Vinh Hoan Corporation (HSX: VHC)

Benefits from Market Conditions

Particulars (VND Bn)	Q2-FY18	Q1-FY18	+/-qoq	Q2-FY17	+/-yoy
Net revenue	2,240	1,804	21.1%	2,353	-5%
PAT	329	89	268%	145	127%
EBIT	438	100	337%	186	135%
EBIT margin	19.6%	5.6%	14%	7.9%	12 bps

Source: VHC, RongViet Securities

1H2018: Profits rose sharply due to the strong growth of selling prices, the advantage of anti-dumping (AD) tax and the dollar appreciation

According to the 1H2018 report, although revenue grew flat by 2% YoY to VND 4,044 Bn, PBT increased by 76% YoY to VND 511 Bn mainly due to a sharp rise in the average selling price. While the price of raw fish kept moving upward, the favorable conditions of the AD tax in the US market, the dollar appreciation and high demand in the US and China are the major factors supporting the selling price.

Outlook for 2H2018: the strengthening US dollar and China's new import tax on pangasius versus slightly reduced selling prices

It is possible that the USD/VND rate continues to stay at current levels in the second half of 2018. In addition, China has officially reduced the pangasius import tax for MFN countries (including Vietnam) from 7/2018. Besides, July-August 2018 is the main harvest time for the company's self-farming areas. This will help reduce material costs in 3Q. Nevertheless, selling prices would possibly drop slightly to maintain competitiveness.

Valuation and recommendation

Despite facing a problem of raw material in 2018, Vinh Hoan's business still prospers in virtue of the favorable conditions of the USD/VND exchange rate, demand and tax policies in its two major markets - the US and China.

In the longer term, the growing demand and its market diversification strategy would be the key drivers for VHC's growth. The capacity of culturing and processing will be enhanced because of Tan Hung farm and Thanh Binh factory. The price of raw fish will gradually stabilize when the projects of MARD on the fingerling quality improvement provide large amounts of fingerlings to the market. These are the principle factors that are expected to help the company expand its profit margin in the long run. In addition, the company's stringently certified aquaculture quality and its superior ability of R&D over competitors will ensure its leading position in the pangasius sector of Vietnam and the world.

*Based on the closing price of VND 90,000 per share on Sep 19th, 2018 and an expected dividend of VND 3,300 per share for the next 12 months, we recommend **ACCUMULATE** with a total return of 10%. This target price is adjusted upward compared with our May 2018 report to reflect the potential growth, in the context that the USD/VND exchange rate has risen significantly and the China's import tax became more favorable.*

ACCUMULATE +10%

Current price (VND)	90,000
Target price (VND)	95,400
Cash dividend (VND)*	3,300

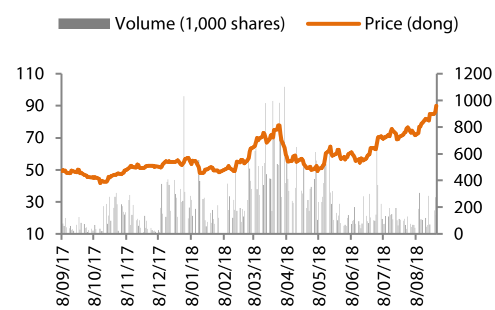
** Expected in the next 12 months*

Stock info

Sector	F&B
Market Cap (VND billion)	8,316
Current Shares O/S	92.3
Beta	0.55
Free float (%)	38.5
52 weeks High	90,000
52 weeks Low	43,000
20-session average trading volume	105,584

	FY2017	Current
EPS	6,544	4,527
EPS growth (%)	6.7	63.3
Adjusted EPS	6,544	4,527
P/E	8.1	8.5
P/B	1.7	2.1
EV/EBITDA	5.7	5.7
Cash dividend	2,000	2,000
ROE (%)	20.5	24.2

Price performance



Major Shareholders (%)

Trương Thị Lệ Khanh (Chairwoman)	42.9
Misubishi Corp.	6.5
Võ Phú Đức	5.9
Foreign ownership room left (%)	60.5

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Exhibit 1: Q2 2018 results

Particulars (VND Bn)	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)	2Q-FY18	+/-(YoY)
Net revenue	2,240	1,804	18.4%	2,353	-9.2%	4,044	2%
Gross profit	461	254	78.2%	298	51.6%	715	35%
SG&A	23	154	-45.8%	112	-25.9%	177	-16%
Operating income	438	100	268.3%	186	98.4%	538	76%
EBITDA	425	199	103.6%	238	70.1%	624	49%
EBIT	438	100	268.3%	186	98.4%	538	70%
Financial expenses	94	15	71.5%	23	14.6%	109	134%
- Interest Expenses	13	13	1.2%	19	-32.8%	26	-23%
Dep. and amortization	13	99	-63.6%	52	-30.9%	86	-16%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	398	113	252.7%	169	136.5%	512	73%
PAT	329	89	268.0%	145	127.1%	418	76%
(*) Adjusted PAT	329	89	268.0%	145	127.1%	418	

Source: VHC, RongViet Securities

Exhibit 2: Q2 2018 performance analysis

Particulars	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	20.6%	14.1%	6.5 bps	12.7%	8.5 bps
EBITDA margin	19.0%	11.0%	7.9 bps	10.1%	8.8 bps
EBIT margin	19.5%	5.6%	14.0 bps	7.9%	9.4 bps
Net margin	14.7%	5.0%	9.7 bps	6.2%	9.2 bps
Adjusted net margin	14.7%	5.0%	9.7 bps	6.2%	9.2 bps
Turnover *(x)					
-Inventories	9	6	2.4	6	2.3
-Receivables	6.4	5.5	1.0	7.9	-1.8
-Payables	9	9	0.4	19	-10.5
Leverage (%)					
Total debt/ equity	64.7%	73.4%	-8.6%	101.9%	-37.1%

Source: VHC, (*) Annualized turnover

Exhibit 3: Q3 2018 performance forecast

Particulars (VND B)	Q3-FY18	+/-(QoQ)	+/-(YoY)
Revenue	2,500	12%	23%
Gross profit	450	-2%	55%
EBIT	350	-13%	69%
NPAT	275	-16%	63%

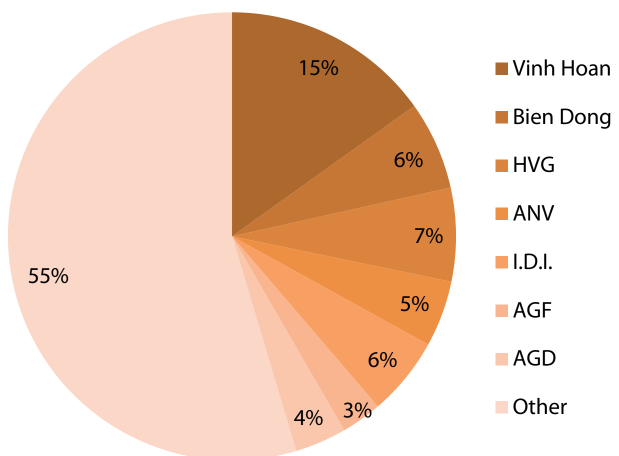
Source: VHC, RongViet Securities.

Update

Exports to the US and China surged while they dropped in the EU

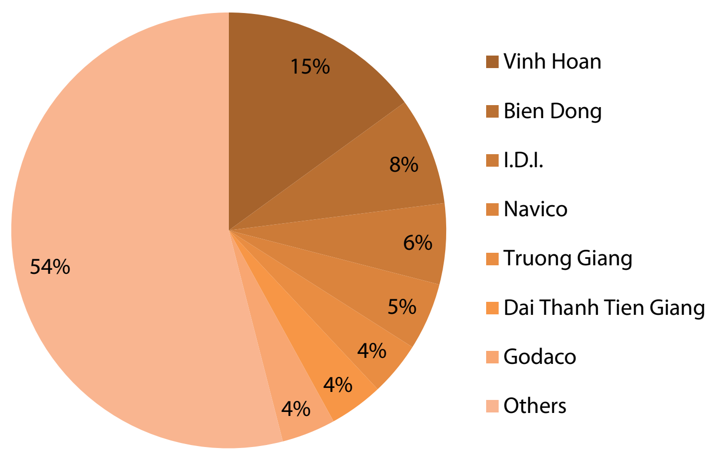
Vinh Hoan continues to be the leader with a market share of 15%, unchanged compared to that of the end of 2017. The market structure of the company continued the three-year trend as it increasingly focuses on the US and China. 1H2018 total export value increased by 14% YoY to USD 163 Mn, but exports to the US and China grew at a faster pace, by 44% YoY and 111% YoY, respectively. Although boosting exports to the US and China is a common trend of the sector, the concentration of Vinh Hoan exports in these two markets is higher than the sector average: 76% compared to 43% of the industry (in export value).

Figure 1: Market share of companies in 2017



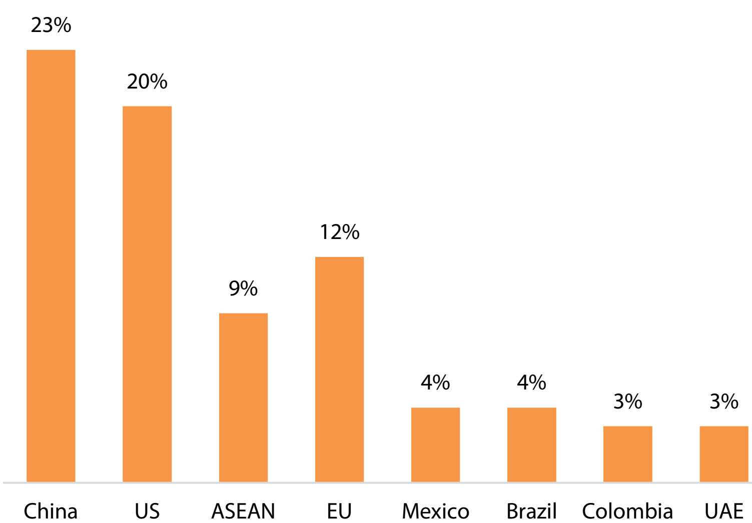
Source: VASEP

Figure 2: Market share of companies in 1H2018



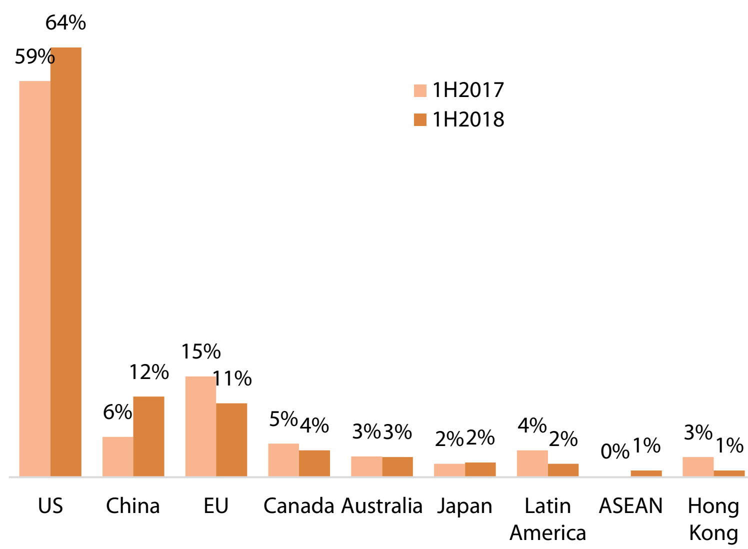
Source: VASEP

Figure 3: Sector's export structure by market in 1H2018



Source: VASEP

Figure 4: Vinh Hoan's export structure by market



Source: VHC

Exports to the US expanded strongly due to the anti-dumping (AD) tax advantage of USD 0 per kg. Currently only Vinh Hoan and Bien Dong are the Vietnamese companies being able to export pangasius to the US because other companies in the sector are taxed too high at USD 3.87 - 7.74 per kg. Vinh Hoan's market share in the US has therefore increased from 43% at the end of 2017 to 56% in 1H2018. However, as the AD tax is reviewed annually, we keep a prudent view on the VHC's ability to maintain its competitive advantage in the US market. If the final decision on AD tax for POR 14 is not different from the preliminary one announced by DOC recently, Vinh Hoan will lose its AD tax advantage in 2019 because Hung Vuong is charged USD 0/kg.

Exports to China increased mainly in the frozen fillet and whole fish segments, due to a more than 35% increase in selling prices compared to the average price of 2017. Because gross margin of the China market is lower than the gross margin of the US market by 10-12 basic points, if the company does not adjust its product structure in the Chinese market while continuing to promote exports to this market, the overall gross margin may decline.

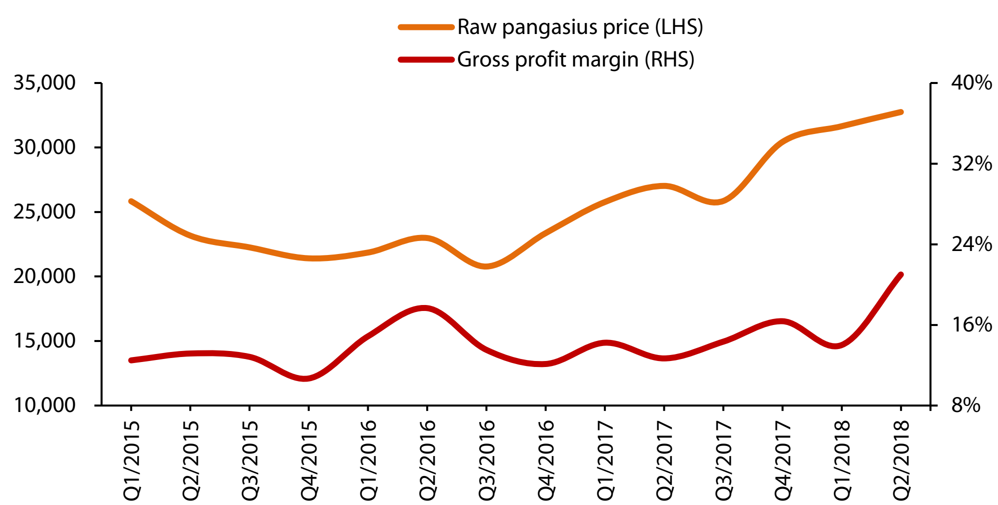
Sales in the EU market continued to fall due to the adverse effects of the sabotaging media campaigns that smear the image of pangasius. In addition, more than 50% of EU market revenues were from value added products (the main segment in the UK market) where prices have a low potential to increase. The export value to the EU has decreased by 11% YoY.

As Vinh Hoan has determined that it will continue to promote sales in new markets (Japan, Brazil, Mexico and South East Europe), we believe that the issues of market structure are not worrisome. Japan is a high value-added market.

Selling prices increased faster than raw material prices

1H2018 sales were flat compared to the same period last year (+2% YoY) due to the decrease by 3% YoY of sales in June. In that month, the company reduced its production because the sizes of a large amount of its raw fish were larger than the sizes required by customers. However, 1H2018 gross profit was up 35% YoY as selling prices increased faster than raw material prices. The company said that the average selling price (ASP) of 1H2018 was 35% higher than 1H2017 ASP. Meanwhile, the average raw material price in 1H2018 just increased by 22% compared to the 1H2017 average. Gross profit margin, thus, increased from 13.3% (1H2017) to 17.7% (1H2018), of which the gross profit margin of finished product went up from 14.4% to 20.9%.

Figure 5: Gross profit margin 2015-1H2018



Source: VHC, RongViet Securities

Potential for profit growth as China has reduced the import tax on pangasius and tightened control of seafood smuggling at the Vietnam-China border

As China's demand for pangasius has increased significantly over the past three years, the export of pangasius has been in fierce competition with smuggling rings across the Vietnam-China border. Traffickers buying raw fish in large volumes is one of the major factors that pushed up prices of raw fish in the market.

However, the Chinese government recently has reorganized the management of seafood imports. Specifically, from the end of 2017 to now, Chinese police and customs have destroyed many rings of smugglers from Vietnam into China and maintain strict supervision of the border between the two countries. In addition, starting July 1st , China officially reduced the import tax on frozen pangasius fillets from 10% to 7% for most favored nation (MFN) countries, including Vietnam.

We believe that the competition in purchasing raw materials between processing factories and smuggling rings would be under less stress and the price of raw fish would decrease slightly, creating conditions for processing companies to increase profit margins.

Processing output could increase sharply from 2019 because of Thanh Binh factory and Tan Hung farm

Tan Hung farm will be ready for harvest in 3Q/2019. The building of the 220 hectares farming area, which includes 90 ponds for raising adult fish and 50 ponds for raising fingerlings, has started in April 2018. The company expects this farm to give the first fingerling crop in January 2019 and the first crop of adult fish in July or August 2019. Accordingly, we estimate that the volume of self-raised material in 2019 will increase by 40% YoY and that the level of material self-supply is expected to reach 68% by the end of 2019 (compared to 57% in 2018).

Thanh Binh factory has offset the production capacity of Van Duc Tien Giang (VDTG). At present, Thanh Binh factory is operating at a capacity of 120-130 tons of finished products per day. With this capacity, Thanh Binh has completely compensated for the lost capacity of Vinh Hoan due to the reduction of ownership in VDTG (VDTG's capacity in 2017 was 120 tons per day). The capacity of Thanh Binh plant is expected to reach 150 tons of finished products per day by the end of 2018.

Changes in projections and target price to reflect profit growth potential in the context of favorable market conditions

Compared to our recent valuation report, we change some assumptions to reflect the favorable USD/VND exchange rate and the new China's import tax policy:

Raw fish price and selling price declines slightly in the second half of 2018

The third quarter is the main harvest time for the company's farms. The price of raw fish in the market has also started to cool down a little in early June. We expect that raw material costs will decrease in 3Q and increase again in 4Q. The control of seafood smuggling across the Vietnam-China border and the Chinese policy of lowering import tax on pangasius will also alleviate the competition of purchasing raw materials between processing factories and smuggling rings. As a result, we lower the average price of raw material bought from farmers in 2018 from VND 32,600/kg to VND 32,000/kg. We do not believe that the price of raw fish in the market can be significantly reduced as demand from China is still high.

As well, 3Q is also the harvest season of other companies so there will be competition in export prices. In addition, pangasius has to compete with alternative proteins such as shrimp, pollock, cod and meat. As a result, we forecast the company's selling price will fall slightly in 2H2018. As output will increase sharply in 2H2018 but the selling price goes down slightly, the ASP growth of the whole year is expected to be 13.2%, unchanged from the previous projection. Gross profit margin would come at 17.2%.

Materials cost increases slightly in 2019 while selling prices fall slightly

The price of fingerlings has risen significantly from 2017 up to now. At the end of May 2018, the price of fingerlings has tripled compared to the beginning of 2017. We forecast that material price in 2019 would continue to be in stress as a result of high fingerling price in 2018. The high price of fingerlings impacts both the purchase price of raw fish and the cost of self-raised fish. We expect that the average price of raw fish in 2019 will increase slightly to VND 33,000/kg. For self-raised fish, Tan Hung farm's harvest is in August 2019 and will improve input costs as this farm can produce fingerlings for its need. As a result, the mutual effect of high-priced fingerlings bought from the market and low-priced fingerlings self-produced in Tan Hung will maintain the price of self-raising adult fish approximately at the same level as in 2018.

The company expects to raise selling prices to offset any increase in raw material cost. However, as ASP has grown significantly in 2018, we do not believe that selling prices can keep moving much higher. We keep our perspective that selling prices will decrease slightly as in the previous report. Also, we assume that the company will reduce its dependence on the US and Chinese markets, which selling prices grew strongly in 2018. Accordingly, the gross profit margin of 2019 will fall to 15.82%.

Increasing the exchange rate of USD/VND. More than 83% of Vinh Hoan sales come from export, so the company will benefit from the appreciation of the USD. In 1H2018, USD has appreciated 2.6% against VND. USD is forecasted to continue to stay at current levels in the second half of the year, following the recovery of the US economy, the monetary tightening policy of the FED and the impact of the US-China trade war. However, the macroeconomic policy of the Government of Vietnam in 2H2018 has shown some measures to curb the rising momentum of the USD/VND exchange rate to stabilize macro conditions. Therefore, we forecast that the average appreciation of the USD/VND exchange rate to be around 3% compared to the average exchange rate in 2017.

Table 4: Sensitivity of net profit with the USD/VND exchange rate

	Change in USD/VND exchange rate								
	2%	2.25%	2.50%	2.75%	**3%**	3.25%	3.50%	3.75%	4%
Net profit (VND bn)	959	978	997	1,015	**1,034**	1,052	1,071	1,090	1,108

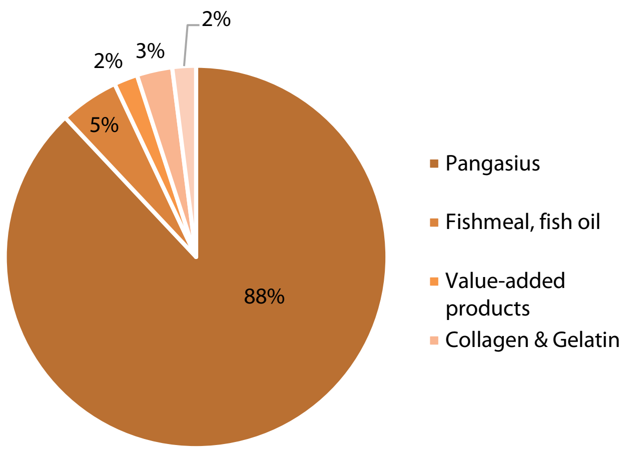
Source: RongViet Securities

As the drivers of profit growth in 2018 do not come from the improvement of the company's core business conditions, we do not highly appreciate the role of these factors in the long-term growth prospects of Vinh Hoan. Accordingly, the P/E level is maintained at 8x as in the previous valuation report.

As what we observed, the ratio of cash dividend/ net profit of the company in the recent five years is always higher than 30%. Together with 2018's net profit result undoubtedly much higher than the plan's (VND 620 bn), we expect the company to raise the cash dividend rate for 2018 to 30-33% compared to 20% as announced at the 2018 shareholder meeting.

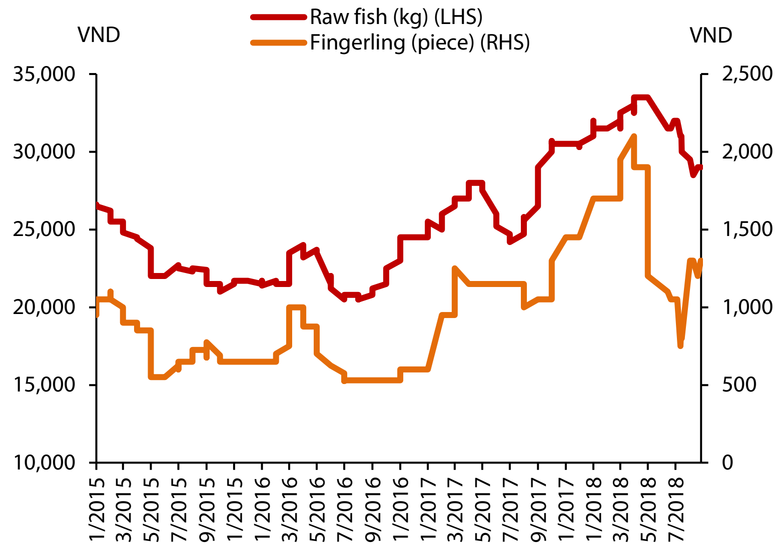
Appendix:

Export revenue by products 1H2018



Source: VHC, RongViet Securities

Raw fish and fingerlings prices of 2015-8/2018



Source: VASEP, RongViet Securities

VND billion

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	7,304	8,152	9,270	10,248
COGS	6,237	6,980	7,675	8,626
Gross profit	1,067	1,172	1,595	1,622
Selling expense	266	269	278	297
G&A expense	115	141	148	164
Finance income	87	58	90	118
Finance expense	93	89	123	60
Other profits	-7	-8	-8	-8
Gain/(loss) from JVs	0	0	90	100
PBT	672	723	1,218	1,310
Prov. of tax	107	118	185	199
Minority's interest	-1	0	0	0
PAT to equity S/H	567	605	1,034	1,112
EBIT	686	761	1,169	1,161
EBITDA	823	945	1,317	1,357

Financial ratio	FY2015	FY2016	FY2017E	FY2018F
Growth				
Revenue	12.5%	11.6%	13.7%	10.6%
Operating income	45.1%	14.8%	39.3%	3.1%
EBIT	58.6%	11.0%	53.5%	-0.7%
PAT	75.7%	6.7%	70.9%	7.5%
Total assets	2.2%	13.3%	9.6%	14.7%
Equity	14.9%	23.3%	24.2%	17.4%
Profitability				
Gross margin	14.6%	14.4%	17.2%	15.8%
EBITDA margin	11.3%	11.6%	14.2%	13.2%
EBIT margin	9.4%	9.3%	12.6%	11.3%
Net margin	7.8%	7.4%	11.1%	10.8%
ROA	12.7%	12.0%	18.7%	17.5%
ROE	23.7%	20.5%	28.3%	25.9%
Efficiency (x)				
Receivable turnover	6.3	6.1	6.7	6.9
Inventory turnover	5.1	5.8	5.7	5.9
Payable turnover	10.4	11.4	11.0	11.8
Liquidity (x)				
Current	1.9	1.9	2.2	2.4
Quick	1.0	1.1	1.5	1.6
Solvency				
Total debt/equity	58.0%	47.9%	29.9%	28.9%
Current debt/equity	36.3%	34.3%	28.5%	26.9%
Long-term Debt/equity	21.7%	13.7%	1.4%	1.9%

VND billion

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	165	45	100	111
Short-term investments	169	373	969	1,410
Accounts receivable	1,150	1,329	1,390	1,486
Inventories	1,214	1,202	1,335	1,466
Other current assets	50	54	69	68
Property, plant & equipment	1,389	1,633	1,350	1,461
Acquired intangible assets	183	271	165	172
Long-term investments	17	1	1	1
Other non-current assets	114	134	148	167
Total assets	**4,451**	**5,043**	**5,528**	**6,343**
Accounts payable	602	614	701	733
Short-term borrowings	866	1,008	1,042	1,155
Long-term borrowings	518	402	53	83
Other non-current liabilities	23	27	30	33
Bonus and welfare fund	49	48	48	48
Technology-science, dev. fund	0	0	0	0
Total liabilities	**2,058**	**2,100**	**1,873**	**2,052**
Common stock and APIC	1,140	1,140	1,140	1,140
Treasury stock (enter as -)	-3	-3	-3	-3
Retained earnings	1,250	1,805	2,518	3,153
Other comprehensive income	0	0	0	0
Inv. and dev. fund	0	0	0	0
Total equity	**2,387**	**2,943**	**3,655**	**4,290**
Minority interest	6	0	0	0

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
EPS (VND)	6,133	6,544	10,189	10,959
P/E (x)	9.4	8.1	7.6	7.0
BV (VND)	25,836	31,848	39,602	46,483
P/B (x)	2.2	1.7	1.9	1.7
DPS (VND/cp)	2,000	2,000	3,300	3,300
Dividend yield (%)	3.5	3.8	3.7	3.7

Valuation model	*Price*	*Weight*	*Average*
FCFF	116,306	40%	46,522
PE	81,516	60%	48,909
Target price (VND)			**95,432**

Valuation history	*Price*	*Recommendation*	*Period*
21/05/2018	61,100	Accumulate	1 year

RESULTS 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%

ABOUT US

RongViet Securities Corporation (RongViet) was established in 2007, licensed to perform the complete range of securities services including brokerage, financial investment, underwriting, financial and investment advisory and securities depository. RongViet now has an operating network that spreads across the country. Our major shareholders, also our strategic partners, are reputable institutions, i.e Eximbank, Viet Dragon Fund Management, etc... Along with a team of the professional and dynamic staffs, RongViet has the man power as well as the financial capacity to bring our clients the most suitable and efficient products and services. Especially, RongViet was one of the very first securities firms to pay the adequate attention to the development of a team of analysts and the provision of useful research report to investors.

The **Analysis and Investment Advisory Department** of RongViet Securities provides research reports on the macro-economy, securities market and investment strategy along with industry and company reports and daily and weekly market reviews.

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