

Tomorrow's Cash Today

Faced with sky-high capital costs, some CFOs in Asia eye asset-backed securitization.



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These days, raising capital in Asia is about as easy as raising sugar cane in Saskatchewan. Bankers, spooked by the specter of wholesale corporate bankruptcies, have simply stopped lending. Skittish foreign investors have retreated from the region, taking billions in funds with them. And local money managers, hammered by the nosedive on local bourses, have shied away from all but the most stellar of corporate equity issues.

The Asia Pacific Economic Cooperation (APEC) forum has committed to the abolition of trade barriers for the industrialized Asian economies by 2010, and for the non-industrialized by 2020.

Not exactly a rosy scenario for CFOs looking to scare up a little cash. Given that backdrop, some finance managers in Asia have turned to less traditional methods of raising cash. One of those methods: asset-backed securitization (ABS). While ABS is old hat for corporates in the US and Europe, it has never really caught on in Asia.

In the past, many finance managers in the region were put off by the complexity of structuring an ABS deal. What's more, with banks willing to lend at next to nothing, most CFOs had no need to seek more exotic forms of funding. But Fazel Ahmed, head of securitization at CIBC World Markets,

a division of Canadian Imperial Bank of Commerce, says the regional financial crisis may be changing all that. "Right now in Asia options are limited if you need liquidity. Companies should look hard at ABS. We know it works, and the risks can be managed in a way that will satisfy both investors and borrowers."

Just ask Oranuch Apisaksirikul. In July 1997, Oranuch, CFO at Tisco Finance in Thailand, attempted to securitize the company's auto loan portfolio. "I was told that we couldn't do securitization in Thailand because it's a developing country, and the necessary legal and financial frameworks would take years to evolve," she says. "I read the books anyway. And it seemed to me that it could work."

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She was right. Tisco raised around US\$250 million - while keeping its cost of funding to a mere 23 basis points above the London Interbank Offered Rate (Libor). Of course, unlike some cash-strapped Asian corporates, Tisco had a good receivables portfolio with three years of detailed performance. What's more, Tisco's receivables came from a variety of sources, ideal for securitization. Even then, the process wasn't easy or cheap.

The structure of the Tisco securitization was more complex than those arranged in the US and Europe. And Oranuch says Tisco needed to do a sizeable issue to help defray the cost of putting together such a complicated offering. "We needed a big deal to offset some of the costs associated with tackling the legal and financial work, which was groundbreaking."

Still, as Oranuch points out, the hard part is over now. With the model for the securitization completed, Tisco can go back and dip into the market as often as needed. "We now have the ability to repeat the process for our other portfolios and to recoup our costs by acting as a back-up servicer for other borrowers," says Oranuch.

Pay Less, Get More

Some skeptics, however, say ABS will never be more than a novelty in Asia. They point out that some issuers have been burned by the drop in prices of some Asian asset-backed securities.

But the truth is, Oranuch is not the only CFO in the region securitizing assets. Outside of Japan, at least 50 securitizations have been carried out in Asia since 1996. In late December, the Export Import Bank of Korea (KEMIX) placed nearly US\$700 million of asset-backed securities in the US, Europe and Asia, the largest Korean issue since a sovereign bond offering in April.

The deal was the first-ever asset-backed securitization by a Korean institution. And in the Philippines, Home Development Mutual Fund, a provident association that primarily lends on housing, securitized 500 million pesos (US\$12.5 million) of mortgage receivables last year. Philippine Long Distance Telephone Company (PLDT), the telecommunications carrier with revenues of 35 billion pesos (US\$875 million), has also become a major ABS player. Last year, PLDT arranged deals totaling US\$214 million. Says Anabelle Chua, vice-president of finance at PLDT: "We began in December 1997 and now do sales quarterly."

Indeed, many companies that securitize assets come back to the market on a regular basis - particularly if they securitize cash streams. Securitization, in its bare bones, is the transformation of illiquid assets - such as receivables - into a

security that is issued and traded in a capital market. Typically, mortgages, auto loans and utility payments are the most common types of revenue streams that can be used to create asset-linked securities, which are traded on markets in the US and Europe.

Asset securitization differs from traditional asset-based lending in a number of ways, however. In an ABS deal, loans or other financial claims, such as receivables or future revenues, are assigned to a third party known as a special purpose vehicle (SPV). The SPV then issues debt instruments whose interest and principal repayments are derived from the cash flows generated by the underlying assets.

This separation of assets from the issuing company is crucial. Why? Because the quality of the assets is no longer tied to the creditworthiness of the originator. That would seem to be a big attraction for investors in Asia these days. It's certainly a plus for CFOs doing the deals. By offering high-quality assets - assets that are no longer tied to the financial health of the issuing company - finance managers can secure a lower cost of funding.

According to Sung Hwan Choi, senior manager for KEMIX's international finance department, the coupon on the company's senior notes in its recent ABS offering is Libor plus 1.5 percent. Choi says that's 300 or so basis points less than what KEMIX would have had to pay on senior unsecured notes.

Moreover, securitization opens up a whole new world of capital for local CFOs to tap into. "Through ABS, you are able to access new investors who would probably not buy equities in Asia but who will invest in highly rated securities," says Ahmed. "These investors include banks, hedge funds, pension funds and money market funds, and they collectively comprise a vast source of capital."

Unlike equity and some credit facilities, an ABS bond has a specific lifespan and interest rate. Costs remain fixed, even in times of economic turmoil and currency fluctuation. "This takes away a lot of the uncertainty and makes planning decisions easier," says Ahmed. But while risks are minimized, they cannot be eliminated. Depending on the quality of the assets, a degree of over-collateralization is usually required for ABS. This usually involves putting up additional assets or cash. The extra collateral is then used to service debt due the SPV when certain trigger events occur, such as an obligor's late or non-payment.

Residential mortgage loans constitute the core of the global asset-backed securities market. Other assets commonly securitized include credit card receivables, home equity loans, cellular phone receivables, heavy equipment loans, corporate loans and leases. Virtually any income-producing asset with an adequate performance record can be securitized. PLDT, for example, securitizes its revenues due from overseas carriers. In the KEMIX deal, the securities were backed by more than 100 promissory notes issued by foreign importers of Korean goods.

From Prussia, With Love

In the US and Europe, property is the most common asset used in an ABS deal. This has been true since the 1930s, when the Federal National Mortgage Association (Fannie Mae) in the US began buying up mortgages from commercial banks. During the 1970s the asset securitization market developed to cover assets of virtually every class. More than 1,000 companies now rely on ABS to reduce the cost of borrowing and increase available cash.

Property is, in fact, at the very heart of the rise of asset-backed securitization. An early prototype of the ABS model emerged in Prussia - yes, we said Prussia - after the

Seven Years' War had destroyed farmland in the mid-18th century, leaving landowners in desperate need of capital. Responding to the crisis, the government organized landholding pools - effectively large pools of collateral. Pfandbriefe, an early form of mortgage bond, were issued at up to half of a property's value. These were cross-collateralized by other landholdings in the pool. Borrowers paid interest and principal to the pool, which in turn paid the bondholders.

Still, property is not as readily securitized in Asia

This is more than just a historical curiosity. The impetus for Pfandbriefe was the fact that conventional sources of funds had dried up. Considering the liquidity problems facing companies in Asia today, the parallel is striking. Still, property is not as readily securitized in Asia. Although some transactions have been completed in the Philippines, Indonesia, Hong Kong and Thailand, property does not form the bulk of the securitizations, as it does in the US and Europe.

The reason is obvious: volatility is not great for securitization, and few markets are as frenetic as the Asian property market. In addition, real estate deals in Asia rarely afford ABS investors the right of first recourse. In Singapore, for example, the Central Provident Fund Board has first recourse on 85 percent of residential property.

So far, most deals in Asia have been future-flow deals - that is, the assignment of future income streams, rather than existing receivables, to the SPV. It makes sense. Evaluating assets to be securitized requires a good deal of transparency. The borrower needs to furnish comprehensive data on its receivables portfolio, including at least three years of performance

history and details on specific customers. The shoddy financial and accounting records at many Asian companies, therefore, jacks up the risk for investors. That, in turn, means issuers must be willing to put more assets on the table as collateral. In the end, such a deal may simply become too expensive. Hence, the popularity of future-flows securitizations.

Finance managers at the Bank International Indonesia (BII) know all about future-flow deals. BII, one of the few relatively healthy commercial banks left in Indonesia, raised some US\$140 million in July 1997 by securitizing credit card receivables. The bank issued ten-year securities on the 144A market - the US market for private placements - backed by future receivables from Visa and Mastercard payments. The bonds were relatively cheap, priced at 140 points over equivalent US Treasuries - about the same level as the yield on Indonesian sovereign debt at that time. "We felt that by doing a securitization, we'd be able to tap non-traditional sources of funding," says Manuel Sia, head of financial institutions at BII, who worked on the deal with Citibank. "It also gave us access to longer term funding than we'd get from the banks, which is normally between three to five years."

BII's timing was exquisite. Its issue hit the market just as the rupiah began to nosedive, taking the Indonesian economy with it. "One month later and we couldn't have done it," says Sia.

So far, BII has not had problems servicing the interest on the bonds. Repayments on the bond are weighted towards the latter half of the securities' seven-year average life. This gives BII, which had assets in 1997 of 25 trillion rupiah (US\$5.4 billion), some breathing space. Sia says the company may tap the markets again next year, if it can find a solid and predictable flow of hard-currency

receivables to securitize. Export receivables from OECD countries are one possibility. That, of course, depends on whether Indonesia's worrisome political climate improves. Says Sia: "We're all living under the shadow of the country risk rating."

No One Said It's Easy

Indeed, increased risk has made it difficult for most CFOs in Asia to borrow money. The appetite of most US lenders for Asian paper has diminished dramatically. In the first half of 1998, lending in the region (ex-Japan) fell 73 percent year-on-year, to US\$11 billion. Hong Kong syndicated loan volumes, which reflect the China market, are down 88 percent. Bond issuance from Asian borrowers in US dollars slumped 61 percent to only US\$5.25 billion.

Across the region, disgruntled investors complain of bonds being downgraded or falling outright. A Philippines Airlines future-flows deal completed in late 1996, for example, was based on the future revenue from the sale of passenger tickets. Actually selling these tickets became tougher when the airline stopped flying in July 1998.

Even success can be limited. The Philippines' Home Development Mutual Fund securitized 500 million pesos (US\$12.5 million) of its mortgage receivables last year. The exercise was the company's first foray into the ABS market. "We hoped for a billion-peso float but only sold half," admits Acela Santos, vice-president of funds management. "When market conditions improve, we'll try to do the other half."

Lack of investor confidence is not the only obstacle facing CFOs who go the ABS route. As Chua of PLDT notes, securitization may not work everywhere in the region. "There are regulatory

questions and tax questions in some jurisdictions." To avoid the pitfalls, she believes finance managers should seek out knowledgeable partners. "It could be complicated, and there is a lot of work involved," she warns, "so you need good advisors."

Even with good advisors, ABS deals generally take time - and patience. For BII, legal questions needed to be worked out. Moreover, the bank had to delay the issue for two months while payment systems were customized according to Visa's and Mastercard's stipulations, to ensure that receivables ended up in the right places. "Door to door, [the deal] took at least nine months," says Sia. "One or two ladies here had children during that time."

Setting up an SPV is a task in itself. Most funding for Asian assets comes from the US and European bond markets. Because the funds are US dollar-denominated, the SPV is usually based offshore. In Thailand, for instance, that adds extra complications. "Since we couldn't legally assign receivables to an offshore vehicle we had to create two SPVs, one onshore and one offshore," explains Oranuch of Tisco. The onshore SPV reassigned the receivables to the offshore SPV, which then became the investment vehicle.

Asian Paper: Pulp Fiction?

Still, if asset-backed securitization is really going to take off in Asia, analysts say a domestic bond market must take root. By tapping domestic funds, companies can avoid the hassles of setting up offshore SPVs.

That bond market, ballyhooed for years, may finally be on its way. In general, Asians save a far greater proportion of their income than Europeans and

Americans. Many of those savers have to pay for their own retirements. As retirees - and managers of pension plans - look for safe ways to invest, bonds would seem an obvious choice. Indeed, a developed bond market, including floating-rate securities and asset-backed securities, will take much pressure off governments to finance pension plans.

Players in Asia's securitization game have much faith in ABS as both a source of funds and a vital first step in the creation of effective local capital markets. Their confidence is bolstered by the phenomenal growth in ABS activity in the US and Europe. Between 1991 and 1996,

ABS issues in the US went from US\$50 billion per annum to US\$150 billion. Analysts say ABS issues by European corporates will reach US\$1.8 trillion before 2003. Certainly, banks like CIBC, Deutsche Bank, and Citibank are spending plenty beefing up their securitization teams in Asia in anticipation of a local ABS market. "Ideally, companies should have access to a number of sources of funds," says Ahmed. With banks and equity markets in disarray, ABS is an obvious choice. "Investors get a higher return and the risk is acceptable," Ahmed notes. "That adds up to a good deal." Getting more conservative CFOs to see it that way, though, may take a little persuading.



“At the age of six I wanted to be a cook.
At seven I wanted to be Napoleon.

And my ambition has been
growing steadily ever since.”

~ Salvador Dali

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