



Newsletter

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Key Points and Risk Management for M&A Targeting Vietnamese Companies

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1 Opening Remarks

Even during the COVID-19 pandemic, interest in the Vietnamese market has remained strong among Japanese companies. Many Japanese companies considering entering the market are eyeing active cooperation with local companies, with the goal of gaining efficiency by leveraging their existing local networks and licenses.

From the Vietnamese viewpoint, many companies are experiencing a shortage of funds, etc. as a result of the pandemic and expectations are high for investments by and joint ventures with foreign investors.

In this newsletter, we discuss key points and risk management issues for making investments in Vietnamese companies, in particular through partial acquisitions and joint ventures.

2 Overview of Investment in Vietnamese Companies

The flow of a generic M&A transaction is as follows:

- (i) Initial considerations (e.g., selecting the target company, licensing requirements and transaction structuring)
↓
- (ii) Conducting due diligence
↓
- (iii) Execution of equity transfer agreement / joint venture agreement, etc.
↓
- (iv) Closing; administrative procedures

Whilst the overall transaction flow is the same as in domestic M&A deals in Japan, there are also points of difference worthy of particular note, such as Vietnam's foreign investment regulations, obtaining approvals for acquisitions, and registration procedures with supervisory authorities.

The following explanation is based on the acquisition of equity in a Vietnamese limited liability company, a common type of M&A transaction for Japanese investors in Vietnam.¹

3 Initial Consideration

(1) Selection of target company

When selecting a target company for investment, investors may use consulting companies, etc. to introduce target candidates or explore the possibility of investing in a company with which they have an existing business relationship.

When using a consulting company, etc., the first evaluation is conducted on the basis of anonymous materials, with a subsequent more detailed review carried out on the basis of detailed information provided after entering into a non-disclosure agreement (NDA).

As discussions progress further and the process moves on to due diligence, which is discussed below, and the preparation of transaction agreements, in some cases the basic terms and schedule of the investment are agreed upon through a letter of intent (LOI) or memorandum of understanding (MOU); an LOI or MOU may be non-binding or include some binding terms, such as an exclusivity period or break fees.

(2) Consideration of structure

The initial stage must include consideration of the specific structure and order of the investment procedure and the form of the investment, such as an equity transfer, business transfer, merger, or company split.

As the procedure for change of registered investors of a Vietnamese corporation is likely to take several months to complete, in some cases to effect a quick acquisition an interim holding company is established outside Vietnam by the existing shareholder to hold the shares in the Vietnamese company, and the shares of that holding company are transferred to the new investor.

(3) Survey of related regulations

The initial consideration of an investment in a Vietnamese company must include confirmation of the applicable foreign investment laws and regulations to ensure that the envisioned business can be conducted as intended.

Whilst the Vietnamese market has become more accessible to foreign investors since Vietnam's entry into the WTO in 2007, there remain some business areas where foreign investment is not allowed or is restricted. Many local companies hold registrations in several business areas, including areas in which they are not conducting business, and some of those inactive areas may be subject to a prohibition of or restriction on foreign investment or on participation by foreign investors in company management.

¹ A Vietnamese company can be a limited liability company or joint stock company; limited liability companies are far more common as a joint stock company requires at least three investors, among other reasons.

In addition to confirming foreign investment regulations, in order to avoid misunderstandings it is also advisable to have a high-level understanding of the basic differences between the Vietnamese and Japanese legal systems; for example, private ownership of land is permit in Japan but not in Vietnam.

Investors may also have to address anti-trust issues under the Law on Competition, which is equivalent to the Japanese Act on Prohibition of Private Monopolization and Maintenance of Fair Trade. The Law on Competition provides that “a direct or indirect acquisition of all or part of the capital or assets of another company with the result that a company can control or dominate the other company or any business area of the other company”² constitutes “economic concentration”,³ and that if an equity transfer is “economic concentration” and any of the following thresholds apply, then notice to the Vietnam National Competition Commission⁴ is required.⁵ The Commission will then conduct an investigation based on the notice, and the proposed transaction will be classified as (i) a permissible economic concentration, (ii) a conditionally permissible economic concentration subject to the satisfaction of certain requirements, or (iii) a prohibited economic concentration.⁶

Economic concentration thresholds

- (i) The company or the consolidated group to which the company belongs has total assets of three trillion Dong or more in the Vietnam market in the fiscal year preceding the year in which the “economic concentration” is scheduled to occur;
- (ii) The company or the consolidated group to which the company belongs has a gross revenue or gross trading volume for purchases of three trillion Dong or more in the Vietnam market in the fiscal year preceding the year in which the “economic concentration” is scheduled to occur;
- (iii) The value of the transaction constituting the “economic concentration” is one trillion Dong or more;
or
- (iv) The companies to be parties to the “economic concentration” transaction have a combined share of 20% or more of the related markets [in Vietnam] in the fiscal year preceding the year in which the “economic concentration” is scheduled to occur.

4 Conducting Due Diligence

(1) Overview

Due diligence (DD) is the process of identifying risks associated with an investment. The common approach is to conduct DD of the target company from legal, accounting and tax perspectives and base further consideration of the transaction and its structure on the results.

(2) Key points for legal DD

The following are examples of issues commonly detected in legal DD in Vietnam.

² The cases where a company is considered as “controlling or dominating another company or any business area of another company” are provided in Article 2.1 of Decree 35/2020/ND-CP.

³ (Article 29, paragraph 4 of the Law on Competition)

⁴ At the date of this memorandum the Vietnam Competition Commission has not been established so the dossier must be submitted to the Vietnam Competition and Consumer Authority.

⁵ (Article 13, item (i) of Decree 35/2020/ND-CP)

⁶ (Articles 14, 15, and 16 of Decree 35/2020/ND-CP, and Article 41 of the Law on Competition).

- (i) Company's establishment and management:
 - The company's business lines have not been properly registered with the competent Department of Planning and Investment ("DPI");⁷
 - The company's information specified in its Enterprise Registration Certificate ("ERC") does not correctly reflect the current situation;
 - The company has not obtained a business license required to conduct any of its businesses; and
 - The registered business purposes include a business which is subject to foreign investment regulations.
- (ii) Status of the existing owners' investment:
 - The existing owner(s) has/have not invested all or part of the capital stated in the articles of incorporation
- (iii) Compliance and legal violations:
 - Compliance violation (most notably bribery) and violations related to intellectual property
- (iv) Validity of material agreements and change of control:
 - A material agreement, such as a loan agreement, has not been validly executed
 - Existence of change of control provisions⁸
- (v) Restrictions on land -use rights:
 - Certificate of land use right, ownership of residences or assets attached to land (a so-called "Red Book") has not been issued
 - Existence of a security interest or other encumbrance or defect relating to land-use rights or building ownership, etc.
- (vi) Disputes, including potential disputes:
 - Risk of disputes related to labor or environmental obligations

Normally, DD is conducted after agreeing a scope and time period with the seller/target company. However, Vietnamese companies can sometimes fail to understand the need for DD and may not disclose requested documents in a timely manner, so it is crucial to communicate the purpose and importance of DD and the need for full and prompt disclosure.

For accounting and tax DD, it is not uncommon to discover the existence of dual bookkeeping, or unpaid taxes or insurance premiums and it is necessary to work with professionals in those and other areas for efficient DD.

If the DD shows the acquisition of the target company's shares would be difficult, it is possible to consider other options such as establishing a separate corporation and transferring the target company's business to the new corporation, or, if the target company is a transaction partner in need of funding, providing a loan, etc. of operating funds.

5 Execution of Equity Transfer Agreement / Joint Venture Agreement

(1) Overview

The next step is for the parties to draft and execute an equity transfer agreement based on commercial considerations and the results of DD. In a partial investment, this step will also include executing a joint venture/shareholder agreement with the existing equity holder regarding how the company will be operated after the investment has been made.

(2) Drafting/Execution of Equity Transfer Agreement

When drafting the equity transfer agreement, particular importance is placed on setting out the obligations and rights of each party, in particular addressing issues identified in DD, conditions precedent for closing,

⁷ In Vietnam, companies are required to register their business lines with the competent DPI in order to operate the businesses.

⁸ Provisions for termination of an agreement or obligation on a change of control of a party and requiring the approval of or notice to the agreement counterparty for the change of control.

representations and warranties, and covenants, in addition to general provisions such as the transfer price, dispute resolution procedures, and the governing law and language of the agreement.

The conditions precedent for closing commonly include obtaining any required regulatory approval for the acquisition and any consent from the counterparty where a contract has a change of control clause, and delivery of the Red Book, etc.

It should be noted that the transfer price must be agreed and paid in Vietnamese Dong for equity transfers of Vietnamese companies, whether between residents or between a resident and a non-resident⁹.

(3) Drafting/Execution of Joint Venture Agreement, Shareholder Agreement

When drafting a joint venture agreement and shareholder agreement, it is essential to ensure adequate and effective participation in the decision-making process of the joint venture company. Specifically, it is important to decide on the scope of veto rights over important management issues, methods of appointing officers, and restrictions on transfers of equity, etc., in addition to general provisions such as the share of voting rights in a general shareholders' meeting.

There have been cases where, after entering into a joint venture, even if the officers are appointed by the Japanese investor, the Vietnamese partner nonetheless has actual control over practical operations due to their fluency in the local language and better understanding of the local business environment. As such, management structure needs to be considered carefully to ensure the effectiveness of operations after the joint business has commenced, and provisions in respect of the parties' rights in the shareholder agreement/joint venture agreement be clear and unambiguous.

The charter of the target company must also reflect how the company is to be operated post-investment and so also be agreed before closing.

6 Closing

Closing is the series of procedures for executing and completing the investment, including the actual transfer of equity and payment of the purchase price or investment capital.

The following is an overview of the administrative procedures required for a foreign investor to make an investment in a Vietnamese company.

- (i) Obtaining approval for the acquisition (see below)
- ↓
- (ii) Establishing a Direct Investment Capital Account (DICA) or Indirect Investment Capital Account (IICA)
- ↓
- (iii) Money transferred to the DICA or IICA is transferred to the account of the target company or the account of the seller
- ↓
- (iv) Application for modification of ERC, notification of registered information of target company
- ↓
- (v) Application for registration of corrected information on the National Business Registration Portal

Obtaining approval for an acquisition under (i) above is required under the Law on Investment ("LOI") if a foreign investor acquires equity in a Vietnamese company and the target company falls under any of the following cases¹⁰:

⁹ (Article 10, paragraph 3, item (b) of Circular No. 06/2019/TT-NHNN)

¹⁰ (Article 26, paragraph 2 of the LOI)

- (a) Investment by a foreign investor in a company conducting business in a business area subject to conditions applicable to foreign investors will result in an increase in foreign investor ownership in the company;
- (b) In certain cases as specified in the LOI, where an investment will cause over 50% of the company's charter capital to be held by foreign investors or an "economic organization with foreign investors"¹¹; or
- (c) If the foreign investor is investing in a company which holds rights to use of land in areas affecting national security, etc.

In the case of (ii) or (iii) above, the investment by the foreign investor must be made through a DICA established by the Vietnamese company or an IICA established by the foreign investor, depending on the proportion of the shares of the target company to be held by the foreign investor;¹² particular care is necessary as this type of regulation does not exist in Japan.

6 Final Remarks

An M&A transaction generally involves a complex mix of commercial and legal considerations and it is not uncommon for the process to take at least six months from the initial approach to the seller, etc. to completion. Whilst Vietnamese business owners generally wish to conclude the procedures quickly, their knowledge of international transactional procedures is often limited, which makes smooth and effective communication critical in the DD process and preparation of transaction agreements.

¹¹ As specified in clause 1 Article 23 of the LOI

¹² (Circular No. 05/2014/TT-NHNN and Circular No. 06/2019/TT-NHNN)

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