
VNDIRECT
WISDOM TO SUCCESS


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FOREWORD

Dear valued investors,

In retrospect, the Vietnam stock market has come a long way from 351 points at the beginning of 2012 to reach the eight-year peak of 688 in 2016. Total market capitalisation also doubled over the same period. After telling the same story about several large equities for many years, the market witnessed a record-high number of high-quality new listings in 2016. These listings helped VNINDEX maintain its upward trend at the end of 2016 although most traditional blue-chip stocks underperformed.

In 2017, we anticipate a change in quality of equities following the change in quantity, resulting in new developments for the market. As the government's goal is for the Vietnam stock market to attain emerging market status, we expect the next step to be improving transparency and information quality. The efforts to improve the market are necessary to attract more foreign direct investment.

In this **"Market Strategy Report 2017 – Hoist sails when the wind is fair",** we aim to deliver our view on Vietnam's economic prospects, as well as the likely challenges and opportunities in the stock market in 2017. We see the Vietnam's stock market as a galleon that is about to leave the harbour to embark on a voyage across the vast global ocean. We expect the Vietnam stock market to encounter favourable winds and challenging times but, ultimately, move forward.

PERFORMANCE OF OUR 2016 INVESTMENT RECOMMENDATIONS

Ticker	First recommendation	Adjusted price at recommendation	(*) Price to calculate performance	Performance	Closed recommendation	Recent recommendation	Target price	New recommendation
BUY recommendations (at Initial reports)								
VSC	Mar 14, 2016	62,055	56,000	-9.8%		Buy	70,900	
CVT	Apr 11, 2016	21,762	**44,600**	104.9%	21/10/2016	Closed		
PET	Apr 11, 2016	11,450	**11,100**	-3.1%	12/10/2016	Closed	16,100	
ACB	Apr 12, 2016	16,671	17,600	5.6%		Buy	19,951	Hold
VCB	Apr 12, 2016	30,567	35,450	16.0%		Hold	40,750	
DPM	Apr 12, 2016	25,237	22,350	-11.4%		Buy	34,523	Close
FPT	Apr 12, 2016	39,647	44,000	11.0%		Buy	58,000	
HPG	Apr 12, 2016	26,721	43,150	61.5%		Hold	39,478	Sell
PNJ	Apr 12, 2016	50,464	66,500	31.8%		Buy	87,130	
PGS	Jun 30, 2016	16,023	15,900	-0.8%		Buy	18,191	
CTG	Jul 12, 2016	17,700	15,050	-15.0%		Buy	20,000	
SDI	Jul 12, 2016	42,400	48,000	13.2%		Buy		Sell
VIT	Jul 12, 2016	24,200	**28,900**	19.4%	24/10/2016	Closed	30,000	
TRC	Jul 12, 2016	21,500	**29,800**	38.6%	16/11/2016	Closed	29,400	
DPR	Aug 24, 2016	33,595	37,000	10.1%		Hold	33,595	
VNS	Sep 05, 2016	32,083	33,200	3.5%		Buy	40,600	
BMI	Oct 06, 2016	28,000	24,100	-13.9%		Buy	37,000	
CHP	Oct 12, 2016	20,600	20,700	0.5%		Buy	28,000	
CTI	Oct 12, 2016	27,893	25,056	-10.2%		Buy	36,521	
FMC	Oct 12, 2016	21,582	19,200	-11.0%		Buy	24,849	Close
SJD	Oct 12, 2016	26,491	25,500	-3.7%		Buy	32,429	Close
VNR	Nov 21, 2016	20,800	21,200	1.9%		Buy	25,500	
TDH	Nov 22, 2016	10,300	10,200	-1.0%		Buy	16,400	
PPC	Nov 29, 2016	15,247	16,700	9.5%		Buy	17,725	
HOLD recommendations (at Initial reports)								
BCC	Mar 30, 2016	13,781				Hold		
GSP	Apr 11, 2016	13,332				Hold		Close
MBB	Apr 11, 2016	13,809			12/10/2016	Closed		
PVT	Jun 14, 2016	11,148				Hold		
KBC	Jul 12, 2016	16,700			12/10/2016	Closed		
GMD	Aug 04, 2016	25,000				Hold	28,000	
NT2	Aug 29, 2016	34,277				Hold		
PVD	Oct 05, 2016	23,818				Hold		
DHC	Nov 29, 2016	37,200				Hold		
Average				10.3%				
Time weighted average (%/year) (**)				20.9%				
VNINDEX 2016 (%/year)				14.8%				

(*) For closed recommendations, prices were taken on the date of closing
The others is closed prices at Dec 30, 2016
(**) Calculated by number of days throughout the recommendation period, converted to annual rate to compare with VNINDEX

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MAIN CONTENT

Chapter 1: Global economy

In 2016, the global economy continued on a recovery trend despite the many unforeseen political events. Many of the world's largest economies experienced higher growth in 2016 than in 2015, especially the US. The optimistic economic prospects encouraged central banks to steadily tighten monetary policy. The Fed finally approved the second interest rate hike in a decade in Dec 2016, the European Central Bank (ECB) and the Bank of Japan (BOJ) showed no signs of further loosening monetary policy. Heightened economic activities increased the demand for commodities, which led to strong price recovery throughout the year. Increase in demand from developed countries and the commodity price recovery paved the way for revival of economic growth in emerging and developing countries.

However, 2016 also witnessed several significant and unexpected political events (Brexit, Donald Trump winning the US presidential election). These events represent a new era of rising populism and unconventional politicians. They support protectionism in policy making, which may restrain global commercial trading and investment over the next few years.

In our view, the global economy will continue to recover in 2017. Many renowned research institutions predict that the global economy in 2017 will be much improved, with two main drivers: (i) optimistic US economic growth, and (ii) economic revival of oil-exporting countries (especially Brazil and Russia) after the oil price crash at the end of 2014. We also believe that 2017 will mark the start of pivotal policy changes, including: (1) the Fed continuing its predetermined route of tightening monetary policy through interest rate hikes, (2) the ECB and People's Bank of China (PBOC) gradually pulling back on aggressive monetary policies, (3) the increasing use of expansionary fiscal policy to support economic growth in many developed countries, (4) heightening of trade protectionism.

Chapter 2: Vietnam's economy

Vietnam's economy achieved 6.21% GDP growth in 2016, below the target set by the government at the beginning of the year. The main cause was the lower-than-expected growth in the agriculture and mining sectors. All other sectors of the economy showed signs of recovery. The services and manufacturing industries were the two main propellers of the economy in 2016.

Inflation was heightened in 2016 (4.47%) due to price adjustments in medical and education services. In 2017, we forecast that the consumer price index (CPI) will rise by 5.5-6.0%.

Commercial activities and FDI investments also registered positive results in 2016. At end-2016, Vietnam had a trade surplus (US$2.7bn), with the largest contribution from FDI. FDI investment in 2016 rose to the highest level in many years (US$15.8bn), with the focus on manufacturing and production.

The state budget continued to face many difficulties in 2016 due to unbalanced spending structures and escalating public debt burden. We estimate that public debt at the end of the year exceeded the 65% (of GDP) ceiling imposed by the government. However, the good news is that in 2016, the government successfully issued government bonds with lower yields and longer maturity. In addition, 2016 saw a high level of net buying by foreign investors. At the peak in 2016, total value of government bonds purchased by foreign investors amounted to VND22,000bn. At the end of the year, net buying by foreign investors remained high at VND11,000bn. Heightened activities in the bond market was attributed to the strong macroeconomic foundation, raising of foreign ownership limits and supportive monetary policy.

The government's expansionary monetary policy continued in 2016 (credit growth reached 18.71%, M2 increased by 18%). The sustained expansionary monetary policy helped to stabilise interest rates, facilitate business activities and issuance of government bonds. The forex market had a quiet year in 2016, despite the worries about the VND/US$ exchange rate at the beginning of the year. The factors that contributed to the favourable exchange rate were: (i) consolidated macroeconomic foundation, and (ii) new operational approach that reduced exchange rate speculation. Despite the many exchange rate pressures in 2017, we believe that the VND/US$ exchange rate will be fairly stable throughout the year.

Chapter 3: Stock market

2016 was a successful year for the Vietnam stock market. In 2016, the VNINDEX rose 14.8% and the HNXINDEX increased 0.2%. Total stock market capitalisation and the bond market accounted for 70.9% of Vietnam's GDP at end-2016, a strong increase from the 56.5% in 2015.

The government implemented many supportive policies in 2016, the most prominent of which were the reduction in settlement time for security transactions to T+2 (from T+3) and Circular 115/2016/TT-BTC that shortened the listing time from IPO date. In addition, there were several efforts to privatise state enterprises in 2016, such as the Vinamilk share auction and listing of leading beer companies Sabeco and Habeco.

Investment in the stock market focused on securities with large market capitalisation and industries that benefited directly from government policy (steel). This is one of the reasons that the VNINDEX registered higher growth in 2016 than the HNXINDEX.

In our view, 2017 will be another positive year for the Vietnam's stock market. We expect the focus to be on newly-listed securities of big companies en route to state divestment. We also expect securities in cyclical industries such as banking, real estate and construction materials to attract investment in 2017.

Chapter 4: Industry outlook

We have identified the following industries as having promising earnings outlook for 2017: Banking, Real Estate, Building Materials, Steel, Food and Beverage, Automotive and Retail.

In addition, we also take note of two neglected industries: Oil & Gas and Fertiliser Manufacturing. Given their poor business performance in 2016, the share prices of companies in these two industries have declined to levels below their historical price evaluation. However, we think that significant positive changes in earnings outlook are required for these stocks to become attractive investments.

CHAPTER 1: THE GLOBAL ECONOMIC OUTLOOK IN 2017

1. Global economic growth: brighter outlook

a. Global economy to pick up

In 2017, we expect positive signs of recovery in global economic growth. We anticipate the following good news for the economy in 2017:

- Some developed economies will start implementing expansionary fiscal policy to spur economic growth, starting with the US under the new president Donald Trump;
- Strong economic recovery in oil-exporting countries, especially Brazil and Russia.

In addition to the above favourable factors, we foresee challenges from: (1) China's likely economic slowdown, and (2) political risks that may hold back European countries' economic growth.

GDP growth forecasts by the International Monetary Fund (IMF) and Organisation for Economic Co-operation and Development (OECD)

0	IMF					OECD				
Years	Average 1998-2007	2014	2015	2016F	2017F	Average 1992-2002	2014	2015	2016F	2017F
I, World	4,2	3,4	3,2	3,1	3,4		3,3	3,1	2,9	3,3
Developed countries	2,8	1,9	2,1	1,6	1,8	2,7	1,9	2,1	1,7	2,0
US	3,0	2,4	2,6	1,6	2,2	3,4	2,4	2,6	1,5	2,3
EU	2,4	1,1	2,0	1,7	1,5	2,1	1,2	1,5	1,7	1,6
Japan	1,0	0,0	0,5	0,5	0,6	0,8	0,0	0,6	0,8	1,00
II, Emerging and Developing countries	5,8	4,6	4,0	4,2	4,6		4,6	3,8	4,0	4,5
1, BRICs										
China	9,9	7,3	6,9	6,6	6,2		7,3	6,9	6,7	6,4
Russia	5,8	0,7	-3,7	-0,8	1,1		0,7	-3,7	-0,8	0,8
Brazil	3,0	0,1	-3,8	-3,3	0,5		0,1	-3,9	-3,4	0,0
2, South East Asia										
Campuchia	9,3	7,1	7,0	7,0	6,9					
Indonesia	2,7	5,0	4,8	4,9	5,3				5,0	5,3
Laos	6,3	7,5	7,6	7,5	7,3					
Malaysia	4,2	6,0	5,0	4,3	4,6				6,7	4,7
Myanmar	12,0	8,7	7,0	8,1	7,7					
Philippines	4,2	6,2	5,9	6,4	6,7				7,3	6,4
Thailand	3,8	0,8	2,8	3,2	3,3				3,0	3,1
Vietnam	6,8	6,0	6,7	6,1	6,2				6,2	6,5

Source: IMF,OECD

The IMF and OECD have positive 2017 outlooks for the US and Japan, as well as certain emerging economies, expecting them to register positive economic growth despite the possible slowdown in China and Europe. The IMF and OECD forecast that 2017 global GDP growth will fluctuate between 3.3-3.6%, 0.4-0.5% pt higher than 2016 estimates. The IMF and OECD expect the economic growth of developed countries to improve by 0.2-0.3% pt in 2017, and the economic growth of emerging and developing countries to improve by 0.4-0.5% pt. (Source: IMF, OECD)

b. OECD GDP forecasts for certain countries and regions

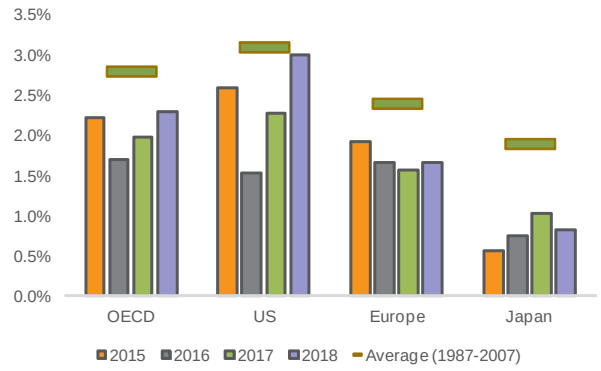
The US: GDP started to show strong recovery in 3Q16, with positive employment and consumption figures. President Donald Trump's new government is expected to project much higher economic growth for 2017 than in 2016.

Europe: GDP growth slows down as internal political hurdles loom

Japan: economic growth improves but is likely to be slow in 2017.

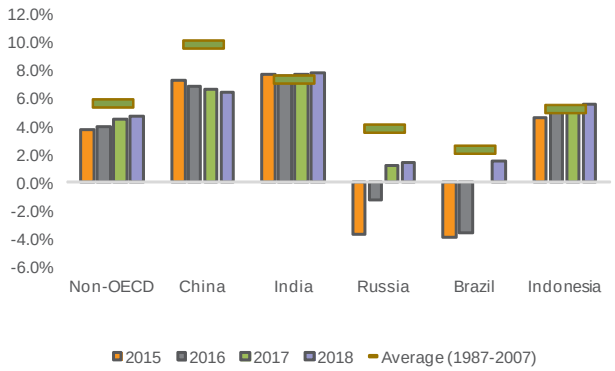
China: economic growth is likely to weaken further in 2017.

Real GDP growth in certain developed countries



Source: OECD

Real GDP growth in certain non-OECD member countries

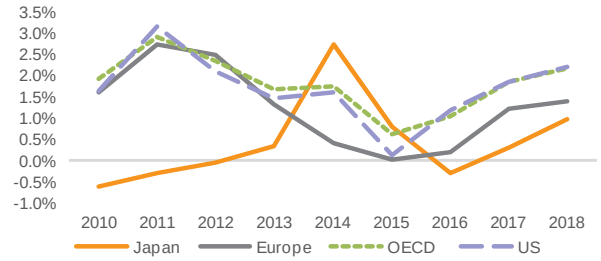


Source: OECD

Russia and Brazil: expected to be on the path to recovery in 2017. In 2017, the OECD forecasts that Russia will register GDP growth of 0.8-1.1%, the first time in three years. It projects that Brazil's economy will grow by 0.5% (Source: OECD)

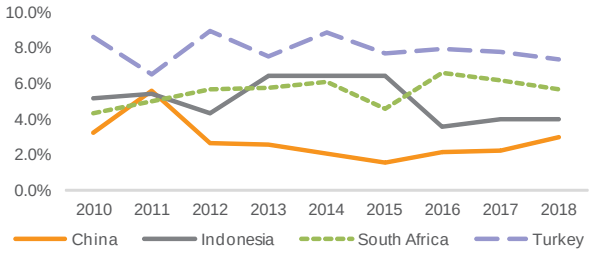
2. OECD inflation forecasts for developed countries

Inflation in developed countries



Source: OECD

Inflation in certain emerging and developing countries



Source: OECD

Some of the factors that could drive inflation in 2017:

- After the commodity price crash that created downward pressure on inflation in 2015-2016, commodity prices (including oil) showed signs of recovery in 2016, which could signal a rise in inflation.
- Decline in unemployment rate and higher wages would spur consumer demand.
- Certain developed countries are likely to increase government spending to support economic growth.

According to the OECD, inflation will rise in certain developed economies in 2017-2018, especially the US. Inflation in the US is expected to increase to 1.84% in 2017 (from 1.17% in 2016) and surpass the 2% mark in 2018. In 2017, inflation is also expected to increase in the Eurozone and Japan but would remain far below the target level by the respective governments. As for emerging and developing economies, the OECD expects inflation to stabilise in the next two years.

3. Monetary policy: expect gradual tightening

a. The US Federal Reserve System (Fed)

Given that the Fed is typically cautious on changing interest rates and monetary policy, we believe that it will only implement two interest rate hikes in the second half of 2017.

b. Central banks and monetary policy

Exchange rate forecast from creditworthy financial institutions

Pair	Current Prices (26/12/2016)	Royal Bank of Canada	Goldman Sachs	ING	Barclays	Scotiabank
EUR/USD	1.05	1.00	1.00	1.12	0.99	1.10
USD/JPY	117.15	115.00	115.00	120.00	100.00	115.00
GBP/USD	1.23	1.15	1.14	1.27	1.30	1.25
USD/RUB	61.21		62.00	63.40	70.00	64.00
USD/INR	67.82		68.50	68.50	70.80	69.00
USD/CNY	6.95		7.30	6.80	7.35	7.20

Source: VNDIRECT research

ECB: At its December meeting, the ECB decided to extend its quantitative easing (QE) program until the end of 2017 and reduce its bond buying from €80m/month currently to €60m/month in Apr 2017 onwards. The ECB also decided to keep the refinancing rate, marginal lending rate and deposit facility rate steady at 0.00%, 0.25% and -0.4%, respectively.

We believe the stable rate policy is in preparation for the ECB gradually withdrawing from the QE program, similar to the Fed's approach to QE in 2013. We predict that the ECB interest rate and European government bond yield will increase slightly in 2017.

PBOC: China has implemented an expansionary monetary policy since the end of 2014 to support economic growth. However, we believe this will change in 2017 due to: (1) the Fed speeding up the progress of interest rate normalisation in the second half of 2017, and (2) the overheated real estate market, which is a side effect of the expansionary monetary policy.

We believe that the PBOC will not expand its current monetary policy and may even consider tapering its stimulus program in the second half of 2017 to cool down the real estate market.

BOJ: At its latest meeting in December 2016, the BOJ decided to keep its current monetary policy steady. Interest rate was unchanged at -0.1% and 10-year Japanese government bond (JGB) yield was kept close to 0%. In addition, the BOJ stated that it was committed to keeping annual increases in JGB holdings at ¥80tr (approximately US$700bn). We forecast Japan inflation forecasts for 2017-2018 will remain far below the 2% governemt target.

We believe that the BOJ will maintain and even expand monetary policy in 2017 in order to lift Japan out of the economic stagnation it has endured for decades.

4. Fiscal policy: tool for developed countries to support global economic growth

Given there is little room to expand monetary policy and political instability, we believe that certain developed countries will combine expansionary fiscal policy and expansionary monetary policy to stimulate economic growth in short-term and consolidate long-term growth. The timing and scale of fiscal policy would be tailored to each country's economic characteristics, budget and public debt level. Certain developed countries such as the US, Canada, the UK, France, Germany and Italy have more room to conduct expansionary fiscal policy. In contrast, Japan, Korea and certain emerging countries such as India and Brazil have limited room to expand fiscal policy.

In our view, President Trump's new government will spearhead the implementation of expansionary fiscal policy. Based on his promises during the election campaign, we think that the new government will conduct expansionary fiscal policy by cutting taxes and increasing infrastructure spending.

5. Investment flows and asset distribution trends

a. Investment cash flow trend in 2016: bonds preferred

Equity (US$m)

Nations	Week	Month	Quarter	YTD	12M
Asia					
Indonesia	-13	-399	-1.493	1.133	1.162
Philippines	-61	-164	-641	110	132
Thailand	-92	-144	-1.703	2.083	2.096
Japan	2.414	5.939	23.843	-39.535	-42.137
India	-173	-250	-3.607	3.903	4.24
America					
Brazil	-15	-246	380	3.896	3.713
Canada		1.365	1.365	29.19	33.455
US		15.351	15.351	-48.686	-78.754
Europe					
Eurozone		14.298	14.298	-104.889	-203.594
France		11.124	11.185	12.56	14.24
Germany		4.807	4.807	66.322	70.588
Italy		-3.428	-3.428	2.528	3.002

Source: Bloomberg

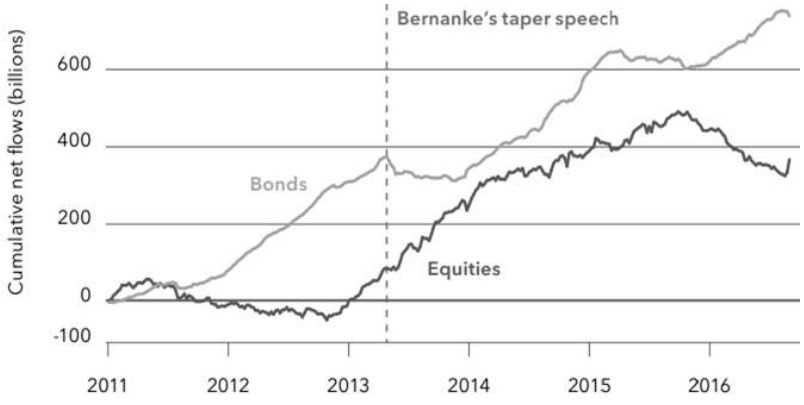
Bonds (US$m)

Nations	Week	Month	Quarter	YTD	12M
Asia					
India	-200	-3.157	-7.096	-6.835	-7.103
Indonesia	-102	741	-1.436	7.644	8.621
Japan	6.41	12.213	2.59	47.654	35.744
Thailand	29	15	-1.955	9.521	9.513
America					
Brazil		1.033	4.282	28.093	29.423
Mexico		2.022	779	-6.307	-3.647
Canada		10.53	10.53	76.148	75.795
US		-6	-6	287.94	323.449
Europe					
Eurozone		-18.15	-18.15	562.591	753.84
France		457	457	27.481	19.168
Germany		18.225	18.225	131.617	188.09
Italy		-12.665	-12.665	77.192	123.196

Source: Bloomberg

b. Investment cash flow focus in 2017: equities

Cash flow into equity and bonds (2011-2016)



Source: BlackRock

In the context of normalised monetary policy, a combination of rising interest rates and expansionary fiscal policy would encourage economic growth in most developed countries, as investments would flow from bonds to equity. We think that the conditions in early 2017 are very similar to early 2013, when the Fed started tightening its QE program. As a result, net buying activities in the equity market rose significantly, while cash flows into the bond market slowed down in 2013.

According to JP Morgan, historical equity returns in the initial period after an interest rate hike outperformed bond returns.

c. Asset distribution recommendation

We are optimistic on equity market prospects, especially in the US, Japan and emerging countries namely Russia, Brazil and India. With the pressure from the Fed's interest rate hike, we are less confident on gold and bond market prospects in 2017.

2017 investment prospects, by asset class (excluding commodities)

	Asset Allocation	Investment Recommendation				
		Negative	Slightly negative	Neutral	Slightly Positive	Positive
Asset class	Stocks					
	Bonds					
	Cash					
Stocks	Us Large Cap					
	US Small Cap					
	Europe (except UK)					
	UK					
	Japan					
	Asia - Pacific (except Japan)					
	Emerging Markets					
Bonds	US Treasury					
	US Treasury (> 10 years)					
	US High Yield					
	US Investment Grade					
	TIPs					
	Euro Core Bund					
	Euro High Yield					
	Emerging Market Debt					
Currency	USD					
	EUR					
	GBP					
	JPY					
	CNY					
	RUB					
	Gold					

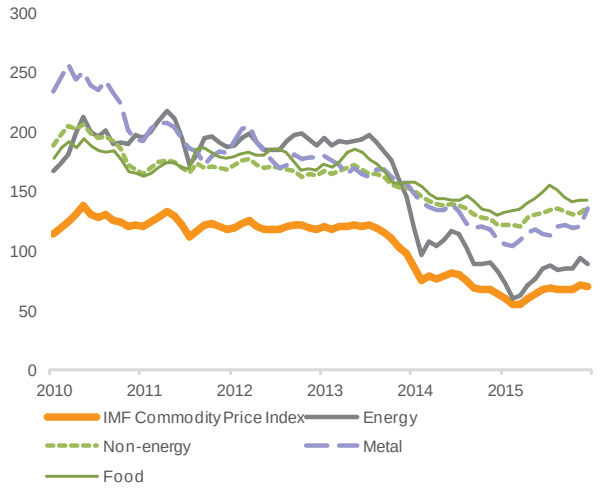
Source: VNDIRECT

6. Commodity prices in 2017: on track to recovery

We expect the recovery trend in commodity prices to continue in 2017 as: (1) improvement in global economic growth increases demand for commodities, and (2) the surge in oil price drives up the prices of other commodities.

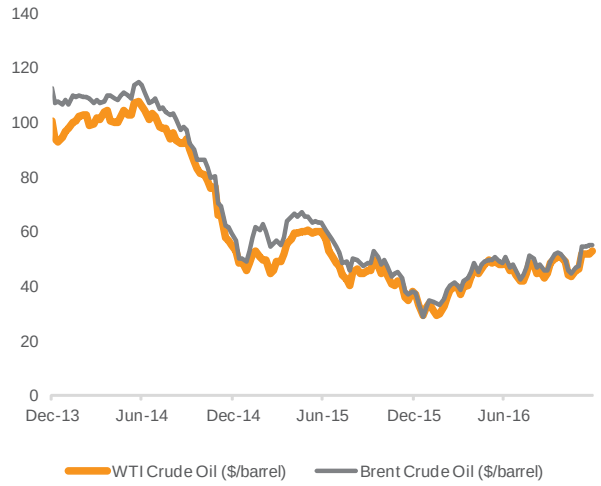
a. Energy

World Commodity Price index by IMF



Source: Bloomberg, IMF

Oil prices



Source: Bloomberg

Brent oil price: Fell to historical trough around US$30/bbl in mid-Feb 2016 but recovered to US$55/bbl at the end of the year. The oil price recovery was influenced by many factors: (1) decline in excess oil supply, as non-OPEC output fell, with excess supply of 1.1m bpd at end-Sep 2016 (a 50% decrease from the level at end-Sep 2015), (2) active bottom-fishing by investors after the oil price plunge, (3) OPEC reaching an agreement to reduce total output by 1.2m bpd, the first in more than eight years.

Oil price forecasts for 2017 after OPEC agreement (US$/bbl)

Institutions	Previous Forecast	Current Forecast
EIU		55.5
IMF		50.6
OPEC		50-60
World Bank	53	55

Source: VNDIRECT compiled

We estimate that global excess supply will end in mid-2017 if OPEC members keep to the agreement, and the resulting demand-supply equilibrium would support price recovery. We forecast that oil price in 2017 will fluctuate between US$50-65/bbl to average at US$55/bbl for the year (a 28% increase from the 2016 average).

Gas: We predict that gas price will continue on the recovery trend in 2017, increasing by 5-10%, depending on the region.

Coal: After the coal price spike at end-3Q16 to early-4Q16, coal price stabilised at end-4Q16. The sudden increase occurred after China reduced its coal production significantly. However, we believe that this output decline would be offset by the supply increase from miners in Brazil and Australia. We estimate that global coal price will increase by 10-15% in 2017.

b. Metals

After falling to its historical trough in 1Q16, the metals index recovered by 24% at end-Nov 2016. Increase in demand from manufacturing and speculation from China were the main reasons for the index bouncing back. The strongest price recovery was registered by iron ore, tin and zinc.

We predict that metal prices will continue on upward trends in 2017, with the exception of iron ore (expect slight adjustment in price due to strong supply from Australia and Brazil).

Commodity price outlook for 2017

Metal	Price forecast in 2017
Iron Ore	Price adjustment of 10% due to supply increase from Australia and Brazil,
Aluminium	Price adjustment of 8% due to production cost increase and worries about short-term supply shortage
Copper	Price increase predicted between 18%-20% due to demand increase and bottom fishing activities
Nicken	Price increase predicted between 17%-18% due to supply shortage when China's demand rises
Tin	Price increase predicted between 15%-16% due to demand in China, Taiwan and Korea rising faster than suppy
Zinc	Strong price increase predicted as global demand forecast rises by 11.8%

Source: VNDIRECT

c. Agricultural products

Historically, agricultural product prices are more stable than those of energy and metal. We believe that agricultural prices will be stable in 2017, with the exception of rubber. We expect rubber price to post strong recovery in 2017 due to supply shortage (four Southeast Asian countries- Indonesia, Malaysia, Thailand and Vietnam- agreed to reduce exports in order to stabilise prices).

Agricultural product price outlook in 2017

Products	Price forecast in 2017
Rice	Cheap supply from India, Cambodia increases, slight price increase of 2% predicted
Cocoa	Predict price to decline by approximately 15% due to prevailing excess
Robusta Coffee bean	Price increase is between 5%-6% due to stable rise in demand
Corn	Improved demand but leftover inventory still high, less price volatility
Soy bean	Price to increase by approximately 4% due to lower-than-expected improvement in demand
Sugar	Price stablised at current level, encouraging Europe export and reducing sugar usage in Ethanol production
Palm oil	Price increase is between 4%-5% due to improved demand
Cotton	Price increase is between 5%-6% due to decline in supply
Rubber	Strong price increase by 30% due to supply shortage, especially after four big Southest Asian producers agreed to reduce export to stablize price

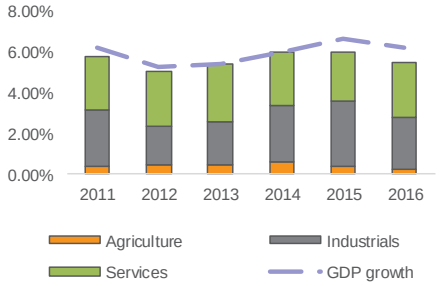
Source: VNDIRECT

CHAPTER 2: VIETNAM'S ECONOMY – SILVER LINING

1.Lower-than-expected economic growth in 2016 due to one-off factors

Economic growth remains the government's priority in 2017. We forecasts 2017 GDP growth of 6.46-6.67%.

GDP growth and contribution by sector (2011-2016)



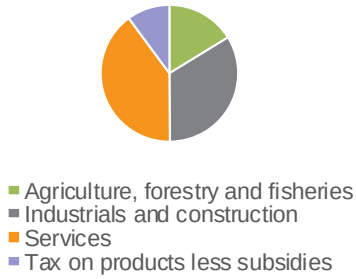
Source: GSO, VNDIRECT

2016 GDP growth reached 6.21%, below the government's target of 6.7% due to the decline in growth of the agricultural and mining sectors.

Agricultural growth was only 1.36% in 2016, lower than the 2015 level of 2.41% due to serious impact from unfavourable weather conditions. In addition, mining growth declined by 4%, which also negatively affected the country's GDP growth rate.

Apart from those two sectors, all other sectors experienced positive growth in 2016. Services and construction increased by 6.98% and 10%, respectively, in 2016 (the highest rates in the past five years). Another important GDP growth driver in 2016 was the expansion of the manufacturing sector (11.6%). The robust growth of this industry in recent years (including 2016) mainly came from strong FDI. Manufacturing accounted for the largest proportion of FDI inflows to Vietnam (65% in 2016). The positive PMI movement in 2016 was a key indicator of strong growth in the manufacturing sector. Vietnam's PMI remained above 50 throughout 2016 and hit a record high of 54 in Nov.

GDP composition (2016)



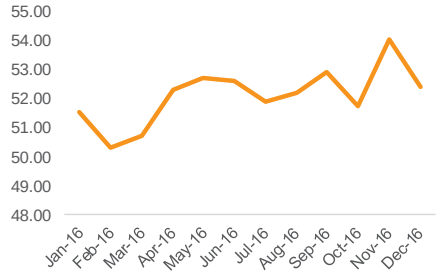
Source: GSO, VNDIRECT

The structure of the Vietnam economy consists of agriculture, forestry and fisheries (which accounted for 16.32% of total GDP in 2016 vs. 17.0% in 2015), industrials and construction (32.72% in 2016 vs. 33.25% in 2015), services (40.92% in 2016 vs. 39.73% in 2015) and product taxes less subsidies (10.04% in 2016 vs. 10.02% in 2015). **We observed rapid expansion in the manufacturing and services sectors, mostly from the supply side**.

Ignoring the seasonal and one-off factors, the supply side (the key driver of the Vietnam economy) showed signs of recovery in 2016. **We calculate that excluding the contribution from the agricultural and mining sectors, GDP growth from other sectors rose to 8.37% in 2016 (higher than the 7.66% in 2015).**

Aggregate demand improved in 2016, albeit slowly, driven mainly by investment as domestic consumption rose at a slow rate.

Vietnam 2016 Purchasing Managers' Index (PMI, 2016)



Source: STOXPLUS, VNDIRECT

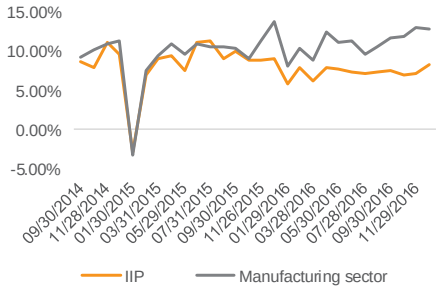
Social investment continued to post strong growth in 2016 and as we stated in our 2016 strategic report released Jan 15, 2016, social investment is once again becoming one of the most important engines for Vietnam's economic growth. Investment/GDP reached a 5-year high of 33% in 2016. Low investment cost (including interest and tax) and the economic recovery prospects were the two key reasons that boosted the enterprises' investment activities. In 2017, we expect the factors that stabilised the macroeconomy in 2016 to be sustained and forecast strong investment growth in the coming years, given the record-high number of newly-established firms (110,000) in 2016.

As for social investment, by sector, non-state accounted for the highest proportion (39% in 2016). Non-state and FDI registered growth rates of 9.7% and 9.4%, respectively, in 2016, much higher than the 7.2% growth rate for the state sector.

The industries that would benefit from investment growth are construction materials, real estate, logistics and financials (banking), in our view.

Regarding consumption, total goods and services retail in 2016 rose by 10.2% yoy (higher than the 9.8% in 2015). Excluding the price factor, we estimate that total goods and services retail rose by only 7.8% yoy in 2016 (lower than the 8.5% in 2015) because purchasing power barely changed but consumer prices were much higher in 2016 than in 2015.

Vietnam Index of Industrial Production (IIP, 2014-2016)



Source: GSO, VNDIRECT

Domestic consumption registered slow growth in 2016 as consumer incomes fell significantly due to the economic crisis. Apart from that, the unfavourable asset market conditions (including stock and real estate markets) led to spending cuts (asset effect). Consumer incomes started to improve following the rebound in economic and business activities, which is expected to boost consumption in the coming months. The underdeveloped financial market and lack of securities in Vietnam caused residents to switch to real estate as a means of investment and store of value. Hence, recovery of the real estate market would have a significant, positive impact on consumer behaviour.

We observed that the consumption of luxury products such as **automobiles and jewellery** that cater to the high-income segment of the population recorded strong growth in 2016. According to the Vietnam Automobile Manufacturing Association, car sales rose by 40% p.a. in 2015-2016

Excluding extraordinary factors, we believe that the Vietnam economy is still recovering and if there is no external shock in 2017, the rebound will consolidate further.

In 2017, economic growth remains the government's priority. We expect expansionary fiscal policy to be employed in 2017 despite the high budget deficit and public debt, while monetary policy will be roughly similar to that of 2016.

In our view, such government policy is reasonable in the current context, which requires the government to boost economic growth to unblock bottlenecks (high public debt and bad debts). Higher economic growth would lead to improvement in employment figures and consumers' income, which would in turn, boost aggregate demand (especially consumption) and have positive impact on asset market recovery (stock and real estate markets). This would pave the way for the settling of bad debts, unfreezing credit flows and stabilising interest rates.

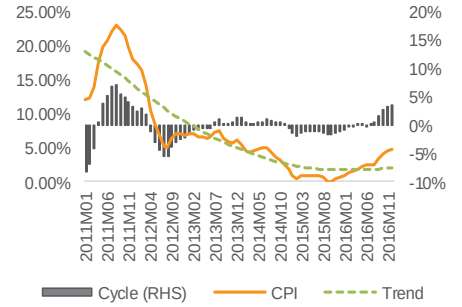
High GDP growth would also help the government meet its public debt/GDP target in 2017. As nominal GDP was only VND4,500tr in 2016, public debt/GDP ratio broke through the government ceiling of 65%.

We forecast GDP growth of 6.46% for 2017 under a worst-case scenario and 6.67% under a best-case scenario.

2. Inflation: 2106 CPI rose mostly due to price adjustment for public goods and services; stable core inflation.

We forecast Consumer Price Index (CPI) rate of 5.5-6.0% yoy for Dec 2017.

Vietnam's CPI 2016 (YoY)



Source: GSO, VNDIRECT

CPI in Dec 2016 rose 4.74% yoy and average CPI for 2016 rose by 2.66% yoy, which we deem strong based on historical comparison. However, core CPI was stable at below 2% in 2016. Thus, we believe that the strong increase in CPI for 2016 was mostly due to seasonal factors (price adjustment for medical and educational services).

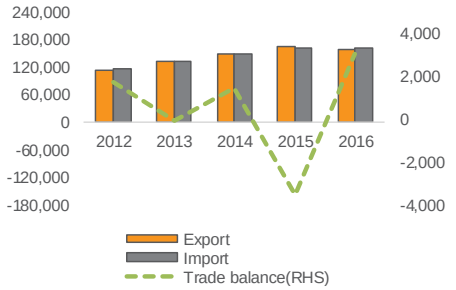
The price of medical goods and services rose by 77.57% yoy, causing the CPI to increase by 2.7% in 2016. The price of educational services in December increased by 12.5% yoy (contributing 0.58% increase in 2016 CPI). Of the 4.74% rise in CPI of 2016, medical and educational goods and services contributed about 3.28% pts.

Monetary and demand-pull factors did not have any significant impact on inflation in 2016. From our point of view, the main reason for this is that aggregate demand (especially consumption) did not recover as expected. The government plans to lower the prices of certain public goods and services in 2017 and we expect this to have sizeable impact on CPI. At end-2016, only 27 provinces had not adjusted the health services price scale.

Analysing the yoy change in CPI from 2010-2016, we observed that after falling to historical trough in 2015, the CPI has been on a steady uptrend and appears to be entering a new upcycle.

The government targets 2017 average **CPI growth of 4% compared to 2016**. Please note that this is CPI yearly average figure, which differs from the CPI figures disclosed for previous years (**CPI % yoy change**). In 2016, average CPI growth in 2016 was only 2.66% but CPI increased by 4.74% yoy. In our opinion, it appears the government is prioritising GDP growth, public debt and budget deficit figures over CPI. We project CPI growth of 5.5-6.0% yoy in Dec 2017.

Vietnam's trade balance in 2012-2016 (US$m)



Source: GSO, VNDIRECT

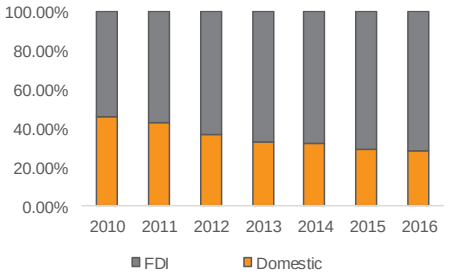
3. Imports and exports

Vietnam posted trade surplus of US$2.68bn in 2016, mostly from FDI (FDI enterprises exported goods worth US$23.7bn, while domestic companies imported goods worth US$23.7bn). This was an important factor that supported the VND/US$ exchange rate in 2016.

Currently, Vietnam's export and import turnover-to-GDP ratio is about 180%, which is high compared to other countries. Hence, Vietnam would be highly sensitive to any changes in global economic conditions.

The expansion of trade in Vietnam in recent years came mostly from the FDI sector, which accounted for about 70% of total exports and 60% of imports in 2016.

Export, by economic segment (2010-2016)

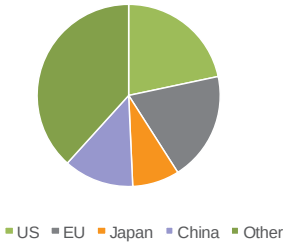


Source: GSO, VNDIRECT

We estimate that 2016 export turnover was US$175.9bn (+8.6% yoy), of which the domestic sector accounted for US$50.0bn (+4.8% yoy) and the FDI sector (including crude oil) comprised US$125.9bn (+10.2% yoy). Excluding crude oil, we estimate that FDI export turnover in 2016 was US$123.5bn (+11.8% yoy).

The export structure in 2016 had barely changed from that of 2015. In 2016, export turnover from heavy industry and mining amounted to US$79.8bn (+8.9% yoy, 45.4% of total export turnover or +0.1% pt yoy), light industry and handicrafts accounted for US$71bn (+9.0% yoy, 40.4% of total export turnover or +0.2% pt yoy), agricultural and forestry products comprised US$18.1bn (+6.5% yoy, 10.3% of total export turnover or -0.2% pt yoy) and fisheries contributed US$7.0bn (+6.8% yoy, 4% of total export turnover or -0.1% pt yoy).

Vietnam's key export markets (2016)



Source: GSO, VNDIRECT

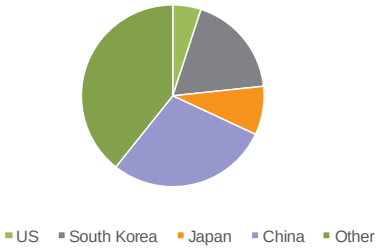
The US remained Vietnam's key export market in 2016, accounting for exports worth US$38.1bn (+14% yoy), followed by the EU with US$34bn (+10% yoy), China with US$21.8bn (+26.3% yoy). In 2016, Japan accounted for total export turnover of US$14.6bn (+3.4% yoy) and South Korea comprised US$11.5bn (+29% yoy). Export turnover to ASEAN countries fell slightly to US$17.4bn (-4.8% yoy).

We estimate that total import turnover in 2016 was US$173.3bn (+4.6% yoy), of which US$71.1bn (+4% yoy) came from the domestic sector and US$102.2bn (+5.1% yoy) came from FDI enterprises.

With regards to import structure in 2016, capital goods reached US$157.9bn (+4.4% yoy, 91.1% of total import turnover), of which imports of equipment, machines and spare parts were US$71.8bn (+5.6% yoy, 41.4% of total import turnover), raw materials comprised US$86.1bn (+3.5% yoy, 49.7% of total import turnover). Imports of consumer goods amounted to US$15.4bn in 2016 (+6.8% yoy), accounting for 8.69% of total import turnover.

China remained the leading import market for Vietnam in 2016, with total turnover of US$49.8bn (+0.5% yoy), followed by South Korea with US$31.7bn (+14.6% yoy) and the ASEAN countries with US$23.7bn (-0.3% yoy). In 2016, total imports from Japan rose to US$15.0bn (+4.3% yoy), while imports from the EU accounted for US$11.1bn (+6.7% yoy) and those from the US comprised US$8.7bn (+11.6% yoy).

Vietnam key import markets (2016)



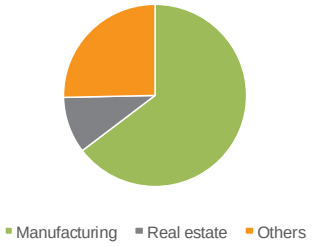
Source: GSO, VNDIRECT

We note that **total import turnover from China declined**, which we attribute to: (i) improvements in domestic support industries, as the presence of big corporations attracts satellite companies to follow suit and invest in Vietnam. This helped to reduce imports, especially from China, (ii) the government's adjustment to reduce dependence on the China market, following the Haiyang Shiyou 981 incident in 2015.

With regards to possible US trade protectionism under the upcoming Trump administration, we have yet to see any moves by the US government that could negatively affect exports from Vietnam. Assuming that the US economy continues to grow, we remain optimistic about Vietnam's export turnover to the US.

4. FDI

Vietnam FDI structure (2016)



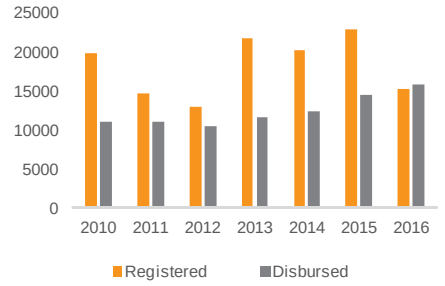
Source: GSO, VNDIRECT

We estimate that FDI disbursed in Vietnam in 2016 amounting to US$15.8bn (+9% yoy), an all-time high.

In 2016, the manufacturing and processing industry attracted FDI of US$9.81bn (64.6% of total newly-registered FDI), real estate accounted for US$1.52bn (10.1% of total newly-registered FDI); wholesale, retails and repair of automobiles and other motor vehicles attracted FDI of US$367m (2.4% of total newly-registered FDI) and all other industries comprised US$3.48bn (22.9% of total newly-registered FDI).

Hai Phong attracted the largest amount of registered FDI, with US$2.46bn (16.2% of total newly-registered FDI), followed by Hanoi with US$1.92bn (12.7%), Binh Duong with US$1.63bn (10.7%), Dong Nai with US$1.04bn (6.6%), Bac Giang with US$937.5m (6.2%) and Ha Nam with US$604.3m (4%).

Registered and disbursed FDI 2010-2016 (US$ m)



Source: FID, VNDIRECT

South Korea is Vietnam's largest investor, accounting for FDI of US$5.52bn (36.3% of total newly-registered FDI), followed by Singapore with US$1.59bn (10.5%), China with US$1.26bn (8.3%), Hong Kong with US$1.1bn (7.3%), Japan with US$868.1m (5.7%) and Taiwan with US$826m (5.4%).

We estimate that total official development assistance (ODA) and preferential loans signed in 2016 amounted to US$5.38bn (up 39.7% yoy). Disbursement was US$3.5bn as of 21 Dec 2016 and we estimate that it was US$3.7bn at end-Dec 2016 (80.4% of the figure recorded in 2015).

Registered FDI in Vietnam fell in the last three months of 2016, partly contributed by the possibility of Trans-Pacific Partnership (TPP) agreement being delayed. However, it is still too early to confirm this prediction. We still have a positive view on FDI in Vietnam, given the recent bilateral and multilateral Free Trade Agreements (FTAs) signed.

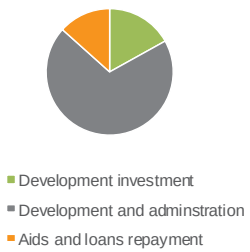
5. Fiscal Policy: no tightening signals detected

State budget: imbalanced

By 15 Dec 2016, total state revenue was estimated at VND943.3tr, making up 93% of the annual target. Out of this, revenue from the domestic sector reached VND744.9tr (94.9% of annual target), revenue from crude oil amounted to VND37.7tr (69.2% of target) and revenue from export-import was VND156.2tr (90.8% of target).

Out of domestic revenue, land use fees reached VND77.9tr (155.8% of the annual planned amount), commercial, industrial and non-state services came to VND144.7tr (100.8% of the annual planned amount), environment taxes totalled VND38.7tr (100.7% of target), revenue from personal income tax was VND61.7tr (97%) and revenue from the FDI sector (excluding crude oil) reached VND147.7tr (92.9%). Revenue from state-owned enterprises amounted to only VND193.7tr (75.6%). The Ministry of Finance has ordered the tax and customs agencies to take drastic measures to collect tax and account receivables while ensure the timely sale and equitisation of state-owned enterprises.

Government expenditure structure (%)

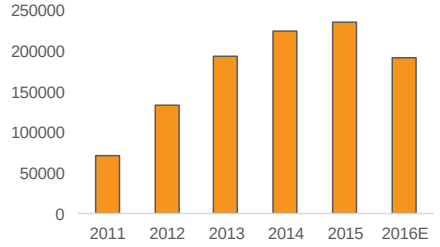


Source: GSO, VNDIRECT

Total state expenditure as at 15 Dec 2016 was estimated to be VND1,135.5tr (89.2% of the annual target), out of which spending on investment and development reached VND190.5tr (74.7% of target), expenditure on social-economic development, national security and defense and administration was VND786tr (95.4%) and repayment of debt and aid totalled VND150.3trl (96.9%).

Regular expenditure and debt repayment accounted for 85% of total expenditure, rendering any spending cuts infeasible. Instead, the government has to increase revenue to make up for spending and, in the short run, selling state-owned assets and floating public goods and services prices is an appropriate approach. In the medium and long run, expanding tax base is the natural step.

Budget deficit 2011-2016 (VNDbn)

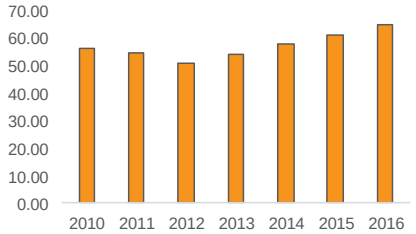


Source: MOF, VNDIRECT

For 2017, the budget deficit is expected to be 3.5% of GDP. Please note that this is calculated based on the new budget law, effective from 1 Jan 2017, the most important point of which is the exclusion of debt repayment from the budget deficit calculation. If that is still included, we estimate the 2017 budget deficit to be 6.7% of total GDP.

Thus, we see no signs of fiscal policy tightening in 2017. In the short run, this will have a positive impact on economic growth, which is currently quite important as the private sector is facing a lot of difficulties. However, if the budget deficit is not lowered in the coming years as the economy rebounds, fiscal risk will increase over time.

Public debt/ GDP (%)

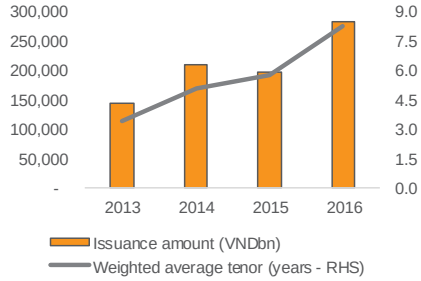


Source: VNDIRECT

As we have already discussed in our specialized report on Vietnam's public debt, this issue will not be addressed in detail here. One of the key points is that the public debt to GDP had crossed the ceiling of 65% by the end of 2016. As the congress will not relax the limit , the government will have to apply certain technical adjustments to bring the ratio back to below 65%, of which GDP growth boost is a reasonable choice.

G-bond issuance: The amount of issuance rose alongside a decline in winning interest rates. Weighted average tenor increased. Foreign investors showed solid buying on a net basis.

Issuance amount and weighted average tenor of State Treasury bonds 2013-2016



Source: HNX, VNDIRECT

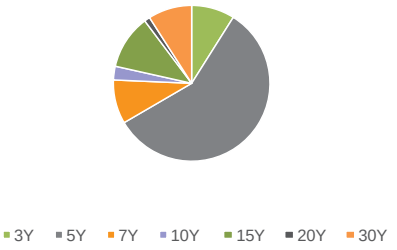
By 16 Dec 2016, the primary market successfully mobilised VND315.7tr of G-bonds, out of which nearly VND281.3tr was from the State Treasury (ST), VND13tr from the Vietnam Bank for Social Policies and VND21.479tr from the Vietnam Development Bank. Thus, the ST officially achieved its 2016 target of VND281tr, out of which 3-, 5- and 30-year tenor bonds surpassed targets. The winning interest rate fell quite significantly, especially for 5- and 7-year tenor bonds, by 130bp and 123bp, respectively. The weighted average tenor rose to 8.54 years in 2016, much higher than the levels of 4.84 years and 7.12 years in 2014 and 2015, respectively.

Foreign investors net bought at a record level, pouring in more than VND22tr at its height. By the end of 2016, the net buying value of foreign investors stood at more than VND11tr on the secondary market. Firm macro fundamentals and a change in policy, raising the ceiling (from 15% to 35%) for short-term capital used for G-bond purchases by foreign banks, were the key reasons behind the strong performance of the bond market in 2016.

6. Monetary Policy: slight tightening in second half of 2017

Interest rate: a hike is inevitable

2016 State Treasury bond structure



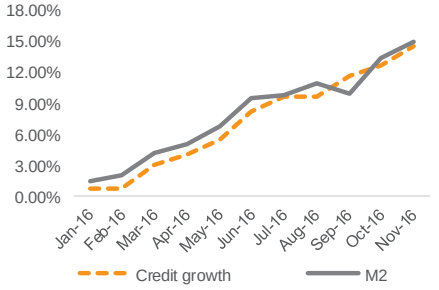
Source: HNX, VNDIRECT

According to the SBV, by 29 Dec 2016, total means of payment rose by 17.88%, deposits grew by 18.38% compared to the figure recorded by the end of 2015 and credit growth reached 18.71%.

The 2016 interest rate fell slightly by 0.5% pts to 1.0% pts. However, there has been differentiation among terms and banks. Lending rates for short-term loans (less than 12 months) did not change from 2015 while those for mid and long-term loans declined slightly. Short-term deposit rates at state commercial banks continued to fall but those at private commercial banks moved in the opposite direction. Mid- and long-term deposit rates rose generally.

Lending rates for mid- and long-term loans are on the decline, which is understandable as they reflect the long-term prospects of the economy. As macro fundamentals are well maintained, lending rates will soon fall below the level recorded during the recent instability. This is good news as such lending rates directly impact enterprises' investment and a lower rate will mean higher social investment.

M2 and credit growth from the beginning of 2016 (%)



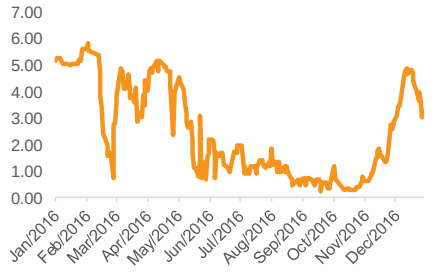
Source: STOXPLUS, VNDIRECT

The difference in interest rates between state and private commercial banks is due to two key reasons. (i) State commercial banks are at an advantage when it comes to cheap capital access, specifically deposits from the state and big state-owned corporations, etc. (ii) The banking system was affected when the SBV mentioned that it might allow ailing banks to go bankrupt. From our observation, to ensure the safety of assets, people tend to switch from smaller to larger banks with better creditworthiness, especially state commercial ones.

From the second half of 2016, mid- and long-term deposit rates increased quite clearly due to (i) higher inflation, and (ii) banks' preparing for Circular 06 (Amending Circular 36) with the new requirement for ratios of short-term capital over mid- and long-term loans.

As mentioned in previous reports, in the recent three years, interest rates for retail and business segments have low correlation with the interbank market and inflation. Even though inflation fell, the overnight rate was at a record low while lending rates just slid rather slowly. This phenomenon proved that market interest is only barely influenced by macro and policy factors, such as inflation and the overnight rate.

Interbank rate 2016 (%)



Source: Bloomberg, VNDIRECT

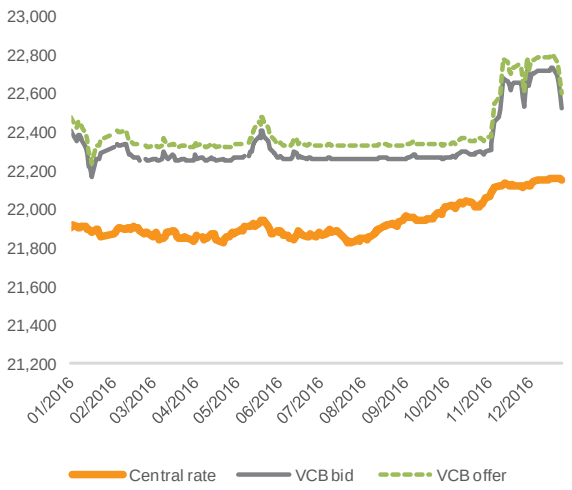
From our view, the banking system's inherent problems, especially bad debts, are the key factors influencing market interest. Bad debts caused banks to increase their risk provisions, leading to higher operational costs. Thus, to ensure profitability, banks will be unlikely to lower their lending rates, which is reasonable as they are **currently dealing with bad debts using future income.**

We expect interest rates to rise in 2017 from about 0.5-1.0% pts and a strong increase is unlikely. A decline in interest rates (if any) will only come in the mid and long term due to the following three reasons: ***(i) CPI could rise quite strongly (5.5-6.0%), (ii) winning interest rates of G-bonds tend to increase, and (iii) the government aims to stabilise interest rates***. Please note that looking solely at inflation, interest rates are expected to rise quite significantly but, as we previously pointed out, the correlation between inflation and the banking system interest rate is currently low, making this development unlikely. This also makes sense given the exchange rate policy and the government's priority to boost GDP growth.

Foreign exchange: VND will depreciate no more than 2% despite higher inflation and stronger US$, barring any big external shocks.

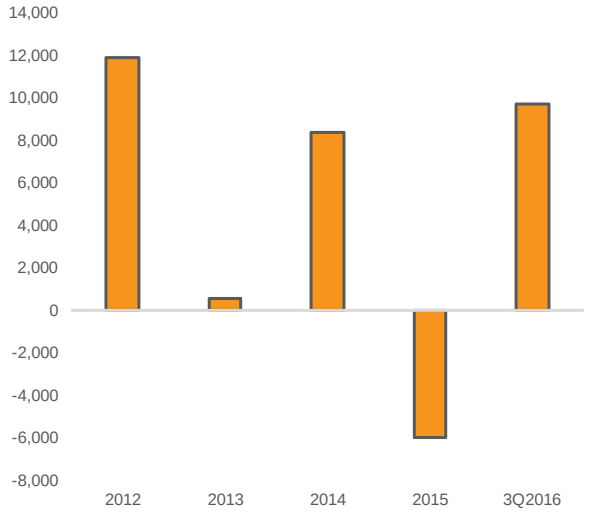
The foreign exchange rate remained roughly stable throughout 2016, proving our forecast at the beginning of the year right. Key reasons behind the stable rate are: *(i) strong macro fundamentals, including well controlled inflation and surplus balance of payment, which are key to foreign exchange moves, and (ii) a new exchange rate mechanism, discouraging investors from speculation.*

USD/VND in 2016



Source: Stoxplus, VNDIRECT

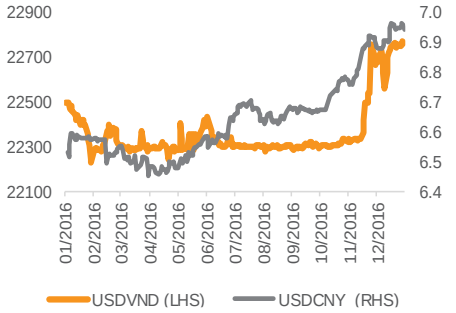
Vietnam's balance of payment 2012-3Q2016 (USD bn)



Source: STOXPLUS, VNDIRECT

In addition to higher inflation expected in 2017, there are concerns that other global factors (stronger US$, further depreciation in the yuan, etc.) may cause the exchange rate to increase strongly this year (VND to weaken) which are understandable given the economy's high degree of openness. However, we find such concerns to be unwarranted for the following reasons.

USDVND and USDCNY in 2016



Source: Bloomberg, VNDIRECT

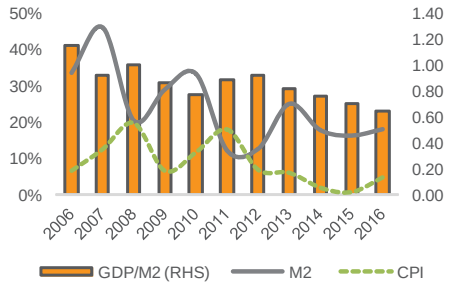
Following the Fed's tightening moves, there has been an outflow of short-term capital from emerging markets to the US. However, major capital inflows to Vietnam mostly come from FDI, which is stable, long-term and non-speculative, while short-term outflows from the US due to the Fed's QE did not come to Vietnam as the country's economy was undergoing a crisis back then. Thus, **Vietnam is unlikely to experience significant capital outflows once the Fed raises the interest rate, which was demonstrated in 2016 by the strong inflows, including FII.**

With regards to the **weakening of the yuan**, we reassert that this will have **negligible effects on Vietnam's foreign exchange market**, which was illustrated in 2016. Despite further depreciation of the yuan throughout the year, the VND was much more stable.

We expect the **exchange rate between the VND and USD in 2017 to remain stable within the 2% band** in 2017, barring any major shocks.

When will monetary policy be tightened?

Vietnam's CPI and M2 2006-2016

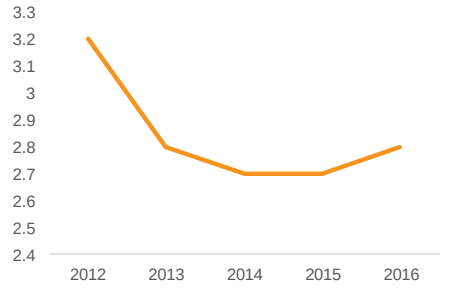


Source: GSO, SBV, VNDIRECT

Many investors and market observers are interested to find out **when monetary policy will be tightened**. We believe that the current policy stance will be maintained (for the first half of 2017) without sudden changes for two reasons: *(i) loosening monetary policy will help the government achieve the growth target, and (ii) the cycle of money is slow currently and therefore inflation derived from monetary policy is not significant yet (core inflation is currently at 2%).* However, we do **believe it is possible that monetary policy will be tightened in the second half of 2017** (according to our forecasts, GDP growth during the first six months of 2017 will be optimistic. Hence, we believe the probability of achieving the government's growth target of 6.7% is high. Therefore, reducing pressure on monetary policy to support economic growth will increase the prospect of monetary policy being tightened, especially when inflation pressure is higher).

7. Banking Industry outlook

NIM movements 2012-2016



Source: NFSC, VNDIRECT

Credit growth was 18.71%, with consumer credit expanding strongly by 39% to make up 11.4% of total credit. Within consumer credit, 50% came from the mortgage segment.

Capital mobilisation grew 18.38%, higher than 2015's 16.1%, out of which capital mobilisation in VND increased by 23% and foreign capital mobilisation shrunk by 7%. The main reason was the stark difference between interest rates in VND and US$. High growth in capital mobilisation allowed the LDR ratio to be stable compared to 2015 despite the fast credit expansion (2016 LDR: 85%).

Banking system activity continued to improve: According to the National Financial Supervision Commission of the Socialist Republic of Vietnam (NFSC), the profitability ratio in the financial institutions performed better in 2016 compared to 2015. PAT grew 26.8% and NIM reached 2.8% (increased 2.7% pts compared to 2015). Average ROA was 0.52% (2015: 0.4%) while ROE was 7.83% (2015: 5.7%).

Non-performing loans (NPL) reduced from 2.9% in 2015 down to 2.8% (by 29 Dec 2016, NPL was only 2.46%). Provision for NPL inched up 3.2% compared to 2015. DPRRTD/profit before provision ratio decreased from 62.5% in 2015 to 58.5%. Indeed, the ratios reflecting banking system quality improved significantly (especially NIM), helping the financial institutions boost their business performance during the next few years.

In 2017, pressure to increase capital will heighten as banks comply with Basel II standards, especially the four state commercial banks (Agribank, VCB, BID and CTG). According to recent reports, the CAR ratios in these four banks are maintained above 9% and are expected to lower to 8% when Basel II standards are applied.

It is possible there will be a new solution for bad debts in 2017. Hints from government officials suggest they are planning to use state resources to the resolve bad debt problem. This will be a policy breakthrough if it is true as the Vietnam government has so far not allowed state resources to be used to resolve bad debts.

Investment View: there are some highlights in the industry for 2017.

The implementation of Basel II standards will create pressure to raise capital for the 10 banks chosen by the SBV to participate in the pilot experiment, especially those with low CAR ratios, such as BID and CTG. Moreover, at this point of time, it is difficult for banks to achieve the target due to limited domestic capital, maximum foreign ownership (in the case of CTG) or no more room to increase Tier-2 capital (BIDV). These banks need to curb their credit growth in 2017 to ensure their

CAR ratios are within safe limits. Therefore, investment will flow to banks with relatively high CAR ratios, such as MBB, ACB and VCB.

The issue of increasing the foreign ownership limit may resurface. The implementation of Basel II standards and compliance with capital adequacy requirements according to the timeframe set by SBV (Sep 2017) will be a challenge for the pilot banks, especially for the two large banks mentioned above. Thus, we expect regulators to introduce supporting policies in 2017. Relaxing the deadlines for implementation or raising the foreign ownership limit in banks can be a solution. If these materialise, CTG will benefit the most.

Profit opportunity could come from banks that actively dealt with bad debts in previous years. By 3Q2016, a number of banks posted LLR ratios higher than 100%, giving them enough room to tackle bad debts. Thus, credit risk provisions may fall gradually in the coming years. VCB and ACB are two notable banks with declining risk provisions and growing credit. PAT growth in 2017 for VCB and ACB is estimated at 15% and 13%, respectively.

8. Real Estate Industry Outlook

Slowing growth. Swing to lower segment and lacking products.

Price and liquidity on positive track. According to the Vietnam National Real Estate Association (VNREA), the ASP in the primary market went up 5-7% while that in the secondary market rose 10-15%. Most of the market segments registered growth in both price and volume but we see some difference between Hanoi and HCMC. According to Savills, in 4Q2016, HCMC had 10,200 apartment units sold (+36% yoy) while villas and townhouses also reached record highs, up 55% yoy. In Hanoi, ASP of apartments and villas stayed stable amid a slowdown in sale volume.

Recently, credit growth for real estate has decelerated and shifted to the supply side. According to official statistics, FDI into the real estate market in 2016 arrived at US$1.52bn (dramatic fall from US$2.4bn in 2015). In 2016, credit for real estate increased 12.6% YTD (much lower compared to 28.3% in 2015). Circular 06/2016/TT-NHNN raised the risk index for real estate loans from 150% to 200% and reduced the ratio of short-term capital used for medium- and long-term loans. We suppose the circular has two aims: (i) reining in the mid and high-end segments' credit growth, which have higher percentage use of debts translating to risker credit system, and (ii) encouraging the market to switch to affordable apartments and public housing projects with low capital investment, thus avoiding a frozen market due to supply and demand imbalance. Meanwhile, consumer credit used for real estate development increased significantly (50% of consumer credit is used for real estate).

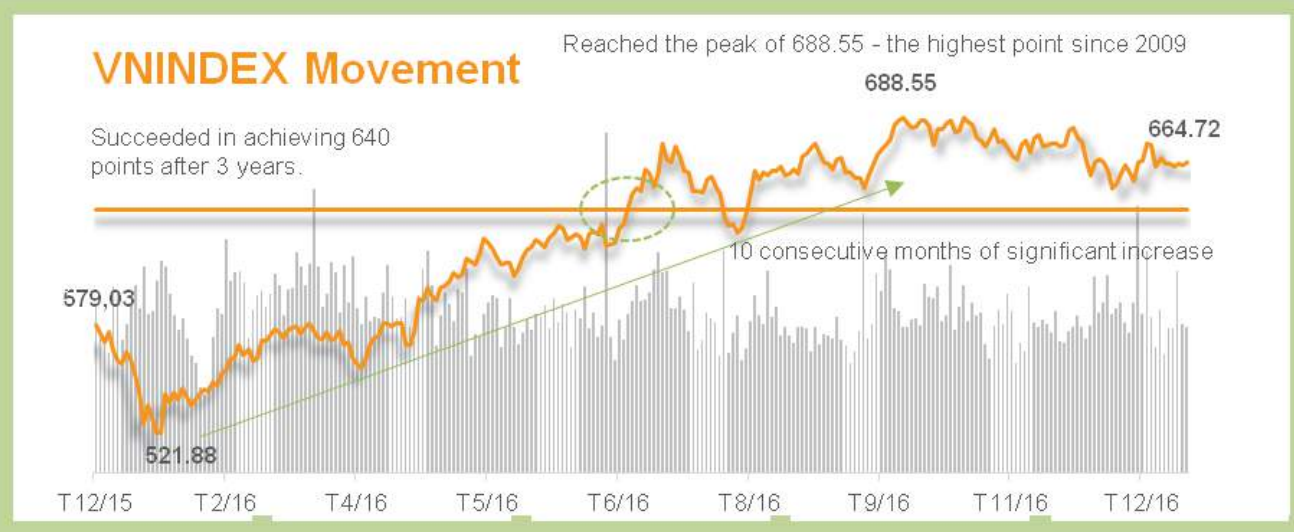
We maintain our optimistic view on the real estate market for 2017. Particularly, we believe the market will trade at high volumes, thanks to (i) the end of buyers' 'waiting sentiment' as 2017 is the peak time for most housing projects' hand-over , (ii) huge supply and participation of well-known developers into affordable housing segment will stablise prices after two consecutive years of rising since 2014. This will also help stabilise liquidity in the market.

On the other hand, we believe that ASP in the mid-high-end segment will not be significantly affected. Developers are completely capable of relaxing the selling schedule as small fluctuation in interest rate is anticipated and this is within the tolerance level of most developers.

Regarding affordable and public housing apartments, we predict a surge in open-for-sale volume and transaction volume, thanks to (i) a supply-demand imbalance as most market demand comes from this segment while its supply is only 20% of total market supply, and (ii) Circular 06/2016/TT-NHNN, which is aimed at encouraging the increase in supply for the segment.

In 2017, the real estate market will add low-rise housing products (such as land lots, townhouse, villas) and affordable apartments to meet real demand. Selling prices in the mid-high-end segment will vary. Apartment prices in the CBD area are falling while prices in prime locations with developed infrastructure are rising, especially in the eastern area of the city.

Investment view. For 2017, we prefer certain real estate stocks that possess some of these factors: a successful track record, large land bank in prime locations, new products suitable to real demand, large sales contract and a healthy financial status. Some of the notable stocks are: VIC, NVL, KDH, TDH.



VNINDEX Performed

14.82%

In 2016

2016 – Market review

Well performance...

HNX increased by 0.2%, UPCOMINDEX reached 9.6% higher.

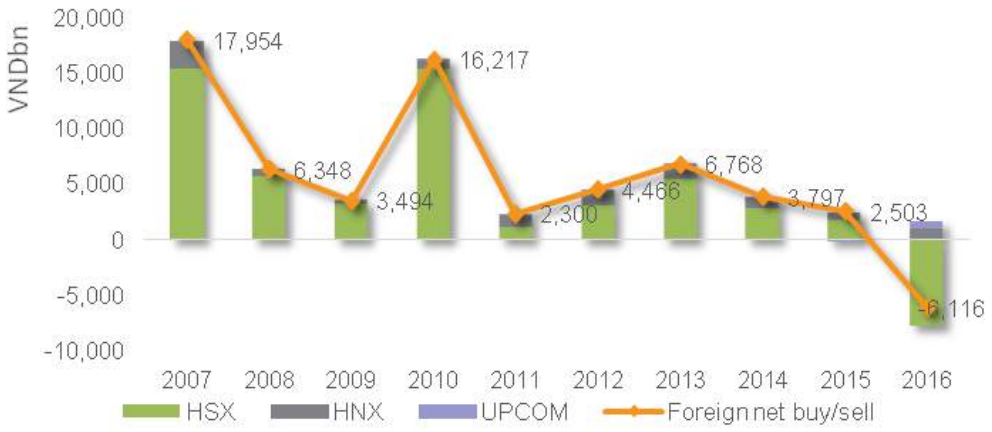
The most volatile stocks in 2016 in HSX and HNX

Top winners	Performance	Top losers	Performance
ROS	810.3%	TNT	-91.0%
SIC	591.2%	SGO	-85.1%
TV2	374.7%	TTF	-81.4%
DTL	273.2%	TSC	-81.1%
TLH	223.5%	HKB	-80.1%
KTS	222.6%	HNG	-78.5%
NKG	216.7%	DPS	-78.4%
SMC	213.1%	FID	-78.3%
DZM	197.4%	MBG	-78.1%
TMX	185.4%	KVC	-78.0%

The unfavorable introduction of VNXINDEX

VNXINDEX was introduced on October 24th, 2016, calculated based on price data of 488 companies in HSX and HNX.

Foreign Investors net sold for the 1st time since 2007

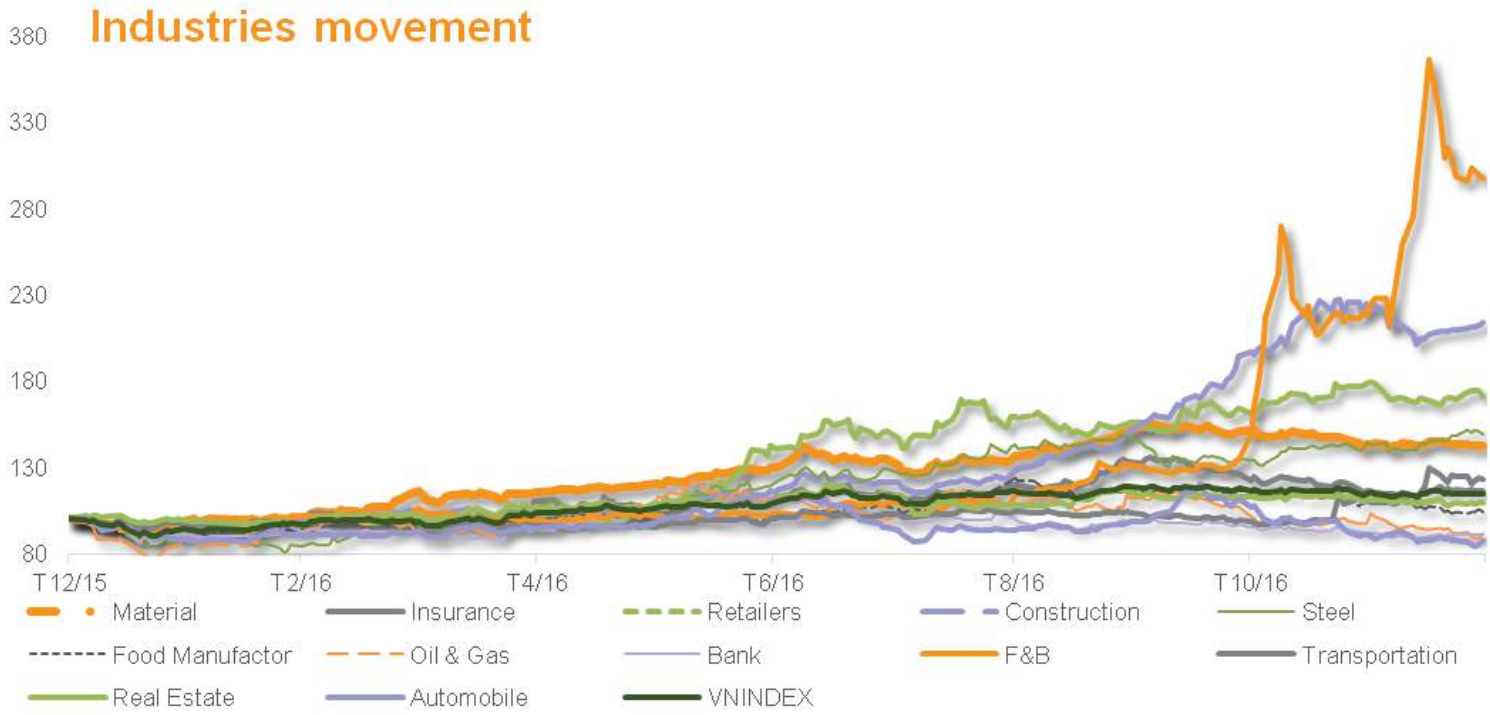


In general, the foreign investment flows still maintained net buy status. However, focus was shifted to FDI and Bond market instead of Equity market.

Top buy	Value (VNDbn)	Top sell	Value (VNDbn)
MBB	1,555	VIC	-7,187
CII	1,115	VNM	-2,244
GAS	898	HPG	-893
SSI	595	STB	-581
MWG	587	PVD	-478
PVT	396	CTD	-476
NT2	313	DPM	-467
EIB	262	HBC	-421
PVS	220	HSG	-404
HAH	202	BID	-387

… overcome many challenges

Industries movement

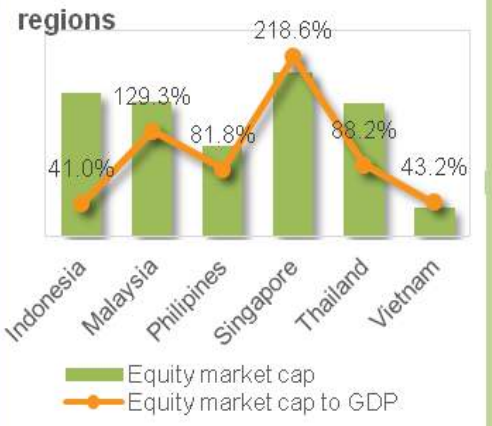


Market capitalization increased by **30%** in 2016

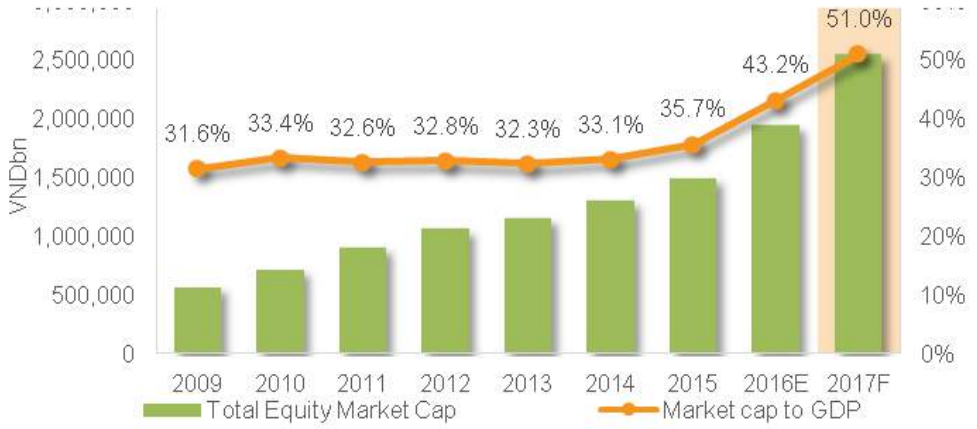
Market capitalization and competition landscape change due to the listing of large companies.

Equity market capitalization is **43.2%** of GDP

Market capitalization comparison of Vietnam and countries in regions



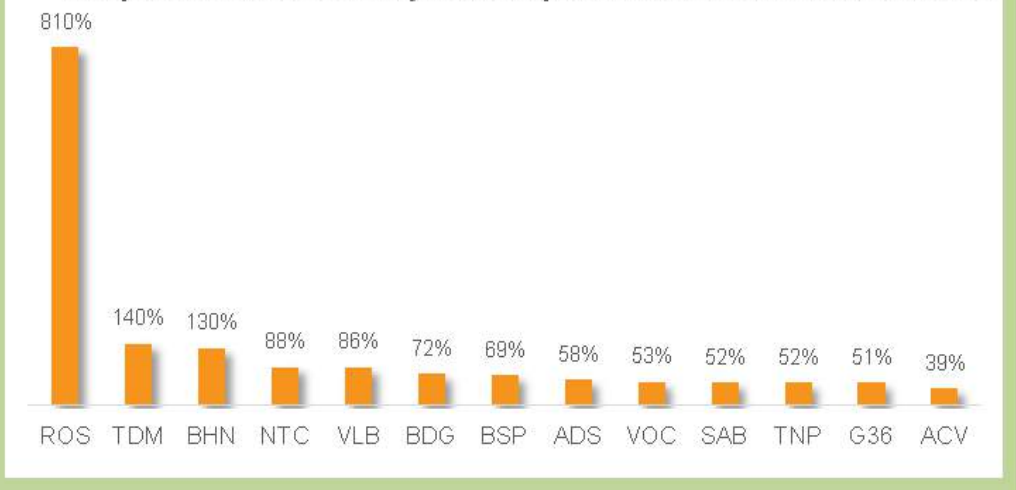
Growth of Market Capitalization



A huge change in market capitalization rankings; 3 newly listed stocks in 2016 entered the top 10 largest companies in 3 exchanges.

The significant increase in stock price of ROS, SAB contributed to the high demand for newly listed equities in the second half of 2016.

The performance of newly listed equities in 2016 since introduction



CHAPTER 3: VIETNAM'S STOCK MARKET 2017 – QUANTITY CHANGES, QUALITY CHANGES

1. Entrance of large companies

In 2017, we believe that the equitisation and listing roadmap of state enterprises will continue to accelerate. The Vietnam's stock market capitalisation will increase rapidly with the entrance of many large companies, such as Vietnam Airlines, Vietjet, Petrolimex, Vinatex and Masan Consumer. We forecast market capitalisation will expand to 51% of GDP as at the end of 2017.

List of large companies that will be listed in 2017

Company	Industry	Expected time of listing	Chartered Capital (VND bn)	Estimated market capitalization (VND bn)
Viwasupco	Construction	No official information	500	2,000
Thaco	Automobile	In 2017	4,145	85,527
Petrolimex	Oil & Gas	1Q2017	1,370	10,363
Veam	Automobile	In 2017	13,288	19,000
Vietjet	Airlines	Feb 2017	1,450	22,600
PV Power	Utilities	No official information	13,078	27,000
BSR	Oil & Gas	No official information	35,000	35,000**
PV Oil	Oil & Gas	No official information	10,884	10,884**
Mobifone	Telecommunication	No official information	15,000	83,200

Source: VNDIRECT

* Our projection is based on accessible information so as to estimate market capitalisation. Hence, the table above should be used only for reference and not advisory, valuation and investment recommendations.

** Due to the lack of input, we estimated capitalisation using the company's authorised capital.

In addition, the divestment roadmap of SCIC in some well-known enterprises, such as Nhua Binh Minh (BMP), Nhua Tien Phong (NTP), FPT Telecom (FOX) and Vinaconex, will be a hot topic at stock forums in 2017.

Tentative Divestment List of SCIC

No.	Ticker	Company	State's Ownership
1	BMI	BaoMinh Insurance Co.	50.7%
2	VNR	Vietnam National Reinsurance Co.	40.4%
3	HGM	Ha Giang Mineral and Mechanics JSC	46.6%
4	NTP	Tien Phong Plastics JSC	37.1%
5	VIID	Vietnam Infrastructure investment & Development JSC	47.6%
6	BMP	Binh Minh Plastics JSC	29.6%
7	VNM	Vietnam Dairy Products JSC	39.3% (*)
8	FPT	FPT Corporation	6.0%
9	SGC	Sa Giang Import Export Co.	45.1%
10	FOX	FPT Telecom JSC	50.2%

Source: VNDIRECT

(*)The effect of shares auction in December 2016 already included.

Number of shares listed and market capitalization

Source: VNDIRECT

The number of enterprises with market capitalization above USD1bn in the stock market over the years

Source: VNDIRECT

2. Market capitalisation: Larger size changes the competitive landscape

The change in quantity leads to the change in quality: Significant growth in both volume and value of capitalisation generates new impetus for market growth.

- **More diverse market:** With a series of newly-listed stocks, such as Habeco, ACV, Sabeco and Vietnam Airlines, the Vietnam stock market is filled with high-quality choices that serve the diverse demand of domestic and foreign investors.
- **Greater attractiveness to foreign investors**: Larger market capitalisation either increases the chance of Vietnam's market being elevated to emerging market status or attract top-notch international investment funds.
- **Market cash flow reallocation:** The appearance of large newly-listed companies, such as Sabeco, ACV, Vietnam Airlines and Habeco will significantly affect investors' strategies and investment portfolios, especially the ETFs.
- **Market revaluation resulting from the emergence of substitutes:** The current ranking of stocks in the market in terms of size will be changed due to the listing of many large companies. Thus, existing stock valuation (especially the blue chips) can be affected when investors have more options.

3. Market Trend Projection:

We believe the stock market in 2017 will go through three main stages:

Stage I – Inspiration: Investors will witness an increase in price beginning in the middle or the end of the first quarter, which could create a medium peak in the beginning of 3Q. It will be the result of:

- Positive macro-economic growth especially GDP, in the first half of 2017.
- Inspiration generated from the consistent introduction of newly-listed stocks in the first half of 2017.

Stage II – Appearance of risk: After reaching a peak in 3Q, the market will remain stable until the end of this quarter and there is a possibility of a downward trend in 4Q. The potential risks underlying this forecast are:

- Tightening of monetary policy in second half of 2017.
- An increase in inflation at the end of the year. 2017 inflation rate could reach 5.5-6%.

Stage III – Short-term recovery: The downward trend may end in mid-December and there will be a short-term recovery at the end of 2017.

We do not have an index target as VNINDEX may be influenced by the entrance of large newly-listed companies. However, we expect a low free-float rate.

4. Investment opportunity in 2017

In addition to investment opportunities in the banking sector mentioned above, we also advocate an investment strategy based on two main ideas.

a. Industries that benefit from growth of the economy

The building materials, steel, consumer goods, auto and retail industries will have a positive outlook. They will benefit the most from GDP growth and optimistic consumption and investment.

The revenue growth prospects of **building materials and steel** are underpinned by the boost in direct investment, especially infrastructure investment. In addition, **consumer goods** tend to be more elastic in lockstep with changes in personal income and domestic consumption.

b. Are there opportunities for the forgotten industries?

Business performance of oil and gas will observe a widespread decline. The year 2016 was a particularly difficult year for the oil and gas sector as oil prices fell and remained at a low level for three consecutive years, leading to a reduction in industry revenue and income (-22.5% yoy and -7.5% yoy, respectively, in the first 9 months of 2016).

Regarding the **fertiliser industry**, the domestic market encountered difficulties due to oversupply, substandard/counterfeit products and ineffective tax policies. It led to a downturn in fertiliser companies' income within 1-2 years. Additionally, El Nino, which lasted over 2015-2016, affected demand.

Overall, poor business performance has led to a downturn in stock prices, causing them to be undervalued. **However, we believe these could become attractive investment opportunities if clear and effective catalysts appear**, such as:

- Oil prices rising higher than our forecast in 2017. If oil prices soar above the average price of US$60/bbl, PVN will be able to continue their exploration, exploitation and investment activities. Accordingly, business performance of companies in this industry can improve (our 2017 oil price forecast is approximately US$53.5/bbl).
- Fertiliser output and prices increasing sharply in 2017, thanks to a recovery in agricultural production and protectionist measures for the fertiliser market (aggressive crackdown on counterfeit and substandard products as well as adjustments in VAT policy applied to fertilizer).

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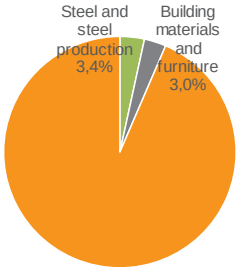
CHAPTER 4: INDUSTRY PROSPECTS

1. Buiding Material Industry: Real estate and infrastructure construction as growth drivers

Building materials industry market cap vs total market cap



Source: VNDIRECT

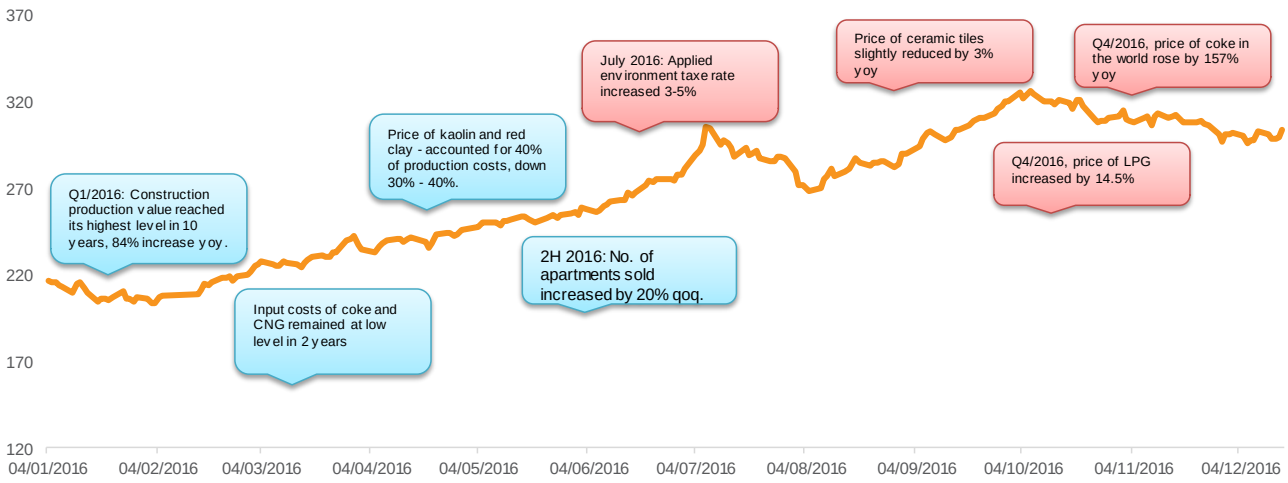
The building materials industry, in the scope of this paper, is comprised of two groups of small industries: (1) building materials and furniture (brick, building stone, concrete, cement), and (2) steel and steel production. As at 28 December 2016, total market capitalisation for the industry reached VND116tr, accounting for **6.4%** of total market capitalisation.

Demand for building materials comes with the cycle of real estate projects while competition in the market depends on demand-supply relationship and, most notably, competition with Chinese products.

FY 2016: Positive growth as a result of lower input costs and increasing demand

In FY2016, the building materials industry index increased by 40% yoy, 15% higher than the increase in the VNINDEX yoy. The index peaked at 326.53 (+50.1% YTD) on 6 October 2016. CVT and PTB recorded the highest growth rates, with returns of 125% and 101%, respectively.

Factors that affected price index fluctuations of building materials industry in 2016



Source: VNDIRECT

Industry's revenue growth in 2016: 14.6% yoy; Industry's PAT growth: 15.8% yoy.

We will divide the industry events happening during 2016 into two main parts: the first phase of 1Q and 2Q/2016, where net margin reached its highest five-year level at 18.5% on average. However, in 3Q/2016, the second phase, the increase in the price of raw materials and the drop of selling prices led to a reduction in the industry profit margin to 17.6%.

The industry's positive growth stemmed from the following factors:

Recovery of real estate and construction market: the demand to complete real estates projects pushed construction production value to its highest level in 10 years, an increase of 7% in 2016. Therefore, building material demand increased 12% in 2016.

Investment in infrastructure continued to grow. According to BMI, investment in infrastructure increased by 6.8% in 2016, in which the road sector saw robust growth of 10.8%. Large-scale projects, such as the North-South highway Danang-Quang Ngai segment, the expansion of National Road No.1A, the Trung Luong-My Thuan

expressway and the metro no.1 project, drove the consumption of construction stone in 2016 up by an average of 8%.

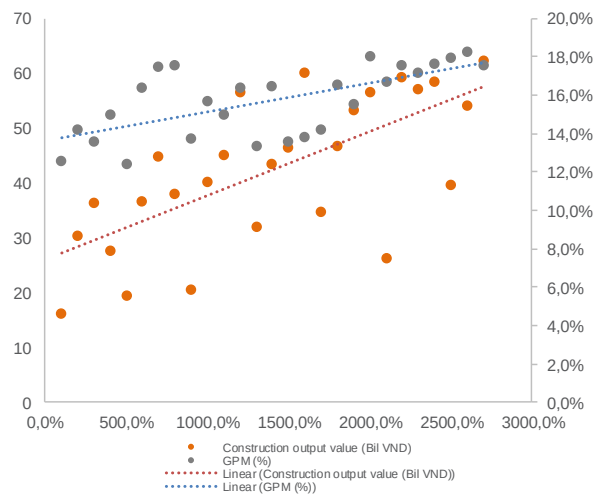
Input costs declined in the first half of 2016. The price of kaolin and red clay, accounting for 40% of production costs, slumped 30% yoy. At the same time, coal, the main material for some factories that produce ceramic and porcelain, and compressed natural gas (CNG) for other factories of Viglacera, accounting for 20% of production costs, remained at a low level for two years. Thus, the average gross profit margin of the industry increased 4.5% yoy from 17.2% in 2015 to 17.9% in 2016.

Sale price of ceramic tiles in the last 6 months of 2016 decreased by 3-5%. As the real estate market showed signs of slowdown at the end of the year, there were very few new units, with the majority coming from new projects. Therefore, the completion period for the majority of upcoming supply will be 3Q/2017. At the same time, some firms' double-expanded plants commenced operation in the second half of 2016 while older plants increase utilisation rates to the maximum, leading to a slight price reduction. Thus, year-end sale prices of ceramic tiles dropped 3-5% qoq on average.

Building materials index and PE historical

Source: Stoxplus

GPM (%) and Construction output value



Source: GSO

Prospects for 2017: Maintaining growth momentum, thanks to increasing demand.

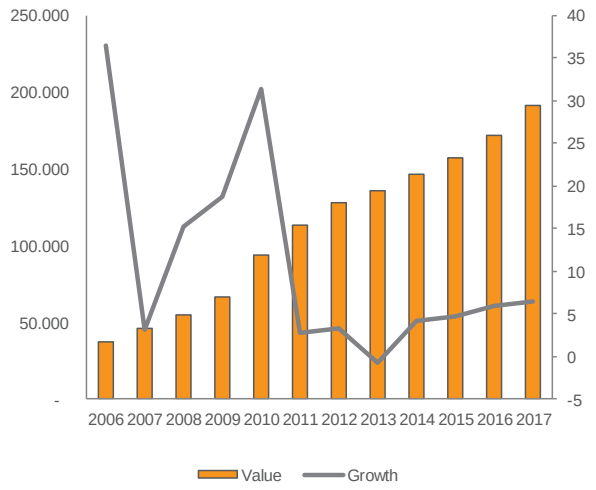
We forecast revenue growth in 2017 to be 11.7% yoy, mainly coming from increasing sales volume and unchanged selling prices. EAT growth of the whole industry is projected at 9.8% yoy due to the negative impact of raw material price recovery, pushing the gross profit margin down to 2%.

We assess that the ceramic tiles and building stone industry in 2017 still has growth prospects despite some potential risks, as below:

Positive driver #1: Demand is expected to grow 11.7% yoy. According to BMI, construction production value is projected to grow 5.8% yoy in 2017. CBRE also said that the mid-range segment will continue to grow and new projects will be completed in the second half of 2017. Running a regression model between the number of new housing and demand for ceramic tiles, we find that correlation between these two factors is at a substantially high level of 0.89, i.e. a 1% increase in the number of new housing will lead to a 0.89% increase

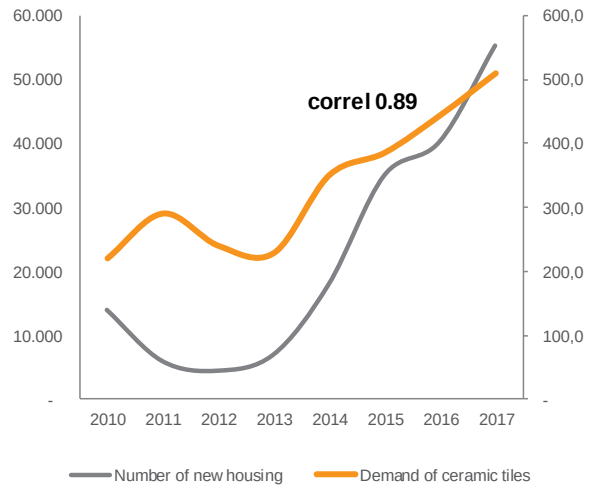
in the demand for ceramic tiles. Therefore, we expect demand for ceramic tiles to expand 11.7% yoy in 2017.

Construction industry value (bil VND) and growth (%)



Source: BMI

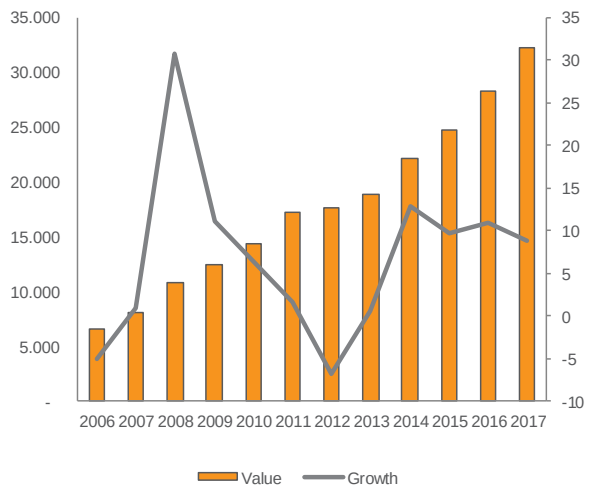
Correlation between number of new housing and demand of tiles



Source: VNDIRECT

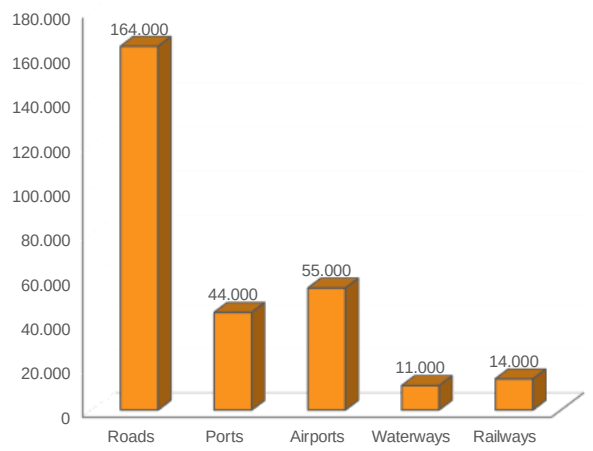
Positive driver #2: Building stone sector to continue to grow, thanks to infrastructure projects, at an average rate of 10% pa. We believe infrastructure construction activity will increase in 2017, with investment expected to climb 6.4% yoy, according to BMI. Simultaneously, based on the governmental's development plan for construction materials till 2020, demand is expected to surge 44.5% in the period 2017-2020. At the same time supplies are predicted to shrink as the right to exploit mines near the center expires and these mines are also included in the urban development plan. The building stone sector is projected to grow by 10% yoy in 2017.

Roads and Bridges Infrastructure Industry value and growth



Source: BMI

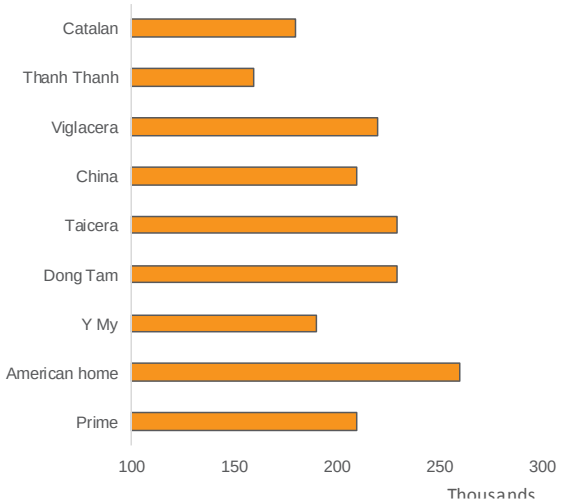
Investment of infrastructure value 2016 - 2020



Source: Ministry of Construction

Positive driver #3: The domestic tile industry is still being protected by the government. Import tariff of building brick and tile in the Asean-China FTA (ACFTA) remain at 20% for the period 2016-2018, protecting the industry from Chinese competitors, which make up more than 50% of total imports of brick and tile into Vietnam.

Product price comparison



Source: VNDIRECT

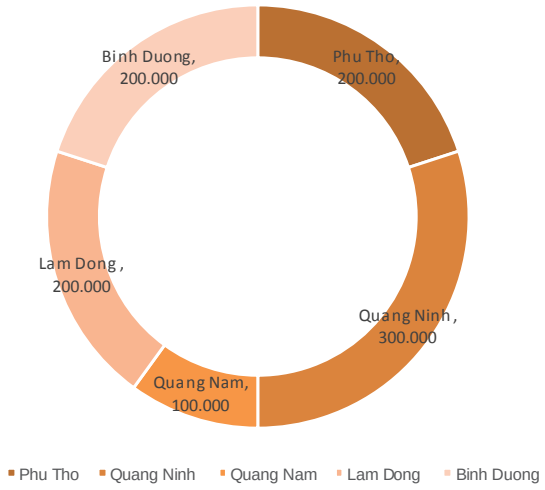
Import tariff of building brick and tile, 2016-2018

Tax	Tax rate			Circular
	2016	2017	2018	
ASEAN (ATIGA)	5%	5%	0%	Decree 129/2016/NĐ-CP
ASEAN - China (ACFTA)	20%	20%	20%	Decree 128/2016/NĐ-CP
ASEAN - Korea (AKFTA)	10%	10%	0%	Decree 130/2016/NĐ-CP
ASEAN - Japan (AJCEP)	20%	18%	15%	Decree 135/2016/NĐ-CP
ASEAN - Australia New Zeland (AANZFTA)	7%	5%	0%	Decree 137/2016/NĐ-CP
ASEAN - India (AIFTA)	22,50%	20%	15%	Decree 136/2016/NĐ-CP

Source: Board of customs

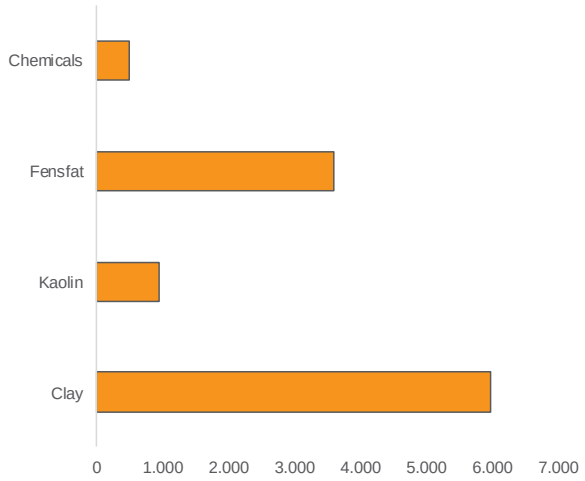
Positive driver #4: Supply of main raw materials, feldspar and clay, are sufficient in long term. The main raw materials to produce tiles are kaolin and fensfat brick, which account for 40% of production costs for ceramic tiles and granite. According to the government's development plan for construction materials till 2020, kaolin production is planned in 5 key areas, Phu Tho, Quang Ninh, Quang Nam, Lam Dong, Binh Duong, and fensfat in Phu Tho, which ensures a stable source of materials for the production of ceramic tiles.

The governmental development plan of kaolin till 2020



Source: Decision 1469/QĐ-TTg

Demand for materials ceramic tiles, ceramics 2020 (thousand tons)

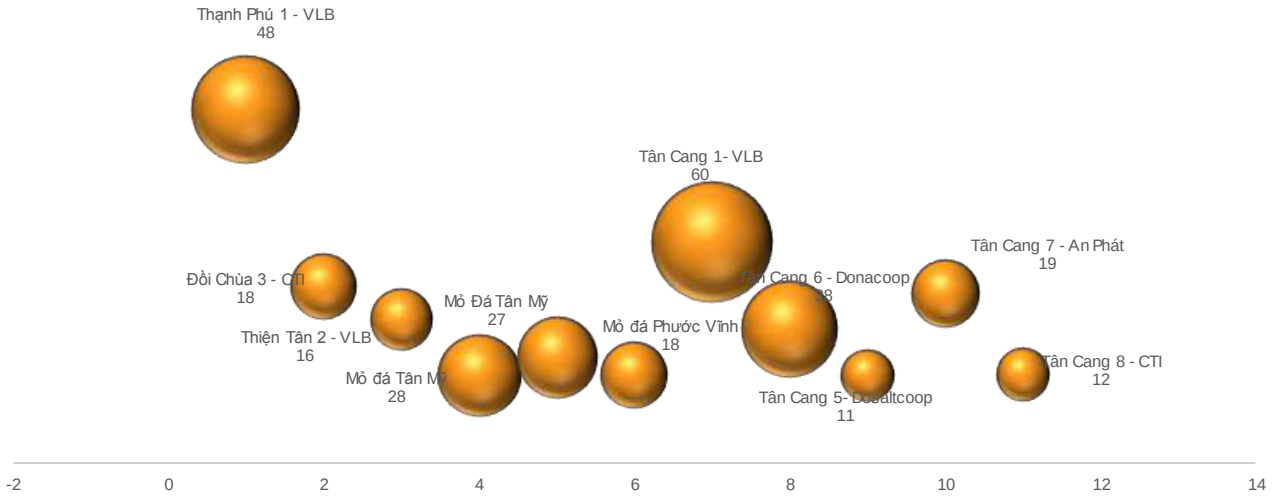


Source: Decision 1469/QĐ-TTg

Positive driver #5: High barriers to entry. VNDIRECT assesses that barriers to entry are relatively high as (1) central mines have been closed and there are no alternative mines at this location, and (2) the acquisition cost for a new quarry is extremely high due to the costs of auctioning for mining rights, site clearance compensation, etc. Simultaneously, in the period of 2017-2020, quarries in Tan Cang and

the Thanh Phu cluster will see high growth in its sales volume, thanks to infrastructure projects in the southeast region, including some by firms such as Cuong Thuan Idico (Ticker: CTI), Bien Hoa Material Construction (Ticker: VLB) and Hoa An Stone (Ticker: DHA).

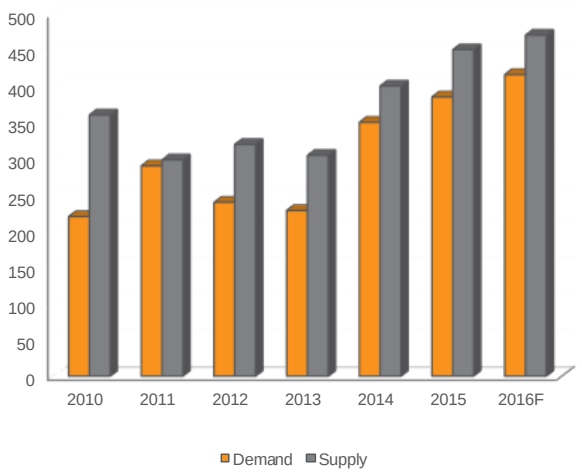
Largest construction stone quarries Southeastern (million m3)



Source: VNDIRECT

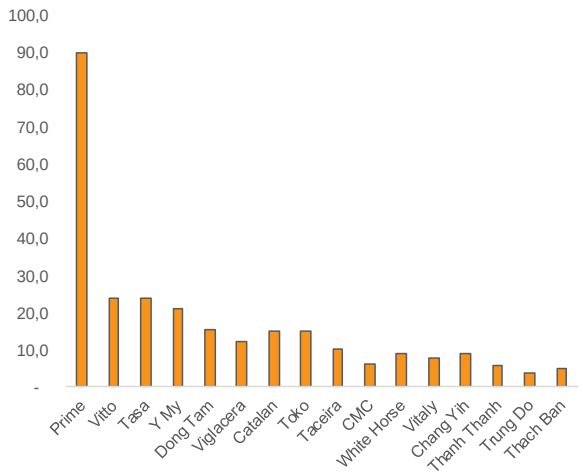
Risk #1: Intense competition in ceramic products as many firms expand aggressively. In 2015 and 2016, numerous enterprises expanded capacity, including some FDI firms, lifting supply from 300m m^2 to 450m m^2. We are concerned that this could result in an oversupply, which could lead to a situation akin to that of 2011, where firms competed in terms of price and inventories rose. However, to control this risk, the government has advised, based on its plan for construction materials till 2020, against building any additional ceramic plants and to focus on expanding capacity for granite production.

Total supply and demand for ceramic tiles sector (million m^2)



Source: VNDIRECT

The capacity of the factory bricks (million m^2)



Source: VNDIRECT

Risk #2: Increased fuel costs. In late-2016, the prices of some commodities sharply increased, with coal and LPG in the world market growing by 154% and 15%, respectively. Thus, we believe that a fuel price jump will affect the business of ceramic tiles when output prices

have hardly increased. We estimate that every 1% increase in fuel costs will reduce ceramic tile firms' gross profit margin by 0.2%.

The hike in resource tax rate from 7% to 10% for building stone and the calculation of taxable price based on selling prices will cause production costs to rise 15% in 2017. Nevertheless, these firms can make their customers bear the costs if demand is projected to increase.

Investment Recommendation

We are sanguine about the growth potential for ceramic tiles and building stone in 2017 given the prospects and risk above. We recommend investor consider Viglacera Corporation (VGC), Cuong Thuan IDICO Investment and Development JSC (CTI) and Bien Hoa Construction and Building Stone Production JSC (VLB).

#1. VGC – Viglacera Corporation

We like this firm as it is a leading enterprise in the construction materials industry and we also believe business activity will grow rapidly after 2018, mainly on the back of glass and granite production. In addition, the company's divestment firms that produce red bricks can be positive when the majority has been provisioning and prices are above par. Thus, in the long term, our target price for VGC is VND20,400/share, based on DCF.

#2. CTI – Cuong Thuan IDICO Investment and Development JSC

CTI has the advantage of owning a closed value chain, ranging from inputs (quarries, hot asphalt) and finished products (concrete pipes) to construction activity and five build-operate-transfer (BOT) projects in Dong Nai. Thanks to its closed value chain and favourable location, the firm is expected to benefit from the construction of the Long Thanh airport. Thus, based on the NPV method, we value CTI at VND37,400/share.

#3. VLB - Bien Hoa Construction and Building stone Production JSC

We like the fact that its Tan Cang 1 and Thanh Phu 2 quarries have the largest reserves in the southeast region. It should simultaneously benefit from the growth in the infrastructure sector. Based on NPV valuation, we value VLB at VND45,000.

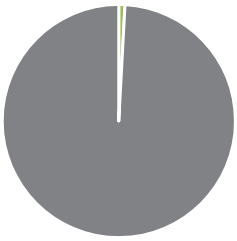
Stocks in the spotlight for 2017

	Market measures					Growth ratios		Operating ratios		2017E		
Ticker	Current price	Market cap (VND bn)	PE	PB	Div yield	9M2016 Revenue growth	9M2016 Net income growth	Gross margin	ROE	Revenue growth 2017	Net income growth 2017	EPS
CTI	25,500	1,096	9.2	1.6	6%	40.8%	213.0%	32.1%	14.5%	-2.0%	27.4%	3,244
VGC	15,800	1,027	9.6	1.2	5%	-1.7%	49.2%	24.8%	12.7%	13.9%	10.1%	1,279
VLB	35,000	1,573	15.4	2.7	0%	17.0%	65.6%	31.8%	22.6%	15.0%	20.0%	3,200

Source: VNDIRECT

2. Steel Industry: Revenue to continue to grow

Steel market cap vs total market cap



Nguồn: VNDIRECT

The steel industry supplies raw materials to several sectors, such as construction, engineering and machinery. The main products include reinforced steel bar (rebar), steel sheets and steel pipes. Industry leaders include HPG (rebar), HSG and NKG (galvanised steel plates).

In 2016, total consumption of steel products could reach 12m tonnes. Rebar accounts for 53% of total consumption while steel plates and steel pipes make up around 30%. 90% of rebar is domestically produced and the remaining is mostly imported from China. Regarding steel plates, 50% of the domestic demand is fulfilled by regional products.

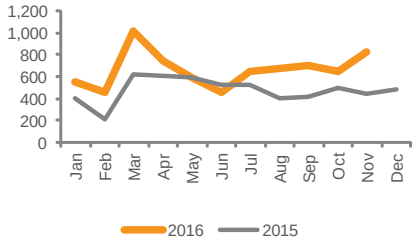
The majority of Vietnam steel makers do not own production process that utilizes iron ore. They have to import semi-processed products, such as steel billets, HRC and scrap metal. China, the biggest supplier of these products, accounts for 60% of steel imports in terms of volume. HPG is the only steel maker that owns a complete steel complex, including blast furnaces and rolling mills.

The production capacity of domestic factories is sufficient to meet the rising demand for rebar coming from the construction industry. In contrast, the majority of hot rolled steel used in engineering and machinery is imported. The largest steel provider to Vietnam is also China, making up 60% of annually imported volume.

FY 2016: Escalating sales, impressive earnings

- Revenue: VND84,079bn, +7% yoy
- Net profit after tax: VND26,326bn, +82% yoy

Sales volume of rebar (m tonnes)

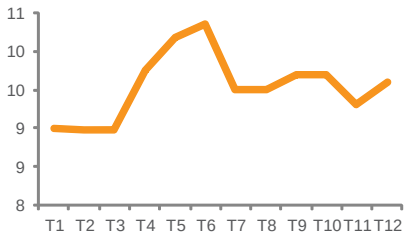


Source: VSA

YTD sales volume at the end of November 2016 reached 7.3m tonnes (+23% yoy). Monthly sales volumes peaked in March due to the application of the protection tariff on rebar. Monthly sales subsequently plummeted in mid-Jun as distributors had stocked enough inventory. Near the end of the year, sales volume rose again as developers pressed on with construction progress and as distributors amassed inventory to catch the steel price rally in South East Asia.

Sales volume of steel pipes and galvanised steel plates skyrocketed compared to 2015. At the end of November 2016, steel pipe sales reached 1.7m tonnes (+32% yoy) and galvanised steel plate sales reached 2.6m tonnes (+34% yoy).

Rebar price 2016 (million VND/tonnes)

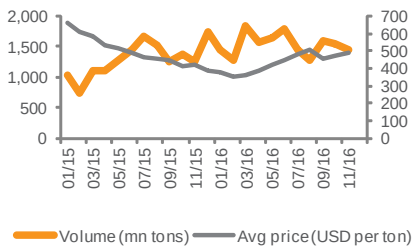


Source: FiinPro

YTD price level of rebar rose 7% to VND9.6m per tonne. There are two reasons behind the increasing rebar price: 1) Growing demand from the construction sector, and 2) Climbing regional rebar prices. Rebar prices hit its highest point in the second quarter as speculators hoarded inventory. Meanwhile, prices of steel plate dropped significantly due to the influx of Chinese products.

Import volume of steel products at the end of October was as high as 15.8m tonnes (+23% yoy). Chinese products accounted for around 60% of the total import volume. Specifically, imported rebar at the end of 3Q2016 grew to 440k tonnes (+99% yoy). It looks like the protection tariff on rebar is ineffective against the flood of Chinese products, which we believe is due to several reasons: 1) Distributors can replace tariff-bearing products with tariff-free substitutes, 2) Chinese manufacturers do not raise prices or cut production as tariff expenses increase, and 3) the renminbi has depreciated against the VND by 6% since January, making imported steel cheaper.

Steel import



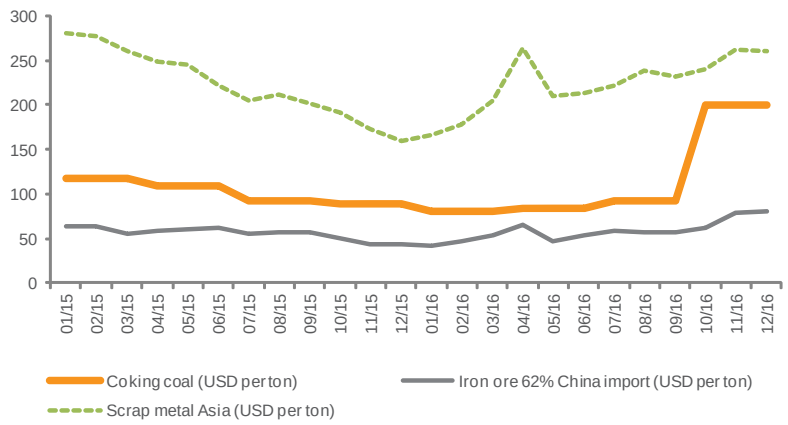
Source: Vietnam Customs

Metallurgical commodities rally heat up raw material costs. We believe the main reasons fuelling the rally are 1) anxiety over disruptions in the Chinese supply of coking coal, and 2) speculators. The commodities rally began as the Chinese government restructured the domestic coal mining industry to improve working conditions. Mining days per annum were reduced to 276 from 336. Moreover, floods in the mining regions of China and Australia created supply chain disruptions, adding fuel to the fire. Speculators played on these elements and hoarded coking coal to drive up prices. As a result, steel makers became desperate as blast furnaces cannot halt operations even for one day. Some Japanese steel makers had to signed quarterly contracts at prices as high as US$200 per tonne, three times higher than the lowest historical price in November 2015.

However, coking coal prices' elevated levels may not be sustained as the Chinese supply is still ample. According to the National Bureau of Statistics of China, coking coal production during the first nine months of 2016 declined by only 1.6% yoy. The inventory level of coking coal in major northern China ports and power plants has increased by more than 30% since August 2016.

The coking coal rally also led to an iron ore and scrap metal rally as these elements substitute/complement each other in steel production. The price level of iron ore and scrap metal has doubled since the beginning of the year. When the cost for coke becomes too high, steel makers could use iron ores with greater impurity, requiring less coke, and/or use more high quality scrap metal.

Commodities rally



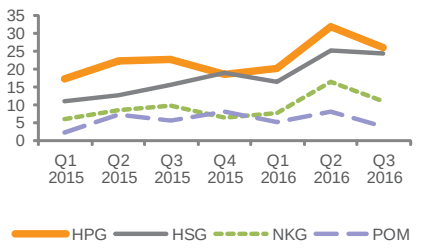
Source: Bloomberg

Operating results (9 mths 2016)

%Incr	Sales	GP	NPAT
Total	7%	18%	82%
HPG	15%	43%	58%
HSG	3%	61%	61%
NKG	65%	138%	341%
POM	-17%	-16%	547%
TIS	1%	36%	190%
TLH	23%	323%	192%
VIS	-1%	20%	-142%
TVN	-3%	-3%	166%
HMC	24%	152%	550%
DNY	9%	18%	167%
DTL	-16%	200%	-490%

Source: VNDIRECT

Gross profit margin (%)



Source: VNDIRECT

Majority of steel producers achieved positive net profit after tax (NPAT) growth in 9M16 through higher steel sales and by using cheap inputs stocked up from end-2015 to early 2016. Gross profit climbed 18% due to decline in input prices from end-2015 to early 2016. 9M16 NPAT jumped by 82% yoy.

Hoa Phat Group (HOSE: HPG)

In 9M2016, HPG accomplished VND23,709bn revenue (+15% yoy) and VND4,656bn NPAT (+58% yoy). We think that 2016 revenue and NPAT may be even higher as sales volume in 4Q surpassed 3Q by 35%. According to our view 2016 sales of steel could reach 1.8m tonnes (+34% yoy). HPG's main revenue growth driver in 2017 will be the completion of its third steel mill on 3Q2016 which will boost its construction steel capacity by 57%, i.e. from 1.4m tons p.a. to 2.2m tons p.a.

Hoa Sen Group (HOSE: HSG)

In FY2016, HSG's NPAT surged 61% yoy to VND1,054bn. However, revenue only edged up 2% yoy to VND18,006bn with 1.2bn tons in sales volume. The average selling price was depressed as Chinese steel plates flooded the market. Even so, NPAT increased strongly as HSG had cheap inventory stocked up in the beginning of 2016.

In our view low price inventory is currently sufficient for production in 1Q2017. This is HSG's competitive advantage as hot rolled coil (HRC) price has increased by 30% since Oct 2016.

Nam Kim Group (HOSE: NKG)

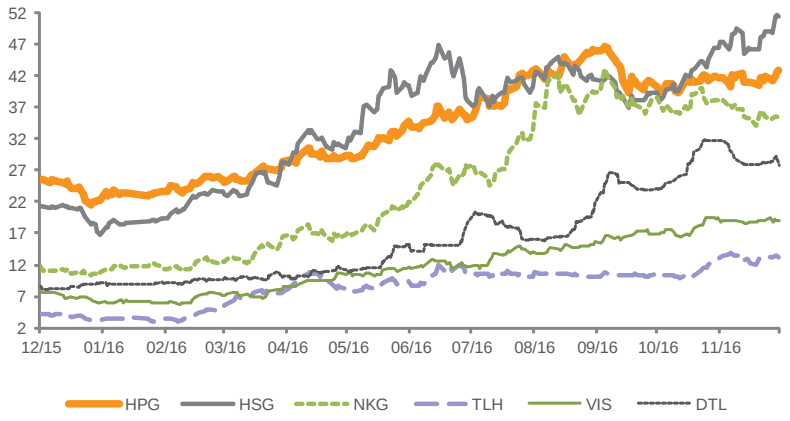
In 9M2016, NKG's revenue rose 65% yoy to VND6,483bn and NPAT jumped 341% yoy to VND454bn.

Revenue growth came from the new cold galvanising facility in 2016 with capacity of 300,000 tons p.a. NKG's total capacity of cold galvanised steel plates is now 560,000 tons p.a. In 2017, NKG's growth engine could be the new cold rolling facility which has a capacity of 450,000 tons p.a. The said facility will be operational in 1Q17. The total capacity of cold rolled sheets will be 950,000 tons p.a. in 2017.

Stock price performance

In 2016, steel stocks rallied as operating results improved. The share prices of several stocks, including industry leaders such as HSG and NKG, soared more than 100% in 2016.

Steel stock price chart (in VND thousand)



Source: Bloomberg

Industry growth prospects in 2017: Strengthening consumption and selling prices

- 15% revenue growth
- 16% NPAT growth

Revenue growth is mainly supported by: 1) rising sales volume as construction sector continues to grow, and 2) soaring selling prices as regional steel prices are improving. In our view, steelmakers such as HPG, HSG and NKG, who have spare capacity and have attained a certain level of economies of scales, could outgrow the market.

Commodity prices could stay elevated in 1Q2017. We believe that the coking coal rally is temporary as there has not been any permanent shift in global demand and supply. This could impair gross profit margin in 1Q2017 as steelmakers are unable to transfer the 100% increase in raw material cost to customers. At the moment, the ongoing rally in coking coal and iron ore prices has not affected steelmakers' gross profit margin because steelmakers had fixed quarterly contracts before the price rally. Steelmakers who are the most vulnerable to changes in coking coal and iron ore prices are blast furnace operators, as well as steel billet and HRC importers. We think that electric furnace operators are less vulnerable as the scrap metal price lags behind coking coal and iron ore prices.

Protectionist tariff policy on steel plates could be extended. The policy was effective since 15 Sep 2016 and lasts for 120 days. The tariff ranges from 4% to 38%. The policy aims to protect domestic steel plate makers from Chinese competitors. We expect the duration to be extended in the same way as the protectionist policy on long steel was. This could greatly improve gross profit margin of steel plate makers such as HSG and NKG.

Investment Recommendation

The average P/E TTM of the industry is as high as 39x. This is because several companies have low EPS.

However, industry leaders such as HPG and HSG still maintain attractive valuation multiples. HPG is trading at 5.6x 2017 P/E while HSG is trading at 5.1x 2017 P/E. These multiples are lower than the last 3-year average P/Es of HPG (7.8x) and HSG (8.2x). In our view, the two companies still have strong growth engines for the foreseeable future. We recommend that investors buy now or wait for the price correction at the beginning of 2017.

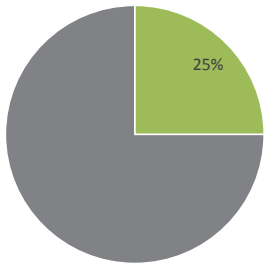
Stocks in the spotlight for 2017

	Market measures					Growth ratios		Operating ratios		2017E		
Ticker	Current price	Market cap (VND bn)	PE	PB	Div yield	Rev 1-yr growth	NPAT 1-yr growth	Gross margin	ROE	Rev 1-yr growth	NPAT 1-yr growth	EPS
HPG	43,250	36,365	6.9	2.0	4%	15.0%	58.5%	25.8%	32.6%	15.2%	11.8%	7,471
HSG	51,400	10,003	6.7	2.4	5%	2.9%	60.8%	23.2%	41.0%	13.0%	31,0%	10,031
NKG	35,300	2,305	3.7	1.6	NA	65.1%	340.8%	11.8%	56.2%	NA	NA	NA

Nguồn: VNDIRECT

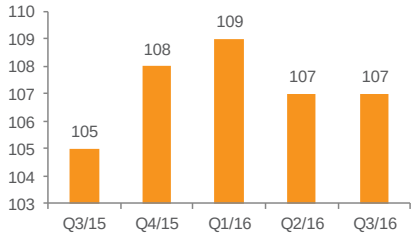
3. Food and Beverage Industry: Turning on the charm thanks to new listings

F&B industry market cap vs. total market cap



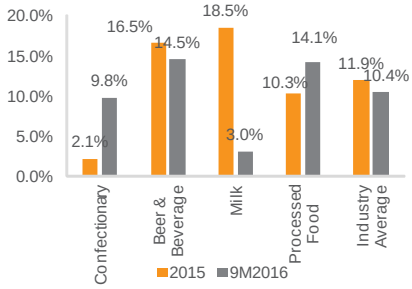
Source: VNDIRECT

Consumer Confidence Index



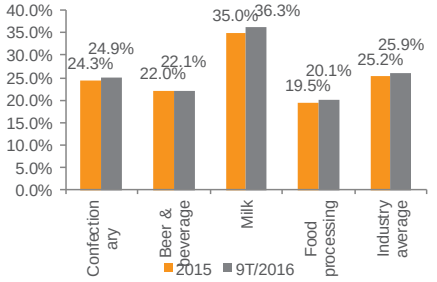
Source: AC Nielsen

Revenue growth by sectors (Confectionary)



Source: VNDIRECT

GM slightly improved in 2016



Source: VNDIRECT

Market capitalisation of F&B stocks on both HOSE and HNX is about VND378tr, accounting for 24% of market value of these two bourses. Including UPCOM, the total market cap of the F&B industry reaches VND445tr, equivalent to 25% of Vietnam's stock market value. The F&B industry can be classified into four categories: Beer & beverage, Milk, Confectionery and Food processing.

In our view, the F&B sector will become more appealing in terms of scale and qualitative terms when big producers such as QNS, SAB, BHN and VSN are listed.

2016: Listed F&B companies recorded double-digit growth

- 2016 revenue of listed F&B companies (including UPCOM) increased an average of 10.4%.
- Listed F&B companies' profit after tax rose 12.4% on average.

According to the General Statistics Office of Vietnam, the F&B industry in general witnessed a 12.6% increase in revenue in the first 11 months of 2016, which exceeded the retail sector's 9.4% revenue growth.

In 11M16, the CPI of the F&B industry, rose 2.75%, higher than the country's CPI of 2.47%.

According to Nielsen's latest report on Nov 2016, the consumer confidence index for 9M2016 reached 107 vs. 105 during the same period last year, indicating that Vietnam consumers are becoming more optimistic and are willing to spend more.

Given the general growth in the industry, listed F&B companies also flourished in 2016 with 10.4% yoy revenue growth and 12.4% yoy net profit growth on average.

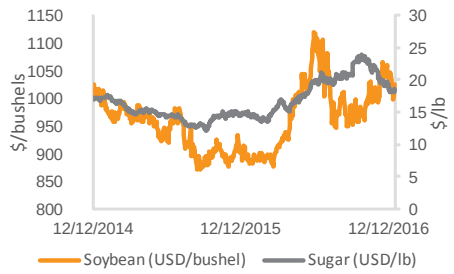
Gross profit margin improved slightly in 2016. In 2015, F&B sector benefited significantly from the downtrend in the prices of energy and commodities which almost hit a 5-year bottom. In 2016, changes in commodity prices started to differ: fuels, wheat and corn prices continued sinking while sugar, whole milk powder and soybean prices bounced back. Therefore, F&B sector's average gross profit margin improved slightly from 25.2% in 2015 to 25.9% in 2016.

Beer & beverage had highest revenue growth of 14.5% in 9M16. Gross profit margin of beer & beverage improved slightly due to a 10% yoy decrease in prices of malt, a beer ingredient, and aluminium, can manufacturing input. Vietnam's leading brewer Sabeco (SAB) reported VND21,890bn revenue in 9M16, up 9% yoy.

Sabeco's gross profit margin improved from 27.0% in 9M2015 to 27.6% in 9M2016 due to lower raw material prices and improved control of operating expenses; PBT reached VND4,510bn (+21% yoy).

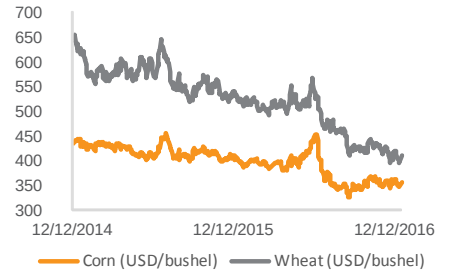
Despite cheaper raw material and better opex control, Habeco (BHN) posted 4.8% lower revenue and a 25% decline in net profit in 9M16 due to its subsidiaries' and affiliates' poor performances.

Sugar and soybean prices bounced back while..



Source: VNDIRECT

…wheat and corn prices keep declining



Source: VNDIRECT

The milk sector's revenue grew 3% in 9M16 which was far below the 18% growth same period last year mainly due to the weaker performance of QNS and HNM. Quang Ngai Suger (QNS) controls 85% market share of soya milk in Vietnam with 2 prominent brands Vinasoy and Fami. After a period of high revenue growth (average 20%) in 2012–2015, QNS showed sign of slowing down with 12% decline in 9M16 revenue, mainly due to the surge in soybean price amid the decrease in whole milk powder (WMP) price. Therefore, QNS had no choice but to lower its selling price to protect market share despite an increase in raw material price.

In contrast, VNM, the sector's leading company, met our expectation with an 18% yoy increase in revenue and 28% yoy rise in PBT in 9M16. VNM's gross margin improved from 40.6% in 2015 to 41% in 2016, thanks to the decline in the price of WMP in 1H16 and a higher proportion of premium products sold.

Food processing sector includes cooking ingredient producers (eg. CMF, MSN and TAC) and packaged food manufacturers (eg. KDC, SGC and VSN). In 9M16, revenue and net income of this sector increased 10.7% yoy and 6.8% yoy respectively, abnormal earnings arising from KDC's divestment of confectionery segment excluded.

Confectionery sector recorded a 6.7% yoy increase in revenue in 9M16 which was higher than the 2.7% growth in 9M2015. As flour (mostly wheat flour) and sugar account for about 60% of the sector's production cost, the fluctuations in sugar and wheat prices had a strong impact on the confectionery sector's profit. Since the beginning of 2016, sugar price showed an upward trend while wheat price sank to a 15-year low. Therefore, gross profit margin improved from 24.3% in 2015 to 24.9% in 2016.

M&A creates more opportunities for F&B equities. In 2016, several F&B companies resorted to M&As in order to gain market share or switch business strategy. After divesting their interests in the confectionery segment, KDC shifted its core business to packaged food and cooking condiments by acquiring a 24% stake in Vocarimex (VOC) and a controlling 65% stake in Tuong An cooking oil (TAC).

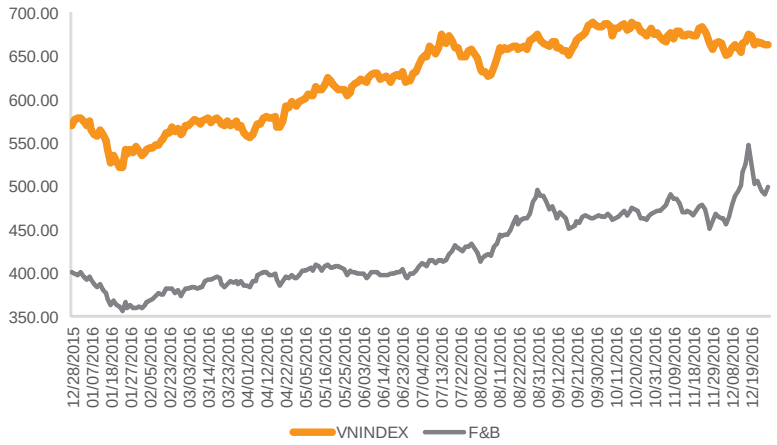
Thong Nhat Investment and Manufacture Joint Stock Company (GTN) expanded their operation to the agricultural products and food industry sector by changing its company name into GTNFoods and acquiring a controlling 75% stake in Vinatea and 12% stake of Vilico.

Recently in Jun 2016, Masan paid more than VND2,100bn to acquire a 24.9% stake in Vissan at average price of VND106,000/share.

Stock price performance

Up until now, the prices of F&B stocks in all three bourses surged 26% compared to early 2016. The share prices of confectionery stocks (including HHC and BBC) rose a remarkable 50% since early 2016. However, they drew less attention from the stock market due to their low liquidity levels. Notably BHN and SAB stocks hit the ceilings for several trading sessions following their listing, also helping equities from the industry's smaller companies increase in price.

F&B stock price performance in 1 year

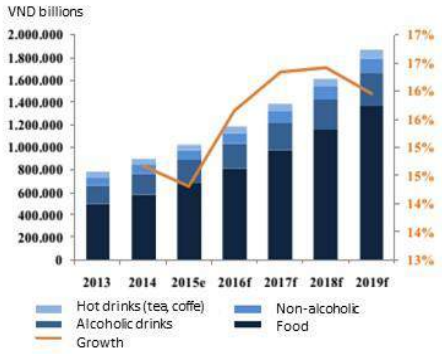


Source: VNDIRECT

2017: F&B sector to keep growing against the backdrop of macro stability.

- We estimate listed F&B companies' revenue to increase by 10% yoy in 2017.
- PAT is expected to rise by 14% yoy in 2017.

Forecasted F&B revenue grow at CAGR of 16.1% in 2016 – 2019.



Source: BMI

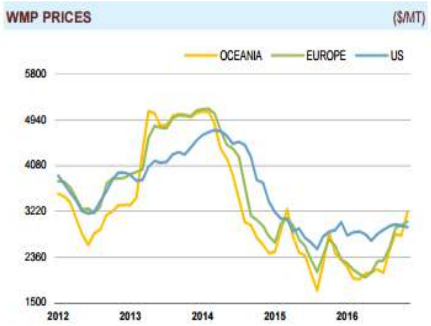
Vietnam's F&B industry as a whole enjoyed 12% CAGR in sales during the period 2010–2015. In 2015, the industry revenue increased 14.3% yoy to VND1,033bn, of which food was estimated to be VND690bn, i.e. 67% of the whole industry, beer and beverage sector were VND203bn, accounting for 19.7% of the F&B industry. We believe that in 2017 the F&B industry will still achieve double-digit growth against a backdrop of a stabilising economy, rising CPI, an expanding middle-class and improving consumer confidence

Production capacity expansion to continue in 2016–2017: Vinasoy (QNS) completed the construction of its 90m litres capacity milk factory in Binh Duong, which has started production in 4Q2016. KDC plans to open another instant noodle factory in South Vietnam in the future after setting up its first factory in Bac Ninh in 2015. In the same year, SAB also inaugurated a factory of 50m litres capacity in Vinh Long. These production capacity expansion projects show that F&B industry can still expect further revenue growth in the future.

However, F&B industry will have to face the pressure coming from energy and commodity price increase as well as the pressure to adapt quickly to changes in the retail business. Consumers' shopping preferences have shifted from traditional channels (street markets, mom-and-pop grocery stores) to modern channels (supermarkets, convenience stores, online stores). In addition, consumers are now more concerned about the quality and origin of products rather than the price. Therefore, we believe that there are opportunities for industry participants who are able to quickly develop "organic, higher quality" products, to adapt to the changing consumer trend while control rising costs.

We have a positive outlook on the beer & beverage sector, based on (1) increase in beer consumption per capita due to the rise in personal income, (2) room for further development for premium product segment, (3) government's divestment of its stake in leading companies (eg: Habeco, Sabeco) is expected to create more values for the companies and enhance their competitive advantages.

Whole milk powder (WMP) price has surged since mid-2016



Source: VNDIRECT

Risk of WMP price increasing further is fading away. After a 2-year downtrend, WMP price started to take off in 2Q2016. Until now, the price of full-cream milk has recovered about 50%, butter price increased by 50-70%, and the price of cheese increased by 30-40% from their troughs. The price of full-cream milk was around US$3,220/ton by the end of 2016. However, this price level is considered stable considering the large quantity of inventories in the industry, moderate demand for milk and low cereal price. Thus, we evaluate the prospect of the milk sector as positive due to the low possibility of WMP returning to its 2014 peak.

Confectionery sector – great prospects but weak competitive force. As KDC transferred all confectionery segments to Mondelez International and entered the processed food segment, there are only three listed companies, namely BBC, HHC and HNF (UPCOM). Although there is still room for growth, we evaluate the prospects of this segment as neutral because of the intensive competition among domestic enterprises, whose production and distribution remain weaker than their foreign rivals.

Investment recommendation

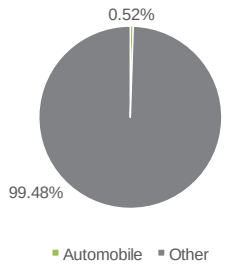
We believe F&B stocks will continue to improve in 2017, attracting more investors due to their large market capitalization and strong fundamentals. Our top pick is VNM as we believe it is now undervalued due to its recent share price underperformance. QNS, trading at 17x P/E (lower than VNM at 19x), is another outstanding stock as its price moves have become more stable since its listing on December 20, 2016.

Brewery equities, namely SAB and BHN, have stirred up the stock market with their continual share price increase since listing. SAB and BHN are currently trading at P/E of 37x and 34x respectively, many times higher than the average P/E of the F&B industry (15.8x) and the overall market (15.3x). These two stocks are also in our recommendation list. Nonetheless, we advise investors to be cautious of price heating amid low trading volumes as it could imply that a stock may be overvalued compared to its intrinsic value.

With average ROE of 18.5% and P/E of 15.1x, the processed food segment is at an attractive valuation level, in our view. However, the majority of profitable companies, namely SGC, CMF and SAF, do not have good liquidity.

4. Automotive industry: demand high, sales continue to improve

Automotive industry market cap vs total market cap



Source: VNDIRECT

According to the International Project Management Association (IPMA) Individual Competence Baseline 4th Version (ICB4), the automotive industry consists of automakers, importers and distributors. However, most of the listed automotive stocks on HNX and HSX are distributors. Currently, vehicles sales volume in Vietnam are divided into three categories: 1) passenger cars (PCs, having fewer than nine seats) -- Hang Xanh Motors Service (HAX) and Savico (SVC); 2) commercial vehicles (CVs, e.g. trucks) -- TMT Automobile (TMT), Hoang Huy Investment Services (HHS) and Truong Long Engineering and Auto (HTL); and 3) special-purpose vehicles.

2016: Dynamic growth from passenger cars

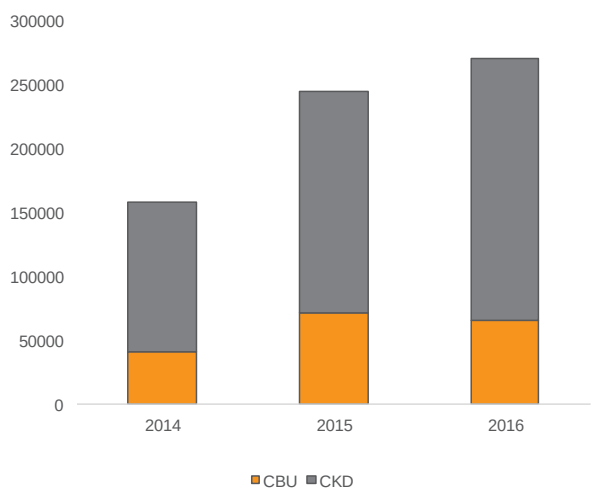
- Total 9M16 sales reached VND15,438bn, up 8% yoy (PC sales +40%, CV sales -39%)
- 9M16 net profit decreased to VND337bn, down 20% yoy (PC +26%, CV -72%).

Total sales volume reached 271 thousand units in 9M16, up 25% yoy. Sales volume of completely built up (CBU) vehicles reached 66 thousand (+7% yoy) while completely knocked down (CKD) sales volume rose to 205 thousand units (+33%, yoy). The sales volume of CKD was more than three times the sales volume of CBU due to rising taxes on CBU vehicles.

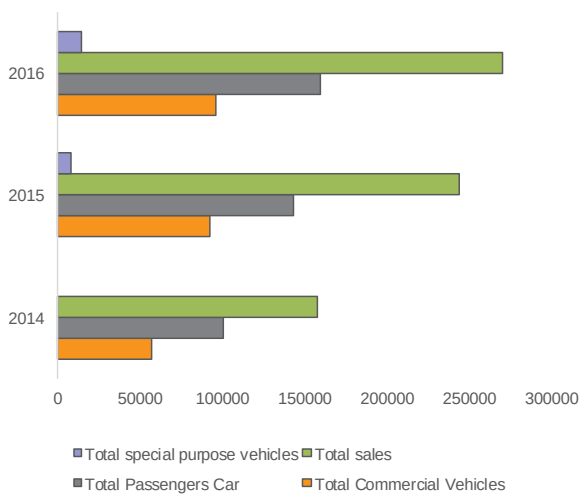
In term of categories, PC sales volume was the highest in 2016 due to rising personal vehicle ownership demand. PC sales volume grew more than 20% qoq in seven out of the past 10 quarters; the remaining three quarters saw slower growth due to seasonal effect. In general, the average sales volume for 10 quarters grew strongly above 11% (qoq) and 37% (yoy). CAGR since 2014 reached 9% quarterly. PC sales volume reached 160 thousand units for 9M16, up 26% yoy.

CV sales volume slowed down in 2016. In 2015, the government cut the allowance weights of CV. This had push logistic firms to buy more vehicles in order to fulfil the backlog of orders. As a result, the sales volume of CV surged nearly double in 2015. However, the unexpected demand is only in the short-term and have been saturated. Therefore, sales volume of CV for 11M2016 only reached 97 thousand units (+19% yoy).

Sales volume of CBU and CKD, unit



Sales volume by categories



Source: VAMA

Source:VAMA

A new tax structure. On 1 July 2016, the Vietnamese government implemented a new excise tax structure based on vehicle engine size. Taxes on cars with engines of above 2.5 litres rose significantly and vehicles with an engine capacity less than 1.5 litres dropped by 5%. Consequently, sales volume of PC with engines capacity above 2.5 litres surged significantly in the first half of 2016. In particular, sales volume of high-end car brands like Lexus and Mercedes-Benz rose above 42% yoy in 6M16. Sales volume of small engine brands like Ford, Kia, Huyndai and Mazda expanded 30-50% in 9M2016.

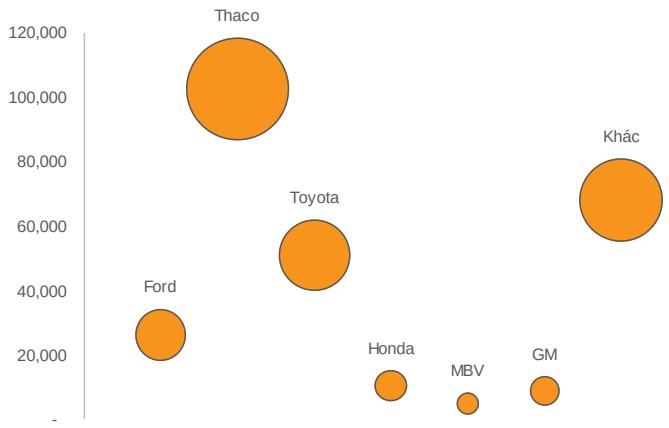
Excise tax on passenger cars

Engine capacity (Litre)	Before 01/07/2016	01/07/2016	01/01/2018
1.5	45%	40%	35%
1.5-2.0	45%	45%	40%
2.0-2.5	50%	50%	50%
2.5-3.0	50%	55%	60%
>3.0	60%	90%-150%	90%-150%

Source: Tax Authority Rules

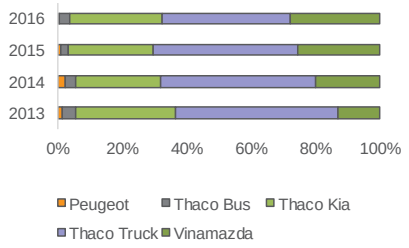
Thaco expanding significantly and taking market share from its big competitors. In 2016, Truong Hai Auto Corporation (Thaco) raised its market share to 38% (+15% yoy), more than double the market share of the second leading brand Toyota (19%). The market shares of other big automotive companies like Honda, Ford, GM Vietnam were unchanged. Firms not in Vietnam Automoblie Manufacturers Association (VAMA) saw their combined market share drop significantly to 10% (-30% yoy).

Sales volume and market share in 2016



Source: VNDIRECT, VAMA

Sales structure of Thaco



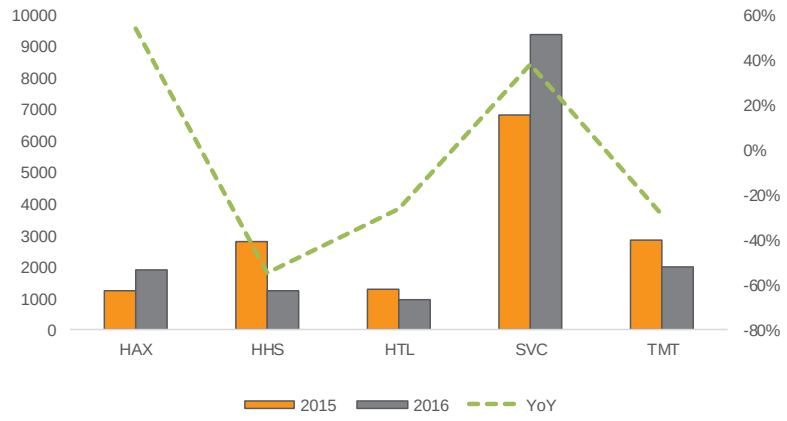
Source: VAMA

Thaco's growth surged due to a big jump in Kia and Mazda sales volume. In 2014, the combined sales volume of Kia and Mazda was only 20 thousand units, commanding 27% PC market share. However, the volume nearly tripled in 9M2016, propelling them to the market leadership position with a combined 37% share. At the same time, Thaco's CV portfolio continued to lead the market with a 43% market share in 9M2016 ,reaching 41 thousand units.

Contrasting business performances. While PC firms continued to grow rapidly, CV firms showed signs of slowing growth in 2016. The growth and net profits of TMT and HHS have been tumbling since 2Q16. Their sales slumped 29% and 55% yoy, respectively, while their net profits plunged c.75% yoy.

As opposed to CV firms, HAX and SVC were on an upturn, with their sales growth surging 54% and 38%, respectively,in 9M2016. HAX's 9M16 net profit jumped 243% yoy to VND63bn. Excluding one-off items, SVC's 9M16 net profit was at VND99bn, up 126% yoy.

Revenue of automotive companies, 2015-2016 (VND bn)

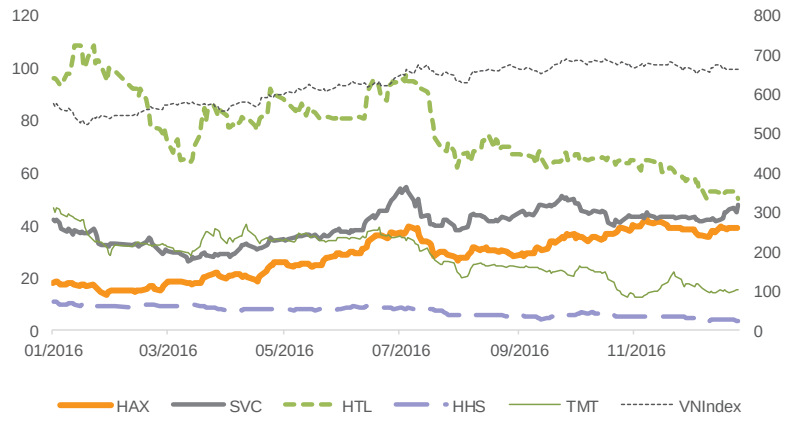


Source: VNDIRECT

Price performance

Stock price movements reflected accurately the diverging business performance. The share prices of HHS, HTL and TMT have all shrunk by nearly 50% since the beginning of 2016 till now due to depressing sales and net profits. In contrast with those above, HAX's share price has nearly doubled over the same period. While SVC did not have as huge an upside as HAX, it still gained more than 8% in 2016.

Automotive companies' stock prices vs VNINDEX



Source: VNDIRECT

Outlook for 2017: Growth continues to be driven by PC

We project the automotive sector to register:

- Sales growth of 15% yoy
- Net profit growth of 10% yoy
- Sales volume growth of 20% yoy.

Official distributors will continue to benefit from government policies. Circular No. 20 of Ministry of Industry and Trade (stating only official distributors are permitted to import and distribute fewer-than-

nine-seat PCs) became void in July 2016. According to Deputy Minister Dong Huy Dang, the new circular replacing Circular No.20 will focus on building a more competitive market. We believe the new circular will center around opening up the market and protectionist measure for CKD firms. At the same time the government will still put up other barriers in order to restrict the entry of unofficial distributors into the market. Therefore, the official distributors will still have advantages over unofficial distributors.

Market competition rising from 2018. By 2018, imports from ASEAN members will no longer be subjected to taxes. We believe the price for vehicles may not be cheaper than before as the government could create other fee barriers. However, there will be more options for consumers and we believe this will put pressure on existing brands and automotive firms in Vietnam.

Risks from government policies. With the rise in the country's traffic density putting pressure on its infrastructure, the government could introduce more policies to reduce the demand of vehicles for personal ownership. For example, the new excise tax implemented starting from 1 July 2016 led to an increase in prices for PCs with engine capacity above 2.5 litres.

Increase in excise tax on 1 Jan 2018 will boost sales volume of PCs with engine capacity above 2.5 litres in 2017. According to the schedule of increasing excise tax, tax on PCs with engine capacity of above 2.5 litres will increase between 5-10% in 2018. This is a revenue growth opportunity for PC firms in 2017. However, as prices of those PCs will be rising in 2018, business performance in the long run will be less positive.

We expect the automotive industry to continue to grow stronger in 2017. We believe that overall, CV sales will slow down in 2017 as the unexpected demand has faded and Vietnam's economic outlook has not shown significant improvement. We see PC sales as the dynamic growth factor for the automotive industry in 2017.

Sales volume 2014-2018 (No. of vehicles)

Contents	2014A	2015A	2016E	2017E	2018E
Total Sales	157,809	244,914	310,335	383,659	456,983
Total Passenger Cars	57,371	93,105	112,290	137,677	163,064
Total Commercial Vehicles	100,438	143,392	183,000	223,491	263,983
Others	0	8,417	15,045	22,490	29,936

Source: VAMA, VNDIRECT

We forecast total sales volume growth of 20% yoy in 2017, with PC sales volume reaching 223 thousand vehicles (+23% yoy).

If Thaco were to list on the Vietnamese stock exchange, the country's overall automotive sector will see a huge improvement; its price performance could enhance significantly.

Investment perspective

As we expect PC sales to be a dynamic growth driver for the industry in 2017, we would like to recommend HAX and SVC.

HAX is an official distributor of Mercedes-Benz Vietnam. It is expanding its business to the north of the country. Given that the new excise tax to be implemented on 2018 will raise the price for luxury cars, we believe the demand for Mercedes-Benz will increase significantly this year, boosting HAX's 2017 sales growth.

SVC is one of the top distributors in Vietnam. It distributes big brands like Ford and Toyota. Most of the vehicles SVC have been distributing are under 2.5-litre engine capacity so their prices will decline, making

them more affordable to the majority of the population. Therefore, the sales growth of SVC will be bright for the years ahead, in our view.

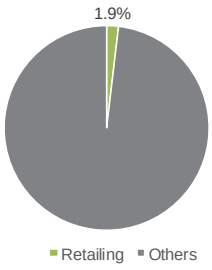
Stocks in spotlight for 2017

	Market measures					Growth ratios		Operating ratios		2017E		
Ticker	Current price	Market cap (VND bn)	P/E	P/B	DY	REV 1-YR Growth	NPAT 1-YR Growth	Gross margin	ROE	REV 1-YR Growth	NPAT 1-YR Growth	EPS
HAX	38900	553.61	5.9	1.9	n/a	54%	243%	6.4%	22.1%	30%	30%	6,600
SVC	46400	1158.86	12.1	1.4	2.60%	38%	-8%	5.0%	9.8%	10%	10%	7,000

Source: VNDIRECT

5. Non-grocery retailing industry: The early bird catches the worm

Retailing market cap vs. total market cap



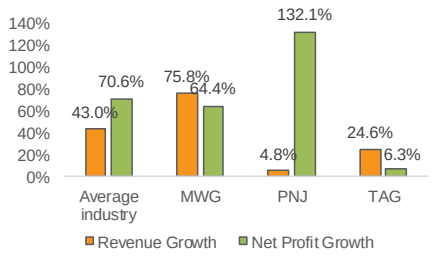
Source: VNDIRECT

Retailing includes all the activities involved in the sale of goods and services to the end-consumers through different channels. In this report, we only consider the potential of non-grocery retailers (i.e. not including supermarkets, convenience stores etc.).

2016: The race to expand retail chain stores

- Industry's 9M16 revenue: +43% yoy
- Industry's 9M16 net profit after tax: +72% yoy

Revenue and profit growth 9M16

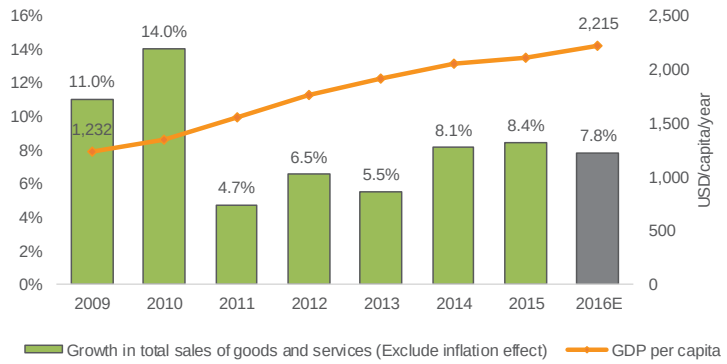


Source: VNDIRECT

Of which the biggest contribution came from the electronics giant Mobile World Investment Corp (MWG), which generated VND30,775bn in revenue (+75.8% yoy) and VND1,222bn in PAT (+64.4%). Coming in second was Phu Nhuan Jewelry (PNJ), the industry leader in jewellery retailing, with VND5,920bn in 9M16 revenue (+4.8% yoy) and PAT growth of 132.1% yoy.

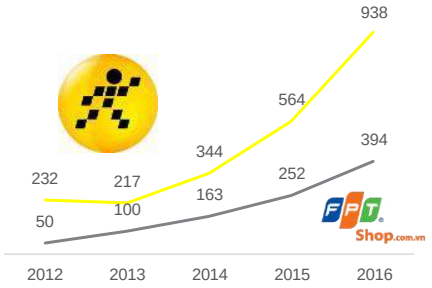
Domestic consumption continues to improve: We expect total sales of goods and services to increase by 9.4% in 2016. Excluding the effect of inflation, the increase would only be 7.8%, lower than in 2015 but still showing a recovery trend from 2013. The Consumer confidence index (CCI) remaining positive at 107 in 3Q16 (ranked 7th in the world) was another supporting factor to the retailing industry.

Growth in consumer demand and income



Source: GSO

The race to expand mobile devices stores

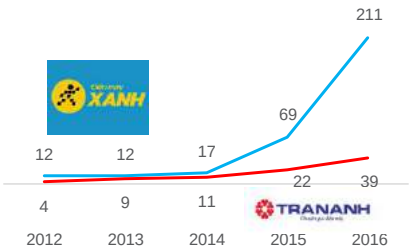


Source: FPT, MWG

Retail chain stores racing to expand in 2016. MWG surprised the market by rapidly increasing the number of both its Mobile World and Dien May Xanh chain stores. MWG opened 374 Mobile World stores and 142 Dien May Xanh stores, boosting its market share to 40% in the digital mobile devices segment and 14% in the consumer electronics segment (according to MWG's press release)

FPT Shop increased its number of stores from 252 to 394 (+56% yoy) in 2016, making it the 2nd largest digital mobile devices retailer in the country. Tran Anh Digital World (TAG) also ended the year with an impressive electronics supermarket store count of 39, double the 19 stores it had at the end of 2015. Nguyen Kim, after it was bought by Central Group (Thailand), also increased its number of stores from 21 to 35.

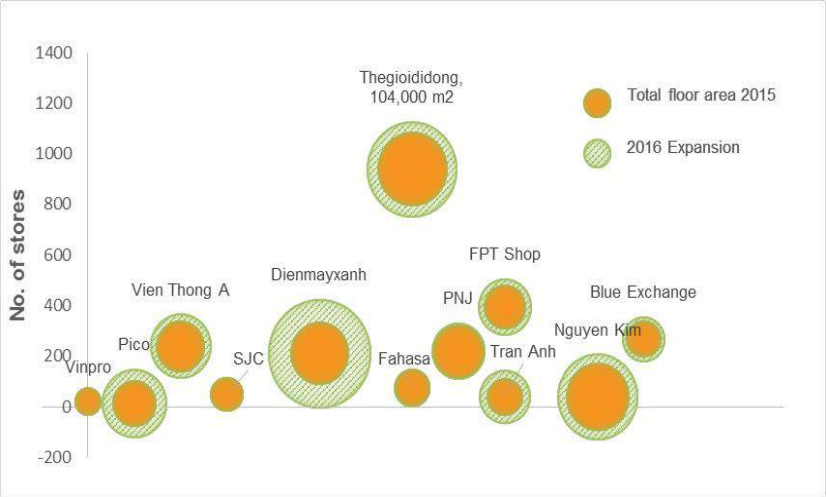
Electronic stores expanding race



Source: MWG, TAG

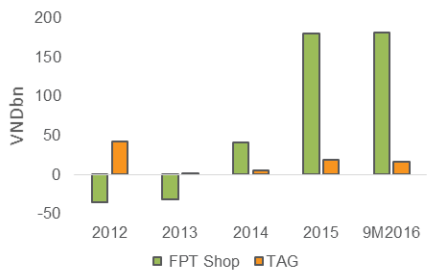
In another catergory of product, PNJ now owns 221 retail stores, following the opening of 27 new stores in 2016, leaving its rivals in the jewellery industry, such as SJC, Doji and Bao Tin Minh Chau, far behind.

Growth in store floor area of some retailers



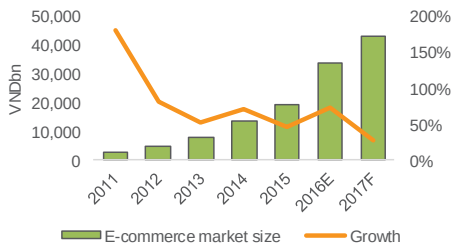
Source: Euromonitor, VNDIRECT estimate

FPT Shop and TAG's pre-tax profit



Source: FPT, TAG, VNDIRECT

E-commerce industry growth



Source: Euromonitor

Positive results from store expansion. With MWG growing continuously in recent years, two other firms in the mobile devices and electronics segment - FPT Shop and TAG - also started to register positive performance in 2015-2016. Along with its expansion, FPT Shop's profitability also improved, recording a 9M16 PBT of VND213bn (+55% yoy).

Following its corporate restructuring and deeper involvement from Japan's Nojima, now its largest shareholder, TAG showed positive changes after two difficult years (2013-2014). It recorded VND3,127bn in revenues (+24.6% yoy) and VND12bn in PAT (+6.4% yoy) for 9M16.

In order to increase the contribution of jewellery retailing in its earnings, PNJ expanded the number of its retail chain stores to 221 by end-2016. This also helped to improve its gross profit margin for from 8.9% (in 2012) to 17.3% in 2016. We estimate that its 2016 PBT reached VND561bn (+132% yoy), with 86% growth in core earnings.

Heated e-commerce market due to new competitors. Following Vingroup's (VIC) success with Adayroi.com, MWG launched its first online retailing platform Vuivui.vn, with the aim of becoming the leading e-commerce site in the country.

In 2016, Nguyen Kim also completed the purchase of Zalora Viet Nam. Meanwhile, with a VND384bn investment from VNG Corp, Tiki.vn transformed from an established online books retailer to an intimidating rival in the e-commerce industry.

Stock price performance

With the retailers posting strong growth in their financial results, the retail industry outperformed the VNINDEX, with a 70% increase in value in 2016. The leading stocks are MWG (+101%) and PNJ (+62.1%). TAG's share price was volatile in July, reaching a high of

VND82,000, before declining to VND49,500 on 23 Dec, recording an overall increase of 105.7% for the whole year. In short, the retailers' stock prices accurately reflected the sector's overall business performance in 2016.

Performance of retail equities vs VNINDEX

Soure: FiinPro; VNDIRECT

Retail equities' price movement

Source: VNDIRECT

TAG's 1-year price (VND/share)

Souce: VNDIRECT

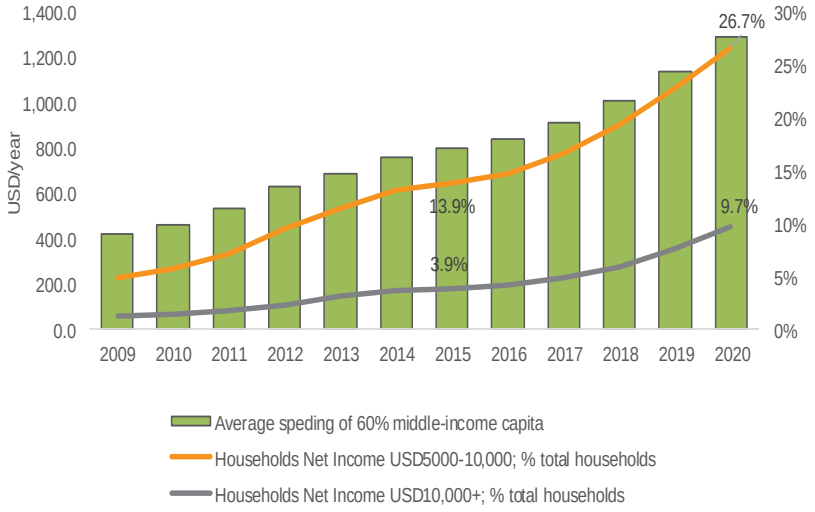
2017 outlook: Strong growth continues

We expect listed retailers (MWG and PNJ as representatives) to see growth of 33% in revenue and 44% in profit vs. 2016. We project revenues will continue to improve through the expansion of retail chain stores -- MWG will push to expand its Dien May Xanh chain stores and develop Bach Hoa Xanh, while PNJ anticipates the opening of 25-30 new stores in 2017. We believe the return on MWG's investment in Bach Hoa Xanh and Vuivui.vn needs to be observed further. As such, we have not included the two segments' contributions to MWG's overall business performance in our forecasts for 2017.

Improving economic outlook and consumption will boost retailers' business performance. BMI estimates that the number of Vietnamese households with annual income between US$5,000 and US$10,000 will reach 8.1m in 2017, more than double the number in 2015 (3.7m households). Also, the average monthly spending of the

middle-class group (60% of Vietnamese population) is estimated to increase from US$799 to US$1,290.

Average spending of middle-class group vs. change in population structure by income



Source: VNDIRECT, Euromonitor

Expansion of market through FTAs and AEC will create opportunities as well as challenges for domestic retailers. Market expansion via free trade agreements (FTAs) and the ASEAN Economic Community (AEC) will help widen the list of imports with favourable tax rates. But on the other hand, the entry of more experienced and dominant foreign retailers will intensify the competition pressure. Therefore, retailers will need to combine their growth in store count with an effective inventory and distribution channel management in order to survive the tough competition.

Favourable store locations - a determining factor in 2017. We believe that having favourable store locations with good infrastructure and demographics corresponding to the retailers' respective target consumers would be an effective barrier to new entrants into the market.

The flow of investment from foreign retail giants, many of which are grocery retailers, will continue to intensify the competition for shelf space in the supermarkets, shopping centres, convenience stores and even in the electronics and jewellery retail outlets. This investment flow explains the intensive M&A scene during 2015-2016 with many notable deals; M&As will probably continue over the next few years.

Following the expansion of Circle K and Shop & Go in Vietnam, another US retail giant, 7-Eleven, is preparing to open 1,000 stores in the country in the next few years. Other big names such as Aeon (Japan), Central Group (Thailand) and Lotte (Korea) are also pushing to expand their operations here after having been in the market for several years.

Retail index and P/E of retail industry

Source: FiinPro, VNDIRECT

Investment recommendation

Prices of the industry's equity grew strongly during the year and even experienced a period of correction near the end of 2016. This can be preparation for a new upward trend in 2017, supported by a prospect of high growth and retailers' optimistic business performance next year. Retail stocks are currently trading at an average P/E 13.4x, not expensive compared to VNINDEX, which is trading at 16x P/E.

Within the retailing industry, we maintain our positive evaluation for two stocks, PNJ and MWG, in view of their strong growth, large market cap and distinct business.

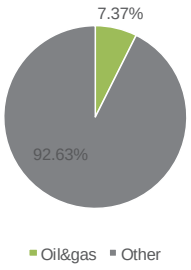
Stocks in the spotlight for 2017

	Market Measures					Growth Ratios		Operation Ratios		2017E		
Ticker	Current price	Market Cap (VNDbn)	P/E	P/B	DY	Rev. Growth 9M2016	NPAT growth 9M2016	Gross margin	ROE	Revenue Growth	NPAT Growth	EPS (VND)
MWG	154,600	23,794	14.4	6.5	n/a	75.8%	64.4%	16.4%	54.2%	39.1%	43.0%	16,643
PNJ	68,000	6,683	18.8	4.2	3%	4.8%	132.1%	17.4%	11.3%	2.5%	36.5%	6,851

Source: VNDIRECT

6. Oil & Gas Industry: Light at the end of the tunnel?

Oil and gas capitalization vs total market cap



Source: VNDIRECT

Petroleum industry comprises oil and gas exploration and production, transportation, storage and distribution, oil refinery and gas processing. Some of the listed oil and gas companies are GAS, PVD, PGS, and CNG.

Besides the oil and gas companies, the Vietnam Oil and Gas Group (PVN) also has many subsidiaries and associates that provide services to the petroleum industry. A large number of these subsidiaries and associates are listed, such as PVX, PXS, PVC, PVB, and PXT.

Including all the companies that provide services to the petroleum industry, the total capitalisation of oil and gas companies reached VND140tr as of our report date, accounting for about 7.37% of Vietnam's total stock market capitalization (HOSE, HNX and UPCOM combined).

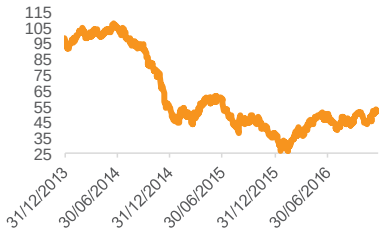
2016: Disappointing results due to low crude oil prices

- In 9M2016, the listed oil and gas companies' revenue fell 22.6% yoy on average.
- PAT decreased by 7.5% on average during the same period.

Crude oil prices recovered after OPEC production cut agreement but remain low. Crude oil prices plunged in late 2014 and continued to decline in 2015. In early 2016, news about a potential OPEC production cut supported the strong rebound in oil prices from US$27/bbl to US$50/bbl. However, the average oil price in 2016 remained low. The average WTI oil price was US$43/bbl in 2016, 11.42% lower compared to 2015 and 54% lower compared to 2014.

On 30 Nov 2016, for the first time in 8 years, OPEC agreed to cut oil output after weeks of tense negotiations in Vienna, Austria. According to the agreement, OPEC will cut output by 1.2m bpd, from 33.6m bpd, starting 1 Jan 2017. OPEC's agreement supported the jump in WTI oil price to nearly US$50/bbl at the beginning of December.

WTI prices (USD/barrel)



Source: Bloomberg

Ten days after the OPEC agreement, non-OPEC countries agreed to cut production by 558,000 bpd, bringing the total production cut to approximately 1.8m bpd, equivalent to about 1.9% of the total output per day worldwide.

In 2016 the number of shale oil wells in US fell to its lowest level since 2011, about half of 2015 levels. Credit Suisse's survey of shale oil investors and industry professionals in 2016 showing majority of analysts expecting shale production level in 2017 to be: (1) similar to 2015 levels if WTI price were to be flat at US$40-50/bbl in 2017; (2) higher by 500,000 bpd if WTI price were US$50-60/bbl; (3) a strong increase if WTI price were US$60-70/bbl. Credit Suisse reckons that these estimates are a little more optimistic and its model only shows the US shale production rising by about 280,000 bpd at US$60/bbl. With the oil price likely at around US$53-55/bbl in 2017, we believe this price is not attractive enough for the increase in exploration of shale oil.

Disappointing results by most oil and gas companies. 2016 was a particularly difficult year for the petroleum industry after three consecutive years of low oil prices. The average oil price in 2016 was US$43.2/bbl (-11.42% yoy), lower than the average cost of exploration in Vietnam which is US$45/bbl.

As the production cost was higher than the selling price, it forced PVN to hold or delay exploration and production projects. This led to a fall in the selling price and utilisation of the companies that provide drilling services, M&C services, and exploration services to PVN, resulting in a sharp decline in gross margins and net profits over the same period.

In the case of gas distribution companies, GAS's subsidiaries and associates are guaranteed a price spread between input and output. Therefore, their gross margins were stable in 2016. PGD was an exception as its gross profit margin increased from 14.6% in 9M2015 to 20.6% in 9M2016 due to more favorable input gas prices. This helped its 9M2016 PAT to increase by 12.24% yoy. PGS's gross profit margin fell slightly, but the company recorded a PBT of VND310bn, a strong growth due to its CNG divestment. Other companies generally reported lower PAT in 9M2016 due to lower selling price.

Financial performance of listed oil and gas companies

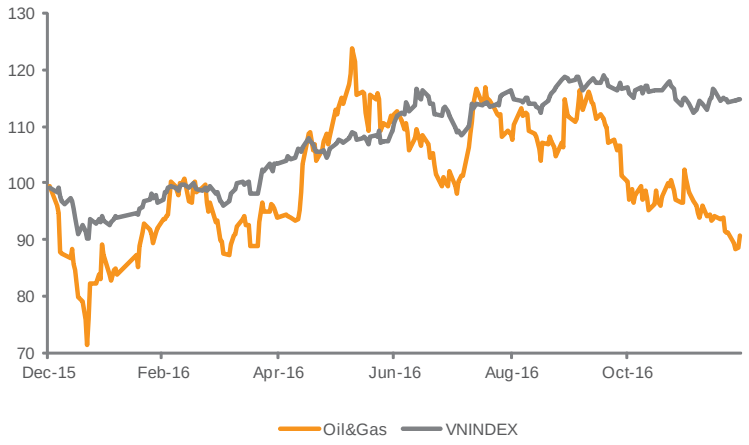
Ticker	Revenue			GPM			PAT		
	9M2015	9M2016	% change yoy	9M2015	9M2016	% change	9M2015	9M2016	% change yoy
GAS	47,025,713	43,482,454	-7.53%	24.30%	15.52%	-8.78%	7,488,954	3,944,820	-47.32%
CNG	691,653	666,167	-3.68%	24.68%	26.14%	1.46%	88,484	84,914	-4.03%
PGS	4,460,964	3,842,035	-13.87%	19.09%	18.55%	-0.54%	108,502	237,429	118.83%
PGD	3,747,442	3,240,696	-13.52%	14.61%	20.67%	6.06%	190,708	214,056	12.24%
PVG	2,002,841	1,827,224	-8.77%	10.87%	13.71%	2.84%	21,280	8,722	-59.02%
PVD	11,932,488	4,541,503	-61.94%	22.98%	16.56%	-6.42%	1,570,934	85,884	-94.53%
PVS	19,324,346	13,917,549	-27.98%	8.71%	5.45%	-3.26%	1,250,372	816,051	-34.74%
PVT	4,043,381	4,866,936	20.37%	12.91%	11.49%	-1.42%	198,803	300,471	51.14%
PXS	1,456,017	1,276,295	-12.34%	14.39%	14.36%	-0.03%	92,530	83,392	-9.88%
PVC	2,865,290	2,291,588	-20.02%	14.46%	8.38%	-6.08%	93,700	(46,433)	N/A
PVB	914,770	4,097	-99.55%	24.44%	-1605.00%	-1629.44%	142,111	(53,250)	N/A

Source: Stockplus

b. Stock performance

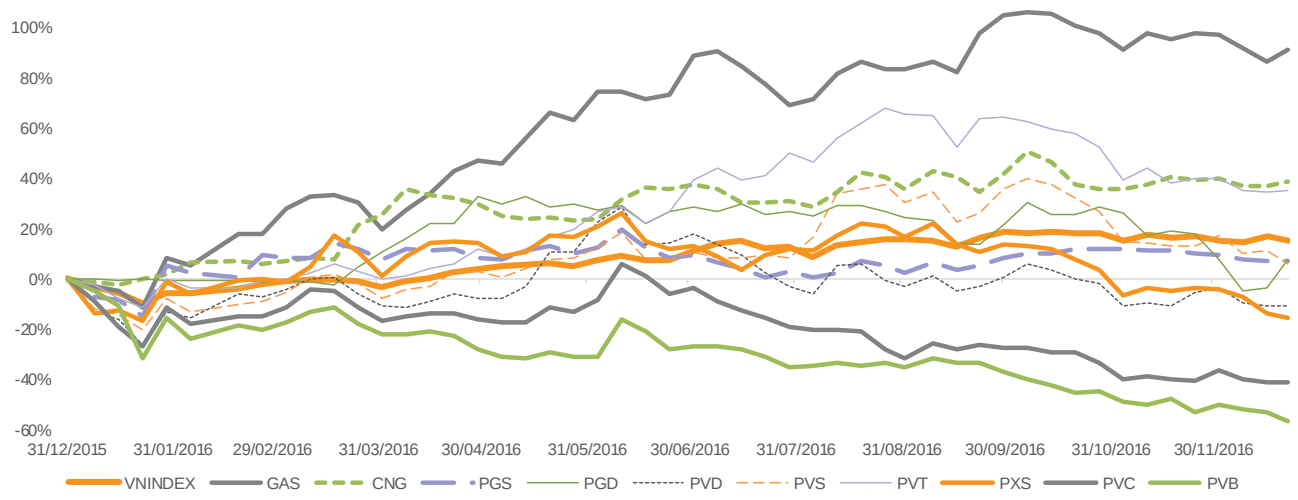
Oil and gas stocks surged in 1H2016, before retreating in the second half of 2016. As of 21 Dec 2016, oil and gas sector was up 6% compared to the end of 2015. In particular, GAS was up 91.27%, CNG was up 38.49%, and CNG and PVT were up 35.07%. Generally, gas distribution stocks were up while drilling services and M&C services companies stocks were down as of 21 Dec 2016.

Oil & Gas stock's price performance vs VNINDEX



Source: VNDIRECT

Stock price performance



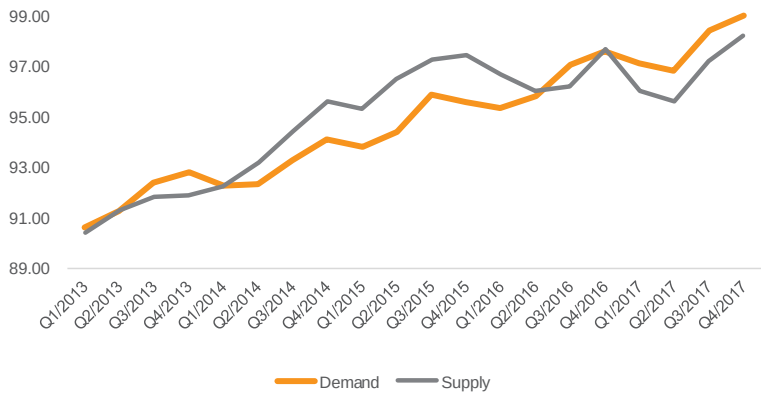
Source: VNDIRECT

c. 2017 outlook: growth expectations thanks to the recovery in oil prices

- Oil and gas revenue is expected to increase by 10.6% yoy in 2017 (estimates from GAS, CNG and PVS)
- PAT is estimated to increase by 5.9% yoy.

Oil prices are expected to continue recovery. OPEC and non-OPEC countries reached an agreement to cut 1.8 million barrels per day equivalent to approximately 1.9% of the daily production worldwide. The agreement is for 6 months from 1 Jan 2017 and may be renewed for another 6 months. Oil prices rose 10% after OPEC reached the agreement and 5% more after the non-OPEC countries decided to cut production. We believe the production cuts will result in demand outstripping supply. According to Credit Suisse, this will happen from the first quarter of 2017.

Supply and Demand (bn barrels/day)



Source: Credit Suisse, IEA, EIA

The plunge in oil prices in 2014 and 2015 was due to a sharp decline in oil demand, especially from China. However, the oil demand and supply graph shows steady growth in oil demand from 2013 and the demand is forecast to continue rising in 2017. Increasing demand and declining supply will lead to higher prices in 2017 vs. 2016. According

to EIA and Credit Suisse, WTI oil price is forecast at $53-55/barrel in 2017.

WTI quarter estimation

	Q1	Q2	Q3	Q4
Bloomberg	52.2	54.0	54.8	55.1
EIA	49.0	49.0	51.0	53.7
Credit Suise	54.3	55.6	55.7	55.6
Average	**51.8**	**52.8**	**53.8**	**54.8**

Source: Bloomberg, EIA, Credit Suisse

WTI estimation

	2015	2016	2017	2018	2019
WorldBank	48.8	43.2	55.2	59.9	62.7
EIA	48.8	43.4	50.7		
Bloomberg	48.8	43.1	54.0	55.4	55.4
Credit Suise	48.8	43.2	55.3	54.9	54.6
Average	**48.8**	**43.2**	**53.8**	**56.7**	**57.6**

Source: WorldBank, EIA, Bloomberg, Credit Suisse

Gas distribution companies - earnings growth expectation. Oil prices have recovered and are forecast to be higher than in 2016. This should benefit stocks related to downstream activities like processing and gas distribution (GAS, PGD, CNG, PGS and PVG) and help to improve business performance significantly.

It is difficult to improve business results for companies that provide services for the petroleum industry such as oil drilling, oil and gas engineering and construction (PVD, PVS, PVX, PXS, PVB, PVC) because oil and gas projects require a relatively long preparation period before re-starting.

d. Investment recommendation

We evaluate gas distribution stocks to be optimistic as we expect this business to grow and we also believe it is undervalued at a P/E of 15.58x, lower than the market P/E of 16.4x and the regional gas distribution group P/E of 16.75x. Our top picks in this group are CNG and PGS.

Drilling services, oil and gas engineering and construction companies such as PVD, PVS, PVX, PVC, PXS, PVB are rated Neutral because it is difficult to quickly improve business results. This group is trading at a P/E of 16.7x, much cheaper than the regional peer P/E of 59.8x but slightly more expensive than the market.

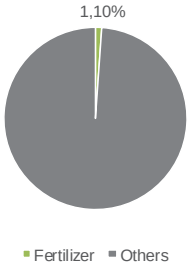
Stocks in the spotlight for 2017

	Market measures					Growth ratios		Operation ratios		2017E		
Ticker	Current price	Market Cap (VND bn)	P/E	P/B	Div yield	Revenue growth 9M2016 (yoy)	PAT growth 9M2016 (yoy)	GPM	ROE	Revenue growth (yoy)	PAT growth (yoy)	EPS (VND/CP)
CNG	41,450	1,119	9.4	2.53	7.52%	-3.68%	-4.03%	26.14%	27.77%	N/A	N/A	N/A
PGS	15,700	785	3.3	0.79	10.07%	-13.87%	118.83%	18.55%	23.34%	10.1%	-69.4% *	1,640

Source: VNDIRECT

7. Fertiliser Industry: Awaiting signals from supporting policies policies

Industry market cap vs. total market cap



Source: VNDIRECT

Fertiliser manufacturing is closely related to the agriculture sector. In Vietnam, most manufacturers produce inorganic fertilisers that include: nitrogen fertilisers (urea), phosphate fertilisers (superphosphates, CMPs), potassium fertilisers and compound fertilisers (DAP, NPK).

Currently, fertiliser industry's market cap account for 1.1% of total market capitalisation in both bourses, valued at VND20,361bn. The most prominent players in the industry with a leading position in each product segment are PetroVietnam Fertiliser and Chemicals Company (DPM), PetroVietnam Camau Fertiliser JSC (DCM), Binh Dien Fertiliser JSC (BFC) and Lam Thao Fertilisers & Chemicals JSC (LAS).

2016: persistent oversupply, lower demand caused by El Nino

- Total revenue of listed fertiliser manufacturing companies fell by 13% yoy in 9M16.
- Earnings after tax fell by 18% yoy in 9M16.

Most fertiliser manufacturers suffered from negative growth in the first nine months of the year, resulting from low consumption and a continued downward trend of fertiliser prices. Total revenue of the seven selected companies decreased by 13% while EBT fell by 16% and EAT by 18% yoy.

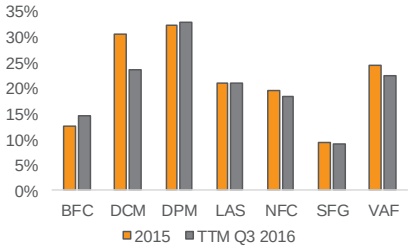
Gross margin generally decreased in 9M16, but the decline varied among the different types of producers. Manufacturers of single-nutrient fertilisers (NFC, VAF) recorded a slight decline in terms of margin as the big leap in selling prices was offset partly by the drop in input prices. However, gross margins for manufacturers of multi-nutrient fertilisers such as NPK (BFC) saw an improvement as prices of input materials, which are single-nutrient fertilisers, dropped more quickly than product prices.

9M2016 business performance of selected companies

Ticker	Revenue growth (%yoy)	EAT growth (%yoy)	TTM Gross Margin
BFC	-3,8%	16,7%	14,6%
DCM	-18,2%	-17,9%	23,7%
DPM	-15,6%	-16,0%	32,9%
LAS	-20,3%	-56,7%	20,9%
NFC	6,1%	8,1%	18,4%
SFG	-5,9%	-8,0%	9,2%
VAF	-1,7%	-28,3%	22,5%
Total	-13%	-18%	

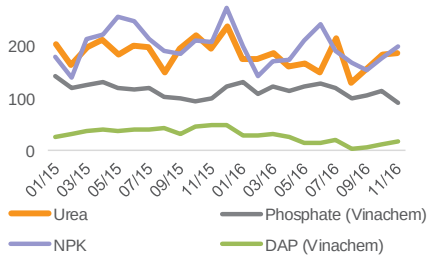
Source: VNDIRECT

TTM Gross margin of selected companies



Source: VNDIRECT

Fertiliser production volume (million tonnes)



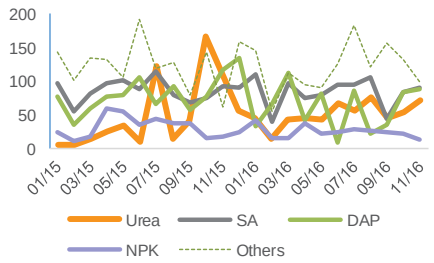
Sources: MOIT, VNDIRECT

Data shows that the BFC's 9M16 gross margin increased significantly from 12.6% (in 2015) to 14.6%. Given the low crude oil prices, gross margin of DPM only increased by 60bps to 32.9% as average selling price dropped. Gross margins of other companies decreased by approximately 0.5-2%, and only DCM recorded a large decline of 7% due to lower-than-average urea prices.

Persistent supply surplus, decreasing demand: According to the Ministry of Industry and Trade, total fertiliser production in 11M16 is estimated at 5.4m tonnes (-11.8% yoy), imports at 3.7m tonnes (-7.5%) and exports at 663 thousand tonnes (-9.6%). Beginning-of-year Ure, NPK and DAP inventory reached 750 thousand tonnes approximately (+45%, according to Agromonitor). Total fertilizer supply in 11M16 was approximately 9.2m tonnes. The estimated supply in 2016 could reach more than 10m tonnes, in our view.

On the other hand, average annual demand is around 10-11m tonnes per year, 90% of which are inorganic fertilisers. Demand in 2016 was even expected to decline, influenced by the poor performance of the agriculture sector and low agricultural product prices. Severe droughts, coupling with growing saltwater intrusion in the Southern region – the biggest market for domestic fertiliser, lowered agricultural productivity and production. Hence, the fertiliser supply is more than sufficient to meet domestic demand.

Fertiliser import volume (million tonnes)



Source: MARD

In terms of products, **urea and NPK are expected to remain in oversupply**, **while DAP, SA and potassium still depend on imports**. Urea production for 11M16 totalled 1.88m tonnes (-9.31% yoy) as Ha Bac and Ninh Binh urea plants suspended their operations. However, imports increased by 6.3% to 562 thousand tonnes, offsetting the decrease in production. Total urea supply was more than enough to meet the country's demand of 2-2.2m tonnes and even contributed to exports.

In terms of other fertilisers such as phosphate and NPK, supply generally meets demand yet in 2016 both production and imports declined as a result of high inventory, low demand and competition from cheap imports. Total phosphate output fell by 1.25% to 1.27m tonnes, NPK output fell by 10.51% to 2m tonnes. DAP recorded the biggest decrease of 52.7% in volume down to around 200 thousand tonnes. Meanwhile, import volumes for DAP and NPK declined by more than 20%, and only SA fertilisers showed a small decrease in imports (-4% yoy) as they were unable to be produced locally.

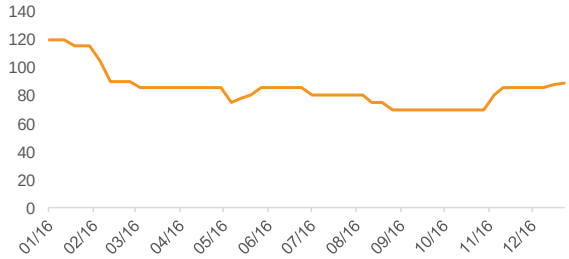
Imports in 11M16 also declined 9.6% and 26.3% in terms of quantity and value, respectively, staying at 692 thousand tonnes and US$193.6m. In short, Vietnam has maintained an import surplus since 2011.

Input prices remained low. In 2016, the input gas price for urea manufacturing (which is calculated based on fuel oil price) experienced a stable increase since the beginning of the year, but it remained at a lower level than the 2015 average. Approximately, the average gas price dropped by 20% compared to the same period in 2015, helping urea producers like DPM reduce input costs. Meanwhile, imported sulfur prices fell by more than 40% in 10M16, which was a positive sign for phosphate and NPK producers, and only increased slightly during the last 2 months of 2016 when global demand soared for the new harvest.

Singapore fuel oil price (US$/tonne)

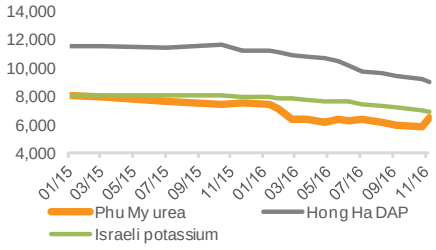
Source: Bloomberg

Vancouver sulfur spot price (US$/tonne)



Source: Bloomberg

Prices of major fertilisers (VND/kg)



Source: Vinacam

Fertiliser prices were still on the decline in 2016. This was the direct consequence of domestic oversupply and falling production costs. Domestic selling prices faced a steady decline in 11M16: DAP recorded the biggest fall of 20%, potassium 13%. Only urea showed a small increase towards the end of the year after falling 18% compared to the beginning of the year, thanks to an increase in global urea prices and seasonal demand for the upcoming crop.

We note that there is a lag between the drop in input prices and the drop in selling prices: single-nutrient fertiliser prices (inputs) fell more quickly than multi-nutrient fertiliser prices such as NPK (output), leading to the difference in gross margin mentioned above.

The industry continued to deal with numerous problems, such as:

- An increasing number of counterfeit and poor-quality fertilisers in Vietnam as the authorities do not have a proper surveillance system.
- Fierce competition from imported fertilisers with cheaper prices than domestic products, especially from China and import tax-free ASEAN countries (Indonesia and Malaysia).

Reference prices for several fertilisers in Northern region in Dec 2016 (VND/kg)

Type	Domestic products		Imported products	
Urea	Ca Mau granular urea	6.500-6.550	China prilled urea	5.600-5.650
	Phu My	6.300-6.350	Indonesia prilled urea	5.300-5.350
	Ha Bac	6.100-6.200		
	Ninh Binh	6.000-6.050		
Potassium	Phu My	6.900-7.000	Laos PDR	5.700-5.750
			Israel	7.350-7.400

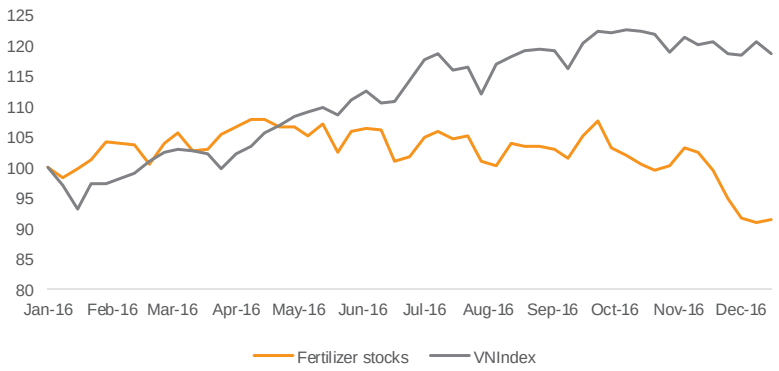
Source: Mard

- The continued impact from Tax Law No. 71/2014 (stipulating that fertilisers are exempt from VAT instead of a 5% VAT in 2014). This regulation prevented fertiliser producers from receiving input VAT deductions, hence increasing the production costs from tens to hundreds of billions VND annually for each producer.

Stock price performance

Stock price movements were consistent with the poor business performance. Most of the stock prices moved sideways in the first half of the year, then fell sharply in the second half when demand did not pick up following the start of the planting season. Only BFC was able to record positive growth in stock price since its business performance was better than average due to stable selling prices.

Fertiliser manufacturer stocks and VNINDEX performance



Source: VNDIRECT

2017 prospects: potential improvement thanks to better climate and possible supporting government policies

- Total revenue of listed fertiliser manufacturing companies is estimated to rise 7% yoy
- PAT for 2017 is expected to rise 2% yoy

We believe the fertiliser manufacturing industry already reached the bottom in 2015-2016 given the poor business performance, downward trend in product prices and heightened competition.

In 2017, several positive signs for the industry include:

Fertiliser demand could grow, thanks to more favourable weather conditions. With the end of El Nino, higher precipitation could subside droughts and weaken saltwater intrusion in the Southern provinces, paving the way for an improvement in the agriculture sector's performance and leading to a recovery in demand. Also, La Nina, which has been confirmed to occur by several international organisations, is expected to bring more rain causing soil erosion and thus bolstering demand for fertilizers.

Domestic selling prices could rise (but to a limited extent, provided there is constant supply surplus and aggressive industry competition), which is affected by an expected rebound in raw material (crude oil and coal) and global fertiliser prices.The urea price in the Chinese market, a major urea supplier in the world, has rocketed in the last few months of 2016 as coal prices rallied, boosting urea production costs. This could support an upward trend in the global urea price and domestic price, even though there is a lag before it is reflected in the domestic selling price.

Additionally, we look ahead to the increase in the prices of agricultural products, which could lead to a recovery in fertiliser demand and prices.

If supporting policies for the industry, for example protective tariffs on specific fertilisers, **are implemented,** this could be beneficial for the industry's recovery. In Mar 2016, the policy to raise the preferential import tax rate on Chinese DAP from 3% to 5% reduced the DAP import volume significantly in the following months, driving the consumption of domestic products.

Another policy highly anticipated by businesses and farmers is reclassifying fertilisers from tax-free (VAT) goods to goods taxed at 0%. This could help companies save more than VND2,500bn of expenses every year (according to Ministry of Industry and Trade) , enabling them to compete with imported products in terms of price. In

addition, with the government's determination to solve the prevailing counterfeit and smuggling problems, we expect a better outlook for the fertiliser industry in 2017.

Some notable risk factors include:

Any change in China's import-export policies could easily affect the import quantity and product demand in Vietnam, as China is the main exporter of fertilisers to Vietnam (accounting for 40% of fertiliser imports). Recently, China announced a new export policy that exempted DAP and TSP from export tax and reduced NPK export tax from 30% down to 20%. Given that this policy is only effective starting from 2017, there has been no impact thus far, but we think the domestic supply will gradually feel the pressure and tougher price competition.

Competition in the market could also increase as total production capacity is expected to rise, especially for NPK products. In 2017, a great deal of new NPK factories are projected to go into production. This includes BFC's NPK factory expansion project to increase its total capacity by 200 thousand tonnes per year to, DPM's new high-quality NPK factory providing 250 thousand tonnes/year and Korea-Vietnam fertiliser company's upcoming 360 thousand tonnes/year factory. Thus, supply should continue to be abundant and competition should increase in 2017-2018. Only established businesses with products that cater to the market's needs will be able to secure market share.

Investment recommendation

Fertiliser stocks have a stable dividend payment history (at a quite high ratio of 20-40%). With stock prices falling sharply in 2016, we also expect a gradual improvement in stock performance, thanks to the recovery in demand/consumption and higher average selling prices. However, a significant boost to the stock prices can only come from a change in the government's regulatory policies.

Companies benefitting the most from new policies will be leading producers with established market positions and economies of scale.

Some notable stocks in the sector are DPM and BFC with the following long-term catalysts:

DPM - PetroVietnam Fertiliser and Chemicals Company

- Established position in the market with the most developed distribution network nationwide
- Global and domestic urea prices are expected to improve slightly
- Fully depreciated factory that could save the company approximately VND100bn per year starting from 2017.
- The NH3-NPK complex, which is expected to go into production by the end of 2017, has the potential to form a full NPK supply chain, hence lowering production costs. Moreover, the high-quality products manufactured are expected to replace the currently imported NPK fertilisers.
- Huge benefit from the government's potential protectionist tariff policy for urea product imports and new VAT policy to rescue the losing Ha Bac and Ninh Binh fertiliser plants.

BFC - Binh Dien Fertiliser Joint Stock Company

- Solid market share in the South (30%) – which accounts for 50-60% of the country's consumption

- Binh Dien–Ninh Binh factory's expansion project adding another 200 thousand tonnes/year to total capacity with the aim of grabbing more market share in the North and exports to nearby countries (Cambodia, Laos, Thailand, etc.)
- Preferential income tax treatment for the Binh Dien–Ninh Binh factory: tax-free in 2015-2017 and 50% discount in 2018
- Improving gross margin, thanks to effective cost management

The risks for both companies are: (1) business operations highly depend on the weather and the performance of the agriculture sector and (2) input prices are expected to rise in 2017 (crude oil, gas, coal), which could depress gross margins in the short term while selling prices have yet to catch up.

Stocks in the spotlight for 2017

						Growth indicators		Profitability indicators		2017E		
Ticker	Current price	Market cap (bn)	TTM P/E	TTM P/B	TTM DY	9M16 revenue growth (%yoy)	9M16 NPAT growth (%yoy)	Gross margin	ROE	Revenue growth	NPAT growth	EPS
BFC	29.300	1.675	6,5	1,8	6,8%	-3,8%	16,7%	14,6%	23,2%	10,0%	9%	5.192
DPM	22.550	8.825	6,7	1,0	13,3%	-15,6%	-16,0%	32,9%	14,8%	6,0%	-1%	3.313

Source: VNDIRECT

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Research Department

VNDIRECT Securities Corporation

1 Nguyen Thuong Hien Str – Hai Ba Trung Dist – Ha Noi

Tel: +84 439724568

Email: research@vndirect.com.vn

Website: https://vndirect.com.vn