FY11 Results Review

01/03/2012

Kinh Do Group Corporation (KDC)

Relentless business expansion

In 4Q11, KDC relished delightful revenue of VND1,194.6bn (+101.8% y-o-y) and a gross profit of VND448.8bn (+120% yoy) along with an improvement on gross-profit margin (GPM) from 34.5% to 37.6%. The weights of both selling and administration expenses on revenue have gotten much heavier. The expense enormity of 4th quarter has reduced all revenue gains to a PAT of VND45.3bn (-62.3% yoy).

KDC surpassed its FY11 revenue target with VND4,232.1bn (+119.6% yoy). Our revenue projection of VND4,392.6bn was +3.8% higher, yet our estimate for gross profit was almost dead on. A combination of diminishing financial income and spiralling expenses has disintegrated all revenue momentum; likewise KDC's plan for a profit before-tax of VND500bn fell short to only VND348.8bn (-48.3% yoy). KDC retained a PAT of only VND292.2bn (-44.1% yoy); however, if we exclude the unusual real-estate gain in 2010, PAT has actually gone up almost 200%.

The 2012 outlook: KDC should have its expansion plan available upon its AGM2011 in April; previously KDC has committed USD20m for imminent capacity investment. The recent strategic partnership with Ezaki Glico may have opened up new business opportunities to KDC. However, we have not factored in the value of such partnership in our model due to the lack of solid information.

Our 2012 revised forecasts show revenue of VND5,166bn (basically unchanged) and a net profit of VND397.3bn (down from the previous VND475.4bn). Our estimate for EPS is adjusted down to VND3,009/share.

Recommendation: Since our last report, KDC has gone up 11% from VND32,000 to VND35,600 per share. We did recommend to buy around VND30,000 (KDC even went down to VND24,000 at some point), thus the least gain could have been 18.7%. We revised our 12M target price down to **VND37,300/share,** which is 4.8% higher than the current price. Therefore, we changed our previous recommendation from **BUY** to **NEUTRAL**. KDC plans to make its first 2011 dividend payment of **VND1,200/share** by 12 April 2012 with ex-right date set for 8 March 2012.

Company Financial Summary			In VND m, year-end December		
	FY08	FY09	FY10	FY11	FY12F
Revenue	1,455,768	1,529,356	1,933,634	4,232,110	5,166,358
Net profit	(85,316)	480,524	522,572	292,197	397,263
% change yoy	-	-	8.8%	-44.1%	36.0%
EPS (VND)	(1,521)	6,120	4,410	2,476	3,009
BV (VND)	37,016	30,735	31,550	32,502	34,283
DPS (VND)	1,800	2,400	2,400	2,400	n/a
Div yield	11.4%	5.3%	4.8%	9.2%	n/a
ROA	-2.9%	11.3%	10.4%	4.9%	6.4%
ROE	-4.1%	19.9%	14.0%	7.6%	8.8%
P/E (x)	-10.39	7.43	11.27	10.50	11.83
P/BV (x)	0.43	1.48	1.58	0.80	1.04

Source: KDC, SBS estimates

NEUTRAL	
CURRENT PRICE	35,600
TARGET PRICE	37,300
PREVIOUS	40,200

STOCK STATISTICS

Bloomberg Ticker	KDC VN Equity
Outstanding shares (m)	132
Market Cap (VNDbn)	4,700
52W Price range	23.7-48.1
3M Average Volume	140,639
Beta	0.8
Foreign ownership (%)	46.21

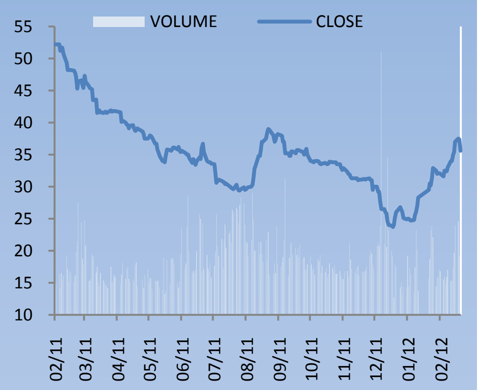
Source: Bloomberg

MAJOR SHAREHOLDERS

PPK Limited Corporation	12.27%
Kinh Do Investment Co Ltd	9.91%
Tran Le Nguyen	8.15%
Deutsche Bank AG	4.99%

SHARE PERFORMANCE (%)

Month	Absolute (VND'm)	Relative (%)
1M	6.1	21%
3M	4.3	14%
6M	0.8	2%
12M	(11.6)	-25%



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4th Quarter: Diminished profit despite the zestful revenue

Upon the shopping zeal for Tet, KDC relished delightful revenue of VND1,194.6bn (+101.8% y-o-y) in the 4th quarter, of which the parent KDC by itself generated VND767.8bn (+26% y-o-y). Likewise, KDC stretched its gross profit (+120% yoy) toward VND448.8bn along with an improvement on gross-profit margin (GPM) from 34.5% to 37.6%. We are not surprise GPM of third quarter is usually the highest, because of the mooncake segment which has GPM of more than 50%.

More revenue intake (and possibly products restructuring) would usually necessitate higher selling expense, and hence the recent surge on this item (+164% yoy, from VND113.9bn to VND299.7bn) which in turn worsened the selling expense/revenue ratio from 19.3% to 25.1%. The administration expense almost tripled from VND34.6bn to VND90.2bn (+160.5% yoy), thus its weight on revenue aggravated from 5.9% to 7.6%. The combined expense enormity has reduced all revenue gain to a downfall of 57.1% yoy on the bottom line, from VND102.5bn to 43.9bn.

VND bn	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11	2010	2011	yoy
Net sales	306.1	279.0	732.4	591.9	634.7	878.0	1,524.8	1,194.6	1,909.5	4,232.1	121.6%
Gross profit	88.8	76.6	323.6	204.1	217.6	311.8	691.4	448.9	693.1	1,669.6	140.9%
GPM	29.0%	27.5%	44.2%	34.5%	34.3%	35.5%	45.3%	37.6%	36.3%	39.5%	
Financial gain/loss	427.4	(24.8)	20.8	24.2	(3.7)	(36.1)	1.1	(15.0)	423.4	(38.7)	-109.1%
Profit before tax	456.7	(31.6)	168.6	113.1	19.4	32.5	252.9	44.0	706.9	348.8	-50.7%
Net profit	349.5	(38.1)	141.3	102.5	6.4	20.8	221.0	43.9	555.1	292.2	-47.4%
Net profit margin	114.2%	-13.7%	19.3%	17.3%	1.0%	2.4%	14.5%	3.7%	29.1%	6.9%	

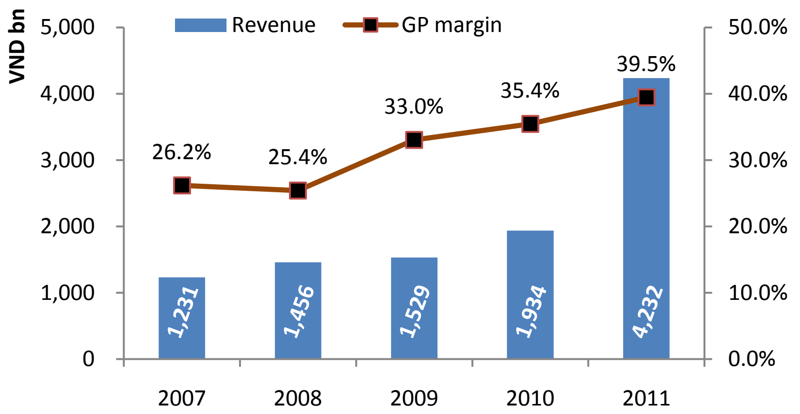
Source: KDC, SBS

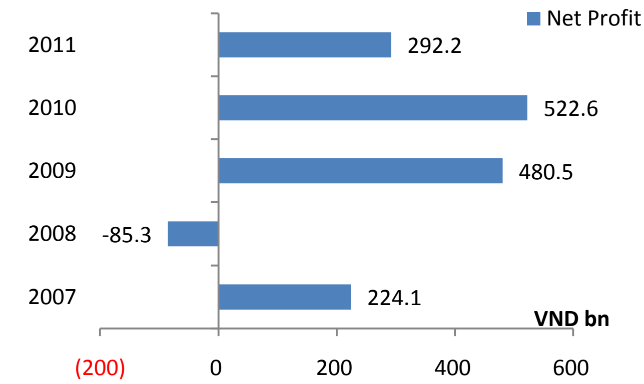
FY2011: Expenses - the intricacy of restructuring

KDC accomplished its revenue target with VND4,232.1bn (119.6% yoy); our projection of VND4,392.6bn was +3.8% higher (or a VND160.5bn gap) than the actual figure, since we felt slightly overconfident with the KDC-NKD-KIDO fusion. However our estimate for gross profit was almost dead on, because we used a lower GPM (38.1%). The Company actually benefits from a better GPM (39.5%) compared to that of last year, partly due to KIDO which has GPM of almost 60%.

The substantial profit (approx. VND550bn) from the transferred Sai Gon Diamond project in 2010 has created a huge downfall of financial income in 2011 (-81.6% yoy, from VND698.9bn to VND128.8bn); even without such unusual transaction, it would still be, although lesser, a decline of 13.5% yoy. That's not all, financial expense was driven to the roof (+179.7% yoy) due to an enormous upsurge in both short-term debts (+131% yoy, from VND380.6bn to VND880.7bn) and long-term debts (+22.9% yoy, from VND93.8bn to VND115.3bn). Therefore, KDC has incurred a net financial loss of VND53.7bn, compared to our projection of only VND15.6bn. We were hoping the Company might actually lower its outstanding loans in fourth quarter, yet the reality has proven otherwise and thus our misestimation on financial loss. KDC does not use much leverage, but we still believe the Company could have better managed its capital. In fact, the already-massive cash and cash equivalent has increased from VND465.2bn to VND967.5bn (+108% qoq), which could have been utilized in place of the interest-bearing loans.

REVENUE AND PROFITS OVERVIEW





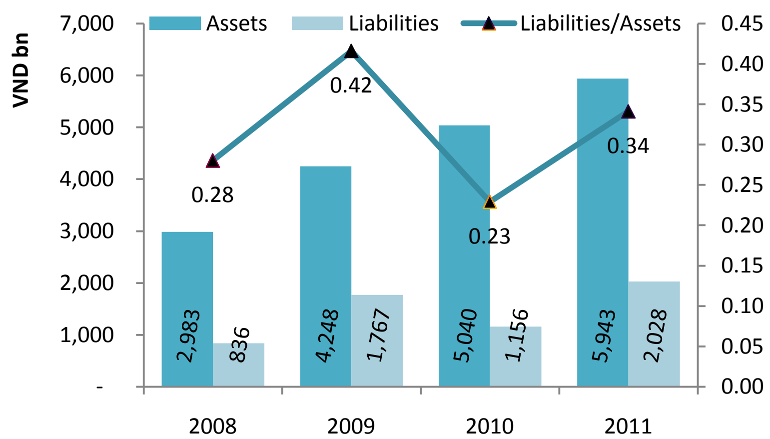
Source: KDC, SBS

Within one year since the merge with NKD and KIDO, selling expense of KDC has climbed +173.1% yoy (faster than revenue growth), resulting in its heavier weight on revenue (from 18% to 22.4%). Administration expense also surpassed revenue in term of augmentation, which was the reason behind the slight increase of administration expense/revenue ratio (from 7.3% to 7.6%). All in all, despite the attained revenue target, exacerbation of expenses has prevented KDC from reaching its profit before-tax target; the initial plan for VND500bn fell short to only VND348.8bn (-48.3% yoy). Likewise, our estimate for PBT was off by +32.7% (or by VND114.2bn) since we did not account for such dramatic extent of selling expense (off by +VND 70.0bn) and financial loss (of by -VND38.1bn). By the end, KDC earned a PAT of only VND292.2bn (-44.1% yoy), while we were expecting VND388.8bn (off by +96.7bn). Nevertheless, the core PAT of 2011 has gone up almost 200% compared to that of 2010, if we exclude the abnormal real-estate gain.

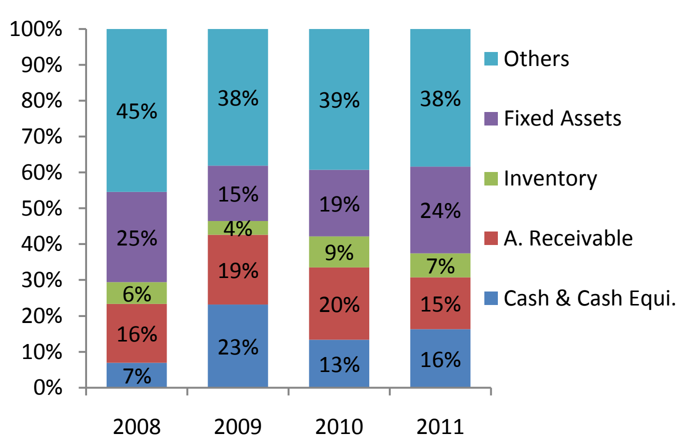
Investment orientation: The Company seemed to be liquidating its non-core investments; the value of stock portfolio has deteriorated from VND471.6bn to VND255.6bn (-45.6% yoy or VND216bn), of which all listed-stocks have been completely disposed. The largest divestment was probably the VND135.5bn worth of 5.2 million EIB shares. We have noticed a curious repetition on short-term investments in 2010 and 2011, whereas its total value would be much higher in the first 3 quarters and suspiciously low in the last quarter; most of these short-term investments were made toward related companies of KDC such as *Kinh Do Investment ltd Co*, and *Kinh Do Food Processing & Construction ltd Co*. After raising ownership within *KDC Binh Duong JSC* to 99.8% in 2Q11, KDC continued to pour another VND200bn (VND800bn in total) onto its joint venture *Lavenue* (a real estate company) without changing its holding status (still 50% of total shares), which was fairly unclear to us why.

The unexpected abnormality: The amount of investment goodwill has surprisingly decreased from VND682.7bn (3Q11) to VND393.3bn (-42.4% qoq, or -VND289.4bn). Normally, goodwill is subject to an 'accounting-base depreciation' of 10 years, thus a depreciation of such significance is questionable, because the real profit of 2011 could have been shrouded. However, we noticed an opposite movement on intangible asset of similar magnitude, from VND164.9bn (3Q11) to VND527.1bn (+219.6% qoq, or +VND362.1bn). Nevertheless, no change in accounting policy was mentioned, and thus we assume nothing at this point.

CAPITAL STRUCTURE



ASSET STRUCTURE



Source: KDC, SBS

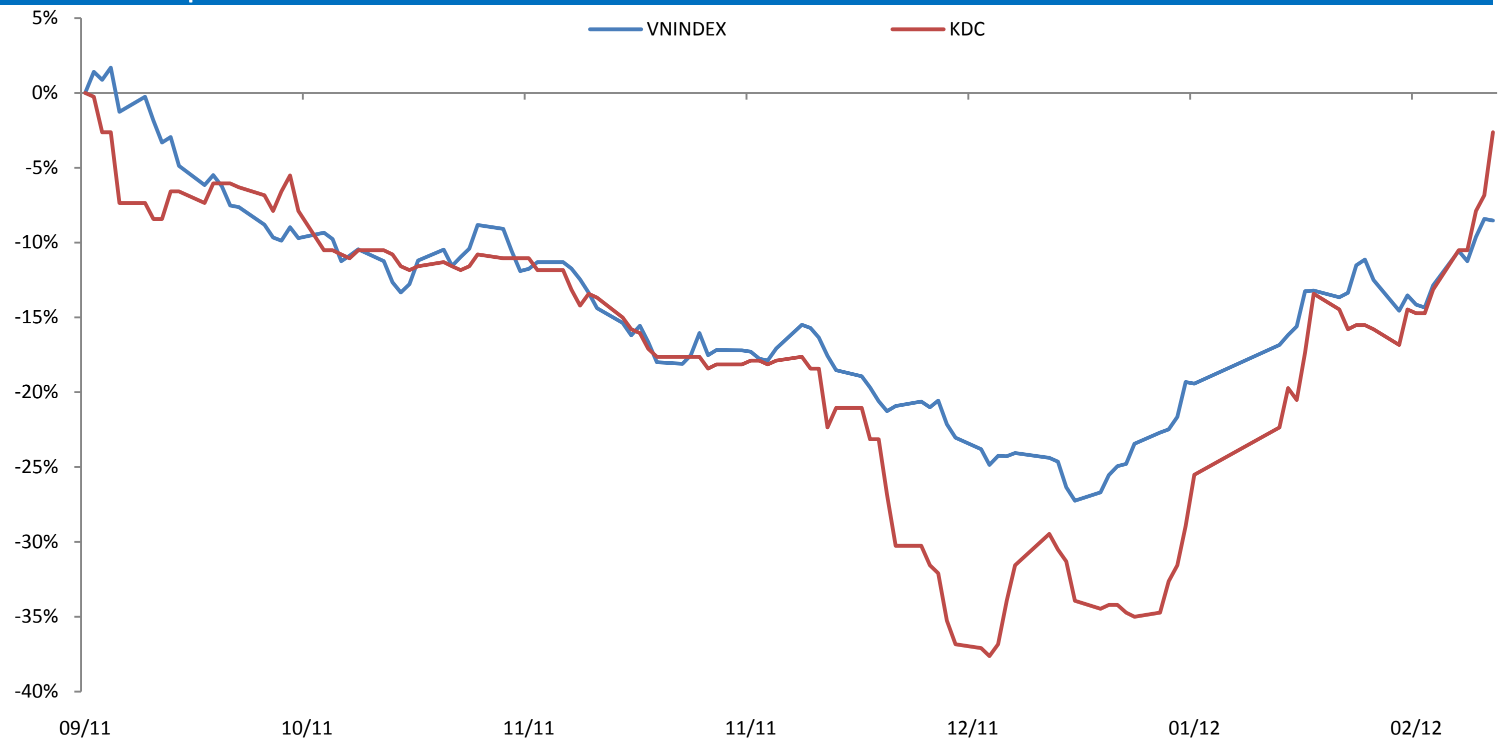
The 2012 outlook: In general, the confectionery industry should be steady in upcoming years. The expansion plan of KDC may be available upon its AGM2011 in April, yet the Company has already committed USD20m for imminent capacity investment, and we should expect more in the future. The recent strategic partnership with Ezaki Glico may have opened up new business opportunities to KDC for being the sole distributor in Vietnam for Glico; Mr Nguyen (CEO of KDC) has mentioned this cooperation may generate **VND1,000bn** in extra revenue for the Company. Besides, KDC may even receive technology supports from this Japanese confectionery giant. However, we have not factored in the value of such partnership in our model due to the lack of solid information. Also, we have not considered the possibility KDC may soon diversify to other products (such as instant noodle, fish sauce, etc.).

Model revision: We have made a few upward adjustments on our expense items and GPM ratio, while maintaining similar revenue to our last estimate; hence, our forecast for PAT got pushed down accordingly. Another factor influencing our evaluation was the recent 14 million share issued to Glico, which lowered our previous EPS (the issuance price was said to be 1.5 times higher than the current price at the time, which is close to VND50,000/share). Otherwise, we maintain our earlier assumption until further notice.

Our revised forecasts show revenue of VND5,166bn (basically unchanged) and a net profit of VND397.3bn (down from the previous VND475.4bn or -16.4%). Our estimate for EPS (2012) is adjusted down to VND3,009/share.

Valuation	We used a combination of valuation methods such as FCFF (70% weight), P/E (15%, P/E~12x), and P/BV (15%) to determine the fair value for KDC. We came up with a 12M target price of **VND37,300/share,** which is about 4.8% higher than the current price and 7.2% lower than our previous estimate of VND40,200/share.
Associated Risk	Confectionery producers are largely influenced by the price fluctuation of raw material, and KDC is no exception since raw material makes up 60-70% of COGS. Competitions within the industry are harsh, especially against foreign firms. KDC is more or less a family-managed company, and thus conflicts of interest can only be minimized. The Company is planning to expand toward other products segments (such as instant noodles and fish sauce) which are not under its specialty, thus risk of mis-diversification is possible
Recommendation	We changed our previous recommendation from **BUY** to **NEUTRAL** with a 12M target price of VND37,300/share. Since our last report, KDC has gone up 11% from VND32,000 to VND35,600 per share. We did recommend to buy around VND30,000 (KDC even went down to 24,000 at some point), thus the least gain could have been 18.7%. KDC plans to make its first 2011 dividend payment of **VND1,200/share** by 12 April 2012. The ex-right date is set for 8 March 2012.

Stock: 12-month performance



Source: Bloomberg, SBS

BALANCE SHEET (VND'm)	QI-11	QII-11	QIII-11	QIV-11
Assets	**5,036,786**	**5,165,006**	**5,618,562**	**5,942,801**
Current assets	2,254,572	2,136,440	2,566,324	2,696,467
Long-term assets	2,782,214	3,028,566	3,052,237	3,246,334
Fixed assets	936,361	1,049,519	1,098,987	1,437,463
Long-term investments	1,712,403	1,138,324	1,115,618	1,641,615
Resources	**5,036,786**	**5,165,006**	**5,618,562**	**5,942,801**
Liabilities	**1,153,217**	**1,350,620**	**1,607,255**	**2,027,947**
Current liabilities	989,314	1,164,341	1,386,418	1,833,100
Long-term liabilities	163,903	186,278	220,837	194,847
Equities	**3,760,300**	**3,779,694**	**3,974,829**	**3,878,835**
Equity	3,744,474	3,765,025	3,962,546	3,836,045
Contributed capital	1,195,179	1,195,179	1,195,179	1,195,179
Capital surplus	1,950,665	1,950,665	1,950,665	1,950,665
Retained profits	667,705	688,628	899,511	771,405

INCOME STATEMENT (VND'm)	QI-11	QII-11	QIII-11	QIV-11
Total Revenue	**640,441**	**884,461**	**1,535,259**	**1,205,652**
Net sales	**634,748**	**877,989**	**1,524,803**	**1,194,570**
COGS	417,184	566,227	833,410	745,714
Gross profit /(loss)	**217,564**	**311,762**	**691,393**	**448,856**
Financial income	21,295	23,371	43,189	40,929
Financial expense	24,998	59,514	42,060	55,913
Interest expense	20,592	30,990	24,583	42,590
Selling expenses	132,333	167,007	350,201	299,690
G&A expenses	66,276	73,511	92,419	90,238
Net operatiing profit	**15,252**	**35,102**	**249,902**	**43,944**
Other income	8,354	(122)	7,463	14,976
Other expenses	4,223	2,455	4,471	14,937
Profit /(loss) before tax	**19,383**	**32,525**	**252,893**	**43,983**
Corporate income tax	5,996	6,496	48,287	7,364
Profit after tax	**13,387**	**18,391**	**222,773**	**45,330**
Net profit	**6,441**	**20,837**	**220,988**	**43,931**

QUARTERLY RATIOS	QI-11	QII-11	QIII-11	QIV-11
Growth rate				
Revenue growth rate (YoY)	108.2%	109.6%	101.4%	213.7%
Gross profit growth rate (YoY)	145%	113.7%	120.0%	307.0%
Net profit growth rate (YoY)	-98%	56%	-57%	159%
Profitability ratio				
Gross margin	34.3%	45.3%	37.6%	35.5%
EBIT margin	6.3%	18.2%	7.2%	7.2%
Net profit margin	1.0%	14.5%	3.7%	2.4%
ROA (4Q)	4.9%	6.7%	5.4%	5.7%
ROE (4Q)	6.6%	9.2%	7.6%	7.7%
Management ratio				
Receivable outstanding days	11	11.4	20.4	12.0
Inventory outstanding days	93	49.7	48.5	78.3
Payable outstanding days	3	3.3	4.8	6.7
Liquidity ratio				
Current ratio	1.8	1.9	1.5	1.8
Quick ratio	1.8	1.5	1.3	1.4
Cash ratio	0.2	0.3	0.5	0.1
Capital Structure				
Total debt/Total equity	30.8%	40.6%	52.9%	35.9%
Total debt/total asset	22.9%	28.6%	34.1%	26.1%
Total asset/total equity	134.5%	141.8%	154.9%	137.2%
Index per share				
PE	17.5	15.1	12.1	14.6
EPS (VND per share)	2,039	2,358	2,935	2,445

Disclaimers

Report tracking

Reports issued	Date	Recommendation	12M Target price	Market price at issuing date
Initiation of Coverage	15/11/2011	**BUY**	40,200	32,000
Company Update	01/03/2012	**NEUTRAL**	37,300	35,600

SBS Research Guide to Investment Ratings

Buy: Share price may exceed 15% over the next 12 months
Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
Neutral: Share price may fall within the range of +/- 15% over the next 12 months
Take Profit: Target price has been attained. Look to accumulate at lower levels
Sell: Share price may fall by more than 15% over the next 12 months
Not Rated (NR): Stock is not within regular research coverage

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