

Vinamilk (VNM)

Attractive valuation & positive long-term outlook

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6M21 earnings and revenue decreased YoY

Vinamilk (VNM) posted VND5,459 billion in earnings (down 6.8% YoY, completing 48.6% of the year plan) on revenue of VND28,906 billion (down 2.5% YoY, reaching 46.6% of the year plan) in the first six months of 2021.

Gross profit margin is affected by input material prices

2Q gross profit margin was flat QoQ at 43.6%, 6M21 margin decreased 2.8 percentage points YoY due to the sharp increase in input material costs (including whole milk powder) from March 2021 (up 20% compared to the average of 2020).

Current valuation is quite attractive. Business recovery and growth mainly depend on the pandemic

VNM shares are traded at a P/E of about 18x, 22x lower than the average of the last five years. The fourth wave of COVID-19 accompanied by social distancing protocols in big cities weakened the purchasing power of consumers in 2Q21.

Recommendation: BUY – Target price: VND102,200 per share

We forecast that in 2021, both earnings and revenue of VNM will not see a sudden growth. The company's earnings and revenue are expected to be VND10,838 billion (down 3.5% YoY) and VND60,012 billion (up 0.6% YoY) in 2021; and VND11,779 billion (up 9.9% YoY) and VND 62,509 billion (up 4.16% YoY) respectively in 2022. Based on VNM's business outlook and valuation results, we recommend BUYING VNM shares with a target price of VND102,200 apiece, 18% higher than the closing price on September 17, 2021.

Buy

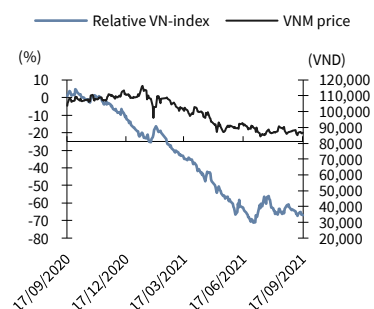
Target price	VND102,200
Upside/downside (%)	0
Current price (July 9, 2021)	86,500
Consensus target price	108,756
Market cap (VNDtn/USDmn)	181,408/7,971

Trading data	
Free float	34%
3M avg trading value (VNDbn/USDmn)	312/13.6
Foreign ownership	26.74%
Major shareholder	SCIC (36%)

Share price performance				
(%)	1M	3M	6M	12M
Absolute	-3.1%	-4.9%	-13.9%	-16.6%
Relative	-0.8%	-0.5%	14%	51.3%

Forecast earnings & valuation

FY-end	2019A	2020A	2021F	2022F
Net sales (VNDbn)	56,318	59,636	60,012	62,509
Earnings/loss (VNDbn)	12,797	13,539	12,888	14,175
Post-tax profit (VNDbn)	10,554	11,236	10,838	11,916
EPS (VND)	5,478	4,770	4,599	5,062
EPS growth (%)	3%	-13%	-3%	10%
P/E (x)	21	22	18	17
P/B (x)	6.8	6.8	5.1	4.6
ROE (%)	38%	38%	34%	34%
Dividend yield (%)	5.21%	4.75%	4%	4%



Source: Bloomberg, KB Securities Vietnam

VNM maintains its leading position

VHM has a system of dairy farms and plants nationwide

As of December 2020, VNM had 13 dairy farms in total with a total herd under direct management of about 32,000 cows. In addition, VNM also buys raw fresh milk of 100,000 cows from domestic farmers, bringing the total number of milked cows to 132,000.

Table 1. VNM – Dairy farms and herd size

	Dairy farm	Year of establishment	Herd size (cows)
1	Tuyen Quang	2007	2,000
2	Binh Dinh	2008	2,000
3	Nghe An	2009	2,600
4	Thanh Hoa	2010	1,600
5	Vinamilk Da Lat	2012	1,600
6	Tay Ninh	2013	8,000
7	Nhu Thanh	2016	2,000
8	Ha Tinh	2016	2,000
9	Organic Da Lat	2017	1,000
10	Thong Nhat Thanh Hoa 1	2018	4,000
11	Organic Xieng Khuang, Laos	2019	24,000 (under construction)
12	Vinamilk Organic Di Linh	2019	700
13	Thong Nhat Thanh Hoa 2	2019	4,000
14	Quang Ngai	2020	4,000

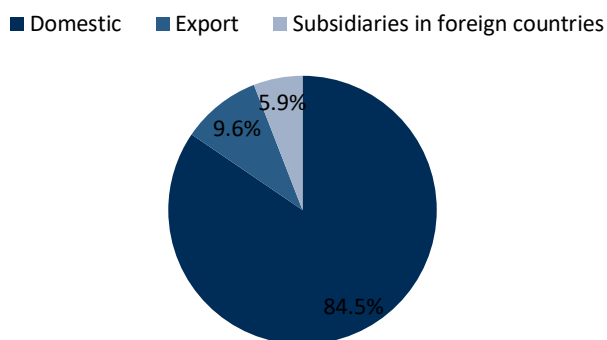
Source: Vinamilk, KB Securities Vietnam

In addition to 13 dairy farms across the country, VHM owns 13 dairies with a total capacity of 5.1 million liters of liquid milk per day, meeting the needs of the domestic and abroad markets with a wide range of products (more than 250 kinds of products). VHM also has a large distribution network with 200 distributors, a total of 240,000 traditional and 7,800 modern retail points.

The revenue structure focuses mainly on the domestic market, but still looks for opportunities in foreign countries

In 2016, VNM officially inaugurated Angkormilk – the first and only dairy plant in Cambodia. In addition, VNM also owns stake in Driftwood – a dairy manufacturer with a long tradition in Southern California, especially in the field of school milk. Most recently, VNM established a joint venture with Del Monte Philippines Inc. (DMPI) – a subsidiary of Del Monte Pacific Limited, is a leading food and beverage business in the Philippines. Thus, VNM is still very focused on finding business development opportunities in foreign markets.

Fig 1. VNM – 1H21 revenue structure (%)

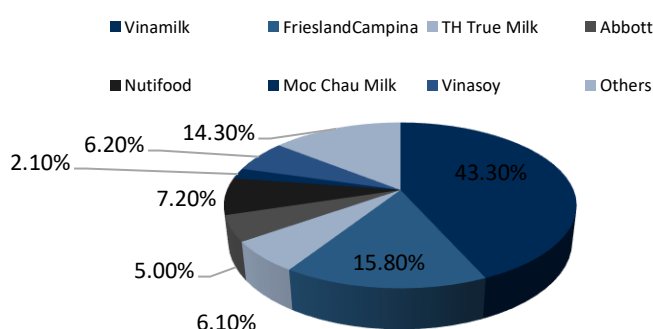


Source: Vinamilk, KB Securities Vietnam

VNM still has the biggest market share in domestic dairy industry

Euromonitor said that in 2020, VNM leads in market share of the whole industry, accounting for 43.3% (excluding Moc Chau Milk) with a strong distribution network covering 64 provinces and cities in Vietnam. VNM holds a very large market share of condensed milk (accounting for about 80%).

Fig 2. Vietnam dairy industry – Market share (%)

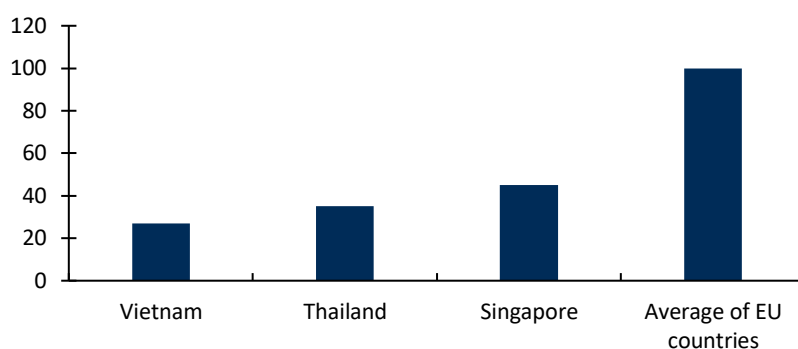


Source: Euromonitor, KB Securities Vietnam

Milk consumption in Vietnam is still lower than in neighboring countries

Currently, the demand for milk and dairy products in Vietnam is only average compared to other countries in the region. The output is 26–28 liters per capita per year (four times lower than the world average and 40% lower than regional peers like Thailand or Singapore). This shows that milk consumption in Vietnam still has good growth potential in the future. According to a report by Kantar Worldpanel, the demand for milk and dairy products in Vietnam is experiencing positive changes thanks to the young population structure and increasing average income. Milk and dairy product sales are expected to maintain at 7%–8% a year in 2020 – 2025.

Fig 3. Global – Dairy consumption per capita in 2020 (litre/capita/year)



Source: KB Securities Vietnam

Negative effects from the pandemic, accompanied by a new trend for products of natural origin

Social distancing measures somewhat have a negative effect on the dairy industry as the demand for on-premise consumption decreases and many tourist facilities, restaurants or schools have to close. Meanwhile, the off-premise consumption is not enough to offset the decline above. In particular, the demand for milk was also hit hard when the whole country had 32.1 million people negatively affected by the pandemic and the average income lost 2.3%.

Regarding product types, as consumers become increasingly aware and interested in health benefits, products from nature that support the digestive system such as 100% organic fresh milk and yogurt have a better growth rate than other commodities. In addition, the new trend of plant-based milk products such as cereals, nuts (beans, almonds and walnuts) is prevalent all over the world. According to Bloomberg Intelligence, the global market of plant-based products could reach USD62 billion by 2030 (thereby representing 10% of the overall dairy market, compared with 4.5% in 2020).

There are two main factors driving the growth of plant-based milk in the future. The first is sustainable growth – plant-based milk has less impacts on the environment than cow dairy products. The second is lactose-intolerant customers (75% of the global population), which should raise the prevalence of lactose-free products and plant-based milk.

There are many opportunities and challenges when the EVFTA comes into force

Adhering to the EVFTA, Vietnam will reduce import tax on products from Europe to 3.5% – 0% compared to 5% – 15% before. This makes imported products from Europe benefit, thereby creating more challenges for domestic dairy producers. On the other hand, some domestic enterprises importing raw materials from Europe may improve their profit margin in the near future.

M&A deals happened among domestic dairy companies

In 2019 – 2020, the dairy industry witnessed two large-scale M&As when VNM bought Seed Moc Chau Dairy Cattle (MCM), and Blue Point acquired International Dairy Products (IDP). This helps subsidiaries take advantage of technology, management experience, and strong distribution network of large parent companies.

1H21 business performance

6M21 net profit and revenue decreased YoY

VNM reported VND5,459 billion in earnings (down 6.8% YoY, completing 48.6% of the year plan) on revenue of VND28,906 billion (down 2.5% YoY, reaching 46.6% of the year plan) in the first six months of 2021.

In 2Q21, VNM recorded the highest quarterly net revenue ever (VND15.716 billion, up 1.4% YoY and 19.2% QoQ). However, post-tax earnings gained in the quarter were only VND2,862 billion (down 7.2% YoY). The company said revenue from domestic sales was VND13,251 billion in 2Q (down 0.8% YoY) as prolonged COVID impacts negatively affected the income and purchasing power of customers.

Meanwhile, net revenue of the export segment recorded a two-digit growth in 2Q (up 17.2% YoY), and the Middle East is still the major export market. VNM received a large number of orders from partners in the US, Taiwan and China in June. Revenue from overseas branches grew 12.8% YoY to VND858 billion, underpinned by Driftwood's recovery when US schools reopened after the pandemic.

Gross profit margin is affected by input material prices

2Q gross profit margin was flat QoQ at 43.6%, but 6M21 margin decreased 2.8 percentage points YoY (Figure 4), which is mainly because of the increase in raw material costs. The prices of input materials (such as whole milk powder) (up 24% YTD) due to strong importing demand from China while the main supply source (mainly from Oceania) decreased (Figure 8).

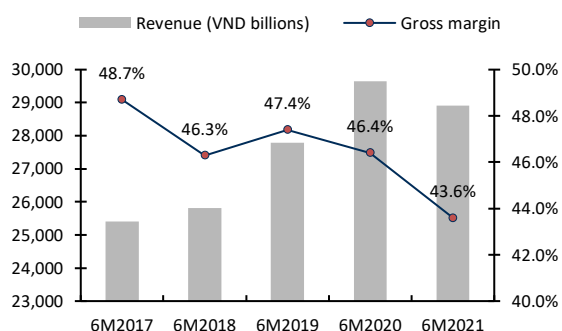
Reduce selling and administrative costs to protect profits

Selling and administrative expenses declined 4.8% YoY and accounted for 22.7% of total revenue in 2Q. These expenses decreased 8.7% YoY and accounted for 22.5% of total revenue in 1H21 (down from 24%). Lower expenses are attributable to optimized sales and promotion expenses which should secure the company's profit from high input material prices.

Net profit margin decreased slightly due to the impact of increasing general & admin expenses

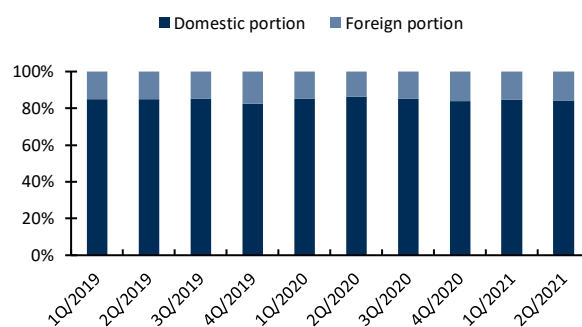
2Q post-tax earnings were down 7.2% YoY to VND2,862 billion (Figure 6). Consolidated net profit margin declined to 18.2% due to VNM's increase in sales and administrative expenses in 2Q for marketing activities.

Fig 4. VNM – Revenue & gross margin (VNDbn, %)



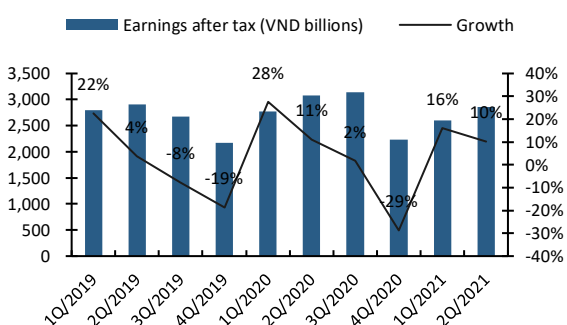
Source: Vinamilk, KB Securities Vietnam

Fig 5. VNM – Revenue structure (%)



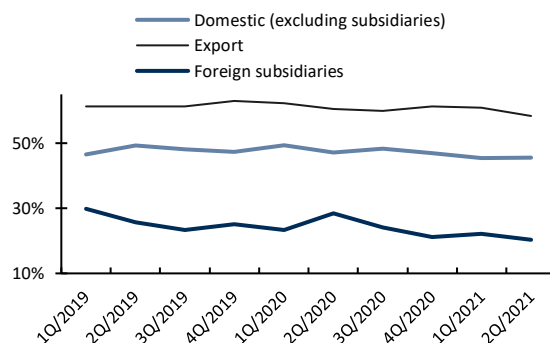
Source: Vinamilk, KB Securities Vietnam

Fig 6. VNM – Earnings & earnings growth (VNDbn, %)



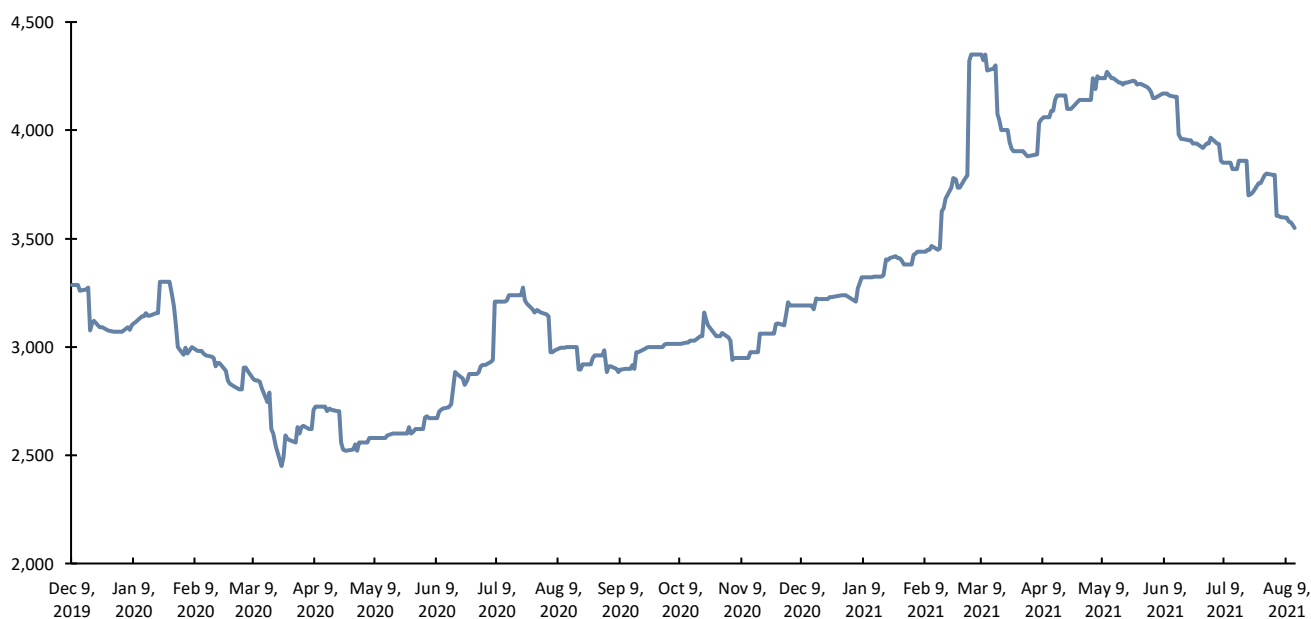
Source: Vinamilk, KB Securities Vietnam

Fig 7. VNM – Gross margin of each business segments (%)



Source: Vinamilk, KB Securities Vietnam

Fig 8. Global – Whole milk power price fluctuation (USD/MT)



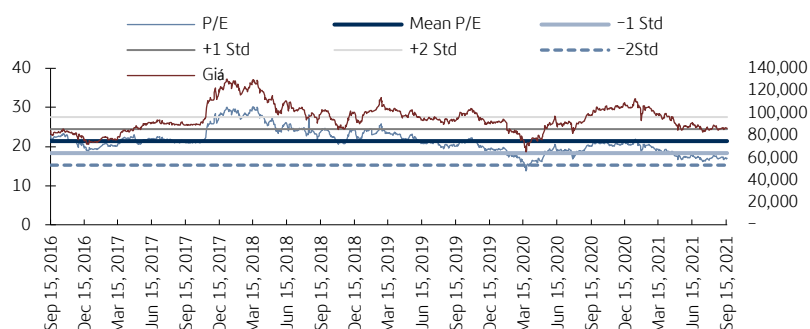
Source: Bloomberg, KB Securities Vietnam

Investment viewpoint

Current valuation is quite attractive

VNM shares are currently traded with P/E of about 18x for the period 2021–2022. VNM's average P/E in the last five years was 22x.

Fig 9. VNM – P/E in the past few years (x)



Source: Fiiipro, KB Securities Vietnam

MCM should be the driving force for the future growth

VNM always leads the market share in the domestic dairy industry. By the end of 2020, VNM's market share (including Seed Moc Chau Dairy Cattle Corp – UpCom: MCM) were estimated at 45%. We are positive about the long-term outlook of VNM, based on the company's great brand advantage, wide distribution network (13 factories in many provinces and cities nationwide), and experienced management team.

- MCM's 6M21 net revenue was VND1,411 billion (up 3.2% YoY), making good advantage of the parent VNM's leverage and distribution channels.
- MCM's 6M21 gross profit margin was improved significantly to 30.3% from 28.9% in 2020 thanks to good resources from VNM. We believe that the growth potential of MCM is still very large as the company has not expanded its market to the Central and Southern regions. In addition, VNM is also proactively looking for partners to carry out M&A, thereby increasing its market share.

Table 2. MCM – Business performance

VNDbn	2Q21	2Q20	6M21	6M20
Net revenue	790	734	1,411	1,367
Gross profit	253	218	428	395
Gross profit margin	32.03%	29.7%	30.33%	28.9%
Net profit	87	59	137	106
Net profit margin	11.01%	8.04%	9.71%	7.75%

Source: Vinamilk, KB Securities Vietnam

Gross profit margin should be higher in the last six months of the year

VNM disclosed it signed contracts with suppliers of some key materials to fix the material purchasing prices for the last six months of the year. In addition, the prices of some main input materials including milk powder tended to be more stable than those in 1Q (Figure 8). Therefore, we expect VNM's net profit margin to improve in 2H21.

A new revenue source comes from a joint venture with DMPI

In August, VNM announced to cooperate with Del Monte Philippines Inc. (DMPI), a subsidiary of Del Monte Pacific Limited, is a leading food and beverage business in the Philippines. Accordingly, each party should invest USD3 million in a joint venture, DMPI would distribute VNM's products which will have trademarks of both brands in the Philippines. This bodes well for VNM's business in the future as the Philippines is the second most populous country in Southeast Asia. Moreover, DMPI is also a reputable brand name in this country, proved with a nationwide distribution network and products being sold in 100,000 domestic stores.

At the end of July 2021, VNM packed the first batch of milk products to the Philippines, which should be on sale by this September. The joint venture's projected total revenue is USD8.8 million in the first year. The revenue CAGR is 50% in the medium term.

Hopes about domestically & globally controlled COVID-19 should raise dairy consumption demand

The fourth wave of COVID-19 accompanied by social distancing protocols from mid-May in big cities weakened the purchasing power of consumers in 2Q21. However, as vaccines were continuously delivered to Vietnam in 3Q and 4Q, and the vaccination plan of the Vietnamese government is timely effective, we expect that the pandemic will soon be contained in 4Q21, which will help to improve macro factors including consumer purchasing power in 1Q22.

The supply of organic raw milk from Laos is expected to start in 1Q22, creating a good competitive advantage for VNM

Currently, the first farm in Lao-Jargo organic dairy farm complex is being completed. The farm should have a herd of 8,000 cows and generate 120 tons of milk per day (equivalent to 44,000 tons per year). The farm achieved Organic certification (EU/NOP standards) for an area of 600ha in May 2021 and is importing more advanced machinery and equipment. VNM expects the farm to start supplying milk (which will be transported to the dairy plant in Nghe An) by 1Q22.

In addition, VNM launched an eco-farm system - Vinamilk Green Farm in Tay Ninh, Quang Ngai and Thanh Hoa in 2Q21 to provide raw materials for new products such as Vinamilk Green Farm Fresh Milk.

According to our research, besides VNM, domestic dairy enterprises which own organic raw milk sources also include TH True Milk with 1,000 organic cows and Nutifood with an organic milk producing joint venture with Backahill Group from Sweden. In addition, Vietnam organic dairy market also saw the participation of big foreign brands such as Dutch Lady and Nestle. However, we believe that VNM still has a strong competitive advantage vs others:

- For domestic enterprises like TH True Milk, VNM owns a larger number of organic cows (1,000 cows in Dalat – according to 2020 data, and 8,000 cows in Laos – Phase 1).
- For foreign businesses that have to import input materials for organic raw milk into Vietnam, VNM has the advantage of lower transportation costs thanks to its nationwide system of farms and dairy plants. In addition, the new organic farm in Laos is geographically located close to Vietnam, hence easier transportation.

Forecast performance, valuation and recommendation

Forecast performance

The company's earnings and revenue are expected to be VND10,838 billion (down 3.5% YoY) and VND60,012 billion (up 0.6% YoY) in 2021; and VND11,779 billion (up 9.9% YoY) and VND 62,509 billion (up 4.16% YoY) respectively in 2022.

Table 3. VNM – 2021–2022F business results (VNDbn)

	2020	2021F	2022F
Revenue	59,636	60,012	62,509
Domestic	50,842	50,333	51,843
Foreign	8,794	9,679	10,666
Gross profit	27,669	27,316	29,055
Selling expenses	-13,447	-13,532	-14,095
SG&A expenses	-1,958	-1,971	-2,052

Source: KB Securities Vietnam

BUY recommendation with a target price of VND102,200 apiece

We believe that in the medium to long term, VNM would be an attractive stock given its leading market share and three main following factors: (1) controlled pandemic would improve the purchasing power; (2) gross profit margin is higher when raw material prices decrease; and (3) new revenue source comes from the Philippines market.

We use a combination of DCF and P/E valuation methods (50–50 ratio). VNM's reasonable P/E is 22x (equal to the average in the last five years), with 2021 adjusted EPS of VND4,599 per share.

Table 4. VNM – Assumptions for DCF method

Risk free rate	2.6%
Risk premium	9.9%
Beta	0.76
Terminal growth rate	3%
WACC	8.8%

Source: KB Securities Vietnam

Table 5. VNM – Valuation results

Method	Weights	Result
DCF	50%	103,211
P/E	50%	101,184
Combined	100%	102,197

Source: KB Securities Vietnam

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Investment ratings & definitions

Investment Ratings for Stocks

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

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

Investment Ratings for Sectors

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

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

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