September, 2017

LOC TROI GROUP (LTG - UPCOM)

More Choice for Agriculture

Loc Troi Group (UPCOM:LTG) is a leading company in pesticide industry with a current market share of 21%. After operating for a long time in the pesticide market, the company decided to change its strategy with the desire to penetrate deeply into the agricultural value chain by expanding its business into two new segments: rice and seed segments.

The value chain guarantees product quality as well as enhances business efficiency as LTG is able to control the input supplied to farmers and the company can cooperate with farmers in the production and purchasing process. Although LTG started the value chain in 2010 with focus on rice production, the business performance of this segment is not as good as expected. Overall, the performance of the whole group still depends on pesticides. We think revenue from the pesticide segment can maintain a growth rate of 10% while LTG continues to improve its rice segment.

*Using the P/E and DCF valuation methods, we believe the fair value of LTG share is VND65,730. At the closing price of VND48,700/share as of Sept 12th, the P/E 2017 forward is 8.0x. So, we recommend investors to **BUY** this stock.*

Investment rationale:

- The Agriculture industry moving towards a more modern and sustainable orientation
- Growth opportunities thanks to changes of pesticide retail selling model
- Rice production is showing short-term positive results but the long-term potential is still questionable

Risk:

- Uncertainty of rice segment

Key financial ratios

Y/E Dec(VND Bn)	FY2015	FY2016	FY2017F	FY2018F
Net revenue	7,856	7,783	8,555	9,719
%change	-11%	-1%	9.9%	13.6%
PAT	319	347	480	532
% change	-36%	8.8%	38.4%	10.8%
Net margin (%)	4.1%	4.5%	5.6%	5.5%
ROA (%)	5.3%	5.6%	7.3%	7.2%
ROE (%)	15.2%	16.0%	21.1%	21.8%
EPS (VND)	3,491	4,454	6,080	6,739
Book value (VND)	30,998	32,012	33,850	36,347
Cash dividend (VND)	3,000	3,000	3,000	3,000
P/E (x)	n/a	n/a	8.0	7.3
P/BV (x)	n/a	n/a	1.4	1.3

Source: LTG, RongViet Research estimation

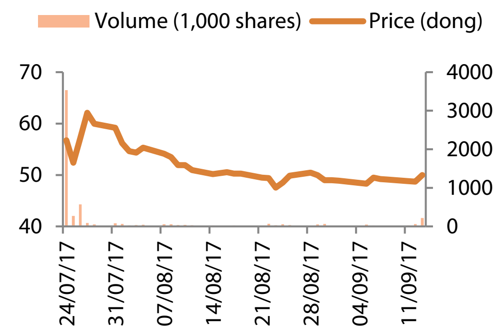
BUY

CMP (VND)	48,700
Target Price (VND)	65,730
Cash Dividend (VND)*	3,000

** Expected in the next 12 months*

Stock Info

Sector	Specialty Chemicals
Market Cap (VND billion)	3,392
Share O/S	67,161,150
Beta	n/a
Free Float (%)	18.4
52 weeks high	64,000
52 weeks low	49,000
Average trading volume (20 sessions)	199,149



Performance (%)

	1M	6M	1Y
LTG	-8,2	n/a	n/a
Chemicals	-4,1	13,0	13,1
VN 30 Index	3,5	19,3	19,1
VN Index	1,2	14,1	20,3

Major sharholders (%)

Marina Viet Pte. Ltd	25,2
UBND Tỉnh An Giang	24,2
SCPE	8.2
Foreigner Investor Room (%)	*49.0*

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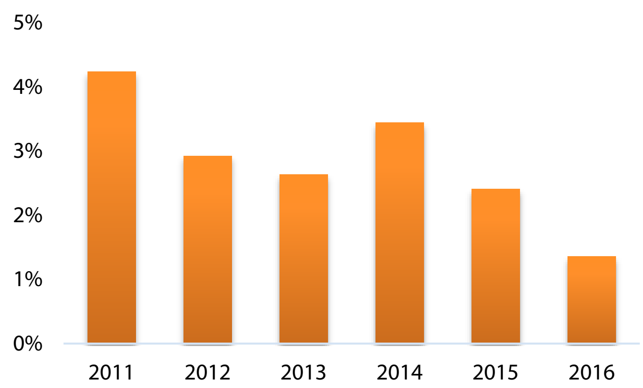
INVESTMENT RATIONALE

Agriculture is receiving more attention and investment towards sustainable and more modern

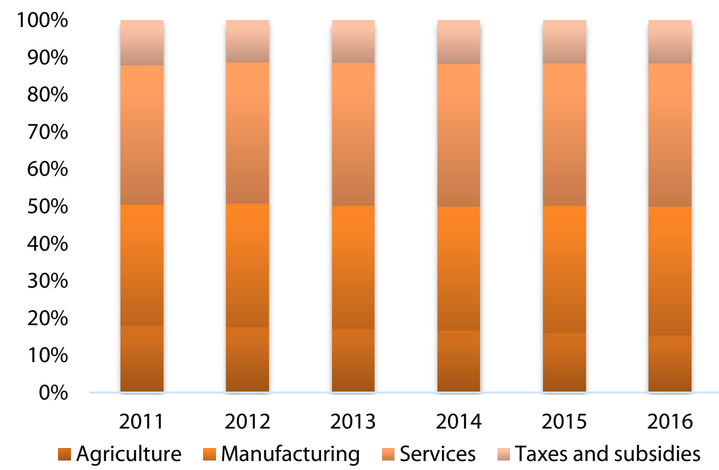
Agriculture always maintains stable growth in the long term. In the period 2000–2015, agriculture increased by 3.7% on average and has always maintained a high contribution to GDP. Thanks to natural conditions and nature of Vietnamese people, growth of agriculture has been quite stable. However, drought in 2016 had a negative impact on the industry, which has slowed down growth. The year 2017 witnessed the recovery of the sector. In the first 2 quarters of this year, the sector recorded positive growth of 2.03% and 2.65%, respectively.

Figure 1: Agriculture industry growth



Source: GSO, RongViet Research

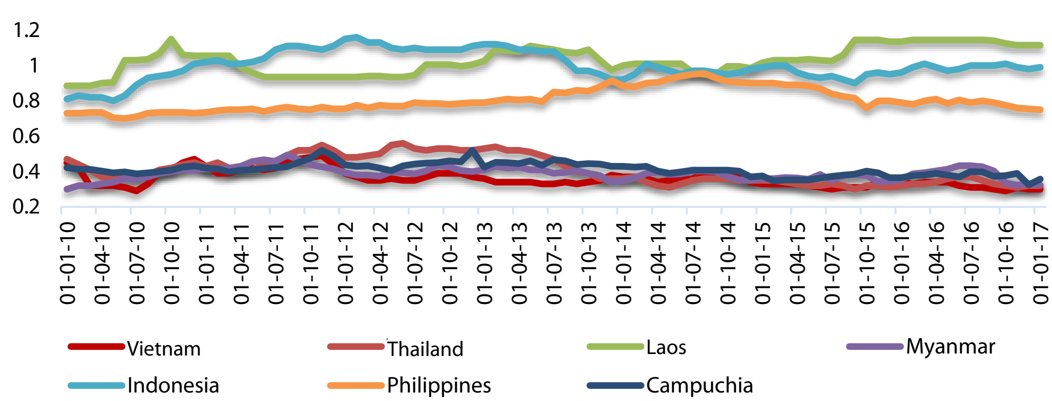
Figure 2: GDP Contribution by Sectors



Source: GSO, RongViet Research

Rice production in Vietnam always maintained sufficient products for domestic demand. According to World Bank, thanks to the irrigation system, farmers can grow 2–3 crops per year. Also, priority policies support fertile land to be used for rice production. World Bank forecasts that Vietnam will always have rice surplus until 2030 even under the worst case scenario whereas the area for plantation reduces by 20–25%. The surplus under such condition is still around 3 to 6 million tons. Thanks to large surplus, Vietnamese consumers are now benefiting from lower domestic rice prices compared to selling prices in other countries in the South East Asia.

Figure 3: Domestic rice selling prices



Soure: FAO

Vietnam Government encourages investment in agriculture. Authorities are showing great concerns on supporting investments into high-tech agriculture. For example, in 2017, the government issued a draft amendment and supplement of Decree 210/2013/ND-CP on preferential policies in the agricultural sector. Some newly modified articles are showing openness for this sector. Besides, the State Bank of Vietnam (SBV) also issued Decision No. 813/QD-NHNN dated 24 April 2017 on lending program to encourage the development of high-tech agriculture. The Decision expresses more details for the Resolution 30/NQ-CQ dated 7 March 2017. This is a VND100,000 trillion credit line with preferential interest rates on loans denominated in VND ranging from 0.5% to 1.5% per annum. (see appendix)

In addition, LTG is a large group in the agricultural sector that is pursuing a full value chain of rice production. LTG can take advantage of government policies to adapt to the trend of agriculture heading toward sustainable growth and focusing on quality rather than quantity.

Pesticide segment can grow on the back of increasing market share via the transformation of the distribution model into one-tier retail model

As the pesticide market is growing very slowly and the competition is quite fierce, a company must have both good brand name and distribution network.

The retail distribution network of LTG is a competitive edge. Before 2016, LTG ran a distribution network comprising of tier 1 (wholesale) and tier 2 (retail) agencies. After realizing the disadvantages of this two-level model, LTG decided to transform the distribution into retail selling model, in which the company treats all agencies as retail agencies. The transformation not only helps LTG expand the location quickly but also enables LTG to stick to farmers' demand. The final outcome is that LTG can maintain a decent growth by capturing market share from other competitors. LTG started to restructure the selling network since Q3 2015. The result of pesticide segment in H1 2017 proved the efficiency of the transformation. The revenue from this segment increased 19% YoY. Gross profit recorded VND771 billion (+36% YoY). The gross profit reached the historical high of 33%.

LTG plans to increase the number of agencies from 5,008 to 6,000 agencies by the year 2020 with a target of 30% market share. We think the plan is possible. Indeed, while revenue from pesticide sales of LTG increased 19% YoY in H1 2017, VFG – a direct competitor of LTG – witnessed a decline in pesticide sales. We forecast LTG can maintain a growth rate of 10% per annum for pesticide revenue in the next 5 years. So, LTG can achieve its market share target. Gross profit margin can be stable at around 33% as LTG can be more active than other smaller firms in setting selling prices and negotiating input cost.

Table 1: Some criteria to compare LTG's pesticide segment with that of other companies

	LTG	VFG	Bayer	HAI	Tan Thanh	Hop Tri
Products	CPCs	CPCs	CPCs	CPCs	CPCs	CPCs
Main distributors	Syngenta, Dow (*) and others	Syngenta and others	N/A	Dupont	N/A	N/A
Distribution network	21 branches and 5,008 agencies	17 branches and 2,500 agencies	3 branches	16 branches and 1,800 agencies	5 branches and 2,200 agencies	600 agencies
Market share	21%	7.4%	5.2%	5.5%	N/A	N/A

Source: LTG, RongViet Research

(*) In July 2017, LTG just became an exclusive distributor for the microbiology product of Dow. This is the only microbiology product in the market with the shortest quarantine period.

In term of agricultural products - rice has been having positive signals in short-term but is still questionable in long-term potential.

LTG started to step in rice production in 2010 and began to record revenue from this segment in 2011.

Business model of this segment and the tradition model showing cooperation between producers and farmers are very much alike. The model for large fields developed by LTG with the name of IA Rice links farmers together. On the one hand, enterprises can support farmers with farming techniques. On the other hand, it ensures the quality of output. In this model, the good thing is it allows people to be able to make their choices and take corresponding benefits. The company allows the famers to choose between selling rice to company or consigning rice in the company's stockpile and wait for the price to increase before selling. LTG also allows farmers to sell rice to the market if the market price is higher than the purchase price of the company. Other companies only sign off-take agreements without other support for temporary storage. Farmers are often forced to sell under adverse conditions. In Vietnam, only large enterprises have resources to supply standard inputs (seeds, pesticides, and fertilizers) to farmers, participate in technical guidance and supervision, as well as have outputs to make exclusive sales of products at a reasonable price. Deployment of large fields can help farmers improve their income (please refer to the appendix for more information), so according to the time when this model is believed and enjoyed, as well as multiplied by more and more people, it will be considered a completive advantage of LTG.

However, the result of rice segment has not been stable yet. In the first 2 years of deployment, gross margin recorded negative figures 8% and 13%, respectively. The next 3 years 2013–2015, gross margin surged to positive figures between 6% and 7% but very quickly pulled back to only 1% in 2016. The H1 2017 saw the rice segment suffering from negative gross margin.

Although LTG tried to operate in a vertical chain from the processing to brand promotion, LTG's current rice business is still characterized by commodity trading as exports account for ~2/3 of LTG's rice production. Unlike other agricultural products, rice does not depend only on the brand of a single company but rather the brand name of a country or a region. We think LTG's own efforts will not be enough to solve this matter. While Thailand or India have already asserted their national rice brands on the export market, Vietnamese rice is still quite "anonymous" and has lower selling prices than these two countries.

Domestic consumption accounts for 1/3 of total production of LTG. This is a potential market as consumers are paying more attention to healthy products. However, it is also fragmented. There are many subjects involved in supplying rice to consumers including wholesalers, retailers, traditional markets and supermarkets. LTG has been also building its own distribution system and selling it through traditional markets or cooperating with supermarkets. The trend of buying branded rice is beginning to appear but not much. Consumers buy rice from traditional retailers (accounting for 85% of consumption volume). Besides, branded rice has many levels with mixed quality, so LTG cannot really stand out among the sold non-branded rice.

We believe LTG is still in the early stage of this segment. It must take a lot of time to confirm its success in rice production. At least after 7 years operating, LTG has achieved some certain improvements and changes to catch up with the market. We forecast that LTG can have 1% gross margin for this segment. The revenue can increase 10% YoY, thanks to the selling price of exported rice – which tends to increase in 2017 – and all inventories in 2016 that cleared in H1 2017. The CAGR of rice segment between 2017 and 2021 will be 8.6% as LTG is now more active in searching for commercial contracts with China, Philippines, Bangladesh, Hong Kong, USA, etc. The gross margin can steadily improve from 1% in 2017 to 5% in 2021.

RISK

Uncertainty of rice segment

LTG is bearing a major risk of uncertainty of rice production. This segment depends on many objective factors that might lead to erroneous forecasts of supply and demand that cause increasing inventory; thereby, affecting the business performance of the segment.

INVESTMENT RECOMMENDATION

Loc Troi Group (UPCOM:LTG) is a leading company in pesticide industry with a current market share of 21%. After operating for a long time in the pesticide market, the company decided to change its strategy with the desire to penetrate deeply into the agricultural value chain by expanding its business into two new segments: rice and seed segments.

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COMPANY OVERVIEW

Loc Troi Group (LTG), formerly known as An Giang Plant Protection Joint Stock Company, was founded in 1993 and went public in September 2004 with chartered capital of VND150 billion. From a small business with 23 employees, up to now, Loc Troi has become the leading agricultural distributor in Vietnam with more than 1,300 employees and the chartered capital of nearly VND672 billion.

Table 2: Introduction of three main business segments of LTG

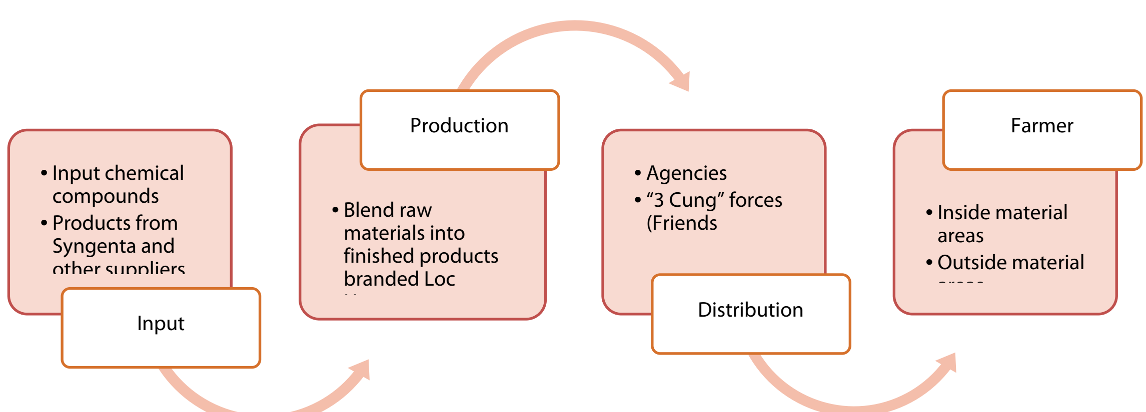
Product Industry	Pesticides & Plant nutrition	Seeds	Food processing
Business model	Manufacture & distribution	Manufacture & distribution	Manufacture
Market position	Lead the market	Lead the market	Have private rice brand
Productions	Herbicide, fungicide, insecticide and fertilizer	Rice, corn and vegetable seeds	Loc Troi white rice, Vibigaba germinated brown rice
Business perfomances	• Distribute pesticides from Syngenta and other firms. • Have 2 agricultural pharmaceutical processing plants with the capacity of 50,000 tons/year • Distribution network: 26 branches, more than 5,000 retailers	• Research pure-line rice, hybrid corn and vegetable seeds • 3 research centers • 8 seed manufacturing center with total capacity of 57,000 tons of rice, 4,000 tons of corn and 0.2 tons of seed per year	• Sucessfully develop sustainable rice production chain model, control inputs and manufacturing process • Technical support from agricultural engineer • 5 rice manufacturing factories with the total capacity of 700,000 tons per year • High quality and branded rice

Source: LTG

Pesticide Segment

Despite of changing its name to Loc Troi and targeting to expanding its agricultural value chain to food sector, LTG is still the largest pesticide provider in Vietnam with 21% of the domestic market share. At the present, LTG has two plants with the capacity of 50,000 tons per year together with over 5,000 retailers from North to South. Approximately 65 to 70 percent of pesticide production LTG provides is mainly from Syngenta. Besides chemical products, LTG also targets to research – develop, distribute biological products. In July 2017, LTG has officially become exclusive distributor Gradiant, a biological product of Dow Chemicals.

Figure 4: LTG's pesticide value chain



Source: LTG, RongViet Research

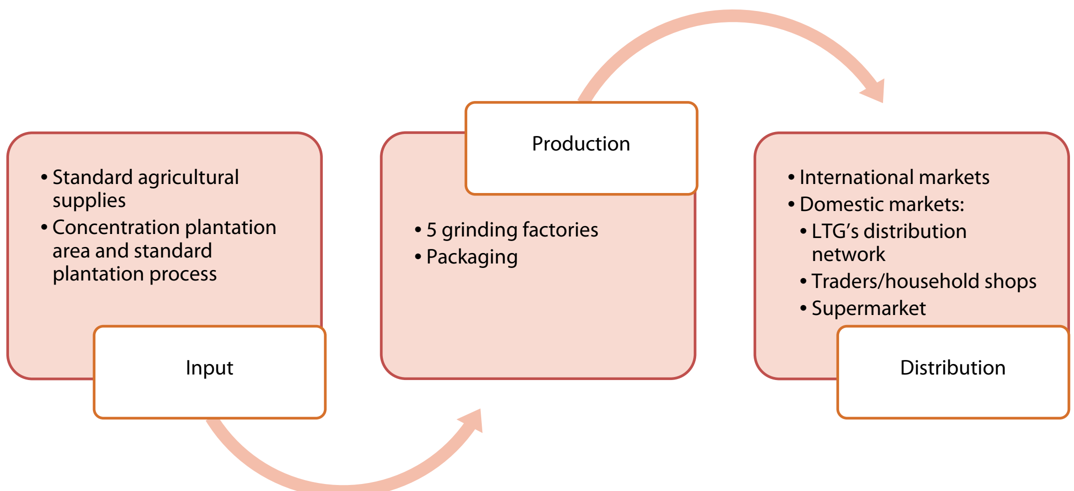
Agricultural Products Segment – Rice

Since 2010, LTG has aggressively expanded into the rice processing when using close business model from seed research to product distribution. The Group has around 36,000 hectares and 5 rice-processing factories at Vinh Binh, Thoai Son (An Giang province), Vinh Hung (Long An province), Tan Hong (Dong Thap province), Hong Dan (Bac Lieu province) with a total capacity of 700,000 tons per year.

Last year, the agricultural products segment – rice of LTG witnessed the biggest change when the Group started assessing its co-operation with farmers. LTG has limited doing business with farmers who got LTG's storage a loan/ borrowed LTG's storage in order to wait for selling to other merchants when the price of rice increases; otherwise selling to LTG for lost minimization. Therefore, the area decreased from over 90,000 to 36,000 hectares in 2017.

Moreover, at the present, rice-manufacturing factories of LTG do not only produce for the Group but also flexibly process rice for merchants in low seasons.

Figure 5: LTG's rice value chain

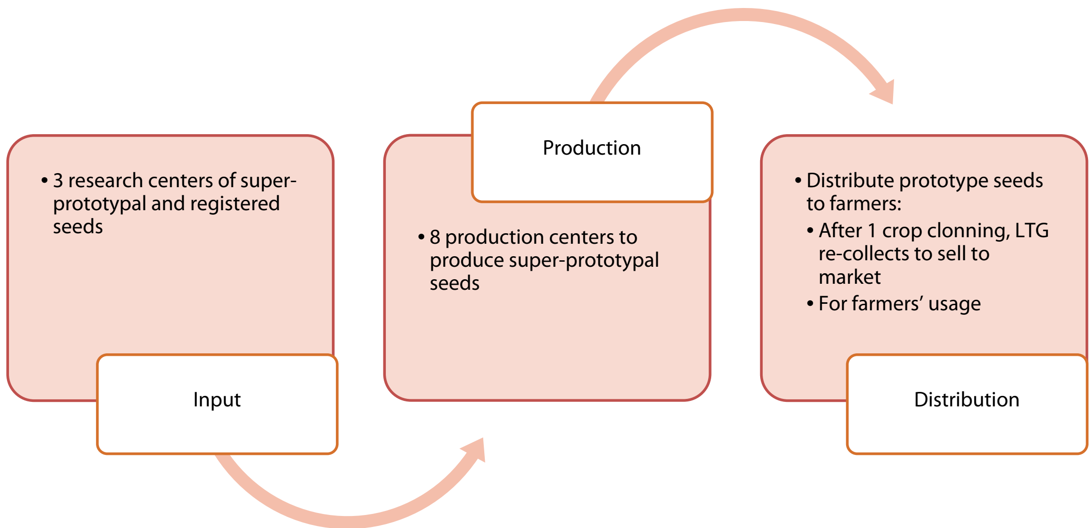


Source: RongViet Research

Seed Segment

According to industry structure, in seed segment, LTG provides three main products: rice, corn and vegetable seeds. LTG has two advantages in seed industry, which are (1) Dinh Thanh research center and (2) Retail systems integrated with selling pesticides.

Figure 6: LTG's seed value chain



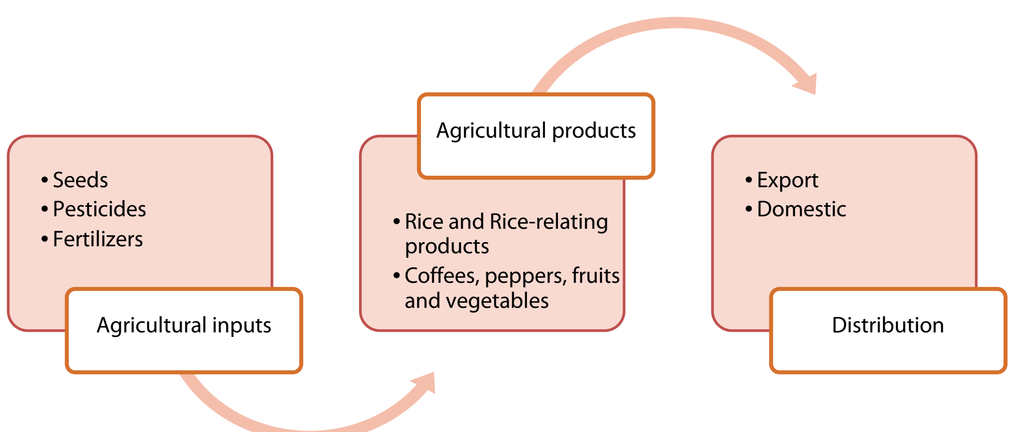
Source: RongViet Research

Firstly, Dinh Thanh–LTG research center was founded in 2012 with the purpose of seed research along with authorization. Dinh Thanh is the only place allowed to author seed certification in Cuu Long Delta by the Ministry of Agriculture & Rural Development. The center can do research on hybrid rice which has high productivity and confronts pestilent insects better. According to LTG, most of the farmers at Cuu Long Delta utilize pure-line rice while hybrid rice is being planted in the north where natural condition for rice is not favorable. However, they will have to change their habit when facing with the problem: they need to maintain the capacity while the area does not increase.

Secondly, with retail system integrated with selling pesticides and large farm model, LTG will have more opportunities to connect and advise farmers to use its seeds for quality guarantee. There is no evidence that LTG only agree to co-operate with farmers buying its seeds and pesticides. However, we claim that the convenience of the close vertically value chain will convince farmers to co-operate with LTG from input (seed, pesticide, fertilizer) to output. It is worth noting that by 2016, LTG was the second player in seed industry after National Seed Joint Stock Company (Vinaseed).

Business segments of LTG toward closed agricultural food chain.

Figure 7: LTG's target agricultural value chain

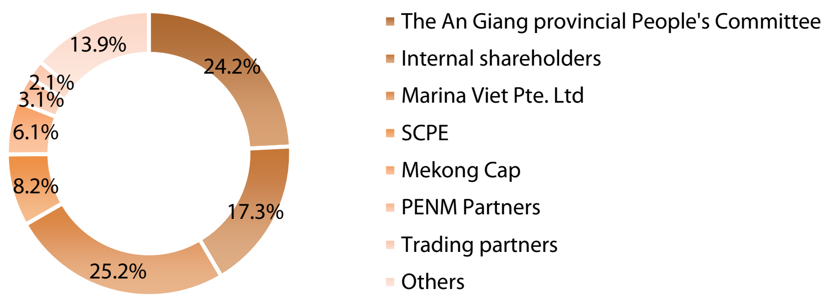


Source: LTG, RongViet Research

Shareholder structure

Shareholder structure of LTG is quite condensed. Two biggest shareholders are People Committee of An Giang Province (24/2%) and the latest name Marina Viet Pte. Ltd (25.2%). Mekong Capital currently holds 1.5% after selling most of their shares when LTG listed in July. The free-float of LTG is around 18.4% after we subtract the holdings of major, strategic and internal shareholders.

Figure 8: Shareholder structure

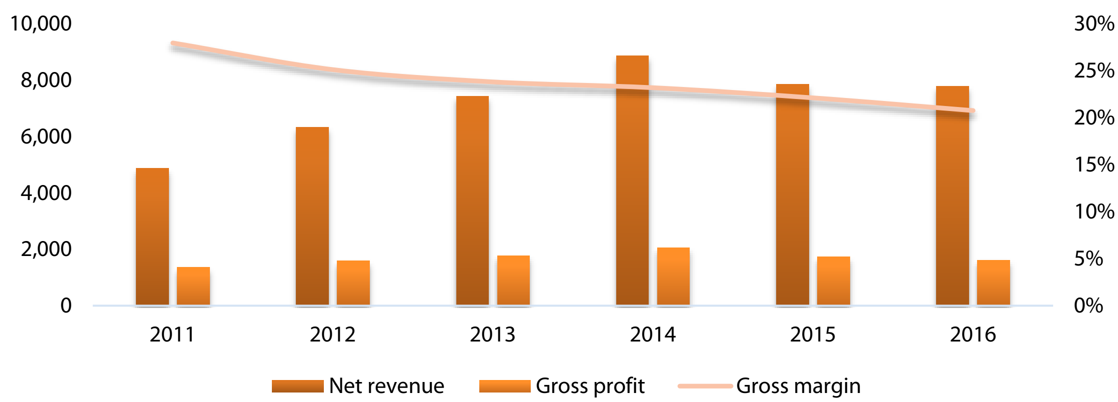


Source: RongViet Research

FINANCIAL ANALYSIS

Growth and profitability analysis

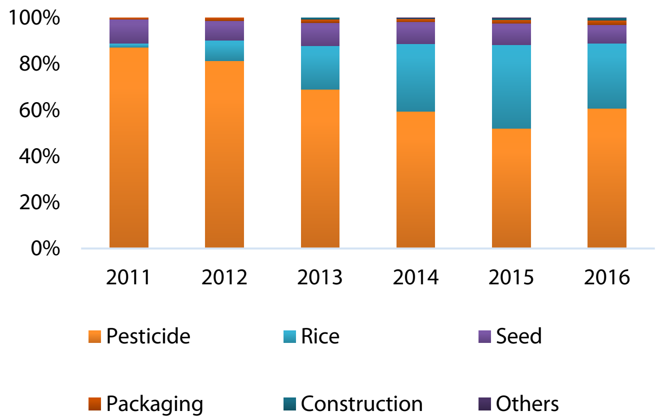
Figure 9: Revenue and gross profit 2011 – 2016



Source: RongViet Research

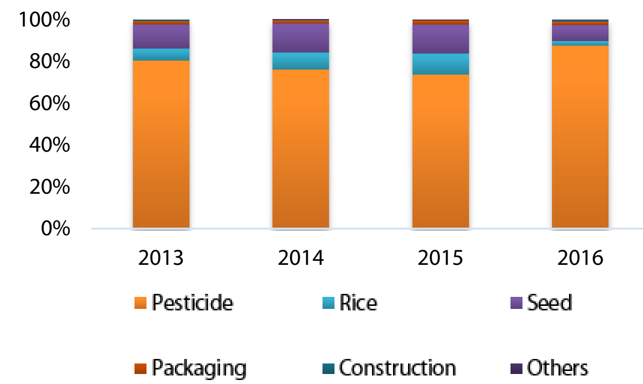
Net revenue of LTG increased during 2011 – 2014 with an average growth rate of 22.1%. Gross profit increased at an average pace of 14.7%. However, gross margin decreased in 2011 and 2012 due to the rice segment recording negative gross margin of -8% and -13%. After 2014, both revenue and gross profit decreased in the next two years 2015 and 2016. The poor management of 2-level distribution system and the unfavorable natural conditions led to this slump.

Figure 10: Net revenue break-down



Source: LTG, RongViet Research

Figure 11: Gross profit break-down (*)



(*) FY2011 – FY2012, Rice had negative gross profit

Table 3: Profitability ratios

	2010	2011	2012	2013	2014	2015	2016
Profitability ratios (%)							
Gross margin	27,4	28,0	25,1	23,8	23,2	22,1	20,8
EBITDA margin	11,3	11,8	9,9	10,1	9,3	9,0	8,8
EBIT margin	11,3	11,8	9,3	9,2	8,3	7,7	7,2
Net margin	7,6	8,8	6,7	6,7	5,7	4,1	4,5
Dupont analysis (%)							
Net margin (%)	7,6	8,8	6,7	6,7	5,7	4,1	4,5
Asset turnover (x)	2,2	1,8	1,8	1,6	1,6	1,2	1,3
Leverage (x)	1,8	2,2	2,5	2,9	2,8	3,0	2,8
ROE (%)	29,2	34,9	29,9	30,6	25,0	15,2	16,0

Source: RongViet Research

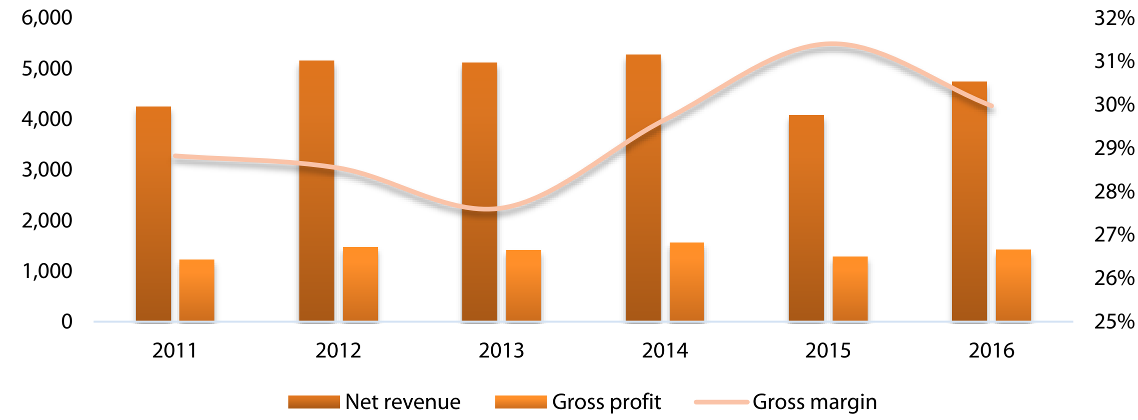
Revenue structure of LTG from 2011 implied changes in strategy: contribution of revenue from crop protection products decreased while rice selling contributed more to total net revenue. However, pesticide still contributed the most to gross profit structure. Gross profit of this segment decreased in 2015 and 2016 but increased again in 1H2017. We can conclude that pesticide still plays a major role in business performance of LTG though the company wants to expand into vertical agricultural value chain.

Performance of pesticide segment

The average net sales growth of this segment was 7.5% from 2011 to 2014 and slowed down when encountering negative growth of -22.6% in 2015 as the restructuring of product distribution. Since Q3/2015, sales of pesticides gradually decreased as LTG stopped selling through wholesale channels while distributed directedly to retail units, resulting in the inventory of wholesale units liquidating at low prices. At that time, the pesticide segment contributed to the revenue structure, which was indirectly attributed to net sales of VND7,856 billion, down 11.2% YoY and only 89% YoY. Plan. In the year 2016, after the restructuring period, pesticide sales grew 16% and accounted for 60.8% of the revenue structure of Loc Troi. Revenue from pesticide continued to increased higher to 19% in 1H2017

Despite the sharp fluctuations in revenue, the gross profit margin of the pesticide sector was almost unchanged when it maintains 31% - 33% from 2011 to 2016. This margin is very good compared to the industry average of 24.6%. The gross margin of crop protection in 1H2017 returned to the best 33% as it used to achieve before 2014.

Figure 12: Business results of pesticide segment



Source: LTG, RongViet Research

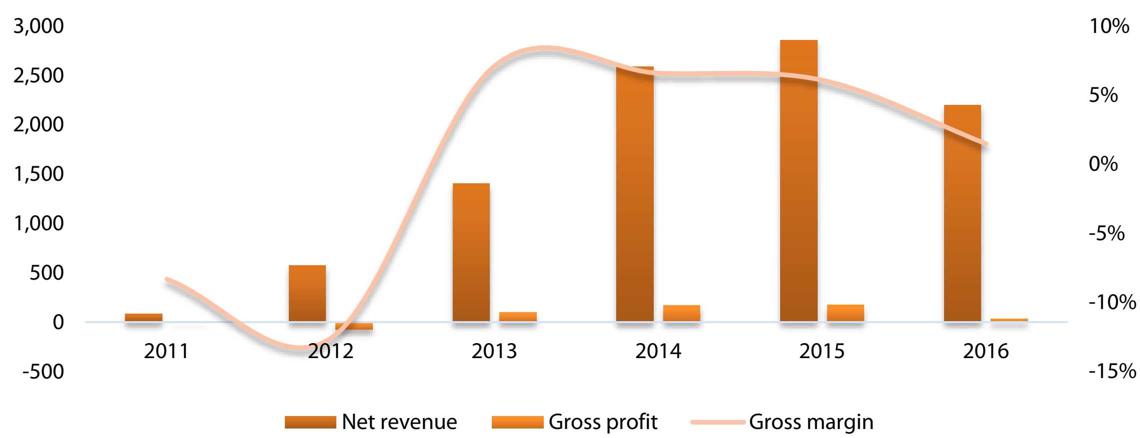
Performance of rice segment

Rice segment saw revenue increased from VND90.5 billion (2011) to VND2,915 billion (2015). The average growth rate in this 5 years was 138%. Gross margin switched from negative figures to positive ones.

However, the situation of the rice sector in general turned difficult in 2016. The total rice output in 2016 reached 43.6 million tons (down 1.5 million tons compared with 2015) due to (1) the decrease of 40 thousand ha and (2) yield downed by 1.6 quintals per hectare. Rice output was also a bad issue in 2016 when Vietnam's rice exports only reached 4.9 million tons with export value of more than USD 2.128 billion, a decrease of 25.5% in volume and 20.5% in value compared to 2015. Revenue from rice was also down by 22% over the same period. Gross margin plummeted to 1% from 6% previously.

We also notice LTG has narrowed the plantation area from 90,000 ha to 36,000 ha. In 1H2017, rice segment saw an increase in revenue but decrease in gross margin to -1%. LTG had to clear inventory in 2016 so the profit was not as desired. The situation seems to be brighter in the second half of 2017 when rice market is showing signs of prosperity again due no more favorable weather factors. Also, the export price of Vietnam's rice tends to increase from the low base in 2016.

Figure 13: Business results of rice segment

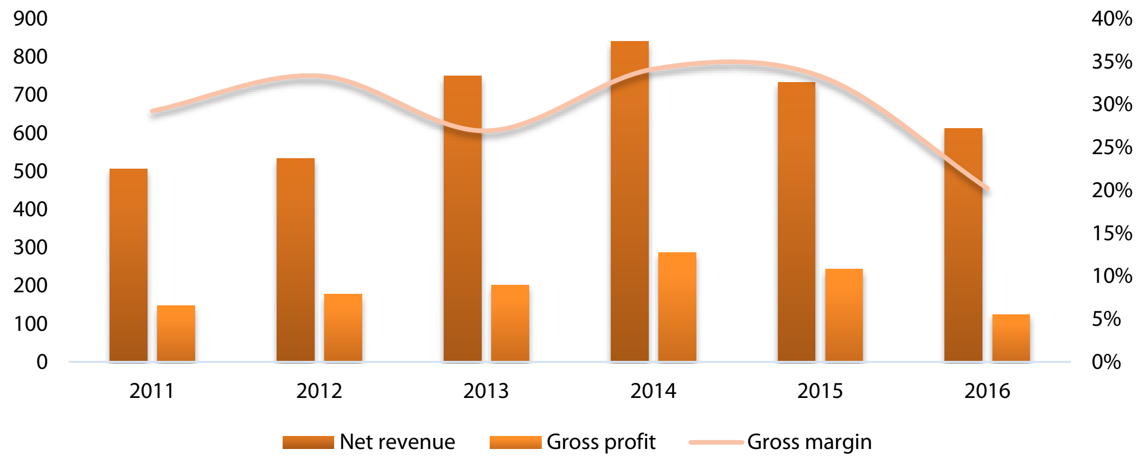


Source: LTG, RongViet Research

Performance of seed segment

Seed industry grew well during 2011 - 2013, but there was a fluctuation from 2014 to 2016 when sales declined continuously from VND850 billion (2014) to VND630 billion (2015). Although the proportion of revenue was only ranked third after two pesticide and rice sectors, the gross profit margin was good enough to maintain over 30% during 2011-2015.

Figure 14: Business results of seed segment



Source: LTG, RongViet Research

Operating efficiency analysis

Table 4: Efficiency ratios

	2010	2011	2012	2013	2014	2015	2016
Working capital turnover (x)							
Inventory turnover (x)	13,6	9,8	5,8	4,2	4,0	2,7	2,5
Account receivable turnover (x)	5,2	4,6	5,3	5,3	5,0	4,4	4,8
Account payable turnover (x)	3,6	3,1	5,1	3,2	3,9	3,8	3,7
Cash conversion cycle (days)	-6,1	-1,4	61,6	41,9	71,0	121,1	120,6

Source: RongViet Research

Since rice segment ran into operation in 2011, the working capital turnover ratios were not as good as it used to be. Inventory turnover changed the most significantly. It decreased from 13.6x in 2010 to only 2.5x in 2016. There are 2 reasons for this decline. Firstly, the characteristics of rice segment did not enable a high inventory turnover like pesticide and seed segment. Secondly, during the early phases of rice segment, LTG did not have much experience in supply and demand forecasts leading to high inventory of rice. Besides, drought and poor management of pesticide distribution also hit the inventory turnover in 2016. Account receivable and account payable turnover did not fluctuate much like inventory turnover ratio. These 2 ratios showed signs of improvement in since 2016. Overall, we believe the working capital turnover will improve since 2017 with the expectation that rice segment will perform better.

Financial structure

Strategy changes led to changes in financial structure of LTG. Financial expenses surged strongly from VND69 billion in 2011 to VND150 billion in 2016. Short-term borrowing increased sharply from VND5.2 billion to VND1,905 billion in the same period. Current ratio of LTG quickly decelerated from 1.5x to 1.1x. Interest coverage ratio also went down from 91.0x to 4.9x. Total debt to equity stayed at 90%. The group had to borrow to finance for working capital, which was majorly used to support farmers for large-field model. However, we think LTG is still having a healthy financial structure. Most of the borrowing is short-term debt (accounts for 89%) at low interest rate around 5% - 6%. Debt-service coverage ratio remained at ~6x. Moreover, cash flow from operating of LTG turned to positive again in 2016 with the CFO/total debt at 27%.

Table 5: Some indicators for financial strength

	2011	2012	2013	2014	2015	2016
Liquidity ratios						
Current liquidity ratio	1,5	1,3	1,1	1,4	1,2	1,1
Quick liquidity ratios	1,1	0,7	0,6	0,8	0,5	0,5
Cash liquidity ratio	0,4	0,1	0,1	0,1	0,0	0,1
Capital structure (%)						
Total liabilities/Total equity	120,8	149,1	182,1	149,0	183,7	177,3
Short-term liabilities/Total equity	120,8	149,1	182,1	149,0	183,7	177,3
Long-term liabilities/Total equity	0,2	4,4	3,7	34,8	20,7	5,8
Total debt/Total equity	0,2	17,9	69,6	92,0	129,5	92,1
Short-term debt/Total equity	0,0	17,9	69,6	60,0	111,7	88,6
Long-term debt/Total equity	0,2	0,0	0,0	32,1	17,9	3,4

Source: RongViet Research

FORECAST

Table 6: Revenue and gross profit forecast of each segment

Unit: billion VND	FY2017F	FY2018F	FY2019F	FY2020F	FY2021F
Revenue	**8.555**	**9.719**	**10.693**	**11.738**	**12.872**
Pesticide	5.271	5.801	6.381	7.019	7.720
Rice	2.446	2.936	3.083	3.237	3.399
Seed	707	848	1.094	1.346	1.615
Others	132	134	135	136	138
Gross profit	**1.984**	**2.239**	**2.589**	**2.878**	**3.193**
Pesticide	1.739	1.914	2.106	2.316	2.548
Rice	24	73	154	162	170
Seed	198	229	306	377	452
Others	22,5	22,7	22,9	23,2	23,4

Source: RongViet Research

Crop protection segment

We forecast pesticide segment can maintain a revenue growth rate of 10% per annum thanks to the new selling model. Gross profit will be 33% on the back of dominant market share, which enables LTG to be more power to set up the selling prices and negotiate with suppliers.

Rice segment

We look for a CAGR of 8.6% for revenue of this segment as we believe LTG now has more experiences to assess the supply – demand. Beisdes, LTG is more actively searching for commercial contracts with Philippines, China, Hong Kong and Bangladesh and USA etc. Gross margin can improve from 1% in 2017 to 5% in 2021.

Seed segment

We think seed segment can have an average revenue growth rate of 22.9% in the next 5 years. Gross margin is forecasted at 27% - 28%. Farmers will use more authorized seeds from LTG to have highly efficient plantation yield. LTG will also develop more varieties of vegetables seeds to meet the changing needs of farmers.

Consolidated results

In conclusion, net revenue in FY2017 will be VND8,555 billion (+9.9% YoY) and will increase 13.6% to VND9,719 billion in FY2018. The PAT for FY2017 and FY2018 will be VND480 billion (+38.4% YoY) and VND532 billion respectively. Accordingly, FY2017 and FY2018 EPS will be VND6,080 and VND6,739.

VALUATION

Comparable method: we use the industry P/E ~9.4x. With the leading position in pesticide and stable growth potential, we think this P/E is justified for LTG. Using the EPS of VND6,739 for FY2018, we believe the fair value for each LTG share is VND63,349.

Discounted cash flow method: we use FCFF with following assumptions: (1) WACC at 13.02% and (2) perpetual growth of FCFF after 2021 is 1%.

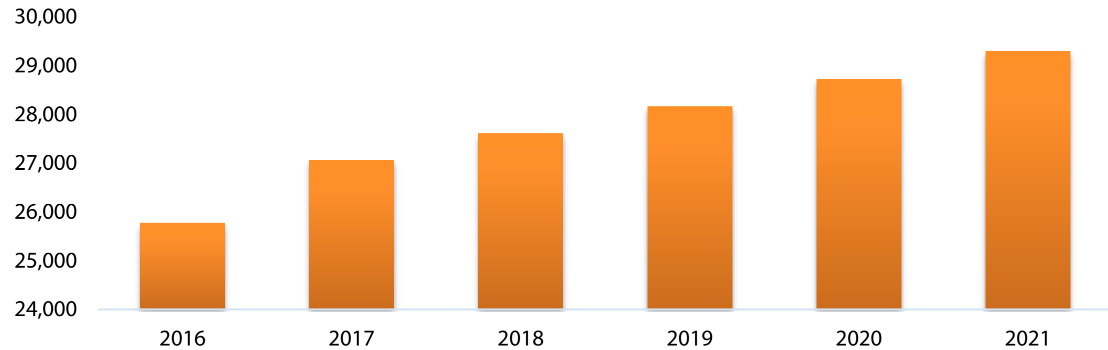
Table 7: Valuation matrix

Methods	Weight (%)	Price (VND)
FCFF	50%	68.039
P/E	50%	63.349
Target price		**65.725**

PESTICIDE INDUSTRY OVERVIEW

If in the early 1980s, demand for daily pesticide using in Vietnam was estimated at 6.5 thousand tons annually, but by 2015, it would increase by nearly 20 times, about 125 thousand tons. The main reason for usage increase of this pesticide is the increase in population, which has led to more demand for food crops, leading to intensive farming increase to produce agriculural crops. However, farmland has not been risen sharply in recent years, and development of seed industry, which gives farmers many new crops with high resistance to pests and diseases that makes this sector slow down. It is forecasted that the pesticide industry will reach an average growth rate of 2.59% over the next five years.

Figure 15: Size of pesticide market

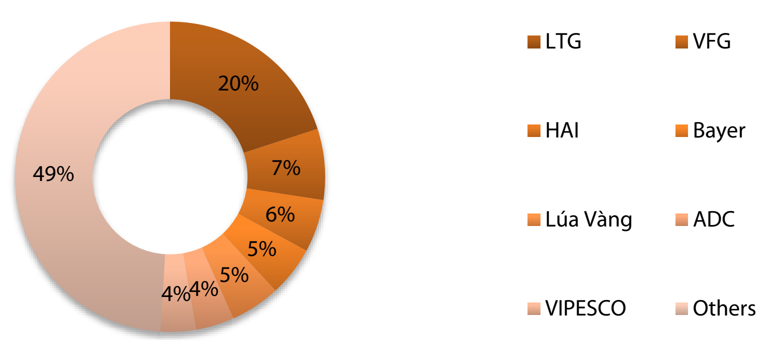


Source: LTG

Currently, there are over 200 pesticide enterprises, and 97 processing factories (meeting 50% of products for domestic usage), 50% of the remaining are imported. It is nearly 100% of active ingredients, and 90% of additives and 50% of Vietnamese products are not locally produced but mainly imported. According to assessment from the Ministry of Agriculture and Rural Development, China is now the No.1 export market for pesticides and pesticides material to Vietnam. In 2016, Vietnam spent more than $725 million importing this commodity and over the last five years, Vietnam spent $500 million on average per year on pesticide import. China is still the main source of import, with the regular proportion of approximately 50%.

In terms of enterprises' market share in the industry, branded companies now hold 51% of the market share. Many other small-sized and retail enterprises still holding 49% of the market share show that the market is still fragmented. This is because of the farmers' usage habit of pesticides. According to our understanding, farmers often prefer products with low cost, immediate-usage efficiency, so some unknown products are still existing.

Figure 16: Market share of pesticide companies

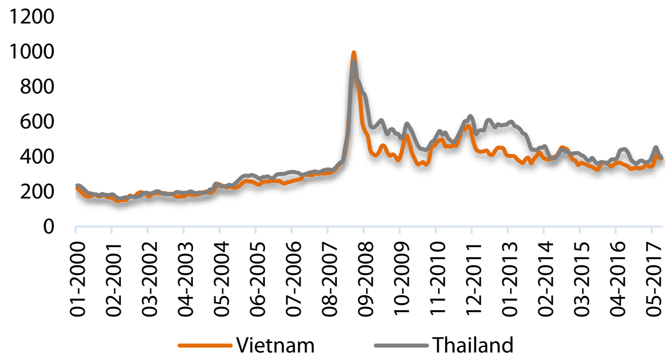


Source: LTG

RICE INDUSTRY OVERVIEW

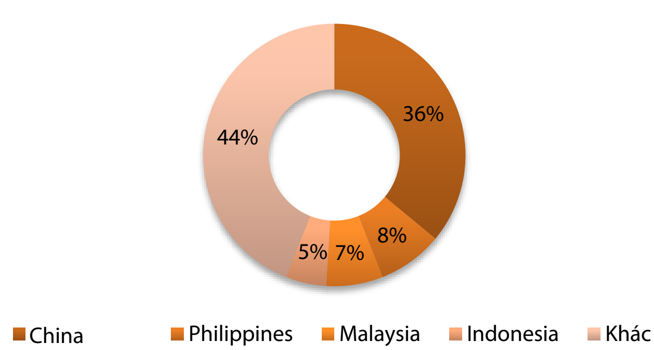
Since the late 1980s, Vietnam's rice industry has grown in output-increase criteria. Vietnam's rice output increased from 19.23 million tons in 1990 to 32.53 million tons in 2000 and up to 43.66 million tons in 2012. However, achievements in the past have become our concern. The output of rice has slowdown signs with the evidence that rice yield only reached 43.6 million tons, equivalent to 27.8 million tons of rice in 2016. Rice yield has been slowed down while degradation risks of soil and environmental pollution have been increased. Too much focus on yields has led to low quality of Vietnam's rice in the world market. As a result, export market is dependent on some of countries in the region, namely China.

Figure 17: Export price



Source: LTG, RongViet Research

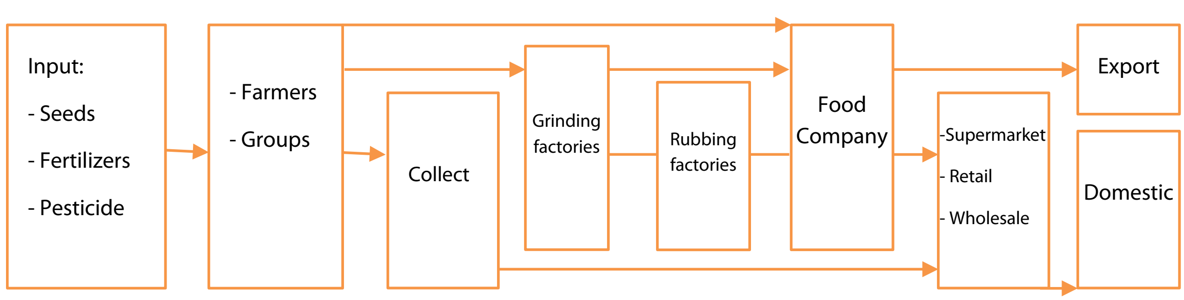
Figure 18: Export of market of Vietnam's rice



Source: Agroinfo

Observing Vietnam's rice value chain, traders play an important role in the value chain. Meanwhile, scratch system (rice grinding and milling factories) play an intermediary role in linking production with consumption, and make direction for farmers to produce which crops, in India and Thailand. In addition, two large state-owned enterprises, namely Vinafood 1 and Vinafood 2, play a key role in rice export, under government contracts. Number of rice exporters is limited at 21 enterprises. Therefore, (1) Vietnam's rice market is not very active, and much dominated by traders, and (2) in spite of significant rice yield, farmers are still inactive.

Figure 19: Vietnam rice industry value chain



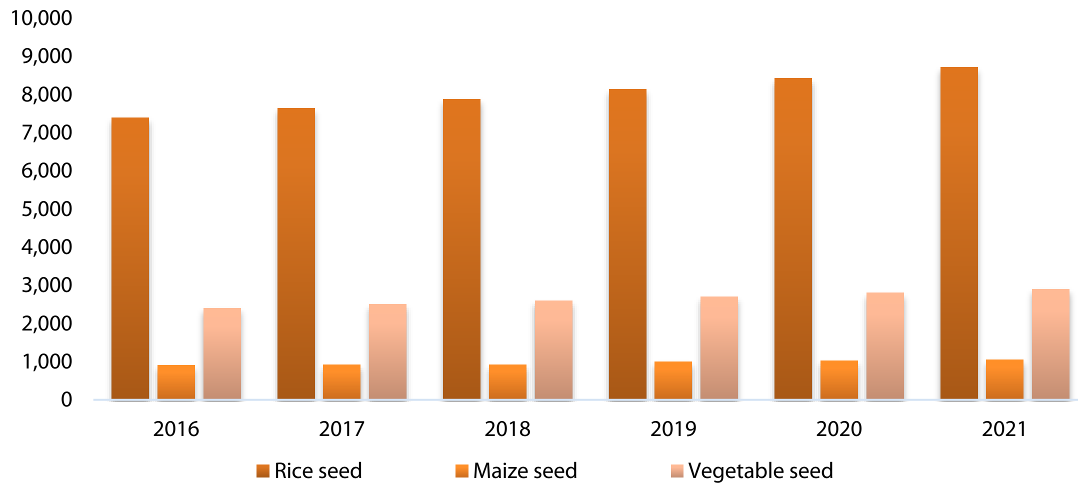
Source: VERP

When the situation of food security has been ensured and consumption trend has been shifted, Vietnam's rice industry will have to change to improve product quality. The current model has been implemented and initially has been achieving some certain results, namely the large-field model associated with the farmers that Loc Troi Group and ADC have been implementing in the Mekong Delta.

SEED INDUSTRY OVERVIEW

There are three major groups in Vietnam's seed sector: rice, maize and vegetable crops. Rice accounts for 69% of the sector value, vegetable crops accounts for 22% and 8% is maize seed. The LTG's results on market research show that the seed industry will continue growing in the next 5 years but the growth rate will not be high. Specifically, rice seed can achieve an average growth rate of 3.4%, maize seed as 3.1% and vegetable with sharply growth rate as 3.9%. This is in line with our conclusions about the agricultural sector that we have mentioned at the beginning of this article as the trend of consumption of rice has been declining.

Figure 20: Size of seed market (Unit: billion VND)



Source: LTG

Potentiality of the seed sector is quite large. The en-shortened area of agricultural land and more strict requirements of pesticide usage will lead usage demand of better quality crops to better yields, and better-disease resistance. In addition, shift from rice to many other vegetables is a factor helping the seed sector develop more diversification trend.

APPENDIX

Table: Some changes between Decree 210/2013/ND-CP and Draft amending and supplementing Decree 210/2013/ND-CP on incentive policies for enterprises investing in agriculture and rural areas

Decree 210/2013/ND-CP	Draft amending and supplementing Decree 210/2013/ND-CP
Article 6. Exemption or reduction of land and water surface rents of the State	
6.3. Investors with agricultural projects eligible for investment incentives shall be entitled to exemption of land or water surface rent within first 15 years from the date of completion and commissioning of this project.	6.3. Investors with agricultural projects eligible for investment incentives shall be entitled to exemption of land or water surface rent within first 15 years from the date of completion and commissioning of this project and 50% discount of land or water rent within the next 7 years.
6.4. Investors with agricultural projects eligible for investment promotion shall be entitled to exemption of land or water surface rent within first 11 years from the date of completion and commissioning of this project.	6.4. Investors with agricultural projects eligible for investment promotion shall be entitled to exemption of land or water surface rent within first 11 years from the date of completion and commissioning of this project and 50% discount of land or water rent within the next 5 years.
Article 7. Support of land rent, water surface rent of households and individuals	
7.1. Investors with agricultural projects eligible for special investment incentives leasing land or leasing water surface of households or individuals for implementation of such projects shall be supported with 20 per cent of land rent or water surface rent by the State according to Clause 1, Article 6 of this Decree within the first five (05) years from the date of completion of basic construction.	7.1. Investors with agricultural projects eligible for special investment incentives leasing land or leasing water surface of households or individuals for implementation of such projects shall be supported with 40 per cent of land rent or water surface rent by the State within the first five (05) years from the date of completion of basic construction.
7.2. Investors with agricultural projects eligible for special investment incentives, investment incentives or investment promotion are encouraged to accumulate land to form material zones through the form of contribution as capital of land use rights by households and individuals to projects without land recovery by State.	7.2. Investors receiving transfer of agricultural land use right of households and individuals shall be entitled to the supporting costs of granting certificates of land use.
	7.3. Investors that have agricultural projects (especially investment incentives) and receive land contributions or receive capital contributions using land use rights of households and individuals to form areas are entitled to the support of construction of infrastructure of material areas at VND50 million/ha and do not have to switch to land lease for the land areas where land has been received or contributed as land use rights.
	7.4. Investors that accumulate land by the forms prescribed in Clauses 1, 2 and 3 of this Article shall be supported by all means prescribed in each of the above-mentioned items.
Article 10. Support for human resource training and market development	
	10.1. Enterprises with agricultural projects eligible for special investment incentives shall be supported by the State budget as follows: a) 70% of the funding for domestic vocational training. Each employee is provided with one-time training and the training period is limited to 6 months. In cases where enterprises employing long-term labors who have not yet received job training and are living in special-use forests for training and use, contributing to the protection of special-use forests, enterprises shall be eligible for one-time direct training expenses. At the enterprise for each employee is VND3 million/ 3 months. b) 50% funding for advertisement expenses and brand building on mass media; 50% funding for cost of participation in domestic and foreign trade fairs; 50% funding for cost of assessment to market information and service fees from the state trade promotion agency. 10.2. The supports mentioned at Points a and b, Clause 1 under this Article shall be implemented under investment projects. The total amount of support for a project shall not exceed VND1 billion. In cases where the enterprises do not use direct support from the State budget, these supports shall be included in the production costs of the enterprises when they settle with competent State authorities.

Source: MARD, RongViet Research

Table: Evaluation of rice production efficiency in large sample fields (2014)

Criteria	Unit	Before	After
Amount seed	Kg/ha	196.9	129.4
Rice seed purchasing price	VND/ha	10,963.9	12,166.2
Rice seed cost	VND/ha	2,148,731.2	1,558,272.0
Labor cost	VND/ha	3,513,891.8	3,250,644.3
Fertilizer cost	VND/ha	6,343,765.5	5,859,664.9
Pesticide cost	VND/ha	5,524,927.8	5,130,412.4
Fuel cost	VND/ha	1,243,714.3	1,219,168.8
Machinery rental fee	VND/ha	3,144,300.5	3,146,502.6
Total cost	VND/ha	21,893,506.9	20,139,019.4
Yield	Tấn/ha	7.96	8.62
Revenue	VND/ha	39,838,028.4	44,073,126.3
Selling price	VND/ha	4,994.7	5,114.2
Profit	VND/ha	17,944,521.4	23,934,106.9

Source: VERP

Unit: VND billion

INCOME STATEMENT	2015A	2016A	2017F	2018F
Revenue	7,856	7,783	8,555	9,719
COGS	6,119	6,167	6,571	7,480
Gross profit	1,737	1,616	1,984	2,239
Selling expense	690	628	856	972
G&A expense	441	427	428	486
Financial income	24	25	18	19
Financial expense	205	150	152	167
Other income/loss	0	27	35	35
Gain/(loss) from JV	0	0	0	0
PBT	425	464	603	668
Tax expense	105	115	121	134
Minority interests	0	2	2	2
PAT	319	347	480	532
EBIT	606	561	701	782
EBITDA	710	684	852	952

Unit: %

FINANCIAL RATIO	2015A	2016A	2017F	2018F
Growth				
Revenue	-11.3	-0.9	9.9	13.1
EBITDA	-13.8	-3.8	24.7	11.6
EBIT	-18.0	-7.4	24.9	11.4
PAT	-36.7	8.8	38.4	-97.2
Total Asset	19.4	-3.9	14.1	9.6
Total Equity	4.6	3.3	5.7	7.4
Profitability				
Gross profit margin	22.1	20.8	23.2	23.0
EBITDA margin	9.0	8.8	10.0	9.8
EBIT margin	7.7	7.2	8.2	8.0
Net profit margin	4.1	4.5	5.6	5.5
ROA	5.0	5.6	6.8	6.9
ROIC or RONA	23.1	23.9	28.0	29.2
ROE	15.2	16.0	21.1	21.8
Efficiency (x)				
Receivables turnover	5.1	4.5	4.0	4.2
Inventories turnover	2.3	2.8	2.6	2.6
Payables turnover	4.2	3.2	2.7	2.9
Liquidity (x)				
Current	1.2	1.1	1.1	1.1
Quick	0.5	0.6	0.5	0.5
Financial Structure				
Total debt/ Equity	129.5	92.1	96.6	103.7
ST debt / Equity	111.7	88.6	93.4	100.7
LT debt/ Equity	17.9	3.4	3.2	3.0

Unit: VND billion

BALANCE SHEET	2015A	2016A	2017F	2018F
Cash and cash equivalents	190	279	266	334
Short term investment	0	25	0	0
Accounts receivable	1,526	1,733	2,137	2,318
Inventories	2,684	2,170	2,546	2,884
Other current assets	145	63	66	70
Tangible Fixed Assets	1,426	1,401	1,519	1,597
Intangible Fixed Assets	336	338	338	337
Long term investment	9	0	0	0
Other non current assets	90	149	157	164
Total Asset	**6,406**	**6,159**	**7,029**	**7,704**
Account Paybale	1,456	1,904	2,406	2,568
Short term borrowings	2,325	1,905	2,123	2,458
Long term borrowings	372	74	74	74
Other non-current liabilities	64	52	55	57
Bounus and Welfare fund	85	48	72	80
Technology – Science dev fund	0	0	0	0
Total Liabilities	**4,302**	**3,983**	**4,730**	**5,237**
Common stock and APIC	950	950	950	950
Treasury stock	0	0	0	0
Retained Earnings	282	335	453	616
Other comprehensive income / (loss)	179	180	180	180
Investment and Development Fund	671	686	691	696
Total Equity	**2,082**	**2,150**	**2,273**	**2,441**
Minority Interest	22	26	26	26

CASH FLOW STATEMENT	2015A	2016A	2017F	2018F
Profit before tax	425	464	603	668
Depreciation	80	98	152	171
Adjustment	260	169	0	0
Working capital	-1,067	329	-401	-494
Net Operating CFs	**-301**	**1,060**	**353**	**344**
Fixed Asset	-434	-343	-276	-256
Deposit, equity investment	61	187	0	0
Interest, dividend, cash profit received	0	0	0	0
Net Investing CFs	**-373**	**-157**	**-276**	**-256**
Capital	20	0	0	0
Debt	865	-718	217	336
Dividend paid & other	-177	-97	-307	-356
Net Financing CFs	**707**	**-815**	**-90**	**-20**
Net Cash flow				
Beginning cash & equivalents	**176**	**190**	**279**	**266**
Effect of exchange rate	33	88	-13	68
Ending cash & equivalents	**190**	**279**	**266**	**334**

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Total Return including Dividends in 12-month horizon	>20%	-20% to 20%	<-20%

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