

DUCGIANG CHEMICALS GROUP JSC (DGC) – UPDATE

Market Price	Target Price	Dividend Yield	Rating	Sector
VND94,300	VND103,200	0.70%	Hold	BASIC MATERIALS

8 September 2022

Outlook – Short term: Neutral
Outlook – Long term: Neutral
Valuation: Neutral

Consensus*: Add:4 Hold:1 Reduce:0

Target price / Consensus: -10.9%

Key changes in the report

➤ Decrease TP by 3.8%

Price performance



Source: VNDIRECT RESEARCH

Key statistics

52w high (VND)	134,700
52w low (VND)	52,938
3m Avg daily value (VNDmn)	242,981
Market cap (VND bn)	37,347
Free float (%)	47
TTM P/E (x)	14.6
Current P/B (x)	5.78

Ownership

Dao Huu Huyen	18.5%
Dao Huu Kha	6.1%
Ngo Thi Ngoc Lan	6.8%
Others	68.6%

Source: VNDIRECT RESEARCH

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Waiting for the bauxite-aluminum project

- Net profit may have peaked in 2Q22 and we expect a weaker earnings growth (-22.9% vs. 1H22) in 2H22.
- We revise up FY22/23F NP forecast by 32.7%/10.7% to reflect the higher-than-expected 1H22 business results.
- Downgrade to Hold rating with lower TP of VND103,200/share.

Robust 2Q22 performance

DGC posted strong 2Q22 results with VND4,002bn (+96.3% yoy) in net revenue regarding to: (1) an 125% yoy increase in yellow phosphorus average selling price (ASP), (2) agriculture phosphates revenue surge 49% yoy thanks to domestic supply shortage as China restrict fertilizer export (including to Vietnam). 2Q22 gross margin (GM) widened to 53.1% (+28.8% pts) mainly driven by higher ASP and cost savings from DGC's apatite ore mine. As a result, DGC's NP in 2Q22 achieved VND1,336bn (+314.9 % yoy). For 1H22, DGC's topline rose 91.6% yoy to VND7,637bn and NP increased 414.9% yoy to VND3,120bn, fulfilling 53.8%/74.9% of our FY22F forecasts. Thus, we revise up FY22/23F NP forecasts by 32.7%/10.7% to reflect the higher-than-expected 1H22 business results.

DGC's net profit may have peaked in 2Q22

Phosphorus price has dropped nearly 15% to from its peak US\$7,200/tonne in May-22 as phosphorus manufacturers in Northeast China have resumed production post Covid-19. We expect phosphorus price to remain stable within US\$5,500-US\$5,700/tonne in 2H22F thanks to the strong increase apatite ore supply from Tunisia (45% yoy). On the other hand, we believe phosphorus prices unlikely to drop further as China production is narrowed down production following government's stricter environment policy. Under base case scenario, we expect a softer GM of 40.4% in 2H22 which will result a deceleration in 2H22 net profit growth (-22.9% vs. 1H22).

The new projects are long term catalyst

We see the short-term catalyst for DGC is diminishing following the downturn of phosphorus prices. We expect FY23F NP to decline 28.3% yoy after a robust FY22F. To secure the long-term growth DGC target to invest in two mega production projects of caustic soda (CAV) and aluminum bauxite with total investment of US\$1.5bn. The CAV project is expected to come online since 4Q24F and likely to contribute 20% in FY25F revenue. While the first phase of aluminum project might start production since 2025 but we have not reflected this project in our forecast due to lack of information.

Downgrade to Hold as we believe the valuation is fair

We decrease our TP by 3.8% following the rollover to mid-FY22F and target P/E of 8.0x apply on average FY22-23F EPS, downgrade to Hold. Upside potential is longer-than-expected drought in China. Downside risks is phosphorus's export tax risk which could put pressure on DGC's business results .

Financial summary (VND)	12-20A	12-21A	12-22E	12-23E
Net revenue (bn)	6,236	9,567	15,669	13,799
Revenue growth	22.5%	53.4%	63.8%	(11.9%)
Gross margin	23.7%	33.4%	44.4%	36.8%
EBITDA margin	13.1%	25.7%	38.3%	29.7%
Net profit (bn)	907	2,405	5,525	3,962
Net profit growth	60.0%	165.3%	129.7%	(28.3%)
Recurring profit growth	65.9%	167.0%	129.7%	(28.3%)
Basic EPS	2,443	6,480	14,883	10,674
Adjusted EPS	2,233	6,293	14,382	10,315
BVPS	10,536	16,306	30,126	38,445
ROAE	25.1%	48.3%	64.1%	31.1%

Source: VNDIRECT RESEARCH¹

WAITING FOR THE BAUXITE-ALUMINUM PROJECT
Robust 2Q22 performance following the average selling price hike
Figure 1: 2Q22 results comparison

VND(bn)	2Q21	2Q22	yoy growth (%)	1H21	1H22	yoy growth (%)	% vs FY22F forecast	Comments
Revenue	2,039	4,002	96.3%	3,988	7,637	91.5%	53.8%	
<i>Phosphorus chemicals</i>	1,099	2,601	136.7%	2,116	5,117	141.8%	56.9%	Yellow photphorus average price reached US\$6,800/tonne (+125% yoy) due to 1) the supply shortage of Chinese apatite ore - the key input material of phosphorus products, 2) Ukraine - Russia conflict and 3) thriving demand from the electronics and lithium battery industries.
<i>Agricultural phosphates</i>	940	1,401	49.0%	1,638	2,520	53.9%	50%	Agricultural photphorate increased 49% yoy in 2Q22 mainly driven by (1) elevated demand for fertilizers both domestically and globally and (2) China and Russia's export restrictions — the key sources of imported fertilizer for Vietnam and India
Gross profit	495	2,125	329.3%	926	3,832	313.8%	68.4%	
Gross profit margin	24.3%	53.1%	+28.8% pts	23.2%	50.2%	+26.9% pts		GM soared 26,9% pts thanks to higher selling prices and cost savings from DGC's first apatite ore mine, which were partly offset by surging input material prices, sulfur, coking coal and ammonia.
Selling expenses	(122)	(174)	42.6%	(237)	(322)	35.9%	40.3%	
G&A expenses	(29)	(17)	-41.4%	(57)	(59)	3.5%	31.9%	G&A expense decreased 41.4% yoy as DGC cut labor costs in other businesses such as washing powder and thermal phosphoric acid (TPA).
Pre-tax profit	354	1,996	463.8%	664	3,583	439.6%	77.4%	
Net profit	322	1,336	314.9%	606	3,120	414.9%	74.9%	

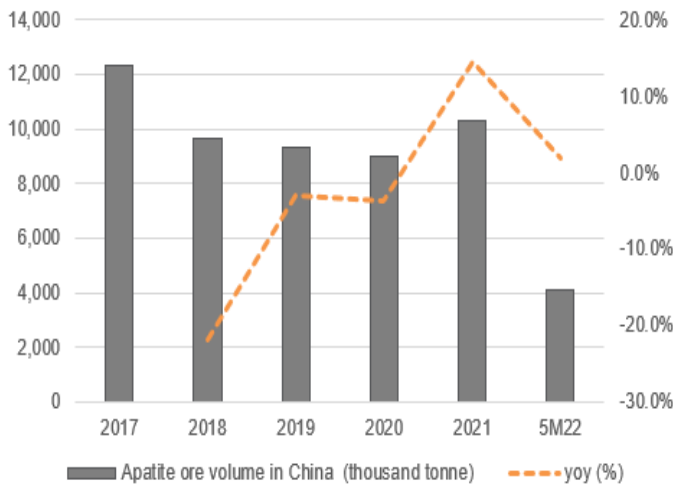
Source: VNDIRECT RESEARCH, COMPANY REPORTS

DGC 's earnings reached quarterly peak in 2Q22, in our view
Phosphorus price is unlikely to fall deeply in 2H22 due to a lack of apatite ore supply

Phosphorus price has dropped nearly 15% to from its peak US\$7,200/tonne in May-22 as phosphorus manufacturers in Northeast China have resumed production post Covid-19. We expect phosphorus price to stay within US\$5,500/tonne-US\$5,700/tonne in 2H22 as China production is narrowed down production following government's stricter environment policy and apatite supply shortage. According to Zhang Xiaorong, after many years of mining, the supply of apatite ore in China has decreased significantly. Additionally, the Chinese government continues to tighten the requirements for mining phosphate rock due to concerns about environmental protection. With a shortage of phosphate rock supply, China's two largest phosphate mining provinces, including Guizhou and Hubei, have been restricted from exporting in 2H22. According to CRU Group, China has issued an export apatite quota of 3m tonnes in 2H22 (-40% vs. 1H22).

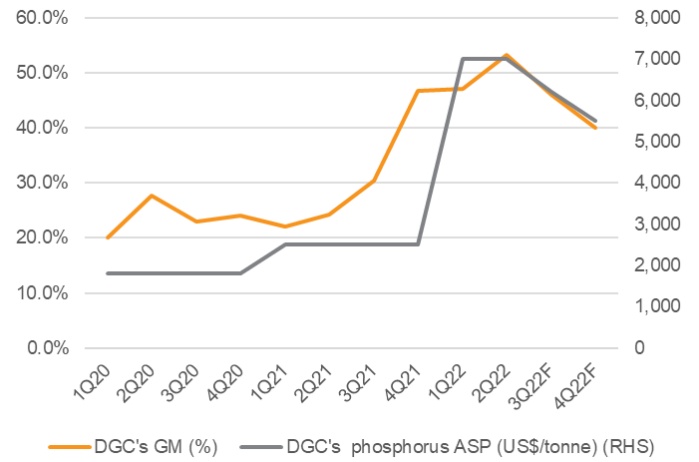
We think that phosphorus price will not rebound strongly in 2H22 as the shortage of apatite ore will be partially offset by the increase in Tunisian exports of apatite ore in 2H22. According to Reuters, State company Gasfa Phosphate in Tunisia aims to produce 3.3m tonnes apatite ore in 2H22 (+45.4% vs. 1H22) to capture the high market demand. In this base case scenario, we expect a softer GM of 40.4% in 2H22 which will result a deceleration in 2H22 net profit growth (-22.9% vs. 1H22).

Figure 2: China apatite ore volume is shrinking over years (Unit: thousand tons)



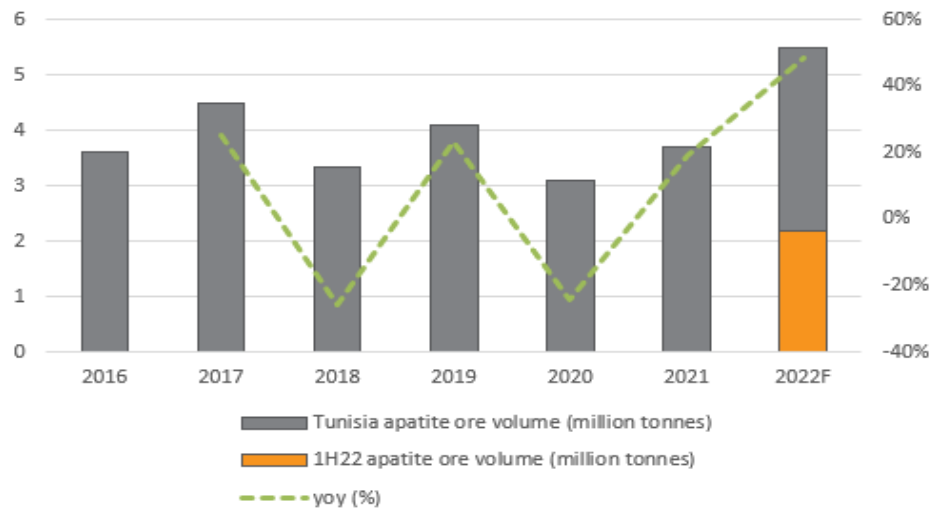
Source: Askci, VNDIRECT RESEARCH

Figure 3: We forecast DGC's GM to reach 44.4% in FY22F



Source: Sunsir, DGC, VNDIRECT RESEARCH

Figure 4: Tunisia aims to produce 5.5m tonnes apatite ore in 2022 (+48% yoy)



SOURCE: Reuters, VNDIRECT RESEARCH

We forecast FY23F phosphorus chemical revenue to decline 20.1% yoy after a robust FY22F driven by 1) cooling down Russia – Ukraine conflict in 2023F and 2) China has approved a new capacity of phosphorus as 356,000 tonnes/year for the period 2023-2024 (compared to 1.4m tonnes/year currently) due to high demand for electric vehicles in China.

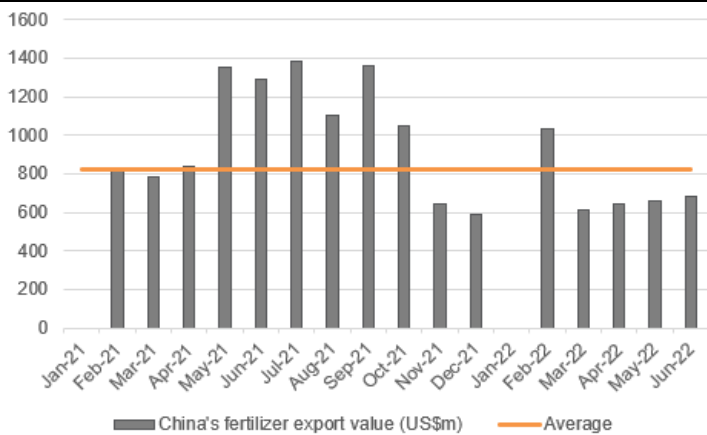
We expect agricultural phosphate revenue to remain growth momentum in 2H22

China has announced that it will continue to extend fertilizer export restrictions until the end of 2022. The restrictions that were first applied in Oct-21 have been set to expire at Jun-22. Those initial restrictions resulted in six Chinese producers, with a production capacity of 2.75m tonnes per year, shutting down operations in Dec-21 due to a slump in demand for their products. According to Argus media, China announced that it was implementing a quota limiting total phosphate exports to 3.16m tonnes in 2H22 (-40% yoy). Argus estimates that 2.4m tonnes of that quota will be diammonium phosphate (DAP) and the

remaining 765,000 tonnes will be monoammonium phosphate (MAP). Argus forecast China's monthly average DAP and MAP exports value in 2022 will plunged 40%/46%, respectively vs. three-year average export value.

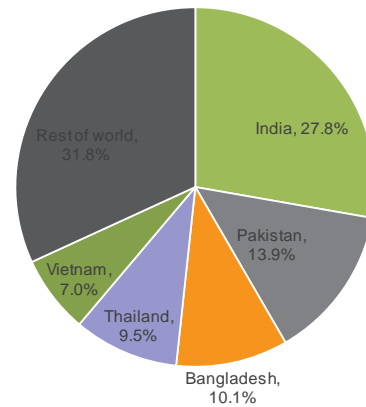
Additionally, Russia's decline on gas shipments due to conflict with Ukraine is hurting industries across Europe. As a result, Europe's fertilizer crunch is deepening with more than two-thirds of production capacity halted by soaring gas costs. Thus, we expect fertilizer export restriction in China and high gas prices to remain DAP and MAP prices at the high level in 2H22-1H23F. We think that the fertilizer price may decrease slightly in 2H23 due to cooling demand from EU market. We increase agricultural phosphate revenue by 4.9%/2.5% in FY22/23F versus our previous forecast.

Figure 5: China's fertilizer export value in 1H22 plunged 40.3% yoy (Unit: US\$m)



Source: GACC, VNDIRECT RESEARCH

Figure 6: Vietnam accounts for 7% of China's fertilizer exports in 2021

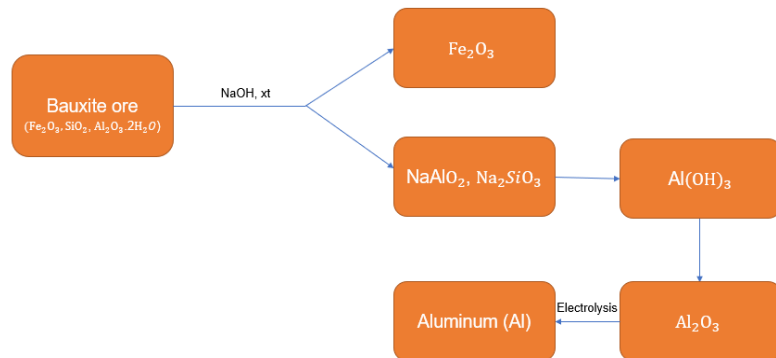


Source: GACC, VNDIRECT RESEARCH

The new projects are long term catalysts

DGC is applying to mine bauxite ore, process bauxite into alumina (first and second phase in 2025-2026) and process alumina into aluminum (third phase) in Dak Nong province. The planned investment capital can reach US\$1.6bn - the largest project of DGC to date. DGC Chairman Dao Huu Huyen said that the Aluminum - Dak Nong Complex project has a scale of exploiting about 14.4m tonnes of bauxite ore/year and three ore extraction plants with a capacity of 5.8m tonnes of refined ore/year. Per DGC's CEO, at the current Al₂O₃ price, the first phase of its project can generate revenue that is on par with DGC's current phosphorus business — US\$430m.

Figure 7: Aluminium bauxite production process



SOURCE: VNDIRECT RESEARCH, COMPANY REPORT

At the 12th Congress of the Party Committee of Dak Nong province, leaders of Dak Nong province identified alumina production and aluminum smelting as the pillars of the province's development strategy. Therefore, the province has attracted many large enterprises to invest in these fields. Four private companies are applying to enter the industry. These include DGC, Hoa Phat Group (HOSE: HPG) and two conglomerates — Sovico Group, which is the founding shareholder of HD Bank (HOSE: HDB) and VietJet Air (HOSE: VJC) — and Viet Phuong Group. Similar to DGC, these companies also applied for both Al₂O₃ and aluminum production.

DGC will carry out two projects of CAV and aluminum production in parallel. We expect new projects may become DGC's the key long-term growth driver in FY25-28F. CAV project is expected to start commercial operation in 4Q24F and likely contribute 20% to FY25F revenue. While DGC's first phase of alumina production could come online in 2025. As this bauxite-aluminum project is still in the early stages, we have not included this project in our forecast and will provide detailed information on the outlook of aluminum segment in the next report.

FY22-23F earnings forecast revision

We change our forecasts on DGC's business as following:

- We increase FY22/23F phosphorus chemicals revenue by 13.3%/0.4% versus previous forecast due to 1) higher-than-our expectation 1H22 results, 2) a lack of apatite ore supply in China.
- We increase agricultural phosphate revenue 4.9%/2.5% in FY22/23F versus our previous forecast mainly driven by the extension of fertilizer export restrictions in China and high gas prices.
- We increase GM in FY22/23F 5.0% pts/1.1% pts thanks to higher-than-expected phosphorus selling prices and cost savings from DGC's first apatite ore mine.

As a result, we revise up FY22/23F net profit forecast by 32.7%/10.7%.

Figure 8: Changes in FY22-23F forecasts (VNDbn)

VNDbn	2021	2022F			2023F		
		Old	New	% change	Old	New	% change
P4 ASP (VNDm/tons)	84	125	142	13.6%	90	90	0.0%
Net revenue	9,567	14,200	15,669	10.3%	13,633	13,799	1.2%
<i>Phosphorus chemicals</i>	5,190	9,177	10,398	13.3%	8,272	8,302	0.4%
<i>Agricultural phosphates</i>	4,377	5,023	5,271	4.9%	5,361	5,497	2.5%
Gross profit	3,198	5589	6964	24.6%	4862	5076	4.4%
Gross margin (%)	33.4%	39.4%	44.4%	+5.0% pts	35.7%	36.8%	+1.1% pts
Selling expense	(503)	(880)	(783)	-11.0%	(845)	(690)	-18.3%
G&A expense	(137)	(185)	(157)	-15.3%	(177)	(138)	-22.0%
EBT	2,654	4,627	6,138	32.7%	3,976	4,403	10.7%
Net profit	2,531	4,164	5,525	32.7%	3,579	3,962	10.7%
EPS (VND)	6,822	11,224	14,891	32.7%	9,647	10,680	10.7%

Source: VNDIRECT RESEARCH, Company report

Downgrade to Hold rating with lower TP of VND103,200/share

We decrease 1-year TP to VND103,200, basing following factors

We decrease DCF valuation by 3.8% based on the rollover to mid FY22F and 32.7% increase in FY22F EPS. Beside we also revise up long term growth to 1.5% to reflect the outlook of CAV and aluminum segments. We decrease P/E valuation by 4.8% following a rollover to average FY22-23F EPS. In addition, we downgrade target P/E to 8.0x as we think that 2Q22 could be DGC's NP peak in 2022-24.

Figure 9: Blended target price

Method	Price	Weight	Weight price (VND)
FCFF	104,199	50%	52,100
P/E	102,283	50%	51,142
Average price (vnd)			103,241
Target price (rounded)			103,200

SOURCE: VNDIRECT RESEARCH

Figure 10: Discounted cash flows - future cash flows to firm (FCFF) approach

Present value of Free Cash Flow to Firm	22,457
Present value of Terminal value (VNDbn)	13,308
Enterprise Value (VNDbn)	35,765
Net debt (VNDbn)	2,914
Equity value (VNDbn)	38,679
No. of Outstanding Share 2021 (million)	371
Equity value per share (VND/share)	104,199
WACC	13.4%
Cost of equity	16.8%
Long term growth	1.5%

SOURCE: VNDIRECT RESEARCH

Figure 11: Peer comparison

Company	Ticker	Recom.	Target price	Market cap		P/E (x)		3 year EPS growth		P/B (x)		EV/EBITDA		ROE (%)	
				US\$m	TTM	2022	CAGR	Current	2022	TTM	2022	TTM	2022		
Hubei Xingfa Chemicals Group Co Ltd	6000141CH	na	na	7,834	6.6	7.1	161.8	2.3	1.8	6.2	5.9	50.4	32.6		
Yunnan Yuntianhua Co Ltd	600096 CH	na	na	10,230	8.6	7.8	507.2	3.0	2.2	6.9	6.6	51.4	38.9		
Hubei Yihua Chemical Industry Co Ltd	000422 CH	na	na	3,738	7.8	6.6	634.9	3.2	1.4	5.4	2.3	86.2	35.3		
Hongda Xingye Co Ltd	002002 CH	na	na	2,661	38.4	na	15.0	na	na	na	na	4.3	na		
Anhui Sierte Fertilizer Industry Ltd Co	002538 CH	na	na	1,039	12.1	10.1	33.4	1.5	1.4	8.7	5.7	11.6	15.6		
Kunming Chuan Jin Nuo Chemical Co Ltd	300505 CH	na	na	896	15.5	10.9	104.1	3.2	2.5	na	na	19.4	20.0		
China General Plastics Corp	1305 TT	na	na	3,257	17.3	11.3	42.0	1.9	1.6	10.8	6.9	14.2	16.9		
Petrovietnam Fertilizer and Chemical Cor	DPM VN	na	na	497	9.0	14.8	152.9	1.5	1.4	1.6	1.7	51.6	40.0		
Petrovietnam Camau Fertilizer JSC	DCM VN	na	na	532	7.6	6.0	80.0	na	na	2.3	2.5	44.7	38.3		
Average					15.2	9.3	214.0	2.5	1.8	7.6	5.5	33.9	26.6		
Median					12.1	8.9	104.1	2.6	1.7	6.9	5.9	19.4	26.3		
Duc Giang Chemicals Group JSC	DGC VN	Hold	103,200	1,319	14.6	6.3	141.2	5.7	3.2	5.4	5.2	73.0	64.1		

SOURCE: VNDIRECT RESEARCH, BLOOMBERG

Figure 12: Multiples (P/E)

Valuation method	
Forecasted Net profit in 2022F (VND bn)	5.525
Forecasted Net profit in 2023F (VND bn)	3.962
Number of fully diluted shares in FY22F	371.000.000
FY22F EPS (VND/ share)	14.891
FY23F EPS (VND/ share)	10.680
Average FY22-23F EPS (VND/share)	12.785
Target P/E (x)	8,0
Target price (VND/ share)	102.283

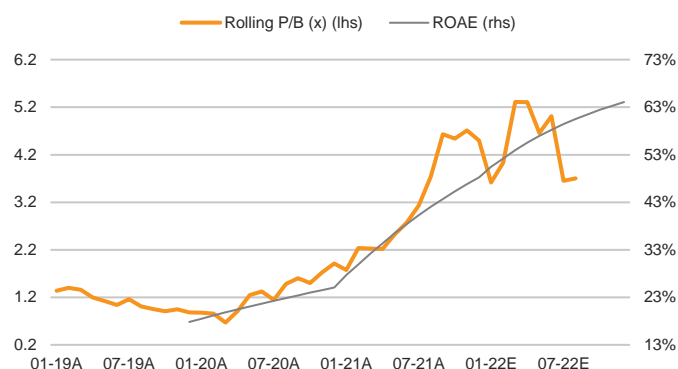
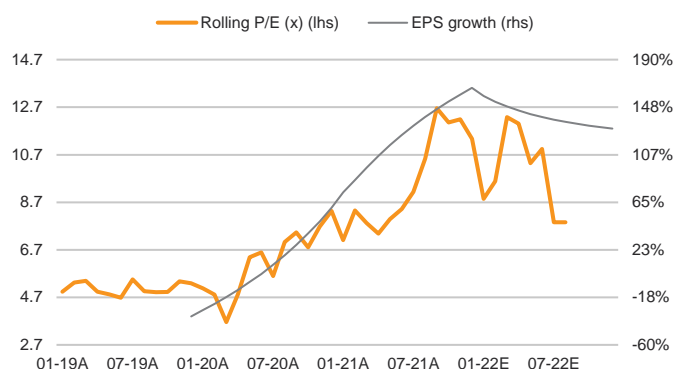
SOURCE: VNDIRECT RESEARCH

We downgrade DGC to HOLD as current valuation is relatively fair

Recently, DGC surged 28.8% since the beginning of 2022, leading to 14.4x TTM PE. We think stock price to reflect the bright outlook in FY22F. We maintain our view that the selling price of DGC will decrease in 2023. Firstly, in the context of booming demand from electric vehicles and shortage of supply, China has approved a new capacity of phosphorus as 356,000 tonnes/year for the period 2023-24 (compared to 1.4m tonnes/year currently), according to China Financial Associated Press. Secondly, the current record high fertilizer prices may reduce demand in 2H23F.

Investment risks

Upside potential come from the increase in gold phosphorus price could last until 2023 as 1) China may continue to tighten restrictions on the production of environmental pollution products and 2) longer-than-expected drought in China. Downside risks include 1) selling price of phosphorus correcting stronger than expected, 2) phosphorus's export tax risk plus an increase in input material prices (sulfur, coke) which could put pressure on DGC's gross margin.

Valuation

Income statement

(VNDbn)	12-21A	12-22E	12-23E
Net revenue	9,567	15,669	13,799
Cost of sales	(6,369)	(8,704)	(8,723)
Gen & admin expenses	(137)	(157)	(138)
Selling expenses	(503)	(783)	(690)
Operating profit	2,559	6,024	4,248
Operating EBITDA	2,345	5,823	3,884
Depreciation and amortisation	213	202	364
Operating EBIT	2,559	6,024	4,248
Interest income	171	205	246
Financial expense	(68)	(122)	(119)
Net other income	(7)	31	28
Income from associates & JVs	0	0	0
Pre-tax profit	2,654	6,138	4,403
Tax expense	(123)	(325)	(233)
Minority interest	(126)	(289)	(207)
Net profit	2,405	5,525	3,962
Adj. net profit to ordinary	2,405	5,525	3,962
Ordinary dividends	(237)	(302)	(355)
Retained earnings	2,169	5,223	3,607

Balance sheet

(VNDbn)	12-21A	12-22E	12-23E
Cash and equivalents	124	223	373
Short term investments	3,632	3,087	3,025
Accounts receivables	781	1,891	1,665
Inventories	1,208	1,812	2,174
Other current assets	81	185	163
Total current assets	5,825	7,198	7,400
Fixed assets	2,145	7,087	9,356
Total investments	0	0	510
Other long-term assets	368	496	552
Total assets	8,339	14,781	17,818
Short-term debt	842	1,567	1,380
Accounts payable	505	174	174
Other current liabilities	659	727	757
Total current liabilities	2,006	2,468	2,311
Total long-term debt	0	600	740
Other liabilities		157	0
Share capital	1,711	1,711	1,711
Retained earnings reserve	2,923	7,953	11,206
Shareholders' equity	6,053	11,183	14,271
Minority interest	280	373	496
Total liabilities & equity	8,339	14,781	17,818

Cash flow statement

(VNDbn)	12-21A	12-22E	12-23E
Pretax profit	2,654	6,138	4,403
Depreciation & amortisation	202	364	650
Tax paid	(123)	(325)	(233)
Other adjustments	0	0	0
Change in working capital	(136)	(1,394)	(255)
Cash flow from operations	2,597	4,783	4,564
Capex	(217)	(4,678)	(3,178)
Proceeds from assets sales	0	0	0
Others	49	205	46
Other non-current assets changes	(2,039)	733	(1,042)
Cash flow from investing activities	(2,207)	(3,740)	(4,174)
New share issuance	0	0	0
Shares buyback			
Net borrowings	(301)	(296)	(147)
Other financing cash flow	(11)	(346)	305
Dividends paid	(237)	(302)	(355)
Cash flow from financing activities	(548)	(944)	(196)
Cash and equivalents at beginning of period	282	124	223
Total cash generated	(158)	99	194
Cash and equivalents at the end of period	124	223	417

Key ratios

	12-21A	12-22E	12-23E
Dupont			
Net profit margin	25.1%	35.3%	28.7%
Asset turnover	1.35	1.36	0.85
ROAA	33.8%	47.8%	24.3%
Avg assets/avg equity	1.43	1.34	1.28
ROAE	48.3%	64.1%	31.1%
Efficiency			
Days account receivable	24.0	39.9	39.9
Days inventory	69.2	76.0	91.0
Days creditor	28.9	7.3	7.3
Fixed asset turnover	4.39	3.39	1.68
ROIC	33.5%	40.3%	23.5%
Liquidity			
Current ratio	2.9	2.9	3.2
Quick ratio	2.3	2.2	2.3
Cash ratio	1.9	1.3	1.5
Cash cycle	64.3	108.6	123.6
Growth rate (yoy)			
Revenue growth	53.4%	63.8%	(11.9%)
Operating profit growth	159.3%	135.5%	(29.5%)
Net profit growth	165.3%	129.7%	(28.3%)
EPS growth	165.3%	129.7%	(28.3%)

Source: VND RESEARCH

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RECOMMENDATION FRAMEWORK

Stock Ratings

Definition:

Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings

Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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