Vietnam Equity Special Access Fund (VESAF)

30 September 2017

NAV/share: VND11,364 (USD0.500)

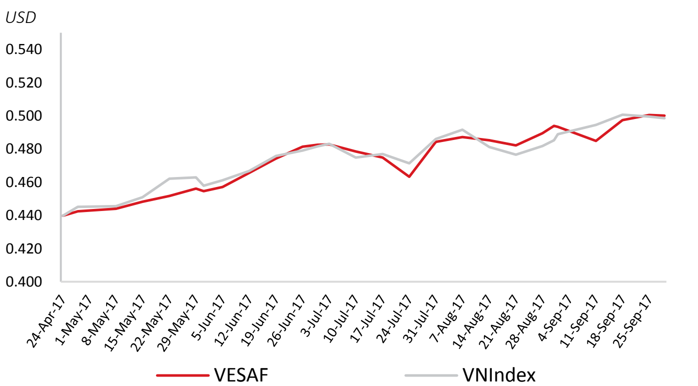
VESAF is a fund that invests in all equity opportunities unencumbered by foreign restriction or size. The strategy of the fund is to take meaningful stakes in companies with a robust franchise that we believe can benefit from the domestic growth of the country.

PERFORMANCE SUMMARY

	Fund	VN Index
September 2017	1.3%	2.7%
Year-to-date	13.8%	13.4%
Cumulative since inception	13.8%	13.4%

** Performance figures are in USD*

PERFORMANCE CHART



TOP 5 HOLDINGS	SECTOR	NAV (%)	PE 2017 (x)	ROE (%)
FPT	Technology	13.6%	11.3	18.2
MBB	Financials	7.2%	10.6	12.6
MWG	Consumer Discretionary	7.2%	16.3	37.1
PNJ	Consumer Discretionary	6.1%	17.0	34.1
ACB	Financials	6.1%	15.9	12.0
Total		40.1%		

EQUITY ALLOCATION

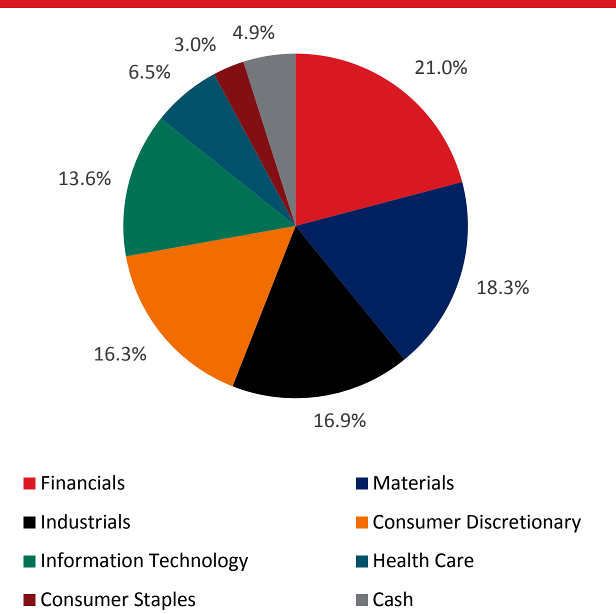
Small- & mid- cap	59%
Stocks traded on UpCom	14%
Stocks at full Foreign Ownership Limit	59%

- Small- cap: stocks with market capitalization below US$250 million
- Mid- cap: stocks with market capitalization from US$250 million to US$1 billion
- UpCom: Unlisted Public Company Market

FUND INFORMATION

Structure	Open-ended fund
Launch date	25 April 2017
Fund size	VND88bn (USD3.9m)
Domicile	Vietnam
Valuation policy	NAV
NAV frequency	Weekly
Fund Manager	VinaCapital Fund Management JSC
Auditor	Ernst & Young (Vietnam) Ltd
Administrator & Custodian bank	Standard Chartered Bank (Vietnam) Ltd
Management fee	1.75%
Subscription/ Redemption frequency	Weekly on every Tuesday (T), requests must be submitted by 10:30 am on T-1
Subscription charges	Subscription amount below VND2bn: 2% Subscription amount of VND2bn or above: 0%
Redemption charges	3% for the 1st year; 1% for the 2nd year; 0% thereafter
Currency	VND

SECTORS ALLOCATION



See reverse side for important information

MANAGER'S QUARTERLY COMMENTARY

VESAF recorded a solid third quarter, increasing 3.6% (USD terms), in line with the VN Index. While VESAF is not benchmarked against the Index, the fund's return is quite encouraging as the market was mostly driven by speculative and large-cap stocks while small- and mid-cap stocks generally underperformed during the reported period. Since inception on April 25 this year, the fund increased 13.8% (USD terms). At the end of the quarter, the fund was 94% invested, reserving capital for an upcoming OTC transaction in a retailing company which will be listed in the first quarter of 2018.

As mentioned in a previous update, VESAF's great advantage over foreign funds is that it can access industry-leading stocks without having to pay the foreign premium. Since VESAF's inception, the full-room stocks in our portfolio have performed extremely well (a return of 25% on average) and contributed 75% to our fund's performance. We believe that our strategy of holding full-room stocks will continue to be rewarded in the future.

Banking sector spotlight

One of our investment focuses for 2017 is the banking sector, which has seen several positive catalysts of late. The banking sector yields higher profitability on the back of high credit growth and net interest margin (NIM) increases. Credit growth is expected to remain strong at 18-20% in 2017-18, particularly with a push from the government to support high economic growth amidst low inflation. The delay of Basel II implementation to 2020 and the delay of prudential ratio (short-term funding used for long-term lending) to 40% in 2019 technically reduces the recapitalization and mobilization pressure for banks, allowing them to achieve high NIM. Retail and consumer lending are the new growth-drivers, sending NIM higher, and indeed, the sector's NIM expanded to 2.8% during the first nine months of 2017 compared with 2.7% for the same period in 2016, according to the National Financial Supervisory Commission. We expect the trend to continue given the low penetration of the consumer lending segment in Vietnam, around just 11.7% of total loans at the end of 2016. This means there is still room for NIM expansion.

For the first half of 2017, listed banks' return on equity and return on assets also improved significantly over the same period last year. Strong earnings enabled several banks to accelerate provision-making for Vietnam Asset Management Company (VAMC) bonds and bad debt, while at the same time banks actively tapped reserves to write-off bad debt in an attempt to clean up their loan books. As a result, the capacity to deal with bad debt legacy issues of many banks has been markedly improved. We expect credit growth to remain strong at around 18% in 2018, with banking sector earnings boosted by improved NIMs as well as by provision reversals and bad debt sales.

Furthermore, a new regulation should speed up the bad-debt settlement process and allow banks to quickly sell collateral assets and book additional profit. On those positive catalysts, bank's profits should see a big jump in earnings in 2017 and 2018. In fact, for the first nine months of 2017, profit of banking sector increased 39% y-o-y with credit growth recorded at 11.5%. Banks such as Asia Commercial Bank (ACB), Military Bank (MBB) and Vietcombank (VCB) have been far more aggressive than their peers in dealing with NPLs, and are now in the enviable position of being able to recover collateral more quickly – sell and book profit – given that the book levels of those debts are now zero (or close to it).

As we are cautiously optimistic about the sector, we are keeping an eye on valuation and asset quality when picking stocks. As it turns out, ACB and MBB are our top picks for the sector, and VESAF took advantage of its unique ability to buy these quality banking stocks at full foreign room at no premium. Both stocks are in high foreign demand on the market and typically trade at 15-20% premiums amongst foreigners.

ACB is a private commercial bank founded in 1993 with the primary focus on retail lending given its highest exposure to individual loans (53% of loan book as at end 1H2017). ACB is now in the last phase of its five-year restructuring, with provisions for legacy assets peaking in 2016-17, expected to decline 50% in 2018, and tapering off in 2019. Without the legacy provision burden, profits should normalize and reflect the performance of a well-run bank with strong retail exposure and decent fundamentals (LDR of 79%, CAR of 12.7%, low interest receivable days). As such, we expect pre-tax profit to increase by 96% in 2017 and 84% in 2018. ACB is now trading at a forward P/B 2017 and P/B 2018 of 2.0x and 1.5x respectively.

MBB is the fifth largest bank in term of total assets, with a robust growth of retail loan book at CAGR of 39% over the last five years. On the back of a strong balance sheet, MBB maintains good profitability as it enjoys a higher NIM of 4.6% vs. the average of 3.2% of listed banks, thanks to its strong current account-saving account (CASA) base of 25% and more exposure to retail lending via its consumer lending company. MBB could achieve a high contribution of service fee due to its full range of services offered in affiliates in insurance, brokerage, real estate, and asset management. Low interest receivable days indicates decent asset quality. We expect MBB's pre-tax profit to increase by 41% in 2017 and 30% in 2018. MBB is now trading at 2017F P/B and 2018F P/B of 1.4x and 1.2x respectively.

Picking the retailing champions

Retailing is a fast-growing industry in Vietnam. According to data from the General Statistics Office (GSO), real retail sales grew 7.8% in 2016 and 9.2% in the first nine months of 2017, 1.4x higher than GDP growth.

There is vast growth potential for the modern trade channel. According to Kantar Worldpanel, the market share for the modern and general trade channels (wet markets, street shops) in Vietnam is 17% and 83%, respectively, while in neighboring countries such as Thailand and Malaysia, the modern trade channel accounts for nearly 50% of grocery sales. Foreign giants like Aeon (Japan) and Lotte (Korea) have established hypermarkets in Vietnam's main cities, while Thai investors have entered the market through mergers and acquisitions: Central Group acquired Big C supermarkets from Casino Group (France), while TCC Holding Co., Ltd. acquired Metro Cash & Carry in 2016. Earlier in 2015, Central Group acquired a 49% stake of Nguyen Kim, then the largest electronics retailer in Vietnam. In June 2017, 7-Eleven opened their first store in Ho Chi Minh City, and aims to open 100 stores throughout the country over the next three years. In Vietnam, there are only 15 convenience stores per one million people, compared to approximately 100 such stores per million in Thailand, Malaysia, and Indonesia.

The local retailing sector is rather fragmented, except for mobile devices where Mobile World Investment Corp. (MWG) holds number one position. The sector is also under-represented on the stock market with 2.6% index weight with less than 10 companies, dominated by the two leaders in their respective segments: MWG (electronics and mobile devices) and Phu Nhuan Jewelry JSC (PNJ) while other names are small-cap stocks, mostly in car dealership business.

Obviously, Vietnam's retailing industry is attractive to foreign investors. However, for listed companies, foreign ownership remains restricted at 49% in companies which own the retail networks. We like this sector and the fund, which is not constrained by the foreign ownership limit regulation, holds stakes in these two leading retailing companies MWG) and (PNJ), both of which have had no foreign room for as long as one can remember. We soon will add one more company in the retailing sector at a sizable position.

At present, MWG holds 44% and 22% market share of mobile phone and consumer electronics retail, respectively. From the first store in 2004, it has expanded its network to all 63 of Vietnam's provinces and currently operates 1,041 mobile phone stores and 475 consumer electronics stores. Revenue and net profit CAGR in the 2013-2016 period reached 68% and 83%, respectively. In 2016, the company leveraged its success in electronics to expand into the grocery retail business, a market estimated at USD60 billion. At present, MWG has opened 153 grocery stores, and has ambitions plans for expansion. Given MWG's reputation for being well-managed, innovative, and providing quality customer service, we expect revenue and net profit to reach USD3.1 billion and USD96 million, respectively, in 2017, a 58% and 39% y-o-y growth. MWG is now trading at 2017F and 2018F P/E of 16.3x and 13.6x.

PNJ is Vietnam's leading jewelry manufacturer and retailer, holding 5% market share of all jewelry and 26% market share in branded jewelry. In Vietnam, most jewelry is sold in small stores and is unbranded, creating significant upside potential for PNJ to gain further market share. Similar to MWG, PNJ is gaining market share by aggressively opening new stores, and in the first eight months of 2017, the company opened 27 new stores, bringing the total number of stores to 242. From 2013 to 2016, PNJ attained a CAGR of 18% in jewelry sales and 46% in core profit. We expect PNJ's revenue and core net profit to reach USD475 million and USD30 million in 2017, growth of 27% and 37% y-o-y, respectively. The stock currently trades at 2017F and 2018F P/E of 17x and 14x respectively.

Outlook

Looking ahead, third quarter earnings will be the main driver for stock performance in the fourth quarter, and we expect companies to announce strong earnings growth of approximately 15% y-o-y, which could be a positive catalyst for stocks. Better-than-expected macro figures, such as robust nine-month growth in manufacturing (+13%), construction (+8%), retail sales (+9%) and bank services (+8%), bode well for companies in the consumer and retailing, banking sectors and construction material. Our in-house research forecast for the market for this year remains in a narrow range of 800-810, with P/E of 16x.

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