September, 2017

PetroVietnam Fertilizer and Chemicals (HSX:DPM)

2019 – The Turning Point

Particulars (VND B)	Q2-FY17	Q1-FY17	+/- QoQ	Q2-FY16	+/- YoY
Net revenue	2,372	1,978	20%	2,433	-2%
PAT	231	223	3%	379	-39%
EBIT	253	242	5%	404	-37%
EBIT margin	10.7%	12.2%	-157bps	16.6%	-594bps

Source: DPM, RongViet Research

H1 2017 performance: the bottom line was poor but in line with DPM's guidelines

PetroVietnam Fertilizer and Chemicals (HSX:DPM) continued to see headwind in the first half of 2017. In Q1, although urea prices surged by 7% YoY following the global urea movements, DPM's selling volume fell by 15% YoY due to the highly competitive business environment. In Q2, the operation picture became brighter as DPM's selling volume expanded by 3% YoY, but the price edged down 0.5% at the same time. Overall, with sales of VND4,350B (-1,7% YoY) and PAT of VND463B (-42.1% YoY), DPM has been experiencing a tough year, but it had anticipated these results in its beginning 2017 guidelines.

Q3 2017 outlook: still in tough times

Domestic urea prices kept declining in July and August, along with serious flood hitting the agricultural activity, leaving us to believe that there will be no surprise in DPM's Q3 results. We project the company's revenue and PAT to be VND1,832B (+0% YoY) and VND186B (-9%YoY), respectively.

For the whole year of 2017, we expect DPM to report sales of VND8,106B (+2.3% YoY) and PAT of VND827B (-28% YoY), adjusted down based on our previous report (in which we forecasted DPM could generate VND9,226B revenue and VND1,197B PAT).

Valuation and recommendation:

Considering the highly competitive environment in the urea fertilizer industry, we do not expect strong growth in DPM's urea operation until the end of 2018. However, the picture may become more promising from 2019, considering that Dam Ca Mau (HSX:DCM), who is the main rival of DPM, will no longer enjoy the natural gas price subsidies; there is high possibility that DPM will benefit from VAT refund, and the NH3-NPK project will start to generate profit. We forecast that DPM will report 9% sales growth and 60% PAT growth for 2019.

We believe that the downside risk for investors who are holding DPM shares is not significant in view of the stock's 8.7% dividend yield. We also expect DPM to maintain a cash dividend of VND2,000/share for the next 3 years on the assumptions that DPM will not develop new projects and urea operation will remain stable.

*We evaluate DPM price at **VND22,400/share**. This target price, coupled with a **VND2,000 cash dividend**, yields a total return of **7,3%** (calculated based on the closing price on 29 September 2017.Therefore, we recommend **NEUTRAL** rating. This target price is revised in relation to our Strategy Report published in March 2017 after updating our forecast upon reconsidering the higher competitive environment in the upcoming years.*

NEUTRAL

CMP (VND)	22,750
Target price (VND)	22,400
Cash dividend (VND)*	2,000

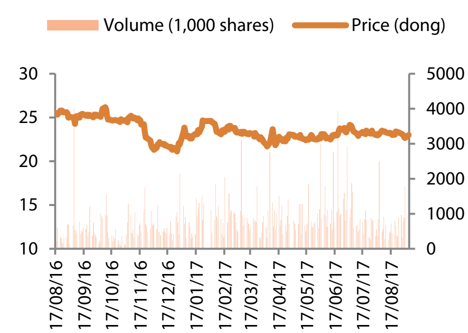
** Expected in the next 12 months*

Stock info

Sector	Chemicals
Market cap (VND B)	9,000.6
Current shares O/S	391,334,260
Beta	0.27
Free float (%)	35.4
52-week high	26,578
52-week low	21,119
Avg. daily volume (20 sessions)	1,025.4

	FY2016	Current
EPS	2,449	1,767
EPS growth (%)	-26.4	-47.1
Adjusted EPS	2,449	1,747
P/E	7.8	13.0
P/B	1.1	1.1
EV/EBITDA	3.5	6.7
Cash dividend	3,000	3,000
ROE (%)	13,7	10,0%

Price performance



Major shareholders (%)

Vietnam Oil and Gas Corporation	59.59
Foreign ownership room (%)	27.81

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Exhibit 1: Q2 2017 results

Particulars (VND B)	Q2-FY17	Q1-FY17	+/- (QoQ)	Q2-FY16	+/- (YoY)	H1-FY17	+/-(YoY)
Net revenue	2,372	1,978	19.9%	2,433	-2.5%	4,350	-2%
Gross profit	612	589	3.8%	739	-17.3%	1,201	-21%
SG&A	65	39	68.4%	101	-35.4%	104	7%
Operating income	546	550	-0.8%	638	-14.4%	1,096	-42%
EBITDA	300	288	4.1%	471	-36.4%	588	-41%
EBIT	253	242	4.5%	404	-37.4%	495	-43%
Financial expenses	6	0	N/A	(4)	-249.7%	7	-37%
- Interest Expenses	-	-		-		-	
Dep. and amortization	47	46	1.7%	67	-30.0%	93	-28%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	288	276	4.2%	485	-40.7%	564	-42%
PAT	231	223	3.5%	379	-39.1%	454	-42%
(*) Adjusted PAT	231	223	3.5%	379	-39.1%	454	-42%

Source: DPM, RongViet Research

Exhibit 2: Q2 2017 performance analysis

Particulars	Q2-FY17	Q1-FY17	+/- (QoQ)	Q2-FY16	+/- (YoY)
Profitability ratios (%)					
Gross margin	25.8%	29.8%	-401bps	30.4%	-461bps
EBITDA margin	12.6%	14.6%	-193bps	19.4%	-672bps
EBIT margin	10.7%	12.2%	-157bps	16.6%	-594bps
Net margin	9.7%	11.3%	-155bps	15.6%	-585bps
Adjusted net margin	9.7%	11.3%	-155bps	15.6%	-585bps
Turnover *(x)					
-Inventories	5	5	0.0	6	-0.8
-Receivables	18.4	16.0	2.5	11.8	6.6
-Payables	8	7	1.0	8	-0.2
Leverage (%)					
Total debt/ equity	17.6%	13.7%	390bps	14.3%	326bps

Source: DPM, (*) Annualized turnover

Exhibit 3: Q3 2017 performance forecast

Particulars (VND B)	Q3/2017	+/- QoQ	+/- YoY
Revenue	1,832	-23%	0%
Gross profit	447	-27%	-9%
EBIT	190	-25%	-3%
NPAT	186	-20%	-9%

Source: DPM, RongViet Research

Updates

DPM is contending with competitive pressure from domestic manufacturers

Heavy rain in 2017 brings advantage to agricultural operations as well as boosts the fertilizer demand. This brightened the picture of the urea industry in the first half of 2017 as total consumption in 6M 2017 increased over 16% compared to the same period last year. However, not all firms recorded positive performance.

Table 1: urea consumption in 6M 2017

6M 2017	DPM	DCM	Imported urea	Other manufacturers
Consumption (million tons)	438	474	231	289
Growth rate (%)	-5%	+17%	-8%	+74%

Source: RongViet Research compiled

According to our estimate, DPM's market share dropped from 31% (2016) to 29% (6M 2017). Overall, DPM is facing difficulty in the highly competitive business environment.

We expect urea prices to experience a recovery for the rest of 2017

In Q1 2017, urea prices recovered on the back of reduced supply, as many Chinese producers have to close business because their selling prices were below their operating costs. Domestic urea prices, which have a high correlation with global urea prices, increased 15.5% at the same time, compared with the prices at the end of 2016. However, global urea prices quickly fell in Q3 and Q4 and slid back to its 2-year lowest level in August, which again put high pressure on the urea producers. This is the main reason leading us to believe that urea prices could experience a recovery in the last quarter.

In fact, the urea global market began to signal recovery in August. Up to now, the price of US Gulf Coast urea grew more than 17% compared to the end of July while Black Sea urea prices also rose 7% in that period. As for the domestic market, Indonesia urea prices and Malaysia urea prices rose 10.3% and 12.5%, respectively, while Phu My urea and Ca Mau urea also saw an increase of 9% in their selling prices, compared to the beginning of August.

Based on the above price forecast, we expect DPM to have better results in Q4. We estimate the company could produce a 14% sales growth and 18% PAT growth in the last quarter.

DPM could benefit both directly and indirectly from the forthcoming policy changes

Since August 19, fertilizers such as DAP, MAP imported from many countries have been applied the temporary safeguard tariff which is VND1,885,790 per ton. This is the main reason explaining the 15% to 20% price increase in these fertilizers in August. Based on the fact that farmers can replace DAP by mixing urea and phosphate in an appropriate proportion, we believe that demand for urea may thus improve.

Also in August, the Ministry of Finance has published some information relating to a draft on VAT amendment, under which fertilizer is proposed to bear 5% or 10% VAT, instead of the current non-VAT condition; the Ministry of Finance prefer the 5% VAT. We expect the VAT amendment to be effective at the beginning of 2019. According to our estimates based on DPM's 2016 material expenses and selling prices, the company could save VND260B-VND270B per year if this policy is adopted.

We also expect DPM could gain more market share on the back of the VAT amendment implementation. Owing to low gross profit margin (~5%), there is a high possibility that urea importers will increase their prices to pass through the major part of the VAT to customers. At the other end of the spectrum, the benefit from the VAT refund could help DPM maintain its selling prices to win more customers.

DPM expects the NH3-NPK to start operation from Q2 2018

In the context of urea market, which is running out of growth opportunities, NPK will become the new growth driver for DPM. We are optimistic about the new NPK product prospects, based on the following observations:

There is a potential room for DPM to develop its NPK fertilizer product. According to our research, we found that: consumers are likely to shift from using NPK, which has poor nutrients, into higher quality NPK. In fact, most of the upcoming NPK projects that we know use modern technology. Based on the demand for high-quality NPK that is around one-tenth of the total demand (400,000 tons) and could increase in the future, we are optimistic about the prospects for NPK fertilizer products.

Phu My brand is also an advantage for DPM. Currently, DPM imports and provides 90,000–100,000 tons of NPK fertilizer per year under the brand "NPK Phu My". Therefore, DPM can take advantage of available market share to continue to develop self-produced products.

Even so, we expect this project to record losses for the year 2018. As for the NH3 plant, we believe the plant will manufacture 30,000–40,000 tons (equivalent to one-third of its capacity), which is just sufficient for the NPK manufacturing operation; DPM will need time to find new customers. Therefore, we believe DPM's NH3 segment will not record any impressive results in 2018.

As for the NPK project, DPM plans to operate at 90% of capacity for the year 2018, equivalent to 250,000 tons of NPK fertilizer. Assuming that DPM can sell 200,000 tons, we estimate that the NH3-NPK project will lose VND110B.

Starting from 2019, assuming that the NPK plant and the NH3 plant will operate at 100% and 70% capacity, respectively, the project will begin making profits.

However, in the case that DPM will operate its NH3 plant at 70% of capacity in 2018, which means it could sell more 40,000 tons of NH3, we estimate that the NH3-NPK project could produce positive earnings in 2018.

Table 2: NH3-NPK project information

	NH3	NPK
Total capital (USD M)	130	95
Capacity (tons/year)	9,.000	250,000
Borrowings proportion	40%	
Interest rate	12-month term lending rate + 2,5% for VND loans or 6 month term Libor +2,5% for USD loans	
Expected starting date	Q2 2018	

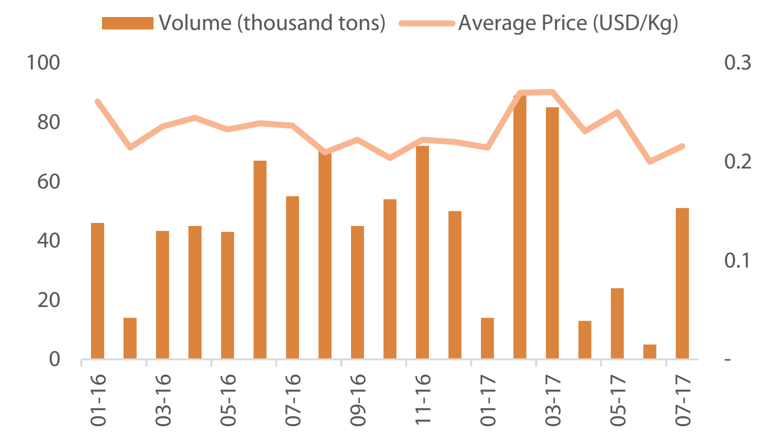
Source: DPM

Table 3: NH3-NPK project's operating results projection

Unit: VND B	2018	2019	2020	2021
Revenue	2,731	3,294	3,480	3,667
Gross profit	247	637	744	853
EBIT	55	176	257	339
PAT	(111)	30	131	210

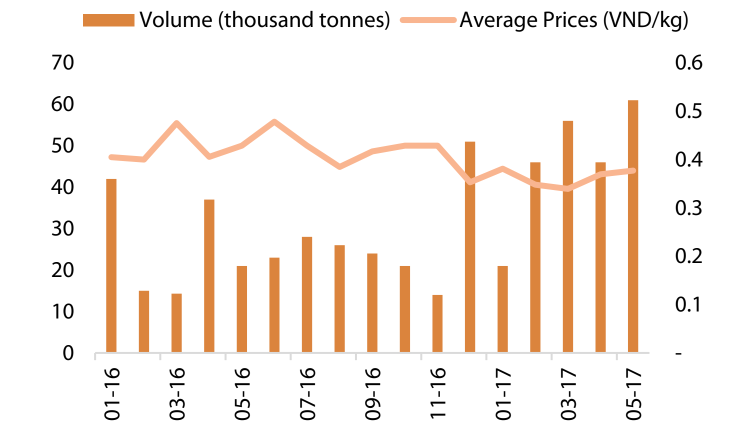
Source: RongViet Research

Imported urea volume and price



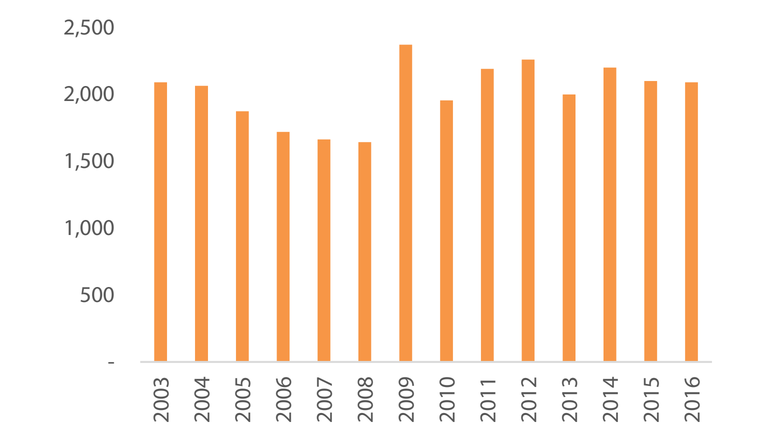
Source: Vietnam Customes, RongViet Research

Imported NPK volume and price



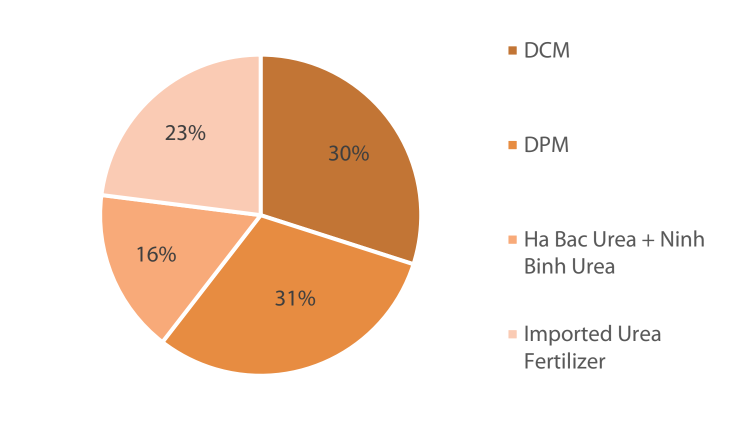
Source: Vietnam Customes, RongViet Research

Domestic urea consumption from 2003 to 2016 (thousand tons)



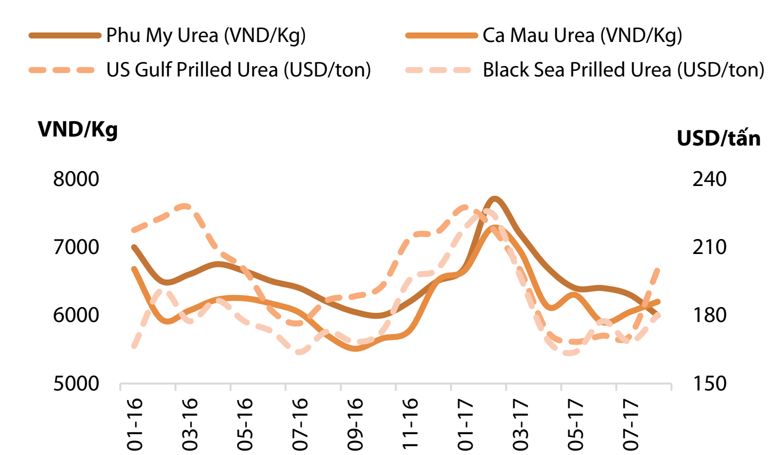
Source: DPM, AgroMonitor, RongViet Research

Urea consumption breakdown by producers



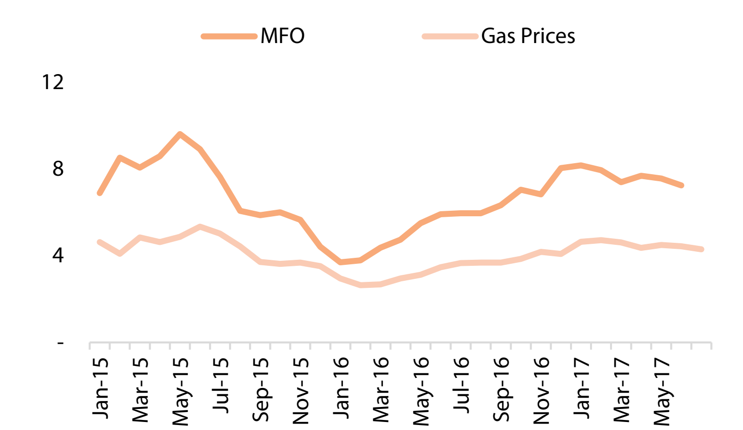
Source: RongViet Ressearch Compiled

Global and domestic urea prices



Source: Bloomberg, RongViet Research compiled

Natural gas input and FO prices (USD/MMBTU)



Source: DPM, Bloomberg, RongViet Research compiled

VND B

INCOME STATEMENT	FY2015	FY2016	FY2017E	FY2018F
Revenue	9,765	7,925	8,106	10,603
COGS	6,612	5,529	5,958	8,235
Gross profit	3,153	2,396	2,148	2,368
Selling expense	751	735	730	848
G&A expense	597	499	486	636
Finance income	257	234	175	183
Finance expense	7	14	98	177
Other profits	25	8	8	-92
PBT	-198	4	4	5
Prov. of tax	1,880	1,393	1,021	803
Minority's interest	358	242	194	153
PAT to equity S/H	34	24	24	24
EBIT	1,488	1,128	803	626
EBITDA	1,804	1,161	932	884

%

FINANCIAL RATIO	FY2015	FY2016	FY2017E	FY2018F
Growth				
Revenue	2.3%	-18.8%	2.3%	30.8%
Operating income	45.3%	-31.9%	-14.0%	36.9%
EBITDA	56.1%	-35.7%	-19.7%	-5.1%
PAT	35.8%	-24.2%	-28.8%	-22.0%
Total assets	4.5%	-7.2%	21.2%	1.4%
Equity	-4.9%	-3.8%	-1.3%	-3.2%
Profitability				
Gross margin	32.3%	30.2%	26.5%	22.3%
EBITDA margin	21.2%	17.8%	14.9%	15.6%
EBIT margin	18.5%	14.7%	11.5%	8.3%
Net margin	15.2%	14.2%	9.9%	5.9%
ROA	14.4%	11.8%	6.9%	5.3%
ROE	21.1%	13.7%	9.1%	8.9%
Efficiency				
Receivable turnover	11.9	15.5	16.7	16.7
Inventory turnover	4.8	6.0	5.0	5.0
Payable turnover	3.8	5.0	4.5	4.5
Liquidity				
Current	4.7	5.2	3.3	2.9
Solvency				
Total debt/equity	2.8%	0.0%	22.8%	21.1%
Current debt/equity	0.0%	0.0%	0.6%	0.8%
Long-term debt/equity	2.8%	0.0%	22.2%	20.3%

VND B

BALANCE SHEET	FY2015	FY2016	FY2017E	FY2018F
Cash and cash equivalents	5,690	4,099	2,542	2,843
Short-term investments	81	55	55	55
Accounts receivable	821	512	486	636
Inventories	1,365	923	1,192	1,647
Other current assets	125	227	238	250
Property, plant & equipment	1,777	2,697	6,025	5,258
Acquired intangible assets	903	845	838	831
Long-term investments	47	45	50	54
Other non-current assets	110	165	173	182
Total assets	**10,919**	**9,569**	**11,599**	**11,756**
Accounts payable	1,734	1,113	1,311	1,812
Short-term borrowings	2	0	48	58
Long-term borrowings	230	0	1,760	1,560
Other non-current liabilities	252	148	156	163
Bonus and welfare fund	99	46	167	261
Technology-science, dev. fund	54	45	45	45
Total liabilities	**2,372**	**1,353**	**3,487**	**3,899**
Common stock and APIC	3,821	3,935	3,935	3,935
Treasury stock (enter as -)	-2	-2	-2	-2
Retained earnings	1,038	612	508	253
Other comprehensive income	0	0	0	0
Inv. and dev. fund	3,499	3,497	3,497	3,497
Total equity	**8,356**	**8,042**	**7,938**	**7,683**
Minority Interest	**192**	**174**	**174**	**174**

VALUATION RATIO	FY2015	FY2016	FY2017E	FY2018F
EPS (dong)	3,329	2,449	1,744	1,360
P/E (x)	6.5	7.8	14.0	17.9
BV (dong)	21,988	20,547	20,280	19,630
P/B (x)	1.1	1.1	1.2	1.2
DPS (dong/cp)	4,000	3,000	2,000	2,000
Dividend yield (%)	13.7	13.4	8.7	8.7

VALUATION MODEL	Price	Weight	Average
FCFF	27,428	50%	13,714
PE	17,445	50%	8,722
Target price (dong)			**22,436**

VALUATION HISTORY	Price	Recommendation	Period
15/03/2017	25,000	Neutral	Long term

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

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