BAOVIET Securities

Sector: Chemicals

Initial Coverage

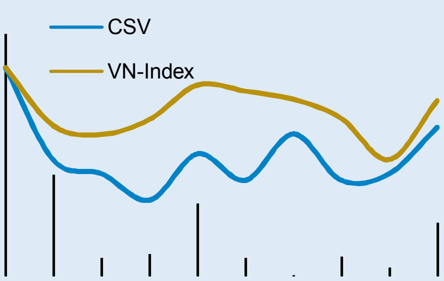
June 15, 2015

Recommendation	**OUTPERFORM**
Target price (VND)	**24,200**
Market price (12/06/2015)	18,900
Expected return	+27%

STOCK INFORMATION

Exchange	HSX
52-week price range	VND16,750 - 19,780
Capitalization	VND840 billion
Outstanding shares	44,200,000
10-day average volume	19,130
% foreign ownership	16.7%
Foreign ownership limit	49%
Dividend per share	VND1,600
Dividend yield	8.4%
Beta	0.34

PRICE MOVEMENT



	YTD	1M	3M	6M
CSV	N/A	5.0%	N/A	N/A
VN-Index	5.4%	2.3%	-2.6%	1.0%

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South Basic Chemicals JSC

Ticker: CSV Reuters: CSV.HM Bloomberg: CSV VN

Long-time customer base ensures stable operation

BVSC rates **OUTPERFORM** on CSV stock with a target price of **VND24,200/share**, suitable for value investment with the following highlights:

- Chemical supply in Vietnam is sufficient to meet 50% demand. Especially, demand for Sodium hydroxide (NaOH), the key product of CSV, is very high. This is one of the core products included in the chemicals development planning of Vietnam with an estimated supply of 900,000 tons per year in the future.
- Chemical demand in Vietnam is relatively high as the product is inputs for the consumer goods and industrial production fields.
- SCV is a reputable brand in the Vietnam National Chemical Group (Vinachem) as well as in Vietnam and its advantage in having a traditional customer network brings stable revenue and profit each year.
- At present, the P/E ratio of CSV is more attractive than other listed companies in the chemicals industry, such as DGC, LAS, HVT. Its gross profit/revenue, operating profit/revenue and net profit/revenue ratios are higher than other listed companies. CSV has a healthy financial situation and abundant cash flows.

Risks. However, investors should pay attention to the risks related to the compulsory relocation of three factories of CSV in Bien Hoa 1 Industrial Zone in the period 2018 - 2020. CSV is estimated to need VND2,700 billion – VND3,000 billion to make the removal, causing huge financial pressure and share dillution if having to increase registered capital. In addition, investors should also consider risks related to raw material price fluctuations and competition pressure.

2015 Forecast. CSV is expected to record slight growth with revenue of VND1,545 billion and net profit of VND165 billion, up 4% yoy, equivalent to an EPS of VND3,312. In 2015, CSV benefits from an on-year 20% decrease in raw material prices but suffers negative impacts of the electricity price increase (7.5%) from Q2/2015, so operating results are forecast to increase slightly.

Financial indicators of CSV

Norm	2012	2013	2014	2015F
Revenue (billion VND)	1,538	1,516	1,551	**1,545**
EBITDA (billion VND)	267	318	339	**301**
EBIT (billion VND)	180	228	223	**214**
Net profit (billion VND)	102	151	158	**165**
EPS (VND)	3,236	5,293	3,172	**3,312**
P/E (x)	5.9	3.61	6.02	**5.77**
P/B (x)	1.35	0.83	1.46	**1.26**

ROA (%)	8.39%	12.45%	14.43%	**13.53%**
ROE (%)	21.12%	22.10%	22.59%	**19.98%**

OWNERSHIP INFORMATION

State	72,51%
Foreign	16,72%
Others	10,77%

MAJOR SHAREHOLDERS

Vietnam National Chemical Group	65%
VN Investment Property Holdings	7.5%

FINANCIAL FORECAST

Income Statement

Unit (billion VND)	2012	2013	2014	2015F	2016F	2017F
Revenue	1,539	1,516	1,551	1,545	1,627	1,713
COGS	1,256	1,204	1,185	1,181	1,244	1,310
Gross profit	283	312	366	364	383	404
Financial revenue	4	6.3	6.9	7	7	8
Financial expense	48	27	16	11	11	10
Net profit	102	151	158	165	179	190

Balance Sheet

Unit (billion VND)	2012	2013	2014	2015F	2016F	2017F
Cash & cash equivalents	140	145	261	373	478	591
Short-term receivables	106	148	127	127	134	141
Inventories	3	9	11	226	238	251
Fixed assets	300	354	269	278	283	289
Long-term financial investments	-	2	-	-	-	-
Total assets	**947**	**1,046**	**971**	**1,082**	**1,214**	**1,357**
Short-term liabilities	531	445	340	164	154	144
Long-term liabilities	40	10	11	10	9	8
Equity	344	565	580	733	868	1,013
Total resources	**947**	**1,046**	**971**	**1,082**	**1,214**	**1,357**

Financial Indicators

Norm	2013	2014F	2015F	2016F	2017F
Growth ratios					
Revenue growth (%)	(1%)	2%	-0.4%	5.3%	5.3%
Net profit growth (%)	49%	5%	4.4%	8.5%	5.9%
Profitability ratios					
Gross profit margin (%)	20.6%	23.6%	23.6%	23.6%	23.6%
Net profit margin (%)	9.98%	10.2%	10.7%	11.0%	11.1%
ROA (%)	12.5%	14.4%	13.5%	13.1%	12.3%
ROE (%)	22.1%	22.6%	20.0%	18.3%	16.6%
Capital Structure					
Total liabilities/Total assets (%)	43.7%	36.1%	32.3%	28.5%	25.4%
Total liabilities/Total equity (%)	77.6%	56.5%	47.6%	39.9%	34.0%
Per share ratios					
EPS (VND/share)	5,293	3,172	3,312	3,592	3,804
Book value (VND/share)	23,032	13,115	15,228	17,820	20,623

High potential growth from NaOH product

Basic chemical supply in Vietnam is sufficient to meet only 50% demand. Basic chemical is one of 10 product groups in the development planning of Vietnam chemicals industry until 2020. The planning emphasizes investment plans for some key basic chemicals, especially building a NaOH - CL production line with a total capacity of 900,000 tons per year.

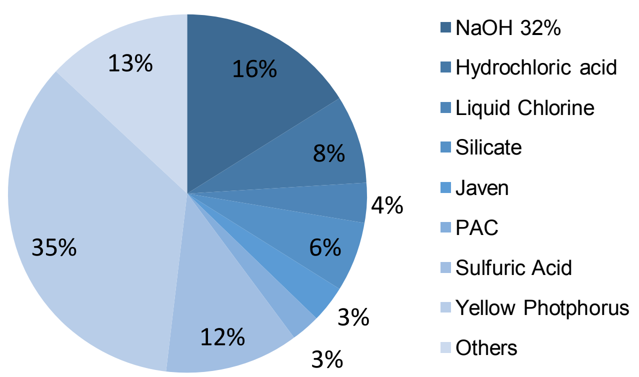
NaOH - CL is the input of some major industries such as the petrochemical industry, PVC manufacturing, FMCG, textile industry, etc.

The petrochemical industry will be emphasized and promoted in the future, whereby NaOH - CL projects will be invested in parallel with the development of petrochemical complexes. When NaOH is produced from salt, Chlorine and Hydrogen will be produced in parallel with the amount of NaOH obtained. On average, the production of 1.1 tons of NaOH will put out 1 ton of Chlorine. The residual amount of Chlorine in the production of NaOH can not be balanced due to the limitations of the petrochemical industry, which affects the maximum production capacity of NaOH from the existing factories. Currently, few plants use calcium to neutralize residual Chlorine to release Calcium Chloride, which is a substance often used in drilling fluids to increase the proportion of liquid brine solution, improve the liquidity and adjust the permeability in mud.

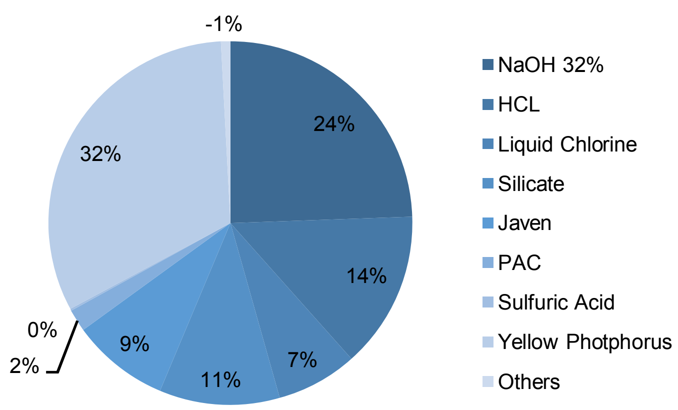
The economy is on the recovery, leading to the development of PVC manufacturing industries, textile and dyeing industry, paper industry and the consumer goods industry, which use a large proportion of NaOH as raw material.

Revenue and profit from NaOH – CL production:

CSV's Revenue Breakdown



CSV 's Profit Breakdown



Source: CSV

Limited capacity expansion, difficult to adjust cost price

The expansion of capacity is limited due to the pressure of removal of three factories at Bien Hoa Industrial Zone (Dong Nai)

Bien Hoa 1 Industrial Zone was established in 1963, with a total area of 335ha. Currently, 52 foundations in this zone release exhaust fumes, smoke and dust, affecting the surrounding environment. As many as 97 operating firms in this zone discharge more than 9,000m3 of waste water each day, including only 1,100m3 treated at Bien Hoa II Industrial Zone and the rest discharged directly into Dong Nai river, causing serious pollution in the river.

Currently, CSV owns 3 factories at Bien Hoa Industrial Zone, forced to be removed in the period of 2018 - 2020. The Company said that it needs about VND2,700 billion - VND3,000 billion for the relocation of 3 factories. CSV will suffer an upward capital pressure for the expansion of capacity at the new location as well as for the welfare of workers at Bien Hoa 1 Industrial Zone.

Factory	Product name	Location
Dong Nai chemicals factory	- Phosphoric Acid (H_3PO_4) technical grade (7,000 ton/year) - Phosphoric Acid (H_3PO_4) food grade (3,000 tons/year)	Road No. 1, Bien Hoa 1 Industrial Zone, Dong Nai province
Bien Hoa chemicals factory	- NaOH (40,000 ton/year) - Hydrochloric acid (HCL) (126,000 tons/year) - Silicate (30,000 tons/year) - Salt (grinded salt 15,000 tons/year, refined salt 21,000 tons/year) - Concentrated sulfuric acid (H_2SO_4 98%) 2,000 tons/year	Road No. 5, Bien Hoa 1 Industrial Zone, Dong Nai province
Tan Binh 2 chemicals factory	- Sulfuric acid technical grade (60,000 tons/year) - Aluminum sulfate (8,000 tons/year) (17% Al_2O_3 &15% AL_2O_3)	Road No. 5, Bien Hoa 1 Industrial Zone, Dong Nai province

Source: CSV

Difficult to raise selling prices due to the competition of Chinese imported products

The impacts of competition on CSV's major products

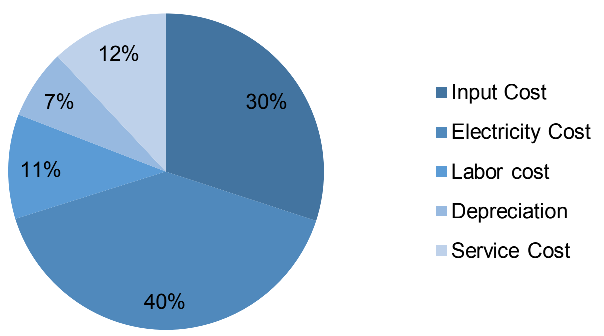
Product name	Application	Market share & rivals	Impacts
NaOH	Water treatment chemicals, pulp and paper manufacturing, textile & dyeing industry, soap detergent, PVC	Market share 25% Vedan is a rival with market share of 35% Vedan: 80,000 tons/year Bai Bang Paper: 10,000 tons/year Viet Tri Chemicals JSC: 20,000 tons/year	Neutral Due to huge demand for NaOH – CL but residual amount of Chlorine in the production of NaOH, the output of NaOH is still limited NaOH is protected with an import tariff rate of 5% - 20%
Sulfuric acid	Fertilizer material, alum in water treatment, battery manufacturing	Market share 50% Chinese imported products, Long Thanh Super Phosphate Plant	High
HCL 32%	Food and seasoning powder production	Market share 50% (not full capacity) Vedan: 40% Viet Tri Chemicals JSC: 10%	Neutral
PAC	Waste water treatment, textile & dyeing industry	Market share 20% Bac Giai Co. Ltd.: 10% Tan Luas Co.: 20%	Neutral
Phosphoric acid	Fertilizer production	Chinese and S.Korean rivals	High

Source: BVSC data

Difficult to control input expenses

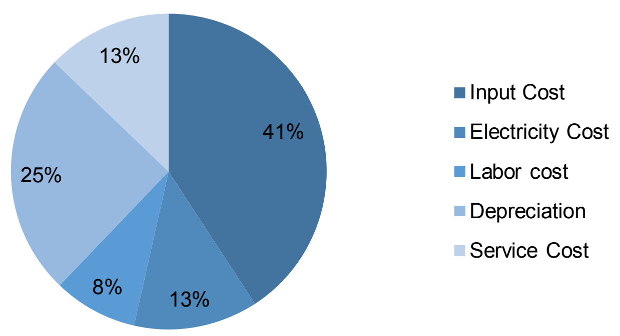
NaOH - CL and Sulfuric acid are two major products of CSV. Raw material costs account for a large proportion in the production costs. Industrial salt and sulphur account for 30% each of the NaOH - CL production costs.

NaOH production cost breakdown



Source: CSV

CSV's COGS breakdown



Source: CSV

CSV has no large warehouse containing raw materials, leading to limited ability in storing materials at low prices and the frequency of material import at every two months.

Major inputs for production as industrial salt and sulphur are unpredictable in price, so the business of CSV has great dependence on the price movements of imported raw materials, not to mention the risks of exchange rate fluctuations. CSV will benefit from low material prices but suffer high risks arisen from the uptrend of material prices. Each year, CSV imports about 75,000 tons of industrial salt, 73% of which from India and the rest from Australia, and about 20,000 tons of sulphur from Singapore, Russia and Turkey.

Major input	Import source	Average volume per year
Industrial salt	**India, Australia**	**75,000 tons**
Sulphur	**Singapore, Russia, Turkey**	**20,000 tons**

Sources: CSV, BCB

Electricity accounts for about 25% of the cost price, with total consumed volume of 180 million kWh per year. CSV must use large amount of power, especially in the electrolysis of brine to produce NaOH and chlorine. Particularly, energy costs in the production of NaOH and chlorine make up 40% of the total costs of this product. Meanwhile, electricity price is on an uptrend (averaged 5%/year in the past), causing concerns about the future business activities of CSV.

Accelerated depreciation rate due to specific activities in the chemicals industry also leads to high annual investment costs. With the depreciation equivalent to 2014, CSV will fully amortize machinery in the next two years. However, due to specific activities in the chemicals industry with heavy depreciation, investment costs will be increased, expected to lead to lower earnings.

Long-time customer base ensures stable operation

Up to 90% of CSV's customers are outside Vinachem and 10% inside Vinachem.

The majority of customers having big contracts with CSV operates in the FMCG industry such as washing powder, detergents, fragrant lotion, shampoo; in the fertilizer and chemical industries; food industry; waste water treatment activities; and the textile & dyeing industry. These companies mostly operate in the essential fields and are long-time customers of CSV. As a result, the business of CSV is running stably, proven even in the most difficult time of the economy as in the period 2011-2013.

List of major customers of CSV

Customer base	Company name
Inside Vinachem	LIX Detergent Joint Stock Company NET Detergent Joint Stock Company Dap Vinachem Co. Ltd. Mien Nam Fertilizer Corp. Can Tho Fertilizers and Chemicals Joint Stock Company
Outside Vinachem	Ulhwa Vietnam Co. Ltd. P&G Dong Duong Co. Ltd. Ho Chi Minh City Urban Drainage Co. Ltd. Viet Tien Food Co. Ltd. Thien Phu Chemical & Equipment Co. Ltd. AJINOMOTO Vietnam Co. Ltd.

Source: CSV

SWOT Analysis

Strengths	Weaknesses
Stable customer base, including institutions and companies under Vinachem and long-time strategic partners	Weak distribution network, non-official sales, unverified ability to develop new customers
Healthy financial situation, abundant cash flows	Small production scale, unsufficient to meet market demand
Opportunities	**Challenges**
The economic recovery will lead to the development of water treatment projects, fertilizer and chemical factories, and higher demand for food and dyeing products	The relocation of three factories in Bien Hoa 1 Industrial Zone in 2018 – 2020 will affect business activities of CSV due to high expense. CSV is estimated to need about VND2,700 billion to make the removal, forcing the Company to borrow loans and issue shares in the next 3-5 years, leading to lower operating results and EPS due to higher financial expense, new appreciation and share dillution.

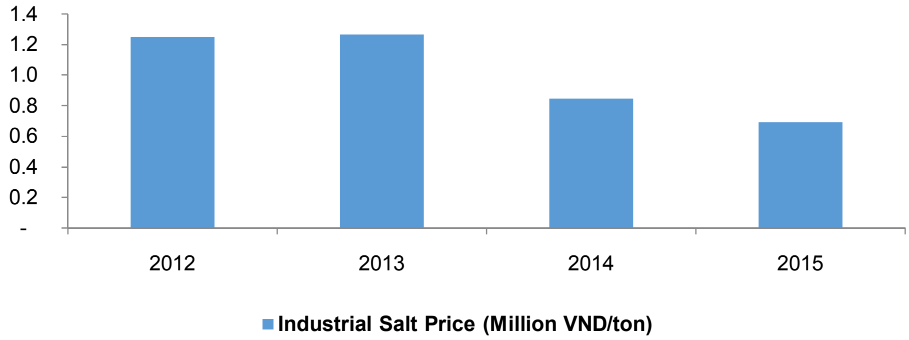
The competition of chemical products is increasingly fierce, especially with imported products from China. CSV is unable to compete with Chinese products in terms of price but able to compete on product quality, so its customers often have long-time relationship. The expansion of customer base needs more time to prove the product quality. In addition, the limited capacity makes it difficult for CSV to develop new customers, except for long-time customers.

2015 Prospects: Slight growth

CSV is benefiting from the decrease of 20% (yoy) in industrial salt price, which is expected to continue to decline in 2015. Therefore, its operating results in Q1/2015 were relatively positive, with revenue and net profit estimated at VND253 billion and VND38 billion, respectively, up 4.5% and 52% yoy. Gross profit margin increased to 26.1% from 21% a year earlier.

The strong profit growth was attributed to increased sales of such products as chlorine, silicate and sulfuric acid and decreased costs of goods sold due to lower industrial salt prices. However, starting from March 2015, electricity price (accounting for 25% of cost price) has been raised by 7.5%, negatively affecting the operating results of CSV. On a prudent scenario, revenue and net profit in 2015 are estimated to reach VND1,545 billion and VND165 billion, respectively, equivalent to an EPS of VND3,312.

Imported industrial salt price



Source: CSV

Norm	2015F	%	Basis for forecasting
Revenue	1,545	-0.4%	**Sales volume:** is forecast to fall slightly in some products as Sulphuric acid, PAC **Selling price:** is assumed to grow in line with inflation (5%) for some products as NaOH, HCL, Chlorine, Sulphuric acid, Phosphoric acid, Ferric chloride solution, sodium chloride (NaCl) of all kinds.
COGS	1,181	-0.4%	**Raw material and energy costs.** Due to benefits from the industrial salt price tumble (20%) compared with 2014 and on downtrend in 2015, along with negative impacts of the electricity price hike (7.5%) from Q2/2014, we assume

			the COGS/revenue ratio equal to that in 2014. **Depreciation cost:** estimated at about VND80 billion per year after averaging the depreciation period of assets such as buildings, machinery, vehicles, management equipment.
Gross profit	364	-0.4%	
Financial expense	11	-30.5%	Little financial obligation => lower financial expense
Sales expense	57	0%	
Administrative expense	93	-0.4%	Administrative expense to revenue ratio is maintained at 6% (equal to 2014) due to: ❑ *Depreciation of fixed assets in two suspended firms (CSV branch and Bao Loc bauxite mine) continues to be allocated in 2015* ❑ *Enterprise value after equitization is VND42 billion, allocated in 10 years from 2014*
Net profit	165	4.4%	
EPS	3,312	4.4%	

Stock valuation

CSV is valued at about **VND24,200/share**, up 27% compared to its current price, based on two valuation methods (cash flow method and comparison method). We choose FCFE method to closely reflect CSV's abundant cash flows and the resettlement of financial obligations, and the comparison method to calculate a fair price for CSV based on market expectations.

Average P/E and P/B of listed chemical companies

Company name	Capitalization (billion VND)	P/E	P/B
Duc Giang Chemical & Detergent Powder JSC	1,123.23	6.97	1.69
Viet Tri Chemical JSC	142.63	6.00	1.07
Lam Thao Superphosphate And Chemicals JSC	2,272.69	6.22	1.46
Average		**6.44**	**1.51**

Valuation results

Method	Weight	Value (VND)	Value of weight (VND)
FCFE	30%	28,800	8,640
P/E	35%	21,400	7,490
P/B	35%	23,100	8,085
Stock price			**24,215**

Comparison with other peers in chemicals industry

By comparison, we found that CSV's gross profit/revenue, operating profit/revenue and net profit/revenue are higher than other listed chemical companies. The proportion of debts and operating efficiency are at the average level. At present, the P/E ratio of CSV is more attractive than other listed companies in the chemicals industry.

Norm	CSV	DGC	HVT
Gross profit/Revenue	23.57%	17.04%	23.10%
Operating profit/ Revenue	13.27%	11.43%	7.61%
Pretax profit/ Revenue	13.40%	12.13%	8.04%
Net profit/ Revenue	10.21%	10.51%	6.24%
ROE	24.45%	26.22%	18.96%
ROA	13.91%	10.07%	7.64%
Basic P/E	3.36	6.86	5.9
P/B	1.36	1.66	1.05
Debts/Total assets	16%	17%	52%

Source: BVSC estimate

Investment recommendation

BVSC rates **OUTPERFORM** on CSV stock with a target price of **VND24,200/share**, up 27% compared to its current price, based on FCFE, P/E and P/B valuation methods, suitable for value investment with the following highlights:

- Chemical supply in Vietnam is sufficient to meet 50% demand. Especially, demand for Sodium hydroxide (NaOH), the key product of CSV, is very high. This is one of the core products included in the chemicals development planning of Vietnam with an estimated supply of 900,000 tons per year in the future.
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However, investors should pay attention to the risks related to the compulsory relocation of three factories of CSV in Bien Hoa 1 Industrial Zone in 2018 - 2020. CSV is estimated to need VND2,700 billion – VND3,000 billion to make the removal, causing huge financial pressure and share dillution if CSV has to increase registered capital. In addition, investors should also consider risks related to raw material price fluctuations and competition pressure.

REPORT COMMENTARY

Target price: is the analyst's valuation based on analysis of the company's business performance, potentials, development prospects and potential risks to determine the share price. Valuation methods commonly used include discounted cash flow (FCFE. FCFF. DDM); NAV-based valuation; comparative indicators (P/E. P/B. EV/EBIT. EV/EBITDA...). Selecting any method will depend on each industry, company and share features. Market sentiment also can affect the valuation of the target price.

RECOMMENDATION SYSTEM

BVSC's recommendation system is based on the increase/decrease of the share price to the target price. There are three levels of recommendation with the corresponding difference in magnitude from low to high. Investors should be noticed that investment recommendations can be changed at the end of each quarter after BVSC's corporate reappraisal.

Recommendation levels

Recommendation	Explanation
OUTPERFORM	Target price above 15% higher than market price
NEUTRAL	Target price between 0% and 15% higher than market price
UNDERPERFORM	Target price lower than market price

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