Vietnam Dairy Product JSC (VNM VN)

Return of the Queen

Non-Rated

CP (30/09/2020) VND109,100

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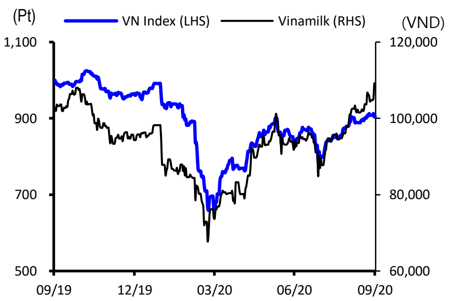
VNINDEX		905
HNXINDEX		133
Market cap (VNDbn)		227,981
Outstanding shares (mn shares)		2,090
Free float shares (mn shares)		1,488
52-week high/low (VND)		112,917/69,750
30-day avg. trading vol. (mn shares)		1.8
30-day avg. turnover (VNDbn)		183.7
Foreign ownership (%)		65.3
Major shareholders (%)	F&N Dairy Investment Pte. Ltd	17.7
	Platinum Victory Pte. Ltd	10.6
Absolute performance (%)	3M	16.2
	6M	43.9
	12M	0.9
Relative performance to VNINDEX (%)	3M	6.5
	6M	7.2
	12M	10.1



- Vinamilk acquired GTNFOODS and its affiliates
- One step back to make two steps forward
- Shares are still attractive for long-term view

Vinamilk acquired GTNFoods and its affiliates

Vietnam Dairy Products JSC (VNM VN), or Vinamilk, finished M&A transaction with GTNFoods JSC (GTN VN) in 2019 and has been stepping further with the acquisition of Moc Chau Milk (MCMilk) in 2020. These two M&A transactions broke the silence of Vinamilk in M&A market since their latest acquiring of VietSugar (2017) and Driftwood (2013). Vinamilk is not a quick player in M&A market, but they are aggressive and good at timing in every single deal. Vinamilk has shown that their M&A transactions always deliver bearing fruit in terms of enhancing the profitability of both parties. Thus, we think these recent M&A deals with GTNFoods group to provide Vinamilk not only extensive expansion tools used for market share but also an intensive enhancement for their vertical value chain.

One step back to make two steps forward

There are doubts about the acquirers' ability to deliver synergies which gives a higher value to shareholders after M&A transactions. Thus, it is almost the same situation with Vinamilk's case. The huge money spent on the M&A deal and higher SG&A costs will lead to a modest net profit growth (~1% p.a.) for VNM at the initial stages. However, we believe that this is a high earnings accretive rather than a dilutive in the long-term view.

Shares are still attractive for long-term view

Vinamilk's shares have gained +61.0% by 30 September 2020 since the bottom of VND67,770 (23 March 2020) and erased the losses in 1H20 due to the COVID-19 pandemic. But we think that share price is still undervalued. We think that the bear fruit of this deal will be uncovered soon through the growth of Vinamilk in the long-term.

Year to December	Sales (bn VND)	OP (bn VND)	Pre-tax (bn VND)	NP (bn VND)	EPS (VND)	EPS Growth (%)	BPS (VND)	PER (x)	EV/EBITDA (x)	PBR (x)	ROE (%)	Net debt ratio (%)
2015	40,080	8,772	9,367	7,773	4,053	53.7	11,973	21.9	14.7	7.4	34.7	82.8
2016	46,794	10,524	11,238	9,350	4,859	19.9	12,728	21.5	14.8	8.2	39.3	80.6
2017	51,041	11,430	12,229	10,296	5,296	9.0	13,422	32.8	22.9	13.0	40.5	86.1
2018	52,562	11,212	12,052	10,227	5,295	(0.0)	14,805	22.7	15.6	8.1	37.5	69.2
2019	56,318	12,182	12,796	10,581	5,478	3.5	15,794	21.3	13.8	7.4	35.8	67.8

Source: Bloomberg, Company data, Shinhan Securities Vietnam / Note: TB = turn black, TR = turn red, RR = remain red

The synergies of M&A deal with GTNFoods and its affiliates

Vinamilk returned to Vietnam M&A market via the friendly acquisition of GTNFoods JSC (GTN VN) in 2019, and through the deal, they indirectly own Vietnam Livestock Corp. JSC or Vilico (VLC VN) and Moc Chau Milk or MCMilk (unlisted). The acquisition is expected to bring mutually synergies to both parties, including:

1. Via taking advantage of MCMilk, Vinamilk will both extensively and intensively expand. MCMilk provides Vinamilk one of the best areas in Vietnam with great quality of raw materials and a favorable location to reach exporting markets (i.e. China). Also, MCMilk currently owns 9% and 35% of nationwide and Nothern Vietnam market share, respectively. Thus, we believe that MCMilk will be a new key and unique growth driver for Vinamilk in long-term view, especially when there are not many sizable M&A opportunities for Vinamilk left in the local dairy market in order to inorganically expand their market share.

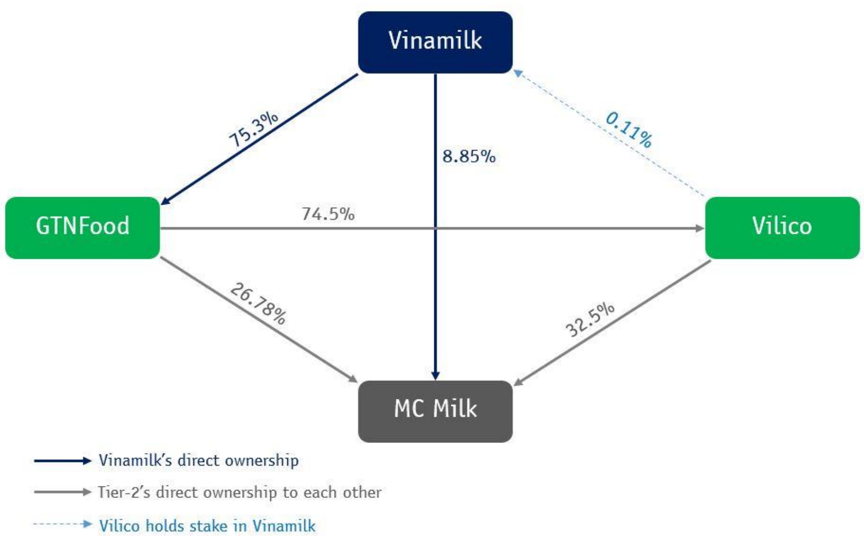
2. MCMilk will be one of the key beneficiaries from Vinamilk's acquisition, including management restructuring, modern technologies, and funding. Consequently, we expect that MCMilk will improve their margins significantly in post-deal management.

Key events of Vinamilk's M&A transactions

Event	Timeline	Pre-event direct ownership	Post-event direct ownership
Vinamilk completely acquired GTNfood.	April – September, 2019	0% stake in GTN	75.3% stake in GTN
Madam Mai Kieu Lien (BOD member of Vinamilk) became the chairwoman of GTNfood, Vilico, and MCMilk.	February 12th – 20th, 2020	-	-
MCMilk announced an additional share issuance plan (43.2mn share or 39.3%) to strategic investors (Vinamilk & GTNfood), existing shareholders (Vilico), and their employees.	July 01st, 2020	MCMilk (VNM: 0%; GTN: 0%; VLC: 51.0%)	MCMilk (VNM: 8.9%; GTN: 26.8%; VLC: 32.5%)
Vilico announced to purchases 2mn shares of Vinamilk.	August 18th – September 16th, 2020	VLC owns 0% of VNM	VLC owns 0.11% of VNM
MCMilk shares will be listed on the stock exchange in 2021.	Expected to be in 1H2021	-	-

Source: Company data, Shinhan Securities Vietnam Research

The post-deal diamond structure of Vinamilk



- Vinamilk directly and indirectly holds 8.85% and 38.25% stake in MCMilk, respectively . Thus, Vinamilk holds 47.1% economic interest of MCMilk.
- GTNFoods directly and indirectly holds 26.78% and 24.23% stake in MCMilk, respectively . Thus, GTNFoods holds 51.0% economic interest of MCMilk.
- Vinamilk indirectly holds 56.09% of Vilico via GTNFoods
- Vilico also purchased 2.2mn share of Vinamilk (or 0.11% stake)

Source: Company data, Shinhan Securities Vietnam Research

"It is a very common sense that M&A transactions are not always successful to related parties. Investors are usually skeptical whether M&As are accretive or dilutive for acquirers as well as absorbed companies. Theoretically, an M&A transaction is accretive if the combined company's earnings per share (EPS) is higher than the buyer's standalone EPS prior to the transaction. Meanwhile, it is dilutive if the blended EPS is lower, and neutral if the EPS remains unchanged afterward."

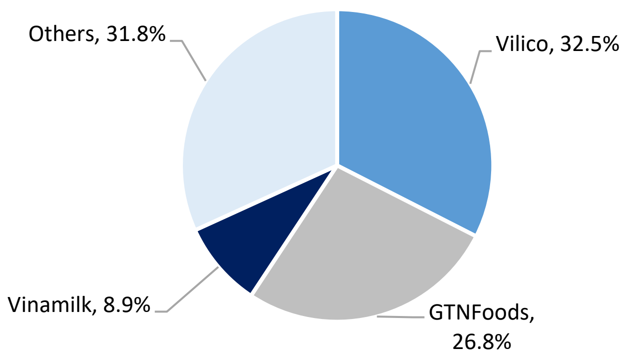
One step back to make two steps forward

The recent Vinamilk's M&A deals seemed likely to be dilutive to the combined entity in the short-term. However, we believe that the post-deal company will bear fruit in mid-term view thanks to the strong management and restructuring practices proved via the success of their previous deals. Eventually, these M&A deals will turn to be accretive in our long-term view, which is a strong catalyst for a higher valuation of Vinamilk.

Vinamilk would post single-digit (~1% YoY) net profit growth over the next 3 years, in light of: 1) annual impairment charge of goodwill from the M&A transaction and 2) minor contribution of GTNFoods as well as MCMilk. In detail, the company spent VND3.8tn (7.5% of its total assets by end-1H2020) to purchase stakes in GTNFoods and its affiliates, which was recorded as goodwill of ~VND2.2tn. Vinamilk will record an impairment charge of VND200bn (accounting for 1.7% of its 5-year average pre-tax profit) annually for this goodwill in 10 years. Moreover, the profitability of the whole GTNFood group is far lower than that of Vinamilk, which is considered as a dilutive effect for Vinamilk.

We believe that the earnings dilution will last only in the short-lived for Vinamilk, which has strong experience in restructuring the absorbed entities. Once Vinamilk is able to well manage the absorbed entities and promote their synergies, we think that Vinamilk and the related parties will enjoy higher growth in both top and bottom-line. Moreover, the management of Vinamilk showed that they have been talented in post-M&A restructuring through their share buyback. Specifically, the share buyback via Vilico has brought more confidence to Vinamilk's shareholders in their good management in both daily operations as well as the financial position of the post-deal entities.

The post-deal ownership structure of MCMilk



Source: Company data, Shinhan Securities Vietnam Research

The bearing fruit of the acquisition

We think that the synergies of this acquisition transaction are improving the profitability of the combined entity. Vinamilk will also make their effort in exploiting MCMilk as a new key driver to deliver higher value to their shareholders in the long run.

MCMilk is not only the ultimate target of the deals but also the greatest beneficiary from the restructuring of Vinamilk, including: 1) rich experience of Vinamilk on brand optimization, higher ASP negotiation, and large distribution network to boost sales; 2) employing modern technologies to save selling and marketing costs, and 3) high financing capability from Vinamilk for their expansion of production facilities and cowherds.

Notably, the ASP of MCMilk is 10-15% lower than other dairy leaders due to: 1) low bargaining power to distributors and retailers and 2) classified as a low-end brand. When MCMilk is under the umbrella of Vinamilk, we expect their ASP will be improved via premiumization strategy. MCMilk would have a convergence of necessary conditions to upgrade to a premium brand and increase their ASP by 15-20%.

MCMilk plans to upgrade their capacity of liquid milk production via a new factory, which has a total CAPEX of VND1.6tn for upgrading their current factory, farms, and cowherds. The new plan will be financed by Vinamilk and current shareholder (ESOP) and commence operation in 2024-26. MCMilk targets to expand a new farm with a size of 4,000 cows from the current of 3,000 cows and buy 2,000 new cows. Moreover, we think that the upcoming Hoa Binh-Son La highway is expected to shorten travel time from Hanoi to Moc Chau and unlock the potentials of this remoting area. Thus, MCMilk would reduce cargo transportation costs and reach further markets.

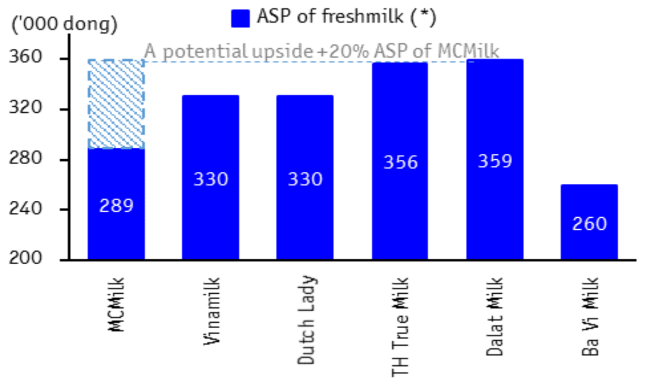
In conclusion, MCMilk is a perfect match to fit in the "steady growth" business model of a mature dairy company like Vinamilk. When Vinamilk successfully scales MCMilk up, it will turn into a higher level of the growth path which results in a growth rate of a two-digit number.

Vinamilk's extensive distribution network

Type	Network	Amount
Distribution	Sales branches	3
	Logistics enterprises	3
Trading	Distributors	200
	Nationwide retail point	251,000
	"Vietnam Dairy Dream" stores	430
	Convenience stores	1,356
	Large & small supermarket	3,899
Foreign countries	Exporting to 5 continents and 53 countries	

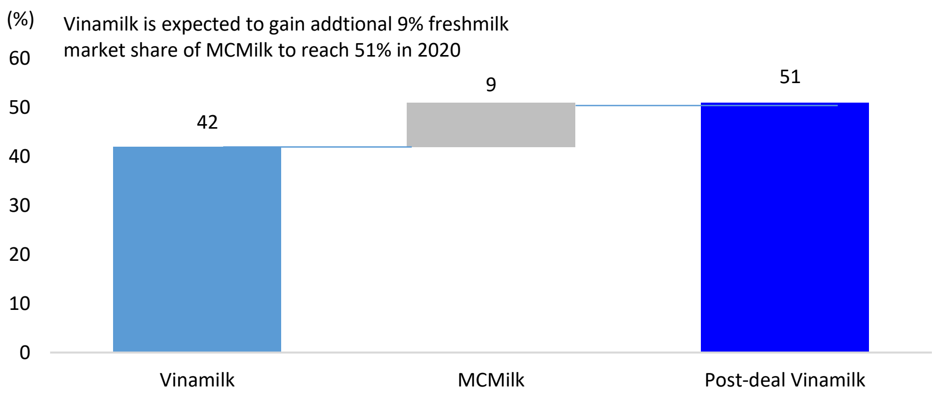
Source: Company data, Shinhan Securities Vietnam Research

Potential increase ASP of MCMilk



Source: Company data, Shinhan Securities Vietnam Research; (*) ASP for a package of 48 180ml-boxes

Increasing in the market share of Vinamilk



Source: Euromonitor, Neilsen, Shinhan Securities Vietnam Research

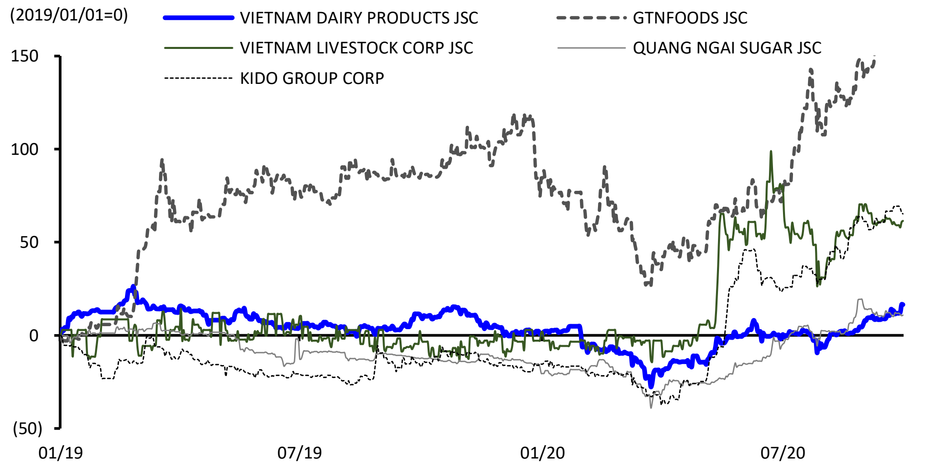
Vinamilk's PER band chart

Source: Bloomberg, Shinhan Securities Vietnam Research

Vinamilk's PBR band chart

Source: Bloomberg, Shinhan Securities Vietnam Research

Vinamilk's relative stock price



Source: Bloomberg, Shinhan Securities Vietnam Research

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