

## SOE Privatization: From the perspectives of foreign investors

### The interest of foreign investors in SOE equitization

Foreign investors have taken note of the second, and accelerated, phase of this program as embodied in Resolution 15 by the prime minister. They feel this is a second opportunity for them to benefit from participation. The driving force behind this new sense of optimism is a change in VN's market environment. With a favorable macro configuration (i.e. moderate growth, low inflation, stable currency) the equity VN Index rose 22% in 2013 and a further 19% in Q1-14.

After equitization, capitalizations of major enterprises (e.g. Vietnam Airlines, Vinatex) would rank at or near the top in local markets making them high-value, blue-chip stocks. As such they fit in well with portfolios of major foreign investors, especially the Vietnam-focused ETF like those managed by Market Vectors and Van Eyck. These investors welcome new large-cap stocks on the market because many popular blue-chip companies including VNM and FPT have no more room to accommodate foreign buyers.

We note a resurgence of interest in Vietnamese equity markets beginning in 2013 and continuing into 2014. Even pessimistic analysts such as Marc Faber declared their confidence in an uptrend in the Vietnamese market and their investments reflect that confidence.

### The concerns of foreign investors participating in the program

With a favorable macro backdrop (i.e. low inflation and stable currency) investors are less concerned with erosion of their investment value via these two sources of instability. However, they also want a **number of other issues** addressed in the SOE privatization process, including:

- **Transparency of financial performance** for companies offered in IPOs. Financial reports should be prepared, audited, and issued before the IPO. Verification and justification of the valuation for state-owned enterprises in the market require full disclosure.
- **Valuations tend to be the most complex** part of the privatization cycle and should be performed by consultants who are experts in the field. At present, such valuations should reflect a de-leveraging trend whereby asset prices adjust downwards to reflect economic realities. In the past, SOE managers based these valuations upon unrealistic expectations of their assets or products flowing from their projects.
- **Transparency** in financial reports and valuation processes instills confidence in investors that the SOE operations are conducted for the benefit of shareholders. Using these methods aligns the interests of management and shareholders.

The share retained by the state after privatization is of particular interest to foreign investors. According to resolution 15/NQ-CP, this should not exceed 65%. Euro Cham, a trade association of European businesses in VN, claims foreign investors have concerns should the share retained by the state remain too large, as this would affect their **voice in the company's governance**. Matters such as appointment of board members and management, dividend payments, debt/capital ratios, and their rights in re-shuffling the work force are important considerations in their decision to purchase shares of SOEs.

As evidence for their concerns, foreign investors point to significant ownership in many SOEs by the state several years after privatization. **Sabeco**, for example, privatized nearly 8 years ago yet the state still holds an 89% stake in the company. **Petrolimex** has been equitizing for two years and the state still holds a 95% position.

### A successful equitization story

**PV Gas (GAS) is a state-owned enterprise** that processes, transports, and distributes gas products throughout Vietnam. In 2010, **GAS made an IPO** issuing 62 million shares, or 3.2% of the company's valuation. Now the largest capitalization on the HOSE, it has significant influence over the general market index, VNI. Its market capitalization tripled since its inception as an equitized company, rising from \$2.8bn to \$8.35bn. Foreign investors hold about 2.5% of GAS market value.

**In early 2014 GAS asked for government** authorization to expand its equitization program by issuing new shares to boost its charter capital. Foreign investors were the targets for the new shares. The company explained that it intended to use the new capital to purchase a large gas field in the seas off southern Vietnam. GAS also needed about \$1 bn to buy a 400 km-long gas pipeline belonging to the US Chevron group. The most feasible solution was further equitization (i.e. the issuance of more stock shares to bring in additional capital).

The above episode is **an example of a successful** privatization of a major SOE with active foreign participation. It has gone through:

- An IPO
- A listing on the HCM stock exchange
- An expansion of its original equitization plan

### Concluding observations

Via frequent contact with investors, we feel that the government's renewed program of privatization **has caught the attention** of the foreign investment community. They think that:

- This is a **new beginning** in an important endeavor by Vietnam.
- The program **launched in a favorable** economic and market environment.
- The program **enjoys the support and supervision from the PM** while managed by the deputy director of his office.
- This ambitious program represents a **major step forward** in rendering the economy more efficient and productive.

**Note:**

We are planning a **series of short papers** on SOE privatization in Vietnam. This is the first one, focused on a **renewed government effort** to accelerate its policy in this area, as contained in Resolution 15/NQ-CP issued by the PM. Subsequent papers are as follows:

**Paper 3**

- The **government motivations** in undertaking privatization.
- Who are the stakeholders?
- How are they affected?
- What is their role in:
  - Speeding up the process with support.
  - Slowing down the process through lack of cooperation.

**Paper 4**

- **Regulatory restrictions**
- Different rules apply to different types of SOEs:
  - SOEs under 100% state control: national security, heavy industries, and mineral resources
  - Special role of banks and financial institutions
  - Restricted sectors:
    - State control must be > 50%
  - Unrestricted sectors:
    - State controls can be < 50%

---

**Disclaimer by VinaCapital**

Copyright 2014 VinaCapital (VNC). All rights reserved. This report has been prepared and is being issued by VNC or one of its affiliates for distribution in Viet Nam and overseas. The information herein is based on public sources believed to be reliable. With the exception of information about VNC, VNC makes no representation about the accuracy of such information. Opinions, estimates and projection expressed in this report represent the current views of the author at the date of publication only. They do not necessarily reflect the opinions of VNC and are subject to change without notice. VNC has no obligation to update, amend or in any way modify this report or otherwise notify a reader thereof in the event that any of the subject matter or opinion, projection or estimate contained within it changes or becomes inaccurate. The information herein was obtained from various sources which we believe to be reliable but we do not guarantee its accuracy or completeness. Prices and availability of financial instruments are also subject to change without notice. This published research may be considered by VNC when buying or selling proprietary positions or positions held by funds under its management. VNC may trade for its own account as a result of short term trading suggestions from its analysts.

Neither the information nor any opinion expressed in this report constitutes an offer, nor an invitation to make an offer, to buy or to sell any securities or any option, futures or other derivative instruments in any jurisdiction. Nor should it be construed as an advertisement for any financial instruments. Officers of VNC may have a financial interest in securities mentioned in this report or in related instruments. This research report is prepared for general circulation and for general information only. It does not have regard to the specific investment objectives, financial situation or particular needs of any person who may receive or read this report. Investors should note that the prices of securities fluctuate and may rise and fall. Past performance, if any, is no guide to the future.

The financial instruments discussed in this report may not be suitable for all investors. Investors must make their own financial decisions based on their independent financial advisors as they believe necessary and based on their particular financial situation and investment objectives. This report may not be copied, reproduced, published or redistributed by any person for any purpose without the express permission of VNC in writing. Please cite sources when quoting.