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WISDOM TO SUCCESS

THANH CONG TEXTILE GARMENT INVESTMENT TRADING JSC (TCM)

Enjoying profit bounce from reducing loss at Vinh Long factory and the yarn business

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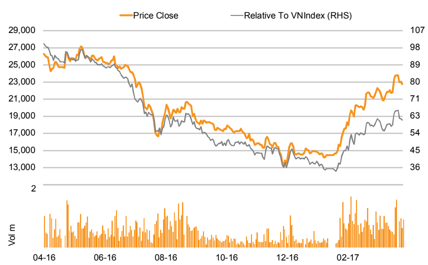
Price performance

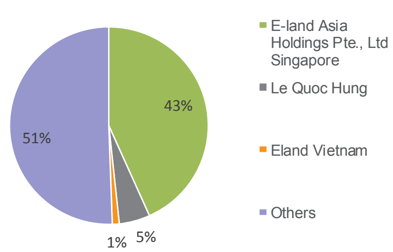


Source: VNDIRECT

Key statistics

52w high (VND)	27,600
52w low (VND)	13,100
Average daily turnover (3m)	421,186
Market cap (VND) billion	1,166
Outstanding shares (m)	49.0
Free float (%)	51
Beta	1.08

Ownership



Source: VNDIRECT

We expect TCM's earnings to rebound dramatically in 2017 but the top line remains the average growth of recent years, about 5-10%/year. The recovery is the result of (1) lowering the loss at the Vinh Long garment factory and (2) saving cost from closing the yarn factory in District 4, HCMC. We believe TCM's managers would attempt to extend those factors' impact in the next three quarters. Also, there are two other drivers for TCM share price in this year, including (1) the decision on lifting the FOL to 70% in this year and (2) the abnormal gain would be probably recorded from transferring the land in District 4, the location of the yarn factory. Noticeably, TCM's managers have not confirmed the process of selling that real estate.

TCM owns the closed-loop process from yarn to sewing. TCM operated in 3 main businesses, namely yarn (~25% total revenue), fabric (~10% revenue), and garment (~65% revenue). In the manufacturing aspect, most of TCM factories work at over 80% of their designed capacity, apart from Vinh Long factory, launched in Mid-2015. This factory operated below the break-even point in 2016 but approached the point in early of this month. In terms of market, approximately 40% of yarn products are consumed internally and the remainder is sold to China and the South of Korea. Over 80% of woven fabric output is purchased by Japanese clients at relatively high margins while the knitting fabric output is only served internally as the input for the garment business. This business, concentrating on Polo and T-shirt products, has a wide range of clients, including Eland (~30%), the strategic investor of TCM, Japanese clients (25%), US clients (~15%) and European clients (15%).

The business outlook maintains recent years' growth rate. Companies in the garment and textile industry have to work under competitive pressure so it is not comfortable for them to break through the industry average growth of 10% per year. TCM sets the 2017's guidance of only 6% growth in revenue and the preliminary 2017Q1's sales remain the same as 2016Q1's.

In contrast, the bottom line of TCM will improve robustly in 2017, backed by (1) lessen loss at Vinh Long factory and (2) less negative effect caused by the yarn business. Vinh Long factory, operating from the mid of 2015, experienced loss in the two consecutive years, that is –VND35 billion and –VND65 billion in 2015 and 2016, in line. Those were due to (1) local workers in Vinh Long province did not own sufficient skills as others in HCMC, the current location of TCM factories, to handle complex contracts and the turnover of VL workers was also higher than HCMC's and (2) the current factory, accounted for only below 50% out of total 13 hectares of leasing land in the Hoa Phu industrial zone, covered the full leasing payments for that land. Besides, in our understanding, in 2015-2016, TCM sales team did not attract enough outsourcing orders so Vinh Long factory, the new one, must work under its breakeven capacity, below ~USD30/day/worker. In Q1/2017, the factory's loss was VND7 billion, significantly lower than the figure of –VND17 billion in Q1/2016. Also, TCM's managers expressed at the meeting that total volume of contracts, ordered in advance, could be sufficient for their operation until July of this year, which is the baseline for us to expect that Vinh Long factory could further mitigate the loss in next quarters thanks to higher running capacity.

We also expect the loss in yarn business to be lower as a consequence of shutting the District 4 factory. Since 2017, TCM has operated without the cost burden of the factory, whose designed capacity was about 12% total capacity of TCM's fiber factories, as previous years. In 2016, the fiber business saw a negative net margin of -2%, equivalent to VND16 billion in the bottom line. Therefore, shutting the factory, the worst one among four factories, would provide TCM a chance to decrease the loss in this business in 2017. Moreover, the factory locates in the position, which is suitable for real estate developers to exploit, so we expect TCM would sell the land to them, which in turn would trigger a huge abnormal profit. Although TCM's managers said that many developers/builders, such as Dat Xanh, Hung Thinh and An Gia, approached them but TCM has not yet confirmed the plan for that land.

The Company has plan to move their operation to Vinh Long province in the future. They stated that they would transfer over 80% of their working volume from HCMC to VL town. For more details, Hoa Phu industrial zone, where they decided to be their next premises, locates along the No.1 National road and near the Can Tho-HCM expressway and near the Hau River, the vital river system in Mekong Delta, which would be very convenient for TCM to transport their goods. Especially, the labor cost in Vinh Long is about 30-50% relatively lower than in HCMC. We believe that TCM will not confront any constraint in recruiting skillful workers if they offer reasonable benefits because in our understanding, the majority of HCMC's current workers at garment companies are local residents in Mekong Delta provinces.

Lifting the FOL for foreign investors. At the AGM's tee-break, investors focused their questions for the managers on the process of lifting the FOLs to 70%, which is set to employ in next two months. The managers did not disclose what extent the Eland investor would extend their ownership rate but they thought that there would probably room left for other investors.

TCM set the guidance to recover their earnings robustly in this year. At the meeting, TCM proposed to increase 2017's revenue and net income at 6% and 55% yoy, in line. Moreover, they would also delivever more benefit to shareholders by making less provision for welfare and compensation fund, from the average level of 25% of net income to only 15% in 2017. The positive target in profit became more practical when the preliminary result of this quarter came out confidently, with the growth of 120% yoy in the bottom line, equivalent to VND49 billion (~20% of the year guidance) but the flat sales compared to the same period of last year. In the growth of profit, Vinh Long factory attributed partially by decreasing the loss by VND10 billion (~20% the total net income) and the second driver was from shutting the inefficient factory in District 4.

As our estimation, 2017's revenue will increase by 6% yoy and net income will rise by 66% yoy, equivalent to the 2017's EPS of VND3,300. According to the closing price on 12/4/2017, TCM was traded at 2017's PER of 6.9x, moderately lower than the average P/E of 8.x in 2014-2015, which we adjusted for the 25% provision for the welfare and bonus fund.

DISCLAIMER

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