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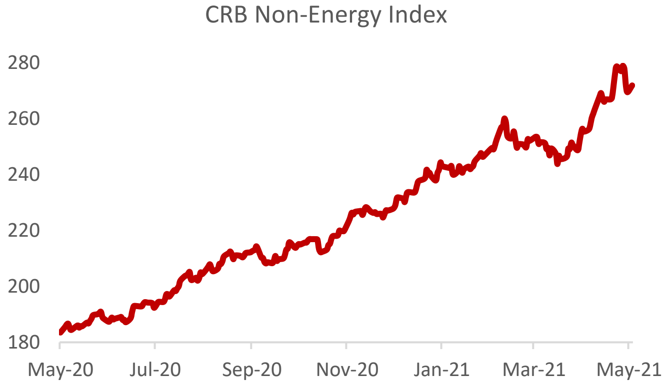
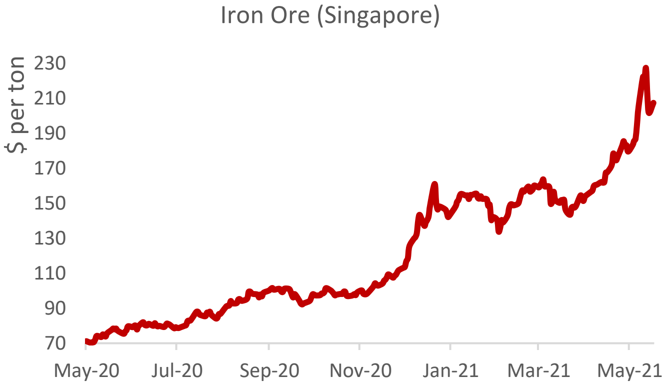
Surging Global Commodity Prices: the Winners & Losers in Vietnam

The Commodity Research Bureau's (CRB) Non-Energy Commodity index surged 40% yoy, which has had a mixed impact on listed Vietnamese companies. Commodity producers benefit from higher selling prices, but such companies do not feature prominently in Vietnam's stock market indices. This report examines the impact of agricultural and industrial commodity prices (excluding energy) on Vietnamese companies.

In contrast, the profit margins of companies that require commodities to produce their products typically shrink as their input prices rise, but as we discuss below, some Vietnamese companies (notably steel companies) have been able to more than pass on those higher input costs to consumers – because the demand for their products is so strong – but higher commodity prices are likely to shrink the margins of other firms with less pricing power.





While commodity producers do not feature prominently in Vietnam's stock market indices, the agriculture sector still contributes about 15% of Vietnam's GDP versus less than 10%/GDP in some EM countries that are typically thought of as commodity producers, such as Brazil, Argentina, and Malaysia.

Furthermore, about 40% of the country's workforce is still employed in the agriculture sector, so surging commodity prices boost the incomes and consumption of the circa two-thirds of the country's population that live outside its major cities. For example, Vietnam is the world's biggest pepper producer, with over half the country's pepper grown on thousands of small, family-owned farms. The 30% surge of pepper prices over the last year is directly supporting the income and consumption of those small farm owners.[1]

Surging Vietnamese Steel Prices Boost the VN-Index

Vietnamese steel prices are up nearly 50% YTD, outpacing the circa 30% YTD increase in global iron ore prices[2], and steel production in Vietnam surged by about 20-60% YTD, depending on the type of steel produced, according to the Vietnam Steel Association (VSA). Consequently, the stock prices of Vietnam's leading steel producers have increased nearly three-fold over the last year (see chart below), which in-turn boosted the VN-Index, given that Vietnam's steel market leader Hoa Phat Group (HPG) now has the 4th largest market capitalization in the country's stock market.

Vietnam's steel demand is very high, and the local industry is operating at close to full capacity, which helps explain why Vietnamese steel prices ballooned this year. Demand has been driven by a few factors, including a 35% yoy rise in the Government's infrastructure spending in 2020 (to ~6%/GDP), followed by a near 20% yoy growth in 4M21, which in-turn boosted the country's steel production by over 30% yoy in 1Q21, according to the VSA.

In addition, Vietnamese steel prices are also being *indirectly* supported by:

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[1] Pepper farming is one example of rising commodity prices supporting rural incomes. Agricultural workers in large-scale farms – including as rubber plantations – also benefit from higher commodity prices because the compensation of those workers is directly or indirectly linked to the price of the commodity being produced.

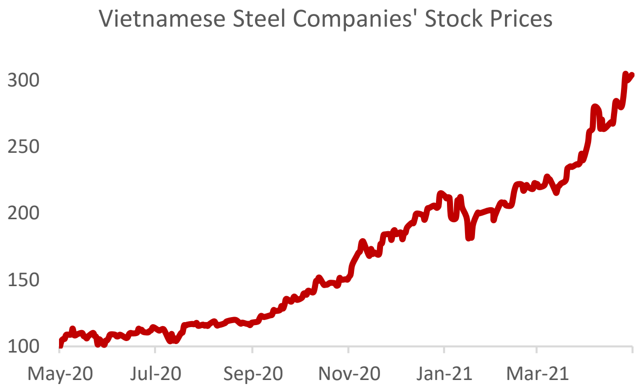
[2] Note: 1) Iron ore accounts for approximately half the cost of making steel, and 2) The global supply of iron ore was disrupted by the Brumadinho dam disaster in Brazil more than two years ago (Vale's production has not yet fully recovered yet), and by COVID-related disruptions last year.

- **Strong Chinese steel demand** from the country's construction industry and electric car makers.

- **Export restrictions** in China aimed at rebuilding the country's inventories of the steel products that were depleted during the COVID pandemic, which are limiting competition to Vietnamese producers from imported Chinese steel.

- **New environmental regulations** in China are constraining the country's steel production.

China's new environmental regulations also helped swell the gross margins of Vietnam's leading steel producers from 16% in 2019 (i.e., pre-COVID) to an expected 25% in 2021F, and lifted the stock prices of those companies. In short, Vietnam's steel producers were able to raise their selling prices by more than enough to offset the higher costs of their production inputs.



Consumer Food Companies' Higher Input Costs

Consumer food companies are negatively impacted by higher commodity prices, but the leading firms in Vietnam mitigate margin pressures by hedging their input price costs, or by passing on rising input prices to their customers:

- ***Vinamilk (Hedge Input Costs)***: About 30% of the cost of goods sold (COGS) of Vietnam's leading consumer food company VinaMilk (VNM) are imported milk powder and sugar, the prices of which have soared 35-40% yoy. However, VNM hedges over half of its milk purchases, so the combined cost of these inputs is only likely to increase by 16% this year, which would reduce the company's gross margin by about 6%pts *ceteris paribus* (note that VNM's gross margin was 47% in 2019). That said, intense competition in Vietnam's milk market could make it difficult for the company to pass on those higher input costs to its customers.

- ***Kinh Do (Price Hikes)***: Vietnam's leading vegetable oil producer Kinh Do (KDC) is in a good position to pass on higher input costs to its customers given the company's dominance of that niche. About 60% of KDC's COGS are soybean oil and palm oil, the prices of which have soared by 67% yoy, and 76% yoy respectively. That increase would reduce KDC's gross margin by about 12%pts *ceteris paribus* (note that KDC's gross margin was 22% in 2019), but we expect KDC to raise selling prices by about 12% to offset its higher input prices.

- ***Quang Ngai Sugar*** (QNS) is Vietnam's leading soymilk producer (80% of revenue) and also produces the sugar it needs to make soymilk but sells about 75% of its sugar production in the wholesale market (20% of revenue). Soybean prices soared 60% yoy, but the company hedged part of those input prices, and sugar prices are up 35% yoy. As a result, QNS is unlikely to suffer much of a gross margin contraction this year.

Conclusions

A sustained increase in commodities prices is generally beneficial for Vietnam's economy (for example, about 15% of the country's exports are of commodities). The specific winners in Vietnam from the bull market of commodity prices include commodity producers that are listed on Vietnam's stock market, although there are only a limited number such companies, and those companies have fairly small market-caps. In contrast, one would *expect* higher commodity prices to hurt the earnings of companies that require a significant amount of raw material inputs to produce their products, but as discussed above, most Vietnamese companies have, to varying degrees, insulated themselves against input price hikes, and some firms (such as steel companies) have been able to more than offset higher input costs by hiking their selling prices.