

PHU NHUAN JEWELRY JSC (PNJ) - UPDATE

Market Price VND98,600	Target Price VND126,500	Dividend Yield 1.5%	Rating ADD	Sector RETAIL
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Outlook – Short term



Outlook – Long term



Valuation



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We expect a continuation of robust performance into 2019, driven by an expanding store footprint and gross margin expansion in the jewellery retail segment. The first flagship PNJ Watch store and PNJ Next stores were also recently launched, beginning a new chapter and augmenting new growth engines for PNJ.

PNJ continued to post double-digit growth in 4Q18, recording VND4,065bn in net revenue (+26.2% yoy) and VND266bn in net profit (+20.2% yoy). For FY18, PNJ reported VND14,573bn in net revenue (+32.8% yoy, completing 106% of annual target) and realised VND960bn in EAT (+32.4% yoy, fulfilling 109% of the annual target).

Price performance



Source: VNDIRECT

Faster-than-expected store expansion elevated sales growth. PNJ exceeded its FY2018 target of 40 new stores, with 61 new store openings, helping it consolidate its lead as the largest jewellery retail chain in the country. This latest footprint expansion has put PNJ (324 stores) far ahead of its competitors including SJC (50 stores), DOJI (52 stores) and PRECITA (19 stores) as at the end of 2018.

Product mix improved with higher quality, value-added products. With the rapid introduction of high-range gemstone gold products, PNJ upgraded its product portfolio and the consequent expansion in jewellery retail segment gross margins pushed up blended margins in 2018.

We forecast 26.7% topline growth and 27.0% earnings growth for 2019. Specifically, retail revenue of gold jewellery, silver jewellery and fashion accessories (watches) are forecasted to grow by 31.3%, 16.0% and 178% in 2019, respectively. We expect 0.2% points of GPM expansion, driven by the continued inclusion of more high-margin gemstone jewellery products and PNJ's entry into the watch segment.

We maintain an ADD recommendation on PNJ with a target price of VND126,500/share using the DCF method, translating to a FY19 forward P/E of 17.3x. PNJ is currently trading at TTM P/E of 16.7x, a substantial discount to the global peer average TTM P/E of 17.4x.

Key statistics

52w high (VND)	135,926
52w low (VND)	73,559
3m Avg daily volume (shares)	0.32m
3m Avg daily value (VNDmn)	30,776
Market cap (VNDbn)	16,466
Outstanding shares (m)	167
Free float (%)	85
TTM P/E (x)	16.7
Current P/B (x)	4.4

Ownership

Cao Thi Ngoc Dung	9.0%
LGM Investments Ltd	4.4%
Route One Investment Company	4.0%
Others	82.6%

Source: VNDIRECT

Financial summary (VND)	12-16A	12-17A	12-18A	12-19E
Net revenue (bn)	8,565	10,977	14,573	18,463
Revenue growth	11.1%	28.2%	32.8%	26.7%
Gross margin	16.5%	17.4%	19.1%	19.3%
EBITDA margin	8.1%	9.1%	9.0%	9.3%
Net profit (bn)	451	725	960	1,219
Net profit growth	517.8%	60.8%	32.4%	27.0%
Recurring profit growth	385.7%	76.2%	33.1%	27.1%
Basic EPS	3,068	4,471	5,749	7,299
Adjusted EPS	2,558	3,922	5,138	6,599
BVPS	10,211	18,193	22,425	27,737
ROAE	32.0%	32.6%	28.7%	29.1%

Source: VNDIRECT

FY2018 review: Robust sales growth and blended GPM expansion offset higher SG&A expenses driven by footprint expansion

The gold jewellery segment continued to be the largest contributor and growth driver of PNJ, accounting for 80% of the company's revenue in 2018 and seeing robust revenue growth of 40.9% yoy thanks to 20% SSSG growth (calculated based on stores operating for over 18 months) and aggressive network expansion. According to management, the customer base expanded by 36% yoy and average ticket size increased by 5% yoy.

Silver jewellery segment witnessed improvement following a change in customer focus. Accounting for only a small share of total revenue (1.9%), the silver jewellery segment has not lived up to expectations and drove management to re-orient its customer focus from young 18-25 year old girls to "white collar" working women aged 25-35 years old. This strategy seems to be working as silver jewellery segment sales picked up in 4QFY18.

Gold jewellery segment saw GPM expansion on improved product mix. PNJ's total jewellery retail margin reached 30.8% in 2018 (+1.4% pts) on the back of gold jewellery retail margin touching 29.8% (+1.9% pts) due to the better product mix (inclusion of more high-margin gemstone jewellery products).

Topline growth fed through to earnings despite soaring operating expenses. With the rapid pace of numerous store openings and the ongoing digital transformation project, selling expenses surged by 51.0% yoy and G&A expenses shot up by 84.0% yoy, bringing SG&A as percentage of revenue up by 1.6% pts. However, PNJ still managed to clock net profit growth of 32.4% mainly thanks to margin expansion in the jewellery segment.

Figure 1: Comparison of Financial Results

FYE (VNDbn)	4QFY17	4QFY18	% yoy	FY17	FY18	% yoy	vs. FY18 forecast	Comments
Net revenue	3,221.6	4,064.9	26.2%	10,976.8	14,572.7	32.8%	102.1%	Slightly higher than our expectations, mainly due to the abnormal surge in services revenue (+293.6% yoy) while jewellery revenue tracked our projection (+32.1% yoy)
<i>Jewellery revenue</i>	3,207.2	3,969.5	23.8%	10,920.1	14,429.7	32.1%	99.0%	
<i>Accessories</i>	5.7	8.5	49.1%	21.7	25.3	16.6%	63.3%	
<i>Services</i>	8.6	87.0	911.6%	29.9	117.7	293.6%	435.9%	
Gross profit	564.8	826.1	46.3%	1,912.0	2,779.0	45.3%	109.0%	
<i>Gross profit margin</i>	17.5%	20.3%	+2.8% pts	17.4%	19.1%	+1.7% pts	+0.7% pts	GPM expanded significantly, following better gold jewellery product mix with higher contribution of the high-margin gemstone jewellery products
<i>Selling expenses</i>	222.9	352.1	58.0%	775.0	1,170.6	51.0%	114.9%	
<i>as % of revenue:</i>	6.9%	8.7%	+1.8% pts	7.1%	8.0%	+0.9% pts	+0.9% pts	Higher than our expectation, following higher revenues and more rapid store network expansion
<i>G&A expenses</i>	59.2	118.5	100.2%	188.0	345.9	84.0%	148.5%	
<i>as % of revenue:</i>	1.8%	2.9%	+1.1% pts	1.7%	2.4%	+0.7% pts	+0.8% pts	Higher than our expectation as PNJ was pushing forward the digital transformation project
Pre-tax profit	276.6	336.4	21.6%	907.4	1,205.8	32.9%	95.5%	
Net profit	221.1	265.8	20.2%	724.9	960.2	32.4%	95.2%	
<i>Net margin</i>	6.9%	6.5%	-0.4% pts	6.6%	6.6%	+0.0% pts	-0.5% pts	

Source: PNJ, VNDIRECT

FY2019 outlook: we expect continued robust growth, driven both by existing businesses and new category penetration

We expect PNJ's revenue and net profit to grow by 26.7% and 27.0%, respectively in FY19. Projected topline growth is based on the assumptions of average revenue growth per gold store of 5.0%/year, average revenue per silver store of 4.0%/year and 45 new stores to be launched in 2019. We believe that PNJ Gold will continue its growth momentum, especially with the full-year operations of 61 stores opened in 2018 while PNJ Silver will gradually improve with the new strategic customer focus and the adjustments in design with the use of higher quality materials (only ~10% of silver products currently use Swarovski's gems). Besides, the wholesale trading segment and PNJ Watch stores are also being revamped to tap the large and growing demand base.

Figure 2: 2019 Earnings Forecast

FYE (VNDbn)	2018A	2019F	% growth	Comments
Net revenue	14,573	18,463	26.7%	* Jewellery revenue is expected to surge by 26.2%, supported by 45 new stores and the full operation of 61 stores opened in 2018.
Jewellery revenue	14,429	18,248	26.5%	* Annual average sales revenue growth per PNJ Gold store of 5.0% and PNJ Silver store of 4.0%
Accessories	27	75	177.8%	* Contribution of 20 PNJ Watch stores (including 1 flagship store, vs. 14 stores as of end-FY18)
Services	117	140	19.7%	
<i>Net revenue growth</i>	<i>32.8%</i>	<i>26.7%</i>	<i>-6.1% pts</i>	
Gross profit	2,779	3,557	28.0%	
<i>Gross profit margin</i>	<i>19.1%</i>	<i>19.3%</i>	<i>+0.2% pts</i>	* We expect GPM to expand by 0.2% pts with the increased contribution from gemstone jewellery products and the introduction of PNJ Watch - a new high-margin segment
Selling expenses	1,171	1,465	25.1%	* Growing in accordance with PNJ's store expansion
<i>as % of revenue:</i>	<i>8.0%</i>	<i>8.0%</i>	<i>+0.0% pts</i>	
G&A expenses	346	461	33.2%	* Soaring staff expenses to account for the extensive retail store network and the establishment of the digital platform
<i>as % of revenue:</i>	<i>2.4%</i>	<i>2.5%</i>	<i>+0.1% pts</i>	
EBIT	1,263	1,631	29.1%	
EBT	1,206	1,524	26.4%	
Net profit	960	1,219	27.0%	

Source: VNDIRECT

PNJ Watch to lead efforts to consolidate a fragmented market

The fragmented retail watch market in Vietnam is estimated to be worth VND17,000bn, according to PNJ. Watches are now commonly used not only to tell the time but also as a fashion accessory to reflect the owner's personality and social status. PNJ has set out to conquer this market by launching both stand-alone stores and merchandising fashion watches online. The product portfolio can be grouped into fashion watches (Calvin Klein, Michael Kors, Guess), basic watches (Seiko, Citizen) and Swiss entry-level luxury watches (Tissot and Longines) with prices ranging from US\$100 to US\$3,600. PNJ has also launched its own exclusive brands called Jowissa (US\$250-US\$400) and Silvana (US\$400-US\$2,250), which were introduced both in its store launched Jan 12 in Ho Chi Minh City. PNJ's competitor DOJL also jumped onto the bandwagon with its own watch retailing unit. However, based on our online research, DOJL only offered three brands of watches (61 products) while PNJ has a broad product portfolio comprising ~12 brands with over 1,000 SKUs. Therefore, we project that PNJ Watch could double its revenue in 2019 and 2020, underpinned by PNJ's cross-selling ability and competitive advantage in terms of retail footprint and overall brand awareness.

PNJ to further expand its store network and boost customer engagement with its new store format – PNJ Next

The store opening plan appears to be tracking our projections of ~45 new stores per year to reach over 500 jewellery stores by FY2022. We believe PNJ could achieve the target based on its historical fast-track store opening record and its ability to secure prime retail locations. PNJ’s footprint could also be enhanced further by the launch of PNJ Watch stores in 2019, reaching 20 stores by the end of the year, per our projection. Furthermore, PNJ recently launched a new store format called PNJ Next on Feb 12. The store will offer customers brand new and more modern interactive experiences.

Figure 3: A jewellery corner in PNJ NEXT



Source: PNJ, VNDIRECT

Figure 4: A watch display corner in PNJ NEXT



Source: PNJ, VNDIRECT

Valuation

PNJ is still a solid growth story given horizontal expansion, continue store operations and improving store-level economics. Our financial model points to FY19-29 CAGR of 8.3% in net revenue and 13.0% in EBIT.

Figure 5: Discounted Cash Flow (DCF Valuation)

DCF Valuation	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
EBIT	1,631	2,123	2,614	3,233	3,903	4,227	4,489	4,698	4,941	5,181	5,439
Tax	(305)	(399)	(494)	(613)	(743)	(806)	(857)	(897)	(944)	(991)	(1,041)
Depreciation	66	79	94	113	136	161	189	224	253	285	285
Capex	(477)	(572)	(599)	(571)	(316)	(347)	(381)	(209)	(219)	(230)	(241)
Change in work cap	(870)	(910)	(926)	(970)	(409)	(252)	(213)	(189)	(186)	(187)	(191)
Free Cash Flows	45	321	689	1,192	2,571	2,983	3,227	3,627	3,845	4,058	4,251
Present Value of FCF	40	254	489	751	1,440	1,492	1,420	1,451	1,346	1,258	1,190

Source: VNDIRECT

Figure 6: Assumptions

Cost of Capital	
Beta	0.93
Market Risk Premium	11.0%
Risk Free Rate	5.0%
Cost of Equity	15.2%
Cost of Debt	5.5%
Corporate Tax Rate	20.0%
WACC	12.4%

Source: VNDIRECT

Figure 7: Discounted Cash Flow (DCF Valuation)

DCF Method	Amount	Unit
PV of Free Cash Flows	9,941	VNDbn
PV of Terminal Value (2.0% growth)	12,807	VNDbn
Enterprise value	22,748	VNDbn
Cash and cash equivalents	367	VNDbn
Total debts	(1,982)	VNDbn
Equity Value	21,133	VNDbn
Shares	167	million
Price per share	126,500	VND/share

Source: VNDIRECT

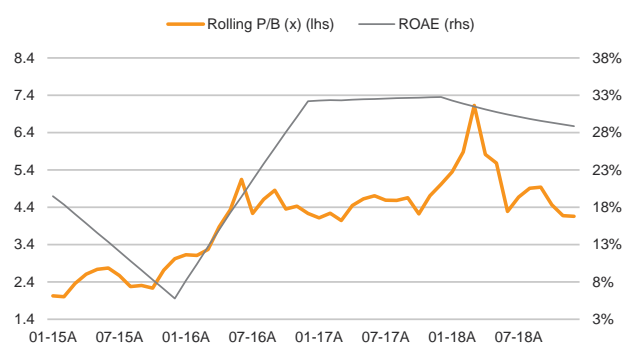
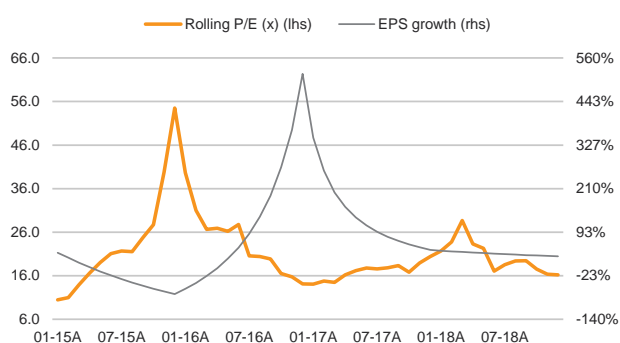
We maintain an ADD recommendation on PNJ with a target price of VND126,500/share. The new target price for PNJ was purely derived from a 10-year DCF valuation as we believe that PNJ is quite unique and does not lend itself to a regional peer-based valuation. Our target price translates into an upside of 28.3% and FY2018 forward PE of 17.3x.

Figure 8: Peer Comparison

Company	Country	Market cap (US\$m)	TTM NPAT Growth (%)	TTM EPS growth (% yoy)	ROE(%)	ROA(%)	D/E (x)	TTM P/E (x)	P/B (x)
Tiffany & Co	U.S	11,168	21.0	(16.8)	19.2	11.4	30.9	19.2	3.7
Chow Tai Fook Jewellery Group	Hong Kong	9,162	16.7	33.7	13.9	7.4	38.9	16.9	2.5
LEYSEN Jewelry Inc	China	626	9.3	8.5	12.9	10.6	1.7	14.3	1.8
Average			15.7	8.5	15.4	9.8	23.8	17.4	2.7
Median			16.7	8.5	13.9	10.6	30.9	17.3	2.5
PNJ	Vietnam	713	39.9	28.2	32.6	17.9	41.8	16.7	4.4

Source: BLOOMBERG, VNDIRECT

Valuation



Income statement

(VNDbn)	12-17A	12-18A	12-19E
Net revenue	10,977	14,573	18,463
Cost of sales	(9,065)	(11,794)	(14,906)
Gen & admin expenses	(188)	(346)	(461)
Selling expenses	(775)	(1,171)	(1,465)
Operating profit	949	1,262	1,631
Operating EBITDA	988	1,304	1,697
Depreciation and amortisation	(39)	(42)	(66)
Operating EBIT	949	1,262	1,631
Interest income	9	7	9
Financial expense	(56)	(66)	(119)
Net other income	6	3	3
Income from associates & JVs	0	0	0
Pre-tax profit	908	1,206	1,524
Tax expense	(183)	(246)	(305)
Minority interest	0	0	0
Net profit	725	960	1,219
Adj. net profit to ordinary	725	960	1,219
Ordinary dividends	(185)	(265)	(334)
Retained earnings	540	695	885

Balance sheet

(VNDbn)	12-17A	12-18A	12-19E
Cash and equivalents	175	207	367
Short term investments	160	0	0
Accounts receivables	85	176	208
Inventories	3,402	4,816	5,712
Other current assets	74	82	110
Total current assets	3,896	5,281	6,397
Fixed assets	487	719	1,129
Total investments	0	0	0
Other long-term assets	109	304	320
Total assets	4,492	6,304	7,846
Short-term debt	846	1,558	1,974
Accounts payable	279	291	346
Other current liabilities	364	693	878
Total current liabilities	1,489	2,542	3,198
Total long-term debt	46	8	8
Other liabilities	7	9	8
Share capital	1,081	1,670	1,670
Retained earnings reserve	772	885	1,700
Shareholders' equity	2,950	3,745	4,632
Minority interest	0	0	0
Total liabilities & equity	4,492	6,304	7,846

Cash flow statement

(VNDbn)	12-17A	12-18A	12-19E
Pretax profit	908	1,206	1,524
Depreciation & amortisation	39	42	66
Tax paid	(154)	(232)	(305)
Other adjustments	(142)	(175)	(9)
Change in working capital	(542)	(1,144)	(706)
Cash flow from operations	109	(303)	570
Capex	(115)	(336)	(477)
Proceeds from assets sales	8	1	2
Others	3	6	0
Other non-current assets changes	(160)	160	(16)
Cash flow from investing activities	(264)	(169)	(491)
New share issuance	975	97	0
Shares buyback	0	0	0
Net borrowings	(615)	672	415
Other financing cash flow	0	0	0
Dividends paid	(185)	(265)	(334)
Cash flow from financing activities	175	504	81
Cash and equivalents at beginning of period	155	175	207
Total cash generated	20	32	160
Cash and equivalents at the end of period	175	207	367

Key ratios

	12-17A	12-18A	12-19E
Dupont			
Net profit margin	6.6%	6.6%	6.6%
Asset turnover	2.72	2.70	2.61
ROAA	17.9%	17.8%	17.2%
Avg assets/avg equity	1.82	1.61	1.69
ROAE	32.6%	28.7%	29.1%
Efficiency			
Days account receivable	1.33	1.98	1.70
Days inventory	137	149	140
Days creditor	11.2	9.0	8.5
Fixed asset turnover	24.3	24.2	20.0
ROIC	18.9%	18.1%	18.4%
Liquidity			
Current ratio	2.62	2.08	2.00
Quick ratio	0.33	0.18	0.21
Cash ratio	0.22	0.08	0.11
Cash cycle	127	142	133
Growth rate (yoy)			
Revenue growth	28.2%	32.8%	26.7%
Operating profit growth	30.9%	33.0%	29.2%
Net profit growth	60.8%	32.4%	27.0%
EPS growth	45.7%	28.6%	27.0%
Share value			
Basic EPS (VND)	4,471	5,749	7,299
BVPS (VND)	18,193	22,425	27,737

Source: VNDIRECT

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Singapore	CGS-CIMB Research Pte. Ltd.	Monetary Authority of Singapore
South Korea	CGS-CIMB Securities Limited, Korea Branch	Financial Services Commission and Financial Supervisory Service
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CIMB

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- 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.

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Definition:

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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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- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
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