In the fourth and final installment of our analysis of Vietnam's coast as a way for investors to profit from the huge growth in Chinese consumers, we look at how investors can enter the market. Investing in an existing project, working with provincial governments to get unallocated land, or buying a resort in operation all have different advantages and disadvantages. We provide a blue print on investing in Vietnam's coast and also show how the $4.1 billion Ho Tram Strip project implemented the blue print.

# Vietnam's Coastal Tourism Growth is Inevitable: Why, Where, When and How to Enter the Market

## Part IV - How

## A Blueprint for Investment & A Case Study of the Ho Tram Strip

May, 2012

**MGT Management Consulting**

**Quantify Your Strategy**

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# A Blueprint for Investment &
# A Case Study of the Ho Tram Strip

*MGT Management Consulting has no affiliation with Asian Coast Development Ltd., MGM Resorts International, or any entity or person involved in the Ho Tram Strip project. We have not had discussions with anyone concerning this report and all information contained is conjecture of MGT Management Consulting from public information.*

**The Blueprint**

In Part I of this series, we explained our expectations for tourism growth in Vietnam using Mexico during the 1960's, 70's, and 80's as our model for determining the shape of the expected demand curve of Vietnamese tourism. Part II of the series disclosed three locations inside Vietnam with different competitive advantages and disadvantages. Finally, Part III identified an arbitrage opportunity for investors outside of Vietnam with sources of cheaper capital than available to Vietnamese developers. Now we provide a simple framework for investors entering the Vietnam market and demonstrate how a newly formed Canadian company with no other resort development projects used the method to build the largest integrated resort in Vietnam and why they did it.

***Step 1: Acquire Land Cheap***

A. Choose a Location

   As we saw in Part II, developers should choose location based on their target customer and the cost of their capital. Companies with higher cost of capital cannot wait as long for demand to grow, they need to choose locations such as Danang (which will have the greatest and fastest growth from Chinese tourists and first time visitors to Vietnam) or in the south, near the large population center of Saigon. But there remains a cost trade-off since these locations are more expensive, so those companies also are more likely to work with provincial governments to acquire land. The south central region has infrastructure in place already, but Cam Ranh and Ninh Thuan have very little development. Phu Quoc Island's International airport opens December 2012, but it is furthest from the China border. In the south, reaching the beaches near Saigon by road remains problematic. Danang is closest to China, but land is already more expensive unless you begin moving north to where the weather is worse and drive times from the airport longer.

B. Sources of Land

   Investors can enter the Vietnam market in three ways, each with advantages and disadvantages.

   i. Unclaimed or underdeveloped land obtained from the provincial government.

      *Advantages:*

- This is the cheapest source for land in Vietnam.
- Depending on the size of the project, the provincial government will support the development venture with infrastructure or incentives.

*Disadvantages:*

- The process for obtaining investment licenses and going through land clearance can take years and significant amounts of money. Success is never guaranteed.
- The total cost for clearance is unknown and difficult to forecast.
- By this time, you will be choosing land with obvious disadvantages like being far from utilities, roads, and airports.[i]

ii. Land already allocated to a Vietnamese company.

*Advantages:*

- Cost certainty. Land clearance has been completed, licenses should be in hand.
- Possibly cheaper. Vietnamese companies have a competitive advantage over foreign developers by using lower cost legal representation, labor, and office space.

*Disadvantages:*

- Paying a premium to the company holding the investment license.
- The development clock has started ticking (see Step 2).

iii. Purchase an existing resort.

*Advantages:*

- Already in operation. Will provide some operating income.
- No pressure to begin building. Can redesign the resort later when demand has increased.

*Disadvantages:*

- Difficult to find a resort that meets your investment criteria.
- Cost of purchasing buildings and then tearing them down to rebuild.
- Will have to pay for the operations as well as land.

Our opinion is that the trade-off between choosing working with the government versus purchasing or partnering with a Vietnamese company has shifted dramatically in the last year to the side of purchasing an existing Vietnamese development project. The reasons why:

1. Most of the good beach land already has been leased.
2. We predict a fundamental change in the attitude of those citizens cleared off land for a new development. Two significant protests in the north signal that Vietnamese residents want a larger share of the increased value of the land from land transfers. In the past, the benefit of the land's increase in value has gone to the new developer (and perhaps indirectly to the officials making the decisions). This shift will cause longer delays and increased costs.[ii]

3. Pressure on the Vietnamese developers who hold investment licenses to build while at the same time the government placed policies making it nearly impossible to get capital for projects.
4. Provincial governments have made promises to large projects that were later not fulfilled. This is especially true for casino licenses.

If working with the provincial government is chosen, then a key success factor is to keep costs as low as possible during the time it takes to acquire and clear the land. Using resources within Vietnam for legal and consulting work can be less expensive than hiring or bringing in a development team early in the process. It is also possible to negotiate other concessions from the provincial government[iii]

***Step 2: Wait as Long as Possible to Build***

A. Wait to Build

With very low land acquisition cost, the significant capital expenditure of a resort project in Vietnam is construction cost. Assuming that low demand in the next few years will not yield the cash flow to pay for the opportunity cost of capital, then it makes financial sense to delay investment in building as long as possible. This is happening all along the coast, and the Vietnamese government has noticed. They have begun to put pressure on companies with investment licenses to begin building or lose their license.

B. Build in Phases

Developers can reduce the cost of capital by building their development in phases which reduces the early use of capital, keeps operating costs lower once opened, and provides operating profits to fund the building of later phases. The phased approach also enables developers to sell off parts of their projects to others developers in the future when land value appreciates.

A key question in 2012 is whether the owners of undeveloped beach land wait because their project would have a negative discounted cash flow valuation, or if they delay to maximize value. Our opinion, based on our research in Parts I and III, is that nearly all developers would begin building immediately if faced with the choice of lose their land or start building[iv]. The closer the land is near an international airport (Danang, Nha Trang, HCMC, Phu Quoc), the more likely they would begin development. Those choosing not to build would immediately look for outside investors with access to cheaper capital to transfer land rights, and the outside investor would begin building immediately. If this is true, then as Vietnamese developers face high costs of capital and government pressure to begin spending on development, land transfer prices will fall, creating opportunities for outside investors to acquire cheap land in Vietnam in anticipation of greater demand from Chinese (and other) tourists in the future.

We analyzed the effect of various WACCs to look at the relative impact in the delay of demand.[v]

**Table 1: Equivalent RevPar**

| WACC | Yr 1 | Yr 2 | Yr 3 | Yr 4 |
|---|---|---|---|---|
| 0% | $300 | $300 | $300 | $300 |
| 12% | $336 | $376 | $421 | $472 |
| 15% | $345 | $397 | $456 | $525 |
| 18% | $354 | $418 | $493 | $582 |
| 21% | $363 | $439 | $531 | $643 |
| 24% | $372 | $461 | $572 | $709 |

For example, a 500 room resort needing an average RevPar of $300 (discounted at WACC) to have a positive NPV, the above chart shows the equivalent RevPar for different years and at different cost of capital.

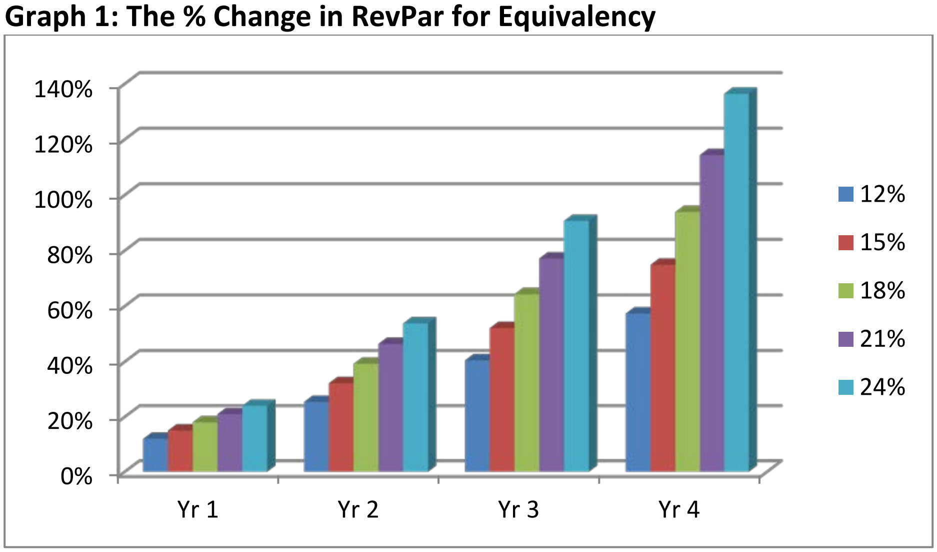
If we assume the price for resort rooms are set by the market and not flexible, then we can hold room revenue constant and determine the change in occupancy rates to achieve the equivalent of a 50% occupancy rate in the future at various WACCs.

**Table 2: Equivalent Occupancy Rates**

| WACC | Yr 0 | Yr 1 | Yr 2 | Yr 3 | Yr 4 |
|---|---|---|---|---|---|
| 12% | 50% | 56% | 63% | 70% | 79% |
| 15% | 50% | 58% | 66% | 76% | 87% |
| 18% | 50% | 59% | 70% | 82% | 97% |
| 21% | 50% | 61% | 73% | 89% | 107% |
| 24% | 50% | 62% | 77% | 95% | 118% |

The two tables above illustrate the importance of low cost of capital when a resort must wait for future demand and the importance of waiting to build. The relative change in RevPar rises exponentially over time, not linearly.

**Graph 1: The % Change in RevPar for Equivalency**

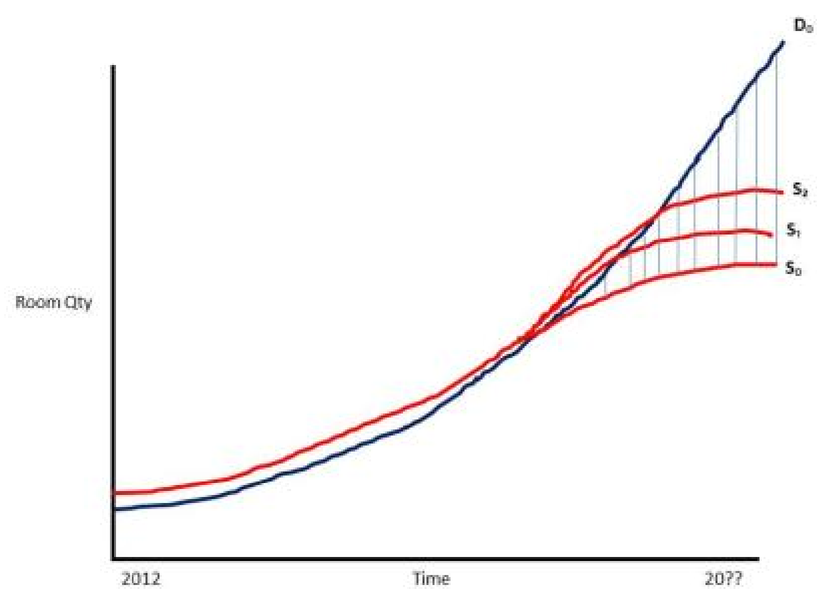



*For example, to provide the same value to a developer with a 24% WACC, RevPar in Yr 1 must increase by 24%. For Yr 4 it needs to have increased by 136% to be equal in value.*

***Step 3: The Payout***

For the next few years, demand will be slightly lower than supply as developers keep building new resorts. Our analysis predicts that eventually the demand for beach resort rooms in Vietnam will surpass the supply,[vi] because at some point in the future, the supply of beach resort rooms will be constrained by the amount of coastline in Vietnam. In the Graph 2, the three different supply curves represent the supply of rooms with characteristics most demanded by Chinese and other tourists. For example, $S_0$ is the supply of resort rooms near major airports, closer to China, in locations with year round warm temperature, and have cultural attractions nearby. The supply curve $S_1$ would be less desirable locations, and $S_2$ would be perceived as less desirable location than the other two. Theoretically, nearly an infinite number of these supply curves occur, not just three. Since the best locations will be developed the quickest, they will also be first to reach maximum supply.

**Graph 2: Exponential Demand Curve for Resort Hotel Rooms in Vietnam**




The shaded area indicates the difference between demand and supply of rooms. It is during this time that RevPar will generate higher than average rates of return. Suppliers on all three curves will benefit from excess demand, but owners of better locations will of course benefit the most and the soonest.

Each developer has their own exit strategy, but whether they sell or continue operating the resort, returns will likely more than make up for the first few years of lower returns, assuming their cost of capital is low enough.

**A Case Study: The Ho Tram Strip**

***Introduction:***
Asian Coast Development (ACDL) was founded in Vancouver, Canada in 2006. The company had one purpose, to find land and develop a resort in Vietnam. Around this time, ACDL established a 100% foreign owned subsidiary in Vietnam called Ho Tram Project Company Ltd., which began negotiating with the Vung Tau/Ba Riang Provincial Government for the investment license on a 164 hectare piece of land with 2.2 kilometers of beach front. In early 2007, they announced a large project called "Vietnam Casino City". In March of 2008, the company officially received the Investment License which stated the investment capital would be $4.2 billion with nearly $800 million in charter capital. At that time, the company raised a little over $25 million from Southpaw Asset Management and some other investors which was added to whatever capital the original owners contributed.

***Step 1: Acquire Land Cheap:***
Ho Tram Beach was empty at that time. It is 130 kilometers south of HCMC, but at the time there were no major roads. Judging from pictures and the amount of time it took to get the investment license, there must have been very little land clearance cost. As Vietnamese began having disposable income for travel, Vung Tau and Phan Thiet gained popularity as a tourist destination for locals and expats. However, Ho Tram Beach was in the middle, unknown and nearly inaccessible. But in 2006, there were no other international airports other the HCMC and Hanoi. A large beach resort project would have had trouble bringing enough people to pay for itself in any other location than within a short distance to the largest city in the country.

During this time, working with the provincial governments was by far the cheapest way to obtain large tracks of land. It cost ACDL between four and five million dollars (US) to obtain the 50 year lease on Ho Tram's 164 hectares of beach land[vii]. Obtaining the land via the government also allowed ACDL to negotiate concessions, and in their case, they received a gaming license. Six years later, they are still the only major developer to receive a casino license[viii] and ACDL expects no other casinos to open in the next five years in Vietnam.[ix]

*Ho Tram Strip in 2008*

***Step 2: Wait as Long as Possible to Build***

With less than 12% of the capital raised by 2008, the company began soliciting the rest during the middle of the financial meltdown. Land acquisition costs were .01% of total investment capital and appreciating in value. There were no suitable roads to bring customers, and the number of customers to begin with was doubtful. The company had very little incentive to spend money on building, other than the pressure from the government. The official groundbreaking ceremony was held in May 2008 and again in July 2009, but construction (slowly) began in mid-2010. By that time they were already in default of the terms on their investment certificate, both for not having the capital and for not beginning development as scheduled. In the summer of 2010, facing the prospect of losing their investment license, ACDL made a deal with New York City investment fund, Harbringer Capital Investments for a convertible bridge loan and equity purchase totally about $55 million. Harbringer's share of the company was substantially over 50% and at a price that upset Southpaw Investment so much that Southpaw took ACDL to court.

With the new capital and a management agreement with MGM Grand signed, building began in earnest. As more capital is spent on construction, the economics shifted to trying and finish the first phase quickly and begin operations. Also, after delays in 2009, the upgrades to the main highway leading to Vung Tau from HCMC (Hwy 51) was now under construction. The new four and six land road are now about 85% complete and scheduled to be finished in first quarter 2013. Not coincidentally, that is when the first of five Ho Tram Strip hotels open.

In May 2011, Pinnacle (PNK Development) purchased 26% of ACDL for $95 million, placing the value of the company at $365,384,615[x]. The infusion of cash from selling equity in the USA has provided the capital to complete phase 1 of the resort complex. The developers chose to build in several stages, the first being a 541 hotel run by MGM Grand and the 2nd stage is another hotel tower and 14 VIP Villas as part of MGM's resort. Once that is completed, they will begin on the 2nd resort, operated by Pinnacle.

Using the valuation from the Pinnacle share acquisition, the debt to equity ratio of the company is under 10%. The company has a $35 million term loan for working capital from BIDV (Bank for Investment and Development Vietnam), but all the rest of the investment is equity from North America. Obviously raising the debt level would reduce the cost of capital, but Vietnamese land cannot be mortgaged outside of Vietnam by law. This is a great indication that the cost of debt within Vietnam is higher than the cost of equity in North America.[xi] Most resort developers have properties already operating outside of Vietnam that they can use as collateral for loans costing less than equity.

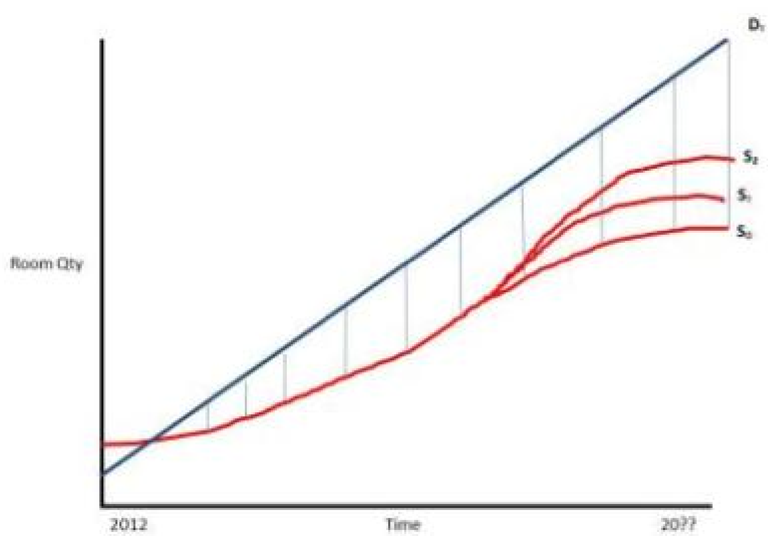
***Step 4: The Payout***

The first hotel (512 rooms) opens in the first quarter of 2013. The hotel will be on a strip of beach more than three hours from an airport and any major population centers. Their number one competitive advantage, a casino, is not an advantage at all with the local population who cannot even walk inside it by law. Mr. Nathan mentions the 8 million Vietnamese who visit Vung Tau every year[xii], but as we pointed out in Part II of this report, these visitors travel to Vung Tau because it is cheap, not to enjoy five star resorts. The MGM Ho Tram's potential market is more likely the Vietnamese and expats who fly to Nha Trang and stay in places like Vinpearl and Ana Mandara Resorts. The majority of the six million foreign tourists who visit Vietnam typically look to experience Vietnamese culture, since beach tourism is still in the infancy stage in Vietnam. Finally, the casino must compete with the new Marina Bay Sands Casino in Singapore and Maccau for high stakes Asian gamblers.

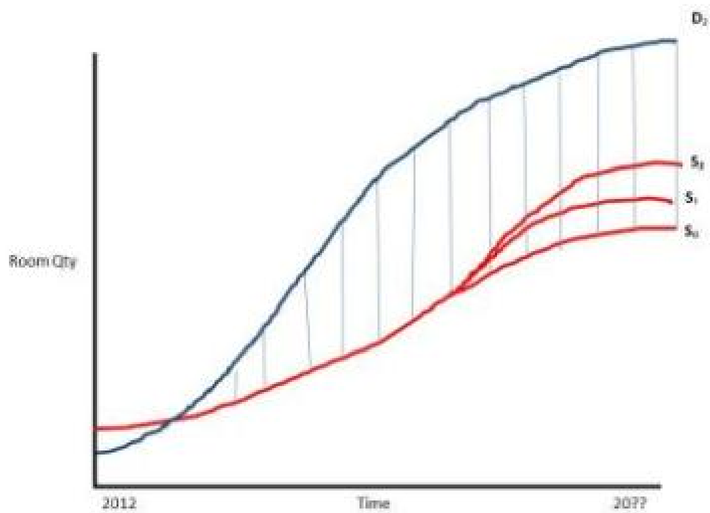
So with these obstacles, how does ACRL expect to get a high return on their investment? As you may have guessed by now, from the growing number of middle class Chinese who will be entering the international travel market for the first time in the next ten years. Being near the HCMC airport (and much closer to the new Long Thanh Airport in 2020), year-round warm temperatures, and most importantly a casino license, moves the integrated resort down towards the $S_0$ supply curve.

We also want to mention that Graph 1 shows the most pessimistic demand curve for beach resort rooms in Vietnam. What would happen if future demand for hotel rooms has a linear or logarithmic demand curve?

**Graph 3: Linear Demand Curve**



**Graph 4: Logarithmic Demand Curve**




If either of these scenarios happens, then ACRL would benefit from an under supply of hotel rooms until other resorts could be built, in addition to the excess demand once capacity is constrained.

By building in phases, Asia Coast Development also will profit by selling or leasing the land for the other three resorts that are planned. Considering the acquisition price of the land, this will be incredibly profitable for the investors.

*MGT Management has had a presence in Vietnam for ten years, seven of those consulting for clients choosing locations for resort developments. We also specialize in creating discounted cash flow valuation models that are integrated into custom management accounting tools, budgets, and tracking reports based on value-added management practices. For more information, visit our website at [www.mgtmanagement.com](http://www.mgtmanagement.com). For questions or to be added to our mailing list, send to* info@mgtmanagement.com.



[i] We believe there is one exception, and that is Ninh Thuan Province. The province is underdeveloped compared to its neighbors Khanh Hoa and Binh Thuan (see Part II). The new coastal highway connects the Cam Ranh Airport to the beaches in under an hour, and in 2012, opens up new coastal areas for the first time.

[ii] We are working on a report that goes into the details about this shift in attitudes of displaced citizens. Our opinion is that we may see the end to state land ownership in the near future.

[iii] From our observations, when expecting new infrastructure to be developed in Vietnam, it is very important to consider the location of the infrastructure in relation to the provincial capital. Part II of our report talks about the importance of provincial governments when considering locations. Within a province, it is also very important to consider distance from the capital of that province. For example, the capital of Khanh Hoa Province is Nha Trang. The capital of Binh Thuan Province is Phan Thiet, and Vung Tau, Danang, Hoi An, and Hue, all provincial capitals. All these places received more infrastructure than any other place in their province. Of course correlation does not necessarily mean causation. However, the experience with developers on Phu Quoc Island has been significantly more difficult. The capital of Kien Giang Province (where Phu Quoc is located), is Rach Gia, located at the opposite end. Quite frankly, investors must understand the motivation of provincial government officials who have interest in seeing the area where they live receive a significant amount of the government funds allocated for infrastructure.

Once again, we have identified one significant exception to this rule, and that is the coastal highway in Ninh Thuan Province which has been identified by the National Assembly as one of five key priorities for funding in 2012. http://vietnamnews.vnagency.com.vn/Economy/224301/irrigation-works-given-priority.html.

[iv] The assumption here is that land acquisition costs are already sunk costs and would not be factored into their decision.

[v] Our assumptions: 500 room hotel with variable costs 30% of revenue. Beginning RevPar was \$300/room, which in the 2[nd] part of the analysis, was broken into a 50% occupancy and \$600 revenue per room night (includes food & beverage etc.).

[vi] When we discuss the supply of rooms, we look specifically at rooms in resort on or very near the beach in Vietnam. Using a very rough comparable, Mexico has 9,330 kilometers of coastline compared to 3,260 kilometers in Vietnam (half of that if we eliminate the north of Vietnam where the weather is not good for beach resorts). China's projected population with disposable income for the first time by 2020 is nearly 400 million people (McKinsey Consulting) while the U.S. population with disposable income growth during its fastest period of growth was less than one quarter of that. So Vietnam has 1/3 the area available for room supply as Mexico, and China will have 4 times the growth in potential demand for rooms as America during the 60's,70's, and 80's.

[vii] Per the share subscription agreement with PNK Development. Actual cost was 71,017,538,200 VND. In reality, they probably had to pay other costs, especially if there were land clearance fees paid to individuals who were living on the land or using the land for their income. Also, two years of negotiations can add significant costs that would not be included in official documents.

[viii] Many other projects have announced they were granted casino licenses by provincial governments, but the National Assembly must approve these licenses. The Vietnam NA has pulled licenses from a competing project in Vung Tau called *Saigon Atlantis*, and later the Polo International *Cali Beach Project* in Ninh Thuan Province.

[ix] From the Lloyd Nathan interview (see xi)

[x] In America, as soon as you drive a new car off the lot, the value decreases substantially. In Vietnam, as soon as you start building, the land increases substantially immediately.

[xi] There have been some discussions about changing this law to help increase the availability of capital to Vietnamese real estate developers, who are being crushed right now by the lack of lending.

[xii] For the complete interview with Lloyd Nathan, , go to
http://www.youtube.com/watch?v=UaW6T12NHwM