CAS Capital

THAILAND DEBT INSIDER

A Publication of CAS Capital (Thailand) Ltd. December 2022

CONTENTS:

Cash Will be King in 2023

The International Monetary Fund has predicted that global growth will slow to 2.7% in 2023, 0.2 percentage point lower than its July forecast, and 2023 will feel like a recession for millions around the world.

Aside from the global financial crisis and the peak of the Covid-19 pandemic, this is "the weakest growth profile since 2001," the IMF said in its latest World Economic Outlook. Its GDP estimate for 2022 remained steady at 3.2%, which is well down from 6% in 2021.

Even the most optimistic observers can see that there are too many things wrong, that need to be reversed before we can think of recovery or rebound. These include:

- **Slowdown in China & USA**
- **War in Ukraine**
- **Oil & gas prices**
- **Residual COVID financial damage**
- **Excessive debt levels**
- **Increasing cost of capital**
- **Bank credit famine**
- **Food prices**
- **Raw material & construction costs**
- **Expensive travel**
- **Adverse climatic events**

The common thread amongst analysts is that 2023 is going to be bad, even if it is unclear as to how this will manifest itself. We can already see huge uncertainty as events play out differently around the globe. For those that say that Asia will be the champion, what they mean, is it won't be as bad as Europe & North America. There will also be winners though, and in order to take advantage in a hesitant 2023, investors will need to be nimble, be prepared to move quickly, avoid debt, and cash will be King!

In addition to the issues that are hampering the global market, Thailand has its own specific issues that need to be addressed.

At the forefront is the Thai bank NPL clean up. In 2022, there has been a 20% YoY reduction in NPL sales, as there was in 2021. Throughout this time, recorded NPLs in the banking system has been falling, which does not correlate with both debt market conditions and reducing NPL disposals.

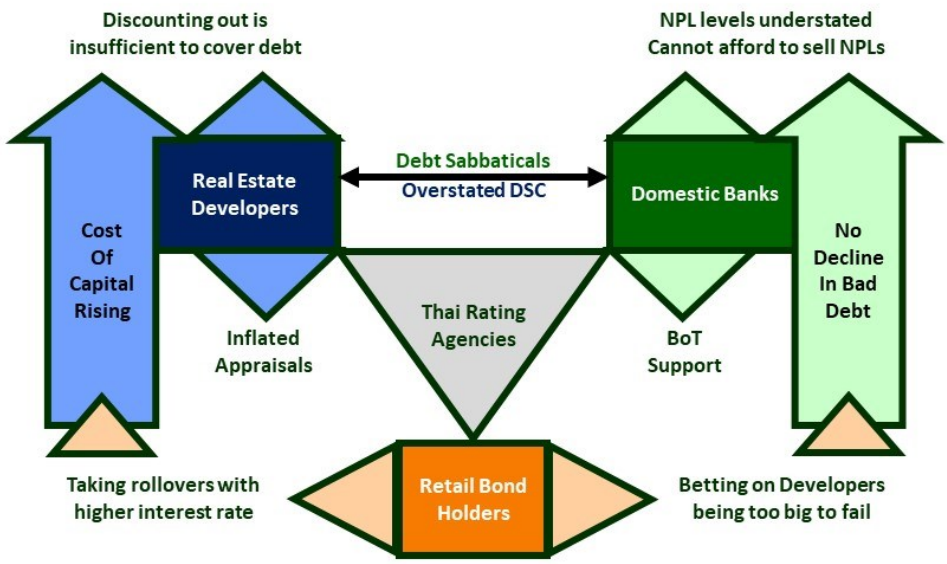
The new JVs between banks and third-party AMC, announced in January 2022, by the BoT as the primary strategy for clearing the huge, bank NPL stockpile, seems to have stalled. A handful of deals have been agreed. The main stumbling block appears to have been an impractical decision making process between the selling bank and the new JV investment partner.

The first half of 2022, saw a rebound in residential development launches from bigger propcos, desperate to bring in fresh revenue and generate cashflow. Ongoing confidence from the local market is central to supporting this. A key factor is affordability in the first time buyer market.

The property industry's reliance upon China for recovery as outlined in our March 2022 edition, looks unlikely to kick in until 2024 at the earliest. In mid-2022, there were 83,000 condos for sale in the Bangkok market. At peak sales in 2019, foreign condo buyers represented only 14% of all buyers though.

Continuing liquidity in the retail bond market is the primary support holding the market together, thereby protecting banks and property companies from the risk of market collapse & meltdown. Annual bond issuances have tripled in the past decade and 2023 volume looks to be 20% higher than 2022. For now, retail buyers seem comfortable to carry the risk, but any loss of confidence would be catastrophic.

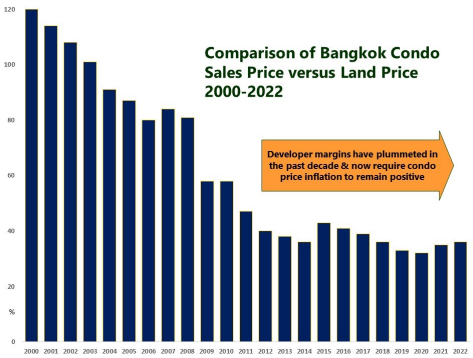
Bond Buyers Carrying Bank & Developer Bad Debt Risk



THAILAND DEBT INSIDER

Property Company Prospects

The future for property companies looks bleak, given current inventory overhang and future uncertainty. In 2022, we have seen a new trend of developers selling land instead of developing, to raise cash or minimize loss. The chart below shows shrinking margins in the condo market, to the extent that they only now stay positive with condo price inflation.



The entry of Japanese investors in 2015, revived the flagging condo market, but also squeezed margins down again. Low margins may be fine for Japanese investors, with low cost of capital, but it is difficult to see Thai developers accepting the same, given the increasing cost of capital in Thailand. Another uncertainty is Japanese investor reaction to their home demographic descent? Some Japanese investors to Thailand have already indicated their desire to leave, given the widespread failure of the current equity JV model in Thailand. Other Japanese investors have indicated their intent to stay for the long term to emigrate capital from a shrinking home market.

The only way we can see such ventures working in the future is through the introduction of new JV structures that are debt-based or use hybrid debt and equity structures. Lower cost of Japanese debt can help leverage Thai developer returns. The challenge facing Japanese investors is how to secure Thai debt, and being prepared to accept lower returns, given the uncertainty of future capital costs in Japan, and FX volatility.

Thai condo developers that have moved product into the hotel market may be facing even more difficult challenges. The hotel market is clearly recovering as foreign tourists return. Arrivals in 2022, will match arrivals back in 2002. There is obvious high growth potential, but the difference now is huge oversupply. We can already see high occupancy in prime hotels, but room rates have plummeted, and look set to remain sluggishly low for years to come, as increased arrivals mop up oversupply. This being the case, achieving breakeven point for hotel development may stretch out many years into the future, whilst the cost of debt capital spirals upwards.

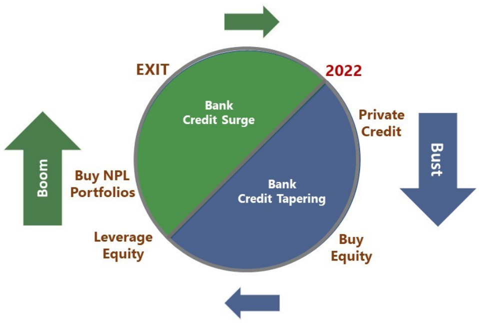
Repaying debt will be the new Propco challenge. At least with condo units, they can be used as debt for equity swaps or discounted out to raise cash. Survival for some companies will depend on banks allowing haircuts to reduce debt. This currently looks difficult for banks as they wrestle with their own bad debt problems. For many Propcos, their 2023 agenda will revolve around, debt haircuts, Japanese divorce and company restructuring. Debt haircuts may only help short-term survival though; recovery for many, still looks to be a distant dream away.

What to invest in and when?

The key to successful real estate investment in Thailand is propelled by the domestic banks. When the banks are in full swing lending, risk pricing plummets to unattractive levels. The best time to invest in Thailand is when bank liquidity erodes and asset prices fall. New, attractive, private credit opportunities have appeared in 2022, and will become increasingly common in 2023.

Equity opportunities will appear as uncertainty continues and values risk further downward erosion. The longer recovery is delayed, the better the investment opportunities will become. It is clear that the local banks still have a long way to go before they can clear their bad debt mountain, and get back to normal lending business again.

Thailand Optimum Investment Cycle



The NPL investment space is best avoided until market recovery is in full swing. Since 2019, many novice investors have been attracted into the NPL space, with zero understanding of value drivers, believing NPLs were the new winner, purely because the market was correcting. Once the newcomers realize that the NPL space is much tougher than expected and leave, it will free up space in the sector.

Furthermore, history shows that the best NPL returns are made when the market is booming & collateral prices rise. Hopefully, this will also coincide with a rebound in the volume of NPL bids, as banks regain confidence and can better manage write-downs. ■

About CAS Capital

Independent real estate asset management & construction specialists, loan & NPL special servicers, established in Bangkok in 2001 as Capital Advisory Services (Thailand) Ltd. CAS undertakes investment sourcing, underwriting diligence & execution, mostly on behalf of foreign investors seeking to enter Thailand. CAS manages investments across the capital structure from debt to equity, and as a local entity, is legally entitled to own land in Thailand

CAS Capital (Thailand) Ltd.
87/2 CRC Tower, All Seasons Place 32nd Fl.
Wireless Road, Pathumwan, Bangkok 10330
Contact: John Sheehan: +66 2 646 4702
Email: jsheehan@capital.co.th