

Vietnam Dairy Products JSC (VNM: HOSE)



MARKET PERFORM – 1Y Target Price: VND 124,000

Current price: VND 107,200

Trang Pham

trangph@ssi.com.vn

+84 24 3936 6321 ext. 537

12 February 2020

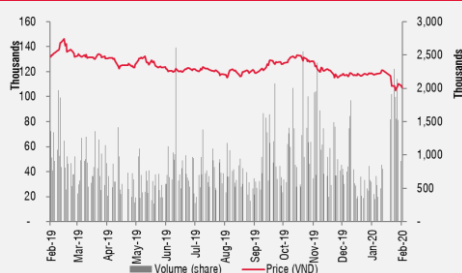
CONSUMER – VIETNAM

Key figures

Market cap (USD mn)	8,031
Market cap (VND bn)	186,676
Outstanding shares (mn)	1,741
52W high/low (VND 1,000)	152.6/101
Average 3M volume (share)	9754,144
Average 3M value (USD mn)	4.94
Average 3M value (VND bn)	114.84
Foreign ownership (%)	58.72
State ownership (%)	36
Management ownership (%)	<1

Source: SSI Bloomberg

VNM Price & Trading Volume



Source: Bloomberg

Company Snapshot

Vietnam Dairy Products JSC (Vinamilk) was founded in 1993 as a State-owned enterprise. Since listing in 2006, VNM has been the best performing stock and driven the VN-Index.

Vinamilk is Vietnam's leading dairy producer. It also exports to 50 countries, such as Iraq, Cambodia and the Philippines.

Its well-known brand, constant product innovation, extensive distribution network of 266 exclusive distributors and 224,000 retail outlets, as well as good and strong corporate governance are VNM main strengths.

EARNINGS UPDATE

Double digit top-line growth from GTN consolidation

What's new

For 2019, VNM posted net sales of VND56.3tn in (+7.1% YoY) and net profit of VND10.55tn (+3.4% YoY), accounting for 100% and 100.7% of its annual targets, respectively. While revenue was within our estimate, net profit was slightly lower than our expectations of VND10.8tn. This was due to a 23% YoY surge in administrative expenses, which was mostly driven by higher bonuses for employees and lower-than-expected net other income.

VNM's gross margin reached 47.2% in 2019 (vs. 46.8% in 2018). During the year, the company had to raise its ASP by 1-3% to cushion its margin from raw material price increases. The company's market share remained steady at 61% by volume by the end of 2019, unchanged compared to 2018.

VNM started to consolidate GTN Foods (GTN: HOSE) in the last days of 2019. Total assets rose 19.6% YoY, partially due to the consolidation of GTN. Goodwill arising from the deal was VND1.5tn.

What's the impact

We cut our 2020E net profit forecast by 5% after updating 2019 results and factoring in GTN's performance. Now, we forecast net sales of VND63.63tn (+13% YoY) and net profit of VND11.07tn (+4.9% YoY) for 2020.

What we recommend

VNM's shares are trading at a 2020F P/E of 18.7x and an EV/EBITDA of 11.3x, which is relatively cheap compared to regional peer valuations of 25x and 14.0x. This we believe is justified given unattractive single digit long-term growth (2019-2024F net profit CAGR of 6.7%). As such, we trim our 12-month target price for VNM to VND 124,000 (from VND 139,000), based on lower 2020E EPS and target P/E of 22x and using DCF (50% weighting for each method). We accordingly maintain our MARKET PERFORM rating for the stock.

Upside surprises: Higher-than-expected sales growth; lower-than-expected raw-material prices.

Downside risks: Higher-than-expected raw-material prices.

4Q19 detailed analysis

(bn VND)	4Q19	4Q18	YoY	3Q19	QoQ	% annual target completed	Margin			
							4Q19	4Q18	3Q19	2019
Net sales	14,239	13,004	9.5%	14,291	-0.4%	100.0%				
Gross profit	6,680	6,163	8.4%	6,723	-0.6%		46.9%	47.4%	47.0%	47.2%
Operating profit	2,488	2,483	0.2%	3,121	-20.3%		17.5%	19.1%	21.8%	22.3%
EBIT	2,685	2,692	-0.3%	3,282	-18.2%		18.9%	20.7%	23.0%	23.1%
EBITDA	3,188	3,128	1.9%	3,782	-15.7%		22.4%	24.1%	26.5%	26.5%
Pretax profit	2,649	2,681	-1.2%	3,254	-18.6%		18.6%	20.6%	22.8%	22.7%
Net income	2,176	2,284	-4.7%	2,677	-18.7%	100.7%	15.3%	17.6%	18.7%	18.7%
NI attributable to shareholders	2,202	2,299	-4.3%	2,690	-18.2%		15.5%	17.7%	18.8%	18.8%

Source: Company, SSI

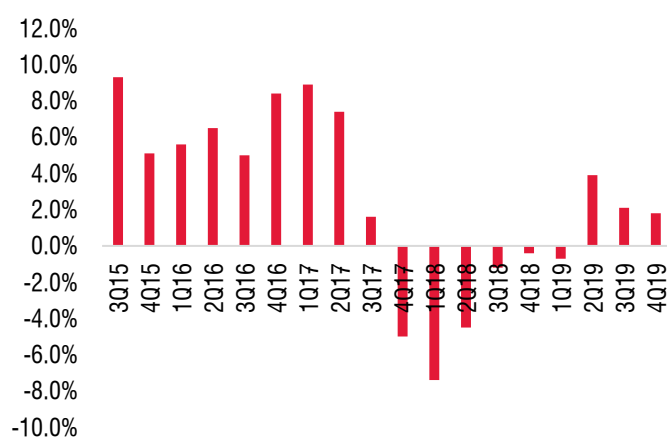
Vinamilk's domestic dairy sales reached VND11.36tn in 4Q19 (+10.1% YoY). Excluding the impact of 1-3% ASP rise in April and August 2019, domestic volume advanced by 7-8% YoY in 2019, which is rather positive compared to the growth rates in the previous quarters and versus the milk-bases consumption growth of only +1.8% YoY in 4Q19, according to Nielsen.

Among VNM's product categories, the company said that most categories witnessed positive growth, except for a slowdown in drinking yogurt and condensed milk. VNM's market share by the end of 4Q19 dropped to 61% from 61.3% by the end of 3Q19, suggesting that VNM lost market share to its competitors. This was despite positive sales growth in 4Q19. Therefore, we believe there was a mismatch between company sales data, which measure sales to distributors ("sell-in"), while its market share is provided by Nielsen, which tracks sales at retail stores ("sell-out").

Meanwhile, Moc Chau and Vinasoy posted revenue growth of 7.4% YoY and -2.4% YoY in 4Q19, lower than VNM in the same period.

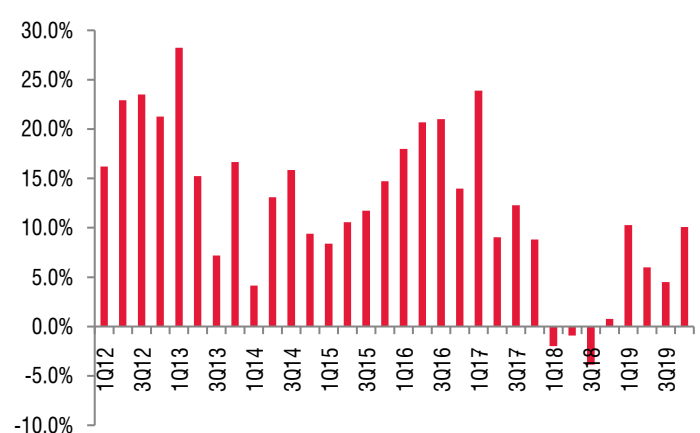
Cumulatively, Vinamilk's domestic sales reached VND45.6tn, +7.6% YoY in 2019, in line with our forecasts.

Milk-bases value growth in Vietnam



Source: AC Nielsen

VNM quarterly domestic dairy sales growth



Source: Company, SSI

Export sales reached VND1.57tn in 4Q19, increasing by 26.6% YoY. Cumulatively, export sales totaled VND5.18tn (+14.8% YoY) for full year 2019. Double-digit growth of export sales in 2019 was a positive, thanks to the recovery of the Iraq market, bouncing back from a low base in 2018. Meanwhile, its gross margin reached 61.8%

(vs. 60.8% back in 2018), which was driven by increased powder milk volume exported to Iraq (which carries a high margin).

Overseas subsidiaries, including Driftwood and Angkor, reported a 5.8% YoY higher sales growth in 4Q19 and 8.6% sales growth in 2019 thanks to strong growth at Angkor Milk (more than 25% YoY in 2019) while Driftwood sales flatlined YoY. The gross margin of overseas subsidiaries was 26.2% in 2019, lower than the 28% in 2018, mostly on a lower margin from Driftwood as they dealt with higher raw material input prices.

Sugar & dairy business. Other revenue in 2019 reached VND 1.96 tn (-17.2% YoY, mostly on lower sugar revenue), with gross margins having improved significantly to 30.5% for 2019, vs. 19.8% in 2018, thanks to improved profitability of the Thanh Hoa farm and the organic farm in Lam Dong.

Margin trend. The domestic dairy gross margin was 47.8% in Q4. This was similar to that in 3Q19, yet significantly lower than the 4Q18 level of 50.1%. For full year 2019, the domestic dairy gross margin totalled 47.9% vs. 48.3% in 2018. As such, the company's 1-3% ASP hike during the year helped to cushion gross margin from rising milk powder prices.

The overall gross margin totalled 47.2% in 2019 (vs. 46.8% in 2018).

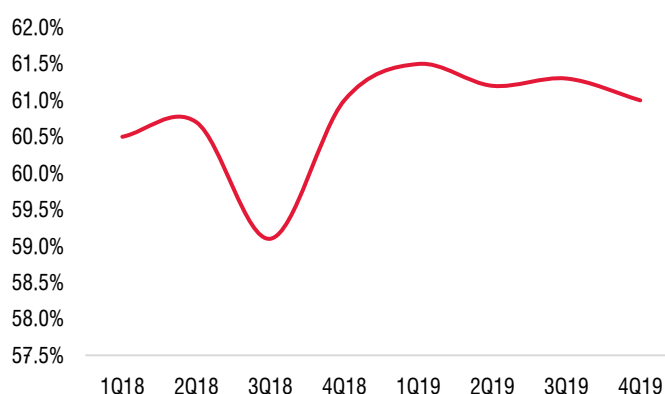
According to the management, VNM has locked in raw milk prices to May 2020. In general, the average raw milk price in 2020 will continue to be higher than 2019, and the company may continue to raise its ASP and pass on costs to distributors and consumers if necessary to protect its margin.

The selling expense-to-sales ratio totalled 23.1% in 2019 vs. 23.3% in 2018. However, admin expenses surged by 23.2% YoY in 2019, accounting for 2.5% of total sales in 2019 (vs. 2.2% in 2018). These mostly came from higher staff expenses and other expenses, which we did not anticipate. According to the company, this was done to retain key employees with the company (given there is no ESOP so far and there was no increase in staff expenses in 2018) while the labor market is competitive, especially in the consumer sector. VNM explained that a strong surge in admin expenses will likely not be the case in 2020.

Cumulatively for 2019, VNM posted net sales of VND56.3tn (+7.1% YoY) and net profit of VND10.55tn (+3.4% YoY), accounting for 100% and 100.7% of its respective annual targets.

Other updates

VNM market share by volume



Source: AC Nielsen

School milk program. Vinamilk has won contracts for 20 out of 22 cities and provinces (including Hanoi, Danang, and Ho Chi Minh City) that participated in the program via public bidding for the suppliers of school milk for 2018-20 period. The potential size of the program for HCMC was not disclosed yet, but could be bigger than Hanoi (we do know that annual revenue from the program in Hanoi is VND 1.2tn a year).

Consolidation of GTN. VNM raised its ownership in GTN to 75% from 41% in December 2019, and started to consolidate it as a subsidiary in the last days of 2019. Total investment costs reached VND3.45tn, implying an average purchasing price of VND 18,380/share. A goodwill of VND1.5tn arose from the transaction, which will possibly increase VNM's administrative expenses by approx. VND150bn (10% of 2019 admin expenses) a year starting from 2020.

Including Moc Chau Milk, VNM is now sourcing milk from 157,500 cows (+ 26% YoY), of which nearly 33,000 cows are from its owned farms (vs. 27,000 heads as of 2018).

VNM's total assets increased by 19.6% YoY to VND44.7tn largely due to the consolidation of GTN. VNM's short-term borrowings rose from VND 1.1 tn by the end of 2018 to VND 5.4 tn by the end of 2019, while cash and short-term investment also increased from VND10.2tn by 2018-end to VND15.1tn by the end of 2019. As such, VNM could use short-term borrowing solutions to finance the purchase of GTN, as its short-term deposits had not yet generated yield.

Impact of coronavirus outbreak: According to VNM, it is quite too early to conclude and estimate the impact. However, in our opinion, the impact could be both positive and negative. Dairy products are considered to be a rich protein supply, while also being convenient to consume, especially given the fact that consumers will likely refrain from going out to public places and reduce out-of-home consumption. On the negative side, coronavirus outbreak might cause potential disruption or difficulties in logistics, and exports to China could be delayed.

Earnings estimates

We have updated our model to factor in lower-than-expected net profit in 2019 and the GTN consolidation.

For 2020, our key assumptions include domestic dairy sales growth of 7.5% YoY. This is on the back of a 5-6% volume growth and a 2-3% price increase due to a change in the product mix. There are also beneficial factors towards a stronger domestic daily sales growth via additional revenue from new products launched in 2019 and milk school co-op programs. Overseas sales growth of 8-10% YoY is also something to watch for, and we have not factored in China market yet. However, raw-material prices are slated to be 5% higher in VND terms, which will be a slight drag on margins. There is also a SG&A-to-sales ratio to note of 25.6% (vs. 25.6% in 2019), which is higher than our previous assumption of 25.4%. Finally, we expect a relatively familiar tax rate for VNM of 18% (vs. 17.5% in 2019). Adding to our expectations, we look for GTN to undergo significant restructuring in 2020, thus generating minimal earnings in 2020. Compared to our previous forecasts, we trim our adjusted 2020F net profit by 4%. As such, we now estimate VNM to post VND63.63tn (+13% YoY) in net revenue and VND11.07tn (+4.9% YoY) in net profit for 2020.

It should be noted that we have not taken into account any one-off gains/losses resulting from GTN restructuring.

Earnings revision

VNDbn	2020F		Note
	Old	New	
Sales	60,585	63,635	Consolidation of GTN
Increase/Decrease		5.03%	
Net income	11,628	11,074	Consolidation of GTN, higher admin costs
Increase/Decrease		-5%	

Source: SSI forecasts

Valuation & recommendation

VNM's shares are trading at a 2020F P/E of 18.7x and an EV/EBITDA of 11.3x, which are relatively cheap compared to regional peer valuations of 25x and 14.0x. We believe these multiples are justifiable given a relatively unattractive single digit long-term growth forecast (2019-2024F net profit CAGR of 6.7%). We trim our 12-month target price for VNM to VND124,000 (from VND 139,000), based on a lower 2020E EPS and target P/E of 22x and using DCF methodology, with a 50% weighting used to derive these metrics. We accordingly maintain our MARKET PERFORM rating for the stock.

Upside surprises: Higher-than-expected sales growth and lower-than-expected raw-material prices would be an event outside the expectations of our call. Further privatization of VNM would likely be seen as a positive sentiment regarding the share price.

Downside risks: Lower-than-estimated sales growth; higher-than-expected raw-material prices.

APPENDIX: ANNUAL FINANCIAL STATEMENTS

VND Billion	2018	2019	2020F	2021F
Balance Sheet				
+ Cash	1,523	2,665	5,304	6,908
+ Short-term investments	8,674	12,436	8,001	8,001
+ Account receivables	4,639	4,503	5,088	5,438
+ Inventories	5,526	4,983	5,822	6,180
+ Other current assets	198	134	155	165
Total Current Assets	20,560	24,722	24,370	26,691
+ LT Receivables	88	21	24	26
+ Net Fixed Assets	13,365	14,894	15,945	16,789
+ Investment properties	90	62	52	43
+ LT Assets in progress	868	944	976	996
+ LT Investments	1,069	987	688	688
+ Other LT Assets	1,325	3,071	2,952	2,790
Total Long-Term Assets	16,806	19,978	20,638	21,331
Total Assets	37,366	44,700	45,008	48,022
+ Current Liabilities	10,640	14,443	13,403	14,226
<i>In which: ST debt</i>	<i>1,060</i>	<i>5,351</i>	<i>2,780</i>	<i>2,951</i>
+ Non-current Liabilities	455	526	614	652
<i>In which: LT debt</i>	<i>216</i>	<i>123</i>	<i>144</i>	<i>153</i>
Total Liabilities	11,095	14,969	14,017	14,878
+ Contributed capital	17,417	17,417	17,417	17,417
+ Share premium	0	0	0	0
+ Retained earnings	7,155	7,875	8,580	10,117
+ Other capital/fund	1,699	4,439	5,005	5,621
Shareholders' Equity	26,271	29,731	31,001	33,155
Total Liabilities & Equity	37,366	44,700	45,019	48,033
Cash Flow				
CF from operating activities	8,083	11,342	16,598	13,133
CF from investing activities	-1,045	-6,748	-2,701	-3,000
CF from financing activities	-6,535	-3,516	-11,247	-8,529
Net increase in cash	503	1,078	2,650	1,604
Beginning cash	963	1,523	2,597	5,247
Ending cash	1,466	2,597	5,247	6,851
Liquidity Ratios				
Current ratio	1.93	1.71	1.82	1.88
Acid-test ratio	1.39	1.36	1.37	1.43
Cash ratio	0.96	1.05	0.99	1.05
Net debt / EBITDA	-0.72	-0.62	-0.64	-0.65
Interest coverage	238.79	118.58	103.88	107.08
Days of receivables	24.3	22.2	21.2	21.8
Days of payables	52.0	46.9	41.5	43.5
Days of inventory	62.3	64.5	56.7	59.4
Capital Structure				
Equity/Total asset	0.70	0.67	0.69	0.69
Liabilities/Total Assets	0.30	0.33	0.31	0.31
Liabilities/Equity	0.42	0.50	0.45	0.45
Debt/Equity	0.05	0.18	0.09	0.09
ST Debt/Equity	0.04	0.18	0.09	0.09

Source: Company, SSI forecasts

VND Billion	2018	2019	2020F	2021F
Income Statement				
Net Sales	52,562	56,318	63,635	68,005
COGS	-27,951	-29,746	-34,756	-36,889
Gross Profit	24,611	26,572	28,879	31,116
Financial Income	760	807	1,117	1,210
Financial Expense	-118	-187	-360	-382
Income from associates	0	0	0	0
Selling Expense	-12,266	-12,993	-14,383	-15,438
Admin Expense	-1,133	-1,396	-1,785	-1,765
Income from business operation	11,877	12,797	13,499	14,775
Net Other Income	175	-1	38	41
Profit Before Tax	12,052	12,796	13,537	14,816
Net Income	10,206	10,554	11,074	12,068
NI attributable to shareholders	10,227	10,581	11,074	12,054
Minority interest	-22	-27	0	14
Key Metrics				
Basic EPS (VND)	5,295	5,478	5,722	6,229
BVPS (VND)	14,802	15,794	16,521	17,749
Dividend (VND/share)	6,000	6,001	5,000	5,000
EBIT	12,103	12,905	13,669	14,956
EBITDA	13,730	14,853	15,627	17,121
Growth				
Sales	3.0%	7.1%	13.0%	6.9%
EBITDA	1.3%	8.2%	5.2%	9.6%
EBIT	-1.3%	6.6%	5.9%	9.4%
NI	-0.7%	3.4%	4.9%	9.0%
Equity	10.0%	13.2%	4.3%	6.9%
Chartered Capital	20.0%	0.0%	0.0%	0.0%
Total assets	7.8%	19.6%	0.7%	6.7%
Valuation				
P/E	22.7	19.6	18.7	17.2
P/B	8.1	6.8	6.5	6.0
Other Metrics				
Dividend yield	4.2%	5.6%	4.7%	4.7%
EV/EBITDA	14.4	11.9	11.3	10.3
EV/Sales	3.8	3.1	2.8	2.6
Profitability Ratios				
Gross Margin	46.8%	47.2%	45.4%	45.8%
Operating Margin	22.9%	21.7%	19.8%	20.6%
Net Margin	19.4%	18.7%	17.4%	17.7%
Selling exp./Net sales	23.3%	23.1%	22.6%	22.7%
Admin exp./Net sales	2.2%	2.5%	2.8%	2.6%
ROE	40.7%	37.7%	36.5%	37.6%
ROA	28.3%	25.7%	24.7%	25.9%
ROIC	39.4%	33.9%	32.3%	34.7%

1. ANALYST CERTIFICATION

The research analyst(s) on this report certifies that (1) the views expressed in this research report accurately reflect his/her/our own personal views about the securities and/or the issuers and (2) no part of the research analyst(s)' compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

2. RATING

Buy: Expected to provide price gains of at least 10 percentage points greater than the market over next 12 months

Outperform: Expected to provide price gains of up to 10 percentage points greater than the market over next 12 months.

Market Perform: Expected to provide price gains similar to the market over next 12 months.

Underperform: Expected to provide price gains of up to 10 percentage points less than the market over next 12 months.

Sell: Expected to provide price gains of at least 10 percentage points less than the market over next 12 months

3. DISCLAIMER


The information, statements, forecasts and projections contained herein, including any expression of opinion, are based upon sources believed to be reliable but their accuracy completeness or correctness are not guaranteed. Expressions of opinion herein were arrived at after due and careful consideration and they were based upon the best information then known to us, and in our opinion are fair and reasonable in the circumstances prevailing at the time, and no unpublished price sensitive information would be included in the report. Expressions of opinion contained herein are subject to change without notice. This document is not, and should not be construed as, an offer or the solicitation of an offer to buy or sell any securities. This report also does not recommend to U.S. recipients the use of SSI to effect trades in any security and is not supplied with any understanding that U.S. recipients will direct commission business to SSI. SSI and other companies in the SSI and/or their officers, directors and employees may have positions and may affect transactions in securities of companies mentioned herein and may also perform or seek to perform investment banking services for these companies.

This document is for private circulation only and is not for publication in the press or elsewhere. SSI accepts no liability whatsoever for any direct or consequential loss arising from any use of this document or its content. The use of any information, statements forecasts and projections contained herein shall be at the sole discretion and risk of the user.

4. CONTACT INFORMATION

 **Trang Pham**

Research Manager

 Tel: (84-24) 3936 6321 ext. 537

 trangph@ssi.com.vn

 **Phuong Hoang**

Deputy Managing Director,

Head of Research & Advisory Center

 phuonghv@ssi.com.vn

 **Hung Pham**

Associate Director

 hungpl@ssi.com.vn