RONGVIET SECURITIES

Brief note

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VIETNAM FORTRESS TOOLS JSC

Capacity Expansion Due to Market Demand Growth

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Company overview:

Vietnam Fortress Tools JSC is going to list its shares on the Hanoi Stock Exchange in 2018. The company is a subsidiary of Formosa Tools, a Taiwanese family-owned business founded in 1974. With a focus on providing quality and low-cost gardening products, Formosa Tools has set up factories in Vietnam to lower its production costs. Fortress Vietnam is currently the manufacturing hub for Formosa Tools, responsible to produce gardening tools.

Starting production in 2007, Vietnam Fortress Tools is currently operating two factories with a total capacity of 60 million gardening tools per year and other products. The company produces a wide range of gardening equipment, in which pruning tools are the main proportion of its sales. Vietnam Fortress Tools' customers are foreign retailers, mainly concentrated in the US and Europe. Ninety-nine percent of its sales come from exports.

Overall comment:

Vietnam Fortress Tools operates based on a well-developed production process that manufactures from raw materials. The major inputs are steel plates imported from Taiwan. Steel is cut, sharpened and put through surface treatments, finally assembled along with the handles. The average time from receiving orders to shipment is estimated at 45 days.

The rising demand for gardening tools provides good opportunities for growth

Vietnam Fortress Tools currently operates two factories on a two eight-hour shift basis, which could be increased to three shifts per day to meet customers' demand if necessary.

Vietnam Fortress Tools is expanding by building its third factory, with a capacity 1.3 times what it has currently. The factory is being built on 20 acres of land near the two existing factories, costing USD 29 million to set up and is scheduled to start operation in 2019. This factory will specialize in producing garden furniture and sporting goods. Right now, these items contribute only around 10% of total sales. Seeing potential in the growth for sporting goods and gardening furniture, Fortress Tools has decided to push this segment as it has successfully raised sufficient capital to fund the factory. Fortress expects the new factory to contribute about around USD 100 million in annual revenues by 2020 which will then account for 80% of the company's forecasted sales.

Fortress's main customers are large retailers in the US and the EU. Its current customer list includes large garden tools suppliers such as Lidl (Europe), Walmart, Home Depot (the US), Daishin (Japan) and Carrefour (France). Fortress has long-term contracts with each of its customers. We consider long-term contracts between producers and retailers to be less risky compared to the traditional partnerships that is common among Vietnamese producers. Therefore, the fact that Fortress secures its customers' orders under long-term contracts plays an important role in improving its inventory management efficiency and is an indicator of Fortress's potential growth.

Fortress has a strategic partnership with Lidl, a German global discount supermarket chain operating over 10,000 stores worldwide. Fortress expects Lidl to be its major customer buying 50% of the company's output in 2020. It shows the potential for Fortress revenue growth when its third factory starts production in 2019. Lidl will also support Fortress in financial planning, credit line and material purchases.

Formosa Tools set up its production hub in Vietnam to take advantage of lower production costs.

Manufacturing labor cost in Vietnam is estimated to be roughly half that of China, which Fortress management considers the key in their strategy.

Additionally, set up cost is another important factor. China's Ministry of Land and Resources calculated the land price for industrial use at around USD 124 per square meter, whereas in Vietnam it is around USD 60 per square meter. Taking into account the construction cost, the Taiwanese company estimates that setting up its third plant in Vietnam saves around USD 6 million compared to doing that in China.

The new plant will be 30 minutes from the seaport, which will help reduce transportation costs.

Finally, yet importantly, Fortress is an exporting firm and is not taxed on imported goods, which we think is a critical element in lowering its costs of production. Using the 'government policies' for foreign investors, Fortress is able to supply to the market a standard quality product with a competitive price.

Financials:

Fortress grew its revenues substantially over the last few years; CAGR of 16% during the period 2014-2017. However, as it is going to derives over 50% of its revenue from sales to Lidl (now 18%), investors should watch out for a dependency risk, as unfavorable growth of that retailer could affect Fortress's development.

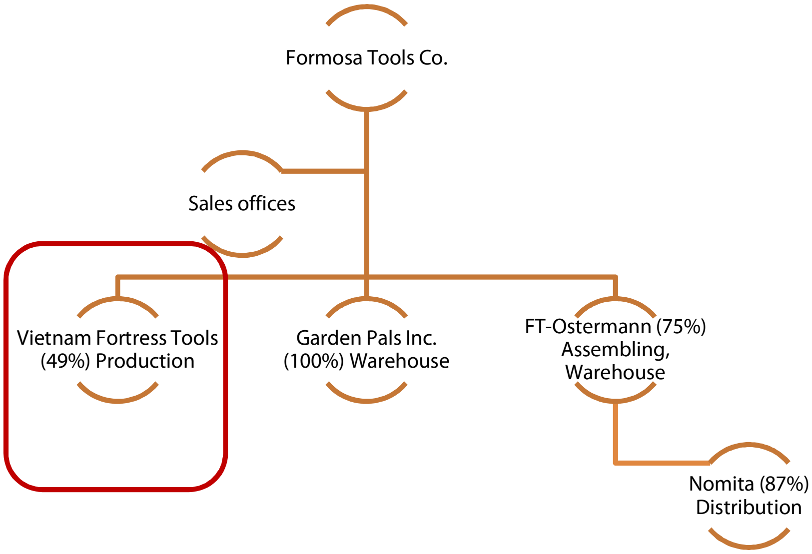
Fortress's gross margin improved as well, rising from 6.6% in 2014 to 22.3% in 2017 thanks to the efficiency of the second factory. As a result, its net margin also rose strongly from 0.4% to 11.4% over the same period. The third factory is expected to improve total profitability when it starts operation in 2019.

Fortress imports most of its inputs from the parent company in Taiwan, who charges a 10% management fee. We estimate that 56% of the company's COGS was imported from Taiwan in 2017, which means the management fee accounted for over 5% of Fortress's COGS. Therefore, if Fortress can decrease the proportion of imports from Taiwan, its profitability will improve.

We are concerned about Fortress' cash flows because the company's short-term liquidity is locked up in inventories. The company's inventories are between 293 and 369 days. This is equivalent to a year's production, resulting in a slow cash conversion cycle. This means that as the third factory starts operation, Fortress's capacity will increase three folds and there may be a strong cash outflow due to inventory increases. Therefore, unless payables or advances from customers manage to increase at the same rate, Fortress will have to take short-term loans, which means higher interest payments and deteriorating profit margins. However, Fortress expects that the partnership with Lidl will help with shortening the cash conversion cycle by taking L/C from this retailer.

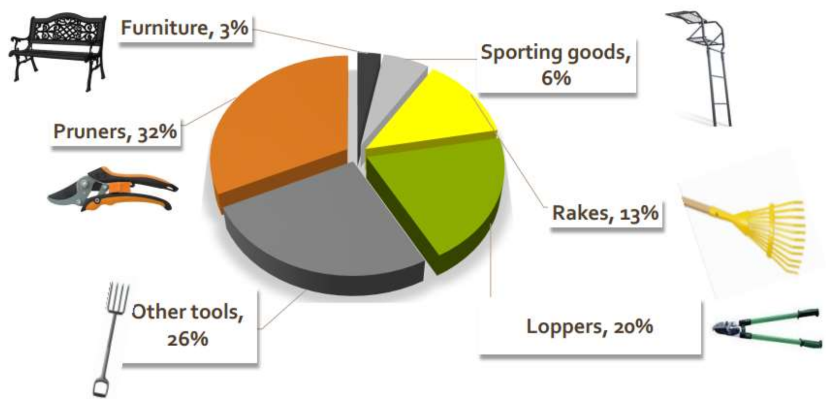
Appendix:

Figure 01: Vietnam Fortress Tools



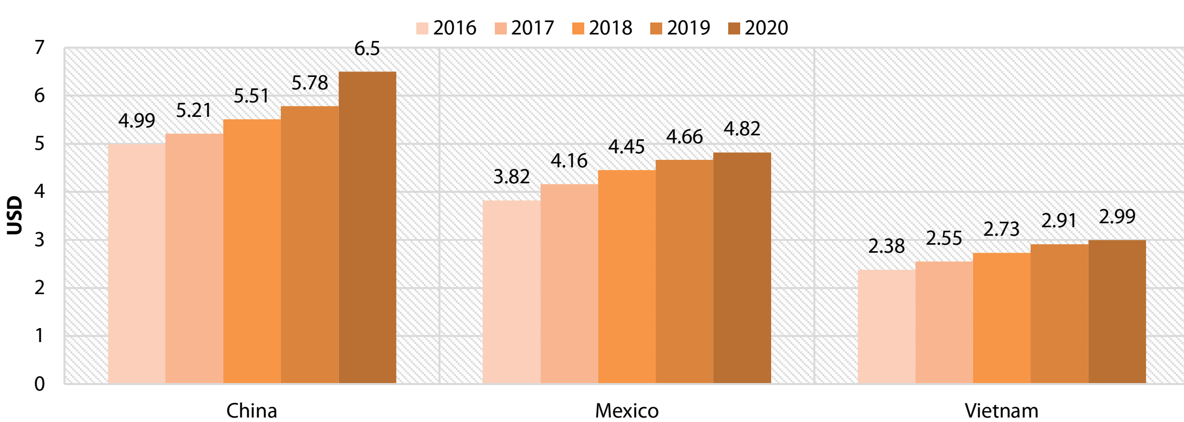
Source: Vietnam Fortress Tools

Figure 02: Vietnam Fortress Tools product lines



Source: Vietnam Fortress Tools

Figure 03: Manufacturing labor cost per hour



Source: Statista

Figure 04: Sales breakdown by product lines

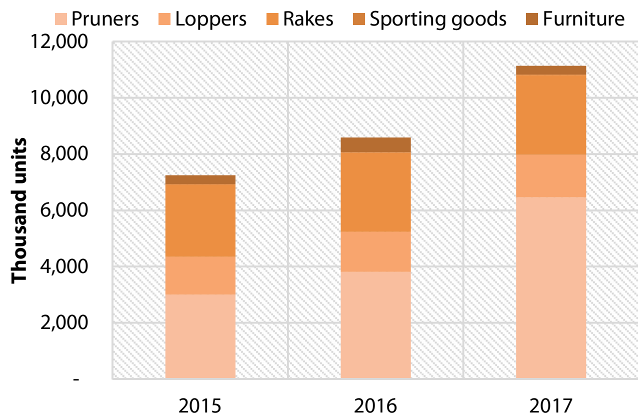
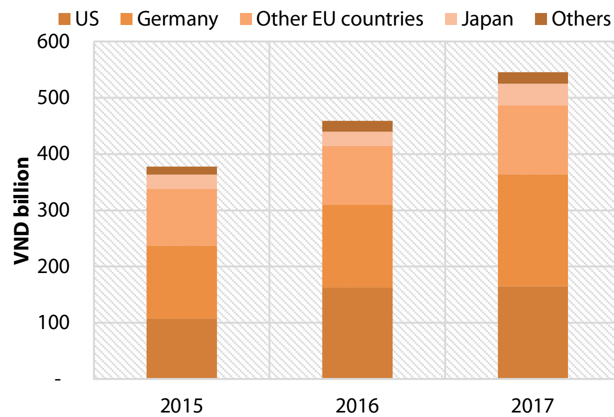


Figure 05: Revenue breakdown by markets



Source: Vietnam Fortress Tools

Figure 06: Lidl's operating outlets and market shares

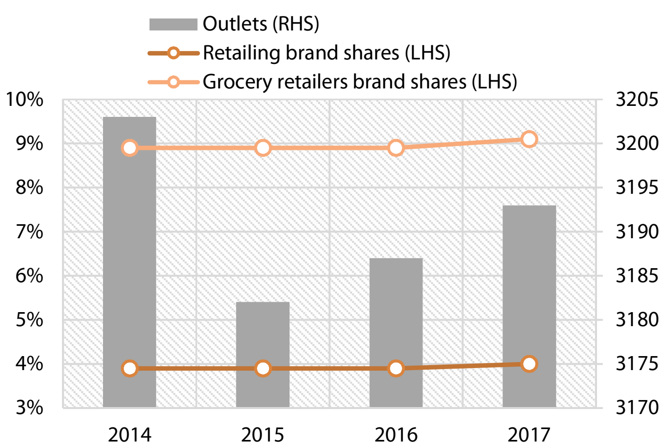
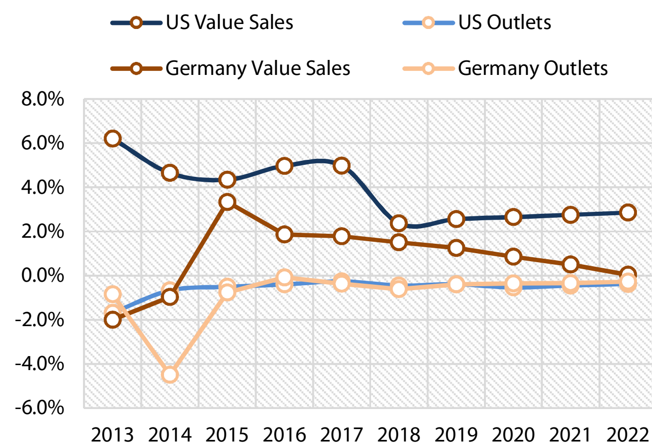


Figure 07: Growth rates of major gardening tools markets



Source: RongViet Securities

VND Billion

INCOME STATEMENT	FY2014	FY2015	FY2016	FY2017
Revenue	350	378	459	545
COGS	327	331	384	424
Gross profit	23	46	75	122
Selling Expense	8	7	8	12
G&A Expense	16	14	22	29
Finance Income	1	3	-4	-3
Finance Expense	8	22	20	16
Other profits	10	-3	0	0
PBT	2	3	20	62
Prov. of Tax	0	0	2	-2
Minority's Interest	0	0	0	0
PAT to Equity Shareholder	2	3	18	64
EBIT	-1	26	45	81
EBITDA	19	47	66	106

FINANCIAL	FY2014	FY2015	FY2016	FY2017
Growth (%)				
Revenue	N/A	7.8	21.5	18.9
EBITDA	N/A	146.1	40.2	61.2
EBIT	N/A	-3648.6	75.4	80.2
PAT	N/A	98.7	464.7	257.6
Total assets	N/A	8.6	21.3	59.1
Total equity	N/A	48.7	33.5	249.8
Profitability (%)				
Gross margin	6.6	12.3	16.3	22.3
EBITDA margin	5.4	12.4	14.4	19.5
EBIT margin	-0.2	6.8	9.8	14.8
Net margin	0.5	0.8	3.9	11.7
ROA	0.3	0.5	2.4	5.3
ROCE	-0.7	16.8	16.6	11.7
ROE	1.6	2.1	8.9	9.1
Efficiency (x)				
Receivables turnover	2.3	1.9	1.7	1.6
Inventories turnover	1.2	1.1	1.2	0.8
Payables turnover	1.2	2.0	1.9	2.0
Liquidity (x)				
Current	0.9	1.1	1.3	1.8
Quick	0.4	0.4	0.6	0.7
Finance Structure (%)				
Total debt/equity	196.3	200.7	170.8	56.1
ST debt/equity	188.6	199.3	137.7	40.3
LT debt/equity	7.7	1.4	33.1	15.8

VND Billion

BALANCE SHEET	FY2014	FY2015	FY2016	FY2017
Cash and cash equivalents	1	0	0	13
Short-term investments	5	0	4	10
Accounts receivable	154	201	277	337
Inventories	268	298	321	537
Other current assets	5	4	7	1
Property, plant & equipment	113	96	78	151
Acquired intangible assets	9	9	9	0
Long-term investments	0	0	0	0
Other non-current assets	13	9	53	142
Total assets	**568**	**617**	**749**	**1,191**
Accounts payable	269	166	203	216
Short-term borrowings	190	299	276	282
Long-term borrowings	8	2	66	111
Other non-current liabilities	0	0	0	0
Bonus and Welfare fund	0	0	4	30
Tech-sci. dev. fund	0	0	0	0
Total liabilities	**467**	**467**	**549**	**639**
Common stock and APIC	54	101	125	565
Treasury stock (enter as -)	0	0	0	0
Retained earnings	47	49	76	132
Other comprehensive income	0	0	0	0
Inv. and Dev. Fund	0	0	0	3
Total equity	**101**	**150**	**200**	**701**
Minority Interest	**0**	**0**	**0**	**0**

CASH FLOW STATEMENT	FY2014	FY2015	FY2016	FY2017
Profit before tax	2	3	28	68
-Depreciation	84	21	21	23
-*Adjustments*	(57)	20	17	18
+/- Working capital	(61)	(186)	(90)	(259)
Net Operating CFs	**(32)**	**(142)**	**(24)**	**(150)**
+/- Fixed Asset	(197)	5	1	(78)
+/- Deposit, equity investment	176	(4)	(37)	(103)
Interest, div, cash profit rec.	-	-	-	-
Net Investing CFs	**(22)**	**1**	**(36)**	**(181)**
+/- Capital	54	47	24	292
+/- Debt	198	103	41	51
Dividend paid & other	(199)	(6)	(5)	1
Net Financing CFs	**53**	**144**	**60**	**343**
Beginning cash & equivalents	**2**	**1**	**0**	**0**
+/- cash & equivalents	(1)	3	0	12
Ending cash & equivalents	**5**	**9**	**7**	**19**

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