13:42 (GMT +7) - Thursday 10/09/2015



## Executive Talk

# M&A to boost Vietnam-Japan strategic partnership

Released at: 15:14, 07/09/2015


Mr. Stephen Gaskill, Deputy General Director, and Mr. Nguyen Luong Hien, Associate Director, Deals - Strategy, at PwC Vietnam take a closer look at M&A activities between Vietnam and Japan.

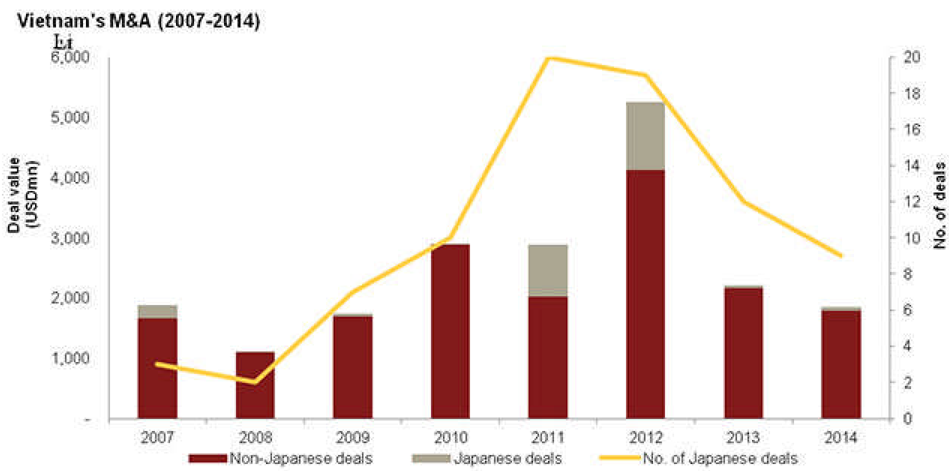
Vietnam has been an attractive destination for foreign investors since the country began opening up its economy in the late 1980s. Japan is currently the second-largest contributor of foreign direct investment (FDI) to Vietnam, ahead of other significant investors such as Singapore, Taiwan, Malaysia, and the US, with $37.7 billion in total registered investment capital as at June 2015 and has also been highly active in the field of merger and acquisitions (M&As).

Vietnam has been a strategic market for Japanese companies investing overseas for some time due to its close geographic proximity, low labor costs, abundant workforce, its openness to investment by Japanese companies, and the positive government-to-government relationship that exists between the two countries.

Vietnam has been an investor-friendly country since the mid-1990s and has remained open to foreign investment, particularly from Japan, which is seen by the Vietnamese Government and domestic companies as a high quality, long-term investor. This combination of factors has led to high ongoing levels of Japanese FDI and M&A, the latter becoming an increasingly common route by which Japanese companies have entered the Vietnamese market, especially since 2007.

**Attractive segments for M&A**

From 2011 to 2015 Japanese investors conducted nearly 70 M&A deals in a wide range of industries in Vietnam. Although Japanese M&A experienced a slow down following a peak in 2012, the first half of 2015 has seen strong signs of recovery, already reaching 75 per cent of the total volume of deals announced in all of 2014 and is indicative of Japanese investors' long-term confidence and commitment to doing business in Vietnam at the current time.

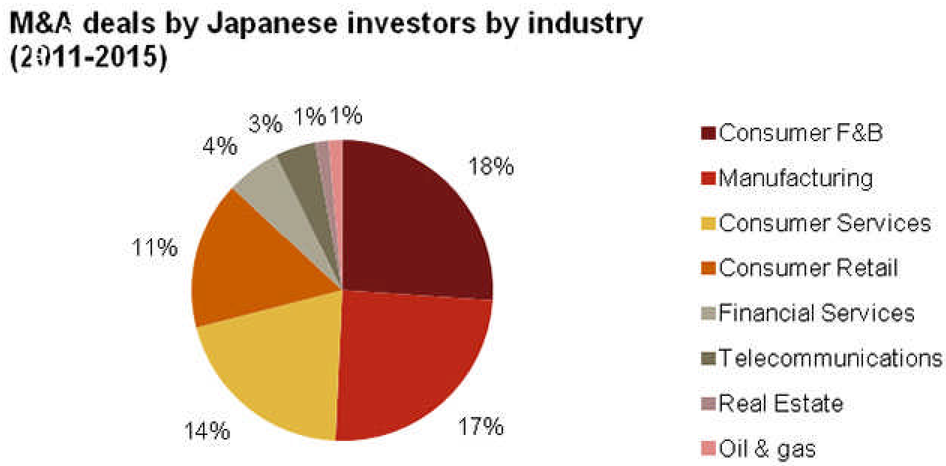



Source: mergermarket.com, PwC's analysis

One of the reasons for the high levels of Japanese M&A is that many Japanese companies, particularly large trading houses and other conglomerates with subsidiaries involved in a diverse range of businesses, will invest in almost any sector of the Vietnamese economy, including power, oil & gas, manufacturing, retail, financial services, and agriculture. There are several factors driving this diverse range of sectors chosen for acquisitions.

Some investors want to tap into Vietnam's low-cost manufacturing base (especially where there are investment incentives to do so), while others are looking to move manufacturing away from China, where labor is becoming more expensive and where there are geopolitical risks. Some Japanese investors want to tap into Vietnam's large, growing population as a market and to benefit from consumer trends that are still developing at a rapid pace as the economy matures and becomes more open. This is especially enticing for Japanese companies facing a domestic consumer market that is mature and a population that is shrinking and rapidly ageing. Many Japanese corporates are also sitting on significant cash piles and have little option but to invest overseas if they are to get a return on these funds given the extremely low interest rates and limited economic growth in Japan.

One factor that differentiates Japanese investors entering into Vietnam via M&A is that they are very flexible on deal terms. Many are willing to take minority stakes because they are very long-term investors who intend to take incremental steps as they form strategic partnerships with Vietnamese companies. Having minority stakes also allows investors to develop their understanding of the market over time without taking as big of a risk in the short term.




Source: mergermarket, PwC's analysis

**Financial Services**

Japanese investors have been focusing on Vietnam's rapidly-growing financial services sector for some time, encouraged by Vietnamese institutions that are looking for strategic foreign investors to support them in improving the performance of their businesses and providing much-needed injections of capital to strengthen their balance sheets. One such example of a successful transaction was Tokyo Mitsubishi UFJ's purchase of 20 per cent of Vietinbank's shares in December 2012 in a deal worth $743 million. Another successful deal occurred in 2011, when Mizuho made a $560 million investment in Vietcombank, acquiring 15 per cent of the bank's shares. These deals not only increased the charter capital of these financial institutions but also gave them access to expertise in banking from a highly-developed economy. Vietnam still has a lot of room to grow in terms of its banking sector as it currently has a large unbanked population compared to neighboring countries like Thailand and Malaysia, making it an extremely attractive ongoing investment destination for Japanese financial services groups.

Japanese investors aren't restricted to investing in banks. Life/non-life insurance, consumer finance, leasing, and other segments of the financial services sector are considered attractive areas for investment, as illustrated in April 2015 by the announcement that Japan's Credit Saison had purchased a 49 per cent stake in HD Bank's consumer finance arm for an undisclosed amount. Another notable deal occurred in 2013, when Sumitomo Life Insurance bought HSBC Holdings Plc's 18 per cent stake in Vietnam's biggest insurer, Bao Viet Holdings, in a deal worth $340 million.

**Consumer Retail and Goods**

In the consumer space there have also been significant acquisitions in both the retail and consumer goods sectors conducted by Japanese investors in order to enter into the local market more rapidly.

Vietnam boasts a population of more than 90 million people with rising disposable incomes and has rapidly growing urban centers that represent an attractive base of potential customers for many foreign consumer product companies.

In 2015, Japanese supermarket chain operator the Aeon Company Limited tapped into Vietnam's consumer retail space by acquiring a 30 per cent stake in Fivimart and a 49 per cent stake in Citimart, two domestic supermarket/convenience store chains with a strong presence in Hanoi and Ho Chi Minh City. Convenience stores are becoming increasingly popular in Vietnam due to a general shift away from traditional retail channels to more modern trade formats; something that has been fuelled not only by lifestyle changes but also by ongoing concerns over food safety.

Japanese investors have also shown considerable ongoing interest in entering the consumer goods space. Japanese F&B company Kirin bought 57.25 per cent of Interfood (a Vietnamese based beverage manufacturer) for $31 million in 2011. In another notable deal in the same year, Unicharm, a Japanese manufacturer of feminine hygiene products, bought a 95 per cent stake in Diana for $181 million.

**General manufacturing**

Manufacturing is another area of interest for Japanese investors since Japanese companies have advanced technological capabilities in comparison to their Vietnamese counterparts and with Japanese investors seeing an opportunity to tap into a dynamic and growing market. In 2014, Dai Nippon Printing Co. Ltd bought a 36 per cent stake in MK Smart, a Vietnam-based smart card manufacturer, in a deal worth $10 million. In another notable transaction, Showa Aluminium Can Corp. bought a 92 per cent stake in the Rexam-Hanacans Joint Stock Company, a Vietnam-based manufacturer of aluminum cans for beer and other types of beverages, for an undisclosed amount. Although neither deal was directly related to the consumer goods sector, both were in industries with indirect links to the growth in the domestic consumer market. We expect this trend to continue as Japanese investors look to benefit from the growth in the domestic market by investing in packaging for consumer goods and other areas with links to rising consumer spending.

We also expect to see more activity in other areas of manufacturing. Many high-quality Japanese consumer and industrial goods manufacturers are shifting their manufacturing bases from China to Vietnam in order to take advantage of more affordable labor costs in Vietnam. Wages in Vietnam remain competitive compared to those of neighboring countries, with an average monthly wage of around $197, or only one-third of that seen in China and Malaysia ($613 and $651, respectively, according to the International Labor Organization). As mentioned previously, Vietnam also offers attractive incentives for investors in certain manufacturing segments (especially high-tech industries) and has a large, hardworking labor force. In addition, Japanese investors have growing concerns about geopolitical risks in other countries in Asia (particularly China), including some in Southeast Asia, and hence are looking to diversify their manufacturing base away from the more traditional geographical locations.

**Future outlook and investor pain points**

The outlook for further M&A activity by Japanese investors looks very positive in the short/medium term as corporate Japan continues to look outward and sees Vietnam as an important and stable investment location that is growing, has a rapidly evolving domestic consumer market, and a large number of willing sellers who are looking for capital and managerial/technical expertise from foreign investors.

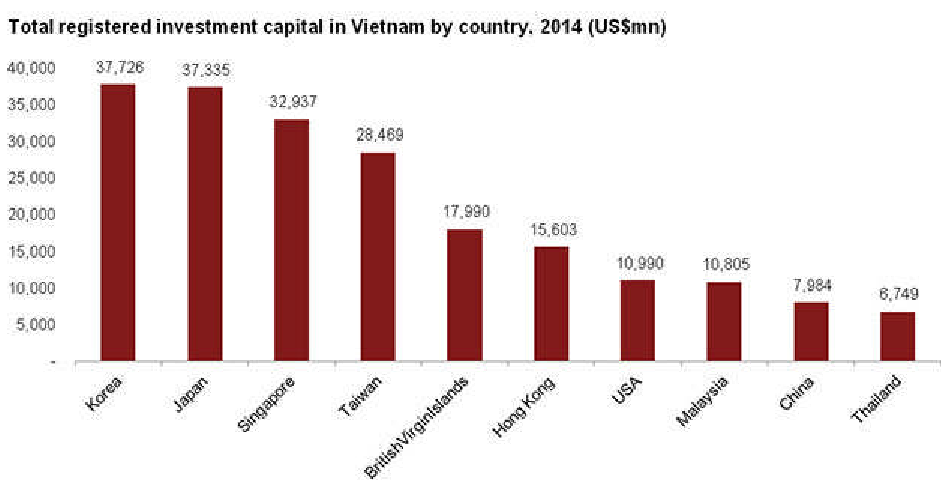
The Vietnamese Government has shown an ongoing commitment to making Vietnam a more investor -friendly country, especially for Japanese investors, whose government is Vietnam's largest contributor of overseas development assistance (ODA), aside from the World Bank. Last June, in a significant step forward, the government agreed to eliminate limits on foreign ownership in many listed companies, addressing one of the chief concerns of the international investment community. Overseas investors will now be allowed to increase their holdings in listed companies operating in a number of industries from 49 per cent to 100 per cent.

However, further enhancing Vietnam's current business relationship with Japan in the future is not without its hurdles to overcome. Although the pricing of deals in Vietnam remains reasonable in terms of multiples, one negative side of pricing is that they are generally set in USD. Since the Yen is devaluing against the USD, deals are therefore becoming more expensive for Japanese companies. Targets of a reasonable size are also in short supply, while State-owned enterprise (SOE) reform isn't happening fast enough for most investors' liking and there remain barriers to entry in sectors such as banking and consumer finance. The economic downturn in China could also affect Vietnam's economy negatively in the short-term, although it is likely to continue growing at a pace that will lead to an ever-growing number of opportunities for foreign investors looking to enter this exciting, if challenging, market.

Despite the existence of these difficulties in doing business in Vietnam and despite the threats posed by the recent trends in the global economy, we believe that M&A is still one of the most effective and rapid ways by which a Japanese company that is eager to tap into Vietnam's dynamic, fast-paced business landscape can gain access to the market. Japanese companies are therefore set to continue leading the way regarding M&A activities in the medium term as they further their presence in this rapidly changing, developing economy.

**Appendix**

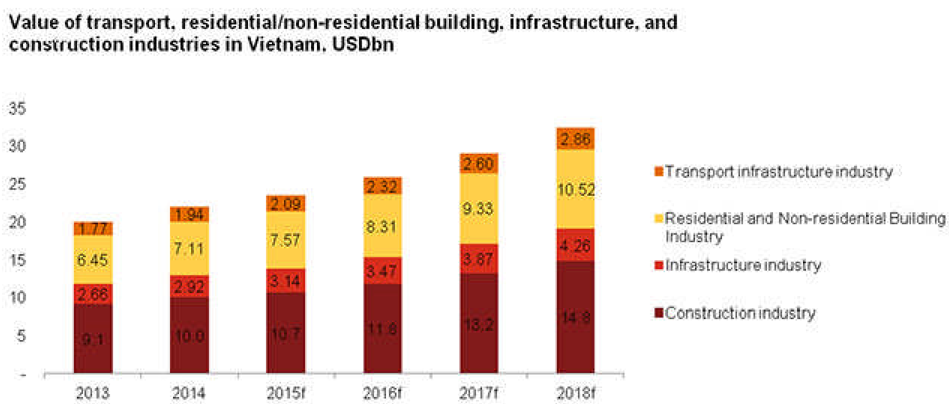
Japan is currently the second-largest contributor of FDI to Vietnam, beating out other top investors such as Singapore, Taiwan, Malaysia, and the US, with over $37 billion in total registered investment capital as at December 2014.




Source: Ministry of Planning and Investment (MPI), JICA

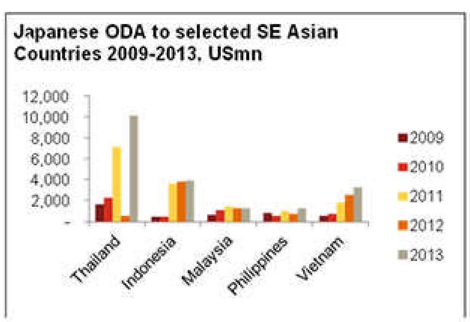
According to a report from the Japan Export Trade Research Organization (JETRO), Japan began recording FDI outflows to Vietnam in 2007, with FDI outward stock of $1.7 billion. That amount grew to over $12 billion in 2014, showing a CAGR of 32 per cent, which represents not only the highest CAGR for FDI outflows from Japan in all of Asia but in the entire world during that period. Although Vietnam doesn't see as much FDI as other countries in Asia (such as Thailand with $52 billion in 2014), Japan has been ramping up the amount of investment Vietnam receives in the past decade faster than anywhere else.

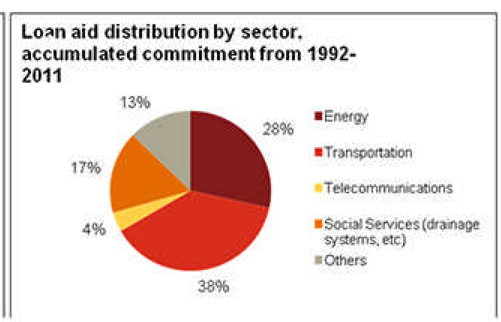
A significant portion of the invested capital is going into infrastructure and construction projects. Vietnam's construction and infrastructure industry is expected to show strong growth in the coming years.



Source: Ministry of Planning and Investment (MPI), JICA

Japan has also been giving Vietnam an increasing amount of attention with regard to ODA in recent years, in the form of both grants and loans, as evidenced by where the money is flowing in the Southeast Asia region.



Source: Ministry of Planning and Investment (MPI), JICA

Japan was Vietnam's largest ODA provider aside from the World Bank during the 1993-2012 period. The Japan International Cooperation Agency (JICA), the main organization in Japan supplying ODA to Vietnam, aligns itself with Vietnamese Government master plans and initiatives by dedicating funds in line with the government's direction and goals. In addition to funding Vietnam's energy sector, JICA has shown a strong commitment to addressing Vietnam's weak infrastructure and transportation industries by focusing the largest amount of ODA into these areas.

**For further information on Vietnam - Japan relations, see the September issue of Vietnam Economic Times.*



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