THANH CONG TEXTILE GARMENT JSC (TCM) – UPDATE

Market Price	Target Price	Dividend Yield	Rating	Sector
VND22,800	VND26,900	2.07%	ADD	Textiles

Outlook – Short term: Negative / **Neutral** / Positive

Outlook – Long term: Negative / Neutral / **Positive**

Valuation: Negative / Neutral / **Positive**

30 October 2018
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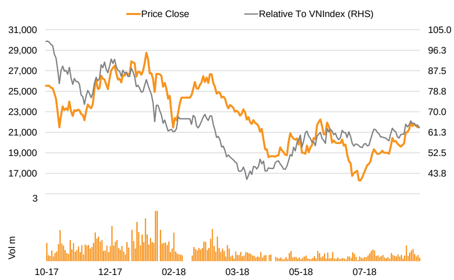
Key changes in the report

- Raise FY18F EAT forecast by 23.9%
- Raise target price by 19.6%

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	28,758
52w low (VND)	16,300
3m Avg daily volume (shares)	656,495
3m Avg daily value (VNDmn)	16,971
Market cap (VNDbn)	1,402
Outstanding shares (m)	54.1
Free float (%)	49
TTM P/E (x)	6.3
Current P/B (x)	1.0

Ownership

E-land Asia Holdings Pte., Ltd Singapore	43.3%
VCBF	2.6%
Lê Quốc Hưng	1.9%
Others	52.20%

Source: VNDIRECT

TCM enjoyed outstanding 3Q18 results on the back of a 26.5% yoy increase in garment revenue while fabric revenue rose 47.6% yoy. We expect TCM's recurring earnings to grow 40.1% yoy in 2018 and 17.7% in 2019, driven by continuing vertical integration marked by the investment in a dyeing factory and benefits from the European Union-Vietnam FTA (EVFTA), which will boost garment exports to the EU. These factors outweigh the impact of the Sears bankruptcy.

TCM saw growth accelerate in the third quarter with revenue of VND1,178bn (+30.7% yoy) and EAT of VND97bn (+85.2% yoy) thanks to large garment orders in August and gross margin expansion in the yarn segment of around 11.1% pts yoy to reach 12.6%, facilitated partly by the closure of inefficient factories. 9M18 revenue reached VND2,797bn (+14.2% yoy) and EAT rose 25.1% yoy to VND213bn.

TCM will strengthen its production chain by investing in a dyeing factory with capacity of 5,000m of fabric per day in Vinh Long for in-house fabric production needs. This is expected to happen in 2019-20 and the estimated CAPEX is between US$30-35m, per management.

The upcoming EVFTA is expected to give Vietnamese garment enterprises an edge over Chinese peers due to a waiver of import tax versus a 12% import tax on Chinese garment imports. Under EVFTA requirements, garment producers are obliged to source materials (fabric) from their home country to enjoy the 0% tax rate. This will benefit TCM as it can produce its own fabric and around 15% of TCM's garment revenues are generated from exports to the EU.

The bankruptcy of Sears will dent future performance. Sears contributed 7% of TCM's annual revenue in FY17 and accounts for VND95bn of FY18 receivables hence its bankruptcy might affect future profits. We apply a VND250bn haircut to our FY19 revenue forecast to account for this. To account for the risk of non-realization receivables from Sears, we forecast a recovery rate of 36.5%, which is the average recovery rate for unsecured debt based on Moody's data. We therefore expect a provision of VND61bn to be fully booked in FY19.

Maintain ADD rating as stronger growth prospects outweigh potential impact of Sears bankruptcy. We now base our valuation on FY2019F recurring EPS of VND4,027/share (which is 23.9% higher than our old FY19 EPS forecast) and a target TTM P/E of 6.7x based on the peer average. We apply a haircut of 4.0% to our target price valuation to account for the Sears receivables risk and arrive at a target price of VND26,900/share (19.6% higher than our earlier target price).

Financial summary (VND)	12-16A	12-17A	12-18E	12-19E
Net revenue (bn)	3,071	3,209	3,627	3,936
Revenue growth	10.0%	4.5%	13.0%	8.5%
Gross margin	13.6%	15.7%	17.5%	17.6%
EBITDA margin	8.4%	12.1%	13.1%	10.4%
Net profit (bn)	116	193	255	207
Net profit growth	(24.8%)	67.1%	31.9%	(18.9%)
Recurring profit growth	(25.6%)	42.1%	40.8%	17.7%
Basic EPS	2,246	3,753	4,951	4,016
Adjusted EPS	1,572	3,195	4,208	3,413
BVPS	18,461	20,635	23,117	25,861
ROAE	12.9%	19.6%	22.0%	15.6%

9M18 REVIEW

In 9M18, TCM's strong results exceeded the annual plan, with robust growth driven by booming garment orders, higher fabric revenue and reduction of lower margin yarn contribution.

Figure 1: 9M18 results

(VND bn)	3Q2018	yoy%	9M2018	yoy%	% vs old forecast	% vs revised forecast	Comments
Total revenue	**1,178**	**30.7%**	**2,797**	**14.2%**	**84.6%**	**77.1%**	Large garments orders in Q3
Yarn	*152*	*-27.0%*	*362*	*-36.2%*	*58.2%*	*75.7%*	Change in product mix (lower yarn production after another factory was sold in Q1) to focus on fabric and garments that have higher margin
Fabric	*158*	*68.9%*	*375*	*47.6%*	*123.4%*	*81.5%*	
Garments	*868*	*44.8%*	*2,060*	*26.5%*	*86.5%*	*77.3%*	
Gross profit	**206**	**52.3%**	**498**	**28.0%**	**88.7%**	**78.7%**	
Gross profit margin	17.5%	+250bps	17.8%	+190bps			Gross margin improved with change in product mix
SG&A	(80)	23.7%	(218)	17.0%	78.8%	71.6%	
Operating profit	101	73.1%	224	34.9%	79.0%	68.2%	
Net other income	21	736.7%	48	29.6%	176.7%	90.2%	Additional profit from selling land in Trang Bang industrial zone
EBT	**121**	**99.8%**	**271**	**33.8%**	**105.6%**	**85.4%**	
Net profit	**97**	**85.2%**	**213**	**25.1%**	**103.6%**	**84.0%**	

Source: VNDIRECT

TCM has surpassed annual plan of FY18 EAT of VND190bn by 12.1% in 9M18. TCM booked strong 3Q18 results with garment revenue increasing 44.8% yoy. This was based on large orders, especially in August, which is the peak time for garment manufacturers to produce clothing for year-end sales. In addition, yarn revenue decreased 27.0% yoy to VND152bn after switching production in the Tan Binh factory from yarn to fabric in 1Q18. Hence, revenue from fabric surged 68.9% yoy to reach VND158bn in 3Q18. Since fabric and garments have much higher gross margins than yarn, the product mix towards fabric and garments has helped to raise the blended margin by 250bp to reach 17.5%.

Figure 2: TCM's dyeing stage

Source: VNDIRECT

Figure 3: TCM's sewing factory

Source: VNDIRECT

TCM has announced a plan to acquire 20.7% of Savimex (SAV), a furniture exporter, with the purpose of (1) taking advantage of the US-China trade war as Chinese wooden furniture is affected by the tariffs, (2) providing furniture for TC1, a real estate project of TCM that is expected to start in 2020 and (3) in our view, strengthening control over E-Land (SAV's major shareholder with 42.3% of stake).

FY18 FORECAST

We raise our FY18 forecast due to outstanding 3Q18 results.

We forecast FY18 net revenue to reach VND3,627 bn (+13.0% yoy) and EAT to reach VND255bn (+31.9% yoy). We raise our forecast revenue by 9.7% on the back of robust 3Q18 results and at the same time, raise EAT by 23.9% vs the previous forecast because of (1) higher blended gross margin due to the continued shift in product mix towards higher margin garments and fabric, and (2) net one-off profit from the sale of land in Trang Bang industrial zone worth around US$0.9m, recorded in 3Q18 results.

Figure 4: FY18 forecast revised

FYE (VND bn)	2017A	2018F			comments
		Old forecast	New forecast	% change of forecast	
Net revenue	**3,210**	**3,307**	**3,627**	**9.7%**	3Q2018 results exceeding our expectations
Yarn	*712*	*621*	*477*	*-23.1%*	Continued shift in product mix towards fabric and yarn according to current operations and TCM's plan. Production volume of yarn is expected to fall by 40% yoy after selling 1 factory and switching production of another from yarn to fabric. Fabric therefore enjoyed a 60% increase in output volume.
Fabric	*279*	*304*	*460*	*51.3%*	
Garments	*2,192*	*2,382*	*2,664*	*11.8%*	
Net revenue growth %	4.5%	3.0%	13.0%	+10%pts	
Gross profit	**503**	**561**	**633**	**12.9%**	
Gorss margin %	15.7%	17.0%	17.5%	+50bps	
Net profit	**193**	**206**	**255**	**23.9%**	
EPS (VND)	**3,195**	**3,394**	**4,208**	**23.9%**	

Source: VNDIRECT

We expect 2019 results will be affected by the Sears' bankruptcy.

The effect of Sears' bankruptcy is forecasted to be relatively large. Sears Holding Corporation (Nasdag: SHLD), a key customer of TCM, has filed for bankruptcy in the USA. According to TCM, Sears' subsidiaries Sears, Roebuck and Kmart account for around 7% of annual revenue and VND95bn worth of TCM's receivables, or around 19% of total receivables outstanding. TCM is trying to use the bankruptcy process to recover these dues. The result of the insolvency proceedings is expected to be announced in the final hearing on 15 Nov 2018. There will be a loss in the top-line of around VND250bn, equivalent to the average annual contribution of Sears' affiliates in revenue (7%), in the following years and possible provision for doubtful debt to be booked for TCM.

We reflect the impact of Sears' bankruptcy into sales from FY19 and possible provision of around VND61bn for the doubtful receivables of Sears, with the expected average recovery rate for unsecured debt of 36.5% (according to Moody's data). We assume this provision to be fully booked in 2019 and to be recorded under general administrative expenses, hence raising this expense by 44.1% yoy to VND245bn.

With a reduction of VND250bn in run-rate recurring revenue (as a result of lost orders from Sears), 2019 revenue is expected to grow 8.5% (versus 13.7% if TCM still had orders from Sears). FY19F recurring profit is expected to grow 17.7% yoy, higher than revenue growth thanks to higher net interest income (negative VND22bn versus negative VND38bn in 2018) while gross margin is forecast to expand by 15bp yoy. FY19F EAT is forecast to decrease by 18.9% yoy to touch VND207bn, mainly due to the provision for doubtful receivables estimated above.

VALUATION

In our view, TCM should be trading at least at the peer average of 6.7x, since (1) TCM is the only garment manufacturer that offers a complete production chain from yarn to garments, which will be upgraded by the upcoming dyeing factory project, and (2) EVFTA, which will benefit TCM when exporting to the EU. The EU accounts for around 15% of TCM's garment revenue.

We use the peer average P/E of 6.7x as our target P/E and apply it to our FY19F recurring EPS of VND4,207/ share (+23.9% vs previous forecast) after stripping out the potential impact of the provision for receivables from Sears worth VND61bn from our FY19 EPS as this is a non-recurring expense but including the impact of the loss of recurring revenue from this client account.

The sharp increase in our EPS forecast is based on outstanding 3Q18 results, driven by a surge in orders from new customers partly due to a shift in sourcing away from China to Vietnam as a fall-out of the US-China trade war. We expect this trend to gather pace as the trade war intensifies.

As the potential provision charge is a one-off event that does not affect recurring profit, we value this provision adjustment based on its impact on book value of equity. We multiply the expected provision charge of VND61bn with a P/B ratio of 1.0x (in line with TCM's current P/B ratio), and deduct this from the market cap to reflect the impact of the receivables non-realization on TCM's equity valuation. We come up with a target price of VND26,900/ share (+19.6% vs previous forecast).

Figure 5: Valuation

Valuation method	
FY19F core earning (VND bn)	**268**
Number of fully diluted shares in 2018	54,231,529
FY19F core EPS (VND/ share)	**4,207**
Target P/E (peers' average) (x)	6.7
Target price (VND/ share)	28,047
Market cap @ target price (VND bn)	1,521
Less	
Provision for Sears' receivables (VND bn)	61
P/B (x) applied to provision	1.0
Adjusted market cap	1,460
Adjusted target price (VND/ share)	**26,928**

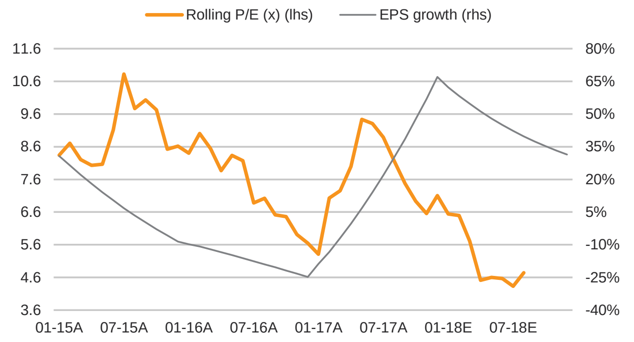
Source: VNDIRECT

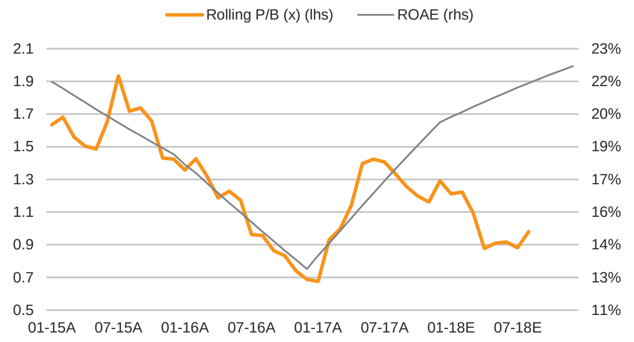
Figure 6: Peer comparison

	Exchange	Market cap (US$ m)	TTM NPAT growth (%)	TTM EPS growth (%)	TTM ROA (%)	TTM ROE (%)	D/E (x)	TTM P/E (x)	TTM P/B (x)
VGG	UPCOM	105.5	0.5%	-9.4%	9.4%	22.0%	0.1	8.5	1.8
STK	HOSE	45.9	196.2%	128.3%	6.4%	17.5%	1.0	8.0	1.3
TNG	HNX	34.8	59.4%	38.0%	6.3%	23.5%	2.1	5.1	1.1
GIL	HOSE	30.9	142.0%	34.9%	11.4%	29.7%	1.0	4.2	1.2
GMC	HOSE	23.3	26.2%	4.8%	7.1%	22.8%	1.3	7.7	1.7
BDG	UPCOM	19.8	1.40%	-6.7%	14.4%	36.3%	0.4	6.6	2.3
Average					**8.1%**	**23.1%**	**1.1**	**6.7**	**1.5**
Median					**7.1%**	**22.8%**	**1.0**	**7.2**	**1.5**
TCM	**HOSE**		**20.1%**	**85.5%**	**7.4%**	**17.6%**	**1.01**	**6.3**	**1.0**

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-17A	12-18E	12-19E
Net revenue	3,209	3,627	3,936
Cost of sales	(2,706)	(2,994)	(3,243)
Gen & admin expenses	(148)	(170)	(245)
Selling expenses	(112)	(134)	(146)
Operating profit	**243**	**329**	**303**
Operating EBITDA	349	431	408
Depreciation and amortisation	**(106)**	**(102)**	**(106)**
Operating EBIT	**243**	**329**	**303**
Interest income	26	34	44
Financial expense	(71)	(91)	(83)
Net other income	42	53	0
Income from associates & JVs	(5)	(5)	(5)
Pre-tax profit	**235**	**319**	**259**
Tax expense	(43)	(64)	(52)
Minority interest	1	0	0
Net profit	**193**	**255**	**207**
Adj. net profit to ordinary	165	217	176
Ordinary dividends	(33)	(27)	(27)
Retained earnings	**161**	**228**	**180**

Cash flow statement

(VNDbn)	12-17A	12-18E	12-19E
Pretax profit	**235**	**319**	**259**
Depreciation & amortisation	106	102	106
Tax paid	(43)	(64)	(52)
Other adjustments	(35)	(171)	(70)
Change in working capital	**23**	**(131)**	**(92)**
Cash flow from operations	**286**	**55**	**151**
Capex	(93)	(100)	(60)
Proceeds from assets sales	82	104	0
Others	(109)	50	0
Other non-current assets changes	0	0	0
Cash flow from investing activities	**(121)**	**54**	**(60)**
New share issuance	0	0	0
Shares buyback	0	0	0
Net borrowings	(48)	(34)	(27)
Other financing cash flow	(50)	0	0
Dividends paid	(33)	(27)	(27)
Cash flow from financing activities	**(131)**	**(61)**	**(54)**
Cash and equivalents at beginning of period	96	130	179
Total cash generated	**34**	**48**	**37**
Cash and equivalents at the end of period	130	179	216

Balance sheet

(VNDbn)	12-17A	12-18E	12-19E
Cash and equivalents	130	179	216
Short term investments	151	201	201
Accounts receivables	475	449	484
Inventories	806	940	1,019
Other current assets	44	96	157
Total current assets	**1,607**	**1,864**	**2,077**
Fixed assets	1,197	1,172	1,103
Total investments	101	1	1
Other long-term assets	131	131	131
Total assets	**3,035**	**3,168**	**3,312**
Short-term debt	969	920	913
Accounts payable	292	269	291
Other current liabilities	366	366	366
Total current liabilities	**1,626**	**1,554**	**1,569**
Total long-term debt	294	308	289
Other liabilities	44	44	44
Share capital	517	542	542
Retained earnings reserve	299	456	572
Shareholders' equity	**1,064**	**1,254**	**1,403**
Minority interest	8	8	8
Total liabilities & equity	**3,035**	**3,168**	**3,312**

Key ratios

	12-17A	12-18E	12-19E
Dupont			
Net profit margin	6.0%	7.0%	5.3%
Asset turnover	1.10	1.17	1.21
ROAA	6.6%	8.2%	6.4%
Avg assets/avg equity	2.97	2.68	2.44
ROAE	19.6%	22.0%	15.6%
Efficiency			
Days account receivable	49.4	41.1	41.1
Days inventory	109	115	115
Days creditor	39.4	32.8	32.8
Fixed asset turnover	2.66	3.06	3.46
ROIC	8.3%	10.3%	7.9%
Liquidity			
Current ratio	0.99	1.20	1.32
Quick ratio	0.49	0.59	0.67
Cash ratio	0.17	0.24	0.27
Cash cycle	119	123	123
Growth rate (yoy)			
Revenue growth	4.5%	13.0%	8.5%
Operating profit growth	36.1%	35.2%	(7.9%)
Net profit growth	67.1%	31.9%	(18.9%)
EPS growth	67.1%	31.9%	(18.9%)
Share value			
Basic EPS (VND)	3,753	4,951	4,016
BVPS (VND)	20,635	23,117	25,861

Source: VNDIRECT

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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.

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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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