

# Jumpy market, strong economy

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graduated in 1985 from Exeter University with a combined honours degree in Law and Sociology. Of his 20 years in investment, 18 have been spent in Asia, principally Hong Kong and Vietnam. He has worked for M&G Investment Management, Sun Hung Kai and Co, and Citicorp Investment Bank. In 1991 he moved to Vietnam and enrolled at Hanoi University, before, in 1994, co-founding Dragon Capital. A Vietnamese speaker, he sits on the boards of a number of Vietnamese companies, including two joint stock banks and four listed companies.

**W**hile the 2006 market broke records for performance, 2007 broke records for volatility, both in terms of values and sentiment. The VNI began 2006 under 400 points, while in 2007 the market oscillated in a 400-point band. Combined listed and OTC market capital more than doubled from US\$20 billion (bn) to US\$50 bn. The 2006 trading volume on the HCMC exchange peaked at US\$40 million (mn), while in 2007 trading on the HCMC and new Hanoi exchanges averaged US\$70 mn, and peaked at US\$180 mn.

Foreign demand for Vietnam equities was in a frenzy, with offshore funds raising nearly US\$4bn and promissory note schemes proliferating. Major investment bank executives piled into the country to glad-hand CEOs, but while companies may have been producing aggregate NPAT growth of 70 per cent, they were still micro-cap entities unable to absorb masses of foreign capital. As stocks highlighted the charms of the financial sector at large, money flowed into new banks, new brokerages and new investment firms. Property was not far behind, and there was a major wave of property listings as the country was gripped with real estate fever. Capital seemed cheap and easy, dilution was ramped up and companies got expensive – 35x at the Index peak of 1180 in March. Foreign demand slumped, though net buying continued, albeit at a much-reduced pace.

And with the frenzy were greatly over-valued IPOs, leading to subscriptions on these long-awaited issues – Vietcombank, Bao Viet Insurance, Phu My Fertilizer and SABECO – at 1x or less. In June, looking to head off undue speculation, the central bank ordered commercial

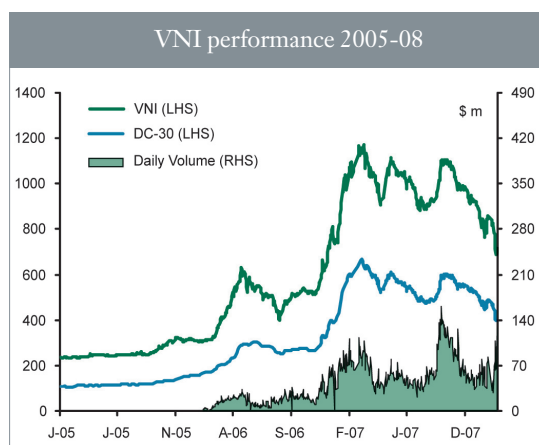
banks to cap lending for securities investment at 3 per cent of total loans. Since many banks were already at 7-10 per cent, that was a severe measure taking an estimated US\$1 bn out of the market. Meanwhile the Central Bank's growing concerns with inflation led to tough monetary tightening, VND illiquidity and rising deposit rates.

These factors have carried over into 2008 and were further aggravated by the Tet holiday. The market has taken quite a hit in recent weeks and was last seen at 715 on the Index. But we expect monetary conditions to start easing soon along with inflation, and stocks are priced at good levels for a rebound.

## MARKET OUTLOOK

The Government took many positive steps in 2007, and this was first year when the Securities Law came into effect, which boosted investor confidence. Market capitalisation of the two listed exchanges reached 35 per cent of GDP and the OTC brought this to ca US\$45 bn. Companies on the OTC market are now required to disclose information as if they were listed on the main boards, and plans are underway to centralise OTC trading in 2008. And the HCMC market has been upgraded to a full-fledged stock exchange, via the establishment of continuous trading versus periodic order-matching.

The lessons of 2007 are already turning into applications. The government is rationalising the equitisation process, with IPOs suspended until property is accurately reflected in valuations. Likewise, share dilution is losing favour as shareholder activism gains momentum. If at the start of 2007 there were



Market Valuations				
25 Feb 08 VNI: 715	2006	2007	2008	2009
PIE (x)	24.5	20.4	18.4	15.7
EPS growth (%)	–	20.3	10.9	17.3
PEG (x)	neg	1.0	1.7	0.9
NPAT growth (%)	–	71.9	28.6	21.1
P/BV (x)	5.7	4.4	3.6	3.1
Yield (%)	1.4	1.4	2.0	2.2
PISales (x)	2.9	3.1	2.9	2.3
Listed companies	195	253	400+	500+

expectations on performance, for 2008 there are expectations on market development. The listed market could easily triple in size, considering the mega IPOs in the pipeline and the 850 companies traded on the OTC market. But given the macro-economic fundamentals, it is hard to believe the market will stay down for long. With lowered valuations, and all the tinder developing as Vietnamese enjoy unprecedented growth in personal wealth, one spark can set the market back on fire.

### SOLID FUNDAMENTALS

And stoking the capital market is an economy undergoing radical modernisation. GDP growth hit 8.5 per cent, while FDI pledges doubled to US\$20 bn and disbursement reached US\$6 bn. That drew in a lot of capital-good imports and helped inflate the trade deficit to US\$12.4 bn, but in the worthy cause of gearing up the export machine and the deficit is entirely supported by stable investment. It is only in years of low FDI that trade surpluses have been seen. Likewise, foreign portfolio inflows, which for 2005 and 2006 totalled US\$2.2 bn, jumped to US\$5.6 bn. The global commodities price hike hit Vietnam's prices, with CPI at 12.6 per cent for the year, primarily led by food and external prices. And for the first time since 1995, the VND appreciated (by 0.3 per cent) against the USD. Indicators that for years followed a constant pattern, convulsed as the economy reacted to new regulation, new capital and new opportunity.

And why was 2007 such a dynamic year? Up to now, the name of the game was legislative reform culminating in WTO accession, which happened in 2006. This levelled the walls between state, foreign, and private business pushing the transition process into a new phase of greater market efficiency. After years of slow progress, IPOs of state firms are now in full swing. And while there are clear kinks in this process, managers at SOEs are preparing to raise capital and run profit-driven businesses. For FDI players, the drive

onshore is from 'China +1' and the possibility of tapping a labour force that is young, hard-working, and cheap. But while these factors grabbed headlines, perhaps the key accomplishment was in the private sector, as 2007 was the first year that the private businesses surpassed the State in share of industrial production.

Touching on both the domestic and global markets, reforms have stirred up new types of policy challenges. While in the past the goal was simply to attract foreign capital, the burden has shifted to managing its effects. Development of financial institutions is in full swing, with 2008 bringing the Central Bank Law and the Banking law. And while the economic indicators might be more volatile as the market matures, this is certainly a much better condition than stagnating under central planning. The fundamentals that support a continued high rate of economic growth remain sound.

### ECONOMY OUTLOOK

The top priority for the Government in 2008 is to contain inflation and we expect here a mix of monetary and administrative measures. However, with inflation being for the most part externally imposed through food and commodity prices, we see little impact from conventional monetary policy. Credit growth will be cooled to an expected target of ca 25 per cent, high by regional standards but a big decline from 37 per cent in 2007. With most businesses investing via cashflow, we expect GDP growth to be resilient and remain above 8 per cent. Export growth should be healthy too. At least 50 per cent of exports are composed of agricultural and energy goods, which have all seen massive price gains, per Vietnam's own inflationary trend. The other 50 per cent of exports are lower-end manufactured goods, such as footwear, textiles and garments, that hold up better during recessions than the upmarket consumer items made in places like Korea or Taiwan. As we continue to kick the tyres and look for weaknesses, we find ourselves reaching the same conclusion: Vietnam is clearly in position as the next Asian Tiger. **F**

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