

Lao PDR Bonds

A Stocktake and Analysis of Lao PDR Bonds

September 2020



Executive Summary

The report is produced to tally bonds issued by the Laos PDR government and its state-owned enterprises. This report is the first of the 2-part series of which the second part will entail: (1) A study of investors’ appetite on bonds issued by the Laos government and its state-owned enterprises and (2) Highlights of key credit risk of Laos PDR in view of credit rating agencies, the Laos government, and market participants including bond underwriters/lead managers, and investors..

In this report, we first discuss the external public debt figures in Laos as well as state-owned enterprises (SOE), in our view, such as Electricite Du Laos (EDL) and EDL-Generation Public Company (EDL-Gen). Then we detail the Laos bond supply in terms of: (1) Currency (Laotian Kip or LAK, Thai Baht or THB, and US Dollar or USD); (2) Places of issuance; (3) Lead managers; (4) Issuers; (5) Credit ratings; (6) Maturity; (7) Issuance; and (8) Pricing.

We note that the Laos bond data in this report may not be a complete picture as unlisted bonds issued by government, mainly treasury bills, are not disclosed publicly. We worked on the Laos bonds listed in Laos Securities Exchange (LSX), Securities Exchange of Thailand (SET), Singapore Exchange (SGX) which amounted US\$ 1.7 bn and US\$ 1 bn, issued by the Ministry of Finance of Laos PDR (MOF) and EDL-Gen, respectively. We obtained a total figure of bonds issued by the Bank of Laos PDR (BOL) from BOL. BOL bonds amounted to LAK 3 trn (USD0.3bn) in June, of which we do not have details on each BOL bond.

Despite the fact that rating agencies do not account EDL-Gen’s debt in Laos external public debt calculation as Laos did not explicitly guarantee EDL-Gen’s debt, we believe Laos will need to come in to honours EDL’s debt obligations if necessary as EDL-Gen is systemically important to Laos economy on the following:

- ▶ EDL-Gen’s role of providing employment and electricity to Laos
- ▶ MOF’s 100% ownership in EDL which owns 75% of EDL-Gen’s shares;E
- ▶ DL-Gen’s status as a core subsidiary of EDL and
- ▶ EDL-Gen’s key role of providing electricity to EDL as EDL-Gen’s sole customerEDL’s influence on EDL-Gen’s strategy and dividend policy

The fact that TRIS rates EDL-Gen’s issuer credit rating at BBB which is the same as Laos’ confirms our assumptions above. As such, our analysis concludes that EDL-Gen’s bonds should be a part of Laos bond stock taking.

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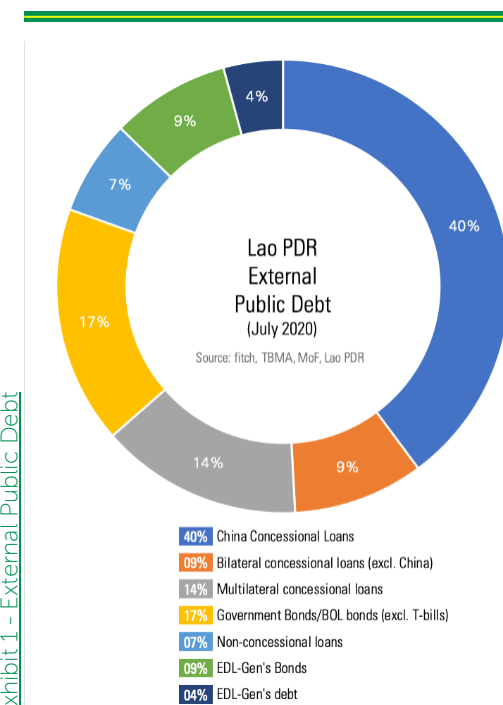
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The Debt Picture

Our debt figures are based on MOF, BOL, Thailand Bond Market Association (TBMA), LSX, SGX, and rating agencies (TRIS, Fitch, and Moody's). The rating agencies confirmed with us that the Laos government had opportunities to review all the facts and figures presented to the public. Thus, we assume that the rating agency's facts and figures are relatively accurate on the dates they published rating reports.

We estimate Laos external public debt, excluding debt owed by state-owned enterprises and treasury bills, to be c.USD10.3bn at the time of this report, versus TRIS' figure of USD9.9bn last December. Including EDL-Gen's debt, EXHIBIT 1 shows an external public debt breakdown of c.USD11.8bn by type of debt, according to Fitch and TBMA, BOL, and LSX. We understand MOF treasury bill maturities can be extended up to 1 year, subject to MOF budget and liquidity situation. Hence, we believe the exclusion of treasury bills from our external public debt figure is justified for investors to only focus on debt which cannot be automatically extended. We note that the bond details in the Bond Stocking section capture all listed EDL-Gen and MOF bonds, excluding BOL bonds which tally LAK3trn (USD0.3bn) in June 2020, according to BOL database.



The concessional loans, project loans to finance infrastructure projects, including the hydro power as well as high-speed rail projects accounted for 63.6% of the external public debt. 40% of the external public debt was in concessional loans from Chinese creditors such as the 25-year USD465m loans from Export-Import Bank of China (CEXIM) with a 5-year grace period, according to the Center for Global Development. Non-concessional loans includes loans from commercial banks such as Malaysia's May Bank and EUR88m syndicated loan arranged by Credit Suisse in 4Q'19. We do not have other information on multilateral loans and bilateral loans. Moody's expected Laos' government debt service of c. USD1.2bn in 2020, up from USD842m in 2019, and a little over USD1bn each year between 2021 and 2015.

EDL-Gen's total debt was LAK13.6trn or c.USD1.5bn in March 2020, 6.4% of which was short-term debt. 73% of EDL-Gen's long-term debt or LAK9.4trn (c.USD1bn bonds) was in long-term bonds which are captured in this report..

Bond Stocktaking

Total Laos bonds at the time of this report were (1) USD2bn for government bonds, including BOL LAK-denominated bonds of LAK3trn (USD0.3bn) and (2) USD1bn bonds issued by EDL-Gen. Our USD3-bn figures do not include unlisted bonds issued by Laos government (i.e. MOF treasury bills) and other state-owned enterprises besides EDL-Gen. We understand MOF is not required to list all of its bonds on LSX. Appendix 1 contains all the bonds under our study.

Currency

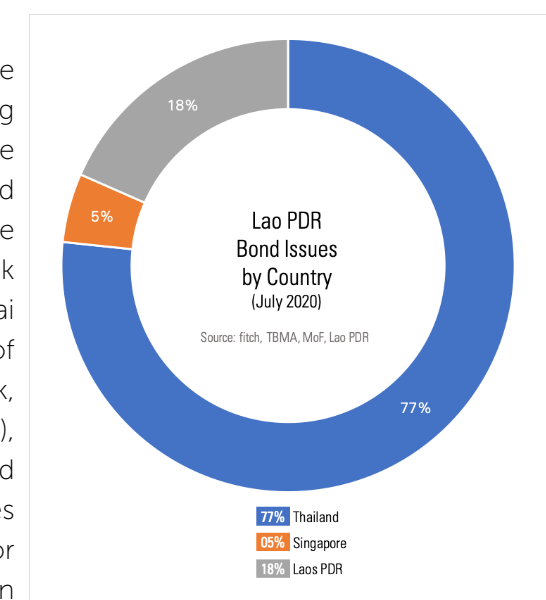
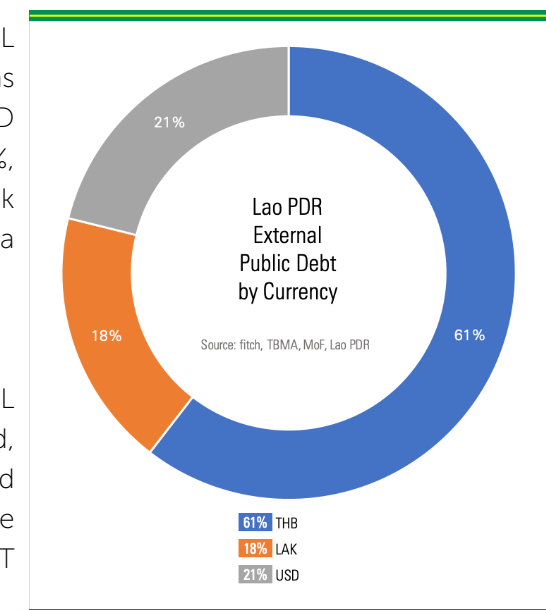
61% of the Laos bonds, including BOL bonds and excluding treasury bills, was denominated in THB, followed by USD and LAK bonds, 21% and 18%, respectively. All the bonds listed in Stock Exchange of Thailand were issued on a private placement (EXHIBIT 2).

Places of issuance

77% of the Laos bonds, including BOL bonds, are issued out of Thailand, following by Laos PDR (18%) and Singapore (5%). We note that the figure does not include treasury bills (EXHIBIT 3).

Lead Managers

Thai banks managed the Laos bonds sale for 86% of the outstanding, excluding treasury bills and BOL bonds, as the majority of the outstanding was issued out of Thailand. Thai banks include all the major banks in Thailand such as Bangkok Bank, the government-owned Krung Thai Bank, Thanachart Bank (now a part of TMB Bank), Siam Commercial Bank, Standard Chartered Bank (Thailand), Kasikorn Bank, Bank of Ayutthaya, and TMB Bank. Thailand's Globex Securities came in to help arrange bond sales for three EDL-Gen bonds. Thailand's Twin Pine Consulting also advised Laos government and EDL-Gen on multiple THB and USD bond issues out of Thailand.



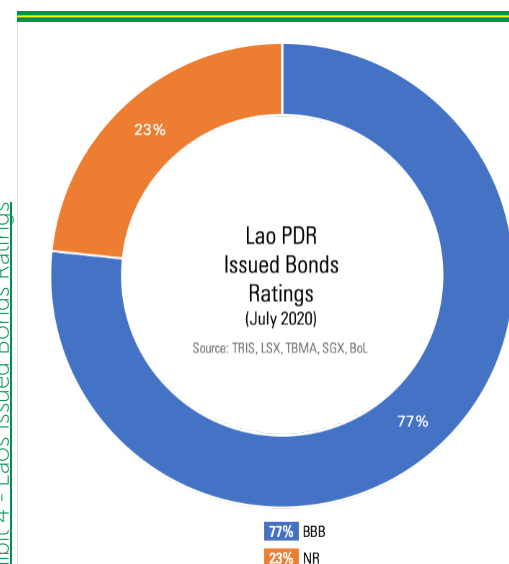
Issuers

MOF was the lead issuer, accounting for 55% of total Laos bonds, excluding treasury bills, followed by EDL-Gen (34%), and BOL (11%)

Credit Ratings

77% of the Laos bonds, excluding treasury bills, are rated “BBB” on a national scale by Thailand’s TRIS on Laos as well as EDL-Gen ((EXHIBIT 4). The recent USD bonds issued from Singapore have not been rated and the international ratings on Laos were obtained during the first quarter of this year. We understand there is an intention to have subsequent SGX-listed USD bonds rated by Fitch and/or Moody’s.

Exhibit 4 - Laos Issued Bonds Ratings



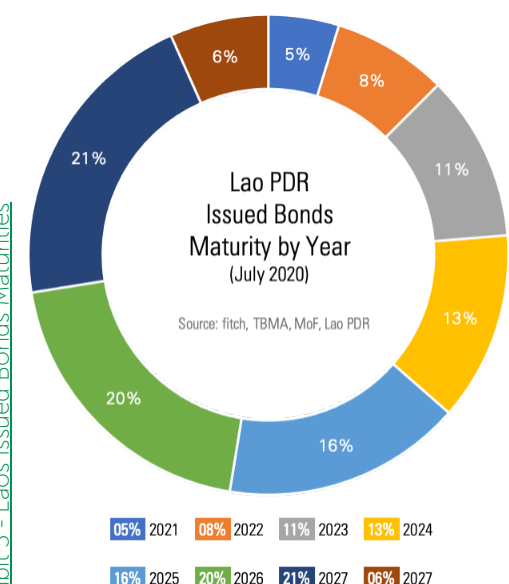
TRIS’ “BBB” rating is considered equivalent to “B-” on an international scale in our view. Fitch and Moody’s assign B- and Caa2 ratings to Laos’ issuer credit rating with a negative outlook at the time of this report. In our next report, we will discuss credit rating rationales and trend in details

Maturities

The listed Laos bonds under our study were fairly distributed in terms of maturities with 7% of the outstanding maturing within 2 years. Year on Year (YoY) rises are being witnessed with a peak being illustrated in 2027. Further we may consider that up to 2025 (ie the end on the 9th NSEDP) 52 percent of the issued bonds will mature, placing a high cost of capital on the government.

In terms of value a different trend can be observed as follows. In 2020, THB 2.8bn bonds (USD90m) issued by MOF will mature on 5-Oct. USD509m of principal in listed Laos bonds will mature, starting in June 2021 (EXHIBIT 5).

Exhibit 5 - Laos Issued Bonds Maturities



Maturities and 9th NSEDP Impacts

The impact of bond servicing can not be under-estimated when considering the issued bonds that are due to mature during the cycle of the 9th NSEDP.. As illustrated (EXHIBIT 6) over US\$ 1,700 million is due to be serviced by the government during the lifecycle of the 9th NSEDP.

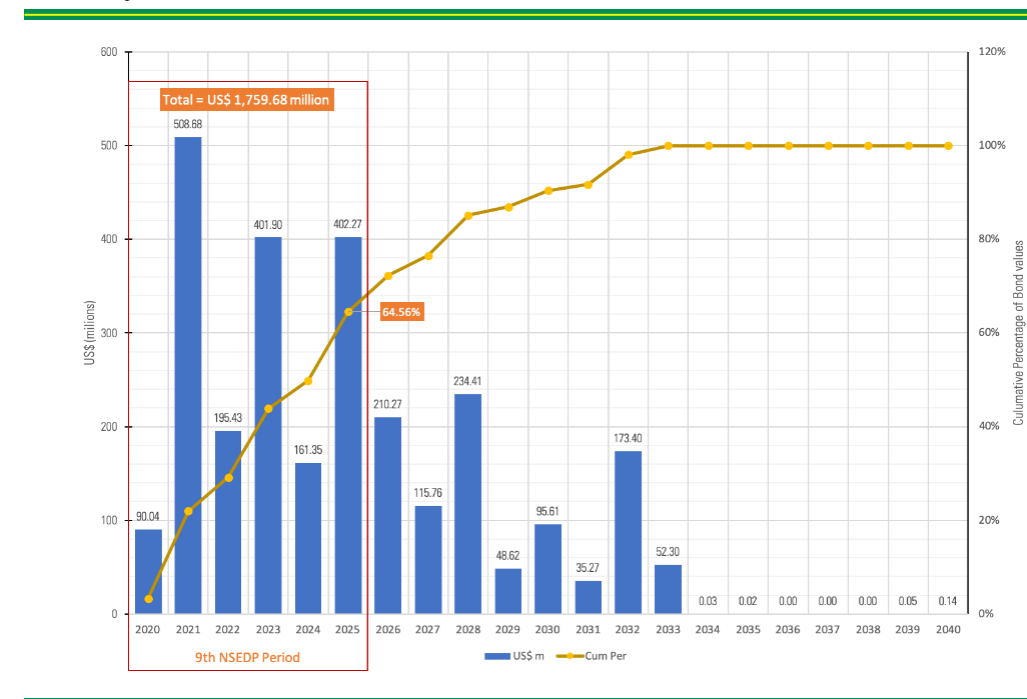


Exhibit 6 - Bond Service Schedule

The current status of the rating downgrades indicate that only a very limited possibility of further bonds being issued during the lifecycle of the 9th NSEDP during which 65 percent of the current bonds will have been settled. Although small bonds may be issued domestically and in local currency, in US dollar-terms such transactions will be small, following similar issues that will mature in 2024 and beyond.

When compared against GDP the bond payments are found to be manageable in terms of ratio to GDP (Constant US\$ 2010). However revenues have been negatively impacted greatly by the COVID pandemic and increased government expenditure has occurred.. The WB are suggesting that the fiscal deficit is expected to rise to between 7.5 to 8.8 percent of GDP and public debt to 65 to 68 percent of GDP, limited fiscal space, the mounting pressure of deficit financing and debt servicing will limit the ability of the Government of Lao PDR (GoL) to stimulate the economy, exacerbating the downturn..

Issuance

The listed bonds in our study have its tenors at issuance fairly distributed (EXHIBIT 7). As mentioned, the listed bonds do not include BOL bonds as well as treasury bills. The issuance of Laos bonds peaked in 2018 with USD677m and declined to only USD99m this year (EXHIBIT 10). There has not been any bond listing by MOF since 16-June-2020. The USD bond issuances in Thailand include (1) MOF bonds (USD162m and USD20m, both on 18-Dec-15) (2) EDL-GEN bonds (USD51m, USD166m, USD95m, all on 2-Sep-16). Laos' issuance of THB and USD bonds in Thailand marked the first time a sovereign issuer is raising THB and USD in Thailand.



Both USD and THB bonds are sold to intuitional investors in Thailand, including non-traditional investors such as SET, Neighbouring Countries Economic Development Cooperation Agency (NEDA), and Thai corporates, all of which formed an anchor investor group for the Laos THB and USD bonds.

Laos subsequently issued the USD150mn 6.875% 06/21 bond issuance (LAOPEO 6/21s) in December 2019 out of Singapore with the bonds being listed on SGX. Reuters reported that MOF initially mandated Credit Suisse, JP Morgan and Standard Chartered bank for the debut international bonds but the lead manager for LAOPEO 6/21s was eventually Oppenheimer. The investor profile was not disclosed by Oppenheimer but we believe most bonds were subscribed by international asset managers.

LAOPEO 6/21s have the mandatory redemption clause which requires MOF to redeem the bonds at 102%, 101%, and 100% should MOF issues bonds in the a principal amount equal to or exceeding the outstanding amount of the bonds (USD150m at the time of this report) prior to 30-June-20, 30-Dec-20, after 30-Dec-20, respectively.

The mandatory redemption clause and the timeline that Laos was rated by Moody's and Fitch (in January and February this year, respectively) right after the USD bond issue in December leads us to believe the government may originally have planned to issue more USD bonds with international credit ratings for a lower coupon to redeem LAOPEO 6/21s during the first half of this year. Needless to say, COVID-19 may have derailed this effort and, with Moody's downgrade of Laos' sovereign issuer credit rating to Caa2 from B3, we believe international bond issuance for Laos and its state-owned enterprise this year will be very difficult as there has not been any demand for "CCC"-rated emerging market bonds in the past.

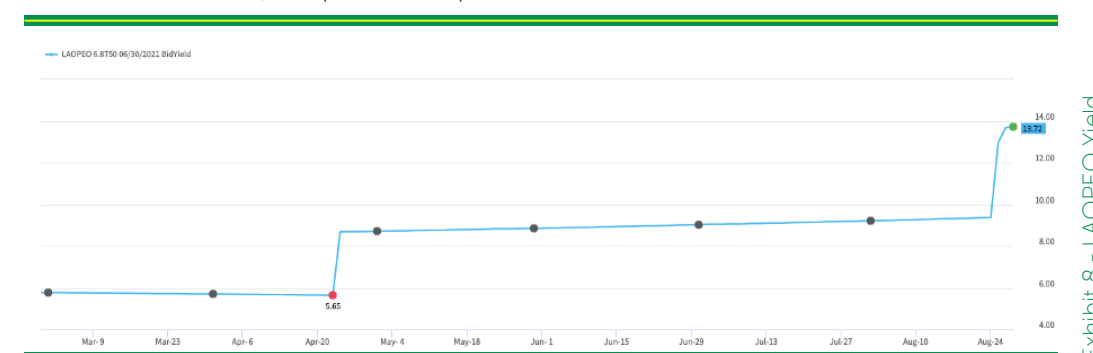
The "CCC" rating put Laos on the lowest Asian sovereign issuer with outstanding international bonds.

Pricing

Most Laos bonds are not liquid as a result of the following, in our view:

- ▶ Thai bond market is not liquid and institutional investors are "buy and hold" types;
- ▶ Thai bond yields in particular do not appear attractive to international investors and most buyers are Thai accounts, including Thailand-domiciled retail accounts which do not have access or are restricted to investing in international bonds;
- ▶ Laos' USD bonds issued out of Singapore have outstanding of only USD150m and most international asset managers only trade bonds that have outstanding in excess of USD200m to USD250m. Many leading asset managers only trade benchmark bonds which have outstanding of USD500m or more;
- ▶ The Laos bond story remains unknown to international investors. Thai banks clearly do not have an access to many international bond investors, in our judgment.

From TBMA database, the only THB bonds that were traded in the past 2 months are MOF's THB bonds maturing on 18-Nov-26 (MOFL26NA) at 5.02% yield to maturity (YTM) at 99.7 cents on 20-July. According to Thailand's Bualuang Securities, only MOFL26NA was quoted at 5.25% YTM (offer) on 27-Aug, marking a 23-bp widening from the 20-July level, We doubt that this level is attractive to investors, considering the recent Moody's rating downgrade and the relative value versus its USD bond peer such as LAOPEO 6/21s (13.7% YTM).



From our conversation with Oppenheimer which managed the Laos USD bond sale in Singapore, Laos as well as EDL-Gen's USD bonds are not liquid and the most reliable pricing is on LAOPEO 6/21s. EXHIBIT 8 shows recent performance of LAOPEO 6/21s, of which YTM has risen in steps, indicating its illiquidity in the market. However, we can still see the widening trend and the recent jump to 13.7% YTM (at 95 cents on a dollar) which, we believe, reflects the recent Moody's downgrade of Laos' issuer rating to Caa2 with a negative outlook from B3. Our recent conversation with Fitch also led us to believe the agency could also downgrade Laos to CCC from B- this year. That said, we believe the market has already priced Laos as a "CCC".

Listings (October 2020)

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Issuer	Symbol	ISIN	Currency	Priority	Outstanding in		Outstanding (USD\$m)	Place of issue	Issue date	Issue year	Credit rating	Time til Maturity				Representatives						
					Issuing amount	local currency(m)						(years)	(years)	Maturity Date	Maturity Year	Coupon	Yield at issuance	Price within a m	YTM within a m	Last trading date	Registrar	Lead manager(s)
Ministry of Finance	MOF120DA II/HNW	TH459803UA07	THB	Unsecured	2,791	2,791	90.0419	Thailand	5-Oct-17	2017	BBB	3	(0.1)	5-Oct-20	2020	3.65%	3.65%	NA	NA		SCB	BBL, SCB, Thanachart
Ministry of Finance	NA	USY52081AA71	USD	Unsecured	150	150	150.0000	Singapore	19-Dec-19	2019	NR	1.5	0.7	30-Jun-21	2021	6.88%	7.03%					Oppenheimer
EDL-Generation PCL	EDLGEN217A II/HNW	TH6162031707	THB	Unsecured	3,810	3,810	122.9129	Thailand	13-Jul-18	2018	BBB	3	0.7	13-Jul-21	2021	3.90%	3.90%	NA	NA		SCB	BBL, KTB, SCB, Thanachart, SCBT
Ministry of Finance	MOF121DA II/HNW	TH4598031A03	THB	Unsecured	1,466	1,466	47.2968	Thailand	10-Oct-14	2014	BBB	7	1.0	10-Oct-21	2021	5.50%	5.50%	NA	NA		BAY	BBL, BAY, KTB, Kasikorn, Thanachart
Ministry of Finance	MOF121NA II/HNW	TH4598031B02	THB	Unsecured	1,871	1,871	60.3387	Thailand	18-Nov-16	2016	BBB	5	1.1	18-Nov-21	2021	4.10%	4.10%	NA	NA		BAY	BAY, KTB, SCB, Kasikorn, Thanachart
Ministry of Finance	MOF121NB II/HNW	TH4598A31B06	THB	Unsecured	1,768	1,768	57.0258	Thailand	29-Nov-18	2018	BBB	3	1.1	29-Nov-21	2021	4.30%	4.30%	NA	NA		SCB	BBL, Thanachart
EDL-Generation PCL	EDLGEN21DA II/HNW	TH6162031C04	THB	Unsecured	2,000	2,000	64.5161	Thailand	12-Dec-14	2014	BBB	7	1.1	12-Dec-21	2021	5.20%	5.20%	NA	NA		BAY	BAY, TMB, SCBT
Ministry of Finance	Government Bond No. 2/2018 Due 2021	LA1001022C85	LAK	Unsecured	60,000	60,000	6.5934	Laos	17-Dec-18	2018	NR	3	1.1	16-Dec-21	2021	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 2/2019 Due 2022	LA1001022A91	LAK	Unsecured	270,010	270,010	29.6714	Laos	5-Apr-19	2019	NR	3	1.4	4-Apr-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 6/2019 Due 2022	LA1001022699	LAK	Unsecured	183,920	183,920	20.2110	Laos	17-Jun-19	2019	NR	3	1.6	17-Jun-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 7/2019 Due 2022	LA1001025692	LAK	Unsecured	50,000	50,000	5.4945	Laos	19-Jun-19	2019	NR	3	1.6	19-Jun-22	2022	6.80%	6.80%	NA	NA		NA	LSX
EDL-Generation PCL	EDLGEN227A II/HNW	TH6162032705	THB	Unsecured	1,086	1,086	35.0161	Thailand	30-Jan-19	2019	BBB	3.5	1.8	30-Jul-22	2022	4.50%	4.50%	NA	NA		SCB	BBL, Thanachart, Globlex Securities
Ministry of Finance	Government Bond No. 8/2019 Due 2022	LA1001021998	LAK	Unsecured	50,260	50,260	5.5231	Laos	5-Sep-19	2019	NR	3	1.9	5-Sep-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	MOF122DA II/HNW	TH4598032A02	THB	Unsecured	1,020	1,020	32.8968	Thailand	5-Oct-17	2017	BBB	5	1.9	5-Oct-22	2022	4.00%	4.00%	NA	NA		SCB	BBL, SCB, Thanachart
Ministry of Finance	Government Bond No. 14/2019 Due 2022	LA1001021A96	LAK	Unsecured	11,130	11,130	1.2231	Laos	17-Oct-19	2019	NR	3	2.0	17-Oct-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 16/2019 Due 2022	LA1001021895	LAK	Unsecured	350,120	350,120	38.4747	Laos	19-Nov-19	2019	NR	3	2.1	19-Nov-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 19/2019 Due 2022	LA1001027899	LAK	Unsecured	245,000	245,000	26.9231	Laos	24-Dec-19	2019	NR	3	2.2	24-Dec-22	2022	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 1/2020 Due 2023	LA10010211A4	LAK	Unsecured	20,015	20,015	2.1995	Laos	29-Jan-20	2020	NR	3	2.3	29-Jan-23	2023	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 4/2020 Due 2023	LA10010212A2	LAK	Unsecured	365,032	365,032	40.1134	Laos	25-Feb-20	2020	NR	3	2.3	25-Feb-23	2023	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 7/2020 Due 2023	LA10010213A0	LAK	Unsecured	88,654	88,654	9.7422	Laos	24-Mar-20	2020	NR	3	2.4	24-Mar-23	2023	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 10/2020 Due 2023	LA10010214A8	LAK	Unsecured	55,195	55,195	6.0654	Laos	7-Apr-20	2020	NR	3	2.4	7-Apr-23	2023	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government bond No. 12/2020 Due 2023	LA10010216A43	LAK	Unsecured	265,987	265,987	29.2293	Laos	2-Jun-20	2020	NR	3	2.6	2-Jun-23	2023	6.80%	6.80%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 17/2020 Due 2023	LA10010276A7	LAK	Unsecured	105,355	105,355	11.5775	Laos	16-Jun-20	2020	NR	3	2.6	16-Jun-23	2023	6.80%	6.80%	NA	NA		NA	LSX
EDL-Generation PCL	EDLGEN237A II/HNW	TH6162033703	THB	Unsecured	4,078	4,078	131.5516	Thailand	13-Jul-18	2018	BBB	5	2.7	13-Jul-23	2023	4.50%	4.50%	NA	NA		SCB	BBL, KTB, SCB, Thanachart, SCBT
EDL-Generation PCL	EDLGEN239A II/HNW	TH6162033901	USD	Unsecured	51	51	51.0000	Thailand	2-Sep-16	2016	BBB	7	2.9	2-Sep-23	2023	5.00%	5.00%	NA	NA		BAY	KTB, SCBT
Ministry of Finance	MOF123NA II/HNW	TH4598033800	THB	Unsecured	1,064	1,064	34.3161	Thailand	18-Nov-16	2016	BBB	7	3.1	18-Nov-23	2023	4.55%	4.55%	NA	NA		BAY	BAY, KTB, SCB, Kasikorn, Thanachart
Ministry of Finance	MOF123NB II/HNW	TH4598A33804	THB	Unsecured	2,547	2,547	82.1452	Thailand	29-Nov-18	2018	BBB	5	3.1	29-Nov-23	2023	5.00%	5.00%	NA	NA		SCB	BBL, Thanachart
Ministry of Finance	Government Bond No. 3/2018 Due 2023	LA1001023C94	LAK	Unsecured	36,020	36,020	3.9582	Laos	17-Dec-18	2018	NR	5	3.1	16-Dec-23	2023	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 3/2019 Due 2024	LA1001023499	LAK	Unsecured	10	10	0.0011	Laos	5-Apr-19	2019	NR	5	3.4	4-Apr-24	2024	6.95%	6.95%	NA	NA		NA	LSX
EDL-Generation PCL	EDLGEN247A II/HNW	TH6162034701	THB	Unsecured	1,661	1,661	53.5710	Thailand	30-Jan-19	2019	BBB	5.5	3.8	30-Jul-24	2024	5.50%	5.50%	NA	NA		SCB	BBL, Thanachart, Globlex Securities
Ministry of Finance	Government Bond No. 9/2019 Due 2024	LA1001022996	LAK	Unsecured	30	30	0.0033	Laos	5-Sep-19	2019	NR	5	3.9	5-Sep-24	2024	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	MOF124DA II/HNW	TH4598034A00	THB	Unsecured	341	341	10.9968	Thailand	5-Oct-17	2017	BBB	7	3.9	5-Oct-24	2024	4.60%	4.60%	NA	NA		SCB	BBL, SCB, Thanachart
EDL-Generation PCL	EDLGEN24DA II/HNW	TH6162034C01	THB	Unsecured	3,000	3,000	96.7742	Thailand	12-Dec-14	2014	BBB	10	4.1	12-Dec-24	2024	5.45%	5.45%	NA	NA		BAY	BAY, TMB, SCBT
Ministry of Finance	Government Bond No. 2/2020 Due 2025	LA10010221A3	LAK	Unsecured	10	10	0.0011	Laos	29-Jan-20	2020	NR	5	4.3	29-Jan-25	2025	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 8/2020 Due 2025	LA10010223A9	LAK	Unsecured	1,000	1,000	0.1099	Laos	24-Mar-20	2020	NR	5	4.4	24-Mar-25	2025	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	Government bond No. 13/2020 Due 2025	LA10010226A2	LAK	Unsecured	55	55	0.0060	Laos	2-Jun-20	2020	NR	5	4.6	2-Jun-25	2025	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	Government Bond No. 18/2020 Due 2025	LA10010289A6	LAK	Unsecured	526	526	0.0578	Laos	16-Jun-20	2020	NR	5	4.6	16-Jun-25	2025	6.95%	6.95%	NA	NA		NA	LSX
Ministry of Finance	MOF1256A II/HNW	TH4598035608	THB	Unsecured	6,000	6,000	193.5484	Thailand	25-Jun-15	2015	BBB	10	4.7	25-Jun-25	2025	5.00%	5.00%	NA	NA		BAY	BAY, KTB, Kasikorn, TMB, Thanachart
EDL-Generation PCL	EDLGEN257A II/HNW	TH6162035708	THB	Unsecured	1,443	1,443	46.5516	Thailand	13-Jul-18	2018	BBB	7	4.7	13-Jul-25	2025	4.85%	4.85%	NA	NA		SCB	BBL, KTB, SCB, Thanachart
Ministry of Finance	MOF125DA II/HNW	TH4598035C15	USD	Unsecured	162	162	162.0000	Thailand	18-Dec-15	2015	BBB	10	5.1	18-Dec-25	2025	6mLIBOR+3.38%	4.18%	NA	NA		BAY	KTB, Kasikorn
Ministry of Finance	Government Bond No. 4/2019 Due 2026	LA1001024497	LAK	Unsecured	40	40	0.0044	Laos	5-Apr-1													

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Lao PDR Bonds

Capital Market Investment and Appetites for Laos Bonds

September 2020

Executive Summary

Executive Summary

Key Findings

Bond Trends

Market Appetite

→ Macroeconomic

→ Institutional

This report is produced to: (1) study the yield curve trend and market appetite on bonds issued by Laos government and its state-owned enterprises (SOEs) in the markets where the bonds are issued (e.g. Singapore, Thailand, and Lao PDR (Laos); and (2) highlight capital market exposure to Laos and the country's rising credit risk according to rating agencies, Laos government, and market participants (e.g. lead managers, advisors, and investors). This report is the second part of the 2-part series after the bond stocktaking report, published on 28-Aug.

The stocktaking exercise includes bonds issued by Laos Ministry of Finance (MOF) and EDL Generations (EDL-Gen). We note that we do not have details of each bond issued by Bank of Laos (BOL) although we obtained the total amount (USD0.3bn) from BOL. The Laos bond figure also does not include MOF treasury bills which are neither listed and disclosed publicly. Our debt figure of the country reflects data from Laos government, the World Bank, as well as rating agencies. We confirmed with the latter that all the published figures on rating reports had been reviewed by MOF.

With Moody's 14-Aug downgrade to Caa2 from B3 on Laos issuer rating, Laos has become the lowest rated sovereign in Asia without actually being in default such as Lebanon. Our survey concludes that Laos is not in a position to issue international bonds in the next 1-2 years at least. Persistent fiscal and current account deficits will force the country to use its foreign exchange reserves to pay its debt unless it manages to renegotiate its debt or attract more foreign direct investments (FDIs). The failure of doing so could lead to Fitch and/or TRIS rating downgrade of Laos, starting later this year as well as a potential default in 2021.

The yield to maturity (YTM) of Laos' USD bonds, LAOPEO 6/21s, of 18.4% at the time of this review tells us investors are very concerned with Laos' debt situation. The recent good news is the upcoming equity injection from China Southern Power Grid (CSG) into Laos even though the details on the amount and conditions are not available at the time of this report. China has in effect increased its stake in Laos and the equity injection can be used to repay debt. In addition to the equity injection, we believe Laos options include: (1) seeking assistance from multinational development banks such as ADB, AIIB, or IMF; (2) negotiating with commercial banks to extend loan maturities; and (3) seeking additional grants or official development assistance (ODA). Laos needs to lower its debt service obligation to below USD750m in 2021 from the current c.USD1bn.

Key Findings

Here we summarize our findings relative to Laos' ability to issue bonds in an international bond market such as Thailand, Hong Kong, and Singapore. First, we believe the window to issue international bonds has closed on Laos and its SOEs on the following:

- ▶ Moody's 14-Aug downgrade of Laos issuer credit rating to Caa2 from B3 as Laos now has the lowest sovereign rating in Asia without actually being in default such as Lebanon. We do not believe there is a market demand for a Caa2-rated Asian sovereign bonds.
- ▶ Laos' depleting foreign exchange reserves relative to total external public debt. As a result, Laos' new debt without boosting foreign exchange reserves will lead to Fitch and TRIS' rating downgrade even if the bond issuance is successful.
- ▶ The Asian bond market sentiment calls for rising defaults against a hunt for yield in a low interest rate environment. Speaking differently, investors go down the credit curve to buy high-yield bonds but avoid the riskiest sector which is a bond rated "B-" or lower, in our opinion.

Second, we believe Laos and its SOEs will need to clear the following hurdles in order to issue international bonds in these three markets:

- ▶ Heighten foreign exchange reserves and/or extend the maturity of its debt so the ratio of foreign exchange reserves as % of total debt service obligations is 1x or below (See Market Perspectives)
- ▶ Increase transparency on how Laos and its SOEs will renegotiate its debt this year
- ▶ Increase disclosure quality on its debt details in terms of amount and maturity schedule
- ▶ Actively engage rating agencies especially Fitch and Moody's and set a realistic timeline on what the country must do to return the issuer credit rating back to "B-" area at the very least.
- ▶ Consider getting a rating from S&P to add more alternative rating to Moody's and Fitch
- ▶ Approach Chinese rating agencies to rate Laos' issuer credit rating. A rating on a Chinese national scale could pave the way for a Panda bond issuance in China. We believe Laos should leverage on its relationship with China to explore if Laos and its SOEs can raise funds in China.

Executive Summary

Key Findings

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Third, only LAOPEO 6/21s are liquid enough for us to gauge Laos’ cost of debt, in our judgment. The bonds’ 18.4% YTM at the time of this report tells us that, without any progress above for Laos to address its image to investors, if the new 10-month bonds were to be issued today, the market will demand the 18.4% yield.

Later in this report, we explain why the fair value of the bonds is at 14.7% YTM and we believe there is a chance to reduce YTM to 14.7% if Laos can eliminate headline risk or uncertainties over its debt repayment at least for 2021. However, the 18.4% or 14.7% YTM is a hypothetical number and we are under impression that investors pushed back at MOF and lead managers when LAOPEO 6/21s were issued last December to have the mandatory redemption clause.

We still believe the bond market conditions in Thailand, Singapore, and Hong Kong are not favourable for a Caa2-rated sovereign issuer to launch in any circumstances, let alone the risk-averse environment where credit analysts expect rising default amid the COVID-19 pandemic. We believe that once the COVID-19 fear subsides and Laos has improved its image to investors, Laos still has the best issuance chance in the THB bond market since TRIS seems to be more positive on Laos than Fitch or Moody’s and, in our view, Thai investors understand Laos better in terms of cultural and historical perspective. We note that the lack of liquidity in the THB bond market leads us to believe the THB yield quotes on the Laos bonds do not reflect the market pricing. In our view, the immediate solutions for Laos to resolve its debt issue are the following:

Box 1

1. Equity injection from international investors. The CSG news is a good start and Laos and/or EDL could seek more equity injections from other Thai, Vietnam, or Chinese counterparts, to name a few. In essence, Laos should pursue more SOE privatisation as well as attract more international infrastructure funds to invest in Laos.

2. Negotiation with commercial banks, bilateral lenders (i.e. China), multilateral lenders to extend the debt maturity so the debt service obligation is reduced to c.USD700-750m from cUSD1bn. Rating agencies expected Laos foreign exchange reserves to drop to USD740-900m by the end of 2020. The figure stood at USD864m in June and we believe there is a chance the lower forecast could be correct. As mentioned, Laos need to maintain the ratio of foreign exchange reserves to debt service obligations of about 1x.

3. Pursue of additional grants or ODA and use them to repay debt.

Other alternatives to solve Laos’ debt situation which require more studies on advantages and disadvantages include the following:

- ▶ EDL can explore the issuance of secured bonds issued by a bankruptcy-remote special purpose vehicle (SPV) which will be rated separately from Laos and EDL.
- ▶ Using EDL-Gen’s Thai shareholders as a contact point, EDL can ring-fence its electric grid/power generation assets and set up an infrastructure trust to be launched in Thailand. A foreign company can launch an infrastructure trust in Thailand and the trust does not have to be listed at the Stock Exchange of Thailand (SET). EDL-Gen can be a majority shareholder of the trust and the proceeds can be used to repay debt.

Bond Trend Analysis

In this section, we look into the Laos bond universe, denominated in Laotian Kip (LAK), US Dollar (USD), and Thai Baht (THB). The universe does not include bonds issued by BOL and MOF treasury bills. According to Laos Securities Exchange (LSX), there is no bond trading information. Thus, a lack of the pricing data prevent the construction of Laos' LAK yield curve. The only one bond issued by Laos government and SOEs we can get recent pricing is Laos' USD-denominated LAOPEO 6/21s which yielded 18.4% YTM (bid) at the time of this review. Oppenheimer also confirmed that the bonds are not that liquid but believed the 92 cents on a dollar at the time of this review was the market price of the bonds when inquired by us. Markit considers LAOPEO 6/21s as "moderately liquid" with a liquidity score of 3 out of 5. EXHIBIT 1 shows LAOPEO 6/21s versus its close peers (with YTM) and other Asian "B-" and "CCC+" peers with outstanding USD bonds as follows:

- ▶ Sri Lanka (B-/B2/B- by S&P/Moody's/Fitch)'s SRILAN complex with SRILAN 7/21s at 12.6% YTM (bid)
- ▶ Pakistan (B-/B3/B-)'s PAKIS complex
- ▶ Mongolia (B/B3/B)'s MONGAA complex
- ▶ Papua New Guinea (B-B2/Not rated)'s PAPUANE 10/28s at 8.2% YTM (bid)
- ▶ Tajikistan (B-/B3/Not rated)'s TAJIKI 9/27s at 10.7% YTM (bid)
- ▶ Iraq (B-/Caa1/B-)'s IRAQ complex

At a "Caa2" rating by Moody's Laos is the lowest rated sovereign in Asia, at the time of this review, without being in default (i.e. Lebanon). SRILAN 10/20's YTM at >30% YTM (bid) tells us investors remain concerned on short-term default probability. EDL-Gen's EDLGEN USD curve in EXHIBIT 2-1 was produced from USD bonds issued in Thailand and we see the curve the same curve as its THB curve which may reflect EDL-Gen's illiquid bonds in the THB bond market. That said, we excluded the EDLGEN USD curve from the comparison

Judging from SRILAN 7/21s at 12.6% YTM (bid) as a "B-" credit, we believe LAOPEO 6/21s at the "CCC" level should trade at a premium of 210 bps over SRILAN 7/21s to compensate for a 2-notch rating differential.

We derive 210 bps from Markit's synthetic "B-" and "CCC" sovereign credit curves at a 10-month tenor. That said, we see LAOPEO 6/21's fair value at 14.7% YTM (bid) vs. 18.4% YTM (bid) at the time of this review. EXHIBIT 2-2 shows a yield convergence of LAOPEO 6/21s and SRILAN 7/21s. Sri Lanka's default worries caused SRILAN 7/21's YTM to rise in March 2020. YTM of LAOPEO 6/21s had risen, starting from 14-Aug when Moody's downgraded Laos' issuer credit rating to Caa2 from B3.

On 1-Sep, Electricite Du Laos (EDL), the country's electricity company, signed an agreement with China Southern Power Grid (CSG), a Chinese SOE, to set up EDL Transmission Company (EDLT) to take control of Laos' electricity transmission grid. We understand CSG will own the majority of ELDT and hence could possess a majority share of EDLT's cashflow at least on paper. We do not have details on how much CSG plans inject into EDLT. CSG's equity injection could be spread positive had there been more information at least on the injection amount.

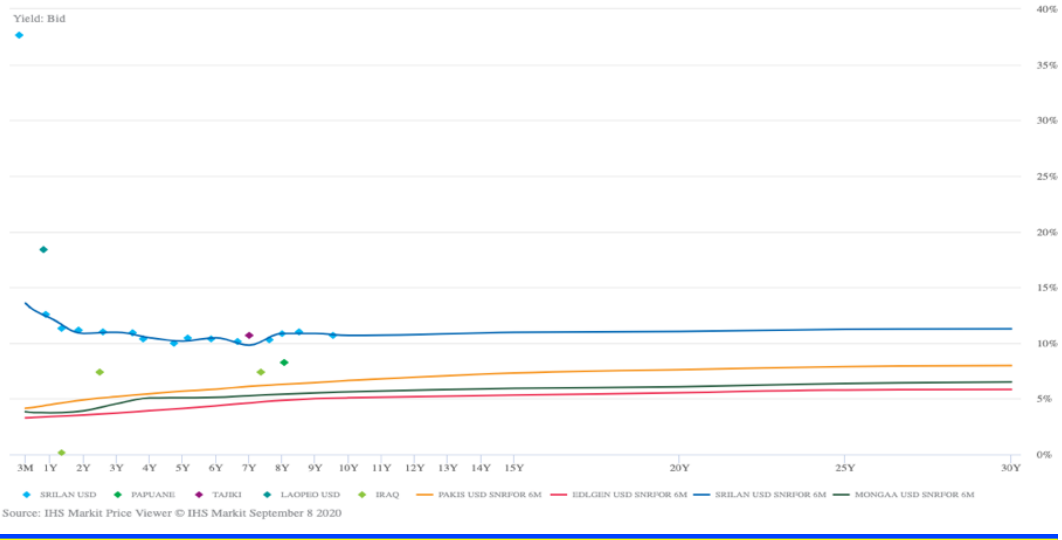


Exhibit 2-1 - EDLGEN Yield Curve

We are the opinion that the market perceives Sri Lanka's data transparency and disclosure as much better than Laos. Hence, even at 18.4% YTM, we would be reluctant to recommend LAOPEO 6/21s on a potential 370-bp upside (to the 14.7% YTM target) on (1) the lack of data transparency; (2) liquidity; and (3) headline risk on more downgrades.

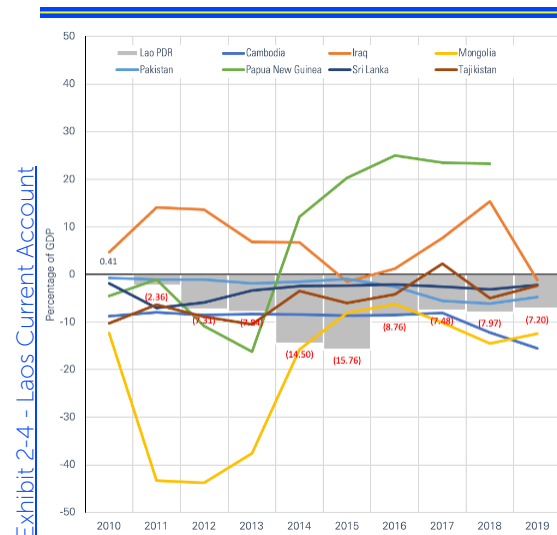


Exhibit 2-2 - Convergence LAOPEO

Oppenheimer did not disclose investor breakdown but said more than 90% of the USD150-m book came from real money accounts. Without much liquidity in the Laos bonds, except for LAOPEO 6/21s, the next step in this report is how investors perceive Laos' macroeconomics fundamentals as well as institutional framework (i.e. political and social developments), both of which fell in the middle among Asian "B-/CCC+" peers such as Cambodia, Sri Lanka, Iraq, Tajikistan, Mongolia, Papua New Guinea, and Pakistan. We will revisit the rationale why Laos' issuer credit rating has been under a negative rating pressure in Capita Market Exposure section in this report.

Macroeconomics

A rising current account deficit amid COVID-19 outbreak



Laos continued to post a deficit in its current account balance equivalent to 7.2% of its GDP in 2019, slightly smaller than 8% in 2018 (EXHIBIT 2-4). Among the selected "B-" and "CCC+" rated peers, Laos outperformed only Mongolia and Cambodia in this indicator in the past few years. Although Laos has so far avoided a major health crisis stemming from the COVID-19 outbreak, we expect the pandemic to lower tourism activities and remittances back to the country. These impacts, coupled with elevated debt service obligations through 2025, will

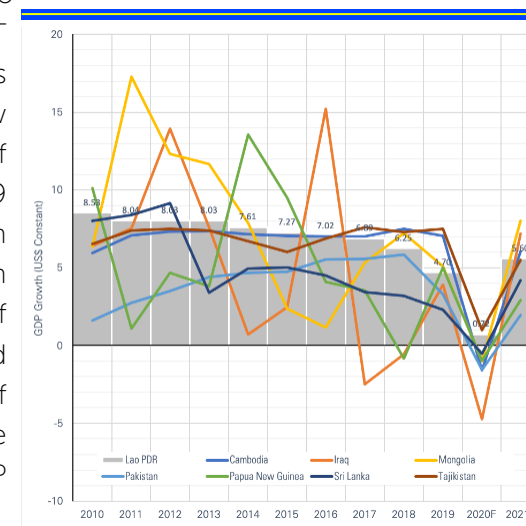
lead to further widening of Laos' already-large current account deficit in 2020, in our judgment.

LAK depreciation against USD

Laos' sustained and large current account deficit has weakened LAK against USD since 2013. The LAK/USD exchange rate has risen to LAK9,112/USD at the time of this review from LAK8,875/USD at end-December 2019, or a c.3% depreciation against the USD. The LAK depreciated 3.6% and 6.9% against the USD in 2019 and 2018, respectively. A depreciating LAK/USD also stems from declining investor's confidence in Laos' ability to pay external public debt, in our opinion. On the other hand, depreciating LAK /USD will make it more difficult for Lao (and EDL-Gen) to service its USD bond obligations, in our judgment.

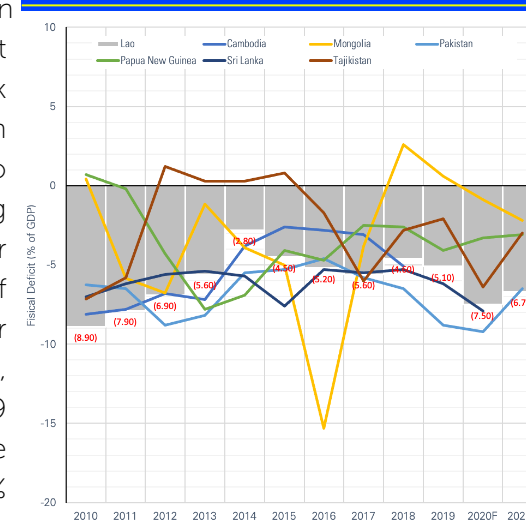
GDP growth slowdown

Laos' GDP growth softened further to 4.7% in 2019 from 6.2% in 2018 (EXHIBIT 2-5). This is the multi-year low in Lao's historical GDP growth and was also low relative to peers (higher only than that of Iraq, Pakistan, and Sri Lanka). The 2019 slowdown was caused by impacts from natural disasters that weighed down on the agriculture and power sectors, of which the GDP shares were ~16% and 12% in 2019, respectively. As a result of the COVID-19 outbreak, IMF and the World Bank projected the country's GDP to grow at the maximum of 1% in 2020.



Rising liquidity risk

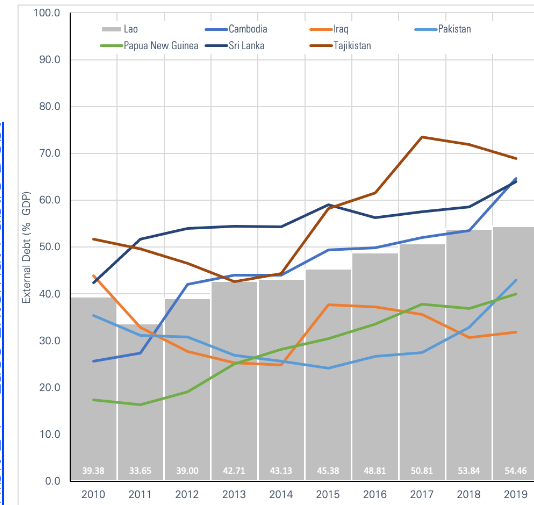
Like many of its Asian peers, Lao has been faced with a chronic large budget deficit (EXHIBIT 2-6), which the World Bank expected to widen to 7.5% of GDP in 2020 from 4.6% in 2018. In our view, Lao government has exhibited a strong discipline in controlling cost. For example, its budgeted compensation of state employees in 2019 was 11.2% lower than budget. Total expenditure, excluding capital expenditure, in 2019 was 4.4% below budget. However, the actual revenue in 2019 was also 13.3% below forecast.



What matters more is declining tax collections which will be impacted further by the COVID-19 pandemic. The World Bank predicted in June that Lao's domestic revenue and tax receipt could fall to 10% and 8.2% of GDP in 2020 from 13.5% and 11.1% in 2019, respectively, while predicting total expenditures to fall slightly from 18.9% of GDP in 2020 from 20.2% in 2019. Limited fiscal flexibility and the mounting pressure of deficit financing and debt servicing has already limited the ability of the government to stimulate the economy during the inability to stimulate the economy could worsen the downturn.

Rising external debt amid thinning foreign exchange reserves

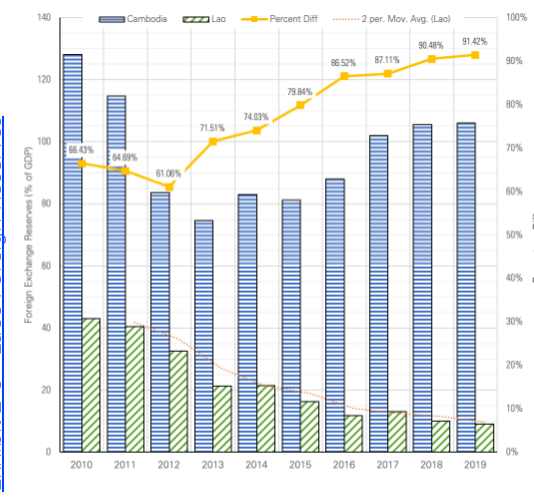
Lao's fiscal deficit has been associated with a yoy increase in external public debt, which we estimate at USD10.3bn, excluding EDL-Gen debt of USD1.5bn, at the time of our review, compared to USD9.9bn last December (according to Fitch). We note a constant increase in debt from c.USD3bn in 2010. As a result, Lao's external public debt as % of GDP increased to 54.5% in 2019 from 39.4% in 2010 (EXHIBIT 7).



Moody's expects Lao's external debt servicing burden to increase to a little over USD1bn each year from 2021 to 2025 vs. its estimated USD1.2bn in 2020 and USD842m in 2019. MOF estimated the same figure at USD1.36bn in 2020. The World Bank's prediction is along the same line with Moody's with c.USD1bn debt service obligation for the next 3

years for Lao. Compared with peers, Lao's external debt-to-GDP ratio is in the middle position.

We note the high percentage of concessional borrowing at 63.6% of total external public debt and believe that could offer Lao a window to renegotiate with its concessional lenders, especially China, down the road.

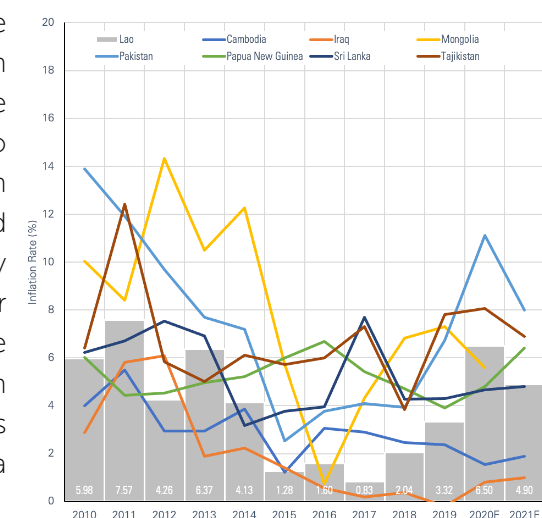


Meanwhile, the foreign exchange reserves of USD1bn in 2019 was less than one month of imports and 9% of GDP in 2019 compared to 43% in 2010 (EXHIBIT 2-8). This year, Lao's foreign reserves have dropped 13.6% in the first 6 months to USD864m in June, according to MOF. In the market perspective section, we report rating agencies' prediction of Lao's foreign current reserves this year to be from USD740m

to USD900m in 2020. Of note, on a comparative analysis, Cambodia has a far greater amount of reserve currency (EXHIBIT 2-8). The trends are also inverse with a sharp decline in reserve fx being held by Laos whilst since 2013 Cambodia has increased its reserve fx.

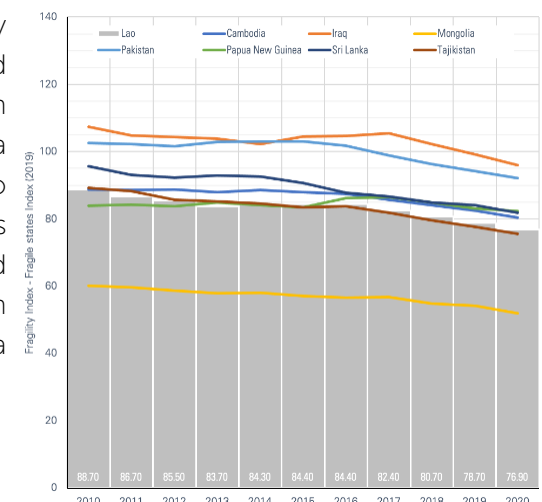
Rising inflation

Lao's inflation stayed at a comfortable level during 2015-2019 compared with Asian peers (EXHIBIT 2-9). However, we expect the country's inflation to rise to 6.5% in 2020 before easing to 4.9% in 2021 due to the LAK depreciation and rising food prices partly offset by declining fuel prices. However worsening agricultural performance due to adverse weather in 2020 coupled with the demand from China for basic foods due to flooding will possibly result in a hike of inflation in Lao PDR in 2021.



Institutional Framework

We view Lao's overall institutional framework as consistent with its Asian peers with similar ratings. Lao's Fragile State score, which measures a country's vulnerability to conflict or collapse, has declined steadily over the last decade, from 88.7 in 2010 to 76.9 in 2020 (EXHIBIT 2-10). As a result, Lao's position has improved to "Warning" from "High Warning", which is on par with Tajikistan and outperformed most of other peers (rated from "High Warning" to "Alert") except only Mongolia ("Less Stable").

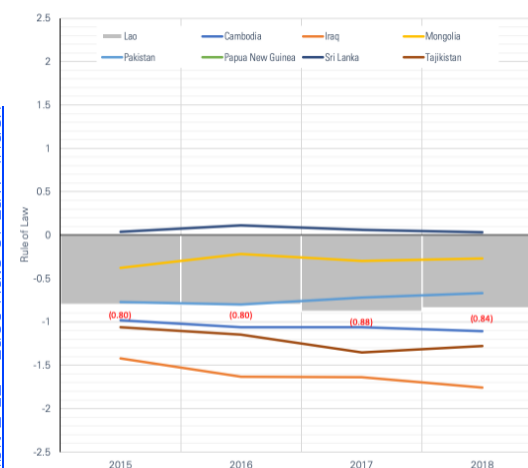


Corruption Index



Lao PDR similarly to its near neighbours (GMS) all return a similar score in the Transparency International Corruption Perception Index. With a score of 29 in 2019, Lao ranked average relative to peers in Corruption Perception Index (EXHIBIT 2-11), slightly higher than its closest peer, i.e., Papua New Guinea (scoring 28). In this context corruption risks related to investment carry a similar weight as found in Cambodia, Myanmar and Thailand, Laos is not considered as a special case.

Rule of Law Index

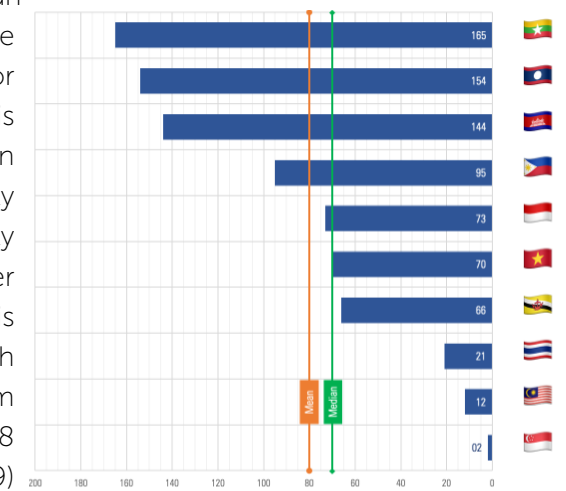


The Rule of Law index developed by the World Bank covers 191 countries and ranks each country in terms of an estimate of the perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence. Likewise, Laos fared average among peers on the rule of Law index (EXHIBIT 2-12) produced by the WB. In 2018, the country scored -0.84, outperforming Iraq, Tajikistan and

Cambodia but underperforming the other three peers (Papua New Guinea is not counted for a lack of data). Laos is positioned 159 out of 193 countries and resides in a group of 108 countries that have negative rule of law scores. Unfortunately Laos is the poorest performing country in ASEAN in this index. It is considered that this index has a significant influence on investor sentiments and the cost of credit, especially in the area of private sector investment attraction and engagement via PPPs including concession based contracts and partnerships.

Ease of Doing Business

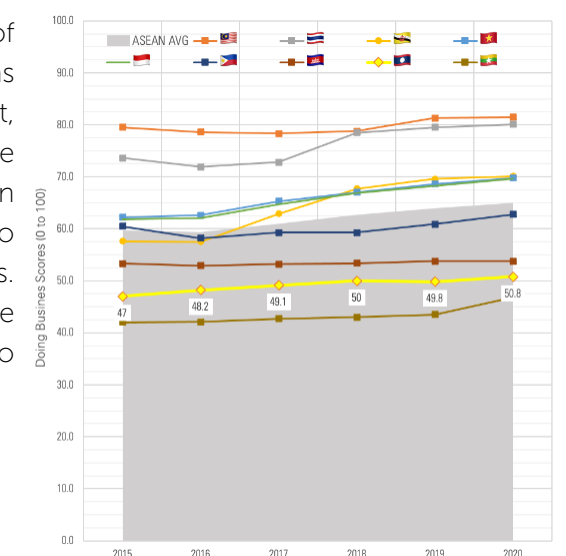
Laos' ease of doing business score versus ASEAN peers in 2019 was second to last at 154 versus Myanmar's 171 (EXHIBIT 2-13). However, we note that, at Caa2, Laos' issuer credit rating is 3 notches lower than Cambodia (KHM)'s B2 rating. These indices will have an effect on investor sentiment going forward. Of concern is the positioning and trend for Laos. In terms of position in ASEAN, Laos only better Myanmar, a country that has only over the last five years opened up after years of international sanctions. It is ranked 154 out of 190 countries, with Cambodia being ranked 144, Viet Nam 70 and Thailand 21. Laos scores 50.8 (2020) increasing from 49.8 (2019) remaining consistently some 15 points



below the ASEAN average (EXHIBIT 2-14), without a distinct improvement being witnessed. This feature suggests that regulatory reforms to improve the ease of business needs to be accelerated, especially in the areas of; (i) business start up, (ii) taxation, (iii) resolving insolvency, (iv) protecting minority investors. (v) enforcing contracts, and (vi) access to electricity.

The lack of performance in terms of improving the ease of doing business has continued to lower investor sentiment, and will have the possibility to influence investor positioning, not only in production type of investments but also within projects and government bonds. These "knock on" effects not only have the ability to reduce credit rating but also the cost of capital.

Regulatory excellence in the context of improving the EOB score must be prioritised in the short-term by the government.



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Lao PDR Bonds

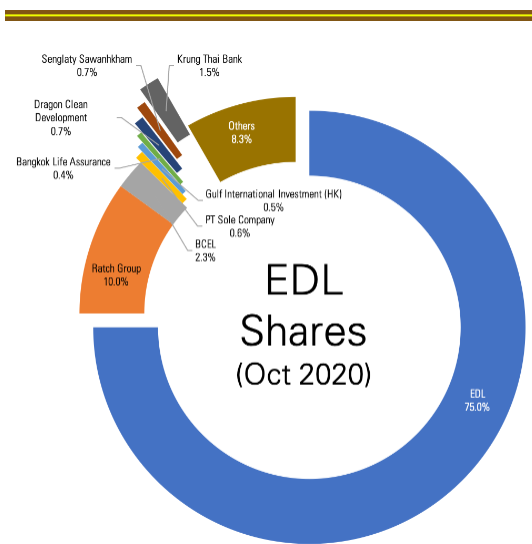
Capital Market Exposure and Sentiments

September 2020

Capital Market Exposure

Overview

Investors’ capital market exposure to Lao lies in (1) Lao and EDL-Gen’s debt issuance (bonds and loans) in Lao, Thailand, and Singapore; and (2) equity investments in LSX. As stated in the stocktaking report, Lao’s debt figure, including bonds issued by EDL-GEN and excluding treasury bills, was about USD11.8bn at the time of this review. MOF predicted its debt service obligations in 2020 to be c.USD1.36bn, excluding EDL-Gen’s debt, with Moody’s and the World Bank’s prediction of c.USD1bn, excluding EDL-gen’s debt, for 2021-2023. Fitch said the debt maturing from 15-May to the rest of year was c.USD900m. Taking in account the USD150m Lao already repaid on THB bonds in June and USD200m Fitch expected Lao to extend commercial bank loan maturity, the remaining gap is USD550m, including USD90m of THB bonds maturing in October, which we expect Lao to be able to repay, thanks to TRIS’ confirmation that the Lao government set aside cash to repay the THB bonds and the upcoming equity injection from CSG. However, with the foreign exchange reserve expectation of USD740-USD900 at the end of this year (according to Moody’s and TRIS), there is a real possibility of default next year if no debt service obligation for 2021 is renegotiated, in our view.



LSX has a total market capitalisation of LAK7trn (c. USD842m) on 3-Sep, of which 54.8% was EDL-Gen’s market capitalisation. Banque Pour Le Commerce Extérieur Lao Public (BCEL)’s market capitalisation was a distant second at 15.5% of the total. We understand the trading volume was very slim with EDL-Gen’s shares accounting for the majority of the trades. EDL-Gen was 75% owned by Electricite Du Lao (EDL) with top minority shareholders in EXHIBIT 2-1.

We note that Thailand’s Ratchaburi Electricity Generating Holding (RATCH) held EDL-Gen’s shares through its wholly-owned subsidiaries in Lao and Singapore, namely Ratch-Lao Services Company (RLS) and RH International (Singapore) Corporation (RHI), respectively. Dragon Capital Clean Development was a subsidiary of Vietnam’s Dragon Capital. Gulf International Investment (Hong Kong) is owned by Thailand’s Gulf Energy Development.

Overall, the combined international shareholding of EDL-Gen was 13.1% as of 10-July or c.USD60.4m. RLS also serves operation and maintenance for EDL’s facilities. RATCH’s investment in EDL-Gen is also a symbol of relationship between EDL-Gen and RATCH, in our view. EDL-Gen has a dividend policy to pay 50% of net profit and we view this dividend pay-off contract as credit negative for EDL-Gen’s bonds as the free cashflow is channeled away from paying off the debt. On the contrary, EDL-Gen’s relationship with RATCH as an investor and a business partner gives us some comfort that EDL-Gen can seek a further equity injection from RATCH and other international investors if necessary. That said, we see EDL-Gen’s relationship with international investors as positive for Lao’s overall debt situation.

Lao’s Credit Risk

Credit risk of Lao and its state-owned enterprises is rising on (1) the accumulation of debt prior to COVID-19 crisis against declining foreign reserves as a result of COVID-19 and (2) its long-term capital expenditures (hydro power and high-speed rail) which, in our view, do not generate near-term revenues. Lao’s situation was exacerbated by the country’s lack of economic diversity and underdeveloped private sector, in our judgment.

In our view, the containment of the already-large fiscal deficit, debt renegotiation, and more FDIs will be necessary in restoring macroeconomic stability and lowering the pressure on foreign currency reserves. The country’s monetary policy is also impaired as an expansionary monetary policy will add a further pressure on the exchange rate and risk rising inflation expectations. A weaker LAK would make it more difficult for the government to finance its external public debt domestically.

Rising debt

We believe that servicing Lao’s external public debt in 2020 and 2021 will be both challenging and costly as a result of (1) COVID-19 (which hurt Lao’s tax revenue collection and derailed Lao’s plan to issue more USD bonds in 2020); and (2) Moody’s rating downgrade of Lao’s issuer credit rating to Caa2 from B3 on 14-Aug. Lao’s fiscal and current account deficits will force the government to fund its deficits with domestic bonds now that international capital markets have closed on Lao, in our view. The domestic borrowing when the economy needs stimulus can have a crowding-out effect on the economy and plunged the economy into a deeper recession, in our view.

Moody’s estimated Lao’s debt service obligations to be c. USD1bn (excluding EDL-Gen’s maturing debt) until 2025 against its foreign exchange reserves of USD864m in June, according to MOF and USD740 to USD900m by the end of 2020 as projected

Market Exposure

→ Overview

→ Laos Credit Risk

→ Rising Debt

→ Rising Cap Spend

Market Sentiment

→ Tris

→ Moody's

→ Fitch

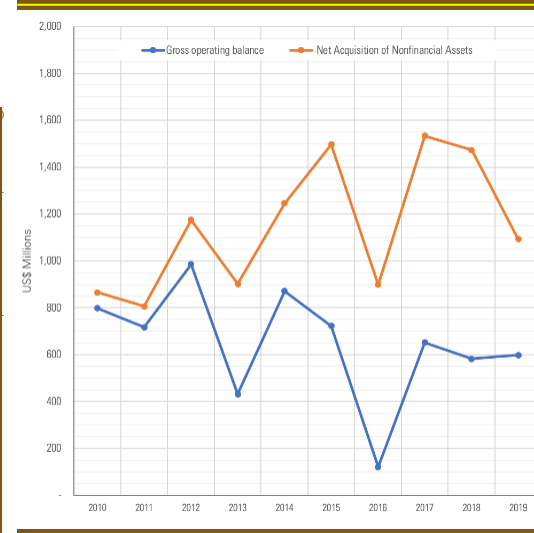
by rating agencies. We still believe the country can pay its debt this year on; (1) the fact that most of the debt service this year was loans, including commercial bank loans, which can be rolled over; and (2) the remaining bond portion in 2020 was only USD90m. In 2021, the bond portion, excluding EDL-Gen's maturing bonds) will rise to USD319m out of c.USD1bn and Lao will have a tougher time to roll over the maturing bonds in light of depleting foreign exchange reserves and unfavourable debt market for a B-/CCC-rated issuer/borrower.

We expect Lao's fiscal deficit to continue in the near term and that will force Lao to resort to FDIs and its foreign exchange reserves to repay its debt service obligation should the government fail to renegotiate/refinance its debt. With its foreign exchange reserves at USD864m in June and c.USD1bn debt service obligation in 2021, we believe a default for Lao government is possible in the second half of 2021, provided that the equity injection proceeds will not be sufficient to repay at least USD250m of debt. CSG's share of revenue stream from electricity distribution in Lao could equate a much larger funding cost for the revenue that Lao will forego in the long-term. That revenue share could be a lot higher than the current funding cost (i.e. 18.4% YTM of LAOPEO 6/21s), in our view.

The negative outlook on Lao, in our view, reflects a debt maturity wall in the next 3-5 years vs. Fitch's rating downgrade by 1-2 notches later this year on (1) a failure to proceed on negotiations on its debt restructuring with key creditors, a discussion on the Debt Service Suspension Initiative announced by the G20, or a search for a joint donor support program, and/or (2) rising debt servicing costs should the country manage to secure financing this year.

Rising capital spending

Exhibit 3-2 - Laos Capital Debt Spending



further while limiting Lao's option to borrow and refinance

EXHIBIT 3-2 shows rising net acquisition of non-financial assets when gross operating balance is on the decline since 2011. Heavy capital expenditures include its hydro power and high-speed rail projects. The widening gap has been obviously funded by debt, in our judgment. In a normal circumstance, the investment in hydro power would be a reasonable strategy for the future recurring cashflow from the electricity generation but the COVID-19 pandemic will reduce the gross operating balance

Lao and China have entered into an agreement to build a 420-km high-speed rail network from Kunming and Vientiane (EXHIBIT 16). This rail line will eventually run through Thailand and Malaysia to reach Singapore. We understand the construction is more than 80% completed at the time of this report and the railway could be in operations as early as 4Q'2021. The cost of the Kunming to Vientiane is estimated at c.USD6bn, 12%, 28%, and 60% of which will be shared by (1) the Laotian government, (2) the Chinese government and (3) private and state-owned enterprises in both countries, respectively. We understand the Lao's portion was partially funded by a USD465m 2.3% 25-year loan from Export Import Bank of China.

Lao's capital spending on the high-speed rail link between Kunming and China (EXHIBIT 3-3) may not bear fruit in the near term as we believe the Laotian corporate sector has not matured enough to take advantage of the rail. As a result, we do not expect the rail project to produce tax revenue for the Lao government to keep pace with the borrowing and equity investments related to the rail project. We are of the opinion that at least at the beginning of the rail operations, China could benefit more from the project than Lao on goods shipped to Thailand. Thailand is one of the top tourist destinations for the Chinese tourists, in our view, and hence could benefit from more Chinese tourists. True, Lao can also receive revenue from Chinese tourists who will pass through the country but we believe the benefits will be more to Thailand rather than to Lao and Thailand did not have to invest in this rail project at all. In the long run, cheaper transportation could lower consumer prices in Lao.



Exhibit 3-3 - Kunming, Vientiane, Rail

Market Exposure

→ Overview

→ Laos Credit Risk

→ Rising Debt

→ Rising Cap Spend

Market Sentiment

→ Tris

→ Moody's

→ Fitch

Market Sentiment

We understand Lao government is working on negotiating with commercial banks, China, and IMF on extending loan maturities and/or seeking additional financing. The equity injection from CSG leads us to believe China is willing to help Lao on its debt situation. However, we have no information disclosure on the talk progress with China on the terms and the injection amount. In addition, our conversation with rating agencies leads us to believe MOF may not be comfortable with IMF conditions. The fact that there has not been any international bond issuance by Lao and its SOEs since December tells us the government is under pressure to refinance to reduce its debt service obligation in the next few years. In addition, COVID-19 has undoubtedly impacted the country's tax revenue collection.

We have discussed with investors and intermediaries (i.e. underwriters/lead managers and advisors of the previous Lao bond issues). All participants are of the opinion that Lao will need to renegotiate to extend its debt maturity. Moody's downgrade to Caa2 prevents Lao from issuing additional international bonds in the near term (See Moody's rating perspective below). There has been worries that Lao may default on its THB bonds next year and investors are assessing what the impact on the THB bond market would be in the event of a Lao default in 2021. Last but not least, there has been a lot of discussions on what needs to be done to refinance Lao debt next year and those include a talk to seek a credit guarantee by a multinational development bank and/or Thai government entities on bonds/loans issued by Lao government and/or SOEs.

We were on the conference calls with TRIS, Moody's and Fitch on Lao. Here are the summary of our calls:

TRIS

Thailand's TRIS Rating downgraded an issuer credit rating of Lao to "BBB" from "BBB+" and revised the outlook to negative from stable on 28-June on the agency's view of Lao's "critically low" foreign exchange reserves and rising debt services in the next three years. Our conversation with Ms. Raithiwa Naruemol, TRIS' lead analyst on Lao, on 17-Aug leads us to believe TRIS remains optimistic that Lao government will be able to manage its fiscal deficits and debt services at least this year.

TRIS' rating of "BBB" for Lao on a national scale is equivalent to "B-" on an international scale, in our judgment. The agency said the negative outlook on Lao means the credit situation is still deteriorating and the negative outlook could resolve in a further downgrade in 6-18 months from 28-June (when the agency revised the country's outlook after consultation with Laos government on the rating situation). TRIS' key downgrade triggers include (1) debt serviceability and (2) fiscal behaviours.

On debt serviceability, the key ratio according to the agency is a multiple of external debt to foreign exchange reserves which was ~10x at the time of the conversation. Should the ratio deteriorate beyond 12x to 13x, the agency said there would be a negative rating pressure. Another ratio that the agency monitors is foreign exchange reserves over the annual debt service which is about 1.1x at the time of the conversation. The agency believed the foreign exchange reserves could fall to ~USD900m at the end of 2020 (which remains much higher than Fitch's and Moody's estimates of USD740-750m at the end of 2020) from ~USD1bn at the time of the conversation. We discussed a few items that could impact foreign exchange reserves:

- ▶ TRIS expected Lao to have more revenue from more hydro power with contracts with Vietnam, China, Cambodia when the distribution grid is done in the next 2 years.
- ▶ The agency expects LAK to depreciate further to ~LAK9,400/USD (LAK9112/USD at the time of this review)
- ▶ The agency expects energy to contribute to a third of Lao's GDP by 2021 and that could reduce revenue diversification. Hence, Lao's government revenue could be more volatile in the future, as evidenced by last year's drought in Mekong river which reduced revenue from the hydropower sector. The GDP breakdown at the time of the conversation is about 30% services, 20% energy, and 50% agriculture.

On the external debt figure, the agency said Lao has already set aside funds to redeem THB bonds maturing this year. There are a few positives on the debt situation:

- ▶ The agency is under understanding that Lao government is already in progress to negotiate with concession lenders, especially China. Our conversation with TRIS leads us to believe a concession loan related to the highspeed rail can be further renegotiate to allow Lao more breathing room.
- ▶ Lao has relationships with many commercial banks which could lend or extend loan maturities to Lao government.

TRIS agreed with us that Moody's downgrade to Caa2 from B3 closed the avenue for Lao to issue more USD bonds. The USD150m USD bond issuance last December preceded the Lao government's plan to issue a larger and lower coupon USD bonds after getting credit ratings from Moody's and Fitch in 1Q'20. On fiscal behaviours, TRIS pointed out Lao government's strong fiscal disciplines in the past through cost and civil servant salary cuts. The agency believes the government can still manage its fiscal deficit within the rating range.

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Our conversation with TRIS leads us to believe TRIS will not necessarily follow Moody's to downgrade Lao's issuer credit rating. The agency pointed out its stance as an adopter of S&P's credit rating model and their methodology is quite different from Moody's. It also said Lao's rating is benchmarked against Thailand's which is AAA on a national scale. Our impression of TRIS is that the agency has more confidence in Lao on its longer history of rating Lao as well as the cultural understand of Lao compared to Fitch and Moody's. TRIS will review Lao's BBB rating in December but we believe TRIS will not downgrade should the government successfully renegotiate its debt.

Moody's Investors Service

Moody's followed Fitch and placed Lao's B3 issuer credit ratings under a downgrade review on 19-June. The downgrade review led to a 2-notch downgrade to Caa2 with a negative outlook on 14-Aug. The downgrade reflects sizeable debt service obligations until 2025 and limited financing options as a result of COVID-19. The agency also highlighted the country's weak external and fiscal buffers and poor governance. More importantly, the agency pointed to a "material" probability of default for Lao in the near term. Our conversation with Ms. Anushka Shah, a lead analyst for Lao on 25-Aug, leads us to believe Moody's acted on a precaution on the agency's belief that the probability of successful negotiations with international financial institutions, multilateral organisations or commercial banks to avoid default in 2021 is unlikely. The analyst cited a lack of transparent financing strategy on how maturing debt obligations will be serviced.

We believe Lao's lack of transparency and good-quality disclosures remain an issue to improve but that does not mean that the country does not have a plan or network to resolve this problem. In our judgment, CSG equity injection is already outside Moody's expectation and the equity injection into Lao indicates some success in attracting FDIs even though it could come at the expense of revenue relinquished to China in the long term. Although we believe Moody's downgrade was too soon, we understand from our experience that Moody's in effect pre-empted what is coming to Lao as a result of COVID-19. We expect Mood's to keep Lao's Caa2 rating with a negative outlook in the near term as this rating is already the lowest Asian sovereign issuer credit rating without actually being in default.

Fitch Ratings

Fitch affirmed Lao's "B-" issuer credit rating but revised the outlook to negative from stable on 15-May. The negative outlook reflects the impact of the COVID-19 pandemic which the agency expects to increase external financing risk associated with upcoming external public debt maturities and declining foreign exchange reserves. The agency estimates the debt service obligation from 15-May to the end of the year to be USD900m with USD1bn from 2021-2023 versus foreign exchange reserves of USD750m by the end of 2020. We understand from our 20-Aug conversation with Mr. Jeremy Zook, Fitch's lead analyst, that Lao government has already started discussions with Chinese creditors, IMF, and commercial banks to negotiate and/or borrow more to service, extend, or suspend the maturing debt. Fitch expects Lao to roll over as much as USD200m in bank loans (with May Bank as a predominant lender) maturing in September. The analyst believes Lao may not seek assistance from IMF on IMF's extensive borrowing conditions although an assistance from IMF would be credit positive for Lao in the near term.

Fitch predicted Lao's current account deficit to widen to 7.6% of GDP in 2020, from 4.5% in 2019 on declining tourism-related revenue, partially offset by rising electricity exports on guaranteed long-term power purchase agreements. The agency believes much for the deficits will continue to be financed by FDIs, a prediction that is proven correct by the recent CSG equity injection. Government revenues were expected to drop 25% on tax exemptions and tax payment deferrals, both of which were announced by the government to stimulate the economy. Lao government committed to Fitch to reduce administrative spending by 10% and some non-critical spending to offset a revenue decline.

The agency's key assumption when it affirmed Lao's rating in mid-May is that the government will be able to use bilateral and multilateral relationship in tandem with issuance in the THB bond market and commercial bank debt to repay or refinance maturing debt in 2020. While the analyst believes Lao will not default this year, he admitted to us that issuing additional bonds in the THB bond market this year is near impossible. The analyst mentioned that a ratio of foreign exchange reserves of USD 750m to 2021 debt service obligations of USD1bn is already 0.8x which fits into the CCC category. Hence, if he decided to downgrade, it would likely be a 2-notch downgrade (from B-). Given the rate of depleting foreign exchange reserves this year so far and the relentless COVID-19 situation, we believe Fitch could downgrade Lao's issuer credit rating on an inconclusive negotiation on debt restructuring with key creditors. However, the key life saver against a potential Fitch downgrade is for the Lao government to have information transparency around what the country will get in terms of cash and other benefits from CSG's equity injections and whether the country will use the cash proceeds to repay its debt maturing in 2021.

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A Stocktake and Analysis of Lao PDR Bonds

September 2020