VINACONTROL GROUP CORP (VNC-HNX)

Embrace the new wave of international commerce

- **Since 2014, profit has showed positive growth signal**
- **The main segment has faced difficult times from fierce competition**
- **Inspection authorized by State Organizations – a spark in long-term plan**
- **Breakthrough growth opportunity comes from service line expansion?**

Outlook:

VNC does business (operates) in inspection industry – a specific service associated with export-import activity. Thus, in the context of foreign trade improvement, especially when the trade agreement will be concluded early, the enterprise can record positive performance. Notably, VNC has currently provided services for all domestic goods traders, except the FDI traders.

Due to fierce competitive pressure in the main segment (providing certificate of inspection), boosting the supply of quality certificate authorized by State Management Organizations is considered as an appropriate strategy to deal with this issue. We concern about a risk that policy change related one-door customs clearance mechanism would impact its workload. However, it takes time for the policy to be implemented. According to RongViet Research, with the current business conditions, VNC will grow stably with the industry rate.

There are still opportunities for VNC to reach outstanding growth if it expands actively in the service chain. We expect the strategy partners after SCIC divestment will take this orientation as high feasibility of potential services. According to our best scenario built, foreign brands in similar industry should become partners. However, SCIC detailed divestment plan has not been announced.

*With relatively attractive cash dividend, long-term investors with value could consider this stock. If excluded the risk of low liquidation, we recommend **NEUTRAL** in **LONG-TERM** with target price of **VND 28,900***

Key financials

EoY (VND bn)	FY2013	FY2014	3M/2015	FY2015E	FY2016F
Net Revenue	297.7	363.5	249.9	425.3	474.2
% chg	13.9%	22.1%	14.0%	17.0%	11.5%
NPAT	15.9	24.7	18.4	28.0	31.2
% chg	-33.6%	55.8%	18%	13.4%	11.2%
EBIT margin (%)	5.3%	6.8%	7.4%	6.6%	6.6%
ROA (%)	7.2%	10.6%		10.8%	10.9%
ROE (%)	9.8%	14.9%		15.7%	16.2%
EPS (VND)	1,510	2,352		2,668	2,967
Adjusted EPS (VND)	1,510	2,352		2,668	2,967
Book value (VND)	15,368	16,231		17,534	18,823
Cash dividend (VND)	1,250	1,500		1,200	1,500
P/E (x)	7.5	7.9		9.8*	8.8*
P/BV (x)	0.7	1.1		1.5*	1.4*

*Source: VNC, RongViet Securities, * Market price@ 14/08/2015*

NEUTRAL

Market price (VND)	26,100
Target price (VND)	28,900
Investment period	LONG TERM

Stock Info

Sector	Support service
Market Cap (VND bn)	270.89
Current Shares O/S	10,499,560
Beta	0.15
Free float (%)	49.47
52 weeks High*	26,000
52 weeks Low*	14,500
Avg. Daily Volume (20 sessions)	15,289

Price peformance (%)

	3M	1Y	3Y
VNC	22.9	77.9	337.3
Support service	5.7	49.4	268.6
VN30 Index	3.9	-6.7	15.6
VNIndex	2.1	-0.5	16.4

Major Shareholders (%)*

SCIC	30.0
Barca Global Master Fund, L.P	10.5
Intereffekt Investment Funds N.V	4.96
Bui Duy Chinh	4.03
Foreigner investor room (%)	33.5

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VNC provides goods inspection and assessment business services

Goods inspection service is known as a key link in foreign trade activity. Through professional and technical measures, inspection companies will determine the actual goods' conditions (quality, specification, quantity, weight, packaging, safety, hygiene and value). Then, a certificate of inspection will be provided to the required parties. This is one of the necessary documents for international trade and customs clearance process.

Currently, VNC has focused on two main services: (1) inspection in import-export, domestic trade activities to provide certificate for delivery documents, (2) inspection at the requirements of the Authorized State Management Organizations. The service (2) was derived from the target of checking import goods quality according to technical barriers; specified in the Law on product and goods quality. However, ***certificate of quality*** is used only in the state management process, which is entirely a separate process from ***certificate of inspection.***

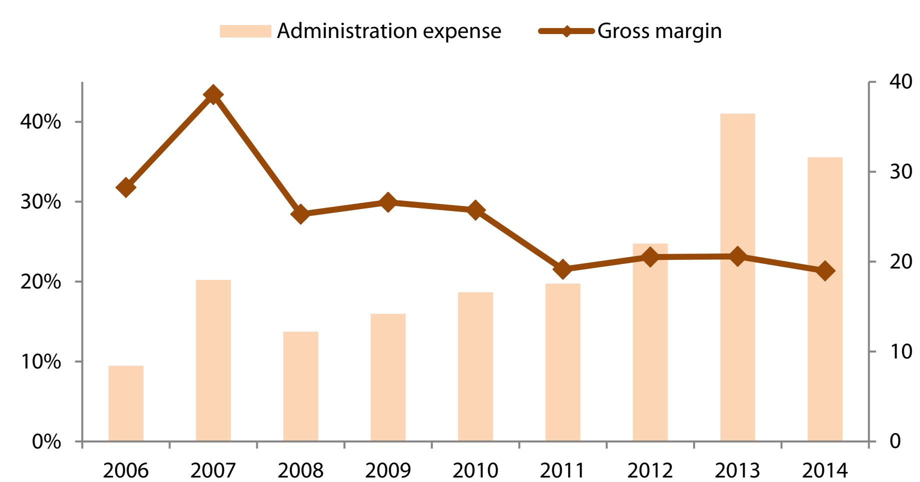
Because this service's platform and customer relationships based on prestige, brand reputation is a prerequisite for success. Being the first enterprise doing inspection business in Vietnam and having standard regulations, VNC has achieved large market share (~40%) with experienced and professional inspection team. VNC brand, thus, has gradually become more and more popular.

Since 2014, profit has showed positive growth signal, thanks to international trade improvement

It can be seen that, in years before 2010, VNC growth rate had hit impressive record when CARG of revenue and PAT respectively reached 40% and 50%. However, during the period of 2011-2013, the growth slumped, even negative growth in PAT. In terms of gross margin, the rate also significantly dropped from 33% (average of period 2006-2015) to 25%

According to VNC, the global economic recession has led to the domino effect; particularly, a sharp decrease in amount of trading goods has caused exporters and importers' bankrupt. The number of customers using inspection services, thus, has been affected. Thus, VNC had to share this difficulty with its customer through cost reduction, payment deadline expansion, as a result, there were bad debts due to customers 'losing payment ability. During 2013, VNC actively provisioned for them. Thus, management cost increased by 64% yoy

Figure: Gross margin and admistration expense in 2006-2014



Source: VNC

Since early 2014, with recovery of economy and foreign trade, VNC has returned to growth track. 2014 revenue and PAT significantly increased, respectively by 22% and 55% yoy. As mentioned above, in 2013, VNC provisioned bad debt (~ VND 7 billion). If excluding this provision, 2014 PAT actually increased by 16% yoy instead of the figure 55%.

We recognized that optimistic change in PAT was mainly based on revenue when gross margin did not show any improvement. In the future, the trend would continue as cost of sales will increase the remaining market share in tough competition situation. Net profit margin, therefore, will only recover with slow speed and be hard to come back to the level during previous golden age.

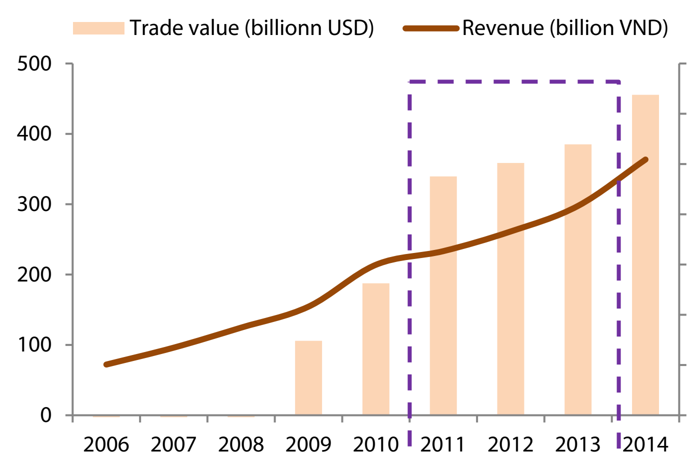
With positive 6.52% forecasted growth of export-import goods (as BMI) in 2015-2019 thanks to of the conclusion of several free trade agreements, we expect that the inspection industry, namely VNC, will get benefit.

The main segment has faced difficult times from fierce competition

Providing certificate of inspection is a key business of inspection industry companies. At the moment, the market divides into 2 segments: domestic import-export corporations and FDI ones. In particular, FDI segment has accounted for ~70% total trade turnover; the remaining is for domestic sector. National inspection companies have competed in small domestic "pie" (only 30%). In FDI segment, foreign inspectors have predominated. The reasons are (1) foreign brands have branches in many nations to take advantage of solving claims, (2) inspection activity in Vietnam is just one of steps in risk and quality management contracts signed between foreign inspectors and multinational corporations

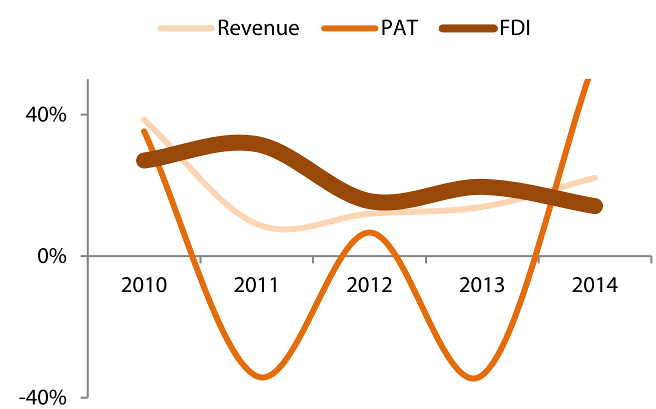
The fact is close to VNC data when VNC revenue shift has been similar to growth of domestic trade turnover. Conversely, there is no such correlation in the FDI segment. It means that VNC has less or even not participated in FDI goods inspection field

Figure: Revenue and trade turnover in domestic sector



Source: GSO

Figure: Growth of revenue, PAT and and trade turnover in FDI sector

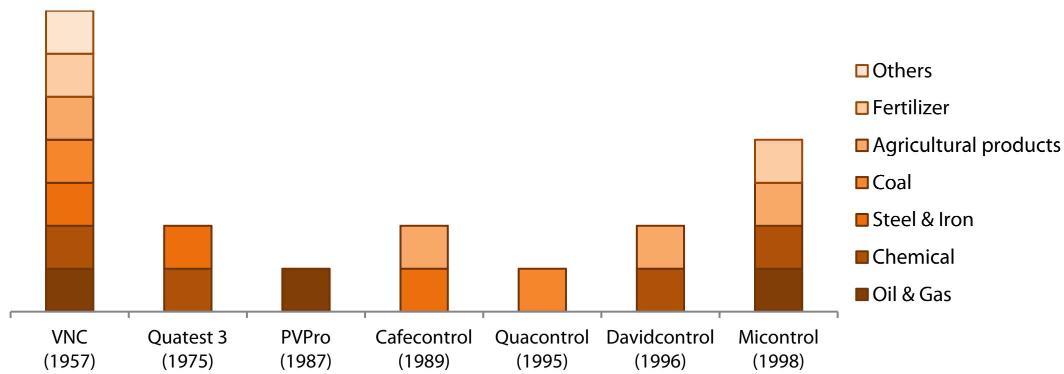


Source: GSO

In terms of trade relationship, foreign importers often play a role of choosing inspectors and tend to select foreign ones to reduce risks, especially in the first contracts with Vietnamese partners. Thus, it is unavoidable that they have expanded in domestic segment. In our observation, rise of foreign firms such as SGS, Bureau Veritas (BV), has gradually taken the market share in sectors which VNC has previous had advantages i, such as rice, crude oil and consumer goods. Therefore, foreign factor has been a major concern for VNC.

Additionally, we also noticed a tendency of Ministries Associations establishing their own inspection companies to serve managed products in order to cut costs and accelerate process time. There are more popular firms as: Quatest 3 (Ministry of Science and Technology), Café control (Ministry of Agricultural and Rural Development)

Figure: Year established and main goods inspection of key local companies



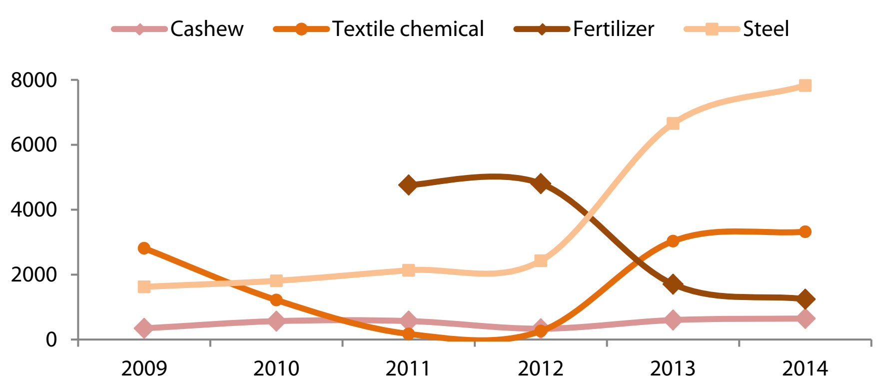
Source: RongViet Reseach

VNC is in under competitive pressure from national and foreign rivals. This is a common trend when the market share battles have become tougher in every field. However, under the provided information from VND, we believe that VNC "certificate of inspection" segment could maintain market share and grow with a speed, equivalent to international trade growth in national sector.

Inspection authorized by State Organizations – a spark in long-term plan.

Acknowledging the competitive pressure in "certificate of inspection" segment, VNC has actively promoted the service which is authorized by State Management Organizations to check imported goods quality and technical requirement. According to VNC, the revenue proportion increased from 5% in the previous to 20% (2014) with 4 main products: cashew, fertilizer, textile chemical and steel.

Figure: Import value of cashew, textile chemical, fertilizer, steel (million USD)



Source: GSO

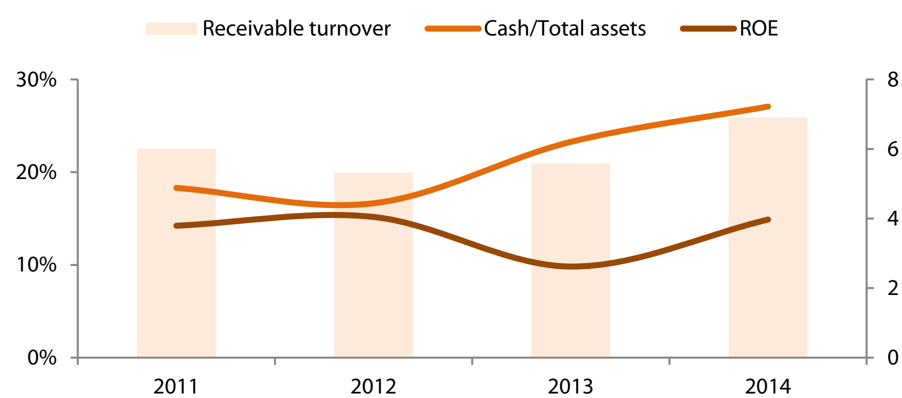
There can be a significant growth opportunity in this service thanks to signing of several free trade agreements. As Vietnamese production did not catch up with the world, so the trade liberalization will go hand in hand with Government policies to support domestic manufacture. Thus, there can be a strong increase in technical barriers to protect national producers in certain period of times; consequently, raising the amount of requirement orders relating to import goods quality inspection. We assessed that this service expansion is an appropriate orientation when VNC can take advantage of the leading position with large capacity and modern technology in the playground of only internal inspectors.

In spite of optimistic outlook, we also considered some of following concerns: (1) foreign firms are applying for license of joining this segment, therefore raising competition; (2) this segment depends entirely on State management organizations according to one-door customs clearance mechanism (draft). Accordingly, State organizations will receive orders from corporations, and then deliver to inspectors. While in the past, requesters and inspectors directly settled deals. In this mechanism, the advantage of long-term relationship with importers almost is out of effectiveness. Nevertheless, it takes time for this mechanism to come into force when draft is only in phase of receiving comment from Ministries. Besides, with prestige and high capacity, VNC still can get a large number of contributed requirements in advantaged fields

Breakthrough growth opportunity comes from service line expansion?

VNC has currently done business with good financial indicators. The ratio of cash remains 20% while turnover of inventory and receivable account are quite high. Especially, the debt proportion in recent years has equaled to ~ 0%. Additionally, after operating the steel examination laborary (worth VND 3 billion), there are no large published investments, if excluding some office constructions. However, compared with cash and cash equivalent amount of ~VND 52 billion, these investments do not raise concerns. Thus, financial indicator will keep on positive track. On the other hand, non-using debt makes VNC not benefit from current low interest rate as well as support ROE improvement.

Figure: VNC financial ratios in 2011–2014.



Source: GSO

In accordance with our research, foreign inspectors in Vietnam provide many services that VNC has not yet supplied such as certification of international standards, risk management, looking for goods standardized supplies,… Hence, if VNC decide to do the service of providing certificate including ISO, Global Gap, it would benefit the Company. The reason is that in the integration context, manufacturing enterprises, farms have to meet international standards of ISO, Global Gap to enhance competitiveness to easily penetrate in developed countries, so increasing this service demand. Additional, due to non-long validation of certificates will lead re-assessment demand. Thus potential growth of the business is quite large. Obviously, there is a chance for VNC to boost performance, but wheather the enterprise will implement this strategy, which will depend on the dynamism and dertermination of BOM.

Another expected highlight is the SCIC divestment. Currently, SCIC has owned 30% of total shares and planned to withdraw in this year. According to RongViet Research, VNC will benefit from change in major shareholder if partner in the deal is a foreign inspection firm. In this case, VNC will have chance to become a link in risk and quality management contracts between multinational corporations and parent inspection companies; thus, taking part in FDI segment. Moreover, VNC will transferr the license of providing certificate of quality to ISO, Global Gap,… as well as other services from parent firm to solve the significant growth issue. Therefore, as our opinion, this scenario will bring positive transformation for VNC in the future. However, detailed divestment plan has currently not been announced.

Outlook

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Unit: billion VND

INCOME STATEMENT	FY2013	FY2014	FY2015F	FY2016F
Revenue	297.7	363.5	425.3	474.2
COGS	228.8	285.9	334.7	373.2
Gross profit	**68.9**	**77.6**	**90.6**	**101.0**
Selling Expense	14.2	17.3	21.0	22.8
G&A Expense	36.5	31.6	37.6	42.7
Finance Income	3.1	3.0	3.3	3.6
Finance Expense	0.0	0.1	0.2	0.2
Other profits	0.4	0.3	0.4	0.4
PBT	**21.8**	**32.0**	**35.7**	**39.6**
Prov. of Tax	5.7	7.0	7.7	8.4
Minority's Interest	0.3	0.3	0.0	0.0
NPAT	**15.9**	**24.7**	**28.0**	**31.2**
EBIT	**21.8**	**32.1**	**35.7**	**39.6**
EBITDA	29.3	32.1	45.4	50.2

Unit:%

FINANCIAL RATIO	FY2013	FY2014	FY2015F	FY2016F
Growth				
Revenue	13.9	22.1	17.0	11.5
Operating Income	-22.4	56.8	11.7	11.2
EBITDA	4.0	9.3	41.6	10.7
EBIT	-22.6	46.7	11.4	11.0
PAT	-33.6	55.8	13.4	11.2
Total Assets	1.9	11.1	12.0	8.1
Equity	0.0	5.6	8.8	7.4
Internal growth rate	0.1	7.0	8.7	8.0
Profitability				
Gross profit/Revenue	23.2	21.3	21.3	21.3
Operating profit/ Revenue	6.1	7.9	7.5	7.5
EBITDA/ Revenue	9.9	8.8	10.7	10.6
EBITDA/ Revenue	7.3	8.8	8.4	8.4
Net margin	5.3	6.8	6.6	6.6
ROAA	7.2	10.6	10.8	10.9
ROIC or RONA	13.4	19.0	19.8	20.3
ROAE	9.8	14.9	15.7	16.2
Efficiency (x)				
Receivable Turnover	5.6	6.9	7.2	7.0
Inventory Turnover	35.3	73.9	69.5	68.0
Payable Turnover	4.1	4.4	4.2	4.1
Liquidity (x)				
Current	2.1	2.0	1.9	1.9
Quick	2.1	1.9	1.8	1.8
Solvency				
Total Debt/Equity	35.5	42.9	47.0	48.0
Current Debt/Equity	0.0	0.2	0.5	0.5
Long-term Debt/ Equity	0.0	0.3	0.3	0.3

Unit: billion VND

BALANCE SHEET	FY2013	FY2014	FY2015F	FY2016F
Cash and equivalents	51	66	75	79
Short-term investment	4	8	9	10
Receivables	51	54	64	71
Inventories	3	4	5	6
Other current assets	11	10	11	12
Total Current Asset	**121**	**142**	**164**	**178**
Tangible Fixed Assets	74	77	80	81
Intangible Fixed Assets	15	16	19	22
Construction in Progress	2	2	3	6
Investment Property	0	0	0	0
Long-term Invest ment	5	4	4	4
Other long-term assets	5	5	5	6
Goodwill	0	0	0	0
Long-term Asset	**100**	**103**	**110**	**119**
Total Asset	**221**	**245**	**275**	**297**
Payables	13	17	20	23
Other current liabilities	44	55	66	71
Current Debt	0	0	1	1
Long-term Debt	0	0	0	1
Other long-term liabilities	1	0	0	0
Total Liability	**57**	**73**	**87**	**96**
Owner's Equity	**161**	**170**	**184**	**198**
Capital	105	105	105	105
Retained Earnings	9	18	30	40
Funds & Reverses	47	47	49	52
Others	**0**	**0**	**1**	**2**
Total Equity	**161**	**170**	**186**	**199**
Minority's Interest	2	2	2	2
TOTAL RESOURCES	**220**	**245**	**275**	**297**

CASHFLOWSTATEMENT	FY2013	FY2014	FY2015F	FY2016F
Pretax Income	21.8	32.0	35.7	39.6
-Depreciation	7.5	9.2	9.7	10.6
-Adjustments	*4.4*	*-0.7*	*0.0*	*0.0*
+/- Working capital	2.9	-0.8	-6.7	-10.7
Net Operating CF	**36.6**	**39.7**	**38.6**	**39.4**
+/- Fixed Asset	-11.6	-13.0	-16.2	-18.1
+/- Deposit, equity investment	0.1	-0.6	3.7	0.0
Interest, cash dividend, shared profits received	2.0	1.4	0.0	0.0
Net Investing CF	**-9.6**	**-12.3**	**-12.6**	**-18.1**
+/- Capital	0.6	0.0	0.0	0.0
+/- Debt	0.0	0.7	0.6	0.1
Dividend paid + Other exp. from retained profits	-12.5	-13.0	-17.9	-17.6
Net Financing CF	**-11.9**	**-12.2**	**-17.3**	**-17.5**
+/- cash & equivalents	15.2	15.2	8.7	3.9
Beginning cash & equivalents	**36.0**	**51.2**	**66.5**	**75.2**
Impact of exchange rate	0.0	0.0	0.0	0.0
Ending cash & equivalents	**51.2**	**66.5**	**75.2**	**79.0**

COMPANY REPORT

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 which 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 / 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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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

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