

CIENCO4 GROUP – PRE-LISTING NOTE

OTC Price	Fair Price	Dividend Yield	Rating	Sector
VND15,570	VND14,390	5.5%	N/A	INDUSTRIALS

Outlook – Short term

N/A

Outlook – Long term

N/A

Valuation

N/A

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Hung Nguyen Xuan

hung.nguyensexuan@vndirect.com.vn

Ratings review catalysts

- Greater contribution from toll road services
- New mega-construction project wins

Infrastructure construction specialist Cienco4 is due to list on the HOSE in 4Q2018. The company is struggling due to reduced state participation in infrastructure projects and Cienco4's increasing exposure to PPP (Public-Private Partnership) projects are mired in regulatory uncertainty and operational challenges.

Total revenues have been showing a steady decline in recent years and will continue falling in the next five years, in our view. Cienco4's infrastructure construction business accounts for about 80-90% of total revenues. This segment has been collapsing in the last three years with a revenue CAGR of -15.8%. We think that revenue from infrastructure construction, which contributes the most to total revenues, will continue to decrease -5% yoy in value over 2018-22F. However, emerging revenue streams from toll road services and real estate activities will mitigate the decrease in total revenues to just above -3% yoy over 2018-22F, in our view.

Gross Profit Margin (GPM) will improve over 2018-22F. Cienco4 is increasing toll road revenues while scaling down its construction operations. Moreover, we expect Cienco4 will see a surge in its real estate project revenues in 2019F. Industry GPM of toll road services and real estate vary from 35% to 75% and 25% to 80%, respectively while Cienco4's infrastructure construction GPM varies from 4.1% to 6.3%. We expect GPM will reach 15.7% in 2022F (FY17 GPM: 12.6%).

We value Cienco4's shares at VND14,390 each. We use a sum-of-parts valuation, valuing each of the three segments of Cienco4 separately. We use a relative valuation method for the infrastructure construction segment and a DCF valuation for a) cash flows from real estate development on a total land bank of 40ha located in Nghe An province (near National Road 48); and b) the toll road segment.

Potential upside catalysts include 1) winning new mega-construction projects, and 2) higher than expected BOT traffic volume.

Downside risks include 1) an increase in interest rates, 2) a lower than expected infra construction revenue growth rate and traffic volume in BOT projects, 3) public protests hampering Cienco4's BOT operations, 4) real estate project execution failures due to limited prior experience, and 5) not being awarded the Dien Chau – Bai Vot BOT.

Key statistics

26w high (VND)	N/A
26w low (VND)	N/A
3m Avg daily volume (shares)	N/A
3m Avg daily value (mn)	N/A
Market cap (VNDbn)	1,557
Outstanding shares (m)	100
Free float (%)	36
TTM P/E (x)	11.8
TTM EV/EBITDA (x)	11.6

Ownership

Dung Hung Construction Co.	21.0%
VPA Group	21.0%
Nhat Minh Co.	14.0%
Internal shareholders	8.0%
Others	36.0%

Source: VNDIRECT

Financial summary (VND)	12-16A	12-17A	12-18E	12-19E
Net revenue (bn)	5,030	4,049	4,020	4,341
Revenue growth	(18.2%)	(19.5%)	(0.7%)	8.0%
Gross margin	10.9%	12.6%	12.3%	14.2%
EBITDA margin	12.3%	13.5%	12.9%	15.9%
Net profit (bn)	168	133	107	247
Net profit growth	117.3%	(20.7%)	(19.5%)	130.5%
Recurring profit growth	117.3%	(20.7%)	(19.5%)	130.5%
Basic EPS	2,549	1,551	1,073	2,474
Adjusted EPS	2,549	1,551	1,073	2,474
BVPS	15,728	11,022	11,217	12,557
ROAE	17.1%	11.9%	9.7%	20.8%

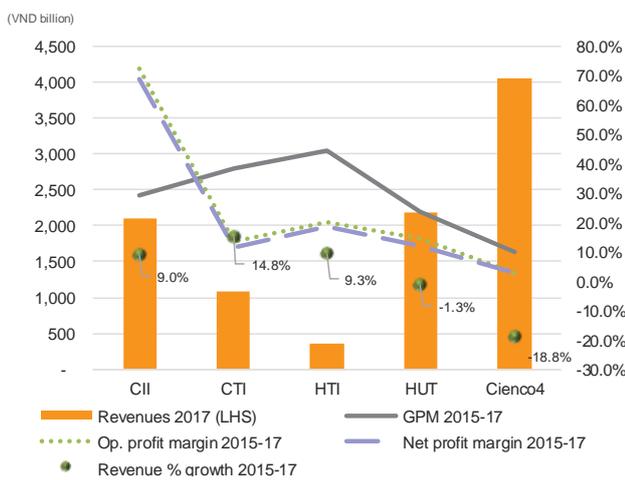
Source: VNDIRECT

COMPANY PROFILE

Cienco4 is a 57 year-old infrastructure construction company in Vietnam established in 1962. The company has a long history and has implemented many historical projects spanning various development stages of Vietnam’s economy. In 2014, the Vietnamese government divested all of its shares and Cienco4 became a private joint stock company. The company’s current ownership structure is rather concentrated. More than two-thirds of its shares are held by three companies (Dung Hung Construction Co., VPA Group and Nhat Minh Co.) and a few individuals related to the management team. The company is expected to list on Ho Chi Minh Stock Exchange (HOSE) in 4Q2018, according to Cienco4.

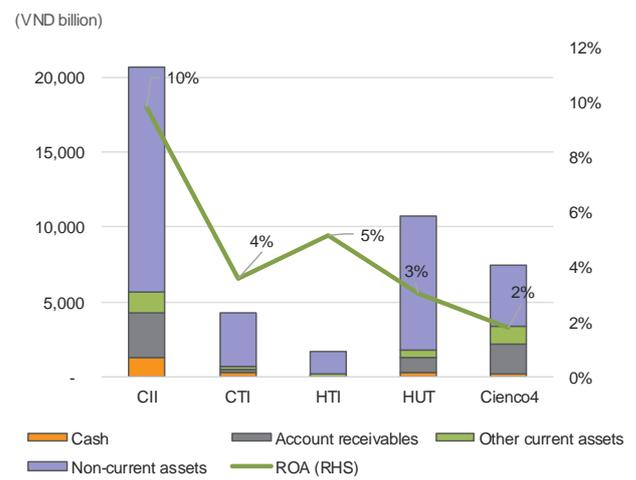
Cienco4 was famous for infrastructure construction, but now the company has also expanded to toll road services and real estate development. Compared to its peers in infrastructure construction and toll road operations in Vietnam, Cienco4’s construction revenue contribution to total revenue is among the highest. As construction has much lower margins than toll road services, Cienco4’s net margin is low despite its superior scale.

Figure 1: Revenue, margins and growth of Cienco4 vs peers



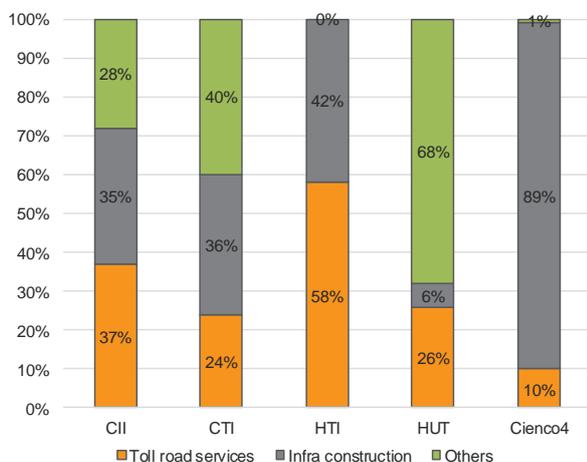
Source: VND RESEARCH, COMPANY REPORTS

Figure 2: Asset breakdown 2017 of Cienco4 vs peers



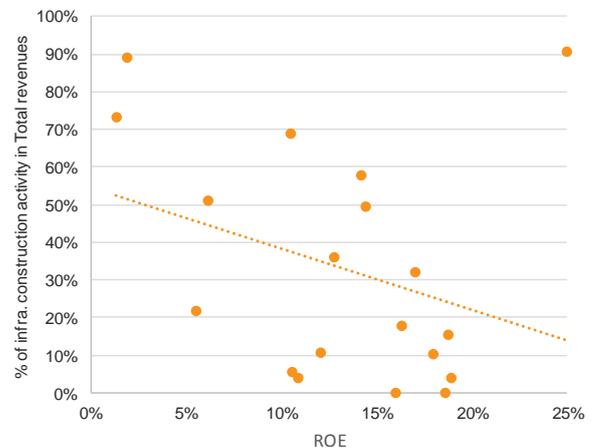
Source: VND RESEARCH, COMPANY REPORTS

Figure 3: Revenue breakdown 2017 of Cienco4 vs peers



Source: VND RESEARCH, COMPANY REPORTS

Figure 4: ROE and % share of infrastructure construction in total revenues across multiple industry players (2013-2017)

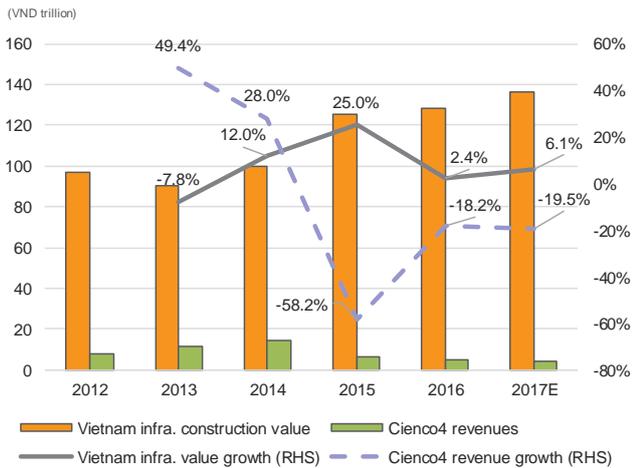


Source: VND RESEARCH, COMPANY REPORTS

Note: Data collected from CII, CTI, HTI and HUT from 2013-17.

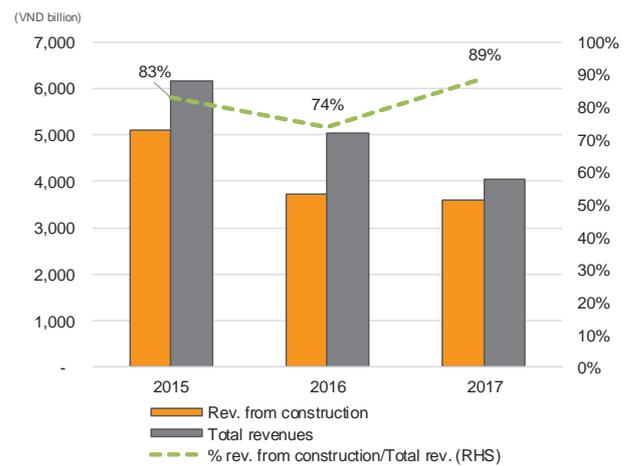
Total revenues have been showing a steady decline in recent years. In the last three years, revenues dropped significantly with a CAGR of -18.8%. We think that there are two reasons for the plunge. Cienco4's infrastructure construction activity accounts for about 80-90% of total revenues and this segment has been collapsing in the last three years with a CAGR of -15.8%. The company has also reduced the amount of raw material sold to its sub-contractors in its projects, according to Cienco4's annual report. This may be explained by the local government forcing Cienco4 and its sub-contractors to use supplier role.

Figure 5: Relationship between VN infrastructure construction value growth and Cienco4 revenues growth is weak at best



Source: VND RESEARCH, CIENCO4, GSO

Figure 6: Infrastructure construction revenue contribution remains very high



Source: VND RESEARCH, CIENCO4

Figure 7: BOT Yen Lenh – Vuc Vong



Source: VND RESEARCH

Figure 8: BOT Ben Thuy – Ha Tinh



Source: VND RESEARCH

Vietnam infrastructure construction is growing, but that does not guarantee Cienco4's growth. From 2012 to 2017, while Vietnam infrastructure construction value grew quickly (CAGR +7.0%), Cienco4's revenues decreased considerably (CAGR -12%). We notice that after equitisation and the departure of the former CEO – Le Ngoc Hoa from Cienco4 in 2014 (for a new position as Vice Chairman of the People's Committee of Nghe An Province), the company's revenues started decreasing. We think that during his time as CEO, Mr. Hoa was able to secure more projects for Cienco4 based on his close relationship with the government because contractors were appointed directly for each infrastructure project by local governments at that time. In recent years, contractors must submit bids for new projects. However, local governments still have their own means to ensure that their favourite contractors win the bid such as establishing rules that only their preferred contractors can meet.

Cienco4's woes are mirrored in other Cienco group companies. In the past, Cienco was the leading infrastructure construction company in Vietnam but this seems to have changed post equitization with a number of Cienco group companies seeing a deterioration in performance. Cienco1 management team admitted that after the equitisation of many state-owned Cienco companies in 2014, these companies have simply not been able to cope with market competition.

The CEO of Cienco8 recently mentioned that the reduction in public investment has resulted in a decrease in the number of large government-sponsored projects. He also mentioned that there are many problems with Build – Operate – Transfer¹ (BOT) contracts recently. Many Cienco companies are now sinking into huge debt and need to sell subsidiaries (Cienco8 sold 7 out of 13 subsidiaries). Their financial difficulties also prevent them from bidding successfully for contracts (Cienco5 management confessed that the company is saddled with too much debt, preventing them from making competitive contract bids and even meeting financial eligibility criteria imposed by regulations).

Figure 9: BOT Nghi Son – Cau Giat



Source: VND RESEARCH

Toll road operations to play a key role in Cienco4's prospects from 2018 onwards...

Since private capital is increasingly required for Vietnam's infrastructure construction needs, Cienco4, like many other infrastructure construction companies, has had to invest in PPP contracts to win projects. At the moment, Cienco4 is operating 4 BOTs and the company is planning to construct another BOT project (Dien Chau – Bai Vot) after 2019. We expect that toll revenue from Cienco4's BOTs will increase going forward even as construction revenue decreases, leading to a fairly drastic change in the revenue mix.

Figure 10: Cienco4's Current Portfolio of BOT Projects

	BOT 1	BOT 2	BOT 3	BOT 4
Name of BOT	Yen Lenh – Vuc Vong	Ben Thuy – Ha Tinh	Nghi Son – Cau Giat	Thai Nguyen – Cho Moi
Location	Ha Nam – Hung Yen	Nghe An – Ha Tinh	Thanh Hoa – Nghe An	Thai Nguyen – Cho Moi
Actual start year	2017	2014	2015	2018
Duration (years)	10	22	16	16
End year (expected)	2026	2035	2030	2033
Investor(s)	Cienco4 (37.9%) Thang Long Construction (62.1%)	Cienco4 (100%)	Cienco4 (51%) 319 Ministry of National Defense Company (49%)	Cienco4 (49.3%) Tuan Loc & Truong Loc Construction (50.7%)
Distance (km)	12.4	88.3	47.7	65.3
Construction value (VND billion)	822	2,434	3,509	2,746
Number of toll booth	1	1	1	2
Estimated total toll revenue (VND billion)	2,539	17,122	9,025	5,419
IRR (%)	34%	19%	6%	1%

Source: VND RESEARCH, CIENCO4

Note: Due to protests, the BOT project in Thai Nguyen is running at only 50% operational capacity in 2018.

...but BOT projects are facing a number of headwinds. Although BOT projects can be profitable for investors and improve Vietnam infrastructure quality without straining public finances, there are many difficulties and risks for BOT investors. According to the Vietnam Ministry of Construction, the main problems of investing in BOT projects are 1) laws and policies for BOT are still a work-in-progress so BOT policy changes are to be expected; and 2) local governments also create difficulties for investors because they intervene deeply in operations and the financial structure of a BOT project.

However, in our view, the most challenging issue is public protests. In fact, for the last few years, there have been many large protests across Vietnam against BOTs and three out of Cienco4's total four BOTs suffered protests. Vietnam's Deputy Prime Minister Trinh Dinh Dung

¹ BOT (Build-Operate-Transfer) is a contract to build an infrastructure project between a competent state agency and an investor. After completing the construction, the investor shall be entitled to operate it for a specified period of time. Eventually, the investor shall transfer it to the Vietnam state agency.

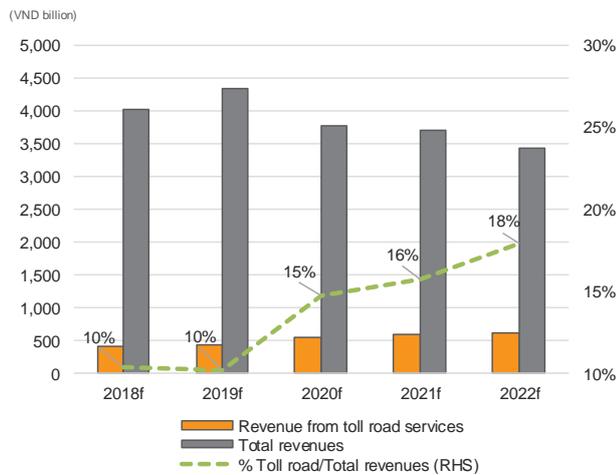
Figure 11: BOT Thai Nguyen – Cho Moi



Source: VND RESEARCH

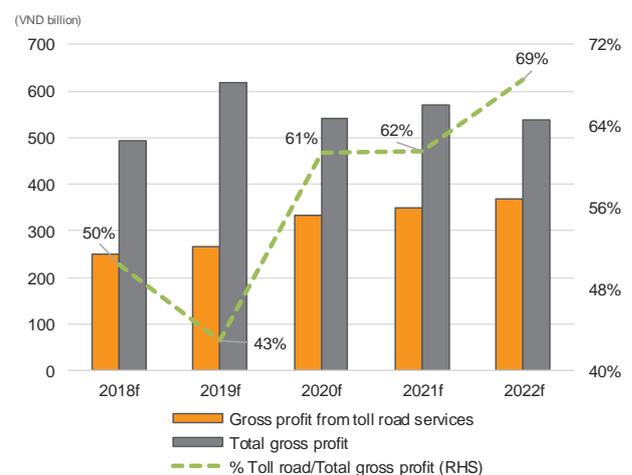
stated in Jan 2018 that there are two main reasons for these occurrences: unreasonably high toll fees and inappropriate BOT locations. As a consequence, the BOT project in Thai Nguyen is running at only 50% operational capacity in 2018. BOT Yen Lenh (04/2017) and BOT Ben Thuy (03/2018) were forced to reduce and exempt fees for local residents. BOT Yen Lenh may have to shorten its operational duration from 15 years to 7 years according to Vietnam state audit's suggestion in May 2018. In our best case scenario, the government will clamp down on BOT protests in 2019, and enable the normal functioning of all 4 BOTs but this cannot be counted on to happen.

Figure 12: Toll road services contribution to total revenue is expected to steadily increase over time...



Source: VND RESEARCH

Figure 13: ...with an even faster increase in contribution of toll road services to total gross profit



Source: VND RESEARCH

Real estate is expected to bring additional revenue for Cienco4 in 2018-20, but this is not significant. BOT contracts have become riskier to operate lately so we think that Cienco4 is changing its focus to BT (Build-Transfer)² contracts. In 2017, Cienco4 participated in one BT project and it was subsequently awarded a parcel of land for sale. This resulted in the Long Son 1- 4 and Tay Hieu projects. However, we estimate that real estate will contribute an average of only 6% in total revenues for the period 2018-20F.

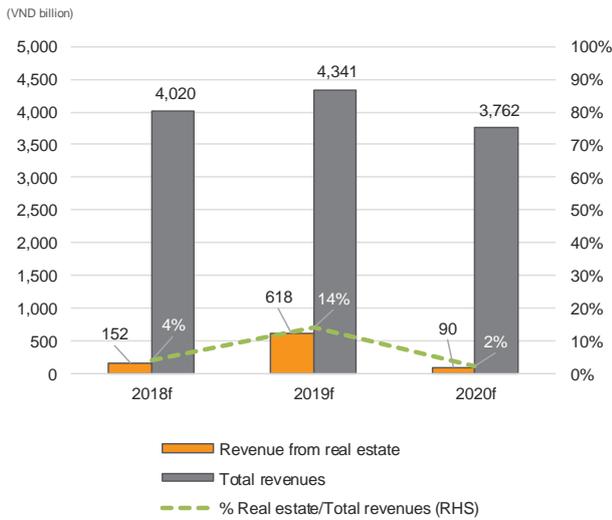
Figure 14: Cienco4's land bank

Name of project	Address	Area (m ²)
Long Son 1	Long Son Ward, Thai Hoa Commune, Nghe An Province	152,086
Long Son 2	Long Son Ward, Thai Hoa Commune, Nghe An Province	19,365
Long Son 3	Long Son Ward, Thai Hoa Commune, Nghe An Province	107,846
Long Son 4	Long Son Ward, Thai Hoa Commune, Nghe An Province	75,000
Tay Hieu	Tay Hieu Ward, Thai Hoa Commune, Nghe An Province	41,648
61 Nguyen Truong To	Dong Vinh Ward, Vinh City, Nghe An Province	11,873

Source: CIENCO4

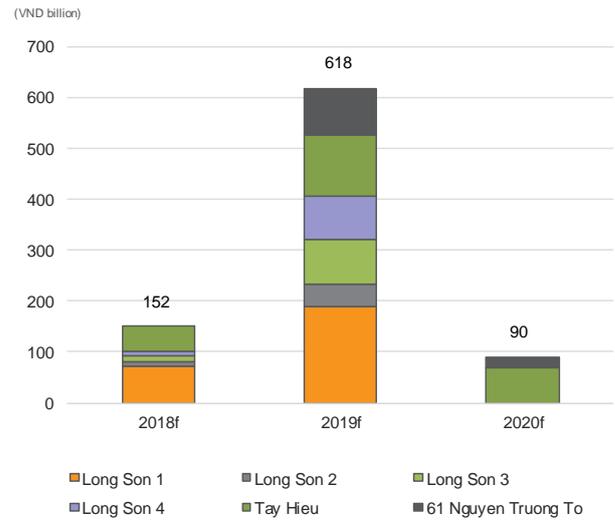
² BT (Build-Transfer) is a contract to build an infrastructure project between a regulatory agency and an investor. After completing the construction, the investor shall transfer it to the competent agency, and the investor will then be allotted a land parcel used for carrying out another project.

Figure 15: Real estate contribution in 2018-20F



Source: VND RESEARCH

Figure 16: Forecasted real estate revenue by project 2018-20F

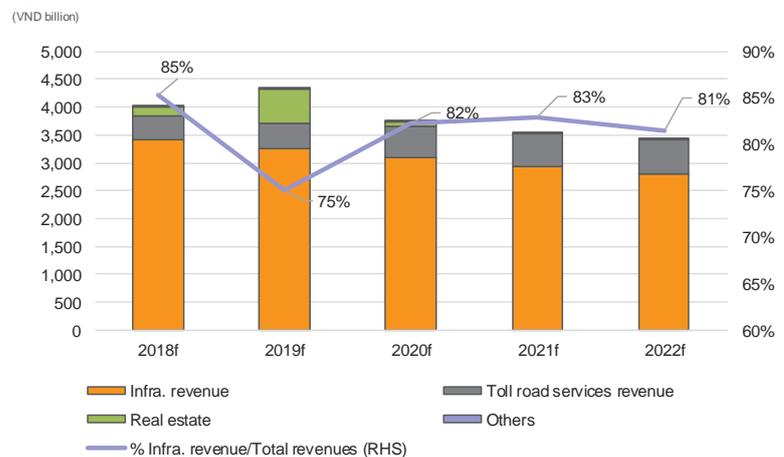


Source: VND RESEARCH, CIENCO4

FINANCIAL FORECASTS

Total revenues will probably continue decreasing in the next five years, in our view. We think revenue from infrastructure construction – which has the largest proportion of total revenues today – will continue to decrease -5% annually in value over 2018-22F. However, revenue from toll road services and some contribution from real estate activities will stem the annual decrease in total revenues to just over -3%, in our view.

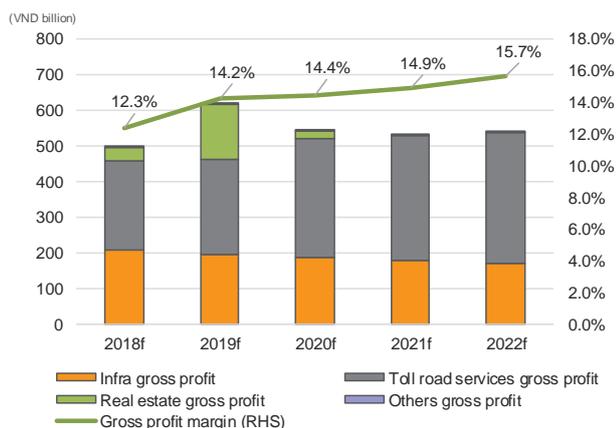
Figure 17: Revenues forecast in 2018-22F



Source: VND RESEARCH

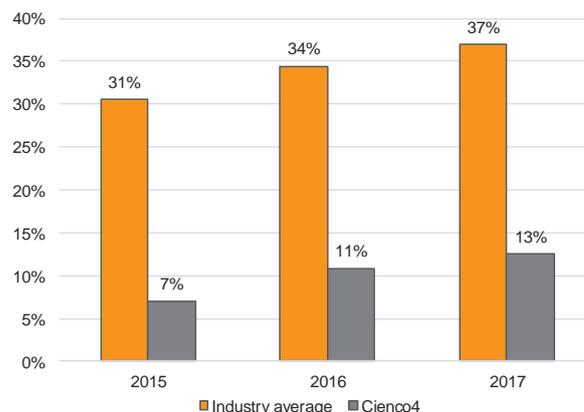
Gross Profit Margin (GPM) will keep improving in 2018-22F due to rising toll road revenue contribution. Cienco4's GPM will keep improving because industry GPM of toll road services varies from 35-75% while infrastructure construction GPM of Cienco4 is only around 4.1 - 6.3%. Therefore, rising contribution of toll road services will help expand blended GPM. We expect that blended GPM will reach 15.7% in 2022F (2017 GPM was 12.6%).

Figure 18: Gross profit forecast breakdown 2018-22F



Source: VND RESEARCH

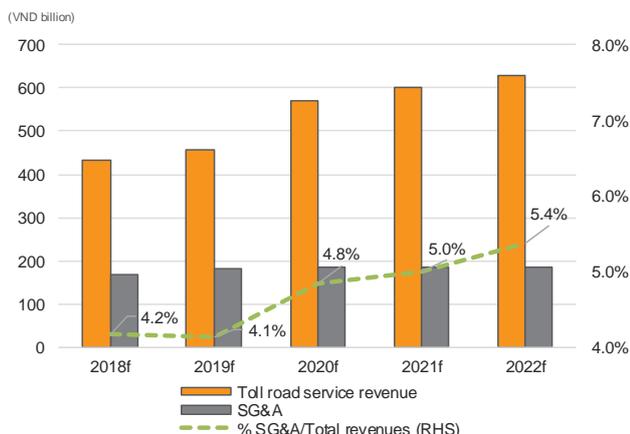
Figure 19: GPM of Cienco4 vs Industry average 2015-17³



Source: VND RESEARCH, COMPANY REPORTS

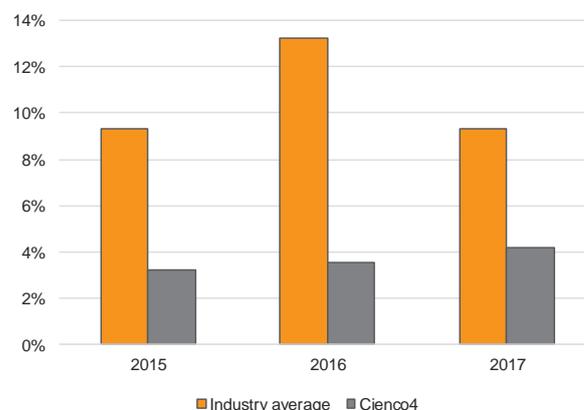
Selling, General and Administration expenses (SG&A) will increase marginally with toll road revenue. The reason is that while construction activity's SG&A/Revenue ratio is 2-3%, the comparable ratio for toll road services is around 12-13%. Increasing toll road services in the revenue structure will trigger an increase in SG&A. We expect that Cienco4's SG&A/Revenues ratio will increase to 5.4% by 2022F (current SG&A/Revenues ratio is 3-4%).

Figure 20: SG&A expenses increase with toll road services revenue in 2018-22F



Source: VND RESEARCH

Figure 21: % SG&A/Total revenues of Cienco4 vs. Industry average in 2015-17



Source: VND RESEARCH

Figure 22: Debt/Equity ratio

	HTI	HUT	CTI	CII	Cienco4
2015	2.19	2.15	3.81	1.73	4.04
2016	2.06	1.81	2.95	0.83	3.42
2017	2.47	1.65	1.81	1.23	3.71

Source: VND RESEARCH, COMPANY REPORTS

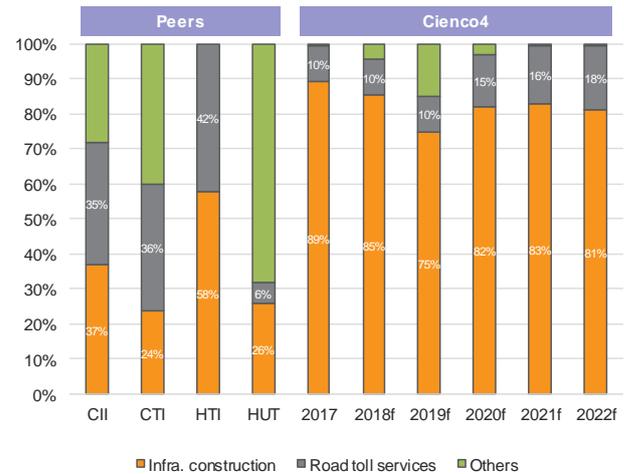
We expect Cienco4 will use less debt in its capital structure. A defining characteristic of infrastructure and toll road companies Vietnam is their use of high leverage. However, Cienco4 is more leveraged than the industry average. This could hurt Cienco4's business if interest rates increase. Cienco4 expects to issue 15 million shares in 4Q2018 (15% of current common stock) in order to decrease debt levels. Without factoring this issuance into our model and based on the assumption that Cienco4 will reduce its reliance on debt as it reduces infrastructure project development activity, we still expect Cienco4 will decrease its Debt/Equity ratio of 3 – 4x in 2015-17 to approach a more reasonable 2.5x by 2022F.

³ Industry mentioned above is defined as Vietnam companies who have large portion of revenue generated from infrastructure construction and toll road services activities. The industry average comprises of CII, CTI, HTI and HUT.

Figure 23: Working capital management of Cienco4 vs peers

	2015-17 average		Cienco4 forecast			
	Cienco4	Industry	2017	2018f	2020f	2022f
Days of account receivables	150-180	80-100	184	176	158	156
Days of inventory	45-80	40-50	79	75	57	57
Days of account payables	90-100	70-80	101	103	95	95
Cash conversion cycle (days)	105-160	50-70	161	148	120	119

Figure 24: We expect rising revenue contribution from road toll services



Source: VND RESEARCH

Source: VND RESEARCH

Working capital management expected to improve in the next five years. As Cienco4 decreases its exposure to infrastructure construction and increases exposure to toll road services, Cienco4's working capital management numbers should improve and gradually approach the industry average as construction activity is working capital intensive, unlike toll road operations. This change in revenue mix will also help reduce cash flow volatility.

VALUATION

We value Cienco4's shares at VND14,390 each. Using a sum-of-parts valuation, we evaluate four segments of Cienco4 separately with relative valuation for infrastructure construction and DCF valuation for real estate and toll road services. Due to lack of reliable information, we do not factor Cienco4's share issuance into our model.

BOT Dien Chau – Bai Vot in the valuation result is separated from other BOTs because the project is yet to be awarded. According to Cienco4, the company is going to participate in a public contract bid in 2Q2019, start construction in 1Q2020 and finish the project in 4Q2021. We expect that Cienco4 will win BOT Dien Chau – Bai Vot. However, if they do not win the project, the revised fair value per share is VND12,261.

Figure 25: Toll road operation assumptions

	Average price per unit (VND)			Average traffic volume per year (million)		
	2018F	2022F	2026F	2018F	2022F	2026F
BOT Yen Lenh - Vuc Vong	70,000	82,600	115,012	2.4	2.9	3.5
BOT Ben Thuy - Ha Tinh	85,000	100,300	139,658	3.6	4.6	5.6
BOT Nghi Son - Cau Giat	70,000	82,600	115,012	4.5	5.6	6.7
BOT Thai Nguyen - Cho Moi	45,460	53,643	74,692	0.5	4.0	4.8
BOT Dien Chau - Bai Vot	N/A	100,300	139,658	N/A	5.9	8.3

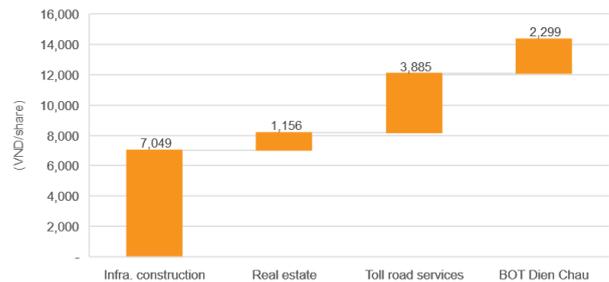
Source: VND RESEARCH, CIENCO4

Figure 26: Valuation summary

Segment	Valuation Method	VND/share
Infrastructure construction	Relative valuation	VND 7,049
Real estate activity	DCF	VND 1,156
Toll road services activity (4 existing BOTs)	DCF	VND 3,885
BOT Dien Chau - Bai Vot	DCF	VND 2,299
Fair price		VND 14,390

Source: VND RESEARCH

Figure 27: Fair price based on sum-of-parts valuation



Source: VND RESEARCH

Figure 28: Peer comparison

Ticker	Market cap (VNDbn)	TTM NPAT growth	TTM EPS growth	ROA	ROE	D/E	TTM P/E	EV/EBITDA
CII VN Equity	6,660	-97%	-97%	-0.1%	-0.2%	208%	N/A	21.7x
CTI VN Equity	1,610	-20%	-41%	3.1%	11.2%	201%	12.1x	8.1x
HUT VN Equity	1,560	-74%	-80%	1.6%	5.9%	170%	10.1x	10.0x
HTI VN Equity	318	-26%	-26%	4.0%	16.0%	269%	4.8x	6.3x
<i>Average</i>				2.2%	8.2%	212%	9.0x	11.5x
<i>Median</i>				2.4%	8.6%	205%	10.1x	9.0x
Cienco4	1,557	-21%	-43%	1.8%	12.1%	371%	11.8x	11.6x

Source: VND RESEARCH, BLOOMBERG

Note: data as of 01 Oct 2018 and Cienco4's market cap is calculated from OTC share price

RISK

Potential upside catalysts include 1) winning new mega-construction projects, 2) higher than expected BOT traffic volume.

Downside risks include 1) an increase in interest rates, 2) a faster decline in infrastructure construction revenue growth than we have forecasted, 3) a lower than expected traffic volume in BOTs, 4) BOT public protests leading to unfavourable changes in Cienco4's BOT business, 5) real estate project execution failures due to limited prior experience and 6) not being awarded the Dien Chau – Bai Vot BOT concession.

Income statement

(VNDbn)	12-17A	12-18E	12-19E
Net revenue	4,049	4,020	4,341
Cost of sales	(3,540)	(3,525)	(3,724)
Gen & admin expenses	(170)	(169)	(180)
Selling expenses			
Operating profit	339	327	437
Operating EBITDA	501	468	589
Depreciation and amortisation	(162)	(141)	(151)
Operating EBIT	339	327	437
Interest income	118	121	120
Financial expense	(255)	(273)	(275)
Net other income	10	11	10
Income from associates & JVs	(59)	(60)	(5)
Pre-tax profit	152	126	287
Tax expense	(18)	(15)	(35)
Minority interest	(0)	(4)	(5)
Net profit	133	107	247
Adj. net profit to ordinary	133	107	247
Ordinary dividends	(162)	(87)	(114)
Retained earnings	(29)	21	134

Balance sheet

(VNDbn)	12-17A	12-18E	12-19E
Cash and equivalents	157	578	786
Short term investments	387	255	255
Accounts receivables	2,038	1,936	1,816
Inventories	762	726	607
Other current assets	33	33	36
Total current assets	3,378	3,527	3,499
Fixed assets	3,148	3,238	3,324
Total investments	433	381	376
Other long-term assets	440	316	341
Total assets	7,398	7,461	7,540
Short-term debt	1,577	1,794	1,832
Accounts payable	978	994	921
Other current liabilities	762	757	817
Total current liabilities	3,317	3,546	3,570
Total long-term debt	2,514	2,330	2,213
Other liabilities	401	398	430
Share capital	1,018	1,018	1,018
Retained earnings reserve	80	100	234
Shareholders' equity	1,102	1,122	1,256
Minority interest	62	66	71
Total liabilities & equity	7,398	7,461	7,540

Cash flow statement

(VNDbn)	12-17A	12-18E	12-19E
Pretax profit	152	126	287
Depreciation & amortisation	162	141	151
Tax paid	(23)	(26)	(23)
Other adjustments	126	170	(15)
Change in working capital	(348)	148	224
Cash flow from operations	69	560	625
Capex	(102)	(231)	(238)
Proceeds from assets sales	17	21	21
Others	(202)	125	(7)
Other non-current assets changes			
Cash flow from investing activities	(287)	(85)	(224)
New share issuance	0	0	0
Shares buyback			
Net borrowings	215	33	(79)
Other financing cash flow	(4)	(1)	0
Dividends paid	(162)	(87)	(114)
Cash flow from financing activities	49	(55)	(192)
Cash and equivalents at beginning of period	326	157	578
Total cash generated	(169)	420	208
Cash and equivalents at the end of period	157	578	786

Key ratios

	12-17A	12-18E	12-19E
Dupont			
Net profit margin	3.3%	2.7%	5.7%
Asset turnover	0.55	0.54	0.58
ROAA	1.8%	1.4%	3.3%
Avg assets/avg equity	6.57	6.68	6.31
ROAE	11.9%	9.7%	20.8%
Efficiency			
Days account receivable	184	176	153
Days inventory	78.5	75.2	59.5
Days creditor	101	103	90
Fixed asset turnover	1.28	1.26	1.32
ROIC	2.5%	2.0%	4.6%
Liquidity			
Current ratio	1.02	0.99	0.98
Quick ratio	0.79	0.79	0.81
Cash ratio	0.16	0.23	0.29
Cash cycle	161	148	122
Growth rate (yoy)			
Revenue growth	(20%)	(1%)	8%
Operating profit growth	(8%)	(4%)	34%
Net profit growth	(21%)	(20%)	131%
EPS growth	(39%)	(31%)	131%
Share value			
Basic EPS (VND)	1,551	1,073	2,474
BVPS (VND)	11,022	11,217	12,557

Source: VND RESEARCH

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Anirban Lahiri – Head of Research

Email: anirban.lahiri@vndirect.com.vn

Hung Nguyen Xuan – Analyst

Email: hung.nguyensexuan@vndirect.com.vn

VNDIRECT Securities Corporation

1 Nguyen Thuong Hien Str – Hai Ba Trung Dist – Ha Noi

Tel: +84 2439724568

Email: research@vndirect.com.vn

Website: <https://vndirect.com.vn>