Private Equity in Vietnam

Poised for growth

April 2018

Foreword

Private Equity investment in Vietnam remains a significant driver behind Vietnam's economic growth. The sentiment expressed by those operating in the Private Equity sector has an important impact on the economy as a whole, which this survey seeks to measure.

In this 17th survey on Private Equity Investment , carried out in March 2018, the majority of respondents (84%) were positive about Vietnam's economy.

2017 was undoubtedly “a good year” for Vietnam, as the economic growth rate and FDI both hit the best level in a decade. Investors' sentiment has been uplifted in the context of improved global economic growth, stable inflation, and the resurrection of the TPP trade deal which was renamed CPTPP, potentially with the participation of 11 countries.

In this survey, the respondents expressed optimism towards Vietnam's investment outlook with regards to the acceleration in the level of investment activities, while Vietnam has risen to be the most preferred destination for PE investors in SEA.

In terms of attractive industries, as home to around 95 million people with an expanding middle and upper class and increasing disposable income, Vietnam still expects the consumerism-driven industries to be performing well in 2018. Investments into F&B sector, healthcare and pharmaceuticals and retail are of the most interest to PE investors. Meanwhile, we also noted a rising interest into the education and renewable energy industries.

This year, expectations for deals from private/family owned businesses has increased significantly to the level equal to “SOEs divestment”, each with 33% of respondents.

At the business level, there are various factors that PE investors are interested in. “Strong management team”, “Transparency”, “Strategic fit” and “Cultural fit” are the top factors the PE investors would consider investing in Vietnamese companies.

The picture would not be complete without mentioning the key challenges, as named by PE investors to include inconsistent and non-transparent investment regulations and processes, corruption, and lack of transparency. We, again, have to emphasize the importance of corporate governance and business transparency on the success of the deals. This is also among the hands-on areas that PE investors are trying to improve in their investee companies.

With an optimistic view of the Vietnam economy, we are looking forward to steady growth in Private Equity investment in the upcoming 12 months.

INVESTMENT ENVIRONMENT

Vietnam ranking the 1st

in terms of investment attractiveness compared to other ASEAN countries

6.81%
GDP growth rate in 2017

Best in the Decade

96%

Percentage of respondents rated the “Rise of the middle class and disposable income” as the main driver when investing in Vietnam

84%

Percentage of respondents being positive about Vietnam’s economic outlook in the next 12 months

100%

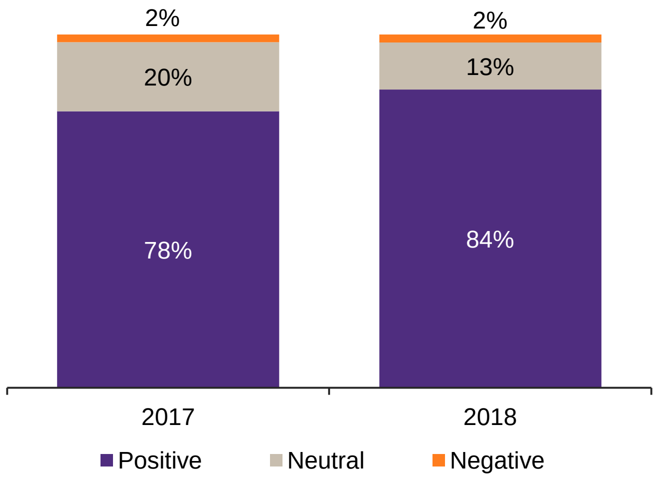
Percentage of respondents rated “Inconsistent and non-transparent policies/regulations/processes” as the biggest obstacles when investing in Vietnam

Economic outlook over the next 12 months

More positive view

84% of survey respondents have a positive view of the economic outlook in 2018, an increase of 6.2% compared with 2017.

GENERAL OUTLOOK FOR THE VIETNAMESE ECONOMY OVER THE NEXT 12 MONTHS



- Vietnam's GDP growth rate recorded a 10-year high of 6.81% in 2017, which is also higher than the target growth rate of 6.7%. GDP growth rate was behind target in Q1 (5.1%) but accelerated in Q3 (7.46%) and Q4 (7.65%). This ranks Vietnam as one of the fastest growing economies in Southeast Asia – according to Bloomberg.

- Vietnam's economic growth was mainly fueled by exports, foreign direct investments and the manufacturing industry. Total registered FDI recorded a 10-year high of USD35.9 billion in 2017. Export turnover reached USD214 billion, up 21% compared to 2016, while trade surplus reached USD2.7 billion. Manufacturing industry also enjoyed a sharp increase of 14.4%[1]

- The general outlook for the Vietnam economy is expected to continue to be positive. In 2018, the Country's GDP is targeted at 6.5 - 6.7%. Inflation is forecast to remain under 4%, higher than the figure in 2017 of 3.5% due to the risk of rising commodity prices.

[1]General Statistics Office

- Nevertheless, major challenges still exist, threatening the economic outlook of 2018, including non performing loans, slowing down in the real estate market's growth, and increased trade protection policies by developed economies.

Global events impacting Vietnam’s economy

Following Donald Trump’s promise to put “America first” in his trade practices, the U.S cancelled its participation in the Trans-Pacific Partnership (TPP). Nevertheless, TPP was still high on the agenda during the APEC Summit held in Vietnam in 2017, with the participation of 11 countries, and renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). A majority of respondents see that CPTPP will bring direct benefits for Vietnam. According to World Bank, CPTPP would increase Vietnam’s GDP by 1.1 percent by 2030. Assuming a modest boost to productivity, the estimated increase of GDP would amount to 3.5 percent from CPTPP.

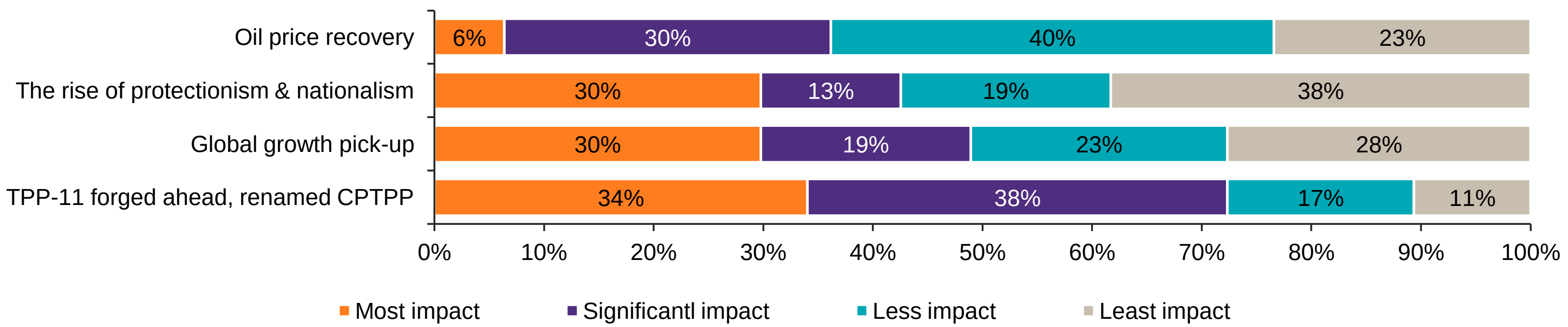
The stock markets around the world are hitting record highs based on strengthened global economic growth, which is estimated to have reached 3.7% in 2017 - a half percentage point higher than in 2016. According to the latest update by IMF (Jan 2018), the global growth is forecast to rise further by 3.9% in 2018 and 2019, followed by favorable global financial conditions, the U.S tax reform, and strong sentiment which will help to maintain the acceleration of investment and demand. However, IMF also shows their concern that the next economic recession may be closer due to the financial market-correction and a faster interest rate hike of the US Federal Reserves.

The global economic revival was disrupted by the rise of protectionism and nationalism sentiment worldwide, as exemplified by Britain triggering Article 50 of the Lisbon Treaty to negotiate terms of its departure from the EU; and Trump’s America-First campaign. However, for Vietnam, the events have little impact on the market sentiment.

CPTPP is considered the most impacting global event for the Vietnam’s Economy

72.3% of respondents rank TPP-11 (CPTPP) as the most significant global event toward Vietnam economy.

THE IMPACT OF GLOBAL EVENTS HAPPENING IN 2017 TOWARDS VIETNAM INVESTMENT ENVIRONMENT

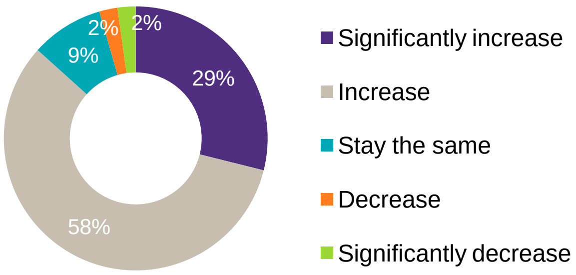


Investment outlook

Expectation for significant increase in level of investment activities

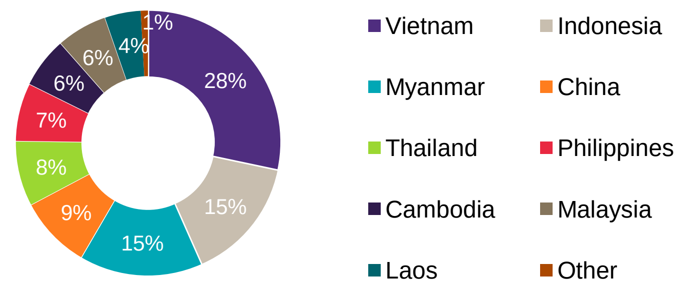
More confidence on the outlook of investment activity in Vietnam

FORECAST LEVEL OF INVESTMENT ACTIVITY IN VIETNAM



- There is a significant increase in the respondents' confidence in the investment activity in Vietnam in 2018 compared with 2017. While 86.7% of survey responses (equivalent to the last survey) foresee an increase in the level of investment activity in Vietnam, the number of respondents who chose 'Significant increase' rose from 8.7% to 28.9% this year.
- FDI continued to be the major driver for the economy as registered FDI reached a new record high of approximately USD35.9 billion in 2017, a 44.4% increase compared with 2016. The highest contribution came from processing and manufacturing sector (44.3%). Japan and Korea continued to be the largest source of capital, contributing 25.4% and 23.7% respectively, of the total registered FDI capital. FII also recorded a 10-year high with foreign investors' net long value on Vietnam's stock exchanges reaching USD1.2 billion in 2017.
- In 2018, FDI disbursement would likely enjoy double-digit growth, resulting from the high registered FDI in 2017. Moreover, several trade agreements, including CPTPP, RCEP, and EVFTA, which are expected to come into effect in 2018, and will be a key driver for FDI. In the meantime, the US' recent tax cuts can potentially drive capital out of foreign markets, including Vietnam.

LEVEL OF INVESTMENT ATTRACTIVENESS COMPARED TO OTHER S.E.A COUNTRIES



- Vietnam continued to be the most attractive destination for investors when compared with other neighbouring countries. 28% of the respondents choose "Vietnam" as the No.1 destination, followed by the promising investment spot "Myanmar" and "Indonesia", chosen by 15% of the respondents.
- According to the World Economic Forum's (WEF) Global Competitiveness Report 2017 – 2018, Vietnam rose to the rank of 55th from the rank 60th in 2016 – 2017 in terms of competitiveness amongst 138 economies.

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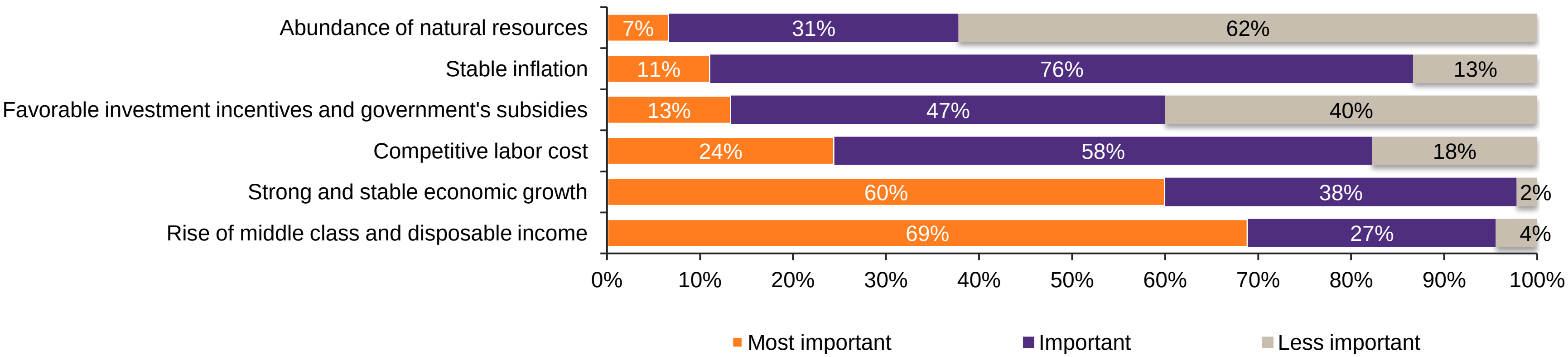
Investment drivers

“The rise of the middle class and disposable income" is the main driver

“Rise of the middle class and disposable income”, “Strong and stable economic growth”, “Competitive labor cost“, and “Stable inflation” were selected as the top four major drivers for investment in Vietnam.

INVESTMENT DRIVERS IN VIETNAM



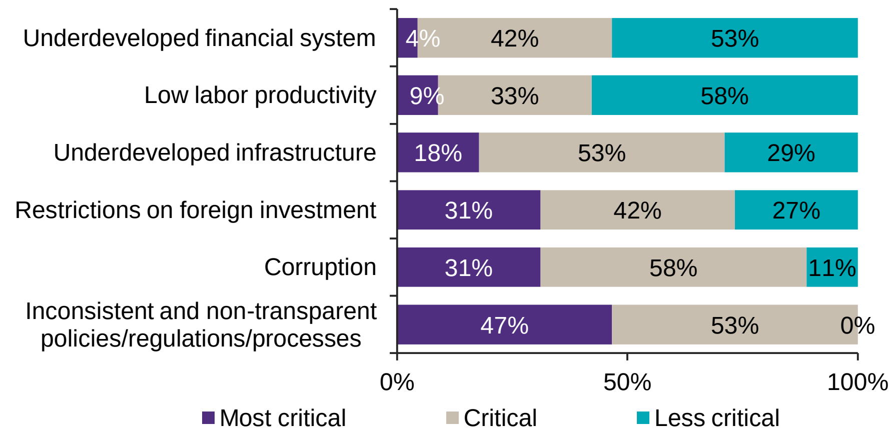
- *“Rise of the middle class and disposable income”* is assessed to be the most important driver for investment by a significant majority of respondents.
- A study by Boston Consulting Group forecast that the middle and affluent class (MAC) consumers in Vietnam will double from 12 million people in 2012 to 33 million in 2020.
- During 2010-2016, GDP per capita increased by 64% while the median disposable income rose by about 46% to an estimated USD3,822 per household from USD2,613 (World Bank and Euromonitor)
- The growth in disposable income, together with Vietnam’s bright economic outlook and stable inflation, has helped to boost consumer confidence and hence, consumer spending. Total consumer expenditure increased to an estimated USD146 billion in 2016 from USD80 billion in 2010, a hike of more than 80% within 6 years.
- With this growth rate, Vietnam has become a favoured market for consumption products, along with consumer-driven sectors such as F&B, retail, services, and high tech products.
- *Strong and stable economic growth* and *Stable inflation* followed closely in importance as assessed by the respondents. These factors contribute to reducing significant risks for investors to achieve their investment plan.

Investment obstacles

Regulation and Corruption are the most critical challenges

Investors show significant concerns for the inconsistent and non-transparent investment regulations and policies, as well as on the issue of corruption.

INVESTMENT OBSTACLES IN VIETNAM



- The Government has been making considerable efforts to improve the business and investment climate. In September 2017, the Ministry of Industry and Trade issued Decision 3610a/QD-BCT, simplifying administrative and investment procedures by removing 675 investment conditions which accounted for 55.5% of the number of existing conditions. The Government also opened some sectors for foreign investment through M&A and joint ventures. Nevertheless, barriers to investment still exist, most significantly the changing and non-transparent business and investment regulations and processes.
- While there are no discriminating law against foreign investors, foreign investors find the investment opportunities undermined by the lack of transparency in processes to deal with the Government and authority bodies, and in many cases the complicated licensing procedures which requires investors to get approval from several ministries, agencies and provincial authorities. There are also differences in procedures and interpretations of investment laws and regulations (US Department of State – Vietnam Investment Climate Statement, June 2017)
- In relation to corruption, the Corruption Perceptions Index (CPI) of Vietnam increased from 33 to 35 points in 2017, and ranking 107 out of 180 countries - an increase of 6 from 2016, according to Transparency International (TI). This has shown positive steps in anti-corruption practices. However, ranking 107 out of 180 in the global index means that one of Vietnam's critical challenges is still there in fighting corruption.
- Restrictions on foreign investment remain an issue. Despite the Government's efforts to lift foreign ownership limits, there are still strict foreign ownership limitations for certain listed companies and service sectors that are attractive to the foreign investors.

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INVESTMENT CONSIDERATION

Expect to have net buy position in the next 12 months

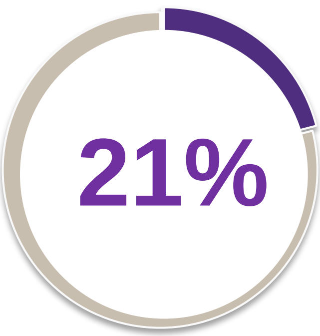
Expect "**SOE divestment**" to be the largest source of deals

Expect "**Private/family owners**" to be the largest source of deals

The most attractive sectors:

- F&B
- Healthcare and Pharmaceuticals
- Retail

Consider "**Lack of transparency**" as the most critical deal breaker



Consider "**Strong management team**" as the most important factor to consider in PE investment

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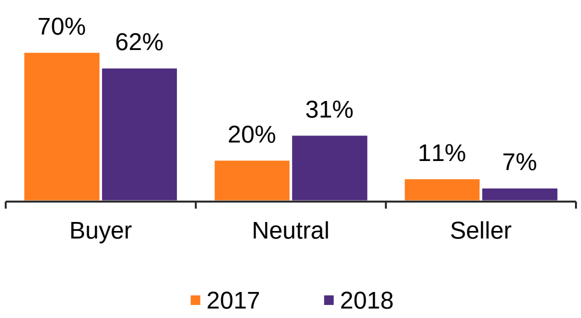
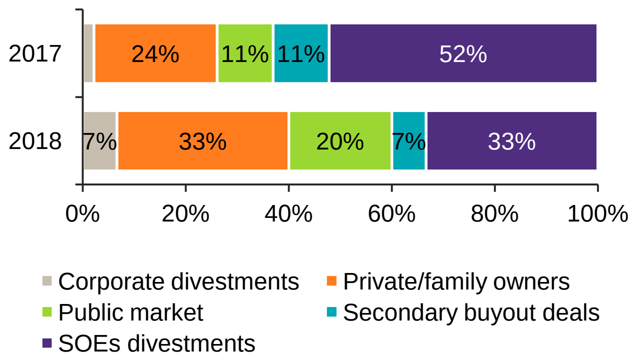
Sources of transactions

SOE divestment and Private businesses are seen as the most significant sources of deals
"SOE divestment" continues to be the most expected source of deals in 2018. However, expectations for deals from private/family owned business has increased significantly

DO YOU EXPECT TO BE A NET BUYER OR SELLER OF ASSETS OVER THE NEXT 12 MONTHS?



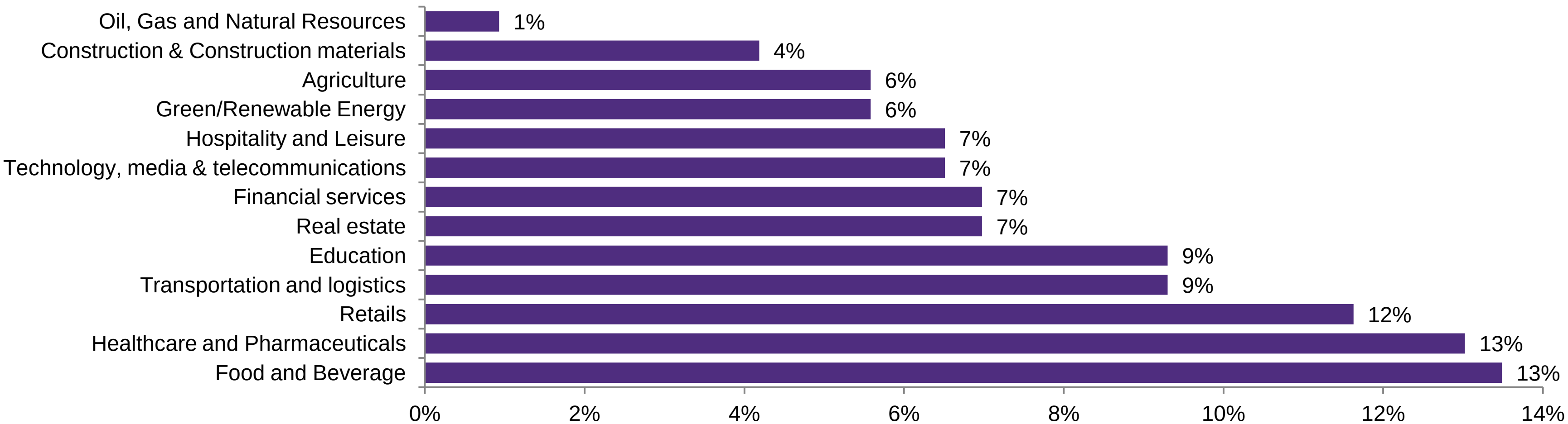
SOURCES OF DEALS IN VIETNAM



- 62% of respondents expect to be "net buyers" in 2018, a decrease of 8% compared to our last survey. Additionally, more investors expect to be neutral between long and short positions in 2018.
- 33% of private equity respondents rated "Private/family owners" as the most significant source of deals this year, compared to only 24% last year.
- SOE divestment, as expected, was a significant source of deals in 2017. The Government successfully raised around USD6.4 billion by divesting stakes in SOEs in 2017, according to an official report. The proceeds were 2.4 times higher than the target set by the National Assembly. Some outstanding deals include the divestment of 53.6% equity in Saigon Beer Alcohol and Beverage Corporation (Sabeco) with proceeds of USD4.8 billion, 3.3% in Vinamilk for USD390 million, and 49.65% in DIC Corporation (DIG) for USD80 million.
- In 2018, the Government plans to equitise 64 SOEs and divest 181 SOEs, which account for 50% and 44% respectively of the 2017-2020 target. These do not include a dozen companies which were in the list to be equitised and divested in 2017 but did not succeed.
- In Q1 2018 alone, capital raised from IPOs of SOEs reached USD940 million including several big names such as Binh Son Oil Refinery (BSR) with USD245 million, PetroVietnam Oil Corporation (PVOIL – USD184 million) and PetroVietnam Power Corporation (POW – USD308 million). Some of the other most expected names for 2018 are Hanoi Alcohol and Beer Beverages (Habeco), Vietnam's largest state-owned shipping corporation Vinalines and Vinafood II.
- These figures, together with our survey results, show that SOE equitisation and divestment will still be a major story in 2018.

Industry attractiveness

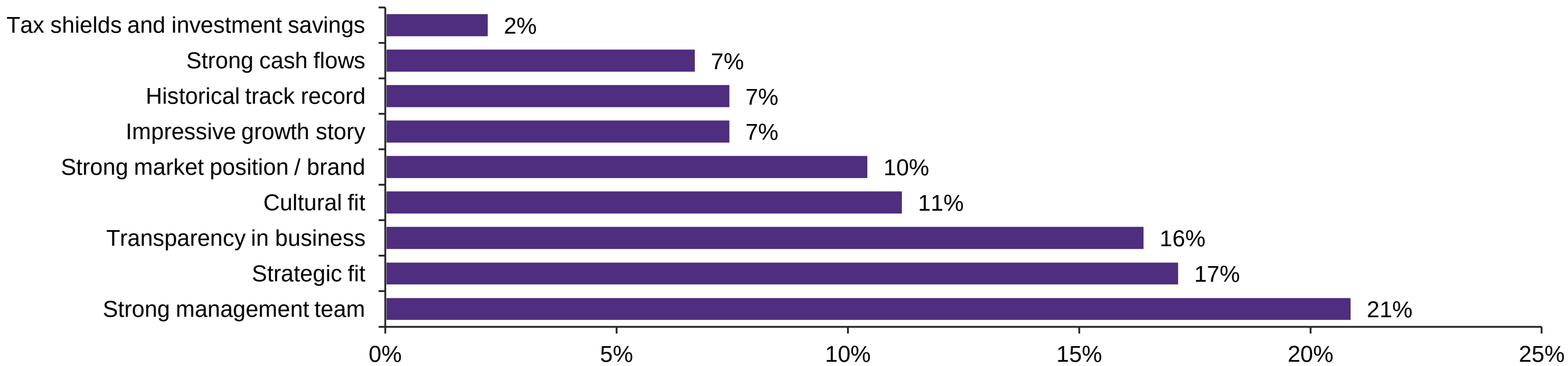
MOST ATTRACTIVE INVESTMENT INDUSTRIES



- With the growth of the middle income class among its population of 94.9 million people[1], **F&B** remains the prominent industry in terms of rapid growth and foreign investment inflow, followed by **health care and pharmaceuticals** and **Retail** sectors, which are in strong correlation with the potential consumption market in Vietnam.
- Private investment in the **F&B** sector has remained active in recent years. The most active investors come from Korea, Japan, Singapore, Thailand and some domestic investors. Several major deals include CJ Corporation (Korea) who bought 64.9% of Minh Dat Food Co Ltd, and 71.6% of Cau Tre Food JSC; Kido acquired 65% of Tuong An Oil JSC; Earth Chemical (Japan) acquired 100% of A My Gia JSC; and Daesang (Korea) bought 100% of Duc Viet JSC
- Investment in **education** and interest in the sector is growing very strongly. With a strong social and ethical value system which emphasizes the importance of education and rising disposable incomes, more and more families now can afford high-quality education such as private tutoring, private schools and English language training. The past 2 years have witnessed a significant number of PE-backed investments into the education sector, notably Mekong Capital invested USD4.9 million into Yola Education JSC; EQT Capital Partners invested in ILA English language Training Center; and TPG acquired stakes in Vietnam Australia School (VAS) from Mekong Capital and Maj Invest.
- Despite not being highly rated, we expect that the **renewable energy** sector, especially the solar energy sector, would attract a good level of investment in 2018, thanks to the Government's incentives to attract investments. Notably, a favorable electricity price of UScent9.35 per kWh will be applied for a 20-year term to solar power projects reaching commercial operation before June 30, 2019. Hence, it is expected that investment into solar power projects would need to speed up to meet this date

Key factors to be considered when investing in private companies

THE MOST IMPORTANT FACTORS TO CONSIDER WHEN INVESTING IN VIETNAM



- **Strong management team** is the most important factor to consider when investing in Vietnam, as rated by 21% of the participants, followed by **Strategic fit** and **Transparency in business.**

- **Transparency in business** has been consistently rated among the top 3 factors to consider when investing in Vietnam, according to our most recent surveys. Transparency in financial systems, operational practices and business processes helps to boost investors' confidence in a potential transaction.

- **Strategic fit** and **Cultural fit** are the two important factors when considering strategic investments. These account for 17.2% and 16.4% among other important factors to consider.

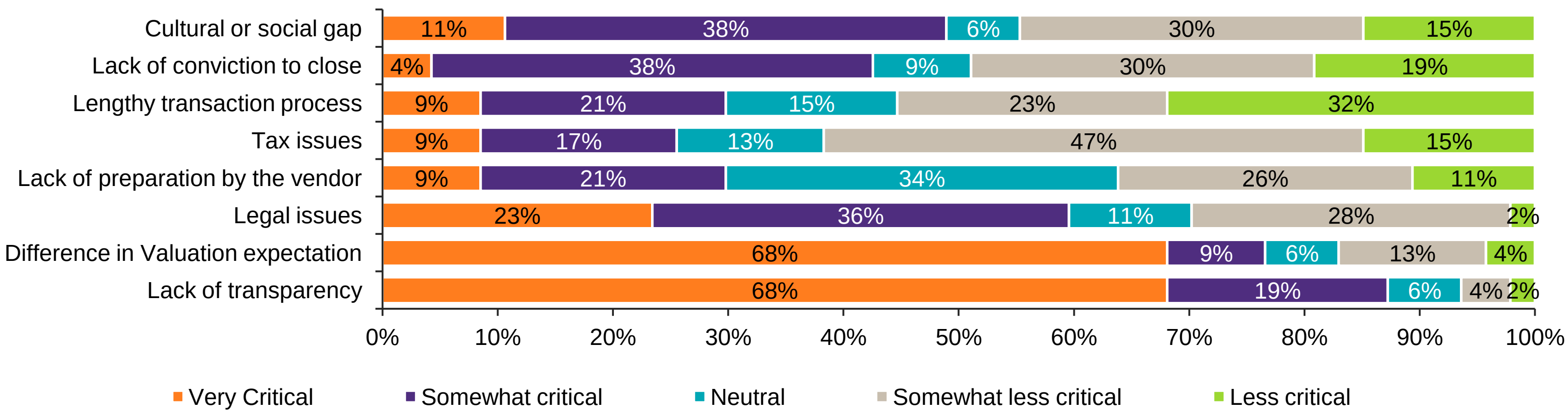
Key deal breakers

Lack of transparency and Difference in valuation expectations

"Lack of Transparency" and "Difference in valuation expectations" are the top two key deal breakers, cited by 87.2% and 76.6% of respondents.

- According to our survey results, difference in valuation expectations has always been a major deal breaker. There are various reasons that could lead to different assumed value of a business. For example, the use of different valuation methods, different assumptions about the prospects of the business. Valuations expectation of a financial investor can also differ a lot from that of an industry investor. It is quite common to have different expectations of price, however, it is important that buyers and sellers understand each other's perspectives and work together to narrow the price gap.
- Lack of transparency in business is another key deal breaker. This is a critical issue, especially for SMEs and SOEs in Vietnam where corporate governance is still a new concept.
- Other critical factors cited by a majority of respondents include legal issues (59.6%), and cultural or social gaps (48.9%), that contribute to deal failures.

FACTORS CAUSING DEAL FAILURE



INVESTMENT PORTFOLIO

Key hands-on involvements

15% - 20%

Being the most expected **required rate of return**, chosen by 44% of respondents

20% - 25%

Being the most expected required rate of return by 50% of **Investment Funds**

Select
Strategic Input

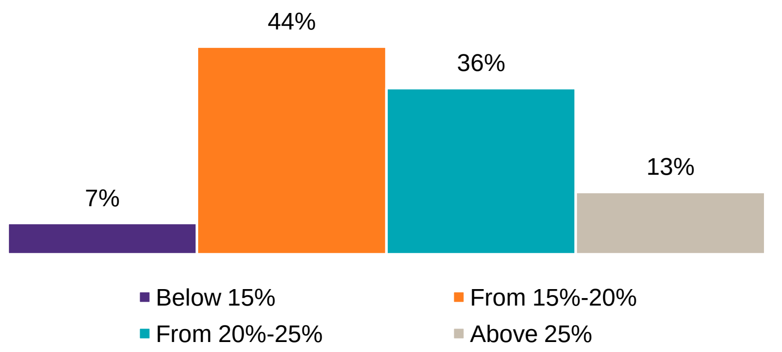
Select
Corporate Governance

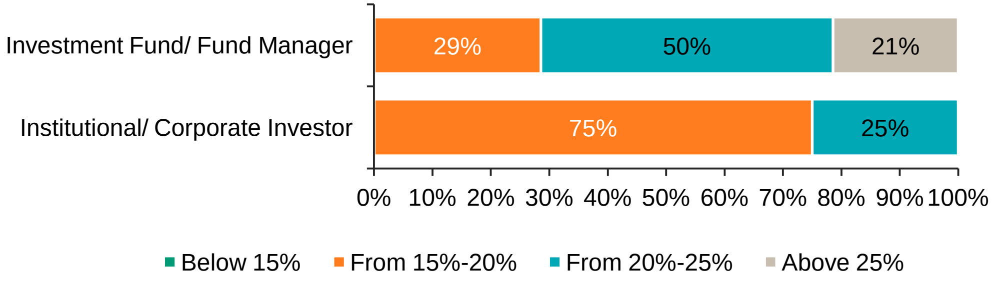
The required rate of return for PE investment portfolio

More than 15% required rate of return

The most expected return is between 15% and 20%. Investment funds generally have higher return requirements than corporate investors

THE REQUIRED RATE OF RETURN FOR PE INVESTMENT PORTFOLIO





- Still, a majority of respondents expect a required rate of return between 15% to 20%.
- However, our data shows that fund managers and corporate investors (strategic investors) have very different required rate of return.
- A majority (71%) of investment funds and fund managers require a minimum return of 20%, with 21% expecting their return to be over 25%. Meanwhile, required returns of 75% of corporate investors are between 15% to 20%.

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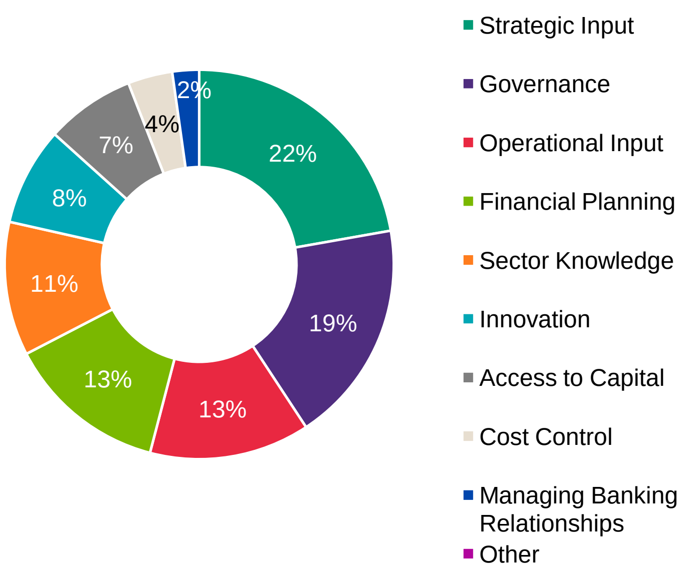
Hands-on involvement with portfolio companies

Strategic Input

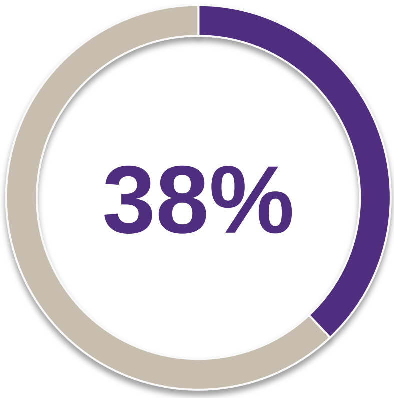
“Strategic input“ and “Corporate Governance” are perceived by the majority of respondents as the key hands-on involvement.

TOP HANDS-ON CONTRIBUTION TO PORFOLIO COMPANIES

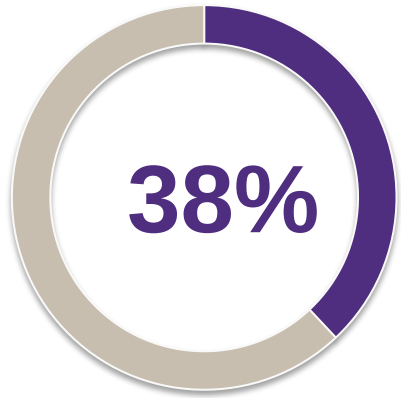


- In order to achieve high returns in PE investments, investors need to provide hands-on involvement to the investee companies.
- Our survey shows that strategic input is the most important contribution to the portfolio companies, followed by the corporate governance and financial planning. While Vietnamese firms face critical issues in corporate governance and business transparency, those inputs can help the investee companies to improve the performance, and hence increase shareholder value.
- Compared to the survey conducted last year, “Operational Input” factor has risen from 3.2% to 13.3%. This consistently shows that PE investors are becoming more concerned with improving operational performance than merely financial engineering.

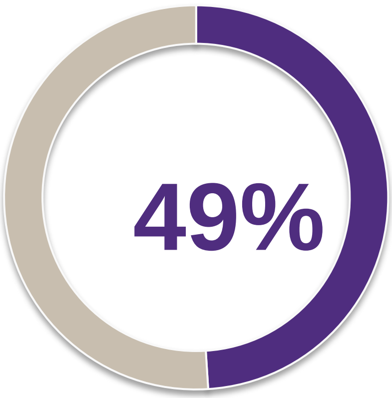
PLANNING AN EXIT



Expect their exit multiples at **5X-10X** EBITDA



Consider "**Trade Sale**" as the most attractive/achievable exit strategy for PE investors

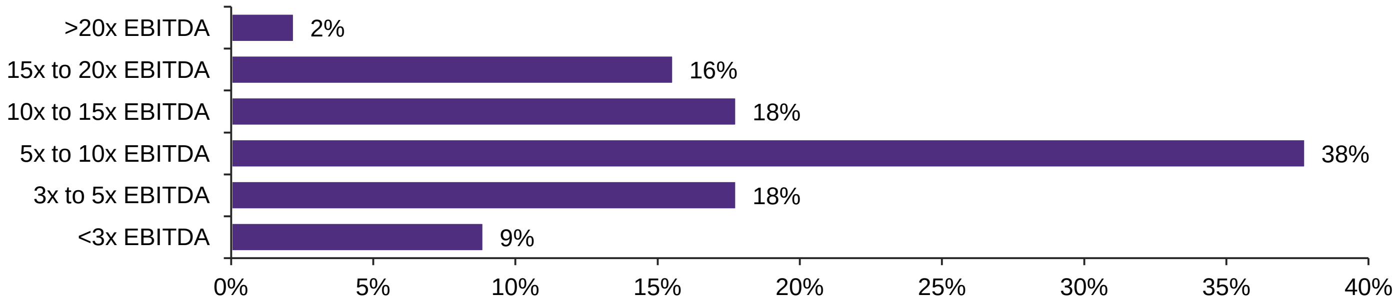


Expect the level of exit will **increase** in the next 12 months

Exit multiples

"5X to 10X EBITDA" is still the most common exit multiple for PE investments in Vietnam. However, there is a significant shift to a higher exit multiple this year. It is noted that 15.6% of respondents expect the exit multiple of 15x to 20x EBITDA, compared to only 2.4% of respondents last year.

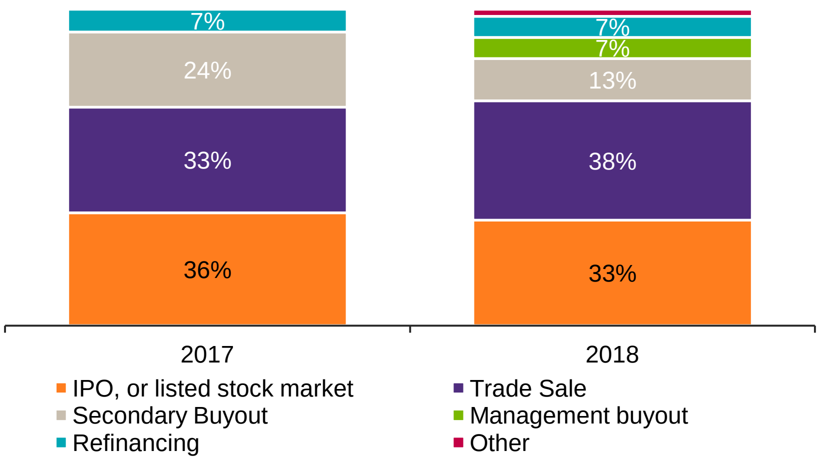
EXPECTED EXIT MULTIPLES ON INVESTMENTS IN VIETNAM



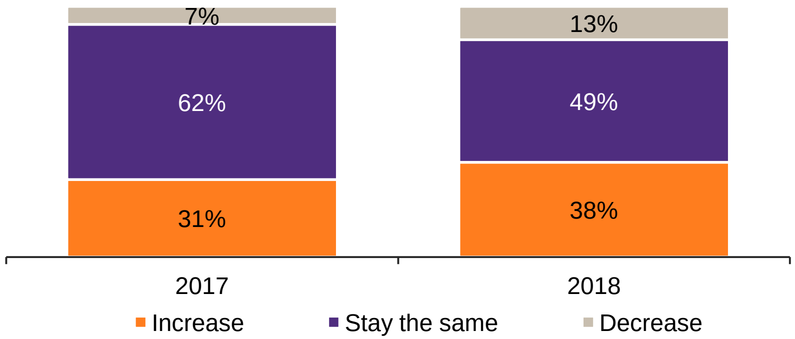
Exit strategies

IPO or Trade sale are the most favorable exit strategies

THE MOST ATTRACTIVE OR ACHIEVABLE EXIT STRATEGY FOR PRIVATE EQUITY INVESTMENT



FORECAST LEVEL OF EXIT ACTIVITY OVER THE NEXT 12 MONTHS



- It is important that PE investors plan their exits early. PE funds normally exit their investments after 3-5 years. Therefore, the level of exit depends largely on the business cycle of the funds.
- A majority of respondents still expect that the level of exit activity will stay the same in 2018 (48.9%). This figure, however, represents a significant decrease from 61.9% in 2017. This response is followed by a series of exit events in 2017 such as the divestments in the banking sector, or the exits of large investment funds.
- IPO's and Trade Sales are still the most-favored exit strategies, with Trade sale becoming the most-chosen strategy while IPOs have moved to the second place.
- However IPO can still be challenging for a clean exit considering that Vietnam's stock market is still underdeveloped and there is still a big gap in corporate governance versus requirement for a private company to be readily listed on the Exchanges. In addition, a financial sponsor will usually not be able to liquidate all of its shares 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.
- On the other hand, retaining a 'rump' in the newly listed vehicle would allow the investor to continue to benefit from growth in shareholder value.

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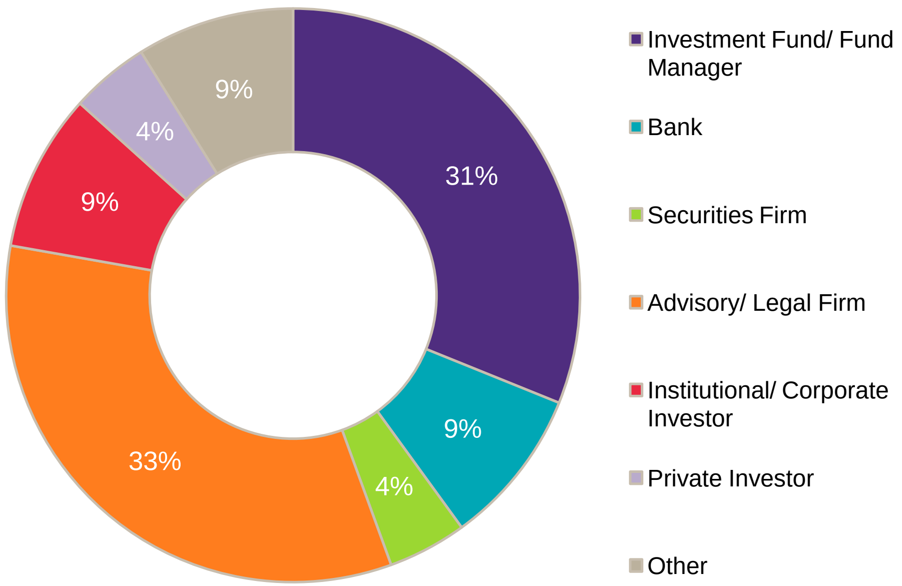
ABOUT THE SURVEY

Grant Thornton and the Private Equity survey March 2018

This is the annual survey that Grant Thornton Vietnam conducted with respondents who are decision makers working in the Private Equity space located both inside and outside of Vietnam. In this study we have again sought to understand the current sentiment of investors in Vietnam towards the economy generally, their industry preferences and the impediments to investment.

This survey was undertaken in February - March 2018.

PRIVATE EQUITY SURVEY PARTICIPANTS IN MARCH 2018



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