

Whither the VND?

Endogenous support, but external threats

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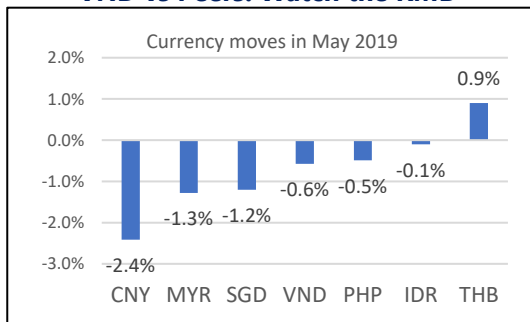
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VND looks fundamentally well-supported, but watch the RMB. Investors have recently expressed concern about the potential downside risks to the VND, especially given the currency's high historical volatility and the moderate softening that was evident in May. We believe the domestic economic fundamentals are broadly supportive. We expect 2% depreciation annually going forward, which we think is more or less in line with consensus. However, a key downside risk to our moderate "Goldilocks" depreciation outlook is the potential for RMB devaluation.

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VND vs Peers: Watch the RMB



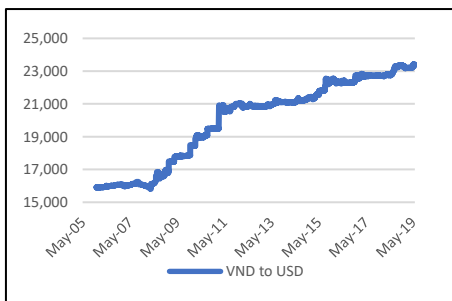
Themes and catalysts

- **Strong fundamentals:** persistent foreign investment inflows, subdued inflation, sufficient reserves.
- **A sharp depreciation of the RMB** could trigger downside risk for the VND (albeit probably less downside than that of other ASEAN currencies).

Risks

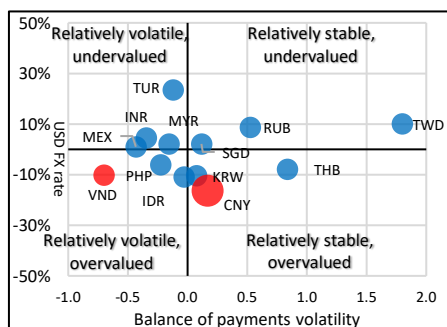
- **Our 2% annual depreciation assumption** is moderate; reality may be more dramatic.
- **Vietnam's current account balance** can be volatile.
- **Yuanta macro team sees VND overvaluation** of 10%.

Moderate depreciation in 2011-19



Source: Bloomberg

VND may be c. 10% overvalued



Source: Dr. Yen Chen-Hui, Yuanta-Polaris Research Institute

Supportive macroeconomic factors include strong FDI and portfolio inflows (still), relatively low inflation despite food and energy price volatility, and reasonable levels for both VND rates and FX reserves. Historical current account instability results in our global macro team pegging the VND at 10% overvalued (see chart at left) but we think a more stable trade account will gradually emerge from the FDI focus on export manufacturing and, longer term, the development of a comprehensive domestic supply chain that allows greater capture of export value.

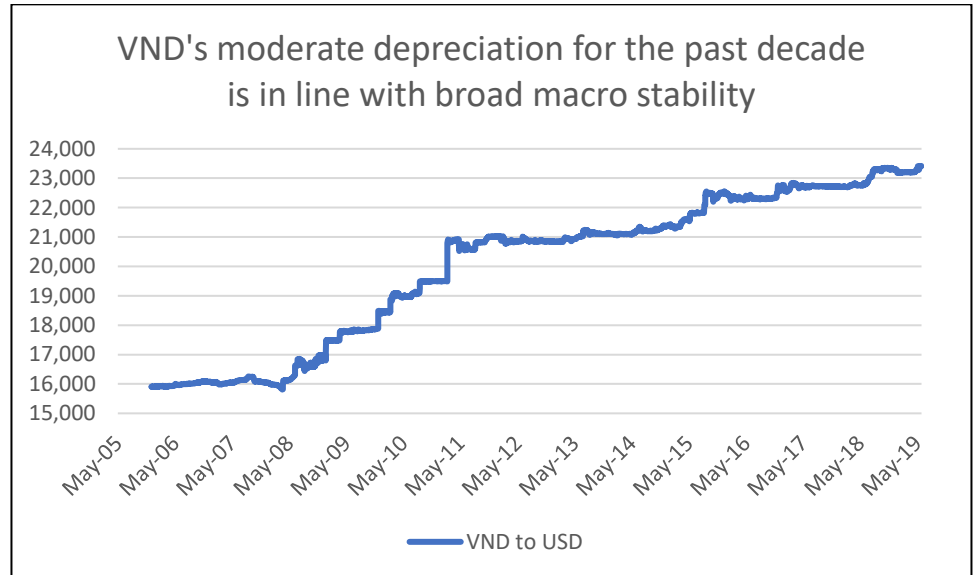
RMB is perhaps the key risk. The US-China trade war has resulted in increased and likely persistent FDI inflows for Vietnam, but also increases the risks for global growth. That said, Vietnam appears well placed to enjoy a larger slice of the overall export pie. We think a more cogent risk from the trade war is the possibility of a sharp decline in the RMB from here. Although the VND would not likely fall as much as the RMB (or regional currencies) in this scenario, depreciation could certainly be more dramatic than our base case expectation of 2% annually going forward. We discuss the sector-by-sector impact of a sharp devaluation in this note.

Our call: Fed easing in 2H19 is more likely than a sharp drop in the RMB. Last week's dismissal (by an ex-PBOC governor) of the idea that 7 RMB to the dollar has any particular importance has driven expectations of further RMB depreciation. However, China also faces food price inflation, banking system troubles, and the potential for renewed capital flight. In our view, the RMB is likely to find support at this level. By contrast, we believe a reversal of previous Fed policy is far more likely to occur in 2H19. This should ease pressure on emerging market currencies such as the VND and is a key driver of our expected stock market recovery in 2H19.

The VND and the potential for depreciation is a key question lately.

VND risk in focus

We've been chatting quite a lot with investors who are relatively new to Vietnam (that's the good news). One of their key concerns is potential currency risk, especially given the VND's historical high volatility and the moderate softening that was evident in May. We understand that a US-national, Vietnam-based equities strategist might not be every investor's first choice for a view on the RMB or USD. But we see global central bank actions as more cogent for the VND than domestic macro factors, which appear to be broadly supportive. In any case, this report represents an attempt to formalize our view on the VND.



As a general statement, we see several endogenous factors that are largely supportive of the VND. They include strong foreign investment inflows into Vietnam, low inflation and interest rate gap to the USD, and what we see as a reasonable level of FX reserves. The current account has historically exhibited volatility but we think a more sustainably balanced trade account should emerge gradually on the FDI inflows into manufacturing investments and, over time, the development of a more comprehensive domestic supply chain.

The authorities are likely to manage the currency and avoid any sharp decline, in our opinion...

We think the SBV has ample levers to manage the currency to a smooth and gradual depreciation. Since the rekindling of the trade war in early May, most regional currencies have fallen vs. the USD, with the RMB down 2.4%. By contrast, the VND has only fallen 0.6%. Again, we think that the relative stability exhibited in recent years should be seen as a template for possible subsequent trends in the currency. In other words, we think that a sharper decline in the RMB would probably mean a fall for the VND too – but a less precipitous decline.



Source: Bloomberg

...and we are looking for a 2% annual depreciation vs the USD, which we also believe to be more-or-less in line with the consensus view.

Our goldilocks outcome is backed up by probable Fed loosening in 2H as well as solid domestic macro factors.

Our global macro strategists reckon the VND is moderately (c. 10%) overvalued, which also supports our expectation of a gradual decline.

Our expectation is for a moderate depreciation of 2% annually for the VND going forward. We think this moderate view of slow depreciation is probably more or less in line with the consensus. This is just fine with us – we aren’t claiming to be the smartest FX analysts on Le Loi Street, let alone in all Vietnam. Sometimes, the consensus is right. We also believe that this expectation of moderate VND depreciation reflects a view of persistent, but moderate, strength in the global reserve currency rather than any particular specific bearishness on the VND.

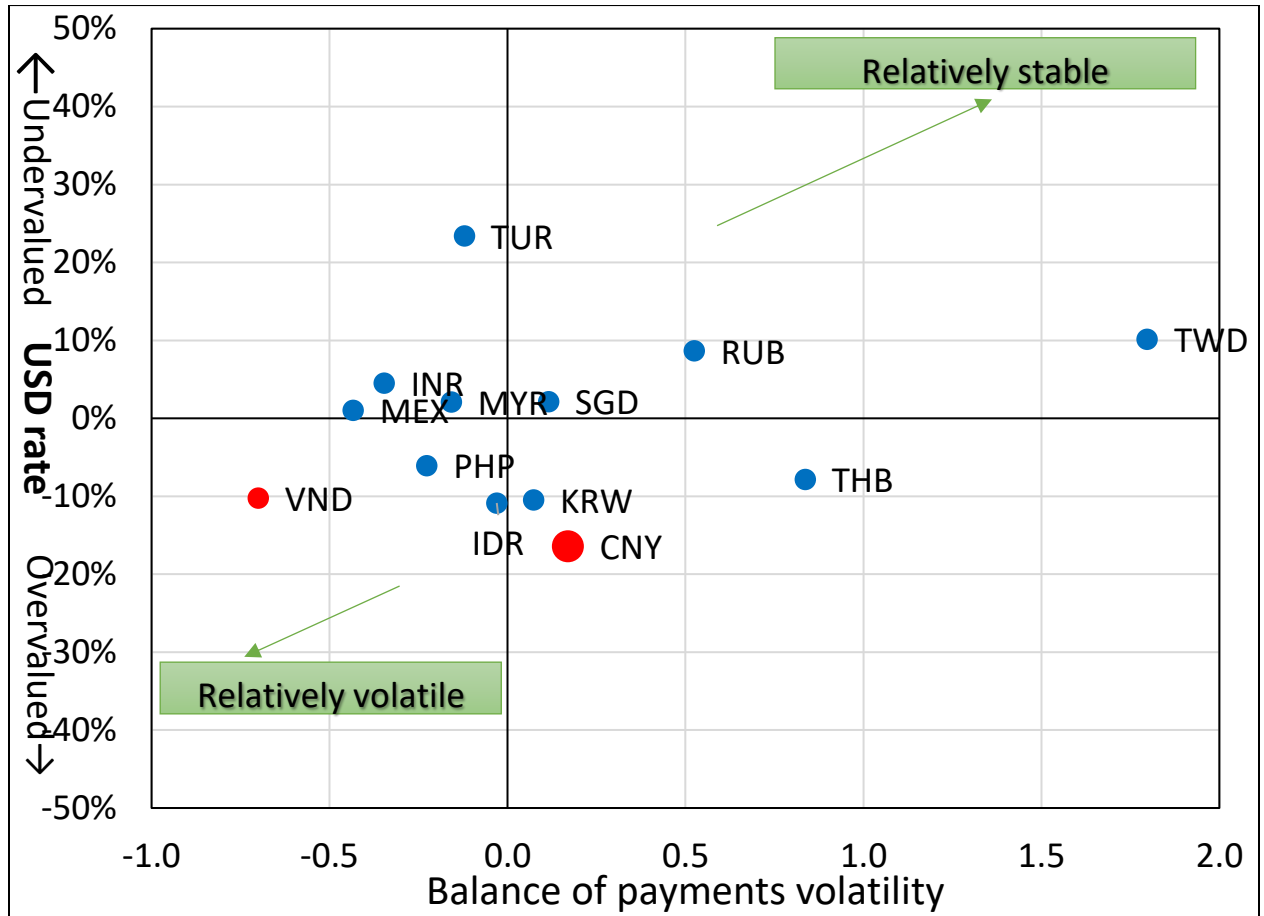
Monetary easing by the Fed, perhaps in late 3Q19 or early 4Q19, could result in a pause in USD strength which would obviously be VND-supportive. But suffice it to say that we think the likelihood of substantial VND appreciation vs the USD is not likely; we’ll stick with our call for 2% annual depreciation.

This expectation for moderate depreciation is also backed up by fundamental analysis undertaken by our regional macro strategy team that suggests the Vietnamese Dong is overvalued by about 10%. Strategist Dr. Yen Chen-Hui of the Yuanta-Polaris Research Institute has analyzed various global currencies (a few of which are illustrated in the chart below), based on the stability/volatility of current account balances in the respective countries. Not only does he find the VND to be overvalued, but his analysis also reveals more substantial overvaluation for the onshore RMB (or CNY in the chart below).

The focus of FDI on export manufacturing as producers shift capacity out of China should support a more balanced trade account going forward as Vietnam develops in the years ahead, in our opinion. GSO data indicate that Vietnam is running a small trade deficit of around US\$540m in the first five months of 2019, a reversal of the US\$3.4bn surplus posted in Jan-May 2018, but not enough for us to panic about the impact on the VND. Notably, the FDI sector is providing a net surplus of \$12.8bn YTD, and this underlines the argument that FDI should be seen not just as a current source of support for the currency but also a source of future support.

Crucial in this expectation is Vietnam’s ability to develop a more diversified and thorough domestic manufacturing ecosystem so that more of the value of export goods is retained.

Yuanta’s Global Macro Team sees the VND as around 10% overvalued



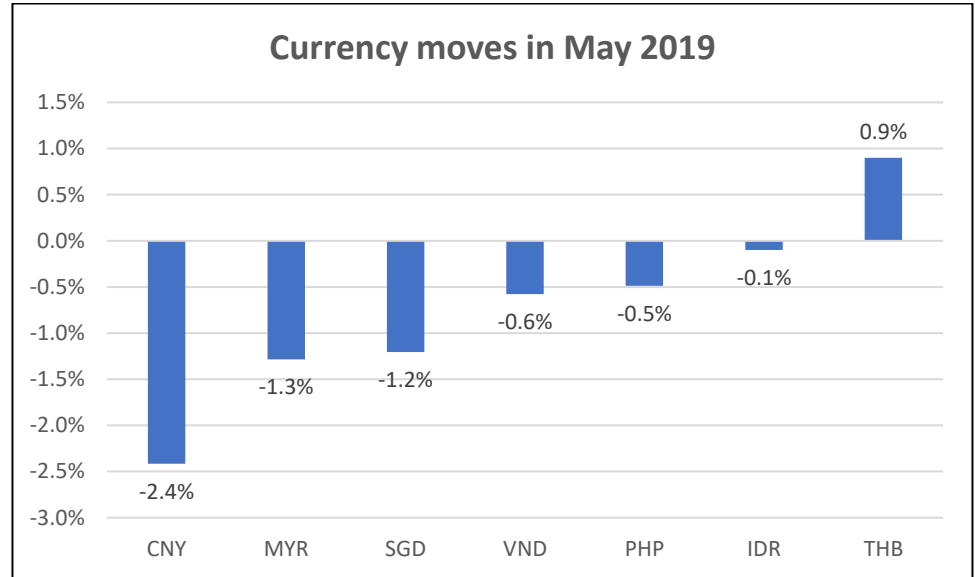
Source: Dr. Yen Chen-Hui, Yuanta-Polaris Research Institute.

The VND’s 10% overvaluation as indicated in the chart above won’t keep us up at night from worry, as we already expect a gradual 2% annual depreciation in the years ahead. However, the CNY’s relative overvaluation of around 18% on this model is worthy of consideration, especially given the clear and present implications of the ongoing US-China trade war (which in our humble view should be seen as a semi-permanent feature of global trade going forward). This leads us to what we see as the biggest downside risk for the VND from here.

We believe the key downside risk stems from the RMB.

We believe that the major downside risk is the RMB, given the likely impact of a potential sharp devaluation of China’s currency. Given that China is Vietnam’s largest trading partner, it would seem reasonable to assume some impact on the SBV’s trade-weighted currency basket approach. From a purely mercantile perspective, in this scenario the currency would likely require some devaluation as a means of maintaining Vietnam’s cost competitiveness – against China itself, but

also against regional peers, many of which have seen greater currency downside since the rekindling of the trade war flames in early May.



Source: Bloomberg

We think the VND would fall if the RMB devalues sharply, but VND would probably not fall as much as regional currencies.

The RMB is clearly the key factor here. The PRC authorities have not allowed the currency to drop through 7 to the US dollar as of press time (and more importantly, they have not done so since 2008), and our assumption is 7 will hold going forward. On the other hand, if the PBOC allows for a sharp RMB devaluation, we believe this would result in a concomitant fall in regional currencies. Based on the recent stability of the SBV's management of the domestic currency, we believe that the VND is not likely to be among the worst impacted in the region. However, given China's size in the SBV's trade-weighted basket, we believe the VND could see further downside than our base case.

Possible impact of an unexpectedly sharp devaluation

This would not be an optimal outcome for at least two reasons.

1) The potential backlash from the authorities in Vietnam's largest export market, the United States, cannot be ignored. As of May, Vietnam has been placed on the US Treasury Department watchlist for currency manipulators. Geopolitics suggests that the frictions with China should remain on the front burner in D.C., but we aren't confident in our ability to forecast Trump administration moves against other countries. In any event, watch this space.

2) But perhaps a greater near-term risk from our perspective is the possible monetary tightening that a sharp VND devaluation might necessitate, which could have a deleterious impact on domestic economic growth and stock market liquidity. The impact on any specific company would depend on its specific circumstances, including debt structures and overall risk management capabilities.

A sharp devaluation of regional currencies would clearly not support our call for a rally in Vietnam equities prices in 2H19.

In general, if the RMB devalues sharply and the VND follows at a more moderate (but still surprising) pace of devaluation vs the USD, we believe that firms in the major listed sectors could be impacted as follows.

Our thoughts on the downside risk of a sharp VND devaluation (which is NOT our base case).

Cost competitiveness of exporters would depend on the degree of depreciation of regional currencies, not just the VND.

Real estate & construction would likely be among the hardest hit sectors.

Upstream O&G players would be net winners, we think.

Banks: VND devaluation would cause liquidity pressure due to higher domestic demand for USD and gold over VND. In such an environment, well capitalized banks with high CASA deposit ratios would benefit. By contrast, highly leveraged banks with low CASA ratios could face pressure.

Manufacturing: Most manufacturers would probably be hurt in a scenario in which the VND depreciates by less than the RMB and ASEAN competitor countries. Exporters with limited external cost inputs would benefit if the VND devaluation were done in a vacuum, but currencies of competitor export countries (including, in our scenario, China itself) would probably decline by more than the VND. A key nuance here is the source currency of a firm's inputs (parts and materials); firms that source inputs predominantly from China would benefit relative to those with inputs predominantly from the US, the EU, or Japan.

Real estate developers: Firms with highly leveraged balance sheets and a large proportion of loans in foreign currencies might face pressure. Although property prices could initially become more attractive from the perspective of foreigners (really, USD holders), sentiment for investing in this scenario would probably be weak. In addition, the likely tightening of domestic liquidity that would result from a sharp depreciation would drive up funding costs for developers, as well as mortgage costs for end-buyers. Thus, both confidence and affordability among Vietnamese residential buyers would take a hit.

Construction: Construction firms would face similar liquidity risks as the real estate firms. VND devaluation could also pressure public finances, leading to a reduction in infrastructure spending and related construction work.

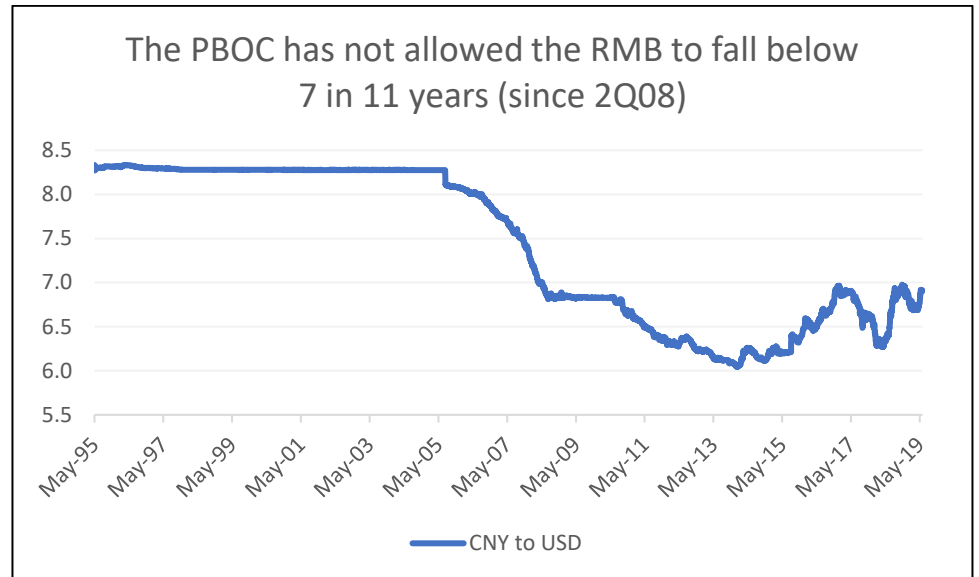
Oil & Gas: We reckon that upstream companies that provide technical services could benefit from a sharp VND devaluation. Companies such as PVD and PVS provide services to local and foreign E&P players with predetermined USD contracts. Thus, devaluation would mean improved VND-based earnings. Although such companies' debt is largely USD-denominated (e.g., PVD (USD 165 mn) and PVS (USD ~40mn)), the bulk of revenue is also in USD. We think mid-stream companies are in a similar position (e.g., 70% or USD147m of GAS's total debt is USD-denominated) because both inputs and outputs are USD-denominated.

For downstream companies (e.g., gas distributors PGS and PVG), VND devaluation could a moderate downside risk because of largely USD-denominated expenses and VND-denominated revenues. This could partly be mitigated by their oligopoly status which could allow them to pass increased costs on to industrial and retail customers. On the positive side, downstream firms have very little foreign currency debt so the balance sheet impact would be marginal at most.

Consumer: Not a beneficiary in general, except for gold sellers (think PNJ VN).

Consumer: The sector is more of a mixed bag when it comes to a VND shock. In general, a weaker currency should lead to decreased purchasing power and thus weaker consumer demand. Textiles (e.g., STK, TCM, and MSH) or food and beverage firms (e.g., VNM and SAB) with imported inputs would face cost pressure as well.

On the other hand, we believe that one subsegment of the consumer sector would clearly benefit from a sharp VND fall. Gold jewelry sellers (e.g., [PNJ – BUY](#)) would probably be major winners from this outcome given the yellow metal’s safe-haven status and especially the Vietnamese traditional (and very much alive) penchant for gold as a store of value.



Source: Bloomberg

Is there something magical about 7? The ex PBOC gov says “no”, but the PBOC has kept the RMB above that level since 2008.

In our view, a scenario of sharp RMB depreciation is not the most probable outcome, but investors should at least consider it as a possibility. Last week’s [comments](#) by former PBOC Governor Zhou Xiaochuan that the 7-yuan per dollar level is not particularly important have generated much economic commentary that essentially reiterate his argument. On the face of it, this view is economically correct in our opinion. However, psychology matters and humans are not purely rational creatures. A sharp devaluation would not only boost inflationary pressures in China, but also could increase the propensity for capital flight. There may be nothing magical about the number seven, but it’s worth considering that the PBOC has ensured that the RMB stays above that level constantly for the past 11 years.

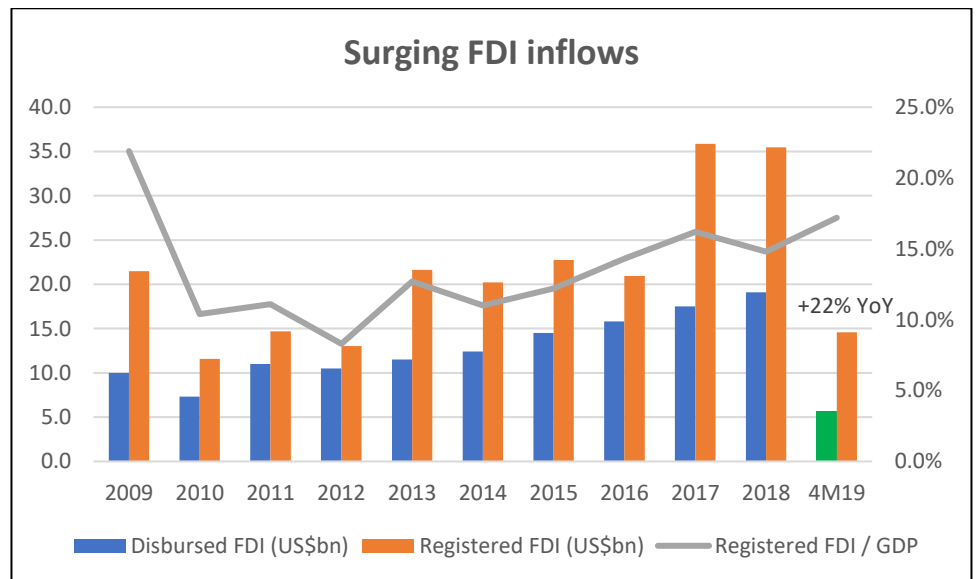
Endogenous factors are broadly supportive

Liquidity inflows into Vietnam remain strong, including foreign direct investment and portfolio flows.

FDI is a key supportive factor of the VND.

Of the two types, we view FDI as more strongly supportive of the domestic currency given its much larger scale (so far) and high relative “stickiness” vs that of portfolio flows. Registered FDI exceeded US\$35bn in both 2017 and 2018, with disbursed FDI at roughly half those levels in the past two years.

Based on the first four months of 2019, registered FDI (US\$15bn, +22% YoY) is on pace to hit a new record high this year. Moreover, the gap between disbursed and registered FDI in the 2017-April 2019 period suggests has reached US\$44bn, indicating considerable inflows going forward even if newly registered FDI dropped to zero (which, we strongly believe, is not going to happen). These figures far exceed even the major strategic investments in listed firms such the US\$1bn investment by SK Group in Vingroup (VIC VN, Not Rated) in mid-May.



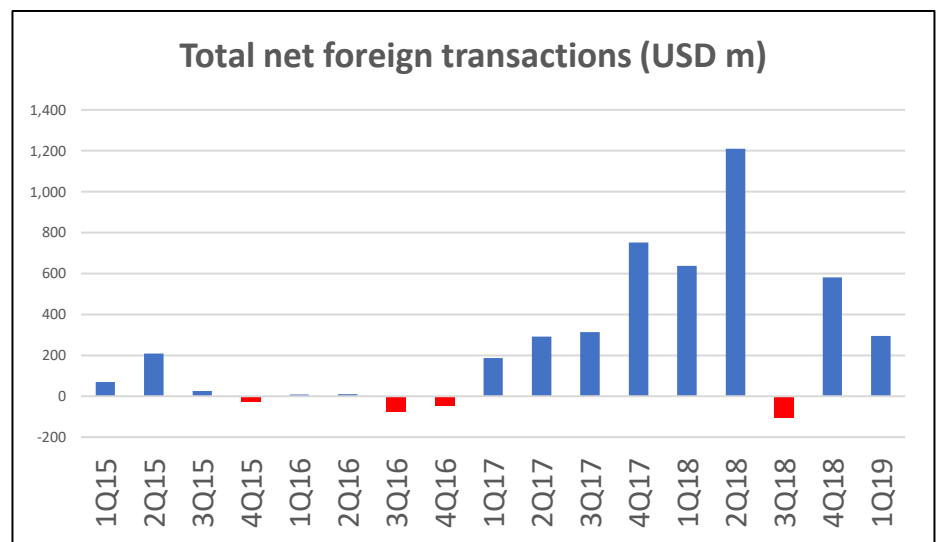
Source: FiinPro, Yuanta Vietnam

We are cautious about using the word “permanent” to describe international capital investments, but FDI represents an extremely long-term capital commitment, in contrast to portfolio flows which include very large strategic investments, but portfolio flows that can create a potential liquidity overhang for domestic markets and the VND. To be clear, we don’t see very much of this so-called “hot money” in Vietnam yet, but the propensity of portfolio managers to pull money out of liquid markets is obviously higher than that of direct investors in manufacturing capacity and other long-term and illiquid business assets.

FDI inflows to manufacturing mean future exports and, perhaps, a more stable current account.

In addition, FDI for export manufacturing represents additional future external inflows. As Vietnam develops a more thorough internal supply chain ecosystem going forward, it will be better positioned to capture more of the value of its gross exports, which again should help boost the trade balance in the years ahead. Thus, FDI should be doubly supportive of the VND, in our view.

Overall, portfolio flows tend to be both smaller and more volatile than FDI. The obvious exception here are the large inflows from strategic investors, such as SK Group’s injection of US\$1 bn into Vingroup (VIC VN, Not Rated) in May, which we believe are intended as extremely long-term investments and less representative of a possible overhang for the currency. Of course, we are sell side brokers and portfolio flows are very close to our hearts. But we won’t discuss them at length in this piece given that we have written at greater length on portfolio flows in other strategy notes, including [Of FOLs and Money](#) (April 8) and [Time for a breather in 2Q19](#) (April 4).



Source: FiinPro, Yuanta Vietnam

Inflation and rates are at reasonable levels

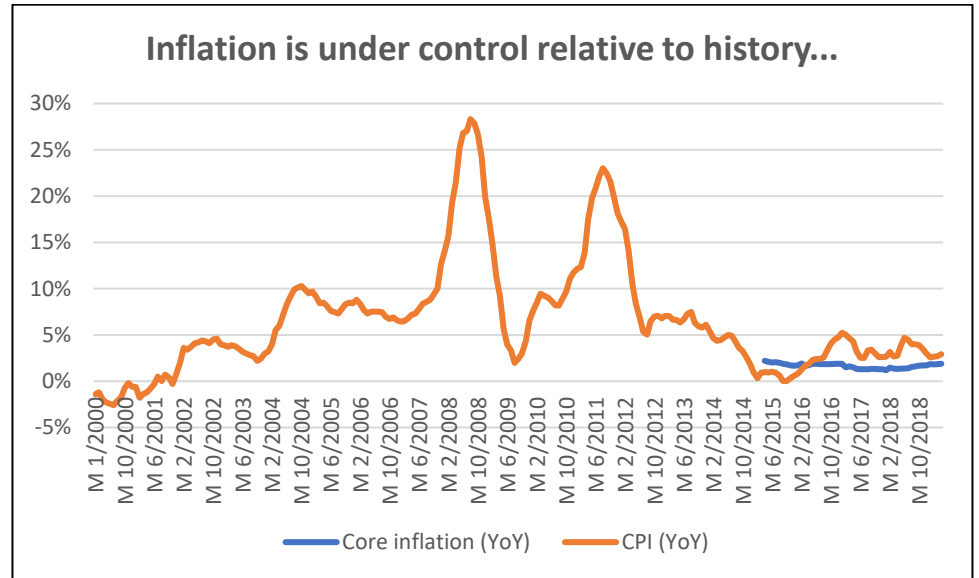
Historically, sharp VND devaluations have typically occurred during periods of high domestic macroeconomic instability. But such is not the case in Vietnam today, with low (albeit trending marginally higher YTD) inflation, moderate credit growth in recent years (domestic media report bank credit expansion of 5% YTD through May), and domestic interest rates at reasonable levels relative to USD rates.

Inflation has ticked higher in the first four months of the year, but remains under control and well below the central bank’s 4% target. We expect core inflation to remain under control in our base case assumption of a 2% VND devaluation, although energy and food prices could potentially move higher.

Yuanta consumer analyst Quang Vo’s coverage of Masan Group (MSN VN, VND 85.7K, BUY, Target: VND93.0K, Quang.Vo@yuanta.com.vn) has frequently drawn our attention to the issue of African Swine Fever and its potential impact on the

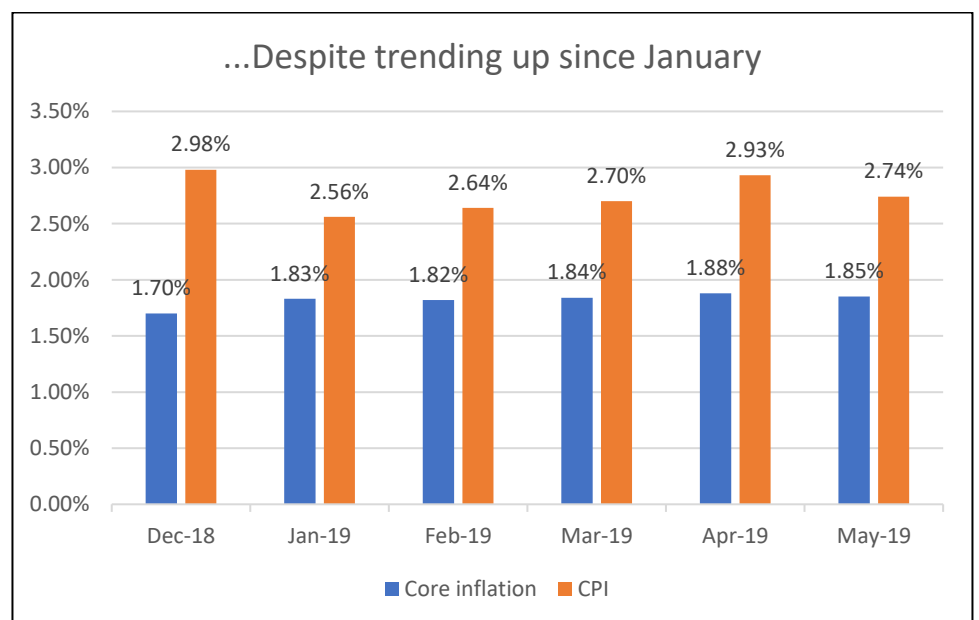
Inflation is well below historical levels and the SBV’s 4% target.

price of pork, which we reckon accounts for 50-60% of Vietnamese animal protein intake in normal times, and the price of alternative meats as demand switches away from pork. Please see Quang's April [quarterly results note on MSN](#) and the following non-rated company notes on the subject: [Vissan \(VSN VN, Not Rated\): Pork to get roasted in 2019](#) and [DBC: Industry consolidation is the silver lining of African Swine Fever](#).



Source: FiinPro

Energy input prices are another swing factor, both for inflation and the trade account. Oil tanked in May along with markets and overall global confidence following the rekindling of the US-China trade war. It is difficult to say, but we think this may be set to turn around now that the US Fed has signaled (apparently in deference to bond markets) that rate cuts could be in the cards earlier than they had previously intoned would be the case.



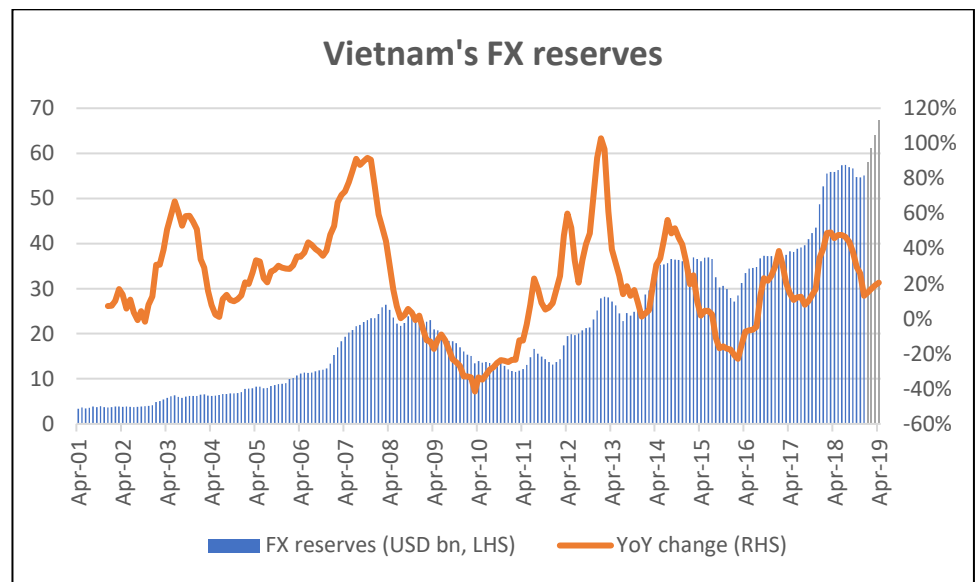
Source: FiinPro, Government Statistics Office for May datapoints

We have been calling for the Vietnamese market to recover in 2H19 once the Fed eases its policy, which should also result in a recovery in oil prices. This is crucial for analyst Binh Truong’s BUY call on PV Drilling (PVD VN, VND18.2K, BUY, Target Price: VND24,5K, Binh.Truong@yuanta.com) given the stock’s 92% correlation with Brent prices and the more critical fundamental threshold price for Brent of US\$60 dollars per barrel (vs the current c. US\$62) that drives PVD’s utilization. For details, please see Binh’s initiation note of June 4 titled [PVD: Drill, Baby, Drill!!!](#)

Vietnam’s FX reserve cushion looks fine

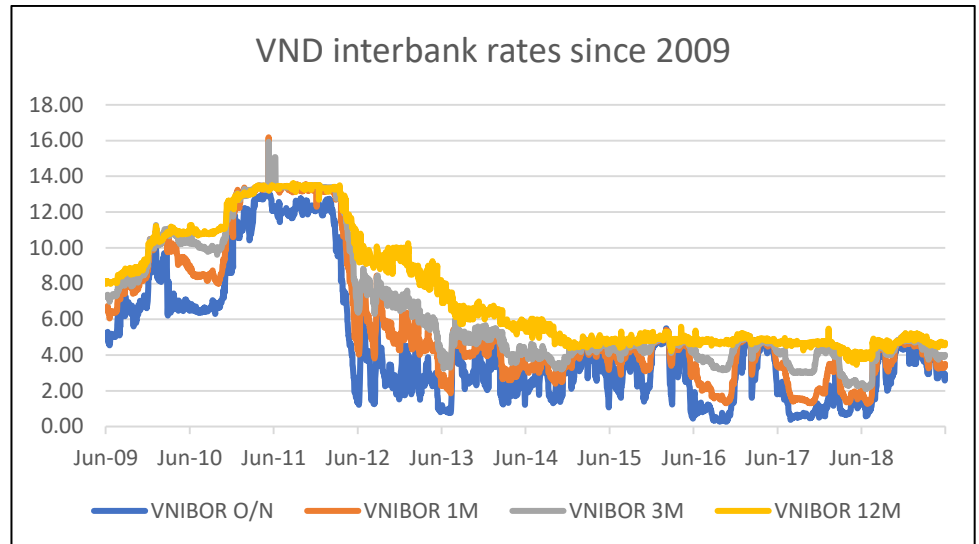
FX Reserves appear sufficient, in our opinion. IMF data indicate Vietnam’s FX reserves at US\$55.1bn at end-2018. Vietnam News reports FX reserves reached US\$67.4bn at around the end of April.

If the latter figure is correct, it would reveal a roughly US\$12bn increase YTD. We see this level as sufficient given that it would cover 15 weeks of average YTD imports (which are in large part driven by export orders and thus would likely fall rapidly coincident with any global trade shock). The US\$55.1bn figure at end-2018, if it were still in place today, would represent 12 weeks of imports, which again appears to be sufficient to support confidence in the VND.



Source: IMF to Dec 2018, Yuanta Vietnam (estimated from Vietnam News) for 2019

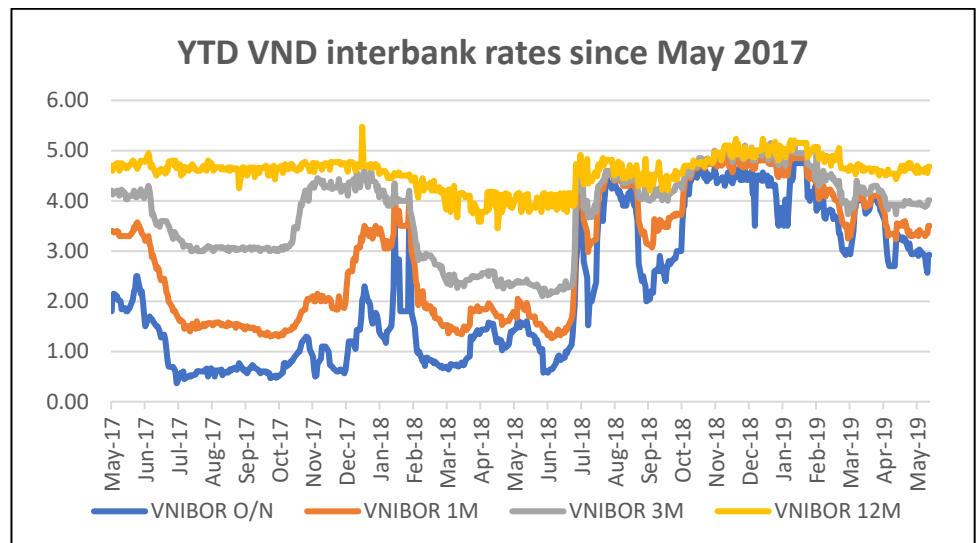
VND-USD Interest rate gap also fails to present a strong reason to shift out of VND, especially if we are right that US dollar yields are heading south later this year. The chart below indicates the trend in VND interbank rates since 2009, and illustrates the period of relative macroeconomic stabilization that started in around 2012-2014 and followed the credit-fueled property bubble of the 2010s.



Source: Bloomberg

Rates and spreads over USD appear reasonably high and stable, especially given our view on a likely Fed loosening in 2H.

The chart below presents the data for the past two years as a reminder of what can happen when rates plummet, as they did in the mid-2017 to mid-2018 period. This period coincided with surging FX inflows and, more importantly for our purposes, a stock market boom. We aren't calling for a repeat of this in 2H19, but we do believe that looser global central bank policy could result in an overall recovery in the second half of this year.

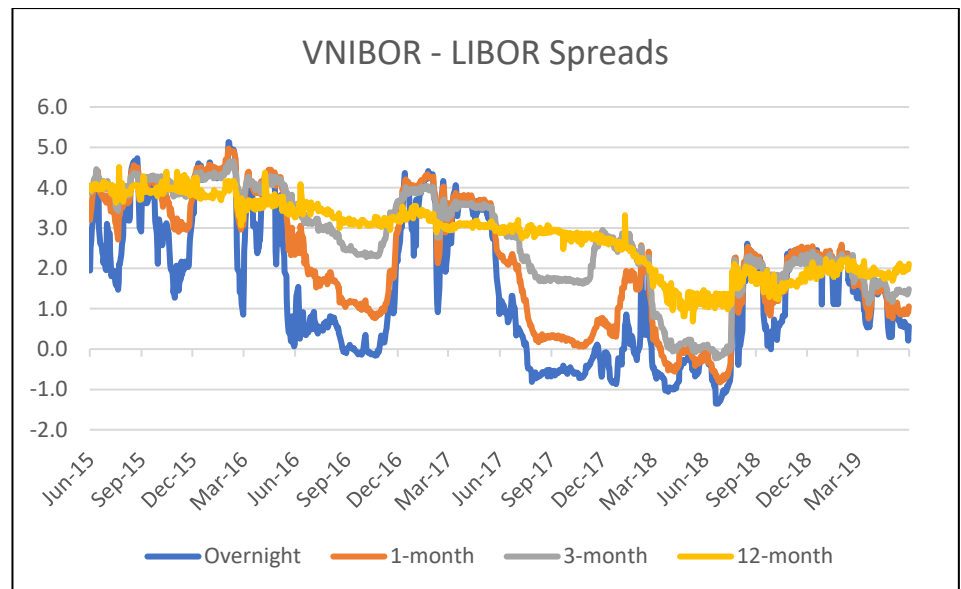


Source: Bloomberg

The gap between short-term interbank rates of the VND and USD is likewise at levels that we think do not suggest imminent devaluation. Current VNIBOR spreads over LIBOR are around 60bps for overnight loans, 100bps for 1-month, 150bps for 3-month, and 210bps for 1-year.

If short term rates were approaching zero or moving into negative territory, we might be more concerned about the currency. Our view on this would of course

depend on the apparent factors driving such a trend (i.e., an inflow of FX driving another reflation of the 2017-18 stock market bubble would be welcome, at least for a little while). In any case, we don't see any obvious signs of a plunge in spreads at the moment. Again, this should be seen as supportive of the VND.



Source: Bloomberg

Yuanta Vietnam Coverage Universe									
Sector	Company	Stock code	Market cap (USDm)	3-month ADT (USDm)	Yuanta Rating	Current price (VND)	Target price (VND)	Up (down) side	12-m TSR*
Banks	BIDV	BID VN	4,586	2.0	BUY	31,400	38,713	23%	26%
	Sacombank	STB VN	898	1.6	BUY	11,650	14,049	21%	21%
	Vietcombank	VCB VN	10,442	2.4	BUY	65,900	75,270	14%	16%
Brokers	HCM City Securities	HCM VN	304	0.6	BUY	23,300	31,308	34%	38%
	Saigon Securities	SSI VN	541	1.5	HOLD	24,850	26,125	5%	9%
	Viet Capital Securities	VCI VN	215	0.2	BUY	30,850	43,850	42%	46%
	VNDirect Securities	VND VN	140	0.5	BUY	15,700	21,029	34%	38%
Consumer	Masan Group	MSN VN	4,224	1.7	BUY	85,000	93,035	9%	11%
	Phu Nhuan Jewelry	PNJ VN	732	1.5	BUY	77,000	118,489	54%	56%
	Digiworld	DGW VN	39	0.3	BUY	21,600	31,574	46%	52%
Oil & GAS	PV Drilling	PVD VN	298	3.1	BUY	18,200	24,535	35%	38%
Property	Nam Long	NLG VN	293	0.9	BUY	28,650	32,000	12%	13%
	Vinhomes	VHM VN	13,123	2.4	HOLD	80,600	91,277	13%	13%

*Note: TSR = Total shareholder return over the next 12 months inclusive of expected share price change and dividends
Pricing data as of close on June 6, 2019.

Source: Bloomberg, Yuanta Vietnam

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HOLD	Between -10% to +10%
SELL	Below -10%

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HOLD-Underperform: In our view, the stock's fundamentals are relatively less attractive than peers at the current price. Our thesis is based on our analysis of the company's outlook, financial performance, catalysts, valuation and risk profile.

SELL: We have a negative outlook on the stock based on our expected absolute or relative return over the investment period. Our thesis is based on our analysis of the company's outlook, financial performance, catalysts, valuation and risk profile. We recommend investors reduce their position.

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