

December 22, 2017

## Building on the momentum: Looking ahead at 2018

By most accounts, 2017 has been a very positive year for Vietnam's economic development. Although the year started off on a somewhat subdued note (Q1 GDP growth was just 5.2 percent, and uncertainty about the new US administration certainly cast a shadow over the region), activity picked up nicely over the course of the year as concerns subsided. Most analysts who had downgraded their Vietnam GDP growth forecasts based on the slow start have since upgraded them, and GDP is expected to grow 6.5-6.7% for the full year. The manufacturing and service sectors grew 12.8 percent and 7.3 percent respectively during the first nine months of the year<sup>1</sup>. Meanwhile, real retail sales increased 9.5 percent in the first 11-months – little surprise given that Vietnamese are among the most confident consumers in the world according to Nielsen.

Beyond GDP, several other factors contributed to 2017's very positive results, including:

- *Record foreign direct investment (FDI)*: From January to November 30, 2017, registered FDI totaled USD33 billion, an increase of 53 percent over the same period in 2016. Meanwhile disbursed FDI hit USD16 billion, a 12 percent increase<sup>2</sup>. International investors are still clamoring to set up operations (or expand existing ones) in Vietnam. Manufacturing continued to be the top sector for investment, followed by real estate and energy. Companies from Japan, Korea, and Singapore were the top three investors.
- *Modest inflation*: The Consumer Price Index remained low in 2017, with inflation of 2.38 percent in the first 11-months of the year<sup>3</sup>, well below our prediction last year of 5.5 percent.
- *VND*: The Vietnamese dong actually appreciated in 2017, and as of December 18, 2017 stood at VND22,708 to USD1; last year we predicted a slight depreciation to VND23,200 to USD1. We note that the strong FDI and FII inflows have been a supporting factor for the VND, and the country's reserves are at an estimated record USD46 billion, with the recent inflow of USD4.8 billion from the sale of Sabeco likely to add to that.
- *Privatization*: After years of talk, Vietnam saw some real activity on the state-owned enterprise (SOE) privatization front, with the successful equitizations<sup>4</sup> of companies such as Viglacera and IDICO. However, there were also some disappointments where the companies failed to adequately engage with potential investors and/or could not justify valuations; overall, the government did not meet its privatization target for the year as 39 of a planned 44 had their plans approved<sup>5</sup> and only 9 actually executed on such plans<sup>6</sup>. That said, investor sentiment is positive on the back of the successful sale of state stakes in Vinamilk and Sabeco – the latter generating a record USD4.8 billion for the government – and those two transactions effectively re-rated the stock market. Other factors include changes in the laws to allow book building during SOE IPOs, enabling investors to offer a fixed price (previously the Dutch auction was the only approved method), as well as penalties against companies that fail to follow through on equitization plans.

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<sup>1</sup> World Bank

<sup>2</sup> Reuters, "Vietnam's Jan-Nov FDI rises 11.9 pct y/y", November 27, 2017

<sup>3</sup> General Statistics Office

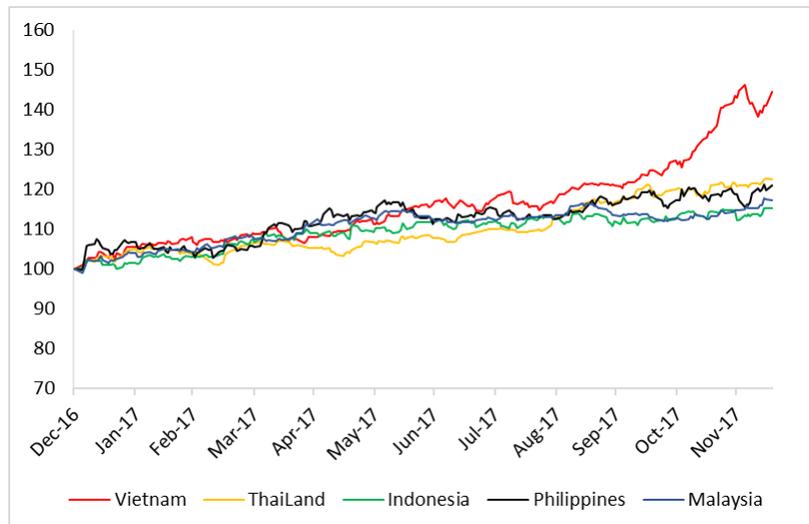
<sup>4</sup> In Vietnam, the privatization of SOEs is usually referred to as "equitization," and the terms are generally used interchangeably.

<sup>5</sup> "SOE reform contributes to bright outlook for economy," VietCapital Securities, November 30, 2017

<sup>6</sup> Ministry of Finance

- Strong stock market:** The VN Index was not just one of the strongest stock indices in the region, but the entire world. As of December 18, 2017, the Index had risen 44 percent since the start of the year. Foreign indirect investment also increased dramatically, reaching USD10.1 billion (including USD4.8 billion from the Sabeco sale) compared to USD3.4 billion<sup>7</sup> in 2016, nearly three times higher. Average daily trading value on the Ho Chi Minh Stock Exchange is around USD150 million, a 69 percent increase over 2016<sup>8</sup>. The market's growth can be attributed to several factors, including new listings, the acceleration of the privatization process, and a new law requiring companies

**Vietnam's stock market outperforms peers**



To December 18, 2017. Source: Bloomberg

to list on the stock exchange after an IPO. The total market capitalization of Vietnam's stock exchanges is over USD145 billion, or approximately 65 percent of total GDP; at the end of 2016, that figure stood at approximately 50 percent. On the private sector front, several companies went public this year, most notably VP Bank and Vincom Retail, with valuations of USD2.6 billion (a price-to-book value of 2.2x) and USD3.4 billion (trailing P/E of 42x), respectively.

- Tourism:** Vietnam welcomed a record 11.6 million international visitors in the first 11-months of 2017, a 28 percent increase for the same period last year<sup>9</sup>. Whether due to easier visa regulations for some nationalities or higher levels of marketing and promotion, Vietnam is on the itineraries of more tourists. This has certainly contributed to the success of a number of stocks this year, including VietJet Air (market cap: USD2.8 billion) and Airports Corporation of Vietnam (ACV; market cap: USD8.6 billion). At present, tourism directly contributes about 6.6 percent to GDP, and the government's target for it to reach 10 percent by 2020 appears to be within reach.

## What to watch in 2018

We expect 2017's strong momentum to carry into 2018, with GDP growth of around 6.7 percent, and continued stable inflation and foreign exchange. Following are some of the key issues we will be monitoring in the year ahead.

**Stock market:** We expect to see a steady flow of new listings, from both equitizing SOEs and private sector companies. We are unsure, however, that ~40 percent rise in the VN Index is sustainable, especially since much of that growth was caused by a handful of large cap stocks. The price-to-earnings ratio of the VN Index is no longer a bargain compared to regional peers, which hovers around 18-19x, although the growth opportunities in Vietnam are much higher. We note that global market valuations are up, and provided global confidence remains high, we would expect the Vietnamese stock market to be positively impacted.

<sup>7</sup> Ministry of Planning and Investment

<sup>8</sup> Bloomberg

<sup>9</sup> Vietnam National Administration for Tourism, December 4, 2017

*Privatization:* The government has set some ambitious goals for privatizing state-owned enterprises for the period 2017-2020: it expects to partially privatize 137 SOEs, a move that could raise USD13 billion or more for the state treasury. Major companies set to undergo equitization in the next two years include Vinataba, Saigon Trading, Ben Thanh Corp, Saigon Tourist, VNPT, and subsidiaries of PetroVietnam. The State Capital Investment Corporation (SCIC) is also authorized to sell down its stake in more than 100 companies, including blue-chips Bao Minh Group, Binh Minh Plastic, Military Bank, Domesco, and Vinamilk. We will be particularly interested to see progress on the planned 20 percent state divestment from ACV slated for 2018.

*Banking sector:* The banking sector was among the strongest on Vietnam's two bourses in 2017. Non-performing loans have dropped to 2.55<sup>10</sup> percent of the banking system's total outstanding credit, a sharp decline from 17.2% in 2012<sup>11</sup>. Recent changes in the law should enable the Vietnam Asset Management Company (the entity created to soak up bad debt in the system) to sell the assets it has acquired more effectively. While there are some good state-owned and private banks (we have invested in a few), more consolidation is necessary, and further strengthening is required to meet Basel II targets. Furthermore, the increased participation in the sector by foreign banks has not yet materialized, even though the government has indicated that it would look at expanding foreign ownership limits on a case-by-case basis. In short, the year ahead should bring more capital raising to fund anticipated strong credit growth.

*Infrastructure:* While the energy sector won a significant portion of FDI in 2017, countless other projects require investment. Traffic congestion in Hanoi and HCMC is getting worse, and progress on metro lines in both cities is proceeding at a snail's pace. To sustain growing tourism, airports in Hanoi and particularly HCMC need to be expanded; one year on and there has been no significant progress on the long-planned (and expensive) Long Thanh International Airport outside of HCMC. Vietnam's continuing appeal as a destination for FDI depends in part on modern infrastructure.

## **Final thoughts**

The year was also good for VinaCapital. From January to the end of November, VOF's net asset value per share has risen 24.3 percent in USD terms, with the capital market portfolio rising in line with the VN Index. VOF's total NAV stood at over USD1 billion. Over the past year, VOF's share price has risen 37.6 percent in USD terms. VVF, our UCITS-compliant fund, has grown to USD84 million, and has returned 32.4 percent year-to-date. In late April, we launched the Vietnam Equity Special Access Fund (VESAF), which enables foreigners to invest in small- and mid-cap companies unencumbered by foreign ownership limits. VinaLand sold several assets, enabling it to make three distributions to shareholders in 2017; its share price is up approximately 30 percent over the past 12 months. We are also excited about several opportunities in the venture capital space – stay tuned for details in the early part of 2018.

In terms of our investment philosophy, little changes. We continue to focus on companies participating in and benefitting from Vietnam's continued strong domestic consumption story. Privatizations are always something we will look at, however many of the companies undergoing this process are of little interest and valuations need to make sense. Meanwhile, on the private equity front, we are in advanced stages of negotiations on a few deals, which, should we successfully close them, will be announced in the first half of the new year (one side effect of the buoyant economy is private equity deals are taking longer to negotiate as expectations are higher).

We are typically guarded in our optimism toward the prospects for Vietnam's economy, a perspective formed from our decades of working and investing in this market. That said, we are greatly encouraged by what we have seen happening over the past few years. Vietnam's "Goldilocks Economy" – neither too hot nor too cold, but just right – should continue into 2018.

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<sup>10</sup> Including debt at the VAMC, the non-performing loan rate stands at 8.6 percent.

<sup>11</sup> *Reuters*, "Vietnam approves bill letting banks be declared bankrupt," November 20, 2017

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