

Private Equity in Vietnam

Catching up and getting ahead

May 2019





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Foreword

Dear Valued Readers,

As the US-China Trade War threatens to shake up the established global value chain, private equity investors are looking for new opportunities in South East Asia, especially the hotspot neighboring country - Vietnam. Venture Capital and Private Equity Investment in Vietnam has soared to a new record level in 2018 and promises vast potential for growth in the coming years.

The Vietnam Private Equity Investment Outlook 2019 is the latest issue of our annual study to offer unique insights and perspectives into the private equity market in Vietnam. The 2019 edition would take a special focus on investment's value creation: how private companies ground support from Private equity funds to seize opportunities and overcome challenges of intense competition and digital disruptions.

Survey respondents represented a wide range of individuals and institutions that are currently working in the private equity investment sector, including: Corporate Investors and Investment funds (23%); Advisory firms (29%); Private companies (29%); Securities firms (9%); and Others (10%).

The first part of our report recaps the private equity landscape in Vietnam and establishes investment outlooks across key promising sectors. In the following parts, we walk you through the issues during the entire investment process from the perspectives of both investors and investees.

We hope that this study will equip you with insights for decision-making and accelerate your investment journey in Vietnam's Private Equity market.

We would like to express gratitude to all of those who responded to our survey request for their valuable contributions.

We hope that you enjoy reading the edition and look forward to your constructive feedbacks. Should you have any concerns or questions, please do not hesitate to contact Ms. Vinh Ha via VinhHa.Nguyen@vn.gt.com Ms. Chau Nguyen via Chau.Nguyen@vn.gt.com

Executive summary



Technology start-ups lead the trend

- Vietnam is among the top attractive investment destinations in ASEAN for private equity investment
- Technology will remain one of the most appealing sectors with E-commerce and Fintech
- Education, Healthcare, Green Energy and Logistics are expected to experience robust growth in the future
- The US trade war and FED policies still remain a big concern



Shift in value creation approach

- The era of surfing on macro growth to drive returns has passed
- New era of value enhancement requires private equity investors to develop new capabilities to catch a fundamental shift in value creation approach by delivering tailored operational improvements to their targets, which include: helping portfolio companies build commercial excellence, make the most of digital technologies, excel at talent management, and upgrade corporate governance



Commercial excellence

- The traditional sales approach is no longer sufficient to win in a complex commercial environment today. Success requires a new customer-centric commercial model
- 64% of PE fund manager respondents are confident to support their investees to build commercial excellence to produce a major impact on exit multiples
- 50% of private companies in our survey expected to have private equity investors to support them to build capabilities in commercial excellence, which include sales force effectiveness, marketing effectiveness as well as technology capabilities



Digital transformation

- The delivery of an operational improvement program could only be successful with the deployment of an effective digital journey
- Most private companies, in Vietnam, are still at the early stage of their digital transformation journey
- Both investors and investees agreed that inexperience and insufficient internal skills in digital technology are major challenges that need to be tackled

Executive summary



Talent management

- 92% of private equity investors chose a strong management team as the main source of value creation in recent successful deal exits
- 70% of private equity investors are having challenges in terms of finding the right talent who are capable of delivering on a value creation plan. PE firms struggle to make early, high-impact talent decisions, both in the C-suite and in other mission-critical roles.
- In contradiction to what is perceived by investors, only 15% of investee respondents expect to have private equity investors help improving their current management team



Corporate governance

- More than 70% of private companies are confident about their corporate governance quality. However, in the view of experts, corporate governance in Vietnam is still poor. Corporate governance in Vietnamese firms remains at early stage of the development cycle and there is still a long way to go
- Private equity investors in Vietnam have proven track records in helping their portfolio companies upgrade corporate governance and continue to demonstrate their commitment and capability in this area of value creation



Exit

- Trade sales and Secondary buyouts are among the most preferable exit strategies
- 65% of private equity investors require a rate of return from 20% - 30%
- Despite higher required returns, 69% of investor respondents believed their portfolios' performance could meet their expectation over the next 12 month compared with their benchmarks

Recap and outlook



The state of the economy

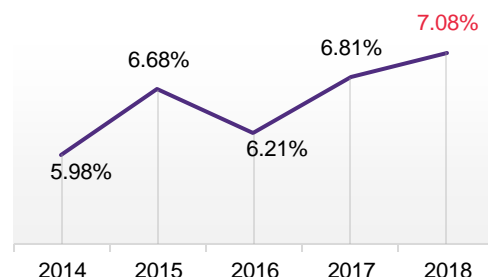
Breaking-record 2018 despite global uncertainty

Vietnam economy achieved **GDP growth of 7.08% (in 2018)** - **peak in a decade**, well-controlled **inflation of 3.54%** and **9% increase in FDI**, in spite of a huge foreign capital outflow from emerging markets in Asia due to the **FED's interest rate rise and US-China Trade war**.

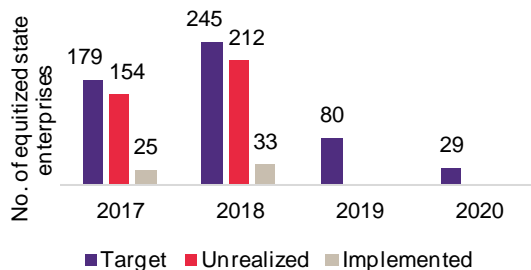
Vietnam stock market in 2018 was characterized by **a fall of 25% in VN-Index**, from the peak of 1,211 in April to 892.5 at the end of the year, negatively impacted by what happened in the global and Asian markets. **SOE's equitization activities were slow**, causing the lack of large value investment opportunities.

Robust expansion of the **Start-up ecosystem**, recording **US\$889 million of investment - triple value** compared to 2017, has made Vietnam one of the most dynamic investment destinations in Southeast Asia (next to Singapore).

GDP Growth Rate



SOE's Equitization



2019 year ahead



Private sector

Private sector is seen as one of the four key drivers of Vietnam's economy in 2019, especially with strong development of start-ups. Technology start-ups lead the trend with Fintech, E-commerce, E-learning and Travel tech. There expected to be more policies and mechanisms in favor of the development of the private sector.



SOEs Equitization

SOEs equitization is expected to speed up in 2019 after the slowdown in 2018, which would bring a large pool of potential investment opportunities.



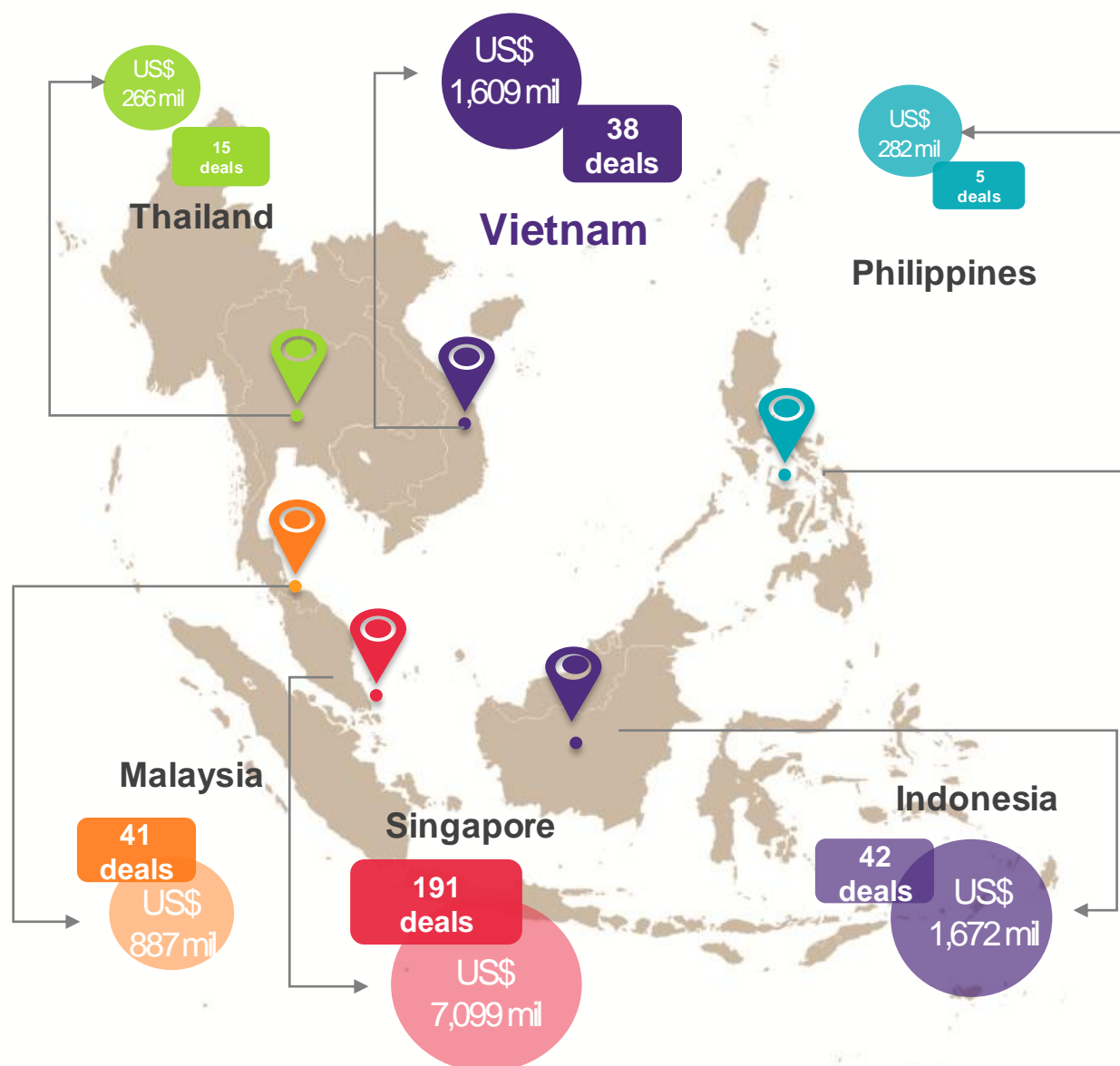
Free Trade Agreement

The economy will have the advantages of the recently and soon to be effective FTAs, particularly CPTPP, EVFTA and ASEAN-Hong Kong FTA, which expect to promote processing and export activities in Vietnam, as well as diversify imported materials.

Private equity investment

ASEAN – A bright spot

Singapore, Vietnam, Indonesia and Malaysia topped ASEAN Private Equity value and volume in 2018, according to Global M&A Review 2018 conducted by Bureau Van Dijk - A Moody's Analytics Company.



Vietnam

38 deals
(+41%) **USD1,609 mil**
(+285%)

(+) Sustained deals activities
(+) Deal value reached new record
(+) High momentum in technology, financial services



ASEAN 5

141 deals
(+18%) **USD4,716 mil**
(-62%)

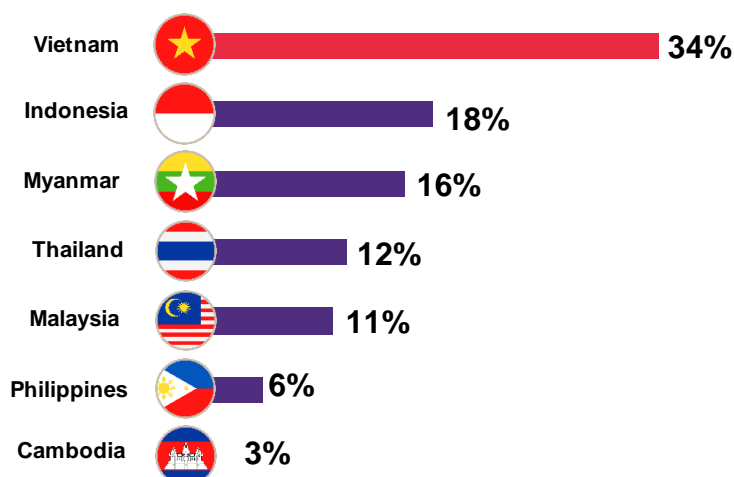
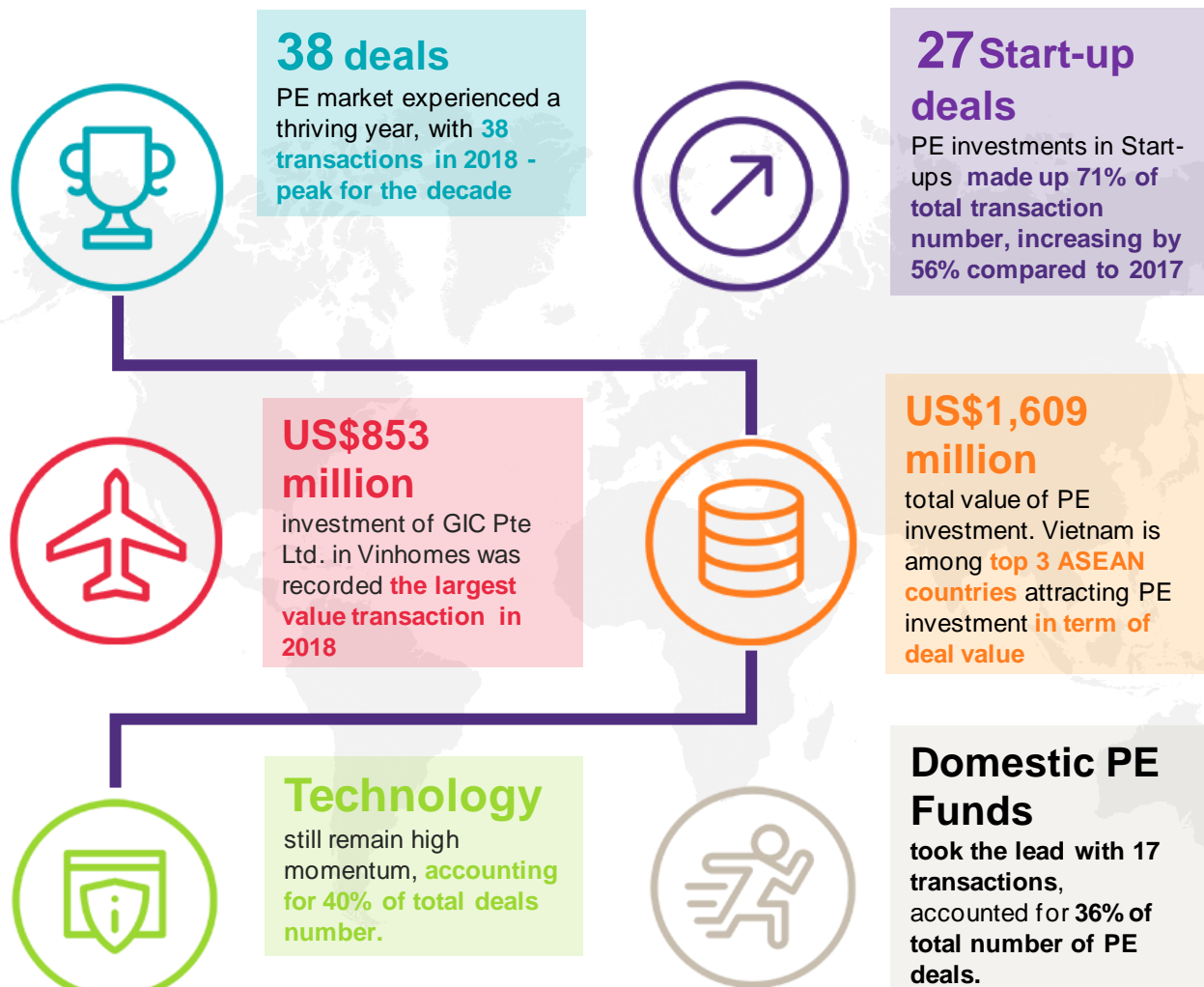
(+) Strong deals momentum
(+) Technology, consumer and internet up
(-) Low deal value

ASEAN 5 include Vietnam, Thailand, Indonesia, Malaysia, Philippines



Grant Thornton | An instinct for growth™

Private equity investment



34% 
of investors see Vietnam as the **most attractive investment destination** in the selected ASEAN.

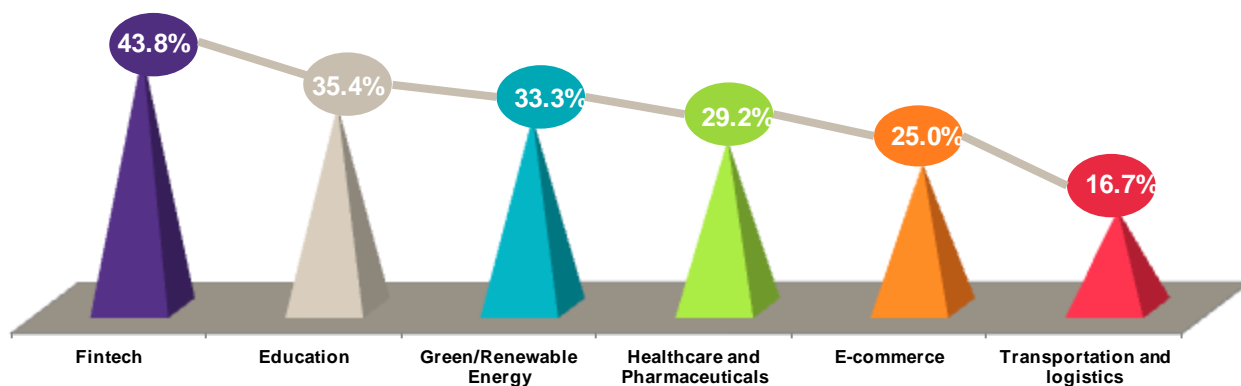
Source: Grant Thornton Private Equity Survey 2019

Industry outlook

Challenges and opportunities by sector

Our survey results showed the top 6 attractive private equity investment sectors in Vietnam for the next 12 months as: Fintech, Education, Green/Renewable Energy, Healthcare and Pharmaceuticals, E-commerce, Transportation and Logistics.

Top 6 attractive sectors in the next 12 months in Vietnam



Source: Grant Thornton Private Equity Survey 2019

% of respondents

Emerging sectors

Fintech

- The Government aims to build a cashless society by 2020 by developing digital infrastructure and ecosystems.
- By 2017, only 10% of payments were made through digital payment systems.
- Robust growth of e-commerce boosts the demand for e-payment

E-commerce

- Vietnam's e-commerce growth rate (69%) is the third highest rate globally
- Vietnam's e-commerce market size (GMV - Gross Merchandise Value) has grown swiftly at a CAGR of 87% during 2015-2018. By 2025, it is forecast to reach US\$15 billion.
- Vietnam's ratio of e-commerce economy GMV/GDP is 4%, far surpassing ASEAN's average (2.8%) with very strong competition among market participants.
- Internet penetration in Vietnam is currently at 56% at the end of 2018, and should reach 69% by 2021.
- Vietnam's Social Media Penetration is 44% of the total population, this is expected to reach 53% by 2021.
- There are currently 35.4 million eCommerce users in Vietnam, representing 38.5% of the total population, with an additional 6.6 million users to be shopping online by 2021. The average user spends 62 USD online, which could grow to 96 USD by 2021.

Industry outlook

Challenges and opportunities by sector

Traditional sectors



Education

- A rapidly emerging middle class is a key driver for investment in education in Vietnam
- Young Vietnamese, who are eager to obtain the skills and knowledge to meet the ever-increasing demands of the labor market, make up nearly 60% of the population
- Vietnam education expenditure is 5.7% of GDP, ranking 29th among 126 countries in the world
- Vietnam e-learning users growth rate reached 44.3% - Top 10 Asia



Green energy

- Energy demand will surpass supply in 2020 (EVN)
- Equatorial location and long coastline provide abundant supply of wind and solar power
- Vietnam's average electricity price is 0.07 USD/kWh, much lower than that of countries with comparable GDP per capita such as Cambodia (0.19 USD/kWh), the Philippines (0.19 USD/kWh).



Healthcare & pharmaceuticals

- Increase in aging population with rising income boosts demand for healthcare products and services
- According to BMI, the industry will reach US\$7.7 billion by 2020, equivalent to a CAGR of 10.3% during 2017-2020.
- Domestic firms lack capital for R&D and technology transformation



Transportation & logistics

- As reported by the WB, Vietnam Logistics Performance Index 2018 ranked 39/160, an increase of 25 levels compared to 2016 and Top 3 in ASEAN (Singapore 7/160, Thailand: 32/160)
- In 2018, Government has issued the Foreign Trade Management Law, Law on Customs and other laws on Logistics to adapt to context of international integration. Customs procedures are being reduced and one-door customs mechanism are being implemented
- The wave of e-commerce and international trade boosted by FTAs (CTTP, EU-VN,...) will raise demand for goods transportation and logistics

Other challenges

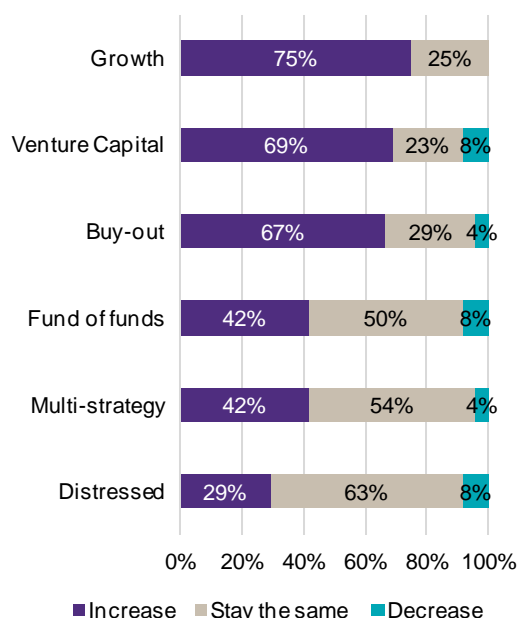
- The Trade war between US-China, two of Vietnam's top trading partners, while driving opportunities, is still a big risk to the economy
- The more open the economy is, the more immediate and the higher the impact of global events

Pre-investment considerations



Investors' considerations

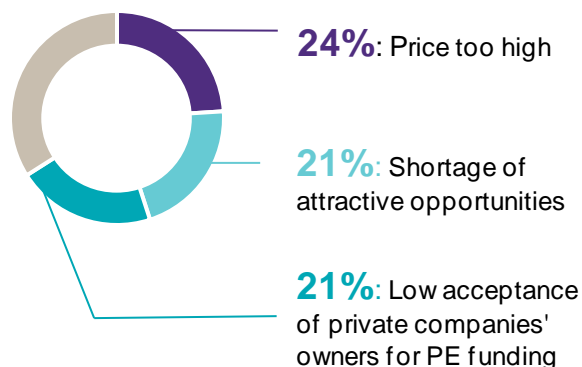
Which strategies will show an increasing trend in 2019?



Source: Grant Thornton Private Equity Survey 2019

- **Growth strategy** is still the most favored amongst all PE strategies, with 75% respondents believing in an increasing trend for this strategy due to the strong momentum of the private sector in Vietnam, with many fast growing profitable companies with a need for capital to pursue transformational changes to support further growth
- **Venture Capital strategy** secured the second place. The rising wave of startups often with tech components and the enormous internet user base in Vietnam promise great potential for growth.
- **Funds of funds, multi-strategy** and **distressed** strategies are not expected to grow in 2019. These strategies have not gained popularity in Vietnam due to lack of appropriate investment opportunities.

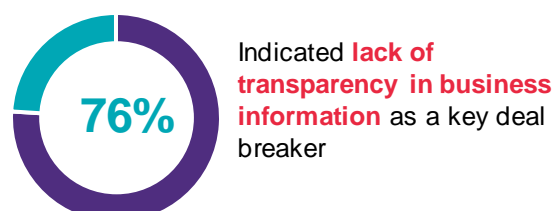
Key challenges in identifying investment opportunities in Vietnam



Source: Grant Thornton Private Equity Survey 2019

- Our survey showed that **high valuation** and **lack of attractive deal opportunities** remained the top two challenges for target identification to most of PE firms looking at Vietnam, which is consistent with the region.
- Another key challenge is **low acceptance of companies' owners for PE funding**. Concerns about potential conflicts in vision and mission together with difficulty in sharing power have made private firms hesitate in co-operating with PE investors.

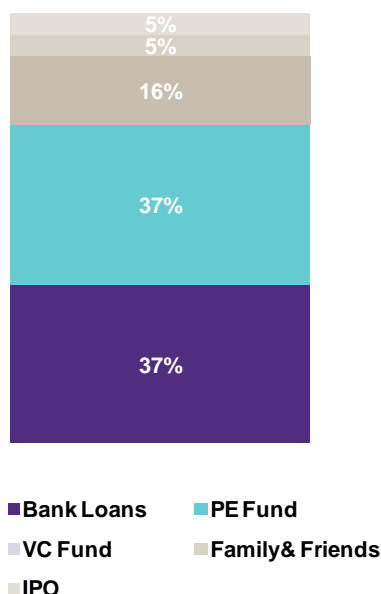
... and other factors to be considered when investing in private companies



Source: Grant Thornton Private Equity Survey 2019

Investees' concerns

What kind of fundraising do you prefer for your organization?



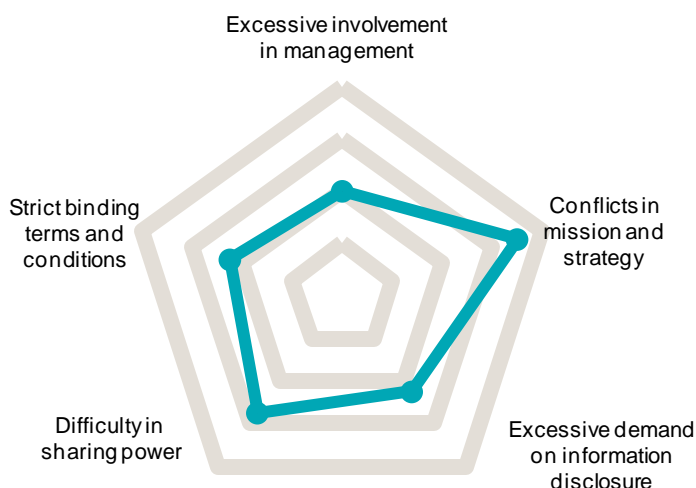
- **Bank loans** - the most traditional and simple funding form - were chosen by 37% of investees - retaining as the most preferred sources of capital despite the expected increase in interest rates.
- **Fundraising from Private Equity Fund** and **Venture Capital Fund** followed as the next preferable options mostly chosen by private companies. The emergence of both domestic and international funds serve as increasingly compelling choices for private entities in Vietnam. Fundraising from investment funds is often more “costly” than traditional approaches, in exchange for investors' profound expertise and extensive networks in the industry.
- **IPO** remained as one of three least popular options, accounting for only 5%.

Source: Grant Thornton Private Equity Survey 2019

Owner of private entities are worried about potential conflicts with coming investors in vision and strategy towards the future of the company

- **Conflicts in vision and strategy** are the top concern. Every business owner would have his/her own vision and plan about future of the company, however, whether the incoming investors would agree to go forward with the same vision could significantly impact the success of the transaction.
- **Difficulty in sharing power** is the second highest concern of private company owners. This is very true when the founding shareholders have always been the power centre, and sharing it with new investors would not be an easy process, and one which requires openness and trust, as well as a clear authorization protocol from very beginning.
- **Strict binding terms and conditions** came as the next significant concern. To protect the fund from downside risks, PE firms would introduce strict binding terms and conditions on performance (such as revenue, profit, EBITDA), time commitment by key management personnel engagement. Failure to achieve these commitments may trigger put options which would become a very costly financing option to the owners.
- **Excessive demand on financial and non-financial disclosures** is another critical concern of private companies owners. This may originate from the historical lack of transparency or insufficient information that business owners are used to, however Transparency is essential and business owners need to brace and prepare themselves for this.

Key concerns of investees in raising capital from investors



Source: Grant Thornton Private Equity Survey 2019

Post investment considerations



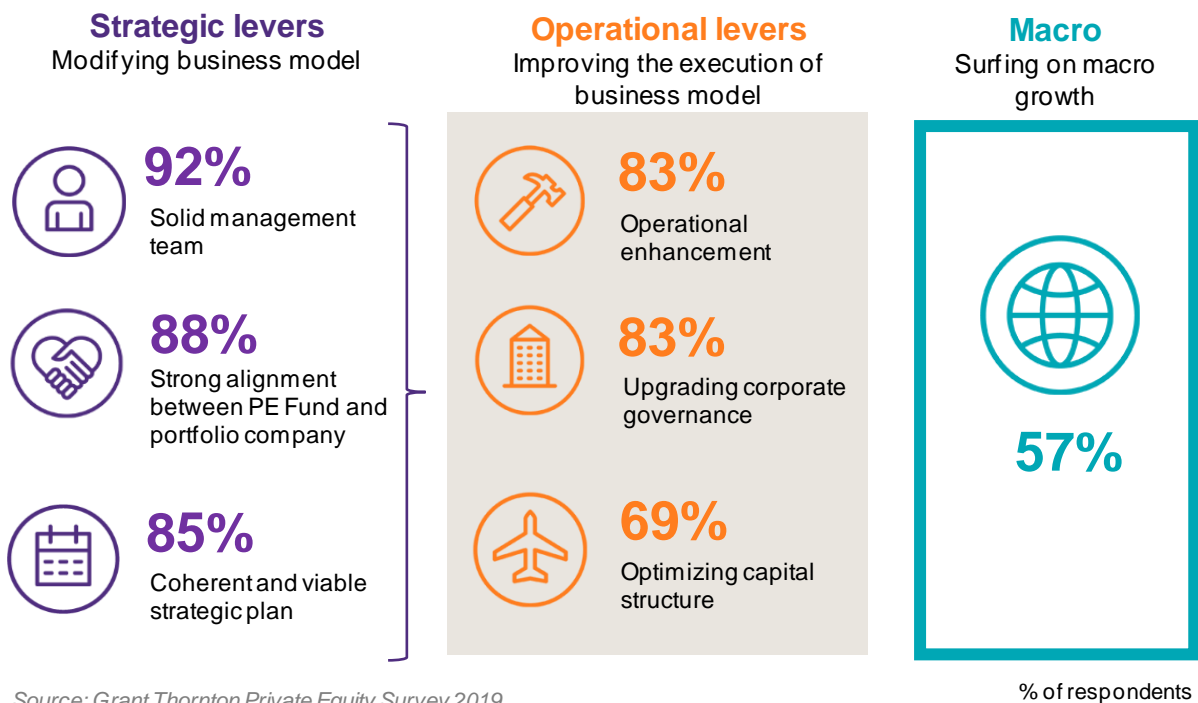
Sources of value creation

Private equity investment in Vietnam and its method of value creation has changed drastically since its early days.

Characterized by strong growth of the Vietnam economy and stock market following the participation of Vietnam in WTO in 2007, the primary source of valuation creation in private equity investment, in this period, was macro growth surfing. The reason was that while the economy grew very strongly, as long as PE investors put capital to work in growing industries, such as consumer goods, multiples would rise without the need for serious changes in business strategy and operations.

However, the current market is heavily competitive. Investors are facing with the challenges of transforming businesses so that those companies are more adept at generating cash, managing costs, and delivering value for their customers. Therefore, it is more crucial for PE investors to enhance the value of their targets by delivering tailored operational improvements and to avoid relying exclusively on economic growth and the capital markets to drive returns.

Important sources of value creation



Anticipating this fundamental shift, it's necessary for PE firms to develop new capabilities to ride the new wave of value creation: help portfolio companies build commercial excellence, make the most of digital technologies, excel at talent management and upgrade corporate governance in order to produce top-tier returns.

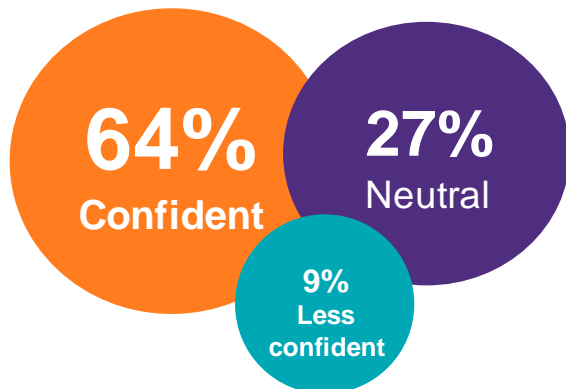
Commercial excellence

"**Commercial excellence**" is an approach in which a company strives toward an increased and more accurate understanding of their customers and their individual needs. Focusing on efficient client-based processes, client-oriented culture, and client-oriented growth strategy

Source: Sand Madsen Consulting

The traditional sales approach is no longer sufficient to win in today's more complex commercial environment. Success requires a new commercial model in which companies apply **systematic and analytic approaches** and tools to sell **integrated product-and-service solutions**. The "**art**" of sales must be enhanced by the more **systematic "science" of sales**.

How do PE funds assess their role in advancing commercial excellence?



64% of PE fund managers responded that their fund is confident to support private companies build commercial excellence.

Helping portfolio companies build commercial excellence is one of the key fundamental shifts in approach that can prepare PE firms to drive the new wave of value creation and produce the biggest impact on exit multiples.

Source: Grant Thornton Private Equity Survey 2019

How do Private Companies expect PE funds to support?



- **Only 15%** of private company respondents desire to have PE investors support them in developing a commercial excellence strategy
- **35%** of respondents expect to have PE funds' involvement in strategy delivery.
- **50%** of private companies in our survey expected to have PE investors to support them in building commercial excellence capabilities which include sales force effectiveness, marketing effectiveness as well as technology capabilities.
- The survey result is consistent with our understanding of the private sector in Vietnam, in which most of private companies are aware of the shift from traditional sales model to new approach, however, problem for them is the lack of capabilities to make the strategy happen.

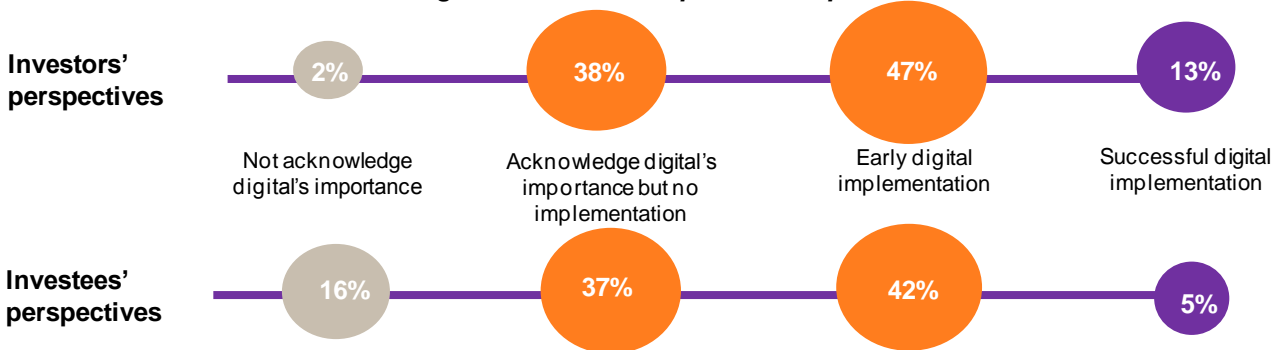
Source: Grant Thornton Private Equity Survey 2019

Digital transformation

Vietnamese companies are at early stage of the digital journey

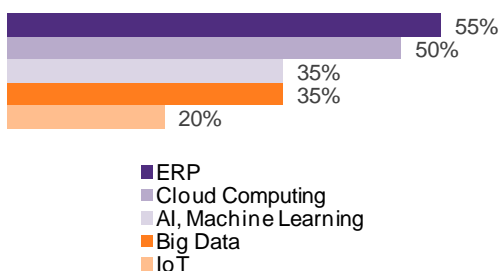
We are only at the dawn of the “Digital Age”, and it is expected to leapfrog in the coming years. Unlike established firms with abundant resources, small and medium private companies in Vietnam are slow to catch up with the game. Investors and investees in our survey agree that digitalization levels of most private companies in Vietnam are only at the early stage of the digital transformation journey. 16% of private companies admitted they do not (yet) acknowledge the importance of digitalization to their business while only 2% of investors shared this opinion.

Digitalization level of private companies



Source: Grant Thornton Private Equity Survey 2019

Private companies show strong demand for technology integration

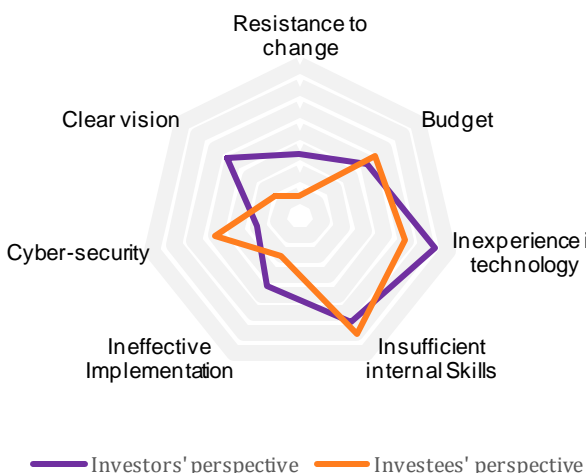


75% private companies showed willingness to integrate more than 1 technology

- **ERP** was undoubtedly the most popular technology with 55% of private firms wanting to establish or enhance.
- **Cloud Computing** - the foundation for Industry 4.0 stood in second place with 50%.
- The advanced utilization of technology in data analytics or the emergence of digital assistance highlighted the potential to establish **Big Data** and **AI/ Machine Learning** according to 35% of respondents.

Source: Grant Thornton Private Equity Survey 2019

But various challenges remain on the road



Investors and investees shared some similar viewpoints about challenges in the digitalization journey for private companies

- More than half of respondents identified **inexperience** and **insufficient internal skills** as the biggest obstacles for private firms in Vietnam. However, investors pinpointed inexperience while investees determined insufficient internal skills as the most alarming one.
- **Inadequate financial budget** stood in the third place with around two-thirds of survey participants selecting the response

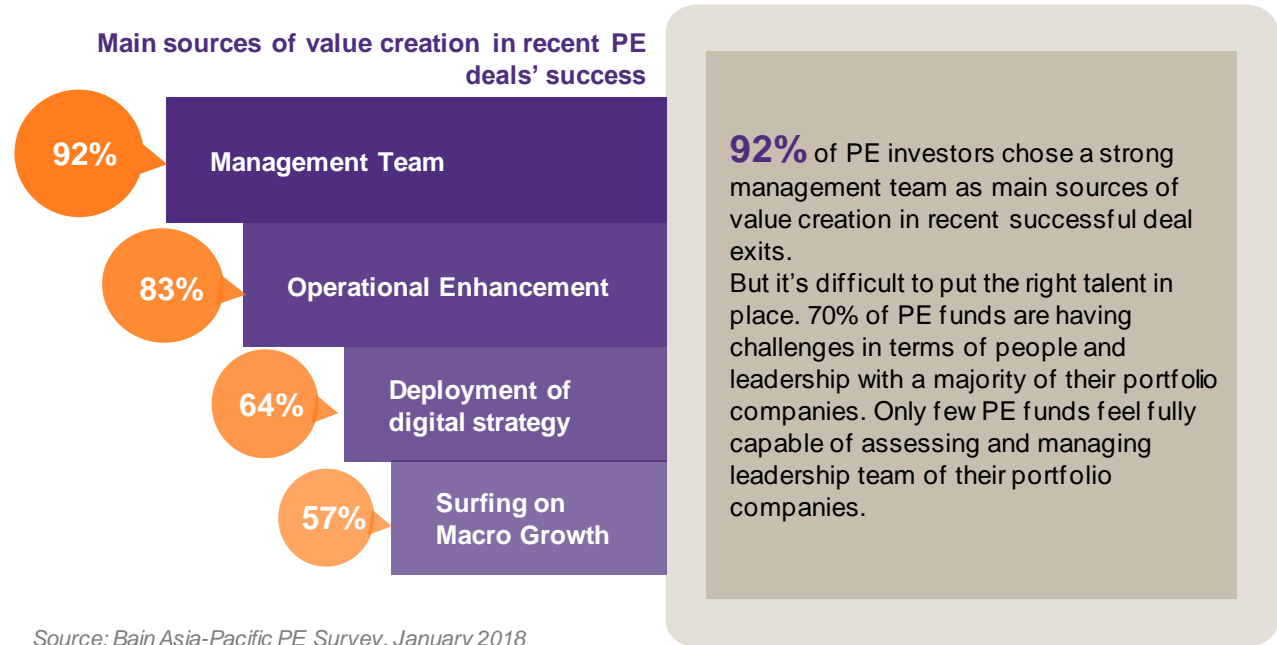
Nevertheless, there are certain differences under two perspectives.

- **Lack of clear vision, resistance to change and ineffective implementation** were of low concerns to investees but were viewed as significant matters by the PE investors
- While 40% of investees opted **cyber-security** as a challenge for their digitalization journey, due to the current stage of digitalization, investors generally considered cyber security as a less-important issue.

Source: Grant Thornton Private Equity Survey 2019

Talent management

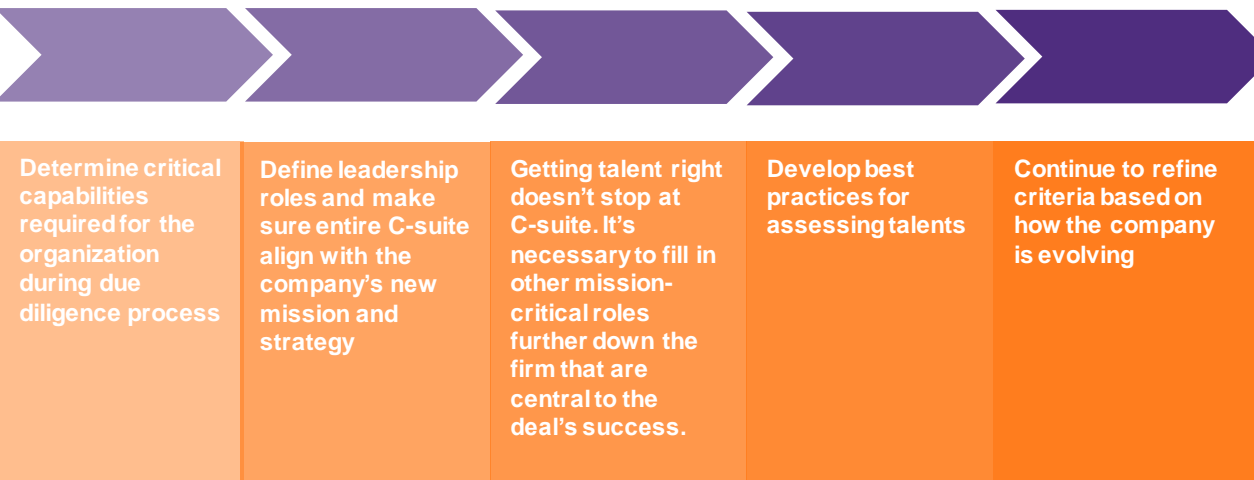
Talent Management is a crucial factor for deal success – investor viewpoint



How to get the right leadership in place to deliver on value-creation plan?

The success of portfolio companies is significantly positively-correlated with having the right management team in place. Finding talent capable of delivering on the value creation plan is challenging but essential, especially when the deal thesis requires a fundamental shift in strategy or operating model. PE firms struggle to make early, high-impact talent decisions, both in the C-suite and in other mission-critical roles.

There are 05 key elements of process to define and fill in mission-critical roles for the value-creation plan:



Talent management

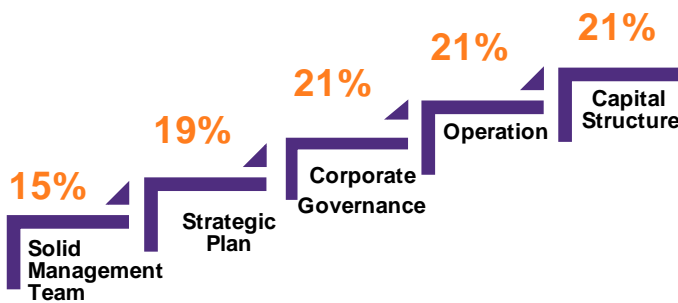
Why PE funds struggle to identify the right talent?



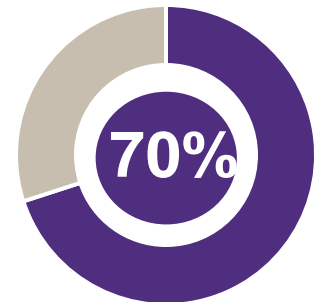
Private companies' view on their management team

What value do investees expect investors to bring to their organization besides investment capital?

How do private firms evaluate their current management team?



Source: Grant Thornton Private Equity Survey 2019



Source: Grant Thornton Private Equity Survey 2019

According to our survey, private companies in Vietnam only rank “building solid management team” as **the 5th prioritized factor among 6 aspects** they expect PE investors to support

The private companies are confident in their capability, whilst 70% thought they **have solid management team**

“

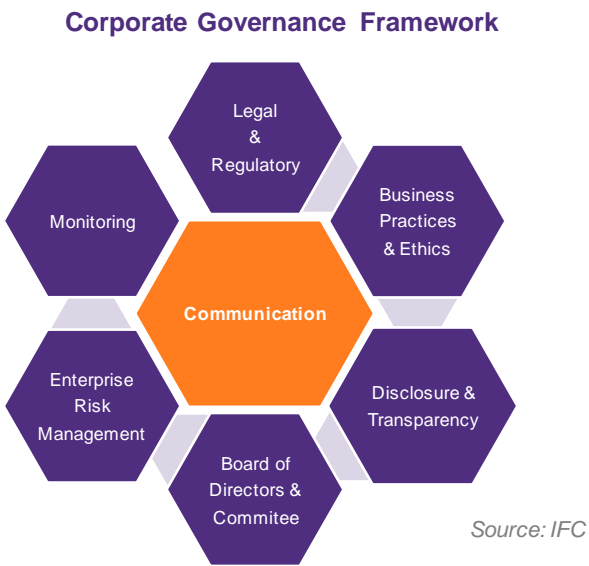
PE firms often spend a lot of time searching for the right company in the right sector, but finding talented leaders is just as important as performance, and has substantial impact on value creation.

”

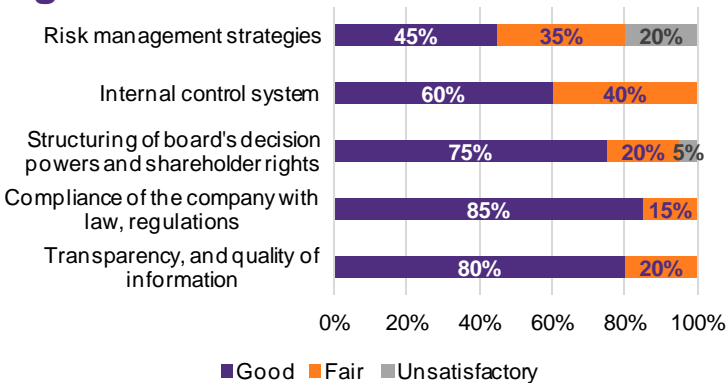
*Kenneth Atkinson, Executive Chairman
Grant Thornton Vietnam*

Corporate governance

“
Corporate governance is a system of relationships, defined by structures and processes for the direction and control of companies.”
Source: Corporate governance definition of International Finance Corporation (IFC)



Most private companies are over-confident in their corporate governance

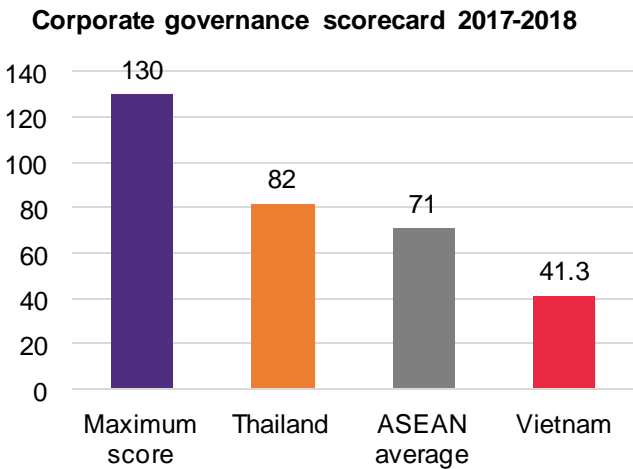


Source: Grant Thornton Private Equity Survey 2019

Overall, the majority of private companies in our survey believed that the current state of corporate governance practices in their organizations is good, and particularly high for the following:

- **85%** of those surveyed said their organization is in good compliance with prevailing laws, regulations and best practices.
- **80%** of respondents thought transparency, and quality of financial and non-financial information of their organizations are in a good status.

However, in the view of experts, corporate governance in Vietnam is still poor



Source: VIOD, VCGI – Report on Corporate Governance in Vietnam

Despite the over-confidence showed by most private companies in our survey, a study on corporate governance in Vietnam by VIOD and VCGI did reveal a contradiction. The findings indicated that Vietnamese firms have not paid enough attention to enhance their corporate governance.

Improper management practices and lack of effective corporate governance are hindering Vietnamese firms’ competitiveness, **making Vietnamese businesses “slow to grow”.**

Corporate governance

Private equity fund plays an important role in boosting portfolio companies corporate governance

Private equity investment firms, in Vietnam, have demonstrated their commitment and capability in helping their portfolio companies pursuing and bolstering best corporate governance practices.



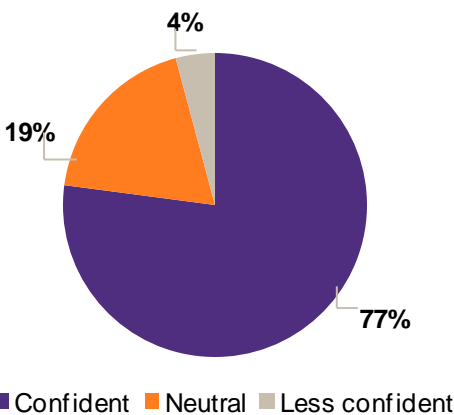
Robust Board

Accountable Senior Management

Effective Internal Control

Improving Risk Management

Assessment on PE fund’s capability to support their investees in upgrading corporate governance?



Source: Grant Thornton Private Equity Survey 2019

Our survey showed that 77% of PE investors are highly confident in their capability to support portfolio companies in advancing best corporate governance practices.

Track records of successful stories in Vietnam

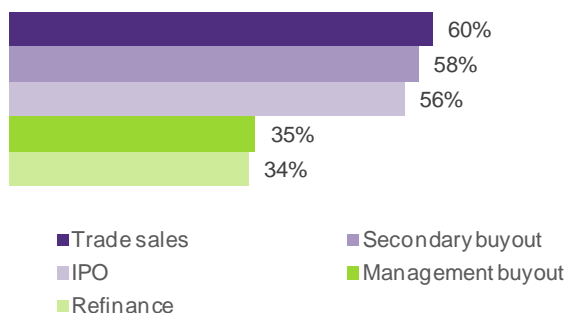
- Dragon Capital with its investee Ho Chi Minh City Securities Corporation (“HSC”) and Mekong Capital with its portfolio company “Mobile World Investment Corporation (“MWG”) stand out as exemplary models of best corporate governance practices among portfolio companies managed by private equity investment firms in Vietnam. In ensuring alignment of management’s interests with those of shareholders, the boards of these two companies instituted a series of measures such as management control, board effectiveness and high level of transparency that helps their companies to improve operational efficiency and achieve substantial growth in market share, revenue, as well as profit.
- These success stories demonstrated as a guiding light to raise greater awareness of the merits of corporate governance for the immediate benefits and long-term value of corporate governance to corporate development in Vietnam.

“Good corporate governance - vision for a greater tomorrow”

Exit



Trade sales is ranked as the most favored exit strategy



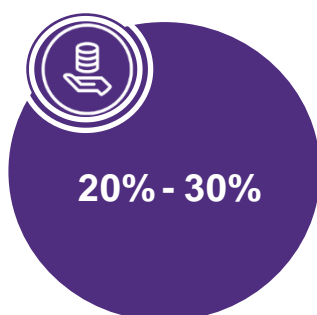
Source: Grant Thornton Private Equity Survey 2019

- **56% - 60%** of those surveyed thought Trade sales, Secondary buyout and IPO are among the most favored exit strategies for Private equity in Vietnam in the next 12 months, with Trade sales and Secondary Buyout being together the most-chosen, while IPO was at the third place.
- This trend was also consistent with trends across Asian countries according to some other regional PE surveys.

Behind these numbers

- While it is still a favorable exit strategy, **IPO** can be challenging considering the recent performance of Vietnam's stock market and the conservative market performance forecast in 2019-2020. It is also observed that a financial sponsor will usually not be able to have a clean exit in an IPO. Retention of a significant shareholding will usually be required in order to show confidence to other investors, in addition to the "lock-up" period that would normally be required for the sponsor investor after an IPO. Last but not least, IPOs could impose considerable costs on the issuing firm.
- In this context, compared to IPO, **Trade sale** and **Secondary buyout** would be simpler, easier and probably faster for PE investors to exit and realize return. This is the reason why these two strategies are most chosen by the PE firms.

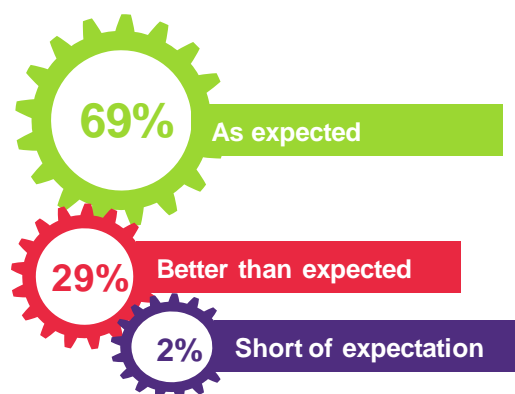
Required rate of return is still high



Source: Grant Thornton Private Equity Survey 2019

- **65%** of PE investors require a rate of return on exit from **20% - 30%**.
- This required rate of return is higher compared to other Asia-Pacific markets (with a median net of IRR of 11.5% in early 2018 according to a survey by Bain & Company). This reflects higher risk perceived by most investors through inconsistent and non-transparent policies, corruption and quality of financial information.

Expected return of PE investment for the next 12 months



Source: Grant Thornton Private Equity Survey 2019

69% of the respondents believed their PE portfolios' performance could meet their expectation over the next 12 months compared with its benchmarks.

Key contacts



Kenneth Atkinson
Executive Chairman
T +84 28 3910 9108
E Ken.Atkinson@vn.gt.com



Nguyen Chi Trung
CEO & Managing Partner
T +84 24 3850 1616
E ChiTrung.Nguyen@vn.gt.com



Nguyen Thi Vinh Ha
National Head of Advisory
T +84 24 3850 1600
E VinhHa.Nguyen@vn.gt.com