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Executive Summary

Vietnam's new vehicle market is characterised by fluctuating tariffs, which often make it hard to identify sustainable sales patterns. After there was evidence of tariff changes kicking in as sales for Q110 were down by 2%, despite an 80% increase in passenger car sales, total sales had returned to positive growth of 5% by the end of H110, although passenger car growth was lower at 29%. The MPV/SUV segment is still impacted by the higher special consumption tax with sales down 10%, while commercial vehicle sales were up just 2% y-o-y. While we believe that consumers appear to be adjusting to the new tax, as shown in the improvement during Q210, we have lowered our forecast for sales of domestically-produced vehicles to growth of 7.8%. This allows for some further growth in Q310, although from there on we believe the results of Q409, which were inflated by tax cuts, will be difficult to replicate.

Looking ahead, with vehicle imports set to surge when tariffs are removed under the ASEAN Free Trade Agreement (AFTA) in 2018, Vietnam's Ministry of Industry and Trade (MOIT) is looking to make the domestic industry competitive in the meantime. **BMI** sees an underdeveloped supplier segment as a major area for concern, which will be addressed through higher import tariffs on parts that can be made domestically. Higher rates will also be applied to vehicles imported as completely built units. In order to facilitate the sector's development, MOIT has proposed that investment projects for the auto industry should be given preference. However, **BMI** believes that there is a vicious circle in the Vietnamese industry in that carmakers are reluctant to invest in production without a well developed supplier base and suppliers will want to see growth potential in vehicle assembly before investing.

Fluctuating tariffs are still a factor in Vietnam's 12th position out of 14 markets in **BMI**'s Business Environment Ratings for the autos sector in Asia Pacific. The highest score is for market risk, which stands at 85.0. Its country risk score has also risen from 49.8 to 51.5, taking its total score for risks to realisation of returns up to 68.2. Vietnam is still a country we would expect to see climb the ratings in the future, particularly if its vehicle tariff policy becomes more consistent.

Only four of the top 10 locally producing carmakers posted positive growth in H110, although the competitive landscape remained largely the same. **Toyota Motor** retained its lead with growth of 29%, down slightly from the 34% growth of Q110. **Visuco** again achieved the best growth of the top 10 manufacturers with a 72% rise in sales, up from 37% in Q110. **Mekong**, representing **Fiat, Ssangyong and PMC**, registered the worst sales with a 65% decline. We would expect to see **Nissan Motor** claim a greater share in future after beginning domestic production of its Grand Livina MPV to become more competitive.

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SWOT Analysis

Vietnam Autos Industry SWOT	
Strengths	▪ Low rate of vehicle ownership provides more opportunity for sales growth. ▪ Low labour costs.
Weaknesses	▪ Fluctuations in import tariffs on completely built units (CBUs) bring instability to the market. ▪ Increased SCT on locally produced vehicles puts pressure on domestic manufacturers.
Opportunities	▪ Ford's largest contract ever in the country will boost the local production and parts industry. ▪ The market shows diversity, with growth in both the premium and small car segments.
Threats	▪ A return to higher import tariffs has started to reduce sales growth after an initial surge prior to the new rates. ▪ Despite government efforts to develop the component sector, growth may still be hindered by a lack of domestic CBU production to absorb output.

Political SWOT	
Strengths	▪ The Communist Party government appears committed to market-oriented reforms, although specific economic policies will undoubtedly be discussed at the 2011 National Congress. The one-party system is generally conducive to short-term political stability. ▪ Relations with the US are generally improving, and Washington sees Hanoi as a potential geopolitical ally in South East Asia.
Weaknesses	▪ Corruption among government officials poses a major threat to the legitimacy of the ruling Communist Party. ▪ There is increasing (albeit still limited) public dissatisfaction with the leadership's tight control over political dissent.
Opportunities	▪ The government recognises the threat that corruption poses to its legitimacy, and has acted to clamp down on graft among party officials. ▪ Vietnam has allowed legislators to become more vocal in criticising government policies. This is opening up opportunities for more checks and balances within the one-party system.
Threats	▪ The slowdown in growth in 2009 and 2010 is likely to weigh on public acceptance of the one-party system, and street demonstrations to protest economic conditions could develop into a full-on challenge of undemocractic rule. ▪ Although strong domestic control will ensure little change to Vietnam's political scene in the next few years, over the longer term, the one-party-state will probably be unsustainable. ▪ Relations with China have deteriorated over the past year due to Beijing's more assertive stance over disputed islands in the South China Sea and domestic criticism of a large Chinese investment into a bauxite mining project in the central highlands, which could potentially cause widescale environmental damage.

Economic SWOT	
Strengths	▪ Vietnam has been one of the fastest-growing economies in Asia in recent years, with GDP growth averaging 7.6% annually between 2000 and 2009. ▪ The economic boom has lifted many Vietnamese out of poverty, with the official poverty rate in the country falling from 58% in 1993 to 20% in 2004.
Weaknesses	▪ Vietnam still suffers from substantial trade, current account and fiscal deficits, leaving the economy vulnerable as the global economy continues to suffer in 2010. The fiscal picture is clouded by considerable 'off-the-books' spending. ▪ The heavily-managed and weak dong currency reduces incentives to improve quality of exports, and also serves to keep import costs high, thus contributing to inflationary pressures.
Opportunities	▪ WTO membership has given Vietnam access to both foreign markets and capital, while making Vietnamese enterprises stronger through increased competition. ▪ The government will in spite of the current macroeconomic woes, continue to move forward with market reforms, including privatisation of state-owned enterprises, and liberalising the banking sector. ▪ Urbanisation will continue to be a long-term growth driver. The UN forecasts the urban population to rise from 29% of the population to more than 50% by the early 2040s.
Threats	▪ Inflation and deficit concerns have caused some investors to re-assess their hitherto upbeat view of Vietnam. If the government focuses too much on stimulating growth and fails to root out inflationary pressure, it risks prolonging macroeconomic instability, which could lead to a potential crisis. ▪ Prolonged macroeconomic instability could prompt the authorities to put reforms on hold, as they struggle to stabilise the economy.

Business Environment SWOT	
Strengths	▪ Vietnam has a large, skilled and low-cost workforce, that has made the country attractive to foreign investors. ▪ Vietnam's location - its proximity to China and South East Asia, and its good sea links - makes it a good base for foreign companies to export to the rest of Asia, and beyond.
Weaknesses	▪ Vietnam's infrastructure is still weak. Roads, railways and ports are inadequate to cope with the country's economic growth and links with the outside world. ▪ Vietnam remains one of the world's most corrupt countries. Its score in Transparency International's 2009 Corruption Perceptions Index was 2.7, placing it in 22nd place in the Asia-Pacific regio
Opportunities	▪ Vietnam is increasingly attracting investment from key Asian economies, such as Japan, South Korea and Taiwan. This offers the possibility of the transfer of high-tech skills and knowhow. ▪ Vietnam is pressing ahead with the privatisation of state-owned enterprises and the liberalisation of the banking sector. This should offer foreign investors new entry points.
Threats	▪ Ongoing trade disputes with the US, and the general threat of American protectionism, which will remain a concern. ▪ Labour unrest remains a lingering threat. A failure by the authorities to boost skills levels could leave Vietnam a second-rate economy for an indefinite period.

Regional Market Overview

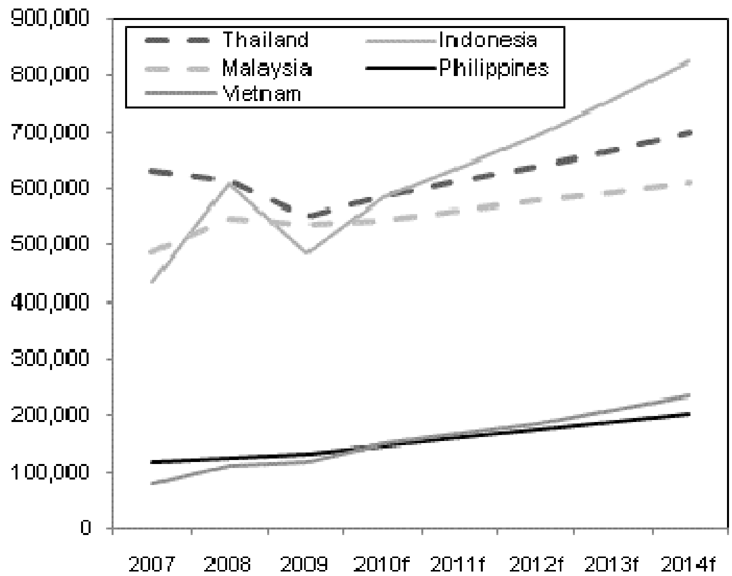
Good Growth Prospects Up For Grabs In ASEAN Markets

First half vehicle sales data for the leading ASEAN markets show plenty of growth potential for carmakers, which **BMI** believes is likely to be sustained following the full implementation of the ASEAN Free Trade Agreement (AFTA) in January. However, data also show that despite its position as a regional production and trade hub, Thailand has lost its crown as the region's largest autos market to Indonesia, which has been thriving on the back of strong domestic demand.

Despite Thailand's highest monthly sales for a decade in June, the H110 total of 356,692 units (up 54.1%) came second to Indonesia's 370,208 units, up 21%. The demand for new vehicles in Indonesia has attracted investment from Japan's **Nissan Motor**, which will double the capacity of its local plant specifically to accommodate the domestic market and will be separate to its export-led investment in Thailand. However, Thai demand for Nissan's new March compact car drove up the company's local sales by 262% in June, before export sales are taken into account.

Two-Tier Sector

Total Vehicle Sales In Major ASEAN Markets (CBUs)



f = BMI forecast; Sources: Toyota Thailand, Gaikindo, MAA, CAMPI, VAMA

Vehicle sales in the Philippines rose by 37% in H110 to 81,157 units, bolstered by record sales of 15,189 units in June. However, the government is well aware that this is far below its neighbouring markets and is looking to address the industry's shortcomings through the new Motor Vehicle Development Programme. Incentives have been proposed, which would favour carmakers producing for export rather than focusing on domestic demand. **BMI** believes this could be detrimental to the industry by putting it into competition against stronger export bases in the region such as Thailand.

Malaysia is also looking to improve its position within the region's auto sector, through a newly established division of the Ministry of International Trade and Industry, charged with overseeing the development of the domestic industry. The unit's arrival is timely, given that Malaysia is on course to achieve record sales by the end of the year. Sales for the five months to May, the latest available, were up 20% at 247,072 units, which is well on the way to surpassing the 552,316 units recorded in 2005. The downside risk, however, is rate hikes, although this will be the case for much of the region during the rate normalisation cycle.

Vietnam has been one of the least impressive markets in the region, registering H1 vehicle sales growth of 5% for the 16 carmakers producing in the country. Sales for June rose by just 4% to 10,052 units, taking the six-month total to 50,278 units. Imports, which the government is trying to restrict to reduce the country's trade deficit, were still 27.6% higher year-on-year, with a value of US$1.29bn. Although H1 growth is low relative to Vietnam's neighbours, it is an improvement on the 2% decline for Q110 and **BMI** does expect positive annual growth in 2010 as pent-up demand is fulfilled.

Business Environment Ratings

The aim of **BMI**'s Business Environment Rating system for the automotive industry is to show the rewards and the risks that carmakers operating in a particular region -- in this case Asia Pacific -- may face. The unique system assesses crucial factors, such as sales and output growth, international trade, market size and location, and the level of market competition, in addition to taking into account a country's economic and political backdrop. The ratings system allows analysts to fully expound the potential advantages and disadvantages of investing in Asian car markets, and offers an overall comparison of the key markets in the region.

The rankings have changed slightly against the backdrop of the global economic slowdown, as some markets have proven better equipped to cope than others. Australia now leads the regional rankings, with a much higher score of 70.1 out of a possible 100, compared with 65.3 in the last ratings. The developed nature of the country means that Australia is at a disadvantage due the near-saturation status of its autos market, which reduces growth potential. On the other hand, a high GDP increases purchasing power, while market risks are reduced by low levels of corruption and a strong legal framework. This is reflected in the market's high score for its low risk. Its Country Rewards score has also risen from 66.7 to 87.2.

China has now fallen to second, although its overall score has risen from 66.5 to 67.7. The market's highest scores are still for its production and sales growth potential, based on **BMI**'s forecasts up to 2013, although signs of a slowdown in the market have been evident. However, even though a low level of vehicle ownership can look tempting in terms of possible growth, the low score for country structure (caused by the large gap that exists between wealthy towns and poorer rural areas) acts as a clear restriction on potential penetration. In terms of China's macroeconomic environment, a healthy long-term political and economic outlook ensures strong scores for Country Risk

A country held back by an auto market on the brink of saturation is South Korea, which has stayed in third with 66.8 out of 100, up from 64.2. Historically poor labour relations weigh on the country's overall rating, although long-term political and economic stability reduce the risks. The score for Rewards has risen this year, as the market's country score rating has gone from 52.2 to 65.8. Free trade agreements add to South Korea's sound regulatory environment, although there is room for improvement if a deal with the US can be ratified.

Japan stays in fourth with an overall rating of 61.1, up from 60.6 in the previous ratings. The risks associated with a developed market still exist, however. Just as Australia and South Korea suffer disadvantages due to their developed statuses, a saturated market also weighs on Japan's ratings. While the country scores well in terms of its Country Risk, with low levels of corruption and a sound legal framework that have bumped up the market's overall score, the auto industry is nearing full capacity, and this consequently reduces production growth potential, while the high level of vehicle ownership restricts possible sales growth. Labour costs are also high, which adds to the cost of expanding production.

Moving up to fifth is Thailand, which has benefited from an improved country risk score, taking its overall rating to 57.4. A number of new export-oriented investment projects have raised the country's production growth potential for the next five years, despite the current downturn, while several existing free trade agreements increase the reach of investors. Government incentives for manufacturers producing low-emission vehicles have boosted Thailand's regulatory environment score, along with good labour relations and trade relationships.

India is now down to sixth with a slightly lower score of 55.4, as a reduction in its Country Rewards rating drags on the Rewards category. India shares the same pros and cons as China, ranking highly in terms of high production and sales growth potential, but with a low score for country structure (again caused by a large gap between wealthy urban and poorer rural areas), which acts as a restriction on future penetration rates. However, the country's regulatory environment rating is bolstered by the government's efforts to encourage 'green' motoring, as well as a number of free trade agreements which are supporting the country's bid to become a regional export hub.

The Philippines has now moved up to seventh, although its overall score is down marginally from 54.6 to 54.0. The market offers only average sales and production growth potential based on **BMI**'s five-year forecast. Although the market is dominated by Japanese brands, the competitive landscape is still far from saturated by carmakers and could still provide opportunities for new entrants, while the country also scores well for its regulatory environment. In terms of Country Risk, solid scores for long-term economic and political risk should assure investors.

Indonesia, which has fallen to eighth on 53.9 compared with 56.2 previously, is the region's largest passenger car market and as such, will always have an appeal for investors. Low labour costs, and a competitive environment with room for new players, increase Indonesia's attractiveness, as do its recently upgraded regulations on intellectual property rights (IPRs), which boost its regulatory environment rating. The country's risks act as a hindrance however, with low scores for corruption, bureaucracy and the legal framework. The Country Rewards score has fallen from 47.5 to 36.3 taking its score for limits to potential returns down from 53.5 to 49.5.

Malaysia follows in ninth position with a rating of 52.6, up slightly from 50.2, although there is room for improvement in terms of the country's regulatory environment. While the country is a leading light of the ASEAN trade bloc, which has made it a popular choice for regional production activities in the auto sector, there is the potential for greater things if a proposed free trade agreement with the US is finalised. In terms of the market itself, production growth potential receives an average rating, while potential sales growth is low in comparison with its peers.

Taiwan, which has climbed to 10th on 49.4 paints a similar picture to Japan, in that its macroeconomic environment is sound, with high scores for long-term economic risk and low corruption. However, auto production is set to fall over **BMI**'s five-year forecast period, while projected sales growth is also minimal. The country receives an above-average rating for its regulatory environment, although links with the Chinese mainland may arouse concerns over IPRs.

Singapore has climbed one place to rank 11th with a rating of 48.5, compared with 45.2 in the previous ratings, with an increase in its Country Rewards score from 76.5 to 90.0. Singapore, along with Thailand, has the highest number of free trade agreements completed for any Asian market. However, in industry terms, the lack of domestic production facilities and the imposition of vehicle quotas, which restrict potential sales growth, weigh on the market's overall rating. Nevertheless, Singapore has climbed three places since our first ratings were produced.

Vietnam, meanwhile, stays in 12th. A newly liberated auto market has witnessed stellar growth, and according to the above-average rating for its potential over the next five years, sales growth should be maintained. The highest score is for Industry Risk, which stands at 85.0. Its Country Risk score has also risen from 49.8 to 51.5, taking its total score for risks up to 68.2. Vietnam is still a country we would expect to see climb the ratings in the future, particularly if its vehicle tariff policy becomes more consistent.

This leaves Hong Kong, which suffers from a lack of local automotive production, in 13th place on 46.6, although this is an improvement from its previous score of 42.9. The country scores highly for its long-term economic and political risk and regulatory environment and indeed its Country Reward score has risen from 72.0 to 87.4. However, with these scores near to the maximum achievable, and with little prospect of vehicle production on the horizon to raise Hong Kong's score for that criterion, the market is unlikely to climb much further in the ratings in the foreseeable future.

Rounding out the rankings now on 38.9, down from 42.4, is Pakistan, which is held back by low production growth potential and an average rating for sales growth. However, as a signatory to the Trade Related Intellectual Property Rights Agreement (TRIPS) under the auspices of the WTO, the country's regulatory environment scores well. A number of free trade agreements also contribute to this criterion, although forming FTA's with non-Asian countries would improve this rating further. Despite low marks for bureaucracy and corruption, the market does score well for its long-term economic risk and policy continuity.

Table: Business Environment Ratings -- Auto Industry Asia Pacific

	Rewards			Risks				
	Industry Rewards	Country Rewards	Rewards	Industry Risks	Country Risks	Risks	Autos Risk/ Reward Rating	Regional Ranking
Australia	58.3	87.2	68.4	80.0	68.2	74.1	70.1	1
China	81.7	44.9	68.8	65.0	65.2	65.1	67.7	2
South Korea	63.3	65.8	64.2	75.0	70.4	72.7	66.8	3
Japan	51.7	76.6	60.4	50.0	75.4	62.7	61.1	4
Thailand	53.3	48.3	51.6	60.0	56.4	58.2	58.3	5
India	68.3	28.2	54.3	60.0	55.8	57.9	55.4	6
Philippines	50.0	46.1	48.6	75.0	58.0	66.5	54.0	7
Indonesia	56.7	36.3	49.5	75.0	52.9	63.9	53.9	8
Malaysia	40.0	61.2	47.4	60.0	69.7	64.8	52.6	9
Taiwan	35.0	50.0	40.3	70.0	71.5	70.8	49.4	10
Singapore	11.7	90.1	35.3	55.0	86.0	70.5	48.5	11
Vietnam	**45.0**	**26.8**	**38.6**	**85.0**	**51.5**	**68.2**	**47.5**	**12**
Hong Kong	10.0	87.4	37.1	55.0	82.9	68.9	46.6	13
Pakistan	31.7	25.2	29.4	75.0	47.0	61.0	38.9	14

Scores out of 100, with 100 highest. Source: BMI.

The Autos Business Environment Rating is our principal rating. It is comprised of two sub-ratings, 'Rewards' and 'Risks', which have a 70% and 30% weighting respectively. In turn, the 'Rewards' Rating comprises an Industry and a Country element, which have a 65% and 35% weighting respectively. These are based upon specific Industry growth and size dynamics within the market, and the broader economic and socio-demographic environment of the country. The 'Risks' rating is comprised of Industry Risks and Country Risks, which each have a 50% weighting. These are based on a subjective evaluation of industry regulatory and competitive issues particular to that market, and the industry's broader Country Risk exposure, which is based on **BMI**'s proprietary Country Risk Ratings. The ratings structure is aligned across all 14 industries for which **BMI** provides Business Environment Ratings methodology, and is designed to enable clients to consider each rating individually or as a composite, with the choice dependant on level of exposure to the industry in each particular state. For a list of the data and indicators used, please consult the appendix located at the back of the report.

Industry Forecast Scenario

Production & Sales

Table: Vietnam Autos Sector - Historical Data And Forecasts

	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Production (value, US$bn)*	1.741	1.79	2.220	2.327	2.569	2.886	3.339	3.844
Production (CBUs)	20,750	21,288	25,310	27,286	29,855	32,821	36,401	40,392
- Cars*	21,895	18,938	22,193	23,576	25,380	27,463	29,979	32,816
- Commercial vehicles*	2,155	2,351	2,658	3,710	4,475	5,358	6,422	7,576
Sales (value, US$bn)*	4.765	5.130	3,117	8.663	10.057	12.112	14.663	17.730
Total sales (CBUs)*	108,392	160,400	172,608	193,018	212,201	234,303	260,167	288,110
Domestically produced sales	80,392	110,000	119,460	128,874	143,341	160,027	180,123	201,923

*Figures are for complete knock down kit/completely built unit assembly, f = forecast, * estimate. Sources: VAMA, Vietnam Bridge News, Saigon Times, VN Economy, Asia Times, Ministry of Investment, BMI*

Vietnam's new vehicle market is characterised by fluctuating tariffs, which often make it hard to identify sustainable sales patterns. Sales of domestically-produced vehicles were impacted by an increase in vehicle ownership tax in 2008. After the tax doubled to 10%, the Vietnam Automobile Manufacturers Association (VAMA) reported that average sales for the last four months of the year dropped by around half, compared with the first eight months. The registration tax was raised again on January 1 2009 to 12% in Hanoi and 15% in Ho Chi Minh City. Furthermore, the Special Consumption Tax (SCT) was increased on April 1, bringing a return to the days of prohibitively high vehicle prices in the country. **BMI** lowered its sales forecast in Q209, in anticipation of a further contraction when the new taxes took effect.

The consensus earlier in the year pointed to a tough H109 and this played out, although monthly sales showed signs of recovery as the year wore on. Vietnam's new vehicle sales for the first 11 months of the year climbed into positive territory after a 132% y-o-y rise in sales in November. The market was buoyed by a 47% rise in passenger car sales, on the back of tax cuts. However, this has unbalanced the market as sales of SUVs and MPVs, usually one of the stronger segments in the country, were up by just 3%, and commercial vehicle sales fell by 7%. By the end of the year, total sales of domestically produced vehicles were 7% higher y-o-y. Passenger car sales were 125% higher in December while the SUV/MPV segment grew 20%, despite the higher taxes. Commercial vehicle sales rose 50%.

The government may be looking to redress the balance in segment sales, however, with reports of a new industry strategy, which will favour small MPVs. This would be a positive outcome for Japan's **Toyota Motor**, in particular, which publicly questioned the logic behind implementing the higher SCT on the country's most prominent vehicle segment. Toyota's Innova is a leader in Vietnam's MPV segment, and the company has invested heavily in increasing its local content.

According to local news site VietNamNet, Toyota has the highest localisation of any manufacturer with 37% local content. However, **BMI** has previously cautioned that by discriminating against MPVs, carmakers may reconsider their local production operations. After an initial rush in March to avoid the higher SCT, when MPV/SUV segment sales were up by 53% y-o-y, sales have been sliding.

We expect sustained positive annual growth in 2010 as pent-up demand is fulfilled. However, signs that the after-effects of the tariff changes are kicking in were evident as sales for Q110 were down by 2%, despite an 80% increase in passenger car sales. Again it is the MPV/SUV segment dragging on growth, with sales down 39% y-o-y, while commercial vehicle sales are down 2% y-o-y. By the end of H110, total sales had returned to positive growth of 5%, although passenger car growth was lower at 29%. The MPV/SUV segment is still impacted by the higher STC with sales down 10%, while commercial vehicle sales were up just 2% y-o-y.

While we believe that consumers appear to be adjusting to the new tax, as shown in the improvement during Q210, we have lowered our forecast for sales of domestically-produced vehicles to growth of 7.8%. This allows for some further growth in Q310, although from there on we believe the results of Q409, which were inflated by tax cuts, will be difficult to replicate.

The government has made efforts to increase domestic output by reducing the tariff on imported components. The Ministry of Finance slashed the import tax on car parts by 2-5% as of March 9 2009, while the import duty on car engines has been reduced to 20% from 22-23%. The tax on engine parts has been cut to 10-20% from 15-25%.

The government remains committed to its masterplan for the industry, which envisages output of 240,000 units by 2010. However, **BMI** has a much lower production forecast, as the target now looks unattainable given the current low levels.

Trade

Table: Vietnam Autos Sector - Historical Data And Forecasts

	2007	2008	2009e	2010f	2011f	2012f	2013f	2014f
Imports (CBUs)	13,000	50,400	53,148	64,143	68,860	74,276	80,044	86,187
Imports (value, US$bn)*	0.523	2.413	2.440	2.947	3.370	3.896	4.586	5.345

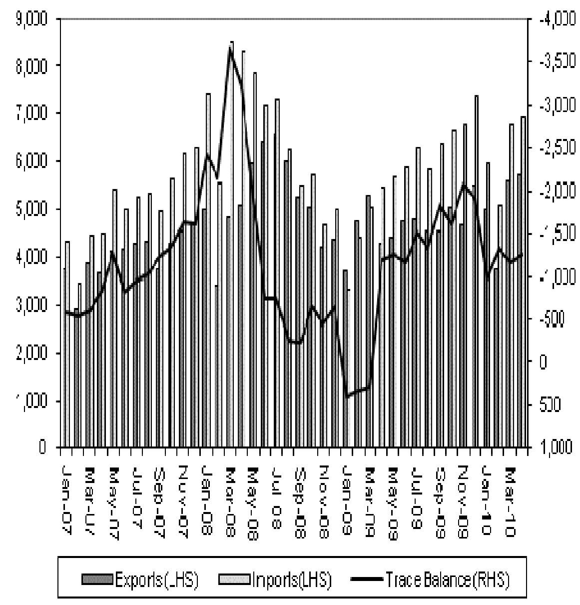
*f = forecast, * estimate. Sources: VAMA, Vietnam Bridge News, Saigon Times, VN Economy, Asia Times, Ministry of Investment, BMI*

The Vietnamese government is once again targeting the imported vehicle segment, which backs **BMI**'s forecast that imports will grow 20% this year if left unrestricted, as it looks to reduce its budget deficit. Official data show that import revenues on vehicles with less than nine seats rose by 44.7% year-on-year (y-o-y) in the first four months of the year to US$106mn. The value of imported car parts used in local assembly also rose by 129% to US$277mn.

Although imports in volume terms were down to 11,000 units in January to April 2010, the lowest level in three years, the government is still aiming to introduce a number of measures to keep imports down. This includes reducing the number of ports that imported vehicles can pass through and restricting access to foreign currency loans for imports. The VAT rate has already been returned to 10% after it was cut by half in 2009 to kick-start sales. The Ministry of Finance is also considering a hike in car registration fees from 10% to 15%.

Trade Deficit At A More Sustainable Level

Vietnam - Exports, Imports and Trade Balance (inverted), US$mn



Source: General Statistics Office

In addition to reducing the trade deficit, the additional charges on vehicle imports can also be seen as an attempt to promote the local production industry. **BMI**, however, believes that without supporting the development of the parts segment, this could prove counterproductive. Although there has been investment in domestic output, with Nissan recently beginning production of its Grand Livina MPV and stating that the high cost of imports was to blame for its low market share in the country, the rising cost of imported parts could lead manufacturers to decide that it is still more cost-effective to import completely built units (CBUs).

Economic Contribution

Table: Vietnam Autos Sector - Historical Data And Forecasts

	2006	2007	2008	2009	2010e	2011f	2012f	2013f
Contribution to GDP* (%)	1.39	1.37	1.33	1.41	1.45	1.50	2.0	2.5
Total stock of passenger cars (CBUs)*	789,577	833,182	874,841	918,583	1.010mn	1.111mn	1.150mn	1.170mn
Car ownership (% of population)*	0.95	0.99	1.03	1.05	1.15	1.20	1.30	1.35
Sectoral employment*	7,000	7,100	7,200	9,100	9,800	10,500	12,000	12,750

*e/f = estimate/forecast, * estimate. Sources: Vietnam Automobile Manufacturers Association, Vietnam Bridge News, Saigon Times, VN Economy, Asia Times, Ministry of Investment, BMI*

Competitive Landscape

Market Overview

The country's autos industry is still in its infancy as producers typically import complete knock down kits (CKDs), which are assembled and sold domestically. The domestic parts sector is small at present, although the government is making it a priority. Given rapid economic growth in the region, there is significant development potential for the industry, especially as car ownership levels stand below 1% of the population. Over the last year, however, significant hurdles have appeared, not least a drastic change to the tax regime.

The increase in consumption tax stems from concerns that manufacturers are not investing heavily enough in the domestic parts industry. By 2005, the government wanted to achieve a minimum 25% localisation of parts, increasing to 30% by 2007. Yet, in 2004, the Ministry of Finance estimated that the proportion of locally made parts in domestically sold vehicles ranged from 2-10%. This is a significant gap, and could largely be attributed to the continued import of CKDs.

Industry Developments

With vehicle imports set to surge when tariffs are removed under the ASEAN Free Trade Agreement (AFTA) in 2018, Vietnam's Ministry of Industry and Trade (MOIT) is looking to make the domestic industry competitive in the meantime. **BMI** sees an underdeveloped supplier segment as a major area for concern, which will be addressed through higher import tariffs on parts that can be made domestically. Higher rates will also be applied to vehicles imported as completely built units.

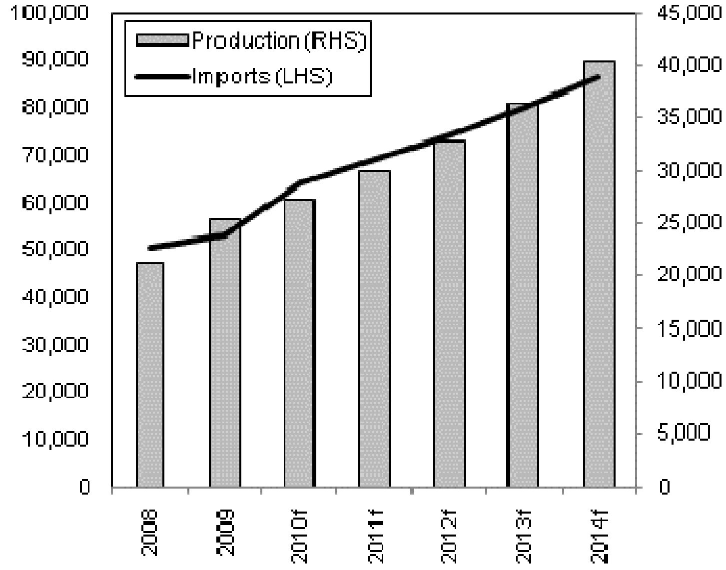
In order to facilitate the sector's development, MOIT has proposed that investment projects for the auto industry should be given preference. However, **BMI** believes that the Vietnamese industry is trapped in a vicious cycle where carmakers are reluctant to invest in production without a well developed supplier base and suppliers will want to see growth potential in vehicle assembly before investing. We expect total vehicle production to rise just 48% between now and 2014.

To help break the cycle and encourage domestic parts production, MOIT is proposing a zero tariff on imported products and materials used in manufacturing components. The ministry is also requesting that the National Assembly consider a special 50% cut in the Value Added Tax on trucks, buses and products that will improve the fuel efficiency and environmental credentials of vehicles.

The government has already made moves this year to limit imports, which **BMI** expects to rise around 20% per year if unrestricted. Official data show that import revenues on vehicles with less than nine seats rose 44.7% year-on-year (y-o-y) in the first four months of the 2010, to US$106mn. The value of imported car parts used in local assembly also rose 129%, to US$277mn. Measures considered include reducing the number of ports that imported vehicles can pass through and restricting access to foreign currency loans for imports. The VAT rate has already been returned to 10% after it was cut by half in 2009 to kick-start sales. The Ministry of Finance is also considering a hike in car registration fees from 10% to 15%.

Tackling Trade Issues

Vietnam Vehicle Production And Imports (CBUs)



f = BMI forecast; Sources: OICA, VAMA

When the floodgates open in 2018, **BMI** expects Asian brands to have the best opportunities. Tariffs on vehicles with less than nine seats from other AFTA signatories will be scrapped while parts will be subject to a lower 5% tax, while tariffs on parts from China and South Korea will also be reduced to 5% under respective FTAs. However, non-Asian brands based in these countries could also benefit, although in a downside risk for Vietnam, this could lead to increased investment in existing production facilities in other Asian countries.

Competitive Landscape

Table: New Vehicle Sales By Top 10 VAMA Members, 2009 & 2008 (CBUs)

	2009	2008	% chg, y-o-y
Toyota Motor	30,110	24,421	23.0
Truong Hai Auto	21,617	17,693	22.0
Vinamotor	15,284	21,147	-28.0
GM Daewoo Auto & Technology	14,200	11,036	29.0
Vinaxuki	8,680	8,070	8.0
Ford Motor	8,286	6,473	28.0
Honda Motor	4,215	5,909	-29.0
Vinastar	3,666	2,925	25.0
Mercedes-Benz Vietnam	3,399	2,118	60.0
Isuzu	2,997	3,385	-11.0

Source: Vietnam Automobile Manufacturers Association

Data from the Vietnam Automobile Manufacturers Association (VAMA) show that despite its recall issues, Toyota was still the most popular brand in Vietnam in 2009, with sales of 30,110 units and a market share of 25.2%, up from the 22% held in 2008. This was a 23% increase on the 24,421 units sold the year previously. The strongest sales performance of 2009 came from **Mercedes-Benz Vietnam**, with sales rising 60%. Sales of 3,399 units lifted the company to ninth place from 10th in 2008. Others suffered from the global downturn, however, with **Mekong** posting the largest drop of 62% y-o-y.

Table: New Vehicle Sales By Top 10 VAMA Members, H109/10 (CBUs)

	H109	H110	% chg, y-o-y
Toyota Motor	10,907	14,089	29.0
Truong Hai Auto	8,933	11,106	24.0
Vinamotor	7,268	6,097	-16.0
Vinaxuki	4,194	4,944	18.0
GM Daewoo Auto & Technology	4,926	4,401	-11.0
Ford Motor	2,699	2,673	-1.0
Visuco (Suzuki)	866	1,491	72.0
Mercedes-Benz Vietnam	1,451	1,224	-16.0
Honda Motor	1,836	1,167	-36.0
VinaStar (Mitsubishi)	1,473	1,070	-27.0

Source: Vietnam Automobile Manufacturers Association

Four of the top 10 locally producing carmakers posted positive growth in H110, although the competitive landscape remained largely the same. Toyota retained its lead with growth of 29%, down slightly from the 34% growth of Q110. **Visuco** again achieved the best growth of the top 10 manufacturers with a 72% rise in sales, up from 37% in Q110. **Mekong**, representing **Fiat**, **Ssangyong** and **PMC**, registered the worst sales with a 65% decline.

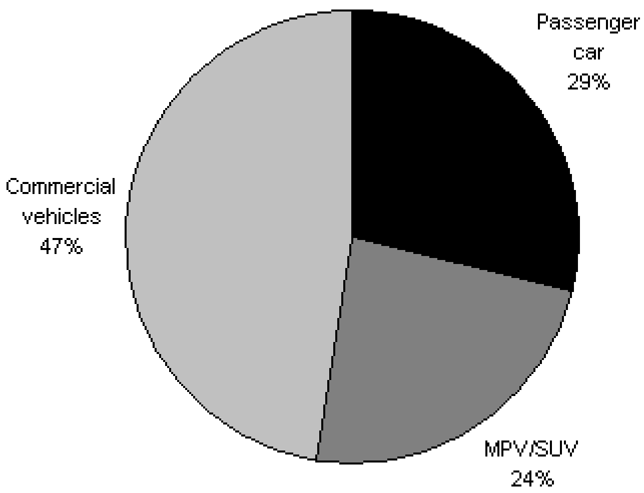
Company Developments

Japan's Nissan Motor has furthered its strategy of focussing on emerging markets for growth with the launch of its first domestically produced vehicle in Vietnam. The Grand Livina MPV is assembled by VMC and distributed by Nissan Vietnam, a joint venture (JV) between Nissan and Denmark's Kjaer Group.

Nissan blamed high import tariffs on imported vehicles for its relatively low market share of less than 1% in Vietnam, which led to the decision to go ahead with investment in the plant, despite the global downturn. Nissan COO Toshiyuki Shiga referred to Vietnam as 'one of the key automobile markets', and this will be marked with the opening of two new dealerships to accommodate the new models. An outlet will open in Ho Chi Minh City on April 6 and Hanoi on April 13.

Nissan Eyes Growth Segment

Vietnam New Vehicle Sales By Segment 2009



Source: VAMA

The Livina is an important part of Nissan's product strategy for South East Asia, as MPVs are popular. However, it is risky in Vietnam where MPVs carry a higher special consumption tax (SCT). The Ministry of Trade and Industry has approached the prime minister to change the country's 'strategic car line' to the smaller MPV segment, with six to nine seats and an engine under 1.5-litres. This was chosen as a fair compromise as MPVs sell well in the country, but no manufacturer currently produces a model that fits the requirements and so the ministry cannot be said to favour one brand over another.

An important factor in Nissan's decision to go ahead with its plant investment is timing. Speaking in July 2009, when Nissan said it would go ahead with the project, a company official said that Nissan believed the Vietnamese autos market was not contracting by as much as in other countries, and expected it to be returning to growth by the time its production operations begin. Combined sales for carmakers producing in Vietnam rose by 13% y-o-y for the first two months of 2010 and **BMI** expects the year to end with sales of domestically produced vehicles up by at least 12.6% y-o-y.

Nissan is looking for sales of around 2,000 units in its first year of selling locally produced vehicles. It will go to expand its product range with two other models assembled locally and a number of imported models, including the 350Z sports car, Murano, Teana and X-Trail SUV. The Japanese company is chasing a global market share of 5.5% within three years and sees emerging markets, such as Vietnam, as playing a strategic role in achieving this.

South Korean carmaker **Ssangyong Motor** has also won a contract to tap into Vietnam's growing SUV segment, through the delivery of 15,500 vehicles over the next five years. Under the terms of the agreement, Ssangyong will ship completely knocked down kits of its Kyron SUV to **Xuankien Vinaxuki Motor** for assembly in Vietnam. Ssangyong has not revealed the value of the exports, which began on February 11.

The contract will give Ssangyong a lift as it implements its restructuring plan, agreed by the Seoul Central District Court in December. After applying for bankruptcy protection in February 2009 and having its initial rescue plan rejected, the court decided it would be in the best interests of creditors, shareholders and suppliers with outstanding bills, that the carmaker was given the chance to restructure.

This will represent one of the first major contracts for Ssangyong after a turbulent 2009, which saw its employees involved in a bitter, and sometimes violent, strike and occupation of the company's plant. The SUV specialist is aiming to return to profitability and triple sales within three years. This follows a net loss of KRW89.7bn (US$77mn) in Q309, compared with a loss of KRW28.1bn (US$24.1mn) in Q308, marking its eighth consecutive quarterly loss. In October, the company also announced that it was in talks with potential foreign investors regarding an acquisition. Ssangyong's co-court receivership manager, Lee Yoo-il, told the Korea Herald that the investors were late entrants to Asia and their products did not overlap with Ssangyong's.

Commercial Vehicles

Vietnam has the smallest commercial vehicle market in the ASEAN region, with around two goods vehicles per 1,000 people. It is perhaps due to the undeveloped condition of the domestic automotive industry that the Vietnamese government is reticent about releasing sales and production data. Even the VAMA does not publicise a definitive record of sales and production by category.

Table: Vietnam - Commercial Vehicle Sales, 2006-Q110

	2006	2007	2008	2009	H110
Commercial vehicle sales	17,562	40,277	61,072	56,737	25,467

Source: BMI

Chinese commercial vehicle manufacturer **Anui Jianghuai Automobile** (JAC) began its international expansion in April 2010 by starting construction on a JV plant in Vietnam, China Daily has reported. China's second largest truck maker, based in Hefei in the eastern province of Anhui, will mostly produce medium and light-duty trucks with its unnamed Vietnamese partners at the plant, the newspaper quoted the company's chairman, Zuo Yan'an, as saying. It will be JAC's first facility outside mainland China.

JAC's Vietnamese plans come after it signed a US$293mn agreement with US truck maker **NC2** to jointly manufacture and sell trucks and parts in China with an eye on particular markets for export. NC2 is itself a JV between carmaker **Navistar International** and manufacturing conglomerate **Caterpillar**.

The overseas plans will help JAC more than double its exports to 15% of total output by the end of China's 12th Five-Year Plan in 2015 and is part of an expansion programme that may also see a production plant built in Brazil. JAC exported 6-7% of the 322,000 units it produced in 2009 to South East Asia, the Middle East and Latin America. The truck maker expects to produce 400,000 units in 2010 and plans to ramp up output to 1mn units by the end of 2015. Traditionally one of China's leading vehicle exporters, JAC's revenue reached US$3bn in 2009.

Suppliers

In a bid to raise localisation in domestically produced vehicles, Hanoi's Department of Industry and Trade has established a programme aimed at developing the automotive supply industry. There are so far around 40 support companies covered by the programme, which will include trade promotion and campaigns to generate investment in the segment.

The government has set localisation targets of 65% by 2010 in all vehicle segments. By 2020, this will rise to 75% for passenger cars and 85% for trucks. At present, 70-90% of all parts and components are imported. According to the Department of Industry and Trade, local value-added processes are restricted to welding and painting, with the few companies that do produce supplies focused on smaller items, such as wires and batteries.

Attempts at raising the number of local parts used are also intended to feed into local sales. By lifting the amount of locally sourced materials in vehicle production, the government hopes that production costs will fall, allowing the savings to be passed on to the consumer to combat the country's notoriously high vehicle prices.

Japan's **Denso Corporation** has taken advantage of the focus on the country's parts segment. **Hamanakodenso**, a subsidiary of Denso, has set up a new company named **Hamaden Vietnam** (HDVN) in the Hung Yen province. Construction of the factory began in 2009 with an initial investment of JPY2.2bn (US$21.2mn).

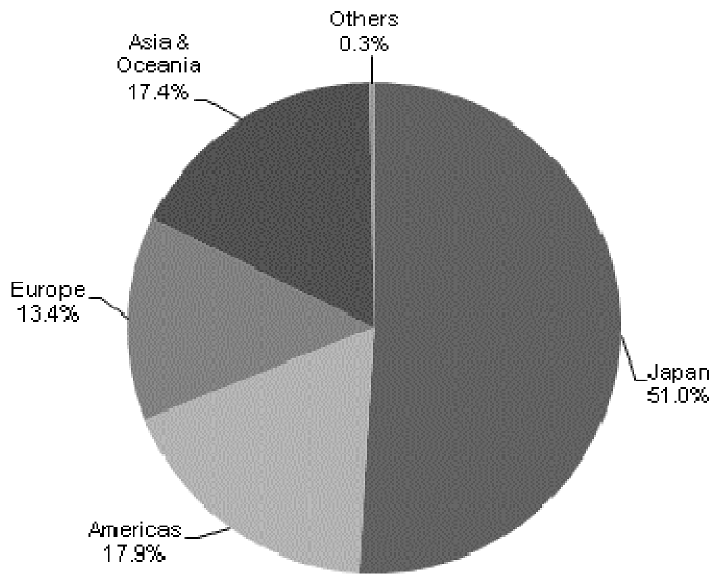
Company Monitor

Denso Eyes Local Content To Build On EM Success

With **BMI** believing that suppliers with emerging market (EM) exposure will benefit from an increased focus on local content, Japan's **Denso Corporation** is following this view with plans to reduce production costs for parts used in low-cost EM models. Achieving this will rely on ramping up its own local procurement to purchase more raw materials and components in the countries where these vehicles are produced.

Delivering To Growth Regions

Denso Corp Sales By Customer Location



Source: Denso

Denso has already learned that EM exposure is good for business. When it became the world's leading supplier, based on sales to original equipment manufacturers (OEMs), in 2009 it cited entry into markets such as China as factors in its growth. Despite the recent wage-related strike action at the plant owned by its Denso Guangzhou Nansha joint venture (JV), the Japanese firm has said it is keen to expand its capacity in the world's largest car market by 'several hundred thousand units' over the next year as its major clients such as **Toyota Motor** boost their own local production. Toyota's new plant in Changchun will have an annual production capacity of 100,000 Corollas on opening in H112.

India has also become a focal point for Denso as production of small budget cars becomes concentrated in the country. The company supplies **Tata Motors** for its Nano, while Toyota will begin sales of its Etios compact model later this year. With this in mind, Denso has entered into a JV with local air conditioning specialist **Subros** to set up a local research and development (R&D) centre by September. Subros itself, which plans to increase capacity to 1.5mn units in the next three to four years, is a JV between Denso, the Suri family and **Suzuki Motor**.

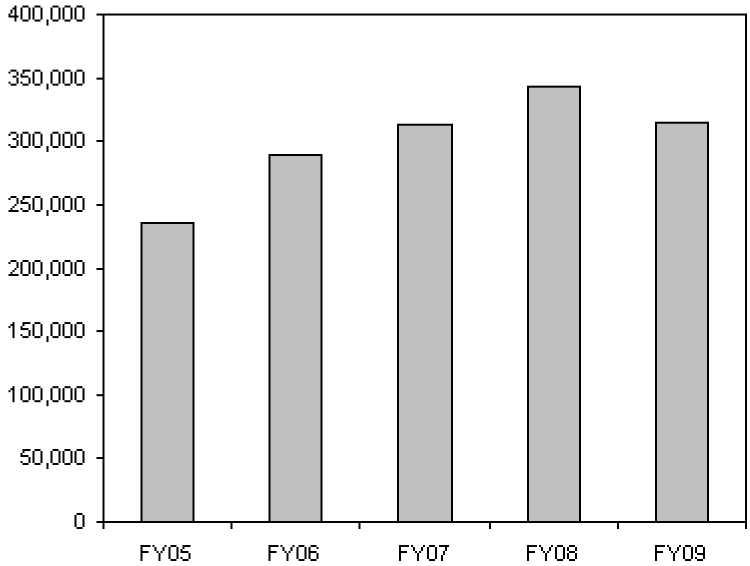
As a result of its involvement in high-growth EMs, Denso says its forecast for the current financial year could exceed forecasts. More developed markets have also played a part, with CEO Nobuaki Katoh referring to strong sales in Japan and the US as other drivers of profit growth. However, Katoh has said he is cautious, like **BMI**, that H210 could be more difficult due to the ending of car purchase subsidies in Japan scheduled for September and the likelihood of a slowdown in Europe.

EMs will bring their own risks. **BMI** expects vehicle sales growth in China to decelerate in H210, despite the extension of incentive schemes. This is already playing out as year-on-year growth in car sales for June was the lowest in 14 months. Nevertheless, the market still offers more growth potential than some developed states. We expect sales growth to average just 3% over the next five years in the US and to fall to a 2% average from 2011 onwards in Japan after 11% growth this year.

Denso has not turned its back on the developed states, however, announcing new facility and product investments in January 2010 in line with the activities of local carmakers. Its **Denso East Japan Corporation** subsidiary, first established in April 2008, will begin work on its first production plant later this year. Construction had been put off due to uncertainty in the industry and a drop in domestic vehicle production, which reduced demand for parts.

Investing In Recovery

Denso Capital Expenditure FY2005-2009 (JPYmn)



Source: Denso Corp

Now, however, Denso expects vehicle production, particularly in the east of the country, to slowly increase and plans to have the plant ready to begin operations by May 2011. It will produce air conditioning systems, among other components, and Denso expects the division to achieve sales of around JPY6bn (US$65.1mn) by the financial year ending March 2012.

BMI forecasts suggest that this is ideal timing for a plant opening, with vehicle production growth set to hit a peak for our five-year forecast period in 2011. By this time we expect growth of around 4.5%, settling to an average of 3.5% thereafter up to 2014. Car production growth is forecast to be slightly above the total vehicle average, up by 4.8% in 2011 and an average of 4% for the next three years.

Denso remains cautious regarding the future of the vehicle production industry, however. Denso East Japan President Yuji Morimoto said the firm will 'continue to evaluate the situation and consider the company's medium-term business plans'.

Tailoring products to the activities of carmakers appears to feature in these plans, as Denso has announced the launch of a new battery monitoring unit for lithium-ion batteries used in cars. The new unit is intended to be simpler in structure than previous units, while performing at the same level. Battery monitoring units use indicators such as a battery's temperature, voltage and current to detect if a cell is operating at a higher than average voltage and make it discharge in such cases.

The product has already been incorporated in the latest Prius, which was launched in late 2009, and with production of hybrid and full-electric vehicles from domestic carmakers set to rise in the next few years there is significant potential for its wider usage.

Denso has also launched a new air conditioning system targeting, in **BMI**'s view, two key growth areas of the Japanese market. The new system is to be deployed on hybrid buses, combining the growing interest in alternative fuel vehicles, as supported by government policy, with an increasing shift towards using public transport.

BMI expects this renewed interest in public transport to result in the bus segment outperforming other vehicle sectors this year, with sales forecast to rise 14.5%, compared with 11% for cars. Anecdotal evidence from dealers suggests that younger people are no longer as motivated to own cars, particularly in urban areas where it can be more convenient to take public transport. Moreover, while **BMI** data show that the largest section of society will actually be the 75 years and older category, accounting for over 11% of the population over the next five years, they are also less likely to own a car.

Akio Shikamura, managing director of Denso's Thermal Business Group, referred to Japan's buses as 'a key means of public transportation' and because of their widespread use, 'must be more fuel efficient'. He claims that Denso's new air conditioning system will use 50% less power because it is smaller and more efficient. This is largely due to an integrated electric compressor, which means the battery-operated system does not have to be connected to the engine and therefore, the pipes can be shorter and the size and weight of the whole system can be reduced. It also means that the air conditioning will still work when the engine is switched off.

Company Profiles

Daewoo Motor (Vidamco)

Market Position

In 2008, **Vidamco** stood in fourth place in the market with sales of 11,036 units and a market share of 10%, almost double the share claimed in 2006. This was the result of a 45.6% increase in sales from 2007. In March 2009, sales rose by 106.8% to 519 units, while Q1 sales were up by 63% to 1,176 units to claim a market share of 17%. This performance was turned around by June, as results for H109 showed a 28% decline in sales to 4,926 units. This took the company's H109 market share down to 10.28%. By the end of the year, the company's sales for 2009 were up by 29% and its market share had also risen to 11.8%.

In H110, the company's sales were down 11% to 4,401 units, taking its market share down to 8.75%.

New Products

Vidamco launched the Chevrolet Spark compact model in June 2008. According to Vidamco's general director, Kim Jung, offering value-for-money models in the region is a strategic policy.

The company has already reached a localisation level of 23% in its domestically produced models, rising to 50% for ASEAN sourced parts, and is on track to achieve localisation of 40% by 2010, in line with the government's plan for the industry.

In April 2010, Vidamco launched the Chevrolet Cruze sedan, a global model based on the Lacetti Premiere. Speaking at its launch, GM Daewoo's president and CEO, Mike Arcamone, outlined the company's strategy to continue offering new products, which he said he it believed would contribute to winning over the country's motorcycle riders to four-wheeled alternatives.

Company Data

- No. of employees: 272
- Year established: 1993

Mercedes-Benz Vietnam

Market Position

(MBV)'s sales for 2008 fell almost 7% y-o-y to 2,119 units, taking the firm's share of the market down to 1.9%. In Q109, MBV sold 712 cars, 432 of which were sold in March alone. The Q1 total was a 48.45% improvement y-o-y, with sales up 200% compared with February. In H109, MBV was the only one of the top 10 manufacturers to post positive growth, with sales up 28% to 1,451 units, for a market share of 3.03%. MBV posted the highest growth of the top 10 manufacturers in 2009 as sales ended the year up 60% to 3,399 units.

In H110, however, MBV's sales fell 16% y-o-y to 1,224 units.

New Products

In April 2010, MBV expanded its alternative fuel range with the launch of the Mercedes S400 hybrid sedan. The company claims the addition of the lithium-ion battery pack, the first in an MBV model, reduces fuel consumption by 20% and increases power by 10%. However, Vietnam's tax system will again influence sales, as the import tariffs, luxury car tax and VAT take the price of the S400 over VND4.41bn (US$231,000).

The new SLS AMG 'super sports car' was also unveiled in April, but with worldwide production already sold out, numbers for Vietnam will be limited.

Company Data

- Annual production capacity: 4,000 units

BMI Methodology

How We Generate Our Industry Forecasts

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. **BMI** mainly uses OLS estimators and in order to avoid relying on subjective views and encourage the use of objective views, uses a 'general-to-specific' method. **BMI** mainly uses a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example a deep industry recession, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately selected regression models. **BMI** selects the best model according to various different criteria and tests, including, but not exclusive to:

- R^2 tests explanatory power; Adjusted R^2 takes degree of freedom into account
- Testing the directional movement and magnitude of co-efficients
- Hypothesis testing to ensure co-efficients are significant (normally t-test and/or P-value)
- All results are assessed to alleviate issues related to auto-correlation and multi-co-linearity.

BMI uses the selected best model to perform forecasting.

It must be remembered that human intervention plays a necessary and desirable role in all of **BMI**'s industry forecasting. Experience, expertise and knowledge of industry data and trends ensures that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not.

Within the auto industry, this intervention might include, but is not exclusive to, significant company expansion plans, new product development that might influence pricing levels, dramatic changes in local production levels, product taxation, the regulatory environment and specific areas of legislation, changes in lifestyles and general societal trends, the formation of bilateral and multilateral trading agreements and negotiations, political factors including trade and the development of the industry in neighbouring markets that are potential competitors for foreign direct investment.

Example of Vehicle Sales Model:

$(\text{Vehicle Sales})_t = \beta_0 + \beta_1*(\text{GDP})_t + \beta_2*(\text{Population})_t + \beta_3*(\text{Inflation})_t + \beta_4*(\text{Lending Rate})_t + \beta_5*$ (Foreign Exchange Rate)$_t + \beta_6*(\text{Government Expenditure})_t + \beta_7*(\text{Vehicle Sales})_{t-1} + \varepsilon_t$

Sources

Aside from government departments and official company reports, we rely on the **International Organization of Motor Vehicle Manufacturers** (OICA), other established think tanks, institutes and international and national news agencies.