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client update

VIETNAM’S NEW WAVE OF EQUITISATION

The equitisation programme of Vietnamese State-owned enterprises (“**SOE**”) was implemented to restructure the economy and lure foreign strategic investors into the market. Whilst SOEs benefit from government support and easy access to capital many of them often operate with great inefficiency. The programme aims to replace the heavily State-oriented economy with one that is competitive and more efficient, and one that will improve the SOEs’ operational and technological capabilities and corporate governance. This client update explains the most significant aspects of the SOE equitisation process and provides you with the latest information.

THE EQUITISATION PROGRAMME

SOEs in Vietnam account for 35 per cent of GDP. Analysts concur that many of these are grossly inefficient enterprises that swallow up land and capital given on preferential terms from the Government. Equitisation refers to the process the Vietnamese Government uses to partially privatise SOEs, with the view to boost the Vietnamese economy and attract foreign know-how, skills and capital. Last year, the Government issued Resolution No. 15/NQ-CP providing a number of measures to speed up equitisation and capital divestment of SOEs. Under Resolution No. 15/NQ-CP, the Government targets to complete the equitisation of 432 SOEs by the end of 2015.

Although this timeline appears to be highly optimistic, the economic backdrop to the equitisation programme is more favourable than Hanoi’s last attempt in 2011. Inflation has stabilised, the country has a current account surplus and the exchange rate is making companies cheaper for investors holding US dollars. The stability of the Vietnamese Dong is key for foreign investors looking to make long-term investments in the country.

Equitisation can take three forms:

1. keeping State shares intact and issuing new shares;
2. selling part of the existing State shares; or
3. selling off all State shares (this final method being mostly applicable to loss-making SOEs).

STATE AUTHORITIES INVOLVED

Various State authorities are involved in the equitisation of an SOE, most notably are the Equitisation Decision Authority ("**EDA**") and the Equitisation Steering Committee (“**ESC”**). The EDA varies depending on the level of the managing authority of the SOE, such as the Prime Minister, Deputy Prime Minister, Minister, Vice-Minister, the chairman of provincial People's Committees or even the board of directors of an SOE with respect to an SOE under the management of a “holding SOE”. The EDA decides the most important issues relating to the equitisation. The ESC is set up by the EDA and is in charge of the day-to-day operations of the equitisation. The prevailing regulations do not clearly regulate the responsibility and structure of both the EDA and the ESC, as well as other matters. This means that in practice, it may be difficult to determine which State authorities are involved and what their respective powers are.

PREPARATORY STEPS

A number of preparatory tasks need to be completed at the initial stages including the establishment of the already mentioned ESC, the appointment of equitisation advisors, and the gathering of information and documents regarding the SOE.

THE EQUITISATION PROCESS

After establishment of the EDA and the ESC, the “real” equisitation process can start. The equitisation process includes the following main steps:

1. formulation of an equitisation plan;
2. initial offering of shares; and
3. “conversion” and hand-over of assets and liabilities.

Formulation of an equitisation plan

During this step, the SOE must make an inventory of its assets and liabilities, restructure its assets and liabilities and determine the value of the SOE. By restructuring assets and liabilities, the ESC and the SOE will formulate and, if necessary, clean up the balance sheet of the SOE and, to the extent possible, resolve any past issues or mistakes before making the SOE available for sale. The SOE can normally be valued by way of assets method, discounted cash flow method or another valuation method.

The asset method determines an enterprise’s value based on the total of all its existing assets at the time of the equitisation. This includes the profitability of the enterprise as acceptable to both purchasers and the State. The discounted cash flow on the other hand is a method of determining an enterprise’s value based on the profitability of the equitising SOE in the future, regardless of the value of the enterprise’s assets. However, the valuation result obtained from the assets method is the minimum threshold, i.e. the disclosable value of the equitising SOE cannot be lower than the value determined by the asset method. The valuation of a special SOE, such as a holding company of a State-owned group of companies or State-owned corporation, may need to be verified by the State Auditor (the State Agency in charge of the controlling the State budget).

Based on the valuation result, the equitising SOE will prepare an equitisation plan (“**EP**”) which covers many important issues regarding the equitisation, including the “commencement” price (the initial price offered for sale to the public), the proposed capital, the shareholding structure of the Joint Stock Company (“**JSC**”) to be formed and the steps for implementing the equitisation. Once approved, the EP will be the bible for the whole equitisation process.

Initial offering of shares

Most equitisations involve the issuance of new shares. The equitisation of a large SOE normally begins with a domestic initial public offer ("**IPO**") and then a strategic sale to foreign investors. An SOE will sell shares to (i) the public through an IPO, (ii) strategic investors either directly or through a strategic sale auction, and/or (iii) employees and trade unions of the equitising SOE.

The share sale will usually be conducted by one or more investment banks as underwriters. The number of shares that an investor is allowed to subscribe to will depend on the proposed shareholding structure of the JSC as set out in the EP. Shares in the JSC can only be issued after the JSC has been created. This results in a substantial delay between the time of payment for shares and their issue to investors. If Mizuho Corporate Bank's 15 per cent acquisition of Vietcombank (2007) will be considered as the standard for this, it could take over one year.

Conversion and hand-over of assets and liabilities

Various tasks need to be undertaken so that the equitised JSC can be set up, including:

- organisation of the initial general meeting of shareholders;
- business registration for the establishment of the future JSC;
- issuance of shares;
- re-evaluation of the State's capital in the equitised JSC;
- preparation of the opening account of the equitised JSC; and
- the hand-over of the assets and liabilities of the SOE to the equitised JSC.

STRATEGIC INVESTORS - APPOINTMENT AND PRACTICAL ISSUES

Strategic investors may be domestic or foreign investors with the financial capability to assist the SOE after equitisation on matters such as transferring new technology, training/manpower resources, raising the SOE's financial capability, improving management, enhancing the supply of raw materials and developing the product sales market.

Each equitising SOE can only have three strategic investors. The reason for this is to encourage a more stringent selection of strategic investors by the equitising SOE. Industry-specific laws may also set out additional requirements for strategic investors.

Special approvals

The plan for the sale of shares to strategic investors and the requirements for selecting strategic investors need to be submitted by the ESC to the EDA for approval. The Prime Minister's approval must also be obtained in the following cases:

1. large scale enterprises with State-owned capital above VND 500 billion (USD 23.8 million);
2. in special sectors and industries (such as insurance, banking, post and telecommunications, aviation, coal mining, petroleum and other rare mineral mining);
3. holding companies of a State-owned group of companies or State-owned corporation; and
4. where it is absolutely necessary to select strategic investors in advance of the IPO.

Private ownership restriction

Room for private investment in the SOEs is different from industry to industry as set out in the table below:

No.	Industries	Room for private ownership
1.	- Manufacture and supply of toxic chemicals and industrial explosive materials; - Transmission and dispatch of the national power system, multi-purpose hydropower and nuclear power particularly important to the economy and society and associated with the national defence and security; - Management/control and exploitation of the infrastructure system of national and urban railway; - Management and exploration of airports that are important to national defence and security; - Flight assurance services; - Money printing and coin production; - Public postal services; and - Lotteries.	None
2.	- Petroleum, natural gas and large-scale mineral extraction; - Provision of telecommunication infrastructure; - Management, exploitation and maintenance of airports not included under 1; - Management and exploitation of sea ports and international gateway(s); - Management and maintenance of roads and inland waterway systems; - Maintenance of the infrastructure system of national railway,	Equal or less than 25%
3.	- Petroleum and natural gas processing; - Cigarette production; - Coffee and rubber planting and processing, as well as forest planting and managing in mountainous and strategic areas, such as remote and isolated areas associated with national defence and security; - Wholesale of gasoline, food, and preventive and treating medicines; - Finance and banking; - Electricity distribution; and - Aviation transportation.	Less than 35%
4.	- Management of public services for urban lighting, water supply, drainage sewerage and environment sanitation; - International sea and railway transportation; - Production of basic chemicals, chemical fertilisers and plant protection drugs; - Coffee and rubber planting and processing, as well as forest planting and managing in areas other than those named under 3;	Less than 50%

A foreign investor being a foreign organisation, foreign individual or foreign invested enterprise in Vietnam in which foreign investor(s) own more than 49% of the charter capital, may only purchase a limited number of shares in accordance with the approved EP and possibly subject to the provisions of relevant industry specific laws in Vietnam. For example, foreign investors may own no more than 49% of the charter capital of a listed company. With respect to the banking sector this percentage is lower and can be no more than the aggregated 30% of the charter capital of a commercial joint stock bank.

As can be seen from the table, there are even industries or business sectors in which foreign investors are not permitted to purchase shares in equitising SOEs as there are restrictions with regard to foreign investment. This is also allowed under Vietnam's WTO commitments and other relevant regulations. Note also that there activities not mentioned in this list, like distribution of medicines. A foreign invested company cannot distribute medicine; it has to use a local distributor.

Methods of shares sale

Shares may be sold to strategic investors via:

- *Strategic auction* if (i) there are more than three investors registering to purchase shares or (ii) there are three or less investors registering to purchase shares but the quantity of shares these investors register to purchase is larger than the quantity of shares available for sale to them; or
- *Direct agreement* if there are three or less investors registered to purchase shares and the quantity of shares these investors purchase is equal to or less than the quantity of shares available for sale to them. Strategic investors can purchase shares by direct agreement prior to or after an IPO.

Pricing

The share price payable by strategic investors is calculated as follows, and the second option will be often chosen:

1. *Prior to an IPO*: the price shall be agreed between the SOE and the strategic investor or be the successful auction price of the strategic auction (if applicable), but it must not be lower than the commencement price;
2. *After an IPO*: the price shall be directly agreed between the ESC and the strategic investor, but it must not be lower than the lowest successful price of the public offer.

Payment account and currency

A foreign investor wishing to purchase shares in an equitising SOE must open a capital transaction account at a banking institution authorised to provide foreign exchange services in Vietnam. The purchase price for the shares must be paid in Vietnam Dong.

Non-refundable deposit

Strategic investors must pay an immediate deposit of 10% of the value of shares they register to purchase at the commencement price approved by the EDA. A strategic investor who gives up its right to purchase is not entitled to recover the deposit of 10%, regardless the reason. However, the law does not specifically regulate the return of the deposit in the following cases:

- the equitising SOE and strategic investor fail to reach an agreement on the purchase or subscription of shares
- the completion of the shares purchase or subscription is subject to fulfilment of conditions precedents.

For this reason, investors should seek to put in place a share purchase or subscription agreement which sets out the conditions under which the deposit will be refunded to the investor if one of the conditions precedents is not satisfied. The deposit would usually be structured in the form of a bank guarantee, escrow account, or cash deposit subject to negotiation between the ESC and the strategic investor.

Lock-in period

The lock-in period for strategic investors' shares is five years, except when a transfer is approved by the general meeting of shareholders. However, the five-year lock-in period is calculated starting from the date on which the SOE is converted into a JSC, so when its enterprise registration certificate is issued. This may mean that, if for example the equitised JSC sells shares to a strategic investor two years after conversion, the lock-in period for those shares will only be three years.

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After the lock-in period, the strategic investors can freely sell their shares in the JSC to any third party; save for the case there is a provision in the share sale agreement concluded between the strategic investors and the SOE setting out restrictions or conditions in that respect.

EQUITISATION OF VIETNAM'S "CROWN JEWELS"

In 2014 about 140 SOEs have been equitised. The intention of the Vietnamese Government is to equitise a further 432 in 2015. Therefore many SOEs are pressing to complete their IPOs by the end of 2015 at the latest.

Vietnam Airlines

Vietnam Airlines is the country's State-owned flagship airline carrier and dominates the local market. Its total annual revenue reached VND 72.55 trillion (USD 3.45 billion) in 2013. Vietnam Airlines signed contracts with Airbus in 2007 and 2009 to purchase a total of 26 Airbus A321s for delivery during the 2011-2014 period as part of a plan to modernise and expand the Vietnamese fleet to 110 and 170 aircrafts by 2015 and 2020 respectively. According to Decision No. 1807/QD-BGTVT issued by the Minister of Transport, the book value of Vietnam Airlines as of 31 March 2013 is VND 57,156 billion (USD 2.74 billion), of which the material portion of State-owned capital is weighed at VND 10.576 billion (USD 507 million).

After 6 years of wait the IPO finally took place in December 2014. However, it did not meet foreign investors' expectations, and no major foreign strategic investor or institution did purchase into Vietnam Airlines. In the end almost all of the shares offered, equalling to a 3.5% stake, were bought by local banks Techcombank and Vietcombank (which according to press reports are supposedly also the company's biggest creditors).

MobiFone

Established in 1993, MobiFone is the third major Vietnamese mobile network operator. It was the first enterprise to operate on GMS 900/1800 mobile services in Vietnam. MobiFone, like Vinaphone, is currently wholly-owned by the State-owned Vietnam Posts and Telecommunications Group ("**VNPT**"). However, as of from 1 July 2014 MobiFone is separated from VNPT and falls under direct control of the Ministry of Information and Communication ("**MoIC**"). The MoIC is together with MobiFone responsible for drafting an EP to be approved by the Prime Minister in 2014, which is to be implemented next year.

As of yet there has not been any information made public with regard to the percentage of shares to which strategic investors may be entitled. According to a ministerial decision in 2006, private investors are entitled to no more than 25% of the offered shares, of which strategic investors are only able to claim the maximum of 50%, which contributes to an equivalent to 12.5% of all shares. It is expected that the equitisation will be finalised before mid-2016.

MobiFone was valued at USD 2 billion in 2009, but according to reports MobiFone has a charter capital of VND 15 trillion (USD 714.2 million) and in 2014 MobiFone's annual revenue was about USD 1.87 billion and profit was over USD 328 million.

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