

Strategic sales in equitisations

Duong Thu Ha and John R Davis of YKVN discuss the position of foreign strategic investors in the equitisation of large state-owned enterprises

Vietnam embarked on its *Doi Moi* reform policy in 1986 when it had around 12,300 state-owned enterprises (SOEs). The first round of SOE reform started in 1989 to dissolve unprofitable SOEs and rearrange the others by merger and consolidation. As a result, the number of SOEs declined to 6,500 by 1992. In 1992, the government decided to experiment with equitisation (or what is called privatisation in other jurisdictions) but major waves of equitisation were only undertaken from the middle of 1998. During the period from 1998 to 2002, 845 SOEs were equitised.

The equitisation of large SOEs (each of which is normally a quasi-monopoly in a given sector) can probably be dated from 2002 when the domestic initial public offering (IPO) of Vietnam Dairy Corporation (Vinamilk) took place. Strategic sales to foreign investors then started with the sales of Vietnam National Insurance Corporation (Bao Viet) and PetroVietnam Finance Corporation (PVFC) completed in 2007 and 2008, respectively. Continuing and prospective deals in 2009 include Bank for Foreign Trade of Vietnam (Vietcombank), Bank for Industry and Trade of Vietnam (Vietinbank), Bank for Investment and Development of Vietnam (BIDV) and Vietnam Airlines Corporation (Vietnam Airlines).

To help a large SOE prepare for its equitisation, an international investment bank is normally appointed by the SOE to act as its financial adviser. Credit Suisse was appointed in the equitisations of Bao Viet and Vietcombank, Morgan Stanley in the equitisation of BIDV and JP Morgan in the equitisation of Vietinbank. Vietnam Airlines is in the process of selecting its adviser. The investment bank then assists in the selection of the lawyers, accountants, domestic securities firms and other advisers (such as property appraisers) necessary for the equitisation. The first and probably most important documents to be prepared by the

investment bank (with the assistance of the other advisers) are a plan on the equitisation of the SOE and a report on valuation of the SOE, both for submission to the government for consideration and approval. The equitisation plan contains among other matters the recommendations by the investment bank on the shareholding structure of the SOE post-equitisation and the steps of equitisation. Once approved, the equitisation plan is the bible for the transition.

In the equitisation process, an SOE is turned into a joint stock company and some of its shares are sold to employees and outside investors, including public and foreign investors. Most equitisations involve the issuance of new shares. The equitisation of a large SOE normally begins with a domestic IPO and then a strategic sale to foreign investors. An international IPO is also contemplated but no equitisation of a large SOE has reached this stage; Vinamilk is however in an advanced stage of preparation for a secondary listing in Singapore and PVFC is taking steps toward a secondary listing, probably in Singapore.

Historically, various obstacles have stood in the way of the foreign acquisition of shares in an SOE being equitised. One of the principal obstacles was the lack of a clear

regulatory framework governing the acquisition of shares in Vietnam by foreign investors. Decree No. 109/2007/ND-CP on Conversion of 100% State-owned Companies to Joint Stock Companies (Decree 109) and Decree No. 69/2007/ND-CP on Acquisition by Foreign Investors of Shares in Vietnamese Commercial Banks (Decree 69) were issued by the government in 2007 in an attempt to create this much needed legal framework. Decree 109 governs any equitisation of an SOE while Decree 69 specifically deals with the acquisition of shares in a state-owned bank.

Although Decree 109 and Decree 69 have improved the regulatory framework in many respects, they have not completely resolved all the issues faced by the strategic sale when a large SOE is equitised. In addition, since these decrees are relatively new pieces of legislation, the interpretation and scope of application of their provisions will only be revealed when strategic sales in large SOEs after the enactment of Decree 109 and Decree 69 like Vietcombank are completed.

Foreign strategic investors

Decree 109 makes a fundamental distinction between foreign investors and domestic investors and for the first time specifically recognises the right of foreign strategic investors to purchase shares in equitised SOEs.

Foreign investors are defined under Decree 109 as “foreign organisations and individuals injecting capital to carry out investment activities in Vietnam”. Domestic investors are “Vietnamese individuals, economic organisations and social organisations, which are established and operate in accordance with the laws of Vietnam”. Decree 109 appears to suggest that companies established and operating in Vietnam, including companies with foreign ownership like wholly foreign-owned companies and joint venture companies, are treated as domestic investors for the purpose of investment in SOEs being equitised. However, a cap applies to the foreign strategic investor and its related persons, including subsidiaries.

Under Decree 109, a foreign strategic investor is a foreign investor who possesses

“The equitisation plan contains recommendations by the investment bank on the shareholding structure of the SOE post-equitisation”

Author biographies



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Ms Ha is a partner of YKVN at the Hanoi office. Her practice focuses on banking, finance and corporate transactions. Ms Ha's representative clients include banks such as Bank for Investment and Development of Vietnam, Citibank, Bank for Foreign Trade of Vietnam, Military Commercial Joint Stock Bank, Indovina Bank, International Commercial Bank of China, Chinfon Commercial Bank and Vietnam Technological and Commercial Joint Stock Bank.

Ms Ha is advising Bank for Foreign Trade of Vietnam on its privatisation, including a domestic IPO and a strategic sale. This is the first privatisation of a Vietnamese state-owned bank. She is also advising Vietnam Bank for Industry and Trade and Bank for Investment and Development of Vietnam on their privatisations, including a domestic IPO and a strategic sale. These are among the first privatisations of Vietnamese state-owned banks.

Her other recent major representative transactions include:

- Advising joint arrangers Czech Export Bank and Bank for Investment and Development of Vietnam on the €110 million financing of Phu Son Cement Plant Project in Vietnam.
- Advising the International Finance Corporation in its financings of consumer finance programs of several Vietnamese joint stock banks, including Techcombank and VIB.
- Advising Holding Company-Vietnam Shipbuilding Industry Group on its \$600 million borrowing arranged by Credit Suisse.
- Advising Holding Company-Vietnam Shipbuilding Industry Group on its \$250 million borrowing arranged by Deutsche Bank.
- Advising Viet-Lao Power Joint Stock Company on its \$130 million borrowing arranged by Natixis. This is the first offshore power project developed by a Vietnamese company.

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John R Davis is a senior foreign lawyer of YKVN and has more than 17 years of experience as a lawyer in both Asia and the US. His practice focuses on corporate and financial transactions, especially cross-border ones, for domestic and international investors. For seven years he was based in White & Case's Hanoi office and involved in matters for clients in Vietnam and most of the other Asean countries. He is licensed by Vietnam's Ministry of Justice as a foreign lawyer in Vietnam.

Mr Davis is advising Bank for Foreign Trade of Vietnam on its equitisation, starting with the strategic sale of shares to foreign investors followed by domestic and international IPOs. This is the first equitisation of a Vietnamese state-owned bank and will set a template for future large IPOs in Vietnam. Mr Davis is also advising Bank for Investment and Development of Vietnam and Industrial and Commercial Bank of Vietnam on their equitisations.

In addition to his transactional practice, Mr Davis is active as a consultant to governments in the region. He advises them on the reform of laws affecting commerce and on regulatory issues, especially those related to competition law.

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“capability in terms of finance, corporate governance, transfer of new technologies, supply of raw materials and materials, [and] development of a product consumption market”, and has “long-term interests with the [equitised] company”. These requirements are relatively vague and presumably can be met by most candidate investors.

The requirements for a foreign strategic investor in a state-owned bank are more stringent and detailed. It should be a foreign credit organisation (i.e. a foreign bank, foreign finance company, or other foreign financial institution operating primarily and

constantly in the banking sector) and should meet certain qualifications as provided in Decree 69: (i) it has assets of at least \$20 billion in the year preceding the year in which the purchase is made; (ii) it has international experience in the banking industry; (iii) it is rated by international rating agencies as being able to perform financial undertakings and maintain normal operations in adverse economic conditions; (iv) it is reputable; (v) it has financial capacity and the ability to assist a Vietnamese bank in developing its products and banking services, strengthening management capacity, operating and applying modern technology;

and (vi) it has strategic interests consistent with the development strategy of the Vietnamese bank, and meets the specific criterion specified by the Vietnamese bank.

The two key tests for a foreign strategic investor are the foreign credit organisation test and the \$20 billion asset test. The foreign credit organisation test may technically disqualify private holding companies or equity investment arms of banks, or equity funds, asset management companies or others that do not have banking as their core business. The \$20 billion asset test disqualifies small foreign credit organisations.

Price of shares

Under Decree 109, the share price to be paid by a foreign strategic investor may not be lower than the average successful auction price in the domestic IPO.

This requirement raises two fundamental problems. First, the domestic IPO must take place before the strategic sale. The reverse sequence of the two steps which is usually recommended by the investment banks in equitisation plans requires government approval. Second, an average auction price in the domestic IPO that is too high (in comparison to the valuation made by potential foreign strategic investors at the time of the deal) will make it impossible for a potential foreign strategic investor to agree on the purchase price. This is a particularly big issue in Vietnam because the valuation by retail investors participating in the domestic IPO is normally higher than that of candidate foreign strategic investors.

Decree 109 appears to provide for certain exceptions to this IPO auction price rule in its Article 6.3(c) and Article 56.4. Article 6.3(c) of Decree 109 provides that:

- “A strategic investor is entitled to purchase shares at a price not lower than the successful average auction price. With respect to state-owned groups [and] general corporations (including State-owned commercial banks), if it is absolutely necessary to select strategic investors, the authority deciding the equitisation process shall report to the Prime Minister to decide on a separate bid among the strategic investors”.
- The phrase “separate bid” may be construed to indicate a separate bidding procedure that is not subject to the average auction price as set forth in the first sentence. This could be a strained analysis, especially in the situation where there is only one potential foreign investor qualified to be a foreign strategic investor in an SOE and such foreign strategic investor does not agree with the auction price. However, it appears this is the drafter's intent for this clause.
- Article 56.4 of Decree 109 also appears to provide for another exception. It provides that “any equitisation of state-owned

commercial banks shall be implemented in accordance with this Decree, provisions on banking management and specific matters stated in each equitisation plan that is approved by the Prime Minister". Article 56.4 appears to implicitly give the Prime Minister the authority to approve an equitisation plan that allows an exception to the auction price requirement.

How these exceptions will work in practice is not clear at the moment. However, we understand that most large SOEs being equitised are requesting an exception to the IPO auction price rule.

Shareholding cap

The Prime Minister will decide on the enlarged charter capital and the shareholding structure of the SOE post-equitisation. The enlarged charter capital of the SOE post-equitisation is equal to the value of the state's equity at the SOE at the time of equitisation and the aggregate par value of the new shares to be issued.

Under Article 35 of Decree 109, the shareholding structure is subject to the following requirements:

- *State interest*: will be decided by the Prime Minister but in any case at least 51% of the total capital;
- *Trade union*: not more than 3% of the total capital at a 40% discount of the domestic IPO auction price;
- *Employees*: 100 shares for each year of employment at a 40% discount of the domestic IPO auction price; and
- *Strategic investors and "other investors"*: in the aggregate, at least 25% of the total capital. Shares sold to "other investors" should be at least 50% of the above aggregate floor, i.e. 12.5%. It is unclear as to how the term "other investors" is defined for the purposes of Article 35. In practice, it appears that this term refers to investors other than the state, the strategic investor, the trade unions and current employees who purchase shares under preferential conditions.

In addition, if a strategic sale takes place after a domestic IPO and listing, the Law on Securities imposes an aggregate foreign ownership cap of 49%.

Foreign acquisition of shares in a Vietnamese bank is subject to the foreign shareholding caps provided in Decree 69. These caps include:

- *A 15% and 20% cap for a strategic investor*: a foreign strategic investor and its related persons cannot own more than 15% of the charter capital of a Vietnamese bank. In special cases, the Prime Minister may decide, based upon the favorable recommendation of the State Bank of Vietnam, to increase the cap to as much as to 20% of the charter capital.
- *Aggregate cap*: all foreign investors (including existing foreign shareholders)

“Questions will only be resolved by the Prime Minister’s approval, whether by way of approving the equitisation plan or otherwise”

and their related persons cannot own more than 30% of the charter capital of a Vietnamese bank.

- *A 5% cap for a foreign non-credit organisation*: a foreign investor who is not a foreign credit organisation and its related persons cannot own more than 5% of the charter capital of a Vietnamese bank.
- *A 10% cap for a foreign credit organisation*: a foreign credit organisation (i.e. a foreign bank, foreign financial company, and other foreign financial organisations whose principal and regular activities are in the banking sector) and its related persons cannot own more than 10% of the charter capital of a Vietnamese bank.
- *Convertible bonds*: convertible bonds held by foreign credit organisations cannot be converted if such conversion would result in a breach of the above caps.

Lock-up period

According to Decree 109, the lock-up period for a strategic investor is at least three years from the issuance of the new business registration certificate for the new joint stock company. A strategic investor may transfer its shares in the lock-up period if such a transfer is approved by a meeting of the shareholders of the company. This three-year lock-up period applies to SOEs being equitised in general.

Decree 69 in particular provides for a different lock-up period. Foreign strategic investors and their related persons are permitted to transfer their shares to other organisations or individuals (including domestic and overseas) but only five years after first becoming a foreign strategic investor. Foreign credit institutions and their related persons who own 10% of the charter capital of a Vietnamese bank are permitted to transfer their shares to other organisations or individuals (including domestic and overseas) but only three years after becoming a 10% shareholder of the Vietnamese bank. Decree 69 does not provide for any shareholder approval exception.

A foreign credit organisation cannot have board representation in more than two Vietnamese banks. Also, a foreign credit organisation cannot be a strategic investor in more than two Vietnamese banks.

Distribution of proceeds

The proceeds derived from the issuance of new shares in the equitisation are to be handled as follows:

- First, the aggregate par value of the new shares will be allocated to the SOE being equitised so that the enlarged charter capital is paid up (at par value);
- Second, the share premium will be used to pay for equitisation expenses and to settle liabilities to employees;
- Third, if there is any amount remaining, a portion of such amount will be allocated to the new equitised company in proportion to the number of new shares issued, e.g. if the new shares account for 30% of the total charter capital, 30% of the amount remaining will go back to the SOE being equitised;
- Fourth, any amount remaining will be distributed to the state.

The third step of the waterfall is especially problematic for strategic foreign investors and equitised SOEs because they want to keep more share premium at the SOEs post-equitisation. The equitisation plans of large SOEs often recommend that a higher percentage of the share premium is kept at the SOEs post-equitisation.

The process for strategic sales in large SOEs is still being developed in Vietnam. Although the basic legal framework for equitisation is in place, some questions will only be resolved after the first equitisation following the enactment of Decree 109 and Decree 69 is completed. Such questions, especially regarding the sequence of the domestic IPO, the share price in the foreign strategic share sale and the distribution of sale proceeds, will only be resolved in each case by the Prime Minister's approval, whether by way of approving the equitisation plan or otherwise.