Private Equity in Vietnam 2009:

Investment outlook survey results – Part II

Grant Thornton Vietnam, May 2009

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Introduction

Notwithstanding Vietnam's recent fascination with listed companies, the Private Equity sector has been quietly providing an avenue for growth for many Vietnamese companies. With the recent global slowdown and the inevitable effects on the Vietnamese economy, Grant Thornton Vietnam sought to gain a more detailed understanding and insight into Private Equity participants and their investment intentions.

Our survey, which was titled "Private Equity – Vietnam Investment Environment and Outlook Survey", involved 169 selected participants involved in a broad cross-section of the investment community with an interest in Private Equity investments. Participants covered both Vietnamese and foreign parties, and included advisors to the industry.

This report, part two of a two-part series, looks at specific industry sectors in Vietnam and the investment outlook for these sectors, along with problems and obstacles faced by Private Equity investors in Vietnam.

Part one of the series looked at where key industry participants feel Vietnam's economy is currently heading, where the country is in investment preference compared to other destinations, and where participants intend to invest in the coming year.

The results of the survey have been encouraging, providing a useful guide, highlighting that not everyone is pessimistic, value is seen by many in Vietnam, and that ultimately Vietnam remains an attractive place for Private Equity investment.

"Vietnam is considered by many as an attractive destination for investment, but it is certainly not an easy destination to invest in. Government red tape, uncertainty in the legal system and under-developed infrastructure, contribute to the difficulties faced by international investors. Investors that can persevere and work through these issues can succeed and reap the rewards."

Ken Atkinson
Managing Partner
Grant Thornton Vietnam

Industry attractiveness

Findings

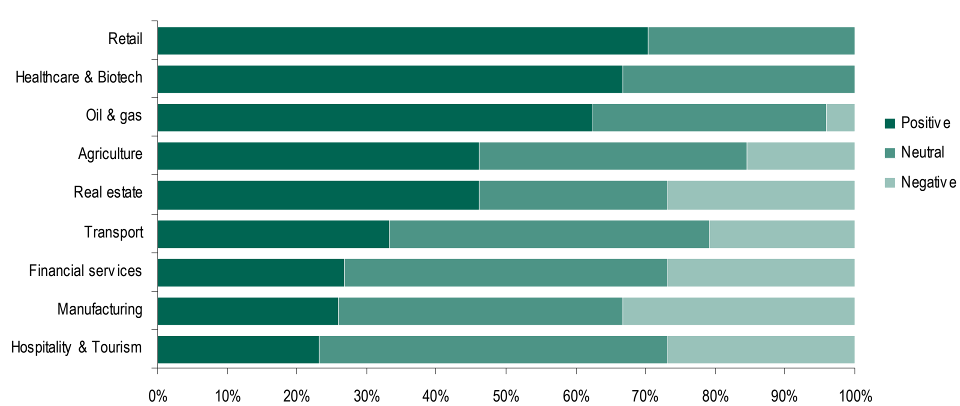
Respondents were asked to rank the attractiveness of selected industries within Vietnam for Private Equity investment, ranking each as attractive, neutral or negative. The two sectors that stood out as the most attractive were Healthcare/Bio Tech and Retail, with no respondent ranking these as negative.

Economic theories would suggest that in times of economic downturn, retail would be a sector that suffers from a reduction in spending. However, the robustness of Vietnam's domestic economy and the opportunities that arise as the sector is being liberalised, makes retail an attractive investment option. There is also the continued shift towards modern trade within Vietnam, which fosters new investment opportunities, and the existing shortage of quality retail space in city centres making the sector desirable to be part of.

Healthcare and Biotech is seen as attractive in Vietnam for a number of reasons, which include the anti-cyclical nature of healthcare in an economic downturn, the growing wealth of Vietnamese and their desire to improve their personal health, and the low-cost environment that has made Vietnam an attractive destination for bio tech and healthcare manufacturing. There are also suggestions that Vietnam may become a destination for future healthcare tourism, however this is unlikely to occur for some time as the industry has a long way to go before there is sufficient numbers of established and experienced centres that can support healthcare tourism.

On the flip side, only 23% and 26% of respondents rated Hospitality & Tourism, and Manufacturing respectively as positive, with around one third of respondents rating them as negative. With global declines in tourism, and reduced spending in the major world economies, these numbers are not surprising. Both Hospitality & Tourism and Manufacturing sectors have in recent years been seen as supporting the economic growth of the country, and with the economic downturn a correction in sentiment has occurred.

Industry attractiveness



Key factors in investing in Vietnam

Findings

Respondents were asked to indicate the most important factors that they consider when undertaking Private Equity investments in Vietnam. Of the respondents 25% indicated transparency in business activities as their number one factor. Having long been an issue in both the public and private sector investment in Vietnam, investors still find it time consuming, costly and difficult to obtain timely and accurate information on their investee companies in Vietnam.

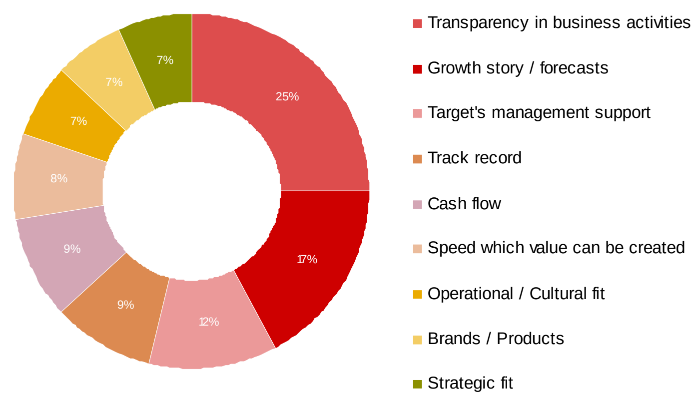
The second and third most important factors considered when investing were the target's growth potential and its management. As the global economy has slowed, investors appear to have become more realistic and are looking increasingly to the longer term growth opportunities away from the "quick buck" achievable in a growing market.

Growth is often best achieved with the alignment of interests of a good management team. As the Private Equity industry is developing, Vietnam's Private Equity firms are focussing on developing quality management within their investee companies.

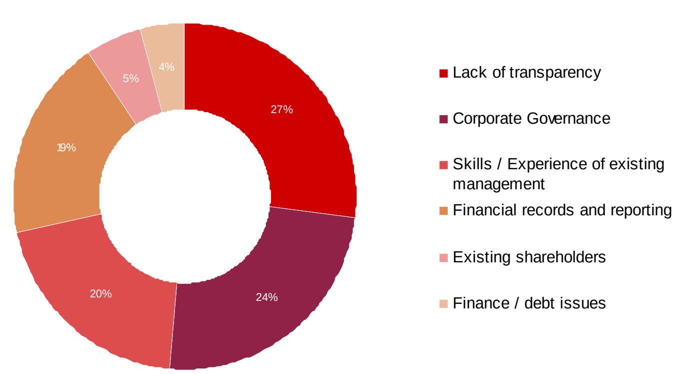
In addition to management being an important factor they are also a concern to investors. The survey indicated that the skills and experience of existing management are significant obstacles, 25% of participants citing the issue as being of most concern. The young population and relative immaturity of the business environment has lead to a knowledge gap in middle and senior management, a space often filled by expensive expatriates or under qualified Vietnamese.

In line with transparency „ 24% of respondents cited corporate governance as being of most concern in Vietnamese companies. The issue is enhanced by the large portion of family operated businesses in the country. There is, however an increasing trend in Vietnam based companies in recognising this and taking the opportunity during the global slowdown to review and implement sound corporate governance and reporting functions.

Important factors to consider when investing in Vietnam



Concerning issues when investing in Vietnamese companies



Investment obstacles in Vietnam

Findings

Frustration in dealing with red tape and the legal system have long been the subject of complaints from investors in Vietnam, and despite stated Government efforts to address these issues 88% and 85% of participants still view dealing with governmental red tape and the legal system, respectively, in Vietnam as significant problems.

Although the Government has been trying to reform bureaucracy and encourage investment into Vietnam, complex and time-consuming procedures, combined with arbitrary and inconsistent regulations, still add extra costs to business and make the investment environment less attractive.

Examples often cited are where regulations specify a certain time period for a license or permit, however in reality the time period is substantially longer through the use of various loopholes and additional information requests. The often confusing legal framework and conflicting interpretations of laws by Government bodies also creates uncertainties for business.

81% of respondents indicated that Vietnam's under-developed infrastructure is a serious obstacle for investment. Although this has been recognised by the Government and foreign donors such as Japan and the World Bank, who have been prioritising funding for infrastructure projects, additional long-term investment is still needed in order to support business growth.

Another reoccurring theme for Private Equity investors in Vietnam is corruption. 100% of participants saw corruption as an issue, whilst 77% saw corruption as a substantial problem. This is an ongoing concern inherent in Vietnamese society as evidenced by the 2008 Japanese aid suspension.

Vietnam's banking system is to some extent sheltered from the outside world, however, the country's economic crisis in mid-2008 that saw effective commercial interest rates soar to 21% per annum and the continued global credit crunch has impacted the availability of debt finance.

This was reflected by 58% of participants who viewed access to debt finance as a substantial obstacle. The Government has recognised this challenge and has implemented a number of policies in order to relieve the pressure somewhat and to encourage banks to lend, such as subsidising interest rates to certain businesses or sectors.

Factors to measure success of Private Equity investments

Findings

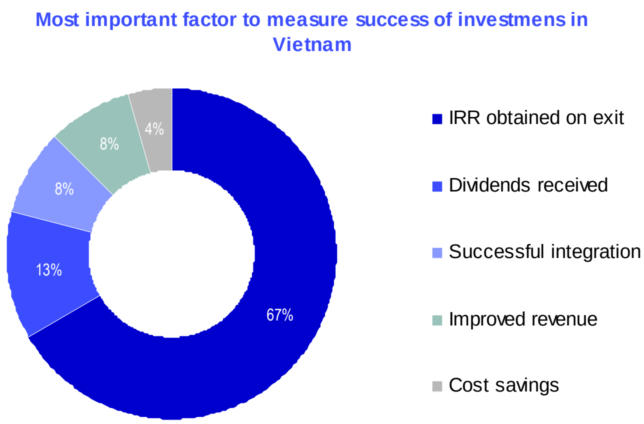
With Private Equity investors coming from a diverse range of countries and backgrounds, we sought to determine how Private Equity investors in Vietnam measure "success" of their investments.

Not surprisingly 67% of participants considered IRR on exit to be the most important factor when measuring success of Private Equity investments. Representing a return on funds invested, IRR is the obvious choice for traditional financial performance measurement.

Our results did, however, identify that not all Private Equity industry participants in Vietnam regarded IRR as the most important factor, and in some cases regarded it as less important than other factors.

Dividends received, successful integration, improved revenues and cost savings all figured in the survey results, indicating the diversity of measuring success in Vietnam.

Successful integration and improved revenues often arise as important factors with certain Private Equity investment opportunities, where the investor is looking to improve businesses which will in turn result in increasing returns to investors. Certain industries are valued based upon revenue multiples, and other industries derive greater returns by acquiring and integrating small and less efficient operations together. As a result, we are seeing Private Equity investors apply different measures to transactions other than a general reliance on IRR depending on the specific business.



Exit strategy

Findings

Respondents were asked which route they saw as the most attractive or the most achievable for exiting Vietnamese Private Equity and Unlisted investments in 2009.

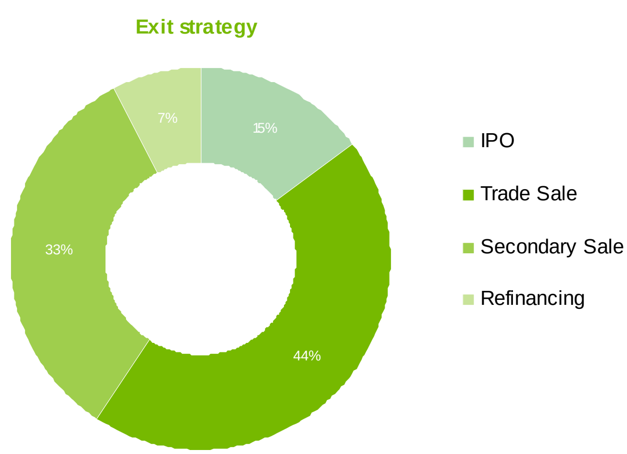
44% of respondents stated that a trade sale would be their most attractive preference, undoubtedly assisted by the recent unfavourable state of listed markets and lack of IPO's.

In the years preceding the global financial crisis there had been an increase in trade purchases by foreign and local buyers. As the Vietnam business environment develops and Vietnamese businesses gain expertise and the capacity to grow through mergers and acquisition we foresee the local mergers and acquisition market as being an increasingly common exit route.

Of particular interest is the fact that 33% of respondents currently see secondary buy outs as the preferred exit route. As the Vietnamese investment fund industry is starting to mature, we are now seeing funds commencing the divestment of portfolio companies by way of secondary buy outs.

Other factors leading to the popularity of secondary buy outs include the lack of good quality Private Equity investments in Vietnam and the need for cash rich funds to invest. Additionally, the recent global slowdown has led to falling equity values, liquidity issues and investor requirements for cash, with cash short funds being pressurised by investors to liquidate portfolios to return funds.

Also of interest was the fact that no respondents indicated that they believed that management buy outs were a preferred exit option. In developing markets the difference between secondary buy outs and management buy outs are sometimes blurred, however, the survey result is most likely a result of the relative lack of quality and experienced senior management in Vietnam. This contrasts with developed markets where management buy outs are a common option.



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