Vietnam: Exploring The Vietnamese Corporate Bond

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Vietnam's Chronology Of Bonds

Corporate bond is a type of debt financing that reaches ubiquity around the world. This financial asset, by definition, promises to give holders (also, investors) financial payoff in the form of a fixed amount of money at certain points of time in the future.

While in more developed countries, the word 'bond' refers to the debt instrument carrying a maturity of 10 years or more, in Vietnam a similar instrument with maturity of over one year is termed as bond. Perhaps, it is worthwhile to take a look back upon the chronology with respect to our discussed bond as a term financing vehicle. In this exploration, corporate bonds (including the specific term of 'project bond' as used in Vietnam) are of the primary concern, with an emphasis on their practicality and technicality. These bonds are issued by and/or on behalf of corporate entities having the need of raising external debt funding other than bank loans.

Recent Issues Of Corporate Bonds

Project	Issuer	Unit	Value	Years of issue	TTM (yrs)	Coupon (p.a.)	Type/Remarks
500KV power line	EVN Corp.	VND	334.0 bn	1992-94	3	3.8-5.0%	Bonj/MOF-gteed; gold-indexed
Cement	Hoang Thach Plant	VND	44.3 bn	1994	3	21%	Bond/S-Treasury-gteed.
Cement	Anh Son Plant	VND	7.5 bn	1994	3	21%	Debenture
Air-con engineering	REE	US$	5.0mn	1996	2	4.5%	Bond/Convertible

Steel casting	Southern Stell Corp.	US$	0.46 mn	1995	3	n.a.	Debenture
Power	Yali Hydro Power	VND	200.0 bn	1995-96	3	8.5%	Bond/S-Treasury-gteed.
Tourism	Khanh Hoa Tourist	VND	25.0 bn	1998	5	n.a.	Debenture
Cement	Phuc Son Plant	VND	63.0 bn	1997-98	3	14%	Bond
Financial service	VILC	VND	10.0 bn	1999	5	11%	Debenture/ICBV-gteed.

**Source: Vietnam Investment Review (various issues); ING Barings Research (1998); and relevant reports.*

These bonds reflect to a certain extent the nature of corporate bond. However, one can immediately recognize the 'transitional' nature of them, sensing enough the State's endorsement in the issuing process. In many cases, Vietnam's local treasury departments intervene greatly to ensure the 'smooth' sales of them.

The situation has naturally changed over time when new companies enter the playing field. Those cost-concerned issuers such as Refrigerant Engineering Enterprise (REE) and Vietnam International Leasing Co. (VILC) did shift the industry by further leveraging up commercial concepts inherent in bonds. 'Plain vanilla bond' now has its sophisticated cousins with more embedded options such as convertible, callable, putable, etc. Vietnam's industries become excited to learn about this methodology of fund-raising, and undoubtedly expect a better choice of financing options.

In this overall picture of Vietnam's corporate bonds, the frequency of bond issues has increased constantly since 1994. Although these numbers provide no ground for the forecasting of Vietnamese future bond market, but since we are talking of the kickoff of a new financing tool, they do give a feel that the value of future bond issues will likely be up exponentially. Those top-tiered SOEs, which have repeatedly expressed their interests in issuing corporate bonds, include industrial powerhouses such as PetroVietnam, Vietnam Electricity Corp., Vinalines, Vietnam Airlines, etc.

Risk-Reward Fundamental: 'Caveat Emptor'

It requires no more than a simple look for one to understand that bond provides badly needed term finance, given term-to-maturity (TTM) of over three years, for enterprises operating in

Vietnam. This fact should be highlighted amid the bankers' sagging morale in providing term lending after serial defaults. In current practices, although not necessarily best, the cost of fund-or coupon rate on any issue is set upfront and remains unchanged. The determinacy of cost as usual is most welcome by firms' management.

From the firm's standpoint, the use of bond very much depends on the technicality that determines the way this finance can benefit its own operation. A bond is recognized by its attributes of:

- Term to maturity (TTM: finite term vs. perpetual);
- Coupon rate (per cent p.a.; fixed vs. floating);
- Coupon payments (annual; semiannual; pure-discount);
- Applicable interest rate (per cent p.a.; flat vs. term structure).

These features of a bond determines how the value of that bond fluctuates and changes over time when applicable discount rate changes. Bondholders in Vietnam are now having little chance to liquidate their holdings, thus tend to buy for holding until maturity. This illiquidity to a large extent prevents the populace from holding a set of bonds instead of depositing funds at banks.

However, many Vietnamese bondholders who have not even been familiar with concepts and terms of corporate finance may not know sufficiently that the value of his/her holding is very sensitive to TTM, and thus may have neglected the risks born to them when holding a longer-maturity debt instrument. The public investors have in reality been exposed to a larger degree of uncertainty, which they are not fully aware of. And due largely to this uncertainty, an investor has to accept the principle that the longer their holding's maturity is the less it is priced today.

<u>Technical Box</u>

Consider a zero-coupon bond, the relation is stated mathematically (Wilmott, *et al.*, 1999, pp. 267) as:

$$r(T) = \frac{-1}{V(t,T)}\frac{\partial V}{\partial T}$$

* **Where**: $r(T)$ is interest rate as function of time;

$V(t,T)$ Bond price as function of time and TTM;

Latter of right-hand side: partial derivative of V with respect to T.

$$\frac{\Delta V}{V} = \frac{-t}{1+r}\Delta r$$

This equation tells the longer the bond's TTM, the less it is worth today. Another simplified math expression gives a feel about the relation between the change in bond price and change in interest rate:

An example of this is a 10-year (*t*) zero-coupon bond, with the face value paid at maturity and a flat discount rate of 10% p.a (*r*). If the interest rate now increases by +1% (D *r*), and stands at 11%, then the change in price of bond (D *V*/*V*) is approximated: [-10(0.01)]/(1+0.10)= -0.091. In other words, with every percent increase of interest rate, the bond price goes down by approx. 9% (economic sense of the negative sign).

The risk is also represented by the fluctuation of bond price in relation to the changes in applicable discount rate, literally the prevailing interest rate. The word expression of that relationship is that the rate of change of bond price is inversely related to the rate of change in interest rate. These considerations do imply that holders of such long-maturity financial claims in fact take a great risk, and thus should be compensated adequately. Potential investors in bonds should definitely take this into account on a caveat emptor basis, demanding an appropriate level of coupon rate.

Let's Make The Bonds Work

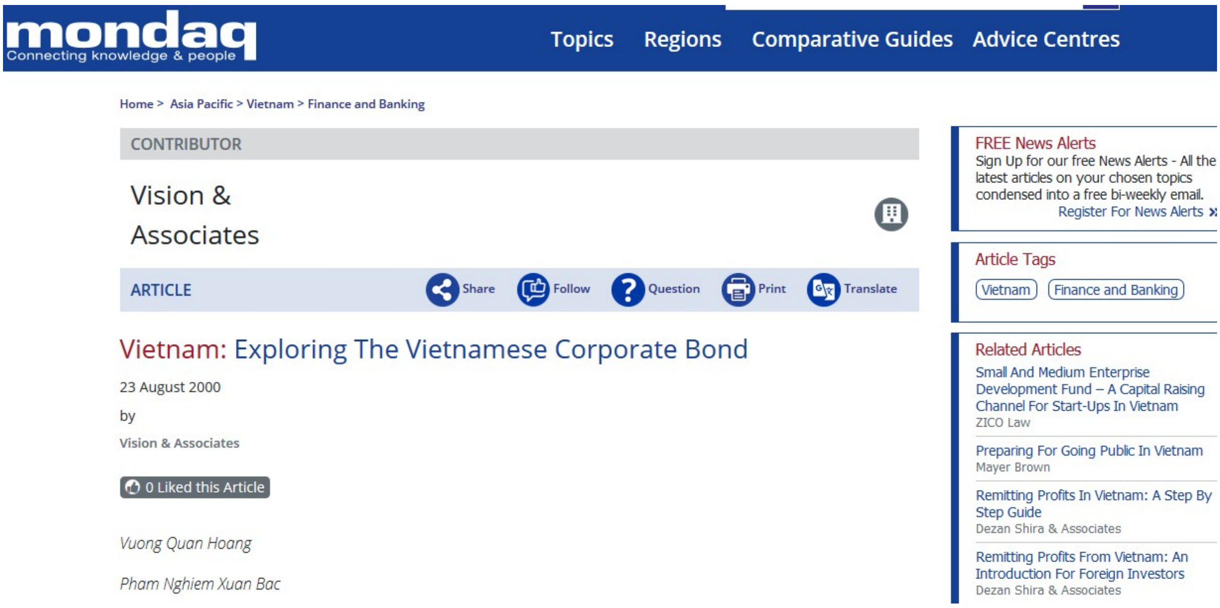
Bonds are becoming more appealing and clearly an important component in the financial market and provide a fund-raising vehicle for Vietnamese enterprises. The need to promote the using of bonds is even further pressed given the fact that local bankers have significantly lagged behind the pace of enterprises' development. Chaos in Vietnam's banking sector also means that commercial banks fail to address the financing need when they are most needed, justifying the driving force for firms to look up their ways.

For bonds to really work, they critically need a higher level of liquidity to become truly tradable financial assets, to which local securities firms would likely pay attention. No one would argue the positive involvement of securities firms in promoting the issuing and trading of corporate bonds, although the official bourse of Vietnam is promised to open not before July. The more bonds are paid attention to by professional securities firms, e.g. the locally-established Bao Viet Securities, the less likely they are mispriced. However, what missing in the picture still is local competent analysts, who serve to figure out technical issues and provide trustworthy advices.

Thus far, the experience has provided the impression that there appears to be no real difference between the pricing of a very risky bond and that of a near-risk-free one with adequate attention by Vietnamese practitioners. In our sample, most bonds carry the coupon rate of little deviation from a one-year bank lending prevailing in the marketplace, with State T-Bond as a 'standard' reference. It is not unfair to say that the lack of significant public awareness of risk-reward principle in Vietnam contributes greatly to this unusual pricing, in which case firms enjoy the comparatively lower cost of funds even if their financial assets are unsecured and riskier.

In the meantime, critically needed is a comprehensive regulatory framework that enables not only state-owned but also non-state enterprises to be able to issue a wide range of bonds legitimately. This move will certainly pave the way towards a functional corporate bond market and open up the funding channel for enterprises via bond issues.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances



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