

LOCTROI GROUP (LTG) – UPDATE

Market Price VND38,500	Target Price VND46,000	Dividend Yield 5.2%	Rating ADD	Sector AGRICULTURE
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Outlook – Short term



Outlook – Long term



Valuation



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We reiterate our ADD rating for LTG with a target price of VND46,000/share based on a good 1H2018 performance which should continue into late 2018. This performance is on the back of a strong recovery in LTG's Agrifood segment as well as stable performance of the CPC and seed segments.

LTG's 2Q18 results were supported by continued sales growth across all segments including CPC (+16% yoy), Agrifood (+31% yoy) and seed (+5% yoy). This resulted in blended topline growth of 18% yoy in 2Q18. The numbers clearly reflect the seasonality in LTG's results (see Figure 3), as LTG often books high revenues in 2Q and 4Q, in line with the beginning of the crop growing season for the main crops in Vietnam.

Price performance



Source: VNDIRECT

1H18 gross margin contracted by 0.9% pts due to CPC margin compression. Despite a 9% yoy increase in total revenue with solid growth in all sectors (Agrifood +19% yoy, seed +6% yoy and CPC +4% yoy), overall gross margin declined 90 bp, partly due to a provision reversal of VND23bn which boosted 1H17 gross margin and higher customer discounts in CPC segment which led CPC gross margin to contract by 1.8% pts yoy to 28.7%. Net profit dropped 4% yoy to VND189bn as a result of slightly higher SG&A expenses (+4% yoy) and an increase in interest expense (+45% yoy) due to a surge in borrowings (+47% yoy) to finance higher working capital needs.

We take a more conservative view than management, but are still positive on the company's prospects. LTG has an ambitious plan for 2018 with projected VND9,878bn in net revenue (+14% yoy) and VND589bn in profit after tax (PAT) (+42% yoy). 1H18 results have achieved 45% of the target in terms of net revenue and 32% in terms of PAT. We forecast 2018 net revenue at VND9,365bn (+8% yoy) and PAT at VND454bn (+9% yoy), as we anticipate no significant improvements in the company's operations in the near future, given the long-term strategy of shifting from CPC-focused to more value-added products in the Agrifood segment.

LTG is trading at a TTM P/E of 6.1x, far below the average of domestic peers at 11.2x. We reiterate our ADD recommendation for LTG with a target price of VND46,000/share on the basis of a target P/E of 8.0x on 2018F EPS. However, it should be noted that low liquidity and low remaining room for foreign investors are the main setbacks for short-term price appreciation. The company hopes to address this problem by migrating its stock listing from Upcom to HOSE in 2019 and this could be a re-rating catalyst for the stock.

Key statistics

52w high (VND)	53,000
52w low (VND)	33,200
3m Avg daily volume (shares)	31,208
3m Avg daily value (VNDmn)	1,210
Market cap (VNDbn)	2,589
Outstanding shares (m)	67.2
Free float (%)	30.7
TTM P/E (x)	6.1
Current P/B (x)	1.1

Ownership

Marina Viet Pte. Ltd	25.2%
An Giang People's Committee	24.2%
Standard Chartered Private Equity	8.2%
Others	42.4%

Source: VNDIRECT

Financial summary (VND)

	12-15A	12-16A	12-17A	12-18E
Net revenue (bn)	7,856	7,783	8,687	9,365
Revenue growth	(11.3%)	(0.9%)	11.6%	7.8%
Gross margin	22.1%	20.3%	21.7%	21.4%
EBITDA margin	8.2%	9.0%	9.0%	9.1%
Net profit (bn)	319	347	414	449
Net profit growth	(36.7%)	8.8%	19.4%	8.4%
Recurring profit growth	(36.7%)	8.8%	19.4%	8.4%
Basic EPS	4,820	5,167	6,169	6,690
Adjusted EPS	4,097	4,392	5,243	5,686
BVPS	31,005	32,018	34,049	31,616
ROAE	15.7%	16.4%	18.7%	18.6%

Source: VNDIRECT

Revised 2017 results

LTG retroactively adjusted its 2017 results downward to reflect some additional commercial discounts and promotional expenses, thus lowering 2017 net profit by 7.1%. This does not affect the company's business guidance for 2018, however, creates a risk of future earnings misrepresentation.

Figure 1: Old and revised 2017 results

FYE (VNDbn)	Old	New	% change	Comments
Net revenue	8,689.8	8,686.8	0.0%	
Net revenue growth	11.6%	11.6%	0.0%	
Gross profit	1,881.0	1,881.0	0.0%	
Gross profit margin	21.7%	21.7%	0% pts	
Selling expense	889.3	938.4	5.5%	The company included additional customer discounts and promotional expenses for some sales campaigns in 2017, but adjusted staff expense downwards to reflect lower compensation to employees.
G&A expenses	320.7	311.1	-3.0%	
EBIT	671.0	631.4	-5.9%	
Pre-tax profit	566.7	527.1	-7.0%	
Net profit	445.9	414.3	-7.1%	

Source: LTG, VNDIRECT

1H2018 results were supported by strong performance of the Agrifood segment

Figure 2: Overview of 1H18 financial results

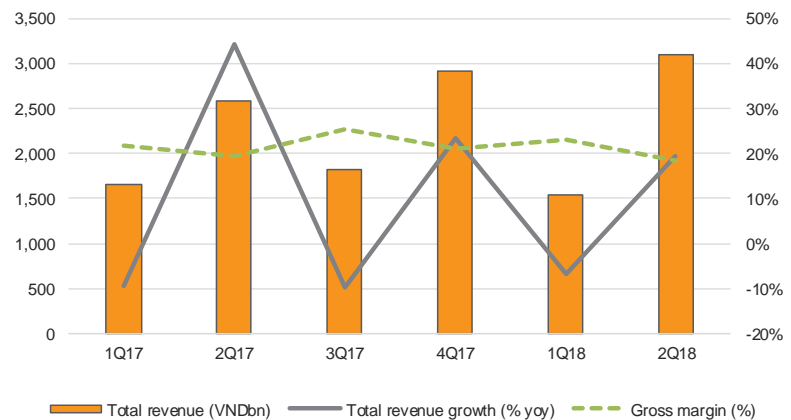
FYE (VNDbn)	2QFY18	yoy chg	1HFY18	yoy chg	vs. old forecast	vs. revised forecast	Comments
Total revenue	3,096.7	19.6%	4,641.8	9.3%	50.7%	47.8%	
CPC	1,795.1	15.5%	2,538.9	3.5%	49.1%	44.7%	CPC revenue accelerated in 2Q due to seasonality, in line with the start of the Summer-Autumn crop.
Agrifood	979.5	31.3%	1,594.2	19.0%	56.4%	55.5%	Rice export price in the market surged 14.2% yoy in 1H2018, which benefited LTG's Agrifood segment as 90% of the segment revenue came from rice exports.
Seed	256.1	5.3%	389.1	5.9%	49.1%	41.9%	
Others	66.0	43.9%	119.6	38.1%	33.4%	50.9%	
Gross profit	536.3	6.7%	889.7	3.1%	44.1%	44.3%	
Gross profit margin	18.5%	-1.9% pts	20.1%	-0.9% pts			GPM was hurt by (1) the decline in CPC segment's gross margin (-1.8% pts) as a result of sharp increases in customer discounts and promotions and (2) provisional reversal of VND23bn in 1H2017, despite a recovery in Agrifood segment's GPM (+6.0% pts) after the rice stock clearance in 2017.
Selling expenses	230.4	-12.1%	403.6	-2.9%	44.8%	43.5%	Selling expenses were adjusted upwards to reflect higher customer discounts to boost sales amid strong market competition.
G&A expenses	104.5	63.8%	174.8	22.4%	46.6%	46.6%	
Operating profit	201.4	13.8%	311.3	2.4%	42.1%	44.2%	
Pre-tax profit	143.8	-4.0%	232.1	-8.8%	34.7%	41.0%	Interest expense increased 45.3% yoy (VND26bn) on higher debt balance, thus pulling down pre-tax profit.
Net profit	115.7	-1.7%	188.9	-3.7%	37.7%	42.1%	
Net profit (excl. provision reversal)	115.7	-1.7%	188.9	6.7%	37.7%	42.1%	If excluding the provision reversal in 2Q17, net profit would have increased by 6.7%.
EPS (sem)(VND/share)	1,722.4		2,812.3		37.7%	42.1%	

Source: LTG, VNDIRECT

Note that LTG's quarterly performance often expresses high seasonality due to fluctuations in the beginning of the growing season, when farmers use the most CPC products. Farmers based their planting schedule on lunar calendar and the weather conditions, hence for a particular crop, part of CPC revenue could be recorded in either quarters. In general, revenue often peaked in the second and fourth

quarter and yoy revenue growth could be negative in one quarter followed by positive growth in the next.

Figure 3: LTG's total revenue during 1Q17 - 2Q18



Source: LTG, VNDIRECT

2018-2019 outlook: Continued restructuring to improve efficiency

LTG plans to reduce the contribution of the CPC segment and focus more on the Agrifood segment. Currently, the CPC segment is still the main driver of LTG's profit, accounting for 75-85% of LTG's gross profit over 2013-2017. However, the company plans to gradually reduce the contribution of this segment to total group revenue in the upcoming period, in line with increasing market demand for organic and bio-products versus toxic, chemical-based crop protection products. This trend reflects rising environmental awareness and concerns over health-related issues not only in Vietnam but globally. Responding to this, LTG will also introduce more high-end products (such as compost, products containing micro-organisms, which are more environmentally-friendly) into its product mix, with the aim of winning more market share in this fairly new segment.

Given the company's leading position in the CPC segment with a market share far exceeding that of the second player VFG (21% vs. 8.3% respectively in 2016), an extensive distribution network and established long-term relationships with foreign suppliers (Vietnam heavily relies on imports to satisfy domestic CPC demand), we believe LTG could still easily maintain its market leadership in this segment in the next few years, equating to a revenue CAGR of 5% over FY18-21 and a stable gross margin at 28.7%. For 2H18, we expect a stable performance of LTG with revenue realization concentrated in 4Q due to seasonality on the back of high demand towards the year-end and normal weather conditions.

Internal restructuring within the Agrifood and seed segment

The Agrifood segment is expected to become the new focus from 2018 onwards, after continuous efforts to restructure the segment in 2016-2017 such as clearing old rice stock and narrowing the cultivation area to 25,000 ha (adjusting the cultivation area in relation to demand to avoid inventory build-up). This has helped the company's gross margin return to the average level of 7-8% seen before the 2016-2017 period.

The new strategy also manifested in a cooperation agreement between the company and China's Hunan Yuan Science Technology in the form of two joint ventures (JV) with a view to expanding LTG's market share in the seed and rice segments. One JV in Vietnam (LTG

owns 52%) will focus on developing high-productivity, hybrid seeds at reasonable costs to export to other Southeast Asian countries, as well as research on expanding LTG's seed offerings from mainly rice to include corn, vegetable seeds and weather-resistant seeds. The other JV will be set up in China (LTG owns 49%) as a trading partner to import rice (at the early phase) and agro-products such as coffee, pepper (at a later stage) into China through official export channels (as opposed to informal border trading). This presents LTG an opportunity to improve access to the Chinese market, both in terms of increased responsiveness to market demands and in creating a brand name for Vietnamese rice and agro-products among Chinese consumers.

Although we consider the cooperation with Hunan Yuan a good move, it is too early to estimate the benefits the joint ventures might bring to LTG. We project a 13% increase in the Agrifood segment's net revenue in 2018 on the basis of: (1) strong 1H18 performance, with this segment managing to record VND26bn in net profit vs. a loss of VND70bn in 1H17, (2) higher demand from potential markets such as China, Philippines and Indonesia in 2H18, according to forecast by the Ministry of Agriculture and Rural Development, and (3) improvement in 2018 GPM as a result of the full-year benefit of the restructuring activities carried out over 2016-2017. In terms of seed, we assume a stable growth of 10% in net revenue with gross margin maintaining at 22.4% (similar to 2017 level).

Figure 4: 2018 earnings revision

FYE (VNDbn)	2017A	2018F		Comments
		Old	New	
Net revenue	8,687	8,781	9,365	6.7% Higher revenue forecast due to better-than-expected results in 1H2018
<i>Net revenue growth</i>	<i>11.6%</i>	<i>1.1%</i>	<i>7.8%</i>	
Gross profit	1,881	2,016	2,006	-0.5%
<i>Gross profit margin</i>	<i>21.7%</i>	<i>23.0%</i>	<i>21.4%</i>	<i>-1.6% pts</i> CPC gross margin revised downward to better reflect the decline in 1H18 CPC gross margin. Since CPC contributed 70-80% to gross profit, the adjustment strongly affected GPM.
EBIT	631	740	704	-4.9%
EBT	527	669	566	-15.3% Higher interest expense as a result of increases in 1H18 debt balance
Net profit	414	500	449	-10.3%
EPS (VND)	6,169	7,451	6,685	-10.3%

Source: VNDIRECT

Valuation

We are still optimistic about LTG's long-term outlook, given its leading position in the CPC market and high growth potential in the Agrifood segment. The company is also strengthening its management board (by hiring more outsiders instead of promoting internally and by hiring PwC as an advisor in this restructuring) to improve corporate governance. Low liquidity and low room for foreign investors might be the main reasons for the current price weakness, which the company aims to address by migrating its stock listing from Upcom to HOSE in 2019.

We reiterate our ADD recommendation for LTG with a target price of VND46,000/share based on a 2018 target P/E of 8.0x (equivalent to its closest peer VFG with similar ROE level) and a 2018 adjusted EPS (after bonus and welfare fund deductions of 15%) of VND5,686/share.

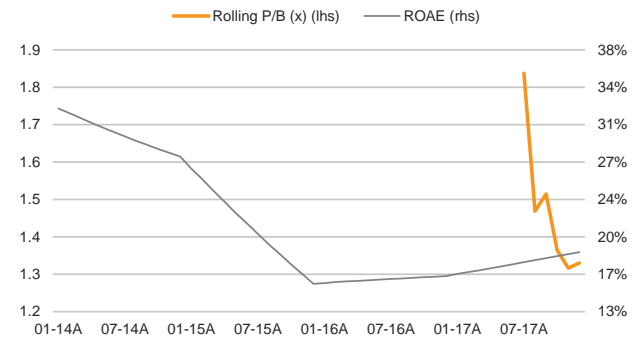
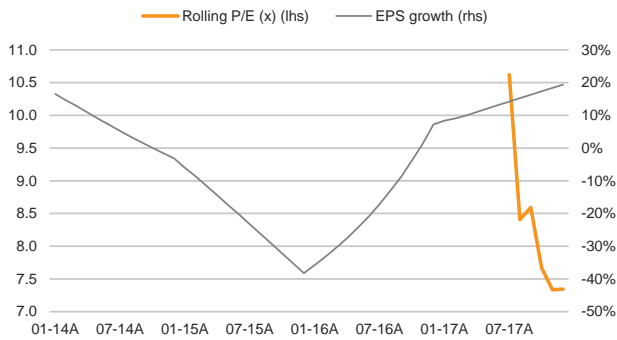
Figure 5: Peer comparison as of Sep 04, 2018

Company	Country	Market Cap (VNDbn)	TTM NPAT growth (%)	TTM EPS growth (%)	TTM ROA (%)	TTM ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
HNG	Vietnam	15,874.5	N/A	N/A	0.4%	1.0%	1.1	128.7	1.4
PAN	Vietnam	6,945.6	147%	108%	6.6%	9.9%	0.4	15.6	2.6
NSC	Vietnam	1,710.1	23%	23%	15.1%	21.8%	0.3	7.4	2.0
VFG	Vietnam	1,169.6	11%	-4%	8.2%	17.6%	0.4	7.8	1.4
SSC	Vietnam	811.0	146%	172%	18.5%	28.8%	0.3	13.9	2.7
LTG	Vietnam	2,588.4	6%	6%	6.4%	18.5%	1.4	6.1	1.1
Peer average (excl. HNG)			82%	75%	12.1%	19.5%	0.4	11.2	2.1
Peer median (excl. HNG)			85%	66%	11.6%	19.7%	0.3	10.8	2.3

*VFG's TTM EPS was diluted due to share issuance in 2H17.

Source: VNDIRECT, Stoxplus

Valuation



Income statement

(VNDbn)	12-16A	12-17A	12-18E
Net revenue	7,783	8,687	9,365
Cost of sales	(6,201)	(6,806)	(7,359)
Gen & admin expenses	(316)	(311)	(375)
Selling expenses	(704)	(938)	(927)
Operating profit	561	631	704
Operating EBITDA	684	768	844
Depreciation and amortisation	(122)	(136)	(140)
Operating EBIT	561	631	704
Interest income	25	15	16
Financial expense	(150)	(136)	(162)
Net other income	27	17	9
Income from associates & JVs	0	0	0
Pre-tax profit	464	527	566
Tax expense	(115)	(113)	(113)
Minority interest	(2)	(0)	(5)
Net profit	347	414	449
Adj. net profit to ordinary	347	414	449
Ordinary dividends	(91)	(290)	(322)
Retained earnings	256	124	127

Balance sheet

(VNDbn)	12-16A	12-17A	12-18E
Cash and equivalents	279	116	349
Short term investments	25	27	27
Accounts receivables	1,733	2,381	2,589
Inventories	2,170	2,148	2,091
Other current assets	63	87	93
Total current assets	4,270	4,760	5,149
Fixed assets	1,739	1,666	1,683
Total investments	0	33	33
Other long-term assets	150	128	138
Total assets	6,159	6,588	7,004
Short-term debt	1,905	2,146	2,146
Accounts payable	1,545	1,401	1,515
Other current liabilities	407	468	505
Total current liabilities	3,857	4,016	4,166
Total long-term debt	74	220	220
Other liabilities	52	40	40
Share capital	672	672	806
Retained earnings reserve	335	403	417
Shareholders' equity	2,150	2,287	2,548
Minority interest	26	25	29
Total liabilities & equity	6,159	6,588	7,004

Cash flow statement

(VNDbn)	12-16A	12-17A	12-18E
Pretax profit	464	527	566
Depreciation & amortisation	122	136	140
Tax paid	(9)	(59)	(113)
Other adjustments	(284)	(74)	(3)
Change in working capital	767	(670)	(3)
Cash flow from operations	1,061	(141)	588
Capex	(163)	(86)	(158)
Proceeds from assets sales	18	19	0
Others	10	(33)	(10)
Other non-current assets changes	(22)	1	0
Cash flow from investing activities	(157)	(99)	(168)
New share issuance	3	2	134
Shares buyback	0	0	0
Net borrowings	(727)	387	0
Other financing cash flow	0	0	0
Dividends paid	(91)	(290)	(322)
Cash flow from financing activities	(815)	99	(188)
Cash and equivalents at beginning of period	190	279	116
Total cash generated	89	(141)	233
Cash and equivalents at the end of period	279	138	349

Key ratios

	12-16A	12-17A	12-18E
Dupont			
Net profit margin	4.5%	4.8%	4.8%
Asset turnover	1.24	1.36	1.38
ROAA	5.5%	6.5%	6.6%
Avg assets/avg equity	2.97	2.87	2.81
ROAE	16.4%	18.7%	18.6%
Efficiency			
Days account receivable	79.6	96.5	96.5
Days inventory	128	115	104
Days creditor	91.2	75.2	75.2
Fixed asset turnover	4.45	5.10	5.59
ROIC	8.4%	8.9%	9.1%
Liquidity			
Current ratio	1.11	1.19	1.24
Quick ratio	0.54	0.65	0.73
Cash ratio	0.08	0.04	0.09
Cash cycle	117	137	125
Growth rate (yoy)			
Revenue growth	(0.9%)	11.6%	7.8%
Operating profit growth	(7.4%)	12.5%	11.5%
Net profit growth	8.8%	19.4%	8.4%
EPS growth	7.2%	19.4%	8.4%
Share value			
Basic EPS (VND)	5,167	6,169	6,690
BVPS (VND)	32,018	34,049	31,616

Source: VNDIRECT

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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.

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Definition:

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- 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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