VIEN DONG PHARMACEUTICAL JSC - UPDATE

OVERVIEW

Vien Dong Pharmaceutical JSC (DVD) is one of the leading pharmaceutical companies in Vietnam. Its main products are drugs and functional foods (77% of the company's revenue in 9M/2009), chemicals and medical packaging (10%) and medical supplies (13%).

The company's success could date back to early 1996 when Dong Au Trading Ltd. (Euphaco), which later became a subsidiary of the company, was established. In the span of 5 years, the company grew tremendously and changed from a pure pharmaceutical trading/importing company into a company specialized in patent purchase and technology transfer with its own brand name of drugs, and in the process, Euphaco created many related companies. In June 2004 Dai Ha Thanh JSC, now the parent company, was established to consolidate marketing, sale and distribution operations nationwide. The company changed its name into Vien Dong JSC in 2005 and was listed on HOSE on Dec. 12, 2009.

Currently, DVD holds 100% stakes in Vien Dong Pharmaceutical Ha Noi Ltd. and Vien Dong Pharmaceutical Da Nang Ltd, and 97% in Lili of France JV.

GENERAL INFORMATION

Industry	Pharmaceutical
Listed	HOSE
Ticker	DVD
Chartered capital (VND bn)	119.1
52-week high (VND)	95,500
52-week low (VND)	69,080
Average 10-day volume	147,542

VALUATION MEASURES

Price (29/1/2010)	91,500
Market capital (VND bn)	1089,8
EPS 2009	9,487
P/E 2009 (x)	9.6
P/B E2009 (x)	2.4
ROE E2009 (%)	24.8
ROA E2009 (%)	18.3
EV/EBITDA 2008 (x)	21.6
Total debt/equity 9M2009 (%)	70.4

INVESTMENT HIGHLIGHTS

Patent purchase and technology transfer provide competitive edge in quality, pricing and cost. DVD's business model is quite different from other listed pharmaceutical companies. The company acquires license to manufacture drugs from overseas pharmaceutical companies and then outsources/transfers the technology; the products are sold in domestic market through DVD's distribution channel. DVD currently works with 9 outsourcing companies: 6 in Vietnam, 2 in Korea, and 1 in India. DVD may or may not be involved in supplying inputs for its outsourcing companies.

Licensed formula and technology assure high quality of DVD's products. DVD's pricing strategy is also competitive as its price is lower than imported drugs but higher than domestic peers.

In addition, the strategy allows faster product launch at less costs. DVD adopted "Blue Ocean strategy"-seeking out potential new drugs with to do patent purchase and technology. Selecting promising drugs avoids direct competition and saves the company in purchasing fee about USD50,000 - 60,000 for one-time purchase and cut down on paperwork process to get manufacturing approval. Using the strategy, drug development costs far cheaper than in-house R&D and the time to introduce a new drug to the market was significantly shortened from 2 years to 6 months.

Differentiate by unique products with focus on nonprescription drugs and functional foods. In the span of 10 years DVD has built 9 flagship blockbuster drugs, i.e. Vidorigyl, Vidorovacyn, Vometis, Vidocenol, Antibox, Andios, Zyzocete, Vova brain supplement and Vova Pluz Multi effervescent vitamin, among its 250 product brands. These blockbuster drugs have gross margin of more than 50%, contributing 15-18% in the company's revenue and 25-34% in the company's profits. A majority of them are nonprescription drugs and functional foods such as liver tonic, neurotonic, eye supplement, and effervescent vitamin which target the pharmacies rather than hospital channel.

Active management is a critical success factor. The success of the company so far depends heavily on management's capability to choose and develop a new product. While its quality is quite assured through franchise production, DVD has gathered an all-star executive team of veterans from multinational consumer goods company such as Coca-Cola and P&G. Starting out with only Korean and Indian brands, DVD has gained its reputation and recently won licensing agreements with many German, France and American pharmaceutical companies.

DVD's strength also lies in its capabilities in innovative R&D. DVD collaborates with research centers such as Hanoi Pharmacy University to develop new active ingredients and specialized drugs. DVD's newly approved products and R&D pipeline include cerebral circulation stimulus, neurolepic, anti-aging and blood fat moderation. Especially the new Fludon H1- a potential cheaper substitution for Tamiflu in preventing and treating A/H1N1- is waiting for approval of Vietnam Drug Administration.

Great emphasize in distribution channel. Sales from the OTC channel accounted for 70% total drug sales while the hospital channel make up about 30% revenue. Quite different than DVD's main competitors who consider the hospital channel as a stepping stone for OTC, DVD's frontier is the OTC channel.

Originally being a distributor, DVD has the right experience in developing a strong distribution network servicing OTC. DVD is the exclusive distributor for international brands such as B.Braun (Germany), GL Rapha (Korea), Sopharma (Bulgaria), and OraSure Technologies (U.S.). The company currently has 3 distribution centers, 22 branches, 14 first-level dealers, and 18,000 sale points nationwide. DVD separated its resource into 5 different teams each oversights different product lines to best tailor.

2009 PERFOMANCE

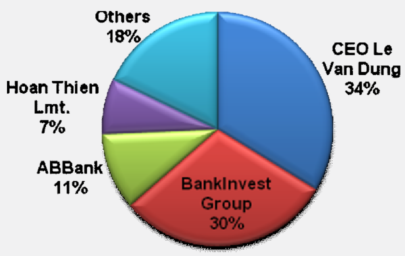
Remarkable growth in 2009. For the year 2009 DVD witnessed 45% revenue growth while net earnings jumped by 3.5x from VND25.0 bn of 2008 to VND112.2 bn while revenue increased at a much lower pace of 45% to VND 927.7 bn. Tremendous growth in profits could be explained by many driving factors.

Firstly, marketing efforts for many flagship products in previous years came to fruition in 2009. DVD could cut back substantially on blockbusters' promotion. As DVD books a large portion of its promotional costs directly to its revenue, the reduction of promotional costs result in gross margin improvement.

FINANCIAL PERFORMANCE 2009

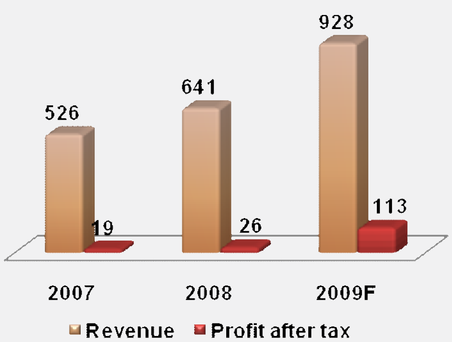
Revenue (VND bn)	927.7
Net profit (VND bn)	112.2
Gross margin (%)	23.2
Operating margin (%)	15.9
Net margin (%)	12.1

OWNERSHIP STRUCTURE



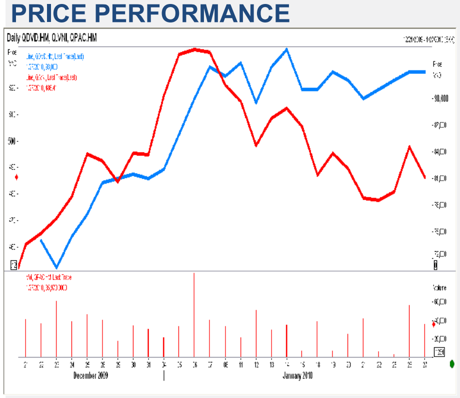
Source: DVD

REVENUE AND NET PROFIT



Source: DVD, VCSC estimate

PRICE PERFORMANCE



Source: Reuters

Secondly, DVD has restructured its product mix drastically in 2009, eliminating low margin products while introducing 15 new exclusive products that are highly profitable such as Viva capsule brain supplement, Vido, Modipine, Zenunel, effervescent tablet Luxy plus C, and Luxy Plus Multi, hence. This also explains gross margin increase from from 17.1% of 9M 2008 to 23.2% 9M 2009.

Thirdly, after aggressively developing distribution networks in 2008, DVD did not have to spend as much in 2009. Therefore, administrative cost reduced significantly. In addition, with less exposure to foreign exchange fluctuation, DVD recorded very nominal financial revenue and expenses compared to its peers.

2010 OUTLOOK

Strong product pipeline for future growth. In 2010, DVD planned to introduce 40 new exclusive licensed drugs and functional foods to the market. DVD will also release 5 scientific projects on which DVD has conducted research in the past 4 years. Fludon, the much talked about H1N1 treatment drug, is filing of a clinical trial and if approved, the drug could be manufactured commercially within 4 months as DVD had set up all the preparation stages. DVD estimated that revenue from Fludon H1N1 and its related products such as nonprescription Fludon Herbal and Fludon France could top VND200 bn, yielding to gross profits of VND100 bn for 2010. In addition, DVD will introduce a new generation of sleeping pill containing active ingredient Melatonin which promises to be a new blockbuster for DVD. Fludon and Melatonin pill could deliver great earnings surprises for DVD in 2010.

Therefore, we believe that DVD's 2010 targets of VND910 bn in revenue and VND125 bn in net earnings are within the company's reach as 2009 estimates are already VND 900bn and VND110 bn, respectively. Additionally, in 2010, the new Lili of France plant operational in mid-2010 will add revenue and early profits in 2010 forward. DVD's targets for 2011 are VND 1,180 bn in revenue and VND143 bn.

Project Lili of France plant will contribute into DVD's revenue and profits starting 2010. With total invested capital of VND450 bn, Lili of France plant which DVD holds 97% stakes and Yvery-France and other shareholders 3% is one of the biggest factory in Vietnam with total capacity of 700 million units per year. The plant will be in Tien Son IZ-Bac Ninh (18 km away from Hanoi) and have a Cephalosporin factory, a Non-Betalactam factory, a functional food factory with a total 11 production chains, and two research centers. The two research centers are at the same size of a standalone plant, run by a expert panel of Dr. Nguyen Hai Nam- to whom creation of Fludon was credited- and 4 other doctors. The first phase is expected to be in operation in May 2010. If the plant is in operation on schedule, it will help increase revenue by 30% in 2010.

RISKS

Limited flexibility and low margin associated with outsourcing. Outsourcing causes certain constraints to DVD's operation. It limits DVD's flexibility in consolidating operations and synchronizing demand with manufacturing, creating situations where the sales were hurt due to inadequate supply.

Uncertainties in margin. During 2007 and 2008, margin was squeezed due to aggressive promotion for the company's new products. Therefore, there is no guarantee that margin will remain at the high level of the last 6 months of 2009 in 2010 when DVD intended to continue its ambitious expansion strategy, introducing 40 products to the market. Moreover, the plant, which is twice the average size of a typical pharmaceutical plant in Vietnam to current (DHG's in-construction plant has invested capital of VND250 bn), once in operation will change DVD fundamentally. Especially with the two grand-scale research centers, a transitory period is needed before the plant achieve its desirable profitability.

RECOMMENDATION

The pharmaceutical industry has been well-liked by investors because of stablly strong growth, high demand. Being a latecomer to join the listed pharmaceutical company group, DVD is standing out with its distinct business model, prospective product pipeline, and its phenomenal bottom line growth. In the years forward, DVD seems to have what it takes to succeed in the industry: one of the best distribution channels, strong product lineups, R&D capability, and stellar management team. However, given the early stage of the new factory and the uncertainties in margins, DVD can bear substantial risks going forward.

At the current price of VND91,500/share (Jan 29, 2010), DVD is trading at P/E 2009 of 9.6x, in line with the pharmaceutical industry's average P/E. Evaluating the pros and cons of investing in DVD, we recommend a HOLD for the stock.

We note that DVD will issue additional 7.09 million shares for existing shareholders (ratio 100:55) and employees (total 539,500 shares) for the price of VND20,000/share and VND10,000/share, respectively in February 2010. The issuance will bring DVD's chartered cap to VND190 bn and provide extra liquidity for DVD stock.

COMPARISION AMONG COMPANIES IN THE PHARMACEUTICAL INDUSTRY

DESCRIPTIONS	DVD	DHG	DMC	IMP	DCL	OPC	TRA
Chartered capital (VND mn)	119	267	178	117	97	82	102
Share Price (VND) Dec. 22, 2009	91,500	124,000	52,500	65,000	53,000	50,000	52,000
Market capital (VND mn)	1,090	3,306	935	758	515	410	530
Revenue 2009	927.7	1,745.4	1,071.8	660.1	550.0	360.0	770.0
Revenue growth (%)	44.8	17.5	14.3	17.5	15.8	64.7	(1.3)
PBT 2009	136.0	411.6	110.0	80.4	70.0	65.0	65.0
PBT growth (%)	289.0	183.8	47.7	13.7	38.1	88.5	10.6
PAT 2009	112.2	366.7	86.9	68.1	63.0	54.0	50.7
PAT growth (%)	348.7	184.6	38.4	16.9	36.6	72.6	10.1
Net Margin	12.1	21.0	8.1	10.3	11.5	15.0	6.6
ROA (%)	18.3	24.3	12.0	9.3	9.8	15.8	11.2
ROE (%)	24.8	35.7	16.0	12.5	20.3	19.1	16.7
EPS 2009	9,487	13,754	4,854	5,873	6,467	6,587	4,972
EPS growth (%)	230.6	113.5	6.4	17.5	37.2	72.6	(13.6)
P/E 2009 (x)	9.6	9.0	10.8	11.1	8.2	7.6	10.5

Notes: DVD, DHG, and IMP have official announced their 2009 operating results. DMC, DCL, OPC, and TRA results are based on estimates of VCSC.

SUMMARY OF HISTORICAL AND PROJECTED FINANCIAL STATEMENTS

INCOME STATEMENT (VND Bn)	*2007A*	*2008A*	*1H 2009*	*9M 2009*	*2009F*	*2010F*
Revenue	525.7	640.8	419.5	648.0	927.7	1,159.6
COGS	465.0	531.0	348.6	510.4	712.0	898.7
Gross Profit	60.7	109.8	70.9	137.6	215.7	260.9
Selling Expenses	4.5	16.3	11.2	21.5	25.4	34.8
Administrative Expenses	27.9	47.5	12.1	26.6	42.7	49.9
Operating Profit	28.4	46.0	47.5	89.5	147.6	176.3
Profit before tax	26.3	35.0	41.9	80.8	136.0	171.4
Profit after tax	**18.5**	**25.0**	**35.9**	**60.6**	**112.2**	**137.1**
Minority Interest	-	(0.6)	(0.2)	-	(0.8)	(1.0)
PAT to the Company's shareholders	**18.5**	**25.6**	**36.1**	**60.6**	**113.0**	**138.1**
BALANCE SHEET (VND Bn)	*2007A*	*2008A*	*1H 2009*	*9M 2009*	*2009F*	*2010F*
Cash	4.5	3.7	40.6	230.2	194.8	173.9
Short term investment	-	-	-	-	93.9	-
Short term receivable	68.5	111.6	239.1	49.7	89.8	144.0
Inventory	33.7	81.0	53.1	44.7	49.7	78.8
Other current asset	2.3	2.3	12.5	1.5	2.1	2.6
Fixed asset	34.8	47.7	42.8	62.0	166.3	432.7
Construction in process	0.8	1.8	3.9	7.2	13.8	1.3
Long term investment	-	-	-	0.1	0.1	0.1
Other long term assets	1.2	2.3	1.9	1.6	1.6	1.6
TOTAL ASSET	**145.8**	**250.4**	**394.0**	**396.9**	**612.1**	**835.1**
Short term loans	27.4	69.3	117.5	126.5	126.1	134.8
Payables	24.9	28.2	101.4	76.8	30.0	62.6
Long term debt	4.2	5.0	4.4	(0.3)	0.8	0.8
Chartered capital	70.0	89.1	89.1	89.1	119.1	190.0
Capital Surplus	-	18.0	18.0	18.0	229.5	236.1
Treasury Stock	-	-	-	-	-	-
Retain earnings	19.3	23.3	50.4	74.1	85.0	160.4
Other funds	-	0.4	0.4	0.4	22.8	50.4
Minority Interest	-	17.2	12.9	13.6	24.0	28.8
TOTAL CAPITAL	**145.8**	**250.4**	**394.0**	**398.3**	**613.4**	**835.1**
CASH FLOW STATEMENT	*2007A*	*2008A*	*1H 2009*	*9M 2009*		
CF from Operating Activities	(48.9)	(36.8)	0.3	115.3		
CF from Investing Activities	(37.7)	(22.5)	(2.0)	(98.8)		
CF from Financing Activites	90.6	58.5	38.7	209.3		
Net cash flow	**4.0**	**(0.8)**	**37.0**	**225.9**		
Beginning Cash Balance	0.5	4.5	3.7	3.7		
Forex adjustments	-	-	-	(1.3)		
Ending Cash Balance	**4.5**	**3.7**	**40.6**	**230.8**		
FINANCIAL RATIOS	*2007A*	*2008A*	*1H 2009*	*9M 2009*	*2009F*	*2010F*
Revenue growth (%)	n/a	21.9	47.1	1.1	44.8	25.0
Gross profit margin (%)	11.6	17.1	16.9	21.2	23.2	22.5
Operating profit/sales (%)	5.4	7.2	11.3	13.8	15.9	15.2
ROA trailing (%)	12.7	10.0	n/a	n/a	18.3	16.4
ROE trailing (%)	20.8	19.5	n/a	n/a	24.8	21.7
ROIC trailing (%)	15.4	12.3	n/a	n/a	19.3	17.8
EPS trailing (VND)	2,080	2,869	4,046	6,801	9,487	7,269
EPS growth (%)	n/a	37.9	n/a	n/a	230.6	(23.4)

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