

# QUANG NGAI SUGAR JSC (QNS: UPCOM)

**HOLD – 1Y Target Price: VND 50,000**

**Current price: VND 43,000**

## EARNINGS UPDATE

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**22 May 2018**

**CONSUMER – VIETNAM**

### Key Figures

Market cap (USD mn)	540
Market cap (VND bn)	12,288
Outstanding shares (mn)	293
52W high/low (VND 1,000)	77.08/35.8
Average 3M volume (share)	305,839
Average 3M value (USD mn)	0.64
Average 3M value (VND bn)	14.55
Foreign ownership (%)	9.66
State ownership (%)	0
Management ownership (%)	20

### QNS Price & Trading Volume



Source: Bloomberg

### Company Snapshot

QNS is known as the largest soymilk maker in Vietnam with market share of 84.3% in 2017 (source: AC Nielsen). Soymilk business (Vinasoy factories with Fami and Vinasoy brand) is the biggest contributor of QNS's earnings, with a contribution of approx. 51% and 86% in revenue and profit before tax respectively. Sugar precedes the soymilk with 24% and 2% of total sales and PBT. Beer, Beverages and Confectionery together accounted for 25% and 12% of sales and PBT in 2017.

## Falling short of expectations

### 1Q 2018 review

QNS posted VND 1.60 tn in net sales (-12.8% YoY) and VND 188 bn in net profit (-15.3% YoY) in 1Q 2018 on reduced revenue for both sugar and soymilk segments, while SG&A expenses rose by 12.6% YoY.

### Sugar segment: Decreased sugar price to drag down earnings

Sugar sales totaled VND 484 bn, declining by -19.6% YoY in 1Q 2018 due to a dramatic drop in the refined sugar (RS) price. More specifically, the average RS price totaled only VND 11,100/kg in 1Q 2018 vs. VND 14,300/kg in 1Q 2017 (-20% YoY). Meanwhile, sugar volume remained flat at 37,000 tons. The gross margin reached 15.7% in 1Q 2018, improving from the level of 13.6% in 1Q 2017. Margin expansion could be attributed to (1) a lower sugarcane purchase price (-26% YoY) and (2) reduced waste from the An Khe sugar mill. According to management, a boost in efficiency at new factory has resulted in cost savings for 2018, and production cost could be maintained at VND 9,500-9,600/kg. At the production cost level, QNS is still within parameters to compete with smuggled sugar, which is sold at ~VND 10,000-11,000/kg in the market. Overall, the sugar segment posted VND 59 bn of PBT in 1Q 2018 (-9.2% YoY).

Management continues to maintain a target of 200,000-220,000 tons of sugar for 2017-2018 season (+53.8% YoY) thanks to favorable weather conditions and a vast plantation area, ~33,000ha in total. In terms of profitability, the company expects to deliver a higher PBT YoY (the sugar PBT totaled VND 49 bn in 2017).

(bn VND)	1Q18	1Q17	YoY	4Q17	QoQ	% annual target completed	Margin			
							1Q18	1Q17	4Q17	2017
Net sales	1,597	1,831	-12.8%	1,709	-6.5%	21.3%				
Gross profit	407	418	-2.7%	602	-32.3%		25.5%	22.8%	35.2%	26.5%
Operating profit	195	229	-14.8%	383	-49.1%		12.2%	12.5%	22.4%	15.2%
EBIT	229	258	-11.4%	389	-41.1%		14.3%	14.1%	22.8%	15.8%
EBITDA	229	258	-11.4%	389	-41.1%		14.3%	14.1%	22.8%	21.2%
Pretax profit	209	239	-12.5%	373	-43.9%		13.1%	13.1%	21.8%	14.8%
Net income	188	222	-15.3%	333	-43.5%	97%	11.8%	12.1%	19.5%	13.3%
NI attributable to shareholders	188	222	-15.3%	333	-43.5%		11.8%	12.1%	19.5%	13.3%

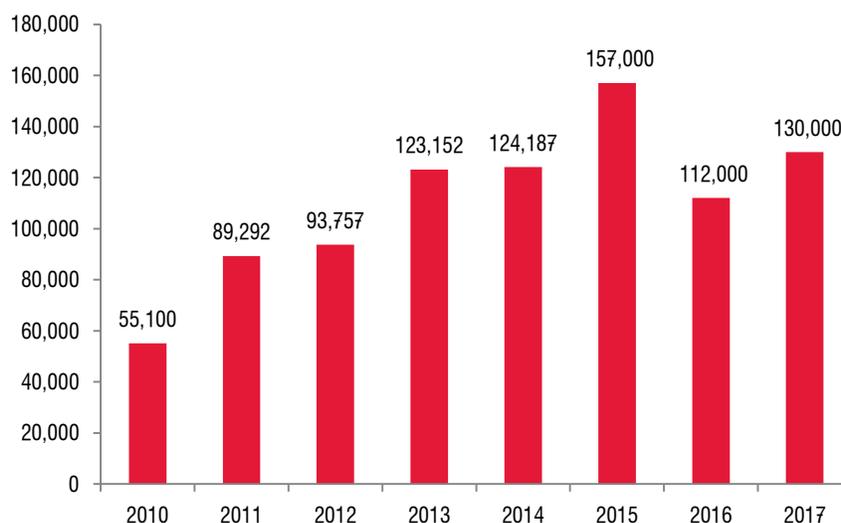
Source: QNS, SSI Research

### Management's guidance on sugar in 2018-2020

Production season	Plantation area (ha)	Sugarcane volume (mn ton)	Sugar volume (thousand ton)	Note
2017-18	33,000	2.2	220	
2018-19	36,000	2.6	250-300	Possible additional 100k tons from imported raw sugar
2019-20	40,000	3	300	Possible additional 200-300k tons from imported raw sugar

The Company's biomass plants have officially commenced as of May 2018, with a total investment of VND 2 tn. Management expects annual power revenue of VND 300bn and power profit to account for 10% of total PBT should the An Khe sugar mill runs at full capacity (2.2 mn tons of sugarcane per year).

### Sugar sales volume ( ton)

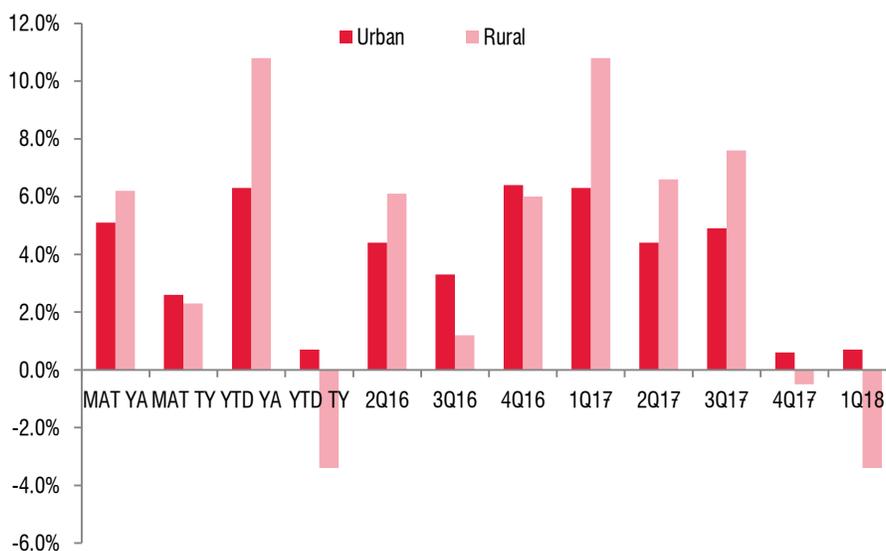


Source: QNS

**Soy milk segment: Volume drop on weak demand**

Soy milk sales reached VND 659 bn in 1Q 2018, down -11% YoY due to dropped volume. Such performance failed our expectation of ~5% volume growth after an accelerated 4Q 2017 quarter (sales were up +11.8% YoY thanks to increased volume). According to management, overall domestic weak consumption was the main reason for poor Vinasoy performance in the first quarter of the year. According to AC Nielsen, FMCG consumption grew at only 0.7% across urban areas, and dropped -3.4% in the rural market. Other dairy companies also experienced negative sales volume growth in 1Q 2018 such as Vinamilk (-2% YoY), Moc Chau Milk (-7% YoY). Aside from the above, we suspect that Vinasoy continued to face rising competition from rivals, especially from Vinamilk and Nutifoods.

#### FMCG growth in urban and rural

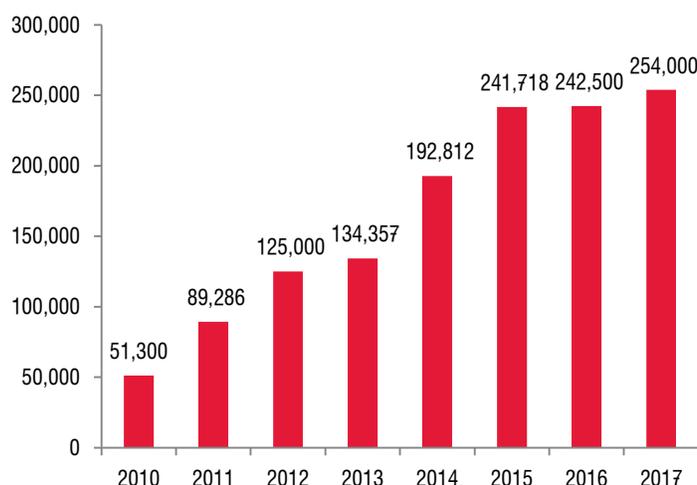


Source: AC Nielsen

Soy milk gross margin totaled 37.6% in 1Q 2018, higher than that of 32.2% in 1Q 2017 thanks to (1) a lowered sugar price (-20% YoY) and (2) a higher utilization of the Binh Duong factory (which started production in November 2016). Currently, the factory runs at 50% capacity (vs.40% at the end of 2017).

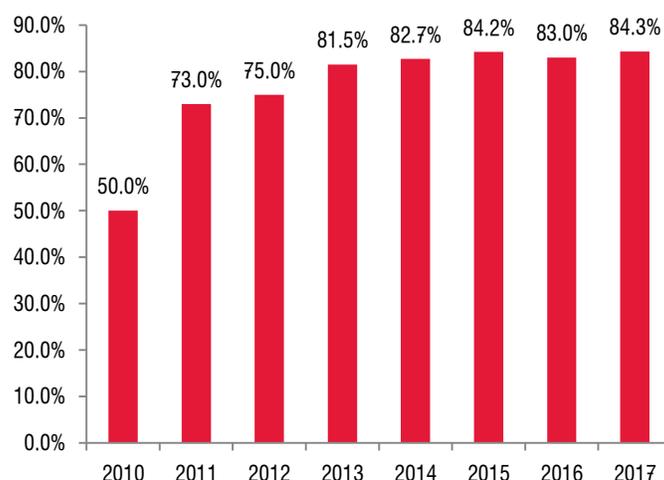
Selling expenses increased by 10% YoY, mostly upon higher expenses for the sales force and advertisement of Vinasoy.

Soymilk (k liter)



Source: QNS

Vinasoy market share



Source: AC Nielsen

### Management's guidance on revenue and PBT contribution by 2020

2020 contribution	Revenue	PBT
Soymilk	40%	60%
Sugar & biomass	40%	30%
Others	20%	10%

Source: QNS

### Estimates revision

Given 1Q 2018 results, we slightly revise down our estimates for QNS. Accordingly, our forecasted 2018 sales and net profit arrives at VND 7.85 tn (+2.8% YoY) and VND 1.07 tn (+4.3% YoY). Compared to previous estimates, we cut our earnings forecast by -7%. Our key assumptions are as follows:

- The sugar price on average will be at VND 10,770/kg (-25% YoY), and sugar volume will be 165,000 tons (-17.5% lower compared to management's guidance). Accordingly, we expect that the sugar business will generate a slight profit in 2018 (VND 38bn).
- Soymilk volume will increase by 3% in 2018 (vs. company guidance of 5-10%), while the price is kept unchanged. Our assumption is also slightly lower than a forecast made by Tetra Pak, which states that total soymilk consumption in Vietnam will experience a shift in consumption adoption from the current level of 780 million liters to 900 million liters over the next 3 years (i.e 5% per annum). The gross margin for soymilk is estimated at 39.5% in 2018 (vs. 39% in 2017) mostly thanks to a lower sugar price.

- We estimate the biomass plant to generate relatively non-material profit of VND 3.5 bn in net profit, drastically lower than the company's guidance of VND 50 bn, since our sugar volume assumption (and sugarcane bagasse volume) is significantly lower than the company's expectations.

## Recommendation

We see that in communicating with investors, management has emphasized upon its sugar business expansion (and biomass power), as well as the Company's ambition to grasp up to 30% of domestic sugar market share (from the current 12%) by 2020, rather than developing the soymilk and other F&B business lines (beer, beverages and confectionery). The company expects sugar & biomass will expand its contribution to PBT to 30% by 2020 from 3% in 2017. This may reduce investors' interest in the company, especially for those who has viewed QNS as a leading soymilk company in Vietnam alongside other F&B businesses in its umbrella. Lowered sentiment upon the stock as well as weak 1Q 2018 results has led to underperformance of the share price in recent time.

At the current market price of VND 43,000/share, QNS is traded at 10x, which is significantly lower compared to overall comparative market valuations across its peers in the F&B sector. We think such a low valuation for QNS reflects its low growth trajectory in the soymilk, beverages, and confectionery businesses (less than 5% in volume/year) as well as the uncertainty of the sugar segment. Our DCF & multiples valuation arrives at the 1-year fair value of VND 50,000/share (already factoring in a 20% bonus share), representing a 16% upside from the current market price.

Despite of low valuation, we decided to downgrade our recommendation from Buy to HOLD until we see the sign of better business performance in the coming quarters.

**Upside catalyst:** Higher than expected sugar price/volume and soymilk volume

**Downside catalyst:** Lower than expected sugar price, which could lead to incurred losses in the sugar business. Lower than expected soymilk volume growth.

## APPENDIX: ANNUAL FINANCIAL STATEMENTS

VND Billion	2016	2017	2018F	2019F
<b>Balance Sheet</b>				
+ Cash	137	628	2,119	3,423
+ Short-term investments	555	651	0	0
+ Account receivables	395	295	311	332
+ Inventories	519	313	393	416
+ Other current assets	170	19	192	205
<b>Total Current Assets</b>	<b>1,775</b>	<b>1,906</b>	<b>3,015</b>	<b>4,375</b>
+ LT Receivables	1	1	1	1
+ Net Fixed Assets	1,849	2,805	3,348	3,055
+ Investment properties	0	0	0	0
+ LT Assets in progress	2,271	2,047	1,847	1,647
+ LT Investments	0	0	0	0
+ Other LT Assets	229	238	273	290
<b>Total Long-Term Assets</b>	<b>4,349</b>	<b>5,091</b>	<b>5,469</b>	<b>4,992</b>
<b>Total Assets</b>	<b>6,124</b>	<b>6,997</b>	<b>8,484</b>	<b>9,367</b>
+ Current Liabilities	1,968	2,352	2,386	2,528
<i>In which: ST debt</i>	<i>1,178</i>	<i>1,404</i>	<i>1,347</i>	<i>1,427</i>
+ Non-current Liabilities	245	172	177	188
<i>In which: LT debt</i>	<i>213</i>	<i>145</i>	<i>140</i>	<i>149</i>
<b>Total Liabilities</b>	<b>2,213</b>	<b>2,525</b>	<b>2,563</b>	<b>2,715</b>
+ Contributed capital	1,875	2,438	2,926	2,926
+ Share premium	288	288	288	288
+ Retained earnings	2,198	2,126	2,252	2,983
+ Other capital/fund	-450	-380	-380	-380
<b>Shareholders' Equity</b>	<b>3,911</b>	<b>4,472</b>	<b>5,086</b>	<b>5,817</b>
<b>Total Liabilities &amp; Equity</b>	<b>6,124</b>	<b>6,997</b>	<b>7,650</b>	<b>8,532</b>
<b>Cash Flow</b>				
CF from operating activities	1,250	1,566	1,991	1,655
CF from investing activities	-1,435	-944	0	0
CF from financing activities	-598	-130	-501	-351
<b>Net increase in cash</b>	<b>-782</b>	<b>492</b>	<b>1,491</b>	<b>1,304</b>
Beginning cash	1,009	137	628	2,119
<b>Ending cash</b>	<b>227</b>	<b>628</b>	<b>2,119</b>	<b>3,423</b>
<b>Liquidity Ratios</b>				
Current ratio	0.90	0.81	1.26	1.73
Acid-test ratio	0.55	0.67	1.02	1.49
Cash ratio	0.35	0.54	0.89	1.35
Net debt / EBITDA	0.64	1.04	0.08	-0.65
Interest coverage	23.16	15.77	17.00	17.93
Days of receivables	1.2	1.0	1.1	1.1
Days of payables	28.9	32.9	35.9	35.9
Days of inventory	33.9	27.0	22.9	24.8
<b>Capital Structure</b>				
Equity/Total asset	0.64	0.64	0.66	0.68
Liabilities/Total Assets	0.36	0.36	0.34	0.32
Liabilities/Equity	0.57	0.56	0.50	0.47
Debt/Equity	0.36	0.35	0.29	0.27
ST Debt/Equity	0.30	0.31	0.26	0.25

VND Billion	2016	2017	2018F	2019F
<b>Income Statement</b>				
<b>Net Sales</b>	<b>6,972</b>	<b>7,633</b>	<b>7,847</b>	<b>8,361</b>
COGS	-4,697	-5,622	-5,613	-5,946
<b>Gross Profit</b>	<b>2,275</b>	<b>2,022</b>	<b>2,234</b>	<b>2,415</b>
Financial Income	73	38	31	64
Financial Expense	-77	-78	-74	-79
Income from associates	0	0	0	0
Selling Expense	-715	-711	-863	-920
Admin Expense	-44	-166	-165	-176
<b>Income from business operation</b>	<b>1,512</b>	<b>1,104</b>	<b>1,163</b>	<b>1,305</b>
Net Other Income	31	26	27	29
Profit Before Tax	1,543	1,131	1,190	1,334
<b>Net Income</b>	<b>1,410</b>	<b>1,027</b>	<b>1,071</b>	<b>1,187</b>
<b>NI attributable to shareholders</b>	<b>1,410</b>	<b>1,017</b>	<b>1,071</b>	<b>1,187</b>
Minority interest	0	0	0	0
<b>Growth</b>				
Sales	-10.4%	9.6%	2.8%	6.6%
EBITDA	10.2%	-16.3%	8.3%	8.6%
EBIT	14.4%	-25.1%	4.7%	11.7%
NI	14.6%	-27.9%	4.3%	10.9%
Equity	50.0%	14.3%	13.7%	14.4%
Chartered Capital	33.0%	30.0%	20.0%	0.0%
Total assets	18.4%	14.2%	21.3%	10.4%
<b>Valuation</b>				
P/E	N.a	9.1	10.1	9.1
P/B	N.a	2.5	2.5	2.2
P/Sales	N.a	N.a	1.6	1.5
Dividend yield	N.a	1.2%	3.5%	3.5%
EV/EBITDA	N.a	8.4	6.0	5.6
EV/Sales	N.a	1.8	1.3	1.3
<b>Profitability Ratios</b>				
Gross Margin	32.6%	26.5%	28.5%	28.9%
Operating Margin	21.9%	15.2%	15.5%	15.8%
Net Margin	20.2%	13.3%	13.6%	14.2%
Selling exp./Net sales	10.3%	9.3%	11.0%	11.0%
Admin exp./Net sales	0.6%	2.2%	2.1%	2.1%
ROE	43.3%	24.3%	22.4%	21.8%
ROA	25.0%	15.5%	13.8%	13.3%
ROIC	30.7%	19.2%	18.1%	18.0%

Source: Company, SSI Research

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- ❖ **Neutral:** The analyst expects the performance of the industry over the next 6-12 months to be in line with the relevant broad market
- ❖ **Underweight:** The analyst expects the performance of the industry over the next 6-12 months with caution vs. the relevant broad market.

*\*The market required rate of return is calculated based on 5-year Vietnam government bond yield and market risk premium derived from using Relative Equity Market Standard Deviations method. Our rating bands are subject to changes at the time of any significant changes in the above two constituents.*

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