Phu Nhuan Jewelry JSC (HSX: PNJ)

Sustainable Growth from the Fragmented Jewelry Market

Particulars (VND B)	3Q-FY18	2Q-FY18	+/-qoq	3Q-FY17	+/-yoy
Net revenue	3,151	3,217	-2%	2,279	+38%
PAT	178	180	-1%	126	+41%
EBIT	239	240	-1%	167	43%
EBIT margin	7.6%	7.5%	+10bps	7.3%	+30bps

Source: PNJ, Rong Viet Securities

3Q 2018 performance: maintaining high growth

- Revenue and PAT increased by 35% and 38% respectively yoy due to the main contribution of the gold jewelry business.
- High same store sales growth (SSSG) of 23%. Ticket size increased 15% yoy[1], while the numbers of new customers and returning customers rose 50% and 58% respectively.
- Opening of the retail network, from 269 stores to 308 stores in nine months, accomplishing 2018's target.

2019: Continuing to open retail stores

The jewelry business will grow well next year due to the continued expansion of stores. Ho Chi Minh City (accounting for nearly 60% of jewelry sales) has not shown signs of saturation while SSSG remains high. The stores in the Northern region are also improving since PNJ brand's awareness is rising. With the rise of a young generation of consumers, demand for jewelry is high.

In addition, the investments in ERP management systems (to be completed by 2019), big data and omni-channel sales will help improve operational efficiency and increase the gap between PNJ and its competitors.

Valuation and recommendation:

At the current price, PNJ's forward PE of 2018 is about 16x, not too cheap compared to the average P / E of the jewelry industry. However, with a strong leadership position in the industry along with high growth expectation in the coming years from the core business, we believe that PNJ is a worthy investment. Negative news from Dong A Bank[2], if any, will only have short-term psychological effects and will not affect long-term prospects of PNJ.

*We combine a DCF valuation and average P/E valuation of large jewelry firms, mainly in Asia, due to their high similarity to the Vietnamese market. Accordingly, the 12-month target price for PNJ shares is **VND 126,000**, plus VND 1,800 cash dividend, and the expected return is **34%** over the closing price on 11/26/2018. We have a **BUY** on this stock.*

BUY +34%

CMP (VND)	96,000
Target price (VND)	126,000
Cash dividend (VND)*	1,800

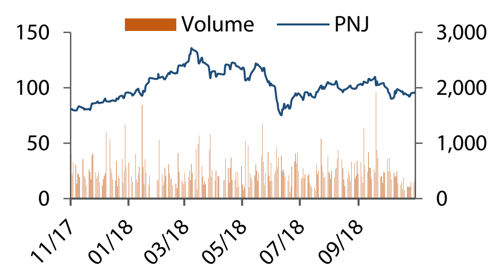
** Expected in the next 12 months*

Stock info

Sector	Consumer Discretionary
Market Cap (VND billion)	15,631
Current Shares O/S	162,138,615
Avg. Daily Volume (in 20 sessions)	313,495
Free float (%)	63.7
52 weeks High	135,694
52 weeks Low	75,174
Beta	1.1

	FY2017	Current
EPS	6.705	5.428
EPS growth (%)	4.289	5.428
Adjusted EPS	47	27
P/E	21,3	17,8
P/B	5,0	4,6
EV/EBITDA	15,6	13,7
Cash dividend	1.800	1.800
ROE (%)	35	30

Price performance



Major Shareholders (%)

Dragon Capital	9.9
Cao Thi Ngọc Dung (Chairwoman)	9.2
VinaCapital	9.0
Remaining Foreign room (%)	0.0

Son Tran

(084) 028- 6299 2006 – Ext 1527

son.tt@vdsc.com.vn

Hieu Nguyen

(084) 028- 6299 2006 – Ext 1514

hieu.nd@vdsc.com.vn

[1] *Ticket size refers to the average purchase amount in the stores.*

[2] *Dong A Bank (which PNJ invested VND 395 bn in) Is put under special control by the Central bank*

Exhibit 1: 3Q 2018 results

Particulars (VND B)	3QFY18	2Q-FY18	+/-(QoQ)	3Q-FY17	+/-(YoY)	3Q-FY18	+/-(YoY)
Net revenue	3,151	3,217	-2.1%	2,279	38.2%	10,508	35%
Gross profit	600	583	2.9%	396	51.5%	1,953	45%
SG&A	175	195	-10.3%	136	28.8%	591	54%
Operating income	425	388	9.6%	260	63.3%	1,362	39%
EBITDA	250	250	-0.1%	176	41.8%	938	35%
EBIT	239	240	-0.6%	167	43.4%	907	36%
Financial expenses	17	14	26.8%	11	63.5%	45	-4%
- Interest Expenses	15	11	36.4%	11	45.6%	40	-12%
Dep. and amortization	11	10	11.2%	10	14.4%	31	8%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	221	228	-2.8%	158	39.9%	869	38%
PAT	178	180	-1.5%	126	40.9%	694	38%
(*) Adjusted PAT	178	180	-1.5%	126	40.9%	694	

Source: PNJ, Rong Viet Securities

Exhibit 2: 3Q 2018 performance analysis

Particulars	3Q-FY18	2Q-FY18	+/-(QoQ)	3Q-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	19.0%	18.1%	0.9%	17.4%	1.7%
EBITDA margin	7.9%	7.8%	0.2%	7.7%	0.2%
EBIT margin	7.6%	7.5%	0.1%	7.3%	0.3%
Net margin	5.6%	5.6%	0.0%	5.5%	0.1%
Adjusted net margin	5.6%	5.6%	0.0%	5.5%	0.1%
Turnover *(x)					
-Inventories	3	3	-0.3	3	0.0
-Receivables	84.9	110.0	-25.0	113.2	-28.2
-Payables	15	16	-1.0	16	-1.0
Leverage (%)					
Total debt/ equity	61.3%	51.9%	9.4%	48.1%	13.2%

Source: PNJ, (*) Annualized turnover

Exhibit 3: 4Q 2018 performance forecast

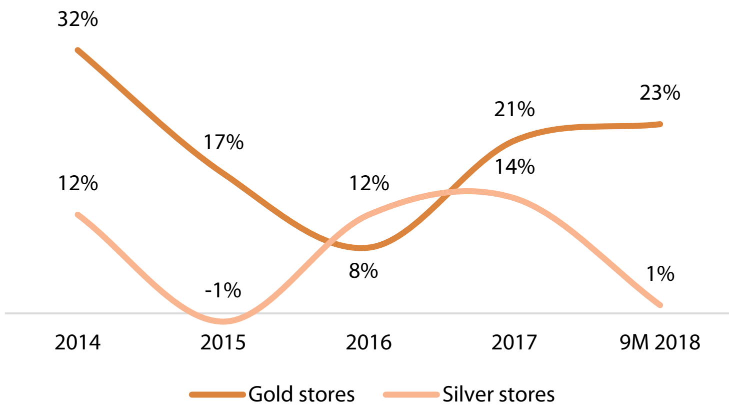
Particulars (VND B)	4Q-FY18	+/-(QoQ)	+/-(YoY)
Revenue	4,540	44%	41%
Gross profit	833	39%	47%
EBIT	404	69%	43%
NPAT	318	79%	43%

Source: PNJ, Rong Viet Securities.

Updates

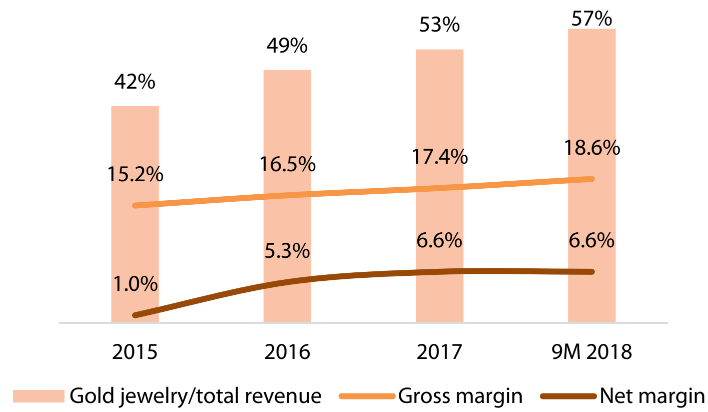
9M revenue reached VND 10,508 bn, up 35% yoy. Profit after tax increased by 38% to VND 694 bn. Gross margins rose sharply to 18.6% due to the gold jewelry retail business (Figure 2). Meanwhile, net margin remained at 6.6% due to higher selling and management expenses for the retail chain expansion.

Figure 1: Same store sales growth (SSSG)



Source: PNJ

Figure 2: Gold jewelry contribution to revenue (%) and profit margins of PNJ



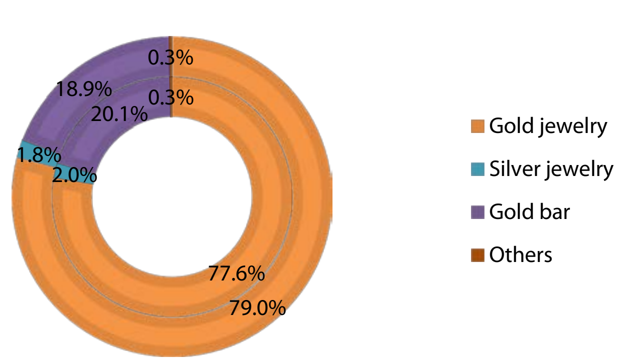
Source: PNJ, Rong Viet Securities

Gold jewelry: Main business (Figures 3 and 4). Sales and profit increased 38% and 51% respectively yoy. Strong growth came from the high SSSG, reaching 23% (Figure 1) and 39 additional stores in the first 9 months (opened 44 and closed 5). High SSSG came from:

- Average ticket size reached VND 17 mn, increasing 15 % yoy.
- Numbers of new customers and returning customers rose 50% and 58% respectively.
- Average time between two purchases for each customer declined by 5%.

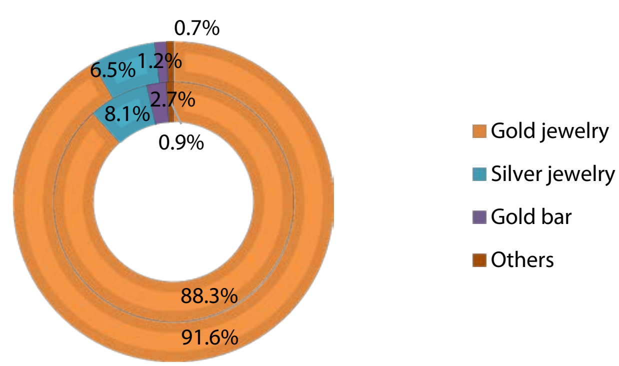
Old stores still record high performances, while the continuous opening of new stores shows that the growing room of the gold jewelry market is plentiful, especially in the Northern region, where consumers still tend to purchase at mom-and-pop stores.

Figure 3: Revenue structure (inner circle: 9M 2017, outer circle: 9M 2018)



Source: PNJ

Figure 4: Gross profit structure (inner circle: 9M 2017, outer circle: 9M 2018)

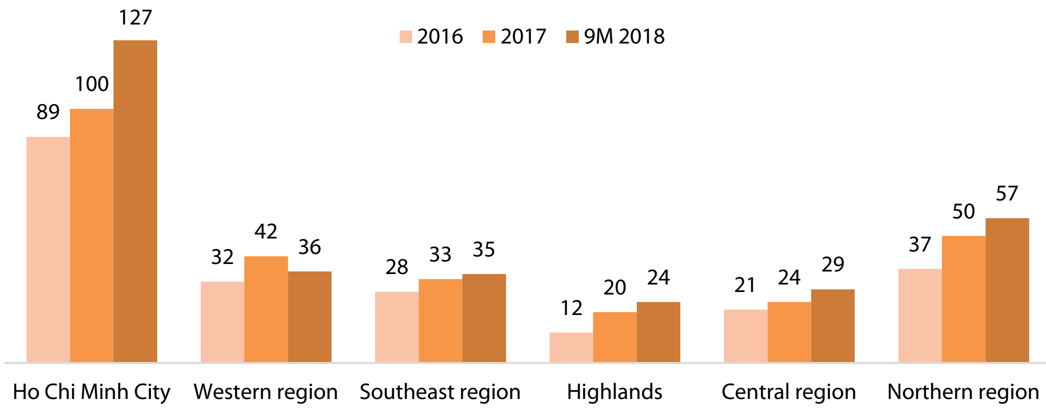


Source: PNJ

Silver jewelry: currently contributes 1.8% of sales and 6.5% of gross profit. The low SSSG of silver stores came from the fact that PNJ Silver products did not meet the demand from customers from 25 to 35 years old (accounting for 2/3 of customers and often spend more). In 2Q PNJ implemented a new product strategy for the silver business and launched a new collection targeting customers in the above age group, but the results have not shown any improvement.

The company has no plan to open more silver stores (currently 62). We also believe that the integrated silver counter in gold stores are sufficient to meet the not-too-high demand for silver, so opening more silver shops is not really necessary. Overall, revenue and gross profit of silver jewelry rose by 22% and 16% respectively due to new opening of PNJ Gold stores.

Figure 5: Number of PNJ stores by areas



Source: PNJ

Wholesale: In 2018, the company spin-off its production plant to PNJ Production to develop its wholesale business and launch a wholesaler center that not only sells PNJ's but also outsourced products. Even though having low gross margin (nearly 4%), wholesale is PNJ's traditional business. This segment helps PNJ take advantage of the large production capacity and reach 12,000 retail outlets (accounting for more than 70% of jewelry market share).

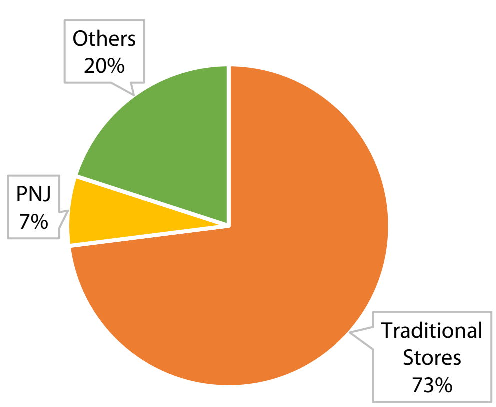
Gold bar: PNJ maintained this product line to meet consumers' demand. Gold bar contributed 19% of revenue but just over 1% of gross profit, but is on a downward trend. We forecast contribution of gold bar to revenue will decrease to 13% by 2022.

2019 Outlook

The gold market is strongly shifting to gold jewelry

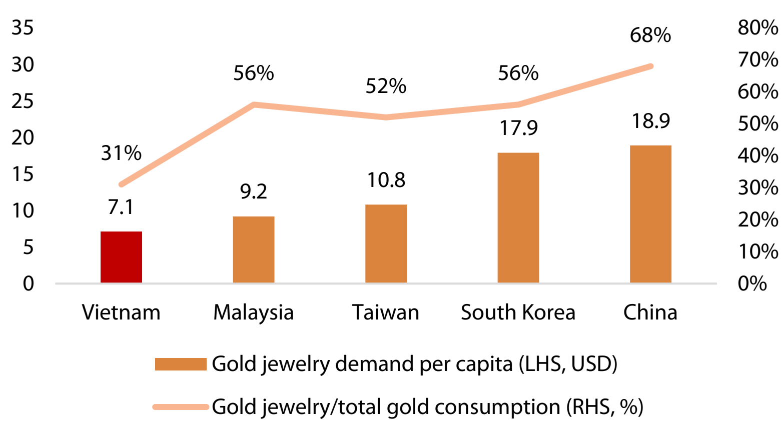
According to statistics by the World Gold Council in 2017, Vietnam ranks 14th in the world in gold per capita consumption. However, due to the common mindset of gold as a cumulative asset, current consumption is still mostly in gold bar. Currently, gold jewelry/total gold consumption in Vietnam is 31%, significantly lower than other Asian countries (Figure 7). Moreover, traditional gold jewelries, which have high liquidity and low fashion ability, remain the dominant market, with a market share of over 70% of traditional small stores (Figure 6).

Figure 6: Gold jewelry market share in Vietnam (2017)



Source: Rong Viet Securities

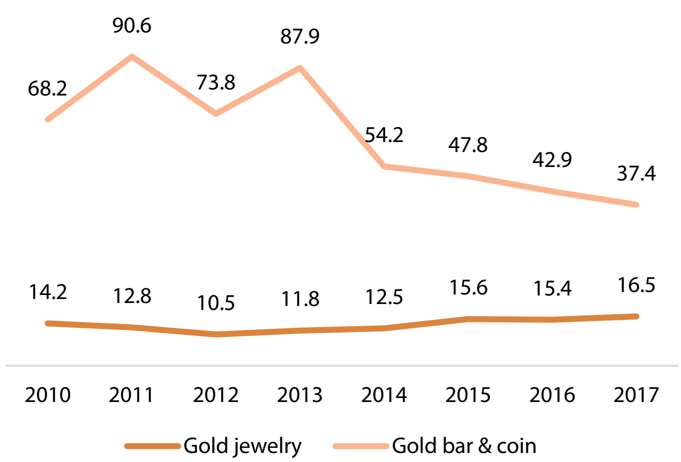
Figure 7: Gold jewelry consumption in some Asian countries (2017)



Source: World Gold Council, Rong Viet Securities

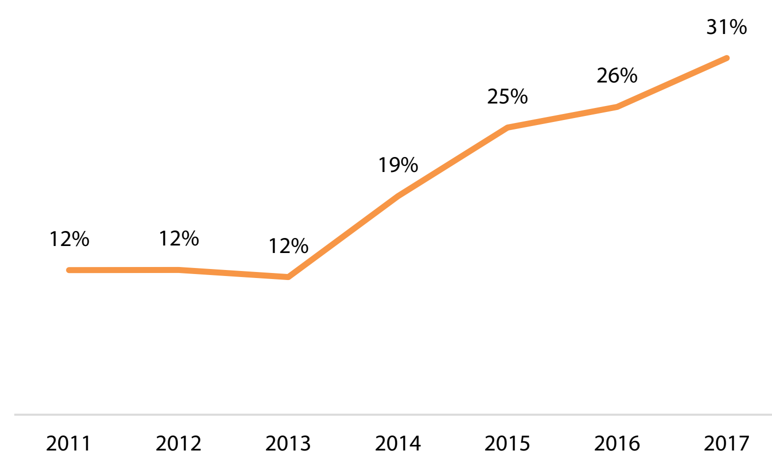
The consumption of gold bars began to decline sharply after the 2010-2013 period when the government issued regulations to control the gold market and put an end to the goldenization in the banking system. Gold jewelry has shown steady growth since 2012 (Figures 8 and 9).

Figure 8: Consumption of gold jewelry, gold bar and coin in Vietnam (ton)



Source: World Gold Council, Rong Viet Securities

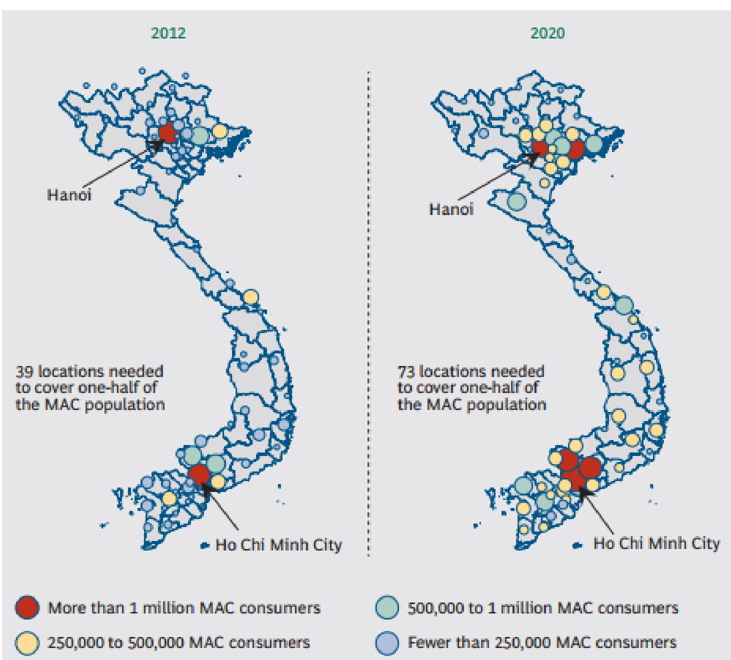
Figure 9: Gold jewelry/total gold consumption in Vietnam (volume)



Source: World Gold Council, Rong Viet Securities

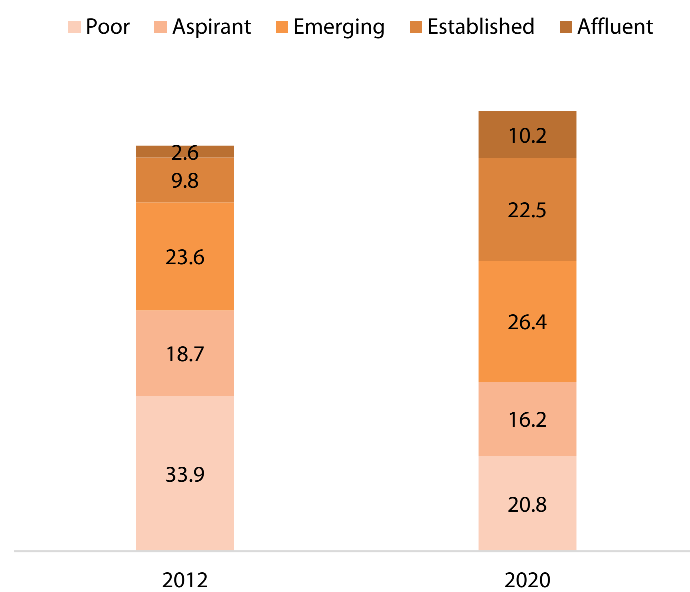
On the other hand, the middle and affluent classes (MAC) is increasing not only in quantity but also in various geographic areas (Figures 10 and 11). They are often modern consumers and have a high demand for jewelry as a way to 'showing off'. This signals a bright future for PNJ. Our analysis also shows that PNJ's customers are mostly young and have a modern life style.

Figure 10: The MAC is spreading out quickly



Source: BCG, Rong Viet Securities
**Location classification includes districts, district-level towns, provincial cities and quarters.*

Figure 11: Vietnam has a fast-growing MAC population (million)



Source: BCG, Rong Viet Securities
**The MAC cutoff is monthly per capita income of USD 190*

PNJ's sustainable advantage in fashion jewelry

With the existing advantages of PNJ, we think it will be difficult for competitors to catch up.

Strong financial capability allows PNJ to invest heavily in production and management systems.

Vietnam's largest jewelry factory of PNJ was inaugurated in 2012 with a capacity of 4 million products per year (8 times more than SJC, the main competitor). Total investment was VND 120 bn and the investment in the ERP system & digital transformation totaled USD 8.3 mn. The low-profitable competitors will not likely be able to finance such kinds of investments.

Strong brand that has consumers' recognition

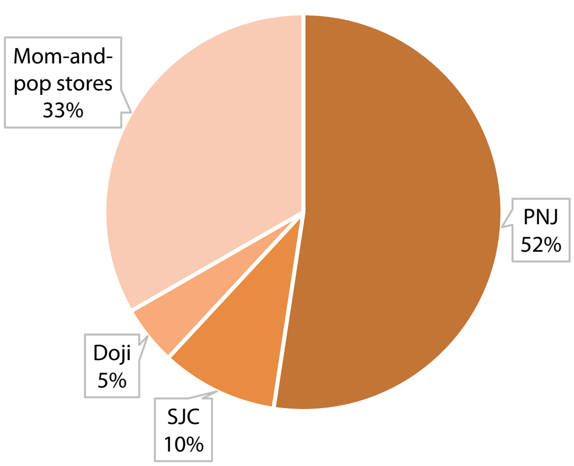
PNJ's brand awareness is much higher than other brands'. Our survey on jewelry consumers aged 20 to 35 also shows that most customers choose PNJ as the place to buy jewelry in the future (Figure 12).

Production & design capabilities

PNJ owns nearly 1,000 goldsmiths (160 are classified as artisans). This is a great advantage of the company in training high-level labors because the specialty of jewelry industry is the training mainly through "hands-on".

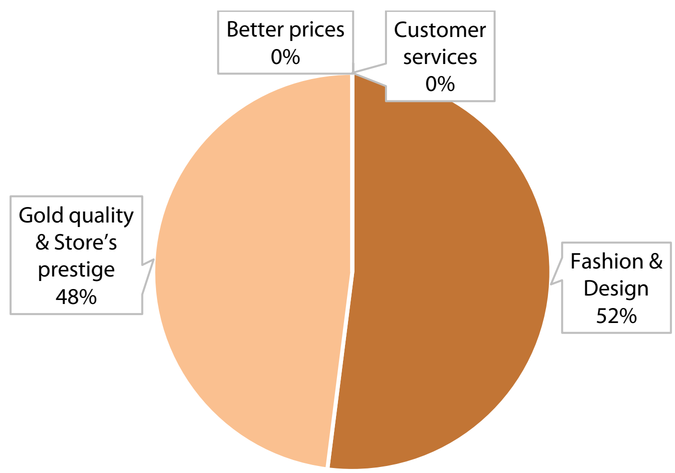
This also explains why PNJ jewelries are more varied and have more sophisticated craftsmanship than other major jewelry chains such as Doji and SJC. This is an edge for PNJ considering young consumers are more interested in the fashion of jewelries than their gold value. Our survey also shows that consumers pay most attention to the criteria "fashion & design", followed by "gold quality & store's prestige" when choosing where to shop for jewelry.

Figure 12: Answering the question "where would you like to shop for jewelry?"



Source: Rong Viet Securities (N= 30)

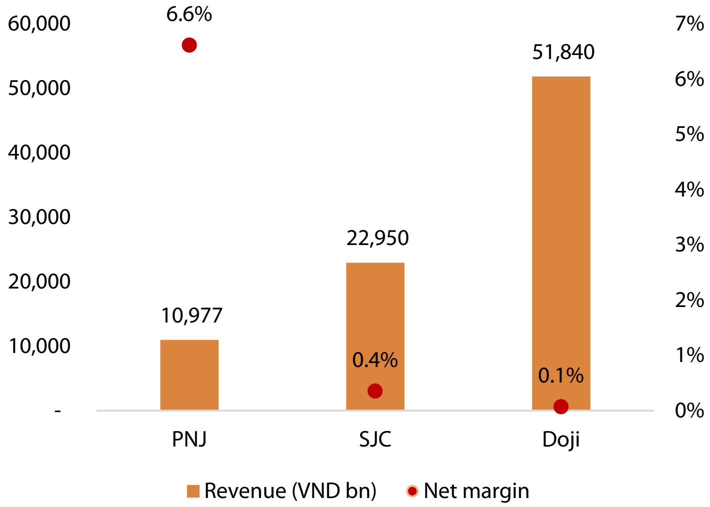
Figure 13: The most important criteria for jewelry purchasing



Source: Rong Viet Securities (N= 30)

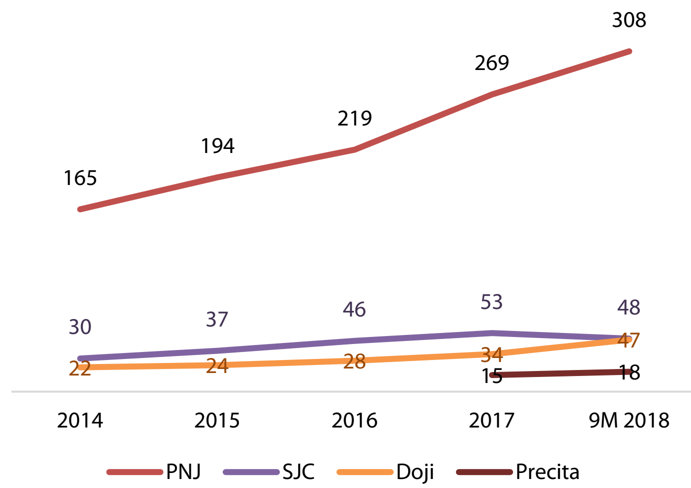
Outstanding number of retail stores (Figure 15), providing greater access to the middle and affluent class that is increasingly spreading out.

Figure 14: Revenue and net margin of major gold companies (2017)



Source: Rong Viet Securities

Figure 15: Store count of major gold retailers



Source: PNJ, Rong Viet Securities

With the higher focus on fashion jewelry, PNJ's profit margin is superior that that of its two major competitors, SJC and Doji (Figure 14), which focus more on gold bar. As for Precita, it is a growing business that also focuses on fashion jewelry and young consumers. However, we believe there is difference between the two businesses. Precita focuses on the medium and low value jewelry categories, which can be considered as "fast fashion" while PNJ targets high-end jewelry segment of 14k gold (58.3% gold) and higher as well as jewelry with diamonds. In addition, with a relatively small scale, Precita is not a significant competitor for PNJ.

Table 1: 2018 and 2019 forecasts

	2017	2018E	2019F
Store count	**269**	**318**	**368**
Retail revenue (VND bn)	6,001	9,096	12,313
Wholesale revenue (VND bn)	3,024	3,629	4,427
Others (VND bn)	1,952	2,323	2,768
Total revenue (VND bn)	**10,977**	**15,048**	**19,508**
Gross margin	17.4%	18.5%	19.0%
PAT (VND bn)	**725**	**1.014**	**1.341**
Net margin	6.6%	6.7%	7.0%

Source: Rong Viet Securities

Valuation

Method	Weights	Valuation
DCF	50%	122,736
P/E 17x	50%	129,874
Cash dividend		1,800
Total		**128,000**

We combined a DCF valuation and average P/E valuation of large jewelry firms, mainly in Asia, due to their high similarity to the Vietnamese market. Accordingly, the 12-month target price for PNJ is **VND 126,000**, plus VND 1,800 cash dividend. Hence, the expected return is **34%** above the closing price on 11/26/2018. We have a **BUY** on this stock.

Considering the risk on the stock market, the 2019 PNJ's P/E of 17x, compared with the average P/E of 2018 (YTD) at about 21x, reflects our conservative view regarding the market next year.

Figure 16: PNJ's P/E in the last five years (adjusted for Dong A bank provisions)

Source: Fiinpro, Rong Viet Securities

Table 2: industry peers

Companies	Country	Market cap (USD mn)	2017 revenue (USD mn)	CAGR 2012 – 2017 revenue (%)	2017 PAT (USD mn)	CAGR 2012 – 2017 PAT (%)	Total debt/total asset in 2017 (%)	2017 ROE (%)	2017 gross margin (%)	2017 net margin (%)	P/E (trailing)	P/B (trailing)
PHU NHUAN JEWELRY	**Vietnam**	**663**	**483**	**10.3**	**32**	**21**	**20**	**29**	**17.4**	**6.6**	**17.6x**	**4.6x**
CHOW TAI FOOK	Hong Kong	8,773	7,575	0.6	512	-6	0	12	27.2	6.8	16.9x	2.1x
CHOW SANG SANG	Hong Kong	1,093	2,134	-1.8	106	-4	15	9	24.0	4.9	7.9x	0.8x
LUK FOOK	Hong Kong	1,863	1,867	1.7	175	2	6	14	25.7	9.4	10.7x	1.5x
TIFFANY	US	12,529	4,170	1.9	516	4	18	17	62.5	12.4	20.8x	4.0x
ZHEJIANG MING	China	404	543	-11.2	7	-10	0	1	9.8	1.2	30.2x	0.9x
CHOW TAI SENG	China	2,165	558	12.6	88	14	0	24	31.7	15.7	24.0x	4.4x
LAO FENG XIANG	China	2,343	5,872	9.3	164	11	29	21	7.9	2.8	9.3x	1.9x
LEYSEN	China	613	283	11.2	46	32	1	14	53.2	16.2	13.6x	1.9x
Average				**3.8**		**7**	**13**	**16**	**28.8**	**8.4**	**16.8x**	**2.4x**

Source: Bloomberg, as of Dec 22[nd], 2018

VND in billions

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	8,565	10,977	15,048	19,508
COGS	7,153	9,065	12,261	15,809
Gross profit	**1,411**	**1,912**	**2,786**	**3,699**
Selling expense	554	775	1,190	1,559
G&A expense	133	188	285	372
Finance income	5	9	2	2
Finance expense	182	56	54	71
Other profits	43	6	6	6
Gain/(loss) from JVs	-1	0	0	0
PBT	**591**	**907**	**1,265**	**1,706**
Prov. of tax	140	183	253	341
Minority's interest	0	0	0	0
PAT to equity S/H	**451**	**725**	**1,012**	**1,364**
EBIT	724	949	1,312	1,769

%

Financial ratio	FY2015	FY2016	FY2017E	FY2018F
Growth (%)				
Revenue	11.1%	28.2%	37.1%	29.6%
Operating income	15.5%	30.3%	41.7%	34.8%
EBITDA	15.6%	31.0%	38.2%	34.9%
PAT	496.3%	60.9%	39.7%	34.8%
Total assets	20.6%	25.2%	24.5%	24.5%
Equity	14.1%	38.2%	64.8%	27.6%
Profitability (%)				
Gross margin	16.5%	17.4%	18.5%	19.0%
EBITDA margin	8.9%	9.0%	9.3%	9.7%
EBIT margin	8.5%	8.6%	8.7%	9.1%
Net margin	5.3%	6.6%	6.7%	7.0%
ROA	12.6%	16.1%	18.1%	19.6%
ROE	30.0%	35.0%	29.6%	31.3%
Efficiency (x)				
Receivable turnover	136.6	129.7	138.2	138.2
Inventory turnover	2.5	2.7	2.9	2.9
Payable turnover	13.5	15.4	19.9	19.9
Liquidity (x)				
Current	1.6	2.7	2.2	2.5
Solvency (%)				
Total debt/equity	100.5%	43.1%	42.9%	38.2%
Current debt/equity	96.6%	40.8%	42.3%	37.8%
Long-term Debt/equity	3.9%	2.2%	0.5%	0.4%

VND in billions

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	155	175	131	244
Short-term investments	0	160	0	0
Accounts receivable	63	85	109	141
Inventories	2,839	3,402	4,291	5,533
Other current assets	46	74	78	82
Property, plant & equipment	215	215	311	299
Acquired intangible assets	209	282	456	449
Long-term investments	0	0	0	0
Other non-current assets	62	99	218	218
Total assets	**3,588**	**4,492**	**5,595**	**6,966**
Accounts payable	531	590	618	796
Short-term borrowings	1,449	846	1,446	1,646
Long-term borrowings	59	46	18	18
Other non-current liabilities	7	8	8	9
Bonus and welfare fund	42	52	89	139
Technology-science, dev. fund	0	0	0	0
Total liabilities	**2,088**	**1,543**	**2,179**	**2,609**
Common stock and APIC	983	1,081	1,670	1,720
Treasury stock (enter as -)	0	0	0	0
Retained earnings	374	772	1,481	2,310
Other comprehensive income	0	0	0	0
Inv. and dev. fund	144	220	265	328
Total equity	**1,500**	**2,073**	**3,416**	**4,358**
Minority interest	**0**	**0**	**0**	**0**

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
EPS (VND)	4,347	6,606	5,846	7,640
P/E (x)	14.5	20.4	16.1	16.5
BV (VND)	15,267	19,174	20,458	25,338
P/B (x)	4.4	5.0	4.6	5.0
DPS (VND/cp)	1,500	1,800	1,800	2,300
Dividend yield	2.3%	1.3%	1.8%	1.8%

Valuation model	*Price*	*Weight*	*Average*
FCFF	122,736	50%	61,368
PE	129,874	50%	64,937
Target price (VND)			**126,305**

Valuation history	*Price*	*Recommendation*	*Period*
07/04/2016	64,000	Buy	1 year
06/08/2017	74,000	Buy	1 year
02/05/2018	97,000	Accumulate	1 year
11/27/2018	126,000	Buy	1 year

RESULTS UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective that is to determine the reasonable value of the stock at the time such analyses are performed. Through this report, we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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The **Analysis and Investment Advisory Department** of RongViet Securities provides research reports on the macro-economy, securities market and investment strategy along with industry and company reports and daily and weekly market reviews

ANALYSIS & INVESTMENT ADVISORY DEPARTMENT

Bernard Lapointe
Head of Research
bernard.lapointe@vdsc.com.vn
+ 84 28 62992006 (1525)

Lam Nguyen
Senior Strategist
lam.ntp@vdsc.com.vn
+ 84 28 6299 2006 (1313)
- Banking
- Market Strategy

Hieu Nguyen
Senior Analyst
hieu.nd@vdsc.com.vn
+ 84 28 6299 2006 (1514)
- Market Strategy
- Pharmaceuticals
- Aviation

Duong Lai
Senior Analyst
duong.ld@vdsc.com.vn
+ 84 28 6299 2006 (1522)
- Real Estate
- Building Materials

Vu Tran
Senior Analyst
vu.thx@vdsc.com.vn
+ 84 28 6299 2006 (1518)
- Oil & Gas
- Fertilizer

Son Phan
Analyst
son.pnt@vdsc.com.vn
+ 84 28 6299 2006 (1519)
- Utilities
- Natural Rubber

Tu Vu
Analyst
tu.va@vdsc.com.vn
+ 84 28 6299 2006 (1511)
- Macroeconomics

Son Tran
Analyst
son.tt@vdsc.com.vn
+ 84 28 6299 2006 (1527)
- Market Strategy
- Retails
- Technology

Tung Do
Analyst
tung.dt@vdsc.com.vn
+ 84 28 6299 2006 (1521)
- Logistics
- Aviation

Thu Pham
Analyst
thu.pa@vdsc.com.vn
+ 84 28 6299 2006 (1520)
- Industrial Real Estate
- Infrastructure & BOT

Thao Dang
Analyst
thao.dtp@vdsc.com.vn
+ 84 28 6299 2006 (1529)
- Food & Beverage
- Textiles

Tam Pham
Analyst
tam.ptt@vdsc.com.vn
+ 84 28 6299 2006 (1530)
- Insurance
- Fishery

Anh Nguyen
Analyst
anh2.ntt@vdsc.com.vn
+ 84 28 6299 2006 (1531)
- Banking

Vy Nguyen
Analyst
vy.ntk@vdsc.com.vn
+ 84 28 6299 2006 (1528)
- Automobile & Parts

Trinh Le
Analyst
trinh.lx@vdsc.com.vn
+ 84 28 6299 2006 (1536)
- Industrials
- Agricultural Medicine

Thinh Bui
Analyst
thinh.bnh@vdsc.com.vn
+ 84 28 6299 2006 (1315)
- Market Strategy
- Steel

Anh Tran
Analyst
anh.tm@vdsc.com.vn
+ 84 28 6299 2006 (1293)
- Building Materials
- Construction

Hoang Nguyen
Analyst
hoang.nt@vdsc.com.vn
+ 84 28 6299 2006 (1538)
- Macroeconomics

Ha Tran
Assistant
ha.ttn@vdsc.com.vn
+ 84 28 6299 2006 (1526)

Vi Truong
Assistant
vi.ttt@vdsc.com.vn
+ 84 28 6299 2006 (1517)

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