JOINT STOCK COMMERCIAL BANK SAI GON – HA NOI (HNX-SHB)

June 24, 2014

INITIAL COVERAGE

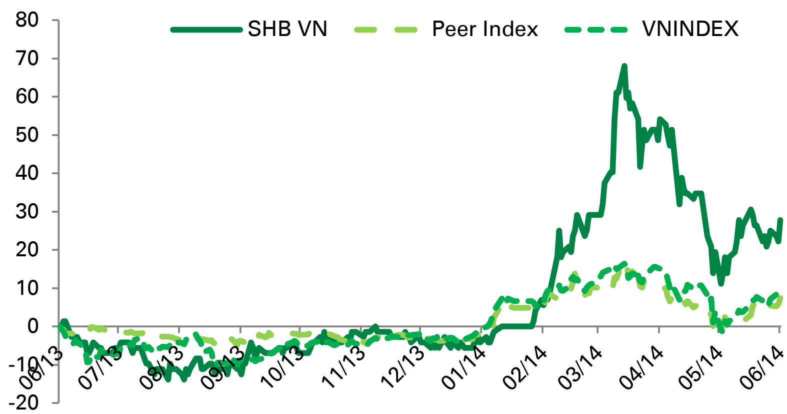
Current Price (6/23/2014):			VND 9,000
Target Price:			VND 9,200
Short Term Trading Recommendation			Hold
Resistance Level			VND 9,300
Support Level			VND8,000
Bloomberg ticker:			**SHB VN**
Exchange:			HNX
Industry:			Banking
Beta:			1.27
52w High / Low (VND'000)			12,200/5.900
Outstanding Shares (mn)			887
Market Cap (VNDbn)			7,979
Free Float (%)			87%
LTM Avg Trading Vol			5,131,219
LTM peers Avg Trading Vol			688,461
Foreign-owned Ratio (%)			9.3%
Year		Div. Rate	EPS
2013		7.5%	959
2012		0%	33
2011		13%	1,745
Ratio	SHB	Peers	VNI
PE	9.8x	14.7x	13.5x
P/B	0.8x	1.2x	1.91x
ROE	8.6%	10.4%	14.4%

Company Description:

– Bank of Sai Gon - Ha Noi (SHB), formerly known as Nhon Ai Rural Joint Stock Bank, was established November 13, 1993 with initial chartered capital of VND400 million.

– SHB provides a full range of commercial banking services and aims to become a leading financial group in its long-term vision.

– The bank currently has chartered capital of VND8,865 billion, total assets of VND143,625 billion, ranking tenth in the banking industry.



We initiate coverage of Saigon-Hanoi Commercial Joint Stock Bank (SHB) with a HOLD recommendation based on the following:

- SHB has been growing aggressively since 2006 and currently ranks tenth in terms of total assets, ranks seventh in terms of network and a credit market share of 2.6% and a deposits market share of 2.4% as of FY2013.
- SHB's non-performing loans, post merger, have been drastically dealt with, however, still remain a tough challenge, at least over the next few years. NPLs and provisions are expected to increase significantly once Circular 02 and Circular 09 come into effect.
- Profitability and efficiency have been declining since the merger and the sustainability of the bank's income is in doubt as provision reversal, a non-recurring source of income, contributed a considerable amount to SHB's total income in 2012 and 2013 and Q1 2014.
- The level of independence of SHB's BOD is another issue that we need to be vigilant about.
- Our residual income valuation and the market multiples approach implies that SHB shares are fairly valued.
- SHB share prices have increased almost 28%, outperforming the peer group (ACB, EIB, STB and MBB) and the VN Index over the past 12 months. Its volatility, however, has been much higher as well, implying a high level of risk.

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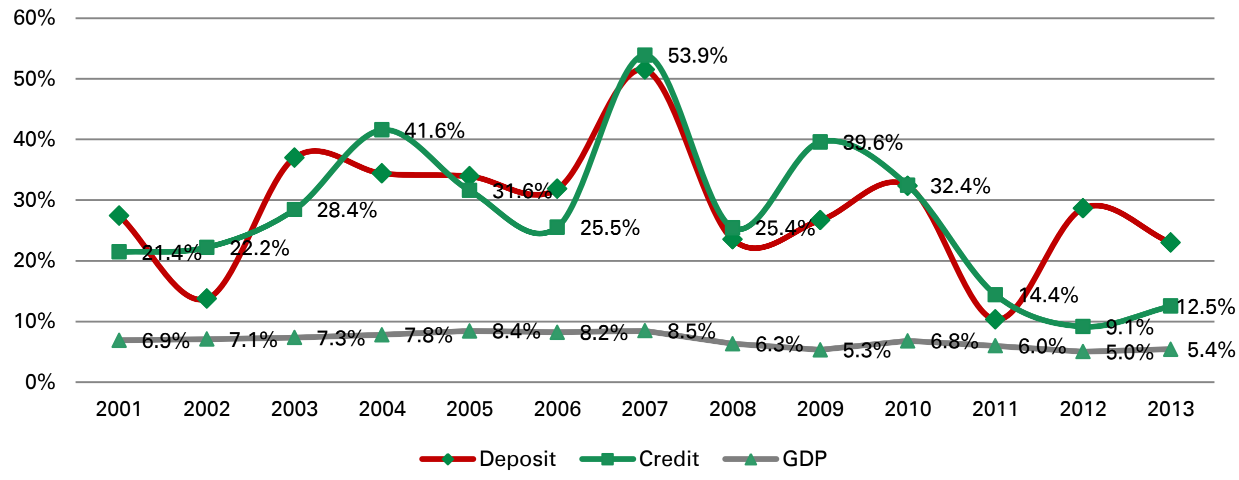
Vietnamese market overview

The banking sector is characterized by a large number of institutions and relatively small size of each. Essentially started in 1990 from a mono-banking system, Vietnam's banking industry has grown tremendously to become a crowded network of banks and non-bank institutions in just 23 years. Currently, there are five state-owned commercial banks (SOCBs), 33 joint-stock commercial banks (JSCBs), four joint-venture banks (JVBs), five 100% foreign owned banks, 100 foreign bank branches and representative office, 18 finance companies, 12 financial lease companies, and almost 1,100 cooperative credit funds.

In terms of assets, Agribank is the largest; in terms of chartered capital, Vietinbank (CTG) is the largest; and in terms of market value it is currently Vietcombank (VCB). Although they have been growing significantly, Vietnamese banks are still rather modest in size compared with regional peers.

Vietnam's banking sector demonstrated impressive growth from 2000 to 2012. For the period 2000 to 2012, the CAGR was 28.87% for deposits and 28.28% for credit. The fastest growth occurred during the period of 2002 to 2007, when the CAGR reached 37.5% and 35.8% for deposit and credit, respectively. The growth reached its peak in 2007 at 51.49% for deposits and 53.89% for credit. The pace of growth over the last three years, however, has declined substantially.

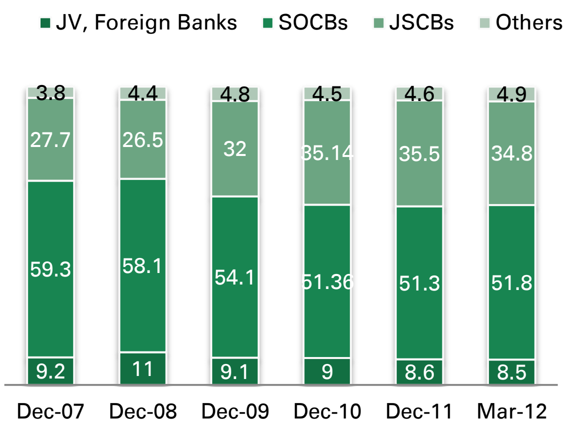
Deposits and Credit Growth 2001-2013

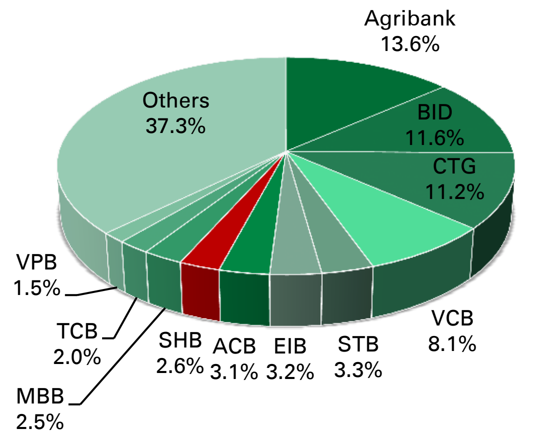


Source: IFS

Vietnam's banking market is both concentrated and fragmented. While the four largest SOCBs enjoyed a huge market share, the remaining JSCBs, foreign banks and other financial institutions had to fight over the remaining piece. However, SOCBs are losing ground year after year to JSCBs. JSCBs have captured more than 15% deposit market share and 7% credit market share from SOCBs over the last five years.

Credit market share (%)	Credit market share 2013

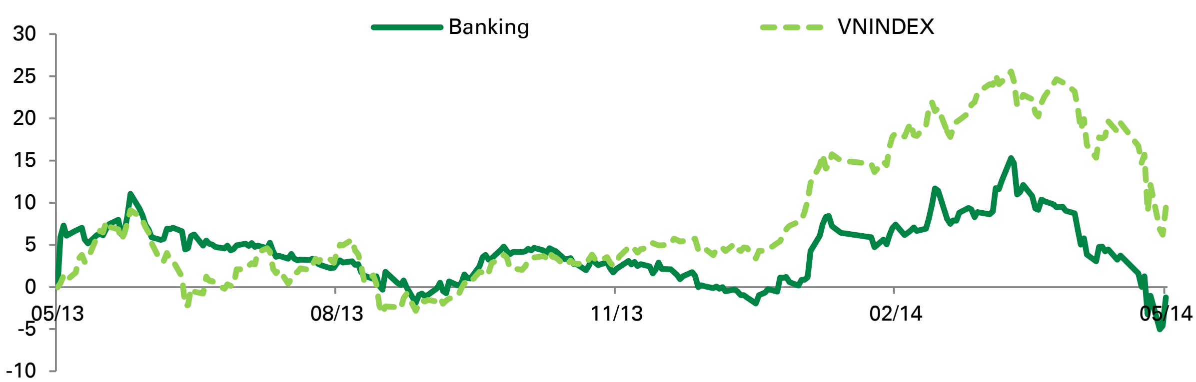




Source: VNEconomy, VPBS

Market outlook

The banking sector continues facing difficulties. The year 2014 is considered a key milestone for Vietnam's Banking sector. With a series of policies taking effect, which impact the operation of the entire system and struggling macro economic conditions, the profitability picture of the banking system has not shown any bright spots. The banking sector has underperformed the VNIndex during the past 12 months, especially from November 2013 till now.



Declining profitability

According to the data recently announced by National Finance Monitoring Committee and the State Bank of Vietnam, by the end of 2013, total assets of the entire banking system increased by 15%, total deposits increased by 23% and total credit increased by 13.17%, compared to previous year. However, the profitability of banks has declined significantly. The rate of return on equity (ROE), on average fell from 15% in 2009 to 6% by the end of 2013. This is the inevitable result of low credit growth, stagnant funding, high provision costs and reduced net interest spreads. This trend is expected to continue, at least in 2014. During the Shareholders'

General Annual Meeting season at the end of April, many investors were disappointed with the modest growth and profit targets of numerous large commercial banks.

ROA and ROE of Vietnamese financial institutions (%)										
Year	2009		2010		2011		2012		2013	
Ratio (%)	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE	ROA	ROE
SOCBs	0.88	19.27	0.92	17.84	1.00	18.01	0.79	7.93	0.67	7.93
JSCBs	1.45	14.94	1.40	15.75	1.22	14.85	0.49	3.60	0.31	3.6
Finance company	0.60	3.81	(1.59)	(11.02)	(0.30)	(2.36)	(0.76)	(22.21)	(2.07)	(22.10)
Financial system	1.12	15.28	1.02	13.39	1.12	14.25	0.62	5.18	0.49	5.18

Source: SBV, NFSC

The risk of bad debt's return

The NPL ratio as reported by credit institutions has fallen sharply in Q4 2013 to 3.61% at the end of the year . Although there is still controversy regarding the reliability of the data from credit institutions' financial reports, the decline in the NPL ratio is the result of a series of measures to reduce NPLs, which have been implemented drastically during the year. However, according to the quarterly financial report Q1 2014 that some banks recently released, bad debt seems to have returned. Loans classified in group 5 of BIDV have increased by over 32% to VND5,561 billion in just three months, ACB's NPL ratio has exceeded the threshold of 3% to reach 3.27%, Dong A Bank's were up to nearly 4%, PG Bank's were over 4%, Sacombank's also increased to 1.86% from the previous 1.45%. According to the SBV's recently released statistics, the NPL ratio of the banking system has increased over two consecutive months, to 3.74% in January and 3.86% in February. The main cause of the problem remains the difficult situation of the economy and businesses. In addition, the return of bad debt is also due to the fact that some potential bad debts were previously "hidden" in groups 1 and 2 to enhance the year end financial statements, which are now forced to move to group 3. Also, some restructured loans under Decision 780 are no longer allowed to extend repayment terms and are forced to move to the bad debts' groups. Furthermore, Circular 09 will take effect from June 1, 2014 and will certainly increase the amount of bad debts reported. Therefore, even though banks are not willing, they must gradually "reveal" a more accurate picture of the actual bad debt situation in order to avoid causing shock to the market and investors.

Regulation updates and their implications

C*ircular 09/2014/TT-NHNN,* revision of Circular 02/2013/TT-NHNN (dated March 18, 2014) added and revised a number of important regulations stipulated in Circular 02. One of the most notable provisions of Circular 09 relating to Decision 780 is additional regulation regarding the restructuring of credit repayment terms of credit institutions and the keeping of the restructured loan in the same group until the end of Q1 2015 with stricter rules. Another important amendment is to allow credit institutions to delay the adjustment of loan classification results according to the classification of the Credit Information Center (CIC) for another six months. These revisions will help banks ease loan classifications and reduce the number of reported NPLs. In the short-term, easing pressures on NPL reporting will help banks extend more credit, make fewer provisions, and thus improve profits. On the other hand, the revisions in Circular 09 will inevitably prolong the banking sector reform, which is very crucial for the long-term prospects of the banking sector.

Decree 01/2014/ND-CP: which took effect from February 20, 2014 allows a strategic foreign investor to own up to 20% in a weak and troubled lender, even more with the prime minister's approval, up from the previous 15%. The foreign capital is hoped to improve banks' financial position, and it is hoped that increased involvement by foreign banks will lead to transfers of technology and experience that will improve the operations of Vietnamese banks.

Resolution No. 15/NQ-CP: The Government issued Resolution No. 15/NQ-CP on promoting equitization and divestment of SOEs. Accordingly, there are many new regulations to make the process much easier than before. The Decree also stipulates measures to encourage state corporations to divest of investments in banks, such as allowing selling prices lower than book value, public offerings of shares in banks, etc.

Circular 13/2010/TT-NHNN revision: the SBV is finalizing a draft of a new Circular to replace Circular 13 regarding prudent ratios of credit institutions activities. This new Circular is expected to reduce cross-ownership, improve the quality of credit institutions' capital, and bring more prudence to the operation of the banking system.

More voluntary mergers

Banking Mergers and Acquisitions (M & A) is becoming increasingly popular. Two years ago, only the weak banks in the mandatory restructuring list of State Bank of Vietnam engaged in this activity, this year the market saw more voluntary mergers and acquisitions. There are a number of motivations for banks to merge, key ones include: the pressure of State Owned Enterprises (SOEs) to divest from banking corporations during the period of 2014-2015 (the typical case Petrolimex divestment from PG Bank); the lack of capital at small banks; the reduction of cross-ownership among banks (Southern bank voluntarily proposed to merge with Sacombank , Mekong Development Bank merged with Maritime Bank) and; the expansion of business activities (SHB intended to merge with a financial company to expand its retail banking activities). In addition to the specific cases mentioned above, a number of other banks such as VCB, MBB, Viet Capital Bank, SeaBank and Viet A Bank also touch upon the possibility of merging with another bank this year. In the context where restructuring pressure is applied to most of the banks, it can be seen that M&A activities in the banking sector will remain vibrant for years to come.

BUSINESS DESCRIPTION

Overview

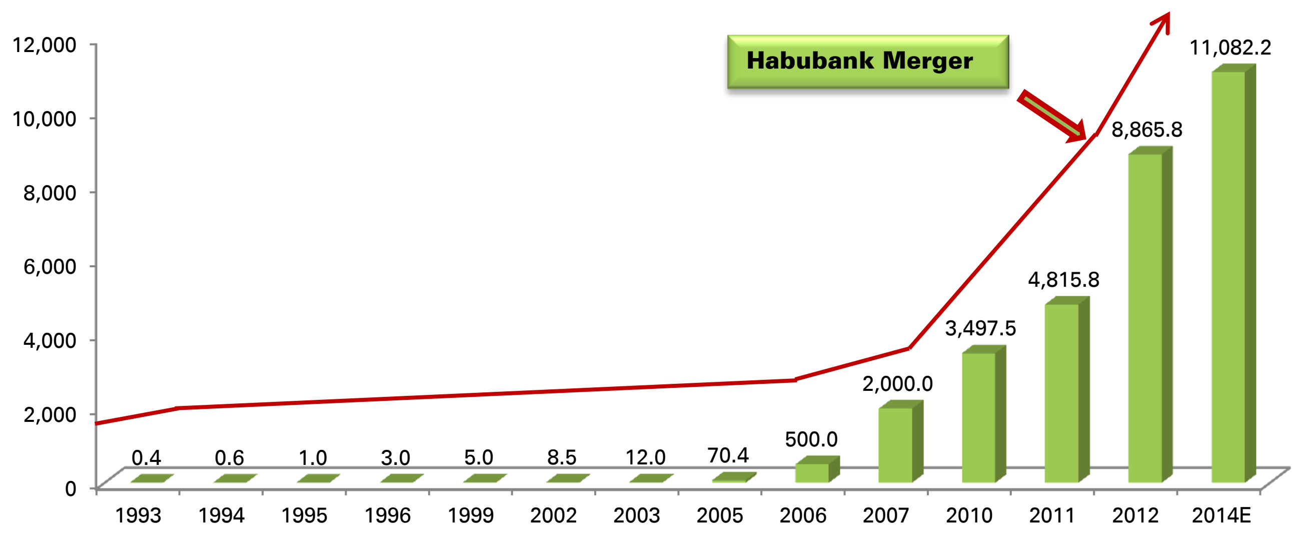
Bank of Sai Gon - Ha Noi (SHB), formerly known as Nhon Ai Rural Joint Stock Bank, was established on November 13, 1993 with initial chartered capital of VND0.4 billion and total assets of VND1.1 billion. The bank initially operated only at its headquarters in Can Tho province with a total staff of eight people. In 2006, T&T Group became the largest shareholder of this small bank, transformed it from a rural bank to an urban commercial bank and renamed it Bank of Sai Gon - Ha Noi (SHB). In 2007, SHB increased its chartered capital from VND500 billion to VND2,000 billion. A year later SHB moved its headquarters from Can Tho to Hanoi, well-positioned for a steep trajectory of its high speed growth period. In 2009, SHB completed its IPO process and officially listed 200 million shares on the Ha Noi Stock Exchange with stock code SHB. The year 2012 is another important milestone in SHB's history of establishment and development. SHB acquired Hanoi Building Commercial Joint Stock Bank (Habubank), following Decision No. 1559/QD-NHNN, increasing its chartered capital from

VND4,816 billion to VND8,866 billion. By expanding its scale, network and competitiveness, SHB successfully joined the top ten largest Commercial Banks in Vietnam.

Year	Major milestones of the Bank
1993	• Established as a rural commercial bank
2006	• Authorized to convert to an urban commercial bank, renamed Sai Gon-Ha Noi Joint Stock Commercial Bank
2007	• Increase of chartered capital from VND500 billion to VND2,000 billion • Vietnam Coal and Mineral Group and Vietnam Rubber Group officially became strategic shareholders and formed a comprehensive strategic partnership with SHB
2008	• Move of Headquarters from Can Tho to Ha Noi
2009	• Successfully listed 200 million shares on the Hanoi Stock Exchange • Recognized as "Best Trade Finance Bank in Vietnam in 2009" awarded by Global Finance Magazine (USA)
2010	• Issued 150 million shares, increased chartered capital to approximately VND3,500 billion • Deployed new Intellect Core Banking System and the new SmartVista Card technology system.
2011	• Converted 1500 billion of convertible bonds issued in 2010, raised chartered capital to VND 4.815,8 billion • Labor Medal Class III presented by the President of Vietnam
2012	• Opening of SHB Representative Office in Cambodia and Laos • Successful acquisition of HBB • Rated A ratings by the State Bank of Vietnam, classified into group I - highest rated group among 4 banking groups
2013	• 20 years anniversary • Labor Medal Class II presented by the President
2014	• Target chartered capital increases to VND 11,082 billion

Source: SHB annual report

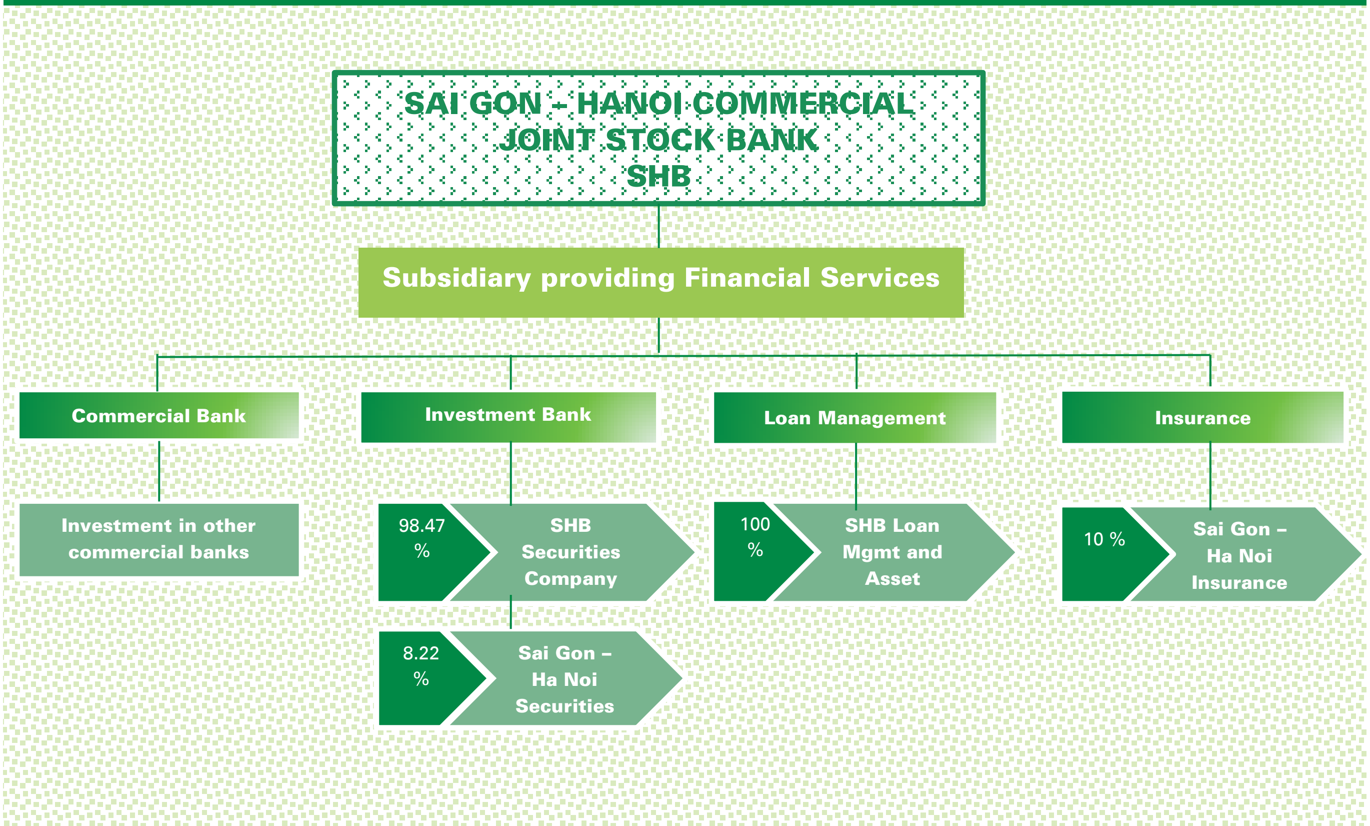
The Process of Increasing Chartered Capital of SHB 1993-2014 (Unit: VND billion)



Source: SHB financial statements

Business Model

Business Model



Source: SHB Annual Report 2013

SHB is currently operating under the business model in which its commercial bank serves as the main business and acts as a holding company for its subsidiaries and affiliates. SHB's main businesses are:

Commercial banking - SHB provides the following services:

- Fund Mobilizing
- Fund lending
- Foreign exchange businesses
- International trade finance
- Discounting commercial papers, bonds and other valuable papers
- International settlement and other banking services

Investment Banking

The bank has a stake in two securities companies. The first one is SHB Securities Joint Stock Company (SHBS), which was taken over from Habubank with the former name of Habubank Securities JSC, and is now 98.47% owned by SHB.

The second securities company is Sai Gon – Ha Noi Securities Joint Stock Company (SHS), established in 2007 from the capital contributions of SHB and its strategic shareholders Vinacomin, Vietnam Rubber Group, T&T Group and other founding shareholders. SHB currently owns 8.22% of SHS. Both securities companies offer services such as brokerage, research, investment banking, underwriting and proprietary trading.

Loan Management

SHB Loan Management and Assets Development One Sole Member Limited Liability Company (SHAMC) is 100% owned by SHB. Its major activities include:

- Receiving and managing non-performing loans and collateral assets related to the loans
- Selling collaterals
- Restructuring outstanding loans
- Handling collaterals loan
- Trading bad loans

Insurance

Sai Gon – Ha Noi Insurance Company (BSH), formerly SHB-Vinacomin Insurance JSC (SVIC) established in 2008 by SHB, Vinacomin, T&T Group and other founding shareholders. BSH provides non-life insurance, reinsurance and other services. The company is currently 10% owned by SHB.

Vision and target

Since 2009, SHB had set its medium-term vision to become a modern multi-functional retail bank by 2015. The long-term vision of SHB is to become a leading financial group by 2020. Particularly, its aim is to become a top 8 bank in Vietnam, a top 3 private-owned bank in Vietnam with large size in all business terms and integrate globally. In realizing this vision, in 2012, SHB successfully acquired Habubank (a bank with a good brand name and medium size) that brought SHB into the top ten largest banks in Vietnam in terms of chartered capital and market share. As of FY2013, SHB rose to the top-five listed largest joint stock commercial banks.

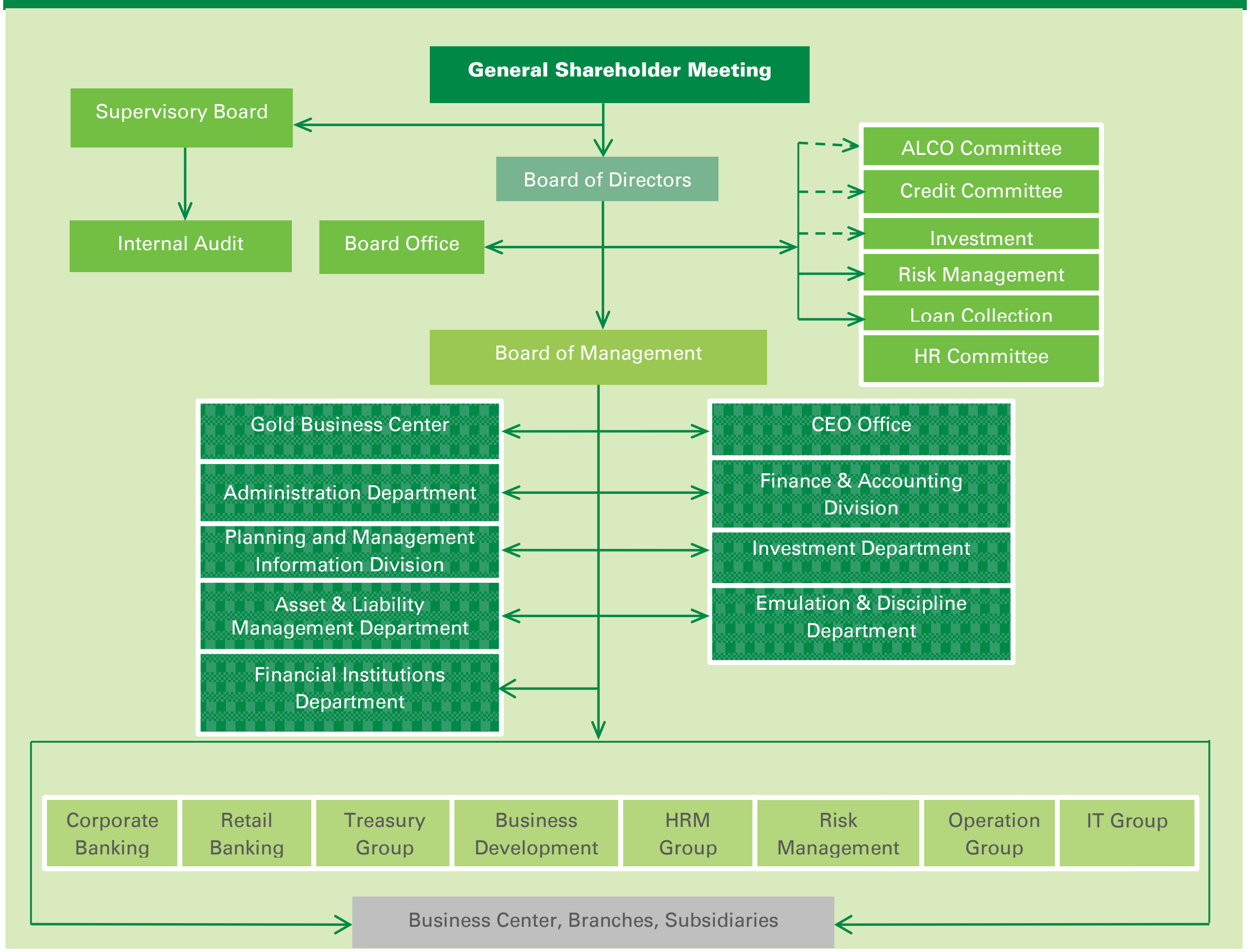
The scope of operation of SHB has been expanding in recent years. Particularly, the investment banking business was developed by taking over Habubank Securities Company (a subsidiary of Habubank) and its investment in SHS. In addition, SHB's investment in the insurance business in Saigon-Hanoi Insurance Corporation (BSH) was also SHB's effort to diversify its income and to become a leading financial group. These subsidiaries and affiliates, however, have not performed very well in recent years, and only marginally contributed to SHB's overall performance.

In order to further develop its retail business, SHB plans to acquire a finance company with strong financial health in 2014 and is in the negotiation process to acquire a potential target (Vinaconex-Viettel Finance JSC). Other than this move, however, we have not seen any particularly compelling strategy given the proportion of individual loans has actually been declining in the last three years and SHB has not managed to stand out in its retail banking products such as personal home loans or personal installment loans in terms of its features.

SHB is also working on its expansion and overseas presence through the opening of branches in Laos and Cambodia in 2012 and it plans to upgrade SHB Laos and SHB Cambodia branches to separate business entities as SHB wholly-owned banks in 2014. Myanmar, Singapore and Europe are the next target for SHB's expansion. Strategic partners who have potential and local know-how to support SHB in its international operations are essential. Overseas expansion has been a common trend within the banking industry for the last few years given global integration trends. As reported by the Foreign Investment Agency - Ministry of Planning and Investment (FIA), as of April 2012, the total number of registered offshore investment projects of the financial sector, banking and insurance Vietnam was 31 projects with a total investment of USD467.8 million (FIA, 2013). Vietcombank and BIDV established representative offices in Singapore and Cambodia, respectively; Sacombank opened branches in Laos and Cambodia, it also upgraded its branch to bank 100% owned by STB in Cambodia (October 2011); Military Bank has also opened a branch in Cambodia. However, the scale and field of operations of these overseas branches are still limited. Given the current situation of SHB, its ambitious expansion plans for new markets might be hard to materialize in the near future as it needs to focus on dealing with NPLs and integration.

Management and shareholder

Organizational Chart



Source: SHB Annual Report 2013

Board of Directors

SHB's Board of Directors consists of seven members, with Mr. Do Quang Hien, the Chairman of T&T Group, who also serves as the Chairman of SHB's BOD. T&T also has two others representatives sitting on SHB's BOD, and the two strategic partners, Vinacomin and VRG, each have one representative. Most of the BOD members are not independent as they also hold important positions on the BOD and the BOM of SHB's subsidiaries, affiliates and strategic partners.

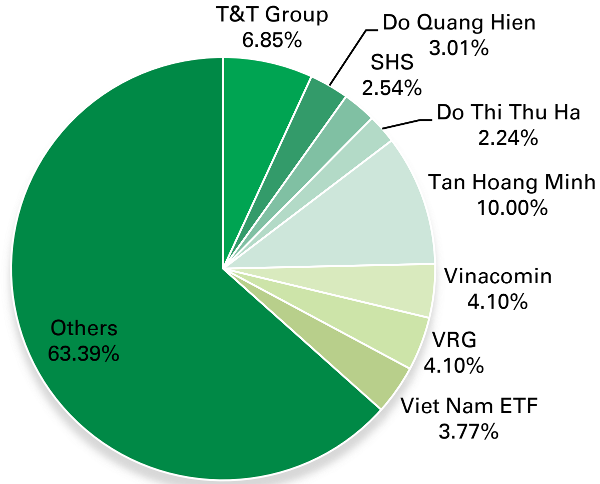
Name	Title	% share holding	Notable experience
Mr. Do Quang Hien	Chairman of BOD	3.010%	SHB's Chairman since 2008. Prior, he was with National Institute of Research and Technology from 1988 to 1993, then left the Institute, found T&T Group Joint Stock Company and served as Chairman of the Group since 1993. Chairman of T&T Ha Giang Mineral Exploitation Processing Joint Stock Co, Sai Gon-Hanoi Investment Fund Management Joint Stock Co, SHB Urban and Industrial Zone Development Joint Stock Co (SHB Land), Svic Insurance Joint Stock Co and Binh An Seafood Joint Stock Co (Bianfishco).
Mr. Nguyen Van Le	CEO, Member of BOD	0.248%	Over 19 years of managerial experience in the banking industry. General Director at SHB since 1998, member of BOD since 2008. Member of the BOD of Nghe An Rubber Investment and Development Joint Stock Co, Sai Gon-Hanoi Investment Fund Management Joint Stock Co, LILAMA-SHB Investment Construction Joint Stock Co and SHB Urban and Industrial Zone Development Joint Stock Co (SHB Land).
Mr. Tran Ngoc LInh	Member	0.218%	Deputy Chief Inspector, Banking Supervision, the SBV.
Mr. Pham Hong Thai	Member of BOD,	-	Member of BOD of SHBS. CFO of Vietnam National Coal – Mineral Industries Group.
Mr. Pham Ngoc Tuan	Member of BOD	-	Member of BOD since 2012. Member of BOM of T&T Urban and Industrial Zone Development Joint Stock Co, SHB Urban and Industrial Zone Development Joint Stock CO and Craft Import Export Joint Stock Co.
Mr. Le Quang Thung	Member of BOD	-	Independent Member of the BOD of SHB. Member of the BOD of Dai Hai Investment and Development JSC. Chairman of Vietnam Rubber Association.
Mr. Do Quang Huy	Member of BOD		Member of the BOD since 2014. Worked for T&T Group since 2004.

Source: SHB annual report

Ownership structure

SHB's current ownership structure is quite dispersed with over 63% of total shares floated and actively traded on the Hanoi Stock Exchange. State ownership takes up to 8.2%, foreign ownership is at 9.3%, the rest belongs to others.

Ownership structure as of December 31, 2013



Source: Bloomberg, VPBS collected

The biggest single shareholder is Tan Hoang Minh group with 10% share holdings. Tan Hoang Minh mainly operates in the field of real estate and focuses on high-end real estate projects. Most of Tan Hoang Minh's projects have been delayed for a while due to a lack of funding and because the high-end segment is still far from recovery.

The strategic partner and shareholder, T&T Group, operates mainly in the field of Industry-Finance-Real estate with current charter capital of VND500 billion. T&T began to invest in SHB in 2006 and became the biggest shareholder of SHB at that time with a 30% stake. As SHB increased its charter capital rapidly since then, although T&T continued to contribute capital, its ownership at SHB has reduced to 22% in 2007 and currently stays at 6.85%. Chairman Do Quang Hien holds only 3.01%. However, the two sisters of the Chairman are also important shareholders of SHB with share holdings of 2.24% and 0.56%, respectively. Mr. Do Quang Hien is also Chairman and CEO of T&T Group, as a result, the total share holdings of Mr. Do Quang Hien and his affiliates is over 15%, making him the most influential shareholder of SHB.

The 8.2% state ownership belongs to the two strategic partners of SHB, which are Vinacomin and VRG. SHB formed comprehensive strategic partnerships with Vietnam Coal and Mineral Group and Vietnam Rubber Group in 2007. According to the agreement, Vinacomin and VRG would transfer most of their transactions, payments and capital to SHB, which help to improve SHB's liquidity. SHB would become the local bank supporting Vinacomin and VRG and their subsidiaries financing large projects. On top of that, Vinacomin, VRG and SHB jointly set up security and insurance companies (SHS and BSH).

To comply with Resolution 15/2014/NQ-CP, regarding divestment in non-core business of SOEs, in 2014, Vinacomin and VRG planned to divest from SHB and SHS. Vinacomin will wait for a reasonable price to sell off its stake in 2014. VRG has also divested from SHS at the end of April and its divestment from SHB is only a matter of time. T&T Group has showed its interest in acquiring these shares.

3.79% of SHB stake belongs to Market Vectors Vietnam ETF and is subject to rebalance. Within only a few months of the beginning of 2014, Vietnam ETF has sold 12.45 million shares of SHB, reducing its stake from 5.17% to only 3.77%.

We have concerns about the complicated relationship between SHB, its shareholders, subsidiaries and affiliates. SHB has likely given substantial amounts of loans to its large shareholders T&T, Tan Hoang Minh, Vinacomin and VRG and their subsidiaries, and these companies also invested in SHB and its subsidiaries – SHS and BHS. Therefore, the independence of the bank's BOD and management may have been compromised. Given that the financial details regarding this issue are not transparently reported, it is hard to fully assess all the potential systemic risks that stem from the cross-holding structure of all parties involved.

BUSINESS PERFORMANCE

In August 2012, the original SHB merged with Habubank (HBB). The post-merger bank has changed not only in size but also in overall performance. We will hereby review HBB's condition before the merger and the SHB-HBB merger in order to have a better assessment of SHB's prospects after the merger.

HBB – alarming NPLs vanquished a once successful bank

Habubank was the first JSCB established in 1989 with initial chartered capital of only VND5 billion. During its 24 years of operations, Habubank had emerged as one of the well-known and strong JSCBs, until 2011.

The problem with Habubank was its concentrated customer loans portfolio. Habubank mainly granted loans to sectors such as ship-building, paper making, construction materials, and fisheries and the loans given to the largest 50 customers accounted for 65% of its outstanding loans portfolio. Therefore, Habubank only needed a handful of bad debts to become insolvent. Vinashin, among others, mainly contributed to the failure of Habubank.

Vinashin had been a major shareholder of Habubank and held more than 10% of Habubank's stake in FY2007 which decreased to 6% as of FY2009. With Vinashin considered its "back yard" corporation, Habubank extended a huge amount of credit to Vinashin. As of FY2011, on top of VND2,745 billion of loans, Habubank also held VND600 billion out of VND3,500 billion corporate bonds issued by Vinashin in 2007. These bond issuances were arranged by Habubank Securities (a subsidiary of Habubank). Thus, the total amount of credit granted for Vinashin was VND3,345 billion, which was equivalent to 83% of Habubank's chartered capital. This was clearly a violation of Circular 13/TT-NHNN and the revision Circular 19/TT-NHNN, which stipulated that total loans to a customer cannot exceed 15% of a credit institution's chartered capital. As Vinashin's loans turned sour, both profitability and liquidity, and eventually the very solvency of Habubank devolved into critical danger.

Due to the recession of the economy, other key customers of HBB also faced difficulties in repaying loans, such as Bianfishco, Tien Dat paper, etc. All this naturally reflects, however, the fact that HBB's risk management practices had been inconsistent and rather feeble.

As Habubank failed to keep abreast with the growth of its aggressive competitors during the last several years prior to the merger, the bank somehow lost both its competitiveness and market share. Once a very profitable bank with ROE maintained at 25% to 30%, HBB then faced severe pressure to satisfy its shareholders, which led the bank to engage in high-risk transactions, such as trading stocks, placing deposits at other credit institutions at "negotiated" interest rates. These latent risks eventually turned into real and substantial losses to HBB as their interbank deposits at Rubber Finance Company (VND270 billion), Global Petro Bank and Ficombank (VND200 billion), Song Da Finance Company, and Handico Finance Company became non-withdrawable.

It was heard through the grapevine that SHB was not the first bank to approach Habubank about a possible M&A. Four banks before SHB had each walked away shaking their heads in disapproval, acknowledging how desperate the situation was at Habubank. Below are some important financial indicators that came out of the special assessment report just prior to the merger. The distressed numbers were truly red flags and required both extreme measures and an immediate solution.

Indicator	Special assessment for the highest level of risk on Feb 9, 2012
Total assets	33,307
Liabilities	33,112
Equity	195.3
NPL ratio	32.06%
Provision	(2,622)
Profit before tax	(4,197)

Unit: VND billion
Source: Habubank

SHB – HBB merger

A draft merger plan was added to the meeting agenda of both banks' annual general meeting that was submitted in April 2012 to seek shareholders' approval in May 2012 and later the SBV's. In June 2012, the merger of SHB and HBB entered stage two of a three-stage process. SBV approved the merger in principle and SHB simply needed to wait for the State Securities Commission (SSC) to approve additional shares issuance. After seven months, the deal was completed in a transparent manner. On August 28, 2012, the Habubank brand name was officially withdrawn from the market. The merger of SHB and HBB, no doubt, has increased the competitive heat in the banking market as it happened at a time when M&A activities were at peak and between two banks that were both listed.

This merger holds the distinction of being the first successful voluntary merger deal between two listed banks in Vietnam's banking industry. During the negotiation process, the two banks agreed to merge and would co-operate post merger as a larger and more competitive entity. However, the Chairman of HBB was, in fact, immediately let go after the merger; the CEO of HBB was assigned to the Deputy CEO position for less than two months before she was unceremoniously demoted and transferred to the Asset and Liability Management Department. The BOD of SHB remained the same without adding any additional members from HBB's BOD. Ultimately, however, the manner in which the former CEO of HBB was treated brought an undesirable decrease in the morale of HBB's former employees and an undesirable increase in the amount of negative media coverage.

Regardless of the above management changes, the merger has certainly benefited both sides. The troubled lender HBB avoided its risk of collapse due to its actual substantial losses of over VND4,197 billion and its huge bad debts of nearly VND5.566 billion. For SHB, the merger helped the bank almost double in size in just seven months with reasonable acquisition costs compared with the option of growing organically, which would have taken at least five years and substantial sums of investment. SHB has increased its chartered capital from VND4.8 trillion to VND8.9 trillion, its total assets from over VND70 trillion to approximately VND120 trillion and successfully joined the top ten largest commercial banks in Vietnam with greater market share. The merger has transformed SHB into a stronger financial institution with a stronger brand name and a wider network. On the other hand, the NPL ratio of SHB climbed to 12.88% immediately after the merger due to HBB's high NPL ratio of more than 16%. In July 2012, SHB's credit outlook was downgraded by Moody's as the company's future is rife with uncertainties. Below are some key financial indicators of SHB and HBB just prior to the merger.

Indicator	February 29, 2012 Audited Financial Statement		
	SHB	HBB	SHB + HBB
Deposits	39,312	21,210	60,522
Credits	28,958	16,208	45,166
Charter capital	4,816	4,050	8,866
Equity	5,928	2,430	8,358
Total Assets	66,571	35,544	102,115
Total Employees	2.595	1.783	4.378
Branches & Transaction Points	158	81	239

Unit: VND billion *Source: Habubank, Sai Gon – Ha Noi Bank*

The SHB - HBB merger was also the first equity swap merger in Vietnam's banking sector. HBB's shareholders were entitled to make a share swap in return for 0.75 SHB's share, and SHB's shareholders received an additional 0.21 of one SHB share for each share already being held. The details of the charter capital's ownership before and after the merger were:

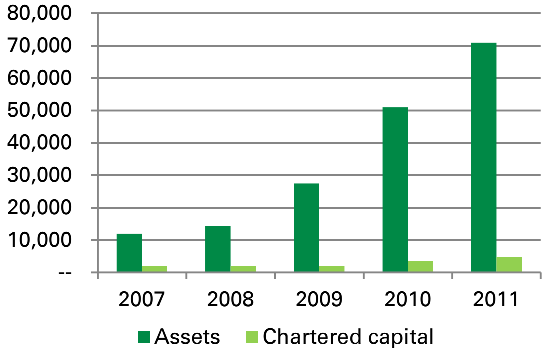
	Before merger	After merger
SHB	4,816	5,828
HBB	4,050	3,038
Total	8,866	8,866

Source: SHB-HBB merger plan

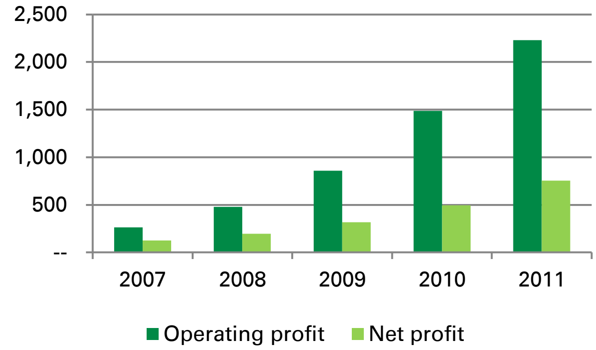
SHB – before and after the merger

SHB had grown tremendously after transforming from a rural joint stock bank to a joint stock commercial bank in 2006 and increased chartered capital from over VND70 billion in 2005 to VND500 billion in 2006 and VND2,000 billion in 2007. The CAGR of total assets and chartered capital from 2007 to 2011 was 56% and 25%, respectively; and the operating profit (revenue) and net profit grew at a CAGR of 71% and 56%, respectively, during this same period. Although growing quite aggressively, the quality of assets at SHB prior to 2012 was considered rather good with an NPL ratio at only 2.23%, well below the industry average of 3.39%, as of FY2011.

Total assets and Chartered capital (VND bn)



Operating profit and Net profit (VND bn)



Source: SHB financial statement

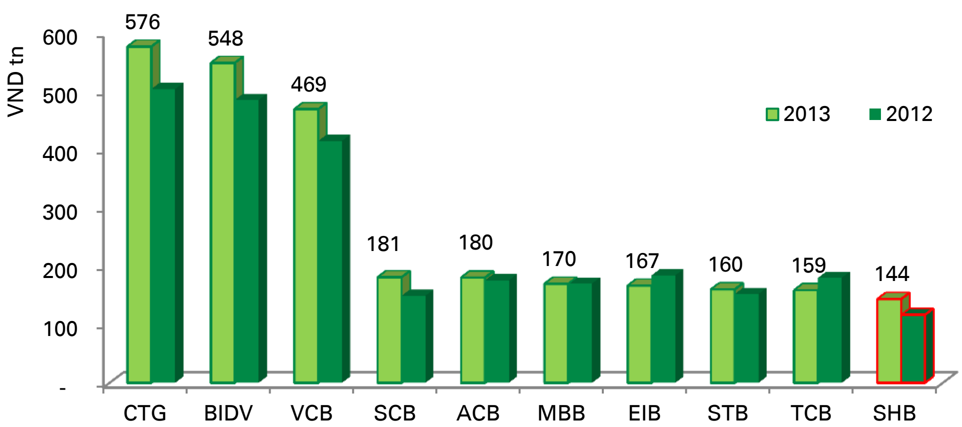
The growth and the overall level of efficiency and profitability, however, have declined since the merger. This weakening performance partly followed the general trend of the banking sector since 2011 and was partly due to the challenges that usually occur after any merger, and even more so in this case given the target bank, HBB, was in such dire straits before the merger.

In this report, we will focus more of our analysis on the performance of SHB after the merger, which we believe more relevant to the forecast of SHB's future performance.

1. Balance Sheet

SHB ranked tenth among all joint stock commercial banks (including state owned commercial banks) in terms of total assets as of FY2013. From a small rural joint stock bank to a large joint stock commercial bank, SHB has certainly come a long way.

Top 10 commercial banks in total assets 2012-2013

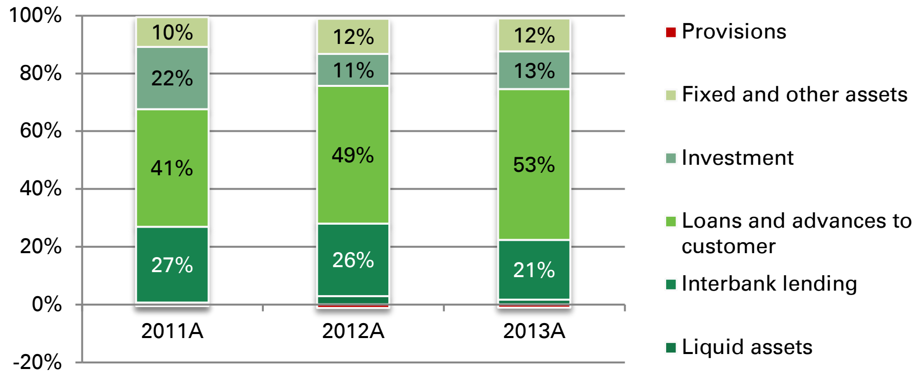


Source: banks financial statements

In 2012, the year of the merger, total assets of SHB increased by over 64% and in 2013, the overall growth of total assets was 23%. Compared with the 11.34% growth of the banking system in 2013, SHB's results were quite impressive.

SHB's assets structure has changed slightly after the merger with a growing portion of total assets in loans and advances to customers and a smaller portion of total assets in interbank lending and its investment portfolio.

SHB's Assets breakdown 2012-2013

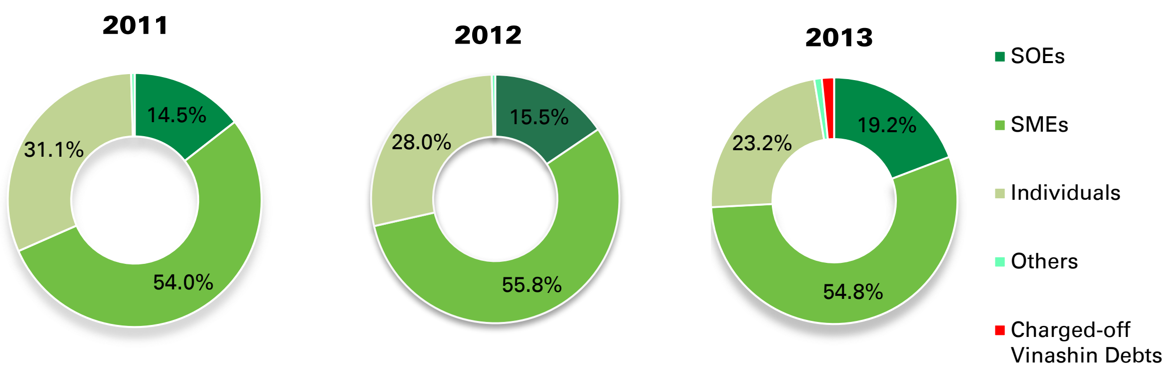


Source: SHB financial statements

- *Customer loans:*

In the past, SHB has achieved very impressive credit growth, well above the industry average. From 2008 to 2010 the growth rate was around 100% each year. After a slower year in 2011 with a growth rate of 20%, in 2012 credit grew 95% as HBB merged with SHB. Despite the sluggish credit growth of 12.61% of the banking system in 2013, SHB managed to grow its loans portfolio 34%. This exceptional growth was partly attributable to the incentives that SHB received from the SBV after the merger, which included a higher credit limit growth compared to most of its peers. The customer loans portion increased from 41% to 53% from 2011 to 2013. This proportion was more in line with the industry's assets composition, which was 55% as of FY2013.

SHB's loans breakdown by customers

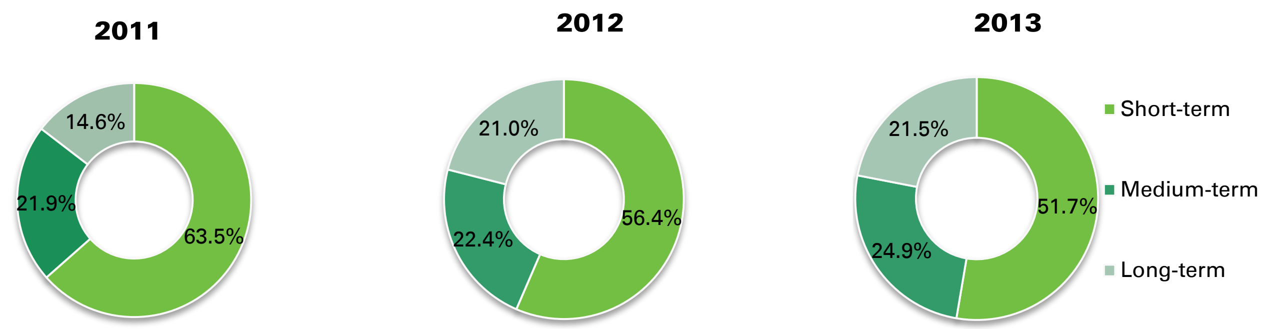


Source: SHB financial statement

SHB's loans breakdown by customers showed that the structure of loans has changed since the merger. The portion of loans given to the SOEs increased from 14.5% in 2011 to 19.2% in 2013. If we include 1.6% of charged-off Vinashin debts, the total portion of SOE debts will account for 20.8%. SHB's SOE loan portions were relatively similar to that of the industry average, which was about 18%. The portion of loans to individuals, on the other hand, declined from 31.1% in 2011 to 23.2% in 2013. This decline, however, is not in line with SHB's current strategy to become a leader in the retail banking segment.

In 2013, we saw that SOE loans grew almost 66.3%, much higher than the 34.4% overall credit growth of SHB. The main reasons for this contradictory movement was that SHB had provided financing for many vital infrastructure projects such as the Highway 1 Expansion Project, the construction of New Dong Nai Bridge, the construction of Nga Ba Hue Intersection for its long-term strategic SOE customers such as CC1, CIENCO 4, UDIC and Trung Nam Group. As these infrastructure projects are mostly funded by the government's budget and the strategic SOE customers are well-known and profitable, it is unlikely that these SOEs will have problem repaying the loans.

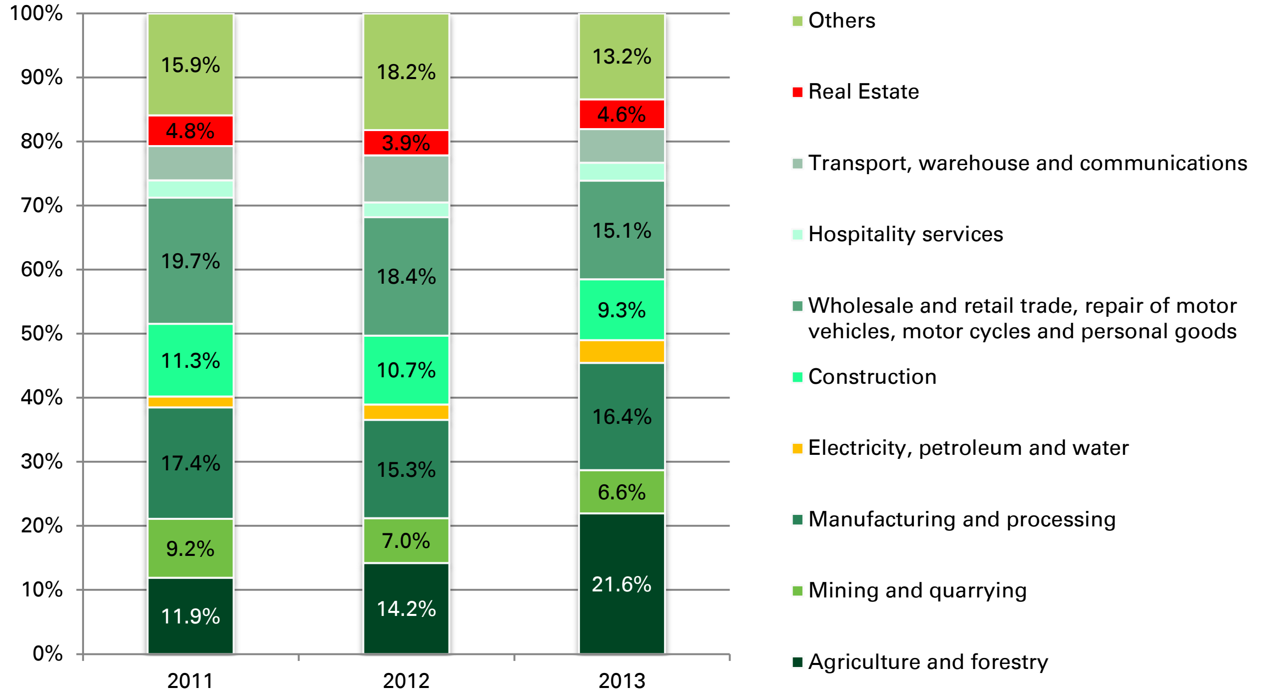
SHB's loans breakdown by terms



Source: SHB financial statement

The duration of SHB's loan portfolio has been lengthened over time as the portion of short-term loans decreased from 63.5% in 2011 to 51.7% in 2013, while the portion of long-term loans increased from 14.6% to 21.5% and midterm's increased from 21.9% to 24.9% during the same period. This is actually opposite of the overall trend of the banking system. Compared with MBB, SHB has a much smaller portion of short-term loans and a fairly larger portion of medium-term and long-term loans. This term structure helps SHB earn higher-than-average interest rates as long-term loans usually require higher margins. As long as SHB can maintain the "short-term funding used for medium-term and long-term ratio" at less than 30%, we think that having a longer-than-average loans duration is actually beneficial for the bank.

SHB's loans breakdown by sectors



Source: SHB financial statements

SHB had a much higher portion of loans in agriculture, forestry and fisheries sectors (21.6%) compared to the banking system average (10.5%) as of FY2013. In recent years, agriculture and rural development were given priority to access bank loans while tightened monetary policies have been kept in place for the non-production sector. In addition, the SBV has provided better monetary policies to support banks and give incentives in regards to mandatory reserves or refinance when the banks extended loans to these areas. This explains why SHB's loan composition in these sectors significantly increased in 2013.

On the other hand, SHB had a lower proportion of real estate loans (4.6%) compared to the banking system average (7.5%) as of FY2013. This is likely to change in the next few years as SHB just recently signed a strategic partnership agreement with Tan Hoang Minh, a large shareholder of SHB (holding more than a 10% stake in SHB), in which SHB agreed to provide financing for one of Tan Hoang Minh's project (VND 1,000 billion) and also loans for this project's customer at favorable interest rates. This agreement was signed on May 9, 2014, less than one month after this large shareholder "suggested" SHB's BOD increase their lending to the real estate sector during SHB's annual general meeting. Not only do we consider this a red flag in terms of SHB's corporate governance practice, but we are also concerned about the loan quality as Tan Hoang Minh targets the high-end real estate segment and this segment is still far from recovery. In addition, SHB also increased the number of loans extended to the real estate and construction sector by signing strategic partnerships with UDIC and participating in a credit package (led by the SBV) linking four parties (real estate developer, contractor, supplier, and end-user).

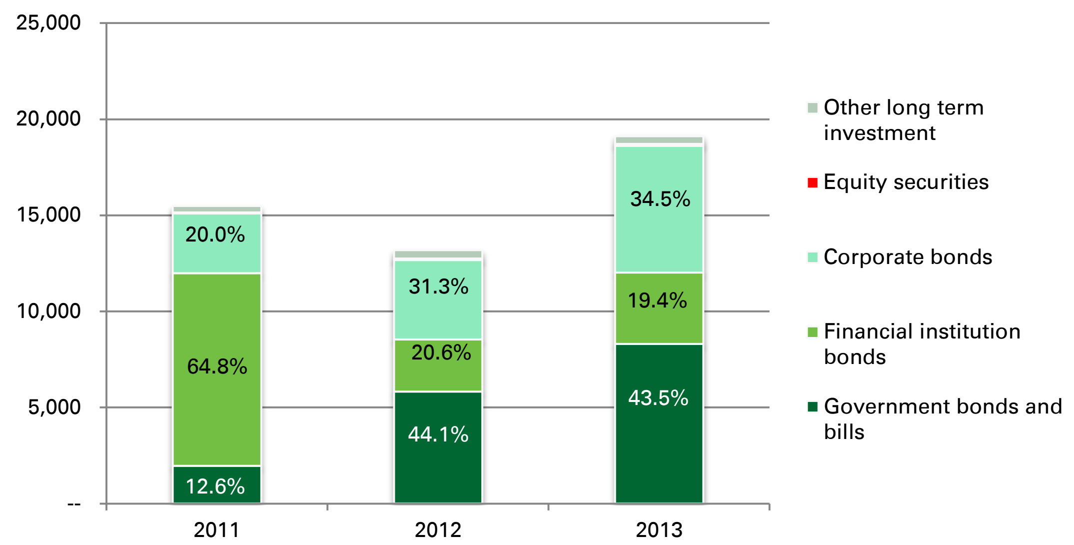
- *Interbank lending:*

The interbank lending balance marginally grew 1% from 2012 to 2013, and as the result the portion of interbank lending decreased from 26% in 2012 to only 21% in 2013. This ratio was still considerably higher than the industry average of 14% as of FY2013. The introduction of Circular 21/2012/TT-NHNN with more restrictive rules governed and reorganized the operation of the interbank market, making it more structured and less profitable. We believe that SHB's interbank lending portion of assets will further reduced to the industry level.

- *Investment:*

The investment portfolio is largely composed of debt securities while investment in equity securities, subsidiaries and other long-term investments were insignificant. Overall, the portion of investment portfolio to total assets decreased from 22% in 2011 to only 11% in 2012 and 13% in 2013. In terms of absolute value, the size of the investment portfolio also declined in 2012 as a result of a sharp reduction in financial institution bonds. This reduction was also caused by Circular 21 on interbank activities because financial institution bonds are essentially the same as interbank loans.

Investments (VND billion)



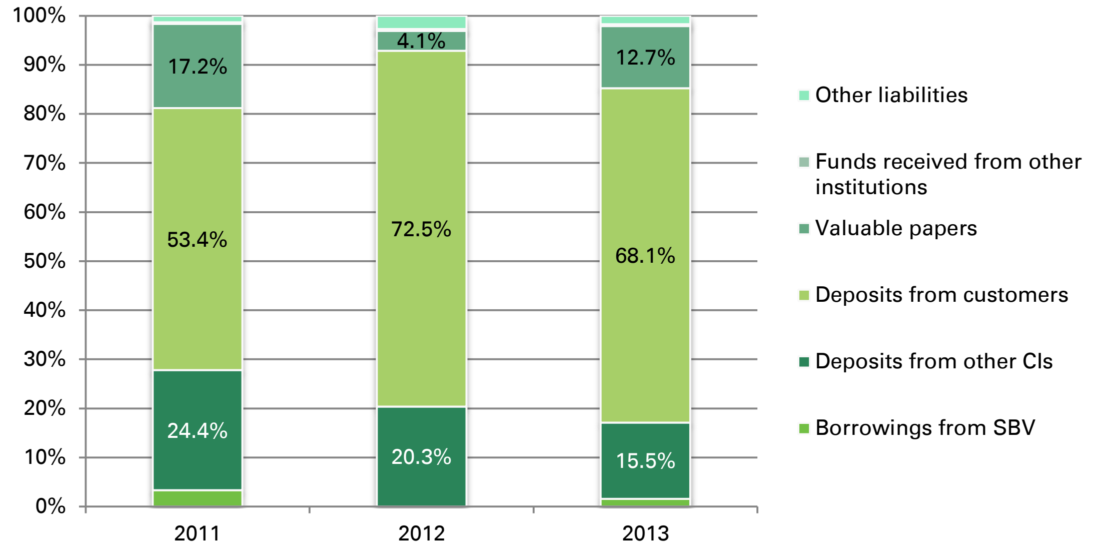
Source: SHB financial statements

The soaring of SHB's government bonds portfolio in 2012 and 2013 resulted from the combined effects of the substantial decline in the whole interbank market and the dull growth of customer loans. The interest earned from debt investment was quite high and stable over time even though it tended to be higher in the past. A high balance of government bonds could also help SHB to flexibly adjust its liquidity position by participating in the open market operation (OMO) when needed.

Liabilities

SHB's liabilities composition has changed quite a bit in the last three years with an overall trend of increasing customer deposits, declining interbank borrowing, and the amount of fluctuating valuable paper issued.

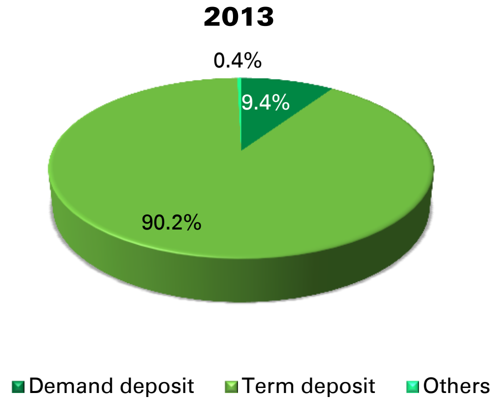
Liabilities composition in 2011-2013



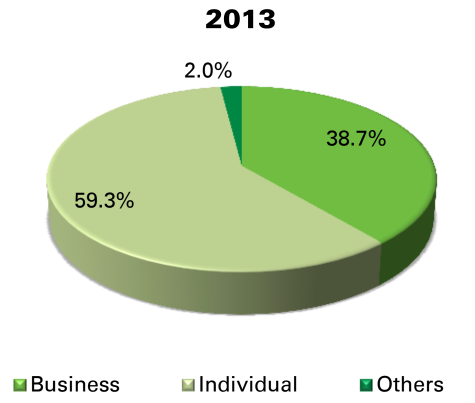
Source: SHB financial statements

The main sources of funding were customer deposits, which accounted for 72.5% and 68.1% of total liabilities in 2012 and 2013, respectively. Customer deposits out of total liabilities was slightly lower than the industry average of 73.71% in 2013. Customer deposits grew at a moderate rate of 17% in 2013, while the average industry deposits growth was 22%.

SHB's deposits breakdown by terms



SHB's deposits breakdown by customers



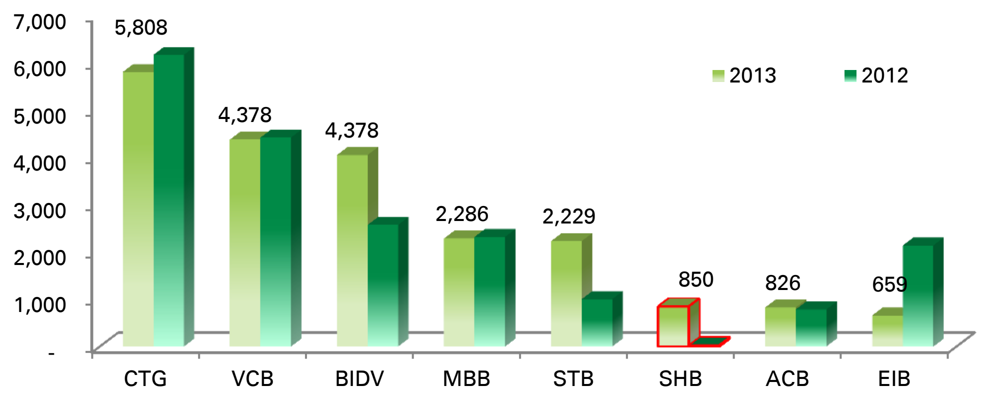
Source: Financial Statements

Deposits breakdown by customer group showed that SHB's individual deposit proportion has fallen back to 59.3% in 2013 from 68.4% in 2012 and was lower than the industry average of 66%. This change in composition was the result of a much faster 54% growth rate of business deposits while deposits from individual merely stayed the same in 2013. This also led to a change in breakdown of deposits by terms, where we observed a much faster growth of demand deposits (41%) than term deposits, which helped to cut down its paying rates as the result.

2. Income Statement

As mentioned earlier, prior to the merger, SHB's net income grew impressively at a CAGR of 56% from 2007 to 2011, and reached VND682.4 billion as of FY2011. Its net income in 2012, however, almost crashed to zero after having to carry a huge accumulated loss of VND1,661 billion from HBB. In 2013, with tremendous effort dedicated to solving NPLs, together with achieving a lower NPL ratio, SHB also recognized a substantial amount of provision reversal, which contributed to its net income of VND850 billion and brought SHB back into the fold of top ten commercial banks in terms of net income.

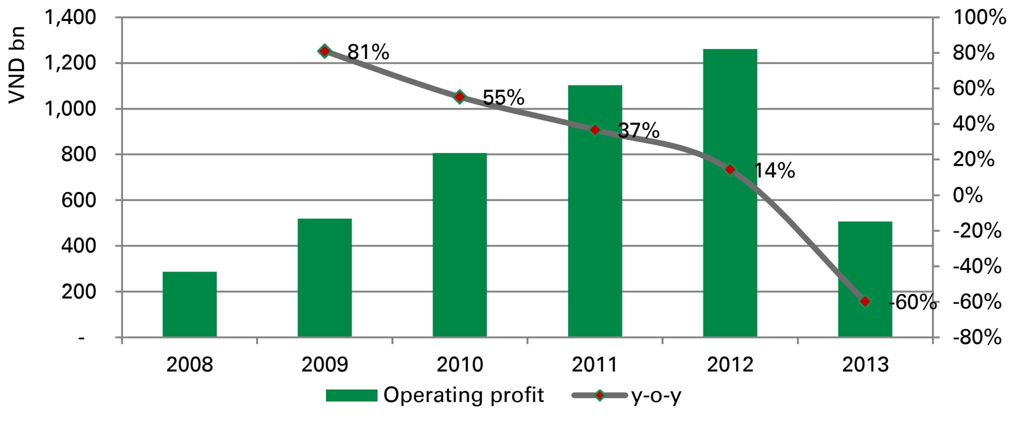
Top ten commercial banks in Net income (VND billion)



Source: SHB financial statements

In order to assess the level of on-going income without the distortion caused by abnormal factors such as HBB's losses or provision reversal, we take a closer look at the operating income of SHB over the last five years. And it is self-evident in the graph below that SHB's operating income growth has been declining since 2008 to 2012 and operating income actually dropped 60% in 2013.

SHB's operating income



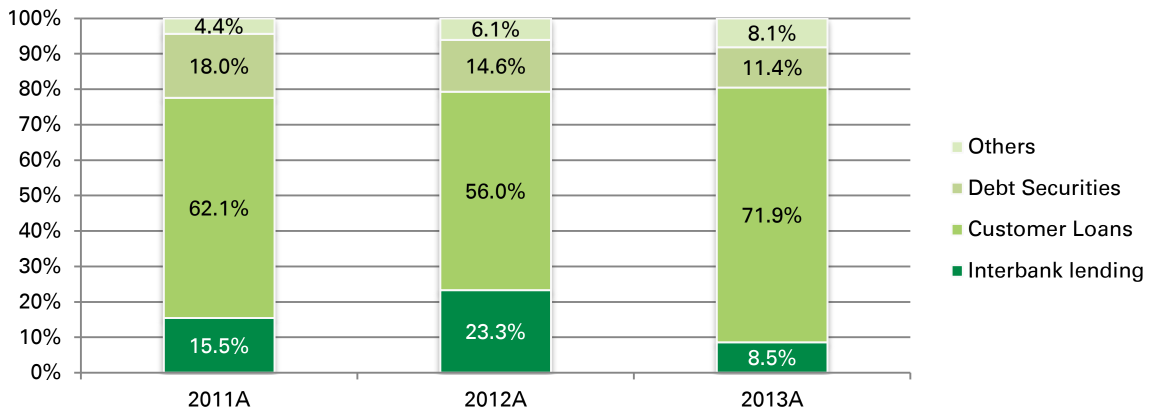
Source: SHB financial statements

Like most of its peers, the majority of SHB's operating income comes from interest income. Compared with the average income structure of the banking industry, of which 85% is interest income and 15% is non-interest income, SHB had a more diversified revenue structure in 2012 with 64% from interest income and 36% derived from non-interest income. However, as of FY2013, its operating income mainly comes from net interest income, with 89%, and the remaining 11% was from non-interest income.

- *Interest Income:*

Interest income grew impressively until 2011 then decreased in 2012 (-1.2%) and grew modestly in 2013 (12.2%) mainly due to the movement of market rates. While customer loans accounted for 46%, 56%, and 60% of total earning assets, they contributed higher proportions to SHB's interest income, which was 62%, 56%, and 72% in 2011, 2012, and 2013, respectively. The portion of interest income from interbank lending decreased drastically from 23.3% in 2012 to only 8.5% while interbank lending still counted for 24% of total assets in 2013. As mentioned previously, this is the effect Circular 21 had on the interbank market which reduced both volume and interest rates in the market.

SHB's Interest Income structure



Source: SHB financial statements

- *Earning and paying rates:*

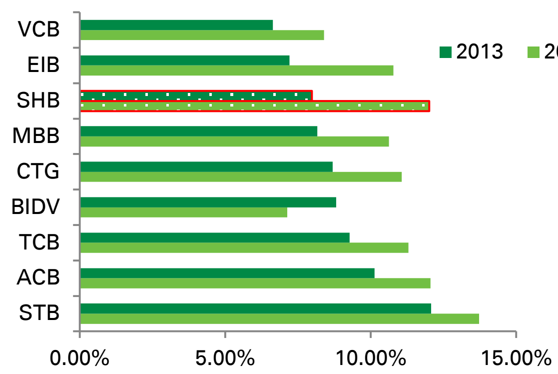
Both SHB's earning and paying rates have declined since 2011 following the market trend, however, earning rates declined faster than paying rates. As a result, NIM and yield spread were in a downward trend.

	2010	2011	2012	2013
Net Interest Margin (NIM)	3.46	3.50	2.26	1.83
Earning rate	10.64	14.35	12.01	7.98
Paying rate	7.14	10.67	9.59	6.02
Yield spread	3.50	3.68	2.43	1.97

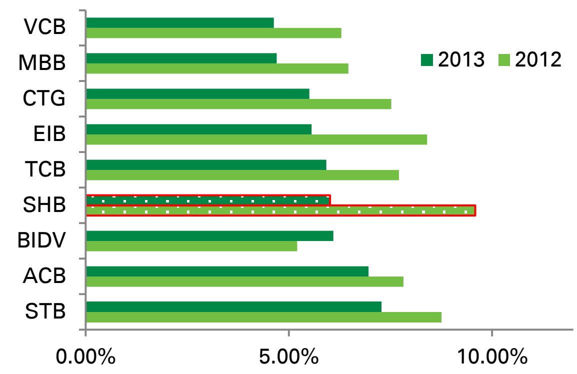
Source: SHB financial statement, VPBS calculated

When we compared SHB with its peers, the declining trend in market interest rates is readily self-evident. Both earning and paying rates of all major banks (except for BIDV) dropped in 2013 by an average of -2% for earning rates and -1.67% for paying rates. SHB was the bank whose interest rates declined the most.

Earning rate – 2013



Paying rate - 2013

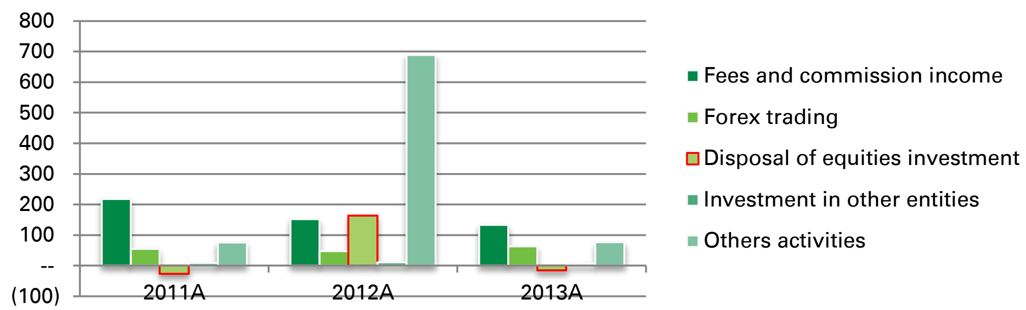


Source: Financial Statements, VPBS calculation

- *Non-interest income:*

Non-interest income includes fee and commission income, net gains from foreign exchange trading, net gains from equity investment and net gains from other activities (which usually include bad debt reversal, interest rate swap and investment trust). NII has been quite volatile during the period of 2011-2013. Income from others activities rocketed in 2012 as SHB recognized some bad debt reversal from HBB. Fees and commission income decreased by 12% y-o-y in 2013 after the merger. This was partly due to the integration cost of the two systems, even though revenue increased as the result of increasing the number of branches and transaction offices. By the end of 2013, the accumulated number of ATM cards issued went up to 400,000. During this same period, SHB became a principal member of both VISA and MasterCard international card organization. This allows SHB's customers to make payment or cash withdrawal at tens of millions points of ATMs and POS in Vietnam as well as worldwide. The increased income from fees and commissions definitely heralds a brighter outlook ahead.

Composition of non-interest income of SHB



Source: SHB financial statements

FINANCIAL RATIOS (CAMELS)

CAPITAL	2009A	2010A	2011A	2012A	2013A
Capital adequacy ratio (CAR)	17.06%	13.81%	13.37%	14.18%	12.38%
Owners' equity/ Total deposits	16.47%	16.32%	16.76%	12.25%	11.41%
Owners' equity/ Total assets	8.80%	8.20%	8.16%	10.02%	7.21%

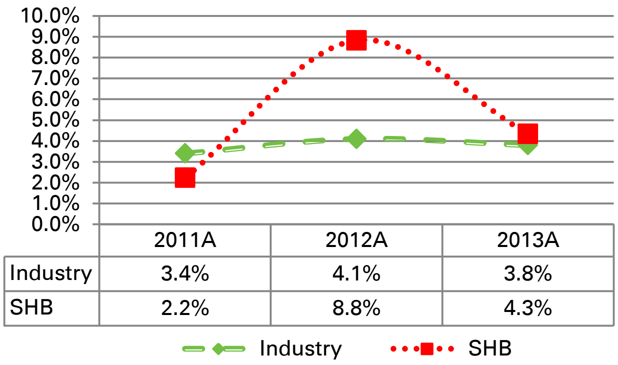
SHB's CAR ratio has actually decreased over the last five years. As discussed earlier, average growth of share capital was over 34.7%, which is lower than average growth of total assets of 39%, which was a driver to decrease the CAR. By the end of 2013, SHB's CAR was 12.38% which was visibly lower than its highest in 2009, however, it was still higher than the minimum required level of 9%. The CAR is expected to be improved as SHB is planning on raising an additional 25% of equity capital in 2014

ASSET QUALITY	2009A	2010A	2011A	2012A	2013A
NPL ratio	2.79%	1.40%	2.24%	8.83%	4.35%
Provisions for loan loss to NPLs	36.47%	79.94%	54.49%	24.77%	37.27%

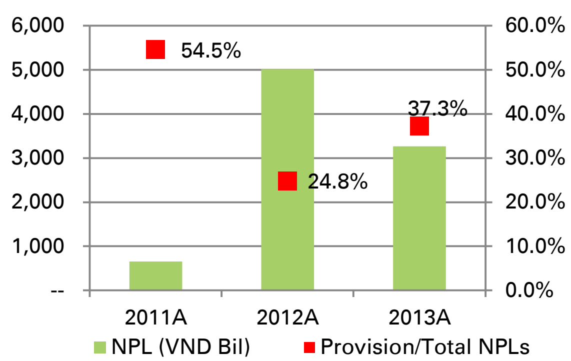
After the merger of HBB in 2012, SHB's NPL has almost quadrupled due to the high NPL ratio of HBB at 16.06%. However, SHB has deftly managed the process of reducing its consolidated NPLs and reduced the NPL ratio to only 4.35% in 2013.

Dealing with the NPL problem has been the most critical task that SHB had to solve since the merger. As mentioned earlier, prior to the merger, SHB was a bank with relatively low NPL ratios. As of year-end 2011, SHB's NPL ratio was only 2.2%. Right after the merger, however, SHB's NPL ratio rocketed to 12.88% and the over-due loans ratio (group 2 to group 5 loans) was 21.32%. As of year-end 2012, with tremendous effort, SHB's NPL ratio declined to 8.8%, still among the highest in the banking system.

SHB's NPL ratio loss



NPLs and provisions for credit losses



Source: SHB financial statements

The total amount of bad debt that SHB had to carry over from HBB in 2012 was about VND5.566 billion, including VND3,345 billion of Vinashin loans and bonds and VND2,221 billion of NPLs from other customers. SHB has applied multiple drastic and dynamic measures in order to bring down the NPL level.

- First, SHB restructured enterprises in order to help them overcome their difficult times and strengthen their financial health to repay debts; some successful restructuring examples include Bianfishco, Thanh Dat Paper Ltd. and Quoc Bao JSC.
- Second, SHB sold VND 1.8 trillion to Vietnam Asset Management Company (VAMC) in return for VND 1.665 trillion of special bonds.
- Third, SHB used almost VND188 billion of previously made provisions to write off bad debts in 2013. This was a substantial amount compared to the previous five years, which was zero.
- Fourth, the bank sold off the collateral of non-paying clients in order to collect as much cash as possible.
- Fifth, for the outstanding VND 3.345 trillion of Vinashin, SHB swapped VND1.103 trillion worth of debts into bonds and the remaining VND1.419 trillion has a provision and allocation within five years. DATC bought Vinashin debt at approximately 70% discount. The remaining Vinashin loans were restructured according to Decision 780/2012/QD-CP and recognized on SHB's balance sheet as charge-off loans.

SHB's loans loss coverage ratio (LLC), which is equal to provisions divided by total NPLs, has been relatively low. This ratio was reduced dramatically from 54% in 2011 to only 25% in 2012 due to the high amount of bad debt that arose after the merger causing provision costs to be too high to catch up with the level of NPLs. The LLC ratio in 2013 was still low at 37% while the LLC ratios of industry peers such as VCB or MBB were approximately 90%. This is another reason we have concerns about the NPL issues at SHB.

Although SHB has shown encouraging results in dealing with NPLs by reducing the NPL ratio to 4.3% as of FY2013, going forward, however, we think that NPLs still pose a considerable threat to SHB and the remaining NPLs will be tougher for SHB to deal with, for the following reasons:

- Circular 02 and 09, with stricter rules regarding loans classification and provisions, are soon to be applied. Unless SHB is given "special" treatment from the SBV, it will have to follow these regulations. Even in an optimistic scenario, in which SHB's current loans classification is already in compliance with the new regulation and new NPLs are insignificant, SHB will still need to provide more provisions as its current LLC is low.
- SHB will have to provide provisions for the VND1,800 billion VAMC special bonds bought in 2013, which is equal to 20% of the bonds' value or VND360 billion every year.
- The remaining Vinashin debt will eventually be recognized as bad debt and will likely require additional provision expenses.

SHB 2014's first quarter results indeed showed that the NPL ratio increased to 4.26% from 4.13% at year-end 2013, and Group 5 loans grew the most (39% or almost VND1,000 billion increase).

MANAGEMENT ABILITY	2009	2010	2011	2012	2013
Growth					
Loan growth	105.2%	90.0%	19.6%	95.3%	34.4%
Deposit growth	54.3%	74.7%	35.7%	123.1%	17.0%
Asset growth	91.0%	85.8%	39.1%	64.2%	23.2%
Interest income growth	300.1%	89.0%	56.0%	-1.2%	12.2%
Non-interest income growth	-31.7%	24.7%	22.5%	221.6%	-75.2%
Revenue growth	80.0%	72.8%	49.9%	31.9%	-19.4%
Cost growth	78.5%	99.8%	65.7%	49.1%	10.8%
Pre-provision profit growth	81.0%	55.2%	36.7%	14.3%	-59.8%
Net income growth	63.5%	32.8%	61.4%	-100.0%	-49.6%
Efficiency					
Cost to average assets	0.5%	0.6%	0.3%	-0.6%	-0.4%
Cost/ Income ratio (CIR)	39.6%	45.7%	50.5%	57.1%	78.6%

We assess management ability by considering SHB's growth and efficiency.

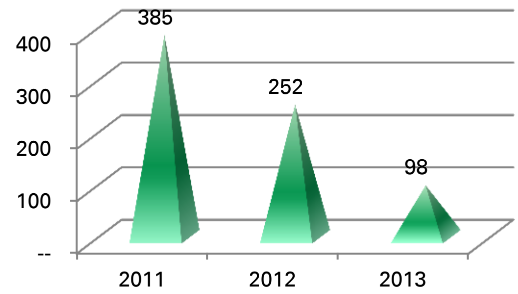
- *Growth:* SHB achieved impressive growth in both balance sheet and income statement prior to 2012. In 2012, the balance sheet grew tremendously as a result of merging with HBB. Excluding HBB's accumulated losses, SHB 2012's net income witnessed a remarkable growth of almost 150%. Looking closely at SHB's 2013 performance, we are concerned as revenue, pre-provision profit and net income all declined.
- *Operating efficiency:* The cost to income (CIR) ratio at SHB has rocketed from 39.55% in 2009 to 78.58% in 2013. Compared with its peers, the level of efficiency at SHB was much lower in most years (reflected by its higher-than-average CIR).

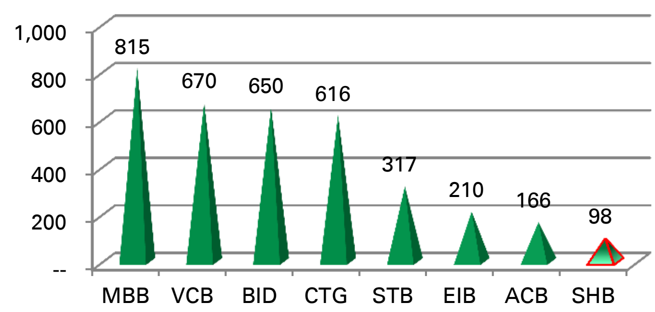
CIR	2009	2010	2011	2012	2013
SHB	39.55%	45.73%	50.52%	57.12%	78.58%
Peers	39.03%	38.89%	39.38%	48.84%	50.89%

Note: Peers include CTG, MBB, BID, EIB, STB, ACB, TCB
Sources: Banks financial statement, VPBS calculation

Looking at net operating Income per employee, SHB was following a downward trend. It seemed that till 2013, operating efficiency per employee is still low as income per employee kept plunging while expenses per employee kept rising. As the integration process was still far from complete, it took time for the consolidated SHB to realize its full potential. SHB's net operating income per employee in 2013 ranked the lowest among peers, and it was significantly lower than its closest peers such as ACB or EIB.

Net Operating Income per employee (VND mn)



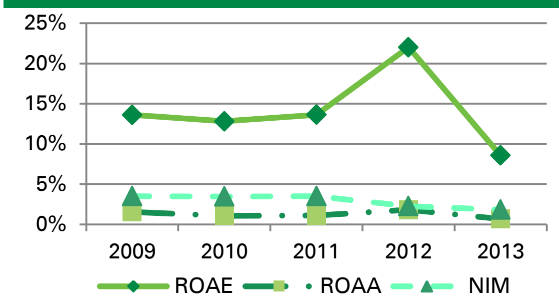


Source: SHB financial statements

EARNINGS	2009	2010	2011	2012	2013
Net interest margin (NIM)	3.50%	3.46%	3.50%	2.26%	1.83%
Return on average asset (ROAA)	1.64%	1.52%	1.24%	1.13%	0.99%
Return on average equity (ROAE)	25.58%	22.87%	17.00%	12.53%	10.28%
Return on earning assets (ROEA)	1.74%	1.61%	1.30%	1.16%	1.02%
Spread	3.44%	3.50%	3.68%	2.43%	1.97%

SHB's profitability in general has been declining from 2009 to 2013. ROAA decreased from 1.52% to less than 0.65% and ROAE dropped from 13.6% to only 8.56%. The drop of ROAE is mainly due to declining NIM year over year. On top of that, total assets rocketed by 64% and 23% in 2012 and 2013 after the merger, while SHB has not been able to utilize its assets at "full capacity".

SHB's profitability



Ticker	2013 NIM (%)	3Yr Avg ROA (%)	2013 ROA (%)	5Yr Avg ROE (%)	3Yr Avg ROE (%)	2013 ROE (%)
SHB	**1.83**	**1.19**	**0.65**	**14.12**	**14.73**	**8.56**
Average	**3.14**	**1.15**	**0.84**	**15.52**	**14.56**	**10.04**
MBB	3.83	1.49	1.28	20.15	19.90	16.25
STB	5.12	1.17	1.42	13.91	12.02	14.49
ACB	2.98	0.71	0.48	17.36	13.48	6.58
EIB	1.92	1.18	0.39	12.04	12.68	4.32

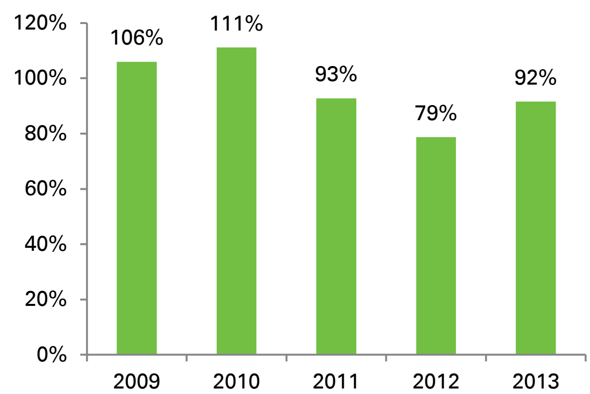
Source: Bloomberg

Compared with peers, SHB was on par with peers' in three-year and five year-averages. Its 2013 profitability, however, was lower. Especially, its 2013 NIM was the lowest among peers.

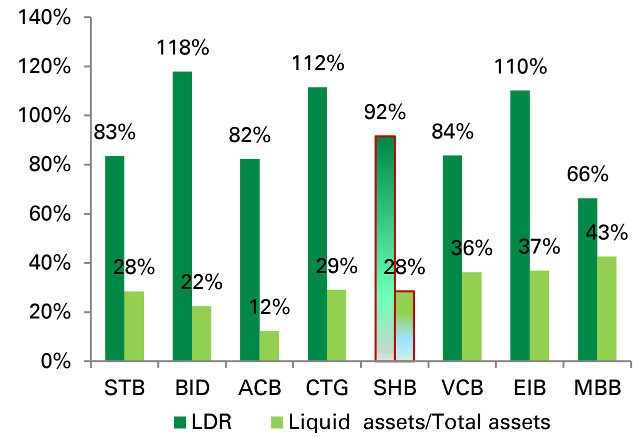
LIQUIDITY	2009	2010	2011	2012	2013
Liquid asset/Total asset	39.20%	39.04%	44.83%	35.88%	28.49%
Liquid asset/Deposit	73.40%	77.73%	91.49%	53.88%	45.08%
Loan/ Deposit	87.44%	95.09%	83.83%	73.38%	84.30%
ST funding for MT&LT lending	18.40%	17.21%	12.86%	18.42%	22.23%

SHB's liquidity situation was assessed by loans to deposits ratio (LDR) and the portion of liquid assets to total assets. LDR of SHB surged from 106% to 111% from 2009 to 2011 during the period of hot credit growth. However, in 2012, this rate plunged because LDR of all commercial banks must be no more than 80%, as stipulated in Circular 19/2010/TT-NHNN. We do note that many banks are still not in compliance, especially the SOCBs CTG and BID, whose LDRs are even higher than 100%. As credit grew much faster than deposits in 2013, SHB's LDR increased back to the level of 2011. The ratio liquid asset out of total assets, although declining, still stayed at 28% as of FY2013, which was similar to its peers. Also, the percentage of short-term funding used for medium- and long-term lending was well below the 30% limit throughout the entire period. In general, SHB's liquidity was on par with the industry's average.

LDR of SHB



Liquidity Comparison 2013



Source: Financial Statements, VPBS calculation

FORECAST

2014 target

As SHB plans to increase its charter capital by 25% in the second quarter of 2014, from VND8,868 billion to VND11,082 billion, the overall total assets, credits, deposits, and profit before tax are all targeted to grow similar to 25%. Particularly:

Indicator	2014 target (VND bn)	Growth	
		(+/-)	% (y-o-y)
Total assets	180,000		
Charter capital	11,082.2	2,216.4	25%
Customer deposits	135,000	26,853	24.8%
Customer loans and corporate bonds	102,100	18,990.3	22.8%
Profit before tax	1,270	269.95	26.9%
Net profit	1,053		
Dividend rate	9%		
NPL ratio	3%		
CAR	10%-12%		
ROA	1%-2%		
ROE	10%-12%		

Source: SHB's 2014 general annual meeting

We think that SHB is likely to be able to achieve growth in its balance sheet items based on their higher-than-average credit and deposit growth in 2013 as well as their Q1 2014 credit growth of 7.6% and deposits growth of 7.9%. As for their profit before tax and net profit targets, however, we have concerns that SHB may not be able to obtain their targets. Upon close inspection of SHB's income statements from 2012 to 2013, we observed that the total operating income actually declined by 19.4% y-o-y and operating profit declined 60% y-o-y in 2013. In these two years and the first quarter of 2014, a large part of their profit actually came from the "abnormal" source of provision reversal, which is a non-recurring source of income. Therefore, given the tough environment the banking sector is facing and stricter rules of loans classification and provisioning that will soon come into force, we doubt that SHB can consistently recognize a substantial amount of provision reversal in the remaining part of 2014 as well as the following years.

Balance sheet forecast

Assets

(1) *Customer loans*: Credit growth rates of customer loans are expected to be at 22.8% in 2014, equal to SHB's target and will be remain around 23% in the period from 2015 to 2018.

Non-performing loans: Although SHB has targeted to lower its NPL ratio to 3% in 2014, and many dynamic measures of collecting bad debts have been effectively applied, we do not think this target can be realized very soon. As a matter of fact, as of Q1 2014, SHB's NPL ratio slightly increased to 4.26% with group 5 loans growing the fastest. Our forecast of loans classification by quality, NPLs ratio and provisions are as follows:

Loans quality	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Standard	95.5%	96.8%	96.2%	83.1%	92.7%	92.0%	92.0%	92.9%	93.5%	94.1%
Caution	2.7%	0.4%	2.4%	8.1%	3.1%	3.0%	3.0%	3.0%	3.0%	3.0%
Sub-standard	0.8%	0.4%	0.1%	1.8%	0.2%	0.4%	0.4%	0.5%	0.4%	0.3%
Doubtful	0.9%	1.2%	0.2%	3.1%	0.6%	0.6%	0.6%	0.6%	0.6%	0.6%
Loss	0.2%	1.2%	1.1%	3.9%	3.4%	4.0%	4.0%	3.0%	2.5%	2.0%
NPL ratio	1.9%	2.8%	1.4%	8.8%	4.13%	5.0%	5.0%	4.1%	3.5%	2.9%
LLC	36.5%	79.9%	54.5%	24.8%	37.3%	40.0%	45.0%	50.0%	55.0%	60.0%

(2) *Interbank:* As SHB's current interbank lending proportion is still quite high compared to the industry average and the 2013 growth rate was merely 1.0%, we forecast that SHB's interbank will grow slowly from 2.0% to 5.0% per year in the next five years.

(3) *Debt securities investment:* which is mainly comprised of government bonds and bills and taken as a low risk and a high fixed income for banks. As the proportion of SHB's debt securities investment out of customer loans was lower than the industry average, 24.3%, compared to approximately 30.0%, we forecast that debt securities investment proportion can gradually increase to 30.0% in 2018.

Liabilities

(1) *Customer deposits* will remain the main source of funding. In the past, SHB's deposits grew at a quite impressive pace with average growth of 55% during the three years prior to the merger and grew at 17% in 2013. As SHB is aiming to grow quite aggressively, we forecast that customer deposits are set to grow at rates similar to its 2014's target, which is 24.8% over the next five years.

(2) *Interbank borrowing* has declined substantially since 2011 and we forecast it will continue this downward trend. Interbank borrowing is forecasted to be equal to 70% of interbank lending, which is the average of the last three years.

(3) *Other sources of funding:*

- Borrowing from SBV is estimated to equal 2.0% of customer deposit, which is similar to the ratio of 2013.
- Funds received from other institutions grew 24% in 2013 and is expected to grow at the same rate as SHB continues to receive ODA's fund in the next few years.
- Valuable paper issued equaled to approximately 20% of customer deposits in the past four years. We also notice that the valuable paper that SHB issued in 2013 were all short term (less than 12 months). As other sources of funding, especially customer deposits, have lower costs, we estimate that the ratio of valuable paper issued out of customer deposits will be reduced to 15% this year and is likely to be in the range between 10% to 15% in the following four years.

Owner's equity

(1) *Charter capital*: SHB plans to raise 25% of its charter capital in 2014, which is equal to an amount of over VND2,216 billion. We believe that SHB will have to continue to raise additional shares in 2016 and 2018 to be able to grow and satisfy capital requirement.

(2) *Dividends:* SHB paid cash dividends regularly at a rate from 8% to 14.5% of the share's face value since 2009. For the year 2014, SHB targets to pay 9%. Based on our estimate of SHB's net income in 2014 and 2015, we think the dividend rate will likely be lower than SHB's target to stay at 6% in the next three years and increase to 7.5% in 2017 and 2018.

(3) *Capital enhanced reserves* are set at 5% of net profit after tax as usual and do not exceed the bank's chartered capital.

(4) *Financial reserves* are set at 10% of net profit after tax as usual and do not exceed 25% of the bank's chartered capital.

BALANCE SHEET (VND bn)	2012A	2013A	2014F	2015F	2016F	2017F	2018F	CAGR
Cash and precious metals	485	541	789	948	1,119	1,453	1,489	*22.4%*
Balances with the SBV	3,032	1,981	3,384	4,231	7,051	8,637	10,624	*39.9%*
Interbank lending	29,887	30,263	30,868	31,485	32,430	34,051	35,754	*3.4%*
Customer loans	56,940	76,510	93,954	115,563	142,143	174,836	215,048	*23.0%*
Debt securities	12,661	18,616	22,549	30,046	42,643	52,451	64,514	*28.2%*
Interest earning assets	102,519	127,369	150,755	181,326	224,266	269,975	325,940	*20.7%*
Equities securities	89	100	120	144	173	207	249	*20.0%*
Other long term investment	435	400	440	485	533	586	645	*10.0%*
Equities investment	524	500	560	629	706	794	894	*12.3%*
Derivatives	6	-	-	-	-	-	-	
Tangible fixed assets	399	406	447	491	540	594	654	*10.0%*
Intangible fixed assets	3,728	3,746	4,120	4,532	4,985	5,484	6,032	*10.0%*
Property investment	85	17	17	17	17	17	17	*0.0%*
Other assets	10,211	12,560	14,444	16,610	19,102	21,967	25,262	*15.0%*
Non-interest earning assets	14,430	16,728	19,028	21,651	24,645	28,062	31,965	*13.8%*
Provisions	(1,420)	(1,513)	(2,134)	(2,753)	(3,038)	(3,696)	(4,353)	*23.5%*
TOTAL ASSETS	116,538	143,626	168,998	201,799	247,697	296,588	355,935	*19.9%*
Borrowings from SBV	-	2,119	2,256	2,820	3,525	4,319	5,312	*23.9%*
Interbank borrowing	21,777	20,685	21,607	22,040	22,701	23,836	25,028	*3.9%*
Deposits from customers	77,599	90,761	112,816	141,020	176,275	215,937	265,602	*24.0%*
Valuable papers	4,370	16,910	16,922	19,743	24,678	30,231	31,872	*13.5%*
Funds received from other institutions	385	476	595	744	930	1,163	1,454	*25.0%*
Total interest bearing liabilities	104,131	130,952	154,198	186,367	228,110	275,486	329,268	*20.3%*
Derivative and other financial liabilities	-	6	8	9	11	13	16	*20.0%*
Interest and fees payable	1,945	1,351	1,621	1,946	2,335	2,802	3,362	*20.0%*
Other liabilities	911	900	1,080	1,296	1,556	1,867	2,240	*20.0%*
Provision for other liabilities	41	58	10	12	14	17	21	*-18.5%*
Corporate income tax payable	1	0	-	-	-	-	-	*0.0%*
Total non-interest bearing liabilities	2,897	2,316	2,719	3,263	3,916	4,699	5,638	*19.5%*
TOTAL LIABILITIES	107,029	133,267	156,917	189,630	232,026	280,184	334,906	*20.2%*
Chartered capital	8,866	8,866	11,082	11,082	13,853	13,853	17,316	*14.3%*
Capital surplus	102	102	102	102	102	102	102	*0.0%*
Treasury shares	(5)	(5)	(5)	(5)	(5)	(5)	(5)	*0.0%*
Reserves	518	642	665	763	972	1,207	1,537	*19.1%*
Retained earnings	26	751	235	225	747	1,245	2,077	*22.6%*
TOTAL EQUITY	9,506	10,356	12,078	12,166	15,669	16,401	21,026	*15.2%*
Minority interest	3	3	3	3	3	3	3	*0.0%*
TOTAL LIABILITIES & EQUITY	116,538	143,626	168,998	201,799	247,697	296,588	355,935	*19.9%*

Income statement forecast

Interest Incomes and Expenses

In order to forecast the interest incomes and expenses component, we make assumptions regarding different interest rates earned and paid by SHB and then multiply these rates with the average balance of each type of earning assets and liabilities.

Overall, we forecast that SHB's NIM may slightly drop in 2014, and will gradually pick up from 2015 and 2018. The reason we forecast a lower NIM in 2014 is due to both lower earning rates and paying rates as deposits interest rates are currently kept at 6.0% for tenors less than 6 months while other longer tenors hovered around 6.0% to 8.3%. Given 2014's expected inflation rate of 5.0%, deposits interest rates are unlikely to go lower, while due to ample liquidity and sluggish credit growth, banks may have to offer lower lending rates.

Non-interest Incomes and Expenses

(1) *Fees and commission incomes* are expected to grow 25% per year during the forecast period, whereas the ratio of fees and commission expenses to incomes will gradually increase from the current level of 21.5% to 25% in 2018. In the past few years, SHB has attempted to increase its customer base by offering low fee or even free of charge for its services. Therefore we believe that SHB has a firm foundation to grow its fees and commission incomes in the next five years.

(2) *Net gains from dealing in foreign currencies and* gold have fluctuated quite a lot in the past (-12% in 2012 and 32% in 2013). Therefore we apply a rather conservative growth rate of 10% for the next five years.

(3) *Net gains from selling securities investment:* are estimated by the rate of return from equity investment, which is 10%, equal to the average return of the previous five years.

(4) *Income from investment in other entities* growth is forecasted at 10%, equal to the average growth of the previous five years.

(5) *Net gains from other activities* are expected to grow at 10%.

Operating expenses

(1) *Salary and related expenses* accounted for almost 32% of operating income in 2013, increased from 23% prior to the merger. We think that it may take SHB a few years to integrate and synchronize the two banks. As such, we estimate that this ratio is likely to drop and maintain at around 30% since 2015 onward.

(2) *Assets expenses* and depreciations and amortizations are estimated to equal 8% and 3% of fixed assets, respectively, which is closed to the 2013's ratio.

(3) *Effective corporate tax rate*: Starting January 1, 2014, the corporate income tax rate was lowered to 22% from its previous level of 25%. It will be lowered further to 20% from 2016. Due to carrying HBB's accumulated losses, SHB's effective tax rate was 8% in 2012 and 15% in 2013, respectively. We estimate that SHB can still lower its tax payment in 2014 and the effective tax rate will be 17%. After that, SHB's effective tax rate will equal the stated tax rate, which is 22% in 2015 and 20% from 2016 onward.

Provision expenses

Provision expenses are likely to increase in 2014 and 2015, then gradually decrease based on our forecast of NPL and LLC ratios in the coming years. In addition, we also forecast that the amount of provision reversals will be much less than in 2012 and 2013.

INCOME STATEMENT (VND bn)	2012A	2013A	2014F	2015F	2016F	2017F	2018F	CAGR
Placements at other CIs	2,320	784	944	1,067	1,271	1,375	1,527	*14%*
Loans and advances	5,574	6,601	7,884	10,266	13,272	16,483	20,664	*26%*
Debt securities investments	1,449	1,043	1,286	1,854	2,744	3,637	4,591	*34%*
Other interest incomes	608	747	821	903	994	1,093	1,202	*10%*
Interest incomes	9,951	9,175	10,935	14,091	18,280	22,588	27,984	*25%*
Deposits	(7,173)	(6,520)	(7,376)	(9,371)	(12,309)	(15,137)	(18,829)	*24%*
Borrowings from local CIs	(211)	(281)	(275)	(282)	(294)	(308)	(158)	*-11%*
Interest for valuable papers	(615)	(266)	(761)	(788)	(1,066)	(1,345)	(1,584)	*43%*
Other interest expenses	(78)	(3)	(4)	(4)	(4)	(5)	(5)	*10%*
Interest expenses	(8,076)	(7,071)	(8,413)	(10,441)	(13,669)	(16,790)	(20,571)	*24%*
Net interest incomes	1,876	2,104	2,523	3,649	4,611	5,798	7,413	*29%*
Fees and commissions incomes	194	219	274	343	429	536	670	*25%*
Fees and commissions expenses	(42)	(86)	(82)	(103)	(129)	(161)	(201)	*18%*
Net fees and commissions incomes	152	133	192	240	300	375	469	*29%*
Net gains from gold and currency dealing	48	63	70	77	84	93	102	*10%*
Net gains from disposal of equities investment	164	(16)	5	29	23	18	10	*-192%*
Incomes from investment in other entities	11	6	7	8	8	9	10	*10%*
Other operating incomes	689	77	84	93	102	112	123	*10%*
Net non-interest incomes	1,064	264	358	446	517	607	715	*22%*
Total operating incomes	2,939	2,368	2,881	4,095	5,129	6,405	8,128	*28%*
Total general and administrative expenses	(1,679)	(1,861)	(1,936)	(2,550)	(3,152)	(3,862)	(4,807)	*21%*
Operating profit	1,260	507	945	1,545	1,977	2,543	3,321	*46%*
(Provision)/write-back for loans loss	565	493	(739)	(580)	(231)	(589)	(570)	*-203%*
Pre-tax profit	1,825	1,000	206	966	1,746	1,954	2,751	*22%*
Taxation	(138)	(150)	(35)	(212)	(349)	(391)	(550)	*30%*
Net profits	26	850	171	753	1,397	1,563	2,201	*21%*

VALUATION

We value SHB utilizing two approaches: (a) the residual income model and (b) the relative valuation model (P/E) with equal weight. The target price derived from our valuation is: VND9,183, which means that the stock is fairly priced. Thus, our recommendation for SHB's stock is HOLD.

Combined Valuation		
Method	Target price	Weight
Residual income	7,605	50%
P/E	10,761	50%
Weighted average target price	9,183	
Expected price appreciation	2.0%	
Expected dividend yield	6.7%	
Total expected return	8.7%	

RESIDUAL INCOME

We use the multi stage residual income (RI) model to value SHB given the business nature of SHB in particular, and financial services in general, is quite different from ordinary companies that we can value using the normal discounted cash flow (DCF) model. Residual income is calculated based on net income and a charge for the cost of equity capital. A company that is generating more income than its cost of obtaining capital – that is, one with positive residual income – is creating value. Therefore, higher residual income should be associated with higher valuations. The persistence residual income model is as follows:

$$V_e = B_o + \sum_{i=1}^{t} \frac{(NI_i - R_e . B_{(i-1)})}{(1+r)^i}$$

In which:

V_e = Value of equity

B_i = Book value of equity at time i

NI_i = Net income at time i

Other inputs of the model are as follows:

- The risk-free rate is taken from the yield of 5-year local currency Government bond yields, which is 7.2%.
- The expected market return is expected to be 15%.
- Adjusted beta of SHB is 1.27.
- Cost of equity (R_e) is estimated by using the CAPM model, which is equal to 17.1%.
- In SHB's case, during the five years of our forecast, the RI is actually negative, or the forecast ROE is less than SHB's cost of equity. This explains the reason SHB's stock is trading below its book value. We think that as SHB deals with the remaining NPLs carried from HBB and gradually improves its efficiency during the post-merger integration process, the bank can

eventually earn ROE equal to its cost of equity after five years. As such, residual income should equal zero after 2018.

Residual Income valuation	2014F	2015F	2016F	2017F	2018F
Net Income	171,023	753,179	1,396,504	1,563,206	2,200,811
Shareholders Investment	10,355,697	12,078,234	12,166,478	15,668,608	16,400,646
Capital Charge	1,769,830	2,064,218	2,079,300	2,677,828	2,802,936
Residual Income	(1,598,807)	(1,311,039)	(682,796)	(1,114,622)	(602,125)
Present Value Factor	0.854	0.729	0.623	0.532	0.454
PV Residual Net Income	(1,365,447)	(956,254)	(425,331)	(592,983)	(273,577)
Total Projected EVA	(3,613,592)				
Curent Book Value Equity	10,355,697				
Value of Equity	6,742,105				
Number of Shares	886,580				
Share Value (VND)	**7,605**				

RELATIVE VALUATION

We select five banks: MBB, STB, EIB, and ACB as SHB's peer group as they are most similar to SHB in terms of size, type of business, and operating efficiency.

Key Financials	SHB	Peer Avg	STB	MBB	ACB	EIB
Shares outstanding (mn)	887	1,105	1,143	1,126	922	1,229
Market capitalization (VND bn)	7,979	17,319	23,536	15,196	14,191	16,351
Foreign ownership (%)	9.3	18.1	5.1	10.0	30.0	27.2
Owner's equity (VND bn)	10,356	14,847	17,064	15,141	12,502	14,680
Operating income (VND bn)	2,368	6,028	7,601	7,614	5,649	3,249
Net income 2013 (VND bn)	850	1,495	2,229	2,267	824	658
ROE	8.56%	10.4%	14.5%	16.2%	6.6%	4.3%
ROA	0.65%	0.9%	1.4%	1.3%	0.5%	0.4%
NIM	1.8%	3.5%	5.0%	4.0%	2.9%	2.2%
EPS (4Q trailing)	915	1,368	1,931	2,145	820	577
BVPS (Q1 2014)	11,681	13,473	14,935	13,451	13,567	11,940
Price (on June 23, 2014)	9,000	15,700	20,600	13,500	15,400	13,300
P/E (x)	9.83	14.70	10.67	6.29	18.79	23.04
P/B (x)	0.77	1.20	1.34	1.12	1.22	1.12

Currently SHB is trading at a P/E of 9.83x, and at a P/B of 0.77x, lower than its peer's average, which means SHB's share is relatively cheaper than its peer's. In our model, however, we applied a 20% discount on SHB's multiple due to the following reasons: (1) its currently higher NPL ratio, (2) its low LLC, and (3) our concerns that the level of independence of SHB's BOD may affect minority shareholders' interests. Using P/E multiple and SHB's trailing EPS, we value SHB share at VND10,761 at the time of issuing report.

P/E valuation	
SHB's 12M EPS (VND)	915
SHB's P/E (x)	9.83
Peer's P/E (x)	14.70
Discount	20%
Target price (VND)	10,761

SENSITIVITY ANALYSIS

There are several important factors that might affect a bank's value and its share price. In this section, we test how sensitivity of SHB's share value to the change in: (1) the level of NPLs, (2) the amount of provisions made each year, (3) the credit growth rate, and (4) the loans-deposits interest spread.

Sensitivity analysis 1

Loan-Deposit spread	Loan growth compared to base case: -20%	-10%	0%	10%	20%
4.00%	9,515	9,575	9,636	9,698	9,761
3.75%	9,318	9,366	9,416	9,465	9,515
3.50%	9,120	9,157	9,183	9,232	9,268
3.25%	8,923	8,949	8,974	8,998	9,022
3.00%	8,726	8,740	8,753	8,765	8,775

Sensitivity analysis 2

LLC compared to base case	NPL compared to base case: -20%	-10%	0%	10%	20%
30%	9,044	8,949	8,854	8,759	8,666
20%	9,136	9,052	8,968	8,883	8,799
10%	9,228	9,155	9,081	9,008	8,934
0%	9,320	9,257	9,183	9,132	9,069
-10%	9,412	9,360	9,308	9,256	9,204

Base case scenario	2014	2015	2016	2017	2018
Loan growth	22.8%	23%	23%	23%	23%
NPL ratio	5%	5%	4.1%	3.5%	2.9%
LLC ratio	40%	45%	50%	55%	60%

TECHNICAL ANALYSIS

The technical chart indicates that the price of SHB has declined from VND12,200 at the end of March 2014 to VND7,900 at the middle of May 2014. After bottoming out at this level, the price of SHB started an uptrend lasting until now and this stock is accumulating below the 50 day moving average, which is currently at 9,300.

We expect that the accumulation phase of SHB will continue over the next few weeks and its price will fluctuate in a band from VND8,500 to VND9,300. Thus, we recommend to HOLD SHB at the time of issuing report.

Ticker	SHB
Horizon analytic	3 to 6 months
3 months highest price	12,200
3 months lowest price	7,900
Current MA50 days (from Jan 14, 2014)	9,300
Current MA100 days (from Jan 14, 2014)	9,300
Mid-term resistance level	9,300
Mid-term support level	8,000
Recommendation	**HOLD**

Unit: VND per share

SHB price performance

Source: VPBS

Guide to Ratings Definition

VPBank Securities uses the following ratings system:

Buy: Expected return, including dividends, over the next 12 months is greater than 15%.

Hold: Expected return, including dividends, over the next 12 months is from -10% to + 15%.

Sell: Expected return, including dividends, over the next 12 months is below -10%.

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