Vietnam Fumigation JSC (VFG – HSX)

Stable operation prevails over peers

- **Vietnam pesticide industry: Imported products dominate domestic market**
- **VFG - Stable growth through market expansion**
- **2016-2020 outlook: Gradually reducing low added value segments**

Outlook and Valuation

Being a well-established agrochemical company, VFG owns numerous advantages in terms of experience as well as distribution system that few companies in this industry have. In the situation that Vietnam agriculture is suffering from several difficulties due to unfavorable weather condition, maintaining growth momentum is a notably bright spot compared with other companies while Vietnam pesticide market is dominated by imported goods from China.

In the period of 2016-2017, VFG took a transformation which gradually shifted from segments bringing low added-value work (packaging, distribution) to the stage of bringing higher value (mixing, blending). This is expected to be the main engine of VFG's growth in long term while increasing domestic production and reducing imports from China are long-term orientation of Vietnam agricultural chemical industry.

*For 2016, VFG earnings result is projected to grow by 8% (in revenue) and 4% (in profit) respectively. However, we expect VFG to have a better breakthrough on profitable growth next year with the forecast of 14% yoy. FY16 and FY17 EPS are expected to reach VND7,258 per share and VND8,127 per share, respectively. The intrinsic value of VFG is projected to be **VND112,000 per share**, 27% higher than the closing price on 22nd September 2016. Therefore, we recommend **ACCUMULATION** in the **LONG-TERM** for VFG's stock.*

Key financials

Y/E Dec (VND bn)	FY2015	1H2016	FY2016E	FY2017F
Net Revenues	2,020	1,101	2,182	2,378
% chg	7%	6%	8%	9%
PAT	139	75	145	165
% chg	37.1%	7.8%	3.9%	14.1%
PAT margin (%)	6.9%	6.8%	6.6%	6.9%
ROA (%)	10.7%		10.0%	10.1%
ROE (%)	20.4%		18.9%	19.2%
EPS (VND)*	7,526		7,258	8,127
Adjusted EPS (VND)	6,852		7,119	8,127
Book value (VND)	38,590		41,869	46,996
Cash dividend (VND)	3,000		3,000	3,000
P/E forward (x)	6.4		12.4	10.8
P/B forward (x)	1.3		2.1	1.9

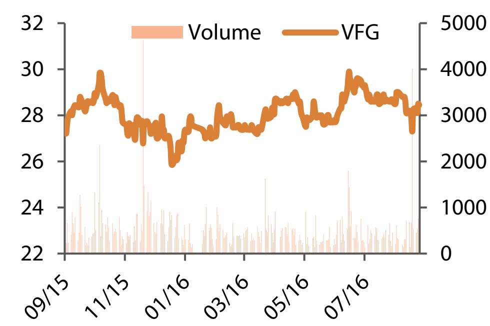
*Sources: VFG, RongViet Research estimated. * Accounted for welfare provision expense (10% of NPAT) and computed based on total share number on September 22nd, 2016.*

ACCUMULATE

CMP (VND)	88,100
Target Price (VND)	112,000
Investment Period	**Long-term**

Stock Info

Sector	Chemicals
Market Cap (VND bn)	1,611
Current Shares O/S	18,283
Beta	-0.29
Free float (%)	77.8
52 weeks High	92,500
52 weeks Low	38,251
Avg. Daily Volume (in 20 sessions)	22,951



Source: Bloomberg

Performance (%)

	3M	1Y	3Y
VFG	21	120	N/a
Chemicals	-5	-4	N/a
VN30 Index	6	15	20
VN Index	7	20	37

Major Shareholders (%)

SSI securities JSC	13.27
SSI Vision Fund	13.04
Foreigner Investor Room (%)	29.1

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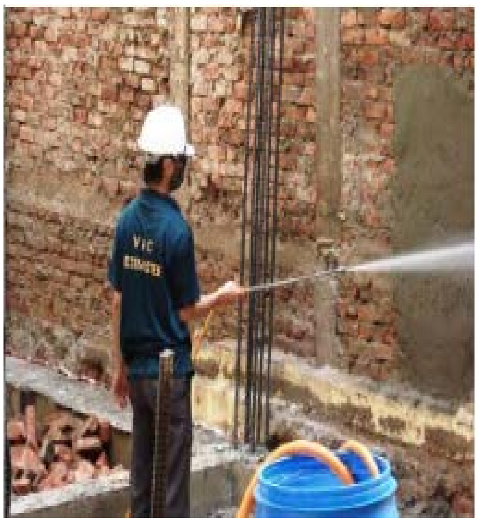
Company overview

Vietnam Fumigation Group **(VFG – HSX)** is the second leading company in Vietnam agro-chemical industry (the first place is Loc Troi Corporation and its previous name was An Giang Plant protection product JSC). The Company has 4 main businesses including Agrochemicals and seeds, Pestman, Fumigation services and Office leasing. In 2001, the company completed the equitization procedure and was officially listed on HOSE in 2009. (Appendix 1: VFG 's equitization process)

Apart from two traditional businesses which are Fumigation service and Pest control, Pesticide is considered as its core business. Owning a wide-spread distribution network, VFG is chosen as a strategic partner by many globally well-known brands such as Syngenta, Kumiai, Sumimoto, Nipon Soda, etc. to distribute their crop sprotection products in Vietnam. In particular, sales from Sygenta accounts for 65% total revenue of this segment. In which, Anvil (fungicide), Karate (insecticide), and Sygnenta genetically modified corn are the most well-known labels.

Figure 1: VFG's products and services

Fumigation services



Insecticide

Fungicide

Pestman

Herbicide

Genetically modified corn

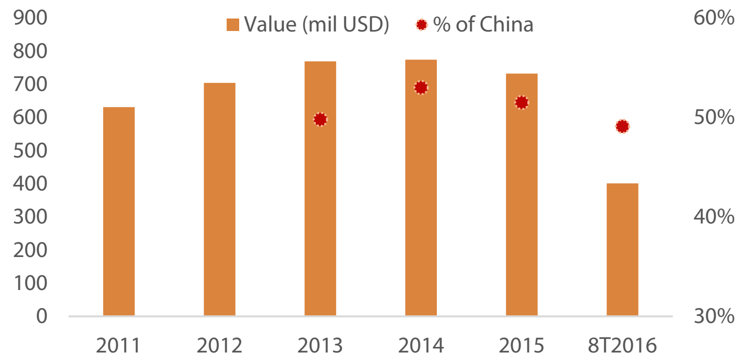
Source: VFG, Syngenta

Vietnam pesticide industry: Imported products dominate domestic market

Among the inputs of agricultural value chain, except domestic fertilizer industry which could basically meet domestic demand, pesticide and seed mainly depend on imports.

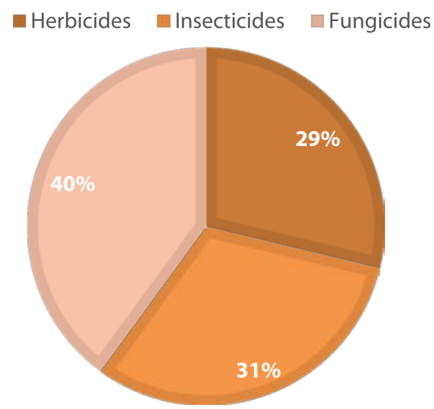
The value of pesticide and related imported materials recorded steady growth rates at high level during 2011-2014 period. Over the last two years, although demand for imported agrochemical products have decreased, that of Chinese products has remained high. In 8M2016, the total imported value of pesticide and imported materials to Vietnam was USD453 million, down 7.3% y-o-y, in which, half was from China.

Figure 2: Vietnam's Pesticide import value



Source: MARD

Figure 3: Vietnam's pesticide import value by type



Source: Plant Protection Department

The value of Vietnam pesticide market was USD800 million in 2015 and is expected to reach 6.8% of CARG annually in 2016-2020 *(Mordor Intelligence)*. There are currently 300 pesticide distributors and producers nationwide, while domestic production capacity is only able to supply about 30,000 to 40,000 tons per year, lower than domestic demand of 165,000 to 170,000 tons per year.

For the whole Vietnam pesticide market, Chinese products account for 40% of total supply and are distributed through many mid and small distributors. The remaining market belongs to foreign firms such as Syngenta (distributed by Loc Troi and VFG), Bayer or local well-established companies (HAI, SPC).

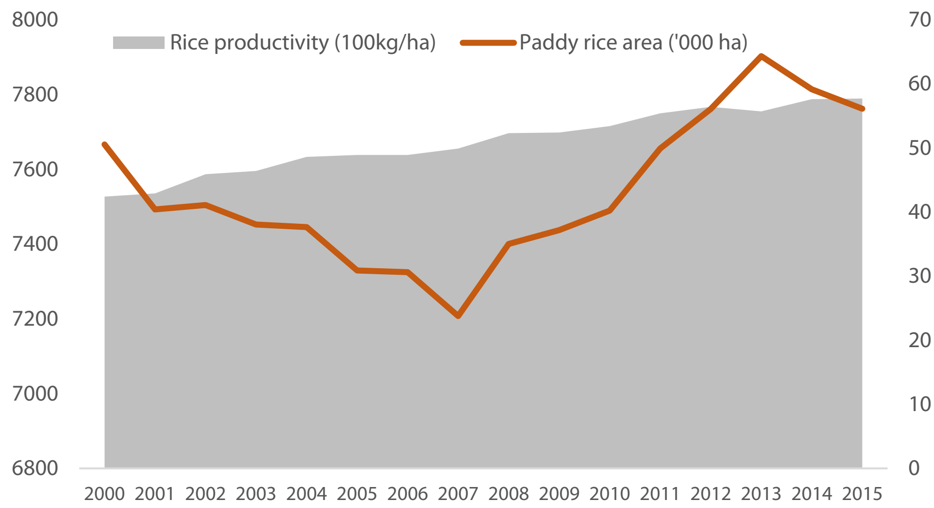
Table 1: Main competitors

No.	Company	Market share (2015)
1	Loc Troi (An Giang Plant Protection JSC)	20%
2	Bayer (Germany)	7-8%
3	VFG	7%
4	H.A.I Agrochem JSC (HAI)	3-4%
5	Saigon Plant Protection (SPC)	3-4%

Source: RongViet Research, VFG

In term of demand, due to harsh weather conditions, the pesticide industry recorded a dip of 8% in 2015 volume. Statistics from Ministry of Agriculture and Rural Development demonstrates that during 7M2016, total cultivated area has decreased by 7% y-o-y due to the impacts of weather and climate changes. Nevertheless, regarding of 2H2016 and 2017 prospects for input demand, the end of drought weather condition would support the recovery of agricultural production in Mekong and Red River Delta.

Figure 4: Vietnam's rice paddy area and productivity (2000-2015)



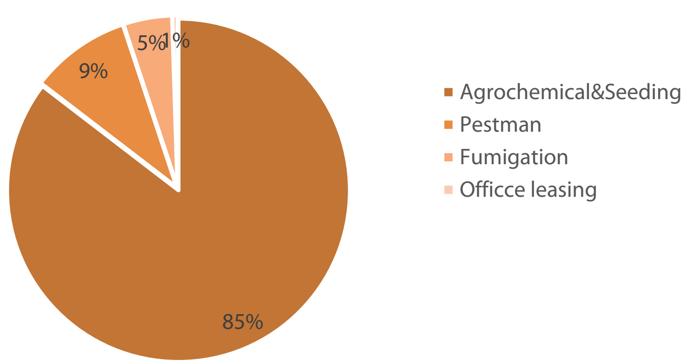
Source: MARD

VFG - Stable growth through market expansion

The Mekong Delta covers an agricultural area of 3.96 million ha and supplies a half of food production for the whole country. Therefore, this area is also a major market for agrochemical companies. Regarding VFG, the Southern market contributed over 75% of total revenue and 79% of total profit. However, this region was also adversely impacted by drought and salinization in 1H2016, which led to a decrease in demand for fertilizer and pesticide.

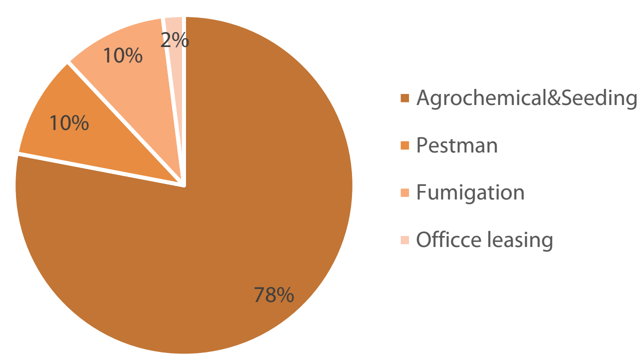
Conversely, VFG's business result is in compliance with 2016 guidance plan. In 1H2016, revenue and NPAT achieved a half of 2016 plan, generating VND 1,157 billion in revenue (+10% yoy) and VND 74.94 billion (+8%) in profit respectively. Facing fierce competition from domestic and Chinese products, VFG could be seen as a remarkable story when it could maintain positive growth momentum.

Figure 5: Revenue by segment



Source: VFG

Figure 6: Profit by segment



Source: VFG

During 2013-2015 period, Loc Troi, which is the key player, experienced a decline in agrochemical sector. At the same time, VFG's revenue in this segment achieved positive improvement **(Table 2)**. SPC, which is well-established pesticide manufacturers and has the same size as VFG, recorded a slow growth over the last few years. Maintaining continuous improvement during industry down-turn could be an evidence that the expansion in market share of VFG resulted from its noticeable advantages.

Table 2: Some listed companies' revenues derived from the agrochemical segment

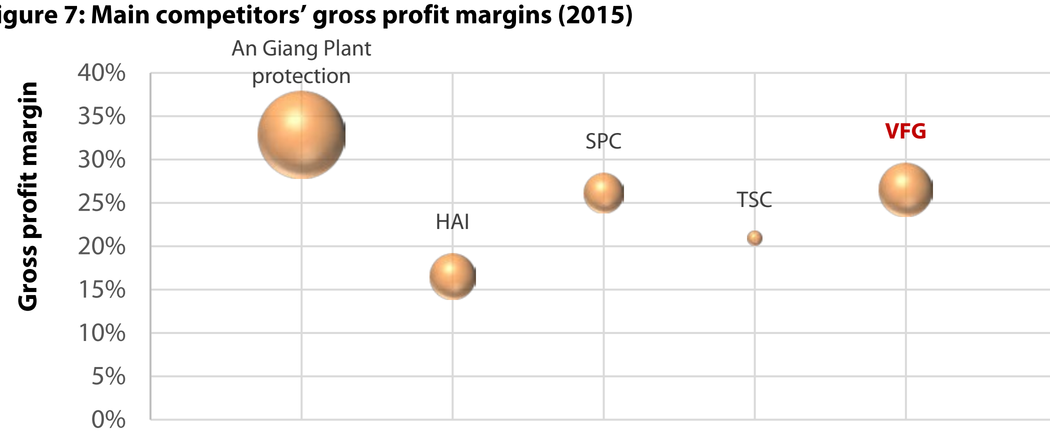
Revenue (Bil VND)	2013	2014	2015
HAI	831	650	995
Loc Troi group	5,499	5,347	4,170
SPC	857	880	872
TSC	93	88	112
VFG	1,190	1,431	1,563
Gross profit margin (%)	**2013**	**2014**	**2015**
HAI	18.6%	17.3%	16.5%
Loc Troi group	33%	31%	33%
SPC	24.0%	24.3%	26.1%
TSC	-4%	26%	21%
VFG	26%	28%	27%

Source: RongViet Research

Firstly, VFG is one of two exclusive distributors for product lines of herbicides, insecticides, fungicides and seeds of Syngenta. In Vietnam, Syngenta is a trusted and long-standing brand and the company owns a factory with the capacity of 16,000 tons/year to manufacture and distribute pesticides and high quality cultivars. While Loc Troi, the distributor of Syngenta along with VFG, shifted into rice-related businesses and has been continuously losing market share, the growth of VFG recently showed that the company has taken the advantage of being a distributor of Syngenta to develop its pesticide distribution segment.

Secondly, with over 20-year of experience in agrochemical industry, VFG has built a wide-spread distribution network from the North to the South and Cambodia. At the present, VFG's sales system consists of 15 branches, 350 employees, 400 agents, 2.500 retailers with 4,500 model farmers. Additionally, the ability to provide credit to agents as well as farmers is also a strength of company operating in the agricultural sector. In comparison with other agricultural chemicals companies, the agricultural chemicals segment’s profit margin of VFG are at the high level (~ 27%), only behind Loc Troi.

Figure 7: Main competitors’ gross profit margins (2015)



Source: RongViet Research

2016-2020 outlook: Gradually reducing low added value segments

Agricultural production is expected to recover in the 2H2016 due to the impacts of La Nina which increase the rainfall in Vietnam (IPSARD) and reduce the adverse effects of drought. It would become a tailwind for pesticide firms including VFG in coming years. In addition, the current consumption trend that moving towards clean products could become a condition for agricultural producers and farmers taking a deeper look into. As a results, they could shift to a safer and more effective use of pesticides. Therefore, VFG would indirectly gain from this trend in long-run through distributing well-known brand names.

According to the Industrial Development strategy with the vision to 2020 - 2030, the Government planned to produce sufficient agricultural products to meet domestic demand and reduce the dependence on China. Put in the whole context that Vietnam agricultural chemicals Industry is trapped at basic works such as distribution, packing and packaging, VFG is one of the pioneers that move up from low added-value segments to self-production. In particular, in April 2016, VFG initiated the construction for agricultural chemical plant in Long An to replace the old factory in Le Anh Xuan Industrial Park. New plant has the total capacity of 9,500 tons/year, three times higher than the old one (capacity: 3,500 tons/year). Total investment is around VND150 billion with 4.5 year payback period.

Table 3: Long An Plant protection's project

Product	Agrochemical products
Location	Long An province
Total invesment cost	VND150 billion
Capacity	9,500 tons/year
Payback period	4.5 years
Starting from April, 2016	Put into operation in Q2/2017

Source: VFG

After a first couple of years putting into operation, the factory is expected to maintain at 50-60% of total designed capacity which helps to increase profit by 10-15% compared to current earnings. In 2016-2020 period, the company aims to achieve a growth rate of 14% in revenue and 20% in profit because of expansion plan to low-income demand. Regarding its targeted growth rates, the ability to penetrate new market is concerned us most at this time. This also heavily depends on the investment strategy for distribution network. Moreover, climate change is another potential risk for VFG's business activities.

Novotel Nha Trang – Expecting earnings consolidation in 2017

Apart from VFG's core activities, investment in Novotel Nha Trang is the remarkable story in VFG's business activities. In 2004, Hai Yen-Ltd (Initial charter capital is VND60 billion) was established, based on the joint-venture between VFG and Fococev Ltd with the ratio of 2:1 to build Novotel Nha Trang. However, due to the conflict of interest after increasing Hai Yen's capital (current charter capital is VND90 billion), Novotel's annual profit since 2008 has not been consolidated into VFG's business results. According to VFG's 2015 financial statement, total investment capital in Hai Yen Ltd is VND180 billion (31/12/2015).

According to VFG, the dispute resolution process since 2013 between VFG and Fococev has made a big improvement in 1H2016. However, both sides still need more time to negotiate the amount that VFG has to spend to acquire Novotel Nha Trang. Under a conservative perspective, we expect that at least into 1H2017, VFG could resolve this dispute.

The most notable investment thesis is the stability of Novotel Nha Trang hotel's business activities. Average annual revenue and NPAT are VND100 billion and VND 34 billion, respectively. Novotel Nha Trang is a 4-star hotel located in the central of Nha Trang City, Khanh Hoa Province. Having many favorable geographical conditions help Nha Trang city attract a lot of tourists each year. In the last 3 years, this coastal city attracts more than 4 million passengers with the growth rate of 15-20%/year. In addition, the average room occupancy rate in Nha Trang – Khanh Hoa hotels maintained at high level ~70% and could have reached 80-85% during peak time (from February to September).

To reinforce the investing rationale in VFG, we conducted an independent valuation based on discounted income approach. With the assumption that Novotel's occupancy rate is 70% and a long-term growth of 2%, Novotel Nha Trang hotel's value is estimated at VND334 billion. Novotel being consolidated is likely to add VND4,000 per share to VFG share value. However, due to the unclear dispute at the Novotel Nha Trang, we do not include the component in the valuation.

In 2016, Novotel Nha Trang planned to achieve VND110 billion in revenue and VND35 billion in PAT respectively. Thus, if the negotiation between VFG and Fococev has stridden, we estimate the consolidated profit of VFG to increase by 25% based on 2015 earnings.

Outlook and valuation

Being a well-established agrochemical company, VFG owns numerous advantages in terms of experience as well as distribution system that few companies in this industry have. In the situation that Vietnam agriculture is suffering from several difficulties due to unfavorable weather condition, maintaining growth momentum is a notably bright spot compared with other companies while Vietnam pesticide market is dominated by imported goods from China. In the period of 2016-2017, VFG took a transformation which gradually shifted from segments bringing low added-value work (packaging, distribution) to the stage of bringing higher value (mixing, blending). This is expected to be the main engine of VFG's growth in long term while increasing domestic production and reducing imports from China are long-term orientation of Vietnam agricultural chemical industry.

For 2016, VFG earnings result is projected to grow by 8% (in revenue) and 4% (in profit) respectively. However, we expect VFG to have a better breakthrough on profitable growth next year with the forecast of 14% yoy. The reasons are changes in revenue structure when the proportion of self-produced goods increases thanks to new crop protection factory in Long An province. The biggest risk for VFG's growth is climate change which will negatively impact sales activities.

FY16 and FY17 EPS are expected to reach VND7,258 per share and VND8,127 per share, respectively. The intrinsic value of VFG is projected to be VND112,000 per share, 27% higher than the closing price on 22nd September 2016. Therefore, we recommend **ACCUMULATION** in the **LONG-TERM** for VFG's stock.

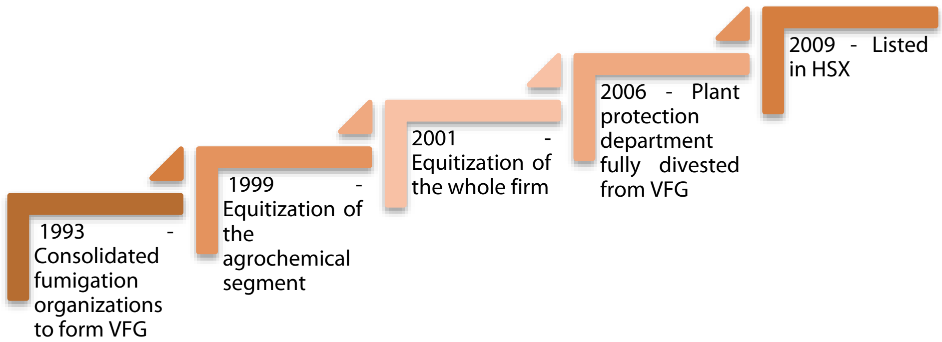
Table 4: Peers' P/E

No.	Company	Country	Market cap (mil USD)	P/E
1	Huikwang Corporation	Taiwan	71	14
2	Hyosung Onb Co Ltd	Korea	78	15
3	Lam Thao Fertilizers And Chemical JSC	Vietnam	80	9
4	Mangalore Chemicals & Fert	India	80	10
5	Excel Industries Ltd	India	59	15
6	Cic Holdings Plc	Sri Lanka	60	7
7	Dongbang Agro Corp	Korea	83	22
8	Pm Thoresen Asia Holdings Pc	Thailand	58	8
9	Southern Petrochemical Inds	India	50	48
10	Nagarjuna Agrichem Ltd	India	50	35
11	Bharat Rasayan Ltd	India	93	18
12	Binh Dien Fertilizer Jsc	Vietnam	89	10
13	Pato Chemical Industry Pcl	Thailand	46	16
	Average			**16.6**

Source: Bloomberg

Appendix

Appendix 1: VFG's equitization process



Source: VFG

Appendix 2: Peer comparison

	VFG	HAI	TSC	VPS
Market capital (bil VND)	**1,454**	999	680	432
ROE %	**20.55**	6.24	3.27	23.77
ROA %	**10.51**	3.82	2.85	14.87
Gross profit margin	**29.73**	13.42	10.23	31.62
Cash liquidity ratio	**0.27**	0.05	0.71	0.26
Days of sales oustanding	**74**	156	36	98
Days of inventory on hand	**104**	275	45	135
Days payables outstanding	**81**	89	27	73
Short-term debt/Total asset	**0.42**	0.35	0.11	0.40
Long-term debt/Total asset	**0.00**	0.01	0.00	0.00

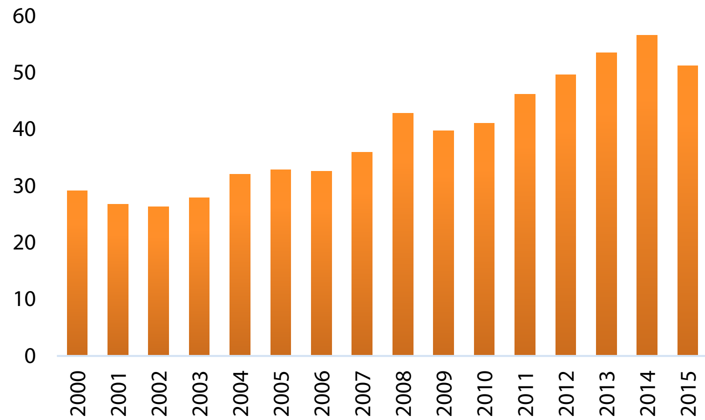
Source: Fiinpro, RongViet Research

Appendix 3: Agrochemical Industry: The Game of Big Players

The Agrochemical industry is a part in the agricultural value chain, which is highly sensitive to economic conditions, climate changes and commodity prices. Recently, land used for agriculture has deteriorated when the rate of urbanization maintains at high level. As a result, to meet the growing demand for food, the conversion from the traditional model to intensive farming is crucial.

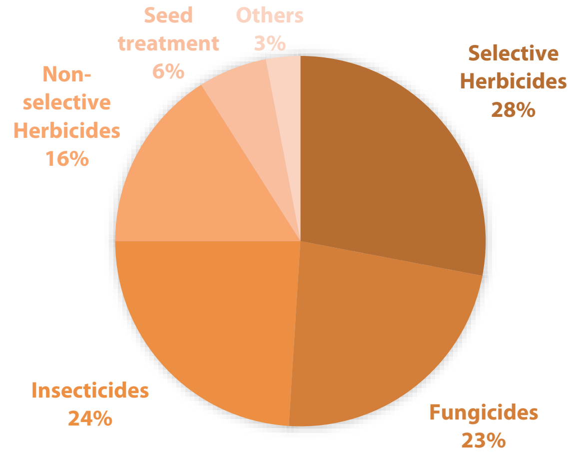
In 2015, value of global pesticides market achieved USD 51.2 billion, down by 10% yoy. This decrease was resulted from the appreciation of US Dollar, low agricultural commodity prices and weak demand due to El Nino effect. According to Syngenta, the demand for agrochemical focuses on Herbicides (44%), following by Fungicides (23%), Insecticides (24%), Seed treatment (6%)…

Figure 8: Global value market for pesticides (Unit:USD billion)



Source: Syngenta

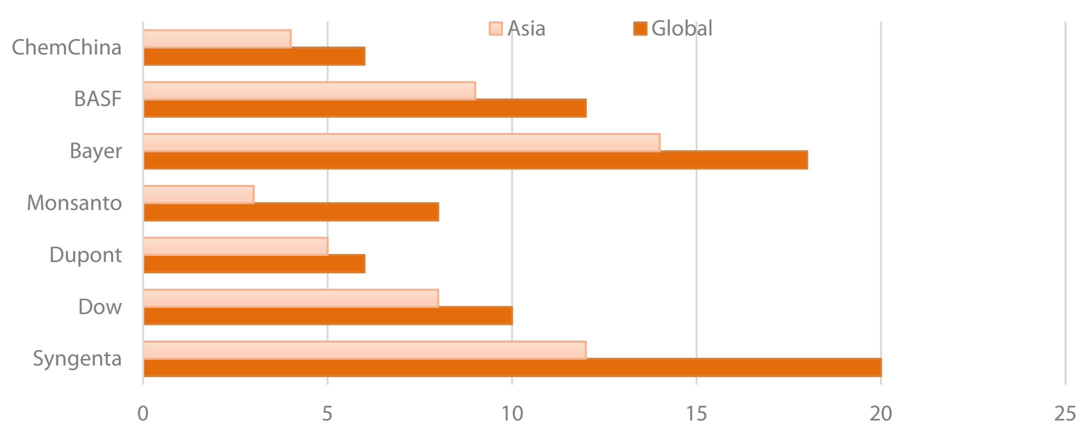
Figure 9: Product category breakdown



Source: Syngenta

In addition, because global agrochemical market is in the hands of several large players such as Syngenta (Switzerland), Dow (China), Dupont (USA), Bayer (Germany)…, those companies possess greater pricing power. Along with the development of technology and growing demand of clean & safe products, there are more and more new agrochemical products with advanced technology, increasing effectiveness, lesser doses and higher safety. The combination of those factors has gradually increased the price of agrochemical products in the last few years.

Figure 10: Top agrochemical companies in the world and their market shares



Source: JP Morgan

According to Market Research, value of global pesticides industry was estimated at USD 58.4 billion in 2015. Its CARG growth in 2016-2021 period is expected to be 5.15%/year and could achieve USD 70.57 billion in 2021. In which, Asia region would experience the highest growth rates (average 7.13% per year) and will be the major targeted market of the global leading agrochemical groups.

VND Billion

INCOME STATEMENT	2014	2015	2016F	2017F
Revenue	1,883	2,020	2,182	2,378
COGS	1,331	1,488	1,598	1,728
Gross profit	**552**	**532**	**584**	**649**
Selling Expense	330	295	349	386
G&A Expense	83	58	55	59
Finance Income	13	18	5	2
Finance Expense	0	17	5	7
Other profits	-4	0	0	0
PBT	**148**	**180**	**181**	**199**
Prov. of Tax	46	41	36	34
Minority's Interest	0	0	0	0
PAT to Equity Shareholder	**101**	**139**	**145**	**165**
EBIT	139	179	180	204
EBITDA	139	179	209	231

FINANCIAL RATIO (%)	2014	2015	2016F	2017F
Growth				
Revenue	15.6	7.3	8.0	9.0
EBITDA	7.8	28.4	17.0	10.8
EBIT	7.8	28.4	1.0	12.8
PAT	52.0	37.1	3.9	14.1
Total Assets	11.9	0.5	11.4	13.2
Equity	8.6	25.8	12.2	12.2
Profitability				
Gross profit/Revenue	29.3	26.3	26.8	27.3
EBITDA/ Revenue	7.4	8.8	9.6	9.7
EBIT/ Revenue	7.4	8.8	8.3	8.6
Net margin	5.4	6.9	6.6	6.9
ROAA	7.9	10.7	10.0	10.1
ROIC or RONA	20.8	23.9	21.0	20.3
ROAE	18.7	20.4	18.9	19.2
Efficiency				
Receivable Turnover	4.8	5.9	4.8	4.8
Inventory Turnover	3.7	3.3	3.7	3.7
Payable Turnover	2.1	2.7	2.7	2.7
Liquidity				
Current	1.5	1.7	1.7	1.6
Quick	0.9	0.9	0.9	0.8
Solvency				
Total Debt/Equity	0.0	0.0	5.2	8.1
Current Debt/Equity	0.0	0.0	0.0	0.0
Long-term Debt/ Equity	0.0	0.0	5.2	8.1

VND Billion

BALANCE SHEET	2014	2015	2016F	2017F
Cash and equivalents	193	168	121	112
Short-term investment	0	0	0	0
Receivables	389	340	457	498
Inventories	364	446	434	470
Other current assets	6	4	4	4
Tangible Fixed Assets	75	78	167	297
Intangible Fixed Assets	63	62	61	54
Other long-term assets	6	4	4	5
Long-term Asset	**1,290**	**1,296**	**1,443**	**1,634**
Payables	622	550	585	633
Other current liabilities	0	0	0	0
Current Debt	0	0	40	70
Long-term Debt	18	0	14	31
Other long-term liabilities	0	0	0	0
Total Liability	**677**	**586**	**678**	**774**
Owner's Equity	133	177	183	183
Capital	-1	-1	-1	-1
Retained Earnings	136	249	304	373
Other comprehensive income	28	26	26	26
Investment/Development fund	247	232	253	278
Total equity	**542**	**682**	**760**	**859**
Minority's Interest	0	0	0	0
TOTAL RESOURCES	**1,290**	**1,296**	**1,433**	**1,634**

CASH FLOW STATEMENT	2014	2015	2016F	2017F
Profit before tax	148	180	181	199
-Depreciation	14	11	29	28
-Adjustments	(162)	(191)	-	-
+/- Working capital	138	6	(107)	(63)
Net Operating CFs	**138**	**6**	**102**	**164**
+/- Fixed Asset	(8)	(13)	(0)	(0)
+/- Deposit, equity investment	31	99	-	-
Interest, dividend, cash profit	-	-	-	-
Net Investing CFs	**23**	**87**	**(0)**	**(0)**
+/- Capital	-	44	-	-
+/- Debt	(81)	-	(40)	(30)
Dividend paid & other	(34)	(81)	(109)	(143)
Net Financing CFs	**(115)**	**(38)**	**(149)**	**(173)**
+/- cash & equivalents				
Beginning cash & equivalents	**147**	**113**	**168**	**121**
+/- cash & equivalents	46	55	(47)	(9)
Ending cash & equivalents	**194**	**168**	**121**	**112**

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

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