September, 2017

KIDO FOODS JSC (UPCOM:KDF)

An Attractive Business Model

Kido Frozen Foods JSC (Upcom:KDF) is the market leader in manufacturing and distributing ice creams in Vietnam. The competency of KDF is ascribed to its manufacturing process, modern technology, large scale distributing system and experience in understanding and meeting the taste of consumers. Its prospects comes from the growing breadth of the ice cream industry which is correlates with the economic growth and the improved income per capita. In 2016, KDF completed the new plant in Bac Ninh province, aiming at augmenting the efficiency of selling and distribution in northern Vietnam. Concurrently, based on its distinguished competence in the frozen products distribution system, KDF aspired to expand its business model by spearheading the manufacturing of a new product: dumpling. However, we think the ambition to become a "King" in frozen foods industry needs time to reach the tipping point in growing its operating efficiency. Based on the business results in nine months of 2017, RongViet Research estimates the company's revenue and NPAT at around VND1,633 billion (+16.9% YoY) and VND168 billion (+17.9% YoY), equivalent to EPS of VND2,852, PE forward ~21.0x. In terms of valuation, we use two methodologies (DCF and PE) to evaluate the intrinsic value of KDF at **VND68,000 per share***, with an upside of 13% compared to its listing price of VND60,000 as of 28 September 2017. Therefore, we recommend* **NEUTRAL** *on this stock despite that KDF has a very attractive business model in the F&B industry.*

Investment Rationale

- The nation-wide frozen products distribution system is the sustainable competitive advantage.
- The market leader in the ice cream industry.
- Proven efficiency in strategies of product lines.
- Taking advantage of its own competence to horizontally expand to frozen foods.

Risk

- Slower GDP growth would impact on the demand of ice cream products.
- Competitiveness in the ice cream industry is getting intense.
- Customer behavior in the frozen food would change slower than expected.

Key financial ratios

Y/E Dec (VND Bn)	FY2014	FY2015	FY2016	FY2017F	FY2018F
Net revenue	783	1,068	1,397	1,633	1,897
%change	-6.6	36.4	30.8	16.9	16.2
PAT	44.2	76.9	142.6	168.1	205.1
% change	-11.2	74.2	85.4	17.9	22.0
Net margin (%)	5.6	7.2	10.2	10.3	10.8
ROA (%)	9.0	12.7	11.5	13.1	14.2
ROE (%)	12.6	25.9	21.5	22.6	24.0
EPS (VND)	6,400	4,356	2,547	2,852	3,480
Adjusted EPS (VND)	789	1,374	2,547	2,852	3,480
Book value (VND)	19,798	16,811	11,837	13,289	15,269
Cash dividend (VND)	na	na	na	1,400	1,500

Source: KDF, RongViet Research estimation

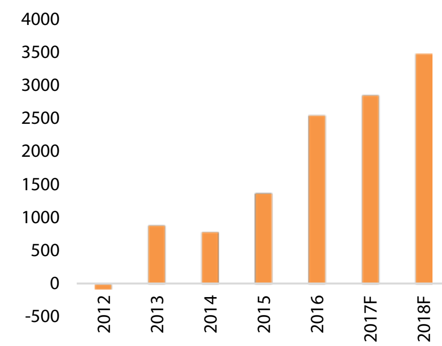
NEUTRAL

List price (VND)	60,000
Target price (VND)	68,000
Cash dividend (VND)*	1,400

** Expected in the next 12 months*

Stock Info	
Sector	F&B
Market cap (VND billion)	3,360
Share O/S	56
Free float (%)	20

EPS (2012–2018) (dong)



Source: RongViet Research estimates

Sharholders structure (%)	
KDC	65.0
KDF's employees	10.0
Tran Le Nguyen	0.1
Tran Kim Thanh	0.1
Strategic partners	4.8
External investors	20
Foreigner Investor Room (%)	49

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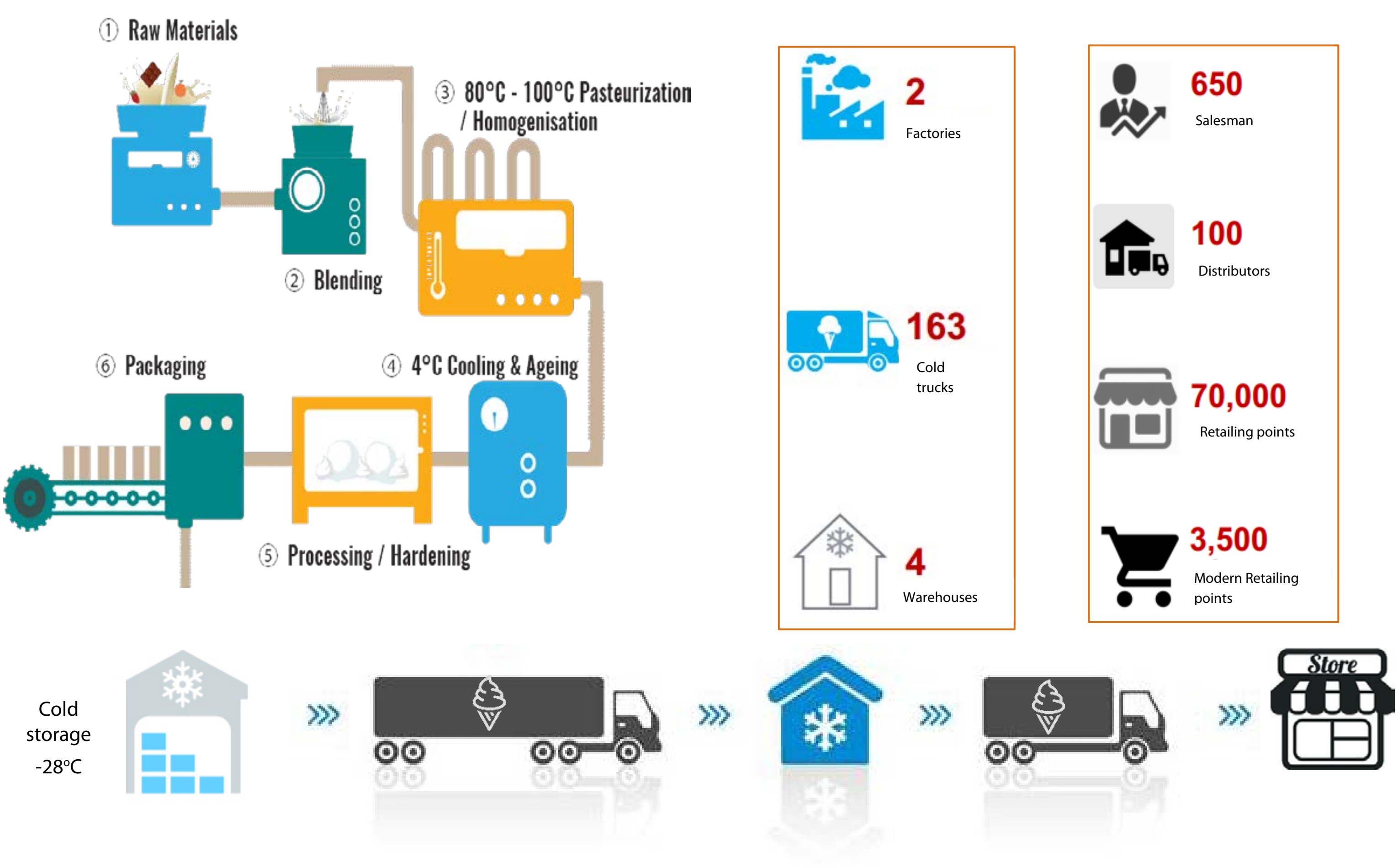
INVESTMENT RATIONALE

The nation-wide frozen products distribution system is the sustainable competitive advantage

KDF inherited the modern ice cream manufacturing system from Unilever in 2003, thereafter, developed gradually to perfect the process of production and distribution. The company possesses four cold storage warehouses all over the nation, specifically, two in the plant and two in the Central area with the radius of 300 km each. Thanks to those strengths, KDF has its own competence to distribute ice creams to mostly all cities and provinces, retailing points ranging from urban to rural areas. Currently, KDF owns 70,000 retailing points in which 3,500 are considered modern retailing points.

Figure 1: KDF's process of production and distribution



Source: KDF, RongViet Research; read more at *Appendix 1: Location of plants and cold storage of KDF – Page 24*

KDF's competitive advantage in the frozen food industry lies in its strong distribution system which consists of: (1) assurance for the quality and structure of the product; (2) ability to quickly meet the demand; and (3) widespread coverage. Compared to other domestic competitors (Trang Tien and Thuy Ta), the distribution system of KDF has a much wider spread. In case of Vinamilk, its ice cream line, which is merely a small portion compared to the whole scale of the company, is less prioritized than dairy products. In the meantime, other ice cream brands such as Monte Rosa and Fanny concentrate on the customer segment of HORECA. Compared to foreign companies, KDF is more appreciated due to its long-term partnership with suppliers, variety of products and large coverage.

Geographically, the northern area accounts for 57% of the total revenue, followed by the southern and the central areas which account for 35% and 7%, respectively. This is rooted in the northern atmosphere condition and customer behavior, explaining the company's decision of expanding the production scale by investing in the new plant in Bac Ninh province. Hence, the decision will likely consolidate the position of the distribution system as well as optimize the logistics and warehousing cost. RongViet Research perceives the horizontal expansion strategy of KDF would utilize its advantages, contributing to the market expansion strategy in the industry.

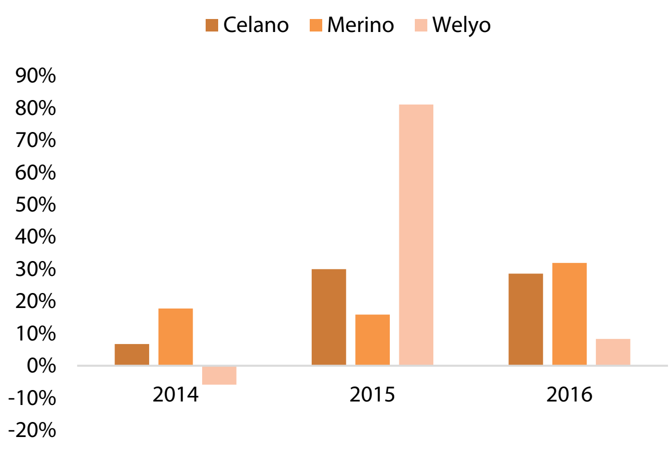
The market leader in the ice cream industry

In addition to the strength of the distribution system, it can help mentioning the ability of utilizing radically the development trends of the industry – a factor that plays its indispensable role in maintaining its leading position with the market share of 40% (2017). KDF managed to catch the trend of the young consumers via numerous marketing campaigns and discount programs. KDF is the exclusive partner of Universal Studio, and it also has the interactive system on social networks.

The second tendency of the ice cream industry is the increasing income per capita, which is in tandem with the demand of premium ice cream products, which is being effectively exploited. The product line of Celano recognized the impressive growth rate of 27% per annum in the period of 2014–2016, higher than the average growth rate of the Merino and 2.1 times higher than the rate of the whole industry.

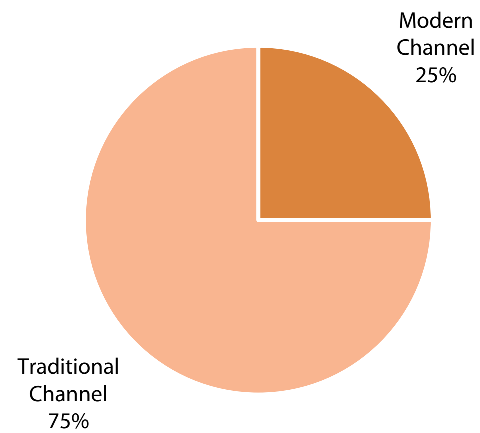
Additionally, with the development of the modern retailing channel, the company also quickly partcipated this channel to increase the brand recognition rate and stimulate the demand. The ratio of revenue between traditional and modern channel of the whole industry is 13:87. This ratio of KDF stands at 25:75. It is obvious KDF achieved the dominant positions not only in the traditional channel but also in the modern channel, which is notorious for a more intensive competition.

Figure 2: Revenue growth of kdf's products lines



Source: KDF, RongViet Research

Figure 3: Ratio of revenue based on sale channels



Source: KDF, RongViet Research

According to Euromonitor, the revenue and volume are forecasted with the CAGR of 7–8% in the period of 2016–2021. This expectation is based on three evidences: (1) the demand of ice cream consumption remains low whilst the income of Vietnamese is gradually increasing; (2) the young demographic profile allows the potential room for increasing demand; (3) the expansion of the modern sale channels and the climate change (Read more at Industry Analysis, Page 21). Therefore, the growing operation in the industry and the market leadership advantage will be the two fundamental elements for the impressive growth rate in the subsequent years. In the base scenario, RongViet Research expects the Merino line to maintain the growth rate of 1.25 times whilst the Celano is 2 times higher than the industry average rate.

After 2021, the ice cream industry of Vietnam is expected to have a growth rate equivalent to that of the Philippine market, when the average income and the population of Vietnam will be close to this market with the growth of approximately 3%.

Proven efficiency in products strategy

We recognize the variety in the company's product portfolio contributing to the competitiveness of KDF against similar items from other ice cream brands. Two strategies, which drive to KDF's success are:

1. Industrializing conventional, handmade products by innovating the quality and packaging, attaching the KDF brand. Some of the prime products in this strategy include: mung bean popsicle, red bean popsicle, ice yogurt, ice banana popsicle as well as ice syrup.
2. Taking over the market share of foreign brands by producing products with equivalent quality with a much lower price. For instance, Celano cupped or boxed ice cream with marketable flavors such as matcha, blueberry as well as scooped ice cream. In 2017, KDF also introduced a new product - mochi ice cream, which imitates Japanese ice cream.

Other than the two mentioned strategies, we highly appreciate KDF restructuring the brand, eliminating unprofitable product lines (eg. UTH milk, fromage, milk cream).

Figure 4: Some examples about KDF's product strategy

Source: KDF, RongViet Research, Read more at [Appendix 4: KDF's products portfolio – Page 26]

Taking advantage of its own competence to horizontally expand to frozen foods

In 2016, KDF introduced a new product line, namely, dumpling as a market test which would be followed by sausages, fish balls, French fries and so on. This strategy is common among businesses operating in the frozen food industry and is the trend implemented by some corporates in the regional area (Thailand, Taiwan, China). Chomthana, a company in Thailand that owns a distinguished brand Creamo also followed this trend in 2005 when they invested more frozen food production lines to introduce dumpling as a new product. However, since it is not the market leader, the market share of Chomthana in ice cream and frozen food industry is gradually taken over by MNCs.

Concerning KDF, we perceive the company possesses distinguished advantages to succeed in this strategy. About production, KDF inherited the experience in manufacturing and understanding of the appetite of the Vietnamese consumers from the success in confectionary production of its parent company. Regarding distribution and sale, the company could take advantage of the available distribution and sale system. Thanks to the integration of the ice cream line in the distribution system, the company can distribute widely as well as save the cost of sale and transportation. Additionally, KDF has another plus in the brand, which is more familiar to customers than those of other suppliers of dumpling products.

As it just started in Q42016, the contribution of this segment to revenue was only 2% in 2016. After one year, KDF has expanded slowly this business. At the moment, dumpling products are distributed to grocery stores, supermarket (Big C, Coop Mart, Lotte, Aeon Mall, Metro) and convenience stores (Vinmart, BiboMart). According to our observations, the brand recognition for Kido dumpling products is not high partly because the company has not pushed marketing while consumers have a variety of alternatives for this type of products. In the first three quarters of 2017, KDF's revenue increased by 7.7% YoY, which is an indicator that the dumpling business has not met the BOD's expectation.

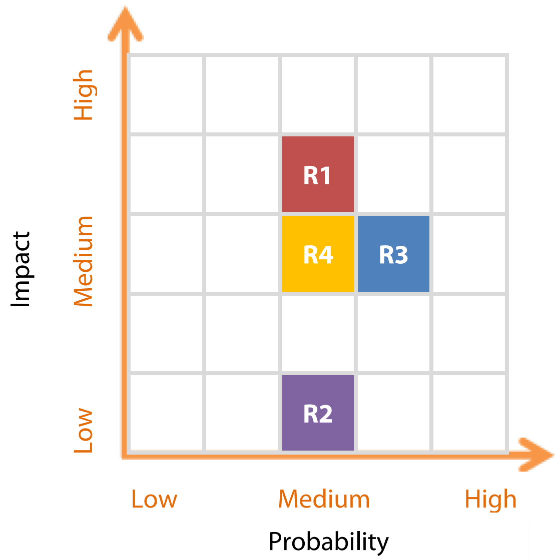
The capacity of KDF to the dumpling product is approximately 5,000 tonnes per annum. In the base scenario under the assumption that the dumpling product is marketable, we expect the company to reach the maximum capacity in the year of 2022 and upgrade the plant to the capacity of 7,000 tonnes per annum in 2026. The gross margin of dumpling products would gradually expand after the initial testing period and is expected to reach the rate of 36–47% in the period of 2018–2022.

Concerning other products such as fish balls, sausages and French fries, the company would not adopt an in-house manufacturing yet; it will channel via M&A/OEM to polish the product portfolio and expand its market share as well as take optimal advantage of its distribution capability. Recently, the parent company of KDF (KDC: HSX) bought 50% shares of a subsidiary of Dabaco Group. The next move is that KDF will be responsible for distributing Dabaco's products including sausages, canned foods and other processing foods. Dabaco's revenue from processing foods is huge at around VND2,000 billion per year yet under loss pressure. With the participation of KDF, Dabaco could develop distribution system and products' brand. However, we think the efficiency of this business has still not contributed to KDF's business performance. Under the estimation of RongViet Research, in the subsequent 5 years, product lines branded Kido Foods are expected to contribute up to 23% of the revenue and 20% of the EBIT of KDF.

Read more at Appendix 3: SWOT Analysis on New Industry Line of KDF – Page 25

INVESTMENT RISK

Figure 6: Risk matrix



Source: RongViet Research

Market risk | The industry growth rate is not as positive as expected (R1)

The GDP negative growth used to have impact on the output and the revenue of KDF in the past. Although the income per capita is expected to soar positively in the forecasted period, yet the room for discretionary products such as ice cream might be subjected to downside risk due to the economic depression.

Operation risk | Soaring material turmoil (R2)

Input price (including milk, sugar, packages, flavor…) accounts for 56% the cost of goods sold. When the price of those factors increase by 1%, the gross margin would decrease by 0.2%. Nevertheless, KDF is capable of optimizing the cost or transferring the escalation to the customers, thus the soaring material turmoil is evaluated as low.

Operation risk | More intensive competition in the industry (R3)

The phenomenon when the foreign ice cream products flock into Vietnam market, especially Korean and Thailand products, might negatively affect the growth of KDF due to the generous investment in marketing image at supermarkets sharing the same nationalities such as Metro, Emart and Lotte Mart. Recently, other dairy producers started participating in the industry like in the case of KitKat Matcha of Nestle. Besides, Wall's and Vinamilk are still strong competitors of KDF in the segment of popsicles and boxed ice cream. The more intensive competition triggers cost escalation in sales and marketing.

Operation risk | Failure in the new product line (R4)

The dumpling product line's move has no clear potentials to KDP in the current time. However, due to the small capital investment combined with the experience in eliminating unprofitable products in the past, the risk of failure in the new product line would not be material.

INVESTMENT RECOMMENDATION

Kido Frozen Foods JSC (Upcom:KDF) is the market leader in manufacturing and distributing ice creams in Vietnam. The competency of KDF is ascribed to its manufacturing process, modern technology, large scale distributing system and experience in understanding and meeting the taste of consumers. Its prospects comes from the growing breadth of the ice cream industry which is correlates with the economic growth and the improved income per capita.

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COMPANY OVERVIEW

The history of establishment

Kido Frozen Food Joint Stock Company (KDF) was formerly known as Wall's Ice Cream Factory of Unilever Bestfoods Vietnam Co., Ltd., established in 1997 located in Northwest Industrial Park of Cu Chi with a total area of 23,728 m2, total capital of USD20 million and operational capacity of 9 million liters per year.

In 2003, Kinh Do Joint Stock Company (now known as Kido Group with the ticker: KDC) bought Unilever's Wall's ice cream factory and established Kido Co., Ltd. with initial chartered capital of VND 30 billion. Since then, the company has experienced four increases in capital: (1) in 2005, from VND 30 billion to VND 40 billion, (2) in 2007, from VND 40 billion to VND 69 billion, and (3) in 2015, from VND69 billion to VND177 billion; and (4) in 2016, from VND177 billion to VND560 billion. Also in 2016, Kido One Member Limited Company is transformed into a joint stock company, with the official name: Kido Frozen Food Joint Stock Company.

Thanks to acquiring the full range of international standard ice cream processing technology from Wall's, KDF has a well-grounded foundation in manufacturing. Moreover, since the acquisition of Wall's, the company has continued to invest more modern machinery lines, help diversify products and meet market demand. In November 2016, KDF inaugurated the largest frozen food factory in the north in Bac Ninh with the investment capital of VND400 billion. Currently, KDF is the largest ice cream maker in Vietnam with a market share of 35–40%.

Shareholder structure

At present, Kinh Do Joint Stock Company holds 65% of charter capital while two other individuals, namely Tran Kim Thanh (BOM) and Tran Le Thanh (Vice Chairman of BOM) holds ~ 0.2% of charter capital of KDF.

- In April 2017, KDC successfully sold 11.2 million shares of KDF (~20% of charter capital) at VND52,000 per share.
- In August 2017, KDC continued to transfer 14.8% of charter capital to KDF's employees and strategic partners. In which, 10% belongs to KDF's employees at VND25,000 per share and 4.8% for strategic partners at VND40,000 per share.

Production capacity

KDF owns two plants with a designed capacity of 50 million liters per year, of which the cream capacity is 25 million liters per year and the yogurt capacity is 25 million liters per year.

Table 1: Manufacturing capacity of KDF

Plant	North-west Cu Chi	Bac Ninh	Total
Establishment year	1997	2016	
Area (m^2)	23,700	25,000	48,700
Investment capital (VND B)	234*	400	584
Capacity (million liters/year)	34	15	50
Yogurt	16	9	25
Ice cream	18	7	25

*Source: KDF, * Exchange rate in 1997 (1USD = 11,683 VND)*

The new Bac Ninh plant came into operation in November 2016, helping KDF's designed capacity increase by 47%. In 2016, KDF produced about 14 million liters of ice cream and 9 million liters of yoghurt, respectively. Actual capacity was not reached due to seasonality of ice cream products and KDF relocated some production lines from the southern to the northern. In addition to European standard processing technology, KDF owns many modern ice cream lines imported from Denmark, Italy and Germany.

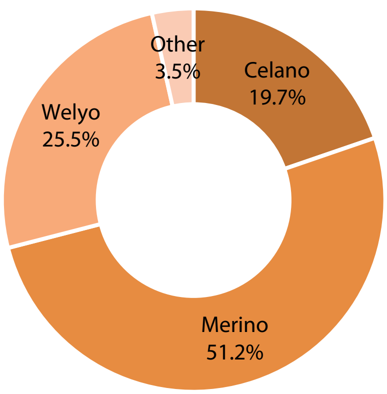
Product structure

KDF's products are divided into three main brands: Merino - regular cream, Celano - premium cream and Welyo - yogurt. Merino Ice Cream has three main categories: ice cream (X, Yeah, Core, Superteen, Kool, Cutie Bear...), ice cream cup (Merino Cup) and cream box (Merino Tub). Celano Ice Cream has five main categories: Passion, Cone Extra, Celano Tub, Celano Cup and Celano Sweetie. Welyo Brands are available in two main categories: premium yogurt (Kidz and Family) and ice yogurt. The products of KDF are diverse and rich, favoring both locally and internationally markets. (Appendix 4: KDF's products portfolio – Page 24)

In the composition of KDF products, Merino cream accounted for the highest proportion of sales (> 50%) due to the price that is suitable to the majority of consumers, the Welyo group and Celano ice cream accounted for 26% and 22%, respectively, while the Kido Foods group did not contribute much due to its recent release late last year.

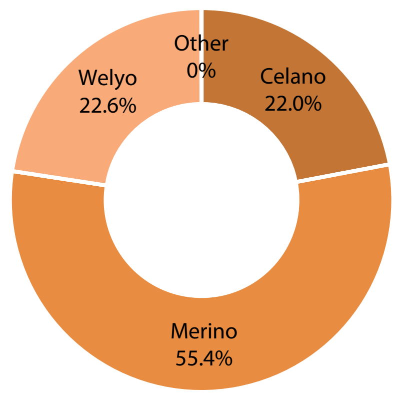
KDF's products have different price segments, banana ice cream is the product with the lowest gross margin of ~26.5%, followed by the low-price Merino ice cream with a margin of ~40%, while the remaining products have margins ranging from 40–70%. The contribution of each brand to the gross profit margin is similar to the contribution to sales.

Figure 7: Revenue breakdown by brands (2016)



Source: KDF

Figure 8: Gross margin breakdown by brands (2016)



Source: KDF

Distribution system

The company has more than 100 distributors in the country, present in all provinces nationwide; retailing places which are serviced directly by distributors are 50,000 points. At the same time, KDF ice cream is available in supermarkets and convenience stores nationwide (~ 3,500 points). In addition, the company has a foreign distributor in Cambodia but with sales accounting for a very small share in revenue structure.

Competitors

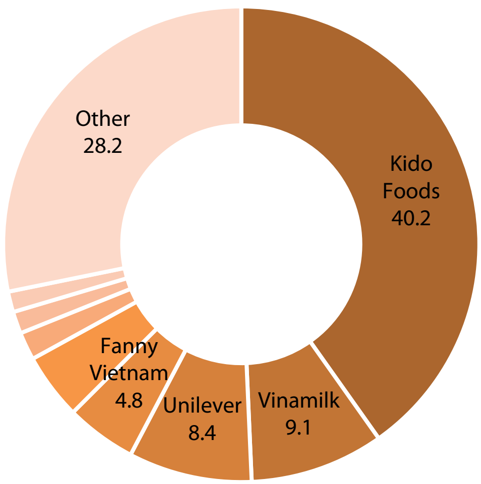
In the ice cream industry, KDF is a leading player with a market share of around 40% (2017). Excluding the high-end segment with the flocking of foreign brands, KDF's two main competitors are Unilever with Wall's and Vinamilk's ice cream brands, with a market share of around 9%. In terms of coverage of product segments, KDF owns a diverse portfolio of products ranging from cheap to premium ice cream. However, the strength of KDF is the line of Merino brand which is at reasonable prices. The cone ice cream with the Celano brand came in second and had a big market share gap form Wall's Cornetto.

For cup and boxed ice cream products, Vinamilk is the market leader with a revenue of VND243 billion in FY2015. Meanwhile, KDF's sales are only VND164 billion. However, the growth rate of KDF and Vinamilk is quite similar, according to RongViet Reseach, estimated at the rate of about 20% in 2016.

Compared to other companies in the industry, KDF is an innovative company that constantly innovates on taste and product diversity, which also creates a fresh feeling for consumers and contributes positively to sales growth. Products that successfully established KDF's position in the industry include Superteen, Cutie Bear, ice cream, yogurt ice and so on.

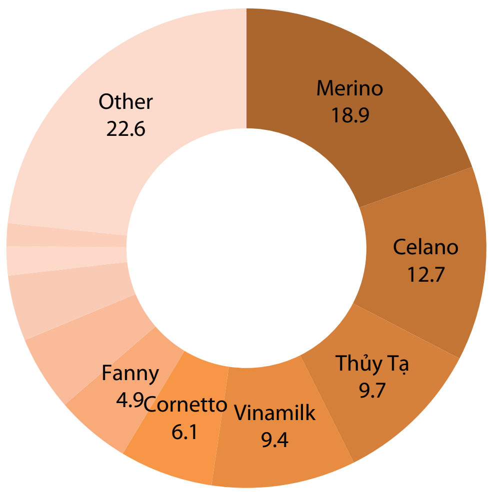
KDF currently owns two of the largest brands in the ice cream sector, namely Merino (~19.5% market share) and Celano (~ 13% market share). Strong brand is one of the factors that help KDF to compete with peers. In addition, the company also carries out dynamic, continuous, and youthful communication activities with young people; fashionable promotion campaigns and trends help cement KDF's lead.

Figure 9: Market share of companies in the industry (2017)



Source:: Euromonitor

Figure 10: Market share by brands (2016)



Source:: Euromonitor

Business strategy

Target customers of KDF are spread across age ranges with different income segments: Specifically, for ages 6–12, there are Merino Cool Cutie Bear, Fruit Tree, Vanilla , Welyo Kidz, Welyo yogurt; for 13 to 19 year olds there are teenage products like Merino X, Yeah, Superteen, and Cup. Segment of youth and young people with income (20–30 years old) has Celano product line. The remaining boxed ice cream product is mainly for mothers and family (30–45 years old).

Meeting traditional and modern needs: KDF implements the strategy of "industrializing" local tastes by capturing local consumers' tastes (from urban to rural); rice ice cream, banana ice cream, banh lot ice cream, three-color ice cream, and ice yogurt are typical products for this strategy. In addition, the company is also catching up with new trends in the world of Vietnamese youth to create the suitable products (mochi cream, green tea, ice cream, Cone Extra, etc). More importantly, modern machinery allows KDF to easily innovate and diversify its products.

Clear pricing strategies: With two prominent Merino and Celano brands, KDF has positioned the price segment separately for each brand. Celano is aimed at the better off consumers and concentrated in urban areas, so the market price is about 50–80% higher than that of the Merino brand. Similarly, the lesser-known Welyo brand also has a clear price for boxed yogurt and packed yogurt. The KDF commission rate is around 5–7% for distributors, and 20% for retailers.

Leveraging the cold distribution system to develop new products: In 2016, KDF began experimenting with frozen dumplings, marking a new direction in its business strategy. This orientation is rooted in KDF's ability to leverage KDF's cold distribution system and see the demand for domestic breakfast products. In the future, if this expansion is successful, KDF will continue to diversify other frozen products such as sausages, spring rolls, food pellets (fish, beef, squid, shrimp, etc).

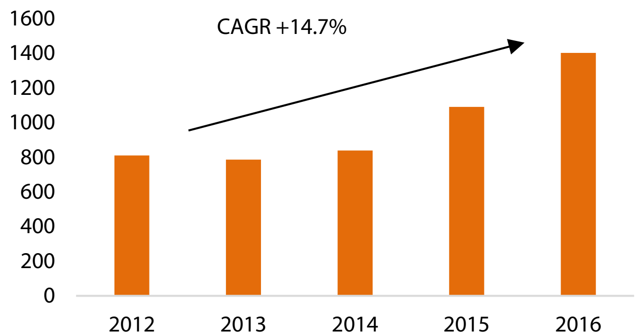
FINANCIAL ANALYSIS

Remarkable growth in the past three years

KDF's sales growth is unstable in 2012–2015, which is due to the economic slowdown in the three years from 2012 to 2014 that has affected the company's sales. In 2012, KDF paid a lot for its aggressive marketing, revenue growth was positive, but operating profit margins fell from 7.1% in 2011 to mere 4.1%. At the same time, the 10% ceiling on advertising and marketing costs is the reason for the company's loss of VND4.6 billion in 2012.

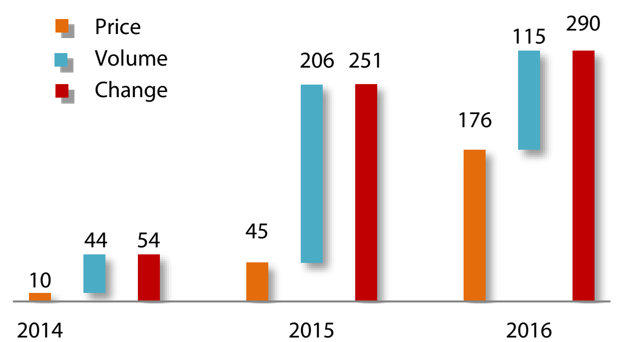
Thanks to the reduction in marketing activities, KDF's performance started to improve from 2013 onwards. In 2015, with the success of ice yogurt products, KDF's revenue growth rate has improved sharply. In 2016, thanks to strong growth in Celano production and increased sales and volumes in the Merino line, the company continued to maintain a high sales growth rate of ~29% over the same period of 2015. Although turnover is unstable, KDF still achieved an average growth rate of ~17% per annum during 2011–2016, higher than industry growth.

Figure 11: Revenue (VND billions)



Source: KDF, RongViet Research

Figure 12: Contribution to The Change in Revenue (VND billions)

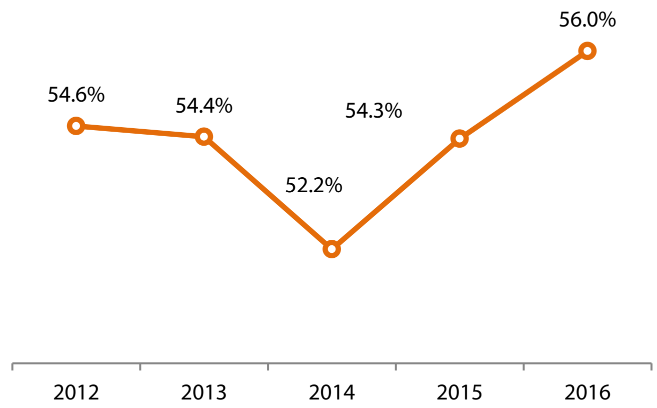


Source: KDF, RongViet Research

Gross profit margin is high and stable

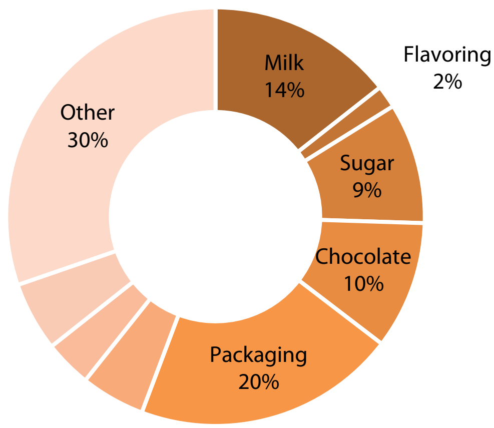
Gross profit margin remained stable over the years with an average of 54.3%, higher than the average of 36% for its peers. Cost of raw materials accounts for about 35% of cost of goods, of which milk, sugar and chocolate are the main raw materials. Packaging costs account for about 20% of COGS. The company signs raw material purchase contracts with local companies, and raw material prices are unlikely to change much while KDF's price increases depend on two factors: (1) changes in income and consumption demand; and (2) trend of price adjustment of competitors.

Figure 13: GPM



Source: KDF, RongViet Research

Figure 14: COGS breakdown

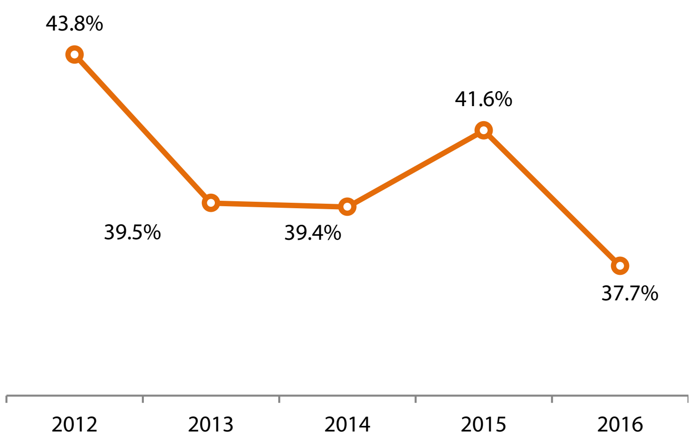


Source: KDF, RongViet Research

The generous expenditure on advertising and sales

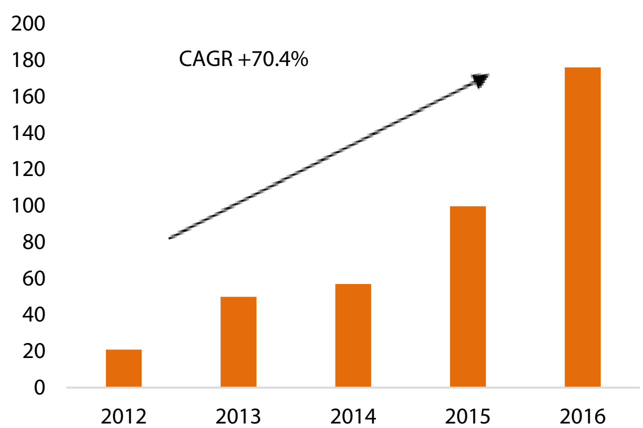
Although gross margin remained stable, KDF's operating profit margin was only about 13%. Marketing and sales expense usually accounted for a relatively high 18% of sales during 2012–2016. Marketing expenses were going down gradually from 17.5% in 2011 to 8.6% of sales in 2016. According to brand, marketing costs for the brand new Welyo is the largest while the second largest comes from Merino; followed by Celano. In the coming years, the company aims to control marketing costs of not more than 8% of sales.

Figure 14: Selling-expense-to-revenue ratio



Source: KDF, RongViet Research

Figure 15: PBT (VND billions)



Source: KDF, RongViet Research

ROE is on the rise

In the period 2012–2013, due to the regulations on ceiling of advertising and marketing expenses, the corporate income tax rate fluctuated sharply. This also caused the return on KDF's equity to be negative. If this regulation was adjusted, the company's ROE would have declined sharply in 2012 as operating profit margin declines in 2013–2014 and there was a breakthrough in efficiency in 2015–2016. ROE improved in part because of better business efficiency while businesses also took advantage of increased debt financing at low interest rates, demonstrating flexibility in corporate governance. KDF's ROE is three times lower than the regional average of its peers in 2016.

Table 2: Dupont analysis of KDF

	2012	2013	2014	2015	2016	2017F	2018F	2019F	2020F	2021F
EBIT/Revenue	4.1%	7.1%	6.9%	8.2%	13.0%	12.2%	12.7%	14.4%	14.3%	14.8%
Revenue/Total asset	1.8	1.8	1.6	1.8	1.1	1.3	1.3	1.4	1.4	1.3
Interest expense/Total asset	3.2%	0.9%	0.2%	0.3%	1.3%	1.7%	1.3%	1.0%	0.8%	0.6%
Total asset/Owners' equity x (1- CIT rate)	(0.85)	1.51	1.05	1.59	1.48	1.5	1.5	1.3	1.3	1.3
ROE	**-3.7%***	**17.6%**	**11.1%**	**22.7%**	**19.7%**	**21.1%**	**22.8%**	**25.3%**	**24.4%**	**24.0%**

*Source: KDF, RongViet Research, *After eliminating the effect of the regulation on the ceiling of advertising expense on CIT*

BUSINESS FORECAST

Table 3: Business forecast

Particular (VND B)	2015	2016	2017F	2018F	2019F	2020F	2021F
Net revenue	1,068	1,397	1,633	1,897	2,269	2,586	2,947
Gross profit	580	783	872	1,011	1,221	1,394	1,591
SG&A expenses	492	601	673	771	893	1024	1155
EBIT	88	182	200	240	327	370	436
EBITDA	119	232	262	307	396	439	508
Financial expense	7	20	21	19	17	14	14
- Interest expense	2	16	19	16	14	11	11
Depreciation	31	51	63	67	68	70	71
NPBT	100	176	191	233	329	381	460
NPAT	77	143	168	205	276	320	386
EPS	4,356	2,547	2,852	3,480	4,685	5,428	6,550

Source: KDF, RongViet Research

Table 4: Cash flow forecast

Particular (VND B)	2015	2016	2017F	2018F	2019F	2020F	2021F
PAT	100	176	168	205	276	320	386
Depreciation	31	51	63	67	68	70	71
Interest expense * (1 – Tax)	1	13	17	14	12	9	9
CF before WC and Investment	129	226	236	275	339	375	431
Change in WC	28	(236)	21	(56)	(45)	(52)	(47)
Investment	(41)	(448)	(77)	(55)	(20)	(20)	(20)
FCFF	116	(459)	180	165	274	302	363
FCFE	185	(187)	42	158	204	264	380

Source: KDF, RongViet Research

Short-term prospects:

According to KDF, revenue and NPAT in the first three quarters of 2017 are VND1,234 billion (+7.7% YoY) and VND147 billion (unchanged compared to the same period last year). The most notable point of KDF's business is an outstanding growth in the third quarter in both revenue and profit. Specifically, revenue and NPAT increased by 19.7% and 41.7% YoY in Q32017. Gross profit margin declined to 53% due to an increase of depreciation cost, meanwhile, selling expense was cut. Net profit declined from 12.9% to 12% in 9 months of 2017. In KDF's business cycle, Q4 would usually be a low season; we think the same scenario is going to happen this year.

RongViet Research estimates the growth of volume at 11.2% YoY. In particular, the ice cream line grows at the rate of 9.6% compared to the same period of 2016, the yogurt line is at 3.0%, and the Kido Foods line rises 217% (the estimated dumpling output is 959 tonnes).

Under the assumption that ASP (average selling price) will increase by 3%, the forecasted revenue would be VND1,633 billion (+16.9% YoY). With a decrease in the gross margin from 56% to 53.4%, the selling expense over revenue ratio would drop from 37.6% in 2016 to 35.9% this year, and PBT of KDF is forecasted at VND191 billion (+8.4% compared to the same period last year).

About investment, 2016 witnessed the completion of KDF's investment in Bac Ninh plant with the capacity for ice cream and yogurt reaching six million liters per annum and nine million liters per annum, respectively. Under the assessment of RongViet Research, although the depreciation cost would increase, by taking advantage of the production lines (transferred from the north-west Cu Chi to Bac Ninh) and saving the transportation cost and CIT due to the tax preference policy, KDF would basically gain advantage when it invests into the new plant. With profit after tax is estimated at VND168 billion for 2017, increasing by 17.9% compared to the same period of last year, the EPS would be VND2,852, with PE forward of ~21x.

Overall, we think KDF cannot meet the target in 2017. In 2018, revenue and PAT are expected to grow at 16.2% and 22% to VND1,897 billion and VND205 billion, respectively. EPS for 2018 is forecasted at VND3,480 and PE forward at ~17.2x.

Long-term prospects:

❖ Prospects for revenue growth

In 2016, the consumption output of KDF is estimated to reach 23.2 million liters, equivalent to 8.8 million cartons of products. Under the scenario of industrial output growth reaching 6.9% per annum in the period of 2017–2021, RongViet Research estimates the growth rate in output of KDF would be 1.4x higher than the growth rate of the industry, specifically 9.5%. By the period of 2022–2026, with the preference to the growth rate in the ice cream industry in Philippines, the growth rate in output (CAGR) of the industry and the KDF would reach 2.8% and 3.1% respectively.

Turning to the yogurt product line, the growth is partially hampered by the intensive competition within the industry and the company has not launched any new or featured product. We forecast the output in this product line standing at approximately 3% per annum in the period of 2016-2021, and no growth in the five subsequent years.

For frozen foods segment (Kido Foods), we estimate the company could achieve 100% of total designed capacity (5,000 tonnes per year) in 2022; the 2016–2021 CAGR of volume will be 49% and continue to grow 5% every year in the five subsequent years.

The average selling price in the period of 2011–2016 increased by 5%. Since 2016, under the scenario of stable economic growth and controlled inflation rate at 5%, RongViet Research hypothesizes the average selling price would increase by 3% per annum with KDF's products.

The average revenue growth rate in the period of 2017–2021 is estimated at 16%, higher than the level of 14.7% per annum in the period of 2012–2016, then expected to drop to 6.5% per annum in the period of 2022–2026.

❖ Prospects for gross margin

The price of milk as ingredient is expected to increase in the next period, yet the ingredient milk accounts for merely 15% while other expenses such as packaging, sugar, electricity and oil are controlled stably. Dependence on the Bac Ninh plant means the increase in the depreciation expense that would affect negatively but not significantly the gross margin. The Kido Foods product line in the very first stage is expected to have a thinner margin compared to those of ice cream and yogurt. This margin is then expected to increase gradually when KDF will have gained a certain market share and bargaining power in negotiating with suppliers. The average gross margin is forecasted at 53.7% in the period of 2017–2026.

❖ Prospect for operating profit margin

In the past, the selling-expense-to-revenue ratio used to be leveraged to a rather high rate (of 45% in 2012) due to the company becoming more aggressive in the marketing activities amid the poor economic situation, keeping the revenue from increasing as expected. Compared to other businesses in the industry, the sellin- expense-to-revenue ratio is considerably higher. With the operation of the new Bac Ninh plant, we expect KDF would save the cost of transportation significantly by integrating the distribution systems of products branded under Kido Foods, lowering the selling expense/product unit ratio. Combined with the improvement in market share and the strong brand, RongViet Research expects the selling-expense-to-revenue ratio would be gradually lower. The average selling-expense-to-revenue ratio in the period of 2017–2026 would be 34.4% and the administrative-expense-to-revenue ratio would be around 5.1%. The average operating profit margin of KDF is estimated to reach the percentage of 14.2% in the period of 2017–2026, lower than Vinamilk yet higher than the margin of other businesses in the industry in Asia Pacific.

❖ **Capital investment**

The capital investment in the surveyed period would consist of refrigerators and dumpling steamers. Under the base scenario, KDF would operate at the capacity of nearly 100% in the product lines of ice cream and dumpling by 2022. By that time, it would require the company to expand their investment to meet the demand from the market. Because the company operates in the industry that is very similar to the FMCG, its working capital is not considerable, days payable outstanding is much longer than the days receivable outstanding, and the average days inventory outstanding is about two months.

VALUATION

Table 5: Valuation Result (VND per share)

Methodology	Price	Weight	Weighted price
DCF	64,871	50%	32,436
PE	71,257	50%	35,629
Target Price		**100%**	**68,064**

Source: RongViet Research

RongViet Research utilizes the combination of two valuation approaches to determine the intrinsic value of KDF:

(1) Using discounted cash flow in 10 years (2017–2026) with the weighted average cost of capital of 12.9%, the perpetual growth rate since 2026 would be 2.9%;

(2) Using a comparable valuation method comparing the P/E of the company to the average P/E of the industry, adjusted for discrepancy among geographical and market factors, the P/E used in the valuation model would be 20.5x.

Combining the two above methods, the intrinsic value of KDF is at **VND68,000 per share**, **13%** higher than the listing price of VND60,000 per share.

Table 6: Information about corporates in the same industry in the region

Corporate	Description	Nationality	PE
Binggrae	The company specializes in manufacturing dairy products. Binggrae possesses the cold storage system and frozen products distribution channel. Prime products of the company include banana milk, yogurt, snacks and many ice cream products branded under Melona.	Korea	23.4
Uni-President Enterprises	Uni-President manufactures, processes and supplies instant noodle products, dairy products, frozen food, soft drink and many other confectionery and desert products.	Taiwan	24.4
Inner Mongolia Yili Industrial	The company specializes in milk, milk powder, ice cream and other dairy products. The company produces frozen food and instant noodles as well.	China	26.9
Netstle' Berhad	Nestle is a corporation distributing dairy products, fruit juice, coffee, instant noodles. Nestle also produces and supplies packages for chocolate products. Some of ice cream brands of the company include: Milo, Drumstick, Matkool...	Malaysia	32.1
RFM	RFM Corporation is a food and drink company in Philippines. The company produces and supplies packaged products from powder, instant noodles, meat, milk, fruit juice and so on. The ice cream brand of RFM is Selecta	Philippines	14.8
San Miguel Pure Foods	San Miguel is the manufacturer and distributor of canned meat products and dairy products. The ice cream brand of San Miguel is Magnolia.	Philippines	9.4
Fraser & Neave Holdings	F&N is the corporation manufacturing and supplying drink products and dairy products	Malaysia	25.3
S & P Syndicate PCL	S&P Syndicate is the company possessing the restaurant chain named S&P. The company specializes in manufacturing snacks, frozen food and canning.	Thailand	29.6
Namchow Chemical Industrial	Namchow is the company producing ice cream products, fruit juice, cookies and instant noodles. The company also markets Nabisco, Kellogg's and Haagen-Dazs in Taiwan.	Taiwan	13.8
Vinamilk	Vinamilk is the market leader in Vietnam producing dairy products. The company also has an ice cream brand Vinamilk with the revenue of approximately VND245 billion in 2015.	Vietnam	23.4

Source: Bloomberg, RongViet Research

Table 7: Financial indicators of some corporates in the same industry in the region

Company	Nationality	Market share of ice cream products (%)	Capitalization (VND billion)	PE	EV/EBITDA	P/S	P/B	ROE (%)	ROA (%)	GPM (%)	OPM (%)	Net margin (%)
Binggrae	Korea	1.4	12,081	23.4	6.0	0.6	1.0	4.6	3.6	30.3	4.6	3.7
Uni-President Enterprises	Taiwan	1	268,454	24.4	11.3	0.9	4.0	15.3	3.6	33.3	4.9	3.5
Inner Mongolia Yili Industrial	China	13	537,668	26.9	Na	2.5	6.9	26.7	14.6	37.8	9.8	9.0
Netstle' Berhad	Malaysia	35	108,314	32.1	25.1	3.9	31.9	86.3	24.7	39.4	15.3	12.6
RFM	Philippines	52	6,700	14.8	7.6	1.2	1.5	9.9	7.2	41.5	11.3	7.9
San Miguel Pure Foods	Philippines	7.9	23,054	9.4	3.9	0.5	1.2	13.4	9.6	23.0	8.6	5.1
Fraser & Neave Holdings	Malaysia	17	48,800	25.3	19.7	2.2	4.2	17.6	11.2	35.6	9.2	9.2
S & P Syndicate PCL	Thailand	4	7,689	29.6	12.7	1.4	5.1	17.8	11.4	44.7	6.1	5.6
Namchow Chemical Industrial	Taiwan	24	13,100	13.8	9.6	0.9	2.9	20.6	5.7	37.7	10.2	7.4
Vinamilk	Vietnam	9	214,941	23.4	17.1	4.3	8.8	38.9	33.2	47.7	23.1	20.0
Industry Average				25.6	8.7	2.5	8.4	25.1	12.5	37.1	10.3	8.4

Source: Bloomberg, Euromonitor, RongViet Research

Frozen food industry: On the Momemtum of Development

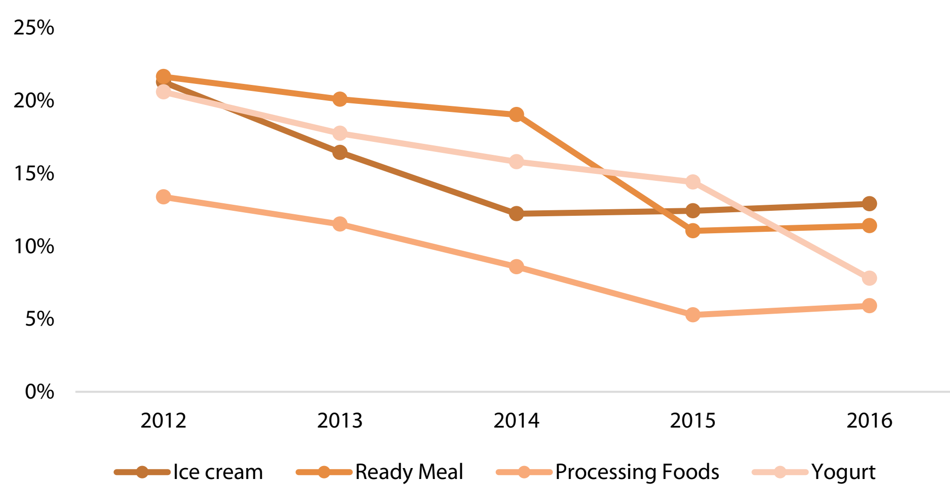
High growth potential due to favorable trend of convenience

Frozen food is a food group in the ready-to-eat food category. Due to the consumption habits of the Vietnamese people, who prefer fresh and hot products, the size of the frozen food industry in Vietnam is still small. With the tendency of the modern life and demand for convenience, and time-saving which is on the rise, frozen food sector has great potential for development in Vietnam market. In addition, along with the development of technology, frozen foods can become substitutes for fresh foods and can be roughly divided into two groups: (1) ready-to-cook food and (2) ready-to-eat food.

According to Euromonitor, the size of the processed food industry (including processed food and processed meat and seafood products) is VND7,698 billion. The average growth rate of processed food is highest at ~12% per year for 2011–2016. For processed meat and seafood products, the growth rate is lower by ~6% per year. Ice cream and yogurt are also classified as frozen food products with the scale of VND2,620 billion and VND9,310 billion, respectively. The average growth rate of output in the period 2011–2016 is 7% per year for ice cream and 10% per year for yogurt.

Thus, in the items that KDF has participated in or intends to participate in, the processed food group has the highest growth opportunities in the future. The average growth rate of this product line for the period 2016–2021 is forecasted to be ~9%, followed by 8% for the second fastest growing yoghurt segment, ~7% for ice cream group and ~5% for processed meat products.

Figure 16: The growth in the value of some product lines in the frozen food industry

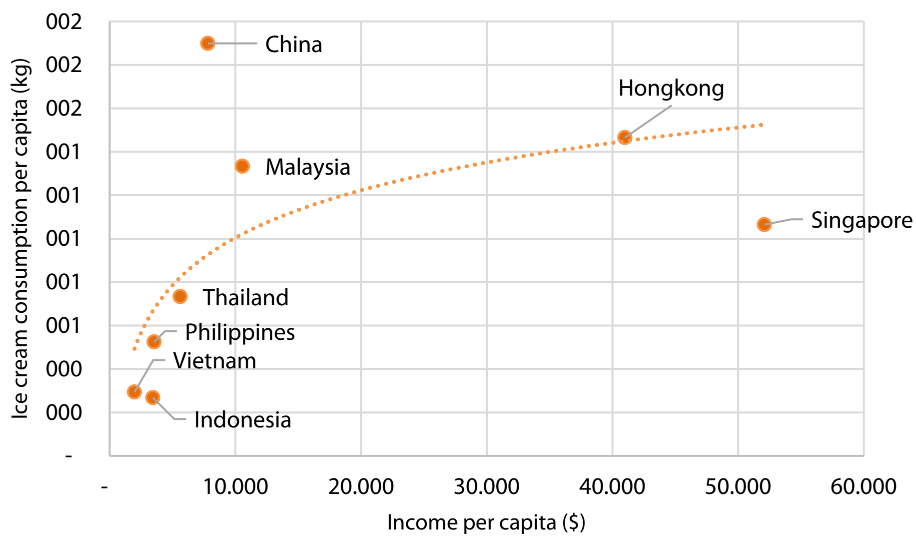


Source: Euromonitor, RongViet Research

Improved per capita income is a key determinant of the industry

The cream industry is currently a light industry valued at about VND2,620 billion with an output of around 28,700 tonnes (2016). The per capita consumption of ice cream in Vietnam is 0.29 liters/person/year, which is quite low compared to neighboring countries. The reason is that the per capita income level in Vietnam is low, leading to low demand for ice cream. The low base of the ice cream industry in Vietnam opens up the potential for positive growth in the future as per capita income improves. In the period 2010–2015, the per capita income growth rate averaged 9.3% per year, while the sectoral consumption value grew 16.2% per year. In the period 2016–2021, Vietnam's per capita income is forecasted to grow at an average annual rate of 10.1% per annum, reaching USD3,400 per person by 2021. It can be said that this is an integral factor to maintain the fair growth in the next few years. Similarly, the demand for processed food and processed meat products are also low compared to other countries, implying that the consumption demand will continue to grow in the future.

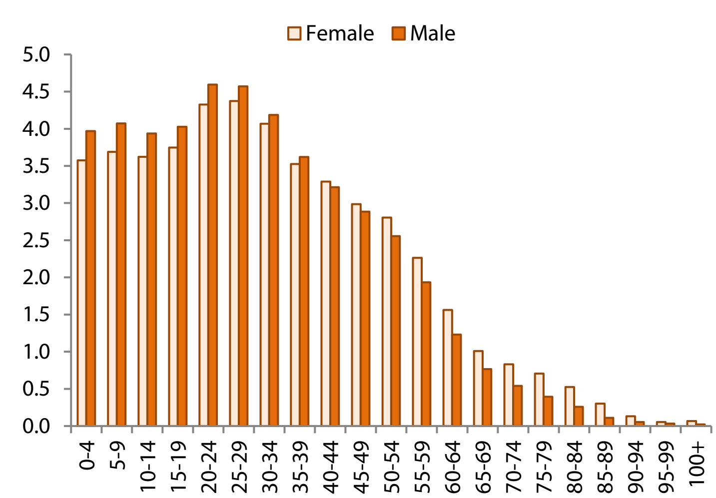
Figure 17: Correlation between ice cream consumption and income per capita



Source: Euromonitor, RongViet Research

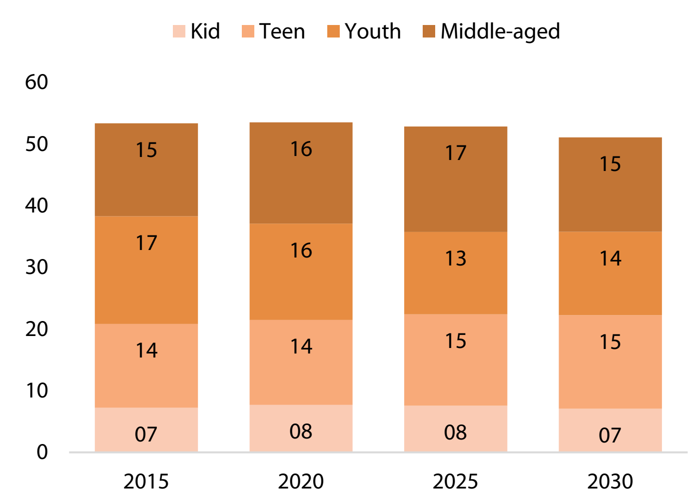
Apart from income, Vietnam's young population structure helps create a large customer base for the industry. Population groups aged 5 to 40 (ages of customers in the industry) account for 57% of the total population. Of these, adolescents account for a high proportion (34% of the total population, equivalent to 31 million). In the period 2015–2020, customer base of the industry will continue to increase, especially for the young and the middle-aged. This factor coupled with improved earnings will motivate the industry to maintain a growth momentum.

Figure 18: Vietnam population structure by ages



Source: GSO

Figure 19: Population tendency by customers' ages



Source: Euromonitor, RongViet Research

The rapid development of the modern retail channel supports the growth of the industry

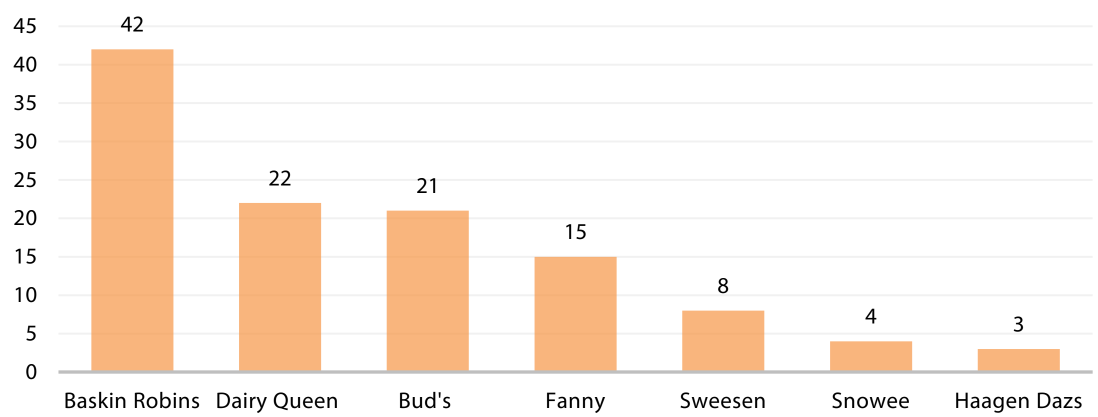
In the world's most attractive retail market, modern retail channels in Vietnam are growing at a rapid rate in recent years. Due to the consumer characteristics of ice cream and processed foods (cold preservation and short-term use), the contribution of the modern retail channel to the sector's turnover has significantly changed over the past five years. In fact, modern retail channels share customers with traditional channels. However, the rapid development of modern retail channels, including convenience stores, will stimulate demand for frozen foods in the future, especially in urban areas.

Competition in the industry: domestic manufacturers dominated

For ice cream, the retail distribution system is one of the determinants of the competitiveness of the industry. In Vietnam, KDF is an ice cream maker that owns a strong distribution system and the largest market share ~40% (2017). KDF's strengths are ice cream products with two prominent brands, Merino and Celano. Vinamilk has the advantage of box ice cream, while the other brands (Thuy Ta, Trang Tien ...) are the local brands. The distribution system is not competitive with KDF and Vinamilk. In addition, Unilever's Wall's ice cream brand is a well-known brand in the industry. Back in Vietnam since 2008, after five years of manufacturing technology transfer to KDF, Wall's ice cream brands Paddle Pop and Cornetto now account for ~10% of the market share.

Apart from the prominent brands, imported ice creams have appeared in many urban areas in recent years such as Korea, Thailand and New Zealand. However, because the product is located in the price segment that is quite high compared to domestic ice cream, so these products have only short-term impact on consumers' curiosity and do not create strong competition pressure on domestic enterprises. The type of ice cream shop that appears increasingly dense through the wave of franchising is also a trend in the industry. Brands such as Baskin Robbins, Bud's, Dairy Queen, Fanny, Sweesen, Haagen Dazs, Snowee, etc. have appeared in many major cities across the country. With more than 115 ice cream stores nationwide, ice cream in the spot does not have a strong impact on the ice cream segment, which mainly competes directly with café and milk tea. However, this is also a difficulty for domestic firms to increase their competitiveness in urban areas as their incomes increase.

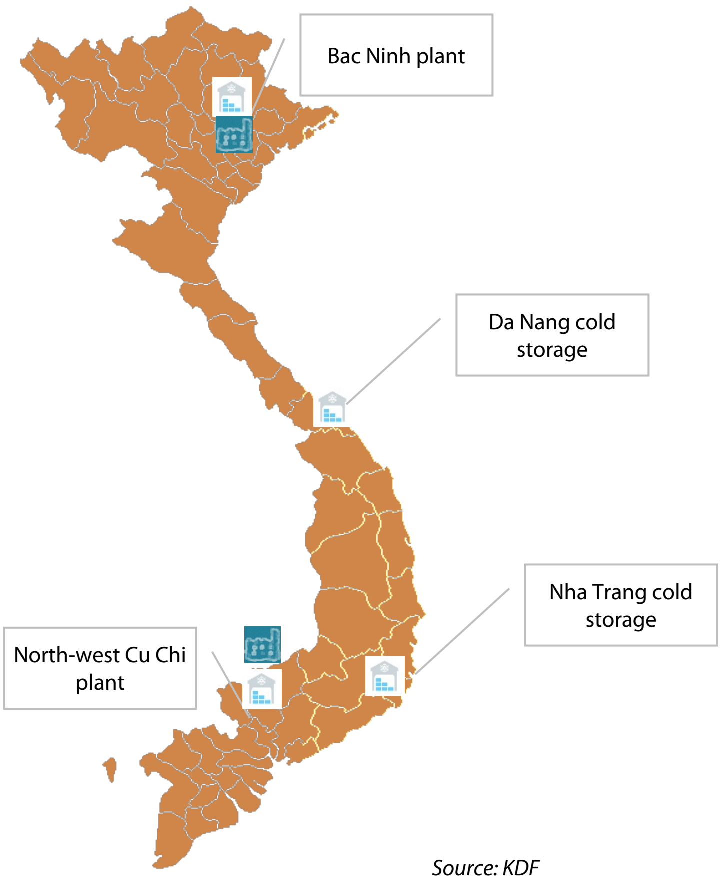
Figure 20: Number of stores of some imported ice cream brand



Source: RongViet Research

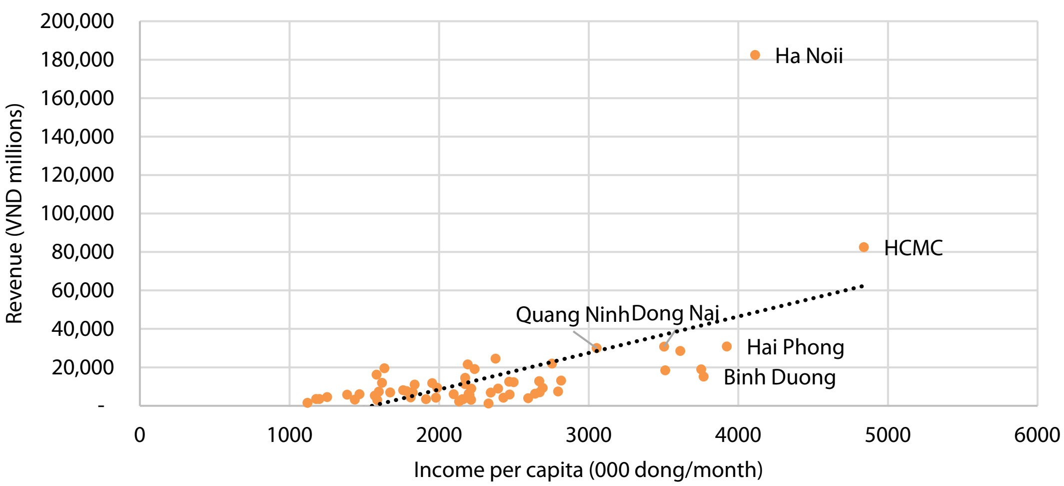
For processed food, with the dumpling product, most manufacturers are local and small, lacking in scale and distribution systems. The strength of domestic businesses is to understand the taste of the Vietnamese people, however, none of them have won the leading position in this niche. Two of the largest companies according to Euromonitor statistics are Malaysian dumplings and Viet Quan dumplings with a market share of 5% of the total value of processed food.

Appendix 1: Location of plants and cold storage of KDF



Source: KDF

Appendix 2: Correlation between revenue and income per capita by provinces



Source: KDF, GSO, RongViet Research

Appendix 3: SWOT analysis of the new product line of KDF

STRENGTH

Inherited the manufacture experience from the corporate

Available cold products distribution system

Strong brand with high recognition rate

WEAKNESS

Probably lower gross margin than those of dairy products

Sausages, french fries, meat balls…: imported or purchased from local suppliers

OPPORTUNITIES

Rapid growth rate (~8-9% per annum)

Dumpling: Small and local competitors

Demand for safe food

THREAT

Sausages, meat balls..: Direct competition with the market leader (Vissan)

Difficulties when penetrating in the industry whose numerous substitutes.

Source: RongViet Research

Appendix 4: KDF's products portfolio


Celano Cub


Cone Classic


Cone Extra


Celano – Passion


Celano – Sweetie


Celano Tube 500ml


Celano Tube 800ml


Premium Celano – 5 Star Desserts


Merino Cub


Super Teen


Merino Yeah


Merino X


Merino Kool


Reasonable Price Merino Kool


Merino Tube 450 ml


Merino Tube 500 ml & 1,000ml


WelYo Kidz Gold


WelYo Home


Welyo Ice Yogurt


Kido Dumpling

Unit: VND billions

INCOME STATEMENT	2015A	2016A	2017F	2018F
Revenue	1,067.9	1,396.8	1,632.7	1,896.9
COGS	487.5	613.9	760.3	885.6
Gross profit	580.4	782.9	872.4	1,011.3
Selling expense	444.5	527.0	586.1	672.3
G&A expense	48.0	74.1	86.5	98.6
Financial income	3.0	13.7	11.5	10.3
Financial expense	6.6	20.0	21.3	18.6
Other income/loss	15.3	0.6	1.1	1.1
Gain/(loss) from JV	0.0	0.0	0.0	0.0
PBT	99.7	176.1	191.0	233.1
Tax expense	22.8	33.5	22.9	28.0
Minority interests	0.0	0.0	0.0	0.0
PAT	76.9	142.6	168.1	205.1
EBIT	87.9	181.9	199.7	240.3
EBITDA	118.6	232.5	262.3	307.1

Unit: %

FINANCIAL RATIO	2015A	2016A	2017F	2018F
Growth				
Revenue	36.4	30.8	16.9	16.2
EBITDA	44.0	96.0	12.8	17.1
EBIT	63.4	106.8	9.8	20.3
PAT	74.2	85.4	17.9	22.0
Total asset	23.0	105.7	3.3	12.3
Total equity	-15.1	123.3	12.3	14.9
Profitability				
Gross profit margin	54.3	56.0	53.4	53.3
EBITDA margin	11.1	16.6	16.1	16.2
EBIT margin	8.2	13.0	12.2	12.7
Net profit margin	7.2	10.2	10.3	10.8
ROA	12.7	11.5	13.1	14.2
ROIC or RONA	24.5	20.4	21.6	24.1
ROE	25.9	21.5	22.6	24.0
Efficiency (x)				
Receivables turnover	9.7	4.8	5.0	5.0
Inventories turnover	6.0	5.3	5.9	5.6
Payables turnover	2.7	3.5	3.1	3.3
Liquidity (x)				
Current	0.9	1.4	1.5	1.6
Quick	0.6	1.1	1.1	1.3
Financial Structure				
Total debt/ Equity	33.4	57.8	35.1	31.4
ST debt / Equity	21.1	26.6	15.4	21.1
LT debt/ Equity	12.3	31.1	19.8	10.3

Unit: VND billions

BALANCE SHEET	2015A	2016A	2017F	2018F
Cash and cash equivalents	27.2	70.4	53.0	175.7
Short term investment	0.1	0.0	0.0	0.0
Accounts receivable	110.2	292.8	328.2	376.2
Inventories	81.3	115.6	129.2	159.4
Other current assets	5.7	16.1	9.0	9.4
Tangible Fixed Assets	292.8	650.7	663.7	617.5
Intangible Fixed Assets	4.1	5.7	5.1	4.6
Long term investment	0.0	0.0	0.0	0.0
Other non current assets	82.4	90.8	95.4	98.2
Total asset	**603.8**	**1,242.0**	**1,283.6**	**1,441.0**
Account Paybale	182.0	173.1	243.3	265.7
Short term borrowings	62.6	176.6	114.3	180.2
Long term borrowings	36.5	206.3	147.2	88.1
Other non-current liabilities	15.8	23.1	34.6	52.0
Bounus and Welfare fund	10.0	0.0	0.0	0.0
Technology – science dev fund	0.0	0.0	0.0	0.0
Total liabilities	**307.0**	**579.1**	**539.4**	**585.9**
Common stock and APIC	176.6	560.0	560.0	560.0
Treasury stock	0.0	0.0	0.0	0.0
Retained earnings	118.1	100.7	182.0	292.9
Other comprehensive income / (loss)	0.0	0.0	0.0	0.0
Investment and development Fund	2.2	2.2	2.2	2.2
Total equity	**296.9**	**662.9**	**744.2**	**855.1**
Minorities interest	**0.0**	**0.0**	**0.0**	**0.0**

CASH FLOW STATEMENT	2015A	2016A	2017F	2018F
Profit before tax	99.7	176.1	191.0	233.1
Depreciation	22.6	48.5	62.5	66.8
Adjustment	7.8	8.7	0.0	0.0
Working capital	-84.2	-154.8	5.3	-84.1
Net operating CFs	**45.9**	**78.4**	**258.8**	**215.7**
Fixed asset	-43.2	-451.0	-81.8	-57.9
Deposit, equity investment	-100.3	-91.4	0.0	0.0
Interest, dividend, cash profit received	0.0	0.0	0.0	0.0
Net investing CFs	**-143.4**	**-542.5**	**-81.8**	**-57.9**
Capital	0.0	383.4	0.0	0.0
Debt	70.2	283.8	-3.2	125.0
Dividend paid & other	-32.6	-160.0	-191.2	-160.2
Net financing CFs	**37.7**	**507.2**	**-194.4**	**-35.1**
Beginning cash & equivalents	**87.1**	**27.2**	**70.4**	**53.0**
Net cash flow	-59.9	43.2	-17.4	122.7
Ending cash & equivalents	**27.2**	**70.4**	**53.0**	**175.7**

COMPANY REPORT

This report is created for the purpose of providing investors with an insight into the discussed company that may assist them in the decision-making process. The report comprises analyses and projections that are based on the most up-to-date information with the objective that is to determine the reasonable value of the stock at the time such analyses are performed. Through this report. we strive to convey the complete assessment and opinions of the analyst relevant to the discussed company. To send us feedbacks and/or receive more information. investors may contact the assigned analyst or our client support department.

RATING GUIDANCE

Ratings	BUY	NEUTRAL	SELL
Total Return including Dividends in 12-month horizon	>20%	-20% to 20%	<-20%

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