Vietnam's equitization program gains momentum, but room for improvement remains

The equitization[1] of state-owned enterprises (SOEs) in Vietnam has long been a hot topic, particularly among international investors, and for good reason: SOEs have been the dominant part of the country's economy, and some of the biggest companies are still state-owned, in whole or in part[2]. Although their hold on the economy is weakening as the private sector continues to expand, SOEs contribute approximately 30 percent of GDP[3] and employ more than 1.5 million Vietnamese people[4].

In past years, the Vietnamese government would publish annual lists of companies to be equitized. After years of minimal activity and missed targets, the lists attracted fleeting attention from large investors; some companies appeared on these lists year after year, with little if any explanation as to why a planned equitization did not occur. Things began to change, however, in 2016 when the current government took office.

Recognizing the need to raise capital for infrastructure and manage the budget deficit, the government made equitization a top priority. Spurred on by a very strong capital market, the government accelerated the pace of equitizations in 2017. Although it did not meet its overall – and some would say overly ambitious – target of completing 44 IPOs of SOEs, it did complete 38 which, combined with the secondary sale of shares in already equitized SOEs, raised approximately USD6 billion. Of note was the secondary sale of shares in Vinamilk in November, which raised USD616 million, and the long-anticipated sale of the government's stake in brewer Sabeco, generating USD4.5 billion.

In January 2018, the market saw three successful SOE IPOs: Binh Son Refinery (USD245 million raised), PetroVietnam Oil (USD185 million raised), and PetroVietnam Power (USD308 million raised). In February, the IPO of Vinasugar 2 generated USD29.2 million, while the end of March saw the government raising a higher-than-expected USD43 million from the IPO of Hanoi Trade Corp (Hapro). During the first quarter of 2018, the Ministry of Finance reported that it had raised USD938 million from these and other SOE IPOs, and an additional USD61.5 million in share sales of companies already equitized. For the full year, the government plans to sell 6.5x the number of shares it sold in 2017, through 86 IPOs and 181 secondary share sales[5].

SOE IPOs Scheduled for 2018

Company	Sector
Housing Development	Real Estate
Vietnam Tobacco	Consumer
Mobifone*	Telecom
Vietnam Cement	Materials
Vietnam Television	Media
Power Generation 1	Energy
Power Generation 2	Energy
Vinalines	Transport
Saigon Trading (SATRA)	Retail
Ben Thanh Group	Real Estate
Saigon Tourist	Hospitality
Urban Development-Investment	Real Estate

** Although Mobifone is on the list to IPO later this year, we believe that is unlikely given the complications around and unraveling of its acquisition of a cable company. Government investigations are underway.*

What's changed?

A number of recent reforms should go a long way to continuing the positive momentum and helping the government meet its targets, including:

---

[1] Equitization is how the privatization process of SOEs is termed in Vietnam. SOEs may still be majority owned by the government, but at least some percentage of stock is available to strategic, financial and/or public investors.

[2] The government has a 50% stake or higher in 2,800 companies (down from 4,000 in 2007), and a100% stake in 781 companies (sources below).

[3] "SOE reform to fuel higher economic growth," Vietnam Investment Review, 16 November 2017

[4] "Privatizing SOEs – Implications for Foreign Investors," KPMG, 2017

[5] "Vietnam looking to drive SOE stake sales forward in 2018," VN Express, 6 March 2018

- A requirement that an SOE does an IPO within six months of receipt of government approval of the company's plan. Previously the law provided no guidance on this subject.
- A requirement that an equitized SOE's share trade on the UpCom within 30-days of the IPO, with a move to one of the larger stock exchanges when they qualify to do so. Eight years passed between Sabeco's IPO in 2008 and its listing in 2016; this can no longer happen.
- The addition of book building for SOE IPOs as a tool, alongside the Dutch auction method. The auction method is confusing for some investors (although it has largely been effective). The internationally common practice of book building is now allowed, although this has yet to be tested.
- A requirement to sell a minimum 20 percent stake in an IPO. Gone are the days of an SOE selling 3 percent.

In addition, the government has formed a ministerial-level "super committee" that will oversee an estimated USD220 billion in SOEs. The move could help clear a common logjam in the equitization process whereby companies are owned by different ministries with different ideas about how they will go about selling SOEs.

SOE Secondary Share Sales Planned for 2018

Company	Sector	Market Cap USDm	Offered Stake %	P/E 2017 x
Airports Corporation	Aviation	9,167	20	50.0
PetroVietnam Gas	Energy	10,896	30	25.9
Petrolimex	Retail	4,329	25	27.9
Vietnam Airlines	Aviation	2,568	20	24.6
Hanoi Beer (Habeco)	Consumer	1,230	32	37.3
Vietnam Textile	Industrial	340	53	21.8
Vietnam Steel	Material	297	58	8.7
Viglacera	Material	496	20	17.8
FPT Corp	Tech	1,499	6	11.7
Domesco	Pharma	148	35	16.2

What hasn't changed?

Viewed as a whole, the progress seen over the past 12 months has been positive. However, there continue to be issues that suggest that room for improvement remains.

First, for all of the attention on the success of the Vinamilk and Sabeco sales, as well as the PV-related IPOs in January, there continue to be some duds. Two privatizations in February – Genco 3 and Vietnam Rubber – were much less successful. The former, a subsidiary of state utility Electricity of Vietnam was valued at a trailing P/E of 13x, rather rich when compared to comparable companies' P/E. Meanwhile, Vietnam Rubber is prohibited from selling a strategic stake to foreign investors due to its large landholdings in sensitive border areas of the country. Both companies' IPOs were significantly undersubscribed, although their listings on UpCom occurred as required. In April, the IPO of VTV Cable, one of the leading cable companies in the country, canceled its IPO as only one bidder registered for the auction. Its lofty valuation of five-to-six times the average P/E ratio of Vietnamese companies[6] (already fairly high) was certainly a turn-off, while a small public relations fiasco in the days leading up to its scheduled IPO probably did not help.

The Sabeco purchase has also raised some issues. When ThaiBev and its affiliates acquired a majority stake in the brewer, it likely thought that it would be able to play an active role in managing the company as it would nearly anywhere else in the world. However, it took some time for that to occur due to procedural and other issues; Ultimately, they were able to nominate three representatives. Meanwhile Habeco, the other main brewer, continues to be engaged in discussions with long-time strategic shareholder Carlsberg on what rights the latter may have when Habeco sells shares as expected later this year. Habeco currently trades at a robust P/E of 38.8x, despite a falling share of Vietnam's foamy beer market.

[6] "VTVCab cancels IPO after few investors bite," VietnamNet, 14 April 2018

VinaCapital's view

We have long been part of a large chorus calling for movement on the privatization of SOEs, and we of course applaud the recent uptick in activity. We were among the first to call for equitizations to require larger stakes to be sold, and we are gratified that the law now requires a minimum of 20 percent. VOF participated in two of the January IPOs, staking stakes in Binh Son Refinery and PV Power. Their valuations, business strategies, and growth plans were compelling. More importantly, we saw an alignment of interests between the government, the companies' management teams, and shareholders that we believe is critical in these types of deals.

Not every SOE IPO or share sale is interesting to us, however. As with any investment, we look at a variety of criteria. First, we want to see an alignment of interest with management, including their participation in an IPO. We also typically like those companies benefitting from the strong domestic growth story, such as construction and materials, banking, healthcare, and consumer brands. Although meeting both criteria, Sabeco was of little interest to us despite its market-leading position due to its P/E of 45.6x.

Of the upcoming SOE IPOs and secondary sales planned for the balance of 2018, it remains to be seen if valuations are a little more down to earth. We will review any such opportunities closely and continue to be very selective in choosing where to invest. What is more exciting to us, however, are the investment opportunities in the private sector, particularly those purely private companies seeking growth capital, or those in the pre-IPO phases of their evolutions.