INDUSTRIAL PROPERTIES: THE EMERGENCE OF TIER-2 CITIES AND PROVINCES

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Vietnam's industrial property (IP) sector still enjoys healthy growth on the back of solid positive economic outlook and manufacturing diversion. We see two trends in the sector: 1) ready-built factory (RBF) leasing is becoming the new profit growth engine of small-size IP operators; and 2) the emergence of Tier-2 provinces; ie Ba Ria – Vung Tau, Hai Duong and Bac Giang.

High growth prospect of Vietnam's IP sector will continue in the next few years

Vietnam's economy has bucked the regional downward trend, with GDP growth accelerating to nearly 7.02% yoy in 2019. We expect the economy to grow 6.8% in 2020F, a healthy pace of expansion given the challenging global economic environment and US-China trade war uncertainties. Ample buffers against external risks including current account surplus, high FX reserves and low inflation could provide support for a stable exchange rate.

On the back of positive economic outlook of Vietnam, we expect IP demand growth to sustain in 2020-21F thanks to 1) the on-going factory relocation trend from China to ASEAN, and 2) FDI inflows attracted by free trade agreements (FTAs), especially the EU-Vietnam FTA.

Figure 1: Key macro forecasts in 2020F

	Unit	2017	2018	2019E	2020F
Real GDP	%yoy	6.8	7.1	7.0	6.8
Exports, custom basis	%yoy	21.6	13.4	8.1	8.0
Imports, custom basis	%yoy	21.4	11.4	7.0	8.5
Trade balance, custom basis	US$bn	2.9	7.6	9.9	8.6
Currrent account	% of GDP	2.3	2.4	2.5	2.2
Headline inflation, average	%yoy	3.5	3.5	2.8	3.2
Refinancing rate	%p.a.	6.25	6.25	6.00	5.75
VND per US dollar, end-year	VND/US$	22,735	23,245	23,230	23,500

Source: VND Research, WB, GSO, SBV, CUSTOMS, VCB

Vietnam is still a hot spot for factory migration from China with low operating costs and tax incentives. The U.S.-China trade war has accelerated the trend of factory relocations from China in 2019, as evidenced by a sharp increase in FDI from China and Hong Kong into Vietnam. The "China plus one" strategy has resulted in an expansion in manufacturing operations from China to neighbouring countries in a bid to diversify risks and enjoy lower wage costs, which in turn creates major opportunities for Vietnam's IPs in the next few years, in our view.

Figure 2: Comparative matrix in operating cost and Corporate Income Tax

	Operating cost				
	Land price	wage	Electricity price for business	Industrial warehouse/factory cost	CIT
Philippines	121.5	220	0.11	na	30
Indonesia	238	296	0.07	504	25
Vietnam	103.5	227	0.08	352	20
Malaysia	224.5	413	0.1	533	24
Thailand	182.5	413	0.12	na	20
Myanmar	80	162	0.11	na	25

Source: VND Research, SAVILLS, JLL, Mifer Myanmar

Compared to neighboring countries like the Philippines, Indonesia, Malaysia, Thailand and Myanmar, in terms of industrial attraction, Vietnam is still the hot destination for company migration due to its low land price, worker's wage, energy price and Ready-built factories and warehouses (RBF & WH) cost. Beside the low operating costs, Vietnam cut its Corporate Income Tax (CIT) to a 20% flat rate in 2016, from 22% previously, for all domestic and foreign companies. Companies in industrial zones also enjoy many incentives, such as tax exemption/reduction and visa exemption. Common tax incentives for companies in IPs include tax exemption for two to four years, tax reduction for the next three to 15 years and import duty exemption.

FTAs will be the key factor for developing IPs in the next period

A total of 12 FTAs were in force as at Oct 2019, while another FTA with the EU (EVFTA) was signed on 30 Jun, 2019. The EVFTA has to undergo an internal approval process in the EU and Vietnam before coming into force.

Vietnam is increasingly taking advantage of FTAs to boost its economy. According to the Ministry of Industry and Trade, the export value subject to FTA tariff incentives in 2018 reached US$46.2bn, or 39% of total export value earned from the markets which signed FTAs with Vietnam, an increase of 5% pts yoy. India has the highest rate of incentive utilisation from AIFTA, at 72%, followed by Chile and South Korea with 67% and 35%, respectively.

The export tax on goods from Vietnam to the EU will be eliminated after the EVFTA comes into effect, or after a short time (maximum of seven years). This is the highest level of commitment that Vietnam has achieved under the FTAs signed so far. Currently, just over 42% of Vietnam's exports to the EU enjoy the 0% tax rate under the Universal Preferential Tariff (GSP). The National Center for Socio-Economic Information and Forecast (NCIF) estimated EVFTA could help Vietnam's GDP increase by 4.3% by 2030. Vietnam's exports to the EU by 2030 are expected to jump 44.4%. The EVFTA will help motivate manufacturing investment companies to come to Vietnam, helping maintain strong FDI inflows into the Southeast Asian nation in the coming years, in our view.

Figure 3: Tax rate of goods in GSP and EVFTA (%)

HS	Goods	EU-VIE Imports (million EUR)	EVFTA tariffs	GSP (%, 2016)
85	Electrical machinery and equipment	12,742.72	0	0.1
84	Machinery	3,995.15	0	0
64	Footwear	3,709.80	0	8.9
62	Apparel and clothing (not knitted or crocheted)	2,082.28	0	9.0
09	Coffee, tea, mate and spices	1,483.42	0	0.1
94	Furniture	1,023.89	0	0
61	Apparel and clothing (not knitted or crocheted)	916.75	0	9.4
42	Leather bags	770.14	0	1.5
08	Edible fruit and nuts	693.50	0	0.2
03	Fish	659.87	0	6.0
39	Plastic and articles thereof	545.37	0	1.6

Source: VND Research, Eurostat, WTO

Ready-built factory (RBF) and warehouse (WH) leasing is becoming the new profit growth engine for small-size operators who own limited land bank

With the development of Vietnam's industry and supporting industries in four main areas, namely mechanical engineering, electric and electronic, plastic and rubber engineering, material and others, many large industrial clusters have been created nationwide. The development of industrial clusters has boosted the demand for RBF & WH because of 1) the scarcity of IP land bank, 2) the efficiency in time and costs for investors, 3) their impact on maximizing the use of development resources, and 4) the sustainability in infrastructure development.

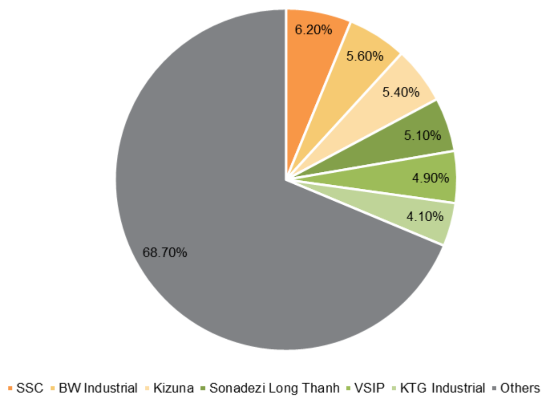
Figure 4: Vietnam's industrial clusters

	Samsung	Thaco	Vinfast	Pouchen
Location	Bac Ninh, Thai Nguyen, HCMC	Quang Nam	Hai Phong	HHCMC, Dong Nai, Long An, Tay Ninh, Tien Giang
Number of factories	4	7 * Component factories	6 * Component factories	7 * Manufacturing plants
Area (ha)		325	335	350
Number of suppliers	210 *Vietnamese suppliers	20		
Localization rate	57%	40%	60% by 2020	

Source: VND Research, CBRE Research

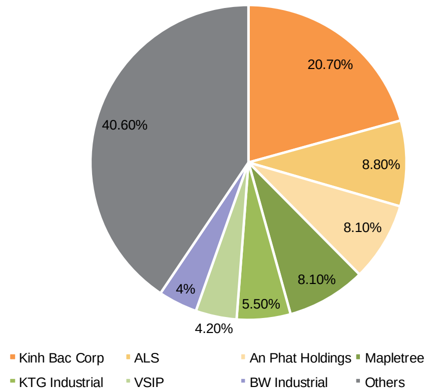
RBF & WH recorded high growth rates of supply area in FY2017-19, with a CAGR of 16.9% in the Northern region and 13.3% in the Southern region. Total RBF & WH supply area in 2019 was nearly 3.7m sq m. In particular, 2019 witnessed a high growth of RBF & WH of as much as 25.2% yoy in the Northern area, and 18.9% yoy in the Southern area.

Figure 5: Southern major developers in RBF & WH supply (%)



Source: VND Research, CBRE Research

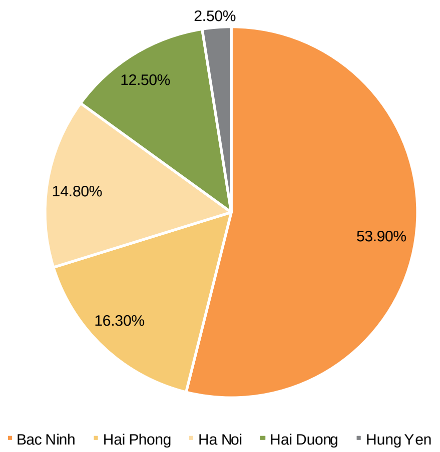
Figure 6: Northern major developers in RBF & WH supply (%)



Source: VND Research, CBRE Research

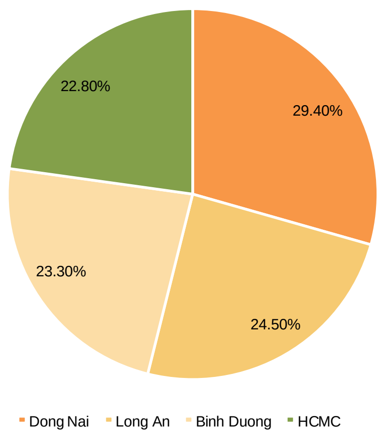
In the North, RBF & WH are mainly in Bac Ninh province, accounting for 53.9% of the total. Meanwhile, in the South, the RBF & WH supply area was evenly distributed in Ho Chi Minh City and Dong Nai, Binh Duong and Long An provinces.

Figure 7: RBF & WH by cities / provinces in Northern region (%)



Source: VND Research, CBRE Research

Figure 8: RBF & WH by cities / provinces in Southern region (%)

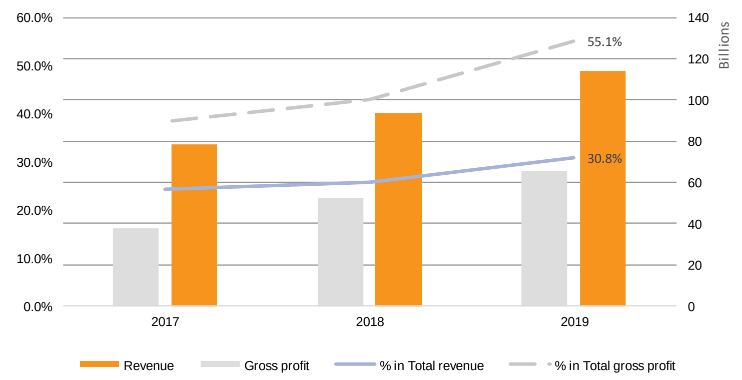


Source: VND Research, CBRE Research

According to CBRE, the land leasing price ranges from US$50 to US$300/sq m/lease term, equivalent to US$0.23 – US$1.38/sq m/month (we assume lease term of 30 years and include interest benefit from prepayments of long-term contract of raw land leasing), lower than average RBF leasing price, which is in the range of US$2-8/sq m/month. With the gross profit margin of approximately 60%, per our estimation, we believe RBF leasing could bring more profit for industrial operators comparing to raw land leasing of the same land size, but it will incur higher investment cost.

We think building and leasing RBF & WH can bring a higher benefit for small-sized companies, who face a shortage of land bank. For the large-sized companies with abundant land bank, the profit of RBF & WH segment does not contribute much to the company's total earnings. For example, Sonadezi Long Thanh (SZL) only has 20ha of raw land in Long Thanh IP and 50ha of raw land in Chau Duc IP - they are focusing on building RBF and WH for sale; the revenue and gross profit from which grew at high rates of 20.9% and 31.8% p.a, respectively, during 2017-2019.

Figure 9: Sonadezi Long Thanh's revenue and gross profit from RBF contributed 30.8% and 55.1% to total revenue and gross profit of SZL in 2019



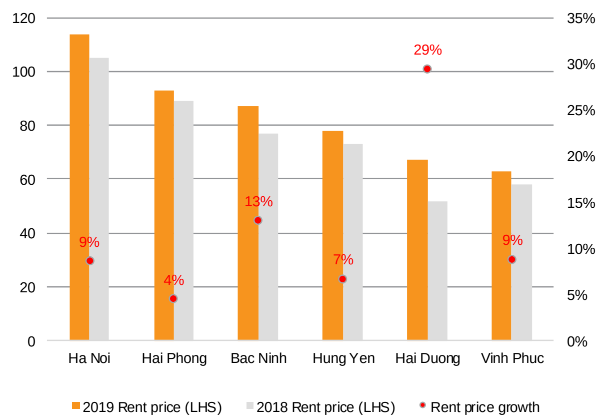
Source: VND Research, COMPANY REPORTS

We expect Ba Ria Vung Tau, Hai Duong and Bac Giang will be the rising stars in IP leasing in 2020F

According to CBRE, IPs in Tier-2 provinces, such as Bac Giang, Vinh Phuc, Ha Nam, Thai Binh, Quang Ninh in the North and Binh Phuoc, Tay Ninh, Ba Ria - Vung Tau in the South will develop strongly in the coming years, given 1) their abundant land bank, while the 2019 occupancy ratio in Tier-2 provinces is only 76% in the North and 58% in the South, below the 91% and 83% ratios in Tier-1 provinces, respectively; and 2) the land rents in Tier-2 provinces, which are only about US$50-150/sq m/lease term, are lower than the US$60-300/sq m/lease term in Tier-1 provinces. Tier-2 provinces with developed infrastructure, especially at the location connected to the port system and highways, will see good IP growth when compared to other Tier-2 provinces and Tier-1 provinces.

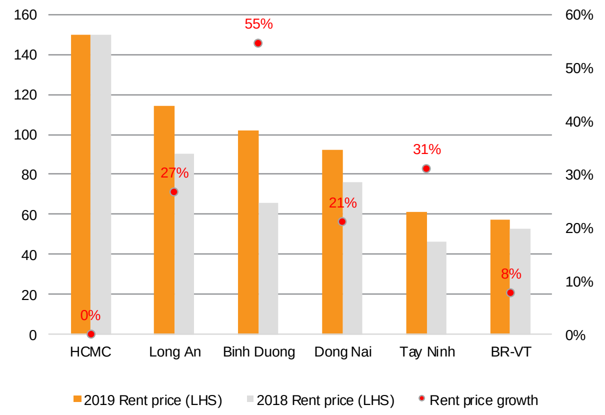
Based on data from Savills at end-1H19, the leasing price in Tay Ninh and Ba Ria - Vung Tau in the South is below US$60/sq m/ lease term, still cheaper than the below US$70/sq m/lease term level in the Northern provinces of Hai Duong and Vinh Phuc. This allows IP companies with land bank in these provinces to compete by price with other Tier-1 provinces.

Figure 10: Northern IP land price in 2018-19 (US$/sq m/lease term)



Source: VND Research, SAVILLS

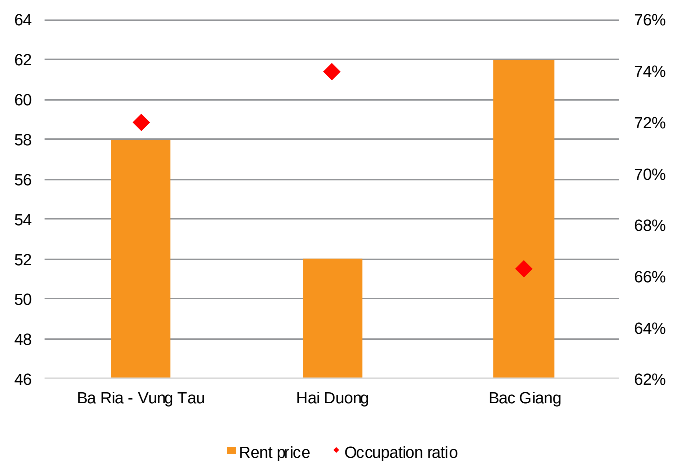
Figure 11: Southern IP land price in 2018-19 (US$/sq m/lease term)



Source: VND Research, SAVILLS

Tier-2 provinces, which have ample land bank, low price, good infrastructure well connected with Tier-1 provinces, ports and highways could achieve a stronger increase in leasing price and area in 2020F compared to other provinces. In the Southern zone, Ba Ria-Vung Tau, with an occupancy ratio at 73% and the lowest price at US$58/sq m/lease term in the South at end-1H19, will be a rising star in FY20-21F thanks to its good infrastructure, including highways and the Cai Mep-Thi Vai international port clusters, in our view. In the Northern zone, we believe IP land in Hai Duong and Bac Giang, which have a good infrastructure of highway, namely expressway Bac Giang – Lang Son and Hai Duong – Quang Ninh and is well connected with Hai Phong port cluster, will have a better performance in leasing price and land when compared with others.

Figure 12: Ba Ria - Vung Tau, Hai Duong and Bac Giang will be the rising star of IP leasing in the next few years, in our view



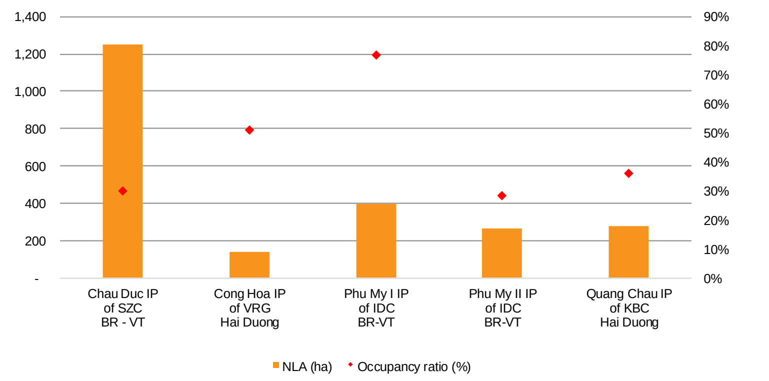
Source: VND Research, Savills, Bac Giang IZ

Figure 13: Good highway connection in the Northern zone of Vietnam will support the growth of IP leasing in Hai Duong and Bac Giang

Source: VND Research, VNExpress

We expect Sonadezi Chau Duc (SZC) with Chau Duc IP and IDICO (IDC) with Phu My IP in Ba Ria – Vung Tau province, Viet Nam Rubber Industrial Zone and Urban Development JSC (VRG) with Cong Hoa IP in Hai Duong province and Kinh Bac City JSC (KBC) with Quang Chau IP in Bac Giang province will enjoy a better result from these IP leasing in 2020F.

Figure 14: SZC, IDC, VRG and KBC will enjoy a better result from IP in rising Tier-2 provinces



Sources: VND Research, COMPANY REPORTS

Figure 15: IP companies peer comparison

Company Name	Ticker	Share price (VND)	TP (VND)	Recom.	Market Cap (US$ m)	3-year EPS CAGR (%)	P/E (x)		P/B (x)		ROE (%)		Dividend yield (%)		EV/EBITDA	
							2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F	2019F	2020F
Investment & Ind	BCM VN	29,300	N/A	NR	1,308.8	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Viglacera Corp J	VGC VN	18,100	N/A	NR	350.2	4.8	12.7	10.7	1.2	1.2	10.5	12.0	5.8	5.8	5.0	4.6
Kinh Bac City De	KBC VN	15,150	17,500	ADD	307.1	7.0	8.5	7.2	0.8	0.7	9.0	10.2	6.5	6.6	6.5	5.9
Sonadezi Corp	SNZ VN	16,300	N/A	NR	264.9	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Saigon Vrg Inves	SIP VN	86,000	N/A	NR	256.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Idico Corp Jsc	IDC VN	17,900	N/A	NR	231.8	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Itaco	ITA VN	2,600	N/A	NR	105.3	277.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Nam Tan Uyen	NTC VN	160,700	N/A	NR	111.0	125.5	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	**5.8**	**5.3**
Sonadezi Chau Du	SZC VN	15,700	N/A	NR	67.8	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	**5.8**	**5.3**
Industrial Urban	D2D VN	66,000	N/A	NR	60.7	21.3	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A		
Average						**87.2**	**10.6**	**8.9**	**1.0**	**0.9**	**9.8**	**11.1**	**6.1**	**6.2**	**5.8**	**5.3**
Median						**21.3**	**10.6**	**8.9**	**1.0**	**0.9**	**9.8**	**11.1**	**6.1**	**6.2**	**5.8**	**5.3**

All prices are based on the closing prices on 20 Jan 2020. All estimates for Non-rated (NR) stocks are based on Bloomberg consensus estimates.

Source: VND Research, Bloomberg

DISCLAIMER

RECOMMENDATION FRAMEWORK

Stock Ratings	Definition:
Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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