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Corporate Bond Market Perspective

Real estate-related liquidity issues will drive up corporate bond defaults in 2023, new regulations to provide some relief for VND113 trillion of bonds at risk

We expect liquidity challenges faced by bond issuers will remain elevated as bond maturities peak over the course of 2023. Real estate-related issuers with weak cash resources are most at risk. Decree No. 8 will offer some relief by allowing alternative repayment methods. Proactive and productive negotiation between issuers and investors will be key to avoid defaults.

Corporate bond default rate rose to 10% at end-March 2023, driven mostly by unlisted real-estate related companies with high leverage, limited cash flow and insufficient cash resources to repay. Many succumbed to duration mismatch between their cash flows and bond repayments, and refinancing difficulties as bond market sentiment deteriorated towards end-2022.

We estimate around VND113 trillion of corporate bonds maturing in Q2-Q4 2023 are at risk of default. Real-estate related companies with weak cash flow and cash resources are most at risk. Given the unfavorable market conditions – weak homebuyer sentiment, risk aversion across banks, these companies will struggle to raise new funds to repay maturing bonds in absence of cash flows. Many large corporate groups have sizable bond maturities in 2023, and hence have limited room to support the bond repayments of their related entities.

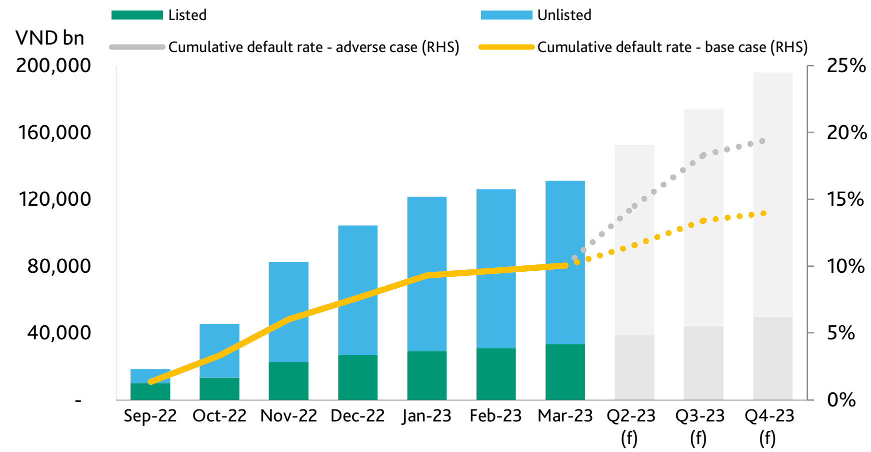
Decree No. 8 implemented by the government in March 2023 will offer bond issuers some relief to resolve repayment issues. A handful of defaulted issuers had obtained approvals from bondholders to either delay repayment or repay in the form of other assets. We expect negotiations to be challenging, particularly for investors to assess the fair value of assets. Until refinancing conditions stabilize, we expect proactive negotiations between issuers and investors ahead of bond maturity will be key to avoid defaults.

We expect a long road ahead before demand for private placement bonds and risk awareness among retail investors improve in a meaningful way. Decree No. 8 also rolled back the implementation of stricter eligibility criteria for individual bond investors and mandatory credit ratings by a year to January 2024. Without these stringent requirements, it is critical for bond issuers to provide timely and comprehensive information for investors to understand and assess investment risks, and in turn, support the recovery of market confidence. We expect outstanding corporate bonds to decline to 11% of GDP by end-2023 due primarily to lackluster investor demand.

Corporate bond defaults rose significantly to 10% as of the end of March 2023

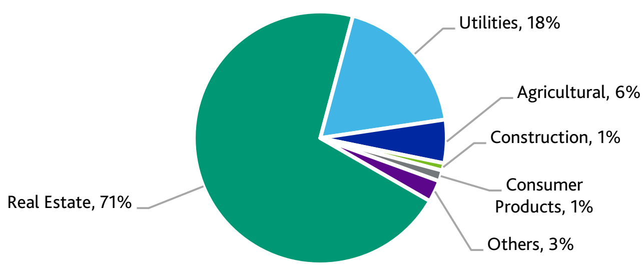
- Based on publicly available information[1], we estimate the default rate of corporate bonds had risen to 10% at end-March 2023, from 1.2% at end-Sept 2022 (Exhibit 1). Our estimate excludes undisclosed corporate bond defaults prior to Sept 2022 and undisclosed cross-defaults.
  - 71% of the bond defaults are real estate-related (Exhibit 2) - mostly unlisted fundraising entities of developers; with high leverage, limited cash flow and insufficient cash resources to make interest or principal repayments when due. Default rate for sector was 17% at end-March 2023 (Exhibit 3)
  - Almost all utilities sector bond defaults were related to companies developing new wind and solar power generation projects and facing difficulties commercializing their projects. Default rate for sector was 31% at end-March 2023.
- Close to 95% of bond defaults were due to issuers not fulfilling their coupon payments on due dates. We view this to be reflective of the weak cash flows of the issuing entities.

Exhibit 1
Default rates reached 10% at end-March 2023



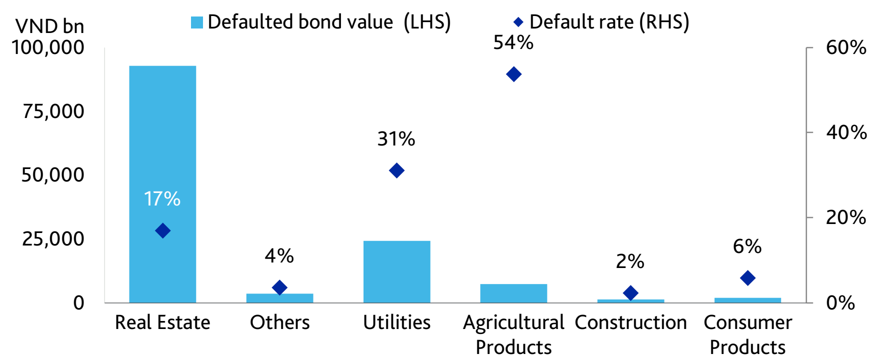
Note: For base (adverse) case, we assume 25% (75%) of total debt at risk to default over Q2-Q4 2023. Refer to Appendix for details on our assumptions
Source: HNX, Vietnam Investors Service

Exhibit 2
Almost 90% of defaulted bonds from real estate and utilities sectors



Source: HNX, Vietnam Investors Service

Exhibit 3
Default rate by sector at end-March 2023



Source: HNX, Vietnam Investors Service

[1] Includes disclosures on Hanoi Stock Exchange (HNX) and media reports

» As shown in Exhibit 4, a substantial number of 73 defaulted bond issuers had weak financial strength, particularly the unlisted issuers. In addition to high leverage and weak profitability, most did not have sufficient cash resources to meet debt repayment obligations.

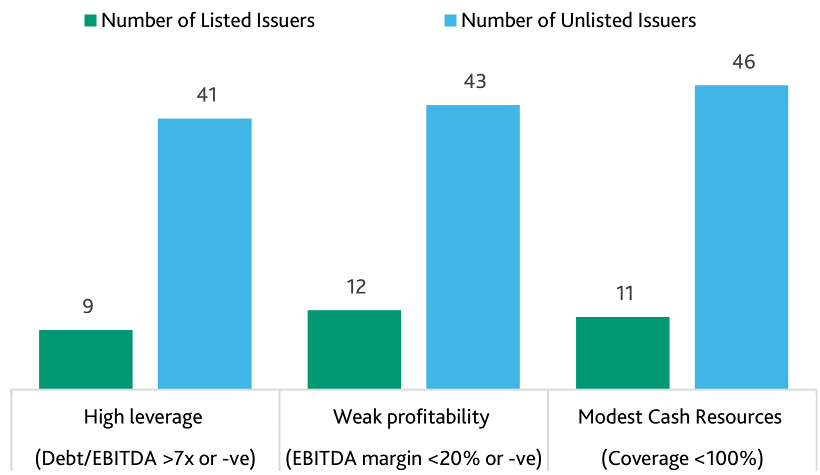
» We note most of the defaulted bond issuers succumbed to duration mismatch between their business cash flows and bond repayments and the eventual refinancing difficulties when bond market sentiment weakened, and market activity collapsed towards the end of 2022.

» Many of the real estate-related bond issuers that defaulted are fundraising entities that issued 1Y-3Y bonds for specific long-term development projects relating to large developer groups (Exhibit 5).

» Many defaulted bond issuers have outstanding loans with banks. We estimate the total loans to defaulted issuers are less than 1% of banking system loans. The overall impact on bank asset quality will be manageable as bank loans to real estate-related entities are typically secured by real estate assets.

Exhibit 4

73 defaulted issuers: weak financial strength to meet debt obligations



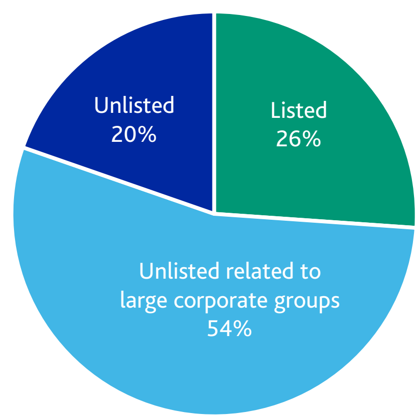
Note: Refer to Appendix for details on our analytical framework

Source: HNX, Vietnam Investors Service

Exhibit 5

Majority of real estate-related defaulters are listed entities or related to large corporate groups

% of value of defaulted bonds

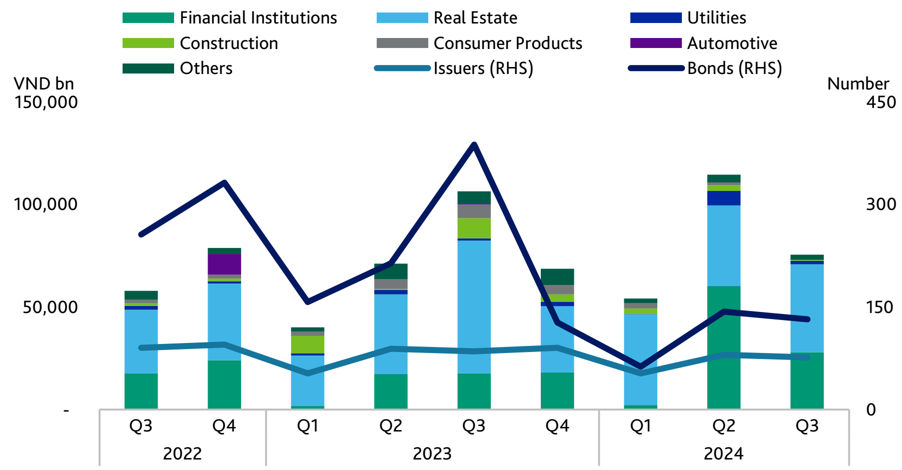


Source: HNX, Vietnam Investors Service

Of the VND252 trillion worth of corporate bonds maturing in 2023, we assess around VND113 trillion (45% of maturing bonds) are at risk of default, mostly attributable to unlisted real-estate related companies with weak cash flow and cash resources

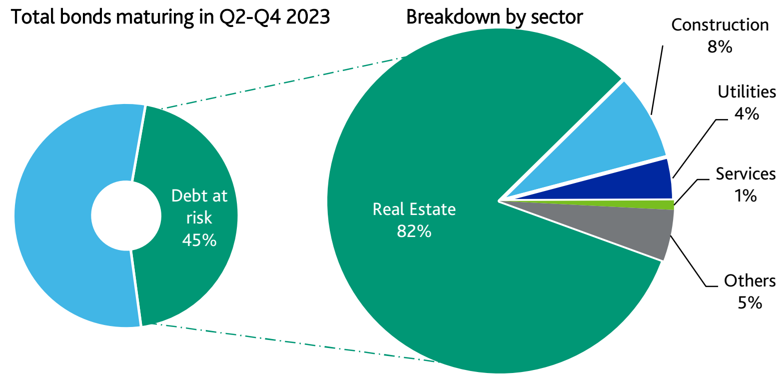
- We expect the liquidity challenges faced by corporate bond issuers to exacerbate as the volume of maturing bonds increase over the course of 2023 (Exhibit 6).
- As shown in Exhibit 7, real estate-related and construction sector issuers account for most of the VND113 trillion debt at risk.
- Given the unfavorable market conditions – weak sentiment across real estate sector, risk aversion across banks, these issuers will face difficulties raising new funds to repay maturing bonds in absence of cash flows.
  - We identified 88 issuers at risk with weak financial strength, and do not expect them to have sufficient cash resources to meet upcoming bond obligations (Exhibit 8).
- Most of the construction issuers have cash flows that are linked to the real estate sector; either owned by or contracted by large real estate developers.

Exhibit 6
Breakdown of bonds maturing in 2023-2024 by sector



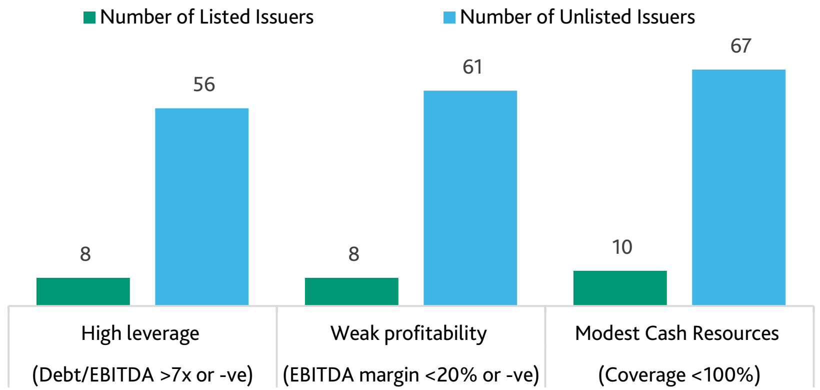
Source: HNX, Vietnam Investors Service

Exhibit 7
Breakdown of VND113 trillion debt at risk by sector



Note: Refer to Appendix for details on our analytical framework
Source: HNX, Vietnam Investors Service

Exhibit 8
88 issuers with debt at risk: issuers have weak financial strength

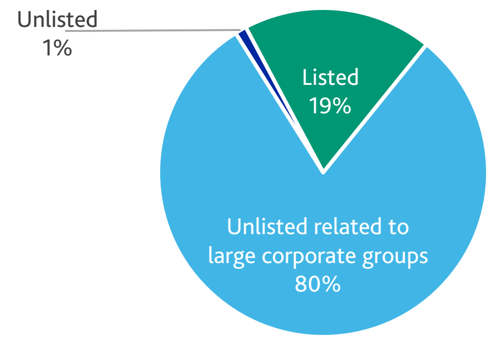


Note: Refer to Appendix for details on our analytical framework
Source: Vietnam Investors Service

Real Estate-related

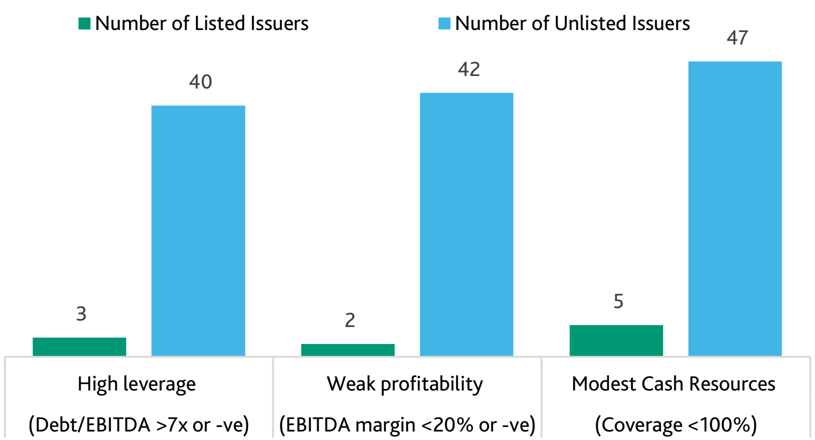
- We identified VND93 trillion worth of debt at risk issued by 58 real estate-related companies.
  - We estimate that 80% of these bonds are linked to subsidiaries or development projects of large corporate groups (Exhibit 9).
  - In addition to high leverage and limited cash flow, these issuers do not have sufficient cash resources to make interest or principal repayments due this year (Exhibit 10).
- Similar to many defaulted issuers, majority of these 58 bond issuers are fundraising entities of specific real estate projects linked to large corporate groups. These entities do not have other sources of business cash flow.
  - We note that majority of the bonds were 1-3 year bonds issued in recent years to acquire land for development. Real estate project development typically takes up to 3 years or more depending on the scale of projects, and bond issuers will need to refinance or seek alternative financing from banks or investors to repay maturing bonds.
  - We are aware of instances where developers faced delays in securing the regulatory approvals for land acquisition, clearance and/or right for land use. Without these approvals, developers are unable to seek financing from banks or homebuyers to advance on their development projects.[2]
  - As such, we expect these bond issuers will require support from group resources to repay debt or agreement among bond holders on alternative repayment methods allowed under Decree No. 8 (see discussion in next section).

Exhibit 9
Majority of real estate-related issuers at risk are related to large corporate groups
% of value of bonds maturing in 2023



Source: Vietnam Investors Service

Exhibit 10
58 real estate-related issuers with debt at risk: issuers have weak financial strength



Note: Refer to Appendix for details on our analytical framework
Source: Vietnam Investors Service

[2] Refer to Credit Insights – Resolution No. 33 NQ-CP on Solutions for Property Sector (23 March 2023)

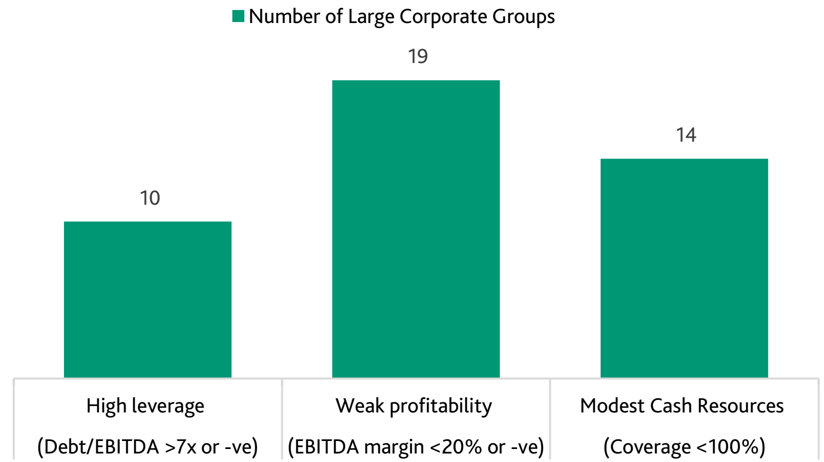
- Based on our analysis, we identified 22 large corporate groups to have substantial exposure to the VND113 trillion debt at risk.
  - Some of the groups had related entities with recent bond defaults, i.e., Van Thinh Phat, Nova, Hung Thinh, Trung Nam, Hai Phat, Egroup and Dat Xanh.
  - More than half exhibit weak financial strength (Exhibit 11) and do not have sufficient resources to meet maturing debt obligations at the holding company level. As such, we do not expect the groups to have sufficient financial resources to support the debt repayment needs of their related companies or project entities.

Resolution No. 33 will support the longer-term growth of real estate sector[3]

- On 11 March 2023, the Government of Vietnam issued Resolution No. 33/NQ-CP to guide the priorities for the real estate sector, include strengthening the legal framework around property construction and development, increasing supply of social housing, and mobilizing capital for housing projects.
- We view this development to be positive for the longer-term growth of property sector. It will take time for the government to revise various laws, as well as for the developers to adjust business plans.
- Over the near-term, we expect developers will need to manage their maturing bonds in 2023 through active negotiations with investors to seek out alternative repayment methods allowed under Decree No. 8 (see discussion in next section) and avoid defaults.

Exhibit 11

22 large corporate groups with exposure to debt at risk: more than half with weak financial strength



Note: Refer to Appendix for details on our analytical framework

Source: Vietnam Investors Service

[3] Refer to Credit Insights: Resolution No. 33/NQ-CP on Solutions for Property sector (March 2023)

Financial Institutions

Liquidity and refinancing risks

» For financial institutions, we view liquidity and refinancing risks to be manageable, as maturing bonds over the next two years (Exhibit 12) account for less than 10% of total assets for most banks and securities firms (Exhibit 13). Banks are primarily funded by customer deposits, while recent equity raises have supported securities firms' ability to pursue business growth.

  – According to the State Bank of Vietnam data at end-2022, the average loan-to-deposit ratio was 81% (for state-owned banks) and 75% (for joint stock commercial banks); the average ratio for short term funding was 26% (for state-owned banks) and 31% (for joint stock commercial banks), below the regulatory limit of 34%.

  – For most securities firms, over 90% of funding for business operations are in the form of equity and short-term bank loans. Over the past two years, many firms raised new equity funds and acquired new customer funds to fund their business growth.

  – A few firms with substantial amount of bonds maturing may need to scale back new business and balance sheet growth if they are unable to replace maturing bonds with new funding.

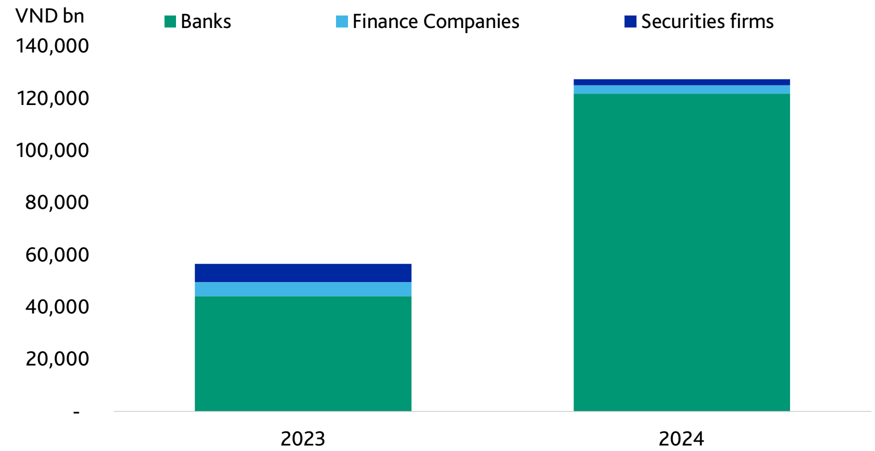
» Banks are currently resolving difficulties in obtaining audited reports on the use of bond proceeds, which have delayed new bond issuances. If the audit process takes longer time than expected, it may adversely affect banks' compliance with the regulatory long-term funding ratio, (i.e., 30% with effect from Oct 2023).

Asset risks

» Asset risks are, however, on the rise, driven by the financial institutions' exposure to bonds at risk and/or exposure to bond issuers at risk through direct lending or collateral assets.

Exhibit 12

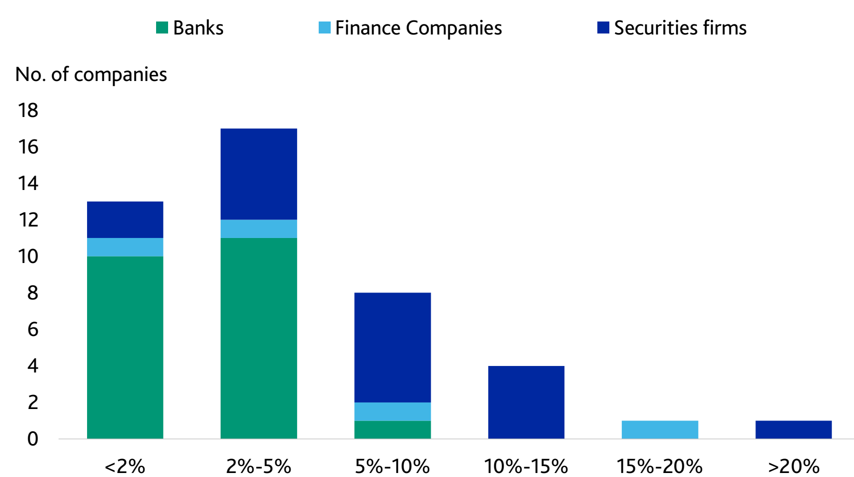
Total outstanding bonds maturing for financial institutions will increase



Source: HNX, Vietnam Investors Service

Exhibit 13

Majority of financial institutions have maturing bonds (up to 2024) not exceeding 10% of total assets



Source: Company data, Vietnam Investors Service

Banks:

» For the banking sector as whole, we estimate the direct lending to real estate-related bond issuers at risk is less than 1% of banking system loans.

» Among banks active in real estate sector, total real estate-related loans and bonds account for around 40% of total credit exposures at end-2022 (Exhibit 14).

  – A handful of banks have corporate bond investments making up over 5% of total credit exposures. Majority of corporate bond investments relate to the real estate sector.

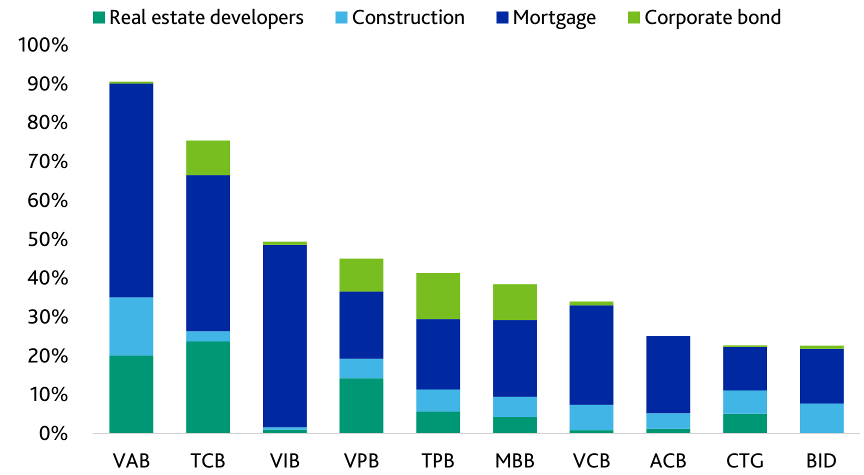
  – These banks are likely to be more vulnerable to downside risks if corporate bond repayment issues spillover to loan servicing difficulties, and the resultant rise in problem loans and credit costs.

Securities firms:

» Firms that are active in bond advisory have over 20% of total assets in the form of non-financial corporate bonds (Exhibit 15).

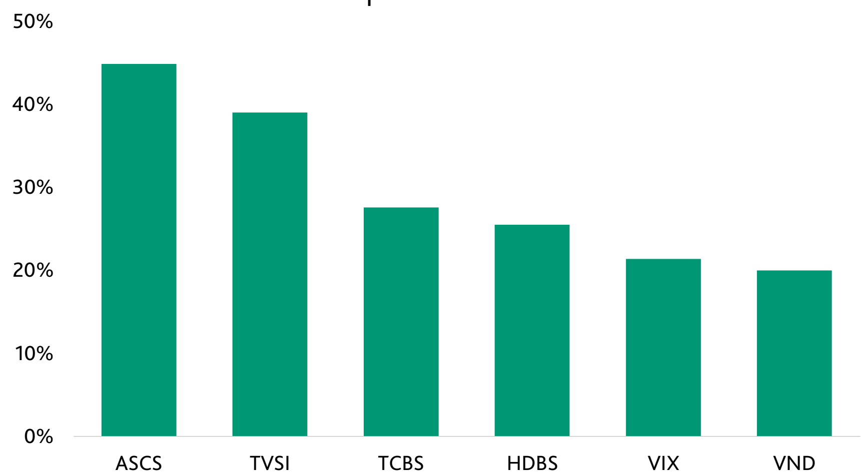
» In addition to direct exposure to asset risks, such firms also have to deal with requests by retail investors to buy back the corporate bonds that the firms distributed.

Exhibit 14
Loans to real estate-related sector contribute nearly 40% of selected banks' credit exposure



Source: Company data, Vietnam Investors Service

Exhibit 15
Securities firms: Non-financial corporate bonds % total assets



Source: Company data, Vietnam Investors Service

Decree No. 8 implemented by the government in March 2023 will allow bond issuers more leeway to resolve bond repayment issues

- As shown in Exhibit 16, bondholders and bond issuers now have additional options to negotiate new repayment proposals and change bond terms, such as extending maturity dates, repaying with physical and other assets, etc.
  - If bondholders and the issuer cannot reach consensus on a solution, the issuer must fulfill its obligation and bondholders have the right to take legal action to pursue debt repayment.
- Based on publicly available information, some of the negotiations have resulted in bondholders and issuers agreeing to extend payment due dates or repay in the form of property assets (i.e. asset swap) (Exhibit 17).
  - We view these solutions to be practical and suitable for financially sound companies with good visibility of incoming cash flows, quality assets or support from related entities. Time taken to recover bond investment will likely be shorter compared to legal proceedings.
  - However, for repayment in the form of property assets, it is important for bond investors to consider not only the future potential of the real estate market, but also the value and price volatility of the assets they will receive, the legal status and liquidity of assets to protect their interests.
  - As of report date, we are not aware of any asset swaps that were completed.
- We expect negotiations to be challenging, particularly for investors to assess the fair value of assets they will receive in lieu of bond maturity proceeds in cash.
  - Until refinancing conditions stabilize, we expect proactive and productive negotiations between bond issuers and investors ahead of bond maturity will be key to avoid defaults.

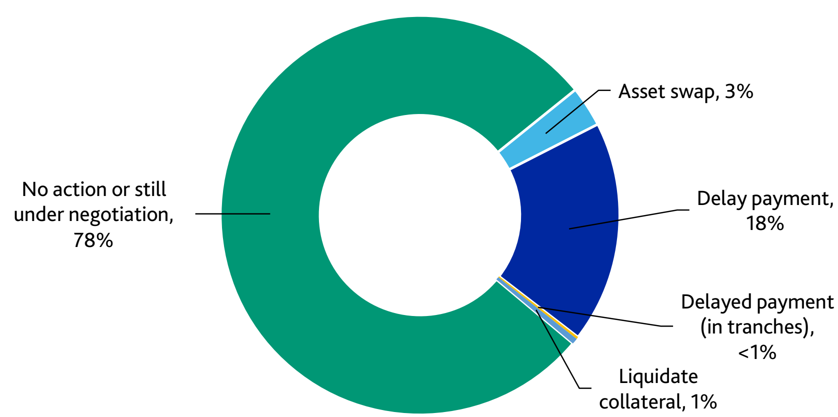
Exhibit 16
Key elements of Decree No. 08

Bond Terms & Conditions	Allow extension of bond tenor for up to 2 years
Repayment Using Other Assets	Issuers need to negotiate with bondholders to reach a bilateral agreement and this solution must: » Comply with the provisions of civil law and relevant laws » Approved by the bond holders » Issuer must disclose unusual information and take full responsibility for the legal status of the assets
Professional Investor Criteria	Temporarily suspended for 1 year » Decree No. 65 required that individual professional investors must secure an average holding portfolio of at least VND 2 billion within 180 consecutive days
Distributing Bond Issuance	Temporarily suspended (the duration of distributing up to 90 days) » Decree No. 65 required that the duration of distributing is no more than 30 days
Credit Rating Requirement	Temporarily suspended for 1 year » Credit rating required for issuers if: The total value of bonds at their face value raised in every 12 months exceed 500 billion VND and exceed 50% of the equity; or The bond outstanding at face value on the offering registration date is greater than 100% of equity

Source: Vietnam Investors Service

Exhibit 17
Majority of the negotiations have led to delay in payments of defaulted bonds

% of value of defaulted bonds



Source: Company data, HNX, Vietnam Investors Service

Delay in implementing some new regulations under Decree No. 65

» The new decree now delays the application of more stringent requirements under Decree No. 65[4] by 1 year, including regulations on determining the status of professional securities investors for individuals and implementing mandatory credit ratings.

» On the one hand, the suspension of these regulations will allow individuals to continue investing in risky bond assets, thereby supporting the demand for bonds issued in the primary market as well as transactions on the secondary market as the bond trading system on HNX rolls out in the next few months. On the other hand, the lack of credit ratings in the market means that individual investors will have to rely on other information sources to assess investment risks.

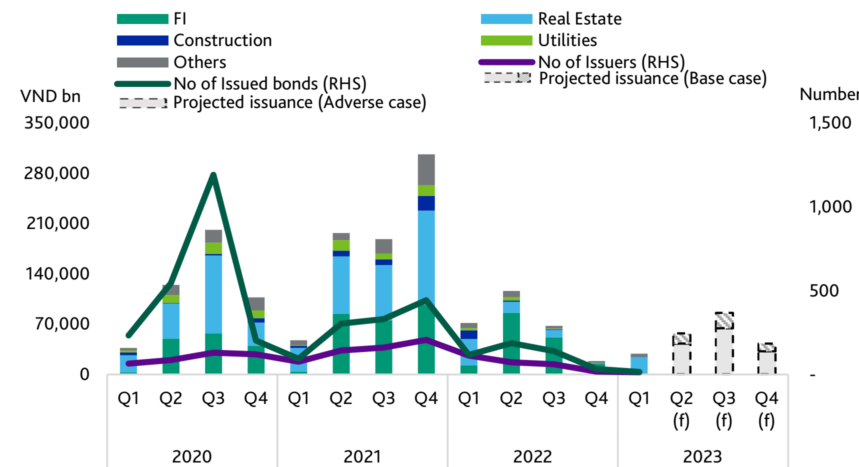
Recovery in new bond issuance

» As shown in Exhibit 18, new bond issuances have recovered in March 2023 following the roll out of Decree No. 8. For the first 3 months of 2023, a total of 18 bonds worth VND 28.5 trillion were issued mostly by real estate-related entities to finance new project development.

» Majority of the bonds issued were in the form of fixed-rate, unsecured, private placements with maturities of 5Y or longer. Bond coupon rates were noticeably higher than similar bonds issued in previous years, which indicates higher risk premium required by investors (Exhibit 19). 6 bonds – totaling VND3.5 trillion - were public bonds issued by non real estate-related companies sold to retail investors.

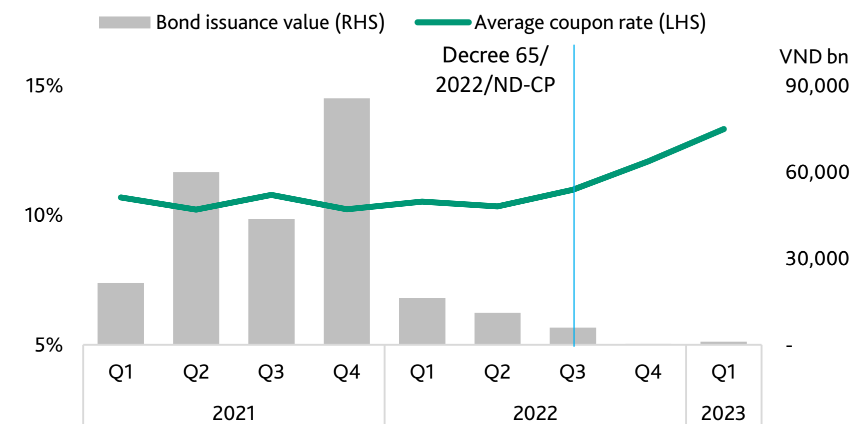
» We view this as a positive signal that the bond market sentiment is stabilizing, and market participants are adjusting to the new regulations to facilitate new financing to be channeled to domestic corporations.

Exhibit 18
Bond issuances have recovered but unlikely to return to pre-2022 levels



Source: HNX, Vietnam Investors Service

Exhibit 19
Bond coupon rates have risen for similar bond issues (3Y-5Y maturity) from a year ago



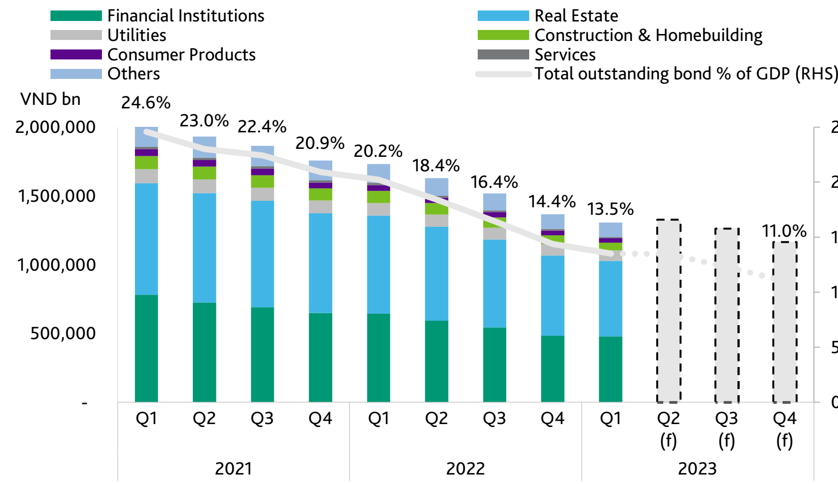
Source: HNX, Vietnam Investors Service

[4] Refer to Corporate Bond Market Perspective: New regulations will guide stable growth of corporate bonds, but keep new issuances subdued until 2H 2023 (November 2022)

- We expect total outstanding corporate bonds to fall to 11% of GDP by end-2023 (Exhibit 20). While issuances of new corporate bonds will gradually pick up (Exhibit 18), the pace of new issuances will not recover to pre-2022 levels, and corporations will prioritize making business adjustments and shoring up cash resources to repay maturing bonds or extend bond maturities.
- In our view, Decree No. 8 does not remove the requirements in Decree No. 65 on new information disclosures to be provided to investors in a timely manner and the need for credit ratings. Moreover, bond issuers must disclose the status of bond payments. This enhances information transparency and allows the market to monitor bond payment conditions and delays.
- Through discussions with market participants, many large financial and non-financial corporations understand the need for credit ratings as an additional information tool to communicate credit quality of bond issues, to enhance their access to bond investors and achieve lower capital raising costs.

Exhibit 20

Total outstanding bonds will fall to 11% by end-2023



Source: HNX, Vietnam Investors Service

Appendix: Analytical framework and assumptions

1. Assessment of the financial strength of bond issuers [Exhibits 4,8,10,11]

We apply the following analysis using most recent available financial information on the issuing entities and companies:

» Leverage: Total debt as a percentage of EBITDA

» Profitability: EBITDA as a percentage of total revenue

» Coverage: Sum of (Cash and cash equivalents, receivables (50% haircut), projected cash flow) less estimated capex and dividends as a percentage of total bonds maturing in 2023

Based on the following criteria that we deem to be "weak financial strength", we identified issuers and companies at risk of default. Bonds maturing in Q2-Q4 for the identified issuers are considered debt at risk.

Criteria for:	High leverage	Weak profitability	Modest cash resources
Weak financial strength	Debt/ EBITDA >7x or negative	EBITDA margin <20% or negative	Coverage <100%

	Total (for all sectors)	Real estate sector only
Number of bond issuers at risk of default	88	58
Debt at risk	VND113 trillion	VND93 trillion

2. Corporate bond default rate – projections (base, adverse) [Exhibit 1]

We compute default rate using total corporate bond defaults as a percentage of outstanding bonds. Below table summarize the assumptions used:

	Base case	Adverse case
Projected defaults	25% of debt at risk to default	75% of debt at risk to default
Outstanding bonds at end-2023	Equals to total outstanding bonds at end-March 2023 + new bond issuances (Q2-Q4) – bonds matured (Q2-Q4) + defaulted bonds (Q2-Q4)	Equals to total outstanding bonds at end-March 2023 + new bond issuances (Q2-Q4) – bonds matured (Q2-Q4) + defaulted bonds (Q2-Q4)
New bond issuances in Q2-Q4 2023 [Exhibit 18]	Gradual increase in issuance volume in Q2-Q3; incorporates our expectation that market sentiment will improve gradually following the rollout of Decree No. 8, as well as seasonality in issuance activity.	75% of issuance volume assumed under base case; incorporates scenario that many bank issuances are delayed by audit process for use of bond proceeds report, and no meaningful improvement in market sentiment.
Nominal GDP for 2023 [Exhibit 20]	Based on the government's targets of 6.5% real GDP growth and 4.5% inflation growth	Based on the government's targets of 6.5% real GDP growth and 4.5% inflation growth

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