



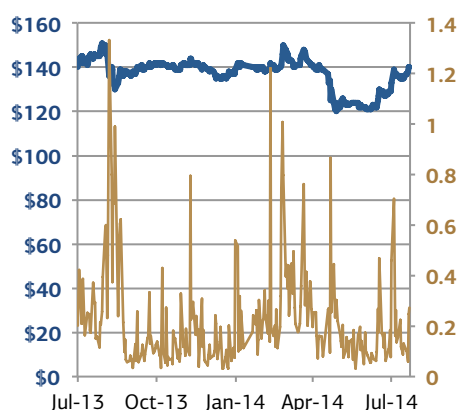
August 8, 2014

Vietnam | Consumer  
**Vinamilk**  
**(VNM VN)**

Jeff Dorr  
 +852 6939 6744  
 jeff@jcapitalresearch.com

# Signs of improvement

**Vinamilk (VNM VN) one-year share price in thousand VND (blue) and volume (gold, in mln shares)**



Source: Bloomberg, August 8, 2014

**Vinamilk (VNM VN)**

Price	VND 140,000
<b>Rating</b>	<b>BUY</b>
<b>Price target</b>	<b>VND 175,000</b>
<b>Difference</b>	<b>25%</b>
Market Cap	USD 5.49 bln
Simple Moving Avg.	0.19 mln
P/E	19.0x

Source: Bloomberg, August 8, 2014

**+ Difficult 2014 H1**

Vinamilk's share price has marginally rebounded since our initiation last month. 2014 Q2 results came in in-line with our expectations. Revenue grew 14.4% YoY, while profits contracted 14.5% over the same period. The decrease in profits was driven by lower gross margins on account of high input costs, higher OPEX, and a marginally higher tax rate.

**+ An improving second-half?**

While 2014 will likely prove a difficult year for Vinamilk—we are not forecasting a turnaround in H2—we note some signs of improvement in Q2, which might explain the recent hike in share price. Domestic sales growth accelerated from a sluggish 3.8% YoY in Q1 to a more normalized 13.6% in Q2. This suggests that domestic consumption may be gradually recovering in Vietnam. Gross margins within the domestic segment also trended upward, expanding from 36% in Q1 to 38% in Q2. Exports—comprising some 15% of sales—was Vinamilk's weak spot for the quarter. Consolidated exports sales grew in line with expectations at 18% YoY, while gross margins contracted slightly from 21% to 18%. However, parent financials, which exclude the Driftwood acquisition in December 2013, show a significant contraction in Q2 on account of instability in the Middle East.

**+ BUY; maintain PT of VND 175,000**

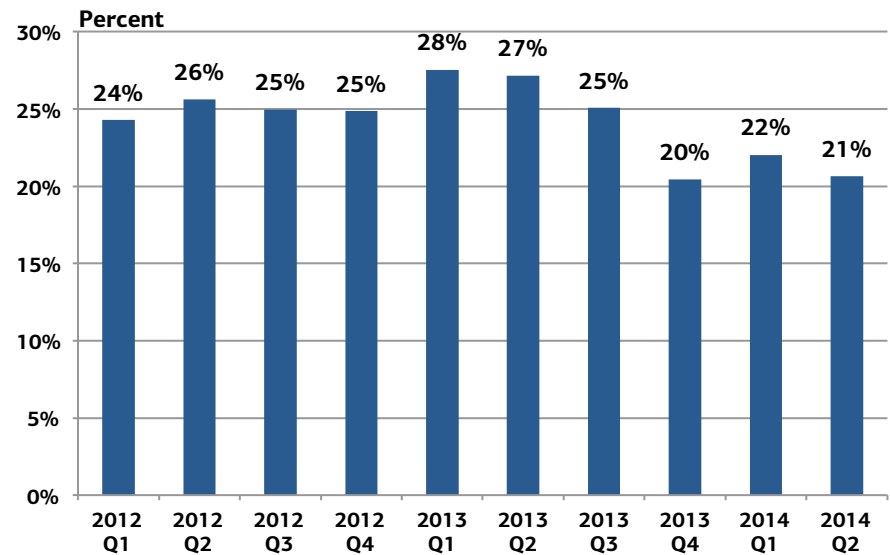
We value Vinamilk on a DCF basis. Following this quarter's results, our view on the business remains unchanged. Using a 12% discount rate and 15x terminal multiple, we arrive at a valuation of approx. VND 175,000 per share, representing a 25% upside to today's share price of VND 140,000.

**Difficult 2014 H1**

**Though 2014 will remain a challenging year for Vinamilk, we believe there are causes for optimism**

While Vinamilk’s share price has rebounded since our initiation, Q2 financials continue to depict a difficult year for Vinamilk. Revenue grew 14.4% YoY for the quarter, while profits contracted 14.5% over the same period. The YoY decrease in profits was driven by lower gross margins on account of high input costs, higher selling expenses, and a marginally higher tax rate.

**Chart 1. VNM operating margins (consolidated)**

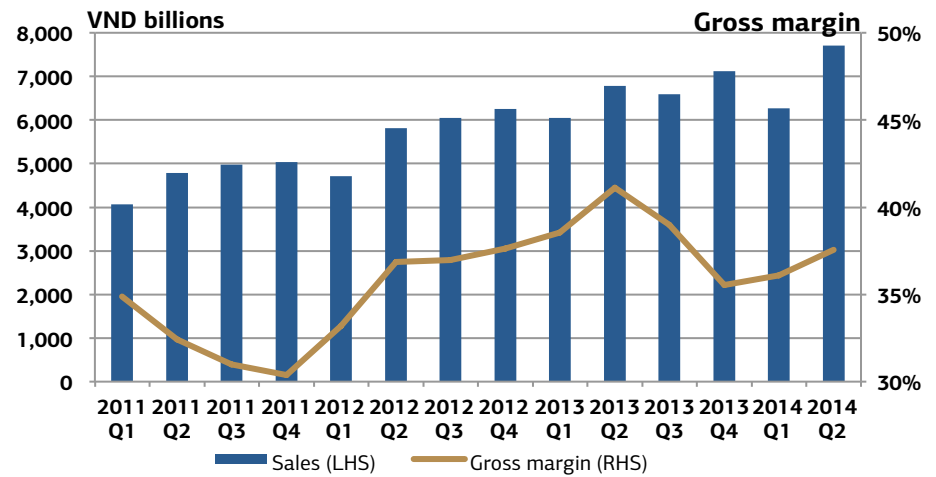


Source: Company filings

**Improving second-half?**

Relative to Q1, however, Vinamilk’s Q2 results show some cause for optimism, primarily in the domestic market, which comprises about 85% of sales. Domestic sales growth accelerated 13.6% YoY over Q1’s 3.8%. Growth was due to a combination of a 5-7% price hike in Q1 and approx. 7-8% volume growth. Gross margins also improved in Vinamilk’s core business, expanding from 36% to 38%.

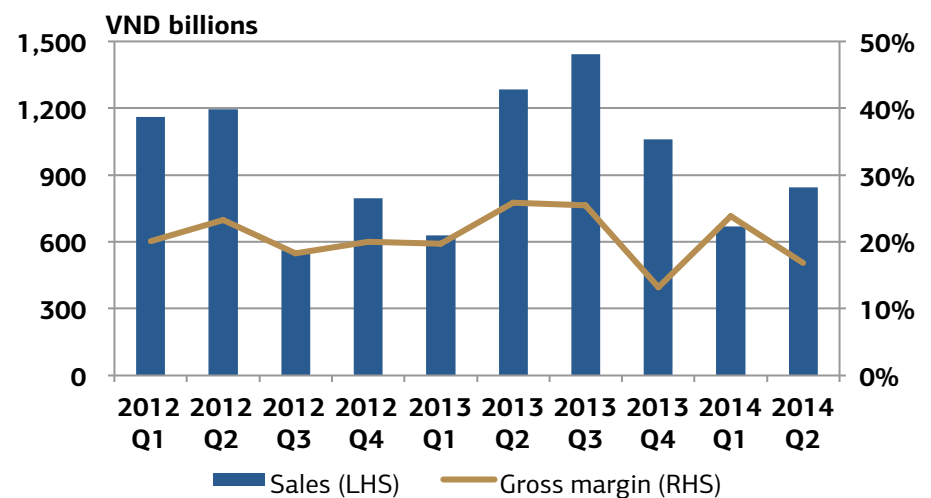
### Chart 2. VNM domestic sales (consolidated)



Source: Company filings

Vinamilk’s exports proved the weak spot of the business in Q2. While the consolidated figures depict relatively healthy growth (18.5% YoY) and margins, these are inclusive of VNM’s recent Driftwood acquisition. Looking at the parent financials, which exclude Driftwood, Q2 results appear incrementally weaker. Excluding results from the Driftwood acquisition, sales fell 34.4% YoY. The decline can be partially explained by a strong base effect in 2013, but also political instability in Iraq, which remains a key export market for Vinamilk. Gross margins fell from 24% in Q1 to 17% in Q2.

### Chart 3. VNM export sales (parent only)



Source: Company filings

---

Management expects exports to remain challenging due to the civil war in Iraq.

**Forecast unchanged**

We believe 2014 is likely to remain a challenging year for Vinamilk, and have not upgraded our earnings estimates for the year. We note that whole milk and skim milk prices have remained low in recent weeks, and as contracts generally low off from higher input costs, Vinamilk will likely benefit. We see this more as a 2015 story, but will continue to monitor results. For the time being, our target price remains unchanged at VND 175,000 per share.

---

## Disclaimer

*This publication is issued by J Capital Research ("J Capital"). This publication has been prepared for the general use of the clients of J Capital and unauthorized copying or distribution is prohibited. Nothing in this document shall be construed as a solicitation to buy or sell any security or product. In preparing this document, J Capital did not take into account the investment objectives, financial situation and particular needs of the reader. Before making an investment decision, the reader needs to consider, with or without the assistance of an adviser, whether the advice is appropriate in light of their particular investment needs, objectives and financial circumstances. J Capital accepts no liability whatsoever for any direct, indirect, consequential or other loss arising from any use of this publication and/or further communication in relation to this document.*