# Positive surprises from EM corporate restructurings

- Of the US$27.7bn worth of EM external bond defaults seen over the 2007-2010 cycle, US$24.5bn has been from 54 corporate issuers.
- On top of the 45.5 cent median recovery, post-restructuring performance shows that investors should have made an added 15.43 cents had they continued to hold their newly restructured bonds. This raises the weighted average recovery to 58.5 cents on a median basis which is 25 cents more than seen for sovereigns this cycle.
- Given that there remain 42 more issuer workouts yet to be completed – and these represent 56% of defaulted corporate debt – there is the possibility that average recovery rates will be forced lower. The average time since default among these is already 16 months, so we will unquestionably see the EM average workout period increase, although whether the impact on the direction of recovery values is higher or lower remains to be seen.

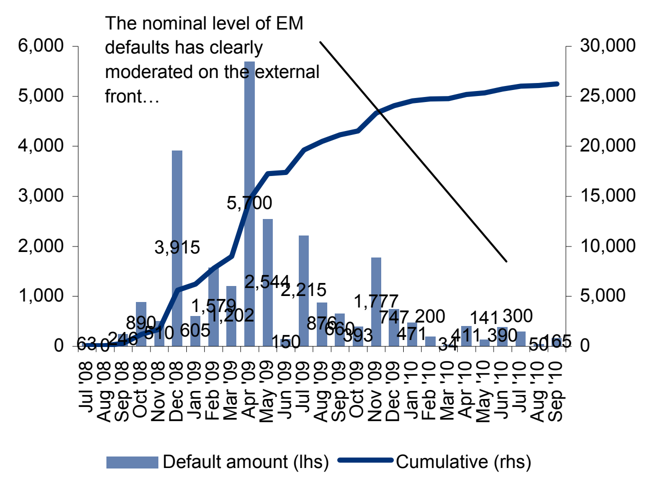
**External debt:** The most recent slate of recoveries in EM clearly work in favour of better corporate valuations. Higher-than-expected recovery values suggest that, in many cases, corporate spreads should be tighter than they are at the moment. Presently, corporate securities roughly assume a 40 cent recovery value. If recovery assumptions are raised to 45 cents, BB bond prices should increase by $1.3 and single Bs by $2.2.

## Defaults are in decline

**The EM spec grade corporate default rated dropped from 4.38% to 4.01% in September, despite Independencia's second default**

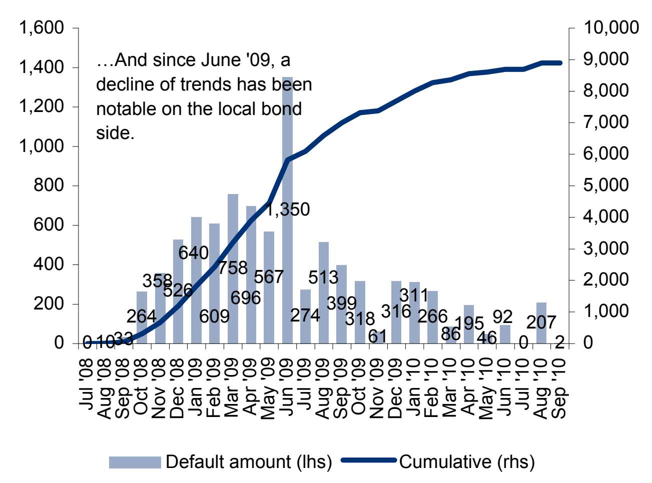
As expected, Brazil's Independencia defaulted for the second time in less than a year. The company failed to make its US$12.4bn coupon payment on its US$160m '15 bond on 30 September. It still has a 30-day grace period yet, but we feel it is unlikely to make it. The action leaves the EM speculative-grade default rate for September at 4.01% and lifts our forecast for the 2010YE default rate from 2.1% to 2.14% (Figure 3). This is assuming that the US$419m worth of EM bonds currently priced to default actually do. Otherwise, there was just one local default out of Korea on a KRW2m bond. Both EM external and local market bond defaults have clearly peaked, with the levels of monthly defaults dropping (Figures 1 and 2). So, overall, the default and technical environment remain very favourable for EM debt, perhaps with the exception of valuations.

**Fig 1 EM external bond defaults (US$m)**




Source: ING

**Fig 2 EM local bond defaults (US$m)**




Source: ING

**Fig 3 External EM bond default levels and 12M trailing rates**

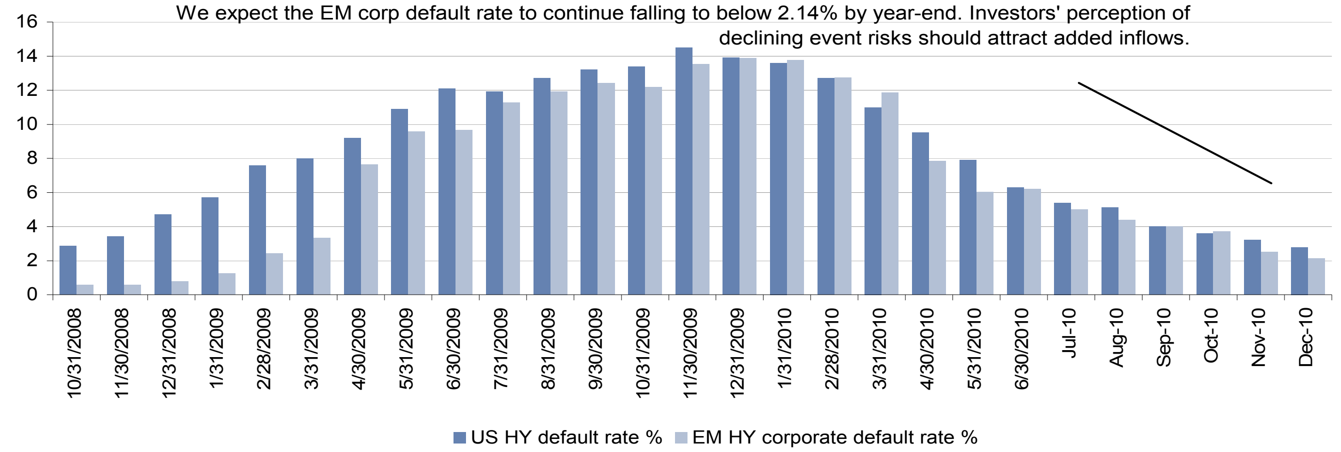
| | Total EM bonds | | EM spec grade corporates | | Spec grade external corporate defaults (US$m) | | | | | 12M trailing default rates (%) (spec grade corporate bonds) | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total (sov+ corp) defaults (US$m) | 12M total EM spec default rate (%) | HY corp defaults (US$m) | 12M corp spec default rate (%) | Latin America | Asia -ex Japan | EM Europe/ CIS | Middle East | Africa | Latin America | Asia -ex Japan | EM Europe/ CIS | Middle East | Africa |
| Jul '08 | 64 | | 64 | | 0 | 0 | 0 | 0 | 64 | 0.00 | 0.00 | 0.00 | 0.00 | 1.01 |
| Aug '08 | 0 | | 0 | | 0 | 0 | 0 | 0 | 0 | 0.00 | 0.00 | 0.00 | 0.00 | 1.01 |
| Sep '08 | 246 | 0.08 | 16 | 0.06 | 0 | 16 | 0 | 0 | 0 | 0.00 | 0.06 | 0.00 | 0.00 | 1.01 |
| Oct '08 | 890 | 0.30 | 690 | 0.58 | 719 | 170 | 0 | 0 | 0 | 1.53 | 0.65 | 0.00 | 0.00 | 1.01 |
| Nov '08 | 510 | 0.42 | 0 | 0.58 | 510 | 0 | 31 | 0 | 0 | 2.62 | 0.65 | 0.07 | 0.00 | 1.01 |
| Dec '08 | 3,925 | 1.48 | 282 | 0.79 | 3,361 | 100 | 530 | 0 | 0 | 9.79 | 1.00 | 1.23 | 0.00 | 1.01 |
| Jan '09 | 615 | 1.64 | 615 | 1.25 | 0 | 464 | 0 | 0 | 151 | 9.79 | 2.62 | 1.23 | 0.00 | 3.39 |
| Feb '09 | 1,579 | 2.06 | 1,579 | 2.43 | 1,525 | 0 | 0 | 0 | 54 | 13.04 | 2.62 | 1.23 | 0.00 | 4.24 |
| Mar '09 | 1,202 | 2.37 | 1,202 | 3.33 | 134 | 968 | 100 | 0 | 0 | 13.32 | 6.00 | 1.45 | 0.00 | 4.24 |
| Apr '09 | 5,757 | 3.81 | 5,757 | 7.63 | 174 | 0 | 5,297 | 30 | 0 | 13.69 | 6.00 | 13.11 | 1.20 | 4.24 |
| May '09 | 2,578 | 4.47 | 2,578 | 9.56 | 774 | 700 | 1,032 | 0 | 0 | 15.34 | 8.45 | 15.38 | 1.20 | 4.24 |
| Jun '09 | 150 | 4.51 | 150 | 9.67 | 0 | 0 | 150 | 0 | 0 | 15.34 | 8.45 | 15.71 | 1.20 | 4.24 |
| Jul '09 | 2,204 | 5.07 | 2,204 | 11.28 | 0 | 470 | 1,400 | 276 | 58 | 15.34 | 10.09 | 18.80 | 12.21 | 4.14 |
| Aug '09 | 876 | 5.30 | 876 | 11.93 | 526 | 0 | 350 | 0 | 0 | 16.47 | 10.09 | 19.57 | 12.21 | 4.14 |
| Sep '09 | 660 | 5.41 | 660 | 12.41 | 0 | 100 | 560 | 0 | 0 | 16.47 | 10.38 | 20.80 | 12.21 | 4.14 |
| Oct '09 | 393 | 5.28 | 393 | 12.19 | 0 | 170 | 223 | 0 | 0 | 14.93 | 10.38 | 21.29 | 12.21 | 4.14 |
| Nov '09 | 1,777 | 5.61 | 1,777 | 13.52 | 355 | 0 | 773 | 650 | 0 | 14.60 | 10.38 | 22.92 | 38.11 | 4.14 |
| Dec '09 | 747 | 4.77 | 747 | 13.87 | 422 | 325 | 0 | 0 | 0 | 8.33 | 11.17 | 21.76 | 38.11 | 4.14 |
| Jan '10 | 471 | 4.74 | 471 | 13.76 | 51 | 0 | 420 | 0 | 0 | 8.44 | 9.54 | 22.68 | 38.11 | 1.76 |
| Feb '10 | 200 | 4.37 | 200 | 12.73 | 0 | 0 | 200 | 0 | 0 | 5.19 | 9.54 | 23.12 | 38.11 | 0.91 |
| Mar '10 | 34 | 3.93 | 34 | 11.85 | 0 | 34 | 0 | 0 | 0 | 4.91 | 6.28 | 22.90 | 38.11 | 0.91 |
| Apr '10 | 411 | 2.61 | 411 | 7.86 | 0 | 25 | 185 | 200 | 0 | 4.54 | 6.37 | 11.65 | 44.88 | 0.91 |
| May '10 | 141 | 2.00 | 141 | 6.03 | 0 | 141 | 0 | 0 | 0 | 2.89 | 4.42 | 9.38 | 44.88 | 0.91 |
| Jun '10 | 390 | 2.06 | 390 | 6.21 | 340 | 50 | 0 | 0 | 0 | 3.61 | 4.59 | 9.05 | 44.88 | 0.91 |
| Jul '10 | 579 | 1.66 | 579 | 5.00 | 0 | 300 | 279 | 0 | 0 | 3.61 | 4.00 | 6.58 | 33.87 | 0.00 |
| Aug '10 | 50 | 1.45 | 50 | 4.38 | 0 | 50 | 0 | 0 | 0 | 2.49 | 4.17 | 5.81 | 33.87 | 0.00 |
| Sep '10 | 165 | 1.33 | 165 | 4.01 | 165 | 0 | 0 | 0 | 0 | 2.84 | 3.82 | 4.58 | 33.87 | 0.00 |
| *Oct '10 forecast* | *0* | *1.23* | *0* | *3.71* | *0* | *0* | *0* | *0* | *0* | *2.84* | *3.23* | *4.09* | *33.87* | *0.00* |
| *Nov '10 forecast* | *190* | *0.84* | *190* | *2.53* | *0* | *190* | *0* | *0* | *0* | *2.08* | *3.89* | *2.39* | *7.97* | *0.00* |
| *Dec '10 forecast* | *229* | *0.71* | *229* | *2.14* | *29* | *75* | *0* | *125* | *0* | *1.25* | *3.02* | *2.39* | *12.95* | *0.00* |
| *Jan '11 forecast* | *150* | *0.63* | *150* | *1.90* | *0* | *90* | *60* | *0* | *0* | *1.14* | *3.33* | *1.59* | *12.95* | *0.00* |

Source: ING

**Although we tally US$26.6bn worth of EM external bond defaults, were we to include 'technical' defaults, the total would be significantly higher**

Of the US$26.6bn worth of EM external bond defaults seen over the 2007-2010 cycle, US$22.5bn has been from 54 corporate issuers. In truth, the level and number of 'technical' defaults has been higher. In some cases, companies who were in 'technical' default, satisfied payment conditions not to enter full default, as was the case with Russia's MARTA Vermogensbertung and Samarskiy Rezervuarny as well as China's Neo-China Land Group. Issuers like Teksid Aluminum of Bahrain, which defaulted due to a covenant breach arising from debt repurchase, are also excluded. Still, in other cases, such as Naftogas and First Ukrainian Bank (which we do not include in our "defaulted issuer" list), restructurings occurred without the issuer entering bankruptcy or full default status.

**Fig 4 US HY default rate versus EM speculative-grade default rate (%)**




Source: Moody's and ING

## Defaults have been replaced with workouts

**Of the 55 corporate bond defaults, there have been 11 workouts**

We have already seen eleven corporate workouts which have provided investors with a few positive surprises. Top among these has been the better than originally anticipated recovery value from CIS corporates. Most investors were highly dubious about receiving anything out of defaults in the region. There the market saw Alliance and BTAS bonds trade below 15 cents after their defaults. Yet, in the end, investors received 45 cents of recovery on BTAS about 42 cents from Alliance. Temir Bank saw 31 cents of recovery. The eventual outcomes from Russia will prove key for the CIS region.

**Corporates have provided 12 cents more than sovereigns in this cycle and 7 cents more than the historic NPV sovereign issuer-weighted recovery looking at defaults from 1998 to 2010**

It is interesting to note that in contrast to the two sovereign workouts by Ecuador and Seychelles – where investors saw respective haircuts of 65% and 47% and received a mere 33.5 to 35 cents on the dollar of final recovery – for corporates, investors have received a median haircut of just 35% and final recovery value of 45.5 cents on the dollar (Figure 5). That is about 12 cents more than sovereigns in this cycle and 7 cents more than the historic NPV sovereign issuer-weighted recovery, looking at defaults from 1998 to 2010 (Figure 7).

On an issuer-weighted basis, EM recovery is about 45 cents. But given that Kazakhstan's Alliance Bank and BTAS defaults were of significant size (US$7.3bn, or 29% of total corporate fails), their outcome tends to skew the final issuer-weighted data.

**Fig 5 EM local and external defaults 2007 to-date**

| Country | Company | Amount (US$m) | First default date | Full default/ technical | Exchange offer announced | Exchange offer effective | % of face after haircut | RV | Restructuring notes/Developments | No. of months |
|---|---|---|---|---|---|---|---|---|---|---|
| **SOVEREIGNS** | | | | | | | | | | |
| Ecuador | Ecuador Republic | 3,197 | 15-Nov-08 | Full | 4/20/2009 | 5/15/2009 | 35.00 | 33.50 | 91% participation | 5.95 |
| Seychelles | Seychelles Republic | 230 | 30-Sep-08 | Full | 12/7/2009 | 1/14/2010 | 52.78 | 33.52 | 89% participation | 15.47 |
| **CORPORATES** | | | | | | | | | | |
| Brazil | Independencia | 525 | 27-Feb-09 | Full | 3/24/2009 | 3/30/2009 | 50.00 | 45.89 | Creditors received 50% of new 2015 bonds and 50% of equity value in warrants that pay in the event of a company sale. | 1.02 |
| Mauritius | Sphynx Capital Markets PCC | 241 | 28-Jan-09 | Full | 3/3/2009 | 7/30/2009 | | | | 6.01 |
| Mexico | Corp Durango SAB de CV | 520 | 5-Oct-08 | Full | 8/27/2009 | 8/27/2009 | 68.48 | 46.21 | US$357m of $508.5m 2017 bondholders received $250m 2016 notes, a $10m cash payment and 6% equity stake worth $4.6m. | 10.71 |
| Argentina | Transportadora Gas del Norte | 354 | 26-Dec-08 | Full | 5/5/2009 | 10/14/2009 | 71.21 | 63.07 | 88.05% of creditors participating. TGN restructured US$347.3m of obligations for US$247.3m of new notes. Creditors received either $40m of cash for $100m of par value of existing note or new notes up to $247.3m at par. TGN's debt was reduced from US$347.3m to US$247.3m. | 9.59 |
| Ukraine | NaftoGas | 500 | 30-Sep-09 | Technical | 9/24/2009 | 11/5/2009 | 100.00 | 78.00 | Restructured US$500m of bonds and $1.1bn of loans for new US$1,595m government-guaranteed 2014 bond. | 1.18 |
| Indonesia | Davomas International Finance Co Ltd | 238 | 8-May-09 | Full | 11/2/2009 | 12/3/2009 | 50.00 | 26.00 | 98.35% participation. Exchanged US$119m in new 2014 notes for old US$238m 2011 notes. Company currently making interest payments on its 2014 bond via PIK. | 6.87 |
| China | Mandra Forestry | 195 | 15-May-09 | Technical | 2/11/2010 | 2/11/2010 | 95.99 | 95.99 | Sino-Forest exchanged US$195m of old 2013 Mandra notes for new guaranteed senior notes in principal of US$187.18m. | 8.94 |
| Kazakhstan | ALB Finance (Alliance Bank) | 1,999 | 20-Apr-09 | Technical | 3/26/2010 | 4/12/2010 | 61.09 | 41.75 | 95% participation. Restructured US$4.6bn of debt. | 11.73 |
| Singapore | PetroRig III Pte Ltd | 265 | 6-Apr-09 | Full | 4/30/2010 | 4/30/2010 | 94.50 | 38.00 | | 12.78 |
| Kazakhstan | Temir Capital BV | 773 | 23-Nov-09 | Technical | 6/30/2010 | 6/30/2010 | 31.22 | 31.22 | Creditors provided with 20% equity stake, 19.7% of 2011 bond face and 20.264% of 2014 bond face in cash and senior notes. Bank reduced debt to KAT167.9bn from KZT283.4bn. | 7.20 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Kazakhstan | BTA Bank JSC | 5,299 | 20-Apr-09 | Full | 7/28/2010 | 8/26/2010 | 56.38 | 45.00 | Restructured US$16.7bn of debt. Cash paid of $945m, new senior notes of $2.3bn, OID notes worth $429m, sub notes worth $773m and $5.3bn worth of Recovery Units. $5.6bn of debt (ie 33.5%) was converted into common shares and $10.8bn of creditor claims cancelled in exchange for $5.1bn of cash and new notes. Debt was reduced from 16.7bn to $4.1bn and maturity extended from 8 to 20 years. | 16.20 |
| **Corporates only>** | | 10,909 | | | | **Weighted average corps>** | **58.46** | **44.96** | | **12.20** |
| | | | | | | **Median>** | **64.79** | **45.45** | | **8.94** |
| | | | | | | **Simple average>** | **67.89** | **51.11** | | **8.38** |

Independencia has since defaulted a second time.

The second defaults within a one year period by Independencia are excluded from our ratings analysis.

Source: ING estimates

**Furthermore, post-workout performances lift the median recovery to 58.5 cents, which lifts relative recovery to 25 cents versus sovereigns**

It is also noteworthy that performance since restructurings (Figure 6) have been more impressive for corporates. Admittedly some, for issuers like Argentina's TGN and Brazil's Independencia have been poor, for the most part, corporates have seen a median return of 13% since restructuring and 15.4% on a weighted-average basis. This raises the weighted-average recovery to 60.4 cents and 58.5 cents on a median basis. Ecuador and Seychelles have both underperformed.

**43 more issuer workouts yet to be completed, which represent 56% of defaulted corporate debt – this leaves both workout duration and RV still undecided for EM corporates**

However, given that there remain 43 more issuer workouts yet to be completed, which still represent 56% of defaulted corporate debt, there is the possibility that average recovery rates will be forced lower. The average time since default among these is already 16 months, so we will unquestionably see the EM average workout period increase. Furthermore, there remains the likelihood of additional defaults and the possibility of second defaults by issuers who had previously completed restructurings. We have already seen one EM issuer – Brazil's Independencia – re-enter default after its first March '09 restructuring.

**A 10 cent increase of RV expectations would see BB corporate prices adjusted upwards by $2.46 and single B corporates by $3.83**

The most recent slate of post-default recoveries in EM clearly work in favour of better corporate valuations. Higher-than-expected recovery values suggest corporate spreads should be tighter than they are at the moment, particularly in the speculative-grade arena. Presently, corporate securities roughly assume a 40 cent recovery value. If we assume recoveries are raised to 45 cents, BB bond prices should increase by $1.3 and single B bonds by $2.2. A 10 cent increase of recovery expectations would see BB corporate prices adjusted upwards by $2.46 and single B corporates by $3.83.

**Fig 6 Post-restructuring security performance**

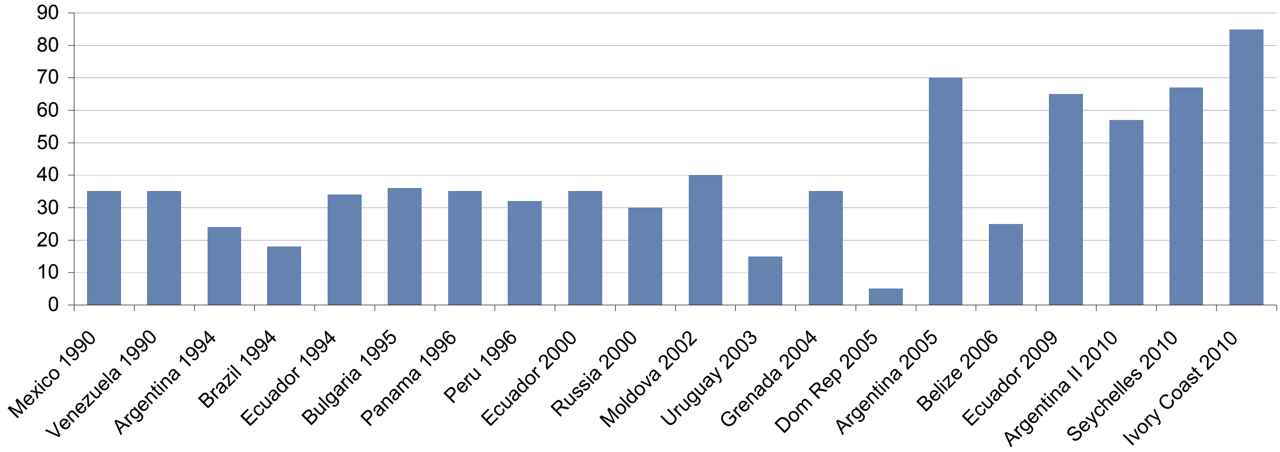
| Issuer | Price of new bonds at restructuring date | 7-Oct-10 price | % change |
|---|---|---|---|
| Ecuador Republic | 30.5 | 25 | -18.03 |
| Seychelles Republic | 60 | 61.6 | 2.67 |
| **Corporates** | | | |
| Independencia International Ltd | 91.781 | 49.5 | -46.07 |
| Sphynx Capital Markets PCC | n/a | n/a | n/a |
| Corp Durango SAB de CV | 61.5 | 87.975 | 43.05 |
| Transportadora Gas del Norte | 88.58 | 45 | -49.20 |
| NaftoGas | 78 | 109.31 | 40.14 |
| Davomas International Finance Co Ltd | 60 | 67.24 | 12.07 |
| Mandra Forestry | 100 | 110 | 10.00 |
| ALB Finance (Alliance Bank) | 65 | 77.875 | 19.81 |
| PetroRig III Pte Ltd | n/a | n/a | n/a |
| Temir Capital BV | 100 | 112.99 | 12.99 |
| BTA Bank JSC | 68.68 | 83.33 | 21.33 |
| **Weighted average corps>** | **69.25** | **79.23** | **15.43** |
| **Median of corporates>** | **78.00** | **83.33** | **13.0** |
| **Simple average corporates>** | **79.28** | **82.58** | **7.12** |

For corporates that have defaulted and restructured in the recent 2007-2010 cycle only.

Independencia has since defaulted a second time, which explains the securities underperformance.

Source: ING

**Fig 7 % NPV loss for bondholders 1-month after restructuring**




Although Ivory Cost bondholders only received a 20% haircut, the price of the new bond and duration of the workout period (10 years) resulted in a higher NPV loss.
Source: ING

**Fig 8 Impact of RV assumption change on 5-year corporate securities**

| | Current spreads | | Implied | | Bond price impact | |
|---|---|---|---|---|---|---|
| | Cash trend | CDS (assume 40 cents RV) | CDS @ 45 cents RV | CDS @ 50 cents RV | Assume 5 cent RV increase | Assume 10 cent RV increase |
| A+ | 170 | 130 | 122 | 112 | 0.40 | 0.88 |
| A | 196 | 156 | 146 | 135 | 0.48 | 1.02 |
| A- | 227 | 187 | 174 | 161 | 0.57 | 1.18 |
| BBB+ | 262 | 222 | 207 | 191 | 0.67 | 1.37 |
| BBB | 303 | 285 | 267 | 249 | 0.79 | 1.58 |
| BBB- | 349 | 326 | 303 | 282 | 0.94 | 1.83 |
| BB+ | 403 | 372 | 345 | 320 | 1.11 | 2.13 |
| BB | 466 | 424 | 391 | 363 | 1.32 | 2.46 |
| BB- | 538 | 484 | 444 | 412 | 1.56 | 2.85 |
| B+ | 621 | 552 | 504 | 466 | 1.85 | 3.31 |
| B | 718 | 630 | 571 | 528 | 2.19 | 3.83 |
| B- | 829 | 718 | 647 | 597 | 2.60 | 4.44 |
| CCC+ | 957 | 818 | 732 | 675 | 3.07 | 5.15 |
| CCC | 1105 | 933 | 829 | 762 | 3.64 | 5.96 |

Source: ING

The most recent slate of post-default recoveries in EM clearly work in favour of better corporate valuations. If future workouts are in line with those seen so far, investors should raise their recovery expectations from the current 40 cents for EM corporates. This will prove of particular price benefit for speculative-grade EM corporate bond prices.

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