TEXTILE & GARMENT INDUSTRY: Two Sides of a Coin

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Growth momentum to be slowed down

- Vietnam's textile & garment export value reached USD 18 bn in 1H2019, up 9% YoY. However, the growth momentum had been slowed down mainly due to the escalation of US-China trade war causing the industry to fall into defense state and negatively affecting to the production and consumption in its main export markets.

- Differentiated growth rate in each segment: (1) Fabric showed the highest growth rate of 27% YoY, (2) Apparel rose by 9% YoY, mainly driven by the increasing demand from the US market (+10% YoY), (3) Yarn faced difficulty, slightly up by 2% YoY compared to double-digit growth of the previous years due to selling price dumping from China, India and delayed purchasing from customers.

Figure: 1 Total export turnover (VND Bn)

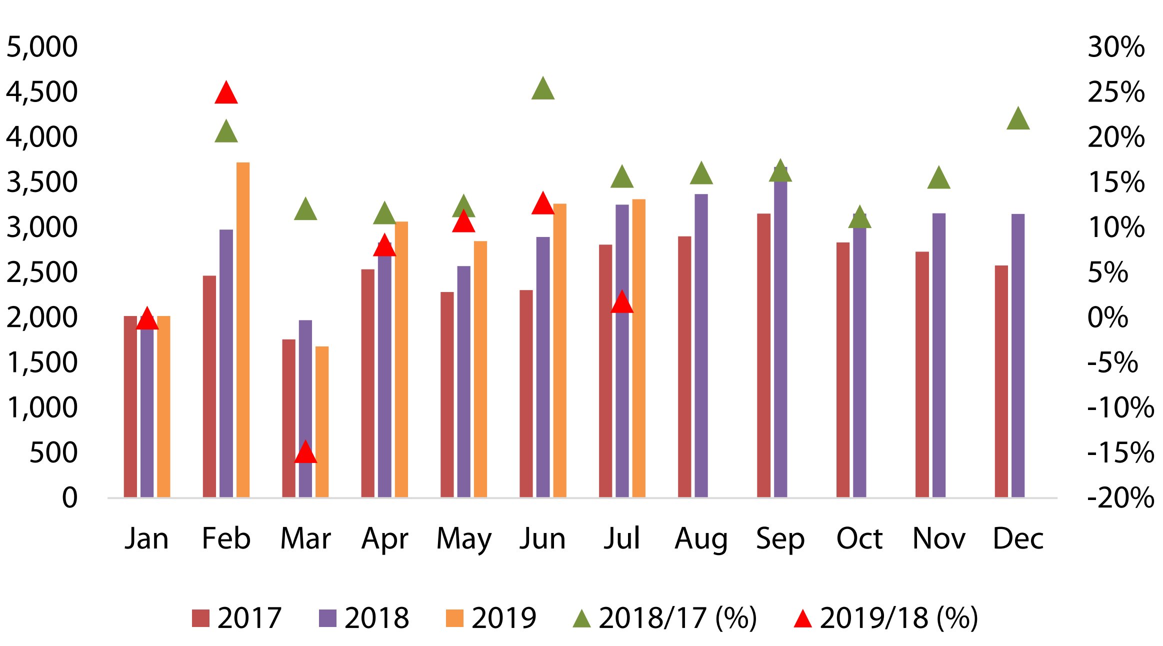
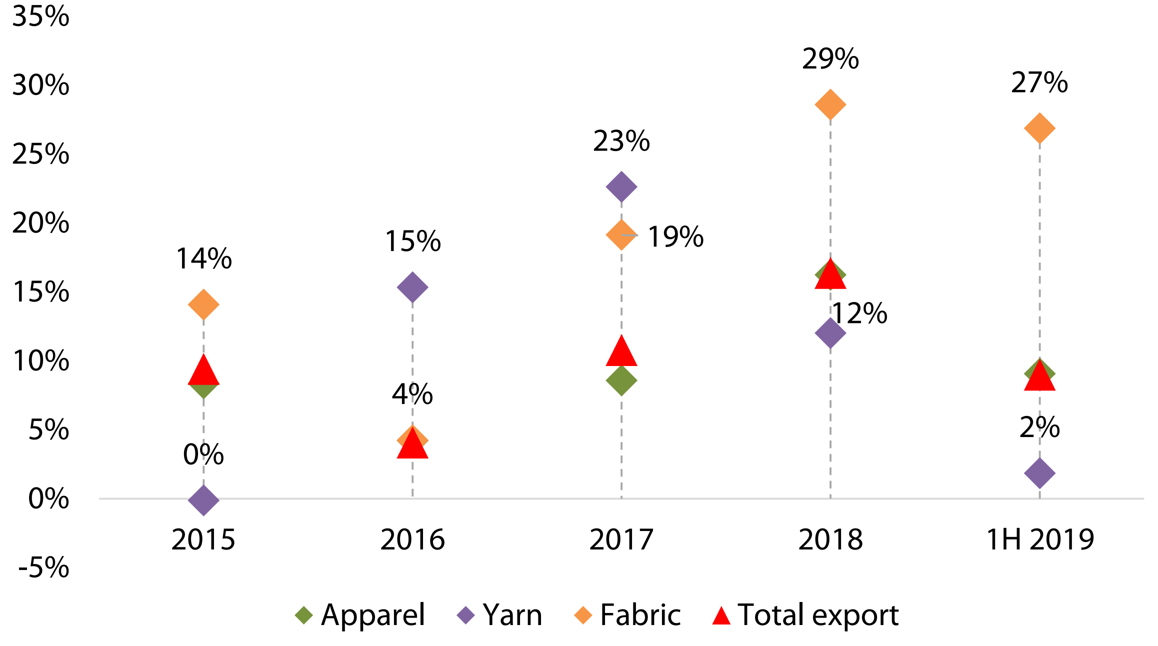


Figure 2: Export turnover growth (%)



Source: Vietnam Customs, VITAS, Rong Viet Securities

But Vietnam still led the export growth compared to its rivals

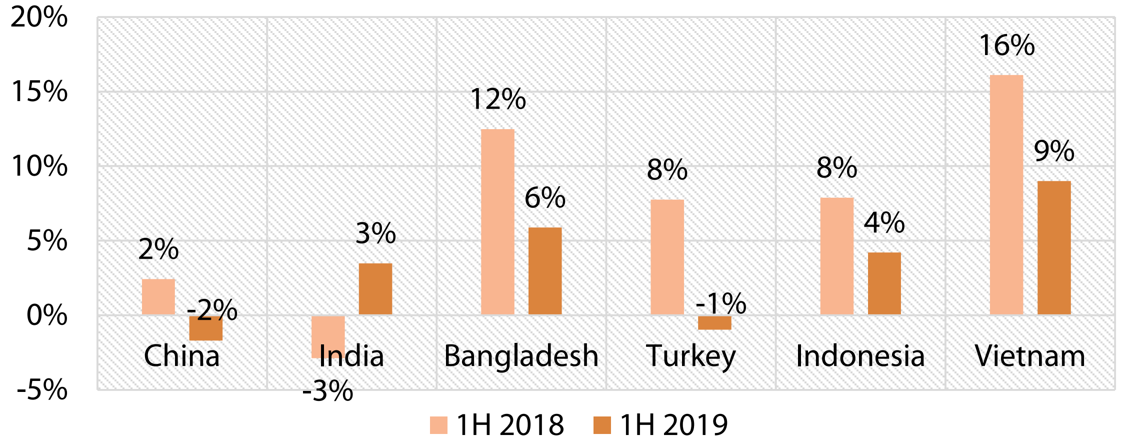
Decline in global demand

- Global import value fell by 2% YoY, at USD 303 bn in 1H 2019.
- The main exporters such as China, Turkey saw a negative growth rate while the remaining countries grew as a lower rate compared to same period last year.

Vietnam, meanwhile, led the export growth rate

- Generally, main markets such as the US, the EU, Japan and Korea saw a higher import growth rate from Vietnam than the industry average.

Figure 3: Export turnover growth in major countries (%)



Source: Trademap, Vietnam Customs, Rong Viet Securities

Figure 4: Import turnover growth in major countries (%)

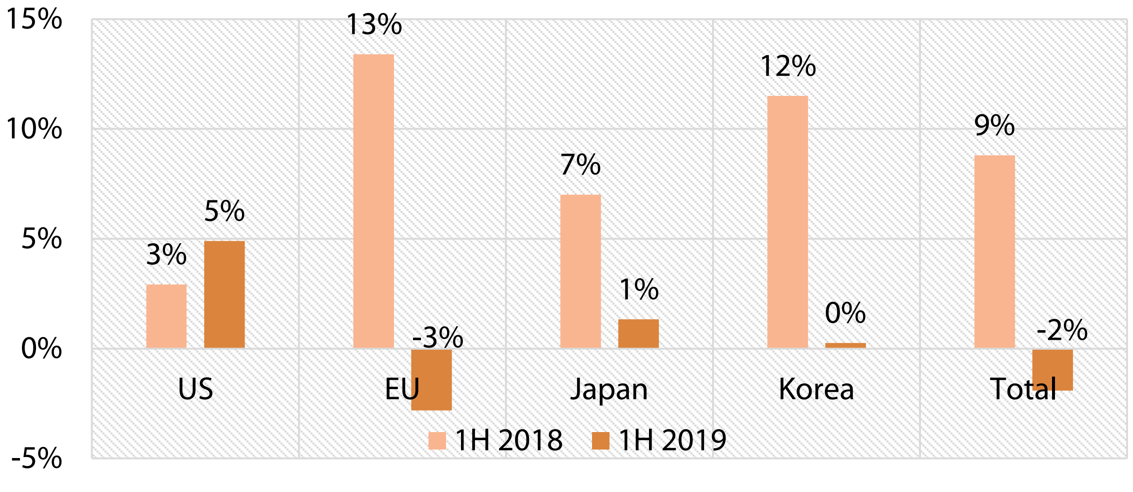
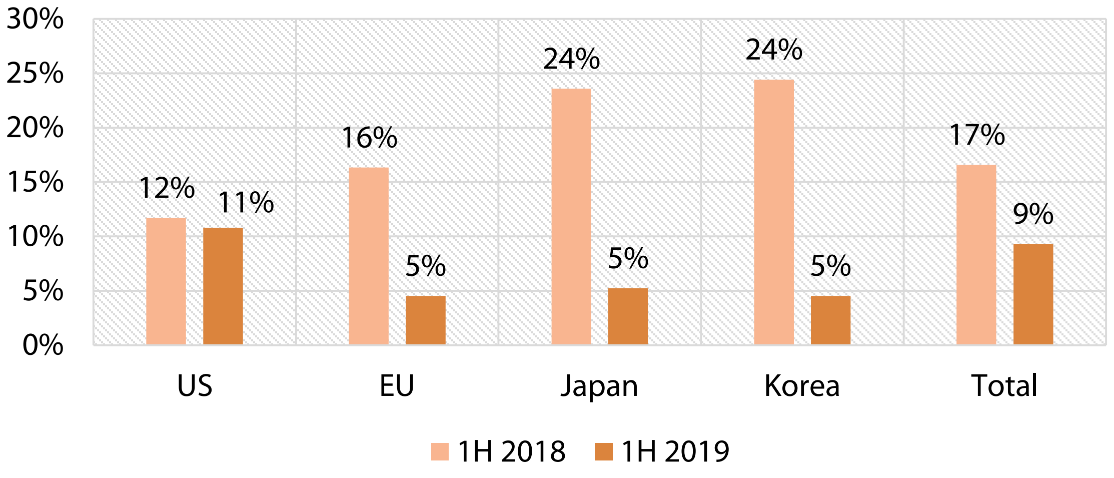


Figure 5: Vietnam's export turnover growth in major countries (%)



Source: Trademap, Vietnam Customs, Rong Viet Securities

Trade war effect is a key driver in the short run

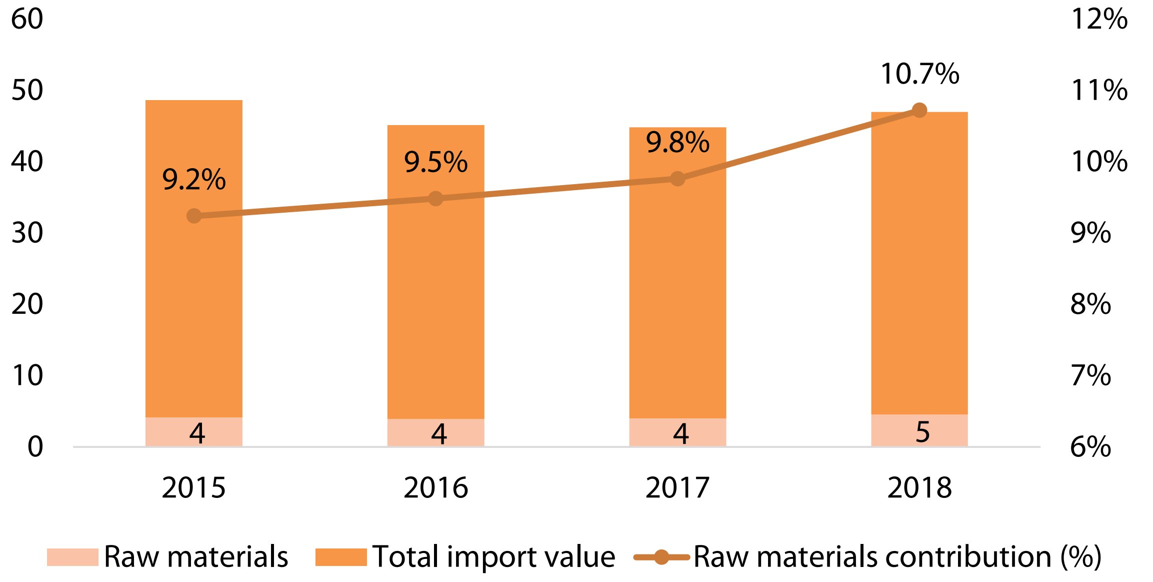
Shifting of orders from China to Vietnam continues to increase

- Although USD 200 bn tax package has not yet struck up Chinese apparel, the fashion retailers already shifted its apparel orders to Vietnam and neighboring countries. We believe that it becomes more and more pronounced once remaining USD 300 bn tax package takes effect.

But there are still risks

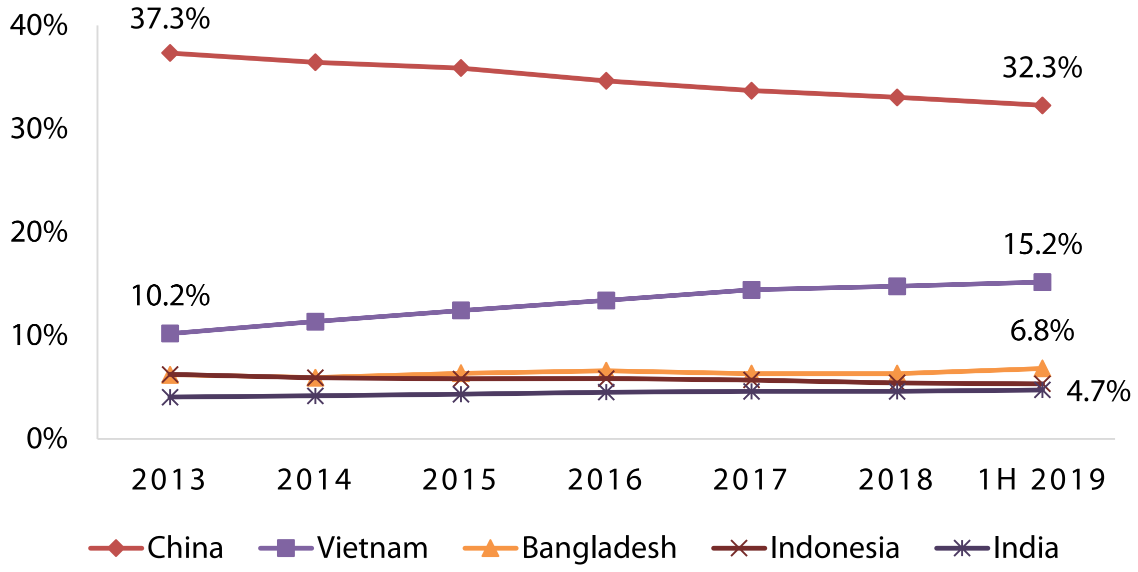
- China is playing an increasingly critical role as a textile supplier for many apparel exporting countries, including Vietnam. Therefore, we cannot exclude the possibility that China could raise its export taxes on fabric products to our country.
- The US may conduct traceability of textile & garment products manufactured in Vietnam to restrict originating materials from China.

Figure 6: Chinese textile & garment import value in the US market (USD bn)



Source: ITC, Rong Viet Securities

Figure 7: Apparel market shares of major exporters in the US market (%)

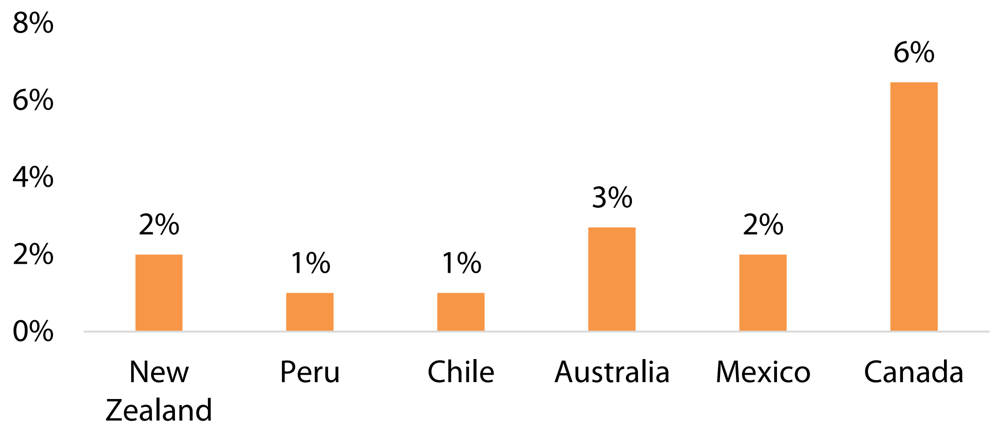


Source: OTEXA, Rong Viet Securities

Meeting the rule of origin from FTAs remains a challenge

- The US, the EU and Japan are major export markets of Vietnamese apparel products, accounting for 72% of total export value.
- However, Vietnam has to import most of fabric materials from China (58% of total fabric import value). This will be a big challenge for us to meet the rule of origin from CPTPP (from yarn onwards) and EVFTA (from fabric onwards).
- Canada is considered a potential market among CPTPP's member countries. In 2018, its total import value was USD 14.4 bn, Vietnam only accounted for 6% of total value.

Figure 8: Vietnam's market shares in total import value of CPTPP members



Source: ITC, Rong Viet Securities

Figure 9: Vietnam's apparel export by market in 1H 2019 (%)

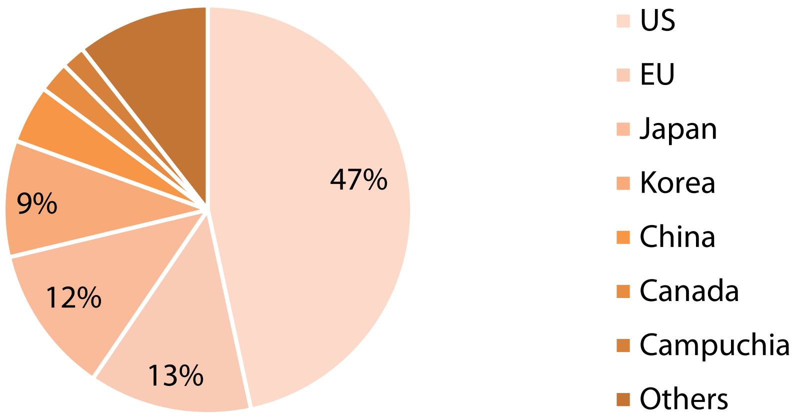
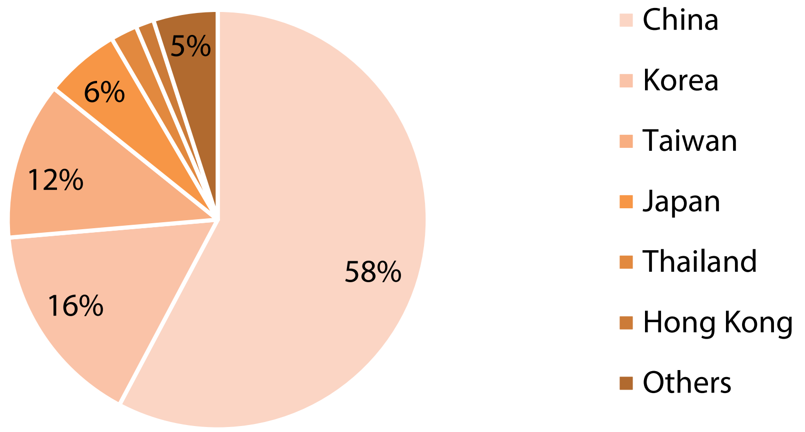


Figure 10: Vietnam's fabric import by market in 1H 2019 (%)

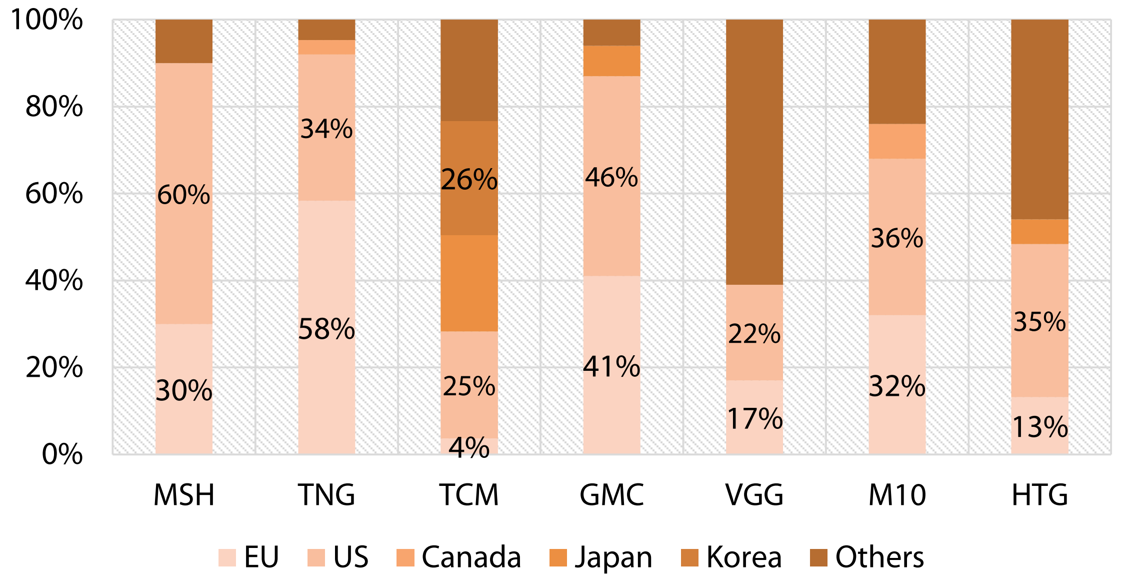


Source: VITAS, Rong Viet Securities

Meeting the rule of origin from FTAs remains a challenge

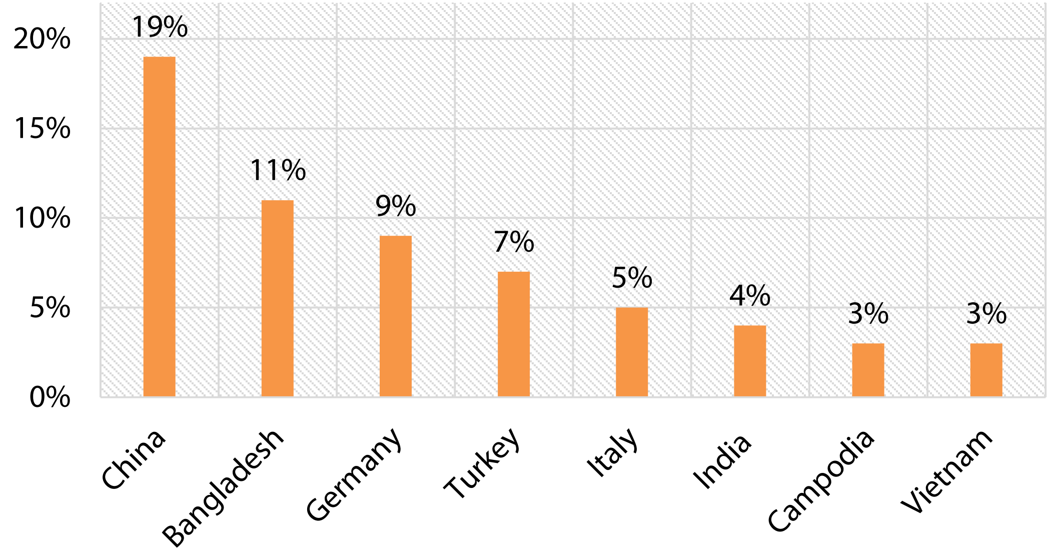
- The EU will eliminate duties for Vietnam's textile sector. In which, 42.5% of tariff lines will be eliminated immediately once the agreement comes into effect, the others will be over a 3-7 year period, with a fabric-forward rule (EU allows Vietnam to import fabrics from Korea).
- Currently, Vietnam enjoys GSP incentives (Generalized System of Preference) at around 9.6%. According to GSP Regulation, once EVFTA enters into force, specified beneficiary country will be removed from the list **two years after the date of application of a preferential market access agreement**. Therefore, enterprises can apply the origin requirements under both GSP and EVFTA may choose to apply better tax incentives in the first 2 years.
- We believe that not many garment companies now meet the origin requirements from EVFTA agreement. However, this is a catalyst to boost orders from the EU to Vietnam, especially those firms already had large orders in that places.

Figure 11: Export structure of listed garment companies (%)



Source: Rong Viet Securities compiled

Figure 12: Vietnam's market shares in total import value of the EU (%)



Source: VITAS, Rong Viet Securities

Industry comparables

Figure 13: Revenue growth of listed textile & garment companies

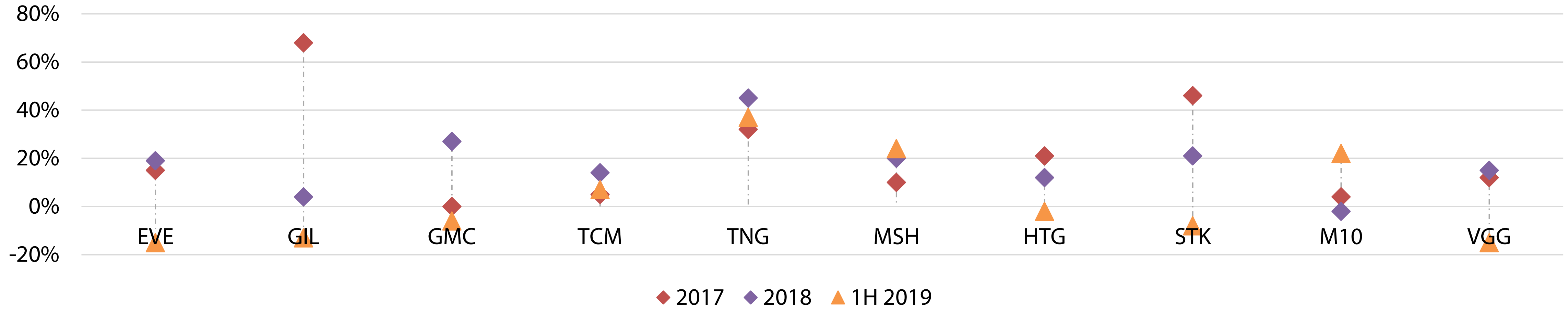
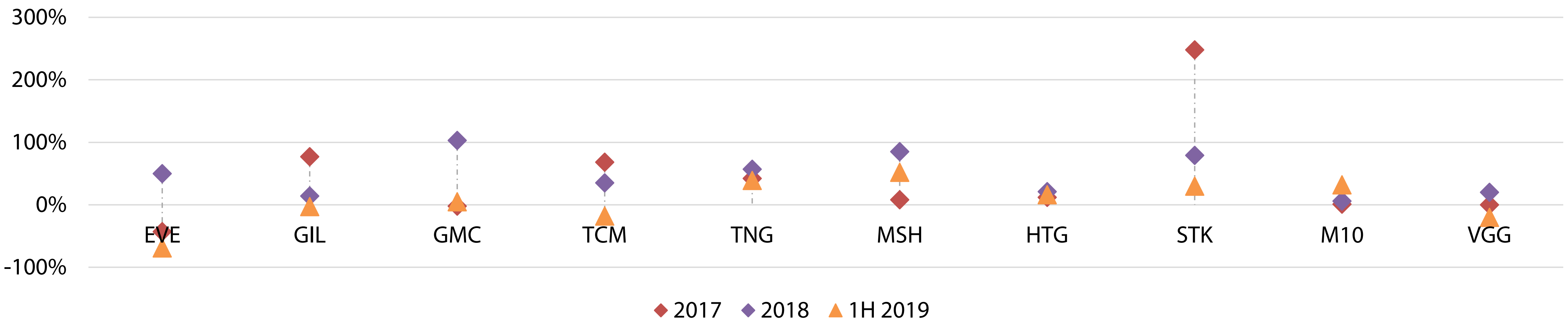


Figure 14: NPAT-MI growth of listed textile & garment companies



Source: FiinGroup, Rong Viet Securities

Industry comparables (TTM)

Ticker	Marlet Cap (VND bn)	P/E	Sales Growth (%)	Gross Margin	Operating Profit Margin	Net Income Growth (%)	Net Profit Margin	EV/EBITDA	Return on Assets	Return on Equity
TNG	1,131	5	40	18	9	47	5	5	7	25
MSH	3,051	4	20	20	11	85	9	4	15	44
VGG	2,425	6	15	12	5	20	5	2	10	24
TCM	1,407	6	14	19	8	25	7	5	8	19
GMC	504	4	11	18	7	94	6	4	13	35
VGT	4,550	14	9	9	2	14	2	12	2	6
STK	1,464	5	2	14	10	51	7	4	9	21

Source: Bloomberg, RongViet Securities

MSH – Keep Going Ahead

INVESTMENT RATIONALES

- **Outperform in profitability compared to other rivals.**
  - MSH continued to improve its profitability in 1H 2019 with impressive gross margin and net margin of 20.5% and 10.3%, respectively (peers: 15% and 5%).
  - 2H is considered a peak season for revenue and profit thanks to the increasing demand of bedding segment. This may help the company to enhance its performance.
- **There is still room to shift its production chain from CMT to FOB.**
  - Benefiting from the escalation of US-China trade war, the orders of its main market, US could move continuously into Vietnam.
  - In 1H 2019, we estimate that it grew the contribution of FOB orders to 80% of its total revenue. Still having room to shift the entire production chain into FOB method in order to enhance its competitiveness.
- **Song Hong No. 10 factory will be a catalyst for growth.**
  - It already established a subsidiary, Song Hong – Nghia Hung Garment JSC, contributing VND 76.5 bn of total chartered capital (equivalent to 51% of ownership).
  - It is expected to go into trial production in Q3 2020, before officially operating in 2021.

RISKS TO OUR CALLS

- Global economic downturn leading to a decline in demand of apparel products.
- Unexpected fluctuation in fabric materials price.
- A sharp increase in labor costs.

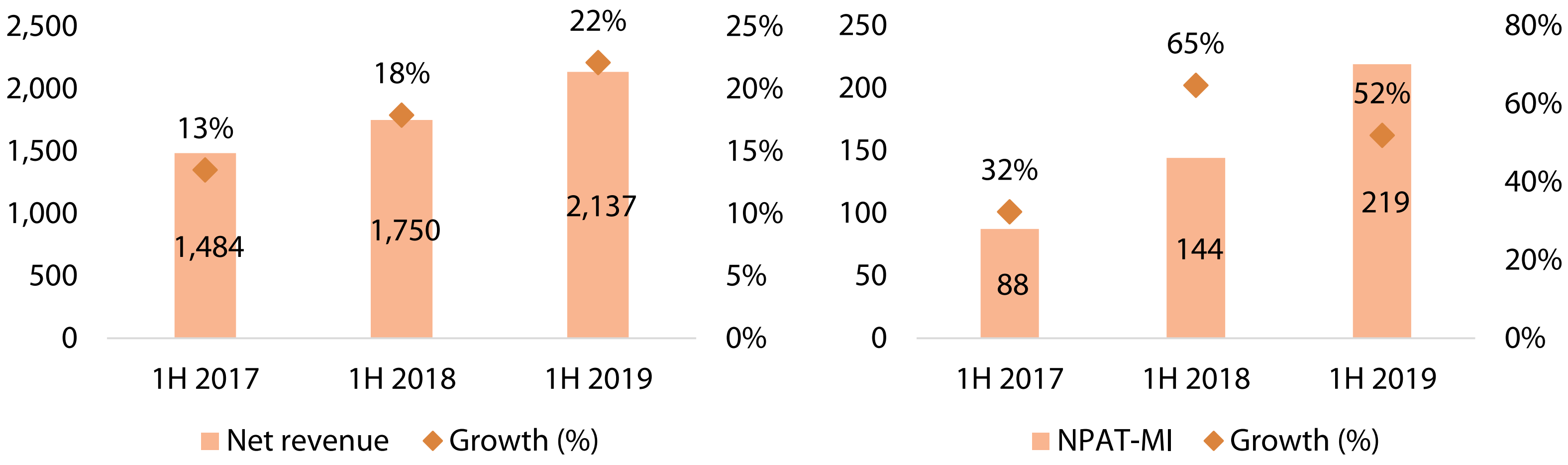
BUY +24%

CMP (VND)	**61,000**
Target price (VND)	**72,000**
Cash dividend in 12 months	*3,500*

STOCK INFO	
Sector	Textile
Market Cap ($ mn)	131
Current Shares O/S (mn shares)	50
3M Avg. Volume (K)	162
3M Avg. Trading Value (VND Bn)	10
Foreign Ownership (%)	7.7
State Ownership (%)	-

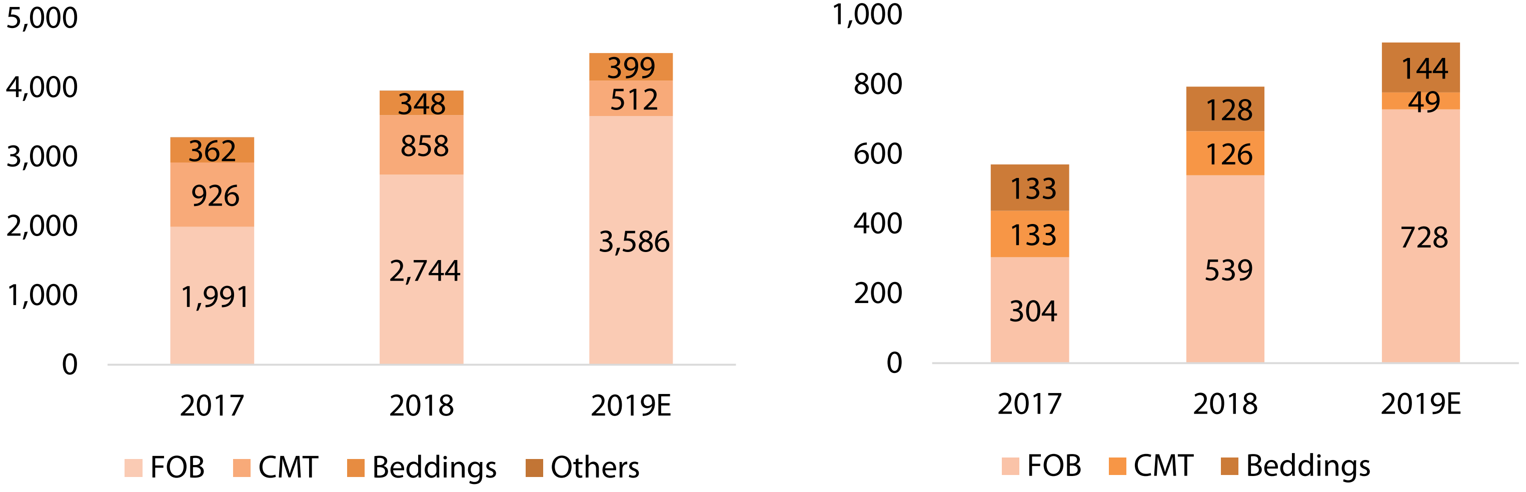
FORECAST	2017A	2018A	2019F	2020F
Revenue	**3,282**	**3,951**	**4,497**	**4,950**
Growth (%)	9.7	20.4	13.8	10.1
NPATMI	**200**	**370**	**433**	**475**
Growth (%)	8.4	84.6	17.0	9.7
ROA (%)	8.8	15.1	15.6	14.7
ROE (%)	28.5	43.8	36.7	33.0
EPS (VND)	4,125	9,745	8,175	8,972
Book Value (VND)	31,711	19,601	24,776	30,248
Cash dividend (VND)	4,500	4,000	3,500	3,500
P/E (x)	N/A	4.2	7.5	6.8
P/B (x)	N/A	3.1	2.5	2.0

Figure: 1H's Business Results (VND bn)



Source: MSH, Rong Viet Securities

Figure: Estimated revenue (LHS) and gross profit (RHS) of each segment in 2019 (VND bn)



Source: MSH, Rong Viet Securities

1H 2019 – Impressive growth rate

- Net revenue and NPAT-MI grew by 22% and 52%, respectively.
- Gross margin improved by 124 bps, up to 20.5%.
- Non-operating profit had the significant improvement, contributing VND 15 bn in net financial income compared to a loss of VND 12.3 bn in net financial expenses over the same period.

2H 2019 – Peak season for growth

- 2H's total gross margin is expected to achieve 20.6%.
- For 2019, we forecast that:
  - CMT's revenue drop by 40% YoY, at VND 512 bn.
  - FOB's revenue keeps growing by 31%, contributing 80% of total revenue.
  - Luen Thai, its new customer, accounts for 5% of its total revenue.

STK – Recycled Yarn is a Bright Spot

INVESTMENT RATIONALES

- **Increasing demand in recycled yarns is way to grow**
  - We believe that the growth of recycled yarns should be quite large due to lacking of global supply. In addition, most of international fashion brand names such as Nike, Adidas, Puma, Decathlon, etc already committed to rise the use of recycled materials in the near future. This will help to boost the demand for recycled yarn products.
  - STK's recycled polyester yarns were already certified by the Global Recycled Standard (GRS), meeting the global quality standard from famous brand names. Besides, its current spinning technology can completely switch to produce 100% recycled orders instead of regular ones.
  - In 1H 2019, it lifted up the contribution of recycled yarn to revenue to 28% vs. 11% over the same period last year.
- **High-quality product development projects continue to be implemented**
  - Dope dyed yarns and recycled color yarns are expected to be put into production in Q3, with a capacity of 4,000 tons/year.
  - It is testing the high-purity yarns to maximize its selling price.

RISKS TO OUR CALLS

- Decline in global demand for yarn materials.
- Chinese manufacturers continue to dump its yarn products.
- Negative volatility in crude oil prices.

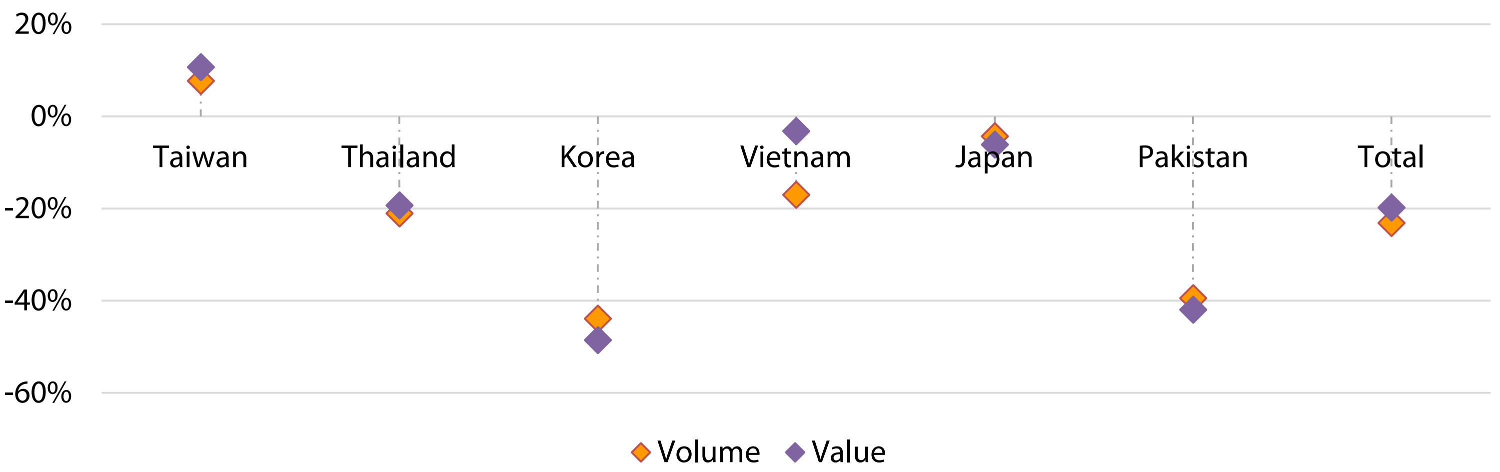
ACCUMULATE +18%

CMP (VND)	**20,700**
Target price (VND)	**24,000**
Cash dividend in 12 months	*500*

STOCK INFO	
Sector	Textile
Market Cap ($ mn)	63
Current Shares O/S (mn shares)	71
3M Avg. Volume (K)	143
3M Avg. Trading Value (VND Bn)	3
Foreign Ownership (%)	9.8
State Ownership (%)	-

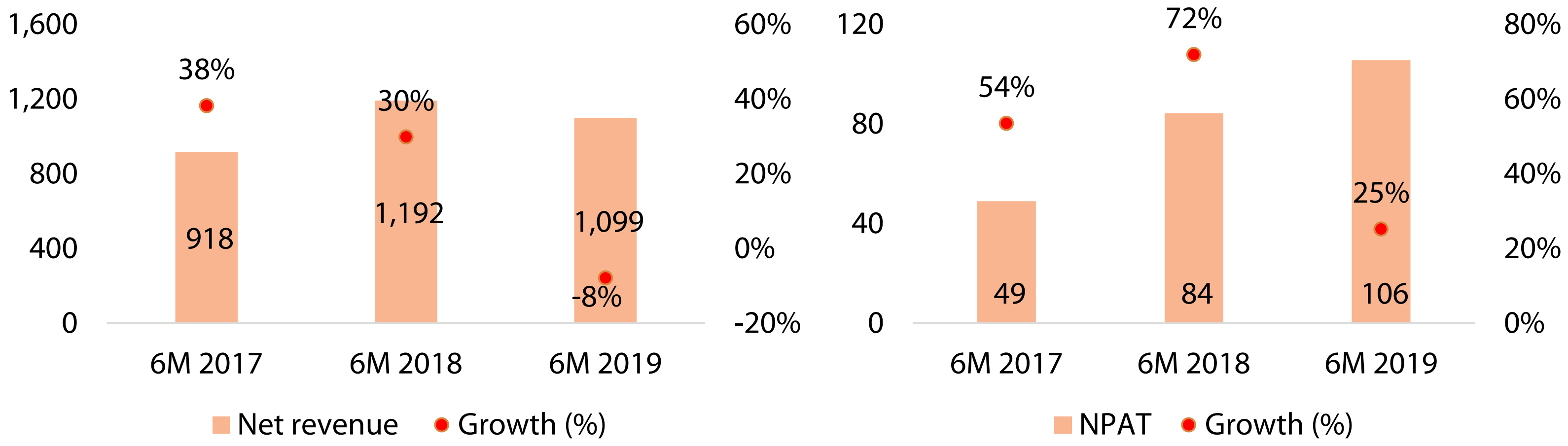
FORECAST	2017A	2018A	2019F	2020F
Revenue	**1,989**	**2,408**	**2,533**	**2,745**
Growth (%)	46.4	21.0	5.2	8.4
NPATMI	**100**	**178**	**215**	**235**
Growth (%)	248.3	79.0	20.3	9.7
ROA (%)	5.0	8.7	9.9	10.8
ROE (%)	13.5	21.1	19.2	18.7
EPS (VND)	1,408	2,522	2,730	2,994
Book Value (VND)	12,991	15,167	15,809	17,803
Cash dividend (VND)	800	1,500	500	500
P/E (x)	10.5	5.9	7.6	6.9
P/B (x)	1.3	1.2	1,3	1,2

Figure 1: Vietnam's yarn export turnover growth in several markets (%)



Source: Vietnam Customs, STK, Rong Viet Securities

Figure 2: 1H's Business Results (VND bn)

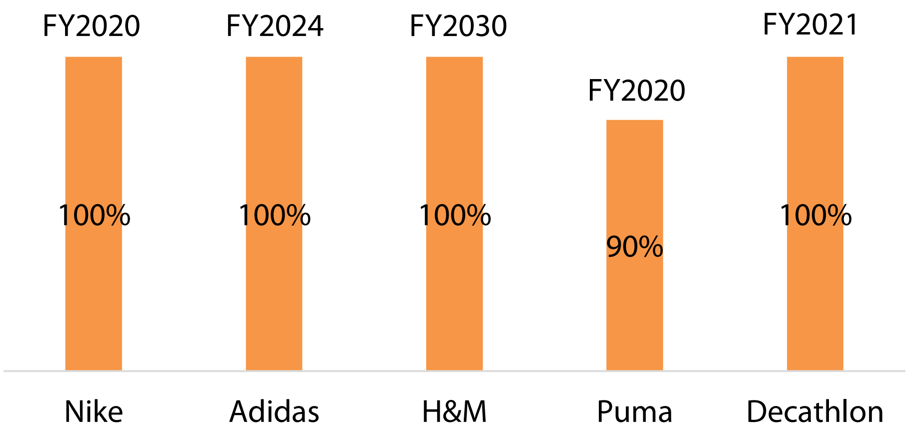


Source: STK, Rong Viet Securities

1H 2019 – A decline in revenue, but double-digit growth in NPAT-MI

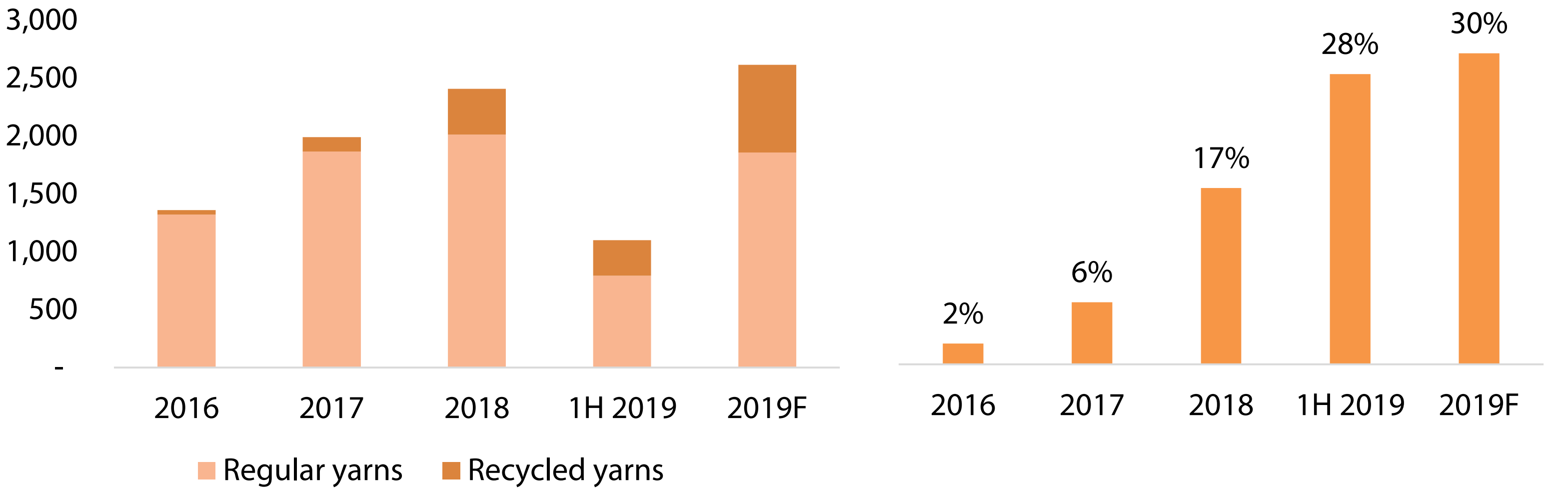
- Yarns to be among first products affected by US-China trade tension, having a significant decrease in demand.
- It already invested VND 5 bn to buy dyed yarn machineries.
- Revenue reduced by 8% YoY but NPAT-MI went up by 25% YoY.
    - Traditional yarn products (such as DTY, FDY) consumption volume went down sharply (-27% YoY).
    - Recycled yarn volume rose by 118% YoY.
    - Raising the contribution of recycled yarns to revenue to 28% vs. 11% over the same period last year.
    - Gross margin improved by 262bps, up to 16.2%.

Figure 3: Sustainable commitment of using recycled materials from international fashion brands



Source: STK, Rong Viet Securities

Figure 4: Estimated revenue (left) and contribution of recycled yarns to revenue (right) in 2019



Source: STK, Rong Viet Securities

2H 2019 – Recycled yarn is expected to climb continuously its contribution to revenue

- Although declining in demand of regular polyester yarns, the impact on recycled yarns is considered to be negligible as this is not alternative products.
- According to Textile Change, recycled polyester yarns account for 14% of total polyester yarn consumption. As it is under increasing demand of international fashion brands (Nike, Adidas, Decathlon, etc), we expect that till having room for STK to shift its product mix to recycled high-quality yarns.
- For 2019, we forecast that:
  - Regular yarns' revenue drop by 11% YoY, at VND 1,783 bn.
  - Recycled yarns' revenue climb to VND 750 bn, up 89% YoY.
  - Contribution of recycled yarns to revenue rises up to 30%.

TCM – Facing Difficulties in the Short Run

INVESTMENT RATIONALES

- **Advantages from its closed supply chain meet rule of origin requirement from FTAs.**
  - TCM already adapts the vertical integration from yarns to sewing production, so it directly benefits from the preferential tariffs of FTAs.
  - However, the contribution to revenue of CPTPP and EVFTA member countries are only 29%, it should develop more orders from these markets.
- **Slow down demand in yarn segment due to escalation of US-China trade war.**
  - Yarn's selling prices were decelerated more than raw cotton prices.
  - In 1H 2019, its main market, China already declined the demand for yarn materials, making its yarn revenue down by 21% over the same period, at only 2% of gross margin.
- **Fabric segment, meanwhile, is a bring spot.**
  - It raised the capacity of woven fabrics by 20%, helping to increase 2.4 mn woven products thanks to the increasing demand of Japanese customers.
  - This is the segment that brings the highest profit margin for the company, at around 21%.
- **Garment segment maintains its growth despite sales decline of Sears' customer.**
  - It has developed new orders with US market to replace the shortage of Sears' revenue.
  - Eland Group, its largest garment customer, also raised the demand for apparel in 1H.

RISKS TO OUR CALLS

- Unexpected fluctuation in cotton materials price.
- Demand for yarn materials continue to decelerate.
- Declining in fabric and apparels demand of its main export markets.

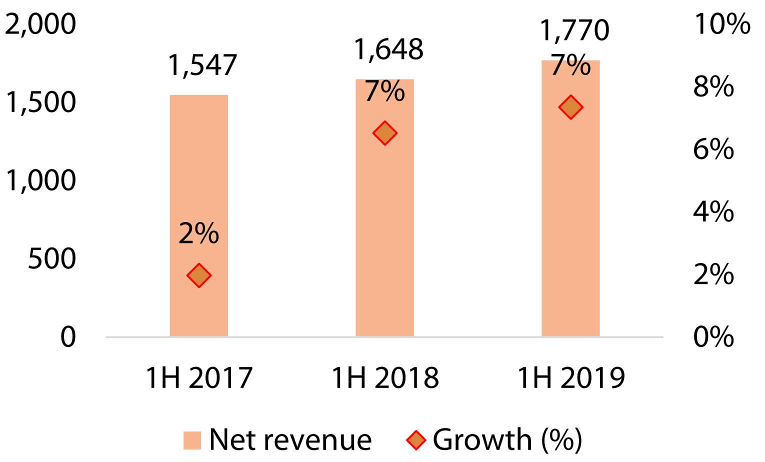
ACCUMULATE +17%

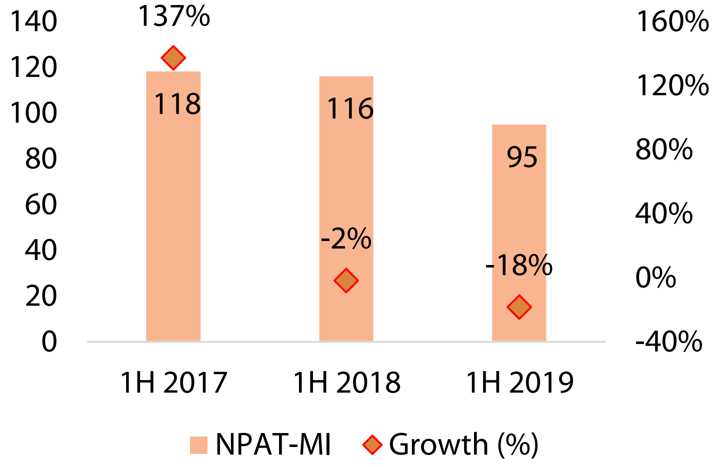
CMP (VND)	**24,300**
Target price (VND)	**28,000**
Cash dividend in 12 months	*500*

STOCK INFO	
Sector	Textile
Market Cap ($ mn)	60
Current Shares O/S (mn shares)	58
3M Avg. Volume (K)	823
3M Avg. Trading Value (VND Bn)	23
Foreign Ownership (%)	49.0
State Ownership (%)	-

FORECAST	2017A	2018A	2019F	2020F
Revenue	**3,209**	**3,662**	**3,750**	**4,010**
Growth (%)	4.5	14.1	2.4	6.9
NPATMI	**192**	**259**	**229**	**284**
Growth (%)	67.8	35.1	-11.8	24.4
ROA (%)	6.5	8.2	6.8	8.2
ROE (%)	19.3	22.1	15.7	16.9
EPS (VND)	3,713	3,937	3,554	4,422
Book Value (VND)	20,595	23,380	25,168	29,090
Cash dividend (VND)	500	500	500	500
P/E (x)	6.5	5.1	6.8	5.5
P/B (x)	1.2	1.0	1.0	0.8

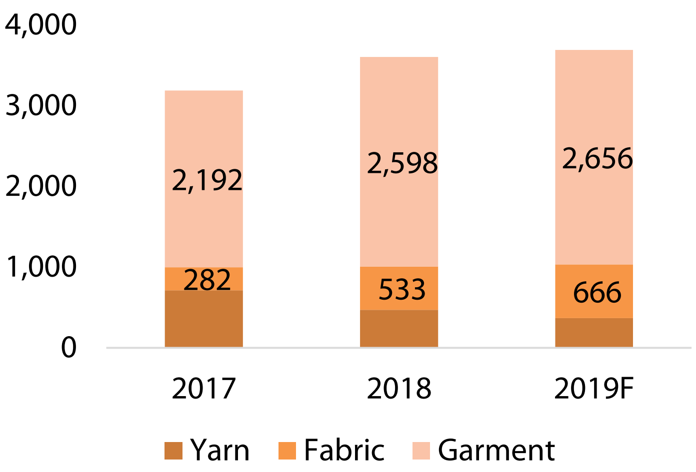
Figure 1: 1H's Business Results (VND bn)

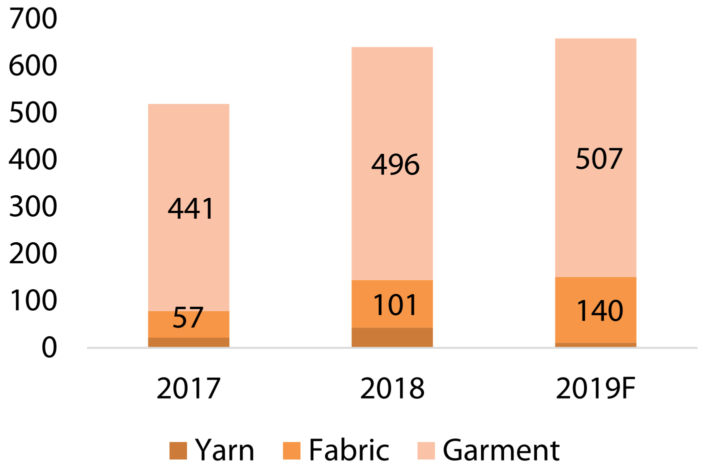




Source: TCM, Rong Viet Securities

Figure 2: Estimated revenue (LHS) and gross profit (RHS) of each segment in 2019 (VND bn)





Source: TCM, Rong Viet Securities

1H 2019 – Sales growth but declining in its profit

- Revenue went up by 7% YoY, whereas NPAT-MI was down by 18% YoY.
  - Garment and fabric revenue grew by 10% YoY and 15% YoY, respectively.
  - Yarn revenue was down by 21% YoY as its main market, China, has reduced the demand for yarn imports.
- Gross margin declined by 220bps, mainly influenced by yarn segment, only 2% vs. 9% in 1H 2018.

2H 2019 – Challenge to fulfill its guidance

- 2H's gross margin is expected to achieve 17.6%.
- It considers to record the remaining VND 20 bn provision for Sear's bad debt in 2H.
- For 2019, we forecast that:
  - Revenue slightly rises by 2% YoY, at VND 3,750 bn.
  - NPAT-MI declines by 12%, at VND 229 bn.

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