

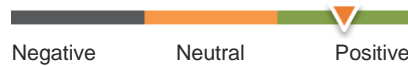
PETROVIETNAM FERTILIZER & CHEMICAL CORP (DPM) - UPDATE

Market Price VND23,200 **Target Price** VND23,000 **Dividend Yield** 4.3% **Rating** HOLD **Sector** BASIC MATERIALS

Outlook – Short term



Outlook – Long term



Valuation



16 March 2018

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Key changes in the report

- Increase 2018 oil price assumption by 11%
- Reduce NPK price assumption by 28%

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	26,100
52w low (VND)	20,150
3m Avg daily volume (shares)	1.34mn
3m Avg daily value (VNDmn)	27,352
Market cap (VNDbn)	8,825
Outstanding shares (m)	391.4
Free float (%)	20
TTM P/E (x)	13.0
Current P/B (x)	1.2

Ownership

PetroVietnam	59.6%
Edgbaston	4.2%
KWE BETEILIGUNGEN AG	1.8%
GIC	1.8%
Others	32.6%

Source: VNDIRECT

We believe that 2018 could mark the trough in DPM's current business cycle as profits from the NPK-NH₃ revamping project can only be realized after 2018. We reiterate our HOLD recommendation but reduce our target price on the basis of higher oil price assumption and lower ASPs of self-produced NPK than previously forecasted.

Sustained high oil prices will likely continue to pressure DPM's margins in 2018. DPM's 2017 gross margin declined from 30.2% to 26.4% as a result of a surge in gas input prices, which is closely linked to fuel oil prices in the Singapore market. We forecast a gradual but continued increase in global oil prices, supported by steady demand growth and compliance with OPEC-led supply cuts, which will further compress DPM's urea margins into 2018.

The new NPK plant is scheduled to come into operation in 2Q2018. While the revamped NH₃ plant has completed the trial run stage and gone into commercial operation in Jan 2018, the NPK unit is a bit behind schedule and is set to go online in April. We estimate that this complex will add approximately VND1,586bn to DPM's revenue this year, but high expenses and depreciation costs will result in a net loss in this business line of VND181bn. This project will contribute to profits from 2020 onwards as the plants approach full utilization.

The potential VAT policy change and PVN's divestment from DPM are potential price catalysts. We expect this VAT amendment to be presented in the upcoming National Assembly meeting in June for it to be effective in 2019, and with this DPM's NPAT could improve by 30-40% from our current forecast, adding 20-25% to our TP.

DPM is trading at a TTM P/E of 13.0x, which is higher than that of domestic peers and its historical 4-year average trailing P/E of 10.7x. Given the low forecasted earnings growth in 2018, we maintain a HOLD recommendation on DPM in anticipation of a growth recovery and potential price catalysts mentioned above kicking in starting in 2019.

Financial summary (VND)	12-15A	12-16A	12-17A	12-18E
Net revenue (bn)	9,765	7,925	7,996	9,104
Revenue growth	2.3%	(18.8%)	0.9%	13.9%
Gross margin	32.3%	30.2%	26.4%	22.7%
EBITDA margin	22.0%	20.7%	13.1%	13.3%
Net profit (bn)	1,488	1,141	694	450
Net profit growth	35.8%	(23.3%)	(39.1%)	(35.2%)
Recurring profit growth	31.1%	(23.3%)	(39.1%)	(35.2%)
Basic EPS	3,917	2,929	1,774	1,149
Adjusted EPS	3,329	2,490	1,508	977
BVPS	21,988	20,581	20,113	20,262
ROAE	17.4%	13.9%	8.7%	5.7%

Source: VNDIRECT

2017 review: rising oil prices hit earnings

DPM's 2017 net revenue remained relatively flat as the recovery in urea price (+5% yoy) fully offset the decrease in sales volume (-3% yoy), which was partly a result of the periodic maintenance that occurs every two years.

However, net profit fell sharply by 39% due to the following factors (1) the Singapore Platts oil price which governs DPM's gas input price increased 42% in 2017, quicker than the urea ASP recovery, leading to a tightening of gross margins by 3.8 percentage points, (2) SG&A expenses rose 17% yoy due to the marketing activities for the new NPK products expected to come on-stream this year and the costs from the new plants, and (3) net financial income declined by 26% on the back of lower interest income, as DPM financed 60% its NPK-NH₃ project through internal accruals which hit the cash balance.

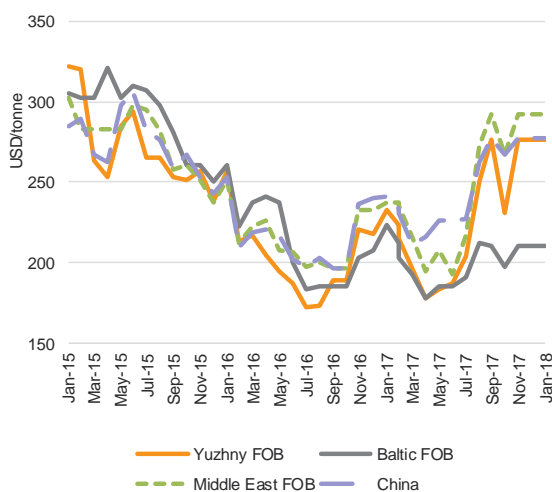
Net profit only met 92% of our 2017 forecast mostly because of a lower sales volume and higher SG&A expenses than we had expected.

2018 outlook: A stepping stone into a new growth cycle

We estimate net revenue could improve by 14% in 2018 thanks to the contribution of the NH₃-NPK complex, the continued recovery in the urea ASP and production volumes no longer being restricted by maintenance operations.

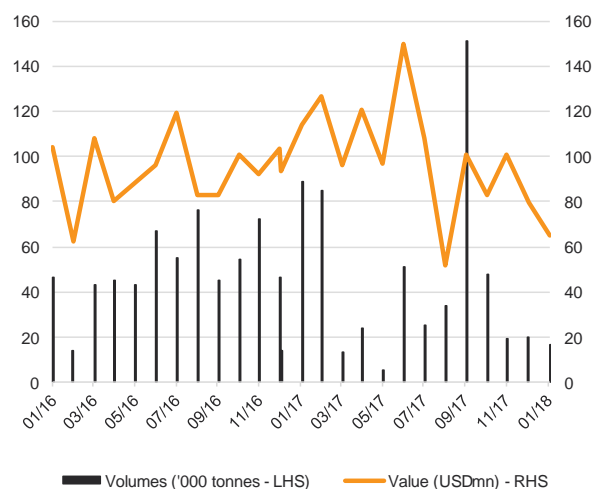
We believe urea ASP could increase by 3% thanks to: (1) high global oil and coal prices forecasted for 2018 which will support urea prices, as these are the main inputs for producing urea, accounting for 60-70% of total production cost; (2) consistently low Chinese exports continue to reduce the urea supply overhang of the last few years in both the international and domestic urea markets. Data from the Customs office also confirmed a decline in total urea imports into Vietnam in the first 2 months of 2018 (-35% yoy), of which 50% is often from China.

Figure 1: Global urea prices in 2015-2018



Source: Ministry of Industry and Trade, VNDIRECT

Figure 2: Urea imports in 2016-2018



Source: GSO, Customs Office, VNDIRECT

We increase the average oil price assumptions for FY18-FY20 from US\$56/bbl to US\$62/bbl, on the back of strong oil price growth during January, and upward revisions of the oil price forecast of

prestigious financial institutions such as JP Morgan, Goldman Sachs, the US Energy Information Administration (EIA), etc. Based on EIA's forecast of US\$62/bbl, we predict a further tightening of 2018 gross margin to 22.7% (-3.7 percentage points) from the 2017 level of 26.4%.

The NH₃ capacity upgrade and new NPK project has started to contribute to total revenue since 1Q2018, but will not generate profits until 2020. According to DPM, the revamped NH₃ plant with additional capacity of 90,000 tonnes/year (+20% to total capacity) has gone into commercial operation in Jan 2018, while the NPK unit is currently in trial runs and is scheduled to come on stream in April.

We maintain our assumptions regarding the utilization rate of each plant and sales volumes of the products, but revise downward the ASP of self-manufactured NPK products by 28% to an average of VND8.5-9mn/tonne, which is the price that DPM charges for the NPK fertilizers that it currently imports and distributes. The new projections for the NH₃-NPK project are as follows:

Figure 3: NH₃-NPK complex projections

	2018	2019	2020	2021
Utilization rate (%)				
NPK	70%	80%	90%	100%
NH ₃	40%	70%	100%	100%
Volumes ('000 tonnes)				
NPK	175	200	225	250
NH ₃ *	36	63	90	90
Financial projections (VNDbn)				
Revenue	1,586	2,025	2,494	2,785
Gross profit	60	299	432	475
EBIT	(111)	(2)	117	152
Net income**	(181)	(90)	40	87

*Volumes including the amount used for producing NPK

**Assuming SG&A equal to 3% off estimated revenue

Source: VNDIRECT

2018 net profit to decline by 35% compared to 2017 as total SG&A expenses remain elevated and net financial income is forecasted to continue to fall due to continued cash disbursement for the NH₃-NPK project. DPM has announced the capex plan for 2018 at VND1,600bn, which is primarily allocated for the remaining work on this project.

We also adjust our dividend payment for 2018, as the company plans to pay 2018 cash dividend of VND1,000/share (equivalent to dividend yield of 4.3% at current price). We adjust the dividend policy for 2018-2019, but maintain a dividend ratio of 20% of par value (VND 2,000 per share) from 2020 onwards when the pressure on DPM's cash flow eases.

Valuation

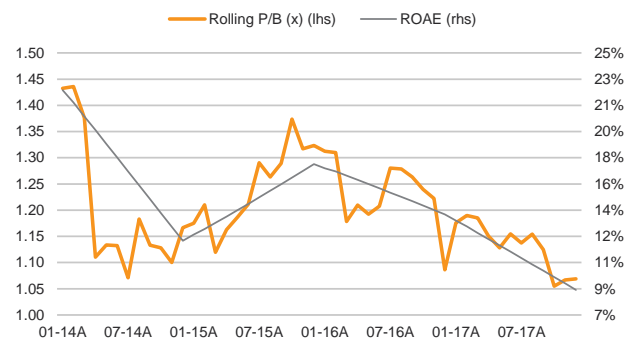
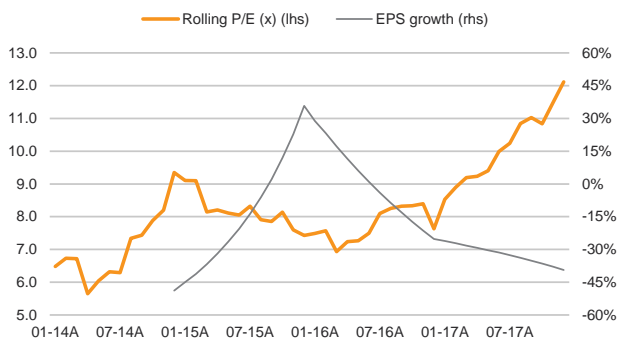
Our view regarding DPM has not changed from our [last update report](#). DPM is trading at a TTM P/E of 13.0x, which is higher than most domestic peers and its historical 4-year average trailing P/E of 10.7x. We consider DPM to be fairly priced at the moment with limited growth potential in 2018 due to the effect of gas input prices increase and little contribution from the early phase of the NH₃-NPK project. Therefore we maintain our HOLD recommendation, with a revised target price of VND23,000/share. However, our forecasts and valuation exclude the impact of the potential change in the VAT policy so this presents upside to our rating.

Figure 4: Peer comparison

Company	Ticker	Country	Market Cap (US\$ mn)	TTM NPAT growth (%)	TTM EPS growth (%)	TTM ROA (%)	TTM ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
The Southern Fertilizer JSC	SFG VN Equity	Vietnam	27	1,5%	1,5%	7,6%	15,8%	0,8	6,8	1,1
Lam Thao Fertilizers & Chemicals JSC	LAS VN Equity	Vietnam	70	-1,9%	-20,5%	5,5%	11,6%	0,7	10,5	1,2
Binh Dien Fertilizer JSC	BFC VN Equity	Vietnam	90	0,2%	-12,3%	7,6%	28,5%	1,6	7,4	2,1
PetroVietNam Ca Mau Fertilizer JSC	DCM VN Equity	Vietnam	309	3,1%	7,4%	5,0%	10,6%	0,8	11,0	1,2
Rashtriya Chemicals & Fertilizers Ltd	NFL IN Equity	India	450	5,1%	5,5%	1,9%	11,8%	1,8	14,0	1,6
Abou Kir Fertilizers & Chemical Industries	RCF IN Equity	Egypt	679	6,4%	6,2%	2,5%	6,3%	0,5	24,6	1,5
Shandong Hualu Hengsheng Chemical Co Ltd	FFC PA Equity	China	983	-38,3%	-38,2%	8,9%	23,2%	0,7	9,5	2,1
PetroVietnam Fertilizer & Chemicals JSC	DPM VN Equity	Vietnam	398	-39,1%	-37,5%	7,0%	8,7%	0,1	13,1	1,2
Peer average				-3,4%	-7,2%	5,6%	15,4%	1,0	12,0	1,5
Peer median				1,5%	1,5%	5,5%	11,8%	0,8	10,5	1,5

Source: Bloomberg, Stoxplus, VNDIRECT

Valuation



Income statement

(VNDbn)	12-16A	12-17A	12-18E
Net revenue	7,925	7,996	9,104
Cost of sales	(5,529)	(5,884)	(7,038)
Gen & admin expenses	(735)	(803)	(840)
Selling expenses	(499)	(639)	(686)
Operating profit	1,161	670	540
Operating EBITDA	1,403	862	1,087
Depreciation and amortisation	(242)	(191)	(548)
Operating EBIT	1,161	670	540
Interest income	234	165	103
Financial expense	(14)	(1)	(71)
Net other income	8	16	14
Income from associates & JVs	4	4	4
Pre-tax profit	1,393	853	589
Taxation	(228)	(145)	(131)
Minority interests	(24)	(13)	(9)
Net profit	1,141	694	450
Adj. net profit to ordinary	1,141	694	450
Ordinary dividends	(2,312)	(783)	(391)
Retained earnings	(1,171)	(88)	58

Balance sheet

(VNDbn)	12-16A	12-17A	12-18E
Cash and equivalents	4,099	2,362	1,844
Short term investments	55	895	895
Accounts receivables	513	257	270
Inventories	923	1,223	1,463
Other current assets	227	281	320
Total current assets	5,816	5,017	4,791
Fixed assets	3,261	4,696	5,760
Total investments	45	47	47
Other long-term assets	447	504	532
Total assets	9,569	10,264	11,130
Short-term debt	0	0	0
Accounts payable	475	298	338
Other current liabilities	684	1,120	1,275
Total current liabilities	1,159	1,418	1,613
Total long-term debt	0	629	1,232
Other liabilities	180	174	174
Share capital	3,914	3,914	3,914
Retained earnings reserve	625	442	501
Shareholders' equity	8,055	7,872	7,930
Minority interests	174	171	180
Total liabilities & equity	9,569	10,264	11,130

Cash flow statement

(VNDbn)	12-16A	12-17A	12-18E
Pre-tax profit	1,393	853	589
Depreciation & amortisation	242	191	548
Tax paid	(318)	(151)	(131)
Other adjustments	613	(950)	(3)
Change in working capital	(94)	138	(94)
Cash flow from operations	1,836	81	910
Capex	(1,289)	(1,379)	(1,606)
Proceeds from assets sales	0	24	0
Others	30	0	(33)
Other non-current assets changes	256	(680)	0
Cash flow from investing activities	(1,002)	(2,035)	(1,639)
New share issuance	114	0	0
Shares buyback	0	0	0
Net borrowings	(227)	615	603
Other financing cash flow	0	0	0
Dividends paid	(2,312)	(398)	(391)
Cash flow from financing activities	(2,425)	217	211
Cash and equivalents at beginning of period	5,690	4,099	2,362
Total cash generated	(1,591)	(1,737)	(518)
Cash and equivalents at the end of period	4,099	2,362	1,844

Key ratios

	12-16A	12-17A	12-18E
Dupont			
Net profit margin	14.4%	8.7%	4.9%
Asset turnover	0.77	0.81	0.85
ROAA	11.1%	7.0%	4.2%
Avg assets/avg equity	1.25	1.25	1.35
ROAE	13.9%	8.7%	5.7%
Efficiency			
Days account receivable	5.25	6.54	5.65
Days inventory	61.1	75.9	75.9
Days creditor	31.5	18.5	17.5
Fixed asset turnover	2.77	2.01	1.74
ROIC	13.9%	8.0%	4.8%
Liquidity			
Current ratio	5.02	3.54	2.97
Quick ratio	4.22	2.68	2.06
Cash ratio	3.58	2.30	1.70
Cash cycle	34.9	63.9	64.0
Growth rate (yoy)			
Revenue growth	(18.8%)	0.9%	13.9%
Operating profit growth	(35.7%)	(42.3%)	(19.5%)
Net profit growth	(23.3%)	(39.1%)	(35.2%)
EPS growth	(25.2%)	(39.4%)	(35.2%)
Share value			
Basic EPS (VND)	2,929	1,774	1,149
BVPS (VND)	20,581	20,113	20,262

Source: VNDIRECT

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Definition:

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- Hold The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
- Reduce The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

- Overweight An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
- Neutral A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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- Neutral A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
- Underweight An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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