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Vietnamese corporate bond market – Adjustments to develop sustainably

14 April 2022

Within the first weeks of April, the authorities have handled several violations related to the corporate bond market ("C-bond"). Deputy Prime Minister Le Minh Khai has just signed and promulgated Official Dispatch No. 304/CD-TTg dated 07 April 2022, of the Prime Minister to rectify corporate bond market activities and land use rights auction.

The series of events is a hot topic for Vietnamese investors and market participants. Licensed by the Ministry of Finance and has announced the credit rating results of 5 issuers, including three real estate businesses in Vietnam, we would like to share our perspective as a credit rating agency on the events' possible impacts on the Vietnam capital market.

Capital mobilisation through C-bonds may decrease, but there will also be changes in quality

Along with the event, there are policy changes, including the State Bank of Vietnam's Circular 16 on corporate bond trading of credit institutions and branches of foreign banks and the draft amendments of Decree 153 on private placement. These policies may cause the issuance value on the C-bond market to decline significantly in 2022. Such decline is likely to occur in the private placement channel by unlisted companies and/or project companies set up to raise capital. As we pointed out in our previous Market Insight Reports, these companies have limited information disclosure and quality.

In 2021, C-bonds attracted VND 682 trillion domestically, reflecting a substantially large capital mobilisation channel. This number accounted for 54% of the new credit growth balance changes in 2021 and has already surpassed such changes if we exclude the short-term credit. Even with the problems detected and handled by the authorities, the C-bond market has proven its vital role as a capital channel for the development of businesses in the medium and long-term to recover from the pandemic.

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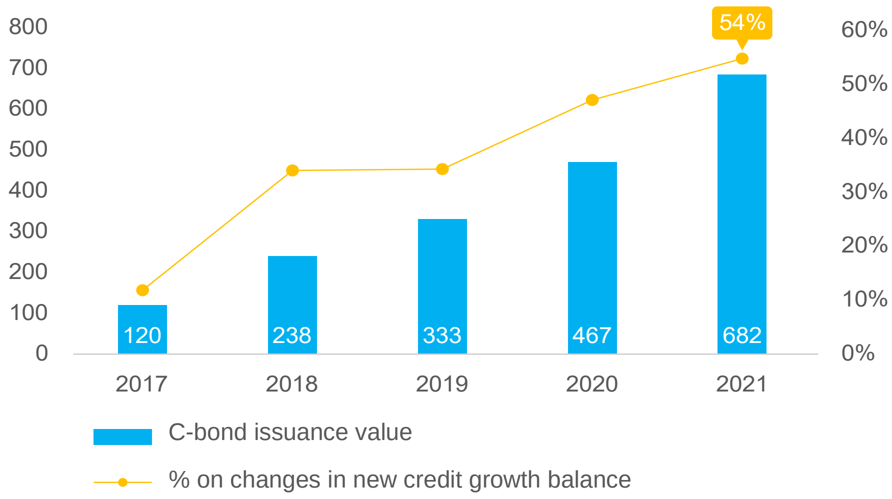
Figure 1: C-bond issuance value continues to increase on the credit growth structure



Source: FiinRatings, SBV, HNX
Note: The above data is compiled and calculated from the information disclosure of the Ministry of Finance and the State Bank of Vietnam, with the structure of changes in new credit growth balance calculated by taking the difference of the credit balance of the economy at the year-end. Corporate bond issuance data does not include corporate bonds issued in foreign currencies.

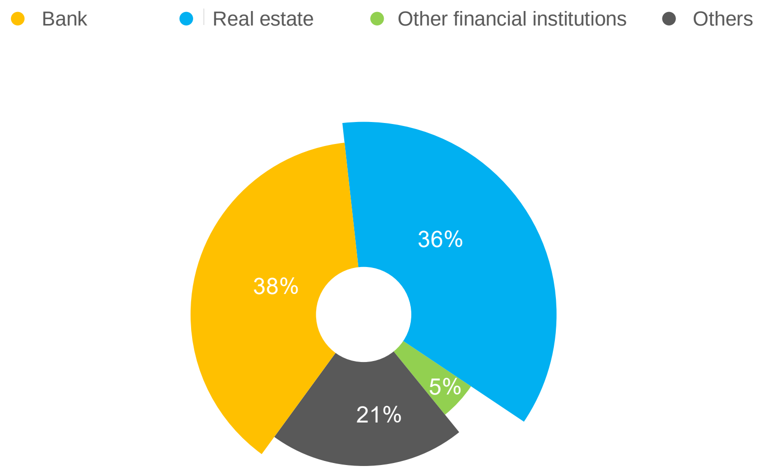
In this current context, we expect the following development that may take place in the second half of 2022 and 2023:

- Companies with a good foundation, which is not established to raise capital, especially listed companies, will still promote bond issuance activities. C-bond issuance is still an effective channel as (i) the interest rates seem to bottom out but are still low; (ii) the restricted credit from banks to the real estate sector, even before Circular 16 came into effect to limit real estate credit through the form of bond purchase from commercial banks.
- Raising capital through issuing new shares may be more active even though the stock market is not as vibrant as it used to be. However, this activity is more suitable for public companies with its current regulations required for information transparency, and their shareowner dilution problem is not significant.
- We also expect a qualitative change in the C-bond market, reflecting by (i) the public offering will grow strongly, especially from businesses with good business records and proactive disclose of their credit records to the market; (ii) private placement may be less active and focus on a broader investor base, including individual professional investors, financial institutions such as insurance, bond funds, pension funds, etc. instead of commercial banks and securities companies as before.

Impacts of C-bond quality on the banking industry credit quality

Along with securities companies, commercial banks are a major player in the primary issuance channel, accounting for 36% in 2021 of the total issued value from real estate businesses. The application of Circular 16, in our opinion, is necessary to not only control the quality of bad debts, especially for banks with poor asset quality, and the size of real estate credit, but more importantly, to control credit transfer activities between the bonds and bank loans channel through refinancing, capital restructuring or possibly “debt reversal” between these two channels.

Figure 2: Structure of corporate bonds purchase of commercial banks in 2021



Source: FiinRatings

Note: Data from financial statements of 29 commercial banks in Vietnam, which accounts for 99.1% of the total credit balance of the whole industry in 2021

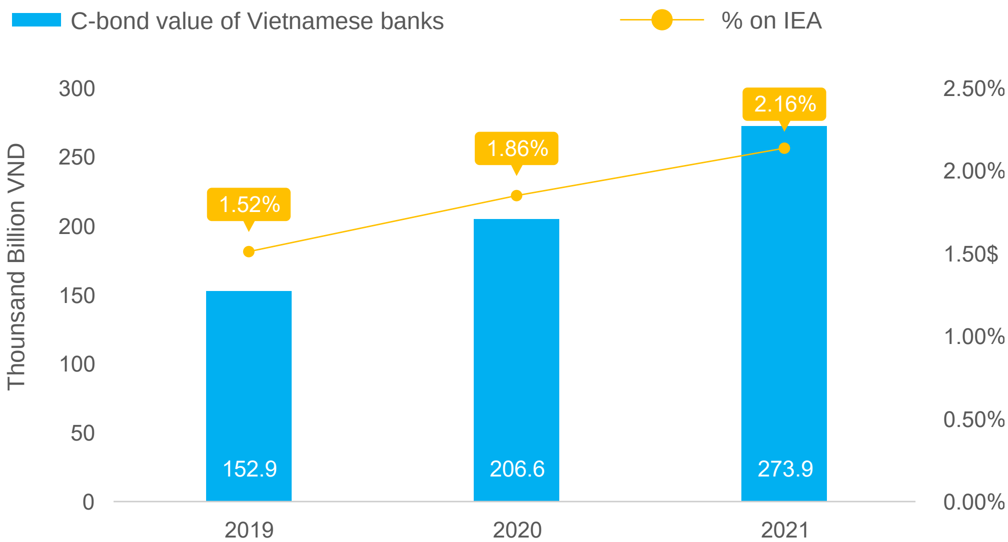
Our data shows that the size of bond outstanding credit is currently at VND273.9 trillion at the end of 2021, which is only 2.16% and 2.63% of interest-earning assets and the total credit balance of commercial banks, respectively. Thus, we expect the impact of the mentioned events on the credit quality of the commercial banking system is insignificant.

However, this risk will only be minimized if the problems of the violated issuers are isolated and the related parties, such as the debt repayment guarantors, make their efforts to protect the investors’ interest.

The above statement is significant because the C-bond market is widespread. It is substantial in scale and has the strong participation of individual and professional investors through retail activities.

Therefore, from the perspective of the banking industry credit quality, we also expect this scale to maintain or improve selectively in banks with high credit growth, decent asset quality (bad debt accounts for less than 3%, according to SBV), and low real estate credit allocation (complying to SBV’s regulation and specific requirements in Circular 16 which came into effect from 15 January, 2022).

Figure 3: Corporate bond ownership/Interest earning assets of commercial banks over the years



Source: FiinRatings

Note: Data from financial statements of 29 commercial banks in Vietnam, which accounts for 99.1% of the total credit balance of the whole industry in 2021

How does it affect the Real Estate Industry?

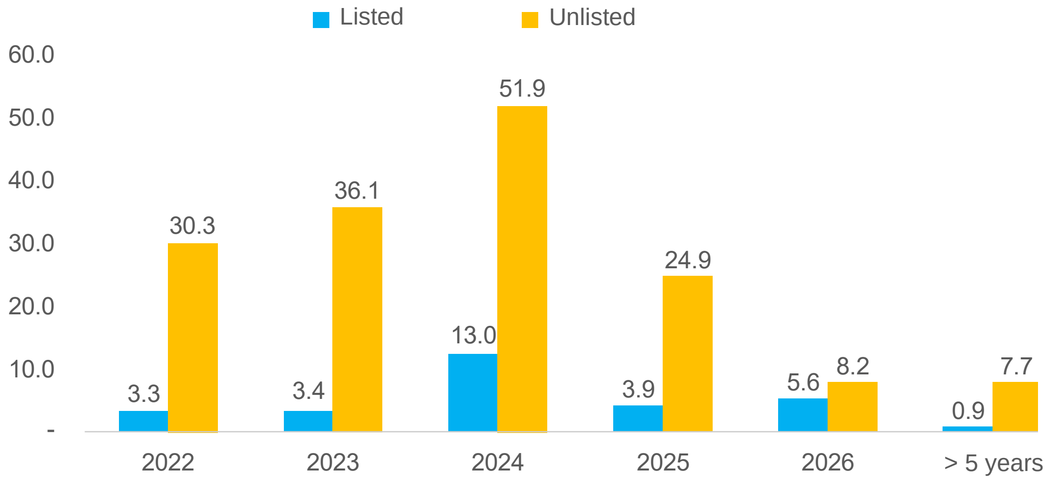
The financial health of most real estate companies remains relatively safe: excluding SPEs set up for raising capital via bond or bank credit, the Real estate industry ("real estate"), particularly the residential real estate segment, still has a relatively low level of financial leverage compared to itself seven years ago. It is reflected in some key criteria when assessing credit capacity, including Listed residential real estate firms' debt/equity ratio of 0.7x; EBITDA/interest expense ratio of 1.8x; and short-term debt coverage of 3.8x at the end of 2021.

It is worth noting that the financial health was recorded within the two years of COVID-19, during which the total number of apartments sold in Hanoi and Ho Chi Minh City had dropped to 29,000 units/year, less than half of the average figure of 66,000 units/year in 2015-2019.

The critical issue, in our opinion, is the pressure to pay bonds matured in the next 2-3 years. The size of the real estate corporate bond outstanding was about VND189 trillion at the end of 2021, 73% of which is expected to mature in the next three years. See Figure 4.

As a result, real estate firms would likely face growing debt repayment pressure while recovering from COVID-19, adapting to regulatory changes, and coping with financial institutions (i.e., banks and securities firms) liquidity risk triggered by recent incidents. In addition, the debt repayment pressure could create significant impacts on the equity market as listed stocks were used as collateral for bonds or as funding sources to purchase low-quality bonds.

Figure 4: Divergence in Maturity Value of Vietnam Real Estate Corporate Bonds (trillion VND)



Source: FiinRatings

Note: The data is compiled from 744 outstanding corporate bond values published on HNX as of 31 December 2021.

How to avoid the collapsing Domino effect? The outlook from 2022 onward will only maintain if the above incidents and regulatory changes do not create a Domino effect, i.e., isolating and dealing with problematic firms instead of applying rough measures to the whole industry. This risk could also be controlled if currently reviewed bond investors' and possibly issuers' benefits are guaranteed, i.e., either the partial or complete amount of principal and interest would be recalled and informed to bondholders.

The isolation of violated firms and other related issues, which aims to protect individual investors' benefits, would prevent the collapsing Domino effect on complied issuers and weak issuers as long as they intend to be transparent. Furthermore, the isolating measures would limit the negative impacts on bank credit and the equity market, as observed in the Chinese real estate market after the "3 red lines" measure was applied.

In credit market practice, when a business is late in paying principal or interest on a loan to this investor, the cross-default clause might be activated, which means payment terms can be activated earlier than other debt owners. The flexibility in the domestic capital market might be applied but will be highly applicable, especially to the terms of credit contracts (loans or bonds) of the company raising capital from foreign investors, foreign financial institutions

Our data shows that foreign currency loans, including bonds of listed Vietnamese real estate companies, are currently around 4 billion USD. It is not a significant number compared with the credit scale in the real estate industry (currently at 7.04% of total residual in debt credit use – excluded 12.79% balance in debt credit use for people buying a home) and national financial safety risk, but the impact of real estate credit risk may affect both Vietnam's national and other industries rating score. It can lead to higher interest rates, reducing the competitiveness of Vietnamese businesses to FDI companies operating in Vietnam or doing business in the international market.

Ensuring bond credit sources for the real estate industry may also limit the risk associated with collateral revaluation and thus determine the effects on the bank's bad debt. We observed that policy agencies, including the SBV, have promptly handled this issue through the developments and outcomes of the recent Thu Thiem land auctions.

But that doesn't mean all issuers contain high risk

As mentioned above, we believe that residential real estate issuers can meet their basic financial obligations, which have been thoroughly analysed in correspondence to other sectors in Vietnam and indicated in FiinRatings' published real estate issuer credit ratings. Hence, there are still opportunities in the corporate bond market for firms with a solid fundamental base and would like to disclose their business risk profile to the public.

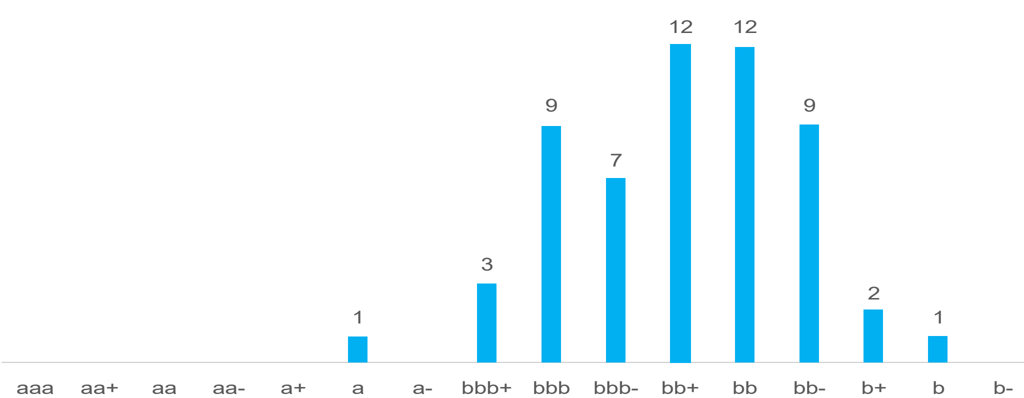
The preliminary credit rating results demonstrate the industry's current financial health for investors and market participants, see Figure 5. Based on a standardized credit risk model, there are currently 35% of listed real estate firms having overall scores within the "investment grade", meaning Tier 4 or BBB- level and above (defined as "possessing relatively good capacity to meet financial obligations but more volatile under unfavorable market conditions. See [the rating framework](#)and explanation of the rating scores in KDH Credit Rating Results).

There are 70% of listed real estate companies have a score within "speculative grade", i.e., BB+ or less, meaning a Moderate or Weak ability to meet financial obligations on FiinRatings' credit rating scale.

It shows a considerable divergence between firms in the industry from level A to level B. Specifically, some real estate companies face more significant difficulties and higher risks; but many possess a good fundamental base and can continue to improve if systematic risks are controlled.

Although not having sufficient data and information to provide a complete assessment and overall credit rating scores for unlisted real estate firms, we have observed that most of them, being project companies, have weak financial health conditions and unconfirmed business capacity.

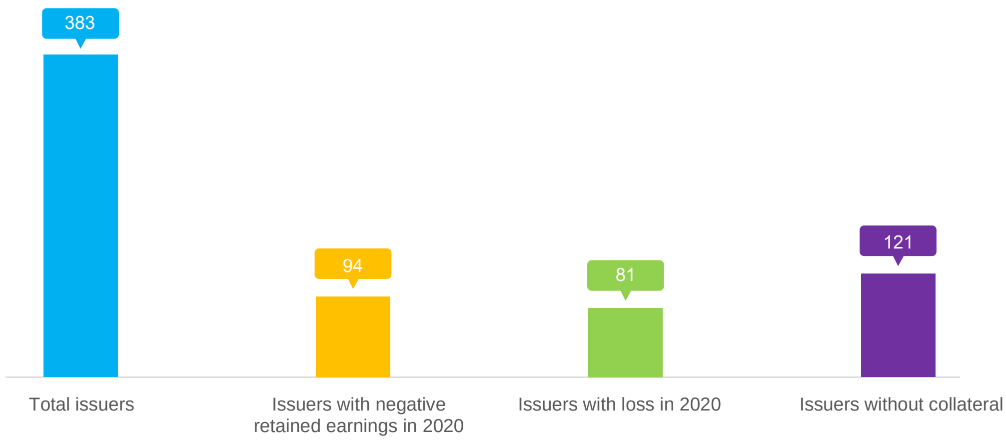
Figure 5: Preliminary credit score of listed residential real estate businesses



Source: FiinRatings
Note: The chart above shows a preliminary ranking result for 56 residential real estate firms based on the financial information we collect and based on a quantitative analytical model.

Along with the intrinsic credit risk factors of real estate issuers, FiinRatings also continue monitoring the industry-specific risk factors, including (i) the pressure to refinance maturing debts in the context of policy changes, including Circular 16 of the State Bank of Vietnam on restricting investment in corporate bonds by commercial banks. (ii) The increasing interest rate may result in higher capital rising costs; (iii) inflation tends to increase, affecting the cost of input materials and outsourced services during the implementation of new projects; (iv) major changes to the Government's legal framework related to land prices, property taxes and standardization of real estate brokerage personnel and other factors.

Figure 6: Issuer's financial situation in 2021



Source: FiinRatings
Note: Includes only issuers that provide information on types of issuance

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