Vietnamese Brokers

Down, but not out

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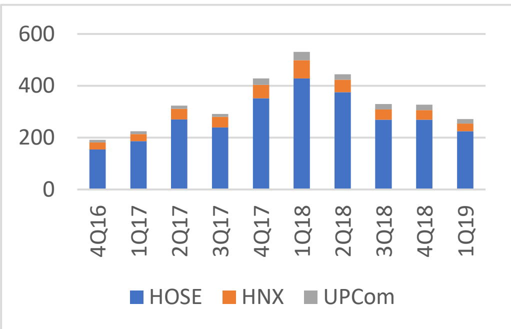
Tactically tough timing for the Vietnam brokers. As outlined in our February brokerage sector initiation, we retain our structural Overweight call on the Vietnam brokers. However, the stocks' extremely high correlations with volatile market index levels and ADT suggest that they are not a one-way bet. We reckon that the brokers' valuations will remain under pressure in 2Q19, but we still think the market will pick up in the second half of the year.

Equities Turnover (VND trn)

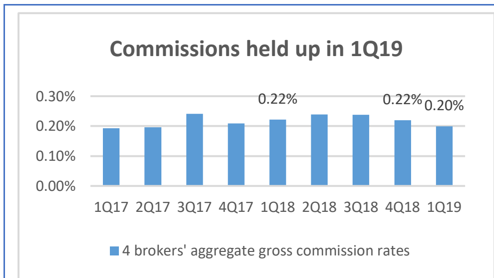


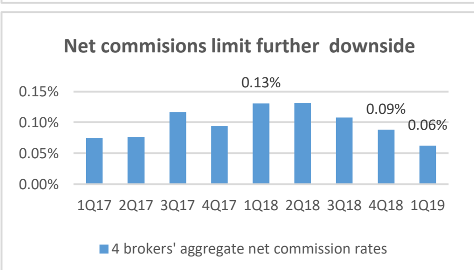
Themes and catalysts

- Stocks are very highly correlated with market levels and ADT.
- Market is under pressure; but we expect a 1H19 rebound.
- Brokerage margins remain under pressure in 1Q19….
- …but margin lending is highly profitable and has been rising.

Risks

- Global CB liquidity: the key driver of equities markets.
- Industry fragmentation, potential new entrants.
- Access to and cost of funding to support margin lending business.
- Pace of market liberalization.





Source: Company data, HOSE, HNX, FiinPro

Yuanta Vietnam Brokers Universe

Stock 2019E	Price (VND K)	Target (VND K)	Rating	%ge Dif	Fwd Div Yield
SSI VN	24.7	26.1	HOLD	6%	4.1%
HCM VN	26.4	36.2	BUY	37%	7.0%
VCI VN	29.7	43.8	BUY	48%	4.2%
VND VN	16.8	21.0	BUY	25%	4.1%

Source: Company data, Yuanta Vietnam

1Q19 earnings were a mixed bag. HCM only managed to post 13% of our full-year reported profit forecast, while SSI did slightly better at 15% of our 2019E target. VCI achieved 29% of our forecast for 2019E, but this was largely due to trading book disposal gains. By contrast, VND was an operational standout, delivering 29% of our full-year forecast on solid net brokerage, margin, and income from HTM assets.

Brokerage commissions down… We estimate our universe's gross commission rate fell to 20bps (-2bp QoQ and YoY) in 1Q19, while net commissions fell to 6bps (-3bp QoQ / -7bp YoY). Gross brokerage income falling by 31% QoQ / 59% YoY vs a decline of 25% QoQ / 54% YoY in attributable stock transactions.

But not much further left to fall. February's demise of the 15bp floor gave rise to concerns (and for some investors, hopes) that brokerage fees would fall substantially. Our view has been that fixed and variable brokerage costs would limit the downside, as net commissions (now 6bp) approach zero.

Margin lending is a far more critical driver of retail brokerage profitability, and margin loans hit a record high of VND48.5 trn (+14% QoQ / +13% QoQ) in 1Q19.

Tactical outlook: Wait for it. The brokers' share price correlation to the VNIndex are north of 90%. As outlined in our Apr 4 strategy note "Time for a breather in 2Q19", we think the market doldrums will persist until well into 3Q19, and we would trade the brokers accordingly. For long-term investors, we prefer HCM given its strong positioning for growth in institutional investor participation in the years ahead. VND's superior online trading platform should allow for greater operational leverage as retail investor activity grows. We are relatively cautious on SSI and VCI, which may face constrained share price performance.

Quarterly earnings summary

SSI	Total (VND bn)	YoY	QoQ	vs our full-year target
Gross brokerage income	154	-58%	-23%	14%
Net brokerage income	23	-85%	-36%	6%
Service fees	5	-29%	-156%	6%
Gross margin income	157	-13%	-10%	22%
Prop trading	68	-15%	2%	8%
Gains from HTM assets	215	47%	0%	23%
Net operating income	**411**	-21%	**20%**	**19%**
PBT	244	-52%	-9%	15%
Reported PATMI	**196**	**-53%**	**-6%**	**15%**
HCM	**Total (VND bn)**	**YoY**	**QoQ**	**vs our full-year target**
Gross brokerage income	111	-52%	-20%	15%
Net brokerage income	38	-74%	-17%	11%
Service fees	-1	-102%	-115%	-1%
Gross margin income	103	-34%	-13%	20%
Prop trading	29	-74%	-93%	1%
Gains from AFS assets	0	nmf	nmf	nmf
Gains from HTM assets	0	nmf	nmf	nmf
Net operating income	**144**	-67%	**1%**	**16%**
PBT	102	-75%	15%	13%
Reported PATMI	**82**	**-75%**	**14%**	**13%**
VCI	**Total (VND bn)**	**YoY**	**QoQ**	**vs our full-year target**
Gross brokerage income	88	-71%	-58%	9%
Net brokerage income	22	-91%	-81%	3%
Service fees	-2	-126%	-125%	-16%
Gross margin income	71	-25%	-55%	16%
Prop trading	184	62354%	890%	74%
Gains from HTM assets	2	nmf	nmf	nmf
Net operating income	**265**	-39%	**27%**	**24%**
PBT	249	-39%	55%	29%
Reported PATMI	**203**	**-39%**	**54%**	**29%**
VND	**Total (VND bn)**	**YoY**	**QoQ**	**Vs. our full-year target**
Gross brokerage income	90,914	-45%	-9%	17%
Net brokerage income	56,424	-37%	-14%	19%
Service fees	4,771	310%	-53%	23%
Gross margin income	87,232	-28%	-12%	20%
Prop trading	33,688	-66%	27%	1%
Gains from AFS assets	0	nmf	nmf	nmf
Gains from HTM assets	60,257	23%	-35%	30%
Net operating income	**255,183**	7%	**24%**	**28%**
PBT	111,570	-35%	111%	30%
Reported PATMI	**88,870**	**-36%**	**96%**	**29%**

Source: Company data, Yuanta Vietnam

Earnings in this sector are typically lumpy and difficult to forecast with confidence. 1Q19 was no exception.

1Q19 earnings were a mixed bag for the brokers in our coverage, two of which substantially lagged our full-year forecasts (HCM and SSI), and two of which hit 29% of our 2019E earnings assumptions (VND and VCI). Of the four, we were most positively impressed by VND, which happens to be one of our two top picks, given that its primary income drivers were client-focused rather than from proprietary trading.

Our other top pick, HCM, only managed to post 16% of our full-year net operating assumption and 13% of our full-year reported profit forecast. SSI did slightly better at 15% of our 2019E target. The 1Q19 run rates at both of Vietnam's two largest brokers were in line with our full year assumptions for gross margin lending income, but trailed in terms of net brokerage, service fees, and investment income (proprietary trading and HTM).

By contrast, VCI achieved 29% of our reported net profit forecast for 2019E, but this was largely due to trading book disposals, as total FVPL gains (realized and unrealized) 69% of VCI's net operating income.

As noted above, VND was an operational standout, delivering 29% of our full-year forecast. This result was driven by solid net brokerage income, margin interest, and income from HTM assets. We think these earnings streams are worth more than gains from prop trading, which are inherently lumpy and difficult to forecast (and can also surprise painfully). VND also posted the highest estimated commission rate in 1Q19, which we believe reflects its retail focus.

Brokerage commissions & the removal of the 15bp floor

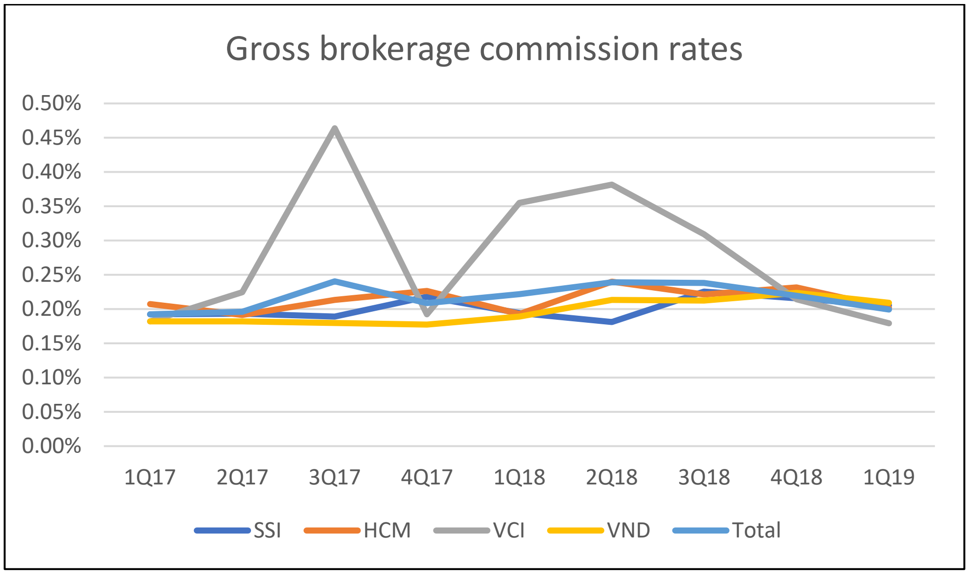
1Q19 saw the removal of the previous 15bps floor on brokerage fees.

One of the key areas of pushback that we received from investors revolved around concerns (and, for some investors, hopes) that brokerage commission rates would plummet to zero following the removal of the erstwhile 15bp commission floor starting from the middle of February. Our view has been that fixed and variable brokerage costs would limit the much of the downside, as brokerage commissions net of costs were already approaching zero.

We are less than fully convinced in the quarterly data quality, but we took a stab at estimating brokerage commission rates by examining each of the four top brokers' quarterly market share on HOSE, HNX, and UPCom. This approach ignores bond and derivative-related brokerage, but we reckon any errors that result should be marginal given the much higher scale of the equities commission pool.

But this did not result in an obvious free-for-all during the quarter. Gross fees fell by 2bps sequentially, while fees-net-of-brokerage costs fell 3bps QoQ.

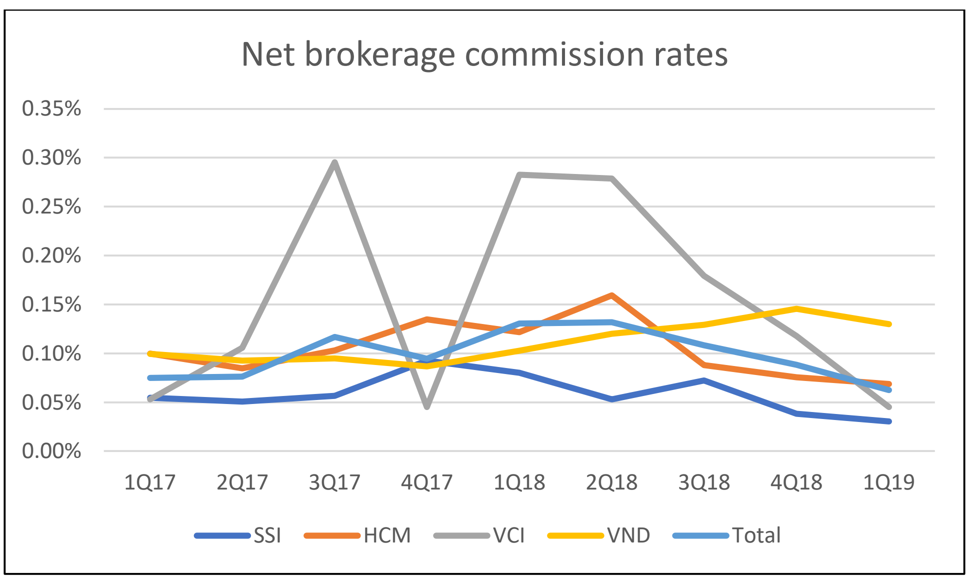
Based on this methodology, we estimate that our universe's gross commission rate fell to 20bps (-2bp QoQ and YoY) in 1Q19, while net commissions fell to 6bps (-3bp QoQ / -7bp YoY). This estimate is underlined by total gross brokerage income for the four brokers falling by 31% QoQ / 59% YoY, a larger decline than the -25% QoQ / -54% YoY drop in attributable stock transactions.



Thus, these numbers fail to confirm the dramatic collapse in gross brokerage commissions that some in the market had anticipated. To be fair, the floor remained in place until the middle of February. But roughly two-thirds of total volumes in 1Q19 occurred after the floor was removed (recall the short-lived post-Tet boom), and the commission rates still do not reflect a free-for-all market share grab.

Net fees were already approaching zero even before the mandatory floor was removed. This should limit subsequent declines, in our view.

Of course, it is still early days, and commission rates may continue to erode going forward. However, we reiterate our view that brokers are not likely to work for free (or at a cost to themselves), and commissions net of brokerage costs (which fell 3bp QoQ / 7bp YoY to reach just 6bps) were already approaching zero prior to the elimination of the 15bp commission floor.



Anyway, pure brokerage is a mug's game...

This is not to suggest that pure brokerage is (or ever has been) an incredibly profitable business – it most certainly is not. Indeed, our universe's aggregate brokerage expenses / turnover rate *increased* by 1bp QoQ / 5bps YoY to reach 14bps in 1Q19. However, we believe that the net commission rate of 6bps in 1Q19 is a reflection of how much lower commission rates should reasonably expected to go. Market share-focused incumbents still have a bit of room to cut rates before they hit zero, but this room is limited (e.g., SSI's estimated net commission rate was 3bps in 1Q19). It is possible for outside disruptors to gain entry with better IT and cut rates further, for reasons that we don't quite understand given the capital commitment of doing so. But we can't rule it out.

Anyway, it's all about margin lending.

…The real money in retail broking is largely about margin lending.

A possible rationale for letting brokerage commissions net of costs slide to zero or negative would be as a loss leader to accrue market share in margin lending, which to our minds is the key driver of sustainable revenues in retail broking. It's hard to argue against gross yields of roughly 12% annualized on collateralized lending, as exhibited in the table below.

Margin lending yields

	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
SSI	12%	12%	12%	12%	11%	12%	11%	12%	10%
HSC	13%	12%	13%	13%	13%	14%	12%	12%	12%
VCSC	12%	11%	10%	12%	10%	9%	9%	18%	11%
VND	12%	13%	14%	14%	14%	14%	12%	13%	14%
Total	**12%**	**12%**	**12%**	**12%**	**12%**	**12%**	**11%**	**14%**	**11%**

Source: Company data

Please note that we are calculating these yields by averaging the brokers' reported gross margin loans from the balance sheets. We would prefer to use actual average margin loans during the quarter (which are not available to us) to get a more accurate sense of competitive pressures in the space. For example, the apparent 3ppt QoQ decline in yields in 1Q19 is probably reflective of yearend doldrums (and thus low margin loans on Dec 31, 2018) as well as the fact that margin loans probably didn't pick up until after the February New Year holidays.

Gross margin income / Gross revenues

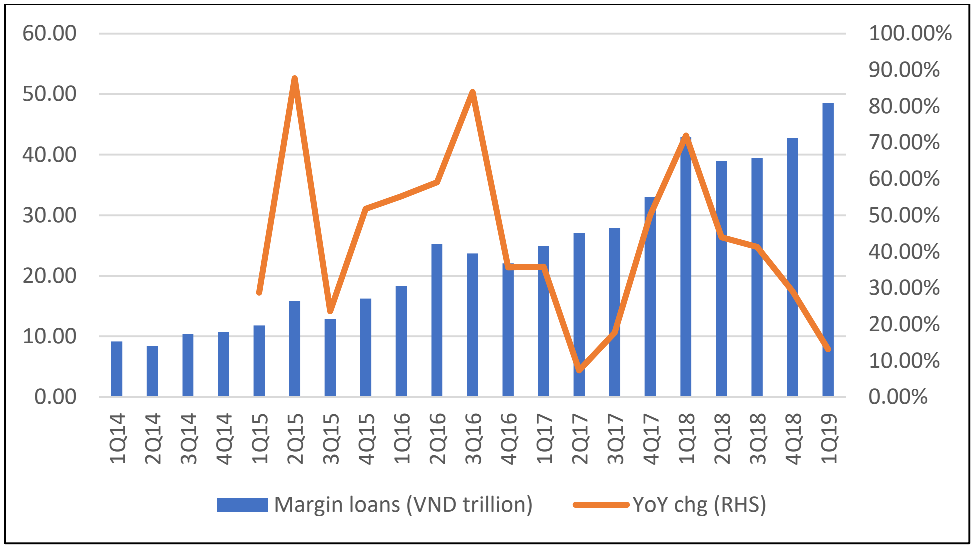
	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
SSI	28%	30%	52%	30%	35%	60%	27%	50%	38%
HCM	65%	50%	60%	55%	35%	60%	54%	82%	71%
VCI	24%	25%	24%	35%	22%	34%	38%	76%	27%
VND	33%	43%	46%	39%	51%	58%	40%	48%	34%
Est. net margin inc / Net operating income									
	1Q17	2Q17	3Q17	4Q17	1Q18	2Q18	3Q18	4Q18	1Q19
SSI	37%	20%	26%	7%	15%	40%	18%	33%	28%
HCM	54%	38%	35%	9%	22%	40%	41%	67%	53%
VCI	13%	18%	13%	17%	13%	21%	23%	46%	16%
VND	18%	26%	26%	24%	31%	42%	25%	35%	22%

Source: Company data

The brokers' reported income from margin loans accounted for between 27%-71% of total gross revenues in 1Q19. Our estimate of net income from margin lending (which includes a funding charge assumption) represents 16%-53% of net operating income. This is far ahead of the range of contributions from pure brokerage (which was 6%-26% of net operating income at our four brokers in 1Q19).

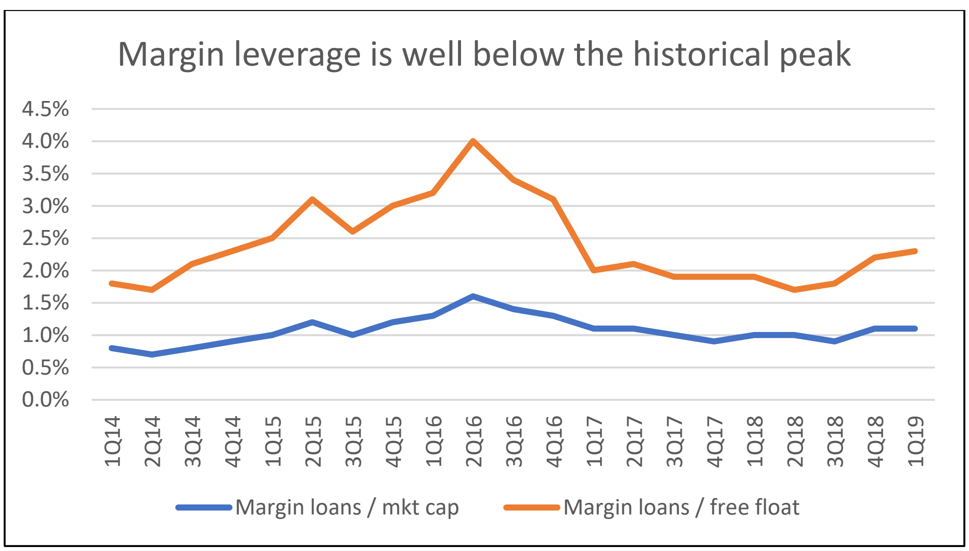
Margin loans hit a record high of US$2.1bn in 1Q19.

Brokerage margin remains a fairly new business in Vietnam, so we believe that the market has plenty of room for growth in the years ahead – given the right conditions for punting sentiment, of course. Margin loans across the entire industry reached a record high of VND48.5trn (USD 2.1 bn) in 1Q19, up 14% QoQ and 13% YoY.



But margin positions are still at reasonable levels. Total sector margin loans are 2.3% of free float, which is a level that shouldn't keep you up at night.

We see this as a healthy trend for the brokers and for the market as a whole. We recall the margin-driven frenzy of China's A-Share markets in 2015, where visible margin lending alone accounted for around 9% of the market's free float (and it didn't end very well). By contrast, we see current margin levels in Vietnam as reasonable at 2.3% of free float market capitalization. Of course, this analysis fails to measure the margin leverage in individual stocks, but in the absence of data transparency, it's the best we can do.



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