



# Quoc Cuong Gia Lai JSC

## Company Visit Note

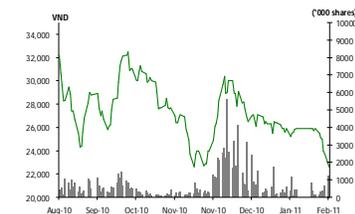
## Phuoc kien residential project to drive earnings

### Analyst

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**Price** VND22,700  
**VN Index** 461.29

### Historical Chart



Performance	1m	3m
Absolute (%)	-13.4	-4.2
Relative (%)	-9.6	-9.6

### Stock Information

Ticker code	QCG
Market cap (VND bn)	2,758.5
52-week high (VND)	32,500
52-week low (VND)	21,700
Shares issued (m)	121.5
6m avg d.vol (VND bn)	20.2
Free float (%)	40.0
Major shareholders (%)	
Nguyen Thi Nhu Loan (50.3)	
VinaCapital (9.7)	

### Key Indicators

ROE (%)	18.1
Net gearing (%)	35.1
NTA (VND)	22,943
Interest cover (x)	9.2

Quoc Cuong Gia Lai JSC (QCG) was established in 1994 as a wood processor. In 2008, it ventured into real estate development and now derives c90% of revenue and profit from residential projects in Tier 1 cities. The group also has interests in hydropower and rubber plantations, which will start contributing c10% of profits by 2013. QCG's main catalyst is the Phuoc kien high-end waterfront development, which will support 1.1mn sqm of development potential until 2015. Company was listed in August 2011 at VND48,000/share.

### Key takeaways from management:

- **Prime development site to bolster real estate business.** QCG has acquired a huge land bank of 1.1mn sqm including 993,140 sqm in Phuoc kien, which is adjacent to the prestigious Phu My Hung area, at a low cost of VND4mn psm in average from 2007. Phuoc kien has development potential for up to 1.1 sqm GFA of high-end waterfront residential projects over the next six years, which at current prices would translate into VND12,200b (USD580mn) worth of revenue. Management expects earnings to ramp from VND485bn FY11E to 2,426bn FY16.
- **Hydro power and rubber plantation to improve earnings cyclicality.** QCG has developed 4,000 ha rubber areas from 2008 and four hydro power plants of MW 48.3. Natural rubber planted from 2008 to 2012 will start contributing to group earnings from 2013. Lagrai 1, Ayun Trung and Pleiko will come operational in 2011 and Lagrai 2 by 2013. QCG has secured off-take agreements with the EVN (Electricity of Vietnam) and the 15.3% electricity price hike effective 1<sup>st</sup> Mar 2011 will help generate sustainable cash flow from late 2011.

### Stock Performance & Valuation

Vietnam's high interest rate environment and VND depreciation has contributed to the overall property sector weakness, including QCG. Most of QCG's key property projects are still work-in-progress so meaningful revenue recognition will only start in 2011. QCG has underperformed the VN-Index by 9.6% in the past month and valuations have dropped to historical lows of 1.1x, a steep 38.9% discount to the sector's average P/B of 1.8x.

Year End Dec 31	2008	2009	9M09	9M10
Sales (VND bn)	22.6	328.4	139.0	709.0
Pre-tax (VND bn)	12.5	147.3	15.5	319.1
Net profit (VND bn)	8.0	123.3	11.1	251.3
EPS (VND)	114	1,753	n/a	3,014
EPS growth (%)	n/a	1,028.5	n/a	19.1
PER (x)	197.9	12.9	n/a	7.5
PB (x)	2.6	2.1	n/a	1.1
EV/EBITDA (x)	56.6	36.6	n/a	8.8

**Company background**

Established in 1994 as a wood processor and wood trader, Quoc Cuong Group focused on real estate segment from 2009 after acquiring land bank from 2005. Simultaneously, the company also has strategic development activities to build hydropower, rubber plantation. The company was listed on the HOSE in August 2010.

**Property segment has overtaken wood processing segment as key revenue driver.**

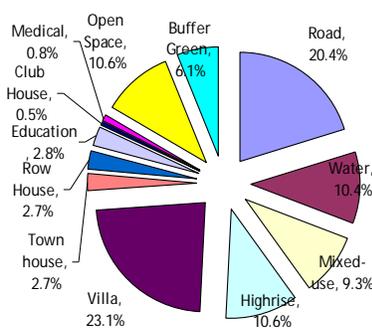
QCG is relatively new to the property markets compared with TDH, DIG, ITC, or NTL. Since QCG entered the property development business in 2005, the company has completed three property projects of 60,255 sqm GFA. The company is now working on an additional 1.1m sqm land area (estimated 2.3m sqm GFA) for delivery through 2015; the bulk of the development pipeline is residential projects in the south of City particularly Nha Be District and Binh Chanh District (Figure 2).

QCG’s key competitive strengths as follows:

- A huge and low cost land bank acquired during the period from 2005-2007 before the run-up in the property cycle from late 2007. Average land cost is 30-50% lower than current market price.
- Good relations with local authorities and property-broking agencies like Sacomland to secure land and marketing channels to push final inventory to buyers.
- Ability to borrow capital at rates that are 2% lower than market lending rates.
- 90% ownership of a construction company helps reduce construction costs. According to QCG’s management, these end-to-end capabilities help QCG maintain a 20% cost advantage over the competition, which they can then pass onto buyers.

In 2010, property development contributed c85-90% of an estimated net income base of about VND360m. Contributions mainly came from three projects including Quoc Cuong Apartment 1, The Mansion and Nguyen Thi Minh Khai Office Building – the last project alone generated VND430bn in revenue and VND220bn in net profit after QCG sold the entire building to BIDV Bank.

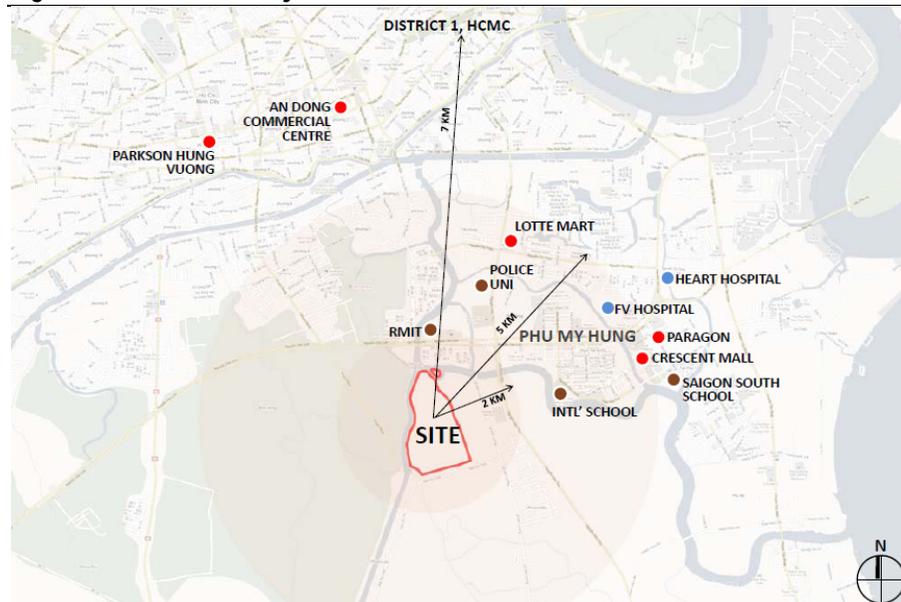
Land use Distribution Chart



From 2011 onwards, QCG has nine key projects in the pipeline with total GFA of 2.3m sqm, including Phuoc Kien, Giai Viet, and Quoc Cuong Apartment 2. QCG’s largest development project in this pipeline is the 1,084,000 sqm GFA Phuoc Kien project, which will be a major revenue source of QCG’s income from 2011 onwards. Phuoc Kien (Figure 1) is located near Phu My Hung, Vietnam’s premier residential site. QCG successfully acquired the land bank at an average cost of VND4mn psm which is considerably lower than average current market price of VND6mn qsm. Management’s strategy is to position Phuoc Kien as an exclusive waterfront development with built in marina facility like the Sentosa Cove projecton Singapore’s Sentosa Island. (<http://www.sentosacove.com/home.html>).

The other two important projects are Quoc Cuong Apartment 2 and Giai Viet. First, Quoc Cuong Apartment 2 is located in Binh Chanh District, HCMC, near to Phuoc Kien Project. This project is a 25 storey high-end residential building with total GFA of 45,738 sqm and will contribute to earnings in 2011-2012. Giai Viet is located in district 8, HCMC, about 6-7 km from CBD; it will consist of three 29-storey high-end 600 unit residential building project with total GFA of 140,000 sqm.

**Figure 1: Phuoc kien Project**



Source: Company reports

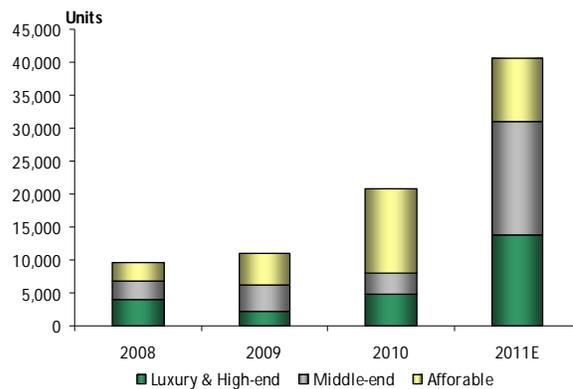
**Soft property market outlook**

According to a recent CBRE study, new home deliveries of 40,000 units this year will double the inventory stockpile to 80,000. Compared with the projected demand of only about 20,000 units last year, the supply overhang imbalance will keep residential markets soft for the medium term. Additionally, the high interest rate environment of c14-17% per year and inflationary backdrop will add to depress demand.

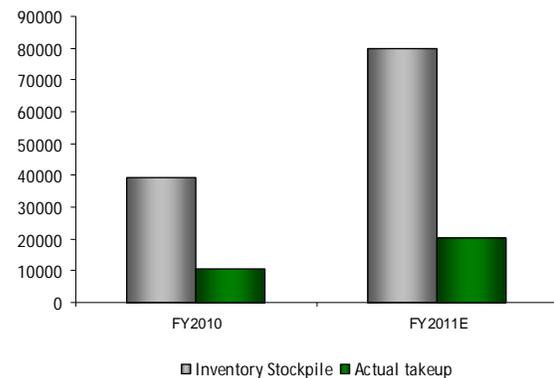
**Figure 2: Some remarkable property projects**

	Stake	Location	Cost (VNDbn)	Land Area (sqm)	GFA (sqm)
<b>Finished Projects</b>					
1	90%	District 7, HCMC	208	3,535	22,977
2	100%	Binh Chanh, HCMC	216	5,777	31,121
3	100%	District 3, HCMC			
<b>On-Going Projects</b>					
1	49.9%	District 8, HCMC	1,444	42,268	140,870
2	95%	Binh Chanh, HCMC	1,262	35,722	112,851
3	100%	District 8, HCMC		7,109	21,329
4	55%	D9, HCMC	1,023	14,389	125,616
5	54%	Binh Chanh, HCMC		118,680	534,060
6	100%	Nha Be, HCMC	7,081	933,140	1,084,000
7	90%	District 2, HCMC	547	6,515	41,101
8	100%	District 1, HCMC	768	1,439	17,268
9	52%	District 9, HCMC	1,038	21,732	130,392

Source: Company Reports, Kimeng Securities

**Figure 3: Supply of apartment**

Source: CBRE

**Figure 4: Inventory stockpile vs actual takeup**

Source: CBRE, Kim Eng

**Rubber plantation segment.** The company has committed investments of US\$13m (VND 260bn) in 2008 to cultivate 4,000ha of rubber plantation in Gia Lai Province: 800 ha have been planted in 2008, 2,000 ha in 2009-2010 and the balance 1200 ha in 2011-2012. The new plantations will be ready for tapping in 2013 year and management forecasts that existing plantation will generate annual revenue of USD22.5m (VND470bn).

**Hydropower Segment.** QCG has licenses to build four hydropower dams in Gia Lai, which is estimated to cost of US\$50m. Lagrai 1, Ayun Trung and Pleiiko will come operational in 2011 and Largrai 2 by 2013. Collectively, these projects will have planned power generation capacity of 48.3MW and will contribute USD3.3mn per annum. QCG has off-take agreements with the electricity of Vietnam (EVN).

**Figure 5: List of hydropower plants**

Project Name	Location	Capacity (MW)	Total Investment	Operation
Lagrai 1	Gia Lai	10.8	11.13	2011
Lagrai 2	Gia Lai	7.5	7.68	2013
Ayun Trung	Gia Lai	16.5	n/a	2011
Pleiiko	Gia Lai	13.5	n/a	2011

Source: Company Reports

**Financial Review**

QCG's FY09 revenue and net profits grew 1,354.1% and 1,435.3% from VND22.6bn and VND8.0bn to VND328.4bn and VND122.6bn, respectively; the strong performance was due to the maiden contribution from the property business. While the wood processing segment just contributed a 5.83% of revenue and 1.5% of profit. In 9M2010, property income lifted group revenue and profits further to VND709bn and VND123.3bn, helped by the sale of Nguyen Thi Minh Khai Office Building. Gross margin improved significantly from -10.9% in 2008 to 13.5% in 2009 and 37.5% in 9M10.

### Earnings outlook

The property business will continue to drive earnings through FY12 until the hydropower and rubber plantations start contributing in FY13. Key project deliveries will include Quoc Cuong Apartment 2, Giai Viet and Phuoc Kien.

Phase 1 of Quoc Cuong Apartment 2 will cover two apartment blocks of 300 units and is expected to contribute VND224bn in pretax profit in FY11. Giai Viet will comprise of two phases with Phase 1 almost 100% sold. The estimated pretax income of VND420bn for this phase will be booked in 2011.

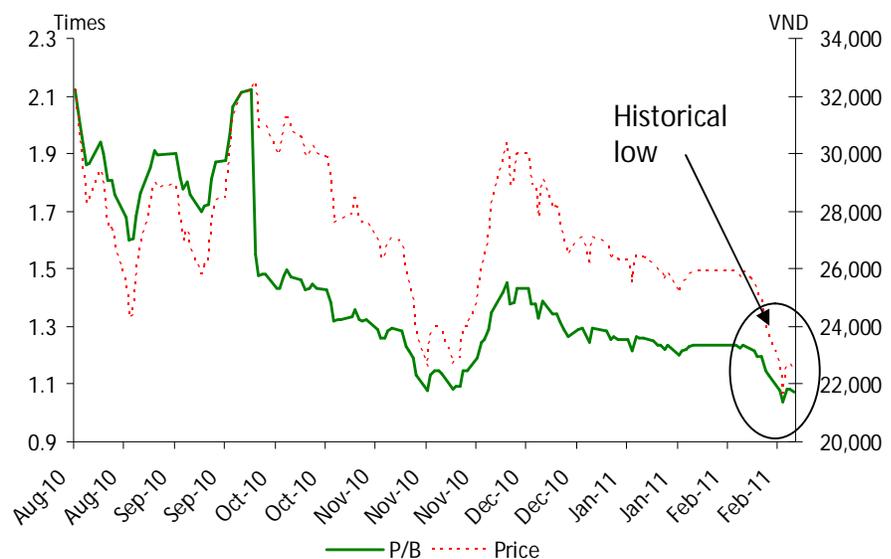
The Phuoc Kien project will be the main earnings driver for the property segment over the next five years. Management estimates that Phuoc Kien will generate revenue and pretax earnings of VND800bn and VND485bn in 2011 and VND1,200bn and VND728bn in 2012.

For the new businesses, we only expect the hydropower business to contribute about 3.0% and 4.0% of pretax profit in 2011 and 2012. Income from the rubber plantations will only be booked from 2013.

### Valuation

QCG is currently trading at historical low P/B of 1.1x which implies a steep 38.9% discount to the sector P/B of 1.8x. QCG's balance sheet is healthy with low net gearing of 35.1%, following the rights issue of 60.2 mn shares in August 2008 and interest cover of 9.2x. QCG is not rated by Kim Eng.

**Figure 6: Quoc Cuong Group historical price to book value**



Source: Kim Eng Securities

### Potential Risks

- Vietnam's high inflation, widening trade deficit, and VND devaluation continue to impact funding cost for developers and housing affordability for home buyers.
- Funding risk aside, business diversification may entail execution risks and detract management's attention from the core property business.

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