

# Donga ST (170900)

Positive
Neutral
Negative

12M rating **BUY (Maintain)**

12M TP **W235,000** from W235,000

Up/downside **+111%**

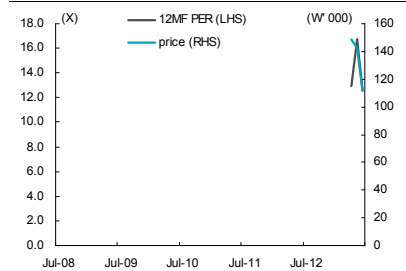
## Stock Data

KOSPI (Jun 21, pt)	1,823
Stock price (Jun 21, KRW)	111,500
Market cap (USD mn)	710
Shares outstanding (mn)	7
52-Week high/low (KRW)	178,000/110,000
6M avg. daily turnover (USD mn)	13.7
Free float / Foreign ownership (%)	76.1/25.3
Major shareholders (%)	
Jung-suk Kang and 30 others	17.5
Glaxo Group Limited	9.9

## Performance

	1M	6M	12M
Absolute (%)	(28.8)	NM	NM
Relative to KOSPI (%p)	(20.8)	NM	NM

## 12MF PER trend



Source: WISEfn consensus

## Visit to CamGold in Cambodia

- On Jun 18-20, we traveled to Cambodia, a major importer of Bacchus, to visit CamGold, a local distributor and seller, and to explore the energy drink market
- Also attended staff meetings at Donga ST and Donga Socio Holdings

## Key findings

- Confirmed solid brand awareness and rapid growth of Bacchus (250mg canned beverage)
- Bacchus accounts for 35-40% of local energy drink market (W50-60bn), twice the share of Red Bull, the second leading player
- Energy drink market substantially developed relative to local GDP (compared to W80-100bn market in Korea)
- Key factors for success: Utilizing aggressive marketing with local partner, Bacchus has emerged as the dominant product, and the brand has grown into a byword for energy drinks
- 2012 Bacchus sales reached W21bn in Cambodia (Korean Hotsix posted domestic sales of W54bn)
- Peak sales can reach double current levels given Korean Bacchus consumption of almost 10 bottles per person
- Capacity: Donga Otsuka, which manufactures canned types for Bacchus, can accommodate more than twice the current sales
- Tasks ahead: Introduce new products backed by solid Bacchus awareness and advance into neighboring ASEAN countries

## Analyst view

- Success in Cambodia is not a one-off, and high sustained growth is expected given structural expansion of energy drink market and dominance of Bacchus
- While Bacchus exports are merchandise sales, they are generating double-digit margins, higher than total margins, due to a low marketing cost burden. As such, Bacchus exports should lead overall margin growth as sales contribution increases
- It is too early to consider exports as a share catalyst given limited sales (W21bn in 2012, 3.4% of total sales; total exports account for 22% of sales)
- Closely monitor expansion in ASEAN region going forward

## Implication & Valuation

- Shares fell as much as 17.5% over the past two weeks, rapid pullback due to weak earnings (including UBIST May outpatient sales) and institutional selling
- Currently trades at 14x 2013 PE excluding tax charge (15% discount to historical average)
- Shares to trade flat on weak 1H13 results and poor investor sentiment

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Yr to	Sales	OP	EBT	NP	EPS	% chg	EBITDA	PE	EV/EBITDA	PB	ROE
Dec	(W bn)	(W bn)	(W bn)	(W bn)	(won)	(YoY)	(W bn)	(x)	(x)	(x)	(%)
2011A*	907	97	86	69	6,366	(5.7)	123	13.9	8.7	1.3	8.9
2012A*	931	88	89	86	8,077	26.9	117	13.5	11.1	1.5	10.3
2013F	668	77	72	(27)	(4,064)	NM	105	NM	11.3	1.0	(3.2)
2014F	771	98	83	67	9,305	NM	128	12.0	8.7	1.0	7.7
2015F	900	117	104	83	11,690	25.6	149	9.5	7.2	0.9	8.9

Note: \*Pre-split data for 2011-2012A

- However, we maintain BUY as we expect shares will rebound from Sep, based on: 1) recovering domestic sales, 2) new drug momentum (NDA to US FDA and license out of European sales rights for super bacterial antibiotics), and 3) possible share upside before equity swap
- TP of W235,000 (sum of DCF-based operating value and new drug pipeline value, equates to 29x 2013 PE stripping out tax charge)

## Key Q&As

### 1) Summary of Cambodia

- Population: 15 million, high percentage of young people (17-35 demographic comprises 60% of total population)
- Income: GDP per capita USD931 2012, monthly income of factory worker is ~USD80
- Neighboring countries: Laos, Thailand, Vietnam (historic tensions with Thailand)
- History/policy: French protectorate in 19<sup>th</sup> century, democratic country, but prime minister Hun Sen has held power for 28 years
- Major Korean companies advanced into Cambodia (ex- Donga ST): Booyoung and Posco E&C in construction industry, Samsung Electronics, Lock&Lock, etc
- Outlook on consumption market: Export of various Korean consumer goods should be possible, considering: 1) high percentage of young people and 2) high acceptability of Western consumption pattern due to French colonization experience, which is similar to other Southeast Asian countries

**Table 1. GDP and population of Major Southeast Asian countries**

	GDP (thousand USD)	Population (million)
Thailand	6,572	67
Indonesia	3,592	237
Vietnam	1,527	90
Laos	1,320	7
<b>Cambodia</b>	<b>931</b>	<b>15</b>
Myanmar	854	60

Source: Wikipedia

### 2) Outline of Cambodian Bacchus business

- Donga previously attempted to expand overseas (US in late-1980s, Philippines in 2000s), but failed
- Entered Cambodian market in 2009; brought to fruition in 4Q10 backed by aggressive marketing cooperating with local partner, CamGold; sales surged in 2012 (W21bn, up 140% YoY)
- Products: 250mg slim can beverage (original and sugar free), positioned as energy drink, similar to Red Bull
- Formulation: Slightly modified formulation of existing Korean Bacchus to develop refreshing energy drink (taurine content 2,000mg, added ginseng and royal jelly components)
- Retail price: Bachhus original and sugar-free USD0.6 (USD0.7 for refrigerated version)
- Distribution channels: Simple channels (wholesales to retailers, two phases), retailers divided into conventional channels (stored in ice boxes, 80%) and modern channels (convenience stores, 20%); Donga currently deals with over 250 wholesalers
- Seasonality: 1Q (peak season), 3Q-4Q (mid season), 2Q (off-season, rainy season)
- Production and sales structure: Donga Pharm supplies raw material → Donga Otsuka manufactures canned beverage → Donga ST manages export

business → local partner CamGold in charge of distribution and marketing

3) Market size of energy drinks and market share of Bacchus

- No official data on size and share breakdown of beverage market. With a large volume of foreign products smuggled and illegally distributed, difficult to assess market size
- Unofficial data estimates beverage market at ~W800bn, and energy drink market around W50-60bn
- Cambodia's energy drink market is highly developed relative to population and GDP (Korea's market size in 2012 was W80-100bn)
- Market share (unofficial data): Bacchus 35-40% (no. 1) and Red Bull 15% (no. 2)
- Core energy drink competitors (USD0.60-0.70): Red Bull (Thailand-made USD0.60, Austria-made USD2.90), Vigor (Malaysia, USD0.55)

4) Keys to success of Bacchus and sustainability of market leadership (answered by CamGold CEO)

- Keys to success: Positioned as a byword for energy drinks in Cambodia backed by product competitiveness, creative package design (first slim can in Cambodia) and aggressive marketing drives by partners (e.g., TV, outdoor and product placement ads and sponsorships for sports events)
- Cambodians tend to shun Thai products (Red Bull), which helped drive sales of Bacchus; but this is not the key driver of sales growth
- Steady new entrants given structural expansion of energy drink market, but there are no brands matching Bacchus in terms of large-scale, preemptive brand marketing strategy and massive distribution channels
- Given Bacchus' dominant lead in the energy drink market, it appears too late for runner-up Red Bull to catch up with Bacchus' brand power.
- To maintain market leadership, aggressive marketing campaigns will continue. For example, ad spending on Bacchus totaled USD0.7mn, equal to 4% of sales. As Cambodia is a low inflation country, a company can enjoy major advantages as an early entrant even with far less ad spending than in developed markets

5) Partner company CamGold overview

- CamGold's existing business is heavy equipment trading (USD2mn in sales); although sales are not substantial, the company has been growing rapidly recently
- Given that Korean conglomerates diversified operations from construction to trading and other areas from the 1960s to the 1980s, CamGold has the potential to follow a similar path
- CamGold's strengths: CEO is very capable in terms of marketing and market targeting; although it is only a partner company, CamGold has shown a strong commitment to expand the presence of Bacchus in the local market; given that the overseas Chinese community in Cambodia has a prominent role in the economy and the media (TV), a Chinese CEO makes it easier to access Chinese business districts and TV channels

6) Stronger tie-up with partner company

- Given the high level of satisfaction with the partner company's marketing tactics and distribution channels, Dong-A may consider providing different types of products
- Rather than giving cash assistance to the partner company, Dong-A plans to increase sample products that are needed for promotional activities

7) Outlook for the Bacchus business in Cambodia

- Growth potential is still strong given: 1) energy drinks' structural growth, 2)

- Bacchus' brand power and 3) the partner's business expansion
- Cambodia's health supplement market has not developed substantially, and is at Korea's 1960-1970s levels; Bacchus is considered an energy drink as well as a health supplement
  - Factory workers, Cambodia's industrial pillar, make the bulk of purchases as family gifts in the run-up to major holidays
  - At present, 80% of the population consumes five cans per person p.a.; if the rate climbs to Korea's level of per capita 10 cans for 80% of the population, peak-based sales would double from current levels to W41bn
- 8) Plans for product lineup/business region expansion and local production
- Currently, CamGold sells and advertises Donga Otsuka's Olatte, a carbonation-free fruit-flavored drink (Donga ST in charge of merchandise sale)
  - Also considering adding more products (Donga Otsuka's beverages and Donga ST's drugs), but the review is in initial phases
  - Actively reviewing business expansion to neighboring ASEAN countries: launched products in Myanmar in Mar 2013 and invited wholesalers from neighboring countries to a conference regarding Bacchus distribution in Apr
  - Since overseas sales are not enough, the firm will continue to produce in Korea only
  - Donga Otsuka's canned beverage production capacity is 150mn p.a. and can handle overseas shipments with 40% utilization currently; since the plant currently operates only a single shift, capacity can be augmented via a double shift system if overseas sales surge

Figure 1. Map of Cambodia



Source: CIA(Central Intelligence Agency)

Figure 2. Bacchus and rival energy drinks



Source: Korea Investment &amp; Securities



**Figure 3. Bacchus display stand at convenience store**



Source: Korea Investment & Securities

**Figure 4. Redbull (manufactured in Thailand) in competition with Bacchus**



Source: Korea Investment & Securities

**Figure 5. Advertisement of parasols on the street**



Source: Korea Investment & Securities

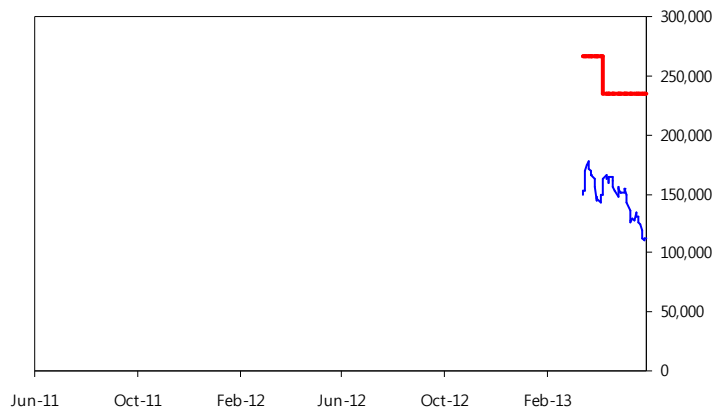
**Figure 6. Outdoor advertising neat Japan bridge (traffic hub in Phnom Penh)**



Source: Korea Investment & Securities

## Changes to recommendation and price target

Company (Code)	Date	Recommendation	Price target
Donga ST (170900)	04-08-13	BUY	W266,000
	05-03-13	BUY	W235,000



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