

BUY (Initiation)

Military Commercial Joint Stock Bank (HOSE: MBB)

Report date	Mar. 05, 2019
Current price	VND 22,150
Target price	VND27,500
Upside	24.4%
Bloomberg	MBB VN
Market cap	VND 47,638bn
	USD 2,040mn
52 weeks movement	VND30,900
	VND18,500
Average daily value	VND 150bn
	USD 6.5mn
FOL	30.00%
Current FO	20.00%

A profitable outlook of prudence

Our takeaway

- We forecast strong core earnings coming from unique funding advantages, diversified non-interest incomes and sound asset quality. Under tech-savvy environment, digital initiatives will support MBB's push on fees and services in retail segment.
- We believe that only banks with prudent risk management like MBB can maintain ROE sustainably at 25% and profit growth at 31% yoy with high provision rate in the current scenario of credit deceleration of the whole banking system together with neutral non-performing loan resolution in 2019.
- On the basis that digital initiatives, unlocking FOL and introduction of new strategic partner are successfully carried out, we recommend BUY to capture the long-term potential of MB Group.

Key highlights

Uneniable low funding cost advantage and lending portfolio restructuring strongly support interest income. We forecast only a minor increase 4 bpts in funding cost to 3.52% in 2019 thanks to continuous high level of CASA, unique funding advantages from MB Group and initiatives in digital banking. On the other hand, value added from consumer finance, higher-yielding investment assets and improved Gov. bond yield would advance lending rate in 2019 and 2020 by 14 bpts from 7.79% in 2018. NIM is forecast to rise gradually from 4.58% to 4.72% in 2019.

Diversified income segments of MB Group ramp up non-NII. The benefit of digital initiatives and brand recognition reflected on settlement income is forecast at 25% yoy in 2019. We forecast that long-term profitability of Bancassurance segment should be promising thanks to GDP potential and low penetration of life insurance market while lingering concern on short-term profit remains.

Conservative risk management sustains long-term future. We forecast NPL in 2019 and 2020 to be stable at the rate of 1.3% based on a very conservative risk management approach. The bank would simultaneously increase LLR in the face of rising NPL as its action in 3Q2018.

MBB is a very attractive long-term investment but corporate action needed. We think that considering fundamentals of MBB solely, MBB is a very attractive long-term investment and should be traded at more than +1stdv from historical means rather than current average P/B of 1.3x. However, with foreign ownership at 20%, MBB still needs to unlock its foreign ownership to attract further interest. We think that the remaining room should be opened to multiple foreign investors rather than one strategic investor to enhance liquidity of MBB for foreign stakeholders.

We also note that the remaining treasury stock purchase has been delayed until late 2019. Thus, there is no share price support in the short term.

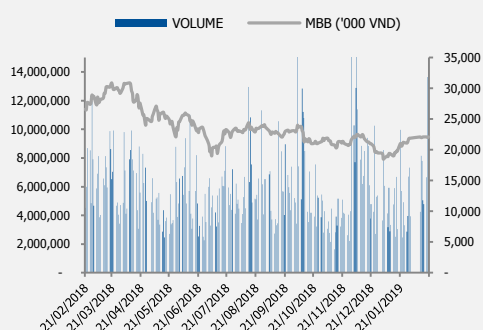
Valuation

We initiate MBB with a BUY recommendation and target price of VND27,500 (+24.4% upside) using weighted average of P/B multiples result (target price (TP) VND25,379, BVPS forecast at 17,847 VND and discounted P/B of 1.42x) and residual income result (TP VND29,698, Re 15.7% and growth rate 2%). Average P/B at the target price is 1.54x.

Unit: VND billion	FY17	FY18	FY19F	FY20F
Operating income	13,867	19,539	22,728	26,352
Pre-provision profit	7,868	10,805	12,728	15,021
Growth y-o-y		37%	18%	18%
Provision expenses	3,252	3,038	2,560	2,982
Growth y-o-y		-7%	-16%	16%
Profit before tax	4,616	7,767	10,168	12,038
Growth y-o-y		68%	31%	18%
Net profit	3,490	6,190	8,134	9,631
Growth y-o-y		77%	31%	18%
EPS (basic) (VND)	1,602	2,865	3,803	4,502
BVPS (VND)	13,039	15,109	16,955	19,388
ROAA	1.2%	1.8%	2.1%	2.2%
ROEA	13.6%	21.4%	24.8%	25.1%
Target P/E		9.5	7.2	6.1
Target P/B		1.81	1.61	1.41
P/E		7.7	5.8	4.9
P/B		1.46	1.30	1.14

Source: MBS Research

Price movement



Source: Bloomberg

Stock performance	1M	3M	12M
MBB (%)	5%	5%	-17%
VNIndex (%)	7%	6%	-11%

Source: Bloomberg

Major Shareholder

Army Industry-Telecommunications Group	12.28%
SCIC	8.19%
Vietnam Helicopter Corporation	6.52%



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Earnings Model & Valuation

We initiate MBB at VND27,500 (24.6% upside) by using P/B multiple and residual income method. In P/B method, we reach the target price of VND25,379 since BVPS is forecast at VND17,847 VND with P/B of 1.42x, weighted average of discounted peers' multiples 1.22x and justified P/B 1.62 to reflect long term potential. In RI method, we reach the target price of VND29,698 at Re 15.7% and sustainable growth g of 2%.

In P/B method, again we assume that valuation P/B of MBB should be below sector average P/B due to consistent discount of more than 30% from average peer over the past 4 years from 2015 to 2018. We believe that although MBB has proven sound fundamentals and diversified subsidiaries, the bank does not stand out for any specific theme within the banking system. Conservative approach over foreign ownership and transformation may lower the expectation over long-term potential of the bank.

In RI method, the stock is given a discount rate of 15.7%, derived from an equity risk premium on Vietnamese market 10.58% and current uplift in Government bond yields of approximate 5.1%. Sustainable growth rate is assumed at 2%.

Figure 1: Valuation Summary

Method	Result	Weight	Contribution
RI	29,698	50%	14,849
P/B	25,379	50%	12,690
Target price (VND)			27,539
Market price (VND)			22,050
Average P/B			1.54

Price as at 20/02/2019

Figure 2: P/B Multiples

Ticker	Mkt Cap (VND bn)	P/E	ROE	P/B
VPB VN	51,960	7.01	22.83%	1.50
ACB VN	37,914	7.38	27.73%	1.80
HDB VN	29,136	15.21	18.88%	2.07
TCB VN	96,331	11.10	21.52%	1.87
BID VN	116,236	14.16	17.41%	2.30
CTG VN	76,702	9.98	11.68%	1.10
VCB VN	219,195	14.52	25.18%	3.33
Average after discount				1.22

Figure 3: Justified P/B Multiples

Justified P/B VPB	
Average 5-yr ROEA (19-22)	24.1%
Cost of equity	15.7%
Growth rate	2.0%
	1.62

Figure 4: RI Valuation Result

	2019F	2020F	2021F	2022F	2023F
<i>Unit: billion VND</i>					
Net profit post welfare reserve	7,849	9,239	10,654	12,158	13,947
Residual value	2,732	3,497	3,743	3,875	4,066
Terminal value					30,325
Cost of equity					15.7%
Growth rate					2.0%
Enterprise value as of 2019					64,160
Share value as of 2019 (VND)					29,698

Notes:

Equity risk premium	10.58%
Beta	1.0
Rf	5.1%
Cost of equity	15.7%
Growth Rate	2.0%

Source: MBS Research

Investment highlights

Undeniable low funding cost advantage and lending portfolio restructuring will strongly support interest income.

We forecast higher improvement in lending rate in 2019 and 2020 by 14 bpts from 7.79% in 2018. NIM is forecast to rise gradually from 4.58% to 4.72% in 2019. Meanwhile, net interest income is forecast to grow at a slower rate 16.9% yoy in 2019 rather than 30% yoy in 2018, given deceleration credit outlook for 2019 (17% in 2018).

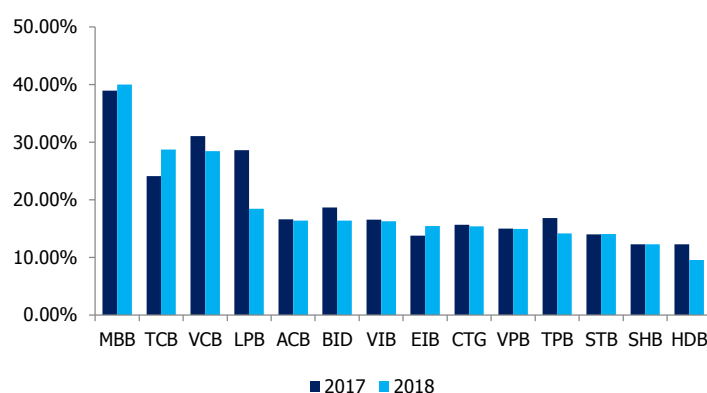
MBB's funding cost belongs to low cost group, comparable to VCB.

We compare the cost base of banks in Vietnam and observed that only VCB and MBB can maintain remarkably low funding cost over the past 5 years. On the other hand, thanks to private bank and consumer finance, lending rate of MBB belongs to medium range, which is comparable to VCB.

Figure 5: Lending and funding cost comparison by banks in 2018

	Cost of fund	Range	Lending rate	Range
VCB	2.81%	Low	5.43%	Low
BID	4.69%	Medium	7.38%	Medium
CTG	5.26%	Medium	7.24%	Medium
TCB	4.06%	Medium	7.63%	Medium
EIB	5.04%	Medium	6.93%	Medium
MBB	3.48%	Low	7.75%	Medium
STB	5.27%	Medium	7.97%	Medium
SHB	6.15%	High	8.25%	Medium
HDB	5.09%	Medium	9.41%	High
LPB	5.69%	Medium	8.61%	Medium
VIB	3.40%	Low	6.12%	Low
ACB	4.83%	Medium	8.13%	Medium
VPB	6.05%	High	14.28%	High
TPB	4.22%	Medium	7.88%	Medium
Med	4.94%		7.81%	
Stdev	1.0%		1.0%	

Figure 6: CASA of Banks



Source: FS Banks, MBS Research

Moreover, lower funding cost of MBB has occurred yearly thanks to consistently improved CASA. The bank currently possesses the highest CASA ratio of 40% in the whole banking system. We strongly value the eco-system that MBB has created, comparable to TCB and VCB. We assume that thanks to new initiatives in digital banking to stimulate number of accounts opened and considerable gap in CASA of MBB and the two top banks, CASA advantage could support MBB to sustain funding cost in 2019 and 2020.

The bank performed well in 2018 to maintain funding cost at 3.48%, comparable to 2017 while other banks have seen this rate rise.

Hence, we forecast only a small increase of 4 bpts in funding cost to 3.52% in 2019 thanks to continuous high level of CASA, unique funding advantages from MB Group and active initiatives in digital banking.

Figure 7: Funding & Lending Cost MBB

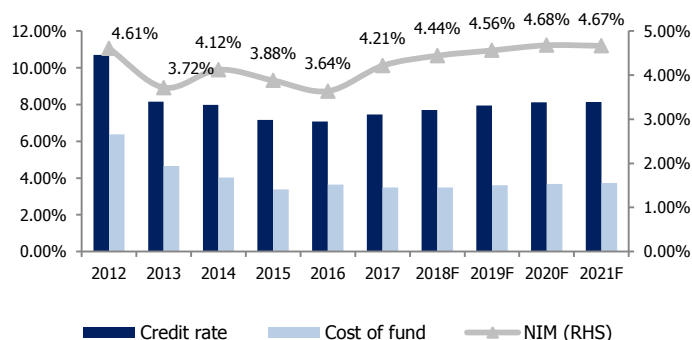
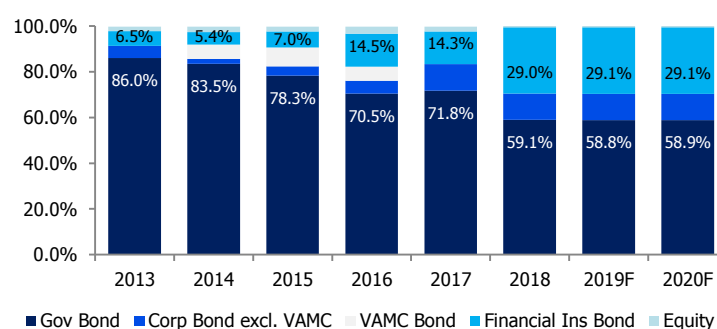


Figure 8: Investment Assets of MBB



Source: FS MBB, MBS Research

On the other hand, value added from consumer finance, higher-yielding investment assets and improved Gov. bond yield would advance lending rate.

Since 2015, the bank has actively restructured its lending portfolio to segments with higher spread, which strengthened lending rate. Total retail lending contribution to total lending portfolio increased consistently over the past 5 years from 2014 to 2018 to 39% (+33% yoy in 2018). Recent initiatives of MBB such as MCredit subsidiaries, launching eMB and MB Fanpage for retail loan disbursement should enhance loan to retail segment further.

Figure 9: Customer Lendings By Types

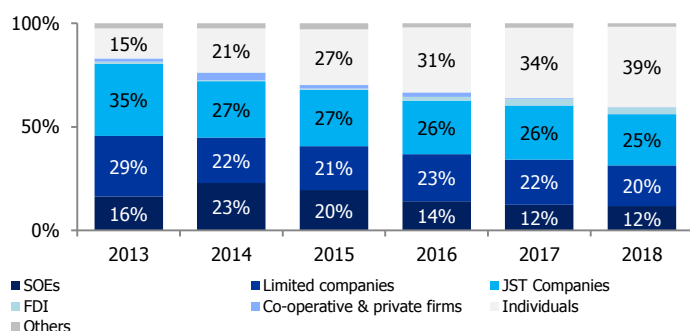
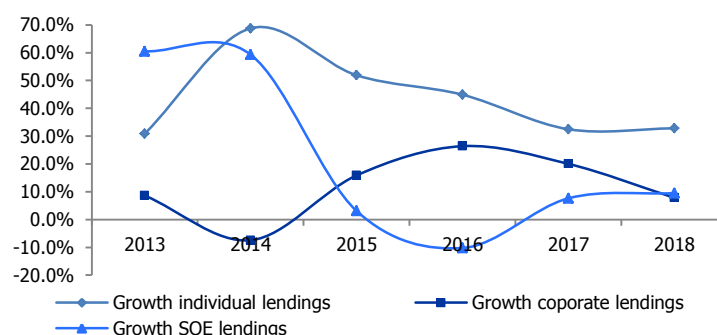


Figure 10: Lendings Growth



Source: FS MBB, MBS Research

Looking at investment portfolio of MBB over the past 3 years, we observe that MBB has been following its proposed investment restructure consistently as indicated by the increase in corporate and financial institution bonds in portfolio. Hence, we project the same growth pace for the two asset types in the upcoming periods 2019 and 2020. Meanwhile, Gov. bond contribution to total portfolio dropped sharply last year to a the level that in our view is relatively low. Bond yield has been gradually improving since 2H2018 and thus we see no reason to decrease total Government bond weight any further.

Diversified income segments of MB Group ramp up non-NII.

Transactional revenue benefited from Fintech transformation

Given the digital strategy from 2017 to 2021 as indicated by MBee new brand recognition, settlement income has seen a robust growth at 33% yoy in 2018. However, for 2019, we do not project a tremendous rise for settlement income compared to the previous two years. We forecast growth of 25% yoy since we observe that digital transformation is a compulsory trend at Vietnamese banks and it is virtually impossible that all more than 20 banks in Vietnam can implement their digital transformation successfully. Competition intensity should squeeze transactional income growth of all banks.

According to Digital Banking Research by JPMorgan in 2018, it would be a challenge for mega banks/ banks with old core system and banks with wait-and-see culture to redesign their old core system to fit the new tech-savvy environment. In the case of MBB, we strongly value the conservative view of the bank in risk management. However, this view also places a hurdle on quick implementation of the bank on operation system transformation.

Long-term profitability of Bancassurance segment should be promising; lingering concern on short-term profit remains.

We see more potential in life insurance segment than non-life segment of MBB. Motor vehicles, hull and P&I segments of MIC non-life insurance saw modest growth of 13% yoy in 2017 and 2018. Insurance Association of Vietnam also forecasts an ambitious performance of life-insurance industry at 25% yoy in 2019. Moreover, as seen in nearby countries (Philippines, Indonesia, Malaysia, Thailand and other developed countries), we observed that higher GDP will enhance insurance penetration rate in that specific country. Hence, given the case of Vietnam with GDP on a rising trend and low life insurance penetration, we place our bet on MBAgeas Life.

Figure 5: Insurance Segment Growth

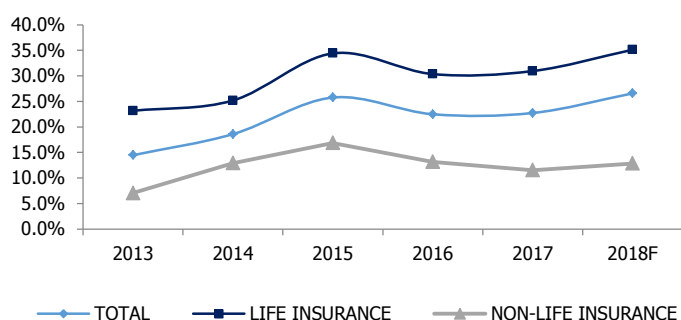
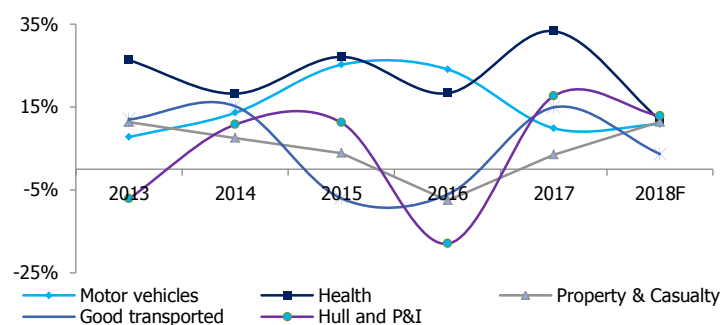


Figure 6: Non-life Insurance Segment Growth



Source: MOF, Insurance Association of Vietnam

Recent exclusive Bancassurance deals between a life-insurance company and a bank have shown the partnered bank initially better off from huge one-off exclusive payment and only record profits from commission paid by the insurance firm. The disadvantage of this type of partnership is that the bank cannot record the whole profit of insurance business compared to long-established insurance companies.

MB Ageas Life (MBAL), on the other hand, cannot expect profit in the first 5-7 years of operation mainly due to high reserves and selling, commission and administrative expenses to build market share at the initial stage. The current joint venture of MBAL includes both agency and banca channel, which allows the company to adapt to different customer's preferences. According to our estimation, MB Ageas contributed more than 40% of insurance revenue of MBB in 2018, only 2 years after establishment. Revenue surged to more than VND 1,000 billion.

As the result, we project a modest growth for non-life insurance revenue of 13%, similar to the previous growth rate in 2018. Meanwhile, we project a robust growth above 50% yoy for life insurance in 2019 and 2020. On the expense side, we keep the projection for technical reserves and claim expenses of MIC and MB Ageas unchanged. Meanwhile, for life-insurance earnings, selling and admin expenses will still be considerably more than 50% of life-insurance revenue and the break-even point in non-life is forecast to be after 2020.

As selling and administrative expense will affect consolidated operating expense of MBB, we expect that CIR of 45% in 2018 will remain in 2019.

Hence, in 2019, we maintain our positive view on the growth rate of net fee and service income at 30%, lower than the robust growth in 2018 of 126% yoy which included the result of extraordinary performance in Bancassurance.

Conservative risk management sustains long-term future.

We forecast NPL in 2019 and 2020 to be stable at the same rate of 1.3% in 2018 based on a very conservative risk management approach of MBB. The bank would simultaneously increase LLR in the face of rising NPL as its action in 3Q2018.

Credit cost rate in 2019 and 2020 resume at 1.2%. We assume that current provision expense over non-performing loan (LLR) of 2018 at 113% and will be maintained approximately 110% in 2019 and 2020.

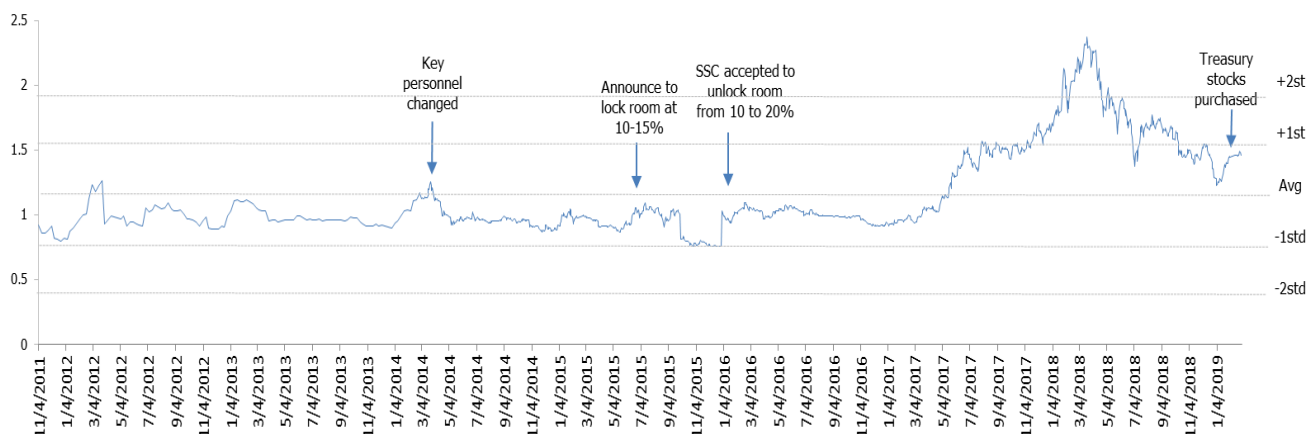
MBB is a very attractive long-term investment but corporate events needed

Following the drop in share price which resulted in adjusted P/B compression of approximately 1 standard deviation from its historical P/B band in late January 2019, we trace back to historical performance and determine that only a major story regarding unlocking of foreign ownership or change in key personnel would support the valuation with a significant jump above 1 standard deviation.

As indicated in Figure 11, there have been 3 periods where the shares have reverted from low band -1 sd to historical average. The first was pre-2014, prior to radical changes in

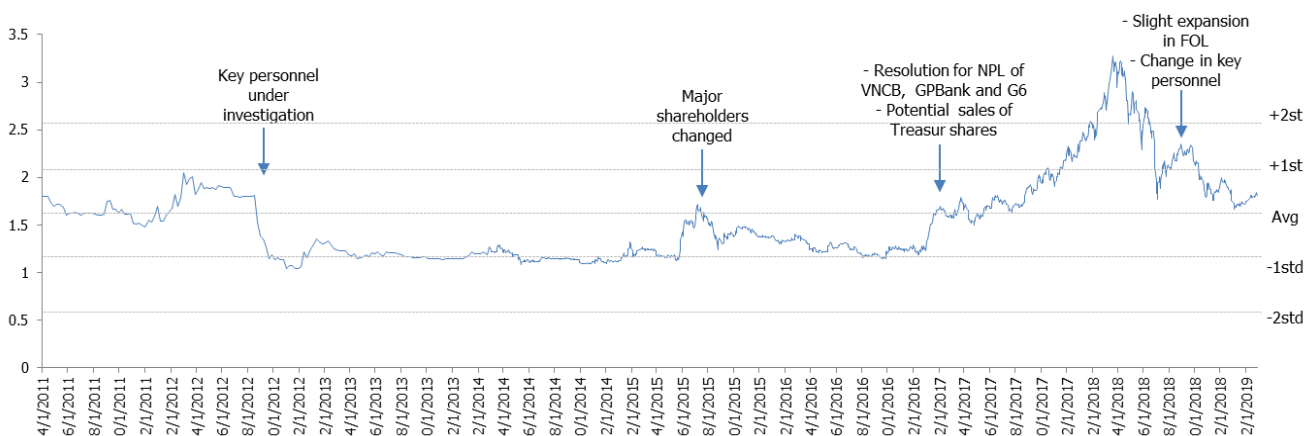
management board, the the remaining two, in pre-2015 and 2016, on both rumors and official approval from SCC to unlock foreign ownership at MBB from 10 to 20%. As the fundamentals of MBB indicating very safe growth was well-known in the market, we assume that after the impressive recovery of banking performance in late 2017 and pre-2018, these same occurrences would support the share price performance to above +1stdv, especially the success of Treasury buy-back and issuance to strategic shareholders.

Figure 11: MBB Price to Adjusted Book Value



Source: Bloomberg, MBS Research

Figure 12: ACB Price to Adjusted Book Value



Source: Bloomberg, MBS Research

Stock performance of MBB shares showed similar patterns with ACB in the period from 2012 to 2015. ACB shares were downgraded remarkably by 1.5 stdv in Sep 2012 following the investigation into key personnel. The shares consistently stood at -1stdv for 3 years til 2015 when new strategic shareholders came in and again in 2016, when the resolution on non-performing loans was passed.

However, foreign-owned limit is locked at 20% and we presume that the chance for MBB to unlock room would be minimal given conservative approach of the bank. Besides, recent treasury stock purchase of 46.81 million shares (as at 27/02/2019) out of total 108 million shares to be purchased (5% total outstanding shares) supported share price already. With the remaining treasury stock purchase delayed till late 2019, there is no near term support on share price.

Overall, we are absolutely positive on the fundamental performance of MBB indicated by very high end on our residual income valuation result of approximately VND 30,000. Yet, that is not enough. MBB still needs an attractive story to sell.

Financial Update

(VND bn)		Q1/2017	Q2/2017	Q3/2017	Q4/2017	Q1/2018	Q2/2018	Q3/2018	Q4/2018	yoy Q4/2017	yoy Q4/2018	yoy FY2017	yoy FY2018
Income/ Expenses	TOTAL OPERATING INCOME	2,902	3,479	3,632	3,855	4,234	4,791	4,799	5,715	26.2%	48.3%	40.7%	40.9%
	Net interest income	2,407	2,732	2,835	3,245	3,293	3,504	3,633	4,154	42.2%	28.0%	40.6%	30.0%
	Non NII	495	747	797	610	940	1,287	1,166	1,562	-20.9%	156.2%	41.1%	87.1%
	OPERATING EXPENSES	1,211	1,324	1,540	1,925	1,623	1,927	1,968	3,216	49.3%	67.0%	43.7%	45.6%
	Profit before credit provisions	1,691	2,155	2,092	1,930	2,611	2,864	2,831	2,500	9.4%	29.5%	38.5%	37.3%
	Credit provisions	579	743	614	1,316	692	953	646	747	45.9%	-43.2%	60.2%	-6.6%
	EBT	1,112	1,412	1,478	614	1,918	1,911	2,185	1,752	-28.8%	185.6%	26.4%	68.3%
		Q1/2017	Q2/2017	Q3/2017	Q4/2017	Q1/2018	Q2/2018	Q3/2018	Q4/2018				
Loan/ Deposit Growth	Customer loan growth	0.4%	14.1%	2.4%	5.3%	5.2%	6.0%	0.0%	5.3%				
	Customer deposit growth	-6.4%	10.7%	4.2%	4.4%	3.1%	3.5%	-1.0%	3.3%				
	NPL	1.3%	1.3%	1.3%	1.2%	1.4%	1.3%	1.6%	1.3%				
	Loan group 2/Total Loan	1.6%	1.4%	1.6%	1.7%	1.8%	1.7%	1.6%	1.7%				
	LLR	100.5%	102.9%	87.0%	95.9%	91.0%	106.2%	106.0%	113.2%				

Source: FS MBB, MBS Research

(*) Growth rate YTD

Pre-tax profit of 2018 maintained increase with a rise of 30%, higher than the increase of 26.4% in 2017, reaching VND7,768 billion, especially non-interest income growth of 87%yoy from fees and charges growth (over 100%) while interest income grew 30% yoy thanks to 17% credit growth and 37 bpts improvement of NIM.

Credit deceleration is a proven trend given the increase in 2018 was of 17% yoy vs. the increase by 22% yoy. In detail, we observed that the bank succeeded in restructuring their lending portfolio to retail lending, in which retail contribution rose by 33% yoy from 34% to 39% in 2018.

NPLs were well managed in 4Q2018 to 1.3% and the reduction in provision expenses this year contributed positively to revenue growth. MBB continues to maintain a prudent risk management perspective with an increase in bad debt coverage of over 100% in 2018.

Financials and Valuation Summary

Income Statement (VND billion)	2018	2019F	2020F
Net interest income	14,583	17,064	19,688
Net fee and commission income	2,564	3,511	3,931
Net gain from trading foreign currencies	445	489	528
Net gain from sales of investment securities	300	412	852
Net other income	1,517	1,223	1,324
Income from investment in other entities	130	29	29
TOTAL OPERATING INCOME	19,539	22,728	26,352
OPERATING EXPENSES	(8,734)	(10,000)	(11,331)
Profit before credit provisions	10,805	12,728	15,021
Credit provisions	(3,038)	(2,560)	(2,982)
Earnings Before Tax	7,767	10,168	12,038
Total income tax expenses	(1,577)	(2,034)	(2,408)
Earnings After Tax	6,190	8,134	9,631
Minority interest	-	(81)	(96)
Net profit	6,190	8,053	9,534

Balance Sheet	2017	2018F	2019F
Cash	1,737	2,048	2,341
Balances with the SBV	10,548	9,708	10,917
Balances with and loans to other credit institutions	45,062	47,257	50,615
Trading securities	578	-	-
Derivatives and other financial assets	36	36	36
Loans and advances to customers	211,475	244,375	281,042
Loans and advances to customers	214,686	247,962	285,157
Allowance	(3,211)	(3,587)	(4,114)
Investment securities	73,834	81,509	88,017
Long-term investments	497	500	499
Fixed assets	2,730	2,832	2,888
Tangible fixed assets	1,586	1,665	1,699
Intangible fixed assets	1,113	1,135	1,158
Investment properties	31	31	31
Other assets	15,865	18,318	19,502
TOTAL ASSET	362,361	406,582	455,858
Amount due to the Government and the SBV	2,633	2,410	2,603
Deposits and borrowings from other credit institutions	60,471	67,137	70,175
Customer deposits	239,964	272,592	310,330
Derivatives and other financial liabilities	11,519	11,596	11,674
Other liabilities	13,601	14,684	15,434
EQUITY	34,173	38,163	45,643
- Charter capital	21,605	21,605	21,605
-Surplus	-	(0)	(0)
-Treasury shares	-	-	-
-Other capital	28	(2,241)	(2,241)
Reserves	3,887	5,268	6,814
Foreign exchange differences	-	-	-
Asset revaluation differences	-	-	-
Retained profits	7,124	11,998	17,913
Minority interest	1,530	1,533	1,553
TOTAL LIABILITIES AND EQUITY	362,361	406,582	455,858

Source: FS MBB, MBS Research

Key ratio	2018	2019F	2020F
Capital Adequacy			
CAR	12.88%	12.62%	0.00%
Total Equity/Total Assets	9%	9%	10%
Total Assets/Total Equity	10.60	10.65	9.99
Asset Quality			
Loan group 3-5	1.2%	1.3%	1.3%
Loan group 2	1.7%	1.7%	1.5%
Provision reserve/Loan group 3-5 (LLR)	95.9%	113.2%	109.6%
Credit cost rate	1.2%	1.5%	1.4%
Liquidity			
LDR	82.2%	83.6%	85.5%
Customer deposit growth	9.0%	13.6%	13.8%
Liquid asset/Total Assets	32.9%	28.6%	27.0%
Liquid asset/Customer deposit	49.7%	42.7%	39.6%
Profitability			
ROA	1.8%	2.1%	2.2%
ROE	21.4%	24.8%	25.1%
NIM	4.6%	4.7%	4.8%
Interest Income/ Operating Income	74.6%	75.1%	74.7%
Operating Expense/ Operating Income	44.7%	44.0%	43.0%
Growth			
Asset growth	15.4%	12.2%	12.1%
Customer loan growth	16.6%	15.5%	15.0%
Customer deposit growth	9.0%	13.6%	13.8%
Profit before provision and tax growth	37.3%	17.8%	18.0%
EBT growth	68.3%	30.9%	18.4%
Valuation			
EPS (basic) (VND)	2,865	4,003	4,739
BVPS (VND)	15,109	17,847	20,408
P/E		6.88	5.81
P/B		1.54	1.35

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Pharmacy, Natural Rubber

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Fisheries

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STOCK RATING: The recommendation is based on the difference between the 12-month target price and the current price:

Rating	When (target price – current price)/ current price
BUY	>=15%
HOLD	From -15% to +15%
SELL	<= -15%

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