January 3, 2020

Vietnam Banks

POSITIVE *[Upgrade]*

Balanced regulations, robust fundamentals and reasonable valuation – what more?

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POSITIVE; but stick to alpha banks

We upgrade our neutral view on the Vietnam banking sector to POSITIVE. Key drivers behind this upgrade include: i) balanced regulations continue to support banks in maintaining growth and robust ROE, ii) Favourable macro backdrop and less stress with regards to the credit/GDP ratio (upon revised GDP base) allows VN banks to maintain steady mid-teen credit growth, and iii) valuation of many VN banks has retreated to a very attractive level, and there are re-rating catalysts from new ETFs to be launched in 1Q20 that will help fix valuation discrepancies caused by FOL issues. We recommend sticking to leaders which have clear competitive moats to sustain long-term growth and profitability, and these banks also have significant weights in new benchmark indices and ETFs. Our top picks, ranked by preference: VCB, VPB and MBB.

Balanced regulations support robust ROE

After detailed analysis of safety limits, adjustment and implementation timelines of all the regulations introduced from 2014 to date, we believe that Vietnam's banking regulator is attempting to strengthen the sector's soundness in a gradual and balanced manner that will be supportive of banks' steady growth and robust profitability. The phased implementation of Basel 2 with some adjustments only led to moderate ROE pressure. We forecast VN banks can still maintain 10-12x gearing; coupled with improving ROA to 1.8-2%, will enable leading VN banks to maintain attractive 18-22% ROE.

Healthy credit growth, margin and rising fee income

We expect sector-wide credit growth to stay at 13-14%, thanks to a favourable macro backdrop and strong credit demand from manufacturing, construction, mortgage and household business/ consumer finance (accounting for 65% of total credit). In addition, stable NIM at healthy levels of 3.5-4% for most big banks, lower credit-cost amid benign asset quality; and rising fee income driven by bancassurance will support VN banks' steady 15-30% earnings growth and robust profitability c.18-22% ROE.

Time to buy the leading banks at reasonable price

Limited/full foreign room has caused huge valuation discrepancies for many VN banks so far. Banks such as TCB, MBB, VPB and ACB with 17-23% FY20E ROE trade at only 1.0-1.1x forward P/BV, because local retail investors trade on short-term news while foreign institutional investors can't buy in due to full foreign ownership limits (FOL). We expect the launch of new ETFs in 1Q20 (i.e. Diamond-index ETF which is a gateway for foreign funds to buy full-room stocks with undemanding valuations) to help partly fix such valuation discrepancies and represent a re-rating catalyst. Taking into consideration fundamental strength, ROE, valuation and their weighting in new ETFs, we select the following bank stocks as our top picks for 2020: VCB, VPB and MBB.

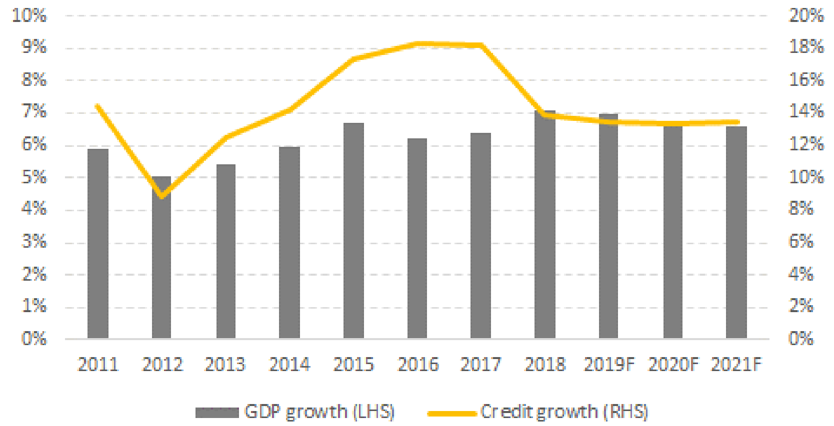
Stock	Bloomberg code	Mkt Cap (USD m)	Rating	Price (LC)	TP (LC)	Upside (%)	P/E (x) 19E	P/E (x) 20E	P/E (x) 21E	P/B (x) 19E	P/B (x) 20E	P/B (x) 21E	ROE (%) 19E	ROE (%) 20E	ROE (%) 21E
Vietcombank	VCB VN	14,358	BUY	90,200	107,300	19.0%	19.2	15.5	13.5	4.1	3.3	2.7	23.5	23.3	22.3
VP Bank	VPB VN	2,092	BUY	20,000	31,100	55.5%	6.6	5.6	5.0	1.2	1.0	0.8	19.4	18.8	18.0
MB Bank	MBB VN	2,076	BUY	20,800	26,000	25.0%	6.2	4.9	4.1	1.3	1.0	0.8	22.1	23.1	22.7
Asia Commercial Bank	ACB VN	1,621	BUY	22,800	25,700	12.7%	5.4	5.3	5.3	1.3	1.1	0.9	24.8	22.3	18.2

Banks

Vietnam

1. Key focus charts

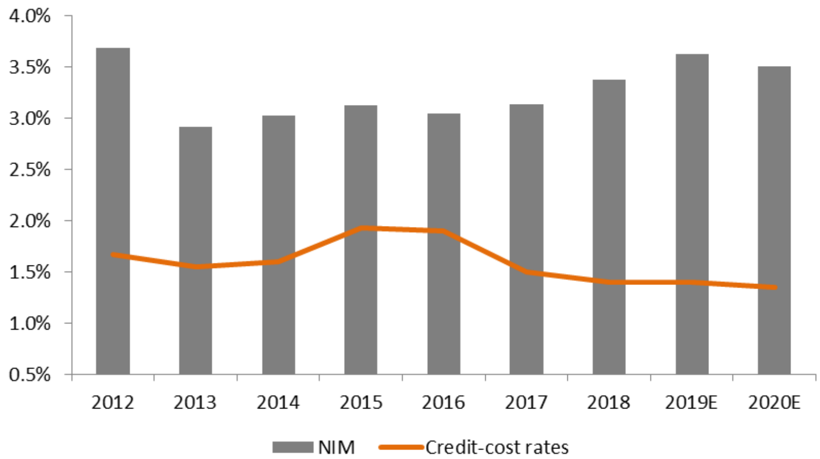
Favourable macro backdrop to support steady credit growth in 13-14% range.



Source: Vietnam GSO, MBKE estimates

- We maintain our view that Vietnam's macro economy will see robust growth over the next 24-months, which is conducive to the banking sector's growth.
- Favourable macro backdrop and lower stress credit/GDP ratio (i.e. 106% vs. previously 130% due to 25%-upward-revision to GDP base) will essentially support the central bank to maintain a steady 14% credit growth target for the next two years.
- On the demand side, we expect credit demand from manufacturing, construction, mortgage, household business/ consumer finance (accounts for 65% of total credit) to remain key drivers.

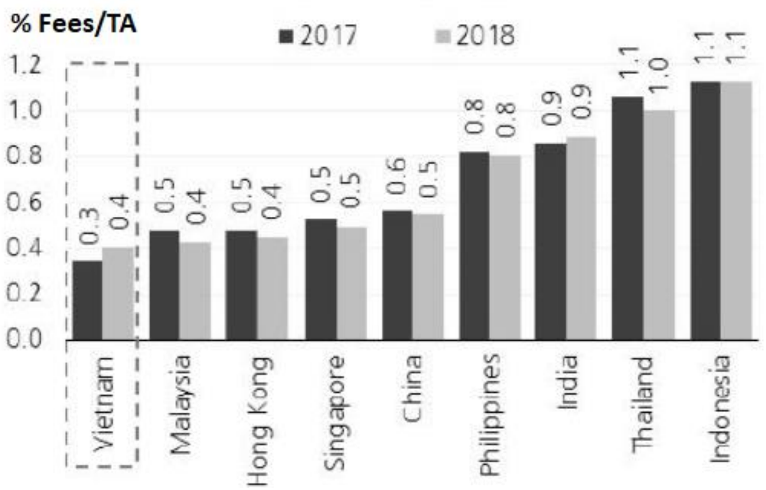
Average NIM and credit-cost of VN listed banks



Source: Company, MBKE estimates

- Stable NIM and easing credit-costs will continue to drive VN banks' robust earnings growth and profitability in 2020.
- Stable asset quality with no major systematic NPL risk in sight, we expect credit-cost to stabilize for most banks and ease for some banks like VPB and MBB.
- In view of balanced policies introduced by the central bank (i.e. cutting policy rates, raising LDR cap from 80% to 85% for private-sector banks) & stable macro (i.e. inflation and FX outlook), we believe VN banks have room for managing and easing their cost of funds to partly neutralize the impact of some reduction in lending rates. Moreover, thanks to their ability to pass cost increases to retail customers, we expect most big banks can still maintain good NIMs in 2020.

Improving Fee/Total Assets ratio will be a key driver of higher ROA



Source: Company, Bloomberg

- Compared to the Fees/Total Assets ratio of Thai and Indon banks, we see significant room for Viet banks to improve this ratio and ultimately their ROAs.
- Bancassurance ("banca") will be a key driver for fee income growth. Most big Viet banks have ramped up banca business over the last three years by entering exclusive partnerships with global & regional insurers. Banks with the strongest banca capacity include: VCB, TCB, BIDV, MBB, HDB and STB.
- A conservative forecast (life insurance penetration rate (% Premium/GDP) in Vietnam rises to 2.5% and banca contribution increases from 14% currently to 30% by 2025) indicates a banca premium 2018-25 CAGR of 36%, which will underpin robust banca fee growth for Viet banks.

Selective financial metrics of VN listed banks

Ticker	Average	VCB	BID	TCB	CTG	VPB	MBB	ACB	HDB	STB	TPB	EIB
Price (VND, as of 31 Dec 2019)		**90,200**	**46,150**	**23,550**	**20,900**	**20,000**	**20,800**	**22,800**	**27,550**	**10,050**	**21,050**	**17,800**
# shares O/S (m)		3,709	4,022	3,570	3,723	2,438	2,326	1,657	981	1,804	827	1,229
Mkt Cap (VND bn)		334,541	185,616	84,083	77,819	48,755	48,374	37,769	27,027	18,127	17,399	21,884
(USD m)		*14,358*	*7,966*	*3,609*	*3,340*	*2,092*	*2,076*	*1,621*	*1,160*	*778*	*747*	*939*
FOL		30.0%	30.0%	22.5%	30.0%	23.2%	20.0%	30.0%	30.0%	23.6%	30.0%	30.0%
Current foreign ownership		20.8%	3.1%	22.5%	29.3%	23.2%	20.0%	30.0%	27.0%	16.0%	29.9%	29.6%
2020 Forward P/BV	**1.37**	**3.32**	**2.22**	**1.14**	**0.93**	**0.97**	**1.03**	**1.06**	**1.31**	**0.70**	**1.09**	**1.34**
FY20E ROE	**17.4%**	**23.3%**	**14.1%**	**16.4%**	**13.4%**	**18.8%**	**23.1%**	**22.3%**	**19.5%**	**10.3%**	**22.4%**	**8.0%**
FY19E ROE	16.8%	23.5%	12.9%	16.8%	10.8%	19.4%	22.1%	24.8%	18.7%	8.6%	21.8%	5.1%
FY18 ROE	16.9%	22.5%	11.5%	21.5%	8.3%	22.8%	20.1%	26.9%	19.1%	7.5%	20.8%	4.5%
FY20E ROA	**1.5%**	1.7%	0.8%	2.7%	0.8%	2.2%	2.3%	1.8%	1.5%	0.7%	2.0%	0.5%
FY19E ROA	1.4%	1.5%	0.6%	2.7%	0.7%	2.1%	2.0%	1.7%	1.4%	0.6%	1.8%	0.5%
FY18 ROA	1.3%	1.2%	0.6%	2.9%	0.5%	2.4%	1.8%	1.6%	1.4%	0.5%	1.4%	0.4%
Earning strength score		**4.6**	**2.6**	**3.3**	**2.8**	**3.0**	**4.3**	**4.2**	**2.8**	**2.3**	**3.1**	**1.6**

Source: Company, MBKE estimates for VCB, VPB, MBB and ACB. For other banks not yet under our coverage, we use Bloomberg consensus statistics (as of 31 Dec 2019)

Please refer to Section 6 for our discussion and computation of Earning-strength score.

VCB, VPB and MBB are our top picks, taking into consideration a combination of their operational competitiveness, earnings strength, ROE, valuation and potential re-rating catalysts over the next 12months.

2. Balanced regulations continue to support Viet banks' robust ROE

Banking, in any country, is a heavily regulated sector. Globally, bank regulations have become tighter, especially in terms of provisioning and capital adequacy requirements. Stricter provisioning requirements (i.e. IFRS 9) weigh down banks' profits, resulting in lower ROA. Meanwhile, stricter capital adequacy requirements (i.e. Basel 3 and now moving to Basel 4) force banks to maintain a higher capital base, resulting in a lower balance sheet gearing ratio (i.e. TA/TE) which in turn, lowers banks' ROE (as ROE = ROA * TA/TE). In fact, tightened regulations have caused bank ROEs in many markets applying the most advanced regulations to decline to a merely 9-15%.

In Vietnam, the banking sector is very young with a less-than-30-year history. Banking regulations are still evolving to adopt the international standards. After a mini-banking crisis in 2008-2012 (when the system-wide NPL ratio reached 17.2%), the State Bank of Vietnam, i.e. the central bank, gradually introduced new regulations and policies with an aim to fix legacy issues (i.e. cross ownership, reckless lending to related shareholders and risky sectors) and to strengthen the sector's operations (i.e. stricter NPL classification and provisioning, more prudent regulations on liquidity, asset-liability management, and stricter capital adequacy requirements).

Figure 1: Vietnam's key banking regulations

2014: *Cir.36* regulating operational safety ratios (including CAR) and credit limits

(Cir.36 replaced Cir.15/2009 on SML ratio with more reasonable timeline)

2015: *Cir.09* [introduced in 2014 in lieu of Cir.02/2013] took effect with stricter regulations on NPL classification and provisioning.

2016: *Cir.06* replaced Cir.36 with more relaxed limits and timeline.

Cir.41, an adjusted version of Basel 2 standards, was introduced, aiming to have 10 banks (selected by the central bank) to adopt first from 1/1/2020

**) Before that, in 2014, VN central bank had alerted local banks about Basel 2, and aimed to have some banks adopted Basel 2 in 2016.*

2020

Cir. 41/2016, or adjust Basel 2 version -- 12-15 banks applying standard norms

Cir.22/2019 limits Short-term funding used for Mid-long-term loans (SML) ratio at 40%, limits LDR at 85% for all banks.

(Cir.41 & Cir.22 together replaced Cir.36/2014)

2021

Cir.41 -- banks apply ICAAP norms

Cir.18/2019: cash-loan limit at 70%

(Cir.18 replaced Cir.43/2016)

Cir.22 limits SML ratio at 37%

2022

Cir. 18: cash-loan limit lowered to 60%

Cir.22 limits SML ratio at 34%

2023

Cir.41 -- banks apply FIRB norms

Cir.18: cash-loan limit lowered to 50%

Cir.22 limits SML ratio at 30%

2024

Cir.18: cash-loan limit lowered to 30%

After 2025

IFRS 9 will be implemented, according to MoF's proposal

Source: SBV

We observed that Vietnam's central bank has been adopting a gradual approach to strengthening the banking sector without disrupting its growth, margin and profitability. In our view, the central bank is aware of the fact that the banking system remains the key funding source for Vietnam's economy (given a under-developed capital market), and that, due to state-budget constraints and 30% FOLs on banks, local banks basically have to rely on their internal capital generation to build up their capital base to support asset/credit growth. Hence, we believe the regulator should and needs to adopt a balanced approach that allows local banks to grow and maintain good profitability while gradually strengthening their operational metrics.

After careful analysis of safety requirements/limits, adjustment and implementation timeline of all the regulations introduced from 2014 to date, particularly those introduced during late November and early December 2019 *(Please refer to Figure 3 below)*, we maintain our belief that Vietnam's banking regulations are becoming tighter in a gradual and balanced manner that will continue to support local banks' robust credit growth and profitability (i.e. ROE of 18-22% for leading banks) over the next three to four years.

- According to the Ministry of Finance's proposal, Vietnam will consider adopting IFRS 9 only after 2025. This, along with drivers of steady credit growth & NIM and strong fee income *(please refer to discussion in following sections)*, will essentially support Viet banks' ROAs at 1.2-1.5%, and 1.8%-2% for the banks who have strong fee income profiles.

- On the other hand, we believe Vietnam will likely stay on current Basel-2 CAR standards, i.e. Circular 41, over the next five years (before considering a move to higher Basel standards), because the central bank understands that it will take time for Viet banks to build up their capital base while looking for solutions to the FOL matter. Under the adjusted Basel 2 standards, we estimate that Viet banks can still maintain about 10-12x balance sheet gearing ratio (vs. 15x previously, on average).

- Altogether, we believe robust ROEs (= ROA * BS gearing ratio) of 18-22% will be achievable for Vietnam's high-performing banks over the next four-year cycle.

Figure 2: Vietnamese banks still enjoy robust profitability, driven by improving ROA and reasonable BS gearing level.

	ROE (3Q19)	ROA (3Q19)	TA/TE (x)	ROE (2018)	ROA (2018)	TA/TE (x)	ROE (2017)	ROA (2017)	TA/TE (x)
Average	**18.7%**	**1.6%**	**13.5**	**17.3%**	**1.44%**	**14.0**	**14.3%**	**1.06%**	**15.0**
High performers									
VCB	26.2%	1.8%	14.2	22.3%	1.33%	16.8	15.1%	0.83%	18.2
VIB	26.1%	1.9%	14.1	22.5%	1.73%	13.0	12.8%	0.99%	13.0
ACB	25.0%	1.8%	14.1	27.7%	1.76%	15.7	14.1%	0.82%	17.2
MBB	23.2%	2.1%	11.1	20.1%	1.81%	11.1	12.9%	1.21%	10.7
TPB	22.7%	1.8%	12.9	20.8%	1.63%	12.8	15.6%	0.84%	18.6
VPB	20.4%	2.3%	8.8	22.8%	2.45%	9.3	27.5%	2.54%	10.8
HDB	19.6%	1.6%	12.0	19.1%	1.38%	13.8	14.9%	1.03%	14.5
TCB	17.0%	2.7%	6.3	21.5%	3.47%	6.2	27.7%	2.60%	10.7
Laggards (under restructuring, leadership transition)									
BID	13.6%	0.5%	25.3	11.7%	0.46%	25.4	11.6%	0.46%	25.2
CTG	12.8%	0.8%	16.2	6.5%	0.38%	17.3	9.3%	0.56%	16.6
STB	10.1%	0.6%	17.2	7.5%	0.45%	16.5	4.4%	0.29%	15.2
EIB	7.7%	0.8%	10.0	4.5%	0.44%	10.3	5.9%	0.59%	10.1

Source: Company

Figure 3: Banking regulations introduced in a fairly gradual and balanced manner that would support VN banks to maintain good profitability

Legal documents / Regulations	Background/ Key focus	Impacts / Remarks
Circular 41/2016 (i.e. Basel-2 with adjustments)	Cir.41 was officially launched in 2016, two years after Vietnam's central bank mentioned Basel-2 application for the local banking system. Before that, VN banks had never applied any Basel standards. The local CAR standards were close to only Basel 1. Essentially, applying Basel-2 CAR standards makes banks more risk-sensitive when allocating their assets, because riskier assets/customers will be charged higher risk-weights. In addition, the risk is also tied to the borrowers' credit rating/debt service capacity, instead of basing it mostly on the loan purpose, sector and collateral assets. According to Cir.41, local banks must apply Basel 2 standards from Jan 2020, meaning that VN banks had almost 4 years to prepare. Local banks will start with the standard approach of Basel 2, then move up to the more sophisticated approach in 2021 (ICCAP) and 2023 (FIRB).	Cir.41 actually charges stricter risk weightage (than Basel 2) on exposure to real estate (i.e. 200% vs. up to 120% under Basel 2) and on loans to corporates with higher leverage (i.e. 10-30bps higher in respective risk weightage ratios). Meanwhile, the risk weightage applied to retail exposure under Cir.41 is generally similar to that of Basel 2. But, **Cir. 41 requires less strict risk weightage ratios to claims on government/central banks (i.e. 0% vs. 100% in case of BB+ sovereign rating) or VAMC bonds (20% vs. up to 150%).** **These adjustments resulted in a moderate increase in revised risk-weighted asset (RWA) (i.e. est.20-30%, vs. est. 35-60% increase if full Basel 2 standards were applied).** Therefore, many local banks managed to comply with Cir.14 earlier than expected. By Dec 2019, 18 banks (16 domestic + 2 foreign banks) have announced to apply Basel 2, as bellow:
Circular 22/2019	Cir.22/2019 replaces Cir. 36/2014 (and its related revision), which covers operational safety ratios for the banking sector. Cir.22/2019 will become effective on Jan 1st, 2020. Key changes include: 1. Reduction of the ratio of short-term funds used for medium and long-term lending (i.e. SML ratio) from the current 40% to 30% by Oct 2022. Specific timeline as follows: 1 Jan 2020 – 30 Sep 2020: max.40%; 1 Oct 2020 – 30 Sep 2021: max 37%; 1 Oct 2021 – 30 Sep 2022: max 34% 1 Oct 2022 on wards: max 30% 2. Elevation of the risk ratio of real estate-related consumer loans, from the current 50% to a maximum ceiling of 150%. **But this is not applicable to banks which have already applied CAR standards under Cir.41 (i.e. Basel 2).** 3. Loan-to-Deposit ratio (LDR, in broad definition which including adjustments made to both Loans and Deposits) is capped at 85% for all banks, effective from 1 Jan 2020. Those banks, which can't comply with this LDR limit in 2020, have maximum of two years to reduce their LDR and become compliant from Jan 2022.	1. The reduction of SML ratio with phasing-in period has been known/expected by banks and the market for a while. Banks have been prepared for this. According to SBV's statistics, state-owned banks already had SML ratio of below 30%, while private-sector banks' SML ratio stood at 30.9% as of Sep 2019. This regulation is part of the regulator's overall action plan controlling loans made to the property sector. In fact, bank loans made to property developers have decelerated (i.e. -2% YoY in 2018, and -1.4% YoY in 9M19). Share of the loans made to developers to total bank loans stayed stable at around 6.3% YTD (Sep 2019), which has been significantly reduced from the peak of c.13.3% in 2009 (a time when the market overheated, causing asset-quality issues to the banking sector). 2. The higher risk-weighting applied to real estate related consumer loans aims to prevent banks from hiding real estate loans as consumer loans. In fact, for the 17 banks applying Basel 2 now, this won't impact them in terms of CAR, because under Basel 2, the risk weighting applied to real estate retail loans is based on Loan-to-Value (LTV) and Debt Service Capacity (DSC) metrics, which actually enjoy lower risk-weightings (i.e. generally between 50-70%, according to our estimation). 3. The LDR regulation has become stricter for state owned banks (which currently enjoy an LDR limit of 90%), but it is more relaxed for private-sector banks (which are currently subject to an 80% LDR limit). In fact, among state owned banks, Vietcombank (VCB VN, HOLD, TP: VND92,400) already has an LDR below 85%. Relaxing the LDR for private-sector banks, which account for half of total sector credit, will materially help to ease competition for deposits/funding, and thus eases pressure on interest rates. This is essentially a key focus of the Viet government and central bank.

Circular 18/2019	Cir.18/2019 replaces Cir. 43/2016 regulating the consumer finance (CF) business in Vietnam. The key focus is on the limit of cash loans, which will materially impact the prospective growth and margin of consumer finance players. Earlier, there was proposal to limit cash loan/total CF loans at 30%, which caused serious concerns about the growth and profitability of CF companies.	The Cir.18 turned out **much more relaxed than the market expected**, in our view, with key highlights as below: 1. Calculation of cash loan ratio (under Cir.18) includes only the cash loan from customers with outstanding cash-loan balance of above VND20m. In our view, this regulation reiterates the regulator's stance that it doesn't aim to totally prevent cash loans, but it just aims to control high-risk cash loans (i.e. big-ticket ones). Therefore, it set a floor of VND20m in outstanding balance for the cash loans to be included into the cash-loan ratio. Accordingly, **cash loan ratio under Cir.18 appears lower than previous calculation**. For example, FE Credit said íts cash loan ratio stood at 57% currently under Cir.18, not 75% as per all-in cash loan calculation. 2. The cap on cash loans is still 30% but will be phased in: max.70% during 2021 => max.60% during 2022 => max.50% during 2023 => max.30% from 2024 onwards. **The compliance timeline is much more relaxed than expected.** Along with the new cash-loan ratio calculation, this timeline gives local CF companies sufficient room to grow and avoid any abrupt margin contraction for the next three years.
IFRS 9	IFRS 9 is an International Financial Reporting Standard (IFRS) published by the International Accounting Standards Board (IASB). The standard came into force on 1 January 2018. It was designed and launched in 2014 to address criticism of financial institutions having recognised impairment losses "too little, too late'' during the global financial crisis. IFRS 9 is a significant accounting change that banks are (will be) facing, because it requires banks to switch to recognising and providing for expected credit losses (ECL) on financial assets, rather than the current practice of providing only when losses are incurred.	The biggest effect of IFRS 9 is **the increase in loan loss provisions from the new expected loss impairment model.** Based on an estimation by Association of Chartered Certified Accountant (ACCA) in Feb 2019 and our observation of Thai & Malaysian banks [which apply IFRS 9 in Sep 2018 and 2019], **the provisioning costs could increase between 15% up to 60% under IFRS 9 vs. previous standards (i.e. IAS 39).** Higher provisioning requirement will materially reduce banks' bottom-line earnings, and thus profitability (ROA, ROE). Vietnam's Ministry of Finance (MoF) is preparing a plan on implementing IFRS **in Vietnam; Accordingly, IFRS 9 would be considered as compulsory only after 2025.**
Foreign ownership limit (FOL)	Current FOL for Viet banks is 30% in total and max.20% for a foreign strategic investor. Discussions on raising FOL for banks to as high as 49% have been going on for years, but there is no real progress so far.	To help VN banks recapitalize quickly in order to meet higher CAR standards, raising FOL is the most effective way, in our view. In order to open the leeway for raising FOL on banks, it requires revising current regulation on min.65% state ownership at local banks as the first step. According to the central bank's development strategy for the banking sector to 2025 approved by the Prime Minister in 2018, **the State will own at least 65% of voting rights in state-owned banks (including: Agribank, Vietcombank - VCB, BIDV - BID and Vietinbank - CTG) through 2020, and at least 51% under the 2021-2025 period.** This plan outlines a potential increase in FOL on banks post 2020, which will represent strong support for local banks' recapitalization attempts and a strong catalyst for bank stocks and the overall stock market.

Source: Company, MBKE

3. Steady loan growth and margin

3.1 Favourable macro background

We maintain our view that Vietnam's macro economy will continue its robust growth over the next 24 months, which is conducive to the banking sector's growth.

Our house economists forecast Vietnam's GDP growth to maintain at +6.6% in 2020 and 2021 from the break-neck speed of +7.0% in 2019, as Vietnam shifts towards more sustainable growth, near its long-run potential, and manages overheating risks.

Risks to our growth outlook are skewed to the upside given stronger-than-expected export orders and a capex recovery spurred by a probable US-China ceasefire. The government is targeting GDP growth of +6.8% in 2020, while average 2020 GDP forecast (by World Bank, ADB, Fitch, Moody's, HSBC) for Vietnam is 6.62% (as of Dec 2019).

Figure 4: GDP growth outlook for Vietnam remains the most robust in the region

	Real GDP growth (%)					Headline inflation (%)				
	2017	2018	2019F	2020F	2021F	2017	2018	2019F	2020F	2021F
Global	3.7	3.6	3.0	2.8	2.9	3.2	3.6			
US	2.2	2.9	2.3	1.9	1.9	2.1	1.9			
Indonesia	5.1	5.2	5.0	5.0	5.2	3.8	3.2	3.1	3.6	3.3
Malaysia	5.9	4.7	4.5	4.4	4.8	3.8	1.0	0.7	2.0	2.5
Philippines	6.7	6.2	6.0	6.3	6.5	2.9	5.2	2.6	3.0	3.0
Singapore	3.6	3.1	0.9	1.8	2.0	0.6	0.4	0.6	0.9	1.3
Thailand	3.9	4.1	2.6	3.4	3.8	0.7	1.1	0.7	0.9	1.1
Vietnam	6.8	7.1	7.0	6.6	6.6	3.5	3.5	2.6	3.5	3.4

Source: MBKE, December 2019

3.2 Credit growth to remain in 13-14% range

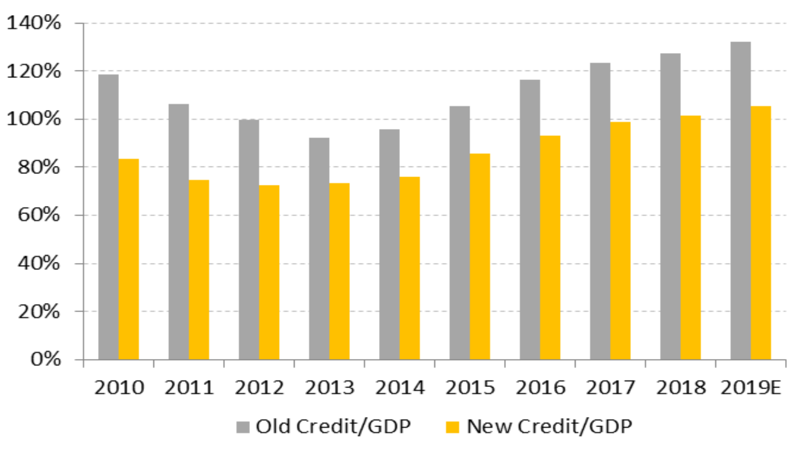
Favourable macro backdrop and lower stress credit/GDP ratio (i.e. 106% vs. 130% in 2019 due to a 25% upward revision in GDP base) will essentially support the central bank in maintaining a steady 14% credit growth target for the next two years.

Vietnam's central bank has been using credit-growth targeting as its main policy tool since 2011 to control credit growth in order to achieve other macro objectives. The credit growth limit has been lowered gradually from 20% during 2011-14 to 18% during 2015-16 and to 14% during 2017-19, because the central bank took into consideration advice from international advisory agencies (including the IMF) that Vietnam's credit/GDP ratio has reached a rather high level of 130% (based on the old GDP calculation). The IMF even recommended that Vietnam should lower credit growth to 9-10% which is in line with nominal GDP growth.

From our talks with the central bank, we understand that they were aware of the need to control the credit/GDP ratio below 130%, but they were also aware that the banking system remains the major funding source for the economy given the country's under-developed capital markets i.e. total IPO proceeds + share issuance + bond issuance equal to less than 3% of total bank loans during 2011-2019, according to statistics from the Ministry of Finance and the State Bank of Vietnam (SBV). Hence, the general view is that a 13-14% credit growth annually is reasonable for Vietnam for the time being.

Furthermore, the government's recent review of the calculation of GDP, which resulted in a c.25% increase in Vietnam's GDP base (upon the inclusion of statistics from 76,000 enterprises), implies that Vietnam's credit/GDP ratio will effectively decrease to c.106% only (instead of 130% as of now). A lower credit/GDP ratio will also be supportive of the central bank's 13-14% credit growth target for the next two years, in our view.

Figure 5: Vietnam's credit-to-GDP ratios



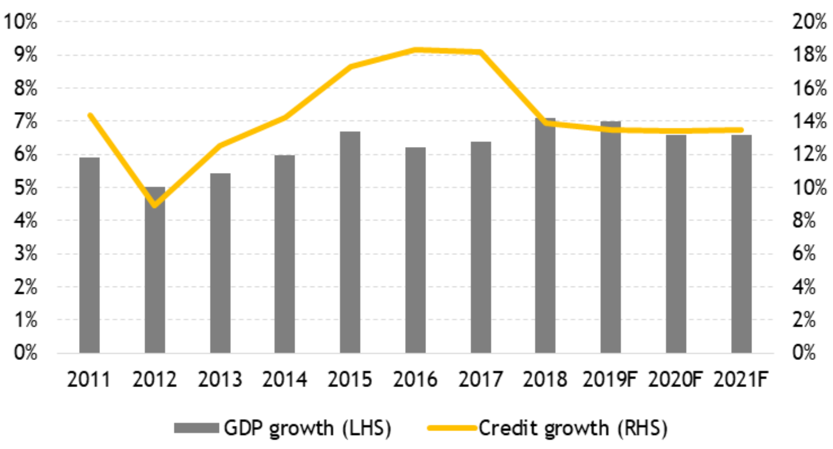
Source: MBKE, December 2019

On the other hand, we believe that the central bank will again give additional credit growth quota for banks which comply with its central bank's regulations, support implementation of its policies and maintain strong operational safety ratios.

On the demand side, we expect credit demand from manufacturing, construction, property (including mortgage), and household business/ consumer finance (accounting for 65% of total credit) to remain key drivers.

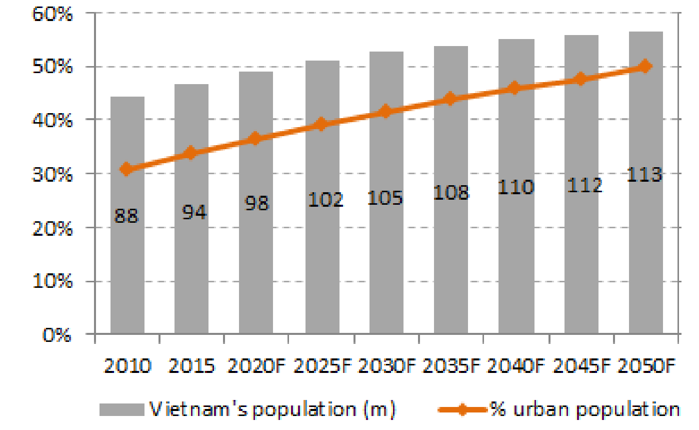
Key downside risk may stem from slower-than-expected property credit growth (i.e. falls below 15%) due to a shortage in residential property supply caused by further delays in project approval/licensing.

Figure 6: Vietnam's credit growth should decelerate but remain robust in the range of 13-14% annually



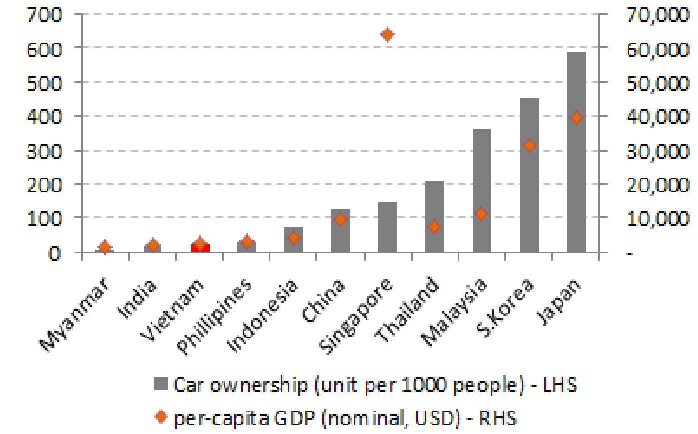
Source: GSO, MBKE estimates

Figure 7: Rising urbanization and low mortgage penetration (<3%) implies still significant room for mortgage growth



Source: SBV

Figure 8: Low car ownership also implies large room for auto-lending growth in Vietnam



Source: BIS

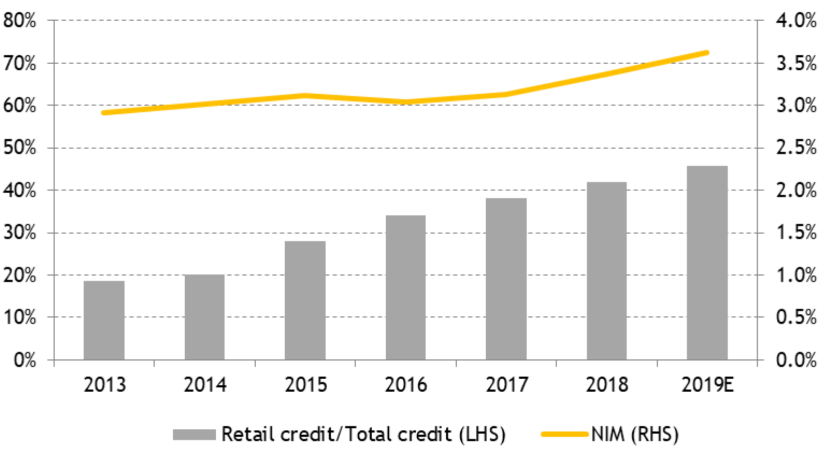
3.3 Resilient margin

Viet banks' NIMs have steadily improved over the past four years thanks to a stable interest rate environment that enabled them to control cost of funds, while lending yields improved thanks to optimized asset mix (i.e. higher loans/total assets) and higher retail loan mix.

- Traditional retail loans' NIMs are generally 100-150bps higher than that of corporate loans, and banks can still pass on most of the impact from a rise in their cost of funds to retail clients.

- Current retail lending terms normally carry favourable fixed rates in the first several months (i.e. six to 12 months) before turning into floating rates that are based on the bank's long-term deposit rates plus a margin (i.e. 3.5-4%).

Figure 9: Vietnamese banks' NIM improved thanks to better asset mix (i.e. higher retail loan mix)



Source: Company, SBV

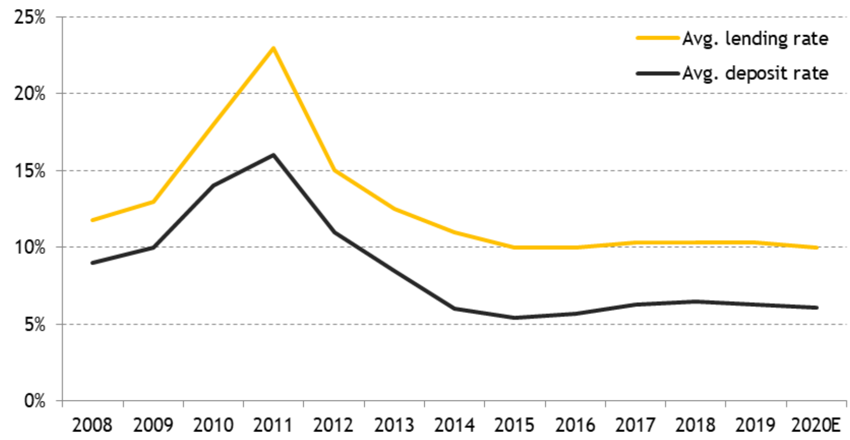
Looking into 2020, we expect Vietnamese banks' NIMs to largely stay stable at current levels, i.e. 3.2-4.5% for most of the large banks, taking into consideration the following factors in play:

i) We forecast lending yields at most banks to ease slightly in 2020-21, because we think that their asset mix has largely been optimized and lending rates in some segments will decrease given the government's target and call for local banks to reduce lending rates (i.e. by about 50bps in 2020) to support local businesses, particularly SMEs and those in high-tech, agriculture, and exports.

But, given that they have room to manage and ease their cost of funds (as discussed below) and pass on cost increases to retail clients, the impact of some reduction in lending rates may be cushioned. We expect most big banks can maintain stable, and good NIMs in 2020.

ii) Stable inflation and foreign exchange rate outlook in the next 12 months should not put significant pressure on deposit rates/funding costs.

Figure 10: Stable interest rate environment since 2015 thanks to the new government's prudent macro policies



Source: SBV, FinPro

iii) Central bank's prudent policy moves provide room for banks to control and ease their cost of funds, i.e. cut in policy rates allows banks to borrow cheaper funds via OMO and via the interbank market. This will also ease the LDR limit (from 80% to 85%) for private-sector banks which will materially help to lower the pressure for fund-raising.

In the longer run, we expect rising CASA mix (thanks to improved transaction banking platform and digital banking initiatives) will help leading banks to reduce their cost of funds further.

Figure 11: Banks with higher retail lending mix and strong CASA (i.e. low-cost funds) are better positioned to preserve their NIMs.

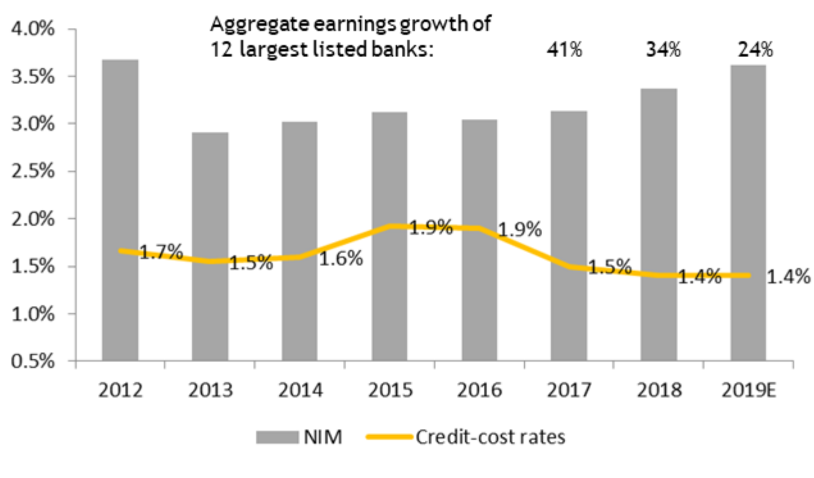
(Ranked by 9M19 NIM)	% retail loans/Total loans	CASA ratio	NIM 2017	NIM 2018	NIM 9M19
VPB	57%	10%	8.9%	9.1%	9.6%
MBB	40%	34%	4.3%	4.7%	5.0%
HDB	50%	11%	4.1%	4.1%	4.5%
TPB	52%	16%	3.0%	3.8%	4.3%
TCB	48%	30%	3.9%	4.2%	4.3%
VIB	78%	11%	3.2%	3.9%	4.1%
ACB	59%	17%	3.6%	3.7%	3.7%
VCB	42%	30%	2.7%	2.9%	3.3%
CTG	29%	16%	2.8%	2.1%	2.9%
BID	33%	15%	3.0%	3.0%	2.7%

Source: Company

4. Stabilized credit-cost amid benign asset quality

Along with NIM, credit-cost is a key driver of Viet banks' earnings. Easing credit-cost partly underpinned strong bottom-line sector earnings growth over the past three years.

Figure 12: Easing credit-cost, along with improving NIMs, underpinned VN banks' strong earnings growth in 2017-19



**) Note: Average credit-cost rates of 12 largest listed VN banks*

Source: Company, MBKE forecasts (for ACB, MBB, VCB and VPB) + using 3Q19 statistics of other banks as their FY20E base forecast.

Credit cost eased thanks to supportive mechanisms introduced by the regulator via the establishment of the Vietnam Asset Management Company (VAMC) to help spread the provisions for legacy bad debts over a five-year period as well as benign asset quality of new loans made from 2013 to date.

Vietnamese banks' all-in NPL ratio (including banks' reported NPLs + VAMC bonds + restructured loans) steadily decreased from 17.2% in 2012 to 6.3% in 2018 and to 4.59% by end-2019. Of this, 1.89% is reported NPLs, and the rest is restructured bad debts and bad debts kept at the VAMC.

- According to the 5-year plan, the bad debts kept at VAMC will be transferred back to the banks by 2020. Many banks (most of them are big and listed) have thus aggressively been provisioning to clean up these legacy NPLs before the 2020 deadline.

- By end 2019, 11 banks have cleaned up legacy NPLs, including: Vietcombank (VCB, already cleaned up in 2016), BIDV (BID), Techcombank (TCB), MB Bank (MBB), VPBank (VPB), Vietnam International Bank (VIB), TPBank (TPB), OCB, NamABank (NAB), KienLong Bank (KLB) and SEA Bank.

Figure 13: VN's system-wide all-in NPLs have been decreasing steadily in both absolute and relative terms

	2012	2016	2017	2018	2019
Sector-wide					
All-in NPLs (VND tr)	505	527	476	444	368
Growth (yoy %)			*-9.73%*	*-6.73%*	*-17.2%*
All-in NPL ratio	**17.2%**	**10.1%**	**7.7%**	**6.3%**	**4.6%**
Reported NPLs (VND b)	126	129	124	133	151
Growth (yoy %)			*-3.90%*	*7.70%*	*13.6%*
Reported NPL ratio	**4.30%**	**2.46%**	**2.0%**	**1.89%**	**1.89%**

Source: SBV, VAMC

A continued favourable macro environment will enable Viet banks to maintain benign asset quality. We expect on-balance-sheet NPLs to stay below 2% over the next two years. This will essentially help banks keep their credit cost stable at around the current 0.8-1% level.

We do not see systematic NPL risk for Vietnam's banking system over the next 12 months. There may be some asset quality risks from exposure to Build-Operate-Transfer (BOT) projects and condotel segments, but the exposure size and concentration indicate that it will not cause systematic risk to asset quality.

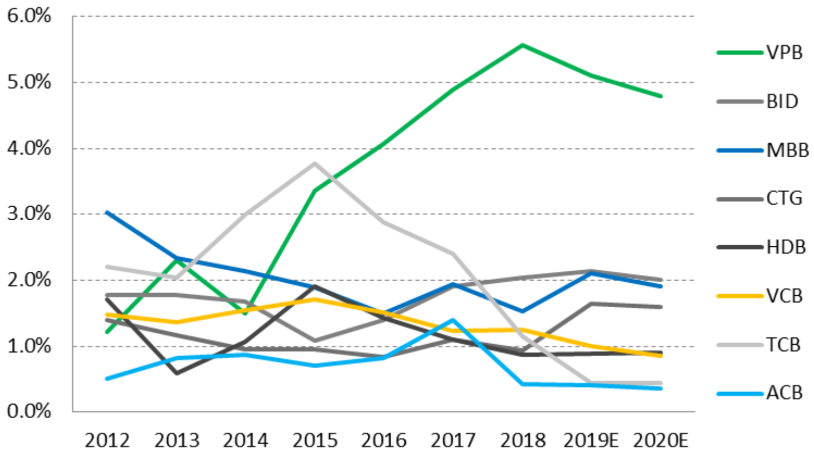
- Regarding exposure to BOT-projects, total BOT loans now account for 1.4% of sector loans, equivalent to c.USD4.7b made to 105 projects. Local banks have slowed down lending to BOT since 2017 upon warnings from the central bank. BIDV (BID), Vietinbank (CTG) and Saigon-Hanoi Bank (SHB) together account for 80% of the total loans made to BOT projects. Given the exposure size and the concentration in a few banks, this is not yet a system NPL risk for the sector, in our view.

- We believe condotel is a trendy property product, and appears to work well particularly for experienced and capable developers. Hence, we don't think the recent scandal related to a condotel project (i.e. Cocobay in Da Nang) (Please click here to download the article) indicates an end or a crisis for this segment. Even in the worst case (which is very extreme and impractical), assuming all mortgages to condotels become bad debts, the size of the NPLs will be less than 1% of total system-wide loans.

  Since there is no official statistics on bank loans to the condotel segment, we estimate that the total exposure to condotel may reach about USD3.5b, c.0.9% of total system-wide loans, with key assumptions (based on statistics from the Ministry of Construction and other real-estate agencies) as follows: i) total condotels licensed during 2016-19: 60,000 units, and assuming 70% take up rate (which is the best absorption rate at the market peak during 2016-17), ii) average size of condotel unit: 70sqm, and average selling price: USD1700/sqm, iii) 70% of the investment funded by bank loans (i.e. mortgage/home loans).

All in all, we expect Viet banks' asset quality will remain stable in 2020, and we thus forecast the credit cost in 2020 to stabilise for most banks, and trend down for some banks which aggressively provisioned in 2018-19 to clean up legacy NPLs, including MB Bank (MBB) and VPBank (VPB).

Figure 14: Provisioning rate to stabilise for most VN banks



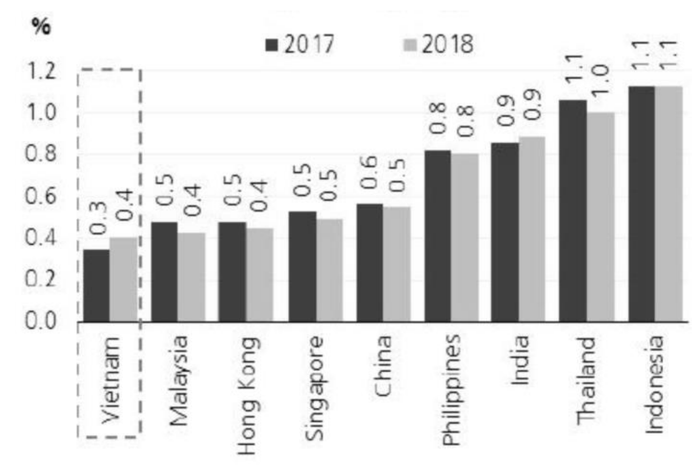
Source: Company, MBKE forecasts (for ACB, MBB, VCB and VPB) + using 3Q19 statistics of other banks as their FY20E base forecast.

5. Rising fee income to drive ROA improvement

In the context of largely stable NIMs and credit costs, rising fee incomes will emerge as an important driver of Vietnamese banks' ROA improvement over the next five-year cycle.

Compared to the Fees/Total Assets ratio of Thai and Indon banks, we see significant room for Viet banks to improve this ratio and thus their ROAs.

Figure 15: VN banks' Fees/Total assets ratio remains low compared to regional banks



Source: Bloomberg

Figure 16: Some leading banks managed to lift up fee income via bancassurance and bond-underwriting business

	2018 Total assets (VND b)	2018 Net fees (VND b)	Fees/TA	2016-18 Fee CAGR
BID	1,313,038	3,551	0.3%	19%
CTG	1,164,435	2,768	0.2%	28%
VCB	1,074,026	3,403	0.3%	27%
STB	406,041	2,682	0.7%	37%
MBB	362,325	2,561	0.7%	94%
ACB	329,333	1,498	0.5%	26%
VPB	323,291	1,613	0.5%	37%
TCB	320,989	3,536	1.1%	34%
HDB	216,057	438	0.2%	93%
EIB	152,652	347	0.2%	8%
VIB	139,166	407	0.3%	26%
TPB	136,179	676	0.5%	180%

Source: Company

We forecast leading banks to maintain c.20% fee income growth (CAGR) in the next five years vs. c.12% asset growth, which would result in the increase in Fees/TA ratio from c.0.4% currently to nearly 0.7% in five years.

Bancassurance will be a key driver of fee income growth. Most big banks in Vietnam have attempted to ramp up the banca business over the last three years by entering exclusive partnerships with global and regional insurers, including: Prudential, Manulife, Dai-Ichi Life and FWD.

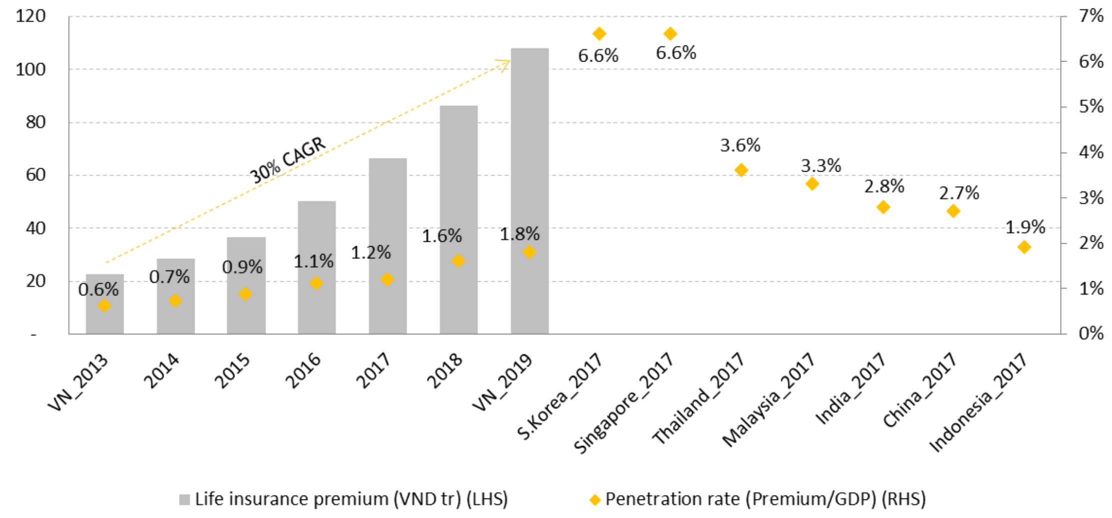
Figure 17: More VN banks enter exclusive bancassurance partnerships to boost fee incomes

Bank	Insurer	Type of deal	Signed	Duration
CTG	Aviva	JV (CTG 50%, Aviva 50%)	2011	
BIDV	MetLife	JV (MetLife 60%, BIDV 40%)	2013	
MBB	Ageas Life	JV (MBB 61%, Ageas 29%, Muang Thai Life 10%)	2015	
VIB	Prudential	Exclusive partnership	2015	15 years
HDB	Dai-Ichi Life	Exclusive partnership	2015	10 years
SCB	Manulife	Exclusive partnership	2015	n.a
EIB	FWD	Exclusive partnership	2016	n.a
TCB	Manulife	Exclusive partnership	2017	15 years
STB	Dai-Ichi Life	Exclusive partnership	2017	20 years
SHB	Dai-Ichi Life	Exclusive partnership	2017	15 years
VPB	AIA	Exclusive partnership	2017	15 years
VCB	FWD	Exclusive partnership	2019	15 years

Source: Company

Vietnam's life insurance sector, with a c.30% CAGR in the past six years, reached its take-off point when the penetration ratio (Premium/GDP) passed the critical point of 1.5% in 2018, in our view. Improved agency execution capacity and improved consumer awareness about life insurance products and benefits along with rising per capita income underpin the robust growth of life insurance in Vietnam.

Figure 18: Vietnam's life insurance has large potential for growth given low penetration rate



Source: GSO, Association of Vietnam Insurers, Swiss Reinsurance

According to industry players, life insurance premiums can continue to grow at a 20% CAGR in the next five years, which would raise the life penetration ratio close to 3.5% by 2025 as per the target set by Vietnam's insurance regulator, i.e. the Ministry of Finance.

In addition, bancassurance is expected to emerge as an important channel driving the sector's growth. Currently, bancassurance contributes only about 14% (9M19, vs. 10% in 2018) to the total sector premium. Thanks to strengthened partnerships between banks and insurers via exclusive framework, bancassurance contribution is expected to surge significantly in the next five years. In developed markets, bancassurance contributes 50-70% to total life premiums annually; or in the Thai market (as a closer reference point), the bancassurance contributes about 45%.

A conservative forecast that life insurance penetration increases to 2.5% and bancassurance contribution increases to 30% by 2025, implies a bancassurance premium CAGR of 36% in Vietnam during 2018-25, which will materially underpin robust bancassurance fee growth for Viet banks.

Figure 19: Significant bancassurance growth potential for VN banks

	2018	2025E	CAGR
Nominal GDP (VND tr) (1)	5,535	10,100	9.0%
Life penetration rate (2)	1.6%	2.5%	
Life insurance premium (VND tr) [(3) = (1) * (2)]	86	253	16.6%
Banca mix (4)	10%	30%	
Banca premium (VND tr) [= (3)*(4)]	**9**	**76**	**36.4%**

Source: Company, MBKE

Furthermore, Viet banks can explore other potential sources of fee income growth from corporate-bond underwriting and private wealth management. Techcombank (TCB), via its brokerage subsidiary, has emerged as a leader in corporate bond underwriting over the past three years, and it showed the market how this business could add strong growth to its total fee income. Thanks to both strong bancassurance and bond-underwriting fees, TCB managed to raise its Fees/TA ratio up to 1% which is close to that of Thai and Indon banks and more than double the average ratio of Viet banks. In 2019, a few other banks have also ramped up their corporate-bond underwriting business, i.e. MB Bank (MBB) and TP Bank (TPB).

Corporate bond issuance in Vietnam has surged in the past two years in the context of credit growth being capped at 14% and banks' shifting focus to retail lending and tightened regulations on liquidity management. However, due to concerns about overheating growth of the corporate bonds amid an underdeveloped market platform (including regulatory framework, corporate bond information centre, credit rating capacity etc.), the regulator has recently made some warnings and conducted inspections into some banks' bond-underwriting business. Together with the fact that many "low-hanging fruits" (good companies having a credit rating) appears to have been harvested, the regulator's warning and inspections could cause a temporary deceleration in the growth of corporate bond activities, in our view.

In the long run when regulatory and credit rating capacity improves, we believe corporate bond-underwriting business will emerge as another significant opportunity for Viet banks to steadily grow their fee income.

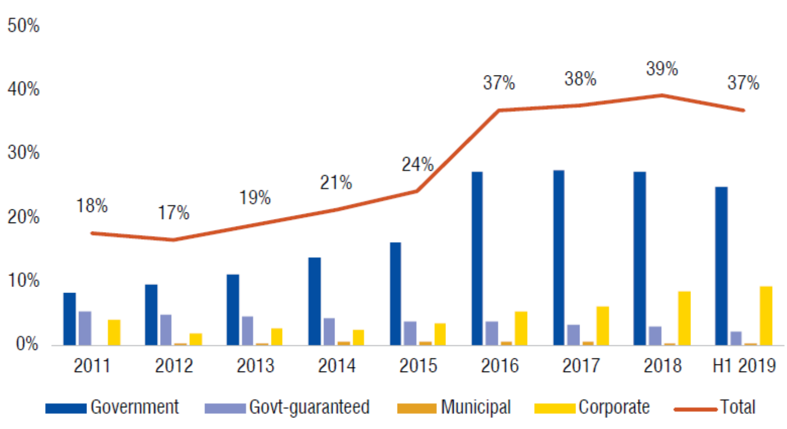
A brief on Vietnam's Corporate Bond Market

Source: World Bank - Unlocking capital markets for Vietnam's future development, 2019

Vietnam's corporate bond market has shown progress over recent years. Its size doubled from about 4.1% of GDP in 2011 to over 9.4% of GDP in 2019, reaching around VND590t/USD25.3b by end-June. Still, Vietnam's corporate bond size remains the smallest among ASEAN-6 countries.

In the coming years, efforts to recapitalize big state-owned banks, fund major SOEs, and finance infrastructure projects, including real estate development, will be the main drivers for the development of the corporate bond market.

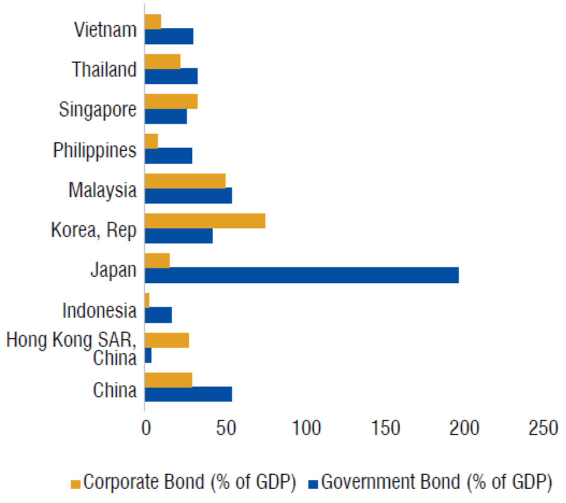
Figure II.5. Size of bond markets (as % of GDP)



Source: MOF.

Figure II.4. Size of selected Asian local currency bond markets

(outstanding bonds as % of GDP as at June 2019)



Source: Asian Bonds Online, ADB.

Note: The percentage for corporate bonds in this chart only covered listed corporate bonds. Outstanding government bonds includes only marketable instruments.

The Government of Vietnam, in its bond-market development roadmap for the period 2017-20 and 2030 vision, aims to achieve a well-functioning bond market which is aligned with international best practices and standards. Under this roadmap, Total bonds/Gross Domestic Product (GDP) ratio is targeted at 45% by 2020 and 65% by 2030. Specifically, corporate bonds should reach 7% of total GDP by 2020 and aggressively expand to 20% of GDP by 2030.

6. Earnings growth outlook and earnings-strength ranking

We forecast strong core EPS growth of 16-26% in FY20 for VN banks under our coverage, driven by steady interest income growth, rising fee income and lower credit costs.

Based on our forecasts for VCB/VPB/MBB/ACB and Bloomberg consensus forecasts for other banks, aggregated earnings growth for 12 of VN's largest listed banks (which account for 55% of the total sector's assets/customer loans and 76% of total sector's pre-tax profit) is estimated at c.21% in 2020.

Figure 20: VN banks' earnings growth

	FY16-17 profit growth (CAGR)	FY18 profit growth	FY19E profit growth	FY20E profit growth
High performers	**41%** *Aggregate (12 banks)*	**34%** *Aggregate (12 banks)*	**24%** *Aggregate (12 banks)*	**21%** *Aggregate (12 banks)*
TCB	98.6%	33%	12%	15%
VPB	62.0%	13%	14%	16%
TPB	38.8%	87%	42%	27%
VCB	28.9%	61%	32%	26%
HDB	75.1%	66%	27%	21%
ACB	42.0%	141%	18%	16%
MBB	19.7%	68%	28%	26%
VIB	46.4%	95%	46%	22%
Laggards (under restructuring, i.e. BS clean-up, leadership transition)				
BID	4.4%	9%	9%	41%
CTG	12.0%	-27%	41%	25%
EIB	309.0%	-19%	30%	3%
STB	30.3%	51%	42%	32%

Source: Company, MBKE estimates for VCB, VPB, MBB and ACB. For other banks not under our coverage, we use Bloomberg consensus statistics (as of 31 Dec 2019)

In our view, besides looking at earnings growth, it is more important to analyze:

- Profitability ratio: ROE (because a bank may have very strong earnings growth, but its ROE may remain modest because of aggressive increase in capital),

- Quality of earnings/ROE, i.e. what drives the earnings? Margin expansion, rising fee incomes, cost efficiency; or is it largely based on relaxed provisioning? Is its high ROE based on structurally high balance sheet leverage?, and

- Visibility of earnings/ROE, i.e. margin sustainability, visibility of fee incomes, room to absorb credit-cost shock which in turn depends on a bank's loan loss reserve against its current NPL level.

Based on a balance-score card of the above factors, we ranked VCB as No.1 in our sector coverage in terms of earnings strength, followed by ACB, MBB, TCB, TPB and VPB.

Figure 21: Earning strength ranking of VN banks

Bank	FY20 earnings growth (above 30%: 5, 21-30%: 4, 11-20%: 3, 5-10%: 2, Below 5%: 1)	ROE (above 25%: 5, 20-24%: 4, 15-19%: 3, 10-14%: 2, below 10%: 1)	Earnings quality (based on key metrics: BS gearing ratio, NIM trend, credit-cost rate vs. loan loss coverage, fee income growth)	Earnings visibility (Based on key metrics: room to preserve NIM [i.e. good CASA and high retail loan mix], sustainable and visible fee income, low NPLs and high loan loss coverage ratio)	Weighted-average score (Weighting: 10% for earnings growth, and 30% each for remaining factors)
VCB	4	4	5	5	**4.6**
MBB	4	4	5	4	**4.3**
ACB	3	4	5	4	**4.2**
TCB	3	3	4	3	**3.3**
TPB	4	4	3	2	**3.1**
VPB	3	3	3	3	**3.0**
VIB	4	4	2	2	**2.8**
HDB	4	3	3	2	**2.8**
CTG	4	2	3	3	**2.8**
BID	5	2	2	3	**2.6**
STB	5	2	2	2	**2.3**
EIB	1	1	2	2	**1.6**

Source: MBKE

7. BUY alpha banks at reasonable price

7.1. Attractive valuation and potential re-rating catalyst in the near term

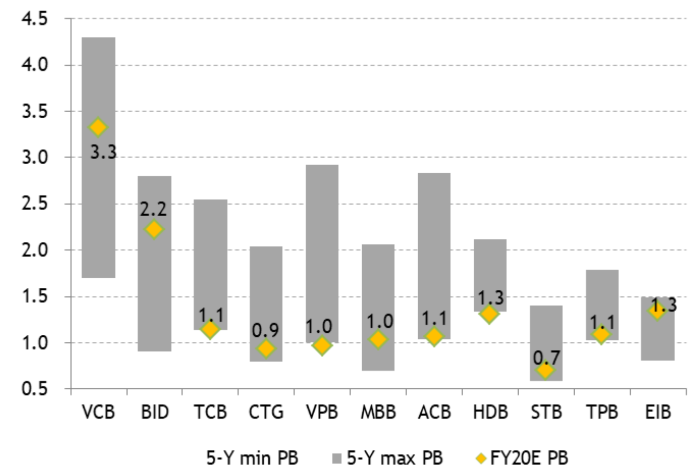
After a good rally till October 2019, VN bank stocks, along with the overall market, experienced a significant correction and volatility in the last two months due to a confluence of factors: i) absence of support from corporate news (as earnings season had just passed), ii) delayed implementation of market-upgrade initiatives, iii) weakened sentiment due to concerns about market makers' manipulation of benchmark indices near maturity date of future contracts and in the last month of the year, and iv) panic caused by [misunderstanding/ interpretation of] new banking policies & regulations introduced by the central bank in December 2019.

- Retail investors and the general public initially misunderstood that the new regulations would abruptly tighten banking growth and margin, partly due to confusion with regards to regulatory jargon and unfamiliarity with the background on how the regulations had been drafted, adjusted (with more relaxation) and phased in. For example, Cir.18 (*Please refer to Fig.3, page 7)* actually turned out more relaxed than the draft version (which had been spread out in 1Q19, causing some bank stocks to drop significantly by c.40%). Still, local retail investors treated Cir.18 as a new regulation and responded by selling in a panic.

Many VN banks' share prices lost between 7-14% (one case lost up to 24%) from its peak during mid-Nov and mid-Dec 2019 (vs. a 7% drop in the benchmark VN Index).

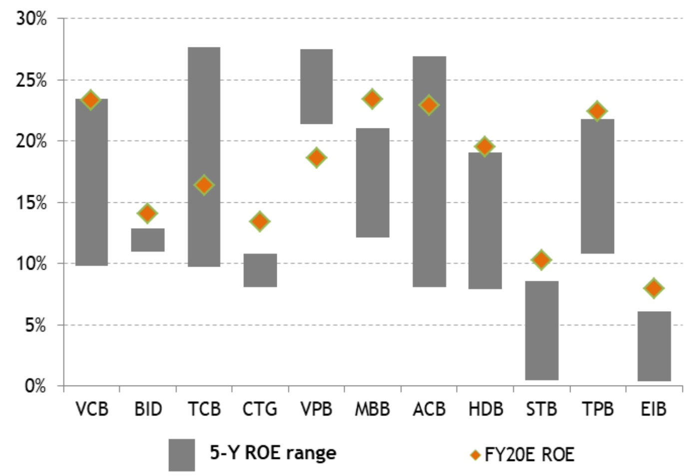
Due to this correction, most VN banks (except for VCB and BID) are now trading at a P/B valuation close to the bottom of their 5-year range, although their ROEs have improved and above the 5-year range.

Figure 22: VN bank's 12-m forward P/B range (last 5 years)



Source: Company, Bloomberg consensus, MBKE estimates (for VCB, VPB, MBB and ACB) (as of 31 Dec 2019)

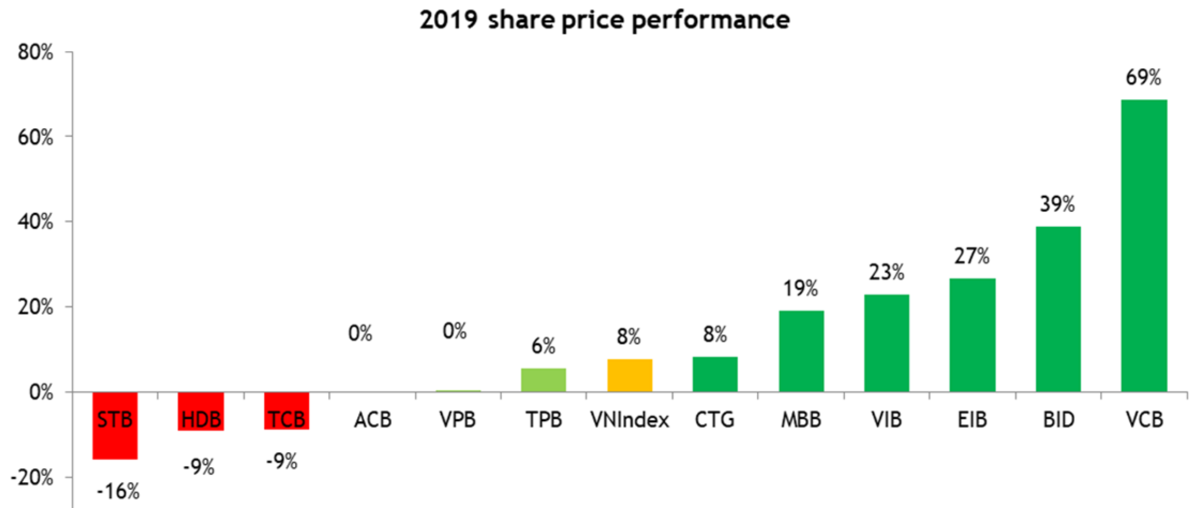
Figure 23: VN banks' ROE (FY20E vs. 5-year range)



Source: Company, Bloomberg consensus, MBKE estimates (for VCB, VPB, MBB and ACB)

Share price performance of VCB (+69%) and BID (+39%) in 2019 and their current premium valuation show that, besides fundamental factors, available foreign room is an equally important factor that drives share price in Vietnam.

Figure 24: VN listed banks' share price performance in 2019



	STB	HDB	TCB	ACB	VPB	TPB	VNIndex	CTG	MBB	VIB	EIB	BID	VCB
FY20E P/BV	0.7	1.3	1.1	1.1	1.0	1.1		0.9	1.1	1.0	1.3	2.2	3.3
FY20E ROE	10%	20%	17%	23%	19%	22%		13%	23%	23%	8%	14%	23%

**) Note: Banks, highlighted in Green, are those with available foreign room.*

Source: Bloomberg, MBKE estimates for VCB/MBB/ACB/VPB

Full/limited foreign room has caused significant valuation discrepancies for many VN banks so far. For example, leading banks such as TCB, MBB, VPB and ACB with nearly 17-23% ROE trade at only 1.0-1.1x forward P/BV, because local retail investors trade on short-term news, while foreign institutional investors can't buy in due to full foreign ownership room.

We expect the launch of new ETFs in 1Q20 (i.e. Diamond-index ETF which is a gateway for foreign funds to buy into full-foreign-room stocks at undemanding valuations) to help partly fix such valuation discrepancies. This represents a re-rating catalyst for leading VN banks.

On the other hand, in mid-2020, there will be another potential supporting catalyst. If Kuwait is upgraded from "Frontier Market" to "Emerging Market" status by MSCI, this would effectively make Vietnam the largest market in the FM league. As such, Vietnam would get a higher weight in the MSCI Frontier index.

According to a simulation run by MSCI in May 2019, Vietnam's weight in the FM index could potentially increase up to 30% from 15%. This would attract some foreign fund flows to Vietnamese stocks. It would benefit more directly the large-cap stocks having available foreign room like VCB.

Figure 25: MSCI's simulation indicated Vietnam's weight in FM index could double in case Kuwait is upgraded from FM to EM

	Current Index (ex AR)*		Simulated Index (ex KW inc IS)**	
	# of constituents	Weight	# of constituents	Weight
KUWAIT	19	25%	0	0%
VIETNAM	28	15%	29	30%
MOROCCO	7	11%	7	10%
KENYA	4	9%	4	9%
NIGERIA	7	9%	7	9%

*Data based on the pro forma index (post reclassification of Argentina and without application of the phasing rules) as part of the May 2019 Semi-Annual Index Review
** Simulated pro forma data as of the May 2019 SAIR (calculation date May 15, 2019, as of date May 29, 2019)

Source: MSCI

In its most recent update in Dec 2019, MSCI announced that it would reclassify Kuwait from frontier to emerging market as Kuwait had met all the necessary requirements. MSCI plans to include Kuwait in the Emerging Market Index in one phase during its May 2020 semi-annual index review.

7.2. Stock picks – stick to the alpha banks

Taking into consideration fundamental strength, ROE, valuation and their weighting in new ETFs (as near-term re-rating catalyst), we would select the following bank stocks as our top picks for 2020 (ranked by preference): VCB, VPB and MBB.

We also think Techcombank (TCB VN, Non-Rated) is also worth putting on long-term investors' watch-list. TCB, along with VCB and MBB, has a clear cost advantage thanks to its improving CASA ratio (i.e. above 30% now) which is key to competing effectively in the traditional banking segment. The market concerns about TCB include its rather high concentration in the property sector (89% of its retail loan book is mortgages) and interest alignment between the bank's major shareholders and the rest. It could take about two more years for TCB to reduce the concentration risk by growing other retail lending such as auto-loans, credit card and household business lending.

Figure 26: VN listed banks' peer comparison

Ticker	Average	VCB	BID	TCB	CTG	VPB	MBB	ACB	HDB	STB	TPB	EIB
Price (VND, as of 31 Dec 2019)		90,200	46,150	23,550	20,900	20,000	20,800	22,800	27,550	10,050	21,050	17,800
# shares O/S (m)		3,709	4,022	3,570	3,723	2,438	2,326	1,657	981	1,804	827	1,229
Mkt Cap (VND bn)		334,541	185,616	84,083	77,819	48,755	48,374	37,769	27,027	18,127	17,399	21,884
(USD m)		*14,358*	*7,966*	*3,609*	*3,340*	*2,092*	*2,076*	*1,621*	*1,160*	*778*	*747*	*939*
FOL		30.0%	30.0%	22.5%	30.0%	23.2%	20.0%	30.0%	30.0%	23.6%	30.0%	30.0%
Current foreign ownership		20.8%	3.1%	22.5%	29.3%	23.2%	20.0%	30.0%	27.0%	16.0%	29.9%	29.6%
2020 Forward P/BV	**1.37**	**3.32**	**2.22**	**1.14**	**0.93**	**0.97**	**1.03**	**1.06**	**1.31**	**0.70**	**1.09**	**1.34**
FY20E ROE	**17.4%**	**23.3%**	**14.1%**	**16.4%**	**13.4%**	**18.8%**	**23.1%**	**22.3%**	**19.5%**	**10.3%**	**22.4%**	**8.0%**
FY19E ROE	16.8%	23.5%	12.9%	16.8%	10.8%	19.4%	22.1%	24.8%	18.7%	8.6%	21.8%	5.1%
FY18 ROE	16.9%	22.5%	11.5%	21.5%	8.3%	22.8%	20.1%	26.9%	19.1%	7.5%	20.8%	4.5%
FY20E ROA	**1.5%**	1.7%	0.8%	2.7%	0.8%	2.2%	2.3%	1.8%	1.5%	0.7%	2.0%	0.5%
FY19E ROA	1.4%	1.5%	0.6%	2.7%	0.7%	2.1%	2.0%	1.7%	1.4%	0.6%	1.8%	0.5%
FY18 ROA	1.3%	1.2%	0.6%	2.9%	0.5%	2.4%	1.8%	1.6%	1.4%	0.5%	1.4%	0.4%
Earning strength score		**4.6**	**2.6**	**3.3**	**2.8**	**3.0**	**4.3**	**4.2**	**2.8**	**2.3**	**3.1**	**1.6**
TA/TE (x)	12.9	14.1	18.6	6.1	16.5	8.7	10.1	12.7	12.7	15.4	11.3	16.0
CAR under Basel 2/Cir.41 (as of 3Q19)	10.9%	9.5%	10.7%	16.5%	Below 9%	11.4%	9.5%	9.7%	11.0%	n.a.	9.1%	n.a.
LDR	96%	78%	99%	94%	104%	124%	95%	86%	112%	73%	110%	80%
NPL ratio	1.72%	1.1%	2.1%	1.8%	1.6%	3.5%	1.5%	0.7%	1.5%	2.0%	1.5%	1.7%
Loan loss coverage ratio	95%	185%	78%	77%	118%	50%	103%	157%	73%	71%	81%	58%

Source: Company, Bloomberg (as of 31 Dec 2019), MBKE estimates for VCB, VPB, MBB and ACB.

Figure 27: Top picks ranked by preference

	Rating	Remarks	Upside catalysts	Downside risks
VCB	BUY TP: VND107,300 <u>TP basis:</u> 4x FY20E P/B, equal to +2SD above 5-year average	- Largest listed banks + available foreign room, making it a proxy bank for Vietnam - Strong balance sheet, with clear cost advantage - Robust ROE, driven by improving NIM, rising fee incomes and lower credit cost - Ranked No.1 in earnings quality and visibility	- More robust earnings growth in 2020 thanks to fast amortization of the USD400m bancassurance up-front fees. - Vietnam's weighting in MSCI Frontier Index increase in case Kuwait gets upgraded to EM status in May 2020	- Slower credit growth due to slowdown in retail mortgage lending - De-rating risk, as VCB's valuation is rather high; hence it is more exposed to market volatility.
VPB	BUY TP: VND31,100 <u>TP basis:</u> 1.5x FY20E P/B, implied P/B (GGM-based, avg. 18% FY19-21 ROE, 12% growth), which is also close to its 1.6x average P/B ratio since listing (in Aug 2017)	- The leader in banking on the mass (BOM), owning the largest consumer finance company in VN with over 50% market share. - Because of its BOM model, VPB's NIM (9%) and credit cost (5%) are significantly higher than that of traditional banks	- Launching of new ETFs tracking new indices, in which VPB has the highest weighting. - Recovery of earnings growth thanks to easing credit cost - Sale stake in FE Credit (its consumer finance subsidiary) which will help the market rediscover the value of the company	- On-going internal restructuring demoralize staff, affecting productivity - Reputational risk related to consumer lending practice/debt collection, caused by aggressive staff and inflated by social media.
MBB	BUY TP: VND26,000 <u>TP basis</u>: 1.3x FY20E P/B, equal to +1SD above 5-year average	- Along with VCB and TCB, MBB will be an anchor in Vietnam's traditional banking segment, in our view. - Distinct customer base provides cost advantages. - The only listed bank with a full-fledged banking platform for high-growth retail/consumer finance, asset management and life insurance.	- Still upbeat earnings growth, driven by robust NIM (>5%, which is the best among traditional banks), strong fee income growth (led by life insurance business), and lower credit cost.	- Unsuccessful capital-raising (in terms of pricing, which is lower than market expectation)

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