



Vietnam

Despite macroeconomic difficulties, the country remains a hot investment destination

Current Environment

During the first six months of 2008, the economy grew by 6.5%. The government's 2008 target for the annual rate of growth is now 7%, below the 8.5%-9% target announced at the beginning of the year and also below the 8.5% growth achieved last year. Inflation started to accelerate towards the end of last year and gained further momentum in the first half of 2008. According to the latest figures available from the General Statistics Office of Vietnam, prices in June 2008 were 26.8% higher than in June 2007 (with the half yearly CPI at 20.34%). It is important to note that inflation is primarily driven by the 45.6% increase in food prices, a situation which is not unique to Vietnam. One other category, housing and construction materials, also experienced an increase above 20% at 23.7%. Given these developments, it is not surprising that the government's policies have become increasingly focused on controlling inflation, mainly through monetary policies aimed at reining in credit growth. This in turn has led to a lowering of the target for annual GDP growth as mentioned above. There has been a realisation during the year that the economy became overheated in 2007 and in particular that credit growth rate, estimated to be around 50% last year, had to be slowed significantly.

In addition to inflation, further economic concerns have emerged. Despite the continued strong growth of exports, the trade deficit increased significantly, reinforcing the trend set in the second half of 2007. The deficit, combined with the effect of inflation, has built up pressure on the Vietnam dong. Whilst the official exchange rate was 16,030 to the US dollar at the end of 2007, by the end of June the rate set by the State Bank of Vietnam ("SBV") was at 16,514 with frequent indications of further declines to come.

The policy measures taken to address these difficulties include the raising of base interest rates from 8.75% to 12% in May and to 14% in June. Furthermore, the SBV has increased bank reserve ratio requirements to 11% from 10%. The government has committed to reduce public spending (excluding salaries) by around 10% during the year and also targets a 25% cut in government bond funded investment projects. A review of other major government funded projects is now under way whilst state-owned enterprises, many of them active players in the real estate and financial sectors in 2007, are being encouraged to re-focus on their respective core businesses and reduce spending on low priority investments.

It is difficult to judge when the economy has reached or will reach a turning point but the general view from economic observers of the country is that inflationary and trade deficit pressures will ease in the second half of 2008. Businesses operating in Vietnam or planning to enter the country are however likely to spend more time scrutinising the latest macroeconomic data and policy announcements before making any major business decisions than was generally the case in earlier periods.

In 2008, the benchmark stock exchange index, the VNINDEX, as calculated by the Ho Chi Minh Stock Exchange, continued its decline from its historical peak of 1,170 in March 2007. The index closed in 2007 at 918 points and fell to 399 on 30 June 2008. This dramatic fall has obviously raised concerns regarding best practices in relation to margin lending for individuals and companies involved in securities trading activities. It is also leading to consolidation amongst the local securities companies that were set up in such great numbers during 2006 and 2007. A further important impact of the declines in share prices is a pause in the equitisation process of state-owned enterprises due to concerns over low take-up of shares and IPO pricing. During the first half of 2007, investing in securities seemed to many the easiest way to make money in Vietnam, whilst later in the year real estate investments became increasingly attractive; there is evidence to suggest that in 2008 much of the past investment into property and securities has been moved into gold. It is difficult to judge when sentiment will change again in favour of (hopefully more cautious) investment in securities although the most recent trends in the exchanges during July 2008 have been more positive.

Despite these difficulties, foreign investors remain very active in Vietnam. Total committed foreign direct investment during the first half of the year surpassed US\$30 billion compared to US\$20.3 billion for the whole of 2007 and US\$12 billion in 2006, although realised foreign direct investment continues to trail total commitments. During the June 2008 round of the Vietnam Business Forum, a dialogue between representatives of foreign businesses and the government, there were indications that most foreign companies already active in Vietnam are well prepared to cope with short-term difficulties and remain committed to growing their businesses in Vietnam. In this context it is well worth noting that a PricewaterhouseCoopers study entitled "The world in 2050" published in March 2008 that analysed long-term economic trends around the world found that Vietnam has the fastest GDP growth potential in the world over the next few decades.

There have been positive regulatory developments in recent months. To comply with WTO commitments, the government issued decree 139 on 1 January 2008 which in principle removed limits on foreign ownership ratios in Vietnamese companies except in relation to:

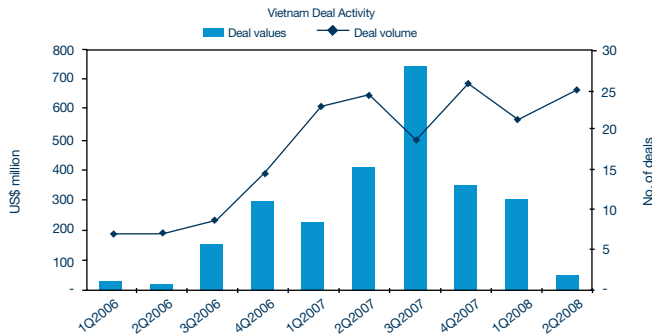
- listed companies as governed by the Law on Securities;
- entities where restrictions apply under specific industry laws, e.g. banking;
- 100% state-owned companies undergoing equitisation/conversion; and
- where ownership ratios have been set out in the WTO commitments regarding service companies which are sector specific.

These are positive steps that will contribute to further improvements in the deal environment and to the growth of M&A transactions, although issues with implementation of these commitments remain.



Whilst there are calls for the government to consider a further relaxation of ownership rules, especially with respect of publicly traded companies (the current cap is 49%), it appears that the government has no such plans at present and will likely remove restrictions no faster than the WTO agreements make it compulsory to do so.

Deal Activity



Source: Thomson Reuters, based on total domestic, inbound and outbound deals announced as of 30 June 2008

M&A activity during H1 2008 totalled US\$347 million from 48 deals; the comparable figures for H1 2007 were US\$736 million and 47 deals respectively. Whilst the numbers are lower than last year, we believe it is too early to tell whether this is an indication of a true slowdown of M&A activity. On the one hand, we see companies postponing closing deals due to economic uncertainties or re-negotiation of pricing, whilst on the other hand, domestic and foreign companies alike attracted much lower valuations in 2008. Vietnamese vendors were also more willing to go through the rigorous deal process foreign buyers needed to undertake. One or two large deals can significantly impact the statistics, given the relatively low overall value of M&A activity. It is also worth noting that in H2 2007 total deal value was US\$1.1 billion, almost twice that of the first half of that year and we would expect this trend of higher levels of M&A in the second half of the year to continue. It is important to note that the reporting of deal activity in emerging markets such as Vietnam is rapidly improving but is yet to reach the level seen in mature markets. In addition, as in all markets, there are many privately negotiated transactions where the value of the deal is not made public hence these statistics may not represent a complete picture.

Notable deals announced during the first six months include:

In January, Swiss Reinsurance Co (“Swiss Re”) acquired a 25% stake in Vietnam National Reinsurance Co (“VinaRe”), for US\$81.9 million. As a result of the transaction, Swiss Re became the sole foreign strategic partner of VinaRe.

In February, Kamaz Inc., a major automobile corporation of Russia obtained 12.5% of the authorised capital of local vehicle assembler, VMIC Company and in April announced its intention to increase the stake to 36%. According to the plans announced by Kamaz Inc., VINACOMIN, the Vietnamese company that set up the facility with Kamaz in 2005, will own 36% of VMIC with the remainder of shares belonging to the employees. Kamaz aims to increase production at the company and targets gaining up to a 15% market share of the truck sector in Vietnam.

In February, BNP Paribas SA, the listed French banking institution, increased its stake in Oriental Commercial Joint Stock Bank (“OCB”), a privately-owned, Ho Chi Minh City based, unlisted commercial bank with 59 branches in the country, from 10% to 20%. Financial terms were not disclosed. Pending final approval, the transaction makes BNP Paribas SA OCB’s second largest shareholder after Sunimex, a Vietnam-based services company. As is often the case in similar deals, the announcement of the transaction implied that BNP will provide significant technical assistance to OCB post-deal.

The first of five deals during the period in the securities industry involved Morgan Stanley acquiring a 48.33% stake in a joint venture with Huong Viet Securities for an undisclosed sum. The Hanoi-based entity known as Morgan Stanley Gateway Securities has already received regulatory approval from Vietnam’s State Securities Commission. Previously, Morgan Stanley unsuccessfully sought to set up a securities joint venture with Vietnam’s State Capital Investment Corporation.

In another notable deal in February 2008, Franklin Resources Inc. (operating as Franklin Templeton Investments) acquired a 49% stake in Vietcombank Fund Management Co, an investment management company. The remaining 51% is held by Vietcombank (the Bank for Foreign Trade of Vietnam). Franklin Templeton also announced its intention to partner with Vietcombank to make its investment funds available, in time, to Vietnamese investors. According to the company, approximately 9% of Franklin Templeton’s funds under management currently derive from investors from the Asia Pacific region, and Vietnam will be a key area of focus in expanding the company’s penetration in Asia.

In March, Malayan Banking Berhad, the largest banking institution in Malaysia, purchased a 15% stake in An Binh Commercial Joint Stock Bank (“ABBank”) for a consideration of US\$135 million. ABBank is an unlisted commercial bank founded in 1993. It had 53 branches at the time the deal was announced. Maybank indicated its interest in raising its stake to 20% subject to government approval.



Following an announcement in March 2007 regarding Hanoi Beer, Alcohol and Beverages Company's ("Habeco") selection of Carlsberg as its strategic partner, April 2008 saw Carlsberg announce that it had completed the long anticipated acquisition of an equity stake in Habeco, further to the equitisation and IPO of the former state-owned company. Carlsberg acquired a 16% interest in Habeco from the government for a purchase price of US\$116 million to become its sole strategic shareholder.

In May, Standard Chartered Bank confirmed a further 6.16% purchase of the ordinary shares in Asia Commercial Bank along with a further purchase of 7.10% of the bank's convertible bonds. This acquisition, which is subject to the appropriate regulatory approvals, increases Standard Chartered's investment in ACB from 8.84% of ACB's ordinary shares and 8.76% of ACB's convertible bonds to 15% and 15.86% respectively. ACB is the fifth largest commercial bank by assets in Vietnam.

Outlook

We expect further deals in the financial services sector in the coming months. This is largely driven by the still very low penetration of modern banking services in the country and the large number of relatively small financial institutions which are likely to be suffering from the current credit crunch and which accordingly may be looking to bring in new capital from foreign strategic shareholders. As in earlier periods, higher deal values are likely to be driven by foreign institutions entering or increasing their presence in the market. In the short-term, we expect that deals involving securities companies will also be prevalent. These companies are suffering from the decline in the stock market, with the consequent reduction in the volume of trading activity, new IPOs and opportunities for other services, whilst the sector's past over-reliance on proprietary trading for profits has significantly hindered the inability to maintain the levels of profitability seen in 2007 during the current year. Given the pressure that firms in this sector are facing and the fact that in Vietnam a number of companies set up securities firms as non-core business subsidiaries, added to the fact that many players have quite low capitalisations, it is reasonable to assume that some will consider exiting the business – either by means of dissolution or sale to a competitor or a foreign investor. It should be noted that M&A in this sector will be limited to a certain extent by the caps in place over purchases of equity by foreign investors (10% for banks and 49% for securities companies).

Looking at other sectors in the economy, there are many foreign companies keen to enter the telecommunications sector when the equitisation process begins in earnest. In addition, expectation is building for deals in the retail and distribution sectors in the wake of the elimination of various restrictions on activities by foreign companies during 2008 and 2009 whilst we also expect a continuous deal flow with respect to companies operating in the consumer goods industry. Retail sales of goods and services are growing rapidly, up by 23% in 2007 compared to 2006, yet organised, modern retail is estimated to still only account for approximately 15% of the market. Another important target sector is likely to be building materials where we are seeing increasing levels of interest from foreign investors attracted by the strong growth in construction activity and high prices currently achieved by players in this sector. However, it is reasonable to say that there is almost no sector of the economy where we would not expect to see at least a few foreign companies showing interest in deal opportunities in the coming months of 2008 since average valuations are down considerably from the heights of 2007 and since most continue to see Vietnam as an important strategic market.