

## Century Synthetic Fiber Corporation (HOSE: STK)

**BUY; Target price: VND 43,000 (upside: 38.2%)**

### Update:

FY20 result: Revenue of VNDb 1,766 (-21% yoy) and net income of VNDb 143 (-33% yoy). Of which, recognized Q4 revenue of VNDb 569 (+73% from Q3.2020 and +4% qoq) and net income of VNDb 69 (3.4-folded from Q3 and +28% qoq). The driving force mostly came from the high-margin recycled yarn, sustaining gross margin of 22% in 2020 and adding 3.7% to revenue whereas the share from virgin yarn dropped 18%.

### Investment thesis:

A BUY recommendation is given to STK based on: (1) Recycled yarn with higher margin of 22% is the long-term growth booster, especially when considering sportswear and apparel are on high demand. (2) Chip spinning technique renders technological advantage. (3) New factories in Cu Chi and Tay Ninh will double the manufacturing capacity to meet the recycled yarn demand from existing customers.

### Key risks:

- (1) US-China trade war can be a double-edged sword as it is putting pressure on yarn selling price in the short term but potentially shifting the demand out of China to Vietnam.
- (2) Deteriorating demand in the US and the EU markets.

### Valuation:

Based on DCF method and assumption of the potential of recycled yarn, we recommend to buy STK with target price of VND 43,000 (upside: +38.2%).



Report date	11/03/2020
Current price	VND 31,000 /share
<b>Target price</b>	<b>43,000 VND/cp</b>
<b>Upside (%)</b>	<b>38.2%</b>
Bloomberg ticker	STK VN
Market cap	VNDb 2,113.74
52-week price movement	VND 12,600 – 32,400
Average trading volume	114,532
Current foreign ownership	7.12%
Foreign ownership limit	49%

Income statement	Unit	2020	2021F	2022F	2023F	2024F	2025F
<b>Revenue</b>	<b>VNDb</b>	<b>1,766</b>	<b>2,309</b>	<b>2,636</b>	<b>3,568</b>	<b>4,396</b>	<b>6,251</b>
Revenue growth rate	%	-20.8%	30.8%	14.2%	35.4%	23.2%	42.2%
Cost of good sold	VNDb	1,510	1,873	2,047	2,550	3,083	4,371
<b>Gross profit</b>	<b>VNDb</b>	<b>255</b>	<b>435</b>	<b>589</b>	<b>1,017</b>	<b>1,313</b>	<b>1,880</b>
Selling expenses	VNDb	24	30	35	47	58	82
G&A expenses	VNDb	57	78	71	96	119	169
<b>EBIT</b>	<b>VNDb</b>	<b>174</b>	<b>327</b>	<b>483</b>	<b>874</b>	<b>1,137</b>	<b>1,629</b>
Financial profit	VNDb	-11	-32	-27	-22	-14	2
<b>Profit before tax</b>	<b>VNDb</b>	<b>163</b>	<b>295</b>	<b>456</b>	<b>852</b>	<b>1,123</b>	<b>1,630</b>
Income tax expenses	VNDb	20	44	68	128	168	245
<b>Profit after tax</b>	<b>VNDb</b>	<b>143</b>	<b>251</b>	<b>388</b>	<b>724</b>	<b>955</b>	<b>1,386</b>
<b>Profit after tax for parent company</b>	<b>VNDb</b>	<b>106</b>	<b>71</b>	<b>29</b>	<b>100</b>	<b>178</b>	<b>214</b>
<b>Not-controlling interest</b>	<b>VNDb</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>

Source: STK, MBS Research

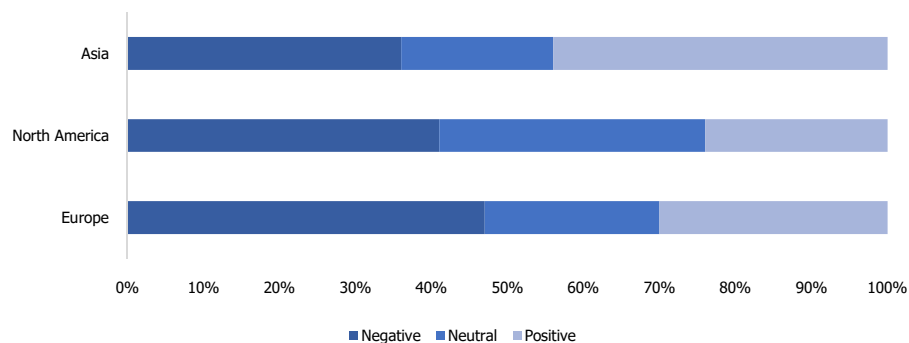
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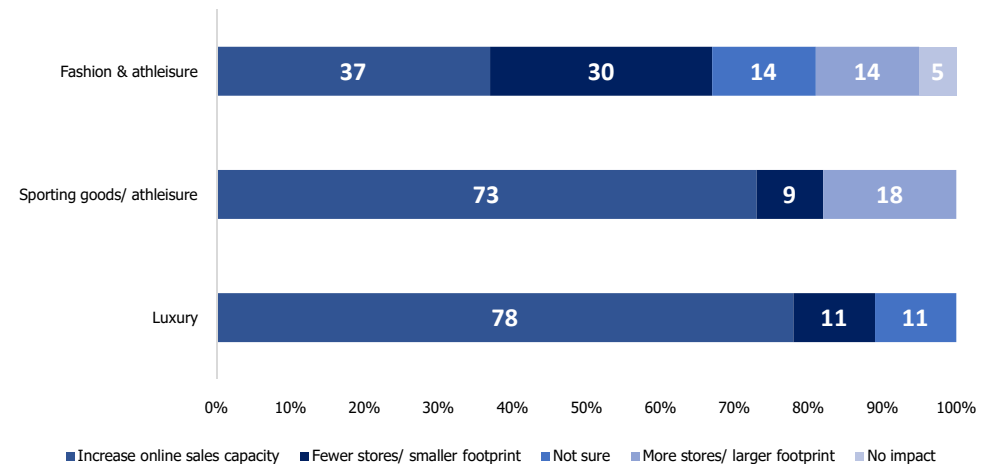
### The changing landscape of fashion retail:

- Apparel demand was plummeting as social distancing measures were enforced and spending was tightening to cope with the economical distress caused by coronavirus. Although garment retail expected a double-digit decline in revenue, one category is beating the expectation to have a strong recovery.
- The term "athleisure" is defined as casual clothing designed to be worn for both exercising and for general use. Pandemic outbreak is protracting the situation of working from home, thus making many gravitate toward comfort and versatility. According to report from NPD Group, until May 2020, sportswear makes up for 28% of total apparel revenue (+4% yoy).
- Online shopping has soon become the alternative as stores are closing. A survey of 950 online retailers from Digital Commerce 360 and Bizrate Insights discloses that about 64% of online revenue comes from athleisure clothing. More specifically, ecommerce of sportswear is up 22%.

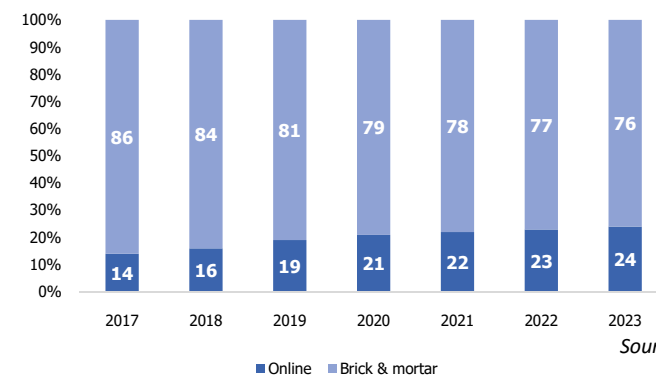
### Outlook on fashion industry in 2021 (% respondents)



### Survey on APC fashion executives on the impact of online shopping in Covid era (% respondents)



### Fashion market share



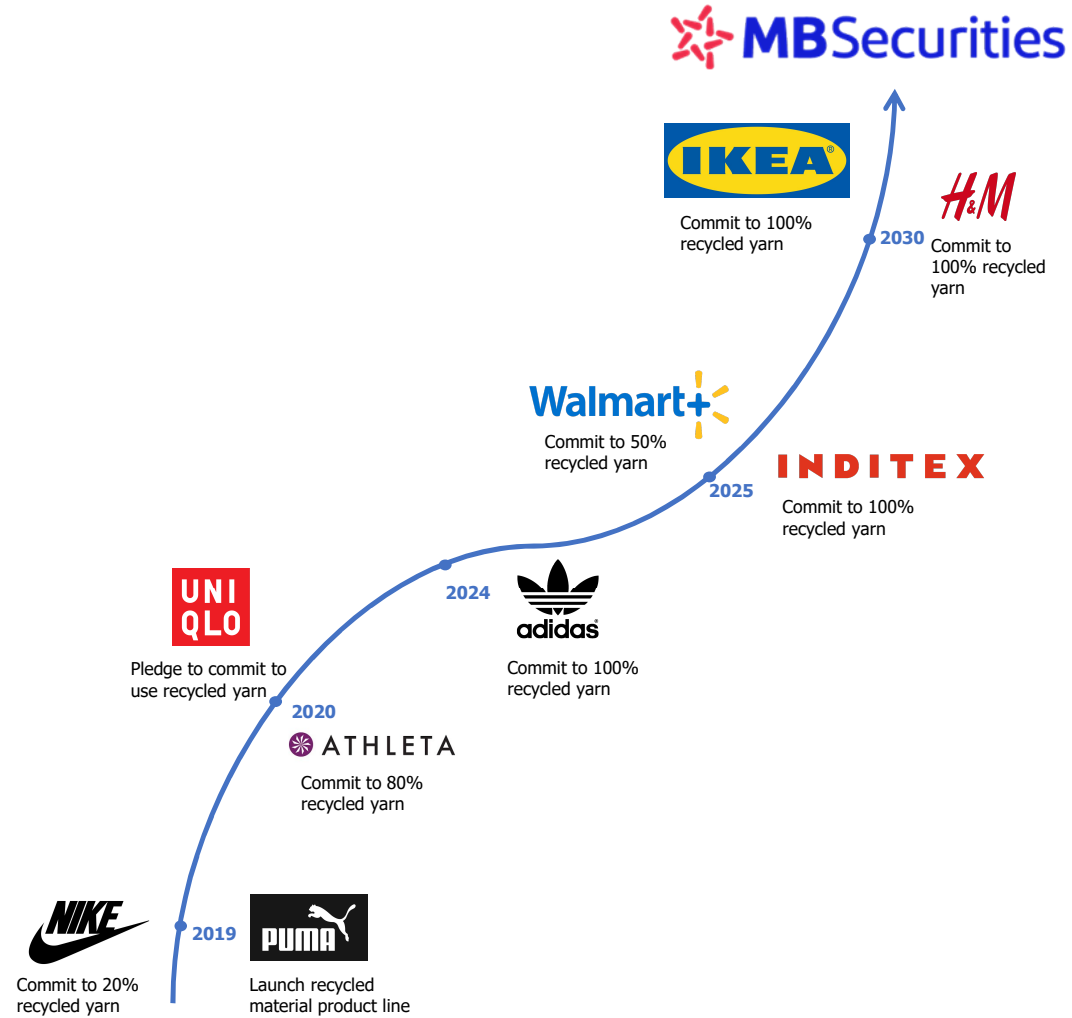
Source: STK, MBS Research

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## Prospective outlook in the recycled yarn segment:

- Major customers of recycled yarn are fabric supplier for renowned brands such as Nike, Adidas, Puma, Inditex, Uniqlo, etc with the focus on mid-tier to high-end. Revenue of sportswear and athleisure brands for the most part is accelerating the last half of 2020: Lululemon recorded revenue of USDb 1.1, beating expecting and increasing 22% yoy; Nike Q2.2021 revenue (ending 30/11/2020) reached USDb 11.2 (+9% yoy) thanks to the major contribution from Chinese market; Adidas FY20 revenue down 8% yoy to EURb 19.9.
- Sportswear brands, some of which are customers of STK, have pledged to commit to increase the usage of recycled yarn in their products as a long-term strategy to achieve sustainability. This marks a great sign as the rising demand for recycled yarn will render STK to expand production to achieve remarkable result.



Source: STK, MBS Research

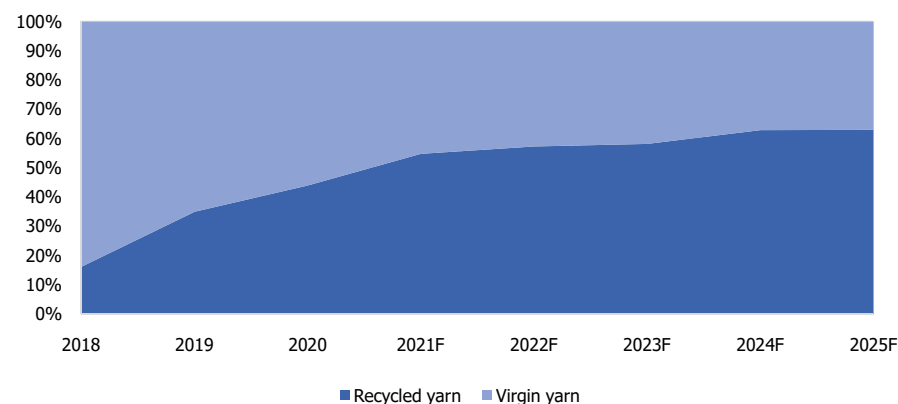
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### Competition within the segment:

- STK targets the mid-tier to high-end customers, therefore, the pricing is not necessarily a factor that attracts customers but more so the product quality is the selling point. Within the pricing model itself already takes the price gap into consideration to assure a healthy margin even under the pressure of rising input material.
- Vietnam yarn industry is concentrated in 4 largest suppliers in Vietnam, naming STK, Formosa, Hualon and Billion Industrials. While STK and Formosa are set on the premium segment, Hulon and Billions focus on the competitive pricing and mass production. Thus, Formosa is the direct competition in Vietnam market. Expanding outside the territory, other competitors can be named such as Reliance of India and Indorama of Indonesia, etc. Despite a much ample production capacity compared to STK, the competition landscape is not as intense as very few firms cut out for making recycled yarn and have the expertise specifically in apparel like STK.
- The current domestic output can only meet up 40% of the demand, thus STK is granted with the opportunity to fill the supply-demand gap. Consumption in the next 5 years will accelerate a lot faster than the expansion pace of business due to the obstacles of supply chain, technology and expertise. As a result, the businesses that already secured their position in the industry are often in a much more advantageous position over the new market entrants.

**Revenue share by product**



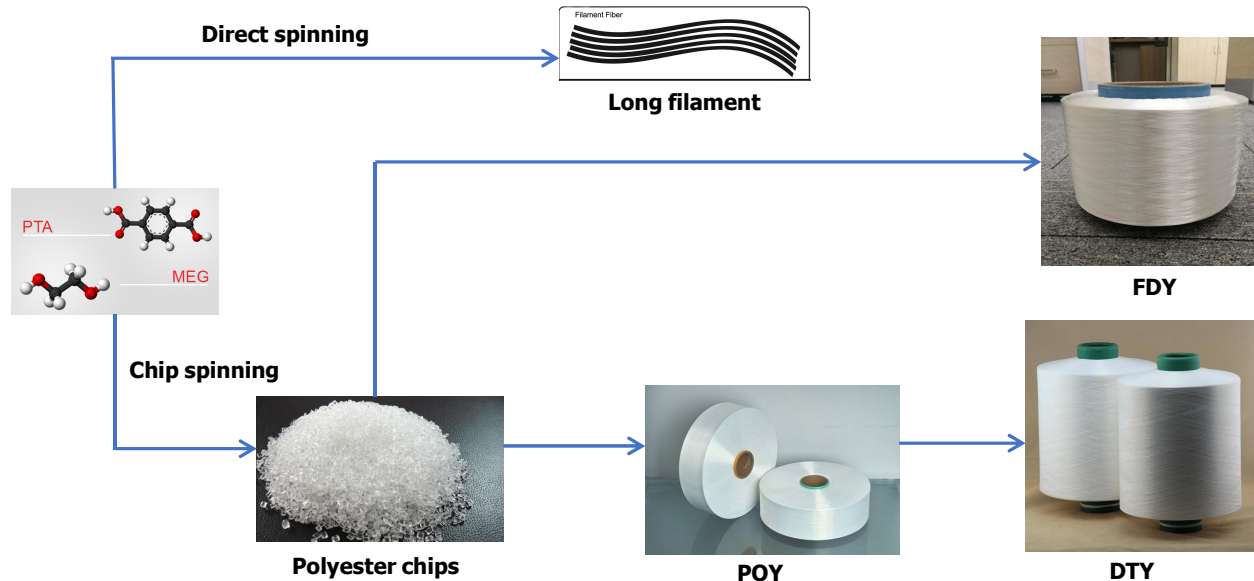
Source: STK, MBS Research

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### Direct spinning vs. chip spinning:

- The competition with products from China is very little to none because of the discrepancy in market segment and manufacturing techniques. In order to mass produce at competitive pricing, Chinese firms often implement direct spinning which is not cut for recycled yarn production. The process of converting into producing recycled yarn will require time, expenses as well expertise to ensure the product quality.
- In direct spinning, through process of heating and spinning, PTA and MEG are converted into long filament. Whereas, in chip spinning, PET chips are first processed to POY (partially oriented yarn) then are drawn at a later time during textile operations into DTY (drawn textured yarn) and FDY (fully drawn yarn). The intermediate product POY that has higher elasticity and porosity, is often used to making sportswear.
- As a result, chip spinning in which the output is dictated by the input material allows more latitude to switch around between recycled yarn and virgin yarn. The company have the option to optimize the production of 2 yarns corresponding to the demand from customers. The initial investment of chip spinning is only a fraction of direct spinning.
- The strategy toward high-margin and value-added products will stimulate the recovery process to the pre-Covid level and magnify the overall profit margin.



Source: STK, MBS Research

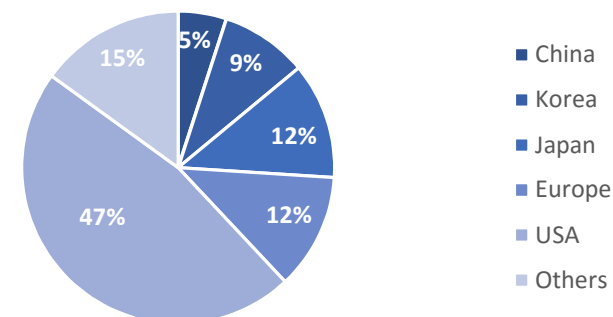
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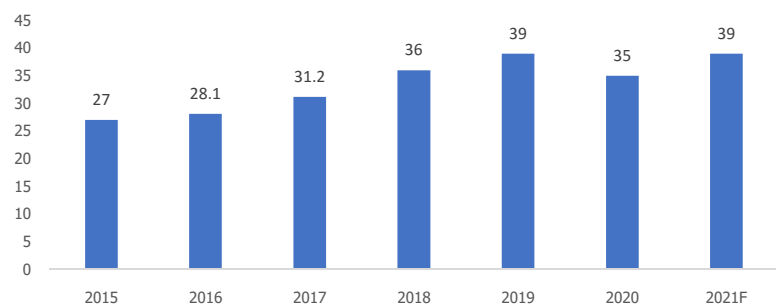
### Vietnam textile in 2020:

- The uptrend of textile export value was interrupted in 2020, dropping from USDb 39 to USDb 35 due to the stagnant demand in major export markets (i.e., USD, Europe) caused by coronavirus. Despite a sign of recovery since Q3, the overall value has not fully bounced back to the pre-Covid era.

### Vietnam's export markets



### Textile export value (USDb)



Yarn: USDb 3.69 ▼ 11.43% yoy

Fabric: USDb 0.45 ▼ 24.1% yoy

Accessories: USDb 1.66 ▼ 17.28% yoy

Garment: USDb 29.47 ▼ 10.22% yoy

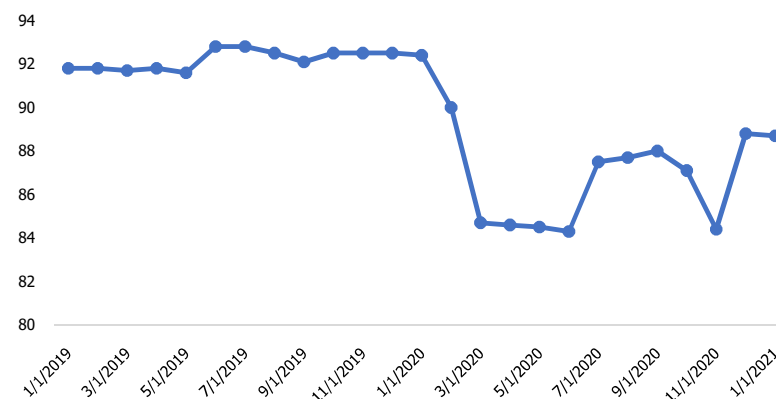
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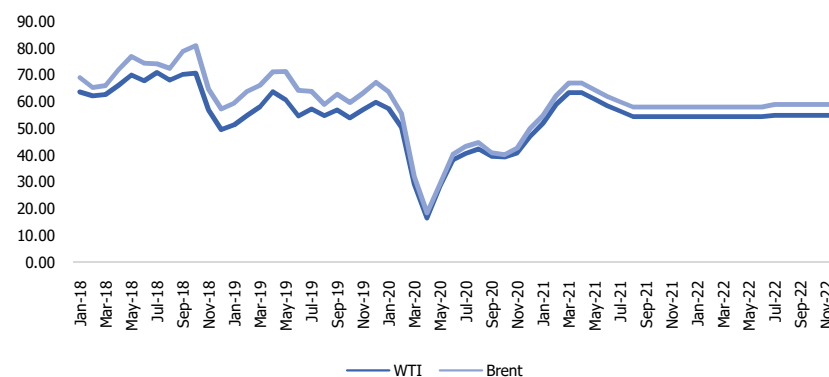
### Consensus view on apparel polyester yarn:

- Oil price fluctuation is dictated much by whether the economic activity is back to the normalcy. US GDP will grow by 5.5% in 2021 and by 4.2% in 2022, compared with an assumption of 3.8% in 2021 and 4.2% in 2022. Expecting OPEC crude oil production in April will average 25.3 million barrels per day (b/d) which is similar to expected production for March and down 1/6 million b/d from EIA's forecast. Production in May is expected to rise to 26.6 million b/d.
- The OPEC+ further cutting existing supply through April added significantly to near-term upward oil price pressure. EIA expect Brent prices will average between 65-70 USD/barrel during March and April. A downward price pressure will emerge in the coming months as the oil market becomes more balanced. Brent prices will average 58 USD/barrel in the second half of 2021.
- Domestic yarn price is greatly correlated with global oil price and the general industry atmosphere. Oil price free fall early 2020 put a pressure on selling price of polyester yarn. Apparel polyester index soared from peak 93.3 in September 2018 to 84.7 in March 2020. Since June 2020, yarn price is bouncing to 88.7.
- In the intermediate future, we expect oil price rally and rising garment demand are what drive yarn price to recover. Moreover, the anti-dumping investigation on yarn imported from China, India, Indonesia and Malaysia may set a protection layer for domestic products.

**Apparel polyester index**



**Oil price forecast**



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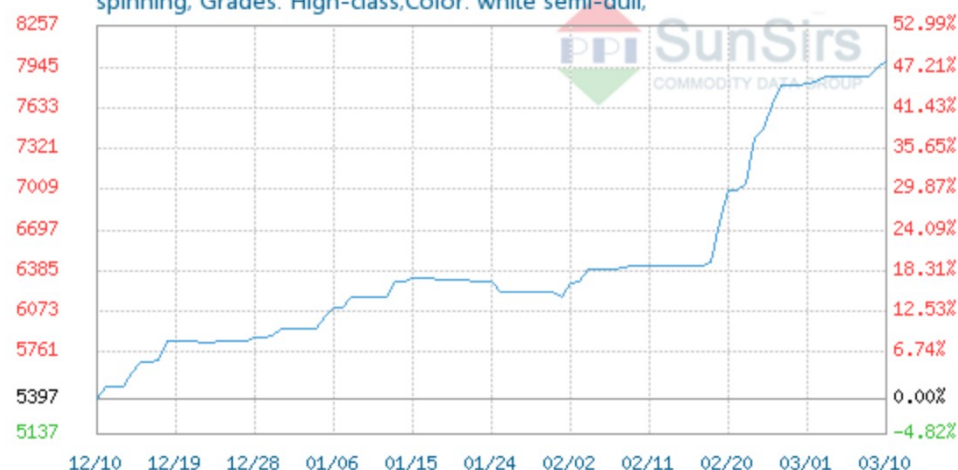
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### Recycled yarn segment as long-term growth strategy:

- With the strategy to make recycled yarn the growth driver in the long run, we expect its share in overall revenue will reach 55% in 2021. Once the factories in Cu Chi and Tay Ninh are put into operation, total output can be up to 143,300 ton/year by 2025 with the recycled yarn capacity is two-fold. We expect the contribution of recycled yarn to overall revenue will reach to close 72% in 2025.
- Yarn orders are not often prebooked far ahead of time but on monthly basis due to the fluctuation in material expenses. According to the company, selling price in January and February is on the upward trend from late 2020. Therefore, Q1 revenue is expected to be positive. Yarn demand is recovering driven by the boost from rising garment orders, especially for sportswear and athleisure clothing.
- Considering world oil price is recovering, price of petroleum byproducts such as PET microchip subsequently is inflated which in essence puts pressure on the material expenses. However, STK's pricing model in place has already accounts for price gap to maintain steady margin even in the situation when material prices are soaring.
- Vietnam spinning industry is heavily dependent on the supply from China which accounts for 70% of domestic consumption. STK's strategy to increase share of recycled yarn in its product mix has helped the firm immunized from the price dumping behavior of Chinese suppliers and allowed to be more defensive during the market changes.

Polyester POY 2020-12-10 - 2021-03-10 (Unit: RMB/ton)

Thickness: 150D; Number of holes: 48F; Category: melt spinning; Grades: High-class; Color: white semi-dull;



Source: STK, SunSirs. MBS Research



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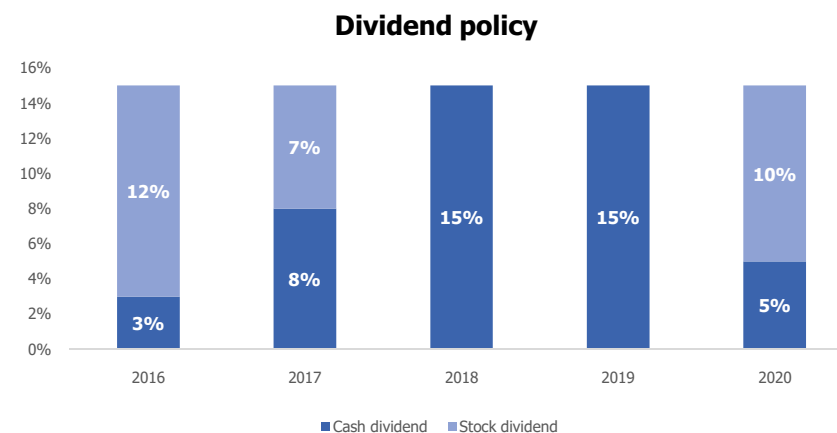
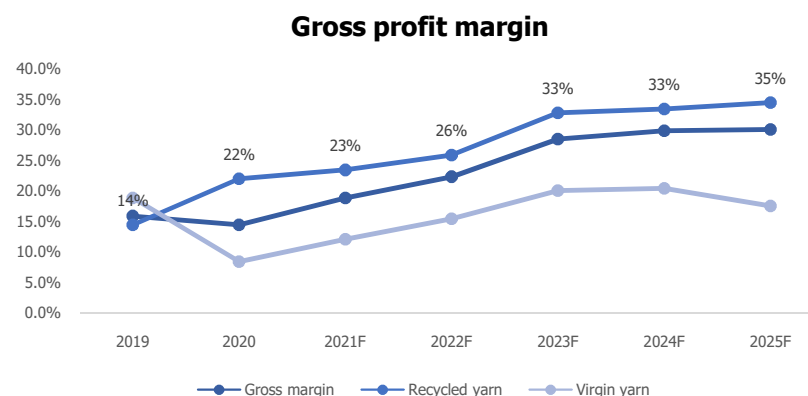
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### FY2021 forecast:

- FY21 revenue is expected to take a leap of 31% to VNDb 2,308 thanks to the boost from recycled yarn and improvement in selling price. Recycled yarn marks VNDb 1,375, increasing its share in revenue increases from 44% in 2020 to 60% in 2021.
- Profit margin is stretched in the future owing to the steady business operating with a secure customer base and great negotiation power from the scale of economies. The installation of factories in Cu Chi and Tay Ninh will bring total capacity up to 143,300 ton/year. Net income is expected to rise 75% to VNDb 251.

### Valuation:

- The company has maintained a consistent dividend policy of 15% over several years. Even when business is stagnant in 2020, the firm assures that the dividend policy is likely kept intact. More information will be disclosed in the annual general meeting in April. A history of steady dividend payments is what attracts long-term investors.
- Based on discounted cash flow method and the premise that recycled yarn will contribute greatly to the bottom line, we recommend to buy STK stock with the target price of VND 43,000 VND (upside 38.2%).



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Balance Sheet (VND bn)	2020	2021F	2022F	2023F	2024F	2025F	Ratios	2020	2021F	2022F	2023F	2024F	2025F
<b>Current assets</b>	<b>634</b>	<b>730</b>	<b>872</b>	<b>1,198</b>	<b>1,696</b>	<b>2,536</b>	<b>Valuation</b>						
I. Cash & cash equivalents	95	64	53	195	461	1,072	EPS	2,115	3,697	5,717	10,685	14,081	20,440
II. Short-term investments	26	26	26	26	26	26	Book value per share (BVPS)	15,956	18,089	22,241	31,362	43,878	62,753
III. Receivables	98	100	132	198	293	417	P/E	12.9	7.4	4.8	2.5	1.9	1.3
IV. Inventory	401	520	640	750	881	971	P/B	1.7	1.5	1.2	0.9	0.6	0.4
V. Other current assets	14	19	21	29	36	51	P/S	1.0	0.8	0.7	0.5	0.4	0.3
<b>Non-current assets</b>	<b>1,070</b>	<b>1,092</b>	<b>1,177</b>	<b>1,473</b>	<b>1,832</b>	<b>2,388</b>	Dividend yield	2%	2%	2%	2%	2%	2%
I. Long-term receivables	-	-	-	-	-	-	<b>Profitability</b>						
II. Fixed assets	914	891	954	1,181	1,478	1,889	Gross profit margin	14%	19%	22%	29%	30%	30%
III. Property	-	-	-	-	-	-	EBITDA margin	17%	20%	24%	29%	30%	29%
IV. Long-term work in progress	1	1	1	1	1	1	Net profit margin	8%	11%	15%	20%	22%	22%
V. Long-term investments	19	22	18	15	13	15	ROE	10%	6%	2%	5%	6%	5%
VI. Other non-current assets	137	179	204	276	340	484	ROA	6%	4%	1%	4%	5%	4%
<b>Total assets</b>	<b>1,703</b>	<b>1,822</b>	<b>2,049</b>	<b>2,672</b>	<b>3,528</b>	<b>4,924</b>	<b>Growth</b>						
<b>Liabilities</b>	<b>621</b>	<b>595</b>	<b>541</b>	<b>545</b>	<b>553</b>	<b>670</b>	Revenue growth	-21%	31%	14%	35%	23%	42%
<b>I. Current liabilities</b>	<b>569</b>	<b>543</b>	<b>489</b>	<b>493</b>	<b>501</b>	<b>617</b>	Profit before tax growth	-35%	81%	55%	87%	32%	45%
1. Short-term payables	347	243	269	293	321	437	Profit after tax growth	-33%	75%	55%	87%	32%	45%
2. Short-term borrowings	223	300	220	200	180	180	EPS	-33%	75%	55%	87%	32%	45%
<b>II. Non-current liabilities</b>	<b>52</b>	<b>52</b>	<b>52</b>	<b>52</b>	<b>52</b>	<b>53</b>	Total Asset Equity	-18%	7%	12%	30%	32%	40%
1. Long-term payables	0	0	0	1	1	1	Equity	0%	13%	23%	41%	40%	43%
2. Long-term borrowings	52	52	52	52	52	52	<b>Liquidity</b>						
<b>Equity</b>	<b>1,082</b>	<b>1,226</b>	<b>1,508</b>	<b>2,126</b>	<b>2,975</b>	<b>4,255</b>	Current ratio	1.1	1.3	1.8	2.4	3.4	4.1
1. Share capital	707	707	707	707	707	707	Quick ratio	0.4	0.4	0.5	0.9	1.6	2.5
2. Share premium	35	35	35	35	35	35	Debt/Total assets	16%	19%	13%	9%	7%	5%
3. Retain earnings	381	525	807	1,425	2,274	3,553	Debt/Equity	25%	29%	18%	12%	8%	5%
4. Non-controlling interest	-	-	-	-	-	-	Interest coverage	10.1	11.0	21.1	41.3	58.3	83.6
5. Other capital	(41)	(41)	(41)	(41)	(41)	(41)	<b>Operating efficiency</b>						
<b>Total liabilities and equity</b>	<b>1,703</b>	<b>1,822</b>	<b>2,049</b>	<b>2,672</b>	<b>3,528</b>	<b>4,924</b>	Receivables turnover	18	23	23	22	18	18
							Days sales outstanding	20	16	16	17	20	21
							Inventory turnover	3	4	4	4	4	5
							Days sales of Inventory	112	90	103	99	97	77
							Payables turnover	5	6	8	9	10	12
							Days payables outstanding	80	57	46	40	36	32

Source: STK, MBS Research

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