VIETNAM INVESTORS SERVICE

CONTACTS

Nguyen Ly Thanh Luong, CFA, ACCA, FMVA
Lead Analyst
luong.nguyen@visrating.com

Nguyen Dinh Duy, CFA
Director – Senior Analyst
duy.nguyen@visrating.com

Simon Chen, CFA
Head of Ratings & Research
simon.chen@visrating.com

https://visrating.com

Corporate Bond Market Perspective

Getting back on track, stronger risk awareness and more institutional investors critical for the new development phase

Recent data suggests that the Vietnam corporate bond market has begun to recover after two years of weak sentiment and subdued growth. Regulatory reforms are shaping market behavior and strengthening the market infrastructure to revive corporate bond activity. This report addresses the key questions received during our market engagement with investors, issuers, and intermediaries.

Is the worst over for the domestic corporate bond market? Since the liquidity crisis and surge in bond defaults in September 2022 – June 2023, we have observed a steady improvement in market sentiment driven mostly by new regulations around the bad debt resolution. Since March 2023, over 200 bonds have utilized Decree No. 08 to extend the principal repayment dates, with the majority extended by an average of 22 months. Many leveraged and financially weak bond issuers, including newly established entities with no core business and limited operating cash flow ("non-operating entities") - mostly related to property investment - were, hence, able to avoid defaults.

With new bond defaults slowing and recoveries gradually improving, market confidence grew as issuers and investors adjusted to stricter issuance requirements. In 8M2024, new bond issuances doubled to VND 298 trillion from a year ago, led by banks and developers. Secondary market trading activity has been brisk since the rollout of the bond trading platform in July 2023, and yield spreads of corporate bond traded have narrowed significantly. Based on our assessment of bond issuers with an 'Average' credit assessment score, the average yield spread for their traded bonds narrowed by over 200 basis points in YTD2024 compared with the Q4 2022 – Q2 2023 period.

What are the key pain points to be addressed? In our view, the corporate bond market has made strides to strengthen market behavior. However, recent bond transactions continue to reflect a lack of adequate risk awareness and a deep pool of investors to support market activity through volatility.

Most of the bonds issued and traded in the secondary market are either issued by non-operating entities or are private placements and, hence, have limited publicly available information that investors can access to analyze and monitor investment risks. Our concern stems from the fact that close to 50% of the bond defaults during 2022 – 2023 relate to such entities that were able to issue bonds at attractive pricing despite their weak financial strength. Today, many bonds from such entities are traded, with little variation in their traded yields compared with bonds issued by financially stronger companies.

The regulator intends to curb excessive risk-taking by restricting private placement bonds to institutional investors only. Hence, greater participation by institutional investors is critical for the sustainable growth of the corporate bond market. Unlike retail investors, who tend to focus on short-term gains, institutional investors typically have developed technical capabilities to assess investment risks, make long-term investments, and have high-risk tolerance to endure short-term volatility.

According to the Ministry of Finance, institutional investors such as insurance companies, pension funds, and investment funds hold only 8% of the total outstanding corporate bonds at end-June 2024. Vietnam's largest institutional investor is the Vietnam Social Security, and it has not begun to invest in corporate bonds.

How can credit ratings be used to support decision-making? Each of the four licensed credit rating agencies (CRA) in Vietnam has its own credit rating scales, methodologies, and processes. Market participants can extract useful information for their own assessment by comparing how each CRA rates various bond issuers and bonds within its rating scale.

Credit ratings can serve as an independent source of information for issuers and investors to consider when determining the risk premiums for bond transactions. Unlike issuer ratings, bond ratings incorporate the specific risk features of an individual bond, help explain the relative differences in investment risks and reduce potential mispricing. Investors can refer to bond ratings and historical bond pricing to determine a benchmark for pricing new bond transactions.

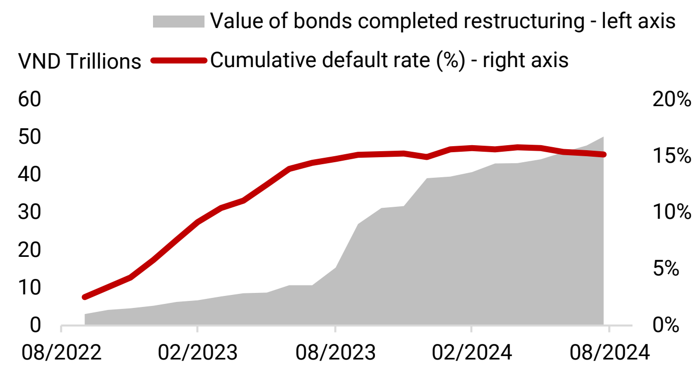
1. Is the worst over for the domestic corporate bond market?

Yes, we view the worst of the liquidity crisis experienced during September 2022 – June 2023 has passed, and we have transitioned to a new development phase marked by stricter regulations and improving market confidence.

Since the liquidity crisis in September 2022 – June 2023, we have observed slower bond defaults and steady improvement in the recovery rate driven mostly by new regulations around restructuring bad debt.

Since March 2023, over 200 bonds have utilized Decree No. 08 to extend the principal repayment dates, with the majority extended by an average of 22 months[1]. In our view, the increasing pace of debt restructuring ahead of bond maturities has helped issuers avoid defaults (Exhibit 1). Close to 80 bonds issued by highly leveraged and financially weak issuers, including newly established entities with no core business and limited operating cash flow ("non-operating entities") and related to property investment, executed the extension of repayment dates just within one month of the maturity date. Another positive sign is that many of the defaulted issuers have gradually repaid bondholders, either partially or in full (Exhibit 2).

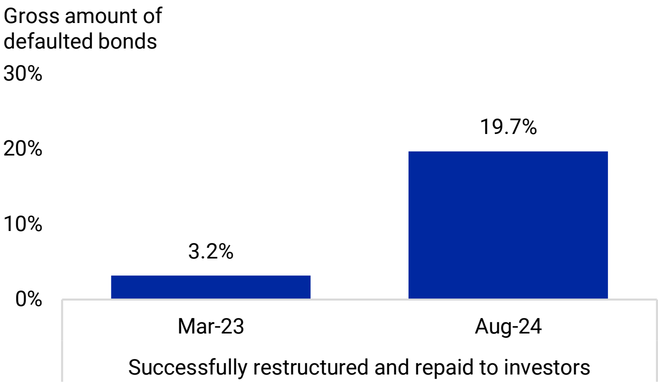
Exhibit 1: New regulations have slowed down new defaults and resulted in more successful debt restructuring



Note: Value of bonds completed restructuring is the total amount of successful cash repaid to investors from defaulted bonds since their first default date

Source: Vietnam Investors Service

Exhibit 2: Recovery for defaulted bonds improves as issuers have had more time to resolve defaults



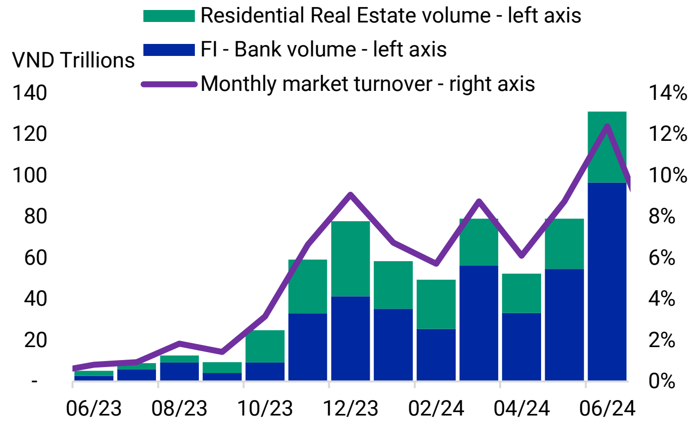
Note: We estimate the recovery rate based on the amount of principal repaid, including cases where only a partial amount has been repaid, and restructuring is still ongoing following the bond default

Source: Vietnam Investors Service

With new bond defaults slowing and recoveries gradually improving, market confidence grew as issuers and investors adjusted to stricter issuance requirements.

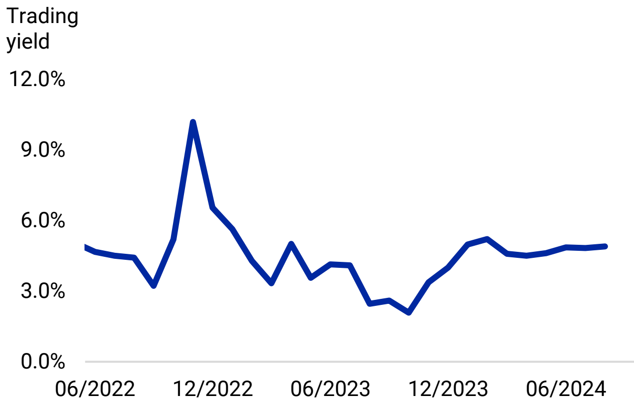
In 8M2024, new bond issuances doubled to VND 298 trillion from a year ago, led by banks and developers[2]. Secondary market trading activity has been brisk since the rollout of the bond trading platform in July 2023 (Exhibit 3), and yield spreads of corporate bond traded have narrowed significantly. Based on our assessment of bond issuers with an 'Average' credit assessment score, the average yield spread for their traded bonds narrowed by over 200 basis points in YTD2024 compared with the Q4 2022 – Q2 2023 period (Exhibit 4).

Exhibit 3: Market liquidity improves with increasing bonds traded in most sectors



Source: Vietnam Investors Service

Exhibit 4: Credit spread narrowed for 3-year bonds issued by "Average" credit quality corporate issuers



Source: Vietnam Investors Service

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[1] Refer to 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 Oct 2023)
[2] Refer to Corporate Bond Market Review: Banks continue to dominate new bond issuances, with more than half being Tier 2 capital bonds (14 Aug 2024)

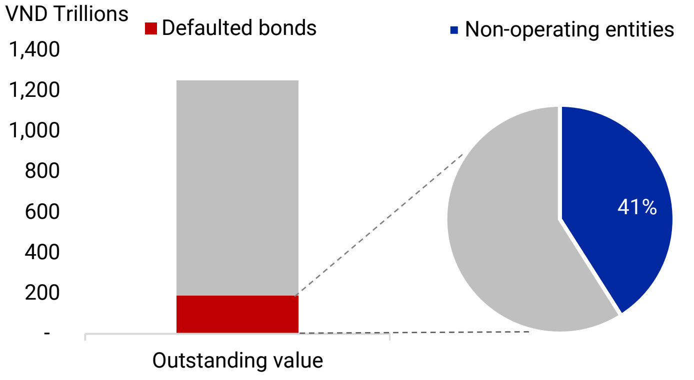
2. What are the key pain points to be addressed?

In our view, the corporate bond market has made strides to strengthen market behavior. However, recent bond transactions continue to reflect a lack of adequate risk awareness and a deep pool of investors to support market activity through volatility.

Most of the bonds issued and traded in the secondary market are either issued by non-operating entities or are private placements and, hence, have limited publicly available information that investors can access to analyze and monitor investment risks.

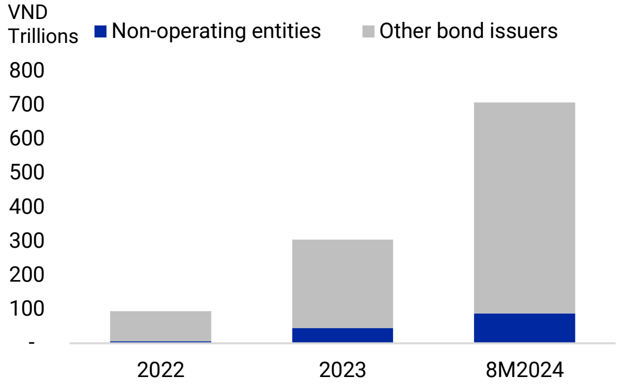
Our concern stems from the fact that close to 50% of the bond defaults during 2022 – 2023 are related to such entities (Exhibit 5). These issuers previously managed to issue bonds at attractive pricing despite their weak financial strength. Today, many of these bonds are traded in the secondary market (Exhibit 6), and we do not see a meaningful difference in their traded yields compared with bonds issued by financially stronger companies.

Exhibit 5: A significant number of non-operating entities defaulted on their bonds



Source: Vietnam Investors Service

Exhibit 6: Non-operating entities still account for sizable secondary trade volume



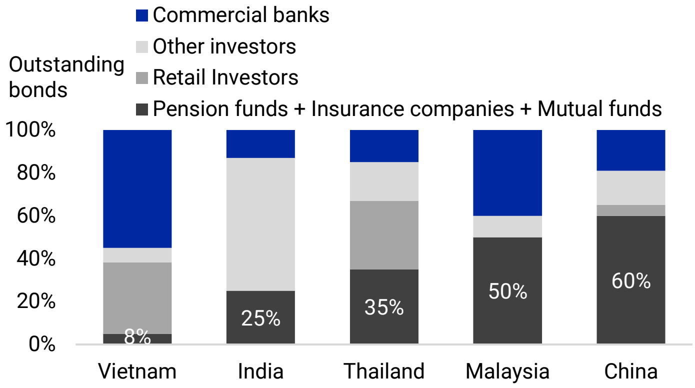
Source: Vietnam Investors Service

Compared with more developed corporate bond markets in the region, Vietnam lacks institutional investors that have long-term investment horizons and risk tolerance to endure short-term volatility.

In the impending changes to the securities law, which is expected to be introduced by Q4 2024, the regulator intends to introduce additional safeguards against excessive risk-taking by investors, such as restricting private placement bonds to institutional investors only. Hence, greater participation by institutional bond investors is critical for the sustainable growth and development of the corporate bond market.

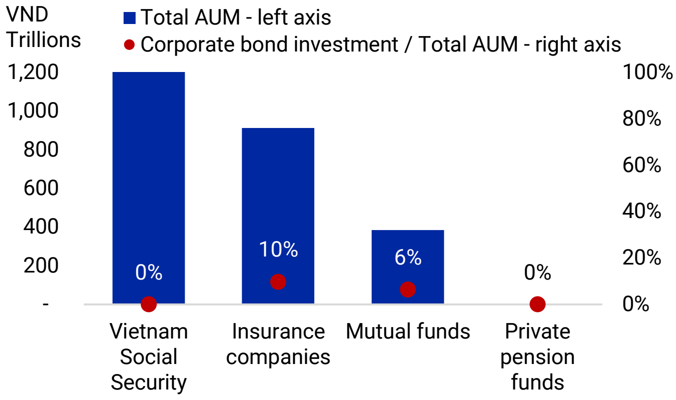
According to the Ministry of Finance, institutional investors such as insurance companies, pension funds, and investment funds hold only 8% of the total outstanding corporate bonds at the end-June 2024, significantly lower compared to regional markets (Exhibit 7). Unlike retail investors, who tend to focus on short-term gains, institutional investors typically have developed technical capabilities to understand and assess investment risks, make long-term investments, and have high-risk tolerance to endure short-term volatility. Vietnam's largest institutional investor is the Vietnam Social Security with assets under management (AUM) of VND 1,200 trillion as at end-Dec 2023, and it has not begun to invest in corporate bonds (Exhibit 8).

Exhibit 7: Vietnam corporate bond market's lack of diversified professional investors



Source: Asian Bonds Online, Ministry of Finance (MOF)

Exhibit 8: Funds with large AUM in Vietnam have not made sizable investments in the corporate bond market



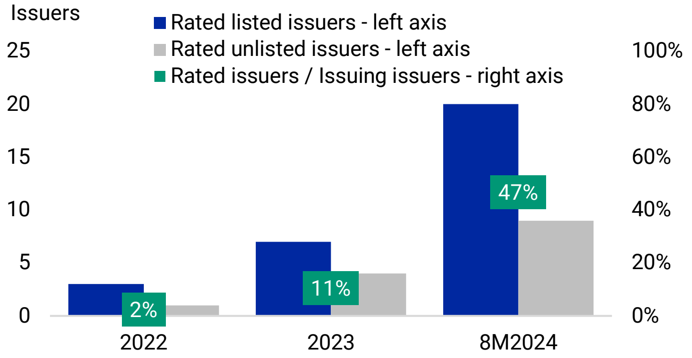
Note: Private pension funds AUM are VND 865 billion. Data updated as of 31 December 2023
Source: MOF, Vietnam Social Security (VSS)

3. How can credit ratings be used to support decision-making?

Each of the four licensed credit rating agencies (CRA) in Vietnam has its own credit rating scales, methodologies, and processes. Market participants can extract useful information by comparing how each CRA positions the ratings of various bond issuers and bonds within its rating scale.

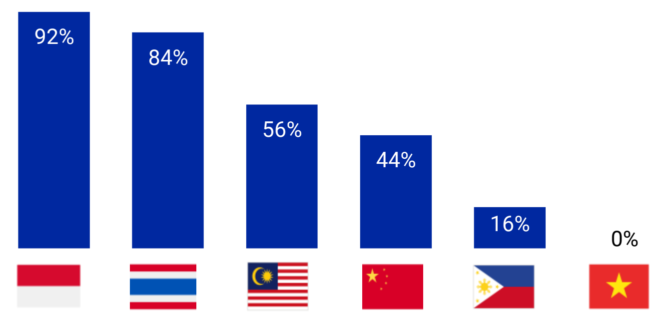
Over the first 8 months of 2024, 29 companies were assigned issuer ratings, almost 3 times higher than in 2023 (Exhibit 9). Investors can refer to the rating announcements and research reports released by the CRAs to understand the rationale behind the rating assigned and extract information related to a company's creditworthiness, such as the strength of a company's core business and cash flows, track record of corporate execution and management stewardship, debt repayment capacity, etc[3]. Such information provides an independent and objective opinion about a company's relative credit strength and ability to repay its debt obligations and serves to complement other information sources that investors will use for their investment analysis.

Exhibit 9: The number of issuers rated increased significantly in the first 8 months of 2024



Source: Vietnam Investors Service

Exhibit 10: Percent of rated bonds in regional markets



Source: Asian Bonds Online, Vietnam Investors Service

Bond ratings can serve as an independent source of information for issuers and investors to consider when determining the risk premiums for bond transactions.

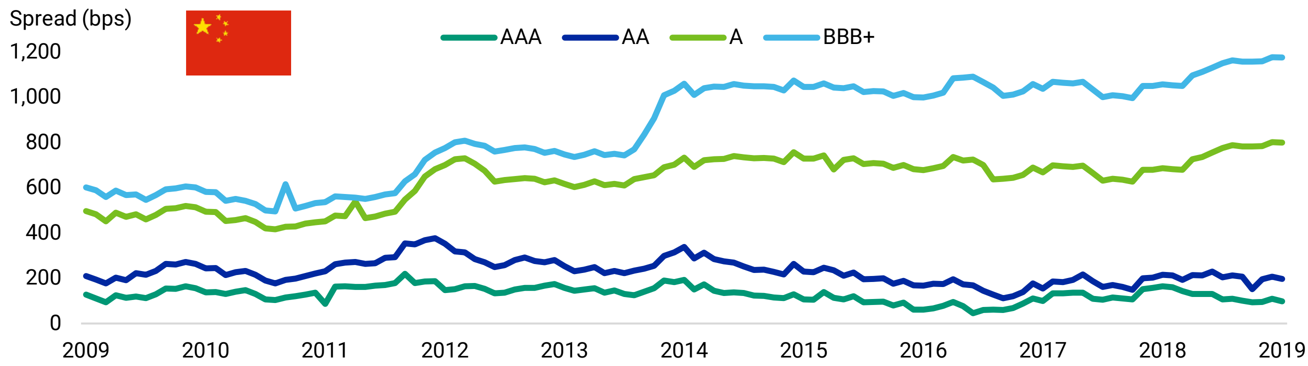
Unlike issuer ratings, bond ratings incorporate the specific risk features of an individual bond, help explain the relative differences in investment risks, and reduce potential mispricing. As of today, none of the corporate bonds outstanding in Vietnam are rated, contrary to other regional bond markets (Exhibit 10).

Investors can refer to bond ratings and historical bond pricing to determine a benchmark for pricing new bond transactions. In principle, for bonds with similar terms and conditions, bonds issued by issuers with stronger creditworthiness should carry a lower coupon rate than those issued by weaker credit quality issuers; bonds issued by issuers of the same credit quality should carry similar coupon rates.

In the regional markets, credit ratings support the assessment of relative credit risks for bond investments. As shown in Exhibit 11, corporate bond spreads in China widen as credit risk increases, and the spreads across different risk and rating categories move in a consistent manner over time.

As more companies and bonds in Vietnam are rated, investors and issuers can benefit as bond pricing systemically incorporates relative risk considerations.

Exhibit 11: Credit ratings support market price discovery in regional markets



Source: Asian Bonds Online, Vietnam Investors Service

[3] Refer to our rating announcements and research reports on VIS Rating website