

VinaCapital Vietnam Opportunity Fund (AIM: VOF)



Investment Manager's monthly update 31 August 2015

Fund background

VinaCapital Vietnam Opportunity Fund (VOF) is a closed-end fund trading on the AIM Market of the London Stock Exchange.

ISIN: KYG9361Y1026
Bloomberg: VOF LN
Reuters: VOF.L

Investment objective

Medium to long-term capital gains with some recurring income and short-term profit taking. Primary investment focus areas are: privately negotiated equity investments; undervalued/distressed assets; privatization of state-owned enterprises; real estate; and private placements into listed and OTC-traded companies.

[Click here for VOF's website.](#)

Fund managing director

Andy Ho

Investment manager

VOF is managed by VinaCapital Investment Management Ltd (VCIM) and requires investment approvals from a six member internal Investment Committee.

[More information about VCIM is available here.](#)

Manager's comment

As at 31 August 2015, VOF's net asset value was USD681.2 million, or USD3.12 per share, representing a 4.6% decrease from a net asset value per share of USD3.27 as at 31 July 2015. During the month, the capital markets component of VOF's portfolio fell 8.0% while the VN Index decreased 11.8% in USD terms as the weak performance of overweight sectors like banking and oil and gas continue to weigh on the local index.

Markets' worldwide reacted negatively to China's currency devaluation and economic slowdown, and Vietnam was not excluded. The roller coaster ride sent the VN Index to its lowest close this year of 527 points on 24 August, a 17% decline versus a month earlier but then rebounded strongly, gaining 8% within a week to pare losses for the month. The VN Index finished August down 11.8% (in USD terms), while the MSCI Asia ex-Japan index and MSCI Emerging Markets index decreased by 10.0% and 9.2% respectively. Trading value on both Vietnam's bourses fell 23.4% to USD2.2 billion on flat volumes, while the combined market capitalization was USD55.0 billion (July: USD58.8 billion). The VN Index traded on a trailing P/E of 11.0x and P/B of 1.7x according to Bloomberg.

Despite August's performance, the banking sector has outperformed year-to-date, benefitting from relatively strong loan growth (10.2% year-to-date). However, any further currency devaluation could force VND deposits to leave the system for USD, gold or real estate. This could compress net interest margins, leading to underperformance of the banks, and if banks wish to maintain margins and force lending rates up, that could lead to rise in non-performing loans if their borrowers are unable to cope with the higher rates. This illustrates our conviction not to increase our portfolio weight in this sector in the short-term.

The picture is more positive for the real estate sector and related industries such as building materials, which benefit from low inflation (CPI is less than 1% year-to-date and year-on-year), record spending on infrastructure projects and accommodative lending conditions. For example, Hoa Phat Group (HPG), one of our investee companies, reported steel consumption growing 50% both for the month of August and year to date, which bodes well for top line growth in Q3. August retail sales registering a 9.1% increase year-to-date as low inflation and greater disposable income benefits consumer related companies like Vinamilk (VNM), Masan (MSN) and Kinh Do Corporation (KDC). We note that for VNM, a decline in commodities prices is good for their margins as lower input milk powder costs should offset more aggressive marketing expenditures.

Finally, on 1 September the foreign ownership limit (FOL) was lifted on Saigon Securities (SSI), paving the way for foreigners to own up to 100% of the company. While this inaugural move was symbolic, given SSI was not trading at its foreign investment limit before the increase, there is still significant work to do to encourage more companies to lift their limits. The FOL theme has consistently been a touted as a market catalyst, but until the government offers clarity on which sectors remain restricted, little meaningful progress can be made.

Overall, until the Q3 reported earnings season commences, we believe that in the short term the market will be driven by global and macro events despite the VN index's very low historical correlation to other markets.

Macroeconomic update

Currency market news dominated the month of August thanks to the now well covered devaluation of the Yuan by the Chinese government. Prompted by this unprecedented move the State Bank of Vietnam (SBV) had no choice but to break their commitment and devalued the reference rate by a further 1% to 21,890, bringing the total devaluation for the year to 3%, as well as widen the currency trading band to +/-3% from +/-1%. This brings the effective devaluation year-to-date close to 5%, and we now expect the VND to settle between 21,500 and 22,800 by year end, although this is open to revision should the US Federal Reserve increase interest-rates or China moves again to devalue their currency.

Performance summary

31 August 2015

NAV per share (USD):	3.12
Change (Month-on-month)	-4.6%
Total NAV (USDm):	681.2
Share price (USD):	2.34
Market cap (USDm):	511.4
Premium/(discount)	-24.9%

Cumulative change (% change)

	3mth	1yr	3yr	5yr
NAV per share (USD)	-1.3	-11.3	30.7	33.0
Share price (USD)	-5.9	-11.6	43.3	56.7
VN Index (USD terms)	-3.8	-16.3	32.4	7.7

Annual performance history (% change)

	CY 2015	2014	2013	2012	2011	2010
NAV per share (USD)	-4.9	9.0	15.0	17.4	-7.6	-1.6
VN Index (USD terms)	-1.4	6.6	20.4	18.9	-25.6	-7.2



Macroeconomic update continued...

While the SBV had sufficient foreign reserves to actively intervene and stabilise the FX market (foreign reserves stood at USD40 billion or 12 weeks of imports at the end of July), such a head-strong policy would have been expensive to defend. Furthermore, given Vietnam's record trade deficit of USD16.7 billion with China (1H2015), General Statistics Office of Vietnam), compared to the country's overall trade deficit of USD3.6 billion to August, persisting with a stronger VND would do more harm to domestic businesses as the market is flooded with cheaper imported Chinese goods competing with domestic producers, and Vietnam's non-FDI exports, already facing fierce competition from Asian export-oriented economies who have devalued their currencies, face additional competition from Chinese goods and services.

On a positive note, Vietnam and the European Union signed their free-trade agreement after 2 years of negotiation, agreeing to eliminate nearly 99% of tariffs over the next 10 years. The EU is one of Vietnam's biggest trading partners, accounting for 11% of trade. Tariff elimination under this and other trade agreements such as the Trans-Pacific Partnership, will give Vietnam's exports a much needed boost.

In the manufacturing sector, the Nikkei manufacturing Purchasing Managers' Index (PMI) fell 1.3 points to 51.3 in August, with the drop attributed to slower new business activity and reduced export orders resulting from increasing competition from China. The PMI remains in expansionary territory, and the Index of Industrial Production (IIP) maintained solid growth at 9.9% year-on-year, with several manufacturing sectors seeing significant growth, such as 40.2% for electronics and computers, and 30.1% for motor vehicles.

Foreign direct investment (FDI) remains unaffected by recent market and currency volatility, given longer investment horizons and the underlying manufacturing competitiveness of Vietnam relative to regional peers. Year to date registered FDI increased to USD13.3 billion, up 30.4% year on year, with Samsung announcing an additional USD2 billion investment into Vietnam to expand LCD production at their existing plant. Samsung's cumulative investment into Vietnam now tops USD13.1 billion, mainly in technology products such as mobile phones and TV's. Foreign indirect investment (FII), where the impact of increased FX risk is more immediate, has seen limited impact given Vietnam has not traditionally been the recipient of "hot money" that features in other regional markets like Indonesia and Thailand.

On the demand side, private consumption growth has increased by 9.1% (real terms) year-to-date but confidence slipped for the second month to 133.7 points as measured by the ANZ Consumer Confidence Index. However, ANZ remains confident that the underlying resilience of Vietnam's economy will see confidence stabilise thanks to ongoing FDI and rising discretionary income, thanks to low inflation and declining energy costs.

Inflation remains low at 0.61% year-on-year due to low commodity prices, with average inflation through January to August muted at 0.83%. The inflationary impact of recent currency devaluations could add 0.3% to inflation as a consequence but otherwise it looks to be well contained for the remainder of the year. With Vietnamese consumers enjoying the benefits of cheaper imported goods from China and lower prices at the fuel pump, overall GDP continues to track towards the near-to-capacity but sustainable rate of 6.0%.

Credit growth rose to 10.2% year-to-date, indicating that the revised SBV annual credit growth target of 15-17% is likely to be achieved. VND-denominated loans have grown 10.1% year-to-date, as priority sectors such as agriculture, high-tech industries, and SME's all benefit from lending to help propel economic activity.

Finally, Moody's Investor Service recently reaffirmed Vietnam's B1 government bond rating, reiterating concerns over the mounting level of public debt and health of the SOE and banking sectors. However, the stable outlook reflects the strong macroeconomic stability, characterised by low inflation, external surpluses, real GDP growth and compositional shift in broader, higher value-added manufacturing. Furthermore, closer economic integration through free trade agreements underpins a favourable outlook for growth.

Macroeconomic indicators

	2014	Aug-15	2015 YTD	Year-on-year
GDP growth ¹	6.0%		6.3%	6.4%
Inflation (%YOY)	1.8%	-0.1%	0.8%	0.6%
FDI commitments (USDbn)	20.2	4.5	13.3	30.4%
FDI disbursements (USDbn)	12.4	1.1	8.5	7.6%
Imports (USDbn)	148.0	14.6	110.1	16.8%
Exports (USDbn)	150.0	14.5	106.4	9.7%
Trade surplus/(deficit) (USDbn)	2.0	(0.1)	(3.7)	
Exchange rate (USD/VND) ²	21,450	22,500	-4.9%	
Bank deposit rate (VND)	6.0%	5.0%	-100bps	

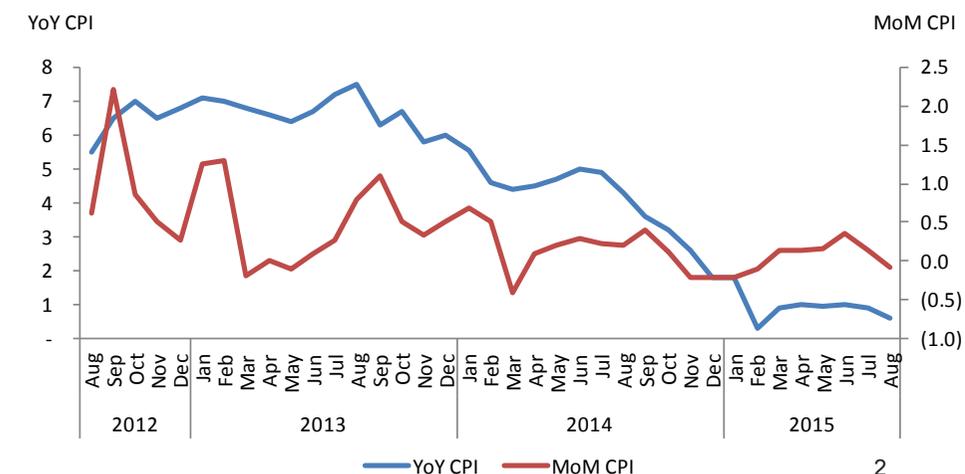
Sources: GSO, Vietnam Customs, SBV, VCB | 1. Annualized rate, updated quarterly 2. (-) Denotes a devaluation in the currency, Vietcombank ask rate

Government bond yields (%)

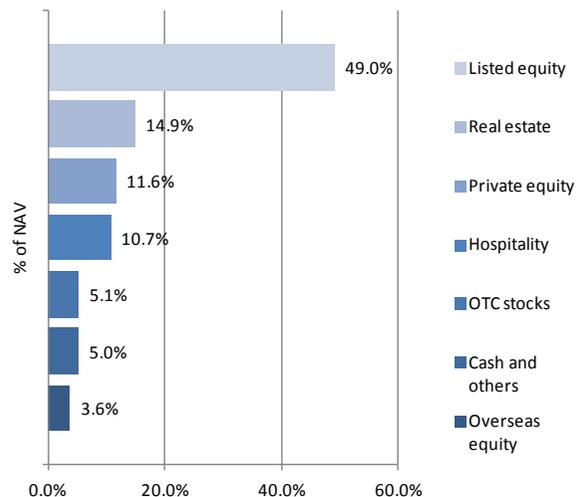
	1yr	2yr	3yr	5yr
31-Jul-15	4.85	5.29	5.68	6.48
31-Aug-15	5.20	5.55	5.95	6.75

Source: Bloomberg

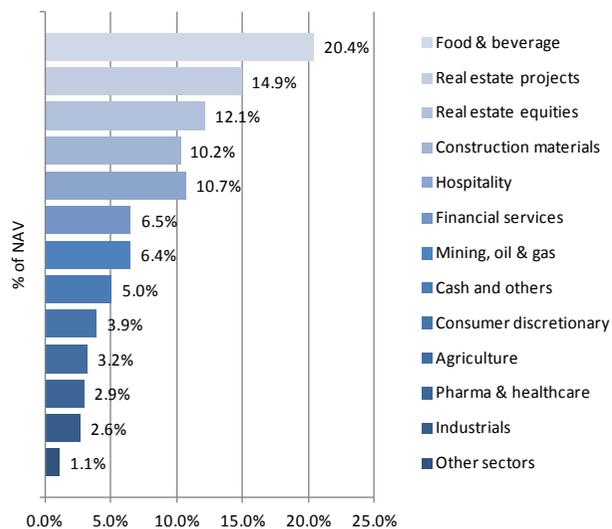
Year-on-year and month-on-month inflation (%)



Portfolio by sector



Portfolio by sector



Top ten holdings

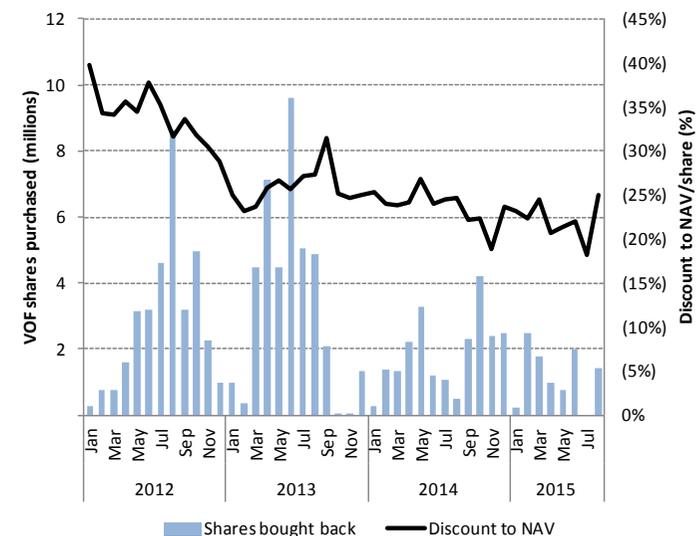
Investee company	% of NAV	Sector	Description
Vinamilk (VNM)	11.8	Food & beverage	Leading dairy company with dominant market share.
Sofitel Legend Metropole Hotel Hanoi	9.3	Hospitality projects	One of Vietnam's premium hotels.
Hoa Phat Group (HPG)	8.4	Construction Materials	Largest steel manufacturer in Vietnam.
International Dairy Product (IDP)	5.3	Food & beverage	One of the top five dairy company with potential growth.
Eximbank (EIB)	4.6	Financial services	A leading dairy company with potential growth.
Petrovietnam Technical Services Corporation (PVS)	3.4	Mining, oil & gas	Leading oil and gas technical service provider in Vietnam.
Khang Dien House (KDH)	3.3	Real estate projects	Leading property developer with strong asset base strategically located in District 9, HCMC.
Century 21	3.1	Real estate projects	HCM City residential development.
PetroVietNam Drilling and Well Services JSC (PVD)	3.0	Mining, oil & gas	Leading drilling contractor in South East Asia.
Hau Giang Pharmaceuticals (DHG)	2.9	Pharmaceuticals & health care	The largest domestic pharmaceutical producer in Vietnam.
Total	55.2		

Share buyback commentary

The Board and Investment Manager remain fully committed to the ongoing share buyback programme.

During the month, VOF bought back 1.4 million shares as part of the share buyback authority granted to the Company's Board of Directors.

Since the commencement of the programme, VOF has spent USD217.5 million overall repurchasing 106.1 million shares which are held as treasury shares and have reduced the total voting rights in the Company to 218,527,612. The total number of shares acquired since November 2011 represents 32.7% of the Company's 324,610,259 ordinary shares in issue.



Earnings Update

Vinamilk (VNM)

Vinamilk (VNM) is Vietnam's leading dairy manufacturer. The company offers a wide range of products including liquid, powder, condensed milk, yogurt, and continues its M&A strategy to extend its portfolio. The company increased its market share amid an increasingly competitive environment and slow recovery in dairy demand during 1H15 with 53% for liquid milk (+2% vs. end 2014) and 25% for powder milk (+1%) with an aggressive marketing strategy and extensive distribution (215k POS). The continuing decline in price of world milk powder has contributed to increased profitability of VNM during 1H15 while the trend is expected to continue in full 2015 and 2016. Ms. Le Thi Bang Tam – an independent BOD member has been appointed as new Chairwoman while Ms. Mai Kieu Lien remains the CEO, considered a positive movement in Management.

VNM achieved impressive 1H result with net revenue of USD890m (+13%) and net profit of USD170m (+26%). A drop in input powder milk price pushed gross profit up by 41% but surging selling expense pulled back part of the net profit. For 2015, net profit is estimated at USD350m, 23% yoy growth.

VNM closed at VND 113,000 per share as at 30 Jun 2015 (pre-adjusted for 20% share bonus in Aug 2015), representing a market capitalization of USD5.3b, trailing PE of 16.5x. As at 30 Jun 2015, VOF held a stake in VNM of USD85m.

Financial highlights

Profit and loss (VND bn)	FY13A	FY14A	1H 2014	1H 2015
Net revenue	30,949	34,976	16,958	19,216
Net profit	6,534	6,069	2,963	3,742
Net margin (%)	21.1%	17.4%	17.5%	19.5%
EPS ¹ (annualised, adjusted) (VND)	6,500	6,065	6,119	6,844
Balance sheet (VND bn)				
Total assets	22,875	25,770	23,734	27,224
Shareholders' equity	17,545	19,680	18,552	21,059
ROE (%)	39.5%	32.6%	32.8%	36.8%
Valuation				
PER (x)	17.2	15.7	15.5	16.5
P/B (x)	6.3	4.9	4.3	5.4
Dividend yield (%)	3.7%	4.2%	4.2%	5.3%

¹EPS calculation not adjusted for bonus fund

Hoa Phat Group (HPG)

Hoa Phat Group (HPG) is a leading industrial manufacturer in Vietnam. Established in 1992 as a trading company, HPG has evolved into a holding group with thirteen subsidiaries, specializing in construction materials such as steel, steel pipe, furniture, refrigerators, construction and mining equipment, real estate and industrial park operations. HPG has a well established nationwide distribution and sales network, with a strong platform for future product expansion and diversification.

HPG announced results for 1H 2015, with revenue of VND13.5 trillion (+2% year-on-year) and a net profit of VND1,888 billion (+4% year-on-year). Excluding real estate contribution, the company's core revenue increased by 5% year-on-year while core net profit increased by 26% year-on-year, explained by 52% growth in sales volume and factory optimization. For 2015, HPG estimates it can achieve net profit of VND3.25 trillion with a proposed dividend of VND2,000 per share, implying a dividend yield of 6.7%.

As of 30 June 2015, HPG closed at VND28,900 per share, equivalent to a trailing P/E of 6.4x and P/B of 1.6x. VOF's stake in HPG was valued at USD56.6 million as at 30 June 2015.

Financial highlights

Profit and loss (VND bn)	FY13A	FY14A	1H2014	1H2015
Revenue	18,934	25,525	13,197	13,486
Net income	1,954	3,144	1,814	1,888
Net margin	10.3%	12.3%	13.7%	14.0%
EPS (annualised, adjusted) (VND)	2,666	4,289	3,817	4,500
Balance sheet (VND bn)				
Total assets	23,076	22,089	20,350	22,968
Shareholders' equity	9,498	11,796	10,618	13,109
ROE (%)	20.6%	26.7%	26.4%	25.2%
Valuation (VND bn)				
PER (x)	10.8	6.7	7.6	6.4
P/B (x)	2.2	1.8	2.0	1.6
Dividend yield (%)	3.5%	5.2%	5.2%	3.5%

Board of Directors

VOF's Board of Directors is composed entirely of independent non-executive directors.

Member	Role
Steven Bates	Non-executive Chairman (Independent)
Martin Adams	Non-executive Director (Independent)
Michael G. Gray	Non-executive Director (Independent)
Thuy Dam	Non-executive Director (Independent)

VinaCapital Investment Management Ltd (VCIM)

Member	Role
Don Lam	Chief Executive Officer
Brook Taylor	Chief Operating Officer
Andy Ho	Chief Investment Officer
Duong Vuong	Deputy Managing Director, Capital Markets
Dang P. Minh Loan	Deputy Managing Director, Private Equity

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Fund summary

Fund launch: 30 September 2003

Term of fund: Five years subject to shareholder vote for liquidation (next vote to be held in 2018)

Fund domicile: Cayman Islands

Legal form: Exempted company limited by shares

Investment manager: VinaCapital Investment Management Ltd

Structure: Single class of ordinary shares trading on the AIM market of the London Stock Exchange plc.

Auditor: PricewaterhouseCoopers (Hong Kong)

Nominated adviser: Grant Thornton UK LLP

Custodian and Administrator: HSBC Trustee

Brokers: Edmond de Rothschild Securities (Bloomberg: LCFR), Numis Securities (Bloomberg: NUMI)

Lawyers: Wragge Lawrence Graham & Co (UK), Maples and Calder (Cayman Islands)

Base and incentive fee: Base fee of 1.5% of NAV. Incentive fees are based on two separate pools of investments: direct real estate and all other investments. The incentive fee paid equates to 15% of the increase in the NAV of each pool during the year over a hurdle of 8%. The total amount of incentive fees paid in any one year is capped at 1.5% of the pool's NAV.

Investment objective: Medium to long term capital gains with some recurring income and short term profit taking. Primary investment focus areas are: Privately negotiated equity investments; Undervalued/distressed assets; Privatization of state-owned enterprises; Real estate; and Private placements into listed and OTC-traded companies.

Investment objective by geography: Greater Indochina comprising: Vietnam (minimum of 70%), Cambodia, Laos, and southern China.