VIETNAM INVESTORS SERVICE

SECTOR COMMENT
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Corporate Bond Market Perspective

Building market discipline is critical to the sustainable growth of corporate bond issuance and slower defaults in the new development phase

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We expect the credit outlook to improve in 2024[1]. Stronger economic activity and low interest rates will support debt repayment and refinancing to a large extent. We estimate bonds maturing in 2024 that are at risk of default[2] to be at around VND 40 trillion. Market sentiment will improve alongside the implementation of stricter regulations among corporate bond participants to support new bond issuances and the deepening of the domestic corporate bond market.

In 2023, the corporate bond default rate peaked at 15% in October and gradually declined to 14.7% in December. Many bond issuers managed to extend the maturity dates of their outstanding bonds to 2024-25, and new bond issuances began to pick up in the second half of 2023. A total of VND 336 trillion worth of corporate bonds were issued in 2023, up 22% from the prior year. We view the corporate bond market to be at an inflection point as stricter rules around corporate bond issuance and investment take effect in January 2024, marking the start of a new development phase for the corporate bond market.

We estimate bonds at risk of default in 2024 to decline to VND 40 trillion, significantly lower than VND 147 trillion of bonds that defaulted in 2023. The majority of the bond issuers at risk are property and construction-related companies with weak cash flows, very high leverage, and very limited cash resources to support debt repayment. In addition, over 60% of these bonds at risk were issued by special purpose entities for financing purposes only, with no operating cash flow, very weak debt serviceability, and related to troubled corporate groups that defaulted on other bonds.

For 2024, we expect market discipline to improve from stringent requirements for new bond issuances, including more timely and detailed information disclosures, and greater participation of institutional investors. Private placement bond issuers will need to provide more timely disclosures on their use of bond proceeds, bond repayment status, financial health, etc. Bond investors will have more information to evaluate investment risks, including credit ratings of the bonds and/or issuers, and market pricing of past bond transactions. Retail investors will continue to benefit from the strict process around public bond issuances, while professional and institutional investors can rely on new information to assess bond issuers, especially unlisted companies with limited public disclosures.

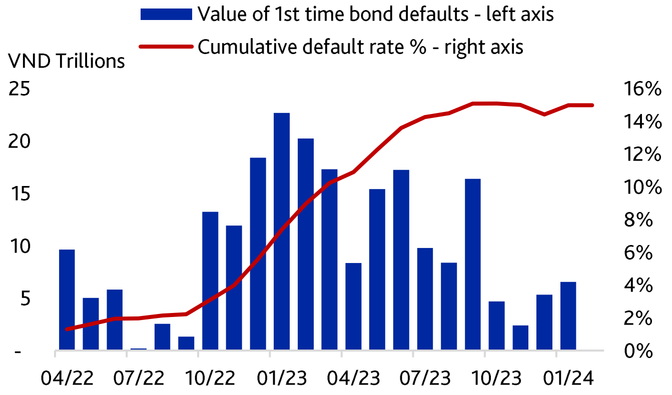
Banks and property-related companies will drive the recovery of new corporate bond issuance in 2024. The privately placed corporate bond trading system that was recently launched in July 2023 will encourage more secondary market trading activity and enhance the liquidity of corporate bonds, which is crucial for the sustainable growth of the fledgling corporate bond market. In December 2023, around 40% of outstanding corporate bonds were available for trading on the new system, and trading volume reached VND 98 trillion. We expect the remaining private corporate bonds to become available for trading in 2024, and the improved liquidity will support investor confidence and increase the demand for corporate bond investments.

[1] Refer to 2024 Credit Outlook: Low interest rates and policy measures will support the recovery of domestic operating conditions and dampen the effects of external uncertainties (12 December 2023)
[2] Refer to Appendix 1 for the definition of bonds at risk of default.

The default rate peaked at 15% in October 2023 and gradually declined to 14.7% in December 2023; maturity dates were extended to 2024-25 and new issuance recovered

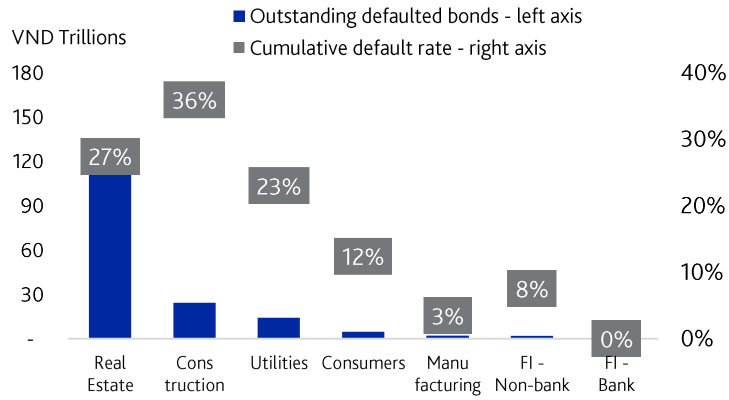
New bond defaults declined significantly from peak level to less than VND 5 trillion per month in Q4 2023 (Exhibit 1). As of December 2023, the sectors with the highest default rates are property, construction, and utilities, driven by issuers impacted by the property downturn and trouble in commercializing new renewable energy projects[3] (Exhibit 2). Nonetheless, default rates have moderated from peak levels in October 2023.[4]

Exhibit 1: New bond defaults peaked in Q1 2023 and slowed down in second half of 2023



Source: Hanoi Stock Exchange (HNX), Vietnam Investors Service

Exhibit 2: Property, construction, and utilities sectors have the highest default rates at end-December 2023

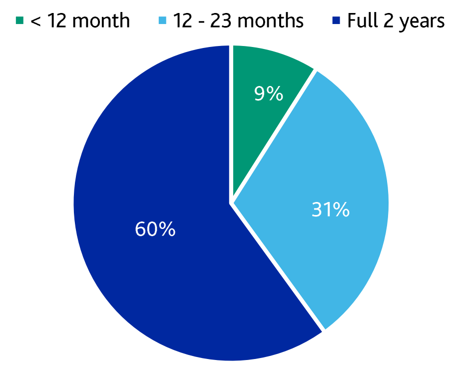


Source: HNX, Vietnam Investors Service

Many bond issuers managed to utilize the provision in Decree No. 08 to extend the maturity dates of their outstanding bonds to 2024-25, especially among property, construction, and utilities issuers. In 2023, a total of 175 bonds worth VND 59 trillion with 2023 maturity dates (i.e. 14% of bonds maturing in 2023) extended their maturity dates by an average of around 20 months - close to the maximum of 2 years allowed under Decree No. 08 (Exhibit 3).

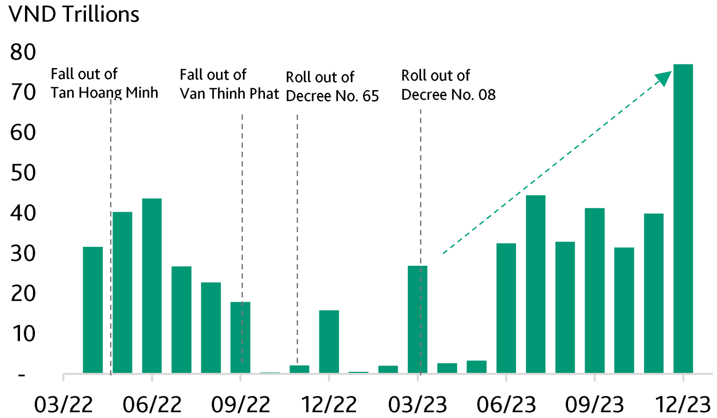
New bond issuance plunged to a low level in first half of 2023 with nearly no new issuance in January 2023 after the Van Thinh Phat incident and the introduction of stricter issuance regulations under Decree No. 65. After the roll-out of Decree No. 08, new issuance gradually recovered. A total of VND 336 trillion worth of corporate bonds were issued in 2023, up 22% from the prior year (Exhibit 4).

Exhibit 3: The majority of maturity extensions were for periods of over one year



Source: HNX, Vietnam Investors Service

Exhibit 4: New issuances recovered in second half of 2023



Source: HNX, Vietnam Investors Service

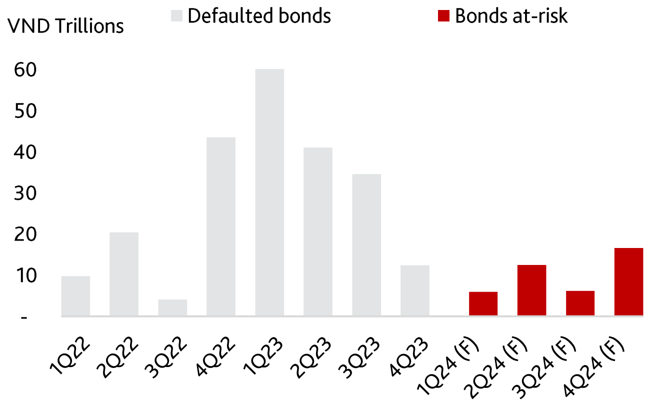
[3] Refer to Corporate Bond Market Perspective: Real estate-related liquidity issues will drive up corporate bond defaults in 2023, new regulations to provide some elief for VND 113 trillion of bonds at risk (6 April 2023)

[4] Refer to our Corporate Bond Market Perspective: Proactive negotiations will slow down bond defaults in 2024, marking the start of a new development phase and recovery of bond issuance (10 October 2023)

We estimate bonds at risk of default to decline to VND 40 trillion in 2024, significantly lower than VND 147 trillion of bond defaults in 2023; majority of bonds at risk are issued by SPEs with weak financials and no operating cash flow

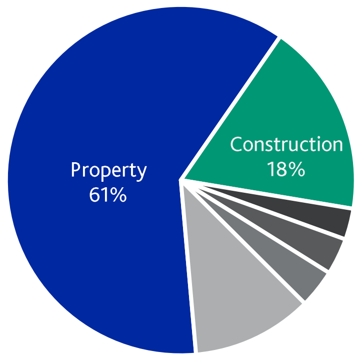
The value of bonds at risk of default (i.e. bonds-at-risk)[5] in 2024 amounts to around VND 40 trillion (19% of maturing bonds in 2024), significantly lower compared to VND 147 trillion bond defaults in 2023 (Exhibit 5). This trend is driven by improved operating cash flow and increased access to new financing, particularly among corporates in the highest default rate sectors, property, construction, and utilities, and support from policy measures and low-interest rates[6].

Exhibit 5: Improving credit outlook among property, construction, and utilities to drive lower bonds-at-risk



Source: HNX, Vietnam Investors Service

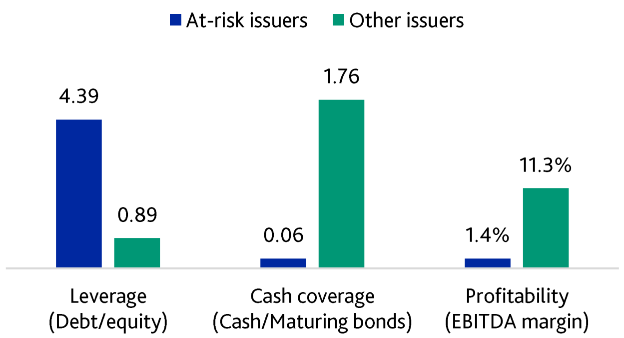
Exhibit 6: Majority of bonds-at-risk are from property and construction sectors



Source: Vietnam Investors Service

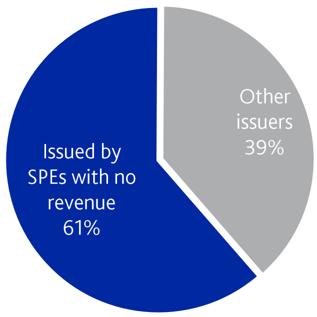
These VND 40 trillion bonds-at-risk relate to 35 issuers, the majority from the property and construction sectors (Exhibit 6). On average, these at-risk issuers have very weak debt repayment capacity, reflected by relatively high leverage, weak profitability, and extremely low level of cash resources compared with other issuers with maturing debt in 2024 (Exhibit 7). We note that half of these at-risk issuers (accounting for 61% value of bonds at risk) are special purpose entities (SPEs) for financing purposes only with no revenue and operating cash flow (Exhibit 8). These SPEs are related to a handful of large corporate groups; some of which had already defaulted on their bond principal and/or interest repayments.

Exhibit 7: At-risk issuers in 2024 have very weak financial capacity to service debt



Source: Vietnam Investors Service

Exhibit 8: Bonds-at-risk mostly from SPEs with no business operation and operating cash flow



Source: Vietnam Investors Service

[5] Refer to Appendix 1 for our assessment criteria of bonds at risk of default.
[6] Refer to 2024 Credit Outlook: Low interest rates and policy measures will support the recovery of domestic operating conditions and dampen the effects of external uncertainties (12 December 2023)

For 2024, we expect market discipline to improve from stringent requirements for new bond issuances, including more timely and detailed information disclosures and greater participation of institutional investors

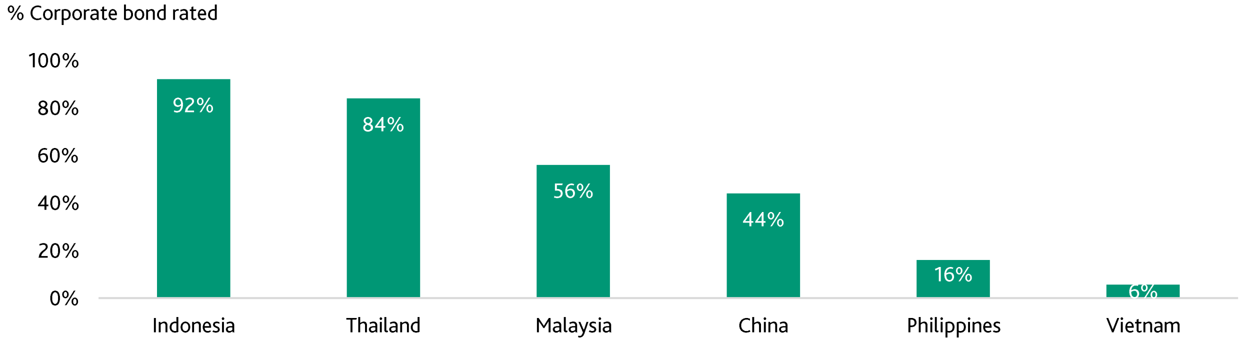
From January 2024, all requirements in Decree No. 65 will come into effect, including regular disclosure of more issuer's information, the use of a centralized depository of private bonds issued from January 2021 onwards, stricter criteria for professional bond investors, and the use of credit ratings[7]. We expect these new requirements will help establish a stronger framework to guide the behavior and practices of issuers, service providers, and investors in the corporate bond market, which will raise the quality of corporate bond issuances.

Under Decree No. 65, private bond issuers will need to provide more timely disclosures on their use of bond proceeds, bond repayment status, financial health, etc. This requirement will address the opacity of the private placement market. Importantly, it enforces issuers to be accountable for the legitimacy and accuracy of their assertions to investors, the usage of bond proceeds, and the repayment duties.

At end-December 2023, close to 40% of outstanding private placements bonds have completed the mandatory registration with the centralized depository managed by the Vietnam Securities Depository and Clearing Corporation (VSD). Such registration will allow bond issuer disclosures to be monitored and bondholder information to be recorded centrally, to facilitate the surveillance by regulatory authorities and support dispute resolution between bond issuers and bondholders.

Credit ratings will serve as an additional source of information for investors and market participants to assess investment risks, especially for bonds issued by unlisted companies with limited public disclosure. In regional countries, credit ratings have played an important role in improving information transparency so that bond investors can assess relative risks, the suitability of the bonds for their risk tolerance, and the adequacy of the risk premiums (Exhibit 9).

Exhibit 9: Credit ratings play an important role in improving information transparency in regional bond markets



** For Vietnam, only issuer ratings have been assigned to bond issuers. Percentage is computed using the number of issuer ratings as a percentage of issuers with outstanding bonds*
Source: Asian Bonds Online, Vietnam Investors Service

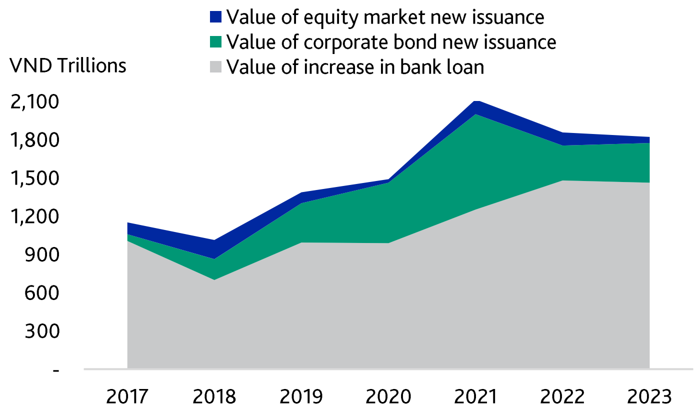
Retail investors will continue to benefit from the strict process around public bond issuances, while professional and institutional investors can rely on new information to assess bond issuers, especially unlisted companies with limited public disclosures. Over time, we expect the improvements in information transparency will drive more institutional investors to participate in the domestic corporate bond market.

[7] Refer to Corporate Bond Market Perspective: New regulations guide stable growth of corporate bonds, but keep new issuances subdued until 2H 2023 (11 November 2022)

Banks and property-related companies will drive the recovery of new corporate bond issuance in 2024

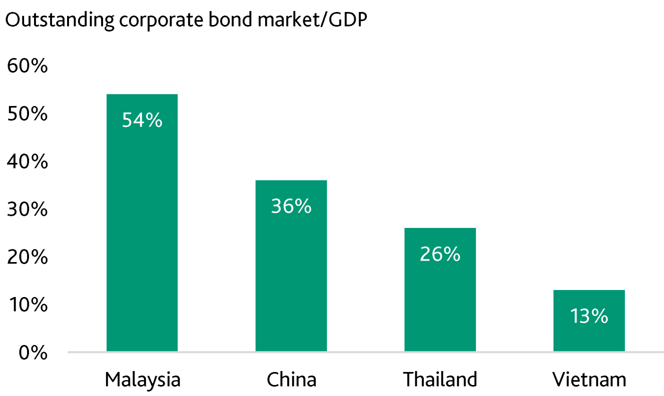
We expect operating conditions for the corporate sectors will improve and lead to business expansion and higher demand for capital investment in 2024. With the corporate bond market becoming an important funding channel (Exhibits 10 and 11), we expect new bond issuance will continue to recover in 2024 in the new phase of development.

Exhibit 10: The contribution of the corporate bond market is growing among funding channels



Source: State Bank of Vietnam (SBV), Ministry of Finance (MOF), State Securities Commission of Vietnam (SSC), HNX, Vietnam Investors Service

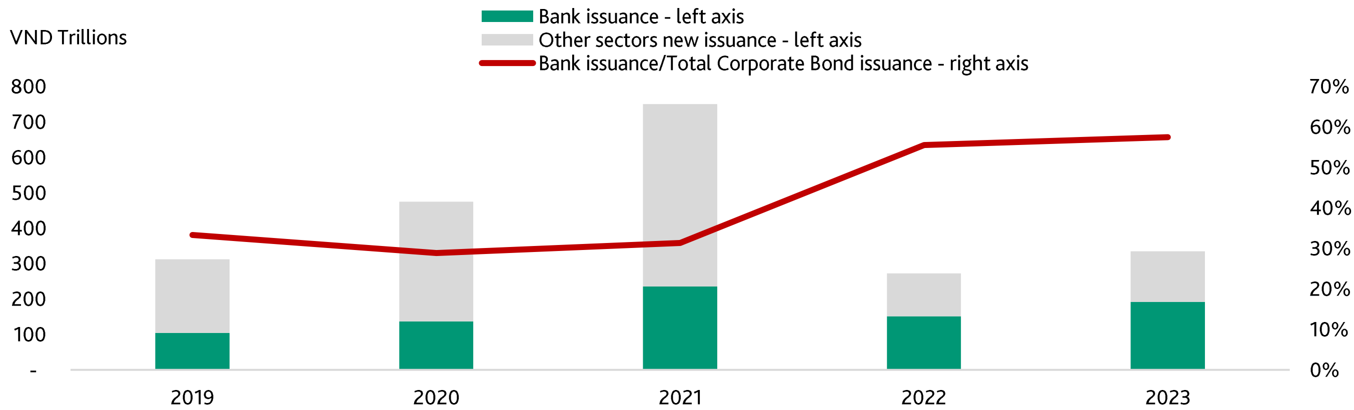
Exhibit 11: Vietnam's corporate bond market has ample room for growth compared to regional countries



Source: Asian Bonds Online, Vietnam Investors Service

Bank issuances will continue to contribute to the majority of new issuances in 2024[8]. In 2023, bank issuance accounted for more than 60% of total corporate bond issuance (Exhibit 12). In 2024, we expect the stricter regulation on long-term lending using medium and short-term funding will drive banks to issue more bonds to supplement their funding. Also, banks will take advantage of low-interest rates to replace existing bonds with low-cost funding.

Exhibit 12: Bank bond issuance contributes a majority of annual issuances

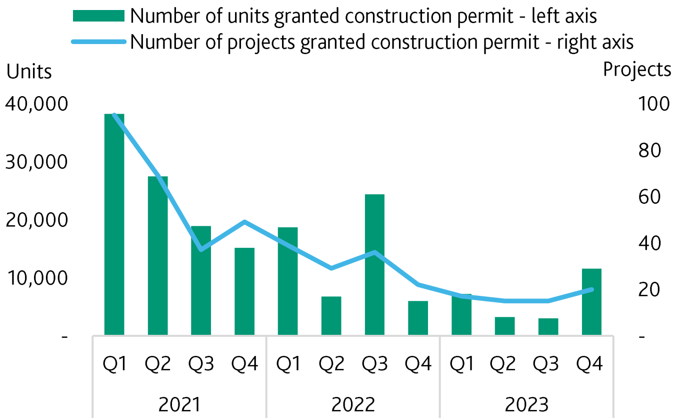


Source: HNX, Vietnam Investors Service

Other than banks, we also expect new bond financing to increase among property-related companies, mostly driven by the resumption of legal approvals and project development work following the roll-out of new property laws[9] (Exhibit 13). We note that bond issuances by property-related companies have already picked up in pace in second half of 2023 (Exhibit 14), boosted by low-interest rates and improving market sentiment.

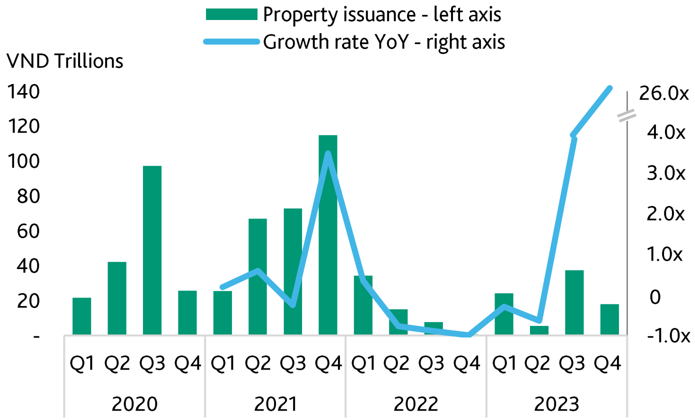
[8] Refer to our Corporate Bond Market Perspective: Proactive negotiations will slow down bond defaults in 2024, marking the start of a new development phase and recovery of bond issuance (10 October 2023)
[9] Refer to our Residential Property Sector: New real estate laws will pave the way for quicker and prudent development of new housing projects, positive for developers' credit profiles and sustainable growth of the housing market (22 January 2024)

Exhibit 13: Project approvals resume under easing legal constraints will incentive capital demand



Source: Ministry of Construction, Vietnam Investors Service

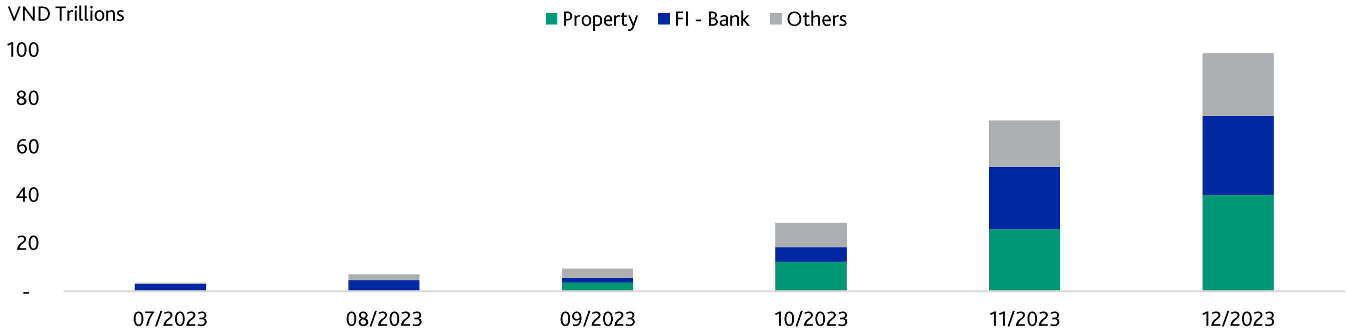
Exhibit 14: Property bond issuances recovered in the second half of 2023



Source: HNX, Vietnam Investors Service

The privately placed corporate bond trading system that was recently launched in July 2023 will encourage more secondary market trading activity and enhance the liquidity of corporate bonds, which is crucial for the sustainable growth of the fledgling corporate bond market. In December 2023, around 40% of outstanding corporate bonds were available for trading on the new system, and trading volume reached VND 98 trillion (Exhibit 15). We expect the remaining private corporate bonds to become available for trading in 2024, and the improved liquidity will support investor confidence and increase the demand for corporate bond investments.

Exhibit 15: Trading volume of private bond issuances increased gradually



Source: HNX, Vietnam Investors Service

APPENDIX 1

Bond-At-Risk: Definition and Assessment Framework

A bond labeled 'Bond-At-Risk' reflects our credit view that the bond issuer has weak financial strength and there is a high likelihood that the issuer does not have the financial capacity to service its upcoming debt repayments over the next 12 months. Our framework to assess an issuer's financial strength centers around the following considerations.

- Leverage: Total debt as a percentage of earnings before interest, tax, depreciation and amortization expenses ("EBITDA")
- Profitability: EBITDA as a percentage of total revenue
- Coverage: Sum of (Cash and cash equivalents, receivables (50% haircut), projected cash flow) less estimated capital expenditures and dividends as a percentage of total bonds maturing in the year

Based on the following criteria that we deem "weak financial strength", we identified issuers and companies at risk of default. Bonds maturing in 2024 for the identified issuers are considered bonds 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%

In addition, we will also include bonds issued by issuers that have defaulted recently on their bond and/or interest repayments in our bonds-at-risk.

	Total (for all sectors)
Number of bond issuers at risk of default	35
Bonds-at-risk	VND40 trillion

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