November, 2018

Dry Cell and Storage Battery JSC (HSX - PAC)

Valuation is not attractive

Particulars (VND B)	Q3-FY18	Q2-FY18	+/- QoQ	Q3-FY17	+/- YoY
Net revenue	769.6	798.1	-3.6%	689.3	11.6%
PAT	49.9	29.2	70.8%	24.3	105.5%
EBIT	71.2	36.7	94.2%	27.0	163.6%
EBIT margin	9.3%	4.6%	466bps	3.9%	533bps

Source: PAC, Rong Viet Securities

9M 2018 performance: Improvement from increase in average selling price (ASP)

9M 2018 net revenue and NPAT reached VND 2,297 billion (+11% YoY) and VND 107 billion (+7%), respectively. This growth mainly resulted from an improvement in ASP (around 15% YoY). Lead prices saw a significant increase in 4Q 2017, then reached a peak in 1Q 2018. PAC and Genzo Shimadzu (GS), the largest competitor of PAC, decided to increase ASPs by 5% in late 2017 and 10% in April 2018. The uptrend in ASP has created a strong impact on the market because distributors accumulated a large number of batteries in early 2018. During the same period, due to relocation of machinery from Tan Tao factory to the Nhon Trach factory, PAC's production capacity temporarily declined. Hence, the company could not meet such considerable increasing demand from distributors. Furthermore, PAC is still facing fierce competition with FDI companies. As a result, sales volume in 9M 2018 decreased by 1% compared to the same period last year.

2018 Outlook: Growth in both gross revenue and NPAT

Compared to 3Q 2018, sales volume and gross revenue in 4Q 2018 is forecasted to decrease because GS, the direct competitor of the company, is launching attractive promotions. However, from a low base of 4Q 2017, gross revenue in the last quarter of 2018 is expected to increase by 11% to VND 670 billion.

Regarding earnings, we forecast that 4Q 2018 NPAT will grow by 40% to VND 38 billion compared to the same period last year. This expected growth mainly results from an expansion in 4Q 2018 gross profit margin of 607 bps thanks to a significant decline in lead price. We forecast that 2018 gross revenues and NPAT will reach VND 2,942 billion (+13% YoY) and VND 147 billion (+14% YoY), respectively.

Valuation and Recommendation:

PAC is the leading player in the battery manufacturing industry, in a highly competitive market. However, PAC's market share has remained stable for the last few years. Hence, we expect earnings improvement at compound annual growth rate (CAGR) of 12% in the next five years. Despite an 8% decline in the stock price recently, PAC is trading at trailing P/E ratio of 18x, and we believe that this valuation is unjustified.

*Our target price is **VND 38,000 per share**. This target price, coupled with a VND 2,500 cash dividend in the next 12 months, would yield a negative total return of **-7%** (calculated based on the closing price on 31st October). Therefore, we come up with a **REDUCE** recommendation on PAC.*

REDUCE -7%

CMP (VND)	43,500
Target Price (VND)	38,000
Cash Dividend (VND)*	2,500

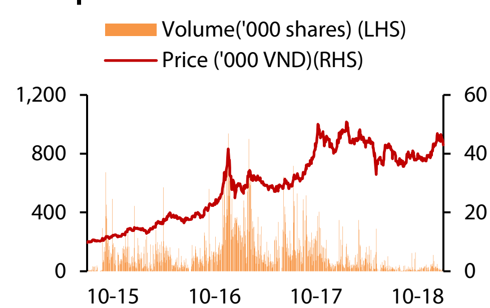
** Expected in the next 12 months*

Stock Info

Sector	Automobile & Parts
Market Cap (VND B)	2,022
Current Shares O/S	46,471,707
Beta	0.18
Free Float (%)	27.6
52-week High	48,166
52-week Low	32,902
Avg. Daily Volume (20 sessions)	15,975

	FY2017	Current
EPS	2,922	2,923
EPS Growth (% YoY)	-28	-3.5
Adjusted EPS	2,229	2,923
P/E	15.2	14.8
P/B	3.1	3.3
EV/EBITDA	13.7	9.4
Cash Dividend	4,500	2,500
ROE (%)	20.3	21.9

Price performance



Major Shareholders (%)

Vinachem	51.4
Furukawa Battery	10.6
Foreign Ownership room (%)	18.7

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Exhibit 1: Q3 2018 Results

Particulars (VND B)	Q3-FY18	Q2-FY18	+/- (QoQ)	Q3-FY17	+/- (YoY)	3Q-FY18	+/-(YoY)
Net revenue	770	798	-3.6%	689	11.6%	2,297	10.6%
Gross profit	136	112	21.1%	94	44.9%	331	25.4%
SG&A	65	76	-14.4%	67	-3.1%	187	12.1%
Operating income	62	36	72.5%	30	109.5%	135	26.1%
EBITDA	95	58	64.4%	43	119.2%	208	57.7%
EBIT	71	37	94.2%	27	163.6%	143	48.3%
Financial expenses	22	13	66.7%	9	130.9%	44	59.5%
- Interest Expenses	11	9	26.3%	7	62.4%	28	68.7%
Dep. and amortization	23	21	12.2%	16	45.0%	65	83.2%
Non-recurring items (*)	0	0		0		0	
Extraordinary items (*)	0	0		0		0	
PBT	62	37	70.8%	30	105.5%	136	3.0%
PAT	50	29	70.8%	24	105.5%	109	7.2%
(*) Adjusted PAT	50	29	70.8%	24	105.5%	109	*7.2%*

Source: PAC, Rong Viet Securities

Exhibit 2: Q3 2018 Performance Analysis

Particulars	Q3-FY18	Q2-FY18	+/- (QoQ)	Q3-FY17	+/- (YoY)
Profitability Ratios (%)					
Gross Margin	17.7	17.0	63.1bps	13.6	405.8bps
EBITDA Margin	12.3	7.2	508.6bps	6.3	603.6bps
EBIT Margin	9.3	4.6	465.9bps	3.9	533.4bps
Net Margin	6.5	3.7	282.8bps	3.5	296.5bps
Adjusted Net Margin	6.5	3.7	282.8bps	3.5	296.5bps
Turnover *(x)					
-Inventories	4.4	5.0	-0.6	3.6	0.8
-Receivables	10.7	14.3	-3.6	11.7	-1.0
-Payables	6.0	7.3	-1.3	5.5	0.5
Leverage (%)					
Total Debt/ Equity	256.8	273.0	-1,624.4bps	224.2	3,257.2bps

Source: PAC, (*) Annualized turnover

Exhibit 3: Q4 2018 Performance Forecast

Particulars (VND Billion)	Q4-2018	+/- (QoQ)	+/- (YoY)
Revenue	645.5	-16.1%	20.3%
Gross profit	99.2	-27.1%	88.7%
EBIT	51.1	-28.3%	63.3%
NPAT	38.1	-23.8%	39.8%

Source: PAC, Rong Viet Securities

Updates

Bien Hoa factory has to be relocated to the An Phuoc industrial park before 2022, resulting in risks of reduction in production capacity.

The current capacity of the Bien Hoa and Nhon Trach factories are 1.0 and 1.2 million kWh, respectively. These battery factories are now operating at 90% capacity. According to PAC, the Bien Hoa factory will be moved to the An Phuoc industrial park, Dong Nai before 2022 because of environmental requirements. To prepare for the construction of the new factory, the company has just deposited 10% of VND 180 billion in an 8.5-hectare piece of land in An Phuoc industrial park. We forecast that it would take at least three to four years to obtain building permissions to build the factory. However, so far we have not seen any clear plans for the new factory. Therefore, we are concerned that until late 2021, if the factory cannot come into operation, total production capacity could be negatively affected. Even if the construction at the An Phuoc factory is on schedule, total capacity could temporarily decrease at the time of relocation due to obstacles in moving machinery.

PAC and Furukawa Battery (FB) are still far from an agreement contract.

Being the second largest shareholder of PAC, Furukawa Battery (FB) is considered PAC's strategic partner. FB was expected to provide technical solutions as well as support for PAC to expand its markets. However, until now, there have been no cooperation agreements between the two companies. According to the representative of the company, the offer from FB includes provisions that PAC considers too unfavorable to accept. First, technology devices that FB offers come with a high price. In addition, FB requires PAC to share a proportion of revenues over the entire product life cycle instead of three to five years as PAC's wishes. Moreover, FB does not permit PAC to enter its current markets. We expect no technology transfer agreement to be signed this year.

Valuation and Recommendation:

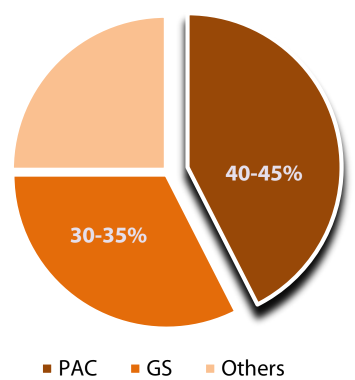
PAC is the leading player in the battery manufacturing industry, in a highly competitive market. However, PAC's market share has remained stable for the last few years thanks to an effective distribution management system and long-standing brand name. Hence, we expect that earnings will grow at a compound annual growth rate (CAGR) of 12% in the next five years. For this reason, we believe that a forward P/E of 11.5x, which the market is applying for PAC's peer group, is suitable. However, despite an 8% decline in the stock price recently, PAC stock is trading at a trailing P/E ratio of 18x, and we believe that this valuation is unjustified.

Our target price is ***VND 38,000 per share****. This target price, coupled with a VND 2,500 cash dividend in the next 12 months, would yield a negative total return of* ***-7%*** *(calculated based on the closing price on 31st October). Therefore, we come up with a* ***REDUCE*** *recommendation on PAC. However, we still maintain our view that the fundamental business of the company is good. Hence, we strongly recommend that investors can consider accumulating PAC at a more attractive price.*

Appendix 1: Effective distribution management system helps PAC maintain its position.

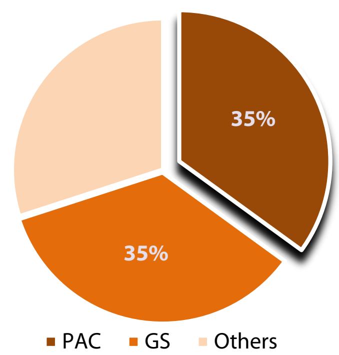
Competition in the battery industry in the country has always been fierce. PAC is the leading player in the battery manufacturing industry. However, PAC's products are facing fierce competition with FDI companies and imported products. GS, a Japanese company, is a direct competitor. Although PAC's distribution management system and quality of batteries are highly rated, the strong brand image from GS seems to be an advantage. In addition, intense price competitiveness of Korean batteries is another difficulty. Korean firms have been receiving considerable support from the government of South Korea. Thus, their products' prices are much lower than those of PAC's products.

Figure 1: Market share of battery segment



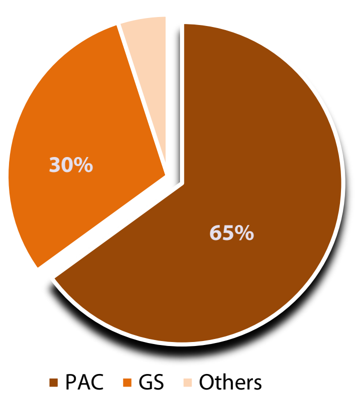
Source: PAC, Rong Viet Securities

Figure 2: Market share of CMF automobile battery segment



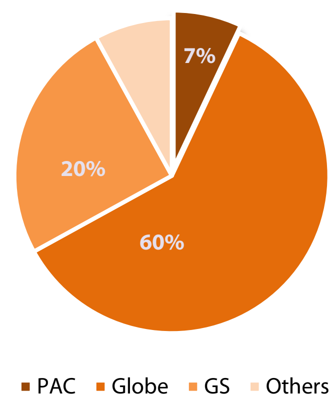
Source: PAC, Rong Viet Securities

Figure 3: Market share of MF automobile battery segment



Source: PAC, Rong Viet Securities

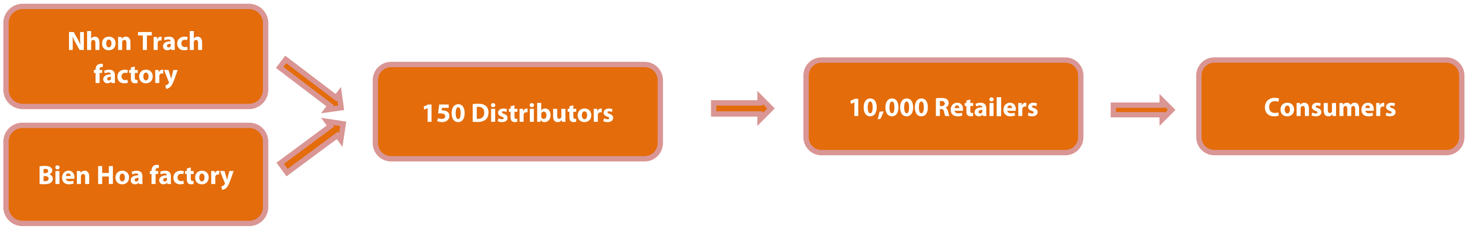
Figure 4: Market share of motorbike battery segment



Source: PAC, Rong Viet Securities

Amid fierce competition from foreign competitors, market share of the leading battery manufacturer remained stable over the last few years. In the automobile battery market, the company accounts for 40-45% of total sales. It is making this segment the largest revenue stream for PAC. Among automobile battery makers, the company has the lion's share in the maintenance free (MF) battery segment (65%), while it still has to share the leading position with its competitor (GS) in the complete maintenance free (CMF) battery sector. Meanwhile in the motorbike battery segment, Globe is the dominant player while PAC has only 7% of the market. We believe that its competitive edge is attributable to an effective management distribution system.

Figure 5: Structure of PAC's distribution channels



Source: PAC, Rong Viet Securities

(1) The company uses advanced software to control its distribution channels. From early 2018, inspired by many dynamic FMCG companies, PAC has implemented document management system (DMS) in sales administration. Thanks to the DMS, the management team of the company can control remotely almost all sales activities at every distributor and retailer. As a result, data related to sales activities is managed with a high degree of accuracy; while inventories are more effectively controlled.

(2) Sales administration policy gives it power over its distributors. PAC is following a "cash on delivery" method. PAC's customers are required to pay their bills within three days of the invoice date (T+3). In terms of sales territory, distributors at a specific area are not permitted to penetrate other areas to avoid cross sales. On the other hand, PAC always supports them in boosting sales performance. Each month, PAC will focus on increasing sales at a specific area by adding directly 1-2% on discount rates for retailers. Distributors indirectly benefit from this campaign, which helps PAC retains its customers. Such highly flexible policies on sales administration helps the company gain power over its distributors.

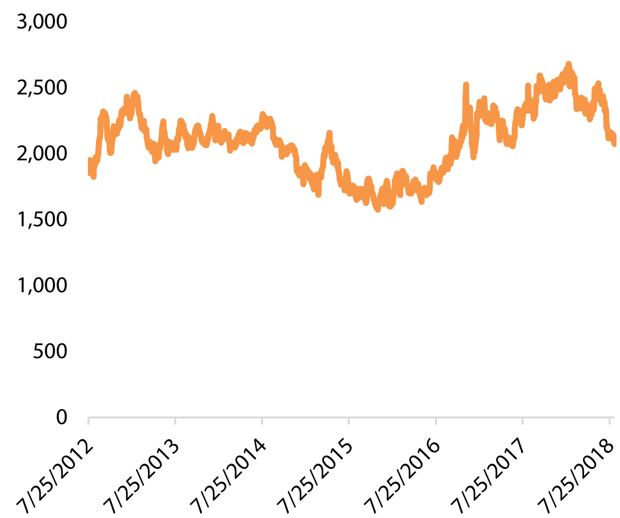
(3) PAC establishes control not only at the distribution system level but also at the retail level. Salespeople are responsible for going directly to retailers to get orders and boost sales. Transactions between distributors and retailers are recorded through the DMS system. Therefore, PAC is able to control the sale situation of each retailer. This management method enables PAC to stick to market as well as to give quick responses to movements in its competitors' strategy within 24 hours.

Appendix 2: Material Price Data

Figure 6: World Zinc Price (USD/tonne)

Source: Bloomberg

Figure 7: World Lead Price (USD/tonne)



Source: Bloomberg

VND Billion

INCOME STATEMENT	FY2016	FY2017	FY2018E	FY2019F
Revenue	2,291	2,613	2,942	3,251
COGS	1,865	2,294	2,512	2,808
Gross profit	**426**	**319**	**430**	**442**
Selling Expense	147	138	191	182
G&A Expense	45	43	44	49
Finance Income	27	50	49	47
Finance Expense	24	37	60	65
Other profits	1	25	5	5
PBT	**238**	**175**	**188**	**199**
Prov. of Tax	51	39	41	44
Minority's Interest	0	0	0	0
PAT to Equity S/H	**188**	**136**	**147**	**155**
EBIT	234	137	194	212
EBITDA	298	213	283	302

%

FINANCIAL	FY2016	FY2017	FY2018E	FY2019F
Growth				
Revenue	8.2	14.1	12.6	10.5
Operating Income	44.3	-28.6	33.0	6.7
EBITDA	66.5	-41.5	41.9	8.8
PAT	107.5	-27.7	8.0	5.8
Total Assets	34.1	5.0	3.9	6.6
Equity	32.1	0.3	2.7	3.8
Profitability				
Gross margin	18.6	12.2	14.6	13.6
EBITDA margin	13.0	8.1	9.6	9.3
EBIT margin	10.2	5.2	6.6	6.5
Net margin	8.2	5.2	5.0	4.8
ROA	11.1	7.6	7.9	7.9
ROE	28.1	20.3	21.3	21.7
Efficiency				
Receivables Turnover	22.5	27.5	27.6	26.2
Inventories Turnover	3.7	3.8	3.9	4.3
Payables Turnover	5.3	7.9	8.3	10.0
Liquidity				
Current	1.3	1.0	1.2	1.2
Solvency				
Total Debt/Equity	98.2	121.0	122.9	133.9
Current Debt/Equity	98.2	121.0	122.9	118.8
Long-term Debt/Equity	0.0	0.0	0.0	15.1

VND Billion

BALANCE SHEET	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	108	37	111	113
Short-term investments	467	248	420	421
Accounts receivable	94	96	118	130
Inventories	572	628	653	646
Other current assets	20	48	29	33
Property, plant & equipment	326	363	377	490
Acquired intangible assets	32	69	66	63
Long-term investments	33	33	33	33
Other non-current assets	44	260	42	44
Total assets	**1,695**	**1,781**	**1,850**	**1,971**
Accounts payable	351	291	301	281
Short-term borrowings	656	811	846	849
Long-term borrowings	0	0	0	108
Other non-current liabilities	1	2	2	2
Bonus and Welfare fund	19	6	11	17
Technology-science, dev. fund	0	0	0	0
Total liabilities	**1,027**	**1,110**	**1,161**	**1,257**
Common stock and APIC	466	466	466	466
Treasury stock (enter as -)	0	0	0	0
Retained earnings	183	192	196	206
Other comprehensive income	0	0	0	0
Inv. and Dev. Fund	19	12	27	42
Total equity	**669**	**670**	**689**	**715**
Minority Interest	**0**	**0**	**0**	**0**

VALUATION RATIO	FY2016	FY2017	FY2018E	FY2019F
EPS (dong)	4,040	2,922	3,157	3,341
P/E (x)	7.0	15.2	13.7	12.9
BV (dong)	14,386	14,423	14,818	15,384
P/B (x)	2.0	3.1	2.9	2.8
DPS (dong/cp)	2,200	4,500	2,500	2,500
Dividend yield (%)	7.8	10.1	5.8	5.8

VALUATION MODEL	Price	Weight	Average
FCFF	37,396	50%	18,698
PE	38,424	50%	19,211
Target price (dong)			**37,910**

VALUATION HISTORY	Price	Recommendation	Period
28/06/2017	40,600	Neutral	Long term
26/11/2017	41,100	Neutral	1-year

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

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