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EYE ON ASIA

By Frederik Balfour

Vietnam: Vibrancy Revived

The country is once again awash with investor optimism, drawing Vietnamese returnees and foreigners out to avoid previous missteps

As our Boeing 747 United Airlines flight from San Francisco touched down in Ho Chi Minh City's Tan Son Nhat airport recently, I contemplated how much things had changed since my first visit there 12 years ago. Back then, Vietnam was still under a U.S. economic embargo, but the city was crawling with Australian, Taiwanese, French, Russians, and a handful of American carpetbaggers. There were no taxis, Internet, mobile phones, five-star hotels, or flights on U.S. carriers. United (**UALAQ**) began flying to Ho Chi Minh City, formerly known as Saigon, only late last year.

Deals were clinched in the bar of the only four-star establishment, the Saigon Floating Hotel, a barge that had been towed all the way from the Great Barrier Reef in Australia to the banks of the muddy Saigon River. Everywhere you went, the city was buzzing with how Vietnam would become the next Asian tiger economy.

YESTERDAY'S STORY? By the time I moved to the country as a correspondent for financial news wire AFX-ASIA two years later, Vietnam hype had reached fever pitch. Billions of dollars in foreign investment poured in, as opportunity seekers signed deals for 80-story office buildings, automobile plants, oil refineries, steel mills, and luxury seaside resorts.

When the Asian financial crisis hit in 1997, Vietnam had already begun to lose its luster. Its labyrinthine bureaucracy, opaque and unpredictable legal system, rampant corruption, and thinly veiled suspicion of foreign influences were proving major obstacles.

Projects were halted or abandoned altogether. Chrysler (**DCX**) exited before the first car ever rolled off its Vietnamese production line. The Sheraton (**HOT**) hotels in both Hanoi and Ho Chi Minh City stood half-built. The French pulled out of a billion-dollar oil refinery in the center of the country. Tourism shriveled, and foreign investment slowed to a trickle. News organizations started scaling back or closing their bureaus altogether. When I left in early 2000, Vietnam had become very much yesterday's story.

BIMMERS AND MERCS. But when I arrived in Ho Chi Minh City in late March as preparations for the 30th anniversary of the city's "liberation" on Apr. 30 were under way, the mood definitely felt upbeat. "Even the most hardened cynic will say things are better on almost all fronts, and I should know, because I am one," said Milton Lawson, a lawyer with Freshfields Bruckhaus Deringer, which has operated in the country for more than a decade. A couple of hours later, I bumped into another old Vietnam hand, Carey Zesiger, an American who gushed about the country's potential as he outlined plans to build several multiplex cinemas.

Everywhere I went, the city seemed to glow with economic well-being. The restaurant at the Sheraton Hotel on Ho Chi Minh City's tony Dong Khoi Street was packed with Vietnamese and foreigners wolfing down Easter brunch. The hotel's slot machines and blackjack tables were doing a brisk business, as were its boutiques selling Prada, Louis Vuitton, and Armani. When I first came to the city, the only private cars were Russian-made imports. Now one sees Bimmers and Mercs in the parking lot beside Q Bar, the hottest watering hole in town.

A block away, those preferring the nostalgia of yesteryear patronize the Rex Hotel. When I visited its kitschy rooftop at sunset overlooking the busy city, I overheard a former American GI declaring that "it was still one of the best bars in the world," as Peter, Paul & Mary's *Puff the Magic Dragon* played in the background (appropriately, Peter was coming to Vietnam to play a benefit concert for Vietnamese victims of Agent Orange).

ACTIVE RETURNEES. But while parts of Ho Chi Minh City may still seem straight out of Graham Greene's *The Quiet American*, the city now belongs to the post-war generation, with more than half the population under 25. It's also proving a magnet for returning overseas Vietnamese, like 31-year-old Henry Nguyen, who left the country with his family in 1975. He now runs IDG's $100 million venture-capital fund.

An extremely affable man in his early 30s armed with a medical degree and an MBA, Nguyen came to Vietnam three years ago to set up a voice-over-Internet company, and joined IDG a few months ago. The fund's first two investments show just how quickly things are changing. One is for a classified-ad Web site, the other focuses on software that helps manufacturers automate. Nguyen also is part owner in a wine-distribution business and a fusion restaurant in Hanoi called Vine, which features everything from ostrich Vietnamese spring rolls to tuna tartar.

Dominic Scriven, who runs Dragon Capital, a Saigon outfit that manages the $65 million Dublin-listed Vietnam Enterprise Investment Fund, is another entrepreneur with fingers in many pies. He runs an eco-resort on Phu Quoc island and a propaganda-art gallery, and has started up his own nongovernmental organization to protect endangered Vietnamese wildlife.

SWAMPS TO SHOPPING MALLS. A couple of days later I visited another returnee, Nguyen Huu Le, who came back from Canada in the late 1990s to help develop Vietnam's fledgling software outsourcing industry. A former Nortel (**NT**) executive with a doctorate, Dr. Le, as he's known, runs TMA Solutions, whose 500 software engineers write, test, and maintain code for his former employer Nortel, as well as Lucent (**LU**), NTT (**NTT**) of Japan, and a Singapore outfit called Equator 1.

As he showed me his R&D lab where his staff maintains firewall-switching equipment for one customer, he extolled the company's merits. "We're not just a back-office coder," he told me. "This is like any R&D lab in North America."

Across town I made a pilgrimage to Saigon South. When I first visited this site in 1996, it was still rice paddies and swamp. At the time, the Taiwanese developer's plan to build a 3,300-hectare city complete with universities, shopping malls, and apartment blocks sounded pie-in-the-sky.

But I was wrong. Today Saigon South boasts tree-lined streets with handsome villas, shops offering a fine selection of imported cheeses, locally made handicrafts -- I picked up a chocolate-scented candle -- and the soon-to-open campus of the Royal Melbourne Institute of Technology.

TOUGH WTO SCHEDULE. Nonetheless, Vietnam is still in the early stages of development. Gross domestic product per capita is around $540, though it's about four times that in Ho Chi Minh City. Its biggest foreign-exchange earnings come from basic commodities: Vietnam is the world's third-largest coffee exporter, third-largest rice exporter, and a net exporter of oil.

Since a bilateral trade agreement with the U.S. took effect in 2001, exports have quadrupled to $7 billion, thanks to soaring sales of Nike (**NKE**) shoes and garments, furniture, and agricultural products. Vietnam has also become a major contract manufacturer for the world's top bicycle companies.

But export growth is slowing this year. Vietnam isn't a member of the World Trade Organization, hence it's still subject to the textile quotas that were lifted at the beginning of this year for WTO members. And although Hanoi keeps hoping to make its self-imposed deadline to join by the end of this year, negotiators on both sides are skeptical.

GREATER KNOWLEDGE. One of the biggest sticking points is the insistence by trading partners like the U.S. and Japan that their businesses be given so-called national treatment, allowing them to compete on a level playing field with their Vietnamese counterparts in such areas as insurance and banking. Currently, for example, foreign banks must put up $15 million in registered capital for each bank branch or ATM, while Vietnamese banks need pay only $200,000.

Still, the prospect of WTO membership is a big talking point when you ask foreign investors about the renewed interest in Vietnam, and they swear they won't make the same mistakes the second time around. "Foreigners know a lot more about the Vietnamese, and the Vietnamese know a lot more about foreigners," says Scriven of Dragon Capital. The question is: Will that knowledge bear sweeter fruits?

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INTERNATIONAL -- FINANCE

Vietnam Is Hot. Don't Get Burned

Growth is solid, and foreign cash is flooding in, but this isn't the first time

Even by Ho Chi Minh City's increasingly hedonistic standards, it was a pretty good bash. In late March more than 200 guests thronged the ballroom of the five-star Caravelle Hotel, downing champagne and feasting on smoked salmon, banana flower salad, and the Vietnamese soup called *pho*. The occasion? The inauguration by International Data Group Inc. of its $100 million IDG Ventures Vietnam (**IDGVV**) private-equity fund and the unveiling of its first two investments in local software enterprises.

"The Timing is Right"

IDG isn't the only group that has recently rediscovered Vietnam. In the past 18 months, a gusher of new money has flowed into that country. The Dublin-listed Vietnam Growth Fund, managed by Ho Chi Minh City-based Dragon Capital Ltd., raised $60 million late last year, which means it now has $200 million to spend on Vietnam investments. It has sunk its money into commercial banks, milk producer Vinamilk, and Vinh Son, Vietnam's first private power producer. The London-listed Vietnam Opportunity Fund (**VOF**) has raised $37 million since 2003 and is on a road show to the U.S. and Europe to drum up as much as $45 million more. "The timing is right today for the fund investor," says Don Lam, managing partner of VinaCapital Investment Management Ltd., which runs the fund and whose net asset value increased 21.5% last year.

Could this be the latest Vietnam bubble? Back in the mid-'90s, when the country's communist government first made noises about opening up to foreign investment, private-equity and pension-fund managers couldn't wait to put their money down. Half a dozen funds raised nearly $400 million. Then, when it became clear that reform would be slow or nonexistent, most pulled their money out. Even Franklin Templeton Investments emerging-market guru Mark Mobius couldn't make things work, and his $117 million Vietnam Opportunities Fund reinvented itself as a pan-Asian Fund.

Investors say that this time things are different -- though skeptics still abound. The government has removed the shackles from the private sector, streamlined some regulations, and is moving ahead with privatization. The economy has seen annual growth of more than 7% for the past four years, while per-capita income has doubled, to $540, in the past decade.

Last year, Vietnam granted foreign companies licenses to invest $4.2 billion in the country -- which, calculated as a percentage of gross domestic product, puts Vietnam on a par with China in foreign direct investment. Exports to the U.S., including coffee, seafood, Nike shoes, and garments, have quadrupled, to nearly $7 billion a year, since a bilateral trade agreement took effect in 2001, and growth could accelerate once Vietnam joins the World Trade Organization, which it wants to do by the end of this year. "The basic drivers of an emerging market are firing more evenly, predictably, and strongly," says Dominic Scriven, managing director of Dragon Capital.

While most of the investment in Vietnam right now is private equity, the government is moving toward creation of a broader capital market. Until now, the Ho Chi Minh City securities trading center, launched in 2000, has been a bit of a joke. It boasts listings of 28 tiny, mostly illiquid companies with a market capitalization of about $270 million. But investors will begin to take the exchange more seriously with several new listings scheduled for this year. The listing of three companies alone -- state-owned dairy Vinamilk and banks Sacombank and Asia Commercial Bank -- could quadruple the market's size. "That will push us over the magic figure of $1 billion," says Jonathan Waugh, director of PXP Vietnam Asset Management Ltd., a closed-end fund with $10 million to invest. "It will encourage larger companies to list and, in turn, stimulate more foreign investors into the market."

In the next two years, the government is also expected to auction off Vietcombank, which has equity capital of $450 million, and Vinaphone, the No. 2 mobile-phone network operator. Meanwhile, private-equity funds are active traders in Vietnam's flourishing informal curb market in shares, which has a market capitalization of about $2 billion.

Eyebrows Rising

But even at this early stage in Vietnam's revival, some are worried that investors' enthusiasm has outrun their good judgment. "We are again approaching a bubble stage where people's expectations are getting unrealistic," says Chris Freund, formerly with the Templeton Vietnam fund and now manager of the privately held $18.5 million Mekong Enterprise Fund, which invests in unlisted manufacturing companies. "Investors incorrectly assume that GDP growth is correlated with high returns."

One investment that raised eyebrows was in Sacombank, Vietnam's largest private bank. When it invited a strategic buyer to take a 10% private stake, Australia's ANZ National Bank outbid Citigroup (**C**) and HSBC (**HBC**) by shelling out $27 million, a hefty 28 times earnings, based on Sacombank's 2004 profit of $9.6 million. ANZ Group Managing Director for Asia Pacific Elmer Funke Kupper admits the price was high but says it was fair: "There are few banks to partner with, so there's a scarcity value to it, and the absolute size of the investment is small." The bidding wars for companies like Sacombank will be all the more fierce, given Vietnam's 30% ceiling on foreign ownership in listed companies.

Meanwhile, Vietnam is hardly an Eden for capitalists. The country's legendary bureaucracy is as labyrinthine as ever, and its legal system opaque, with separate laws for foreign and domestic investors. Corruption remains as big a problem as in the past. And taxes are very high and subjectively applied. One longtime investor, Martin Adams, wound up his Vietnam Fund in 2004, 13 years after its launch, and says investors who bought in the beginning broke even. He now manages the 10-year-old Beta Viet Nam Fund but says while performance has improved, early investors in that fund are still losing money. Every Vietnam investment fund should carry a "health warning," says Adams. The message: Buyer beware.

By Frederik Balfour in Ho Chi Minh City

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INTERNATIONAL -- FINANCE

Online Extra: Banking on Vietnam's Growth

ANZ's 10% stake in the country's No. 1 commercial bank is a bet on the future and the market's potential

Melbourne-based Australia & New Zealand Banking Group in late March became the first foreign bank to buy into a Vietnamese commercial bank. ANZ (**ANZ**) spent $27 million for a 10% stake in Sacombank, Vietnam's largest commercial bank, outbidding rivals HSBC Group (**HSBCX**) and Citigroup (**C**). ANZ Group Managing Director for Asia Pacific Elmer Funke Kupper recently spoke to *BusinessWeek* Asia Correspondent **Frederik Balfour** about Vietnam's fledgling banking industry and why this investment should pay off. Here are edited excerpts of their conversation. (For more on Vietnam's economic resurgence, see BW Online, 4/5/05, **"Vietnam: Vibrancy Revived"**)

Q: What motivated you to take the stake?
A: We have quite a longstanding relationship with Sacombank, as we have for some time been running their ATMs in the local market. It was natural for us when Sacombank looked for a strategic partner to put our hand up and say, how about us?

Q: You certainly weren't the only one interested.
A: No, pretty much everybody was interested in partnering in Vietnam, which isn't surprising given the attraction of Vietnam in the long term.

Q: But you paid $27 million for a 10% stake, which is equivalent to a valuation of 28 times 2004 earnings. Isn't that awfully high for a bank, even in an emerging market?
A: Yes. But there are relatively few good-quality banks to partner with today in Vietnam. And markets like Vietnam are still significantly underbanked, so there is much growth potential. And the absolute size of the investment is modest. Our shareholders don't mind paying high multiples for relatively small investments that are true options for growth.

Q: There are still lots of restrictions on what foreign banks can do in Vietnam, right?
A: Yes. There are three worth noting. One: Each new branch and off-site ATM of a foreign bank requires an allocation of capital of $15 million [while local banks pay only $200,000]. This makes expansion beyond a few branches and ATMs uneconomic.

Two: Non-U.S. and non-EU banks can only take local-currency deposits up to 50% of their in-country capital [the capital of the banks actually held inside Vietnam, i.e. their registered capital, which in the case of ANZ's two branches is only $50 million]. There are restrictions on American and EU banks, but they're at multiples of other foreign banks [Note: The U.S. and EU have reached a special deal with the Vietnamese government through bilateral trade treaties that allows them to lend a higher percentage of their capital, but they're still subject to restrictions that Vietnamese banks aren't.]

Three: Foreign banks cannot take hard-currency deposits from Vietnamese individuals.

Q: Do you think the ceiling on foreign ownership of local banks [currently set at 30% in total, and 10% for a single investor] will be lifted?
A: Maybe in three to five years. This is consistent with the gradual opening of the market. Then we would be interested in increasing our stake in Sacombank.

Q: Isn't transparency a big problem? How did you value Sacombank?
A: Well, the bank is small and organized in a relatively simple way, so it didn't take that long for us to get a good understanding of its credit portfolio. We don't think it's particularly risky, and we have done due diligence. If it were a larger, state-owned bank, then it would be another story.

Q: What overlap will there be between ANZ's Vietnamese business and Sacombank's?
A: We see these as separate brands. We're happy to have two brands in one market, as we've done in New Zealand and Indonesia. In Vietnam, ANZ has served international networks, multinationals, trade, and a modest-size personal-banking type business. But there are restrictions on what a foreign bank can do. So we're taking an option to participate in growth of a local bank.

If you want to be a local bank, partnering makes sense to get around restrictions and be truly local. At the end of day, local banks dominate retail banking in most markets as they mature. This is true in virtually every country.