

BUY(unchanged)

Quangngai Sugar JSC (UpC: QNS)

Report date	Mar. 22, 2019
Current price	VND 42,400
Target price	VND 55,200
Upside	30%
Bloomberg	QNS VN Equity
Market cap	VND 12,405bn
	USD 528mn
52 weeks movement	VND 35,100
	VND 53,600
Average daily value	VND 14bn
	USD 0.6mn
FOL	37.18%
Current FO	11.82%

Modest growth but attractive

Our takeaway

- Sugar segment experienced strong recovery in 2018 thanks to a stable global sugar price while raw material price went down. We expect gross margin will be maintained over the next several years based on a solid sugar price recovery (as mentioned in previous report).
- Soymilk sale volume saw modest growth of 4% despite two new product lines in late 2018, due to a quite weak milk consumption demand.

Stock performance 1M **3M** 12M QNS (%) -11% -8% -24% -9% VN-Index (%) -4% -12% Source: Bloomberg **Major Shareholder** Thanh Phat Trading 15.8%

What's new

FY18 net profit increased by 23% YoY, higher than our expectation of 8%, thanks to positive margin improvement of soymilk manufacturing and sky-high sugar productivity. Soymilk gross margin for 2018 reached 43.6%, up 4.4 ppts and sugar gross profit rose fourfold with GPM increasing from 3.3% to 12.3%.

Reducing FY19 and FY20 earnings forecast due to a gloomy market.

- Seemingly, there is no sign of stronger milk consumption demand in the short term. We
 estimate soymilk selling volume will increase slightly by 6% and 5% in FY19 and FY20
 respectively, instead of 16% and 12% as previous projections. For the long term, we
 remain positive on rising demand thanks to a rising middle class.
- Sugar segment will enjoy a margin stability underpinned by a solid sugar price rebound. GPM is maintained at 12.5% in FY19 with sugar price increase of 7%.
- Overall, we are reducing our FY19 and FY20 earnings by 5% and 12% respectively.

Valuation

We revise our 12-month target price downward from VND 58,900 to VND 55,200 (30% upside) but maintain our BUY recommendation. QNS is currently trading at forward 2019 P/E of 7.4x, a discount compared with its peers' forward 2019 P/E mean of 28.2x.



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Unit: VND billion	FY17	FY18E	FY19F	FY20F
Revenue	7,633	8,029	8,611	8,947
EBIT	1,153	1,352	1,524	1,564
Net profit	1,026	1,238	1,409	1,497
Net profit (basic)	1,026	1,238	1,409	1,497
EPS (VND)	4,168	5,010	5,721	6,077
EPS growth rate (%)		21%	14%	6%
P/E (x)	9.3	8.8	7.4	7.0
EV/EBITDA (x)	8.1	7.3	6.0	5.6
DPS (VND)	1,500	1,500	1,500	1,500
Dividend yield (%)	4%	4%	4%	4%
P/B (x)	1.9	2.0	1.6	1.4
ROE (%)	23%	21%	22%	20%
Net debt/equity (%)	35%	32%	19%	11%

Source: MBS Research



Financial Update

QNS posted its 4th quarter financial statement with whole-year results as follows:

- Revenue increased by 11% thanks to the sugar segment soaring (+63% YoY).
- Gross profit increased by 23% because sugar segment profit returned to black after suffering a loss in 4Q2017.
- Net profit increased by 31% since selling expenses was flat and G&A expenses increased considerably.

Net profit for FY2018 increased by 23% YoY, higher than our expectation of 14%, thanks to positive margin improvement of soymilk manufacturing and sky-high sugar productivity.

Note: Annually, QNS's profit margin in the 4^{th} quarter is usually higher than full-year margin as QNS does not expense soymilk segment depreciation in its 4^{th} quarter results.

Table 1: Company financial res	sults							
VND bn	FY18	FY17	Y/Y chg%	FY18 MBS Estimate	% Diff	4Q18	4Q17	Y/Y chg%
Revenue	8,029	7,633	5.2%	7,999	0.4%	1,884	1,698	11.0%
Cost of goods sold	(5,645)	(5,637)	0.1%	(5,904)	-4.4%	(1,177)	(1,122)	4.9%
Gross profit	2,383	1,996	19.4%	2,095	13.7%	706	576	22.6%
GPM (%)	29.7%	26.1%	3.6ppts	26.2%	3.5ppts	37.5%	33.9%	3.6ppts
Selling expenses	(792)	(697)	13.6%	(721)	9.8%	(154)	(154)	0.0%
G&A expenses	(240)	(146)	64.4%	(152)	57.9%	(81)	(39)	107.7%
EBIT	1,351	1,153	17.2%	1,222	10.6%	471	383	23.0%
EBIT margin (%)	16.8%	15.1%	1.7ppts	15.3%	1.5ppts	25.0%	22.6%	2.4ppts
Financial profit/(expenses)	(9)	(41)		4		8	-3	
Other profit/(expenses)	57	26		0		31	1	
Profit Before Tax	1,400	1,138	23.0%	1,226	14.2%	510	381	33.9%
Income tax expenses	(162)	(111)	45.9%	(123)	31.7%	(60)	-38	57.9%
Minority interest	0	0		0		0	0	
Net profit for shareholders	1,238	1,027	20.5%	1,103	12.2%	450	343	31.2%
NPM (%)	15.4%	13.5%	1.9ppts	13.8%	1.6ppts	23.9%	20.2%	3.7ppts

Source: Company data, MBS Research

Table 2: Performance by segments							
VND bn	FY18	FY17	Y/Y chg%	4Q18	4Q17	Y/Y chg%	
Revenue	8,029	7,633	5.2%	1,884	1,698	11.0%	
Soymilk	3,862	3,885	-0.6%	966	970	-0.4%	
Sugar	2,251	1,867	20.6%	496	305	62.6%	
Others	1,915	1,880	1.9%	421	424	-0.7%	
Gross profit	2,383	1,996	19.4%	706	575	22.8%	
Soymilk	1,685	1,522	10.7%	527	519	1.5%	
Sugar	277	61	354.1%	75	(15)	-600.0%	
Others	421	441	-4.5%	104	99	5.0%	
GPM (%)	29.7%	26.1%	3.6ppts	37.5%	33.9%	3.6ppts	
Soymilk	43.6%	39.2%	4.4ppts	54.6%	53.5%	1.1ppts	
Sugar	12.3%	3.3%	9.0ppts	15.1%	-4.9%	20.0ppts	
Others	22.0%	23.5%	-1.5ppts	24.7%	23.3%	1.4ppts	

Source: Company data, MBS Research



Earnings Model & Valuation

For FY19 and FY20, we adjusted our earnings forecasts downward to VND 1,409bn and VND 1,497bn respectively, earnings growths to 14% and 6% respectively, from 19% and 18% previously.

- Soymilk segment will see a relatively weak growth. We estimate soymilk sale
 volume will increase slightly by 6% and 5% in FY19 and FY20 respectively, versus
 16% and 12% in previous projection, while product price will suffer a decrease of
 1.5% and 0.6% respectively.
- Sugar segment will enjoy a margin stability underpinned by a solid sugar price rebound. GPM is maintained at 12.5% in FY19 with sugar price increase of 7%.

We revise our 12-month target price downward from VND58,900 to VND55,200 (30% upside), maintaining our BUY recommendation.

Table 3: Revision In Financial Model						
VND bn	New		Previous		% Diff	
	FY19F	FY20F	FY19F	FY20F	FY19F	FY20F
Revenue	8,611	8,947	8,864	9,559	-3%	-6%
Gross profit	2,612	2,707	2,534	2,830	3%	-4%
Selling expenses	(836)	(878)	(795)	(862)	5%	2%
G&A expenses	(251)	(264)	(159)	(167)	58%	58%
Financial profit	41	98	47	114	-13%	-14%
Other profit						
EBT	1,565	1,663	1,627	1,915	-4%	-13%
EAT	1,409	1,497	1,464	1,724	-4%	-13%
Net profit	1,409	1,497	1,464	1,724	-4%	-13%
EPS (VND)	5,721	6,077	5,946	6,998	-4%	-13%

Source: MBS Research

Table 4: DCF valuation results					
VND bn	FY19F	FY20F	FY21F	FY22F	Terminal year
Net profit	1,409	1,497	1,590	1,643	
Free Cash Flow	1,778	1,832	1,910	1,952	13,498
WACC%		14.	5%		16.7%
PV of Free Cash Flow	1,553	1,397	1,272	1,136	7,856
	13,215	_			
Cash	2,117	-			
Debt	(1,727)				
Enterprise Value	13,605				
Target value per share (VND)	55,200				

Source: MBS Research

We do not apply multiple valuation due to a lack of comparable peers. Instead, we use it for comparison purpose only. QNS is currently trading at forward FY19 P/E of 7.4x, which is 70% discounted versus its peers' forward FY19 P/E mean of 28.2x, while its profitability and dividend yield are relatively superior.

Table 5: Regional peers (Forward FY19)							
Company	Country	Market Cap (USD mn)	ROE	Dividend yield	EV/EBITDA	P/E	
Quang Ngai Sugar JSC	Vietnam	543	21.9%	3.5%	6.4	8.6	
Vitasoy Int'l	Hong Kong	4,626	24.8%	1.2%	28.2	48.4	
Dali Foods	China	9,160	26.1%	3.6%	10.2	16.2	
Kikkoman Corporation	Japan	9,748	10.3%	0.8%	20.8	39.7	
Average			20.8%	2.3%	16.4	28.2	

Source:Bloomberg, MBS Research



Investment highlights

Prospects by segments

Soymilk segment is a line in the milk product portfolio with the market share of about 10%. Consumption demand is still relatively weak in the short term. For the long term, we believe milk consumption demand will increase thanks to the booming middle class that will surpass 33 million by 2020. With stronger demand, new marketing strategies and potentials from new plants, QNS will reclaim their growth sustainability.

Sugar segment saw a strong recovery in 2018 with sky-high productivity and decreased material price. We expect gross margin to maintain for the next several years based on a solid sugar price rebound.

Biomass energy plant was constructed in 2018 to enhance the closed supply-chain of sugar manufacturing (burning bagasse to generate electric and protect environment). From 2019, the plant is expected to contribute more than 200mn kWh to the national electrical grid, earning an annual free cash flow of nearly VND 300bn.

Fresh cash generation after significant investments

CAPEX will slow down from 2019 as biomass plant was completed at the beginning of 2018 (the investment was deployed mostly in 2017). Biomass plant is part of an investment campaign of QNS including 3 projects: soymilk plant in Binh Duong (2016-2017), An Khe sugar plant expansion (2017) and the biomass plant (2017-2018). The investment size of the campaign was approximately 3,300 billion.

Table 6: QNS's major projects			Investment s	size (VND bn)		
	2013	2014	2015	2016	2017	2018
Soymilk plant – Bac Ninh province	284		178			
Soymilk plant – Binh Duong province				309	98	
Sugar plant expansion		650	175		1,112	
Biomass plant						1,814
Total	284	650	354	309	1,210	1,814

Source: Company data, MBS Research

We forecast that QNS will not have major investments in the next two years and hence large fresh cash generation for the shareholders is probable.

Key risks

Risk of weak soymilk demand regardless of new products performance. Soymilk revenue has been virtually flat for 4 years and selling volume just increased by 4% YoY in 2018. Since launched in 4Q2018, the two new soymilk product lines contributed less than 1% into total volume of QNS, leaving a concern that product innovation is not enough to push up the dairy/soymilk consumption demand.

Risk of competition. Soymilk market is highly profitable and hence attracts big milk players to entry, such as VNM, Nutifood, Vitasoy (Hongkong), etc., who directly compete against QNS. The management team has adopted new strategies to maintain QNS's decent growth rate and high market share.



Financials and Valuation Summary

Income statement (VND bn)	FY17	FY18F	FY19F	FY20F	FY21F	Key ratios	FY18F	FY19F	FY20F
Revenue	7,633	8,029	8,612	8,947	9,252	Valuation			
Cost of goods sold	5,637	5,645	5,999	6,240	6,457	EPS	5,025	5,721	6,077
Gross profit	1,996	2,383	2,612	2,707	2,795	Book value per share (BVPS)	21,718	25,657	29,953
Financial income	38	87	107	146	195	P/E	8.4	7.4	7.0
Financial expenses	78	96	66	48	30	P/B	1.9	1.6	1.4
SG&A expenses	843	1,032	1,088	1,142	1,193	P/S	1.3	1.2	1.1
	1,113	1,343	1,566	1,663	1,767	Dividend yield	3.6%	3.6%	4.8%
Profit before tax	1,138	1,400	1,566	1,663	1,767	Profitability			
Profit after tax	1,027	1,238	1,409	1,497	1,590	Gross profit margin	30%	30%	30%
Profit after tax for parent	1,027	1,238	1,409	1,497	1,590	EBITDA margin	17%	18%	17%
company Not-controlling interest						Net profit margin	15%	16%	17%
						ROE	23%	22%	20%
Balance sheet	FY17	FY18F	FY19F	FY20F	FY21F	ROA	15%	17%	16%
Current assets	1,907	3,182	4,021	5,015	6,053	Growth			
I. Cash & cash equivalents	528	1,366	, 2,885	, 3,835	4,832	Revenue growth	5%	7%	4%
II. Short-term investments	751	751	0	0	0	Profit before tax growth	23%	12%	6%
III. Current accounts receivable	289	468	502	522	539	Profit after tax growth	15%	16%	17%
IV. Inventories	320	589	626	651	674	EPS	21%	14%	6%
V. Other current assets	19	8	8	8	8	Total Asset	14%	6%	8%
Non-current assets	5,092	4,823	4,494	4,180	3,866	Equity	14%	6%	8%
I. Long-term receivables						Liquidity			
II. Fixed assets	2,805	4,387	4,200	3,886	3,572	Current ratio	1.21	1.85	2.80
1. Tangible fixed assets	2,548	4,190	4,052	3,788	3,524	Quick ratio	0.99	1.57	2.44
2. Intangible fixed assets	258	198	148	98	48	Debt/Total assets	33%	26%	20%
III. Investment properties	0	0	0	0	0	Debt/Equity	50%	35%	25%
IV. Long-term assets in progress	2,047	214	73	73	73	Interest coverage	14.06	23.10	32.60
V. Long-term investments	0	0	0	0	0	Operating efficiency			
VI. Other long-term assets	239	221	221	221	221	Receivables turnover	17	17	17
Total assets	6,999	8,005	8,515	9,196	9,919	Days sales outstanding	21	21	21
Liabilities	2,517	2,655	2,194	1,817	1,535	Inventory turnover	10	10	10
I. Current liabilities	2,345	2,628	2,168	1,790	1,509	Days sales of Inventory	38	38	38
1. Short-term payables	941	901	968	990	1,009	Payables turnover	6	6	6
2. Short-term loans	1,404	1,727	1,200	800	500	Days payables outstanding	58	59	58
II. Non-current liabilities	172	27	27	27	27				
1. Long-term payables	27	27	27	27	27	Cashflow Statement	FY18F	FY19F	FY20F
2. Long-term loans	145	0	0	0	0	CFO	1,297	2,004	2,012
Equity	4,482	5,350	6,321	7,379	8,384	CFI	-252	-215	-224
1. Charter capital	2,438	2,926	2,926	2,926	2,926	CFF	-261	-966	-839
2. Surplus	288	288	288	288	288	Cash flow for year	784	822	950
3. Retained earnings	2,135	2,465	3,435	4,493	5,498	Cash & cash equivalents at the beginning of the year	1,279	2,063	2,885
4. Foreign exchange differences	0	0	0	0	0	Cash & cash equivalents at the end of the year	2,063	2,885	3,835
5. Minorities interests	-380	-329	-329	-329	-329	-			
Total liabilities & equity	6,999	8,005	8,515	9,196	9,919				

Source: MBS Research



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STOCK RATING: The recommendation is based on the difference between the 12-month target price and the current price:

Rating	When (target price – current price)/ current price
BUY	>=15%
HOLD	From -15% to +15%
SELL	<= -15%

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