PETROVIETNAM FERTILIZER & CHEMICAL CORP (DPM)

Current Price	Target Price	Dividend Yield	Recommendation	Sector
VND23,300	VND25,600	8.6%	HOLD	BASIC MATERIALS

Outlook – Short term	Outlook – Long term	Valuation
Negative Neutral Positive	Negative Neutral Positive	Negative Neutral Positive

05 May 2017
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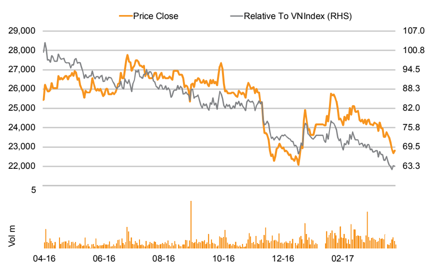
Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	27,749
52w low (VND)	22,050
Average daily turnover (3m)	935,182
Market cap (VND) billion	9,668
Outstanding shares (m)	391
Free float (%)	20
Beta	0.64

Ownership

Major shareholders	%
PetroVietnam	59.6
Deutsche Bank AG London	3.1
VanEck Vector Vietnam ETF	2.3
Norges Bank	1.8
GIC	1.8

Source: VNDIRECT

A leading manufacturer of urea in VN with solid market share of 35-40%, yet DPM recorded poor business performance since 2012 due to a sharp decline in selling prices and the impact of the Law 71 banishing the input VAT deduction. In 2017, we expect an improvement in the company's results thanks to the mild recovery in demand and output prices, however the effect would not be large enough. Therefore, potential upside mostly depends the possibiliy of promulgation of supporting policies for the industry.

1Q2017 business results fell despite an increase in urea selling prices. Total revenue was estimated at VND2.058trl (+2.2% YoY) and EBT at VND270bn (-45% YoY), mainly due to the strong increase in gas input prices of 60% YoY and the decrease in urea consumption of 14% YoY.

Future gross margin would be depressed by the disproportionate increase in input costs and average selling prices (ASP). We forecast 2017 revenue at VND8.524trl (+8% YoY) and EBT at VND1.273trl (-9% YoY), leading to an EPS of VND2,665/share (-9% YoY). Adjusted EPS for bonus and welfare fund (15%) is estimated at VND2,265/share.

NH_3-NPK expansion project needs time to prove efficiency. This project involves the construction of 250,000-ton NPK factory and the upgrade of 90,000 tons NH_3 p.a., which will not yield products until 2018. We estimated this project to add VND1.2-2trl to revenue and VND150-300bn to EAT starting from 2018.

Potential upside comes from the government's possible supporting policies. In the 2017 AGM, the Board of Directors states that the likelihood of the change in VAT law is high, however, it is the tax rate that is still undecided. We estimate that in the case of a change in VAT tax policy, DPM's gross margin could improve by 3-4% at the tax rate of 0%, and 2-3% at the tax rate of 2%.

Valuation: We set the target price for DPM at VND25,600/share using the DCF model, translating to a 2017 fw P/E of 9x. We initiate a HOLD recommendation as we expect a mild improvement in the company's performance, yet not big enough to bring about a significant change in the core business activities. DPM also has a history of stable cash dividend payment (20-30%/par value). Potential upside mostly depends on possibility of implementation of supporting policies for the industry.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Revenue (bn)	9,765	7,925	8,524	9,244
Revenue growth	2.3%	(18.8%)	7.6%	8.4%
Gross margin	32.3%	30.2%	27.7%	27.7%
Operating EBITDA (bn)	2,069	1,403	1,454	1,593
Net profit (bn)	1,488	1,141	1,043	1,120
Net profit growth	35.8%	(23.3%)	(8.6%)	7.4%
EPS	3,917	2,929	2,665	2,862
BVPS	21,988	20,581	21,245	22,107
ROAE	17.4%	13.9%	12.7%	13.2%

COMPANY PROFILE

Established in 2003 to manage the Phu My Fertilizer Plant, PetroVietnam Fertilizer and Chemicals Corporation has quickly become the leading manufacturer of urea fertilizer in Vietnam. The firm's core business activities involve the production and trading of fertilizers and other chemicals with the key products such as prilled urea, NPK, MOP, SA, DAP fertilizers, liquid ammonia (NH_3) and UFC85/Formaldehyde (since 2016).

In 2007, the company was equitized and became a joint stock company with the chartered capital of VND3.8trl, and later listed on the Ho Chi Minh Stock Exchange under the ticker DPM.

As of Nov 30, 2016, DPM's largest shareholder is the state-owned PetroVietnam Oil and Gas Group (PVN) with 59.59% stake, followed by foreign institutional shareholders each holding less than 5% stake such as Deutsche Bank, Market Vector VN ETF, Norges Bank, etc., which accounts for a total of 24.35% of ownership. With this concentrated structure, it is obvious DPM has limited control over the company's operation as the parent company PVN and the government have significant influence on the DPM's primary business decisions.

By the end of 2016, the company has 4 subsidiaries and 3 affiliates as listed below. The subsidiaries, located in 4 main regions of Vietnam, are in charge of distributing Phu My fertilizers across the country, which we consider an effective distribution network that helps DPM maintain its market share. However, the poor performance of affiliates, specifically PVC Mekong and PVTex, has generated big losses that lowered the net income of DPM over the past few years.

Table 1 Company structure

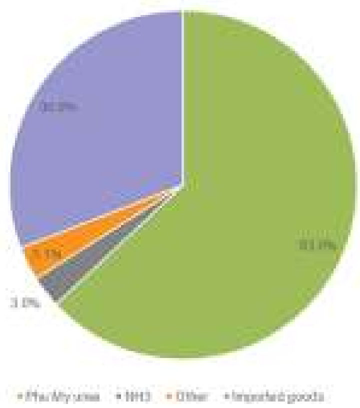
Type	Company name	Business segments	Ownership (%)
Subsidiaries	North PetroVietnam Fertilizer and Chemicals JSC (PMB)	Fertilizer distribution and trading	75
	Central PetroVietnam Fertilizer and Chemicals JSC (PCE)	Fertilizer distribution and trading	75
	South-East PetroVietnam Fertilizer and Chemicals JSC (PSE)	Fertilizer distribution and trading	75
	South-West PetroVietnam Fertilizer and Chemicals JSC (PSW)	Fertilizer distribution and trading	75
Affiliates	Dam Phu My Packaging JSC (PMP)	Packaging	43.34
	PetroVietnam Urban Development JSC (PVC Mekong)	Construction and consulting, real estate trade	35.63
	PetroVietnam Petrochemical and Textile Fiber JSC (PVTEX)	Textile fiber production and trading	25.99

Sources: DPM, VNDIRECT

BUSINESS ACTIVITIES

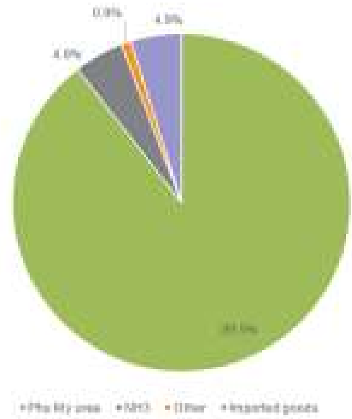
DPM's major source of income comes from its nitrogen fertilizer, which accounts for 63% of revenue and 90% of gross profit in 2016. The imported fertilizer segment contributes 31% to revenue, but only 5% to gross profit, due to the fact that it yields rather low gross margin (at 3-4%). Other sources of revenue include petrochemicals, ammonia (NH_3) and electricity, which account for a minimal but increasing share in revenue and gross profit, as the company is in the process of changing its focus to petrochemicals to diversify the products in the context of harsher competition in the fertilizer industry.

Figure 1 Revenue composition (2016)



Sources: DPM, VNDIRECT

Figure 2 Gross profit composition (2016)



Sources: DPM, VNDIRECT

Market leader in urea manufacturing sector

Given that urea manufacturing industry has high barriers to entry (high initial investment cost and state monopoly of input materials like coal and gas), the domestic supply-demand balance remains quite stable over recent years. Total supply reaches 3.16mn tons p.a., in which 2.66mn tons come from local plants and around 500,000 tons are imported (~50% from China). Meanwhile, total demand stays at 2-2.1mn tons p.a., thus the Vietnamese market is generally in oversupply.

Table 2 Major urea plants in Vietnam

Producer	Capacity (tons/year)	Inputs	Year of operation
Phu My Plant	800,000	Associated gas from Bach Ho oil field and natural gas from Cuu Long oil field - Nam Con Son basin	2004
Ca Mau Plant	800,000	Natural gas from PM3-CAA block	2012
Ha Bac Plant	560,000	Coal from Quang Ninh mine	1975
Ninh Binh Plant	500,000	Coal from Quang Ninh mine	2012

Source: VNDIRECT

Of the four main urea manufacturers in Vietnam, two of the companies are subsidiaries of PVN (Phu My plant - DPM and Ca Mau plant - DCM), which has the largest capacity of 800,000 tons p.a. each, and the other two belong to Vietnam National Chemical Corporation – Vinachem (Ninh Binh and Ha Bac plants). Thanks to the high capacities and favorable locations, DPM and DCM are able to claim 40% market share each, the rest is divided among Ninh Binh, Ha Bac and imports. In terms of regions, DPM dominates the Southeast region and Central-Highlands area, where its market shares reach 75% and 70%, respectively, followed by 35% in Southwest region and 25% in Northern region.

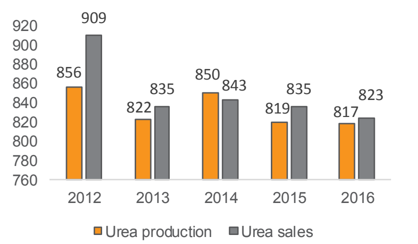
Table 3 Market share by region

Region	DPM	DCM	Others
Southeast	75%	25%	0%
Southwest	35%	55%	10%
Central - Highlands	70%	25%	5%
Northern	25%	12%	63%
Total	41%	40%	19%

Source: DPM, VNDIRECT

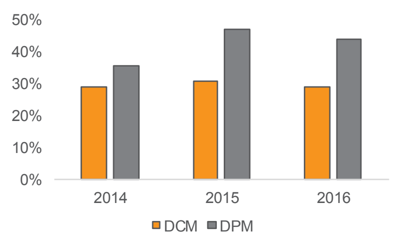
The company owns only one plant with the initial capacity of 740,000 tons p.a., later upgraded to 800,000 tons p.a. The plant utilizes state-of-the-art technologies, specifically Haldor Topsoe solution (Denmark) to produce ammonia and Snamprogetti process (Italia) to produce urea. These are among the most popular processes used by 40-50% urea manufacturers around the world, which are considered energy-saving, efficient and environmentally friendly.

Figure 3 Urea production and sales (thousand tons/year)



Source: DPM

Figure 4 Urea gross margin



Source: VNDIRECT

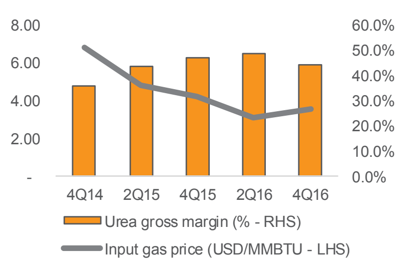
Gas input price formula for 2017 (not including VAT):

*P = Pn + Tp = 46%*MFO + 0,96 USD/MMBTU*

MFO is the monthly average FO oil price in Singapore market according to Platt's magazine

Tp is the transportation tariff, which is equal to 0.96 US$/MMBTU in 2017 and will increase annually by 2% until 2019

Figure 5 The correlation between input gas price and urea gross margin



Source: DPM, VNDIRECT

Over recent years, DPM has been producing and selling at more than its maximum capacity, which we credit to the following factors:

- The plant's location in the center of the Southern region (~50% of the total domestic demand) with easy access to Thi Vai port makes it convenient for the company to transport and distribute the products. Hence it is not surprising that DPM dominates the Southeast and Central - Highlands urea markets.
- DPM has taken well advantage of the early-adopter effect (since it entered the market when there was only 1 producer with total capacity of 180,000 tons while demand was 2mn tons). This enabled the company to develop strong brand awareness and good relationship with the farmers.
- Its extensive distribution network of 30 warehouses (with capacity of 250,000 tons) and more than 3,000 points of sales helps the company penetrate deeply into the market and compete with cheap Chinese imports.

Higher urea gross margin than its peers

DPM is able to enjoy premium gross margin compared to its peers thanks to several reasons: (1) The unit production cost of gas-based urea is generally lower than coal-based urea, and the recent upward trend of coal prices also widens the gap between the unit cost of DPM and Ha Bac/Ninh Binh Company, (2) DPM bears little depreciation costs since the factory was built long ago and was fully depreciated. Meanwhile, DCM plant was built in 2012 with higher investment cost of USD779mn, and is still in depreciation period, (3) The ASP of Phu My urea is often 3-5% higher than other urea products as DPM is able to maintain its high reputation, solid market share and average price-setting power.

Natural gas accounts for more than 60% in COGS

Since DPM plant incurs little depreciation cost, the main component of COGS is natural gas price which makes up 60-70% of total production costs. Input gas is currently provided by GAS (also a subsidiary of PVN) from Bach Ho oil field and Cuu Long – Nam Con Son basin with the cost calculated using a specific formula for the period 2016-2019. Accordingly, the gas price is linked to the market benchmark with 46% proportion plus a transportation tariff pre-set to increase 2% per year until 2019. We do not rule out the possibility of a change in the formula as directed by PVN and the Government, thus this poses an unexpected risk to the company's business.

Table 4 Transportation tariff in the period 2015-2019

Year	2015	2016	2017	2018	2019
DPM's tariff	0.92	0.94	**0.96**	0.98	1.00

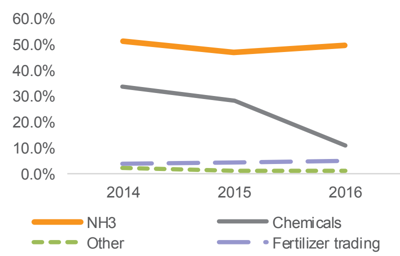
Source: DPM, VNDIRECT

In addition to the change in transportation tariff, the fluctuations in global oil prices is the main reason for the fluctuations in urea production cost. During the period 2014-2016, the decline in oil prices makes the natural gas prices decline faster than the selling prices, leading to a surge in gross margin from 35.4% in 2014 to 46.9% in 2015 and 48.6% in 1H2016. However, since 3Q2016, oil prices started to increase while urea prices fail to catch up, hence gross margin began to fall, reaching 43.8% by the end of 2016.

We believe that the oil prices will follow upward trend in the upcoming period of 2017-2020, which will greatly drive up DPM's production cost. However with the oversupply condition of global and domestic urea market, DPM cannot fully transfer this increase into selling prices, which implies a constant decline in gross margin.

Other business segments: imported fertilizer trading, NH_3, chemicals and electricity

Figure 6 Gross margin of other business segments



Source: DPM, VNDIRECT

DPM imports other fertilizers such as NPK, DAP, MOP, SA and distributes them under the Phu My brand name. Total consumption for these products is around 300,000 tons per year, contributing over VND2trl in revenue to DPM (31%), however it has very low gross profit margin, only 3-4%.

DPM possesses 1 petrochemical plant in Vung Tau province with capacity of 4,000 tons per year, producing additives and chemicals used in oil and gas industry, which contributes VND150-200bn to total revenue. It also owns 1 Grade CO_2 Plant with capacity of 47,500 tons of liquid CO_2 per year, starting operation since 4Q2016 and the UFC85 Plant with capacity of 15,000 tons of UFC85 (additive for urea manufacturing process) per year, going into operation from 1Q2016.

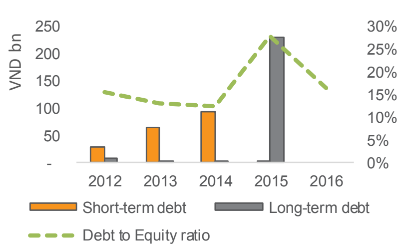
In general, apart from urea, all other products of DPM are fairly new, hence their contribution to revenue are still limited. However, we consider the company's strategy to diversify its products to chemicals a good decision, since the urea industry is already in surplus and highly-competitive. Therefore, we predict a gradual increase in the consumption of these products over the upcoming years, particularly in 2017 due to the recovery of the oil industry and the re-operation of the Ninh Binh Nitrogenous Plant (inferring a recovery in UFC85 demand).

Besides, the intermediate products of the urea manufacturing process (ammonia and extra electricity) contribute over VND200bn in revenue. The primary market for DPM's NH_3 is the Southern area, accounting for 56% of combined market share with DCM. In the North, NH_3 is supplied by Ha Bac and Ninh Binh Plant, the rest 100,000 tons is imported annually. Since the profit margin of NH_3 is highest among DPM's products, the upgrade of NH_3 plant could boost the ammonia sales starting from 2018 and partly offset the decline in margin caused by the increase in gas prices.

FINANCIAL ANALYSIS

Low financial leverage and strong cash flow

Figure 7 DPM's debt structure

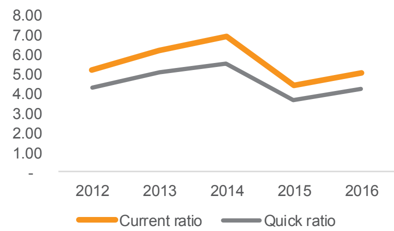


Source: DPM, VNDIRECT

As DPM sells urea fertilizers to its distribution companies instead of selling directly to agencies and farmers, it does not incur high receivables, leading to low number of days receivables and strong cash flow from operation.

The debt-to-equity ratio in 2012-2016 period remained low at 10-15% since the company used little to no debt, except for 2015 (28%) when it borrowed to finance the UFC85 plant. Therefore, DPM hardly bears any interest payment pressure.

Figure 8 DPM's liquidity ratios



Nguồn: DPM, VNDIRECT tổng hợp

The strong financial position of the company is also manifested in high liquidity ratios with stable current ratio around 5-5.5 and quick ratio around 4-4.5.

Ineffective financial investments implying potential risk

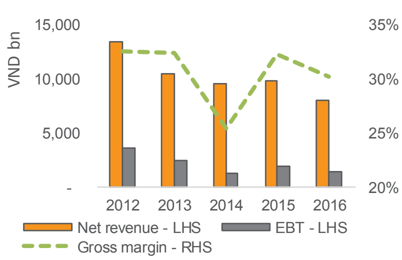
As mentioned above, DPM has 3 affiliates namely Dam Phu My Packaging, PVC Mekong and PVTex. 2 out of the 3 companies (PVC Mekong and PVTex) continuously reported net losses, therefore in 2012-2015, DPM usually recorded consolidated net loss from affiliates of VND100-200bn per year. These two investments (which is worth a total of VND662.7bn) have been fully provisioned in 2015, thus starting from 2016, DPM no longer needs to incur loss from these affiliates.

Notably, DPM has signed a reciprocal guarantee commitments with PVN relating to the guarantee obligations of PVN for short and medium-term loans of PVTex. This requires the company to return to PVN what PVN paid to the banks on behalf of PVTex, corresponding to DPM's 25.99% capital proportion in PVTex. As of end-2016, DPM has paid a total amount of VND108bn to PVN and made provisions for VND101.62bn out of that.

According to the company, the potential payment for 2017 is VND78.7bn and the total amount that DPM could be paying according to the guarantee obligations is USD57mn (excluding interest) for a period of 13 years (2017-2029). Given that PVTex is currently unable to meet its financial obligations and the performance of the company still sees no positive sign, it is likely that this commitment will impact the cash flow of DPM.

Downward business performance in the period 2012-2016

Figure 9 DPM's business performance in 2012-2016



Nguồn: DPM, VNDIRECT tổng hợp

In the 2012-2016 period, DPM's net revenue and profit experienced a continuous decline due to harsh domestic market condition. In 2016, DPM recorded total revenue of VND8.170trl (-19% YoY) and EBIT of VND1.161trl (-36% YoY), which is the lowest figure in the past 5 years. This could be explained by several reasons: (1) Urea consumption decreased as demand was affected by unfavorable weather condition (El Nino, saltwater intrusion in the Mekong Delta region), and (2) ASP of urea and other fertilizers declined in correlation with the global trend (world urea: -17% YoY).

The proportion of selling and administrative expenses over revenue increased to 9.3% and 6.3% respectively, compared to 7.7% and 6.1% of 2015's. In our opinion, this is due to the sharp fall in 2016 revenue and the rise in marketing cost to release inventory and prepare for the launching of new products. Financial profit also declined by 12% from VND249bn to VND220bn as the company continued to finance the NH_3-NPK project (which lowered the interest income), while recorded a loss of VND4bn from divesting from PetroVietnam Southern Building and Development JSC. Nonetheless, 2016 is the first year DPM did not report net loss from affiliates (as explained above), so net profits decreased at a rate less than EBIT, amounting to VND1.141trl (-23% YoY).

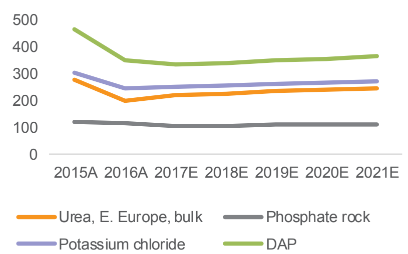
2017 FORECAST

Expected recovery in demand thanks to better weather and improvement in agriculture sector

According to data from Southern Irrigation Institute, until March 2017, the saltwater intrusion in the Mekong Delta region appeared later and affected fewer areas compared to the same period in 2016. It is forecasted that the 2016-2017 dry season will have a normal condition of saltwater intrusion and create less severe damage than the previous session. We believe that with the end of El Nino in 2016 and the appearance of light La Nina in late 2016-early 2017, the weather condition would be more favorable for agriculture production, which will lead to an increase in fertilizer demand.

Selling prices may increase in accordance with global prices

Figure 10 Fertiliser prices forecast (US$/mt)

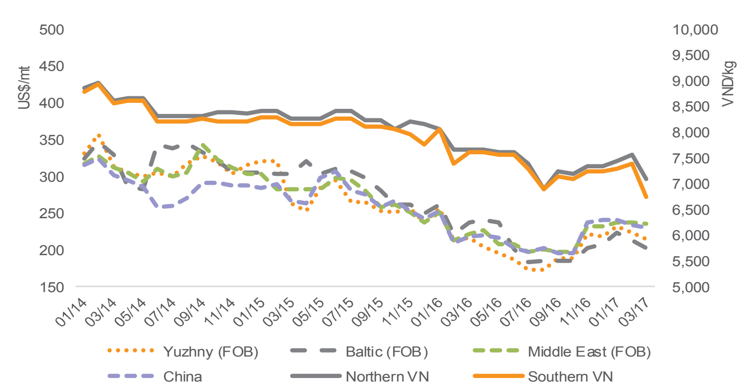


Source: World Bank

According to World Bank forecast, the global fertilizer prices in general, and the urea prices in particular are expected to rise slightly in 2017 and recover in medium term based on these reasons:

- Urea demand is expected to rise at a stable pace of 2%/year, which is equal to the average growth in the past 15 years of 2.2%, in accordance with the growth in population and the demand for agricultural products.
- In 2017, urea supply from China (which accounts for 30% of global supply) will continue the downward trend from late 2016, due to (1) the strong increase in input prices (coal and natural gas), and (2) the prevalent environmental concerns in China makes many factories shut down or work at 55-60% of capacity, creating a decrease in supply. At the same time, new supply will not come into operation until the second half of 2017, while import demand from the Southern America region surges seasonally, which will drive the urea prices up.
- Analyses from well-known market researchers and producers[1] show that in the medium term, urea demand could grow faster than urea supply, leading to the narrower gap between supply-demand and lessening the oversupply pressure. The new supply will be constrained by the high required investment cost (of USD9-14bn/year to satisfy the demand growth rate of 2%/year) while the current fertilizer prices fail to guarantee proper returns.

Figure 11 Global and domestic urea prices from 2015-now



[1] *Fertecon, IFA, AAPFCO, Fertilizers Europe, ANDA, CF Industries*

Source: MoIT, VNDIRECT

In the past, domestic urea prices tended to move along with global urea prices, especially with Chinese urea prices since this is the main source of import into Vietnam. However, the ranges of the fluctuations were usually not as big, governed by the domestic supply-demand balance and the inventory condition of local producers. (Specifically, Ha Bac and Ninh Binh Plants often operated at 50% of designed capacity, so the pressure to reduce prices was not big).

In the first quarter of 2017, the domestic urea prices has increased by 10% from the bottom in August 2016, which correlates with the recovery of global urea prices since July 2016. As we anticipate this global trend to continue further into 2017 and the following years, we expect the domestic prices will follow the path of world prices, however with certain lags.

NH_3-NPK complex is the long-term growth driver

This project includes the construction of a new NPK factory with the capacity of 250,000 tons p.a. and the upgrade of the NH_3 plant adding 90,000 tons of NH_3 to the current capacity. Total investment cost is approximately VND4.98trl, in which 60% comes from loans and 40% from owned capital. The estimated IRR for these two projects are 14.8% and 15.6%, respectively.

According to information from the company, by the end of 1Q2017, the completion progress for the NH_3 and NPK project is 75% and 84%, correspondingly, which is in line with the schedule. DPM expects to complete the construction in 2017 and will launch the commercial products into the market in 2018. The company shares that the products will be consumed mostly in the Southern market and will gradually replace the currently imported high-quality NPK (of 250,000-300,000 tons/year), as well as help diversify DPM's product portfolio in the context of domestic urea supply surplus.

Since DPM's NPK project applies the chemical technology, which is the most advanced NPK production technology in the world, we believe that DPM's products could gradually replace the imported fertilizers, while at the same time the company can take advantage of its wide distribution network and selling channels to distribute the products. Besides, DPM will be able to enjoy tax discounts for the NPK factory: 0% in the first 2 years of operation (2018-2019) and 50% discount in the next 4 years.

Depressed gross margin will persist in the next few years

We expect a continuous decline in gross margin due to the following reasons:

- The gross margin of urea (60% of revenue and 90% of gross profit) will decrease since the company cannot transfer all of the cost increases (from natural gas price) to buyers. According to EIA's forecast, we assume an increase of 25% in Brent oil prices in 2017 to USD55 per barrel and an increase of 5%/year in oil prices in the following years. With the further assumption of 2% increase in the USD/VND exchange rate, we calculate that the urea input prices will increase by 26% in 2017 and 6%/year in 2018-2021. However, the selling prices would not be able to catch up because: (1) Urea is in excess supply even when Ninh Binh and Ha Bac runs at 50% of capacity, (2) The shortage (if possible) in the North will be supplied immediately by the cheap imports from China, Indonesia, Malaysia, and (3) Demand is only forecasted to grow 2%/year.

- Although the in-house NPK will bring about higher gross margin than imported NPK, the NPK's gross margin is only 14-15%, basically lower than urea's gross margin at 30-40%. Therefore when the proportion of NPK in revenue and profit increases, the total gross margin will decline.

Possible policy support from the Government

The Law 71 effective from 2015 stipulates that fertilizers are VAT tax-exempt goods, therefore fertilizer manufacturers cannot receive the input tax deduction, leading to an increase in production cost and reduce the competitiveness of domestic goods in comparison with imported goods.

In early 2017, the Ministry of Industry and Trade and the Vietnam Fertilizer Association proposed to the Government to reclassify fertilizers to goods taxed at 0% VAT, meaning that producers would receive the input tax deduction - 10% applied to natural gas, labor, electricity, etc. (VND300-400bn in the case of DPM). In the 2017 AGM, the Board of Directors states that the likelihood of the new VAT law is high, however, it is the tax rate that is still undecided. We estimate that in the case of a change in VAT tax policy, DPM's gross margin could improve by 3-4% at the tax rate of 0%, and 2-3% at the tax rate of 2%.

Since the beginning of the year, there has been much information regarding the government's policy changes in the fertilizer industry to create transparency and improve the industry's effectiveness as well as competitiveness. Thus, we expect the change in VAT law to be progressed more quickly, with the most positive scenario of being approved in the upcoming National Assembly meeting in May-June 2017. In worse scenarios, the new policy could take 1-2 years to be effective. Therefore, we recommend that investors should keep track of the new information in the market to find suitable investment opportunities.

Regarding the recent information about domestic companies asking Vietnam Competition Authority (VCA) in late-March to apply trade defense instruments on imported fertilizers, we note that the products in investigation here only include multi-nutrients fertilizers such as NPK, DAP. Urea does not belong to this list. Therefore, DPM would only benefit when: (1) The defense instrument for NPK is approved, and (2) The company launch its NPK products into the market in time (expected in 2018 at the earliest).

Earnings forecast

We forecast the company's 2017 revenue and EBT to reach VND8.524trl (+8% YoY) and VND1.273trl (-9% YoY), respectively. EAT could reach VND1.043trl (-9% YoY), leading to the 2017 EPS at VND2,665/share. Adjusted EPS for bonus and welfare fund (15%) is VND2,265/share.

Our forecast is higher than the company's yearly plan (revenue of VND7.743trl and EBT of VND991bn), as DPM accounts for the periodic maintenance of the system which happens once every 2 years. However, based on historical data, we perceive that DPM has always operated over full capacity and exceeded its plan even in the years with big maintenance (2013, 2015).

Our assumptions regarding the valuation of the company are:

- Urea consumption stays at 825,000 tons, similar to 2016 and lower than the average of previous years as we account for the possibility of longer maintenance period to put the new projects into operation. The urea ASP is expected to rise 11% YoY and 3.5%/year in the following years, corresponding to the growth rate of global prices.
- Input gas prices continue to increase as determined in the contract, with the oil base price of USD55/barrel, leading to an increase of 19% YoY in natural gas cost. Consequently, the urea production cost will grow 26%, thereby gross margin falls to 37.1% in 2017 and decreases further in the following years.
- NH_3 consumption increases 5% per year and selling prices also increases 3% per year with the assumption that ASP rises in correlation with oil prices. The NH_3 shortage in Vietnam is also a revenue driver. The gross margin of NH_3 is expected at 50%.
- We estimate the amount of trading imported fertilizers at 300,000 tons/year, contributing VND2.322trl to revenue and gross margin similar to 2016.
- Selling and administration expenses account for 14.6% of net sales vs. 15.6% in 2016.
- The company will spend over VND2.1trl in 2017 and over VND1.3trl in 2018 for the NH_3-NPK project, 40% of which financed by borrowings (equivalent to VND852bn and VND553bn in 2017-2018). The long-term debt will be paid in the following 3 years.
- Effective tax rate is assumed to remain similar to 2016's, but decrease in the next few years as a result of tax discount from the new factory.
- We do not take into account the possible change in VAT tax policy as there is yet any specific information about the time frame and the new tax rate
- The cash dividend ratio stays at 20% of par value.

In our opinion, the 2018 prospect would be much more positive for DPM, as the NPK factory goes into operation and starts to contribute to revenue. DPM's revenue is projected to increase by 8% and EAT +5%, reaching VND9.215trl and VND1.1trl, respectively. We cautiously assume that the new factory will operate at 50% of capacity at first, then the operation rate increases by 10%/year. The NPK selling prices is estimated to be equivalent to the price of BFC product (the leading NPK producer in the country) and increased 3%/year.

VALUATION

Using the Discounted Cash Flow method, we calculate the proper price for DPM at VND25,600/share. The 2017 fw P/E is estimated at 9x, higher than the most recent 5-year average of 8.2x.

DPM also has a history of high dividend payment, which is attractive to investors preferring stable cash flow. The company often maintains its cash dividend ratio at 20-40%, depending on its business performance. Although in 2017-2018, DPM needs to disburse the investment for the NH_3-NPK project, the company's representative assures that DPM can still guarantee a minimum dividend ratio of 20%, equivalent to the dividend yield of 8.6%.

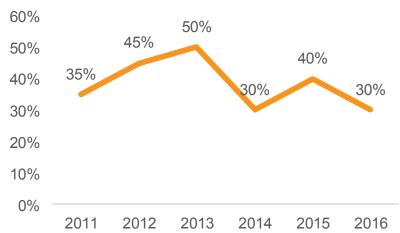
DPM share price has declined sharply after the dividend payment in late 2016 and after the net sales of foreign investors, reflecting the negative factors and idleness in the business performance. We think that DPM is already fairly priced and we initiate a HOLD recommendation for the company. Potential upside could only come from the changes in policies in support of the sector, which DPM will benefit the most as the leading manufacturer in the industry.

Table 5 Key assumptions

Risk free rate	5.0%
Risk premium	12.1%
Beta	0.64
WACC	12.3%
Terminal growth rate	2%

Source: VNDIRECT

Figure 12 Dividend ratio



Source: DPM, VNDIRECT

Table 6 Peer comparison

Name	Country	Market cap (VND bn)	EPS 2016 (VND)	BVPS 2016 (VND)	ROE 2016	ROA 2016	P/E 2016	P/E T12M	P/B 2016	P/B T12M
PetroVietnam Fertilizer and Chemicals	**Việt Nam**	**8,962**	**2,915**	**20,581**	**13.6%**	**11.1%**	**8.0x**	**7.9x**	**1.1x**	**1.1x**
The Southern Fertilizer JSC	Việt Nam	604	2,059	11,820	15.9%	7.2%	5.7x	6.1x	1.0x	1.1x
Binh Dien Fertilizer JSC	Việt Nam	1,949	4,456	15,739	28.2%	7.9%	6.6x	7.7x	1.9x	2.2x
Lam Thao Fertilizers & Chemicals JSC	Việt Nam	1,399	1,126	11,362	9.7%	5.1%	11.5x	10.5x	1.1x	1.1x
PetroVietnam Ca Mau Fertilizer JSC	Việt Nam	5,638	1,171	11,000	10.3%	4.5%	8.7x	9.1x	0.9x	1.0x
Chambal Fertilizers and Chemicals Ltd	Ấn Độ	12,376	1,757	19,201	9.3%	2.6%	10.6x	16.3x	1.0x	1.5x
Rashtriya Chemicals & Fertilizers Ltd	Ấn Độ	16,300	1,138	17,279	6.7%	2.6%	11.5x	25.0x	0.8x	1.6x
Abou Kir Fertilizers & Chemical Industries	Ai Cập	17,708	33,271	90,311	34.4%	21.3%	9.1x	8.8x	3.1x	4.6x
Shandong Hualu Hengsheng Chemical Co Ltd	Trung Quốc	53,072	2,364	21,573	11.3%	7.1%	18.9x	18.4x	2.0x	2.0x
Average		**21,019**			**14.4%**	**7.6%**	**11.7x**	**15.5x**	**1.5x**	**2.1x**
Median		**16,300**			**10.3%**	**4.5%**	**10.6x**	**16.3x**	**1.0x**	**1.6x**

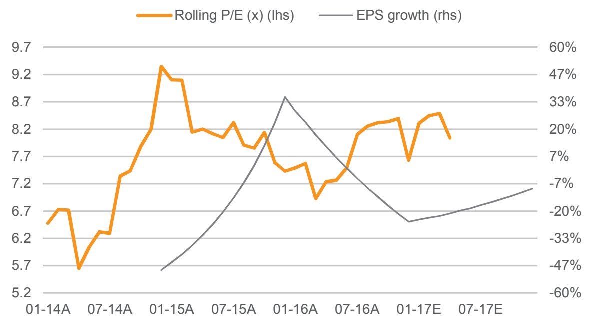
Source: Bloomberg, VNDIRECT

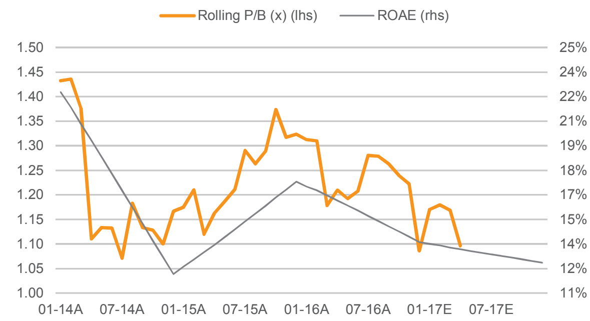
RISK

The biggest operation risk of DPM comes from the fluctuations in input prices, caused by the fluctuations in oil prices and the risk of price formula change from PVN. Furthermore, as PVN is DPM's controlling shareholder, the company hardly has any negotiation power in terms of input gas prices, as well as encounters difficulty in implementing the policies that are to the best interest of the company.

Other risks include: (1) Stronger competition in the fertilizer market, especially with cheap imports while urea and NPK are already oversupplied, (2) Unfavorable weather condition could affect the agriculture sector. It is possible that El Nino could come back in late 2017, which would create drought and impact the fertilizer demand, and (3) Ineffective investment activity, leading to high provisions and bad debts (regarding to PVTex's payment obligations).

Valuation





Income statements

(VNDbn)	12-16A	12-17E	12-18E
Revenue	7,925	8,524	9,244
Cost of sales	(5,529)	(6,166)	(6,685)
Gen & admin expenses	(735)	(748)	(812)
Selling expenses	(499)	(511)	(555)
Operating profit	**1,161**	**1,099**	**1,192**
Operating EBITDA	1,403	1,454	1,593
Depreciation and amortisation	**(242)**	**(355)**	**(401)**
Operating EBIT	**1,161**	**1,099**	**1,192**
Interest income	234	177	166
Financial expense	(14)	(17)	(37)
Net other income	8	11	13
Income from associates & JVs	4	4	4
Pre-tax profit	**1,393**	**1,273**	**1,338**
Taxation	(228)	(209)	(195)
Minority interests	(24)	(22)	(23)
Net profit	**1,141**	**1,043**	**1,120**
Adj. net profit to ordinary	1,141	1,043	1,120
Ordinary dividends	(2,312)	(783)	(783)
Retained earnings	**(1,171)**	**260**	**337**

Balance sheets

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	4,099	3,470	3,635
Short term investments	55	55	55
Accounts receivables	513	521	547
Inventories	923	978	1,007
Other current assets	227	244	264
Total current assets	**5,816**	**5,268**	**5,509**
Fixed assets	3,261	5,047	5,368
Total investments	45	45	45
Other long-term assets	447	449	454
Total assets	**9,569**	**10,809**	**11,377**
Short-term debt	0	213	139
Accounts payable	475	530	546
Other current liabilities	684	736	798
Total current liabilities	**1,159**	**1,479**	**1,482**
Total long-term debt	0	639	842
Other liabilities	180	180	180
Shareholders' equity	**8,055**	**8,315**	**8,653**
Minority interests	174	196	219
Total liabilities & equity	**9,569**	**10,809**	**11,377**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**1,393**	**1,273**	**1,338**
Depreciation & amortisation	242	355	401
Other non cash gains/(losses)	868	0	0
Other non operating gains/(losses)	(0)	(3)	(4)
Tax paid	(318)	(209)	(195)
Other operating cash flow	(255)	0	0
Change in working capital	**(94)**	**29**	**5**
Cash flow from operations	**1,836**	**1,446**	**1,546**
Capex	(1,289)	(2,131)	(1,387)
Proceeds from assets sales	0	0	0
Others	30	(12)	(15)
Other non-current assets changes	256	0	675
Cash flow from investing activities	**(1,002)**	**(2,143)**	**(726)**
New share issuance	114	0	0
Shares buyback	0	0	0
Net borrowings	(227)	852	128
Other financing cash flow	0	0	0
Dividends paid	(2,312)	(783)	(783)
Cash flow from financing activities	**(2,425)**	**70**	**(654)**
Cash and equivalents at beginning of period	5,690	4,099	3,470
Total cash generated	**(1,591)**	**(628)**	**165**
Cash and equivalents at the end of period	4,099	3,470	3,635

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	14.4%	12.2%	12.1%
Asset turnover	1	1	1
ROAA	11.1%	10.2%	10.1%
Avg assets/avg equity	1	1	1
ROAE	13.9%	12.7%	13.2%
Efficiency			
Days account receivable	5	5	5
Days inventory	61	58	55
Days creditor	31	31	30
Fixed asset turnover	3	2	2
ROIC	13.9%	11.1%	11.4%
Liquidity			
Current ratio	5	4	4
Quick ratio	4	3	3
Cash ratio	4	2	2
Cash cycle	35	31	30
Growth rate (yoy)			
Revenue growth	(18.8%)	7.6%	8.4%
Operating profit growth	(35.7%)	(5.4%)	8.5%
Net profit growth	(23.3%)	(8.6%)	7.4%
EPS growth	(25.2%)	(9.0%)	7.4%
Share value			
EPS (VND)	2,929	2,665	2,862
BVPS (VND)	20,581	21,245	22,107
DPS (VND)	5,907	2,000	2,000

Source: VNDIRECT

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