# PRIVATISATION IN VIETNAM

## Opportunities and challenges for investors

**December 2018**

## BACKGROUND

The Vietnamese Government has given equitisation and state capital divestment high priority in recent years. They are expected to play a key role in the ongoing restructure of the economy, with a particular focus on improving the management and operation of dominant, but inefficient, state-owned enterprises, and raising capital to address the state's budget deficit. This is reflected in the Vietnamese Government's ambitious roadmap to equitise and divest state capital in more than 500 enterprises by 2020, so that the state will only retain control in enterprises operating in core sectors such as oil and gas, power and telecommunications.

This roadmap offers an array of opportunities for private investors – particularly foreign investors – to tap into the Vietnamese market, by investing in companies with leading market positions and nationwide networks.

However, the lengthy and complex process for equitisation and state divestment has been a major impediment to foreign investment in this sector. In an effort to improve the legal framework, and ensure efficiency and transparency in this process, the Government recently introduced some major changes to the relevant regulations.

We will briefly discuss the upcoming investment opportunities, Vietnam's legal framework in relation to equitisation and state capital divestment, and the key legal issues that foreign investors need to consider when weighing up investment opportunities in this space.

## EQUITISATION vs STATE CAPITAL DIVESTMENT

The terms *'equitisation'* (the Vietnamese concept of privatisation of SOEs) and *'State capital divestment'* are often confused in the Vietnam market.

In brief, ***equitisation*** refers to the conversion of state enterprises (*'Doanh nghiệp nhà nước'* in Vietnamese), or companies that are wholly owned by state enterprises (collectively, ***SOEs***), into shareholding/joint stock companies, by way of a partial sale of their shares to public investors, strategic investors and/or employees of SOEs.

*State capital divestment* is the process that follows after SOE equitisation, and refers to the sale of all or a part of the interest that the state or a state enterprise (collectively referred as a ***state vendor***) holds in companies (including equitised SOEs) to other investors.

# EQUITISATION

## UPCOMING OPPORTUNITIES

| | Core business | Expected % of shares to be sold |
|---|---|---|
| **Vietnam Mobile Telecom Services (Mobifone)** | Second-largest telecommunications operator in Vietnam | 35-50% |
| **Saigon Trading Group (SATRA)** | Owner of the largest retail distribution system in southern Vietnam, with a chain of supermarkets and convenience stores | 50% |
| **Vietnam Cement Corporation (Vicem)** | Largest cement manufacturer in Vietnam | 50% |
| **Ben Thanh Group** | One of the largest trading groups in Vietnam, with interests in tourism, commerce and property | 50% |
| **Vietnam Maritime Corporation** | One of the largest maritime companies in Vietnam | 35% |
| **Vietnam National Chemical Group (Vinachem)** | Largest chemical company in Vietnam | 49% |
| **Vietnam National Tobacco Corporation (Vinataba)** | Largest tobacco manufacturing company in Vietnam | 49% |
| **Saigon Tourist Co. Ltd.** | Largest tourism company in Vietnam | 35% |
| **EVN Generation Corporation 1 (Genco 1)** | A holding company for numerous power plants | 35% |
| **EVN Generation Corporation 2 (Genco 2)** | A holding company for numerous power plants | 50% |

## HOW CAN INVESTORS PARTICIPATE?

Investors (both domestic and foreign) can participate in the equitisation process as ordinary investors at the initial public offering (***IPO***), or as strategic investors, if they qualify as such.

### Acquiring shares in the IPO

**Share allocation:** The law requires that at least a 20 per cent stake of an SOE be offered to public investors through an IPO. In practice, most SOEs offer only the minimum 20 per cent to public investors, and retain the remaining larger stake to offer to strategic investors, who are expected to assist the SOEs in improving management and operations, through transfer of technology and industry knowledge.

**Sale method:** In addition to traditional sale methods of public auction and underwriting, the new law introduces book building as a form of IPO sale, which is subject to approval by the Prime Minister and the issuing of separate guidance from the Ministry of Finance.

**Pricing:** The floor IPO price is determined based on the state's valuation of an SOE and set out in the approved equitisation plan. The auction price in the IPO must be higher than the floor price.

### Acquiring shares as strategic investors

**Qualifications:** An investor will be qualified as a strategic investor only if it satisfies the various conditions and qualifications set out in the law and the specific equitisation plan of an SOE (eg being profitable, and providing an undertaking to maintain the SOE's core business for at least three years, and to provide assistance and support to the SOE).

**Deposit:** Strategic investors must make a deposit of 20 per cent of the value of the shares registered to acquire at the floor price set out in the approved equitisation plan. The required deposit increased from 10 per cent under the old regime to 20 per cent under new Decree 126, which is considered high, compared with most international M&A transactions. However, strategic investors are now allowed to replace a cash deposit with an escrow or a bank guarantee.

**Sale method:** Before the public announcement of the IPO, qualifying bidders interested in becoming a strategic investor in the relevant SOE will be shortlisted. After the IPO is completed, the sale to strategic investors can be conducted by way of either:

- direct agreement if (i) there is only one shortlisted bidder; or (ii) there are two or more shortlisted bidders, and the total number of shares registered to be purchased is less than, or equal to, the number of shares to be sold to strategic investors under the approved equitisation plan; or
- auction on a stock exchange, which is more common in the market, in other cases.

**Lock-up period:** The law provides a lock-up period for shares held by strategic investors of at least three years (compared with five years under the old law). While the lock-up period is shorter, the previous decree provided a mechanism for an earlier lifting of such a lock-up period via approval of the general meeting of shareholders of the equitised SOE, which is not available under the new law.

In the absence of clear guidance, in practice the lock-up of shares may be broadly interpreted to capture both direct and indirect share transfers (such as a change of control in the holding company of the strategic investor), and even prohibit granting of any security over the shares by the strategic investor, which may prevent them from raising acquisition financing.

**Shareholding ratio:** Given the strict rules for strategic investors, including the lock-up period, investors may, in return, expect to have a controlling stake in an SOE post-equitisation. However, an investor's shareholding ratio in an SOE will largely depend upon the sectors in which the SOE operates and the discretion of the state. In particular, the state may decide to retain a controlling stake (being 50 per cent or more) important sectors such as banking, oil and gas, telecommunications and mining. In practice, the ratio of shares earmarked to be sold to strategic investors is usually in the range of 10–35 per cent, which may not be sufficient for them to obtain effective control.

**Pricing:** The price for the purchase of shares by strategic investors depends on the sale method used (whether by direct agreement or auction on a stock exchange). However, the price cannot be less than the IPO average selling price (being the average of the winning prices at the IPO).

# STATE CAPITAL DIVESTMENT

## UPCOMING OPPORTUNITIES

| | Core business | Expected % of shares to be sold |
|---|---|---|
| **Vinamilk** | Largest dairy company in Vietnam | N/A |
| **Habeco** | Brewing and other beverages | 25.56% |
| **PVOil** | Import and export of crude oil | 44.72% |
| **PV Power** | Holding company of numerous power plants | 28.88% |
| **Binh Son Refinery (BSR)** | One of the largest operating oil refineries in Vietnam | 49% |
| **Bao Minh Insurance (BMI)** | Leading player in non-life insurance and reinsurance | N/A |
| **Vietnam National Reinsurance** | Inward and outward reinsurance business | N/A |
| **Tien Phong Plastic** | Leading manufacturer of plastic products | 10.28% |
| **Vinaconex** | Large construction group | 21.79% |

## HOW CAN INVESTORS PARTICIPATE?

After an SOE is equitised according to the process described above, the state will often retain a significant stake in the company and may decide to sell down their stake, subject to the strategic policy. Investors (both domestic and foreign) can also consider participating in the subsequent divestment by the state, as follows:

**Sale method:** Under the new law, if the shares of a target SOE are listed or registered for trading on a relevant stock exchange (eg HOSE, HXN or UPCoM), the state vendor may decide to carry out the divestment, either:

- **on-market divestment** through put-through or order-matching transactions, according to the trading rules of the relevant stock exchange; or
- **off-market divestment** in the following order of priority:
  - first, the state vendor must launch a **public auction**, which can either be (i) an ordinary auction or (ii) auction by lots (applicable in certain limited cases, such as transfer of capital subject to a transfer restriction under the *Law on Enterprises* or as permitted by the Prime Minister);
  - if the public auction fails, a **competitive offering** may be carried out. In this case, bidders can divide their bids into different share blocks with different bidding prices; and
  - if the competitive offering fails, the state capital can be sold by way of a **direct agreement** between an investor and the state vendor.

**Pricing** In both on-market and off-market divestments, the **initial price** for sale of the state capital is the higher of:

- the price decided by the state vendor, based on the appraisal result of the valuation organisation engaged by the state vendor; or
- the average reference price of 30 consecutive trading days of the SOE's shares on the relevant stock exchange before the date of public announcement of the sale of state capital in the SOE.

In addition, on the date of launching the public auction, the competitive offering or, in the case of direct agreement, the execution of the share purchase agreement, the **purchase price** for the sale of the state capital must be the higher of:

- the winning price as determined in each method of sale under the applicable rules; or
- the floor price of the SOE's shares on the relevant stock exchange.

# CHALLENGES FOR INVESTORS

Although the SOE equitisation and state capital divestment process offers an appealing opportunity for investors to acquire a stake in the leading market players, various commercial and legal obstacles have made it difficult for them to participate effectively in the process and make the most of this opportunity. We discuss below some of the key legal issues for investors.

## 1 Minority stake offered for sale

Investors often want to acquire a controlling stake in SOEs, in order to have management control in the companies after the acquisition. However, this often cannot be achieved in practice, for the following reasons:

- **foreign ownership cap** foreign ownership limitations may apply, as set out in the approved equitisation/divestment plan or as applicable to certain specific business activities of an SOE (eg banking, telecommunications);
- **allocation of shares** the state may not want to sell the entire amount of state capital in a single tranche and may decide to sell down gradually. Also, the state may allocate shares into different baskets for sale to different types of investors (eg strategic or financial investors, local or foreign investors); and
- **caps on individual bidders** the auction rules may set out caps on the maximum volume of shares that a single bidder can purchase. Eg in the State Capital Investment Corporation's (*SCIC*) divestment of its 9 per cent stake from Vinamilk, a cap of 2.7 per cent shares was applied to each bidder participating in the public auction.

Investors may also be subject to various conditions, such as a lock-up period, and have limited control (as discussed below), making SOEs equitisation and state capital divestment unattractive to investors.

## 2 Valuation

Valuation is an integral part of the equitisation and divestment process, and provides a baseline for determining the initial price for the sale of shares in a relevant SOE or target.

Under the law, only registered valuation companies can conduct a valuation. Given the potential administrative and criminal liabilities on the persons who undertake the valuation if the Government subsequently deems it too low, resulting in 'lost' state capital, valuators may err on the side of caution by providing a higher valuation, which may not align with the investors' expectations.

It is also worth noting that investors, including foreign strategic investors, have very limited (if any) ability to negotiate the price resulting from the valuation process.

The general policy is that the sale price cannot be lower than the market price. However, given the original high valuation and the developing nature of the Vietnamese stock market, the stock market price of SOEs may not reflect their true value.

It is not uncommon that the share prices of SOEs will rise significantly in the IPO, or when the information regarding the strategic sale is released, and fall down after the equitisation or divestment is completed. Eg in the PVOil equitisation, the average IPO price was VND20,196 but the share price has since dropped, to approximately VND17,000. In SCIC's divestment of Sabeco, ThaiBev bought in at VND320,000 per share. The price has since fallen sharply, to approximately VND220,000 per share.

## 3 Transaction process and timeline

**Limited due diligence:** Despite the significant amount of money investors are to pay in the equitisation and divestment process, their ability to conduct due diligence is relatively limited. In particular, the timeline for due diligence is usually short, due to the timeline of the equitisation/divestment plan or under law; and, in practice, is largely subject to the state's discretion. Furthermore, foreign investors may not be able to access important information about an SOE, due to restrictions on disclosure of information classified as 'State secrets'. Finally, Vietnam does not have a public filing system capable of tracking and recording litigation or bankruptcy of Vietnamese enterprises, which can be problematic for investors.

**Limited negotiation:** The above obstacles may be dealt with, to some degree, by having appropriate warranties in the share purchase agreement (the *SPA*). However, in recent cases, the state has only provided a short-form SPA template, with very limited representations and warranties. The state may also require investors to enter into a shareholders' agreement, with various obligations and commitments of the foreign investor. Therefore, a foreign investor's ability to negotiate the terms of the SPA and a shareholders' agreement is limited, leaving them in a 'take it or leave it' situation.

**Equitisation timeline:** To deal with the main reason behind the prolonged delay in the SOEs equitisation process, the new law provides that the process must be completed in four months from the date of approval of the equitisation plan, including sale of shares to the strategic investors. However, so far, in practice it seems that this four-month period is too short for SOEs to complete the equitisation process, mainly due to the required timing to select the strategic investors and complete the sale of shares to them. The failure to sell shares to strategic investors in three major PetroVietnam's subsidiaries, PVOil, PVPower and BSR, in the first half of 2018 are notable examples. These companies tried to seek extensions of this deadline, which the Government has rejected. Therefore, these companies had to complete their equitisation without a strategic investor and go through the state divestment process for the strategic investor sale.

## 4 Management control

**Voting rights:** Due to the minority stake that investors may acquire, as discussed above, an investor may not have a meaningful degree of control in the company's management following equitisation/divestment.

While some control can be obtained through a shareholders' agreement or voting agreement, the state may not be willing to enter into such agreements, given the difficulties that doing so may cause to future divestments by the state. In addition, the validity and enforceability of such agreements have yet to be tested in Vietnam and may be challenged by the state.

**Nomination rights:** Similarly, foreign investors may not be able to exercise rights to nominate representatives in the management of the SOEs.

- In the **equitisation** process, Decree 126 requires that a sale to strategic investors be completed before the first general meeting of shareholders (*GMS*). Foreign investors would theoretically be able to exercise their nomination rights and have their nominees nominated to the management of the company at the GMS. However, given the short timeline, of four months, to complete the equitisation, in practice it would be difficult to complete the sale to strategic investors before the first GMS. In other words, the investor may only become a shareholder after the first GMS has already appointed the SOE's management post-equitisation and its directors for a five-year term.
- In the **state divestment** process, the nomination rights of foreign investors are limited, because an investor must hold shares for at least six consecutive months before it is entitled to exercise its nomination right. A recent example was the highly publicised divestment of the Ministry of Industry and Trade from Sabeco, where ThaiBev had acquired more than 51 per cent of Sabeco but was initially unable to appoint any nominees to the board, despite paying the state nearly US$5 billion for its majority stake.

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# WANT TO LEARN MORE?

Allens has extensive experience advising investors on SOE equitisation and on state capital divestment opportunities. If you would like to discuss the upcoming opportunities and find out how we can assist you, please contact us.


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