

PETROVIETNAM FERTILIZER AND CHEMICALS (DPM VN)

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SELL INTO ETF-DRIVEN STRENGTH IN 2Q2011 (NOT TODAY)

No serious medium-term profit momentum

We are initiating coverage on PetroVietnam Fertilizer and Chemicals ('DPM'), a 60%-owned subsidiary of PetroVietnam (PVN). DPM is Vietnam's leading fertilizer manufacturing and trading company, majoring in urea produced directly from domestic natural gas. DPM currently meets 50% of domestic demand for urea and thus occupies a sensitive position as a key input provider to Vietnamese farmers, a status that sees it receiving gas inputs at a favourable government-subsidised price but also being subject to close government attention on its end-product pricing. DPM is not expensive but it is difficult to see there being a catalyst to ignite the stock – therefore in a binary buy or sell world, we say sell. At our estimated FY11 sales of VND6,508bn (-2% YoY) and net profit of VND1,558bn (-8.7% YoY), it is on 8.6x earnings, 47% lower than the 16.3x of regional peers; 2011 PBR is 2.0x, 13% lower than the regional average of 2.3x; and 2011 PSR is 2.1x, 75% above the regional average of 1.2x. As DPM is now running at maximum capacity, near term sales growth is constrained; but reported gross profit margins will hold up on account of a now-fully-depreciated fixed asset base, even despite rising raw material costs (i.e. gas).

In order to grow its business and make full use of its strong national distribution network, DPM plans to build a nitrogen phosphate potassium (NPK) plant with design capacity of 400,000 tonnes per year. Based on peer comparison and in the absence of management guidance, we estimate lower gross profit margins from this new plant at 20% (about half the existing plant's).

The huge amount of net cash and equivalents (over VND3trn, a full 55% of shareholders equity) that DPM has on its balance sheet raises the issue of capital structure inefficiency, a familiar one for PetroVietnam entities (another example of such being PVI). Despite this inefficiency, DPM still manages to achieve a respectable ROE in the low 20s. We forecast flat sales until the new plant comes on-line in 2013; followed by a good leap to 2015. Our profit growth projections however are tepid, mainly due to a leap in depreciation costs when the new plant opens.

It now seems highly unlikely that DPM will buy the now-70%-finished Ca Mau urea plant (the capex cost of which is \$900m) from its parent, which had worried investors. Instead it will sign a contract to distribute its production (capacity of 800,000Tpa); DPM will sign an MOU with Japan to export about 400,000Tpa to Thailand, Myanmar and the Philippines; 100,000T will go to Cambodia and the rest for domestic use.

	2010	2011E	2012E	2013E	2014E	2015E
Sales (VNDbn)	6,619	6,508	6,461	6,145	8,577	9,523
EBITDA (VNDbn)	2,328	1,994	1,951	2,050	2,740	2,844
Net income (VNDbn)	1,707	1,558	1,566	1,620	1,817	1,963
Sales growth (%)	-0.2	-1.7	-0.7	-4.9	39.6	11.0
Net income growth (%)	26.3	-8.7	0.6	3.4	12.2	8.0
Net profit margin (%)	25.8	23.9	24.2	26.4	21.2	20.6
ROE (%)	28.9	24.1	22.7	22.1	22.9	22.6
ROA (%)	24.8	20.4	19.5	19.1	19.8	19.3
BVPS (VND)	16,466	17,564	18,686	19,948	21,729	23,895
PER (times)	7.8	8.6	8.5	8.3	7.4	6.8
PBR (times)	2.1	2.0	1.9	1.8	1.6	1.5
DPS (VND)	2300	3000	3000	3000	3000	3000
Dividend yield (%)	6.5	8.5	8.5	8.5	8.5	8.5

Source: DPM, Mekong Securities

Company Coverage

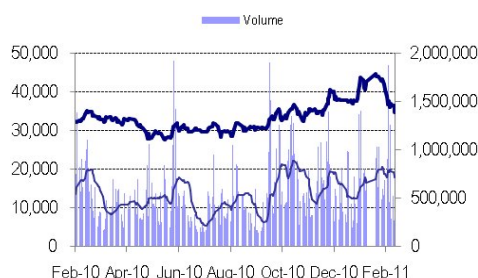
Recommendation

	HOSE: DPM
	Agricultural chemical
Price (VND)	35,200
Price target (VND)	35,000
Expected share price return (%)	-1%
Expected dividend yield (%)	8.5%
Expected total return (%)	7.5%

Stock performance (%)

	YTD	1m	3m	12m
Abs	-9%	-22%	-1%	+7%
Rel	-3%	-12%	+1%	+17%

Source: Bloomberg



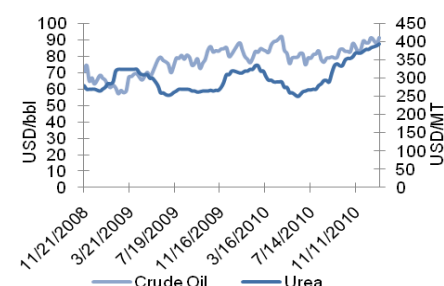
Feb-10 Apr-10 Jun-10 Aug-10 Oct-10 Dec-10 Feb-11

Ownership Structure 03-Mar-11

PetroVietnam (PVN)	61.6%
Foreigners	25.1%
Others	13.3%

Stock Statistics 03-Mar-11

Bloomberg code	DPM VN
52-week range (VND)	27,600- 44,700
Shares O/S (m)	377
Mkt cap (VND bn)	13,186
Mkt cap (USD m)	648
Foreign room (%)	13.3%
Est. free float (m)	144
3m avg daily vol (shrs)	689,272
VND/USD	20,700
Index: VNIndex / HNX	458/91

Figure 1: Crude Oil vs. Urea price

Source: Bloomberg

Industry supply/demand: supply rising fast to meet demand

It is estimated that Vietnam needs 7.5-8.0 million tonnes of fertilizer annually yet domestic production can only meet about 50% of national demand. For urea alone, Vietnam is able to produce also 50% of domestic demand from DPM's 750kTpa Phu My Plant and Vinachem Group's 180kTpa Ha Bac Plant. For DAP, SA and kali (potassium), Vietnam needs to import 80-85%, 100% and 100% of consumption respectively. For NPK and phosphate, Vietnam does not significantly rely on imports because domestic production is nearly 100% sufficient.

The major ingredients of fertiliser are, variously, nitrogen, phosphate, and potassium:- Nitrogen (N): Used to produce leafy growth and formation of stems and branches; Phosphate (P): Essential for seed germination and root development, needed particularly by young plants forming their root systems and by fruit and seed crops; Potassium (K): Promotes flower and fruit production and is vital for maintaining growth and helping plants resist disease.

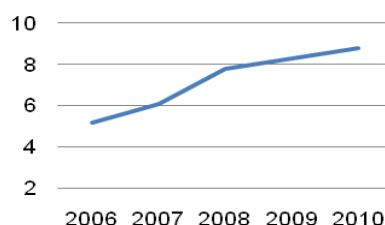
Figure 2: Popular types of inorganic fertilizer in Vietnam and their current prices

Name	Content	Price (mVND/tonne)
Urea	44%-48% N	8.5-9.5
NPK	Combination of N, P, K at different proportions	6.5-12.5 depending on the proportions
DAP (Diammonium phosphate)	18% N & 46% P	13-15
SA (Ammonium sulphate)	20%-21% N	4.5-4.9
Potassium	K	10-10.7

For the first 11 months of 2010, supply of fertilizer was recorded at 5.42mT, of which 3.07mT were domestically manufactured and the remaining 2.35 million tonnes were imported. For urea, according to the Ministry of Industry and Trade, total 2010 supply was 1.85mT, of which 985kT were made in Vietnam and 866kT imported.

Up to 2020, Vietnam will still have to import about 500kTpa of various kinds of fertilizer including urea, DAP and kali until domestic producers are capable of manufacturing the sufficient amount. For urea alone, it is expected that Vietnam will not have to import urea anymore from 2013 onwards, by when another two urea fertilizer plants will have come into operation, namely PVN's Ca Mau Plant (800kTpa capacity, to be finished in 2012) and Vinachem's Ninh Binh Plant (560kTpa capacity, to be finished in 2011). This promising prospect might help to reduce the volatility of domestic urea prices as well as reliance on urea imports from China, which accounted for c. 55% (1.4mT) of Vietnam's total fertilizer import volume for the first 11 months of 2010.

During 2011, urea prices could still be firm given the national excess demand, with China likely to impose a 110% tax on its fertiliser exports (originally planned for Dec 2010, but delayed). However, from 2012 both national and global supply/demand changes appear to favour softer prices. The International Fertilizer Industry Association (IFA) forecasts that world urea capacity will reach 222mTpa by 2014, a growth rate of 6%pa, while demand will grow at less than 4% to c. 175mT for that year. For the East Asian region, ammonia capacity is projected to increase by 10mT of nitrogen during 2008-2012, lifting the region out of a deficit situation. 2012 will thus have a regional nitrogen supply of 60.6mT, versus nitrogen fertilizer demand of 46.6mT and non-fertilizer demand of 13.8mT.

Figure 3: Vietnam's fertilizer consumption

In 2010, Vietnam fertilizer consumption grew 6.3% y-o-y (fertilizer consumption in 2009 was 8.3mT), nearly double the volume used five years ago. We do not expect robust growth in fertilizer consumption when the land used for cultivation is projected to increase only 6% within the next five years (according to the Ministry of Agriculture and Rural Development). We also think that the current uptrend in fertilizer price is just a seasonal phenomenon because winter/spring season is the biggest season in the year when demand for fertilizer is always higher than other seasons.

Figure 4: Vietnam's existing and coming fertilizer plants

Product	Plant	Current capacity (thousand tonnes)	Expected capacity	Owner
Urea	Phu My	800	800	DPM
	Ha Bac	180	500 (2014)	Vinachem
	Ca Mau		800 (2013)	PVN
	Ninh Binh		560 (2012)	Vinachem
Total		980	2660	
NPK	Binh Dien	441	537 (2015)	Vinachem
	Lam Thao	600	600	Vinachem
	Van Dien	120	120	Vinachem
	Phu My		400(2013)	DPM
Total		1161	1657	
Calcium Magnesium Phosphate	Van Dien	270	270	Vinachem
NPK & super phosphate	Southern Fertilizer	600	600	Vinachem

(Source: Vinachem, Mekong Securities)

Company Overview

PetroVietnam Fertilizer and Chemicals, a subsidiary of PetroVietnam Corporation, was officially listed on Hochiminh Stock Exchange in Oct 2007. Phu My urea fertilizer plant cost \$370m for 740kT of design capacity using advanced Danish and Italian technology (Haldor Topsoe, Snamprogetti) and produced its first batch of product in 2004; this was the first urea produced in Vietnam using natural gas (from the Con Son and Bach Ho fields). DPM also trades imported urea.

Products and market share

Capacity was raised by 60kT to 800kTpa during 2010 via a CO2 recovery project at the cost of \$27m. Including its outside-produced trading volume of 200kT-250kTpa, DPM accounts for 50% of national demand for urea fertilizer. It is trusted and favoured by farmers thanks to its high quality standards.

Figure 5: DPM's superior quality standards

	Nitrogen	Biuret	Moisture
Phu My Fertilizer	Minimum 46.3%	Maximum 1%	Maximum 0.4%
Ha Bac Fertilizer	Minimum 46%	Maximum 1.5%	Maximum 0.5%
(Note: Biuret is the most common impurity in synthetic urea that impairs plant growth. The biuret content is a serious concern because it is often toxic to the very plants that are to be fertilized.)			

DPM will in July 2011 start its \$65m, 400kTpa NPK project, which will supply 10-15% of domestic demand, due to be completed in July 2013. Cost per tonne for the NPK plant is low; probably because this project is simpler than a urea project where DPM has to buy P & K from outsiders and blend them with their own N to produce the desired final products.

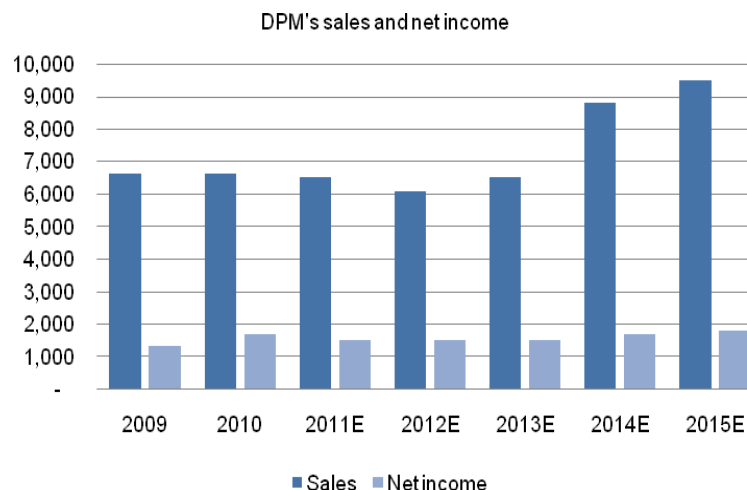
Key assumptions and growth prospects

As the average urea price was already high in 2010 (VND6,750/kg), we assume urea prices remain unchanged in 2011. Since excess demand will cease from 2012, we forecast only modest urea price increases of 7%pa thereafter. The company's sales volumes stay flat given its full existing-capacity utilisation, but then rise from 2013 when the new NPK plant comes into operation. We roughly estimate the product price for NPK at VND10,000/kg for period 2014-2015 (compared to current price of VND9,500 and 2010 average of VND8,000). From 2010-11, DPM's depreciation costs plummet due to fully-depreciated plant, offset by rising natural gas prices (\$3.4/mmBTU in 2010, \$4.33 in 2011, still higher thereafter). Gross profit margins for the manufacturing business thus work out at a maintained 36%-44% for the period 2011-15. Gross profit margins for trading are assumed at zero, since DPM imports urea at a high cost and sometimes sells it on at a loss. For the NPK project, due to limited available data, we assume gross profit margin at 20%, higher than the biggest peer (Binh Dien Fertilizer, c. 10%), due to advanced technology of the new production line. The weighted gross profit margin of these three businesses (urea, NPK, and trading) are thus 32%-36%. From 2013 we assume that DPM no longer trades outside-produced urea.

A major amount of net cash and equivalents (an estimated VND 3,621bn as at YE10) also contributes net interest income of VND200-300bn. Net cash on our projections rises over 2011-15, allowing for only dividends and the \$65m capex for the NPK project. In the absence of company guidance, we currently do not take into account capital expenditure for the following project in Figure 6. This is a major issue because the possible capex on it amounts to twice DPM's current net cash position; in other words, DPM would go from being heavily net cash to having net debt to equity of perhaps around 50%.

Figure 6: The possible but as yet unaccounted for ammonia project

Plant	Usage	Investment Cost (mUSD)	Investment Phase	Capacity (Tpa)	1Y Global average price (USD/ton)
Ammonia	Industrial use	350	2012-2014	200000	350

Figure 7: DPM's projected sales and net income

Source: DPM, Mekong Securities

Figure 8: Peer Comparisons

Ticker	Mkt Cap ((USD)	P/B (x)	Est P/E Curr Yr (x)	2010 Gross margin (%)	2010 Net margin (%)	EV/EBITDA T12M (x)	2010 ROA(%)	2010 ROE (%)
NFCL IN	5,507,478	0.70	7.2	#N/A	3.3	10.0	1.3	3.5
FATIMA PA	5,804,353	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
DFPC IN	6,344,378	1.09	7.4	60.9	12.5	5.2	8.9	19.1
ZUAR IN	8,632,494	1.32	10.9	#N/A	4.1	11.0	5.2	20.4
FFBL PA	9,328,865	2.73	6.4	32.2	17.0	2.5	18.2	57.0
DPM VN	13,104,380	2.32	7.1	36.0	26.0	4.2	24.8	28.9
CHMB IN	13,652,960	1.78	8.9	#N/A	5.3	7.5	4.0	16.0
600423 CH	14,001,250	2.77	48.6	18.6	1.6	#N/A	1.9	5.3
000950 CH	14,984,810	2.01	18.8	23.0	6.5	#N/A	3.2	5.6
ENGRO PA	17,144,680	2.09	#N/A	23.2	8.5	15.5	3.6	16.4
RCF IN	20,814,290	2.39	20.8	#N/A	8.7	16.1	4.7	13.4
FFC PA	24,439,240	5.36	9.2	35.7	10.7	3.9	15.2	68.8
600426 CH	33,737,020	2.38	34.3	8.0	0.6	#N/A	3.6	8.7

(Source: Bloomberg, Mekong Securities)

DPM FINANCIALS MODEL Price (VND): **35,200** Target (VND): **35,000** Mkt cap: **13,376,000**
Analyst Duong Pham

(VND mil except where stated)	2009	2010	2011e	2012e	2013e	2014e	2015e
Total Net Sales	6,630,061	6,618,784	6,508,215	6,461,249	6,145,365	8,577,428	9,523,124
<i>Sales growth (%)</i>	2.4%	-0.2%	-1.7%	-0.7%	-4.9%	39.6%	11.0%
CoGS ex-dep'n	3,606,691	3,549,489	3,784,606	3,786,064	3,406,271	4,875,830	5,611,482
Gross profit	1,985,245	2,382,690	2,335,689	2,281,435	2,339,493	2,788,217	2,987,810
<i>Gross profit margin (%)</i>	29.9%	36.0%	35.9%	35.3%	38.1%	32.5%	31.4%
SG&A	579,145	741,703	729,313	724,050	688,652	961,189	1,067,164
<i>SG&A as % of sales</i>	8.7%	11.2%	11.2%	11.2%	11.2%	11.2%	11.2%
EBITDA	2,444,225	2,327,592	1,994,297	1,951,135	2,050,443	2,740,408	2,844,478
<i>EBITDA margin (%)</i>	36.9%	35.2%	30.6%	30.2%	33.4%	31.9%	29.9%
<i>EBITDA growth rate (%)</i>	-1.6%	-4.8%	-14.3%	-2.2%	5.1%	33.6%	3.8%
Depreciation	1,038,125	686,605	387,921	393,749	399,602	913,380	923,832
Bad debt provs, other costs (net)	0	0	0	0	0	0	0
Operating profit	1,406,100	1,640,987	1,606,376	1,557,386	1,650,841	1,827,028	1,920,646
<i>Operating profit margin (%)</i>	21.2%	24.8%	24.7%	24.1%	26.9%	21.3%	20.2%
Extraordinary income/expense	(38,928)	(49,712)	(48,882)	(48,529)	(46,156)	(64,423)	(71,526)
Net interest expense	152,532	330,367	222,543	281,171	246,380	313,690	394,195
Tax	168,418	214,773	222,505	223,753	231,383	259,537	280,414
<i>Effective tax rate (%)</i>	11.08%	11%	13%	13%	13%	13%	13%
Minorities	0	0	0	0	0	0	0
Net profit	1,351,286	1,706,869	1,557,533	1,566,274	1,619,681	1,816,758	1,962,900
<i>Net profit margin growth</i>	-2.45%	26%	-9%	1%	3%	12%	8%
Net profit margin	20%	26%	24%	24%	26%	21%	21%
Cash earnings	2,389,411	2,393,474	1,945,454	1,960,023	2,019,283	2,730,138	2,886,733
Number of shares (m)	380	380	380	380	380	380	380
EPS (VND)	3,556	4,492	4,099	4,122	4,262	4,781	5,166
<i>EPS growth (%)</i>	-2.5%	26.3%	-8.7%	0.6%	3.4%	12.2%	8.0%
Cash EPS (VND)	6,288	6,299	5,120	5,158	5,314	7,185	7,597
Key cashflow and balance sheet items							
	2009	2010	2011e	2012e	2013e	2014e	2015e
Increase in working capital	-1,021,840	(100,030)	(3,421)	497	(20,709)	108,514	40,767
Capex inc acquisitions	862,279	360,796	774,491	747,943	678,973	108,784	109,047
Other cashflow items	-372,451	-513,471	0	0	0	0	0
Free cash flow	2,176,521	1,619,237	1,174,384	1,211,584	1,361,019	2,512,841	2,736,918

Share issues (m)	0	0	0	0	0	0	0
Dividends paid	453,518	870,072	1,140,000	1,140,000	1,140,000	1,140,000	1,140,000
Increase in net debt	-1,723,003	-749,165	-34,384	-71,584	-221,019	-1,372,841	-1,596,918
Net debt, end of year	-2,649,377	-3,398,542	-3,432,926	-3,504,510	-3,725,529	-5,098,369	-6,695,287
Enterprise value	10,726,623	9,977,458	9,943,074	9,871,490	9,650,471	8,277,631	6,680,713
Shareholders' equity	5,556,876	6,256,940	6,674,473	7,100,747	7,580,428	8,257,187	9,080,087
BVPS (VND)	14,623	16,466	17,564	18,686	19,948	21,729	23,895
Net debt / equity (%)	-47.7%	-54.3%	-51.4%	-49.4%	-49.1%	-61.7%	-73.7%
Net debt / EBITDA (x)	-1.1	-1.5	-1.7	-1.8	-1.8	-1.9	-2.4
Total assets	6,351,200	7,432,131	7,836,549	8,260,737	8,683,405	9,708,099	10,663,741

Key return and valuation ratios	2009	2010	2011e	2012e	2013e	2014e	2015e
ROE (%)	26.2%	28.9%	24.1%	22.7%	22.1%	22.9%	22.6%
ROA (%)	23.4%	24.8%	20.4%	19.5%	19.1%	19.8%	19.3%
ROIC (%)	25.8%	29.0%	23.0%	22.5%	21.7%	22.7%	22.7%
WACC (%)	17.3%	17.3%	17.3%	17.3%	17.3%	17.3%	17.3%
EVA (%)	8.5%	11.7%	5.7%	5.2%	4.4%	5.4%	5.3%
PER (x)	9.9	7.8	8.6	8.5	8.3	7.4	6.8
EV/EBITDA (x)	4.4	4.3	5.0	5.1	4.7	3.0	2.3
EV/FCF (x)	4.9	6.2	8.5	8.1	7.1	3.3	2.4
PBR (x)	2.4	2.1	2.0	1.9	1.8	1.6	1.5
PSR (x)	2.0	2.0	2.1	2.1	2.2	1.6	1.4
EV/sales (x)	1.6	1.5	1.5	1.5	1.6	1.0	0.7
NOPAT	1,250,272	1,457,582	1,405,579	1,362,713	1,444,486	1,598,650	1,680,565

DCF Financial model	2009	2010	2011e	2012e	2013e	2014e	2015e
FCF	2,447,958	1,883,421	1,022,430	1,008,022	1,185,824	2,294,732	2,454,583
Discount factor			1.00	1.17	1.38	1.61	1.89
Present value of given year's FCF			1,022,430	859,398	861,890	1,421,841	1,296,472
PV of FCF 2010-14			5,462,031				
Terminal growth rate			3%				
PV of terminal value			9,331,940				
DCF valuation per share (VND)			47,966				

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