VIET CAPITAL SECURITIES

Fortress Tools Vietnam (FTV) — Listing Note

Industry:	**Household Goods**		2016A	2017A	2018E
Report Date:	**May 7, 2018**	Rev y/y	17.6%	18.9%	147.1%
Current Price:	VND40,000	EPS y/y	NA	167.5%	167.3%
Dividend Yield:	NA	GPM	15.5%	22.4%	22.9%
		NPM	4.9%	11.5%	12.4%
		EV/EBITDA	23.2x	12.3x	5.4x
		P/OCF	(29.4x)	(6.4x)	19.9x
		P/E	42.4x	15.8x	5.9x

Company Overview

Founded in 2006 by Taiwan-based Formosa Tools Co., the company is a leading manufacturer of gardening tools with two factories in Thai Binh Province in northern Vietnam with a total capacity of USD76mn p.a. 90% of products are exported to Europe and North America, supplying large retailers such as Lidl in Germany, Walmart and Home Depot in the US and Daishin in Japan.

			FTV	Peers	VNI
Market Cap:	$42.1mn	P/E (ttm)	15.8x	23.8x	18.8x
Foreign Room:	$4.2mn	P/B (curr)	1.7x	2.7x	2.9x
ADTV30D:	NA	Net D/E	0.7x	0.2x	NA
State Ownership:	0%	ROE	16.7%	2.7%	15.3%
Outstanding Shares:	26.8mn	ROA	6.4%	1.6%	2.3%

Listing Date: May – June 2018. *
Listing Exchange: HNX.
Listing Price: VND40,000
Plan to list on HSX in 2019
* dependent on approval from regulators.

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Rising production hub for German giant retailer Lidl

- Taiwanese-origin gardening tool maker with strong presence in European and North American markets is expanding thanks to Vietnam's low-cost competitiveness and support of partners.
- Sales orders and new factories suggest an impressive 2018-2020 CAGR of 60.9% facilitated by both organic growth of gardening tools and expansion into sporting goods and wooden toys.
- Strategic partnership with Lidl, the second-largest discounter in Germany and fourth-largest retailer in the world, ensures the company's ambitious growth targets and supports its capabilities.
- Valuation looks cheap given expected huge growth in 2018-2020. The expected listing price implies a P/E 2018E of just 5.9x, significantly lower than the peer median of 23.8x.

Full contribution of second factory will double 2018 revenue and NPAT. This factory was just completed in Q3 2017, so the effects of the 137.5% rise in capacity will be fully reflected in 2018. Based on FTV's orders, 2018 revenue and NPAT should rise 147.1% YoY and 167.3% YoY, respectively.

Strategic partnership with the world biggest discount chain will boost sales in Europe and North America. In June 2018, Lidl, which operates 10,000 supermarkets across Europe and the US, will sign a strategic agreement with FTV to supply its gardening tools and wooden toy demand, which is USD200mn-USD400mn. However, FTV has to build up its capacity gradually to meet the demand. In 2018, contract value with Lidl will increase 447% YoY to USD23mn. Lidl also helps facilitate technology partnerships in wooden toys and provides a letter of credit for FTV.

FTV will invest USD20mn in a third factory to support the Lidl partnership. In Q3 2018, the company will start constructing its third factory as a step toward fulfilling this partnership. The first phase will add USD100mn of capacity to FTV from Q3 2019, up 135% to USD176mn. In 2017, the company prepared all equity needed for this project and does not plan to issue more in 2018-2019.

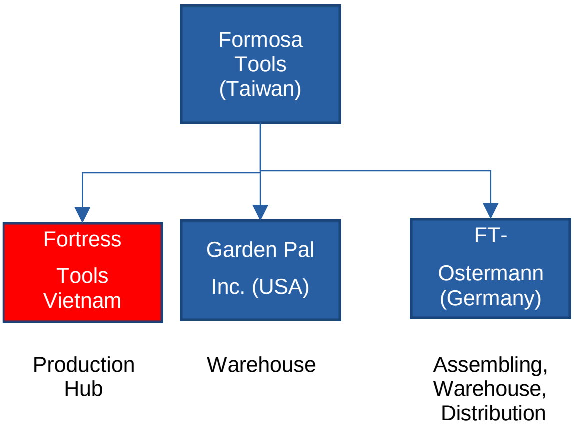
Favorable tax rate until 2018. The company is entitled to various tax incentives, including a favorable CIT rate of 15% for the first 12 years, tax exemption for the first three years and a 50% reduction for seven subsequent years from the first year the company has profit. According to this, FTV's CIT rate will continue at 10.0% in 2018 and then return to the normal rate of 20% from 2019. The company also enjoys duty-free imports as it mostly exports.

Related party transactions dominate operations but will be reduce in 2018-2020. Currently, 87% of FTV's sales and procurement are made through affiliates of Formosa Tool due to the trading conditions of its clients. However, from 2018, the company expects to trade directly with customers and reduce this problem. Additionally, Formosa Tool commits to retain all future profit in Vietnam.

Business Overview

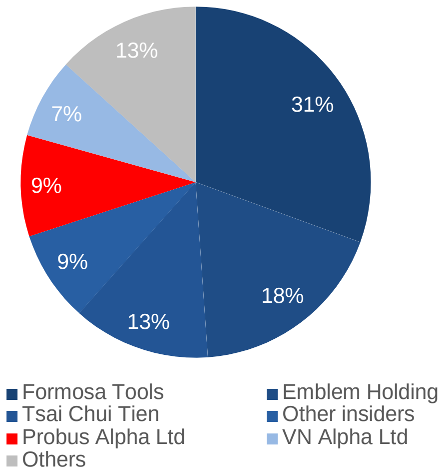
Founded in 2006 by Taiwan-based Formosa Tools Co., the company is an ODM manufacturer of gardening tools with 90% of products exported to Europe and North America. Currently, the company has two factories in Thai Binh Province in northern Vietnam with a total capacity of USD76mn p.a. or 60 million units per year. The main products are gardening tools, such as pruners, loppers, rakes and trawlers. However, the company is expanding into other categories, such as sporting goods, patio furniture and wooden toys.

Figure 1: Structure of Formosa Tools



Source: FTV

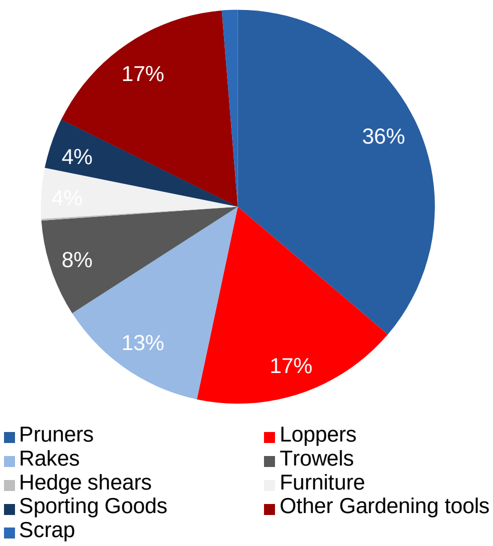
Figure 2: Shareholder structure of FTV



Source: FTV

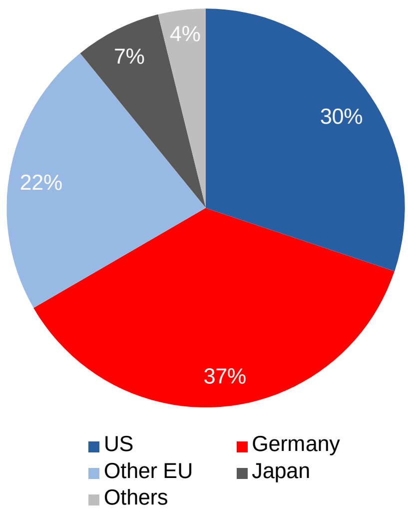
The company benefits from the low-cost competitiveness of Vietnam and its favorable tax policy, which make FTV a good choice for sourcing affordable/cost-competitive products. Most clients of FTV are large retailers in overseas markets, such as Lidl in Europe, Walmart and Home Depot in the US and Daishin in Japan. Currently, the largest customer, Lidl, accounts for ~18% of FTV's revenue. Germany with Lidl is the largest and most profitable single market of FTV. In 2017, this market also had the highest growth rate of 219.7%, thanks to more orders from Lidl.

Figure 3: Revenue by product as of 2017



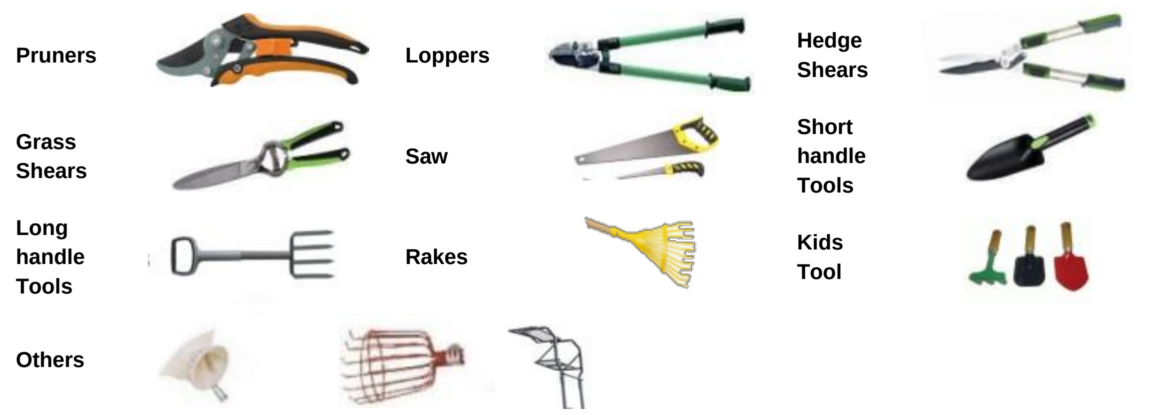
Source: FTV, VCSC

Figure 4: Revenue by the market as of 2017



Source: FTV, VCSC

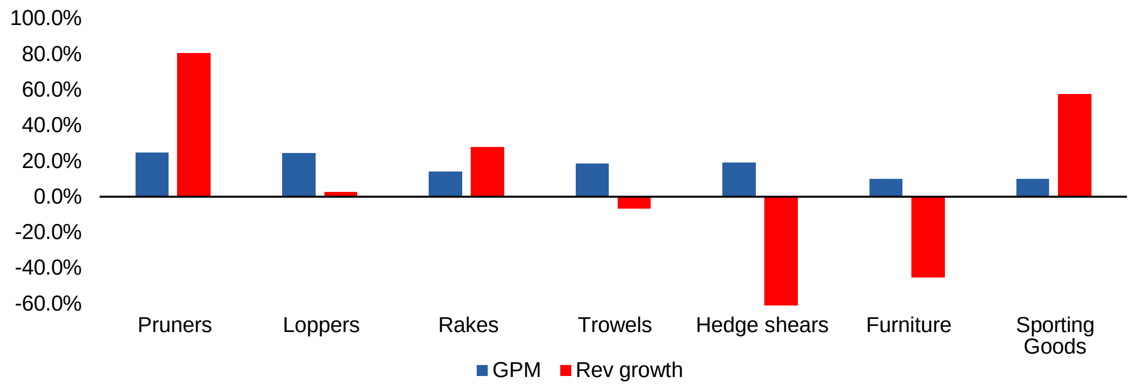
Figure 5: FTV's gardening tool portfolio



Source: FTV

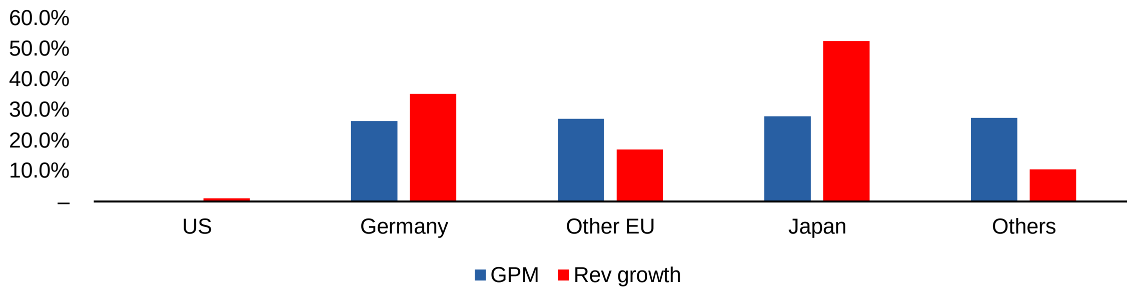
In terms of product mix, cutting tools, such as pruners, are the biggest product category and have the highest growth potential. The company also planned to expand and specialize in this category, with a new factory that opened in 2017 designated to mainly produce cutting tools. However, because FTV is more an order-based manufacturer, its product portfolio is not fixed, and changes to follow customer demand. The good side of this is that its products are not too specialized, so FTV can easily divert products to other clients without major additional cost. The company also plans to expand into sporting goods, furniture and wooden toys with secured orders from its clients.

Figure 6: GPM and revenue growth of each product



Source: FTV

Figure 7: GPM and revenue growth of each market in 2017



Source: FTV, VCSC

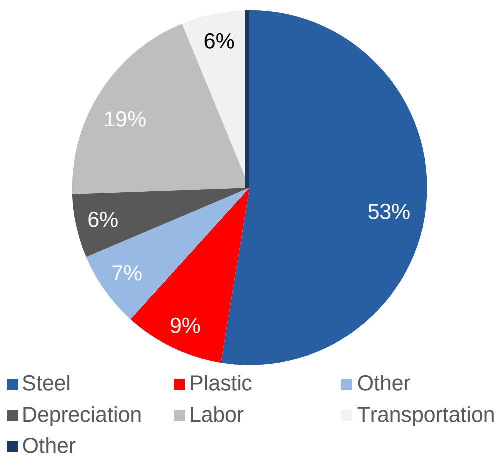
Table 1: FTV's capacity

Factory	Capacity (USD mn)	Capacity (mn units)	Area (ha)	Investment (USD mn)	COD	Products
No 1 Thai Binh Province	32.0	29.0	6.7	17.0	2006	Current: Cutting tools, Digging tool, Toys, Furniture 2019: Digging Tools + New products
No 2 Thai Binh Province	44.0	25-30.0	2.7	6.5	Q3 2017	Cutting tool
No 3 Thai Binh Province	100.0	NA	20.0	10.0	2019	Furniture, Toys, Sporting Goods

Source: FTV, VCSC.

Steel and plastic are the two biggest inputs, but are hedged by its parent, Formosa Tools. Thanks to its B2B model and hedging, FTV seems to be protected from price volatility**.** However, its lack of a long track record leaves some uncertainty. Currently, the company sources steel and plastic from Taiwan and wood from Brazil. Its parent company, Formosa Tool, hedges the input prices and re-sells these materials to FTV. Currently, 75% of steel and 100% of plastic are supplied in this way. From 2018, FTV should benefit from the operation of a new Formosa Ha Tinh Steel plant due to their close locations, reducing inventory delays and transportation costs.

Figure 8: Cost structure of FTV



Source: FTV

Related party transactions dominate operations, but mainly due to trade relationships. Almost all revenue and inputs were supplied by FTV's related parties, including sales orders, steel and plastic. In 2017, 87.4% of revenue was through its related parties. Per management, this was due to current trade conditions as the company cannot export directly. However, in 2017, FTV was assigned as the main production hub as well as the profit center of the entire FT group, as it is the only listed entity of the group. The Hsu family, the owner of FT group, is committed to listing its company in Vietnam as its market capitalization is more suitable for Vietnam than Taiwan.

Favorable tax rate until 2018.

FTV currently enjoys very favorable tax rates in both import/export tariff and corporate profit tax. As most of the revenue comes from the export market, FTV is fully exempted from import tariffs on materials and export tariffs on finished products. Moreover, the CIT rate applied to FTV is very low at 15% against the normal rate of 20% for 12 years from 2006-2018. The company also received a tax exemption for the first three years of having a profit (2009-2011) and a 50% tax reduction for the seven following years (2012-2018).

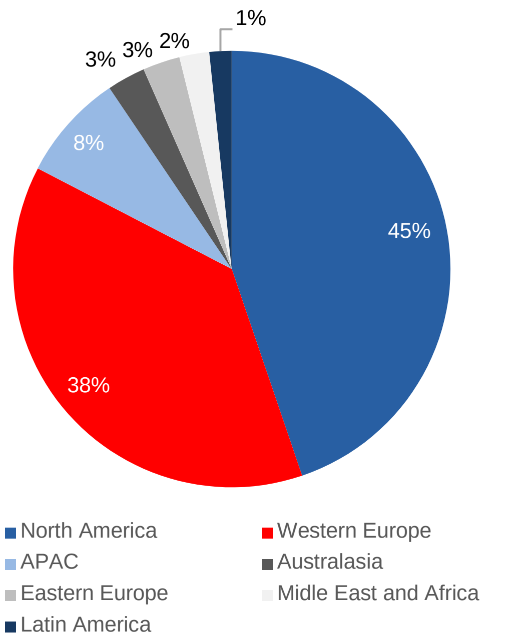
Figure 9: Global gardening market by country

The USD83bn gardening market is highly fragmented with the US, Germany, France and UK the top markets.

The USD83bn gardening market is highly fragmented with the US, Germany, France and UK the top markets. There is no clear dominant player in the market as the largest single brand, Scotts Miracle-Gro Co., controls a market share of just 5% while private labels account for another 5%. In terms of growth, APAC is considered the fastest growing market with a CAGR of over 6% by Euromonitor. In general, gardening activity highly correlates with disposal income, age and home size as it is considered an activity for seniors who have large houses with a garden.

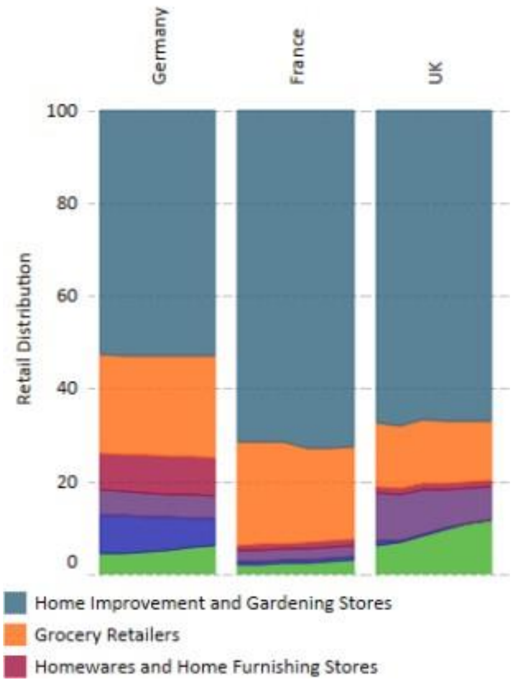
By channel, non-specialist stores such as Lidl have gained a significant share of ~48%. These chains often offer products under their own private brands and source products from other small suppliers, such as FTV.

Figure 9: Global gardening market by country



Source: Euromonitor

Figure 10: Distribution channels in top three EU markets



Source: Euromonitor

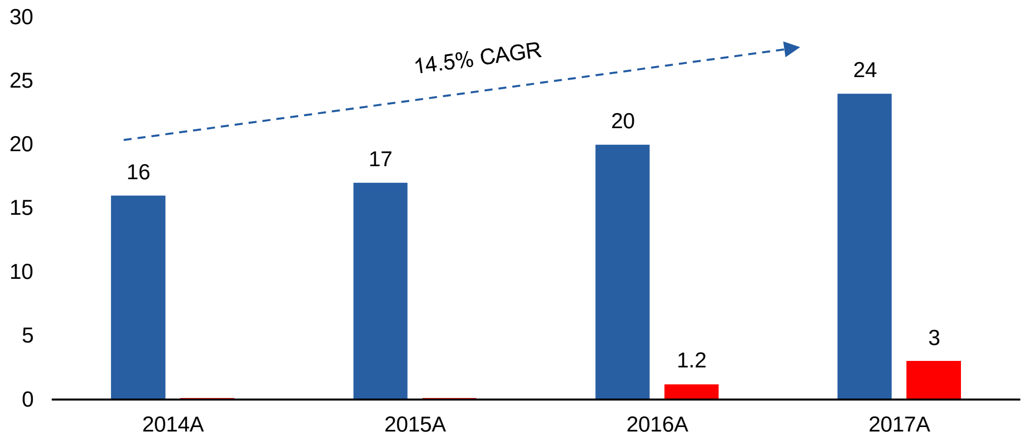
Financial Performance

Sales growth momentum and margin increased significantly in 2016-2017.

In 2014-2017, both the revenue and profit of FTV posted significant growth, especially the latter, with a CAGR of 14.5% and 457.6%, respectively. Additionally, sales momentum tended to accelerate in this period with a 20% increase in 2017. The margin also had the same trend with GPM increasing 6.9 ppts from 15.5% to 22.4%. However, as FT transferred a part of FTV's profit to its Taiwanese parent company, the increase in margin was a combination of both actual improvement and profit re-distribution effects.

In terms of efficiency, although higher than the peer median, its ROE of 16.6% is still dragged down by its low asset turnover of 0.6x and weak operating cash flow. Rapid increases in inventory and slowdowns in receivables collection (which are dominated by its parent) are the main reasons for the poor cash performance. In 2015-2017, FTV's ratios improved a lot with deleveraging net D/E from 2.0x to 0.7x and increasing gross margin. These improvements can be justified by its expansion and commitment to keep the profit in Vietnam in 2018-2020.

Figure 11: Historical performance of FTV (USD mn)



Source: FTV

Capital raising in 2017 to finance the third factory

In 2017, FTV raised capital through private placements and a debt-to-equity conversion, which increased the number of total shares by 2.15x from 12.47 million to 26.81 million. Total proceeds of VND298bn (USD13.1mn) are being used to finance the upcoming third factory of the company. Details of these capital raising is as follows:

- Converted VND15.5bn (USD683,000) of debt to equity at a conversion price of VND15,000 per share
- Private placement of 2.5 million shares at offering price of VND15,000 per share.
- Private placement of 9.0 million shares at offering price of VND25,000 per share.

Outlook

Strategic partnership with the world biggest hard discounter will boost sales in Europe and North America.

In June 2018, FTV and Lidl will sign a strategic partnership agreement which will open up USD200-USD400mn (VND4.5tn-VND9.0tn) of demand for gardening tools and wooden toys for FTV. Lidl will also grant an L/C for FTV to import needed materials and broker a partnership with a wooden toy maker in Thailand, Wonderworld Toys, who will transfer technology and knowhow to FTV. In other words, Lidl will divert its outsourcing orders from existing suppliers in China to Vietnam, and FTV is the selected vendor. However, FTV needs to expand more to fully realize the benefit as the current capacity of USD76mn is not enough to meet all of the demand of Lidl. In 2018, total contract value with Lidl will increase 474% YoY to USD23mn, of which USD7.5mn is for wooden toys.

Although FTV's concentration risk will significantly rise in 2018-2020 as the company relies more on Lidl, the products are not too specialized and can be sold to other retailers, such as Wal-Mart. The company also seeks other partners to diversify its client base. For example, in order to expand into the patio furniture segment, FTV signed a USD3mn furniture contract for 2018 with XHL, a Chinese furniture maker, and another USD2.5mn contract with Brown Jordan, an American patio furniture brand. Nevertheless, the company expects Lidl's sales contribution will increase from 18% to 44% in this period.

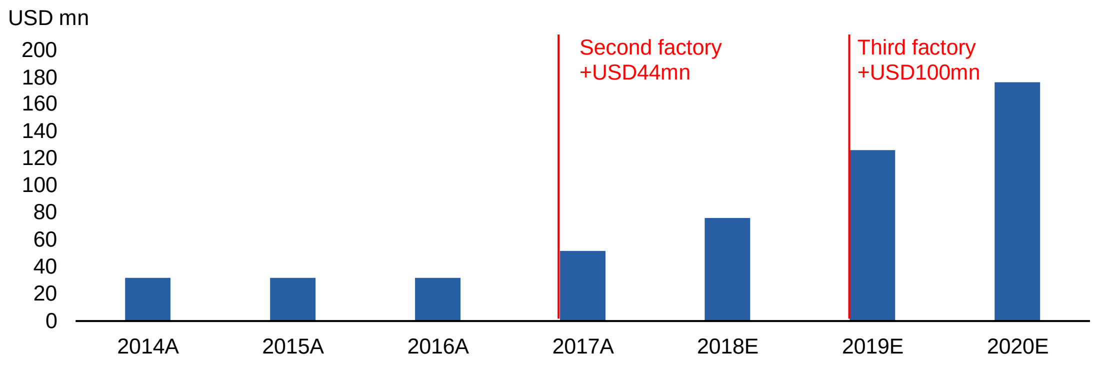
In the long term, thanks to Lidl's hard discounter model and aggressive global conquest, FTV will benefit from not only the current market share of Lidl but also its own growth story. Compared to other retailers, Lidl usually offers a limited range of products with very low prices, most of which are private brands owned by Lidl. However, the cost-cutting nature of Lidl also poses a threat if the business costs of Vietnam increase and Lidl can choose another cheaper destination for its production. Currently, the direct competitor of Lidl is German retailer Aldi, which has the same business model as Lidl.

Aggressive expansion with full contribution of second factory in 2018 and third factory in 2019

As FTV's second factory only started operation in Q3 2017, production in 2018 is expected to increase tremendously. The new factory has an annual capacity of USD44mn, which would increase overall capacity by 137.5%, and playing a part in a 65% YoY increase in the year-end inventory balance in 2017. The company expects sales to increase 150% YoY to USD60.0mn in 2018.

Moreover, as mentioned above, with the commitment from Lidl, FTV is going to build a third factory that will increase its total capacity by more by 131.6% to USD176mn per year in 2019 and leave an option for further expansion after 2020. These aggressive steps will boost the benefit of FTV's strategic partnership with Lidl as well as increase production capability for future partnership with other major clients.

Figure 12: Capacity expansion plan of FTV



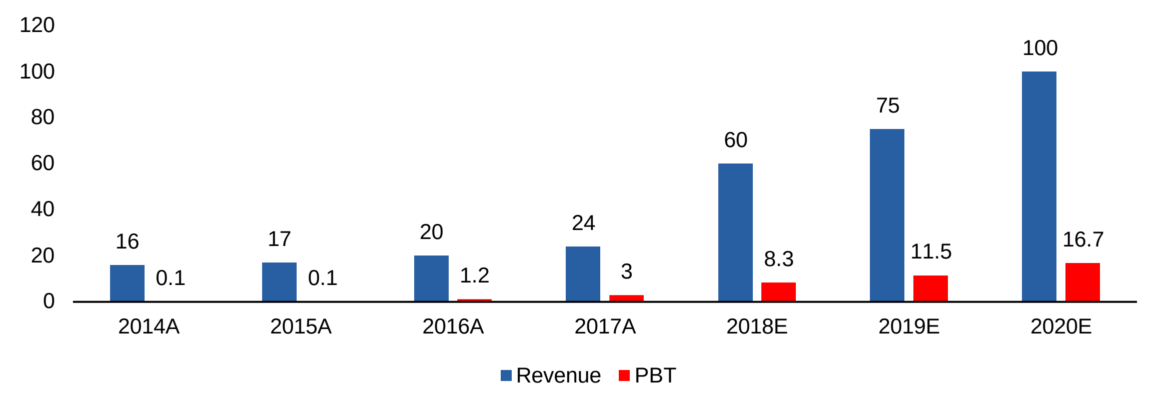
Source: FTV

Table 2: New factory No. 3 investment plan

Detail	Phase 1	Phase 2
Capacity	USD100mn	NA
Area	20 ha	
Investment	USD20mn	USD8mn
Construction Date	Q3 2018	After 2020
Operation Date	Q3 2019	After 2020
Debt/Equity	50:50	NA

Source: FTV

Figure 13: FTV's guidance for 2018-2020 (USD mn)



Source: FVTN

Table 3: Comparison of operation cost in Vietnam and China

	Vietnam	China
Cost of Labor		
Average Minimum Wage	USD175 per month	USD385 per month
Average Manufacturing Wage	USD240 per month	USD417 per month
Social Welfare	**22% of salary**	**30%-50% of salary**
Corporate Income Tax	**20% + Tax incentives**	**25%**
Dividend Tax	**nil**	**10%**
VAT	**10%**	**17%**

Source: Asia Briefing, Trading economics, PwC

Valuation

Given the aggressive expansions, FTV's current valuation looks especially attractive. Its 2018E P/E is only 5.9x while the peer median is 23.8x. Despite the lack of diversification and authentic brand names, this valuation is still quite low.

Table 4: Peer comparison

Company*	Market Cap (USD mn)	TTM Sales Growth	TTM EPS Growth	ROE	ROA	Net D/E	GPM	NPM	LQ PBR	Adj. TTM PER
2908 TT	403.8	4.3%	21.7%	10.9%	3.5%	0.6x	29.2%	2.2%	2.7x	18.5x
EIN3 GR	438.7	13.6%	127.4%	12.4%	6.3%	0.0x		3.8%	3.3x	22.0x
300483 CH	349.6	7.3%	-58.8%	1.5%	1.1%	-0.4x	23.2%	1.3%	3.6x	159.0x
7442 JP	138.2	-1.5%	-49.4%	2.7%	1.6%	-0.1x	18.4%	1.2%	1.5x	34.2x
1538 TT	14.8	-5.4%	-44.3%	-30.4%	-10.3%	1.3x	16.9%	-23.9%	1.8x	NA
WHH PW	6.5	21.5%	NA	7.0%	3.3%	0.2x	20.8%	4.3%	3.2x	30.0x
SVGR IN	0.5	-6.7%	-82.7%	1.8%	0.7%	1.0x		0.4%	0.6x	23.8x
Median	**138.2**	**4.3%**	**-46.8%**	**2.7%**	**1.6%**	**0.2x**	**20.8%**	**1.3%**	**2.7x**	**23.8x**
FTV	**47.2**	**18.9%**	**167.5%**	**16.7%**	**6.4%**	**0.7x**	**22.4%**	**11.5%**	**2.0x**	**15.8x**

Source: Bloomberg, VCSC

Note: These companies have more diversified businesses than FTV and usually have their own brand names, which FTV is lacking.

Financial Statements

Income statement (VND bn)	2016A*	2017A	2018E
Revenue	**459**	**545**	1,347
- Cost of goods sold	-388	-423	-1,039
Gross profit	**71**	**122**	**308**
- Sales & marketing	-8	-12	-27
- General & admin	-22	-29	-69
Operating profit	41	81	212
- Forex gains/(losses)	0	0	0
- Net non-op gains	-4	2	0
EBIT	37	83	212
- Interest expense	-12	-16	-27
EBT	**25**	**68**	**186**
- Income tax expense	-2	-5	-19
NPAT before MI	23	62	167
- Minority interests	0	0	0
NPAT less MI, reported	**23**	**62**	**167**
NPAT less MI, adjusted	**23**	**61**	**162**
EBITDA	58	109	251
EPS basic adjusted (1), VND	944	2,525	6,749

Ratios			
Growth (%)			
Revenue growth %	17.6%	18.9%	147.1%
Op profit growth %	NA	97.0%	162.5%
EBIT growth %	NA	127.1%	154.8%
NPAT growth%	NA	175.8%	167.3%
EPS growth %	NA	167.5%	167.3%
Profitability ratios			
Gross margin %	15.5%	22.4%	22.9%
EBIT %	9.0%	14.8%	15.8%
EBITDA %	12.6%	19.9%	18.6%
NPAT less MI, margin %	4.9%	11.5%	12.4%
ROE Dupont %	13.0%	16.7%	26.5%
ROA Dupont %	3.3%	6.4%	10.7%
Efficiency ratios			
Days inventory on hand	289.3	366.7	203.7
Days AR outstanding	184.0	201.5	149.8
Days AP outstanding	143.7	160.1	124.6
Cash conversion cycle	329.6	408.1	228.9
Liquidity/Solvency			
Current ratio	1.1	1.6	1.4
Quick ratio	0.5	0.7	0.8
Cash ratio	0.0	0.0	0.0
Debt/assets %	0.5	0.3	0.3
Debt/capital %	0.6	0.4	0.4
Debt/equity %	1.7	0.7	0.8
Interest coverage ratio	3.0	5.3	7.9

Balance sheet (VND bn)	2016A*	2017A	2018E
Assets			
+ Cash & equivalent	0	13	47
+ Short-tm investments	4	10	10
+ Accounts receivable	272	330	775
+ Inventories	317	534	626
+ Other current assets	17	12	12
Total current assets	610	899	1,470
+ Gross fixed assets	241	417	604
- Accum. depreciation	-124	-149	-178
+ Net fixed assets	117	268	425
+ LT investments	0	0	0
+ Other long-tm assets	23	26	26
Total long-term assets	141	294	451
Total Assets	751	1,193	1,922
+ Accounts payable	174	197	512
+ Short-term debt	325	304	384
+ Other short-term liabilities	37	53	131
Current liabilities	536	555	1,028
+ Long-term debt	17	89	182
+ Other long-term liabilities	0	0	0
Total LT debt	17	89	182
Equity			
+ Preferred equity	0	0	0
+ Addt'l paid in capital	0	149	149
+ Share capital	125	268	268
+ Retained earnings	73	133	295
+ Minority interest	0	0	0
Total equity	197	550	712
Total debt & equity	751	1,193	1,922

Cash flow (VND bn)*			
Beginning cash	0	0	12
Net Income	23	63	167
+ Depreciation	21	25	38
+ Other non-cash adj.	8	3	0
+ ∆ in non-cash	-85	-242	-157
Cash from operations	-33	-150	48
+ Disposal fixed assets	0	0	0
+ Capex	-23	-176	-187
+ ∆ in investments	0	-38	0
+ Other investments	0	0	0
Cash from investing	-27	-181	-187
+ Dividends paid	0	0	0
+ ∆ in capital	24	277	0
+ ∆ in ST debt	26	-21	80
+ ∆ in LT debt	15	71	93
+ Other financing act.	36	67	0
Cash from financing	60	343	173
Net changes in cash	0	12	34
Ending cash	0	12	47

Source: Company financial statements, VCSC forecasts.

* recalculated numbers based on FTV's two fiscal year-end financial statements in 2016 as the company changed its legal status from limited company to joint-stock company in September 23, 2016.

(1) Ratios are calculated based on reported earnings. Adjusted EPS are based on earnings normalized to exclude extraordinary profits and adjusted for provisions for contributions to employee bonus funds (3% of NPAT) according to Circular 200.

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