Investment Strategy

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Merrill Lynch

Vietnam — Regional Plays

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Near 100% return raises short term risks

The near doubling of the VNINDEX since early February has resulted in arguably inflated valuations in the listed market. Whilst our long term confidence is under pinned by one of the most dramatic, but underinvested, growth stories in Asia, there are clearly near term risks.

Retail calm needs to be restored

The government is reforming post the Party Congress, setting the stage for more rigorous moves to curb margin-fueled retail investor enthusiasm. The equity market will be vulnerable in the short term. However, the path of broader reform looks intact.

Regional plays span resources, manufacturing and property

Exposure to Vietnam's compelling growth story can, however, also be constructed from a basket of stocks that are listed on other exchanges. These include Yue Yuen, Air Asia, SPC, Amata, Pogo, Olam, Juki, OCBC, Daehan Pharmaceutical, Ascott, Chalco and F&N.

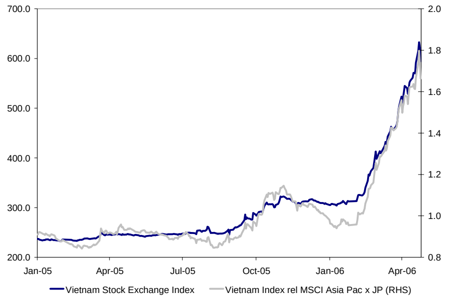
Post Plaza Accord flash backs

The Vietnam of today shares many similarities with Thailand post the Plaza Accord in 1985. We believe it will undergo many of the same structural changes, driven by ballooning FDI, WTO entry and capital market development.

Some key predictions for Vietnam

We believe : the VNINDEX will (in time) surpass 1,000 points; you will be investing here within two years; dramatic expansion of the listed equity market will be fueled by OTC-transfers as well as privatizations; tourist arrivals will out number other key Asian destinations as the low cost carriers gain access.

A little too much, a little too fast



Source: Bloomberg

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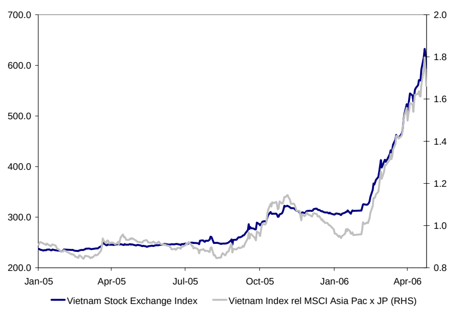
Vietnam – Predictions and regional plays

The VNINDEX has recently set all time highs. The sheer rate of ascent (+100% in less than three months) will invite further government measures to cool domestic retail investor activity. Despite the likely capital market volatility ahead the growth story remains highly compelling, hence our continued enthusiasm and long term buy recommendation.

For overseas investors exposure to Vietnam's growth trajectory can also be derived from a basket of stocks that are listed on other exchanges, and these include Vedan, Amata, Ellipsiz, Yue Yuen, Cheong An Biotech, Air Asia and F&N. These probably represent a much less volatile, and more diversified, way to build exposure whilst we await the process of more profound capital market development. The first overseas listing (Vietcombank) is still in discussion, but will likely be three-to-six months away.

Profound changes are afoot

The VNINDEX has seen parabolic moves – but short term these gains are vulnerable



Source: Bloomberg, MSCI

Vietnam is poised for a dramatic and compelling period of change over the next decade, as we outlined in our in-depth Vietnam report in *Asian Insights*, dated 2nd February, 2006. This path will, of course, come with significant challenges and the trajectory of this progress, whether economic or capital market-related, will encounter volatility along this journey. One such period of volatility appears to be unfolding now.

The Party Congress has just been concluded and over the next few days we will have confirmations of the key government appointments, including the President and Prime Minister. The early indications are that the new cabinet will be biased towards pursuing the path of reforms that have already begun. Of these the privatization schedule is, of course, one of the most market significant issues that investors are focused upon, with the other being WTO-entry (likely in November, 2006).

Market volatility ahead

Since we published *Asian Insights* in early February Vietnam equities have doubled, hitting all-time highs, on a wave of retail investor buying. Market volumes have risen almost twenty-fold, to USD9m with some recent spikes to USD15m, putting Vietnam within reach of the volumes seen in the Philippines.

Average PE's are now in excess of 20x – that is more expensive than Japan, US or indeed, India

This is, perhaps, less of a concern than the PE's that many of these stocks are now trading on. A large number of the HCMC-listed stocks are at developed Asian market multiples of close to 21x, and in the OTC market the banks are trading at 6x-7x book value. Against this backdrop OCBC's 10% stake in VP Bank was relatively attractively priced at 4.2x PB. Nevertheless, in the context of the broader region these valuations are far short of compelling – whatever the growth rates.

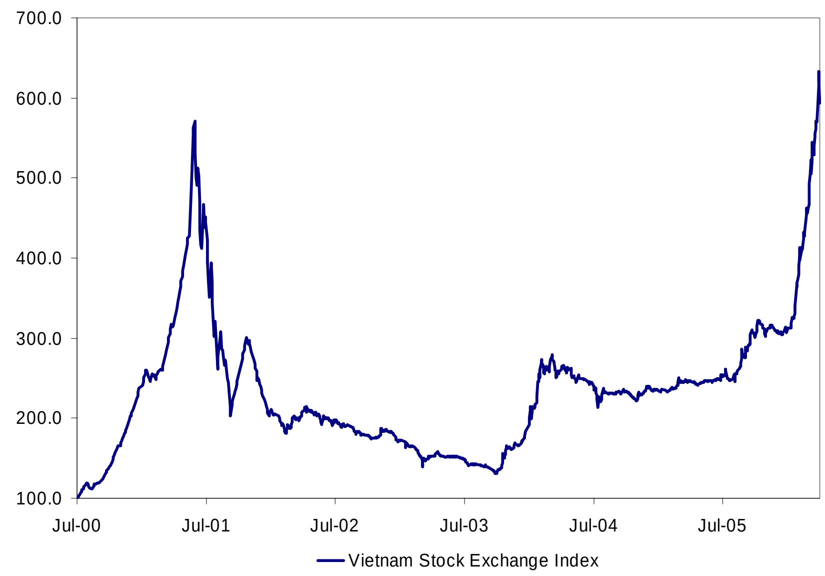
Margin Fueled speculation will come under fire

The heady rate of appreciation in the VNINDEX has already induced the government to begin issuing health-warnings, but the intensity of these has been relatively muted due to the political changes taking place. However, the value of margin lending is now estimated to have (perhaps) reached USD150m. A move to curb this speculation is very likely we believe, and this will probably induce much greater short term volatility as retail investors account for close to 95% of market turnover.

The estimated USD150m-worth of outstanding retail margin positions could come under profound pressure either through a market correction or through government intervention, or indeed both

This is not without precedent. In it's relatively short market history the VNINDEX has already undergone significant volatility. Within twelve months of its inaugural trading session (July, 2000) the market had risen five fold to peak at 572 as domestic investors participated in an unrestrained feeding frenzy in this new asset class. The government signaled its intention to restrict individual trading activity in June, 2001, precipitating a steep decline in the equity market that lasted almost two-and-a-half years.

New all-time highs for the VNINDEX – but remember 2001 ?



Source: Bloomberg

The equity market certainly has more depth and breadth now but the combination of margin financing and heady valuations leave it just as vulnerable to a correction. From our perspective there is greater value to be found in the upcoming privatization issues.

Investing Beyond The Borders

Despite the recent gains in the equity market, and the bond issuance that is being planned, the capital market opportunities within Vietnam are still relatively limited – especially for overseas investors. As we originally argued in *Asian Insights (Febraury, 2006)*, the privatization program will decisively, and dramatically, alter the status quo over the next couple of years.

However, in the meantime, there are significant offshore avenues for gaining equity exposure to the growth in Vietnam. From our perspective these represent a lower volatility route to gaining exposure to Vietnam's growth story, and are obviously much easier to transact for the majority of potential investors that have not established domestic I.D.'s.

To simplify this process we have compiled a basket of stocks from across the world that enable investors to express a view on Vietnam. For inclusion the company must meet one of two criteria :

- Significant production facilities have already been established in Vietnam, or future capacity expansion will account for a significant proportion of incremental additions
- At least 20% of incremental *growth* in revenues or earnings are reasonably expected to come from Vietnam over the next five years

A Vietnam basket from around the world

From our perspective the following 22 stocks represent a diverse play on the growth trajectory of Vietnam. To maintain liquidity, however, we have imposed a cut off of USD1m for average daily trading volume.

Many have extensive production bases already in place, others are focusing their future expansion there. Sources of revenue include property, beverages, refined oil products and tourism. The rich natural resource base of Vietnam also offers opportunities for a number of global players that have signed contracts ranging from oil and gas exploration to gold mining.

Vietnam growth basket – from around the world

Sectors	Country	Ticker	Name	Price	Mkt Cap (US$mn)	Turnover (US$mn)	Comments
Materials	Hong Kong	2600 HK	Chalco	7.4	3,149	29.5	In feasibility stage, but capex expected to be US$2bn in total, spread over several years, to include Bauxite and Alumina, with potential to expand to Aluminium & power, After the phase I and phase II complete, it will account for about a third of Chalco's total Alumina capacity.
Consumer Discretionary	Hong Kong	162 HK	China Golden Dev.	0.5	26	1.2	Provides cruise and cruise-related business from China to Vietnam
Consumer Discretionary	Hong Kong	494 HK	Li & Fung	19.0	7,182	19.8	Now accounts for 7% of apparel sourcing, the second largest apparel sourcing base. The growth would be exponential.
Consumer Discretionary	Hong Kong	321 HK	Texwinca	5.6	958	1.1	Acquisition of Megawall Industrial in 1997 gave Texwinca garment manufacturing facilities in Vietnam to compliment upstream facilities in PRC.
Consumer Discretionary	Hong Kong	551 HK	Yue Yuen	24.4	5,098	5.4	This sports shoe manufacturers maintains more than 700,000 sq m plant capacity close to HCMC and Vietnam continues to be most important base outside of the PRC.
Energy	India	ONGC IN	ONGC	1,386.5	43,885	10.3	Currently only accounts for 2% of the revenues. The company is awaiting the results of oil exploration.
Consumer Discretionary	Japan	6440 JP	Juki Corp	744.0	838	4.9	JUKI Corp manufactures and sells sewing machines for industry and household use. The Company also produces industrial machinery such as chip mounters and printing machines and electronic equipment including printers. Vietnam is the main offshore production base after China.
Health Care	Korea	015170 KS	Choong Ang Biotech	6,410.0	68	5.7	Manufactures veterinary medicines and feed additives, such as antibiotics, sulfa-drugs, live yeast culture, insecticides and multi-vitamins. Vietnam is a major export destination, together with other parts of ASEAN.
Health Care	Korea	054670 KS	Daehan New Pharm	4,955.0	45	15.7	Manufactures pharmaceutical drugs, such as vaccines, diagnostic kits, and antibiotics, which are exported to VN as well as Japan, Malaysia and Brazil.
Telecom	Korea	017670 KS	SK Tel	222,500.0	19,340	48.0	SKT owned 27.5% of S-Fone, which is also 50% owned by Saigon Postal. SKT is ramping up spending on its Vietnamese biz, as S-fone's expanding network coverage to all of Vietnam (from just 3 cities). So this year, SKT will put add'l $100mn, and next year, another $180mn, for nationwide coverage (CDMA).
Industrials	Malaysia	AIRA MK	Air Asia	1.8	1,147	4.0	Vietnam currently only accounts for 2% for the group earnings and 5% for the associate. However, VN is a focus country for the group and it will sharply expand services in the next 3-5 yrs as new routes are added to destinations such as Danang and HCMC.
Consumer Staples	Philippines	URC PM	Universal Robina	22.0	942	0.6	Recently raised US$84mn which at least US$20mn is earmarked for Vietnam. The capex would be for a PET bottling plant and a snack food line.
Real Estate	Singapore	SCOT SP	Ascott	1.1	1,119	1.4	Ascott Group manages two properties in Vietnam (Somerset HoChiMinh and

Vietnam growth basket – from around the world

Sectors	Country	Ticker	Name	Price	Mkt Cap (US$mn)	Turnover (US$mn)	Comments
Information Technology	Singapore	ELL SP	Ellipsiz	0.6	98	1.6	Somerset Grand Hanoi) which are owned by the new Ascott Residential Trust. These two properties represent 15% of the current investment portfolio. % of revenues will be 50 - 60% by next year, they just bought the other 50% of SV Probe Card. Vietnam will be the key mfg market for their Probe Card business.
Consumer Staples	Singapore	FNN SP	Fraser & Neave	22.0	3,242	3.3	F&N has considerable exposure to Vietnam including property development (Saigon Residences), Asia Pacific Breweries (APB) for which 50% of EBIT comes from IndoChina (mostly Vietnam) and APB accounts for 35% of group profits. There is also a small dairy operation.
Real Estate	Singapore	KPLD SP	Keppel Land	4.8	2,154	10.1	Vietnam will represent as much as 10% of group earnings over the next two years. The company has three projects in or around HCMC - Tamarind Park, Villa Riviera and the Saigon Sports Centre residential project. These are the company's first projects in Vietnam, once the company has established its footing it is likely that many other projects will follow.
Banks	Singapore	OCBC SP	OCBC	6.8	13,276	21.0	OCBC has recently taken a 10% stake in VP Bank for a modest price of USD100mn. Although this is currently less than 1% of earnings and assets management have indicated its intention to at least double the size of the stake and we envisage considerable growth in the sector in VN over the next five years.
Consumer Staples	Singapore	OLAM SP	Olam	1.7	1,625	4.9	This soft commodities supply chain company has carved out a significant market share in the Vietnamese coffee trade. The product portfolio has expanded to now include exports of rice, spices and cashew kernels and imports of raw cashew nuts and cotton, accompanied with onshore processing facilities.
Energy	Singapore	SPC SP	Singapore Petroleum	5.7	1,848	7.1	Exports refined products such as asphalt to VN. Is also undertaking exploration for oil & gas. For FY06 estimated to account for 5% of total capex budget (US$250mn) but there is significant room for this to grow as drilling activity picks up.
Real Estate	Thailand	AMATA TB	Amata	21.0	595	2.0	About 11% of revenue in 2005 was from Vietnam which is a fast growing business for the group.
Energy	US	PPP US	Pogo Producing	50.8	2,944	43.5	Just signed production sharing contract with PetroVietnam for Block 124 in the Phu Khahn Basin.

Source: Thomson Financial DataStream, IBES

Cumulative FDI by Country i

	FDI in 2005 (US$mn)
Luxembourg	8,401
South Korea	1,371
Taiwan	1,264
Hong Kong	1,156.
Japan	848
Malaysia	455

Source: CEIC

Production facilities and investment

Amongst the largest sources of FDI are Japan, Korea, Taiwan and Hong Kong. The routing of capital via Luxembourg disguises the origin of large flows from around Asia (including Singapore) but also the U.S. Companies such as Yue Yuen and Juki already have significant production bases established in Vietnam. For the likes of Chalco Vietnam is an important focus of their investment plans going forward. Vietnam's large agricultural sector has also provided Olam with the opportunity to build a dominant market share in the export of products such as coffee, rice and spices. The mobile telephony market is one of the fastest growing in Asia and for SKT the investments in S-Fone will account for more than 10% of its total capex by 2007. The contribution to earnings is expected to rise as countrywide coverage is expanded.

Revenue sources

Amata has a range of both commercial and residential property developments that have already been developed, more are in the pipeline. Ascott Residential Trust, in Singapore, owns two properties, the Somerset HCMC and Somerset Hanoi, which together already account for 15% of its portfolio. Fraser and Neave offers exposure both through its brewery division as well as the property development side.

Tourism is not only a major source of growth for the economy (it accounts for 9% of GDP, which is 50% higher than Thailand) but the 3,500 kms of coastline offers many opportunities for this to be expanded still further. For Air Asia (Malaysia) the route have already been established from Bangkok to Hanoi. Other key destinations will include HCMC and Danang, whilst the proposed airport at Mui Ne will (eventually) dramatically improve access to one of the most attractive areas in southern Vietnam. A new operating subsidiary, Air Asia Vietnam, is also under discussion.

In the pharmaceuticals sector, both Choong An Biotech and Daehan New Pharmaceutical are experiencing significant growth in their exports to Vietnam.

Resource rich, capacity constrained

In common with Brazil, Vietnam has considerable natural resources and the rights to many of the mines and deposits are licensed to overseas entities. The contractual problems that have plagued the likes of Indonesia since the late 1990's have not been encountered in Vietnam so capital commitments have remained high.

On the energy front, there is significant exploration activity in Vietnam for the likes of ONGC. The most recent production sharing contract to be signed by PetroVietnam was with Pogo Producing (PPP US) and Keeper Resources (KEE CN). This granted these foreign exploration companies the rights to 1.5m acres of the Phu Khanh Basin. We suspect that the greatest challenges may well be the supply of rigs to develop these fields. Globally the shortages remain acute as was recently evidenced by the delay to the USD2.6bn Cepu project in Indonesia as Pertamina and Exxon Mobil still cannot secure the four rigs they need for this development.

Vietnam remains a net exporter of crude, but lacks any onshore refining capacity. Singapore Petroleum is a major exporter of products ranging from lubricants to asphalt to Vietnam, and is also undertaking exploration activities for oil and gas.

Smaller Cap Opportunities

There are a number of smaller cap companies that did not make the liquidity requirements of our screening basket. For investors that are not similarly constrained we have listed these in the table below :

Small Cap Vietnam Plays

Sectors	Country	Name	Price	Mkt Cap (US$mn)	Turnover (US$mn)	1mth (%)	3mth (%)
Materials	Australia	Nuplex Industries	5.1	304	0.024	-5.2	12.5
Industrials	Australia	Vietnam Industrial	0.1	5	0.007	-18.8	-28.6
Materials	Canada	Asian Mineral Resources	0.5	19	0.006	11.1	29.9
Materials	Canada	Olympic Pacific Minerals	0.7	95	0.189	12.1	27.5
Materials	Canada	Tiberon Minerals	2.7	178	0.500	2.3	4.3
Consumer Discretionary	Hong Kong	Top Form	1.9	265	0.500	7.3	-0.5
Consumer Staples	Hong Kong	Vedan Internation	0.9	181	0.065	2.2	-5.2
Materials	Japan	Eidai Kako	560.0	36	0.063	-6.7	-19.8
Industrials	Japan	Taisei Oncho	566.0	71	0.150	0.9	-15.5
Consumer Staples	Japan	Unicafe	1,722.0	104	0.098	-0.3	-0.4
Consumer Discretionary	Korea	Hansae	21,150.0	90	0.582	-16.0	42.4
Materials	Saudi Arabia	Zamil Industries	119.8	1,118	0.088	24.0	-36.4
Consumer Staples	Singapore	Koda	0.5	38	0.082	26.7	60.3
Industrials	Singapore	New Toyo	0.4	75	0.042	2.4	-13.9
Consumer Discretionary	Thailand	Hua Thai Manufacturing	105.0	28	0.003	-2.8	0.0
Consumer Discretionary	Thailand	Minor International	10.9	832	0.535	36.3	66.4
Materials	Thailand	Padaeng Industry	36.0	217	0.994	41.2	75.6
Industrials	Thailand	Tipco Asphalt	18.1	69	0.035	0.0	-2.7
Materials	UK	Triple Plate Junction	20.0	34	0.182	2.6	-18.4

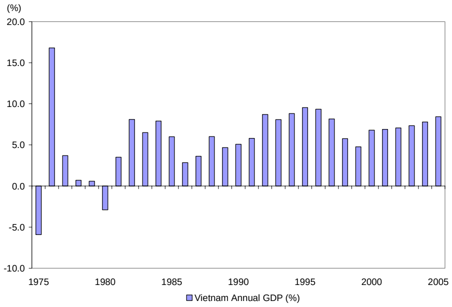
Source: Thomson Financial DataStream

We acknowledge the tremendous help that our friends at Aegis, in Singapore, have given us in assembling these baskets of stocks.

Capital Market Developments

The privatization schedule is generating the most anticipation within the capital markets we sense this may be missing the implications of key regulatory changes that are also taking place. Watch for some major contributions to market size and liquidity from the OTC market in 2007. Offshore dual-listings are another avenue which will probably be evolving over the course of this year.

Vietnam Annual GDP Growth YoY (%)



Source: CEIC

Privatization Activity Could Be A Re-Run Of Pakistan

The privatization process has been underway since the Enterprise Act of 2000. So far more than 2,000 SoE's have been privatized, and many of these now trade on the OTC (pre-listed) market. Of the limited number that have so far made it across to the Main Board (33 in total), the largest is Vinamilk, which listed in January, 2006. In the last three months the share price has risen by more than 100% to now have a market capitalization of close to USD1bn.

However, this is only the beginning of the larger cap listings. Over the course of the next two years there is likely to be a dramatic increase in the average size of new listings, led by Sacom Bank and then Vietcombank. The latter of these is the largest of the State banks and is due to list this year with a dual listing planned, either in Singapore or Hong Kong. This would represent a very important step, from our perspective. Not only will it give investors a major offshore route for gaining exposure to the growth in Vietnam but, perhaps more significantly, it would act as an important driver to improved standards of financial disclosure for the market as a whole. Given the current wave of interest in this nascent equity market, the issue would probably be very well bid.

Overseas, dual-listings will be an important avenue for investor exposure – Vietcombank will be the first

Listings will follow a familiar pattern of breadth and depth

From here will follow the usual emerging market pattern of more (banks and insurance), telecoms and energy. The table below shows the leading SoE's nominated by the Vietnam Association of Financial Investors for listing. According to their estimates these companies would, collectively, take market capitalization closer to USD15bn. At this point we have to believe that Vietnam would have a strong case for inclusion in regional indices such as those run by MSCI.

Much rests on how quickly the process of larger-scale privatizations can be undertaken. The government has already approved Vietcombank, Bao Viet Securities, MobiFone and VinaPhone but timetables for the eventual listing remain extremely opaque. Once the new government settles into position we trust that the relevant Ministers appreciate that the current levels of investor interest can only be sustained if equity supply expands sufficiently quickly to satisfy this demand. In a world of competing demands for capital, the margin for delay is extremely thin.

VAFI's proposed list of leading firms to be equitised through listings on the securities market

Order	Names of enterprises	Agencies in charge
1	Vietnam Bank for Foreign Trade (Vietcombank)	State Bank of Vietnam
2	Bank for Investment and Development of Vietnam (BIDV)	State Bank of Vietnam
3	Vinaphone company	Ministry of Post and Telematics
4	Mobifone company	Ministry of Post and Telematics
5	Bao Viet Insurance Company	Ministry of Finance

VAFI's proposed list of leading firms to be equitised through listings on the securities market

Order	Names of enterprises	Agencies in charge
6	Hanoi Beverage, Beer and Alcohol Corporation (Habeco)	Ministry of Industry
7	Saigon Beverage, Beer and Alcohol Corporation (Sabeco)	Ministry of Industry
8	Viet Tien Garment Corporation	Ministry of Industry
9	Vietnam Shipping Company	Ministry of Transport
10	Phu My Nitrogenous Fertiliser Plant	Ministry of Industry
11	Dau Tieng Rubber Company	Ministry of Agriculture and Rural Dev

Source: VAIF – Vietnam Association of Financial Investors

From OTC To The Main Board

The OTC market currently comprises of close to 2,400 companies that together trade between five and ten times the value seen on the main board (VNINDEX). To date these OTC companies have had little incentive to transition to the main board, thus creating a reasonably opaque, two tier system. The Securities Law due to come into effect on 1st January, 2007, we believe will change this to an extent that is not widely appreciated by many overseas investors.

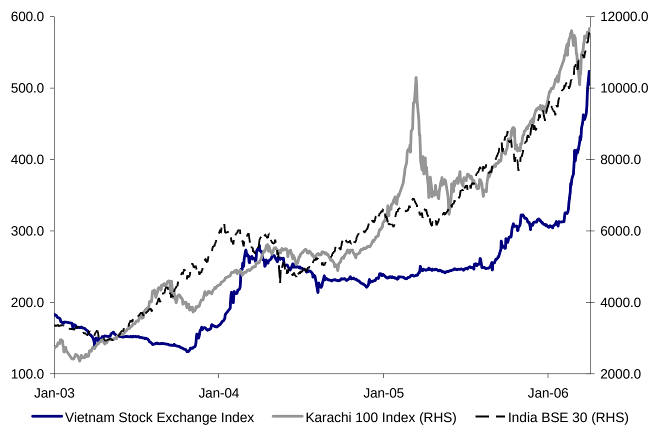
The transition of some of the 2,400 companies from OTC to main board will add significant breadth and depth

This new law simultaneously introduces a carrot to induce companies to shift to the main board whilst yielding a stick that removes the key advantages of remaining OTC-listed :

The carrot - companies listing on the main board will be eligible for two years of tax free earnings from the date that they list. For the two years following this period, earnings will then only be taxed at half of the full, 28%, corporate tax rate. One potential side effect could be a wave of higher-than-expected dividends over this four year, post-listing period.

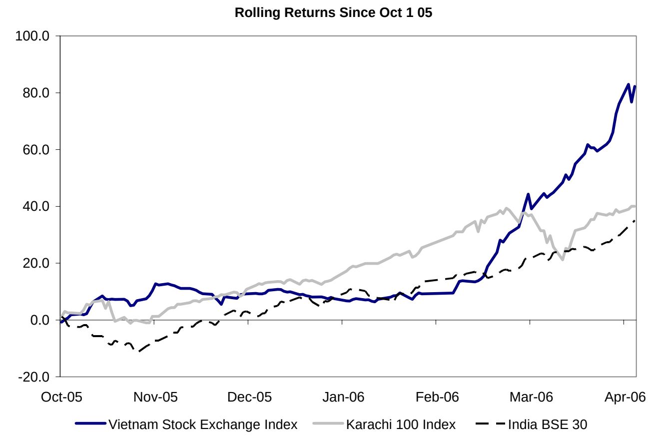
The stick – in the meantime companies that remain OTC listed will become subject to the same rules of disclosure and corporate governance as those currently imposed on the main board. This removes one of the major incentives that currently keep companies in the opaque confines of the OTC market.

Performance of Vietnam, Pakistan and India Index



Source: Thomson Financial DataStream

Rolling Returns of Vietnam, Pakistan and India Index



Source: Thomson Financial DataStream

Echoes of Thailand

Putting aside the likelihood of short term market gyrations, the Vietnam of today has important parallels with Thailand from 1986 through to 1994 that are worth recaping.

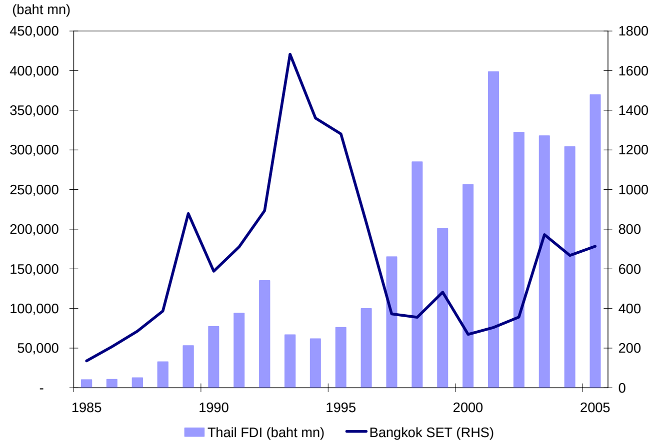
The Plaza Accord in September 1985 set the stage for a dramatic inflow of foreign direct investment from Japan to Thailand, as the stronger Yen forced companies to seek lower cost production elsewhere around the region. Within a couple of years this flow of capital began to spill over into the property market and Thailand experienced an extraordinary construction boom and period of hyper economic growth. Between 1986 and 1994 the SET Index rose almost six-fold. The bursting of the bubble thereafter was a painful one, precipitated by an accumulation of foreign debt and a currency that pegged to an appreciating dollar.

Look at Vietnam, think Thailand (post Plaza Accord) twenty years ago

Vietnam has only begun to see a swelling in foreign direct investment over the last four years but the pace continues to accelerate. Entry into WTO is only one of the factors driving this – VN remains an extremely stable, low cost environment. In this regard it is both a complimentary as well as competitive production proposition to China.

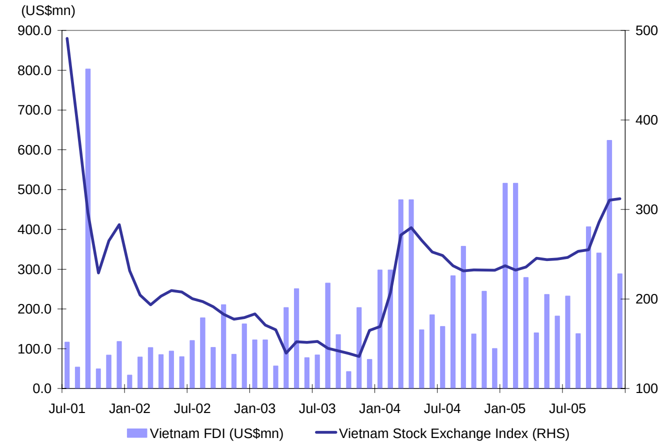
The property market is also going through a period of intense inflation with prices in both Hanoi and HCMC estimated to have risen more than four fold since the Asian Crisis. However, the rate of property development appears to have substantial room for growth before it reaches the levels achieved by Thailand almost twenty years ago.

Thailand FDI & Bangkok SET



Source: CEIC

Venture FDI & Vietnam Index (Through End 2005)



Source: CEIC

More importantly, perhaps, industry is starting with very low levels of debt, primarily due to the under-developed and relatively unsophisticated banking system. Our sense is that loan financing will begin to become significantly more available going forward as foreign banks drive changes through their strategic investments. OCBC has now joined Stan Chart, HSBC and ANZ as the latest of the regional majors to commit capital. We believe that there will be many more announcements of this nature as Vietnam prepares itself for the impact of WTO membership.

Foreign Direct Investment

Over much of the past five years Vietnam has benefited as a complimentary production base for companies investing in China. Broadening sources of capital, rising infrastructure needs and a rich mineral base, combined with stable government policy suggest that FDI will continue to grow very strongly over the next decade.

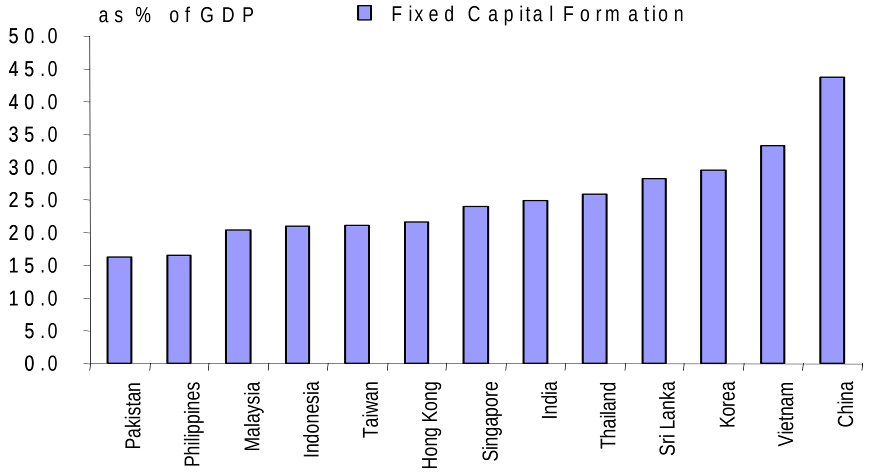
FDI is up 80% YoY and total investment now accounts for 32% of GDP

Cost Advantages Are Improving

Common borders, short shipment times for part finished Chinese goods and cheap labour have all helped to boost FDI by more than 80% YoY such that it is now running at circa USD5bn per annum, or 10% of GDP. Over the past twelve months an estimated two-thirds of this is coming from increased commitments from existing investors that are expanding capacity.

Add to this other elements of fixed capital formation and the total for Vietnam, at 32% of GDP, is the second highest in Asia.

Fixed Capital Formation as % of GDP for Asian Countries



Source: CEIC

However, the competitive position of Vietnam versus China is strengthening as labour costs on the Mainland continue to accelerate for semi-skilled labour. As we note in this month's edition of *Asian Insights* (dated 27 April, 2006) margin compression is becoming more pronounced across many segments of the Chinese economy and this will, we believe, help to fuel the production capex into lower-cost Vietnam.

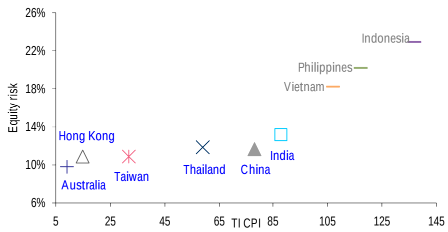
Wage and other inflation in China is boosting the competitive proposition of Vietnam

MNC's that we visited recently observed that for comparable positions that cost circa USD100 per month in southern China, they pay USD60 in Vietnam. Furthermore, the indirect costs are much lower because staff retention is much better. For example, Ellipsez, the probe card manufacturer listed in Singapore, experiences turnover rates as high as 22% in China versus just 3% at its major plant at the Singapore Vietnam Industrial Park outside of HCMC.

And Policy Is Extremely Supportive

Moving beyond pure operating costs for MNC's, the stability of government policy and force of law continues to be another important driver for the enthusiasm of companies to increase their production exposure to Vietnam. In his recent report on CLP, Joseph Jacobelli, our regional utilities analyst, produced two charts that illustrated this point so succinctly that we have decided to simply reproduce them here :

Corruption and risk



Source: Transparency International

TI 2005 Corruption Perceptions Index (selected AsiaPac countries)

Country rank	Country	2005 CPI score[1]	Confidence range[2]	Surveys used[3]
2	New Zealand	9.6	9.5 - 9.7	9
5	Singapore	9.4	9.3 - 9.5	12
9	Australia	8.8	8.4 - 9.1	13
15	Hong Kong	8.3	7.7 - 8.7	12
21	Japan	7.3	6.7 - 7.8	14
32	Taiwan	5.9	5.4 - 6.3	14
39	Malaysia	5.1	4.6 - 5.6	14
40	South Korea	5.0	4.6 - 5.3	12
59	Thailand	3.8	3.5 - 4.1	13
78	China	3.2	2.9 - 3.5	14
88	India	2.9	2.7 - 3.1	14
107	Vietnam	2.6	2.3 - 2.9	10
117	Philippines	2.5	2.3 - 2.8	13
130	Cambodia	2.3	1.9 - 2.5	4
137	Indonesia	2.2	2.1 - 2.5	13
144	Pakistan	2.1	1.7 - 2.6	7
158	Bangladesh	1.7	1.4 - 2.0	7

1. CPI Score relates to perception of the degree of corruption as seen by business people and country analysts and ranges from 10 (highly clean) to 0 (highly corrupt).
2. Confidence range provides a range of possible values of the CPI score. This reflects how a country's score may vary, depending on measurement precision. Nominally, with 5% probability the score is above this range and with another 5% it is below. However, particularly when only few sources (n) are available an unbiased estimate of the mean coverage probability is lower than the nominal value of 90%.
3. Surveys used refer to the number of surveys that assessed a country's performance. 16 surveys and expert assessments were used and at least 3 were required for a country to be included in the CPI.
Source: Transparency International (www.transparency.org)

Ten Predictions For The Path Of Vietnam

The Vietnam of 2016 will be dramatically different from the Vietnam of today. That much is clear. Here are our top ten predictions for Vietnam :

1. **You will be investing in Vietnam within the next two years** – the move into the mainstream of Asian investment is already underway
2. **Equity market capitalization and trading volumes will expand dramatically** – privatizations and transfers from the OTC should make the VNINDEX a USD10bn capitalization index before the end of 2007
3. **The VNINDEX will breach 1,000 points** – but government measures to curb retail speculation will make this a bumpy ride in the short term
4. **The strain on infrastructure will be acute** – USD140bn is slated for spending over the next five years but the demands from accelerating FDI and domestic consumption will likely leave this short
5. **Property market development will boom** – the abundance of commercial, residential and tourism opportunities is likely to attract substantial capital over the next five years
6. **VN will surpass Indonesia and the Philippines combined in terms of tourist arrivals** – budget airlines such as Air Asia and Tiger are already gearing up for this
7. **Consultancy services to companies will mushroom** – for everything from investor relations to M&A advisory, this is a hugely untapped opportunity
8. **Financial services will undergo the most profound changes** – incumbents are already evolving to provide more sophisticated products, new brokerages will appear and foreign competitors will be more prevalent
9. **Home grown talent will gain ground** – the pool of domestic intellectual talent is very deep, competition will be much more aggressive, and successfully, against incumbent foreign entities
10. **Your favourite head hunter will open a representative office in HCMC before 2008** – dramatic growth in the financial services industry will be the catalyst

Current asset allocation

Table 1: Asia Pacific ex-Japan country asset allocation & valuations

Country	ML Weight (%)	Asset Allocation	Recent Changes	2006F EPS Growth (%)	2006F PE (x)	2006F PB (x)	2006F RoE (%)	2006F DY (%)
South Korea	23	OW	=	-1.2	11.1	1.5	14.7	1.5
Taiwan	10	UW	=	16.8	12.8	2.1	16.7	3.8
Hong Kong	4	UW	=	-8.9	14.8	1.9	12.5	3.7
China	7	MW	=	19.4	13.0	2.3	17.8	2.7
Singapore	6.3	OW	+	12.9	15.9	1.9	12.1	3.2
Malaysia	1	UW	=	3.7	14.5	1.8	12.7	4.4
Thailand	6	OW	=	6.0	10.3	3.2	20.3	4.2
Indonesia	4	OW	=	42.3	14.0	3.7	20.3	3.2
Philippines	0.2	UW	-	2.3	11.3	1.5	13.5	1.9
Vietnam	3	OW	=	20.2	21.1	5.2	29.1	1.8
Australasia	28.5	UW	=	15.6	15.2	2.9	18.9	3.6
Pakistan	1	OW	-	13.6	11.4	3.2	28.1	5
India	6	MW	=	21.7	18.8	4.0	23.4	1.4
Total	100							

Source: Merrill Lynch Asia Pacific Equity Strategy Group estimates

- **Singapore** continues to deliver solid, low volatility returns. The hub of Chinese capital re-cycling in Asia, property will continue to rise. Consumption rising, credit growth picking up. Upgraded to OW.
- **Pakistan** has recently benefited from earnings upgrades and strong retail flows. Catalysts ebbing and market discount has narrowed. Reduce OW and await budget.
- **Indonesia** performing exceptionally well. We have downgraded the banks. Switch exposure to focus more fully on resources/energy, infrastructure and consumer.
- **Philippines** down to UW. Lacklustre earnings growth and flagging performance drivers despite macro improvements.
- **Taiwan**. Seasonal headwinds from slowing tech momentum and liquidity drain from forthcoming tax period. Tech downgrades have yet to be reflected in market. UW.
- **Vietnam** is one of the most compelling growth stories in the region. Conspicuous consumption meets FDI and capital market expansion. But expect govt measures to cool the retail speculation**.**
- **Hong Kong** still faces headwinds from currencies and rates. More downside likely in property sector whilst forward earnings growth is most anemic in the region for 2006. UW.

Table 2: Asia Pacific ex-Japan sector asset allocation and valuations

Sector	ML Weight (%)	Asset Allocation	Last Change	2006F EPS Growth (%)	2006F PE (x)	2006F PB (x)	2006F RoE (%)	2006F DY (%)
Banks	22	OW	+	9.9	13.6	2.0	14.4	4.0
Non-Banks	19	OW	=	-1.7	17.1	1.7	11.9	3.2
Materials	12.2	MW	-	25.9	8.6	2.3	28.5	3.7
Industrials	6	UW	=	-12.8	15.7	1.7	11.0	3.0
Consumer Discretionary	7.9	MW	=	1.6	15.1	2.3	14.8	2.1
IT – Semis	7.3	UW	-	39.0	11.4	2.1	18.6	1.5
IT - Non-Semis	5	UW	-	46.4	18.3	3.4	18.7	1.7
Telecom	7	OW	+	3.1	13.4	2.2	16.6	4.0
Consumer Staples & Health Care	6.1	MW	=	17.1	24.7	4.5	17.9	2.5
Utilities	2.5	UW	=	4.5	13.2	1.4	11.1	3.2
Energy	5	MW	=	12.5	11.0	2.6	23.9	3.5
Total	100							

Source: Merrill Lynch Asia Pacific Equity Strategy Group estimates

- The Banks allocation rises to reflect the near-term peak in interest rates and improving outlook for regional investment. Materials finance this after strong relative performance so moved down to MW.
- Telecom OW. Valuations are now at steep discounts to region while will be a defensive hedge against the further monetary tightening in US. IT is cut to UW as we approach cyclical headwinds in 2Q06.

Analyst Certification

We, Spencer White, Willie Chan and Stephen A. Corry, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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Buy	1145	40.29%	Buy	393	34.32%
Neutral	1474	51.86%	Neutral	430	29.17%
Sell	223	7.85%	Sell	44	19.73%

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