

THANH CONG TEXTILE GARMENT JSC (TCM) - UPDATE

Market Price VND29,550	Target Price VND32,300	Dividend Yield 1.55%	Rating HOLD	Sector TEXTILE
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Outlook – Short term



Outlook – Long term



Valuation



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Key changes in the report

- Raise FY19F core EPS by 16.4%
- Raise target price by 20.0%

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	30,300
52w low (VND)	16,300
3m Avg daily volume (shares)	626,558
3m Avg daily value (VNDmn)	15,746
Market cap (VNDbn)	1,537
Outstanding shares (m)	53.4
Free float (%)	52.2
TTM P/E (x)	7.2
Current P/B (x)	1.0

Ownership

E-land Asia Holdings Pte., Ltd Singapore	43.3%
VCBF	2.6%
Le Quoc Hung	1.9%
Others	52.2%

Source: VNDIRECT

We expect this to be a muted year for TCM with EAT to decrease by 1.8% yoy. This is due to the Sears bankruptcy which will continue to negatively impact the bottomline while a possible reduction of Eddie Bauer's orders might reduce topline growth.

TCM's FY18 financial results were excellent with revenue of VND3,662bn (+14.1%) and EAT of VND260bn (+34.6%) despite booking of provisions worth VND79bn for doubtful receivables from Sears; normalized profit growth was a stellar 72.8% yoy. Blended gross margin expanded by 280bp thanks to higher revenue contribution of fabric which has the highest gross margin in TCM's product portfolio.

Construction of TCM's Vinh Long dyeing factory will start in FY20F with expected CAPEX of US\$30m and designed capacity of 5,000m of fabric/day. The factory will satisfy in-house fabric needs hence reducing outsourced expenses and potentially raising blended gross margin by around 160bp after the official launch due in FY22F.

We expect topline growth in FY19F to decelerate from FY18 levels while earnings could fall slightly. We forecast FY19F revenue to increase slightly by 1.8% to touch VND3,728bn, with garment revenue expected to decline by 1.5% due to (1) loss of Sears' orders following its bankruptcy and (2) reduction in orders from Eddie Bauer which accounts for around 10% of total revenues. Besides, EAT is estimated to decrease by 1.8% yoy, touching VND256bn, due to slower topline growth and a high base effect due to one-off profits of VND48bn in FY18 from selling land and revaluation of investments in SAV worth VND27bn.

We raise our TP but downgrade our rating to HOLD given the recent rally in the share price, which has rendered the valuation fair in our view. TCM is trading at a core TTM P/E of 6.4x, which is higher than peers average of 5.8x. We value the stock on a FY19F core EPS of VND4,673/share and a target P/E of 7.0x which is the 1-year historical average TTM P/E of TCM. We also apply a haircut of 1.5% to our target price valuation to account for the residual Sears receivable balance that is yet to be provisioned for to come up with a target price of VND32,300/share. Our new TP is 20.0% higher than our previous TP we use a higher target P/E to account for TCM's fully integrated chain of production which makes it unique among domestic peers and a 16.4% increase in our core FY19 EPS forecast largely due to higher gross margin assumptions.

Financial summary (VND)	12-17A	12-18A	12-19E	12-20E
Net revenue (bn)	3,209	3,662	3,728	4,081
Revenue growth	4.5%	14.1%	1.8%	9.5%
Gross margin	15.7%	18.5%	19.0%	19.0%
EBITDA margin	12.1%	13.1%	13.1%	13.8%
Net profit (bn)	193	260	256	301
Net profit growth	67.1%	34.6%	(1.8%)	17.6%
Recurring profit growth	28.8%	72.8%	3.9%	11.5%
Basic EPS	3,753	4,802	4,715	5,545
Adjusted EPS	3,195	4,081	4,008	4,699
BVPS	20,635	23,379	25,843	28,391
ROAE	19.6%	22.3%	19.2%	20.4%

FY18 review: TCM delivered strong business results in FY18 with robust growth driven by both fabric and garments.

Figure 1: FY18 earning comparison

(VND bn)	4Q18	yoy%	FY18	yoy%	% vs our previous forecast	Comments
Total revenue	866	13.9%	3,662	14.1%	101.0%	
<i>Yarn</i>	108	-6.1%	469	-31.2%	98.4%	Increasingly focused on fabric, which has the highest gross margin and away from yarn.
<i>Fabric</i>	158	56.7%	533	50.2%	115.9%	
<i>Garments</i>	538	11.4%	2,598	23.0%	97.5%	
Gross profit	181	58.8%	679	35.0%	107.2%	
Yarn gross margin	12.8%	+1190bp	13.0%	+1210bp	+100bp	GPM improved due to higher efficiency of yarn production after selling an inefficient yarn factory and switching the operations of another yarn factory to produce fabric, both done during 1H18.
Fabric gross margin	25.3%	+630bp	19.8%	+80bp	+30bp	Operation of a new fabric factory helped to achieve economies of scale hence reducing cost of fabric production and raising gross margin
Garment gross margin	23.6%	+320bp	19.7%	+50bp	+70bp	Input material cost was lower due to in-sourced fabric, hence expanding garment gross margin
Blended gross profit margin	20.9%	+590bp	18.5%	+280bp	+100bp	Higher due to the change in product mix towards fabric
SG&A as % of revenue	18.0%	+873bp	10.2%	+210bp	+180bp	Administrative expenses surged due to the provision of VND79bn for Sears' receivables, which exceed our previous estimation of VND30bn in FY18.
<i>Operating profit</i>	25	-37.7%	305	25.4%	92.7%	
Net other income	0	-55.7%	48	28.0%	100.0%	
Profit from joint venture	28	N/A	28	N/A	N/A	In 4Q18, TCM recorded VND27bn of profit from its affiliate SAV, which is the investment revaluation following the acquisition in 3Q18.
EBT	52	60.6%	323	37.5%	101.4%	
Net profit	47	113.3%	260	35.2%	102.1%	4Q18 and FY18 deferred tax of VND17bn and VND15bn, respectively

Source: VNDIRECT

In 4Q18, the fabric segment, which has the highest gross margin, continued to surge with a 56.7% yoy increase in revenue to reach VND158bn, while yarn segment profitability continued to improve significantly after TCM sold an inefficient yarn factory and switched the operations of another yarn factory to produce fabric in 1H18, hence driving up blended gross margin by 590bp yoy to 20.9%. TCM worth a total gross value of VND101bn, following Sears' bankruptcy filing in Nov 18. This is much greater than our previous forecast of provision of VND30bn, which was based on TCM's management guidance. Overall, 4Q18 EAT surged 113.3% yoy to touch VND47bn (with the help of deferred tax), raising FY18 EAT by 35.2% yoy.

Figure 2: fabric production



Source: VNDIRECT

Figure 3: Garment production



Source: VNDIRECT

FY19F FORECAST

We expect muted FY19F results due to the twin impacts of Sears' bankruptcy filing and a possible reduction in revenue contribution from Eddie Bauer.

Figure 4: FY19F forecast

(VND bn)	FY18	FY19F	yoy% Comments
Net revenue	3,662	3,728	1.8%
Yarn	469	500	6.7%
Fabric	533	642	20.4%
Garments	2,598	2,560	-1.5%
Gross profit	679	707	4.1%
Gross margin	18.5%	19.0%	+50bp
Financial income	32	44	38.4%
Financial expense	(89)	(93)	4.2%
SG&A	(374)	(343)	-8.2%
SG&A as % of revenue	10.2%	9.2%	-100bp
Profit from joint venture/ affiliates	28	5	-82.1%
Net other income	48	-	-100.0%
Net profit	260	256	-1.8%
Net margin	7.1%	6.9%	-20bp
EPS (VND)	4,081	4,008	-1.8%

Source: VNDIRECT

Fabric will become the main growth driver while garment sales might slow down. We forecast FY19F revenue to rise slightly by 1.8% yoy to reach VND3,728bn on the back of the fabric segment, which is expected to record revenue of VND642bn (+20.4% yoy), while the garments segment might suffer with a decrease of 1.5% yoy in revenue to VND2,560bn due to (1) loss of Sears' orders (worth around VND250bn) and (2) a possible reduction of Eddie Bauer's orders (this customer currently accounts for 10% of TCM's FY18 revenue, per management).

TCM plans to reduce exposure to Eddie Bauer's orders with the aim of reducing revenue contribution from this account to total revenue from 10% to 5%. Eddie Bauer is a US apparel retailer which accounts for nearly VND80bn worth of FY18 receivables (equivalent to 24% of TCM's receivables). In our opinion, this is because (1) Eddie Bauer's payment method is telegraphic transfer (T/T), which seems to be risky as there are no payment guarantees (the Sear's bankruptcy has made management weary of such payment methods), and (2) Eddie Bauer's solvency situation is fragile as its parent company Everest Holdings currently has a Corporate Family Rating (CFR) of B3 and Default Rating (PDR) of B3-PD, which all indicate a high probability of default risk and is classified as Non-Investment Grade, according to Moody's.

We expect all of Sears' receivables will be fully provisioned in 2019. Sears has been downgraded to D-PD in Probability of Default Rating (PDR) by Moody's following its filing for bankruptcy in Oct 18, indicating a "default on all of their long-term debt obligations". This means that the total amount of Sears' receivables worth VND101bn until the end of FY18 will be uncollectible, hence making it necessary for TCM to make a provision for the whole amount. In FY18, TCM booked a provision of VND79bn, leaving the remaining VND22bn to

be booked in FY19F, hence reducing FY19F SG&A expenses by 8.2% yoy.

Vinh Long dyeing factory will help to expand blended gross margin in FY22F by around 160bp. The dyeing stage, which is a part of fabric production, is currently a bottleneck in the Vietnamese textile production chain. As such, a new dyeing factory will be a huge comparative advantage for TCM. Vinh Long dyeing factory, with expected CAPEX of US\$30m and designed capacity of 3,000m/day, will be officially launched in FY22F. It will reduce outsourcing expenses, which currently accounts for 17.9% of total operating expenses, therefore helping to raise fabric gross margin by 220bp. Garment gross margin might also expand by 150bp because the fabric inputs will be sourced in-house, lowering overall cost. Overall, blended gross margin is expected to rise by 160bp in FY22F.

VALUATION

Even though we raise our target price by 20.0%, we downgrade our rating to HOLD, given the 27.2% increase in the share price since our last update.

We use TCM's 1-year average TTM P/E of 7.0x as our target P/E and FY19F recurring EPS of VND4,673/share after excluding the booking of the remaining provision for Sears' receivables of VND22bn in the FY19 P&L as it is a one-off event. We however, do apply a discount to our target P/E-based valuation to account for the impact of the provision for the residual Sear's receivables balance on TCM's book value of equity.

We come up with a target price of VND32,300/share (+20.0% vs our previous target price) thanks to higher core EPS forecast by 16.4% and higher target P/E of 4.4% vs previous forecast. We believe that TCM stock deserves to trade at P/E of 7.0x (equivalent to its historical average P/E and a 20.7% premium to average P/E of Vietnamese textile peers of 5.8x) since TCM is the only garment manufacturer in Vietnam that offers a complete production chain from yarn to garments, which will be further reinforced by the upcoming Vinh Long dyeing factory.

Figure 5: Valuation

Valuation method	
FY19F core profit (VND bn)	292
Less	
Bonus and welfare fund	38
FY19F core profit for calculating EPS	253
Number of fully diluted shares in 2019	54,230,055
FY19F core EPS (VND/ share)	4,673
Target P/E (peers' average) (x)	7.0
Target price (VND/ share)	32,712
Market cap @ target price (VND bn)	1,774
Less	
Provision for Sears' receivables (VND bn)	22
P/B (x) applied to provision	1.0
Adjusted market cap	1,752
Adjusted target price (VND/ share)	32,299

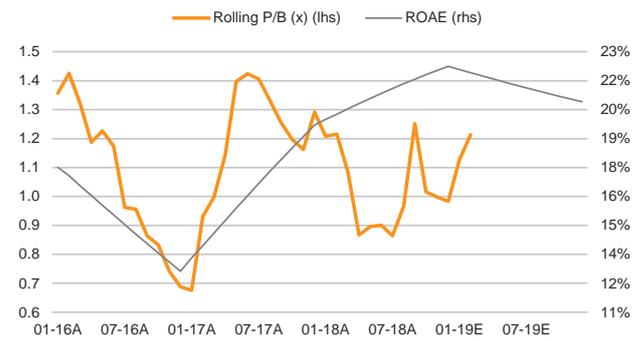
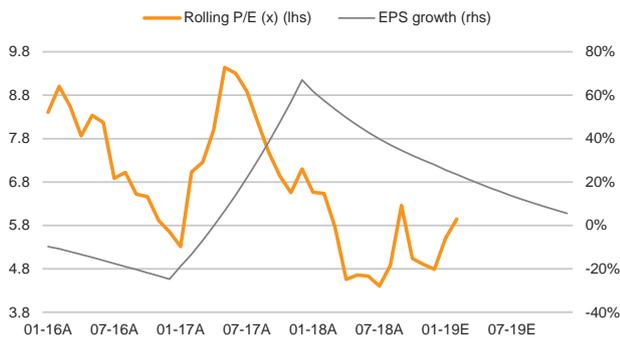
Source: VNDIRECT

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	105.2	23.7%	23.7%	10.5%	29.8%	0.0	5.4	1.5
MSH	HOSE	102.5	85.4%	-7.3%	15.2%	44.0%	0.9	6.6	2.5
STK	HOSE	54.0	80.3%	67.8%	8.8%	21.3%	0.9	6.4	1.2
TNG	HNX	40.1	57.1%	30.9%	7.5%	25.4%	1.6	5.1	1.2
Average			61.6%	28.8%	9.4%	28.4%	1.1	5.8	1.5
Median			68.7%	27.3%	8.8%	25.4%	0.9	5.9	1.3
TCM	HOSE	66.8	34.6%	28.7%	8.2%	22.1%	1.0	7.2	1.0

Source: VNDIRECT

Valuation



Income statement

(VNDbn)	12-18A	12-19E	12-20E
Net revenue	3,662	3,728	4,081
Cost of sales	(2,983)	(3,021)	(3,304)
Gen & admin expenses	(230)	(194)	(188)
Selling expenses	(144)	(149)	(163)
Operating profit	305	364	426
Operating EBITDA	410	481	552
Depreciation and amortisation	(105)	(117)	(126)
Operating EBIT	305	364	426
Interest income	32	44	51
Financial expense	(89)	(93)	(105)
Net other income	48	0	0
Income from associates & JVs	28	5	5
Pre-tax profit	323	320	377
Tax expense	(63)	(64)	(77)
Minority interest	0	0	0
Net profit	260	256	301
Adj. net profit to ordinary	221	217	255
Ordinary dividends	(26)	(27)	(54)
Retained earnings	234	229	246

Balance sheet

(VNDbn)	12-18A	12-19E	12-20E
Cash and equivalents	216	489	656
Short term investments	203	203	203
Accounts receivables	280	318	358
Inventories	1,138	1,067	1,169
Other current assets	100	86	87
Total current assets	1,937	2,163	2,472
Fixed assets	1,107	1,050	1,274
Total investments	67	67	67
Other long-term assets	141	141	141
Total assets	3,252	3,421	3,954
Short-term debt	1,008	1,121	1,223
Accounts payable	300	302	357
Other current liabilities	398	344	418
Total current liabilities	1,705	1,767	1,998
Total long-term debt	222	197	360
Other liabilities	48	48	48
Share capital	542	542	542
Retained earnings reserve	406	540	678
Shareholders' equity	1,268	1,401	1,540
Minority interest	9	9	9
Total liabilities & equity	3,252	3,421	3,954

Cash flow statement

(VNDbn)	12-18A	12-19E	12-20E
Pretax profit	323	320	377
Depreciation & amortisation	105	117	126
Tax paid	(66)	(64)	(77)
Other adjustments	(10)	(27)	(56)
Change in working capital	(266)	(11)	(64)
Cash flow from operations	86	334	306
Capex	(66)	(60)	(350)
Proceeds from assets sales	104	0	0
Others	42	0	0
Other non-current assets changes	0	0	0
Cash flow from investing activities	79	(60)	(350)
New share issuance	0	0	0
Shares buyback	0	0	0
Net borrowings	(10)	25	265
Other financing cash flow	(43)	0	0
Dividends paid	(26)	(27)	(54)
Cash flow from financing activities	(80)	(2)	211
Cash and equivalents at beginning of period	130	216	489
Total cash generated	86	273	167
Cash and equivalents at the end of period	216	489	656

Key ratios

	12-18A	12-19E	12-20E
Dupont			
Net profit margin	7.1%	6.9%	7.4%
Asset turnover	1.16	1.12	1.11
ROAA	8.3%	7.7%	8.2%
Avg assets/avg equity	2.70	2.50	2.51
ROAE	22.3%	19.2%	20.4%
Efficiency			
Days account receivable	33.1	41.1	41.2
Days inventory	139	129	129
Days creditor	36.7	36.5	39.5
Fixed asset turnover	3.20	3.46	3.51
ROIC	10.4%	9.4%	9.6%
Liquidity			
Current ratio	1.14	1.22	1.24
Quick ratio	0.47	0.62	0.65
Cash ratio	0.25	0.39	0.43
Cash cycle	136	134	131
Growth rate (yoy)			
Revenue growth	14.1%	1.8%	9.5%
Operating profit growth	25.4%	19.3%	17.2%
Net profit growth	34.6%	(1.8%)	17.6%
EPS growth	28.0%	(1.8%)	17.6%
Share value			
Basic EPS (VND)	4,802	4,715	5,545
BVPS (VND)	23,379	25,843	28,391

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.

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:

- 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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- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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