LOC TROI GROUP JSC (UpCOM: LTG)

Attempting to restructure due to increasing competition

Particulars (VND bn)	*3Q-FY19*	*2Q-FY19*	*+/- qoq*	*3Q-FY18*	*+/- yoy*
Net revenue	1,940	2,810	-31%	2,012	-4%
PAT	41	191	-79%	45	-9%
EBIT	111	304	-64%	97	14%
EBIT margin	5.7%	10.8%	-512bps	4.8%	87bps

Source: LTG, Rong Viet Securities

9M 2019: CPC sales continued growing while the rice segment was weak

- In the first 9 months, net revenue of the CPC segment is estimated to have increased by 8.0% YoY, reaching VND 3,580 billion due to (1) the demand for products containing Glyphosate and (2) area affected by pests increased. Meanwhile, net revenue of the rice segment is estimated to have decreased by 17.2% YoY to VND 1,940 billion due to the difficulties of exporting rice to China.
- LTG's gross profit margin (GPM) in the first nine months of the year improved slightly from 20.2% to 20.9%. This mainly came from the increase in the margin of the CPC and seed segments which offset the decline in the rice business. As a result, gross profit went up by 1.4% YoY to VND 1,320 billion.
- Net revenue of LTG in the first nine months decreased slightly by 2.0% to VND 6,319 billion and net income reached VND 288 billion (+23.1% YoY).
- In the first nine months of 2019, SG&A expenses to net sales were well managed, dropping to 12.4% compared to 13.5% last year.

2019 Outlook

We forecast that LTG can achieve VND 8,498 billion of net revenue (-6% YoY) and VND 493 billion of net income (+20% YoY) in 2019.

The CPC segment will continue to play a key role as the rice segment has not yet showed any positive signs of growth. In addition, the restructuring of the distribution system and a better management of account receivables and inventories will reduce the dependence on short-term borrowings. Thereby, interest expenses can be lower in the next few years. In addition, LTG will likely book VND 162 billion from a real estate transaction in 4Q2019 as they will transfer this real estate to another organization.

Valuation and recommendation

Loc Troi is a well-operated company with a large and stable market share in the sectors in which they are active. Although the pesticide segment is nearly saturated, the company still maintains a leading position and the GPM has slightly improved. Similarly, the company's seed segment is operating efficiently as it always gets a high GPM. In contrast, the rice segment has not brought any positive results as its revenue decreased and the GPM fluctuated unpredictably. In addition, high interest expenses and the difficulties of collecting debts from distribution agents are other risks. However, the results of 3Q2019 illustrated that there were some slight improvements. LTG's target price is ***VND 29,400/share****. Combined with cash dividend, it is* ***32%*** *higher than the closing price on November 7th, 2019. We have a* ***BUY recommendation.***

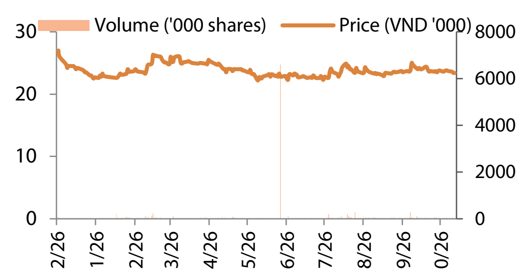
BUY	**+32%**
Target price (VND)	29,400
Current market price (VND)	23,400
Cash Dividend (VND)*	1,600

(*) Expected in the next 12 months

Stock Info	
Sector	Agricultural chemicals
Market Cap (VND billion)	1,910
Current Shares O/S	80,593,340
Avg. Daily Volume (in 20 sessions)	33,111
Free float (%)	35
52 weeks High	29,167
52 weeks Low	22,200
Beta	0.54

	FY2018	**Current**
EPS	4,362	5,768
EPS Growth (%)	-17	26
Diluted EPS	4,362	5,768
P/E	5.4	4.1
P/B	0.8	0.7
EV/EBITDA	5.7	4.2
Cash dividend yield (%)	8.4	-
ROE (%)	17	18

Price performance



Major Shareholders (%)	
Marina Viet Pte. Ltd	25.2
People's Committee of An Giang province	24.2
Kingsmead Vietnam	6.0
Foreign ownership room (%)	4.8

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Exhibit 1: 3Q2019 Results

(VND Bn)	3Q-FY19	2Q-FY19	+/-(qoq)	3Q-FY18	+/-(yoy)
Net revenue	1,940	2,810	-31.0%	2,012	-3.6%
Gross profit	348	629	-44.6%	391	-10.9%
SG&A	238	324	-26.7%	294	-19.1%
Operating income	111	304	-63.6%	97	13.7%
EBITDA	146	340	-56.9%	136	7.7%
EBIT	111	304	-63.6%	97	13.7%
Financial expenses	62	72	-14.3%	55	13.4%
- Interest Expenses	40	51	-22.0%	46	-13.7%
Dep. and amortization	35	35	0.6%	38	-7.5%
Non-recurring items (*)					
Extraordinary items (*)					
PBT	63	248	-74.8%	53	17.7%
PAT	41	191	-78.7%	45	-8.7%
(*) Adjusted PAT	41	191	-78.7%	45	-8.7%

Source: LTG, Rong Viet Securities

Exhibit 2: 3Q2019 Performance Analysis

Particulars	3Q-FY19	2Q-FY19	+/-(qoq)	3Q-FY18	+/-(yoy)
Profitability Ratios (%)					
Gross Margin	18.0%	22.4%	-4.4%	19.4%	-1.5%
EBITDA Margin	7.5%	12.1%	-4.5%	6.8%	0.8%
EBIT Margin	5.7%	10.8%	-5.1%	4.8%	0.9%
Net Margin	2.1%	6.8%	-4.7%	2.2%	-0.1%
Adjusted Net Margin	2.1%	6.8%	-4.7%	2.2%	-0.1%
Turnover *(x)					
-Inventories	3	3	-0.5	2	0.2
-Receivables	3.3	4.9	-1.6	3.4	-0.2
-Payables	4	7	-2.4	4	0.0
Leverage (%)					
Total Debt/ Equity	149.3%	179.1%	-2,978bps	200.9%	-5,165bps

Source: LTG, Rong Viet Securities

Exhibit 3: 4Q2019 Performance Forecast

Particulars (VND Bn)	4Q-FY19	+/- qoq	+/- yoy
Revenue	2,179	12%	-18%
Gross profit	564	62%	-14%
EBIT	167	51%	-46%
NPAT	204	404%	16%

Source: Rong Viet Securities

Update

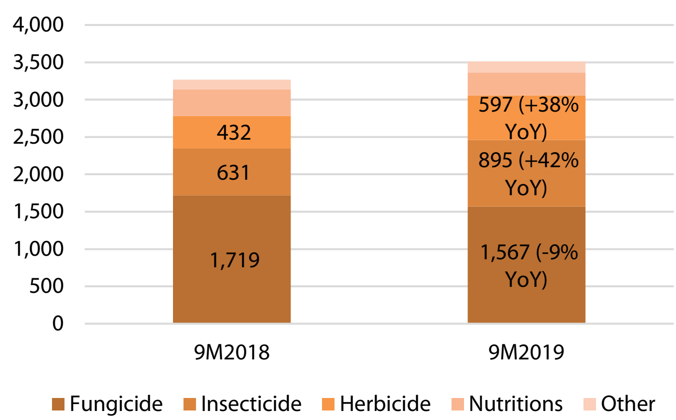
Positive results for the Crop Protection Chemicals (CPC) segment in the context of difficult market conditions.

Although the pesticide industry is considered to be saturated due to the restrictions on usage in order to protect human health and the ecosystem, LTG still posted positive results with estimated net sales in the first nine months of the year increasing by 8.0% to VND 3.580 billion. The GPM improved from 28.9% in the first nine months of 2018 to 30,2%.

Revenue of the CPC segment expanded mainly due to the demand from insecticide and herbicide. For herbicide, the prohibition on the import of products containing Glyphosate[1] caused a significant growth in the demand of those products as distributors purchased much more than usual in order to boost reserves. Therefore, net sales of herbicide rose by 38% YoY, to VND 597 billion. In the insecticide segment, agricultural land which was affected by pests grew sharply and the prohibition on importing and using products containing Chlorpyrifos Ethyl, Fipronil[2] were the two reasons leading to higher demand. In fact, the insecticide revenue was VND 895 billion, up by 42% YoY. On the other hand, there was a slight decrease of 9% in the sales of fungicide, from VND 1,719 billion to VND 1,567 billion.

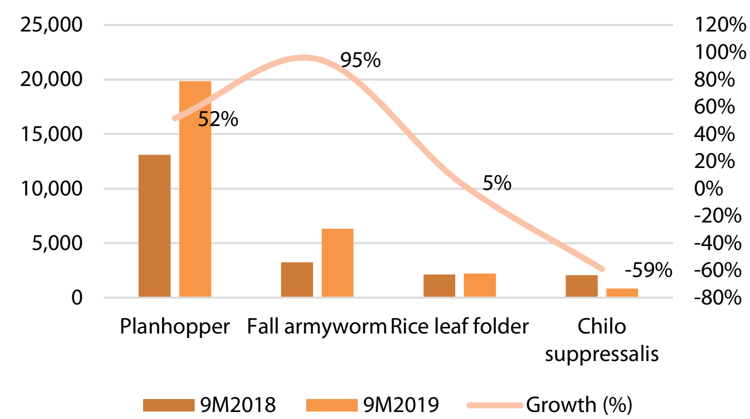
The GPM of CPC was better in the first nine months of the year because of higher selling prices.

Figure 1: Revenue structure of the CPC segment (VND bn)



Source: LTG

Figure 2: Land affected by pests needing insecticide (hectares)



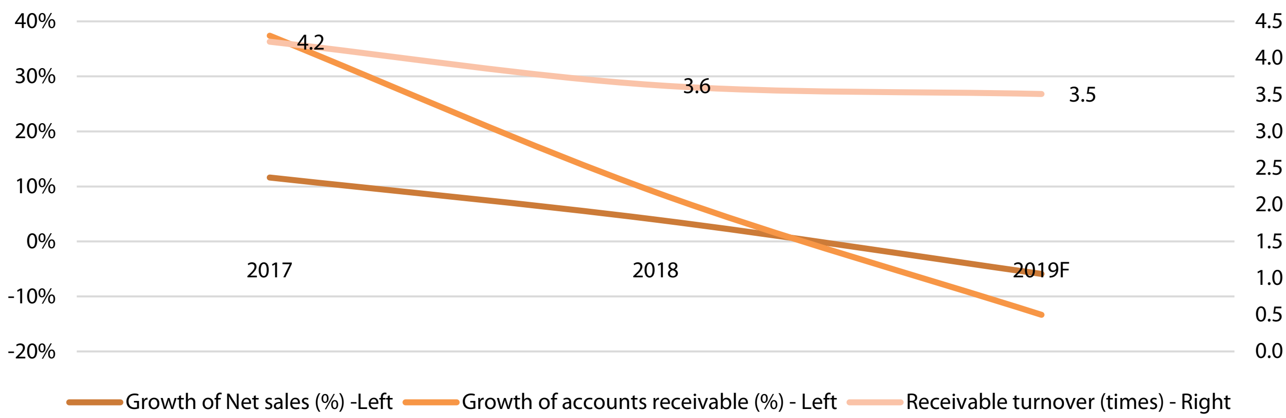
Source: LTG

The pesticide industry is saturated so LTG has loosened its sales policy to support growth. Consequently, account receivables have increased dramatically recently, leading to a steady drop in receivables turnover. In order to face these challenges, LTG has restructured the CPC distribution system to improve profitability. Since 2018, LTG stopped cooperating with inefficient distributors while focusing on expanding its relationship with effective distributors. As a result, the number of agents has been going down from 5,000 in early 2018 to barely more than 3,000 recently. In addition, LTG also applied stricter sales policies with higher KPI. From 2019, the company also used a tighter debt strategy to improve the situation. Hence, if an agent cannot pay back LTG within 60 days, the company will stop supplying goods to that agent. However, the efficiency of the restructuring has not yet paid off since account receivable continued climbing from VND 2,381 billion in 2017 to VND 2,594 billion in 2018 and VND 2,135 billion in 3Q2019 after reaching a peak of VND 2,607 billion in 2Q2019. Furthermore, receivables turnover has observed a downward trend year over year, from 4.2 times in 2017 to 3.8 times of the last 4 quarters. Even LTG has made lots of efforts on debt management but the efficiency is still not as expectation.

[1] ***Decision No. 1186/QD-BNN-BVTV*** *was issued on April 10, 2019. It highlights the prohibition by the Government on producing and importing; only trading and usage are allowed within a year of CPC containing ingredients Glyphosate from the date this Decision applies. This Decision will be applied 60 days after its issuance.*

[2] ***Decision No. 501/QD-BNN-BVTV*** *was issued on February 12, 2019. It announces that manufacturing and importing are only allowed within a year; trading and usage are allowed up to 2 years of CPC containing ingredients Chlorpyrifos Ethyl and Fipronil from the date this Decision applies. This Decision will be applied from the date of its issuance.*

Figure 3: Receivable turnover over time



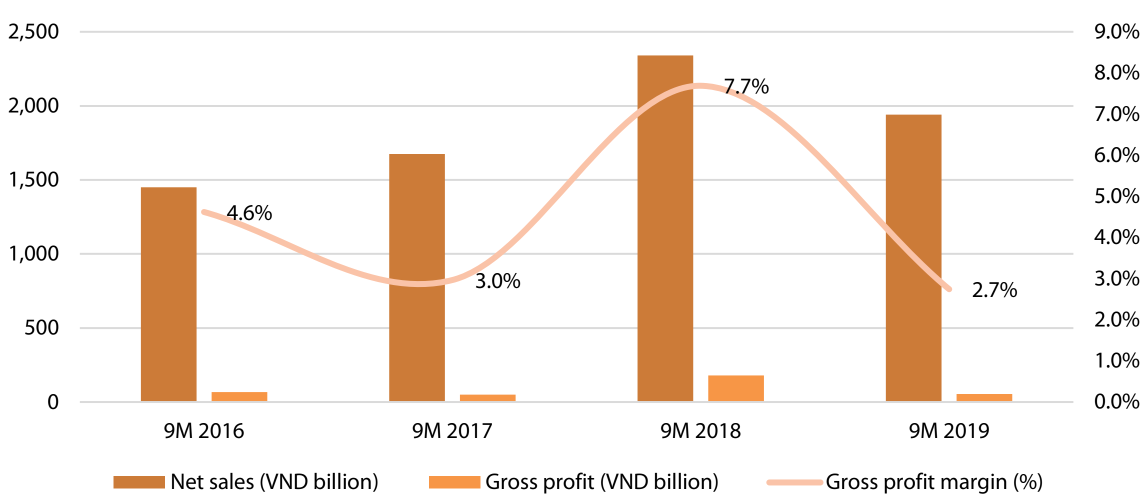
Source: LTG, Rong Viet Securities

In the short term, we believe that LTG can maintain its growth in this sector despite the fact that national policy in the last few years was about encouraging farmers to limit the usage of CPC. Reasons are (1) the research of the Ministry of Natural Resources and Environment showed that the agricultural land has remained stable at 27 thousand hectares in the last few years; and (2) farmers need more time to change their cultivating habits when most of them still rely heavily on pesticides. According to Mordor Intelligence survey, the industry CAGR for the period of 2019-2024 will remain at 3.4% per year. In the long term, the CPC industry is still facing many barriers to be able to grow since the global trend of agriculture production is about green - fresh - modern. One way for LTG to grow sustainably is to concentrate on biological CPC. The company is currently working with the Plant Protection Department to develop and experiment bio-fertilizers on a parcel of 100 hectares of rice. The results will be available by June 2020. If this project is successful, the scale may expand to 12,000 hectares of rice.

Rice segment has not found any footing as its results went down

The rice export market has been challenging so far this year. In fact, LTG only booked VND 1,940 billion in net revenue for the segment, down by 17.2% y/y while the GPM was 2.7% which is significantly lower than 7.7% for the same period in 2018. This is the lowest 9M GPM since 2016.

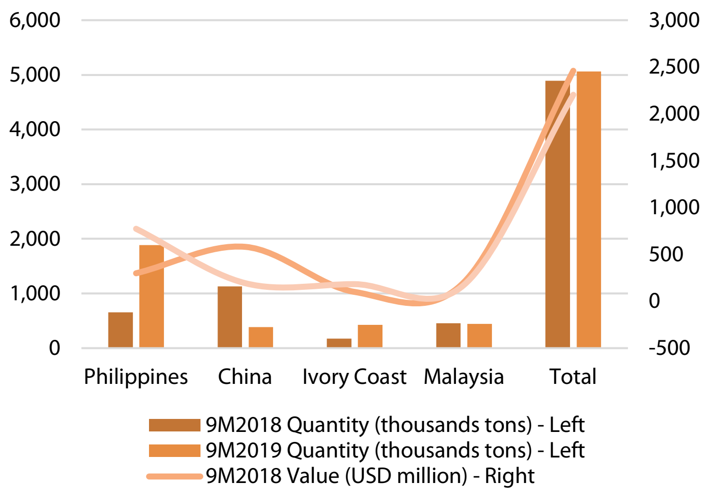
Figure 4: Results of the rice segment over time (calculated for the first 9 month of the year)



Source: LTG, Rong Viet Securities

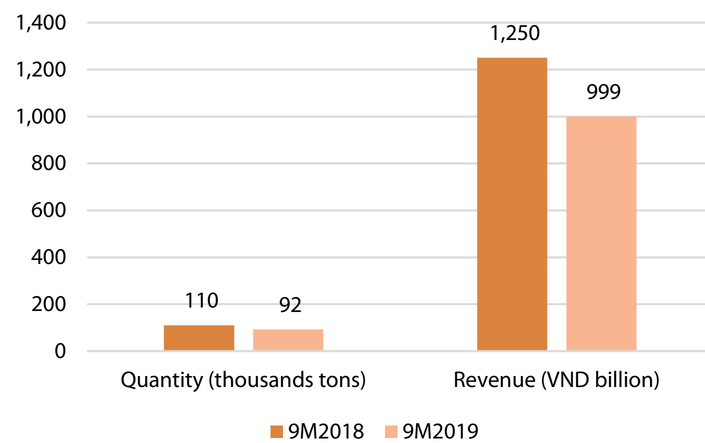
The main reason for the decline in revenue came from a drastic drop in China's imports. Actually, China's rice inventories are relatively high (about 114-116 million tons)[3], accounting for 60-70% of global rice inventories. Vietnam competes against other countries to get a share of Chinese imports, which have been restricted. In addition, China not only raised requirements on food quality and safety but also adjusted the import tax on rice since July 1, 2018. Those are some of the reasons while exports to China have been challenging. In the first nine months of 2019, Loc Troi rice exports to that market have declined to VND 160 billion (-81% YoY). At the same time, rice stockpiled for China has been stagnant so that LTG had to lower the selling price in order to export successfully to other countries. Consequently, the export price was lower than expectations and the GPM was estimated at around -1.2%, this shrank the gross profit margin of the whole rice sector which stayed at 2.7%. It is expected that the liquidation of the warehoused rice will last until the end of November. We believe that the gross profit margin of exported rice will not improve much in the last quarter of this year.

Figure 5: Rice exports of Vietnam in the first 9 months of 2018 and 2019



Source: Vietnamese Customs, Rong Viet Securities

Figure 6: LTG's rice export in the first 9 months of 2019



Source: LTG, Rong Viet Securities

Although the company wants to avoid depending on exports and concentrate more on the domestic market, the portion of domestic sales in the first nine months of 2019 was only 24% of total revenue compared to 26% last year. However, there was some growth in the branded rice of LTG as its sales in the traditional and modern channels increased. In fact, sale of branded rice (including premium and middle ones) jumped by 22% to VND 165 billion. However, the non-branded rice which accounted for the biggest proportion of domestic revenue, witnessed a 49% decrease in revenue. As a result, revenue of the domestic market dropped down by 27% to VND 322 billion. LTG has wanted to restructure the domestic market so they have stopped selling non-branded rice since Q3 of 2019, which has lower profit margins. In the short term, we think this strategy will lead to lower revenue but the GPM will improve. LTG is ongoing some consumer behavior research to put together an appropriate marketing strategy. In 2020, LTG will stop operating two out of five rice mills. This restructuring will cost about VND 65 billion before tax.

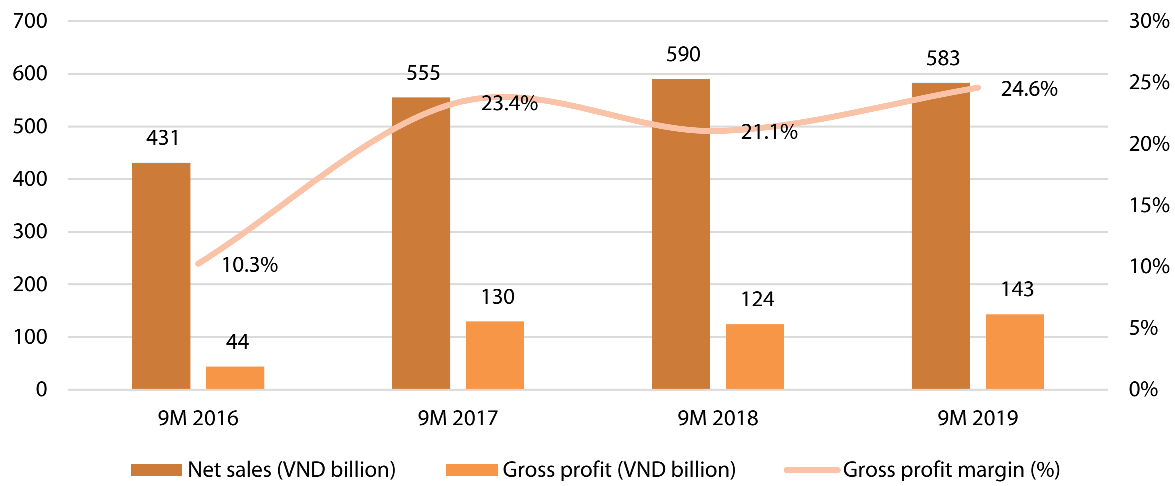
Due to the reduction of China's rice import and the objective to end the sale of non-branded rice, we believe that the revenue and profit of this segment in 2019 will be lower than the company's plan at the begin of the year.

Crop seeds could be the future

Even though estimated net sales of the seeds segment declined moderately by 1.7% to VND 583 billion in the first nine months of 2019, the GPM improved, reaching 24.6%, which is much higher than 21.4% for the same period in 2018. This represents LTG's highest gross profit since 2016 (for the first nine months of the year). In fact, gross profit of the seeds segment was VND 143 billion (+13% YoY).

[3] *The number of 2Q2019.*

Figure 7: Seeds segment over time (calculated for the first 9 month of the year)



Source: LTG, Rong Viet Securities

The rising demand for corn seeds combined with the fact that the company is one of the biggest distributors of Syngenta's products are the reasons for the slight increase in Loc Troi corn seeds' sales volume and selling price. In fact, corn seeds sales went up by 2.2%, reaching VND 162 billion. Meanwhile, the growth in the sales of subsidiary crops seeds came from the positive reaction of the market to the 2 brand-new watermelon seeds distributed by LTG which are Thien Vuong and Loc Phat. Sales rose by 5.7% to VND 167 billion.

In the long term, we believe that LTG will be able to maintain the growth in the seeds segment as its market share of the two main products (rice and corn) is still quite small. LTG's current market share in rice seeds and corn seeds (for animals and for humans) is only about 12% and 20% respectively.

Planning to move the stock to HoSE

According to the Minutes of the General Meeting of Shareholders in 2019, the company has discussed and received 100% approval from shareholders to be listed on HoSE in 2020 instead of 2019. The given reason is that the market for their businesses in 2019 is not favorable, so moving to HoSE in 2019 will not bring much value to the company. Actually, LTG thinks that its business will be better in 2020 so that it will be a reasonable moment for them to be listed on HoSE. However, according to our assessment, in the coming year, it is not sure that the pesticide segment will see sustainable growth. Products containing Glyphosate will be officially banned in June of 2020. Furthermore, the efficiency of the rice segment and the ability of managing accounts receivable have not seen much improvement. Therefore, we do not strongly believe that 2020 is a good time for LTG to move to HoSE.

Real estate transfer in Ho Chi Minh City

The company expects to earn VND 162 billion from the real estate transfer and it is likely to be booked in 4Q of this year.

Valuation

In 2019, we forecast that LTG's net sales and net income will be VND 8,498 billion (-6% YoY) and VND 493 billion (+20% YoY) respectively. The forecasts are based on the earning from real estate transfer in Ho Chi Minh city and the following assumptions:

	Net sales (VND billion)	Gross profit margin (%)
CPC segment	5,183	30.2
Rice segment	2,135	2.4
Seeds segment	888	24.4

In terms of valuation, we combine the P/E and FCFF methods with 50% allowed to each method in order to determine the fair value of LTG.

P/E method: The industry average P/E is 10.2 times. However, because of (1) the concerns about LTG's ability in managing accounts receivable and inventory (2) the risks of using a much higher financial leverage compared to other companies in the same industry (3) although LTG has operated in the rice segment for a long time, this segment has been unstable and ineffective (4) the probability of increasing LTG's sales and profit is low in the future. Hence, we took the current LTG's P/E assessed by the market, 4.1 times. We forecast that the EPS in 2019 will be VND 5,195 so that the price using this method is VND 21,301 per share.

FCFF method: we used the following assumptions: (1) WACC is 10.1% and (2) the long-term growth rate of FCFF from 2023 onwards is 0.2%.

Therefore, the fair value of LTG is **VND 29,400 per share**, coupled with a VND 1,600 cash dividend in the next 12 months. This would yield a total return of **32%** (calculated based on the closing price on November 7th, 2019).

Table 4: LTG valuation

Valuation model	Weight (%)	Price (VND)
FCFF	50%	37,579
P/E	50%	21,301
Target price (rounded)		**29,400**

Source: Rong Viet Securities

VND Billion

INCOME STATEMENT	FY2017	FY2018	FY2019F	FY2020F
Revenue	8,687	9,031	8,498	8,224
COGS	6,806	7,098	6,614	6,283
Gross profit	1,881	1,934	1,884	1,941
Selling Expense	938	866	848	879
G&A Expense	311	349	334	343
Finance Income	15	20	21	21
Finance Expense	136	194	214	170
Other profits	17	5	162	5
PBT	527	549	670	575
Prov. of Tax	112	135	175	141
Minority's Interest	0	3	3	3
PAT to Equity S/H	415	412	493	431
EBIT	631	718	702	719
EBITDA	768	865	844	865

%

FINANCIAL RATIO	FY2017	FY2018	FY2019F	FY2020F
Growth (%)				
Revenue	11.6%	4.0%	-5.9%	-3.2%
Operating Income	12.3%	12.7%	-2.5%	2.5%
EBITDA	12.5%	13.8%	-2.3%	2.5%
PAT	19.6%	-0.8%	19.7%	-12.5%
Total Assets	7.0%	17.0%	-13.5%	1.5%
Equity	7.8%	7.4%	11.6%	7.4%
Profitability (%)				
Gross margin	21.7%	21.4%	22.2%	23.6%
EBITDA margin	8.8%	9.6%	9.9%	10.5%
EBIT margin	7.3%	8.0%	8.3%	8.7%
Net margin	4.8%	4.6%	5.8%	5.2%
ROA	6.3%	5.3%	7.4%	6.4%
ROE	17.9%	16.5%	17.7%	14.5%
Efficiency				(times)
Receivable Turnover	3.6	3.5	3.8	3.4
Inventory Turnover	3.2	2.3	2.7	2.7
Payable Turnover	3.8	3.6	4.5	3.6
Liquidity				(times)
Current	1.2	1.2	1.4	1.4
Quick	0.7	0.6	0.7	0.8
Finance Structure (%)				
Total Debt/Equity	102.1%	126.6%	80.7%	62.2%
Current Debt/Equity	92.6%	120.6%	80.0%	61.1%
Long-term Debt/Equity	9.5%	6.0%	0.7%	1.1%

VND Billion

BALANCE SHEET	FY2017	FY2018	FY2019F	FY2020F
Cash and cash equivalents	116	151	168	251
Short-term investments	27	0	6	6
Accounts receivable	2,381	2,594	2,248	2,438
Inventories	2,149	3,096	2,450	2,327
Other current assets	87	161	150	165
Property, plant & equipment	1,314	1,226	1,118	1,015
Acquired intangible assets	352	318	324	330
Long-term investments	33	36	36	36
Other non-current assets	128	126	169	203
Total assets	**6,588**	**7,708**	**6,668**	**6,770**
Accounts payable	1,801	1,966	1,477	1,760
Short-term borrowings	2,146	3,000	2,222	1,823
Long-term borrowings	220	150	20	33
Other non-current liabilities	40	30	46	40
Bonus and Welfare fund	37	47	98	105
Technology-science, dev. fund	0	0	0	0
Total liabilities	**4,244**	**5,193**	**3,864**	**3,761**
Common stock and APIC	950	1,084	1,084	1,084
Treasury stock (enter as -)	0	0	0	0
Retained earnings	434	564	839	1,032
Other comprehensive income	174	80	95	108
Inv. and Dev. Fund	759	760	760	760
Total equity	**2,318**	**2,488**	**2,778**	**2,983**
Minority Interest	**25**	**26**	**26**	**26**

VALUATION RATIO (*)	FY2017	FY2018	FY2019F	FY2020F
EPS (dong)	4,369	4,341	5,195	4,548
P/E (x)	n/a	6.3	4.6	5.2
BV (dong)	29,075	31,207	34,469	37,017
P/B (x)	n/a	n/a	0.7	0.7
DPS (dong/cp)	3,000	2,000	1,600	2,000
Dividend yield (%)	n/a	8.4%	6.8%	8.4%

VALUATION MODEL	*Price*	*Weight*	*Average*
FCFF	37,579	50%	18,789
PE	21,301	50%	10,650
Target price (VND)			**29,400**

VALUATION HISTORY	*Price*	*Recommendation*	*Period*
2019/04/04	29,400	Accumulate	Intermediate
2018/12/28	31,200	Accumulate	Intermediate
2018/09/14	39,500	Accumulate	Intermediate

RESULT UPDATE

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective that is to determine the reasonable value of the stock at the time such analyses are performed. Through this report. we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information, investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings	BUY	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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