Vietnam

The hidden tiger

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Vietnam is quietly but quickly emerging as an economy to rival its Southeast Asian neighbours. It is rich in human and natural resources. The country is still a communist one, but the government encourages the creation of wealth, and the legal apparatus is increasingly equipped to protect it. The US is the largest trading partner while North Asian countries are the largest investors. FDI is around 9% of GDP, while Overseas Vietnamese remit around 12% of GDP per annum, most of which is now being invested. A middle class has been created which is keen to invest beyond currency and property. The government is keen to develop the stock market to oblige them.

An overlooked but accommodative economy

- The first wave of foreign investment in Vietnam from 1990 to 1997 was too big for the size of the economy and finally coincided with the Asian crisis.
- Vietnam's report has accelerated since the Asian crisis contrary to popular belief.
- Business and investment laws are now in place, and the economy is large enough, to accommodate a large amount of foreign investment.

From nowhere to top tier in private business and exports

- The number of private companies has gone from 100 to 150,000 in the past fifteen years.
- The country is the world's largest exporter of pepper, and the second-largest exporter of seafood, rice and coffee.
- It is East Asia's only net importer of oil after Malaysia.

A nascent capital market

- The stock market was kept purposely small during its first four years and is still capitalized at just US$250 million with a turnover of $600,000 per day.
- It is at a discount to the region, trading on 7.3x with a 5.5% dividend yield.
- The Over-the-Counter market is five times the size of the stock market and where most new listings come from. The government's market capitalisation-to-GDP target infers a market cap of around US$8 billion in five years.
- Vietnam is neither like China nor like Southeast Asia: the state becomes a minority investor in privatisations, but family dynasties are also inexistent.
- The country's history and culture are conducive to a consensus-style approach, which means development is not as frenzied.
- Foreigners can buy Vietnamese stocks and some patient accumulation will reap good rewards.

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Vietnam: Then and now

What a difference fifteen years can make

Fifteen years ago, residents of the United States who wanted to call someone in Vietnam had to drive to Canada to do it. Their call was routed through Havana and Moscow, at a cost of US$10 a minute. Fifteen years ago was also when I first visited Vietnam. A group of US veterans and I spent a month scooting around the country in hand-me-down Tupolevs, piloted by hung-over Russians.

I love Vietnamese food, but it was hard to find good food there in 1990. The only private restaurants in Ho Chi Minh City were in people's homes with the tacit inattention of the authorities, the most famous being that of ex-South Vietnamese congresswoman Madame Dai.

In Hanoi, the only bar that wasn't selling unpasteurized beer on a street corner was at the German embassy. A small store selling non-Soviet bloc foreign goods like toothpaste, laundry detergent and chocolate bars had just opened, and was considered a great novelty.

Foreigners weren't supposed to use the local money, but that didn't really matter, because the preferred currency was greenbacks, or blue jeans and 555 cigarettes, which you could trade for caviar or Cuban cigars. I felt sorry for the Overseas Vietnamese ("Viet Kieu") travelling with us, as they grappled with their dual identities and were occasionally taunted as "traitors" by street touts and children. The Caucasians among us were more playfully labeled "Lien Xo's" ("Soviets"), as there were virtually no Western visitors to the country at the time.

From Tupolevs to 777s, Lien Xos to investment bankers

Nowadays of course, you can call Vietnam directly from the US, for a fraction of what it cost before. You can also fly there easily, too. In early December 2004, United Airlines started the first direct flight from the United States to Vietnam since Pan Am stopped flying there six days before the fall of Saigon.

Fast-forwarding to the present is quite a jolt in more ways than one. For one thing, the Tupalevs are gone. Spanking-new Airbus and 777's do more than twenty daily flights between the two major cities, Ho Chi Minh City and Hanoi.

Madame Dai's restaurant is long gone too, but Ho Chi Minh City has dozens of top-grade restaurants, both Vietnamese and international. Gone too is the bar at the German embassy in Hanoi, but that city now has many trendy bars and clubs, and foreign products are available everywhere.

People don't take dollars in everyday transactions any more, let alone blue jeans or 555 cigarettes. There aren't any more cans of caviar or boxes of Cuban cigars to barter them with anyway, unless you want to pay whatever price you'd pay for the same in Bangkok or Hong Kong. Indeed, there is nary a Lada in sight to remind you of the old days, and the Russian restaurant in Ho Chi Minh City finally folded three years ago.

But the good news is Viet Kieu are accepted and even considered chic, and the younger ones are frequently courted by prospective suitors.

Clearly, Vietnam has come a long way in the past fifteen years. I visited it six times since I first went, and noticed that on every trip it was a bit more developed.

In one of my meetings on my most recent trip there, I suddenly realized I had been in the same room with the veterans fifteen years earlier. Then, we had sweated through lectures in French, given by aged army colonels, on the evils of the US embargo. This time, I was discussing Vietnam's route to a capitalist economy with fluent English-speaking government officials. And the room was now air-conditioned …

Some big changes had taken place inside those government buildings. But something had changed outside of them, too.

On previous visits, a few luxury cars had stuck out like very sore thumbs among the trishaws, motorcycles and compact Korean cars that crowd the streets of Ho Chi Minh City. But this time, Lexuses and BMW's seemed to be everywhere.

Wealth is now encouraged, and on display

This really surprised me, because I had heard many times before that Vietnamese with money were careful not to display their wealth: Having lived through decades of upheaval and communism, they liked to keep it hidden. So what was it that had happened in the past five years to make them change their minds?

The Acceleration of Reform

Vietnam has been moving from communism to capitalism since the first business, land reform and foreign investment laws were passed in 1986. But the pace has been especially quick in the past seven years, after the first wave of foreign investment there (from 1990 to 1997) proved to be a failure.

That failure wasn't really Vietnam's fault. Seven funds raised US$400 million. But there were so few opportunities for that kind of money, most of it stayed in cash; went into very indirect "Vietnam plays"; or unprofitable local JVs.

As an example of how much demand had exceeded supply in the direct investment segment, by 1997 there were fourteen licensed car assembly JVs in the country, while the total number of cars sold that year was just 5,000.

Vietnam's economy had already begun to slow down in early 1996, a year and a half before the Asian crisis struck. When it did, most foreign partners in Vietnamese JV's suddenly had problems elsewhere and wanted to scale down what they had already put in the country. Committed foreign direct investment hit a peak at US$8 billion in 1996, but fell to US$1.5 billion by 1999. Now, of the seven country funds raised pre-crisis, only four remain, with a combined market cap of US$16 million.

The Last Of The Old Warriors

A more pragmatic and growth-oriented technocracy since 1997

This slow down proved to be a blessing in disguise. As a result of it, a showdown emerged between the old guard that wanted a reversal in economic reforms, and the new guard that wanted to accelerate them.

The new guard won, and in 1997, the last of the old warriors was retired from the National Assembly (Vietnam's parliament).

A more pragmatic and growth-oriented technocracy has steadily taken over ever since, although few outside Vietnam seem aware of this.

Most people outside Vietnam don't realize changes are taking place

But most people outside Vietnam don't seem to realize this. Either they never really looked at it in the first place and have pre-conceived notions of a hermetic military communist state. Or they stopped looking at it after the first wave of foreign investment proved a failure.

For example, the CIA Fact Book (http://www.cia.gov) states: "The 1997 Asian financial crisis highlighted the problems in the Vietnamese economy, but rather than prompting reform, reaffirmed the government's belief that shifting to a market-oriented economy would lead to disaster."

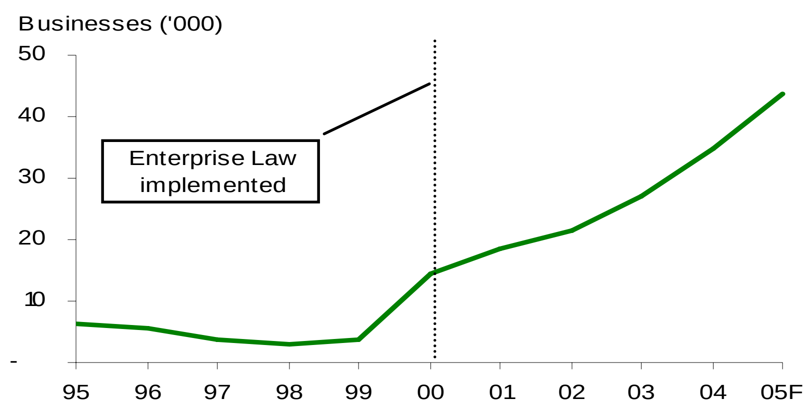
Competition law and Enterprise law regulate and encourage private sector

This is simply incorrect. Prime Minister Khai (PM since 1997) and his team are reformers. They have made it very clear they want the economic reform to accelerate. In 1998, the government introduced an Investment Incentive Enterprise Law, which crystallized the rights of the private sector, defined the status of each type of company, and cut away red tape for setting companies up. Another Enterprise Law was passed in 2000, which makes it very easy to register new businesses. In November 2004, a Competition Law was passed, which aims to monitor and prevent unfair and monopolistic practices. And this year, a Unified Enterprise Law is expected to be passed, which will act as a super regulator of business practices, to ensure everyone is treated fairly.

From just 100 private companies in 1990, there are now 150,000

The fruits of this effort have been plain to see. From just 100 private companies in 1990, there are now 150,000. And while there were 14,000 State Owned Enterprises (SOEs) then, today there are only 4,000, employing just 5% of the total workforce. By contrast, only 12% of the Chinese workforce is employed by the private sector, although private SME's there are responsible for 75% of new job creation and over half of GDP.

Figure 1: New businesses registered



Source: Dragon Capital

A solid, pro-growth administration

Vietnam has had no individual who personifies politics since Ho Chi Minh died in 1969. This makes it quite different from China, and one senses the people who do run the country (the Prime Minister, President, and National Assembly Secretary General) are more cautious than their counterparts in Beijing.

But like China, Vietnam is still a de facto communist country, and carries some of the baggage of that style of governance. For example, property ownership is a bit vague. “Land use rights” are what change hands, not the actual land or buildings on it. The media is still rigorously controlled. The government sometimes makes sudden and draconian decisions; for example last year it decided there were too many motorcycles in Hanoi, so it simply stopped licensing them. You could buy a motorcycle, but you couldn’t drive it.

A quarter of the legislature is now non-Communist party members

But there is little discontent from society overall, because living standards are rising. Like China, the country appears to be relatively well-managed for a transitional economy. And like China, the government is becoming younger and more open. The average age of cabinet members has gone from 65 in the mid-1990s to 53 now, and from nil, a quarter of the legislature is now non-Communist party members.

So for every strange decision made by the government, there are many more good ones. The press may be controlled, but it frequently carries corruption-busting stories, and not just at the middle, but even at high levels. Most recently this happened at the trade ministry, where a senior official was arrested on charges of accepting money in exchange for garment quotas to the US, and last year high-ranking officials at PetroVietnam were arrested on corruption charges that cost the state millions of dollars.

And while it is not a democracy, Vietnam, like Australia, has compulsory voting for local representatives in its national elections, which are held once every five years. These need not be party members.

Latest constitution states private sector should be the largest part of the economy

And when the party attempted to have enshrined in the constitution that the state would have a majority role in the economy, it was rejected by the National Assembly. The latest constitution also specifically states the government’s intention to make the private sector the largest part of the economy. Last year, Communist party members were officially allowed to own private companies. And over the past year, a wave of firings at the Stated Owned Enterprises and at the provincial authority level has brought home the message that privatization is not something the central government wants put on the backburner.

A Strong Trading Nation

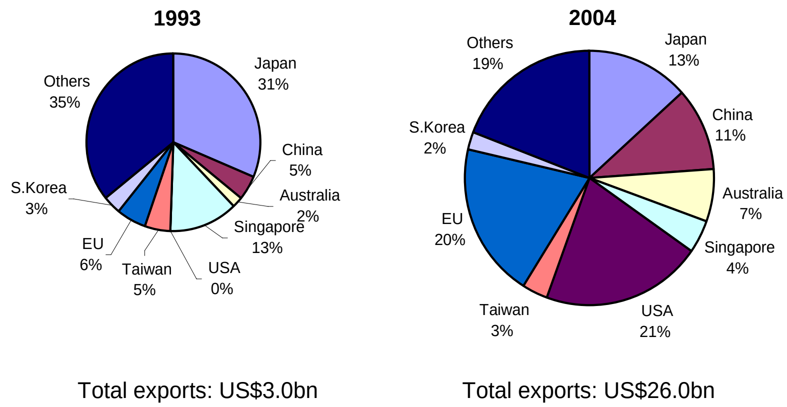
Vietnam’s is officially a US$45 billion economy. But registered trade is 110% of GDP, suggesting actual GDP is significantly larger than stated. GDP growth has been a steady compounded annual 7% over the past decade, not as high as China, but enough to attract legions of entrepreneurs.

On paper, agriculture accounts for 50% of economic output, manufacturing 35%, and services are the balance.

Just over half of what Vietnam produces gets exported, and Vietnam's export momentum has been nothing short of stunning. Exports have grown by 14% per year since 1997 and as of 3Q04 were up 27% YoY. In just a few years, the country has gone from being a net food importer to a net food exporter.

Over half of what Vietnam produces gets exported

Figure 2: Export markets in 1993 and 1994



Source: Dragon Capital

Seven years ago Vietnam was not even on the map in the seafood business. Now it's the world's second-largest exporter of seafood after Thailand. It is the world's second-largest exporter of rice, the world's largest exporter of pepper, and the world's second-largest exporter of coffee. The earth is rich with minerals, although few companies have put money into it for exploration. Vietnam is also East Asia's only other net exporter of oil after Malaysia.

A Bilateral Trade Agreement with the United States in 2001 cut tariffs between the two countries. It has taken the US's proportion of Vietnam's exports from just 6% before to 20% now, making it Vietnam's largest trading partner. Vietnam is also hoping to join the World Trade Organization by 2006.

The US is now Vietnam's largest trading partner

Foreign direct investment

Cumulative Foreign Direct Investment (FDI), which was US$230 million in 1990, reached US$41 billion by end-2003. After slowing to between US$2 billion to US$2.5 billion per year during the 1996–2003 period, actual FDI rose by another US$4 billion in 2004. As a percentage of GDP, it is 7% versus China's 3%, suggesting Vietnam gets more than its fair share, or that GDP is wrong.

This is not surprising as many Japanese and other large Asian manufacturers have a "China + One" strategy. That is, have most of the manufacturing in China, but keep one manufacturing base elsewhere. FDI from existing investors was up 77% year-to-date by end 3Q 2004, showing they still have confidence in Vietnam.

FDI 7% of GDP vs. 4% for China

Figure 3: Export markets in 1993 and 1994

Promising countries for business operations over the medium term			
	2003	**2001**	**1999**
1	China	China	China
2	Thailand	U.S.	U.S.
3	Vietnam	Thailand	Thailand
4	Indonesia	India	Philippines
5	U.S.	Germany	India
6	India	Vietnam	Mexico
7	Malaysia	Hong Kong	Indonesia
8	Hong Kong	Indonesia	Malaysia
9	Korea, Taiwan	Brazil	Vietnam
10	Brazil, Mexico	France	U.K.

Source: JBIC (2003)

Lifting visa requirements for some countries

Most FDI is from North Asia, and most tourists visiting Vietnam come from there too. Japanese and South Korean citizens can enter Vietnam visa-free and China might become visa-free as well soon.

The number of tourist arrivals is large, with 2.3 million arrivals in 2003, and 3 million in 2004. By means of comparison, the Philippines gets just over half a million. But tourism is still only 4% of GDP, compared to 9% in Thailand.

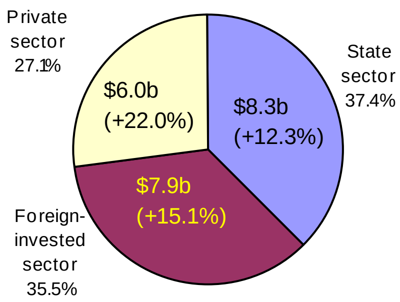
It is pleasant to walk around downtown Ho Chi Minh City, especially compared to fifteen years ago, when hawkers and beggars would follow a tourist for several city blocks. They are largely gone now, replaced by upwardly mobile Vietnamese and North Asian tourists.

Overseas Vietnamese remit US$5-7 billion per year

Approximately three million Vietnamese are citizens of other countries and have successfully integrated into them. These Overseas Vietnamese officially remit UUS$3 billion into the country per year, but one local fund manager Dragon Capital believes this figure is probably closer to US$5 or US$6 billion. Overseas workers, primarily in Asia and the Middle East, remit another US$1.6 billion per year.

Overseas Vietnamese money used to go into household items like TV sets and refrigerators for their relatives living in Vietnam. With a more open regulatory environment and a more vibrant economy, they are now investing it into property and business. Concurrently, family-owned SME's are flourishing.

Figure 4: Growth by sector in 2004



Source: Dragon Capital

Creating a financial sector to legitimize the private sector and grow the economy

The reason the Vietnamese government is so actively encouraging the private sector is simple - there are 1.4 million new entrants to the job market every year, and the government knows there is no chance the public sector can accommodate them all. Indeed, while the private sector created 1.5 million new jobs last year, the public sector continues to contract.

1.4 million new entrants to the job market every year

Stability was the key watchword before, now the government says stability is important, but growth is more important. Ho Chi Minh City, a city of 6.5 million people, is the centre of economic activity. Only 8% of Vietnamese live there, but the city's GDP is estimated at US$8 to US$9 billion, or 20% of total GDP. The city is growing by 11 to 12% per year, compared to the country's 7% growth rate.

A middle class and an entrepreneurial class have been created, condoned, and are expanding quickly, not only in Ho Chi Minh City, but all over the country. This explains the Mercedes and BMW's you can now see in the cities, and is one reason why property prices in Ho Chi Minh are on par with Singapore. Property in Hanoi is twice as expensive as it is in Ho Chi Minh.

A middle class is expanding quickly

These property prices are reflective of a lack of supply, but more importantly as well, of a lack of places to put money. The wealth you see on display in Ho Chi Minh City is the tip of the iceberg. Dragon Capital believes there is at least US$10 billion hidden under mattresses. Much of it would come out if it could be given some amnesty.

Taking baby steps in banking

As you can imagine, Vietnam is still a very cash-driven economy. In 1990, the banking sector was a single bank – the State Bank of Vietnam - which also acted as the central bank. In 1992, the regulator and commercial banks were divided, and the first private sector banks were licensed.

Only 1.4 million bank accounts in a country of 83 million people

But even today, there are only 1.4 million bank accounts in this nation of 83 million people, which means there is more money in circulation outside the banking system than in it. By means of comparison, Thailand has 56 million bank accounts, while the population is 65 million, and Taiwan has more than people!

A legacy of war and the fear of the state, and the memory of double-digit inflation, is still fresh in many peoples' minds. White collar staff – even in banks - have traditionally withdrawn their cash to put the proceeds into dollars or gold.

But this too is changing. People have more trust in banks since a deposit insurance scheme was implemented five years ago. Half of all bank accounts have been opened in just the past two years. Local currency deposits have risen from US$5 billion in 2000 to US$20 billion now, while dollar deposits have risen from US$3 billion to US$6.5 billion.

Last year, when inflation spiked up, Vietnam had borderline real savings rates, and they may have even dipped slightly into negative real territory (inflation spiked as a result of global oil prices, and the impact of chicken flu on food.) But before that, real interest rates were positive, if not very inspiring. Hence the interest in property and insurance policies.

Banks can now price risk

Two years ago, the central bank abolished a lending ceiling of 11%, so banks now lend on interest as high as 15% to borrowers they would otherwise not have lent to. i.e. they can now price risk.

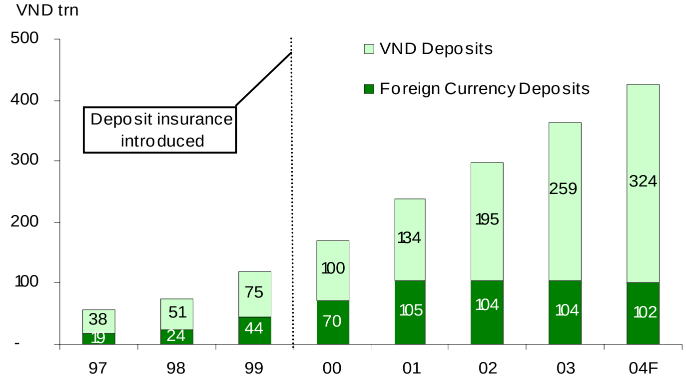
But, banking remains to all intents and purposes primitive. I met one of the private banks – VP Bank. There were few computers visible in the offices I saw, and management was forthright in saying it lends according to "character", as the small and medium sized enterprises who account for almost all private bank lending have "simple" bookkeeping. The bank looks at the amount of tax their potential borrowers pay, what they intend to do with the money they borrow, and how much collateral they have to give.

Simple bookkeeping

In general the system does not appear to suffer from excess. There is a central credit information centre that banks can check on to see if borrowers have lent to someone else, and there is a collateral registration centre. The bank keeps original collateral documents to prevent borrowers from using the same collateral again. As simple as it sounds, the system seems to work.

The banking sector's loans-to-GDP is 60%, and assets-to-GDP is 78%. The loan-deposit ratio is around 60%. State banks now have 55% of deposits, private banks 30% (although this is growing), and foreign banks the remainder, but state banks are still responsible for 70% of the credit in the system. This will change as Hanoi keeps gradually increasing the pressure on state banks not to lend to SOEs unless it is justifiable.

Figure 5: Deposit growth 1996-2004



Source: Dragon Capital

Another illustration of hidden wealth can be found in the recent development of the insurance sector. Life insurance was introduced to Vietnam five years ago. Since then, Prudential of the UK has written 2 million policies worth a total of US$350 million. Manulife and AIA have underwritten around US$100 million each, and the largest local insurer, Bao Viet, has underwritten US$400 million. The majority of these policies were probably - like property – not genuine “insurance policies” per se, but a way to make an investment and legitimize wealth, instead of hiding it in gold or dollars.

Almost US$1 billion of insurance policies written

Ultimately, the government would like investment to be more equally distributed than in property, insurance, gold and dollars. Which is the reason why it has been developing the stock market.

Diversifying investments: the need for a stock market

The stock exchange: Joining the capitalist world

The Vietnam Stock Exchange Index (VNINDEX <Index> on Bloomberg), which comprises all listed companies, has had a roller coaster history in its four and a half short years, as can be seen in Figure 7 below. This is despite the fact that it was purposely kept very small in its formative years, in case anything went wrong.

It was developed with a base index value of 100 as of July 28, 2000 and it opened with just two stocks. Within 12 months it had jumped fivefold to 500, by which time there was a total of 5 listed companies. The index then fell back to 200 the next year, and descended gradually to a low of 135 in November 2003, at which time there were over twenty listed companies. Since then it has risen 73 percent to 233.32.

There are currently 26 listed companies. The market cap is US$249 million, and the average daily turnover is around US$600,000. By any standard, trading volumes are exceptionally low.

A tiny stock market for an economy this size

Figure 6: Comparative statistics on regional stock markets

	Vietnam	Thailand	Philippines	Indonesia
No. of listed cos	26	435	153	334
Mkt cap ($bn)	0.25	128	24	76
Avg daily turnover ($mn)	0.6	581	35	103
PER ('04) x	7.4	10	12.6	9.2
Div yield ('04) %	5.5	4.3	1.6	4
No. of brokers	13	36	125	170

Source: CLSA, Dragon Capital

Figure 7: Vietnam Stock Exchange Index

Source: Saigon Securities

Trading on around 6.3x '05 PER with a dividend yield of 5.5%

The historical market Price-to-Earnings ratio was 10.1x in 2002, and 9.2x in 2003. 2004's PERs ranged from 5x (beverage company TRI) to 11x (cable company Sacom), with the average at 8.3x according to local investment house Dragon Capital. The PER in 2005 is thought to be around 7.3x according to the same, dropping to 6.3x next year.

The average payout ratio of a listed Vietnamese company is 50% and the 26 listed companies have a combined average dividend yield of 5.5%, compared to the 12-month deposit rate of 8%. Only two listed companies have debt/equity ratios over 1x. Not all 2004 dividends have been declared. However, here is a list of those stocks that have declared and that have a yield of more than 5%:

Figure 8: Examples of high-yield stocks

Stock	'04 Div Yield
GILIMEX	8.46%
TRIBECO	7.50%
Saigon Hotel	6.30%
LAFOOCO	5.35%

Source: PXP Fund

In order to qualify for listing, companies must sell at least 20% of their shares to the public, have at least two years of continuous profits, and have a minimum capital of 5 billion dong (US$315,000).

There is currently only one domestic fund, Viet Fund Management, which opened in May 2004. It received US$20 million from over 1,000 investors and after the first six days had to stop taking applications.

The maximum up or down movement of any stock is 5% per day. Settlement is T+3, the maximum commission that can be charged is 50 basis points, and the average is 30 basis points. There is no capital gains tax and a 10% withholding tax has been abolished, although a 1% stamp duty is envisaged.

Foreigners can own up to 30 of Vietnamese stocks

Foreigners can invest directly in Vietnamese stocks. They must keep their principal in the country for one year, but can repatriate dividends. Seven stocks have hit the 30% foreign ownership limit (which the government has signalled may be raised to 49% eventually). The 30% foreign cap for companies applies whether the foreign shareholding is held by a single foreign individual/entity, or multiple ones. For banks, however, in addition to the 30% aggregate cap, there is also a 10% cap on how much a single foreign individual/entity may hold.

Unfortunately though, investing in Vietnam directly requires going there in person to have your birth certificate and passport notarized at your embassy in Hanoi or consulate in Ho Chi Minh City. Once that's done it's relatively easy to open a custodian account (at the cost of US$250) at one of three banks that offer the service, and then a trading account at one of Vietnam's thirteen stock brokers.

Still, there is a long way to go. There are 19,000 custodian accounts, 200 of which are in foreigners' names, and only 10% of those are institutions. By means of comparison, and although there are no firm statistics, it is thought there are around 1 million brokerage accounts in Thailand.

A 30-fold increase in market cap in the next five years

The government's official target is for there to be 1,200 listed companies on the stock market by 2010, with a combined capitalization equivalent of 10% to 15% of GDP. It is 1.6% now. So, if we assume the economy continues to grow at 7% per annum as it has in the past decade, this means a market cap of around US$8 billion by 2010.

To put this in perspective, Thailand has a market cap of US$128 billion and the Philippines US$25 billion. Indeed, one Thai stock alone, PTT Public Company Limited, has a market cap sixty times the size of the whole Vietnamese stock market.

The OTC market dwarfs the stock market in size

The informal Over-The-Counter market is where most companies trade before they list on the stock market. The companies that trade there are SOE's that have privatized, or as is the popular expression in Vietnam, "equitized". In the equitization process, the state reduces its holding to a minority, shares are allocated to related parties (staff, customers etc.), and the assets and liabilities are transferred to a corporate entity.

The OTC market is six times the size of the stock market.

The OTC market currently comprises around 500 companies. Dragon Capital believes it is six times the size of the stock market. They are mostly profitable, with Return-on-Equities averaging 20% and dividend yields 10%, according to a source at Saigon Securities. But it lacks transparency, corporate governance and regulatory compliance (an agency to govern and monitor the OTC market is meant to be set up in Hanoi but has not yet done so).

The OTC market is the first step to privatizing for SOE's

Many newly-equitized SOE's should also be added to the OTC market. The number of SOEs that have equitized has gone from 100 in 1998 to 2,600 this year. The 4,000 that remain to be privatized are the bigger ones.

In the short term, recent regulations allowing "joint stock" banks to list pave the way for two of Vietnam's banks, Sacom Bank and Asia Commercial Bank, which alone are capitalized at US$145 million in the OTC market, or over 60% of the stock market's current capitalization.

One OTC company alone - Vina Milk - would almost double market capitalization

Medium-term, in the pipeline to list are also the largest beverage company Vina Milk, Saigon Tourist which owns many hotels across the country, the country's largest bank VietCom Bank, and its second-largest insurer, Bao Minh Insurance. Vina Milk alone would almost double the current capitalization of the stock market. It's share auction in mid-February reduced the state ownership from 75% to 60%, paving the way for a stock exchange listing. 122 firms registered to partake in the auction, and according to Vietnam Investment Review, eight of the nine buyers were foreign investors. average price paid was 42% above the floor price. Vinamilk collected US$36.4 million from the auction.

Figure 9: Active OTC companies

	Approx. mkt cap US$m
Vina Milk	242
Asia Commercial Bank	81
Saigon Thuong Tin Bank	64
Bao Minh Insurance	61
Tuong An Vegetable Oil	20

Source: PXP Fund

Private companies reluctant to disclose their books

By contrast, listing on the stock market has not proved popular with the private sector. All of the 26 listed companies were originally state-owned, with the exception of beverage company Tribeco, and the recently-listed candy maker North Kinh Do Food Joint Stock Company (North Kido).

Even though it drives the economy, and despite the number of new business registrations, the private sector remains very much at the urban household level and transparency is low. Taxation is a problem. Many private companies do not pay taxes, and listing on the stock market would expose that.

A tax amnesty must be offered to get past this problem, at which point there will be great potential, as there are over 100,000 private companies in Vietnam, although if other countries offer any precedent it may take more than this. Tax amnesties have not worked in the Philippines for example because companies always assume there will be one more. Indonesia and China also show that paying the tax collector under the table still pays off.

Between now and then, some private companies are getting around this problem by selling their assets to new companies, so they can start on a fresh sheet. But to list on the stock market, at least a two year track record is required.

A long-term story

Should we be positive about the Vietnamese economy? Yes, for the following reasons:

Four reasons why Vietnam's will remain a dynamic economy

(1.) Politics: In the old days, the leftists were influential in all kinds of decision making in Vietnam. Now they have lost their clout; the country is firmly committed to growing the private sector; and hardly anyone wants communism to come back.

(2.) Human resources: Vietnam has a large surplus of educated people. The end of the war in 1975 was followed by a baby boom, so half the population is under 30 years old. As of 2002, the country's income levels are on par with China's. The rift between rich and poor is not as extreme as some other Southeast Asian countries. For example, using the World Bank definition of poverty as less than US$20 a day, 30% of the country is below the poverty line. By means of comparison, the Philippines is 70%. This is in part because Vietnam practices a "development capitalism" - Much recognition must be given to Vietnam's decade-old Hunger Eradication and Poverty Reduction Programme. It provides among other things vocational training and loans to set up businesses, such as street vendors and pedicabs.

(3.) Competitiveness: It is generally more expensive to operate a service sector business out of Ho Chi Minh than it is Bangkok as Figure XX below shows. But as 85% of Vietnam's economy is agricultural and manufacturing-based anyway, the most important aspect is labour, and that is still cheap. Labour costs are less than Thailand, China and the Philippines, but slightly more than Indonesia.

(4.) The country is rich in natural resources, although war, communism, the lack of a proper mining law (enacted finally in 1996, together with an amending decree in 2000), and finally the Asian crisis all mean that only a tiny bit of what's in the ground has been properly surveyed.

Figure 10: Comparative costs of operating in Vietnam versus Thailand

In USUS$	Vietnam	Thailand
Semi-skilled worker salary per month	73	375
Rent (office downtown sqm/month)	23	10
Phone call to Hong Kong during working hours	0.65	0.46
Mobile phone per minute	0.11	0.08

Source: CLSA

Take Thailand as a comparison

Looking at another emerging market as an example

Can people make money by being long-term holders of financial assets in Vietnam from this very early stage? This is a different question. A stock market and an economy are not the same thing. Let's get perspective from looking at an historical experience: What would have happened if you had taken your money from the already relatively mature Hang Seng Index in 1975, put it in the brand-new Thai stock market, and kept it there for a long period, say 15 years?

The beginnings in Thailand's stock market were remarkably similar to Vietnam's (ironically, the Securities Exchange of Thailand officially started on April 30 1975, the same day Saigon fell). Eight companies first listed on the SET. They were Siam Cement, Bangkok Bank, Berli Jucker, Dusit Thani Hotel, Thai Glass Industry, AIG Finance, Carnaudmetalbox and Faber Merlin.

Thailand's stock market underperformed Hong Kong during its formative years …

The first three years of trading saw the SET index rise threefold by 1978, then inflation and high interest rates saw it drop 60% by 1981. Then, a combination of events joined together in Thailand's favour in the early and mid-1980s. Oil prices and interest rates fell. Protection was reduced or removed in foreign ownership laws for direct investment (where new tax incentives also encouraged inflow), and portfolio, through amendments to the SET Act. So while FDI was less than US$10 billion per year before 1988, by 1988 it jumped to US$44 billion, and in 1989 to US$57 billion. By the end of 1988, the SET rose by 230% in local currency terms and 141% in USD dollar terms, or 7% compounded annually. However, over the same period, the HSI rose by 863% in local currency terms and 517% in US dollar terms, or 15% compounded annually.

So it certainly wouldn't have made sense to be in the newer, more exotic Thai market.

There are two lessons to be drawn from the Thai experience:

(1.) Stock selection is as important in emerging markets as it is in developed markets. Of the eight original companies listed on the SET, only four remain (Bangkok Bank, Siam Cement, Berli Jucker and Dusit Thani Hotel). The parents of three of the others tendered for the outstanding shares and they were de-listed. In fact, from its inception, 124 companies have de-listed from the SET (there are currently 435 listed companies).

Had you held the four remaining ones until today, you would have done very well in Siam Cement for example, but much less well in the Dusit Thani Hotel.

Figure 11: How you would have done in the SET's "original four"

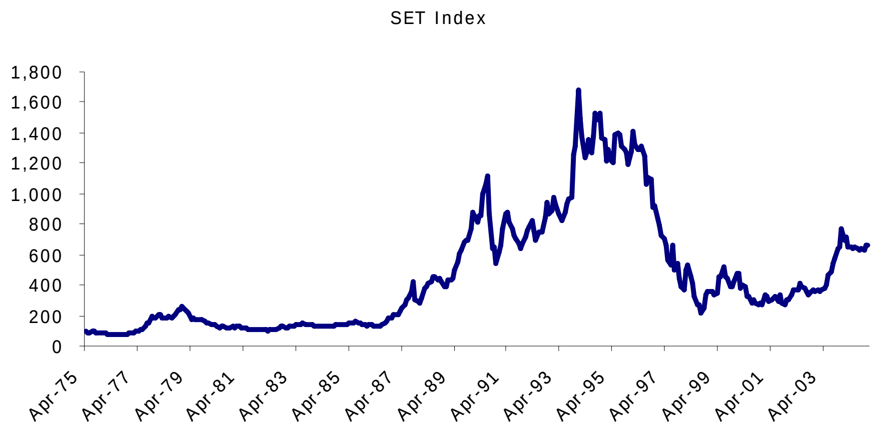
	Bangkok Bank	Siam Cement	Berli Jucker	Dusit Thani
Cumulative return (%)	28.70%	528.1	225.9	89.0
Annual return (%)	0.96	17.6	7.5	3.0

Source: Stock Exchange of Thailand

(2.) Although other events conspired in its favour (i.e. falling oil prices and interest rates), clearly the opening of the Thai economy and stock market to foreign investors in the early and mid-1980s was the catalyst to its outperformance. Indeed, from 1985 to 1995, Thailand outpaced all the other Asian markets, and that was where it was really re-rated.

... But took off once it opened up to foreign investors

Figure 12: Stock Exchange of Thailand from inception to present



Source: Stock Exchange of Thailand

Figure 13: Turnover value expansion in Thailand

Growth of the Stock Exchange of Thailand

	No. of companies listed	Volume (m shares)	Value (Baht)
1975	14	3	545
1985	80	43	9,563
2005	521	123,908	666,278

What a difference opening up a market to the outside world makes

Source: Stock Exchange of Thailand

Figure 14: Thai PE expansion and yield contraction as the market opened up

	P/E (x)	Market Yield (%)		P/E (x)	Market Yield (%)
1975	4.98	10.16	1991	15.59	3.59
1976	5.83	7.28	1992	16.29	2.91
1977	11.34	3.93	1993	26.09	2.01
1978	8.46	5.74	1994	19.51	1.86
1979	5.84	9.18	1995	19.75	2.25
1980	6.4	9.42	1996	11.97	3.5
1981	9.52	9.57	1997	6.59	6.04
1982	11.83	8.53	1998	10.04	1.34
1983	6.54	6.97	1999	14.7	0.61
1984	7.19	9.07	2000	5.52	1.78
1985	9.59	8.15	2001	4.92	2.06
1986	12.34	4.3	2002	6.98	2.72
1987	9.31	3.86	2003	13.65	1.81
1988	12.03	3.84	2004	9.4	2.75
1989	26.39	2.07	2005	10.31	2.86
1990	13.81	3.63			

Source: Stock Exchange of Thailand

More Conservative Development

A consensus society

Vietnam takes things slowly and, as such, has avoided a lot of the negative aspects of really fast growth. It's a consensus society, and there is a high level of concern about income equality, which makes the reform process more of a step by step process than other countries. By the same token though, there is an obvious assertion from the highest level of government that people should be encouraged to make money.

Hence the current leaders' view is that the merits of the capitalist system are to create wealth, and the merits of the socialist system are to distribute it. And to a certain extent, this has been reflected in the nature of the Vietnamese economy and Vietnamese businesses. Unlike China where the largest shareholder in most SOEs remains the state, in Vietnam the state is a minority investor in most cases.

An absence of family or government nepotism …

While the Thai economy remains to this day deeply influenced by family-owned conglomerates that pay scent attention to minority shareholder interests, most Vietnamese listed companies have several thousand shareholders each, which contributes to a remarkable degree of transparency and pressure to raise accounting standards. There are already over 200,000 shareholders of listed companies. If just 10% of shareholders get together, they can call an EGM. Minorities that feel they have been abused have been known to blow the whistle through journalists. For example minorities of Haiphong Paper Co., teamed together in an EGM in 2001 to force management to lower the price of a new share offering to them by 20%.

For some however, Vietnam's pace of reform in Vietnam has been frustratingly slow. The private sector remains only vaguely interested in the stock market, and this is unlikely to change as long as a tax amnesty is not in place, or at least rules relieving private companies from the obligation to do a backward audit.

None of the big corporates have listed. Vietcom Bank's application for equitization last year appears to be at a mysterious standstill. Vina Milk too, which was originally supposed to divest by 49%, is now divesting 35%. And an OTC market in Hanoi has been delayed again.

... But a slower pace of development

Some of the big SOE's will probably not be listed at all. The government does not want to be seen as "selling out" of high profile or sensitive companies like PetroVietnam or Vietnam Airlines.

Progress will be slow

But there is a reason why the government is not pushing harder. To force changes too quickly would invite a negative response from the many stakeholders who are advantaged by the current framework. Like any country in the midst of reform, there is a whole middle stratum of bureaucracy in Vietnam that is in a comfort zone, and is quietly resisting instructions to change the way things are done. Some of the big SOEs are cash cows and the potential for kick-backs is large, therefore it is to be expected those who benefit from them will fight equitization tooth-and-nail.

Enacting legislation is the easy part. Institutions also need to be built to supervise the market economy that simply weren't there before. These are now slowly being put into place. There is a certain sense that Vietnam will do things it's way.

Vietnam realizes it needs to join the regional capital markets

Vietnam is unlikely to radically depart from the road it is on. What is important to highlight though, is that the government does realize once the institutions are in place, some big cap offerings need to be presented to the capital market. If they are not, it will never gain the traction it needs to be a viable part of the economy, and Vietnam will never have the weight an economy of its size deserves in international financial markets.

So, at some point in the future, when the leadership decides the economy is mature enough, it will open the economy and stock market up for greater foreign participation, just as Thailand did in the mid-1980s. But when?

In terms of the economy, the pace and depth of that opening up process will largely be determined by various time-bound commitments that Vietnam has made, such as the US BTA and WTO accession.

The velocity and extent to which the stock market will open up to greater foreign investor participation is harder to gauge, but it is probably the key for when Vietnam is re-rated from 7.3x PER and 5.5% dividend yield to something more in tune with the regional average or China. That's because the government has a greater ability to adopt a pace of its own choosing with the stock market than it does with the economy.

Patient accumulation now will yield good

It is entirely likely the stock market will double in size this year, and again in 2006. But that would still only make it a US$750 million market, or 0.6% the *results*

size of the Thai market, and 3% the size of the Philippines' market. Anyone anticipating a big bang scenario will be sorely disappointed. But some prudent accumulation in good names there now, and in firms that come to the market in the next few years should, given the performance of the previous markets if an investor is prepared to be patient - yield good results.

It won't be tomorrow, there will be no massive boom, but keep your eye on Vietnam, because it is likely to creep up on you.

How To Invest

A scarcity of investment vehicles

Short of flying there yourself to open a custodian and securities account, the most obvious way to invest in Vietnam is through funds. Total new and old funds are now at about US$270 million. LCF Rothschild's County Funds directory lists eight of them, but there is almost no way of dealing in most of them, as they hardly ever trade. (to see these on Bloomberg, type LCFR <GO>, (1.) <GO>, and page forward to page three). This is certainly not a reflection of the merits of the economy, but more a reflection of the liquidity of the underlying vehicles.

Dragon Capital is the largest and most established portfolio investor in Vietnam. Their Vietnam Enterprise Investments (US$130 million) has been in existence since 1995 [VIETENI KY]. Their new Vietnam Growth Fund invests in listed or listable (OTC) securities only. The company has been in Vietnam for eleven years. (www.dragoncapital.com).

Vina Capital, launched in Sept 2002, has US$20 million under management, and invests in private equity deals. It is listed in London [VOF LN]. (www.vinacapital.com).

There is also the recently-launched PXP Fund (US$10.5 million), which focuses purely on listed companies (www.pxpam.com).

Finansa PLC [FNS TB] is launching a new US$20 million fund which invests in OTC companies (www.finansa.com), which should close in the next month or so.

Arisaig Partners are the only regional fund that invests partially in Vietnam. (www.arisaig.com.sg).

A variety of obscure Vietnam plays also exist, almost all of them minerals. Tiberon [TBR CN, mkt cap US$58 million] is a tungsten mine with all its assets in Vietnam. Olympus Pacific [OYM CN, mkt cap US$26 million] is a gold mine. Triple Plate Junction [TPJ LN, mkt cap US$32 million] is a truly conceptual mine stock (minerals in the "palaeo tectonic plate junction" of northern Vietnam). Vedan [2317 HK, mkt cap US$320 million], is one of the world's largest makers of MSG, which manufactures its product & sells 60% of it there. Vietnam Industrial Investments [VII AU, mkt cap US$14m)] operates steel mills in Vietnam.

Singapore's stock exchange has been making overtures to Vietnamese companies to list there following the success of Chinese and Indian listings on the SGX, and listed company (Gemadept) has already expressed interest.

But most importantly, a substantial revamp and upgrade of the regulatory and physical infrastructure should allow foreign institutions overseas to invest directly in stocks there, perhaps by the end of next year, although we should not assume this is engraved in stone.

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Useful websites:

Vietnam Investment Review: http://www.vir.com.vn

Vietnam News: http://vietnamnews.vnagency.com.vn

State Securities Commission: http://www.ssc.gov.vn

Dragon Capital: http://www.dragoncapital.com

Saigon Securities (real time quotes): http://web2.ssivn.com

Appendix 1: Companies listed on the Vietnam Stock Exchange

Name	Co profile	Market Cap US$	Trailing PE	Dividend yield
An Giang Fisheries Import & Export Joint-Stock Co	Catfish breeder and processor	9,426,210	7.5	7.1
Bien Hoa Confectionery Corp	Food processing, predominately biscuits and sweets	5,977,508	6.6	-
Bach Tuyet Cotton Corp	Largest domestic producer of sanitary napkins and bandages	4,563,187	5.8	10
Bim Son Packaging Joint-Stock Co	50% owned by a cement co of same name, produces cement bags for them	4,080,310	5.9	8.9
Chau Thoi Concrete Corporation No.620	Produces dry concrete slabs for bridge spans and telephone poles	11,848,356	10.9	5
Binh Trieu Construction And Engineering Joint-Stock Co	Engineering contractor	1,178,078	-	-
Halong Canned Food Corp	Seafood and processed meat canning	3,335,663	8.7	4.3
Hoa An Joint Stock Co	Quarry producing construction materials for cement	6,982,655	5.7	9.6
Da Nang Plastic Joint-Stock Co	Plastics company serving the Danang area	907,651	55	3.4
Binh Thanh Import-Export, Production And Trade Joint-Stock Co	Garments, backpacks and shoes, a little seafood exporting	5,184,573	5.5	7.1
General Forwarding & Agency Corp	Logistics; one of largest freight forwarders and warehousers	57,301,537	9.8	2.3
Hai Phong Paper Joint-Stock Co	Produces "hell money" to be burned for ancestors, all exported to Taiwan	4,914,923	6.9	12.7
HACISCO	Telecoms installation and repair	2,663,447	6.7	5.8
Khanh Hoi Import Export Joint-Stock Co	Garments, and construction	4,840,238	10	8.1
Long An Food Processing Export Joint-Stock Co	Predominately cashew nuts	3,931,560	8.6	5
North Kinhdo Food Joint-stock Co	Biscuits and bakery	9,816,380	10	5.3
Petroleum Mechanical Stock Co	Manufacturer of steel oil drums	3,375,056	10	8.4
Refrigeration Electrical Engineering Corp	Mainly electronics for white goods, and a large landlord	34,023,763	14.4	5
Cables And Telecom Materials Joint-Stock Co	Cable laying for telcoms	43,458,924	10.8	4.4
Import-Export & Economic Co-Operation Joint-Stock Co	Furniture manufacturer	9,006,290	7.6	5.5
Saigon Fuel Co	Distribution of fuel through petrol stations	2,138,637	6.7	8
Saigon Hotel Corp	Owns the Saigon Hotel in downtown Ho Chi Minh City	1,616,032	14.2	4.4
Trans-Forwarding And Warehousing Corp	Logistics; one of largest freight forwarders and warehousers	6,814,283	7.9	7
Sai Gon Beverages Joint-Stock Co	Non-alcoholic soft drink producer	5,924,225	5.8	9.1
Sea Food Joint-Srock Company No. 4	Fish processor	1,667,832	6.6	7.1
VTC Telecommunications Joint-Stock Co	Producer of smart cards, also installs and repairs telco equipment	3,655,104	6.3	4.2

Source: Saigon Securities