Petrovietnam Fertilizer and Chemicals Joint Stock Company

PVFCCo • DPM

Target Price: VND66,000 • US$4.13 (+22.2%)

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Too Cheap to Ignore.... BUY

Company's Statistics

Exchange	Ho Chi Minh City Stock Exchange	Last price	VND 54,000 • USD 3.38
Sector	Chemicals	BPS	VND 11,479 • USD 0.72
Index weight	7.26%	EPS	VND 3,476 • USD 0.22
Market cap.	VND 20,520bn • USD 1.28bn	EPS trailing	VND 3,476 • USD 0.22
52-week range	VND 98,000 – VND 48,500	Hist DPS	n.a.
30-day average daily turnover	US$3.8mn	Dividend yield	n.a.
Beta	1.0	PER	15.5x
ROCE	31.0%	P/BV	4.7x

Investment Highlights

We are initiating our coverage for Petrovietnam Fertilizer and Chemical Joint Stock Company (DPM) with a BUY recommendation and a target price of VND66,000 (US$4.13) based on our discounting cash flows (DCF) model. Our investment case is highlighted as follows:

Dominant position in the domestic fertilizer sector and heavyweight in the stock exchange. We believe that DPM offers good exposure to the robustness in Vietnam's fertilizer sector given its strong brand name and dominance in the domestic market. Furthermore, the company serves as a good proxy to the potential recovery of the equity market given its heavy weighting on the VN Index.

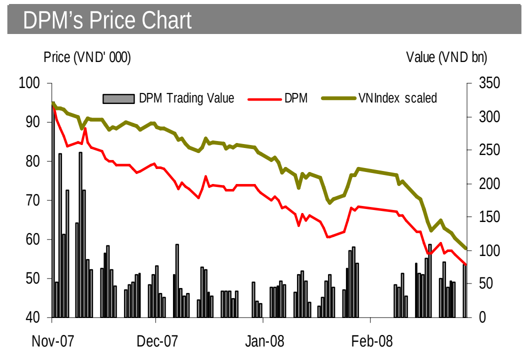
Stable earnings growth and resilient business model. Given that DPM's manufacturing plant is currently running at full capacity, we foresee the near term earnings growth will stem mainly from the rising average selling price of urea and the distribution of imported urea. Nevertheless, the planned capacity expansion to 800,000 tonnes/year in 2009 and subsequently 925,000 tonnes/year in 2015 are expected to boost the company's earnings going forward. As domestic urea manufacturers only fulfill around 50% of the country's urea consumption with the remaining imported from abroad, we expect the demand for the company's product to remain strong over the next few years.

Trading at a significant discount against its regional peers. The company is currently trading at an expected 2008 PER of 13.8x which is significantly below the 26.9x average expected PER of its regional peers. Although we believe that DPM may trade at a discount due to its single market exposure and an increasingly challenging operating environment with the gradual removal of favorable treatment by the Government coupled with the new supply coming on stream in 2011, we believe that the huge valuation gap at present is largely unjustifiable. Potential catalysts for the company include the continued hikes in urea prices and possible injection of a urea manufacturing plant in Ca Mau province at reasonable price upon completion.

Analysis of Share Performance

DPM is currently trading at VND54,000 (US$3.38), which is below its IPO price of VND54,400 (US$3.40) per share and 46% lower than its reference listing price of VND100,000 (US$6.25). However, foreign investors have shown great interest in the stock, accumulating 12.7mn shares since its listing on the 5th of November 2007. The company is consistently among the top three stocks in terms of liquidity with average daily trading value of US$4.4mn.

DPM's Price Chart



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Ownership

State	228,204,253	60.05%
Foreign	40,434,977	10.64%
Domestic	111,360,770	29.31%
Outstanding shares	380,000,000	100.00%

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Earnings Outlook

We expect DPM to experience earnings growth ranging from 9% to 13% between 2008 and 2009 supported by strong price increase despite being constrained by the production capacity. We are forecasting the company's net earnings to be US$93.2mn and US$101.5mn respectively for 2008 and 2009.

*Stable earnings growth in the near term....*Given that DPM's manufacturing plant is currently running at full capacity, we foresee that the near term earnings growth for the company will stem mainly from the rising average selling price of urea and the distribution of imported urea which typically yields low profit margin.

.....Mid term capacity expansion to boost earnings. Nevertheless, management has planned to increase its production capacity from the current 740,000 tonnes/ year to 800,000 tonnes/year by 2009 and subsequently 925,000 tonnes/year by 2015. We expect the expansion in production capacity to boost the company's earnings going forward.

Upward trend in urea price likely to continue in the near term. We believe that the uptrend in the urea prices will be sustainable over the next two years in line with the rising global urea price coupled with the domestic supply shortage as local urea manufacturers only fulfill around 50% of the country's urea consumption. Furthermore, the rising major input prices such as coal and natural gas coupled with higher transportation costs should induce the manufacturers to pass on the higher costs of production to consumer. We assume that the average selling price of urea will increase by 8% y-o-y in 2008 which we believe is conservative given that the urea price has experienced double digit growth in the first two months of 2008.

Venturing into real estate to boost its earnings. DPM is planning to diversify into property development projects to expand its income streams and to boost its earnings growth. The company is planning to invest US$25m between 2008-2009 to purchase office space and an additional US$50m from 2009 onwards on two real estate projects in Ho Chi Minh City. We have not factored in any potential earnings contribution from its real estate venture into our earnings model.

Potentially high dividend yield. Management plans to distribute up to 70% of their earnings as dividend which gives a dividend yield of 5.1% based on its current share price. We believe that this represents one of the highest dividend yields among the listed companies in Vietnam.

Income Statement (US$ mn)	2005A	2006A	2007E	2008F	2009F
Net Revenue	158.6	190.7	236.2	313.4	375.9
Gross Profit	56.4	70.4	92.6	105.4	117.1
Operating Income	43.4	51.3	82.1	93.5	110.1
Pre-tax Income	49.5	72.6	82.6	94.1	110.9
Net Income	49.5	72.6	82.5	93.2	101.5
Dividend	n.a.	n.a.	0.0	65.3	71.0
Gross Profit Growth (%)	n.a.	24.8	31.5	13.8	11.2
Operating Income Growth (%)	n.a.	18.3	60.0	13.9	17.8
Pre-tax Income Growth (%)	n.a.	46.7	13.7	14.0	17.8
Net Income Growth (%)	n.a.	46.7	13.7	12.9	8.9
Gross Margin (%)	35.6	36.9	39.2	33.6	31.2
Operating Margin (%)	27.4	26.9	34.8	29.8	29.3
Pre-tax Income Margin (%)	31.2	38.1	35.0	30.0	29.5
Net Profit Margin (%)	31.2	38.1	35.0	29.7	27.0
Dividend Payout Ratio (%)	n.a.	n.a.	0.0	70.0	70.0

Investment Risks

Competition from Chinese urea manufacturers. We expect minimal competition from the domestic front since DPM controls around 80% share of the domestic urea production. However, the increased imports of competitively priced urea from China could pose some threats to the company. Nonetheless, we believe that the pie is large enough at present to be shared by all players since domestic urea production accounts for around 50% of the country's urea consumption.

*Rising gas price…*We believe that the rising cost of sales could be one of the major concerns for the company with the gradual removal of favorable treatment in terms of gas sales. The gas price sold to DPM was revised upward from US$1.3/mn to US$2.2/mn BTU from 2007 to 2009.

Uninspiring demand growth for urea. The consumption growth for urea has been lackluster in the last few years due to the reduction in agricultural land as a result of increased industrialization and urbanization. Nonetheless, we expect the demand for urea to remain strong going forward with more farmers switching from growing of rice to planting of fruits and vegetables which typically consume larger amount of fertilizer coupled with the rising agricultural price that encourages farmers to use more fertilizers to boost the fresh fruits yields.

Potential oversupply risk with two new manufacturing plants. The Government has planned to construct additional two urea manufacturing plants which are expected to be operational by 2011 with estimated total production capacity of 1.3mn tonnes (Mt) per year. The completion of these manufacturing plants could heighten the oversupply risk of urea with total domestic production surge from the present 0.9Mt to 2.4-2.5Mt assuming that urea demand stays at the present level of 2.0Mt/year.

Valuation

The company is currently trading at an expected 2008 PER of 13.8x which is significantly lower than the 26.9x average expected PER of its regional peers. Although we believe that DPM may trade at a discount due to its single market exposure and an increasingly challenging operating environment with the gradual removal of favorable treatment by the Government coupled with the new supply coming on stream in 2011, we believe that the huge valuation gap at present is largely unjustifiable.

We have fairly valued DPM at VND66,000 (US$4.13) per share based on our DCF model. Our DCF analysis utilizes a 14.0% WACC and a 4.0% terminal growth rate. The total return of 27.1% (the potential upside of 22.2% in the stock coupled with the dividend yield of 5.1%) has prompted us to initiate our coverage for DPM with a BUY recommendation. Our DCF valuation implies an expected 2008 PER of 17x which we believe is conservative compared to the average expected PER of its regional peers. Furthermore, our valuation model has factored in the potential contributions from its real estate business and the company's capacity expansion in 2015. Potential catalysts for the company include the continued surge in urea price, substantial contribution from the real estate projects and the possible injection of a urea manufacturing plant in Ca Mau province to the company at reasonable price upon completion.

Relative Comparison Table

	Country	Market Cap (US$)	P/E 2007	P/B 2007	P/S 2007	ROE (%)	P/E 2008E	P/E 2009E
China BlueChemical	China	3,015	9.6	3.2	4.6	31.4	15.2	15.9
Hubei Yihua Chemical Industry	China	2,276	49.2	9.7	3.6	16.0	26.7	20.7
Yunnan Yuntianhua	China	4,883	59.6	11.0	6.2	22.3	53.0	39.5
Sichuan Lutianhua	China	1,945	31.3	6.3	2.6	20.6	n.a	n.a
Fauji Fertilizer	Pakistan	1,126	13.2	5.7	1.7	43.0	13.6	11.6
Engro Chemical Pakistan	Pakistan	1,029	21.3	4.3	1.8	23.7	21.8	19.6
Chambal Fertilisers & Chemicals	India	465	16.3	2.1	0.8	12.9	n.a	n.a
Gujarat Narmada Valley Fertilizers	India	618	6.7	1.9	1.0	31.9	n.a	n.a
Taiwan Fertilizer	Taiwan	3,811	30.8	2.2	10.0	7.4	30.8	28.7
Namhae Chemical	South Korea	1,419	182.7	5.0	1.8	2.8	27.1	15.9
Average			26.4	5.1	3.4	21.2	26.9	21.7
DPM	Vietnam	1,283	15.5	4.7	5.4	29.3	13.8	12.6

APPENDICES

1. Corporate Profile

DPM is the largest domestic fertilizer manufacturer in Vietnam. The company was formed in 2001 by Vietnam Oil and Gas Corporation (Petrovietnam) to control and administer the Phu My fertilizer plant. The company started its operation in 2004 and has achieved full production capacity in 2007. DPM was listed on the Ho Chi Minh Stock Exchange (HOSE) in November 2007 and is currently the largest listed company on HOSE in terms of market capitalization.

The company is principally involved in the manufacturing and distribution of urea fertilizer which accounts for about 80% of its revenue. DPM captures around 40% of the domestic urea market which is far ahead of the number two player, Ha Bac Nitrogen Fertilizer and Chemicals Company (Hanichemco), that controls less than 10% of the market share, with the remaining taken by the imported urea. The Phu My Fertilizer Plant has a total production capacity of 740,000 tonnes of urea and 445,000 tonnes of ammonia per year. The plant was engineered and constructed using advanced licensed technology from Denmark (Haldor Topsoe) for urea production and Italy (Snamprogetti) for ammonia production.

The company's main plans in the near term include investing in three chemical manufacturing plants (acid sulfuric, sulfate amon, and melamine) on a 28 hectare piece of land nearby its existing plant, as well as building its warehouse and storage system in Southern provinces. In addition, the company also plans to utilize its strong operating cash flow to invest in several real estate projects in Ho Chi Minh City.

2. Management Team

Board of Directors	
Ms. Dinh Huu Loc	Chairman
Mr. Hoang Xuan Hung	Member
Ms. Vu Thi Chon	Member
Mr. Luu Quang Lam	Member
Mr. Cao Tung Son	Member

Board of Management	
Mr. Phan Dinh Duc	Managing Director
Mr. Cao Tung Son	Deputy General Director
Mr. Ngo Hong Minh	Deputy General Director
Mr. Nguyen Duc Hoa	Deputy General Director
Mr. Pham Thanh Vinh	Deputy General Director

Certifications

- ISO 9001-2000
- Vietnam High Quality Product Awards 2004, 2005, 2006
- 7 Golden Medals & Cups from Ministry of Agriculture & Rural Development, Ministry of Trade, Ministry of Industry
- Quality Certificate from Ho Chi Minh City's Agriculture & Rural Development Department
- "Vietnam Golden Bull" Award by Vietnam Farmer Association, 2006

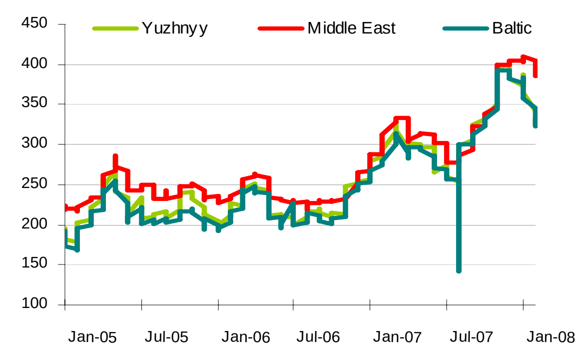
3. Sector Outlook

Strong growth in global demand for fertilizer in 2007. According to International Fertilizer Industry Association (IFA), rising demand from Asia and the Americas has boosted the global consumption of fertilizer by 5.0% in 2007 compared with the modest growth of 1.5% in 2006. Nitrogen fertilizers enjoyed the fastest consumption growth rate of 5.4%, followed by Phosphate fertilizers (5.1%) and Potash fertilizers (3.5%).

IFA expects the global consumption of fertilizer to grow by 3.9% in 2008 and 3.2% in 2009, supported by continued strong economic and population growth, increasing demand for agricultural products such as corn, oil palm as feedstock for bio-fuels coupled with farmers switching to higher protein agricultural commodities such as fruits and vegetables which require a large amount of fertilizer.

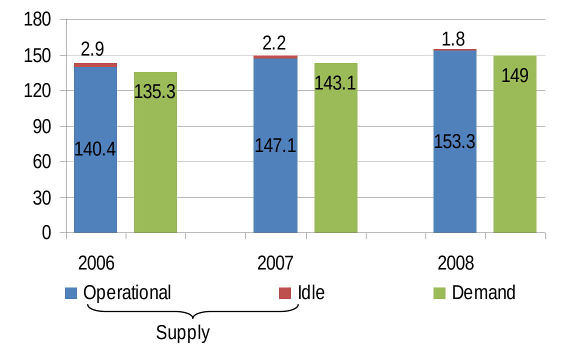
Manufacturers running at near full capacity. Global fertilizer manufacturers have increased their production output to cope with the strong demand growth. For urea specifically, global production of urea per annum has increased by 4.2% to 143.1MT in 2007. According to IFA, the manufacturers are running at near full capacity in 2007 and the production capacity is expected to remain tight in the first half of 2008. Due to the tight supply and growing demand, average urea price has surged by 17% on a y-o-y basis for the first two months of 2008.

Urea price FOB (US$/tonne)



Source: Bloomberg

Tight urea supply situation versus demand (in Mt)



Source: IFA

Shortage of domestic urea production in the near term…Vietnam is the sixth largest fertilizer consumer in Asia with approximately 1.6% of the global share. At present, DPM and Hanichemco are the only two domestic urea fertilizer manufacturers with production capacity totaling 920,000 tonnes per year.

Government's incentive to support the operations of fertilizer manufacturing. Given the importance of the agriculture sector to the country, the Government has offered various incentives to support the operations of the domestic fertilizer manufacturers. PetroVietnam is currently supplying natural gas to DPM at US$2.2/mmBTU, which is substantially below the natural gas traded in the US that exceeds US$9/mmBTU. Meanwhile, coal sold to Hanichemco is around 20% lower than the domestic price and represents about 50% discount to the export price. Although the Government has planned to remove the subsidies on coal and natural gas supplied to fertilizer manufacturers, we believe that these subsidies would be taken away in a gradual manner to prevent the fluctuation of urea prices as well as to protect the sector from imported urea.

Uninspiring demand growth for urea. Domestic consumption growth of urea has been lackluster in the past few years due to the reduction in agricultural land as a result of increased industrialization and urbanization. Nonetheless, we expect the demand for urea to remain strong going forward with more farmers switching from planting of rice to growing fruits and vegetables which typically consume larger amounts of fertilizer. Besides that, the rising agriculture price also encourages farmers to use more fertilizer to boost their fresh fruits yields.

New manufacturing plans expected to be operational in 2011. Vinachem is currently constructing a coal gasification urea plant in Ninh Binh province with a production capacity of 560,000 tonnes of urea per year. On the other hand, PetroVietnam is planning to start the construction of another urea manufacturing plant in Ca Mau province in May 2008 with a production capacity of 800,000 tonnes of urea per annum. Both plants are expected to be operational by 2011.

Besides that, Hanichemco is expected to increase its production capacity to 480,000 tonnes urea per year prior to 2011 while DPM may expand its production capacity of urea by 60,000 tonnes in 2009 and a further 125,000 tonnes by 2015. In view of the additional production capacity coming on stream by 2011 which could increase total urea supply to 2.4 - 2.5 Mt/year, we foresee that there is a possibility of saturation assuming that the domestic consumption of urea stays at the present level of 2.0Mt/year.

4. Summary of Financials

Income Statement (US$ mn)	2005A	2006A	2007E	2008F	2009F
Net Revenue	158.6	190.7	236.2	313.4	375.9
COGS	(102.2)	(120.3)	(143.6)	(208.0)	(258.8)
Gross Profit	56.4	70.4	92.6	105.4	117.1
Financial revenue	4.9	9.4	8.8	10.2	15.0
Financial expense	(10.9)	(15.6)	(6.1)	(6.5)	(5.6)
SG&A	(7.0)	(12.9)	(13.2)	(15.5)	(16.3)
Operating Income	43.4	51.3	82.1	93.5	110.1
Net other income/(expense)	6.1	21.3	0.5	0.6	0.8
Pre-tax Income	49.5	72.6	82.6	94.1	110.9
Income Tax	0.0	(0.0)	(0.0)	(0.9)	(9.4)
Net Income	49.5	72.6	82.5	93.2	101.5

Balance Sheet (US$ mn)	2005A	2006A	2007E	2008F	2009F
CURRENT ASSETS					
Cash & Short-term Investments	95.0	163.6	123.3	209.0	280.1
Accounts Receivable	3.2	27.0	3.7	4.9	5.9
Inventory	30.1	15.5	25.0	26.8	33.4
Others	1.2	0.1	2.2	0.2	0.3
Total Current Assets	129.5	206.2	154.2	241.0	319.6
Property, Plant & Equipment, net	280.8	198.5	167.3	120.3	103.6
Others	1.1	11.9	37.3	68.1	65.0
Total Fixed Assets	281.9	210.4	204.6	188.4	168.6
TOTAL ASSETS	411.4	416.6	358.8	429.4	488.2
CURRENT LIABILITIES					
Short-term Debt	35.7	36.2	36.3	62.7	77.9
Trade & Other Creditors	21.3	34.7	49.5	65.7	78.8
Total Current Liabilities	57.0	70.9	85.8	128.4	156.8
Net Current Asset/ (Liabilities)	72.5	135.3	68.4	112.6	162.8
NON-CURRENT LIABILITIES					
Long-term borrowings	125.0	54.4	0.0	0.0	0.0
Total Long-term Liabilities	125.0	54.4	0.0	0.0	0.0
Net Asset / (Liabilities)	229.4	291.3	273.0	301.0	331.4
SHAREHOLDERS' EQUITY					
Paid up capital	196.8	160.7	237.5	237.5	237.5
Retained Earnings	0.9	0.0	35.1	63.1	93.5
Other funds & reserves	31.7	130.6	0.4	0.4	0.4
Total Shareholders' Equity	229.4	291.3	273.0	301.0	331.4

5. Recent News and Developments

- *DPM announces targets for FY2008.* 19 Dec 2007 – DPM has announced targets for FY2008 as follows: total urea production of 740,000 tonnes; urea imports of 250,000 tonnes; total revenue of VND4,400bn; pretax income of VND1,191bn. [DPM]
- *Investment of US$1bn to build Ca Mau Fertilizer Manufacturing Plant.* 19 Nov 2007 - Mr. Pham Van Dinh, manager of Ca Mau gas-power-fertilizer project, announced that the investment for the project has been adjusted from US$1.5bn to US$2.5bn. Among this, the Ca Mau Fertilizer Manufacturing Plant expected total investment of over US$1bn. There are currently four bidders. According to the plan, the bid will be decided in Feb 2008 and the construction will be started in May 2008. The plant is expected to be operational after forty months with capacity of 800,000 tonnes/ year of urea. [Youth newspaper]
- *EPC signing contract ceremony of Ninh Binh Urea Plant.* 15 Nov 2007 - In Hanoi, EPC contract signing ceremony of Ninh Binh coal-originated urea production project was held. Under the approval of both the Vietnamese and Chinese Governments, VINACHEM chose Global Corporation (HQCEC) as its EPC contractor for the project. This 560,000 tonnes/year urea project has been prepared since early 2006. The negotiation process began in Nov 2006. After the EPC Signing Ceremony, two partners continued to implement necessary works and try to build the Plant at the beginning of 2008. The Plant is expected to be officially in operation in 2011. Apart from the above project, VINACHEM also plans to expand Hanichemco's urea capacity up to 480,000 tonnes/year. With the completion of these two projects, VINACHEM would be able to provide nearly 50% of the urea demand for the domestic market. [VINACHEM]

6. Corporate Actions

- *27th Feb 2008 – PVFC register to buy DPM shares.* Trader: Petrovietnam Finance Company (PVFC); related person: Mr. Luu Quang Lam – member of Board of Directors; volume of shares held before the transaction: 6,118,560 shares (1.6% of the chartered capital); Volume of shares registered to buy: 2,000,000 shares; Volume of shares held after the transaction: 8,118,560 (2.1% of chartered capital).
- *1st Feb 2008 – BIDV completed selling 5mn shares to PVFC.* Trader: BIDV; volume of shares held before the transaction: 19,000,000 shares (5.0% of the chartered capital); Volume of shares sold: 5,000,000 shares; Volume of shares held after the transaction: 14,000,000 (3.7% of chartered capital).
- *Appointment of executives.* 6 Nov 2007 – DPM announced the change in management as follows: Mr. Hoang Xuan Hung, member of Board of Directors of PetroVietnam Company, will be member of DPM's BoD to substitute for Mr, Pham Thanh Binh as of 1st of Nov 2007.

Equity Rating Definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of +15% over 12-months, with low risk of sustained downside.
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between –15% and +15% over 12-months, with low risk of sustained downside.
SELL	Negative recommendation of stock under coverage. High risk of negative absolute return over 12-months.
NOT RATED	No research coverage and report is intended purely for informational purposes.