

# DRY CELL AND STORAGE BATTERY JSC (PAC) – COMPANY UPDATE

RECOMMENDATION: BUY

September 30, 2009

## COMPANY OVERVIEW

Pinaco is the largest maker of storage battery and dry-cell in Vietnam, famous for its popular trademarks of “Con O,” “Dong Nai,” JP, and Pinaco. Established in 1996 as a former state-owned enterprise, the company was equitized in 2004 and listed on HOSE in November 2007.

Its main products are storage battery (85% of the company total revenue), and dry-cell battery (15%). Storage batteries are mainly used for part replacement and divided into 3 sub-categories: car battery (55%), motorcycle battery (21%), and lighting battery (24%).

The company currently operates “Con O” dry-cell battery factory in District 6, Saigon storage battery factory in Tan Tao industrial zone and Dong Nai storage battery factory in Bien Hoa. Pinaco’s current production capacity is 250 million dry-cell pieces and 1,080,000 kWh in storage battery each year.

## GENERAL INFORMATION

Industry	Personal&Household Goods
Listed	HOSE
Ticker	PAC
Charter Capital (VND bn)	165.0
52-week high	106,000
52-week low	27,380
Avg 10 day trading volume	125,325

## VALUATION MEASURES

Price (Oct. 1, 2009)	100,000
Market Cap. (VND bn)	1,650.0
P/E trailing (x)	9.9
P/B trailing (x)	4.5
P/E forward 2009 (x)	8.2
P/B forward 2009 (x)	3.5
ROE trailing (%)	37.0
ROA trailing (%)	25.8

## FINANCIAL PERFORMANCE 1H 2009

Revenue (VND bn)	630.3
Profit after tax (VND bn)	88.6
Gross margin (%)	29.3
Net margin (%)	14.1
Debt/Equity (%)	19.3

Following a strong Q2 performance, Pinaco continued to project positive Q3 revenue of VND330 bn in revenue and VND59 bn in earnings before tax, up 4% and 64% compared to the same period of last year, respectively.

## 9M FINANCIAL PERFORMANCE

**Strong demand continued.** Q3 extended growth momentum in selling volume from Q2. Selling volume was up 17% compared to the corresponding period of last year. In total, selling volume in the first 9 months of the year increased 15-16% yoy. Pinaco continued reporting its production lines were running at full capacity but still could not fill up strong demand. However, total 9M revenue is just identical to last year’s because selling prices were 15% lower than 9M 2008 prices. Pinaco’s market share has expanded from 50% in 2008 to 55% as of end Q3 2009 in which market share for truck battery is 60-70%, for car battery is 40-50%, for motorbike battery is 30% and lighting battery is 30%. The company has successfully further secured its leadership in the industry and prepared itself for future growth.

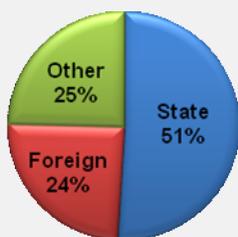
Unexpectedly strong demand of motorbike in the first quarter carrying forward and new sales from the new production line of motorcycle dry-charged sealed storage battery led to an increase of 33% yoy in motorbike battery production in Q2 vs. a 25% increase yoy in Q1. In addition, as Q2 is the start of the rainy season, lighting battery is also an important driver for revenue growth in Q2 and Q3. Compared to the same period of last year lightning production jumped 22% in Q2.

**Strong growth in gross margin in 1H was backed by lower input prices and increasing domestic sales.** Pinaco’s 1H net earnings surged 190% yoy to VND88.6 bn on the back of no increase in revenue compared to the corresponding period last year. The higher than expected earnings were supported by the expansion of gross margin from 15.2% in 1H 2008 to 29.3% in 1H 2009. Pinaco was able to take advantage of the price weakness when lead price hit its multi-year lows in Q1 to stock up lead ingot to use in manufacturing battery in Q2 with an average price considerably lower than the same period of last year. Nevertheless, because most of the growth in production was for products sold in domestic market, domestic sales which traditionally delivered most of Pinaco’s profits rose 19% yoy, much faster than total sales growth of 15%. Hence, gross margin was noticeably better in 1H.

Even though selling expenses increased from 3.4% of revenue in 1H2008 to 6.5% in 1H2009 in an effort to expand market share, Pinaco ended the first six months with net income of VND88.6 bn, up 190% yoy. We note that Pinaco did not further rewind any amount of provision for inventory devaluation into Q2 profits as it did with VND10.2 bn in Q1.

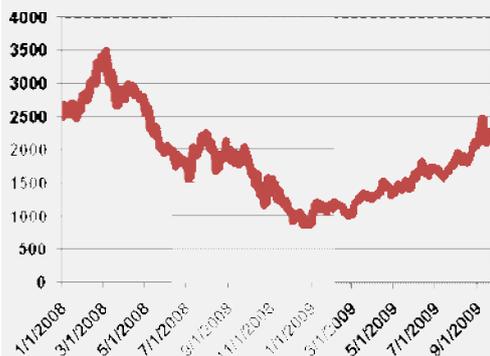
**Profits remained high in Q3 as reversion of inventory provision offset the affect of rising lead price.** As lead price has soared from an average of USD1,150/ton in Q1 to USD1,500/ton in Q2 and to a fresh 2009 high of USD2,270/ton at the end of Q3 amid concerns of China’s smelter closure, gross margin shrank Q3. However, reversion of part of Pinaco’s last year’s provision for inventory devaluation created profit cushion for the company. Income before tax excluding the reversion of provision of VND14 bn was still up 25% compared to the same period of last year. Ending the first 9 months of 2009, Pinaco estimated to achieve VND960 bn in revenue and VND160 bn in profits before tax, in line with 9M2008 revenue but up 124% yoy in income before tax.

## OWNERSHIP STRUCTURE



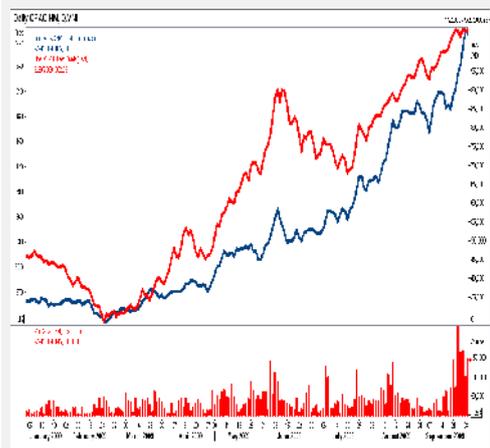
Source: Pinaco

## LME 3-MONTHS LEAD PRICE (USD/ton)



Source: Datastream

## SHARE PERFORMANCE



Source: Reuters

## Q4 2009 FORWARD

Given current demand and lead price level, as Q4 is traditionally high season for battery replacement and stocking-up, we forecasted a revenue of VND350 bn and earnings before tax of VND71 bn with the assumption that Pinaco will be able to rewind an additional of VND29 bn of inventory devaluation into Q4 profit. And thus, we expect Pinaco is aiming at a full-year revenue of VND1,310 bn and net earning of VND202 bn, representing an EPS of VND 12,234.

We are optimistic that Pinaco's product will continue to enjoy a robust growth rate in the future. Even though we still harbor concerns that fluctuation in lead prices could impair future performance of the company, Pinaco is still comfortable at the current lead price at USD2,200-2,300/ton. Furthermore, as we have mentioned in our previous report, given the industry's competitive landscape, low penetration rate and Pinaco's dominant position, the company would likely be able to transfer part of these price risks to its customers.

## ONGOING PROJECT PIPELINE

**Power up for the future with Nhon Trach plant.** Going forward, once the prices of lead ingo are stablized, we expect gross margin will continue to improve as Pinaco's product focus continues to shift toward battery-manufacturing. The new Nhon Trach-Dong Nai plant will start to contribute into Pinaco's revenue and profit in Q4/2010. Ground breaking ceremony for the first phase with a designed capacity of 600,000 kWh/year (an increase of 55% from the current capacity) was held this past August 10. Nhon Trach plant will add variety of new more technology-advanced product lines such as maintenance-free car battery (CMF) (about 150,000kWh/year), dry-cell lighting battery, and storage battery for mobile phone base stations and high voltage stations.

**Recycle waste battery project.** Pinaco will partner up with a company specialized in environmental solutions (of which IFC holds 15% stake) to set up a recycle waste storage battery company of which Pinaco will hold 49% stake. Pinaco estimated an investment of USD10 mn in construction and machinery for the project. The company currently is in search for a site for the plant. Once successfully in operation, the project will facilitate Pinaco in many ways, increasing flexibility in lead materials, taking advantage distribution network, stimulating sales, and ensuring environmental compliance.

## RECOMMENDATIONS

We continue to like Pinaco in view of its strong position in its industry, a trusted brandname and extensive distribution networks, high profitability expressed by high ROA and ROE ratios, and strong growth potentials. Although demand for replaced storage battery is quite stable, potential growth of the company is high as the economy is at the start of a sustained recovery and demand for container trucks and new car battery has been picking up.

Pinaco's stellar performance in the 9 months of the year was well recognized by the market. At the current price at VND100,000/share (on Oct. 1, 2009), PAC is trading at P/E forward 2009 of 8.2x. Taking into account Pinaco's leading position in its industry, solid performance and strong growth potentials, we believe Pinaco is good for long term investment. Our target price for PAC is VND 120,000/share, equivalent to PE 2009 at 10x.

It is worth noticing that one of the limitations of PAC stock is low liquidity. However, liquidity has improved noticeably recently and Pinaco is asking for shareholder approval for stock dividend of 4:1, and hence will increase its share supply in the future.

## SUMMARY OF HISTORICAL AND PROJECTED FINANCIAL STATEMENTS

<b>INCOME STATEMENT (VND Bn)</b>	<b>2007A</b>	<b>2008A</b>	<b>1H 2009</b>	<b>2009F</b>
Revenue	989.8	1,241.2	630.5	1,310.3
COGS	851.9	999.7	445.5	894.2
Gross Profit	137.9	241	185	416.0
Operating Profit	81.5	165.1	134.2	313.9
Profit before tax	52.2	90.6	101.3	230.7
<b>Profit after tax</b>	<b>44.9</b>	<b>77.8</b>	<b>88.6</b>	<b>201.9</b>
<b>BALANCE SHEET (VND Bn)</b>	<b>2007A</b>	<b>2008A</b>	<b>1H 2009</b>	<b>2009F</b>
Cash	39.8	62.6	66.7	62.4
Short term investment	-	69.3	131.3	115.5
Short term receivable	113.5	67.3	90.3	72.8
Inventory	218.9	196.8	116.2	196.0
Other current asset	0.8	0.7	0.9	0.7
Fixed asset	66.0	60.0	83.9	104.0
Construction in process	0.2	16.0	5.5	38.9
Long term investment	0.1	0.2	0.2	0.2
Other long term assets	3.1	32.9	30.5	30.5
<b>TOTAL ASSET</b>	<b>442.4</b>	<b>505.9</b>	<b>525.6</b>	<b>620.9</b>
Short term loans	173.0	85.8	70.2	59.8
Payables	71.8	108.3	86.9	92.4
Long term debt	1.9	1.5	1.6	1.5
Chartered capital	120.0	165.0	165.0	165.0
Capital Surplus	17.4	62.3	62.3	62.3
Treasury Stock	-	(12.7)	(19.1)	(19.1)
Retain earnings	26.3	41.0	79.3	192.4
Other funds	32.0	54.9	79.5	66.7
<b>TOTAL CAPITAL</b>	<b>442.4</b>	<b>505.9</b>	<b>525.6</b>	<b>620.9</b>
<b>CASH FLOW STATEMENT</b>	<b>2007A</b>	<b>2008A</b>	<b>1H 2009</b>	
CF from Operating Activities	8.9	89.5	141.7	
CF from Investing Activities	(63.0)	(141.5)	(92.3)	
CF from Financing Activates	129.9	(7.4)	(45.3)	
<b>Net cash flow</b>	<b>75.9</b>	<b>(59.4)</b>	<b>4.1</b>	
Beginning Cash Balance	16.1	92.0	62.6	
<b>Ending Cash Balance</b>	<b>92.0</b>	<b>32.6</b>	<b>66.7</b>	
<b>FINANCIAL RATIOS</b>	<b>2007A</b>	<b>2008A</b>	<b>1H 2009</b>	<b>2009F</b>
Revenue growth (%)	46.8	25.4	(2.4)	5.6
Gross profit margin (%)	13.9	19.5	29.3	31.8
Operating profit/sales (%)	8.2	13.3	21.3	24.0
ROA (%)	10.1	15.4	25.8	32.5
ROE (%)	22.9	25.1	37.0	43.2
ROIC (%)	12.2	19.6	31.0	38.3
EPS (VND)	3,740	4,713	8,234	12,234
EPS growth (%)	89.1	26.0	n/a	159.6

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