Emerging markets: Vietnam

by Max King

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The first thing you notice on leaving the airport in Vietnam is the extraordinary number of motorcycles. There are hordes of them in every street and on every road, solving the problem of congestion (there are few cars) but making crossing the road a death-defying running of the gauntlet. If there aren't signs saying "don't drink and jaywalk," there should be. Motorcycles are not used just as solo transport, but also to carry families of four, livestock, building materials or enough produce to fill a market stall or a corner shop. In Saigon, there are over seven million among a population of around ten million

Officially, it was renamed Ho Chi Minh City at the time of the "liberation" in 1975, but all the locals call it Saigon. Southerners will tell you that only foreigners and Northern communists call it by the "new" name. There are clear differences between the more populated and prosperous South, and the more conservative North, where political control resides. In the North, pilgrims (admittedly, mostly schoolchildren) queue round the block to visit the ghastly Ho Chi Minh mausoleum and the museum built in the Soviet brutalist style which is dedicated to him. In the South, the Ho Chi Minh hats, a fashion accessory in the North, attract about as much respect as a hoodie at Ascot.

In the North, they refer to the Vietnam war as "the American war" (but there is no lingering resentment); in the South, they are not sure that they weren't on the losing side. In the North, communism had deep roots; in the South, it lasted less than 15 years of famine and hardship before it started to be dismantled in the Gorbachev era. Prosperity and the appointment of a Southern president may have diffused political discontent for now, but corruption and cronyism is rife.

The differences reflect not just the division of the country between 1954 and 1975, but much more ancient rivalries – the country had been divided before. In the North, they don't like the Chinese, Vietnam's traditional enemy, particularly in the border regions which suffered badly from China's invasion in 1978. This was in retaliation for Vietnam's ousting of the murderous Pol Pot regime in neighbouring Cambodia. In the South, they don't much like the North, and in the middle, where Vietnam's royal family used to be based, they don't appear to much like either. The French, who divided the country into Tonkin, Annam and Cochin, probably got it right.

Surprisingly, the French left more of a mark on Hanoi than Saigon, or maybe the North has preserved it better. While Britain's legacy to its colonial outposts was botanical gardens, exclusive clubs and brown Windsor soup, France's was opera houses, town halls and the baguette. The only legacies left by the Americans is the tasteless glass and concrete former presidential palace in Saigon (which replaced a fine colonial era building) and military bric-a-brac sold on street corners, much of which is probably fake.

Far more pervasive than the legacies of the past, however, whether colonial, real communist or of the old South, is the evidence of the current economic boom. This is not just the motorcycles that have replaced the bicycles, once regarded as a luxury item, but the new houses, offices, factories and hotels either completed or under construction.

The numbers support the visible evidence. Economic growth has been consistently above 7% for 5 years, and is expected to remain so. Income per capita in Vietnam is only $600 a year, and this has encouraged an increasing number of foreign enterprises to base operations there rather than in China, where income per capita is now $1700. Companies also believe it makes sense to diversify the geographic spread of their operations and many of them think that Vietnam is a better guardian of intellectual property than China. The easy availability of fake Polo t-shirts and pirated DVDs suggests they are wrong.

Infrastructure is struggling to keep up. Roads are poor, electricity supply subject to black-outs, ports congested and planning permission, it seems, is often a question of knowing and paying the right people. As a cynic might expect from a supposedly socialist government, there is almost no public transport, no welfare state, little higher education and healthcare is basic. The hospital bequeathed in 1973 to the people of Saigon by Madame Thieu, wife of the last President of South Vietnam, is still reserved for party apparatchiks.

The irony is that the international development banks are turning their backs on Vietnam, not through disappointment but because it has been too successful. They would rather invest in more struggling countries. This means that Vietnam's development is dependent on foreign investment, now 14% of GDP, and the local oligarchs. Nowhere do entrepreneurs get rich so quickly as in reforming or former communist countries where the government owns all the assets but has no money and no business skills.

To be fair, the Vietnamese government do seem to have learned a few lessons. The privatisation programme started with small businesses, 3500 of which have been sold. 1500 more sales are scheduled by 2010, including larger companies. The first of these was dairy company Vinamilk, which accounted for 40% of the stock markets capitalisation when floated. Banks, utilities, energy and telecoms are all set to follow. The performance improvement in all areas following privatisation has been marked.

Land is sold in standard 5m by 15m plots to individuals, accounting for the curious tall but thin houses, as well as in larger sites for development. Tourism is growing fast; numbers from Europe, North America and Australia are small compared to Thailand, but there is greater potential from Korea, Japan, Taiwan, Hong Kong and China, for whom Vietnams offers proximity, a warm climate and long beaches.

A report by BCA Research is complimentary about Vietnam's economic record and prospects, both in absolute terms and relative to the ostensibly similar example of Pakistan. They note that growth is broadly based, rather than consumption led; exports are well-diversified, account for over 60% of GDP and are growing at 20% per annum. A modest current account deficit is the result of the import of capital goods to sustain investment. As a result, industrial output has increased to over 40% of GDP. The currency is competitive, and the government is determined to keep it so by being prepared to accumulate foreign currency reserves. Public finances are stable and inflation is under control. Investment and savings are both over 30% of GDP.

Investors might be tempted to think that this is all very interesting, but Vietnam is not a country they need to pay any attention to. Anyway, the market returned nearly 150% last year, outperforming even China, so it must be over-heated. If there are opportunities, surely they will be covered by general emerging market funds.

The counter-argument is that, with a population over 80 million, Vietnam is no minnow as an economy, but general emerging markets funds have tiny exposures. The theory that investors should focus on large, important countries rather than their smaller neighbours, as assumed by the obsession with the BRIC acronym, is deeply flawed. In the developed world, the great success stories have been Ireland, Switzerland and New Zealand, rather than their larger neighbours. Among emerging countries, it has been Chile, Botswana and the Baltic States. There may well be a smaller countries effect to match the smaller companies effect, in which case investors should be more interested in Sri Lanka than India and in Vietnam more than China.

The market may have soared last year, but it is still small (total value $15bn) and has had a 20% correction this year. Growth is strong, valuations are reasonable and the market is extremely young; total market value was only $1 billion three years ago. Last year's performance reflects not so much investor euphoria but the first appearance of Vietnam as a tiny dot on the global radar screen. The recent setback has probably run its course, and this presents a good opportunity to add to holdings or invest for the first time.

Direct investment in Vietnam is neither realistic nor sensible for overseas investors, but there are three specialist listed closed-end funds which we consider attractive, all run by the Saigon-based VinaCapital. Vietnam Offshore Fund invests approximately a third of its portfolio in property (alongside VinaLand), a third in private equity and a third in quoted equity. The shares have retreated from a January peak of $4.65 to a current $3.55. This is a 12% premium to asset value, but the unquoted investments are valued conservatively or held at cost.

VinaLand focuses more on land than on completed properties, buying up strategic blocks with significant development potential. It is intended that investment by the Vietnam Infrastructure Fund in nearby projects (bridges, ports, airports and cables) will add value to these opportunities. This is a much more attractive business plan than only buying buildings, as there is greater potential for adding value and because new construction could make valuations of completed buildings volatile. The projects all look highly promising. The shares trade at a 29% premium to asset value, but asset value is, again, historic.

VinaCapital's new fund is the Vietnam Infrastructure Fund, which is seeking to raise $250m. The broad investment opportunity and the intention to work closely with VinaLand on projects have already been outlined. VinaCapital have a highly interesting pipeline of potential investments on projects which clearly stand up to independent and objective scrutiny, though there is execution risk.

There are two other listed funds; CSFB's recently launched Indochina Capital Vietnam Holdings and Vietnam Holding Limited, launched last summer, but we are not familiar with them. The more cautious investor should consider the Advance Frontier Markets Fund, also seeking to raise money at present – up to $200m. This will be a closed-end listed fund-of-funds, similar to Advance's two existing investment trusts. It will focus not on the well known emerging markets, such as the BRIC countries, or the large, well-know companies there, but on lesser known countries, including Africa, the Middle East and Vietnam.

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