DEBTWIRE

ASIA-PACIFIC DISTRESSED DEBT & SPECIAL SITUATIONS MARKET UPDATE

NOVEMBER 2016

pwc

ReedSmith

The business of relationships.

CONTENTS

FOREWORD

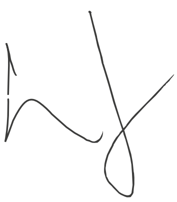
The first trading day in 2016 opened to a meltdown on China's major stock exchanges, triggering a circuit-breaker mechanism which suspended trading nationwide for the first time. This sparked a global selloff that concluded with the obation of approximately US$8 trillion across stock markets worldwide. In June, Britain voted to leave the European Union, driving the pound to a 31-year low against the dollar. As the year marches through its final quarter, the combination of panic and excitement precipitated by these events, spurred on no less by a good deal of fear-mongering, has begun to temper into a mood of watchful waiting, especially when it comes to the valuation process in deal-making. As the world reckons with the result of the US presidential election, and while Brexit negotiations remain hanging in the air, there have been speculations of realignments in political and trade relations involving Europe and the US, prompting investors to sharpen their focus on markets in the Asia-Pacific region.

In the Asia-Pacific, economies continue to sustain the ripple effects of China's slowdown in growth, which looks set to continue as the country undergoes an economic rebalancing, transitioning from an export-driven economy to a consumer-led one. Along with the unveiling of its 13th Five-Year Plan at the 2016 plenary session of the National People's Congress in March, China announced a target growth range of 6.5%-7% for the year. A legacy from its heyday of double-digit ambitions, the country is seeing its non-performing loans (NPLs) surge to increasingly unmanageable levels. Official data stated that the NPL ratio of China's commercial banks had risen to 1.67% at the end of 2015, and the Chinese government is reported to be considering debt-for-equity swaps for banks.

Resource-reliant industries have been some of the hardest hit in the current climate of diminished demand, with oil prices freefalling from 2014 in a low commodities price environment as the sector experienced oversupply. In the meantime, the shipping and steel industries are seeing the slump in demand amplify chronic overcapacity, with overleveraged companies turning to asset divestitures and merge-to-survive strategies in anticipation of imminent waves of industry consolidation. With some commodity markets, such as coal and iron ore having rebounded as others have remained depressed, the opportunities for distressed debt investors are expanding in a growing number of universes, as overleveraged companies scramble to stay afloat upon the contraction of demand from China.

For emerging Southeast Asia, decelerating regional growth, dampened global demand and the potential for a tightening of monetary policy in the United States have all contributed to a mounting corporate debt burden, which may translate into more distressed and special situation opportunities over the next 12 months. Meanwhile, Singapore, an advanced and open economy accustomed to punching above its weight, has set its sights on higher targets. By dint of its transparent governance, business efficient, as well as strong legal and regulatory frameworks, the nation-state is positioning itself as a hub to facilitate restructuring work in the region.

In Q3 2016, Debtwire polled 60 private equity investors, prop desk traders, hedge fund managers, credit risk or workout managers, and emerging market investors in the Asia-Pacific region, to gain perspectives from professionals on the ground. A number of respondents, while recognising the advantages of leveraging on nascent distressed opportunities in the region, are also placing emphasis on staying level-headed and in line with their core investment strategies, training their focus on sectors in which they possess prior experience and knowledge in terms of investment, operations or turnaround processes. Nonetheless, volatility and uncertainty remain the watchwords of the year to come, both in economic and geopolitical terms, and it is up to the shrewd investor to know when to strike while the iron is hot.



Luc Mongeon
Managing Editor, Debtwire Asia-Pacific

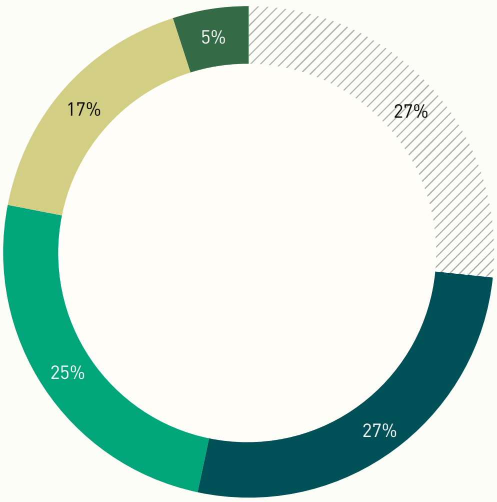
In the third quarter of 2016, Debtwire canvassed the opinions of 60 private equity investors, prop desk traders, hedge fund managers, credit risk or workout managers, and emerging market investors in the Asia-Pacific region.

Respondents were questioned about their expectations for the Asia-Pacific distressed debt and special situations market over the next 12 months. The respondents were guaranteed anonymity. Responses were collated by Debtwire and are presented in aggregate. Percentages may not add up to 100% due to rounding.

DISTRESSED DEBT
Distressed debt in general refers to high-risk debt securities which are in default or bear a significant chance of defaulting in the near future, and typically sell at a depressed percentage of par value with a potential for high return.

SPECIAL SITUATIONS
Special situations are circumstances in which the trade of a security is motivated by conditions pertinent to the situation, such as a change in valuation, making the situation event-driven.

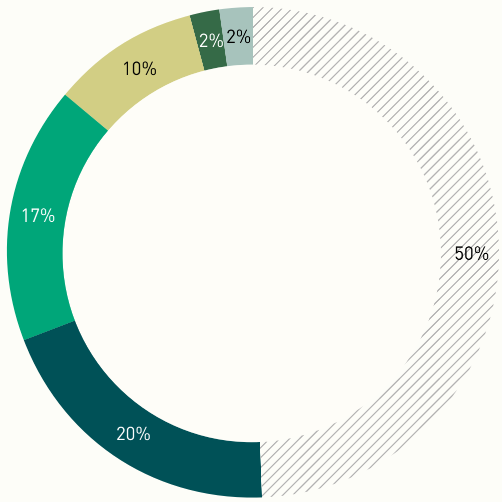
Q **Please confirm that your firm is primarily a _________.**



Key:

- Private equity investor
- Proprietary trading desk at bank or investment bank
- Hedge fund
- Bank/investment bank credit risk management/credit workout department
- Emerging market investor

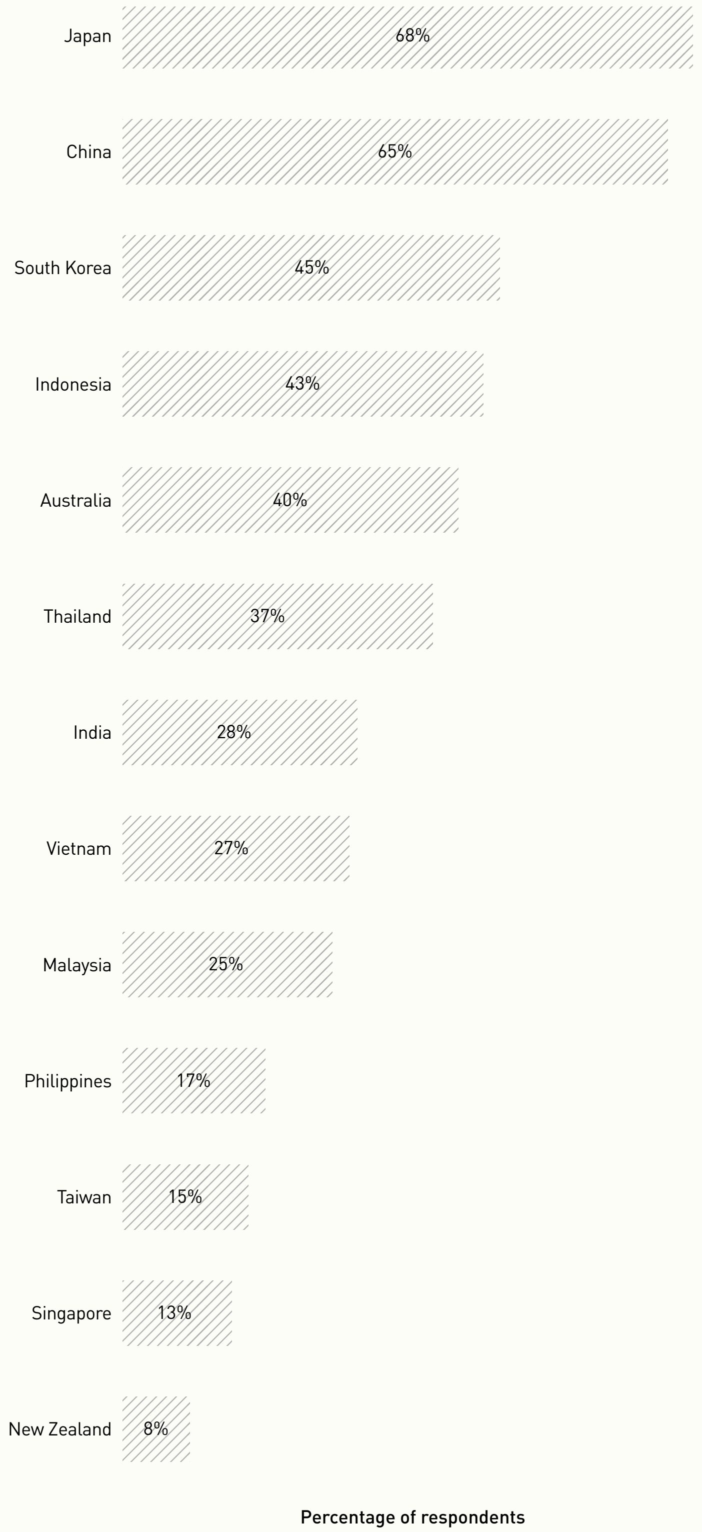
Q **Please describe your core investment strategy.**



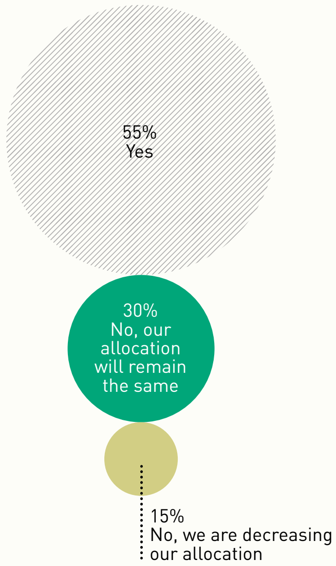
Key:

- Multi-strategy
- Distressed debt
- High yield
- Private equity
- Secondary trading
- Event driven

Q Please indicate all geographies in which you have made distressed debt/special situations investment in the last two years.



Q For the next 12 months, is your firm setting aside more capital for distressed debt?



Q Excluding advisory work, what percentage of distressed debt or special situations in Asia-Pacific that you explored in the last 12 months have represented an actionable and attractive investment opportunity?

According to 65% of respondents, a sizeable 26-50% of distressed debt or special situations in Asia-Pacific that they explored in the last 12 months have represented an actionable and attractive investment opportunity. Almost one-fifth (18%) venture further to say 51-75%, while 15% saw less than 25% of the situations eventually transpose into opportunities.

"Most respondents felt that at least one in four distressed debt or special situation opportunities explored in the region were attractive. This reflects the extent and quality of opportunities in the region and suggests that supply should be able to continue to meet the appetite of the investment community."

—Peter Greaves, Partner, PwC Singapore

SURVEY FINDINGS

Q Market volatility over the next 12 months will be:

The vast majority (88%) of survey respondents expect market volatility over the next 12 months to rise. Against the backdrop of China's continuing slowdown in growth and the ongoing Eurozone crisis, several respondents attribute this to geopolitical uncertainty emanating from the United Kingdom's vote to leave the European Union, as well as the result of the presidential election in the United States. In light of the unpredictable macroeconomic climate, the Chief Financial Officer of a prop desk at a bank in Japan elaborates, "It has become very challenging for businesses to run their operations as usual due to the recent uncertainties affecting the market and thus economic performance appears stagnant. Pressures to reduce costs are increasing and businesses are facing business continuity challenges, which is affecting the investors. This negative business environment and lack of government support to drive performance will increase the level of volatility in the market."

While there are regional variations and many countries are trying to maintain momentum and make modest improvements in growth amidst divergent monetary policies, a market recovery is unlikely to transpire over the next 12 months as currency values fluctuate and the regulatory landscape changes its countenance. Citing lackluster portfolio performances, the Chief Executive Officer of a prop desk at a bank in Taiwan observes, "Investors have not been able to generate value on their investments by investing in the stock market and thus their participation there will reduce. This will impact the market significantly and therefore added volatility will prevail over the next year or so."

A number of respondents have also identified the low commodities price environment as a contributory factor, with the Chief Investment Officer at a hedge fund in Hong Kong pointing out, "Falling commodity prices have affected businesses and forced them to undertake restructuring activities, which will keep the economies low till the businesses are thoroughly ready to introduce their growth strategies which will take at least another year. Till then, market volatility will continue to increase."

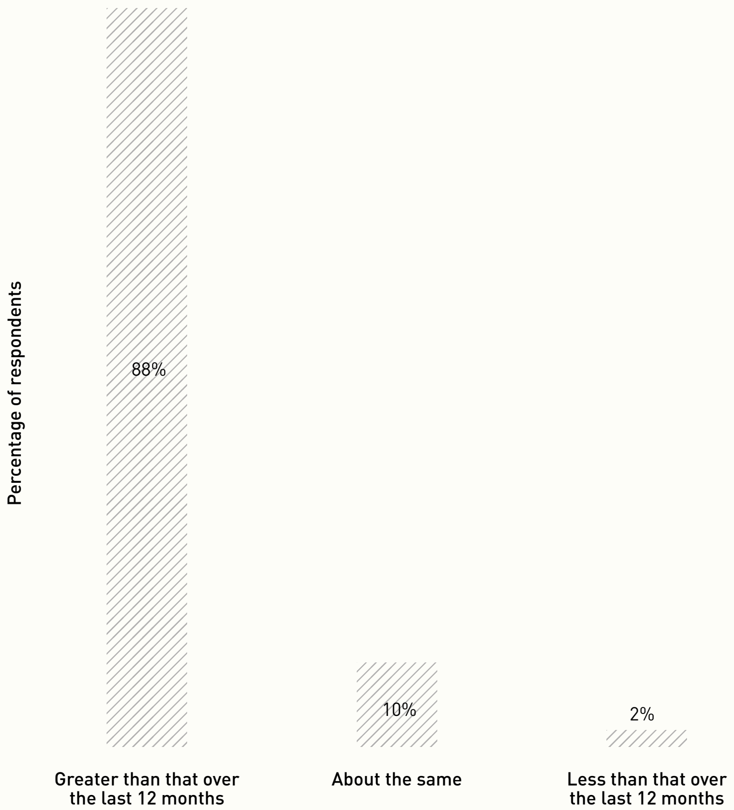
A minority group of respondents (10%) take a more optimistic view, anticipating that volatility will remain about the same as that over the last 12 months. However, only 2% of respondents have indicated expectations for market volatility to decrease over the next 12 months.

"Navigating pockets of volatility can be challenging for the market, but at the same time volatility provides definite opportunities for restructuring and investment for those investors with risk appetite. There seems to be positive sentiment throughout the market for new opportunities to present themselves over the next 12 months."

—Diane Roberts, Restructuring Partner, Reed Smith

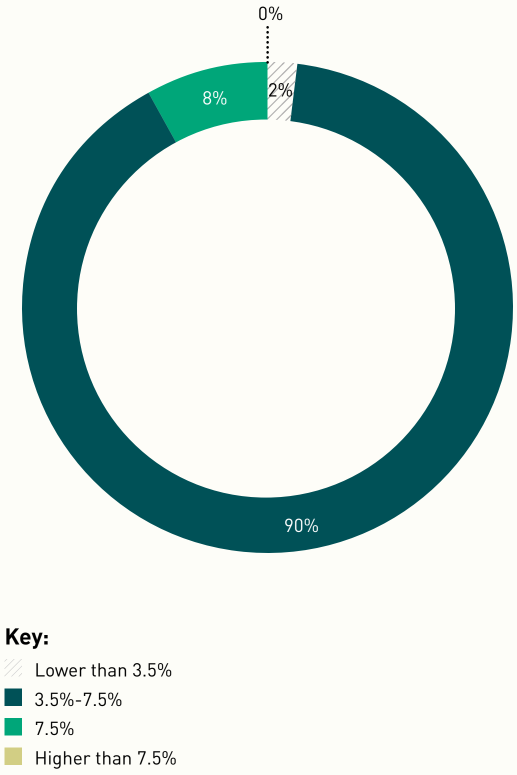
"After an extremely volatile 2015 and 2016, almost all (98%) respondents expect this to persist or increase in the next 12-18 months. This confirms our view that there will be no let-up in new opportunities becoming available. Earlier in the year, there was more optimism of steadying markets. However, recent events and the prolonged depression in certain key sectors such as offshore and marine, along with some high profile defaults, have increased the markets' expectations of volatility in recent months."

—Peter Greaves, Partner, PwC Singapore



Q By how much will the Chinese economy grow over the next 12 months?

100% of respondents expect the Chinese economy to grow by no more than 7.5% over the next 12 months, with 90% anticipating a growth rate of 3.5%-7.5% and 8% predicting 7.5% growth. Meanwhile, 2% of respondents forecast a growth rate of lower than 3.5%. Rising corporate debt (a problem made urgent in a time of weakening international demand and lower exports in a low commodities price environment) together with fiscal deficits, regional competition and the devaluation of the yuan are dampening China's growth prospects. Elaborating on the effect of corporate debt exacerbated by a rise in underperforming assets, the Managing Director of a hedge fund based in India explains, "The market is going to face the consequences of their high debt levels and the decreasing size of operating units caused by high pressures on operational expenses and these negative factors are affecting the economic growth rate."



Touching on industry consolidation and the reduction of excess supply capacity, rising opportunities and intensifying competition from emerging regional economies, as well as reduced foreign direct investment, the Partner & Chief Operation Officer of a prop desk at a bank in Hong Kong says, "Expected unemployment as a result of the decreased production houses and rise of more stable emerging countries and investment opportunities are impacting the Chinese economy to a certain extent and hence its growth will be minimum in the next 12 months."

Similarly the Director of Investment at a hedge fund in Malaysia opines, "It has become challenging for businesses in China to continue their large capacity operations as the regulations to its exports have increased significantly, causing an increase in costs to the buyers and therefore the Chinese will lose out on a lot of international business opportunities which will impact their economy."

"Following the reduced growth in China, we are seeing a direct impact on the natural resources and commodities sectors, and accordingly the companies connected to those sectors."

—Matthew Gorman, Partner, Singapore, Reed Smith

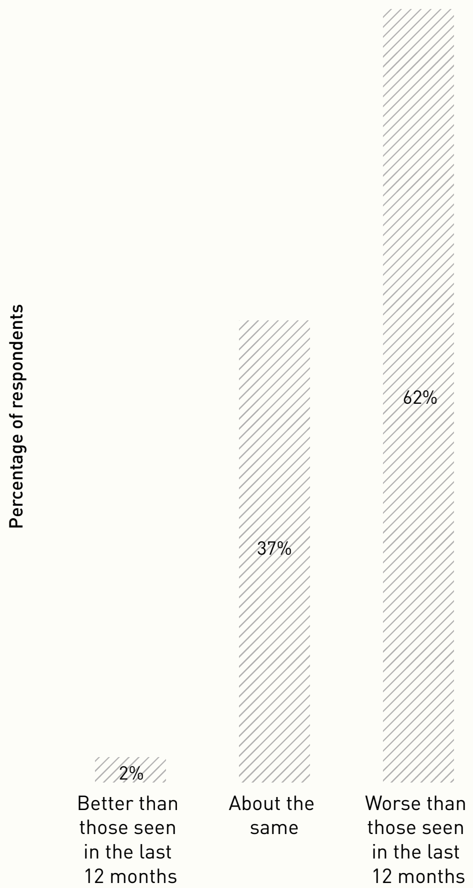
100% expect the Chinese economy to grow by no more than 7.5% in the next 12 months.

Q Will liquidity conditions over the next 12 months be about the same, worse or better than those in the last 12 months?

In their outlook for liquidity conditions over the next 12 months, more than half the survey participants (62%) take the position that liquidity conditions will be worse than those seen in the last 12 months, with 37% expecting conditions to maintain the status quo, and a mere 2% anticipating better conditions than those seen in the last 12 months.

The Managing Director of a private equity firm in Hong Kong explains, "Liquidity conditions will continue to worsen in the next 12 months as economies are being affected by rising uncertainties and risk. The appetite for new investments has reduced considerably as the market conditions are unfavourable to derive sufficient returns and therefore the liquidity conditions are being impacted significantly."

According to the Head of Investment of a private equity firm in Japan, "The volatility in the oil prices is likely to exert increased pressure on funding environments – it has reduced deposit inflows and have affected the lending interest rates and hence the liquidity conditions are likely to worsen."



Liquidity conditions may vary across geographies, and while some regional governments are showing signs of being more willing to ease regulations and reduce interest rates to strengthen weakened economies, others are maintaining tight regulatory standards and policies. As the Managing Director of a private equity firm in South Korea points out, "The equity markets are being impacted by the fluctuating currency values and depreciating business performance depicted by firms in the emerging markets caused as a result of the recent changes in the regulatory environment and therefore the liquidity conditions will worsen till there are positive signs of economic recovery and faster pace of growth."

To generate funds and strengthen cash flows, large corporates are divesting non-core and under-yielding assets, while others in the market are creating more liquid finances by way of restructurings, reorganisations and scaling back.

"Whilst the feedback suggests that most expect tighter liquidity there is no outright consensus. However the nature of the liquidity (in terms of providers) is certainly shifting. This dynamic has already been seen extensively in Europe. Corporates might therefore expect to see a change in their type of capital providers as refinancings or restructurings occur in the coming year, and that pricing may also increase as the funders providing the required capital will require a higher return than the incumbent funder. On the flip side, it also suggests that there will be strong opportunities for fixed income investment in those situations where the incumbent lenders and corporates can agree on realistic values relative to the size and urgency of the funding requirement."

—Peter Greaves, Partner, PwC Singapore

"Anticipated liquidity contractions from regulated banks may be partially eased or off-set by new entrants to the lending and restructuring market, including credit funds and distressed investors."

—Charlotte Moller, Restructuring Partner, Reed Smith

Q What do you expect for the amount of distressed debt and special situation opportunities in Asia-Pacific (inclusive of Japan and Australia) in the next 12 months?

With China's deceleration and the negative ripple effect on its neighbours, 58% of respondents expect the amount of Asia-Pacific distressed debt to rise over the next 12 months, while a far greater 80% of respondents expect special situation opportunities, such as buyouts and recapitalisations, to increase over the same period. In light of continued volatility across global stock markets, 32% of respondents are expecting distressed debt levels to stall and 20% think the amount of special situation opportunities will remain the same. 10% of respondents foresee a decrease in distressed debt opportunities, while no respondents expect special situations opportunities to falter.

Accounting for the greater expectations towards a rise in special situation opportunities, the Executive Vice President of Finance at a bank in Japan explains, "Restructuring managerial competencies is greatly helping businesses across the globe and funding sourced through social growth negotiations is even better for the economy and thus I believe in order to grow along with the economy most businesses in this situation will consider special situation deals over distressed deals."

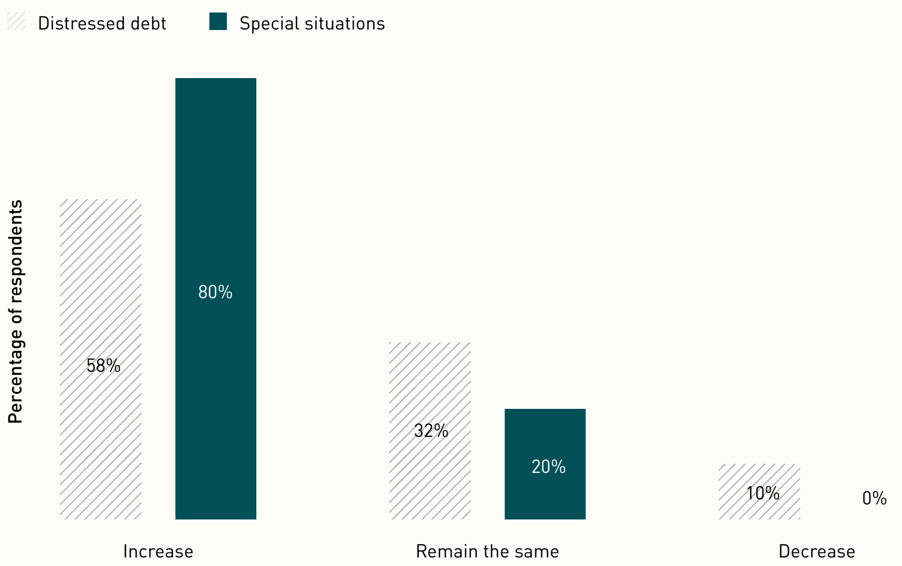
Suggesting that special situations can occur as a result of efforts to keep debt from going into distress, a Partner at a private equity firm in Hong Kong says, "The gradual effect on the credit market is increasing the demand for special situation activities. Entering an equally negotiated deal is helping businesses transform their performance, leaving the distressed phase and entering new growth heights."

Expressing the view that special situation transactions offer more scope for refinancing and business continuity plans, the Head of Investment Banking at a bank in Japan states, "The likelihood of an increase in special situation opportunities is high as it allows business leaders to stay involved in the business despite the transfer of assets to the investor and this strategy is also doing well as there are fewer risks involved in this."

"2015 and 2016 were clearly very active for distressed debt and special situations and the view appears to be that next year will continue along that trend. When you look at the expectations of what themes will be, and combine these with some of the expected hurdles to restructuring that are cited later in this survey, these may reflect that portfolios have not been through the extent of pain that the market conditions would suggest is to be expected. Therefore, until this is fully realised and dealt with, we should not expect to see the level of distressed debt and special situations declining."

—Peter Greaves, Partner, PwC Singapore

Key:



Q Is your firm setting aside more capital for distressed debt and special situation opportunities in Asia-Pacific (inclusive of Japan and Australia) in the next 12 months?

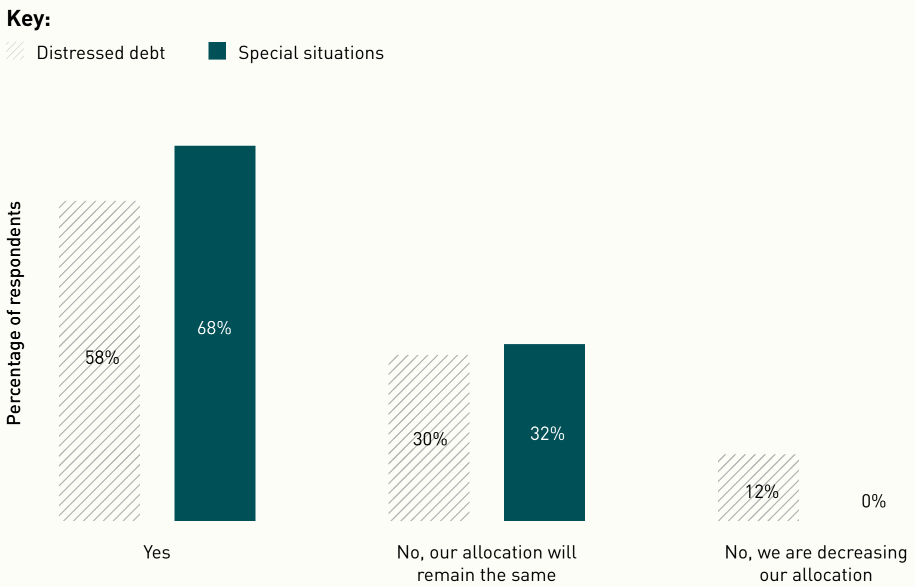
More than half (58%) of those surveyed state that their firms are apportioning more capital towards the distressed debt universe in the Asia-Pacific region in the next 12 months, while a greater 68% plan to raise their current levels of capital allocations towards special situations over the same period. Distressed debt investors often look to gain from low valuations, with some playing the role of opportunistic bargain hunters looking for quality distressed assets at undervalued or discount prices. Elaborating on the heightened interest in special situations, a Partner at a private equity firm in Hong Kong states, "We believe special situations will help us manage time risk, price risk and deal risks more effectively, giving us higher chances of improving our return on investment rate."

Meanwhile, the Director at a hedge fund based in Singapore opines, "Special situation funds have been performing extremely well in scenarios where the portfolio managers are highly experienced and qualified with regards to transformation or development of businesses and we have identified such funds where we plan to increase our capital allocation over the next year to draw significant returns for our shareholders."

Amid concerns over overcrowding in the distressed investment field, an additional 30% and 32% of respondents indicate they will maintain their current levels of capital allocation for distressed debt and special situation opportunities respectively, while 12% are looking to decrease their allocation towards distressed debt, with no respondents planning to cut back on allocations for special situations.

"Our clients have been raising capital for investment and tell us that they are patiently waiting for opportunities to present themselves. They are cash rich and there will be ample investor competition for the best investments."

—Diane Roberts, Restructuring Partner, Reed Smith



Q What percentage return are you targeting for distressed debt transactions in the next 12 months?

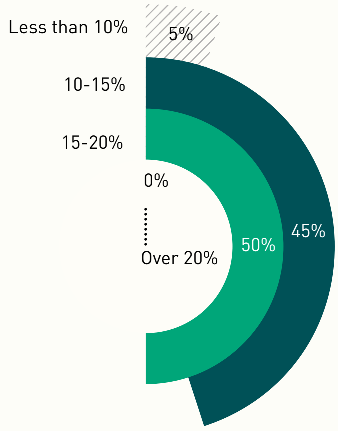
Half (50%) the respondents are targeting returns of 15-20%, 45% are aiming for 10-15% returns, and 5% are targeting less than 10%. The Managing Director at a private equity firm in South Korea says, "Concerns over rising operational costs and the increasing number of underperforming assets are affecting business performance and therefore we are not able to fully leverage the potential of our distressed assets in the market."

On regulatory barriers, a Partner at a private equity firm in Australia explains, "New competition laws and compliance procedures are driving our focus away from improving core objectives and hence we are unlikely to meet our targets on time. Our distressed assets will see better growth in 2017 as we would have completed their risk assessments by then."

Taking a bearish view, the Managing Director of a private equity firm in Hong Kong asserts, "The process of transforming distressed businesses into highly productive businesses is lengthy and has been delayed even more due to the increasing challenges faced by business managements in applying effective profitable strategies and risk management techniques."

"The regulatory framework within a jurisdiction can have a significant impact on the potential return of an investment. Accordingly, this is a key consideration to be factored into the equation when firms are making investment decisions."

—Panos Katsambas, Special Situations Partner, Reed Smith



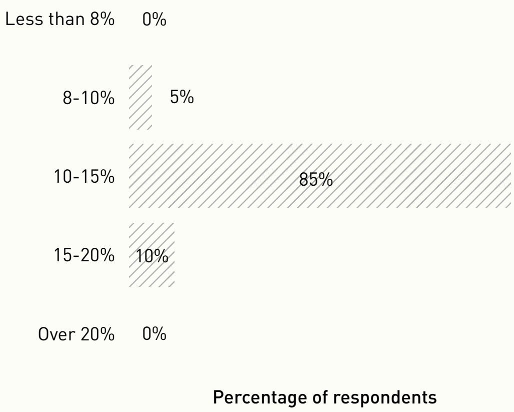
Q What percentage return are you targeting for special situation transactions in the next 12 months?

Most respondents (85%) are targeting 10-15% returns for special situation transactions in the next 12 months. Higher returns of 15-20% are expected by 10% of respondents, while more modest gains in the 8-10% belt are expected by 5% of respondents. This is lower on average than what is targeted for distressed debt transactions, possibly due in part to special situation opportunities being generally among the lower risk arbitrage.

"On a portfolio basis it is not unexpected that returns of 10-20% are targeted by most. However, given the jurisdictional and sector specific issues in many of the individual cases, we would expect case specific returns to be extremely volatile within a given portfolio. Whilst true turnaround stories can be protracted, there are opportunities on fixed-income deals where high-teen returns are available due to short term 'burning platform' liquidity needs. These deals clearly come with heightened default risk or subordinated positions, but they are there to be had."

—Peter Greaves, Partner, PwC Singapore

100% targeting no more than 20% return for distressed debt and special situation transactions in the next 12 months.



Q If you expect an increase in distressed debt, please indicate which of the following is/are likely to be the cause(s). (Please indicate all that apply.)

Out of the respondents forecasting an increase in distressed debt in the next 12 months, almost all (98%) are attributing its cause to China's economic slowdown, along with 93% citing slowing Asian economies due to monetary policy or regulation. The maintenance of price stability, the controlled expansion of bank credit, and restrictions on inventories and stocks are some elements of monetary policy that are contributing to the slowdown in Asian economies. Expounding on the effect of China's slowdown, the Principal at a private equity firm in Singapore observes, "China was considered to be the top most economy in the Asia-Pacific region, and its depreciating conditions will certainly impact the economic recovery pace in the Asia-Pacific region posing pressures on businesses to sell of their underperforming assets or restructure their capital structures which will lead to the increase in special situation opportunities."

At the same time, 88% of respondents point to continued problems in the Eurozone. As the Managing Director & Chief Executive Officer at a bank in China discusses, "The continued problems in the Eurozone are likely to impact the largest sector in the Asia-Pacific region, which is manufacturing, as regulatory changes and export laws are being tightened, reducing the demand for Asia-Pacific goods and this will drive the distressed and special situations environment in the Asia-Pacific region."

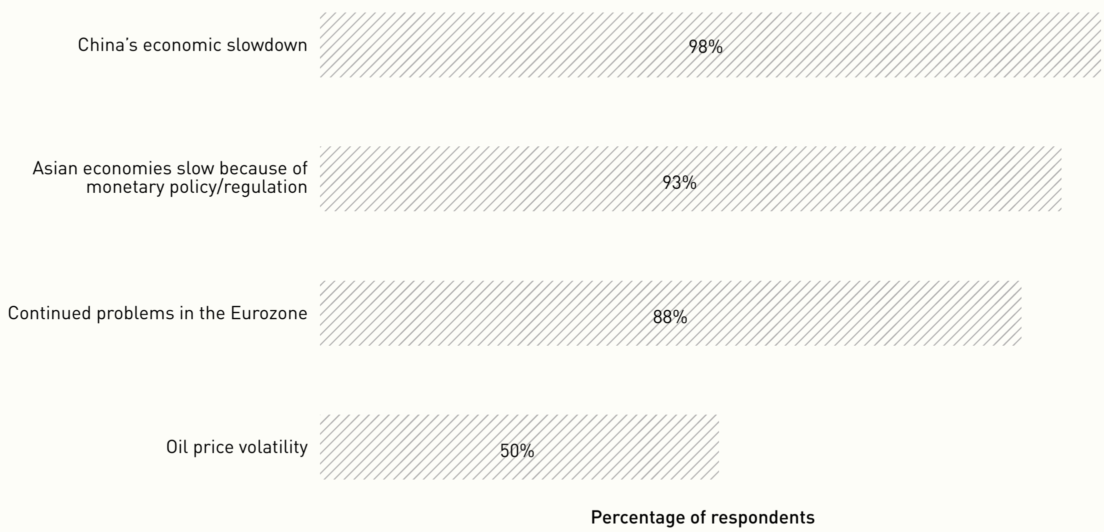
Meanwhile, half (50%) the respondents have identified oil price volatility as a key factor. The Managing Director of a hedge fund in India explains, "The volatility in the oil prices are affecting business financials in the Asia-Pacific region and managements are unable to protect their businesses from this unseen uncertainty. In order to recover from their low performances they will either have to sell off their assets at cheap valuations or restructure their activities by gaining support from foreign acquirers, driving distressed opportunities in the market."

"A multitude of factors have contributed to an increase in distressed debt, including but not limited to the economic slowdown in China, the decrease in oil prices, the uncertainty of the future direction of interest rates and other changes to monetary policies, the increased costs of banking and trade regulation and the uncertainty of the US elections and Brexit implications."

—Diane Roberts, Restructuring Partner, Reed Smith

"The importance of Eurozone uncertainty is already being seen, but unlike that in China, this does not appear to be purely trade/demand led in this region, but also includes the impact on liquidity from Eurozone lenders retrenching capital to Europe."

—Peter Greaves, Partner, PwC Singapore



Q Which of the following situations do you think will offer the most attractive opportunities for special situation/distressed debt investors in the next 12 months?

Amend and extend situations will offer the most attractive opportunities for special situation or distressed debt investors in the next 12 months, according to three-quarters (75%) of respondents. In an exemplification of this stance, the Partner & Chief Operation Officer of a prop desk at a bank in Hong Kong explains, "Investor sentiments to the market decline are driving the amend and extend transactional activity. Investors are hoping for a better market in the years to come and so are helping businesses improve their performances by fulfilling their funding requirements to help develop their operational performances."

Backed by 68% of respondents, debt-to-equity conversion comes in at a close second, a situation which allows distressed businesses under debt pressures to renegotiate and offer equity positions to creditors to reduce their debt burden and improve operations.

Moreover, 65% of the survey respondents have selected the provision of emergency funding or working capital, making it the third-most attractive opportunity. As the Principal at a private equity firm based in Singapore puts it, "Investors are looking to make additional returns on their investments by taking advantage of the challenges in the traditional lending market such as lending limitations from banks and other financial institutions due to the uncertainties in the economic environment. They are also becoming good in their due diligence and so are lending to businesses who are restricted from borrowing from banks but have significant growth potential, and this demand for additional capital is provided to businesses at a higher interest rate, benefiting the investors significantly."

Pertaining to funding sponsor-led debt buybacks, backed by 63% of respondents, the Managing Director of a hedge fund in India says, "Lenders are agreeing to share the risk with businesses and so the attractiveness of debt buybacks is increasing."

Respondent interest in the remaining situations is spread out somewhat evenly, with all of the situations garnering nominations from at least half (50%) of the respondents. According to the Director of Investment at a prop desk at a bank in Singapore, "The fall in the real estate market is the main attraction to distressed debt investors. Investing in distressed real estate non-performing loan (NPL) portfolios will bring greater returns to investors in the long run and hence I believe the NPL transactions will prove to be most attractive over the next 12 months."

Meanwhile, a Partner at a private equity firm in Japan asserts, "The solid fundamentals and low default rate in the private equity business portfolios is creating more attractiveness for the distressed debt and special situation investors. Private equity performance indicators are also positive and therefore investors will look to make the best of the existing investment opportunity they are witnessing."

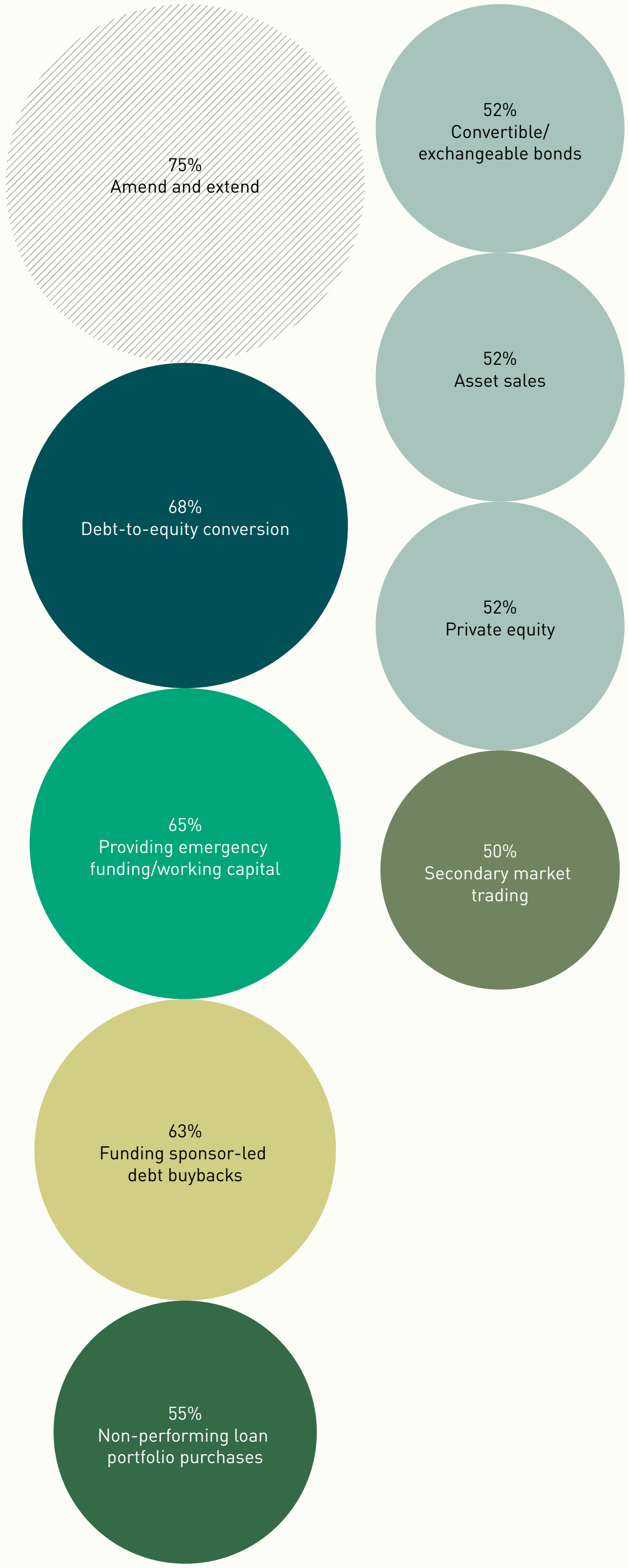
Likewise, there is appeal in asset sales, as the Director of Investment at a hedge fund in Malaysia points out, "Asset sales are being more attractive currently as the valuations are fairly good and the rise of strategic partnerships will increase the scope for sale of underperforming assets to a business that can leverage the benefits of these assets in their operations to make it more productive and profitable."

"There appears to be a preference towards longer term/equity type upside investments. This suggests that investors recognise the short term cash and debt serviceability issues facing corporates in the current climate, but expect recovery in the medium term to allow the prospect of back-ended upside in order to make their overall target levels of return."

—Peter Greaves, Partner, PwC Singapore

"The observation relating to NPL transactions correlates to the increase in portfolio sales observed across the region. Additionally, the results indicate a confidence that the market will improve in the medium term, with investment decisions being made on that basis."

—Matthew Gorman, Partner, Singapore, Reed Smith

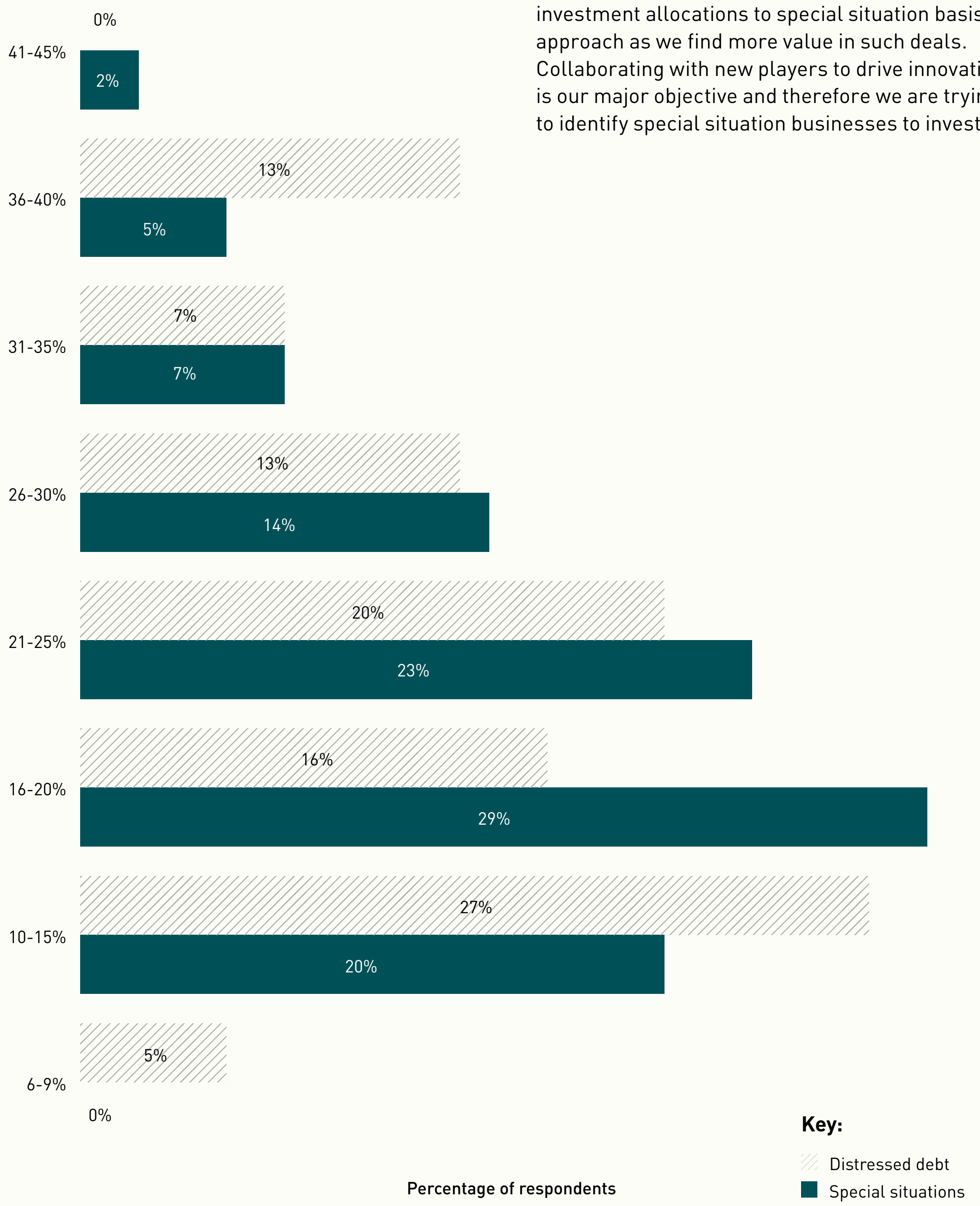

75%
Amend and extend
52%
Convertible/
exchangeable bonds
52%
Asset sales
68%
Debt-to-equity conversion
52%
Private equity
65%
Providing emergency
funding/working capital
50%
Secondary market
trading
63%
Funding sponsor-led
debt buybacks
55%
Non-performing loan
portfolio purchases

Q What percentage of your investment capital will you allocate to distressed debt? What percentage to other special situations?

For distressed debt, 27% of respondents plan to allocate 10-15% of their investment capital to distressed debt, with 20% of respondents looking to allocate 21-25%, and 16% of respondents looking to allocate 16-20%. By comparison, 29% of respondents expect to distribute 16-20% of their investment capital to special situations, while 23% of respondents planning to allocate 21-25%, and 20% of respondents looking to allocate 10-15%.

A number of respondents appear to be focused on longer-term growth, with the Managing Director of a private equity firm in South Korea opining, "Distressed businesses are under risks currently and their scope of growth is limited due to the volatility in the economic environment and therefore we are planning on decreasing our investment allocations towards the distressed business assets."

In a similar vein, the Partner & Senior Vice-President of Investments at a private equity firm in India explains, "We are going to increase our investment allocations to special situation basis approach as we find more value in such deals. Collaborating with new players to drive innovation is our major objective and therefore we are trying to identify special situation businesses to invest in."



Q Please rate the following in terms of the opportunities they present for distressed investors in the next 12 months (Rate using: significant opportunities, some opportunities, few opportunities).

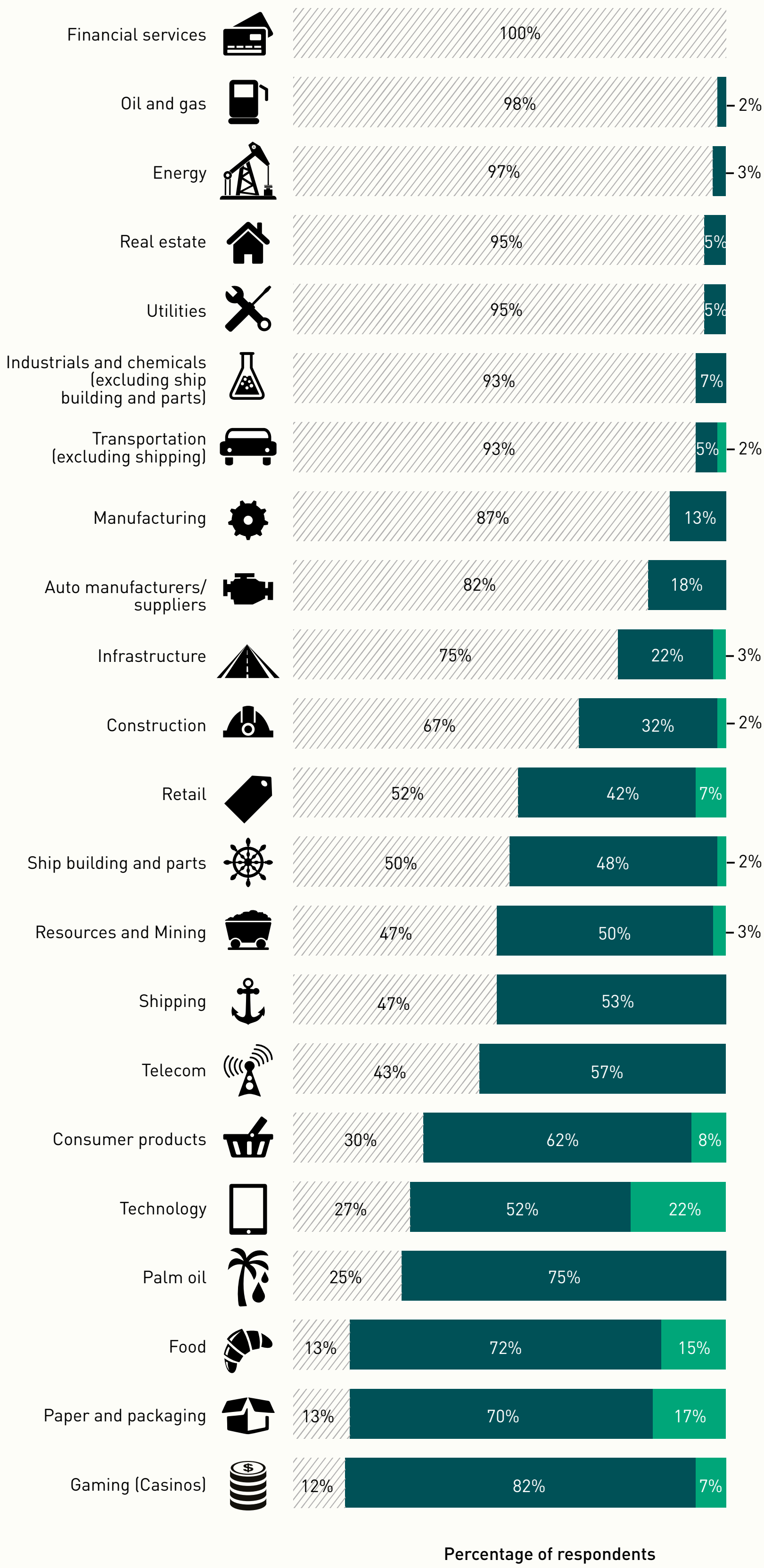
100% of respondents deem the financial services sector to be presenting significant opportunities for distressed investors, due in part to market volatility, geopolitical uncertainty and various industry specific factors. In Malaysia, for example, the "financial sector is being affected due to the instability caused by the regulatory hindrances which are of negative impact to their performance and therefore the need to restructure the capital environments are creating special situational opportunities to invest in," according to the Director of Investment of a hedge fund based in Malaysia.

Given freefalling oil prices throughout 2015 and into 2016, the oil and gas sector has been rated by 98% of the survey respondents to be a sector presenting significant opportunities for distressed investors. The Senior Executive Director & Head of Equity Capital Markets at a bank in India says, "The falling commodity prices are making it challenging for businesses to achieve efficiency in operating their current business activity and their level of performance is diminishing and they are entering the distressed asset stage which investors and foreign acquirers have appetite for."

In the energy sector, rated by 97% of respondents to offer significant opportunities, "demand is high but businesses cannot meet these demands as the cost of executing operations has increased and new investments are required to improve the operational capacity which requires significant investments and hence the opportunities in this sector are relatively high," says the Managing Director at a prop desk at a bank in India.

"Financial services is identified as presenting the most opportunities in the next 12 months. The pressure of the regulatory requirements on institutions, combined with the market factors leading to underperforming loans, will continue to drive the sale of non-core and non-performing assets - with this deleveraging creating opportunities for investors.

—Diane Roberts, Restructuring Partner, Reed Smith



Q Which three sectors did you target in the last 12 months for distressed debt/special opportunities?

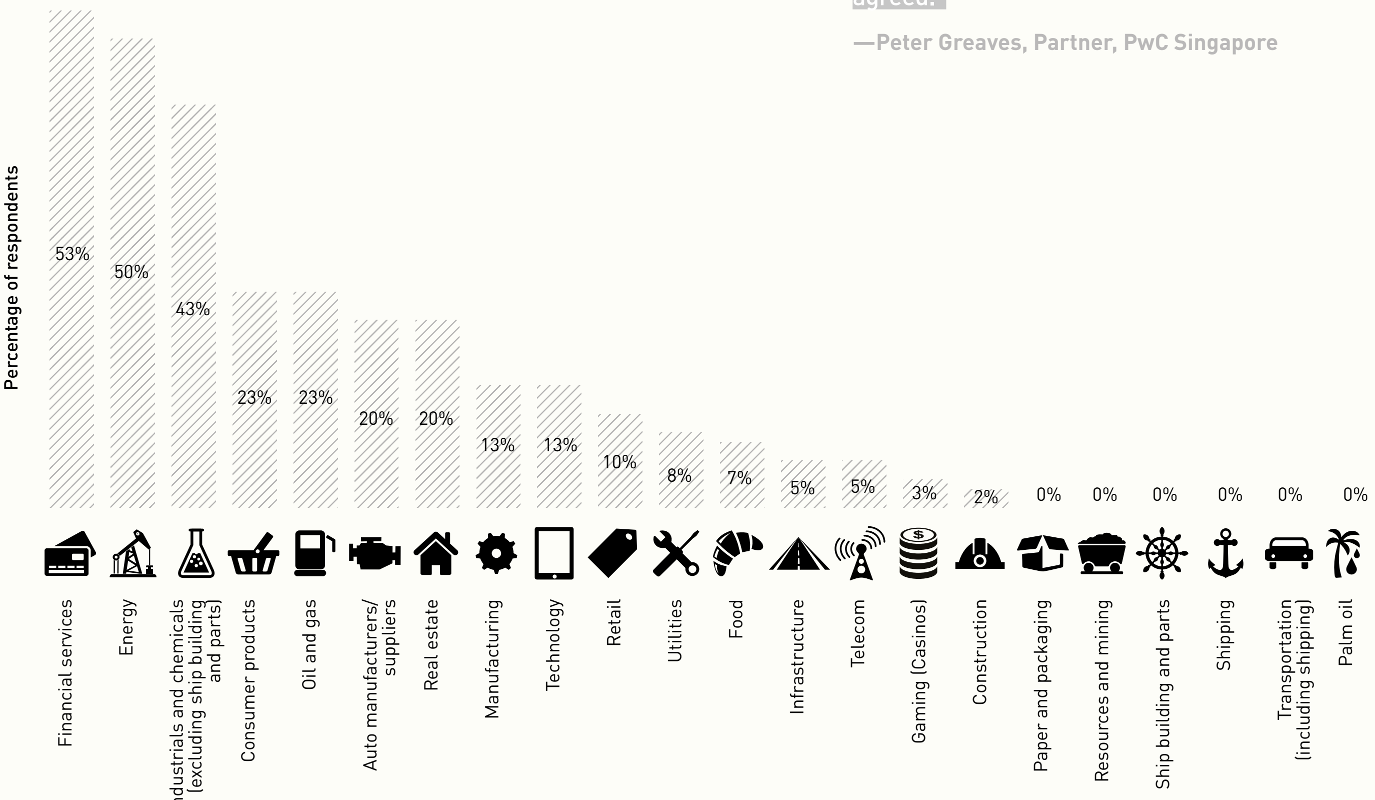
Financial services investments were targeted by 53% of respondents in the last 12 months, making it the top target sector for distressed debt or special opportunities. Weighing in on the issue, the Head of Investment Banking at a bank in Japan asserts, "Financial service businesses have significant potential in the Asia-Pacific region but their capital environments need to be restructured to leverage the opportunities that exists and so investments in this industry will sooner or later prove to be good investment decisions." The Managing Director of a private equity firm in New Zealand concurs, explaining that "Financial service sector requires significant investment in the Asia-Pacific region as they have to streamline their entire business to be compliant to the new regulations and this is calling for investments in the financial service sector."

Coming in at a close second is the energy sector, which attracted 50% of respondents. A Partner at a hedge fund in Hong Kong observes, "The energy sector is suffering losses due to the high cost of production and therefore they need additional investments to be at par with their energy demands and this is creating investment opportunity."

This was followed by industrials and chemicals (excluding ship building and parts), target to 43% of those surveyed. As the Managing Director at a bank based in Japan puts it, "Instability in the commodity pricing environment and the squeezed cash flows are making it difficult for the industrials and chemicals sector to sustain operations amidst the economic recession phase. There are a lot of opportunities emerging as many are actively divesting their non-core areas."

"Oil and gas is an obvious example of a sector where the debt market may be more reluctant to invest compared to the perceived level of opportunities expected. Real estate and resources and mining appear to have similar comparisons as uncertainty over sector recovery still remains high despite recent market trends. This correlation is very relevant to bear in mind when the restructurings materialise as incumbent lenders may find it harder than expected to exit their investments and therefore force more consensual restructurings with the corporates or even formal procedures where these cannot be agreed."

—Peter Greaves, Partner, PwC Singapore

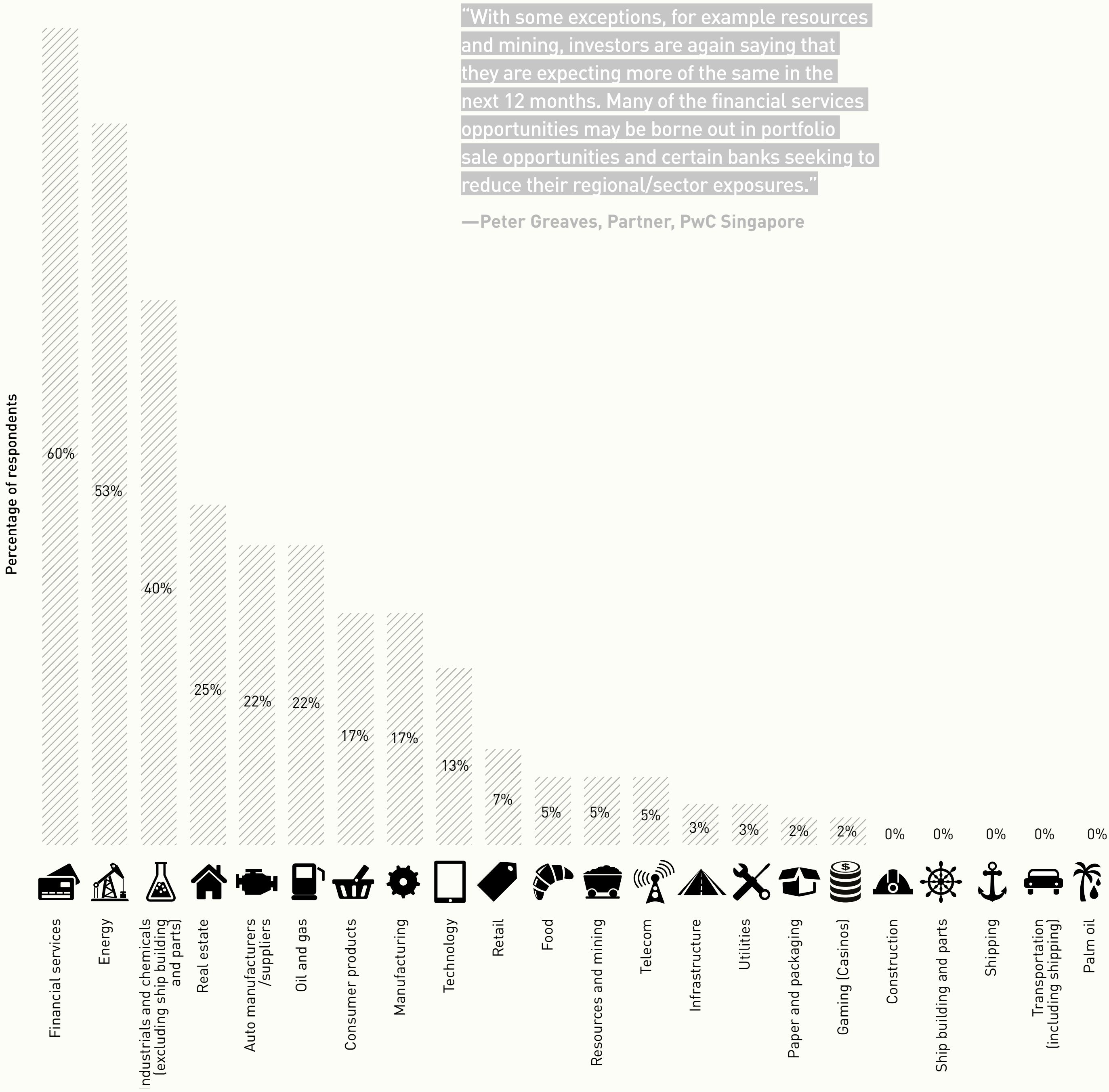


Q Which three sectors will you target in the next 12 months for distressed debt/ special opportunities?

The financial services sector looks set on track to continue being the top target sector for distressed investors, with 60% of respondents choosing it as one of three sectors they look to target in the next 12 months. Similarly, the energy sector and industrials and chemicals rank second and third at 53% and 40% respectively.

Distressed investors may not necessarily invest in the markets they find most attractive for distressed opportunities. Prior experience in and knowledge of the sector, such as prior exposure to sector-specific business management and risk analysis, is often a key consideration. For some, keeping their acquisition focus trained consistently on the same sectors enables them to enlarge their portfolio strength and value.

> "With some exceptions, for example resources and mining, investors are again saying that they are expecting more of the same in the next 12 months. Many of the financial services opportunities may be borne out in portfolio sale opportunities and certain banks seeking to reduce their regional/sector exposures."
>
> —Peter Greaves, Partner, PwC Singapore



Q **Rate each country based on its expected distressed debt/special opportunities in the next 12 months using the following: significant opportunities, some opportunities, few opportunities, no opportunities.**

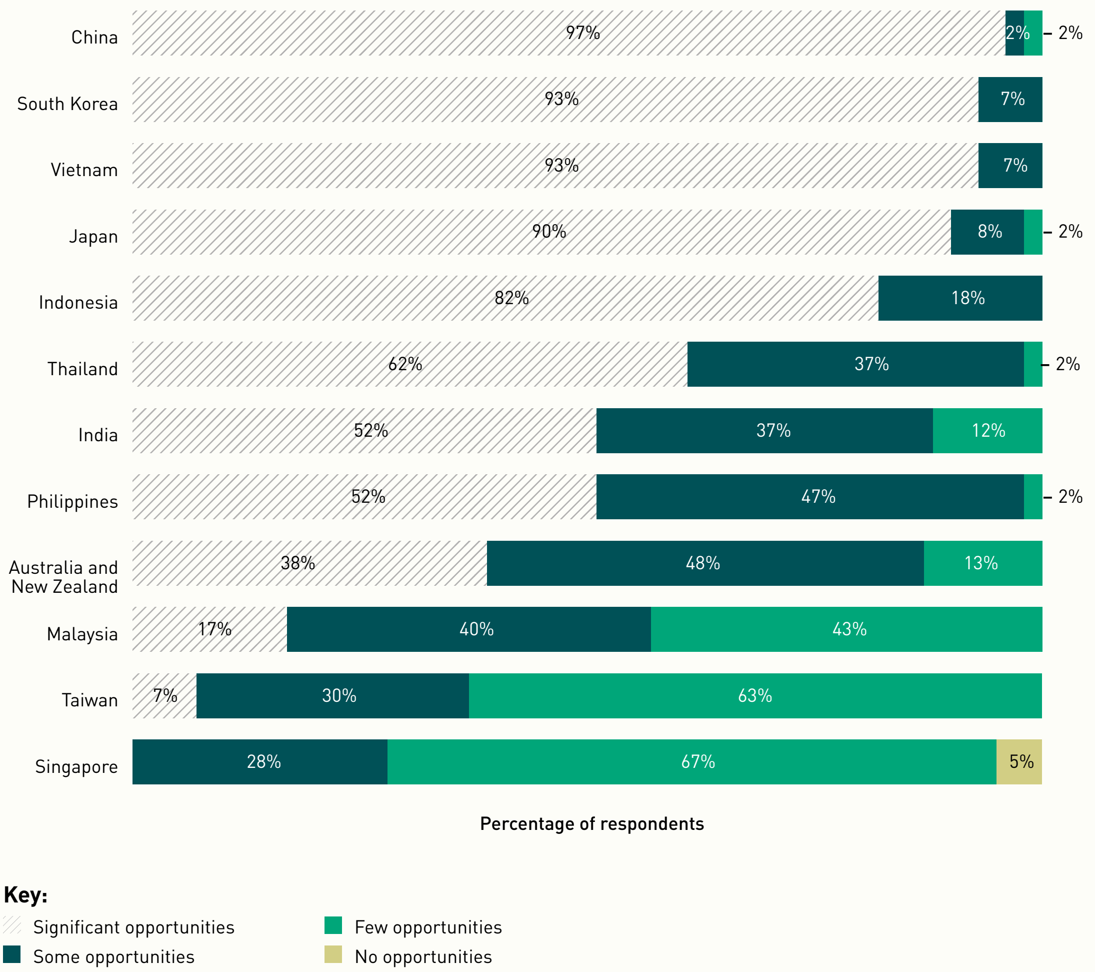
China is rated by the most respondents (97%) as a country offering significant opportunities in distressed debt and special situations, followed by South Korea and Vietnam both at 93%.

In support of these ratings, the Partner & Chief Operation Officer at a prop desk at a bank in Hong Kong says, "China has a very interesting way of navigating the market trends and it is doing just that – they are calling foreign investments into their country at low valuations and this will help them improve their economic conditions in the long run, having achieved growth in performance and financials."

As for South Korea, the Chief Investment Officer at a hedge fund in Hong Kong observes, "The reduction in trade activity across the South Korean businesses and the decrease in export demand have affected the country badly but the scope for growth seems to change the investor attitudes and hence I feel South Korea will pose great opportunity in the next year for distressed investing."

"The disparity for certain jurisdictions between locations where opportunities are expected vs. where capital is being targeted is interesting as it suggests that despite deemed opportunities investors are still focused on the more mature markets and remain cautious over markets with less tried and tested end-game options – such as Indonesia and Vietnam."

—Peter Greaves, Partner, PwC Singapore



Q Which countries in Asia-Pacific offer the most attractive distressed opportunities in the next 12 months?

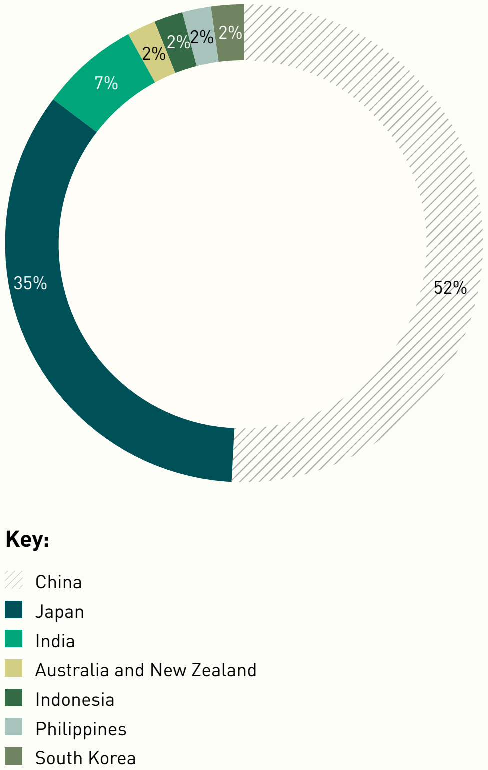
China offers the most attractive distressed opportunities in the next 12 months, according to 52% of those surveyed. In support of these sentiments, the Partner at an emerging market investment firm based in Singapore elaborates, "The decreasing demand for Chinese goods will certainly impact business productivity and will make it challenging for borrowers to pay back debt which will put them into more interest rate losses and therefore the Chinese businesses are selling out some assets to raise funds and focus on core business units." In addition, the Chief Executive Officer of a prop desk at bank or investment bank based in Taiwan says, "The restructuring of the capital markets in China is impacting businesses and we will see the worst of performances in the next year which will result in the increase of distressed investment opportunities in China."

Coming in second is Japan, with 35%, followed by India at 7%. The Head of Asset Management at a bank in Japan states, "Japanese economic conditions are not picking speed and therefore the high levels of debt is affecting banks, making them sell off their loans. Therefore the level of distressed opportunities is likely to increase." Adding to this, the Managing Director of a prop desk at bank or investment bank in Australia suggests, "Japan is facing regulatory changes as they are under pressure to streamline their structural investment activities to bring stability to their economy and so are raising funds by selling non-core assets."

On opportunities in India, the Director of Proprietary Trading & Fixed Income at a prop-desk at a bank in India says, "The Indian market growth is slowly picking up speed and the firms affected by the regulatory and compliance changes are offering their assets to strategic investors to derive the right values on the assets, their chances of rapidly coming out of the distressed conditions will attract most investors."

"We are seeing a notable uptick in investment and NPL opportunities out of India. This data suggests, however, that investors still remain cautious of the evolving recoveries environment, with the Indian insolvency law introduced in May 2016 still in its infancy."

—Peter Greaves, Partner, PwC Singapore



Q In which geographies do you expect to target distressed debt/special opportunities in the next 12 months? (Please rank the top five geographies, where 1 = most favoured target; 5 = least favoured target.)

China is ranked the most favoured target by 40% of respondents, followed by Japan at 23% and India at 17%. According to a Partner at an emerging market investment firm based in Singapore, "China's future potential is looking good as their efforts to streamline their capital investment structure is being put in place at the right time and this will make them more advanced in comparison to the developed markets." Elaborating on this, the Vice President Investment & Asset Management at a bank in Hong Kong explains, "The Chinese market is facing external issues due to the global economic slowdown and the introduction of new regulations and once these have sunk into the business operations and achieves stability, businesses will regain their ability to focus on growth but this will take an additional amount of time and we find investing in long term equity acceptable."

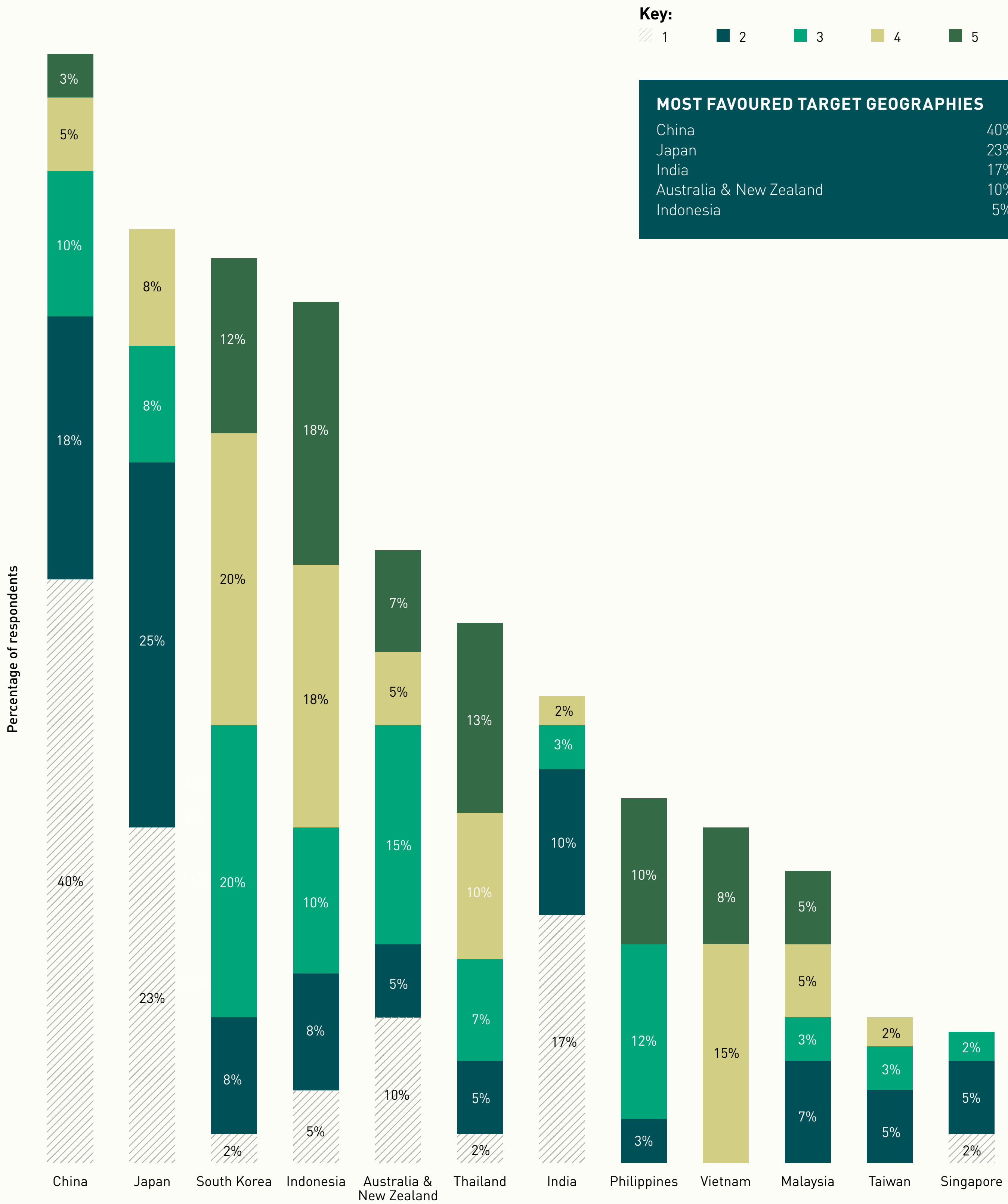
Meanwhile, a Partner at a private equity firm in Japan observes, "Japanese targets are looking very attractive mainly because of the low valuations and acquiring technology and intellectual property rights from Japan can greatly contribute growth in the future and hence we are likely to target Japanese distressed market for potential asset investments."

On India, the Director of Proprietary Trading & Fixed Income at a prop desk at a bank in India opines, "Distressed targets in India are known to have not been able to exploit their potential in the marketplace and therefore with effective guidance distressed and special situation deals could be extremely successful and hence we are looking for such an opportunity."

Foregrounding the importance of conducting effective due diligence prior to making an investment, the Partner at a hedge fund in Hong Kong says, "Knowledge and thorough understanding of regulatory and policy environments is essential when investing in distressed situations as the level of risks are high and hence we will continue to invest in Chinese distressed opportunities as we understand the market best."

"From what we have seen in the year to date in China and Hong Kong, this response is no surprise. We don't expect this trend to abate in the coming years due to underlying macro conditions and investors continuing to hunt for bargains. Despite low absolute levels of appetite, the focus on some of the smaller markets by some indicates that certain investors still do have territory specific strategies."

—Ted Osborn, Partner, PwC Hong Kong, China



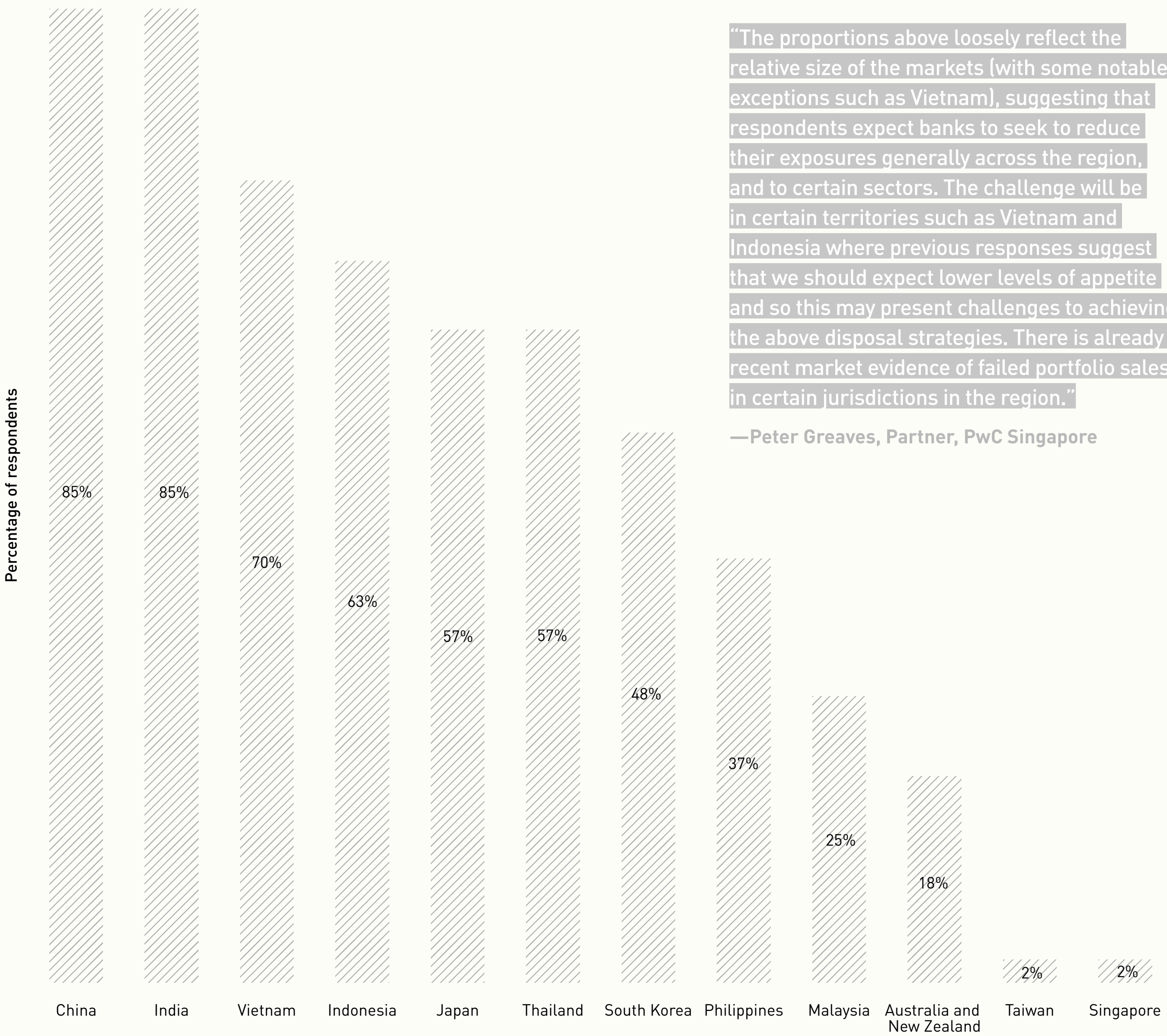
MOST FAVOURED TARGET GEOGRAPHIES

China	40%
Japan	23%
India	17%
Australia & New Zealand	10%
Indonesia	5%

Q In which geographies do you most expect banks to sell their loan holdings?

The vast majority of respondents (85%) most expect banks to sell their loan holdings in China and India. According to the Partner & Chief Operation Officer at a prop desk at a bank in Hong Kong, "The conditions of banks in China have worsened and the ongoing pressures it is facing due to the global economic slowdown are forcing them to sell their risk weighted assets such as their loan holdings to recover from the losses they are likely to face in the future as borrowers find it impossible to return the debt they have taken from the banks."

Expounding on the issue, the Executive Vice President of Finance at a bank in Japan asserts, "The issues in the Chinese banking sector are caused because of the high debt levels that they had issued to borrowers without thoroughly examining the business potential and this in return is affecting their business as borrowers are unable to improve their performance and payback their outstanding debt which is significantly affecting the bank forecasts and therefore they are transferring their debt to other institutions where the chances to securitise maximum debt are high which will result in slightly less losses."
The third geography in which banks are most expected to sell loan holdings is Vietnam, as nominated by 70% of respondents.



"The proportions above loosely reflect the relative size of the markets (with some notable exceptions such as Vietnam), suggesting that respondents expect banks to seek to reduce their exposures generally across the region, and to certain sectors. The challenge will be in certain territories such as Vietnam and Indonesia where previous responses suggest that we should expect lower levels of appetite and so this may present challenges to achieving the above disposal strategies. There is already recent market evidence of failed portfolio sales in certain jurisdictions in the region."

—Peter Greaves, Partner, PwC Singapore

Q When assessing whether or not to enter into a distressed debt transaction, what hinders the transfer of assets? (Please indicate all that apply.)

Nearly all (92%) of respondents think that valuation based on market timing is the top hindrance to the transfer of assets. Valuations based on market timing may lack clarity during the negotiation process, with the Managing Partner of a private equity firm in the Philippines pointing out the difficulties in making predictions, given, "Market volatility levels are high and the regulatory and legal framework challenges are causing delays in the transfer of shares. Valuations as per market timings are changing and this is affecting buyer seller relations as they are unable to decide on a suitable price."

The next biggest hindrance to the transfer of assets is an extend and pretend scenario, according to 82% of respondents. The Director of Proprietary Trading & Fixed Income at a prop desk at a bank in India says, "Extend and pretend scenarios in the distressed market will only hamper the investing appetite as assets extending their development in anticipation of the market improvement will soon see negative reactions on their assets and this will trigger the hindrance of transfer of shares during a transaction."

Adding to this, the Chief Investment Officer at a hedge fund in Japan is of the opinion that "Transparency is reducing, the chances of nonperforming debt is a part of an extend and pretend scenario and this is likely to affect investors as their ability to gain returns based on their projections have changed to a negative prospective."

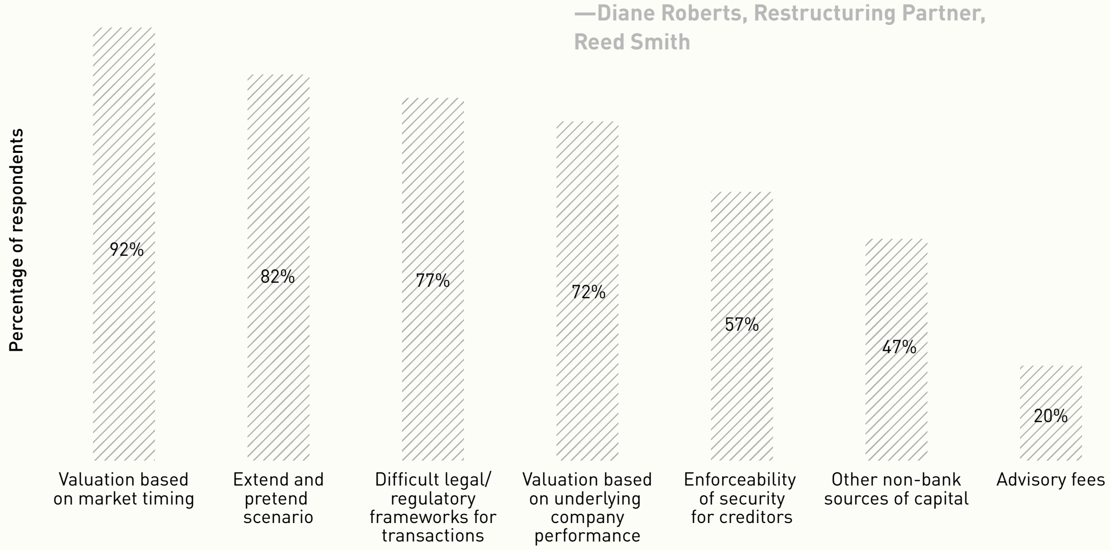
The third biggest hindrance, according to 77% of respondents, is difficult legal or regulatory frameworks for transactions, especially where regulatory bodies have introduced strict parameters and approval procedures for transactions, making compliance with these frameworks challenging. According to the Principal & Portfolio Manager of a hedge fund in Singapore, "The difficulties in fulfilling the regulatory and legal requirements are increasing as the capital markets are being restructured and this is causing slight delays in transferring the shares which reduces the synergy levels of a distressed transaction." Furthermore, the Vice President of Investment & Asset Management at a bank in Hong Kong points out that "many countries in the Asia-Pacific region have regulations that protect the owner and the separation laws between the ownership and control is not defined correctly raising issues in the transfer of shares."

"There is a regular theme in the market consistent with this data which suggests that whilst appetite for investment is healthy, there is a mismatch between bid and ask values. This is due to a combination of unrealistic valuations and also unwillingness or, in some cases, inability to take losses through the P&L."

—Peter Greaves, Partner, PwC Singapore

"In addition to Peter's comment, the legal/regulatory environment and the enforceability of security also weighs heavily on investment decisions – and the final value that is placed on an opportunity."

—Diane Roberts, Restructuring Partner, Reed Smith



Q Please rank from one to five the greatest impediments to restructuring efforts (where 1 = greatest impediment).

The issue of unfavourable bankruptcy laws is ranked as the greatest impediment to restructuring efforts, nominated by 35% of the respondents. According to the Managing Director of a private equity firm in Singapore, "Bankruptcy procedures generally shape decisions over a business's restructuring by deciding where and how it will resolve its issues and this affects management ability to carry out the necessary restructuring within their business." Moreover, as a Partner at a private equity firm in China explains, "Bankruptcy laws and its interpretations are complex and their impact on restructuring of business operations and financials are a growing concern. Most times, it is easier to file for bankruptcy straightaway rather than dive deep into restructuring as the laws are unfavourable for business growth."

This is followed by the lender's own capital issues, according to 33% of the respondents. As the Director of Investment at a hedge fund in Malaysia opines, "Lenders own capital issues will lead to a far more worse situation as it will force the borrower to reduce the size of the business by selling off underperforming assets which will destroy the business interests and will not make restructuring worthwhile."

Debtor delay due to legal and regulatory permissions comes in third, ranked as the greatest impediment by 15% of those surveyed, especially in jurisdictions where new laws and regulatory changes have come to pass. As the Partner at a private equity firm in Japan puts it, "Debtor delays in gaining approvals would be the greatest impediment to restructuring as it delays the entire recovery process and adds more risks in such businesses as the impact of the market directly affects business performances."

"As important as understanding the options under each of the insolvency/bankruptcy laws across the region to achieve a successful restructuring, is understanding the pressure points within the transaction, and leveraging both the legal and practical elements as appropriate to achieve results."

—Charlotte Moller, Restructuring Partner, Reed Smith

"The region is a patchwork quilt of bankruptcy frameworks. This was seen earlier in the variability of appetite between different jurisdictions. Some territories such as Malaysia and Singapore are already making inroads into the harmonisation of bankruptcy frameworks with international practices. It will be interesting to see what extent and how quickly other territories are willing and able to follow suit."

—Peter Greaves, Partner, PwC Singapore

Key:

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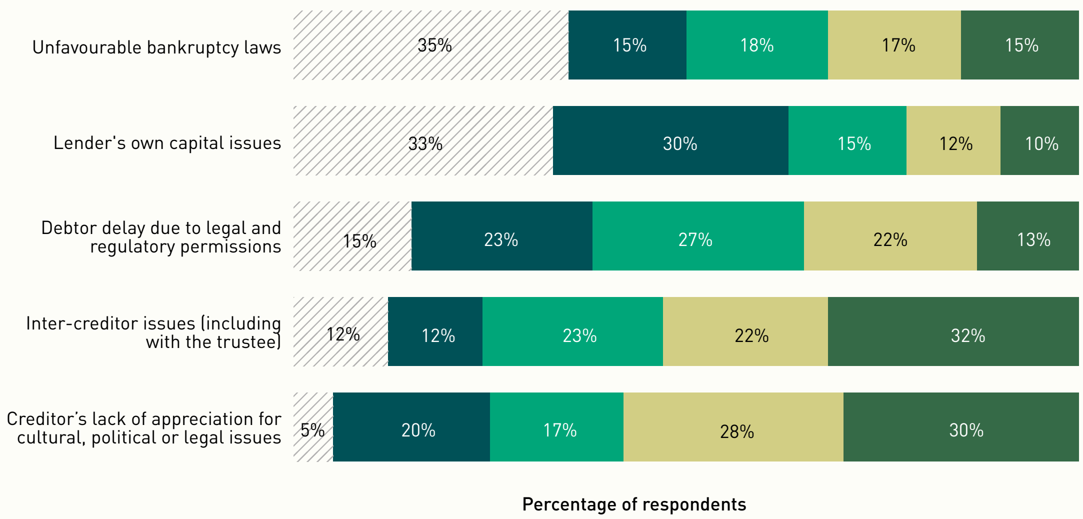


Q For distressed debt investing, please rank the top five geographies/jurisdictions that are most difficult from a legal and regulatory perspective (where 1 = most difficult).

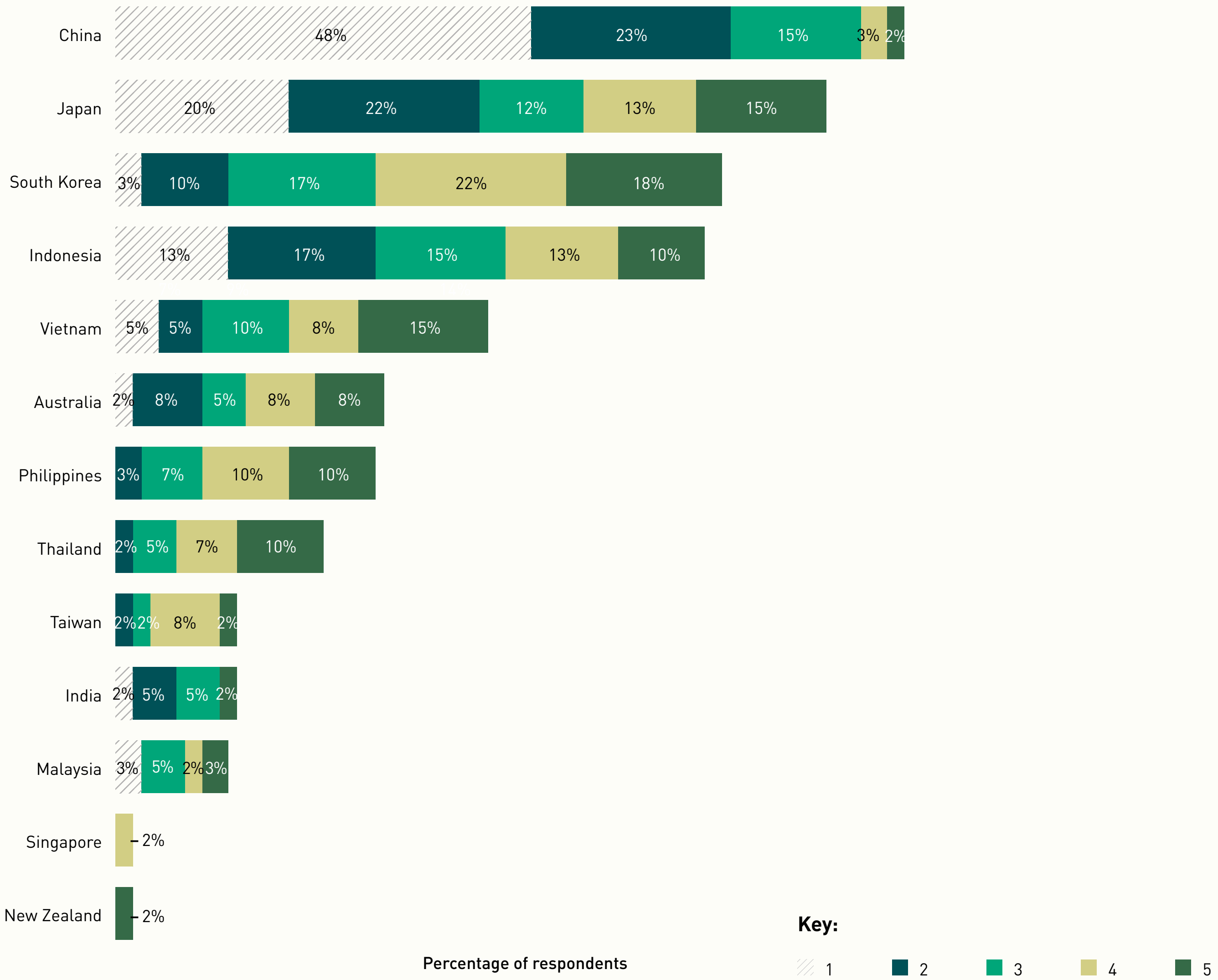
Almost half (48%) of the respondents rank China as the jurisdiction that is most difficult from a legal and regulatory perspective, followed by Japan at 20% and Indonesia at 13%.

"It is very interesting that earlier we saw a high extent of appetite for opportunities in China and Hong Kong. This is despite these responses which suggest that investors are still focused on China despite legal and regulatory challenges given that the size of the opportunity is so large."

—Ted Osborn, Partner, PwC Hong Kong, China

"It is not unexpected to see China listed as the most difficult jurisdiction from a legal and regulatory perspective. However, it is interesting to see Australia listed where it is. While Australia does have an evolved directors liability regime which may involve personal risk for directors of stressed companies, Australia has a sophisticated court system and a robust legal framework which gives comfort to creditors on the enforcement of security and generally lowers execution risk – particularly when compared to other jurisdictions in the region."

—Diane Roberts, Restructuring Partner, Reed Smith



Q For each of the five geographies you named, please indicate whether you believe that the legal and regulatory landscape in the next 12 months will: improve rapidly, improve slowly, remain the same, deteriorate slowly, or deteriorate rapidly.

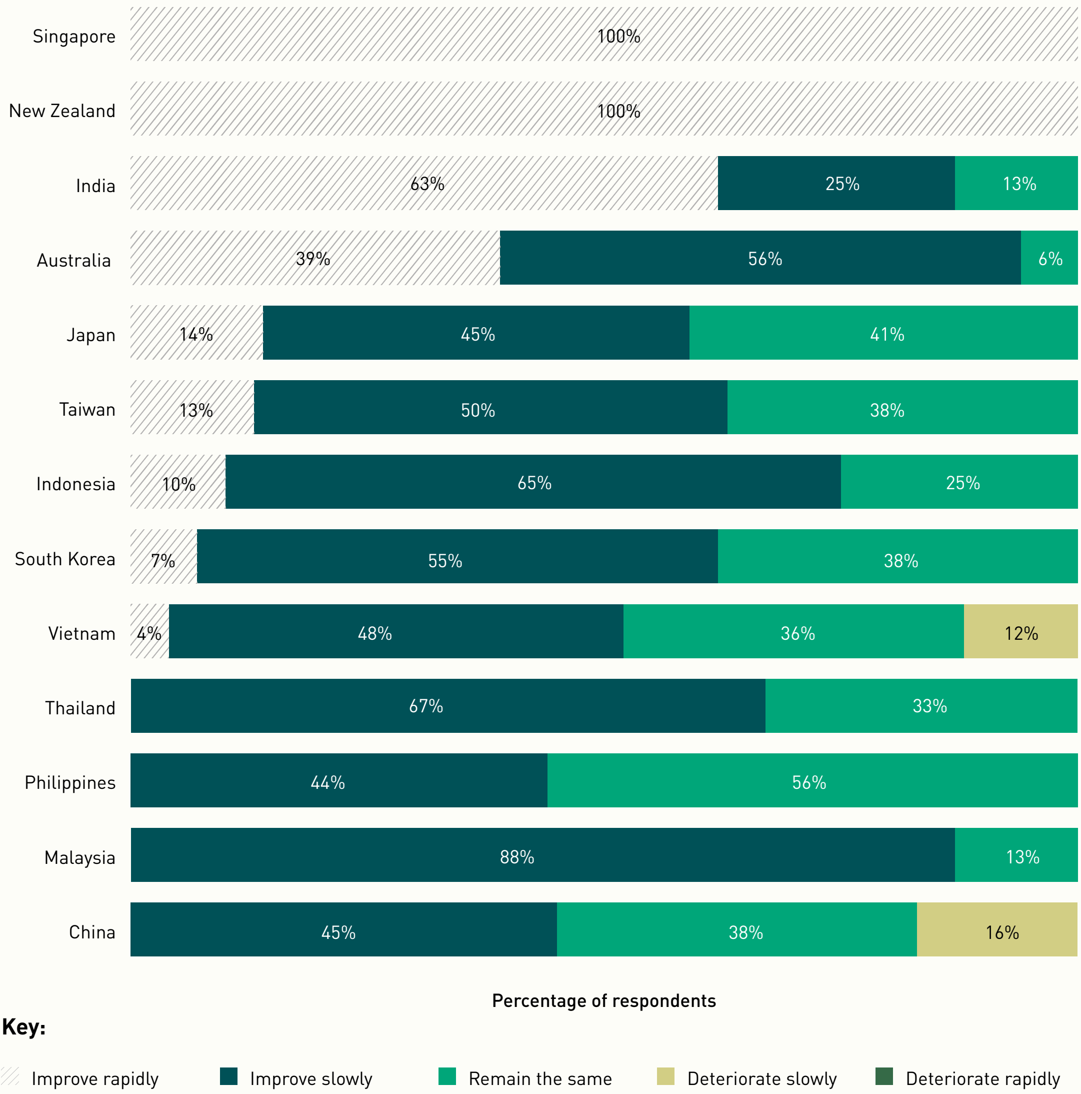
None of the respondents who rank China as the most difficult jurisdiction expect it to improve rapidly in the next 12 months, with 45% of the opinion that it will improve slowly, and 38% expecting it to remain the same.

Japan is seen to be in better shape, with 14% of respondents who perceive it as a difficult jurisdiction seeing rapid improvement and 45% seeing slow improvement on the horizon in the next 12 months, though 41% expect its situation to remain the same.

Meanwhile, 10% of those who find Indonesia a difficult jurisdiction expect to witness rapid improvement over the next 12 months, with a further 65% expecting slow improvement and 25% anticipating no change.

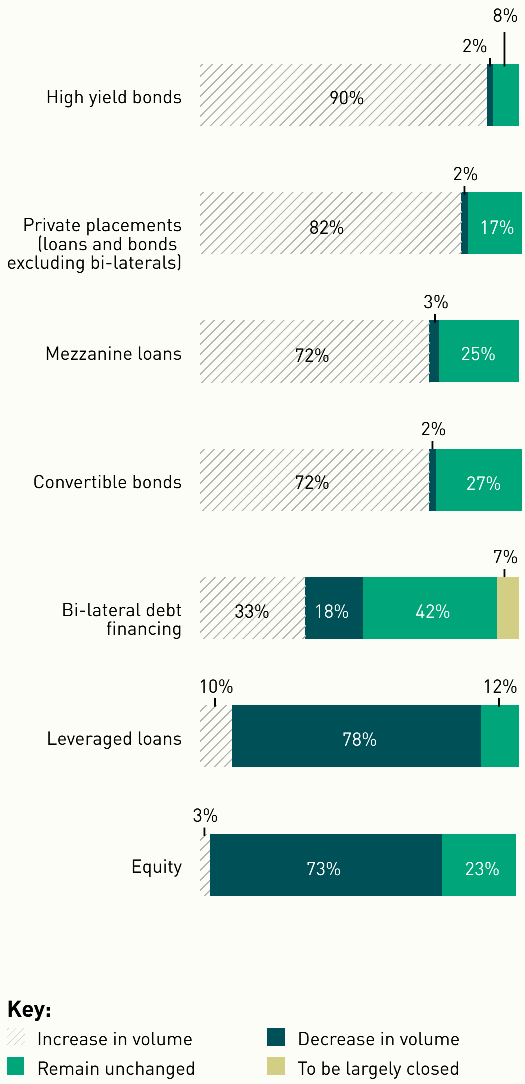
"Singapore has shown a strong commitment to the review and development of its legislation as it relates to the facilitation of restructuring processes, and has clear ambitions to be a restructuring hub in Asia, which would appear to be reflected in the results of the survey."

—Diane Roberts, Restructuring Partner, Reed Smith



Q Do you expect primary markets for the following products to increase in volume, decrease in volume, remain unchanged or to be largely closed in the next 12 months?

Respondents seem to be feeling bullish about primary markets for high yield bonds and private placements (loans and bonds excluding bi-laterals), with 90% and 82% expecting to see an increase in volume in each market respectively. According to the Director of Investment of a prop desk at a bank in Singapore, "The primary market for high yield bonds will increase in volume with the increase in volatility in the global market. High yield bonds are likely to see double figure return rates which will again drive the volumes in this product type." Furthermore, the Managing Partner at a private equity firm based in South Korea points out that "Cheap valuations and improved fundamentals are good characteristics that will lead to a growth in the volumes of high yield bonds."



As for private placements, the Partner & Chief Operation Officer at a prop desk at a bank in Hong Kong observes, "Accessing the public market in the current economic environment is highly challenging for businesses and therefore the primary market may shift to private placements as the likelihood to secure a loan in these terms are relatively easier." Also, according to a Partner at a private equity firm in Japan, "The increase of premiums have enabled the private placement markets to offer better pricing and therefore the primary market for private placements will increase in volume."

By contrast, a significant 78% of respondents expect leveraged loans to decrease in volume over the next 12 months.

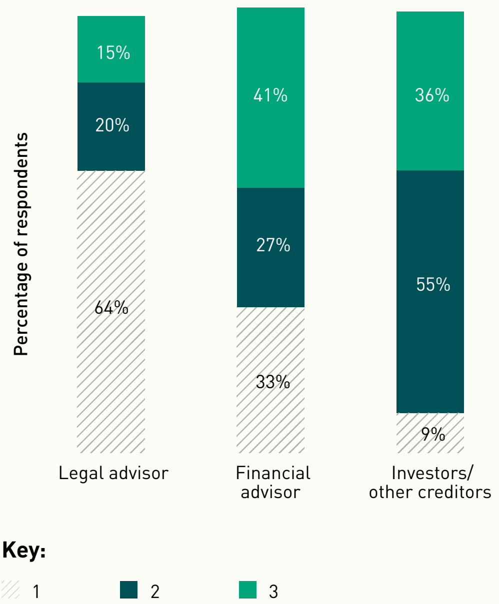
"The nature of the instruments favoured is interesting. There is a clear theme that long run equity-type upside is expected to be prevalent. This supports the view that much of the opportunity exists due to depressed current conditions but that overall recovery is expected eventually. The ability to conclude deals therefore will hinge on realistic and up to date valuations from corporates and incumbent lenders, taking into account the underlying economic fundamentals of the corporates, balanced against the cash/funding needs in the short and medium terms. We suspect that not all of the instruments referred to above represent bank exit transactions, and some will be lender groups simply swapping their risky fixed income for longer run/deferred returns. It will be interesting to see the impact of recent high profile defaults on the ability of corporates to raise capital via high yield bonds."

—Peter Greaves, Partner, PwC Singapore

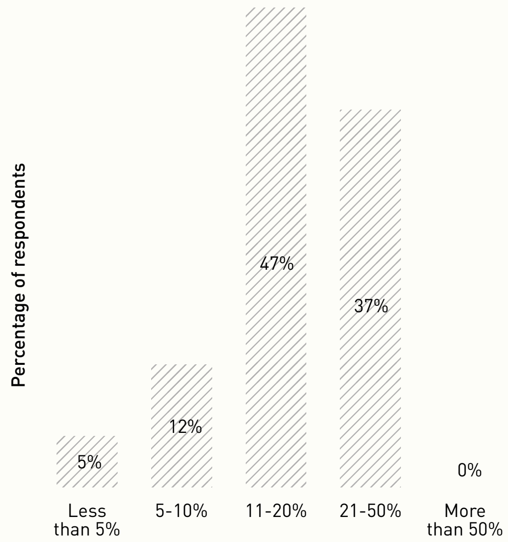
"High yield bond demand currently continues to be high, often exceeding supply, and the product has shown itself to be flexible and robust in volatile conditions. What is lacking is certainty as to how these products will work in restructurings, workouts and bankruptcies in various jurisdictions, but it is likely that there will be more high yield led restructuring activity in the future to give the market guidance."

—Diane Roberts, Restructuring Partner, Reed Smith

Q Rank in order of priority the parties you would contact when one of your investments has defaulted (1st priority, 2nd priority, 3rd priority).



Q How much of your portfolio do you plan to allocate to direct lending in the next 12 months?



In the event that one of their investments defaults, respondents overwhelmingly stated that legal advisors would be their first port of call, according to 64% of those surveyed. A smaller 33% said financial advisors would be sought in such an event.

Of those who look to legal advisors first, a Partner at a private equity firm in Japan explains, "Defaults will first be communicated to the legal team to take immediate action to safeguard the investments made by our investors, an intensive financial analysis will then be conducted with the financial advisory team and the results will be disclosed to the investors for their knowledge and actions."

47% of respondents plan to allocate 11-20% of their portfolios to direct lending in the next 12 months, while seeing new opportunities in small and medium market segments, 37% expect to put in 21-50% of their portfolios.

Of the 11-20% group, one comments, "The Brexit has impacted the global economic conditions and performances across the financial industry is falling, this is highlighting the demand for direct lending activity and therefore the return rates on direct lending will increase with its rise in demand."

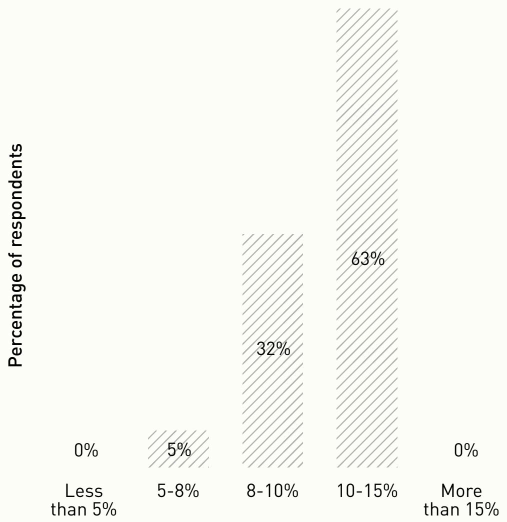
"Despite direct lending becoming more common for the investment community, the fact that no respondents plan to allocate more than 50% of capital suggests that the lean towards direct lending is opportunistic and situation driven."

—Peter Greaves, Partner, PwC Singapore

"Direct lending will often be part of a portfolio strategy, particularly when the margins are available, as it allows increased control of the target company."

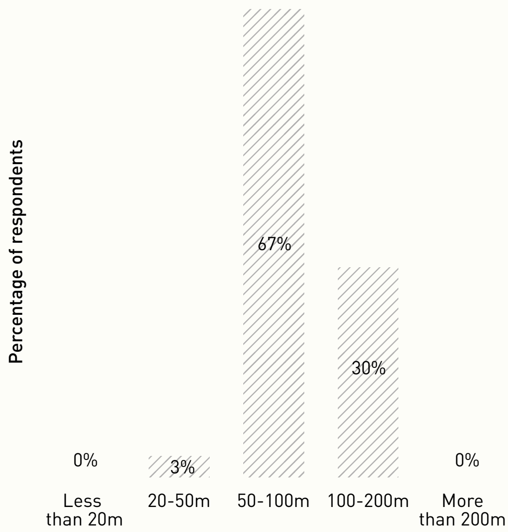
—Diane Roberts, Restructuring Partner, Reed Smith

Q What percentage return are you targeting for direct lending in the next 12 months?



63% of survey respondents are targeting a 10-15% return on direct lending in the next 12 months, while 32% are aiming for 8-10% return.

Q What do you expect to be your average investment (US$) size in the next 12 months?



67% of those surveyed gauge their average investment size in the next 12 months to be US$50-US$100m, 30% expect their average investment to be US$100m-US$200m, whereas 3% expect theirs to be US$20m-US$50m.

Peter Greaves
Partner
PwC Singapore

A comprehensive understanding of locale-specific legal, regulatory and industry knowledge is essential to charting the best method of approach towards identifying, assessing and zeroing in on distressed debt and special situation opportunities. Peter Greaves, Partner at PwC Singapore, discusses trends in the swiftly morphing landscape of the Asia-Pacific distressed debt universe, as well as various key considerations for distressed investors in choosing a target geography and industry.

How do returns on distressed debt and special situation opportunities compare to other asset classes? Are they worth the risk?

To start with the second question, the returns certainly can be worth the risk, but there are a myriad of considerations on a situation by situation basis of which the buyer or investor must beware and be aware. The volatility of returns requires a portfolio approach.

Rising levels of distressed debt and special situations offer increased opportunities for investors – assuming, that is, that they can pick a situation that has the right characteristics for their portfolio at the "right" price. The issue is the potential mismatch between value expectations from a situation and an investor's target rate of return, a calculation that is complicated by the concentration of situations in certain sectors and the backdrop of a developing landscape in Asia in terms of the law and practice of how such situations play out. A lack of predictability in an end game can be one of the main issues.

With the new normal of lower interest rates, increasing bond defaults and stock markets that are seemingly increasingly volatile and prone to shocks; special situations retain the potential to offer superior returns and will remain attractive to the right investor. Indeed, there is some convergence with characteristics and expected returns of other asset classes, with convertible instruments and other equity mechanisms moving returns closer to equity type upsides.

What are some of the key considerations for distressed investors in evaluating a target geography?

It is clear from the survey that many investors are still wary of jurisdictions where the exit routes are less proven, or where the system may appear to be stacked in favour of the debtor. This is despite an acknowledgement that the extent of opportunities in these jurisdictions is significant. Therefore a track record and predictable legal framework are clearly high on the agenda.

Having said that, despite indicating a number of concerns over the Chinese legal and regulatory framework, the sheer size of the opportunity available means that this remains one of the most targeted geographies.

How do issues of corporate governance influence the formation and outcome of distressed debt or special situations in the Asia-Pacific region?

As far as corporate governance is concerned, in these situations it is all about the quality and transparency of information flow.

As the legal frameworks for restructuring evolve across the region, there will have to be a shift towards greater onus on the veracity of financial data provided by management and ensuring that the appropriate level of rigour has been applied by advisors in their vouching of projections.

In terms of strategic governance, short term measures such as deferral or short tenor refinancing are increasingly the options of choice for corporates, as opposed to taking longer term measures and addressing the value break. Whilst it is understandable why corporates are reluctant to take long term hits to the balance sheet, this effectively creates a gamble that value will recover quickly, whether that be oil, commodities, shipping charter rates or property price driven. More realism over value will be needed, otherwise large, long term refinancing, and portfolio sales will continue to be hampered.

What are some of the current product innovation trends in the Asia-Pacific distressed debt universe?

Investors have been quick to acknowledge the challenging market conditions for a number of sectors and have recognised the underlying potential in a number of corporates in special situations. This has led to greater use of convertible or option based structures to allow businesses to retain more free cash flows within the business, whilst offering investors longer run upside returns.

As for advisors, their product offerings continue to be innovative. Cross-border regulations are transforming and strategic jurisdiction shopping is becoming a more widespread tool.

What can be learnt from the evolution of restructuring options for distressed companies in the Association of Southeast Asian Nations (ASEAN)? How are member states making legislative changes to become more creditor-friendly?

Singapore is already amongst the most creditor friendly jurisdictions, but it is not resting on its laurels with the current live consultation on the development of restructuring and insolvency laws to promote a rescue culture to match, and Singapore's wider ambitions to cement its position as a hub for restructuring in Asia. However, other countries are also making progress as Indonesia is exploring regulatory change and Malaysia has added new options within its Companies Bill to facilitate more of a turnaround culture.

It is essential for stakeholders to have a certain level of predictability when considering their restructuring options and the more that regional territories' regulations converge, and respect each other's processes, the easier investors will find it to deploy capital as they can better calculate the exit risks.

This will provide much needed liquidity across the region which corporates will need as current facilities must be repaid or renewed in a market where the refinancing of certain instruments (e.g. bonds) will be difficult if not impossible in certain sectors and jurisdictions. Those jurisdictions who resist reform and remain insular will find that their corporates will have much narrower options and tighter liquidity when it comes to special situations. International lenders/investors consider their practical experiences as well as the cost of capital implications (to which territory risk factors are a component) when making new lending decisions.

How are liquidity conditions in the region likely to pan out over the next 12-24 months? How is this likely to affect capital raising among different distressed investors?

There is undoubted flight of capital back to Europe as a number of large international lenders are actively reducing their exposure to the region. Fortunately, the distressed investment market appears buoyant, although these investors are selective and focussed on value. The shift in the nature of providers of capital is similar to that which was seen in the UK and Europe over the last five years.

What is the outlook for the Asia-Pacific distressed debt and special situations market for the next 12-24 months?

The last 12 months has been extremely active in the region but there are a large number of problems which have not been resolved or have only had temporary measures put in place. As distress broadens out into more sectors, the market will continue to be busy as these new opportunities will add to the second rounds of restructurings for those cases seen in 2015 that were not fully dealt with.

Opportunities will therefore abound – the level of activity will depend on the appetite of distressed debt investors to play in the sectors where the opportunities are likely to be seen. By way of example, investors sitting in the US have plenty of oil and gas situations closer to home and therefore, for this sector in particular, they would need to see real value in order to deploy capital further afield in what they deem to be riskier jurisdictions with less familiar recovery routes.

Diane Roberts
Restructuring Partner
Reed Smith

Gaining a thorough understanding of a potential investment's domicile market is imperative to ensuring a smooth transaction process and to securing optimal returns. Diane Roberts, Restructuring Partner at Reed Smith, weighs in on the key considerations and challenges of investing in Asia-Pacific distressed opportunities, from a legal and regulatory perspective.

What are some of the main jurisdictional challenges and risks associated with cross-border investment in distressed opportunities in emerging Asia, as compared to more developed markets? How can foreign distressed investors go about mitigating such risks?

Regulations in the Asia-Pacific region are generally becoming more supportive for investors, but compared to more mature and legally robust jurisdictions globally, investors must remember that markets in Asia are still developing legal systems and procedures around corporate debt. Regardless of their experience in mature markets like the US and Europe, investors must be mindful of the lack of a unifying legal framework and the absence of meaningful consistency from country-to-country regarding bankruptcy and insolvency.

Distressed investors have and continue to run into jurisdictional challenges on several fronts. Viewing the region as a single geography has proven troublesome. Labour laws contrast substantially in each country, as do union influence in individual markets. For instance, India's legal system has traditionally been more advantageous to company owners and saving businesses for the sake of their workers than creditors – although recent developments are showing a shift in policy. As a result, both factors have played a significant role in influencing the level of government support for corporate restructuring. These are two of many issues underscoring the importance of understanding individual market jurisdictions and corporate debt regulations before deploying capital.

Additionally, emerging Asia's web of laws and regulations pose challenges for distressed investors in their complexity. Furthermore, a diverse range of accounting and reporting processes and oversight from market-to-market has presented issues for many distressed investors' compliance charters and established know-your-client (KYC) policies. In order to mitigate the risks of investing in an emerging distressed debt market in Asia-Pacific countries, fully understand the legalities and the corporate landscape. In the region, regulations can change quickly and unexpectedly, and having insights on the ground is an advantage.

Local market knowledge is also essential for gaining a firmer understanding of how, why and when corporations will typically declare distressed positions. Timing plays an influencing role in any investment decision in emerging Asia. For example, creditors and bondholders have generally benefited from more methodical restructuring plans earlier in the bankruptcy or insolvency process. But in the majority of Asian markets, due to cultural practices and underlying labour issues, many corporations do not consider restructuring plans until they are out of options. As such, we advise clients to look not only at the timeline but also to complete a thorough diligence process of any prospective distressed investment.

What are some of the key considerations for distressed investors in evaluating a target sector/industry?

Investors must be aware of the sources of distressed debt in Asia when evaluating a target sector or market. In the current environment, the cycle of swelling debt is a result of several factors including the sustained low interest environment and active lending by regulated and unregulated financial institutions.

Complementarily, debt restructurings are also resulting from high corporate debt levels combined with milder economic fundamentals, placing pressure on cash-flows.

We also encourage investors to voice their own concerns and requirements before evaluating a target. In recent months, demand for liability management and debt restructuring solutions have increased across several sectors and markets. Of equal importance, investors need to push issuers on upcoming redemption and maturity dates in case alternative borrowing options are required.

Sector-wise, the Chinese banking sector provides an illustration of the importance of thorough diligence and market understanding before committing to a distressed investment. For several years, foreign distressed debt managers have been patiently watching the growing number of non-performing loans (NPLs) on Chinese bank balance sheets for investment opportunities. However, regulations have limited the level of investment in distressed debt until recently. Now, foreign players are poised to build scale as the extent of bad loans in the system increasingly tests the capacity of local distressed debt managers to absorb them.

However, building a Chinese NPL business is not a straightforward process. To invest in this market requires forging relationships with distressed asset suppliers, and developing and implementing a network of due diligence service providers to evaluate assets and collateral. Essential to the investment is also establishing a strong in-house local team with experience in China NPL underwriting, restructuring, evaluating legal options and negotiating exits to the investment.

How do Asia-Pacific bankruptcy regimes and insolvency laws compare to those in North America and Europe? What are some of the reforms being undertaken to improve creditor protection in the region?

Generally, in Asia-Pacific, most bankruptcy regimes tend to lean towards more out-of-court consensual solutions. In many markets, governments are reluctant to support foreign creditors' use of domestic courts to enforce claims against domestic obligors given the cultural and economic landscape of many countries.

Despite some similarities, bankruptcy and insolvency laws in Asia-Pacific occupy a wide spectrum. There are pockets of sophistication and legislation which should be familiar to creditors in mature markets in geographies such as Malaysia and Taiwan. In the former, creditors can expect to recover more than 80 cents on the dollar for assets they are owed.

At the other end of the spectrum, China is still very much a work in progress, with insolvency law progressing but still in largely unchartered waters. This should not come as a surprise, given the country's measured move towards a market-based economy and its legacy of economic and judicial experimentation.

And then there is Singapore. The country is planning on revising its insolvency laws with the ambition of becoming a regional centre for the debt restructuring process.

What is the outlook for the Asia-Pacific distressed debt and special situations market for the next 12-24 months?

The underlying factors appear to support a greater role for distressed debt investors in the coming years. Economists and think tanks estimate that a sizable increase in declared bankruptcies and workouts in Asia is likely. With the backdrop of slowing economies and a cycle of loose credit, companies have been left vulnerable and their ability to cover rising levels of debt will be tested, creating opportunities for investors, subject to regulation.

Outside of China and India, Southeast Asia also presents a new pocket of potential opportunity. NPLs continue to build on balance sheets, particularly loans collateralised by real estate. The scale of this, and exactly when this happens, remains to be seen. However, experienced distressed investors, who can also identify future real estate trends accurately, and value assets correctly at the time of purchase, could be positioned to for opportunities, especially as regulations soften.

We also believe that Asia could further benefit from the development of the global private debt marketplace. Key to this market, for foreign investors, will be local partnership. Knowledge of local laws and regulations will remain essential for any distressed strategy in this region, ensure more stringent KYC processes and a window into the right time and right sector to investor. While global investors will undoubtedly look more favourably at the region, expertise based on the ground is both the safest and most reliable avenue for success for the time being.

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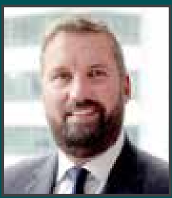

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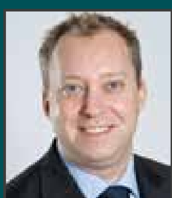

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