Thanh Cong Textile Garment Invt. Trading JSC (HSX – TCM)

Benefits from the Rebound in Textile Demand

Particulars (VND bn)	Q4-FY16	Q3-FY16	+/-qoq	Q4-FY15	+/-yoy
Net Revenues	763	790	-3%	648	18%
Profit after tax	25	40	-37%	22	14%
EBIT	59	57	4%	36	63%
EBIT margin	7.7%	7.2%	59bps	5.6%	214bps

Source: TCM, RongViet Research

- *Yarn segment: Gross margin improves on the back of restructuring*
- *Garment segment: TCM will benefit from the rebound in textile demand and the improvement in Vinh Long factory's performance*
- *Fabric segment: Productivity is increasing*

Outlook and Valuation:

TCM's poor performance during 2015-2016 resulted from challenges that Vietnam's textile industry faced, as well as certain internal challenges. The demand for yarn fell and the demand for textile products also witnessed a slowdown. Furthermore, Vinh Long factory has not been operating at full capacity, operating at a loss of VND50 billion during 2016.

TCM has made significant efforts to restructure its business, which includes the following: (1) increasing the ratio of yarn used for internal manufacturing and liquidating some of its yarn machines, (2) raising its fabric capacity from 7 million meters to 10 million meters and (3) researching new kinds of yarn and fabric that will allow it to achieve a higher gross margin. These efforts, along with the rebound in textile demand, especially in the US market, could improve TCM's business results this year.

We estimate that TCM's reasonable price is VND25,300 per share. Therefore, we recommend investors to ACCUMULATE the stock in the LONG-TERM. The valuation is higher than our recommendation in our 2017 Strategy Report by 13% due to the important adjustments in TCM's welfare and bonus fund.

Key financials

Y/E Dec (VND bn)	FY2015	FY2016	FY2017F	FY2018F
Net Revenue	2,792	3,071	3,206	3,325
% growth rate	9	10	4.4	3.7
PAT	154	114	178	191
% growth rate	-9	-25.6	55.5	7.3
EBIT margin (%)	5.5	3.7	5.5	5.7
ROA (%)	6.7	4.3	6.3	6.7
ROE (%)	18.1	12.7	15.1	14.7
EPS (VND)	2,189	2,095	3,071	3,100
Adjusted EPS (VND)	3,127	2,328	3,071	3,100
Book value (VND)	18,109	18,499	20,576	22,682
Cash dividend (VND)	1,000	500	1,000	1,000
P/E (x)	13.4	6.9		
P/BV (x)	1.6	0.8		

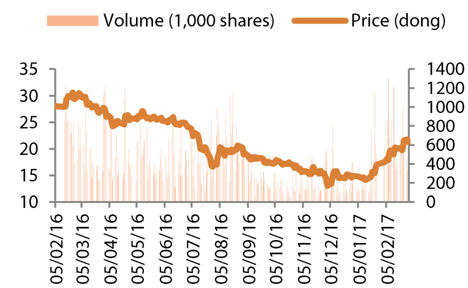
*Sources: TCM, RongViet Research estimated. * Accounted for welfare provision expense and computed based on total share number on 03 April, 2017.*

ACCUMULATE

CMP (VND)	21,750
Target Price (VND)	25,300
Investment Period	**Long-term**

Stock Info

Sector	Personal Goods
Market Cap (VND bn)	1,068
Current Shares O/S	49,099,051
Beta	0.84
Free float (%)	50
52 week High	30,610
52 week Low	13,050
Avg. Daily Volume (in 20 sessions)	605



Source: Bloomberg

Performance (%)

	3M	1Y	3Y
TCM	48	-19	-13
VN30 Index	10	23	5
VN Index	7	29	23

Major Shareholders (%)

Eland	43.3
Foreigner Investor Room (%)	0.0

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Table 1: 4Q16 TCM's Operating Result

Particulars (VND bn)	Q4-FY16	Q3-FY16	+/-(qoq)	Q4-FY15	+/-(yoy)	FY2016	+/-(yoy)
Net revenue	763	790	-3.4%	648	17.8%	3,070	10%
Gross profit	117	117	0.0%	92	27.6%	419	-2%
SG&A	58	60	-4.2%	55	4.4%	240	16%
Operating profit	59	57	4.5%	36	62.8%	179	-13%
EBITDA	83	79	5.5%	55	50.7%	265	-8%
EBIT	59	57	4.5%	36	62.8%	179	-19%
Financial expense	28	16	73.6%	23	23.1%	68	-22%
Interest expense	11	9	19.5%	8	28.8%	38	38%
D&A	24	22	8.0%	19	27.5%	86	25%
Nonrecurring items (*)							
Extraordinary items (*)							
PBT	30	47	-36.3%	23	28.0%	133	-26%
PAT	**25**	**40**	**-37.4%**	**22**	**14.4%**	**114**	**-20%**
(*) Adjusted PAT	25	40	-37.4%	22	14.4%	114	

Source: TCM

Table 2: 4Q16 Operating Results

Particulars	Q4-FY16	Q3-FY16	*+/-(qoq)*	Q4-FY15	*+/-(yoy)*
Profitability (%)					
Gross margin	15.3%	14.8%	0.5%	14.1%	1.2%
EBITDA margin	10.9%	10.0%	0.9%	8.5%	2.4%
EBIT margin	7.7%	7.2%	0.6%	5.6%	2.1%
Net margin	3.3%	5.0%	-1.8%	3.4%	-0.1%
Adjusted net margin	3.3%	5.0%	-1.8%	3.4%	-0.1%
Turnover* (x)					
-Inventories	4	4	-0.4	3	0.6
-Receivables	9.1	12.0	-2.9	10.2	-1.1
-Payables	6	7	-1.2	6	0.4
Leverage (%)					
Total Debt/Equity	**160.3%**	**136.8%**	**23.5%**	**137.5%**	**22.9%**

Source: TCM, (*) annualized

Positive Operating Results in 4Q16 Could Not Improve its Final Results

In the fourth quarter of 2016, TCM's net revenue and PAT was VND763 billion (+17% YoY) and VND25 billion (+14% YoY). Notably, TCM's gross margin improved significantly, from 11.9% (1Q16) to 15.3% (4Q16), which was close to its gross margin in 2015. We believe that the amelioration of Vinh Long factory's performance and the increase in the capacity of its fabric segment were the main sources of this improvement.

During 2016, TCM recorded revenue of VND3,070 billion (+10% YoY), while the company's profit after tax fell by 26% YoY due to its disappointing bottom-line in the third quarter.

We expect that TCM's business results in 2017 will be more favorable

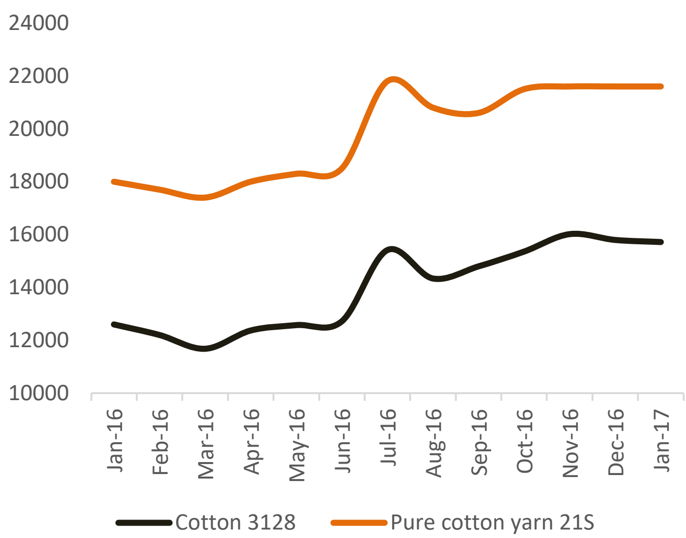
Yarn Segment: Gross Margin Could Benefit from Restructuring

The company's yarn segment accounts for 25-30% of its revenue, and was considered an advantageous point for the company in the event that the TPP was ratified. At the moment, this segment is less positioned to benefit due to the uncertainty of TPP, and the fluctuation of this segment's margins is also a risk for the company.

In the first half of 2016, cotton prices remained low leading to a slowdown in TCM's yarn orders, as customers waited for lower prices. The company's No. 1 yarn factory's inefficient activities also made the segment's performance worse, as the gross margin remained at a negative level (-5%). Since the second half of 2016, there were more positive signals in the prices of cotton and yarn. Furthermore, TCM increased its internal yarn use proportion, which led to a rebound of 3%-4% in the gross margin of its yarn segment. However, this increase in its gross margin just helped TCM to reach the break-even point.

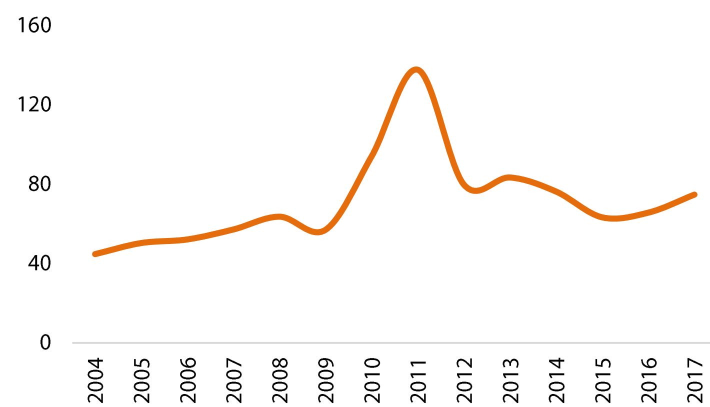
The fall in yarn demand was a notable challenge for most yarn producers, as other producers including STK and FTM also witnessed a decrease in profit margins during 2016.

Figure 1: Cotton and cotton prices on China market (CNY/ton)



Source: VCOSA

Figure 2: Cotton prices (USD/pound)



Source: Bloomberg

Recently, we observed that TCM made considerable efforts to restructure its yarn segment in order to reduce risks. TCM liquidated some polyester yarn producing machines in its No.1 yarn factory that were not operating efficiently. The liquidation will not significantly affect TCM's supply capacity because yarn manufacturing from the factory accounts for a small proportion of its operations (only 2% of total yarn revenue). The company's No. 2 yarn factory (Tan Phu District, HCMC) has the ability to produce fabrics that have higher margins. Moreover, TCM raised the proportion of internally used yarn from 10% in 2014 to 30%-35% in 2016, and this could rise to 40% by 2017. In the long term, TCM plans to research techniques to produce high-quality yarn with high profit margins, and to seek new customers for these products. Based on the preparation that TCM has went through for this segment during 2016, we believe that the yarn segment will no longer be "a drag" for TCM in 2017, assuming that there is not a significant change in cotton and cotton yarn prices.

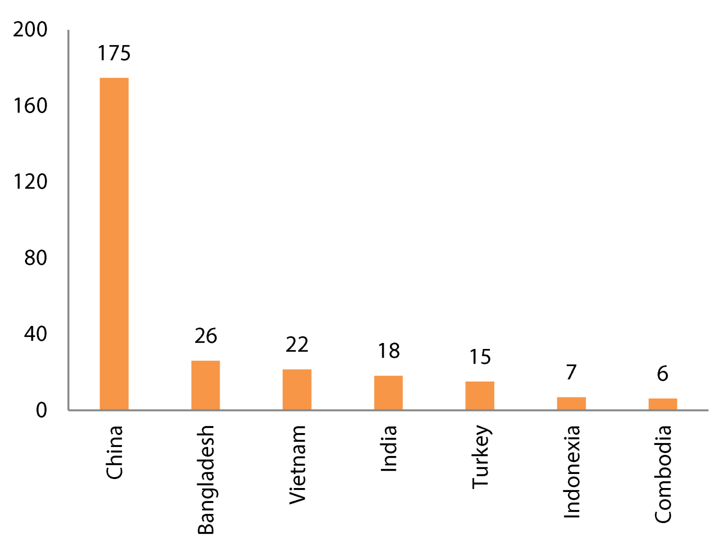
Garment Segment: The rebound in textile demand and the improvement of Vinh Long factory's performance could ameliorate the segment's profitability

In 2016, the garment segment continued to play an important role for the company, having the highest gross margin out of all segments, and accounting for 65% of its revenue. However, the segment's gross margin reduced from ~22% in 2015 to 18-20% in 2016. There were three main difficulties that TCM had to face in 2016 including (1) competitive pressure on its selling price, (2) the slowdown in the growth of its orders and (3) Vinh Long factory's inefficient performance.

Specifically, the competition from other markets such as Myanmar, Cambodia, and Bangladesh has become more intense, as the TPP has become a story of the past. Similar to Cambodia, Myanmar benefits from GSP preferences in the US and the EU, both of which are the main markets for Vietnam's textile industry. Although Bangladesh was not included in the US's GSP preferences, the risk of orders shifting from Vietnam to these countries is still high, because Bangladesh has huge advantages due to its comparatively lower labor costs.

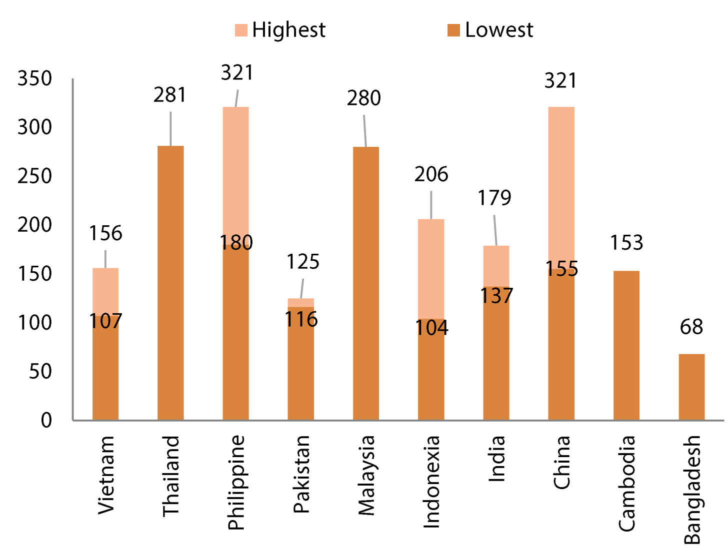
The slowdown in textile demand was troublesome for Vietnam's textile industry. In 2016, the fall in market demand from China (-1.7%) caused the value of orders from Eland to decrease by 2% (~VND20 billion) YoY. However, the revenue from its garment segment still recorded a positive growth rate of 10.4% YoY due to more orders from the US market. The main issue for the company is that the gross margin from US orders is not very attractive, as compared to Eland (~22-25%). In 2017, we hold the view that the recovery in the US's economy will support textile demand from the market. The IMF forecasted that the US economy will grow by 2.3% in 2017. Moreover, Euler Hermes forecasted that the demand for textile products from the US and China markets could rebound, leading to a 0.5% and 1.5% increase in prices, during 2017 and 2018, respectively.

Figure 3: Largest Textile Exporters (2015)



Source: WTO, RongViet Research

Figure 4: Minimum Wages for Textile Exporters (USD/month)



Source: ShengLu, BDG Asia, Rong Viet Research

TCM also faced problems regarding Vinh Long factory's productivity, which has still not reached a breakeven point. In the first half of 2016, the factory's loss was USD~200,000/month. By the 4th quarter of 2016, the numbers reduced to between USD70,000 and USD80,000/month. As a result, the total loss from Vinh Long factory in 2016 was roughly VND50 billion.

According to TCM, Vinh Long factory's productivity is currently $28/worker/day, which is quite close to the break-even point of $30/worker/day. In the event that Vinh Long factory operates at full capacity, TCM could reduce the number of orders outsourced to other companies (which is 3 million products per year) at higher costs. In the first 2 months of 2017, the improvement in Vinh Long factory's performance was the main contributor to the increase in its GPM (by ~3 percentage points). We expect that Vinh Long factory will not record a loss in 2017, which will further improve the company's margins.

Fabric segment: Hope from the increase in capacity

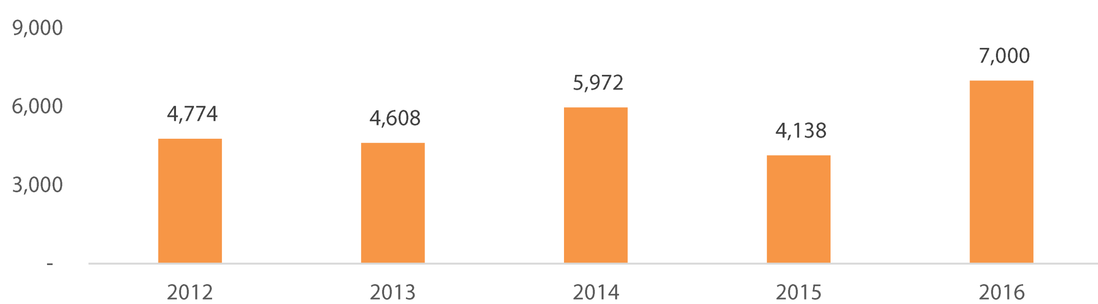
TCM produces two kinds of fabric, woven fabric and knitting fabric, with a total capacity of 10 million meters per year and 7,000 tons per year. The company's knitting fabric accounts for 90% of its fabric materials for its garment manufacturing segment. The woven fabric is exported to Japan.

Since 2014, TCM's focus on high quality woven fabric has created a huge turning point for the segment. Although customers from Japan have strict requirements in terms of product quality, they offer an attractive gross margin of ~16-18%. The main issue at the moment is that these products make a small contribution to the company's overall results, accounting for ~8% of total revenue.

At the end of 2016, TCM increased its woven fabric capacity from 7 million meters to 10 million meters per year, in order to effectively expand to Japan. Therefore, we estimate that the revenue from its fabric segment could contribute around USD14.3 million to its total revenue. Currently, TCM is considering expanding the segment's capacity by making its No. 2 yarn factory change its function to focus on producing fabric, similar to the 2nd phase of VInh Long Factory.

TCM also plans to raise the efficiency of its knitting fabric. TCM is cooperating with Korea Textile Inspection and Testing Institute to develop new knitting items with special features including keeping warm and smart water absorption. The company also established its Knitting Fabric Sales Division in December of 2016, which aims at improving the commercialization of these new products. We forecast that TCM will face difficulties in finding customers for new items in the initial stages, and will consequently only use new items for orders from Eland. In the long term, we expect that these activities will improve the company's GPM.

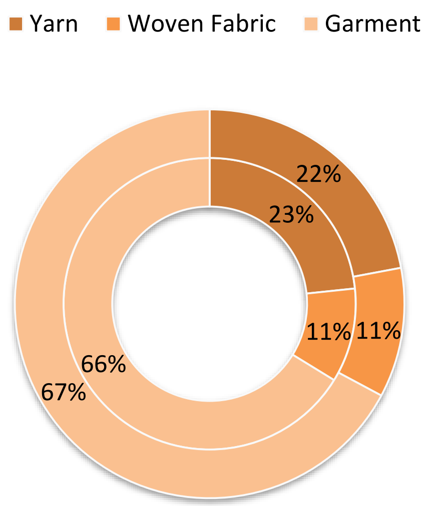
Figure 5: TCM's Woven Fabric Production (1,000 meters)



Source: TCM, RongViet Research

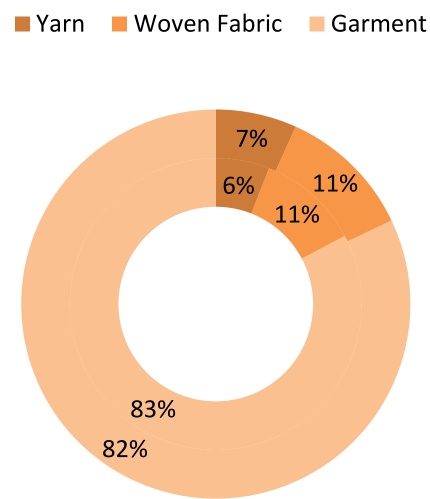
Overall, we forecast that the yarn segment will no longer record a loss and that the fabric segment will be the largest contributor to TCM's revenue (~10%). This trend could remain for several years, as TCM raises the yarn proportion for internal using and invests more in fabric making machines. The garment segment will still be the most important segment for TCM. However, we expect that the segment's revenue growth will only be between 4% and 5% due to high levels of competition experienced from other competitors.

Figure 6: Forecasted Revenues by Segment



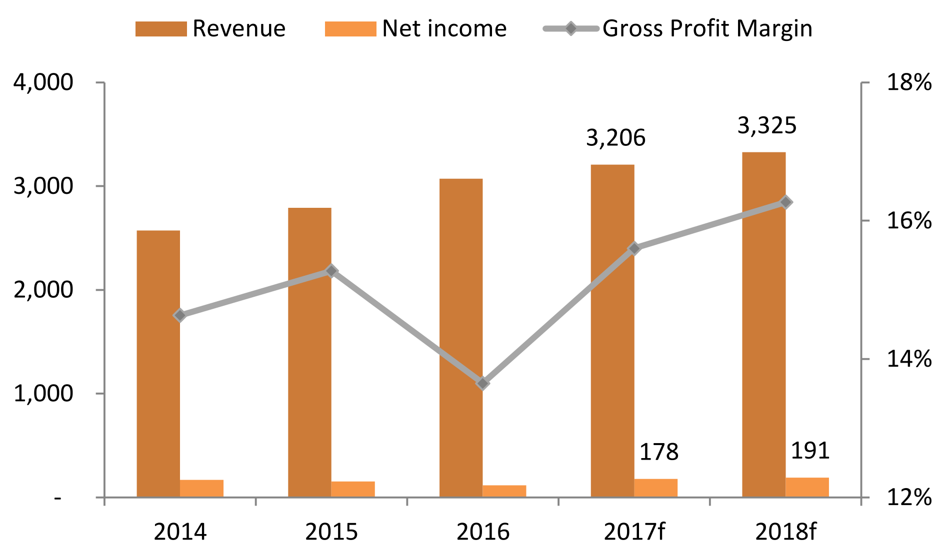
Source: TCM, RongViet Research,
Inner circle is 2017, outside circle is 2018

Figure 7: Forecasted Gross Profit by Segment



Source: TCM, RongViet Research,
Inner circle is 2017, outside circle is 2018

Figure 8: TCM Forecasted Revenue and PAT



Source: TCM, RongViet Research

Outlook and Valuation

TCM's poor performance during 2015-2016 resulted from challenges that Vietnam's textile industry faced, as well as certain internal challenges. The demand for yarn fell and the demand for textile products also witnessed a slowdown. Furthermore, Vinh Long factory has not been operating at full capacity, operating at a loss of VND50 billion during 2016.

TCM has made significant efforts to restructure its business, which includes the following: (1) increasing the ratio of yarn using for internal manufacturing and liquidating some of its yarn machines, (2) raising its fabric capacity from 7 million meters to 10 million meters and (3) researching new kinds of yarn and fabric that will allow it to achieve a higher gross margin. These efforts, along with the rebound in textile demand, especially in the US market, could improve TCM's business results in 2017. We expect that the company's yarn segment will record no loss, while its fabric and garment segment's gross margin will increase by 39% and 12%.

We estimate that TCM's reasonable price is VND25,300 per share. Therefore, we recommend investors to ACCUMULATE the stock in the LONG-TERM. The valuation is higher than our recommendation in our 2017 Strategy Report by 13% due to the important adjustments in TCM's welfare and bonus fund.

Table 3: TCM's Valuation

Method	Price	Proportion	Result
FCFF	25,061	50%	12,530
PE	25,490	50%	12,745
Summary		**100%**	**25,275**

Source: RongViet Research

APPENDIX: CONSIDERATION OF EFFECTS OF FTAS, BORDER-TAX POLICY AND INCREASED FOREIGN ROOM ON TCM'S BUSINESS

Future Impacts of FTAs on TCM's Operations are not Obvious

Regional Comprehensive Economic Partnership (RCEP) is in negotiation between ASEAN countries and China, Korea, Japan, India, Australia and New Zealand, and could be a positive catalyst for Vietnam's textile industry. However, the benefits for TCM are not clear at the moment.

TCM imports cotton materials mainly from the US and Brazil, and high quality yarn from Indonesia and Thailand. China and Korea are the largest customers for its yarn segment; the US, Korea, Japan and the EU are the main customers for its garment segment and Japan is its largest market for woven fabric. Therefore, many of TCM's transactions take place in RCEP countries.

However, the effect of RCEP on TCM in the event that RCEP is not ratified is not obvious, consider that RCEP is a combination of other FTAs signed with other countries such as Japan, Korea, China, and other ASEAN countries.

EU – Vietnam Free Trade Agreement (EV-FTA) has also been drawing investor's attention, since the tariffs for Vietnam's textile products will be reduced from 8-12% to 0% and TCM fully meets the rule of origin for this FTA. However, the EU market currently accounts for only 10% to 15% of TCM's total revenue, so the impact of EVFTA in the short term is not clear. Furthermore, EV-FTA could bring more investors to invest in the fabric segment, which can help domestic manufacturers access cheap fabric sources. We doubt that domestic companies can take full advantage of cheap materials to reduce processing prices. This will allow it to compete with Cambodia, Bangladesh or Myanmar. TCM will not benefit from the cheap fabric sources because TCM produces almost 90% of its fabric material, and the price competition could be harmful for TCM's gross margin.

In the case that the US does not participate in **Trans-Pacific Partnership (TPP),** TCM's performance will not improve significantly because only the US and Japan, among all TPP countries, are TCM's largest customers and because Vietnam signed VJEPA with Japan.

The US's border tax policy could accelerate the speed of orders shifting from Vietnam to other countries having lower manufacturing costs.

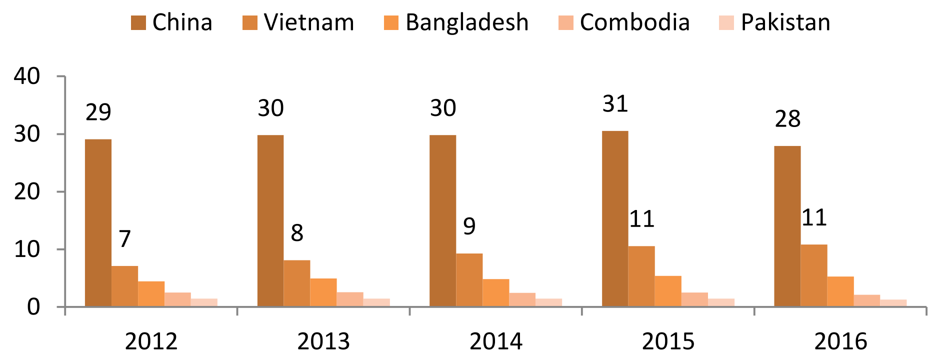
The US market could be a source of concern for TCM in the case that the border tax policy comes into effect and items exported to the market will suffer a tariff of 20%. We believe there are 3 scenarios that could happen:

Scenario 1: TCM's customers in the US will shift their orders to domestic manufacturers. However, this sector is very labor intensive in nature, and Vietnam's comparatively lower wages further makes this scenario nearly impossible. The minimum wages of a US worker is around \$7.2/hour, while the number is \$0.8/hour for Vietnam, \$1.7/hour for China, \$0.8/hour for India and \$0.4/hour for Bangladesh. It is very unlikely that a 20% tariff would result in this shift taking place.

Scenario 2: TCM's customers in the US will transfer the tariff burden to US consumers. In the short term, consumers may negatively react by reducing the amount of imported textile products purchased. However, the tax policy could benefit the US economy and consequently promote the consumption of essential products, including textiles.

Scenario 3: TCM's customers will seek manufacturers from other countries having lower production costs. Vietnam has some advantages compared to its rivals including China (Vietnam manufacturers have lower production costs), Bangladesh (Bangladesh focuses on the EU market, while the US is the largest market for Vietnam), Cambodia and Pakistan (Vietnam has larger capacity to process garment than both of these countries). However, the tax policy could accelerate the movement of orders to these countries, which have lower costs. Therefore, we believe that this is the main source of concern in the case the tax-border policy is ratified.

Figure 7: Largest Textile Exporters to The US Market (billion USD)



Source: OTEXA, RongViet Research

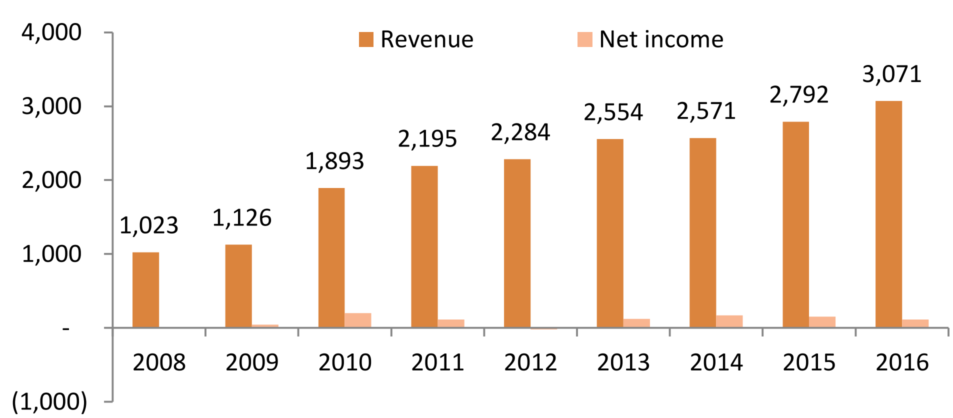
The impact of increased foreign room on TCM's stock price depends mostly on Eland's strategy

On April 7th, 2017, TCM submitted its plant to raise room for foreign investors from 49% to 70% in 2017 and to raise this further in the near future. TCM transferred activities to TCM's subsidiaries including retail and real estate that prevent TCM from loosening its room. We believe that TCM will not face any difficulties in this plan.

Since 2009, TCM's operating results have improved considerably after the participation of Eland. TCM's CAGR was 15%/year during the period of 2008-2016. TCM's PAT also witnessed a strong increase in the first 2 years with Eland (~VND3 billion in 2008 to VND200 billion in 2010). Therefore, it is reasonable for investors to hope for positive results due to the increasing of foreign room for this company.

Considering the high level of competitiveness, we forecast that Eland may shift a part of its orders to countries having lower costs and, consequently, TCM's role can be weakened. Besides, the fact that TCM could be treated as an FDI company may also make Eland reconsider. Based on these concerns, we expect that Eland will not raise its ownership to above 50%.

Figure 8: TCM's Revenue and Profit After Tax During 2008-2016 (VND billion)



Source: TCM, RongViet Research

VND Billion

INCOME STATEMENT	**2014**	**2015**	**2016F**	**2017F**
Revenue	2,792	3,071	3,206	3,325
COGS	2,365	2,652	2,706	2,784
Gross profit	426	419	500	541
Selling Expense	86	97	101	106
G&A Expense	121	144	144	150
Finance Income	24	26	2	2
Finance Expense	87	68	56	53
Other profits	5	-6	3	3
PBT	5	3	3	3
Prov. of Tax	167	133	207	239
Minority's Interest	13	18	28	48
PAT to Equity Shareholder	0	1	1	1
EBIT	154	114	178	191
EBITDA	219	179	255	285

FINANCIAL RATIO	**2014**	**2015**	**2016F**	**2017F**
Growth				
Revenue	8.6	10.0	4.4	3.7
Operating Income	9.3	-8.2	29.0	10.9
EBITDA	6.8	-18.6	42.7	11.8
EBIT	-8.8	-25.6	55.5	7.3
PAT	29.5	12.4	1.4	-1.2
Total Assets	10.2	2.2	11.2	10.2
Equity				
Internal growth rate				
Profitability	15.3	13.6	15.6	16.3
Gross profit/Revenue	10.3	8.6	10.7	11.4
Operating profit/ Revenue	7.9	5.8	7.9	8.6
EBITDA/ Revenue	5.5	3.7	5.5	5.7
EBITDA/ Revenue	6.1	4.1	6.2	6.7
Net margin	16.6	12.6	17.2	17.5
ROAA	17.3	12.6	17.6	17.1
ROIC or RONA				
ROAE				
Efficiency	13.9	8.3	13.5	13.5
Receivable Turnover	3.0	3.6	3.1	3.6
Inventory Turnover	6.4	5.2	6.8	6.8
Payable Turnover				
Liquidity	1.0	0.9	0.9	1.0
Current	0.3	0.4	0.3	0.4
Quick				
Solvency	130.2	141.5	132.0	106.1
Total Debt/Equity	92.0	98.4	97.1	70.3
Current Debt/Equity	38.3	43.1	34.9	35.8
Long-term Debt/ Equity	8.6	10.0	4.4	3.7

VND Billion

BALANCE SHEET	**2014**	**2015**	**2016F**	**2017F**
Cash and cash equivalents	88	91	98	83
Short-term investments	5	30	4	5
Accounts receivable	200	369	237	246
Inventories	781	729	863	775
Other current assets (inc. non-trade receivables)	98	86	91	95
Property, plant & equipment	951	1.009	1.078	1.149
Acquired intangible assets (inc. Goodwill)	96	209	186	159
Investment in affiliates	140	142	145	147
Other non-current assets	143	150	148	165
Total assets	**2,509**	**2,820**	**2,860**	**2,825**
Accounts payable	372	514	400	412
Short-term borrowings	818	894	981	782
Long-term borrowings	340	392	352	399
Other non-current liabilities	42	43	48	50
Bonus and Welfare fund	39	61	61	61
Technology-science	0	0	0	0
Total liabilities	**1,614**	**1,905**	**1,843**	**1,704**
Common stock and APIC	492	463	492	492
Treasury stock (enter as -)	-6	-6	-6	-6
Retained earnings /	236	201	247	279
Other comprehensive income /	50	50	50	50
Investment and Development	117	171	227	298
Total equity	**889**	**908**	**1.010**	**1.114**
Minority Interest	**7**	**7**	**7**	**7**

CASH FLOW STATEMENT	**2014**	**2015**	**2016F**	**2017F**
Profit before tax	167	133	207	239
-Depreciation	30	56	87	94
-Adjustments	55	78	-	-
+/- Working capital	(260)	(27)	(149)	38
Net Operating CFs	**(8)**	**240**	**145**	**371**
+/- Fixed Asset	(180)	(254)	(140)	(146)
+/- Deposit, equity investment	(56)	46	22	(3)
Interest, dividend, cash profit	5	3	-	-
Net Investing CFs	**(230)**	**(205)**	**(118)**	**(149)**
+/- Capital	-	-	-	-
+/- Debt	289	127	(39)	46
Dividend paid & other	(103)	(154)	14	(284)
Net Financing CFs	**187**	**(27)**	**(25)**	**(237)**
+/- cash & equivalents				
Beginning cash & equivalents	**141**	**88**	**96**	**98**
Impact of exchange rate	(52)	8	2	(15)
Ending cash & equivalents	**88**	**96**	**98**	**83**

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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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