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What's in store for Vietnam in 2017?

Vietnam's economy and markets continued to grow in 2016, although not at the same pace as the year before. With GDP growth for the year coming in at 6.2% (vs. 6.7% in 2015), the country continued to be one of the world's outperformers and proved to be resilient despite a devastating drought in the first half of the year and global geopolitical upheaval. On the back of solid gains in 2016, we believe the pieces are in place for even stronger growth in 2017 – albeit with some new challenges on the horizon, such as higher interest rates. Following are VinaCapital's thoughts on some of the key developments in the past 12 months and what we are watching for in the year ahead.

New government accelerates listings, but private sector was more successful

The party congress in January saw the election of a new government, one which to date has been aggressive in pushing economic and market reforms. Perhaps most notably, the government jump started the privatization/equitization process. Until recently, there has been limited progress on this front, at least in terms of deals that might be interesting to foreign investors. With the listings of brewers Habeco and Sabeco, the first sale of the government's remaining stake in Vinamilk and new regulations requiring companies to list after public offerings, the focus on making things happen has been welcomed by investors, although more improvements are necessary, particularly in execution and process.

The impetus for the renewed momentum is clear: capital raising is part of a larger effort to manage a growing budget deficit. The government is on record as saying that some of the country's largest enterprises will privatize and list in 2017 – something long-time observers have heard before. But this government aggressively pushed things forward in 2016, and we have little reason to doubt its commitment to see things through in the year ahead. We are interested to see if the stakes sold in newly privatized state-owned enterprises are larger and at fairer valuations – two factors that have stymied the equitization process to date. Should these issues be addressed, we believe that more foreign investors will be eager to participate.

Real estate sector: continued growth

Vietnam's residential property market recorded a huge number of sales in 2015, and some observers believed that certain segments of the market were getting a bit frothy. The reality is, however, that home sales (and prices) remained stable over the course of 2016, and some observers have commented that 2016 was the best year in recent memory. Meanwhile, the commercial sector in Ho Chi Minh City continues to be strong, with little new supply coming on the market and increasing demand for premium office space. Likewise, industrial parks have seen solid demand as manufacturing continues to attract the vast majority of foreign direct investment.

With several property developers looking to raise capital in the year ahead – including Novaland, which listed in late December and is now the second-largest developer by market cap – and home sales still strong, we expect that the property market will continue to grow in 2017, but perhaps in different directions. Less flashy than the upper-end of the industry – but arguably more important – affordable housing developments will take on new prominence in the year ahead. With one of the highest rates of urbanization in the region, Vietnam's urban population is expected to reach 50% by 2040 (currently 30%), and the World Bank estimates that Vietnam's cities need to build 374,000 additional units each year “to cope with demand.”ⁱ The country's largest developer, Vingroup,

recently announced an expansive nationwide affordable housing project that expects to construct up to 300,000 units starting at approximately USD31,000 eachⁱⁱ; we expect other developers to follow suit.

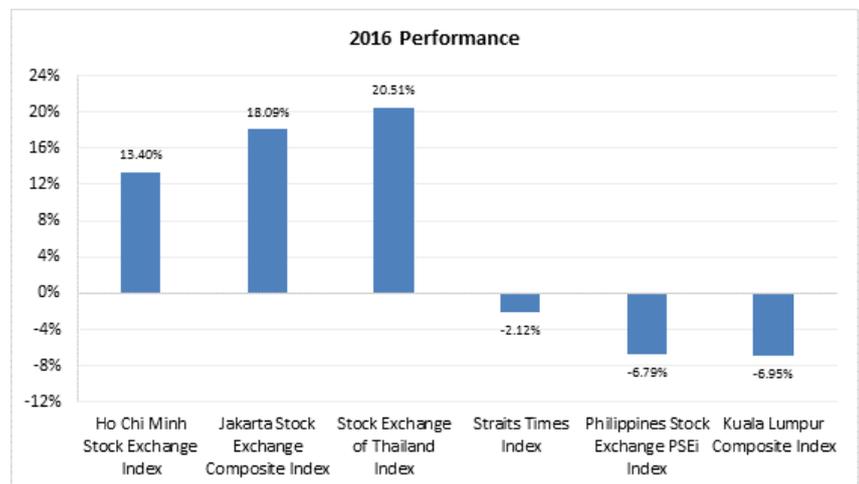
Free trade: what's next?

In less than a year, the Trans-Pacific Partnership went from being heralded as the most important free trade agreement (FTA) in recent history to, at the time of this writing, being on life support with little hope of recovery. Vietnam was widely regarded as the greatest beneficiary of the 12 nations involved in the pact, and some believe that TPP was the impetus behind a fair amount of the foreign direct investment flowing into the country over the past few years.

To be sure, the expected demise of TPP is disappointing, and there will certainly be some ramifications. But all is far from lost. Vietnam is party to sixteen FTAs (and in the process of negotiating several more), including those with Korea, the EU, Russia and Asean Economic Community. The government has already indicated that many of the reforms being implemented to comply with TPP would continue regardless. Vietnam is eager to further integrate into the global economy, and is well positioned to negotiate bilateral agreements with other nations.

Market rerating: not yet

Vietnam's stock markets are on track to once again outperform many of its regional peers in 2016, up over 13%. This past year saw the market break through several "psychological ceilings" and liquidity improved. Foreigners significantly increased their participation in the market, although profit taking in the last weeks of the year resulted in net selling of USD266mn.



Source: Bloomberg

In the year ahead, we expect the number of state-owned and private companies listing on the stock exchanges to rise significantly. Recent state-owned listees Habeco, Sabeco, and ACV have seen a tremendous amount of interest, while the IPO of private VietJet Air was rumored to be oversubscribed. We believe this interest should continue into the new year as new companies list.

The country's desire to graduate to MSCI emerging market status is well-known. Although we do not believe that will happen for at least another 18-months, a key milestone toward achieving that goal will be continued liquidity growth, and the increased number of listings of interesting companies will play an important role in helping to achieve that goal.

Trump: the big unknown

The world will be watching how incoming US President Trump's trade and foreign policies take shape; the way he will govern is somewhat of a mystery. As such, the impact of those policies on Vietnam (and the rest of the world) remains to be seen. Of course, the near-certain demise of TPP is not positive for Vietnam, nor are any new protectionist policies that could be implemented by the new administration. From a positive viewpoint, Vietnam's prime minister recently had a call with the incoming US president, who reportedly stressed a desire to build a stronger relationship between the two nations. Of greater concern is what happens between the US and China, and it appears that the relationship could turn much more tense, due to range of issues such as trade, currency and

territorial issues – each of which could have ramifications for Vietnam. But we tend to agree with the view of Goldman Sachs’s strategists that the risk of an all-out trade war “is overrated.”

Infrastructure: who’s going to pay?

From urban subway lines and elevated flyovers, to a new international airport, seaports and more, Vietnam’s infrastructure wish list is long; Ho Chi Minh City alone has USD7.6b in projects planned from now to 2020ⁱⁱⁱ. Unfortunately, the treasury is a bit bare. As these projects are integral to the country’s continued growth, we expect to see greater government focus on promoting investment in this sector, and laws will be amended to make this sector more attractive to private investors both foreign and domestic.

Banking reform: possible takeover by foreigners?

While there has been some progress on strengthening state-owned banks, the pace of reforms has been slow going, and the consensus is that much more needs to be done in terms of consolidating banks, cleaning up non-performing loans and otherwise strengthening the system as a whole. The Prime Minister recently announced that laws will be changed to allow higher foreign ownership stakes in banks (currently capped at 30%), and we believe that one or two large foreign banks will increase existing stakes or take new ones in Vietnamese banks. We also believe that laws will be changed to allow the Vietnam Asset Management Corporation (the entity created to purchase bad debt from banks) to better fulfil its mandate – it has been hamstrung in terms of how it can sell the distressed assets it has bought.

Metrics

Provided there is no repeat of the drought of 2016 or other disasters – natural or man-made – our chief economist believes that 2017 GDP growth will come in at 6.5%. Inflation at year-end 2017 will be 5.5%. Credit growth will be 16-18%, while the Vietnamese dong will stand at VND23,200 to USD1.

Final thoughts

For VinaCapital, 2016 was a year of solid performance across each of our funds. VOF, our multi-asset fund listed on the Main Market of the London Stock Exchange, significantly outperformed the VN Index and was the top performing Vietnam-focused fund, while VVF, our open-ended UCITS-compliant fund, also did well. Meanwhile, we divested several assets of VinaLand and made a distribution to shareholders. We have seen a tremendous amount of foreign interest in Vietnam, and are working on creating new products that provide access to some of the lesser known, more interesting opportunities in the market today.

The events of the past year have made us even more confident in our strategy of focusing on Vietnam’s domestic consumption story. We continue to like companies in the consumer discretionary (particularly food & beverage), construction and materials, and healthcare sectors. While we expect to see new listings from both private and state-owned companies, we believe that the economy’s growth will yield tremendous opportunities in private equity as well.

We enter 2017 with our usual level of guarded optimism. The economy continues to head in the right direction, but the challenges that could arise, whether external (natural disasters, geopolitics) or internal (inflation, currency), are likely to continue to test Vietnam’s mettle.

ⁱ “Affordable housing key to Vietnam’s goals of increased productivity and inclusive urban growth, WB reports”, World Bank, December 14, 2016

ⁱⁱ “Vietnam’s property giant Vingroup decides to tap affordable apartment market”, *Tuoi Tre*, December 5, 2016

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