THE PAN GROUP (PAN) – VISIT NOTE

Market Price	Target Price	Dividend Yield	Rating	Sector
VND68,400	N/A	1.5%	NOT RATED	CONSUMER GOODS

Outlook – Short term
Negative Neutral Positive

Outlook – Long term
Negative Neutral Positive

Valuation
Negative Neutral Positive

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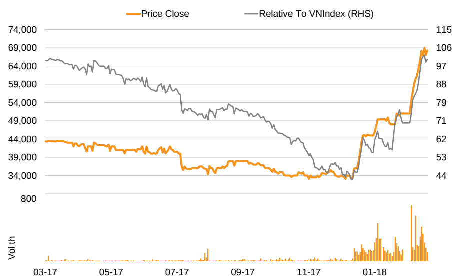
Key changes in the report

- None

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	69,000
52w low (VND)	33,100
3m Avg daily volume (shares)	157,872
3m Avg daily value (VNDmn)	8,357
Market cap (VNDbn)	7,887
Outstanding shares (m)	120.2
Free float (%)	18.9
TTM P/E (x)	21.7
Current P/B (x)	2.6

Ownership

Tael Two Partners	20.2%
SSI	13.7%
NDH Investment Co. Ltd.	10.5%
Others	55.6%

Source: VNDIRECT

Through rigorous M&A activities in recent years, PAN Group (PAN) has transformed from a mundane services company to a prominent agriculture and food conglomerate in Vietnam with a portfolio of brands. We just had a meeting with PAN's managers, who provided some insights into the group's future direction.

The recent acquisition of a 30.5% stake in Sao Ta Foods JSC (FMC) in Jan 2018 should unlock synergies through (1) bundling of the related but distinct product offerings of both seafood processing subsidiaries ABT (pangasius and clams) and FMC (shrimp), and (2) the spillover of R&D investments made by ABT to FMC which could help FMC expand its material zone and improve profitability.

We believe 2018 will be another good year for the seed segment. We expect rising sales fueled by farmers' gradual shift from home-saved seeds to certified, patented seeds for better yield and productivity. Meanwhile, profit margins could expand as PAN's seed producing subsidiaries restructure their product mix from low-margin seeds such as unpatented seeds, feed-grade corn seeds to higher-margin products, such as patented seeds and food-grade corn seeds.

2018 reported earnings could grow at double digits due to (1) full consolidation of FMC and BBC's business results, (2) strong performance of the seed segment, (3) a possible recovery in the seafood segment, as ABT will no longer suffer from the effect of 2016's drought-induced saltwater intrusion, and starting from 4Q2017 profit margins have recovered partly thanks to the implementation of a new water filtering system.

Sharp share price appreciation since the beginning of 2018 could be credited to impressive 2017 business results. PAN is currently trading at a TTM P/E of 21.7x which is fairly high compared to its peers. However, with strong potential in the seed and confectionary segment that is expected to boost 2018 EPS growth, we still consider PAN a good buy-and-hold investment opportunity for investors who want longer-term exposure to Vietnam's developing agriculture and food processing sectors.

Financial summary (VND)	12-14A	12-15A	12-16A	12-17A
Net revenue (bn)	1,122	2,650	2,753	4,075
Revenue growth	81.6%	136.2%	3.9%	48.0%
Gross margin	26.7%	25.5%	23.3%	23.0%
EBITDA margin	19.4%	17.3%	18.5%	16.9%
Net profit (bn)	100	215	257	371
Net profit growth		114.7%	19.4%	44.5%
Recurring profit growth		44.4%	(33.2%)	10.9%
Basic EPS	1,711	2,414	2,384	3,154
Adjusted EPS	1,651	2,355	2,332	3,154
BVPS	19,710	20,961	22,651	26,528
ROAE	11.6%	12.9%	11.6%	14.7%

Source: VNDIRECT

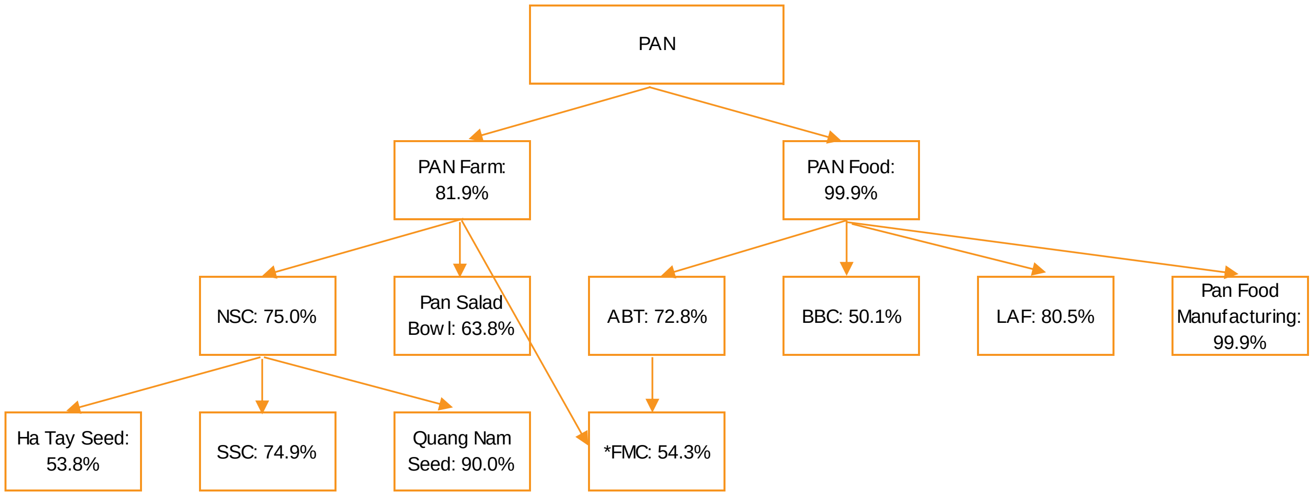
Company background: inorganic growth strategy to build a diversified agriculture and foods portfolio

PAN began to reorient its business towards the agriculture and food sectors since 2013 through an acquisition-led growth strategy. It started to invest in the farming sector in 2014 through the acquisition of 53.2% of the largest seed producer in Vietnam: National Seed Corporation (NSC) and then expanded by increasing its stake in NSC and the indirect stake in Southern Seed (SSC) through NSC in later years.

In the food sector, PAN gradually acquired controlling stakes of leading companies in 2 business lines: seafood processing and packaged foods. The two seafood processing subsidiaries are Aquatex Bentre – ABT (a prominent pangasius and clam exporter) and Sao Ta Foods – FMC (a top shrimp exporter). In the packaged foods segment, PAN holds a stake in Bibica – BBC (a confectionary company with the highest market share in the mass customer segment) and Lafooco – LAF (a top cashew exporter in Vietnam).

As of Jan 2018, PAN's subsidiaries are reported as below:

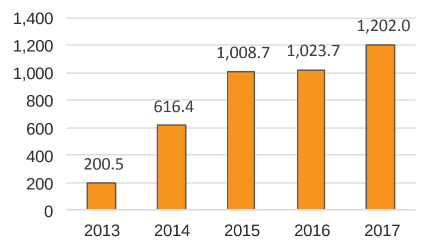
Figure 1: PAN's subsidiaries



*represents total holding in FMC from PAN Farm (34.2%) and ABT (20.1%)

Source: VNDIRECT

Figure 2: PAN's charter capital



Source: VNDIRECT

The group financed its M&A activity mostly through raising equity capital in the 2014-2017 period but this strategy was still largely accretive to EPS. PAN's liquidity ratios have remained relatively healthy throughout the years.

Besides, PAN has 3 affiliates namely Pan Pacific Service (20%), Pan Pacific (20%), both of which offer cleaning services and 584 Nha Trang (22%), a traditional fish sauce producer with 30 years of history. PAN aims to sell the remaining 20% stake in both of its cleaning services in 2018 and become a purely agriculture and food processing corporation. In addition, the group also plans to further reduce the ownership in its JV with a Japanese partner PAN Salad Bowl from 64% to 51%. These divestments could yield substantial one-off financial gains in 2018.

2017 growth was mainly driven by strong growth in the seed segment and the consolidation of the recently-acquired confectionary business

2017 marked another good year for PAN as net revenue grew 48% yoy to VND4,075bn, supported by the partial consolidation of BBC's revenue starting from 3Q2017, strong performance of the seed segment (NSC +14%, SSC +26%) and the cashew nut segment (LAF +48%, thanks to higher ASPs). If we exclude the contribution of BBC, we estimate that PAN's core net revenue would still have increased by a healthy 26% yoy.

Figure 3: 2017 business results of PAN's subsidiaries and affiliates

Companies	Net revenue growth (%)	Earnings growth (%)	∆ GPM (bps)
NSC	14%	20%	(14)
SSC	26%	79%	45
ABT	-9%	-43%	(515)
LAF	48%	-83%	(464)
BBC	2%	19%	(353)
FMC	14%	9%	6
PAN	48%	44%	(33)

Source: VNDIRECT

PAN Farm, whose revenue comes mainly from the NSC subsidiary, reported net revenue of VND1,520bn (+15%), contributing 37.3% to PAN's consolidated net revenue. PAN Food, which comprises of ABT, LAF, PAN Manufacturing (PFM – a unit that produces PAN Foods' own branded foods) and BBC, recorded net revenue of VND2,555bn (+93%), contributing 62.7% to PAN's net revenue.

Gross margin remained relatively unchanged, but operating profit was hurt by a surge in SG&A expenses (+66%), which we believe was caused by the consolidation of BBC, a 12% increase in NSC's SG&A expenses and PAN Foods' efforts in expanding its distribution network. All these factors eroded margins and resulted in a moderate operating profit growth of 7%.

Net profit, however, surged by 44% to VND371bn due to an abnormal financial gain of VND240bn from the revaluation of PAN's investment in affiliates after BBC changed its status from an affiliate to a subsidiary. PAN also reduced its ownership in PAN Farm from 99.9% to 81.9% to make way for strategic investments by the IFC, Daiwa-SSIAM II Vietnam Growth Fund II and SSI, and thus NSC's contribution to net profit declined accordingly.

Normalizing for the effect of changing stakes in subsidiaries and affiliates and abnormal gains, we estimate that net profit should have risen by roughly 11%. Core profit growth was the result of sustained high margins at NSC and SSC and an effective management of production costs.

Seed segment: product portfolio restructuring helping to improve margins

NSC holds the highest market share in the seed segment, with a goal to expand its presence in the South through its subsidiary SSC. The three main products of NSC are paddy seed (11% market share in terms of conventional seeds, 20% market share in terms of hybrid seed), corn seeds (30% total market share) and vegetable seeds (5% market share).

NSC currently has a very strong presence in the North, but limited presence in the Central and the South, which the company is looking to address through the acquisition of SSC, a strong player in the South. More specifically, NSC and SSC could complement each other in terms of R&D initiatives, a more diversified product portfolio (NSC is strong in paddy seeds while SSC is strong in corn seeds), more extensive distribution network and larger production area (land bank).

Given this, we consider PAN's decision to acquire SSC through NSC to be a good one as it will help unlock synergies between both companies and benefit PAN as a whole in the long-term.

Product portfolio restructuring is catalyzing an improvement in margins

In terms of rice seeds, the main demand catalyst is the shift from the informal channel (farm-saved seeds) to formal channel (certified/patented seeds) that have higher quality and possibly more favorable characteristics such as drought-resistance, salinization-resistance. This will benefit leading producers such as NSC, SSC, LTG who possess the required technology, size and resources to develop those in-demand products. Note that the patented seeds (currently accounting for 70% of NSC's rice seed revenue) also carry higher margins (40-50%) compared to unpatented seeds (20-30%).

In terms of corn seeds, a shift in SSC's product portfolio from a focus on feed-grade corn to higher-margin food-grade corn started to help SSC generate better margins in 2017 (+45bps), a trend which we expect to continue further into 2018.

Seafood processing segment: recovering from unfavorable market conditions with strong future synergy potential

In 2017, the pangasius export industry faced many challenges in its traditional markets such as the EU (negative stories featuring pangasius from Vietnam on Spanish TV) and higher barriers in the US market. Total export value to the US and EU market fell 11% and 22.3%, respectively (Source: VASEP), which directly affected ABT's performance as over 60% of ABT's volume is exported to the EU market. Meanwhile, due to the lasting effect of salinization during 2016 and early 2017, which significantly impacted ABT's own farming area, pangasius production costs shot up, squeezing margins.

We expect 2018 to be a better year for ABT as: (1) the company no longer suffers from the severe salinization mentioned above, and (2) a new water filtering system (RAS) coming into operation will help improve the living conditions of pangasius, increase productivity and yields and cut costs. In fact, ABT's 4Q2017 GPM has recovered to 18.6% (vs. 9.4% in 9M2017), which is a good sign for ABT.

PAN's recent acquisition of a controlling stake in leading shrimp-exporter FMC is a milestone. FMC is among the top 10 shrimp exporters in Vietnam. PAN expects to unlock synergies in the seafood processing segment through (1) the sharing of customer bases as FMC and ABT both export to the EU and Japan but their customer portfolios do not currently overlap, and (2) the spillover of R&D achievements in the seafood segment from ABT to FMC, helping FMC to expand its own material zone (FMC currently self-supplies only 10% of its raw shrimp input) and thereby improve its profitability.

In our opinion, PAN's objectives look achievable as ABT has a strong background in R&D related to seafood processing while in a previous meeting with FMC, the company also expressed caution in expanding its material zone due to the complexity of required technology and difficulties in controlling risk. We expect that through the parentage of PAN, over the long-term ABT and FMC could combine to create a horizontal value chain in the seafood segment.

Confectionary and nuts segment: Targeting premium segment and value-added products

According to the company's representative, BBC is the leading producer of baked goods and sugar confectionary with a solid 50% market share in the mass customer segment, with a particularly strong presence in rural areas. However, its presence in the higher-income segment is still limited. PAN's strategy in the confectionary industry is to maintain BBC's existing strengths in the mainstream baked goods and candies, while simultaneously penetrating into the higher-income segment by developing premium, locally-customized products under PAN Foods' own brand name. To realize this strategy, PFM has invested in a new factory producing the premium sponge cake products which PAN expects to launch in 1Q2018.

With the acquisition of a controlling stake in BBC, PAN could leverage BBC's large distribution network of around 150 distributors, 132,000 point of sales (POS) and its expert knowledge of the confectionary market to further its own product distribution initiatives.

In the nut segment, LAF reported impressive 2017 revenue growth of 48% yoy thanks to the upsurge in cashew export prices, however, a peak in input prices (due to poor crop) led to the squeeze in gross margin to 1.7%, the lowest in the past 5 years. Although LAF has made a strategic shift from pure commodity trading to producing more value-added products starting from 2012, the contribution of the premium segment is still quite low at 10%. We are cautious on the company's high exposure to cashew commodity prices, as LAF does not grow its own cashew nuts, instead sourcing raw cashew through imports (70%) and from domestic farmers (30%) and these raw materials account for 80% of COGS.

Valuation and recommendation

We expect PAN's 2018 earnings to grow in double digits, thanks to (1) full consolidation of FMC and BBC's business results, (2) prospective strong results of the seed segment, (3) a possible recovery in the seafood segment, and (4) growth from continued possible M&A activities. Regarding this, PAN has announced the plan to acquire the remaining shares in NSC's two subsidiaries SSC (25%) and Quang Nam Seeds (10%), though other possible deals remain undisclosed.

We like PAN for its economic interest in the leading players in a range of agriculture and food segments together with the high growth potential in the confectionary and seed segment. The shrimp exporting sector will also benefit from certain free trade agreements (for example CPTPP) that could help boost revenue growth in the upcoming period. However, at the current price of VND68,400/share, PAN is trading at a TTM P/E of 21.7x, which is fairly high compared to its local peers. Given our expectation for strong earnings growth in 2018 and beyond, via both organic growth and M&A, PAN would be suitable for investors who want exposure to the agriculture and food sector in Vietnam and have longer-term investment horizons (note that the shares of some profitable and listed subsidiaries of PAN such as NSC, SSC have low liquidity and limited room for foreign investors).

Risks

There are several risks regarding PAN's core business activities, including: (1) the high exposure of the agriculture sector to weather conditions. Adverse conditions such as salinization, El Nino, La Nina, could impact the performance of several of PAN's businesses, (2) the rising import barriers in the seafood industry's traditional export markets, (3) the exposure of the cashew processing and trading operation to input price fluctuations, (4) dilution risk from raising equity capital to finance M&A activities, which could lead to low EPS growth despite strong revenue and earnings growth.

Figure 4: Peer comparison

Company	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)
HAG	Vietnam	258.2	N/A*	N/A*	1.2%	3.7%	1.25	10.2	0.5
HNG	Vietnam	220.3	N/A*	N/A*	2.8%	9.2%	1.35	6.6	0.6
AGM	Vietnam	163.8	75.5%	75.4%	1.5%	3.2%	0.82	14.4	0.5
LTG	Vietnam	118.2	24.4%	24.4%	6.8%	19.2%	1.02	6.5	1.2
GTN	Vietnam	111.2	639.6%	-42.6%	3.0%	3.6%	0.01	23.8	1.1
NSC	Vietnam	75.7	20.3%	20.3%	13.7%	19.7%	0.1	8.2	1.9
SSC	Vietnam	40.8	78.9%	78.9%	15.6%	20.0%	0.1	20.3	2.7
PAN	**Vietnam**	**354.8**	**44.5%**	**35.2%**	**7.6%**	**10.5%**	**0.2**	**21.7**	**2.6**
Peer average					10.8%	14.4%	0.1	17.5	1.9
Peer median					13.7%	19.7%	0.1	20.3	1.9

*HAG and HNG incurred losses in 2016 but made profit in 2017.

Source: Stoxplus, VNDIRECT

Valuation

Income statement

(VNDbn)	12-15A	12-16A	12-17A
Net revenue	2,650	2,753	4,075
Cost of sales	(1,973)	(2,111)	(3,137)
Gen & admin expenses	(236)	(251)	(342)
Selling expenses	(163)	(173)	(361)
Operating profit	**277**	**219**	**235**
Operating EBITDA	357	319	380
Depreciation and amortisation	**(80)**	**(100)**	**(146)**
Operating EBIT	**277**	**219**	**235**
Interest income	126	181	325
Financial expense	(83)	(61)	(42)
Net other income	9	5	2
Income from associates & JVs	34	41	22
Pre-tax profit	**362**	**385**	**542**
Taxation	(47)	(49)	(41)
Minority interests	(100)	(79)	(130)
Net profit	**215**	**257**	**371**
Adj. net profit to ordinary	215	257	371
Ordinary dividends	(130)	0	(29)
Retained earnings	**86**	**257**	**342**

Balance sheet

(VNDbn)	12-15A	12-16A	12-17A
Cash and equivalents	729	558	1,119
Short term investments	5	444	512
Accounts receivables	568	435	635
Inventories	723	549	720
Other current assets	21	30	53
Total current assets	**2,046**	**2,015**	**3,039**
Fixed assets	710	696	1,880
Total investments	391	464	296
Other long-term assets	546	586	784
Total assets	**3,693**	**3,761**	**5,999**
Short-term debt	481	476	682
Accounts payable	134	110	264
Other current liabilities	233	172	455
Total current liabilities	**848**	**758**	**1,401**
Total long-term debt	58	12	236
Other liabilities	70	68	198
Share capital	1,009	1,024	1,177
Retained earnings reserve	37	179	390
Shareholders' equity	**2,114**	**2,319**	**2,716**
Minority interests	603	604	1,449
Total liabilities & equity	**3,693**	**3,761**	**5,999**

Cash flow statement

(VNDbn)	12-15A	12-16A	12-17A
Pretax profit	**362**	**385**	**542**
Depreciation & amortisation	80	100	146
Tax paid	(55)	(47)	(39)
Other adjustments	201	(434)	(353)
Change in working capital	**(521)**	**199**	**27**
Cash flow from operations	**67**	**203**	**323**
Capex	(124)	(140)	(475)
Proceeds from assets sales	0	12	23
Others	(578)	69	(288)
Other non-current assets changes	85	(280)	512
Cash flow from investing activities	**(617)**	**(338)**	**(228)**
New share issuance	936	0	293
Shares buyback	(0)	15	0
Net borrowings	129	1,601	203
Other financing cash flow	0	(1,652)	0
Dividends paid	(130)	0	(29)
Cash flow from financing activities	**935**	**(36)**	**467**
Cash and equivalents at beginning of period	344	729	558
Total cash generated	**385**	**(171)**	**561**
Cash and equivalents at the end of period	729	558	1,119

Key ratios

	12-15A	12-16A	12-17A
Dupont			
Net profit margin	8.1%	9.3%	9.1%
Asset turnover	0.89	0.74	0.84
ROAA	7.2%	6.9%	7.6%
Avg assets/avg equity	1.79	1.68	1.94
ROAE	12.9%	11.6%	14.7%
Efficiency			
Days account receivable	66.4	43.1	50.5
Days inventory	134	95	84
Days creditor	24.8	19.0	30.7
Fixed asset turnover	5.42	3.92	3.16
ROIC	6.6%	7.5%	7.3%
Liquidity			
Current ratio	2.41	2.66	2.17
Quick ratio	1.56	1.94	1.66
Cash ratio	0.86	1.32	1.16
Cash cycle	175	119	104
Growth rate (yoy)			
Revenue growth	136.2%	3.9%	48.0%
Operating profit growth	131.0%	(20.9%)	7.2%
Net profit growth	114.7%	19.4%	44.5%
EPS growth	41.1%	(1.2%)	32.3%
Share value			
Basic EPS (VND)	2,414	2,384	3,154
BVPS (VND)	20,961	22,651	26,528

Source: VNDIRECT

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CIMB

Country	CIMB Entity	Regulated by
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Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

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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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Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
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