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IN ALLIANCE WITH

2018

Navigating Vietnam

Entering Uncharted Waters:

A course correction might be in order

December 27, 2017

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EXECUTIVE SUMMARY

Vietnam's economy is on a tear led by "snowballing" FDI inflows, growing trade integration and sustained highs in consumer confidence. GDP grew by 6.8% this year on the back of a 14.4% expansion in industrial production, an 8.4% rise in consumption and a 21.1% surge in exports. Inflation remains subdued despite estimated credit growth of 19% while the Dong has been one of the most stable currencies in the region, facilitated by a trade surplus of US$2.7 billion and an estimated current account balance of US$1 billion at 2017 year end.

We expect close to 7% GDP growth to be sustained into 2018 on the back of continued loose monetary policy and a pick-up in public spending. An estimated 44.4% increase in registered FDI this year should fuel export growth over the next 2-3 years, provided that global demand stays robust. We expect around 6.6-6.8% GDP growth next year based on a forecasted 12.0% expansion in industrial production, a forecasted 8.2% rise in consumption and a revival in public spending (forecasted +40%). The new Nghi Son refinery project should come onstream, satisfying up to 40% of domestic refined products demand, adding further oomph to manufacturing momentum and bolstering the trade balance. Our forecast is predicated upon an assumed "soft reversal" of quantitative easing and a gradual tightening of monetary policy by the Fed.

Rapid credit growth and growing infrastructure bottlenecks could have an inflationary impact towards the end of 2018 and into 2019. With credit growing at nearly three times the pace at which GDP is growing, there is a risk of inflation picking up to levels that might get the SBV a little edgy, particularly into 2019. While we recognize the rapid pace of infrastructure development, growing congestion on urban roads and some major airports, combined with the lagged impact of oil price rises, could portend a rise in supply chain and transportation costs and have a broad inflationary impact across the economy. This does not really pose a risk to our sanguine 2018 outlook on the economy but it is something to keep an eye on over the medium-term.

The rapid growth in consumer finance has democratized access to credit but also risks fuelling a rapid rise in household debt levels. Consumer finance is the new darling of the banking system. While we applaud the reallocation of credit away from the SOEs and "white elephant" real estate projects and towards individual retail borrowers and homebuyers, an estimated 59.0% rise in consumer debt over the course of 2017 is a cause for concern. While total systemwide leverage still remains moderate by global standards (estimated at around 131.2% of GDP, excluding public debt), the lack of a collateral base for consumer loans and limited credit history and underwriting expertise in this segment create some vulnerabilities. Rising leverage also makes the economy more sensitive to future interest rate hikes that might accompany a pick up in inflation.

The VN Index's stellar rise in 2017 masks the idiosyncratic nature of the market rally. While the stock market rose by a record 44.2% in the first 11 months of the year, the underlying narrative was much more nuanced. Large caps drove the entire expansion in the market, with a 30% expansion in the VN30 trailing P/E multiple while mid and small-cap valuations moved sideways. Even within the large cap space, a handful of landmark listings and state divestments had a disproportionate impact on the market as foreign investors tried to elbow their way into a new breed of large, relatively liquid names, driving up the "scarcity premium" in what is still a relatively inaccessible stock market. Speculation-driven outlier stocks like ROS moved irrationally, further distorting the market. Newly-listed names this year accounted for a staggering 11.5% of total stock market capitalization at year end.

We remain cautiously optimistic on the stock market's performance into 2018 as continued strong earnings growth across the listed universe could be countered by a contraction in large cap multiples. Continued strong economic growth and around 17-20% EPS growth should comfortably hoist the VNINDEX past the 1100 point psychological level in early 2018 but the picture gets cloudier, thereafter, as large cap valuations look toppy and a slew of large IPOs should bring an onslaught of fresh supply onto the market. The lofty valuations announced on some of these upcoming IPOs makes us particularly skeptical on whether all this new supply can be absorbed. Suffice to say that the 2017 show will be a hard act to follow

A possible reversal of this year's record foreign portfolio inflows and the growing risk of "Black Swan" events like conflict with North Korea or a Chinese debt crisis pose real risks to the stock market. Foreign portfolio money drove the market in 2017. Even though the real economy is not vulnerable to "hot money" outflows, the stock market certainly is. Global macro risks are building and a hard landing in China or war with North Korea could easily trigger a return to risk-off sentiment and suck capital out of frontier equities. Even in the absence of such black swans, Fed rate hikes and balance sheet normalization could suck an estimated $US 30-40 bn out of emerging markets between 2017 and 2019.

Vietnam's upgrade to Emerging Market status is still a few years away but inclusion on the MSCI EM watchlist could be a positive catalyst. Vietnam still faces barriers to an EM upgrade given foreign ownership limitations and information disclosure; but the rapid increase in the size of Vietnam's stock market and liquidity might qualify it for watchlist inclusion which, in itself, would be a major catalyst. In the meantime, Vietnam's rise to "top dog" status in the frontier market club might further boost foreign interest, even prior to an EM upgrade.

We advocate a "bottoms-up" approach to investing in the stock market in 2018 with a particular focus on the mid-cap space which is trading at half the PE multiple of the large cap space. The strong rally in large caps has left mid caps in the dust; mid caps are trading at only 11.4x trailing earnings versus 22.0x for large caps despite comparable earnings growth. Capital flows also showed a visible reallocation by local retail investors from mid and small caps to large caps to ride the tsunami of foreign investor interest in new listings and divestments. Some of this money might find its way back into the mid cap space in 2018 as investors start hunting for bargains. We do not necessarily foresee a broad rally in mid caps however and still think bottoms-up stock selection should be the mantra. But the mid-cap space might just be a better place to go treasure-hunting next year.

The tsunami of upcoming IPOs will continue to shape the market but we feel that most of the best new listings are already behind us and SOE IPO valuations look expensive. The next wave of IPOs include some landmark SOE names like PVOil, PVPower and Genco3 as well as sought-after private sector names like HD Bank and Techcombank but these will hardly be a match for the listings of VJC, ACV, VRE, SAB and VPB which have reshaped the market over the past 18 months. We suggest keeping an eye out for IPOs but not being fixated on them.

We are bullish on select Banking, Consumer, Materials, Power, Transportation, Logistics, and Agriculture stocks for 2018. Continued loose monetary conditions and a strategic reorientation towards higher yield lending to retail borrowers and small enterprises should benefit banks. In particular, we like VPB, LPB and MBB which all have growing exposure to these segments. The strong growth in infrastructure and industrial investment and continued strength in select pockets of the property market should buoy materials companies, particularly, the long steel giant, HPG. Power remains a broad play on industrialization and economic growth but we like power infrastructure more than generation due to the commodity price risk inherent in the latter and the huge pipeline of investment in power infrastructure; PC1 has seen a surge in its share price recently but remains a good long-term pick in our view. The agriculture sector looks interesting due to a cyclical recovery and cheap valuations; we like LTG which is a broad play on this recovery and on Vietnam's strong potential in agricultural exports over the longer term. Aviation is one of the best growth stories in the country and we think VJC's stellar rise since listing still has plenty of steam left. Port stocks are going to continue to benefit from strong FDI and trade activity and we think VSC's current valuation does not reflect its strong fundamentals. Consumer stocks are looking expensive, leaving minimum near term upside, but branded retailers like PNJ continue to excite us from a long term perspective.

We like the Automotive and Shipping sectors based on macro-trends and put these on our watchlist. Automotive stocks could benefit from a surge in passenger car purchases next year as import tariff reductions unleash pent-up demand. The shipping sector is starting to look interesting due to the recovery underway in the global shipping industry and with strong trade activity growth and coal power capacity addition which is expected to drive growing demand for both container and bulk shipping. VOS might be best positioned to benefit from this trend given its return to positive cash flow generation and its large bulk carrier fleet.

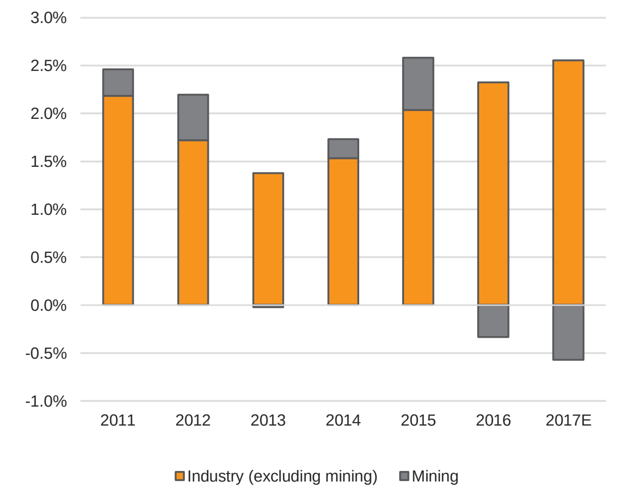
Anirban Lahiri – Head of Research

VIETNAM'S ECONOMY IS ON A TEAR

In a sweet spot with high value exports leading the charge

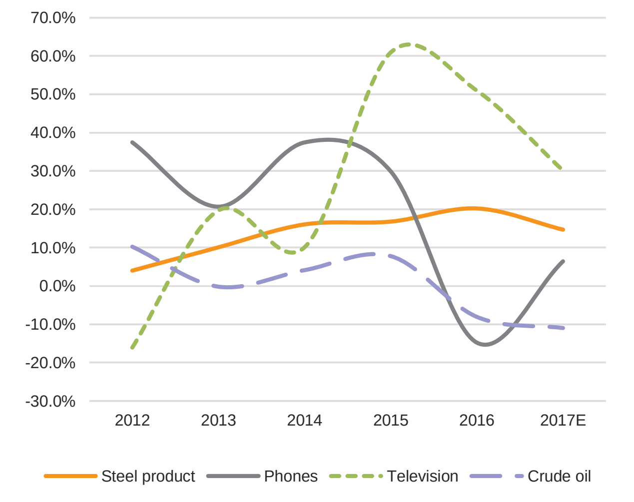
In 2017 Vietnam's real GDP grew by 6.8%, faster than consensus. While manufacturing activity and domestic consumption were strong this year, it is also imperative to note that the economy is relying more on the FDI sector for growth amidst the decline in crude oil production. Vietnam's crude oil output has declined over the past two years due to the country's fast maturing oil and gas fields and lack of investment in new field development, given the weakness in oil prices in recent years. This has resulted in the mining sector making a negative contribution to GDP growth. The country's services sector continues to play a key role in driving economic growth, and expanded by 7.4% in 2017 but Vietnam's strong GDP growth in 2017 was mainly driven by the manufacturing sector, which grew by 14.4%. As the figure below illustrates, television and steel products recorded the highest growth in terms of output this year. The recovery in mobile phone production also contributed to the strong performance of the manufacturing sector this year, after a dip due to problems with the Galaxy Note 7 model last year. Notably, most of these volume gains were from the FDI sector, specifically from Samsung and Formosa Complex.

Figure 1: The Industrial and Mining Sector's Contribution to GDP Growth in 2010 prices (%)



Source: GSO, VNDIRECT

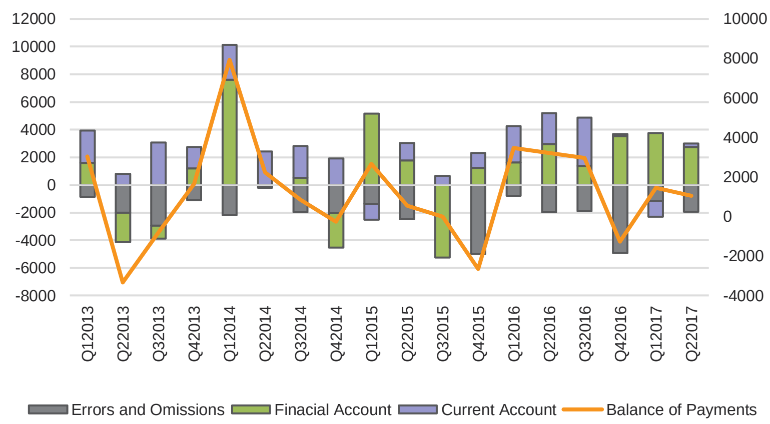
Figure 2: Output Growth of Key Industrial Product Categories (%)



Source: GSO, VNDIRECT

Vietnam's trade has benefited from the recovery in external demand in 2017 and has been facilitated by the country's growing trade openness. Export growth accelerated to 21.1% in 2017, while import growth was 20.8%YoY. Vietnam maintained a trade surplus of around US$2.7 billion in 2017, compared to a trade surplus of US$2.1 billion in 2016. Vietnam has continued to attract strong FDI capital flows, receiving US$35.9 billion in registered FDI this year, and also saw a record high in disbursed FDI of US$17.5 billion this year. The country's trade surplus and robust FDI inflows have supported the overall balance of payments and FX reserves hit a record high of US$51.1 billion (an increase of $12.0 billion compared to the end of 2016).

Figure 3: Vietnam Balance of Payments ($US million)

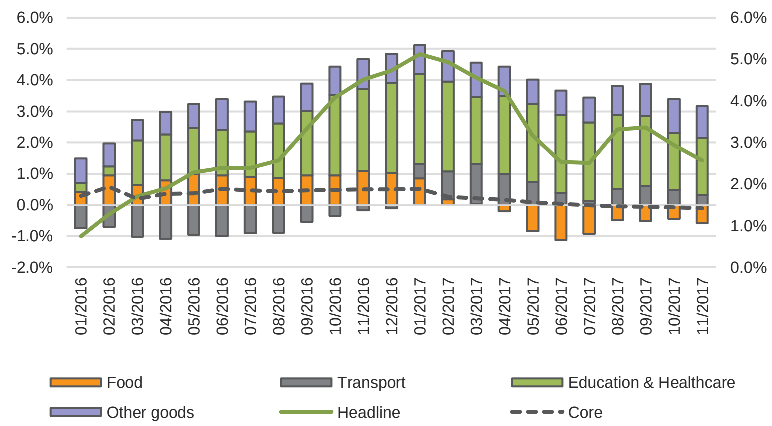


Source: VNDIRECT

Inflation creeping up but still subdued despite loose monetary conditions and rising commodity prices

CPI growth continued to remain high in the last quarter of this year due to the rise in oil prices. In 2017, overall CPI growth was 3.5% and core CPI growth was 1.4%. About half of the growth in inflation was due to price adjustments for public services & goods. This relatively benign inflation outlook also provided the State Bank of Vietnam (SBV) with room to further implement monetary easing to support economic growth, marking a departure from its more hawkish stance during H1 2017. The government raised its credit growth target from 16-18% to 21-22% in August 2017. Consequently, credit expansion continued to remain high at around 19.3% this year, compared to 18.2% last year.

Figure 4: CPI Breakdown (2016-2017)



Source: GSO, VNDIRECT

Strong fundamentals have, however, masked lingering problems in the banking system and the slow pace of SOE reform

Although the overall macroeconomic picture in 2017 looks perfect, Vietnam's economic reforms have been moving slower than planned. In our opinion, the bad debt resolution and reforms in the banking industry both remain far from being complete. In addition, a heavier reliance on bank loans for growth could lead to a deterioration of asset quality in the banking system when economic growth tempers. Limited fiscal space and the slow progress of SOE reforms and equitization have led to sluggish public investment, increasing the burden on monetary policy to support economic growth in the absence of fiscal expansion and slowing productivity growth.

2018 OUTLOOK: STEADY STATE

Global monetary policy will not become tight, just less loose

Even though there was an upswing in global economic activity in 2017 and some stock markets have been soaring to record highs, global investors have also raised concerns of an imminent recession striking within the next two years. We also share some of these concerns, but hold the base case view that this will not happen during 2018. In general, the global economy will be bolstered by a continued non-inflationary US and European recovery, with both regions look set to continue growing strongly next year. Meanwhile, China's economy will see a manageable slowdown. Interest rates will rise in developed countries, but most economies will be able to handle this given that monetary policy normalization should proceed at a gradual pace due to low inflation expectations. While the Fed has begun tapering its QE program and the ECB is planning to follow in its wake, global monetary policy is unlikely to change dramatically. At this point, we think that monetary policy will be less loose in 2018 and that investors are already finding ways to respond to a gradual reversal of the unconventional monetary policy stimulus seen over the last few years.

Vietnam's economy to sustain growth momentum in 2018

Stable GDP growth of 6.6% to 6.8% expected in 2018

Similar to previous years, Vietnam's positive growth outlook for 2018 will be supported by strong manufacturing growth and high levels of consumer confidence. We forecast that real GDP growth will be 6.6% to 6.8%, driven by 12.0% manufacturing growth on the back of continued FDI inflows and 8.2% consumption growth, supported by record high consumer confidence. However, the decline in oil production will continue to drag on growth, as we expect crude oil output to decrease by two million tons compared to 2017. We believe that policy makers will make stability a top priority in 2018, and focus on a few key policy initiatives such as: (1) accelerating SOE reforms, especially IPOs and state divestment progress; (2) supporting the private sector to help it shoulder the burden of meeting economic growth targets; and (3) reversing the recent slowdown in public investment.

We expect inflation to tick up but stay at a manageable level

Vietnam's inflation touched 3.5% during 2017, with core inflation (excluding food and energy prices) remaining subdued We think that the rise in food prices during 2018 will be one of the main sources of concern, while the recovery of oil prices will have a limited impact on inflation. According to the latest report from IEA, OPEC-led production cuts have helped to stabilize the oil market, and the crude oil price is expected to be steady next year as demand grows at the same rate as non-OPEC supply. We think that the price of oil will remain at around US$55-65/ barrel, which does not pose a major risk to Vietnam's inflation. In addition, the government seems to have a strong desire to keep inflation under control by adjusting the rate of increases in the prices of public goods and services such as electricity, healthcare and education. However, inflation could still face upward pressure from rising food prices, especially vegetable and pork prices. The main reasons for this include: (1) tropical storms hitting Vietnam in the end of 2017, which could lead to tighter supply and trigger inflation in early-2018; (2) China's renewed focus on slashing surplus capacity coupled with pollution-control measures could lead to tighter supply of certain commodities like steel and coal and fuel commodity price inflation in 2018. We expect core inflation of 2.1% and we headline inflation of 4.6% in 2018, assuming that there will be a 5.0% increase in the food price index next year.

Trade surplus to be sustained by FDI-led export growth

We expect exports to continue growing next year as a knock-on effect of the record-high FDI inflows this year and improving global trade activity. Vietnam has improved its ease of business ranking recently to 68 among 190 economies according to the World Bank, up from 82 in 2016 and 91 in 2015. In 2017, exports of electronic products were responsible for more than half of the country's export growth, and we expect the exports of electronic products to continue to deliver double digit growth during 2018, albeit slightly slower than the 21.5% surge experienced this year. Refined fuel imports may drop as the nation's refinery capacity grows with the commissioning of the new Nghi Son Refinery, but crude oil imports may rise due to the maturing of domestic oil fields and delays in new fields coming on stream. However, crude and refined imports only account for around 3.5% of total imports, so the new refinery will have a negligible impact on Vietnam's trade account. Thanks to strong FDI-driven export activity and continued FDI inflows into emerging industry clusters such as consumer electronics, we expect the country maintain a trade surplus of US$2-3 billion in the next year. We also expect a current account surplus of US$1.5 billion in 2018, as the trade balance has been improving and net foreign investments continue to rise. This current account surplus, although small, will help to mitigate the pressure on the country's external position and currency, particularly in an environment of continued US Fed rate hikes.

Policymakers will continue to be supportive: we expect continued loose monetary policy and expansionary fiscal policy

Monetary conditions in Vietnam have been accommodative, with M2 and credit growth estimated at 16.5% and 19.3% in 2017, respectively. Although M2 growth was slower than the previous year, the M2/GDP ratio reached a new record of 163.0%. Leverage is also rising with the credit to GDP ratio estimated at 131.2%, among the highest levels in the Asia Pacific region. We believe that Vietnam's monetary market saw greater liquidity in 2017 than in 2016, as stable macroeconomic fundamentals and subdued inflation helped to boost liquidity conditions in both the bond and stock markets. In addition, the government is highly motivated to encourage abundant liquidity in the banking system to help facilitate the "clean-up" of NPLs (through the expansion of bank loan books) and to ensure demand for IPO and state divestment deals. Assuming that inflation remains manageable, economic growth stays stable and structural reforms continue, we expect a continuation of current monetary policy with interest rates staying unchanged during 2018.

The government has started to build fiscal space by implementing fiscal consolidation plans since 2017. However, we think policy makers will find it difficult to stick to the fiscal consolidation pledge, which includes lowering the fiscal deficit to 3% of GDP in 2020. According to the budget guidance for 2018, the fiscal deficit is estimated at

VND204,000 billion (+17%YoY), equivalent to 3.7% of GDP. Tax collection from the private sector plus revenue from State IPO/divestments are the main contributors to budget revenue growth. Current expenditure growth is limited at 5.0% despite the 6.9% base salary increase in June 2018. Meanwhile, public investment is likely to pick up after sluggish disbursements during 2017. Under the current plan, public debt to GDP would rise to 63.9% in 2018, up from 62.6% this year.

We expect the VND to continue to be relatively stable next year

In order to manage exchange rates in the future, the SBV will improve current operations as well as prepare for a more flexible exchange rate in the near future. The Dong was among the most stable currencies in Asia in 2017 and we expect that this stability will persist into next year due to positive FDI inflows, trade surplus and record high FX reserves. The unwinding of quantitative easing measures by the Fed is unlikely to have a pronounced impact on Vietnam as FDI accounts for 89.5% of total inflow capital versus only 10.5% for FII ("hot money"). In addition, whether US tax cuts are going to lift economic growth materially in the longer run is debatable while Trump's support for a weak dollar in order to achieve his ongoing promise to reduce the US trade deficit is another potential drag on USD appreciation. Overall, we are bearish on the overall outlook for the USD and bullish on the EUR moving into 2018. The current VND exchange rate management regime, being linked most to the USD and CNY movements, should support the stability of the USD/VND currency pair. We expect the VND to depreciate by a maximum of 2% against the USD next year.

We expect an acceleration in the pace of structural reform

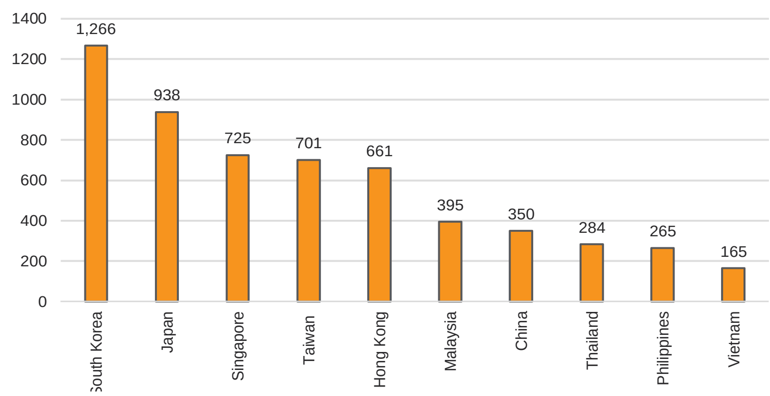
Vietnam aims to equitize 137 additional SOEs in 2017-2020, and divestment from these SOEs will bring around US$11 billion (5% of GDP) to finance public investment. In 2017, the government only executed about 47%/37% of the IPOs/divestments planned for 2017, which means it is likely that many of these divestments will roll over to 2018. There are also 64/181 IPOs/divestments planned for next year, before accounting for the 2017 backlog. The main challenge for SOE reforms is that many of the remaining companies are large with complex ownership and management structures. In addition, some of these companies also have unclear financial and debt obligations, which are difficult and time-consuming to resolve. Given that revenue from SOE equitization is a reliable source of revenue for the country's fiscal budget, we think the progress of SOE reforms could accelerate next year particularly given the growing pressure on the government to step-up public spending. The latest legislation on this (Decree 126 which will be effective starting 01/08/2018) outlined mechanisms to accelerate the investment process and addressed the problems in the transfer of ownership and lack of clarity in valuation. In our view, SOE reforms will be one of the most attractive aspects of Vietnam's economy in 2018, and will benefit the economy by not only attracting international attention but also bringing in foreign capital, increasing transparency and improving the efficiency of SOEs over time.

BEYOND 2018: WE BOIL VIETNAM'S MEDIUM-TERM GROWTH STORY DOWN TO THREE KEY MACRO THEMES

Theme 1: Continued FDI-led industrialization driven by both "New Economy" and traditional industries

2017 marked the fifth consecutive year of expansion in the current manufacturing cycle in Vietnam, supported by several years of large FDI inflows and the rapid expansion of the country's export base. We believe that the strong connection between economic growth and the growth of the export-oriented manufacturing sector will continue in 2018, as Vietnam is gaining popularity globally as a leading high-tech manufacturing location. Vietnam is in a sweet spot for export-oriented electronics manufacturing as Vietnam's wages are much more competitive than other major Asian electronics exporters such as China, Taiwan, South Korea and Japan.

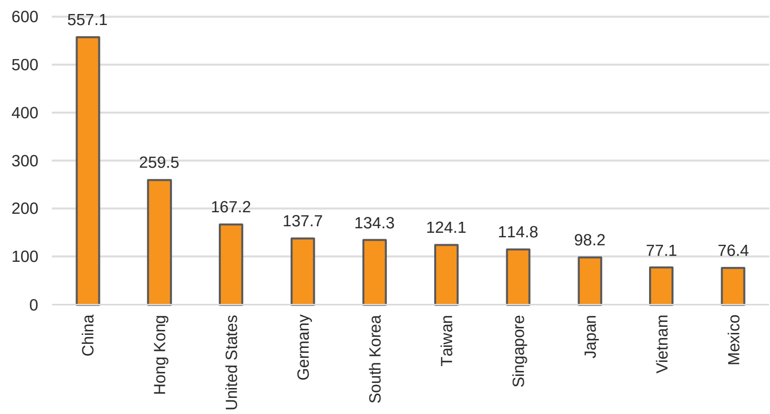
Figure 5: Minimum Wage (US$/month)



Source: VNDIRECT

Moreover, it has the lowest minimum wage among the top 10 Asian electronics exporters. Other Asian frontier markets such as Cambodia and Bangladesh that have similar wages levels to Vietnam's currently have much lower tech exports (less than US$1 billion/year typically according to the World Bank), and are primarily focusing on lower value export categories such as textiles and footwear.

Figure 6: Total Tech Exports (US$ bn)

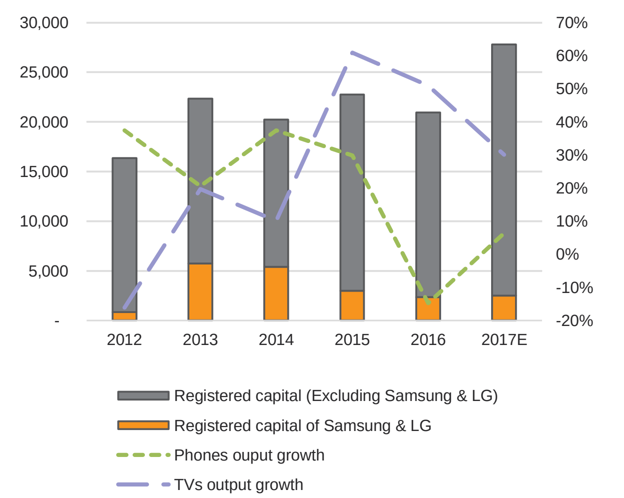


Source: VNDIRECT

In 2018, LG Display will begin operating its OLED display manufacturing operation, with an annual capacity of 84 million units of OLED screens for mobile phones and 1.1-1.2 million units of OLED screens for TVs. Meanwhile, Samsung continues to expand its business in Vietnam to protect its OLED market share in the TV market.

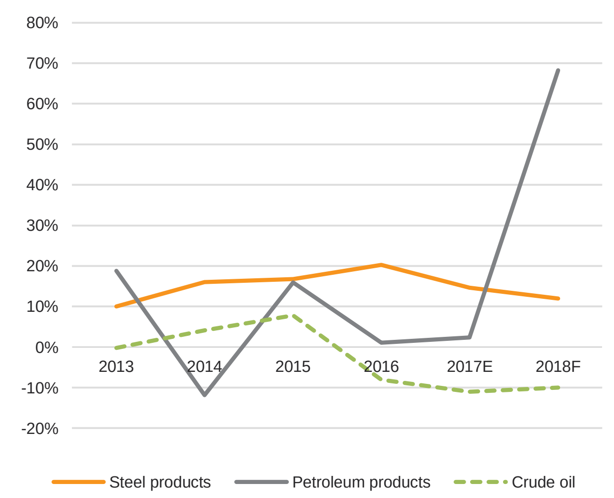
Vietnam's economy has been primarily benefiting from the manufacturing of electronics, yet the steel industry will be another driving force in 2018. Formosa Complex plans to double its steel production capacity by March 2018, and the first phase of HPG's Hoa Phat – Dung Quat steel project is expected to be completed by June 2018. We believe that both steel and electronics manufacturing will be key drivers of industrial production and, indirectly, also consumption through large scale new job creation.

Figure 3: FDI Inflow (US$ million) and Key Electronics Categories Output Growth (%)



Source: FII, GSO, VNDIRECT

Figure 4: Steel and Petroleum Products Output Growth (%)



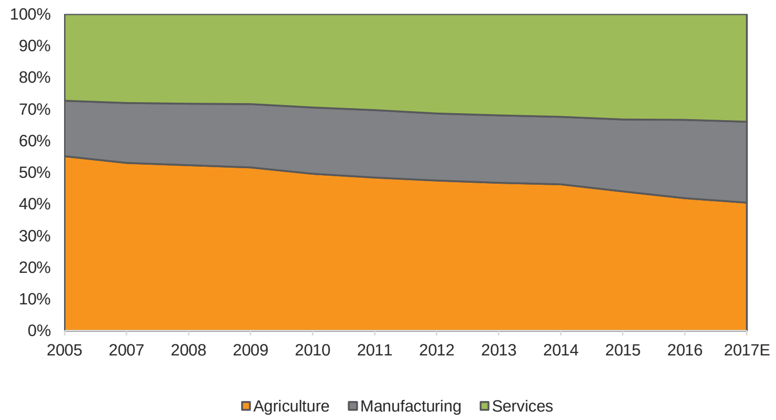
Source: GSO, VNDIRECT

Taking into account the fact that Vietnam's Nghi Son Refinery and Petrochemical Complex began operating at the end of 2017, we think the growth momentum of manufacturing activity will be stronger in 2018. The Nghi Son Refinery will meet 40% of Vietnam's domestic demand for petro products and the petroleum output is estimated to reach 11.8 million tons (+68.2%YoY) in 2018. The expansion of refining capacity can enable the country to rely less on importing petroleum products, as 70% of the demand will be met domestically through both the existing Dung Quat and new Nghi Son refineries.

Theme 2: Robust consumption growth driven by Vietnam's burgeoning middle class and tourists

Vietnam has the fastest growing middle class in Southeast Asia with the total middle class population expected to grow by 18% between 2016 and 2020 according to Brookings Institute. Consumer spending is rising rapidly due to the combination of low interest rates and inflation and rapidly increasing incomes, as well as new job creation by the manufacturing sector (dominated by FDI and private companies); the manufacturing sector is steadily increasing its share of total employment across the economy and this is lifting incomes as people move out of low productivity farm and informal service jobs and into high-value, export-oriented manufacturing.

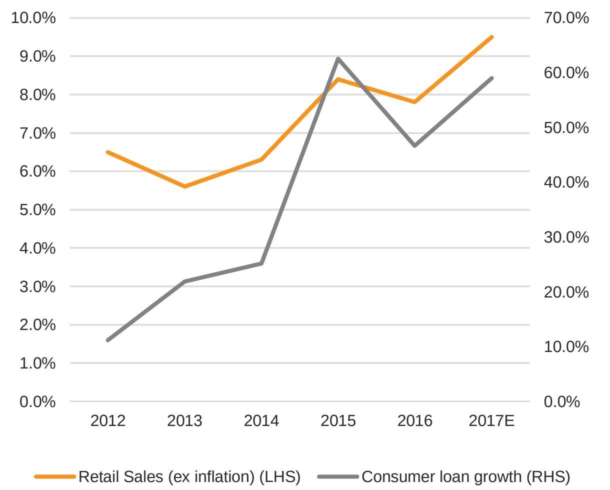
Figure 5: Share of Labor by Key Economic Sector (%, 2005-2017E)



Source: GSO, VNDIRECT

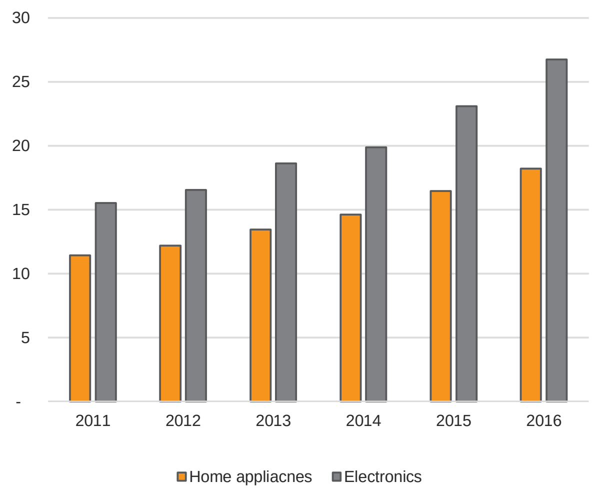
In 2017, Vietnam's household final consumption expenditure accounted for around 67% of the country's GDP and increased by 7.5%YoY, while retail sales grew about 9.5% in real terms during the same period. According to the National Financial Supervisory Commission, consumer credit surged by more than 59% in 2017, accounting for 13% of total loan stock. Housing and home improvement loans accounted for 52.9% of total consumer credit, while home appliances and furniture loans and vehicle loans accounted for 15.3% and 8.3% of this, respectively. In the medium term, we believe the continued buoyancy of private consumption will be supported by moderate inflation, rising incomes as well as easier access to consumer finance, particularly in smaller towns and rural areas where the population is still relatively under-banked.

Figure 6: Retail Sales Growth and Consumer Loan Growth (%)



Source: GSO, NFSC, VNDIRECT

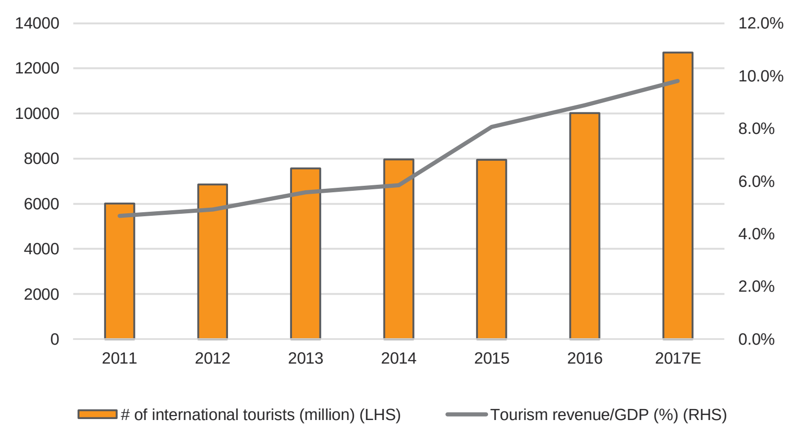
Figure 7: Sales of Consumer Electronics and Home Appliances (million units, 2011-2016)



Source: EUROMONITOR, VNDIRECT

Tourism is becoming an important growth engine for the economy. Tourism provided a sizeable lift to Vietnam's economy in 2017. During 2017, international tourist arrivals increased by 29.1% YoY. Vietnam's inbound tourist growth was mainly driven by Chinese tourists, as well as the pickup in tourist arrivals from South Korea, various ASEAN countries and Russia. There was a 34.4% YoY increase in tourist arrivals from other Asian countries. Chinese tourist arrivals jumped by 48.6%, South Korean tourist arrivals surged by 56.4%, and Taiwanese tourist arrivals increased by 21.5%. Moreover, rising incomes in Vietnam are also catalyzing rapid increases in domestic tourism, as consumer spending starts to shift to discretionary purchases, over and above basic necessities. Given the favorable global outlook, coupled with the government's policy initiatives to develop tourist attractions, we believe that tourism can support the economy and add another pillar of support to domestic consumption in 2018. The government also plans to open three special economic zones (SEZs) by 2020 (Van Don, Bac Van Phong and Phu Quoc) which will be a further catalyst for this growth. Phu Quoc SEZ is the centerpiece of the Government's tourism development masterplan until 2020, and is witnessing robust investment inflows. Van Don SEZ was established with the aim of becoming a centre for eco-maritime tourism, and an aviation and international trade hub to promote local economic development for the northern Province of Quang Ninh. Meanwhile, Bac Van Phong SEZ has been selected by the Government to be developed into an urban, industry, service, and tourism centre for the South Central Coast.

Figure 8: Number of International Tourist Arrivals (000's) and Tourism Revenue/GDP (%)



Source: GSO, VIETNAM NATIONAL ADMINISTRATION OF TOURISM, VNDIRECT

Theme 3: Growing trade – 2018 will be a milestone year for Vietnam's ongoing trade integration

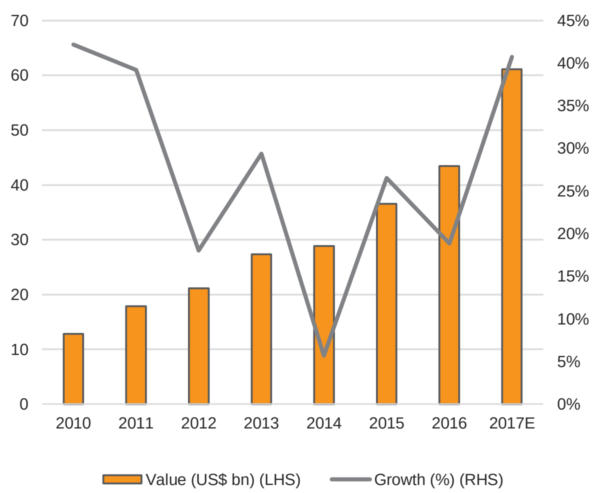
In recent years, Vietnam's trade and investment activities have been benefitting substantially from the 11 bilateral and multilateral Free Trade Agreements (FTAs) the country has signed. The most notable pacts are the ASEAN Economic Community (AEC) and the ASEAN Trade in Goods Agreements (ATIGA) to remove tariffs on trade between ASEAN member countries by 2018. Nearly 7 years after being implemented, the ATIGA has had a tangible impact on the economy. Total trade value between Vietnam and the rest of ASEAN was up by 1.8 times compared to 2010 (~US$49 billion in 2017), and Vietnam also grew its exports to other ASEAN members at a much faster rate (CAGR: 11.1%) than its imports (CAGR: 7.7%). Other ASEAN countries have also become a major source of FDI into Vietnam, particularly into the industrial manufacturing sector. By the end of 2017, the total registered FDI stock reached almost US$65 billion for 3,898 valid investment projects, with around 60.7% of this originating from Singapore. In addition, Thai investors are dominating cross-border M&A activity in Vietnam, primarily in the retail and consumer goods sectors with several landmark deals such as the investments into Metro (TTC Holdings, US$710 million), Big C (Central Group, US$1.1 billion), Nguyen Kim (Central Group, US$200 million), Vinamilk (F&N, US$2.3 billion) and Sabeco (Thai Beverage, US$4.8 billion).

Another success story is the FTA between Vietnam and Korea (VKFTA), which came into effect in December 2015, and has boosted economic ties between the two countries, in terms of both investment and trade. Two-way trade increased 1.7 times from US$36.5 billion in 2015 to US$60.5 billion in 2017, and Korea also surpassed the US for the first time to become Vietnam's second largest trade partner, after China. In addition, Vietnam is beginning to import more products from Korea, and as a result, Vietnam has decreased its reliance on Chinese products; the country's largest trade deficit is now with Korea, followed by China. This reflects the huge investments in Vietnam made by large Korean conglomerates which has driven demand for both capital equipment as well as input parts and components from Korea. At the end of 2017, Korean investors topped the line-up in Vietnam with over US$57.7 billion invested in total, 27.4% higher than the figure at the end of 2015. Besides, the number of Korean tourists to Vietnam increased to nearly 2.4 million in 2017, double that of 2015.

Figure 9: Vietnam – Korea trade value and growth (2010-2017E)

Source: CUSTOMS, VNDIRECT

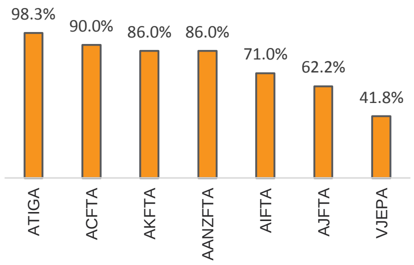
Figure 10: Vietnam – ASEAN trade value and growth (2010-2017E)



Source: CUSTOMS, VNDIRECT

2018 will mark a significant milestone in Vietnam's trade integration as import tariffs across multiple product categories will be decreased to 0% under the commitments of the FTAs (see the figure below). Based on this, we think investors should monitor the automobile industry, as there will be a slew of changes in the upcoming tariffs covering imports of auto parts and components and fully-built cars. We believe 2018 will also mark the beginning of a new era in Vietnam's trade deals despite the US withdrawal from the TPP. In November 2017, the TPP was resurrected by the remaining 11 members with a renamed trade pact called CPTPP (the Comprehensive and Progressive Agreement for Trans-Pacific Partnership). This trade pact will likely be ratified in February 2018 and take effect from 2019, and the FTA Vietnam – EU will follow the same schedule. Vietnam is also negotiating four other FTAs, including the most important trade pact in the ASEAN region –

Figure 11: Percentage of import tariff lines that will be removed in 2018 by FTAs



Source: MoIT, VNDIRECT

the Regional Comprehensive Economic Partnership (RCEP). In our opinion, the RCEP trade agreement presents huge opportunities for Vietnam, yet it might face challenges during the negotiation progress because of strained ties between China and other member countries largely due to territorial disputes.

In general, we believe that Vietnam's trade growth will be sustained in the medium term. This will be driven by the increased domestic demand in most major trade partner countries and Vietnam's growing stature as the destination of choice for factories moving out of China. We do note, however, that a recession in the global economy, greater protectionism in the West or a "Black Swan" event like the outbreak of war on the Korean peninsula could derail this growth story.

Figure 12: The tariff reduction schedule for select imported product categories: past and future tariffs (%)

	WTO MFN2006	WTO MFN2014	AFTA 2007	AFTA 2018	ACFTA 2007	ACFTA 2020	AKFTA 2007	AKFTA 2021
Agriculture	23.5	21.0	4.4	0.8	17.3	1.2	23.1	3.3
Fish, fishery products	29.3	18.0	4.7	0.0	9.9	0.0	29.3	0.0
Petroleum	3.6	3.6	5.6	5.6	15.2	11.7	8.4	1.4
Wood, paper	15.6	10.5	2.1	0.0	12.9	0.3	15.7	1.1
Textile	37.3	13.7	4.3	0.0	27.3	0.6	33.4	0.3
Leather and rubber	18.6	14.6	5.2	3.1	12.5	1.0	17.6	3.6
Metal	8.1	8.1	1.5	0.0	7.9	0.9	8.3	1.2
Chemical	7.1	6.9	1.8	0.3	5.8	0.0	7.1	0.8
Cars/ transportation equip.	35.3	35.3	29.2	3.8	41.9	19.6	43.0	36.1
Machinery	7.1	7.1	1.2	0.0	6.6	1.4	7.4	2.0
Electric machinery/equip.	12.4	9.5	2.5	0.0	11.1	0.8	13.2	2.3
Mineral	14.4	14.1	1.7	0.0	13.1	4.7	14.1	2.1
Other manufactured products	14.0	10.2	2.0	0.3	11.1	0.0	13.8	0.4
Total average	17.4	13.4	4.5	0.6	14.4	2.3	17.0	4.1

Source: MUTRAP, VNDIRECT

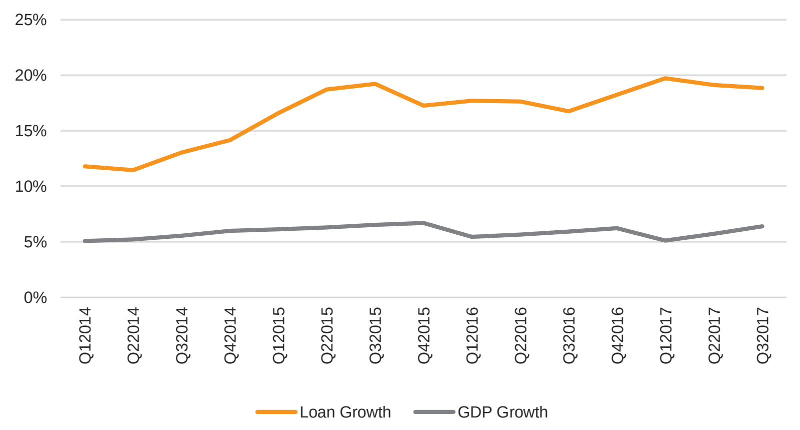
DESPITE OUR BULLISH OUTLOOK ON GROWTH, THERE ARE SOME BUILDING MACROECONOMIC RISKS

Credit expansion is far outpacing GDP growth

In 2017, policy makers continued with an expansionary monetary policy in order to boost near-term economic growth. This expansion occurred at the expense of a further rise in leverage and government debt levels. According to the Ministry of Finance, Vietnam's public debt rose to VND3,130 trillion, or USD138 billion, by the end of 2017, equivalent to 62.6% of GDP. Although this only represents a one percentage point decline from 2016 levels, the total amount of public debt is expected to increase by 9.3% in 2017.

In fact, credit has been rising consistently since the second half of 2014 due to loose monetary policy, relaxation on the ratio of short-term funds used for long-term loans and also due to the government persuading banks to ratchet up credit growth. We estimate that the private credit to GDP ratio will reach 131.2% in 2017, assuming that credit growth for the full year comes in at 19.3%.

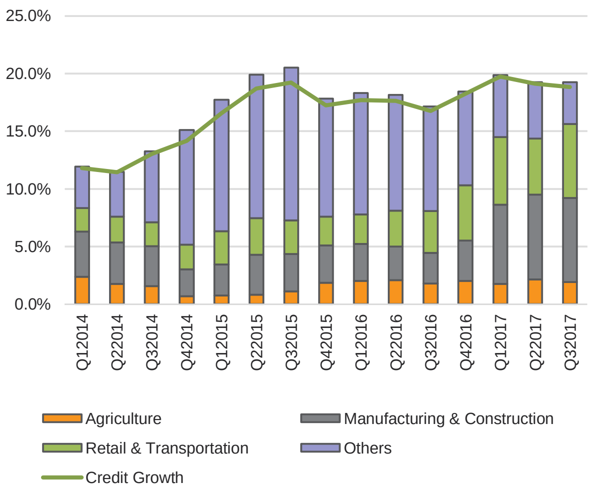
Figure 13: Real GDP growth vs. loan growth (%YoY)



Source: GSO, SBV, VNDIRECT

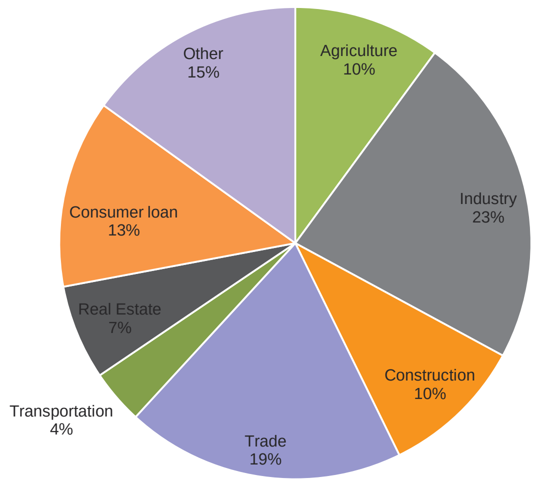
There has been a substantial change in Vietnam's credit allocation mix in 2017 with a greater share of funds going into the trade, transportation, manufacturing and construction sectors. However, we still think that the increased funding for infrastructure build-outs to attract FDI inflows and home mortgage loans, on the back of steady recovery in the real estate market, have been the main drivers of credit growth. Credit to the construction sector increased by 26.4%YoY during the first nine months of 2017, expanding its share of total loans outstanding from 9.2% in 2016 to 9.8% in 2017. We have also observed that consumer finance loans have been expanded rapidly, from around 9.8% of total loans in 2016, to its current level of 12.9% in 2017.

Figure 14: Contribution to loan growth by Sector (%)



Source: SBV, VNDIRECT

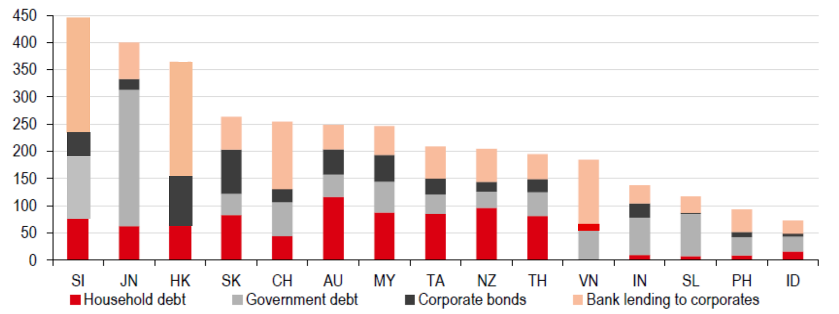
Figure 15: Outstanding loan value by sector (2017) (%)



Source: SBV, VNDIRECT

Vietnam's total debt to GDP ratio is expected to stand at approximately 193.8% at the end of 2017, moving up the rankings of Asia's most leveraged economies. We think this ratio could inch higher in 2018 as the government is targeting a higher budget deficit of 3.7% of GDP, and will maintain accommodative monetary policy to support growth. Although Vietnam's debt burden is still moderate compared to the region's average, we think that the level of debt is less significant than the pace of its increase, given that the speed of increase in leverage in Vietnam is among the highest in the region. If debt continues to build at this pace, then there is a greater risk of capital misallocation and the eventual increase in non-performing loans.

Figure 16: Total debt to GDP (2016) (%)



Source: HSBC, VNDIRECT

For Vietnam: household debt is assumed as consumer loans, Bank lending to corporates include corporate bonds

Another interesting aspect of the continued rise in Vietnam's leverage is that it is now being driven by consumer lending rather than by lending to SOEs as was the case earlier. Consumer loan growth has accelerated notably over the past three years and we estimate that consumer loans will rise by around 59% in 2017. More than 50% of consumer credit was used for housing and home improvement purposes. At the moment, Vietnam policymakers face the dilemma between having to lower borrowing costs to support the private sector and to ensure sufficient credit growth while also containing bad debt risks. We believe the medium-term risk of deteriorating credit quality and deepening financial vulnerabilities from this rising debt could lead to more prudent monetary policy in the next 2-3 years.

External risks are rising in importance due to Vietnam's growing trade integration and reliance on FDI

In our opinion, the main risks to Vietnam's economy in 2018 could emerge from the external environment and include the following:

A slowdown in global growth, resulting from slower expansion in developed countries or a faster-than-expected slowdown in China.

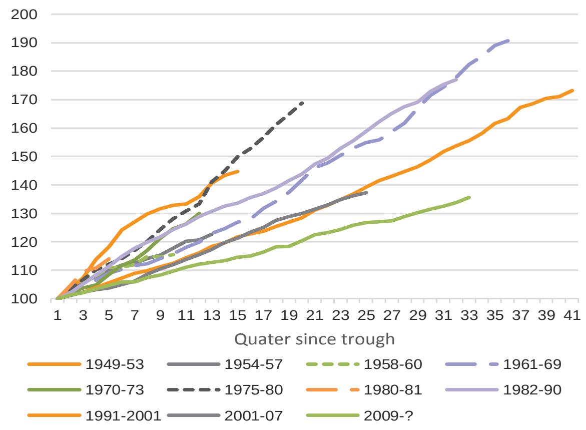
Figure 17: The recovery/expansion cycle in The US (1948-current)

Recessions	Durations (months)	Expansions	Duration (months)
1948-49	11	1949-53	45
1953-54	10	1954-57	39
1957-58	8	1958-60	24
1960-61	10	1961-69	106
1970	11	1970-73	36
1973-75	16	1975-80	58
1980	6	1980-81	12
1981-82	16	1982-90	92
1990-91	8	1991-2001	120
2001	8	2001-07	73
2008-09	18	2009-?	102 so far
Averages:		Averages:	
1854-1919	22	1854-1919	27
1919-45	18	1919-45	35
1945-2009	11	1945-2009	58

Source: MARKET WATCH, VNDIRECT

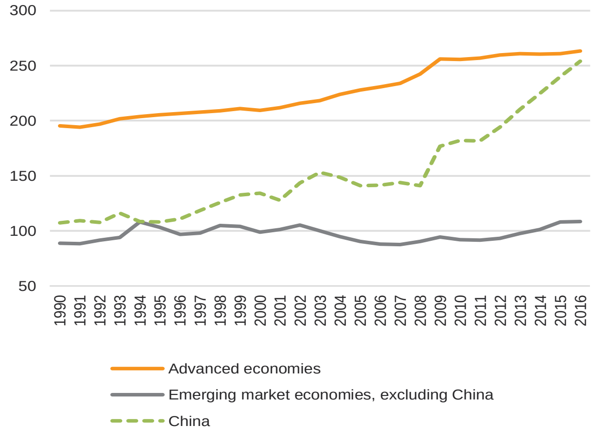
Global economic growth still remains healthy but the characteristics of the current economic cycle warrant caution: there is a weak relationship between growth and inflation, large central banks are moving forward with their normalization cycles, and global debt has hit a new all-time high. The current expansion has already lasted nearly 102 months, now the third-longest stretch of uninterrupted growth in US history over 11 business cycles going back to 1949. However, it has been the slowest one in terms of the pace of expansion and also surprisingly non-inflationary given the extent of monetary policy loosening. Since a highly accommodative monetary policy stance helped catalyze this current expansion cycle, the risk of a global recession has become higher as the Fed tightening commences with three rate hikes expected in 2018 per consensus forecasts. According to the IMF, leverage has risen since 2006 in many G20 economies amid record loose monetary conditions, making the global economy more sensitive to a turn in the interest rate cycle.

Figure 18: Cumulative nominal GDP post-recessions



Source: FRED, VNDIRECT

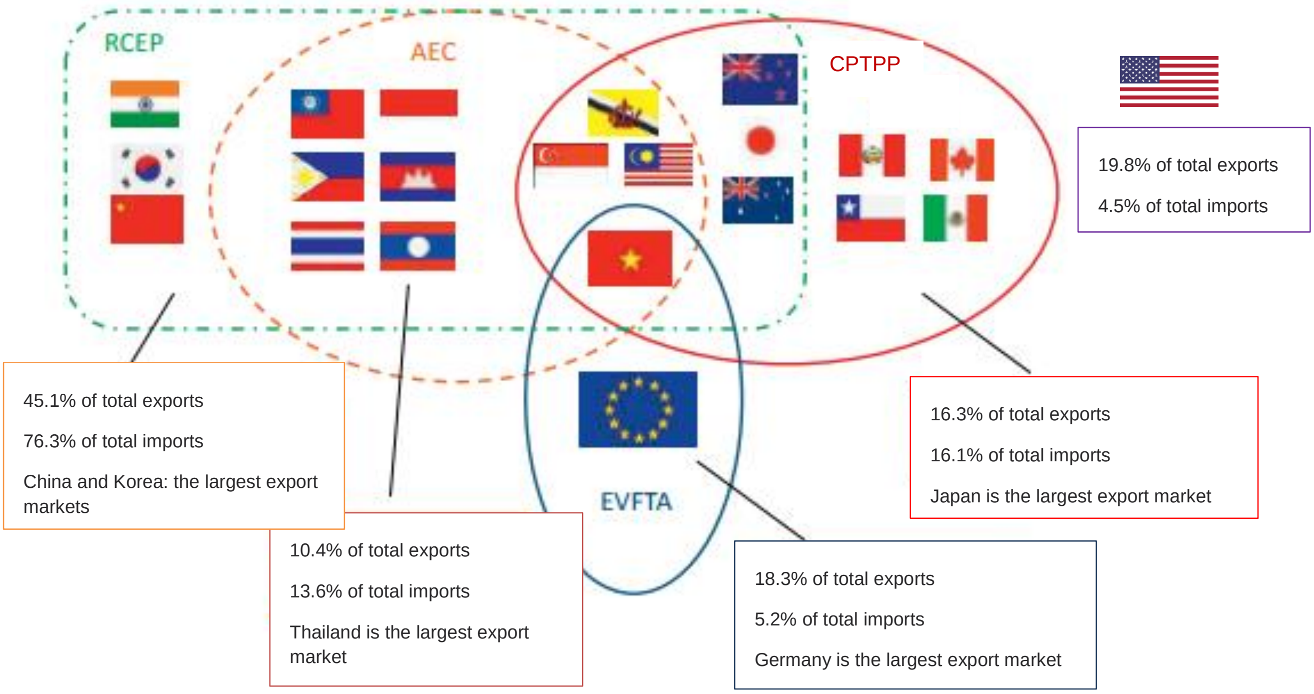
Figure 19: Gross debt-to-GDP ratio by region (%)



Source: IMF, VNDIRECT

Vietnam's growing integration into global trade and investment flows means that its exposure to the risk of a global economic downturn has risen significantly.

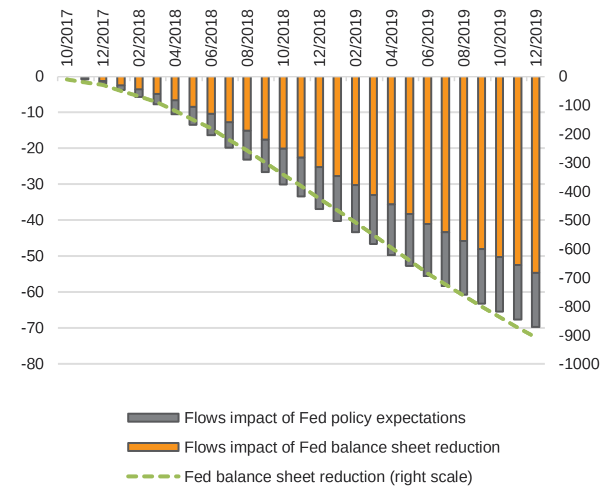
Figure 20: Vietnam's global trade linkages



Source: CUSTOMS, VNDIRECT

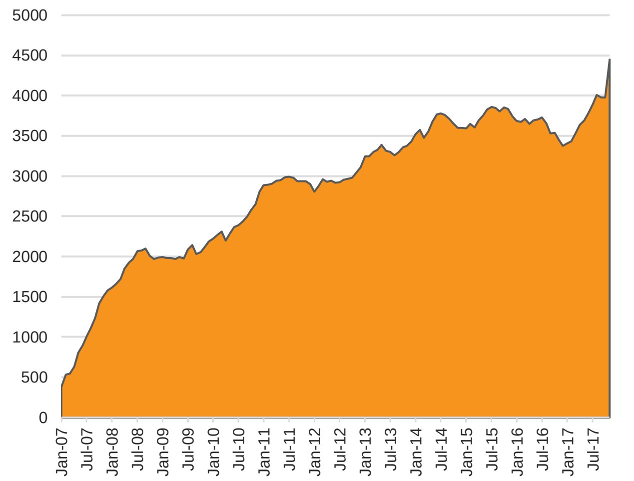
Vietnam is also more likely to get buffeted around by volatility in global capital flows, as central banks in developing markets embark on monetary policy normalization through rate hikes and a reversal of balance sheet expansion (mainly the Fed). The current consensus is that monetary policy will continue tightening at a gradual pace, while fiscal policy will turn more expansionary in 2018 to support economic growth. Depending on the degree of expansionary fiscal policy, an earlier than expected rise in the global cost of capital could create more volatility in foreign portfolio flows into Vietnam's stock market and negatively impact the progress of SOE IPOs/divestments. According to IMF estimates, there will be a substantial reduction in portfolio flows into emerging markets due to the US monetary policy normalization after the second half of 2018. Therefore, as a frontier market, Vietnam will not be spared from this flow out of risk assets. Over the first eleven months of 2017, the cumulative net inflow from foreign portfolio investors was 1.5 times the 2011 level.

Figure 21: Forecasted cumulative monthly emerging market portfolio outflows due to FED reversal: 2017–19 (US$ billion)



Source: IMF, VNDIRECT

Figure 22: Cumulative net inflows to Vietnam's stock market: YTD 2017 (US$million)



Source: FIINPRO, VNDIRECT

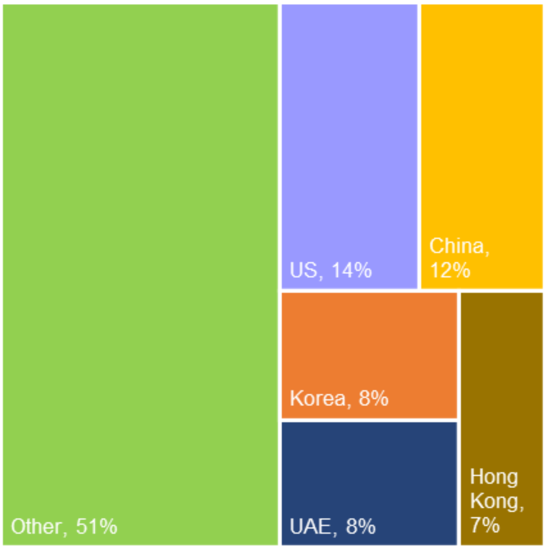
Rising risk of "Black Swan" events such as North Korea conflict. The extremely unpredictable international policy strategy of North Korea clearly remains a problem, and investors need to be aware of the risk of a war, improbable as it may seem. An armed conflict between the US and North Korea, should one occur, would darken the global economic outlook, and prove devastating for South Korea and very disruptive for Vietnam.

We believe that the impact of this scenario would be significant, given the following facts:

- Korean investment in Vietnam has been a major engine of growth for Vietnam recently, with cumulative FDI at USD57.5 billion (18.1% of total registered FDI in the period from 1988 to 2017).
- Korean-invested firms tend to be export-oriented and contribute significantly to Vietnam's exports (more than 30% of total export value). These firms are also a major source of employment domestically (1.3% of total labor) and a proportionately larger share of income growth as FDI companies usually pay higher wages than domestic companies due to their higher productivity.
- South Korea is also an important export market for Vietnam. We project that Vietnam's total exports to South Korea will be around US$14.6 billion this year, accounting for around 6.5% of Vietnam's GDP and 7.1% of Vietnam's total exports.
- Bilateral trade ties have likewise been growing continuously, particularly between 2013 to 2017, with Korea remaining Vietnam's second-largest source of imports and fourth-largest export market. Therefore, a stoppage in Korean imports into Vietnam due to war could disrupt the whole supply chain and threaten Vietnam's exports particularly in high-value added categories like consumer electronics.

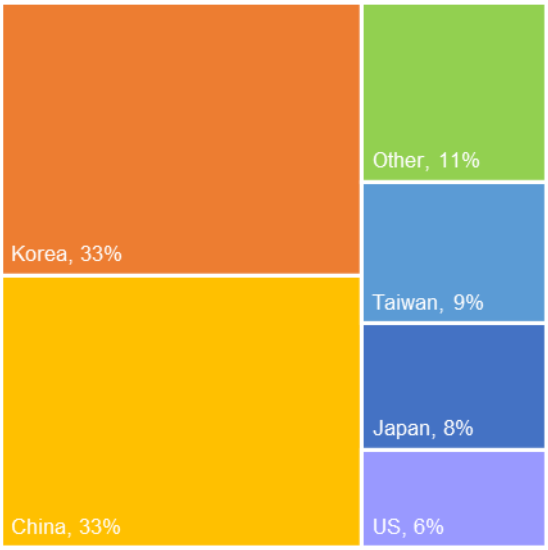
- In a recent report, Moody's estimates that every 10% decline in South Korea's GDP would lead to a 0.7%-1% drop in Vietnam's GDP if there is conflict on the Korean peninsula.
- We also think that the "risk-off" global investor sentiment sparked by any such war would lead to a flight from riskier asset classes such as frontier market equities and this could further impact Vietnam's currency and stock market.

Figure 23: Top markets for Vietnamese electronic products exports, share of total (%)



Source: CUSTOMS, VNDIRECT

Figure 24: Top source countries for electronic product imports into Vietnam, share of total (%)



Source: CUSTOMS, VNDIRECT

STOCK MARKET REVIEW: A STELLAR SHOW BUT NOT WITHOUT ITS QUIRKS

A large-cap rally pushed the stock market to a decade-long high

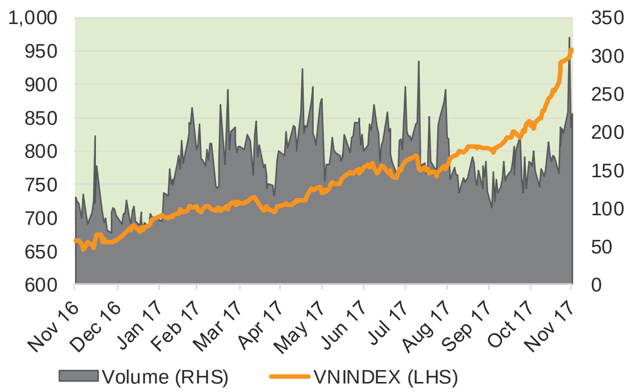
In 2017, the VN index saw its best performance in a decade.

The VNINDEX rallied strongly during the first 11 months of 2017 without any significant corrections. The index continuously broke multiple resistance levels to reach 949.93pts (+44.2% YTD), the highest increase in any year since the bubble market of 2009.

Figure 25: VNINDEX from 2000 to 2017: Approaching the Historical Peak

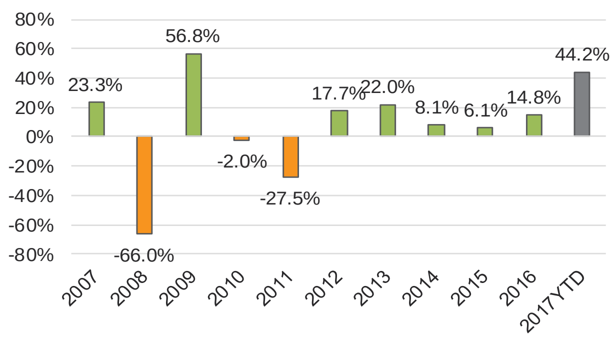
Source: VNDIRECT

Figure 26: VNINDEX 2017 Performance



Source: VNDIRECT

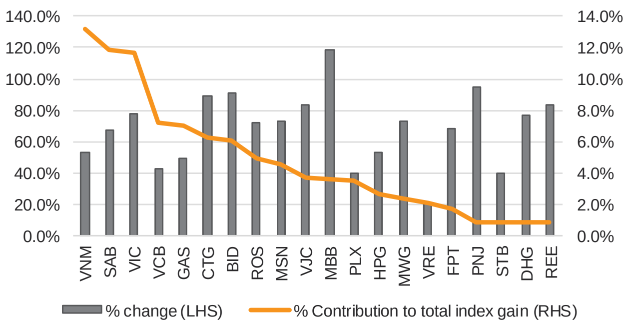
Figure 27: VNINDEX Yearly Performance



Source: VNDIRECT

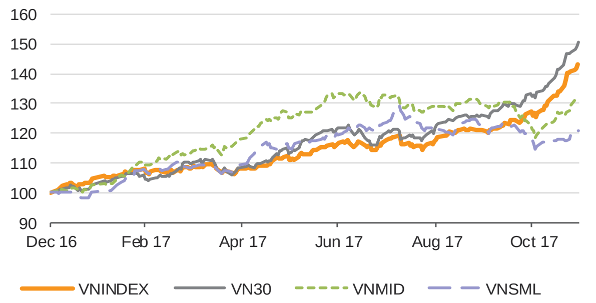
The market was driven by a broad-based rally in large cap stocks. The top 7 movers contributed to 64% of the total increase in the VN index in the first 11 months of the year. The biggest contributors were VNM (12.8% to total index gain), SAB (12.6% total index gain) and VIC (12.2% to total index gain), collectively adding 35 points to the index. Meanwhile, 96 decliners over the period knocked only 8.6 points off the index.

Figure 28: VNINDEX's top movers: YTD 11M2017 price change



Source: Bloomberg, VNDIRECT

Figure 29: Index performance by Tier 11M2017



Source: VNDIRECT

We believe that the market's performance has been driven by a set of very new catalysts this year including a slew of new listings, many of which traded at a premium to the market.

The limited free float of several newly listed companies, often with high state ownership, pushed up valuations, as seen with cases such as Sabeco (SAB), Habeco (BNH), Petrolimex (PLX), and Airports Corporation of Vietnam (ACV). The resulting scarcity of supply particularly for foreign investors, triggered a "gold-rush" into these landmark listings, driving up valuations. Moreover, odd cases, such as FLC Faros Construction, that trade at irrational multiples further illustrates how performance has partially been driven by outlier stocks, and that the broader index is actually cheaper than it appears.

Figure 30: Stock Price Performance of major sectors 11M2017

Sectors	11M2017 Performance
Retailer	81.7%
Banking	66.8%
Financial Services	58.5%
Beverages	55.2%
Real Estate	53.5%
Industrial Transportation	53.2%
Health Care	51.3%
Technology	48.1%
Construction	36.3%
Food Producers	29.5%
Basic Resources	28.8%
Building Materials	28.8%
Utilities	27.8%
Oil & Gas	21.8%
Chemicals	10.3%
Insurance	8.0%
…	
VNINDEX	**42.9%**

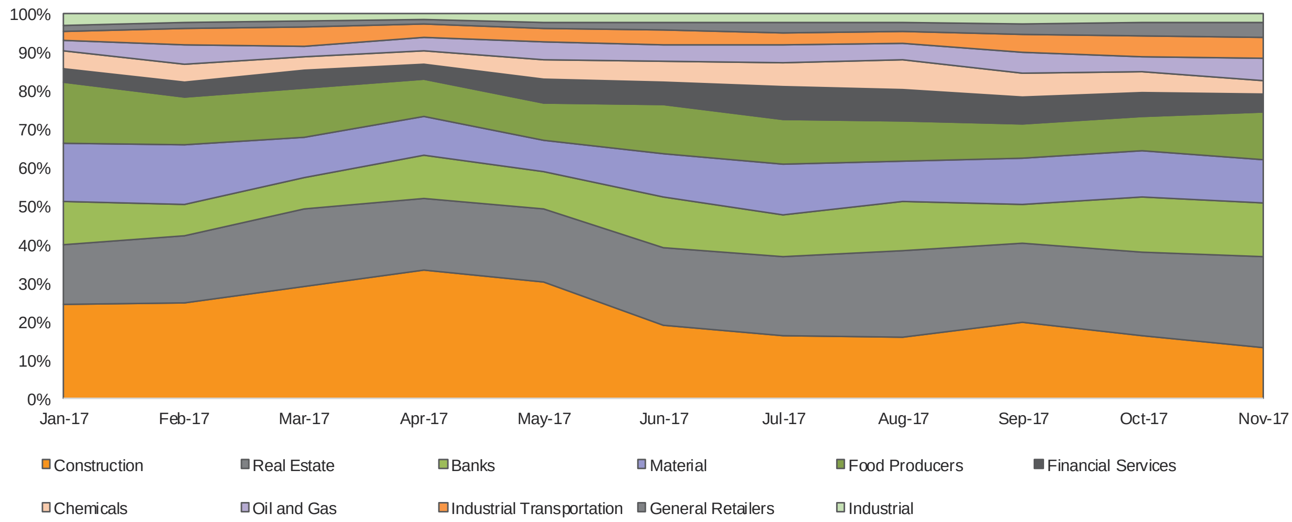
Source: VNDIRECT

The VN Index's meteoric rise was quite broad-based from a sectorial perspective but retailers and banking stocks were king. Key retail names benefited from aggressive store expansion. Blue chip food and beverages stocks performed well due to strong growth on the back of record high consumer confidence and despite margin pressure stemming from rising commodity prices and intensifying competition. Banking stocks outperformed on the back of positive policy moves, including new legislation on NPL resolution mechanisms in August and Moody's upgrade of Vietnam's banking sector outlook to "positive" this year. Market sentiment in November was further buoyed by the successful auction of Vinamilk, MOIT's announced divestment from Sabeco, and SCIC's announcement of its divestment plans for sought-after names in its portfolio, such as FPT, DMC, BMP, and NTP.

- **Retail sector key gainers:** MWG (74.5%), PNJ (90.8%)
- **Banking sector key gainers:** SHB (104.3%), MBB (100.2%), ACB (98.3%), BID (86.4%).
- **Financial Services sector key gainers:** SHS (371%), HCM (96.4%), VND (79.4%), SSI (42.8%)
- **Beverages sector key gainers:** SAB (64.4%), BHN (25.0%)
- **Real Estate sector key gainers:** VIC (77.4%), VRE (20.89%)

Capital flows focused on the construction, real estate, banking, materials and food producer sectors.

Figure 31: Trading value share by sector



Source: VNDIRECT

The quirky nature of the market's rise this year was reflected in the fact that actively managed funds underperformed the Index.

We have noticed a major divergence in the performance of the VN Index and actively managed funds, which in some ways reflects the lack of maturity of the market. The market is being distorted by odd cases such as FLC Faros Construction, and strong rallies in newly-listed large caps with limited free float (ACV, SAB, BNH, and PLX).

We observe that a group of 10 actively managed funds only returned around 30% YTD as of the middle of December, while the VN Index returned 46% over the same time period. Moreover, passive ETFs, namely Van Eck Market Vectors Vietnam ETF and DBX Trackers Vietnam ETF, both returned 31.5% and 22.5%, respectively during this same time period. The fact that ETF performance this year was on par with that of actively managed funds is a strange twist in the market, as these ETFs have massively unperformed in the past five years compared to both the index and actively managed funds. Meanwhile, the VFM Vietnam 30 ETF has strongly outperformed other Vietnam ETFs as well as the index, as it focuses 100% on Vietnamese listed equities (unlike other Vietnam ETFs that invest in non-Vietnamese equities that have exposure to Vietnam), and is not subject to foreign ownership restrictions.

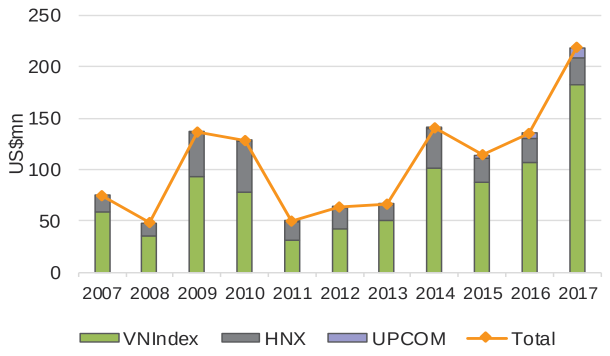
From our view, the performance of actively managed funds is a more accurate reflection of the market's underlying performance this year, due to the distortions in the overall VN Index. That being said, a 30% return year-to-date, still ranks Vietnam as a top performing market in Asia.

2017 saw a quantum leap in market liquidity

Market liquidity surged by more than 60% with reallocation of capital out of the small and mid cap space as retail investors jumped on the large-cap bandwagon.

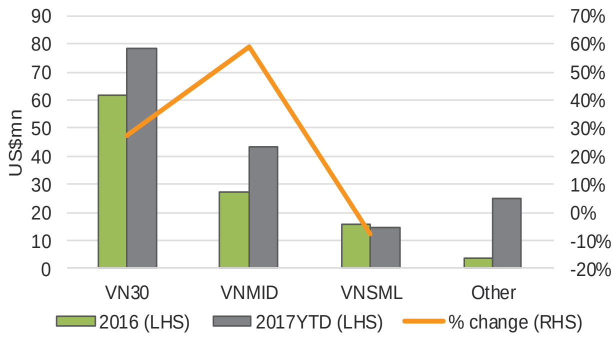
Total market liquidity surged by 60% in terms of average daily trading value during 11M 2017. On the HOSE, Midcaps and the VN30 were the main focus, as the average daily trading value of those stocks increased by 58.8% and 27.2%, respectively, while the ADTV of small caps decreased by 0.08%. Newly-listed stocks this year contributed to 11.5% of the total market liquidity over the period, driven by large names such as PLX, VJC, and VRE. Since domestic retail investors dominate trading activity in the small cap space, the fall in liquidity in this tier illustrates that retail investors jumped into large cap stocks to preempt strong interest from foreign portfolio investors in new large cap listings and divestments.

Figure 32: Average Daily Trading Value (2007- 11M2017)



Source: VNDIRECT

Figure 33: VNINDEX Average Daily Trading Value by Tier



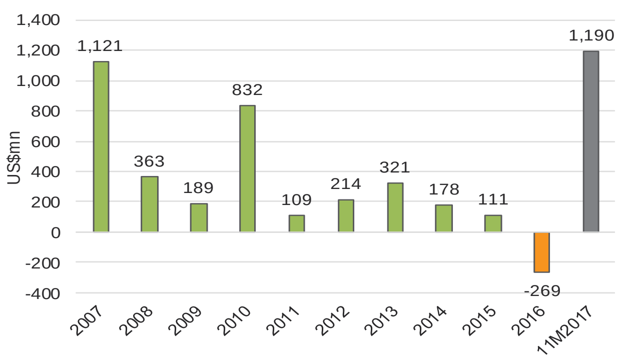
Source: VNDIRECT

Vietnam's ADTV recently surpassed the Philippines, but still lags behind other emerging markets. The market's ADTV recently surged past US$350 million in November, which mainly occurred due to one off cases such as Vincom Retail and Vinamilk. This allowed the market to surpass the Philippines in terms of ADTV, yet Vietnam still trails behind many emerging markets, including Indonesia (around US$413 million), and Malaysia (around US$500 million). Another distinct trait of the market includes the fact that foreigners were net buyers of Vietnam for all three quarters, while this did not hold true for market such as Thailand, Indonesia, Philippines, Taiwan, and South Korea.

Foreign investors were a key driver of the market this year

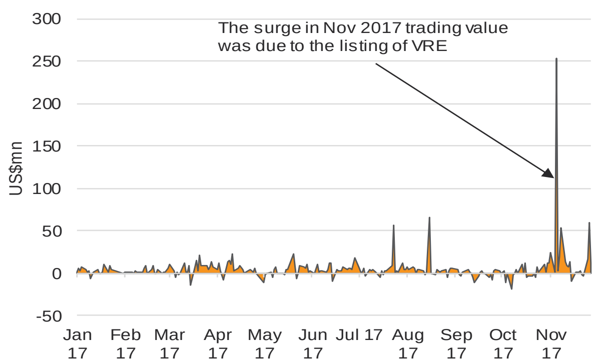
Foreign investors were strong net buyers during 2017, net buying US$1.19bn over 11 months in 2017, even higher than during the bull market of 2007 (US$1.12bn). Foreign investors also made the greatest contribution to the market's liquidity in 10 years, accounting for 13.8% of the market trading value over 11M2017.

Figure 34: Foreign Net Transaction Value 2007-2017



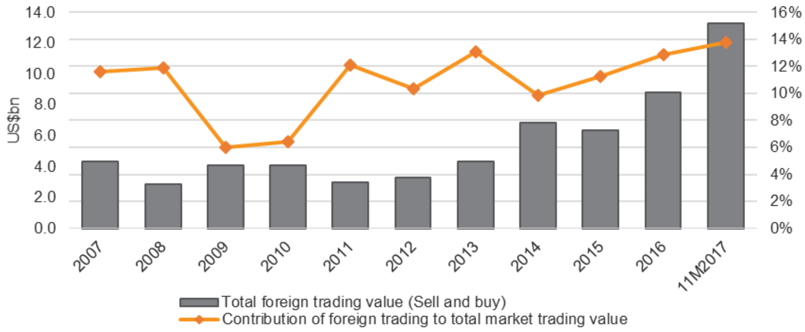
Source: VNDIRECT

Figure 35: Foreign Monthly Net Transaction Value during 2017



Source: VNDIRECT

Figure 36: Total Foreign trading value and contribution to market liquidity



Source: VNDIRECT

Newly listed stocks attracted the attention of foreign investors. Besides the popular names such as VNM (net bought US$334mn) and HPG (net bought US$89mn) , foreign investors bought into newly listed large caps such as VRE (US$231mn), PLX (US$70mn), VCI(US$65mn), VPB (US$64mn), VJC (US$40mn).

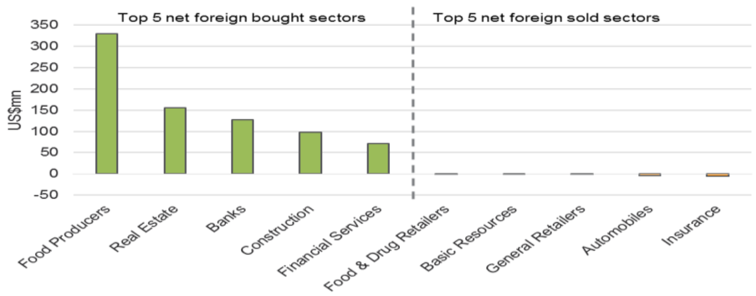
Figure 37: Top Foreign Net Bought and Net Sold Stocks During 11M2017 (US$bn)

		Top net bought					Top net sold		
		Net bought	Value bought	Value Sold			Net bought	Value bought	Value Sold
1	VNM	334	2,026	1,692	1	MSN	-57	316	373
2	VRE	231	792	562	2	PVS	-33	25	58
3	HPG	89	322	233	3	NTP	-29	45	74
4	PLX	70	105	36	4	PVD	-28	27	55
5	VCI	65	80	15	5	NVL	-26	88	114
6	VPB	64	71	7	6	BMP	-23	30	53
7	PGD	55	56	1	7	VIC	-19	144	163
8	CTD	48	80	33	8	HT1	-16	16	32
9	DIG	40	51	11	9	HSG	-15	86	101
10	VJC	40	120	80	10	KBC	-11	55	66
11	ROS	39	103	63	11	SSI	-11	99	110
12	BID	35	61	26	12	FIT	-11	1	12
13	GAS	28	87	59	13	DXG	-10	41	52
14	VHC	24	43	19	14	CII	-10	79	90
15	HCM	21	35	14	15	QCG	-10	2	12
16	PC1	21	24	3	16	SKG	-10	13	22
17	SCS	21	21	0	17	DRC	-9	22	30
18	SAB	21	109	88	18	HBC	-8	35	43
19	LPB	19	20	1	19	KDC	-8	32	41
20	QNS	17	22	6	20	SCR	-8	4	11

Source: VNDIRECT

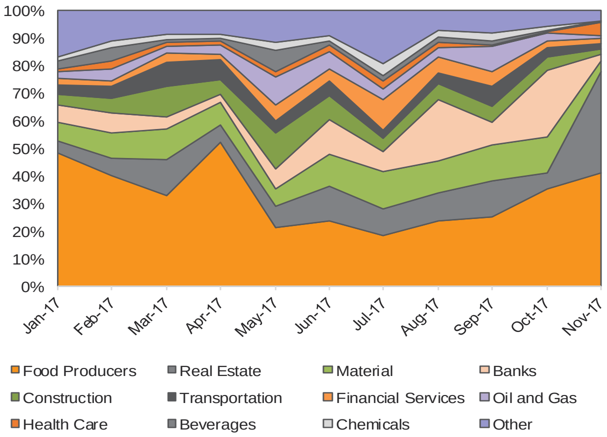
Foreign investors continued to show their preference for main-stream sectors including food producers (VNM,MSN), real estate (VIC, VRE, NVL), materials (HPG, HSG) and banks (VCB, ACB, VPB, BID).

Figure 38: Top 5 Foreign Net Bought and Net Sold Sectors: Net Flow (US$mn)



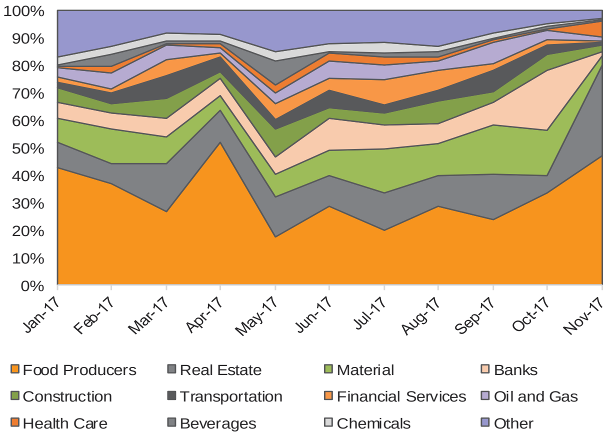
Source: VNDIRECT

Figure 39: Foreign Buying by Sector



Source: VNDIRECT

Figure 40: Foreign Selling by Sector

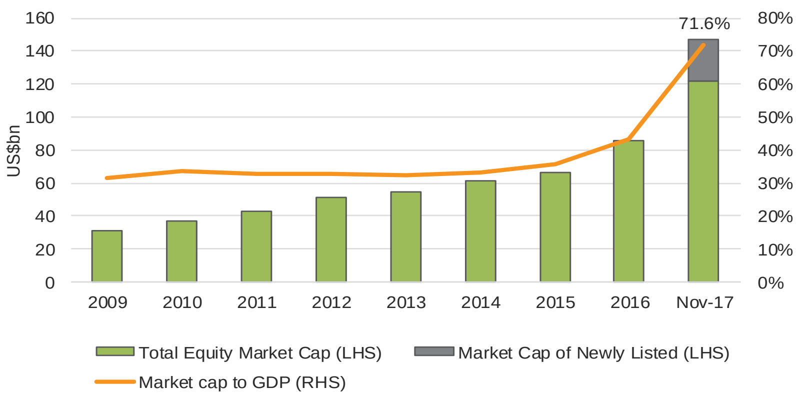


Source: VNDIRECT

Total market cap surged, supported by new listings

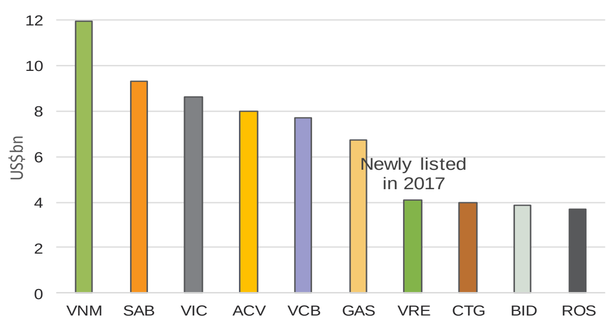
Vietnam's stock market capitalization has grown considerably, recently reaching 71.6% of GDP. The total market cap of the 3 exchanges jumped by 71%, as the market cap growth of existing stocks accounted for 42% and stocks listed in 2017 contributed to the other 29% of the stock market capitalization.

Figure 41: Vietnam's Total Stock Market Capitalization (2009-11M2017)



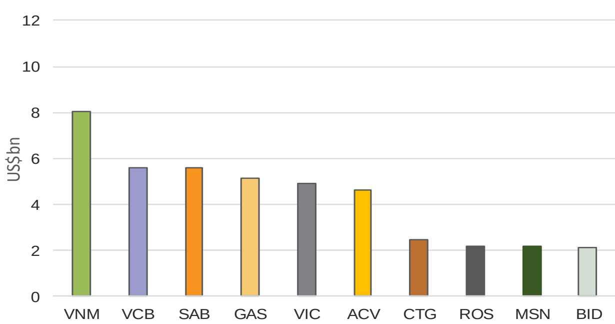
Source: VNDIRECT

Figure 42: Top 10 Companies by market cap as of November 2017



Source: VNDIRECT

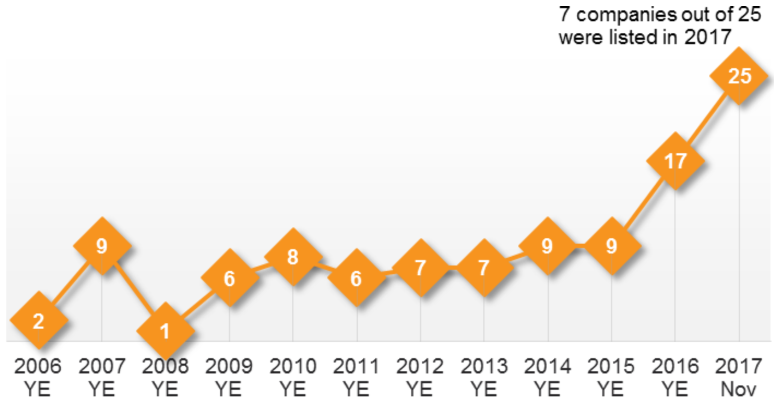
Figure 43: Top 10 Companies by market cap as of December 2016



Source: VNDIRECT

The market deepening was driven both by expansion in market capitalization of existing large caps as well as new listings. Existing large cap names such as Vinamilk, Sabeco, Airports Corporation of Vietnam, and Vietcombank saw their market capitalizations surge. Meanwhile, newly listed Vincom Retail is now one of the top 10 largest companies on the stock market, and was joined by a large number of new listings with a market cap exceeding US$1 billion this year.

Figure 44: Number of Stocks above US$1 Billion in Market Cap



Source: VNDIRECT

The rise in the VN-Index has only partially been driven by earnings growth, with multiple expansion being a significant contributor.

Investors are placing a fatter premium on growth. The index has risen by 42.8% over the past 12 months, while TTM earnings have only grown by 18.7%, YoY. Consequently, the market's TTM P/E has expanded by 15.8% over the same period, and has reached its current level of 19.0x.

An expansion in the P/E multiple is not necessarily a sign of over-optimism, as earnings growth has been accelerating. We decided to take a look at the PEG ratio and noticed that the PEG ratio for the VN-Index has expanded by 16% to touch 1.04x. We believe that the P/E multiple expansion is not entirely justified by the acceleration in earnings growth. A falling risk premium driven by a continued strengthening of the economy and improving global business conditions can justify some of this expansion in the PEG ratio, but not all of it, in our view.

Large caps drove the market's PE expansion this year

The P/E expansion in the index has mainly been driven by large caps (VN 30). Small and mid-cap P/E ratios have flat-lined for the past two years, while the P/E of large caps has expanded by a significant 30% over the same period to touch 22.0x, quite lofty for a frontier market. We looked at the TTM earnings growth of large, mid and small caps and found that large caps are seeing faster earnings growth as compared to mid and small caps: large caps saw around 15.2% TTM earnings growth versus 14.8% for mid-caps and only 7.9% for small caps, implying that the large cap P/E premium is somewhat justified. But the PEG ratio for large caps has risen by an astonishing 74% over the past 12 months to touch 1.45x. The large cap PE multiple has expanded over the past year despite a nearly 500bps deceleration in large cap TTM earnings growth over the same period.

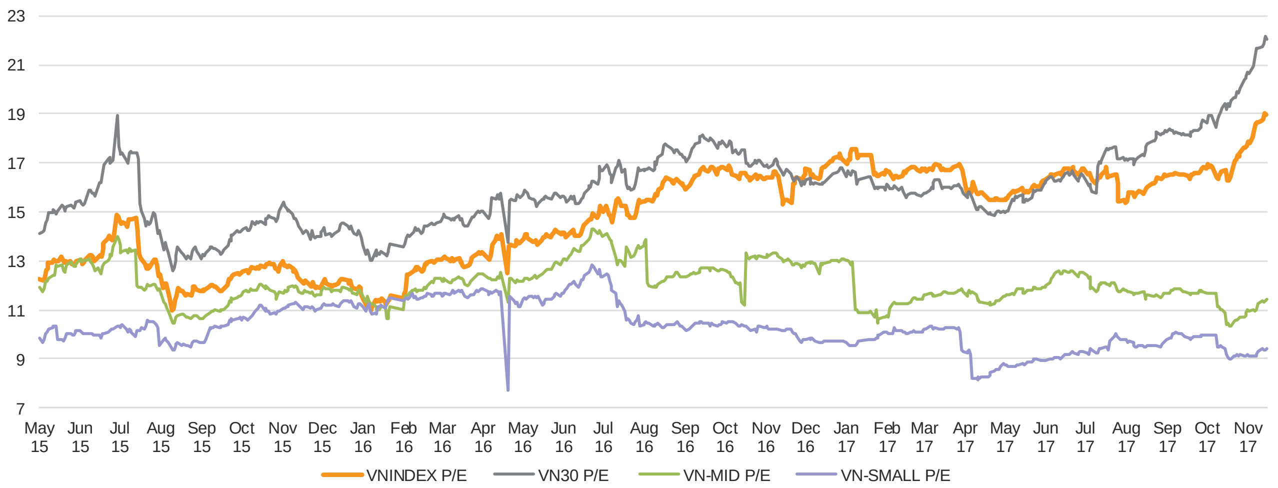
Figure 45: Key statistics of the VNIndex by Market Cap Tier

	P/E as of Nov-17	P/E as of Nov-16	Marketcap US$bn	Earning growth TTM
VNINDEX	**19.0x**	**16.4x**	**112.4**	**18.7%**
VN30	22.0x	16.9x	78.7	15.2%
VN-Midcaps	11.4x	13.3x	10.5	14.8%
VN-Smallcaps	9.4x	8.4x	3.4	7.9%
Top 30 Marketcap (*)	**22.5x**		**91.0**	**20.5%**

Source: Fiinpro, VNDIRECT calculation

(*) List of 30 largest companies on HOSE in terms of market cap (including VPB, VJC, PNJ, etc which are not in VN30 Index)

Figure 46: Historical TTM P/E of VNINDEX, VN30, VN-MID and VN-SMALL



Source: FiinPro, VNDIRECT

STOCK MARKET OUTLOOK: MID CAP NAMES ARE WORTH LOOKING AT IN 2018

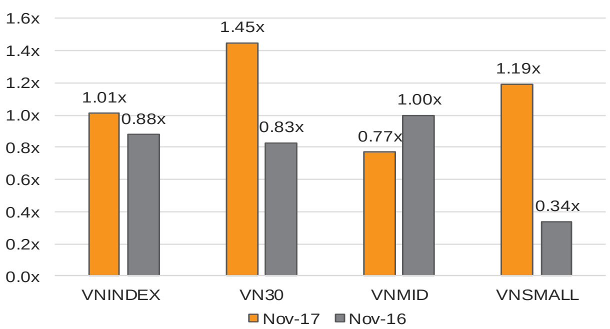
We do recognize that large caps in frontier markets deserve to trade at a premium to the rest of the market. In economies like Vietnam, success begets success more so than in the developed world. Larger companies have better access to capital, disproportionate bargaining and pricing power, better connections with the government and the ability to attract the best talent from relative shallow talent pools. While large companies in developed economies often face market saturation, large companies in a frontier economy like Vietnam enjoy all the benefits that come with scale without the corresponding slowdown in growth associated with being a giant in a saturated, mature market. This is reflected in the fact that large caps are seeing faster earnings growth than small and mid-caps. Moreover, we also believe that the relative scarcity of stocks with sizeable market cap and good liquidity also serves as a pretext for the relatively higher valuation for this asset class.

But the PEG ratio of large caps in Vietnam is an astounding 88% higher than that of mid-caps. This looks like a screaming imbalance to us. This could mean that large caps have to correct at some point, but we think that the strong pipeline of large cap IPOs over the next year or so could prevent a major correction in large cap valuations. The new listings will be driven by SOE equitizations such as PVPower, Becamex, PVOil, Genco 3 as well as some large non-SOE listings such as Techcombank and FPT Retail. The migration of large, recently listed SOE names such as ACV and HVN from the UPCOM exchange to the HOSE bourse could further cushion a correction in large cap valuations. We believe that the valuation gap between large and mid-caps will be partially bridged by a rally in mid-caps rather than a major mean reversion in large cap valuations. However, some correction in large caps is still likely to us given that the huge supply of new large cap equities expected in 2018 might not be easily absorbed by investors.

We see upside in the mid cap space but advocate selectivity.

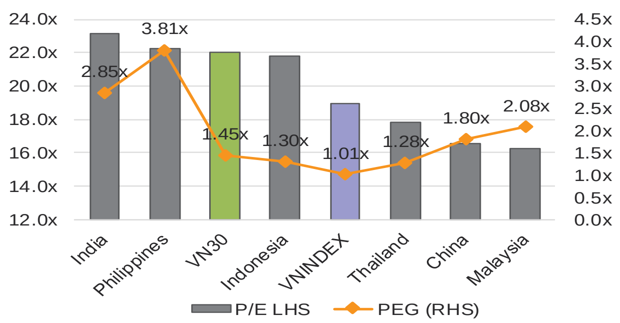
Given that the mid cap space is trading at nearly half the PE of large caps, we believe that focusing on this area could be more profitable for investors. The deep discount in the mid cap space, even after accounting for earnings growth, will not go unnoticed by value investors during 2018, given the toppy valuations in the large cap space. However, we do not necessarily expect a broad rally across this space and still advocate bottoms-up stock selection.

Figure 47: PEG ratio of VNINDEX and its components: current versus 12 months ago



Source: VNDIRECT, FiinPro

Figure 48: P/E and PEG ratio of Vietnam and regional markets

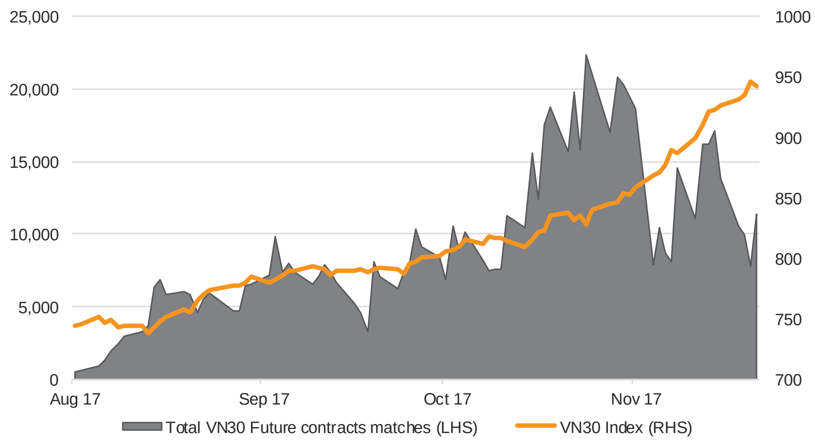


Source: VNDIRECT, Bloomberg, FiinPro

Derivatives products will support market sentiment

Vietnam's Stock Market launched its first derivative products with VN30 INDEX Future contract and the initial results look promising. On August 08, 2017, Vietnam's derivatives market was launched with future contracts. This market began with a modest start, as only 485 contracts matched, but the future market's liquidity picked up in the following months. It peaked at over 20,400 contracts matches per day in November (46 times higher than on the launch). We expect the futures market to triple in 2018 in term of transaction volume.

Figure 49: Vietnam's VN30 Futures market Aug 17- Nov 17



Source: VNDIRECT

Covered warrants will be available starting in January 2018, which may further promote the participation of foreign investors. Covered warrant products will be launched in January with a short-list of 21 stocks in the VN30 and HNX 30, including stocks with full foreign ownership.

The trading of covered warrants is similar to that of stocks, as investors are allowed to use their stock trading accounts to buy and sell covered warrants. As covered warrant transactions still follow the T+2 rule, they are unlikely to attract the attention of retail investors. However, this product can be an attractive vehicle allowing foreign investors to invest in blue chips, which have reached their foreign ownership limits.

Issuers of covered warrants are securities companies and they must meet some standards, such as no accumulated losses, charter capital and ownership equity of at least VND1trl (roughly US$44mn), as reported in the latest annual and half-year financial reports, and have fully licensed securities operations.

SOE divestments and IPOs will continue to be important market catalysts but the best new listings might be behind us already

Q4 2017 is turning into a vibrant quarter with many notable IPOs and SOE Divestments

SCIC successfully divested 3.33% of its registered shares of VNM at an average bidding price of VND186,000 per share (23% higher than the initial reference price), allowing it to collect approximately VND9,000bn (US$398mn) in total proceeds. SCIC only sold 5.4mn VCG shares out of 96.2mn auctioned shares at an initial price of VND25,600 per share, allowing it to collect approximately VND137bn (US$6mn) in total proceeds.

SCIC is also divesting from 3 other enterprises including FPT, BMP and NTP and has delayed the auction to the beginning of 2018.

Beside SCIC divestments, investors were closely following SAB's auction, which became one of the biggest divestments made so far. The Ministry of Industry and Trade (MoIT) has collected approximately USD4.8bn from divesting its 53.6% stake in Vietnam's beer giant.

Figure 50: SCIC and MoIT divestment pipeline

Company	Sector	Share offered (mn)	% stake offered	Time of auction	Starting price (VND)	Average winning price (VND)	% sold	The actual amount collected from the divestment (US$mn)
Completed								
VCG	Real Estate	96.2	21.8%	Dec-17	25,600	25,600	5.6%	6.0
VNM	Food & Beverage	48.3	3.3%	Nov-17	150,000	186,000	100%	396.0
SAB	Food & Beverage	343.7	53.6%	Dec-17	320,000	320,000	100%	4,845.8
Upcoming								
BMP	Plastics	24.1	29.5%	1Q/2018	Not yet announced			
DMC	Pharmaceutical	12.1	34.7%	1Q/2018				
NTP	Plastics	33.1	37.1%	1Q/2018				
FPT	Technology	31.6	6.0%	1Q/2018				

Source: VNDIRECT

Figure 51: IPO deals completed in the first 2 months of 4Q2017

Company	Sector	Stake offered in IPO	Free float after IPO	Starting price (VND)	Average winning price (VND)	Time of listing	Exchange	Market Cap (USDmn)
IDICO	Industrial	18.4%	18.4%	18,000	23,940	05-Dec	Upcom	316.4
THALEXIM	Petroleum	5.0%	5.0%	10,600	14,823	na	na	na
BECAMEX	Real Estate	23.6%	1.4%	31,000	31,008	na	na	na

Source: VNDIRECT

But SOE equization and divestment progress in 2017 will still fall short of targets

Thanks to the success of SAB's auction, the government has surpassed the targeted value of divestments (completed 207%) this year. As of Dec 22nd, 2017, we estimate that total proceeds from equitizations and divestments in state-owned enterprises was approximately US$5.4bn versus the government's targeted US$2.6bn from equitizations and state ownership divestments for the full year. However, in terms of numbers of companies, the state divested its holdings in only 10 SOEs as of out of the total target of 135, meeting a mere 7% of the total divestment target.

The government has also set a target to equitize 44 state-owned enterprises (not included state-owned enterprises under management of Ministry of Defense) in 2017. In the first 11 months of 2017, authorities had managed to equitize only 21 state-owned enterprises, excluding those that are under the Ministry of Defense.

The authorities are evaluating 9 other state-owned enterprises for equitization and the pricing has been announced for seven of these. The government has approved the plan for 4 companies to delay the equitization process to the beginning of 2018; these companies include Housing and Urban Development Corporation, Vietnam Cement Industry Corporation (VICEM), Khanh Viet and Vietnam Cable Television (VTV cab).

2018 could see a marked acceleration in SOE IPOs and divestments to clear the 2017 backlog

According to Decree 991/TTg-ĐMDN of the Prime Minister, 64 state-owned companies will be equitized in 2018. Some of these companies are very large companies, including Vietnam Mobile Telecom Services One Member Limited Liability Company (MobiFone), Genco 1, Genco 2, Urban Infrastructure Development Investment Corporation (UDIC), and Hanoi Housing Development and Investment Corporation (HANDICO).

Besides, the backlog of approved but pending equizations from 2017 and before is huge as pointed out above, much of which will need to be cleared in 2018.

According to Decree 1232/QĐ-TTg Prime minister, the state will divest from 181 companies in 2018 and this number does not include divestments by the state investment arm SCIC. This excludes the divestment backlog from 2017, pointed out earlier.

Figure 52: Major IPO Deals Expected in Dec 2017 and 2018

SOE	Financial data 2016									
	Stake offer (%)	Revenue (VNDbn)	Revenue growth (%)	NPAT (VNDbn)	NPAT growth (%)	Total assets (VNDbn)	Stockholders' equity (VNDbn)	ROA (%)	ROE (%)	Expected IPO timing
BSR	>4	73,686	-22.7	4,436	-27.2	62,690	32,573	7.3	13.9	Jan-18
PVOIL	20.0	50,910	-23.2	674	Na	20,445	9,912	2.8	6.4	Jan-18
GENCO 3	na	35,942	27.6	281	38.1	85,590	8,673	0.3	2.8	Na
PVPOWER	20.0	28,212	21.4	1,517	-40.7	69,732	26,797	1.5	4.1	Jan-18
VICEM	Na	26,529	8.4	2,932	24.8	44,630	19,468	6	13	Na
VINAFOOD2	23.0	22,751	-13.6	-9	na	11,013	4,124	Na	Na	Na
VNRG	11.8	15,694	3.9	2,808	45.1	70,137	45,569	3.6	5.5	Na
HUD	23.7	6,553	11.4	459	105	15,003	4,062	2.6	9.6	Na

Source: VNDIRECT

Figure 53: Government has proposed a plan to divest from 406 state-owned enterprises over 2017-2020, of which 316 will take place between 2017 and 2018

SOE	Sector	Financial data of 2016							
		Revenue (VNDbn)	Revenue growth (%)	NPAT (VNDbn)	NPAT growth (%)	Total assets (VNDbn)	Stockholders' equity (VNDbn)	ROA (%)	ROE (%)
ACV	Aviation	14,650	11.2	5290	201.8	46,942	24,333	10.1	22.4
BHN	F&B	9,996	3.7	796	-16.3	9,781	6,538	5.6	16
BMI	Insurance	3,375	7.5	182	41.1	5,126	2,171	3.6	8.2
BMP	Materials	3,678	18.5	627	20.9	2,891	2,297	23.5	29.1
CC1	Construction	6,584	17.7	211	-29.1	9,399	1,769	0.8	4
DIG	Real Estate	1,152	75.9	66	375.3	5,876	2,798	1.5	3.2
DVN	Pharmaceutical	6,036	-17.1	662	89.1	6,898	3,671	9.4	17.9
FICO*	Materials	5,458	-6.2	97	-7.4	5,109	1,661	1.4	4.4
FPT	IT	39,531	4.1	2575	5.7	29,833	11,448	7.3	17.7
HAN	Construction	3,884	1	109	-3.7	8,984	1,635	1.2	5.8
HND	Utilities	9,157	0.5	287	-26.6	17,103	4,709	1.6	6
HVN	Aviation	70,089	6.3	2105	161.2	96,480	15,296	2.2	14.5
KTL	Steel	927	-3.8	59	-1	1,199	332	4.7	18.8
MIE	Industrial Machinery	2,143	-5.6	0	-99.4	2,143	1,246	0	0
MTH	Water Treatment Services	208	-7.2	15	-0.9	126	106	12	17.7

Source: VNDIRECT
(*) Data 2015

"Black Swan" events pose a growing risk to our 2018 stock market outlook

We believe that a conflict on the Korean peninsula would also negatively impact Vietnam's stock market. Events such as South China Sea tensions and Brexit can be considered as precedents, although they are by no means the most accurate benchmarks, as this conflict would have a long term economic impact.

In the middle of 2014, Vietnam's stock market sold off amid rising tensions in the South China Sea. However, the market quickly rebounded then as investors realized that this event would have limited impact on Vietnam's economy. Vietnam's stock market experienced a rapid six week sell off following these tensions, causing the market to decline from its high, and wiping out nearly 20% of the advance. In this case, many institutional investors actively bought during the dip, seeing the market as offering great value, and the recovery picked up steam after international companies confirmed that they would continue operating in Vietnam. Vietnam's stock market also experienced strong volatility amid global turmoil triggered by Brexit last year, with the HOSE plunging by as much as 5% before closing with a 1.8% drop, in line with the decline seen for some of its regional peers. There was not a major correction following this initial day, as investors realized that Brexit would not have a significant impact on Vietnam's economy, as the UK only accounts for a small proportion of its total exports.

The geopolitical tensions stirring in North Korea present a very different degree of risk. Vietnam's economy will certainly be impacted on a large scale, and this event also poses larger global risks which could have a direct and immediate impact on the Vietnamese stock market.

2018 looks positive for the stock market, but 2017's performance will be a tough act to follow

We are cautiously optimistic on 2018 stock market performance

- The macroeconomic environment will continue to be positive. We are projecting 6.6% growth for next year, driven by strong manufacturing growth, a loose monetary policy, and a pickup in public spending.
- Market valuation is not cheap anymore: The VNINDEX is trading at a traiing P/E of 18.9x and the VN30 is trading at a trailing P/E of 22.0x; this compares with a 19.6x average trailing P/E for regional stock markets.
- Some market-wide multiple contraction is possible but a continued market uptrend should be supported, nonetheless, by strong earnings growth. We forecast around 17-20% EPS growth across our coverage universe.

- The government is trying to accelerate the IPO process for SOEs and this could result in some landmark listings next year including PVPower, PVOil, BSR and Genco 3.
- State divestments from SAB, BHN, BMP, BMI, FPT, and VCG should also be received with strong interest
- The current large premium on large cap stocks combined with the huge supply of large cap equities into 2018 might weigh on large cap valuations; we therefore remain a bit concerned about the market's ability to absorb all this new supply as well as the steep price-tags being placed on key SOE IPOs.
- We do not predict a broad rally across the mid-cap space but do advocate bottom-up stock selection in this space due to its huge discount to the overall market.
- The VNINDEX should easily surpass 1000 points but the picture, thereafter, gets more murky due to dependence on the pipeline of new listings.

VIETNAM'S PROSPECTS FOR GRADUATING TO MSCI EMERGING MARKET STATUS IN 2020

Emerging Vietnam in 2020? One major potential catalyst for Vietnam's stock market would be an upgrade to MSCI Emerging Market status, which would occur in June 2020 at the earliest, assuming that Vietnam is placed under review next June, and MSCI announced its acceptance in 2019 after the review period. Moreover, there is ample opportunity for the market to rally nearly 30-40% between 2019-2020, once MSCI officially announces that Vietnam has been successfully upgraded, as seen with markets such as United Arab Emirates, Qatar, and Pakistan. While MSCI has noted that Vietnam has been moving in the right direction on many fronts, there are still some factors holding the market back, while markets such as Argentina and Saudi Arabia are much closer to receiving an EM upgrade. This section highlights Vietnam's current achievements, as well as barriers, to becoming an emerging market, and also notes how Vietnam can benefit as a frontier giant until this transition comes into fruition.

There are still multiple barriers to Vietnam's upgrade to emerging market status but liquidity is no longer one of them

Foreign ownership limitation removal is an important catalyst, thought complete removal is not mandatory. Vietnam has taken some appropriate steps in terms of foreign ownership limitation removal, although there are still limitations due to conditional sectors not being fully open to foreign investors. Full openness to foreign investors can surely be a catalyst for Vietnam's eventual upgrade, as exemplified by now emerging Pakistan, which does not distinguish between domestic and foreign investors (China even owns 40% of the Pakistan Stock Exchange). Vietnam needs to open up more companies to foreign ownership, and allow equal rights for foreign investors. However, markets that are not fully open to foreign investors have still been able to receive upgrades or be considered for an upgrade, as seen with the Philippines, which is still working on removing foreign ownership limitations in sectors such as construction. Moreover, Saudi Arabia, which is being reviewed for an emerging market upgrade in 2018, still restricts foreign ownership to 49%, though other sophisticated characteristics make it appealing for a potential upgrade, and it has begun working towards opening up other sectors such as health, education, and engineering. Furthermore, we can also see cases of foreign ownership limits in developed markets. For example, the foreign ownership limit for airlines in Japan, USA, and Europe are 25%, 33%, and 49%, respectively. Nonetheless, steps to remove foreign ownership limits in Vietnam, especially in highly sought-after sectors such as banking, retail, and pharmaceuticals, would bode well for the market in general, and certainly improve its prospects of being upgraded.

Access to English information is also a key barrier. The availability of corporate and market information in English is another barrier for Vietnam's EM upgrade. According to the HSX in 2016, only 59.8% of companies had a website in English, and only 35.4% had disclosures in English. Furthermore, investor registration and account set up documents often involve translated documents. Argentina could provide further insight as to how necessary this is, as it is being considered for an upgrade next year, but currently requires all of the documents for account registration to be filled in Spanish, and often does not have detailed stock market information available in English. The jury is out but we believe that Vietnam could certainly benefit from making English language disclosure a binding requirement.

Vietnam's liquidity portends its EM potential. Vietnam's stock market liquidity is soaring, and this by no means will be a barrier, as its ADTV has already surpassed Pakistan's at the point of its inclusion. Notably, Pakistan's ADTV was slightly above US$150 million prior to its inclusion, compared to US$50 million in 2010. A flurry of large IPOs, listings and state sell-downs such as Vincom Retail's listing and SCIC's divestment from Vinamilk have allowed Vietnam's ADTV to reach new record highs, with ADTV surpassing US$200 million on average this year. Given that Vietnam's ADTV was even able to recently surpass the Philippines' proves that the market's liquidity is not a barrier, as it is trouncing other frontier markets and beginning to approach the levels seen in emerging markets. For example, FTSE Russell has been reviewing Romania for an emerging market upgrade, yet the market's low liquidity has been the major barrier (ADTV is below 10 million euros for this market, a far cry from Vietnam). While Sri Lanka is more open to foreign ownership (except for banks and plantations), and has a far greater amount of English information published for foreign investors, its ADTV is also below US$10 million, which is a major barrier for an upgrade.

Improving market free float would make Vietnam less frontier. Vietnam appears to have clearly crossed the liquidity bridge, though it could improve its prospects by increasing the free float for some of the constituents that could potentially be added to MSCI Emerging Markets Index (ie. Petrolimex). Though this is not a concrete obstacle to an EM upgrade, freeing up more float would do wonders to improve the broader market sentiment, and to ensure that Vietnam is eligible to have a higher weighting in MSCI Emerging Markets, post-inclusion, by having more eligible constituents. The plethora of new listings in the market has also allowed Vietnam to have a respectable stock market capitalization, already surpassing smaller emerging market constituents such as Peru (US$85 billion) and even beginning to approach its emerging Asian peers. Similar to Vietnam, Peru was once one of the larger members of MSCI Frontier markets, accounting for 11.6% of MSCI Frontier Markets at the end of 2015, before being upgraded. We see Vietnam in a much more favourable position in terms of market cap, given the abundance of listings in the market this year and the long pipeline of listings expected in 2018. We believe that Vietnam is poised to exit MSCI Frontier Markets as a giant, and enter the MSCI Emerging Markets club with a respectable standing. Vietnam's weighting in MSCI Frontier Markets has risen from 3.4% at the end of 2015 to its current level of 13.5%, and could increase as its stock market grows and other larger countries in MSCI Frontier Markets are removed due to an EM upgrade.

Argentina and Saudi Arabia may be upgraded soon, and provide additional insight about Vietnam's further requirements

Argentina EM upgrade is in the cards. There are several markets that are closer to being upgraded as compared to Vietnam, though MSCI is closely observing Vietnam. Argentina is one of the most notable markets to watch, which failed last year after being reviewed. Though Argentina did make notable improvements in the removal of capital controls and FX restrictions, MSCI rejected its upgrade as these changes needed to be proved irreversible which they were not. Similar to Pakistan, Argentina was also once an emerging market but removed in 2009, as the government introduced capital and import restrictions to minimize capital flight and to control the widening current account deficit, rising inflation, and economic slowdown. However, capital controls were lifted in December 2015 under the new president, as well as other macroeconomic measures to improve the economy. While these upgrades were acknowledged, MSCI rejected Argentina's case for an upgrade back into the EM club due to the questionable sustainability of these measures. Argentina is currently the largest constituent of MSCI Frontier Markets, and is poised to exit MSCI Frontier Markets once its macro picture becomes more clear. MSCI is still reviewing the market, and will announce its decision next June. If Argentina is removed from MSCI Frontier Markets, Vietnam will be the 2nd largest constituent, only topped by Kuwait.

The frontier giant Saudi Arabia is being considered despite FOLs remaining in place; this bodes well for Vietnam's inclusion. MSCI recently stated that it would consider adding Saudi Arabia to MSCI Emerging Markets, and it plans to announce its decision in June 2018 (upgrade would take place in two phases between May 2019-August 2019). Saudi Arabia has a stock market capitalization of around US$442 billion much higher than other frontier markets that are currently seeking an EM upgrade. The market has made notable strides, including opening up FOL from 20% to 49% for "Qualified" foreign investors based on regulations from the CMA, and also allowed short selling and securities lending, a unique trait for a frontier market. MSCI did praise Saudi Arabia this January, saying that it welcomed the recent positive market reforms undertaken by the stock exchange and capital market authority. Saudi Arabia has also taken notable strides to open up select sectors completely to foreign ownership, announcing that it would allow 100% foreign ownership in industries such QW engineering and retail and wholesale (PWC), as well as health and education.

There are benefits to Vietnam's delayed EM upgrade

The downside of entering as a small player. Pakistan's stock market only represented 0.13% of MSCI Emerging Markets upon its inclusion, making it the 2nd smallest country in MSCI Emerging Markets. The market's relatively lower liquidity, coupled with its smaller standing in MSCI Emerging Markets, led some passive fund managers to not participate initially, and Pakistan has not performed well so far as a newly-promoted emerging market. Pakistan's upgrade reflects the potential risks of being upgraded and becoming a "small fish in a big pond", and we consequently believe that the expected delay in Vietnam's EM upgrade could be better for the market, giving it time to mature.

Vietnam's rise in MSCI frontier as a short term perk. As Vietnam will not be able to be upgraded until 2020 in the best case scenario, it is more crucial to focus on its position within MSCI frontier markets in the coming years. Vietnam is currently the 3rd largest country in MSCI Frontier Markets, and this could increase in the future. Vietnam is poised to benefit in the short term from the potential upgrade of other frontier markets to emerging market status, which would increase its weight in MSCI frontier markets. This occured when Pakistan was removed, and may also take place in the future if Argentina is upgraded. This would bode well for Vietnam, as Argentina currently accounts for 20% of MSCI frontier markets. As seen with Pakistan, an EM upgrade is not always the best news, as it transitioned from a larger constituent in MSCI frontiers to a minute constituent in MSCI Emerging Markets, only accounting for 0.13% of the index. Although Vietnam's emerging market upgrade is a much needed catalyst to continue supporting higher valuation, delaying this upgrade for several years could be better for the market. A further implementation of FOL removal and increasing of free floats for new listings would allow the market to enter as a larger player; ADTV/free float is a greater barrier for Vietnam, as Vietnam currently already has 25 stocks with a market cap surpassing US$1 billion. In addition to the US$1.27 billion market cap requirement from MSCI, the float market cap must exceed US$635 million and the ATVR must be greater than 15%. Vietnam needs to make strides for the latter requirements, though it already has the minimum number of constituents that meet the free float and ATVR requirements.

An EM upgrade is a necessary supporting factor for the market, given the increased complexity of the investment landscape

Markets such as Argentina and Saudi Arabia appear to have a much stronger chance of graduating to emerging market status in the near future, though Vietnam may be placed under review in coming year or two. While Vietnam's discount to emerging Asia has disappeared, and an EM upgrade is not feasible until 2020 at the earliest, there is still ample opportunity in the mid cap space, as we previously outlined. The best trend to watch for is the potential removal of Argentina from MSCI Frontier Markets, and perhaps even Kuwait, which would become the largest constituent in MSCI Frontier Markets if Argentina is removed in 2019. This would bode well for Vietnam, allowing it to slightly increase its current weight of 13.5% in MSCI Frontier Markets. This is perhaps a better move in the short term for Vietnam, as opposed to being prematurely promoted to an emerging market with a smaller weighting, as its rise within MSCI Frontier Markets in recent years has already proved to be beneficial. Moreover, Vietnam’s frontier market characteristics, especially the somewhat irrational price movements in some stocks due to market manipulation and low free float must be resolved, to ensure its future MSCI Emerging market constituents are credible and appropriately priced at the time of the emerging market upgrade. This also mitigates the risk of Vietnam being upgraded with a small weighting in MSCI Emerging Markets.

Vietnam’s investment narrative is still attractive, yet its complexity is surely growing: Vietnam’s investment narrative in 2015-2016 was much more straightforward, given the massive 30-40% market discount to emerging Asia at the time, yet there is now a sense of urgency to move on schedule with state divestments and to move forward with an EM upgrade, as the market is beginning to be priced as if this will happen in the near future. The EM upgrade is most crucial, as other markets have a historical precedent of rallying 30-40% after receiving an emerging market upgrade from MSCI. This creates the risk of a short term reversion to mean for market valuations, closer to its trailing 2-year TTM PE of 15.4x, if privatization continues to move behind pace and Vietnam is not placed under review for an EM upgrade next year. Vietnam’s emerging market-like valuation can be justified in the short term, with the main catalysts including continued successful state divestments, attractive IPOs, the continued process of opening up to foreign investors and a potential acceleration in economic growth, driven by FDI and export growth. But the story is far more nuanced now than it has been in the recent past.

BANKING SECTOR: BRIGHT OUTLOOK DRIVEN BY LOOSE MONETARY POLICY, NEW GROWTH ENGINES AND A CLEARER LEGAL FRAMEWORK

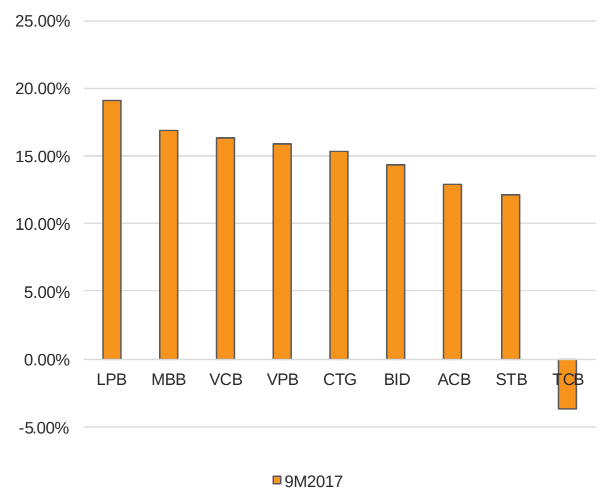
Vietnam's banking system is continuing to recover, facilitated by loose monetary policy

The Vietnamese banking sector began 2017 on a positive note, with Moody's upgrading Vietnam's sovereign rating to "positive" from "stable" in April 2017. Moody's subsequently updated its rating of 8 Vietnamese banks in May, re-rating some of them as "positive".

System-wide credit expanded by 12.16% in the first nine months of 2017, which was the highest growth rate in the past six years. In an effort to boost economic growth, the Prime Minister asked the State Bank of Vietnam (SBV) to lift the annual credit growth target from 18% to 20%. Consequently, several banks have requested the SBV to seek approval to lift their credit growth limit, as some banks were beginning to approach the assigned credit growth quota for the year.

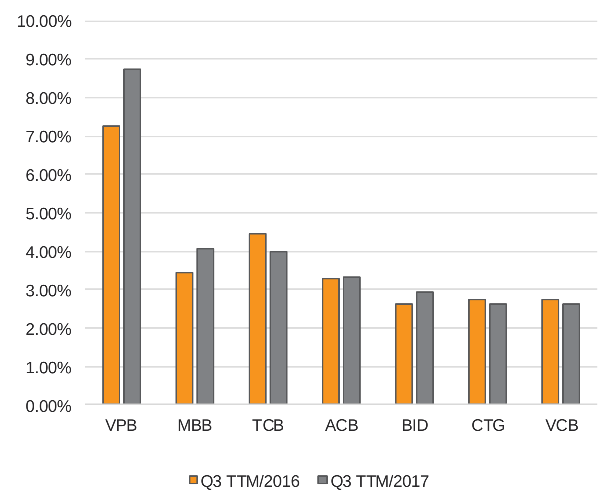
We estimate that the top-ten banks posted an increase of 32.1% yoy in aggregate pre-tax profit for 9M2017. It should be highlighted that the net interest margin (NIM) among top-tier banks has gradually expanded, reflecting a changing asset mix toward higher yield loan segments.

Figure 54: Credit growth among banks in 9M2017



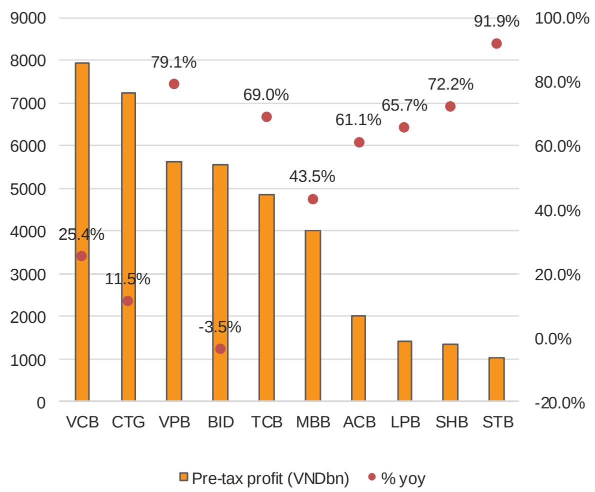
Source: VNDIRECT

Figure 55: NIM of top-tier banks has improved in 9M2017



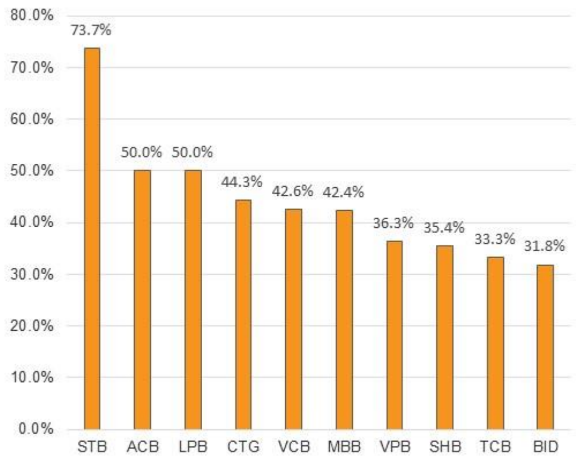
Source: VNDIRECT

Figure 56: Pre-tax profit and YoY growth of top listed banks for 9M2017



Source: VNDIRECT

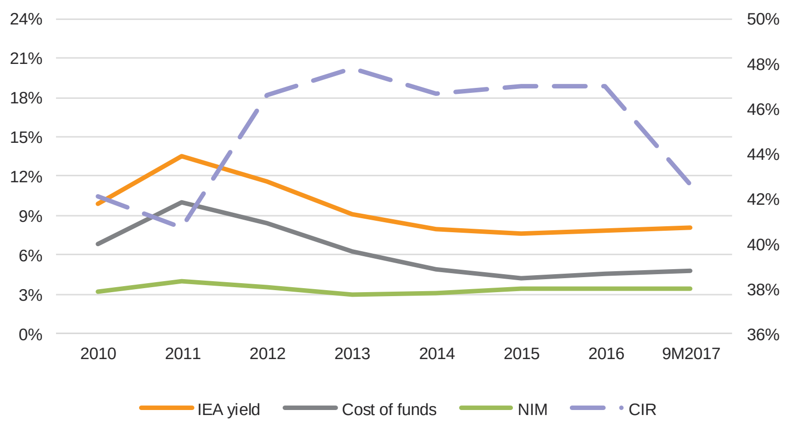
Figure 57: Cost-on-income ratio of top listed banks by 9M2017



Source: VNDIRECT

The sector's strong profit growth was driven by increasing NIM and improved CIR. The strategic re-orientation to retail lending has improved IEA yields, and thus NIM, since 2015. The cost-to-income ratio (CIR) surged in 2012-2013 as operating profits shrunk and banks spent more on IT development. CIR slightly reduced in 2014 and we expect CIR continued to fall on account of better cost control and strong top-line growth driven by interest and fee income.

Figure 58: Sector-wide NIM and CIR



Source: VNDIRECT

Credit growth is accelerating once again but credit quality is better than in the previous credit up-cycle

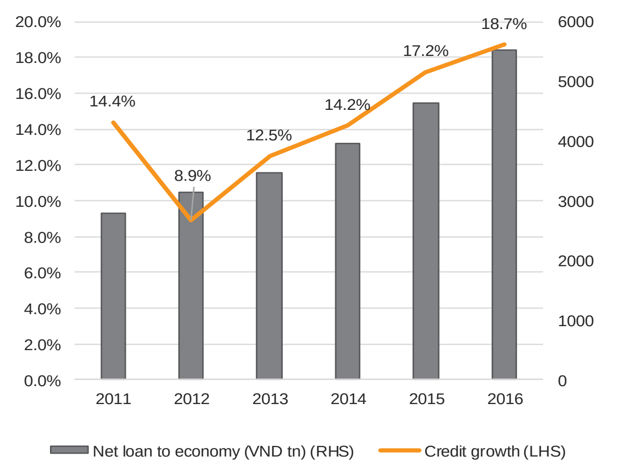
Vietnam's credit growth has started accelerating again since 2013, driven by a combination of (1) overall improvement in economic growth led by strong FDI inflows, (2) an effective de-dollarization campaign and (3) much lower inflation, all of which taken together have propelled business sentiment and consumer confidence to new highs.

We believe Vietnam might be able to pursue 16% - 18% credit growth during 2018-2019 based on the following factors:

- Credit growth has recently been driven more by private businesses and consumers, both of which still have ample room to grow. Consumer and small-business confidence remains high and credit penetration in these segments is still low by international standards.
- Broad-based economic growth, policy focus and banks' own strategic re-orientation should support SME credit appetite; Examples include subsidized lending rates for preferential industry sectors such as agriculture, advanced technology and certain export-oriented sectors.
- The Basel 2 implementation deadline delay to 2020 allows more time for banks to prepare themselves, implying they do not need to curb loan growth.

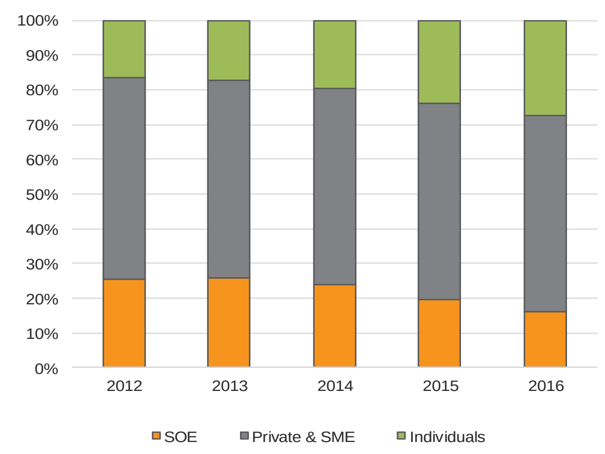
We have noticed that credit allocation to private sector enterprises and SMEs, in particular, has increased significantly in line with the Government's efforts to reduce SOE domination over the economy. This has also been driven by capital pools as well as several recent policies supporting private and SME access to credit. For banks, growing exposure to individual and private sector loans will mitigate the asset quality risk associated with SOE lending and allow banks more room to boost credit as loans to individuals carry a lower risk weighting compared with loans to the SOE segment, allowing banks to reduce the Risk Weighted Assets (RWA) and boost Capital Adequacy Ratio (CAR).

Figure 59: Credit growth has re-accelerated since 2013…



Source: VNDIRECT, Company

Figure 60: … with SOE's share of loan book on the decline



Source: VNDIRECT, Company

Credit growth to the real estate sector decelerated in 2017

According to a recent report of the National Financial Supervisory Commission, Vietnam's loan exposure to real estate and construction declined from 17.1% by the end of 2016 to 15.5% as of September 2017. Meanwhile, credit growth to the real estate sector witnessed a deceleration from ~15% in 2015 to 11.0% in 2016 and only 4.0% during the first seven months of 2017 (Source: SBV)

We believe this deceleration mainly resulted from the following factors: (1) **Circular 06 (Cir.36 amendments), which increased the risk-weighting for loans to real estate projects (primarily loans to developers)** to 200% from 150%, effective since Jan-2017; (2) **the growing appetite among banks to lend to home buyers, which cannibalized lending to developers** (real estate and construction exposure does not include home loans). This shift was primarily driven by the higher yields on loans to end-users as compared with loans to developers. The currently low yields on government bonds has, in general, sent banks out on a quest for higher yielding assets including retail loans and home loans.

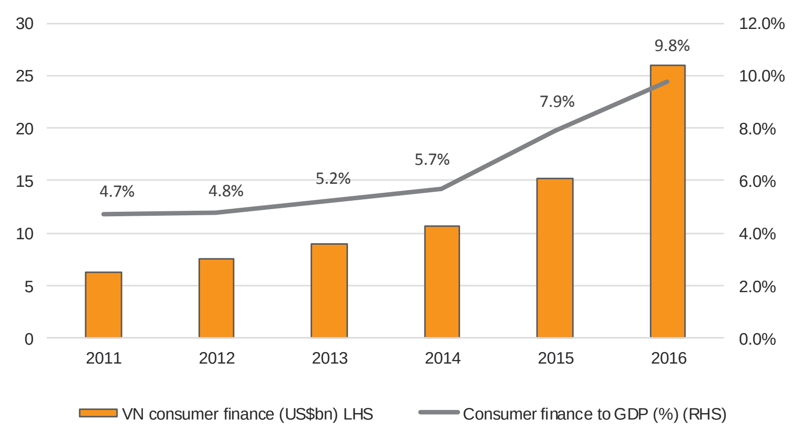
The new Cir.06 also specified a roadmap for the maximum ratio of short-term funds used for medium and long term loans to be reduced from 60% to 50% in Jan 2017 with a further drop to 40% in 2018. This would have impeded banks' ability to lend to real estate developers.

Vietnam's consumer finance market is the new growth engine: Blistering pace of growth expected to be sustained through to 2020.

Vietnam's consumer lending industry enjoyed a robust CAGR of 37.8% in terms of outstanding loans over the past 5 years. This has largely been driven by favorable demographics, increased urbanization, rising incomes, and increased levels of home, car, and durable goods ownership. A growing propensity to borrow and rising per capita disposable incomes should help to sustain this growth through 2020.

According to Stoxplus, the total system-wide consumer loan balance reached approximately US$26.6bn in 2016, an increase of 29% yoy. However, this level only represents ~9.8% of 2016 GDP, nearly 320 bps lower than the average penetration ratio for regional peers (Malaysia ~14.0%, Thailand ~13.2%). Consumer finance loans have rapidly expanded their share of the total loan book from around 5% in 2012 to 11% in 2016, becoming the new engine for overall credit growth.

Figure 61: Vietnam consumer finance loan value (US$bn) and penetration



Source: Stoxplus

According to the Economist Intelligence Unit (EIU), consumer credit is projected to sustain an average CAGR of 27% until 2020 on the back of rising incomes and the acceleration in e-commerce transaction growth. Even though the majority of e-commerce transactions today are based on a cash-on-delivery payment model, this is expensive and hence online retailers are pushing adoption of non-cash payment solutions including credit cards and e-wallets. This should boost credit card penetration, which is very low by regional standards.

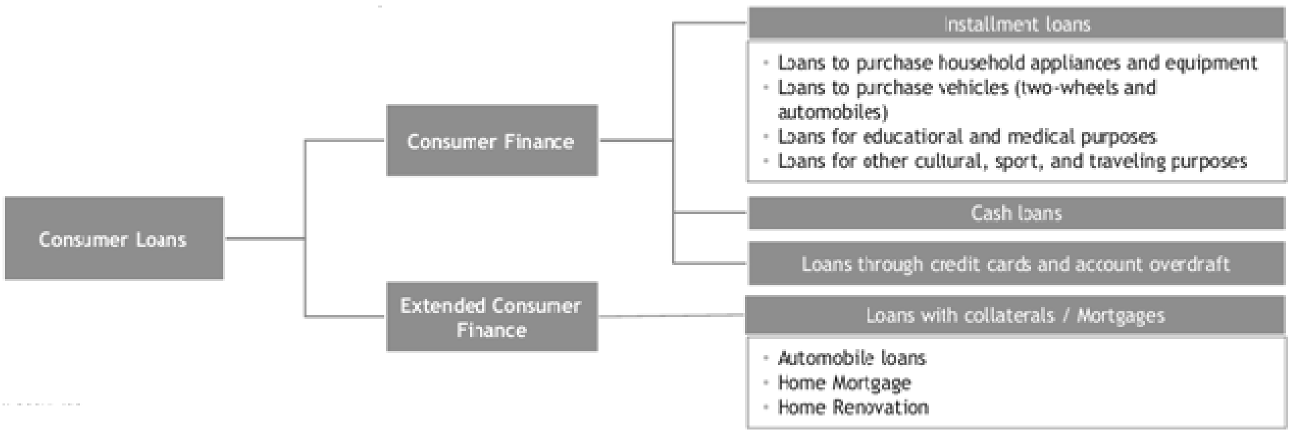
Clearer legal framework to underpin robust consumer finance growth

Commercial banks and non-bank financial companies are the two major providers of consumer loans in Vietnam. In recent years, several commercial banks have set up divisions specializing in consumer lending, though the SBV has began imposing stricter rules on consumer lending since mid-2014. Current regulations allow commercial banks to provide consumer loans only to "standard" customers (with collateral). In order to offer these loans to "non-standard" customers (non-collateralized loans), banks are required to set up separate non-bank finance companies.

In 2016, the SBV issued two important Circulars (Circular No 39/2016/TT-NHNN and Circular No 43/2016/TT-NHNN) pertaining to financing activities, including consumer finance. These regulations not only facilitate consumer finance, but they also sought to protect borrowers from taking on too much credit risk through strict requirements for publication of transparent interest rates and also by detailing loan limits. Some key points in these Circulars are summarized below:

- **Loan limit**: total loans provided by a financial company to any one borrower at any time is limited to VND100 million (~US$4400). However, this limit does not apply to consumer loans for the purchase of cars, where the car can be used as collateral.
- **Interest rate:** must be calculated on the actual loan balance with no interest rate cap. Overdue interest rate is 150% of the interest rate applicable to the underlying loan.
- **Other requirements:** Standard terms for a consumer credit contract are required. Finance companies must disclose their standard form contracts and terms across their distribution channels.
- **No restrictions on foreign ownership of consumer finance companies.**

Figure 62: Consumer lending product categories

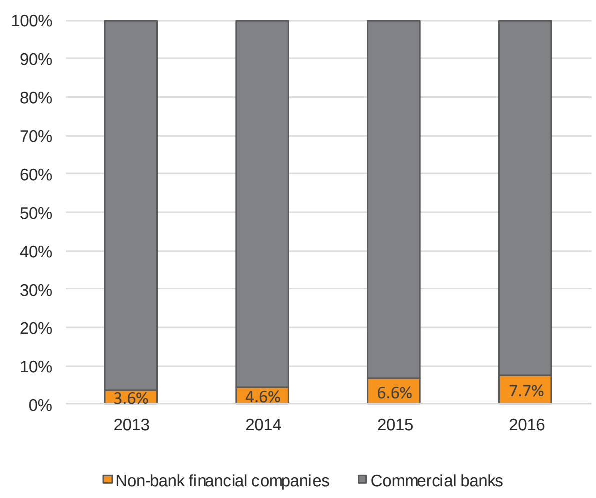


Source: Stoxplus

Competition is heating-up in the consumer finance space; a flurry of M&A deals and alliances has ensued

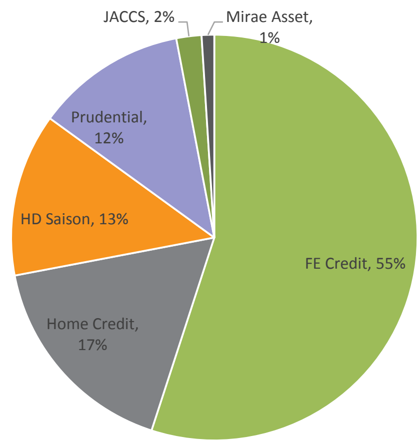
FE Credit is currently the leader in the consumer finance space with a 55% market share, and has left other finance consumer companies including HD Saison, Home Credit and Prudential Finance in the dust. These top four companies control 97% of the local consumer lending market. Although this is still a lucrative business, the market has become more competitive recently with an increasing number of participants jostling for space at the top.

Figure 63: Market share of CBs and Non-bank FCs 2016



Source: VNDIRECT

Figure 64: Market share among CF companies 2016



Source: VNDIRECT

In late 2016, MBB partnered with Shinsei Bank (Japan) to introduce a new consumer finance company, MCredit, with the ambition to leverage its strong customer database and wide sales network to cross-sell consumer finance and bancassurance products. From the beginning of 2017, MCredit started to set its footprint in the North with more than 100 POS to provide cash loans, 2-wheeler loans and durable loans.

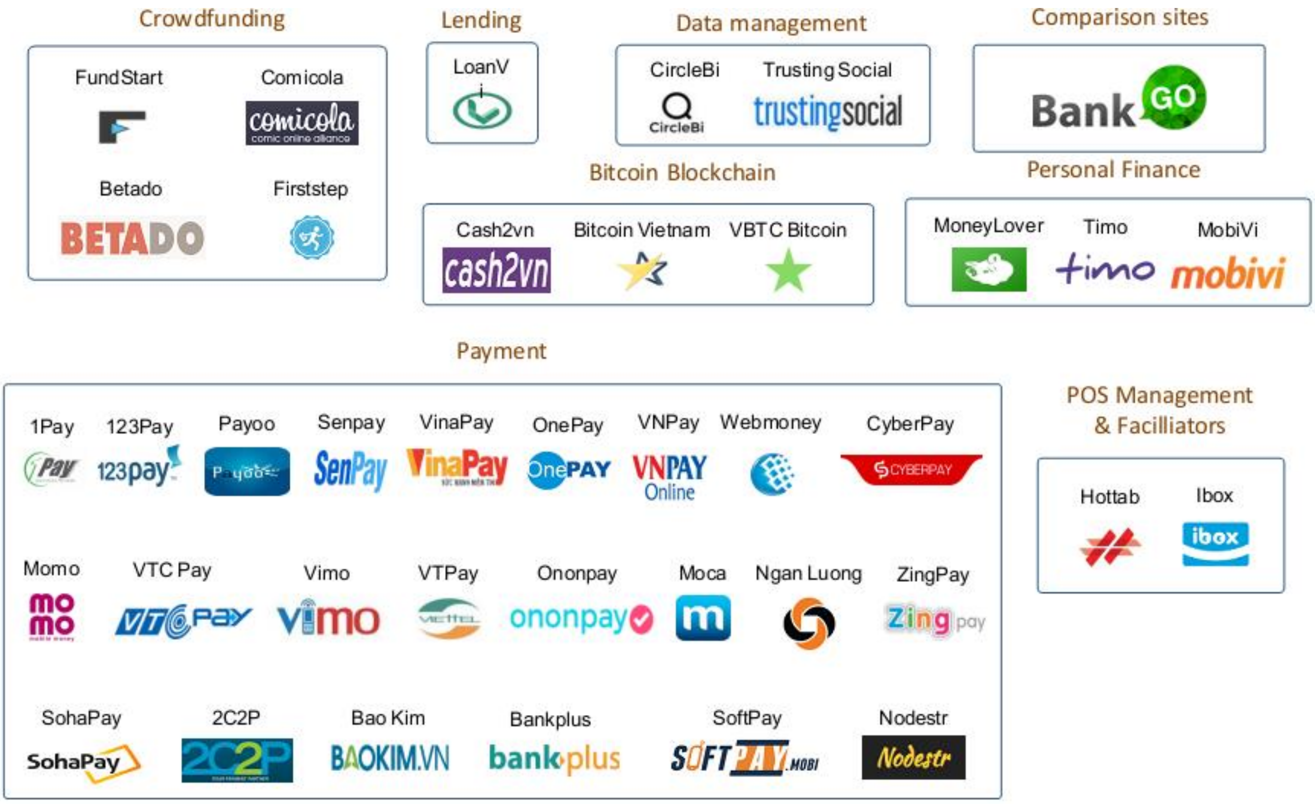
In 2015, HDBank sold a 49% stake of its financial arm, HD Finance to Japan's Credit Saison. The company was renamed as HD Saison and became the third largest consumer lender with a 13% market share by 2016. Recently, in Jan 2017, HD Finance got a capital injection to boost charter capital from VND550bn to VND800bn.

Techcombank also bought a non-bank financial company in 2015 and renamed it TechcomFinance, but it has seen no noticeable activity so far. On September 26th this year, Techcombank announced the 100%-stake transfer of TechcomFinance in a deal worth VND1,734bn to Lotte Card, a subsidiary of Lotte Group.

Fintech companies have recently emerged as a new threat to traditional lenders

In 2017, Vietnam's banking sector also seen the emergence of several fintech startups which provide digital banking, payment solutions, peer-to-peer loans and day loans. They are also trying to enter the market by using digital channels to target the unbanked population and boosting efficiency through the application of technology to the lending business. The majority of fintech companies in Vietnam are focusing on mobile payments, with only a few participants focused on lending activities but this is likely to change in the future as the booming consumer finance space attracts more fintech players. Using advanced data-driven credit-scoring systems, automatic and fast loan approval processes and their wide reach through digital channels, fintech companies might well emerge as a future threat to both consumer finance companies and commercial banks.

Figure 65: Vietnam's fintech landscape



Source: Fintech VN 06/2017

However, we have observed that some traditional banks are applying technology faster than others and quickly grabbing the opportunities created by fintech to improve customer experience. On August 2015, VPBank, in partnership with Global Online Financial Solution Company, launched Vietnam's first fully digital bank – TIMO – with impressive initial features, including the following: versatile account management, mobile top-ups, money transfers and bill payment, money management, term deposit and loans. Another player, TPBank, has set a target to become the best digital bank in Vietnam. The bank has launched "LiveBank" – an automatic transaction office that is open 24/7 and provides all the basic bank services using Video Teller Machines, with no human teller on site. Earlier this year, Vietinbank (CTG) deployed a QR code payment to benefit its customers on the Vietinbank iPay mobile apps.

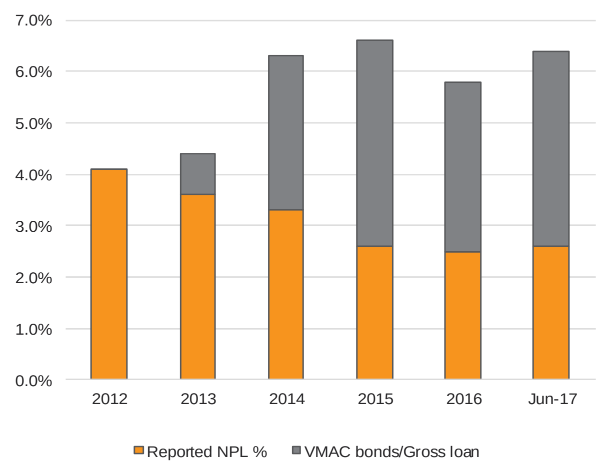
New policy measures to improve bad-debt handling process and recovery rates

Led by stronger loan growth, the system-wide reported NPL ratio rose to 2.9% in June 2017 from 2.6% at the end of 2016. Currently, NPLs clearing still relies on repayment by customers and internal resolutions, which hurt the banks' profitability.

For the first seven months of 2017, around VND45 trillion of system-wide bad debts were resolved. 31.7% of these loans were transferred to VAMC, 26.3% were addressed through the banks' write-offs, and 33.6% were recovered through repayments from borrowers. Meanwhile, the liquidation of collateral is still a challenge accounting for only 1.5% of total bad debt clearance. Around 15% of accumulated NPLs which VAMC bought since 2014 have been cleared so far. VAMC cleared NPLs by liquidating collateral or selling bad debt to other financial institutions.

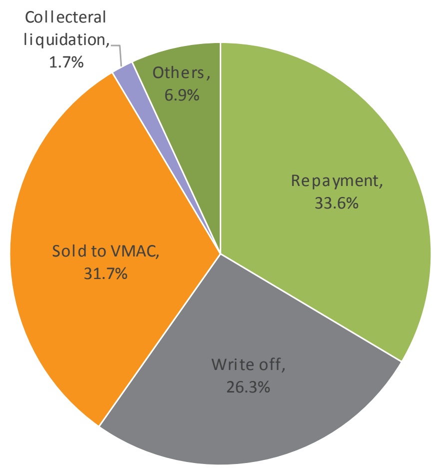
In the past, both the banks' collateral liquidation and VAMC's bad debt clean-up have been limited by the lenders' right to seize collateral property and the ability to sell bad debt at market prices. New resolutions introduced in August of this year could potentially address these bottlenecks.

Figure 66: System-wide reported NPL% and VAMC bonds %



Source: VNDIRECT, Company

Figure 67: Bad debt handling by method in 7M2017



Source: VNDIRECT, Company

This August, the Government issued Resolution 42/2017/QH14 on piloting bad debt settlement of credit institutions to provide thorough guidance on the procedures for recovery and repossession of collateral. Six commercial banks including VCB, CTG, BID, Agribank, STB and ACB have been selected to pioneer the application of this Resolution. The new legal framework confers lenders with more power in collecting collateral which could be considered as the first critical step to resolve legacy assets. The new legal framework also provides incentives to encourage NPLs trading, as it provides liquidity and helps price the assets through market mechanisms. It also sets a framework for a secondary debt trading market, which is high on the wish list of both foreign and domestic investors.

VAMC took serious measures to accelerate its debt collection, with a successful case seen one month after the activation of Resolution 42. In Sep 2017, VAMC seized Sai Gon One Tower, an asset mortgaged for VND7,000 of bad debt, which Maritime Bank (MSB) and Dong A Bank (DAB) transferred to VAMC in April 2015.

We believe the new resolution has removed previously existing legal impediments and that it will hasten the bad debt clean-up progress.

In addition, various banks, including VCB, MBB, CTG and VIB, have started to repurchase bad debt from VAMC to handle them in-house, signaling an improvement in their financial capacities and confidence in the new policy measures to streamline bad debt recovery.

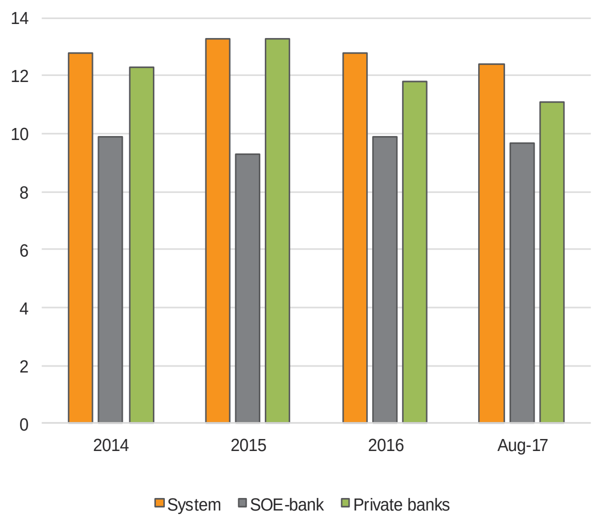
Major recapitalization is still a pressing need

Although Basel II will be implemented in 2020, continued strong credit growth will deplete capital and exacerbate banks' weak internal capital generation. Our bottom-up analysis indicates that Vietnamese banks need to raise about US$7.9bn in aggregate capital (including Tier-1 and Tier-2 capital), which translates into a system-wide need for US$5.5bn of equity capital in order to comply with Basel II standards. Banks also have to maintain a satisfactory ~12% CAR to support banks' continued high credit growth into FY17-18.

Under Basel II, a bank's capital base consists of both Tier I capital (equity) and Tier II capital (long-dated, subordinated debt). The Basel II rules stipulate that the amount of a bank's Tier II capital should be capped at 50% of its Tier I capital, but in Vietnam's case, we have made the assumption that the sector-wide figure will realistically be constrained to about 30%, given the difficulty that smaller banks will have in convincing investors to buy their long-dated debt. This assumption is the basis for our estimate that local banks will need to raise about US$7.9bn of capital in aggregate, and that US$5.5bn of this will be in the form of equity.

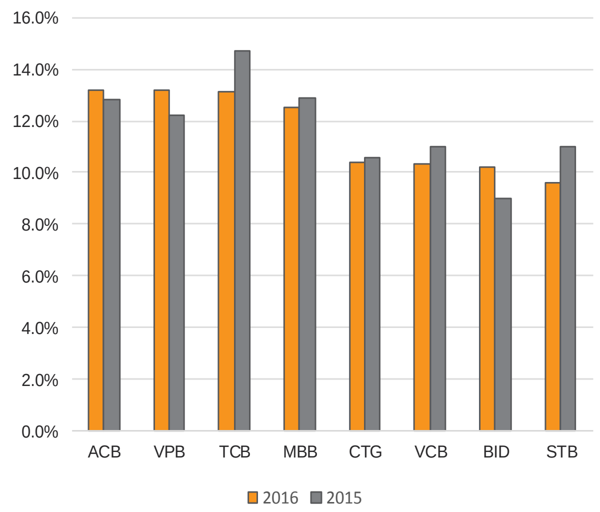
However, higher FOLs will mitigate the under-capitalization risk and continued strong foreign investor appetite for Vietnamese banks is positive in this regard. Although the process of lifting FOLs might be slow, we believe this topic will move to center stage, as the Government continues to use credit growth as a means to achieve economic targets.

Figure 68: System-wide CAR (*)



Source: VNDIRECT

Figure 69: CAR by major bank



Source: VNDIRECT

(*) System-wide CAR includes CAR of SOE-banks, private banks, foreign banks and financial companies. Foreign banks and financial companies have much higher CAR than SOE and private banks.

BANKING SECTOR STOCK PICKS: WE LIKE VPB, MBB AND LPB

Figure 70: Sector comparative multiples (price as of 22 December 2017)

Banks	Ticker	Market cap (VND bn)	ROA FY16	ROE FY16	P/B FY17	P/E FY17	P/B FY18	P/E FY18
Vietcombank	VCB	182,767	0.9%	14.7%	3.5	25.3	3.2	20.3
Vietinbank	CTG	83,032	0.8%	11.8%	1.3	11.9	1.2	11.4
BIDV	BID	81,536	0.7%	14.4%	1.7	16.6	1.5	14.3
VPBank	VPB	60,495	1.9%	25.8%	2.2	8.8	1.7	8.7
Military Bank	MBB	45,842	1.2%	11.6%	1.6	13.5	1.4	10.5
Asia Commercial Bank	ACB	34,112	0.6%	9.9%	2.2	19.4	1.9	12.5
Vietnam International Bank	VIB	12,415	0.6%	6.5%	1.8	20.9	1.6	18.3
Lienviet Post Bank	LPB	9,402	0.9%	13.3%	1.0	6.6	0.8	6.0
Average		**63,700**	**0.9%**	**13.5%**	**1.9**	**15.4**	**1.7**	**12.7**
Median		53,168	0.8%	12.6%	1.7	15.0	1.6	12.0

Source: VNDIRECT, Bloomberg

We are generally positive on the banking sector, but believe that each bank has its on unique combination of challenges and opportunities. We like banks with the following key characteristics: (1) good exposure to and good capability to capture the opportunities arising from retail banking, digital banking, consumer finance and fintech; (2) better capitalized and/or having a relatively good chance of being re-capitalized in the future; and (3) trading at a discount to the sector average. The three banks in our view that meet all the above criteria are VPB, MBB and LPB.

VPB: Making a timely bet on the recent consumer lending boom in Vietnam, VPB has realized exceptional growth (FY12-16 CAGR of 51% in net profit and 22% in total assets) and impressive returns on capital in recent years (FY16 ROA of 1.9% and ROE of 24.8%), the latter being the highest among local peers and impressive even in a regional context. The bank's sound business model and aggressive focus on technology changes allow VPB to capture the "sunrise" segments of the banking sector, including digital banking, micro SME banking and Fintech. Besides, VPB is well capitalized with current non-Basel II CAR and Basel II CAR of 16.7% and 13.5%, respectively, which will allow the bank to maintain robust loan growth in the future. VPB is trading at a FY18 P/B of 1.7x and FY18 P/E of 8.7x, which is a 3.2% premium to the industry average P/B but a 32.0% discount to the industry average P/E. We think that VPB should trade on earnings more so than book because of its industry-leading return on equity.

MBB: We believe that MBB is better equipped to capture growth than ever for the following reasons: (1) above average CAR of 11.4% and low LDR of 69.3% (as of 3Q2017) should support loan growth of ~18% in the next two years; (2) nearly fully provisioned for VAMC bonds ensure tapering off of VAMC provisions in the coming years (3) the bank's recent strong push, under its new dynamic CEO, into retail banking (intention to acquire PG Bank to expand its retail network, launch bancassurance) will allow the bank to expand NIM. We also think that MCredit, MBB's new consumer finance arm, is interesting. Though a "newbie", MCredit gives MBB a foothold in a high growth segment of the banking industry in Vietnam. At the current price, MBB is trading at a P/B of 1.6x, lower than the industry average of 1.9x.

LPB: This newly-listed bank has sound fundamentals but is trading at a deep discount to peers, which we believe is unwarranted. Compared to peers, LPB has a high ROE, strong capital buffer and good asset quality as reflected in its low NPL and high provisioning buffer. In addition, LPB has some distinct competitive advantages over other retail banking peers, such as a large network and low cost of funds, which will be key in pursuing retail lending expansion. LPB is currently trading at 1.0x P/B, which is a large discount versus industry average of 1.9x.

Keep an eye on upcoming listings

We believe investors who seek a high return in banking sector should keep an eye on upcoming listings in 2018, as there are some promising names in the pipeline.

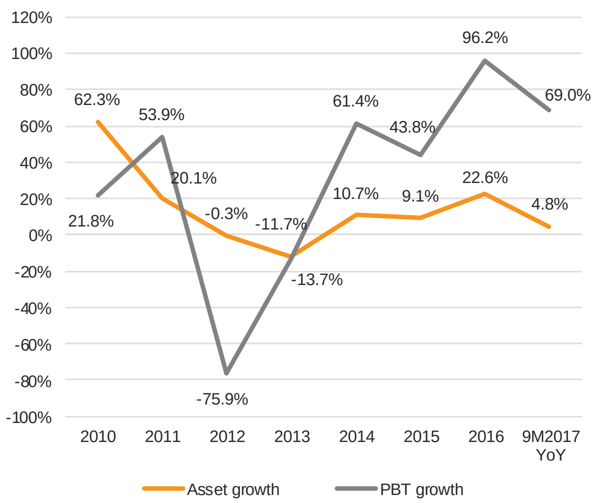
Techcombank (TCB) – a fast-growing retail lender with a solid technology core and diversified income mix

Founded in 1993, TCB is ranked 8th in terms of total assets and 7th in term of book value of equity. TCB is known for being a tech-savvy bank and a pioneer in providing online savings, online bill payments, and supply chain financing. A modern core banking system allows the bank to develop new products with a high level of customization to meet the special needs of different customer groups. As a result, TCB has the largest non-interest income franchise among the listed banks: non-interest income accounted for 38.8% of total operating income at TCB, versus the only 18% on average for peers.

TCB has heavy exposure to real estate loans, which has helped it to accelerate its loan growth on the back of the property market upcycle in recent years. TCB's bad debts recoveries jumped by 9.5 times in 2015 and 1.7 times in 2016. TCB is currently in a robust growth phase as the bank has fully provisioned for VAMC bonds and its non-interest income is soaring thanks to income from bancassurance and securities trading.

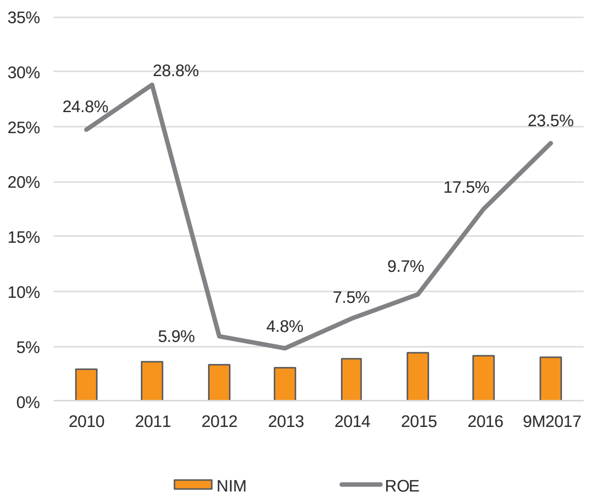
TCB is also one of the most profitable among listed banks. It ranks third after VPB and MBB in terms of NIM, and second only after VPB in terms of ROE. TCB charges high interest rates, but its cost of funds is lower than the peer average thanks to a high CASA ratio of 25.7%. However, NIM has contracted slightly in recent years due to higher cost of funds as TCB raised short-term deposit rates given more competition in fund mobilization TCB is currently trading at an OTC price at ~VND59,000 per share, translating to a P/B of 2.2x.

Figure 71: TCB's profit growth has recovered strongly



Source: VNDIRECT

Figure 72: TCB's ROE has improved despite NIM compression



Source: VNDIRECT

HDBank (HDB) – the third largest player in consumer finance

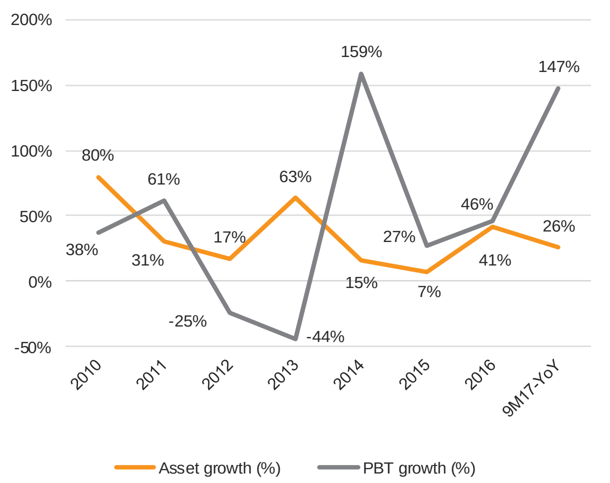
HDB is a mid-sized bank, ranking 12th in terms of assets and with a top-notch management team. The bank's Chairwoman, Ms. Le Thi Bang Tam, is also Chairwoman of Vinamilk. Vice chairwoman, Ms. Nguyen Thi Phuong Thao, is the vice chairwoman and CEO of Vietjet. The bank was established in 1989 and was equitized in 1992, but its performance was only modest until 2013, when it acquired DaiA Bank and Société Générale Viet Finance Company.

The acquisition of a bank and a finance company proved to be very strategic moves for HDB, fuelling rapid growth with a CAGR of 68.4% in pre-tax profit during FY13-16. HDB also became one of the first players in the Vietnam consumer finance market by acquiring Société Générale Viet Finance Company, which was later renamed to HDFinance. In 2015, HDBank sold a 49% stake in HDFinance to Credit Saison, a Japanese financial services company, to set up HD Saison.

As of 9M2017, HD Saison was the third largest consumer lender in Vietnam, with a 13% market share, contributing 10.4% to HDBank's consolidated pre-tax earnings. HDB's NIM and ROE are rising on the back of high-yield lending by HD Saison and retail lending expansion at the parent bank.

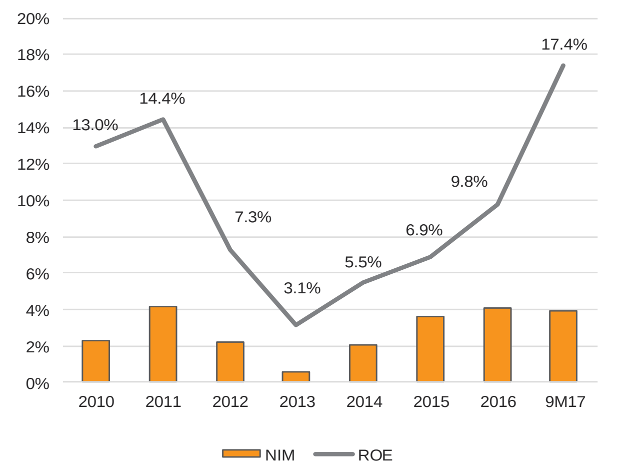
HDB recently increased its capital from VND8,100bn to VND9,810bn by issuing a 7% stock dividend, 2% stock bonus and 12% private placement. On 25 December 2017, the Ho Chi Minh Stock Exchange approved for HDB to list 981 million shares on HOSE, or a 100% stake of the bank. The bank also got approval from shareholders to increase its capital further to VND10,000bn by issuing ESOP in the beginning of 2018. We expect that the bank will list in January 2018. HDB is currently trading on the OTC market at a price of VND32,000 per share, translating to a P/B of 2.3x.

Figure 73: HDB has seen strong profit growth after acquiring DaiA Bank and HD Finance in 2013



Source: VNDIRECT

Figure 74: HDB's NIM and ROE are rising



Source: VNDIRECT

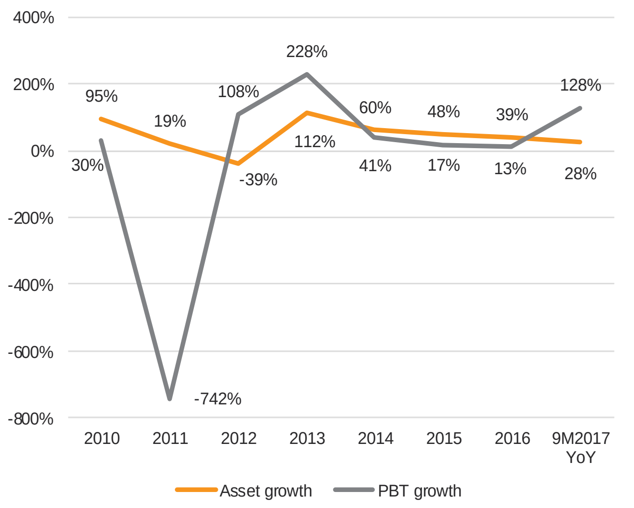
TPBank (TPB) – strong technology with clear priority to digitalize

Established in 2008, TPB is currently ranked 16th in terms of total assets and the 21st in terms of owner's equity. The major shareholders of TPB before restructuring were FPT, MobiFone, Vietnam National Reinsurance Corporation (Vinare), and SBI VEN Holdings. TPB was put on the list of banks that needed to be restructured by SBV. In 2012, new investors, including DOJI Gold & Gems Group (DOJI) and some other investors, entered and began to restructure the bank.

The turnaround strategy was successful as TPB became profitable again in 2012 and sustained a CAGR of 22.8% in its pre-tax profit during 2013-2016. The company acknowledged the disadvantage of its small network of only 66 branches and transaction offices, and instead chose to focus strongly on marketing activities via advertisements on television, online channels and other channels. In addition, TPB is well-known for technology innovation, as evinced in the introduction of TPBank LiveBank, an automatic transaction office that opens 24/7 and provides all the basic bank services using a Video Teller Machine.

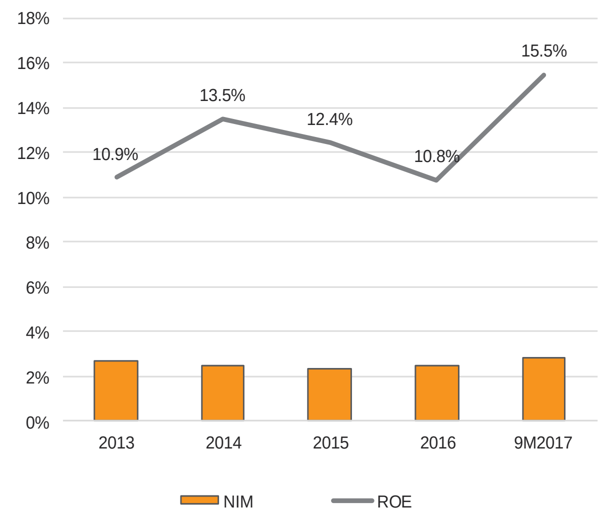
TPB is currently trading on the OTC market at VND25,000 per share, translating to a P/B of 2.0x.

Figure 75: TPBank returned to profitability after ownership changes in 2012



Source: VNDIRECT

Figure 76: TPBank's NIM and ROE have surged recently due to higher utilization of funds and improving asset yields



Source: VNDIRECT

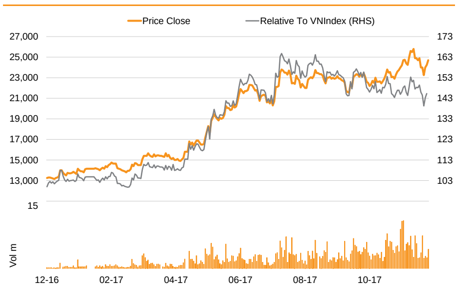
MILITARY COMMERCIAL JSB (MBB)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND25,250	VND27,700	2.38%	ADD	FINANCIALS

Outlook – Short term	Outlook – Long term	Valuation
Negative Neutral Positive	Negative Neutral Positive	Negative Neutral Positive

Hien Tran Khanh
hien.trankhanh@vndirect.com.vn
Thuy Le Minh
thuy.leminh@vndirect.com.vn

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	25,850
52w low (VND)	12,011
3m Avg daily volume (shares)	4.7mn
3m Avg daily value (VNDmn)	109,279
Market cap (VNDbn)	45,842
Outstanding shares (m)	1,816
Free float (%)	20
P/E TTM	14.4x
P/B	1.6x

Poised for strong growth as the current provisioning cycle is tapering off.

The bank's continued focus on retail lending paid off, and resulted in a strong increase in its NIM. With a high CASA rate of 36.9%, MBB continues to enjoy low funding costs while individual loan book grew 27.5% versus year-end 2016 balance pushed its NIM from 3.6% to 4.2%. Individual loans accounted for 32.6% of the total loan book, lower than the 50% weight in ACB, another bank that strongly focuses on retail. We believe that there is still headroom to expand retail lending, and that its NIM will continue to rise.

High profit growth forecasted for 2018 and 2019 as MBB reaches the end of the current provisioning cycle. The bank's 43.5% PBT growth in 9M2017 allowed MBB to speed up bad debt provisioning. MBB actively provisioned for VAMC bonds over 9M2017 to buy back all VAMC bonds in 2018, in line with the plan set out in its 2017 AGM. We estimate that 77% of outstanding VAMC bonds will be provisioned for by the end of 2017, thus VAMC provision expenses will drop in 2018. Although we modelled for more provisioning for loans on the balance sheet, a reduction of VAMC provision expense in 2018 and zero VAMC provisioning in 2019 will boost bottom line growth.

Healthy capital and loan-to-deposit position ensures high loan growth in the coming years. With a CAR of 11.4% and a LDR of 69.3% in 3Q2017 as per our estimates, MBB can sustain 18% loan growth in the next two years.

The bank's consumer finance business is still small but has good earning potential. MCredit - MBB's consumer finance subsidiary just started operation in 2017 but it has made profit and outstanding loans reached VND1,000bn. We think this business has high potential due to its very high yields and the underserved consumer finance market.

We issue an ADD recommendation for MBB on account of good fundamentals and attractive valuation. At the current price, MBB is trading at a P/B of 1.6x, lower than the industry average of 1.9x. We forecast 39.3% and 28.8% growth in its profit before tax (PBT) for 2017 and 2018, respectively. The bank's forward P/B for these years is only 1.6x and 1.4x, respectively. We increase our target price to VND27,700**,** which presents an 12.1% total stock return.

Ownership

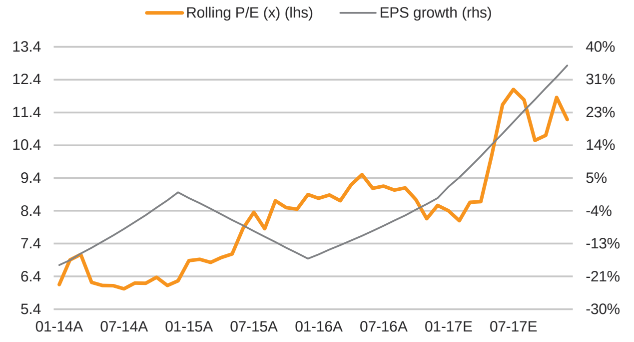
Viettel	14.75%
SCIC	9.83%
Vietnam Helicopter Corporation	7.84%
Tan Cang Saigon	7.52%
Vietcombank	6.97%
Others	53.09%

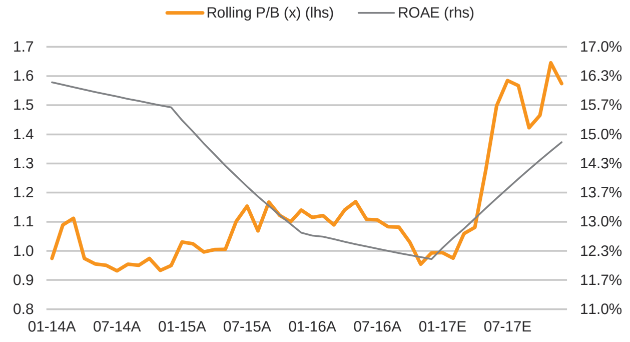
Source: VNDIRECT

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net interest income (bn)	7,319	7,979	10,753	12,440
Net interest margin	3.7%	3.5%	4.2%	4.3%
Total operating income (bn)	8,772	9,855	13,478	15,516
Total provision charges (bn)	(2,102)	(2,030)	(2,868)	(2,450)
Net profit (bn)	2,496	2,912	3,990	5,140
Net profit growth	0.8%	16.7%	37.0%	28.8%
Adjusted EPS	1,395	1,390	1,877	2,406
BVPS	12,808	14,097	15,690	17,921
ROAE	12.7%	12.1%	14.8%	16.8%

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net interest income	**7,979**	**10,753**	**12,440**
Non interest income	**1,876**	**2,724**	**3,076**
Total operating income	**9,855**	**13,478**	**15,516**
Total operating costs	(4,175)	(5,526)	(6,517)
Pre-provision operating profit	**5,681**	**7,952**	**8,999**
Total provision charges	**(2,030)**	**(2,868)**	**(2,450)**
Income from associates & JVs			
Net other income			
Pre-tax profit	**3,651**	**5,084**	**6,549**
Taxation	(767)	(1,068)	(1,376)
Profit after tax	**2,884**	**4,016**	**5,173**
Minority interests	28	(26)	(33)
Net profit	**2,912**	**3,990**	**5,140**

	12-16A	12-17E	12-18E
Growth rate (yoy)			
Cust deposit growth	7.3%	13.0%	13.0%
Gross cust loan growth	24.2%	20.0%	18.0%
Net interest income growth	9.0%	34.8%	15.7%
Pre provision operating profit growth	6.7%	40.0%	13.2%
Net profit growth	16.7%	37.0%	28.8%
Growth in IEAs	16.2%	12.6%	12.2%
Share value			
Basic EPS (VND)	1,635	2,208	2,831
BVPS (VND)	14,097	15,690	17,921
DPS (VND)	600	600	600
EPS growth	(0.4%)	35.1%	28.2%

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Gross loans to customers	150,738	180,885	213,445
Loans to banks			
Total gross loans	**150,738**	**180,885**	**213,445**
Securities - total	55,833	56,112	56,673
Other interest earning assets	37,009	37,194	37,566
Total gross IEAs	**243,579**	**274,191**	**307,683**
Total provisions	**(3,671)**	**(4,004)**	**(4,540)**
Net loans to customers	**148,687**	**178,511**	**210,550**
Total net IEAs	**239,908**	**270,187**	**303,144**
Cash and deposits	1,520	1,611	1,740
Total investments	991	1,051	1,135
Other assets	13,839	14,669	15,843
Total non-IEAs	**16,351**	**17,332**	**18,718**
Total assets	**256,259**	**287,519**	**321,862**
Customer deposits	194,812	220,138	248,756
Cds outstanding	2,367	4,367	6,367
Customer interest-bearing liabilities	197,179	224,505	255,123
Bank deposits	0	0	0
Broad deposits	197,179	224,505	255,123
Other interest-bearing liabilities	24,971	24,976	24,982
Total IBLs	**222,151**	**249,481**	**280,104**
Deferred tax liability			
Other non-interest bearing liabilities	7,520	8,242	7,911
Total non-IBLs	**7,520**	**8,242**	**7,911**
Total liabilities	**229,670**	**257,723**	**288,015**
Share capital	17,127	18,155	18,155
Additional paid-in capital	0	0	0
Treasury shares			
Retained earnings reserve	4,699	6,805	10,855
Other reserves	3,525	3,525	3,525
Shareholders' equity	**25,352**	**28,485**	**32,536**
Minority interests	1,236	1,311	1,311
Total equity	**26,588**	**29,796**	**33,846**
Total liabilities & equity	**256,259**	**287,519**	**321,862**

Key ratios

	12-16A	12-17E	12-18E
Net interest margin	3.5%	4.2%	4.3%
Cost-income ratio	(42.4%)	(41.0%)	(42.0%)
Reported NPLs / gross cust loans	1.3%	1.2%	1.1%
Reported NPLs / net cust loans	1.3%	1.2%	1.1%
GP charge / average cust loans	1.5%	1.7%	1.2%
Total CAR	12.5%	11.9%	11.2%
Loan deposit ratio	76.4%	80.6%	83.7%
Margins and spreads			
Return on IEAs	6.9%	7.5%	7.7%
Cost of funds	3.6%	3.6%	3.7%
Interest return on average assets	3.3%	4.0%	4.1%
ROAE	12.1%	14.8%	16.8%

Source: VNDIRECT

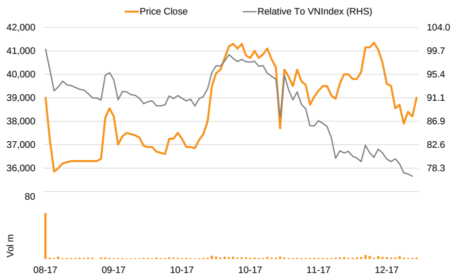
VIETNAM PROSPERITY JSCB (VPB)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND40,400	VND53,400	0.0%	ADD	FINANCIALS

Outlook – Short term	Outlook – Long term	Valuation
Negative / Neutral / Positive	Negative / Neutral / Positive	Negative / Neutral / Positive

Hien Tran Khanh
hien.trankhanh@vndirect.com.vn
Thuy Le Minh
thuy.leminh@vndirect.com.vn

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	41,500
52w low (VND)	35,850
3m Avg daily volume (shares)	1.3mn
3m Avg daily value (mn)	52,166
Market cap (bn)	60,495
Outstanding shares (m)	1,497
Free float (%)	74
P/E TTM	9.6x
P/B	2.3x

Ownership

Mr. Ngo Chi Dzung	14.6%
Mr. Bui Hai Quan	7.3%
Mr. Lo Bang Giang	2.5%
Others	75.6%

Source: VNDIRECT

At the forefront of the consumer finance revolution

Initiate with an ADD rating. We initiate coverage on VPB with an ADD rating and target price of VND53,400. The target price implies a FY18 P/B of 2.3x and FY18 P/E of 11.2x. Our rating is underpinned by (1) the bank's sound business model and aggressive focus on the high-potential retail and SME segments; (2) the bank's ability to capture the huge opportunity in a number of high-potential sunrise segments of the banking industry in Vietnam including consumer finance, digital banking, micro SME banking and Fintech; and (3) an attractive relative valuation on a P/E basis which we think is more relevant than a P/B ratio given VPB's standout ROE.

A top retail lender with exceptional growth and returns on capital. The bank enjoyed a FY12-16 CAGR of 51% in net profit and 22% in net assets. VPB has now entered the pantheon of the top 5 commercial banks in terms of profitability with industry-leading ROA of 1.9% and ROE of 24%.

The 800-pound gorilla in the sunrise consumer finance sector. Making a timely bet on the recent consumer lending boom in Vietnam, FE Credit – VPB's 100%-owned consumer finance subsidiary – became the leading market player with 48.4% market share in FY16 and solid PBT growth of 53%.

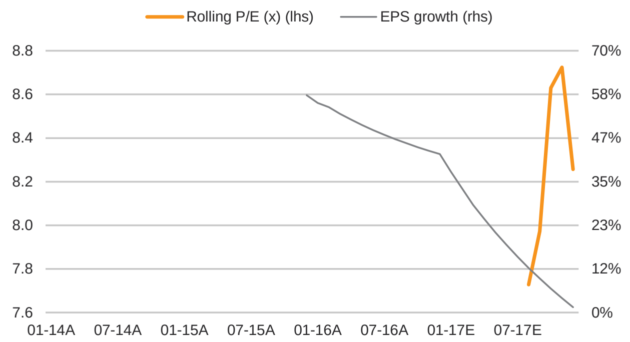
Well equipped to ride consumer lending growth while managing risk. VPB has the following advantages over competitors: (1) It is well capitalized with current CAR (non-Basel II) and CAR (under Basel II) of 16.7% and 13.5%, respectively, which will allow the bank to maintain robust loan growth; (2) A more aggressive bad debt write-off policy to help withstand the rise in NPLs expected due to the continued foray into higher-risk consumer lending activities; (3) Superior risk management capabilities powered by technological innovation helps pinpoint high-risk exposures and has also facilitated a gradual but progressive improvement in bad debt recoveries.

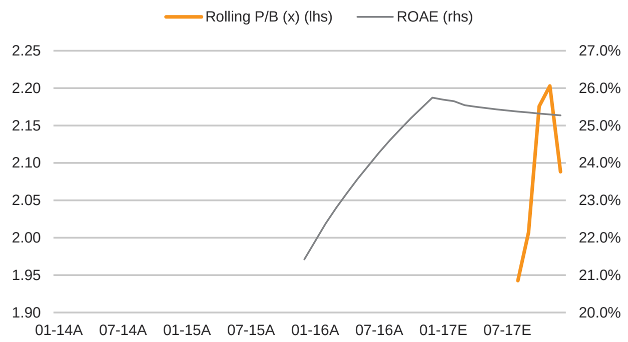
Superior ROE justifies a premium to book-based relative valuation. VPB is trading at a FY18 P/B of 1.7x and FY18 P/E of 8.7x, a 3.2% premium to the industry average P/B and 32.0% discount to the industry average P/E. This apparent discrepancy is due to the fact that VPB has a stand-out ROE among its peer group.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net interest income (bn)	10,353	15,168	20,589	25,782
Net interest margin	6.2%	7.6%	8.8%	9.4%
Total operating income (bn)	12,066	16,864	22,870	28,596
Total provision charges (bn)	(3,278)	(5,313)	(6,833)	(8,276)
Net profit (bn)	2,249	3,789	5,731	7,325
Net profit growth	91.1%	68.5%	51.3%	27.8%
Adjusted EPS	3,072	4,485	4,606	4,664
BVPS	16,619	18,710	18,676	23,339
ROAE	21.4%	25.7%	25.3%	22.6%

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net interest income	**15,168**	**20,589**	**25,782**
Non interest income	**1,696**	**2,282**	**2,814**
Total operating income	**16,864**	**22,870**	**28,596**
Total operating costs	(6,621)	(8,691)	(10,981)
Pre-provision operating profit	**10,242**	**14,180**	**17,615**
Total provision charges	**(5,313)**	**(6,833)**	**(8,276)**
Income from associates & JVs			
Net other income			
Pre-tax profit	**4,929**	**7,347**	**9,339**
Taxation	(994)	(1,469)	(1,868)
Profit after tax	**3,935**	**5,878**	**7,471**
Minority interests	0	0	0
Net profit	**3,935**	**5,878**	**7,471**

	12-16A	12-17E	12-18E
Growth rate (yoy)			
Cust deposit growth	(5.0%)	5.3%	5.2%
Gross cust loan growth	23.9%	20.6%	20.2%
Net interest income growth	46.5%	35.7%	25.2%
Pre provision operating profit growth	60.7%	38.4%	24.2%
Net profit growth	64.2%	49.4%	27.1%
Growth in IEAs	17.4%	16.6%	16.6%
Share value			
Basic EPS (VND)	4,658	4,723	4,757
BVPS (VND)	18,710	18,676	23,339
DPS (VND)	160	93	93
EPS growth	42.4%	1.4%	0.7%

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Gross loans to customers	144,673	174,484	209,769
Loans to banks	12,372	12,619	12,871
Total gross loans	**157,045**	**187,103**	**222,640**
Securities - total	59,037	64,941	71,435
Other interest earning assets			
Total gross IEAs	**216,082**	**252,043**	**294,075**
Total provisions	**(2,835)**	**(3,460)**	**(4,277)**
Net loans to customers	**142,583**	**171,887**	**206,441**
Total net IEAs	**213,247**	**248,584**	**289,798**
Cash and deposits	1,727	1,911	2,114
Total investments	250	277	306
Other assets	13,547	14,988	16,582
Total non-IEAs	**15,524**	**17,176**	**19,003**
Total assets	**228,771**	**265,759**	**308,801**
Customer deposits	123,788	130,377	137,140
Cds outstanding	48,651	69,553	97,374
Customer interest-bearing liabilities	172,438	199,930	234,514
Bank deposits	1,104	1,126	1,148
Broad deposits	173,542	201,056	235,662
Other interest-bearing liabilities	30,417	31,114	31,830
Total IBLs	**203,959**	**232,170**	**267,492**
Deferred tax liability			
Other non-interest bearing liabilities	7,635	4,258	4,653
Total non-IBLs	**7,635**	**4,258**	**4,653**
Total liabilities	**211,593**	**236,427**	**272,145**
Share capital	9,181	15,706	15,706
Additional paid-in capital	1,289	6,065	6,065
Treasury shares			
Retained earnings reserve	3,757	4,611	11,935
Other reserves	2,950	2,950	2,950
Shareholders' equity	**17,178**	**29,332**	**36,657**
Minority interests	0	0	0
Total equity	**17,178**	**29,332**	**36,657**
Total liabilities & equity	**228,771**	**265,759**	**308,801**

Key ratios

	12-16A	12-17E	12-18E
Net interest margin	7.6%	8.8%	9.4%
Cost-income ratio	(39.3%)	(38.0%)	(38.4%)
Reported NPLs / gross cust loans	2.9%	2.9%	2.9%
GP charge / average cust loans	4.1%	4.3%	4.3%
Total CAR	13.2%	16.6%	16.5%
Loan deposit ratio	83.9%	87.3%	89.4%
Margins and spreads			
Return on IEAs	12.8%	14.1%	15.0%
Cost of funds	5.5%	5.7%	6.1%
Interest return on average assets	7.2%	8.3%	9.0%
ROAE	24.8%	24.6%	22.2%

LIENVIET POST BANK (LPB)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND13,100	VND17,700	9.16%	ADD	FINANCIALS

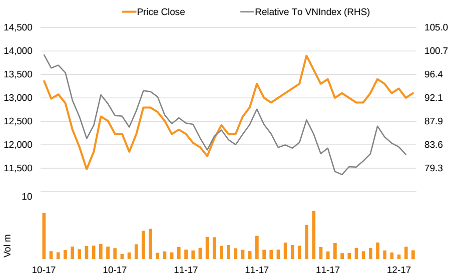
Outlook – Short term		
Negative	Neutral	Positive

Outlook – Long term		
Negative	Neutral	Positive

Valuation		
Negative	Neutral	Positive

Hien Tran Khanh
hien.trankhanh@vndirect.com.vn
Thuy Le Minh
thuy.leminh@vndirect.com.vn

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	13,900
52w low (VND)	11,381
3m Avg daily volume (shares)	2.2mn
3m Avg daily value (VNDmn)	28,448
Market cap (VNDbn)	9,402
Outstanding shares (m)	718
Free float (%)	68%
P/E TTM	6.7x
P/B	1.0x

Ownership

Vietnam Post	12.54%
Nguyen Duc Huong (Chairman)	4.95%
H.T.H Co., Ltd	4.95%
Nguyen Dinh Thang	4.31%
Khai Hung Co., Ltd	2.46%
Others	70.79%

Source: VNDIRECT

Current valuation not in sync with strong fundamentals

The bank's 61% profit growth in 9M 2017 was driven by high loan growth, improved NIM on rising asset yields and good cost controls. The bank's 19.1% loan growth and expanding NIM led to 43.1% growth in net interest income (NII). LPB's CIR dipped to 49.1%, an improvement from the 52.5% seen in 2016 and provisioning expenses growth of 24.7% trailed pre-provision profit growth of 53.2% boosted the bottom line.

NIM is expanding due to strong retail lending growth. LPB was able to increase its NIM from 3.65% in 3Q2016 to 3.83% in 3Q2017, by focusing on retail loans, especially on niche products such as pension loans and army staff loans. Given its large network of postal transaction offices, LPB is expanding its reach to rural areas and tapping into the large unbanked population in these areas to drive loan growth.

LPB's good asset quality is reflected in its low NPL ratio and high LLR ratio. As of 3Q2017, LPB was ranked 4th in terms of the lowest NPLs (at 1.19%) and third in terms of the highest LLR (at 105.3%) among listed banks in Vietnam. LPB has consistently kept its NPLs below 3%, even during the past banking crisis, despite a low annual write-off rate of only 0.1% of the average loan book.

2017 capital raising will enhance the capital buffer. LPB received approval to increase its capital by 16.1% in 2017, of which 6% was used to pay the 2016 stock dividend, 5.1% was rights issues and 5% will be ESOP. As of 3Q2017, LPB disclosed that its CAR was above 11%, and we estimate that its CAR can increase to 12% in 2017 post capital injection.

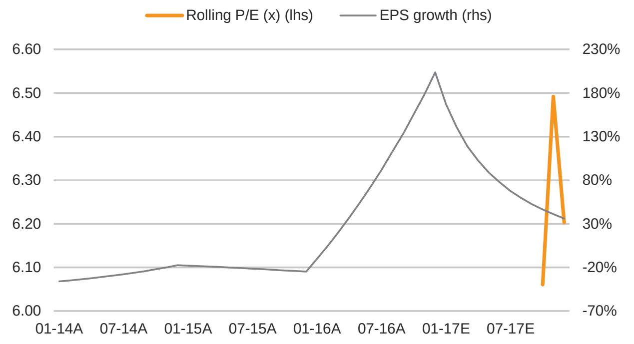
The bank's low loan-to-deposit ratio (LDR) allowed robust loan growth but headroom for loan growth is contracting. With a 45.5% LDR in 2014, LPB has aggressively pushed loan growth over the past few years, hiking its LDR up to the current level of 71.4%. As its LDR moves closer to the 80% cap, we expect that loan growth will slow but LPB can maintain 18% loan growth in 2018, in line with system-wide credit growth.

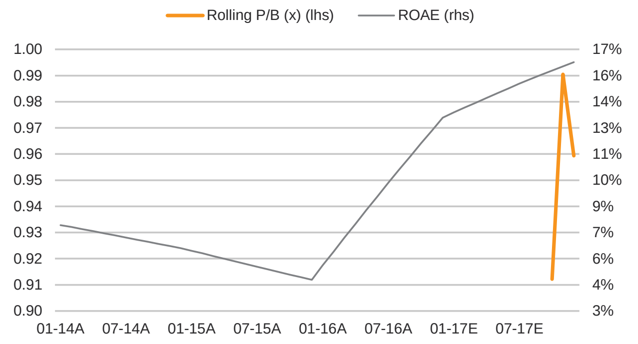
LPB trades at a discount to peers despite strong fundamentals. At the current price, LPB is trading at a P/B of 1.0x, well below the industry average P/B of 1.9x. The bank's 2017 and 2018 forward P/B are only 1.0x and 0.8x, respectively, which looks cheap relative to industry. Given its high ROE, strong capital buffer and sound asset quality, we expect that it should be traded in line with peers. We maintain our ADD recommendation and increase our target price to VND17,700, implying 35.1% upside.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net interest income (bn)	2,894	4,024	5,318	6,055
Net interest margin	3.1%	3.5%	3.8%	3.9%
Total operating income (bn)	2,488	3,872	5,263	6,019
Total provision charges (bn)	(502)	(492)	(632)	(651)
Net profit (bn)	350	1,063	1,515	1,743
Net profit growth	(25.0%)	203.8%	42.6%	15.0%
Adjusted EPS	451	1,467	1,997	2,197
BVPS	11,100	12,168	13,655	15,478
ROAE	4.7%	13.3%	16.3%	16.0%

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net interest income	**4,024**	**5,318**	**6,055**
Non interest income	**(152)**	**(55)**	**(36)**
Total operating income	**3,872**	**5,263**	**6,019**
Total operating costs	(2,031)	(2,737)	(3,190)
Pre-provision operating profit	**1,840**	**2,526**	**2,829**
Total provision charges	**(492)**	**(632)**	**(651)**
Income from associates & JVs			
Net other income			
Pre-tax profit	**1,348**	**1,894**	**2,178**
Taxation	(285)	(379)	(436)
Profit after tax	**1,063**	**1,515**	**1,743**
Minority interests	0	0	0
Net profit	**1,063**	**1,515**	**1,743**

	12-16A	12-17E	12-18E
Growth rate (yoy)			
Cust deposit growth	43.0%	13.0%	15.0%
Gross cust loan growth	41.9%	28.0%	18.0%
Net interest income growth	39.0%	32.2%	13.9%
Pre provision operating profit growth	99.1%	37.3%	12.0%
Net profit growth	203.8%	42.6%	15.0%
Growth in IEAs	40.5%	8.0%	13.5%
Share value			
Basic EPS (VND)	1,552	2,112	2,324
BVPS (VND)	12,168	13,655	15,478
DPS (VND)	450	400	500
EPS growth	203.8%	36.1%	10.0%

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Gross loans to customers	79,676	101,985	120,343
Loans to banks			
Total gross loans	**79,676**	**101,985**	**120,343**
Securities - total	34,050	34,118	35,141
Other interest earning assets	21,516	10,134	10,438
Total gross IEAs	**135,242**	**146,238**	**165,923**
Total provisions	**(1,774)**	**(2,148)**	**(2,451)**
Net loans to customers	**78,706**	**100,642**	**118,721**
Total net IEAs	**133,468**	**144,089**	**163,472**
Cash and deposits	640	643	675
Total investments	325	326	343
Other assets	7,433	7,470	7,843
Total non-IEAs	**8,397**	**8,439**	**8,861**
Total assets	**141,865**	**152,528**	**172,333**
Customer deposits	110,985	125,413	144,225
Cds outstanding	4,100	6,191	7,191
Customer interest-bearing liabilities	115,085	131,604	151,416
Bank deposits	311	2,175	1,740
Broad deposits	115,396	133,779	153,156
Other interest-bearing liabilities	15,905	6,309	5,296
Total IBLs	**131,300**	**140,088**	**158,452**
Deferred tax liability			
Other non-interest bearing liabilities	2,233	2,199	2,272
Total non-IBLs	**2,233**	**2,199**	**2,272**
Total liabilities	**133,533**	**142,287**	**160,724**
Share capital	6,460	7,500	7,500
Additional paid-in capital	0	0	0
Treasury shares			
Retained earnings reserve	941	1,810	3,178
Other reserves	931	931	931
Shareholders' equity	**8,332**	**10,241**	**11,609**
Minority interests	0	0	0
Total equity	**8,332**	**10,241**	**11,609**
Total liabilities & equity	**141,865**	**152,528**	**172,333**

Key ratios

	12-16A	12-17E	12-18E
Net interest margin	3.5%	3.8%	3.9%
Cost-income ratio	(52.5%)	(52.0%)	(53.0%)
Reported NPLs / gross cust loans	1.1%	1.1%	1.1%
Reported NPLs / net cust loans	1.1%	1.2%	1.2%
GP charge / average cust loans	0.7%	0.7%	0.6%
Total CAR	13.2%	12.0%	12.2%
Loan deposit ratio	69.2%	77.5%	79.5%
Margins and spreads			
Return on IEAs	7.7%	8.3%	8.5%
Cost of funds	4.3%	4.6%	4.8%
Interest return on average assets	3.2%	3.6%	3.7%
ROAE	13.3%	16.3%	16.0%

Source: VNDIRECT

THE REAL ESTATE BULL MARKET CAN CONTINUE FOR A COUPLE MORE YEARS

We have observed that the rate of increase in prices and transaction volume has recently declined. However, we believe Vietnam's property market still has at least two more positive years ahead of it, as we see enormous real demand in the low-to-mid range segments, as well as landed properties, which is currently not being satisfied by new supply.

Demographic shifts and repercussions of the 2008-2009 bubble have supported a sustainable recovery

Since 2014, we have noticed that buyers are increasingly able to afford real estate products, as reflected in the increase in transaction volumes. We believe this is being driven by the following major factors:

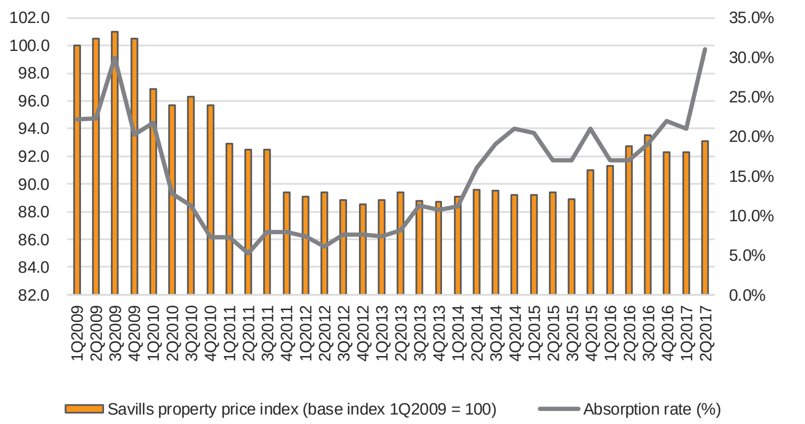
- There was a 40-50% drop in selling prices from the peak of the 2008-2009 bubble to the trough that followed
- Developers have "learnt their lessons" from the last bubble and focused on developing products that are more affordable and actually address the real needs of end-users; this is reflected in shrinking unit sizes
- Even though land prices in major urban areas are rising fast, improving infrastructure has allowed mid-range and affordable housing developers to develop housing far out from the CBD where land prices are lower; this lateral expansion has helped maintain and improve affordability of the end products
- Incomes have been rising fast, outpacing the rise in property prices
- Young couples are starting to move out of multi-generation homes; this fragmentation of households is reflected in the steady decline in the average household size over the years
- Mortgages are becoming increasingly available, and are also being offerred at more favorable rates thanks to the prevailing low interest-rate environment. Mortgage rates are currently only around 8-11%.

The bursting of the last real estate bubble led to a massive correction in prices, leaving enough room for a sustained rise

Vietnam's real estate sector has experienced three major downturns. In 2008, Vietnam's 3rd real estate bubble market was concentrated in the developer-built residential real segment, as the modest demand at this time was mainly driven by speculators rather than end-users. Most of the transactions took place in the secondary market and there was a wide spread between selling prices in the primary and secondary market, signaling the role of speculators in driving up prices as they kept buying and "flipping" property. The compelling profitability of projects attracted developers to a race to develop ever-grander projects, often heavily financing these projects through bank loans. Many developments were proverbial "white elephants" with limited utility to end-users, just serving as speculative investment vehicles.

The market was also fragmented as the barriers to entry were extremely low, which resulted in numerous small developers with equity capital of less than VND20 billion entering the market.

Figure 77: Savills property price index and absorption rate (HCMC)



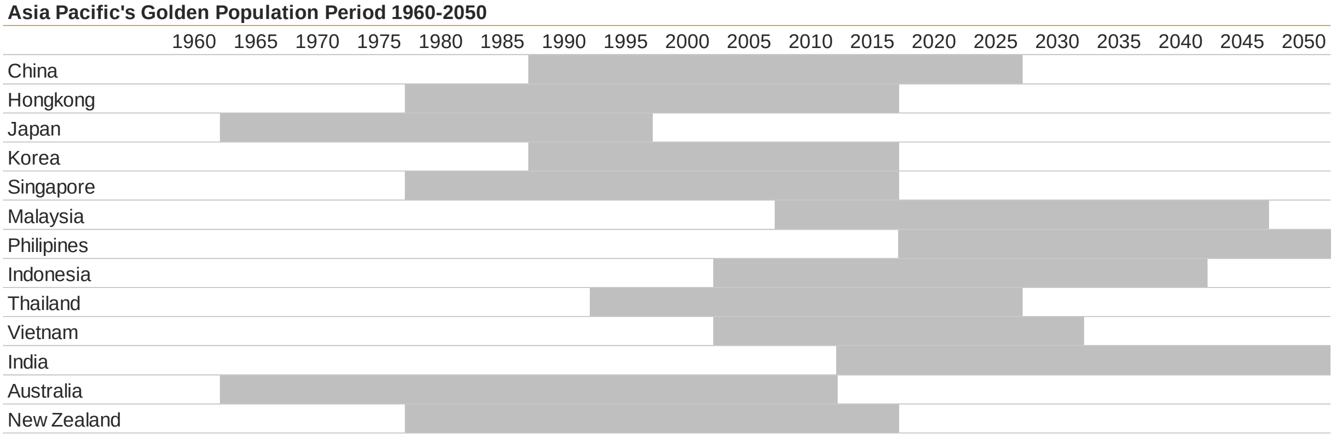
Source: Savills

High inflation, coupled with inappropriate interventions of the central bank, resulted in a rapid rise in interest rates between 2008 and 2011, which triggered the burst. Consequently, home prices later corrected substantially, particularly in the middle and high-end segments, leading to a stagnation in new housing production and scarcity of liquidity. This resulted in a sizable inventory of unfinished high-end housing stock. Average property prices dropped by 40-50% in 2013 from the peak of the 2008-2009 bubble.

During 2010-2013, NPLs to the real estate sector reached an all-time high. Many developers were in deep financial distress, which had the positive impact of weeding out many incompetent and poorly managed real estate developers from the market. Many strong developers and even newly-emerging developers began opportunistically acquiring raw land and unfinished projects from distressed companies or from banks that had seized collateral from insolvent developers that they had lent to. The deep correction in prices and the Darwinian market consolidation the followed laid the foundation for a sustained and more solid, multi-year upcycle.

Massive demographic shifts are underpinning the development of the property development

Asia Pacific's Golden Population Period 1960-2050



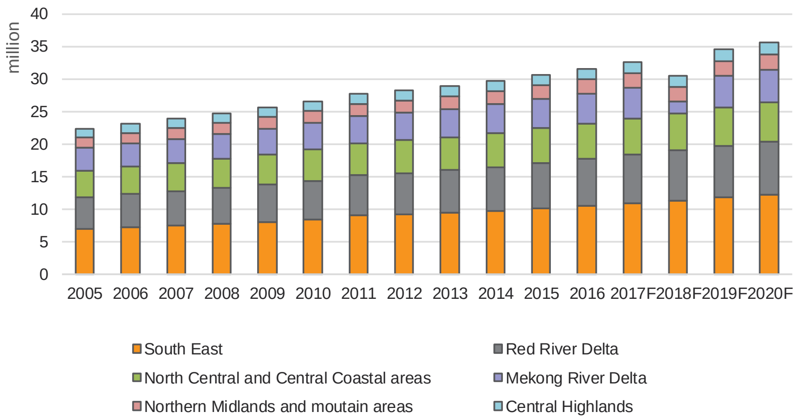
Source: Savills

The current demographic window creates enormous room for development. Vietnam's golden population period began in 2005, and so far about 50% of the total population is under 31 years old, and 70% of the total population is of a working age. A rapid fall in the birth-rate over the last few decades has helped reduce the dependency ratio in the population (dependents per working age member), generating the classic "demographic dividend" seen in many other developing Asian economies in the past.

Population growth and household formation trends have been making a key contribution to the increased demand for housing, which has been supporting the real estate market. According to the World Bank, the total number of urban households in Vietnam is projected to increase from 8.3 million in 2015 to 10.1 million in 2020. This will result in demand for 374,000 new housing units every year until 2020, on average. This increase will be driven by a projected 3.03% growth in Vietnam's urban population per annum, and a 1.1% decline in the urban household size per annum over the same period.

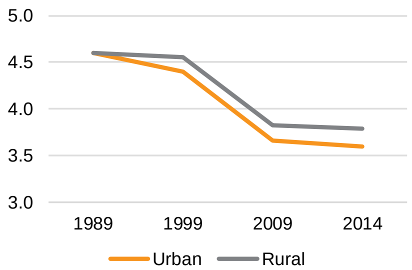
Vietnam is rapidly urbanizing. The country's urban population has grown at a CAGR of 3.5% since 2000, which is one of the highest growth rates in the region. One third of the total population currently lives in urban areas. Around 3 million more Vietnamese will move to urban areas during the next three years, according to the World Bank. The share of the urban population is expected to reach 50% of the total population by 2040, as Vietnam continues to see economic growth and industrialization which will continue to attract rural inhabitants with agricultural livelihoods to manufacturing and service jobs in urban areas.

Figure 78: Urban population by region (million people)



Source: Work Bank

Figure 79: Average household size 1989-2014



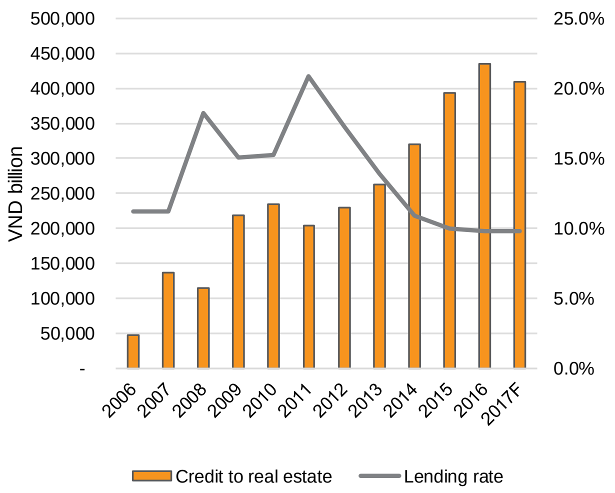
Source: Savills Vietnam

Households in Vietnam are getting smaller. In the past 20 years, there have been significant changes in the average household size in Vietnam, which has fallen from 4.7 people/household in 1995 to 3.6 people/household in 2014. There is an increased preference among young people to move out of their parents' homes in major cities, which has resulted in the fragmentation of multi-generation households and a steady decline in the average size of urban households. This shift in preferences will result in a sustained demand for affordable apartments over the next decade. Moreover, 40% of Vietnam's population is between 20-40 years old and will likely buy their own homes, which will further support this demand. The number of 3-generation family households will decline, as the younger generation begins to adopt a more independent life style. This will be favorable for the development of the condominium market in the future.

Abundant credit to the real estate sector spurred the recovery

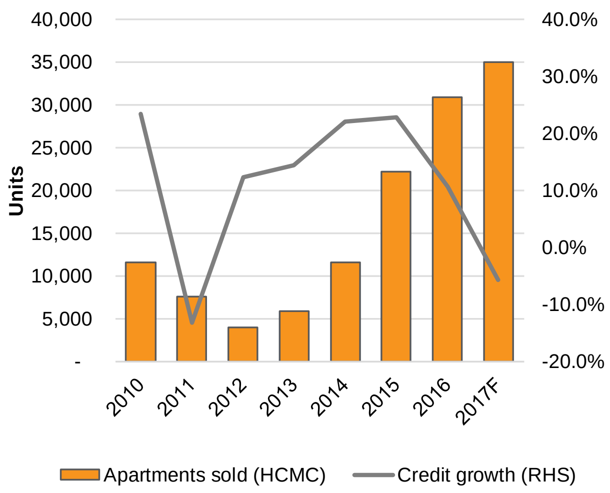
Access to housing finance supported the real estate market by increasing affordability during the post-bubble period. During the 2007 and 2011 bubble, less than 15% of home purchases were financed by banks. Most of the payments were made by cash or financed from family and friends. Banks instead primarily lent to developers and speculators during this time period. Starting at the end of 2010, the government tightened monetary policy to mitigate the risk of run-away inflation, pushing interest rates to touch an all-time high. Therefore, credit to developers and buyers dropped dramatically during 2011-2012.

Figure 80: Credit to real estate and average lending rate



Source: SBV, VNDIRECT

Figure 81: Growth in credit to the real estate sector spurred the recovery in transaction volumes



Source: Savills, General Statistic Office, VNDIRECT

From 2013, mortgage rates gradually decreased in line with a gradual easing of monetary policy, which helped improve the affordability of new homes for the masses. Buyers have been enjoying mortgage rates of 8-11% per year, while developers have to pay around 11%/year, which is still much lower than around 25% seen in 2010-2013. Between 2014 and 2017, more than 50% of buyers used mortgages to finance their home purchases. The increased availability of mortgages is being driven by the higher profitability and lower risk of lending to end-buyers in comparison to developers. Mortgage financing is currently available at an interest rate of 10% per year, with a loan to value (LTV) of 70-80% and a loan tenure of 15-20 years. For high value assets like property in a developing country, the availability of mortgages is truly essential to enhance affordability and we see this as a broadly positive development.

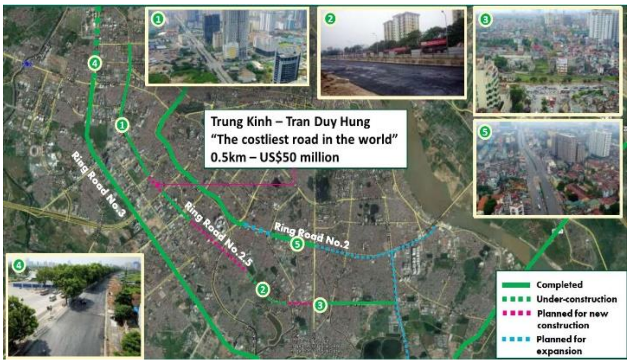
Subsidized programs for affordable housing have helped the chronically underserved bottom tier of the market. Between 2013-2016, a VND30,000 billion stimulus package was fully disbursed with a total of 19 participating banks. 50,000 individuals received credit through this program. This stimulus package has enhanced the affordability of housing for middle income households by offering mortgage interest rates that are 4-5% points below prevailing market rates. Most recently, Vietnam Bank for Social Policies launched a loan program worth VND15,000 billion with an interest rate of 4.8%, targeted at low-income home buyers.

Improvement in infrastructure is supporting the property market

Vietnam has been spending an average of 5.7% of GDP on infrastructure development in recent years, the highest ratio in South East Asia. The elevated spending in infrastructure has been changing Vietnam, especially Hanoi and HCMC, and has fueled the rise in demand for property in various segments.

The metro lines in HCMC and Hanoi will be positive for Vietnam's real estate market. The lines will create new commuting routes, help expand the cities outwards and create new mixed-use development opportunities in areas near the lines by triggering a shift from private vehicles to public transportation and thereby creating large retail catchment areas. Demand for condominium projects in close proximity to these infrastructure projects has been rising faster than the rest of the market in the past few years and properties with convenient access to metro stations are trading at a significant premium to properties in the same vicinity without the same ease of access.

Figure 82: Hanoi: upgrading of ring roads to create better connection amongst districts

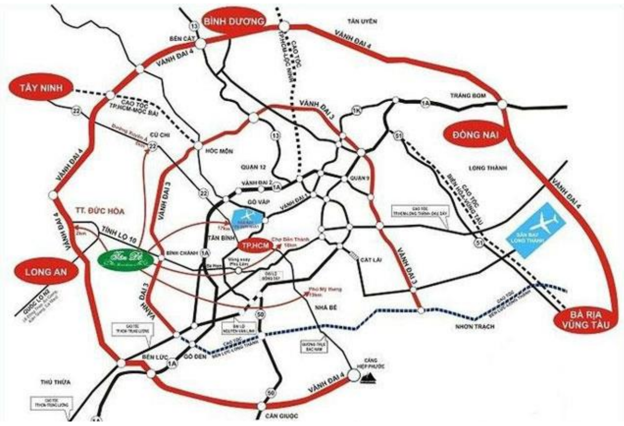


Source: CBRE

Figure 83: Hanoi metro line attracts a slew of condo projects

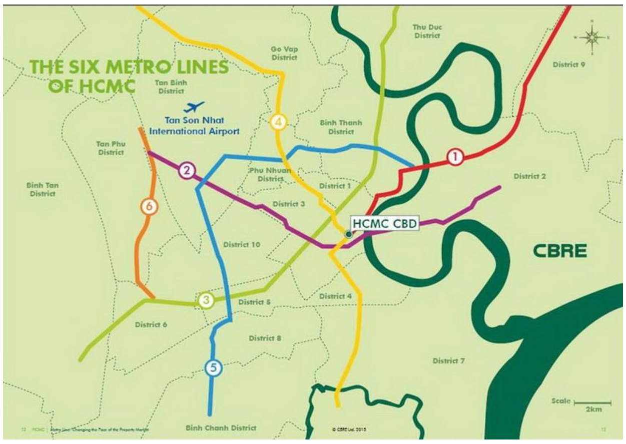
Source: CBRE

Figure 84: HCMC's ring road development masterplan (red lines, under construction)



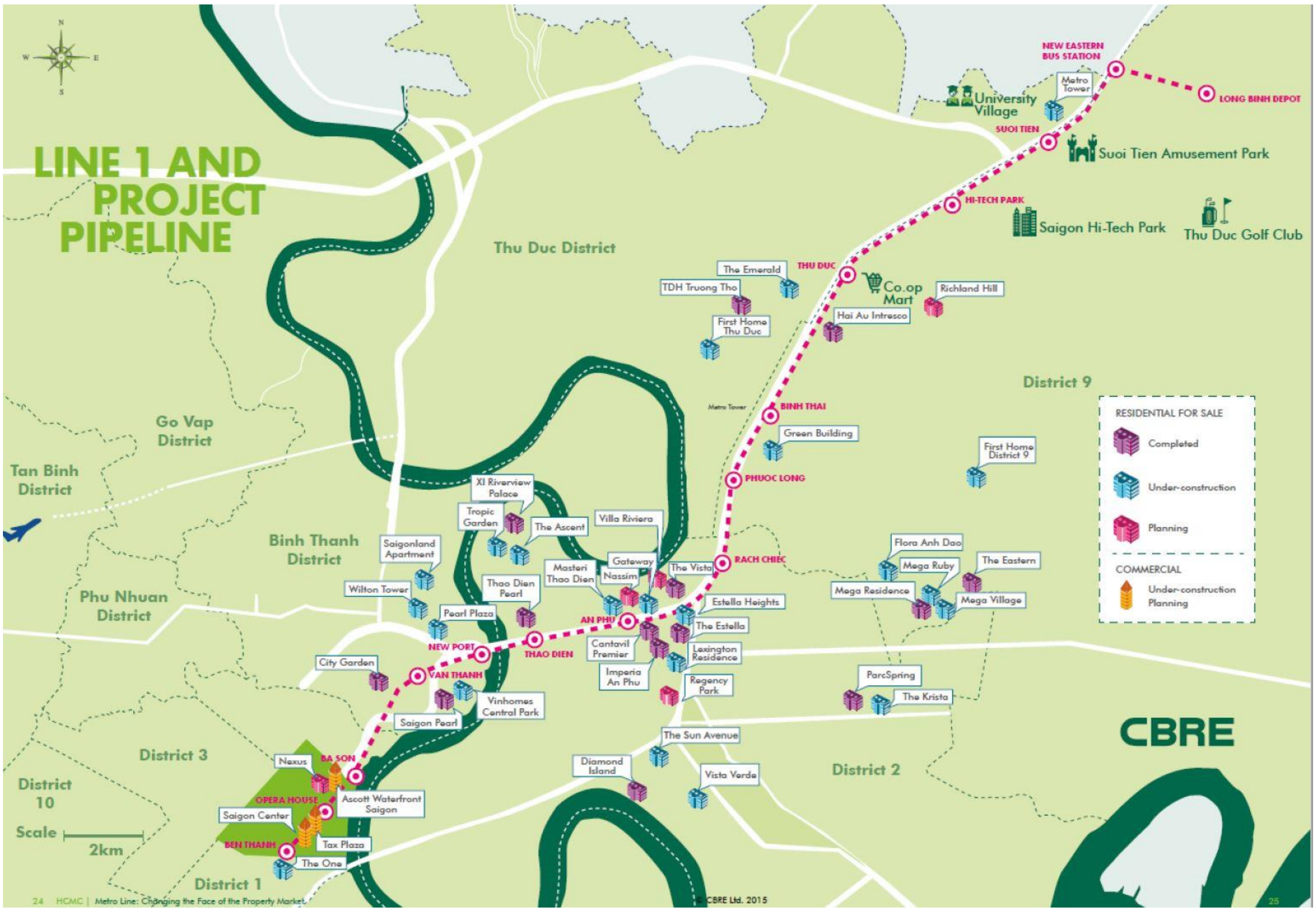
Source: www.vneconomictimes.com

Figure 85: HCMC's metro development masterplan (line no.1 is under construction)



Source: CBRE

Figure 86: Projects in close proximity to metro line no.1 (HCMC)



Source: CBRE

Better regulation mitigates the risk of another bubble

Vietnam's developer-built real estate market grew uncontrollably in the last bubble market due to a lack of proper regulation and oversight. As nobody controlled the degree to which developers financed projects using bank loans and pre-sale advances from buyers. Since then, Vietnam's government has taken a lot of measures to control and support the market.

Homebuyers are being offered more protection. Since July 2015, the new Housing Law raised the equity capital required for developing projects to a minimum of VND20 billion, in line with the government's plan to raise market entry barriers and flush-out weak developers. The law also gave regulations regarding the schedule for advanced payments to protect homebuyers, whereby developers are not allowed to receive any payment from homebuyers until they complete the building's foundation. Moreover, the initial down payment is capped at 30% of the total purchase price.

The new Housing law and Tax law ensures that the government does not exclude low income Vietnamese from the market and that they are supported in finding access to affordable and adequate housing. The value added tax applied to social housing projects is set at 5%, compared to the normal average of 10%, and the corporate income tax rate has been reduced by 50% to 10% to encourage developers to build more supply in this underserved segment of the market.

Furthermore, 20% of the total site area of each project must be used for social housing development (strictly enforced for site area > 10ha).

Amended housing law has made it easier for foreigners to buy property in Vietnam. Between 2009 to June 2015, there were only 126 pink books granted to foreigners. However, this has increased to 1,000 since July 2017, and is still poised to rise further in the future. This will occur on the back of the amended Vietnam Housing law 2014 (took effect since July 2015) which allows foreigners to buy up to 30% of the apartment units in a particular project, and a maximum of 10% of the townhouses/villas of a project. Obviously, there are other administrative procedures that prevent or discourage foreigners from owning a home in Vietnam. However, the general trend in the direction of loosening foreign ownership regulations will help boost investor and developer confidence and we expect that this will increase the flow of FDI into the housing market, particularly for condominiums. There is already plenty of anecdotal evidence to suggest that foreign nationals are aggressively buying up beachfront properties in key tourist destinations such as Danang.

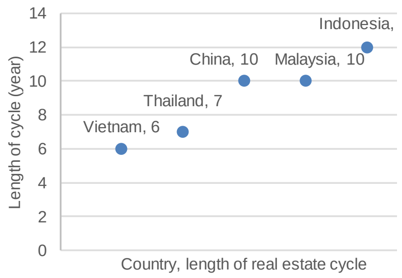
No signs of a property bubble yet: A gradual moderation underway

Despite the fact that each real estate market has unique specificities, it seems that Vietnam's real estate cycles are shorter compared to other countries. In the UK property cycles typically last 10 years, 7 in Thailand, 10 years in China and Malaysia and 12 years in Indonesia. Vietnam's property cycles have been observed to last only 5-7 years. We believe that this may be a result of the market being less mature relative to other countries. However, we believe that the current property cycle will last longer than the previous three cycles based on the following five reasons: 1) the market size is much larger today with more market depth as evinced in transaction volumes 2) Vietnam's demographics are favorable, and support real end-user demand 3) buyers are more experienced and aware of what they are buying into, 4) developers have reoriented their products to cater to the real needs of homeowners, and 5) the government has stepped up regulation and oversight. The residential market will continue to be favourable for at least 2 more years, but will grow at a slower pace. We have made the following comparisons to the most recent pre-bubble period and note key areas of improvement versus in the previous upcycle.

- **Lower degree of speculation.** Before the 2008-2009 bubble, the market saw fewer transactions, and these mainly took place in the secondary market. Moreover, there was a wide spread between the selling prices of the primary and secondary market, due to the lack of supply and intense speculation. At that time, it was not unusual to see prices surge by 50-70% within a quarter. The current spread between the primary and secondary market price is now much lower. For some mid-end projects, we see that prices increased by only 10-15% within 12 months from the launch date and inched up afterwards as the supply was abundant. Price growth, therefore, does not appear irrational.

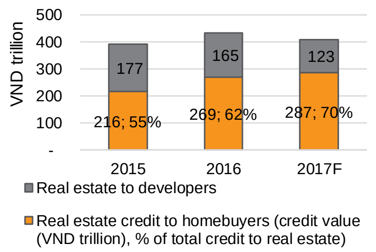
- **Better allocation of credit within the real estate sector and favorable interest rates**. The real estate downturn in 2009-2012 exposed the weaknesses in the way mortgages were being issued at the time. Bank underwriting standards were varied and risk management practices were weak. Unlike in 2008, banks now prefer to focus their real estate lending on

Figure 87: Length of cycle (year) by country



Source: VNDIRECT

Figure 88: RE credit allocation shifting away from developers and to buyers



Source: VNDIRECT

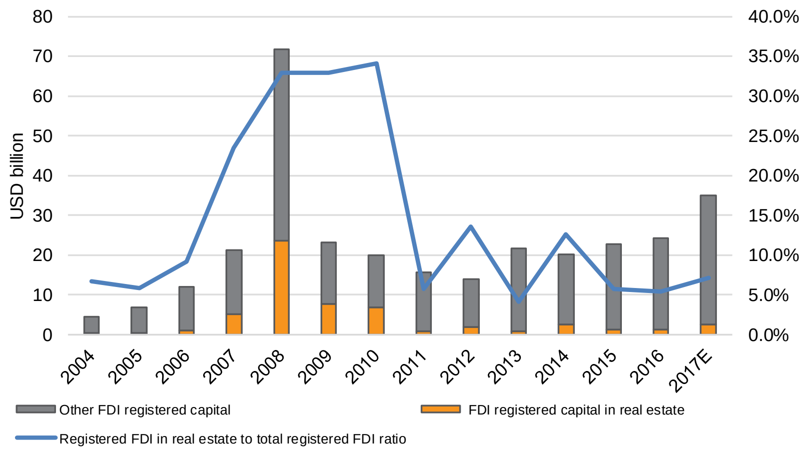
end-buyers rather than on developers for two reasons (1) yields on lending to end-users are higher than yields on lending to developers and (2) the loan book is spread out across multiple individual borrowers rather than being concentrated across a few developers; this diversification helps reduce credit risk. Bank mortgages to end-users accounted for about 70% of total real estate loans in 2017 vs 62% in 2016 and 55% in 2014.

- **Developers are now focusing on end-users**. Before the recovery of the market, developers focused on the mid-high and high-end segments with large unit sizes aimed at speculative buyers and resulting in a higher selling price/unit. However, developers have changed their strategies recently to focus on real end-users and shrinking unit sizes to address affordability; they have sharpened their focus on producing 1-2 bedroom units. According to Vietnam Ministry of Construction, the average size of 1-bedroom units has decreased from 50 sqm to 48 sqm, while the average size of 2-bedroom units has decreased from 91 sqm to 75 sqm. The number of 1-2 bedroom units has increased from 66% of total new supply prior to 2012 to 72% of new supply, post-2012.

Muted FDI and remittance flows into the real estate sector relative to past are another indication that market is far from overheating

Vietnam's real estate industry has attracted significant FDI since its "Doi Moi" economic liberalization reform program was launched. Between 1988 and 2016, Vietnam saw a total of 2,115 FDI projects with registered capital of US$290.7 billion, which included 562 real estate projects with registered capital of US$56.0 billion. According to the Foreign Investment Agency (FIA), registered FDI into the real estate sector totalled USD2.5 billion (+237% YoY) during the first 11 months of this year, equivalent to 6.5% of total registered FDI over the same period, and lower than the cumulative share seen historically.

Figure 89: Registered FDI into the real estate sector vs. total FDI registered 2004-2017

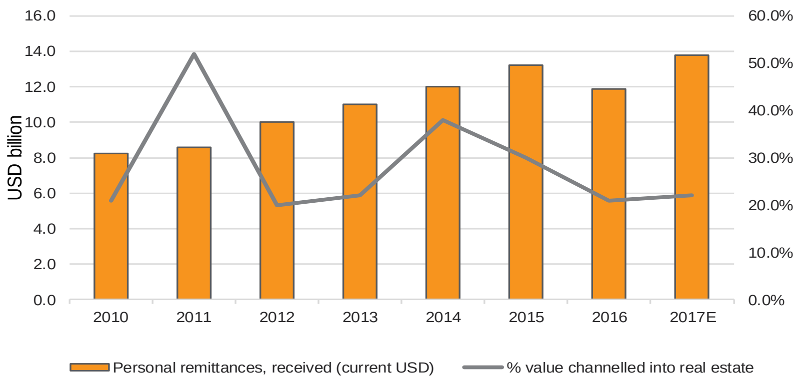


Source: GSO, World Bank, VNDIRECT

We believe that FDI in real estate is a lead indicator of the development of the market. There was a marked build-up in FDI into the real estate sector leading up to the last property bubble. The fact that FDI into real estate remains rather subdued both in absolute terms and as a share of total FDI is another "sanity check" on our belief that the property market is far from a repeat of the heady days seen in 2008 and 2009.

This muted FDI inflow into the real estate sector is also borne out in remittance data. Even the government's new Housing Law passed in 2015 made it much easier for foreigners and Vietnam's huge overseas diaspora to buy directly into real estate in Vietnam, the share of total remittances being funnelled into the sector remain subdued by historical standards. We recognize the data might understand the true inflows as many overseas Vietnamese could be using local proxies or nominees to invest into property here, the historical trend is rather telling and dispels the notion that demand in the high-end segment is being driven by speculative foreign capital.

Figure 90: Total Remittances into Vietnam and share of total flowing into Real Estate



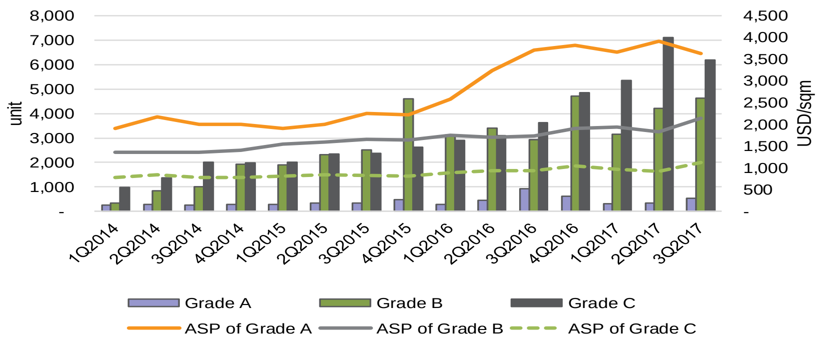
Source: World Bank, IMF (2017)

Slowing growth in credit to the real estate sector and rental yield compression in the high end segment are creating headwinds

Vietnam's property prices are still rising but at a slower pace as the developer-built market size is large enough and products are now well-matched with end-user demand.

Over the past 4 years, the average selling price in the primary market has increased by 50% for the low-end apartment segment and 60% for the mid-range apartment segment. These price increases have prompted on onslaught of supply in the high-end segment in the past 4 years. It is widely forecasted that the residential market will peak in 2018, which is prompting speculators to sell their property and end-users to defer their home purchases in anticipation of a price correction. In fact, prices have actually declined not just decelerated in the high-end segment.

Figure 91: Quarterly transaction volume and average selling price by segment in HCMC



Source: Savills Vietnam

Credit growth to the real estate sector decelerated in 2017. The new Circular 06 specified that the maximum ratio of short-term funds used for medium and long term loans should be lowered from 60% to 50% in January this year and further to 40% during 2018-2019. This will reduce the ability of banks to continue to lend to real estate developers. Even though the ratio of short-term funds used for medium and long term loans for most banks in Vietnam is already below 40%, this new regulation will limit the ability of banks to continue lending to the real estate developers at the brisk pace seen in the last few years.

According to a recent report of the National Financial Supervisory Commission, Vietnam's loan exposure to commercial real estate and construction gradually fell from 17.1% at the end of 2016 to 15.5% by November 2017. Credit to real estate accounted for 5.8% of this. Meanwhile, credit growth to the real estate sector fell from ~15% in FY15 to 11.0% in FY16 and only 5.0% in 9M2017, according to SBV. This indicates that the new regulation might already be taking effect.

Decline in rental yields limits the growth of the high-end segment

The high-end segment of the market is under some visible pressure as evinced in the decline in price and transaction volumes since the beginning of 2016 as had been predicted by most real estate brokers and consultants including CBRE, Savills and JLL. In HCMC and Hanoi, the demand for mid and high end products is largely being driven by an increase in buy-to-let purchases. However, the increase in home prices and the ample supply in recent years has significantly compressed rental yields. There is intensifying competition in apartment rentals, given that 60-70% of the total stock of high-end units are now on the rental market versus 40% in 2016 and just 20% in 2015. According to CBRE, the average rental rates as of December 2017 were 5-10% lower than observed at the beginning of the year. The rental yield of high-end apartments peaked at 6-7% in 2016, remained flat in 2017 at 6% and is expected to decline in 2018.

Developers are shifting their focus to the mid-range segment

Developers are focusing on the mid-range segment for the following reasons:

- **The high-end segment is now oversupplied**
- **There is a strong demand for mid-end products due to the burgeoning young middle class**. Approximately 58,000 and 42,000 couples get married in HCMC and Hanoi every year, respectively. As mentioned earlier, there is an ongoing cultural shift whereby young couples are now opting to move out of their parents' homes.

- **Infrastructure build-outs are enhancing the feasibility of of mid-range developments.** There are roughly 11,500 hectares of urban land required for new housing construction every year, across the nation. The formal supply of available land is failing to keep pace with demand, which is pushing up prices. Infrastructure developments, including metro lines, urban upgrading, and redevelopment have allowed developers to move out to fringe areas where land prices are still relatively low and land supply is still faily abundant. This enables them to offer competitively-priced products without compromising their own margins.
- **The mid-range segment offers juicy margins as compared with the affordable segment.** Usually, developers enjoy a net margin of above 25-30% for mid-range apartment projects versus just 12-18% for affordable apartment projects. Meanwhile, the net margin for social apartment projects is capped at 10% making it totally unattractive without government subsidies.

Despite the fact that the prices of low-end and mid-range apartments have risen by 17.5% and 14.6% annually over the past 3 years (according to Savills), housing prices are still affordable at around 4.4x the average annual household income, which is 30% lower than average cost-to-household income ratio of 5.7x observed across major cities in Southeast Asia (according to Global Property Guide). We believe that even if the average selling price of property increases by 30% in aggregate over the next 3 years, the cost-to-household ratio will stay stable as incomes in major urban areas have been growing by 10% per annum.

Mid-range apartment affordability

Average household income (USD/year)	24,000		
Monthly salary (USD/month, x2 persons)	2,000		
Months of income/year	12		
Average price USD/sqm	1,500		
Unit size (sqm)	70		
Unit price (USD/unit)	105,000		
House price/income	4.38		
% of borrowing	70%		
No. of months	120		
Interest rate (%/year)	8%	10%	12%
Monthly mortgage payment (USD)	892	971	1,055
Monthly payment as % of income	**45%**	**49%**	**53%**

Source: VNDIRECT

Note:The General Statistics Office estimates that the income of upper 20% households in Hanoi and HCMC exceeds USD2,000 per month

Afforadable apartment affordability

Average household income (USD/year)	17,280		
Monthly salary (USD/month, x2 persons)	1,440		
Months of income/year	12		
Average price USD/sqm	1,000		
Unit size (sqm)	55		
Unit price (USD/unit)	55,000		
House price/income	3.18		
% of borrowing	70%		
No. of months	120		
Interest rate (%/year)	8%	10%	12%
Monthly mortgage payment (USD)	467	509	552
Monthly payment as % of income	**32%**	**35%**	**38%**

Source: VNDIRECT

Note:Base on lower bound of income/month of middle class according to classification of Boston Consulting Group (USD 720/month)

Developing full-service communities is in vogue

Learning from the development stories of other countries in Asia, major developers in Vietnam now prefer to develop communities with a diverse product mix. For example, Van Phuc City project (HCMC), which is developed by Dai Phuc Group (unlisted), is a huge project with total investment of US$2 billion on a site area of 198ha. This project contains a water park, park, hospital, commercial centre, and canoe station. Other landmark projects are the Vincity(s) series developed by Vingroup (VIC). VIC has secured land outside the 10-km radius of major cities, where land costs are still favourable and is developing complete self-sustaining communities to offset the disadvantage of being far from the urban center. Vincity will launch 3 projects during 2017-2018 in Hanoi, HCMC, Thanh Hoa or Ha Tinh with a total GFA of around 1 million sqm, comprising a total of around 10,000 units according to our estimates.

Landed property products will enjoy high transaction volumes

The preference for landed properties (land lot, terraced house, commercial townhouse, and villas) has been ingrained in most Vietnamese people for generations and is not dissimilar to cultural preferences in other Asian countries such as China. Real estate assets are considered as a store-of-value for money, especially during periods of high inflation and landed properties are seen as being the closest alternative to purchases of raw land. Many developers have jumped on this bandwagon in a rush to develop landed property projects at prime locations in major cities. In HCMC, the supply of villas/townhouses will continue to grow with more than 12,600 units coming online in the next two years, which is threefold the total transaction volume in 9M2017, according to Savills Q3 2017 market report but still not enough to satisfy total estimated demand.

Development activity to continue to radiate out to suburban areas

Urban areas will spread laterally. The country's urban population has grown at a CAGR of 3.5% per annum since 2000, one of the highest growth rates in the region. One third of the total population currently lives in urban areas. According to the World Bank, around 3 more million Vietnamese will move to urban areas over the next 3 years. We believe that a shift to developments in suburban areas is inevitable due to the following factors:

- Rezoning of main urban areas by the authorities to expand commercial catchment areas
- Scarcity of land bank surrounding central business districts, exacerbated by voracious demand for commercial real estate
- Growing congestion in urban areas which is prompting policy responses to depopulate the inner cities. The two largest cities in the country are tightening approvals for new projects in inner city areas and prioritizing development in suburban areas.
- Improvement in infrastructure in suburban areas which will improve connectivity to the city centers
- The development of full-service communities which will reduce the need to travel into the city center to avail of basic amenities.

Mortgage rate rises are a key risk but not in the near term

The current property price is quite high, at around 80% of the price in 2008, but we think the price appreciation seen so far is backed by improvements in infrastructure and inflation in construction costs. Thus, we believe the property price will not decline by 40-50% like it did in the most recent market downturn. The greater risk remains the credit cycle and interest rate hikes to combat a future acceleration in inflation.

We calculate that if the mortgage rate touches 15%, it will start having a very material impact on customers' decision to buy property.

However, the psychological impact may kick-in sooner if interest rates start creeping north, leading to a slowdown in the market even before mortgage rates hit this critical level. However, since we believe interest rates will not increase significantly in the next 2 years, we expect this to be a risk over the medium-to-long term horizon.

Real Estate outlook for 2018: Favorable conditions to persist

We forecast that the transaction volume will remain high in 2018-2019 thanks to high demand and re-orientation of supply towards the mid-to-affordable end of the market. On the supply side, the recent relaxation of foreign ownership regulations in the housing market will continue to have an impact on investor and developer sentiment, which will continue to attract more FDI into the housing market, particularly into the condominium segment. On the demand side, increasing confidence among homebuyers' on strong economic growth and rising incomes as well as improving product affordability will continue to support absorption rates.

More developers are shifting their focus to the mid-range segment which still has sizeable visible demand and huge latent demand from end-users. Buyers will place more emphasis on construction quality, supporting facilities and amenities, as well as the surrounding environment when choosing their homes and developers are expected to race to fulfil these expectations which will have a net positive impact on product quality across the board.

REAL ESTATE SECTOR STOCK PICKS: WE LIKE NLG

We like developers that have a solid project pipeline of affordable-to-mid end apartments and landed property products, including VIC and NLG.

We like VIC given its successful exection track record and huge undeveloped land bank and following its recent strategic shift from the high-end to the mid-range segment. VIC's experience in building self-sustaining communities is also a key advantage and something very few other developers can replicate at the moment. However, VIC is a diversified conglomerate and we are not so sure about its non-property business segments.

NLG is one of our top picks as it is the most successful listed affordable housing developer in Vietnam and is moving upmarket into the higher margin, yet high demand mid-range segment**.** The company is moving up to the mid-range segment which should help improve margins. The biggest impediment, however, is NLG's brand which is associated more with affordable housing and might deter buyers in the mid-range segment even though the company has been using differentiated branding strategy for its mid-market products; the company has been able to leverage its Japanese partners' brand equity and execution capabilities in this move up-market. Also, ***NLG is a long-term buy in our opinion as the company looks quite fairly valued at present.*** The company has near-term land bank constraints but this should be addressed next year with the imminent acquisition of 33ha of new land in HCMC which should support the development pipeline for the next 3-4 years.

NAM LONG INVESTMENT CORP (NLG)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND31,000	VND31,850	1.70%	HOLD	REAL ESTATE

Outlook – Short term	Outlook – Long term	Valuation
Negative Neutral Positive	Negative Neutral Positive	Negative Neutral Positive

Quyet Nguyen Ngoc
quyet.nguyenngoc@vndirect.com.vn

We maintain a positive view on NLG, as its solid pipeline of projects ensures future growth. We reiterate our HOLD recommendation with a RNAV of VND 31,850/share, as its sales progress and cash collection are in line with our forecasts but the company seems fairly valued according to our base case forecasts. The valuation does not include some potential projects (1ha Areco, 43ha in Can Tho city, 33ha in eastern HCMC, Water Point), which would provide additional upside over the long-term.

- For 2017, we pencil in 38.6% YoY growth in revenue and 58.2% YoY growth in NPATMI, mainly driven by the sale of land.
- Hoang Nam project should be revalued in 2018. In our base case scenario, the project will add around VND 500bn to its revenue and VND 150bn to its bottom line.

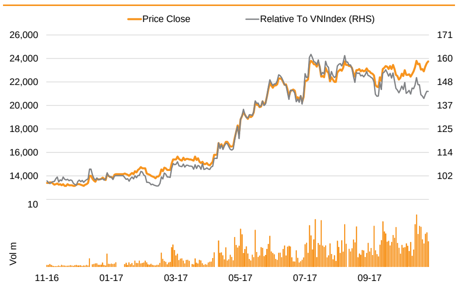
Prospective land bank acquisition could be a catalyst in 2018: NLG revealed plans to acquire two land parcels with a total area of 33ha, located in the east of HCMC. In order to complete the acquisition, NLG is seeking shareholders' approval to issue 31.4mn shares to existing shareholders at a 5:1 ratio between Q4 2017 and Q1 2018.

2018 earnings will grow even with conservative assumptions for Hoang Nam. We estimate contracted volume for 2018 of around 2,963 units (-25% YoY) with a value of VND 5,132bn (+29.8% YoY). We forecast that its revenue for the year will reach VND 4,444bn (+26.5% YoY) and NPATMI at VND 570bn (+4.5% YoY), resulting in an EPS of VND 3,369.

IFRS compliance in preparation for planned overseas listings. Management has revealed plans to list the company's shares on the Singapore stock exchange. Accordingly, the company will concurrently prepare 2 financial statements in compliance with IFRS and VAS, starting from 2018. Under IFRS the inventory will be marked-to-market value and therefore we expect investors will have a valuable reference point to gauge the fair value of the company.

Although the stock looks fairly valued at present, we still see long-term upside given strong sale progress on major projects, and lank bank (30ha) growth in 2018, which should support the project pipeline.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	32,600
52w low (VND)	19,400
3m Avg daily volume (shares)	846,759
3m Avg daily value (VNDmn)	23,708
Market cap (VNDbn)	4,874
Outstanding shares (m)	157
Free float (%)	36
TTM P/E	9.0
P/B	1.3

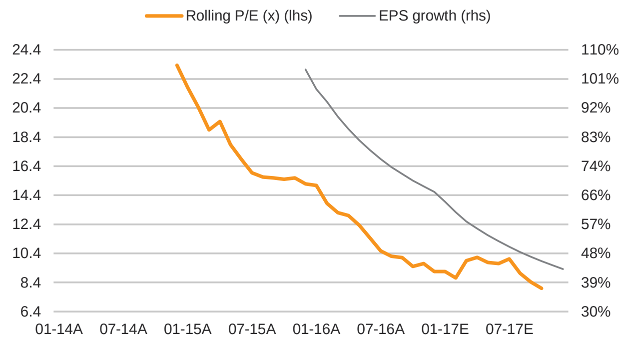
Ownership

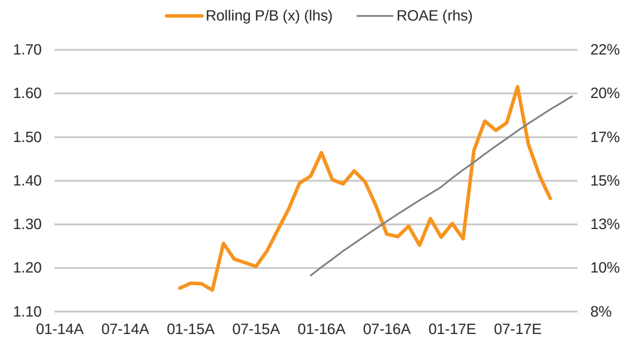
Founders	36.8%
Tan Hiep Investment Ltd. Co.	9.3%
PYN Elite Fund	6.8%
GOLDMAN SACHS	6.1%
Keppel Land	5.0%
Others	36.0%

Source: VNDIRECT

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	1,259	2,534	3,512	4,444
Revenue growth	45.2%	101.3%	38.6%	26.5%
Gross margin	33.2%	32.5%	37.7%	31.8%
EBITDA margin	22.2%	18.8%	26.7%	20.8%
Net profit (bn)	206	345	545	570
Net profit growth	115.6%	67.3%	58.2%	4.5%
Recurring profit growth	101.0%	63.2%	(13.3%)	46.1%
Basic EPS	1,455	2,425	3,468	3,623
Adjusted EPS	1,362	2,265	3,225	3,369
BVPS	15,667	17,477	19,728	22,851
ROAE	9.9%	14.7%	19.5%	17.0%

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	2,534	3,512	4,444
Cost of sales	(1,711)	(2,187)	(3,030)
Gen & admin expenses	(154)	(180)	(184)
Selling expenses	(189)	(248)	(373)
Operating profit	**480**	**897**	**858**
Operating EBITDA	494	903	864
Depreciation and amortisation	**(14)**	**(6)**	**(7)**
Operating EBIT	**480**	**897**	**858**
Interest income	26	83	96
Financial expense	(29)	(24)	(18)
Net other income	7	0	0
Income from associates & JVs	0	0	0
Pre-tax profit	**484**	**956**	**935**
Taxation	(97)	(191)	(171)
Minority interests	(42)	(220)	(195)
Net profit	**345**	**545**	**570**
Adj. net profit to ordinary	345	545	570
Ordinary dividends	(97)	(78)	(79)
Retained earnings	**248**	**467**	**491**

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	932	701	654
Short term investments	39	0	0
Accounts receivables	1,220	1,543	1,725
Inventories	3,698	3,845	3,948
Other current assets	64	88	109
Total current assets	**5,953**	**6,177**	**6,436**
Fixed assets	55	67	71
Total investments	31	615	965
Other long-term assets	170	31	51
Total assets	**6,209**	**6,889**	**7,523**
Short-term debt	354	292	222
Accounts payable	199	66	108
Other current liabilities	1,626	1,755	1,905
Total current liabilities	**2,179**	**2,113**	**2,234**
Total long-term debt	813	671	510
Other liabilities	69	120	107
Share capital	1,421	1,572	1,572
Retained earnings reserve	578	1,045	1,536
Shareholders' equity	**2,484**	**3,102**	**3,593**
Minority interests	664	883	1,078
Total liabilities & equity	**6,209**	**6,889**	**7,523**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**484**	**956**	**935**
Depreciation & amortisation	14	6	7
Tax paid	(81)	(191)	(171)
Other adjustments	(22)	15	0
Change in working capital	**(689)**	**(498)**	**(115)**
Cash flow from operations	**(294)**	**288**	**656**
Capex	(8)	(9)	(7)
Proceeds from assets sales	36	1	1
Others	(73)	(521)	(331)
Other non-current assets changes			
Cash flow from investing activities	**(45)**	**(529)**	**(337)**
New share issuance	345	0	0
Shares buyback	41	0	0
Net borrowings	526	(203)	(231)
Other financing cash flow	0	0	0
Dividends paid	(97)	(78)	(79)
Cash flow from financing activities	**815**	**(281)**	**(309)**
Cash and equivalents at beginning of period	423	932	701
Total cash generated	**475**	**(522)**	**9**
Cash and equivalents at the end of period	899	410	710

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	13.6%	15.5%	12.8%
Asset turnover	0.45	0.54	0.62
ROAA	6.1%	8.3%	7.9%
Avg assets/avg equity	2.39	2.34	2.15
ROAE	14.7%	19.5%	17.0%
Efficiency			
Days account receivable	176	160	142
Days inventory	791	642	476
Days creditor	42.7	11.1	13.0
Fixed asset turnover	48.0	57.6	64.5
ROIC	8.0%	11.0%	10.5%
Liquidity			
Current ratio	2.73	2.92	2.88
Quick ratio	1.03	1.10	1.11
Cash ratio	0.45	0.33	0.29
Cash cycle	925	791	604
Growth rate (yoy)			
Revenue growth	101.3%	38.6%	26.5%
Operating profit growth	231.7%	87.0%	(4.4%)
Net profit growth	67.3%	58.2%	4.5%
EPS growth	66.6%	43.0%	4.5%
Share value			
Basic EPS (VND)	2,425	3,468	3,623
BVPS (VND)	17,477	19,728	22,851

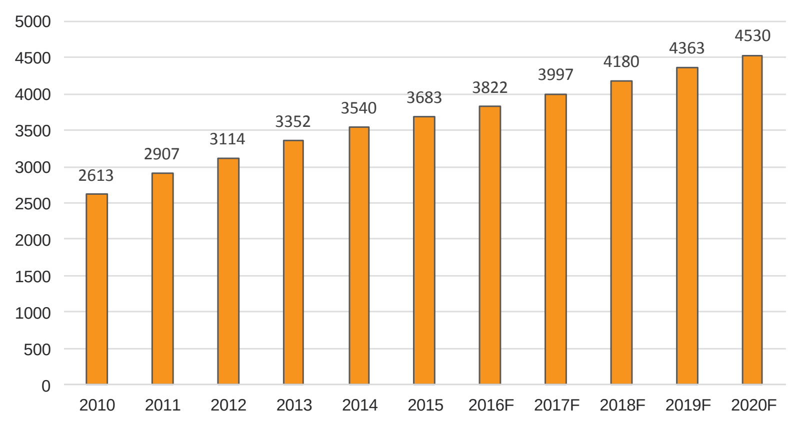
CONSUMER: SURGING DEMAND BUT INCREASINGLY DARWINIAN

Consumption is booming due to a surging middle class and broad-based disposable income growth

Steady increase in disposable incomes per household is driving a surge in consumer spending

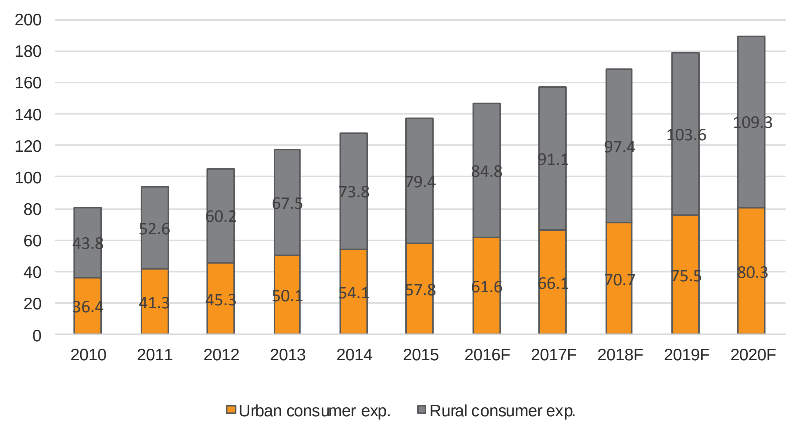
Consumer expenditure has been increasing steadily in Vietnam, mainly due to rising incomes amid strengthening economic activity. During 2010-2016, average disposable incomes rose at a CAGR of 7.9%, rising from US$2,613 per household to the current level of US$3,822 per household, which directly stimulated consumer spending on goods and services. Consequently, total consumer expenditure surged at a CAGR of 12.8% during 2010-2016, increasing from merely USD$80 billion in 2010 to US$146 billion in 2016 according to Euromonitor.

Figure 92: Vietnam's average disposable income per household (US$)



Source: Euromonitor

Figure 93: Vietnam's consumer expenditure (US$bn)



Source: Euromonitor

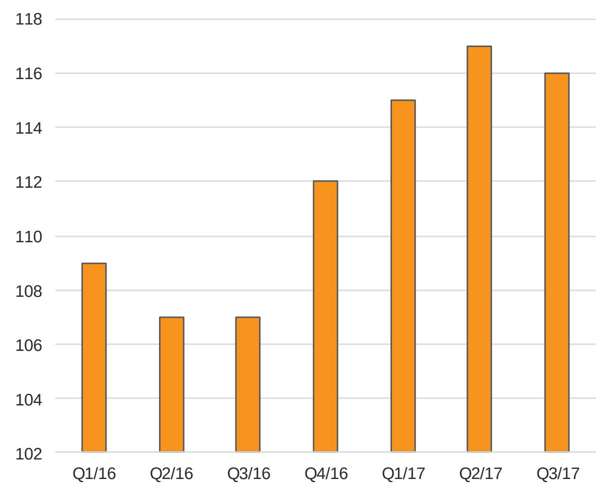
Vietnam's disposable income per household is estimated to reach US$4,530 in 2020, which will expand the middle-class from 12 million in 2014 to 33 million by 2020. According to Boston Consulting Group (BCG), Vietnam's middle class growth will be the fastest among ASEAN-5 economies and Vietnam's middle class population will be equal to 2/3 of Thailand's middle class by 2020. The rise of Vietnam's middle class coupled with higher disposable incomes will drive consumer expenditure growth of 6.7% per year during 2016-2020.

High consumer confidence makes saving less of a priority

The faster growth in consumer expenditure compared with income rises can be attributed to the strengthening of consumer confidence, as Vietnam's bright economic outlook and falling unemployment have made consumers optimistic about their future incomes. The average unemployment rate of working-age labor was only around 2.3% in 2016, 3.2% in urban areas and 1.9% in rural areas.

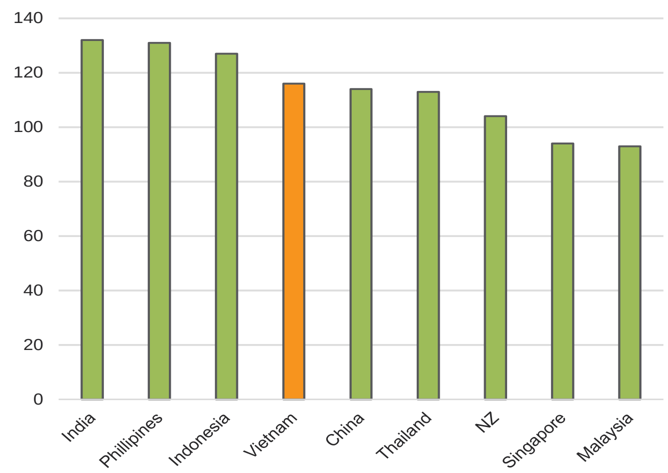
Vietnam's consumer confidence continued to improve in 2017, helping Vietnam become the fifth most optimistic country globally, with an index score of 117as of Q2/2017 (+5 points from Q4 2016). This was the highest score during the past five years, according to the Consumer Confidence Index update released by Nielsen.

Figure 94: Vietnam's consumer confidence index



Source: Nielsen

Figure 95: Consumer confidence index across APAC nations



Source: Nielsen Q3/2017

The research also revealed that consumers in Vietnam are no longer the most avid savers, globally. The study shows that only 63% of Vietnamese put their spare cash into savings (compared to 76% in 2016), below Thailand (69%), as well as Singapore and Indonesia (66%). Consumers in Vietnam are beginning to spend more on disscretionary items after covering essential living expenses. Around one in three Vietnamese consumers are willing to spend on discretionary items like holidays (38%), new clothes (36%), new technology products (31%); home improvement (30%), and out-of-home entertainment (29%).

We see 3 major trends shaping the consumption landscape

Growing health-consciousness is driving demand for healthier products and greater discretion in product selection.

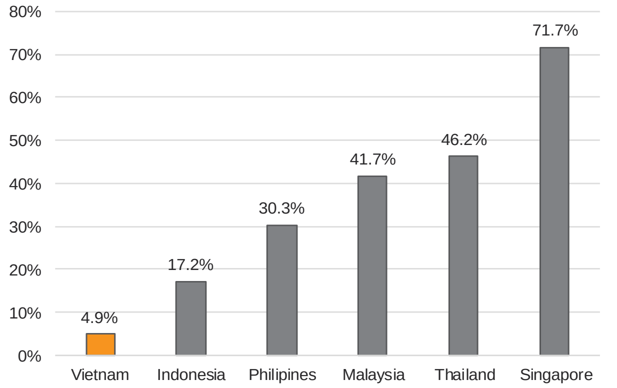
Thanks to improved living standards, Vietnamese consumers have become more health conscious. Moreover, as scandals regarding toxic toys and personal care products, as well as pesticide-contaminated foods have become revealed, Vietnamese consumers are now exercising more caution when choosing which types of food to consume. They are gradually beginning to switch from unbranded products to branded products, as it is easy to check the quality, manufacturing date and origin. Recently, organic food products have become more popular in Vietnam, and F&B companies are now jumping on this new growth trend. Vinamilk, the largest local milk producer, began launching organic milk products in 2016, and its products have been well received by consumers.

Rising penetration of modern retail

For years, Vietnam's consumer market was dominated by traditional channels, including traditional markets, as well as mom-and-pop shops. However, as consumers' focus on quality and safety is increasing, shopping habits have also changed, with the result that consumers are beginning to switch from traditional markets to more modern shopping channels such as super markets, convenience stores and online shopping. The penetration of modern retail in Vietnam is still the lowest in the region, at just under 5.0%, versus 17.2% in Indonesia, 30.3% in Philippines, 41.7% in Malaysia and 46.2% in Thailand.

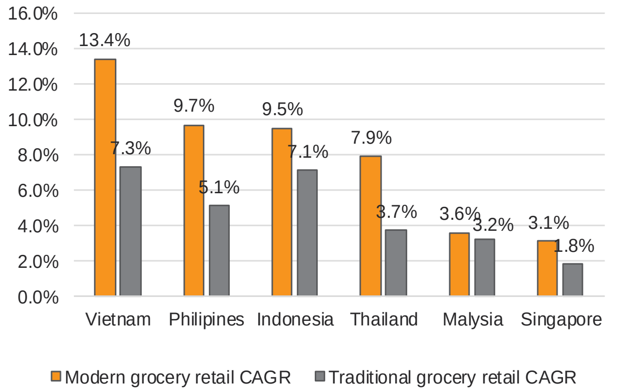
A visible spin-off from Vietnam's economic growth combined with the rising of young and rich popular are propelling the prospect of modern retail. According to EIU, Vietnam's modern retail sales are expected to grow at a CAGR of 13.4% during 2016-21, outpacing regional peers which are starting out from a much higher base in terms of penetration.

Figure 96: Modern grocery getail as part of total grocery retail by value in 2016(%)



Source: VRE, Euromonitor, EIU, Colliers

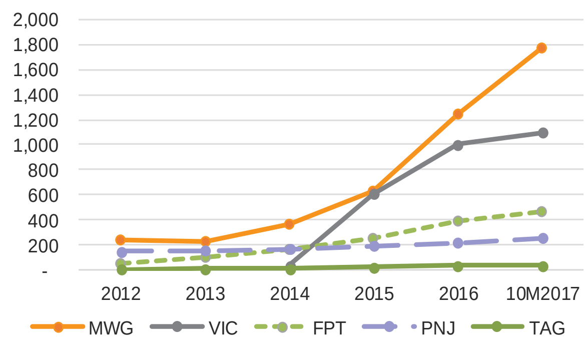
Figure 97: Modern and traditional grocery retail growth 2016A - 2021E



Source: VRE, Euromonitor, EIU, Colliers

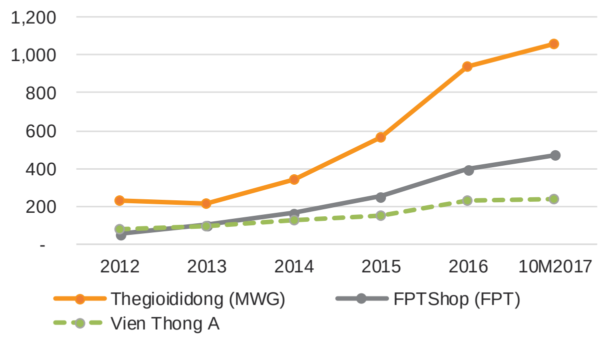
The supply-side has noticed this opportunity and as a result, there is an ongoing "arms-race" in retail store footprint expansion with Vinmart (super markets), Theigioididong, FPT (mobile & IT stores); and PNJ (jewelry) accelerating new store openings. Thegioididong, the mobile and IT products store chain of Mobile World (MWG:HOSE), expanded its footprint by 5 times between 2013 and Oct 2017. Meanwhile, Dienmayxanh, another store operated by MWG that specializes in consumer electronic appliances, has set up 531 outlets across the country as of September 2017. Vingroup (VIC:HOSE) joined the market in late 2014 and has aggressively expanded its nationwide network with 76 super market (Vinmarts) and 950 convenience stores (Vinmart+) currently in operation.

Figure 98: Number of retail stores by listed retailer



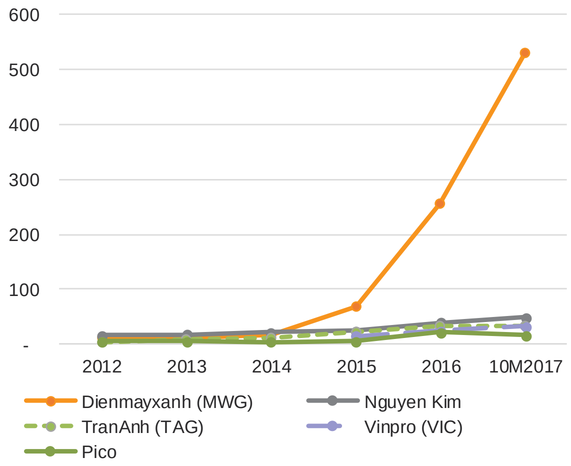
Source: VNDIRECT Research

Figure 99: Number of stores by mobile phone retail chain



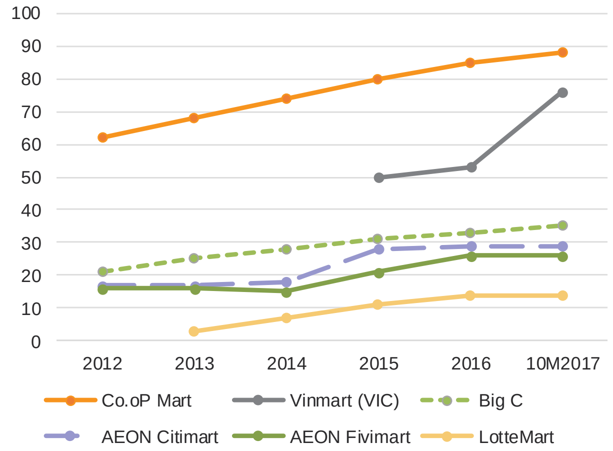
Source: EIU, VNDIRECT Research

Figure 100: Number of stores by consumer electronic retail chain



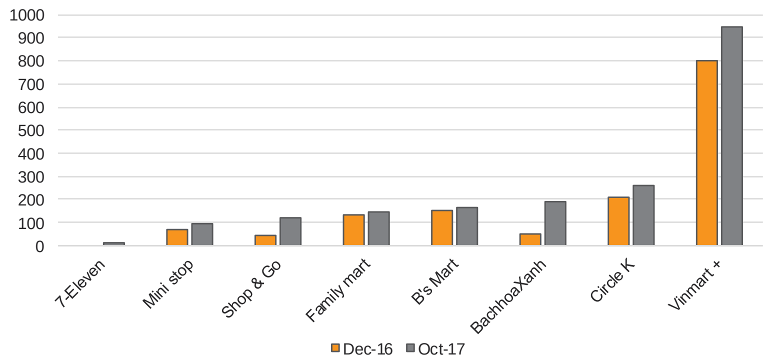
Source: EIU, VNDIRECT Research

Figure 101: Number of hypermarkets/supermarkets by grocery chain



Source: Euromonitor, Companies, VNDIRECT Research

Figure 102: Number of convenience stores by chain



Source: EIU, VNDIRECT Research

Increasing consumer preference for speed, convenience and comfort in the consumption experience.

The emergence of a tech-savvy generation of consumers has further aided the growing demand for convenience and comfort. Vietnamese consumers, especially in urban populations, now have easier access to smartphones, as at least 37% of the total population owns a smartphone. In addition, approximately 42% of the population were reported as internet users in 2015. Websites, online payment systems and smartphone applications have all provided an opportunity for consumers to consume products and services from the comfort of their homes or offices.

E-commerce platform such as Lazada, Tiki, Shopee, and Adayroi have, as a result, become more popular among Vietnam consumers. Foreign e-commerce giants, such as Alibaba and Amazon, have also shown their interest in Vietnam's e-commerce market with Alibaba recently acquiring Lazada from Rocket Internet and Amazon announcing its plans to enter the market.

Opportunities are not equal for all

Stiffer competition from foreign participants as they ramp-up investments and consumers trade-up to more premium brands.

Recently, Vietnam's market has lured a slew of foreign and regional FMCG producers and retailers and now, many of them are aggressively ramping up investments to try and establish dominant market positions even at the cost of low profitability, upfront. Following the entrance of Circle K and Shop & Go a few years ago, the global convenience store giant 7-Eleven entered the market with 9 stores in 2017, marking the first step in its quest to open 1,000 stores nationwide. Other big names such as Aeon (Japan), Central Group (Thailand) and Lotte (Korea) are also expanding their operations here after entering the market several years ago.

Due to their growing health-consciousness, as mentioned above, Vietnamese consumers have become more interested in foreign products particularly when it comes to food and beverages. For example, 75% of formula powder milk sales comprise foreign brand names according to Euromonitor. The beer market is also heating up, with increasing competition between Sabeco, Habeco and Heniken NV, as well as newcomers such as Sapporo and AB InBev. Fierce competition has fuelled an "arms race" of product innovation and promotions which is bound to pressure margins over the next few years. Industry participants who are sluggish in product innovation and slow to capture the rapidly emerging trends in consumer behavior might not be able to survive in the long-term.

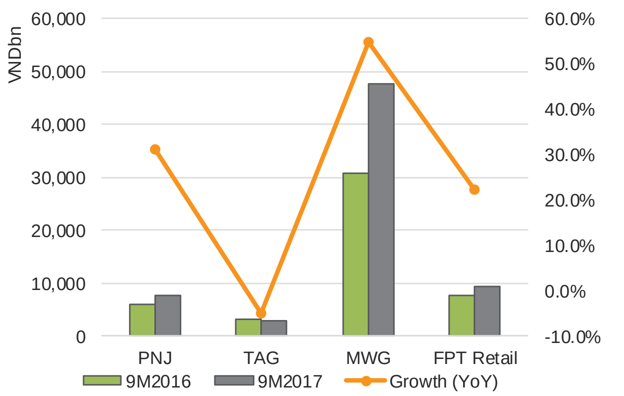
2017 consumer sector review: A mixed bag across all segments

According to General Statistics Office (GSO), in 11M2017, Vietnam's retail sales of goods and services touched VND3,600tn (~USD156.5 billion), increasing by 10.7% YoY. Retail sales of goods touched VND2,698tn (~USD117.3bn), accounting for 74.9% of total sales, and rising by 10.8% YoY. Consumer spending remains resilient, supported by the decline in inflation coupled with record high levels of consumer confidence.

Retailers: rapid network expansion fuelled growth.

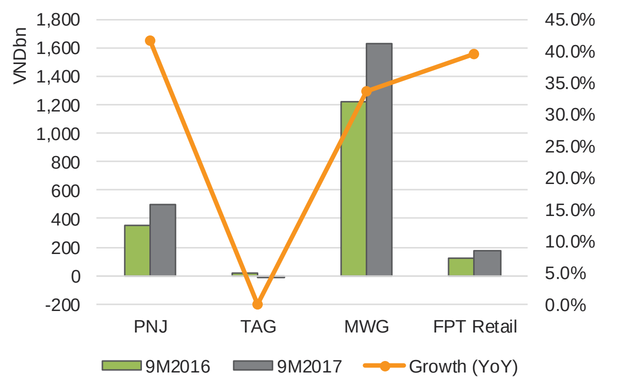
Most listed retail companies reported positive results during 9M2017 except for TAG. Companies such as FPT Retail, MWG and PNJ were able to boost revenue by expanding their retail networks. This, together with slight margin expansion, helped drive impressive profit growth in the period.

Figure 103: Revenue growth during 9M2017



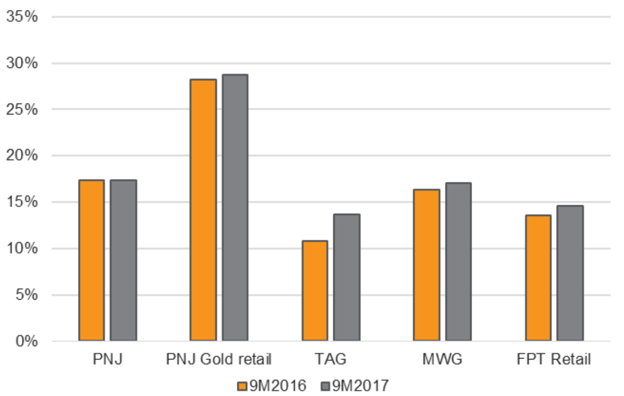
Source: Companies

Figure 104: Net profit growth durng 9M2017



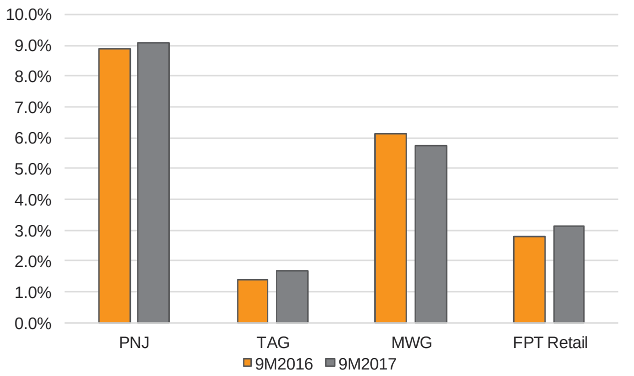
Source: Companies

Figure 105: Gross margin 9M2016-2017



Source: Companies

Figure 106: EBITDA margin 9M2016-2017

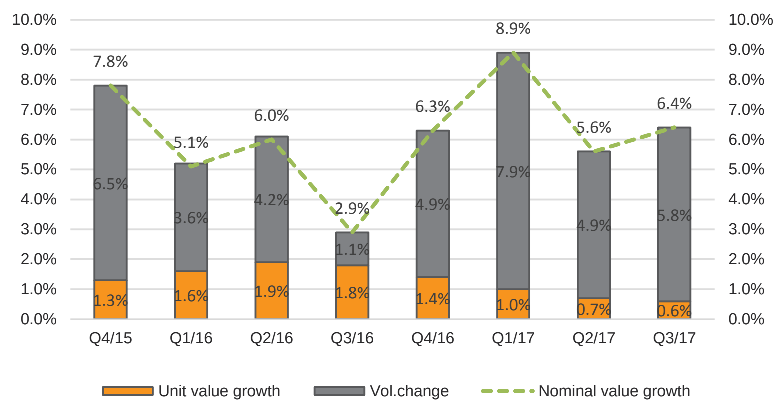


Source: Companies, VNDIRECT calculation

Food & beverage producers: volume growth did not feed through to bottom lines and growth decelerated in the third quarter

According to a recent report by Nielsen on Dec 5th 2017, the nationwide growth rate of FMCG sales rose 6.5% YoY in 3Q2017, mainly driven by an increase of 5.8% YoY growth in volume.

Figure 107: FMCG YoY sales growth nationwide by quarter



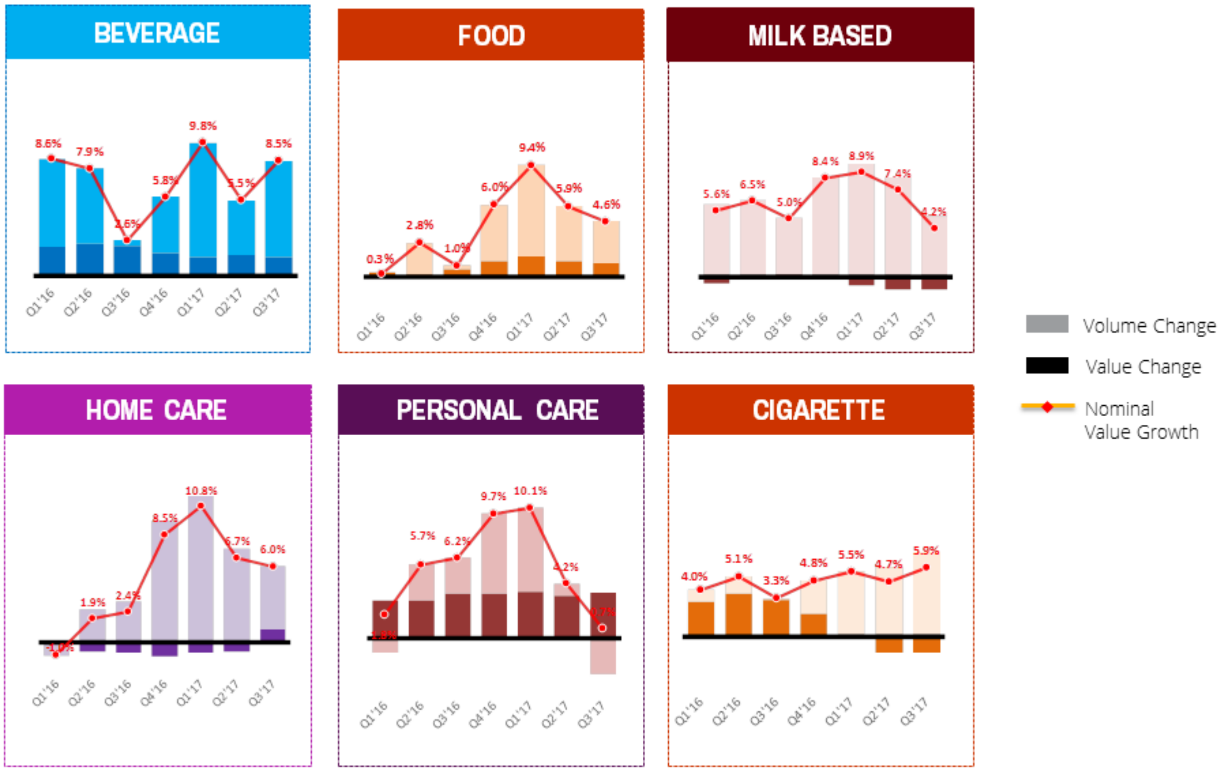
Source: Nielsen 2Q17

Among the six FMCG "super categories", beverages and cigarettes saw an acceleration in Q3 2017 with 8.5% and 5.9% growth YoY, respectively. Other categories started to decelerate since the beginning of this year. Food sales rose by 4.6% YoY in Q3, lower than

5.9% YoY of Q2; milk-based products sales grew by 4.2% YoY, lower than 7.4% of Q2. Home care and personal sales were up only by 6.0% YoY and 0.7% YOY, respectively. Beverages still accounted for a large proportion of total FMCG sales during Q3, at 42%. Food, cigarettes and milk-based products accounted for approximately 16%, 15% and 14% respectively.

We see that prices actually declined in some high-growth categories such as milk-based products and cigarettes; we see this as symptomatic of increasing competition which led to aggressive promotional pricing strategies, stoking overall volume growth.

Figure 108: Growth across the six "Super" categories between

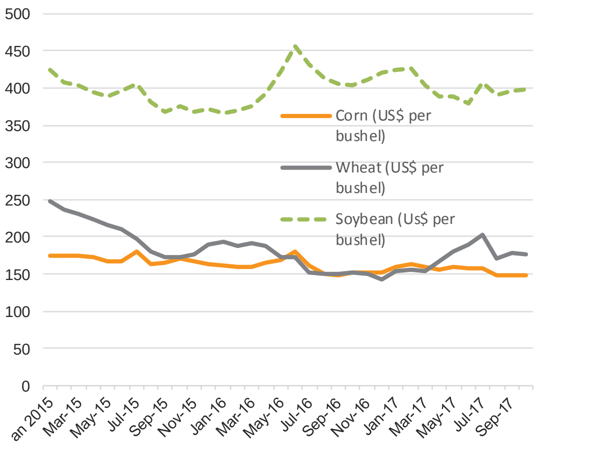


Source: Nielsen 2Q17

A rebound in prices of select agricultural commodities limited margin expansion. In order to reduce the impact of rising input prices and combat increasing competition, F&B players had to ramp up sale promotions to allow for pass throughs of higher input prices to consumers without compromising volume growth. They also had to diversify their product portfolio and, in some cases, implement de-stocking initiatives.

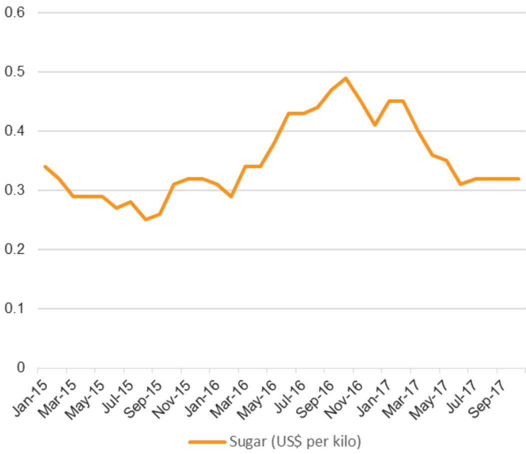
This was reflected in the 9M performance of the top 5 FMCG companies in the country. In the top 5 players, all except for VNM witnessed a declined in EBITDA margin which led to a deceleration in bottom line growth, despite volume growth

Figure 109: Corn, wheat, and soybean spot prices



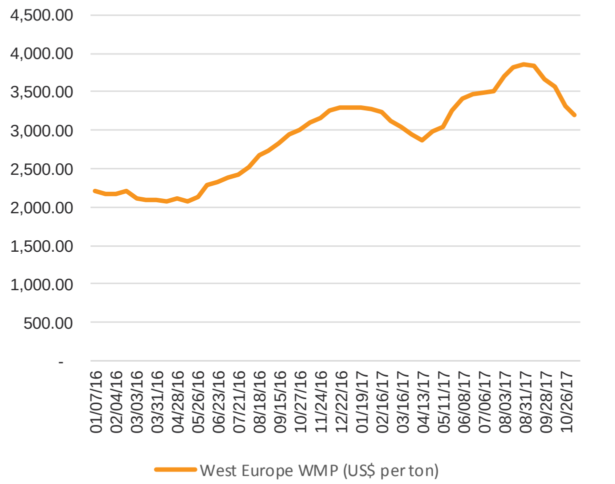
Source: Index Mundi

Figure 110: Sugar spot price



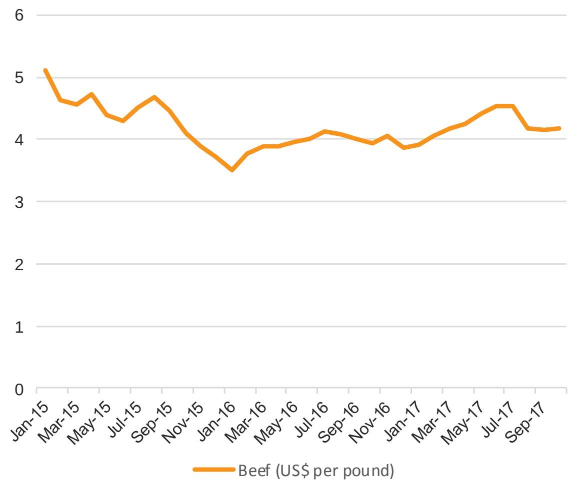
Source: Index Mundi

Figure 111: Whole milk powder spot price (26% butterfat)



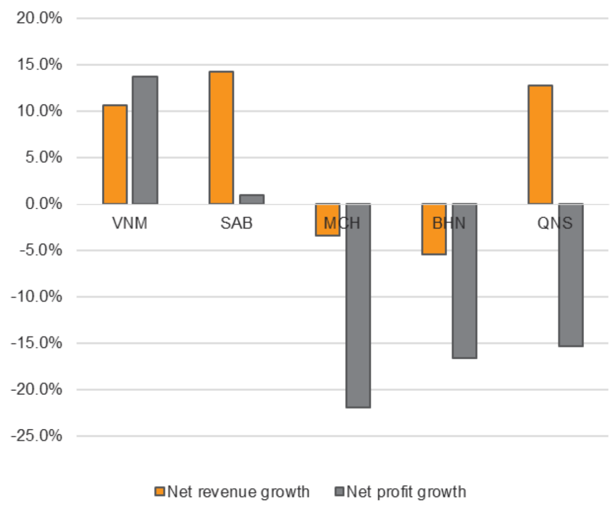
Source: Bloomberg

Figure 112: Beef spot price (US$ per pound)



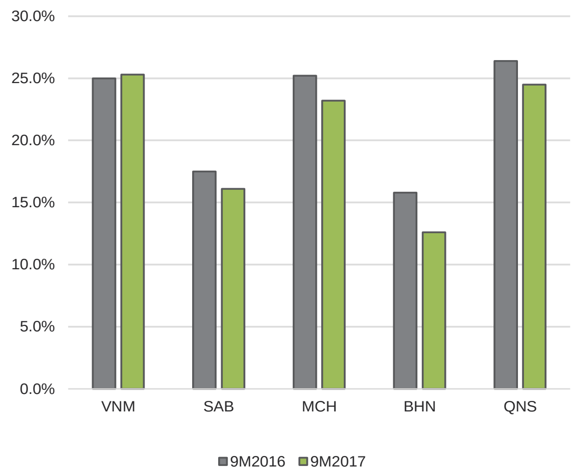
Source: Index Mundi

Figure 113: Net revenue and net profit growth in 9M2017



Source: VNDIRECT

Figure 114: EBITDA margin 9M2017



Source: VNDIRECT

Vinamilk (VNM: HOSE), the country's largest milk producer, posted a 10.6% YoY and 13.7% YoY growth in its 9M2017 net sales and net profit, respectively. The company's gross margin remained resilient despite the higher whole milk input prices in 9M2017, as the company launched several premium products during the end of 2016 through 9M2017 (organic milk products).

In the beer segment, the competition between local and foreign players became more fierce as both **Sabeco** (SAB:HOSE) and **Habeco** (BHN:HOSE), two of the largest local beer producers, saw significant net margin erosion in 9M2017. SAB's net revenue and net profit rose by 14.2% YoY and 1.0% YoY, respectively during 9M2017. The net margin compression stemmed from the combination of a contraction in gross margin (from 27.6% in 9M2016 down to 27.0% in 9M2017) and an increase of 14% YoY in SG&A expenses. Meanwhile, BHN posted a 5.4% decline in its net revenue and a 16.6% decline in its net profit.

Masan Consumer (MCH:HOSE) implemented de-stocking initiatives in 1H2017, which led to a decrease in the company's 9M2017 sales across various categories including seasonings (-6.5% YoY); convenience foods (-6.0% YoY) and beverages (-1.7% YoY). Consequently, 9M2017 net revenue declined by 3.4% YoY. The company's 9M2017 gross margin remained at 45.2% (vs. 45.3% same period last year) while a surge in selling expenses related to de-stocking dragged 9M2017 net profit down by 23.0% YoY.

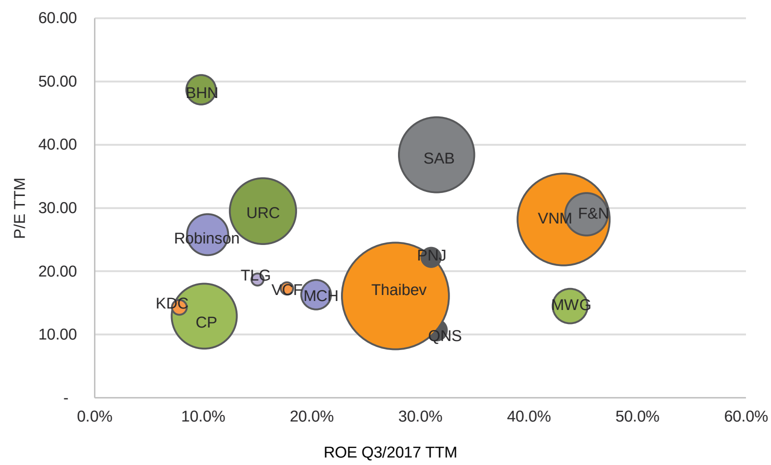
Quang Ngai Sugar (QNS:UPCOM), Vietnam's largest soymilk and sugar producer, also posted a 12.8% increase in its 9M2017 revenue. This mainly stemmed from 31.9% YoY growth in its sugar revenue during 9M2017, due to the higher sugar yield and low base in 2016 due to the prolonged drought in that year. Meanwhile, its soymilk business saw relatively sluggish performance with only 4.1% YoY growth in 9M2017 revenue due to stronger competition from new foreign brands. Although QNS was able to generate a considerable improvement in its topline, a steep decline in the price of sugar in 9M2017 hit sugar segment margins and dragged earnings down by 15.3%.

CONSUMER STOCK PICKS: WE LIKE PNJ

Stay selective in the consumer space

We recommend that investors be very selective when picking stocks in the consumer sector during 2018, given that valuations have been rising considerably, across the board and several popular names already look fairly valued from a medium-term perspective.

Figure 115: Valuation of the ten largest Vietnam listed consumer companies versus regional peers.



Note: Bubble size represents market cap as of Dec 21st 2017

Source: VNDIRECT

Figure 116: Vietnam listed consumer companies comparison

Company	Market Cap (mn US$)	TTM NPAT growth (%)	ROA (%)	ROE (%)	D/E (x)	TTM P/E (x)	P/B (x)
F&B companies							
VNM	12,979	10.2%	33.5%	43.2%	0.0x	28.5x	12.3x
SAB	7,009	1.0%	22.5%	31.5%	0.1x	35.8x	10.8x
MCH	1,660	-21.9%	14.5%	20.4%	0.3x	16.3x	3.9x
BHN	1,290	-16.6%	6.3%	9.6%	0.2x	48.5x	5.1x
QNS	601	11.4%	19.1%	31.5%	0.4x	10.7x	3.2x
KDC	346	-40.9%	5.4%	7.8%	0.3x	14.2x	1.6x
VCF	296	-0.3%	12.8%	17.7%	0.2x	17.4x	2.9x
TLG	226	10.4%	18.2%	26.8%	0.2x	19.3x	4.8x
F&B average peers		*-5.8%*	*16.5%*	*23.6%*	*0.2x*	*23.8x*	*5.6x*
F&B median peers		*-0.3%*	*16.5%*	*23.6%*	*0.2x*	*19.3x*	*4.8x*
Retail companies							
MWG	1,855	33.0%	12.0%	43.8%	3.2x	14.5x	5.2x
PNJ	621	75.7%	16.2%	31.0%	0.3x	22.3x	5.3x
Retail average peers		*54.4%*	*14.1%*	*37.4%*	*1.8x*	*18.4x*	*5.3x*

Note: as of Dec 22nd 2017

Source: VNDIRECT

We like both **PNJ** and **MWG** due to their dominant market positions even though neither company looks cheap at the moment. As of Dec 22nd 2017, PNJ and MWG are trading at TTM P/Es of 22.3x and 14.5x, respectively, yet the potential double digit profit growth ahead for these companies in 2018 justifies these lofty multiples. However, PNJ's prospects are clearer and more predictable as compared with MWG, as it will take time for the success of MWG's BachhoaXanh chains and TAG acquisition to become visible.

VNM's share price started to take off since the beginning of November, ahead of the divestment auction by SCIC. Currently, VNM is trading at a TTM P/E of 28.5x, an all-time high. We believe some premium is justified due to the success of the SCIC divestment auction. We still like VNM given its leading position and the strong organic growth of the dairy market in Vietnam. We think any downward price adjustment in the near future could present a good entry opportunity.

SAB's stock price increased by nearly 60% this year, ahead of the divestment by Vietnam's Ministry of Industry and Trade (MOIT). On Dec 8th, Thai Beverage PCL – a Thai brewery company – officially won the bid for a 54% stake in SAB for VND320,000 ($14.1) per share. The deal value was approximately US$4.8bn. However, after the bidding sucessfully closed, we saw that many investors started to book profits which dragged on SAB's share price. Currently SAB is trading at a TTM P/E of 35.8x, a premium of 50% to local F&B peers. Although, the beer market of Vietnam is promising, we believe this valuation is rich even in a regional context.

PHU NHUAN JEWELRY JSC (PNJ)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND130,900	VND143,700	1.37%	HOLD	Retail

Outlook – Short term			Outlook – Long term			Valuation		
Negative	Neutral	Positive	Negative	Neutral	Positive	Negative	Neutral	Positive

Tuan Nguyen Thanh
tuan.nguyenthanh@vndirect.com.vn

2018 promises to be another positive year for PNJ with a favorable macro environment and quickly expanding retail footprint. We downgrade our Recommendation to HOLD as the stock price has surged recently but we see further upside over a long-term horizon.

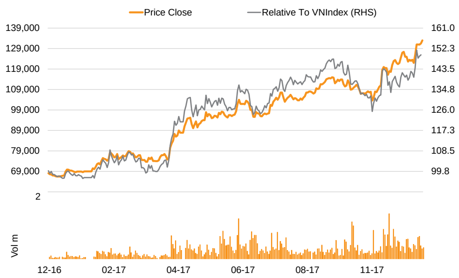
- Market leader in jewelry retail with over 26% market share (branded market) and with quickly expanding store network Market leader in jewelry retail, with over a 26% market share in the branded market, and an expanding network of stores.
- Combination of growth in the number of its stores and the double digit same store sales growth will lead to impressive earnings growth in 2018.
- PNJ's stock price nearly doubled in 2017, yet it is still attractive given the projected 44% earnings growth ahead in 2018.

PNJ is speeding up the expansion of its stores. PNJ was operating 261 stores as of the end of November 2017 (+19.8% YTD) and plans to increase this to 300 by Q2 2018. If the current pace continues, PNJ might reach the ambitious target of 300 stores by early FY18, earlier than its original plan of FY19. The successful private placement to Dragon Capital and Vinacapital worth nearly VND1,000bn in July 2017 allowed PNJ to raise cash to fund its aggressive store expansion plans.

2018 SSSG may not remain as high as in 2017 (22% for 9M2017), but the 12% target is achievable and will help boost retail sales. The impressive SSSG figures in 2017 was a result of (1) poor performance in 2016 sales per store and (2) restructuring in merchandise/logistic department. Therefore, SSSG in 2018 will likely return to the historical norm of 12%.

Impressive earnings growth will continue in 2018. During 2017**,** we estimate that the company's net revenue will grow by 28.8% (VND11,028bn) and net profit will reach VND791bn (+75.7%), 31% higher than the company target (VND600bn). We expect for this strong growth trend to continue into 2018, with topline growth of 19.3%. We project that retail revenue, which has very favorable margins, will grow by 35%.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	133,500
52w low (VND)	66,500
3m Avg daily volume (shares)	502,628
3m Avg daily value (VNDmn)	29,294
Market cap (VNDbn)	14,150
Outstanding shares (m)	108
Free float (%)	53
P/E TTM	21.9x
P/B	5.2x

Ownership

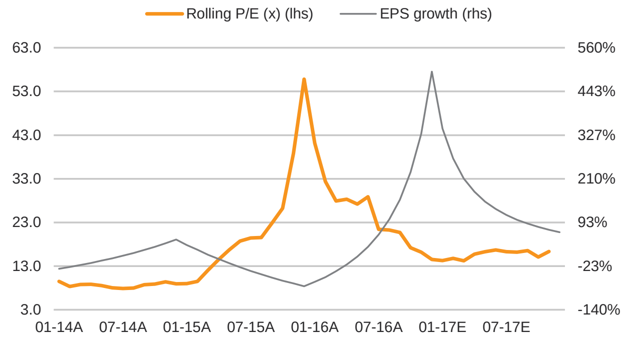
Cao Thi Ngoc Dung	9.22%
LGM Investment	4.53%
Route One Investment Co.	4.06%
Others	82.19%

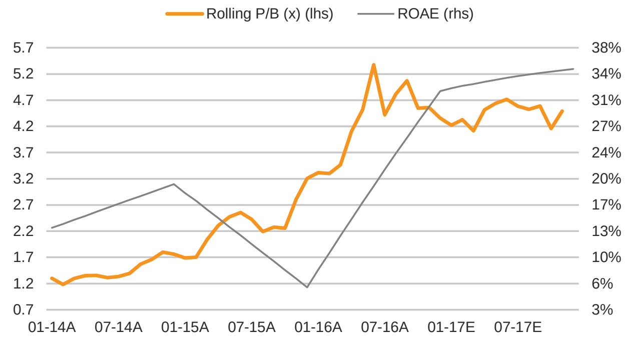
Source: VNDIRECT

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	7,706	8,565	11,028	13,155
Revenue growth	(16.2%)	11.1%	28.8%	19.3%
Gross margin	15.2%	16.5%	17.6%	19.2%
EBITDA margin	3.9%	8.2%	9.9%	11.6%
Net profit (bn)	76	450	791	1,140
Net profit growth	(70.5%)	496.3%	75.7%	44.0%
Recurring profit growth	63.3%	20.8%	53.1%	43.7%
Basic EPS	769	4,584	7,670	10,542
Adjusted EPS	568	4,383	7,212	9,913
BVPS	13,383	15,267	28,011	34,339
ROAE	5.8%	32.0%	35.0%	33.8%

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	8,565	11,028	13,155
Cost of sales	(7,153)	(9,089)	(10,627)
Gen & admin expenses	(133)	(168)	(200)
Selling expenses	(554)	(713)	(848)
Operating profit	**724**	**1,058**	**1,480**
Operating EBITDA	759	1,092	1,524
Depreciation and amortisation	**(34)**	**(33)**	**(44)**
Operating EBIT	**724**	**1,058**	**1,480**
Interest income	5	11	8
Financial expense	(182)	(82)	(66)
Net other income	43	1	2
Income from associates & JVs	(1)	1	1
Pre-tax profit	**591**	**989**	**1,425**
Taxation	(140)	(198)	(285)
Minority interests			
Net profit	**450**	**791**	**1,140**
Adj. net profit to ordinary	450	791	1,140
Ordinary dividends	0	0	0
Retained earnings	**450**	**791**	**1,140**

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	155	126	202
Short term investments	0	0	0
Accounts receivables	63	76	96
Inventories	2,839	3,564	4,531
Other current assets	46	46	54
Total current assets	**3,103**	**3,813**	**4,883**
Fixed assets	416	499	537
Total investments	0	39	0
Other long-term assets	70	0	0
Total assets	**3,588**	**4,351**	**5,420**
Short-term debt	1,449	643	869
Accounts payable	326	285	337
Other current liabilities	247	340	374
Total current liabilities	**2,022**	**1,268**	**1,579**
Total long-term debt	59	54	49
Other liabilities	7	1	79
Share capital	983	1,081	1,081
Retained earnings reserve	374	750	1,229
Shareholders' equity	**1,500**	**3,028**	**3,712**
Minority interests	0	0	0
Total liabilities & equity	**3,588**	**4,351**	**5,420**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**591**	**989**	**1,425**
Depreciation & amortisation	34	33	44
Tax paid	(160)	(198)	(285)
Other adjustments	145	74	43
Change in working capital	**(637)**	**(755)**	**(897)**
Cash flow from operations	**(27)**	**143**	**330**
Capex	(87)	(117)	(82)
Proceeds from assets sales	165	0	0
Others	68	0	34
Other non-current assets changes	0	0	0
Cash flow from investing activities	**146**	**(117)**	**(48)**
New share issuance	0	997	0
Shares buyback	0	0	0
Net borrowings	244	(816)	216
Other financing cash flow	0	0	0
Dividends paid	(246)	(237)	(421)
Cash flow from financing activities	**(1)**	**(56)**	**(206)**
Cash and equivalents at beginning of period	38	155	126
Total cash generated	**117**	**(29)**	**76**
Cash and equivalents at the end of period	155	126	202

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	5.3%	7.2%	8.7%
Asset turnover	2.61	2.78	2.69
ROAA	13.7%	19.9%	23.3%
Avg assets/avg equity	2.33	1.75	1.45
ROAE	32.0%	35.0%	33.8%
Efficiency			
Days account receivable	0.42	0.37	0.37
Days inventory	145	143	156
Days creditor	16.7	11.4	11.6
Fixed asset turnover	19.0	24.1	25.4
ROIC	15.0%	21.2%	24.6%
Liquidity			
Current ratio	1.53	3.01	3.09
Quick ratio	0.13	0.20	0.22
Cash ratio	0.08	0.10	0.13
Cash cycle	129	132	144
Growth rate (yoy)			
Revenue growth	11.1%	28.8%	19.3%
Operating profit growth	15.6%	46.1%	39.8%
Net profit growth	496.3%	75.7%	44.0%
EPS growth	496.3%	67.3%	37.4%
Share value			
Basic EPS (VND)	4,584	7,670	10,542
BVPS (VND)	15,267	28,011	34,339

AUTOMOTIVE: THE CALM BEFORE THE STORM

Imminent reductions in import tariffs in 2018 will unleash a flood up pent-up passenger vehicle demand

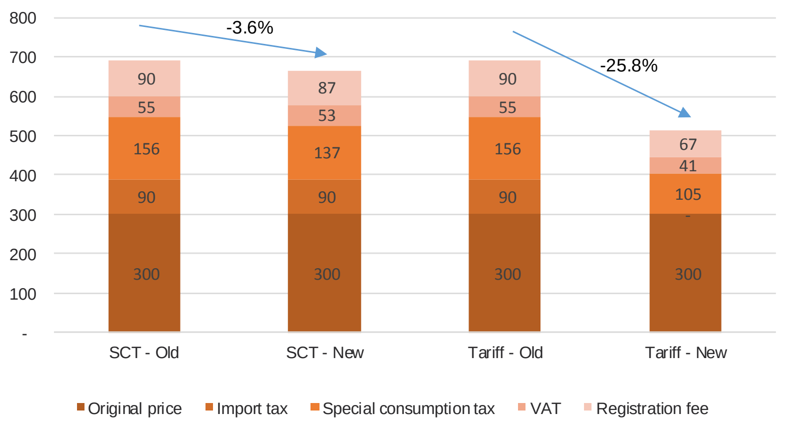
Import tariff removal and special consumption tax (SCT) reduction to lead to price reductions. In 2018, the tariffs on ASEAN cars will be removed (currently 30%) under the ASEAN Free Trade Area (AFTA) agreement and the SCT rate on small engine (2.0 liter or below) cars will be reduced by 5 percentage points. Most affordable car models should qualify for the SCT reduction, and the net effect should be a 3-4% reduction in the price of imported cars. The tariff exemption could greatly reduce the full price by ~25% but this is harder to achieve given that there are a very few car models that could satisfy the localization rate required to qualify for this tariff exemption (40% of production value added within ASEAN). We believe that most brands will see a small price reduction in 2018, with larger price reductions being seen for a select few models that meet the ASEAN localization criteria.

Figure 117: Special consumption tax change

Engine size (litre)	Change (% pts)
2.0 or less	-5%
Over 2.0 - 2.5	-
Over 2.5 and below 3.0 litre	5%
Over 3.0 litre	-

Source: VNDIRECT

Figure 118: Potential Impact of Taxes and Tariff reductions on car prices (VNDmn)



Source: VNDIRECT

Expected price reductions is leading to postponement of car purchases. Automotive sales for most popular brands have already started declining, and we have witnessed 4-14% price reductions for the top 15 best-selling models since H1 2017. At the end of 2016, car prices plunged by 6-7% following the 10% tariff cut in 2017, but the demand for cars still grew firmly during this time as the price reductions spurred more demand. However, the current wave of aggressive price reductions from local dealers has had a "reverse psychological" impact, fuelling hesitation among buyers as they now seem to be delaying their purchases in anticipation of continued price reductions. This postponement of purchases has resulted in a 3% fall in 10M 2017 passenger car (PC) sales volumes. For the last 2 months of 2017, we believe that the sales volume will remain low and that the total volume of cars sold at the end of the year will come in at around 145,000 units (-9% YoY).

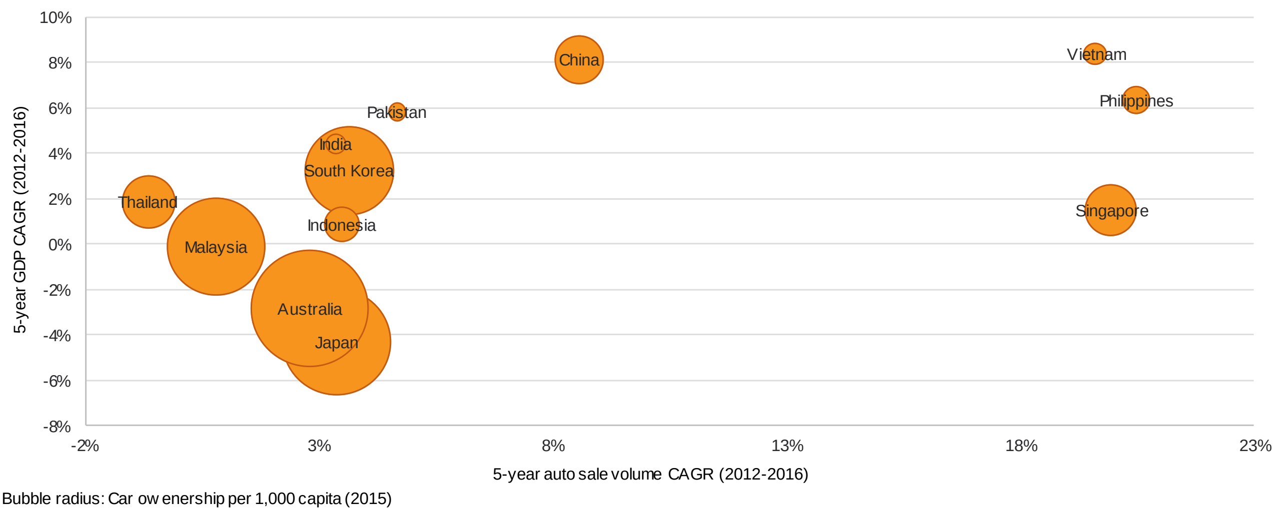
Figure 119: Top 15 best-selling models, recommended retail price (VNDmn)

Model	Jun-17	Nov-17	Change	Change %
Toyota - Vios 1.5E/VE	564	513	-51	-9.0%
Kia - Morning	319	305	-14	-4.4%
Mazda - Mazda3	690	660	-30	-4.3%
Toyota - Innova E	793	743	-50	-6.3%
Mazda - CX-5	849	879	30	3.5%
Toyota - Fortuner Diesel/FG	981	981	0	0.0%
Ford - Ranger 4x2 CBU	659	685	26	3.9%
Toyota - Vios 1.5G/VG	622	565	-57	-9.2%
Ford - Ranger 4x4 CBU	604	634	30	5.0%
Honda - City 1.5 AT	568	568	0	0.0%
Toyota - Fortuner G (4x2)/FX	1149	1149	0	0.0%
Kia - Cerato	569	553	-16	-2.8%
Toyota - Corolla Altis 1.8AT	747	707	-40	-5.4%
Honda - CR-V 2.4AT	1158	988	-170	-14.7%

Source: VNDIRECT

Economic growth to support future demand for passenger cars. The recent decline in automotive sales this year is an outlier, as this industry has historically had very strong growth. Car sales in Vietnam grew at a CAGR of 19.6% during the past five years, the 3rd highest rate of growth in Asia. Vietnam also saw one of the fastest rates of increase in purchasing power over the past five years but the car ownership per capita remains much lower than most other markets in Asia. Vietnam's middle class population is expected to grow rapidly over the next decade and this will fuel a rapid rise in demand for all manner of consumer durables. Our macro team projects that Vietnam's GDP will rise by 6.6-6.8% in 2018. We believe that the demand for cars will continue to outpace GDP growth, and that the downturn during 2017 was merely a result of short term hesitation among car buyers who were waiting for more clarity in 2018.

Figure 120: Vietnam's auto market has plenty of room to grow driven by strong GDP growth and low penetration



Source: OICA, VAMA, World bank, VNDIRECT

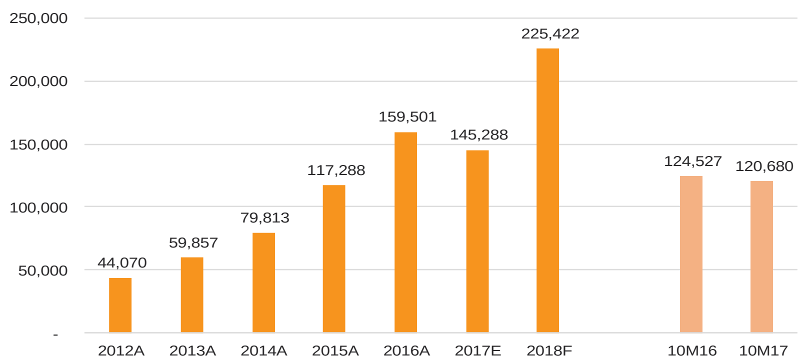
Uber and Grab behind 2016 auto sales growth but these tail winds might moderate in 2018. The increased popularity of ride-hailing applications like Uber and Grab is also indirectly fueling small car sales. These applications have made cars rent-yielding assets that now generate economic value for society and their owners rather than merely serving personal purposes. While Uber and Grab have not made their fleet size public. However, we estimate that nearly 15,000 Uber and Grab cars joined the local fleet in 2016, and a significant portion of these vehicles were newly purchased. This expansion largely supported auto consumption in the past, but this may be absent in 2018, as authorities are making efforts to constraint the size of these service fleets and this business model is increasingly becoming less attractive and profitable for drivers and car-owners.

Possible government backlash against imported car dumping and rising traffic congestion creates some risks. After paying tariffs and SCTs, car buyers also have to pay other taxes and fee layers, which adds upto 26-28% on the post tariff/SCT price. These taxes and fees are not addressed in the AFTA requirements and could easily become a tool for the government to readjust car prices. In our view, the government might be tempted to use these local taxes as levers to constrain the growing pressure on the current poor urban road infrastructure and growing traffic congestion. The government's intent to do this is already hinted in the recent changes in import permission norms, which aims to add more customs and logistics costs to the imported car price. This change, however, does not fully impact licenses dealers, which are capable of getting approval from customs quickly and hence this should not widely impact car prices in general. We do not expect to see any other policy change in the next six months, as it may take time to create and apply any new regulations.

We expect passenger car sales to surge by 20% next year. We expect that volume may exceedd 225,000 units in 2018, a 50-60% rise over the 2017 full year projected volume based on extrapolation of 10M 2017 actual results.

The main beneficiaries of this growth will be those car dealers with the most popular and affordable OEM brands in their portfolio that have factories in AFTA countries such as Toyota, Honda, Suzuki, Hyundai, GM, and Ford. The potential growth in volume may offset the price declines and result in positive earnings growth for these companies next year, although this depends on the mix of car models in each dealer's 2018 sales mix.

Figure 121: Passenger car sale volume



Source: VNDIRECT, OICA, VAMA

AUTOMOTIVE SECTOR STOCK DISCUSSION: WE PREFER DEALERS TO ASSEMBLERS

We do not officially cover any stock in this sector yet, but have been monitoring some stocks in this area that demonstrate potential. We like companies that can directly benefit from a boom in imported affordable car demand next year. Amongst all passenger car dealers, SCV and CTF are most exposed to this market trend, as they are distributing most of the low-end and medium-range brands in the market. These dealers could be much less vulnerable to a future price war between assemblers and importers, as they could quickly switch between selling Complete Built Units (CBU) and Semi Knocked-Down Units (SKD) cars. We prefer SCV the most due to its well diversified brand portfolio, and expect the car models in its porfolio to see deep price cuts and a consequent surge in sales volume. HAX has been performing well in the luxury car segment, as its car models such as E-class, C-Class, and SUV models have recently received a positive response from customers. Some of these models may still be exposed to SCT reductions, as they come with small engines.

In the short-term, some local assemblers like Thaco may suffer a decline of sales, as some of their brands may be more price competitive when imported as CBUs from factories in other regions, post the import tariff reductions. As one of the best local auto assemblers, Thaco does have potential to hold its ground, as it is seen as the centerpiece of the government's automobile industry development master plan. Hence, there will be more supportive policies or tax incentives for these assemblers, but we believe that this may take time to be implemented. The 2018 tariff on imported car parts from AFTA has already been reduced to 0% for those assemblers that meet the 20% minimum localization requirements and minimum output levels for each model. This makes it hard to determine how or when local assemblers can compete with imported CBU cars.

Figure 122: Automobile company monitor

Company	Business model	Main type of vehicle	Source	Distributed brand
Thaco	Assembler & Dealer	Passenger car, truck, & bus	SKD	Mazda, Peugeot, Kia, Thaco (truck & bus)
SVC	Dealer	Passenger car	CBU and SKD	Hyundai, Toyota, Ford, Suzuki, Volvo, Chevrolet, Mitsubishi, Fuso, Honda, Hino, Veam.
HHS	Dealer	Truck & Bus	CBU	Dong Feng
HAX	Dealer	Passenger car	CBU and SKD	Mercedes-Benz
HTL	Dealer	Truck & Bus	CBU	Datano, Hino, Shinmaywa
TMT	Assembler & Dealer	Truck & Bus	CBU and SKD	Tata, Sinotruk, Hyundai (truck)
CMC	Assembler & Dealer	Industrial vehicle	CBU	Komasu, Hitachi
CTF	Dealer	Passenger car	CBU and SKD	Ford

Source: VNDIRECT

Figure 123: Automobile sector comparable valuation

Sticker	Country	Market Cap (US$mn)	TTM NPAT growth	TTM EPS growth	ROA	ROE	D/E (x)	TTM P/E (x)	P/B (x)
Thaco* (Unlisted)	Vietnam	1.025	12,2%	12,2%	14,6%	33,9%	1,3	N.a	N.a
TMT	Vietnam	393	-78,0%	-78,0%	0,4%	2,2%	3,9	37,2	0,9
CMC	Vietnam	29	110,1%	76,3%	2,6%	4,7%	0,6	9,4	0,4
Assembler average		**482**	**745,1%**	**98,4%**	**5,9%**	**13,6%**	**2,0**	**23,3**	**0,7**
SVC	Vietnam	54	-59,3%	-13,8%	3,0%	8,7%	1,2	12,1	1,4
HHS	Vietnam	51	-29,4%	-8,3%	2,3%	2,4%	-	19,0	0,5
HAX	Vietnam	39	31,5%	-28,8%	6,4%	22,3%	2,9	11,8	2,5
HTL	Vietnam	22	-17,7%	-5,1%	4,5%	8,1%	0,2	26,3	2,2
CTF*	Vietnam	17	140,0%	112,0%	4,5%	10,7%	1,3	15,4	1,8
Dealer average		**37**	**13,0%**	**11,2%**	**4,1%**	**10,5%**	**1,1**	**16,9**	**1,6**

(*) All data are based on The audited financial statement for the year ended on 31 Dec 2016
All prices are based on the closing prices are on 21 Dec 2017

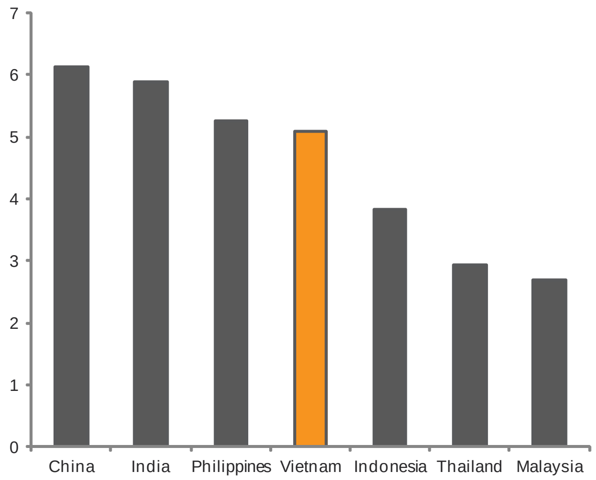
Source: VNDIRECT, FiinPro

AVIATION: A FANTASTIC LONG-TERM GROWTH STORY BUT EXPECT COMPETITION TO INTENSIFY

Vietnam's rising middle class population, coupled with low air travel pentration, will be catalysts for this industry.

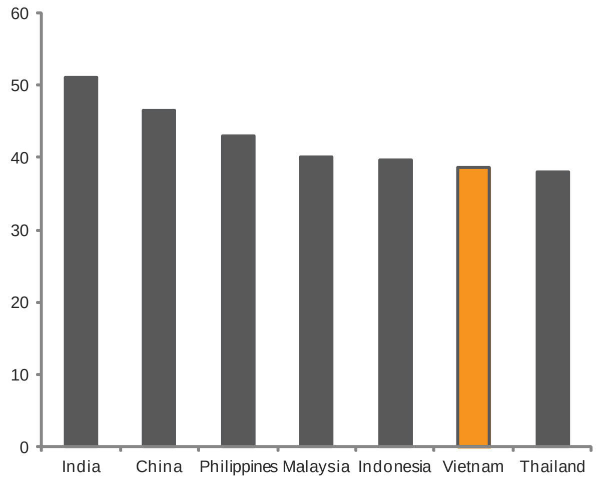
Vietnam's middle and affluent class (MAC) population will reach 33 million by 2020, double the figure in 2014, according to the Boston Consulting Group. This market is sizeable in a regional context as it is equal to two-thirds of Thailand's projected MAC in 2020 and is nearly as big as Indonesia's current MAC population of 36 million. Vietnam's MAC population growth rate will be the highest among ASEAN countries over the period, driven by the following trends: 1) 6% growth in GDP per capita to reach USD3,400 in 2020 and 2) a modest increase in income disparity over the period, lower than that of several Asian countries such as China, India, and Indonesia; this implies economic growth is lifting incomes in a broad-based manner rather than having the spoilts of growth simply accruing to a small share of the population.

Figure 124: APAC countries' GDP per capita growth rate (%), 2016



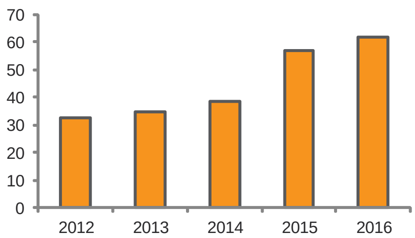
Source: World Bank

Figure 125: Gini score, avaiable within 2013-2016



Source: World Bank

Figure 126: Vietnam domestic tourist arrivals (millions)



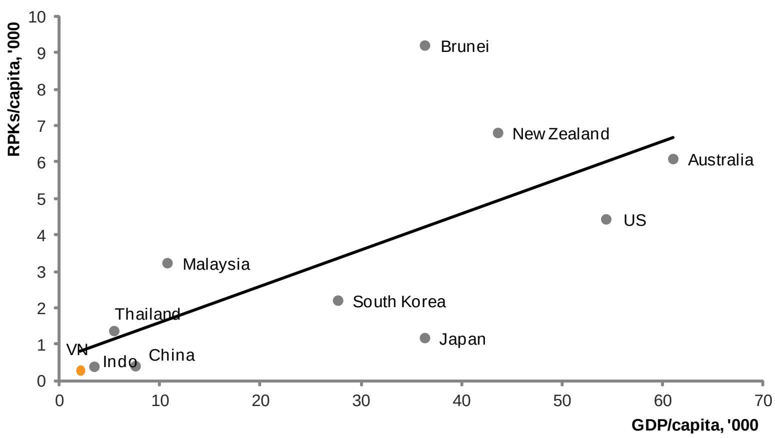
Source: VNAT

Young demographics, an expanding working age population and rising incomes are boosting discretionary spending on travel. People are no longer just spending on basic necessities but also on life-enhancing and self-enriching goods and services including additional education, smart phones, and leisure travel. Vietnamese, especially baby boomers, have started traveling more, both domestically and internationally. Vietnamese baby boomers, who were born within 1975 and 1985 and make up 35% of the population, are the main driver of the country's tourism industry. In future years, retired baby boomers will still drive the growth of tourism in Vietnam, as they will start to spend their savings or transfer their wealth to their children.

According to the Vietnam National Administration of Tourism, the number of domestic tourist arrivals has been growing at a CAGR of 17% since 2012, and reached 62 million in 2016. As a result, the domestic passenger traffic in the country's airports grew by 24% YoY over the same period, and reached 57 million in 2016. Apart from domestic tourism centers, overseas destinations within the APAC region are becoming more and more popular among Vietnam travelers. Recently, Vietjet Air (HOSE: VJC), the largest low-cost carrier (LCC) in Vietnam, opened several new routes to South Korea, China, and Myanmar, which reflects the steady flow of tourists from these countries to Vietnam as well as outbound travel from Vietnam to these countries. According to research by Mastercard, Vietnam's outbound travel volume could grow at 9.5% per annum until 2021, which is the 2nd highest rate of growth among APAC countries.

The aviation industry has significant growth opportunities, as Vietnam has the lowest air travel penetration among APAC countries, in terms of revenue passenger kilometers (RPKs) per capita. RPKs are a proxy for the total number of paying passengers and the total travelling distance. A rise in GDP per capita is highly likely to encourage RPK growth as passengers are increasingly likely to travel more frequently and to travel longer distances, whether this is for personal or business trips. Vietnam's air penetration is far behind Thailand and Malaysia, as the country's GDP per capita is only one-third of Thailand's and one-fifth of Malaysia's. However, Vietnam's GDP growth rate of 6.2% (2016) was higher than Thailand's GDP growth rate of 3.2% (2016) and Malaysia's GDP growth rate of 4.5% (2016). Furthermore, as the chart below shows, Vietnam's air travel penetration is even lower than would be warranted by its GDP per capita, implying that air travel growth should actually outpace growth in per capita incomes in the future.

Figure 127: Air Travel Penetration, 2016

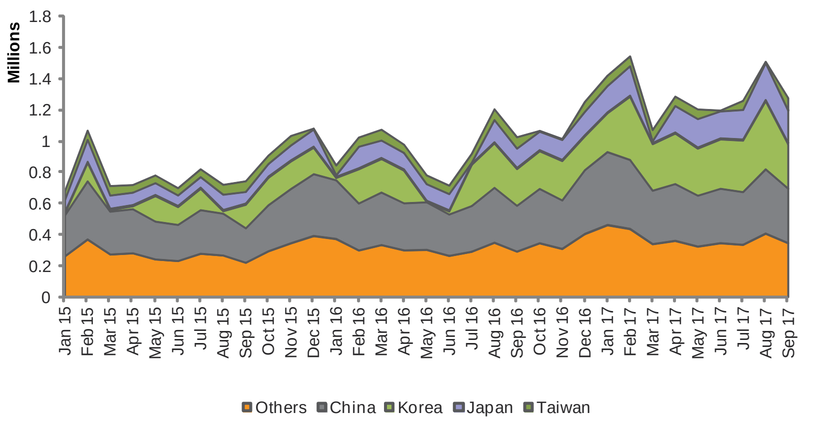


Source: VJC

Vietnam's growing popularity as a tourism detination, particularly among North East Asians, is another key driver of air travel. Another important growth driver of RPKs per capita is the increasing number of foreign visitors in recent years. During 2016, the total number of foreign tourists arriving by air into Vietnam grew by 23.1% to reach 8.5 million. For 9M 2017, the growth accelerated significantly to 41.5% YoY, taking the total number of foreign tourist arrivals by air travel to 8.7 million. One new emerging trend includes the rise of South Korean tourists and the emergence of a new class of Chinese tourist – those originating from tier 2 and tier 3 cities in China, travel in large groups and typically arrive in Vietnam via chartered flights. At the end of September 2017, Korean tourists accounted for one-fifth of total foreign tourist arrivals so far this year, twice the 2015 share. Japanese tourists have also shown more interest in Vietnam. Chinese tourists remain the largest source country for foreign tourists visiting Vietnam, accounting for more than one-third of the total number.

We expect that the proportion of Korean and Japan visitors will rise in the future as Vietnam – South Korea and Vietnam – Japan diplomatic relations continue to improve and trade and investment ties between Vietnam and these countries continue to flourish. At the moment, South Korea and Japan are Vietnam's largest FDI investors, followed by Singapore and Taiwan. Both countries are planning to loosen visa requirements for Vietnamese visitors in the next year. Lower visa requirements will further encourage the number of Vietnamese travelers, which have been growing significantly in recent years.

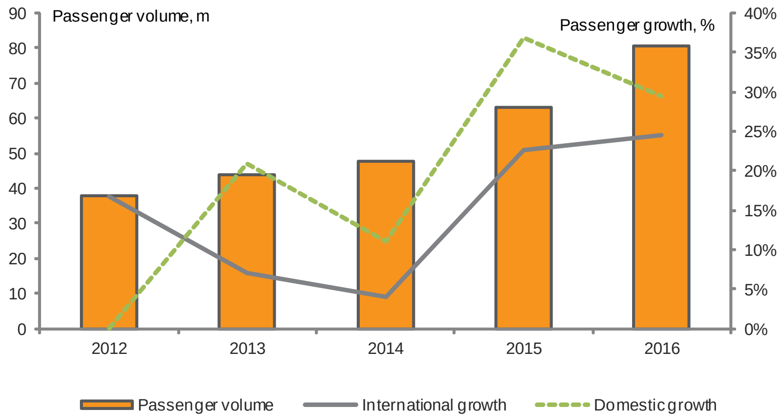
Figure 128: Foreign visitor arrivals in Vietnam



Source: Vietnam National Administration of Tourism

Vietnam has the highest air travel passenger growth rate in Southeast Asia, and we expect Vietnam to remain the regional growth leader for several years to come. Over the last five years, passenger volume grew at a CAGR of 17%, and reached 79mn in 2016. The 2nd rank in growth terms belongs to the Philippines, with a passenger growth rate of around 14.3%. Domestic passenger volume grew by 19% on average, outpacing international passenger volume (13%). However, we have noticed that international passenger volume growth has accelerated significantly in the past two years, and has caught up with the domestic passenger growth rate. We expect international passenger volume growth to outpace domestic passenger volume growth over the next few years. In 9M 2017, international passenger traffic through Tân Sơn Nhất Airport (SGN) grew faster than domestic passenger traffic by 4-5 percentage points, rising by more than 20% YoY.

Figure 129: Air Travel Passenger Volume Growth



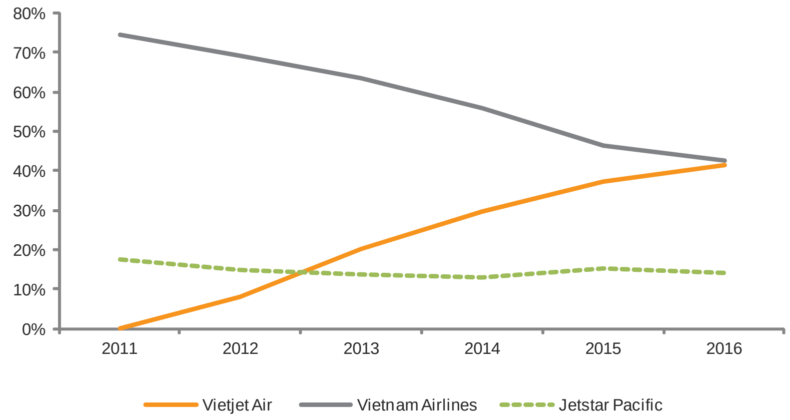
Source: VNDIRECT

The LCC segment remains the growth engine of the aviation industry, as it is able to capture demand from first time flyers.

The fleet expansion in LCC segment, most notably of VJC, continues to attract first time flyers and is now also poaching customers of full service carriers. The Vietnam LCC segment consists of two carriers, namely Vietjet Air (VJC) and Jetstar Pacific (JPA). JPA, the subsidiary of Vietnam Airlines (HOSE: HVN), was the first mover. Although VJC was established years after the launch of JPA, it has rapidly become the dominant player by launching highly successful sales and marketing campaigns, using aggressive promotional pricing offers and rapidly expanding its fleet through sales-and-lease back (SLB) transactions. By the end of 2016, VJC accounted for 42% of the domestic market, roughly equal to HVN.

According to VJC, one-third of the company's passengers are first time flyers. We also believe that VJC has started to attract passengers who were long time clients of full-service airlines (FSAs) such as HVN, as signaled by rising ancillary revenue per passenger: VJC's ancillary revenue per passenger for the first nine months of this year was up 30% on the average for 2016. This strong rise is a signal of the transition in market perceptions and VJC's client base. Customers are now likely to view VJC as an affordable airline, not just an option for passengers who are unable to afford FSA fares. This implies that VJC's passenger mix might include a growing share of middle class passengers who are ready to pay for extra services such as seat selection, check-in luggage or in-flight meals. Given that a similar transition occurred for AirAsia when the company directly pitted itself against FSA and Malaysian national carrier Malaysia Airlines, we are certain that VJC could repeat a similar story, and capture customers across a range of income segments.

Domestic Market Share



Source: VJC

We project that passenger demand will continue to grow rapidly, as fares will remain reasonable due to stable oil prices. Vietnamese airlines are all racing to expand their fleets to capture the industry's growth, as this industry is becoming more competitive. VJC is going to receive 17 new aircraft this year (of which 14 have already been delivered) and 13 aircraft in 2018; HVN has signed contracts to buy eight B787s and one has been delivered in May 2017; JPA also plans to buy 30 new A320 by 2020. The increase in supply will surely lead to more competitive fares and more aggressive promotional pricing. We believe there is no absolute winner in this race, and that success will be based on the company's image in the market. Moreover, stable oil prices will allow fares to remain at a reasonable level, which can support further growth of the market. Although oil prices have been slowly rising, we believe there are several factors impeding the oil price recovery, thus making a strong recovery scenario unlikely: 1) oversupply will remain despite OPEC's efforts to cut production as output curbs will become difficult to enforce at current oil price levels and marginal producers such as shale oil wells come back onstream; 2) the increasing supply of natural gas, which is more eco-friendly; 3) the rapid expansion of renewable energy capacity particularly solar and wind energy as they become cheaper through continued technology improvements.

Duopoly no more. While Vietnam's aviation market is currently dominated by VJC and HVN, regional behemoth Air Asia recently announced its entry into the Vietnam aviation market in partnership with Hải Âu Aviation and Gumin Ltd. The LCC will provide 30% of the JV's charted equity through its subsidiary, AirAsia Investment. The JV is expected to launch operations in 2018. However, AirAsia Investment has not received the investment license from the Ministry of Planning and Investment, according to Vietnamese newspapers. As a result, the launch date could be delayed a little bit. We believe that Air Asia's entry will spur intense competition and further lower fares, thereby boosting the addressable market as prices come within reach of an ever greater segment of the Vietnamese population.

AVIATION SECTOR STOCK PICKS: WE LIKE VJC

We prefer VJC as the company has a great growth story and it is the leading LCC in Vietnam.

Even though the company has experienced amazing revenue growth in the last few years, VJC's growth story could still hold for several years to come. The company has received 17 new aircraft during 2017. For 2018 and 2019, VJC will receive 13 and 11 new aircraft respectively. Since 2019, VJC will start to employ the new 737 Max 200 which burns 16% less fuel compared to the current A321 model. VJC will gradually increase the proportion of 737 Max 200 in the fleet. This will help the company to further cut its operating costs. Moreover, we believe that VJC has started to poach passengers of full service airlines as evinced by the fact that ancillary revenue/passenger has been growing over the past 12 months. Growing ancillary revenue/passenger could signal a transition in market perceptions and VJC's client base: VJC is no longer considered a secondary option for customers.

VIETJET AIR JSC (VJC)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND139,200	VND147,000	0.16%	HOLD	AVIATION

Outlook – Short term

Negative Neutral Positive

Outlook – Long term

Negative Neutral Positive

Valuation

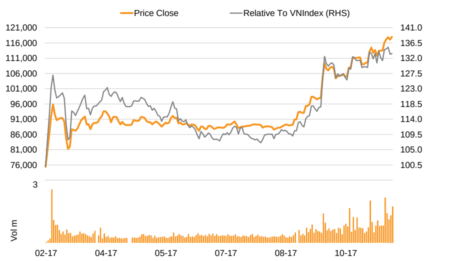
Negative Neutral Positive

Quang Nguyen Hong, CFA
quang.nguyenhong@vndirect.com.vn

Key changes in the report

- Increase price by 12%
- Increaser ancillary revenue/pax by 4.5%

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	129,900
52w low (VND)	75,335
3m Avg daily volume (shares)	1,017,233
3m Avg daily value (mn)	119,914
Market cap (VND bn)	58,449
Outstanding shares (m)	453
Free float (%)	53.3
P/E TTM	19.1x
P/B	7.6x

Ownership

Sunny Investment Corp	28.6%
Nguyen Thi Phuong Thao	8.8%
GIC	5.1%
Others	57.5%

Source: VNDIRECT

During Q3 2017, VJC's transport revenue grew slightly slower than we expected, as there were fewer aircrafts operating during the quarter. However, the company will soon resume its growth momentum as nine new aircrafts have already been delivered in Q4. We raised our target price for 2018 to VND147,000, as VJC has increased ancillary revenue per passenger to VND331,420 from VND318,231 in Q3.

VJC's Q3 transport and ancillary revenue reached VND6,185bn, growing by 34.4% YoY. The main growth drivers were the following: 1) +25% YoY in passenger volume growth to 4.4m; 2) 31% YoY rise in ancillary revenue/passenger, which reached VND331,000 (US$14.6). The company's core net profit excluding aircraft sales gains reached VND966bn (+105% YoY). The company's total revenue fell by -10.3% YoY as VJC reported no aircraft sales during 3Q2017, compared to the sale of three A321s in 3Q2016.

The delays in aircraft deliveries proved management's operational mettle, pushing efficiency to new heights. The size of the operating fleet fell by five A320s during Q3, compared to the previous quarter. Airbus could not make deliveries on time as it encountered disruptions in its supply chain stemming from its engine vendor. VJC was still able to meet its 2017 target of 17 new aircraft but the deliveries will occur at the end of the year, leading to a lower weighted average operating fleet size for the year. Due to the delivery delay, VJC had to push its fleet to the limit, leading to record-levels of operational efficiency. Q3 load factor touched 89.7%, the highest level in the company's history. Aircraft utilization reached 14.04 block hours per aircraft a day while maintaining on-time performance of 85%.

We project that the company's 2018 core net profit will reach VND6,574bn (+92.4% YoY) mainly due to 1) higher ancillary revenue/passenger, 2) increasing fleet sizes, and 3) increasing Chinese tourist arrivals into Vietnam. VJC plans to open five new international routes to cities such as Binhai, Changsha, and Nanjin. Aircraft sales revenue could drop by 24% YoY due to a lower number of aircraft deliveries, but the gain on sales per aircraft should hold at around US$7.2mn; reported NPAT should still rise 45.3%.

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	19,845	27,532	42,654	48,337
Revenue growth	127.9%	38.7%	54.9%	13.3%
Gross margin	10.6%	12.7%	17.8%	22.3%
EBITDA margin	6.5%	9.4%	16.8%	21.2%
Net profit (bn)	1,170	2,292	5,501	7,995
Net profit growth	215.8%	95.8%	140.0%	45.3%
Recurring profit growth	104.0%	56.3%	221.0%	92.4%
Basic EPS	10,135	19,614	14,894	17,713
Adjusted EPS	10,135	19,614	14,894	17,713
BVPS	14,810	15,085	21,550	38,599
ROAE	75.2%	68.7%	77.2%	58.9%

Source: VNDIRECT

VJC faced delivery delays for several A321s, but issue resolved

In Q3 and Q4 of 2017, Airbus delayed several of its deliveries of the A320neo model. The delay was mainly due to Pratt & Whitney failing to meet on-time deliveries of its new Pratt & Whitney PW1000G engines. Even though these delays were specifically related to the A320neo, VJC confirmed that these postponed deliveries had an adverse impact on VJC's A321 delivery schedule. Another possible explanation is that Airbus has launched an internal investigation after recent bribery allegations and this could have impacted operations across the company. However, VJC's deliveries resumed and the company has received 16 out of 17 aircraft due to be delivered in 2017. The company's 2017-end fleet will consist of 25 A320s and 28 A321s.

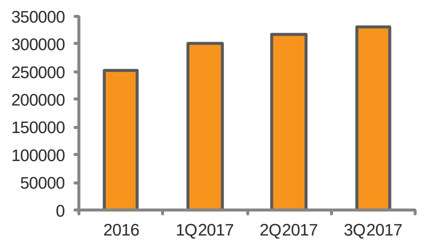
Figure 130: VJC, aircraft on order, to 31 Oct 2017

			Future Deliveries			
Model	Current fleet	On order	4Q2017	2018	2019	Beyond 2019
A320	25	0				0
A321	17	32	8	13	11	0
A320neo		42				42
A321neo		31				31
737 Max		100			4	96
Total	42	205	8	13	15	169

Source: VJC, Airbus, Boeing

2018 core profit will skyrocket thanks to higher ancillary revenue/passenger

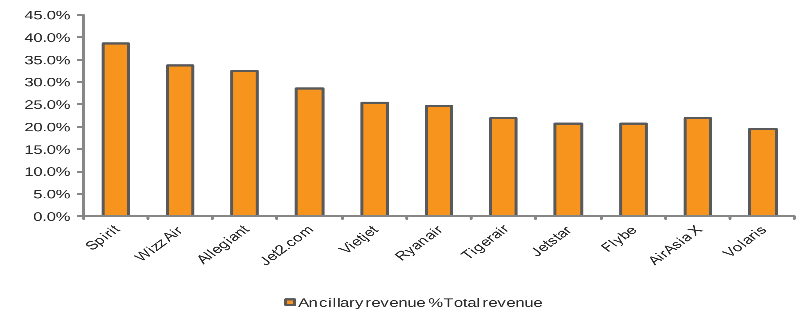
Figure 131: Ancillary revenue/passenger, VND



Source: VJC

The company's ancillary revenue/passenger touched VND331,420 in 3Q2017, rising from VND251,225 in 2016. Even if its ancillary revenue/passenger were to level-off at the Q3 figure, its 2018 core net income would still be able to reach VND6,285bn, 4.5% higher than our previous forecast made in Q2 2017. However, ancillary revenue/passenger could still continue to grow as the recent improvement signals a transition in market perceptions and VJC's client base: VJC is an affordable airline, not just an option for passengers who are unable to afford full service airline fares. This implies that VJC's passenger mix might be seeing a growing share of middle class passengers who are ready to pay for extra services such as seat selection, check-in luggage or in-flight meals. The ancillary revenue per pax could also continue to rise through improved in-flight merchandizing and training of cabin crew. As shown in the chart below, VJC's ancillary revenue as % of total revenue (ex-aircraft sales) is no longer that low by global and regional LCC standards and, hence, we conservatively assume that its 2018 full year ancillary revenue per pax will remain near the levels of Q3 2017.

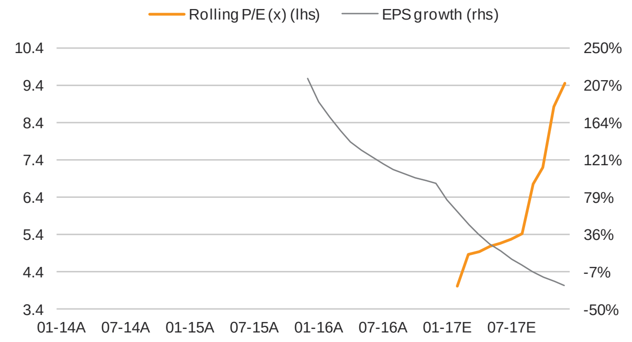
Figure 132: Ancillary revenue as % of total revenue (ex-aircraft sales) by LLC, 2016*

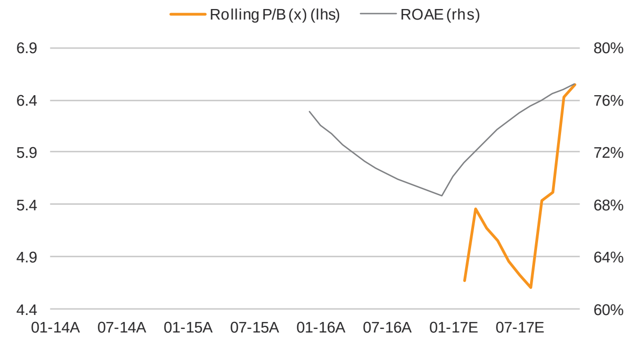


Source: VJC

*Note: VJC figure is based on 3Q2017 financial data.

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	27,532	42,654	48,337
Cost of sales	(24,033)	(35,043)	(37,565)
Gen & admin expenses	(185)	(210)	(293)
Selling expenses	(492)	(566)	(789)
Operating profit	**2,822**	**6,834**	**9,690**
Operating EBITDA	2,822	6,834	9,690
Depreciation and amortisation	**0**	**0**	**0**
Operating EBIT	**2,822**	**6,834**	**9,690**
Interest income	175	323	581
Financial expense	(624)	(262)	(257)
Net other income	32	0	0
Income from associates & JVs	(9)	(9)	(9)
Pre-tax profit	**2,395**	**6,885**	**10,005**
Taxation	(105)	(1,384)	(2,010)
Minority interests	2	0	0
Net profit	**2,292**	**5,501**	**7,995**
Adj. net profit to ordinary	2,292	5,501	7,995
Ordinary dividends	0	(300)	(300)
Retained earnings	**2,292**	**5,201**	**7,695**

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	2,740	7,376	10,838
Short term investments	0	0	0
Accounts receivables	7,638	8,694	10,071
Inventories	127	175	234
Other current assets	141	209	300
Total current assets	**10,645**	**16,455**	**21,443**
Fixed assets	1,221	2,205	3,469
Total investments	68	68	68
Other long-term assets	7,982	11,877	17,013
Total assets	**19,916**	**30,605**	**41,993**
Short-term debt	6,036	5,333	4,266
Accounts payable	407	561	752
Other current liabilities	4,608	6,809	9,694
Total current liabilities	**11,051**	**12,703**	**14,712**
Total long-term debt	761	2,850	2,231
Other liabilities	3,579	5,326	7,629
Share capital	3,000	3,000	3,000
Retained earnings reserve	1,525	6,727	14,421
Shareholders' equity	**4,525**	**9,727**	**17,421**
Minority interests	(1)	(1)	(1)
Total liabilities & equity	**19,916**	**30,605**	**41,993**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**2,395**	**6,885**	**10,005**
Depreciation & amortisation	41	119	222
Tax paid	(40)	(1,384)	(2,010)
Other adjustments	(2,701)	(313)	(571)
Change in working capital	**964**	**1,182**	**1,549**
Cash flow from operations	**659**	**6,489**	**9,194**
Capex	(2,194)	(1,102)	(1,485)
Proceeds from assets sales	0	0	0
Others	2,685	313	571
Other non-current assets changes	(2,370)	(3,895)	(5,136)
Cash flow from investing activities	**(1,879)**	**(4,684)**	**(6,050)**
New share issuance	72	0	0
Shares buyback	0	0	0
Net borrowings	3,266	1,385	(1,685)
Other financing cash flow	(300)	1,747	2,303
Dividends paid	0	(300)	(300)
Cash flow from financing activities	**3,037**	**2,832**	**318**
Cash and equivalents at beginning of period	924	2,740	7,376
Total cash generated	**1,816**	**4,637**	**3,462**
Cash and equivalents at the end of period	2,740	7,376	10,838

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	8.3%	12.9%	16.5%
Asset turnover	1.72	1.69	1.33
ROAA	14.3%	21.8%	22.0%
Avg assets/avg equity	4.79	3.54	2.67
ROAE	68.7%	77.2%	58.9%
Efficiency			
Days account receivable	23.5	22.5	28.4
Days inventory	1.94	1.82	2.27
Days creditor	6.20	5.84	7.30
Fixed asset turnover	39.7	24.9	17.0
ROIC	20.2%	30.7%	33.4%
Liquidity			
Current ratio	0.96	1.30	1.46
Quick ratio	0.95	1.28	1.44
Cash ratio	0.25	0.58	0.74
Cash cycle	19.2	18.5	23.4
Growth rate (yoy)			
Revenue growth	38.7%	54.9%	13.3%
Operating profit growth	77.6%	142.2%	41.8%
Net profit growth	95.8%	140.0%	45.3%
EPS growth	93.5%	(24.1%)	18.9%
Share value			
Basic EPS (VND)	19,614	14,894	17,713
BVPS (VND)	15,085	21,550	38,599

Source: VNDIRECT

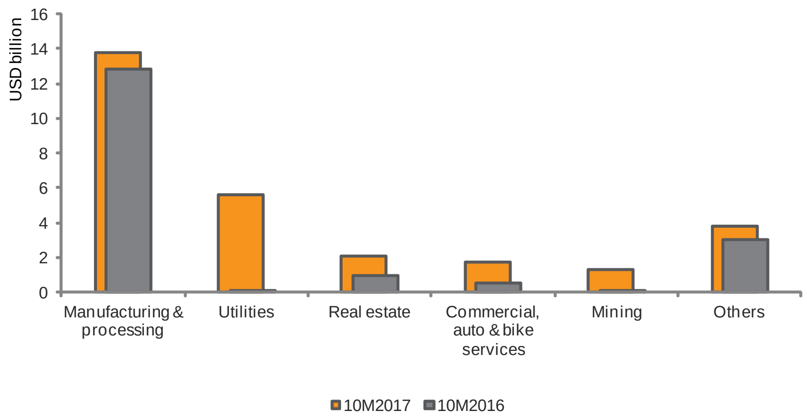
PORTS & MARITIME SHIPPING: RIDING ON THE COATTAILS OF THE FTA AND FDI BONANZA

Vietnamese port operators, especially those in Hai Phong, are continuing to ride the strong FDI inflows.

During the first ten months of 2017, the total amount of registered FDI grew by 60.3% YoY to touch USD$28.2 billion. The manufacturing and processing industries remained the leading sectors in attracting FDI, reaching USD13.8 billion, an increase of 7% YoY. Registered FDI into brownfield projects (expansion purposes) accounted for 47.9% of the total registered FDI. The proportion of expansion projects in the total FDI mix increased by 13.2 percentage points versus 10M2016. This shows that existing FDI projects are performing positively and that investors want to upsize their factories through follow-on capital investments. Some major FDI projects that expanded recently included Samsung Display in Bắc Ninh (+USD2.5b) and Polytex Far Eastern in Bình Dương (+USD486m). The manufacturing and processing sector is the main growth driver of port cargo throughput, as most FDI facilities in Vietnam are involved in export-oriented assembly operations implying that they import plenty of components and export virtually all of the finished products.

One sector that attracted much more attention from foreign investors this year included the utilities sector and its 10M2017 registered FDI grew at a staggering rate of 4,135% YoY due to several large generation projects including Nghi Sơn 2 Power Plant (1,200 MW capacity) and Nam Định 1 Power Plant (1,109 MW capacity). However, new utilities projects will have a minimal impact on container throughput as they will import bulk commodities such as coal and natural gas.

Figure 133: Newly registered and brownfield (Expansion) FDI projects

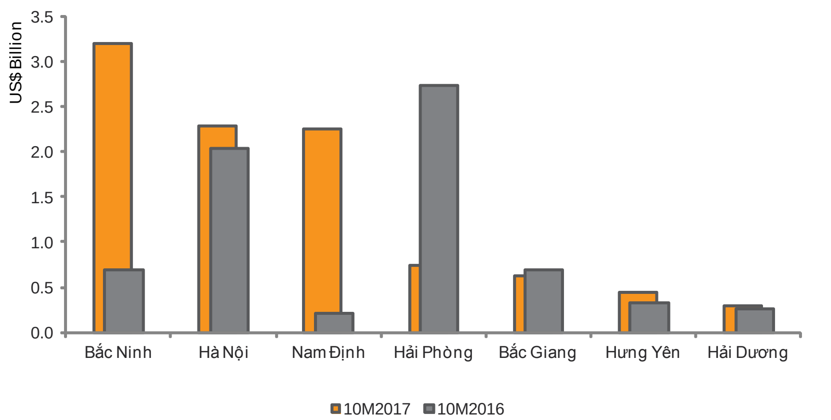


Source: VNDIRECT

Port operators in Hai Phong will greatly benefit from emerging "cluster effects" in the Northern economic triangle. During 10M2017, Bắc Ninh was the top FDI destination among FDI northern provinces, attracting USD$3.2 billion of registered FDI (+359.3% YoY) as a result of the USD2.5b expansion of Samsung Display. Hải Phòng has dropped in this ranking, and only received USD744m of registered FDI, due to the high-base effect from USD2.2b worth of investment by LG in the same period last year. However, if we exclude LG's huge investment last year, FDI this year still grew at 24% YoY. Normally, new FDI projects start production after around one year, following construction and setting up of supply chains. This commissioning timeline is shorter for expansion FDI projects, and the production ramp-up could be shorter as these projects do not have to go through a thorough a test run and simply plug into existing operations. We expect that these newly announced expansion projects in 2017 will generate additional container throughput by the end of 2018. We project that container throughput will grow by 15% per annum for the next several years, barring a major shock to trade flows due to a downturn in the global economy or regional geopolitical conflict.

FDI projects in Hải Phòng, which received investment around one to two years ago, have now begun to generate higher import and export activity in the region. For 10M2017, the Industrial Production Index (IPI) grew by 20% YoY, led by growing output of washing machines (+158% YoY), monitors (+93% YoY), fertilizers (+89% YoY), and rubber tires (+79% YoY). Increasing production pushed cargo throughput to 74.6m tones, including dry bulk cargo and container, (+15.3% YoY) with total export value growth of 22.7% YoY and import value growth of 24.6% YoY during the same period.

Figure 134: Registered FDI in Northern Provinces



Source: FIA

Ports downstream on the Cấm River to outdo upstream ports

Container throughput growth will be stronger for companies operating downstream ports. Upstream ports risk seeing a shrinkage in their client base, as vessels opt to dock at downstream ports, instead. The only vessels that will continue to dock at upstream ports will be those of smaller size (10,000 DWT), and run domestic routes. This transition will mainly occur due to the completion of the Bạch Đằng bridge, which will likely be completed by the beginning of 2018. This will shorten the Hà Nội – Quảng Ninh routes and will also impose a height limit for vessels traveling on the Cấm river. According to several port operators, 20,000 DWT vessels will not be able to dock at upstream ports, so downstream ports will be their only option. The bridge has drawn a distinct line that defines the service quality of port operators. Downstream ports, having advantageous locations, will be able to get all of the larger clients who use vessels of 20,000 DWT, and will receive higher handling rates. Upstream ports will only have the option to serve small clients and small vessels of 10,000 DWT. Several ports such as Greenport (VSC), Nam Hải (GMD), and Hải An

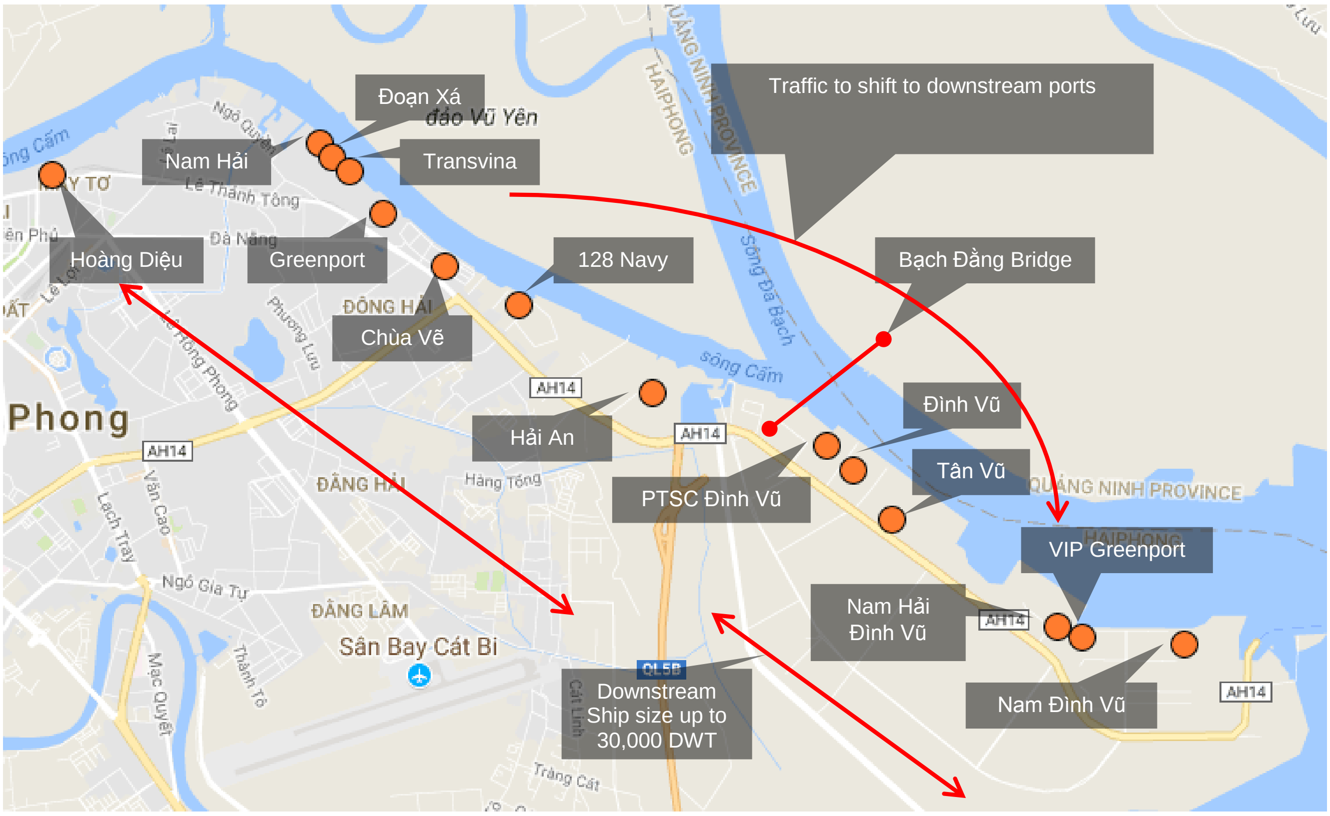
(HAH) have to restructure their operations to maintain revenue generation. Greenport will convert its container yard to a distribution center (DC) and the revenue from this will make up for the decline in container handling revenue. Nam Hải and Hải An have to build their own shipping fleets, which will then became their captive clients. These two ports will try to offer importers and exporters service packages combining shipping and cargo-handling services which will cost less than buying these services separately from third party service providers. At the moment, GMD has four container ships, of which one has been acquired recently. HAH has increased its fleet size from three to four. Ports that are unable to adapt their business strategies to meet these changes will see a large drop in revenue.

Figure 135: Comparison of port operators in Hải Phòng

Port		Capacity TEU pa	2015	2016	Note
Upstream		**1,450,000**	**1,603,743**	**1,241,273**	**Disadvantageous position, lower handling rates**
Greenport	VSC	300,000	350,000	260,000	Lower handling charges, 8-10% less than VIP Greenport
Nam Hải	GMD	150,000	250,000	250,000	Still turning profit because of GMD's strong market position
Đoạn Xá	DXP	150,000	214,000	120,761	Next to Nam Hải but facing intense competition; less container, more dry bulk handling (low margin)
PTSC Đình Vũ		100,000	265,357	n/a	
Tân Cảng 128		300,000	135,000	209,394	
Transvina		100,000	79,544	70,761	
Hải An	HAH	300,000	309,842	325,000	Most throughput is internally generated from its fleet of 4 vessels.
Downstream		**2,700,000**	**1,854,654**	**2,612,056**	**Advantageous position, favored by liners**
VIP Greenport	VSC	500,000	0	350,000	Could be expanded to 800,000 TEU pa
Tân Vũ	PHP	1,200,000	1,002,987	1,086,630	State-owned company, weak competitor
Đình Vũ	DVP	500,000	574,635	649,224	Main client: SITC, solid revenue stream, full capacity
Nam Hải Đình Vũ	GMD	500,000	277,032	526,202	Full capacity
Nam Đình Vũ 1	GMD				Launch in 2018, 600,000 TEU pa

Source: VNDIRECT

Figure 136: Ports in Hải Phòng



Source: VNDIRECT

We believe that the transition of cargo will not be the end for upstream ports as there is small but consistent demand from domestic exporters. One more reason is that downstream capacity is not sufficient to handle all the current container throughput of upstream ports. We expect the spread between downstream-upstream handling rates to gradually widen in the next several years. At the moment, the spread is around 8-10% but we expect it to widen to 15% in the next two years.

Lach Huyen port does not pose a major threat to existing downstream ports, at least for a few years. The mega project Lạch Huyện is reportedly going to be launched at the end of 2019. However, we do not believe that the project will pose a major threat to current ports for the next several years. The main reason is that Lạch Huyện will carry higher transportation / access costs. Truckers will have to incur additional bridge toll as they travel to Lạch Huyện via the 5.4km long Tân Vũ – Lạch Huyện bridge, which was completed recently, making it one of the longest sea bridges in Southeast Asia. Also, this port will be playing in a different segment, catering to larger mother vessels (50,000 DWT and above). Lạch Huyện port is likely to be underutilized for a few years post commissioning following the experience of deep water ports in Cái Mép port zone in the South. The main reason is that cargo flow is still not large enough to allow for quick turn around of large vessels; the vessels will have to return with suboptimal loads or wait for extended periods at the port to collect sufficient cargo loads. Either way, this will increase operating costs for carriers.

PORTS SECTOR STOCK PICKS: WE LIKE VSC

We LIKE VSC as the company has strategically located ports in the Hải Phòng port zone and still has some spare capacity

VSC has a good blend of attributes such as: 1) a simple and focused business model and portfolio mostly concentrated in container handling and providing storage services, 2) advantageously located ports downsteam along the Cấm river and 3) unused capacity to support growth unlike most ports in the regions which are at full capacity: the company is expanding its capacity by 38% to 1.1mn TEU p.a.

VIET NAM CONTAINER SHIPPING JSC (VSC)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND44,600	VND62,300	0.4%	ADD	LOGISTICS

Outlook – Short term	Outlook – Long term	Valuation
Negative Neutral Positive	Negative Neutral Positive	Negative Neutral Positive

Quang Nguyen Hong, CFA
quang.nguyenhong@vndirect.com.vn

Price performance

Source: VNDIRECT

Key statistics

52w high (VND) (**)	56,260
52w low (VND) (**)	40,270
3m Avg daily volume (shares)	201,165
3m Avg daily value (mn)	10,335
Market cap (VND bn)	2,235
Outstanding shares (m)	50.1
Free float (%)	56
P/E TTM	9.7x
P/B	1.6x

(**) Adjusted price

Ownership

Vietnam Holding Ltd	7.0%
Forum One - VCG	4.9%
Deutsche AGM	4.4%
Others	83.7%

Source: VNDIRECT

The company's 9-month consolidated revenue grew strongly, while its net profit remained relatively unchanged due to lower handling rates in Greenport and rising fuel costs that negatively impacted trucking activity. Even though the company did not meet our FY17 forecast, we reiterate our ADD recommendation. We believe VSC will have strong earnings growth in 2018, and that the recent sell off from foreign investors has resulted in the stock being undervalued.

The company's 9M2017 revenue reached VND959bn (+21.9% YoY) and its net profit touched VND190bn (+0.4% YoY). The company's total container throughput reached 600,000 TEU, nearly the same as 2016. VIP Greenport (VGP) is the real powerhouse of VSC, as the subsidiary recorded VND395bn in revenue (+67% YoY) and VND65bn of net profit (+357% YoY). Greenport's throughput dropped by 6% YoY.

VSC will boost VGP's capacity by a third to 800,000 TEU by 2019 through the addition of a new quay crane and a back-end logistics center, which is 75% complete at the moment. This should help sustain throughput growth until 2019. We expect the additional capacity to generate around VND200bn of incremental container handling revenue per year. The expansion requires VND122bn in capex, with VND65bn for the quay crane and VND67bn for the logistics center.

We expect that the company's net profit in 2018 will rise to VND370bn (+36.1% YoY). Revenue is likely to rise only moderately to touch VND1,480bn (+12.8% YoY) as VGP could reach its full capacity of 600,000 TEU. However, we project that its net profit margin will improve by 4 percentage points to 24.3%, as VSC is progressively paying down VGP-related debt.

VSC's valuation is attractive due to the sell off from foreign investors in recent weeks. VSC is currently trading at a 12M EV/EBITDA of 5.6x, well below the peer average of 6.7x. We believe that the recent sell-off does not reflect a downturn in fundamentals. We expect that the strong rise in earnings growth next year will support the share price, and help VSC to close the valuation gap with peers.

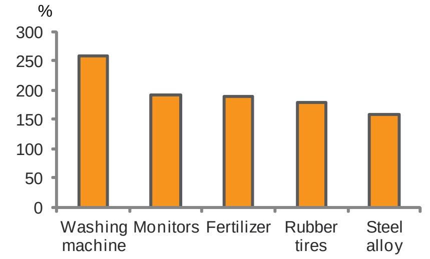
Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	928	1,082	1,312	1,480
Revenue growth	4.1%	16.6%	21.2%	12.8%
Gross margin	39.9%	36.6%	31.6%	34.8%
EBITDA margin	27.7%	17.3%	12.1%	17.0%
Net profit (bn)	279	251	256	345
Net profit growth	19.0%	(10.0%)	1.9%	34.8%
Recurring profit growth	11.5%	(5.3%)	1.9%	34.8%
Basic EPS	8,085	6,067	5,619	7,577
Adjusted EPS	8,085	6,067	5,619	7,577
BVPS	34,556	33,266	36,966	42,625
ROAE	21.1%	17.1%	16.0%	19.0%

Source: VNDIRECT

The Future is Still Bright for Leading Port Operators like VSC

We expect the risk of lower handling rates to linger on for the reason that container liners are struggling to make a profit and have also seen a rise in their bargaining power with port operators due to continued consolidation in the shipping industry. However, several factors will partially offset this.

Figure 137: Top 5 fastest growing products in term of output YoY, Hai Phong province

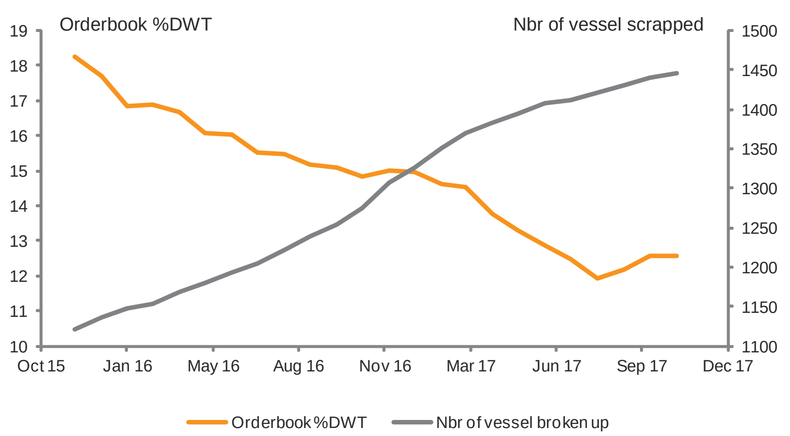


Source: GSO

The expansion of VGP will give VSC more leeway in reducing its cargo-handling activities at Greenport, which is highly exposed to the risk of falling handling tariffs due to its unfavorable location. According to VSC, the total capex for the additional capacity of 200,000 TEU pa is around VND122bn. The amount includes a new crane worth VND65bn and a logistics center worth VND67bn. The logistics center will be operated by GIC, a subsidiary in which VSC owns 66.3%. The logistics center is 75% complete and will be ready by the end of 2017. Greenport will not totally relinquish container handling activity. The current container yard will be converted into a new distribution center (DC) and the current berth will serve ferries and vessels under 10,000 DWT, which mostly run on domestic routes. We expect that net profit from the new DC will partially offset the earnings reduction due to lower cargo handling activities at Greenport. According to VSC, the net profit of the newly formatted Greenport will be 8% lower compared to the current net profit, which stood at VND106bn for 9M2017. At the moment, we have no information on the exact timing of the transition.

The container shipping industry's prospects are finally improving as liner order books have become leaner while vessel scrapping has picked up momentum on the back of the global steel price recovery. Container liners are focusing on improving fleet profitability by ordering larger vessels and boosting utilization rates. At the moment, 65% of the current order book is for vessels of over 12,000 TEU. At the same time, container liners should continue to optimize their small vessel fleets and refrain from new orders. This should reduce the pressure on profitability for vessels under 2,000 TEU in capacity and mitigate the pressure on handling rates for this vessel class. According to Bloomberg Intelligence, if container liners remain disciplined, the industry could see a sustained recovery over the next few years.

Figure 137: Global container vessel order book (left) and vessel scrapping (right)



Source: Bloomberg

We project that the company's 2018 net profit will rise significantly, as VGP approaches full capacity of 600,000 TEU

We expect for VGP to reach full practical capacity of 600,000 TEU in 2018, even though the designed capacity is 500,000 TEU pa. We believe VSC can easily operate at 20% above capacity through more efficient operations, and have also observed similar cases for other companies; DVP had a designed capacity of 500,000 TEU pa but has reached 649,224 TEU in 2016. VGP could expand its capacity to 800,000 TEU pa by 1) adding one quay crane which will help the port to serve ships which are longer than its berth and 2) adding a logistics center of 10 ha, which will help smooth out container traffic and remove current bottlenecks arising from a mismatch between front-end and back-end facilities.

We expect for the company's 2018 revenue to reach VND1,480bn (+12.8% YoY) and net profit to touch VND370bn (+36.1%). Interest expenses will decrease by 15% YoY as VSC continues to pay off VND80-100bn of debt per year. According to VSC, the company will pay off all of its VGP-related debt in 4 years.

The current valuation is very attractive

The stock is undervalued according to both P/E and EV/EBITDA multiples. We believe EV/EBITDA is the more appropriate valuation method for port operators as these companies require very small maintenance capex, even though they need large investment in infrastructure and equipment. In these types of businesses, earnings sometimes fail to reflect true business performance due to large non-cash depreciation expenses. EBITDA is a better basis for relative valuation as it is a proxy for operating cash flow.

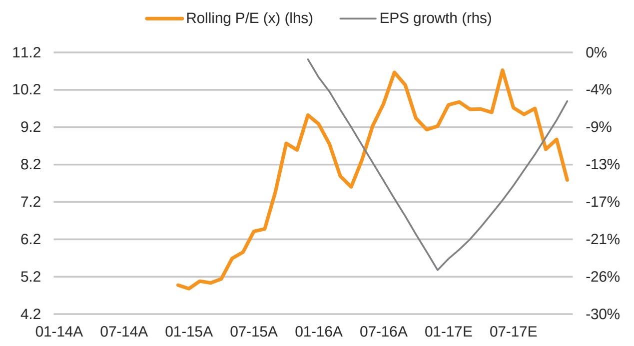
The valuation of peers varies greatly. Downstream ports have higher valuations compared to upstream ports due to competitive advantages stemming from their location. Among downstream ports, companies which have spare capacity usually have higher valuation due to the promise of continued throughput growth. VSC is clearly undervalued as the company has both an advantageous position as well as spare capacity. The stock trades at much lower multiples compared to GMD despite generating three times the ROE of GMD.

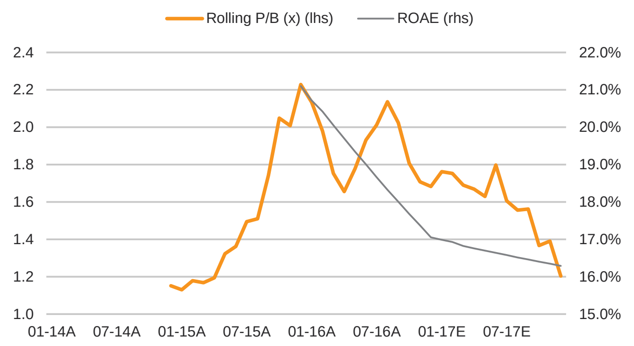
Figure 138: Valuation

Company	TTM P/E	EV/EBITDA	ROE
Mean	**11.8**	**6.7**	**18.9%**
VSC	**9.1**	**5.6**	**17.4%**
GMD	20.9	16.1	6.8%
DVP	9.5	6.7	30.0%
DNP	14.2	8.3	20.4%
DXP	12.9	3.4	8.4%
HAH	5.8	4.1	21.0%
PHP	10.2	4.4	12.1%
CLL	11.8	5.2	13.2%

Source: Bloomberg

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	1,082	1,312	1,480
Cost of sales	(686)	(897)	(965)
Gen & admin expenses	(53)	(65)	(73)
Selling expenses	(11)	(13)	(15)
Operating profit	**331**	**337**	**427**
Operating EBITDA	163	140	225
Depreciation and amortisation	**168**	**196**	**202**
Operating EBIT	**331**	**337**	**427**
Interest income	17	18	30
Financial expense	(44)	(48)	(41)
Net other income	1	0	0
Income from associates & JVs	6	7	8
Pre-tax profit	**311**	**314**	**423**
Taxation	(49)	(41)	(53)
Minority interests	(11)	(11)	(15)
Net profit	**251**	**261**	**355**
Adj. net profit to ordinary	251	261	355
Ordinary dividends	0	(91)	(91)
Retained earnings	**251**	**170**	**264**

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	331	650	1,119
Short term investments	32	32	32
Accounts receivables	130	192	214
Inventories	9	17	19
Other current assets	102	57	64
Total current assets	**605**	**948**	**1,449**
Fixed assets	1,226	1,314	1,164
Total investments	105	105	105
Other long-term assets	461	352	246
Total assets	**2,397**	**2,718**	**2,964**
Short-term debt	58	52	47
Accounts payable	63	168	179
Other current liabilities	177	288	322
Total current liabilities	**297**	**508**	**548**
Total long-term debt	585	511	438
Other liabilities	(0)	2	3
Share capital	456	456	456
Retained earnings reserve	1,024	1,197	1,465
Shareholders' equity	**1,515**	**1,689**	**1,957**
Minority interests	0	7	19
Total liabilities & equity	**2,397**	**2,718**	**2,964**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**311**	**314**	**423**
Depreciation & amortisation	168	196	202
Tax paid	(50)	(41)	(53)
Other adjustments	80	(24)	(38)
Change in working capital	**(191)**	**181**	**14**
Cash flow from operations	**318**	**625**	**548**
Capex	(461)	(273)	(52)
Proceeds from assets sales	0	0	0
Others	(14)	25	38
Other non-current assets changes	26	109	105
Cash flow from investing activities	**(448)**	**(139)**	**92**
New share issuance	0	0	0
Shares buyback	0	0	0
Net borrowings	218	(80)	(79)
Other financing cash flow	0	2	0
Dividends paid	(89)	(91)	(91)
Cash flow from financing activities	**129**	**(168)**	**(170)**
Cash and equivalents at beginning of period	332	331	650
Total cash generated	**(1)**	**318**	**469**
Cash and equivalents at the end of period	332	650	1,119

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	23.2%	19.9%	24.0%
Asset turnover	0.47	0.51	0.52
ROAA	10.9%	10.2%	12.5%
Avg assets/avg equity	1.57	1.60	1.56
ROAE	17.1%	16.3%	19.5%
Efficiency			
Days account receivable	38.2	44.4	44.4
Days inventory	4.94	7.03	7.03
Days creditor	33.4	68.3	67.8
Fixed asset turnover	0.95	1.03	1.19
ROIC	11.6%	11.6%	14.4%
Liquidity			
Current ratio	2.04	1.87	2.64
Quick ratio	2.01	1.83	2.61
Cash ratio	1.23	1.34	2.10
Cash cycle	9.7	(16.9)	(16.4)
Growth rate (yoy)			
Revenue growth	16.6%	21.2%	12.8%
Operating profit growth	3.1%	1.6%	26.7%
Net profit growth	(10.0%)	3.9%	36.1%
EPS growth	(25.0%)	(5.6%)	36.1%
Share value			
Basic EPS (VND)	6,067	5,729	7,799
BVPS (VND)	33,266	37,077	42,957

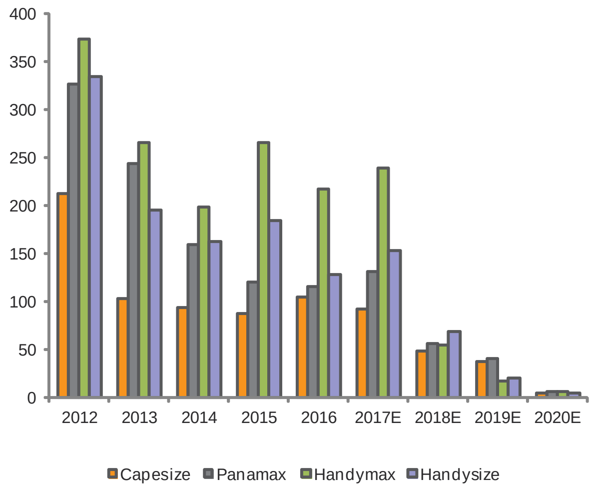
Source: VNDIRECT

DRY BULK SHIPPING: A RECOVERY SCENARIO IS ON THE HORIZON

The dry bulk shipping industry looks to have finally bottomed

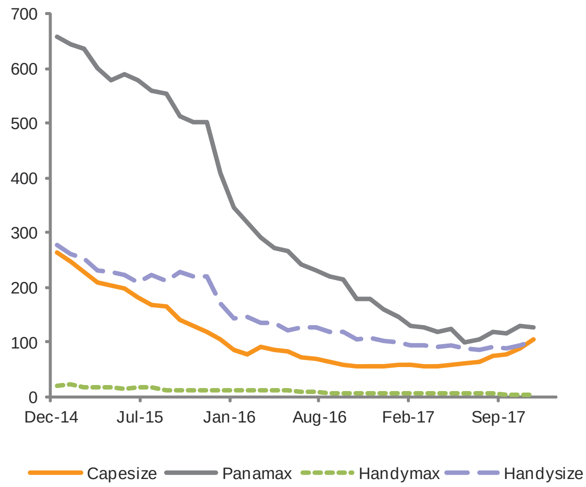
The number of newbuild deliveries prior to 2017 has dropped significantly. This is the result of the low charter rates during previous years, which discouraged new entrants and led to a shrinking orderbook. The orderbook for Panamax, Handymax, and Handysize class vessels are near their lowest points in nearly a decade. Capesize orderbooks picked up a little bit since the beginning of 2017 due to the following factors: 1) consolidation of dry bulk liners; 2) increasing demand from China for high quality iron ore from Australia (Australia – China is one of the main corridors for Capesize ships). If its orderbook stays low for the next several years, dry bulk supply will stabilize and demand will likely catch up to supply. According to Clarkson Research, 2018 dry bulk supply may grow by 1.2%, while demand may increase by 2.7%, mainly driven by China's renewed demand for iron ore and coal. It normally takes one to two years to build a ship, however, it is likely that a number of buyers have delayed deliveries due to the low freight rate environment. This technique is used widely by dry bulk companies to control the number of available ships as contract cancellation is costly.

Figure 139: Number of vessel deliveries each year, globally



Source: Clarkson Research

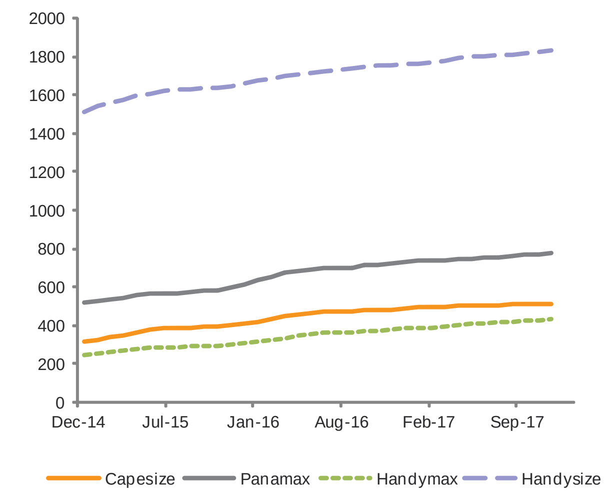
Figure 140: Orderbook by vessel class, no. of ships, globally



Source: Bloomberg

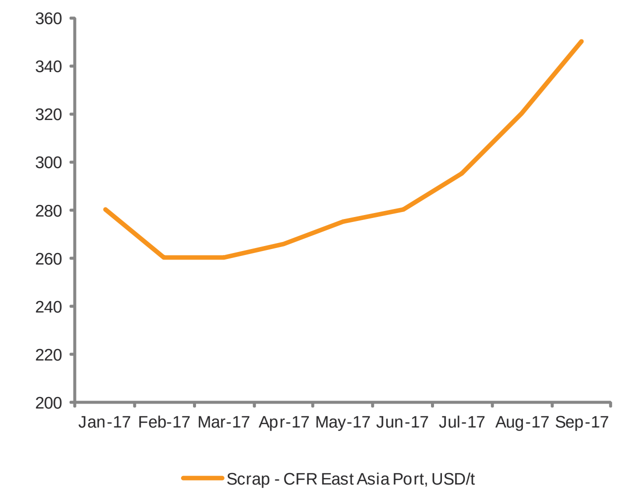
Increasing demolition rate, supported by rising scrap prices, will contain supply growth. According to Allied Shipping Research, the average age of scrapped vessels at the end of 2016 was 24.8 years, down from 27.6 years at the end of 2014, inplying that vessels are being sent for scrapping earlier than before as shipping lines feel have found it more economical to sell scrap than to continue to run their vessels in the current low freight rate environment, particularly given rising scrap prises. Scrap prices may continue their uptrend as Turkey and India, the two largest scrap importers in the world, are displaying a growing appetite for scrap. This might incentivize ship owners to continue to scrap vessels earlier in their useful life.

Figure 141: Cumulative no. of demolished ships since 2005



Source: Bloomberg

Figure 142: Scrap price, East Asia



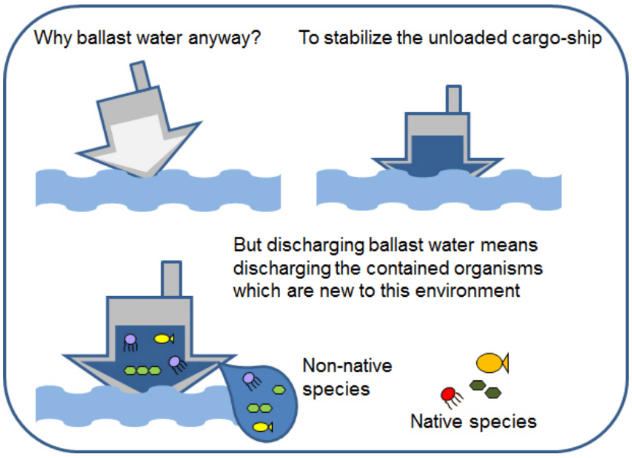
Source: Bloomberg

As China's appetite for high quality iron ore (62% Fe) grows, both tonne mile demand and charter rates should improve, especially for Capesize ships. As China accounts for 76% of seaborn iron ore imports, the shift in preference to higher grade iron ore will have a huge impact on the trade pattern of iron ore. At the moment, 83% of China's iron ore imports are from Australia and Brazil, compared to 69% in 2013. It should be noted that Australia and Brazil are the two largest exporters of 62% Fe iron ore. This will lengthen the voyage distance of vessels, thus improving charter rates by limiting the number of vessels available for lease. The main reason for this push for quality of China is the government's crackdown on pollution caused by steel makers. Steel makers who want to stay in business have to install emission filters or change to finer iron ore which requires less coking coal. This hunger for 62% Fe iron ore could last for the next one or two years as the Chinese government continues to display strong will in expanding the crackdown.

The Ballast Water Management Convention (BWMC), applicable since 2017, and the Sulfur cap, to be applicable starting 2020, could impede vessel fleet expansion. These two environmental protection treaties, passed through by the International Maritime Organization (IMO), will be troublesome to loss-making liners as they require ship owners to incur additional costs in ballast water treatment and emission filter or change to oil with less sulfur content. Installing a ballast water treatment system could cost up to US$5mn per ship and an emission filter could cost several million USD.

Ballast water is used to stabilize unloaded ships. When being discharged, ballast water carries non-native marine species that could jeopardize the local marine environment.

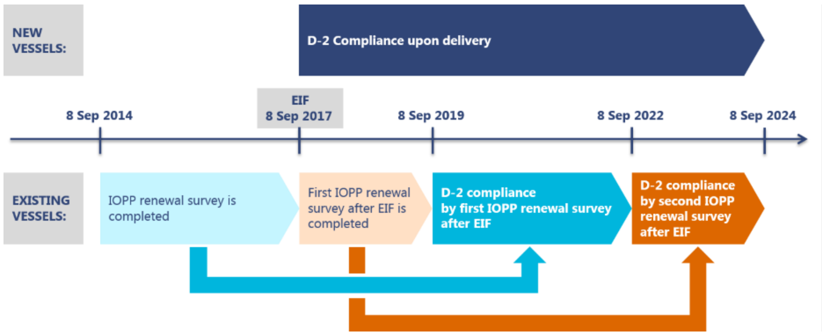
Figure 143: What is ballast water



Source: The Green Optimistic

The BWMC's entry into force (EIF) is on 8th September 2017, applicable to ships of 400 gross tonnes and above participating in international trade, excluding floating platforms, FSUs & FPSOs.

Figure 144: BWMC implementation schedule



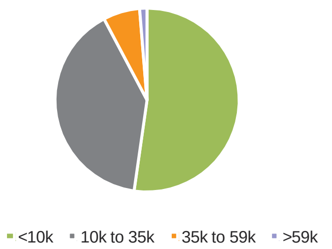
Source: Gard AS

Moreover, the IMO has decided to lower the sulfur limit seven fold from the current level 3.5% mass/mass (m/m) to 0.5% m/m. The new sulfur cap will be applicable since 1st January 2020. The new decision means ships will have to use low-sulfur oil, which is more expensive and not readily available compared with heavy fuel oil, which is cheap and abundant. The current heavy fuel oil is abundant because it is a by-product of the refinery process that refiners do not intend to produce. The low-sulfur oil, or the marine gas oil (MGO) is more expensive as it is not the main product of the refinery process. The second option is to install emission filters on vessel which could cost several million US$. Even though the sulfur cap will be effective in two years, the expected additional cost could pose new entry barriers for industry entrants.

MARITIME SECTOR STOCK DISCUSSION: WE LIKE VOS

VOSCO and Vinalines could be the only two dry bulk shipping companies benefiting from recovering rates as they own the largest vessels

Figure 145: Vietnam dry bulk fleet by ship size, DWT



Source: world-ship.com

At the moment, Vietnam dry bulk fleet consists of 155 ships, including:

- Below Handysize: 81 vessels, these ships mostly run short domestic journeys
- Handysize, from 10,000 DWT to 35,000 DWT: 62 vessels, these suits are suitable for longer routes such as Southeast Asia countries
- Handymax, from 35,000 DWT to 59,000 DWT:10 vessels, VOSCO owns 4 Handymax and Vinalines owns 3 Handymax
- Panamax, from 60,000 DWT to 80,000 DWT: 2 vessels owned by Vinalines

In a rate recovery scenario, charter rates for largest ships are likely to go up first as 1) the supply-demand dynamics for large vessels are more tied to global dynamics; 2) large vessels are likely to be deployed on major trade routes where charter rates are more sensitive to supply and demand and should, consequently, see the fastest recovery. Even though Vietnam carriers do not own Capesize bulkers, the Handymax and Panamax fleet could still benefit from the recovery in pricing even though rate hikes in this vessel class could lag behind Capesize class rate hikes.

Moreover, there should be growing demand for bulkers in Vietnam as several power plants are coming online in the next few years such as Thái Bình 1, Thái Bình 2, Duyên Hải 3 etc. This will encourage thermal coal imports and the Handymax and Panamax fleet will likely be utilized to meet this demand.

In addition, the Handymax fleet is likely to see a slower pace of demolitions compared to the Panamax fleet due to the fact that the fleet is quite young with an average age of 11.9 years while the Panamax bulker fleet average age is more 20 years, and thus their operating and mantenance expenses are lower compared to Panamax bulkers. It should be noted that vessels which are older than 20 years have to go through an expensive special survey every 2.5 years while this special survey only needs to be conducted once every 5 years for younger vessels. This special survey forces several old vessels to be scrapped especially when the rates are low due to lower profitability.

In our opinion, VOS could be the only company worth putting on the watch list in light of the possible recovery in the global shipping industry as 1) the company owns most of the Handymax fleet in Vietnam and 2) is listed. The company is still making losses but is trading at a discount to regional peers and is likely to be a strong beneficiary of the recovering industry environment.

Figure 146: Valuation of dry bulk shipping companies (new)

Ticker	Name	Market cap, US$ bn	Net profit growth YoY	EPS growth YoY	ROA (%)	ROE (%)	D/E	TTM P/E (x)	P/B (x)	EV/EBITDA
VOS	Vietnam	21.5	na	na	-8.5	-61.6	614.3	na	1.2	17.0
Malaysian Bulk Carriers Bhd	Malaysia	201.1	na	na	-29.1	-56.3	70.1	na	1.8	37.0
Shipping Corp of India Ltd	India	691.3	-77.5	-77.5	1.2	2.6	58.5	25.2	0.6	8.1
Cosco Shipping Hld	China	9,158.8	na	na	-0.7	-4.1	137.8	na	1.7	24.6
Ningbo Marine Ltd	China	835.8	-9.5	-9.6	2.2	4.9	82.9	40.7	2.0	na
Great Eastern Shipping	India	921.6	-31.2	-31.2	5.2	11.0	82.2	7.8	0.8	4.9
Bumi Armada Bhd	Malaysia	1,078.9	na	na	-5.1	-16.9	213.4	na	0.8	15.1
Diana Shipping Inc	US	422.3	na	na	-5.8	-9.7	58.6	na	0.4	48.5
Dryships Inc	US	367.0	-242.7	na	-22.3	-40.7	39.6	na	0.6	na
Scorpio Bulkers Inc	US	547.1	na	na	-5.3	-8.4	56.7	na	0.6	67.9
Star Bulk Carriers Corp	US	703.8	na	na	-3.2	-6.2	97.5	na	0.7	18.1
Eagle Bulk Shipping Inc	US	324.7	na	na	-20.8	-33.3	65.9	na	0.6	44.6
Average		1,272.8	na	na	-7.7	-18.2	131.5	24.6	1.0	28.6
Median		619.2	na	na	-5.2	-9.1	76.2	25.2	0.7	21.4

Source: Bloomberg

Figure 147: Valuation of dry bulk shipping companies

Ticker	Name	Market cap, US$ bn	Net profit growth YoY	EPS growth YoY	ROA (%)	ROE (%)	D/E	TTM P/E (x)	P/B (x)	EV/EBITDA
VOS	Vietnam	21.5	46.7	46.8	-8.5	-61.6	614.3	na	1.2	17.0
Malaysian Bulk Carriers Bhd	Malaysia	201.1	42.2	42.2	-29.1	-56.3	70.1	na	1.8	37.0
Shipping Corp of India Ltd	India	691.3	-77.5	-77.5	1.2	2.6	58.5	25.2	0.6	8.1
Cosco Shipping Hld	China	9,158.8			-0.7	-4.1	137.8	na	1.7	24.6
Ningbo Marine Ltd	China	835.8	-9.5	-9.6	2.2	4.9	82.9	40.7	2.0	na
Great Eastern Shipping	India	921.6	-31.2	-31.2	5.2	11.0	82.2	7.8	0.8	4.9
Bumi Armada Bhd	Malaysia	1,078.9			-5.1	-16.9	213.4	na	0.8	15.1
Diana Shipping Inc	US	422.3	68.7	74.7	-5.8	-9.7	58.6	na	0.4	48.5
Dryships Inc	US	367.0	-242.7	100.0	-22.3	-40.7	39.6	na	0.6	na
Scorpio Bulkers Inc	US	547.1	49.8	50.0	-5.3	-8.4	56.7	na	0.6	67.9
Star Bulk Carriers Corp	US	703.8	81.2	86.0	-3.2	-6.2	97.5	na	0.7	18.1
Eagle Bulk Shipping Inc	US	324.7	47.0	71.2	-20.8	-33.3	65.9	na	0.6	44.6
Average		**1,272.8**	**-2.5**	**35.3**	**-7.7**	**-18.2**	**131.5**	**24.6**	**1.0**	**28.6**
Median		**619.2**	**44.4**	**48.4**	**-5.2**	**-9.1**	**76.2**	**25.2**	**0.7**	**21.4**

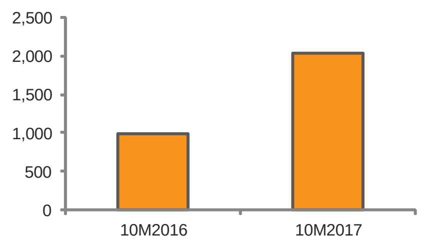
Source: Bloomberg

MATERIALS SECTOR: WE LIKE THE STEEL SECTOR BECAUSE IT IS A BROAD PLAY ON THE ECONOMY BUT WE ARE BEARISH ON CEMENT

2018 steel consumption will maintain its growth momentum due to real estate and infrastructure investments.

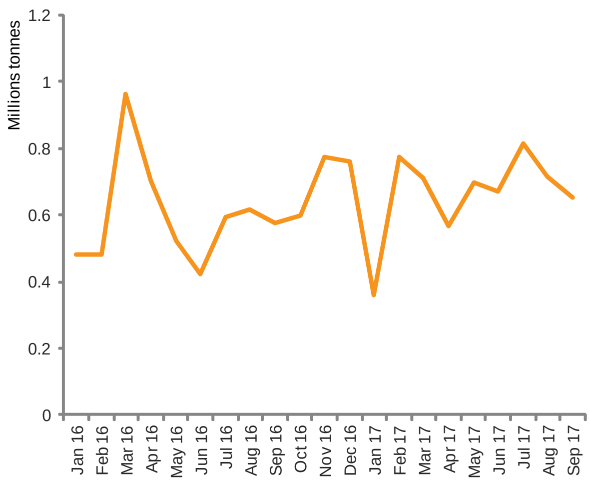
During 9M 2017, construction steel consumption grew by 11.3% YoY to 6 million tones, driven by growing construction activity in the real estate and infrastructure sectors. Within this period, steel consumption grew the fastest at 29.9% YoY between May and September 2017, just after the Tet holiday ended and before the typhoon season kicked-in. Accelerating construction activity led to a 28% YoY increase in the number of new apartments for sale in Hanoi and Hochiminh City (HCMC) during 9M 2017. During this period, the low-end apartment segment saw the fastest growth in supply, with total units for sale rising 55.5% YoY to reach 10,900 units. This reflects the broad market trend whereby developers have begun to turn their attention to the affordable housing segment, which still has a lot of room for growth compared to the high-end segment which has seen an onslaught of new supply in recent years. New supply in the mid-range segment continued to grow strongly, rising 44.5% YoY to reach 25,400 new units for sale, and this segment is currently the main growth catalyst for this market. The new supply in the high-end segment dropped by 11.1% YoY to just above 11,000 new units for sale. We expect the share of the low-to-mid range segment in the total supply mix to rise in the next several years due to significant housing demand from young, middle-class couples who are moving out of multi-generational family homes and are keen on being home owners.

Figure 148: FDI into Real Estate, $US million



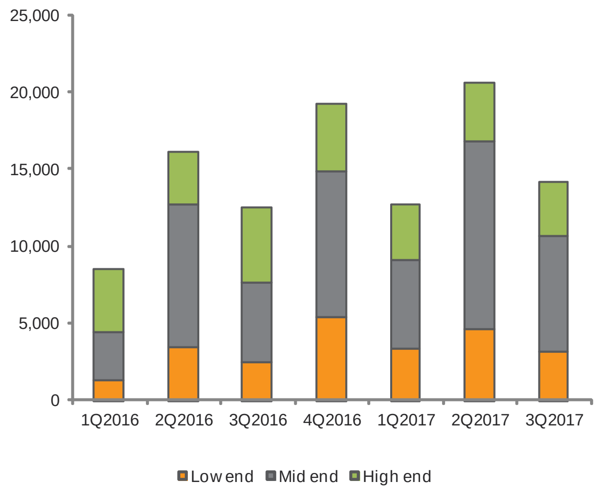
Source: VNDIRECT

Figure 149: Construction Steel Sales Volume



Source: VSA

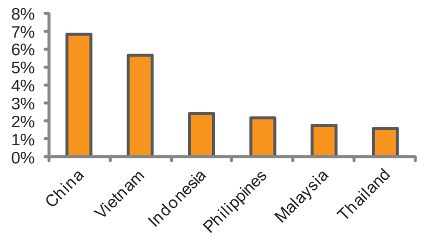
Figure 150: New Supply of Apartments in Hanoi and HCMC (units for sale)



Source: CafeLand

Infrastructure spending remains one of the driving forces of steel consumption but dependence on private capital is a key risk. According to Asia Development Bank (ADB), Vietnam's infrastructure spending is 5.9% of GDP, based only on public spending, which is the second highest among APAC countries. Over the next five years,

Figure 151: Annual Infrastructure Spending (%of GDP)



Source: VNDIRECT

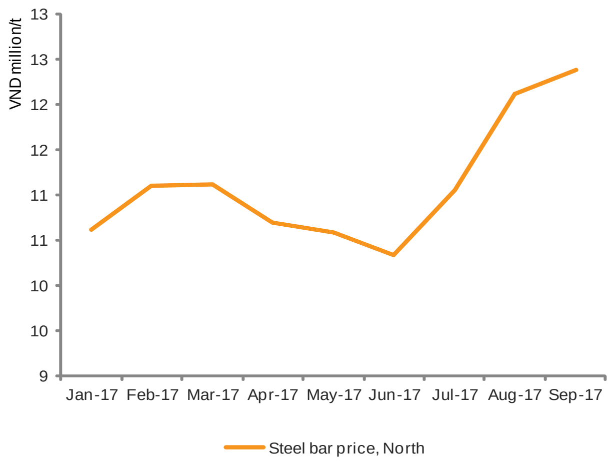
Vietnam requires around USD$480 billion of infrastructure spending for 11 new power plants and 1,380km of highways. The Ministry of Planning and Investment (MPI) expects that 25% of this amount will be funded by FDI and ODA borrowings. In the near future, infrastructure spending will have to rely more and more on the private sector as ODA borrowings are becoming less available and more expensive as Vietnam has now graduated to "lower middle income" status. We believe that the infrastructure segment will be more attractive to private investors if the government is able to design the right models and incentives but this remains a key risk as there is no demonstrable success yet of public-private partnerships in infrastructure development in Vietnam. Nonetheless, some segments of the infrastructure sector are attraction foreign private capital: in 10M2017, FDI into the utilities segment increased by around 40x YoY to touch USD5.6b.

2018 construction steel prices may keep on rising in the near-term due to increasing demand and moderate supply growth

We project that steel prices will increase during 2018, due to the increase in demand for construction steel, coupled with the limited short-term total capacity. The total casting capacity of Vietnam's steel makers will remain at around 12.7m tones per year for the next two years. By the end of 2019, HPG will add another 2 million tons of construction steel per year, due to the launch of Dung Quat Steel Complex at the end of 2019. As a result, other steel makers will have two years to improve gross profit margins and utilization rates, which are very low due to overinvestment in the past. As of the end of October 2017, construction steel prices have increased by 16.3% compared to January prices. We believe construction steel prices will continue to rise for the next year. The current price level is still lower than the 2014 level of more than VND15m per ton.

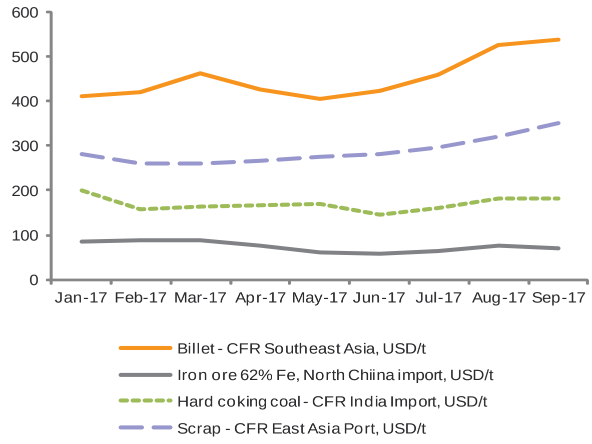
One more reason for rising steel prices is the increase in the price of ferrous scrap, which is the main input of Vietnam's steel makers. More than 60% of steel maker's input materials comprises of ferrous scrap. Since the beginning of 2017, ferrous scrap prices in Asia have increased by 14%, mostly due 1) increasing demand from Turkey, the largest scrap importer in the world; 2) ravaging hurricanes in the US leading to massive demand for scrap, rebar, and steel products. Scrap prices may continue their uptrend in the medium term, as Turkey and India continue to display increasing demand from the construction and infrastructure sectors. This will support billet prices in Asia.

Figure 152: Steel Bar Price in the North



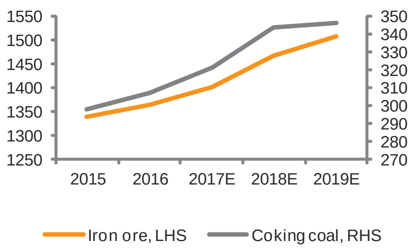
Source: Bloomberg

Figure 153: Steel Input Raw Material Prices



Source: Bloomberg

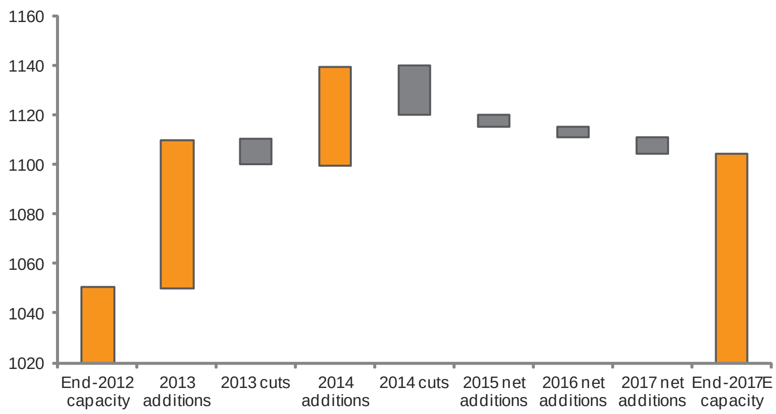
Figure 154: Global supply of Steel input materials (million tons)



Source: Bloomberg

Blast furnace steel makers could make the most of rising steel prices as the prices of their main inputs, iron ore and hard coking coal, may remain stable in the near future. We believe that iron ore and hard coking coal prices may not increase for the next several years due to: 1) fading demand from China, as the government continues to close steel factories that fail to meet emission requirements; 90% of China's crude-steel capacity is based on blast furnace technology that consumes ore and coal; 2) supply of iron ore and coking coal is likely to outstrip demand as more projects come online in 2018 and 2019. We expect the gross profit margin of blast furnace steel makers to rise. We believe that electric arc furnace (EAF) steel makers could benefit from rising steel prices, but not as much as blast furnace steel makers as EAF steel makers have to incur rising scrap prices while blast furnace steel makers could enjoy low 58% Fe iron ore prices. The largest blast furnace steel maker in Vietnam is HPG, and the largest EAF steel maker is Pomina (HOSE: POM).

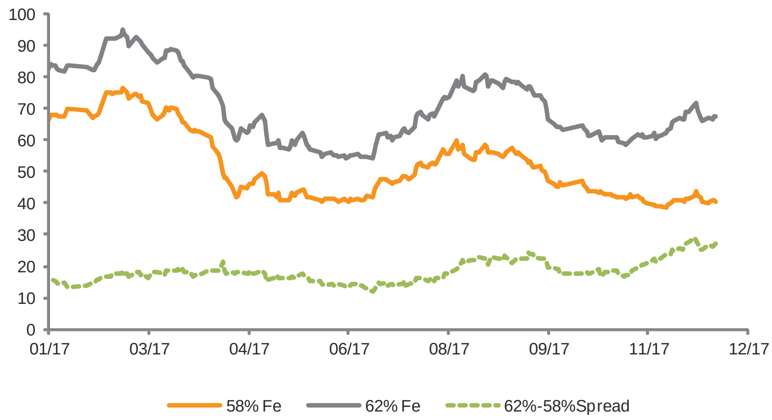
Figure 155: China's Crude Steel Capacity, million tonnes



Source: Bloomberg

Blast furnace steel makers could buy lower grade iron ore (58% Fe) at inexpensive prices due to China's shift to high quality iron ore (62% Fe). Tightening emission regulations in China, coupled with rising steel prices, have whetted Chinese steel makers' appetite for high quality iron ore from Australia. As a result, the hunger for this commodity has reduced demand for low quality iron ore and coking coal which is needed to remove impurities from 58% Fe iron ore. As a result, the high-to-low iron ore price spread has increased by 50% over the last 12 months.

Figure 156: Spot iron ore import into China, US$/tonne



Source: Bloomberg

Formosa Hà Tĩnh Steel Corp (FHS) is an imminent threat to coated steel makers. The company produced 0.8m tons of hot rolled coil (HRC) in 9M2017. The total capacity of phase 1 is 5.3m tons of HRC and 1.2m tons of billet. The 5.3m tons will likely be absorbed by Vietnamese coated steel makers such as Hoa Sen Group (HOSE: HSG) and Nam Kim Group (HOSE: NKG), as Vietnam steel makers cannot produce HRC at the moment. There is a risk that FHS could integrate downstream to produce coated steel as the upgrade required from producing HRC to producing coated steel is relatively simple in terms of technology. The theorized additional steel coated capacity, whether sold to other ASEAN countries or within Vietnam, will negatively impact Vietnamese coated steel makers such as HSG which currently export more than 60% of their output.

We remain bearish on the cement business as the industry is still structurally unattractive.

The cement industry remains oversupplied: total capacity in 2016 was 87.7mn tonnes pa while 2016 consumption was only 59.8mn tonnes, equivalent to a 68% utilization rate. The oversupply situation is more severe in the North and the Central provinces where utilization rates are currently hovering around 50%. In contrast, Southern provinces are undersupplied due to poor limestone quarry reserves but there are no explicit capacity additions planned by Southern cement players like Ha Thien (HT1). Moreover, cement consumption this year has been sluggish with 10M2017 consumption touching 47.6mn tonnes, up only 3% YoY. This could be due to unexpectedly wet weather this year which hampered construction activity. Even though export volume increased by 20% YoY during 10M2017, we are skeptical about the sustainability of this export growth as there are strong regional competitors such as China and Thailand. We believe the industry will continue to see gloomy conditions into 2018.

MATERIALS SECTOR STOCK PICKS: WE LIKE HPG

We like HPG as the company could benefit the most from positive macro factors, compared to other Vietnam steel makers

HPG will benefit from both 1) rising steel prices, and 2) cheaper low grade iron ore while most other steel makers have to incur higher scrap prices as they utlize electric arc furnace technology. Moreover, HPG is the only Vietnam steel maker with huge expansion projects over the next five years. HPG will have another 2mn tonnes of long steel by Febuary 2019 and 2mn tonnes of HRC by the end of 2019. Vinakyoei, one of the top five largest steel makers intends to expand its capacity by 500,000 tonnes of construction steel by 2020.

HOA PHAT GROUP (HPG)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND44,250	NA	3.31%	NON-RATED	Materials

Outlook – Short term

N/a

Outlook – Long term

N/a

Valuation

N/a

Quang Nguyen Hong, CFA
quang.nguyenhong@vndirect.com.vn

HPG is the largest construction steel maker in Vietnam, claiming up to 24% of the total market. In 2017, the company will reach full capacity in terms of construction steel, equivalent to around 2mn tonnes of long steel. However, the growth story of the company is still in its early stages, as HPG will expand its capacity by 4mn tonnes of steel by the end of 2019.

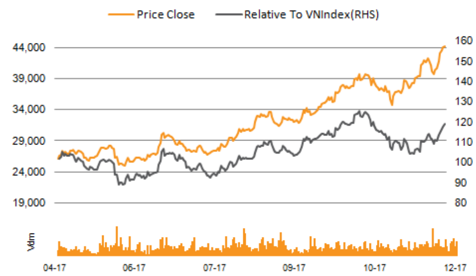
The company's revenue grew by 43% YoY during 9M2017, reaching VND33,417bn, thanks to 1) increase of rebar sales volume by 31% YoY to 1.6mn tonnes and 2) increase of its selling prices by more than 7% since the beginning of 2017. Construction steel accounts for more than 80% of the company's total revenue and net income. The remaining revenue comes from steel pipes, machinery trading, furniture, home appliances and real estate.

The Dung Quat Project (DQP) will be the main growth engine of HPG. Phase one (completed in February 2019), will add 2mn tonnes of rebar production per annum. Phase two (the end of 2019), will add 2mn tonnes of HRC production per annum. The total capex is around US$2.5bn and 50% will be funded by debt. HPG expects each phase to reach full capacity within two years. In 2018, HPG will first complete part of the rolling factory of DQP, which will add 0.2mn tonnes of rebar capacity. As a result, the company's 2018 rebar revenue will still grow at around 10-15%. The 2mn tonnes pa of HRC is likely to be fully absorbed by local galvanized steel makers such as HSG and NKG, as most HRC is imported at the moment.

HPG will enjoy lower COGS per tonne compared to other Vietnam arc furnace steel makers: Low-grade iron ore is becoming cheaper as Chinese steel makers turn to high-grade iron ore, while the scrap price is rising. HPG is using a mix of low and high grade iron ore.

Formosa Steel Corp (FHS) has started production but does not post a major threat to HPG. FHS will be the main competitor in HRC with capacity of 6.2mn tonnes pa. However, FHS, with 1.3mn tonnes pa capacity of rebar, may find it hard to enter the rebar market as it is difficult to set up the wide distribution network that HPG has set up over the past several years. FHS poses a greater threat to coated steel makers.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	44,100
52w low (VND)	24,967
3m Avg daily volume (shares)	4,458,107
3m Avg daily value (VNDmn)	174,034
Market cap (VNDbn)	67,274
Outstanding shares (m)	1,516
Free float (%)	44
P/E TTM	6.6x
P/B	1.7x

Ownership

Tran Dinh Long	25.15%
Dragon Capital	7.65%
Vu Thi Hien	7.29%
Others	59.91%

Source: VNDIRECT

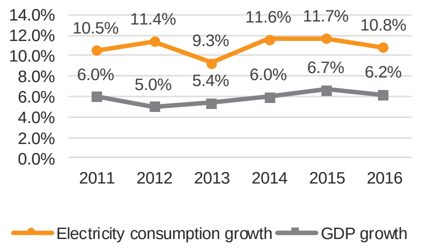
Financial summary (VND)	12-13A	12-14A	12-15A	12-16A
Net revenue (b)	18,934	25,525	27,453	33,283
Revenue growth	12.5%	34.8%	7.6%	21.2%
Gross margin	17.3%	20.3%	20.4%	26.3%
EBITDA margin	10.0%	12.2%	11.4%	18.6%
Net profit (b)	1,954	3,144	3,485	6,602
Net profit growth	96.6%	60.9%	10.9%	89.4%
Basic EPS	1,467	2,328	2,452	4,470
BVPS	8,857	10,686	14,623	19,797
ROAE	22.2%	29.5%	25.2%	35.3%

Source: VNDIRECT

POWER SECTOR: A BROAD PLAY ON INDUSTRIALIZATION

Economic growth and rapid industrialization will drive a sustained rise in power consumption

Figure 157: Electricity consumption growth vs. real GDP growth



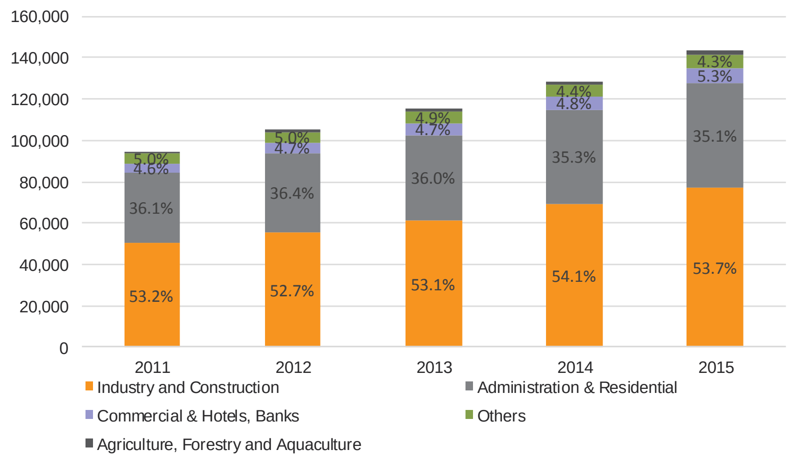
Source: GSO

Vietnam's GDP growth averaged 5.9% per year between 2011 and 2016, while electricity consumption grew at an average rate of 10.9% per year over the same period. On average, Vietnam has therefore been consuming 1.84% more electricity in order to deliver every 1% increase in GDP. This number, also known as the Energy Elasticity, is considered relatively high in the region, and also in a global context. In developed countries, this ratio is approximately 1.0x and can even be as low as 0.5-0.8x in some countries. Vietnam is currently trying to increase its electricity usage efficiency under its revised Power Development Plant VII (PDP 7). Based on this plan, electricity consumption is expected to continue growing at 10-12% per annum based on assumed average GDP growth of 7% over the same period (equivalent to an energy elasticity of approximately 1.5 to 1.7x).

Inefficient electricity usage, as reflected in the high energy elasticity of Vietnam's economy, can be attributed to the lack of detailed guidelines as well as the lack of energy saving awareness and practices. Moreover, there is little incentive to do so in the absence of market-based electricity prices.

Vietnam's economic growth mainly depends on the industrial and service sectors, with industrial activities consuming most of the electricity. Over the period 2011-2015, power consumption was mostly driven by the Industry and Construction (53.4%) and Administration & Residential (35.8%) sectors. The industrial sector is currently and will continue to be the biggest consumer of electricity in the next few years, as Vietnam is still in the early stage of industrialization.

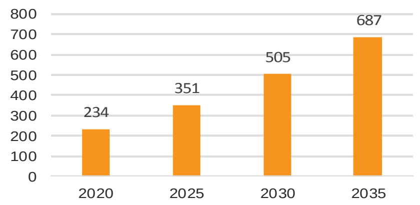
Figure 158: Power Consumption by Sector, mn kWh (% of total)



Source: EVN

Robust FDI inflows into manufacturing and industrial activities also supported the strong growth in electricity demand. In 10M2017, the manufacturing sector attracted 48.7% of the total newly registered FDI, with 7% YoY growth in registered FDI. Manufacturing in Vietnam primarily focuses on consumer electronics and semi-conductors.

Figure 159: Electricity Demand Forecast based on revised PDP 7 (bn kWh)

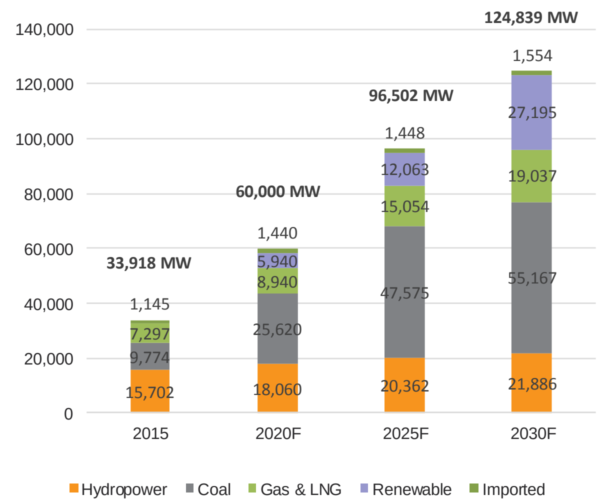


Source: PDP 7 (MOIT)

Increasing demand for electricity will require a tripling of current generation capacity over the next decade

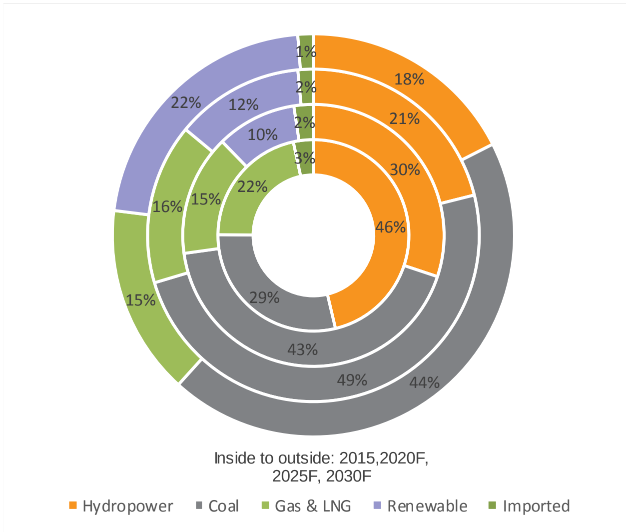
The total installed power plant capacity in Vietnam reached 41,424MW by the end of 2016, with EVN owning the largest share of nationwide capacity. Given the forecasted power demand growth of 10% per annum through 2030, revised PDP 7 has laid out a plan to increase total capacity by nearly three times in the next decade. Total domestic electricity output and imports are expected to reach 265-278bn kWh by 2020, 400-431bn kWh in 2025 and 572-632bn kWh by 2030, representing a surplus over the forecasted electricity demand in order to maintain a "buffer", according to revised PDP 7.

Figure 160: Structure of power source by type (MW)



Source: PDP 7

Figure 161: % of total power source by type

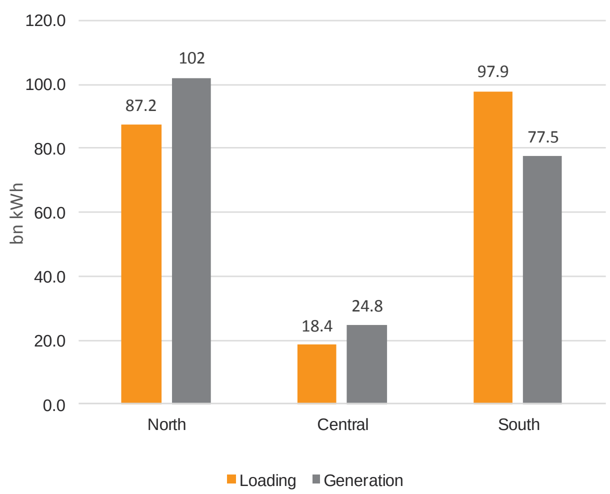


Source: PDP 7

The majority of future power plants will be coal and gas-fired until 2030 due to the following two reasons: (1) hydropower potential in Vietnam has been almost fully exploited already, (2) there is a need to move toward more stable sources of power for energy security since hydropower output fluctuates depending on weather patterns which, in turn, are becoming increasingly unpredictable due to climate change. Some future gas thermal plants will run on liquefied natural gas (LNG) instead of dry gas also because production from existing gas fields in Vietnam has already peaked and new gas fields are yet to be developed. Examples of planned plants which will use LNG in the future include Nhon Trach 3 (750MW capacity), Nhon Trach 4 (750MW capacity) and the Son My 2 series of power plants (3 plants with 750MW capacity each).

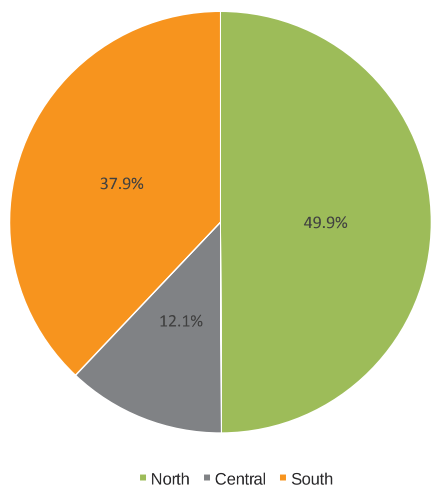
We expect that new gas and thermal capacity will be built in the South but transmission line upgrades are imperative to balance regional disparities, also because the new plants will take advantage of their proximity to the gas supply in East Sea. Southern Vietnam is the main consumer of electricity, accounting for 48% of nationwide demand load, but only 35% of total generation capacity in 2016 according to National Load and Dispatch Center (NLDC). Northern and Central Vietnam, in contrast, have surplus electricity. As the consumption structure and generation capacity is different across regions, the government is trying to rebalance the supply-demand of electricity nationwide to ensure that the shortage in the south is made up for through (1) pushing for construction of new power plants in the South and (2) upgrading and investing in the North-South transmission line to allow for more efficient transfer of excess electricity from the North and Central regions to the South. Transmission losses on the North-South grid are high due to the long transmission distance.

Figure 162: Expected power generation & loading plan by region in 2017



Source: NLDC

Figure 163: Expected share of total planned power generation plan by region in 2017



Source: NLDC

The power generation sector is already attracting the attention of foreign and private investors

This continued FDI-led industrialization has created strong potential for the power sector, especially with the government's gradual liberalization initiatives. Foreign investors have seen opportunities in (1) constructing new power plants to capture the growth in electricity demand in the future, and (2) making financial investments in existing plants. In fact, 19.9% of the newly registered FDI during the first ten months of this year went into electricity production and distribution – the second largest share just after the manufacturing sector – and amounted to US$5.6bn, a big jump from the mere US$133mn realized in the same period last year. Two out of the top five FDI projects in terms of investment value were thermal power plants, including BOT Nam Dinh 1 power plant (1,109.4MW capacity) which received US$2.07bn of FDI from Taekwang Power (Korea) and Acwa Power (Saudi Arabia); and BOT Nghi Son 2 (1,200MW capacity) which received US$2.79bn of FDI from Marubeni (Japan) and KEPCO (Korea).

Build-Operate-Transfer (BOT) is a type of contract signed between private investor(s) and the Ministry of Industry and Trade (MOIT) to build power plants. After the construction is completed, the investor(s) can operate the plant for a predetermined period of time and transfer back to MOIT after this period of time expires.

However, the legal framework to build power plants in Vietnam is still complicated and difficult for many private investors. An easier, albeit indirect, way to benefit from the increasing electricity demand is to make financial investments in existing power plants, a trend we expect to accelerate in the future as Vietnam is making progress in privatizing its large state-owned power companies and listing them on the stock market (eg. PVPower which is the second largest power generator in Vietnam is expected to hold its IPO auction on Jan 31st, 2018).

Renewable energy still in its infancy but has long-term potential

Figure 164: Summary of existing wholesale prices paid by EVN for renewable energy by source

Sources	Electricity sale price
Wind power	7.8 Usc/kWh (on land)
	9.8 Usc/kWh (on the sea)
Solar power	9.4 Usc/kWh

Source: MOIT

According to the latest report by Vietnam Energy Association (VEA), Vietnam has promising potential to develop various sources of renewable energy: up to 40,000-50,000MW of wind power potential on land and huge solar power potential due to long hours of sun (up to 2,700 hours in average per year on the South Central Coast). Due to environmental reasons, the government is expected to push for development of renewable energy sources to supplement traditional coal and gas thermal power.

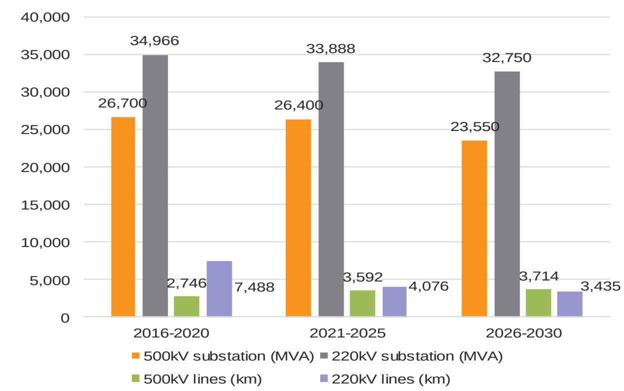
Revised PDP 7 also plans to gradually increase the percentage of renewable energy (RE) in the national generation capacity mix, but this will take time. The lack of incentives has been a hindrance for investors that want to invest in RE, due to the low power purchase price from EVN and unclear development guidelines.

Vietnam is still in the very early stages of developing RE. There are currently 4 large wind power projects with a total capacity of 159MW, only covering about 2.7% of the wind power target in 2030 as laid out in the PDP 7 (6,000MW). Most of the investment in RE capacity is being made by private firms. Some of the names include Central Hydropower JSC (HOSE: CHP) with Cu Jut solar power project in Dak Nong (112MW) planning to connect to the grid by 2019; Thanh Thanh Cong Group (TTC) with plans to develop various solar power plants in Tay Ninh (324MW), Binh Thuan (300MW), Ninh Thuan (300MW), Hue (30MW), Gia Lai (49MW); and Cong Ly Construction, Trade and Tourism Co. which is currently operating the largest wind mill so far in Vietnam with a capacity of 99.2MW. We believe that the economics of RE project development will improve in the future, as innovation brings down capital and operating costs. Moreover, the government also begins to pay more attention to this area and develops appropriate incentives. This should attract more investment from private investors over the long-term.

Increasing need to upgrade transmission lines

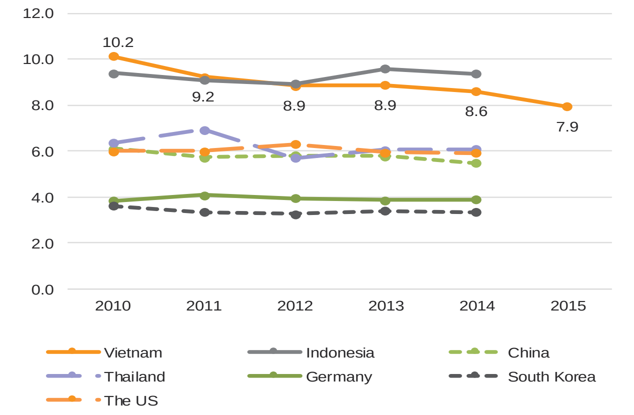
As mentioned above, the government is seeking to expand and upgrade the existing transmission lines to reduce transmission losses, as well as to address the electricity deficit in the South. In revised PDP 7, the total value of investment into development of the national grid is projected to touch VND214.7trl (~US$9.4bn) during 2016-2020 and VND610.5trl (~US$26.9bn) during 2021-2030.

Figure 165: Transmission System Expansion (PDP 7)



Source: PDP 7

Figure 166: Electricity Transmission and Distribution Losses by country (% output)



Source: World Bank

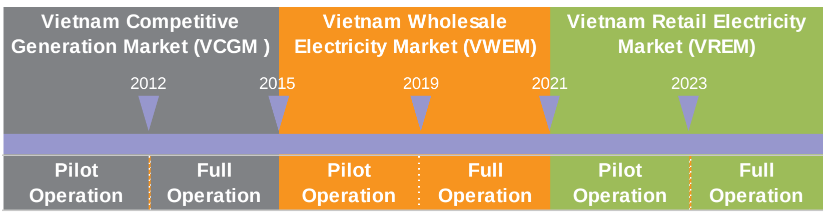
Vietnam's current electricity transmission and distribution losses are much higher than other countries in the region and also by global standards. However, continued investments in the grid have helped reduce losses in recent years. EVN and the National Power Transmission Corporation (NPTC) aim to lower the percentage to 6.5% by 2020. Given the country's 2016 electricity output of 183.28bn kWh, even a 1% decrease in transmission loss is very significant for both the supply and demand sides of the electricity market.

Vietnam's power system has distinctive challenges due to the long transmission distance between the power production and consumption hubs. For instance, the surplus electricity in the North has to be transmitted nearly 2,000 kilometers to the South to make up for the shortage there. Moreover, some of the transmission lines have been operating for more than 20 years and thus have depreciated considerably, including 500kV Ha Tinh, Phu Lam, Pleiku, Da Nang substations, and 500kV North-South transmission line branch #1. This has led to difficulties in maintenance, repairs and operations. Therefore, there is a strong need to upgrade and construct new transmission lines to complement the existing transmission grid infrastructure. We also expect the government to invest in smart grid technology in the not-too-distance future to improve energy efficiency and load balancing.

Liberalization across the power value chain should lift tariffs over time, to the benefit of private sector generators

The pilot version of Vietnam Wholesale Electricity Market (VWEM) is being run by EVN Ho Chi Minh City (EVN HCMC). The details of VWEM's launch process have been designed by the Ministry of Industry and Trade (MOIT) to follow two stages: trial period from 2016-2018 and official operation from 2019 onward. EVN is currently building the technical infrastructure required for the operation and supervision of VWEM to prepare for its launch in 2019.

Figure 167: Deregulation process of the power market



Source: EVN

VWEM will remove the monopoly buying power from EVN when the five power companies (EVN NPC, EVN SPC, EVN CPC, EVN Hanoi and EVN HCMC) sign contracts directly with power plants. Another feature of this market is that large electricity buyers not owned by EVN, and with direct connectivity to 220kV transmission lines, will also be able to join the market as direct buyers, thereby loosening EVN's monopoly grip on wholesale distribution of power. The main difference between the current Competitive Generation Market (CGM) and VWEM is that EVN will no longer be the sole buyer of electricity as is currently the case.

The current Dutch auction pricing mechanism governing the CGM market will also be applied to the VWEM, according to Decision 8266 from MOIT in 2015. On day D-1, power plants will submit their offering price-quantity pairs for the supply of electricity for 48 sessions in day D. The National Load Dispatch Center (NLDC) will then forecast demand and dispatch generating units based on the list using the Dutch auction pricing method. After that, the price-quantity pair will be sent back to each power plant 6 hours before the operating time to let them arrange their operating schedule accordingly.

The Competitive Retail Market (CRM) will be the last phase of the deregulation process, in which direct transactions will take place between power plants and end users of electricity without the need to go through the five power companies that control wholesale operations. End-users will be able to choose their power provider directly from the market based on their preferences.

Ongoing privatization of the power sector creates opportunities for investors

Privatization of the power sector is underway within EVN and other players outside EVN. PVPower, under the Vietnam Oil and Gas group (PVN) and is also the second largest power generator after EVN, will undergo an IPO auction on January 31st, 2018 as the first step in the privatization of existing large power companies in the market. EVN has also set out a timeframe for privatization of the power generation companies under it during 2016 – 2018, beginning with Generation Company No 3 (GENCO 3). EVN will still hold a controlling stake in the three power generation companies (>51%). The National Power Transmission Corporation (NPTC), National Load Dispatch Center (NLDC) and Electric Power Trading Company (EPTC) will continue to be 100% held by the state. During the period between 2019 and 2020, the government will consider lowering the state stake in the three power generation companies (GENCO 1, GENCO 2 and GENCO 3) to below controlling levels after assessing the results of privatization. The government will consider divesting from the five power corporations between 2021 and 2025.

POWER SECTOR STOCK PICKS: WE LIKE PC1

We remain bullish on power sector given stable economic growth and continuing divestment of state stake from power companies

As mentioned above, there is growing demand for expansion and upgrading of transmission lines to (1) reduce transmission losses in the already depreciated grid in some areas, and (2) address the electricity shortage in the South. Among the currently listed companies, we prefer electricical engineering companies like Power Construction JSC No.1 (PC1 VN) as it will directly benefit from the investment in the grid which is more than certain to play out over the next few years with contract awards being front-end-loaded. Moreover, unlike listed power generators in the market, PC1 is not dependent on unpredictable variables such as weather patterns, commodity prices (coal versus natural gas) and electricity selling price to EVN.

PC1 is a market leader in the electrical engineering sector, which still has ample room for growth. We recommend PC1 even though it is rated a HOLD now as market price has increased since our last update but the fundamentals still suggest further upside over the long-term.

Within the upcoming wave of companies IPOs in the power sector, we think that PVPower will be a suitable choice for investors who are looking to bet more directly on electricity demand growth and therefore want to play upstream in the power value chain. PVPower is currently the second largest power generation player in Vietnam after EVN with a portfolio of multi-source generation assets along with sizeable potential capacity expansion planned in the next few years. The company's IPO auction on January 31st, 2018 has already attracted significant investor attention. The company's diversified generation portfolio provides a natural hedge against commodity price movements and we also see a strong possibility of strategic investor participation given the recent surge in FDI into the power generation sector.

POWER CONSTRUCTION JSC NO.1 (PC1)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND39,000	VND42,100	n/a	HOLD	INDUSTRIALS

Outlook – Short term

Negative Neutral Positive

Outlook – Long term

Negative Neutral Positive

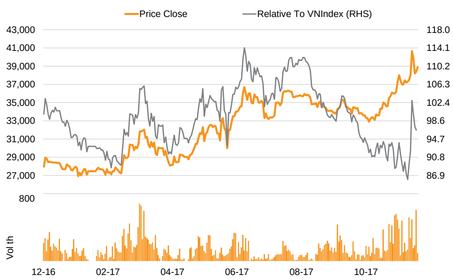
Valuation

Negative Neutral Positive

Nguyen Hanh Trang

trang.nguyenhanh@vndirect.com.vn

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	40,650
52w low (VND)	26,923
3m Avg daily volume (shares)	0.19
3m Avg daily value (VNDmn)	7,451
Market cap (VNDbn)	4,433
Outstanding shares	115,452,410
Free float (%)	55
P/E TTM	16.0x
P/B	1.8x

Ownership

Trịnh Văn Tuấn	17.7%
VEIL	9.9%
Vietnam Holding Limited	5.1%
Others	67.30%

Source: VNDIRECT

PC1 is the leader in the electrical construction market in Vietnam. With growing electricity consumption and the need for huge investments to expand and upgrade the power transmission and distribution infrastructure, PC1 has bright prospects. We expect 2018 to be a positive year for PC1 thanks to the recognition of VND1.1trl (US$48.4mn) in revenue from My Dinh Plaza II project and the launch of Bao Lam 3 and Bao Lam 3A hydropower plants. The recent surge in the stock price has diminished near-term upside but we think the stock is still a good long-term bet.

PC1 is the leader in power transmission and distribution engineering. with years of experience and advanced technology, PC1 has advantages in bidding for construction and installation packages especially in difficult terrain. The firm is the market leader in construction of transmission lines and substations with a revenue CAGR of 22.4% in this segment during 2011-2016. With electricity consumption growing at a rate of 10-13% p.a, a total of VND214.7bn (US$9.5bn) needs to be invested in transmission network upgrades over 2016-2020. This will give PC1 plenty of growth opportunity in its core business.

Real estate segment to deliver significant earnings catalyst in 2018. with My Dinh Plaza II's recognition of approximately VND1.1trl (US$48.4mn) of revenue and EAT of VND216bn (US$9.5mn). This is PC1's fourth mid-range housing project following track record of success in residential complex development. Complete sales of all available apartments during 2017-2018 will be made possible by the building's favorable location in the West of Hanoi and My Dinh center

Growing hydropower portfolio should provide a stream of relatively steady recurring earnings. PC1 has already obtained licenses to develop a total of 162MW worth of hydropower projects. PC1 is currently operating two plants (total capacity of 60MW) and two others just connected to the grid in November 2017 (Bao Lam 3 and 3A at total capacity of 54MW). The new plants are forecast to bring around VND59bn of revenue in Q4 2017 and VND246bn on an annual basis thereafter (estimated based on average electricity selling price of VND1,100/kWh).

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	3,101	3,008	3,476	5,123
Revenue growth	0.0%	(3.0%)	15.5%	47.4%
Gross margin	13.8%	17.5%	15.3%	19.1%
EBITDA margin	11.4%	15.2%	15.0%	18.8%
Net profit (bn)	245	305	301	575
Net profit growth	(42.0%)	24.1%	(1.2%)	91.0%
Recurring profit growth	(42.0%)	24.1%	(1.2%)	91.0%
Basic EPS	4,568	4,532	2,606	4,979
Adjusted EPS	4,413	4,233	2,433	4,805
BVPS	40,106	27,406	21,998	26,977
ROAE	22.0%	17.8%	13.1%	20.3%

Source: VNDIRECT

PC1 also plans construct two more plants in 2018 at combined capacity of 48MW with earning contributions starting 4Q2019, making hydropower generation the second core business segment after electrical construction. Hydropower is anticipated to bring about stable cash flows for PC1 in the future and lift blended gross margins.

Total revenue from hydropower will increase significantly in 2018 thanks to the fact that all 4 hydropower plants will be in operation during the year. We forecast total electricity output for 2017 to be 298mn kWh, mainly generated by Trung Thu and Bao Lam 1 plants while in 2018 this number will be 469mn kWh. One advantage of these hydropower plants, which are classified as small hydropower plants, is that the selling prices are calculated according to the Annual Avoided Cost Tariff Rates issued by the Ministry of Industry and Trade, annually. Average selling prices based on such tariffs (ranging from VND 1,070-1,100/kWh) are usually 20% higher than the average electricity prices that large hydropower plants are allowed to charge EVN based on their power purchase agreement (PPA). At present, the estimated average selling price is assumed to be VND1,100/kWh.

My Dinh Plaza II construction is going according to schedule. PC1 is currently in the final stages of this project. The company's management is trying to complete the project three months earlier than plan within Q1 2018, without compromising the project quality. PC1 has also started the second round of apartment sales in October. We assess that they will be able to achieve the target sales of 70% of the total number of apartments by the end of this year.

Electrical engineering sector has ample room for growth. Thanks to the rising demand for electricity (average increase of 11% per year per EVN's estimation) and the expected deepening of the shortfall in the South, the Government has to step up investment in substations and transmission lines to balance power across the country. According to the revised Power Development Plan VII in 2016, the total investment capital for the development of power grids approved by the state in the 2016-2020 period is VND214.7trl (US$9.5bn) and in the period 2021-2030 it is VND610.5tr (US$26.9bn). EVN expects to add 10,234 km of new transmission lines in 2016-2020. The current value of PC1's order backlog stands at VND3.6trl (US$158.4mn) with 80% of the projects coming from EVN and the majority related to construction of transmission lines.

Dominant market share in steel poles. PC1 is also the only company currently in the market capable of designing & manufacturing single steel poles 110kW, 220kV – 1,2,4 due to its unique technology. PC1 possesses two fully-owned steel manufacturing factories at total capacity of 50,000 tons/year. The market share of PC1 in this segment is 40%. In addition to producing for the domestic market, PC1 also signed export contracts with partners in 10 countries including Japan, Korea, Pakistan, India, Laos and Chile. Most recently, the company has partnered with AG Ajikawa (AG) Japan to tap into their large customer portfolio. At the present, PC1 has exported 40,000 tons of steel columns to Indonesia in Q3/2017, according to the first phase of the contract signed with AG.

Healthy order backlog in steel tower manufacturing segment. PC1 owns 100% stake in two steel structure manufacturing factories with total capacity of 50,000 tons/year. Currently they are the sole suppliers of single steel columns in the market used in building transmission towers. PC1 holds a 40% market share in the steel columns market with a growing export segment as well. Most recently, the company has partnered with AG Ajikawa (AG) Japan to tap into their large customer portfolio. At the present, PC1 has exported 40,000 tons of steel columns to Indonesia in Q3/2017, according to the first phase of the contract signed with AG. Total value of new contracts signed in 2017 was around VND66bn (US$2.92mn).

Announcement of weak 2017 full year results could create an attractive entry opportunity. In 9M2017, the company only recorded VND193bn in earnings after tax (-26.2% YoY) due to its higher financial expenses. Moreover, the lack of real estate revenue contribution will also depress its full year 2017 results. If the market reacts negatively to this news, this could open up the opportunity for investors to buy on the dip in preparation for strong earnings growth during 2018.

Valuation:

We value the firm using a "sum-of-the-parts" method due to the different fundamentals of each business segment. Our target price based on 2018 forecast business results after dilution is VND 42,100/share. At this price, the forecast 2018 P/E is 11.9x using an adjusted EPS of VND4,805/share.

The multiple assumptions and base value for each business segment is as followed:

Figure 168: Valuation methods

Method	Segment value (bn VND)	Contribution to target price
Electrical Engineering - P/E	2,581	22,356
Industrial Production - P/E	605	5,243
Real Estate - NPV	327	2,830
Hydropower - FCFE	1,271	11,010
Others - P/BV	81	698
Target Price		**42,138**

Source: VNDIRECT

Figure 169: Multiples applied

Valuation method	TTM P/E	Forecast one year EPS (VND/share)	Segment Value (bn VND)
Electrical Engineering		**2,486**	**2,581**
CTD	10.3		
HBC	9.0		
VNE	7.2		
SJE	9.5		
Applied Average TTM P/E	**9.0**		
Industrial Production		**831**	**605**
HPG	6.4		
HSG	6.2		
Applied Average TTM P/E	**6.3**		

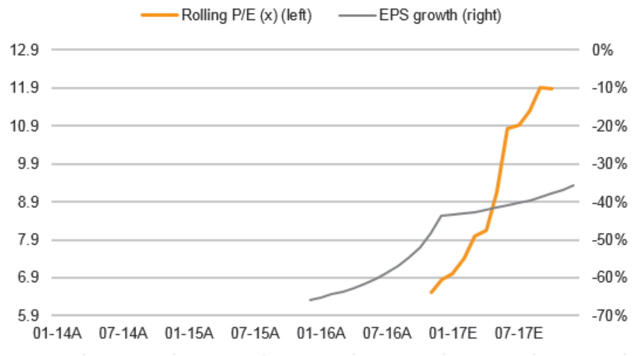
Source: VNDIRECT

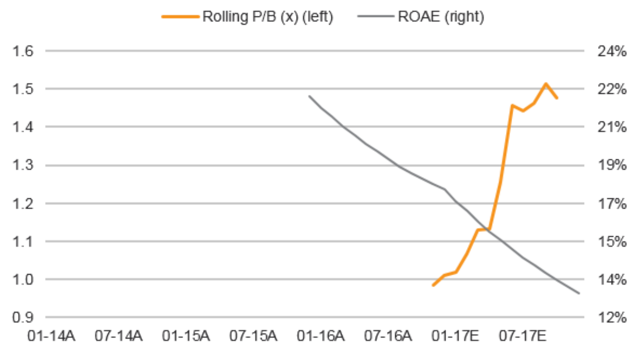
Figure 170: Peer comparison

Company	Country	Market Cap (mn US$)	Dividend yield (%)	TTM P/E	1YF P/E	TTM P/B	Net Debt/ Equity	ROE (%)	ROA (%)	EPS growth 2017 (%)
Electrical Engineering										
CTD	Vietnam	683.7	n/a	10.3	n/a	2.5	-0.8	29.1	14.6	-16.5
HBC	Vietnam	357.2	n/a	9.0	n/a	3.8	1.3	53.4	7.1	21.3
VNE	Vietnam	32.5	n/a	7.2	n/a	0.7	0.1	11.2	6.4	n/a
SJE	Vietnam	13.7	7	9.5	n/a	1.0	0.8	9.6	2.2	n/a
Average		*271.8*		*9.0*		*2.0*	*0.3*	*25.8*	*7.6*	*2.4*
Median		*194.9*		*9.3*		*1.7*	*0.4*	*20.2*	*6.7*	*2.4*
Hydropower										
GHC	Vietnam	31.9	7.6	11.0	n/a	2.4	-0.1	22.2	17.7	n/a
PIC	Vietnam	20.0	2.7	17.1	n/a	1.4	0.4	8.0	5.4	n/a
DRL	Vietnam	18.4	n/a	6.7	n/a	3.1	-0.5	47.1	46.9	n/a
Average		*23.5*	*5.2*	*11.6*		*2.3*	*0.0*	*25.8*	*23.4*	
Median		*20.0*	*5.2*	*11.0*		*2.4*	*-0.1*	*22.2*	*17.7*	
Industrial Production										
HPG	Vietnam	2650.2	n/a	6.4	n/a	1.9	-0.1	34.9	20.9	-1.9
HSG	Vietnam	447.4	n/a	6.2	n/a	1.6	2.1	36.4	11.7	4.9
Average		*1548.8*		*6.3*		*1.7*	*1.0*	*35.7*	*16.3*	*1.5*
Median		*1548.8*		*6.3*		*1.7*	*1.0*	*35.7*	*16.3*	*1.5*
PC1	**Vietnam**	**145.5**	**n/a**	**16.0**	**8.8**	**1.8**	**0.3**	**18.7**	**7.8**	**-1.2**

Source: VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	3,008	3,476	5,123
Cost of sales	(2,482)	(2,944)	(4,147)
Gen & admin expenses	(129)	(149)	(219)
Selling expenses	(0)	(1)	(1)
Operating profit	**397**	**383**	**756**
Operating EBITDA	433	481	922
Depreciation and amortisation	**(36)**	**(98)**	**(166)**
Operating EBIT	**397**	**383**	**756**
Interest income	14	11	14
Financial expense	(22)	(29)	(48)
Net other income	72	55	55
Income from associates & JVs	(61)	(24)	(24)
Pre-tax profit	**401**	**396**	**752**
Taxation	(96)	(95)	(178)
Minority interests	0	0	0
Net profit	**305**	**301**	**575**
Adj. net profit to ordinary	305	301	575
Ordinary dividends	(0)	0	0
Retained earnings	**305**	**301**	**575**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**401**	**396**	**752**
Depreciation & amortisation	36	98	166
Tax paid	(80)	(79)	(148)
Other adjustments	(405)	(42)	(45)
Change in working capital	**(14)**	**(351)**	**(226)**
Cash flow from operations	**(62)**	**21**	**500**
Capex	(993)	(1,091)	(911)
Proceeds from assets sales	0	0	0
Others	(75)	42	45
Other non-current assets changes	(21)	(13)	(53)
Cash flow from investing activities	**(1,089)**	**(1,062)**	**(919)**
New share issuance	414	176	0
Shares buyback	0	0	0
Net borrowings	585	945	61
Other financing cash flow			
Dividends paid	(0)	0	0
Cash flow from financing activities	**999**	**1,121**	**61**
Cash and equivalents at beginning of period	571	419	499
Total cash generated	**(153)**	**81**	**(358)**
Cash and equivalents at the end of period	419	499	141

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	419	499	141
Short term investments	20	20	20
Accounts receivables	1,046	1,094	1,560
Inventories	532	854	1,145
Other current assets	29	40	150
Total current assets	**2,046**	**2,507**	**3,015**
Fixed assets	2,111	3,012	3,668
Total investments	85	85	85
Other long-term assets	288	238	308
Total assets	**4,530**	**5,842**	**7,077**
Short-term debt	135	149	0
Accounts payable	815	638	897
Other current liabilities	427	631	920
Total current liabilities	**1,377**	**1,417**	**1,816**
Total long-term debt	981	1,777	1,987
Other liabilities	109	108	159
Share capital	753	1,155	1,155
Retained earnings reserve	940	1,016	1,590
Shareholders' equity	**2,063**	**2,540**	**3,115**
Minority interests	0	0	0
Total liabilities & equity	**4,530**	**5,842**	**7,077**

Key ratios

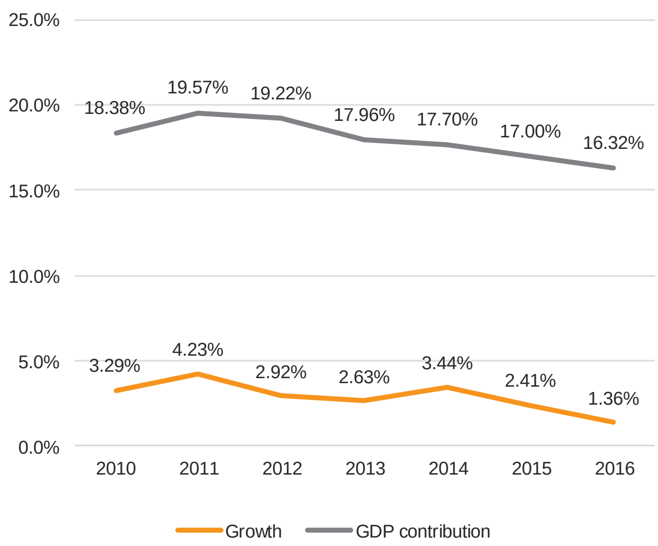
	12-16A	12-17E	12-18E
Dupont			
Net profit margin	10.1%	8.7%	11.2%
Asset turnover	0.77	0.67	0.79
ROAA	7.8%	5.8%	8.9%
Avg assets/avg equity	2.27	2.25	2.28
ROAE	17.8%	13.1%	20.3%
Efficiency			
Days account receivable	97.2	88.7	88.7
Days inventory	79	106	101
Days creditor	120	79	79
Fixed asset turnover	2.07	1.36	1.53
ROIC	9.6%	6.7%	11.3%
Liquidity			
Current ratio	1.49	1.77	1.66
Quick ratio	1.10	1.17	1.03
Cash ratio	0.32	0.37	0.09
Cash cycle	55	116	111
Growth rate (yoy)			
Revenue growth	(3.0%)	15.5%	47.4%
Operating profit growth	34.1%	(3.7%)	97.6%
Net profit growth	24.1%	(1.2%)	91.0%
EPS growth	(43.6%)	(35.6%)	91.0%
Share value			
Basic EPS (VND)	4,049	2,606	4,979
BVPS (VND)	27,406	21,998	26,977

Source: VNDIRECT

AGRICULTURE: RECOVERING AND RESTRUCTURING

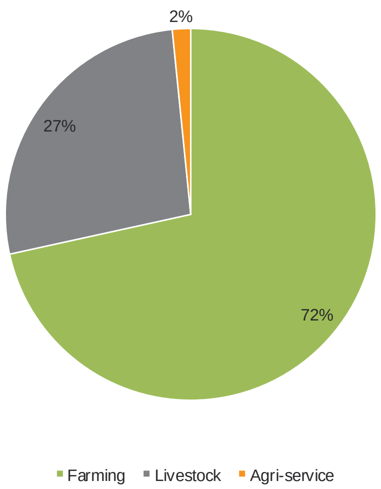
Though the agriculture, forestry and fishery sector is an ever smaller contributor to the country's GDP, the current level of 16-17% still remains high by regional standards. These sectors continue to be key contributors to the country's GDP growth, and employ over 42% of the total labor force as of 2016. Vietnam has transformed from merely meeting domestic demand, reducing rural poverty, and achieving food security, to becoming a regional agriculture export powerhouse. Vietnam is currently among the top five exporters, globally, of rice, coffee, cashew, rubber, pepper and aquaculture products.

Figure 171: Growth rate and contribution to GDP of agriculture, forestry and fishery sector



Source: GSO, VNDIRECT

Figure 172: Breakdown of the agriculture sector, 2016



Source: GSO, VNDIRECT

Farming makes up around 70% of Vietnam's total agriculture production, while the livestock and agri services segments account for the remaining share. Due to the lack of sufficient coverage of these segments and limited representation in the stock market, we will only focus on the farming segment and its related industries in this report. The term "agriculture" used henceforth should therefore be broadly understood to be referring to the farming segment.

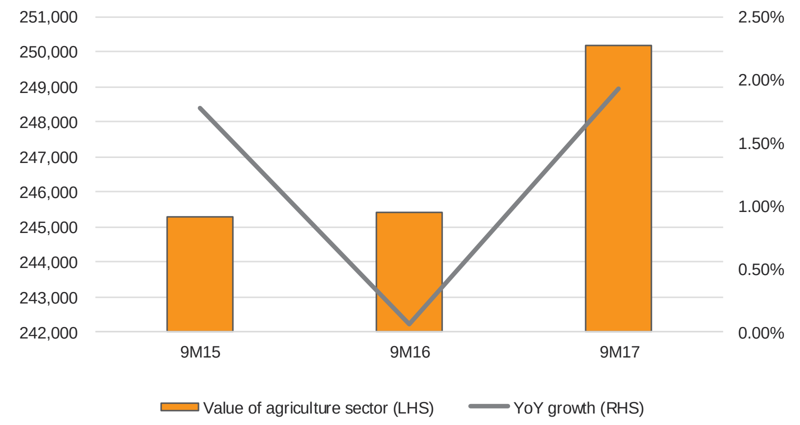
2017 was a year of recovery for the agriculture sector

Market conditions improved following the normalization of weather patterns

Agricultural production in 2015-2016 was heavily impacted by El Nino, which caused severe droughts in many provinces. This later led to earlier and harsher saltwater intrusion in the Mekong Delta region, the "rice bowl" of Vietnam. Vietnam's rice production consequently declined during 2015 and 2016, and there was also a decline in coffee production in 2016/2017 crop (which ended in 1Q2017). This strongly impacted Vietnam, as coffee and rice are two of the country's key agricultural exports. With weather conditions returning to a more normal pattern this year, the sector has experienced a recovery in production volumes and yields. Data from the General Statistics Office

(GSO) showed a significant improvement in agricultural production in 9M2017 compared to the same period in 2016, recording a 1.96% YoY growth rate vs 9M16's growth rate of just 0.05%.

Figure 173: Value of agriculture in GDP at 2010 constant prices (VNDbn) and YoY growth (%)



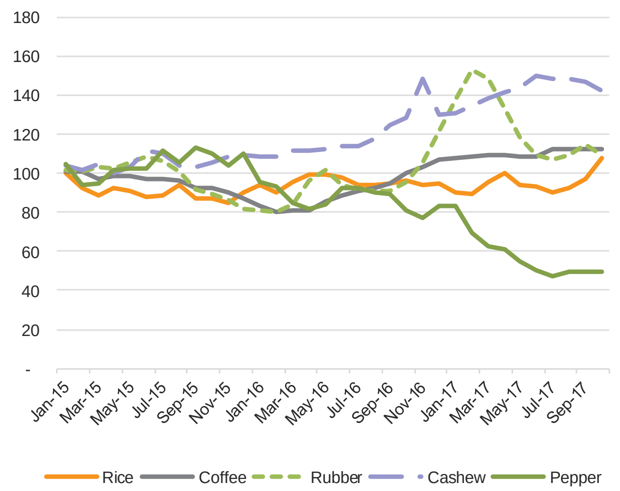
Source: GSO, VNDIRECT

Export value surged primarily due to the price recovery in major agricultural commodities

According to data from the Ministry of Agriculture and Rural Development (MARD), the total export value of major agricultural products during the first 10 months of 2017 reached US$15.8bn, an increase of 16.5% YoY from the same period last year. Rubber and vegetables/fruits reported the biggest rises of 42.8% and 42.7%, respectively. Rice also witnessed strong growth in both volumes (+23.5% YoY) and values (+23.2% YoY) thanks to a surge in demand from traditional export markets such as China (+33.9% YoY), Phillipines (+31.8% YoY), Malaysia (+76.8% YoY) and new orders from flood-striken Bangladesh.

Most of the other commodities likewise saw a recovery in both volumes and prices, except for coffee and cassava, which was driven by favorable weather conditions and high demand from export markets, especially China, the largest importer of agri-products from Vietnam.

Figure 174: Monthly Average Change in Export Prices of Key Agricultural Products (Jan 2015 = 100)



Source: MARD, VNDIRECT

Figure 175: Export Performance of Key Agricultural Products

	Volumes ('000 tonnes)			Value (US$ mn)		
	10M16	10M17	%Δ	10M16	10M17	%Δ
Coffee	1,518	1,182	-22%	2,757	2,707	-2%
Rubber	994	1,071	8%	1,260	1,799	43%
Rice	4,127	5,097	24%	1,856	2,287	23%
Tea	103	116	13%	169	186	10%
Cashew nuts	291	292	0%	2,332	2,892	24%
Pepper	159	192	21%	1,287	1,018	-21%
Vegetables and fruits	N/A	N/A	N/A	2,008	2,865	43%
Cassava	1,327	1,310	-1%	232	223	-4%

Source: MARD, VNDIRECT

Vietnam's agricultural export market base is relatively concentrated, with only a few countries accounting for a large proportion of the total export value. For example, China accounts for 63.1% of Vietnam's rubber exports, 39.8% of rice exports, 75.6% of its vegetable and fruit exports, and 87.7% of its cassava exports. The USA is also a key market for Vietnam's agricultural exports, as the USA accounts for 17.4% of its fishery exports, 36.4% of its cashew nut exports, and 19.3% of its pepper exports (Source: GSO report Nov 2017). This heavy dependence creates high exposure to demand fluctuations in these select export markets, leading to high volatility in total agricultural exports. For example, in 2016 the strong decrease in rice exports to China (17.5% YoY decline in terms of volumes and 8.6% decline in terms of value) largely contributed to the 26.4% decline in rice export volume and 21.8% decline in rice export value experienced during the year.

The recovery in the agriculture sector also positively impacts prices and demand of inputs such as fertilizers

The fertilizer sector also experienced a challenging year during 2015-2016 due to the downturn in the agriculture sector, with suppressed demand and consistently low prices not only in Vietnam, but also in other regional markets. However, farmers are currently more willing to invest in inputs like fertilizers due to improved weather conditions and better financial strength, which has led to increases in price and demand for fertilizer products.

Figure 176: 9M2017 volumes and revenues of major fertilizer producers in Vietnam

	Volumes ('000 tonnes)	YoY growth (%)	Revenue (VNDbn)	YoY growth (%)
DPM	644	0%	6,546	4%
DCM	656	19%	4,343	35%
LAS	786	6%	2,832	-1%
BFC	519	10%	4,855	6%
NFC	152	10%	450	6%
VAF	N/A	N/A	914	4%
Fertilizer import	3,526	18%	21,497	16%
Fertilizer export	730	38%	203	34%

Source: MARD, Company reports, VNDIRECT

Vietnam's agricultural sector is still plagued by inefficiencies

Restructuring is under way but progress remains slow

Even though the government has been implementing measures to reform the sector over the past decade, including land consolidation and farm mechanization, the progress of restructuring has been slow. Local agricultural production continues to be very fragmented with over 99% of production units in agriculture being small households, according to the 2016 Agricultural census data; this remains largely unchanged from 2006. The share of households using less than 0.2ha for agricultural production increased slightly from 34.7% to 36.1% during 2011-2016, while households cultivating on more than 5ha only accounted for 2.3% of total households using agricultural land in 2016.

Figure 177: Number of Agricultural Units by Type of Production Unit

	2006	% weight	2011	% weight	2016	% weight
Enterprise	608	0.01%	955	0.01%	1,740	0.02%
Cooperative	6,971	0.07%	6,072	0.06%	6,646	0.08%
Household	9,740,160	99.92%	9,591,696	99.93%	8,454,263	99.90%

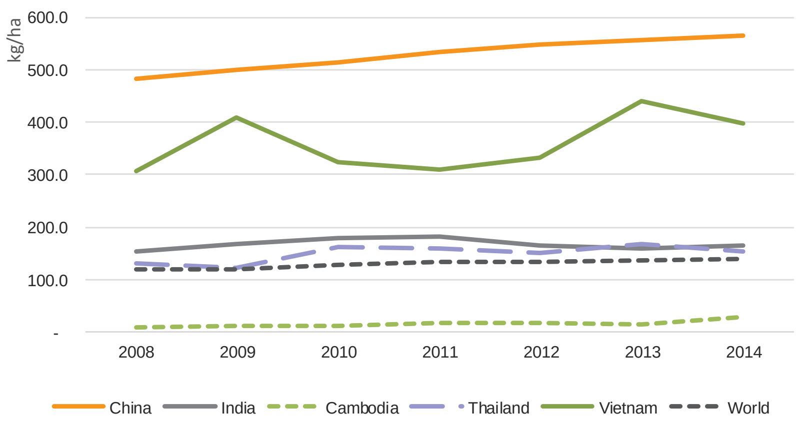
Source: GSO, VNDIRECT

The small scale of production also prevented the mechanization process from going smoothly, since a sole household does not have sufficient resources to invest in machinery and new technology to lower the production cost per hectare. Records showed a significantly lower mechanization rate in Vietnam than regional peers, measured by power availability per hectare, of 1.6 horsepower per hectare (HP/ha) compared to 4HP/ha of Thailand, 8HP/ha of China and 10HP/ha of Korea (Source: MARD 2015). GSO data also confirmed that the mechanization level remains low in 2016, as the agri-forestry-fishery sector utilized an average of only 0.3 seeders, 0.28 combined harvesters and 2.68 food processors per 100 households.

Intensive farming at the expense of the environment

Intensive farming refers to the heavy (and sometimes inefficient) use of agriculture inputs such as fertilizers, crop protection chemicals (CPC), natural resources (land and water), and labor to produce higher volumes and yields. Despite the previously mentioned challenges of the sector, Vietnam still has relatively high rice and coffee yields compared to its regional peers, which could be traced back to the expansion of intensive farming.

Figure 178: Vietnam's fertilizer consumption per hectare of arable land is much higher than its regional peers' and world average



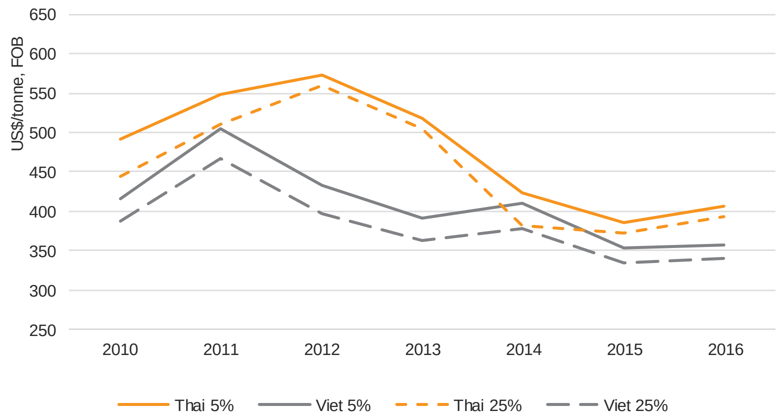
Source: World Bank, VNDIRECT

However, the negative externalities of intensive farming lie in increased environmental costs such as deforestation, soil degradation, water pollution and higher emission of greenhouse gases. For example, the expansion of aqua-product farming (shrimp and catfish) in the Mekong Delta contributed to water pollution and also degraded the biodiversity of the region, while the expansion of coffee and other tree crop plantings in the upland regions led to deforestation and affected groundwater resources. The government has only recently begun to become more attentive to the sustainability of agricultural sector growth. This trend will not, however, play out fast enough to harm aggregate fertilizer demand in the country and so does not post a real threat to fertilizer companies. However, in the long-term fertilizer players that develop more high-end, value-added products could actually benefit from this trend towards sustainable farming.

Vietnam’s agricultural products are still at the low-end of the value chain despite large export volumes

Exports from Vietnam are often cheaper than other market’s exports. For example, Vietnam’s 25% broken rice often sells at a 9-13% discount to similar products from Thailand, and Vietnam’s Robusta coffee tends to sell at a discount to the LIFFE Index. This is due to the country's focus on low-value products, with goods often traded as raw commodities. There is currently low emphasis on added value and building brand names.

Figure 179: Vietnam's Broken Rice Price Trades at a Discount to Thailand's



Source: FAO, VNDIRECT

Additional factors that contribute to the inferior value and, consequently, low pricing power of Vietnam's products include the following:

(1) The extensive use of chemicals and pesticides, as mentioned above

(2) The lack of a robust quality control system that has led to increasing concerns over product quality. This has created barriers to Vietnam's ability to export to high-end markets, due to its global image.

(3) The underdevelopment of the agricultural support ecosystem, including farming technology, transportation, and the storing and processing of goods.

2018: Gathering momentum for sustainable growth

Ample growth opportunities in the domestic and export realms

The demand for agricultural products in Vietnam is being driven by population growth as well as the continuous increase in disposable incomes. We believe the sector will continue to benefit from the increase in demand in coming years, as Vietnam's population is expected to rise at a CAGR of 1% per annum from 2015-2020, according to BMI. We also expect for there to be strong continued demand from China, the largest importer of Vietnam's agriculture products.

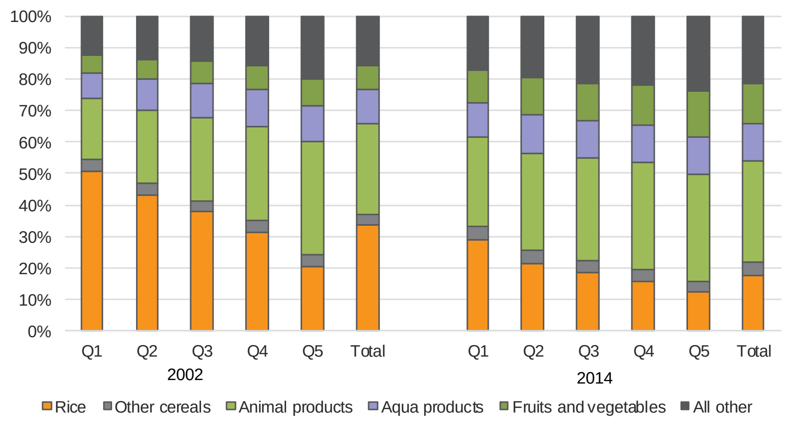
There is a shift underway in the domestic demand mix which will create new opportunities across the protein value chain

The Boston Consulting Group (BCG) forecasts that the middle and affluent class (MAC)[1] of Vietnam will rapidly expand from 12mn in 2014 to 33mn in 2020, and that this will account for almost a third of the population by the end of the period, while per capita incomes could also rise from US$1,400 to US$3,400. This will likely lead to a

[1] MAC is defined as consumers whose monthly income is from VND15mn (US$660) or more.

corresponding decline in the share of rice, and increased consumption of meat, vegetables/fruits and aqua products in the total consumption mix, which will open up new opportunities in the non-farming segment.

Figure 180: Share of household food expenditures by income quintile (%)



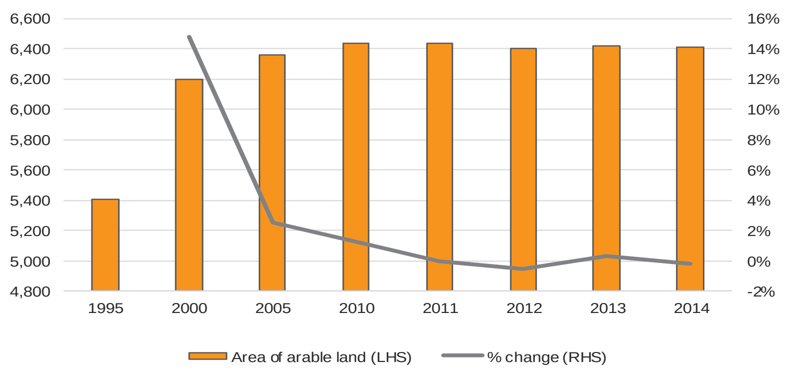
Source: GSO, VNDIRECT

Future farming growth has to be driven by yield improvements that do not compromise food safety; this is boosting demand for high-quality fertilizers and seeds

Data from Food and Agricultural Organization of the United Nations (FAO) shows that the total amount of arable land in Vietnam seems to have reached its limit in the past few years. Therefore, Vietnam needs to rely heavily on the growth of fertilizers and chemicals, in order to maintain strong enough growth in crop yields to satisfy the young and growing population.

Farmers are also paying more attention to the quality of inputs and its usage to meet the increasing demand for safe and eco-friendly products, both in domestic and export markets. This is driving greater demand for certified seeds and high quality fertilizers. Larger players in these emerging product categories will be in a stronger position to capture this growth trend.

Figure 181: Total area of arable land in Vietnam ('000 ha)



Source: FAO, VNDIRECT

Big companies are jumping on the agricultural bandwagon to capture this growth potential and to build integrated value chains

There has been a wave of M&A and investment activity in the agriculture sector with huge participation from large domestic conglomerates. Some prominent investments include the following:

(1) Vingroup (VIC VN) established its own agriculture arm VinEco, developed an integrated value chain from cultivatiom on farms all the way to processing and distribution of its products to end-customers through the Vinmart chain of grocery stores.

(2) PAN Group (PAN VN) entered the agriculture sector by acquiring majority stakes in a number of agro-focused companies (Agifish JSC – ABT VN, Long An Food Processing Export JSC – LAF VN, National Seed Corporation – NSC VN) and then extended its business lines to high-quality vegetables and flowers in 2016.

More recent investments in 2017 include the merger of 2 giants in the sugar sector, SBT and BHS, to collectively form the largest sugar manufacturer in Vietnam, which currently holds a 30% market share. Other recent plans include VNM's plan to acquire 65% of Khanh Hoa Sugar JSC and MSN's intention to increase its shareholding in Vinacafe Bien Hoa (VCF VN) from 68.5% to 100%.

The common underlying characteristic across these M&A/investment activities is the acquisition of small / uncompetitive players and assets by large companies, with the purpose of building vertically integrated value chains and achieving lower production costs due to economies of scale. The advantages of the acquirers include strong brands, financial strength, experienced management teams, and good access to the international markets, driven by relationships and access to capital. We expect this trend to continue which will help accelerate the restructuring process in the agriculture sector and improve sector-wide productivity. We also believe that favorable policy measures by the government will support this growth.

AGRICULTURE SECTOR STOCK PICKS: WE LIKE LTG

While the ongoing restructuring process presents many growth opportunities for private sector participants, progress will be slow. We believe that the main beneficiaries of this change will include companies with abundant financial resources that take the lead in consolidation of fragmented segments and achieving large-scale production. However, the initial investments are very high, and the restructuring processes will take time to materialize, so we do not see any short term benefits ahead. Challenges for companies making this transition are not only company-specific, but are also related to the transition of Vietnam's agriculture sector in general, as Vietnam needs time to build its brand internationally as an exporter of high quality agricultural products and farmers need more time to adopt best practices.

The agriculture sector might be an interesting growth story in the medium-to-long term, and some prominent names in the sector include PAN, LTG, and GTN. At the moment, we are most optimistic about LTG for the following reasons:

- Its leading position in the CPC market (core business line), with a 21% market share, which is 3x the market share of the number two player.
- The significant improvement in the company's efficiency, following the restructuring of its distribution network in the seed segment and the creation of a vertically-integrated value chain in the rice segment.
- Attractive valuation, as the company's 2017 and 2018 forward P/E is currently 7.8x and 6.7x, respectively.

LOC TROI GROUP (LTG)

Market Price	Target Price	Dividend Yield	Rating	Sector
VND43,500	VND66,200	6.9%	ADD	AGRICULTURE

Outlook – Short term
Negative Neutral Positive

Outlook – Long term
Negative Neutral Positive

Valuation
Negative Neutral Positive

Mai Pham Le
mai.phamle@vndirect.com.vn

Loc Troi Group is the dominant agribusiness in both the crop protection chemical (CPC) and seed segments in Vietnam with a vertically-integrated value chain. We believe the company's major competitive advantage of large production scale, wide distribution network and value chain will allow LTG to reap the benefits of the restructuring and recovery process in the agriculture sector. Besides, the large share price correction since its listing has rendered the valuation attractive in light of medium-term prospects.

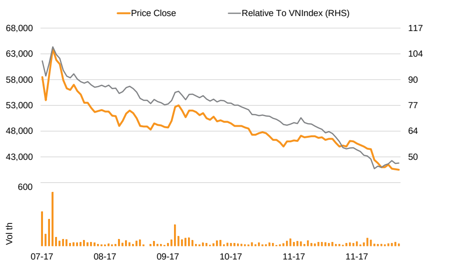
Dominant position in the CPC and seed segments thanks to a nationwide distribution network and strong facilities. LTG is the market leader in the CPC industry with 21% market share, far exceeding the 2nd largest player VFG with 8.3% market share. In the seed segment, it possesses strong production capacity with 7 seed factories and 3 R&D centers that develop and supply open-pollinated rice seeds and hybrid corn and vegetable seeds. These two segments share an extensive distribution network of 5,000 retailers across the nation.

Improving production efficiency and output quality via a unique and sustainable vertically-integrated value chain. The close business model from seed research to rice processing and distribution allows the company to leverage its strength in the CPC and seed segments. Meanwhile, comprehensive technical supports from the unique "Farmers' Friends Force" of 1,200 engineers enables a higher and more consistent product quality and controlled CPC residue, paving the way for LTG to expand its domestic and export markets.

Capturing potential upside in the agriculture sector. CPC industry sales are expected to increase at a CAGR of 4.4% from 2017-2020 due to growing demand for food and limited application of new technology and research achievements in production. In the seed segment, we project growth to be driven by the shift from the informal to the formal channel in rice seed segment, and in-house supplies gradually replacing the currently imported vegetable seeds. In the agrifood segment, we expect export markets to remain the primary growth driver, with China and Philippines being the key contributors.

Valuation: We use a target 2017 TTM P/E of 12.0x to value LTG, close to the peer average TTM P/E of 12.4x, and forecast FY17 EPS of VND5,523/share. Our target price for LTG is VND66,200/share.

Price performance



Source: VNDIRECT

Key statistics

52w high (VND)	64,000
52w low (VND)	40,600
3m Avg daily volume (shares)	38,400
3m Avg daily value (VNDmn)	1,705
Market cap (VNDbn)	2,922
Outstanding shares (m)	67.2
Free float (%)	10
TTM P/E	7.5x
P/B	1.4x

Ownership

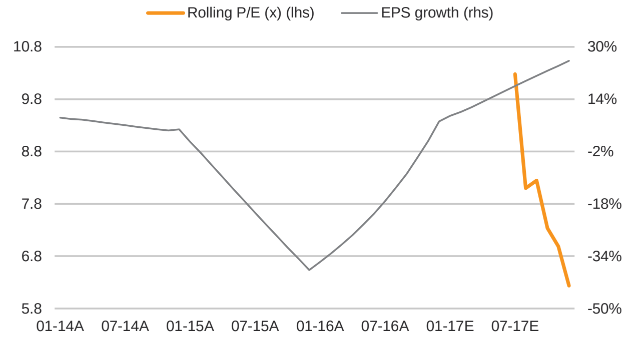
Standard Chartered Private Equity	33.4%
An Giang People's Committee	24.2%
Employees	18.2%
Others	24.2%

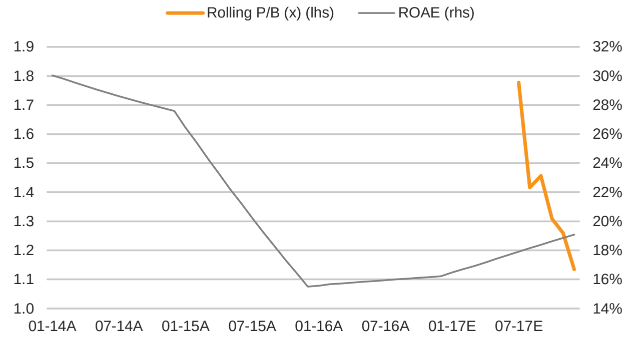
Source: VNDIRECT

Financial summary (VND)	12-15A	12-16A	12-17E	12-18E
Net revenue (bn)	7,856	7,783	8,198	8,781
Revenue growth	(11.3%)	(0.9%)	5.3%	7.1%
Gross margin	22.1%	20.8%	22.4%	23.0%
EBITDA margin	11.0%	10.9%	12.1%	12.8%
Net profit (bn)	319	347	436	517
Net profit growth	(36.7%)	8.8%	25.8%	18.4%
Recurring profit growth	(36.7%)	8.8%	25.8%	18.4%
Basic EPS	4,820	5,167	6,498	7,693
Adjusted EPS	4,097	4,392	5,523	6,539
BVPS	31,335	32,400	35,703	40,165
ROAE	15.5%	16.2%	19.1%	20.3%

Source:VNDIRECT

Valuation





Income statement

(VNDbn)	12-16A	12-17E	12-18E
Net revenue	7,783	8,198	8,781
Cost of sales	(6,167)	(6,363)	(6,765)
Gen & admin expenses	(427)	(350)	(375)
Selling expenses	(628)	(842)	(901)
Operating profit	**561**	**643**	**740**
Operating EBITDA	828	961	1,097
Depreciation and amortisation	**(267)**	**(317)**	**(358)**
Operating EBIT	**561**	**643**	**740**
Interest income	25	18	19
Financial expense	(150)	(130)	(127)
Net other income	27	29	31
Income from associates & JVs	0	0	0
Pre-tax profit	**464**	**560**	**663**
Taxation	(115)	(121)	(144)
Minority interests	(2)	(2)	(2)
Net profit	**347**	**436**	**517**
Adj. net profit to ordinary	347	436	517
Ordinary dividends	(91)	(201)	(201)
Retained earnings	**256**	**235**	**315**

Balance sheet

(VNDbn)	12-16A	12-17E	12-18E
Cash and equivalents	279	652	689
Short term investments	25	0	0
Accounts receivables	1,733	1,654	1,751
Inventories	2,170	2,292	2,481
Other current assets	63	85	90
Total current assets	**4,270**	**4,683**	**5,011**
Fixed assets	1,563	1,543	1,498
Total investments	0	0	33
Other long-term assets	326	352	377
Total assets	**6,159**	**6,577**	**6,919**
Short-term debt	1,905	1,697	1,430
Accounts payable	1,545	1,774	1,895
Other current liabilities	407	457	406
Total current liabilities	**3,857**	**3,928**	**3,732**
Total long-term debt	74	220	220
Other liabilities	52	32	269
Share capital	672	672	672
Retained earnings reserve	335	311	346
Shareholders' equity	**2,176**	**2,398**	**2,698**
Minority interests	0	0	0
Total liabilities & equity	**6,159**	**6,577**	**6,919**

Cash flow statement

(VNDbn)	12-16A	12-17E	12-18E
Pretax profit	**464**	**560**	**663**
Depreciation & amortisation	122	196	221
Tax paid	(9)	(121)	(144)
Other adjustments	31	150	167
Change in working capital	**452**	**123**	**(238)**
Cash flow from operations	**1,060**	**908**	**670**
Capex	(163)	(176)	(176)
Proceeds from assets sales	18	11	15
Others	(12)	(33)	(77)
Other non-current assets changes	(0)	0	0
Cash flow from investing activities	**(157)**	**(197)**	**(238)**
New share issuance	3	0	0
Shares buyback	0	0	0
Net borrowings	(727)	(136)	(193)
Other financing cash flow	0	0	0
Dividends paid	(91)	(201)	(201)
Cash flow from financing activities	**(815)**	**(337)**	**(394)**
Cash and equivalents at beginning of period	190	279	652
Total cash generated	**88**	**373**	**37**
Cash and equivalents at the end of period	279	652	689

Key ratios

	12-16A	12-17E	12-18E
Dupont			
Net profit margin	4.5%	5.3%	5.9%
Asset turnover	1.24	1.29	1.30
ROAA	5.5%	6.9%	7.7%
Avg assets/avg equity	2.94	2.78	2.65
ROAE	16.2%	19.1%	20.3%
Efficiency			
Days account receivable	79.6	70.7	70.7
Days inventory	129	131	134
Days creditor	92	102	102
Fixed asset turnover	4.99	5.28	5.78
ROIC	8.4%	10.1%	11.9%
Liquidity			
Current ratio	1.11	1.19	1.34
Quick ratio	0.54	0.61	0.68
Cash ratio	0.08	0.17	0.18
Cash cycle	117	100	102
Growth rate (yoy)			
Revenue growth	(0.9%)	5.3%	7.1%
Operating profit growth	(7.4%)	14.7%	15.0%
Net profit growth	8.8%	25.8%	18.4%
EPS growth	7.2%	25.8%	18.4%
Share value			
Basic EPS (VND)	5,167	6,498	7,693
BVPS (VND)	32,400	35,703	40,165

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RECOMMENDATION FRAMEWORK

Stock Ratings	Definition:
Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

The total expected return of a stock is defined as the sum of the:(i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

Anirban Lahiri – Head of Research
Email: anirban.lahiri@vndirect.com.vn

VNDIRECT Securities Corporation
1 Nguyen Thuong Hien Str – Hai Ba Trung Dist – Ha Noi
Tel: +84 2439724568
Email: research@vndirect.com.vn
Website: https://invest.vndirect.com.vn/