275	326	300	583	704	735
ROE 2009	21%	10%	15%	19%	23%	33%	8%
ROE 2010F	18%	10%	18%	24%	21%	19%	17%
P/E 2010	9.0	13.0	6.7	7.6	6.5	10.2	6.7

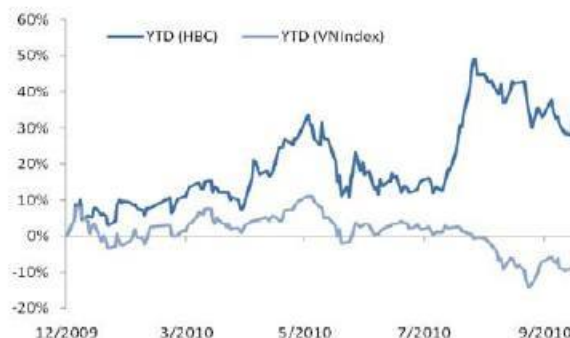
Source: Companies' data, VCSC estimate, price on 19-10-2010

Chart 2. HBC is at historical low and a discount to VNIndex



Source: Bloomberg, VCSC

Chart 3. HBC outperformed VNIndex by 40% YTD



In calculating PE ratios of its peers, we took into consideration companies' plans, their actual results in 1H2010, and the seasonality of the construction sector in the second half. We also selected companies that have little or no exposure to property development, and those with relatively the same size as HBC.

We used the 2010 average PE multiple from peers of 8.8x, since this is a more accurate available forecast as 2011 estimates are not available for all companies or have a small sample of consensus estimates. We used HBC's FY11E earnings to calculate the equity value in one year's time and since we are using 2010 multiples, we then discount the result back by an estimated 17% discount rate to arrive to our target share price.

Table 4. Relative valuation heralds upside

Valuation	
Industry simple average PE	8.8
HBC's earnings 2011 - VND	120
Equity 2011 - VND bn	1,061
Discount rate	17%
Equity value 2010 - VND bn	907
Outstanding shares	16,231,003
Target price - VND	55,877
Current price - VND	45,300
Upside	23%

Source: VCSC, average PE calculated from PE of peer group in table 3

Major risks: revenue growth may slow down

We are concerned that several of HBC's client developers have requested the company to delay construction progress as they are impacted by the slowdown in the real estate market.

Concurrently, human resources scarcity has repeatedly been a hindrance to growth in the industry. HBC's ability to expand at similar rates as in the past three years will depend on the company's capability to secure and train its workforce in order to handle additional contracts. This may come at the expense of slower growth in the near future.

Definition of recommendation

BUY	Highly appreciated stock with targeted 20% return over one year period. Little amount of downside risk is foreseen.
HOLD	Fairly priced stock with less than 20% returns over one year holding period. Little amount of downside risk is foreseen.
SELL	Over-valued stock or poorly performing company with high amount of downside risk.

History of recommendation

Date	Recommendation	Closing price	Target price
19 Oct 2010	BUY	43,500	56,000

Contact

Viet Capital Securities Joint Stock Company (VCSC)

Head office

67 Ham Nghi, District 1, Ho Chi Minh City, Vietnam
T : +84 8 3914 3588 F: +84 8 3914 3209

Transaction office

136 Ham Nghi, District 1, HCM City
T: (84) 8 3914 3588 F: (84) 8 3914 3209

Trading office

236 - 238 Nguyen Cong Tru, District 1, HCM City
T: (84) 8 3914 3588 F: (84) 8 3821 6186

Ha Noi branch

18 Ngo Quyen St, Hoan Kiem District, Ha Noi
T : (84) 4 6262 6999 F : (84) 4 6278 2688

Research

Head of Research

Marc Djandji, M.Sc., CFA
+84 8 3914 3588 (ext 116)
marc.djandji@vcsc.com.vn

Research Manager

Hoang Thi Hoa
+84 8 3914 3588 (ext 146)

Senior Analyst

Truong Vinh An
+84 8 3914 3588 (ext 143)

Analyst

Vu Thanh Tu
+84 8 3914 3588 (ext 105)

Analyst

Hoang Huong Giang
+84 8 3914 3588 (ext 142)

Analyst

Luu Song Thuan
+84 8 3914 3588 (ext 139)

Research Manager

Ong Thi Thanh Thao
+84 8 3914 3588 (ext 107)

Senior Analyst

Dinh Thi Nhu Hoa
+84 8 3914 3588 (ext 140)

Senior Analyst

Pham Cam Tu
+84 8 3914 3588 (ext 120)

Analyst

Vo Xuan Quynh
+84 8 3914 3588(ext 145)

Analyst

Nguyen Thi Ngoc Lan
+84 8 3914 3588 (ext 147)

Sales & Brokerage

Head of Institutional Sales & Brokerage

Michel Tosto
+84 8 3914 3588 (ext 102)
michel.tosto@vcsc.com.vn

Manager of Institutional Sales & Brokerage

Nguyen Quoc Dung
+84 8 3914 3588 (ext 136)
dung.nguyen@vcsc.com.vn

Disclaimer

Copyright 2010 Viet Capital Securities Company. All rights reserved. This report has been prepared on the basis of information believed to be reliable at the time of publication. VCSC makes no representation or warranty regarding the completeness and accuracy of such information. Opinions, estimates and projection expressed in this report represent the current views of the author at the date of publication only. They do not necessarily reflect the opinions of VCSC and are subject to change without notice. This report is provided, for information purposes only, to institutional investor and retail clients of VCSC, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction. Investors must make their investment decisions based upon independent advice subject to their particular financial situation and investment objectives. This report may not be copied, reproduced, published or redistributed by any person for any purpose without the written permission of an authorized representative of VCSC. Please cite sources when quoting.