Harsh M&A lesson for local producers

By Thanh Oanh

Photo: Le Toan

Despite Sunhouse's previous M&A successes, the home appliance manufacturer had failed to evaluate its partner's expertise and financial potential

Local enterprises need to be careful with co-operation proposals through merger and acquisition deals from foreign investors in order to prevent speculation, according to one group that suffered from just that fate.

Domestic appliance manufacturer and distributor Sunhouse Group JSC was a victim of such speculation, after it was revealed that the overseas partner did either not have the money or the expertise but still conducted the merger and acquisition (M&A).

The information was shared by Nguyen Xuan Phu, chairman of the Management Board of Sunhouse Group at a recent workshop themed on Vietnam welcoming foreign investment inflows and the prospects and difficulties therein.

Phu said that Sunhouse decided to team up with a partner from South Korea to establish joint venture Narae Sunhouse System JSC last year. The two aimed to build a microchip manufacturing factory located at Ngoc Liep Industrial Zone in Hanoi's Quoc Oai district.

At the time, Sunhouse expected that this tie-up would be a stepping stone for the company to meet Samsung's criteria for first-tier vendors to produce high-tech products such as microchips for smartphones, televisions, and air conditioners.

"Sunhouse, with a lack of experience in this particular field, decided to hold 49 per cent stake in the venture and put entire trust in the South Korean partner," Phu said.

However, during the process, Sunhouse found out that its partner was not experienced in the sector either, and boasted only limited financial capability. The South Korean partner even planned to abuse Sunhouse's strength, Phu said, and mobilise loans from domestic banks to develop the project. The refusal from the banks caused the project to fall to a standstill. "At the time, the expenditure for machinery lines and land access cost around VND200 billion ($8.69 million). In order to salvage the situation, Sunhouse was forced to acquire stakes from the South Korean partner," Phu said.

After that purchase, challenges continued to pile up when Sunhouse expressed intention to co-operate with a domestic partner to manufacture microchips for LG's mobile phones. "When this partner visited the factory, he found that the capacity of all machine lines imported from the South Korean partner was so low, they couldn't possibly meet the demand on manufacturing the microchips," Phu explained. "This was a really harsh lesson for Sunhouse, even though the company has had extensive experiences in M&A in the past."

Sunhouse acquired Saigon Maritime JSC, a subsidiary of Vietnam National Shipping Lines (Vinalines) at the end of 2011. Two years later, Phu bought over 2.6 million shares of Son Ha International JSC for VND7.7 billion ($334,782) to become a large shareholder in this Asia leading manufacturer of inox household and industrial products.

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> CEO
> Vietnam RECOF Corporation

Lurking pitfalls

News of the failed M&A deal is an alarm bell for domestic enterprises when choosing foreign partners via this investment channel.

"The shifting wave of foreign investors opens massive opportunities for local enterprises. However, the risk is much larger if these enterprises fail to evaluate the expertise and financial potential of the investors. Approximately 70 per cent of proposals are either fake or to abuse domestic businesses," Phu insisted.

According to Samuel Son Tung Vu, lawyer at consultancy firm Bae, Kim & Lee Vietnam, Vietnamese laws regulate foreign direct and indirect investment under both laws on investment and ordinance on foreign exchange, and its implementing decrees and circulars. Vu explained that, in general, it is not uncommon to see investors raise funds elsewhere to make a short-term investment.

However, in order to raise funds within the territory of Vietnam itself, they are subject to requirements and regulations under the Law on Securities. Thus, it is uncommon for foreign investors to raise funds here, instead they establish a special purpose vehicle or a fund in another country where they are licensed, and use such special purpose vehicle or fund as the immediate investor in Vietnam.

Besides the legal barriers, Vu added, the costs of borrowing in Vietnam are usually higher than other countries.

"In the speculation scheme, the creditor may face a high risk on their investment. And they should be wise when reviewing the feasibility of the investment scheme on several aspects such as what are the collaterals, what would be the expected earnings, and what would be the capacity to pay out dividend," Vu said.

He further noted that under the current regulations, strategic investors into certain types of company such as credit institution and insurance companies are required to show proof of healthy financial status, including presenting the audited financial statement to the licensing authority. Unfortunately, in the case of simple manufacturing companies, there is no such requirement.

"In the global market, it is not uncommon to have speculators or hedgers instead of investors, but it is very difficult to make a clear legal distinction. In a typical speculation/hedge scheme, the risks are shifted to those who actual finance the scheme so they should be aware of the risks," Vu noted.

Lawyer Truong Thanh Duc, chairman of BASICO law firm said that the regulatory bodies do not regulate the tie-up between sellers and buyers. In this case, Sunhouse is just unfortunate to have such a foreign partner. It is crucial that the Vietnamese firm needs to have specific terms in the contract to support themselves in case of failed M&As with foreign ones. Otherwise, they just lose the M&A game.

Building barriers

In the period before the COVID-19 pandemic broke out, the capital volume in terms of contribution and share purchase made up a massive part in the foreign direct investment capital.

Specifically, in 2019, overseas investors poured $15.47 billion in M&A deals in Vietnam, up 56.4 per cent on-year and accounting for 40.7 per cent of the total registered capital. However, in the first six months of this year, foreign-invested capital via capital contribution or share purchases was $3.51 billion, only 43.2 per cent of last year's figure due to pandemic impacts.

Despite the decline, there is a number of M&A deals in the pipeline as many cash-starved Vietnamese companies seek funding from foreign buyers to overcome their difficulties in the midst of the pandemic.

Thus, there are some proposals to halt M&A deals involving such buyers during this tough time.

Commenting on the matter, Masataka Sam Yoshida, CEO and head of the Cross-border Division of Vietnam RECOF Corporation, told *VIR*, "Once such a crisis affecting heavily the corporate performances occurs, it is a natural tendency that the government feels obliged to protect local companies against foreign ones. In every extent, this is the duty of each country's government."

On the other hand, he added, it is also true that people should examine the importance and the previous contribution of foreign investments to the country's economy.

"This will depend on each country, and the government should have the capability of analysing and filtering the nature of such investments which will be divided simply into two categories – those with good intentions, and those based on bad faith," he added.

The former category is an investment with a purpose to realise a real and solid partnership which will bring mutual and strategic benefits so that every stakeholder can win.

The latter is a solely return-oriented investment which aimed to buy cheap and sell high. Such investors, Yoshida explained, would want to enjoy today's profit for themselves and leave tomorrow's loss to the counterparty.

"Needless to say, in a recession period, I personally see many companies going into bankruptcy. Thus, although a highly cautious inspection from the government would be essential, it would be very dangerous if government officials come to the conclusion that they have to shut the doors to all possible options," Yoshida concluded.■