November, 2018

VIGLACERA CORPORATION - JSC (HNX: VGC)

A blitz on restructuring amidst rising challenges

BUY	**+36%**
Target price (VND)	21,000
Current market price (VND)	15,500

(VND bn)	Q3-FY18	Q2-FY18	+/- qoq	Q3-FY17	+/- yoy
Net revenue	2,270	2,274	-0.2%	2,517	-9.8%
PAT	136	222	-38.7%	185	-26.5%
EBIT	230	329	30.3%	257	-10.8%
EBIT margin	10%	14%	-40 bps	10%	+0 bps

Source: VGC, Rong Viet Securities

9M 2018 – Real estate stayed positive while building materials could be revamping

- 9M 2018's revenue and NPAT-MI came at VND 6,374 billion (-6% YoY) and VND 461 billion (-14% YoY), respectively. Oversupply caused building materials' ASP to drop, particularly in building glass and tiles segments, shrinking total earnings. The combined gross profit thus decreased 9% over the same period in 2017.
- Residential property contributed 11% of profits. Industrial park recorded about 40 ha leased in 9M as a result of a high FDI level in the northern region.
- The Ministry of Construction was unsuccessful in divesting an 18% stake in July. Accordingly, the MoC plans to withdraw the entire 54% stake in 2019. Viglacera is still in the process of finding strategic partners for the divestment.

FY2019 outlook - Industrial park lease as a key driver, while expecting building materials to improve in view of restructuring

VDSC thinks Viglacera is in a turnaround mode, demanding an effective restructuring against inside-out obstacles from the building materials, the segment representing 64% of profit. Several efforts have been carried out, including the divestment from ineffective businesses, investment in quality improvements and focusing on high-value products. My Xuan sanitary ware and Phu My ultra-white glass factories are expected to bring distinct advantages in the long term. Industrial park lease is expected to make substantial contribution to long term growth as a result of favored FDI and the manufacturing shift from China. Residential projects in Hanoi and social houses encircling industrial zones also will help the company maintain stable income.

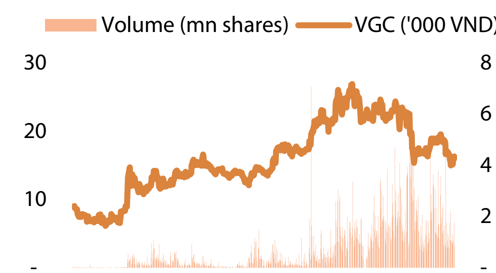
Valuation and recommendation

We apply a sum-of-the-parts method, comprising of RNAV and EV/EBITDA, to evaluate the real estate and building materials segments, respectively. Our target price is down to ***VND 21,000 value per share****, reflecting a tougher-than-expected competition in building materials. The failure of the MoC's early divestment and a less optimistic prospect of building materials market may have contributed to the decline of stock price recently. However, we do not expect a worse scenario than the current situation. Upside potential depends on better restructuring performance while downside risk lies in the downturn of the construction market and properly a strong surge in fuel price. We come up with a* ***BUY*** *recommendation on Viglacera with* ***a total return of 36%****, as of the closing price in November 13th, 2018.*

Stock Info	
Sector	RE & Materials
Market Cap (VND billion)	7,129
Current Shares O/S	448,350,000
Avg. Daily Volume (in 20 sessions)	1,189,902
Free float (%)	49
52 weeks High	26,884
52 weeks Low	15,000
Beta	0.724

	FY2017	Current
EPS	1,339	1,028
EPS Growth (%)	17	-14
Diluted EPS	1,339	1,028
P/E	19.7	15.2
P/B	1.76	1.05
EV/EBITDA	7.5	20.0
Cash dividend yield (%)	4%	6%
ROE (%)	13	7

Price performance



Major Shareholders (%)	
Ministry of Construction	53.9
Others	46.1
Foreign ownership room (%)	24.2

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Exhibit 1: Q3/2018 Results

(VND Bn)	Q3-FY18	Q2-FY18	+/-(qoq)	Q3-FY17	+/-(yoy)
Net revenue	2,270	2,274	-0.2%	2,517	-10%
Gross profit	513	563	-9%	540	-5%
SG&A	-268	-250	+7%	-281	-4%
Operating income	245	313	-22%	259	-5%
EBITDA	363	447	-19%	354	+2%
EBIT	230	329	-30%	257	-11%
Financial expenses	-60	-50	+21%	-47	+28%
- Interest Expenses	-49	-46	+6%	-41	+19%
Dep. and amortization	133	117	+13%	97	+38%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	212	303	-30%	264	-19%
PAT	136	222	-39%	185	-27%
(*) Adjusted PAT	136	222	-39%	185	-27%

Source: VGC, Rong Viet Securities

Exhibit 2: Q3/2018 Performance Analysis

Particulars	Q3-FY18	Q2-FY18	*+/-(qoq)*	Q3-FY17	*+/-(yoy)*
Profitability Ratios (%)					
Gross Margin	23%	25%	-20 bps	21%	+20 bps
EBITDA Margin	16%	20%	-40 bps	14%	+20 bps
EBIT Margin	10%	14%	-40 bps	10%	+0 bps
Net Margin	6%	10%	-40 bps	7%	-10 bps
Adjusted Net Margin	6%	10%	-40 bps	7%	-10 bps
Turnover *(x)					
-Inventories	0.6	0.7	-1 bps	0.7	-1 bps
-Receivables	1.7	1.7	+0 bps	1.7	+0 bps
-Payables	1.6	1.7	-1 bps	2.0	-4 bps
Leverage (%)					
Total Debt/ Equity	34%	35%	-10 bps	37%	-20 bps

Source: Rong Viet Securities

Exhibit 3: Q4/2018 Performance Forecast

Particulars (VND Bn)	Q4-FY18	+/- qoq	+/- yoy
Revenue	2,458	+8%	-5%
Gross profit	553	+8%	+3%
EBIT	293	-7%	+13%
NPAT	219	+31%	+178%

Source: Rong Viet Securities

Update

Intense competition has been eroding the profitability of the building materials business.

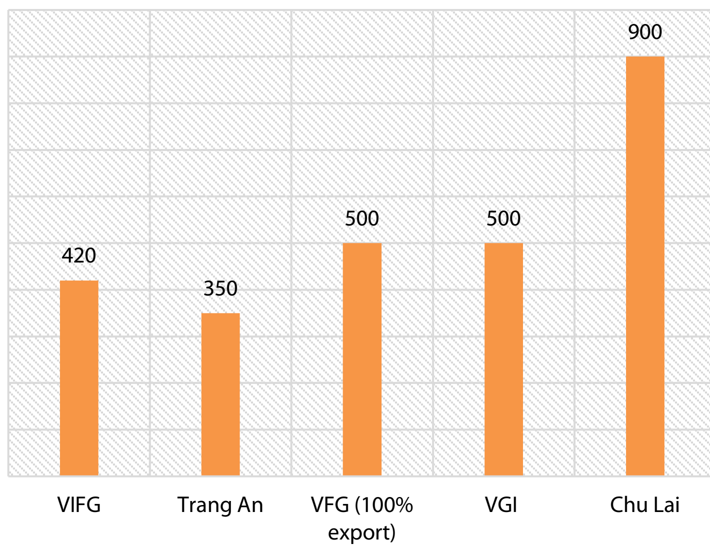
Oversupply and slowdown of construction across the country negatively affected ¾ materials segments in 9M 2018. Details are as followed:

- **Building glass segment was strongly hit due to a huge increase in supply and high cost-push pressure.** Gross margin plummeted to a 15% in 9M 2018 after a considerable hike to 30% in the previous year. Market supply surged almost 1.5x from the beginning of 2018, mainly due to:
  (1) Trang An building glass plant, 350,000 units/year capacity, resuming its operation after a pause for restoration in 2017;
  (2) Sizable penetration of Malaysian imported products, which are granted a zero % tariff and seems more cost advantageous.
  As a consequence, most domestic producers had to decrease their average selling price. Profit was likewise tapered off due to escalating oil prices, which accounted for a large proportion of input costs. The average fuel price is respectively 32% and 86% higher than that of in 2017 and 2016, when profitability from this segment peaked. Low-e glass has not yet shown a strong move for a 'rescue'. Coupled with a 6 – 7% decrease in ASP, earnings contribution from this segment was modest at 8%, about VND 117 billion in 9M 2018.

Figure 1: FO 180 price (USD per MT)

Source: Bloomberg

Figure 2: Domestic building glass capacity (tons per year)



Source: Rong Viet Securities

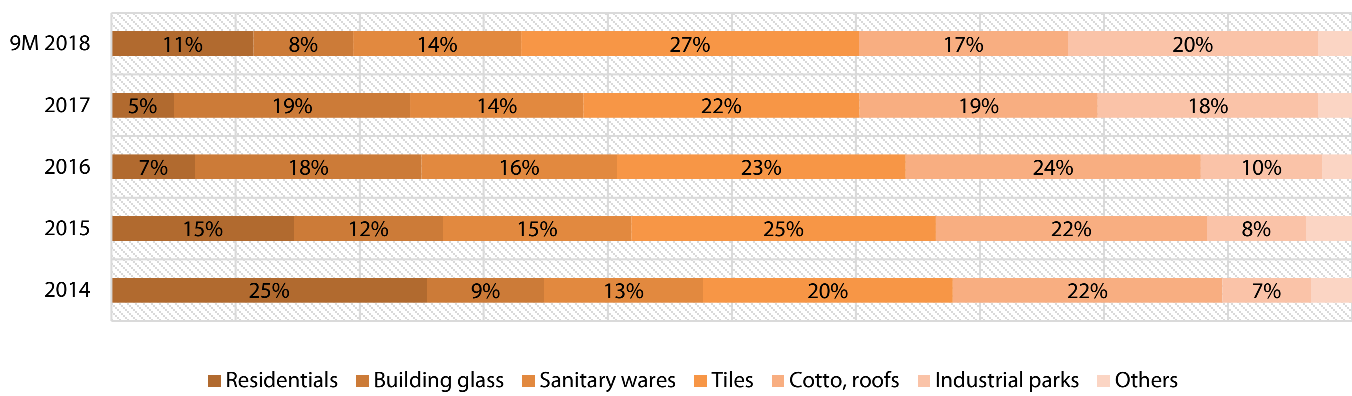
- **Sanitary wares performed well, albeit a not-much adding to the bottom line**. This segment shows that Viglacera is one of the leading domestic producers amidst the dominance of foreign brand names such as TOTO and Inax. Its current factories, Viet Tri and Thanh Tri, are running at full capacity. Gross margin has stayed between 28% to 32% since 2015. We estimate that gross margin could ease to 24% in 3Q, dragging the average 9M to 28%, corresponding to VND 196 billion of earnings.
- **Tiles were struggling in the first half and showed improvements in Q3 2018.** Market supply was up 40% from the beginning of the year, putting downward pressure on manufacturers' margins. The segment recovered in 3Q as revenue was reported at VND 755 billion, equivalent to 70% of that of 1H 2018. Gross margin improved to around 23%. Production and consumption upturned in 3Q as production costs shrunk around 10%. In October, Viglacera Tien Son recorded about 9 billion profit, equal to 57% of 3Q results. We think sale figures should ramp up in 4Q due to a seasonal high level of demand and justifiable selling prices.
- **The teracotta segment is under restructuring, focusing towards high value products.** The business recorded VND 244 billion in gross profits, equal to a gross margin of 15%, lower than the average margin of 21% in recent years. Restructuring is taking place: gradually abandoning bricks and baked products. Gross margin will possibly shrink to 15 – 17% instead of the average of 21% in the last three years.

Residential property recorded a high profitability and industrial park remained stable.

Ramped-up FDI and the relocation of production from China reinforced industrial park leasing activities. Gross profit from leasing and services activities are of VND 192 billion and VND 100 billion, equal to 44% and 55% that of 2017, respectively. The combined margin increased to 38% in 9M 2018 compared to 29% in 2017. About 40 ha were leased in 9M, mainly in Yen Phong Expansion and Dong Van IV. We understand that asking price could increase slightly as a result of rising rental demand and a more diverse customer backgrounds.

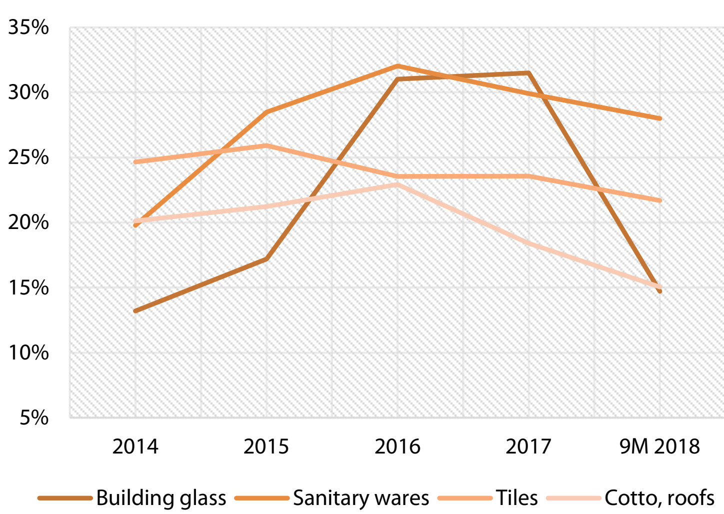
The residential segment contributed a higher earning level as low-rise units were booked. Revenue came at VND 374 billion and gross margin soared to 44% in 9M. The increase in profitability was because Viglacera recorded sales of low-rise units from Hoa Vien, 671 Hoang Hoa Tham and Xuan Phuong. Besides, sale of social housing projects in Yen Phong IP bolstered residential profits.

Figure 5: Gross profit breakdown (%)



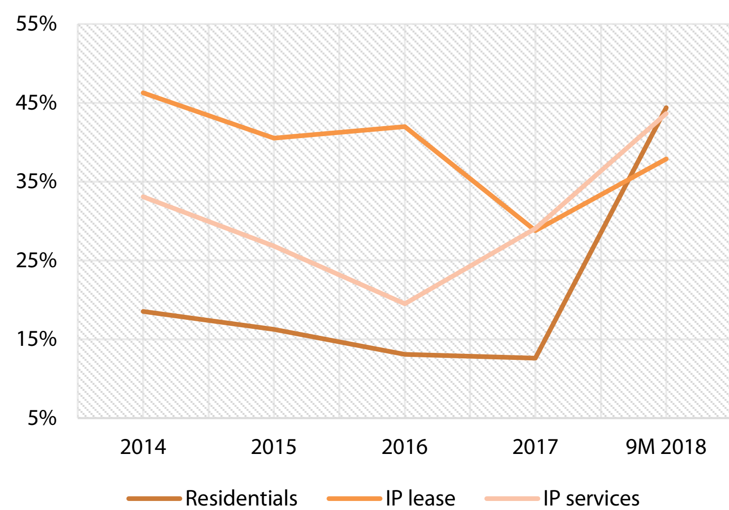
Source: VGC

Figure 3: Building materials gross margin (%)



Source: VGC

Figure 4: Real estate gross margin (%)

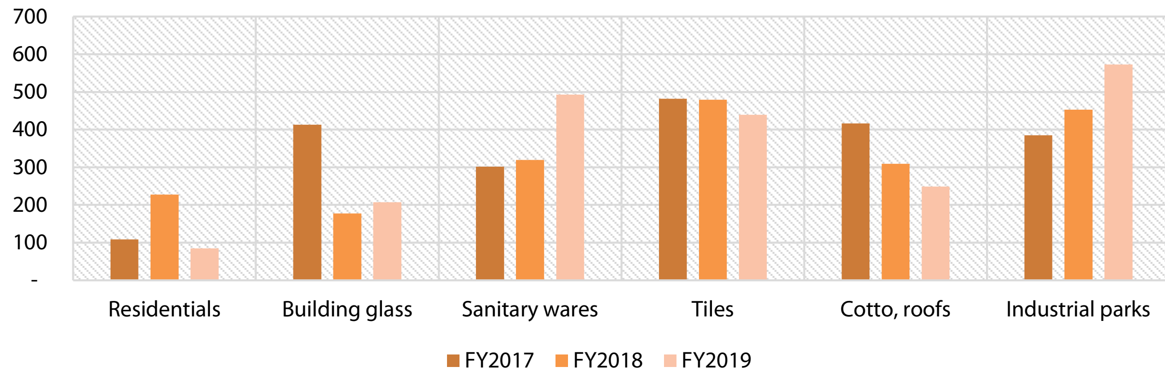


Source: VGC

We expect tiles and industrial parks to have relatively large earning contributions in 4Q. Viglacera thus can meet the full year target. The amendment of Viglacera Tien Son in 3Q is being maintained in 4Q. A 6 - 7% drop in fuel price from the beginning of 4Q is expected to improve margin level. In addition, we expect a large area to be sold in 4Q, based on increasing number of foreign enterprises visiting the zones in the last 3 months. For FY2018, Rong Viet estimates a 24% and 23% contribution of gross profit from industrial parks and tiles, respectively. Our FY2018 forecast comes in at VND 8,823 billion (+0.5% YoY) in revenue and VND 541 billion (-10% YoY) in NPAT-MI. Here are our key assumptions:

- Residential segment to have a gross margin of 40%, deriving from the remaining units of 671 Hoang Hoa Tham; Hoa Vien and Xuan Phuong;
- Industrial parks to lease about 92 hectares, mainly clustered in Yen Phong, Dong Van IV and Phu Ha;
- Building materials to stay flat due to the negative impact from ongoing competition.

Figure 6: FY2018 – 2019 forecast, gross profit by segment (VND billion)



Source: Rong Viet Securities

FY2019 outlook

For FY2019, VDSC maintains a prudent scenario on building materials due to (1) a modest list of handover projects, (2) declining construction market whereas (3) input prices possible remain in an uptrend. We expect:

- **Building glass to improve gross margin as a result of cost restructuring and better utilization of Low-e products**. We estimate a 3% improve in COGS of building glass in 2019 in the case of efficient fuel management. We expect that the Phu My ultra-white Glass Plant, with a capacity of 600 tonnes per day, will be granted a favorable fuel price. Rong Viet thinks this improvement will partially offset the negative impacts from current deadlocks. In addition, we expect Low-e glass to have a greater contribution in the near term as it is becoming more prevailing in buildings or apartments, namely Vinhomes, Sunshine City and Rivera Park.
- **My Xuan plant to operate at 55% of total design capacity in 2019**. The plant has a total capacity of 750,000 units per year (+61% of current capacity). My Xuan started its 'pilot' production in August, 2018 and is supposed to officially launch its products into the market from the beginning of 2019. The plant is expected to break even when production reaches 65 – 70% of total capacity, equal to about 550,000 units per year. We assume production will reach 45% and 65% of total design capacity at the end of 2019 and 2020, respectively. According to the company, about 30% of its output from this plant are for exports.
- **Tiles contribution to stay flat and boost export sales**. We think that ceramic and granite tiles shall continue to contribute 64 - 67% of earnings. We note that tiles originating from China are becoming less competitive in terms of price and quality versus domestic ones, especially the ceramics and granites. However, Chinese tiles are more competing in high-end products that have refined designs and sophisticated production requirements. Meanwhile, Viglacera Tien Son reported better figures in 3Q after a structural change in management and attempt to improve production efficiency. We see this as a positive sign from restructuring efforts amidst the ongoing competition.
- **Teracotta production to be more concentrated as a result of eliminating low-value products**. Viglacera is going to fully divest from its six brick subsidiaries but will maintain stakes in Viglacera Ha Long (HNX: VHL) and Viglacera Dong Anh (UpCom: DAC). By doing that, the company will concentrate on high-value products. We therefore expect contribution from this segment to shrink to 12 – 15% in 2019 due to production cutdown.

We also noted the potential sale for Vinhomes's upcoming project - Vincity. The project encompasses 124 buildings in Hanoi and 71 in HCMC, with an estimated of 132,000 apartments. Vincity's positioning is aligned with Viglacera's building materials products such as middle and high grade tiles, sanitary wares and building glass. For ceramic and granite tiles, we think that Viglacera is capable of providing 20 - 30% of the project's demand. However, the profitability from Vincity cannot be attractive compared to the average level of 23%. Revenue from Vincity should be recognized from 2020 on.

In terms of real estate in FY2019, revenue shall come from the sale of social houses in Yen Phong & Tien Son industrial parks; houses for low-income employees in Kim Chung (a joint venture between VGC and Handico) and remaining low-rise products. Gross margin may fall to 23% as our assumption. We expect industrial parks to lease about 85 - 95 ha. The expansion of giant technology groups, accompanied with scalable FDI vendors from Japan, Korea and Taiwan is the driver. Furthermore, manufacturing relocation from China is expected to rise in 2019 due to the complexity of the US - China trade war. Thereby, northern industrial zones will continue to benefit from this trend in the short to medium term.

Rong Viet does not expect a more pessimistic scenario. On the other hand, we appreciate the company's restructuring efforts, including:

(1) Investing in high value products that requires complex production processes such as Low-e glass, ultra-white glass & sanitary wares;
(2) Cooperating with strategic partners to improve production technology and product quality;
(3) Cutting off inefficient operations.

We understand that the process will take time. The MoC's divestment plan to zero % in 2019 could be a driver for the company to carry out the agenda more aggressively. Current restructuring attempts can be the premise for strategic partners to engage in the coming time.

Valuation

We use sum-of-the-parts method to evaluate the stock. In which, we apply RNAV and EV/EBITDA of 6.3x to evaluate real estate and building materials segments, respectively. Our fair value arrives at **VND 21,021 value per share**, implying a **FY2018 P/E of 12.9x** and **a total stock return of 36%** as of closing price on November 13th, 2018.

Table 1: VGC valuation

Building Materials	EV/EBITDA	6,813
Industrial Parks	RNAV	2,236
Residentials	RNAV	375
Enterprise Value		**9,425**
Total outstanding shares		448
Value per share		**21,021**
Current market price		15,500
Total stock return		**36%**

Source: Rong Viet Securities

VND Billion

INCOME STATEMENT	FY2016	FY2017	FY2018F	FY2019F
Revenue	8,139	9,197	8,832	8,810
COGS	-6,160	-7,056	-6,829	-6,749
Gross profit	**1,979**	**2,141**	**2,003**	**2,062**
Selling Expense	-561	-562	-585	-576
G&A Expense	-550	-574	-425	-432
Finance Income	85	78	81	80
Finance Expense	-96	-125	-121	-114
Other profits	62	110	132	101
PBT	**769**	**914**	**938**	**996**
Prov. of Tax	-148	-192	-191	-199
Minority's Interest	-107	-122	-206	-178
PAT to Equity S/H	**514**	**600**	**541**	**619**
EBIT	868	1,005	1,017	1,074
EBITDA	1,302	1,459	1,539	1,665

%

FINANCIAL RATIO	FY2016	FY2017	FY2018F	FY2019F
Growth (%)				
Revenue	4	13	-4	0
Operating Income	15	12	5	8
EBITDA	18	16	1	6
PAT	56	17	-10	14
Total Assets	11	22	4	-2
Equity	32	58	2	3
Profitability (%)				
Gross margin	24	23	23	23
EBITDA margin	16	16	17	19
EBIT margin	11	11	12	12
Net margin	6	7	6	7
ROA	4	4	3	4
ROE	8	7	7	8
Efficiency				(times)
Receivable Turnover	6.4	7.3	6.7	6.6
Inventory Turnover	2.2	2.4	2.3	2.2
Payable Turnover	6.0	6.7	6.3	6.1
Liquidity				(times)
Current	2.5	2.9	2.6	2.4
Quick	1.1	1.7	1.4	1.1
Finance Structure (%)				
Total Debt/Equity	54	34	30	27
Current Debt/Equity	28	20	20	19
Long-term Debt/Equity	26	14	10	8

VND Billion

BALANCE SHEET	FY2016	FY2017	FY2018F	FY2019F
Cash and cash equivalents	1,054	2,166	1,356	961
Short-term investments	10	246	378	215
Accounts receivable	1,233	1,289	1,357	1,308
Inventories	2,949	2,896	3,043	2,992
Other current assets	146	183	153	161
Property, plant & equipment	6,874	8,042	9,036	9,285
Acquired intangible assets	0	0	0	0
Long-term investments	315	734	770	809
Other non-current assets	511	480	518	503
Total assets	**13,093**	**16,034**	**16,612**	**16,233**
Accounts payable	1,045	1,072	1,110	1,089
Short-term borrowings	1,122	1,266	1,272	1,220
Long-term borrowings	1,024	877	616	549
Other non-current liabilities	5,425	5,884	6,729	6,460
Bonus and Welfare fund	34	101	81	104
Technology-science, dev. fund	76	116	81	84
Total liabilities	**8,725**	**9,315**	**9,889**	**9,506**
Common stock and APIC	3,070	4,484	4,484	4,484
Treasury stock (enter as -)	0	0	0	0
Retained earnings	741	765	830	950
Other comprehensive income	50	794	799	804
Inv. and Dev. Fund	91	195	245	292
Total equity	**3,953**	**6,238**	**6,358**	**6,530**
Minority Interest	**414**	**482**	**688**	**866**

VALUATION RATIO (*)	FY2016	FY2017	FY2018F	FY2019F
EPS (dong)	1,673	1,339	1,207	1,381
P/E (x)	9.1	19.7	12.9	11.3
BV (dong)	12,875	13,913	14,180	14,564
P/B (x)	1.2	1.9	1.1	1.1
DPS (dong/cp)	950	950	950	950
Dividend yield (%)	6%	4%	6%	6%

VALUATION MODEL	Price	Weight	Average
Sum-of-the-parts	21,021	100%	21,021
Target price (VND)			**21,021**

VALUATION HISTORY	Price	Recommendation	Period
2017/07/12	30,000	Buy	Long term
2018/12/11	21,021	Buy	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	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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