

## IS A BUBBLE BUILDING IN THE VIETNAM STOCK MARKET?

With the Vietnam stock market edging ever higher, we are starting to hear growing concerns around a building bubble. We decided to look at the market's gravity-defying performance at a more granular level and conclude that the huge divergence in valuations between large caps and mid caps is unjustified.

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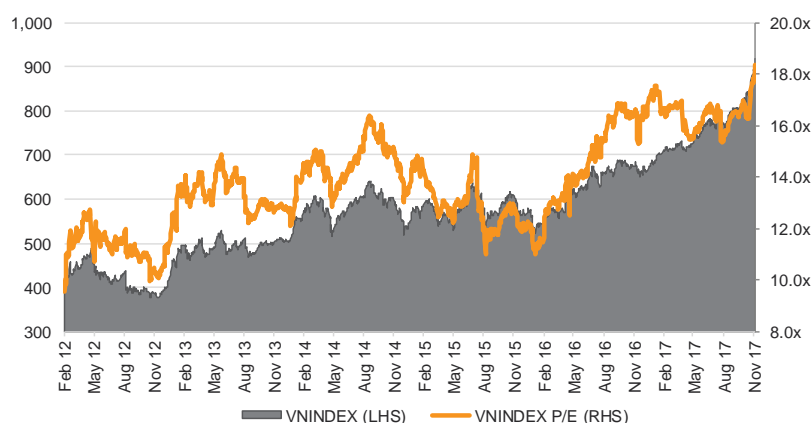
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The rise in the VN-Index in the past year has been only partially driven by earnings. The index has risen by 36.1% over the past 12 months but TTM earnings have only grown by 18.7%, YoY. This is reflected in the fact that the market's TTM P/E has expanded by 11.7% over the same period to touch 18.3x, currently.

Figure 1: VNINDEX performance 2012-2017



Source: VNDIRECT, FiinPro

**Investors are placing a fatter premium on growth.** An expansion in the P/E multiple is not necessarily a sign of building euphoria if earnings growth has accelerated. So we dug one level further to look at the PEG ratio based on the current trailing P/E and TTM earnings growth. In the last year, the PEG ratio for the VN-Index has expanded by 15% to touch 0.98x. So, the P/E multiple expansion is not entirely justified by any 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.

**Blame the large caps.** While it is tempting to draw conclusions at an aggregate market level, a more granular examination is rather revealing – the P/E expansion in the index has been entirely driven by large caps (VN 30). Small and mid-cap P/E ratios have flat-lined for the past two years while the large cap P/E has expanded by a significant 41% over the same period to touch 21.2x, quite lofty for what is still considered a frontier market. We looked at the TTM earnings growth of large, mid and small caps and found that large caps are indeed seeing faster earnings growth than 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 69% over the past 12 months to touch 1.40x (Figure 4). Put another way the large cap PE multiple has expanded over the past year despite a nearly 500 bps deceleration in large cap TTM earnings growth over the same period.

This implies that scarcity of large, liquid stocks relative to investor demand as outlined in our [IPO Investment Strategy Report](#) is also as important in explaining the huge large cap rally in the past year.

Large caps are now trading at P/E levels that are significantly higher than the recent historical average (Figure 3).

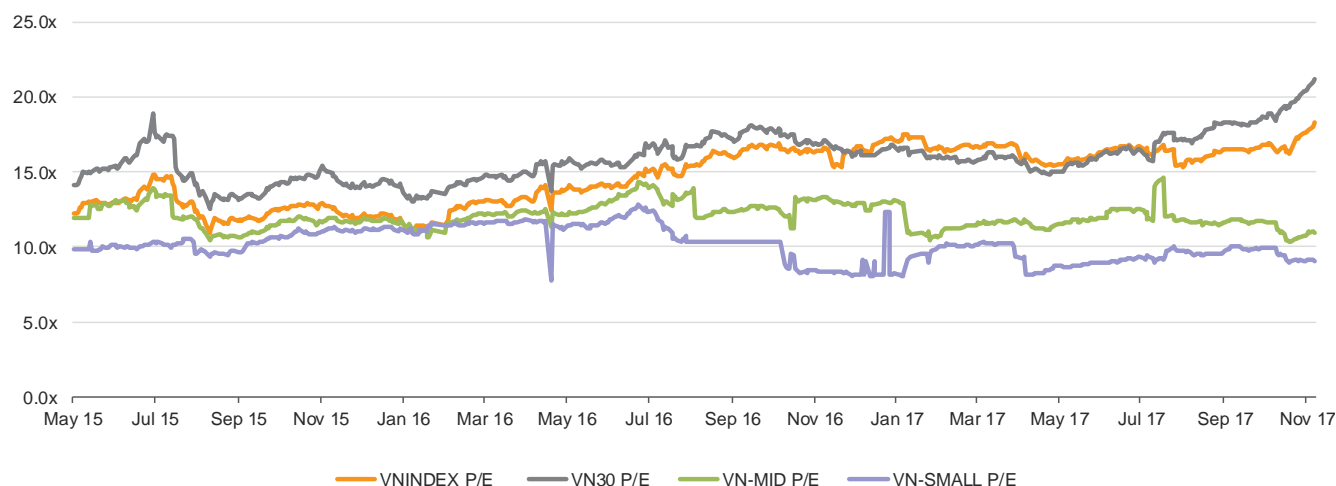
Figure 2: Key statistics of VNIndex by market cap

	P/E current Nov-17	P/E as of Nov-16	Marketcap US\$bn	Earning growth TTM
<b>VNINDEX</b>	<b>18.3x</b>	<b>16.4x</b>	<b>101.10</b>	<b>18.7%</b>
VN30	21.2x	16.9x	73.92	15.2%
VNINDEX Midcaps	10.9x	13.3x	10.01	14.8%
VNINDEX Smallcaps	9.1x	8.4x	3.12	7.9%
Other			14.06	
<b>Top 30 marketcap (*)</b>	<b>21.3x</b>		<b>85.98</b>	<b>20.5%</b>

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



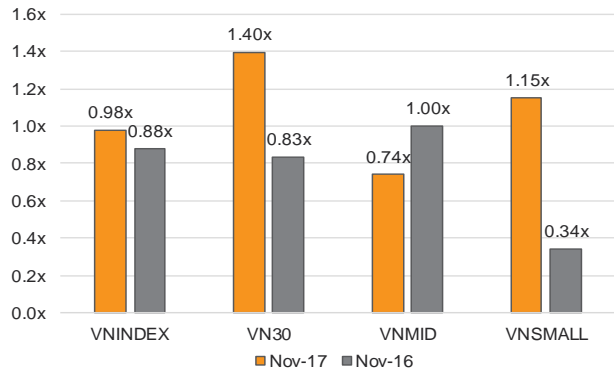
Source: VNDIRECT

**Mid-caps are the sweet spot; a major near-term large cap correction is possible but not likely.** We do recognize that the large cap premium in a frontier market like Vietnam could be higher than in more developed markets, even based on just fundamentals rather than unmet demand for this asset class. 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 government and the ability to attract the best talent from relative shallow talent pools. Of course, you could also conclude that the better-run companies grew faster and become large caps but we think that larger companies have better growth prospects; unlike large companies in developed economies that 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 that comes 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.

All that being said, the PEG ratio of large caps is an astounding 88% higher than that of mid caps and only 20% higher than that of small caps. This looks like a screaming imbalance to us. This could mean that large caps have to correct at some point but we think this is unlikely given the strong pipeline of large cap IPOs over the next year or so, largely driven by SOE equitizations such as PVPower, Becamex and PVOil as well as some large non-SOE listings such as

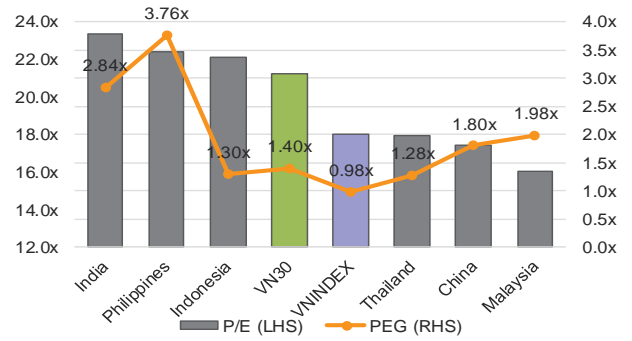
Techcombank and FPT Retail. Migration of large recently listed SOE names such as ACV and HVN from the UPCOM exchange to the HOSE bourse will also support large cap valuations. This leads us to conclude that the valuation gap between large and mid caps will be partially bridged by a rally in mid caps rather than a major crash in large cap valuations. The jury is out.

**Figure 4: PEG ratio changes of VNINDEX and its components over last 12 months**



Source: VNDIRECT, FiinPro

**Figure 5: P/E and PEG ratio of Vietnam and peers**



Source: VNDIRECT, Bloomberg, FiinPro

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