Dry Cell & Storage Battery JSC (HSX:PAC)

There Are Still Many Difficulties

Particulars (VND bn)	Q3-FY17	Q2-FY17	+/- QoQ	Q3-FY16	+/- YoY
Net revenue	689,340	695,097	-0.8%	552,165	24.8%
PAT	24,308	56,195	-56.7%	31,903	-23.8%
EBIT	27,013	37,307	-27.6%	34,976	-22.8%
EBIT margin	3.9%	5.4%	-1.4bps	6.3%	-2.4bps

Source: PAC, RongViet Research

9M 2017 performance: In the first 9 months of 2017, PAC's revenue reached VND2,261.3 billion, up 15.3% YoY, but due to cutting down the discount rate for its agencies, its net revenue increased significantly 23.0% YoY to VND2,076.2 billion. We suppose this cutting down action is to protect the gross profit margin, which is under huge pressure from the sharp increase in raw material prices while the company could not raise the selling price because of intense competition. In particular, the average selling price of lead materials, which accounted for over 70% of COGS, has surged 26.9% YoY in the last 9 months of 2017. This led to PAC's GPM narrowing by 1.4 percentage points compared to the same period of last year to just 12.7%. If the compensation from relocating the 445-449 Gia Phu project had been excluded, PAC's PAT in the first 9 months would have been VND76.7 billion (-6.4% YoY), fulfilling only 46.5% of the year target.

The forecast for Q4 2017 and the year 2018: Many barriers for breakthroughs

Based on the sales performance in the first three quarters of 2017, we project that PAC's net revenue could reach VND669 billion in Q4 (+ 10.9% YoY), thus, the whole-year figure would be VND2,745 billion (+19.8% YoY). Despite the strategy of cooperation with Furukawa Battery that could contribute many prospects, we hold the view that PAC's net revenue in 2018 could grow only 12.7% YoY to VND3,094.1 billion because its factories are operating at maximum capacity and the discount rate for agencies are reducing.

World lead price is trading at a high price of over USD2,400 per tonne, and is forecasted to continue its uptrend in the near future. Furthermore, the company could not raise its selling price; we expected that its GPMs for the years 2017 and 2018 would fall to 13.2% and 15.1%, respectively. In addition, the pressure from intense competition will force PAC to increase its selling expenses to boost sales. Regarding this less favorable scenario, we project PAT of the company this year and next year would only be VND122.1 billion (-34.9% YoY) and VND140.5 billion (+ 15.1% YoY), respectively.

Valuation and recommendation:

The information about Vinachem's divestment from PAC has made its share price experience a dramatic increase since the beginning of the year. However, due to the pessimistic outlook affecting the performance of the company, such as fierce competition and rising material prices, we believe it would be difficult for PAC to have positive changes. Based on two valuation methods of FCFF and P/E (using 2018 estimated EPS), we rate NEUTRAL on this stock at a target price of VND41,100 per share, which bears a negligible change compared to the price in the latest report. However, the story of Vinachem's divestment and the desire to acquire PAC by Furukawa Battery could still be the safe bases to prevent decrease in the stock price.

NEUTRAL

CMP (VND)	50,000
Target price (VND)	41,100
Cash dividend (VND)*	2,000

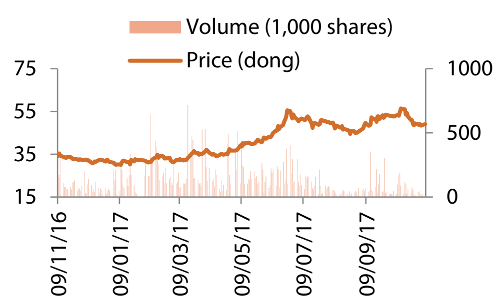
** Expected in the next 12 months*

Stock Info

Sector	Construction & Materials
Market cap (VND B)	811.4
Current shares O/S	46,471,707
Beta	1.0
Free float (%)	89.2
52 week high	56,400
52 week low	30,055
Avg. daily volume (20 sessions)	43,520

	FY2016	Current
EPS	3,721	3,562
P/E	8.8	11.7
P/B	2.4	3.8
EV/EBITDA	5.1	8.2
Cash dividend	2,200	>= 1,500
ROE (%)	29.8	30.3

Price performance



Major shareholders (%)

Vinachem	51.43
Furukawa Battery	10.54
Vietnam Holding Limited	5.01
Foreign ownership room (%)	16.30

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Exhibit 1: Q3 2017 results

Particulars (VND B)	Q3-FY17	Q2-FY17	*+/- (qoq)*	Q3-FY16	*+/- (yoy)*	9T-FY17	*+/-(yoy)*
Net revenue	689	695	-0.8%	552	-0.8%	2076	-0.8%
Gross profit	94	95	-1.3%	56	-1.3%	264	-1.3%
SG&A	44	30	47.2%	10	47.2%	100	47.2%
Operating income	50	65	-23.3%	46	-23.3%	164	-23.3%
EBITDA	45	55	-18.6%	45	-18.6%	575	-18.6%
EBIT	27	37	-27.6%	35	-27.6%	394	-27.6%
Financial expenses	9	12	-20.3%	4	-20.3%	28	-20.3%
- Interest expenses	7	5	32.5%	3	32.5%	16	32.5%
Dep. and amortization	18	18	0.2%	10	0.2%	53	0.2%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	30	64	-52.9%	40	-52.9%	132	-52.9%
PAT	24	56	-56.7%	32	-56.7%	101	-56.7%
(*) Adjusted PAT	24	56	-56.7%	32	-56.7%	101	-56.7%

Source: PAC, RongViet Research

Exhibit 2: Q3 2017 performance analysis

Particulars	Q2-FY17	Q1-FY17	+/- (qoq)	Q2-FY16	+/- (yoy)
Profitability Ratios (%)					
Gross margin	13.6	13.7	-0.1	10.2	3.5
EBITDA margin	6.5	7.9	-1.4	8.2	-1.7
EBIT margin	3.9	5.4	-1.4	6.3	-2.4
Net margin	3.5	8.1	-4.6	5.8	-2.3
Adjusted net margin	3.5	8.1	-4.6	5.8	-2.3
Turnover *(x)					
-Inventories	3.6	4.0	(0.4)	3.9	(0.3)
-Receivables	11.7	13.9	(2.2)	12.9	(1.3)
-Payables	5.5	5.7	(0.2)	4.8	0.7
Leverage (%)					
Total debt/ equity	224.2	197.5	26.7 pps	187.8	36.4 pps

Source: PAC, (*) Annualized turnover

Exhibit 3: Q4 2017 performance forecast

Particulars (VND bn)	Q4-FY2017	+/- QoQ	+/- YoY
Revenue	669	-2.9%	10.9%
Gross profit	99	5.5%	-36.9%
EBIT	42	55.0%	-28.4%
NPAT	39	61.1%	-0.6%

Source: PAC, RongViet Research

Updates

Revenue from OEM segment: Waiting for the draft of new excise tax on automobile

Approximately 10% of PAC's sales come from domestic assemblers, but only 20% of OEM's orders are signed long-term. Therefore, domestic consumption of assembled automobiles has a significant impact on PAC's OEM revenue. In the first 9 months of 2017, the consumption of assembled cars has declined sharply by 14.5% YoY because some of Vietnam's automobile manufacturers have shifted to importing complete units. This trend is forecasted to continue as the import tax on cars higher than 40% localization rate from ASEAN will be reduced from 30% to 0%. However, the Ministry of Industry and Trade has proposed that excise taxes would not be applied on auto components manufactured in Vietnam. This means that the more domestic components are used, the more advantages assemblers are going to take. If approved, this proposal would be the greatest incentive offered to date for Vietnam's auto manufacturers, and boost the domestic auto industry. It is also a positive signal for auto part manufacturers like PAC.

Gross profit margins were affected negatively by raw material price hike

In the first nine months of this year, the average price of lead and zinc rose sharply by 26.9% and 42.2%, respectively, over the same period last year. It came after the increase in demand from China, which shut down more than 80% of illegal secondary smelters as support to its environmental protection campaign, and banned imports of lead from North Korea due to international sanctions.

In spite of the pressure from raw material prices, PAC could not transfer the pressure of input price into its output price because the market share gap between PAC and GS Vietnam is very small and GS does not intend to raise its selling price. The solution given by the PAC if raw material prices continue to rise is to either force the suppliers to cut the input price down or to increase the selling price, together with GS, its main competitor. However, according to the World Bank's forecast in October 2017, lead price would maintain its upward trend until the end of next year. Thus, we suppose these two options are only feasible in the short term and the gross profit margin would be difficult to improve rapidly.

Compensation from relocating the plants will be no recorded to profit

According to the information from PAC's representative, contrary to what was expected, there will be no relocation compensation for the 752 Hau Giang project. In addition, the compensation from relocating 445 Gia Phu Project was recorded temporarily as Q2 income (equivalent to VND25 billion), and it would probably be withdrawn this year after the state audit.

Furukawa Battery (FB) and PAC become strategic partners

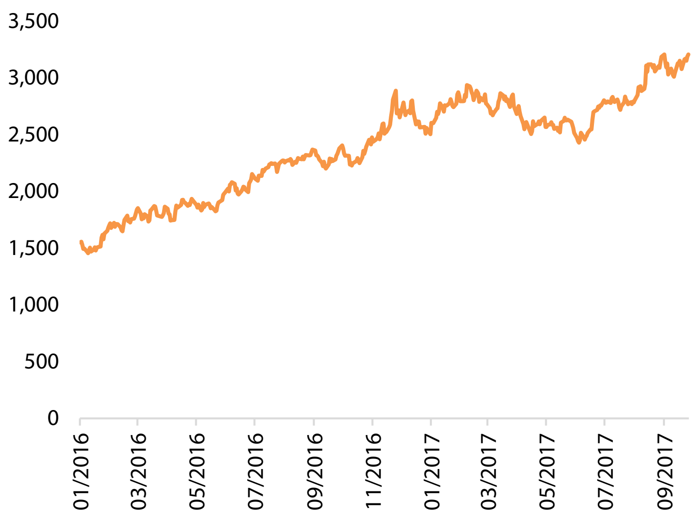
Recently, shareholders of PAC has approved to choose FB as its strategic partner. This agreement has a five-year term from the effective date, expected to be inked in the last quarter of this year. FB will provide technical inputs as well as sales support for PAC. The two sides pledge to minimize direct and indirect competition related to specific products in certain areas. The Japanese firm is entitled to buy additional shares if PAC conducts additional share issues. On the implementation progress, the two sides will sign a strategic cooperation agreement in the fourth quarter of 2017 and a technology transfer contract from the end of 2017 to the beginning of 2018. " We consider this agreement as FB's first official step in its plan to acquire PAC before the divestment of Vinachem.

PAC plans to build a new factory in Dong Nai in 2019

Regarding production, Con O battery factory is being relocated from Hau Giang factory to Tan Tao factory. Dong Nai 1 and 2 factories have been completely upgraded to their capacities of 800,000 kWh and 1,000,000 kWh, respectively. It is worth noting that these two factories are now operating at 100% capacity in both dry cell and storage battery factories and PAC could not continue lifting their capacities after 2018. Therefore, it has planned to build a new factory in Dong Nai. We estimate that the new factory will produce new battery products from FB's technology transfer, such as industrial batteries or telecom batteries at the capacity of around 800,000–1,000,000 kWh, with an initial outlay of VND300 billion (excluding land purchase amount).

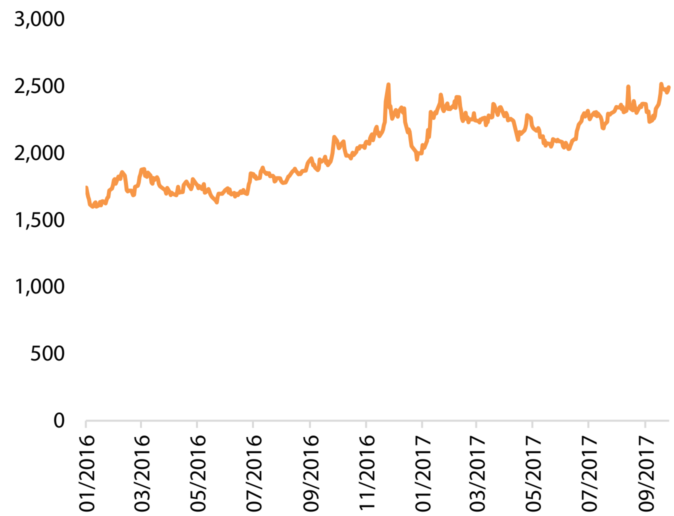
Appendix:

Figure 1: World Zinc Prices (USD/tonne)



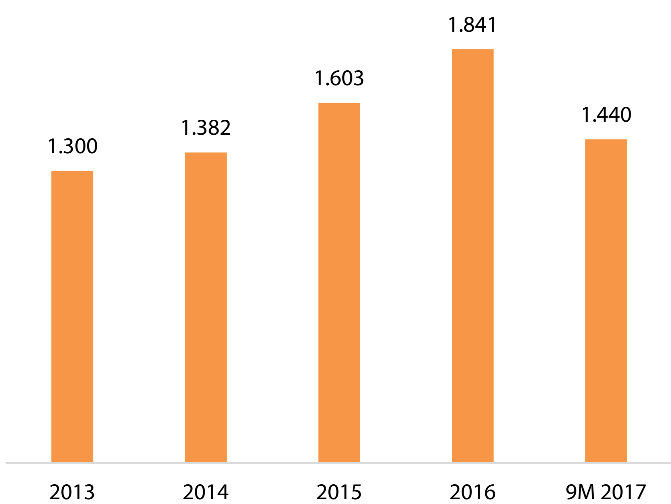
Source: Bloomberg

Figure 2: World Lead Prices (USD/tonne)



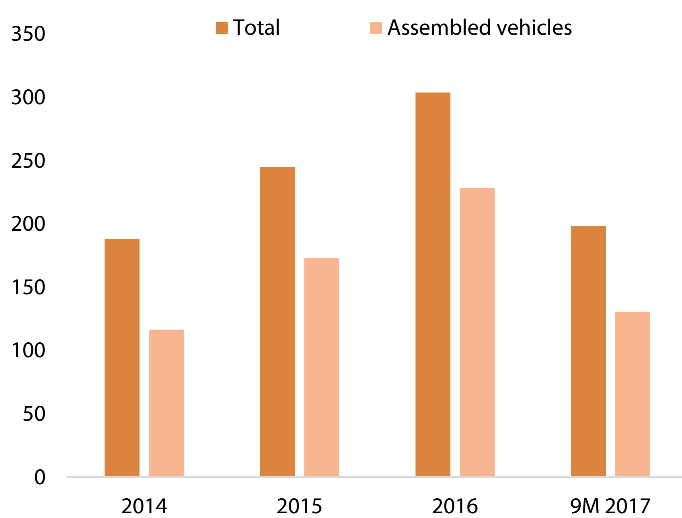
Source: Bloomberg

Fugure 3: PAC's Sale Volume of Storage Battery (Unit: million kwh)



Source: Vinachem, RongViet Research

Figure 4: Car Consumption in Vietnam in the period of 2014 – 2017 (Thousand units)



Source: VAMA, RongViet Research

VND B

INCOME STATEMENT	FY2015	FY2016	FY2017E	FY2018F
Revenue	2,117	2,291	2,745	3,094
COGS	1,744	1,865	2,382	2,626
Gross profit	372	426	363	468
Selling expense	193	147	178	235
G&A expense	38	45	47	56
Finance income	20	27	48	41
Finance expense	39	24	34	39
Other profits	0	1	4	1
PBT	121	238	157	180
Prov. of tax	30	51	34	40
Minority's interest	0	0	0	0
PAT to equity S/H	90	188	122	141
EBIT	141	234	139	177
EBITDA	207	303	203	245

%

FINANCIAL RATIO	FY2015	FY2016	FY2017E	FY2018F
Growth				
Revenue	4.5	8.2	19.8	12.7
Operating income	22.8	46.8	-32.9	20.6
EBITDA	35.9	66.5	-40.8	27.5
PAT	21.6	107.5	-34.9	15.1
Total assets	1.0	32.7	15.6	4.4
Equity	-1.0	24.6	0.7	5.2
Profitability				
Gross margin	17.6	18.6	13.2	15.1
EBITDA margin	9.8	13.2	7.4	7.9
EBIT margin	6.6	10.2	5.0	5.7
Net margin	4.3	8.2	4.4	4.5
ROA	7.2	11.2	6.3	6.9
ROE	27.0	36.0	21.1	25.5
Efficiency				
Receivable turnover	19.3	24.4	15.4	17.2
Inventory turnover	4.0	3.3	3.5	3.4
Payable turnover	5.4	4.3	5.4	5.2
Liquidity				
Current	1.2	1.2	1.2	1.2
Quick	0.6	0.7	0.6	0.6
Solvency				
Total debt/equity	83.3	93.4	132.8	123.5
Current debt/equity	83.3	93.4	132.8	123.5
Long-term debt/equity	0.0	0.0	0.0	0.0

VND B

BALANCE SHEET	FY2015	FY2016	FY2017E	FY2018F
Cash and cash equivalents	133	108	125	144
Short-term investments	200	467	467	467
Accounts receivable	110	94	178	180
Inventories	437	562	683	763
Other current assets	11	20	21	22
Property, plant & equipment	293	320	356	339
Acquired intangible assets	31	29	27	26
Long-term investments	4	33	33	33
Other non-current assets	46	46	48	50
Total assets	1,264	1,677	1,939	2,023
Accounts payable	322	439	438	505
Short-term borrowings	421	589	843	825
Long-term borrowings	0	0	0	0
Other non-current liabilities	4	1	1	1
Bonus and welfare fund	11	19	22	25
Technology-science, dev. fund	0	0	0	0
Total liabilities	758	1,047	1,304	1,355
Common stock and APIC	372	466	466	466
Treasury stock (enter as -)	-14	0	0	0
Retained earnings	55	145	138	157
Other comprehensive income	0	0	0	0
Inv. and dev. fund	94	19	31	45
Total equity	506	630	635	668
Minority Interest	0	0	0	0

VALUATION RATIO	FY2015	FY2016	FY2017E	FY2018F
EPS (VND)	2,334	3,721	2,548	2,976
P/E (x)	14.3	8.8	19.6	16.8
BV (VND)	16,336	13,565	13,660	14,375
P/B (x)	2.0	2.4	3.7	3.5
DPS (VND/cp)	2,000	3,000	2,000	2,000
Dividend yield (%)	6.0	9.1	4.0	4.0

VALUATION MODEL	Price	Weight	Average
FCFE	42,007	50%	21,004
PE	40,173	50%	20,086
Target price (VND)			41,090

VALUATION HISTORY	Price	Recommendation	Period
04/07/2016	36,600	Neutral	Long term
28/6/2017	40,600	Neutral	Long term

RESULT 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	NEUTRAL	SELL
Total Return including Dividends in 12-month horizon	>20%	-20% to 20%	<-20%

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