

PHUOC HOA RUBBER JOINT STOCK COMPANY

January 18, 2011

Current price	VND 37,700
Target Price	VND 46,793
Listed	HOSE
Symbol stock	PHR
Sector	Natural Rubber
Outstanding shares	81,300,000
Market Cap. (VND Bn.)	3,065
P/E (2010F)	6.8
P/B (2010F)	2.4



Overview

Phuoc Hoa Rubber JSC. (PHR) was established from Phuoc Hoa State Rubber Farm in 1993. The company was privatized on March 3th, 2008 and was officially listed on Hose on August 18, 2009. PHR focuses on planting, exploiting and producing the rubber latex. Possessing approximately 15,588 ha of total area and about 11,373 ha of exploiting area, PHR is ranked in 5th position in terms of total rubber areas and 4th position in terms of the rubber exploiting areas in the Vietnam Rubber Group (VRG).

Investment Highlight

- **High growth rate for industry:** the demand for consuming natural rubber continues increasing thanks to recovery of automobile industry. Meanwhile, supply of this product is going to decrease because of replacing of planted rubber tree area by other plantations or effects of weather. In addition, increasing crude oil prices or appreciation of Yen will also be the main factors leading to higher natural rubber’s price, thereby they positively affect to the Vietnam natural rubber industry.
- **Economy of scale creates many advantages as the selling price increases:** PHR has the largest planted area compared to other listed rubber companies. Accordingly, as the selling price of natural rubber has increased about 100% since the beginning of this year, PHR’s revenues surged higher than values of other companies which had lower output. In particular, the first nine-month revenues of PHR reached about VND1,385 billion, 118% higher than the same period last year. Because of this advantage, we expect that 2010 revenues of PHR will reach about VND2,360 billion, up to 120% compared to 2009. Furthermore, we also suppose that the company’s revenue will grow 10% in 2011, 7% in 2012 and 5% for the next two years.
- **Improving profitability:** Yield reduction was the main reason dragging gross margin down continuously in recent years, from about 40% in 2006 to 26.5% in 2009. In addition, there was also a sharp decline in rubber price from quarter III/2008, seriously affecting to PHR’s business performance. In 2010, the company’s gross margin rebounded and estimated to reach 31.5% in 2010 lifting EBIT ratio to reach to about 24.5% compared to 20.5% in 2009. Although continuing benefiting from the price increase, we forecast that operation efficiency of the company will drop somewhat in next few years. Specifically, the gross margin in 2011 is expected to drop to about 30% and to 29% in 2012. Since then, it can recover due to high productivity and growth of the exploiting areas.
- **Huge resource for developing core business:** while many other companies in the industry cannot expand their own rubber plantation area – the main resource of the rubber company, PHR can do that and it is implementing a project of planting 8,000 ha of rubber trees in Kampong Thom (Cambodia). This is a large advantage for PHR’s growth when the project is put into operation.
- **Long-term potential growth thanks to good investment projects:** PHR is expanding its activities into some other sectors such as Hydropower, Industrial Zone, and Residential Zone... Totally, PHR has contributed into 18 projects with an amount of over VND830 billion until the end of 2010.

Recommendation

According to our valuation outcomes, the PHR’s price will reach approximately VND46,793, higher than 24% compared to the closing price at 18/01/2011. Vietnam natural rubber industry has a high potential for growth, while projects of PHR are expected to bring long-term profitability for the company. We recommend buying PHR at current price.

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World Natural Rubber Industry

Overview

As being known, rubber is an important material, and is used to produce many necessary things in human life. The rubber industry is divided into two groups including natural rubber (NR) and synthetic rubber (SR). Natural rubber latex is derived from latex of rubber trees, while synthetic rubber is derived from petroleum. Both of these products can be used interchangeably, so prices of these two products are closely correlated. That's the reason why fluctuations of natural rubber price also depend considerably on crude oil prices.

Every year, the world consumption of rubber is about 22 million tons, including NR and SR. Particularly, consumption of NR fluctuates between 40 – 70%, depending on the demand of tire manufacturing industry. Besides, the natural rubber is also used to produce medical equipment, gloves, cushions and condom, etc.

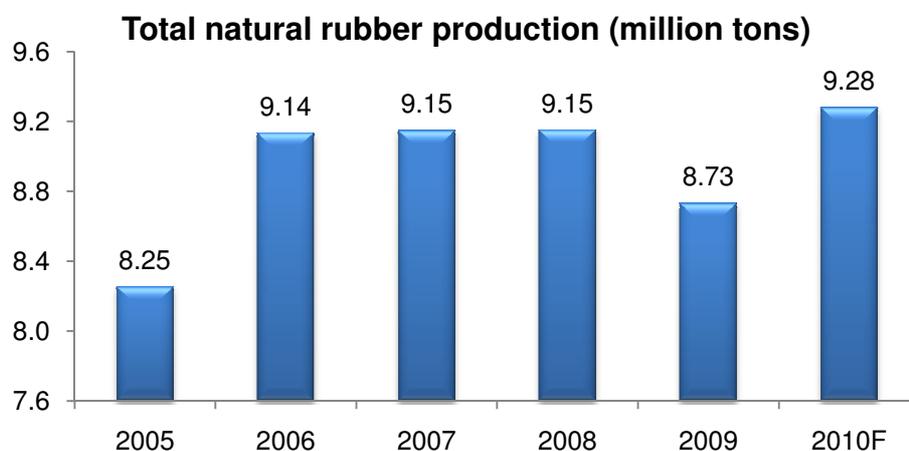
World Natural rubber output

There are 94% of natural rubber productions all over the world is provided by Asia countries, 4.3% is produced by Africans, and the remaining is from Latin American. In which, Thailand is the leader with 2.83 million tons in 2009. Indonesia ranked in second with 2.59 million tons, and next is Malaysia with 821 thousand tons. Vietnam ranked in the fifth position with about 723 thousand tons.

Affected by the economic crisis, the natural rubber outputs were firstly down after a long time climbing up. The natural rubber outputs just reached 8.73 million tons, down 4.6% compared to 2008. However, in 2010, natural rubber industry was expected to recover thanks to the recovery of automobile industry. According to Association of Natural Rubber Producing Countries (ANRPC), the output is estimated to reach 9.3 million tons, up 6.3% compared to 2009 and it is also projected to improve about 4.2% in 2011.

However, we believe that the outputs will be quite similar in the next few years or tend to be lower because of following reasons:

- Low yield due to unfavorable weather.
- Reductions of rubber area, for instance palm trees have been planted instead of rubber trees in Malaysia.



Source: ANRPC

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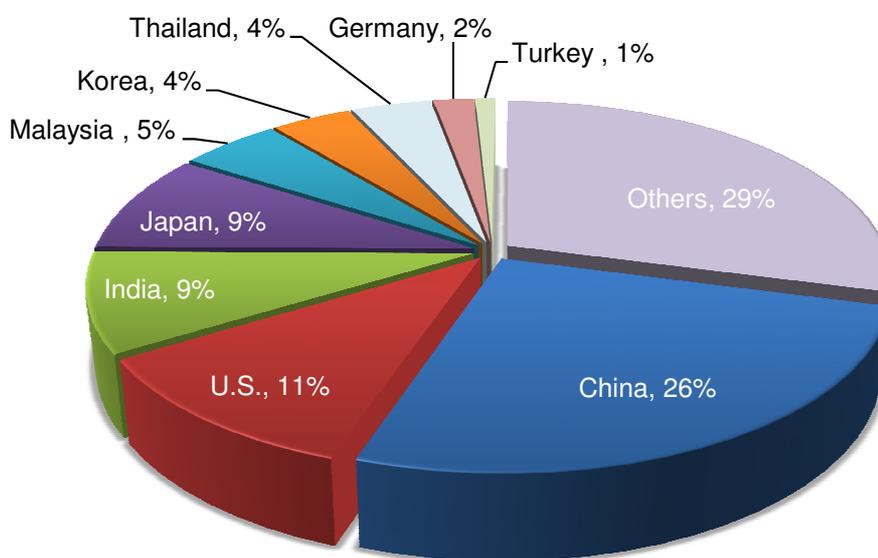
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World Natural rubber consumption

In 2009, total natural rubber consumption in the world was about 9.6 million tons, down 5.2% compared to 2008. This reduction was mainly due to the decline of the world automobile industry.

Asia is the largest market for natural rubber, accounting for about 67% of total consumption. China is the largest consumer and has created a vibrant rubber market in the world. Following China is the U.S., Japan and EU. Additionally, India is a potential market due to many prospects of its automobile. In 2009, India has passed Japan to become the third largest consumer of natural rubber products.

Rubber consumption 2009



Source: ANRPC

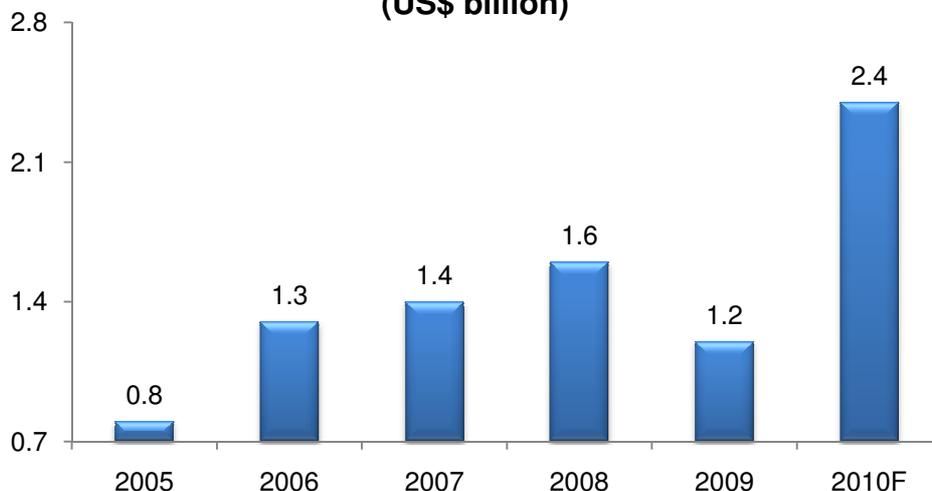
In 2010, the consumption of rubber products has increased sharply thanks to the significant growth of tire manufacturing industry in Asia, especially China, India and Malaysia... it is forecasted that total consumption of natural rubber products will consecutively increase till 2020. The consumption in 2010 is estimated to reach 10.43 million tons, 8% higher than previous year, and in the following years it will increase about 3.5% annually.

Furthermore, natural rubber will be preferred to synthetic rubber because people tend to use friendly environmental products. Hence, the demand of natural rubber will be higher in the future. In addition, as mentioned above, the outputs will be stable or reduced somewhat, but the demand is estimated to increase more so we believe that probability of price increase will be high. Thereby, this, in turn, will create high profits for countries having high rubber productions.

Vietnam Natural Rubber Industry

Vietnam is one of three largest natural rubber exporting countries in the world, the export value of rubber in 2009 reached US\$1.2 billion. However, after more than 50 years of development, the industry is still quite backward when about 90% of Vietnam's products that are exported have still been raw materials.

**Export value of natural rubber of Vietnam
(US\$ billion)**



Source: GSO

Export value of rubber has continuously advanced sharply in recent years and has become one of the main exporting industries of Vietnam. The export value continued achieving over US\$ 1 billion since 2006. In 2009, because of impacts of the world economic crisis, natural rubber prices fell about 60 - 70%, causing the export value of the industry declining significant. However, in 2010, the strong increase of natural rubber price helped the industry to achieve a very positive result; particularly export value in 2010 was estimated to reach to US\$2.4 billion, doubling the value of 2009.

Vietnam natural rubber products has exported to more than 70 countries around the world, however, because of low quality products, so China is still the largest exporting market of Vietnam, accounting for 65% of export value. Currently, Vietnam tends to gradually export to other markets such as Malaysia, Taiwan, Korea, Germany, Russia, India ...

Characteristics of the Vietnam natural rubber

Seasonality in nature: more than 70% of total output focuses on the last 6 months, especially from September onward. During quarter I, latex mainly was exploited in January because Vietnam's Tet Holiday and deciduous time of rubber trees from February to April, so the output is very low. This leads to low output in quarter II. However, the Vietnam's seasonality nature are quite different from other countries, thus it is not likely to have a situation that rubber price declining in all seasons. That's the reason making majority of revenues are concentrated heavily on the last 6 months of every years.

Rubber trees are area mainly distributed in the Southeast region (64%) and highland area (24.5%), followed by the Middle area with about 10% of the total areas of rubber plantation. However, these areas cannot be expanded further, so Vietnam tends to expand to the North or neighbor countries such as Cambodia, Laos, Myanmar ...

In Vietnam, total rubber plantation area in 2009 reached 674,200 ha, an increase of 42,700 ha (13.5%) compared to 2008, in which exploiting area was about 421,600 ha. In 2009, total production reached over 723,700 tons. It was estimated that the rubber plantation area in Vietnam reached 715,000 ha in 2010; and the total output reached 770,000 tons, up 8.3% compared to 2009.

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Most of largest businesses are owned by Vietnam Rubber Group of Vietnam (VRG). VRG now manages about 298,800 ha of tapped area, and is exploiting 300,000 tons rubber per year (over 41% of total national outputs).

Average yield of Vietnam natural rubber is quite high, about 1.8 tons/ha compared to 1.7 tons/ha of Thailand, about 1 ton/ha in Indonesia and 1.3 tons/ha of Malaysia. However, for the large companies, especially VRG's members, the average yield is even higher, over 2 tons/ha.

Because of the backward technology of domestic tires manufacturing industry, so there are only about 10-15% of natural rubber outputs are consumed domestically.

Product structure

Block rubber is Technically Specified Rubber (TSR) that VRG launched with brand of Standard Vietnam Rubber (SVR). This product takes the highest proportion in Vietnam rubber products structure, occupying to over 70% of the total outputs. Of which:

- SVR L, 3L: is processed from latex immediately after harvesting, it has the bright color. It can be seen as a high quality product of Vietnam, accounting for more than 50% of total products. However, this has a poor efficiency due to low demand in over the world, and is mainly exported to China.
- SVR 10, 20: is processed from frozen latex. The product color is dark and black, and suitable for producing tires. This has a very high demand in the world but it only accounts for 16% of total Vietnam's products because of features of Vietnam natural rubber industry.
- SVR CV 50, 60: is the rubber having stable elasticity. It accounts for about 4% of total products, producing mainly by orders of customers.

Coagulated latex: is a high quality product as well, using for producing gloves, cushion, condom... this accounts for about 10% of total products. Because there is only 60% dry rubber content (DRC) in product's ingredients, thus this is a highly efficient product.

Rubber smoked sheet (RSS): is processing by rolling into thin rubber layer and smoking. This has high tensile strength and less aging than block rubber so it is suitable for producing high quality tires. This product is only about 6% of total industry output.

Other products include crepe rubber and mixture rubber (mixed between natural rubber and synthetic rubber), accounting for about 14% of total productions.

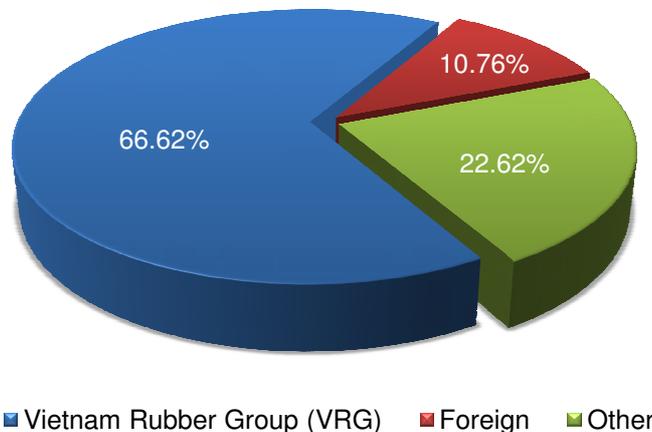
Phuoc Hoa Rubber Joint Stock Company**Overview**

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Ownership structure



Source: PHR

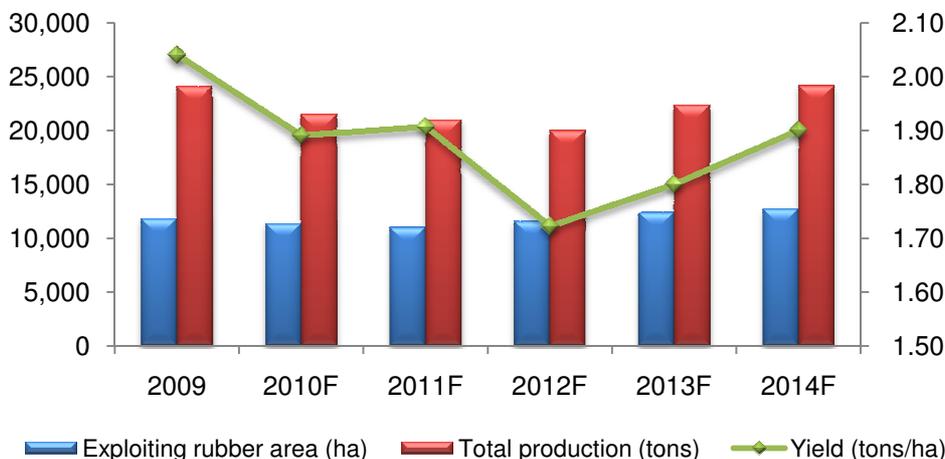
Similar to other large companies in the sector, PHR is owned by Vietnam Rubber Group.

Production capacity

Rubber plantation area: Currently, PHR has 7 rubber farms with a total area of about 15,800 ha. In 2010, the exploiting area reached to 11,373 ha, with an average yield of over 1.89 tons/ha. Besides, rubber area under contracts smallholdings reached to about 1,000 ha.

The exploiting area will continue decreasing in 2011, estimating to attain about 11.014 ha. However, after about 5-7 years of planting, the exploiting area will increase again in 2012. According to the industry characteristics, new tapped area's productivity is very low, thus it will probably be a bottom of output in 2012, with the production of about 20,000 tons. Then, in following years, the exploiting area and yield will be likely to improve higher. It is estimated that PHR' outputs will increase sharply in 2016 due to new planting rubber trees in Cambodia which can be exploited as well as higher yield.

Productivity of PHR in coming years



Source: SBB

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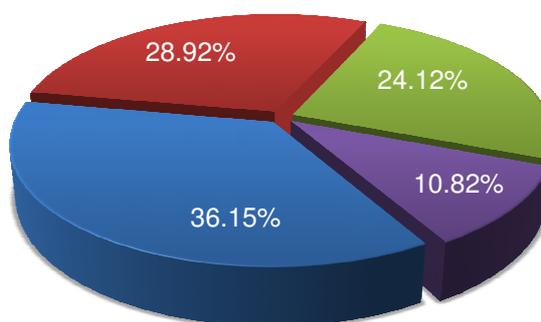
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Rubber processing factories

PHR has currently three rubber processing factories, with a total designed capacity of 27,000 tons per year, as follows:

- Bo La Processing Factory: 6,000 tons/year.
- Centrifuged Latex Processing Factory: 3,000 tons/year.
- Cua Paris Processing Factory: 18,000 tons/year.

Product structure



■ SVR CV 50-60 ■ SVR 3L-L ■ SVR 10-20 ■ Latex

Source: PHR

PHR's dominant products are SVR CV 50 – 60, accounting for 36.15% of total company's products. Meanwhile, products of SVR 3L – L are only about 29% and products of SVR 10 – 20 are 24.12%, a high proportion compared to other companies, the remaining is from Latex. Here is the biggest difference of PHR to other companies in the industry. This was expected to help PHR to improve its business performance.

Products for domestic consumption are quite large, accounting for 50% of total company's products. 50% of the remaining products are exported to the Asian markets (Chinese, Korean, Japanese ...) and Europe (Belgium, Czech Republic, Germany ...), Americas (USA, Argentina and Brazil ...).

Age of rubber plantation

More than 60% of the rubber areas are in the age of 21 to 27 year-old. These rubber forests can bring to PHR a current exploitation advantage; yet leading to the long-term stability. The company has re-cultivated about 800 ha/year since 2004. Hence, PHR's exploiting productivity tends to reduce largely; it is estimated to reach a bottom level in 2012, with production of less than 20.000 tons. Then, the production will recover due to new planted rubber that can be tapped. However, recovery rate will be low because of low productivity of new planted rubber. We also note that the company has other incomes from sale of rubber wood when re-cultivating.

Long-term investment projects

PHR's financial investment is quite large, at the end of quarter III/2010, the investment amount reached to more than VND775 billion and is estimated to reach more than VND800 billion by the end of 2010. Of which, PHR mostly contributed its capital to other companies in the industry or other subsidiaries of VRG, expecting to bring income in 2013. Besides, remarkably, some projects will bring long-term revenues for the

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company as projects of planting rubber trees in Cambodia and projects of hydroelectric power and real estates.

For rubber plantation project in Kampong Thom (Cambodia), planned area is 9,184 ha, including rubber plantation area of 8,000 ha. Currently, the company has planted 2,000 ha, is planned to plant about 2,000 ha/year in coming years. As planned, this project will bring income in 2016. With a advantage of labor cost in Cambodia only reach 25% of total cost compared to over 50% of Vietnam, we really appreciate prospect of this project.

No.	Project name	Total invested capital	Contributed by PHR	%	PHR's contribution in 2010
I	Contribute capital to invest projects	2,691,507	491,437		
1	Nam Tan Uyen JSC	160,000	59,552	37.22	52,565
2	VRG Infrastructure Development Investment JSC	268,507	77,975	29.04	79,965
3	Song Con Hydroelectricity JSC	300,000	57,000	19.00	57,000
4	Truong Phat Rubber JSC	50,000	35,000	70.00	35,000
5	Saigon VRG Investment Holdings Corporation (SVI)	600,000	120,000	20.00	132,224
6	Quasa Geruco (Laos) Rubber JSC	500,000	53,750	10.75	24,300
7	Hochiminh Rubber JSC	200,000	30,000	15.00	27,295
8	Son La Rubber JSC	200,000	20,000	10.00	20,000
9	Ngoc Linh Hydroelectricity JSC	160,000	24,000	15.00	10,350
10	VRG Long An Joint Stock Co.	77,000	3,850	5.00	1,600
11	Saigon - Hanoi Commercial Bank (SHB)				35,703
12	Thuan An Wood Processing JSC	104,000	7,280	7.00	8,600
13	Rubber Industry & Import Export JSC (Rubico).	50,000	2,030	4.06	2,362
14	Geru Star Sport JSC	22,000	1,000	4.55	1,042
II	Direct Investment	1,195,000	594,000		
1	Phuoc Hoa Resident Area	70,000	70,000	100	50,288
2	Phuoc Hoa – Kampong Thom Development Rubber Company Ltd. (Cambodia)	935,000	374,000	100	273,014
3	Tan Binh Industrial Zone project (Binh Duong)	100,000	60,000	60	645
4	Farms Resident Area	90,000	90,000	100	
	Total	3,886,507	1,085,437		763,600

Unit: VND Million; Source: PHR

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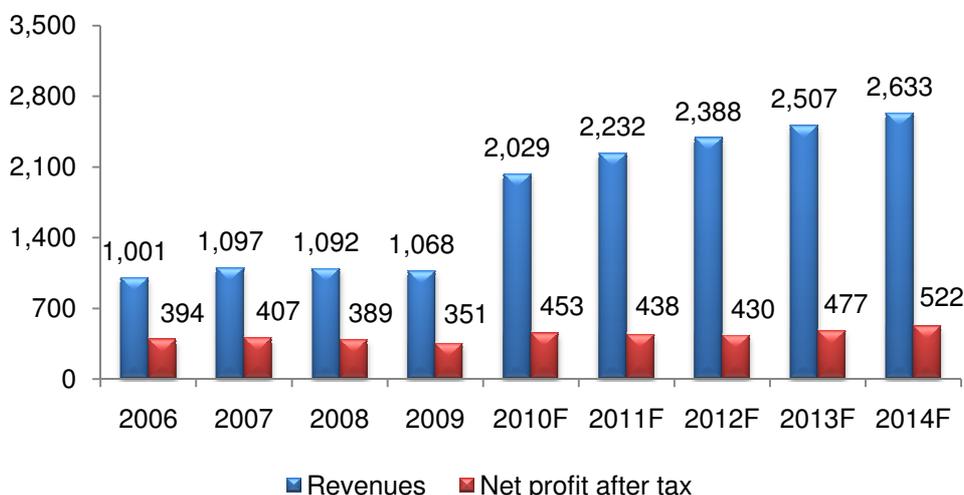
Business performance

Price increase will determine revenues growth rate

Only the project of expanding rubber area planting at Kampong Thom (Cambodia), can bring income in 2016. Meanwhile, because of continuing rubber trees re-cultivation from 2004 up to now, so the tapped area of PHR tends to fall down in next few years. Leading production is also in a downward trend. Hence, if there is not price increase, the turnover of PHR certainly will reduce in next three years.

PHR's revenues from 2006 to 2009 are quite similar. However, due to the strong increase in natural rubber price, the revenues will surge in 2010. Specifically, PHR's revenues in 2010 is predicted to reach to about VND2,029 billion, up 90% compared to 2009.

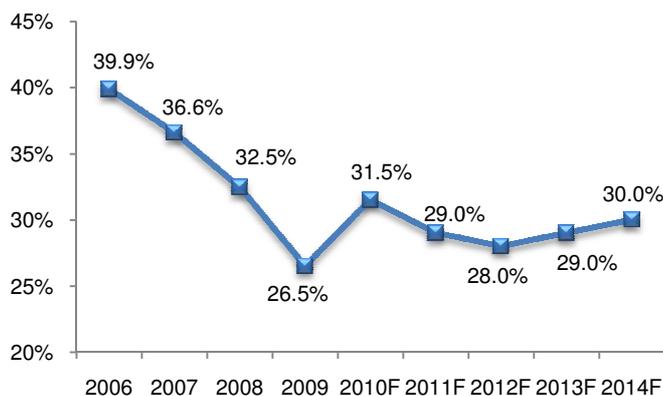
Revenues and Net profit after tax of PHR



Therefore, it can be said that price increase is a main reason helping the PHR's income to grow in the coming years. However, as mentioned, the output of PHR is in downward trend, so we forecast that the company's revenue will grow about 10% in 2011, 7% in 2012 and 5% for the next two years.

Efficiency of business

Gross margin



Source: SBB

Fluctuations in rubber prices



Source: TOCOM

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Yield reduction is the main reason making gross margin lower continuously in recent years, from about 40% in 2006 fell to 26.5% in 2009. In addition, there is a sharp decline in rubber price from quarter III/2008, seriously affected PHR's business performance.

In 2010, rubber price increased 100%, compared to the end of 2009, leading to higher gross margin and it is estimated to reach to about 31.5% in 2010. Thereby, the EBIT ratio can attain 24.5% compared to 20.5% of 2009.

Although continuing to benefit from price increase, but we forecast that efficiency of PHR will drop. Specifically, the gross margin in 2011 dropped to about 29%, and 28% in 2012. Then it will recover due to high productivity and growth of the exploiting area.

Comparison of business performance in 2010

Items	PHR	DPR	TRC	HRC	TNC
Total rubber plantation area (ha)	15,800	10,400	7,200	5,096	4,000
Exploiting rubber area (ha)	11,373	7,553	5,550	3,380	1,220
Yield (ton/ha)	1.89	2.25	2.16	1.60	1.10
Total Asset (VND Bn.)	2,331	1,484	989	456	299
Total equity (VND Bn.)	1,418	1,158	748	415	268
Charter capital (VND Bn.)	813	430	300	173	193
Revenues (VND Bn.)	2,350	1,115	790	324	206
Net Profit (VND Bn.)	453	357	250	85	44
Gross margin (%)	31.5	41.5	40.0	32.0	28.0
Net margin (%)	22.3	32.1	31.6	26.1	21.3
Asset Turnover (x)	1.1	0.8	0.9	0.7	0.7
Liabilities/Equity (%)	64.4	28.2	32.2	9.9	11.6
Current Ratios (x)	1.0	1.9	2.0	2.0	2.0
ROE (%)	35.1	33.1	36.3	21.9	17.1
ROA (%)	21.5	26.1	28.1	19.2	15.4
P/E (x)	6.8	7.7	8.3	12.2	7.4
P/B (x)	2.4	2.4	2.8	2.7	1.2

Productivity of PHR, though higher than average yield of the industry, but it is lower than DPR and TRC. This is why PHR have lower margin than the two companies. In addition, PHR's liabilities/equity ratio is quite large - 64.4% compared to the industry's average level of about 20%, because the company uses short-term loan to finance for rubber plantation project in Cambodia. Hence, PHR have to suffer high interest expenses, leading low net margin. Consequently, it also reduces current ratio of the company, only 1.0x compared to 2.0x of industry average.

In 2010, economy of scale helped PHR significantly in developing more impressively than other companies. It explains why its productivity is not high, but ROE of PHR leads others.

Besides, PHR's P/E ratio only is 6,8x, quite attractive compared to other companies in the industry and average of the market (about 10x).

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Valuation

Assumptions

We assume that WACC is calculated in period of 2010 - 2014, Rd is 15% and Re is 21%. Growth rate of 6% for stable period.

Average P/E ratio is 10x and Average P/B ratio is 2.2x

Valuation outcomes

Based on the valuation model, PHR's intrinsic value will be VND46.793.

Model	Price	Weighted	Weighted average
FCFF	45,777	35%	16,022
FCFE	47,935	30%	14,381
P/E	55,663	20%	11,133
P/BV	35,053	15%	5,258
Weighted price		100%	46,793

Recommendation

According to our valuation outcomes, the PHR's price will reach approximately VND46,793, higher than 24% compared to the closing price at 18/01/2011. Vietnam natural rubber industry has a high potential for growth, while projects of PHR are expected to bring long-term profitability for the company. We recommend buying PHR at current price.

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