

PHU NHUAN JEWELLERY (PNJ VN)

The fat hits the fire

Buy

Current price: VND 76,200

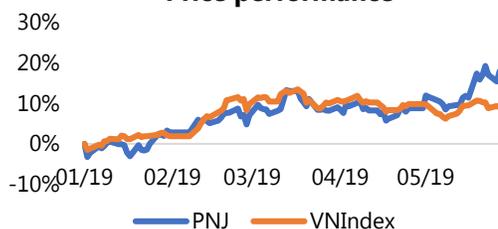
Target price: VND 86,200

Upside: 13%

We attended PNJ's 2Q19 analyst meeting on July 22 where the spotlight was on PNJ's 8% YoY revenue decline in 2Q19. Management attributed the poor performance to two main reasons: difficulties in implementing the new ERP system and weak jewelry consumption. We view jewelry demand as the key concern going forward. However, we retain our Buy call and VND86.2K target price for now.

| | | | | | |
|---------------------------|-----------------------|----------------------|------------------------|--------------|-------------------|
| 52-week Price Range (VND) | Market Capitalization | FY19E Dividend Yield | Remaining Foreign Room | Free-float | ADTV-3month |
| 64,800-82,700 | USD 738 mn | 2.0% | 0% | 30.6% | USD 1.6 mn |

Price performance



Key takeaways

- 2Q19 sales declined by 8% YoY.
- PNJ managed to keep its gross profits (+9% YoY) afloat.
- But the bottom-line still saw a 6% decline on higher SG&A.

Risks

- Slowdown in gold jewelry demand is the key risk and requires monitoring.
- ERP system implementation hiccups are less of a concern to us.
- Full-FOL status = price premium, liquidity, and settlement risks.

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Company profile: PNJ is a leader and consolidator in Vietnam's fragmented jewelry market. Gold products account for 80% of sales and 92% of profits. The company has the largest gold jewelry retail network in Vietnam at 273 stores.

PNJ 2Q19 results and FY19 guidance

| USD Bn | 2Q19 | YoY growth | FY2019 Guidance |
|------------------|-------|------------|-----------------|
| Net revenues | 2,962 | -8% | 18,100 |
| Gross profit | 636 | +9% | 2,779 |
| Profit after tax | 169 | -6% | 960 |

Source: PNJ

2Q19 sales declined by 8% YoY which management attributed to two issues. **1) Problems with ERP system implementation.** Employees who lacked familiarity with the new system failed to input data properly, causing company-wide operational problems. **2) Surprisingly to us, PNJ also reported a 13% YoY decline in gold jewelry sales during 2Q19.** In response, PNJ de-emphasized its jewelry wholesale business (3% GMs, -23% YoY sales decline) in favor of the retail segment (30% GMs, -9% YoY drop in sales), where it opened additional jewelry stores and launched new collections. As a result, PNJ managed to drive gross profit growth of 7.4% YoY in gold jewelry and company-wide gross profit growth of 9.1%.

Solutions? PNJ said that the ERP problems are almost solved now, as evidenced by rebounding sales in June and July. The system should help optimize PNJ's operations and improve cost efficiencies, but it may take 12-18 months for this to occur. Management adopts a cautious view on demand weakness but still expects much better 2H19 results.

Opex growth pressuring the bottom line. Despite the 9.1% YoY increase in gross profit, 2Q19 PAT still declined by 6% YOY due to a 17.6% YoY increase in SG&A expenses. Higher costs were driven by new store openings in the gold jewelry and watch segments. PNJ remains in the expansion phase, and management guides for double-digit growth of such expenses going forward.

Our view: A possible slowdown in jewelry demand is clearly more of a concern than the ERP system problems. However, the magnitude of demand weakness is unclear given that the poor 2Q19 sales performance was a product of blended factors. Additionally, a single 3-month period is perhaps too short to call the weak demand a trend. We thus retain our assumptions on PNJ for now, and continue to recommend **BUY** on the shares.

PROFIT AND LOSS (VND bn)

| <i>FY Dec 31 (VND'bn)</i> | 2017A | 2018A | 2019E | 2020E | 2021E |
|-------------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 10,977 | 14,573 | 18,286 | 22,295 | 26,439 |
| Gold jewelry | 8,672 | 11,658 | 14,827 | 18,178 | 21,897 |
| Silver jewelry | 215 | 262 | 263 | 263 | 263 |
| Gold bar | 2,086 | 2,609 | 3,130 | 3,756 | 4,132 |
| Others | 33 | 44 | 66 | 98 | 148 |
| Cost of goods sold | (9,065) | (11,794) | (14,782) | (18,001) | (21,290) |
| Gross profits | 1,912 | 2,779 | 3,504 | 4,294 | 5,150 |
| Operating expenses | (963) | (1,517) | (2,011) | (2,453) | (2,908) |
| Operating profits | 949 | 1,263 | 1,493 | 1,842 | 2,241 |
| Net interest expenses | (56) | (66) | (93) | (96) | (101) |
| Net investments income/(loss) | - | - | - | - | - |
| Net other incomes | 6 | 3 | 3 | 3 | 3 |
| Pretax profits | 907 | 1,206 | 1,425 | 1,772 | 2,169 |
| Income taxes | (183) | (246) | (285) | (354) | (434) |
| Minority interests | - | - | - | - | - |
| Net profits | 725 | 960 | 1,140 | 1,418 | 1,735 |
| EBITDA | 988 | 1,305 | 1,534 | 1,890 | 2,294 |
| EPS (VND) | 6,434 | 5,330 | 4,607 | 5,731 | 7,013 |

KEY RATIOS

| | 2017A | 2018A | 2019E | 2020E | 2021E |
|--------------------------------|------------|------------|------------|------------|------------|
| Growth (% YoY) | | | | | |
| Sales | 28.2 | 32.8 | 25.5 | 20.3 | 16.5 |
| Gold jewelry | 30% | 34% | 27% | 21% | 18% |
| Silver jewelry | 26% | 22% | 0% | 0% | 0% |
| Gold bar | 22% | 25% | 20% | 20% | 10% |
| Others | 28% | 33% | 50% | 50% | 50% |
| Operating profit | 31.0 | 33.0 | 18.2 | 21.0 | 15.4 |
| EBITDA | 30.3 | 32.0 | 17.6 | 20.8 | 15.3 |
| Net profit | 60.9 | 32.5 | 18.7 | 21.9 | 15.8 |
| EPS (VND) | 46.8 | (17.2) | 18.7 | 21.9 | 15.8 |
| Profitability ratio (%) | | | | | |
| Gross margin | 16.5 | 17.4 | 19.1 | 19.2 | 19.1 |
| Operating margin | 8.5 | 8.6 | 8.7 | 8.2 | 8.2 |
| EBITDA margin | 8.9 | 9.0 | 9.0 | 8.4 | 8.4 |
| Net margin | 5.3 | 6.6 | 6.6 | 6.2 | 6.3 |
| ROA | 13.7 | 17.9 | 17.8 | 17.2 | 18.4 |
| ROE | 32.0 | 32.6 | 28.7 | 28.1 | 29.0 |
| Stability | | | | | |
| Net debt/equity (x) | 0.9 | 0.2 | 0.4 | 0.3 | 0.2 |
| Int. coverage (x) | 4.0 | 16.8 | 19.0 | 16.1 | 18.7 |
| Int. & ST debt coverage (x) | 0.5 | 1.1 | 0.8 | 0.9 | 1.0 |
| Cash conversion days | 106.2 | 105.5 | 107.0 | 110.3 | 107.0 |
| Current ratio (X) | 1.6 | 2.7 | 2.1 | 2.3 | 2.5 |
| Quick ratio (X) | 0.1 | 0.3 | 0.2 | 0.3 | 0.3 |
| Net cash/(debt) (VND mn) | (1,353) | (717) | (1,360) | (1,222) | (1,140) |
| Efficiency | | | | | |
| Days receivable outstanding | 2 | 2 | 3 | 3 | 3 |
| Days inventory outstanding | 127 | 126 | 127 | 130 | 127 |
| Days payable outstanding | 23 | 23 | 23 | 23 | 22 |

Source: Company data, YSVN

BALANCE SHEET (VND bn)

| <i>FY Dec 31 (VND'bn)</i> | 2017A | 2018A | 2019E | 2020E | 2021E |
|-----------------------------|--------------|--------------|--------------|--------------|--------------|
| Total assets | 4,492 | 6,303 | 7,164 | 8,469 | 9,946 |
| Cash & cash equivalents | 175 | 207 | 585 | 849 | 1,050 |
| ST Investment | 160 | - | - | - | - |
| Accounts receivable | 85 | 176 | 165 | 183 | 239 |
| Inventories | 3,402 | 4,816 | 5,265 | 6,263 | 7,466 |
| Other current assets | 74 | 82 | 86 | 91 | 95 |
| Net fixed assets | 497 | 787 | 816 | 823 | 823 |
| Others | 99 | 236 | 247 | 260 | 273 |
| Total liabilities | 1,543 | 2,558 | 2,625 | 2,860 | 3,037 |
| Current liabilities | 1,436 | 2,479 | 2,550 | 2,788 | 2,965 |
| Accounts payable | 590 | 921 | 931 | 1,085 | 1,167 |
| ST debts | 846 | 1,558 | 1,618 | 1,703 | 1,798 |
| Long-term liabilities | 106 | 78 | 75 | 71 | 72 |
| Long-term debts | 46 | 8 | 4 | - | - |
| Others | 60 | 71 | 71 | 71 | 72 |
| Shareholder's equity | 2,950 | 3,745 | 4,540 | 5,609 | 6,909 |
| Share capital | 1,958 | 2,595 | 2,595 | 2,595 | 2,595 |
| Treasury stocks | (0) | (0) | (0) | (0) | (0) |
| Others | 1,186 | 1,711 | 939 | (102) | (1,368) |
| Retained earnings | 772 | 885 | 1,656 | 2,698 | 3,963 |
| Minority interest | - | - | - | - | - |

CASH FLOW (VND bn)

| <i>FY (VND'bn)</i> | 2017A | 2018A | 2019E | 2020E | 2021E |
|--------------------------------|--------------|--------------|--------------|--------------|--------------|
| Operating cash flow | 109 | (305) | 749 | 598 | 607 |
| Net income | 725 | 960 | 1,140 | 1,418 | 1,735 |
| Dep. & amortisation | 28 | 39 | 42 | 48 | 53 |
| Change in working capital | 59 | 331 | 11 | 154 | 82 |
| Others | (351) | (435) | (289) | (359) | (438) |
| Investment cash flow | (264) | (169) | (82) | (67) | (66) |
| Net capex | (99) | (271) | (82) | (67) | (66) |
| Change in LT investment | (160) | 160 | - | - | - |
| Change in other assets | - | - | - | - | - |
| Cash flow after invt. | (5) | (58) | - | - | - |
| Financing cash flow | 174 | 505 | (289) | (267) | (339) |
| Change in share capital | 98 | 589 | - | - | - |
| Net change in debt | (615) | 674 | 56 | 81 | 95 |
| Change in other LT liab. | 692 | (758) | (345) | (348) | (434) |
| Net change in cash flow | 20 | 31 | 378 | 264 | 201 |
| Beginning cash flow | 155 | 175 | 207 | 585 | 849 |
| Ending Cash Balance | 175 | 207 | 585 | 849 | 1,050 |

KEY METRICS

| | 2017A | 2018A | 2019E | 2020E | 2021E |
|--------------------|-------|-------|-------|--------|--------|
| PE (x) | 21.3 | 17.5 | 15.9 | 12.8 | 10.5 |
| Diluted PE (x) | 21.3 | 17.5 | 15.9 | 12.8 | 10.5 |
| PB (x) | 5.0 | 4.2 | 3.7 | 3.0 | 2.4 |
| EBITDA/share | 9,143 | 7,812 | 9,186 | 11,315 | 13,737 |
| DPS (VND) | 1,713 | 1,585 | 2,000 | 2,000 | 2,500 |
| Dividend yield (%) | 1.3 | 1.2 | 2.0 | 2.0 | 2.5 |
| EV/EBITDA (x) | 10.4 | 15.5 | 12.9 | 11.0 | 8.9 |
| EV/EBIT (x) | 15.5 | 13.0 | 11.3 | 9.1 | 7.5 |

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| Ratings | Total expected return within the next 12 months |
|----------------|--|
| BUY | Above 10% |
| HOLD | Between -10% to +10% |
| SELL | Below -10% |

BUY: We have a positive outlook on the stock based on our expected absolute or relative return over the investment period. Our thesis is based on our analysis of the company's outlook, financial performance, catalysts, valuation and risk profile. We recommend investors add to their position.

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