VIET CAPITAL SECURITIES

Vietnamese banks – Q3 2018 wrap-up

Sector report

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Vietnamese banks deliver growth on par with 2017

Strong momentum in both net interest income (NII) and non-interest income (NOII) in 9M 2018 offers investors an attractive entry point to take a more positive view of Vietnamese banks, especially in light of 21 months of strong earnings in the sector. NII across our coverage universe[1] during 9M 2018 grew at 19.7% YoY and comes on top of strong CY2017 growth of 23.2%. NII constituted 75% of total operating income (TOI) in 2017. Meanwhile, NOII across our coverage universe delivered 9M 2018 growth of 44.3% YoY, on top of CY2017 growth of 57.3%. This research piece sets out our short-term views on the banking sector, and our view is the sector remains attractive.

9M 2018 NII growth for coverage stocks expanded from 19.7% to 29.2% if BID and CTG are excluded. Of the banks that we can calculate credit growth for in 9M 2018, we saw a weighted YTD figure of 11.7% (vs 13.7% for same time last year), accompanied by a full coverage universe NIM of 3.02% for 9M 2018 from 2.93% for 9M 2017. The most rapid 9M 2018 NIM increases were seen in STB (60 bps), MBB (36 bps) and VCB (31 bps).

Retail lending growth in 9M 2018 remains strong but is skewed toward traditional secured banks. Patterns in retail banking mirror what our consumer team sees in its coverage stocks, that middle-affluent consumers are doing relatively well whereas lower-income consumers are no longer a growth engine, though we think this situation for the latter group is less severe for banks than for consumer stocks. VCB saw 9M 2018 retail lending growth of 28%, growing off a sizeable USD23bn loan book at the start of 2018 (absolute growth is VND49tn/USD2.1bn vs VND63tn/USD2.8bn for all of 2017). Meanwhile, loan growth for the same period at FE Credit and HD Saison came in at 4.2% and 6.6%, respectively.

Profit taking on the fixed income portfolio peaked in Q1 2018 but came off in the subsequent two quarters. On the basis of 9M 2018 vs 9M 2017, we have seen 11.4% growth in profit taking from bank fixed income portfolios, but Q3 2018 was down 28.8% vs Q3 2017. Q1 2018 coincidentally was when rates on 10-year Vietnam Government bonds bottomed.

Credit quality metrics for Q3 2018 suggest favorable trends for the banking sector. Our metrics only track banks in our coverage universe predominately focused on secured lending, and this group continues to track favorably in terms of credit quality. Particularly interesting is that the last two quarters have seen relatively low write-offs compared to the preceding six quarters.

Our analysis of specific provision balances indicates only STB, and to lesser extent BID, face provisioning burden ahead of them. Our view is that with the exception of the two aforementioned banks, the other banks in our coverage universe are adequately provisioned and unlikely to see a bottom-line drag from provisioning in the coming quarters. Our analysis establishes threshold provisioning targets and company specific developments will always occur, as exemplified by the spike in provisioning at CTG in Q3 2018.

Lastly, a better look at the recovery of written-off debt trends and fee income must await Q4 2018 results, when audited statements are released.

[1] Coverage universe in this research piece is defined to exclude consumer finance subsidiaries.

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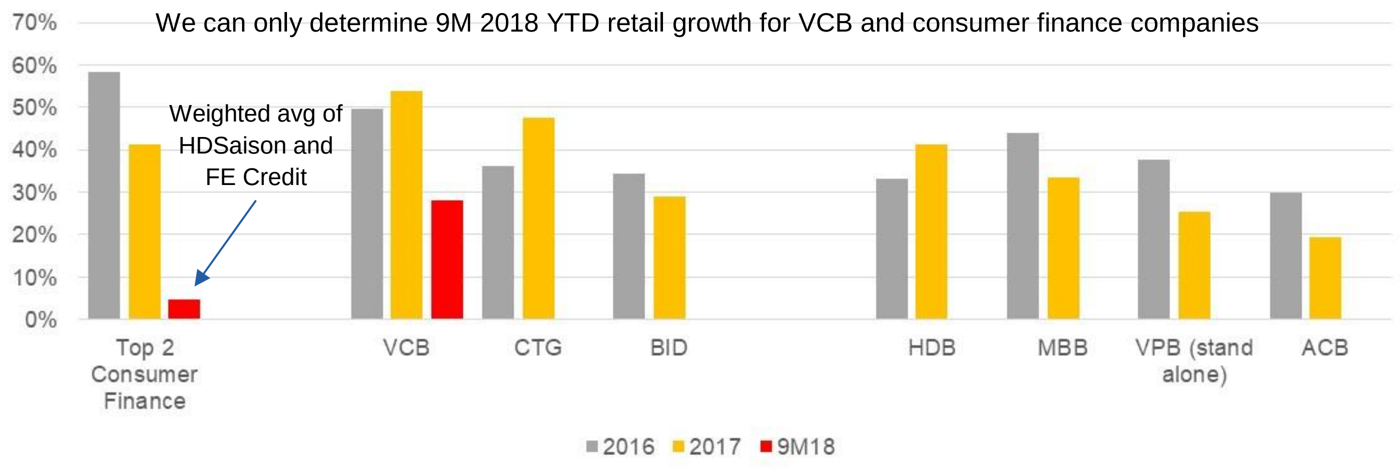
VCB maintains absolute growth momentum in retail lending in 9M 2018

Outside of consumer finance subsidiaries, to calculate retail lending growth at our coverage banks depends on banks separately disclosing this figure. So far, only VCB has done so. The figure from VCB for 9M 2018 was a drop on a relative basis, but on an absolute basis, growth was on par with 2017, with a retail lending expansion of VND49tn (USD2.1bn) vs VND63tn (USD2.8bn) for all of 2017. State-owned commercial banks (SOCBs) outperformed Private Banks in 2017, and it will be interesting to see if this continues in 2018.

Figure 1: Consumer Finance vs SOCBs vs Private Banks (YTD growth in retail loan book)

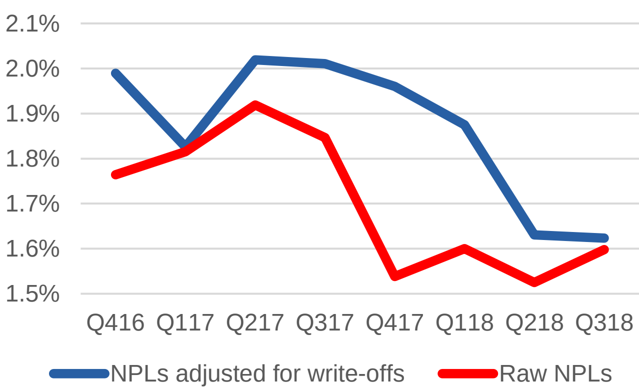


Source: VCSC and company financial statements and disclosures

Credit quality metrics suggest banking sector is experiencing favorable environment

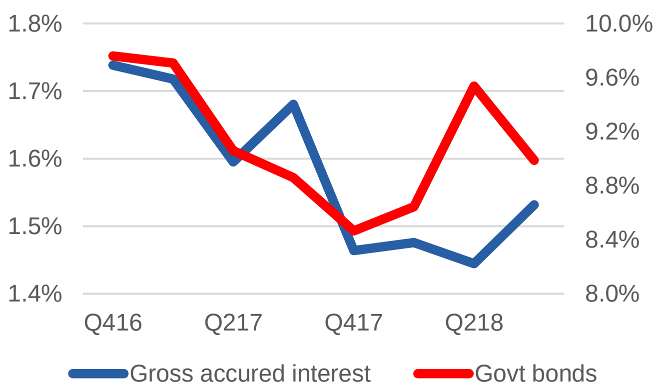
There is no single metric we rely on to track credit quality in our coverage universe, rather, we look at signals from all three metrics of officially declared NPLs, accrued interest and receivables. All three metrics taken together suggest favorable credit quality trends, and a particularly interesting point taken from **Figure 2** is that the last two quarters have witnessed relatively low write-offs across our coverage universe.

Figure 2: Raw NPLs and adjusted NPLs to take into account write-offs (blue line should be the focus)



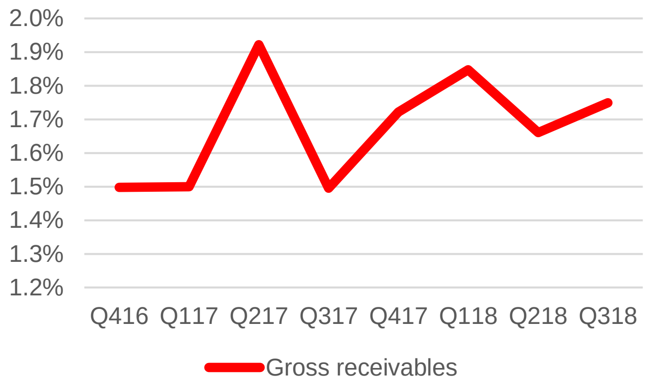
Source: VCSC. Sample includes banks in our coverage universe that do not have consumer finance subsidiaries

Figure 3: Accrued interest and Government bonds as percentage of total assets



Source: VCSC. Sample includes banks in our coverage universe that do not have consumer finance subsidiaries

Figure 4: Gross receivables as percentage of total assets

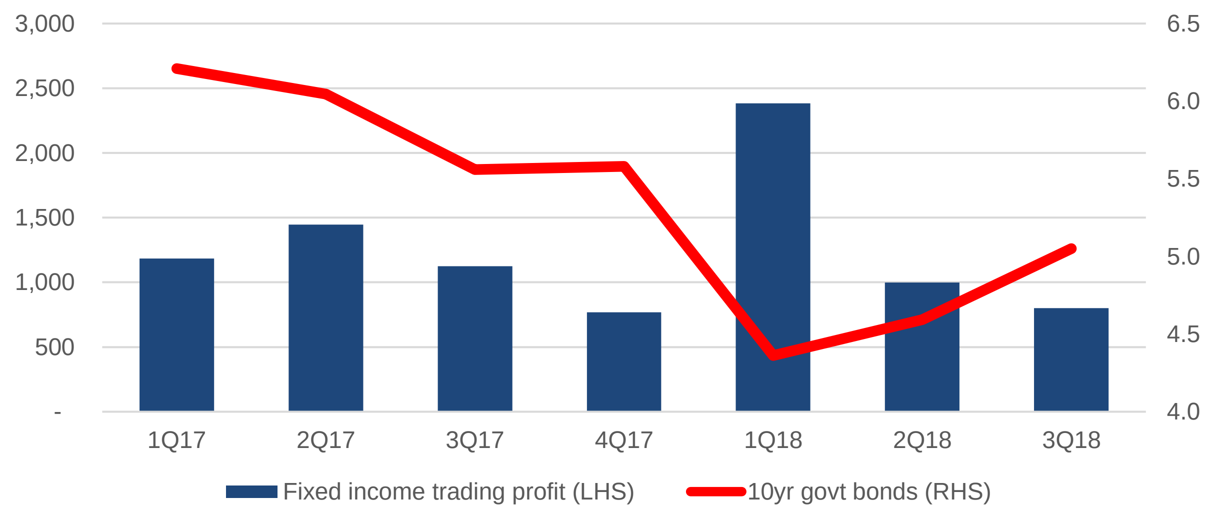


Source: VCSC. Sample includes banks in our coverage universe that do not have consumer finance subsidiaries.

Bank profit-taking on fixed-income portfolios peaked in Q1 2018

The peak in profit-taking coincided with a bottoming of rates on 10-year Government bonds. On the basis of 9M 2018 vs 9M 2017, we saw growth of 11.4%.

Figure 5: Profit-taking on bank fixed-income portfolios in our coverage universe (VND bn)

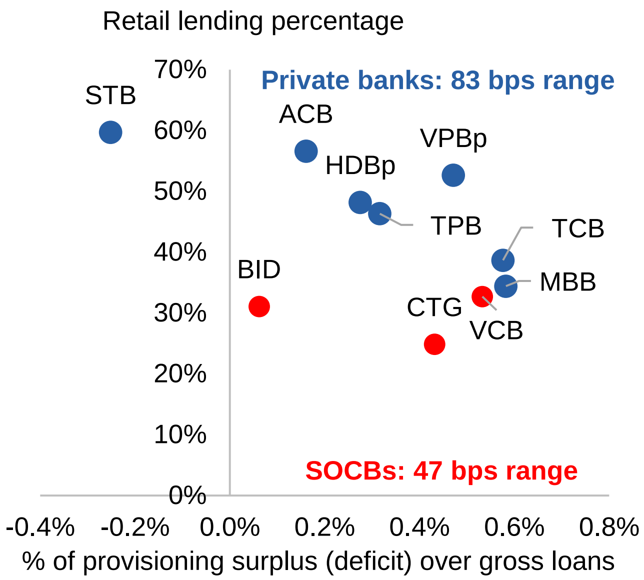


Source: VCSC, Bloomberg and company disclosures

Most banks in our coverage universe adequately provisioned even on 100% provisioning of Group 3 to 5

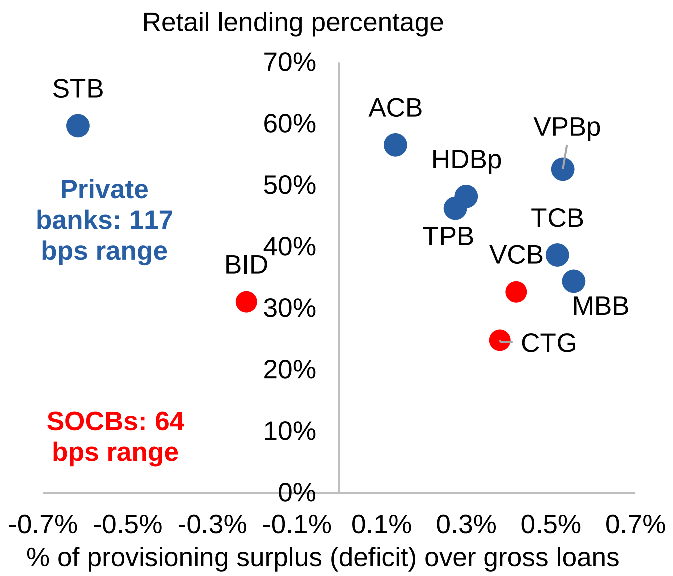
Our provisoining analysis takes into acount collateral types, collateral levels, official NPL levels, external receivables and net VAMC balance to assess the adequacy of existing specific provision balance levels. Our analysis is not perfect as we are using totals from financial statements and cannot incorporate granular details on collateral quality and qualitative adjustments to loan classifications, so what is presented here are yardstick figures. However, even on the most difficult treatment of 100% provisioning for Group 3 to 5 presented in **Figure 7**, most of our coverage banks have excess provisioning levels.

Figure 6: Surplus (deficit) provisioning analysis using SBV provisioning rules*



Source: VCSC. (*) Assuming 100% provisioning for external receivables and net VAMC

Figure 7: Surplus (deficit) provisioning analysis using 100% provisioning approach**



Source: VCSC. (**) Assuming 100% provisioning for external receivables and net VAMC

Views on the adequacy of provisioning levels differ within the investment community, but it's our view that in the absence of marked changes in the macro backdrop in Vietnam or the real estate market then the bottom lines of banks in our coverage universe are unlikely to see provisioning drags for the rest of 2018 and 2019 (with the exception of STB and BID).

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Absolute, long term (fundamental) rating: The recommendation is based on implied total return for the stock defined as (target price – current price)/current price + dividend yield, and is not related to market performance. This structure applies from 27 May 2015.

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BUY	Total stock return including dividends over next 12 months expected to exceed 20%
OUTPERFORM (O-PF)	Total stock return including dividends over next 12 months expected to be positive 10%-20%
MARKET PERFORM (M-PF)	Total stock return including dividends over next 12 months expected to be between negative 10% and positive 10%
UNDERPERFORM (U-PF)	Total stock return including dividends over next 12 months expected to be negative 10%-20%
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