15th October 2019

AFC VIETNAM FUND UPDATE

Fund Category	Vietnam Public Equities
Country Focus	Vietnam
Subscriptions	Monthly at NAV (five business days before month end)
Redemptions	Monthly at NAV 30 days' notice
Benchmark	VN Index
Fund Manager	Vicente Nguyen
Investment Manager	Asia Frontier Capital (Vietnam) Limited, Cayman Islands
Investment Advisor	Asia Frontier Investments Limited, Hong Kong
Fund Base Currency	USD
Minimum Investment	USD 10,000
Subsequent Investments	USD 1,000
Management Fee	1.8% p.a. of NAV
Performance Fee	12.5% p.a. of NAV appreciation with high watermark
Fund Domicile	Cayman Islands
Launch Date	23 December 2013
Custodian Bank	Viet Capital Securities, Ho Chi Minh City
Auditor	Ernst & Young, Hong Kong
Administrator	Trident Fund Services, Hong Kong
Legal Advisor	Ogier, Hong Kong
ISIN	KYG0133A1673

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The first few trading days of October were uneventful. Again, volatility was very low compared to other markets. Even news about progress in the trade talks between China and the USA had little impact on the Vietnamese stock market. The indices in HCMC and Hanoi moved in the opposite direction with -0.4% in HCMC and +0.9% Hanoi respectively. Small and mid-cap stocks were also little changed and so was also our portfolio, which is up +0.1% to USD 1,833, according to internal calculations.

Market Developments

Trading was concentrated in a few groups of stocks, such as banks, the family of *Vingroup* stocks and *FLC Faros Construction (ROS),* which alone has been responsible for more than 10% of the total turnover on the Ho Chi Minh Stock Exchange for the past few weeks, and rising. Meanwhile, turnover on both the Hanoi Stock Exchange and UPCOM is around 20% lower than the average for the past 12 months and valuations are getting cheaper as a consequence of weak market breadth.

	Ho Chi Minh City	Hanoi	UPCOM
Mkt cap (USD bln)	144.1	8.0	42.2
P/E TTM	16.8x	7.5x	8.6x
Dividend yield	1.9%	2.6%	5.1%

(Source: Viet Capital Securities)

A few heavily weighted stocks in the Ho Chi Minh City Index are pushing up the closely watched index valuation, but the reality, apart from these handful of stocks, is that there are numerous stocks with very attractive valuations, and several of them are part of our portfolio. A portfolio consisting of high dividend yields and stocks mostly trading at or below 10x earnings in a large and fast-growing economy like Vietnam has historically always enjoyed an excellent long-term risk-reward ratio.

New Indices

Looking to further improve attractiveness and liquidity, the Ho Chi Minh City Exchange will introduce two new indices later this month, the *Vietnam Diamond Index* and the *Vietnam Financial Select Sector Index*. It is expected that new products will be introduced based on these indices, which would also allow foreigners to bypass foreign ownership limits. With underwriter risks on such products, similar to the recently introduced warrants, those products are once again most likely to be trading vehicles for local speculators and not for institutional investors like us.

Furthermore, the expected composition of both indices shows again the same issues like existing indices: a concentrated weighting of the top 5 stocks (a combined weighting of more than 50%!) and the top 6 and top 5 stocks for the Diamond and Financial Indices are not available for foreign investors.

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VIETNAM DIAMOND INDEX

Ticker	Sector	Weight
MWG VN Equity	Consumer Discretionary	15.0%
TCB VN Equity	Financials	15.0%
FPT VN Equity	Information Technology	14.6%
VPB VN Equity	Financials	11.0%
MBB VN Equity	Financials	8.8%
PNJ VN Equity	Consumer Discretionary	8.2%

VIETNAM FINANCIAL SELECT SECTOR INDEX

Ticker	Sector	Weight
TCB VN Equity	Financials	15.0%
VPB VN Equity	Financials	15.0%
MBB VN Equity	Financials	12.3%
VCB VN Equity	Financials	10.7%
STB VN Equity	Financials	9.0%
HDB VN Equity	Financials	8.8%

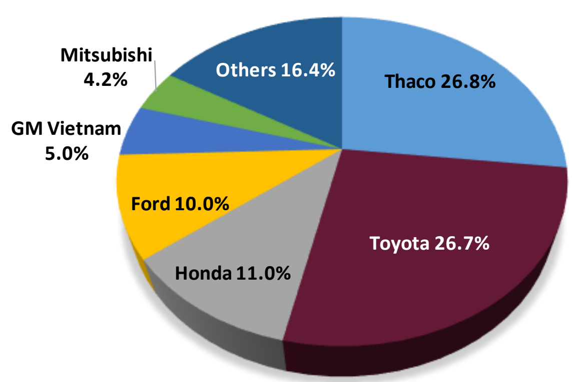
(Source: Viet Capital Securities)

Vinfast - a new hope for the Vietnamese auto industry?

More than two decades ago the Vietnamese Government issued multiple policies in an attempt to stimulate and encourage the very small local automotive industry with the hope that one day Vietnam would make the first car built in Vietnam. Tax exemptions, free land leases and high import taxes are common policies to protect and stimulate local enterprises. Simultaneously, the government also attracted foreign investment enterprises such as Honda, Toyota, Ford and Suzuki to set up factories in Vietnam with the purpose of technology transfer to local enterprises. Among those policies, the car import tax is considered to be the most powerful incentive to establish local production. Particularly, the car import tax reached as high as 600% in the past. This is why cars were always too expensive for local citizens to afford.

After more than 20 years, foreign companies such as Toyota, Honda, Ford, etc., continue to dominate the market with nearly 75% market share. The only local success story is Truong Hai Automobile Corp (Thaco), mainly due to its impressive Chairman, Mr. Tran Ba Duong, who saw a niche market in the local truck segment. Today Thaco is the largest truck manufacturer and also the largest auto distributor in Vietnam. In 2018, Thaco sold nearly 28,000 trucks, 2,000 buses and more than 66,000 cars. Thaco is the exclusive distributor of Kia, Mazda and Peugeot.

Car market share in 2018 (%)



(Source: VAMA, AFC Research)

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There are many reasons why local auto companies failed to create their own brands in the past, with a lack of technology and scarce capital resources being among the main factors. History shows that the only successful countries in Asia developing their own cars after World War II were Japan and South Korea, and more recently China and India. Malaysia tried as well with limited success with their Proton brand. Thailand, on the other hand, attracted a lot of capital from international auto companies over the past 20-30 years and is currently still the most important production hub in Asia, without having a national brand.

Vinfast, which belongs to Vingroup, is the first Vietnamese auto manufacturer, founded only two years ago. Vingroup announced the incorporation of Vinfast in order to produce its own cars and electric motorbikes. Interestingly enough, the Vinfast name doesn't actually have anything to do with velocity. Instead, the *Vin* part stands for Vietnam, while the *FAST* part is a sort of an acronym. In Vietnamese, FAST stands for F (Phong Cach) - style, A (An Toan) - safety, S (Sang tao) - innovation, T (Tien Phong) – pioneer. Vingroup is the largest company in Vietnam with a total market cap of USD 17 bln. Its size gives them strong financial power to make the Vietnamese car dream come true, although Vingroup had to raise debts of a few bln USD to start this venture. To skip the many years of R&D necessary to develop new cars, Vingroup bought licenses from BMW. Furthermore, Vingroup took over GM Vietnam to access its distribution network and client base. At the beginning of 2019, Vinfast announced its first car to the market and ran a huge and costly marketing campaign to promote the brand. For example, Vinfast signed a contract with David Beckham to promote its new car at the Paris Motor Show 2018, which became a much-viewed event at the show. Additionally, the mother company Vingroup will also be one of the main sponsors of the Formula 1 race in Hanoi in 2020.

Vinfast – David Beckham at Paris Motor Show 2018.

(Source: VINFAST)

Everything seems to be in place to provide a good start for Vinfast. However, in order to create a successful story like Thaco, Vinfast needs time to establish its brand and earn trust in the quality of its cars. From a customers' perspective, everything seems to be a little bit rushed, taking only two years to launch its first car, and some potential customers might worry that they didn't have the time to fully test the new car, but the future will tell. If Vinfast manages to win over the market with their products in the coming months, then it will be a new important milestone in the history of the Vietnamese auto industry.

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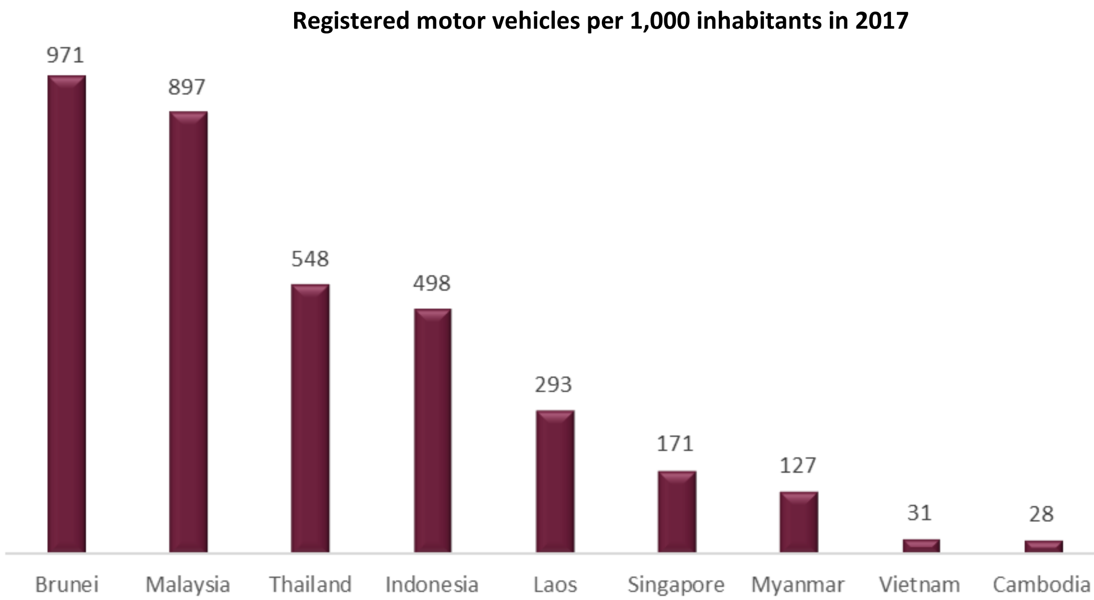
On many independent automobile websites one can find comparisons between Vinfast cars and its competition, and it seems that Vinfast has a strong focus on an attractive price policy. But if Vinfast aims to become an international success story, then it is crucial that the whole supply chain and its companies set up production facilities in Vietnam, in order to avoid high import taxes on parts or end up on the radar of other car manufacturing countries as being seen for unfair trade practices.

	VINFAST SA 2.0	Toyota Fortuner 2019 (2.8 V 4x4)
Price (VND mln)	1,250	1,354
Number of seats	7	7
Engine	DOHC, I4	1GD-FTV
Gears	8	6
Cylinder capacity	2.0L	2.8L
Horse power (PS)	228	174
Torque (Nm)	350	450

(Source: NEXTGEN Vietnam Joint Stock Company, AFC Research)

There is huge room for the growing auto industry in Vietnam, with current growth rates of 15% annually. Passenger car sales in particular are growing very strong and are ahead of estimates, growing 30% in the first 10 months over the same period last year. Vietnam has one of the lowest car ownership ratios in the world. According to ASEAN, registered motor vehicles per 1,000 people in Vietnam stands at only 31 in 2017, compared to 971 in Brunei, 897 in Malaysia, 548 in Thailand and 498 in Indonesia.



(Source: ASEAN, AFC Research)

However, increasing car sales are also a problem for Vietnam's road infrastructure which is not keeping up with the growing number of cars and motorbikes on the road. This is a serious social and economic problem for Vietnam and is the reason why Vietnam needs to invest aggressively into infrastructure in order to facilitate its economic growth.

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Traffic in Hanoi - Vietnam stands among the lowest car ownership per capita in the world but traffic jams are one of the worst in the world

(Source: Dantri, AFC research)

Furthermore, air pollution is becoming a more and more serious problem, not only in Vietnam but also all over the world. Therefore, most giant automobile companies are spending billions of dollars to invest into environmentally friendly vehicles like electric cars. Vinfast is cooperating with an Austrian company, Kreisel Electric, to manufacture new battery packs to enter the market with electric cars and buses by 2020. Already in November 2018, Vinfast introduced its electric motorbike, Vinfast Klara.

Vinfast Electric Motorbike, VINFAST KLARA

(Source: Vinfast)

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What looks to make sense for the daily city traffic, one wonders how soon Vietnam will have the infrastructure in place to support electric vehicles throughout the country, when this is still one of the major issues for the breakthrough in developed countries. But maybe a country government like Vietnam has here even an advantage in executing the necessary development - if they really want to.

Economy firing on all cylinders

The economy in Vietnam is also running on 8 gears and shows no signs of slowing down. The 9-month GDP in 2019 reached its highest level in nine years. Despite the global slowdown and delays in many important real estate and infrastructure projects, Vietnam's GDP posted 7.31% YoY growth in Q3 2019 vs the 6.82% YoY seen in Q3 2018. Industrial production has also improved +10.3% in the latest quarter, despite several headwinds which should somewhat dampen growth in the very near future. Although consumption is also very strong with a healthy growth rate of 11.6%, inflation is still well under control at a three-year low of just 1.98% yoy.

Meanwhile, disbursed FDI rose to USD 2.22bln, which was the highest monthly disbursement in 2019 YTD and further supports the stable exchange rate, which hardly moved this year, which is exceptional, given what has happened around the emerging world this year. Maybe the biggest surprise this year so far has been the high fiscal surplus of VND 63.8tln (USD 2.2bln) versus a deficit of VND 26.8tn (USD 1.17bln) which was recorded in the first 9 months 2018. The main reason for that – and this is the downside of this news – is the sluggish disbursements for investment and development. The trade balance also improved over the course of 2019, which shows now a trade surplus of USD 7.1bln in the first 9 months versus the preliminary estimates of USD 5.8bln.

With all those fantastic economic parameters we are stunned that Vietnamese equities still trade at such cheap valuations, if we exclude the few index heavy weights we were mentioning. More importantly, we are wondering when this is going to change.

Subscription

The next subscription deadline will be 25th October 2019. If you would like any assistance with the subscription process please be in touch with Andreas Vogelsanger.

Best regards,

AFC Vietnam Fund

15th October 2019

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Estimated NAV as of 15th October 2019

NAV	1,833*
Since Inception	+83.3%*
Inception Date	23/12/2013

Monthly Performances AFC Vietnam Fund

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2013	**USD**												+2.37%	**+2.37%**
2014	**USD**	+8.75%	+4.50%	+2.18%	−4.65%	−0.32%	+1.45%	+1.86%	+5.49%	+3.87%	+2.83%	+2.50%	+0.60%	**+32.50%**
2015	**USD**	+0.44%	+1.76%	−0.96%	+1.93%	−0.48%	+0.06%	+0.22%	−4.57%	+1.18%	+6.90%	−1.82%	+0.25%	**+4.62%**
2016	**USD**	−0.10%	+3.30%	+1.28%	+3.17%	+1.40%	+4.97%	+3.0%	+0.13%	+0.11%	-1.83%	+0.88%	−1.76%	**+15.29%**
2017	**USD**	+1.90%	+1.10%	+1.94%	+1.03%	+2.96%	+4.52%	+1.94%	-4.38%	+1.09%	-0.75%	+1.47%	+0.01%	**+13.33%**
2018	**USD**	+0.41%	+0.42%	+0.58%	-0.93%	-3.24%	-0.12%	-1.28%	+0.79%	+3.02	-2.14%	+0.45%	-2.05%	**-4.17%**
2019	**USD**	-1.63%	+2.90%	+1.58%	+0.82%	-3.35%	+1.98%	+1.18%	+1.63%	-1.89%	+0.1%*			**+3.2%***

***According to internal calculations**