VIETNAM PPP

Darco-InfraCo team pioneers water concessions in Vietnam

A Singapore government-brokered partnership between Darco Water Technologies and InfraCo Asia is treading virgin ground for foreign companies in Vietnam. Bearing the demand risk is the price to pay for getting back into the asset ownership business.

This month in Asia Pacific:

Singaporean industrial water engineer Darco Water Technologies is negotiating with InfraCo Asia to create a joint venture which will hold a portfolio of four rural water supply systems in Vietnam. With the first project due to start construction later this quarter, Darco is poised to become the first foreign group to run municipal water concessions in the nation.

Allard Nooy, CEO of InfraCo Asia, a commercially managed development fund (*see box, right*), told GWI that JV negotiations should be finalised within two months. A 50:50 JV would be established in Singapore, and would in turn "invest in a Vietnamese joint stock company, in which a local partner will have a 10% shareholding." The JSC will invest approximately S$50 million ($37 million) in four concessions with a total treatment capacity of 62,000m³/d, serving half a million people. Darco and InfraCo Asia were introduced to one another by IE Singapore, the government agency for promoting the overseas development of Singaporean firms that also helped Memiontec get its Jakarta BOT.

Foreign investment targets in the Vietnamese water sector have to date been limited to provincial utilities and large-scale water treatment plants in the big cities (by Manila Water, Salcon and Acuatico). However, sources involved in projects on the ground estimate that there are dozens, potentially hundreds, of privately owned water treatment plants and networks in the smaller towns, of which the new JV's first project, at 15,000m³/d, will be one of the largest. These small-scale projects are almost all owned by local entrepreneurs who have received investment licences from the local People's Committees under the 'direct investment' rule, through which local governments can avoid the need for competitive tendering. ASX-listed De.mem started off in this space in 2013 (at capacities up to 4,000m³/d), operating under a model where it would control the treatment plants under BOO contracts, and sell water to local partners which billed the customer.

Many foreign investors and banks have been put off from investing in Vietnamese infrastructure projects partly by the scarcity of government guarantees – especially around currency convertibility – and these are now even less likely to materialise, given the fact that Vietnam has almost hit its self-imposed 65% ceiling in terms of public debt (including guarantees) as a percentage of GDP. However, for Darco CEO Thye Kim Meng, guarantees or take-or-pay agreements with utilities were not a requirement for the formation of the JV. "We think it will be less risky here if you are collecting the tariff yourself, because then you don't have to worry about non-payment. Vietnam is a very organised society, and non-revenue water from non-collection is very low."

Thye estimates that investment licences for all four projects will be received ▶

PRIVATE SECTOR SUPPORT

InfraCo Asia dives into water sector

A joint venture with Darco will be InfraCo Asia's first investment in the water and wastewater treatment industry. It will be looking for a quick exit.

InfraCo Asia's first investment in the water sector will see the government-owned firm pick up a 45% stake in a portfolio of Vietnamese projects run by Darco Water Technologies, although some or all of that stake could be put back up for sale within a couple of years.

InfraCo Asia is funded directly by the British, Australian and Swiss governments through the Private Infrastructure Development Group (PIDG), a multilateral organisation owned by the World Bank and donors from seven countries. Its remit is to provide early stage finance to risky but commercially viable infrastructure projects across South and Southeast Asia, and it can potentially exit as early as financial close – although it must make commercial returns.

"We basically put development dollars at risk to de-risk projects. We aim to be a catalyst for private sector capital – both debt and equity – to be raised," CEO Allard Nooy told GWI.

"We get them to financial close, and at that point in time we review whether we are looking for an exit or we stay involved," he elaborated. It has not yet been finalised whether Darco will have an option to buy InfraCo's shares or first right of refusal on a third-party sale.

Last month, InfraCo Asia exited two wind farms in Pakistan with a total project value of $260 million, after just one year of operations, while it divested part of its 70% shareholding in a hydropower plant in Vietnam soon after commercial operations started. Having financed the hydropower plant with debt from a single Vietnamese bank and successfully completed a refinancing deal, Nooy is confident that they will be able to organise non-recourse project finance with local lenders for the Darco projects.

"We are potentially going to work with a local currency guarantor to get a longer tenor in place for the amount of debt that we require," Nooy told us. The inability to hedge or mitigate currency risk has been a problem with some of the tens of water deals which InfraCo has looked at in the last few years, he observed. "If they are not commercially viable, then there is no route to exit for us," he explained.

"Once news of the JV with Darco was in the public domain, the phone didn't stop ringing from other water project developers who want to do other things with us in other countries," said Nooy. ■

within three to six months, and explained that each would serve households and factories, according to tariffs pre-set by provincial governments, with an in-built adjustment mechanism for inflation. Each target district does not currently received piped water service from the local utility, and is dependent on increasingly depleted – and degraded – groundwater reservoirs.

While industrial tariffs are higher than domestic, Thye notes that industrial growth is "less predictable" and that some industries "are reluctant to set up factories" as a result of public fervour against polluting industrialists (fish deaths caused by cyanide and phenol discharged by a Formosa steel plant resulted in mass protests and a $500 million bill last year). Thye's economic calculations are therefore mainly based on residential population growth.

Bulk water from BOTs in similar situations sells for around $0.25-$0.35/m^3, according to GWI's sources, with tariffs rising to around $1.00/m^3 where saline intrusion is a problem and RO systems are needed. Darco expects to be using low-pressure membranes for surface water treatment. With InfraCo's help (*see box, facing page*) Thye hopes to secure local financing to mitigate foreign currency risk, and he observed that, even though "the cost of borrowing in dong is very high, at 8-9%", the projects remain "commercially viable" at the tariffs set by the government.

This deal will see Darco return to the asset ownership business it exited in 2013 when it sold a portfolio of Chinese water assets to Salcon to repay debts following a fraud scandal at a Taiwanese subsidiary (the plants were promptly sold on to BEWG). "Since the Taiwan problem, we have not done any investment because it took time to resolve the issue and the banks have not lent us much money yet," Thye explained to GWI. However, this has resulted in a situation where Darco's debt-to-equity ratio is around 10-15%. "There is plenty of room for more funds," Thye told GWI. "We have already done a private placement for $3 million, and it's our intention to raise more funds at a company level through [another] private placement."

An additional placement is necessary to build liquidity in the stock, according to Thye. "Right now there is not much trade in Darco because most investors are waiting for our story to develop."

That story has come a long way in the last few years. Revenue nearly tripled between 2013 and 2016, reaching S$60 million ($44 million) last year, largely as a result of a merger with Chinese EPC contractor Wuhan Kaidi, which became Darco's largest shareholder in 2015. "Wuhan Kaidi is strong in the zero discharge area for power generation, because they have a licence with Vacom for their vaporisation technology," Thye explained. He acknowledged, however, that "the power industry in China is quite saturated." Darco's core revenue, meanwhile, comes from the electronics market in Malaysia, where "there are not many new projects coming up or new technologies to drive sudden growth. The industrial market is still very competitive, [but] we do not see it as a long-term profit driver," he told GWI.

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>
> Thye Kim Meng, CEO, Darco

"Based on the immediate needs and opportunities, I think we will focus on Vietnam with any money that we raise now," Thye continued, adding that the country "has a very organised governance – their policies are very clear, and they also have an urgent need to develop their country quickly. There is a lot of demand and a lot of interest in investing in Vietnam, but their infrastructure cannot catch up."

In the future, a return to BOTs in China, leveraging Wuhan Kaidi's engineering expertise and sales network. may be on the cards. "When we have raised more interest and we have more funds, then we can also take part in some of the projects in China. Not in the coastal cities, but more in the second- or third-tier cities," Thye concluded. ■

PRIVATISATION

IFC eyes Vietnam water player DNP

Dong Nai Plastic Company, which has built up a portfolio of five water projects and utilities in Vietnam, has piqued the IFC's interest. An equity injection is on the cards.

DNP Water, a subsidiary of Hanoi-listed Dong Nai Plastic Company, is negotiating a convertible loan with the International Finance Corporation (IFC) to support its expansion plans in the water treatment sector.

Le Tuan, investment director at DNP Water, declined to disclose the value of the loan, but confirmed to GWI that a minority equity injection is also possible. The IFC is expected to approve its investment on 30 November 2017. According to Le, DNP Water intends to expand the capacity of its water treatment plant portfolio from 140,000m^3/d today to 240,000m^3/d next year, and to 1 million m^3/d within five years.

Currently DNP Water owns stakes in two operating water treatment plants (Binh Hiep & Dong Tam), and two which are under construction (Nhi Thanh & Bac Giang). It also owns 40% of the water and wastewater utility serving the province of Long An, just south of Ho Chi Minh City, having bought 26% of the utility from Manila Water-backed developer SII in 2016.

Le told GWI that he plans to use the proceeds "to acquire state-owned water companies being privatised", as well as to build and buy water treatment plants.

Acknowledging that local governments find it a lot easier to do direct investments than PPPs under Decree 15, Le explained that his projects are not "BOO or BOT, but freehold", meaning that the developer receives an investment licence from the local people's committee, and is then free to sell the water either to the utility or directly to end-users. Two of DNP Water's projects include a distribution network element, and only one of the four benefits from a take-or-pay contract. "In a lot of cases take-or-pay is not applicable, so the developer has to take on that risk," said Le, stressing that the viability of these projects hinges on the demand for water.

Currently fewer than 20% of Vietnam's water utilities have taken on private capital, but the government plans for all utilities to be 'equitised' by 2020.

In Decree 57 of December 2016, the government pledged to reduce its stake in more than 20 water and wastewater utilities to less than 50% by 2020. The list included Vietnam's largest water utility SAWACO, although Le affirmed that it is "far away and a little too big for us." ■