Century Synthetic Fiber JSC (HSX – STK)

Momentum from the Rebound in Textile Demand

BUY	
CMP (VND)	17,650
Target Price (VND)	24,200
Investment Period	**Long-term**

- *2016 - A bad year for STK*
- *We expect that demand for textiles and yarns will rebound in 2017*
- *Expanding customer networks and developing new products show great promise*

Outlook and Valuation:

Considering the leading position of STK in the yarn industry in Vietnam, the company has benefited greatly from the recovery of textile and garment demand. STK's Q1 business results recorded revenue and PAT growth rates of 70.6% and 764.1% YoY, respectively. These figures were impressive partly when we compare them with 2016 - a bad year for STK as many unexpected problems occur. In 2016, STK's PAT dropped sharply by nearly 60% to around VND28.5 billion, which is the lowest level since 2009.

In 2017, we believe that the recovery of textile and garment demand, along with positive signals from potential markets including Japan and South Korea, will benefit STK. For long-term perspective, the development of yarns that are in line with the "eco-friendly consumption" trend including recycled and colored yarns will be the highlight of this company.

It is worth to note that STK uses high financial leverage as its total debt in 2016 equaled 1.5 times of equity. Given that the majority STK's debt are long-term borrowings used for finance its plants, STK's depreciation and interest expenses have accounted for a significant part of the EBITDA. In fact, these expenses accounted for 76% of the EBITDA in 2016. However, given that STK does not have any new investment plan, we expect that the issue of financial structure will improve in the future.

*Overall, we initiate a **"BUY"** recommendation on the stock at the **"2- year target price"** of **VND24,200**. In the short term, low liquidity and large fluctuations in exchange rate and input prices are risks that investors should monitor.*

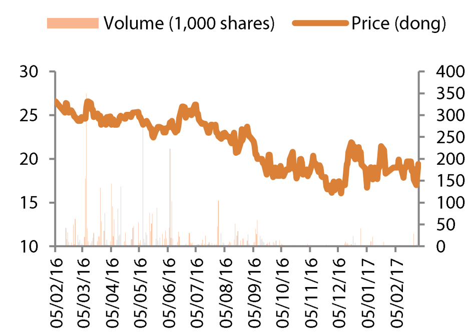
Key financials

Y/E Dec (VND bn)	FY2015	FY2016	FY2017F	FY2018F
Net Revenues	1,035	1,358	1,882	2,030
% growth rate	-29%	31%	38.6%	7.9%
PAT	71	29	106	142
% growth rate	-33%	-59.9%	272.3%	33.4%
EBIT margin (%)	6.9%	2.1%	5.7%	7.0%
ROA (%)	0.0%	0.0%	0.0%	0.0%
ROE (%)	0.0%	0.0%	0.0%	0.0%
EPS (VND)	1,533	534	1,990	2,654
Adjusted EPS (VND)	1,333	534	1,990	2,654
Book value (VND)	14,822	12,989	13,979	15,133
Cash dividend (VND)	1,363	432	1,000	1,500
P/E (x)	17.8	37.2	8.8	6.6
P/BV (x)	1.8	1.5	1.3	1.2

*Sources: STK, RongViet Research estimated. * Accounted for welfare provision expense and computed based on total share number on 09, June 2017.*

Stock Info

Sector	Textile
Market Cap (VND bn)	1,064
Current Shares O/S	53,516,024
Beta	-0,02
Free float (%)	68,8
52 weeks High	26.600
52 weeks Low	16.050
Avg. Daily Volume (in 20 sessions)	2,3



Source: Bloomberg

Performance (%)

	3M	1Y	3Y
STK	0%	-31%	N/A
Textile	1%	-24%	19%
VN30 Index	11%	17%	21%
VN Index	5%	19%	34%

Major Shareholders (%)

Huong Viet Investment Consultant Corporation	20.16%
Foreigner Investor Room (%)	37.10%

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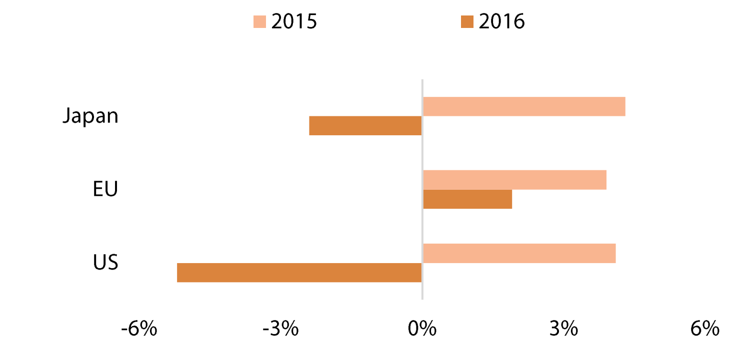
2016 - A bad year for STK

STK disappointed its investors when PAT dropped by 60% despite good growth of the top-line (+31%). In Q4-2016, STK even recorded a loss of VND14 billion. Trang Bang 3 plant, which used to be considered as a motivation (STK report 2015), unintentionally became a burden of depreciation and interest expenses as growth in demand for textiles and clothing began to slow down. Besides, the benefits from the Turkey also disappeared as the country promulgated an anti-dumping tariff for polyester yarns. Both external and internal difficulties created a bad year for STK.

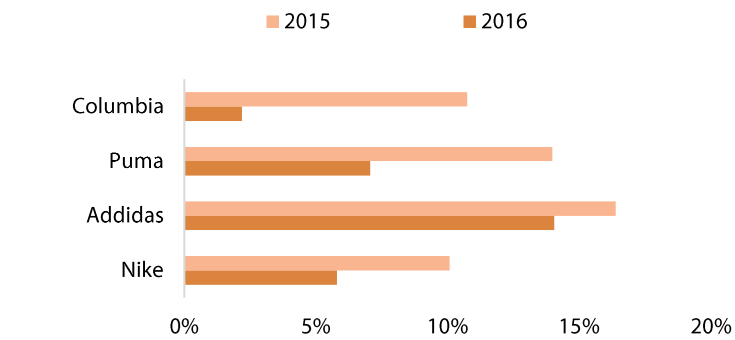
The slow growth in demand for textiles and garments and the shrinkage of the Turkish market negatively affected the demand for yarns. Given unfavorable conditions in the market in 2016 as apparel imports slowed in the EU and even declined in Japan and the US, sales of major brands including Columbia, Puma, Adidas and Nike were significantly affected. STK's products consumption was hit because polyester filament yarns are used as raw materials for sports products as well as other apparels.

Figure 1: Textiles and Garments Consumption in the US, the EU and Japan



Source: Eurostat, OTEXA, MOF-Japan

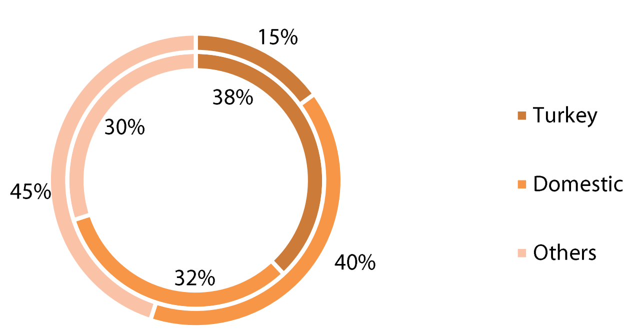
Figure 2: Revenues Growth Rate of Major Brands in 2015 and 2016



Source: Columbia, Puma Adidas and Nike Annual Reports

Furthermore, STK's yarn products were imposed a 34.81% of tariff in the Turkish market. Many STK's customers narrowed their orders from the beginning of 2016, although the duties went into effect at end-2016. This had a significant impact on STK's gross margin as these customers often require high-quality yarns at better prices (which can bring a gross margin of up to 18%) compared to other markets (with gross margin averaging at 12%). Therefore, STK's gross margin dropped sharply to 9.5% in 2016 from 18.1% in 2015.

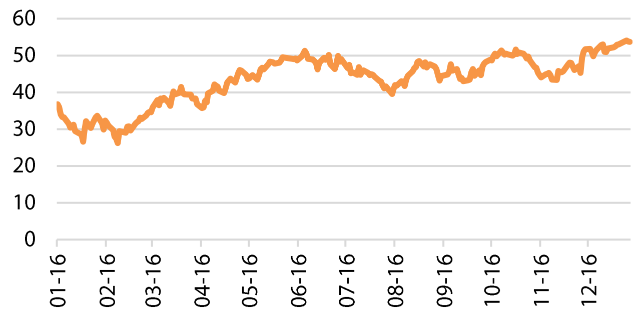
Figure 3: Revenues by Countries in 2015 and 2016



Source: STK
(*) Inside Circle: 2015; Outside Circle: 2016

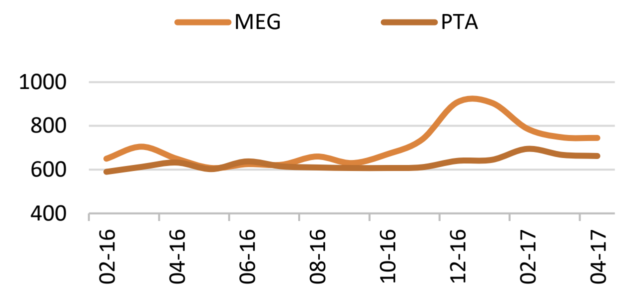
Raw material prices increased sharply from the end of Q3 2016. STK's inputs are polyester chips. These chips are manufactured primarily from PTA and MEG, which are petroleum products. Given the recovery of oil prices in 2016, both PTA and MEG prices entered in an uptrend, which created a burden for STK in 2016. Compared to PTA, MEG fluctuated stronger than expected due to the recovery of the Chinese economy, the shrinking supply of MEG and the birth of MEG Futures in Dalian Futures Exchange in China.

Figure 4: Crude Oil Prices



Source: Bloomberg

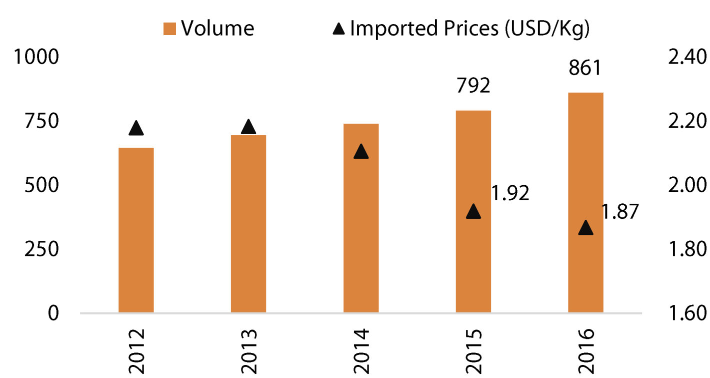
Figure 5: PTA and MEG Prices



Source: VCOSA

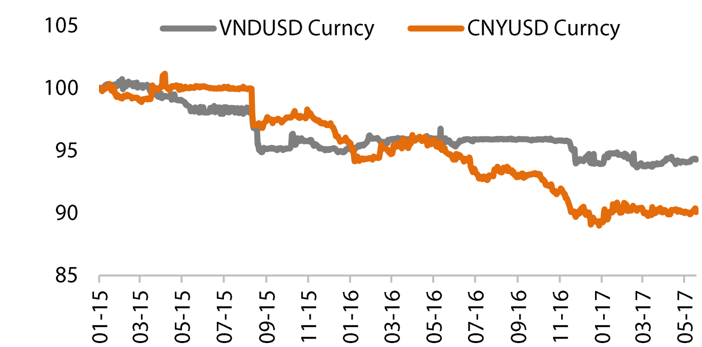
Selling prices encountered downward pressure by cheap supply. Given the weak demand, the increase in yarn supply from imports (+9%) along with the fall in prices (-2.6%) put significant pressure on domestic prices. Besides, the devaluation of the CNY bolstered Chinese yarn manufacturers and, consequently, they had ability to cut prices by more than 4% in 2016. Considering yarns imported from China accounted for more than 40% of total imported yarns, domestic firms had to accept low or even negative profits to compete. This was also the main reason for STK's fourth quarter losses.

Figure 6: Imported Yarn Volume and Prices



Source: Vietnam Customs

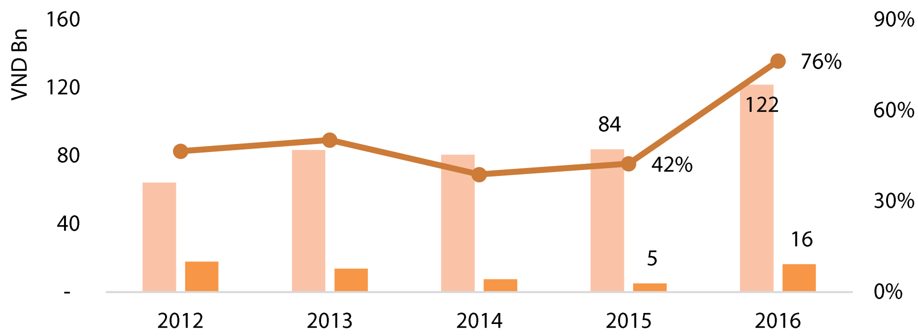
Figure 7: Devaluation of VND and CNY Versus USD (Base Date: 01/01/2015)



Source: Bloomberg

Cost burden from Trang Bang 3 and 4 projects increased. Due to unfavorable conditions, STK's total depreciation and interest expenses in 2016 surged and accounted for approximately 76% of STK's EBITDA, while the average in the previous period was only 45%.

Figure 8: Depreciation and Interest Expenses during 2012 -2016



Source: STK, RongViet Research

Overall, the poor performance of STK in 2016 came from both external and internal factors. Disappointed results in the yarn segment of TCM or FTM showed that yarn business is risky. Besides, STK also showed many "weaknesses" including excessive reliance on the Turkish market.

We expect that demand for textiles and yarns will rebound in 2017.

More than 90% of orders from STK's final customers are manufactured in Asia, with Vietnam usually accounting for a large share. We believe that the trend of moving orders from China to Vietnam will continue in the future due to environmental problems and increasing labor costs in China. Therefore, there are evidences that the performances of Vietnamese textile firms will be a reliable indicator for STK's operating results.

The textile and garment industry witnessed strong growth in the early months of 2017, showing signs of a recovery of this industry. In addition, the IMF also expressed optimism about world economic growth in 2017 (especially the US, which is the largest market of Columbia, Puma, Adidas and Nike). Based on the positive correlation between economic growth and the consumption of textiles and garments, we believe that large brands will record good growth this year. The need for yarns, therefore, will also improve.

STK's production in the first quarter showed signs of a strong rebound as yarn sales reached 12,500 tons, increasing by 54% (YoY) and PAT jumped by more than eight times. Currently, STK's factories, including Trang Bang 4, are operating at full capacity (~5,000 tons/month).

Table 1: 1Q17 STK's Operating Result

Particulars (VND bn)	Q1-FY17	Q4-FY16	+/- (QoQ)	Q1-FY16	+/- (YoY)	1Q-FY17	+/-(YoY)
Net revenue	448	392	14.1%	262	70.6%	447.6	**70.6%**
Gross profit	52	31	67.9%	14	270.9%	51.7	**270.9%**
SG&A	18	18	2.4%	16	18.2%	18.4	**18.2%**
Operating profit	33	13	159.6%	-2	-2129.5%	33.3	**768.6%**
EBITDA	70	46	52.6%	25	181.3%	70.2	**181.3%**
EBIT	33	13	159.6%	(2)	-2129.5%	33.3	**-2129.5%**
Financial expense	10	21	-52.2%	4	152.3%	10.1	**152.3%**
Interest expense	5	6	-6.4%	3	68.8%	5.3	**68.8%**
D&A	37	33	11.3%	27	38.8%	36.9	**38.8%**
Nonrecurring items (*)							
Extraordinary items (*)							
PBT	28	(17)	-264.3%	3	739.0%	28.1	**764.1%**
PAT	25	(14)	-279.0%	3	764.1%	25.0	**739.0%**
(*) Adjusted PAT	25	-14	-279.0%	3	764.1%	25.0	

Source: STK

Table 2: 1Q17 STK's Operating Result Analysis

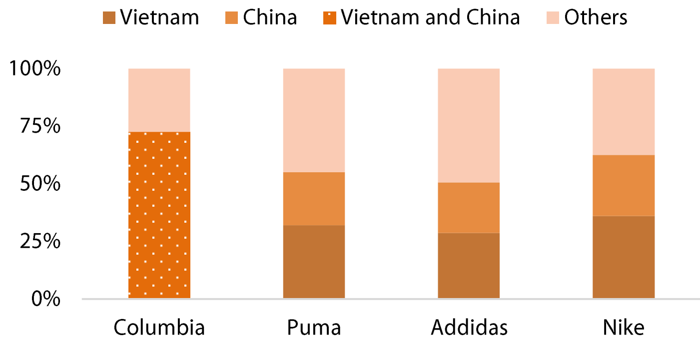
Particulars	Q4-FY16	Q3-FY16	*+/-(qoq)*	Q4-FY15	*+/-(yoy)*
Profitability (%)					
Gross margin	11.6%	7.9%	3.7%	5.3%	**6.2%**
EBITDA margin	15.7%	11.7%	4.0%	9.5%	**6.2%**
EBIT margin	7.4%	3.3%	4.2%	-0.6%	**8.1%**
Net margin	5.6%	-3.6%	9.2%	1.1%	**4.5%**
Adjusted net margin	5.6%	-3.6%	9.2%	1.1%	**4.5%**
Turnover* (x)					
-Inventories	4.2	3.8	0.4	3.2	**1.1**
-Receivables	15.0	17.1	-2.1	16.6	**-1.5**
-Payables	5.8	5.2	0.6	6.0	**-0.2**
Leverage (%)					
Total Debt/Equity	102.7%	97.9%	4.9%	46.6%	**56.1%**

Source: STK, (*) annualized

It is worth to note that STK's orders are usually short-term orders due to increasing competition. STK also stocks inputs for production in only one month. However, STK's customers made certain forecasts about the demand for goods in the year and current domestic, Japanese, Korean and Thailand demands are enough for STK to reach this year's target.

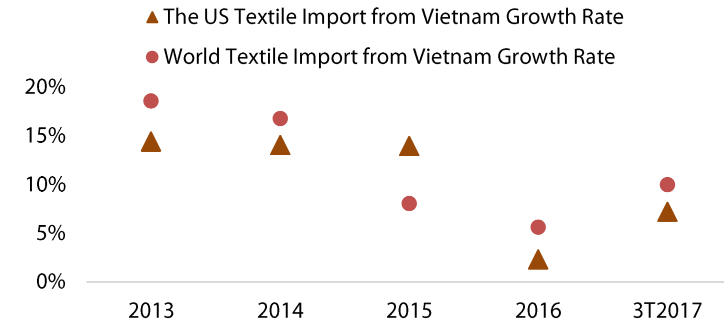
While many "accidental" problems negatively affect STK's performance in 2016, the combination of recovering textile demand and STK's increased capacity helped STK record impressive growth.

Figure 9: Large Manufacturers for Major Brands



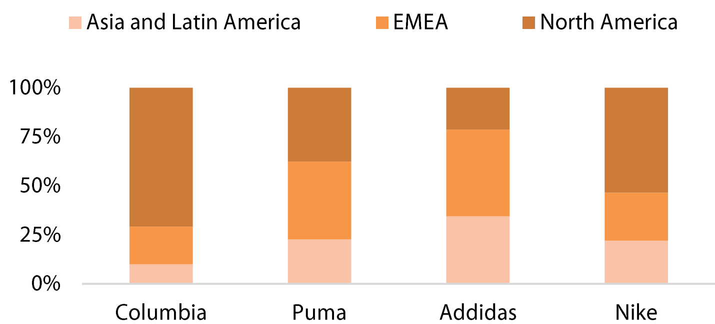
Source: Collected by RongViet Research

Figure 10: Vietnam Textile Export Turnover Growth (YoY)



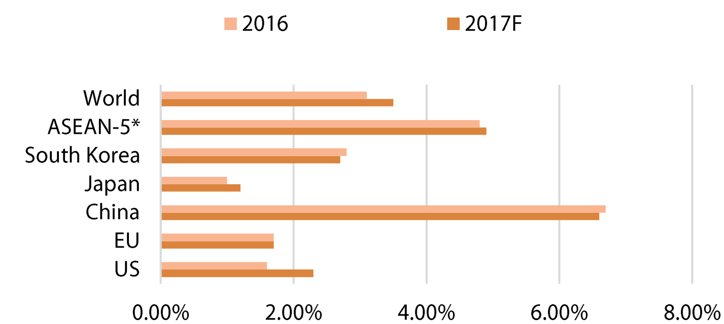
Source: OTEXA, Vietnam Customs

Figure 11: Revenues by Regions of Major Brands



Source: Collected by RongViet Research

Figure 12: Forecasted World Economic Growth Rate



Source: IMF, RongViet Research
(*) Indonesia, Malaysia, Philippines, Thailand and Vietnam

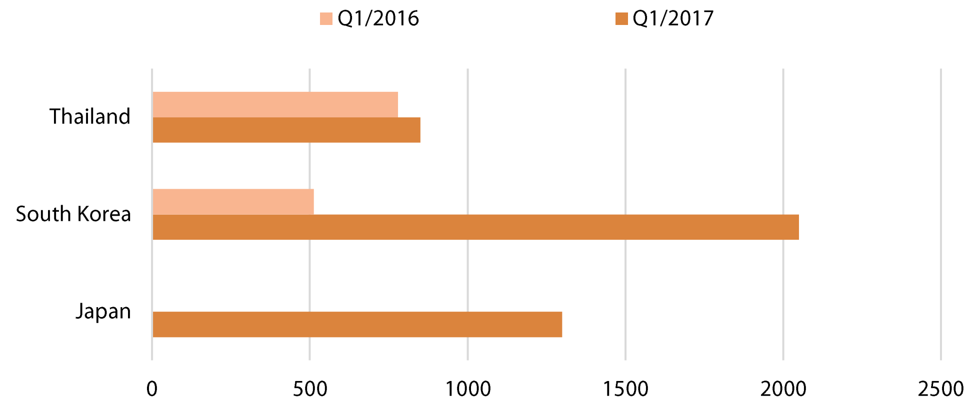
Expanding customer networks and developing new products show great promise.

After encountering the anti-dumping tariff in Turkey, STK sought new customers from other Asian countries, including South Korea and Japan, which proved to be quite promising. In the early months of 2017, positive signals emerged as yarn exports to Korea increased by more than four times, while the Japanese market also yielded impressive results.

South Korean and Japanese customers have high requirements for products' quality, compared with other markets, so the profit margins of the Japanese and South Korean firms are usually high (which may be up to 18%). Besides, they tend to have long-term cooperation with customers meeting their criteria.

Free trade agreements (FTAs) are also a reason for us to believe that South Korea and Japan will be a good replacement for Turkey. Currently, Vietnam signed FTAs with South Korea (with the effective date of 20/12/2015) and Japan (with the effective date of 01/10/2009) and enjoys preferential tariff rate of 0% for yarns in these two markets.

Figure 13: STK's Revenues from Japan, Thailand and South Korea in Q1 (tons)



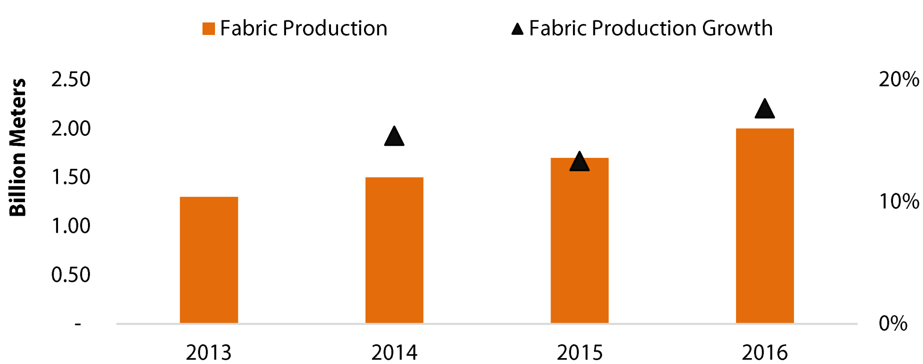
Source: STK

Although having low gross profit margins (<12%), domestic market is a "safe zone" as it does not face protectionist risks. In fact, the majority of STK's new clients since the beginning of 2017 are domestic firms.

To assess benefits from the domestic market, we believe that the EU-Vietnam Free Trade Agreement (EV-FTA) will be a highlight. The wave of FDI with hundreds-of-millions-dollars projects started to flow into the textile and apparel industry from 2014 to 2015 amidst expectations of TPP agreement. Currently, although it is likely that the US will withdraw from the agreement and, consequently, the benefits from TPP will not be the same as before, some large projects are still in operation. With capital-intensive features, it is hard to divest from yarn and fabric projects due to their huge investment capital. Besides, the rule of origin for EU-FTA is fabric-forward, so this agreement can partly replace the TPP (the EU is the second largest market, accounting for more than 13% of Vietnam's textile exports).

According to current data of VCOSA, total fabric production in Vietnam surged from 2013 until now with a CAGR of 15% to 2 billion meters. However, the amount of fabric meets only 15% of total fabric demand. Therefore, we believe that the fabric industry is having large room to develop.

Figure 14: Fabric Production in Vietnam



Source: VCOSA

In general, we believe that the flow of FDI into the fabric sector will continue in the future (although the intensity may not be as great as before) because Vietnam still faces a serious shortage of fabric supply and the EU is a potential market.

Table 3: Major Fabric Projects

Company	Investment Started Year	Capital (USD Mn)	Capacity	Status
Haputex Development Ltd.	2014	120	96 million meters woven fabric	In Operation
Shengzhou International	2014-2015	140	55.000 tons knitting fabric	In Operation

Source: Collected by RongViet Research

For long-term perspectives, we believe that new products will play a key role in improving STK's profit margin. STK plans to increase the proportion of recycled yarns and to develop new products including colored and spandex covered yarns.

Currently, STK's revenue from recycled fiber has accounted for only ~3%. Recycled fibers and raw materials are no different in character compared to STK's current products. If polyester chips are made from the recycling of plastic utensils, yarns produced from these chips will be considered "recycled yarn". As a result, the demand for additional capital to produce recycled yarns is insignificant.

Certification is also an advantage for STK as developing these recycled yarns. In order to get the "Recycled Yarns" label, the products must obtain an international certification (such as Global Recycle Standard (GRS) certificate). STK has achieved GPS certification for recycled products. In addition, STK is also cooperating with Unifi in producing these yarns, so the company can use the REPREVE brand name for its recycled products. With the reputation of the REPREVE brand, we believe that this is STK's notable advantage.

In addition, we expect that demand for recycled products will increase in the future due to consumers' preference for eco-friendly products. Major brands are committing to increase gradually recycled yarn proportion using for their products.

We also believe colored and spandex covered yarns will yield a high gross margin due to their high demand. Besides, the dyeing process for producing dyed yarns does not pollute the water, so the development of these yarns is also suitable for the "eco-friendly consumers" trend, which is similar to recycled yarns.

Table 4: STK's New Products

Product	Gross Margin	Common Finished Products
Recycled Yarn	22%	Apparel and Footwear
Dyed Yarn	>17%	Apparel and Footwear
Spandex Covered Yarn	>17%	Socks, Apparel

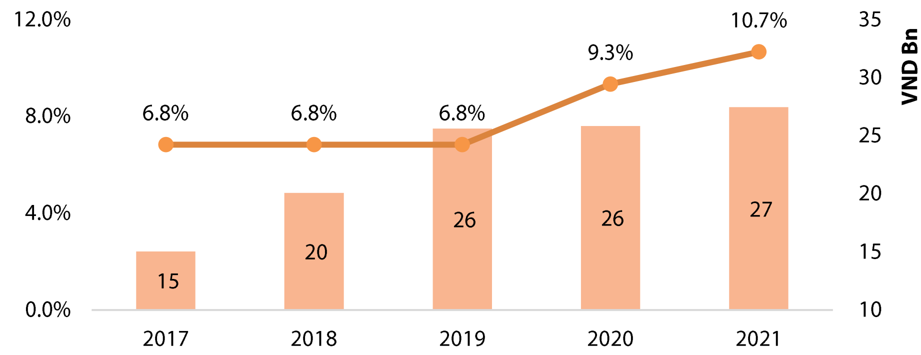
Source: RongViet Research

STK is turning into the domestic market and other Asian countries after the anti-dumping tariff problem in Turkey. We forecast that the domestic market will account for 50%, while Thailand, South Korea and Japan will account for 30%. In addition, we think that new types of yarn will be the main driver for STK's profitability in the long term, although this will not reflect on the short-term results. Overall, STK's long-term prospects are positive in terms of both market and product.

Tax preferences are among great advantages of STK

STK earnings from Trang Bang 1 and Trang Bang 2 plants enjoy a corporate income tax of 10% during 15 years from 2016. Meanwhile, earnings from Trang Bang 3 and Trang Bang 4 is corporate income tax – free in the first 4 years and enjoy 50% of the current tax for the next 9 years. Basing on current capacity of each plants, we compute STK's corporate income tax as follows:

Figure 15: Projected Corporate Income Tax (LHS) and the Saving Tax Compared to 20%-corporate Income Tax (RHS) of STK during 2017-2021



Source: RongViet Research

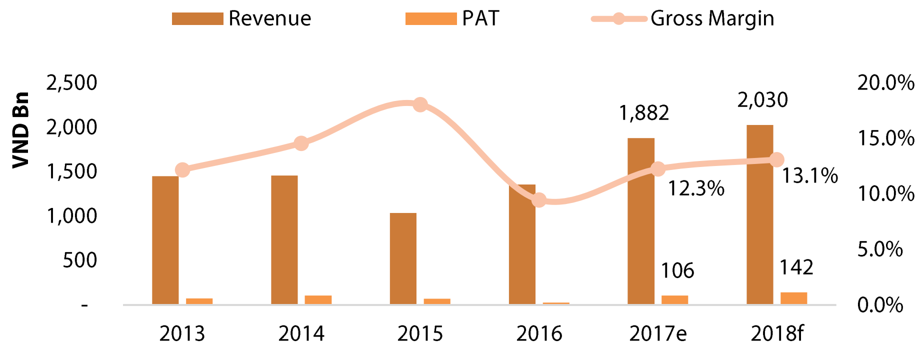
STK will gather momentum in 2017

STK's yarn prices in Q1 increased by 11% YoY, while its input prices was up by 10% YoY. In general, considering market demand is on the recovering stage, we think that this increase can maintain until the end of 2017. In addition, STK's capacity increased by 13,000 tons/year to 60,000 tons/year, so we forecast the yarn output will increase sharply by 31%. In general, we forecast that STK's revenue in 2017 will increase by 47% to VND1,399 billion.

STK have not had any new investment plan in 2017. However, considering opportunities from the domestic market and the Korean and Japanese markets, we believe that STK will continue develop new types of yarn having higher profit margin and demand. Therefore, we forecast that STK's revenues will grow at an average annual rate of ~ 11% during the next five years.

Along with the increase in yarn prices, the greater proportion of recycled yarns in STK's products will help STK's gross margin improve in 2017 and beyond. Currently recycled yarns account for only 3% of total sales, and expect to account for 10% in 2017. Given an average gross profit margin of 22%, the expected increase recycled yarn proportion will improve STK's gross margin by roughly 2 percentage points. We expect that recycled yarns will comprise 20% of total sales by 2020 and, along with new products, will help improve STK's gross margin to 16%.

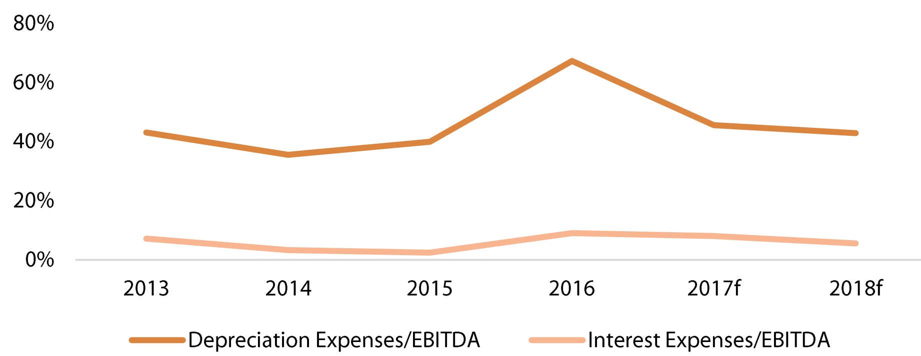
Figure 16: Business Results Projection in 2017 And 2018



Source: RongViet Research

Given the expansion of capacity before, depreciation and interest expenses are big STK's financial burden. In 2017, we expect the depreciation expense will increase by 11% (due to the Trang Bang 4 plant), while interest expenses may increase by more than 50% (mainly due to the USD24 million loan for Trang Bang 3 and 4 plants). However, due to the improvement in EBITDA, the impact from these costs will not be as severe as in 2016.

Figure 17: Depreciation and Interest Expenses in STK's EBITDA



Source: RongViet Research

Overall, we think STK's business outlook will be positive. We forecast that STK's revenues and profits during the next 5 years will increase with a CAGR of 11% and 25%. Given the projected PAT of VND106 billion in 2017, STK's EPS will be VND1,990.

Risks related to input prices' fluctuation or market demand will still have a significant impact on STK earnings, but we believe these risks will be temporary and will not significantly affect STK long-term results.

Outlook and Valuation

Considering the leading position of STK in the yarn industry in Vietnam, the company has benefited greatly from the recovery of textile and garment demand. STK's Q1 business results recorded revenue and PAT growth rates of 70.6% and 764.1% YoY, respectively. These figures were impressive partly when we compare them with 2016 - a bad year for STK as many unexpected problems occur. In 2016, STK's PAT dropped sharply by nearly 60% to around VND28.5 billion, which is the lowest level since 2009.

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Overall, we initiate a "**BUY**" recommendation on the stock at the "**2- year target price**" of **VND24,200**. In the short term, low liquidity and large fluctuations in exchange rate and input prices are risks that investors should monitor.

VND Billion

INCOME STATEMENT	2015	2016	2017F	2018F
Revenue	974	1,358	1,882	2,030
COGS	848	1,230	1,651	1,764
Gross profit	126	129	231	266
Selling Expense	24	25	27	30
G&A Expense	38	45	49	53
Finance Income	14	1	1	0
Finance Expense	50	30	42	33
Other profits	1	1	1	1
PBT	0	0	0	0
Prov. of Tax	28	31	114	152
Minority's Interest	15	2	8	10
PAT to Equity Shareholder	0	0	0	0
EBIT	13	29	106	142
EBITDA	125	58	154	184

FINANCIAL RATIO	2015	2016	2017F	2018F
Growth (%)				
Revenue	-33.2	39.4	38.6	7.9
Operating Income	-7.5	-13.6	62.5	10.2
EBITDA	-14.3	-53.5	165.6	19.0
EBIT	-87.7	118.5	272.3	33.4
PAT	46.8	17.8	-3.4	-4.2
Total Assets	2.2	0.8	7.6	8.3
Equity				
Internal growth rate				
Profitability (%)	12.9	9.5	12.3	13.1
Gross profit/Revenue	21.5	13.3	15.6	16.0
Operating profit/ Revenue	12.8	4.3	8.2	9.0
EBITDA/ Revenue	1.3	2.1	5.7	7.0
EBITDA/ Revenue	0.8	1.4	5.4	7.6
Net margin	9.5	4.3	11.5	14.8
ROAA	1.9	4.1	14.2	17.5
ROIC or RONA				
ROAE				
Efficiency	13.1	16.0	14.3	12.9
Receivable Turnover	2.4	3.1	3.6	3.7
Inventory Turnover	4.1	4.3	4.5	4.4
Payable Turnover				
Liquidity	1.2	0.9	1.0	1.1
Current	0.3	0.3	0.3	0.3
Quick				
Solvency (%)	118.5	149.9	112.7	81.7
Total Debt/Equity	27.5	56.2	34.3	28.8
Current Debt/Equity	91.0	93.7	78.4	52.8
Long-term Debt/ Equity	-33.2	39.4	38.6	7.9

VND Billion

BALANCE SHEET	2015	2016	2017F	2018F
Cash and cash equivalents	7	82	19	20
Short-term investments	0	0	0	0
Accounts receivable	74	85	132	157
Inventories	356	402	462	481
Other current assets (inc. non-trade receivables)	30	20	21	22
Property, plant & equipment	1,167	1,350	1,240	1,109
Acquired intangible assets (inc. Goodwill)	4	1	1	1
Investment in affiliates	40	40	40	40
Other non-current assets	39	40	39	44
Total assets	**1,719**	**2,025**	**1,957**	**1,874**
Accounts payable	209	286	363	401
Short-term borrowings	190	391	257	234
Long-term borrowings	627	652	587	428
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	2	1	1	1
Technology-science	0	0	0	0
Total liabilities	**1,029**	**1,329**	**1,209**	**1,064**
Common stock and APIC	465	503	535	535
Treasury stock (enter as -)	0	0	0	0
Retained earnings /	188	123	176	238
Other comprehensive income /	35	35	35	35
Investment and Development	1	1	1	1
Total equity	**690**	**695**	**748**	**810**
Minority Interest	0	0	0	0

CASH FLOW STATEMENT	2015	2016	2017F	2018F
Profit before tax	87	31	114	152
-Depreciation	84	122	140	141
-Adjustments	43	26	-	-
+/- Working capital	(303)	24	(38)	(17)
Net Operating CFs	**(89)**	**202**	**216**	**276**
+/- Fixed Asset	(192)	(865)	(32)	(12)
+/- Deposit, equity investment	(347)	569	-	-
Interest, dividend, cash profit	-	-	-	-
Net Investing CFs	**(539)**	**(296)**	**(32)**	**(12)**
+/- Capital	54,132	70	-	-
+/- Debt	584,324	225	(65)	(159)
Dividend paid & other	(637,963)	(121)	(187)	(103)
Net Financing CFs	**492**	**173**	**(252)**	**(262)**
+/- cash & equivalents				
Beginning cash & equivalents	**148**	**7**	**87**	**19**
Impact of exchange rate	(136)	80	(68)	1
Ending cash & equivalents	**7**	**87**	**19**	**20**

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Ratings / Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to10%	-15% to- 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

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