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## **OPPORTUNITIES IN VIETNAM'S LOGISTICS SECTOR**

Vietnam has one of the fastest growing logistics sectors in the world, but the sector is still highly fragmented, which presents attractive investment opportunities for private equity firms and other well capitalized investors with “on the ground” expertise helping local businesses accelerate their revenues & earnings by adopting international best practices. The industry grew 14-16% annually in recent years<sup>1</sup>, and total logistics expenditures in Vietnam are over 20%/GDP, which is among the highest in the world - because of the industry’s innumerable inefficiencies (for example, three-quarters of Vietnam's freight volume passes through just 6 of the country's 75 seaports).

The rapid growth of Vietnam’s logistics sector growth is sustainable because of: 1) the on-going expansion of the country’s manufacturing sector – driven by the manufacturing of high-tech products, and 2) the continued growth of the country’s middle-class. Regarding the former, Vietnam’s manufacturing sector currently accounts for just over 20% of the country’s economy but this figure reached above 30% for other “Asian Tiger” economies, and that continued FDI investment inflows – which have helped fund the build-out of Vietnam’s industrial base for – are essentially ensured for years to come, partly because Vietnam is a beneficiary of the nascent “friendshoring” phenomenon, which we discussed in [this report](#), and which is part-and-parcel of the broader “China + 1” effort of multinational companies to diversify some of their production outside of China (ie. to Vietnam, India, Mexico, etc.)

Finally, the on-going growth of Vietnam’s middle class also presents numerous investment opportunities, especially in niches such as cold-chain logistics - because of a greater demand for fresh food and certain perishable pharmaceutical products - and in ecommerce beneficiaries such as last mile delivery services. Further to that last point, ecommerce in Vietnam is growing by more than 25% annually, and the Vietnamese Government targets a much bigger role for ecommerce for the country’s economy going forward – which is likely to lead to a regulatory environment that is especially favorable for “last mile” and other logistics firms.

### **An Overview of Vietnam’s Logistics Industry**

Vietnam’s logistics industry is comprised of foreign and local firms, but local firms are essentially absent from the international shipping business<sup>2</sup> - with the exception of the handling and delivery of goods overland across Vietnam’s northern border with China (although this conduit represents a small portion of the goods that flow in and out of Vietnam). The industry’s biggest challenge is

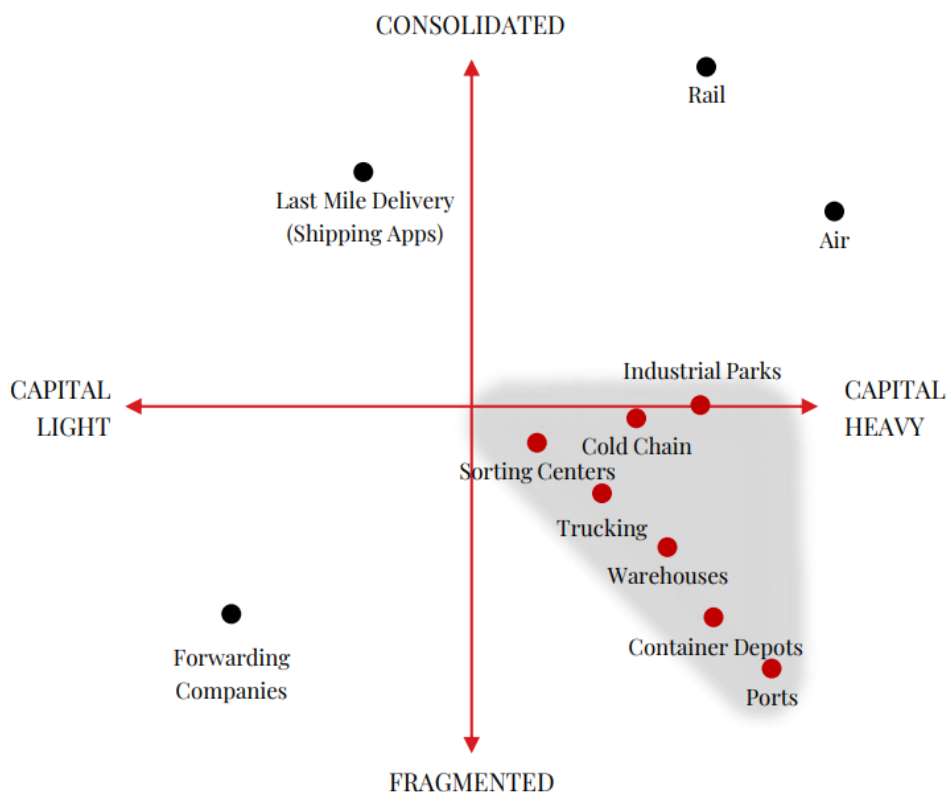
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<sup>1</sup> According to the Vietnam Logistics Business Association (VLBA)

<sup>2</sup> There are over 1,600 registered ships in Vietnam – but only 0% of them are private. 17<sup>th</sup> Floor, Sun World Tower 15 Nguyen Huu Duc Street, Ho Chi Minh City, Vietnam  
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increasing the **quality and reliability** of its services – but these problems can be addressed by replicating best practices from other logistics markets.



In order to analyze the investment opportunities in the sector, we’ve partitioned the industry into capital-intensive versus “capital light” businesses, and into segments of the industry that are highly fragmented, versus those that are highly concentrated, as can be seen above, and we note that the domestic logistics industry is comprised mostly of micro-to-small companies.

The businesses in Vietnam’s logistics sector most in need of investment are those that are capital intensive, and in segments of the industry that are highly fragmented. For example, transportation firms account for about two-thirds of the total enterprises in Vietnam’s logistics industry, but over 80% of trucking firms in Vietnam have a fleet size of less than 5 trucks, and it’s estimated that for about 70% of the deliveries trucks in Vietnam make, the truck returns to its home base empty. Furthermore, middle-men get paid an estimated ~30% commission on the final service fees that those trucking companies earn. Even in cold storage transport, which is considered to be one of the most promising segments of Vietnam’s logistics industry, and which is dominated by foreign-invested firms, it is estimated that 70% of firms have less than 10 trucks.

In our view, some very compelling opportunities for local firms stem from the fact that sophisticated foreign customers are willing to pay premium prices for reliable logistics services, and that middle class customers’ demand for products & services that entail high-quality logistics is soaring (i.e. on-

line shopping with home delivery, demand for perishable foods & medicines, etc). Additionally, the long-term investment returns generated from those companies will be augmented by the fact that Vietnamese logistics operators that have sufficient scale and are professionally managed will experience falling costs over time, as bottlenecks stemming from Vietnam's infrastructure, and other issues are eventually addressed.

We also expect attractive investment returns for logistics firms that are beneficiaries of increased high-tech manufacturing in Vietnam, and from the on-going growth of Vietnam's emerging middle class. The growth of high tech manufacturing entails increased demand for higher value-added logistics services such as bonded warehouses for the consolidation of relatively high-value goods (compared to garments & footwear, for example), before those products are exported. Also, the inputs to the production of consumer electronics are typically very valuable, so the customs clearance and freight forwarding activities entailed in handling those items necessarily must be of a much higher precision and specification than that entailed in handling textiles and yarns for garment production, for example.

Finally, we see three potential investment strategies: 1) invest into leading logistics companies, to aggressively grow their assets into an integrated platform which offers clients economies of scale, 2) identify particular assets which need capital for upgrading or can be re-purposed, and drive new business by increasing efficiencies and 3) M&A / consolidation. The adoption of best international practices – such as digitization – together with capital injections are critical to all of these strategies, although capital injections are particularly essential if the investors' strategy is to grow the capacity of the target firm – by adding additional trucks in a trucking firm, for example, or by adding additional cranes/heavy equipment in a port/warehouse business.

### ***Attractive Segments***

One attractive niche in Vietnam's logistics industry is the customs clearance business, in which brokers with good relationships with the proper officials can expedite the clearance of goods in and out of the country by assuring compliance with the complex regulations entailed. Most of Vietnam's 800+ freight forwarding companies provide customs clearance services, according to the Vietnam Logistics Business Association (VLBA), but we believe firms which can bundle customs clearance services as part of a "core carrier" relationship, capable of satisfying all of the shipping/logistics needs of high tech manufacturing firms can enjoy enhanced pricing power in exchange for providing premium logistics services to those firms.

Further to that last point, high-quality logistics are essential to the handling of high-value consumer electronics items, but logistics costs account for just over 1% of the final price of those items (versus circa 30% for agriculture products like rice, for example). The combination of customers' high sensitivity to quality, together with the low contribution of logistics services to the total costs of consumer electronics producers equates to enhanced pricing power for integrated logistics firms



that are able service the needs of those demanding customers, by providing what is known in the industry as “Third Party Logistics Services (3PL)”.

The vast majority of logistics handling done by local firms in Vietnam can be characterized as “First Party Logistics (1PL)”, or “Second Party Logistics (2PL)”, which essentially facilitates the direct shipment of products from one point to another, but the global logistics industry is increasingly moving towards the so-called “3PL” model in which Logistics Service Providers (LSP), provide not only transportation & warehousing services, but additional value-added services such as inventory management, picking & packing, and RFID tracking. The larger firms in Vietnam’s logistics industry are primarily state-owned enterprises (SOE), so although those firms may have the financial resources to begin providing 3PL services, they typically do not have the flexibility and/or management capability.

### Summary

Vietnam has one of the fastest growing logistics sectors in the world, and that growth is expected to continue for years to come, driven by the continued expansion of the country’s manufacturing sector (especially high tech manufacturing), and by the continued growth of the country’s middle-class, which in-turn is driving high growth in the logistics-intensive ecommerce business, as well as demand for perishable food and other products. The industry is fragmented and inefficient, which when combined its high growth is a recipe for attractive investment returns. In our view, the most attractive businesses to invest in are those that are capital intensive and are in particularly fragmented segments of the industry.

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