FPT CORPORATION JSC (FPT – HSX)

The Restructuring Progress Remains a Long-term Story

- **Telecom is expecting profitability improvement owing to the completed cablization in major cities**
- **IT remains a solid contributor to the corporation's performance**
- **Distribution and Retail: two contrasting colors**
- **The restructuring progress remains a highly anticipated story.**

Outlook and Valuation:

FPT Corporation JSC (FPT-HSX) *has been among RongViet Research's favorite stock list owing to its fundamental aspects. FPT has the leader position in all markets it operates in, namely telecommunication, IT outsourcing and high-tech device distribution & retailing, which allows it to record sustainable growth. We expect Distribution & Retail to have opposing results regarding growth in 2017 while Telecom (FOX) and software will solidly remain to be the two major contributors to the corporation's profit. FPT also possesses a solid financial strength including a strong operating cash flow and a decent cash holding, which allow the company to offer a consistent cash dividend policy.*

In contrast, FPT share price seems to bear influence from a fully occupied foreign room and the market's expectation of the reforming progress, which has caused the price to hover around the same level for a long time. Assuming the restructuring deals will not be concluded in the near future, we use FCFE and P/E valuation methods to determine FPT's fair price at ***VND53,200*** *per share, which offers a* ***26.4%*** *upside from the closing price on 26/05/2017. The target price is revised from VND50,400 per share in our most recent report published in September 2016 as we attribute the fair price to FPT's outstanding performance stability. We recommend to* ***BUY*** *the stock in the* ***LONG-TERM*** *based on the stable outlook of the company.*

Key financials

Y/E Dec (VND b)	FY2015	FY2016	1Q-FY17	FY2017E	FY2018F
Net Revenues	37,960	39,531	9,418	48,104	54,465
% chg	16%	4%	11%	21.7%	13.2%
PAT	1,931	1,991	413	2,408	3,532
% chg	17%	3.1%	19.4%	21.0%	46.7%
PAT margin (%)	5.1%	5.0%	4.4%	5.0%	6.5%
ROA (%)	7.4%	6.7%		7.1%	8.9%
ROE (%)	22.5%	20.9%		20.2%	22.9%
EPS (VND)	4,203	4,333		4,532	6,473
Book value (VND)	21,579	20,727		22,544	29,017
Cash dividend (VND)	2,000	2,000		2,000	2,000
P/E (x)	9.6	10.2		9.3	6.5
P/BV (x)	1.6	1.8		1.9	1.5

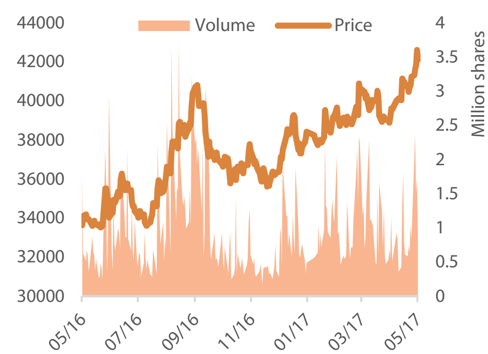
Sources: FPT, RongViet Research estimated.

BUY

CMP (VND)	42,100
Target Price (VND)	53,200
Investment Period	**Long-term**

Stock Info

Sector	Technology
Market Cap (VND b)	22,554
Current Shares O/S (m)	529
Beta	0.679
Free float (%)	69
52 weeks High	42,696
52 weeks Low	33,825
Avg. Daily Volume (in 20 sessions, '000)	855



Performance (%)

	3M	1Y	3Y
FPT	8	23	60
Technology	6	21	30
VN30 Index	8	18	17
VN Index	5	22	33

Major Shareholders (%)

Truong Gia Binh	7.08
SCIC	5.96
Red River Holding	4.56
Foreigner Investor Room (%)	0

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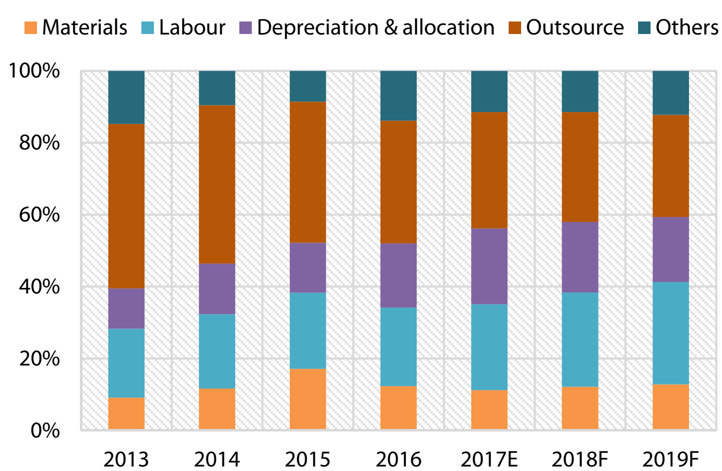
Telecom is expecting profitability improvement owing to the completed cablization in major cities

FOX's tangible fixed assets at-cost doubled in value from Q2/2014 to 2016 which depicts FPT's cablization process at major cities including HCMC and Hanoi. However, the depreciation expense grew at a higher rate than at-cost (9.5% compared to 6.9%), which adheres to FOX's cost recognition policy.

The telecom sector is highly anticipated in 2017, as the optical fiber cablization is concluding in large urban areas, gradually decreasing the allocated costs for terminal equipment and bringing up FOX's efficiency. First of all, the need for an intensive funding for Capex has been relaxed, as two large cities accounting for a major part of FOX's user base and revenue has completed the cablization. FPT's Capex for 2017 is estimated at VND1,537 billion, 265 billion lower than 2016 thanks to the fact that optical fiber internet's infrastructure has mostly finished setup. As a result, FPT is likely to benefit from an enhanced free cash flow in the future.

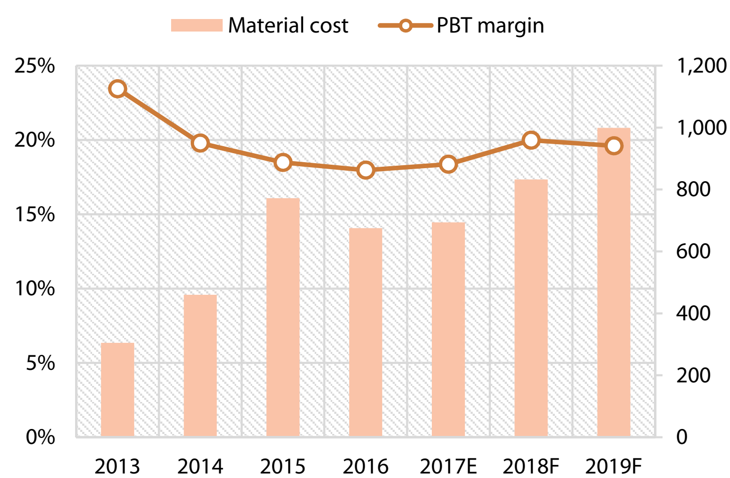
Secondly, FOX's cost recognition policy allows an increasing profit margin, as last-mile equipment costs are quickly allocated in the first two years. As a consequence, we have seen FOX's margin declining during the expanding phase of optical fiber user base (2014-2016). We forecast that this material cost in 2017 will be similar to 2016.

Graph 01: FOX's Cost Structure



Source: FOX, RongViet Research

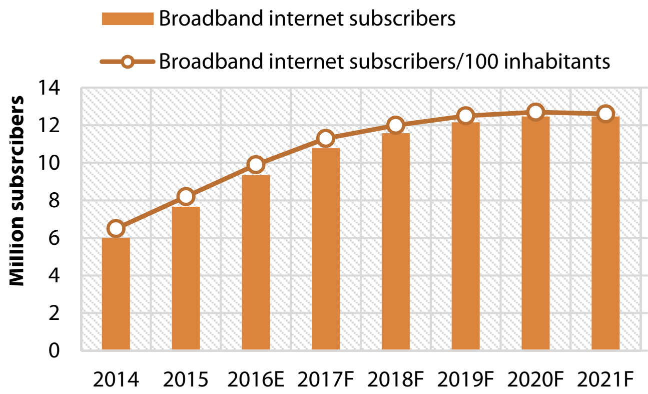
Graph 02: FOX's Material Cost and PBT Margin



Source: FOX, RongViet Research

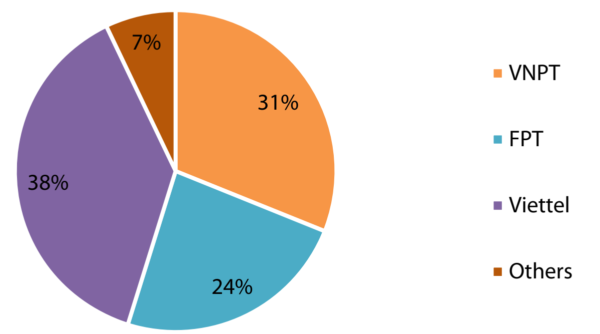
Therefore, the spotlight for FOX's future will depend on its capability to defend its market share and expand the user base against VNPT and Viettel, two state-owned internet providers. For a long time, FPT has been known as a service provider of high quality among household internet users compared to the other two rivals. Because both internet quality and price range is similar among the three internet companies in the same geographical area, customers tend to seek premium in the service quality. Regarding customer experience, FPT ranks the first in new subscription procedure and technical support and is perceived to have helpful response and support, to be friendly and efficient in solving customer complaints. FPT has a tech-team management system that focuses on improving customer experience and building a reputation based on the service quality. This strategy is considered appropriate and outstanding given the market of similar products.

Graph 03: Vietnam's Internet Users and Penetration



Source: RongViet Research compiled

Graph 04: Vietnam's Broadband Internet Market Share



Source: RongViet Research compiled

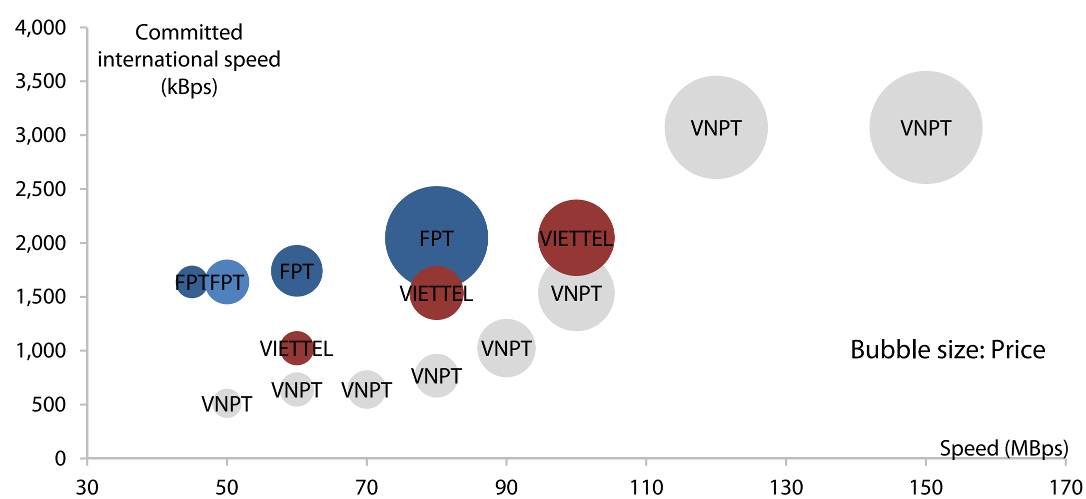
It also explains FPT's strong growth in market share, which went from 6% in 2014 to over 20% within a year. Advertising as the first provider to offer optical fiber broadband internet, FPT has attracted new subscribers as well as existing customers shifting from copper cable and is also able to grow the loyal subscriber group.

Other telecom businesses show promising signs. Digital content's income was improved thanks to the advertising revenue, while FPT's infrastructure is sufficient for 4G service and the company might enter the business of a cellphone carrier to exploit the fresh demand for 4G mobile internet.

We expect that FPT's internet user base will increase at a faster rate than the market, at 25% in 2017. Accordingly, FOX is forecasted to be able to maintain revenue CAGR above 20% in 2014-2019 period, as the longer term's revenue growth rate can decrease gradually and hover around 5% due to the fixed broadband user penetration rate at large cities will reach the saturation point in the next 3 to 4 years. Regarding profits, the sector is going to experience a strong increase in pretax profit in 2017 and a long term profit margin kept stable around 20%.

In a longer term, we expect FOX to be one of the two most significant contributor to FPT's bottom line results owing to the market's promising potential and the company's outstanding efficiency. As FOX is committing to invest another VND800 billion into the fiber optic cable system in the second-tier cities, their subscriber base is predicted to increase steadily in the next 3-5 years, resulting in their profitability picking up.

Graph 05: Pricing among Internet Providers



Source: RongViet Research compiled

Q1/2017, Telecom recorded VND1,746 billion and VND295 billion in revenue and PBT respectively, increasing 13% and 18% YoY. The first quarter's results are below our growth forecasts of 22% and 25%. However, broad-band's sales activities are observed to peak during the middle of the year, thus we expect FOX to operate more sufficiently in the remaining time of the year to average the annual growth rates. It should be noticed that Telecom's PBT has increased faster than revenue, which implies that the segment is improving similar to our expectation.

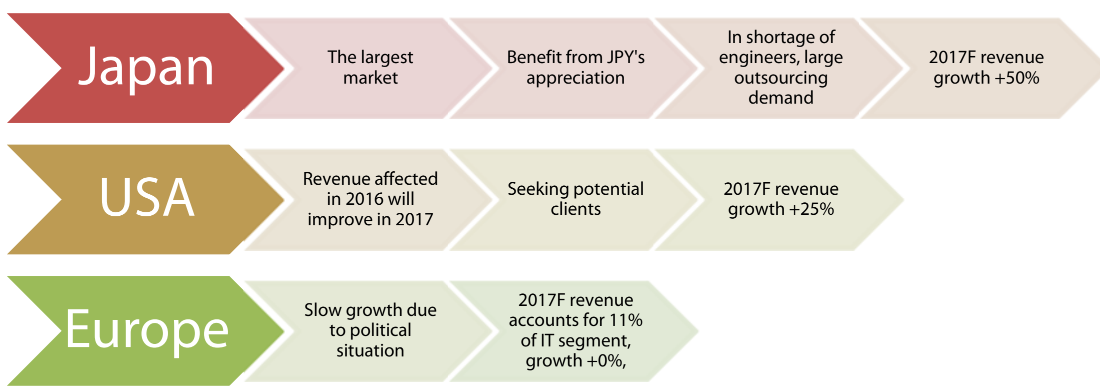
IT remains a solid contributor to the corporation's performance

IT is an important business of FPT, not only because it is the second largest contributor to FPT's results in terms of both revenue and profit but also because it is the only segment whose demand is not limited by the domestic market. In addition to Telecom, we also expect Technology to be one of the two most significant contributor to FPT's bottom line results in the longer future.

Software Outsourcing: The Global Market Favors Vietnamese Firms

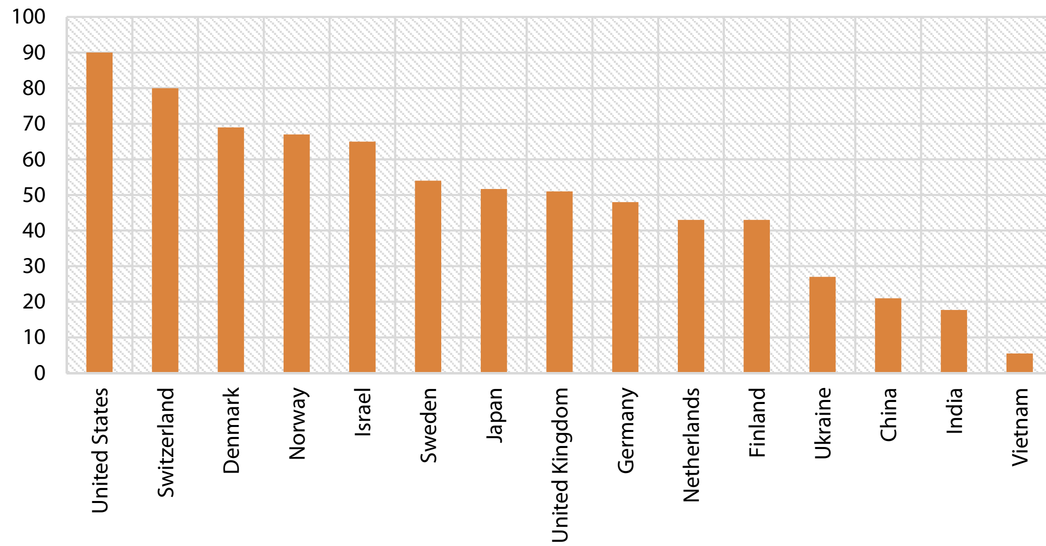
The total global IT outsource demand of nearly USD90 billion per year offers a remarkable opportunity for a Vietnamese bidder who possesses a huge advantage of an abundant and cheap labor force. In recent years, China and India have dominated the market, taking over most projects from the US and Japan, whose labor costs are top-expensive but have great demand for IT outsourcing. However, at a remarkably favorable labor cost compare to the two nations, Vietnamese IT firms can offer more attractive price and can still be able to keep a profitable margin.

FPT as the largest IT outsourcing firm in Vietnam, who employs over 10% of the software engineer labor force of total 88 thousand headcounts, is considered to benefit the most from this global trend, as all major markets show promising growth potential.



IT services, accounting for half of IT segment's revenue and a quarter of its pretax profit also has substantial boost from the domestic market. A circular announced in 2014 allows state agencies to outsource their IT demand and the recent trend of e-government has created abundant jobs for IT companies. High-tech zones have been established and operated by the government, which have attracted FDI and domestic businesses. In particular, FPT has committed hundreds of billion dong of investment into 3 high-tech parks in Hanoi, HCMC and Da Nang. Lastly, the private sector also brings about a growth driver, as a survey shows that 91% firms have plan to virtualize 30% of their data assets in the near future. This sector is the main contributor to the Vietnamese IT industry value's CAGR of 9.9% for the next 5 years. It is worth mentioning again that as the leading firm in the domestic IT service market, FPT is capable of skimming the highly profitable bids and continue to make IT segment one of the two major leading businesses of FPT group.

Graph 06: Software Engineer's Average Annual Salary (thousand USD)



Source: RongViet Research compiled

We forecast that the IT segment will record VND12 trillion and VND1,427 billion revenues and PBT in 2017, achieving 20.8% and 29.5% growth YoY. In Q1/2017, Technology's business results increased by 19% in revenue and 38% in PBT, which is in line with FPT's quarterly targets as well as our projections**.** It is observed that this segment is used to completing the annual targets, thus 2017 guidance of 19% and 23% for revenue and PBT growth are likely to be fully achieved.

Distribution and Retail: two contrasting colors

Regarding Distribution business, 2016 witnesses several unfavorable incidences. Microsoft's termination on Lumia smartphone sales and FPT's halted distributorship for Apple products in Vietnam heavily impacted the segment's business results in 2016. The distribution segment's revenue went down by nearly 30% while PBT decreased 25%, which affected the whole group's performance. Apple products' distribution revenue went down by 62% and Nokia's was almost wiped out, other mobile phones' distribution revenue only saw a marginal increase, as IT device distribution's sales grew by only 4%.

In contrast, FPT Retail was able to maintain a sharp performance as the revenue went up by 35%, the number of FPTShop increased by a half and profit margin improved by 15 percentage points to 2.45%. Compared to Thegioididong of MWG, FPT is expanding the number of stores more slowly as it is more conservative and selective in location. Pricing its products at a slightly higher range than Thegioididong's and has advantages in the northern market, FPT has lower average revenue per store. While Thegioididong tackles the middle and low-income market segments and grows strongly on affordable personal devices, we predict that FPT will develop more moderately with the current strategy. As a relative valuation using equally weighted P/E and P/S ratios, assuming FPTShop has the ratios equal to 80% those of Thegioididong, the business value would be determined at nearly VND4,000 billion.

Table 1: Comparison with Retail Peer

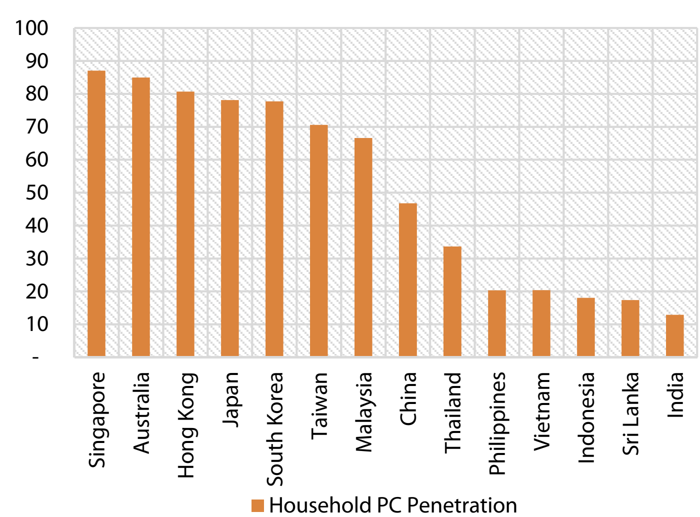
Criteria	FPTShop	Thegioididong
Current number of stores	419	1,359
No of new stores per year 2014-2016	111	403
2016 Revenue (VND billion)	10,585	45,613
Average annual revenue/store 2016 (VND billion)	27	37
PBT 2016 (billion)	259	2,006
Market share (%)	18	40
Trailing P/E	-	16.9
Trailing P/S	-	0.6

Source: RongViet Research compiled and estimated

At the end of Q1/2017, the Distribution & Retail segment recorded a deterioration in PBT compared to last year due to the strong decrease of 40% in the distribution segment's profit. However, the surge in retail's profit managed to compensate a major part, which we believe will prolong during the rest of 2017. FPT's 2017 guidance for the segment seems to be ambitious, aiming at 36% growth in PBT, but as Q1's results show that the distribution business has not escaped difficulties yet, we forecast the segment is going to record a more moderate growth.

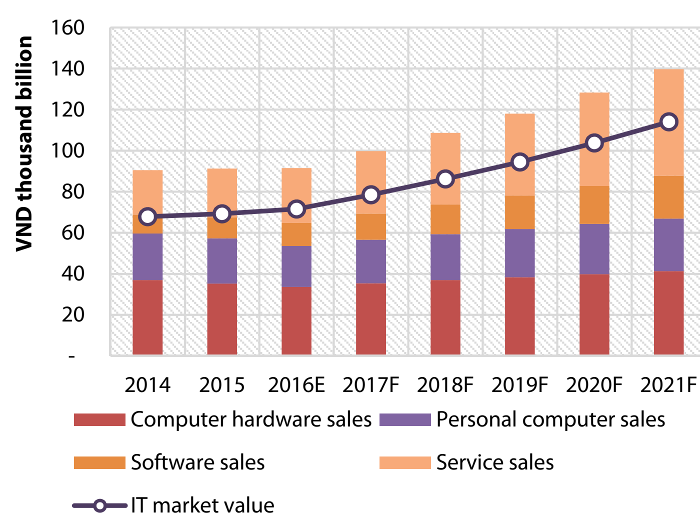
In a longer term, we expect Retail to maintain a decent growth based on the Vietnamese population structure, a majority of which are willing to spend more on personal high-tech devices. FPT, who has a well-developed retail and after sales service chain will continue to be a well-perceived brand for smart device retailing. Especially, spending on marketing, logistics and repairing services is a suitable strategy to maintain revenue growth while profit growth is going to rely on improvements in the distribution value chain. However, Distribution is forecasted to have difficulties because at the current development pace of the distribution market, their clients might either have sufficient economies of scales to deal directly with foreign upper distributors or gradually go out of business due to the enormous expansion of larger retail chain including FPTRetail itself or Thegioididong.

Graph 07: Household's PC Penetration (%)



Source: RongViet Research compiled

Graph 08: Vietnam's IT Market



Source: RongViet Research compiled

Other segments of Distribution & Retail including hardware and software sales are experiencing steady development and are forecasted to sustain a stable growth in the future. The market for personal computers is expecting a moderate CAGR of 3.9% due to the fact that the computer era is coming to an end, being replaced by portable smart devices, the more popular choice of the general public. However, FPT who sells both PC and smartphones is unlikely to be negatively influenced by the trend. Furthermore, households, businesses and governmental offices are still able to provide a profuse demand for desktop computers and laptops. Such working tools' lack of substitutability and a low household computer penetration are going to support the market's sales volume and revenue, which FPT can take advantage of using their nation-wide retail network. Regarding software sales, the market expects a CAGR of 13% during 2017-2021 owing to a risen awareness from business owners, the flexibility of cloud solutions and the data virtualization trend in both private and public sectors. In short, being a leading player, FPT benefits largely as all participating markets offer promising potential.

The restructuring progress remains a highly anticipated story

It has been widely known that FPT has been seeking a buy side for FPTTrading and FPTRetail and trying to increase its ownership at FOX (FPTTelecom). In our previous FPT company update report, we calculated outcomes based on different scenarios for proceeds from the divestments as well as the expenditure for taking over FOX. However, FOX has been listed on UpCom and it is now trading at a much higher price, which implies that it has become more capital-demanding for FPT to buy FOX shares from SCIC. Information from the current state holder of FOX can be interpreted that FPT's plan is unlikely to be achieved in the short and intermediate term. Our previous estimation predicts that if successfully divesting 100% from Trading and Retail subsidiaries, FPT will proceed VND4,488 billion. However, in order to buy all SCIC's holdings at FOX at the current market price (VND86,000 at April 28th 2017), it would take VND5,914 billion, much higher than the proceeds. At the present, the divestments are still under partner seeking and negotiating and we expect the restructuring progress will not conclude in 2017. The story still deserves a spot light in FPT's long term potential since FOX is projected to demonstrate a remarkable efficiency that can boost the corporation's performance. However, investors will need to be more patient for SCIC's moves as FPT can only complete the reforming schedule when SCIC has divested from FOX.

Q1/2017 Performance and Summary of 2017 Forecast:

FPT's first quarter of the year recorded VND9,768 billion and VND540 billion in Revenue and NPAT respectively, equivalent to YoY growth rates of 14% and 21%. FPT is tracking closely to its year-to-date guidance as it has achieved 106% and 104% of its three-month targets. Technology stood out with 19% growth in revenue and 38% growth in PBT owing to the company's winning bids in developing countries especially in the Asian region. The second highest contributor, Telecom also saw a steady growth of 13% and 18% in revenue and PBT respectively. FPT representative has announced that the aggressive cost allocation ended in June 2016 owing to the completed optic fiber cablization in large urban areas and Telecom's profit margin started picking up since last year. It can be clearly observed that its PBT is growing more strongly than its revenue. In fact, the four-month results displayed the same revenue growth rate of 13% but even higher PBT growth rate of 20%, implying that Telecom segment is promising in 2017. On the contrary, Distribution & Retail continued to show a negative performance in terms of PBT, as it decreased by 14% YoY. A revenue growth of only 7% was said to result from a normally flat sales during Tet holiday, yet the segment is still sticking comfortably to FPT's year-to-date targets.

In general, FPT has been performing in line with our expectations so far. Most figure sees a moderate to significant growth except for Distribution& Retail's PBT, which was depressed by several unfavorable incidents mentioned above. Compared to FPT's guidance, even though some particulars completed less than a quarter of the annual targets, the Year-on-year growth rates still show optimism, as the first quarter is usually the lowest performing.

Table 2: Q1/2017 Business Results

	Revenue	YoY	%Guidance	%Forecast
IT	1,929	18.7%	16.3%	16.1%
Telecom	1,749	13.4%	22.6%	21.0%
Distribution & Retailing	5,864	12.2%	22.5%	21.5%
Education	255	48.3%	26.8%	24.4%
	PBT	**YoY**	**%Guidance**	**%Forecast**
IT	183	38.6%	13.5%	12.8%
Telecom	295	18.0%	24.4%	18.7%
Distribution & Retailing	117	-13.3%	15.8%	16.2%
Education	48	6.7%	49.0%	22.9%

Source: RongViet Research compiled

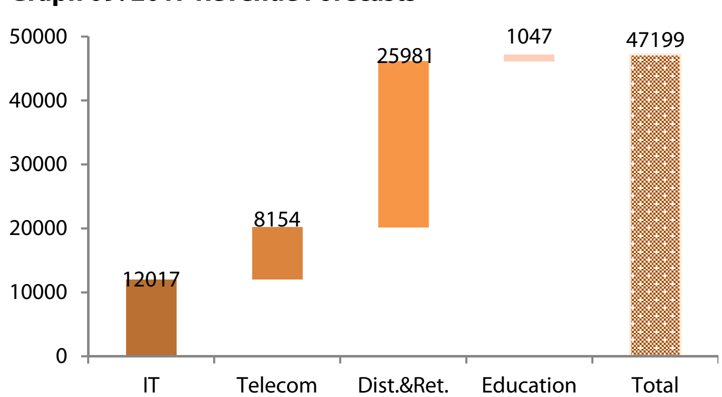
We forecast FPT's 2017 revenue and NPAT to be VND48,107 billion and VND2,408 billion, increasing 21.7% and 21.0% respectively. FPT's gross margin and net margin will be 21.5% and 5.0%, showing a slight improvement compared to 2016. FPT's tangible fixed assets will keep increasing strongly as the cablization is on-going at other areas and the company keeps investing in new office buildings for IT's working space, however the efficiency in Retail's operation is going to keep FPT's inventory at a moderate and stable level compared to its COGS. Therefore, FPT's cash flow situation is predicted to remain sufficient for the company business. FPT may record an EPS of over VND4,500.

Table 3: FPT's Sector Forecasts

Revenue growth rate (%)	2016A	2017E	2018E
Technology	15.7	20.8	21.8
Telecommunication	21.6	22.3	21.7
Distribution & retail	-8.6	16.1	13.4
Education	26.8	32.5	17.3
Total	**1.4**	**21.7**	**17.0**
Pre-tax profit growth (%)			
Technology	19.0	29.5	35.6
Telecommunication	15.1	25.0	32.4
Distribution & retail	-25.4	12.2	41.6
Education	9.7	38.7	29.0
Total	**5.7**	**25.1**	**34.9**

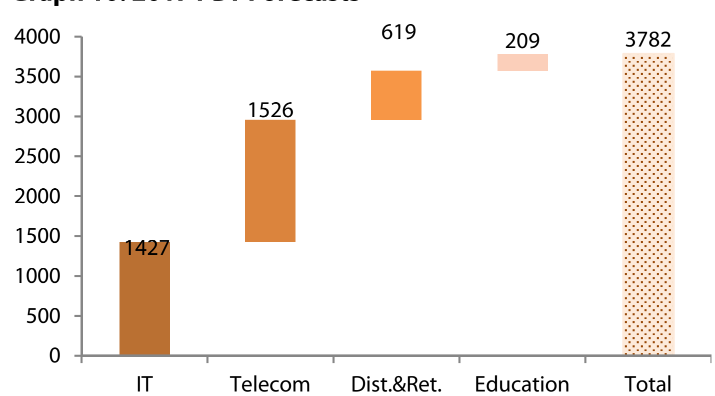
Source: RongViet Research

Graph 09: 2017 Revenue Forecasts



Source: RongViet Research compiled

Graph 10: 2017 PBT Forecasts



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VND Billion

INCOME STATEMENT	2015	2016	2017E	2018F
Revenue	37,960	39,531	48,107	56,293
COGS	30,466	31,093	37,788	43,559
Gross profit	7,494	8,438	10,320	12,734
Selling Expense	2,227	2,638	3,127	3,659
G&A Expense	2,332	2,751	3,271	3,828
Finance Income	453	575	151	159
Finance Expense	620	694	386	403
Other profits	49	50	50	50
PBT	34	35	35	35
Prov. of Tax	2,851	3,014	3,771	5,087
Minority's Interest	413	438	600	804
PAT to Equity Shareholder	507	585	763	839
EBIT	1,931	1,991	2,408	3,443
EBITDA	2,935	3,049	3,921	5,247

FINANCIAL RATIO	2015	2016	2017E	2018F
Growth				
Revenue	16.3%	4.1%	21.7%	17.0%
EBITDA	27.3%	8.6%	25.0%	29.9%
EBIT	25.7%	3.9%	28.6%	33.8%
PAT	18.3%	3.1%	21.0%	43.0%
Total assets	14.9%	14.5%	14.2%	17.0%
Total equity	8.5%	10.0%	25.2%	28.7%
Profitability				
Gross margin	19.7%	21.3%	21.5%	22.6%
EBITDA margin	9.7%	10.1%	10.3%	11.5%
EBIT margin	7.7%	7.7%	8.2%	9.3%
Net margin	5.1%	5.0%	5.0%	6.1%
ROA	7.4%	6.7%	7.1%	8.6%
ROCE	25.8%	24.0%	24.7%	26.0%
ROE	22.5%	20.9%	20.2%	22.4%
Efficiency				
Receivables turnover	6.9	6.0	6.8	6.8
Inventories turnover	5.8	6.8	7.5	7.6
Payables turnover	4.7	3.9	4.8	5.3
Liquidity				
Current	1.3	1.3	1.4	1.6
Quick	0.9	1.0	1.1	1.3
Finance Structure				
Total debt/equity	102.7%	104.4%	97.7%	88.0%
ST debt/equity	95.5%	96.7%	85.7%	74.1%
LT debt/equity	7.2%	7.7%	12.0%	13.9%

VND Billion

BALANCE SHEET	2015	2016	2017E	2018F
Cash and cash equivalents	3,585	6,013	7,856	11,078
Short-term investments	2,617	3,472	3,819	3,819
Accounts receivable	5,534	6,640	7,091	8,297
Inventories	5,268	4,554	5,051	5,729
Other current assets	1,955	1,229	1,475	1,770
Property, plant & equipment	4,652	5,141	5,926	6,255
Acquired intangible assets	319	456	416	371
Long-term investments	728	826	861	897
Other non-current assets	1,374	1,487	1,562	1,640
Total assets	**26,032**	**29,819**	**34,057**	**39,856**
Accounts payable	6,467	7,904	7,935	8,276
Short-term borrowings	8,191	9,207	10,217	11,363
Long-term borrowings	614	733	1,433	2,133
Other non-current liabilities	281	223	245	269
Bonus and Welfare fund	309	319	386	552
Tech-sci. dev. fund	0	0	0	0
Total liabilities	**15,863**	**18,385**	**20,216**	**22,593**
Common stock and APIC	4,025	4,644	5,572	6,687
Treasury stock (enter as -)	-1	-1	-1	-1
Retained earnings	4,395	4,614	6,081	8,389
Other comprehensive income	81	138	138	138
Inv. and Dev. Fund	79	127	127	127
Total equity	**8,578**	**9,522**	**11,918**	**15,340**
Minority Interest	**1,601**	**1,923**	**1,923**	**1,923**

CASH FLOW STATEMENT	2015	2016	2017E	2018F
Profit before tax	2,851	3,014	3,771	5,087
-Depreciation	675	909	1,055	1,216
-Adjustments	92	174	-	-
+/- Working capital	(2,463)	215	(1,762)	(2,643)
Net Operating CFs	**1,156**	**4,312**	**3,064**	**3,660**
+/- Fixed Asset	(1,660)	(1,199)	(1,881)	(1,578)
+/- Deposit, equity investment	(1,276)	(860)	35	35
Interest, div, cash profit rec.	34	35	-	-
Net Investing CFs	**(2,901)**	**(2,024)**	**(1,846)**	**(1,543)**
+/- Capital	536	619	-	-
+/- Debt	1,941	1,134	310	446
Dividend paid & other	(1,483)	(1,612)	309	660
Net Financing CFs	**993**	**141**	**619**	**1,105**
Beginning cash & equivalents	**4,336**	**3,585**	**6,019**	**7,856**
+/- cash & equivalents	(752)	2,429	1,837	3,222
Ending cash & equivalents	**3,590**	**6,019**	**7,856**	**11,078**

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RATING GUIDANCE

Ratings / Return Potential	BUY	ACCUMULATE	NEUTRAL	REDUCE	SELL
Intermediate- term (up to 6 months)	>20%	10% to 20%	-5% to10%	-15% to- 5%	<-15%
Long-term (over 6 months)	>30%	15% to 30%	-10% to 15%	-15% to -10%	<-15%

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