

PETROVIETNAM FERTILIZER & CHEMICAL CORP (DPM) - UPDATE

Market Price VND18,700 **Target Price** VND15,600 **Dividend Yield** 5.3% **Rating** REDUCE **Sector** BASIC MATERIALS

Outlook – Short term



Outlook – Long term



Valuation



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Key changes in the report

- Oil price assumption increased from US\$62/bbl to US\$70/bbl
- NPK sales volumes and depreciation period revised

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	26,100
52w low (VND)	18,200
3m Avg daily volume (shares)	779,532
3m Avg daily value (VNDmn)	16,994
Market cap (VNDbn)	7,319
Outstanding shares (m)	391.4
Free float (%)	20
TTM P/E (x)	10.8
Current P/B (x)	1.0

Ownership

PetroVietnam	59.6%
Edgbaston	4.2%
KWE BETEILIGUNGEN AG	1.8%
Others	34.4%

Source: VNDIRECT

Prospects for 2018 remain unattractive due to the constant increase in input prices and high depreciation burden from the commissioning of the ~VND5,000bn NH₃-NPK complex.

1Q2018 net revenue rose 5% YoY to reach VND2,084bn on the back of favorable weather conditions that supported fertilizer demand for the Winter-Spring crop. Much of this increase was due to an improvement in urea sales volume (+6% YoY), as the urea ASP only rose by 1% YoY, while revenue from trading activities declined 7% YoY. The lower imported fertilizer sales resulted from the lower inventory in 1Q2018 and higher global fertilizer prices, which discouraged DPM from importing products.

The continued gross margin contraction was driven by the 14.6% YoY rise in gas input prices (linked to Singapore Platts oil price), which boosted COGS by 16.6% YoY even as ASPs barely moved. This caused gross margin to decline by 7.5 percentage points to reach 22.3%, and gross profit to fall by 21.1% YoY to VND465bn.

1Q net income declined by 19.2% YoY to VND180bn. Net income decreased at a lower rate than gross profit, as the company incurred lower selling and admin expenses. These expenses only accounted for 12.8% of net revenue this quarter, compared to 17.6% in 1Q2017. However, financial income also declined by 50% YoY (around VND15bn), as DPM continued to disburse capital for the NH₃-NPK complex, thus lowering its cash and equivalents balance by 23% YoY.

The NH₃-NPK complex is finally ready for commercial operation. The upgraded NH₃ plant began operating during the end of 1Q2018, and the NPK plant has completed its trial run for the 16-8-16 NPK product, which is scheduled to come on stream in 2Q. DPM cautiously aims to sell 150,000 tonnes of self-manufactured NPK in 2018, which is lower than our current assumption of 175,000 tonnes this year and equivalent to capacity utilization of 60%. According to management, the depreciation for this complex could reach nearly VND500bn, which is also higher than our current assumption of ~VND350bn. Both of these imply a much depreciation burden per unit produced in 2018.

Financial summary (VND)	12-15A	12-16A	12-17A	12-18E
Net revenue (bn)	9,765	7,925	7,996	8,978
Revenue growth	2.3%	(18.8%)	0.9%	12.3%
Gross margin	32.3%	30.2%	26.4%	19.5%
EBITDA margin	22.0%	20.7%	13.1%	10.3%
Net profit (bn)	1,488	1,141	694	200
Net profit growth	35.8%	(23.3%)	(39.1%)	(71.2%)
Recurring profit growth	35.8%	(23.3%)	(39.1%)	(71.2%)
Basic EPS	3,917	2,929	1,774	510
Adjusted EPS	3,295	2,452	1,532	434
BVPS	21,988	20,581	20,113	19,623
ROAE	17.4%	13.9%	8.7%	2.6%

Source: VNDIRECT

Figure 1: 1Q2018 financial overview (Unit: VNDbn)

	1Q17	1Q18	% change
Net revenue	1,978	2,084	5.3%
Gross profit	589	465	-21.1%
Gross margin	30%	22%	-7.5% pts
Selling expenses	193	144	-25.5%
Gen. and admin. Expenses	154	123	-20.5%
Profit/(loss)from financial activities	32	15	-51.4%
PBT	276	219	-20.6%
NPAT	223	180	-19.2%

Source: DPM, VNDIRECT

We expect DPM's earnings to remain under pressure as a result of the rise in its gas input prices and the surge in depreciation costs caused by the operation of the NPK-NH₃ project. We raise the average oil price assumption for FY18-FY20 from US\$62/bbl to US\$70/bbl as Brent crude oil price already averaged US\$68/bbl in 4M2018, with the rise from 4Q2017 levels stoked by growing political and geopolitical risks in large oil-producing countries in the world, and the continuing output curbs maintained by the OPEC. However, prices will be capped by slowing consumption growth and rising supply from shale producers and non-OPEC countries. Our revision in the forecasted oil price results in an additional 10.2% increase in full year average input gas costs and a further contraction of 5.2 percentage points in full year urea margins.

We also adjusted down the NPK sales volumes for this year to 150,000 tonnes per management guidance and the NH₃-NPK depreciation schedule was accelerated to match management's forecast of up to VND500bn of depreciation costs stemming from the new NH₃-NPK complex. All of this effectively reduces our 2018 net revenue and NPAT forecast by 1.4% and 44.4%, respectively, and we now project that net revenue and NPAT will reach VND8,978bn and VND200bn, respectively.

It should be noted that 1Q revenue and earnings completed 23.2% and 90.2% of our full-year forecast, correspondingly, implying that NPAT will be dragged down by the upfront losses incurred on the NH₃-NPK complex during later quarters. Our forecast exceeds DPM's 2018 guidance for VND8,577bn in total revenue but trails the company's guidance for VND371bn in NPAT before MI. This apparent anomaly is due to the fact that DPM predicated its 2018 plan on the basis of a 5% decrease in urea ASP (vs. our assumption of 3.8% increase) and an unreasonably low oil price of US\$50/bbl.

An acceleration in the divestment process could support its share price. At the recent 2018 AGM, PVN's representative confirmed the plan to reduce the parent company's stake in DPM within 2018. DPM's proposal for PVN to reduce its holding from 59.6% to 36.0% has been submitted for consideration. The AGM also approved the removal of DPM's foreign ownership limit (currently at 49%) to encourage the participation of foreign strategic partners during the divestment process.

DPM's valuation is unattractive. The recent share price correction of roughly 30% from its peak in Jan 2018 reflects DPM's limited earnings growth in 2018 and investor pessimism stemming from the low 2018 guidance. At the current price, DPM is trading at a 2018 and 2019 forward P/E of 36.7x and 27.6x, respectively, which appears unjustifiable even despite the possible lift from the imminent passing of the new input VAT deduction policy which could support earnings in 2019 and beyond. DPM's 2018 cash dividend is VND1,000/share,

Figure 2: Key assumptions

Risk free rate	5.0%
Risk premium	10.1%
Beta	0.7
WACC	11.1%
Terminal growth rate	2.0%

Source: VNDIRECT

which is equal to a dividend yield of 5.3% which is also not attractive enough to justify the valuation premium to market.

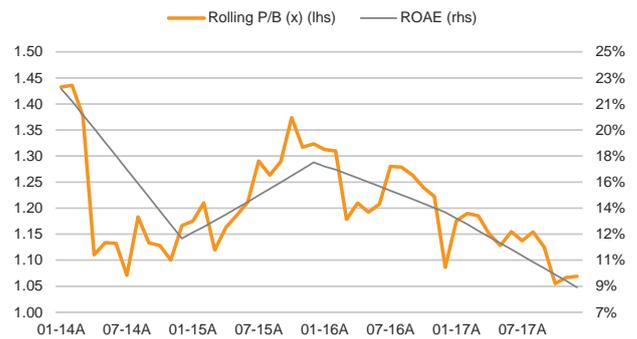
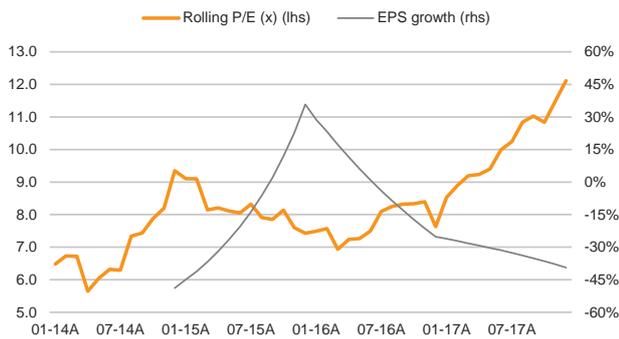
We downgrade DPM to a REDUCE rating with a 1-year DCF-based target price of VND15,600/share, down from VND23,000/share, previously. Note that we also lifted our risk free rate from 4.1% previously to 5.0% due to the expectation of rising yields globally in 2018 as liquidity tightens, which also appears to be reflected in the recent market re-rating.

The upside to our valuation includes the pending change in the VAT policy, which if approved, could result in a 20-25% increase in our target price. Further supporting factors include the potential for a greater than anticipated rise in urea prices, which would help boost margins, aside from positive news regarding the divestment process.

The potential VAT change may become a topic of discussion during the next National Assembly in June 2018, and thus could lend short-to-medium term support to the share price as investors bet on the approval of the policy change in June. We will closely monitor any new information that may be released with regards to this VAT policy change and update our target price accordingly.

Downside risk include a further increase in gas input prices due to a continued rally in global oil prices, which DPM is not able to pass through to its customers.

Valuation



Income statement

(VNDbn)	12-16A	12-17A	12-18E
Net revenue	7,925	7,996	8,978
Cost of sales	(5,529)	(5,884)	(7,232)
Gen & admin expenses	(735)	(803)	(856)
Selling expenses	(499)	(639)	(700)
Operating profit	1,161	670	191
Operating EBITDA	1,403	862	806
Depreciation and amortisation	(242)	(191)	(615)
Operating EBIT	1,161	670	191
Interest income	234	165	99
Financial expense	(14)	(1)	(61)
Net other income	8	16	13
Income from associates & JVs	4	4	4
Pre-tax profit	1,393	853	245
Tax expense	(228)	(145)	(42)
Minority interest	(24)	(13)	(4)
Net profit	1,141	694	200
Adj. net profit to ordinary	1,141	694	200
Ordinary dividends	(2,312)	(783)	(391)
Retained earnings	(1,171)	(88)	(192)

Balance sheet

(VNDbn)	12-16A	12-17A	12-18E
Cash and equivalents	4,099	2,362	1,660
Short term investments	55	895	895
Accounts receivables	513	257	266
Inventories	923	1,223	1,503
Other current assets	227	281	315
Total current assets	5,816	5,017	4,639
Fixed assets	3,261	4,696	5,692
Total investments	45	47	47
Other long-term assets	447	504	528
Total assets	9,569	10,264	10,906
Short-term debt	0	0	0
Accounts payable	475	298	348
Other current liabilities	684	1,120	1,257
Total current liabilities	1,159	1,418	1,605
Total long-term debt	0	629	1,272
Other liabilities	180	174	174
Share capital	3,914	3,914	3,914
Retained earnings reserve	625	442	251
Shareholders' equity	8,055	7,872	7,680
Minority interest	174	171	175
Total liabilities & equity	9,569	10,264	10,906

Cash flow statement

(VNDbn)	12-16A	12-17A	12-18E
Pretax profit	1,393	853	245
Depreciation & amortisation	242	191	615
Tax paid	(318)	(150)	(42)
Other adjustments	613	(951)	(2)
Change in working capital	(94)	138	(134)
Cash flow from operations	1,836	81	682
Capex	(1,289)	(1,392)	(1,606)
Proceeds from assets sales	0	24	0
Others	30	0	(30)
Other non-current assets changes	256	(680)	0
Cash flow from investing activities	(1,002)	(2,048)	(1,635)
New share issuance	114	0	0
Shares buyback	0	0	0
Net borrowings	(227)	629	642
Other financing cash flow	0	0	0
Dividends paid	(2,312)	(398)	(391)
Cash flow from financing activities	(2,425)	230	251
Cash and equivalents at beginning of period	5,690	4,099	2,362
Total cash generated	(1,591)	(1,737)	(702)
Cash and equivalents at the end of period	4,099	2,362	1,660

Key ratios

	12-16A	12-17A	12-18E
Dupont			
Net profit margin	14.4%	8.7%	2.2%
Asset turnover	0.77	0.81	0.85
ROAA	11.1%	7.0%	1.9%
Avg assets/avg equity	1.25	1.25	1.36
ROAE	13.9%	8.7%	2.6%
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	1.73
ROIC	13.9%	8.0%	2.2%
Liquidity			
Current ratio	5.02	3.54	2.89
Quick ratio	4.22	2.68	1.95
Cash ratio	3.58	2.30	1.59
Cash cycle	34.9	63.9	64.0
Growth rate (yoy)			
Revenue growth	(19%)	1%	12%
Operating profit growth	(36%)	(42%)	(72%)
Net profit growth	(23%)	(39%)	(71%)
EPS growth	(25%)	(39%)	(71%)
Share value			
Basic EPS (VND)	2,929	1,774	510
BVPS (VND)	20,581	20,113	19,623

Source: VNDIRECT

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Score Range:	90 - 100	80 – 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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Stock Ratings

Definition:

- Add The stock's total return is expected to reach 15% or higher over the next 12 months.
- 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.

Country Ratings

Definition:

- Overweight An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
- 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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