Will Vinamilk's elimination of its foreign ownership limit start a trend?

The May announcement by Vinamilk – the country's largest publicly traded company with a market capitalization of over USD7 billion – that it would completely eliminate its foreign ownership limit ("FOL") was a long-time coming, and welcomed by all. The announcement, rumoured for some time, came nearly a year after the government announced the relaxation of FOLs (during which time there was little progress on the matter, and was mostly limited to smaller companies), and was the first such move by a large company in Vietnam.

As a shareholder of Vinamilk and many other companies, VinaCapital applauded the move, and believes that it could be a positive catalyst for the market, despite the government's apparent reluctance to sell its stake in a trophy asset. Finally it seems FOL momentum could be starting to build....or has it?

Why has it taken so long?

Between June and December 2015, just one company, brokerage Saigon Securities (SSI), increased its foreign room to 100%. Two other companies joined the club during the first quarter of 2016: fishery company Vinh Hoan and bedding manufacturer Everpia (which already had a large foreign investor). A number of factors have likely contributed to the slow pace of foreign ownership expansion:

Too many restricted sectors.

- Lack of clarity regarding allowed sectors: Companies operating in "strategic" or "conditional" sectors are limited in their ability to expand FOLs, of which there are 267 such sectors. Banks' foreign ownership remains capped at 30%, while sectors such as telecommunications remain capped at 49%. At the end of 2015, the Ministry of Finance released a list of 17 sectors open to foreign investment, including real estate, services in tourism, entertainment, computing, research and development, information, leasing, transportation, construction, health care and trading.

Significant legal hurdles remain.

- Uncertain/conflicting legal issues: If companies open full ownership, and foreigners hold more than 50% of the outstanding stock, will a company be treated as a foreign enterprise, and subject to the tax and other laws that apply to "non-Vietnamese" companies? While companies may have the legal right to expand their FOLs, other laws make it impractical or even impossible. For example, foreign-owned retailers face economic needs tests and other restrictions when seeking to expand the number of stores that local retailers do not. While other reforms announced in 2015 allow foreign businesses to "own" a certain amount of property, there remain limits. As such, while real estate firms can open to 100%, such a move would limit their ability to build land banks. Many Vietnamese companies operate in several different sectors, some conditional, some not.
- Wait-and-see: Given some of the uncertainties, most companies would rather let others take the lead on the issue and see how those companies fare before committing to such a move themselves.
- Loss of control: Many of Vietnam's companies are family-owned and operated, and as much as they might welcome additional investment, concerns about losing control or outside meddling outweigh the desire for more capital.

Other companies taking FOL action

After next-to-no activity on FOLs in the six months following the government's June 2015 announcement, the start of 2016 saw a number of companies announce plans to lift or remove their FOLs in advance of shareholder meetings, which typically take place in April and May in Vietnam.

Some of the more interesting companies to take action on FOLs are a few of Vietnam's largest banks, which operate in a restricted sector. Military Bank (MBB), the country's fourth-largest and owned by the army, expanded from 10% to 20%. VietinBank and Vietcombank are rumored to be looking to increase their FOLs to 35% and 40%, respectively, which would require changes in existing law. While some exposure to particular bank stocks may be worthwhile, strategic foreign investors are unlikely to be interested in the sector unless FOLs are expanded beyond 50%.

Company	Industry	Foreign ownership limit (%)	Actual foreign ownership (%)	Market cap (USD)
Vinamilk	Consumer	100*	49	7.7 bn
Military Bank	Bank	20	19.4	1 bn
Saigon Securities	Brokerage	100	56.6	455 mn
REE	Engineering, manufacturing, real estate	49	49	287 mn
Vinh Hoan	Seafood	100	31.6	120 mn
BIC	Insurance	49	45.2	110 mn
Hoang Quan	Real estate	60*	10.4	100 mn
Domesco	Pharma	100*	48.7	87 mn
Techno-Agricultural Supplying	Agriculture	100*	3.6	56 mn
Everpia	Bedding	100	51.5	54 mn
Fecon	Infrastructure construction	100	31.9	44.5 mn
An Phat Plastic	Plastic	100*	19.5	41 mn
Thu Duc Housing	Real estate	60*	41.5	40 mn
TNG	Garment	100*	19.2	27 mn
SMC	Steel distributor	100*	9.7	4.9 mn

*Announced/Proposed. Not all-inclusive. As of 3 June 2016. Source: RongViet Securities, VinaCapital research

In total, fewer than two dozen companies have taken any action on FOLs at this point. While any movement is encouraging, these companies represent a fraction of the 689 companies listed on Vietnam's two bourses, and are mostly small- or mid-cap.

FOL expansion is great, but what if the government doesn't sell?

Lack of a divestment timeline is frustrating.

The State Capital Investment Corporation ("SCIC") holds 45% of Vinamilk – valued at more than USD3 billion – and sizeable stakes in many other large companies. Although it was reported that the SCIC was "required"[i] to sell its stake in Vinamilk, it has outlined no time frame for doing so. Indeed, on 1 June 2016, the agency published its new divestment plan for the remainder of 2016 and Vinamilk dropped off the list, having been on the previous list released in October 2015. While Vinamilk may allow foreigners to purchase more stock, the government is not going to sell its holding.

SOE privatization progress

The privatization process has been somewhat of a disappointment, and some foreign investors are questioning the state's commitment to this process.

The privatization of state-owned enterprises ("SOEs") has long been one of the top items on Vietnam's list of economic reforms, and the government has indeed made progress in reducing the number of SOEs. But the reality is that for whatever reason, the equitization process as it is commonly known here, has been somewhat of a disappointment to foreign investors. The stakes sold have been minute, valuations too high and the process too slow. While there have been some reasonably successful offerings in the past few months, namely Airport Corporation of Vietnam and Vissan, the stakes being sold continue to be small -- just 3.47% and 14%, respectively.

The start of 2016 brought a recommitment to privatization by the government. The pipeline *looks* impressive and includes some of the largest companies in the country, including conglomerates Satra and Ben Thanh Group, as well as mobile phone service provider Mobifone, which by some estimates could raise more "money than the collective IPOs of nearly 560 state-owned firms within the past five years."[ii] The simple fact is, however, that the

privatization process has been beset by delays and unfulfilled promises that have left many foreign investors sceptical as to whether some parts of the government are fully committed to seeing these through.

Renewed urgency for capital

Whether it be IPOs, secondary offerings, or expansion of foreign ownership, the urgency for the government to do something has become increasingly important for one key reason: the fiscal deficit continues to grow. Public debt has "exceeded 62 percent of GDP, or just 3 percent below the safety line, while government's debt accounts for over 50 percent."[iii] During a National Assembly session earlier this year, it was reported that there was identified funding for just 50% of planned infrastructure projects. Indeed, the deficit has already "corroded infrastructure investment, which fell from a 2011 level of 26% of total budget spending to just 16% in 2015."[iv] These projects are critical if the country is to continue to be attractive for foreign investment and continued development.

The fiscal deficit is becoming a pressing issue - inaction could stall the country's momentum.

Adding to the pressure, the Ministry of Finance announced earlier this year that the country would no longer be eligible for Official Development Assistance (ODA), which are loans with preferential interest rates and long repayment schedules, as of July 2017[v] due to Vietnam's steady progress toward becoming a lower-middle income country. Major ODA loans are due to mature in 2022-2025[vi]. Finally, continued low oil prices (previously a source of significant revenue) and a drought that has decimated large parts of the agriculture sector (an important exporter) will bring in less revenue for the foreseeable future.

At a time when the government plans to borrow more than USD20 billion (mostly via bond sales and loans from the SCIC)[vii], foreign ownership expansion would seem to be an expeditious way for the state to exit ownership stakes in non-strategic companies and raise much-needed capital. Continued reliance on still-strong FDI is an easy path to take, but one that will reach a dead-end at some point. The easiest option – continuing business as usual – will only delay the inevitable difficult decisions that have to be taken.

Conclusions

Further legal clarity is needed before any real momentum builds.

Vinamilk's decision to eliminate its FOL is clearly a milestone in this process, but whether it leads to more such moves in the near-term remains to be seen. We continue to be hopeful that other large companies will take the lead and move to expand or remove their FOLs, with small- and mid-cap companies following suit. The SCIC's lack of specific plans to divest its stake in Vinamilk, as well as missed goals and deadlines in the past could dampen foreign investor enthusiasm. What is clear is that further legal clarity is necessary before any *real* FOL momentum is likely to build.

Right now, Vietnam has positive economic momentum, with some of the highest GDP growth in the world; foreign investors have once again turned their attention to the country. But for the country to capitalize on that, and benefit from the "risk-on" money that seems to be coming back to frontier and emerging markets, it needs to act now. Change comes slowly to Vietnam, but it does eventually occur. We hope that this time around another opportunity to finally start realizing Vietnam's long talked about but never-quite-achieved potential is not squandered.

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[i] "Vietnam state to exit Vinamilk, to divest stake in 9 other businesses: Report," *Deal Street Asia*, 14 October 2015
[ii] "Vietnam: MobiFone seeks to tap pay TV market, to acquire An Vien parent," *Deal Street Asia*, 7 January 2016
[iii] "Public debt exceeds 62 percent of GDP, Vietnam walks tightrope," *Vietnam Net,* 23 March 2016
[iv] "All work and no monkey business: Vietnam market strategy 2016," SSI, pg. 10
[v] "Preferential ODA loans to be cut off from July 2017," *Vietnam News*, 23 March 2016
[vi] "Public debt increasing rapidly, Vietnam under repayment pressure," *Voice of Vietnam*, 21 April 2016
[vii] "Vietnam gov't plans to borrow over $20 billion this year," *Thanh Nien News,* 7 June 2016

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