

**BUY** (upgrade)**Refrigeration Electrical Engineering Corp. (HSX: REE)**

Report date	Mar 26, 2020
Current price	VND 28,700
Target price	VND 39,000
Upside	36%
Bloomberg	REE VN
Market cap	VND 8,914bn USD 376mn
52 weeks movement	VND 27,800 – VND 37,800
Average daily value	VND 28bn USD 1.2mn
FOL	49%
Current FO	49%

**Stock to Buy under the Coronavirus Threat****Our takeaway**

- We upgrade REE to buy. The stock price has overreacted to the Coronavirus disease situation. In our view, power and water segments will be the last sectors to be negatively affected in value chain. Moreover, leasing office division is expected to remain profitable given its affordable rentals.
- We decrease our target price by 4% to VND 39,000 (36% upside). Although the higher holding of REE in VSH (Vinh Son Song Hinh Hydroelectric Power JSC) and new investment in phase 2 of TBW (Thuan Binh Wind Power JSC) will bring more profit to power segment, we lower our estimate of M&E division and also anticipate higher interest expenses compared to our previous forecast.

**Price movement**

Stock performance	1M	3M	12M
REE (%)	-12%	-18%	-6%
VNIndex (%)	-27%	-31%	-32%

Source: Bloomberg

**Major Shareholders**

Platinum Victory Pte Ltd.	29%
Apollo Asia Fund Ltd.	5.9%
Nguyen Thi Mai Thanh	12%
Nguyen Ngoc Hai	5.5%
State-owned (HFIC)	5.3%

**What's new**

**BUY recommendation.** 58% of total net profit comes from power and water segments, sectors that are the last to be negatively impacted in value chain for services and manufacturing. According to EVN, Vietnam electricity consumption still increased by 7.5% yoy in 2M20, in which, February volume recorded a 24% yoy higher number. If FY20 Vietnam electricity output remains at a 7.5% yoy increase, which is lower than target of a 9.1% yoy growth, EVN may decrease the proportion of oil-fired thermal power generation with high production costs. This will not affect current power segment of REE. Regarding office for lease segment (accounting for 32% of total net profit), all of ongoing towers and project are in B & C classes offering affordable prices, which will allow them to thrive during difficult operating environment.

**Higher forecasted earnings in power segment yet lower ones in M&E segment.**

An increase in REE holding in VSH from 21.01% to 49.45% in 4Q19 could earn an additional net profit of VND 156bn per year on average in the period of FY20 – FY30 (accounting for 6% of total net profit). Besides, REE intends to invest in phase 2 of TBW with capacity of 26 MW. We expect the project will contribute net profit of VND 66bn per year on average during its 20-year life time starting from FY22. However, the company's interest expenses after consolidating MHP (Muong Hum Hydropower JSC) and TBW starting from 4Q19 could be 8% higher than our previous forecast. In contrast with power segment, we decrease our forecasted revenue and net profit of M&E segment by 23% and 24% on average based on more conservative view on the difficult situation of real estate market.

**Valuation**

The stock is currently trading at FY20F and FY21F P/E of 5x and 4.6x respectively, lower than its five-year historical P/E of 7x. Upside potential comes from positive news of major shareholders increasing their holdings and the forthcoming restructuring of business model. Business activities will be divided into four main holdings containing M&E, Real Estate, Water and Power holdings. It will offer financial flexibility, ability to list and call new investors for separate segments.

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Unit: VND billion	FY19	FY20F	FY21F	FY22F
<b>Revenue</b>	<b>4,890</b>	<b>5,696</b>	<b>5,212</b>	<b>5,386</b>
EBIT	2,334	2,596	2,803	3,066
<b>Net profit</b>	<b>1,639</b>	<b>1,791</b>	<b>1,940</b>	<b>2,166</b>
Net profit (basic)	1,481	1,791	1,940	2,166
EPS (VND)	5,286	5,763	6,243	6,972
EPS growth rate (%)	-8%	9%	8%	12%
<b>P/E (x)</b>	<b>5</b>	<b>5</b>	<b>5</b>	<b>4</b>
EV/EBITDA (x)	7	6	6	5
DPS (VND)	1,800	1,600	1,600	1,600
Dividend yield (%)	6%	6%	6%	6%
P/B (x)	0.8	0.7	0.6	0.6
<b>ROE (%)</b>	<b>16%</b>	<b>15%</b>	<b>15%</b>	<b>15%</b>
Net debt/equity (%)	63%	68%	62%	49%

Source: MBS Research

### Net profit is forecasted to increase by 9% yoy in FY20 and 8% yoy in FY21

In FY20, the office leasing segment will record a 10% yoy growth in revenue to VND 985bn and a 17% yoy increase in net profit to VND 463bn mainly thanks to high occupancy rate of 97% of the Etown 5 office for lease (operating in 3Q19). We expect the power and water segments will earn the same net profit of VND 965bn (-1% yoy). In addition, REE will consolidate two subsidiaries MHP (Muong Hum Hydropower JSC, 34.8 MW) and TBW (phase 1 of 24 MW with annual forecasted net profit of VND 52bn on average with REE holding 58% shares) from 4Q19.

- We forecast MHP could generate revenue of VND 172bn and net profit of VND 50bn on average annually. MHP has two hydropower plants including the Muong Hum plant (32 MW, commercial operation date - COD in FY11) and the Ban Xeo plant (2.8 MW, COD in FY19). According to Circular No. 32/2014/TT-BCT, after COD of the Ban Xeo plant, both plants could enjoy avoided cost tariff (ACT) mechanisms for small hydropower plant. Thus, we estimate the FY20 average selling price is 1,300 VND/kWh (+19% yoy). REE holds 80% stake in MHP (49% directly, 31% indirectly through Thac Ba Hydroelectric JSC, HOSE: TBC).
- VCW (Song Da Water Investment JSC, REE holding 36% shares) is forecasted to rebound to VND 152bn net profit (+10% yoy). In FY20, our forecasts do not take into account any expenses incurred by water quality troubleshooting (VND 80bn in 4Q19). We forecast 5% higher generated capacity from nearly 286,000 m<sup>3</sup>/day to 300,000 m<sup>3</sup>/day after completing investment in the Tay Mo station and 6.4 km pipeline in 2Q19. As the same time, VCW will record additional expenses of VND 65bn, factoring depreciation costs and part of interest expenses of the project.
- These improvements could help to offset lower net profit of VSH (Vinh Son Song Hinh Hydroelectric Power JSC) of VND 72bn (-55% yoy). We anticipate the Thuong Kontum hydropower project (220 MW, 62% larger than current VSH's total capacity) will start operating from 3Q20. In the first year of operation, it could incur a loss of VND 98bn due to a low temporary Pc of about 906 VND/kWh, which is estimated ex ante from the initial approved investment of VND 5,744bn and applied during the finalization phase of work construction. Thereafter, with the official PPA agreement expected to take effect from 4Q21, it could bring net profit of VND 26bn in FY21 and an annual net profit of about VND 330bn on average for VSH in the period of FY22-FY29 (long term loan repayment period). We estimate that the project would "run in profile" with 20% higher fixed price in the period of FY20 – FY24 in order to meet debt service obligations.
- Our forecasts do not take into account any one-off profits including gains from liquidating investments in Vung Ang II plan of VND 161bn for REE and reimbursement from EVN for foreign exchange losses of VND 225bn for PPC (REE holding 24% shares) in FY19.

We expect FY21 net earnings will be VND 1,940bn (+8% yoy) given a 26% yoy increase in net profit in the power and water segments to VND 1,214bn. Anticipated better hydrological conditions and Thuong Kontum turning a profit will drive earnings in the hydropower group.

## Financials and Valuation Summary

Income statement (VND bn)	FY19	FY20F	FY21F	FY22F
Net revenue	4,890	5,696	5,212	5,386
Cost of goods sold	3,644	4,021	3,604	3,698
Gross profit	1,246	1,675	1,608	1,688
Financial income	442	408	453	503
Financial expenses	386	502	533	562
Profit of associates	907	833	1,067	1,214
Selling expenses	78	91	83	86
G&A expenses	222	233	245	257
Operating profit	1,910	2,090	2,267	2,500
Other profit	11	13	13	13
EBT	1,921	2,103	2,280	2,513
EAT	1,720	1,892	2,052	2,287
<b>Net profit</b>	<b>1,639</b>	<b>1,791</b>	<b>1,940</b>	<b>2,166</b>
Minority interests	81	102	112	121

Balance sheet (VND bn)	FY19	FY20F	FY21F	FY22F
<b>Current assets</b>	<b>5,999</b>	<b>6,297</b>	<b>5,841</b>	<b>6,388</b>
I. Cash & cash equivalents	1,540	518	486	911
II. Short-term investments	1,221	1,221	1,221	1,221
III. Current accounts receivable	2,138	2,589	2,369	2,448
IV. Inventories	987	1,915	1,716	1,761
V. Other current assets	113	55	49	47
<b>Non-current assets</b>	<b>13,624</b>	<b>15,010</b>	<b>17,074</b>	<b>17,637</b>
I. Long-term receivables	39	39	39	39
II. Fixed assets	1,859	1,729	4,413	4,167
1. Tangible fixed assets	1,827	1,698	4,383	4,138
2. Intangible fixed assets	32	31	30	29
III. Investment properties	1,856	1,726	1,597	1,468
IV. Long-term assets in progress	68	1,504	650	1,232
V. Long-term investments	9,214	9,451	9,841	10,225
VI. Other long-term assets	588	560	533	506
<b>Total assets</b>	<b>19,623</b>	<b>21,307</b>	<b>22,915</b>	<b>24,025</b>
<b>Liabilities</b>	<b>8,521</b>	<b>8,916</b>	<b>9,086</b>	<b>8,533</b>
<b>I. Current liabilities</b>	<b>3,269</b>	<b>3,303</b>	<b>3,210</b>	<b>3,149</b>
1. Short-term payables	2,381	2,234	2,066	2,242
2. Short-term loans	888	1,069	1,144	907
<b>II. Non-current liabilities</b>	<b>5,252</b>	<b>5,613</b>	<b>5,876</b>	<b>5,383</b>
1. Long-term payables	513	513	513	513
2. Long-term loans	4,739	5,100	5,363	4,870
<b>Equity</b>	<b>11,102</b>	<b>12,391</b>	<b>13,829</b>	<b>15,493</b>
1. Charter capital	3,101	3,101	3,101	3,101
2. Surplus	1,050	1,050	1,050	1,050
3. Retained earnings	6,246	7,535	8,973	10,637
4. Minorities interests	705	705	705	705
<b>Total liabilities &amp; equity</b>	<b>19,623</b>	<b>21,307</b>	<b>22,915</b>	<b>24,025</b>

Key ratios	FY19	FY20F	FY21F	FY22F
<b>Valuation</b>				
EPS (VND)	5,286	5,763	6,243	6,972
BVPS (VND)	35,801	39,958	44,595	49,960
P/E	5	5	5	4
P/B	0.8	0.7	0.6	0.6
<b>Profitability</b>				
Gross profit margin	25%	29%	31%	31%
EBITDA margin	50%	51%	61%	64%
Net profit margin	34%	31%	37%	40%
ROE	16%	15%	15%	15%
ROA	9%	9%	9%	9%
<b>Growth</b>				
Revenue growth	-4%	16%	-8%	3%
EBT growth	-9%	10%	8%	10%
Net profit growth	-8%	9%	8%	12%
EPS	-8%	9%	8%	12%
Total assets	27%	9%	8%	5%
Equity	12%	12%	12%	12%
<b>Liquidity</b>				
Current ratio	1.84	1.91	1.82	2.03
Quick ratio	1.53	1.33	1.28	1.47
Liabilities/Total assets	43%	42%	40%	36%
Liabilities/Equity	0.77	0.72	0.66	0.55
Interest coverage ratio	6.55	4.91	5.01	5.54
<b>Operating efficiency</b>				
Receivables turnover	2	2	2	2
Days sales outstanding	153	166	166	166
Inventory turnover	4	2	2	2
Days sales of Inventory	98	174	174	174
Payables turnover	2	2	2	2
Days payables outstanding	217	203	203	203

Cashflow Statement (VND bn)	FY19	FY20F	FY21F	FY22F
CFO	319	(614)	1,036	918
CFI	(1,630)	(454)	(909)	732
CFF	985	46	(159)	(1,225)
Net cash flows during the period	(325)	(1,022)	(31)	425

Source: MBS Research

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Rating	When (target price – current price)/ current price
BUY	>=15%
HOLD	From -15% to +15%
SELL	<= -15%

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