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Clifford Chance and Rothschild commissioned Debtwire to undertake a research project in order to garner current sentiment on issues surrounding the Asia-Pacific distressed debt market. More specifically, 75 hedge fund managers and proprietary trading bankers were surveyed on their expectations for the Asia-Pacific distressed debt market in 2008. Interviews were conducted in November 2007 and all responses are presented anonymously and in aggregate.
As has been the case elsewhere in the world, the Asian market saw very few restructuring opportunities in 2007. This forced distressed debt investors to continue to search for high returns in other ways. For most, that meant extending new loans through private placements, often with equity kickers included. Yet with so many funds having piled into the Asian market since 2006, the prospective returns on such deals were on the decline. The sub-prime crisis changed all that but not as it did in the US. Indeed, the Asian private placements market seems to have mushroomed since July this year, with some hedge fund managers saying that they could hardly keep up with the pace of new deals showing up on their desks in the second half of the year.

To be sure, the Asian market is different, but most hedge fund managers practicing here would probably be cautious in attributing this uniqueness to the fashionable idea that Asia’s economies are “decoupling” from the rest of the world.

Indeed, as this survey shows, most hedge fund managers cite a slowdown in the US as being the most likely cause of financial distress in 2008. However, as this survey also shows, investors don’t expect a significant pick up in the number of restructuring opportunities in 2008. If anything, expectations seem to be for refinancings to continue but with tighter liquidity conditions forcing borrowers to pay more for money while a few others will probably be forced to call for restructuring negotiations.

One reason why fund managers are not predicting dark days for Asia in 2008 is that the loan markets of the last few years had never become quite as reckless as those in the US: covenant-lite deals never made their appearance in Asia and PIK notes were rarely seen. Arguably, most of the private placement loan structures that have emerged in Asia have sought to mitigate the peculiar risks of lending in countries such as Indonesia and China. In general, hedge fund managers seem to think that, in terms of structure, the quality of loans is very good.

Nevertheless, it is probably no surprise the respondents to the survey identified secondary buyouts and recapitalizations as the most likely source of distressed products in 2008, with share-backed financings and private placements running clearly behind.

Anyone familiar with these markets would know that many of these types of deals were being transacted by companies whose majority shareholders have a history of intentionally defaulting and using nefarious tactics to win concessions from their creditors.

In this context, it’s no surprise that Indonesia was cited as the country most likely to provide distressed debt opportunities. This would also reflect the fact that Indonesia has been the most attractive and active market for recapitalizations, private placements and share-backed loans from 2003 until recently. Many of the deals will be maturing over the next year. Given that many commercial domestic and foreign banks are still refusing to go near such borrowers, the chances are that at least a few will default, if hedge funds are unable or unwilling to roll over their loans.

Approximately 80% of survey respondents identified the Philippines, Thailand and China as generating some distressed debt opportunities in the next year. This again reflects the volume and quality of borrowers over the last few years, but also, as is the case with Indonesia, the belief that corporate governance, transparency and rule of law remain unpredictable in these countries.

Given that Hong Kong is home to so many companies with manufacturing operations in China, expectations are also for the SAR to generate a few restructuring deals. These expectations are also fueled by a number of high profile defaults over the last few years that have been the result of fraud; a reminder, that despite its commitment to rule of law, Hong Kong’s governance standards remain patchy.

Singapore manages to hang on to its squeaky-clean reputation but this is perhaps because there have been almost no large restructurings out of Indonesia in the last few years. No doubt, if or when these Indonesian restructurings emerge, everyone will be reminded of the Asia Pulp & Paper debacle and how that Indonesian group’s Singapore holding company managed to stay out of judicial management, despite being in default of some $14bn of debt.

In China, many appear to have high hopes for the new bankruptcy laws, but might be surprised to learn that Indonesia has, since 1999, arguably had one of the best bankruptcy acts in the world. Unfortunately, it has also had a judiciary that does not consistently apply the law. China’s courts might not prove as venal, but as seen everywhere else in Asia, the law bends when there are significant adverse social and political consequences in applying creditor rights in the dispassionate manner that creditors are used to seeing many Western jurisdictions.

Luc Mongeon
Editor, Debtwire Asia
SURVEY FINDINGS

Over half believe that refinancing opportunities will at least be equally available in 2008
Do you expect refinancing opportunities to be more available, less available or equally available in 2008 versus 2007?

• 54% of respondents consider that refinancing opportunities will at least be equally as available in 2008 as they have been this year, with exactly one-third thinking that refinancing opportunities will be more available next year. However, 46% thought that refinancing opportunities would become less available over the next 12 months.

• The jury is out on whether liquidity will tighten significantly in Asia even if the US credit crunch worsens. With the Asian economy expected to remain relatively strong, and domestic banks still flush with liquidity (especially in China and India), investors are sanguine about the state of Asian credit markets. Nevertheless, issuers will probably find that their borrowing costs and terms will not be as favorable as they were in early 2007 as lenders revert to cautious practices.

“Whilst the impact of the credit crunch has seen a tightening of terms in Q4 of 2007, it has also resulted in an increase of liquidity as capital flows out of North America and Europe into Asia. Whilst there is no definitive consensus, many investors believe that liquidity will not tighten in Asia until after the Beijing Olympics.”

Scott Bache, Partner, Clifford Chance

“On balance, refinancing will proceed with large Asian corporates that have been disciplined borrowers since having borne the brunt of the 1997-1999 Asian crises. Underwritings will return to basics and for companies with sustainable cash flow and strong sponsorship. Whilst this market will be inhospitable to speculative credits, the strength of certain domestic markets might pleasantly surprise us.”

Robert Schmitz, MD, Rothschild

More than 90% expect restructuring prospects to at least be equally accessible next year

Do you expect restructuring opportunities to be more available, less available or equally available in 2008 versus 2007?

• 91% of respondents believe that prospects of restructuring next year are at least equal to what they have been in 2007. Close to two-thirds thought that restructuring opportunities would be more available next year in comparison to 2007, while less than one in ten thought that restructuring opportunities would be less available in 2008.

• Tighter credit conditions and the inability of some borrowers to obtain refinancing is likely to trigger some defaults. However, the crucial question is to what extent liquidity dries up, and how well Asian economies hold up as the US economy slows?

“Given the amount of liquidity flowing through Asia, there will inevitably be more restructuring opportunities in 2008 if Q4 of 2007 is any guide. The $64 million question is whether the restructurings will be company specific issues driven by inappropriate capital structures, or broader based as a result of a significant fall off in growth in Asian economies.”

Scott Bache, Partner, Clifford Chance

“Systemic breakdowns in Asia seem remote. Restructurings in 2007 involved mostly fraud cases, several fallen tech companies and underperforming commodity producers. Company and sub sector-specific restructurings are again likely due from pricing pressures from China and plummeting consumer spending in the US. This may take some time to manifest itself. Given Asia’s reserves, a global slowdown could mean outbound flows for distressed assets.”

Robert Schmitz, MD, Rothschild
SURVEY FINDINGS

Secondary buyouts and recapitalizations most likely source of distressed products in 2008

What type of situation will be the most likely source of distressed products in 2008?

- Secondary buyouts and recapitalizations were the most likely source of distressed products in 2008 according to 42% of respondents. Share-backed financings (30%), private placements (28%) and private and family businesses (23%) were all featured as likely sources of distressed situations in 2008.

- Since 2003, a large number of the private placements, share-backed deals and private and family businesses loans have been taken out by borrowers that have a history of intentionally defaulting to extract concessions from their bankers. It will be interesting to see how some of these borrowers will react if they find that their creditors are unwilling to rollover maturing facilities in 2008.

"The pre-IPO market has been very active in the second half of 2007. Potential issuers who are unable to list in 2008 are likely to provide interesting opportunities for distressed investors in Q4 2008 and into 2009."
Scott Bache, Partner, Clifford Chance

"Investors of recent share-backed financings and pre-IPOs are now more reliant upon buoyant equity markets than six months ago."
Robert Schmitz, MD, Rothschild

Indonesia most likely to provide opportunities for distressed debt markets

Rate each country based on its expected opportunities for the distressed debt market

- Between 2003 and mid-2007, Indonesia was the most active market for private placements, share-backed financings and pre-IPO deals and high-yield bond issues. It should come as no surprise then that respondents cited Indonesia as the most likely source of distressed debt in 2008, with one in ten respondents saying that significant distressed debt opportunities would likely arise in the country. Overall, more than 80% of respondents said that Indonesia would at least witness some distressed debt opportunities. The Philippines, Thailand and China also featured prominently, with at least 80% considering that some distressed debt opportunities exist in these regions. Again this reflects the volume and quality of borrowers over the last few years, but also, as is the case with Indonesia, the belief that corporate governance, transparency and rule of law remain poor in these countries.

- At the other end of the scale, Taiwan and Singapore scored the lowest, with 35% and 60% of respondents respectively believing that the two countries will experience little or no distressed debt opportunities. Hong Kong is placed in the middle of the table. This perhaps reflects a number of high profile defaults that have been the result of fraud, a reminder that despite its commitment to rule of law, Hong Kong’s governance standards remain poor.

"Whilst China should be congratulated for its bankruptcy reforms, the lessons learnt during the Asian financial crisis will remain very relevant to investors in 2008 and beyond."
Scott Bache, Partner, Clifford Chance

"This accords with the type of distressed transactions we are experiencing in Southeast Asia. There is a clear appetite for the opportunities which exist within Indonesia and the Philippines - the added risk in these jurisdictions generally comes with higher returns."
Troy Doyle, Consultant, Clifford Chance
Pre-IPO financings offer most attractive investment opportunity next year

Which of the following securities do you think will offer the most attractive investment opportunities in 2008?

- 35% of respondents thought that pre-IPO financings would offer the most attractive investment opportunities in the coming year, while senior secured bank loans (30%) and private placements (23%) were also cited by more than one-fifth of respondents. At the other end of the spectrum, equity linked notes are thought of as offering the most attractive investment opportunity by only 8% of respondents.

Tight credit conditions are being welcomed warmly by investors who, amid the glut of money earlier this year, bemoaned the shrinking margins and unappealing equity kickers coming from private placements and pre-IPO deals. With less money sloshing around the system at the end of 2007, IRRs on private placements were mostly in the high teens to mid-20s, compared with 9-14% earlier in the year. That trend is expected to continue in 2008 with tighter liquidity forcing borrowers to offer greater equity kickers to their pre-IPO, mezzanine and private placement facilities.

Senior secured bank loans and asset backed securities believed to be least attractive investment opportunities

Which two of the following securities do you think will offer the least attractive investment opportunities in 2008?

- Close to one-third of respondents (30%) thought that senior secured bank loans would offer the least appealing returns next year, while asset backed securities were cited by 19%. On the other hand, preferred/mezzanine (7%), common shares post bankruptcy (7%) and private placement (4%) were cited by just a handful of respondents.

Interestingly, a high ranking in the previous chart did not guarantee a low placement here. Pre-IPO financing, cited as the most attractive investment opportunity earlier, is also considered the least attractive opportunity by 16% of the respondents surveyed – putting it in fourth place. This discrepancy might be explained by the view that some respondents think that tighter liquidity conditions are enabling them to demand better terms on the equity kickers they obtain through IPO deals. Simultaneously, however, tighter credit conditions are likely to undermine equity markets, and hence make it less likely that the equity upside being offered by pre-IPO deals will be realized.

“Yields are likely to decline in this sector. As borrowers and lenders return to basics, competition for senior secured loans will intensify among funds and the traditional providers. At this stage, the volume of distressed senior assets will remain limited because primary lenders hesitate selling their securitized assets.”

Robert Schmitz, MD, Rothschild
SURVEY FINDINGS

Slowdown in the US economy most likely to trigger financial distress in 2008

What events are the most likely to trigger financial distress over the next year?

- Perhaps unsurprisingly, fears of a US economic slowdown weighs heavily on respondents’ minds, with 61% stating that such an event will most likely trigger financial distress next year. An equity market crash was also cited as a possible trigger by close to half of respondents, while just under two-fifths thought that increasing commodity prices were also a precursor for financial distress. Appreciating Asian currencies and rising labor costs were not considered as triggers by the majority of respondents, with only 14% and 11% respectively believing them to be the most likely cause for financial distress next year.

- As would be expected, respondents had a number of comments in reply to this topical question. One respondent said, “The worrying aspect is that all events listed above have a high probability of occurring. The Asian manufacturing base is already beginning to see a major margin squeeze arising from currency appreciation, increases in the cost of raw materials and labor, as well as interest rate increases (unless US linked). A slowdown in the US economy will adversely impact Asian businesses but not to the same degree as it has in the past (domestic demand has reduced reliance on the US shopping trolley).” Another said: “Further misconduct-related corporate collapses will significantly deteriorate confidence in Asian markets. Hong Kong will be the most significantly hit, as there are far too many publicly listed companies publishing fictional financial information.”

"Historically high raw material costs, the appreciating Renminbi and increasing labor costs are already causing stress among many manufacturers. If there is a sharp slowdown in the US, any manufacturers who have a leveraged balance sheet are likely to face financial distress. Manufacturers based in the Pearl River Delta may be particularly vulnerable regardless of how China’s broader economy performs in 2008.”

Scott Bache, Partner, Clifford Chance

Networking with industry contacts most prominent method of searching for opportunities

How do you search for investment opportunities?

- Industry contacts were the predominant method of searching for investment opportunities according to 88% of respondents. 37% also utilized specialized databases to explore potential prospects while company filings, newspapers and the internet were all used by 30% or less of respondents.

- Respondents used a variety of other sources which were not mentioned in the question. One said that he utilizes “local partners that we are active with in each country we deal with,” while another said that he uses “brokers for my small to mid-cap opportunities and also general networking.”
Credit default swaps most popular hedging strategy in 2007...

Rate the following hedging strategies in terms of the frequency you used it in 2007

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<tr>
<th>Strategy</th>
<th>Most frequent</th>
<th>Quite frequent</th>
<th>Frequent</th>
<th>Least frequent</th>
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<tr>
<td>Short equity</td>
<td>18</td>
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</tr>
<tr>
<td>Calls or puts</td>
<td>10</td>
<td>24</td>
<td>27</td>
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...and look set to remain the most popular going into 2008

“CDS contracts now total $45.5 trillion of outstanding credit risk, growing at an amazing nine-fold in the last three years alone. Putting such a large number in some perspective, $45 trillion is almost five times the US national debt and more than three times US Gross National Product.” (Ted Seides, Economics and Portfolio Strategy)

“At some level, credit default swaps might become a topic of discussion in 2008 in Asian restructuring community. Tracking down the underlying credits or obligors in securitizations has become topical in Europe and the US.”

Robert Schmitz, MD, Rothschild

Which hedging strategy do you expect to use most frequently in 2008?

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• Credit default swaps (CDS) are by far the most popular method of hedging according to respondents, with 56% having at least used them quite frequently during 2007. This trend is set to continue into 2008, with 59% saying that they will use CDS at least quite frequently in the coming year. Short equity – the second most popular hedging strategy – has fallen from favor slightly, with just over half (51%) of respondents citing the strategy as at least quite frequently used in 2007. This proportion fell to 46% when respondents were asked to set out their hedging strategies for 2008.

• One respondent noted that they use “short index futures” as a hedging instrument, while another said “we are long only - I can’t use any of these strategies.”

“Restructuring companies with derivatives and hedging cocktails adds an element of risk to restructuring that is difficult to price.”

Robert Schmitz, MD, Rothschild
SURVEY FINDINGS

Hedge fund dominated restructurings look set to increase next year

Do you expect hedge fund dominated restructurings to increase, decrease or remain the same in 2008?

- Over three-quarters of respondents (76%) believe that hedge fund dominated restructurings will increase in 2008 compared to levels seen this year. The remaining 24% were fairly evenly split in their thoughts, with 14% thinking that such restructurings will remain the same next year and one in ten considering that these restructurings will decrease.

- Compared to the 1998-2002 period, commercial banks are more willing to sell distressed and nonperforming assets, and so the availability of such assets to hedge funds should increase as more distress situations arise. In addition, the number of hedge funds that are ready to invest in Asian distressed situations has grown enormously in the last two years. Finally, because private placements, pre-IPOs and mezzanine deals are almost exclusively held by hedge funds, these same investors will be the institutions that will dominate any restructurings that emanate from their lending portfolios.

“Whilst distressed investors will continue to dominate the larger restructuring, it will remain a challenge to access mid to small-cap deals given the continuing reluctance of single country focused commercial banks’ to mark to market.”

Scott Bache, Partner, Clifford Chance

“Funds with a distressed orientation have been important sources of capital for turnaround situations. Special situation or distressed funds are our first port-of-call. Funds bring dynamism along with capital to the restructuring process; they generally make quick, commercial decisions.”

Robert Schmitz, MD, Rothschild

Majority think it will be harder to raise new funding next year

Will it be harder, easier or equally challenging to raise new funding in 2008?

- Over three-fifths of respondents believe that it will be harder to raise new funding in 2008, while over one-quarter think that it will be as equally challenging, and just 10% consider it easier.

- Respondents attributed this difficulty to a number of factors. One respondent said that it will be harder to raise funds because “of the tightening of liquidity as a result of the US slowdown.” Another put it down to “tightening monetary conditions and tightening risk appetite.” However, there were some relatively optimistic replies. One said that “there are positive and negative factors which will offset each other, so the effect will be neutral.” Another said “companies with a fundamentally sound business won’t have difficulty,” while yet another said “if you show investors that you have a good deal, there is no problem raising funds.”

“Those in Asia with proven track records with either special situations or distressed assets should not find fund raising a challenge. Obviously the smaller funds will struggle to raise funds.”

Robert Schmitz, MD, Rothschild
Over two-fifths utilized no leverage in 2007
How much leverage did you use in managing your fund in 2007?
- 43% of respondents utilized no leverage to manage their funds in 2007, while close to four-fifths used three times or less leverage over the course of the year. However, a sizable proportion (14%) made use of over four times leverage to manage their funds.

80% of respondents will use the same amount of leverage going forward
Do you anticipate using more, less or the same amount of leverage in your portfolio in 2008?
- The vast majority (80%) of respondents highlighted that they would use the same amount of leverage in 2008 as they have done this year. Close to 10% thought that they would use less, while 11% are anticipating using more.
**SURVEY FINDINGS**

Many respondents either have set redemption restrictions or no policy

What policy do you have in regards to redemptions from investors?

- 84% of respondents noted that they either had no policy with regards to investor redemptions or had set restrictions, with just 16% mentioning that their redemptions from investors were set by current market conditions.

- Many respondents who had set restrictions commented on what they were. Monthly redemptions featured around 20% of the time, while quarterly redemptions were mentioned by roughly the same proportion. Longer periods of redemption – anywhere from one to five years – were observed by approximately 45% of respondents while the remainder – around 15% – were redeemed upon the final maturity of the fund.

“Given the lengthy timetable for implementing restructurings in Asia, that it is likely that those investors with the most patient capital will achieve the most significant returns over the long term.”

Scott Bache, Partner, Clifford Chance

Chances of a systematic hedge fund shock in 2008 most likely to be less than 50%

What do you expect the risk, if any, for a systemic shock in the hedge fund industry will be in 2008?

- Respondents were fairly optimistic on the chance of a systematic shock hitting the sector this coming year. Only 15% thought that the chance of this event occurring was greater than 50%, while more than eight out of ten believed that the likelihood of a shock was less than 50%. The largest single majority (44%) thought that the chances of this occurring were less than 25%.

“The probability of a systemic run on the funds is fairly remote. Markets are more discerning after one shock and usually do not overreact to occasional Amaranth-type situations. Investors stay with diversified and prudently hedged funds. At the margin, however, some funds will vacate the region due to problems in their home markets.”

Robert Schmitz, MD, Rothschild
Respondents evenly split on the effect of the sub-prime crisis on Asian credit markets.

What is the level of impact arising from the sub-prime issues on the credit markets in Asia?

- Respondents were evenly split on the effect of the sub-prime crisis on Asian credit markets. A combined 48% thought that the crisis would have either no or a slight impact on Asian markets, while the majority (52%) thought otherwise.

- Respondents had a large number of comments on what is such a topical issue. One comment noted that, “The level of impact arising from the sub-prime issues will be significant. The results that were initially announced did not take losses into account. Banks like Citibank and Merrill Lynch are proactive in investing in this area.” Another said, “There will be a significant impact on the credit market in Asia because it will reduce financial flexibility and some of the financial institutions will reduce their risk appetite, which will tighten overall liquidity,” while another simply said the Asian credit market would be impacted a “fantastic amount” by the crunch.

- Others were more wary about committing themselves. A respondent said that the sub-prime crisis has had “no real direct impact but ultimately as an instigator of a credit correction it will impact.” Another said, “so far, the impact of the crisis is not significant, but that could change quickly.” Further respondents agreed with this attitude stating that, “The impact will be less but it will still be meaningful” and “the impact will not be direct but via general risk appetite and repricing of risk.”

Watch words 2008 could be: US consumer credit crunch and stagflation.

Robert Schmitz, MD, Rothschild

Who are you going to call? Your legal adviser

Rank in order of priority the contact parties you would call when one of your investments has defaulted

- Respondents highlighted the fact that they would first call their legal advisers if one of their investments were to default, with close to two-thirds ranking a call to their legal advisers as their highest priority. Financial advisers came second, with just over one-quarter of respondents noting that their first call following an investment default would be to these advisers. Interestingly, investors were cited over accounting firms – only 2% of respondents would call their accountants first following a default of one of their investments.

“When a distressed situation occurs it is important to understand the state of play. It is imperative that you understand the legal framework, the legal standing of other relevant parties and your points of leverage. The earlier a strategy with various contingencies built in is developed, the higher the likelihood of a favorable resolution.”

Troy Doyle, Consultant, Clifford Chance
SURVEY FINDINGS

Singapore and Hong Kong most protective of creditors’ rights

Before the East Asian financial crisis of 1997, only a few of the Asian bubble countries could boast strong protection for creditors’ rights. Which countries do you feel offer the most protection for creditors currently?

- Commonly feted as two of the world’s freest economies, it is unsurprising that Singapore and Hong Kong offer the most comprehensive protection of creditors’ rights in Asia – an opinion shared by 85% of respondents. Surprisingly, both countries were ranked over Australia, which only polled 70%.

“Whilst Hong Kong and Singapore undoubtedly provide significant protection for creditors, it is hardly ever the entire story. Given the majority of deals in Asia are cross-border, the assets with the real value are usually located in jurisdictions with patchy track records on creditor rights.”

Scott Bache, Partner, Clifford Chance

“Singapore provides a very stable and reliable legal environment. It is for this reason that a Singapore holding company will often feature in a structure with investments in South-East Asia. A fund often subscribes to the Singapore company, with the subscription funds being the source of investment funding.”

Troy Doyle, Consultant, Clifford Chance

Indonesia and China most difficult Asian countries to foreclose on security

Which countries do you think are most difficult to foreclose on security?

- Indonesia and China were cited by around three-quarters of respondents (76% and 74% respectively) as the most difficult countries to foreclose on security, with the Philippines and Thailand being cited by 45% and 35% respectively. At the other end of the spectrum, only 2% thought that Hong Kong was the most difficult place to foreclose on security, while none of the respondents surveyed thought that was the case in either Australia or Singapore.

“Indonesia and China were cited by around three-quarters of respondents (76% and 74% respectively) as the most difficult countries to foreclose on security, with the Philippines and Thailand being cited by 45% and 35% respectively. At the other end of the spectrum, only 2% thought that Hong Kong was the most difficult place to foreclose on security, while none of the respondents surveyed thought that this was the case in either Australia or Singapore.

“Indeed, because enforcing security is all but impossible in some of these countries, almost all private placement structures feature a significant security package pledged to offshore escrow accounts, including a pledge of company shares and accounts receivables.

“There are various issues with Indonesian security, from registration to foreclosure. The key is to be aware of the potential difficulties and to implement a structure and processes to mitigate these risks as much as possible.”

Troy Doyle, Consultant, Clifford Chance

“Hard core commercialism should be the rule of thumb. In most Asian jurisdictions, following a legalistic path has led to mutually assured destruction.”

Robert Schmitz, MD, Rothschild
Chinese bankruptcy code most improved according to respondents
Which two countries have the most improved bankruptcy code over the past ten years?

- The Chinese bankruptcy code is cited as the most improved over the past ten years across the region according to 36% of respondents. 23% thought that the Korean bankruptcy code was the most improved, while Thailand and Singapore were polled by 21% of respondents apiece. The Taiwanese and Filipino bankruptcy codes were cited as the least improved, with only 7% and 5% of respondents choosing them respectively.

- A number of respondents clarified their choices. One – who said that the Chinese and Indonesian bankruptcy codes were the most improved – elaborated on his answer: “The bankruptcy code has improved in terms of legislation. But this does not necessarily equate to an effective bankruptcy regime. The legislation needs to be consistently applied by the judiciary. This doesn’t happen in Indonesia and is yet to be seen in China.” Another who answered China and Thailand said, “The key is in implementation of the code by the courts. Thailand has disappointed massively after a good start in the late 90s. China is, as yet, untested.”

“A commercially astute and experienced bankruptcy court is often more important than the legislation the judiciary is seeking to apply. In our experience, certainly in Manila, distressed investors have had more success in the Philippines, despite its legislative shortcomings, than some of the other jurisdictions ranked higher by the respondents to the poll.”

Scott Bache, Partner, Clifford Chance

Singapore and Thailand most improved enforcement of bankruptcy over past ten years
Which two countries have the most improved enforcement of bankruptcy over the past ten years?

- The Singaporean and Thai enforcement of bankruptcy has improved the most over the past ten years according to 30% and 23% of respondents respectively, while China came in third place with 21% of the survey’s poll. On the flipside, the Philippines and Indonesia were cited as the two regions with the most improved enforcement of bankruptcy by only 7% and 5% in that order.
SURVEY FINDINGS

More than half wary of lending to companies and their subsidiaries located in China, Indonesia and Taiwan

Given the difficulties of foreclosing on assets in China, Indonesia and Taiwan, are fund managers wary of lending in these countries?

- Close to three-fifths of respondents (58%) believe that fund managers are wary of lending to holding companies and their principal operating subsidiaries that are located in China, Indonesia or Taiwan, with the slight majority (32%) wary against lending to subsidiaries as opposed to holding companies themselves (26%). A large percentage (42%) said that they were unsure.

- It is indeed these risks that have given rise to the market for high yielding structured loans that are placed almost entirely to hedge funds. The belief among these investors is that risks can be mitigated through proper structuring, and independent due diligence.

  “Whilst proper legal structuring is always important, those investors who pay as much attention to structuring the business operations partly offshore are likely to find they have more leverage in a distressed situation.”

  Scott Bache, Partner, Clifford Chance

“The number of successful restructurings in Taiwan and China is abysmally low because, in large measure, domestic creditors are unwilling to mark-to-market their positions or to allow for commercial resolutions. These economies would benefit from those governments complementing their well-intentioned bankruptcy regimes with effective banking reforms and user friendly regs for AMCs.”

Robert Schmitz, MD, Rothschild

Real estate and construction sectors most likely to see distressed opportunities in 2008

Do you expect opportunities for distressed investors in the following sectors to increase, decrease or stay the same in 2008?

- Close to two-thirds of respondents thought that distressed opportunities would increase in the real estate sector, while over half believed that the construction sector would also see an increase in opportunities for distressed investors. At the other end of the scale, the oil, gas & mining and telecom sectors were the least likely to offer distressed investors many opportunities – only 21% and 14% respectively thought that distressed opportunities would increase in these two sectors next year.

- A number of respondents offered their predictions as to whether these industries would increasingly feature distressed opportunities. One said that “there will be a lag for the real estate, telecom, oil, gas & mining and construction sectors.” Another said distressed investors would increasingly look towards the “consumer sector, (on the back of a) US economic slowdown, and oil, gas & mining.”
Respondents evenly split over where funds are invested

Does your fund invest in opportunities outside of Asia?

- Respondents were almost evenly split between their funds investing in opportunities outside of Asia. 49% said that their fund did invest outside of the continent, while 51% said otherwise.
- One respondent who answered the question in the affirmative, said that “only if they are companies from Asia”, while another who also said yes stated, “I buy Asian bonds for US funds.”

Majority not put off from investing in foreign assets by legal restrictions

Have legal restrictions discouraged you from investing in foreign assets?

- The majority (62%) did not believe that legal restrictions would discourage them from investing in foreign assets, while the remainder (38%) thought otherwise. One respondent, who answered in the positive said, “Legal restrictions have discouraged us in investing in foreign assets because of the issues over enforceability and transparency of the process.” Another, who was in the majority camp said, “We are very flexible. If it is a good investment, we will invest.” Yet another respondent, who was not fazed by legal restrictions said that he is however, “wary about investment in Indonesia and China.”
SURVEY FINDINGS

Over three-quarters pay withholding tax in dividends

What taxes have you faced on your investments in distressed assets?

- 77% of respondents stated that they paid withholding taxes on dividends with interest paid offshore, while capital gains tax of distressed debt settlement and income tax on interest and service income from investment portfolios were cited by 40% apiece.
- One respondent said that the question was "complicated to answer, as it depends on the country. All Asia-Pacific countries are different."

"Capitalizing on the taxation laws of various jurisdictions is a key part of devising the structure in which an investment will operate. This will involve consideration of the tax treaties between jurisdictions, the withholding tax payable on dividends, and generally, the inclusion of a vehicle in a jurisdiction which does not tax gains on profits of a capital nature - such as Singapore."

Troy Doyle, Consultant, Clifford Chance

Using favorable tax treaties between countries is respondents’ favorite strategy

What strategies have you used to reduce the amount of taxes encountered on distressed asset investments?

- Exactly half of respondents used favorable tax treaties to reduce the amount of taxes encountered on distressed asset investments, while 42% stated that they utilized pass through entities to reduce the number of layers of tax on investments. However, only 13% noted that they characterized profit as capital gains in order to attract lower rates of tax.
- One respondent noted that "special treatments [were available] for foreign investors in some jurisdictions," while another "didn’t want to comment on these issues," as they were deemed secret.
Is your glass half full, or half empty?

Asia’s distressed debt market has grown increasingly sophisticated in recent years, offering opportunities as well as challenges for debtors, creditors and investors alike.

If you are looking for advice on turning a problem into an opportunity, speak to Clifford Chance. With a market-leading restructuring and insolvency team on the ground in Asia, we can offer unparalleled advice and support across the region, complemented by the strength of our global network.

Call Scott Bache in Hong Kong on +852 2826 2413, or email scott.bache@cliffordchance.com, or Troy Doyle in Singapore on +65 6410 2248 or email troy.doyle@cliffordchance.com for more information.

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ABOUT CLIFFORD CHANCE

Experienced in restructuring from every angle

Our award winning team has consistently been ranked in the first tier having acted on a wide range of restructuring and insolvency matters throughout Asia.

We have extensive experience of voluntary and involuntary restructurings. Having acted for both creditors and debtors, we understand the tension points that often arise during a restructuring and are well placed to guide our clients to ensure that their interests are best served.

As Asia has become more open to non-bank, non-relationship based participants, our involvement in these complex cross-border restructurings has meant that we know and act for some of Asia’s most active distressed debt investors.

Clifford Chance has advised on all aspects of restructuring and insolvency transactions, including:

• reschedulings
• loan to own transactions implemented through debt-for-equity swaps
• distressed M&A
• schemes of arrangement
• administration
• voluntary reorganisation
• court driven rehabilitation
• receiverships
• voluntary and compulsory liquidations
• bankruptcy

For more information, please contact any of the individuals listed overleaf or visit our website at www.cliffordchance.com
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Rothschild is one of the world’s leading independent investment banks with over 200 years of expertise. It is located in key financial centres namely Beijing, Frankfurt, Hong Kong, London, Milan, Mumbai, New York, Paris, Shanghai, Singapore and Sydney. Rothschild provides its clients with banking & treasury, investment banking, private banking & trust and asset management services. Investment banking services include the highest quality financial advice and execution expertise encompassing mergers & acquisitions, restructuring and debt advisory, private placements, privatisations and equity capital markets. It has 40 offices around the globe supported by 850 bankers.

Rothschild has a strong Asian focus with 81 bankers, of which 40 are based in South and South East Asia. In Asia, Rothschild concentrates on providing investment banking services, private banking and venture capital.

Globally, Rothschild has one of the largest independent restructuring and capital markets practice. There are over 65 bankers based in Europe, US and Asia. The Asian restructuring and debt advisory practice was established in 2006 with 8 dedicated bankers based in Hong Kong, Mumbai and Singapore.

The exclusive financial adviser to the principal Indian lenders in the Dabhol power company restructuring, one of the world’s most complex restructurings. Rothschild also advised Astra International and United Tractors, both significant restructurings in Indonesia. At present, it is the exclusive independent financial adviser to Garuda Indonesia, the first commercial restructuring of a state-owned Indonesian enterprise. IFR Asia has recently awarded Dabhol Power the Restructuring Deal of the Year, 2006.

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