# VIET NAM CONTAINER SHIPPING JSC (VSC) – EARNINGS UPDATE

| Market Price | Target Price | Dividend Yield | Rating | Sector |
|---|---|---|---|---|
| VND48,300 | VND69,000 | 0.4% | ADD | LOGISTICS |

| Outlook – Short term | Outlook – Long term | Valuation |
|---|---|---|
| Negative Neutral Positive | Negative Neutral Positive | Negative Neutral Positive |

**14 November 2017**
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**9-month consolidated revenue grew strongly while net profit was almost flat purportedly due to lower handling rates in Greenport and rising fuel costs that negatively impacted trucking activity. Even though the company did not meet our FY17 forecast, we reiterate our ADD recommendation due to 1) expected strong 2018 earnings growth and 2) our belief that the recent foreign investors' sell-off has left the stock undervalued.**

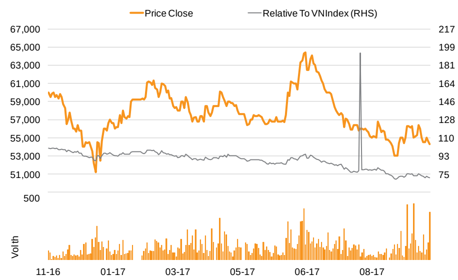
**9M2017 revenue reached VND959bn (+21.9% YoY) and net profit touched VND190bn (+0.4% YoY).** Container throughput stood at around 600,000 TEU, equivalent to 2016 volume. VIP Greenport (VGP) is the real powerhouse of VSC as the subsidiary recorded VND395bn in revenue (+67% YoY) and VND65bn of net profit (+357% YoY). Greenport's throughput dropped by 6% YoY.

**VSC will boost VGP capacity by a third to 800,000 TEU by 2019** through the additional of a new quay crane and a back-end logistics center which is 75% complete at the moment. This should help sustain throughput growth until 2019. We expect the additional capacity to generate around VND200bn of incremental container handling revenue per year. The expansion requires VND122bn in capex, with VND65bn for the quay crane and VND67bn for the logistics center.

**2018 net profit expected to soar to VND360bn (+34.8% YoY).** Revenue is likely to rise only moderately to touch VND1,480bn (+12.8% YoY) as VGP could reach its full capacity of 600,000 TEU. However, net profit margin could improve by 4 percentage points to 24.3% as VSC is progressively paying down VGP-related debt.

**Valuation is attractive** due to the foreign investors' sell off over the last few weeks. VSC is currently trading at 12M EV/EBITDA 5.6x, well below the peer average of 6.7x. The recent sell-off does not, in our view, reflect deteriorating fundamentals. We expect the 2018 earnings surge to reinvigorate the share price and help VSC close the valuation gap with peers.

### Price performance




*Source: VNDIRECT*

### Key statistics

| | |
|---|---|
| 52w high (VND) | 68,000 |
| 52w low (VND) | 51,200 |
| 3m Avg daily volume (shares) | 127,100 |
| 3m Avg daily value (mn) | 6,808 |
| Market cap (VND bn) | 2,506 |
| Outstanding shares (m) | 46.1 |
| Free float (%) | 56 |

### Ownership

| | |
|---|---|
| Vietnam Holding Ltd | 7.0% |
| Forum One - VCG | 4.9% |
| Deutsche AGM | 4.4% |
| Others | 83.7% |

*Source: VNDIRECT*

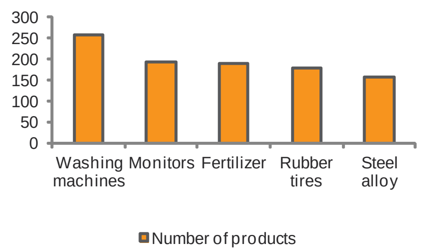
| Financial summary (VND) | 12-15A | 12-16A | 12-17E | 12-18E |
|---|---|---|---|---|
| Net revenue (bn) | 928 | 1,082 | 1,312 | 1,480 |
| Revenue growth | 4.1% | 16.6% | 21.2% | 12.8% |
| Gross margin | 39.9% | 36.6% | 31.6% | 34.8% |
| EBITDA margin | 27.7% | 17.3% | 12.1% | 17.0% |
| Net profit (bn) | 279 | 251 | 256 | 345 |
| Net profit growth | 19.0% | (10.0%) | 1.9% | 34.8% |
| Recurring profit growth | 11.5% | (5.3%) | 1.9% | 34.8% |
| Basic EPS | 8,085 | 6,067 | 5,619 | 7,577 |
| Adjusted EPS | 8,085 | 6,067 | 5,619 | 7,577 |
| BVPS | 34,556 | 33,266 | 36,966 | 42,625 |
| ROAE | 21.1% | 17.1% | 16.0% | 19.0% |

*Source: VNDIRECT*

## The future is still bright for leading port operators like VSC

We expect the risk of lower handling rates to linger on for the reason that container liners are struggling to make a profit and have also seen a rise in their bargaining power with port operators due to continuing consolidation in the shipping industry. However, several factors will partially offset this.

**Top 5 fastest growing products**



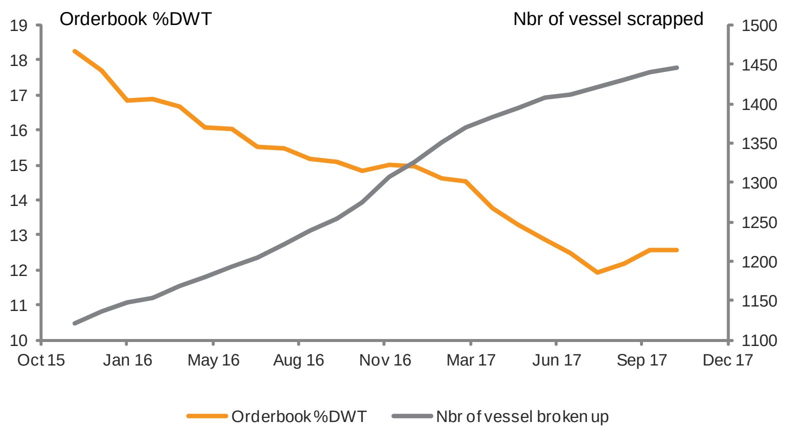

Source: VNDIRECT analysis

**Hai Phong's economy is in rude health thanks to unceasing FDI inflows.** For 10M2017, Industrial Production Index (IPI) grew at 20% YoY, led by growing output of washing machines (+158% YoY), monitors (+93% YoY), fertilizers (+89% YoY), and rubber tires (+79% YoY). Increasing production pushed cargo throughput to 74.6m tones (+15.3% YoY). As a result, 10M2017 export value grew at 22.7% YoY and import value rose by 24.6% YoY. The amount of registered FDI was only US$757mn compared to US$2.8bn for 10M2016 but last year's FDI figure was inflated due to large investments from LG Group (US$1.6bn of LG Display and US$0.6bn of LG Innotek). For 10M2017, 90% of FDI registered came from South Korea, Japan and Hong Kong. The huge jump in FDI last year is starting to translate into higher import and export activity.

**The expansion of VGP will give VSC more leeway in reducing its cargo-handling activities at Greenport** which is highly exposed to the risk of falling handling tariffs due to its unfavorable location. According to VSC, the total capex for the additional capacity of 200,000 TEU pa is around VND122bn. The amount includes a new crane worth VND65bn and a logistics center worth VND67bn. The logistics center will be operated by GIC, a subsidiary in which VSC owns 66.3%. The logistics center is 75% complete and will be ready by the end of 2017. Greenport will not totally relinquish container handling activity, however. The current container yard will be converted into a new distribution center (DC) and the current berth will serve ferries and vessels under 10,000 DWT which mostly run on domestic routes. We expect net profit from the new DC will partially offset the earnings reduction due to lower cargo handling activity at Greenport. According to VSC, the net profit of the newly formatted Greenport will be 8% lower compared to the current net profit, which stood at VND106bn for 9M2017. At the moment, we have no information on the exact timing of the transition.

**Container shipping industry prospects are finally improving** as liner order books have become leaner while vessel scrapping has picked up momentum on the back of the global steel price recovery. Container liners are focusing on improving fleet profitability by ordering larger vessels and boosting utilization rates. At the moment, 65% of the current order book is for vessels of over 12,000 TEU. At the same time, container liners should continue to optimize their small vessel fleets and refrain from new orders. This should reduce the pressure on profitability for vessels under 2,000 TEU in capacity and mitigate the pressure on handling rates for this vessel class. According to Bloomberg Intelligence, if container liners remain disciplined, the industry could see a sustained recovery over the next few years.

**Global container vessel order book (left) and vessel scrapping (right)**




Source: Bloomberg

## 2018 net profit should skyrocket as VGP approaches full capacity of 600,000 TEU

We expect VGP to reach full practical capacity of 600,000 TEU in 2018 even though the designed capacity is 500,000 TEU pa. The designed capacity is not the absolute upper limit of a port as the company could optimize operations to squeeze out up to an additional 20% of the designed capacity. This has happened to DVP: the port has a designed capacity of 500,000 TEU pa but has reached 649,224 TEU in 2016. VGP could expand its capacity to 800,000 TEU pa by 1) adding one quay crane which will help the port to serve ships which are longer than its berth and 2) adding a logistics center of 10 ha, which will help smooth out container traffic and remove current bottlenecks arising from a mismatch between front-end and back-end facilities.

We expect 2018 revenue to reach VND1,480bn (+12.8% YoY) and net profit to touch VND360bn (+34.8%). Interest expenses will decrease by 15% YoY as VSC continues to pay down VND80-100bn of debt per year. According to VSC, the company will pay off all its VGP-related debt in 4 years.

## The current valuation is very attractive

**Valuation**

| Company | TTM P/E | EV/EBITDA | ROE |
|---|---|---|---|
| **Mean** | **11.8** | **6.7** | **18.9%** |
| **VSC** | **9.1** | **5.6** | **17.4%** |
| GMD | 20.9 | 16.1 | 6.8% |
| DVP | 9.5 | 6.7 | 30.0% |
| DNP | 14.2 | 8.3 | 20.4% |
| DXP | 12.9 | 3.4 | 8.4% |
| HAH | 5.8 | 4.1 | 21.0% |
| PHP | 10.2 | 4.4 | 12.1% |
| CLL | 11.8 | 5.2 | 13.2% |

Source: Bloomberg

The stock is undervalued according to both P/E and EV/EBITDA multiples. We believe EV/EBITDA is the more appropriate valuation method for port operators as these companies require very small maintenance capex even though they need large investment in infrastructure and equipment. In these types of businesses, earnings sometimes fail to reflect true business performance due to large non-cash depreciation expense. EBITDA is a better basis for relative valuation as it is a proxy for operating cash flow.

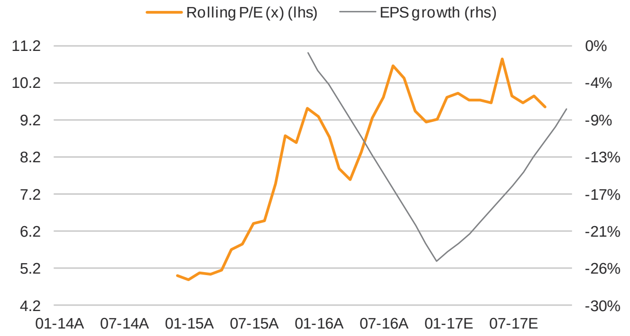
Valuation of peers vary greatly. Downstream ports have higher valuations compared to upstream ports due to competitive advantages stemming from their location. And among downstream ports, companies which have spare capacity usually have higher valuation due to the promise of continued throughput growth. VSC is clearly undervalued as the company has both an advantageous position as well as spare capacity. The stock trades at much lower multiples compared to GMD despite generating three times the ROE of GMD.

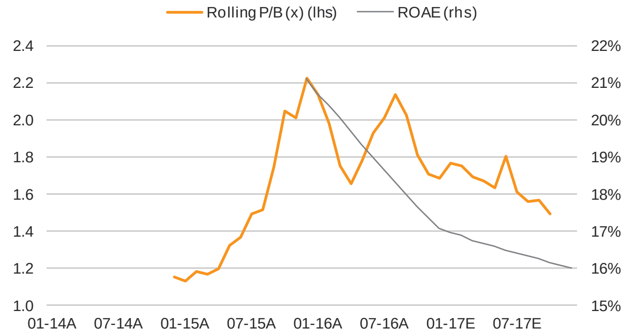
**Hai Phong port operators, competitive landscape**

| Port | | Capacity TEU pa | Realized throughput 2015 | 2016 | Note |
|---|---|---|---|---|---|
| **Upstream** | | **1,450,000** | **1,603,743** | **1,241,273** | **Disadvantageous position, lower handling rates** |
| Greenport | VSC | 300,000 | 350,000 | 260,000 | Lower handling charges, 8-10% less than VIP Greenport |
| Nam Hải | GMD | 150,000 | 250,000 | 250,000 | Still manage to make profit thanks to GMD |
| Đoạn Xá | DXP | 150,000 | 214,000 | 120,761 | Next to Nam Hải, but face intense competition, less container, more dry bulk with lower margin. |
| PTSC Đình Vũ | | 100,000 | 265,357 | n/a | |
| Tân Cảng 128 | | 300,000 | 135,000 | 209,394 | |
| Transvina | | 100,000 | 79,544 | 70,761 | |
| Hải An | HAH | 300,000 | 309,842 | 325,000 | Most throughput is internally generated from its fleet of 4 vessels. |
| **Downstream** | | **2,700,000** | **1,854,654** | **2,612,056** | **Advantageous position, favored by liners** |
| VIP Greenport | VSC | 500,000 | 0 | 350,000 | Could be expanded to 800,000 TEU pa |
| Tân Vũ | PHP | 1,200,000 | 1,002,987 | 1,086,630 | State-owned company, weak competitor |
| Đình Vũ | DVP | 500,000 | 574,635 | 649,224 | Main client: SITC, solid revenue stream, full capacity |
| Nam Hải Đình Vũ | GMD | 500,000 | 277,032 | 526,202 | Full capacity |
| Nam Đình Vũ 1 | GMD | | | | Launch in 2018, 600,000 TEU pa |

Source: VNDIRECT

## Valuation




### Income statement

| (VNDbn) | 12-16A | 12-17E | 12-18E |
|---|---|---|---|
| Net revenue | 1,082 | 1,312 | 1,480 |
| Cost of sales | (686) | (897) | (965) |
| Gen & admin expenses | (53) | (65) | (73) |
| Selling expenses | (11) | (13) | (15) |
| **Operating profit** | **331** | **337** | **427** |
| Operating EBITDA | 163 | 140 | 225 |
| **Depreciation and amortisation** | **168** | **196** | **202** |
| **Operating EBIT** | **331** | **337** | **427** |
| Interest income | 17 | 11 | 18 |
| Financial expense | (44) | (48) | (41) |
| Net other income | 1 | 0 | 0 |
| Income from associates & JVs | 6 | 7 | 8 |
| **Pre-tax profit** | **311** | **307** | **411** |
| Taxation | (49) | (41) | (51) |
| Minority interests | (11) | (11) | (15) |
| **Net profit** | **251** | **256** | **345** |
| Adj. net profit to ordinary | 251 | 256 | 345 |
| Ordinary dividends | 0 | (91) | (91) |
| **Retained earnings** | **251** | **165** | **254** |

### Balance sheet

| (VNDbn) | 12-16A | 12-17E | 12-18E |
|---|---|---|---|
| Cash and equivalents | 331 | 426 | 674 |
| Short term investments | 32 | 32 | 32 |
| Accounts receivables | 130 | 192 | 214 |
| Inventories | 9 | 17 | 19 |
| Other current assets | 102 | 287 | 505 |
| **Total current assets** | **605** | **954** | **1,444** |
| Fixed assets | 1,226 | 1,303 | 1,153 |
| Total investments | 105 | 105 | 105 |
| Other long-term assets | 461 | 352 | 246 |
| **Total assets** | **2,397** | **2,713** | **2,948** |
| Short-term debt | 58 | 52 | 47 |
| Accounts payable | 63 | 168 | 179 |
| Other current liabilities | 177 | 288 | 322 |
| **Total current liabilities** | **297** | **508** | **548** |
| Total long-term debt | 585 | 511 | 438 |
| Other liabilities | (0) | 2 | 3 |
| Share capital | 456 | 456 | 456 |
| Retained earnings reserve | 1,024 | 1,192 | 1,450 |
| **Shareholders' equity** | **1,515** | **1,684** | **1,942** |
| Minority interests | 0 | 7 | 18 |
| **Total liabilities & equity** | **2,397** | **2,713** | **2,948** |

### Cash flow statement

| (VNDbn) | 12-16A | 12-17E | 12-18E |
|---|---|---|---|
| **Pretax profit** | **311** | **307** | **411** |
| Depreciation & amortisation | 168 | 196 | 202 |
| Tax paid | (50) | (41) | (51) |
| Other adjustments | 80 | (18) | (26) |
| **Change in working capital** | **(191)** | **(49)** | **(197)** |
| **Cash flow from operations** | **318** | **396** | **338** |
| Capex | (461) | (273) | (52) |
| Proceeds from assets sales | 0 | 0 | 0 |
| Others | (14) | 19 | 26 |
| Other non-current assets changes | 26 | 109 | 105 |
| **Cash flow from investing activities** | **(448)** | **(145)** | **80** |
| New share issuance | 0 | 0 | 0 |
| Shares buyback | 0 | 0 | 0 |
| Net borrowings | 218 | (80) | (79) |
| Other financing cash flow | 0 | 2 | 0 |
| Dividends paid | (89) | (91) | (91) |
| **Cash flow from financing activities** | **129** | **(168)** | **(170)** |
| Cash and equivalents at beginning of period | 332 | 331 | 426 |
| **Total cash generated** | **(1)** | **83** | **248** |
| Cash and equivalents at the end of period | 332 | 414 | 674 |

### Key ratios

| | 12-16A | 12-17E | 12-18E |
|---|---|---|---|
| **Dupont** | | | |
| Net profit margin | 23.2% | 19.5% | 23.3% |
| Asset turnover | 0.47 | 0.51 | 0.52 |
| ROAA | 10.9% | 10.0% | 12.2% |
| Avg assets/avg equity | 1.57 | 1.60 | 1.56 |
| ROAE | 17.1% | 16.0% | 19.0% |
| **Efficiency** | | | |
| Days account receivable | 38.2 | 44.4 | 44.4 |
| Days inventory | 4.94 | 7.03 | 7.03 |
| Days creditor | 33.4 | 68.3 | 67.8 |
| Fixed asset turnover | 0.95 | 1.04 | 1.21 |
| ROIC | 11.6% | 11.4% | 14.1% |
| **Liquidity** | | | |
| Current ratio | 2.04 | 1.88 | 2.64 |
| Quick ratio | 2.01 | 1.84 | 2.60 |
| Cash ratio | 1.23 | 0.90 | 1.29 |
| Cash cycle | 9.7 | (16.9) | (16.4) |
| **Growth rate (yoy)** | | | |
| Revenue growth | 16.6% | 21.2% | 12.8% |
| Operating profit growth | 3.1% | 1.6% | 26.7% |
| Net profit growth | (10.0%) | 1.9% | 34.8% |
| EPS growth | (25.0%) | (7.4%) | 34.8% |
| **Share value** | | | |
| Basic EPS (VND) | 6,067 | 5,619 | 7,577 |
| BVPS (VND) | 33,266 | 36,966 | 42,625 |

*Source: VNDIRECT*

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| **Stock Ratings** | Definition: |
|---|---|
| Add | The stock's total return is expected to reach 15% or higher over the next 12 months. |
| 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. |

| **Country Ratings** | Definition: |
|---|---|
| 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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