

# Capturing new waves of investment

*A call for change*

*Vietnam private equity report: Q2/2015*

August, 2015



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# 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 13th survey on the Private Equity sector carried out in the second quarter of 2015, respondents have shown a significant increase in their positive views towards Vietnam's economy. There have been encouraging improvements compared to the prior survey results, with 86% of the respondents believing that investment activities will increase significantly in the next 12 months.

It is believed that the recovery, together with numerous opportunities stemming from free trade agreements under negotiation and ratification, M&A deal flow will beat the 2012's record of US\$5.2 billion, and will reach US\$20 billion between 2015 and 2018. <sup>[1]</sup>

Oil and Gas, Food & Beverage, and Clean Tech are the leading sectors which were seen as especially attractive for investment, according to

[1] M&A forum press conference July 2015

our respondents' opinions.

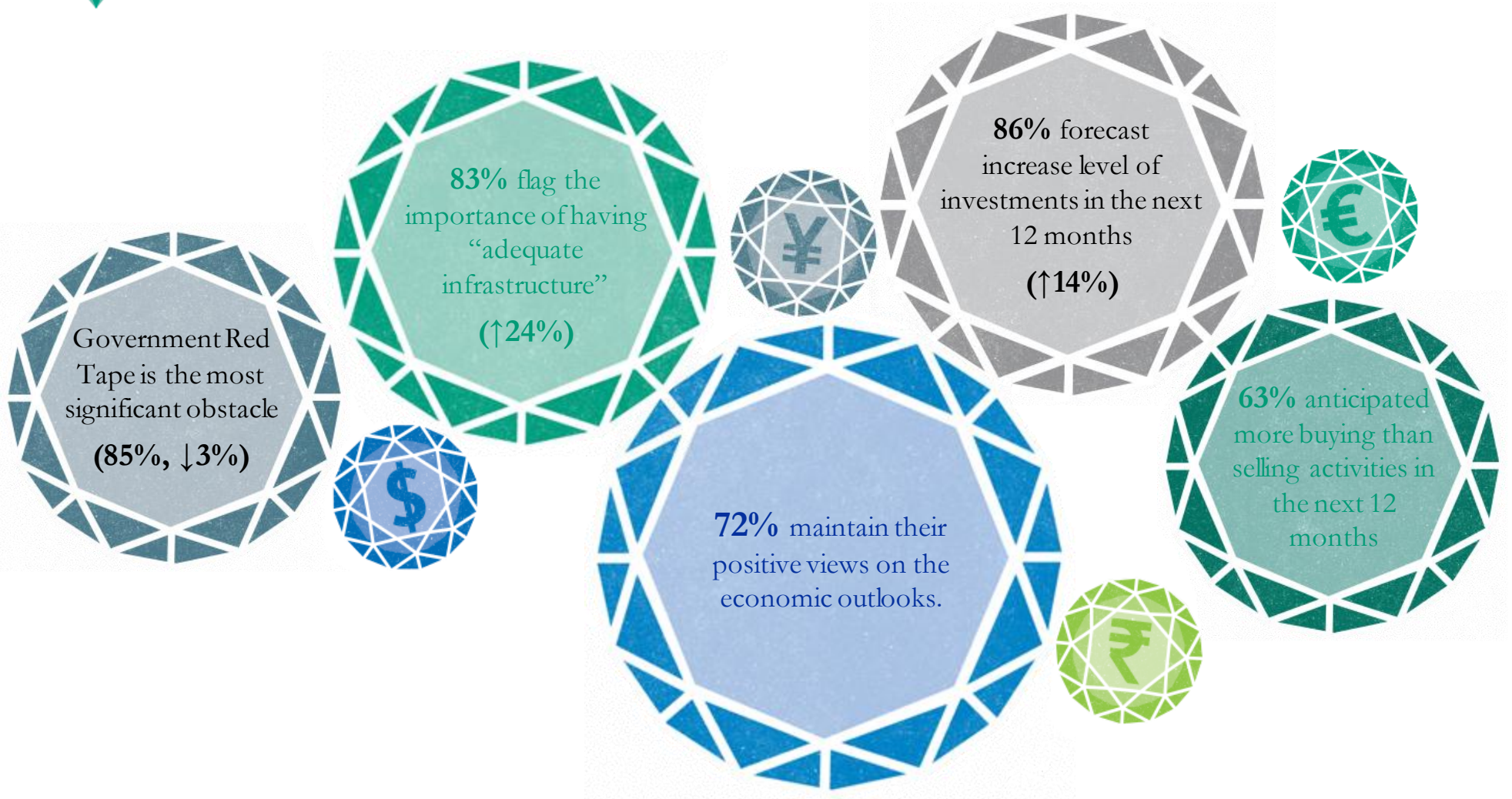
Regarding the critical success factors, "Sector specific opportunities" is seen as critical to source and complete a good deal. "Difference in valuation expectation" continued to be the most significant factor contributing to deal failure.

With an optimistic view of Vietnam's economy, we see that many PE investors are paying more attention to Vietnam. They are ready to put additional resources in the market with an expectation of better long-term returns.



## 1

# Investment environment



# Economic outlook over the next 12 months

## Positive outlook

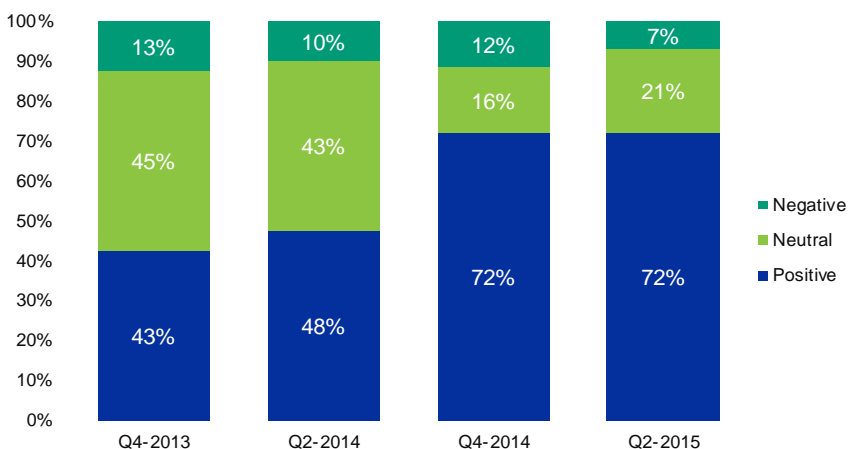
Positive outlook is voted by 72% of PE respondents thanks to various positive news during the first half of 2015. Especially, significant legislation changes and increasing opportunities for foreign investments have boosted investors' confidence in the recovery of the economy.

There are a lot of positive signs towards the continued recovery of the economy.

In the first quarter, GDP growth rate was 6%, a milestone that Vietnam has not been able to meet since 2011. The statistics released in Q2-2015 showed GDP growth of 6.44%, further confirming recovery of the economy.

In terms of inflation, CPI index was well under control at c.4% and c.1% in 2014 and H1-2015 respectively. Other favourable factors include stable interest rates at 8% - 10%, and the credit growth being relaxed from the tight 12% - 14%, and now

GENERAL OUTLOOK FOR THE VIETNAMESE ECONOMY OVER THE NEXT 12 MONTHS



expected to grow at 15% - 18%.

With the AFTA, TPP, and EVFTA likely to be completed within 2015 - 2016, Vietnam also sees many opportunities for cross border trading and investments.

On legal framework, two significant positive changes have been introduced during H1-2015. The first is the Public Investment Law followed by a decree on Public Private Partnership in Q1-2015 strengthening the legal framework for partnering principles between government and enterprises in infrastructure investment. The second is the

increase in the foreign ownership limits to 60% in publicly listed companies.

Nevertheless, there still exists long standing problems including slow reforms of SOE's, inadequate infrastructure, corruption, and Government red tape. As a result, total of neutral and negative sentiments have remained unchanged, at 28% of survey participants.

# Investment outlook

## Investment activities

In this survey, 86% of our respondents forecast the level of investments will increase, by 14% compared to the last survey

Most respondents forecast investments to increase. The anticipation is based on several factors.

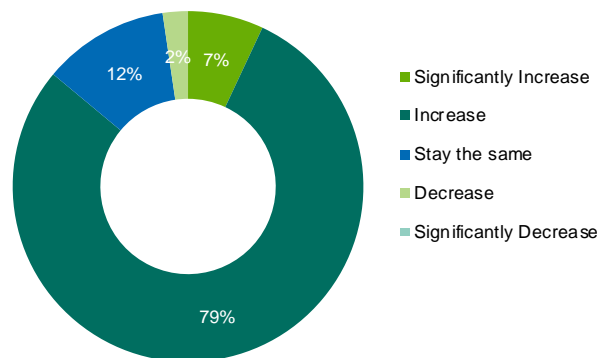
Firstly, it is due to the recovery of the economy that is boosting consumer confidence, and potential for growth across industries.

Secondly, when joining global and regional partnerships such as the Trans Pacific Partnership Agreement and the Asian Free Trade Area (AFTA), it provides many investment opportunities that benefit both local businesses and foreign investors.

Thirdly, the improvement in legislation that shows a positive commitment for investors. The

[1] M&A forum press conference July 2015

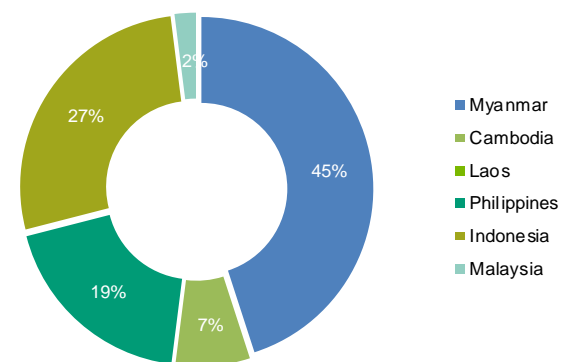
FORECAST LEVEL OF INVESTMENT ACTIVITY IN VIETNAM



government is addressing the need of reform in both private and public sectors. This is providing opportunities for investors to make investments in strong-local enterprises which have good operating systems, market share, and trained workforces in place. These chances are so large that tapping to high entry barrier firms such as SOEs and financial institutions. It is expected that total values of M&A deals could beat the 2012's records of US\$5.2 billion in 2015, and reach US\$20 billion between 2015 and 2018.<sup>[1]</sup>

These are some of the reasons why 86% of respondents selected "Significant increase" and "Increase" when asked about their forecast of investment activities in Vietnam, over the next 12

LEVEL OF INVESTMENT ATTRACTIVENESS, COMPARED BETWEEN OTHER S.E.A REGION



months.

With regards to the attractiveness of neighboring countries, respondents indicate that Myanmar is the most attractive destination, with 45% selecting. Indonesia came second with 27%. The ranking orders are slightly different from ASEAN Business Outlook Survey conducted by the American Chamber of Commerce in Singapore in May 2015 when US investors voted Indonesia as top and Myanmar in the third place. Vietnam took the second position as in their last survey, but obtained more positive views in terms of satisfaction level with lower business costs, cheaper labor cost, reduced housing and office leasing costs.

# Investment obstacles

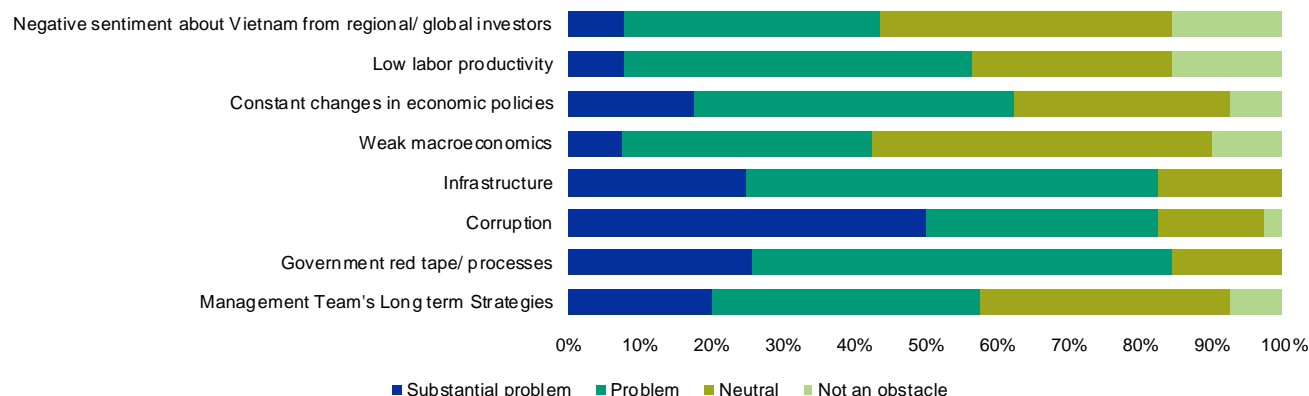
## Investment obstacles

Government red tape remains the most critical obstacle amongst PE investors in Vietnam according to 85% of respondents.

Government red tape is the leading factor among obstacles to investment in Vietnam according to 85% of the respondents. Although there is a slight decrease of 3% versus the last survey, it appears that there has not been any major improvements in this regard. A similar situation is noted for Corruption, voted by 83%, which has been repeatedly marked as the most critical obstacle in our last few years' PE reports.

We noted some improvements in bureaucratic procedures, for instance, new business registration procedure (reduced from 32 days to 5 days in 2014 and 2 – 3 days in 2015) or tax payment time (from

INVESTMENT OBSTACLES IN VIETNAM



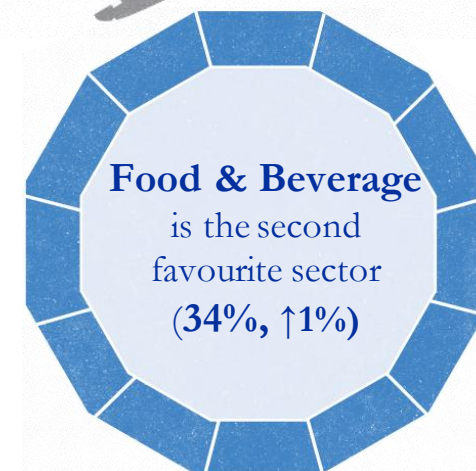
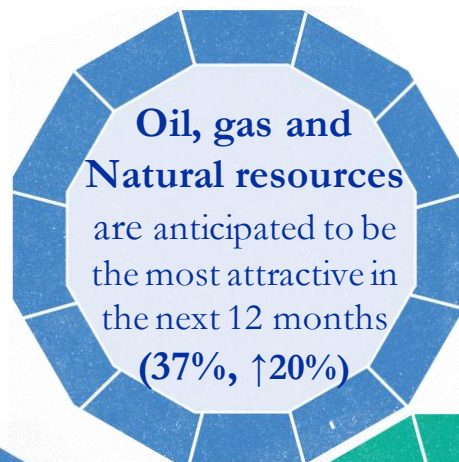
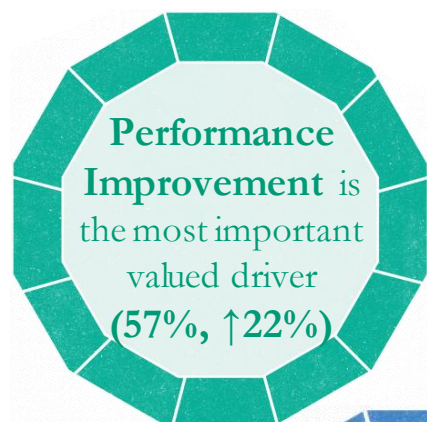
537 hours to 201 hours and is expected to reduce to 171 hours by 2015) as stated in Resolution 19 issued in March 2015. However, it will take a lot of effort and determination, not only to improve in procedures but also in the legal framework to improve the investment environment. As indicated by the head of Central Institute for Economic Management (CIEM), there are 3,299 conditions issued by Ministries that conflict to those regulated in the Investment Law and Enterprise Law, but commitments to resolve these have not yet been met.

Closely following the concern on corruption and

government red tape, are the issues with “Infrastructure” that have been flagged attention in this Survey, by 83% of the respondents, significantly increasing by 24% versus the survey in Q4/2014. In the last survey, we mentioned an opportunity for MNCs to move their operation bases to Vietnam in order to capitalise on the country's economic and political stability, investment incentives and the advantages of labour cost competitiveness. The chance will not be able to be realised without having adequate supporting infrastructure and hopefully a full implementation of Public Private Partnership regulations could help solve this problem.

## 2

## Investment considerations



# Sources of transactions

## Sources of deals

“Private Family Owners” has been the biggest source of deals. This is also consistent with the view of the global PE investors as highlighted in Grant Thornton’s Global PE survey.

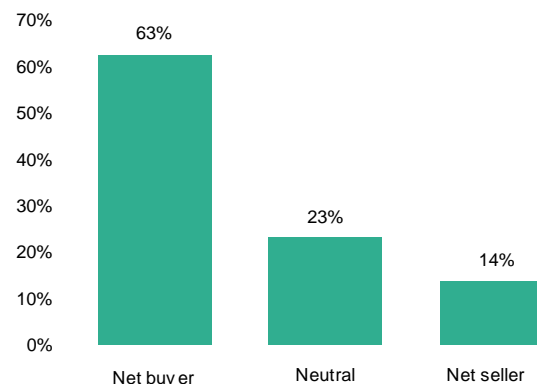
In general, PE investors foresee more buying than selling in the coming year, with 63% expecting to be net buyers, following their positive assessment on the macro economy.

With regards to deal origination, although there is a slight decrease from 33% in the last survey to 30% in Q2/2015, “Private/Family owners” continues to be the first choice of investors. On the other hand, after a long period of being out of favour with investors, “Public market” surged in to the top 3, indicating an excitement of investors as foreign ownership limits have been increased.

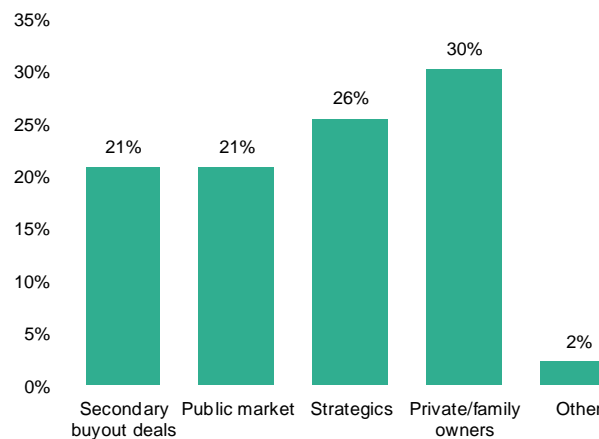
Investors have also considered deals from equitisation as one of the potential sources, but only 2% see this as an opportunity.

In reference to our Global private equity report 2014/15, it is interesting to note that “Private Family/ Owners” is seen as the most important source by 66% of respondents. The second favourite option is “Secondary transactions” which is unlikely to change any time soon since there are increasing pressures on Global Private equity houses to both buy and sell, and increasing PE market maturity in countries, such as India and China.

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



SOURCES OF DEALS IN VIETNAM



# Competition on M&A transactions

## Competition for deals

It is confirmed that higher competition for deals is from Foreign/International PE investors, with nearly a half of the respondents agreeing with this.

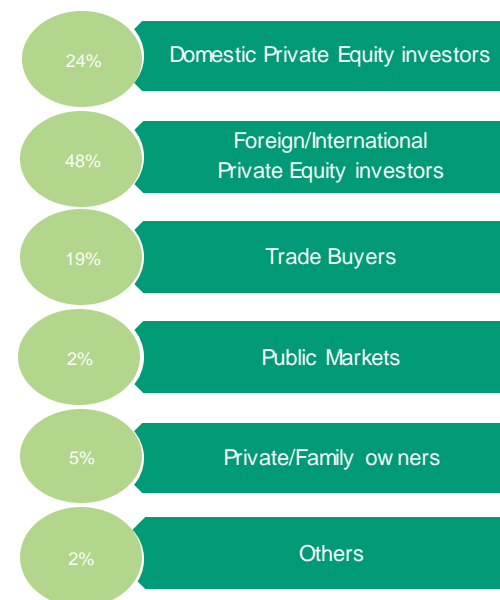
In the Survey Q2/2015, we sought PE views on where they see the most competition for deals. The result, consistent with the last survey, is Foreign/International PE investors, with 48% respondents agreeing.

In the local market, most M&A transactions have overseas buyers. Although most deals are small-market (below US\$20 million for small and from US\$20-500 million for mid market), local investors can not compete with foreign buyers. For certain reasons, Foreign/International PE investors prefer to purchase secondary sales. It may be because the similarity on criteria of deal sizes and deal management policy would help

them to save time and cost since the acquired business is probably seen as lower risk with better governance, usually with quality management teams that understand how PE works.

With regards to other sources, it is noted that competition for deals from Domestic Private Equity investors and Trade Buyers both remained unchanged versus the last survey. However, some respondents also foresee increasing competition from family offices at 5% versus Nil in the Survey Q4/2014.

FROM WHICH SOURCES DO YOU FORESEE THE MOST COMPETITION FOR DEALS OVER THE NEXT 12 MONTHS?



# Key deal success factors

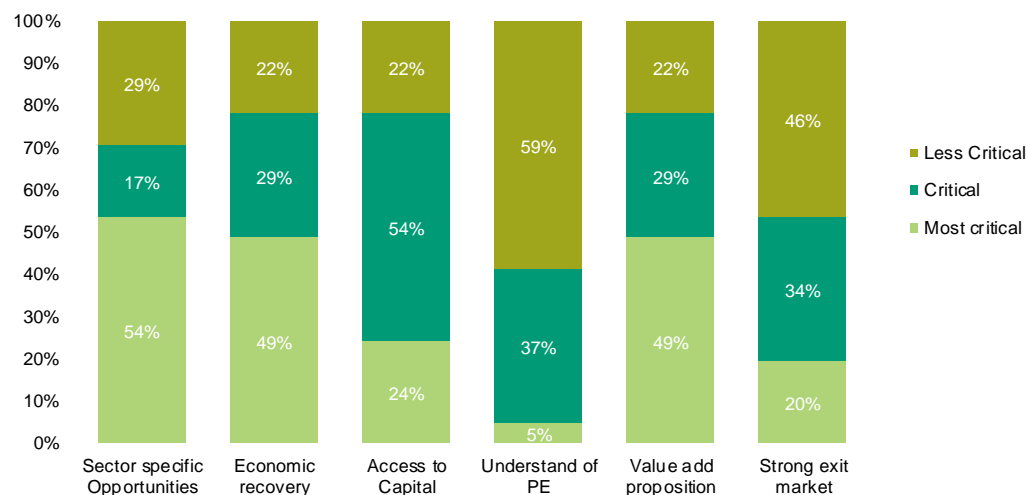
## Deal success factors

Over one-half of respondents agreed that “sector specific opportunities” is the most critical success factor to identify and win deals (54% versus 40% in the last survey)

“Sector specific opportunities” is considered as the most critical success factor, as selected by 54% of the respondents. Investors see that good deals can be found when they use sector specific insight from previous experience and connections to obtain knowledge and opportunities from subsectors in order to find suitable investment assets.

“Economic recovery” is the second important

WHAT DO YOU BELIEVE ARE THE GREATEST OPPORTUNITIES FOR PE IN VIETNAM?



success factor, cited by 49% respondents. Combined factors, such as government stimulation, access to finance, consumer confidence etc. altogether could help regain momentum to capture more investments both domestically and internationally.

In addition, we note that “Value add proposition” was considered as a key deal success factor as agreed by 49% PEs. As observed in

previous surveys, private companies are now looking not only for financial support but also for sector knowledge and international-standard management experience of PE investors to cope with highly competitive and open market environment today.

# Key deal breakers

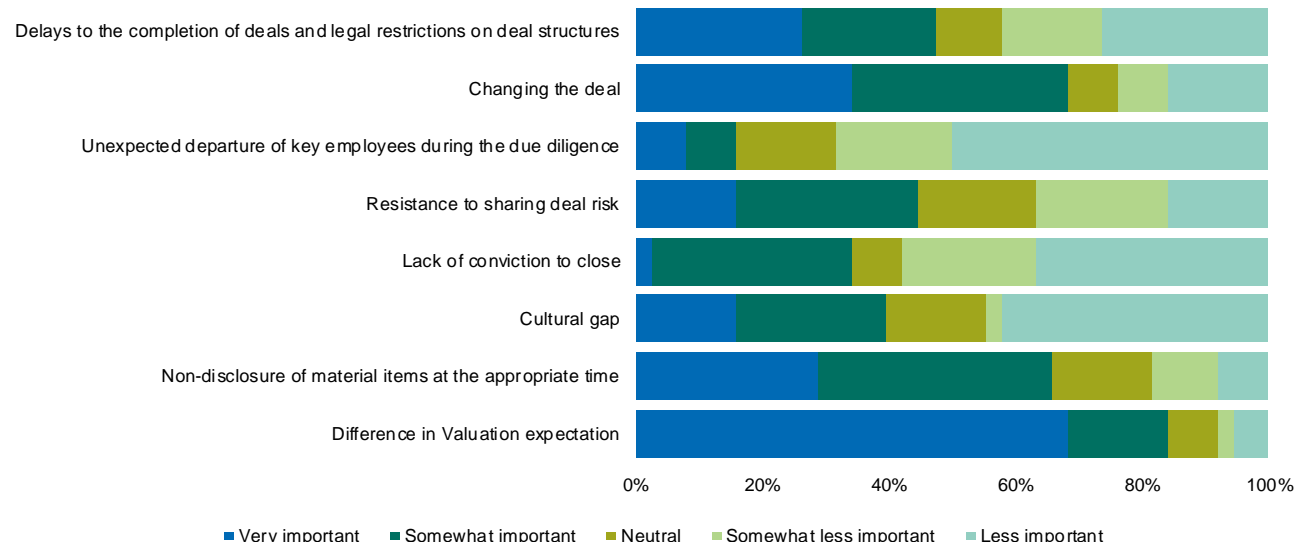
## Key deal breakers

“Difference in Valuation expectation” continued to be the most common deal breaker, cited by 68% respondents

68% of the respondents cited the difference in value expectations between buyers and sellers as the cause for deal failure.

With regards to “Non-disclosure of material items at an appropriate time”, continues to be among greatest concerns of investors with 29% of respondents selecting this.

## FACTORS CAUSING DEAL FAILURE



These two issues are not only particular to Vietnam. Our 2014/15 Global PE survey also revealed that "Valuation" and "Management issues" are the key deal breakers worldwide, with 37% and 42% respectively.

In addition, “Changing the deal” and “Delays to completion of deals and legal restrictions on deal structures” are two other major deal breakers, as

selected by 34% and 26% of respondents respectively.

# Industry attractiveness

## Top industries

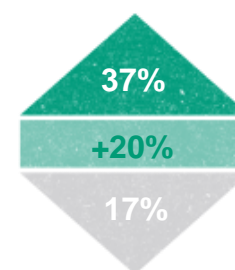
- In this survey, Oil, Gas and natural resources is considered as the most attractive sector
- Food and Beverage takes the second position

The growth in supply, along with weaker-than-expected growth in demand have resulted in a collapse in crude oil prices in 2014, which ultimately affected investors in the sector and thus received the poor rating by only 17% of survey respondent in Q4 2014. In this survey, however, Oil, gas and natural resources sector has been selected as the most attractive with 37% of respondents. The sharp increase in the sector attractiveness is probably due to the opportunities to acquire assets from distressed sellers, or investing in assets at lower costs. For PE in Vietnam, these opportunities can be realised as 4 refinery projects Nghi Son, Nhon Hoi, Nam Van Phong, Vung Ro are in the pipeline providing investment opportunities when project owners have limited capital. Going to downstream subsector, investors could also have further opportunities in oil and gas trading, following a

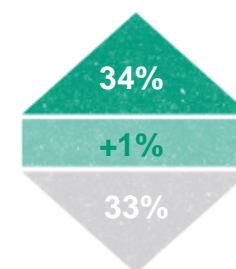
draft decree by MOIT reclassifies oil and gas trading as a conditional subsector and no longer considered as monopolised by the State.

Ranked in second position, Food and Beverage maintain its attractiveness with a rating slightly increased to 34% from 33% in the last survey. It is the large population (90 million) with growing income per capita providing solid support for a potential growth in this sector. It is estimated that food consumption growth rate per capita can achieve at CAGR 17.6% during 2014 – 2019. At sub-sector level such as pre-packed food, volume growth and revenue growth are even significantly higher, estimated to reach 24.2% and 48.7% respectively (BMI).<sup>[1]</sup> For beverage subsector, it is expected that growth rate is approximately 10.5% in which beers are expected to have higher growth rate at 32.8%.<sup>[2]</sup>

## OIL, GAS AND NATURAL RESOURCES



## FOOD & BEVERAGES



<sup>[1]</sup> BMI Research

<sup>[2]</sup> Vietnam report, released on 17 April 2015

# Industry attractiveness *continued*

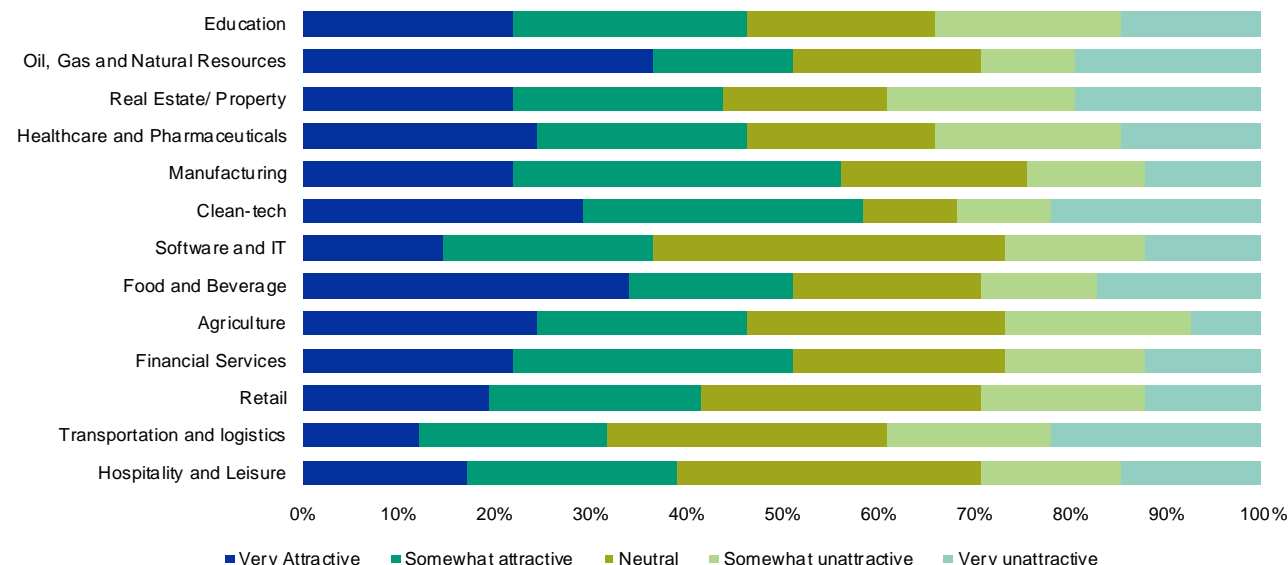
## Top industries

Investors also put their faith in Clean tech sector with 29% of respondents

Ranked third with 29% of respondents, Clean tech is considered very attractive. Green growth is one of the key topics in EVFTA. Under the negotiation of EVFTA between Vietnam and European, EU will finance a part of the National Plan on Green growth introduced in March 2014 estimated at US\$30 billion until 2050 (MPI). The conditions are that there has to be to have equal

[1] the Saigon times, issued June 19, 2015  
Decision 403/QĐ-TTg issued in March 2014  
The Whitebook 2015, Eurocham

INDUSTRY SECTORS IN VIETNAM



treatments for firms in the sector, and gradual tax reductions to 0% for green technology equipment. The two parties have agreed on major issues in the renewable energy sector and it is expected that negotiations on FTA between Vietnam and European should be concluded by September 2015.<sup>[1]</sup>

Sharing the fourth position is Agriculture and Healthcare/ Pharmaceuticals with 24% selected for each. Other industries also come close, with 22% of respondents, including Financial Services, Real Estate, Education and Manufacturing.

# Key value's drivers

## Value's Drivers

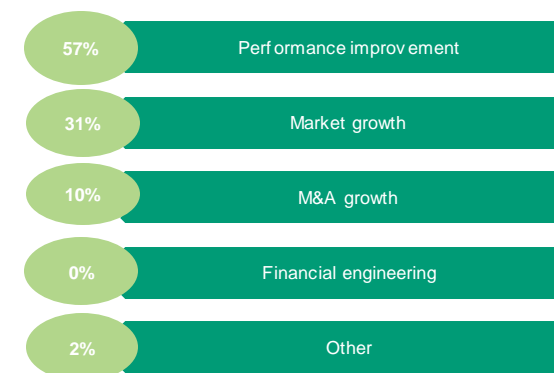
Investors believe that “Performance Improvement” is the most important value driver

In this survey, Performance improvement takes the first position with 57% of respondents selecting this, 22% higher than in our last survey. It is also the first time there has been such a significant gap between the first and second value driver. The result is consistent with our Global PE survey whereas old fashioned multiple arbitrage has been no longer enough. It was, as indicated by GPs who

participated in our Global PE survey, how good PEs think about managing businesses even before buying them.

In terms of other key drivers, both investors in Vietnam and worldwide believe that organic growth is likely more sustainable and cheaper, therefore M&A growth was only chosen by 10%, dropping by 9% versus the last survey.

## IMPORTANT DRIVERS OF VALUE - VIETNAM



# Hands-on involvement with portfolio companies

## Hands-on involvement expected by PE investors

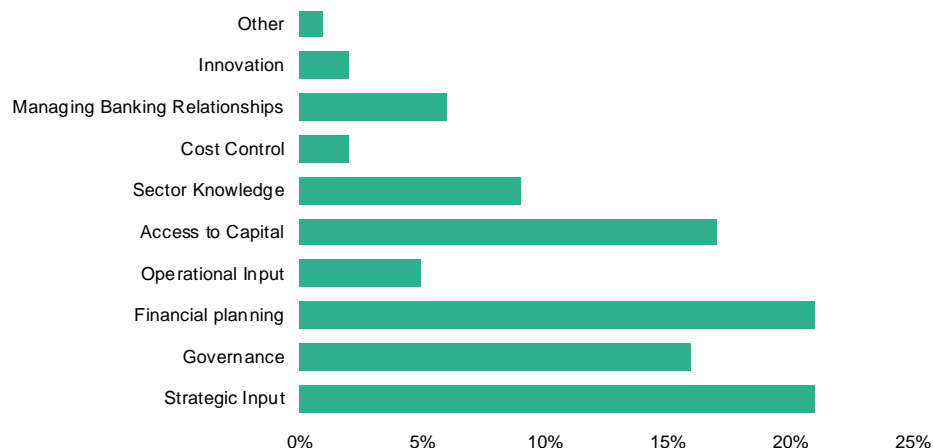
Strategic input and financial planning topped the list as expected areas needing PEs' involvement (21% selected)

Strategic input was chosen by 21% of respondents and is considered to be the most important area for portfolio company involvement which has not changed since our last survey. In the Survey Q4/2014, we mentioned a necessity of working closely with investee companies rather than limiting to periodic reviews. This should be more emphasised in today's market as the environment is changing unpredictably and exposing enterprises both top opportunities and

threats. Having early and close involvement could help investee enterprises to remain focussed and not depart from their chosen direction, thereby increasing PEs' exit values.

There are also another three areas that PE investors plan to have more hands-on involvement in portfolio companies, namely Financial Planning (21% selected), Access to Capital (17% selected) and Governance (16% selected). Among the three, it is "Access to Capital" that surprisingly came into

## PARTICULAR AREAS FOR HANDS-ON INVOLVEMENT WITH PORTFOLIO COMPANIES



the Top 3 after the fourth or fifth position in at least the last 3 surveys. The ranking change, probably could be seen as a need of capturing investment opportunities during the economic recovery, and taking global integration opportunities arising from the multilateral free trade agreements that will be coming into effect in 2015 and beyond.

# Key factors to be considered when investing in Vietnam

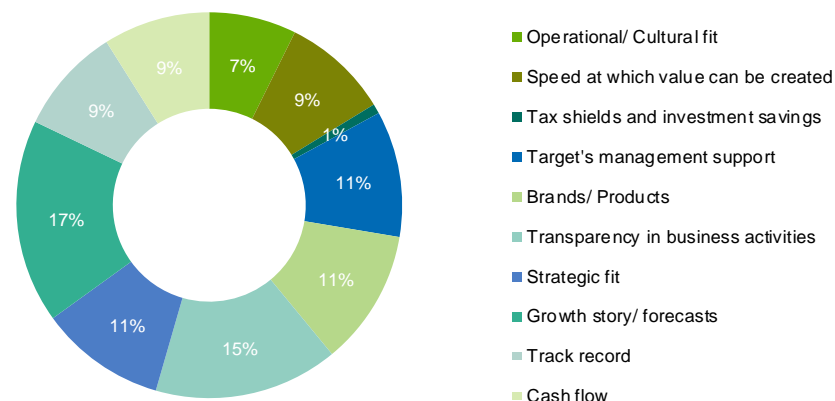
## Top factors

While Growth story/forecast is the factor that attracts PEs to private companies, the issues of Corporate Governance, Transparency and Management issues cause concern for PEs when selecting Vietnam investee companies

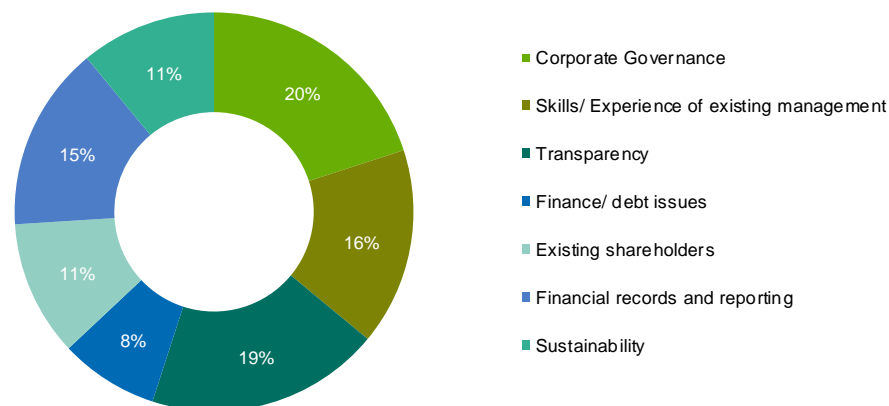
With regards to Important factors to consider when investing in Vietnam, same as in the last survey, the top consideration is Growth story/forecast as selected by 17% of respondents confirming the importance in attracting investors to Vietnam. This perspective is also agreed by our Global PE investors (GPs) views when accepting to pay a premium if the investee company shows strong growth potential or operates in an area in which the GP has specific knowledge and experience.

In relation to concerning issues, 20% of respondents rated Corporate Governance as their most concerning issue when investing in Vietnam. The Transparency issues closely follow with 19% selected. These two issues have been continuously on the top of the list for PE investors' in our previous surveys and are flagging an urgent need for improvement by companies in Vietnam, should they wish to make themselves more attractive to PE investors.

THE MOST IMPORTANT FACTORS TO CONSIDER WHEN INVESTING IN VIETNAM

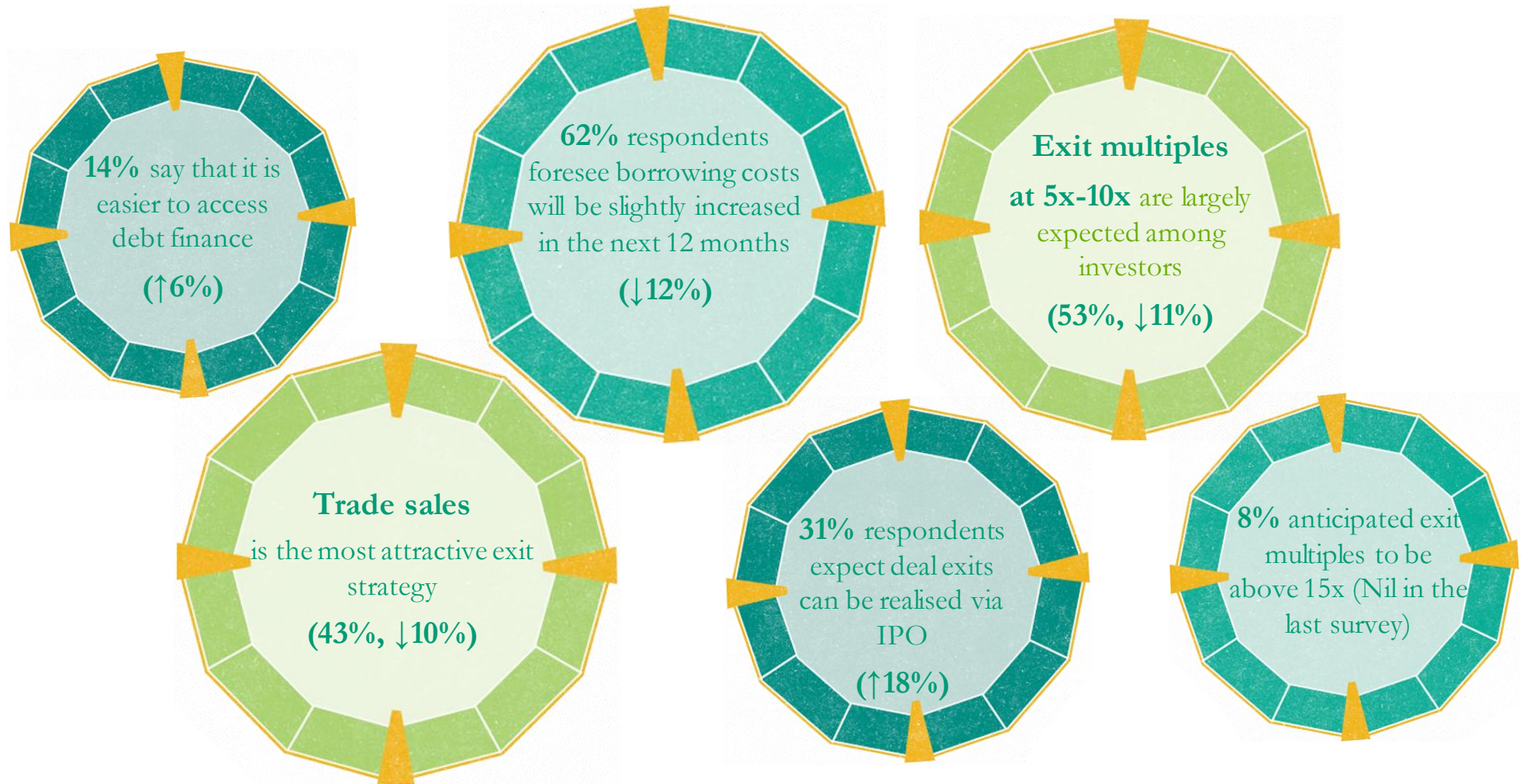


MOST CONCERNING ISSUES WHEN INVESTING IN VIETNAM



# 3

## Planning an exit



# Access to finance

## Cost of debt

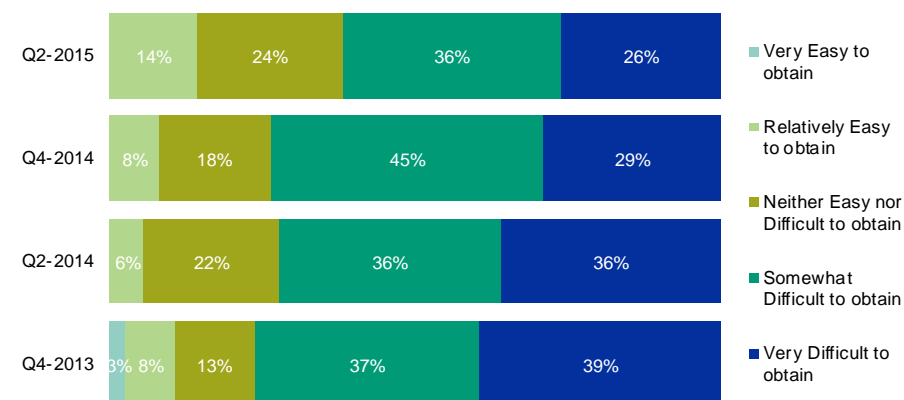
In the next 12 months, loans are expected to be easier to obtain as selected by 14% of respondents. On the other hand, it is expected that costs of borrowing will be slightly increased to reflect higher demand for financing new investments during the recovery period

Access to debt finance is expected to less difficult as an increasing respondents cited loans are “relatively easy to obtain” (14%, increased by 6%). The number of respondents who rated “difficult” or “very difficult to obtain” also declined by 12% to 62%. The results reflect the fact the State Bank of Vietnam has increased the credit growth target from 12% - 14% to 15% - 18%. Although during the last three years, credit growth rates were lower than targets, the increase of

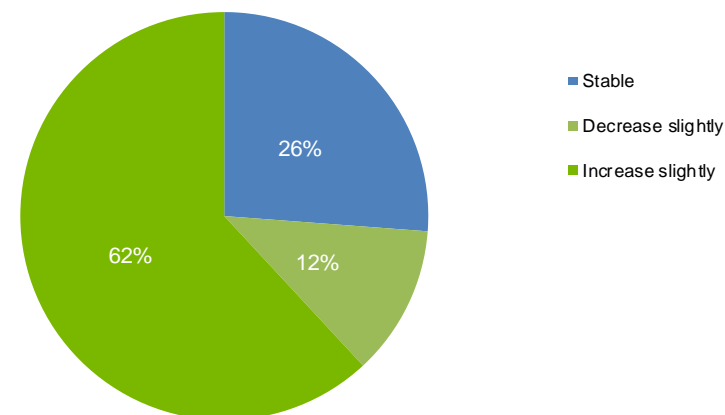
such target (to 18%) has also been seen as not likely to be met, cited by investors.

In terms of costs of borrowing, although the majority of respondents (62%) anticipate an increase of borrowing costs, no respondents expect any significant change in the interest rates in the coming year.

THE AVAILABILITY OF DEBT FINANCE WITHIN VIETNAM



THE COST OF DEBT OVER THE NEXT 12 MONTHS



# Exit multiples

## Exit multiples' ranges

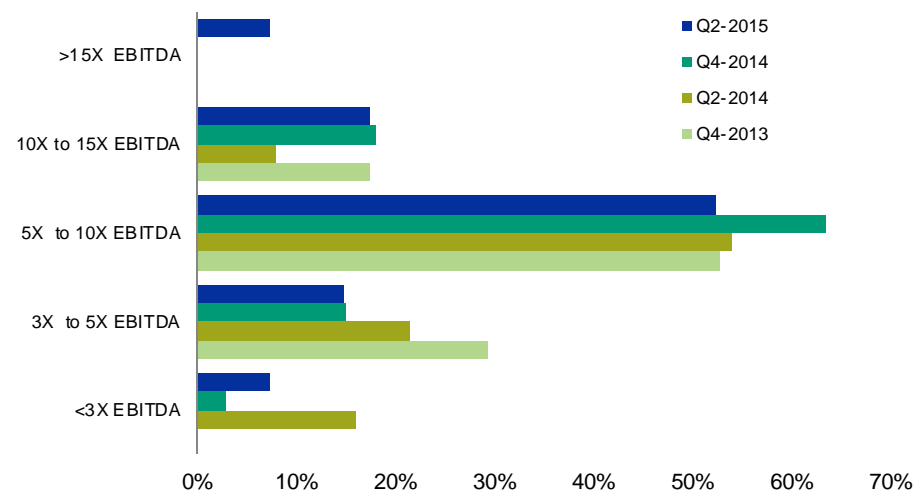
While the majority PE investors still anticipate exit multiples in the range of 5x-10x EBITDA, there is an increased expectation on realising higher returns, at multiples above 15x due to positive sentiments on market conditions

53% of respondents forecast the average exit multiple at “5X to 10X EBITDA”. This result shows a decrease by 11% since our previous survey.

The proportion of respondents who chose “10X to 15X EBITDA” remain unchanged. However, 8% of respondents chose “above 15x EBITDA” versus Nil in the last survey.

The views reflect the optimistic outlook of PE investors towards the Vietnamese economy, and the expected continued growth. In addition sentiment towards exits has improved in part due to the increasing of the foreign ownership limited for publicly traded entities.

EXIT MULTIPLES FOR INVESTMENT IN VIETNAM



# Exit strategies

## Top exit strategy

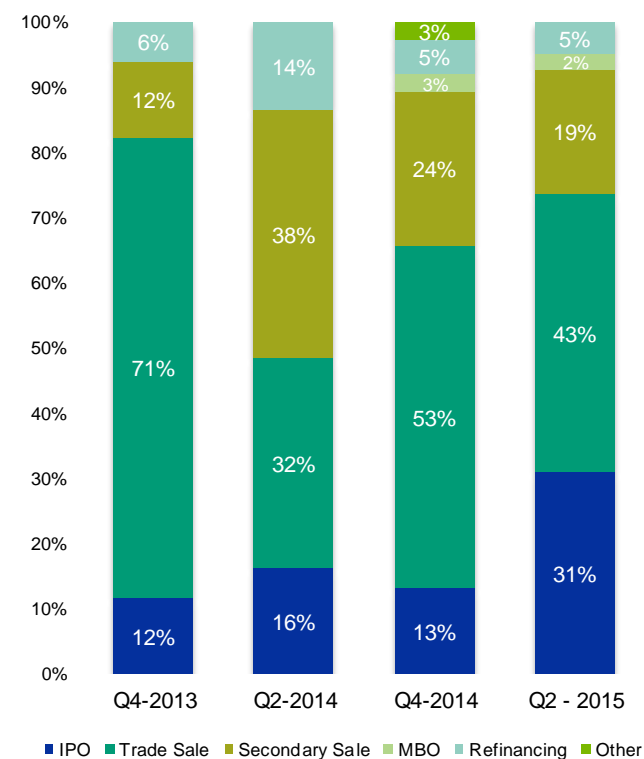
This Survey's results show investors' expectation that IPO will be an important exit strategy during the next 12 months

Although there is a big reduction (by 10%), “Trade sales” continues to be most preferred exit strategy of PE, as selected by 43% respondents.

Noticeably, exit strategy via IPO has become the second best exit route, cited by 31% respondents. This reflects a significant increase from 13% to 31% of respondents choosing this strategy. This is consistent with those reported in relation to deal sources. The strategy reflects the positive sentiments toward the increase in foreign ownership limits in certain publicly listed companies.

Ranked the third, the “Secondary sale” strategy seems to be declining in attractiveness, in accordance to PEs' views in the last two surveys. However, this could be changed due to two factors. Firstly, the implementation of the decree on increasing in foreign ownership limits in listed companies may take longer time to be implemented, and eventually may cause PEs lose their patience. Secondly, as discussed in the “Competition on M&A transactions”, PEs may see the average quality of companies via secondary sales is better than for primary deals, therefore they can choose this safer route.

THE MOST ATTRACTIVE OR ACHIEVABLE EXIT STRATEGY FOR PRIVATE EQUITY INVESTMENTS



# Grant Thornton and the Private Equity Survey Q2 - 2015

This is the bi-annual survey that Grant Thornton Vietnam conducted with respondents being the decision makers working in the Private Equity space located both in and outside 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.

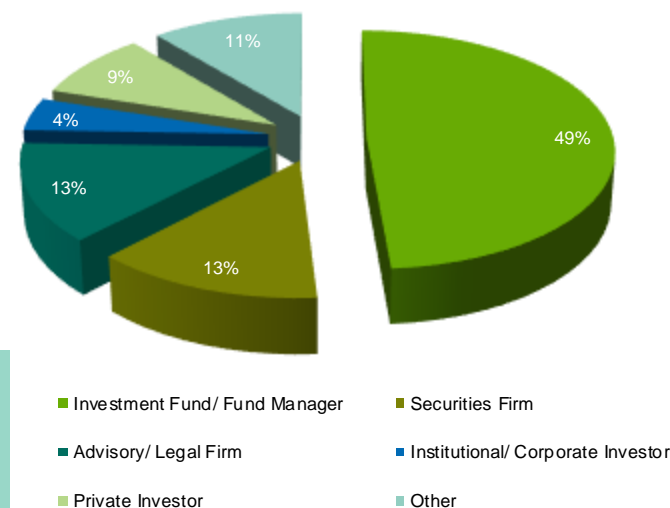
This survey was undertaken in July 2015.

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PRIVATE EQUITY SURVEY PARTICIPANTS IN Q2 - 2015



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