

Saigon Beer - Alcohol - Beverage Corporation (SAB: HOSE)

HOLD – 1Y Target Price: VND 184,000
Current price: VND 200,000

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CONSUMER – VIETNAM

Key Figures

Market cap (USD mn)	5,822
Market cap (VND bn)	134,990
Outstanding shares (mn)	641
52W high/low (VND 1,000)	347/200
Average 3M volume (share)	66,072
Average 3M value (USD mn)	0.66
Average 3M value (VND bn)	15.24
Foreign ownership (%)	9.66
State ownership (%)	89.59
Management ownership (%)	N.a

Source: SSI Bloomberg

SAB Price & Trading Volume



Source: Bloomberg

Company Snapshot

Sabeco is the leading beer producer in Vietnam with 23 subsidiaries and 31 joint ventures. Sabeco has 23 beer factories across the country with a total annual capacity of 1,800 million liters. Utilization rate reached ~82% in 2015. It has 11 trading companies managing 44 branches and 800 distributors across Vietnam. Its products are available at 32,000 PoS. The company also exports to 27 countries but exports accounted for a minimal proportion of sales.

2018 AGM Note

2017 results

(bn VND)	12M2017	12M2016	YoY	% annual target completed	Margin	
					12M2017	12M2016
Net sales	34,193.4	30,466.7	12.2%	99.2%		
Gross profit	8,865.5	8,167.0	8.6%		25.9%	26.8%
Operating profit	6,062.2	5,702.2	6.3%		17.7%	18.7%
EBIT	6,391.0	5,809.5	10.0%		18.7%	19.1%
EBITDA	7,016.3	6,442.0	8.9%		20.5%	21.1%
Pretax profit	6,077.1	5,727.3	6.1%		17.8%	18.8%
Net income	4,948.6	4,517.3	9.5%	105.2%	14.5%	14.8%
NI attributable to shareholders	4,711.5	4,338.8	8.6%		13.8%	14.2%

Source: SAB, SSI Research

Vietnam beer sector performance in 2017

According to SAB, global beer consumption has experienced a decline. Meanwhile, the Vietnam beer market has been bucking the trend, exhibiting stable consumption rates in 2017. With consumption per capita having reached 43 liters/year, Vietnam remains the top beer consumer in Southeast Asia, and climbed to 3rd place in Asia.

According to Statista, total Vietnam beer consumption industry-wide in 2017 reached 4 billion liters (+6% YoY), in which SAB sales volume reached 1.791 billion liters (+8.7% YoY), which accounted for 44% of total industry consumption, still by far holding the torch as the leading brewer in Vietnam. SAB currently has 25 beer factories with a total capacity of 2 billion liters per year, with 10 trading companies and managing 37 branches and over 1000 distributors across Vietnam. Competition in the industry is still fierce, with Sabeco and Vietnam Brewery Limited (VBL - which sells Heineken, Tiger Beer and Larue Beer) enjoying steady growth all the while other FDI brewers such as San Miguel and Foster took some profit hits, and exited the market accordingly. *While SAB's market share declined slightly from 45.8% in 2015 to 40% in 2017, its direct competitor VBL gained market share, climbing from 17.3% in 2015 to 25% in 2017 (source: VBA) thanks to their investment in productivity improvements, as well as an intense pace of marketing activities.*

SAB's 2017 results

In 2017, SAB beer sales excluding SCT reached VND 29.838 tn (+13.3% YoY), and accounted for 87.3% of net sales (vs. 86.4% in 2016). *Sales volume reached 1.790 billion liters (+8.5% YoY), in which Sai Gon beer volume reached 1.731 billion liters (accounting for 97% of total beer sales).* In response to intense competition, SAB launched its first high-end product (Saigon Gold) in August to capture the growing demand for the premium segment, where SAB still lags behind VBL. However, there has been minimal impact in the short term as consumers still drink mostly because of taste, brand popularity, and price. SAB beer was exported to 33 countries in 2017, with a total volume of 28.6 million liters, 4 times higher than the equivalent in 2016. In contrast, there was a significant drop in alcohol and soft drink revenue. Soft drinks consumption declined sharply by -22.5% YoY due to heated competition with Coca-Cola and Pepsi, among others.

Gross profit reached VND 8.866 tn, up 8.6% YoY and in line with the rate of sales growth, but the gross margin declined slightly from 26.8% in 2016 to 25.9% in 2017. *According to IndexMundi, the average barley malt price was steady until October 2017. By the end of 2017, it soared by 26% YoY, leading to a lower beer gross margin of 28.5% (vs. 29.5% in 2016).* According to management, SAB had to adjust its sales price marginally in 2017 by 1-2% in order to compensate for the increase in the SCT rate, at 60% in 2017 and 55% in 2016. In 2018, the SCT rate continued to increase to 65%, and SAB might have to adjust their sales price to counter such an increase.

Net profit reached VND 4.949 tn, up 9.5% YoY. Despite a lower gross margin, the net margin declined marginally from 14.8% in 2016 to 14.5% in 2017, due to:

- Reduction in financial expense of 48.8% YoY, from VND 82 bn to VND 42 bn in interest expenses, as an amount of VND 319 bn in short-term loan principal and VND 162 bn of long-term loan principal having been repaid;
- Income from investment in associates (some of which are SAB beer production factories and a few non-core businesses) increased by 35% to reach VND 412 bn;
- SG&A/sales ratio declined to 10.95% in 2017 vs. 11.33% in 2016. This was due to the fact that the marketing expenses/sales ratio declined from 4.3% in 2016 to 3.5% in 2017.

2018 Outlook

Company's target

In 2018, Vietnam Beverage Limited officially participated in the management and production operation of SAB. As a result, it was a significant milestone and pivotal year for SAB to go through in terms of restructuring and developing new business strategies for the coming years. SAB has forecasted the following advantages and disadvantages as follows:

- Advantages:
 - ✓ Beer consumption, although showing signs of decline, is still forecasted to grow at 5% per year;
 - ✓ SAB products still dominate consumption in urban areas, and among the standard segment. The growing middle class and continued trend towards urbanization act as key drivers for long-term sales growth.
- Disadvantages:
 - ✓ Increasing competitive pressure among brewers;
 - ✓ Imported prices of raw materials are forecasted to increase sharply due to seasonal effects upon input prices, and bad weather could exacerbate such an effect;
 - ✓ Premium products have not been developed in order to target young consumers with growing income;
 - ✓ Special consumption tax has increased 5%, from 60% in 2017 to 65% as of 1/1/2018.

In 2018, SAB new management will apply new directives to improve the Sabeco brand image, develop new products, and enhance the efficiency of the entire supply chain and distribution channels to reduce logistical costs and optimize production. This will be done in order to increase sales volume to reach a maximum capacity of 2 billion liters.

For 2018, SAB aims to achieve VND 36.092 tn in net sales (+5.6% YoY) and VND 4.007 tn in net profit (-19% YoY). Beer sales volume is estimated to reach 1.803 billion liters (+0.7% YoY). Management forecasted lower PBT than the prior year due to: (i) the 5% increase of SCT from 60% to 65% in 2018; (ii) the substantial rise in the cost of raw materials affecting the gross margin. SAB also expected to incur additional expenses during the transition period which might also affect net profit margin.

Dividend rate for 2018 is the same as 2017 at 35% on par.

Restructuring plan and progress up to date

There have been some changes in the company's business lines: management removed advertising, tour operator activities and real estate valuation as stated business lines, as they are non-core activities and SAB has never previously done them before.

The Supervisory Board has been replaced with the Audit Committee going forward.

On 16/7/2018, SAB established a 100% ownership subsidiary called Saigon Company Beer Limited, with a charter capital of VND 10 million. Management indicated that the company has been launched to protect the intellectual property of the Saigon Beer brand.

Some restructuring plan has been provided as follows:

- Consider an increase in the increasing ASP depending on competition and strength of the Sabeco brand;
- Develop new products to target distinct customer segment;
- Some strategies to reduce costs include: (i) increase synergies by consolidating subsidiaries and associates; (ii) coordinate with ThaiBev to negotiate better price on bulk purchase of raw materials; (iii) utilize ThaiBev's marketing channels and (iv) reduce logistic costs.

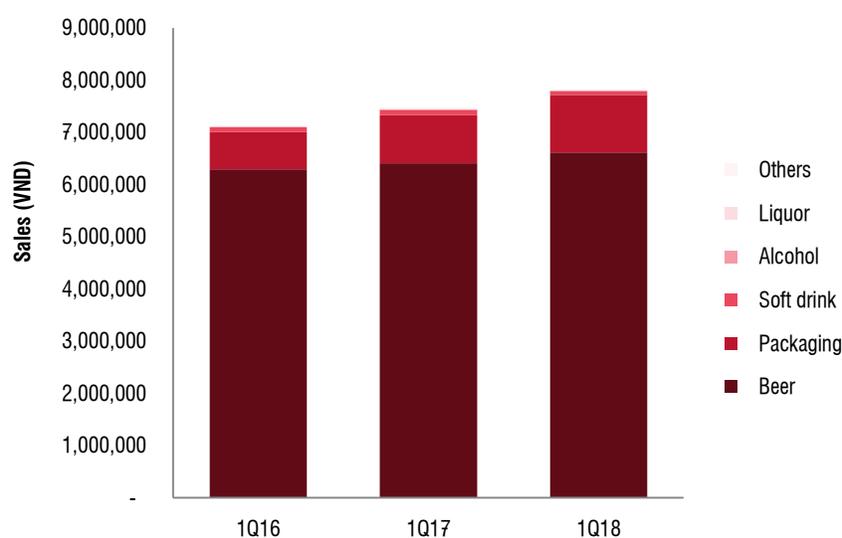
1Q 2018 Results

SABECO has released its 1Q 2018 business results, and here is the key summary.

(bn VND)	1Q18	1Q17	YoY	4Q17	QoQ	% annual target completed	Margin		
							1Q18	1Q17	4Q17
Net sales	7,809.9	7,464.7	4.6%	10,467.2	-25.4%	21.8%			
Gross profit	1,944.0	2,115.9	-8.1%	2,549.6	-23.8%		24.9%	28.3%	24.4%
Operating profit	1,173.4	1,272.8	-7.8%	1,396.3	-16.0%		15.0%	17.1%	13.3%
EBIT	1,418.9	1,459.5	-2.8%	1,821.2	-22.1%		18.2%	19.6%	17.4%
EBITDA	1,575.9	1,616.6	-2.5%	1,989.4	-20.8%		20.2%	21.7%	19.0%
Pretax profit	1,408.8	1,448.4	-2.7%	1,790.2	-21.3%	23.4%	18.0%	19.4%	17.1%
Net income	1,155.7	1,188.0	-2.7%	1,418.8	-18.5%	24.0%	14.8%	15.9%	13.6%
NI attributable to shareholders	1,113.5	1,126.8	-1.2%	1,300.1	-14.4%		14.3%	15.1%	12.4%

Source: SAB, SSI Research

Revenue increased by 4.6% YoY to VND 7.801 tn, accomplishing 21.8% of the 2018 plan. The main driver for growth was a modest amount of beer sales, increasing of 3.2%, as well as a packaging revenue increase of 19.7%.



Source: SAB, SSI Research

Gross profit reached VND 1.944 tn (down -8.1% YoY), whereas overall GPM decreased from 28.3% in 1Q 2017 to 24.9% in 1Q 2018. Beer GPM also decreased from 35.6% to 28.6%. The average barley malt price was still on a rising trend since 4Q 2017, and increased by 39.7% YoY and 7.6% YTD. According to VBA, since the amount of stock brought forward was high since the beginning of the year, the ASP only marginally increased during the Tet holiday. In addition, the 5% rise of SCT since the beginning of the year also affected the GPM of all beer producers. As a result, the retail price of some brands have been reported to have increased since May 2018 compared to 2017. This includes Saigon Special, 333, Heineken, and so on. We expect this trend to continue going forward to counter the rise in SCT.

Net income reached VND 1.156 tn (down -2.7% YoY), with the net margin having declined from 15.9% in 2016 to 14.8% in 2017. Income from associates surged by 311%, and the SG&A/Sales ratio also showed improvement from 11.3% in 1Q 2017 to 9.9% in 1Q 2018.

Change in management

A new BOD has been approved at the AGM as follows. These are all new members introduced by ThaiBev. None of them were in the previous BOD when MoIT still held majority stake.

Mr. Koh Poh Tiong – Chairman

Mr. Nguyen Tien Dung – Chief Accountant (MoIT representative)

Mr. Michael Chye Hin Fah – Member of BOD

Mrs. Tran Kim Nga – Member of BOD

Mr. Luong Thanh Hai – Member of BOD (MoIT representative)

Mr. Nguyen Tien Vy – Member of BOD

Mr. Pramoah Phornprapha – Independent member of BOD

Estimates and valuation

For 2018, our estimate for net sales comes to VND 36.296 tn (+5.4% YoY) based on the assumption that beer sales volume increases by 1% YoY and the beer ASP has increased by 3.8% YoY, and net profit is VND 4.593 tn (-7.6% YoY) based on a lower overall gross margin of 25.6%. For 2019, our estimate for net sales is VND 38.82 tn (+7% YoY), and net profit is VND 5.027 tn (+9.5% YoY) as we expect the gross margin to improve to 26.8% as the company becomes more efficient after the 1 year period of restructuring.

At the moment, SAB's scattered warehouse network across the country supports distributors to pick up SAB products easily. However this convenience has a tradeoff in terms of uncompetitive logistic costs due to the need for a certain amount of production volume to be transferred among different regions. Therefore, one of management's new directives is to consolidate SAB subsidiaries who produce and trade beer

across the country and restructure the entire supply chain system. While such an ambitious restructuring takes time, we expect SAB's margin to nonetheless improve going forward. In our opinion, SAB is going through major restructuring this year, so a growth catalyst to fuel the stock is expected by 2019 at the earliest, when the aforementioned new directives are implemented and materialized. With a new capable management team which has been drastically changed this year, we expect SAB's performance to improve in the long term.

Excluding the 6% bonus and welfare fund, EPS might reach VND 6,476 in 2018 and VND 7,089 in 2019. At the current price of VND 200,000, SAB is being traded at 2018 P/E levels of 31x and 2019 P/E of 28x, which is high when compared to other consumer stocks such as VNM: 25x, KDC: 20x and MCH: 17x. We recommend to HOLD the stock, with a 1Y target price of VND 184,000/share, equivalent to a 1Y target P/E of 27x.

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The research analyst(s) on this report certifies that (1) the views expressed in this research report accurately reflect his/her/our own personal views about the securities and/or the issuers and (2) no part of the research analyst(s)' compensation was, is, or will be directly or indirectly related to the specific recommendation or views contained in this research report.

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Industry Rating: We provide the analyst' industry rating as follows:

- ❖ **Overweight:** The analyst expects the performance of the industry over the next 6-12 months to be attractive vs. the relevant broad market
- ❖ **Neutral:** The analyst expects the performance of the industry over the next 6-12 months to be in line with the relevant broad market
- ❖ **Underweight:** The analyst expects the performance of the industry over the next 6-12 months with caution vs. the relevant broad market.

**The market required rate of return is calculated based on 5-year Vietnam government bond yield and market risk premium derived from using Relative Equity Market Standard Deviations method. Our rating bands are subject to changes at the time of any significant changes in the above two constituents.*

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