

FINANCIAL RESTRUCTURING IN ASIA

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Emerging Asian markets (excluding Australia and Japan) have seen a large influx of foreign capital over the past decade as governments have relaxed constraints on foreign investment and as institutional investors continue to search for yield in a low interest rate environment. While the region offers many intriguing investment opportunities, there are numerous cultural, political and structural differences that present unique challenges that differ from those faced by investors in more developed markets.

In the current economic climate, corporate debt in Asia continues to mount as a growing list of distressed borrowers hovers on the verge of insolvency. This massive buildup comes at a time when economic forecasts for Asia ex-Japan are tumbling to four-year lows. The Asian Development Bank predicts regional growth of around 6.2 percent for the year ahead. At the same time, China's slowdown and the anticipated halt to the US Federal Reserve's bond buying program reverberate across the region's emerging markets.

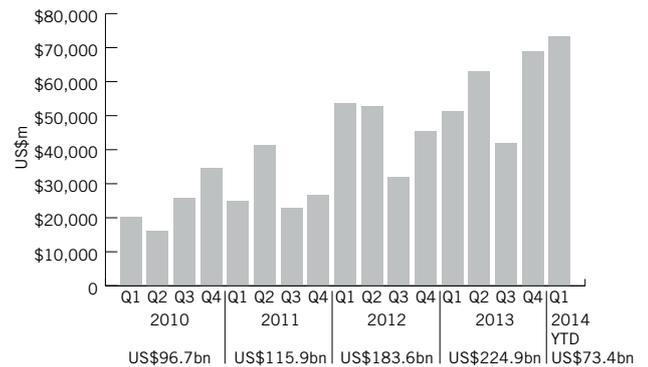
In light of the increase in foreign denominated debt held by international creditors, Asian companies face additional financial difficulties in an insolvency context given the complex cross-border investment base and the divergent motivations of international vs domestic creditors.

Capital structures and G3 currency bonds

Economic growth and increased capital flows have allowed capital structures in Asia to reach new levels of maturity over the past decade, which has provided corporates access to various new types of equity and debt capital. In turn, as credit markets deepen across the region, capital structures are becoming more complex and attracting a new, diverse mix of investors.

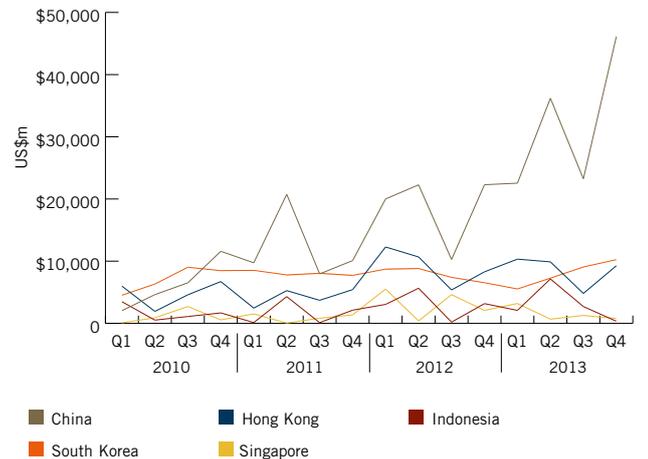
Emerging Asia's corporate bond sales have grown significantly since 2000. Exemplifying this trend have been bonds denominated in G3 currencies – US dollars, euros or yen – which rose from US\$97bn in 2010 to US\$225bn in 2013. In the first quarter of 2014, Asia had

Figure 1: G3 currency issued corporate debt in Asia-Pacific

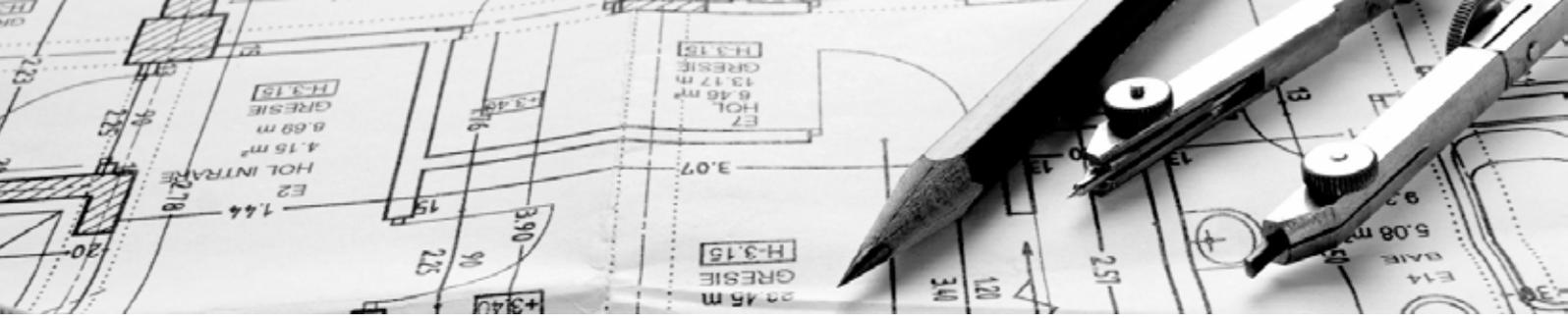


Source: Asian Development Bank

Figure 2: G3 currency issued corporate debt



Source: Asian Development Bank



its busiest start to a year in terms of G3-denominated bond sales at US\$73bn, or US\$294bn annualized, according to ADB data. Standard & Poor's estimates that if this level of issuance continues, driven in part by a credit surge in China, total corporate debt in Asia could surpass the combined debt of the United States and Eurozone within the next several years.

In China, G3 bond issuance almost doubled between 2012 and 2013 – from US\$74bn to US\$128bn – led in part by Chinese and Hong Kong property developers. These developers sold almost US\$6.5bn in bonds in January 2014 alone, a tenfold increase over December issuance, according to Bloomberg.

A Tale of Two Chinese Restructurings: Suntech & LDK

There are currently two high-profile restructuring cases underway in China – Suntech Power and LDK Solar – with substantially similar dynamics on paper in terms of location, industry, size, underlying business, capital structure, corporate structure, etc. These cases, however, are likely to result in vastly different outcomes for stakeholders involved. Many lessons can be learned from these restructurings, including the importance of communication, process, and understanding the objectives of everyone involved, as well as how working constructively to reach a negotiated settlement often results in a value maximizing outcome vis-à-vis an involuntary bankruptcy filing in an untested jurisdiction like China.



LDK Solar

Default Date
August 2013

Offshore vs Onshore Debt Mix



In-Court vs Out-of-Court

Consensual out-of-court negotiation

Situation Overview

- After a missed coupon on its \$265m USD-settled Senior Notes, LDK initiated restructuring discussions with its onshore and offshore creditors in August 2013
- Following months of negotiation, in late December 2013 the company announced the basic framework of a consensual restructuring transaction which will keep the public listing intact and provide LDK with the liquidity necessary to continue to fund operations and creditors a path to recovery over time
- In late March 2014, LDK entered into restructuring support agreements with the majority of its offshore creditors and obtained a commitment for interim financing
- The agreed restructuring is expected to be implemented through a Cayman scheme of arrangement and ancillary proceedings in the United States and Hong Kong; LDK is targeting to exit in late summer 2014

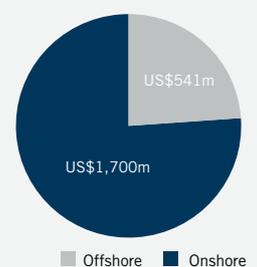
Outcome for Key Stakeholders

- Onshore Creditors – Unimpaired
- Offshore Creditors – Potential path to recovery over time through new convertible bonds and restructured equity
- Public Equity – Will continue to retain ownership stake in the company

Suntech

Default Date
March 2013

Offshore vs Onshore Debt Mix



In-Court vs Out-of-Court

Involuntary bankruptcy filing in China

Situation Overview

- Suntech defaulted on \$541m in foreign denominated convertible bonds at maturity in March 2013
- Subsequent to the default, in an effort to protect their interests, Suntech's domestic banks filed involuntary insolvency against the company under the Enterprise Bankruptcy Law ("EBL") in China
- Following the EBL filing, an administrator was appointed by the court to oversee the restructuring process, which ultimately led to a sale of the company's key manufacturing assets to a strategic third-party
- Wuxi Suntech's onshore creditors approved the onshore restructuring plan in November 2013 (pending implementation); offshore bondholders have initiated litigation in opposition of the onshore restructuring process and sale

Outcome for Key Stakeholders

- Onshore Creditors – Significant impairment; recovery limited to proceeds from sale of onshore manufacturing facilities in China
- Offshore Creditors & Public Equity – Left with no value onshore after the sale of the company's key manufacturing assets in China; recovery from international assets remains uncertain

Undertaking a restructuring: The options and obstacles



Brandon Gale

The complexity of restructuring corporate debt can throw a struggling company even further into uncertainty. Brandon Gale, who leads Houlihan Lokey's restructuring efforts in Asia, elaborates on the restructuring process, relevant laws in Asia and how companies facing financial issues can navigate the process and reach an amicable solution with creditors.

When companies reach the point of insolvency, what options exist for them to avoid liquidation?

The options available very much depend on the circumstances of each situation and how a number of questions are answered. It's key to understand what the fundamental problem is – which can range from minor operational hiccups that require only a simple amendment to existing debt docs to more fundamental issues with business that necessitate the need for a reworking of the entire capital structure – and how much time the company has before a “trigger” event, that is, before it runs out of liquidity or defaults on debt instruments. It is also critical to understand valuation, debt capacity and the motivations of the various stakeholders involved, such as creditors, equity sponsors, and the government to name a few.

The answers to these questions will determine what solutions are potentially available, which can include:

- Raising new debt or equity capital, either from third party or existing stakeholders;
- M&A solutions, ranging from the sale of non-core assets to bolster liquidity to the sale of the entire company;
- Amending existing debt facilities, such as relaxation of covenants, modification to interest rate, amortization schedule and/or maturity date;
- Debt-for-debt exchange
- Debt-for-equity swap

What are the origins of the current restructuring model in Asia, and what actions will help yield the best results for debtors and creditors?

While there's no established “model” for restructuring, there are certain principals and market practices that have proven to yield positive results. Running an organized process with open lines of communication between the company and its creditors, and having a clear understanding of the motivations and goals of key stakeholders can set the stage for a proper negotiation. Also, a transparent flow of information to help creditors understand the current state of the business, prospects for the future, and what all this means for valuation and cash flow will help inform which strategic alternatives make sense to pursue.

Organizing focused sub-groups or committees of creditors for negotiation purposes is also common practice in restructuring situations. These groups should represent enough of the debt in value to be considered legitimate by the company, but not so large in number that the negotiating process is cumbersome.

Engaging the right legal and financial advisors – those that have relevant restructuring experience – can provide valuable insight, help expedite the process and enhance the likelihood of delivering a value maximizing alternative. These advisors typically help their clients

communicate with key stakeholders, evaluate the company's business plan and future prospects, assess all available strategic alternatives, and negotiate and structure the best value maximizing alternative.

What are the main obstacles in an out-of-court-restructuring, and what are the incentives for pursuing this course in China? In Indonesia?

No matter what the circumstances or where you are in the world, it is generally best to avoid restructuring under the purview of the court due to the added time, cost, and complexity involved. This is especially true in emerging Asia, where court systems and insolvency regimes in many jurisdictions are largely untested. There's also a degree of unpredictability and inconsistency in their application of the law, and varying degrees of corruption can also come into play. Lengthy court cases can also damage the long term value of a business, which is counter to the objectives of the various stakeholders involved.

Court-led strategies are often used as a threat to keep parties engaged or honest in out-of-court negotiations, and as a tool for implementation once a deal has been agreed to. There are several recent examples in Indonesia and India in particular where court-led strategies were successful in bringing parties to the table and leading to a resolution in relatively short order.

How underdeveloped are bankruptcy laws in Asia compared to the United States and Europe?

While a number of insolvency regimes in Asia are based loosely on the U.S. Bankruptcy Code or European common law principles, they can be described as largely untested, unpredictable in their application of the law, and as suffering from varying degrees of corruption – characteristics that aren't typically found in more developed Western markets.

Even so, as the credit markets across Asia continue to mature and capital structures become more complex, we have and will continue to see restructuring practices and insolvency laws in Asia evolve at a rapid pace. Over the next few years, we expect to continue to see distressed players in the region push the envelope with creative strategies and innovative deal structures that set precedent and further develop the market.

What is the outlook for the year ahead in terms of corporate debt and restructuring activity in Asia?

We expect corporate defaults to increase moderately over the next 12-18 months on account of slowing economic growth across the region. Reduced liquidity in the credit markets as the US Federal Reserves' tapering continues will also have an impact. As far as geographies, we expect the most active markets in the year ahead to be Indonesia, India, China, Thailand and Korea.

Natural resources, clean energy and shipping are industries we expect to see continued activity. These are industries that were historically financed with significant amounts of debt and are currently in cyclical downturns. We are also taking a hard look at the Chinese real estate market, which we believe may be overdue.

Houlihan Lokey is an international investment bank with expertise in mergers and acquisitions, capital markets, financial restructuring, and valuation.

Creditor diversity and complex restructurings

As capital structures develop, a diverse universe of creditors continues to enter the Asian markets. This has led to an increased number of complex restructurings, many far more contentious than the traditional bank workouts familiar to domestic corporations in the past.

The Asia Pulp & Paper (APP) debt restructuring from 2002 highlights these complexities. With operations in Indonesia, China and India, in addition to a business presence in over 65 markets, the Indonesian conglomerate found itself heavily indebted following an ambitious expansion. Creditors from the company's major operating bases in China, Indonesia and North America were involved in a multi-year restructuring that continues to this day. Many of the involved parties question whether the litigation surrounding the 2001 default will ever be fully resolved.

More recently, the pan-regional corporate debt restructuring case involving, Indonesian ship operator Berlian Laju Tanker (BLT) highlights the evolution of the Asian restructuring market over the past decade. In early 2011, faced with falling freight rates and the arrival of new ships to its fleet, BLT found itself with c. US\$1.9bn in debt and in default on six of its debt instruments. By 2012, a restructuring plan was proposed and laid out for an international consortium of creditors that comprised six secured creditors and as many as 216 unsecured creditors. Negotiations were settled in early 2013 via a multi-jurisdiction implementation process that included a PKPU process in Indonesia and a bankruptcy filing in the United States.

Legal and regulatory changes

National policies and regulations relevant to insolvency and restructuring proceedings continue to develop across Asia. However, these efforts have ultimately failed to keep pace with the rapidly changing environment and overall internationalization of business. In China and Indonesia, two countries at the top of many investor agendas, laws have recently been enacted that are being put to the test.

Modern bankruptcy legislation in Indonesia was implemented in 2004, replacing the previous bankruptcy regime that was first introduced in the early 1900s and later overhauled in 1998. While still in its infancy, the latest piece of legislation has been tested recently in several cross-border restructuring cases.

In 2007, China passed the Enterprise Bankruptcy Law, a new and more comprehensive bankruptcy regime that embraces many concepts drawn from the U.S. Bankruptcy Code, although the exact meaning and scope of these concepts remain largely untested. One of the more prominent features of the new bankruptcy law is the inclusion of rescue options to restructure debt or rehabilitate the business.

Other major changes included prioritization of stakeholders involved in any insolvency or restructuring proceedings. Previously, employee claims ranked ahead of secured creditors' claims. This claim priority was changed after much debate, with employees now holding priority over unsecured creditors while secured creditors hold the highest priority.

Challenges and roadblocks

While banks and certain creditor groups often attempt to use local legal systems to seize assets from insolvent companies, the unpredictability of courts and lack of legal precedents means investor rights are not always guaranteed. Recovering funds can also prove difficult when local economic interests, such as potential employment issues resulting from the closure or seizure of debtor facilities, cause local governments to intervene.

Given these concerns and regulatory issues across the region, it is often the best course of action for creditors, foreign creditors in particular, to engage with the company or equity sponsors on a consensual, out-of-court basis. This often requires creative deal structuring and a detailed understanding of the motivations and agendas of the various stakeholders involved, including an understanding of the cultural, regulatory, and legal norms in the jurisdiction in question.

Getting a deal done, in theory, requires everyone's support, and getting parties on both sides of the table to see eye to eye can prove time consuming to an already time-sensitive matter. As such, approaching situations early and engaging knowledgeable external advisors can be helpful in bringing the parties together and facilitating a negotiation that maximizes recoveries for everyone involved.



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