

POWER CONSTRUCTION JSC NO.1 (PC1) – UPDATE

Market Price VND22,500	Target Price VND28,400	Dividend Yield 0.00%	Rating ADD	Sector INDUSTRIALS
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Outlook – Short term



Outlook – Long term



Valuation



13 November 2018

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The results of recent bids for the third 500kV national transmission line missed our expectations. However, apart from this project, PC1 has secured new orders and will be able to raise its backlog to VND2,500bn by the end of 2018 (+92.3% vs. backlog at end-2017). In FY19F, we expect the grid erection and steel pole segments to recover but this will not be enough to offset a drop in the real estate segment. Earnings could fall next year but a robust order backlog and new real estate project should support earnings into 2020.

Price performance



Source: VNDIRECT

The result of recent bids for the third 500kV national transmission line missed our expectations... PC1 won VND350bn from recent bids for the third national transmission line. This result is below our previous expectations (VND1,000bn for grid erection and installation contracts), highlighting increasing competition in the bidding process.

...but year-end backlog to see strong growth. Despite disappointing results from the bidding of the third 500kV transmission line project, we see that PC1 is actively sourcing new contracts from both EVN and non-EVN clients. According to PC1, the total backlog of the grid erection and installation segment is estimated to stand at VND2,500bn at end-2018, which is much higher than the backlog value at the beginning of this year (VND1,300bn).

We expect margin contraction in FY19F. In 9M2018, margin of grid erection and steel pole production segments declined due to higher input costs and rising competition in bidding activities. Because of fierce competition in grid erection and steel pole production segments and smaller contribution from the real estate segment in 2019F, we expect PC1's blended gross margin to shrink by 3.3% pts in FY19F to touch 14.9%.

Earnings likely to fall in FY19F. In our view, the recovery of the grid erection and steel pole production segment in FY19F will not offset a significant drop in profit booking from the real estate segment (My Dinh Plaza 2 project is expected to contribute around VND200bn to PC1's net profit in 2018). We project a net profit of VND342bn in FY19F (-33.1% yoy), mainly due to smaller revenue contribution from the real estate segment. If we exclude the real estate segment, we expect to see a 8.5% growth in PC1's earnings in FY19F.

We lower our target price but maintain ADD rating. Based on the softening prospects for 2019, we lower our target price from VND31,300 to VND28,400 but maintain an ADD rating on PC1. Our ADD rating is underpinned by: 1) an anticipated recovery in the grid erection and installation and steel pole segments into 2019 and beyond driven by a strong order book; 2) stable cash flow from the hydropower segment. Key upside catalysts are: 1) Better-than-expected results from the remaining bids for the third national transmission line; 2) Sooner-than-expected launch of new real estate projects.

Key statistics

52w high (VND)	35,348
52w low (VND)	22,500
3m Avg daily volume (shares)	277,740
3m Avg daily value (VND m)	6,660
Market cap (VND bn)	2,987.3
Outstanding shares (m)	132.8
Free float (%)	71.0
TTM P/E (x)	7.2
Current P/B (x)	1.0

Ownership

Trinh Van Tuan	17.7%
Vietnam Enterprise Investments Ltd.	11.1%
Vietnam Holding Limited	4.1%
Others	67.1%

Source: VNDIRECT

Financial summary (VND)	12-16A	12-17A	12-18E	12-19E
Net revenue (bn)	3,008	3,161	4,987	4,761
Revenue growth	(3.0%)	5.1%	57.8%	(4.5%)
Gross margin	17.5%	15.2%	18.2%	14.9%
EBITDA margin	15.2%	16.3%	17.9%	16.3%
Net profit (bn)	305	237	511	342
Net profit growth	24.1%	(22.3%)	116.0%	(33.1%)
Recurring profit growth	24.1%	(22.3%)	116.0%	(33.1%)
Basic EPS	2,294	1,782	3,848	2,574
Adjusted EPS	2,124	1,643	3,579	2,394
BVPS	26,003	23,238	23,286	25,378
ROAE	18.7%	10.2%	17.7%	10.6%

3Q18: WEAK RESULTS DUE TO LOWER PROPERTY-RELATED INCOME AND SLUGGISH ENGINEERING PROJECT PROGRESS

3Q18 net profit dropped 39.6% qoq but still rose 125.3% yoy

In 3Q18, PC1 posted net revenue of VND1,132.4bn (-28.8% qoq and +23.1% yoy) and net profit of VND131,0bn (-39.6% qoq and +125.3% yoy).

The real estate and hydropower segments continued to be the main contributors to both the topline and bottom line. The main reason for a qoq decline in net profit is the lower contribution of My Dinh Plaza 2 project in PC1's earnings versus in the previous quarter. In 3Q18, PC1 recorded revenue of VND252bn from the My Dinh Plaza 2 project vs. VND600bn in 2Q18. The grid erection and installation segment continued to be sluggish with a revenue decline of 44.6% qoq and 40.5% yoy due to the slow progress on PC1's main projects.

In 3Q18, the highlights included: 1) the recovery of the steel pole segment with a 68.3% qoq rise in revenue and margin recovery from 4.2% in 1H to 9.5% in 3Q18, thanks to higher sales volume which drove down unit production costs; 2) PC1 signed new contracts in the grid erection and installation segment worth VND947bn, raising the backlog of this segment to VND2,300bn.

Figure 1: Comparison of Financial Results

FYE (VND bn)	3QFY18	yoy	9M18	yoy	vs. old forecast	vs. revised forecast	Comments
		chg		chg			
Net revenue	1,132.4	23.1%	3,578.0	55.5%	71.7%	71.7%	In line with our expectations
<i>Industrial manufacturing</i>	441.4	11.3%	1,232.2	54.9%			Surge in trading activities
<i>Grid erection & installation</i>	250.2	-40.5%	1,003.0	-20.4%			Continued slow progress of PC1's main projects
<i>Real estate</i>	256.4	6979.3%	862.7	7170.4%			Recognition of revenue from My Dinh Plaza 2
<i>Hydropower</i>	160.0	93.4%	429.4	122.0%			Contribution of new hydropower plants
<i>Other</i>	24.4	47.0%	51.0	27.6%			
Gross profit	226.5	90.9%	701.7	92.3%	77.3%	77.3%	In line with our expectations
<i>Gross profit margin</i>	20.0%	7.2% pts	19.6%	3.8% pts			Tracking above our full year forecast as most of My Dinh Plaza 2's profit was recorded in 2Q and 3Q
Selling expenses	17.0	342.1%	47.7	na	87.0%	87.0%	Higher than our forecast due to distribution expenses for My Dinh Plaza 2 project
G&A expenses	34.0	9.5%	105.1	5.8%	63.9%	63.9%	In line with our expectations
Operating profit	175.5	110.2%	548.9	105.0%	79.8%	79.8%	
Pre-tax profit	157.0	112.9%	497.4	115.3%	79.2%	79.2%	
Net profit	131.0	125.3%	411.1	127.9%	80.4%	80.4%	Profit growth could be slower in 4Q because most of My Dinh Plaza 2's profit was recorded in 2Q and 3Q
EPS (VND)	917.6	125.3%	2,879.8	127.9%	80.5%	80.5%	

Source: PC1, VNDIRECT

Note: Industrial manufacturing is steel pole production.

9M18 still in line with our expectations

In 9M18, PC1 posted net revenue of VND3,578 bn (+55.5% yoy) and net profit of VND411 bn (+127.9% yoy), completing 63.4% and 89.6% of its revenue and net profit targets, respectively. The 9M18 results are still in line with our expectations, fulfilling 71.7% and 80.4% of our FY18F revenue and net profit forecasts, respectively. Therefore, we make no change to our 2018 forecasted revenue of VND4,987.1bn (+57.8% yoy) and net profit of VND511.2bn (+116.0% yoy). We expect net profit to post a qoq decline in the last quarter because most of My Dinh Plaza 2's profit was recorded in 2Q and 3Q.

2019 OUTLOOK: NOT AS BRIGHT AS EXPECTED

The results of recent bids for the third 500kV national transmission line missed our expectations

EVN has finalised contractors for the VND2,435bn construction package of the Quang Trach - Doc Soi 500kV transmission line – the longest line with the highest investment value (VND6,758bn) among all segments related to the third national transmission line project. According to the company, PC1 won VND250bn worth of contracts from this package, which accounted for 10.3% of total bidding value. PC1 also won VND100bn from another bidding package of the third national transmission line. The results are below our expectations, highlighting increasing competition in the bids for the national transmission line. At the end of Oct 2018, PC1’s accumulated backlog was around VND2,300bn, including the package of VND350bn that PC1 won from the bidding of the third 500kV national transmission line.

The bidding for the remaining lines and steel pole packages are underway. However, due to concerns about rising competition, we lower our expectations about the contribution of the third 500kV national transmission line to PC1’s future earnings. We expect PC1 to win new orders worth up to VND700bn from the remaining bids for this project (including both grid erection and steel pole production).

Figure 2: Key facts about the third 500kV national transmission line

Circuit	Length (km)	Investment value (VND bn)
Vung Ang - Quang Trach	32	1,595
Quang Trach - Doc Soi	500	6,758
Doc Soi - Pleiku 2	209	3,606
Total	741	11,959

Source: VNDIRECT, Decision 2025/TTg, MoIT

Robust backlog heading into 2019F

Despite disappointing results from the bidding of the third 500kV transmission line project, we see PC1 actively sourcing for new contracts from both EVN and non-EVN clients. According to the company, after booking revenue in 4Q18, the total backlog of the grid erection and installation segment is estimated at VND2,500bn at the end of 2018, nearly double the backlog value at the beginning of this year (VND1,300bn).

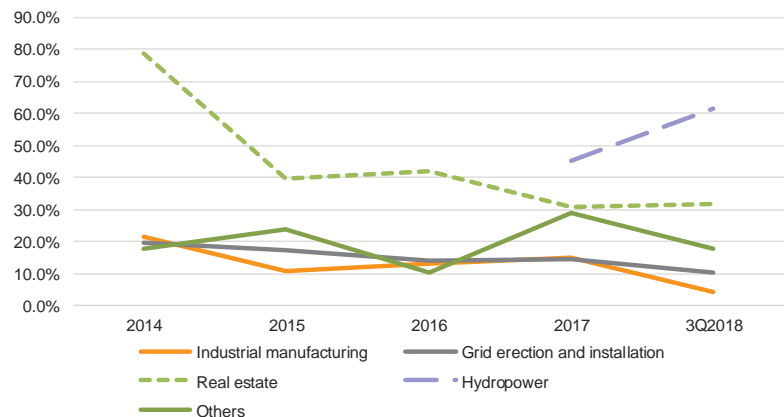
Given this order book strength, we estimate a 27.7% and 15.0% increase in revenue for the grid erection segment and steel pole production segment, respectively in 2019. But overall revenue is expected to decline by 4.5% yoy because a sharp drop in the real estate segment (My Dinh Plaza 2 project is expected to contribute more than VND1,000bn to the company’s revenue in FY18E).

We expect margin contraction in FY19F

In 9M18, PC1’s gross margin increased by 3.8% pts thanks to the contribution of the real estate segment (i.e. My Dinh Plaza 2 project) and margin expansion of the hydropower segment. The company expects to book the remaining revenue from My Dinh Plaza 2 project in 4Q18 and is implementing another two real estate projects in Ha Noi (Thanh Xuan project and unnamed project located in Hoang Mai district). According to the management, the Thanh Xuan project will be completed by the end of 2019. We therefore think that most of this project’s profit will be booked in 2020. Land at Hoang Mai district is under the land use repurposing process. As a result, we do not expect the launch of this real estate project anytime soon.

Due to a fall in margin of the grid erection segment and higher input prices in the steel pole production segment, gross margins of both the grid erection and installation segment and the steel pole production segment declined in 9M18 to 10.5% and 7.0%, respectively (vs. 14.4% and 12.5% in the same period last year). Because we expect gross margin of the grid erection segment to remain at the same level seen in 2018 (~11.0%) and given a smaller contribution from the relatively high margin real estate segment in 2019F, we project PC1's gross margin to shrink by 3.3% pts in FY19F to 14.9%.

Figure 3: PC1's gross margin by segment (2014-3Q2018)



Source: VNDIRECT

We expect a decline in both revenue and earnings in FY19F

In our view, the recovery in the grid erection and steel pole production segments in FY19F will not offset a significant drop in profit from the real estate segment. Assuming most revenue from the Thanh Xuan project will be booked in FY20F, we project the company to achieve VND4,761bn in revenue in FY19F (-4.5% yoy). Because of the aforementioned margin contraction, PC1's net profit is estimated at VND342bn in FY19F (-33.1% yoy). If we exclude the real estate segment, we expect to see 8.5% growth in PC1's earnings in FY19F.

VALUATION

Despite disappointing results from recent bids for the third 500kV national transmission line, we still expect a recovery in the grid erection and steel pole production segment in FY19F with the sizable new order wins in 2018. Rising stable cash flows from the expansion of the hydropower asset base is also a positive for PC1's business. However, we think negative earnings growth in FY19F will weigh on investor sentiment in the near term.

In this report, we used the SOTP valuation method based on PC1's FY19F outlook as we believe the market has factored 2018 business results into PC1's share price. Based on 2019 prospects, we lower our target price from VND31,300 to VND28,400 but maintain an ADD rating on PC1. Our ADD rating is underpinned by several factors: 1) a drop in the real estate segment is broadly expected and not alarming given the inherent volatility in revenue booking in this segment as it is not yet a core business of the company; 2) a recovery in the grid erection and installation segments on the back of a strong order backlog; 3) stable cash flow from hydropower segment which will see further capacity addition post-2019. This translates to a potential upside of 26.2% based on the closing price at 12 Nov 2018.

Downside risks to our call include: 1) lower-than-expected revenue growth of the grid erection and installation segment as well as steel pole production segment; and 2) lower-than-expected margins.

Key upside catalysts are: 1) better-than-expected results of the remaining bids from the third national transmission line; 2) Sooner-than-expected launch of the Thanh Xuan project.

Figure 4: SOTP valuation estimate

Segment	Value (VND bn)	% of total	Valuation methodology
M&E & Industrial manufacturing	890.8	23.6%	Target P/E of 6x
Real estate development	101.4	2.7%	NAV, discount rate of 16%
Real estate investment	29.5	0.8%	DCF, discount rate of 16%, terminal growth rate: 0%
Hydropower	2,652.9	70.4%	DCF, discount rate of 8.5%, terminal growth rate: 1%
Other	92.6	2.5%	Book value
Total	3,767.2		
No of shares outstanding (shares)	132,769,862		
Target price (VND/share)	28,400		

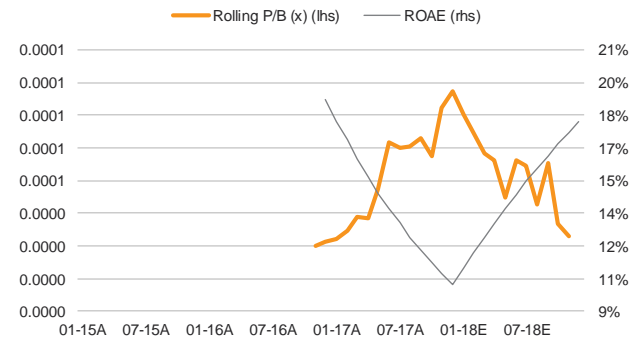
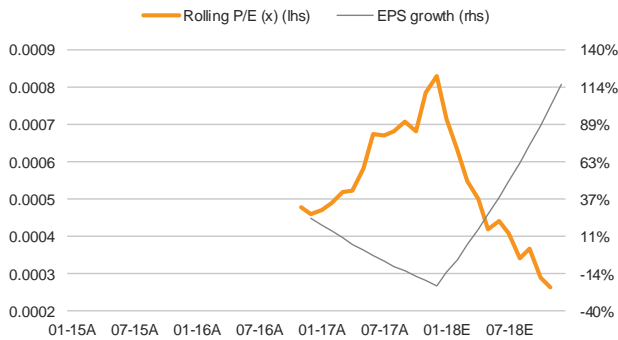
Source: VNDIRECT

Figure 5: Peer comparison

Ticker	Market cap	TTM NPAT growth	TTM EPS growth	ROA	ROE	Net D/E	P/E	P/B	EV/EBITDA
	(US\$ m)	(%)	(%)	(%)	(%)	(%)	(x)	(x)	(x)
Speciality Construction									
TV2 VN Equity	56.0	68.9	72.9	15.2	51.8	(126.4)	5.0	2.1	1.6
VNE VN Equity	16.6	4.5	12.9	5.9	10.5	(0.3)	3.7	0.4	na
SC5 VN Equity	17.0	(37.2)	(37.2)	2.1	11.8	43.6	9.9	1.2	7.9
TV3 VN Equity	13.3	90.1	80.0	8.9	22.6	(69.6)	24.1	3.3	8.1
SJE VN Equity	12.1	102.4	92.9	5.4	21.5	139.7	3.7	0.7	5.9
TV4 VN Equity	12.2	(2.7)	(5.7)	9.1	14.5	(45.6)	10.5	1.6	11.3
<i>Average</i>	21.2	37.7	36.0	7.8	22.1	(9.8)	9.5	1.5	7.0
<i>Median</i>	14.9	36.7	42.9	7.4	18.0	(23.0)	7.4	1.4	7.9
Hydropower									
SHP VN Equity	90.5	13.5	13.2	7.9	15.8	88.7	11.5	1.8	6.3
SJD VN Equity	77.0	(8.2)	(8.2)	12.5	19.9	7.7	8.9	1.9	5.8
VPD VN Equity	64.0	189.7	210.5	6.1	14.0	-	9.2	1.2	5.6
SEB VN Equity	41.2	(20.8)	(21.3)	15.0	33.0	68.4	7.9	2.6	6.9
ISH VN Equity	28.0	274.1	321.3	8.4	13.6	41.7	9.3	1.2	5.1
GHC VN Equity	29.7	66.0	66.0	29.5	34.3	(37.7)	6.3	2.0	4.3
DRL VN Equity	20.8	(20.4)	(21.9)	39.7	40.0	(64.2)	10.0	4.2	8.3
HJS VN Equity	21.2	84.0	84.0	11.7	19.0	3.0	9.3	1.7	6.0
PIC VN Equity	18.1	59.2	53.2	7.4	12.2	52.0	10.3	1.2	11.1
HPD VN Equity	5.7	148.2	148.2	8.1	16.4	87.5	7.3	1.2	4.9
<i>Average</i>	39.6	78.5	84.5	14.6	21.8	24.7	9.0	1.9	6.4
<i>Median</i>	28.8	62.6	59.6	10.0	17.7	24.7	9.2	1.8	5.9
PC1 VN Equity	127.1	110.1	108.3	7.6	18.1	45.5	6.3	1.0	5.9

Source: Bloomberg, VNDIRECT

Valuation



Income statement

(USDbn)	12-17A	12-18E	12-19E
Net revenue	3,161	4,987	4,761
Cost of sales	(2,679)	(4,080)	(4,051)
Gen & admin expenses	(126)	(165)	(167)
Selling expenses	0	(55)	(14)
Operating profit	355	688	529
Operating EBITDA	470	831	715
Depreciation and amortisation	(115)	(143)	(186)
Operating EBIT	355	688	529
Interest income	11	22	9
Financial expense	(103)	(122)	(157)
Net other income	40	40	40
Income from associates & JVs	1	1	1
Pre-tax profit	303	628	422
Tax expense	(47)	(94)	(55)
Minority interest	(20)	(23)	(25)
Net profit	237	511	342
Adj. net profit to ordinary	237	511	342
Ordinary dividends			
Retained earnings	237	511	342

Balance sheet

(USDbn)	12-17A	12-18E	12-19E
Cash and equivalents	567	683	606
Short term investments	100	50	50
Accounts receivables	1,302	1,627	1,520
Inventories	1,085	671	1,054
Other current assets	38	40	42
Total current assets	3,092	3,070	3,272
Fixed assets	2,816	3,077	3,965
Total investments	91	98	98
Other long-term assets	213	307	271
Total assets	6,212	6,552	7,606
Short-term debt	294	669	938
Accounts payable	794	559	555
Other current liabilities	745	531	494
Total current liabilities	1,833	1,759	1,987
Total long-term debt	1,527	1,507	2,055
Other liabilities	40	40	40
Share capital	1,155	1,328	1,328
Retained earnings reserve	716	941	1,208
Shareholders' equity	2,684	3,093	3,371
Minority interest	128	153	153
Total liabilities & equity	6,212	6,552	7,606

Cash flow statement

(USDbn)	12-17A	12-18E	12-19E
Pretax profit	303	628	422
Depreciation & amortisation	115	143	186
Tax paid	(63)	(94)	(55)
Other adjustments	(74)	(77)	(77)
Change in working capital	(240)	(341)	(297)
Cash flow from operations	41	259	179
Capex	(821)	(468)	(1,068)
Proceeds from assets sales	2	0	0
Others	(77)	(7)	0
Other non-current assets changes	0	0	0
Cash flow from investing activities	(896)	(474)	(1,068)
New share issuance	519	0	0
Shares buyback	(0)	0	0
Net borrowings	705	186	749
Other financing cash flow	0	(71)	26
Dividends paid	0	0	0
Cash flow from financing activities	1,224	116	775
Cash and equivalents at beginning of period	419	567	683
Total cash generated	369	(100)	(113)
Cash and equivalents at the end of period	788	467	570

Key ratios

	12-17A	12-18E	12-19E
Dupont			
Net profit margin	7.5%	10.2%	7.2%
Asset turnover	0.59	0.78	0.67
ROAA	4.4%	8.0%	4.8%
Avg assets/avg equity	2.31	2.21	2.19
ROAE	10.2%	17.7%	10.6%
Efficiency			
Days account receivable	101	86	81
Days inventory	148	60	95
Days creditor	108	50	50
Fixed asset turnover	1.28	1.69	1.35
ROIC	5.1%	9.4%	5.2%
Liquidity			
Current ratio	1.69	1.75	1.65
Quick ratio	1.09	1.36	1.12
Cash ratio	0.36	0.42	0.33
Cash cycle	141	96	126
Growth rate (yoy)			
Revenue growth	5.1%	57.8%	(4.5%)
Operating profit growth	(10.6%)	93.7%	(23.0%)
Net profit growth	(22.3%)	116.0%	(33.1%)
EPS growth	(22.3%)	116.0%	(33.1%)
Share value			
Basic EPS (USD)	1,782	3,848	2,574
BVPS (USD)	23,238	23,286	25,378

Source: VNDIRECT

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- 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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