

PHU NHUAN JEWELRY JSC (PNJ) - UPDATE

Market Price VND76,800	Target Price VND88,000	Dividend Yield 2.6%	Rating ADD	Sector RETAIL
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Outlook – Short term



Outlook – Long term



Valuation



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Key changes in the report

- Lower target price by 7.8%
- Downward adjustment to FY2019 earnings by 4.9%

Price performance



Source: VNDIRECT RESEARCH

Key statistics

52w high (VND)	81,856
52w low (VND)	64,004
3m Avg daily volume (shares)	544,655
3m Avg daily value (VNDm)	49,364
Market cap (VNDbn)	17,413
Outstanding shares (m)	221
Free float (%)	81
TTM P/E (x)	16.3
Current P/B (x)	4.2

Ownership

Cao Thi Ngoc Dung	9.0%
LGM Investments Ltd	4.4%
Route One Investment Company	3.9%
Others	82.7%

Source: VNDIRECT RESEARCH

1H19 overview: losing some shine

Lower-than-expected 1H results. PNJ's 2Q19 net profit dropped 6.3% yoy to VND169bn following a 7.9% yoy decline in net revenue to VND2,962bn. The 1H19 results were modest, with a 5.3% yoy rise in the top line and an increase of 15.7% yoy in the bottom line. Accordingly, the results were slightly below our forecasts, completing 42.0% and 49% of our revenue and earnings forecasts.

PNJ suffered from more than just temporary operational issues. PNJ has officially implemented the new ERP system but has come across operational problems in the production process as workers remained unfamiliar with the new technology which lowered the productivity. PNJ also identified weaker sales in its long-term main markets, a lack of skills in the sales teams and the cannibalisation effect of new stores (especially PNJ Next) over the old ones. The factors were combined and drove PNJ's SSSG to 1% in 1H19 (vs. double-digit growth in 1H18).

Slower-than-expected store expansion amid cannibalisation effect. In 1H19, PNJ brought the total net store count to 339, with 19 new stores (or 33% of our forecast for FY2019). Coupled with a slow store opening pace, the concern over the cannibalisation effect of new stores also prompted us to cut the number of projected store openings to 35 (from 45) in FY2019.

1H19 gross profit margin remained high at 21.8%. 1H19 witnessed blended GM expanding by 3.4% pts, mainly driven by better product mix (inclusion of more gemstone jewellery and watches) and better waste management thanks to the new ERP system.

Maintain ADD but lower TP to VND88,000. We curtail our DCF-based TP by 7.8% to reflect lower-than-expected 1H19 results and our more conservative outlook for the period FY20-22 with slower store openings of 30 stores/year (vs. 45 stores/year in previous forecast) and diminished average revenue per store growth to 2.0%/year (4.0% previously).

Risk and re-rating catalyst: Potential re-rating catalysts include faster-than-expected store openings and a higher-than-expected SSSG. Downside risk to our call is the further decline in consumer demand for jewellery products.

Financial summary (VND)	12-17A	12-18A	12-19E	12-20E
Net revenue (bn)	10,977	14,573	16,402	19,189
Revenue growth	28.2%	32.8%	12.6%	17.0%
Gross margin	17.4%	19.1%	21.1%	21.3%
EBITDA margin	9.1%	9.0%	9.9%	11.2%
Net profit (bn)	725	960	1,157	1,554
Net profit growth	60.8%	32.4%	20.5%	34.3%
Recurring profit growth	76.2%	33.1%	20.6%	34.4%
Basic EPS	6,707	5,749	5,905	6,910
Adjusted EPS	6,013	5,246	5,435	6,474
BVPS	27,290	22,425	20,009	24,927
ROAE	32.6%	28.7%	28.1%	30.8%

Source: VNDIRECT RESEARCH

1H19 review: Disappointing results mirrored the operational issues of the recently rolled-out ERP system

Having been the largest contributor and growth driver (accounting for 78% of PNJ's total revenue), the gold jewellery segment lost steam in 2Q with flat sales growth (+1.1% yoy) and muted SSSG of 1%. Management ascribed this underperformance to 1) the weak demand for jewellery products in PNJ's main markets and 2) the flat stock in April-May due to workers' unfamiliarity with the new ERP system, which has affected both retail sales (accounting for ~60% total revenue, -2% yoy in Q2) and wholesale revenue (accounting for 20% total revenue, -23% yoy in Q2).

Gold jewellery segment continued to help expanding gross margin with better product mix. PNJ's total jewellery margin reached 27.1% in 1H19 (+4.7% pts) on the back of gold jewellery margin touching 26.3% (+4.9% pts) thanks to 1) the lower contribution of wholesale segment (GPM at ~3.1%), 2) the better product mix (inclusion of more high-margin gemstone jewellery and watch products), 3) lower gold input price (30% of production cost) while the selling prices remained unchanged and 4) better waste management, helped by the new ERP system.

Double-digit earnings growth was preserved by the surge of jewellery retail sales and enhanced gross margin. With the official implementation of the ERP system in 1H19, G&A expenses surged 72.6% yoy, bringing SG&A as percentage of revenue up 1.0% pts. However, PNJ still managed to clock a net profit growth of 15.7% thanks mainly to margin expansion in the jewellery segment (+4.7% pts).

Figure 1: 1H19 results review

FYE (VNDbn)	2QFY19	% yoy	1HFY19	% yoy	vs. FY19 forecast	Comments
Net revenue	2,961.8	-7.9%	7,745.3	5.3%	42.0%	Q2 result was below our expectation, accounting for 16% of our FY19 topline forecast (vs. projected 2Q19 revenue's contribution to full-year revenue of 20%), mainly due to 1) shortage of inventory resulted from the operational problem of the new ERP system, 2) lower sales recorded in PNJ's main markets and 3) declining wholesale revenue (-23% yoy)
<i>Jewellery revenue</i>	<i>2,935.8</i>	<i>-8.3%</i>	<i>7,698.4</i>	<i>5.1%</i>	<i>42.2%</i>	
<i>Accessories</i>	<i>12.8</i>	<i>166.7%</i>	<i>21.2</i>	<i>75.2%</i>	<i>28.3%</i>	
<i>Services</i>	<i>13.2</i>	<i>21.1%</i>	<i>25.6</i>	<i>23.7%</i>	<i>18.3%</i>	
Gross profit	635.7	9.1%	1,685.1	24.6%	47.4%	
<i>Gross profit margin</i>	<i>21.5%</i>	<i>+3.4% pts</i>	<i>21.8%</i>	<i>+3.4% pts</i>	<i>+2.5% pts</i>	GPM expanded significantly, driven by gold jewellery margin improved (+4.9% pts vs 1H18) thanks to the boosted sales of the high-margin gemstone jewellery and
<i>Selling expenses</i>	<i>286.9</i>	<i>6.7%</i>	<i>654.1</i>	<i>18.8%</i>	<i>44.6%</i>	
<i>as % of revenue</i>	<i>9.7%</i>	<i>+1.3% pts</i>	<i>8.4%</i>	<i>+0.9% pts</i>	<i>+0.5% pts</i>	
<i>G&A expenses</i>	<i>116.2</i>	<i>57.7%</i>	<i>231.8</i>	<i>72.6%</i>	<i>50.3%</i>	
<i>as % of revenue</i>	<i>3.9%</i>	<i>+1.6% pts</i>	<i>3.0%</i>	<i>+1.2% pts</i>	<i>+0.5% pts</i>	
Operating profit	210.4	-7.2%	753.7	16.6%	46.2%	
Pre-tax profit	210.1	-7.6%	753.3	16.2%	49.4%	
Net profit	169.1	-6.3%	597.9	15.7%	49.0%	In line with our projections as the decline in revenue was compensated by the improvement in gross profit margin
Net margin	5.7%	+0.1% pts	7.7%	+0.7% pts	+1.1% pts	

Source: PNJ, VNDIRECT RESEARCH

2H19 outlook: Concerns needed to be addressed

We examined other factors in PNJ's sales formula, such as the capability of its sales team and the cannibalisation impact of new stores on existing stores in the same neighbourhood.

PNJ to re-train sales team. Coping with the unforeseen trouble from the new ERP system, PNJ needed to prolong the delivery of customised jewellery products and realised the significant size of the requested products. Given that the majority of items on PNJ's store display are produced in mass volume and distributed across all the stores, this has raised the question over the selling ability of PNJ's sales team. Thus, the company plans to re-train its sales team and adjust the KPI to boost sales of in-stock products.

The cannibalisation riddle of new opening stores. According to PNJ, the newly opened stores (especially PNJ Next) are eating up the revenue of other top-performing stores in the neighbourhood. Particularly, PNJ Next's monthly sales reached VND10-20bn (equivalent to ~7x of PNJ's standard jewellery stores). To fix the issue, PNJ is considering upgrading its standard stores to PNJ Next format to attract more customers. Management says that sites have been secured for openings in 2H19 but with the cannibalisation impact, we expected further consideration going into store locations.

PNJ to recover in 2H19 but still undershoot our previous projection. We expect PNJ to show recovery in 2H19 (+20.0% yoy in revenue) on the back of better SSSG and the acceleration of store expansion. However, the whole-year results will still fall short of our previous forecast. Thus, we have cut our forecasted FY19 revenue by 11.2% and reduced by 4.9% our projected net profit.

Figure 2: Earnings revision

FYE (VNDbn)	2018A	2019F		%change	Comments
		Old	New		
Net revenue	14,573	18,463	16,402	-11.2%	* Jewellery revenue is expected to surge by 12.3% (vs. old forecast of 26.2%), supported by 35 new stores (from 45 previously) and the full operation of 61 stores opened in 2018.
Jewellery revenue	14,429	18,248	16,198	-11.2%	* Annual average sales revenue growth per PNJ Gold store of 1.0% (vs. old projection of 5.0%) and muted sales growth for PNJ Silver store (from 4% previously)
Accessories	27	75	75	0.0%	
Services	117	140	129	-7.9%	
<i>Net revenue growth</i>	<i>32.8%</i>	<i>26.7%</i>	<i>12.6%</i>	<i>-14.1% pts</i>	
Gross profit	2,779	3,557	3,465	-2.6%	
<i>Gross profit margin</i>	<i>19.1%</i>	<i>19.3%</i>	<i>21.1%</i>	<i>+1.8% pts</i>	* We expect GPM to expand by 1.8% pts with the upward adjustments in gold jewellery retail margin and watch retail margin
Selling expenses	1,171	1,465	1,452	-0.9%	* Growing in accordance with PNJ's store expansion
<i>as % of revenue:</i>	<i>8.0%</i>	<i>7.9%</i>	<i>8.9%</i>	<i>+1.0% pts</i>	
G&A expenses	346	461	471	2.2%	
<i>as % of revenue:</i>	<i>2.4%</i>	<i>2.5%</i>	<i>2.9%</i>	<i>+0.4% pts</i>	
EBIT	1,263	1,631	1,542	-5.5%	
EBT	1,206	1,524	1,449	-4.9%	
Net profit	960	1,219	1,159	-4.9%	

Source: VNDIRECT RESEARCH

Valuation

Given the cautions regarding weakening market demand and store expansion strategy, we made adjustments to our projection on PNJ for the next 3 years (FY20-22), including: 1) trimming down average revenue per store growth to 2.0% per annum (from 4.0% in previous forecast) and 2) reducing store openings to 30 stores per year (vs. 45 stores in previous forecast).

Figure 3: Discounted Cash Flow (DCF Valuation)

DCF Valuation	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
EBIT	1,542	2,054	2,525	2,831	3,180	3,424	3,634	3,807	4,016	4,210	4,424
Tax	(290)	(389)	(480)	(539)	(607)	(655)	(695)	(729)	(769)	(807)	(849)
Depreciation	66	79	94	113	136	161	189	224	253	285	285
Capex	(210)	(232)	(278)	(167)	(183)	(201)	(221)	(121)	(127)	(133)	(140)
Change in work cap	(594)	(534)	(511)	(450)	(242)	(199)	(182)	(165)	(165)	(162)	(167)
Free Cash Flows	514	978	1,350	1,788	2,284	2,530	2,725	3,016	3,208	3,393	3,553
Present Value of FCF	457	773	945	1,109	1,279	1,240	1,199	1,176	1,123	1,052	959

Source: VNDIRECT RESEARCH

Figure 4: Assumptions

Cost of Capital	Current
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	12.5%

Source: VNDIRECT RESEARCH

Figure 5: Target valuation

DCF Method	Amount	Unit
PV of Free Cash Flows	10,353	VNDbn
PV of Terminal Value (2.0% growth)	10,520	VNDbn
Enterprise value	20,873	VNDbn
Cash and cash equivalents	482	VNDbn
Total debts	(1,761)	VNDbn
Equity Value	19,593	VNDbn
Shares	223	million
Target price (rounded up)	88,000	VND/share

Source: VNDIRECT RESEARCH

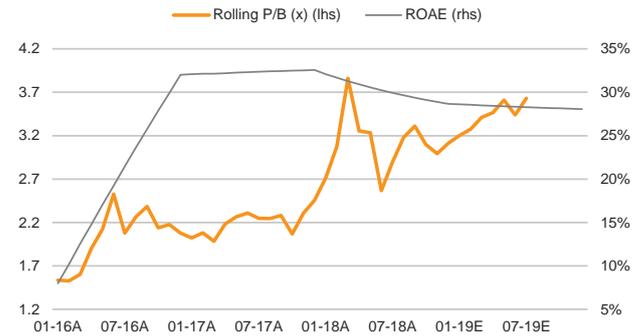
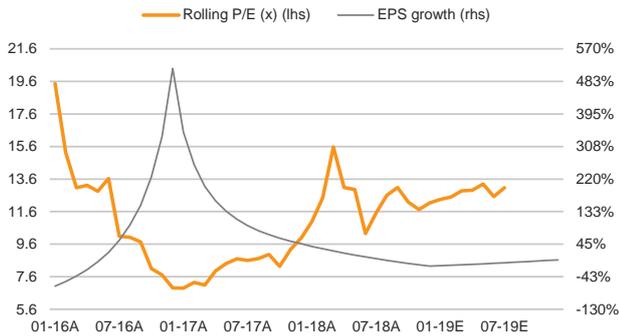
We cut our target price to VND88,000/share from VND94,900/share and keep the ADD rating. The new TP for PNJ is solely derived from a 10-year DCF valuation, which translates into an upside of 14.6% and FY2019 forward P/E of 14.9x. We maintain the ADD rating as PNJ is still the leading branded jewellery producer to ride on the expansion of middle-affluent consumer class and retail platform development in Vietnam.

Figure 6: Peer Comparison

Company	Country	Market cap (US\$m)	TTM NPAT Growth (%)	TTM EPS growth (% YoY)	ROE (%)	ROA (%)	D/E (%)	TTM P/E (x)	Current P/B (x)
Tiffany & Co	U.S	11,403	0.1	1.9	17.8	9.7	31.8	20.2	3.6
Chow Tai Fook Jewellery Group	Hong Kong	9,482	14.7	14.7	14.3	7.7	57.5	16.2	2.4
LEYSEN Jewelry Inc	China	560	(32.2)	(35.4)	9.0	7.5	0.1	18.4	1.6
Average			(5.8)	(6.3)	13.7	8.3	29.8	18.3	2.5
Median			0.1	1.9	14.3	7.7	31.8	18.4	2.4
PNJ	Vietnam	738	20.6	18.4	27.9	17.8	41.8	16.3	4.2

Source: BLOOMBERG, VNDIRECT RESEARCH

Valuation



Income statement

(VNDbn)	12-18A	12-19E	12-20E
Net revenue	14,573	16,402	19,189
Cost of sales	(11,794)	(12,937)	(15,099)
Gen & admin expenses	(346)	(471)	(484)
Selling expenses	(1,171)	(1,452)	(1,552)
Operating profit	1,262	1,542	2,054
Operating EBITDA	1,304	1,608	2,133
Depreciation and amortisation	(42)	(66)	(79)
Operating EBIT	1,262	1,542	2,054
Interest income	7	8	9
Financial expense	(66)	(106)	(123)
Net other income	3	3	3
Income from associates & JVs	0	0	0
Pre-tax profit	1,206	1,447	1,943
Tax expense	(246)	(290)	(389)
Minority interest	0	0	0
Net profit	960	1,157	1,554
Adj. net profit to ordinary	960	1,157	1,554
Ordinary dividends	(265)	(450)	(450)
Retained earnings	695	707	1,104

Balance sheet

(VNDbn)	12-18A	12-19E	12-20E
Cash and equivalents	207	482	1,299
Short term investments	0	0	0
Accounts receivables	176	184	198
Inventories	4,816	5,411	5,977
Other current assets	82	98	118
Total current assets	5,281	6,175	7,592
Fixed assets	719	862	1,013
Total investments	0	0	0
Other long-term assets	304	312	323
Total assets	6,304	7,349	8,928
Short-term debt	1,558	1,753	2,051
Accounts payable	291	297	343
Other current liabilities	693	782	913
Total current liabilities	2,542	2,832	3,307
Total long-term debt	8	8	8
Other liabilities	9	9	7
Share capital	1,670	2,249	2,249
Retained earnings reserve	885	983	1,980
Shareholders' equity	3,745	4,500	5,606
Minority interest	0	0	0
Total liabilities & equity	6,304	7,349	8,928

Cash flow statement

(VNDbn)	12-18A	12-19E	12-20E
Pretax profit	1,206	1,447	1,943
Depreciation & amortisation	42	66	79
Tax paid	(232)	(290)	(389)
Other adjustments	(175)	(3)	3
Change in working capital	(1,144)	(519)	(426)
Cash flow from operations	(303)	701	1,210
Capex	(336)	(210)	(232)
Proceeds from assets sales	1	2	2
Others	6	0	0
Other non-current assets changes	160	(8)	(11)
Cash flow from investing activities	(169)	(216)	(241)
New share issuance	97	45	0
Shares buyback	0	0	0
Net borrowings	672	195	298
Other financing cash flow	0	0	0
Dividends paid	(265)	(450)	(450)
Cash flow from financing activities	504	(210)	(152)
Cash and equivalents at beginning of period	175	207	482
Total cash generated	32	275	817
Cash and equivalents at the end of period	207	482	1,299

Key ratios

	12-18A	12-19E	12-20E
Dupont			
Net profit margin	6.6%	7.1%	8.1%
Asset turnover	2.70	2.40	2.36
ROAA	17.8%	16.9%	19.1%
Avg assets/avg equity	1.61	1.66	1.61
ROAE	28.7%	28.1%	30.8%
Efficiency			
Days account receivable	1.98	1.69	1.70
Days inventory	149	153	145
Days creditor	9.01	8.38	8.31
Fixed asset turnover	24.2	20.7	20.5
ROIC	18.1%	18.5%	20.3%
Liquidity			
Current ratio	2.08	2.18	2.30
Quick ratio	0.18	0.27	0.49
Cash ratio	0.08	0.17	0.39
Cash cycle	142	146	138
Growth rate (yoy)			
Revenue growth	32.8%	12.6%	17.0%
Operating profit growth	33.0%	22.2%	33.2%
Net profit growth	32.4%	20.5%	34.3%
FD EPS growth	29.0%	19.0%	33.0%
Share value			
Basic EPS (VND)	5,749	5,905	6,910
BVPS (VND)	22,425	20,009	24,927

Source: VNDIRECT RESEARCH

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Description:	Excellent	Very Good	Good	N/A	

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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.

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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- Overweight An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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