

PV Fertilizer & Chem (DPM)

Healthy finance and high fertilizer prices

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Fertilizer prices continue to remain high because of increasing coal prices

China, the world's largest fertilizer producer (accounting for a third of global output) using main raw material from coal, is currently facing a severe energy crisis. The prices of coal in China and imported from Australia rose 67% and 180% YTD respectively. This will help fertilizer prices to stay high in the coming time while not affecting PV Fertilizer & Chemicals Corporation's (DPM) profit margin.

DPM has healthy financial status with highest ROE in the industry and low leverage

With a return on equity of 8%, DPM has the most efficient operation among fertilizer businesses. With effective cost control, DPM's gross profit margin (GPM) reached 23.7%, three times higher than the industry average.

The change in tax policy will reduce the production cost of fertilizer for DPM by more than VND360 billion

It is expected that by the end of 2021 and early 2022, the Government will submit a draft Resolution on the conversion of fertilizers from non-VAT subject to 5% taxable items to the XV National Assembly.

BUY recommendation with a target price of VND52,600/share

We believe that in 2021, both revenue and NPAT of DPM will have a breakthrough growth. Specifically, NPAT should reach VND1,667 billion (up 137.7% YoY) on revenue of VND10,820 billion (up 39.4% YoY). Revenue from Urea and NPK segment may hit VND7,069 billion and VND1,323 respectively (up 41% YoY). Based on the business outlook and valuation results, we recommend BUY for DPM stocks with a target price of VND52,600/share, 7.4% higher than the closing price on October 28, 2021.

Buy

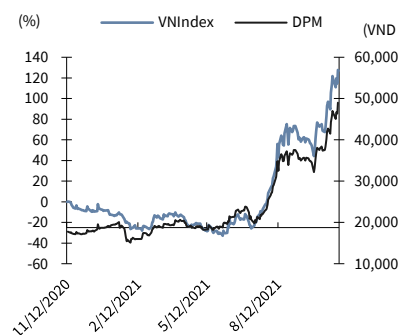
Target price	VND52,600
Upside (%)	7.3%
Current price (October 28, 2021)	49,000
Consensus target price	42,000
Market cap (VNDbn/USDmn)	19,718/843

Trading data	
Free float (%)	40.0%
3M avg trading value (VNDbn/USDmn)	256/11
Foreign ownership (%)	10.4%
Major shareholder	59.6%

Share price performance				
(%)	1M	3M	6M	12M
Absolute	37	100	158	182
Relative	42	114	181	215

Forecast earnings & valuation

FY-end	2020A	2021F	2022F	2023F
Net sales (VNDbn)	7,762	10,662	10,775	10,048
Earnings (VNDbn)	755	1,501	1,913	1,591
NPAT (VNDbn)	681	1,668	1,804	1,522
EPS (VND)	1,535	3,377	3,730	3,105
EPS growth (%)		120%	10%	-17%
P/E (x)	11.5	15.6		
P/B (x)	0.8	2.4		
ROE (%)	8%	19%	19%	15%
Dividend yield (%)	14%	10%	10%	10%

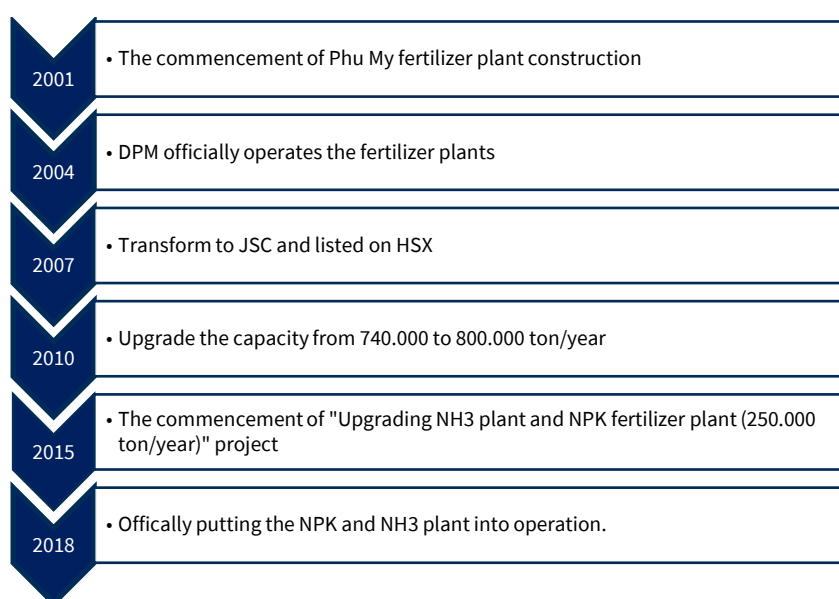


Source: Bloomberg, KB Securities Vietnam

Overview

DPM, formerly known as Petroleum Fertilizer and Chemicals Company, started operating on January 19, 2004. As a member of the Vietnam Oil and Gas Group (PetroVietnam – PVN), DPM holds the largest market share of nitrogen fertilizers among listed companies and holds the top position in terms of market capitalization and total assets.

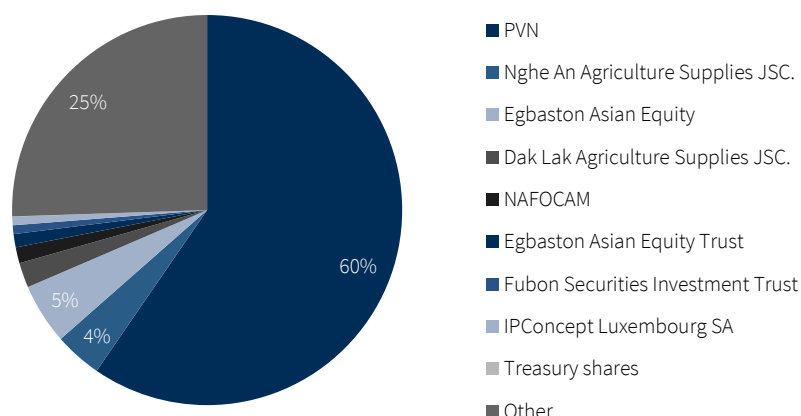
Fig 1. DPM – History of development



Source: PV Fertilizer & Chemicals Corporation

The shareholder structure of DPM is quite concentrated. PVN is the largest shareholder, holding 59.58% of the shares. PVN has planned to reduce the ownership rate in PVFCCo to less than 50% since 2018 and is promoting the plan. However, we observed that PVN has not made any move of divestment.

Fig 2. DPM – Ownership structure



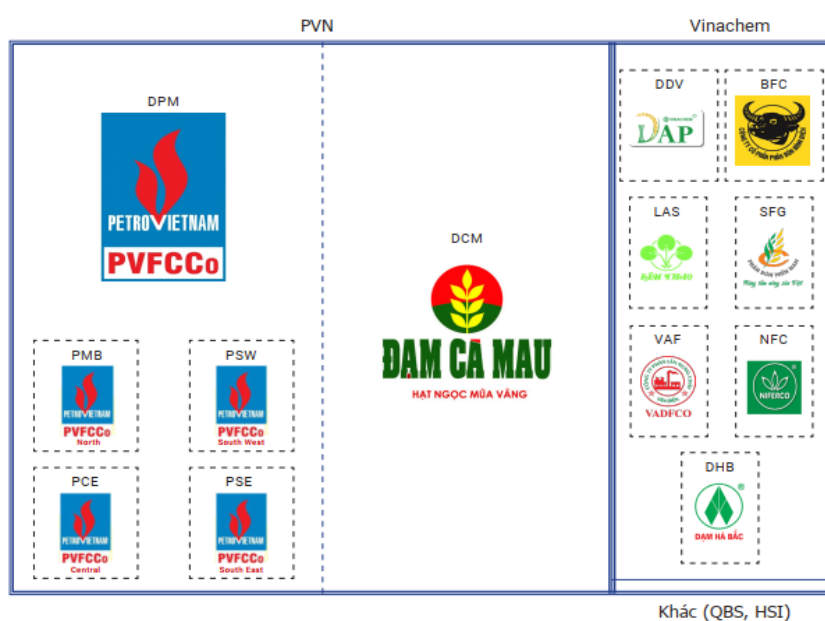
Source: PV Fertilizer & Chemicals Corporation

Business operation

There are 16 fertilizer manufacturing and trading enterprises currently listed and registered for trading on three stock exchanges. PVN and Vietnam Chemical Group (Vinachem) are the two largest shareholders of fertilizer businesses with a stake of over 51%.

DPM currently owns four subsidiaries, namely North Petro Vietnam Fertilizer and Chemicals (PMB), Central PetroVietnam Fertilizer & Chemicals (PCE), South-West PetroVietnam Fertilizer and Chemicals (PSW), and South-East PetroVietnam Fertilizer & Chemicals (PSE). All four companies are listed on HNX, they distribute products for the parent company. In addition, DPM also cooperated to contribute capital to three companies Petrochemical and Fiber Petrochemical (ownership rate of 26%), Urban Development (PXC, 35.6%), and Dam Phu My Packaging (PMP, 43.3%).

Fig 3. Vietnam – Market cap weight of listed fertilizer companies

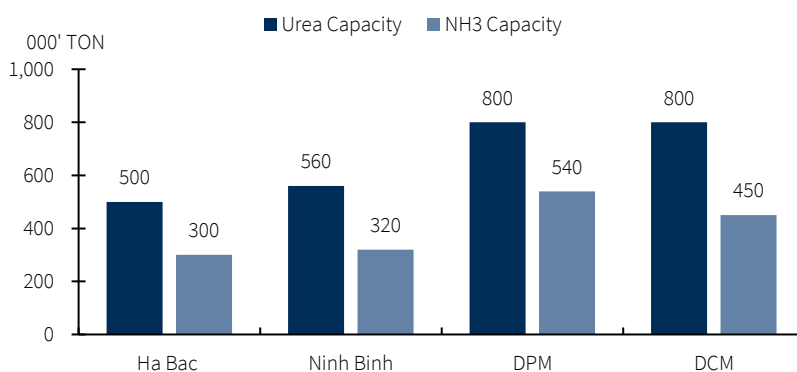


Source: Fiinpro, KB Securities Vietnam

DPM has a modern fertilizer production technology

The production technology, machinery and equipment for synthesizing ammonia, urea and urea granulation are not much different among factories. However, the input material of Phu My Fertilizer and Ca Mau Fertilizer is natural gas, while the input material for Ha Bac Fertilizer and Ninh Binh Fertilizer is coal bran from Quang Ninh's coal mines. Therefore, the fertilizer production process of these plants has an additional step of air separation and coal gasification using European technology (production costs are higher than using natural gas).

Fig 4. DPM – Urea and NH3 output of fertilizer plants

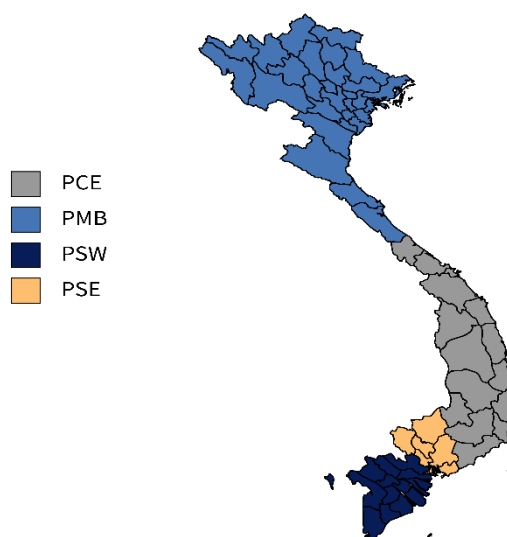


Source: PV Fertilizer & Chemicals, KB Securities Vietnam

DPM has a distribution system spreading throughout the country

DPM’s fertilizers are distributed across the country via a system of subsidiaries headquartered in different regions – the North (PMB), the Central & Central Highlands (PCE), the Southeast (PSE), and the South West (PSW). DPM’s transshipment warehouses are located near seaports and convenient locations for transporting and distributing fertilizers across the country. Besides the domestic market, DPM also exports fertilizer products to many countries, focusing on Asia. However, the corporation’s export revenue was just over VND9.7 billion in 2020, accounting for a negligible proportion in total sales and service provision. Therefore, the DPM’s production and business activities mainly take place in the territory of Vietnam.

Fig 5. DPM – PVFCCO distribution system

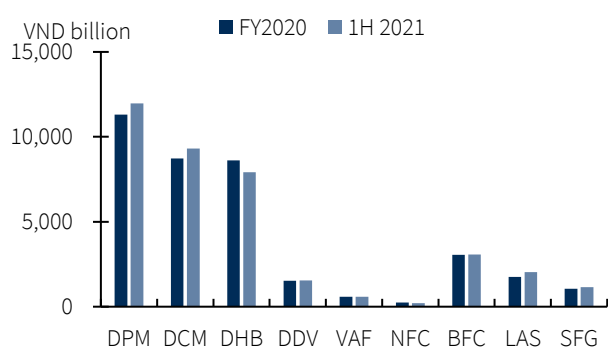


Source: KB Securities Vietnam

DPM's revenue structure

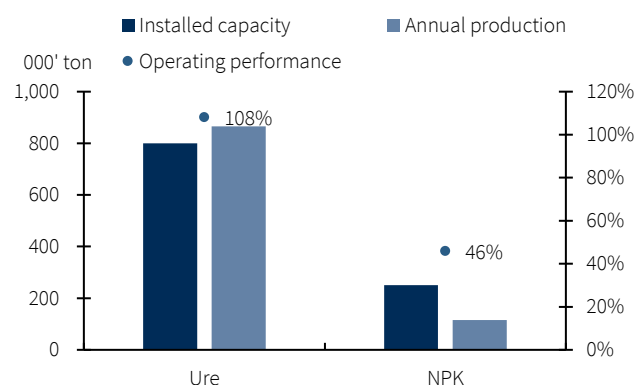
With the characteristic of investing in large-scale machinery systems, nitrogen fertilizer enterprises have the largest total assets among fertilizer enterprises. DPM has the largest total assets among listed companies after increasing the capacity of NH₃ factory and putting Phu My NPK into operation. For most of the time in 16 years of operation, Phu My Fertilizer Plant has maintained a fertilizer output of over 800 thousand tons (equivalent to 100% of design capacity). Currently, the plant completed depreciation and carried out regular maintenance and replacement with short-term annual maintenance and long-term maintenance once every two years. Meanwhile, the NPK plant was put into operation in 2018 and is only operating at 46% of its design capacity. We believe this will be the driving force for DPM's growth in the coming years.

Fig 6. Vietnam – Total assets of listed fertilizer companies



Source: FiinPro, KB Securities Vietnam

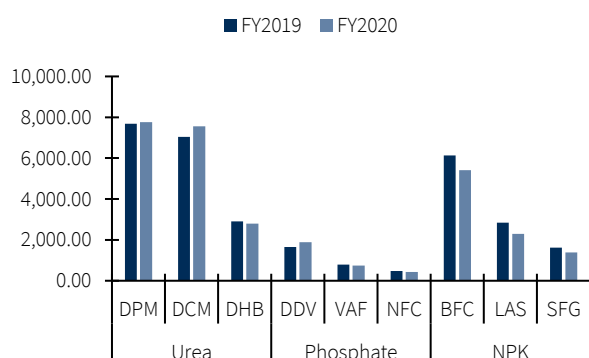
Fig 7. DPM – Performance efficiency of Urea and NPK plants (%)



Source: PV Fertilizer & Chemical

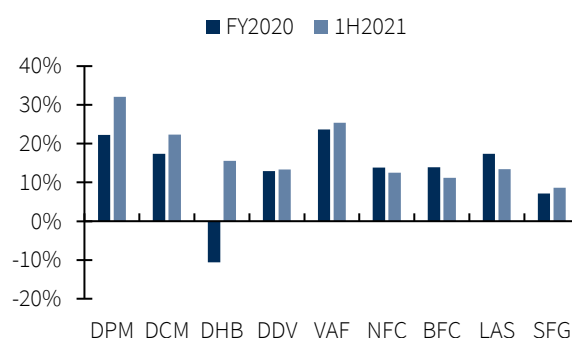
Despite a sharp drop in selling prices in 2020, DPM continued to be the leading company in terms of revenue (VND7,761 billion, VND200 billion higher than DCM) thanks to boosting production output after 72 days of machine maintenance in 2019. In 2021, taking advantage of low-priced inventories and strong selling prices, DPM's GPM in the first half of 2021 reached 32.08%, the highest among listed fertilizer companies (DCM's GPM reached 22.32%, and industry average was 17.15%).

Fig 8. Vietnam – Revenue of fertilizer companies (VNDbn)



Source: FiinPro, KB Securities Vietnam

Fig 7. Vietnam – GPM of fertilizer companies (%)

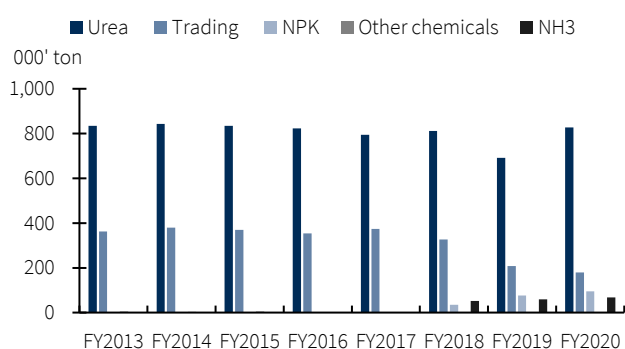


Source: FiinPro, KB Securities Vietnam

DPM's current main products are clear granular nitrogen fertilizers, NPK fertilizers, liquid ammonia gas, UFC85/Formaldehyde chemicals, and chemicals used in oil and gas exploitation.

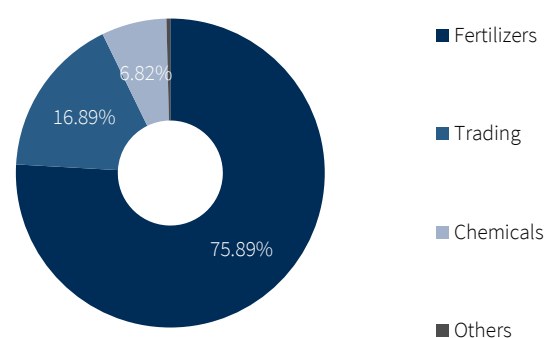
DPM's revenue mainly comes from fertilizers, accounting for 76% of total revenue in 2020. Urea fertilizers account for the largest proportion of DPM's business with output fluctuating around 800 thousand tons per year. In 2019 and 2021, business output is expected to decrease by 15% and 4% respectively due to shutdown and 72-day periodic maintenance. The current NPK fertilizer still accounts for a small proportion but strongly grew by 119% and 23% respectively in 2019 and 2020. It is expected that the growth rate of the NPK segment in 2021 is 41%, equivalent to 132 thousand tons.

Fig 10. DPM – Product output (thousand tons)



Source: PV Fertilizer & Chemicals

Fig 11. DPM – Revenue structure in 2020



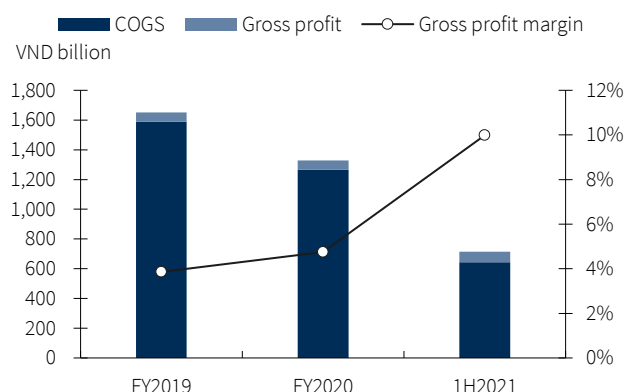
Source: PV Fertilizer & Chemicals, Finpro

Proprietary fertilizer – chemicals segment

Before 2018, DPM's revenue from import goods reached over VND2,000 billion with products imported from Europe such as NPK fertilizer, DAP fertilizer, SA fertilizer, and potassium fertilizer. From 2019 to now, DPM tends to gradually reduce the proportion of this segment when NPK Phu My factory is put into operation. In 2021, we forecast revenue to be flat with gross margin improving from 5% to 8% thanks to stably high product prices.

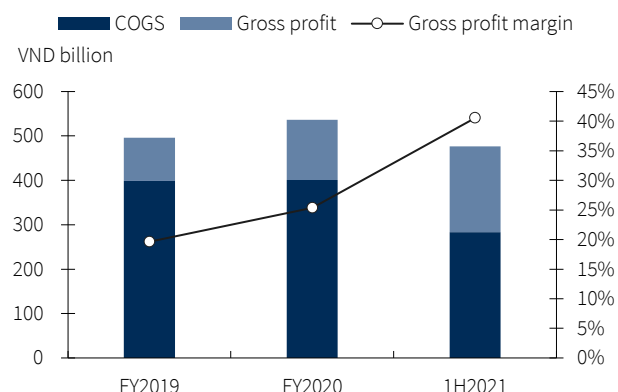
Although the chemical segment of the company accounts for a small proportion of total revenue, GPM has always remained high at 20–25%. With the increase of NH₃ factory capacity from 500 to 540 thousand tons, DPM sold more than 67 thousand tons of NH₃ in 2020 (+15% YoY). With two key products, UFC85 (an important input chemical in urea production) and NH₃, DPM's chemical business is projected to grow at 15% in 2021 and 10% in 2022–2025.

Fig 12. DPM – Import goods trading



Source: PV Fertilizer & Chemicals

Fig 11. DPM – Chemicals segment



Source: PV Fertilizer & Chemicals, Finpro

Cost structure – natural gas price

Input materials cost 44–46% of DPM's current fertilizer business revenue. The gas source for nitrogen fertilizer production is guaranteed by the Government, but the selling prices are based on the market price.

According to the gas supply contract between GAS and DPM in 2015, the fuel gas prices are calculated according to the formula based on the FO price on the world market (Gas price calculation formula: $P = P_n + T_p$).

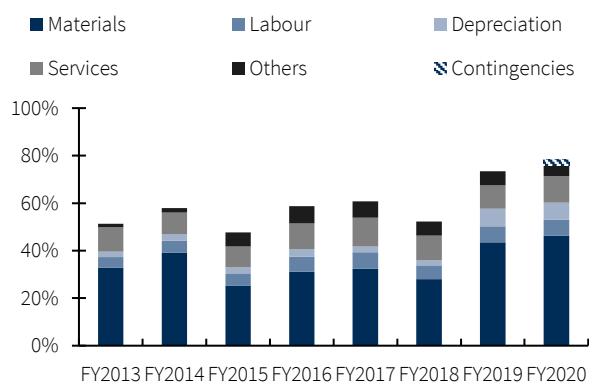
- P is the contract gas price, excluding VAT and expressed in USD/MMBTU;
- $P_n = 46\% * MFO$ is the gas price equivalent to 46% of the average monthly FO price (MFOC) in Singapore market according to Platt's magazine, expressed in USD/MMBTU;
- Average oil price MFOC: The coefficient per ton of FO corresponding to gross heating value (GHV) is 40.60 MMBTU;
- TP is the freight and distribution fee.

It is expected that in 2021, the average FO price will reach USD395/Mt, the converted gas price will reach an average of USD6.57/MMBTU, up 21.4% compared to the 2020 price.

With large and continuous gas demand, DPM cannot store low-priced input gas. This led to negative effects on DPM's profit margin in the context of high oil prices since the beginning of the year.

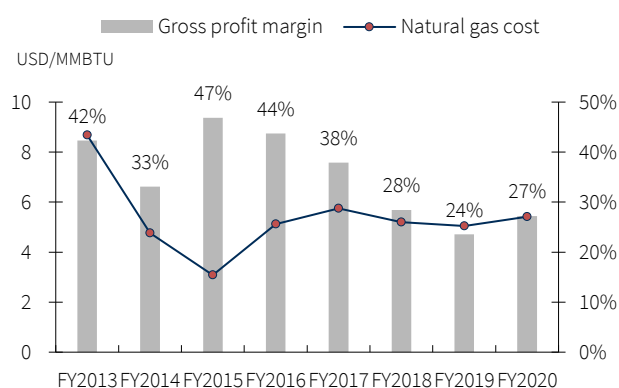
In addition, the proportion of low-priced associated gas sources (Bach Ho – Rong Doi Moi field, in Cuu Long Basin) has a lower capacity than planned and is declining faster than forecast, the proportion of gas supplied from the source (Nam Con Son and other Cuu Long) increased and had high transportation costs, which led to an increase in gas costs.

Fig 14. DPM – Cost structure (%)



Source: PV Fertilizer & Chemicals, Finpro

Fig 15. DPM – Input gas costs and GPM (USD/MMBTU, %)



Source: PV Fertilizer & Chemicals, Finpro

Depreciation expense of Phu My Fertilizer Plant before 2018 only accounted for a small proportion in net revenue (2–3%), and DPM has completed the depreciation in 2018. However, increasing the capacity of NH₃ factory and putting the Phu My NPK factory into operation since 2019 has caused this cost to increase sharply (accounting for 7% of revenue).

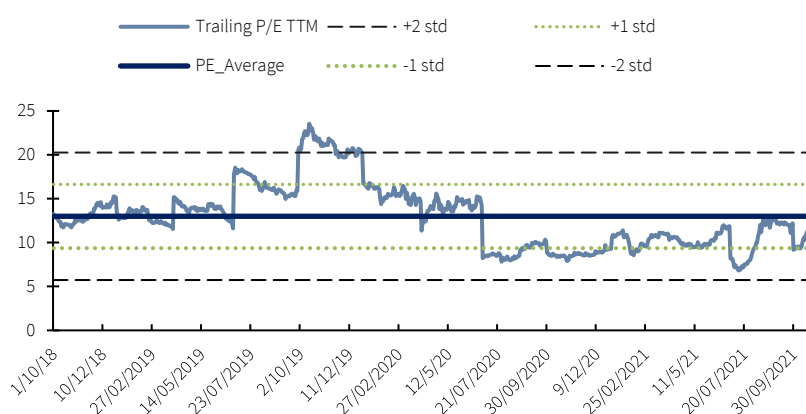
Labor costs have not changed much, maintaining at 6–7% of revenue in the past five years.

Investment catalysts

DPM is the industry leader in terms of the largest nitrogen fertilizer market share in the country. With a strong brand advantage, wide distribution network and a leadership team with many years of experience in the industry, we believe that DPM stock would maintain its attractiveness in the long term.

In terms of valuation, the current price of DPM is VND46,700/share, equivalent to a trailing P/E of 25x, higher than the average in the past three years.

Fig 26. DPM – P/E



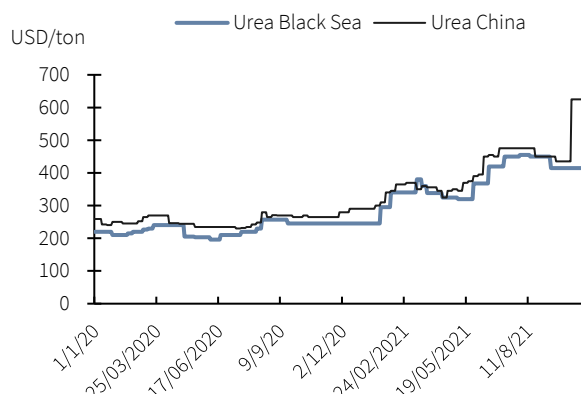
Source: PV Fertilizer & Chemicals, KB Securities Vietnam

Fertilizer prices continue to remain high, benefiting from coal prices

In 2021, increasing oil prices helped urea prices record an impressive growth. Black Sea urea prices increased 69.3% to USD415/ton while China's urea price rose 115.5% to USD625/ton. Using coal instead of natural gas for urea production as in Eastern European and North American countries, China witnessed a sharp increase in the selling price of urea in the first few days of October amid the coal scarcity and energy crisis. Oil prices gained 55–60% since the beginning of the year, and coal export prices of China and Australia rose 67% and 180% respectively. Besides, China's nitrogenous fertilizer producers operate with a much lower profit margin than those producing nitrogenous fertilizers from natural gas (average at 8–9%). Therefore, the pressure from the supply shortage and the sharp increase in coal prices forced fertilizer enterprises to increase their selling prices (USD200/ton higher than the average).

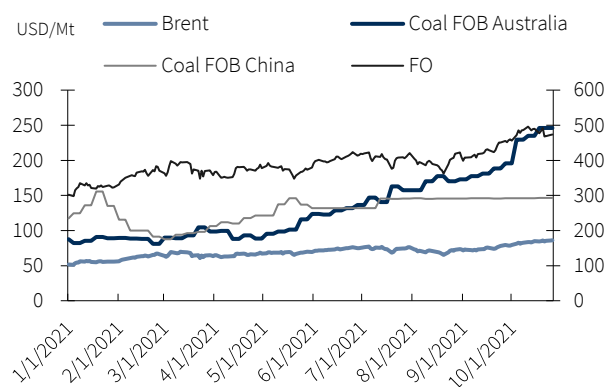
With natural gas as the input material, nitrogenous fertilizer producers like DPM do not have to bear the cost pressure from the increase in coal prices while still benefiting from high selling prices. The prices of urea of conventional units is determined by the formula: **FOB price in large market + r + C**, in which **r** is the domestic regulatory coefficient, **C** is the domestic costs. Currently, the domestic prices of urea are equivalent to the average FOB price of international markets, excluding domestic costs.

Fig 17. Global – Nitrogen fertilizers prices (USD/ton)



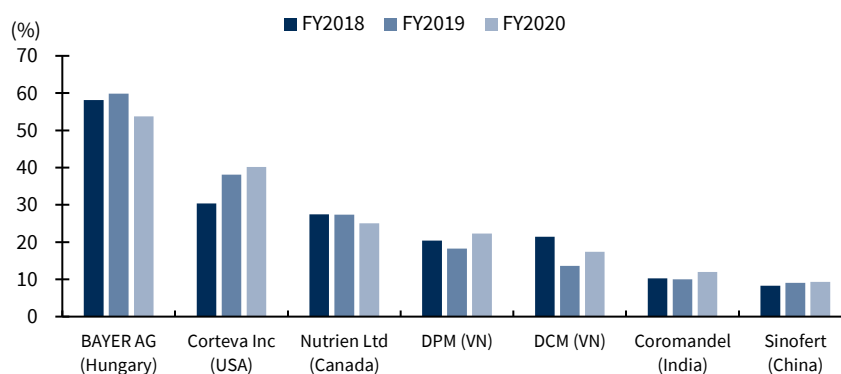
Source: Bloomberg

Fig 18. Global – Input coal and gas prices (USD/million tons)



Source: Bloomberg

Fig 39. Global – GPM of urea fertilizer producers (%)

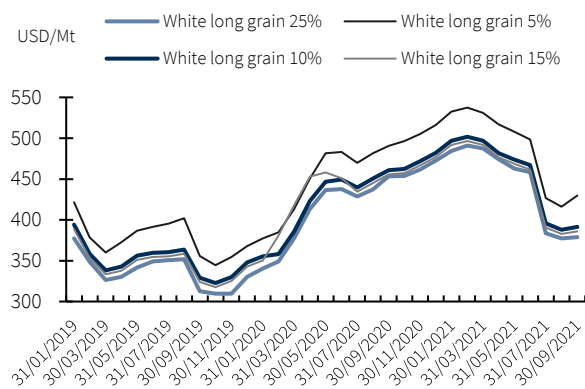


Source: Bloomberg, KB Securities Vietnam

Rice prices show signs of bottoming and recovering

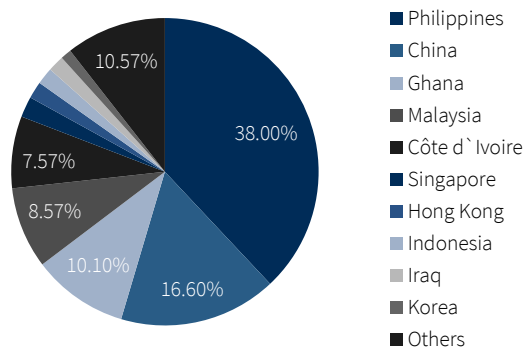
Figure 20 shows that after the impressive growth at the beginning of the year, the FOB price of Vietnam's rice tended to decrease sharply in 3Q. The cause came from the 4th outbreak that caused many southern provinces and cities to fall, prolonged lockdowns and export disruptions. However, the prices of rice showed signs of bottoming and recovering in early 4Q thanks to better domestic demand and export volume to countries such as China, Ghana, Singapore, Bangladesh and Hong Kong. Fertilizer consumption is also expected to improve but not as strongly as in the first half of the year. The reason comes from the seasonal factor of agriculture as fertilizer consumption in 2H21 for the winter-spring crop is only half of that in 1H21. Besides, the Philippines, Vietnam's largest rice importer, actively reduces rice imports when this year's harvest is good. Rice supplies of India, the world's largest rice exporter, also benefited from the good season. These factors are likely to continue to put pressure on rice prices in the near future.

Fig 20. Global – Exported rice prices (USD/million tons)



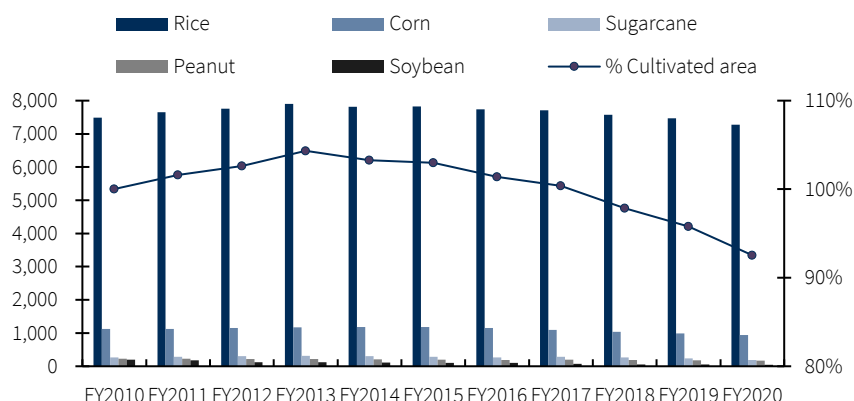
Source: Bloomberg

Fig 21. Global – Market share of urea fertilizer export (%)



Source: KB Securities Vietnam

Fig 22. Vietnam – Cultivation area by plant type (thousand ha)

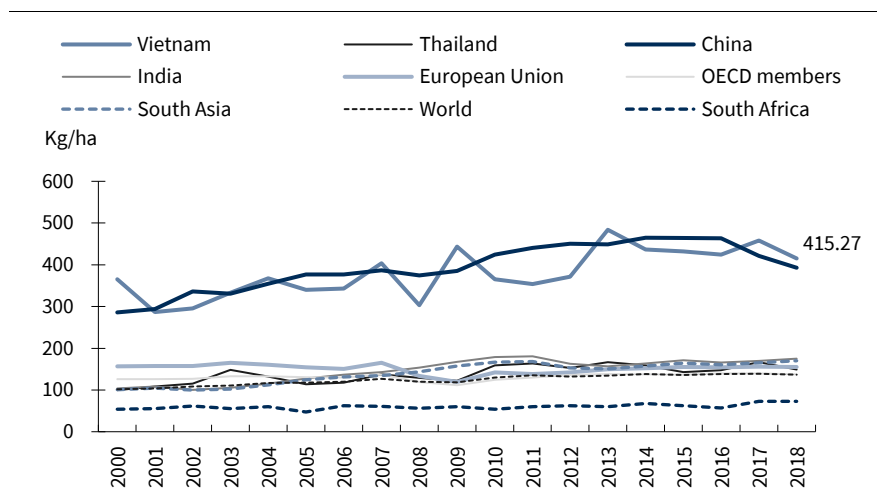


Source: General Statistics Office, KB Securities Vietnam

Vietnam uses fertilizers more efficiently, the chemical NPK segment is the long-term growth driver

According to the General Statistics Office, the rice growing area in Vietnam reached 7.28 million ha in 2020, down 3% compared to 2019, followed by maize with 0.94 million ha and sugarcane with 0.19 million ha. The area of cultivation land in the period 2010–2020 tends to decrease slightly from 9.3 million ha to 8.6 million ha, equivalent to a decrease of 8%. However, the export value of Vietnam's agricultural crops has continuously grown over the years, reaching about USD42 billion in 2020 and USD44 billion in 2021. The reason for this is the focus on agriculture development in the direction of green farming, which would reduce the use of inorganic fertilizers and pesticides and increase the use of organic fertilizers in recent years. Vietnam is one of the top five countries in Asia and the leading country in Southeast Asia in terms of fertilizer consumption per ha of agricultural land. However, the five-year growth rate tends to slow down, and consumption has decreased gradually in recent years (down from 458 kg/ha in 2017 to 415 kg/ha).

Fig 23. The fertilizer consumption per agriculture field ha

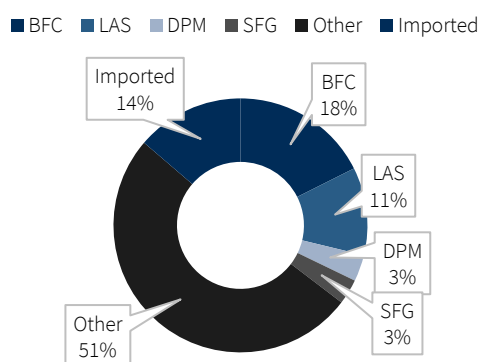


Source: Statista, KBSV

NPK market is diverged, and the demand for high-quality NPK is high

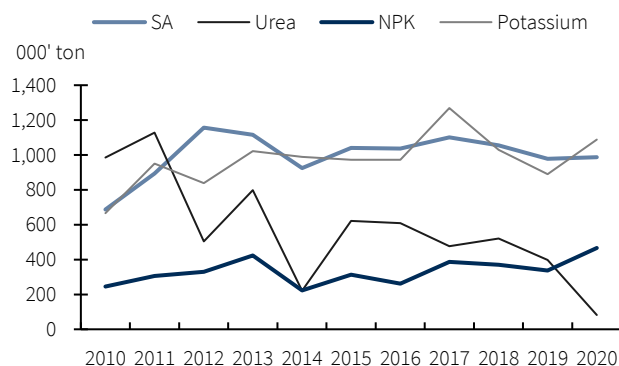
The domestic NPK fertilizer market is diverged and fiercely competitive as leading listed companies such as Binh Dien Fertilizer (BFC), Lam Thao Fertilizers & Chemicals (LAS), and The Southern Fertilizer (SFG) account for just over 36% of the market share. The country's annual demand for fertilizer is about 10 million tons. Of that, NPK accounts for more than 1/3 of consumption demand. While the output of imported urea gradually decreased from more than 1,100 thousand tons to 82 thousand tons in the period 2010–2020. The volume of imported NPK remained high at more than 466 thousand tons. Imported products are mainly high-quality NPK fertilizers from markets such as Russia, China and Korea, showing that the demand for high-grade fertilizers will create opportunities for businesses that have quality products, good brand name and modern production technology like DPM. Following the trend, DPM also aims to make NPK become the second key product by raising Phu My NPK output to 500,000 tons/year by 2025 and 750,000 tons/year by 2030.

Fig 24. Vietnam - NPK market share in 2020 (%)



Source: KB Securities Vietnam

Fig 25. Vietnam - Imported volume of fertilizers (thousand tons)



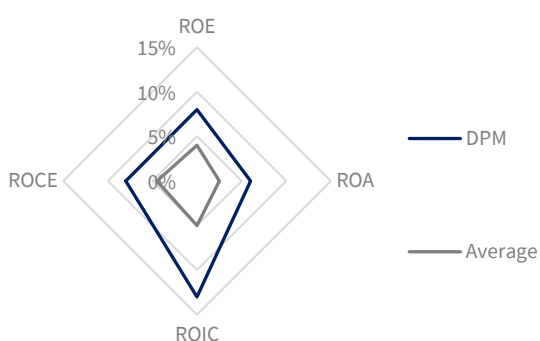
Source: Agrimonitor, KB Securities Vietnam

DPM has healthy financial status, highest ROE in the industry and low leverage

DPM is currently the most profitable company in the industry with ROE of 8% (compared to the industry average of 4%). Although the leverage ratio is among the lowest in the industry (at 1.36x), DPM still maintained its GPM at 23.66%, nearly doubling Ca Mau Fertilizer and tripling the industry average

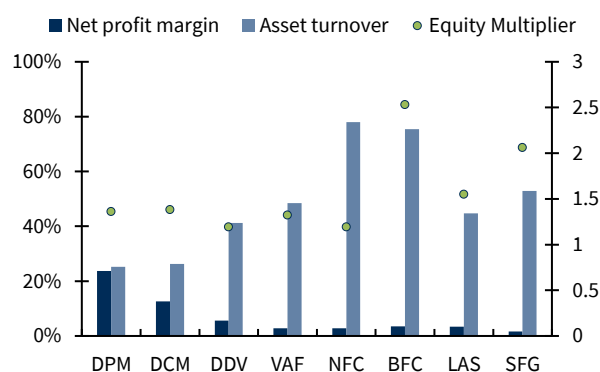
thanks to reducing production costs and taking advantage of low-cost inventory from the beginning of the year. With fertilizer prices remaining high until the end of 2021 and early 2022, we expect DPM's profit margin to continue to improve and reach 28% for the whole year 2021.

Fig 26. DPM – Efficiency data (%)



Source: Fiipro, KB Securities Vietnam

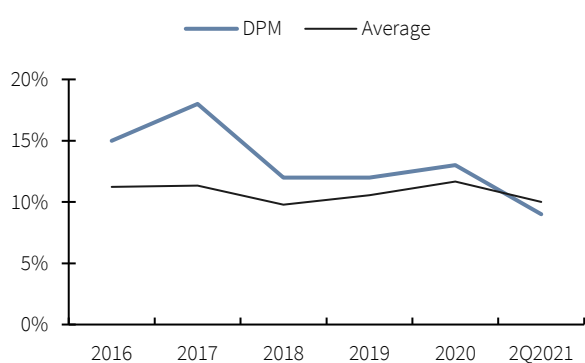
Fig 27. Vietnam fertilizer producers – Dupont analysis



Source: Fiipro, KB Securities Vietnam

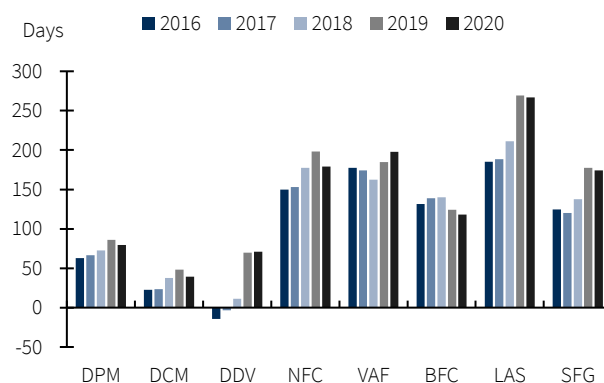
DPM has the lowest number of days of receivables among listed fertilizer companies (14.81 days) and ranked second among the companies with shortest cash conversion cycle. DPM's SG&A expenses also improved in 2Q21, down 6% YoY to 9% of total revenue, which is 1% lower than the industry average.

Fig 28. DPM – SG&A expenses (%)



Source: Fiipro, KB Securities Vietnam

Fig 29. DPM – Cash conversion cycle (day)



Source: Fiipro, KB Securities Vietnam

Tax policy changes may help DPM reduce production costs by more than VND360 billion

After the National Assembly passed Law No. 71/2014/QH13 on amending the VAT Law in November 2014, fertilizers were free of tax instead of being subject to 5% VAT as before. The policy change has caused the production costs of fertilizer enterprises to increase, negatively affecting the competitive advantages of domestic products and profit margins of fertilizer producers. At the June 2018 meeting, the Ministry of Finance confirmed that the classification of fertilizers into the group subjecting to 5% VAT. However, the draft amendment to the tax law has not been approved. We believe that the Government will continue to submit the draft resolution to the National Assembly in the upcoming November session.

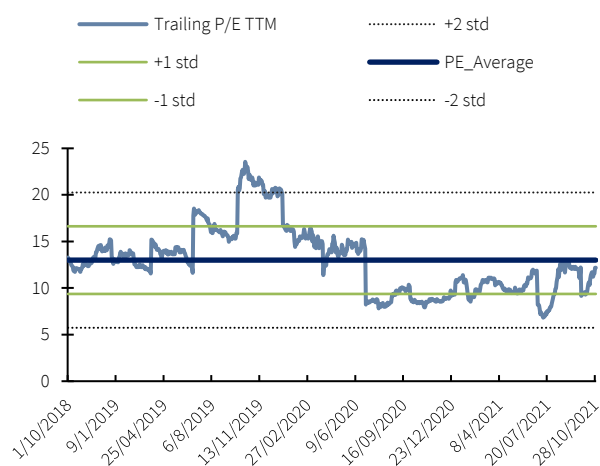
Forecast & valuation

We made forecasts for DPM's 2021 business results, assuming that nitrogen and NPK fertilizer prices increase by 46% and 36% respectively compared to 2020. Nitrogen fertilizer trading volume is expected to decrease 5% to 785 thousand tons due to routine machine maintenance. NPK output should grow by 40%, similar to the increase in 3Q.

In terms of cost, we assume the average FO oil price in 2021 in the Singapore market is USD395/Mt. Accordingly, input gas price is expected to increase 21% to USD6.57/MMBTU.

In case fertilizer prices outpaced input costs, DPM's GPM will also improve significantly from 22% in 2020 to 28% in 2021. Along with the recognition of real estate revenue of VND392 billion, NPAT of the parent company should gain 139% to VND1,654 billion, equivalent to EPS of VND3,377/share.

Fig 28. P/E ratio



Source: Fiinpro, KB Securities Vietnam

Fig 29. DPM – Forecast

	2020	2021F	% change
Quantity of urea (thousand ton)	827	785	-5%
Urea price (VND/kg)	6,170	9,000	46%
Quantity of NPK (thousand ton)	95	132	40%
NPK price (VND/kg)	7,330	10,000	36%
FO price (USD/Mt)	301.93	395.00	31%
Input cost (USD/MMBTU)	5.41	6.57	21%
Net revenue (VND billion)	7,762	10,662	37%
Gross profit (VND billion)	1,730	2,937	70%
NPAT-MI (VND billion)	691	1,654	139%
EPS (VND)	1,535	3,377	120%

Source: Fiinpro, KB Securities Vietnam

Using DCF and P/E comparison methods (at the ratio of 50:50), we recommend BUY for DPM shares with the target price of VND54,900/share, 19% higher than the closing price on November 19, 2021.

DPM stock is currently trading at a forward 2021 P/E of 12.3x. With long-term growth potential, we expect a reasonable P/E for DPM at the end of 2021 to reach 13x, commensurate with the growth of an industry-leading fertilizer enterprise.

Fig 28. DPM – P/E ratio

Risk free rate	2.6%
Risk premium	9.9%
Beta	0.81
Growth rate	2.2%
WACC	10.66%

Source: Fiipro, KB Securities Vietnam

Fig 29. DPM – Forecast

Method	Weight	Outcomes
DCF	50%	54,810
P/E	50%	54,950
Target Price	100%	54,900

Source: Fiipro, KB Securities Vietnam

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Investment ratings & definitions

Investment Ratings for Stocks

(based on expectations for absolute price gains over the next 6 months)

Buy:	Hold:	Sell:
+15% or more	+15% to -15%	-15% or more

Investment Ratings for Sectors

(based on expectations for absolute price gains over the next 6 months)

Positive:	Neutral:	Negative:
Outperform the market	Perform in line with the market	Underperform the market

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