Vietnam Dairy Products JSC (HSX: VNM)

Expecting a Recovery

(VND bn)	Q2-FY18	Q1-FY18	*+/-qoq*	Q2-FY17	*+/-yoy*
Net revenue	13,702	12,121	+13.1%	13,348	+2.7%
PAT	2,666	2,701	-1.3%	2,922	-8.8%
EBIT	3,017	2,928	+3.0%	3,248	-7.1%
EBIT margin	22.0%	24.2%	-210bps	24.3%	-230bps

Source: VNM, RongViet Securities

1H 2018 performance: net revenue increased slightly due to the consolidation of Vietsugar

Net revenue increased slightly by 1.7% to VND 25,823 bn because of the increase of 3.2% in domestic sales through the recognition of an additional VND 900 bn in consolidated revenue from Vietsugar (its new subsidiary). However, export revenues fell by 6.8% due to political issues in the Middle East, especially Iraq, its main export market. Until now, revenues from Iraq have continued to decline and have not showed signs of recovery.

Gross margins dropped from 48.7% to 46.3% due to the rise in raw material prices including skimmed milk powder, butter and whole milk powder. In addition, the acquisition in the sugar segment, which has tight margins, also exerted pressure on the bottom line. As a result, NPAT was VND 5,361 bn, decreasing by 8.4% over the same period last year.

2H 2018 outlook: expectation of a recovery in dairy demand and the efficiency of penetration into new markets

The dairy industry has recorded a negative growth rate from Q4 2017 to Q2 2018. However, its momentum has showed some sign of recovery in Q2 2018 and that is the reason why we expect a better second half. Vinamilk will continue to dominate the market and gain more market share from its competitors. The effectiveness of its domestic cooperation strategy with Hau Giang Pharmaceutical (DHG), Vietnam Airlines (HVN) and its joint venture in export markets such as Myanmar, Indonesia, China will boost its sales growth. For 2018, we forecast revenue growth of 5.6% YoY to VND 53,910 bn, NPAT of VND 10,317 bn (+0.2% YoY) corresponding to an EPS of VND 5,331 per share.

Valuation and recommendation*: The decline in the demand of dairy products and the fluctuation of raw material prices negatively affects VNM's earnings. However, we believe that VNM has adopted the right strategies that will boost its revenue in both domestic and export markets. In the long run, VNM is still a promising stock with a healthy financial structure, a low debt ratio (1.6%) and a large amount of cash. This will be the key catalyst for its M&A activities in order to expand its scale and increase its competitiveness in the market.*

We combine two valuation methods: FCFF and P/E to evaluate VNM's fair value. The conclusion is that the stock is worth ***VND 141,800/share*** *an anticipate a cash dividend of VND 3,000 per share in the next 12 months, which results in a* ***6.5%*** *total return from the closing price on September 17th, 2018. Therefore, we recommend ACCUMULATE on this stock.*

ACCUMULATE

CMP (VND)	136,000
Target price (VND)	141,800
Cash dividend (VND)*	3,000

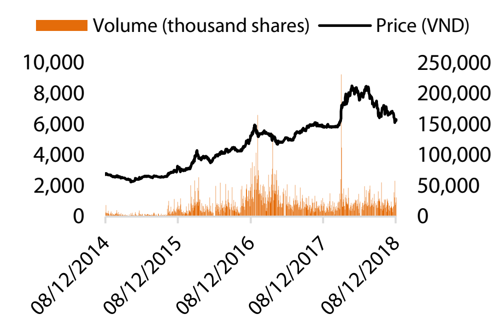
** Expected in the next 12 months*

Stock info

Sector	Food & Beverage
Market Cap (VND billion)	236,835
Current Shares O/S (Bn shares)	1.74
Avg. Daily Volume (in 20 sessions)	1,041,628
Free float (%)	4.86
52 weeks High	175,200
52 weeks Low	119,580
Beta	0.61

	FY2017	Current
EPS	5,295.0	5,065.0
EPS growth (%)	8.9	-8.6
Adjusted EPS	5,295.0	5,065.0
P/E	32.8	26.3
P/B	12.9	8.9
EV/EBITDA	22.9	18.2
Cash dividend	5,000	2,000
ROE (%)	40.5	34.9

Price performance



Major Shareholders (%)

SCIC	36.0
F&N Dairy Investment, F&N Bev	20.0
Platinum Victory	10.6
Foreign ownership room (%)	40.9

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Exhibit 1: Q2 2018 results

Particulars (VND bn)	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)	1H-FY18	+/-(YoY)
Net revenue	13,702	12,121	13.1%	13,348	2.7%	25,823	1.7%
Gross profit	6,469	5,487	17.9%	6,541	-1.1%	11,955	-3.3%
SG&A	3,452	2,559	34.9%	3,292	4.8%	6,010	3.1%
Operating income	3,017	2,928	3.0%	3,248	-7.1%	5,945	-9.1%
EBITDA	3,412	3,313	3.0%	3,563	-4.2%	6,725	-6.0%
EBIT	3,017	2,928	3.0%	3,248	-7.1%	5,945	-9.0%
Financial expenses	43	19	124.1%	29	48.9%	63	10.3%
- Interest Expenses	17	9	101.8%	4	329.6%	26	48.4%
Dep. and amortization	395	385	2.7%	314	25.8%	781	24.8%
Non-recurring items (*)							
Extraordinary items (*)							
PBT	3,161	3,176	-0.5%	3,444	-8,2%	6,337	-8.4%
PAT	2,666	2,701	-1.3%	2,922	-8,8%	5,368	-8.4%
(*) Adjusted PAT	2,666	2,701	-1.3%	2,922	-8,8%	5,368	

Source: VNM, RongViet Securities

Exhibit 2: Q2 2018 performance analysis

Particulars	Q2-FY18	Q1-FY18	+/-(QoQ)	Q2-FY17	+/-(YoY)
Profitability ratios (%)					
Gross margin	47.2	45.3	190bps	49.0%	-180bps
EBITDA margin	24.9	27.3	-240bps	26.7%	-180bps
EBIT margin	22.0	24.2	-210bps	24.3%	-230bps
Net margin	19.5	22.3	-280bps	21.9%	-240bps
Adjusted net margin	19.5	22.3	-280bps	21.9%	-240bps
Turnover *(x)					
-Inventories	6.3	6.3	-0.1	6.7	-0.5
-Receivables	10.6	9.9	0.7	13.5	-2.9
-Payables	4.3	3.3	1.0	4.9	-0.6
Leverage (%)					
Total debt/ equity	33.4	32.1	130bps	27.1%	630bps

Source: VNM, (*) Annualized turnover

Exhibit 3: Q3 2018 performance forecast

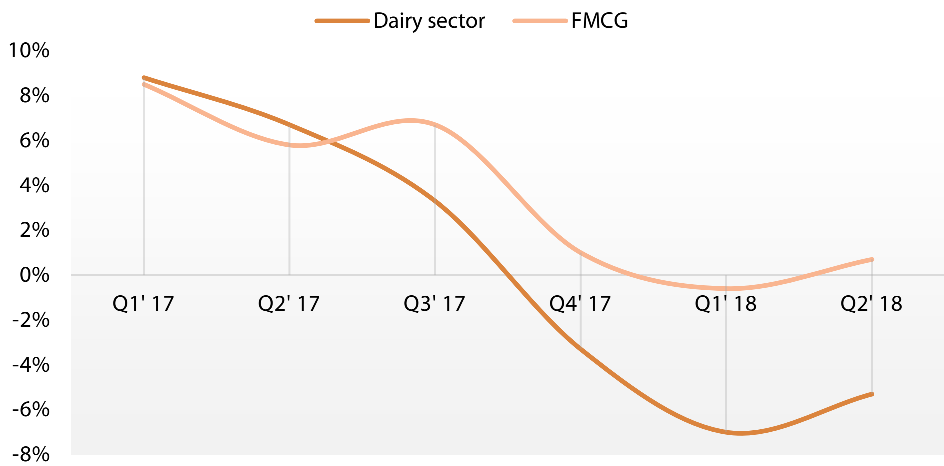
Particulars (VND bn)	Q3-FY18	+/-(QoQ)	+/-(YoY)
Revenue	14,746	10%	11%
Gross profit	6,975	7%	11%
EBIT	3,170	-2%	5%
NPAT	2,816	-4%	5%

Source: VNM, RongViet Securities

Update

The dairy industry has seen a negative growth rate in recent quarters but there are signs of recovery

Figure 1. Dairy growth rate in Q2 2018 (%)

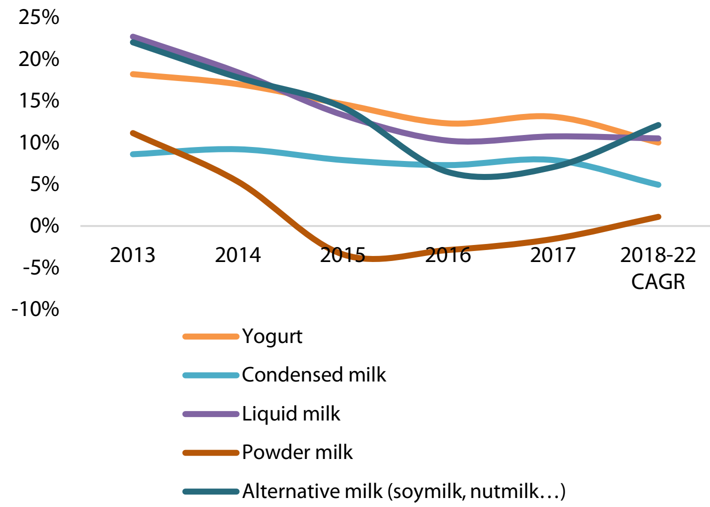


Source: Nielsen, RongViet Securities

According to Kantar Worldpanel, the FMCG growth rate showed signs of slowdown in both urban and rural areas, mainly due to a drop in the demand of dairy products, packaged food and household care products. From Q4 2017, the dairy sector saw negative growth, but Q2 2018 has shown signs of a positive change. We believe that the reason for this downtrend may reflect the change in consumption trends. Consumers become more concerned about their health, switch to high-nutrient, healthy beverages with more stringent quality standards. These are high-end product lines where consumers have to spend less on some mid-range products to spend more on these ones. This reduces the number of products in the consumer basket. The FMCG is focusing on researching and producing the high–quality products. Although these products can help the company to sell higher price products, it could reduce volume and total revenue compared to producing only traditional products.

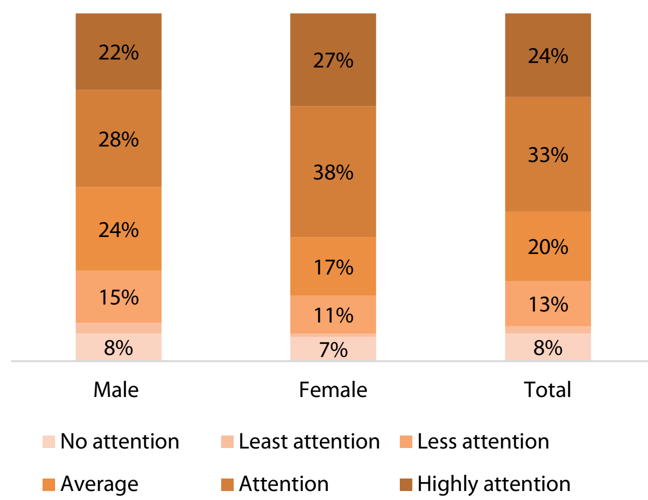
In the dairy industry, Kantar Worldpanel considers that animal and cow's milk demand tend to decrease due to: (1) consumers have more alternative products such as nutmilk, soymilk or beverages, (2) yogurt has more specific products to exploit various taste, (3) consumers change their shopping habits, especially in big cities. Hence consumers are switching to higher nutritional products, typically the premium organic milk line, up to European standards where Vinamilk is a pioneer. However, high quality products still account for a relatively small proportion of total milk supply. In general, the trend of consumption in this sector is to shift to yogurt, high quality liquid milk and alternative milk (nutmilk, soymilk…).

Figure 2. Revenue growth rate in each segment (%)



Source: Euromonitor

Figure 3. A scale of consumer interest in organic milk (%)



Source: Q&Me

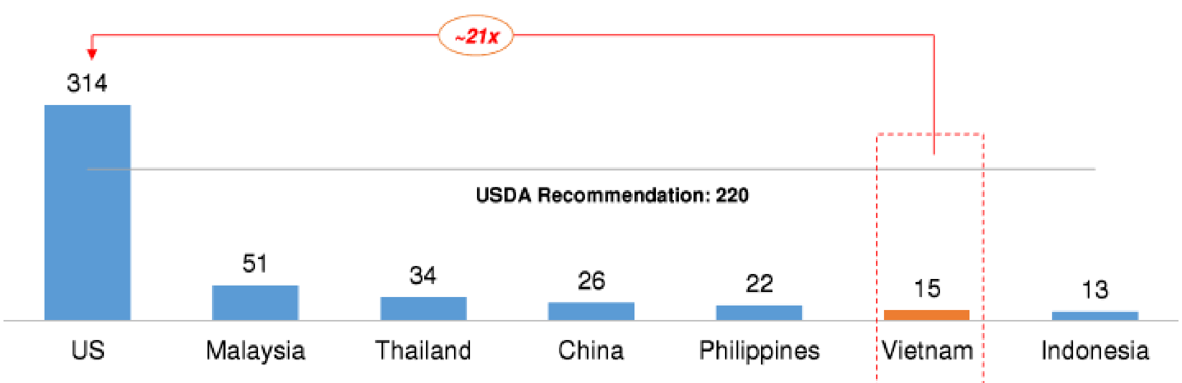
Vietnam is still considered as a potential market for the dairy manufacturers due to:

(1) Large population with high population growth rate (+1.03%/year),

(2) Young population structure with under 15 years of age accounting for 25% of the total population (~24 million people), this is the "golden age" with high consumption demand for dairy products,

(3) Milk consumption per capita is quite low (around 15kg/person) compared to other countries in the region (Figure 4),

Figure 4. Dairy consumption per capita (kg)



Source: VNM

We consider that the decline of this essential sector is over in the short run because the dairy consumption per capita is low. The main drivers for dairy products demand are (1) high population growth rate coupled with a young population structure, (2) low consumption per capita. Vietnam has both, so the dairy industry is expected to keep growing in the near future.

VNM, with its strong financial structure and its ability to develop new product lines combined with effective marketing will benefit In the near future. Currently, VNM has strategies to promote its revenue growth in both domestic and export markets, launch its new product lines to keep up with consumer trends through high-quality products and the promotion of yogurt and alternative milk products.

Transferring to high-end dairy products and other dairy products

Figure 5. New products launched in 1H 2018

Source: VNM

In 1H 2018, VNM launched eight new products: yogurt, fresh milk, condensed milk and powder milk. As the demand for animal milk tends to level off, VNM promoted the development of other dairy products such as yogurt (Greek, sticky price, pineapple yogurt) and alternative milk products (banana milk, drink cheese). In addition, VNM paid more attention to the expansion of the dairy farm, closely cooperating with household farmers. It aims to reduce the proportion of raw milk imported from 70% to 60% by 2022. We consider that the increase in material self-sufficiency will help VNM to control the quality of raw milk input, thereby improving the quality of output in the future.

Besides, VNM imported 200 pure A2 dairy cows from New Zealand to produce 100% pure sterilized milk products, expected to be sold by "Giac mo sua Viet" stores (VNM showroom) and targeted to be launched in the second half of this year. Moreover, VNM signed a cooperation agreement with Song Hau Farm (Can Tho province) to plan a complex of hi-tech dairy farms with a scale of 22,000 cows, square of 6,000 ha and total investment of around VND 4,000 bn.

Improving its domestic revenue through cooperation with airlines

The recent cooperation with Vietnam Airlines (HVN), the leading airline in Vietnam, shows its long-term commitment between two partners. The cooperation with HVN will help to reach customers in the aviation sector. The company will meet the demand for 25-30 million passengers in the categories of liquid milk, yogurt, fruit juice... Revenues are expected to grow 10% per year. Growth of tourists coming to Vietnam (CAGR of 9% in 2017-2020) will be the main driver.

Finding new export markets

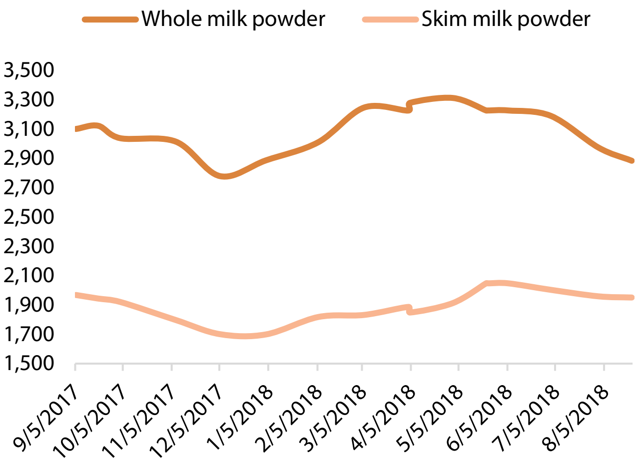
In 1H 2018, Iraq, its main export market (60% of revenue) showed no signs of recovery due to political issues. Revenues in the ASEAN market grew by 15% over the same period (especially Cambodia, the Philippines). Although ASEAN still accounted for a small proportion of total export revenue, this is a positive sign for VNM to seek the opportunity to promote its products into these markets.

VNM has an active strategy to find new export markets to replace Iraq. In China, the company has exported the Probi drinking yogurt and received positive feedbacks. VNM is waiting for the signing of a free trade agreement between Vietnam and China to export its liquid milk, condensed milk and powder milk.

In addition, VNM is in the process of establishing a joint venture in Myanmar and Indonesia to initially sell yogurt products. VNM can utilize its knowledge of consumer behavior as well as distribution channels from its partners to reduce expenses and promote the export of current products to boost revenues.

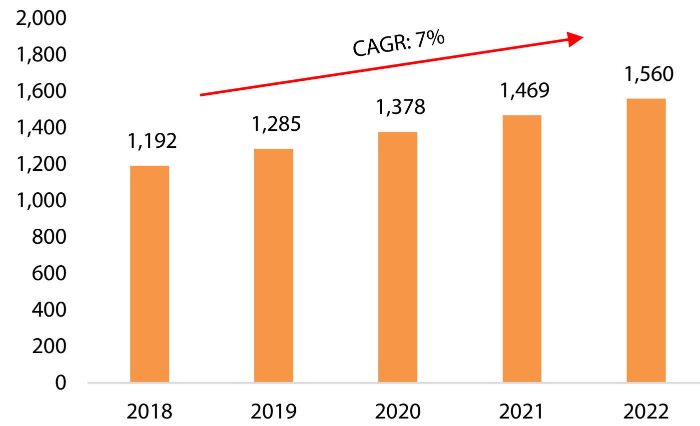
Appendix:

Figure 6. Milk powder price (USD/ton)



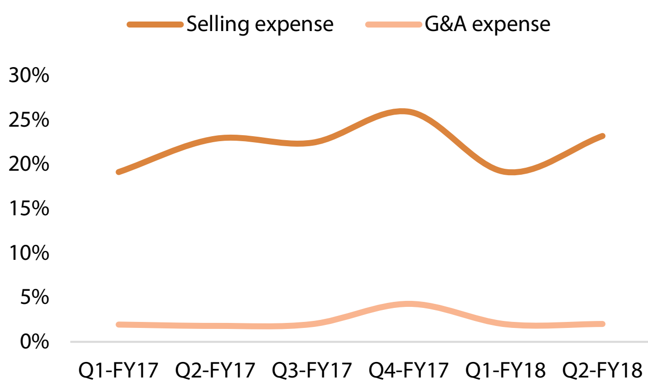
Source: Bloomberg

Figure 7. Milk consumption in Vietnam 2018-2022 (thousand tons)



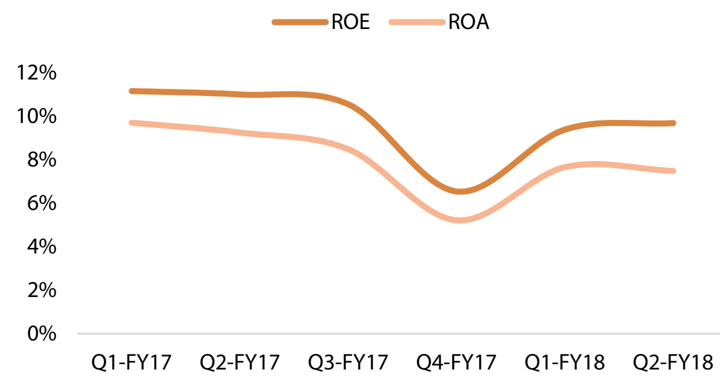
Source: Euromonitor

Figure 8. Selling expense, SG&A expense over revenue (%)



Source: VNM, RongViet Securities

Figure 9. ROE, ROA (%)



Source: VNM, RongViet Securities

VND in billions

Income statement	FY2016	FY2017	FY2018E	FY2019F
Revenue	46,794	51,041	53,910	57,718
COGS	24,459	26,807	28,444	30,304
Gross profit	22,336	24,234	25,466	27,414
Selling expense	10,759	11,537	12,399	12,698
G&A expense	1,053	1,268	1,348	1,385
Finance income	723	816	723	731
Finance expense	102	87	99	97
Other profits	77	3	40	20
Gain/(loss) from JVs	16	67	27	30
PBT	11,238	12,229	12,410	14,015
Prov. of tax	1,874	1,951	2,110	2,523
Minority's interest	14	-17	-17	-17
PAT to equity S/H	9,350	10,296	10,317	11,510
EBIT	10,524	11,430	11,719	13,331

%

Financial ratio	FY2016	FY2017	FY2018E	FY2019F
Growth (%)				
Revenue	16.8	9.1	5.6	7.1
Operating income	20.0	8.6	4.0	13.3
EBITDA	20.0	8.6	2.5	13.8
PAT	20.3	10.1	0.2	11.6
Total assets	6.8	17.9	6.4	6.4
Equity	7.1	5.4	14.9	6.1
Profitability (%)				
Gross margin	47.7	47.5	47.2	47.5
EBITDA margin	25.0	24.9	24.6	26.0
EBIT margin	22.5	22.4	21.7	23.1
Net margin	20.0	20.2	19.1	19.9
ROA	32.0	29.9	28.1	29.5
ROE	42.2	44.0	40.7	43.6
Efficiency (x)				
Receivable turnover	16.3	11.1	13.0	14.3
Inventory turnover	5.4	6.7	6.3	6.3
Payable turnover	5.2	2.9	3.8	3.8
Liquidity (x)				
Current	3.1	2.1	2.6	2.5
Solvency (%)				
Total debt/equity	7.5	2.3	3.4	3.9
Current debt/equity	6.0	1.1	1.9	2.1
Long-term Debt/equity	1.5	1.2	1.5	1.9

VND in billions

Balance sheet	FY2016	FY2017	FY2018E	FY2019F
Cash and cash equivalents	655	963	1,094	1,478
Short-term investments	10,454	10,562	10,562	10,562
Accounts receivable	2,867	4,592	4,151	4,040
Inventories	4,522	4,021	4,551	4,849
Other current assets	176	170	178	187
Property, plant & equipment	8,919	12,133	14,089	15,836
Acquired intangible assets	529	794	764	725
Long-term investments	614	556	582	612
Other non-current assets	516	696	731	768
Total assets	**29,251**	**34,486**	**36,703**	**39,056**
Accounts payable	4,668	9,235		
Short-term borrowings	1,333	268	7,395	7,879
Long-term borrowings	327	275	516	587
Other non-current liabilities	188	324	407	538
Bonus and welfare fund	457	692	340	357
Technology-science, dev. fund	0	0	692	692
Total liabilities	**6,973**	**10,794**	**9,350**	**10,054**
Common stock and APIC	14,775	14,775	17,678	17,678
Treasury stock (enter as -)	-1	-7	-7	-7
Retained earnings	5,592	5,737	5,282	5,782
Other comprehensive income	6	18	18	18
Inv. and dev. fund	1,797	2,852	3,884	5,035
Total equity	**22,169**	**23,375**	**26,855**	**28,505**
Minority interest	**237**	**498**	**498**	**498**

Valuation ratio	FY2016	FY2017	FY2018E	FY2019E
EPS (VND)	4,859	5,296	5,331	5,948
P/E (x)	21.5	32.8	25.5	22.9
BV (VND)	15,273	16,105	15,419	16,366
P/B (x)	8.1	12.7	8.8	8.3
DPS (VND/cp)	6,000	5,000	5,000	5,000
Dividend yield	4.8%	2.4%	3.1%	3.1%

Valuation model	*Price*	*Weight*	*Average*
FCFF	145,436	50%	72,718
PE	138,101	50%	69,051
Target price (VND)			**141,800**

Valuation history	*Price*	*Recommendation*	*Period*
15/09/2017	169,300	Buy	Long term
19/12/2014	110,000	Buy	Long term

RESULTS UPDATE

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	ACCUMULATE	REDUCE	SELL
Total Return including Dividends in 12-month horizon	>20%	5% to 20%	-20% to -5%	<-20%

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