Kinh Do Corporation Vietnam
Kinh Do CORP • KDC

TASTY AND YUMMY!!!

NOT RATED

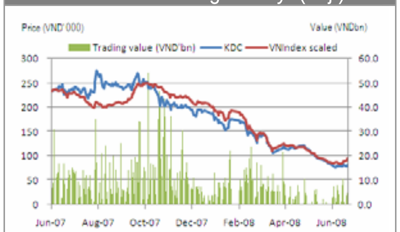
KINH DO

Office:	6/134 13th National Rd. Hiep Binh Phuoc Ward, Ho Chi Minh City, Vietnam
Telephone:	+84 4 7269474
Fax:	+84 4 7269472
Website:	www.kinhdofood.com.vn
Email:	kido.co@kinhdofood.com
Contact:	Mr Patrick Ho Chief Operating Officer

Ownership

Foreign	39.3%	18,077,060
Domestic	60.7%	27,920,549
State	0.0%	0
Outstanding shares		45,997,609

KDC• 52-week trading history (adj.)



King Yoong Cheah, ACA, CFA
Head of Research
king.cheah@mekongsecurities.com

Bui Cam Van
Associate, Research
van.c.bui@mekongsecurities.com

Tri Nguyen
Analyst, Research
tri.m.nguyen@mekongsecurities.com

OPERA BUSINESS CENTRE, FLOOR 9A
60 LY THAI TO, HOAN KIEM DISTRICT
HANOI, VIETNAM
TEL.: +84 4 936 1389
FAX: +84 4 936 1393

SAIGON FINANCE CENTRE, FLOOR 9
9 DINH TIEN HOANG, DISTRICT 1
HO CHI MINH CITY, VIETNAM
TEL.: +84 8 520 2050
FAX: +84 8 822 8014

Company's Statistics

Exchange	Ho Chi Minh City Stock Exchange	Last price	VND81,000 • US$4.90
Sector	Confectionery	BPS	VND61,361 • US$ 3.72
Index weight	2.0%	Expected EPS	VND 5,503• US$ 0.33
Market cap.	VND3,588bn • US$ 221.2bn	Trailing EPS	VND 5,679 • US$ 0.34
52-week range	VND 277,000 –VND74,500	Hist DPS	VND 1,800 • US$ 0.11
30-day average daily turnover	US$0.19mn	Dividend yield	2.2%
Beta	1.1	Expected PER	14.7
ROCE	7.7%	P/BV	2.1

Exchange rate: 1USD=VND16,500

Company Updates

We recently paid a visit to Kinh Do Corporation. The key highlights of our company visit are below:

- *Double digit growth in top line but lower earnings for FY08.* Management has forecasted revenue and profit before tax (PBT) for FY08 to grow by 30% and 21% on a y-o-y basis to US$96.9mn and US$16.4mn respectively. The top line is mainly boosted by the doubling of production capacity to 80,000 tonnes with the commencement of Kinh Do Factory in Binh Duong this year. Given that the new plant is equipped with modern technologies and is able to meet international food hygiene standards, management is hopeful that this could boost the Company's export revenues by 40% per annum. As such, export contribution could increase from US$10mn per annum in 2007 to US$30mn per annum in 2010. Management believes that the improved product quality will enable KDC to expand its market share in the US and Japan. Nonetheless, management guided that net earnings are expected to decline by 5.2% on a y-o-y basis to US$12.8mn with the expiration of tax exemption incentives and higher minority interests since the Company only owns 80% stake in the new factory.

- *Traditional products to remain growth drivers.* KDC's traditional products such as buns & breads, crackers and mooncakes will continue to be revenue drivers going forward. We gather that these products have contributed more than 70% of the Company's total revenue and have enjoyed robust compound annual growth rates (CAGR) of around 50%, 37% and 11% respectively in the past two years. Furthermore, KDC's mooncake product is extremely popular in the market and has captured around 80% of the market share.

- *Extensive distribution network nationwide.* Throughout the years, the Company has established an extensive distribution network to market their products. At present, KDC has around 190,000 retail outlets spreading across the Northern Central and the Southern regions. Traditional distribution channels continue to be popular for the Company to market their products given that around 95% of their products are sold through traditional channels while modern channels only account for around 5% of their product sales. KDC has also placed emphasis on attractive packaging to capture the attention of its target segments.

- *Limited investment in real estate.* Management guided that KDC is primarily set up to conduct confectionary business for its parent company, Kinh Do Group (KDG) and have limited involvement in KDG's real estate projects.

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Recent Financial Results Highlights

*Higher revenue and operating profit……..*KDC's revenue and operating profit for 1QFY08 grew by 12.8% and 22.5% to US$15.5mn and US$3.2mn respectively compared with 1QFY07 despite a 59.1% fall in financial income. We believe that the higher operating profit was mainly due to a better sales mix and improved cost efficiencies which boosted its operating margin.

…… but net earnings dropped….. Nonetheless, the Company's net earnings declined by 13.2% on a y-o-y basis. This is mainly reduced by minority interest amounted to US$0.6mn in correspondence to KDC's 80% ownership in the new Kinh Do factory in Binh Duong. Although Kinh Do only completed 16% and 20% of its revenue and net earnings target on an annualized basis, we believe that the Company is on track to achieve its full year target given that the second half has traditionally been its stronger period.

Quarterly Results (US$mn)	1Q 2007	4Q 2007	1Q 2008	Change QoQ	Change YoY
Revenue	13.7	22.2	15.5	-30.3%	12.8%
Gross profit	3.5	4.7	4.3	-9.5%	22.5%
Operating Profit (ex.Net Financial Income)	1.8	3.7	2.9	-21.7%	61.2%
Operating Profit	2.6	4.3	3.2	-25.0%	22.4%
Pre-tax Profit	2.9	4.6	3.2	-30.0%	9.5%
Net profit	2.9	4.6	2.5	-44.5%	-13.2%
Gross Profit Margin (%)	25.5%	21.3%	27.7%	29.8%	8.7%
Operating Margin (%)	19.2%	19.4%	20.9%	7.6%	8.6%
Pre-tax Margin (%)	21.4%	20.7%	20.8%	0.3%	-2.9%
Net Margin (%)	21.4%	20.7%	16.5%	-20.4%	-23.0%

Investment Risks

We believe that investing in KDC is subject to the following risks:

Rising global raw material prices. The need for KDC to source their main material inputs such as wheat flour, margarine and milk powder and sugar externally has exposed the Company to rising global prices. Management estimates that KDC needs to spend an additional US$1.2mn –US$1.8mn every month to cover increased input costs.

Intensified competition. Market competition is expected to intensify going forward with an increasing number of foreign players following Vietnam's accession to WTO and aggressive expansion from domestic players eager to capture market share. Although KDC has controlled about 30% market share at present and has established a dominant position in its main products (bun & bread, crackers, mooncakes and layer cakes), we believe that it will be challenging for the Company to sustain and expand its market share going forward with increased competition from domestic and foreign players. For instance, Bibica (BBC), a domestic confectionery manufacturer, has recently sold a 31.5% stake to Korean Lotte and increased its production capacity at its two factories to expand its market shares. Even though KDC has been successful in building up its own brand, continuous improvement in both product quality and product diversification is crucial to prevent consumers from switching to other brands.

Market misconception. As mentioned above, KDC is primarily set up to conduct the confectionary business for its parent company and therefore has limited involvement in KDG's real estate projects. Nonetheless, the market has generally perceived that KDC has significant interests in three major real estate projects including an Office Tower on Le Loi, An Phuoc Town in Thu Duc and Cong Hoa Garden in Tan Binh District.

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Unspecified merger valuation. Management expects the merger exercise between KDC and its sister company, North Kinh Do (NKD), to complete in the second half 2008. Although we are optimistic that the merger will put KDC on a stronger footing, we are not able to determine whether the merger excise will be beneficial to the shareholders of KDC given the non- availability of the share swap ratio at present.

Valuation

Based on the management guidance, KDC is currently trading at an expected PER of 14.7x, which is significantly higher than the 7.7x average expected PER of its domestic peers. Although we believe that the Company deserves a valuation premium due to its dominant position and large market capitalization, we believe the valuation is rich at present based on domestic comparison. On a regional comparison, KDC is trading at around 5.4% discount against the regional average PER of 15.6x.

Name	Country	Market Cap (USDmn)	P/E 2008	P/B	P/S
Regional					
London Biscuits Bhd	Malaysia	23.1	9.7	0.6	0.6
Orion Corp	S Korea	1,177.0	17.8	2.4	2.0
Lotte Confectionery Co Ltd	S Korea	1,635.7	13.6	1.0	1.5
Want Want China Holdings Ltd	China	5,118.4	19.4	0.7	0.5
Grupo Bimbo Sab-Series A	Mexico	7,426.4	17.3	2.7	1.1
Average			15.6	1.5	1.1
Domestic					
*HaiHa Confectionery Joint Stock Company	Vietnam	6.5	6.8	1.1	0.3
*Bibica Corporation	Vietnam	26.2	6.7	1.2	2.4
*North Kinh Do Food Joint Stock Company	Vietnam	55.5	9.7	3.5	1.6
Average			7.7	1.9	1.4
*Kinh Do Corporation	Vietnam	221.2	14.7	1.8	1.1

Source: Bloomberg, Reuters, Various

**Earnings estimates based on the management guidance*

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Appendices

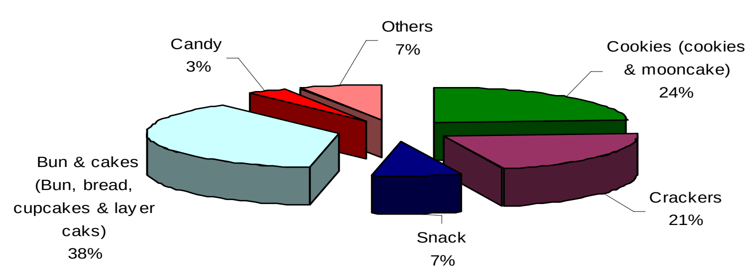
1. Corporate Profile

Started its operations in 1993 with only six employees, KDC has now become a dominant player in the domestic confectionary sector. At present, the Company has a chartered capital of US$28.5mn, more than 6,000 staff and controlling about 30% of that domestic market share. Besides that, KDC has around 190,000 retail outlets spreading across the Northern Central and the Southern regions.

KDC produces more than 200 varieties of medium to high end confectionery products. Its main products include bun & breads, crackers, custard cakes and mooncakes. Its buns/ breads and custard cakes are marketed under the 'Aloha' and 'Solite' brands. The Company has placed strong emphasis on R&D activities to ensure good product quality and to provide diversified product offerings to its consumers. KDC has enjoyed strong growth rates ranging between 20%-30% in terms of revenues and net earnings between 2004 and 2007. This is comparatively higher than the revenue growth rate of the whole sector, which is estimated to be around 13.9% during the same period.

KDC's vision is to become a leading confectionery and food manufacturer. In achieve its vision, the Company has been aggressively expanding its market reach through mergers and acquisition. For instance, KDC has signed an agreement to buy a 51.2% stake or 2.6mn shares in Vinabico Confectionery in December 2007 of which 13.3% or 1.2mn shares was acquired in January 2008. It has planned to merge with its sister company, NKD, in the second half of 2008 to further strengthen its foothold. Management also plans to merge with Kido Ice Cream, which is 40% owned by KDC and currently dominates over 60% of the domestic ice cream market, although a concrete time frame for this merger has yet to be confirmed. Besides that, it has actively diversified its product offerings by acquiring a 35.4% stake in Tribeco to penetrate the soy drink market followed by an acquisition of 30% stake in Nutifood, a local nutrition food manufacturer. KDC has also recently formed a strategic alliance with Cadbury Schweppes to be their sole distributor of chewing gum and candies in Vietnam for a two year period prior to further production development.

Classification of revenue by product lines (2007)



Source: KDC

Ownership structure	
KDG	11.5%
Chairman & Managing Director	25.5%
Foreigner	39.3%
Domestic	23.7%

Distribution network	Number of Wholesalers	Number of retail outlets
Confectioneries	200	70,000
Cold Storage	70	15,000
Beverage	335	104,000
Wholly-owned Bakery & Franchise	n.a	25

2. Management Team

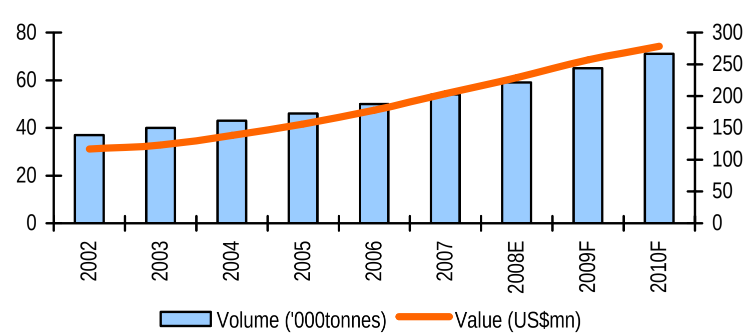
Board of Directors	
Mr Tran Kim Thanh	Chairman
Mr Tran Le Nguyen	Vice Chairman
Ms Vuong Buu Linh	Member
Mr Vuong Cam Sang	Member
Mr Co Gia Tho	Member
Board of Management	
Mr Tran Le Nguyen	Managing Director
Mr Patrick Ho Loke Yin	Chief Operating Officer
Ms Vuong Buu Linh	Vice General Director
Ms Vuong Ngoc Xiem	Vice General Director
Mr Le Phung Hao	Vice General Director
Mr Nguyen Xuan Luan	Vice General Director
Mr Vuong Cam Sang	Vice General Director
Mr Mai Xuan Tram	Vice General Director

3. Sector Outlook

Favorable underlying fundamentals to support sector developments. Strong economic growth, rising per capital income, favorable demographics and a low penetration rate remain the key ingredients to sustain higher per capita consumption spending on confectionary market. There is also great potential for manufacturers to develop high end products which typically command favorable profit margins given that Vietnam's average confectionary selling price per volume is quite low at US$2,895/ton compared to China of US$3,783/ton or Singapore of US$12,778/ton.

Sustainable and strong growth rate. According to Euromonitor International, Vietnam's confectionery market has enjoyed an estimated CAGR of 8.2% in volume between 2004 and 2007. In term of value, the sector has registered 13.9% CAGR in the same period, outperforming Asia Pacific, European and global markets which grew at 6%, 2% and 5% respectively. Confectionery sales in Vietnam exceeded US$204mn in 2007, making it the third largest market in South East Asia trailing only the Philippines and Indonesia. High single digit growth rates are expected to be sustainable in the medium term and confectionary sales are expected to reach US$278mn by 2010.

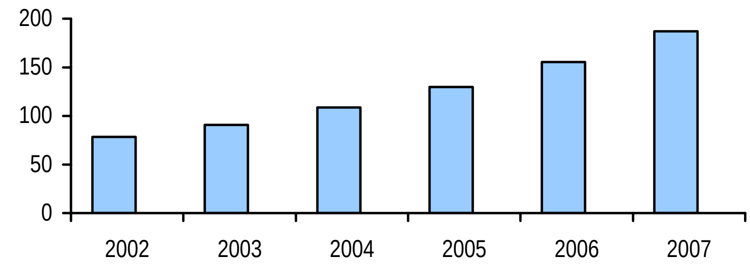
Vietnam's Confectionery Market (2002-2010)



Source: Euromonitor International

Biscuits and crackers enjoy the highest growth rates. Vietnam's biscuit sector is dominated by more than ten prominent domestic confectionery manufacturers that account for approximate 80% of the market share. According to Euromonitor International, this sector has enjoyed an average compound annual growth rate (CAGR) of 19% in value between 2002 and 2007 with market size estimated to reach US$187 in 2007 from US$78 in 2002. In terms of grow rate by products, savory biscuits and crackers registered the strongest growth of 26.5% CAGR in the same period.

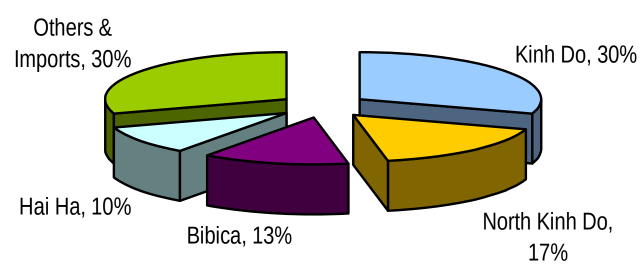
Market value of biscuit sector (2002 – 2007)



Source: Euromonitor International

Domestic manufacturers aggressively expanding their market shares. At present, domestic confectionary manufacturers have fulfilled around 70% of domestic demand. Leading confectionery manufacturers are Kinh Do Corp, followed by Hai Ha and Bibica. To meet the growing demand and to cope with an increasingly competitive business environment, leading manufacturers have been aggressively expanding their production offerings. Some domestic manufacturers have formed strategic alliances with international confectionery players to expand their market share and to ensure transfer of technologies.

Confectionery Market Share in Vietnam (2007)



Source: Companies & MKS Estimates

Intensified competition upon WTO accession. The market has become increasingly competitive with the sector liberalization upon Vietnam's accession to WTO. Although WTO agreement will benefit the Vietnamese confectionery exporters, the reduced import tariffs will attract more imports of confectionary products to Vietnam. Furthermore, gradual removal of trade barriers will also attract increased number of global confectionery giants from penetrating the market. Some foreign players have formed strategic alliances with the domestic companies to take advantage of their local market experience and existing distribution network. Others have decided to push forward on their own; Orion Confectionery has just constructed a US$40mn second factory in Northern Vietnam to meet growing demand and will export 50% their total outputs to South East Asia. On the other hand, domestic companies such as Kinh Do and Bibica are gearing up to strengthen their market presence through mergers and acquisition (M&A). This is evidenced by the recent acquisition of 30% stake in Nutifood by KDC, who have also invested a significant stake in Tribeco Beverage and Vinabico.

Raising commodities price may dent earnings. Rising commodities prices both domestically and externally have significantly increased production costs of domestic manufacturers. We gather that many domestic players do not hedge their raw materials prices given that hedging instruments are not popular in Vietnam. Furthermore, domestic players may find it difficult to pass on the increased costs to consumers given the intensified competitive environment. Therefore many domestic players may have to endure thinning margins.

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Strong growth potential challenged by intensified competition and hiking material costs. In short, we remain positive on the long term development of the sector in view of strong underlying fundamentals. Nonetheless, intensified competition coupled with higher material costs may put downward pressure on profit margins of domestic manufacturers.

4. Summary of Financials

Income Statement (US$mn)	2005A	2006A	2007A	*2008F
Revenue	48.4	60.5	74.6	96.9
Gross profit	13.9	17.0	19.5	25.4
Operating Profit	6.7	10.5	14.4	18.7
Profit before tax	6.5	10.3	13.5	16.4
Net profit	5.7	10.3	13.5	12.8
Gross profit margin	28.8%	28.2%	26.2%	26.2%
Operating margin (%)	13.9%	17.3%	19.3%	19.3%
Pre-tax margin (%)	13.5%	17.0%	18.1%	16.9%
Net margin (%)	11.9%	17.1%	18.1%	13.2%
Revenue growth (%)	11.1%	25.0%	23.3%	29.9%
Operating growth (%)	18.6%	55.5%	37.6%	29.9%
Pretax profit growth (%)	21.2%	58.0%	30.8%	21.4%
Net profit growth (%)	16.9%	80.1%	30.4%	-5.2%

**Management guidance, MKS estimates*

Equity Rating Definitions

BUY	Positive recommendation of stock under coverage. Expected absolute return of +15% over 12-months, with low risk of sustained downside
HOLD	Neutral recommendation of stock under coverage. Expected absolute return between –15% and +15% over 12-months, with low risk of sustained downside.
SELL	Negative recommendation of stock under coverage. High risk of negative absolute return over 12-months.
NOT RATED	No research coverage and report is intended purely for informational purposes