

## QUANG NGAI SUGAR JSC (QNS) - UPDATE

|                                  |                                  |                               |                      |                                 |
|----------------------------------|----------------------------------|-------------------------------|----------------------|---------------------------------|
| <b>Market Price</b><br>VND51,400 | <b>Target Price</b><br>VND65,600 | <b>Dividend Yield</b><br>2.9% | <b>Rating</b><br>ADD | <b>Sector</b><br>CONSUMER GOODS |
|----------------------------------|----------------------------------|-------------------------------|----------------------|---------------------------------|

### Outlook – Short term



### Outlook – Long term



### Valuation



20 April 2018

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### Key changes in the report

- Increase FY2018 forecasted revenue by 6.1%
- Decrease FY2018 forecasted NPAT by 23.8%

### Price performance



Source: VNDIRECT

### Key statistics

|                              |         |
|------------------------------|---------|
| 52w high (VND)               | 125,100 |
| 52w low (VND)                | 45,000  |
| 3m Avg daily volume (shares) | 0.26    |
| 3m Avg daily value (VNDmn)   | 13,957  |
| Market cap (VNDbn)           | 12,954  |
| Outstanding shares (m)       | 252     |
| Free float (%)               | 60      |
| TTM P/E (x)                  | 10.3    |
| Current P/B                  | 2.8     |

### Ownership

|                           |       |
|---------------------------|-------|
| Thanh Phat Trade Co., Ltd | 15.8% |
| Foremost Worldwide Ltd    | 5.0%  |
| Vo Thanh Dang             | 4.9%  |

Source: VNDIRECT

**QNS reported its 2017 business results recently. The highlights were: 1) modest growth in soymilk sales and 2) margin contraction on sugar sales. We lower our target price by 13.7% to reflect the heavy impact of the fall in the sugar price on QNS's sugar segment performance. We, however, maintain our ADD rating as the stock is trading at a deep discount to the market.**

The soymilk segment generated VND3,885bn in net sales (+5.5% YoY) in FY2017, below management's annual growth target of 10%, due to intense competition from foreign brands. QNS expects further growth in the domestic soy milk market and has consequently set targets to boost soy milk sales volume at a 10.0% AAGR during 2018-2020. Thanks to continued market growth and the company's plans to launch new products, we project that its soymilk revenue will reach VND4,115bn (+5.9% YoY) this year on the back of 7.0% volume growth and a 1.0% decrease in its ASP.

**Sugar segment sales up 27.4% YoY to VND1,867bn, but gross margin contracted to just 3.3% (vs. 21.5% in FY2016) due to the 24% plunge in the sugar price during the year.** The sugar selling price is not likely to recover soon, especially given import tariffs reductions from 2018 according to the ASEAN Trade in Goods Agreement (ATIGA). However, QNS should start to benefit from lower sugarcane prices. In 2018, we forecast that QNS will generate VND2,433bn in sugar revenue (+30.3% YoY) with a gross profit of VND57bn (-6.7% YoY). Despite the expected 20% fall in sugarcane purchase prices of around 20%, QNS' sugar gross margin will contract further to 2.3%.

**We haircut our target price to VND65,600/share as the sugar segment is still under pressure, but we maintain our ADD rating.** The company is currently trading at a TTM P/E of just 10.3x, a 70.1% discount to consumer peers and a 22.6% discount to sugar peers. QNS is now placing greater emphasis on its soymilk business and the consumer segment contributed a sizeable 76.3% to gross profit in 2017. Over time, QNS should trade closer in line with consumer stocks as sugar production contribution shrinks.

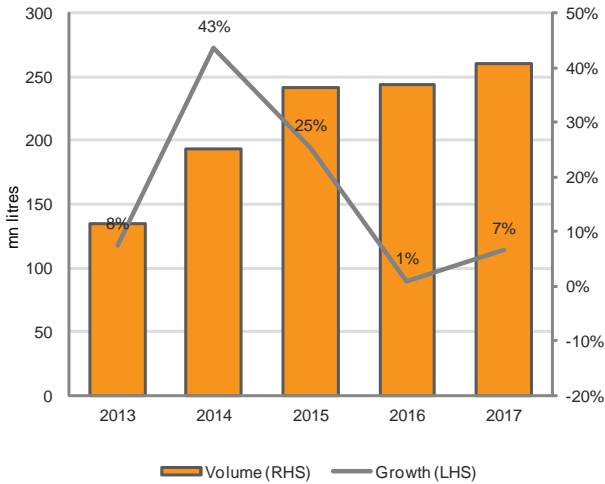
| Financial summary (VND) | 12-15A | 12-16A  | 12-17A  | 12-18E |
|-------------------------|--------|---------|---------|--------|
| Net revenue (bn)        | 7,785  | 6,971   | 7,633   | 8,489  |
| Revenue growth          | 24.6%  | (10.5%) | 9.5%    | 11.2%  |
| Gross margin            | 29.5%  | 33.1%   | 26.2%   | 24.1%  |
| EBITDA margin           | 13.7%  | 18.7%   | 10.5%   | 9.3%   |
| Net profit (bn)         | 1,230  | 1,408   | 1,027   | 1,072  |
| Net profit growth       | 58.9%  | 14.5%   | (27.1%) | 4.4%   |
| Recurring profit growth | 61.3%  | 13.9%   | (27.3%) | 5.1%   |
| Basic EPS               | 10,407 | 8,920   | 5,003   | 4,220  |
| Adjusted EPS            | 10,513 | 9,009   | 5,021   | 4,236  |
| BVPS                    | 18,492 | 20,846  | 18,382  | 18,066 |
| ROAE                    | 56.6%  | 43.2%   | 24.5%   | 22.0%  |

Source: VNDIRECT

**Soymilk business: Marketing efforts paid off in 4Q2017**

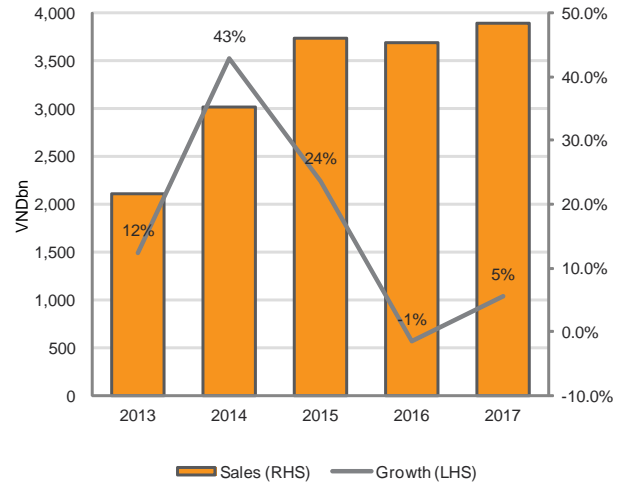
QNS continued to assert its domestic market leadership with a market share of 84.3% in 2017, up from 83.0% in 2016 (Nielsen). This was achieved despite intensifying competition from foreign brands with volumes growing 7% but 1% ASP erosion.

**Figure 1: QNS's soymilk sales volume and growth during 2013-2017**



Source: VNDIRECT estimates

**Figure 2: QNS's soymilk sales value and growth in 2013-2017**



Source: QNS, VNDIRECT

The soymilk business segment's net sales reached VND3,885bn (+5.5% YoY) and its gross profit reached VND1,522bn (+2.7% YoY). Segment growth was under pressure due to the entrance of foreign brands such as Vitasoy and Soy Secretz. Those brands carry diversified product portfolios, with a variety of value-added functionality in their products.

**Figure 3: Vinasoy still enjoys prime shelf-space but has to now share it with foreign brands**



Source: VNDIRECT

Figure 4: Vinasoy's viral clip for Tet Holiday

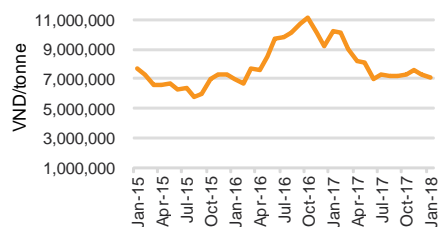


Video link:

<https://www.youtube.com/watch?v=Mkw6OtJQmik>

Source: VINASOY, VNDIRECT

Figure 5: Global Sugar Price



Source: VNDIRECT Research

To combat this, QNS sought to re-capture consumers' attention by ramping up lower-cost promotions and advertisements even though the company saw A&P spending decline to VND187.4bn in 2017 (-12.1% YoY). QNS effectively controlled its A&P expenses by coming up with creative and fresh marketing campaigns that have been distributed through digital channels, instead of only focusing on high-cost TV commercials. During the Tet holiday, the firm made a successful video clip named "Sowing Kindness" which went viral and received over 3 million views in just 2 weeks, thereby reinforcing the brand image of QNS's flagship soymilk brand Vinasoy. This marketing-driven strategy has started to show an impact, as soymilk sales growth reached 11.6% in 4Q2017 (vs. 4.0% in 3Q2017), lifting the performance of the segment for the entire year.

**2017 ended badly for the sugar business.**

For the first half of 2017, the sugar segment posted VND1,190bn in revenue (+34.9% YoY), driven by both volume growth and a higher selling price. In 2H2017, the segment generated revenue of VND677bn (+15.5% YoY), driven by over 30% volume growth, as the domestic sugar selling price plunged in line with global trends to around VND12,000/kg towards the end of 2017 (-24.1% YoY). At the same time, QNS's purchase price of raw sugarcane in the making of total sugar sold in 2017 was locked at VND1.1mn/tonne (+10.9% YoY), which led to a dramatic contraction in its GPM to touch just 3.3% in FY2017 (vs. 21.5% in FY2016).

**Soymilk segment expected to regain momentum in 2018.**

Vietnam's packaged soymilk sales is forecasted to grow by 7.8% in the period 2017-2022 (Euromonitor International 2017), based on 1) the growing health-consciousness of consumers, which will increase overall soy milk consumption and 2) the rising awareness about food hygiene to urge consumers to switch from unpackaged soy milk products to the packaged version. QNS aims to increase its soy milk sales volume at a 10.0% AAGR during 2018-2020. The company also plans to introduce new soy milk products this year, which is essential for competing with other foreign brands that have more diversified soy product portfolios. Furthermore, QNS could better leverage its expansive distribution network of 150,000 POS in 63 cities and provinces across the country to get newly launched products to customers.

**Sugarcane prices should temper this year, cushioning some of the impact of falling refined sugar prices.**

QNS expects to produce 220,000 tonnes of sugar (+57% YoY), following the capacity expansion in its An Khe sugar factory. However, the sugar selling price may continue to be depressed, especially following the reduction in out-of-quota sugar import tariffs to 5% beginning in 2018 under the ASEAN Trade in Goods Agreement (ATIGA). Thus, we project that the Refined Standard (RS) sugar average selling price (ASP) will fall to around VND11,000/kg (-17% versus 2017 ASP). For the 2017-2018 harvest season, we also estimate that QNS's purchase price of sugarcane will fall by around 20% as sugar refiners pass through some of the pricing pressure upstream to farmers.

**2018 AGM: QNS continues to set conservative business targets.**

**Guidance looks unduly conservative as usual:**

As expected, QNS has continued to set very conservative targets of VND7,500bn in total revenue (-3.1% YoY) and VND194bn in net profit (-81.1% YoY) for this year. QNS announced 2017 audited business



results with total revenue of VND7,739bn (+10% YoY, completing 104.6% of the annual target) and net profit of VND1,027bn (-27.1% YoY, 5.6 times the full-year target). Similarly, QNS also surpassed its target in 2016 with revenue and net profit recorded at 1.1 times and 7.0 times the respective target, set for that year, which reaffirms management's conservative approach to guidance.

#### Dividend Policy:

QNS announced the plan to pay a 2017 stock dividend in a ratio of 10:2, thus raising the company's chartered capital to about VND3,000bn. Besides, the company stated that it will pay a 2018 dividend at a minimum ratio of 15% of par value (not stated whether in cash or stock) which corresponds to a dividend yield of 2.9% based on the current share price.

#### Future Capex:

Shareholders also approved management's plan to set up a Refined Extra (RE) sugar production line with capacity of 1,000 tonnes per day in 2019. In the anticipated event of the removal of sugar import quotas, we regard this as an opportunity for QNS to purchase cheap import raw sugar and process to make RE sugar. This is cost-efficient as QNS could make use of its captive biomass power and discontinue its sugarcane cultivation and harvesting operations.

#### We maintain an ADD rating as valuation remains attractive.

For FY2018, we forecast that QNS's revenue will reach VND8,489bn (+11.2% YoY) and that its NPAT will reach VND1,072 (+4.4% YoY), which implies an upward revision of 6.1% in revenue and downward revision of 23.8% in net profit from our previous projections.

Figure 6: FY2018 Forecast

|                         | Previous forecast | Current forecast | Change (+/- %)          | Rationale  |
|-------------------------|-------------------|------------------|-------------------------|--|
| <b>Soymilk segment</b>  |                   |                  |                         |  |
| Volume (mn litres)      | 269               | 278              | 3.4%                    | New product launches<br>Consumers are seeking out for more healthy products  |
| ASP (VND/litres)        | 14,940            | 14,793           | -1.0%                   | Further promotions and discounts   |
| Sales                   | 4,019             | 4,115            | 2.4%                    | Driven by volume growth  |
| Gross profit            | 1,554             | 1,566            | 0.8%                    | COGS per litre stays unchanged   |
| Gross margin (%)        | 38.7%             | 38.0%            | -0.7 percentage points  |  |
| <b>Sugar segment</b>    |                   |                  |                         |  |
| Volume (tonnes)         | 158,932           | 219,780          | 38.3%                   | Higher plantation area of 33,000 ha<br>Higher average sugar yield of 74 tonnes/ha  |
| ASP (VNDmn/tonnes)      | 14,094            | 11,069           | -21.5%                  | Sugar price to fall to around VND11,000/kg   |
| Sales                   | 2,240             | 2,433            | 8.6%                    | Mostly driven by volume growth   |
| Gross profit            | 307               | 57               | -81.5%                  | The fall in sugar price was sharper than previously projected<br>Taken into account the adjustment in sugarcane purchase price |
| Gross margin            | 13.7%             | 2.3%             | -11.4 percentage points |  |
| <b>Total sales</b>      | <b>8,003</b>      | <b>8,489</b>     | <b>6.1%</b>             |  |
| <b>Total net profit</b> | <b>1,407</b>      | <b>1,072</b>     | <b>-23.8%</b>           |  |

Source: VNDIRECT

With the revised projections, we arrive at a new target price for QNS of VND65,600/share (previously VND76,000/share) via a sum-of-the-parts approach. We applied a 1-year forward P/E multiple of 18.2x for its soymilk business (maintaining a 40% discount to VNM's TTM PER) due to the tough competition in this segment and maintained a target

1-year forward P/E of 8.0x for its sugar business. For other businesses in QNS' portfolio including beer, confectionary, biomass power and mineral bottled water production, we adjusted our blended 1-year forward P/E multiple upward to 10.1x based on the average TTM P/E of small beer, confectionary and power companies, given the small scale of these businesses in QNS' portfolio.

Figure 7: SOTP Valuation

|              | %EBT        | EPS FY2018 (VND) | Target PE multiple | Implied value (VND) |
|--------------|-------------|------------------|--------------------|---------------------|
| Soy milk     | 75%         | 2,896            | 18.2x              | 52,701              |
| Sugar        | 5%          | 232              | 8.0x               | 1,857               |
| Others       | 20%         | 1,092            | 10.1x              | 11,033              |
| <b>Total</b> | <b>100%</b> | <b>4,220</b>     | <b>15.5x</b>       | <b>65,591</b>       |

EPS projection for each segment is calculated by estimated contribution in QNS's EBT (using contribution to gross profit)

Source: VNDIRECT

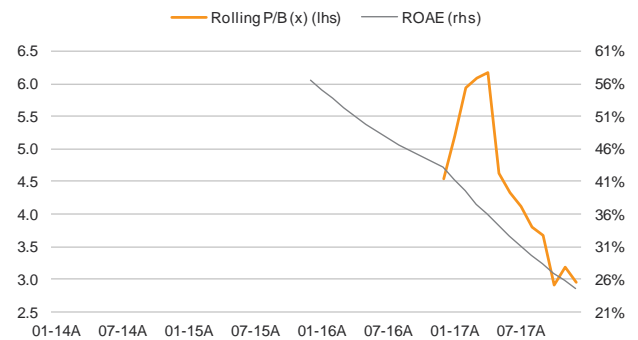
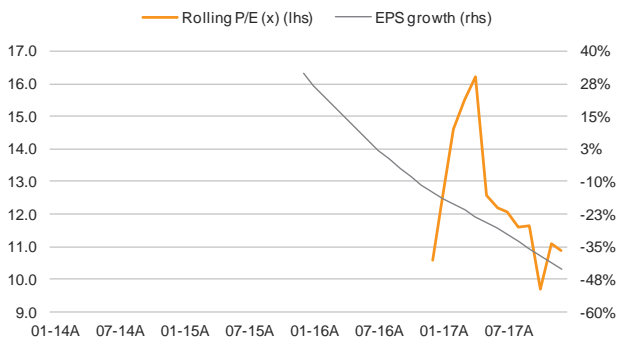
Accordingly, we reiterate an ADD recommendation for QNS, with over 25% upside to our reduced target price. Currently, the company is trading at a TTM P/E of 10.3x, a 70.1% discount to the beverage peer average and a 22.6% discount to the sugar peer average. With new product introductions in the pipeline and ongoing marketing campaigns, we anticipate that its soymilk business is becoming more of a core business and QNS could see itself being valued more in line with pure-play consumer stocks over time.

Figure 8: Peer comparison

| Company                             | Country  | Market cap (mn US\$) | TTM NPAT growth (%) | TTM EPS growth (%) | ROE (%)      | ROA (%)     | D/E (x)     | TTM P/E (x) | P/B (x)     |
|-------------------------------------|----------|----------------------|---------------------|--------------------|--------------|-------------|-------------|-------------|-------------|
| VNM                                 | Vietnam  | 11,948               | 10.2                | 9.0                | -46.0        | 40.5        | 32.2        | 29.5        | 11.6        |
| Vitasoy                             | Hongkong | 2,813                | -34.9               | 15.7               | -23.9        | 20.3        | 11.0        | 39.5        | 8.4         |
| <b>Beverage peers average</b>       |          |                      | <b>-12.4</b>        | <b>12.4</b>        | <b>-35.0</b> | <b>30.4</b> | <b>21.6</b> | <b>34.5</b> | <b>10.0</b> |
| <hr/>                               |          |                      |                     |                    |              |             |             |             |             |
| SBT VN Equity                       | Vietnam  | 439                  | 40.52               | 2.9                | 129.6        | 7.4         | 3.3         | 16.5        | 1.4         |
| LSS VN Equity                       | Vietnam  | 28                   | -58.49              | 43.0               | 32.0         | 3.8         | 2.4         | 10.1        | 0.4         |
| <b>Sugar peers average</b>          |          |                      | <b>-9.0</b>         | <b>23.0</b>        | <b>80.8</b>  | <b>5.6</b>  | <b>2.8</b>  | <b>13.3</b> | <b>0.9</b>  |
| <hr/>                               |          |                      |                     |                    |              |             |             |             |             |
| <i>Beer</i>                         |          |                      |                     |                    |              |             |             |             |             |
| Sai Gon - Phu Tho Beer              | Vietnam  | 14                   | 47.9                | 52.4               | -1.0         | 22.3        | 13.7        | 5.9         | 1.3         |
| Hanoi Beer Trading                  | Vietnam  | 5                    | 74.9                | 122.9              | -139.3       | 49.9        | 19.9        | 4.2         | 1.7         |
| Thanh Hoa Beer                      | Vietnam  | 9                    | -12.2               | -16.5              | -29.0        | 6.0         | 3.6         | 24.2        | 1.0         |
| <i>Mineral water</i>                |          |                      |                     |                    |              |             |             |             |             |
| Quang Ninh Mineral Water            | Vietnam  | 7                    | -3.9                | 3.8                | 25.9         | 19.7        | 0.0         | 4.9         | 1.2         |
| <i>Power</i>                        |          |                      |                     |                    |              |             |             |             |             |
| Nam Mu Hydropower                   | Vietnam  | 21                   | 53.1                | 53.1               | 49.4         | 14.4        | 8.3         | 12.3        | 1.7         |
| Que Phong Hydropower                | Vietnam  | 14                   | -64.9               | -64.9              | 17.4         | 10.2        | 0.3         | 7.0         | 1.2         |
| <i>Confectionary</i>                |          |                      |                     |                    |              |             |             |             |             |
| Bibica Corporation                  | Vietnam  | 51                   | 19.7                | 23.2               | -70.5        | 12.4        | 9.0         | 12.1        | 1.4         |
| <b>Other business peers average</b> |          |                      | <b>16.4</b>         | <b>24.9</b>        | <b>-21.0</b> | <b>19.3</b> | <b>7.8</b>  | <b>10.1</b> | <b>1.3</b>  |
| <hr/>                               |          |                      |                     |                    |              |             |             |             |             |
| <b>QNS VN Equity</b>                |          | <b>551</b>           | <b>-27.1</b>        | <b>-27.1</b>       | <b>6.0</b>   | <b>24.4</b> | <b>15.6</b> | <b>10.3</b> | <b>2.8</b>  |

Source: BLOOMBERG, VNDIRECT

**Valuation**



**Income statement**

| (VNDbn)                              | 12-16A       | 12-17A       | 12-18E       |
|--------------------------------------|--------------|--------------|--------------|
| Net revenue                          | 6,971        | 7,633        | 8,489        |
| Cost of sales                        | (4,663)      | (5,637)      | (6,446)      |
| Gen & admin expenses                 | (54)         | (146)        | (149)        |
| Selling expenses                     | (728)        | (697)        | (749)        |
| <b>Operating profit</b>              | <b>1,526</b> | <b>1,153</b> | <b>1,145</b> |
| Operating EBITDA                     | 1,207        | 739          | 664          |
| <b>Depreciation and amortisation</b> | <b>319</b>   | <b>414</b>   | <b>481</b>   |
| <b>Operating EBIT</b>                | <b>1,526</b> | <b>1,153</b> | <b>1,145</b> |
| Interest income                      | 73           | 38           | 109          |
| Financial expense                    | (77)         | (78)         | (93)         |
| Net other income                     | 31           | 26           | 20           |
| Income from associates & JVs         | 0            | 0            | 0            |
| <b>Pre-tax profit</b>                | <b>1,552</b> | <b>1,138</b> | <b>1,182</b> |
| Taxation                             | (144)        | (112)        | (110)        |
| Minority interests                   | 0            | 0            | 0            |
| <b>Net profit</b>                    | <b>1,408</b> | <b>1,027</b> | <b>1,072</b> |
| Adj. net profit to ordinary          | 1,408        | 1,027        | 1,072        |
| Ordinary dividends                   | (160)        | (339)        | (268)        |
| <b>Retained earnings</b>             | <b>1,248</b> | <b>687</b>   | <b>804</b>   |

**Balance sheet**

| (VNDbn)                               | 12-16A       | 12-17A       | 12-18E       |
|---------------------------------------|--------------|--------------|--------------|
| Cash and equivalents                  | 137          | 528          | 240          |
| Short term investments                | 555          | 751          | 849          |
| Accounts receivables                  | 394          | 289          | 522          |
| Inventories                           | 522          | 320          | 618          |
| Other current assets                  | 171          | 19           | 85           |
| <b>Total current assets</b>           | <b>1,779</b> | <b>1,907</b> | <b>2,315</b> |
| Fixed assets                          | 1,849        | 2,805        | 3,221        |
| Total investments                     | 0            | 0            | 0            |
| Other long-term assets                | 2,497        | 2,286        | 2,286        |
| <b>Total assets</b>                   | <b>6,125</b> | <b>6,999</b> | <b>7,822</b> |
| Short-term debt                       | 1,178        | 1,404        | 1,469        |
| Accounts payable                      | 475          | 540          | 530          |
| Other current liabilities             | 317          | 401          | 399          |
| <b>Total current liabilities</b>      | <b>1,970</b> | <b>2,345</b> | <b>2,398</b> |
| Total long-term debt                  | 213          | 145          | 95           |
| Other liabilities                     | 32           | 27           | 42           |
| Share capital                         | 1,875        | 2,438        | 2,926        |
| Retained earnings reserve             | 2,196        | 2,135        | 2,398        |
| <b>Shareholders' equity</b>           | <b>3,910</b> | <b>4,482</b> | <b>5,286</b> |
| Minority interests                    | 0            | 0            | 0            |
| <b>Total liabilities &amp; equity</b> | <b>6,125</b> | <b>6,999</b> | <b>7,822</b> |

**Cash flow statement**

| (VNDbn)                                     | 12-16A         | 12-17A         | 12-18E       |
|---|----------------|----------------|--------------|
| <b>Pretax profit</b>                        | <b>1,552</b>   | <b>1,138</b>   | <b>1,182</b> |
| Depreciation & amortisation                 | 319            | 414            | 481          |
| Tax paid                                    | (144)          | (112)          | (110)        |
| Other adjustments                           | (575)          | (424)          | (0)          |
| <b>Change in working capital</b>            | <b>37</b>      | <b>608</b>     | <b>(608)</b> |
| <b>Cash flow from operations</b>            | <b>1,189</b>   | <b>1,625</b>   | <b>945</b>   |
| Capex                                       | (2,192)        | (874)          | (897)        |
| Proceeds from assets sales                  |                |                |              |
| Others                                      | 0              | 0              | (98)         |
| Other non-current assets changes            | 604            | (177)          | 0            |
| <b>Cash flow from investing activities</b>  | <b>(1,588)</b> | <b>(1,051)</b> | <b>(994)</b> |
| New share issuance                          | 103            | (0)            | 0            |
| Shares buyback                              |                |                |              |
| Net borrowings                              | (359)          | 222            | 15           |
| Other financing cash flow                   | (58)           | (64)           | 15           |
| Dividends paid                              | (160)          | (339)          | (268)        |
| <b>Cash flow from financing activities</b>  | <b>(474)</b>   | <b>(182)</b>   | <b>(238)</b> |
| Cash and equivalents at beginning of period | 1,009          | 137            | 528          |
| <b>Total cash generated</b>                 | <b>(872)</b>   | <b>392</b>     | <b>(288)</b> |
| Cash and equivalents at the end of period   | 137            | 528            | 240          |

**Key ratios**

|                          | 12-16A | 12-17A | 12-18E |
|--------------------------|--------|--------|--------|
| <b>Dupont</b>            |        |        |        |
| Net profit margin        | 20.2%  | 13.5%  | 12.6%  |
| Asset turnover           | 1.23   | 1.16   | 1.15   |
| ROAA                     | 24.9%  | 15.6%  | 14.5%  |
| Avg assets/avg equity    | 1.73   | 1.56   | 1.52   |
| ROAE                     | 43.2%  | 24.5%  | 22.0%  |
| <b>Efficiency</b>        |        |        |        |
| Days account receivable  | 20.69  | 13.83  | 22.46  |
| Days inventory           | 40.96  | 20.75  | 35.00  |
| Days creditor            | 37.29  | 34.94  | 30.02  |
| Fixed asset turnover     | 3.97   | 3.28   | 2.82   |
| ROIC                     | 26.6%  | 17.0%  | 15.7%  |
| <b>Liquidity</b>         |        |        |        |
| Current ratio            | 0.90   | 0.81   | 0.97   |
| Quick ratio              | 0.64   | 0.68   | 0.71   |
| Cash ratio               | 0.35   | 0.55   | 0.45   |
| Cash cycle               | 24.36  | -0.37  | 27.43  |
| <b>Growth rate (yoy)</b> |        |        |        |
| Revenue growth           | -10.5% | 9.5%   | 11.2%  |
| Operating profit growth  | 14.5%  | -24.4% | -0.7%  |
| Net profit growth        | 14.5%  | -27.1% | 4.4%   |
| EPS growth               | 14.5%  | -27.1% | 4.4%   |
| <b>Share value</b>       |        |        |        |
| Basic EPS (VND)          | 8,920  | 5,003  | 4,220  |
| BVPS (VND)               | 20,846 | 18,382 | 18,066 |

Source: VNDIRECT

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