

QUANG NGAI SUGAR JSC (QNS) - UPDATE

Market Price VND57,000	Target Price VND76,000	Dividend Yield 1.8%	Rating ADD	Sector CONSUMER GOODS
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Outlook – Short term



Outlook – Long term



Valuation



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Key changes in the report

- Reduce FY17 forecasted revenue by 2.9%
- Reduce FY17 forecasted NP by 8.6%
- Revise the target P/E multiple downward for soymilk business

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	128,800
52w low (VND)	54,400
3m Avg daily volume (shares)	0.15
3m Avg daily value (VNDmn)	8,978
Market cap (VNDbn)	13,260
Outstanding shares (m)	243
Free float (%)	91
P/E (TTM)	10.3x
P/B (Curr.)	3.1x

Ownership

Thanh Phat Trade Co., Ltd	12.17%
Vo Thanh Dang	4.66%
Foremost Worldwide., Ltd	3.83%
Others	79.34%

Source: VNDIRECT

QNS posted a sluggish 3Q17 performance with a growth of 4.1% YoY in revenue and a sharp decline of 38% YoY in net profit. We lower our target price by 20% but maintain our ADD rating due to the recent slide in the share price.

Volume growth did not feed through to the bottom line. For 9M2017, QNS posted an increase of 12.8% YoY in revenue, mainly stemming from a 31.9% YoY rise in sugar revenue regarding a recovery of volume in 2017 from a low base last year due to the prolonged draught. Meanwhile, the soymilk business saw sluggish top line growth of only 4.1% YoY due to stiffer competition from new foreigner brands. Despite the top-line growth, a plunge in aggregate gross margin dragged 9M2017 earnings down by 15.2% YoY.

We lower our TP due to a marked stiffening of competition in the domestic soymilk market. We adjusted our target price down from the previous VND95,600/share to 76,000VND/share based on a decrease of 8.5% in our forecasted FY18 net profit and also because we now apply a lower target PE multiple to value the soymilk segment. We lower our target one-year forward PE multiple of 16x (previously 19x) for the soymilk segment (a 40% discount to VNM) due to the increasing competition recently seen in domestic soymilk market. We however maintain our target one-year-forward PE of 8x for the other businesses as there is no material change in market conditions.

But the recent share price fall means valuation is still attractive. Currently, QNS is trading at a TTM P/E of 10.4x, a 69% discount to consumer peers and a 13% discount to sugar peers. The recent sharp fall in share price was a kneejerk reaction to the sluggish 9M performance. We maintain an ADD rating for QNS based on an upside of 33.3% and consider QNS an investable alternative to ride the consumer F&B growth story in Vietnam at a time when other consumer plays have limited foreign room and look fully-valued. Furthermore, as the company diversifies its consumer product portfolio over time, revenue contribution from the sugar segment should shrink and help QNS close its valuation gap with pure-play consumer stocks.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	7,785	6,971	7,622	8,003
Revenue growth	24.6%	(10.5%)	9.3%	5.0%
Gross margin	29.5%	33.1%	32.0%	31.9%
EBITDA margin	13.0%	17.7%	14.9%	14.7%
Net profit (bn)	1,230	1,408	1,348	1,407
Net profit growth	58.9%	14.5%	(4.3%)	4.4%
Recurring profit growth	61.3%	13.9%	(4.3%)	5.2%
Basic EPS	10,407	8,920	6,567	6,698
Adjusted EPS	10,407	8,920	6,567	6,698
BVPS	18,492	20,846	19,795	21,301
ROAE	56.6%	43.2%	30.9%	27.8%

Source: VNDIRECT

Figure 1: QNS's 9M performance by product category

(in VNDbn)	9M2017	9M2016	%YoY
Revenue	5,935	5,261	12.8%
<i>Soymilk</i>	2,915	2,802	4.0%
<i>Sugar</i>	1,562	1,184	31.9%
<i>Others</i>	1,458	1,275	14.4%
Gross profit	1,420	1,586	-10.5%
<i>Soymilk</i>	1,003	1,017	-1.4%
<i>Sugar</i>	76	229	-66.8%
<i>Others</i>	341	340	0.3%
SG&A expenses	651	737	-11.7%
PBT	758	878	-13.7%
NPAT	684	807	-15.2%

Source: QNS, VNDIRECT

Soymilk business feeling the heat from intensifying competition.

Soymilk revenue only rose by 4.0% YoY to touch VND2,915bn in 9M2017, putting the full year target of 10% growth out of reach. Given the stable demand for packaged soymilk in Vietnam (accounting for approximately 33% of total soymilk consumption), QNS's incremental growth was challenged by the growing market penetration of foreign brands such as Vitasoy and Homesoy. Through some of our site visits, we have learnt that these foreign products have gradually managed to secure the best shelf space in supermarkets, making them more visible to consumers. QNS's product portfolio is not diversified like that of its competitors, giving it less bargaining power with retailers and also creating product concentration risk.

The company has been responding to stronger competition through more aggressive sales promotions, as well as launch of new products (eg: Soyman, Vinasoy black sesame) which have yet to make significant contributions to revenue (the original product line - Fami continues to account for around 80% of total soy milk sale volume).

Gross margin contracted by nearly 200 bps due to promotions and depreciation from new factory.

Gross margins shrank to 34.4% from 36.3% in 9M2016, led by a combination of two factors: (1) accelerating sales promotions (eg: buy 4 get 1 free offers), which effectively reduced ASPs; (2) a rise of VND67bn YoY in depreciation costs stemming from the new factory in Binh Duong. Consequently, the 9M2017 gross profit of the soymilk segment fell to VND1,002bn (-1.5% YoY).

QNS's current total capacity is 390mn liters with 3 plants distributed across the country. Before new plant was launched in the South, the 2 legacy plants were running at a utilization rate of around 80% - 85% and products had to be transported from the Quang Ngai factory in Central Vietnam to the southern market which increased logistics expenses.

Figure 2: QNS's current plants and capacity

Plants	Region	Year operation	Capacity (mn litres)
Vinasoy Quang Ngai	Central	2002	120
Vinasoy Bac Ninh	North	2013	180
Vinasoy Binh Duong (stage 1)	South	2017	90

Source: QNS

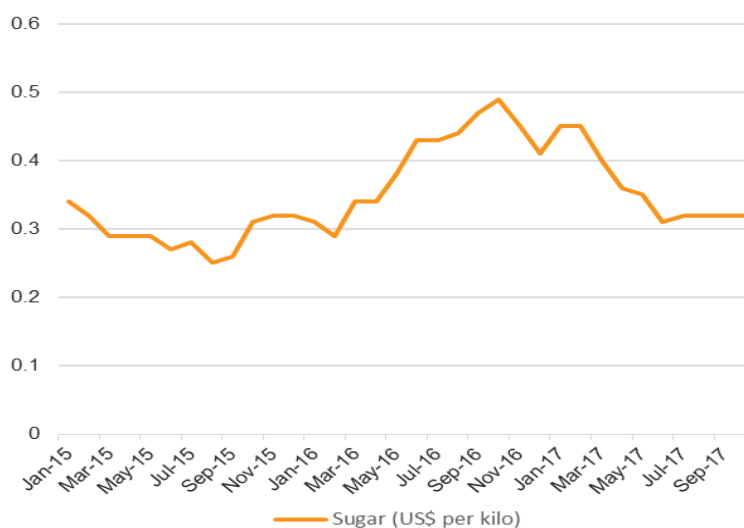
The new Binh Duong plant commenced the first stage of production in December last year and will be expanded to 180mn liters in the second stage over the next few years. Management did not reveal the current utilization of the new plant.

We change our 2017 forecasted ASP growth of 1% for the soymilk segment to a reduction of 2% to reflect the recent ramp-up in sale promotion activities. Consequently, our soymilk revenue and gross profit forecast for 2017 have fallen by 8.3% and 8.6%, respectively, versus the previous forecast.

Sharp fall in selling price and sub-optimal utilization of newly added capacity hurt sugar segment profitability.

Sugar revenue surged by 31.9% YoY on a nearly 60% jump in volumes but profitability was hurt by a lower domestic selling price and additional depreciation. Vietnam’s RS (refined standard) sugar price fell by approximately 17% since the beginning of the year, tracking the movement in global sugar prices. According to management, 9M2017 sugar ASP was about VND12,000-13,000/kg, versus VND15,000-16,000/kg in the same period last year.

Figure 3: Global sugar price



Source: Index Mundi

9M2017 sugar gross margin contracted dramatically from 19.3% in same period last year to touch just 4.9%. Like other large sugar producers, QNS has to lock-in sugarcane purchase prices with farmers at the beginning of the cropping season. Thus, a sharp fall in sugar ASPs hurt producers’ earnings. In addition, 9M2017 depreciation expenses also increased as QNS expanded its sugar refining capacity from 12,000 tons per day last year to 18,000 tons per day, this year.

Consequently, sugar 9M2017 gross profit plummeted by 66.8% YoY keeping in line with our previous forecasts.

We reduce our forecasted FY18 revenue and net profit by 5.5% and 8.5%, respectively.

2018 could be a challenging year for both the sugar and the soya business lines. Competition is heating up as foreign brands such as Vitasoy and Homesoy have just entered and are expected to spend heavily to ramp-up market share; meanwhile QNS’ product portfolio is not diversified which makes it more vulnerable to growing competition.

Starting from Jan 01st 2018, according to the ASEAN trade in goods agreement (ATIGA), the quota restrictions on ASEAN imported sugar will be removed while import tariffs will fall to zero one year later. This will create more competition for domestic sugar producers. We factor these into our 2018 forecasts.

Lower target price but still attractive valuation. Maintain an Add rating.

Currently, QNS is trading at a 10.4x of TTM P/E and a P/B of 3.1x. The recent sharp fall in the share price reflects investors' concerns over sluggish 9M performance. QNS valuation has, as a result, become more attractive as the company is now trading at a large discount of 69% to consumer pure-plays and a 13% discount to sugar peers, with the latter being totally unwarranted in our opinion.

Figure 4: Peer valuation

Company	Country	Market Cap (mn US\$)	TTM NPAT growth (%)	TTM EPS growth	ROA (%)	ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
VNM	Vietnam	12,851	10.2%	9.3%	33.5%	43.2%	0.3x	28.1x	12.2x
Vitasoy	Hongkong	2,739	-34.7%	-34.9%	12.0%	20.4%	0.0x	38.3x	8.1x
<i>Beverage peer average</i>			-12.2%	-12.8%	22.7%	31.8%	0.2x	33.2x	10.1x
SBT	Vietnam	514	12.4%	6.5%	3.3%	8.8%	1.8x	16.2x	1.7x
LSS	Vietnam	34	-7.5%	-9.2%	4.1%	6.4%	0.5x	7.4x	0.5x
<i>Sugar peer average</i>			2.5%	-1.4%	3.7%	7.6%	1.2x	11.8x	1.1x
QNS	Vietnam	586	11.4%	-13.4%	19.1%	31.5%	0.6x	10.3x	3.1x

Source: VNDIRECT

We use a sum-of-the-parts approach to value QNS. We lower our target price from the previous **VND95,600/share** to **76,000VND/share** based on a decrease of 8.5% in our FY18 forecasted net profit and also due to a lowering of our target PE multiple for the soymilk segment which reflects the competitive challenges ahead that we adhered to earlier in the report. We are comfortable with a 1-year forward target PE multiple of 16x (previously 19x) for the soymilk segment (a discount of 40% to VNM), and 8x for other businesses.

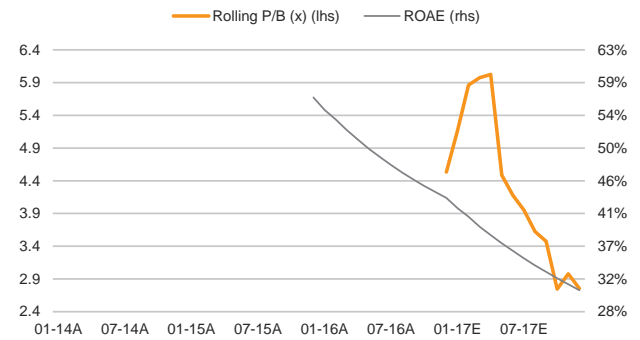
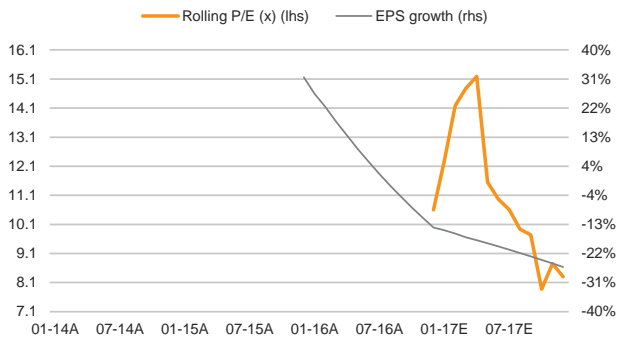
Figure 5: SOTP Valuation

	EPS FY2018 (VND)	Target P/E multiple	Implied equity value (VND)
Soy milk	3,563	16.0x	54,004
Sugar	989	8.0x	7,909
Beer	449	8.0x	3,592
Others	991	8.0x	7,927
Implied equity value per share(VND)			76,432

Source: VNDIRECT

We believe that the soy milk segment still has potential, despite growing competitive pressures. Soy milk is the principal alternative to dairy milk in Vietnam with nearly 650mn litres consumed in 2015 (source: Tetra Pak). Currently, packaged soy milk only accounts for 33% of total soy market sales volume, as unpackaged soy milk sells at a 50% discount to the packaged variety. However, there is a gradual shift underway from unpackaged towards packaged products across several food and beverage product categories mainly driven by rising consumer concerns around food safety and hygiene and a growing preference for convenience. QNS is well equipped to grab this opportunity by expanding its capacity and tapping into the southern market. As soymilk will likely become the company's core business in the future, we think QNS will start to trade more like a consumer company, rather than a commodity producer.

Valuation



Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	6,971	7,622	8,003
Cost of sales	(4,663)	(5,186)	(5,450)
Gen & admin expenses	(54)	(191)	(195)
Selling expenses	(728)	(797)	(871)
Operating profit	1,526	1,449	1,486
Operating EBITDA	1,207	1,100	1,110
Depreciation and amortisation	319	349	377
Operating EBIT	1,526	1,449	1,486
Interest income	73	79	96
Financial expense	(77)	(72)	(51)
Net other income	31	30	20
Income from associates & JVs	0	0	0
Pre-tax profit	1,552	1,486	1,551
Taxation	(144)	(138)	(144)
Minority interests	0	0	0
Net profit	1,408	1,348	1,407
Adj. net profit to ordinary	1,408	1,348	1,407
Ordinary dividends	(160)	(994)	(985)
Retained earnings	1,248	354	422

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	137	566	580
Short term investments	555	762	800
Accounts receivables	394	480	559
Inventories	522	497	523
Other current assets	171	152	80
Total current assets	1,779	2,459	2,543
Fixed assets	1,849	1,869	1,891
Total investments	0	0	0
Other long-term assets	2,497	2,497	2,497
Total assets	6,125	6,825	6,931
Short-term debt	1,178	878	578
Accounts payable	475	497	449
Other current liabilities	317	422	453
Total current liabilities	1,970	1,797	1,480
Total long-term debt	213	163	113
Other liabilities	32	38	40
Share capital	1,875	2,438	2,487
Retained earnings reserve	2,196	2,483	2,835
Shareholders' equity	3,910	4,826	5,297
Minority interests	0	0	0
Total liabilities & equity	6,125	6,825	6,931

Cash flow statement

(VNDbn)	12-15A	12-16A	12-17E
Pretax profit	1,362	1,552	1,483
Depreciation & amortisation	347	319	349
Tax paid		(144)	(138)
Other adjustments	403	(575)	
Change in working capital	(219)	37	85
Cash flow from operations	1,893	1,189	1,779
Capex	(898)	(2,192)	(369)
Proceeds from assets sales			
Others	0	0	(207)
Other non-current assets changes	(19)	604	0
Cash flow from investing activities	(917)	(1,588)	(576)
New share issuance	0	103	563
Shares buyback			
Net borrowings	133	(359)	(250)
Other financing cash flow	(152)	(58)	6
Dividends paid	(340)	(160)	(994)
Cash flow from financing activities	(359)	(474)	(675)
Cash and equivalents at beginning of period	392	1,009	137
Total cash generated	617	(872)	527
Cash and equivalents at the end of period	1,009	137	664

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	20.2%	17.7%	17.6%
Asset turnover	1.23	1.18	1.16
ROAA	24.9%	20.8%	20.5%
Avg assets/avg equity	1.73	1.48	1.36
ROAE	43.2%	30.9%	27.8%
Efficiency			
Days account receivable	20.7	23.0	25.5
Days inventory	41.0	35.0	35.0
Days creditor	37.3	35.0	30.0
Fixed asset turnover	3.97	4.10	4.26
ROIC	26.6%	23.0%	23.5%
Liquidity			
Current ratio	0.90	1.37	1.72
Quick ratio	0.64	1.09	1.36
Cash ratio	0.35	0.74	0.93
Cash cycle	24.4	23.0	30.5
Growth rate (yoy)			
Revenue growth	(10.5%)	9.3%	5.0%
Operating profit growth	14.5%	(5.0%)	2.6%
Net profit growth	14.5%	(4.3%)	4.4%
EPS growth	(14.3%)	(26.4%)	2.0%
Share value			
Basic EPS (VND)	8,920	6,567	6,698
BVPS (VND)	20,846	19,795	21,301

Source: VNDIRECT

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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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