T&A INDUSTRY: MORE PAIN THAN GAIN FROM TRADE WAR

Outlook – Short term

Negative Neutral Positive

Outlook – Long term

Negative Neutral Positive

Valuation

Negative Neutral Positive

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NEUTRAL

Highlighted Company

Song Hong Garment JSC (MSH VN, ADD, TP VND66,600)

One of Vietnam's top apparel manufacturers, solidified by a strong customer base - global premium fashion brands, which will build MSH's reputation as a supplier of upper class brands.

An improvement in product mix from high-margin FOB apparel production forecast to be the near-term growth driver. Manufacturing capacity expansion is expected to be the long term growth engine from FY20F onwards thanks to the US$16m apparel factory Song Hong 10 (SH10) that will start construction in 2Q2019F, and production in 2H2020F. MSH's total capacity would rise by 25%.

Also, the firm has a very attractive dividend policy, with FY20F dividend expected at VND4,000/share (equivalent to a dividend yield of 7.0%).

P/E (x)	Dec-18	Dec-19F	Dec-20F
MSH	7.2	5.6	4.8

P/B (x)	Dec-18	Dec-19F	Dec-20F
MSH	2.9	2.2	1.7

ROE (%)	Dec-18	Dec-19F	Dec-20F
MSH	44.0%	44.9%	39.4%

ROA (%)	Dec-18	Dec-19F	Dec-20F
MSH	15.2%	16.9%	16.0%

Good news is Vietnam gained market share in the U.S amid trade war tension. Vietnam's share in the U.S. market has edged up to 7.8% of the sector's export volume and 11.8% of export value in 8M19, from 7.2% and 11.7% in FY18, respectively.

…but more pain than gain. Both the number and the size of orders have been shrunk due to buyers' concerns over U.S.-China trade war uncertainties. The country's 9M19 T&A export value reached US$24.6bn, a rise of 9.6% yoy (well below the 16.5% yoy growth in 9M18). Most of Vietnam's export markets witnessed the sluggish performances since the beginning of this year. Specifically, the U.S. market's export value grew 8.7% yoy in 9M19 (vs. the 11.8% yoy of 9M18). The European Union and Japan also marked the decelerations with 4.2% and 4.6% yoy, respectively, in 9M19 (vs. 11.4% and 24.2% yoy in 9M18).

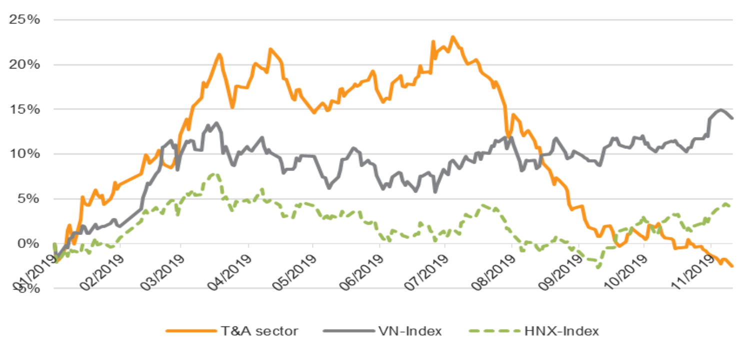
Listed T&A companies had a lacklustre performance in 9M19. The 9M19 aggregate sales of listed T&A companies subdued 1.6% yoy, while aggregate net profit dropped 13.8% yoy. Indeed, more than half of the large listed T&A firms in our observation had negative growth in 9M19, caused by (1) fewer and smaller orders due to on-going U.S.-China trade tensions; and (2) contracting gross margins due to lower average selling price, especially among virgin yarn producers.

In 9M19, **only a few large listed T&A companies in our observation (e.g., STK, MSH, PPH, EVE), enjoyed a gross margin expansion** amid the industry recession thanks to an improvement in product mix, while others witnessed the contraction in gross margin.

We maintain Neutral outlook in short-term on Vietnam's T&A sector. The T&A sector's price movement outperformed the VN-Index from Jan to Jul 2019 on the back of positive expectations about EVFTA's approval, but then sector prices dropped sharply to underperform against VN-Index due to the weak business results. However, **in the long term, our view is positive** for the industry on the back of significant benefits from FTAs, especially when Vietnam solves the bottlenecks of fabric production in the value chain.

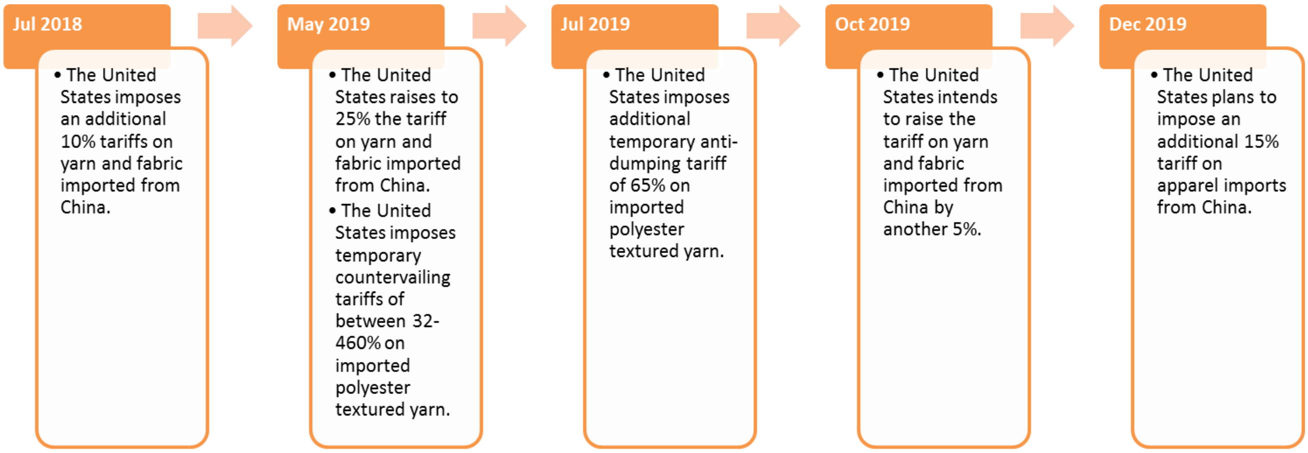
Our top pick is MSH - one of the leading apparel manufacturers in Vietnam - solidified by a strong customer base of global premium fashion brands, mainly from the United States and European Union, helping its business to be less affected by trade war.

Figure 1: T&A sector price performance in 2019



VIETNAM'S TEXTILE AND APPAREL (T&A) EXPORT AND IMPORT SLOWED IN 9M19

Figure 2: Timeline of U.S. tariffs on China's T&A products



Source: STK, VND Research

China's T&A industry in deep trouble as trade war lingers. In particular, China's textile exports value rose 7.9% yoy to US$119.3bn last year, partly because Chinese companies raced against the time to export to the United States before the tariff hike began in Jul 2018. But as the front loading has worn off, the trade war consequences have become more apparent, and in 10M19, textile exports only grew 0.3% yoy to US$99.3bn. China's 9M19 T&A export to the United States dipped 3.2% yoy to US$28.95bn, from US$29.90bn in 9M18.

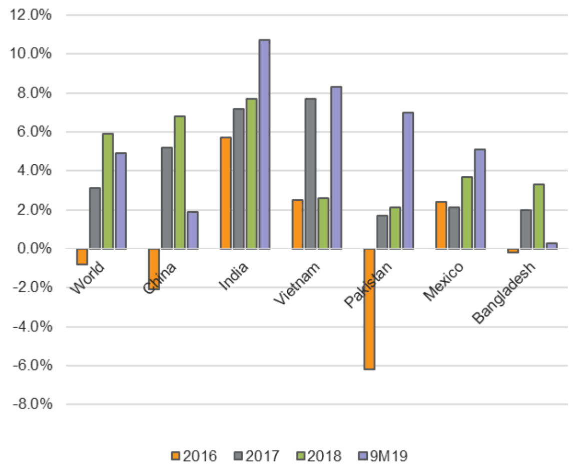
Plunging orders from the United States have also depressed the price of raw materials needed for textile production, particularly yarn. China paid US$2,397 per tonne of imported raw materials in Oct 2019, down from US$2,606/tonne in Dec 2018, or an 8% decline ytd. This drop, which trimmed the value of China's yarn inventory, has been cited among the reasons for the closure of many Chinese yarn manufacturers.

Figure 3: China's yarn average import price (US$/ tonne)

Source: Bloomberg, VND Research

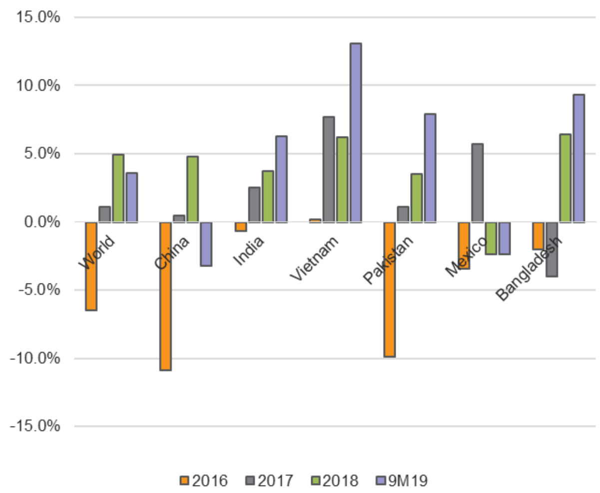
This slowdown has also dented companies' willingness to hire more workers as the labour cost has been surging in recent years. China's labour cost standing above that in Vietnam, Pakistan, Bangladesh, India and other Southeast Asian countries is becoming an increasing disadvantage to manufacturers based in the country. Given the cost advantage, the Asian nations mentioned above have seen positive export growth in the U.S. market in 9M19.

Figure 4: U.S. T&A import volume growth by countries



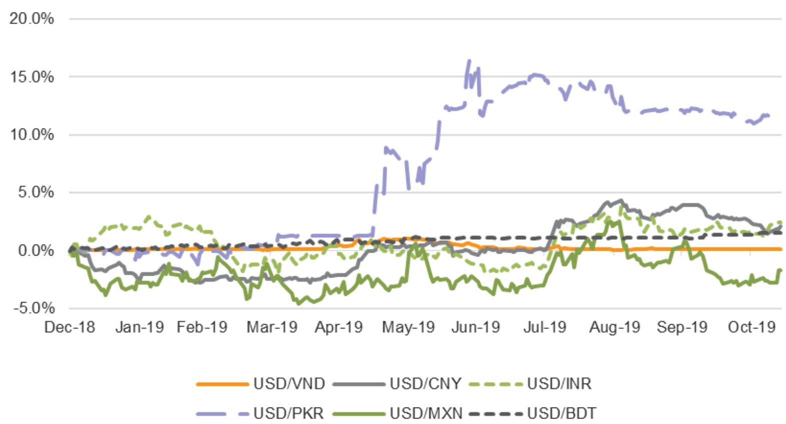
Source: OTEXA, VND Research

Figure 5: U.S. T&A import value growth by countries



Source: OTEXA, VND Research

Figure 6: Exchange rates performance of major T&A exporting competitors (%)

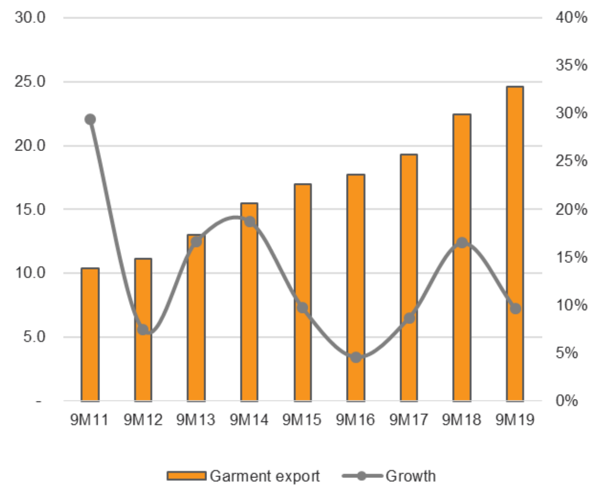


Source: Bloomberg, VND Research

Vietnam's T&A export and import slowed in 9M19. Specifically, the country's T&A export in 9M19 grew 9.6% yoy to US$24.6bn, below the 16.5% growth in 9M18. Fibre and yarn export bagged US$3.1bn in 9M19, up only 3.1% yoy (vs. 13.9% in 9M18). The growth momentum is slowing due to a shortage of orders. Buyers are concerned over the on-going U.S.-China trade war, which has reduced both the number and the size of orders. The 3.3% yoy growth of fabric import and 2.8% yoy increase in materials and accessories import in 9M19 clearly illustrated weaker production of domestic manufacturers.

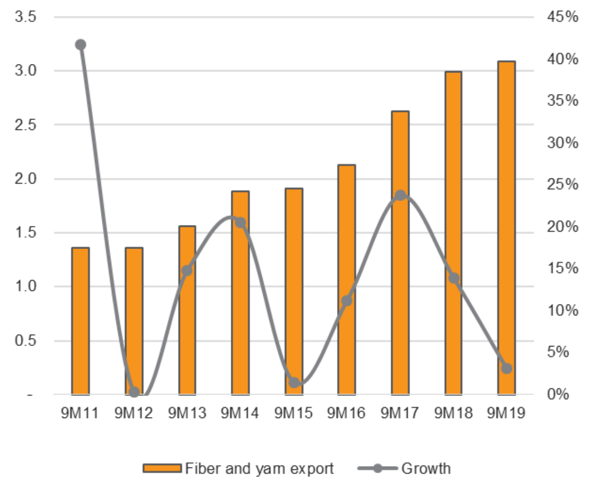
The stability of the Vietnamese dong against the U.S. dollar so far this year has reduces Vietnam's export competitiveness. The VND has been moving sideways since the start of FY2019 (+0.1% ytd as of 13 Nov 2019), while the currencies in rival nations (such as China, India and Pakistan) had a larger depreciation in 9M19. The stability in the Vietnamese dong has thus placed the country's exports at a disadvantage.

Figure 7: Vietnam's garment export (2011-2109)



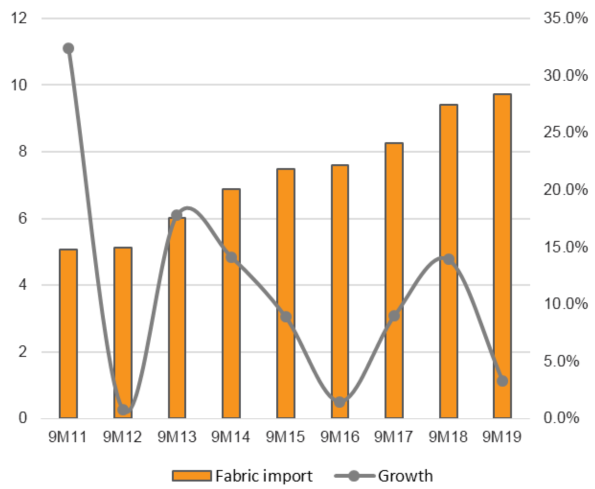
Source: Vietnam's customs, VND Research

Figure 8: Vietnam's fibre and yarn export (2011-2019)



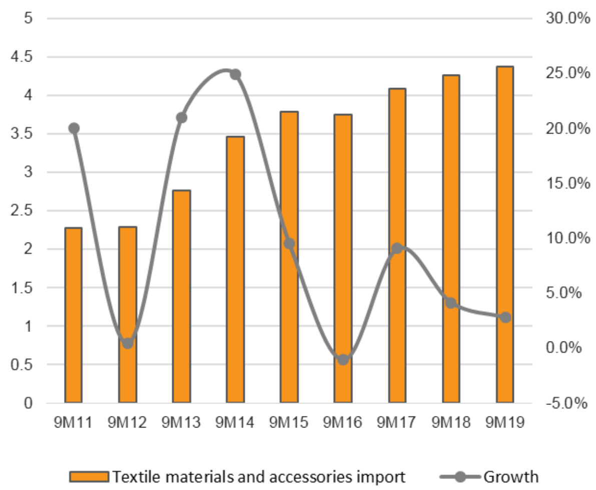
Source: Vietnam's customs, VND Research

Figure 9: Vietnam's fabric import (2011-2109)



Source: Vietnam's customs, VND Research

Figure 10: Vietnam's textile materials and accessories import (2011-2019)

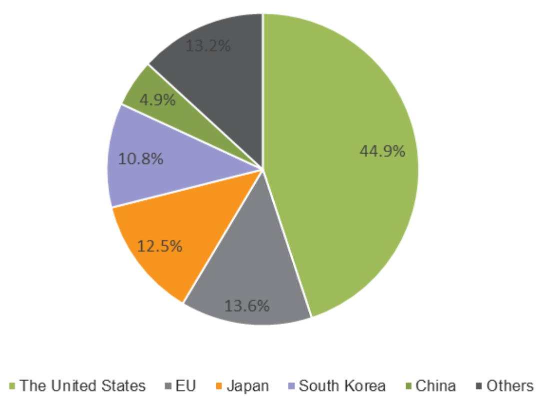


Source: Vietnam's customs, VND Research

Lower country's export growth is due to a slower improvement in major export markets. Specifically, the U.S. market's export value grew 8.7% yoy in 9M19 (compared with 9M18 of 11.8%). The European Union and Japan also saw decelerated growth from 11.4% and 24.2% yoy in 9M18 to only 4.2% and 4.6% yoy in 9M19.

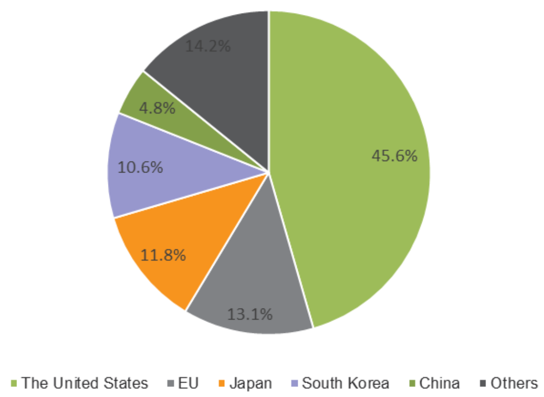
In 9M19, the United States remained the top buyer of Vietnam's T&A, with an import value of US$11.21bn, accounting for 45.6% of Vietnam's total T&A export; followed by Japan, the European Union, South Korea and China, with export value of US$2.91bn (accounting for 11.3% of total T&A export), US$3.22bn (11.8%), US$2.6bn (10.6%), and US$1.18bn (4.8%), respectively.

Figure 11: Vietnam's garment export markets in 2018



Source: STK, VND Research

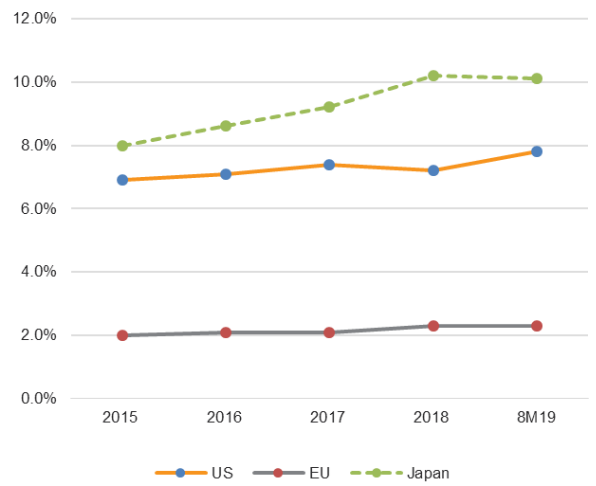
Figure 12: Vietnam's garment export markets in 9M19



Source: STK, VND Research

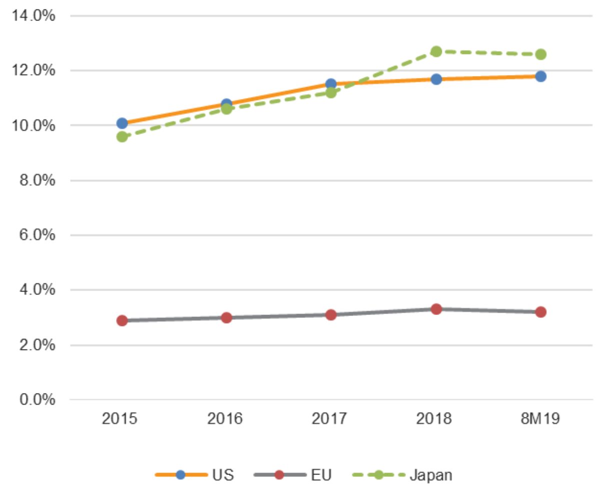
Vietnam's T&A has gradually increased foothold in major markets. Vietnam's share in the U.S. market has increased to 7.8% of the sector's export volume and 11.8% of export value in 8M19, from 7.2% and 11.7% in FY18, respectively. Whereas, the country's T&A market shares in Japan and Europe remained relatively stable, reaching 12.6% and 3.2% regarding the export value, respectively.

Figure 13: Shares of Vietnam's T&A in big markets by export volume



Source: STK, VND Research

Figure 14: Shares of Vietnam's T&A in big markets by export value



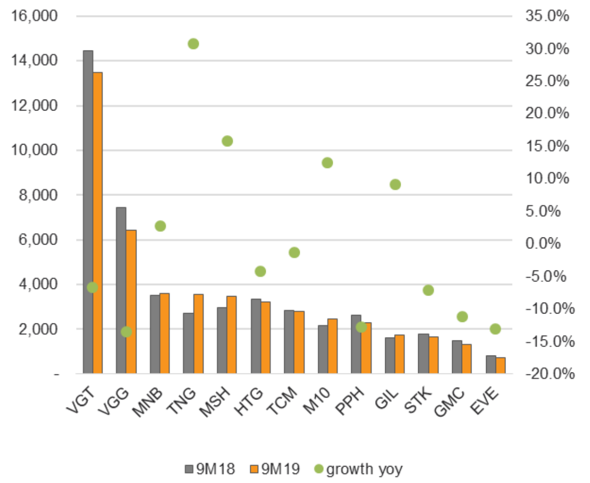
Source: STK, VND Research

T&A COMPANIES HAVE BEEN STRUGGLING AMID TRADE WAR

While corporate results vary, Vietnamese T&A enterprises in general recorded a weak performance both in topline and bottomline in 9M19. The latest 9M19 business results published by listed Vietnamese T&A companies showed their revenue slowed down 1.6% yoy while their net profit fell 13.8% yoy.

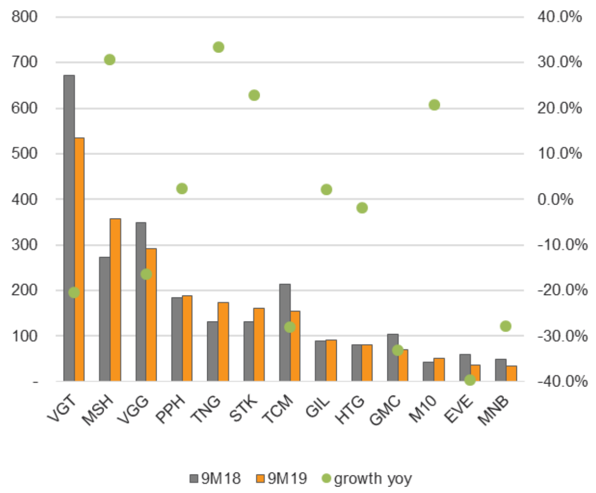
Indeed, more than half of the large listed T&A companies in our observation had negative growth in 9M19, caused by (1) fewer and smaller orders because of the on-going U.S.-China trade tensions; and (2) contracting gross margins due to lower average selling price, especially virgin yarn producers.

Figure 15: Vietnamese T&A enterprises' revenue performance in 9M19 (VNDbn)



Source: Company reports, VND Research

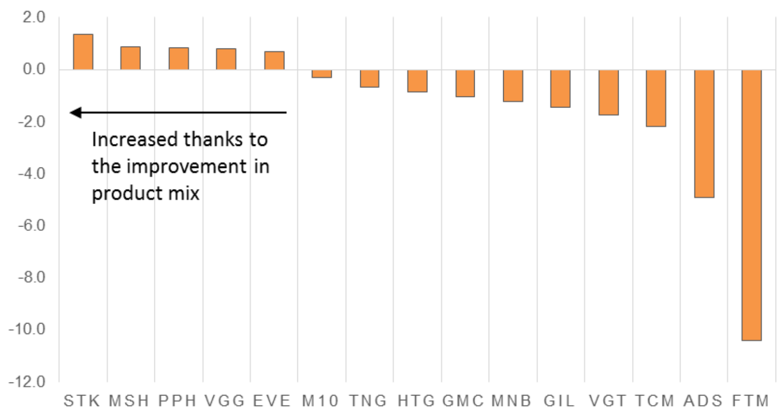
Figure 16: Vietnamese T&A enterprises' net profit performance in 9M19 (VNDbn)



Source: Company reports, VND Research

However, based on our observation, a few companies (e.g., STK, MSH, PPH, EVE) who had ability to upgrade product mix, enjoyed a gross margin expansion amid the industry recession.

Figure 17: Vietnamese T&A firms' change in gross profit margin between 9M19 vs. 9M18 (% pts)



Source: Company reports, VND Research

Meeting the Rules of Origin under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (from yarn onwards) and the European Union – Vietnam Free Trade Agreement (EVFTA) (from fabrics onwards) is still a challenge due to bottlenecks in fabric production. Vietnam now has to import most of its fabric need from China (accounting for 58% of the total T&A import value). According to the Vietnam Textile and Garment Association (Vitas), to take advantage of FTAs, it is necessary to add 1.7bn metres of fabrics for production this year and in 2020. If not sourcing from the import, Vietnam needs to invest US$1.7bn in fabric production. By 2025, it needs 10bn metres of fabric, equivalent to an investment of US$10bn.

TEXTILE SECTOR OUTLOOK AND STOCK PICK

We have a Neutral outlook in the short term for Vietnam's T&A sector due to the on-going U.S.-China trade war. However, **in the long term, our view is still positive** for the industry given FTAS' significant benefits. Various export destinations may support Vietnam to reduce reliance on the U.S. market and ensure a bright outlook for the T&A industry, especially when Vietnam solves the bottleneck of the value chain. Yarn price in China will recover after having fallen to a three-year low level as China and the United States move towards a possible renegotiation on tariff elimination. We believe that T&A sector price will move sideways until there is more optimistic information on international trade.

Our stock pick is MSH because its business is less affected by trade war. In 9M19, the company's revenue and net profit grew 15.8% and 30.7% yoy to VND3,456bn and VND357bn, respectively. MSH is one of the leading apparel manufacturers in Vietnam, solidified by a strong customer base of global premium fashion brands, mainly from the United States and European Union, helping MSH to ignore the pain from trade war.

We expect an improvement in product mix, with larger contribution from high-margin FOB apparel production forecast to be the near-term growth driver. Manufacturing capacity expansion is expected to be the long term growth engine from FY20F onwards thanks to the US$16m apparel factory Song Hong 10 (SH10) that will start construction in 2Q2019F, and production in 2H2020F. MSH's total capacity would rise by 25%. Also, the firm has a very attractive dividend policy, with FY20F dividend expected at VND4,000/share (equivalent to a dividend yield of 7.0%).

Figure 181: T&A peer comparison (as of 13 Nov, 2019)

Company	Bloomberg Ticker	Recom.	Target price (local curr)	Market Cap (US$m)	TTM NPAT growth (%)	TTM EPS growth (%)	TTM ROA (%)	TTM ROE (%)	D/E (x)	TTM P/E (x)	TTM P/B (x)
Synthetic fiber manufacturers											
Century Synthetic Fiber	STK VN	ADD	25,200	71.4	16.8%	13.2%	9.4%	22.0%	0.9	6.0	1.3
Texhong Textile Group Ltd	2678 HK	N/A	N/A	1,063.9	-11.3%	-11.8%	6.8%	18.4%	1.1	6.9	N/A
Vardhman Textiles Ltd	VTEX IN	N/A	N/A	895.1	-5.6%	-4.9%	8.5%	13.9%	0.3	6.9	0.9
Shinkong Synthetic Fibers	1409 TT	N/A	N/A	713.9	-8.6%	-9.9%	1.5%	7.7%	2.5	9.2	0.6
Indo-Rama Synthetics	INDR IJ	N/A	N/A	229.0	-61.1%	-55.6%	9.0%	21.9%	0.5	6.5	0.4
Daehan Synthetic Fiber	003830 KS	N/A	N/A	121.7	10.6%	10.6%	8.5%	9.9%	0.0	2.1	0.2
Hong Yi Fiber Industry	1452 TT	N/A	N/A	89.8	-1.1%	-0.7%	6.9%	8.1%	0.0	14.4	1.0
Average				**455.0**	**-8.6%**	**-8.4%**	**7.2%**	**14.6%**	**0.8**	**7.4**	**0.7**
Median				**229.0**	**-5.6%**	**-4.9%**	**8.5%**	**13.9%**	**0.5**	**6.9**	**0.8**
Apparel and garment manufacturers											
Thanh Cong Textile Garment	TCM VN	ADD	28,200	54.0	-23.0%	-23.0%	6.6%	13.2%	1.0	7.4	0.9
Song Hong Garment	MSH VN	ADD	66,600	122.6	22.7%	-8.9%	15.0%	43.8%	0.8	5.6	2.9
Viet Tien Garment	VGG VN	N/A	N/A	97.9	19.8%	19.8%	10.1%	24.0%	0.0	6.4	1.4
TNG Invm't and Trading	TNG VN	N/A	N/A	39.7	24.3%	20.7%	7.8%	26.0%	1.6	4.0	0.9
Viet Thang Corp.	TVT VN	N/A	N/A	19.6	11.2%	11.2%	6.1%	13.5%	0.8	5.2	0.7
Garmex Saigon	GMC VN	N/A	N/A	15.9	14.8%	14.8%	8.7%	21.6%	0.9	4.3	0.8
Nha Be Garment	MNB VN	N/A	N/A	28.9	12.0%	12.0%	1.8%	15.6%	4.7	14.2	2.1
Average				**54.1**	**11.7%**	**6.7%**	**8.0%**	**22.5%**	**1.4**	**6.7**	**1.4**
Median				**39.7**	**14.8%**	**12.0%**	**7.8%**	**21.6%**	**0.9**	**5.6**	**0.9**

Source: Bloomberg, VND Research

DISCLAIMER

RECOMMENDATION FRAMEWORK

Stock Ratings	Definition:
Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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