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PXP Vietnam Fund*

Interview with Kevin Snowball, CEO of PXP Vietnam Asset Management

In this note, we talk to Kevin Snowball, Chief Executive Officer of PXP Asset Management ('PXP'), about his views on the Vietnamese market and the background to the launch of PXP over 10 years ago. PXP is a Ho Chi Minh City-based asset manager whose flagship product - PXP Vietnam Fund (VNF LN) - was last year's best performing Vietnam closed-end fund.

Biography

Kevin Snowball spent a decade in Hong Kong from 1985 as a specialist manager and trader of proprietary funds in equity and equity derivatives markets in Hong Kong and South East Asia. During that period, among other activities he established the Hong Kong equity derivatives businesses of Baring Securities and Deutsche Morgan Grenfell. On returning to the United Kingdom in 1995, Kevin expanded his coverage to encompass global emerging markets at Dresdner Kleinwort Benson, Bear Stearns and ABN Amro before returning to Asia to establish PXP Vietnam Asset Management in 2002.

Q&A

Most investors that follow Vietnam will be familiar with PXP. For the benefit of those that aren't, could you give some background on how you came to be in Vietnam and why you established PXP 10 years ago?

I have always had a preference for very early-stage markets over their more mature counterparts, not least because of a sartorial aversion to the use of hair gel, striped shirts and braces (known in the Western-lying former colonies as "suspenders" if I am not mistaken) but also because they are so much more exciting. For example, I moved to Hong Kong in 1985 initially as an analyst when the Hang Seng Index was below 1,700 points. Having converted to a proprietary trader within a year I then expanded my coverage to South East Asian markets in 1988. I made the move to trading Hong Kong listed derivatives in 1991 when less than 150 futures contracts were traded each day at the HKFE. I reluctantly returned to London in 1995 for family reasons and spent the next five or six years familiarising myself with Latin American and Eastern European markets but ultimately could not resist the pull of Asia.

I was never particularly interested in Vietnam as an investment destination until it had a stock market, which opened in July 2000, and so I came to have a look for the first time in mid-2001. The combination of the emerging dynamism of a liberalising centrally-planned economy and a brand-new equity market were impossible to resist and I felt that once the government had figured out what a stock market was actually for, there would be an exciting opportunity for a listed equity specialist investment manager, and so it has proved.

Could you provide an update on PXP today: AUM, investment team and the mandates you run?

Sure - PXP is a listed equity specialist investment manager. The firm was established in October 2002 by myself and Jonathon Waugh, who left the firm at the end of 2008 to pursue other interests. We currently manage two funds and a segregated mandate, with total Assets Under Management of a little over US$105 million. PXP Vietnam Fund, launched on 31 December 2003, is a London Stock Exchange Main Market-listed closed end fund wholly invested in Vietnam-listed equities.

PXP Vietnam Fund has assets of approximately US$57 million, with 12 million shares issued from a total of 50 million authorised. Shareholders gave permission for the issue of 20 million 'C' Shares within a year of the last Annual General Meeting, on 31 May 2012. The timing of such an issue will depend on market conditions.

The Investment Manager's second product, Vietnam Emerging Equity Fund ("VEEF") was established in November 2005 as a closed end fund but was converted into a Cayman Islands-domiciled mutual fund in January 2010. VEEF has monthly liquidity and currently has assets of

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**Jefferies Hoare Govett is broker to this company* approximately US$34 million with capacity for a further US$140 million or so at current NAV levels. The Fund is roughly 95% invested in Vietnam-listed equities.

VEEF's long-term performance has been good although it lags behind that of PXP Vietnam Fund. In 2012 VEEF's Net Asset Value rose by 24.95% whilst PXP Vietnam Fund returned 33.7%. The VNI rose by 18.89% in US dollars. VEEF has also outperformed the VNI in US dollars over 2, 4, 5 and 6 years.

The segregated mandate, managed on behalf of a European institution, has current total net assets of just over US$16 million and is similarly over 95% invested in Vietnam-listed equities.

We are a fundamental, research-driven, bottom up investment manager with a full-time staff of 22, 10 of whom are investment professionals, based in Ho Chi Minh City, Vietnam. Our two Heads of Research - for Financials and Non-Financials - have been with the firm for 4½ and 6½ years respectively and manage teams of 3 analysts each who have been at PXP for an average of 3 years. The close working relationship and familiarity among the investment team ensures a consistent and efficient approach to stock selection, which we regard as our core competence and the Portfolio Manager has the utmost respect for and confidence in the views of the analysts although all investment decisions are ultimately taken by the Portfolio Manager under the supervision of the respective Boards of Directors.

We are strictly bottom up in our approach and the sectoral view of portfolios is a factor of our stock selection rather than an influence on it. Our aim is to construct portfolios comprising the highest quality stocks available in Vietnam based on our belief that quality will be the main determinant of performance over the long term. We cover roughly 120 of Vietnam's listed stocks with full proprietary financial modelling, representing in excess of 90% of market capitalisation. The length and depth of coverage of our listed universe is, in our opinion, unrivalled on either buy- or sell-side in Vietnam and this is reflected in the long-term performance of the Funds.

What do you believe are the benefits of investing in Vietnam through funds like PXP Vietnam, as compared to investing directly or through ETFs?

Although closed end funds have fallen out of favour in the past few years we firmly believe that the classic rationale behind the creation and operation of such vehicles - in terms of providing actively-managed access to markets which have barriers to entry due to foreign ownership restrictions and severely limited research coverage - is still relevant for early stage developing markets such as Vietnam.

Exchange Traded Funds provide quick and easy (one might also say "lazy") access, they are of necessity quantitative in approach since the criteria for inclusion in the relevant index are simply size (market capitalisation), liquidity and availability (to foreign investors). The PXP approach is entirely qualitative and revolves around a fundamental long-term approach to stock selection with core positions now at foreign ownership limits added well before such limits were full. The ETFs are required to sell their holding once a stock reaches the foreign ownership limit and therefore cannot benefit from any relaxation of such limits, whereas the fund structures of the PXP funds have no such restrictions.

The benefits of the qualitative vs. quantitative approach can be seen in the relative NAV performance over time of the different vehicles. The DB ETF (XVTD LN) outperforms the PXP vehicles as long as money continues to flow into it; for the past two years significant inflows have been a feature of the first four months of the calendar year and the Net Asset Value of the Tracker has outperformed that of PXP Vietnam Fund (VNF LN) by roughly 10%.

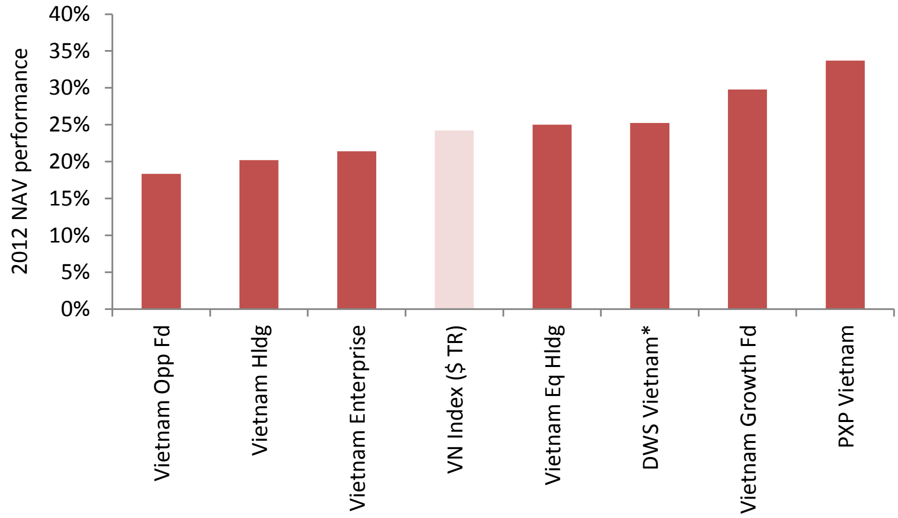
Over the remainder of 2011 and 2012 when inflows have ceased the focus of the market has switched to qualitative stock selection with the result that the NAV performance of PXP Vietnam Fund has comfortably beaten that of the DB Tracker (2012 VNF +33.70%; XVTD +16.06%. 2011 VNF -21.89%; XVTD -51.0%)

Speaking of outperformance, PXP Vietnam Fund generated an NAV return of 34% in 2012 as compared to a total return of 24% for the VN-Index and 24.8% for the Vietnam CEF peer group. What were the main reasons behind this?

At the risk of appearing trite we would obviously answer "superior stock selection techniques", but, on a more serious note; PXP Vietnam Fund is, to our knowledge, the only Vietnam fund (with the exception of the DB Vietnam Tracker ETF) that has 100% of its assets (excluding cash) in Vietnam-listed equities. In a rising stock market the ability to reliably mark the entire portfolio to market every day should continue to ensure superior real NAV performance over funds with less exposure to listed stocks which do not have access to the same truly independent valuation methodology.

The Fund in fact has a rolling one- to eight-year track record of outperformance against its benchmark - the Viet Nam Index - in US dollars and has outperformed by more than 50% over seven and eight years. The single exception in the Fund's life, the nine-year performance record, is a little under 10% behind the VNI which can be attributed to the timing of the Fund's launch in relation to the efficiency of the award of trading codes (which are necessary for participation in the Vietnamese stock markets); the VNI rose by 27.5% in the six weeks that the Fund was awaiting authorisation to deal.

Chart 1: Vietnam Equity CEFs - 2012 NAV return



Source: Bloomberg, respective managers, *Jefferies estimate

In PXP Vietnam's annual report for the year ending 30 September 2012, you say that a rally will only be sustainable once a solution has been found for NPLs in the banking sector. What is your view on the scale of the problem and when do you expect this to be resolved?

We are encouraged by the fact that the Vietnamese government recognises the necessity for NPLs to be dealt with and we expect to see a roadmap toward resolution of the problem in the near term. The government is similarly focused on making improvements to the investment environment for both portfolio and direct foreign investors and the combination of expectations for both structural and investment reforms has driven the rally from the November 2012 low. We expect to see the market continue to move higher as effective reforms are introduced and implemented in the first half of 2013.

Do you have any thoughts as to how a resolution might be structured, and who will recapitalise the banks afterwards?

We have no useful insight into how the "rescue" might be structured, although the government has stated that they will not print money to resolve the issue. Whilst this is encouraging for continued confidence in the domestic currency it does remove one potential solution. Our view remains that recapitalisation is ultimately likely to be encouraged from external sources and that the foreign ownership cap in the banking sector will be raised to facilitate this.

On the potential lifting of foreign ownership restrictions: there have been rumours of this for months, if not years - when do you think it will happen, and what impact will it have?

The State Securities Commission has been relatively vocal on this issue in the past few days, with talk of an impending "pilot scheme" of removed limits in certain sectors as well as the introduction of non-voting shares in companies at the foreign ownership limit in more sensitive sectors. Whilst we are not convinced that the latter has been particularly well thought through in relation to certain stocks we will reserve judgement until the detailed plan is published.

With the results of any relaxation of foreign ownership limits likely to be positive for the prices of stocks already at such limits, PXP Vietnam Fund, with over 46% of its assets in stocks currently unavailable for purchase by foreigners, is likely to benefit on an NAV basis.

Other concerns investors in the region have include: 1) inflation and currency weakness returning, 2) inadequate reform of State Owned Enterprises, 3) corruption and corporate governance, 4) politics (following recent arrests that were seen as politically motivated), 5) territorial disputes in the South China Sea. Which of these do you think are legitimate and what are your views on these?

I believe that all of these concerns are legitimate and investors should pay attention to news releases about Vietnam accordingly. The most important real issue remains macroeconomic stability but territorial disputes will generate most headlines. I do not believe that the current state of multinational sabre rattling will ultimate result in anything other than continued verbal conflict. The other issues will likely improve over the course of the year ahead as the government recognises investor concerns in these areas.

Lastly, what are your overall views for the market in 2013?

We have been very positive for over a year now and the Fund's performance has justified that call. Although the market has had a decent run we feel that any correction ahead of the release of reform plans will be short and shallow. Vietnam is a market in which far too much reliance is placed on technical analysis and we disagree very strongly with the analysts who are suggesting that the market is overstretched since we feel that the basis has changed dramatically. Two months ago the market was cheap but no-one cared. The New Year has brought renewed optimism for the future development of the Vietnam economy and its capital markets and just as importantly a willingness to take on more risk globally by international investors.

Improved access through the relaxation of foreign ownership limits is a game changer. A better environment in the world's major economies will stimulate growth onshore. We are reluctant to make outlandish forecasts too often and so will content ourselves with projecting the VNI at 550 by the end of June assuming that effective reforms are introduced in a timely fashion.

Thank you Kevin.

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