

July 26, 2022

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**Net revenue reached VND1,577 billion in 2021, equivalent to the pre-pandemic level**

Thanks to the post-pandemic recovery of industrial production, especially the manufacturing and processing industry, the production and business activities of South Basic Chemicals (CSV) gradually bounced back and returned to growth orbit. In 2021, CSV's net revenue was VND1,577 billion (+18% YoY), equivalent to the pre-pandemic level. NPAT also expanded by 21.1% YoY to VND218 billion.

**NPAT in 2022 is expected at VND345 billion (+58% YoY) with the improvement of core businesses**

Core businesses continued to show improvements thanks to sharp increases in inorganic chemicals prices, helping CSV's NPAT in the first quarter touch VND112.3 billion (+3x YoY). CSV has now delivered 28% and 55% of its targets for revenue earnings in 2022. We estimate CSV's NPAT and net revenue this year to be VND345 billion (+58% YoY) and VND1,814 billion (+15.1% YoY), respectively.

**Yellow phosphorus sales this year should grow 19.2% YoY, assuming high selling prices until the end of 2022**

Phosphorus prices jumped by 30% YTD and 2.3 times compared to the pre-pandemic levels, boosting the subsidiary's revenue in the first quarter to VND149 billion (+3x YoY), the highest recorded over the past five years. Assuming that the average price of yellow phosphorus (P<sub>4</sub>) in 2022 remains around VND120–125 million/ton, CSV's P<sub>4</sub> sales should reach VND537.5 billion, up 19.2% YoY.

**We recommend HOLD for CSV stock with a target price of VND48,300**

Based on the business outlook, valuation results, and possible risks, we recommend HOLD for CSV stocks. The target price is VND48,300/share, 12.32% higher than the closing price on July 15, 2022.

## Hold

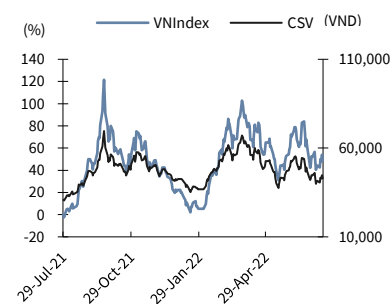
<b>Target price</b>	<b>VND48,300</b>
Upside/Downside	12.32
Current price (Jul 15, 2022)	VND 43,000
Market cap (VNDbn)	2,136

<b>Trading data</b>	
Free float	35%
3M avg trading value (VNDbn)	45.55
Foreign ownership	1.59%
Major shareholder	VinaChem (65%)

<b>Share price performance</b>				
(%)	<b>1M</b>	<b>3M</b>	<b>6M</b>	<b>12M</b>
<b>Absolute</b>	-1	-24	11	69
<b>Relative</b>	7	-2	33	82

### Forecast earnings & valuation

FY-end	2019A	2020A	2021A	2022F
Net revenue (VNDbn)	1,566	1,339	1,577	1,814
EBIT (VNDbn)	326	238	278	435
NPATMI (VNDbn)	246	179	209	289
EPS (VND)	5,028	3,636	4,299	6,544
EPS growth (%)		-28%	18%	52%
P/E (x)	9.6	13.3	11.2	7.4
EV/EBITDA	2.12	4.20	5.74	3.22
P/B (x)	2.3	2.1	1.8	1.5
ROE (%)	26%	18%	19%	22%
Dividend yield (%)	31%	20%	10%	15%



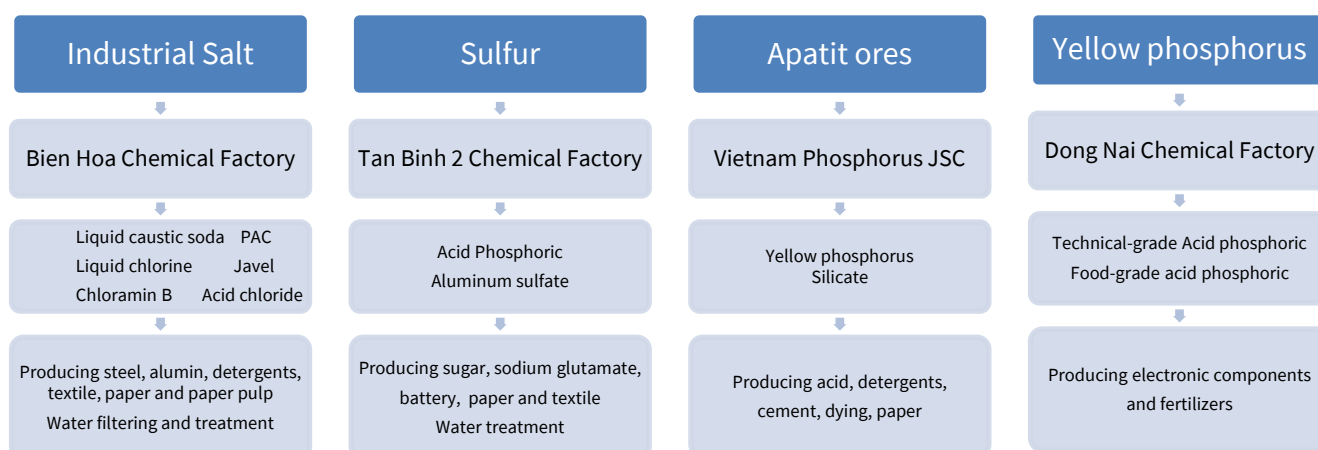
Source: Bloomberg, KB Securities Vietnam

## Production & business activities

As one of the largest inorganic chemical manufacturers in Vietnam, CSV has been running three chemical factories in Bien Hoa 1 Industrial Park, Dong Nai Province. Specifically, Bien Hoa Chemical Factory specializes in the production of caustic soda and chlorine-based products, Tan Binh 2 Chemical Factory specializes in sulfuric acid  $H_2SO_4$  and aluminum sulfate, and Dong Nai Chemical Factory specializes in phosphoric acid ( $H_3PO_4$ ) products.

Besides, CSV owns 65% capital of Vietnam Phosphorus Joint Stock Company, specializing in exploring apatite ore to produce  $P_4$  for Dong Nai Chemical Factory as well as export to regional countries. The company's chemical products are mainly supplied to the southern market and domestic industries such as steel production, textile dyeing, detergents, battery & accumulator production, sewage treatment and disinfection.

Fig 1. CSV – Value chain



Source: South Basic Chemicals, KB Securities Vietnam

### CSV's revenue and NPAT in 2021 increased by 18% YoY and 21% YoY, respectively

In terms of business results, the company's net revenue in 2021 reached VND1,577 billion, up 18% YoY and exceeding the full-year plan by 10%. Gross profit margin was down slightly by 1.1% YoY to 26.1% in 2021. The unprecedented supply chain disruption caused by COVID-19 sent freight rates and input material prices spiraling. Having said that, CSV's NPAT in 2021 still grew by 21.1% YoY to VND218 billion, with the major contribution of  $P_4$  sales of Vietnam Phosphorus Joint Stock Company (VND25 billion in 1Q22 vs. VND4.5 billion in 1Q21).

**CSV's 1Q22 earnings reached VND112.3 billion, fulfilling 55% of the whole year plan thanks to the yellow phosphorus segment**

At the FY22 Annual General Meeting, CSV announced relatively positive business results in 1Q22 with net revenue of VND482.5 billion (+63.38% YoY). Sharp increases in selling prices of various products, notably H<sub>2</sub>SO<sub>4</sub> (+137% YoY), H<sub>3</sub>PO<sub>4</sub> (+99% YoY), P<sub>4</sub> (+112% YoY), liquid caustic soda (+74% YoY), ... offset surging raw materials costs. Therefore, CSV's NPAT in 1Q22 was triple YoY to VND112.3 billion. CSV has delivered 28% and 55% of the full-year plan for revenue and earnings, respectively. The yellow phosphorus segment continued to be the major momentum generator for CSV's profit growth as input material costs only jumped by 27.8% YoY, much lower than the increase in selling prices of finished products.

## Investment catalysts

### 1. Core business improved on post-Covid industrial production recovery

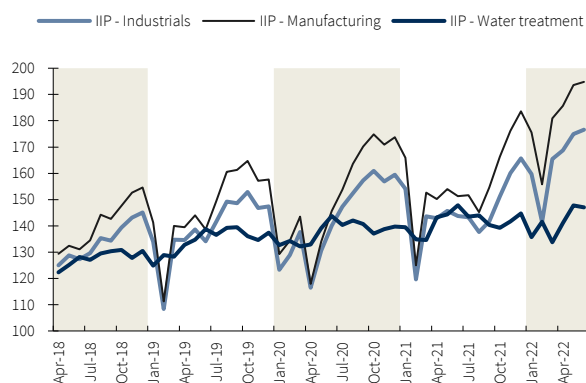
**CSV's production and business activities are associated with industrial production activities of Vietnam**

CSV manufactures and distributes a wide range of chemicals as inputs for numerous industries. Therefore, macroeconomic conditions will directly impact the company's production and business activities. It can be clearly seen that when Vietnam's index of industrial production (IIP) over the courses of 2Q20, 2Q21, and 3Q21 slumped sharply under the adverse impacts of the COVID-19 pandemic, CSV's revenue and profit margin also fell off to eight-year lows.

**The recovery of industrial production lifted revenue in 1Q22**

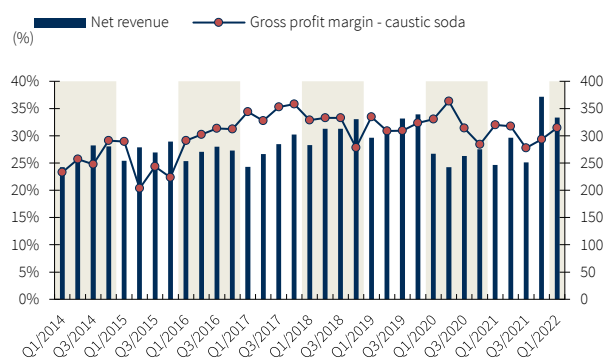
The post-pandemic recovery of industrial production has helped CSV's core business, chemical manufacturing, and distribution, gradually return to its growth orbit. The IIP in 4M22 was estimated to rise by 7.5% YoY. Specifically, the processing and manufacturing industry posted industrial output growth of 8.3% in 4M22 and 11.3% in April alone (higher than that of the pre-pandemic period of 2018-2019). Figure 3 shows that revenue in the low season of 1Q22 still hit VND333 billion, up 12% compared to the pre-pandemic levels and equal to the annual peak of the fourth quarter. Improved economic conditions supported the demand for chemicals in industry, agriculture, and consumer goods sectors and thus boosted CSV's production and business activities.

Fig 2. Vietnam - IIP



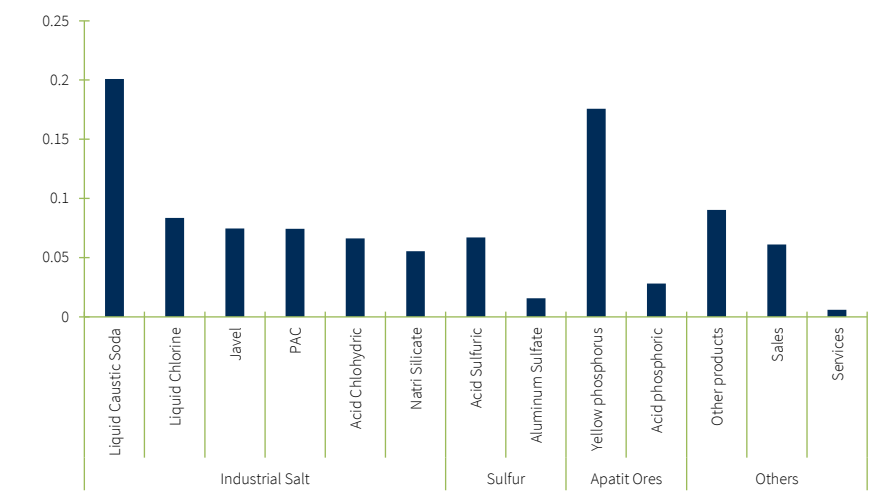
Source: General Statistics Office, KB Securities Vietnam

Fig 3. CSV - Net sales, gross profit margin (VNDbn, %)



Source: South Basic Chemicals, KB Securities Vietnam

Fig 4. CSV – Revenue breakdown based on different input materials (%)



Source: KB Securities Vietnam

Based on input materials, the final products of CSV are categorized as follows:

The **caustic soda-chlorine** segment provides inputs to manufacture alumina, textile, pulp & paper, and detergents. It is the core business of CSV, contributing more than 50% to total revenue. CSV produces caustic soda solutions mixed at 25%, 32%, 40%, 50% to satisfy different needs.

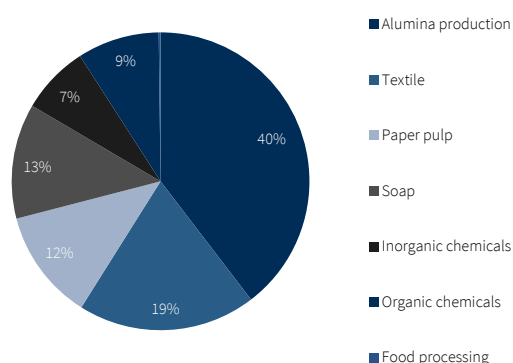
**The rise in caustic soda prices was driven by the Covid-19 pandemic in China and the Russia-Ukraine conflict**

The selling prices of liquid caustic soda 32% in the Chinese market have advanced by 22% since early 2022 to USD188.2/ton. The resurgence of the Covid-19 pandemic has spurred demand for downstream products of caustic soda, namely detergents and soaps. Additionally, the disrupted gas supply chain due to the Russia-Ukraine war has exacerbated the energy crisis in many countries from the end of 2021. The surge in electricity prices forced caustic soda producers around the world to raise selling prices. Although there have been signs of coming down on better pandemic control, the caustic soda price is currently still 57% higher than the 2021 average.

**The difficulties in looking for target customers for chlorine-based products would undermine the growth of the caustic soda-chlorine segment**

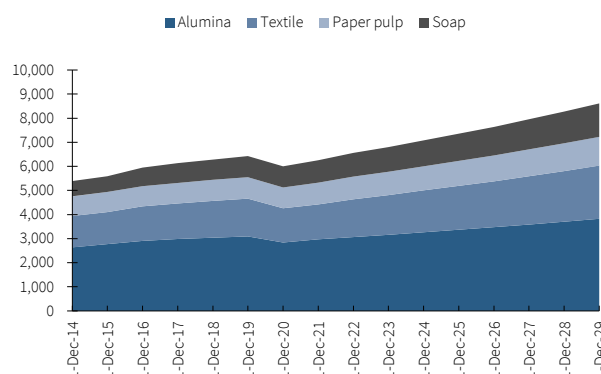
CSV and other large-scale caustic soda producers in Vietnam like Vedan Enterprise Corporation, Viet Tri Chemical JSC, Dong A JSC, etc provide nearly 60% of domestic consumption, with a combined design capacity of 200,000 tons/year. Tecnon OrbiChem estimates that the demand for caustic soda in Southeast Asia, including Vietnam, will continue to grow by 4% per annum in the 2022-2025 period on the sound prospects for growth of industrial production. Although there is still a lot of room for growth, domestic enterprises are somewhat reluctant to expand caustic soda production capacity due to difficulties in looking for target customers for chlorine-based products. Data from the International Trade Centre (ITC) show that Vietnam has to import an average of 150,000 tons of liquid caustic soda and 60,000 tons of solid soda each year from countries such as China, Korea, Japan, etc. Therefore, domestic caustic soda prices are often affected by these markets.

**Fig 5. Global – Proportion of caustic soda consumption based on finished product**



Source: KB Securities Vietnam

**Fig 6. Global – Caustic soda consumption based on finished product (tons)**



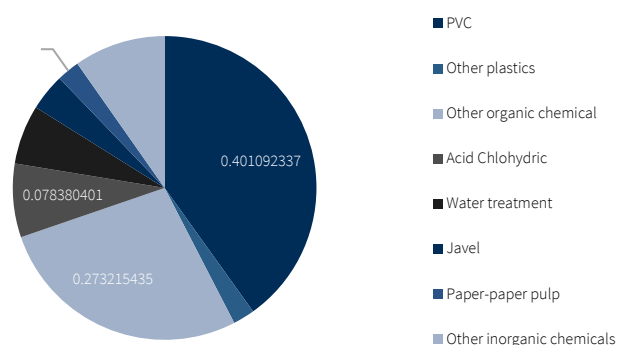
Source: Tecnon Orbichem

**PVC production in Vietnam did not accommodate domestic demand, thus hindering the consumption of chlorine-based products**

CSV's main chlorine-based products include hydrochloric acid, liquid chlorine, Javen, and PAC, contributing an average of 7–8% of net sales/product/year. These chemicals are used mainly in steel making, electronic component production, detergent manufacturing, and water treatment. The consumption of these items should keep growing by 2.4% per year during 2022–2025, and PAC and Javen would enjoy the highest growth at 3.5%/year and 2.9%/year respectively.

Chlorine is primarily used in PVC production, with more than 30 million tons or 40% of global chlorine consumed in 2021. In Vietnam, plastic beads production of upstream enterprises has not accommodated domestic demand. For 2016–2020, Vietnam had to import an average of 380 thousand tons of PVC plastic beads annually from Taiwan, Japan, China, and Thailand. Production capacity has not seen any improvements in recent years due to low investment hindering the consumption of chlorine-based products by caustic soda producers. To date, Duc Giang Chemicals Group (DGC) is the only unit developing a large-scale PVC production project named Duc Giang – Nghi Son Chemical Complex with a capacity of 150,000 tons of PVC per year.

**Fig 7. Global – Proportion of chlorine consumption based on finished products (%)**

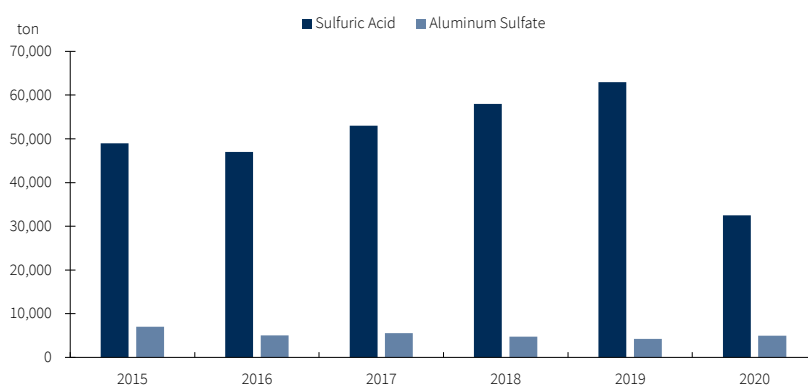


Source: Bloomberg, KB Securities Vietnam

The growth potential of H<sub>2</sub>SO<sub>4</sub> is subdued while aluminum alum is gradually being replaced by PAC

The **sulfate** segment includes two main products, H<sub>2</sub>SO<sub>4</sub> and aluminum sulfate, contributing 6.5% and 1.6% to CSV's total revenue respectively. Domestic sulfur market was depressed as its regular customers are long-term partners with stable consumption demand. Major consumers of H<sub>2</sub>SO<sub>4</sub> are subsidiaries of Vietnam National Chemical Group, namely Southern Battery Joint Stock Corporation, Southern Fertilizer JSC, DAP-Vinachem JSC, to name a few. Aluminum sulfate sales were depressed due to the shift from using aluminum sulfate to PAC for water treatment. Thanks to lower cost and stronger flocculation, PAC consumption rose by 10%/year during 2016–2020 while aluminum sulfate consumption shrank by 6.63%/year to 5,000 tons in 2020.

Fig 8. CSV – H<sub>2</sub>SO<sub>4</sub> and aluminium sulfate consumption (tons)



Source: South Basic Chemicals, KB Securities Vietnam

## 2. Surging selling prices offset the rise in material costs and profit margin

**Material cost:** accounts for the largest share or 45% of CSV's production costs. The primary input materials are industrial salt, apatite ore, white sand, yellow phosphorus, and sulfur.

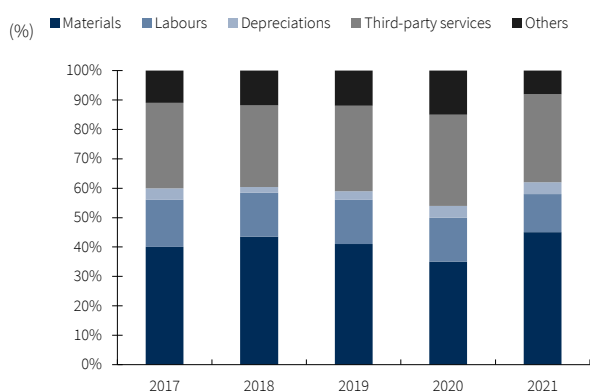
CSV had to import most of its industrial salt from India with an out-of-quota levy of 50%

– **Industrial salt:** Domestic demand for salt ranges from 1.5 to 1.6 million tons annually. Despite the great potential for production and a large amount of salt amassed among salt farmers, Vietnam still has to import more than 600 thousand tons/year. It was attributable to the deficiencies in salt production and processing like conventional hand-harvesting methods, small-scale and scattered production, heavy dependence on weather patterns, and ineffective application of scientific advances. As per Circular No. 24/2021/TT-BCT, the tariff quota-based import of salt in 2022 is 80,000 tons. CSV uses between 58,000 and 60,000 tons of salt every year. Since the quota allocated to CSV is only 20,000 tons/year, it had to import the remaining salt from India with an out-of-quota levy of 50%. Industrial salt production is energy-intensive because the treatment of brine obtained from salt mines needs to be done through vacuum boilers. Rising crude oil and coal prices have pushed wholesale electricity prices in India to their decade-highs (Figure 10). Consequently, industrial salt imports experienced a sharp increase in the first quarter (+79% YoY).

**A surge in H<sub>2</sub>SO<sub>4</sub> price since the start of 2022 could mitigate the negative impact of the sulfur price increase on gross profit margin**

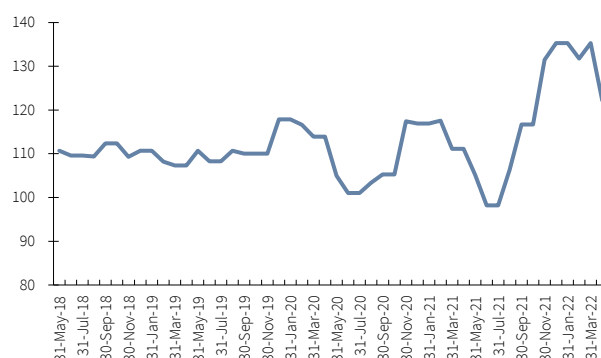
– **Sulfur:** Every year, CSV imports an average of 20,000 tons of sulfur to produce H<sub>2</sub>SO<sub>4</sub> and aluminum sulfate. Sulfur prices in China have climbed 72.1% since the start of 2022, similar to the movement of global oil prices (Figure 11). However, we believe that the increase in sulfur price will have little impact on CSV's profit margin because: (1) Sulfur sales only contribute a small proportion to total revenue and (2) a sharp rise in the selling price of H<sub>2</sub>SO<sub>4</sub> (+137% YoY) made up for additional costs.

**Fig 9. CSV – Production cost breakdown (%)**



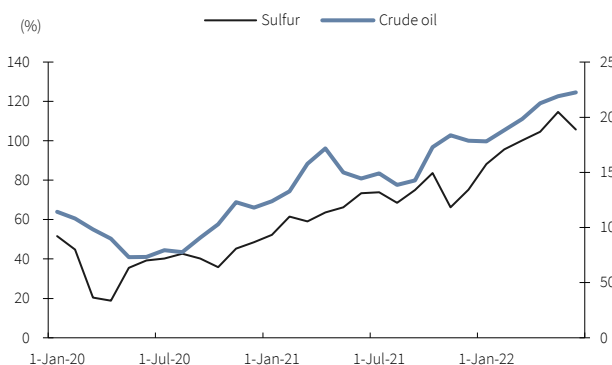
Source: South Basic Chemicals

**Fig 10. India – Wholesale price index of electricity**



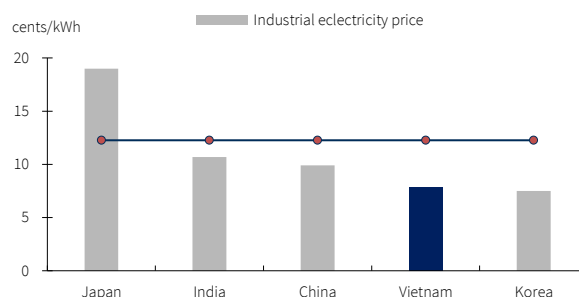
Source: Bloomberg

**Fig 11. Global – Sulfur and crude oil prices (USD/ton, USD/bbl)**



Source: Bloomberg

**Fig 12. Asia – Wholesale price of electricity (cents/kWh)**



Source: Global Petrol Price, KB Securities Vietnam

**Depreciation expense:** CSV currently operates five electrolytic cells DD350 and BM2.7 using ion exchange membranes, with a combined capacity of 50,000 tons/year. BM2.7, thanks to the automatic operation system, saves energy better than DD350 that CSV put into operation in late 2021. The remaining machinery and equipment have mostly been depreciated, so depreciation expense only takes a small proportion of the cost structure.



**Electricity cost:** accounts for 30% of the production cost of CSV, mainly from the electrolysis of industrial salt and synthesis of  $P_4$  in electric furnaces. Thanks to wholesale electricity prices lower than other Asian countries' average, CSV's caustic soda and yellow phosphorus prices are lower than those imported from Japan, China, and Korea (Figure 12). Besides, despite spiraling prices of primary fuels like coal and petroleum in recent years, Vietnam Electricity (EVN) has committed not to increase electricity prices this year, helping CSV save costs substantially. In our estimates, a 5% increase in the average electricity price can reduce CSV's earnings by VND7–8 billion.

### 3. Phosphorus price surge should drive growth

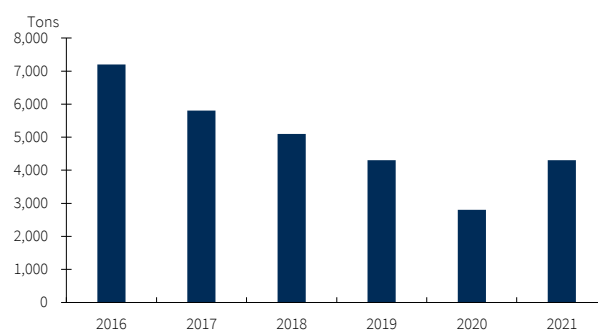
**CSV runs a yellow phosphorus plant up to 8,000 tons/year, mainly exported to Japan and India**

CSV's phosphorus segment comprises two main products,  $P_4$  and  $H_3PO_4$ , accounting for 20% of CSV's total sales. Vietnam Phosphorus JSC, CSV's subsidiary, principally exploits apatite ore to produce  $P_4$  with a design capacity of 8,000 tons/year. However, due to equipment and machinery deterioration after a long time in operation,  $P_4$  sales have declined over the years due to losing a competitive edge (Figure 13). In particular, more than 90% of  $P_4$  production output is destined to Japan and India, and the rest is sold to Dong Nai Chemicals Plant to produce phosphoric acid and other phosphate-based products.

**CSV's annual consumption of phosphoric acid remains low**

There are two popular methods of phosphoric acid production: extraction from apatite ore and burning  $P_4$ . The Dong Nai Chemicals Plant applies the latter with two production lines manufacturing 7,000 tons of technical grade  $H_3PO_4$  and 3,000 tons of food grade  $H_3PO_4$  per year. Phosphoric acid is used predominantly as an anti-oxidant in beverages, a flavor additive for sharp taste in food, and an acid catalyst in water treatment, metal cleaning, and detergent formulations. The annual consumption of this product is relatively low at only 1,700 tons on average, equaling 17% of the total capacity.

**Fig 13. CSV – Yellow phosphorus ( $P_4$ ) sales (tons)**



Source: KB Securities Vietnam

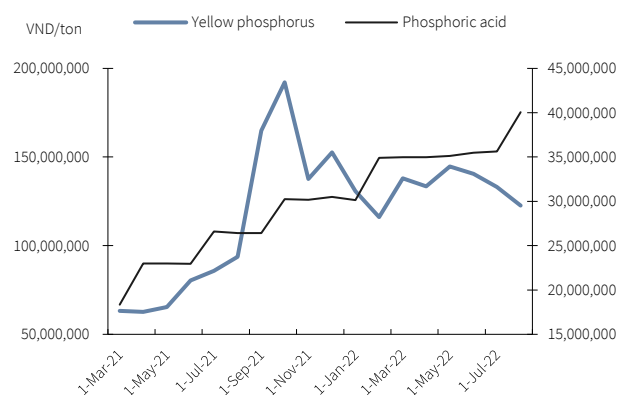
### Yellow phosphorus prices continue to increase 30% YoY due to prolonged supply chain chaos

The global supply of yellow phosphorus ( $P_4$ ) and phosphoric acid was hit by the shutdown of many phosphorus plants and the fertilizer export ban of the Chinese government. Besides, Russia's war in Ukraine aggravated the supply deficiency in the wake of the consistently increasing demand for fertilizers and semiconductors. The yellow phosphorus price at the end of May was VND140 million/ton, 30% higher than the 2021 average and 2.3 times higher than the pre-pandemic level. It is forecast to remain at VND120–125 million/ton thanks to (1) favorable weather conditions that promote fertilizer consumption, including DAP and MAP, (2) rising consumption of semiconductor's input material which is phosphoric acid (produced from yellow phosphorus) thanks to global chip shortages, and (3) the shift from electric vehicle battery production to lithium iron phosphate (LFP) battery production.

### The yellow phosphorus segment's revenue and gross margin reached five-year highs

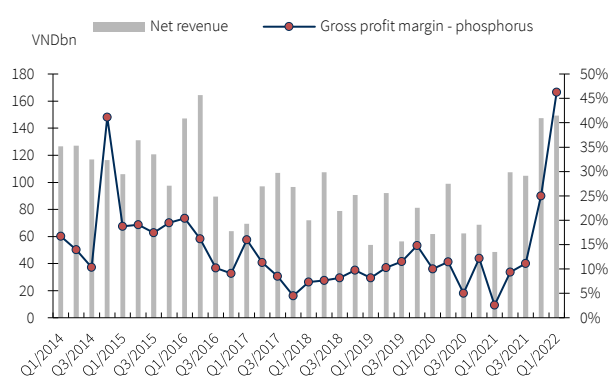
CSV's gross profit margin of the yellow phosphorus segment in the past five years has ranged around 5–10%, far below that of the industry-leading enterprise DGC at an average of 17% before 2021. A marked increase in its selling prices helped CSV's profit margin improve substantially from 3% in 1Q21 to 46% in 1Q22. Net revenue also tripled to VND149 billion, the highest in the last five years (Figure 15).

Fig 14. Global -  $P_4$  and  $H_3PO_4$  price performance (VND/ton)



Source: Bloomberg

Fig 15. CSV - Net sales, gross margin of  $P_4$  segment



Source: South Basic Chemicals

## Risks

CSV's three main chemical plants in Bien Hoa 1 Industrial Park are subject to compulsory relocation in the 2024–2025 period. CSV signed a consulting agreement to prepare a Feasibility Study Report last December. The project will be licensed and implemented from 2023 with an estimated investment capital of VND2,100 billion.

The relocation in the early stage will hurt core businesses of CSV in terms of revenue and profit.

India produces nearly 30 million tons of salt each year, of which 12.5 million tons are used in industrial production, 7.5 million tons are for domestic consumption, and the rest is for export. Adverse weather made salt harvesting in late June and early July behind schedule. Therefore, salt production output is set to decrease by nearly 30% or 9 million tons, posing a risk of an export ban on salt along with other commodities such as sugar and wheat in the foreseeable future.

The price of yellow phosphorus should come down soon when China removes export bans as scheduled from October 2021 prompt.

## Forecast

We assume the price of liquid caustic soda solution 100% is VND12 million/ton and H<sub>2</sub>SO<sub>4</sub> is sold at VND3.8 million/ton. Accordingly, sales volume of inorganic chemicals in 2022–2023 will slowly recover to the pre-pandemic levels before falling off due to the relocation of three chemical plants. Net revenue in 2022 should grow by 15.14% YoY to VND1,814 billion.

The company's main inputs such as industrial salt and sulfur are all imported in light of supply shortages and high transportation costs. Therefore, in the base scenario, we assume CSV's gross margin of caustic soda and sulfate segments will continue to stay flat YoY at 30%.

As for the yellow phosphorus segment, inputs such as apatite ore and white sand are all exploited domestically with negligible cost increases (+27.8% YoY). Meanwhile, the selling price of yellow phosphorus is beneficial from the general uptrend as most of the production output is exported to regional countries. As a result, the gross margin of the yellow phosphorus segment is expected to improve from 15% in 2021 to 38% in 2022.

**Table 1. CSV – 2022F business results**

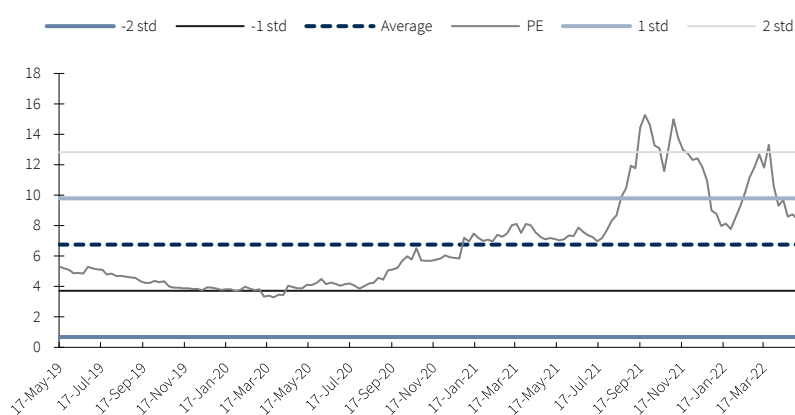
Unit: VNDbn	2021A	2022F	%YoY
Net revenue	1,576.77	1,814.00	+15.14%
COGS	(1,164.76)	(1,227.90)	
Gross profit margin	412.01	586.10	+42.25%
Selling expense	(79.11)	(90.70)	
Administration expense	(66.23)	(76.19)	
Operating profits	266.67	419.22	
Financial income	12.39	14.51	
Financial expense	(6.36)	(3.63)	
- Interest expense	(5.11)	(2.72)	-46.77%
Profit before tax	272.86	432.09	
Income tax	(57.53)	(86.42)	
Net profit after tax	218.05	345.68	+58.53%
Minority interest	8.79	56.44	
NPAT-MI	209.26	289.24	+38.22%
Earnings per share (VND)	4,299.00	6,543.80	

Source: KB Securities Vietnam

## Valuation

Based on the FCFF (free cash flow to the firm) and P/E valuation methods with a ratio of 50:50, business prospects, and possible risks, we recommend HOLD for CSV stocks. The target price is VND48,300/share, equivalent to a total return of 12.32% compared to the closing price on July 15, 2022. CSV stocks are currently trading at a 2022 forward P/E of 6.57x. Considering the company's long-term growth potential, we give CSV a reasonable end-2022 P/E of 7.0x.

Fig 16. CSV – P/E performance (x)



Source: Bloomberg

Table 2. CSV – Target price according to DCF valuation method (VND/share)

Beta	1.05	FCFF current value	1,754
Risk-free rate	3.10%	(+) Cash and financial investment	804
Market risk premium	7.80%	(-) Short-term and long-term debt	194
Cost of equity	11.29%	(-) Minority interest	91
Cost of debt	5.00%	Owner Equity value	2,273
WACC	9.65%	Outstanding shares	44,200,000
		Intrinsic value	50,800

Source: KB Securities Vietnam

Table 3. CSV – Target price according to valuation methods (VND/share)

Valuation method	Weight	Weighted price
DCF (FCFF)	50%	50,800
P/E	50%	45,800
Target price		48,300
Current price (July 15, 2022)		43,000
Total return		12.32%

Source: KB Securities Vietnam



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## Investment ratings & definitions

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### 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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