FPT DIGITAL RETAIL JSC (HOSE: FRT)

Aggressive Plan needs to be proven

FPT Retail (FRT) is the second largest mobile phone retailer in Vietnam, after MWG. Its smaller size will allow FRT to expand, although the smartphone market is gradually becoming saturated. Additionally, we believe that F.Friends and Subsidy can make a difference and will partly help FRT maintain its growth for the next two years.

The Long Chau pharmacy chain is promising. However, in order to truly become the driving force of FRT, Long Chau needs to succeed on a large scale, not only in Ho Chi Minh City. This is a difficult task, especially since the current environment is not really ideal for the development of pharmacy chains

*While the outlook for the mobile phone business does not seem too attractive, FRT's stock price is now at a level that is within a realistic trading range. After a 25% drop from its peak, the stock is not too expensive. Using a "sum of the parts" valuation method, we estimate the combined value of FPT Shop and F.Studio at about VND 75,500/share, and the Long Chau drugstore chain at VND 8,500/share. Adding a cash dividend of VND 2,000, the potential gain is **17%**, enough for an **ACCUMULATE** recommendation on the stock.*

Investment Rationale

- Smartphone market – there is still room for growth
- F.Studio – take advantage of the unauthorized Apple market
- Long Chau pharmacy chain - has got off on the right foot

Risk

- Bad debt risks from F.friend and Subsidy
- Risk of ineffective expansion and legal issues in the pharmaceutical industry

Key financial ratios

Y/E Dec (VND Bn)	FY2016	FY2017	FY2018F*	FY2019F
Net revenue	10,853	13,147	16,278	20,869
%change	37%	21%	23,8%	28,2%
PAT	207	290	375	478
% change	42%	39.7%	29.3%	27.5%
Net margin (%)	1.9%	2.2%	2.3%	2.3%
ROA (%)	4.4%	7.5%	7.9%	8.0%
ROE (%)	40.3%	36.4%	28.4%	27.8%
EPS (VND)	10,375	7,247	5,278	6,594
Book value (VND)	25,762	19,911	18,996	24,271
Cash dividend (VND)	0	2,000	2,000	2,000
P/E (x)	N/A	N/A	13.9	11.1
P/BV (x)	3.0	7.8	3.9	3.0

Source: FRT, RongViet Securities

**2018 numbers do not include Long Chau Pharmacy (will be consolidated from 2019 onwards)*

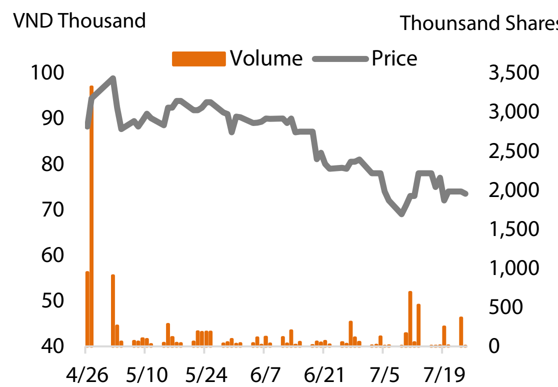
ACCUMULATE + 17%

Market price (VND)	73,500
Target price (VND)	84,000
Cash Dividend (VND)*	2,000

** Expected in the next 12 months*

Stock Info

Sector	Consumer discretionary
Market Cap (VND Bn)	5,032
Share O/S (Mn)	68
Free Float (%)	37.9
52 weeks high	98,824
52 weeks low	67,100
Average trading volume (20 sessions)	25,695



Performance (%)

	3M	1Y	3Y
FRT	-16.7	N/A	N/A
Consumer discretionary	1.43	23.7	145.4
VN-Index	-13.6	22.9	48.0

Major shareholders (%)

FPT Corporation	47
Dragon Capital	20
VinaCapital	15
Foreigner Investor Room (%)	*49*

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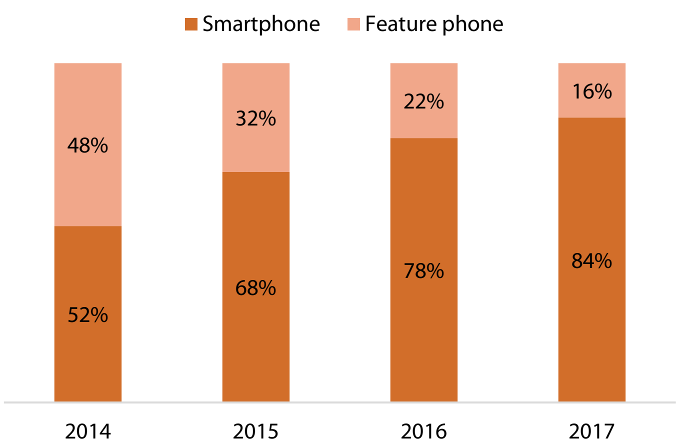
INVESTMENT RATIONALES

Smartphone market – there is still room for growth

Number of stores continues to expand

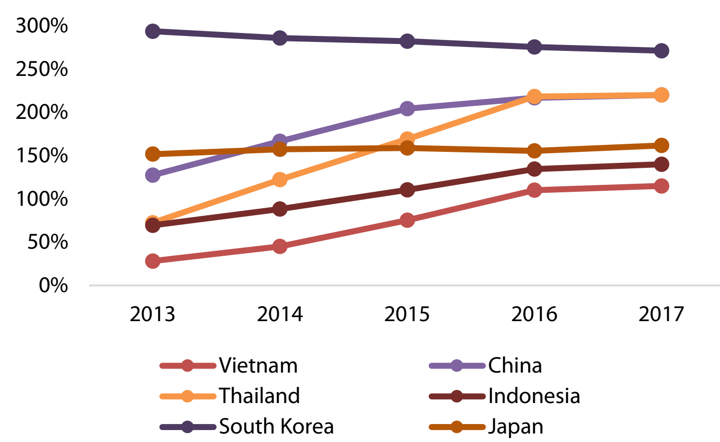
Smartphones have achieved a high penetration In Vietnam, according to Nielsen's survey in key cities, about 80% of people now own at least one smartphone (in the total of 95% population who own mobile phone in general). The growth drivers for this industry in the coming years will mainly come from customers' demand to upgrade their phones. UN statistics shows that over the next five years, the population aged 14 and over will increase by about 8 million. This will be a potential source for phone retailers such as FRT.

Figure 1: Mobile phone consumer trend in Vietnam (% of users)



Source: Nielsen

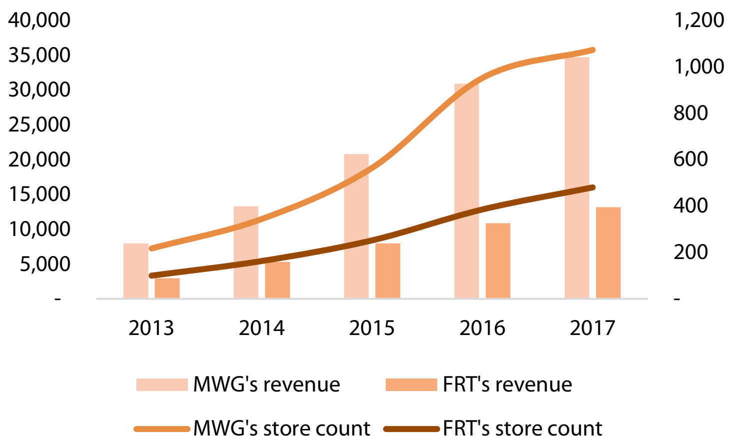
Figure 2: Smartphone penetration in some countries (to total population)



Source: Euromonitor

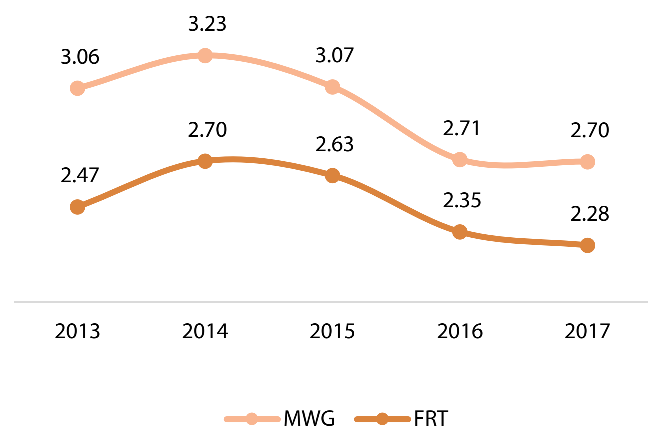
According to statistics from Euromonitor (Figure 2), smartphones in Vietnam still have a lower penetration than other countries in the region. We believe that although Vietnam's mobile phone market has overpassed the "smartphone universalization" period, it will still take another two-three years to reach the "saturation" level. Hence, there is still room for FRT to open more than 100 stores per year in 2018 and 2019, implementing a "revenue sharing" strategy with the largest phone retailer, Mobile World (MWG). Specifically, FRT will seek for locations that meet two requirements: (1) Having one MWG's store nearby that has monthly revenue of over VND 3 bn and (2) FPT Shop has not had any store there. In the context that most of the ideal locations already have the footprints of MWG, opening FPT Shop next to will help FRT take advantage of available customers in the area. Expectedly, each store can generate from VND 1.5 to 2 bn/month in revenue.

Figure 3: Revenue (LHS, VND bn) and store count (RHS) of thegioididong (MWG) and FPT Shop



Source: RongViet Securities

Figure 4: Average revenue per store (VND bn/month)



Source: RongViet Securities

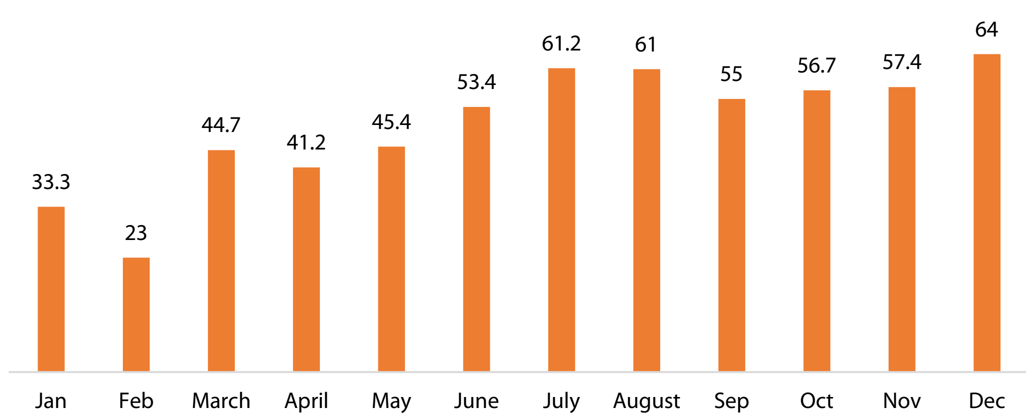
Revenue per store is growing due to the development of consumer finance

According to a report by the National Financial Supervisory Commission (NFSC) 2017, consumer lending grew 65% in 2017, compared to 50% in 2016. The share of consumer credit in total outstanding loans increased from 12% in 2016 to 18% in 2017. In the revenue structure of FPT Shop, about 30% comes from products financed by consumer finance companies. Therefore, it can be seen that consumer finance is becoming more and more popular in Vietnam.

This is why FRT is promoting two installment programs **F.friends** and **Subsidy** to boost sales/stores, as the organic growth of the mobile phone industry is slowing down. F.friends applies to products that are worth over VND 1 mn, including 184/267 phones sold at FPT Shop, most laptops, tablets and convertible products. Meanwhile, Subsidy only applies to Samsung phones in all segments from cheap to high-end.

F.friends is a 6-month installment plan with 0% interest for members who have been employed for at least eight months by companies that participate in the program with FPT Shop. Installment payments will be deducted from the buyer's monthly income. Starting from the end of 2016, FRT has signed contracts with 2,000 companies with a membership of 650,000. Monthly sales has reached 60-70 billion VND, and FRT aims to double this number by the end of 2018.

Figure 5: Revenue generated by F.friends in 2017 (VND bn)



Source: FRT

Table 1: Compare F.friends with other installment methods

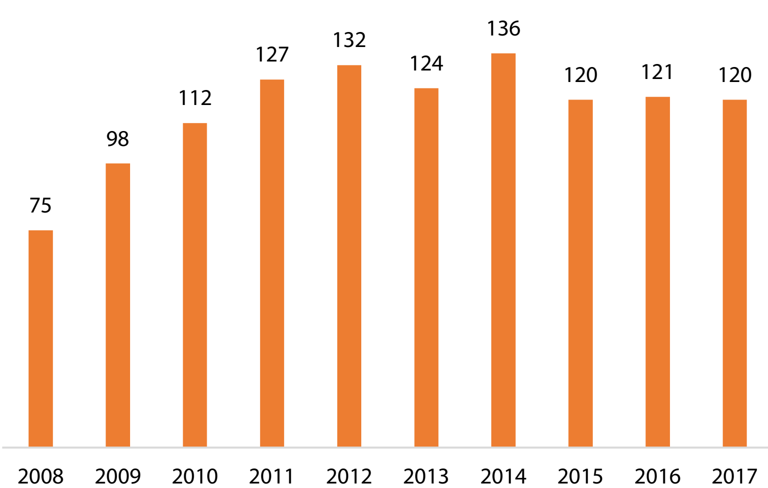
	Traditional consumer finance	Credit cards	F.Friends
Interest rate	30%	0%-30%	0%
Initial payment	40%-60% product value	0	0
Applicable periods	All year	Seasonally	All year
Applicable products	Minimum value of VND 3 mn	Minimum value of VND 3 mn	Minimum value of VND 1 mn
Enjoying other promotions	Yes	No	Yes

Source: FRT

Subsidy: a program to buy subsidized phones from the network operators, introduced in late 2017. When buying a phone with a package from one of the two networks: Vietnamobile and Mobifone, customers only have to pay in advance 50% of the value, the remaining amount will be paid in 12 months under the contract with the operator. FRT and network operators promote sales and buyers can purchase phone with packages at attractive prices.

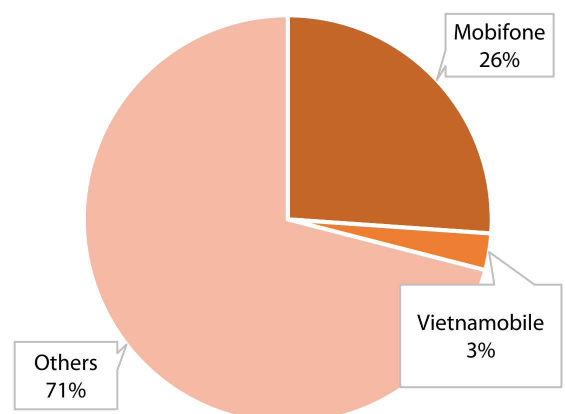
In comparison, even at the lowest subsidized packages, the additional charges for the Subsidy's monthly package are only equivalent to the internet fees that are being applied to existing subscribers. Besides that, customers also get extra minute voice calls. Therefore, while new subscribers benefits from the program, old users still have the motivation to participate as all the applicable phone models have two SIM slots.

Figure 6: Mobile subscription in Vietnam (millions)



Source: General Statistics Office

Figure 7: Market shares of network operators (2016)

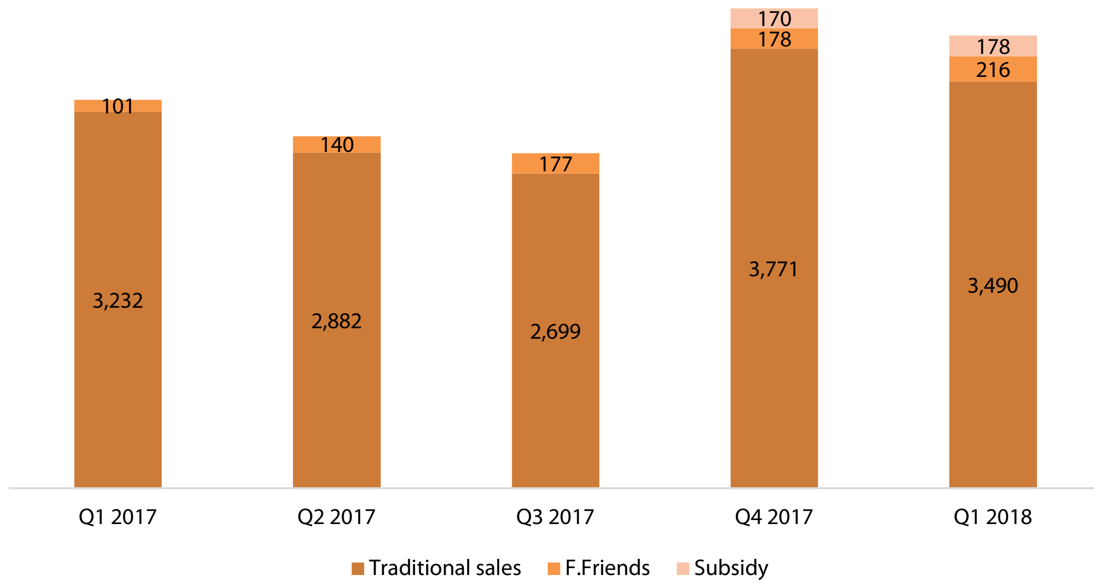


Source: Ministry of Information and Communications

The number of mobile subscribers has fallen since 2014, mainly due to the fact that operators have eliminated junk subscribers. The Ministry of Information and Communications inspector said that 24.3 million junk SIMs were removed in 2017. As such, the number of actual subscribers has grown.

In addition, according to Decision No. 1178 of MIC, operators will soon apply a policy that allows customers to change operator without giving up their numbers. Therefore the battle for market share between operators will become more drastic, and the form of cooperation with retailers to provide 12-months committed contracts will be very useful in keeping customers.

Figure 8: Revenue structure



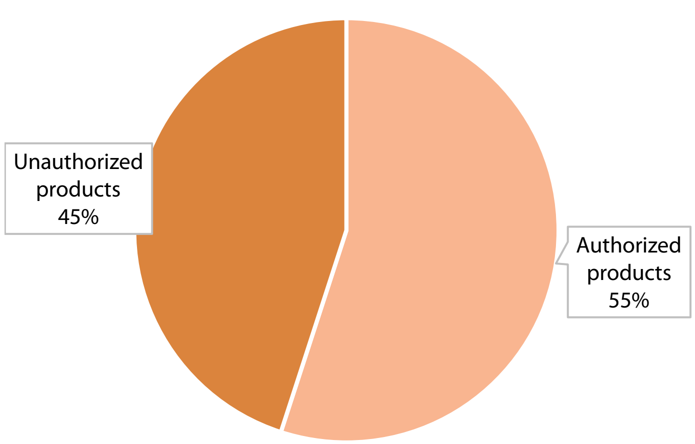
Source: FRT, Rong Viet Securities

The contribution of these two programs to total revenue in 2017 was nearly 9%, and is progressing well in the first months of 2018. Therefore, FRT is expected to increase this rate to 20% by the end of 2019, and about 30% in the next five years.

The Apple product market in Vietnam is worth about USD 1 bn, of which iPhone maintains a stable 10% market share (Figure 11). Meanwhile, the largest piece still belongs to unauthorized products (Figure 9) - which have advantages over authorized items in terms of price and release time.

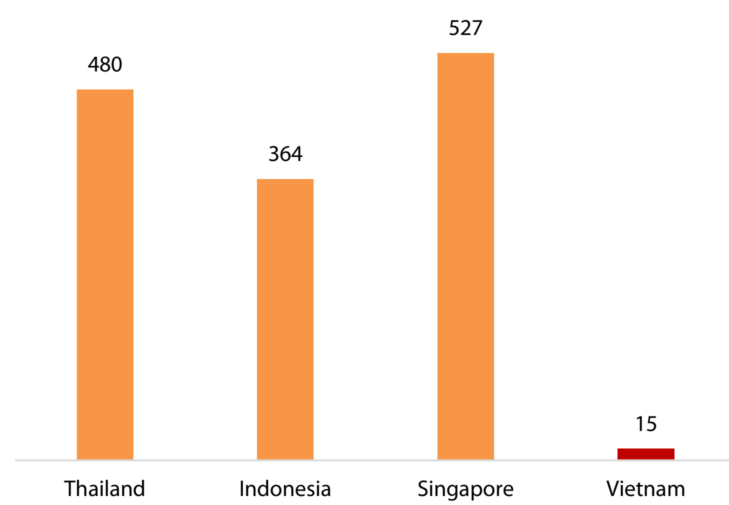
F.Studio – the unauthorized Apple market

Figure 9: Market for Apple products in Vietnam (USD mn)



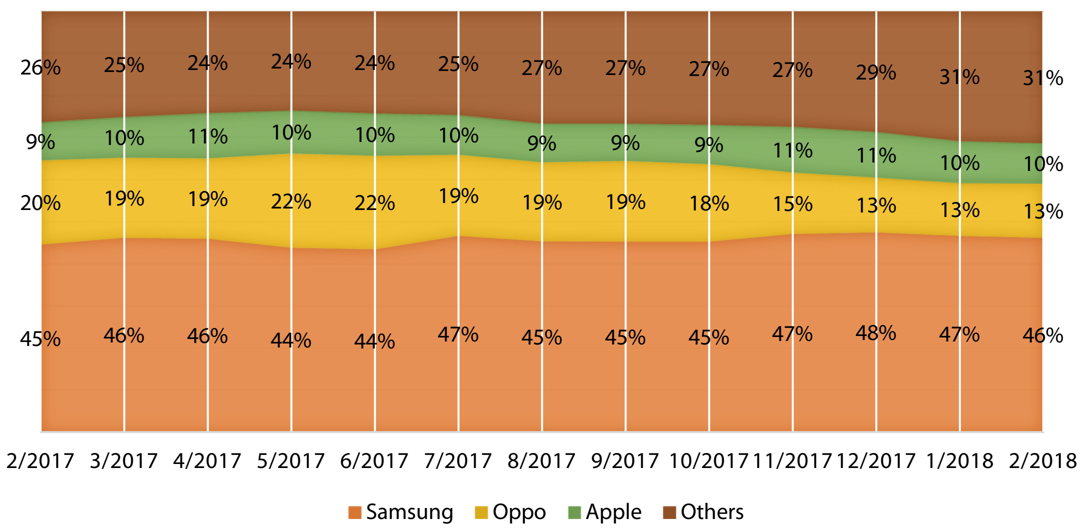
Source: FRT

Figure 10: Apple authorized resellers



Source: FRT

Figure 11: Market shares of phone manufacturers in Vietnam (by volume)

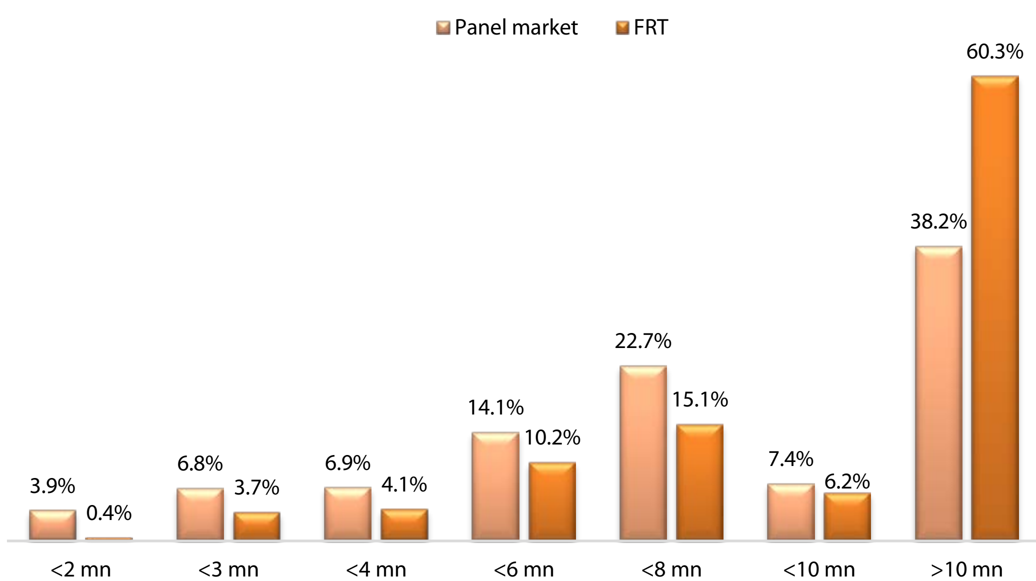


Source: GFK

Targeting this potential market, FRT has signed a partnership agreement to open the Apple Premium Resellers (APR) chain. Specifically, APR is the highest authorized dealer level, just behind the Apple Store itself and is supported by Apple in store establishment as well as a high warranty. At present, there are only 15 authorized Apple stores in Vietnam, which are very few compared to other countries in the region (Figure 10).

In the authorized segment, FRT is leading with a 40% market share. With experience in the premium product segment (Figure 12) and more than 10 years working with Apple, FRT has a great advantage over other unauthorized retail chains. In addition, the policy of Apple not providing warranty to unauthorized products is also an advantage of FRT as consumers are increasingly evaluating after-sales services.

Figure 12: Revenue structure by segment, in VND (2017)



Source: FRT, GFK

Until now, 12 F.Studio stores have been put into operation, with average sales per store reaching VND 1.2 bn to less than VND 2 bn per month. These stores are split from FPT Shop stores that have high sales of Apple products. This helps to take advantage of the existing shop space, the amount of customers available, and save on operating costs.

On the product side, F.Studio has a similar price policy with FPTshop. F.Studio has a team of professional consultants in accordance with Apple global standards, has its own marketing budget and gets Apple's media branding on its official website. Fstudio creates a great deal of psychological and brand identity when compared to other retailers.

Long Chau pharmacy chain has got off on the right foot…

Although FRT will still be able to open phone shop in the next two years, the slowdown is inevitable. To sustain growth, FRT has step foot on the pharmaceutical retail industry through the acquision of the Long Chau pharmacy chain. As the company has started the expansion plan, Long Chau has got off on the right foot in our opinion:

Suitable pharmacy model

Long Chau follows a traditional pharmacy model which focuses on selling medicines and healthcare products. Vietnamese have got used to that model for a long time. On the contrary, people are still unfamiliar with the drugstore-hypermarket hybrid model, which is common in North American. In Vietnam, Pharmacity is an example of that model.

Store expansion is well planned

Store location is crucial in order to get traffic. Unlike its competitor, Pharmacity that opened store without caring about traffic, FRT has carefully tested strategic locations such as intersections, nearby markets, hospitals, or crowded residential areas to find a winning formula. Only after successfuly opening large stores, the company will strive to open smaller stores. Good locations are rare, but FRT has the advantage to be able to convert its phone stores into Long Chau if needed.

Figure 13: Long Chau Tan My. Located opposite to Tan My market, near residential area, near Viet Phap Hospital and Tam Duc Heart Hospital. The store has good traffic.

Figure 14: Long Chau Huynh Tan Phat. Located in the intersection, the store has two fronts, next to FPT Shop, and near the crowded routes. It is able to claim almost all customers from the nearby mom-and-pop pharmacy.

The stores meet the customers' requirement

Our survey from customers and storeowners shows that there are three key factors that consumer desire:

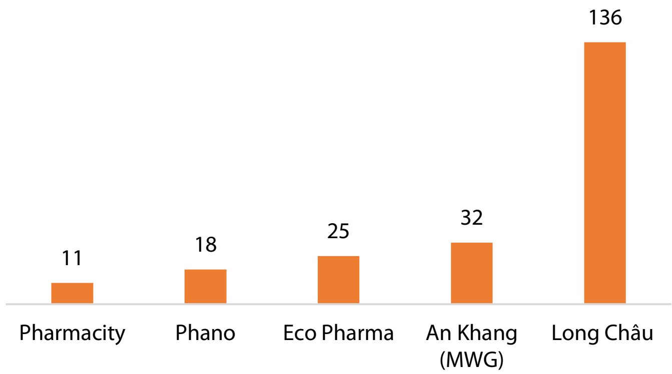
(1) The store has the medicines needed
(2) Cheaper price (assume similar quality)
(3) Good consulting servives

Table 2: Compare Long Chau with mom-and-pop stores

Factors	Mom-and-pop stores	Long Chau
Number of drugs	Most of them only cover basic drugs	The number of SKUs outweighs independent pharmacies
Quality and price of drugs	Unclear origin and quality, results in price fluctuation among stores	Guarantee quality thanks to trusted source of drugs. Price is higher, but can be reduced if the scale is large enough
Counseling Quality	Many stores do not have qualified staff for consulting and dispensing drugs. Employees are trained on the "hands-on" basis	Employees undergo one-year training course.

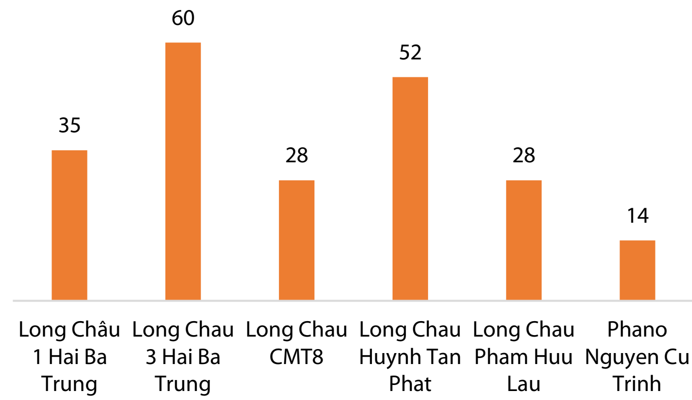
The table above shows that Long Chau appears to be on the right track to meet customer's demand. Compared to other pharmacy chains, Long Chau has a much larger amount of SKUs and competitive prices. This, coupled with strategic locations, explains the significantly higher revenues per store (Figure 15). Observing the store traffic in peak hour, we find that the figure seems reliable.

Figure 15: Average revenue per store per month of different pharmacy chains (unit: USD thousand)



Source: FRT

Figure 16: Survey of traffic in several stores in one peak hour (unit: customer)



Source: RongViet Securities

Reasonably handling inventory-traffic problems

Having a large number of SKUs means that Long Chau has to deal with its inventory. This is very challenging because (1) selling expired medicine is strictly forbidden, and (2) marketing to boost revenue is not as effective in this industry. FRT's solution rely on customers' data to determine the demand trend and restructure the SKU portfolio. Data driven is a good approach, and it should help partially to solve the potential problem with inventories.

Having said that, inventory remains an issue that Long Chau has to live with. However, this is a necessary trade-off to acquire a loyal customer base, the most important factor. A large customer base will eventually draw more prescriptions to the stores, because consumers tend to buy drugs in a familiar store, and are significantly influenced by word of mouth. It is also a potential large source of buyers when Long Chau will start selling health supplement products.

Figure 17: Times of buying drug in 3 months (N=2,648)

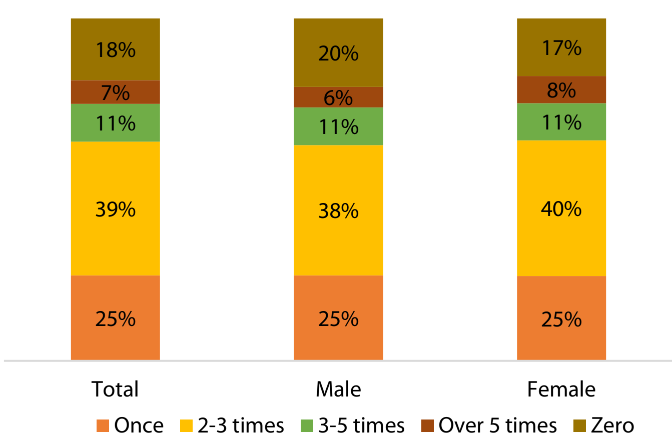
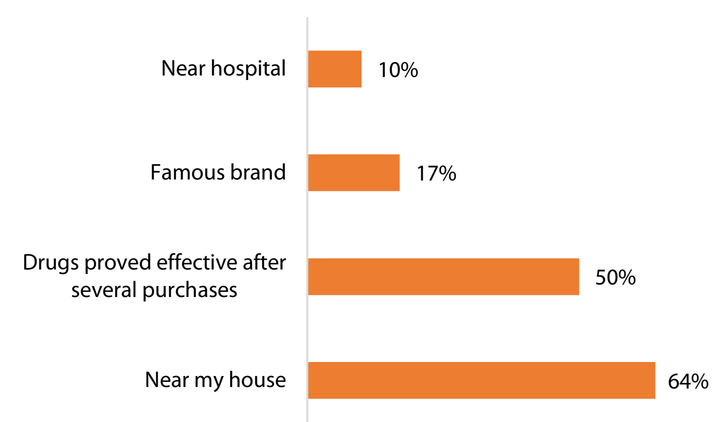


Figure 18: Criteria to choose pharmacy (N=2,045)



Source: Survey of DI-marketing in 2015 in Vietnam

Intelligent promotion based on Long Chau Hai Ba Trung's prestige.

The first Long Chau stores in Hai Ba Trung Street (widely known as the pharmacy street) has a very good traffic thanks to its long time reputation. However, in some far away places, consumer may be unware of Long Chau. Therefore, the new stores are always accompanied with the message: "Long Chau Hai Ba Trung is now present at ...".

We think Long Chau can also implement a membership programs with incentives and constraints, which proved to be effective in many other chains. For example, Mercury, the largest pharmacy chain in the Philippines, has Suki Card, a rewards system for its loyal customers that is fully transferable, without annual membership fees, to enable customers to earn points with their purchases that can be used as rebates in their next purchases or to redeem exclusive Mercury Drug items. The earned points will be reverted back to zero if the card is not used after 180 days from the date of the last purchase. Since the Suki card is transferable, any member of the family can use it, making the rule of 180 days long enough for users. The main goal is to prevent switching to other competitors.

At a sufficiently large scale, a massive marketing campaign may also help improve brand recognition.

… but difficulties:

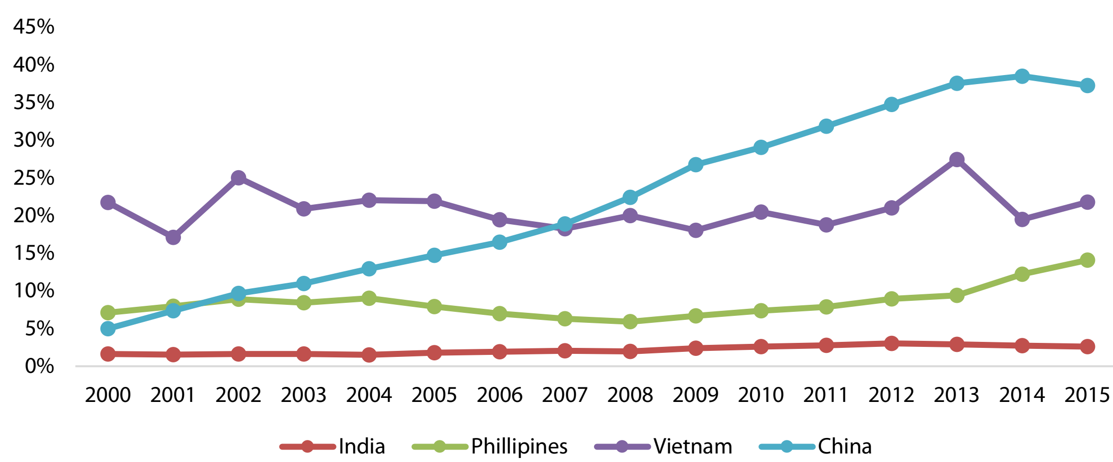
Mediocre market size

According to BMI, sales of the Vietnam pharmaceutical market is USD 5.3 Bn of which sales to hospitals account for 70%. Retail channels cover only 30% of the total market, which is equal to USD 1.6 Bn. The pie is shared among 57,000 pharmacies in the country.

Lack of a supportive environment

Healthcare expenditures are financed by three sources: government healthcare plan, private insurance, and out-of-pocket payment. In a country where the contribution of government payments is small, such as India and the Philippines, the retail market accounts for a big part of revenue of the total pharmaceutical market. This is the ideal environment for pharmacy chains to succeed.

Figure 19: Social health insurance as % of current health expenditure



Source: WHO

However, a big retail market does not guarantee the success of a pharmacy chain. For example, mom-and-pop stores still dominate in India, contributing up to 86% of total domestic sales. Unorganized pharmacy plays an important role in the Indian pharmaceutical market growth because of it high volume. The biggest reason for unorganized retail pharmacy success is to be present in every corner of India.

Table 4: Quick glance at the retail pharmaceutical in several country

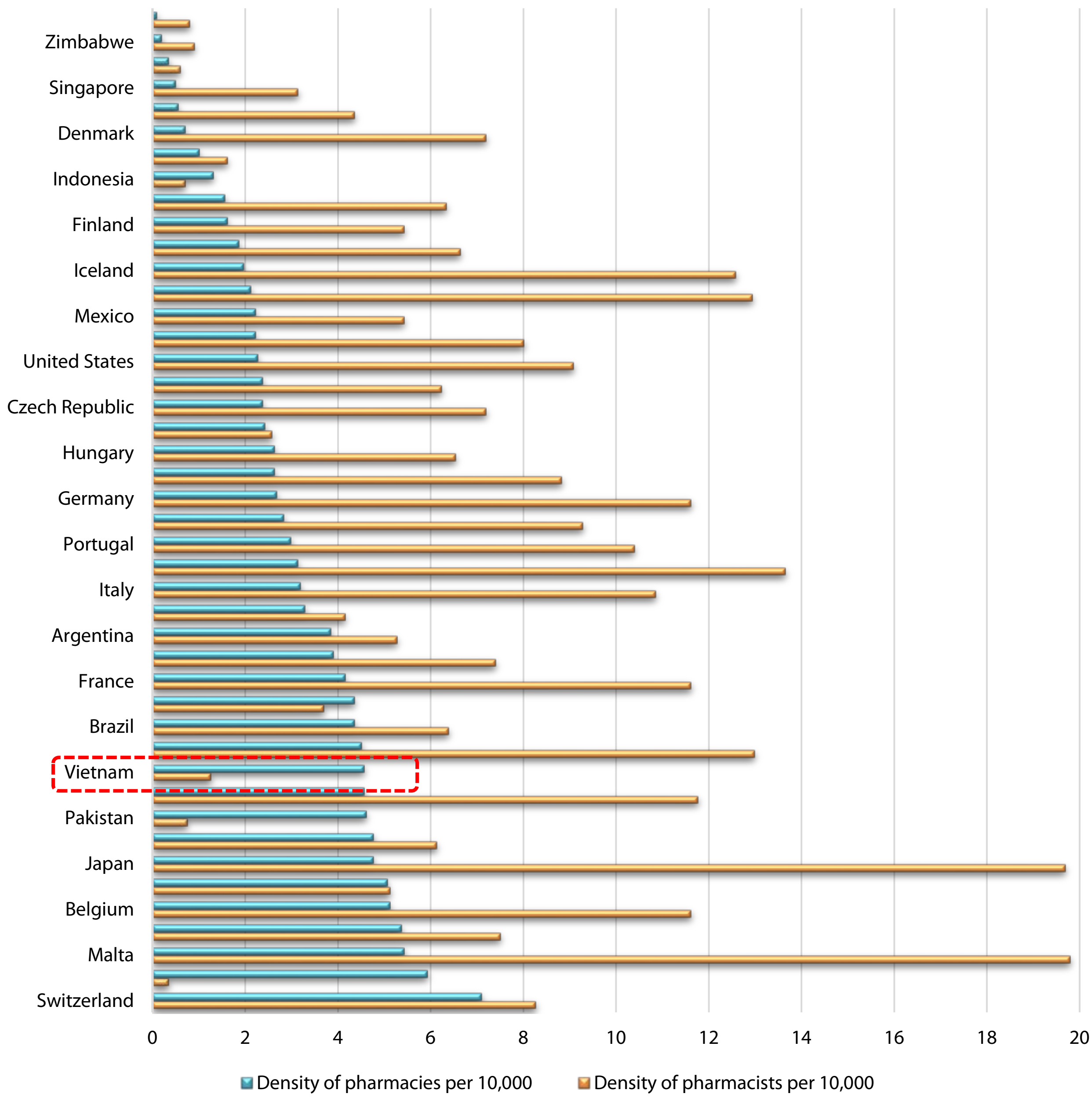
	Philippines	India	Brazil	Vietnam	China
% sales retail/total market	80%	70%	64%	30%	24%
Dominated by mom-and-pop stores		X		X	X
Dominated by pharmacy chain	X		X		
Number of stores in the country	32,000	900,000	60,000	57,000	n/a

Source: RongViet Securities

We expect the proportion of social health insurance to become bigger and bigger in Vietnam, as it happened in China. The fact that social health insurance only covers the expenditures in the hospital will limit the growth of the retail market.

Moreover, similar to India, mom-and-pop stores still dominates in Vietnam, displayed by the high pharmacy density (Figure 20). Pharmacy chains like My Chau and Phano, despite launching nearly ten years ago, still play a minor role at the moment.

Figure 20: Pharmacy and pharmacist density in various countries



Source: NAP

Overall, Vietnam's current environment does not really support pharmacy chains. Therefore, the success of Long Chau will depend on how much market share it can claim from the current fragmented market, rather than the industry's organic growth (estimated at 12% per year by BMI). FRT's implementation will play a crucial role in this matter.

Risk

Bad debt risk from F.friend and Subsidy

FRT's sales promotion programs come with bad debt. To mitigate this risk, FRT has partnered with manufacturers to install the remote lock software in case customers fail to pay the contract. FRT has now reached an agreement with Samsung, and is working with Oppo (the company that owns the third largest phone market operator in Vietnam) to develop and install the embedded software on all models of the company. For Apple products, due to its policy of discouraging the development of hardware interference programs, FRT has yet to reach an agreement to install the lock software.

FRT also booked a provision for bad debt of 2% on receivables of F.friends (real bad debt is currently less than 1%). For Subsidy, because customers are not selected as carefully as F.friends and have a higher risk, FRT has acquired full coverage on receivables, insurance costs are estimated at 2%.

Risk of ineffective expansion and legal issues in the pharmaceutical industry

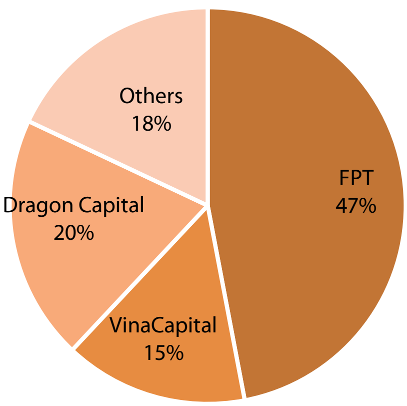
FRT stores located far from the center may not achieve the required traffic. In the pharmaceutical industry alone, there are legal features that FRT cannot fully anticipate.

COMPANY OVERVIEW

FPT Digital Retail Joint Stock Company was established in 2007 and was a subsidiary of FPT Corporation until the end of 2017. The company operates in the field of retailing mobile phones, laptops, tablets and accessories. In the period of 2014 - 2017, the CAGR of revenue was 36% and the profit after tax was 92%.

FPT Retail currently has three major shareholders, accounting for 82% of the outstanding shares: FPT Corporation (47%), VinaCapital (15%) and Dragon Capital (20%).

Figure 21: FRT's major shareholders

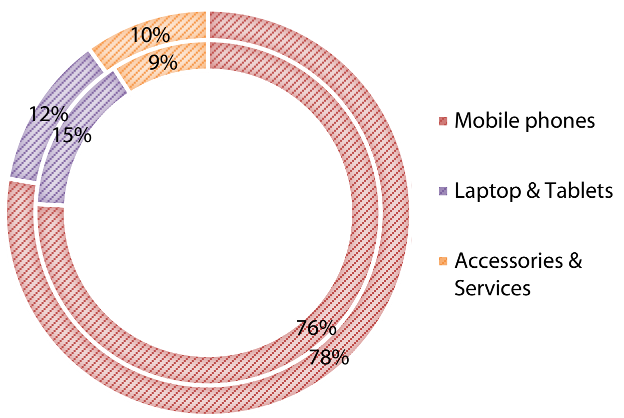


Source: FRT

Product structure

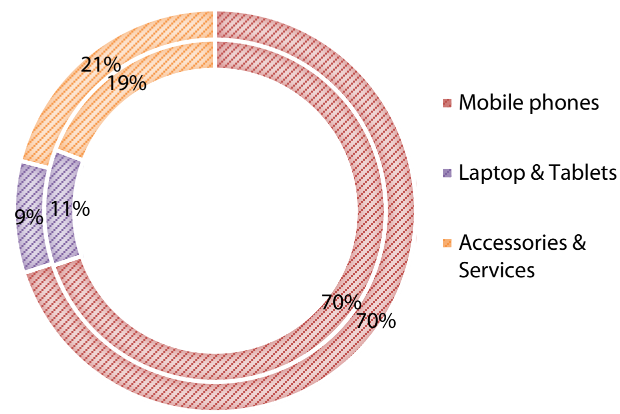
FRT is operating two retail chains: FPT Shop sells electronic products in general and F.Studio sells Apple products. In terms of product composition, mobile phones and Apple products are the main contributors (78% of revenue and 70% of gross profit in 2017) and tend to increase with the expansion of F.Studio. FRT targets the high end segment of the market and focuses on Apple products. Even though the gross margin of these products are not high (11%), significantly lower than other phone brands (14-15% gross margin), the growth room is quite plentiful and can encourage the sales of accessories and services which have very high margin (21%).

Figure 22: Revenue contribution by product types (inner is 2016, outer is 2017)



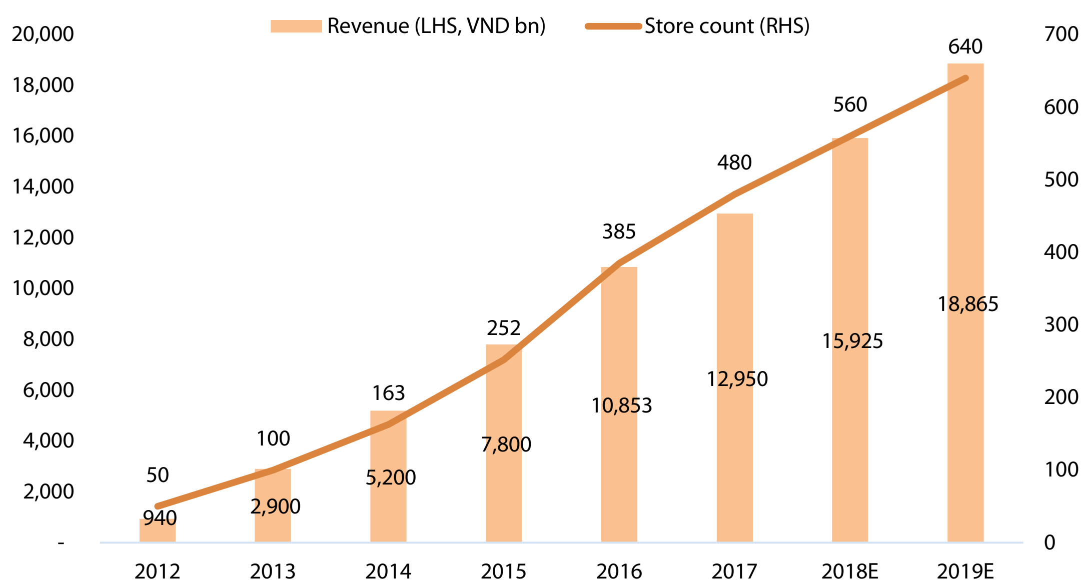
Source: FRT

Figure 23: Gross profit contribution by product types (inner is 2016, outer is 2017)



Source: FRT

Figure 24: FPT Shop's development

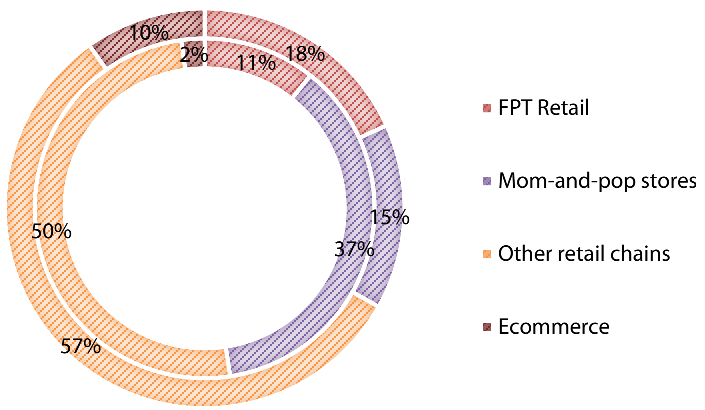


Source: FRT

Company's position in the industry

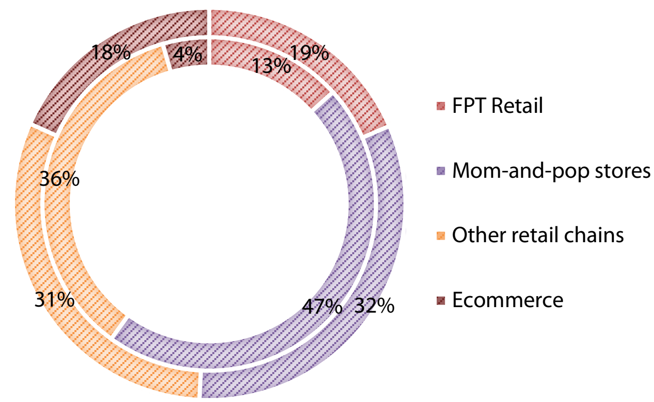
FRT entered the market in 2012, relatively late compared to other major retailers such as Mobile World (MWG), Nguyen Kim and Vien Thong A. FRT is the only retailer beside MWG to follow a model to massively open small stores to achieve high coverage. By following MWG to establish stores all over the main roads, FRT thus meets the needs of shoppers who need a second address outside of MWG for comparison. With the support of FPT-the former mother company, FRT has grown rapidly from 50 stores in 2012 to 480 stores by the end of 2017. Regarding performance (Table 4), FRT is among the top 10 retailers in Vietnam according to Retail Asia Publishing and Euromonitor Intenational.

Figure 25: Mobile phone market share (inner is 2014, outer is 2017)



Source: FRT

Figure 26: Laptop market share (inner is 2014, outer is 2017)



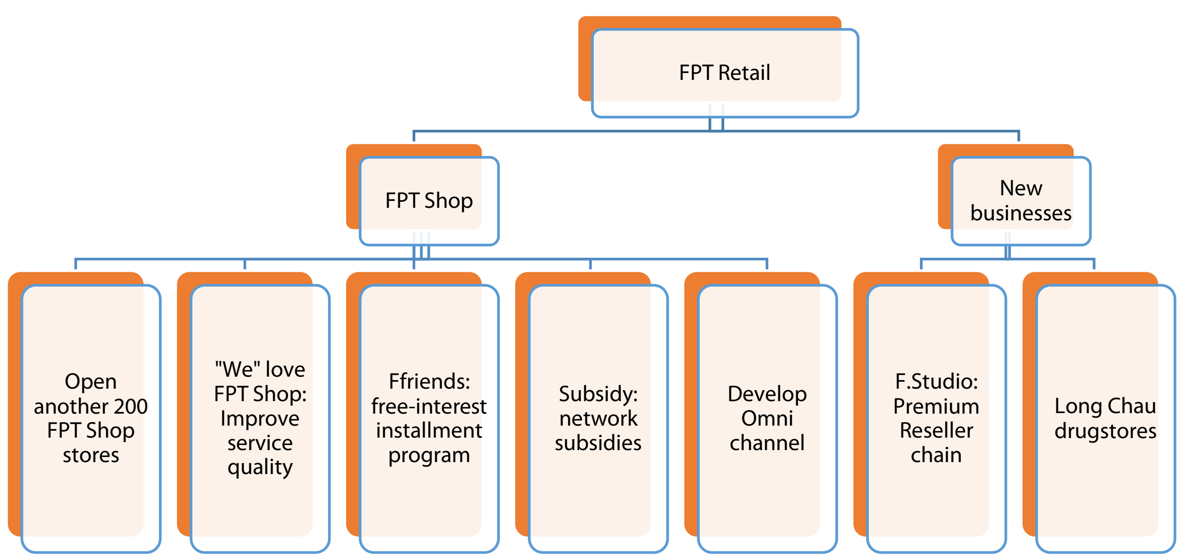
Source: FRT

Table 4: Comparison with other big retail chains

	Store count	Selling space (thousand sqr meter)	Average selling space (sqr meter/store)	2017 Revenue (VND bn)	Average revenue (VND bn/month/store)	Monthly revenue /sqr meter (VND mn)
FPT Shop	500	40.9	82	13,356	2.2	27.2
Thegioididong	1,060	135.9	128	36,784	2.9	22.6
Dienmayxanh	504	656.9	1,303	34,594	5.7	4.4
Vien Thong A	310	61	197	9,196	2.5	12.6
Dien May Cho Lon	51	105.8	2,075	9,415	15.4	7.4
Nguyen Kim	50	99.6	1,992	12,042	20.1	10.1
Sector average	8,503	1.884	222	218,952	2.1	9.7

Source: Euromonitor, RongViet Securities

Figure 27: FPT Retail's development plan

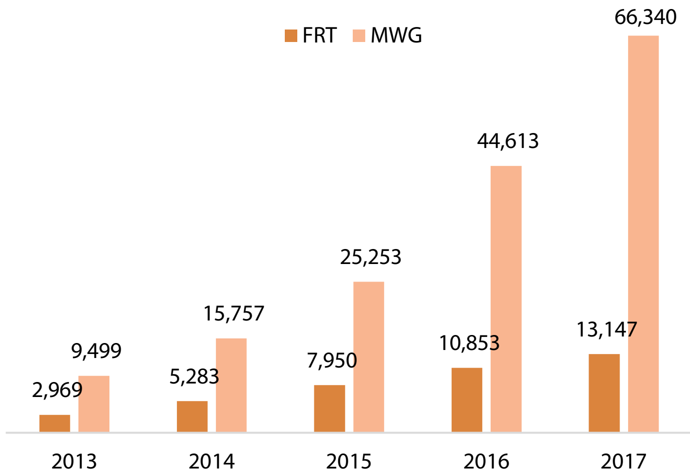


Source: FRT

FINANCIAL ANALYSIS

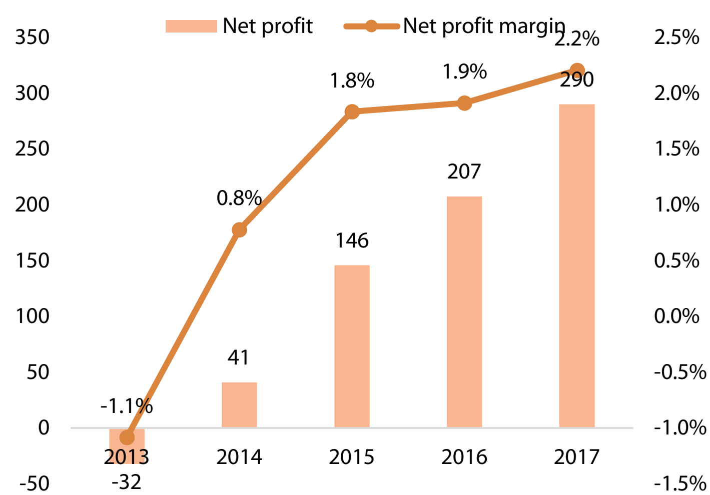
Positive growth in revenue and profit

Figure 28: Sales growth of FRT and MWG



Source: FRT, MWG

Figure 29: After-tax profit growth

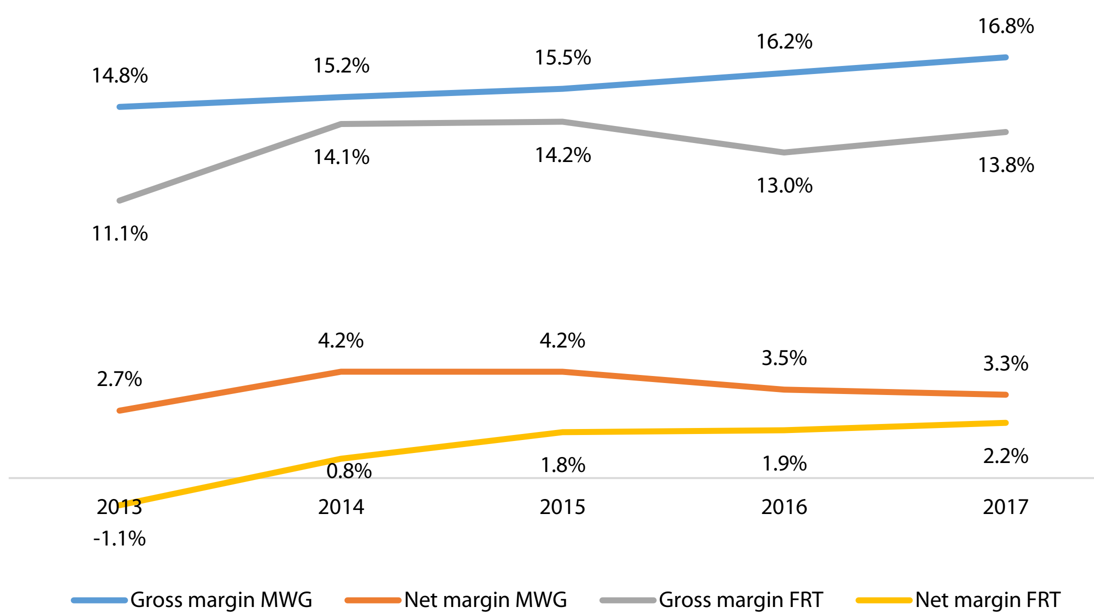


Source: FRT

FRT's revenue and net income increased impressively with the mobile retail explosion. Although sales growth rate is slowing down due to the changes in the industry, net income still posted a 40% growth last year thanks to economies of scale, changes in product mix (Figure 22 and 23) and contribution of F.Friends installment program.

Due to its smaller market share and its low gross profit margin on products like Apple and laptops, gross profit margin and net profit margin are 13,8% and 2,2%, respectively - lower than its major competitor MWG (16,8% and 3,3% respectively). Apple products account for a third of FRT's total sales, while this figure for MWG is only about 7%. In our view, FRT's gross profit margin from the electronics business will be hard to improve. However, FRT can maintain a strong growth if F.Studio and Long Chau chains operate as expected.

Figure 30: Operating efficiency comparison between MWG and FRT

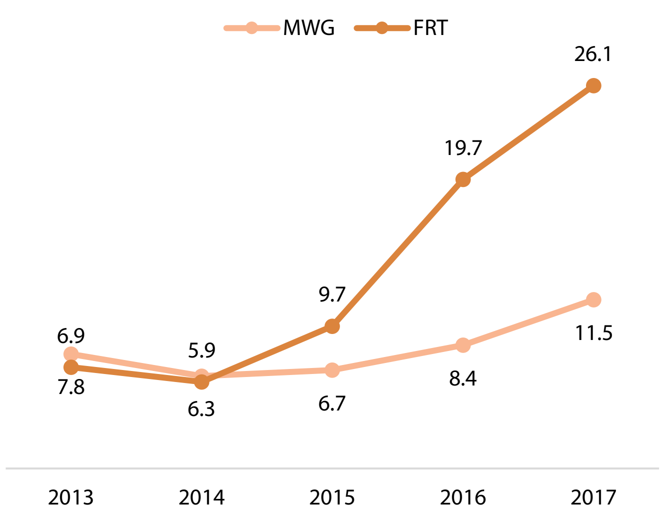


Source: RongViet Securities collected

Profitability and operating efficiency

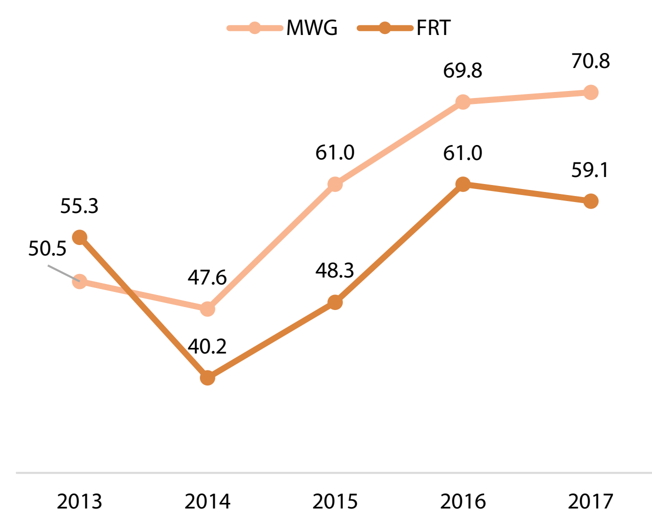
Due to the characteristics of the retail industry, FRT has a very low day sales outstanding (DSO). The company launched the F.friends installment program at the end of 2015 and the subsidy smartphone program at the end of 2017. As a result, DSO surged to 26.1 - significantly higher than major competitors in the industry. On the other hand, thanks to these programs, FRT can accelerate inventory turnover. DOH dropped from 61 days to 59 days in 2017.

Figure 31: Days of receivables (DSO)



Source: FRT, MWG, RongViet Securities

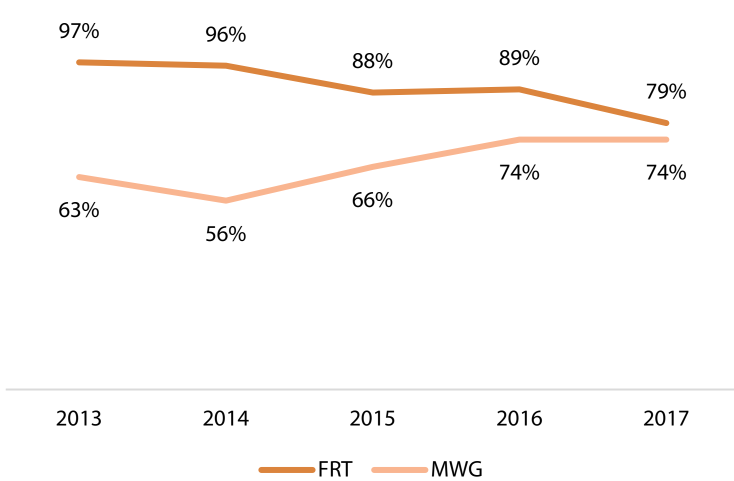
Figure 32: Days of inventory(DOH)



Source: FRT, MWG, RongViet Securities

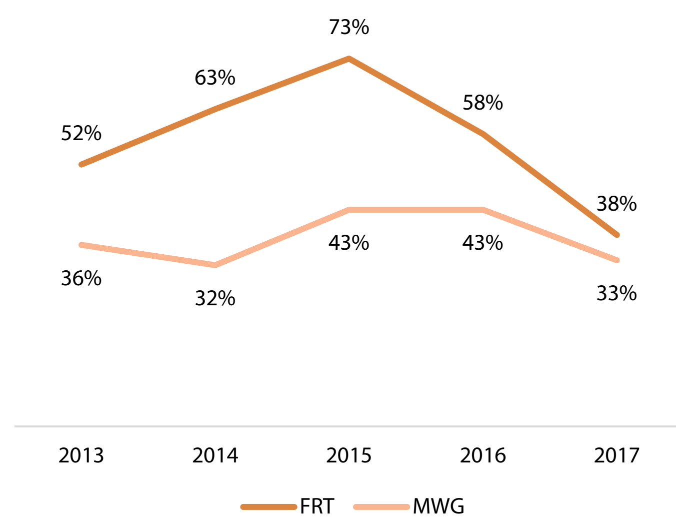
Capital structure

Figure 33: Total liabilities/ Total assets



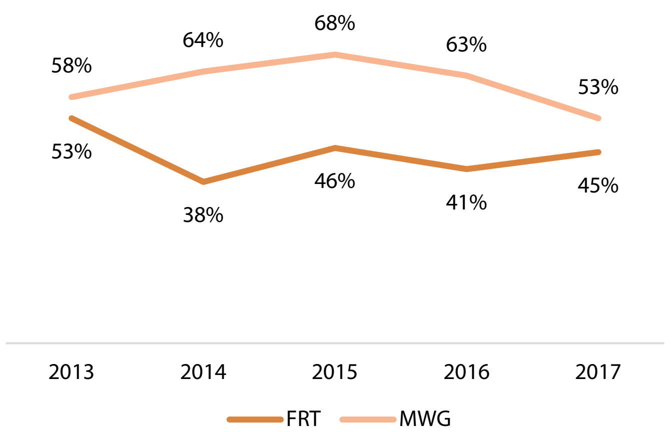
Source: FRT

Figure 34: Current liabilities/ Total liabilities



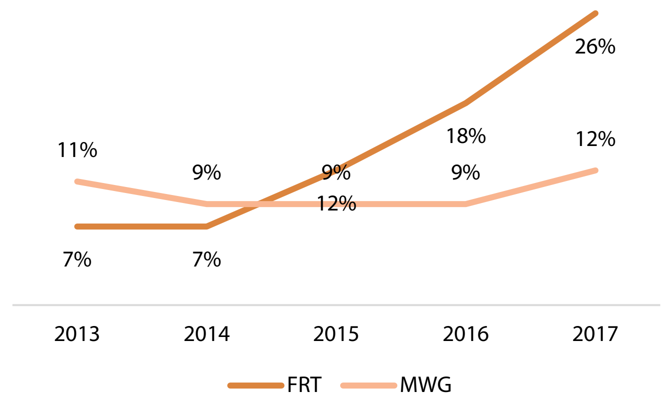
Source: FRT

Figure 35: Inventories/ Total assets



Source: FRT

Figure 36: Receivables/ Total assets



Source: FRT

FRT's asset structure includes two main items: inventory and receivables, which are financed by short-term loans. In the early stage of development, as part of FPT Corporation, FRT was focused on acquiring market share and catch up with other peers. The number of stores always increased by over 50% per year. As a result, the company had a very high debt ratio. In recent years, the company has reduced its reliance on FPT Corporation and has become more similar to MWG.

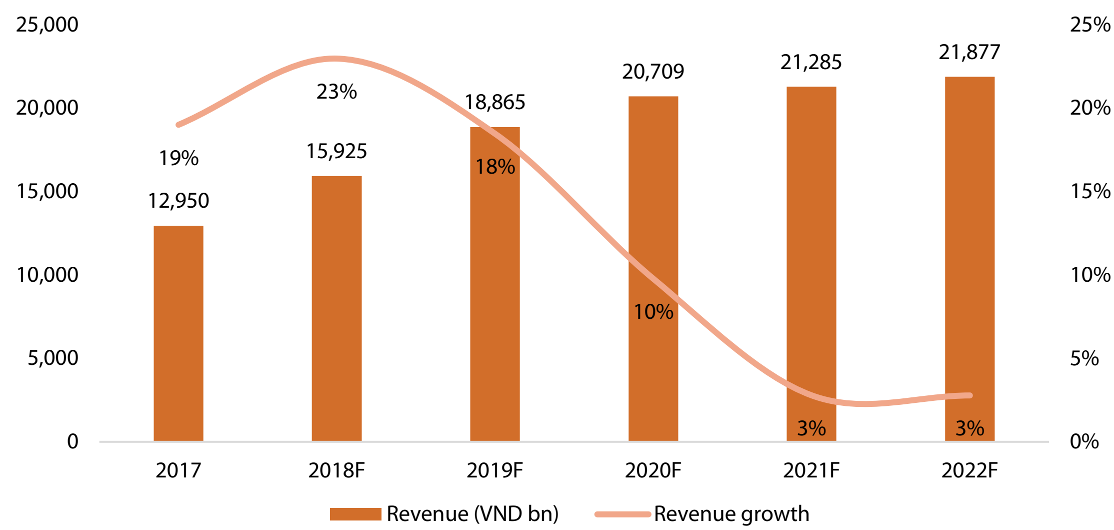
On the other hand, the development of F.Friends and subsidy smartphone programs also posed a pressure on short-term debt and receivables. It is a necessary cost to maintain sales growth in the electronics segment.

Valuation

FPT Shop

We believe that FPT Shop will continue to be the revenue driver of FRT until 2020. Additional revenue will be driven by: (1) 480 existing stores with about 3% of SSSG from the two installment programs; (2) 160 new stores will be opened in 2018 and 2019 (lower than the company's guidance). The gross margin is currently at 13.9%, we expect this number to rise to 14.3% by 2020 due to changes in the product mix and economies of scale.

Figure 37: Forecast on FPT Shop



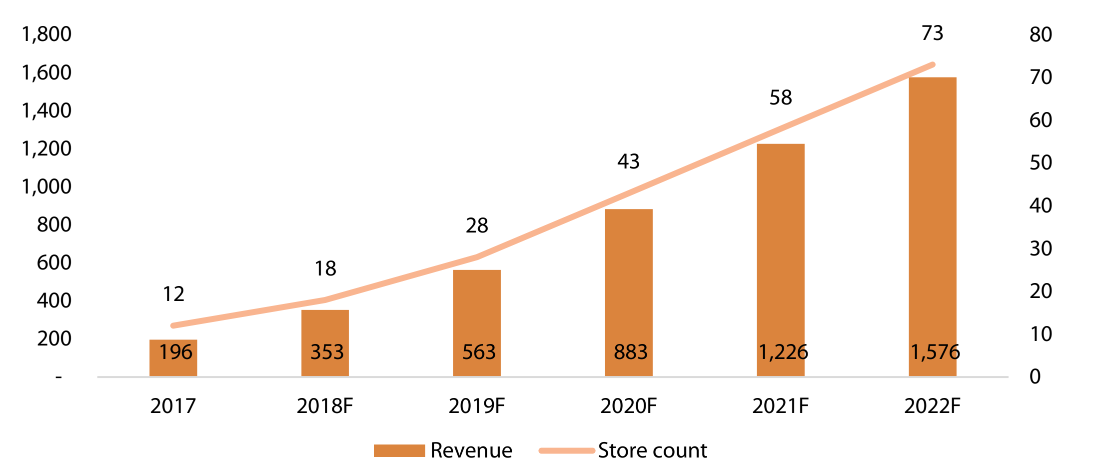
Source: RongViet Securities estimated

F.Studio

Although FRT's strategy is to open 100 F.Studio stores by 2020, we believe it would be hard for FRT to reach its target due to Apple pickiness in store locations.

Same-store sales growth (SSSG) is estimated at 2%-3%.

Figure 38: Forecast on F.Studio



Source: RongViet Securities estimated

Long Chau

FRT's plan to open 400 Long Chau stores by 2021 seems very challenging. Even in the case of successful drug chains such as Mercury (Philippines) or Raia Drogasil (Brasil), it takes a very long time to reach this milestone (Figure 39 and 40). Finding the right places to replicate the success of the first stores is no easy task.

Figure 39: Mercury's number of stores

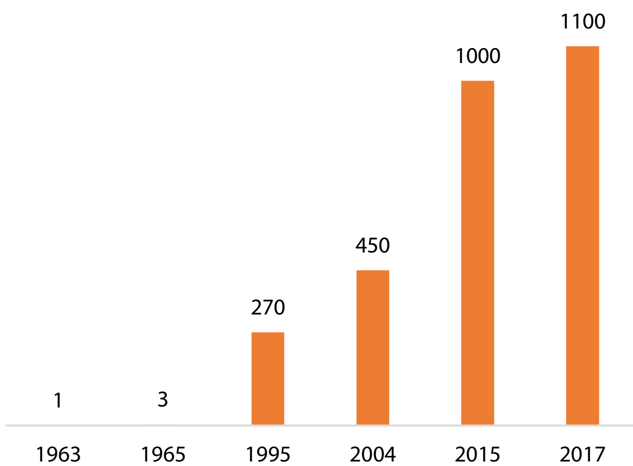
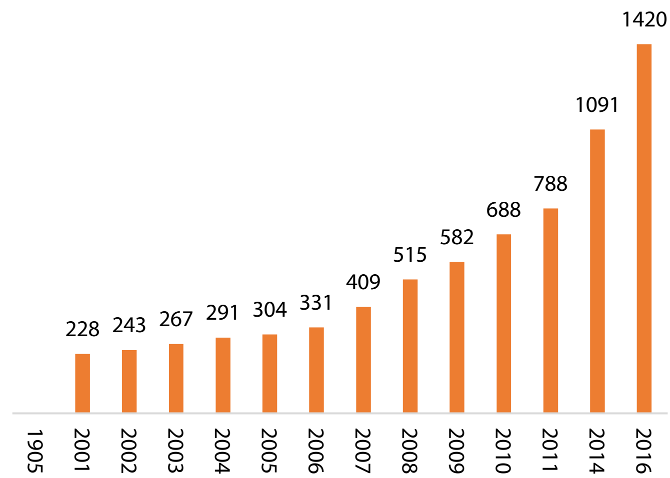


Figure 40: Raia Drogasil's number of stores



Source: RongViet Securities

Long Chau expects to claim 30% of the market, equivalent to VND 10 trillion and contributes 40% of FRT's revenue. This requires Long Chau to succeed in expanding into many areas. However, only in Ho Chi Minh City are customers familiar with a pharmacy chain. Rural areas do not yet know the concept. We believe it would still take a long time for the pharmacy chain to become mainstream. Therefore, we do not take into account this possibility until Long Chau actually proceeds to expand to other areas.

However, considering what Long Chau has been doing, we believe the chain has the potential to succeed in Ho Chi Minh City. It could grow bigger than Phano, a chain with over 70 stores after 10 years of development. We estimate the maximum scale Long Chau can expand in Ho Chi Minh as follows:

- Every district in the city can has room for 2-3 large stores and 5-6 small stores.
- Revenue of large store is around VND 2.5 billion - VND 3 billion per month, while that of small ones can reach VND 400 million per month.
- The net margin of pharmacy chains around the world are around 3%-4%. For Long Chau, as the chain is pursuing a competitive pricing strategy and given its small scale, we estimate a net margin of about 2% -3%. The figure should increase over years as the chain reaches a larger scale.

By 2021, if this scale can be reached, Long Chau will record about VND 2,100 billion -3,100 billion in terms of revenue and VND 60 billion - 90 billion in NPAT. It would account for 25% -30% of revenue and 10% net profit of FRT.

It is estimated that Ho Chi Minh City accounts for 25% -30% of Vietnam total market sales, equivalent to USD 0.5 billion. Assuming a growth rate of 10% per year, the size of this market in 2021 could reach USD 0.65 billion, or VND 14,500 billion. Thus, Long Chau would have about a 15% -20% market share in Ho Chi Minh.

The above figures show that if Long Chau cannot expand further, it can only provide a stable cash flow for FRT. However, it seems not big enough to be a growth engine for FRT.

Valuation

We use the Sum of the parts method:

With the mobile phone segment including FPT Shop and F.Studio, we use a P/E of 14x.

For Long Chau, we use the DCF method with a discount rate of 12%.

	Method	Valuation
FPT Shop + F.Studio	P/E 14x	75,600
Long Chau	DCF	8,500
Total		**84,100**

Table 5: Peers comparison

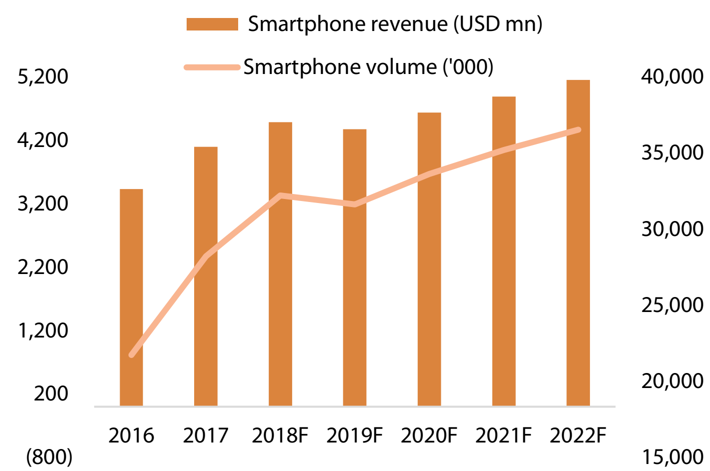
Company	Country	Market cap (bn VND)	2017 Sales (bn VND)	2012-2017 CAGR of Sales	2017 Profit (bn VND)	2012-2017 CAGR of Profit	Total liabilities/ Total assets	2017 ROE (%)	P/E	P/B	EV/ EBITDA	P/CF
FPT Retail	Vietnam	5.032	13.147	36%	290	92%	79%	42,9	17,9	6,3	15,5	23,6
Thế Giới Di Động	Vietnam	36.777	66.340	55%	2.206	78%	74%	45,3	14,4	5,0	10,7	24,5
GOME Retail Holdings	China	53.498	240.937	7%	(214)	-38%	72%	-0,3	41,3	0,7	15,1	-
Jaymart	Thailand	4.615	8.469	10%	340	8%	72%	16,5	35,9	2,1	16,4	-
Electronic City	Indonesia	2.349	3.088	5%	(16)	-156%	10%	-0,5	-	0,9	131,1	11,9
Tiphone Mobile	Indonesia	10.052	47.408	28%	709	9%	60%	12,4	14,8	1,8	10,5	-
Samart Corporation	Thailand	1.887	8.730	-5%	(583)	-196%	72%	-16,8	-	3,3	42,7	2,6
Ningbo Bird	China	8.558	5.428	9%	(514)	-218%	20%	-16,6	-	3,0	-	40,6
Harvey Norman	Australia	67.607	31.177	1%	6.342	11%	37%	14%	9,9	1,4	9,2	9,7
Best Buy	United States	493.017	957.818	3%	30.836	-	72%	33%	16,2	6,3	7,6	10,7
JB Hifi	Australia	46.150	95.719	7%	3.515	9%	65%	33%	12,8	2,8	7,3	9,4
Fnac Darty	England	58.220	191.280	12%	4.087	-	79%	15%	17,1	1,9	7,4	7,4
Dixon Carphone	England	62.659	308.153	329%	9.800	-	58%	11%	8,8	0,7	4,5	7,1

Source: Bloomberg at July 23rd 2018

RETAIL SECTOR OVERVIEW

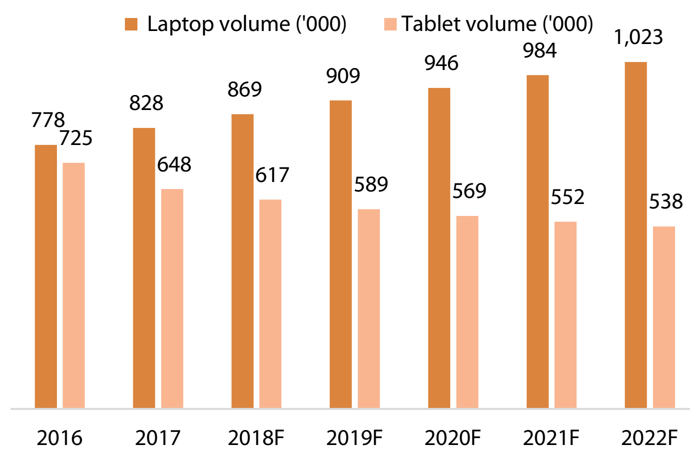
The slowdown of the electronics market

Figure 41: Smartphone market (2016 – 2022)



Source: BMI

Figure 42: Laptop&tablet market (2016 – 2022)



Source: BMI

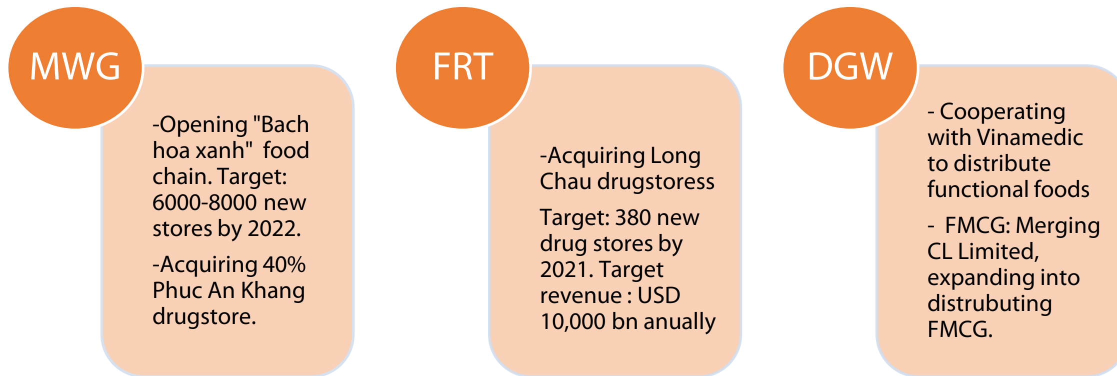
The Vietnam market and the world in general have gone through the explosion demand for smart phones. The development of technology and improvement of the average income were the main catalysts for the "golden" era of the smartphone market. At the present time, smartphones have reached a high level of coverage (80% of the population), and the growth momentum has seen the trend of users switching from feature phones to smartphones. However this is not as strong and exciting as before 2016.

As the result, we consider that the traditional mobile phone and electronics market will slow down in the years to come. At this stage, R&D will play a decisive role to determine the competitiveness of electronics manufacturers. New technologies like Internet of Things (IoTs) will create a new market for smart electronics. For Vietnamese retailers, the growth driver is switching from chain expansion to improving performance, along with applying new retail model like Omni-Channel, offering convenient payment methods and enhancing customer experience.

Xiaomi's IoTs devices

Electronic retailers are expanding into other retail industries

In Vietnam, except electronics retail, most other retail markets are still fragmented and dominated by traditional retailers; also known as Mom-and-pop stores. With the experience of chain management, retailers and distributors such as MWG, FRT or DGW are gradually expanding their businesses to other retail industries. However, new potential markets are not easy to graduate to. Food retailing has low margin and high requirements in terms of inventory management due to the short product lifecycle. Even though the pharmaceutical market has a size of around USD 5 bn, the piece for retailers is just over USD 1 bn, and the level of competition is enormous. We believe that even the large retailers with financial strength and retail experience will have to wait at least two or three years to earn a profit.



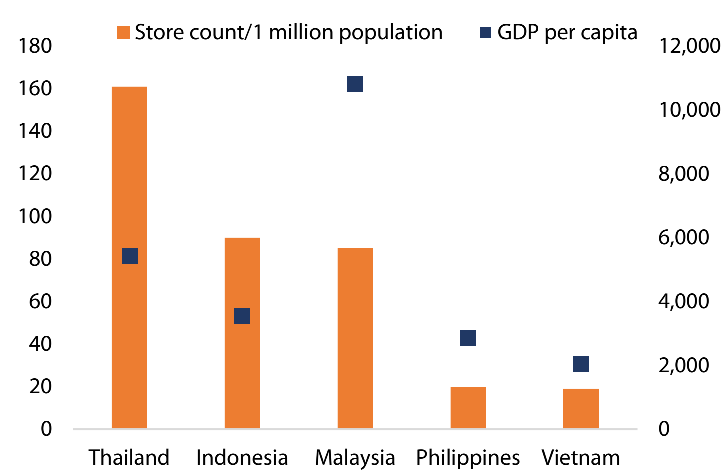
The Vietnam's retail market is witnessing the expansion of modern retailing. According to the Ministry of Industry and Trade, in the 2016-2020 period, the growth rate of retail trade in Vietnam was nearly 12% per year. In 2020, the market size will be about USD 179 bn, of which modern retail will account for over 45% instead of 25% at the moment. Despite the fact that the traditional retail model such as wet markets and small groceries will still be the favourite place for the majority of the population due to their wide coverage and competitive prices, we can see that there is an increasing number of consumers who prefer supermarkets and convenient stores. The modern retail model with high quality of goods and convenient payment is the preferred destination for young people.

Table 6: The shift in consumer behavior

	Convenience stores	Super markets	Traditional groceries	Wet market
<24 years of age	58%	27%	20%	16%
Office workers	36%	26%	20%	21%
Students	23%	11%	6%	4%

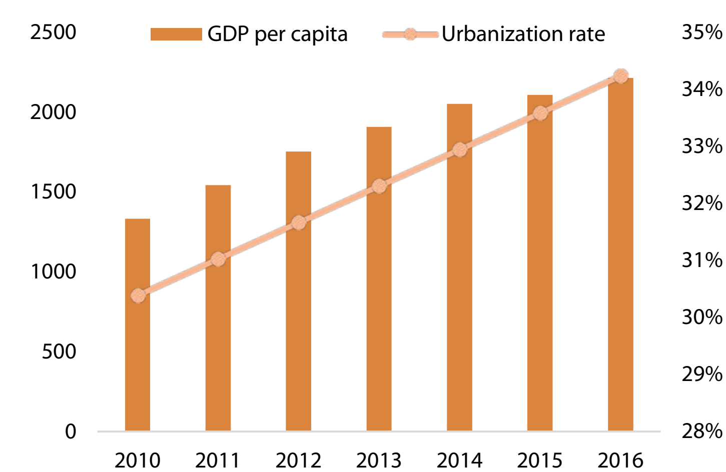
Source: Nielsen, RongViet Securities

Figure 43: The penetration of small and modern stores (2014)



Source: Vietnam Advisors, Rong Viet Securities

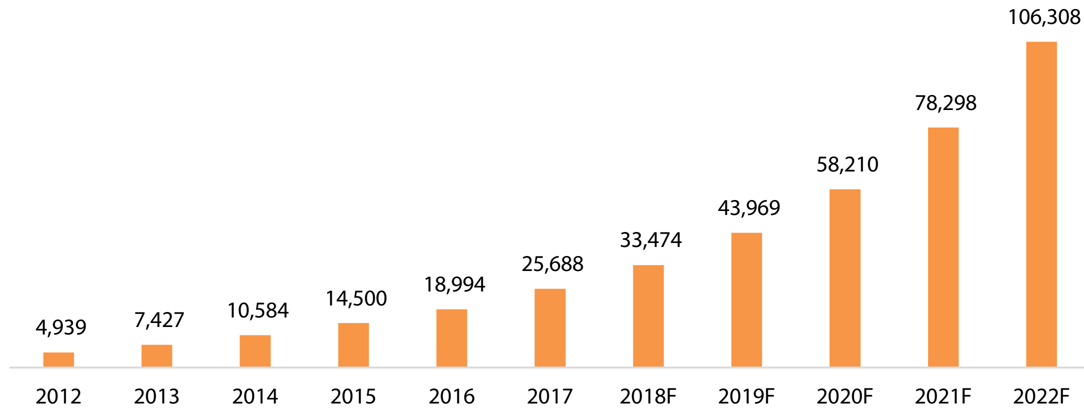
Figure 44: Average income and urbanization rate 2010-2016



Source: World Bank, Rong Viet Securities

E-commerce and multi-channel sales (Omni channel)

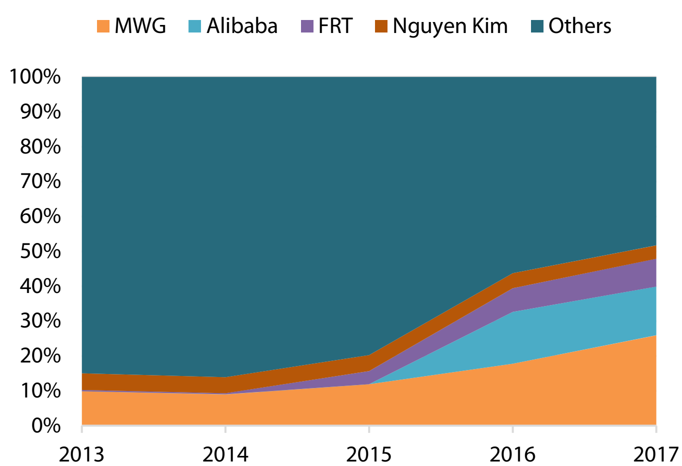
Figure 45: E-commerce in Vietnam (VND bn)



Source: Euromonitor

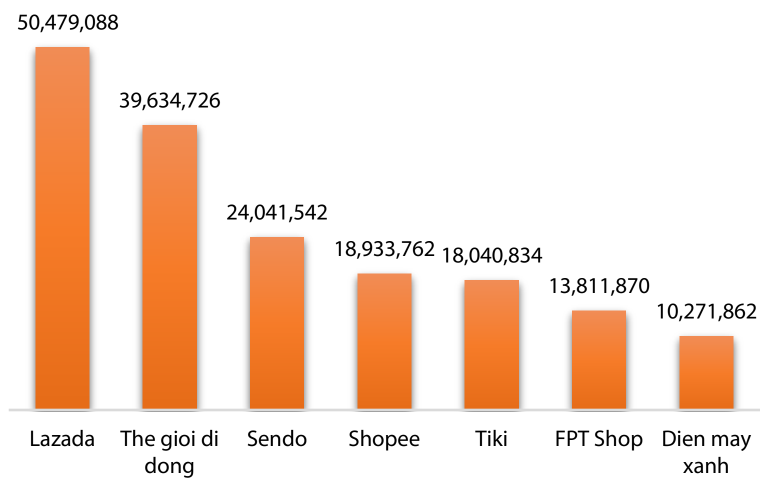
The CAGR of e-commerce in Viet Nam is expected at 33% from 2017 to 2022. Currently, the scale is quite small, only accounting for 2% of the total retail revenue. Consumers are still conservative and purchases through the internet are not important due to concerns about product quality as well as a lack of convenient payment methods. Therefore, mobile phone and electronics retailers such as MWG and FRT are still in a solid position in the e-commerce market due to the high product homogeneity. In 2017, 35% of online retail revenue came from cell phones and tablets.

Figure 46: E-commerce market share in Vietnam



Source: Euromonitor, RongViet Securities collected

Figure 47: Numbers of access to some e-commerce website in Q1 2018



Source: iPrice, RongViet Securities collected

Omni-chanel : According to Nielsen's shopping application report, Viet Nam is second just behind Singapore in terms of total online users . The number of mobile users in Vietnam accounts for 95% of total population, in which there are 79% of users browsing products on mobile applications or websites before purchasing. Therefore, the online channel is considered the main channel to promote and introduce products to customers, which is different from direct marketing. In addition, the brick-and-mortal store system and wide-covered distribution center will be a great advantage of retailers because it enables them to reduce the cost of shipping and delivery time. Therefore, we believe that retailers such as MWG and FRT will continue to be pioneers in multi-channel sales thanks to the extensive network.

Unit: VND billion

PROFIT & LOSS STATEMENT	2016	2017	2018F	2019F
Revenue	10,853	13,147	16,278	20,869
COGS	9,443	11,330	13,974	17,822
Gross profit	1,410	1,816	2,304	3,047
Selling expenses	937	1,154	1,465	1,914
G&A expenses	243	300	374	504
Financial income	75	54	40	29
Financial expense	75	82	65	89
Other income/loss	30	29	29	29
Gain/(loss) from joint	0	0	0	0
Profit Before Tax	259	363	468	597
Tax expense	52	73	94	119
Minority interests	0	0	0	0
Profit After Tax	207	290	375	478
EBIT	230	362	465	628
EBITDA	232	363	470	634

Percentile changes	2016	2017	2018F	2019F
Growth				
Revenue	36.5%	21.1%	29.0%	23.0%
EBITDA	8.3%	56.7%	33.1%	31.1%
EBIT	8.8%	57.4%	32.2%	31.2%
PAT	42.4%	39.7%	31.0%	25.9%
Total assets	79.6%	-17.8%	26.9%	22.3%
Total equity	65.2%	54.6%	73.1%	24.6%
Profitability				
Gross margin	13.0%	13.8%	14.3%	14.6%
EBITDA margin	2.1%	2.8%	2.8%	3.0%
EBIT margin	2.1%	2.8%	2.8%	3.0%
Net margin	1.9%	2.2%	2.2%	2.3%
ROA	4.4%	7.5%	7.7%	8.0%
ROIC	43.9%	44.8%	34.2%	35.9%
ROE	40.3%	36.4%	27.5%	27.8%
Efficiency				
Receivables turnover	12.6	12.9	12.5	11.6
Inventories turnover	4.8	6.6	5.7	5.6
Payables turnover	5.4	6.0	7.0	6.9
Liquidity				
Current	1.1	1.1	1.3	1.3
Quick	0.6	0.6	0.5	0.5
Finance Structure				
Total debt/equity	472.5%	147.3%	105.0%	98.8%
ST debt/equity	472.5%	147.3%	105.0%	98.8%
LT debt/equity	0.0%	0.0%	0.0%	0.0%

Unit: VND billion

BALANCE SHEET	2016	2017	2018F	2019F
Cash and cash equivalents	1,458	638	390	293
Short-term investments	0	0	0	0
Accounts receivable	865	1,016	1,325	1,806
Inventories	1,948	1,723	2,376	3,183
Other current assets (inc. non-trade receivables)	138	131	138	145
Property, plant & equipment	1	5	5	5
Acquired intangible assets (Inc. Goodwill)	1	41	36	31
Long term investments	0	0	0	0
Other non-current assets	300	316	471	549
Total assets	**4,710**	**3,871**	**4,741**	**6,011**
Accounts payable	1,752	1,890	1,956	2,566
Short-term borrowings	2,435	1,173	1,447	1,697
Long-term borrowings	0	0	0	0
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	9	12	20	32
Technology-science development fund	0	0	0	0
Total liabilities	**4,195**	**3,075**	**3,423**	**4,294**
Common stock and APIC (additional paid in capital)	200	400	694	707
Treasury stock (enter as -)	0	0	0	0
Retained earnings / accumulated deficit	315	396	624	1,010
Other comprehensive income / (loss)	0	0	0	0
Investment and Development Fund	0	0	0	0
Total equity	**515**	**796**	**1,318**	**1,717**
Minority Interest	-	-	-	-

CASH FLOW STATEMENT	2016	2017	2018F	2019F
Profit before tax	259	363	468	597
Depreciation	1	1	5	6
Adjustments	37	20	-	-
Change in Working capital	-56	-205	-995	-715
Net Operating CFs	241	179	-522	-112
Change in Fixed Asset	2	-37	-156	-77
Change in Deposit, equity investment	-329	300	-	-
Interest, dividend, cash profit	-	-	-	-
Net Investing CFs	-327	263	-156	-77
Change in Capital	2	200	280	-
Change in Debt	754	-1,262	274	250
Dividend paid & other	-0	-200	-125	-128
Net Financing CFs	755	-1,262	429	122
Beginning cash & equivalents	789	1,458	639	361
Change in cash & equivalents	669	-819	-248	-68
Ending cash & equivalents	1,458	639	390	293

**2018 numbers do not include Long Chau Pharmacy (will be consolidated from 2019 onwards)*

Initial Coverage

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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