

# Horizon Securities

## Research team

Marc Djandji, CFA  
Head of Research  
[marcdjandji@horizonsecurities.com](mailto:marcdjandji@horizonsecurities.com)  
+84.90.318.9687

### Downgrade to Underperform/Medium 3M

#### Company Update

Price (VND)	158,000
Price Objective (VND)*	103,000
* Split-adjusted price objective	51,500
Expected share price return (loss)	(34.8%)
Expected dividend yield	1.3%
Expected total return (loss)	(33.5%)

### Stock Profile/Statistics 24-Aug-09

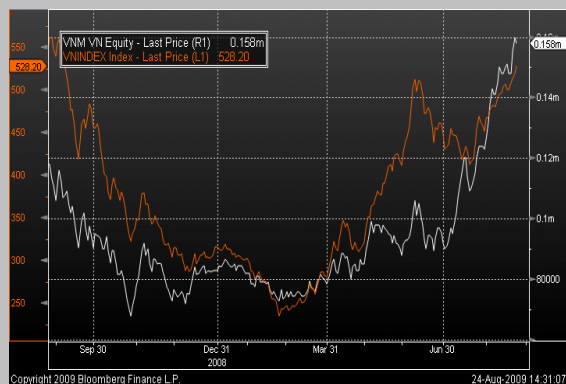
Reuters Ticker	VNM.HM
Sector	Food & Household Products
VND/USD	17,750
Shares Outstanding**	175,640,300
** Split-adjusted shares outstanding	351,280,600
Market Capitalisation (VNDmln)	27,751,167
Foreign Room (%)	0.1%
52 week High/ Low (VND)	162,000 / 66,500
3-mth average daily T/O	23,363
Estimated free float (pre-split)	80,626,808

### Stock Performance (%) 1M 3M 6M

Absolute (%)	31.67	71.74	116.44
Relative (%)	13.35	31.55	(3.50)

### Overship Structure %

State	47.6%
Foreigners	45.9%



## 1HFY09 – Downgrade to UNDERPERFORM

### Results in line, but upside limited

- We have been bullish on Vinamilk since April. However, after a relentless rally, it is time to consider locking in gains.

**Nevertheless, there some interesting points that we think are worth highlighting:**

- Vinamilk's 1HFY09 came mostly in line with our estimates. Units sold increased 27.5% while revenue jumped 35.5% in the first half of 2009 compared to the same period last year. Gross profit margin improved to 35.2% on a better sales mix of added-value products and lower input costs since the beginning of the year. We believe it should take Vinamilk about 7 months to go through its pricier 2008 year-end inventory; therefore we expect gross margins in the 2HFY09 to continue to improve as the company benefits from cheaper raw materials.
- The company announced its 1<sup>st</sup> dividend payment for 2009 as a combination of cash (a dividend of VND2,000 or US\$.11 per share on 5 August 2009) and bonus shares at a ratio of 1:1 (one existing share will get one bonus share). The bonus share issuance has been proposed and approved at an extraordinary shareholders' meeting on August 20<sup>th</sup>. However, the company still has to wait for the final approval from the State Securities Commission. If approved, the issuance should take effect in late September or early October 2009. As there is a strong likelihood that the company would essentially be doubling its outstanding shares, we expect to see increased liquidity in the stock and Vietnamese investors' renewed interest in the company.

### Figure 1. EPS Pre-Split Vs. EPS Post-Split

	2009E	2010E	2011E
Basic EPS Pre-Split	10,216	11,144	10,213
Basic EPS Post-Split	8,171	5,572	5,106

Source: Horizon Securities

- We are raising our earnings estimates to reflect improving revenue trends and controlled operating expenses. Our new 2009 and 2010 EPS estimates are VND10,205 and VND11,144, up from VND7,853 and VND8,489, respectively. We increased our DCF-derived price objective slightly from VND101,000 to VND103,000 (US\$5.80) (our split-adjusted price objective is VND51,500 (US\$2.90)). We believe the stock is fully valued at current levels. Consequently, given the recent run-up on the stock, we downgrade it to **UNDERPERFORM**. We believe the next catalyst will depend on the company's cap ex plan to build its Mega factory project and increase capacity. Interestingly however at its current 14.2x FY10 PER, the company is trading at a 10.1% discount to its regional peers in the dairy industry which for us confirms it is time to consider locking in gains, but may indicate the market still believes there is more upside to the stock.

## Company update – Vietnam Dairy Products

**Figure 2. Vinamilk's earning outlook from 1H2006-1H2009**

Key statistic (VNDmln)	1H2006	1H2007	1H2008	1H2009E
Net Sales	2,821,366	3,114,125	3,871,819	4,743,826
% YoY	N/A	10.4%	24.3%	22.5%
Gross Profit	777,467	873,133	1,285,613	1,675,834
% Margin	27.6%	28.0%	33.2%	35.3%
EBITDA	428,166	394,278	810,852	1,127,571
% Margin	15.2%	12.7%	20.9%	23.8%
Net Income	419,065	571,557	697,755	1,049,915
% Margin	15%	18.4%	18.0%	22.1%
% YoY	N/A	36.4%	22.1%	50.5%

Source: Vinamilk

**Figure 3. Vinamilk earnings revisions**

(VNDm ln)	2009E			2010E		
	New	Old	+/- (%)	New	Old	+/- (%)
Net Sales	9,491,772	9,491,772	0.0%	10,696,973	10,696,973	0.0%
Gross Profit	3,595,999	3,307,606	8.7%	3,980,362	3,664,881	8.6%
Gross margin	37.9%	34.8%		37.2%	34.3%	
EBITDA	2,585,364	2,082,133	24.2%	2,719,112	2,225,697	22.2%
EBITDA margin	27.2%	21.9%		25.4%	20.8%	
Pretax income	2,291,663	1,828,432	25.3%	2,459,290	1,971,067	24.8%
Adj net income (VNDmln)	1,792,410	1,379,509	29.9%	1,957,297	1,491,193	31.3%
Adj EPS (VND)	10,204	7,853	29.9%	11,142	8,489	31.3%

Source: Horizon Securities

## Valuation: VND103,000 Price Objective, Downgrade to Underperform

Our price objective of VND103,000<sup>1</sup> (US\$5.80) (13.3x our 2010 EPS estimate of VND11,142) is based on our DCF model, which incorporates the following assumptions: 11.5% 4-year revenue CAGR, ~20% long-term operating margin, 2.3% long-term capex/sales, 13.43% WACC and 3% terminal growth.

Recent positive market sentiment across Asia has set higher valuations in motion. In spite of the recent run-up on the stock, at its current price the VNM is still trading at a discount relative to its regional peers. Although there may be more upside trading potential on the stock when looking at regional comps, we believe the catalyst to justify further upside re-valuations will depend on the company's plan to increase its capacity.

**Figure 4. Regional comparison with peers**

Company	Company Name	Price (US\$)	Mkt cap (US\$m)	Sale (A) (US\$)	EPS (A) (US\$)	P/E (A)	P/E (FY1)	P/E (FY2)	P/B (A)	ROE % (A)	EBITDA % Margin (A)	EV/EBITDA
506 HK	China Foods Limited	0.64	1,786	1,837	0.02	28.6	20.1	16.6	2.19	4.6%	5.7%	11.51
2319 HK	China Mengniu Dairy Company Limited	2.41	4,188	3,079	(0.07)	NM	27.2	22.3	6.85	(8.4%)	(2.3%)	15.27
FNH MK	Fraser & Neave Holdings Berhad	2.71	965	1,023	0.13	20.3	16.2	15.9	2.57	6.6%	10.4%	8.94
005990 KS	Maeil Dairy Industry Company	13.02	175	601	0.62	20.9	10.2	8.0	0.93	2.2%	5.7%	5.78
NESZ MK	Nestle (Malaysia) Berhad	9.46	2,219	1,105	0.41	22.9	21.2	20.2	15.10	20.5%	13.8%	13.32
2262 JP	Snow Brand Milk Products Co., Ltd.	3.58	1,088	3,023	0.24	14.8	NM	11.6	1.50	3.4%	4.6%	8.89
	Average			1,778		21.5x	18.99x	15.8x	4.9x	4.8%	6.3%	10.62
	Maximum			3,079		28.6x	27.24x	22.3x	15.1x	20.5%	13.8%	15.27
	Minimum			601		14.8x	10.22x	8.0x	0.9x	(8.4%)	(2.3%)	5.78
VNM.HM	Vietnam Dairy Products JSC	8.90	1,557.70	461	0.30	29.4x	15.48x	14.2x	6.1x	27.2%	17.3%	11.5x

Source: Bloomberg, Horizon Securities

Note:: A = 08 actual, FY1 = 09 forecast, FY2 = 10 forecast, price as close on 24 August 2009

<sup>1</sup> Our split-adjusted price objective is VND51,500 (US\$2.90)

### Key investment risks

We rate VNM's shares **Medium Risk**. Key risks to our price objective include the natural volatility of the soft commodity markets and the company's ability to successfully execute its marketing strategy. Earnings can be impaired by higher raw milk products, which can reduce net margins; consumers' preference towards foreign brands, which would adversely affect revenue; the lack of a clear capital expenditures plan, which could cap the company's growth prospects; more write-downs of the company's investment portfolio, which increase costs; and fluctuations in the volume of international purchases.

#### Volatility of raw powdered milk price & impact

Powdered milk is a major raw material for Vinamilk and account for 60% of COGS and Vinamilk has to import all of these raw materials from New Zealand and Holland. Based on Vinamilk's 2008 cost structure, we estimate every 10% unit decrease in milk powder translates into a 7.35% increase in net profit for the company. Unanticipated increases in raw material prices may erode company's profits and impact negatively on our valuation.

**Figure 5. Earnings' Sensitivity to Raw Powder Milk Price**

Raw powder milk price (US\$)	2,552	2,441	2,330	2,219	2,108	1,997	1,886
Change in raw powder milk price	15.0%	10.0%	5.0%	0.0%	(5.0%)	(10.0%)	(15.0%)
Gross profit margin	34.3%	35.0%	35.7%	36.4%	37.2%	37.9%	38.6%
EPS	7,984	8,287	8,591	8,894	9,198	9,502	9,805
% change	(10.2%)	(6.8%)	(3.4%)	0.0%	3.4%	6.8%	10.2%

Source: Horizon Securities estimates

#### Branding strategy to expand into high value products

The company launched a strategy to rebrand itself as a high value, high quality, healthy dairy brand. Management intends to shift sales from low margin products such as condensed milk, to high margin products like yogurt, powdered milk, and liquid milk. The successful execution of this plan will depend on consumers' perception of the brand. For the past twenty years, Vinamilk targeted the mass market with cheap products. Considering most Vietnamese consumers perceive foreign brands to be of superior quality, and that when it comes to dairy products they equate higher prices to higher quality, we believe Vinamilk faces an uphill battle to convince consumers. Should the company's marketing campaign be unsuccessful, this may adversely affect its ability to increase sales and margins.

#### Unclear Capital Expenditure investment plan

Vinamilk is running at 70% of its capacity and we believe that at current growth rates it may reach its full design capacity in the next three years. We believe there is a threat that Vinamilk may lose its leading position to Dutch Lady unless it invests into new production capacity. However, there is a lack of information about their investment plan to expand the company's production capacity in the future. At this stage, due to a lack of clear guidance from management on its expansion plan, we have not included the investment into the Mega factory project in our model.

#### Downside risk from investment portfolio

By the end of 2008, the company's investment portfolio has VND660bln (US\$37.7mln equivalent) in short term investments and VND382bln (US\$21.8mln equivalent) in long term investments in the OTC and listed market. Due to the current stock market situation, they made provisions of VND127.9bln (US\$7.3mln) for this portfolio in 2008. Since there are no clear signs of a significant stock market recovery in the near future, Vinamilk might have to make more provisions for its investment portfolio if the stock market performs poorly.

## Company update – Vietnam Dairy Products

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### **Foreign exchange risk**

Vinamilk imports all raw powdered milk from New Zealand and Holland, which accounts for a large portion of the company's input costs. Hence, a significant devaluation of the Vietnamese dong would have a negative impact on the company's margin.

### **Corporate tax issue**

We learned at Vinamilk's AGM that the company received guidance from the Tax Department that it may not be entitled to a 50% discount tax rate for 2009 and 2010. At this stage, Vinamilk has to wait for an answer from the Prime Minister regarding this issue. We have evaluated both situations in our analysis and found that should the company lose its tax benefit, our price objective would be VND100,000 (US\$5.63).

## Company update – Vietnam Dairy Products

### Financial result from 1H2006 to 1H2009

Income statement (VNDmln)				
FY ended, 31 December	1H2006	1H2007	1H2008	1H2009E
Net Sales	2,821,366	3,114,125	3,871,819	4,743,826
COGS	(2,043,899)	(2,240,992)	(2,586,206)	(3,067,992)
Gross Profit	777,467	873,133	1,285,613	1,675,834
Selling expense	(354,419)	(441,475)	(437,352)	(528,786)
G&A expense	(45,495)	(102,766)	(116,074)	(129,418)
EBITDA	428,166	394,278	810,852	1,127,571
EBIT	377,553	328,892	732,187	1,017,630
Financial expense	(16,811)	(31,681)	(137,858)	(151,244)
Financial Income	56,538	196,641	179,751	130,916
Net Income	419,065	571,557	697,755	1,049,915

Balance sheet (VNDmln)				
FY ended, 31 December	1H2006	1H2007	1H2008	1H2009E
Cash and cash equivalents	124,226	164,376	124,226	875,811
Account receivables	835,869	608,060	835,869	657,550
Inventories	1,807,433	1,183,710	1,807,433	1,239,919
Current assets	3,001,993	2,432,490	3,001,993	4,047,901
Long-term receivables	4,175	0	4,175	59
Fixed assets	804,801	1,220,992	804,801	2,078,207
Long-term investments	142,116	1,365,729	142,116	420,780
Other long-term assets	131,148	116,965	131,148	265,553
Non current assets	1,082,240	2,703,686	1,082,240	2,792,088
Total assets	4,084,233	5,136,176	4,084,233	6,839,989
Account payable	337,497	443,977	337,497	369,291
Accrued liabilities	92,479	116,053	92,479	181,631
Current liabilities	1,428,516	1,085,655	1,428,516	847,446
Long-term loan & debt	40,619	37,363	40,619	17,436
Other long-term liabilities	120,362	55,177	120,362	145,464
Non current liabilities	165,451	98,895	165,451	222,900
Total liabilities	1,593,967	1,184,550	1,593,967	1,070,346
Minority Interest	0	0	0	51,510
Shareholders' funds	2,490,266	3,951,626	2,490,266	5,718,133

Source: Vinamilk, Horizon Securities estimates

## Financial summary

Income statement (VNDmln)							
FY ended, 31 December	2005A	2006A	2007A	2008A	2009E	2010E	2011E
Net Sales	5,638,784	6,245,619	6,648,193	8,208,035	9,491,772	10,696,973	11,949,662
COGS	(4,379,796)	(4,678,114)	(4,835,772)	(5,609,084)	(5,895,773)	(6,716,612)	(7,582,122)
Gross Profit	1,258,988	1,567,505	1,812,421	2,598,951	3,595,999	3,980,362	4,367,540
Selling, G&A expense	(734,540)	(972,284)	(1,178,997)	(1,355,218)	(1,309,864)	(1,540,364)	(1,720,751)
EBITDA	602,084	696,446	764,196	1,422,163	2,585,364	2,719,112	2,955,826
EBIT	524,448	595,221	633,424	1,243,733	2,286,134	2,439,997	2,646,788
Interest Expense	(10,030)	(43,591)	(11,667)	(27,001)	(23,425)	(1,569)	(262)
Financial Income	55,373	74,253	257,865	264,840	28,954	20,862	103,554
Net Income	605,484	659,890	963,448	1,229,570	2,005,205	2,151,879	2,062,560
Adjusted Net Income	550,111	548,746	532,115	945,401	1,792,410	1,957,297	1,793,740
Adjusted EPS Pre-Split					10,205	11,144	10,213
Adjusted EPS Post-Split					8,171	5,572	5,106

Balance sheet (VNDmln)							
FY ended, 31 December	2005A	2006A	2007A	2008A	2009E	2010E	2011E
Cash and cash equivalents	500,312	156,895	117,819	340,633	245,435	1,218,277	2,138,293
Account receivables	706,166	511,623	654,720	646,385	747,480	842,390	941,039
Inventories	1,081,501	965,826	1,669,871	1,796,684	1,888,515	2,151,444	2,428,681
Current assets	2,406,477	1,996,391	3,172,434	3,396,041	3,502,093	4,840,588	6,144,614
Long-term receivables	4,018	860	762	474	--	--	--
Fixed assets	757,373	1,071,980	1,646,962	1,942,921	2,851,692	2,848,007	2,838,199
Long-term investments	609,960	413,901	401,018	378,648	437,869	493,466	551,254
Other long-term assets	120,108	117,401	203,941	215,331	249,009	280,626	313,489
Non current assets	1,491,459	1,604,142	2,252,683	2,537,374	3,538,569	3,622,099	3,702,943
Total assets	3,897,936	3,600,533	5,425,117	5,933,415	7,040,663	8,462,687	9,847,556
Account payable	260,885	436,869	621,376	492,283	517,444	589,486	665,447
Accrued liabilities	62,062	85,821	132,466	154,477	178,637	201,319	224,895
Current liabilities	1,579,433	754,356	933,357	1,221,335	1,142,860	1,294,312	1,452,814
Long-term loan & debt	10,410	42,345	32,381	22,417	12,455	2,492	--
Other long-term liabilities	61,175	62,749	107,492	124,194	143,618	161,854	180,808
Non current liabilities	71,585	107,794	139,873	146,611	156,073	164,346	180,808
Total debts	22,673	60,228	42,344	210,640	12,455	2,492	--
Total liabilities	1,651,018	862,150	1,073,230	1,367,946	1,298,933	1,458,658	1,633,622
Minority Interest	--	--	35,950	50,669	50,669	50,669	50,669
Shareholders' funds	2,246,918	2,738,383	4,315,937	4,514,800	5,691,060	6,953,360	8,163,265

Cash flow (VNDmln)							
FY ended, 31 December	2005A	2006A	2007A	2008A	2009E	2010E	2011E
Pretax income	602,600	734,469	955,381	1,362,177	2,291,663	2,459,290	2,750,080
Pretax income after adjustment	638,521	820,842	1,039,138	1,665,535	2,585,364	2,719,112	2,955,826
Net CF from operating activities	573,655	499,471	313,478	1,249,254	2,203,402	2,214,167	2,061,491
Net CF from investing activities	(386,589)	(589,403)	(1,015,978)	(509,300)	(1,271,471)	(341,783)	(286,328)
Net CF from financing activities	(201,258)	(253,420)	663,413	(517,149)	(1,027,130)	(899,542)	(855,147)
Net increase(decrease) in cash	(14,192)	(343,352)	(39,087)	222,805	(95,198)	972,841	920,016
Cash at beginning of year	515,695	500,312	156,895	117,819	340,633	245,435	1,218,277
Cash at end of year	500,312	156,895	117,819	340,633	245,435	1,218,277	2,138,293

Ratio analysis							
FY ended, 31 December	2005A	2006A	2007A	2008A	2009E	2010E	2011E
Revenue Growth (%)	N/A	10.76%	6.45%	23.46%	15.64%	12.70%	11.71%
Gross Margin (%)	22.33%	25.10%	27.26%	31.66%	37.89%	37.21%	36.55%
SG&A Margin (%)	(13.03%)	(15.57%)	(17.73%)	(16.51%)	(13.80%)	(14.40%)	(14.40%)
Operating Margin (%)	9.30%	9.53%	9.53%	15.15%	24.09%	22.81%	22.15%
EBITDA Margin (%)	10.68%	11.15%	11.49%	17.33%	27.24%	25.42%	24.74%
Interest Margin (%)	(0.18%)	(0.70%)	(0.18%)	(0.33%)	(0.25%)	(0.01%)	(0.00%)
Net Margin (%)	10.74%	10.57%	14.49%	14.98%	21.13%	20.12%	17.26%
Adjusted Net Margin (%)	9.76%	8.79%	8.00%	11.52%	18.88%	18.30%	15.01%
Adjusted Net Income Growth (%)	N/A	(0.25%)	(3.03%)	77.67%	89.59%	9.20%	(8.36%)
Accts Receivable (days)	45	29	35	28	28	28	28
Accts Payables (days)	22	34	47	32	32	32	32
Inventory Turnover days	90	75	126	117	117	117	117
Current Ratio (x)	1.52x	2.65x	3.40x	2.78x	3.06x	3.74x	4.23x
Debt to Capitalization (%)	1.00%	2.15%	0.97%	4.46%	0.22%	0.04%	--
Debt to Equity (%)	1.01%	2.20%	0.98%	4.67%	0.22%	0.04%	--
Assets Turnover Ratio (x)	1.45x	1.73x	1.23x	1.38x	1.35x	1.26x	1.21x
Return on Assets (%)	15.53%	18.33%	17.76%	20.72%	28.48%	25.43%	20.94%
Return on Equity (%)	26.95%	24.10%	22.32%	27.23%	35.23%	30.95%	25.27%
Return on Invested Capital (%)		12.78%	10.55%	15.98%	20.67%	18.15%	14.82%

### Horizon Securities' Rating System

Under our rating system, each stock is given a two-part rating, which indicates the following:

#### Investment Ratings

- Buy (1)
- Neutral (2)
- Underperform (3)

#### Risk Ratings

- Low (L)
- Medium (M)
- High (H)
- Speculative (S)

#### Our Analyst's Methodology

##### Price objective and expected total return

Initially, an analyst derives an expected 12-month price objective using multiple valuation methodologies (as specified in the Valuation section of the research). The current market price is then compared with the price objective to calculate an expected gain or loss. The one-year projected dividend yield, if any, is then added to the expected gain or loss to calculate an expected total return.

##### Risk rating

The analyst then assesses the risk of a stock based on various quantitative and fundamental factors that relate to the stock's local market/country (as specified in the Risk section of the research). We categorize risk as Low, Medium, High or Speculative.

##### Ratings-Risk-Return Matrix

Finally, based on both the expected total return and risk rating, an investment rating is established using our ratings-risk-return matrix (below). We categorize investment ratings as Buy, Neutral or Underperform. All published research contains a Valuation and Risk section where analysts must discuss how they derived their price objectives and risk ratings. Investors are encouraged to read this section for a detailed description.

##### Expected Total Returns Ratings-Risk-Return Matrix

	LOW Risk	MEDIUM Risk	HIGH Risk	SPECULATIVE
<b>BUY (1)</b>	$R \geq 10$	$R \geq 15$	$R \geq 20$	$R \geq 35$
<b>NEUTRAL (2)</b>	$0 < R < 10$	$5 < R < 15$	$10 < R < 20$	$15 < R < 35$
<b>UNDERPERFORM (3)</b>	$R \leq 0$	$R \leq 5$	$R \leq 10$	$R \leq 15$

$R = \text{Expected Total Return (12 months)} = [(\text{Price Objective} - \text{Current Price}) / \text{Current Price}] + \text{Forecast 12-month Dividend Yield}$ .

These benchmarks are subject to change.

#### Important Disclosures

##### Guide to Investment Ratings:

Horizon Securities' stock recommendations include a risk rating and an investment rating.

**Risk ratings**, which take into account both price volatility and fundamental criteria, are: Low [L], Medium [M], High [H] and Speculative [S].

**Investment ratings** are a function of Horizon Securities' expectation of total return (forecast price appreciation and dividend yield within the next 12 months) and risk rating. Investment ratings are:

**Buy [1]** (expected total return of 10% or more for Low-Risk stocks, 15% or more for Medium-Risk stocks, 20% or more for High-Risk stocks, and 35% or more for Speculative stocks); **Neutral [2]** (0% - 10% for Low-Risk stocks, 5% - 15% for Medium-Risk stocks, 10% - 20% for High-Risk stocks, and 15% - 35% for Speculative stocks); and **Underperform [3]** (negative total return for Low-Risk stocks, 5% or less for Medium-Risk stocks, 10% or less for High-Risk stocks and 15% or less for Speculative stocks).

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 **Horizon Securities**  
A Member of Horizon Capital Group

194 Nguyen Cong Tru Street, 5th Floor  
District 1, Ho Chi Minh City  
Vietnam

Tel: +84.9.914.7027 Fax: +84.8.914.7020  
Email: [info@horizonsecurities.com](mailto:info@horizonsecurities.com)