Tricks of the trade: a guide for M&A in Vietnam

Mergers and acquisitions in Vietnam continue to be on the rise despite recent instability on the economic front. Here, Dr Vinh Quoc Nguyen of *Tilleke & Gibbins* provides us with some tips of the trade for foreign investors who have an eye on Vietnam. It's the 'local characteristics,' intrinsic to Vietnam, which one needs to be mindful of, he cautions.

Fostering growth

Since 2008, even before the outbreak of the global recession, the economy of Vietnam has faced difficulties, including extremely high inflation and interest rates, and the weakening of the Vietnamese dong. Foreign direct investment has witnessed a slowdown in parallel with the country's gloomy economic conditions.

Yet despite the adverse economic situation, M&A transactions in Vietnam have strongly increased in both number and value over the same period. According to statistics established by KPMG, there were 93 successful M&A deals in Vietnam in 2008, with an increase to 112, 236, and 262 for the years 2009, 2010, and 2011, respectively. In 2012, through the end of April, approximately 60 deals had been successfully completed. The total value of the completed deals also continues to reach record highs year after year. In 2008, the total deal value accounted for US$0.9 billion. The deal value went on to reach successively higher records of US$1.2 billion for 2009, US$3.2 billion for 2010, and US$4.4 billion for 2011.[1]

One of the primary drivers of M&A growth in Vietnam has been the low valuations of local companies, the result of a number of factors:

- The economic downturn led to an increased number of distressed companies and assets. According to a report made by Stoxplus, 75 percent of the stocks trading on Vietnamese stock exchanges are trading below their book value, while 60 percent of those stocks are trading at a price below their par value of approximately US$0.50. Real estate prices in Hanoi and Ho Chi Minh City fell 40–50 percent in 2011 alone.[2]
- Foreign indirect investment via on-shore and off-shore funds was booming in 2006 and 2007, and now it is time for several of those funds to liquidate, leading to an increased supply of shares for sale.
- State-owned enterprises were channelling money into investment and expansion from 2007 to 2010, but are now being directed by the government to divest their non-core businesses, crowding the market with even more shares and assets.

The decline in the share value of Vietnamese companies has made them more affordable and thus more attractive targets for foreign investors.

Other more typical reasons for M&A growth are apparent. Vietnam is a rather large (and growing) market with a population of about 90 million, presenting a great opportu-

By Vinh Quoc Nguyen, ***Tilleke & Gibbins***

Vinh Quoc Nguyen

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nity for foreign investors to expand their business geography and market size. Via M&A, they can pursue this expansion while leveraging target companies' strengths, such as experienced local staff, existing distribution channels, and governmental permits. Many foreign investors are also treating Vietnam as a – China plus one – country – a secondary hub for production and outsourcing to mitigate the economic risks of having all foreign operations in China. Creating such hubs through M&As is an alternative to setting up the investors' own subsidiary companies in Vietnam.

Practical tips for a successful M&A deal

Experience has shown that if a foreign investor does not pay due attention to the local characteristics in Vietnam, its deal may be delayed or even come to a dead end. To avoid wasting time and resources, a foreign investor should become familiar with these characteristics before proceeding with an M&A deal. Below is a list of primary issues that foreign investors should be aware of before initiating an M&A deal in the country.

The nature of the deal

An M&A transaction in Vietnam for foreign investors is limited to the purchase of shares of local companies. Other forms of M&A transactions, such as mergers between a foreign entity and a local entity or purchases of assets (rather than shares) by a foreign entity, are not available to them. The legal system is not yet ready for such transactions to which a foreign investor is a party.

Lacking knowledge

Many M&A deals involve small or medium-size local companies. Owners of those companies often lack knowledge of international standards in business management. As a result, they do not understand how an M&A transaction should proceed. It may be necessary to provide 'training' to help them understand their roles and obligations during the M&A process, such as their cooperation in the due diligence process and obligations of confidentiality and performance of the contract.

Sky high

Owners of local companies often overvalue their companies and thus demand unreasonably high prices for their shares. Foreign investors should be prepared to present good reasons to the owners to explain what price is reasonable, as well as communicate the additional benefits that they could bring to the company following the transaction.

Misleading information?

The business environment in Vietnam is less transparent than in most developed countries, and the enforcement of law on local companies is rather loose. As a result, local companies are often involved in less-than-transparent transactions. Sometimes they maintain two different accounting books. In addition, company managers tend to hide adverse information about their companies such as tax, social insurance, and other debts and pending litigation cases. Thus, careful due diligence as to the legal and financial matters of the target company is absolutely essential.

Licensing issues

The most time-consuming process for an M&A deal in Vietnam is, regrettably, not the negotiation over the price. Rather, it is the licensing process to record a foreign investor as a new shareholder of the target company. As a matter of practice, depending on the complexity of the deal, it normally takes from three to six months (or even longer) to complete such a process.

Below are some notes on the licensing process relating to restrictions on foreign ownership, the necessity of investment certificates, sophisticated and simplified sale and purchase agreements, evidence of completion, and purchase of shares in the form of private placement.

Restrictions on foreign ownership

A foreign investor should be well aware of any applicable restrictions on foreign ownership in the target company. The government of Vietnam restricts foreign ownership in certain business sectors, permitting foreign investors to purchase only a limited percentage of the target company's charter capital. This foreign-ownership threshold is stated in international treaties to which Vietnam is a member, such as its World Trade Organization commitments and/or relevant bilateral agreements. If a foreign-ownership threshold is absent from an international treaty, it may be stated in domestic laws. If it is not given in domestic laws then it is subject to the discretion of the licensing authority on a case-by-case basis.

The foreign ownership threshold can be 30 percent of the target company's charter capital (applicable to the banking sector, etc.), 49 percent (applicable to facilities-based telecommunications, entertainment and electronic game businesses, etc.), 51 percent (applicable to container stations and depots, storage and warehouses, freight transport agency services, etc.), 65 percent (applicable to non-facilities-based Internet access services, etc.), or up to 100 percent of the entire charter capital of the target company for unrestricted sectors.

It is worth noting that in the business registration process, a local company will often register a long list of business lines in which it may conduct business, even if it does not currently operate in all of them. Among those business lines, a foreign investor may be permitted to own up to 100 percent of the charter capital of the target company for some lines, but only 30 percent of the charter capital for others. In such cases, unless the foreign investor agrees to remove the restricted business line from the business license of the target company, the licensing authority will only allow the foreign investor to own up to the lowest threshold, that is, 30 percent of the charter capital of the target company.

Investment certificate

Legally speaking, in the purchase of shares of a local company, the law only requires the target company to apply for a change in its shareholders. However, in practice, the licensing authority further requires the company to apply for the issuance of an investment certificate in order to convert the company into a foreign-invested company. This is the most painstaking process and normally takes from three to six months to complete.

Sale and purchase agreement

An industry-standard sophisticated sale and purchase agreement is not always accepted by the licensing authority. One of the reasons is the capacity of the staff of that agency. Thus, in many cases where the parties agree upon sophisticated conditions precedent, representations, warranties, payment conditions, etc., they may have to prepare two separate agreements. The primary agreement is kept by the parties for performance. The second, simplified agreement will be submitted to the licensing authority for licensing purposes. Additionally, the licensing authority may require the parties to submit to Vietnamese laws and courts or arbitration as the governing law and jurisdiction.

Evidence of completion

In order to approve a share sale transaction, the licensing authority requires the party to submit proof that the transaction has been completed. The evidence of completion is the full payment by the purchaser to the seller for the shares sold. This requirement often runs counter to the intention of the parties for the payment conditions set out in the sale and purchase agreement. Fortunately, an acknowledgement by the seller and the purchaser of full payment of the sold shares, regardless of whether payment was actually transferred, is normally accepted by the licensing authority.

Private placement

The purchase of shares of an unlisted joint-stock company in the form of private placement is practically impossible in Vietnam at present. In theory, a foreign investor may purchase shares of an unlisted joint-stock company via this form of investment. However, the legislation issued in 2010 guiding this investment form was so rigid that it has never been put into practice. As a result, foreign investors have to overcome this impossibility by converting their form of investment to a direct purchase of shares from the existing shareholders of the target company. It should be noted that the purchase of shares from a limited liability company or its shareholders does not face the same difficulty as purchasing shares from an unlisted joint-stock company via the form of private placement.

(Author's note: After this article was submitted for publication, the Vietnamese government issued a new piece of legislation which will take effect on September 15, 2012. Under the new legislation, it appears that many of the obstructions of the 2010 legislation have been removed.)

A well-prepared sale and purchase agreement

As mentioned above, it is very common for the parties to an M&A deal to prepare two sale and purchase agreements: a comprehensive one for the parties to perform the contract, and a simple one to be submitted to the licensing authority for licensing purposes. The primary comprehensive sale agreement should be carefully prepared to protect the foreign purchaser, containing detailed conditions precedent for the payment, representations, warranties, covenants and indemnification of the seller, rights of the purchaser acting as a special shareholder in purchasing the shares, etc. In some cases, those rights of the purchaser should be incorporated into the charter (that is, articles of association) in order to make them become part of a constitutional document of the company rather than private agreements. A well-prepared agreement will help the parties define their rights, obligations, and duties during and after the transaction, thus minimising the possibility of future disputes.

Endnotes

1 Statistics provided by KPMG in the Vietnam M&A Forum 2012 held on 7 June 2012 in Ho Chi Minh City.

2 Stoxplus, "Opportunities in Distressed Companies and Increased Deal Flows from Japan" in *Vietnam M&A Research Report,* Issue No. 2, 15 May 2012, page 16.

vinh.n@tilleke.com

www.tilleke.com