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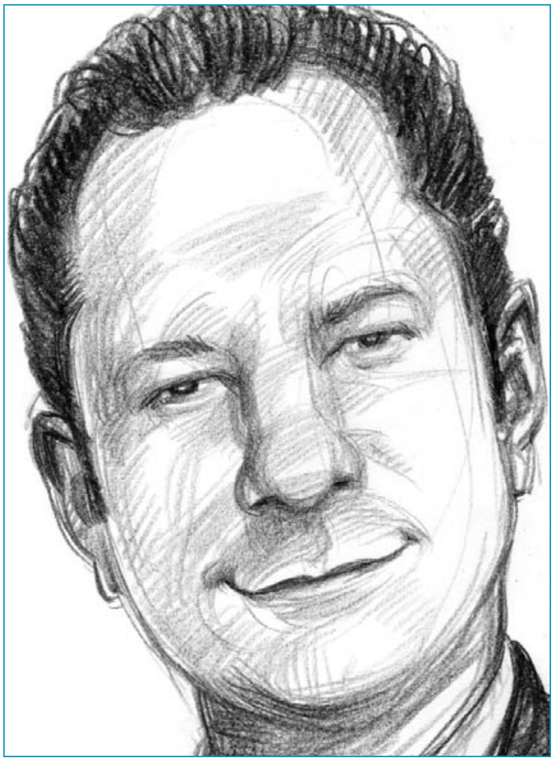
listeningin

Exploring Vietnam

Ex-Pat Fund Manager Nick Singh On Allure Of Nation's Growth +Value



I didn't go to Vietnam in early February to do an interview, or even, really, to join the Lunar New Year celebration, pictured above, in Ho Chi Minh City. I went to accompany my husband on a journey of reckoning, remembrance and rediscovery, 43 years after his sudden medical evacuation during what's now called "The Tet Offensive." What we found is that it's hard to say who has changed most. Suffice it to say that anyone now meeting my spouse, who in the interim has lived what seem like several lifetimes, would be hard put to imagine him as a 25-year old infantry platoon leader. Likewise, a first-time visitor to Vietnam, as I was, can barely reconcile the booming, vibrant, thoroughly electrified and motorized, and almost unfailingly welcoming nation and its people with distant newsreel memories of a primitive, riven, war-torn and utterly hostile society. The interview happened, more or less by chance, and didn't really take place until we returned, shook off the jet lag, and I reached out by phone to **Nikhil Singh***, the young man pictured above, who is principal of* **Indochina Capital Advisors***, the equity management arm of Ho Chi Minh City'-based development company, Indochina Capital.* **Marc Faber***, who sits as Indochina Capital's chairman, had put me in touch with Nick when I told him we were heading for Vietnam, and Nick was*

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Victor Juhasz
Page One Illustration

gracious enough to meet a couple of tourists to share invaluable insights for navigating his adopted home — and spark my considerable curiosity about his day job, guiding investment in such a rapidly evolving, complex and, yes, exotic economic environment. Listen in, as Nick explained it all, in our subsequent chat.
KMW

How did a fellow named Nick, whose folks live in Boca Raton, end up running frontier investments in Vietnam?
As you know, my mother is American and my father is Indian. Being brought into the world from two cultures, I grew up curious about every culture, and we traveled a lot. My father's family lived in England, my grandmother in Scotland and my mother's family comes from Cincinnati. We lived in Bombay, where my father ran **Wyeth India**, when I was a child, and every summer vacation, which would start in April, we'd travel to London, where we had a flat, then to Scotland to see my grandmother in Dumfries, and then to the U.S., where we'd camp out at my uncle's house in Cincinnati for a month. If being brought up in that manner didn't pique my interest in different cultures and the world, nothing would have – but it did.
Then, when it came time for high school, I chose to go to a school in Singapore, part of what is called **United World College**, a program founded by **Lord Mountbatten**. UWC started with one campus in Wales, but had a number of campuses around the world by the time I attended. The UWC of South East Asia was established in Singapore in 1971, and was the nearest to India. The program takes 200 students per campus and they make sure there is no majority nationality. So you'd have two or three Germans, two or three Spaniards, a Mexican, a Guatemalan, three Chinese, an Australian, in your classes. The goal, obviously, is fostering international understanding. And in that setting, unsurprisingly, I got even more curious and became convinced that I wanted to be the next Secretary General of the United Nations. So I went off to Rome, Italy, to an American University, called **John Cabot University**, and studied International Affairs. That was my bachelor's degree. While in Italy, I somehow convinced my parents I should have a travel budget *for cultural reasons*.

"I don't particularly mind that the Vietnamese market has been lagging because it means there are companies to be discovered at very attractive valuations."

But of course! I don't suppose you were terribly specific about what aspects of culture you'd be studying –
Exactly. They thought I'd be going off to the Uffizi Gallery in Florence and researching artwork at the Vatican and all of that. There was *a little bit* of that. But there were *a lot* of boondoggles all around Europe. At that time, the Soviet Union hadn't broken up yet, so I explored Yugoslavia before it opened up and Czechoslovakia while it was still one country, Romania during the time of Ceausescu – all of which was quite fascinating. But when I graduated, I was basically a master of reading the newspaper. I had no technical skills.

I can imagine your parents were thrilled. So what did you do?
That was during the recession of '91. I came back to the States but there wasn't a whole lot to do. So I opened a trading company with friends in various places around the world, and moved goods from the Dominican Republic and India to Japan, the U.S. and Italy; tried to connect people like that. Then I got a job at the World Bank, where I was fascinated by all these different projects and all these different countries. Just for fun, believe it or not, I would go to the library and read *EIU* [*Economist Intelligence Unit*] country reports. I would go, "Tonga, amazing! Brunei, wow! Burkina Faso, look at that!" I had this fascination for countries – especially for ones that are just atolls in the Pacific. How could an atoll be a country? This curiosity drove me to want even more to travel the world to understand cultures, their economic and political systems, etc. But I needed some technical skills, so I enrolled in the MBA program at **NYU's Stern School** to experience New

York and to learn to understand the world financial system, which at that point seemed to me to be just incredibly complicated.

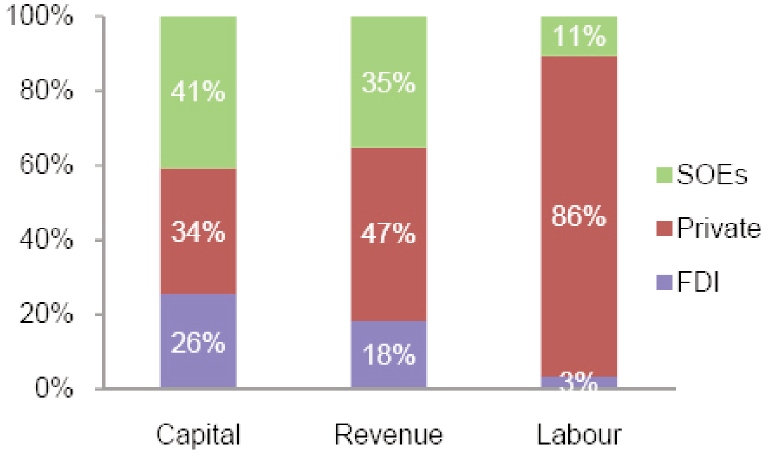
You may have been the only member of your class who didn't go from there *directly* to Wall Street —
Well, I really applied myself when I was there to unraveling those mysteries. But when graduation came around, I still wanted to travel. Happily, one of the offers I got was from **Swiss Re** (SWCEY). For two years they would send me all around the world in their training program, and I'd work in different markets. Then, they would place me in a position that satisfied both their needs and my interests. I joined that program and halfway though, I met the head of their M&A team. At that point, Swiss Re was a very closed organization, very Swiss. They had four underground kind of bunkers, worried about nuclear explosions; it was a very secretive type of organization. I was the first non-Swiss to be asked to join their M&A team. My boss just loved me – I guess primarily because I was *not* Swiss. Where the M&A team worked was close to the CEO's office and one day, the CEO walked in and said, "I understand you are Asian. There's a crisis, I'd like you to go to Thailand and buy the second largest Thai Bank." That's how my career really started. I just got thrown in the deep end at 26 years old. I started doing transactions and things *way* above my head, but had to come up to speed, fast. Soon I found myself in Hong Kong running a $250 million portfolio for them and building up the Asian private equity alternative assets business. There was a lot of restructuring. It was exhilarating, but exhausting, as you can imagine. Based in Hong Kong with investments all around Asia, and with only a small team, you get *really* stretched. So after several years, when the recovery was in motion, I took a time-out. I moved to Thailand and started my own advisory business, which didn't consume that much time and would allow me to pursue the larger questions about life. I went onto to study with many masters – everything from quantum physics to ancient prophecies, just trying to piece it all together: What's going on? Why am I here? What's it all about?

What an incredible luxury, to take a breather like that —
Yes, but eventually, I felt I'd come to a sufficient realization of being-ness– and was a little bit lonely, working on my own off in Thailand. So when a headhunter called in 2008 and asked if I was interested in Vietnam, I came out and had a look. I saw that the fundamentals were fantastic and said I'd love to sign up. Sorry for the long-winded story.

So now you work at something called Indochina Capital?
Yes, since early last year, after a brief stint as CIO of a rival firm.

What exactly is Indochina Capital involved in?
Indochina Capital is a fund management and

Figure 1: Capital, revenue, and employment structure of enterprises by ownership



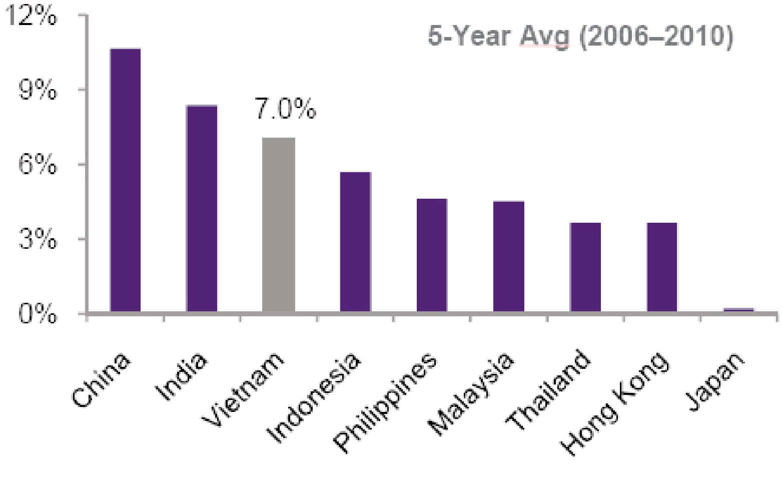
Source: General Statistics Office, 2009

Figure 2: Top investment destination survey ranking

Country	2010	2009	2008
Vietnam	**1**	**1**	**1**
Indonesia	2	6	5
Mexico	3	3	2
Argentina	4	12	8
Saudi Arabia	4	10	10
South Africa	6	4	8
Nigeria	7	2	12
Malaysia	8	5	12
United Arab Emirates	8	2	3
Turkey	8	8	9

Source: Economist Intelligence Unit, September 2010 Survey

Figure 3: GPD growth (% change year-over-year)



Source: HSBC, October 2010

advisory company focused exclusively on Vietnam, founded in 1999. The two principals, **Peter Ryder** and **Rick Mayo-Smith**, are American investment bankers who came out to Vietnam – one 22 years ago and one 20 years ago – and started off doing some advisory work raising financing for hospitals and things like that. Then they launched the first Vietnam real estate GP-LP fund, and began building up their equities business. Our board chairman, as you know because he introduced us, is **Dr. Marc Faber**. These days, Indochina Capital is active in four sectors, real estate, equities, finance/advisory and infrastructure – all at the very top of the market, in Vietnam. You've seen some of our real estate properties first-hand – they're very creative, top-drawer.

Certainly, *The Nam Hai*, on the South China Sea near Hoi An, which we visited all-too-briefly, has to be on anyone's list of world's most exquisite resorts. Other than that, we just caught a glimpse of *Hyatt Regency* you're putting up in Da Nang as we drove to the airport.

There was nothing like *The Nam Hai* in Vietnam before. The whole area where *The Nam Hai* is was just miles of empty sand and a few fishing villages. Peter and Rick took motorbikes out there and drove the sand trails until they found a plot they thought would work. Then they started shifting sand around and working to sell the concept, basically did the entire development, invested in it, and brought **GHM Hotels** into the venture. But Indochina Capital remains very intimately involved in the management company and many aspects of the resort. In fact, Marc has one of the villas there.

He would. The place is stunning.

Isn't it especially gorgeous at night? A drizzly night is actually my favorite time to visit, when everything dissolves into all the water pools in the soft lighting. It's too bad you didn't have the time to stay longer in Vietnam to see more of our properties. Indochina Land, our real estate group, has just developed a beach resort on a pristine island called Con Dao. The whole archipelago has a surface area of only 70 kilometers and a population of just 5,000 people, but multitudes of monkeys, turtles and birds – and our approach to the entire project is very ecologically oriented. Yet the resort, on a remote cove near a national park, is only about 145 miles from Ho Chi Minh City, a distance regular flights cover in 45 minutes.

More or less in the same vein, our infrastructure management business, which was begun in 2007, advises and invests in transportation, energy, environment and social infrastructure ventures in Vietnam, but with a focus in all of its projects on the sustainability angle.

Does your real estate arm focus exclusively on high-end resort properties?

Not at all. It is Vietnam's premier real estate development and fund management firm and is involved in the full range of property types, from multi-family residential and mixed-use commercial to the resorts we've been talking about. In fact, the future of real estate development in Vietnam is really in the mid-market residential segment. That is where the income levels are. Where the bright future is. Indochina Land, which sponsored Vietnam's first real estate fund, currently manages three closed-end funds with about $500 million in committed institutional capital, which translates into roughly $2 billion in projects under development and management, all across the spectrum in Vietnam. It's just that *The Nam Hai* makes such a spectacular first impression!

No kidding. But we did also see a whole bunch of what our Vietnamese guide called "McMansions" and high-rise condos going up on the outskirts of Ho Chi Minh City.

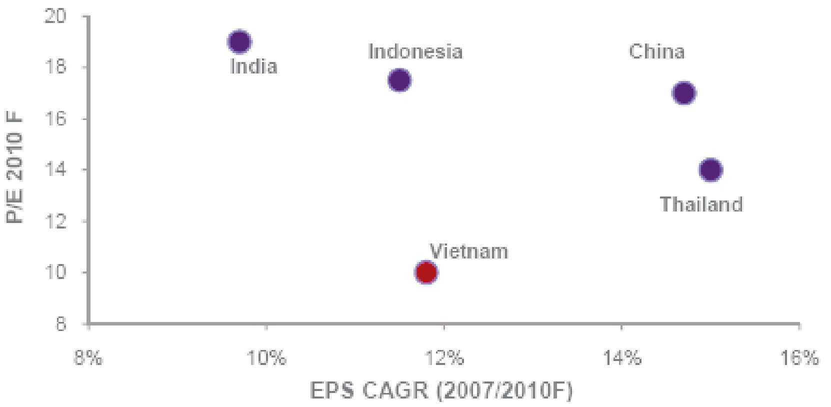
The pace of the development really has to be seen to be believed.

How much capital does Indochina Capital have under management in total?

Currently it has about $550 million under management, all told, so our equities presence is much smaller, obviously, than in real estate. But so is the stock market – the entire market cap of Vietnamese exchange is only about $35 billion. All of the equities investments we manage at Indochina Capital Advisors are in private equity and managed accounts at this point. Indochina Capital did have a listed closed-end fund in London – Vietnam's first [**Indochina Capital Vietnam Holdings Ltd.**] – but it fell victim to arb funds in the aftermath of the credit crisis. The investments we make span the entire spectrum of equity and debt instruments available in Vietnam. This means we invest in listed and pre-listed companies, in private state-owned entities (SOEs), in private companies and in private ventures. Our preferred focus, in private equity, is on privately negotiated meaningful direct investments and direct secondaries

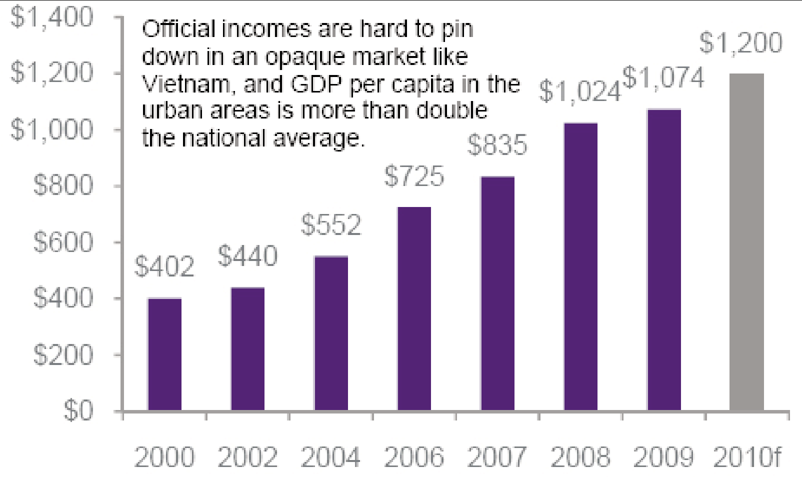
2010 P/E and EPS CAGR (2007 to 2010F)

Low valuations despite strong EPS growth



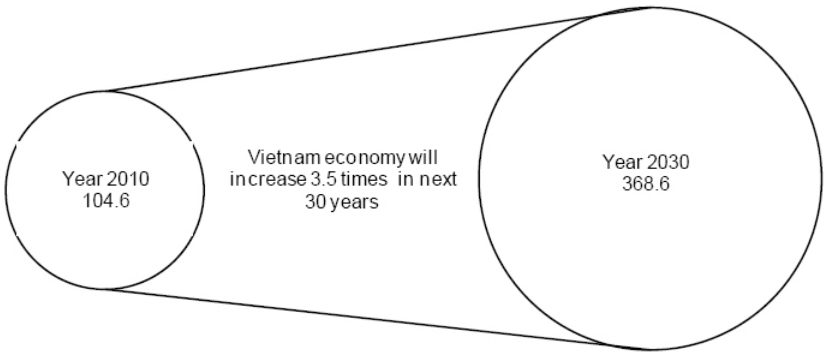
Source: Bloomberg, October 2010

Figure 4: GDP per capital (US$)



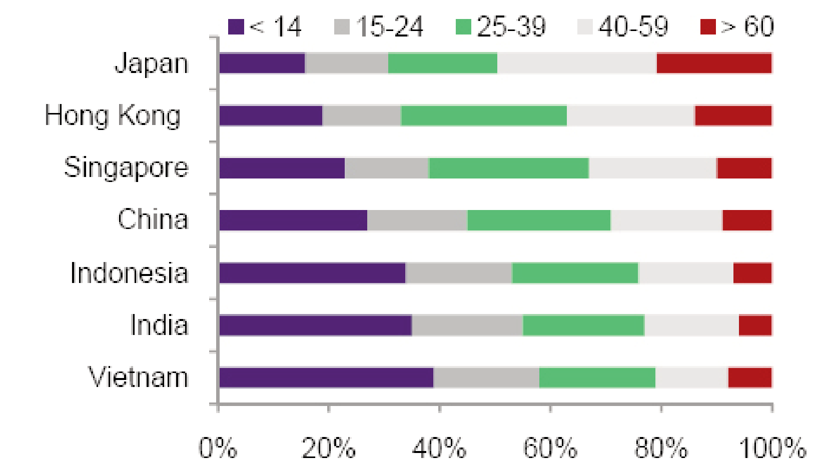
Source: General Statistics Office

Figure 5: Vietnam GDP over the next 20 years (USD billions)



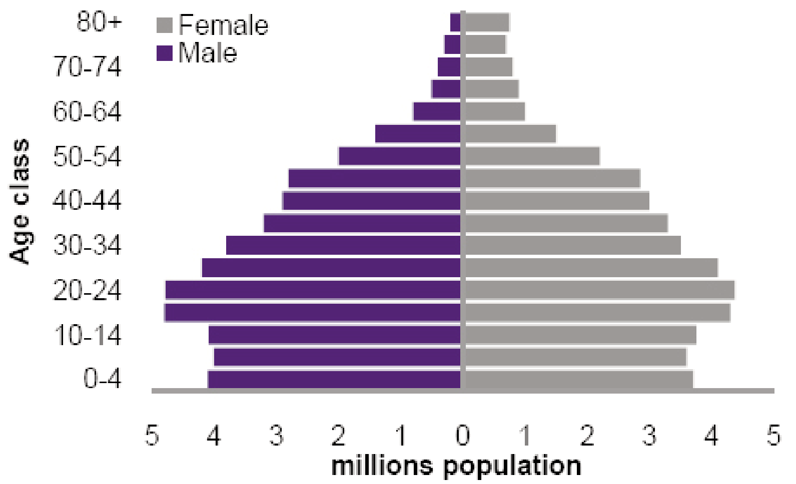
Source: International Monetary Fund, General Statistics Office, ICA's assumption

Figure 6: Age structure of major Asian Countries



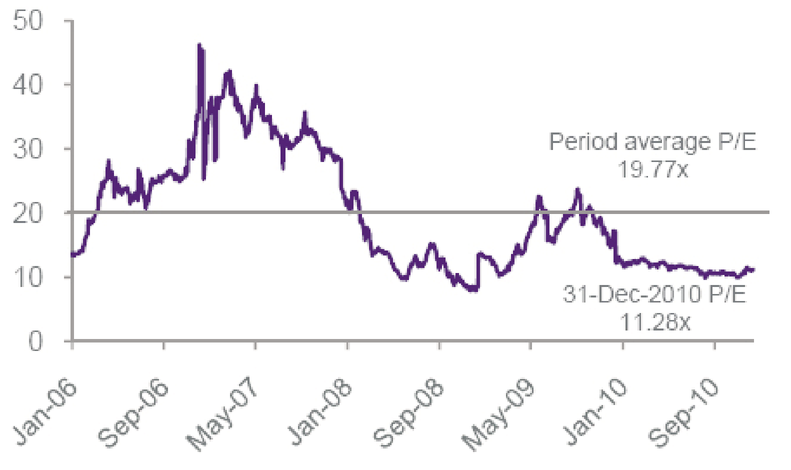
Source: U.N. Population Fund

Figure 7: Vietnam demographic dividend



Source: General Statistics Office

Figure 8: Vietnam trailing P/E ratio



Source: Bloomberg, January 2011

in equities or equity-linked instruments – especially in innovative high-growth companies operating in Vietnam's middle-market sector. But we also get involved in IPO financing and privatization sponsorship, as well as in capital financing for established businesses. On the managed account side, we offer clients exposure to our actively managed model portfolio, which has outperformed the VN-Index over the past five years, or discretionary portfolio management services, as appropriate.

Vietnam, at least to this casual observer, seems to be thriving – booming even. Yet its stock market finished last year in negative territory and it's still a noticeable laggard among emerging markets, isn't it?
That's right. I don't particularly mind though, that the Vietnamese market has been lagging because it means there are companies to be discovered at very attractive valuations.

But what's ailing the market? The 12% inflation rate? The currency was devalued 8.5% while we were in the country, and then the central bank raised borrowing costs to 11% from 9% after we left.
All of that. On a headline basis, Forex and inflation are issues. But I dig deeper into the numbers and what I see is a little bit different than the headline numbers. For example, in the foreign exchange market, most transactions occur at what's called the interbank rate, instead of at the official rate, and the interbank rate has not really moved much. So there hasn't been as much impact on doing business as you'd expect, just from reading the headlines.

What is your reading of what's going on in Vietnam's economy, then?
What has happened this year is that that there were pent-up policy actions that hadn't gotten taken because Vietnam has a once-every-five-years Party Congress. No one wanted to do anything until the Congress, to preserve their jobs etc. So everything got held up until the Party Congress, which was held in January, was safely history. But now that it's over, you have had a slew of policy responses announced to make up for the inaction. That's part of why the rates got out of hand.

Maybe we should delve a little into the relationship between business and the still at least nominally Communist government in Vietnam. I certainly saw lots of evidence of

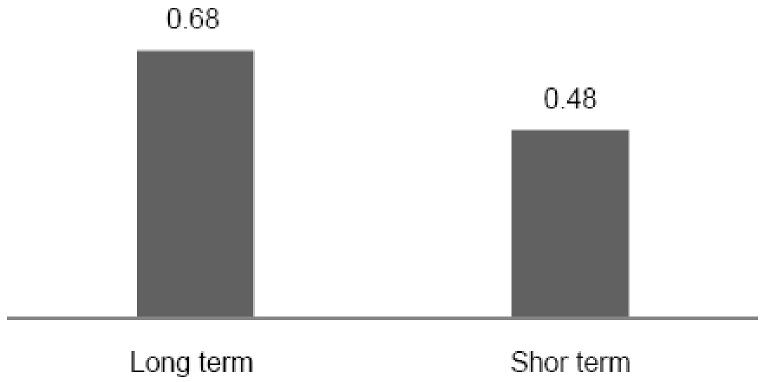
enterprise, and very little of the sort of obvious command economy waste — "see-through" apartments and office blocks, for instance — that I saw all around Beijing four years ago.

First of all, I'll start by pointing out that we are still in the process of shifting over from a command economy to a free market economy. That does not happen overnight. To go from 100% state ownership, where Vietnam was until the reform movement started in the mid-1980s, to what I guess is the ultimate goal of very little state ownership, I would imagine would take at least a couple more decades. I have a chart (figure 1) that shows the relative contributions to the overall Vietnamese economy of the state sector, versus the private sector and foreign direct investment, in terms of capital, revenue and labor. What it shows is that the state controls about 50% of the capital at this juncture; it generates about 35% of the revenue and results in about 28% of employment. So it's *much* more inefficient than the private sector, which contributes just a third of the capital but 40% of the revenue and employs half of the labor force. Of course, incentives are not in place for state-owned enterprises to perform as well as private companies. So the government is slowly privatizing. But of course, you need the right environment to want to sell off your companies. You don't want to do it at very low valuation levels. So it's a matter of market opportunity and market timing to release state capital. But it is very much the case that the state and the Party see privatizing business as a very important goal. We've seen this before in China and Russia. It does take time for the state to sell down. The analogy is that these state-owned enterprises are like leaking buckets. There all these people benefiting from the current structure, from backroom dealings and this and

Ho Chi Minh Stock Index (VNINDEX:IND)

Source: Bloomberg.com

Figure 9: Correlation of VNIndex and S&P500



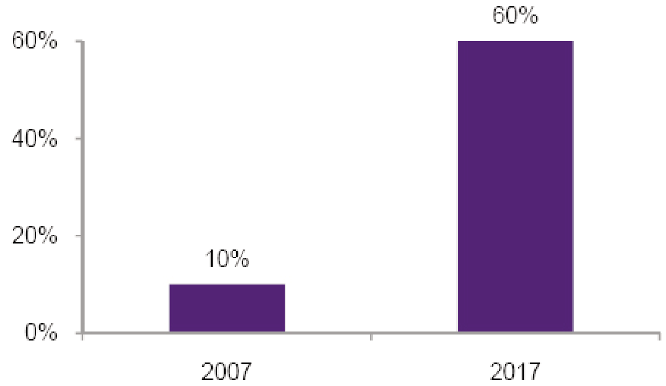
Long term - From Jul 2000 to Dec 2010
Short term - From Feb 2009 to Dec 2010

Source: Bloomberg

Investment theme on Retail sector

- **Ranked as the most attractive retail market in the world in AT Kearney's 2008 GRDI study**
- 13th most populous country, experiencing rising disposable income
- Retail sales to double from USD 39bn in 2008 to $85b in 2012 according to RNCOS
- Highly fragmented market with maximum 3% market-share; conventional outdoor markets make up 90% of sales
- Distribution opportunities given lack of nationwide supply chains and policy directive to formal retail channels

Figure 10: Share of modern retail in term of retail sales



Source: A.T. Kearney

that. So the state-owned enterprises' value is diminishing as long as the state holds the buckets. But the state is aware of this – and wants to move them over to the private sector to stop the leakage.

Obviously, at a price. What sort of prices would it take to hurry them along?
Oh, five times book value.

Dream on!
Well, in 2007, they actually got five times book value for selling a minority stake in a state-controlled bank. But in the current market environment, they wouldn't get a third of that valuation on something like that. They have to ratchet down their expectations. But it takes time for the state to understand what is value, what is realistic, what is a market-clearing price. That takes time for them to learn. But they will. Meanwhile, the economy is growing very quickly despite the inefficiency in the government sector. The track record speaks for itself. A ten-year average GDP growth rate of 7 - 7.5%. Even during the 2008 global crisis, economic growth here just took a small dip and then bounced right back.

Is the political environment as stable as it seems? Even when we probed, the Vietnamese we met insisted they're very satisfied with their lot, and resolutely "facing the future".
That is one of Vietnam's highlights for most investors. They really like its political stability; the homogenous population – in terms of ethnicity, religion, and language; the total absence of terrorism. If you compare to it to say, Indonesia, where – I don't know if you caught it in the news early last month – some Muslims attacked another sect and burned down several churches. We just don't have that kind of thing here. To compare Vietnam with some of its peers – I'd throw in there the Philippines, Indonesia. Perhaps you could broaden it out and compare it to Nigeria and Egypt. These are markets of similar size and import. Maybe Pakistan, Bangladesh. All of these have much, much worse issues in terms of political instability and political risks. North Africa is a prime example right now. Pakistan is another powderkeg. Among frontier markets, Vietnam really stands out in terms of stability. In fact, it chronically comes out on top of the rankings of preferred frontier market investment destinations, when the EIU does its annual surveys. The best beyond the BRICs, we like to call it.

Just because it's stable?
Not at all. The literacy rate is 95% for those over 15 and the country's demographics are quite astonishing actually. Forty-five percent of the population is below 15 years old. That's all a result of the post-war baby boom. It just shows you how much oomph is still in the economy. Compare that with China, which is in almost the opposite demographic position, due to their one-child policy, especially if you forecast out 15 years from now. Demographically, the only areas that compare with Vietnam are India, which also looks good. And the Middle East, where the outlook is cloudy, to say the least. Vietnam just really stands out because of its amazing post-war baby boom.

It seemed we saw at least one baby on every motorbike.
Gosh, I've never seen so many pregnant women in my life. Still, the birthrate isn't unreasonable. Vietnam doesn't have mass poverty issues like in India, where they're trying to encourage people to have fewer children. In India, many of the poorer families have 10 kids, so they can help on their farms. We don't have all of that here. And there is a bit of a natural slowing in the birth rate occurring, too.

Does that go hand in hand with Vietnam's growing urbanization?
Yes. Although Vietnam is one of the least-urbanized countries in Asia at this point. I don't know the precise ranking; but the population is 75% rural to 25% urban, which is in stark contrast to many of the other nations around here, where the proportion of the population that is rural is a fifth of Vietnam's.

Really? Ho Chi Minh City seems to be bursting at the seams. And even a relative backwater of a city, like Quang Ngai, was jammed with people.
Sure. But Hanoi and HCMC are the only cities in the country with more than a million people. Vietnam is seeing a gradual migration of about one million people per year, moving from rural areas to urban areas – and that's expected to last for about 20 years. That's one reason that residential real estate is such a very good long-term theme.

What is driving Vietnam's economic growth?
For me, the whole driver comes from human energy. Basically, people want a better life. That's the aspirational drive. Then too, when you are a

poor country and you have a large young population, you can have fast growth from a modest base. And when a country opens its system to a market economy, it unleashes a lot of human energy. The economy, when you get down to it, is about 20% agriculture, 40% services and 40% manufacturing, and it's both domestic consumption and exports that are driving growth. Retail sales are growing at about 20-25% annually. That is an important sector. Exports are also very important. They are now up to about 75% of GDP, which is a quite high number.

So why, given booming exports, does Vietnam still have a trade deficit?

It does have a deficit, technically. But once again, you have to dig deeper into the numbers. A lot of Vietnam's "imports" are, in fact, intermediate products that go into things that are in fact for export. For example, the garment sector generates about $9 billion in exports but the value added in Vietnam is very, very small. They import the cloth. They just cut it and add some buttons, stitch it up a bit and send it back out. So if exports fell, imports would fall alongside them. It's not that Vietnam would be stuck importing lots of stuff if demand for its exports stopped. One really has to understand that. The other aspect of the trade deficit is that Vietnam is still building its supply chains and manufacturing capacity. Really, the country just opened up. Its first oil refinery is only now starting up. By contrast, I remember as a child in India at five and six years old being taken on school trips to visit refineries. But until **PetroVietnam**'s Dung Quat refinery was completed in 2009, Vietnam, which has the second largest oil reserves in Southeast Asia, had to ship all of their crude out for export and then import refined products. Besides that, just to build the refinery, Vietnam had to import all of the machinery that would go into it. What I'm getting at is that the focus of their imports has shifted. Where they used to import lots of refined petroleum, more recently a bigger import category has been machinery. As a country progresses and builds out its supply chains, it will have these structural issues on the current account. However, this is more than compensated for by Vietnam's foreign direct investment flows and remittances.

Remittances are large?

Yes. As you know, there are many, many overseas Vietnamese. People who left in 1975, at the end of what's known here as "The American War." Many of those South Vietnamese went to the States. I believe there are about 1.5 million Vietnamese in the U.S. Many others went to Australia; there are a few spread around Europe. They all send money home, either to family or for investment. This comes to about $8 to $9 billion a year. Foreign direct investment is disbursing at about $10 or $11 billion a year. So between the two, they easily more than offset Vietnam's trade deficit, of about $12 billion.

What is attracting most of that FDI?

A few years ago it was going into property and construction in pretty unhealthy sectors, bubble-prone areas. But now about half of it is going straight into manufacturing. It's *healthy* foreign direct investment. Committed FDI totaled more than $108 billion over the past three years.

So it isn't *all* going into building garish casinos by the sea for nouveau riche Chinese tourists?

No! Not at all.

There's a startling strip of them along the highway between Hoi An and Da Nang.

Some God-awful building designs, you're right. Terrible!

You might suggest to your Vietnamese friends that the world really isn't clamoring for another Atlantic City —

Yes, there is no accounting for taste, I guess. But I suppose you can find monuments to excess in anyplace growing as fast as Vietnam is.

That reminds me. Did you tell me that both Hanoi and Ho Chi Minh City are growing faster than even the megacities of China and India?

Yes. They are. A lot of this comes from the whole urbanization theme we spoke about. Remember, this is the 13th-most populous nation on the planet. And in a large country of 87 million people, where the population is concentrated around these two magnet cities, which are 1,500 kilometers apart, that's what happens. They are the opportunity centers that draw people, and they are starting from low bases. Hanoi's population is about 6.5 million, HCMC's, roughly 10 million. A PriceWaterhouseCoopers report we found projects the two cities to be the fastest-growing in the world between 2008 and 2025, outpacing even the rising urban centers of Chindia. Another striking little-known fact about Vietnam is that its people are incredibly entrepreneurial. Self-employed workers make up 50% of the population. Wage and salaried workers make up 33%, and 17% of the Vietnamese are underemployed, according to the International Labor Organization's latest statistics.

Is it by necessity, choice or tradition that so many Vietnamese work for themselves?
Let me put it this way: I drove south for six hours, way down deep into the Mekong Delta recently. And for 80% of the distance along the way, I saw mom and pop shops all along the road. I didn't even see the countryside. I can't begin to tell you what they all sold. The signs indicated a hodgepodge of building materials, dry rations, bad furniture, motorbike repair, noodle shops, low end cafes, imitation Nokia phones, made in China, what have you. But one thing you also may have noticed on your trip is that, culturally, the Vietnamese *all* want their houses alongside the road. The downstairs is devoted to a shop of some kind and the upstairs is where the bedrooms and living quarters are. Somehow the system works and everyone can make a living. I had friends from India with me on that trip and they were asking, "What the hell, how can you drive past mom and pop shops for six hours straight?" Eventually, they couldn't stand it. They said, "We want to look at this," so we stopped. We actually went inside one shop and discovered that she only sells two things. Yet somehow, it works. Generally speaking, they are very resilient people. I suspect the shopkeeping tradition probably stretches far back in history – well before Communism. The country's geography, especially its long coastline, probably encouraged their ancestors to become traders, merchants.

I was particularly fascinated to see shops that rented or sold what looked like the same wedding dresses every few miles down what seemed like every road; even in the tiniest villages. Tucked right in among the motorbike and noodle shops. That, and the farmers in rice paddies — on cell phones. At least, where the land hadn't been taken over for a huge furniture assembly plant or some such.
Manufacturing is growing rapidly in Vietnam. A lot of it spurred by this "China plus one" policy many companies have adopted. Essentially, when they are outsourcing manufacturing, most multinationals don't want to put all of their eggs in one basket. They don't want to be exposed to just one country. They want to hedge their risks, diversify their supply sources. A manufacturer might have a number of plants in China, so they'll set up a couple outside China, just in case. It's risk management. And manufacturers who have gone into China have often chosen Vietnam for their "plus one," for its low labor costs. Vietnam has been a big beneficiary of this management strategy. Initially a lot of low value add, low labor cost manufacturing came into Vietnam, we're talking garments, footwear, cheap wooden furniture. Companies like **Nike** (NKE) and **IKEA** set up early operations here. Of late, however, we're seeing people move up the value chain a bit.

Such as?
Well, **Intel** (INTC), for example, as invested $1 billion in a plant here in Ho Chi Minh City. This is the largest, most advanced assembly and testing facility in the world. It just opened last year. This Intel plant will, over time, add up to $5 billion in exports. Vietnam's total exports ran about $70 billion last year. So that's a large percentage increase that is coming from just one Intel plant. What I'm trying to say is one can shift up the value chain a *lot* faster just because of the returns on capital. If you put $1 billion in and $5 billion comes out, then immediately that mix can change. You can move up the value chain quite fast. We have been seeing a lot of Japanese investment come in because of the strength in the yen, and because of the troubles within Japan and China.

Japanese direct investment?
Yes, for example, **Canon** (CAJ), the maker of cameras and printers, made a big investment. **Samsung** (005930) from Korea invested a lot in a plant. So we're starting to see higher value adds. We're seeing aircraft parts being manufactured here. It's still early days, but it's going to happen quite fast. I would imagine the mix of high value add to low value currently is about 15% high value. But I would expect it to shift to, say, 40% in about five years.

That *is* quite fast.
True, but it went from zero to $68 billion in a decade. Vietnam has abundant natural resources and it's in a *very* strategic location. In 2015, we're going to have a lot more ASEAN integration. So there will be a lot more trade and free movement of goods and people within ASEAN. This agreement will also extend to China and to India. What's remarkable to me is how close the regional centers of Hong Kong and Singapore are to Vietnam. Singapore is under two hours by air from Ho Chi Minh and Hong Kong is only a little over two hours from Ho Chi Minh. Those are the

places capital flows from. India is eight hours from Singapore. It's very easy for people to deploy capital, come in to do the due diligence, to cut their deals, to monitor their investments. That's the air dimension.
Then, obviously, with Vietnam's long coast on the South China Sea, as they develop their port sector and infrastructure, that will be very strategic. Right now, in the port of Haiphong in the north, there are no deep water facilities. So shippers can only use smaller ships, like the Handymax, and that isn't as efficient as using the really big ships. Vietnam has plans now to put in deepwater ports in both the north and the south. In the center of the country there's also a natural deep water port near Da Nang, which I think is the facility that probably will be completed first.

You mentioned PetroVietnam's new refinery. The oil sector is still completely government-owned, isn't it?
Yes.

But the country has relatively large reserves, right?
Correct. Some 0.68 trillion cubic meters of gas and 4.5 billion barrels of oil.

So is there any chance of Vietnam achieving self-sufficiency?
At the moment, they're still importing refined petroleum. After all three of its planned refineries are up and running, Vietnam may be close to self-sufficiency – but they may still have to import, because I expect the demand side of the equation to increase strongly as well.

I don't doubt it, given the number of motorbikes I saw everywhere —
A lot, aren't there? But consider that most of the Vietnamese now riding motorbikes are going to be in *cars* one day. And the population is going to continue to grow. So there's going to be huge demand for fuel.

One of our drivers cited a fantastic statistic to us, claiming that the human population of Ho Chi Minh is around 8 million and that its motorbike census is about half that.
Actually the latest count on the people is 10 million, as I said earlier. But I think there were only about one million motorbikes sold last year in the city. Annual sales of the motorbike industry across Vietnam were 3.5 million units. It's the fourth-largest motorcycle market in the world. Indonesia is the largest.

I think our driver was talking about the total bikes on the road, not just new ones. But whatever, they are ubiquitous. Let's focus, though, on some of Vietnam's other advantages for foreign investors —
A big one is that the relative cost of labor here has come down significantly. The cost of labor in China continues to go up and up, and currencies in some of the neighboring countries, like in Thailand and Indonesia, are going up, too. Vietnam's currency, as we mentioned, has been going the other way. So its relative labor affordability has improved a couple of notches over the last 18 months. What's more, the Vietnamese are just not lazy people. They wake up early; they have a lot of energy and they want to get ahead in life. If I were to compare this general attitude to what I've observed in, say, Cambodia and Laos, I'd have to say that the Vietnamese probably expend twice the energy of an average Cambodian in a normal day.

Really? The difference between those neighboring cultures is that strikingly large?
Yes, very much so. Either it's cultural or it's the lingering effect of all the propaganda the Vietnamese were exposed to when the Party controlled everything. They used to have loudspeakers in the streets during the Communist years. Every morning, the Vietnamese would hear: "Get up everyone! Do your exercises! Long live the Party!"

Gee, I wonder if that would work for me... More to the point, though, for all its charms, why should investors bother with the risks and hassles inherent in going into a country like Vietnam today?
The way I really look at it – and my strategy is a buy and hold strategy – is that frontier markets like Vietnam actually have very low correlations to the global markets.

Right, until *all* correlations go to one again in the next crisis —
Even then, it's one of the asset classes with the lowest correlation to global markets. And, assuming you can hold on during the inevitable dips, you have a pretty good expected return *over time*. In a market like Vietnam, I estimate that the economy will triple in the next 20 years – and that is my conservative estimate. That is *below* forecast. It works out to compounding at 5.7% or so. Meanwhile, many blue chip Vietnamese companies will grow at rates that are two to three times as fast as the economy. And many of them

have business models with very defensible margins. So, if over the next 20 years or so, the economy triples and if a blue chip can grow at three times the economy *and* preserve its margins, we're talking a nine to tenfold increase over the next 20 years. Which is not a bad return.

I'd take it. Getting there is the only trick. So how do you plan to do it?

Well, I run very concentrated portfolios because I find that the country lacks management depth. One of my most important tactics is focusing on finding quality management teams. Ones that are disciplined; not tricky. That are committed to good reporting, good governance. Honest managements, simply put.

Where do you find these paragons?

It's not easy. Especially because, once we apply liquidity screens appropriate for different types of investors, our universe is already considerably narrowed. In fact, when I screen for management quality on top of liquidity, I generally find that about 85% of the companies fall away.

I'm glad you brought up liquidity. A hoary but often realistic knock on frontier markets is that they're like *Roach Motels* — you can get in, but you can't get out.

One always has to also consider the liquidity dimension. Liquidity fluctuates in the marketplace based on macro conditions. If we're having a liquidity boom, the daily trading volume can go up to $300 million. If we're going through some tightening in the system, it can fall to $30 - $40 - $50 million a day. What you do about this really depends on an investor's liquidity needs. Many of our managed account investors are family offices who want this 20-year exposure; who don't want to take money out. They want to continue to build their portfolios up over time. But then, if you're doing a Japanese Investment Trust, which is something we're putting together at the moment, they want daily subscription redemptions.With a strategy like that, we need to be in *very* liquid names.

So how do you further narrow your picks?

Then I apply top-down themes. I have done a lot of work with S curves and find that an S curve basically describes how products penetrate the market as a country develops. So what I search for in companies are defensive characteristics with growth – which is a very good, but very rare combination to find.

How about an example?

Take the pharma sector. The Vietnamese today spend only about $20 per person per year on drugs, which is very, very low. That will obviously increase over time. It's not a cyclical sector. It will probably grow at a 25% rate over the next five years. So I look for good companies in the pharma sector. Or, in consumer staples. The per capita consumption of milk in Vietnam is really low – and will increase over time. So the dairy producers could be another defensive growth area. Another theme is financial services – where there is *very* low market penetration in Vietnam. Only one in ten Vietnamese has a bank account. These are *very* early days and that penetration obviously should grow. Insurance is another. Life insurance is 1% of GDP; it will penetrate over time. Property/ casualty insurance is also only about 1% of GDP. So you can see that I have very basic themes from the top down; more of a domestic consumer focus and of course a theme of defensive growth.

I should have asked, what sort of government constraints do you have to contend with as you try to invest foreign capital in Vietnam?

For portfolio investors, most companies have an ownership cap of 49% and there are certain restricted sectors like banks that have a lower cap of about 30%. But for private investors, one has the option of setting up as a local to get around a lot of the ownership restrictions. It's done like in China, where they have "WOFEs," wholly owned foreign enterprises to accomplish this. In Vietnam, we have a similar concept, so we have wholly owned foreign enterprises, where you basically set up as a local and can get around a lot of ownership restrictions. Nonetheless, this is heavily controlled and a private investor needs licenses and permissions and approvals. But as I said, as a portfolio investor, you can acquire up to 49% of a company and it's not an issue.

Okay, back to the nitty gritty of your investment process. You've already thrown out 85% of your universe for not making your basic decency-cum-liquidity cut and further drilled down into defensive growth sectors. But I take it you don't just buy everything you can find that fits into those categories?

No, I don't. The bulk of my work revolves around a lot of very deep security analysis. We of course do very careful and methodical balance sheet analysis to eliminate companies overly burdened with debt. But we take our security analysis to an even deeper level in a way that's unique – or unique to this market, at least, where there are not many people really going in and looking at the economic returns of business. What I mean is that we go very deep in our analysis to understand economic value add and return on invested capital – as in, what is flowing into working capital and capex, and what is actually coming out in operational cash flow. It takes a lot of time and many of the local professionals here are not familiar with this approach. But introducing this kind of economic returns analysis to this market is one of my real contributions, I feel, to dealing in this marketplace.

How do you even get hold of meaningful financial data to analyze?
Well, we start with the data according to Vietnamese Accounting Standards. We put that into one part of our model and then we use the *McKinsey Valuation Institute* model as a data control. So we take the VAS numbers from the local accounting system and then rework the financial statements and then run the models. It is very time-consuming.

I bet.
And we're always having to update the analysis. But we feel that it is very important to look through all of the accounting games to really see what's going on at the companies. There are a number of companies here that actually aren't focused on their core businesses. Their non-operating returns are normally higher than their operating returns – and we really want to see what the economics of those operating businesses are.

All that work, and the market cap of the entire Vietnamese equity market is only, what did you say, $35 billion? So it actually wouldn't take a lot in terms of foreign investment flows to start it boiling –
Actually, no. Foreign investment accounts are roughly only 10% of daily volume. It's really the retail investors who dominate trading in Ho Chi Minh City. It's very interesting. There's not much of a domestic institutional market in Vietnam, but there's a very large domestic *retail* investor market. It is probably the inverse of the U.S., where the retail investor is probably only 10% of turnover. Here, foreign investment institutions have just 10% of the market and 80% is retail. So it's really the retail investors who drive the markets here. Now, they are very active with their savings. They move their money around a lot. If they fear inflation running out of control, they move it to gold, move it to land. Then they they move it to bank deposits, they move it to the stock market, and they go round and round. It's quite restless, actually, and since there is no real mutual fund industry, they do it all by themselves.

It doesn't sound like they're very attuned to long-term investing–
No. In cultural terms, what goes on here is more akin to gambling than investing. In fact, the phrase they use to say "invest in the stock market" literally translates into "play the stock market."

At least they're quite realistic about it!
Ha, that's good. When I tried to move a block of shares the other day, I said, "This is only a P/E of 3 and trading at a discount." But the response came back, "Hey, this is a local trading group. They don't care about P/E." I mean, how do they do it then? Well, they just flip it off to someone else! So yes, they are very playful.

They like to gamble as much as the Chinese?
I would say yes. But I don't play that game. In the final analysis, I'm looking at the intrinsic values of companies. Looking at how they will model out over time and looking to see if their current market values are significantly below those intrinsic values. If so, I'll increase my positions. And if the market price is significantly *over* its intrinsic value, I'll reduce my position. But I will keep a core position in the concentrated portfolio; try to keep a defensive growth exposure for the long run.

How about one example of a company that has passed all of your quality, liquidity and valuation screens?
Well, **Vinamilk** (VNM) is one. It is already at its foreign ownership limit but one can buy it for a premium from another foreign investor. The government still owns, basically, the other half of the company. But this is an extraordinary company. Its market cap is roughly $1.5 billion. They dominate the dairy business in Vietnam; own very, very high market shares all across the segment. They basically produce and sell milk powder, fresh milk, yogurt and condensed milk, which is used quite widely here – it's called for in many traditional Vietnamese recipes and is favored for not needing refrigeration. This company has very high net margins, about 25%. Last year, Vinamilk grew more than 40% and net profits were up

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50%. So it has this strong market share, strong brand, strong management team, an amazing distribution system, and its defensive element is that it's in milk – yet it is trading at a P/E of 9! If this company were in China, its P/E would be 18 or 20 times. So Vinamilk is trading at half off and is probably more profitable than a Chinese dairy. It is my absolute favorite company here. It has probably the best corporate governance in Vietnam. We have a large chunk of our model portfolio invested in it.

That's an incredible growth rate, for something considered as basic as milk.

Well, the dairy sector in Vietnam is very young, so it is starting from a tiny base. In 2006, annual milk consumption was about 16 liters per person, which is about half China's level. It has gone up to about 20 liters presently. Regionally, the average would be about 35 liters a person. Powdered milk is also a very interesting growth area for Vinamilk, with Vietnam's baby boom and its very young population. While many other companies in Vietnam have struggled to compete with the multinational companies in powdered milk, Vinamilk has been making the grade. The locals really care about what powdered milk they give to their kids and with all the milk scandals in China, etc., Vinamilk has really managed to breakthrough with an image of Vietnamese quality. It's a brand they trust.

Do they have to import all their milk?

Not all. They do have a local dairy here; they import a portion from New Zealand, where they have an investment in a dairy producer. Even before the earthquake, they were working to diversify their suppliers, and are ever-vigilant about quality control, where slip-ups are an ever-present risk. But their market shares are just extraordinary. In yogurt, for example, they have a 50-55% share in a very fast-growing category. People here consider yogurt to be a super-healthy food. And it's also marketed – this will sound strange – as a whitening product. "Drinking milk will make you white and the more white you are, the more men will like you!" That's actually going on.

It's supposed to work from the inside out? Unreal. But I did see a lot of women, covered with hats, masks and gloves — to avoid suntans, I was told.

It's actually quite sad. Probably more than half of the population has a dark brown complexion, yet most ads in Vietnam show these Chinese-y-looking beautiful young girls with fair white skin. Holding them up as the standard of beauty is terrible, but the same thing goes on in Thailand – and "whitening products" do a great business. They even sell whitening roll-on deodorants. There's a men's version, too!

Yikes, scary. Do you need any further evidence of the power of advertising, in any culture? But tell me, what in the investment universe keeps you awake at night?

Of course I'm concerned about inflation. Especially about the components of inflation that can't be controlled with monetary policy. About the coming squeeze on resource prices, given the Libyan uprising; about things spinning further out of control in the Mideast. We've already got a drought in Argentina and Russia has slapped limits on its wheat exports. So food prices will rise, especially considering the earthquakes, floods in Pakistan and Australia, all of that. But we can't control those things; all we can do is monitor them. Another concern that haunts me – always – is that I've missed something in my companies that I should know about. Is someone manipulating something? Are the accounts real? You never really know, no matter how much work you do; even the auditors often don't know.

But other than that, I don't worry all that much. I'm comfortable because we look at this as a 20-year thing. Despite our tendency for concentrated portfolios, we're diversified enough and I know enough about these rising companies that I'm comfortable holding our stakes in their incredible future growth – which we've acquired at single-digit P/Es. Even if we do have some future meltdown, I've matured enough as an investment professional that I'm confident I'll see it as a buying opportunity, if that's appropriate, rather than freaking out.

Sounds like a plan. Thanks much, Nick.








Photo Key

Page 1
HCMC Celebrates Tet

Page 15
Left column, from top:
The Nam Hai, entrance;
The Nam Hai, villa;
McMansions, HCMC
Farmer near LZ Liz

Right column, from top:
The Nam Hai, pools
The Nam Hai, beach
Market, Qui Nhon
Market, Qui Nhon

Page 16
Top row:
Supermarket, Mo Duc

Middle row, from left:
Junior cyclist, An Khe
Child, Son My

Bottom row, from left:
Bridal shop, Qui Nhon
Noodle merchant, Hoi An
Fishmonger, Hoi An

Page 17
Left column, from top:
Rice paddy near LZ Dottie
Market, Mekong Delta
Kidmobile, Qui Nhon
Traffic, HCMC

Right column, from top:
High schoolers, My Lai
"Home Depot,"
Mekong Delta-style
Intersection, HCMC
Intersection, Tra Bong

The Nam Hai photos courtesy of GHM Hotels and Indochina Capital.
All other photos: KMW

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