

CENTURY SYNTHETIC FIBER CORP (STK) - INITIATION

Market Price VND16,800	Target Price VND26,800	Dividend Yield 5.33%	Rating ADD	Sector Textiles
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Outlook – Short term



Outlook – Long term



Valuation



14 May 2018

Tu Vu Minh

tu.vuminh@vndirect.com.vn

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	23,500
52w low (VND)	14,300
3m Avg daily volume (shares)	0.02
3m Avg daily value (VNDmn)	500
Market cap (VNDbn)	899
Outstanding shares (m)	56.2
Free float (%)	50
TTM P/E	10.2
Current P/B	1.2

Ownership

Huong Viet Investment Consultant Corporation	20.2%
Dang Trieu Hoa	13.9%
Dang My Linh	8.5%
Dang Huong Cuong	8.5%
Vietnam Holding Ltd	6.0%
Others	42.9%

Source: VNDIRECT

Century Synthetic Fiber Corp. (STK) is one of Vietnam's leading polyester filament yarn manufacturers, with current production capacity of 60,000 tones/year and accounting for 28% of Vietnam's polyester yarn exports (Source: STK). We initiate coverage on STK with an ADD rating and a target price of VND26,800, implying a 57.5% upside.

STK is currently the Vietnam's 2nd largest polyester yarn manufacturer, accounting for 28% of the country's total polyester yarn exports. STK realized the highest growth in export value in 2017 amongst polyester yarn exporters in Vietnam, at 44%, higher than industry-wide growth of 40%. STK produces fully drawn yarn (FDY), drawn textured yarn (DTY) and recycled yarn, which are used as key input materials for the textile industry.

Unmet domestic demand and growing demand from export markets, driven by recent trade agreements. Vietnam's total domestic yarn production only meets 39.2% of domestic demand in 2016, creating significant growth potential for local yarn producers like STK. Vietnam's textile industry is also benefiting from relatively low labor costs and a slew of new trade pacts and agreements (FTAs and CPTPP), which also bodes well for STK.

Margins should improve through a rejigging of geographical focus and an improvement in product mix. STK is changing its export focus from Turkey to Korea and Japan, due to the favorable import tax rate of 0% in these two countries which lends Vietnamese exporters to these countries a competitive advantage. Besides, STK plans to invest a total CAPEX of VND213bn in 2 new projects, focusing on higher value added product lines (recycled yarn and color yarn), which on average generate higher gross margins of around 20% vs 10% for current core products (FDY, DTY).

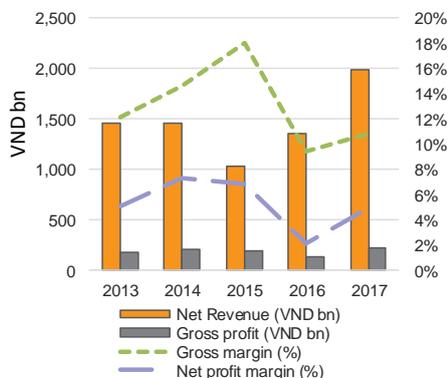
However, fierce competition from Chinese yarn, as well as input price volatility present downside risks. Chinese yarn makers have been able to produce yarn at rock-bottom costs, thanks to their advanced technology, massive scale and generous export subsidies from the Chinese government, hence pressuring Vietnamese yarn makers. This limits STK's ability to pass through any increases in input prices which are rising in line with crude oil prices.

We initiate coverage on STK with an ADD rating. We forecast 2018 revenue and EAT of VND2,364bn (+18.8%) and VND131bn (+30.9%), respectively based on our assumptions of an ASP increase of 10.9% and sales volume growth of 7.2% and a 100 bps expansion in gross margins. We use the regional peers' average TTM P/E to arrive at a target P/E of 13.6x translating to a target price of VND26,800 per share.

Financial summary (VND)	12-15A	12-16A	12-17A	12-18E
Net revenue (bn)	1,035	1,358	1,989	2,364
Revenue growth		31.2%	46.4%	18.8%
Gross margin	18.1%	9.5%	10.9%	11.9%
EBITDA margin	17.1%	12.5%	14.1%	14.4%
Net profit (bn)	72	29	100	131
Net profit growth	(32.8%)	(59.6%)	246.7%	30.9%
Recurring profit growth	(36.6%)	(59.6%)	246.7%	30.9%
Basic EPS	1,537	539	1,662	1,969
Adjusted EPS	1,537	539	1,662	1,969
BVPS	14,829	12,994	12,996	13,349
ROAE	10.5%	4.2%	13.6%	15.7%

STK's will focus on identifying more favorable export markets and moving into higher-end product segments.

Figure 1: STK's revenue and gross profit

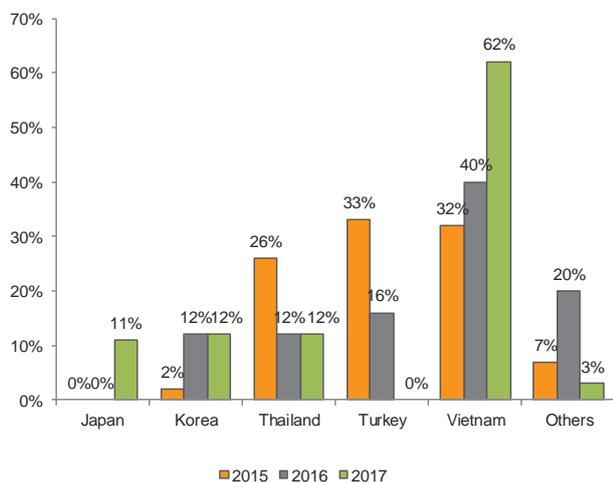


Source: VNDIRECT, STK

STK's revenue fell in 2015 due to difficulties in the global yarn industry coupled with imposition of anti-dumping tariff by Turkey, while profitability deteriorated in 2016 as the company had to slash selling price by 15% to push sales. Global yarn demand fell strongly in the 2nd half of 2015 due to low demand from China, while global yarn production rose by 3.0% YoY. Consequently, Chinese yarn makers heavily dumped price in international markets. Furthermore, in 2016, Turkey, which accounts for 16% of STK's total revenue, imposed an anti-dumping import tax of 34.8 on Vietnam's DTY (drawn textured yarn). To maintain competitiveness, STK had lowered its selling price by 15%, severely affecting its gross margin, which fell from 18.1% in 2015 to 9.5% in 2016; its net margin also fell from 6.9% in 2015 to 2.1% in 2016.

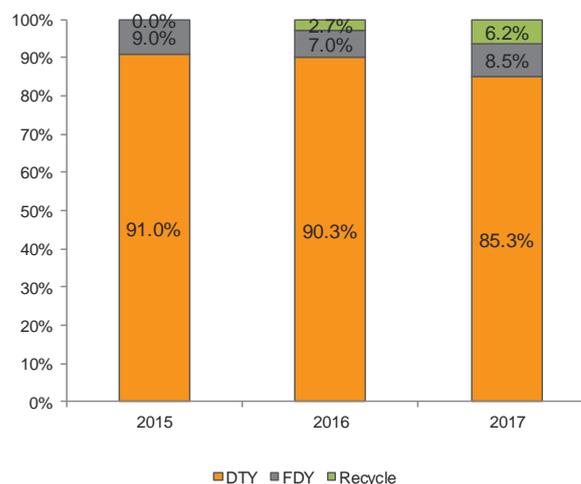
A recovery is on the horizon as the company shifts its focus to more favorable export markets including Japan and Korea and higher value added product. STK has shifted its export focus to Japan and Korea, both of which have 0% import taxes on yarn products imported from Vietnam thanks to FTAs including VJEPA (Vietnam – Japan) signed in 2008 and VKFTA (Vietnam – Korea) signed in 2015. STK was also able to increase its ASP by 12.0% YoY, which contributed to the 45.6% YoY rise in its revenue in 2017 and improved gross margin by 140bps to 10.9%. Korea and Japan currently account for 12.0% and 11.0% of STK's total revenue, respectively and their respective contributions are expected by STK's management to rise to 20.0% and 15.0%, respectively, in 2018.

Figure 2: STK's revenue by markets



Source: VNDIRECT, STK

Figure 3: STK's revenue contribution by products



Source: VNDIRECT, STK

CAPEX of VND143bn in 2018-2020 will raise capacity and expand its product range to include higher value added lines. These newly introduced lines of production will produce high quality products such as color yarn which help the textile firms purchasing STK's yarn to save costs on fabric dyeing. While it is not yet clear how much these new product lines will contribute to revenue over the next few years, they are bound to help lift blended margins.

Figure 4: STK's investment plans

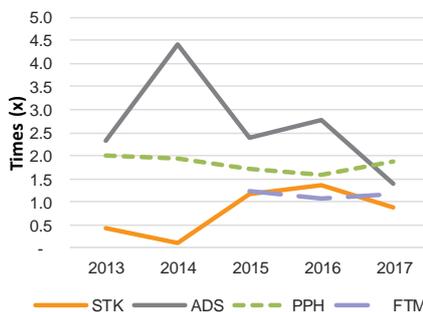
Project	Total value (VND bn)	Net cash investment (VND bn)	Note	Expected capacity (tones)	Construction starting time	Production starting time
Trang Bang 5	129.3	100.0	STK contributes facilities including existing land, factory.	1,500 tones recycle chips and 3,300 tones DTY	Mar-18	1Q-2019
Color yarn	84.0	43.0		6,120 tones color yarn	Feb-17	3Q - 4Q2018
Total	213.3	143.0				

Source: VNDIRECT, STK

A part of capital contribution by STK to these projects are in the form of existing assets (production facilities and available land), real cash injection by STK to these project will be around VND143.0bn. In order to finance Trang Bang 5, which is expected to go into operation in 1Q2019, STK plans to issue 5.99mn shares to existing shareholders (rights issue) and 0.60mn shares through ESOP in 2018. The company can raise around VND65.9bn from this, which can fund 65.9% of Trang Bang 5's cash investment outlays, while the remaining amount will be funded via borrowings. This might result in its net debt/equity slightly increasing from 0.9x in 2017 to an expected 1.1x in 2018, but still lower than its peers' average debt/equity ratio of 1.5x.

After completing Trang Bang 5, STK will raise its total annual capacity by 5.5% to 63,300 tones (its current total capacity is 60,000 tons per year). Besides, color yarn project (including new technology, machines) will utilize STK's existing production facility to produce color yarn which is expected to have high margin of around 20% but will not raise STK's total capacity.

Figure 5: Net D/E of yarn manufacturers



Source: VNDIRECT

High-end products (including recycled yarn, colored yarn, piled yarn) have superior performance characteristics, and are therefore more expensive. For example, colored yarn will reduce the cost of dyeing for manufacturers, while piled yarn is much stronger than normal yarn.

Migrating its product portfolio toward high value added products will help STK increase its margins. STK has launched its new recycled yarn product (produced from recycled chips using normal production lines) from Jan 2017 under Unifi Inc's REPREEVE brand after signing a strategic partnership with Unifi (a global yarn manufacturer listed on NYSE, ticker UFI). Recycled yarn accounted for 6.2% of STK's 2017 total sales and aims to raise this product's contribution in sales to 14.0% (2018), 20.0% (2019) and 30.0% (2020).

Total domestic demand for recycled yarn is around 6,000 tones/year (estimated by STK), and only 2 firms in Vietnam (STK and Formosa) can produce this product, as it requires high-tech production lines. We therefore consider this a strategic move by management to help reduce dependence on low-end products which are getting commoditized over time.

The Trang Bang 5 factory is expected to generated 1,500 tons of recycled chips, which is used as input material for manufacturing recycled yarn, hence partly reducing reliance on imported materials. Management planned to export recycled yarn to regional markets such as China, Korea and Taiwan with a target of contributing to 30% of revenue in 2020. Recycled yarn and other planned product lines (colored yarn, air-covering yarn) have doubled gross margin of around 20% vs polyester yarn of 10%; this will allow STK to improve its margins in the future.

Expanding export markets and unmet domestic demand create huge growth potential

Domestic yarn demand continues to outstrip supply, while demand from export partners is growing. STK operates in a high growth yarn segment that is worth US\$9bn and is directly driven by textile production growth. Vietnam's textile export industry saw total volume growth of 17.7% over the last 5 years. Domestic consumption of yarn is 510,000 tones while the domestic production is only at 200,000 tones in 2016 while 380,000 tones yarn is imported, mainly

Figure 6: Yarn production costs by countries in 2017

	Labour cost (minimum monthly wage in USD)	Electricity cost (USD/ kwh)
Vietnam	114 - 165	0.07
India	395	0.12
Pakistan	200	0.10
China	151 - 330	0.11
Turkey	333 - 433	0.08
Indonesia	248	0.11

Source: VNDIRECT, China chemical fiber

from China, which indicates the growth potential for the domestic yarn industry. Yarn exports recorded a CAGR of 16.5% during 2011-2016 to touch 70,000 tonnes and is expected to continue growing at a CAGR of 13.5% during 2016-2020 according to the Ministry of Finance. Vietnam has exceeded India to become the number 1 yarn exporter to China, alone accounting for 29.9% of imported yarn into China in 2016.

As Vietnam's economy becomes increasingly open to global trade through CPTPP and other FTAs, there will be increased opportunities for the textile industry. According to VCOSA, these trade agreements are expected to raise Vietnam's textile exports by an additional 10% in 2018, to reach around US\$34bn in 2018. The textile industry will be one of the main beneficiaries of recent and upcoming FTAs, due to its relatively cheaper labor and heavily subsidized electricity tariffs, which will give Vietnam an edge over other trading partners. Liberalization of the power industry is unlikely to impact electricity prices much in the near-to-medium term.

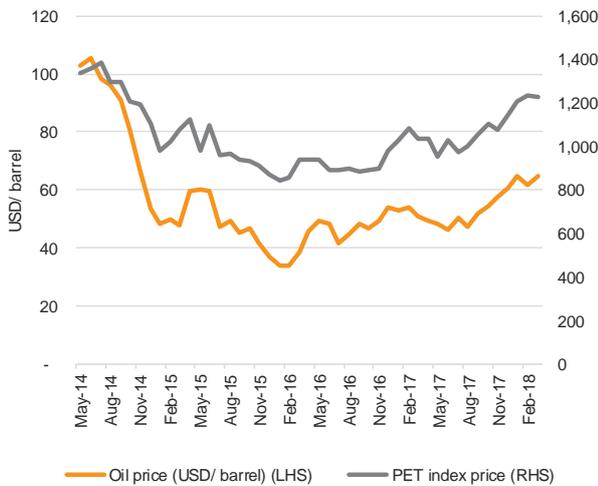
Key challenges include rising competition and input costs

The Vietnamese yarn market faces intense competition from Chinese products, which account for 40% of total domestic yarn consumption, as well as FDI yarn makers, including Formosa and Hualon. Chinese manufacturers using the direct spinning method, which manufactures yarn from PTA (purified terephthalic acid) and MEG (mono ethylene glycol), downstream petrochemical products, have been able to produce yarn at a lower cost due to huge economies of scale. Meanwhile, Vietnamese yarn makers use chips spinning technology, which produces yarn from PET (plastic) pellets which are processed from PTA and MEG. Furthermore, Chinese yarn makers have been able to dump yarn at rock-bottom price, thanks to their massive scale and Chinese government's generous export subsidy (subsidized financing rate, cash grant reward on export, free or discounted services and tax rebate).

According to STK's management, the competition from Chinese yarn will not be fierce as the past years since Chinese Government will reduce subsidy for yarn makers as yarn industry is no longer considered priority.

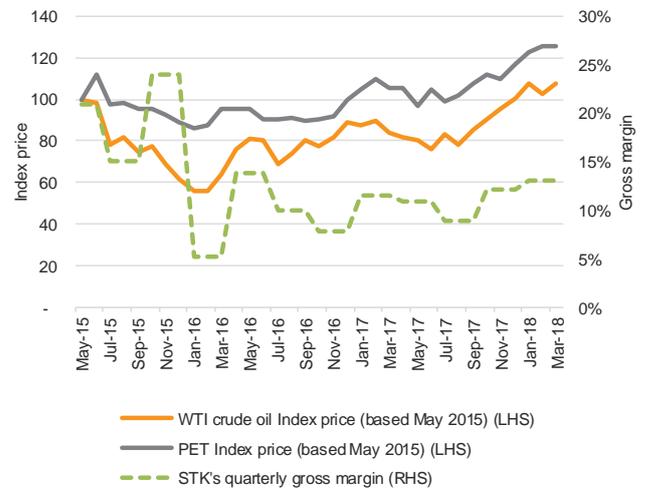
The biggest threat to STK, which is the input cost of plastic pellet PET, will become less of a concern this year, even though oil price is predicted to increase in 2018. The rise of oil price in 2016, along with imported tax in Turkey resulted in the tightening of STK's margins. We assume average crude oil price for 2018 will increase by 36% in 2018 to \$75/ barrel, hence pushing PET index price to 1,190 (+14% YoY) according to our regression model. However the effect will not be large since material cost only accounts for 55% of STK's COGS while average selling price (ASP) of yarn, has already risen 14% in 1Q2018 and is expected to rise by 10.9% for FY2018. As shown in figure 9 below, even though crude oil price and STK's input PET price have continued to climb in 1Q2018, STK's gross margin still expanded to 13.0% due to supportive demand conditions and an improving revenue mix. In addition, in order to mitigate thi10s risk, STK has applied a natural hedge through linking selling prices to raw material input prices (average selling price of received orders should be based on purchasing price of PET chips).

Figure 7: Historical crude oil price and PET index price



Source: VNDIRECT

Figure 8: Historical index price of crude oil and PET (based May 2015) and vs STK's quarterly gross margin



Source: VNDIRECT

STK has very limited control over supply of material as majority of inputs are imported, which accounts for around 55% of its COGS. According to VCOSA, Vietnam imported 346,000 tons of PET in 2017, (mostly from China) while domestic production is only around 145,000 tons per year (manufactured only by Formosa), creating a high dependence on imported raw material for synthetic yarn manufacturers.

Strong top line growth predicted for this year along with rising profitability thanks to improving product mix.

We estimate 2018 revenue and EAT of VND2,364bn (+18.8% YoY) and VND131bn (+30.9% YoY) resulting in a fully-diluted forward EPS of VND1,969 (after rights and ESOP issuance) and driven by a 7.2% increase in expected selling output and 10.9% increase in expected ASP. According to PCI Wood Mackenzie, global demand for synthetic filament will be strong in 2018, while expansion in capacity of Chinese manufacturers (which produce most of global yarn) will not be enough to keep up with demand increased, thereby potentially increasing polyester yarn prices. Our earnings forecast is slightly higher than STK's business plan which guides for 2018 revenue and EAT of VND2,354bn and VND126.0bn, respectively. Total capacity is 60,000 tones/year and current utilization rate of 96% (vs last year's level of 91%). There are few assumptions that we have made for 2018:

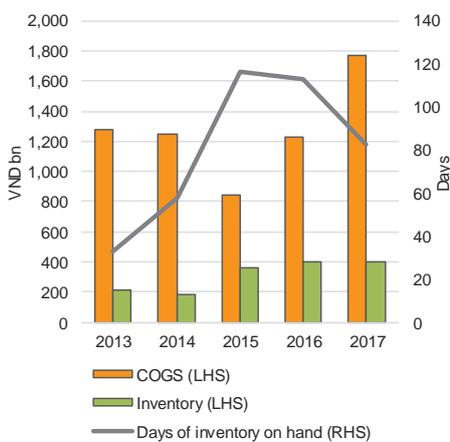
- We expect that capacity utilization will be maintained at current levels of 96.3% (in 1Q2018), while sales volume will equal the production volume, since STK's yarn is usually made-to-order.
- We assume Average selling price (ASP) will increase by 10.9% YoY in 2018 due to favorable global market conditions as explained above. This is a conservative assumption considering the fact that ASP has increased 14.0% YoY in 1Q2018.
- In 2018, we expect STK to focus more on recycled yarn, since it will help improve gross margins. Hence production of recycled yarn is expected to rise significantly by 46.7% YoY to 8,500 tones.

Figure 9: 2018 business result forecasted

Total capacity (tones)	60,000			
Expected utilization rate	96.3%			
Expected total production	57,804			
			Recycled	
	DTY	FDY	yarn	Total
Expected production by product (tones)	42,804	6,500	8,500	57,804
% YoY	11.8%	3.2%	46.7%	14.7%
Selling output (tones, at selling rate of 100%)	42,804	6,500	8,500	57,804
% YoY	4.4%	-3.6%	37.0%	7.2%
Expected ASP (VND/ kg)	46,511	28,179	22,342	40,895
Expected revenue (VND bn)	1,991	183	190	2,364
% YoY	17.3%	8.3%	54.0%	18.8%
Revenue contribution	84.2%	7.7%	8.0%	
Gross profit (VND bn)	219.0	20.1	41.8	281
% YoY	29.1%	19.2%	61.3%	32.2%
Gross margin (%)	11.0%	11.0%	22.0%	11.9%

Source: VNDIRECT

Figure 10: STK's inventory



Source: VNDIRECT

Total production is expected to rise by 14.7% while overall sales volume will only increase by 7.2% due to the fact that STK drew down 3,542 tons of inventory last year that had piled up due to difficult global yarn industry conditions in 2015. Consequently days of inventory fell by 34 days from 116 days in 2015 to 82 days in 2017. We believe that inventory days will rise slightly to 92 days in 2018 due to preparation for commissioning of the new Trang Bang 5 DTY and Color Yarn production facilities.

STK is currently trading at a TTM P/E of 10.2x, a 25.0% discount to the average P/E of 13.6x for regional yarn manufacturers. We think that STK deserves to at least trade in line with regional peers due the following factors: (1) its leading position in the domestic yarn market and (2) improving profitability from a growing focus on higher value added product (recycled yarn) which will expand gross margin by 100bps to 11.9% in 2018 which, combined, with strong volume growth should drive EPS growth of 18% this year. We value STK's shares at VND26,800 each, implying a potential upside of 57.5%.

Figure 11: Valuation

Valuation method		
Forecasted 2018 EAT	131	VND bn
Number of fully diluted shares in 2018	66,250,000	shares
EPS forward 2018	1,969	VND/ share
Target P/E (peers' average)	13.6x	
Target price	26,800	VND/ share

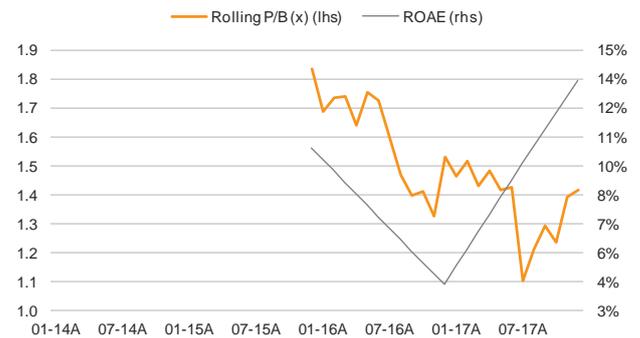
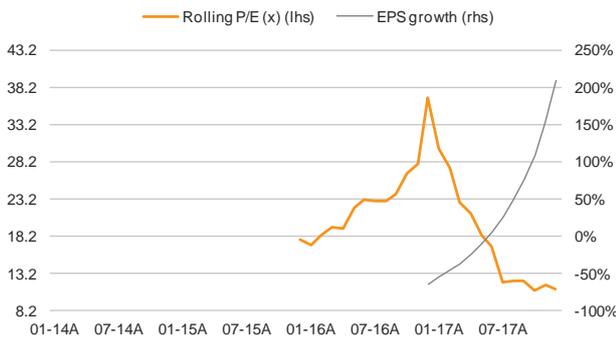
Source: VNDIRECT

Figure 122: Regional yarn manufacturers comparison

	Country	Market Cap (USD mn)	TTM NPAT growth	TTM EPS growth	ROA (%)	ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
Vardhman textile Ltd	India	1,070.0	69.6%	69.6%	11.6%	24.3%	0.5	12.3	1.7
Zig sheng Industrial Ltd	Taiwan	210.0	73.4%	73.4%	3.1%	4.7%	0.3	17.5	1.0
RSWM Ltd	India	99.0	-1.4%	-1.4%	4.4%	17.1%	2.1	6.2	1.5
Hong Yi Fiber Ltd	Taiwan	92.0	8.1%	8.1%	8.1%	8.8%	0.0	13.4	1.2
Tung Ho Textile Ltd	Taiwan	55.0	N/A	N/A	2.0%	2.9%	0.2	18.8	0.5
Average		305.2	37.4%	37.5%	5.8%	11.6%	0.3	13.6	1.2
Median		210.0	69.6%	69.6%	8.1%	8.8%	0.3	13.4	1.2
STK	Vietnam	40.0	246.7%	209.8%	5.0%	13.5%	1.0	10.2	1.2

Source: VNDIRECT

Valuation



Income statement

(VNDbn)	12-16A	12-17A	12-18E
Net revenue	1,358	1,989	2,364
Cost of sales	(1,230)	(1,773)	(2,083)
Gen & admin expenses	(45)	(59)	(70)
Selling expenses	(25)	(32)	(38)
Operating profit	58	126	174
Operating EBITDA	181	274	334
Depreciation and amortisation	(123)	(148)	(160)
Operating EBIT	58	126	174
Interest income	1	8	8
Financial expense	(30)	(30)	(31)
Net other income	2	1	2
Income from associates & JVs	0	0	0
Pre-tax profit	31	105	152
Tax expense	(2)	(5)	(21)
Minority interest	0	0	0
Net profit	29	100	131
Adj. net profit to ordinary	29	100	131
Ordinary dividends			
Retained earnings	29	100	131

Balance sheet

(VNDbn)	12-16A	12-17A	12-18E
Cash and equivalents	86	117	111
Short term investments	0	0	0
Accounts receivables	85	63	59
Inventories	402	399	526
Other current assets	20	34	40
Total current assets	594	613	736
Fixed assets	1,351	1,209	1,468
Total investments	80	156	108
Other long-term assets	0	(0)	0
Total assets	2,025	1,979	2,312
Short-term debt	391	341	295
Accounts payable	251	307	296
Other current liabilities	36	84	72
Total current liabilities	678	732	662
Total long-term debt	652	467	762
Other liabilities	0	0	0
Share capital	535	599	665
Retained earnings reserve	123	143	177
Shareholders' equity	695	779	888
Minority interest			
Total liabilities & equity	2,025	1,979	2,312

Cash flow statement

(VNDbn)	12-16A	12-17A	12-18E
Pretax profit	31	105	152
Depreciation & amortisation	123	148	160
Tax paid	(1)	(5)	21
Other adjustments	(73)	(109)	38
Change in working capital	125	167	(202)
Cash flow from operations	204	306	169
Capex	(297)	(5)	(141)
Proceeds from assets sales	0	0	0
Others	1	(22)	0
Other non-current assets changes	0	0	0
Cash flow from investing activities	(296)	(27)	(141)
New share issuance	0	0	66
Shares buyback	0	0	0
Net borrowings	197	(233)	(46)
Other financing cash flow	(2)	(1)	(1)
Dividends paid	(23)	(16)	(53)
Cash flow from financing activities	171	(249)	(34)
Cash and equivalents at beginning of period	7	87	117
Total cash generated	79	30	(5)
Cash and equivalents at the end of period	86	117	111

Key ratios

	12-16A	12-17A	12-18E
Dupont			
Net profit margin	2.1%	5.0%	5.5%
Asset turnover	0.73	0.99	1.10
ROAA	1.5%	5.0%	6.1%
Avg assets/avg equity	2.70	2.71	2.57
ROAE	4.2%	13.6%	15.7%
Efficiency			
Days account receivable	9.9	10.4	8.1
Days inventory	120	82	92
Days creditor	74.8	63.3	51.8
Fixed asset turnover	1.08	1.55	1.77
ROIC	1.7%	6.3%	6.7%
Liquidity			
Current ratio	0.88	0.84	1.11
Quick ratio	0.28	0.29	0.32
Cash ratio	0.13	0.16	0.17
Cash cycle	54.9	29.4	48.4
Growth rate (yoy)			
Revenue growth	31.2%	46.4%	18.8%
Operating profit growth	(53.5%)	117.2%	37.5%
Net profit growth	(59.6%)	246.7%	30.9%
EPS growth	(64.9%)	209.5%	17.9%
Share value			
Basic EPS (VND)	539	1,662	1,969
BVPS (VND)	12,994	12,996	13,349

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Anirban Lahiri – Head of Research

Email: anirban.lahiri@vndirect.com.vn

Vũ Minh Tú – Analyst

Email: tu.vuminh@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>