

Portfolio Advisory Group

Asia's outlook for non-core
and non-performing loan
portfolios

May 2011



pwc

Introduction



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Welcome to the latest edition of PwC's, Portfolio Advisory Group review of the Asian non-performing loan (NPL) market. This is the 12th edition of this publication and together with the recent release of European outlook for non-core and non performing loan portfolios, PwC provides the most comprehensive overview of the key markets across Asia and Europe.

Since our last issue, the global financial markets have continued to be affected by sovereign debt crises, bank bail outs, soaring unemployment levels and staggering levels of public debt. However Asia has continued to grow and with two notable exceptions, have come through the global financial crisis relatively unscathed. Japan and Korea have been the two economies that have borne the brunt of the global financial crisis in Asia.

As a result of this, Korea has been the most active NPL market in Asia over the past 18 months, with NPL portfolios with a combined face value of over US\$5B hitting the market in 2010. Whilst we do not provide an overview of

the Japanese market in this edition due to the impacts of the recent natural disasters, Japan has been a very active market for buyers of NPL's particularly in commercial real estate and sales of legacy Lehman's portfolios. Outside of these two markets we have seen Taiwan and Thailand continue to provide a constant source of deal flow. However in Taiwan's case the market is largely a locally driven one where there are many local buyers targeting the local selling banks.

Australia has been an interesting market over the past 18 months. As we predicted there has been an uptick in debt sales, these, with one exception, have all been single credit sales. The extent of single credit trading in Australia has been staggering however in contrast, there has been only one portfolio sale of corporate loans over this period. This has reflected the relative health of the Australian banks and the approach by foreign banks to run off local portfolios rather than sell via portfolio sales. On the retail front most banks have become increasingly active in selling their unsecured retail NPL's after a short hiatus when pricing fell in the market. However, buyers are back and as a result, we expect to see the sales continue in the near future as banks continue to clean up their books.

India continues to be an interesting opportunity not only from a size perspective but also from the amount of sales coming to the market. The NPL portfolio sales market continues to develop and 2010 saw 19 transactions taken to market with varying degrees of success. However it is a market where there are a number of foreign buyers participating and the potential size of the opportunity will continue to see it attract the attention of investors.

China continues to be the great unknown for Asia. The growth of lending over a very short period of time is likely to lead to an uptick in NPL's in the near future. On the face of it, this would suggest that this may be a market of interest. However our discussions with local regulatory bodies suggest that any NPL's in state controlled banks that are comprised of loans to local Chinese entities will only be sold to local asset management company buyers i.e. Chinese buyers. Whereas loans to foreign organisations may be sold to foreign buyers, however, Chinese banks have not been as prolific in lending to foreign organisations as they have been to local organisations. Therefore, China debt sales opportunities are unlikely to increase significantly in the near term.

As a result of the relative lack of activity in Asia, buyers have largely been looking at the primary market for deals rather than the secondary market. However we are also starting to see buyers looking at newer markets for opportunities. The Middle East has been one where we have seen increasing levels of activities, however recent unrest may see this slow down. Pakistan is another market that is showing interest. A relatively untapped market of over 150 million people, we have for the first time included an overview of this market in this edition.

So looking forward, we see the most active markets in 2011 to be Korea and India. Pakistan will provide opportunities for those looking for first mover advantages. Thailand will continue to provide some deal flow whereas Japan is likely to see a slowdown in sales as the nation recovers from the terrible events of March. Without some major slowdown in the region we do not expect non-core or NPL portfolio sales to increase substantially over 2011.

Transaction Experience: Sell side

Project Orange Australia

Financial advisor to the seller of a non-core corporate loan portfolio by auction

Portfolio size: USD 500m

Project Motor Australia

Financial advisor to the seller of a non-performing consumer loan portfolio

Portfolio size: USD 40m

Finance Company Hong Kong

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 85m

China AMC

Financial advisor to the seller of a non-performing corporate loan portfolio

Portfolio size: USD 2.4B

China AMC

Financial advisor to the seller of a non-performing corporate loan portfolio

Portfolio size: USD 1.7B

Standard Chartered Bank Taiwan

Financial advisor to the seller of 4 NPL portfolios by auction

Accumulated Portfolio size:
USD 950m

Chinese Bank China

Financial advisor to the seller of a non-performing corporate loan portfolio by auction

Financial Advisor:
Portfolio size: USD 400m

Bank of Taiwan

Financial advisor to the seller of the largest State controlled bank NPL portfolio sale by auction

Portfolio size: USD 1.1B

Taiwan Cooperative Bank

Financial advisor to the seller of 5 NPL portfolios by auction

Accumulated Portfolio size:
USD 4.3B

Transaction Experience: Sell side

First Commercial Bank Taiwan

Financial advisor to the seller of the first Bank NPL portfolio sale by auction

Portfolio size: USD 2B

CIMB Malaysia

Financial advisor to the seller of a non-performing corporate loan portfolio

Portfolio size: USD 450m

Maybank Malaysia

Financial advisor to the seller of the first Bank NPL portfolio sale by auction

Portfolio size: USD 600m

Korea Development Bank

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 600m

National Agricultural Cooperative Federation Korea

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 372m

Korea Exchange Bank

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 618m

Standard Chartered Bank Korea

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 118m

Indonesian Bank Restructuring Agency

Financial advisor to the seller of a NPL portfolio sale by auction

Portfolio size: USD 630m

Bank of Indonesia

Financial advisor to the seller of a NPL portfolio sale by auction

Portfolio size: USD 370m

ICICI Bank India

Financial advisor to the seller of a portfolio by auction

Portfolio size: USD 300m

United Coconut Planters Bank Philippines

Financial advisor to the seller of a NPL portfolio sale by auction

Portfolio size: USD 220m

International Bank Guam

Financial advisor to the seller of a portfolio by auction

Portfolio size: USD 143m

Bank of Ayudhya Thailand

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 445m

Thai Military Bank Thailand

Financial advisor to the seller of a non-performing loan portfolio by auction

Portfolio size: USD 285m

Project Surin Thailand

Financial advisor to the seller of a non-performing loan portfolio

Portfolio size: USD 450m

Project Mango Thailand

Financial advisor to the seller of a non-core corporate loan portfolio

Portfolio size: USD 400m

Transaction Experience – Buy side and other

Project Asia

Valuation of NPL portfolios previously purchased in Malaysia, Thailand and Philippines

Portfolio size: > USD 1B

China Orient AMC

Review, due diligence and valuation of NPL portfolio

Portfolio size: USD 630m

Bank of Indonesia

Financial advisor to the seller of a NPL portfolio sale by auction

Portfolio size: USD 370m

Project Taurus Korea

Loan portfolio due diligence for potential purchaser of local bank

Portfolio size: n/a

Woori Financial Group Korea

Vendor due diligence of loan portfolio

Portfolio size: n/a

Project Siam Thailand

Buy side due diligence on behalf of an international investor on a NPL portfolio

Portfolio size: USD 240m

Project Manila Philippines

Buy side due diligence on behalf of an international investor on a NPL portfolio

Portfolio size: USD 220m

Project Double Australia

Loan portfolio due diligence for potential purchaser of local finance company

Portfolio size: USD 445m

Project Thai Malaysia

Buy side due diligence on behalf of an international investor on a NPL portfolio

Portfolio size: USD 280m

Project HK Malaysia

Buy side due diligence on behalf of an international investor on a NPL portfolio

Portfolio size: USD 75m

Australia: A boom in single credits, but what's next?

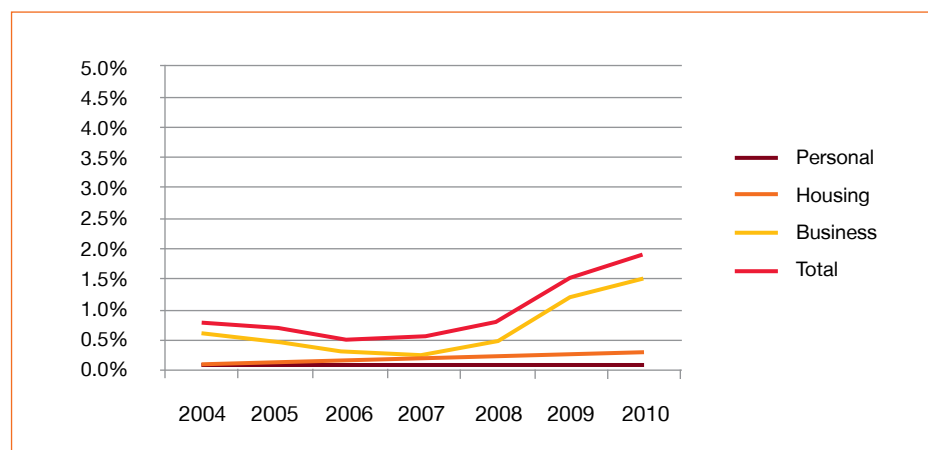
2010 and the first quarter of 2011 has seen a significant volume of trading in distressed single credits in Australia. This has been led by the restructuring of some significant company names such as Alinta, NZ Yellow Pages, Babcock and Brown, iMed and RiverCity. The majority of banks have been willing to trade out of their positions given the significant levels of interest from overseas buyers. We would estimate that in excess of \$3 billion in debt has been traded over the past 18 months in Australia and NZ.

Australia has however not had the expected uptick in portfolio sales, with only one significant corporate loan portfolio sale to date by Suncorp, which closed in the first half of 2010. The foreign banks have not been in a hurry to exit certain market segments, as would have been expected during the global financial crisis (GFC). Many banks have preferred portfolio run off strategies than portfolio sales.

On the retail side, 2010 saw an uptick in the amount of deal flow. Based on PwC sources an estimated 30 or so deals with a face value of just over \$2 billion in deals were brought to market by the big four banks, GE and the local Telco's. Just about all of the big four bank sales were done on a forward flow basis involving both credit card debts and unsecured personal loans. The majority of the buying would appear to have been done by a couple of local servicing platforms.

In terms of the supply side in Australia, the Australian economy has largely come through the GFC in a relatively healthy state. As a result, the Australian banks do not have the levels of non-performing assets as the European or North American banks. Whilst there was definitely an upturn as highlighted in the figure below, levels of non-performing assets are still relatively low.

Graph 1: Banks' non-performing assets (domestic books)



Includes lending to non-ADI financial businesses, bill acceptances and debt securities, and other non household loans.

Source: Financial Stability Review – September 2010

Graph 1 also highlights the relatively low level of distress in consumer banking as compared to corporate banking. Despite high levels of individual indebtedness, the main asset underpinning the individual's wealth, being their home has seen consistent growth over the past five years as compared to many markets of the world. On a price to income basis, Australia now on average, has one of the most expensive housing markets in the world.

As for the way forward in Australia, there continues to be unaddressed problems in the commercial property market in Australia. This is particularly acute with regards to residential developers, in Queensland particularly around the Gold Coast and North Queensland, where in one bankers words, "it is hard to even give some of these properties away". Besides property the other segment we believe under stress is the small and medium enterprise (SME) market. We believe the majority of the larger credits that have been keeping the debt traders busy are largely known in today's market. Of course, there will continue to be some surprise packets, however, the market now is in SME credits. This requires debt buyers to become more hands on and taking active leads in restructuring initiatives. As such, we expect the volume of trades to reduce.

We also doubt that there will be many corporate loan portfolio trades in the near future. Australian banks are largely well capitalised and therefore have few incentives to sell. On the retail portfolio front, we would expect to see similar, if not slightly higher volumes of trades from banks and other sellers. However, we do not expect to see banks selling residential mortgage loan portfolios in the future.

Taiwan: Lower volumes but a consistent NPL market

Taiwan continues to be one of the most active NPL markets in Asia. There are a number of local asset management companies (AMC) in the market who account for the majority of buying and therefore, provide a robust level of competition in keeping prices up. Foreign buyers are largely excluded from the market as it is difficult to compete against the local platforms.

There were 20 NPL auctions with a face value of approximately US\$1.8 billion in Taiwan in 2010 as highlighted in the following table:

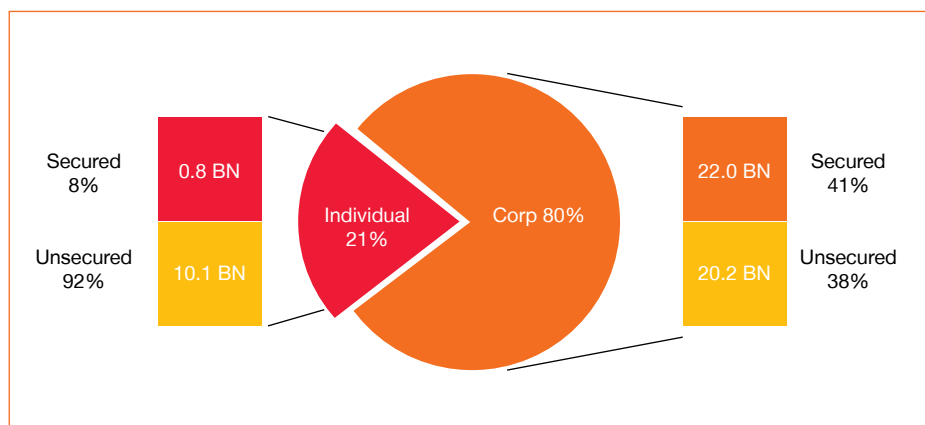
Table 1: NPL Sales between January 2010 and December 2010 (USD in millions)

Transaction Date	Seller	NPL Balance	Buyer
Jan	SCSB	56	Mega AMC
April	Mega Bank	105	Not Disclosed
April	GuoHua Property Insurance	29	Taishin AMC
April	Taiwan Finance Corp	207	GE Capital
May	SCB	190	Chinatrust AMC
July	SCB	28	CDAMC 4
July	SCB	144	Promis Group
August	KTB	1	Not Disclose
September	Taiwan Finance Corp	22	YangTze AMC
September	Entie Bank	1	JSL Corp
September	Entie Bank	7	Mega AMC
October	SCB	190	YangTze AMC
November	Shin Kong Life Insurance	80	Fubon AMC
November	SCB	143	Promis Group
November	CDIB	115	Fubon AMC
November	CDIB	35	Mega AMC
December	Far East Bank	15	Taishin AMC
December	CDIC(From distressed banks)	209	TAMCO
December	Mega Bank	77	Bid Failed
December	Mega Bank	120	Yuanta AMC

Source: Public Information

The relative split of the above transactions are as follows:

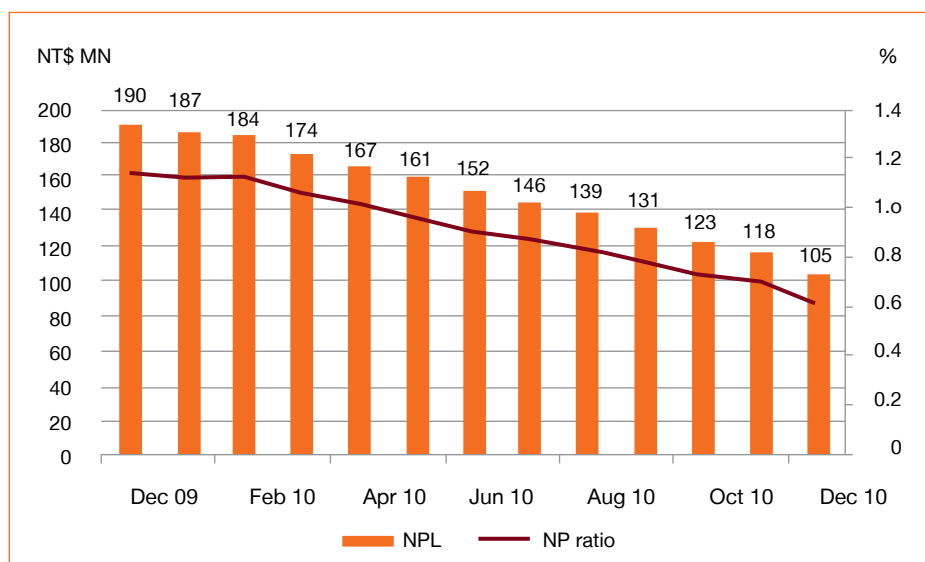
Graph 2: 2010 portfolio analysis



Source: Public Information

The level of competition in the market place has forced some buyers to look at smaller portfolios as well as unsecured portfolios, giving rise to the number of unsecured deals done over the past 12 months. On the sell side, banks have also found it more difficult to sell off syndicated loan positions due to investors being less willing to buy small parts to larger facilities. This has resulted in some banks banding together to sell together, thus, increasing the buyers' appetite. Buyers then try to control or have a larger influence over the restructuring initiatives undertaken by the borrowers. Noticeably, absent from the list of deals above, are the large state controlled banks. This explains why there were no substantial corporate NPL sales in 2010 and this was largely driven by the growing economy as highlighted in the graph below.

Graph 3: Domestic bank NPL's



Source: FSC

Already in 2011, we are seeing the first half sales nearly equal all of 2010 with four deals scheduled for the market as follows:

Table 2: NPL Public auction in Taiwan – First half of 2011 (USD in millions)

Auction Date	Seller	Portfolio	Buyer	Scale
March	Chinatrust	Unsecured Consumer NPLs	Yuanta AMC	340
March	ANZ	Unsecured Consumer NPLs	Yet to determine	490
May	Mega	Secured Syndicated Loan	Yet to determine	130
May	SCB	Mortgage and Unsecured Consumer NPLs	Yet to determine	545

Source: PwC Survey

In the second half of 2011 we anticipate the driving forces behind NPL sales to be as follows:

1. accelerated recovery from written off accounts and selling banks desire to reduce the costs associated with NPL recovery.
2. a more aggressive approach by sellers to target unsecured loan portfolio sales given the recent trend towards this asset class in 2010. If the economy holds then recoveries from this sector should continue to encourage buyers.
3. the government intends to introduce a 3rd wave of banking reform that is likely to encourage mergers between banks. This will put pressure on banks to clean up their loan books in preparation for the mergers.

Korea: The most active Asian NPL market

The Korean NPL portfolio sales market for 2010 has been the most active in terms of number of deals and value of deals. Banks in Korea are comfortable with selling loan portfolios and there have been over 20 deals in 2010 with a face value of over US\$5.4 billion. The table below lists the number of NPL portfolio deals we are aware of in 2010.

Table 3: NPL Sales between January 2010 and December 2010 (USD in millions)

Seller	OPB	Month of Sale	Buyer
IBK	400	Feb	UAMCO
Hana Bank	199	Mar	UAMCO
KEB	35	Mar	Woori F&I
KEB	300	May	Woori F&I
Shinhan Bank	209	May	UAMCO
IBK	164	May	Woori F&I
Woori Bank	127	June	Woori F&I
KB	145	June	Confidential
NH	182	June	Confidential
NH	159	Aug	UAMCO
Hana Bank	231	Aug	Woori F&I
Woori Bank	83	Aug	Woori F&I
Shinhan Bank	150	Oct	Confidential
SC First Bank	117	Oct	Confidential
KEB	322	Oct	Confidential
Hana Bank	105	Oct	Confidential
KB	316	Nov	Confidential
KDB	600	Nov	Confidential
IBK	464	Nov	Confidential
Shinhan Bank	234	Nov	UAMCO
NH	136	Dec	UAMCO
KDB	618	Dec	KAMCO
Suhyup Bank	26	Dec	KAMCO
KDB Capital	115	Dec	KAMCO

Source: PwC

We understand that the majority of sales in Korea have been purchased by local buyers. However, there continues to be significant interest from foreign NPL buyers particularly given the increase in NPLs throughout the banking sector.

The relatively high levels of NPL sales in 2010 reflect the fact that Korea has been one of the hardest hit economies in Asia together with Japan. As highlighted in the table below, there has been a rather sizeable jump in the NPL ratio for the banks in Korea and a large part of this has been because of the rapid build up in property construction. Property finance NPL's have increased by 416% in 2010 as compared to 2009.

Table 4: Total level of NPL's

(USD in millions)	FY2007	FY2008	FY2009	FY2010
NPL Amount	7,000	13,364	14,545	22,182
(Real Estate PF)	273	1,273	1,091	5,636
NPL Ratio	0.72%	1.14%	1.24%	1.86%

Source: Financial Supervisory Service, Korea

Below is a detailed analysis of the value of NPL's for Korea's largest banks as reported by the Financial Supervisory Service

Table 5: Top ten banks NPL's levels

USD in Millions	FY2009			FY2010		
	Total Loan Amount	NPL Amount	NPL Ratio	Total Loan Amount	NPL Amount	NPL Ratio
Shinhan	136,545	1,364	1%	140,909	1,818	1.31%
Woori	154,545	2,455	1.60%	152,818	4,909	3.24%
SCB	38,455	455	1.15%	40,455	455	1.01%
Hana	95,182	1,000	1.05%	98,727	1,455	1.47%
KEB *	64,182	636	0.94%	62,909	818	1.26%
Korea Citi	25,636	273	0.91%	28,182	364	1.33%
KB	185,909	2,091	1.11%	185,909	3,273	1.78%
KDB	78,909	1,727	2.24%	72,182	1,455	2.02%
IBK	109,636	1,364	1.20%	119,091	2,182	1.83%
NH	127,182	1,818	1.41%	127,091	3,273	2.57%

Source: Financial Supervisory Service, Korea

* Hana Bank and KEB close to finalising merger.

As for the future, the first quarter in 2011 has already seen the Financial Services Commission suspend the operations of two savings banks and business suspensions on four other banks for poor financial performance. This brings the total number of Savings Banks under business suspension orders to eight, as listed in the table below.

Table 6: Savings banks under FSC control

Ranking	Name	Total Assets	Total Loans	PF loans
3	Pusan Savings Bank	3.4	3.0	2.1
5	Pusan 2 Savings Bank	2.9	2.9	1.1
13	Daejeon Mutual Savings Bank	1.5	1.5	0.3
19	Samwha Savings Bank *	1.3	1.3	0.2
25	Jungang Mutual Savings Bank	0.8	0.8	0.2
29	Bohae Savings Bank	0.9	0.9	0.2
41	Koyro Mutual Savings Bank	0.5	0.5	0.1
58	Domin Davings Bank	0.3	0.3	0.07

Source: FSS (Units in USD Billions)

* FSC approved the transaction of Samwha Savings Bank to Woori Holding Group on 17th of March, 2011.

As a result of the above, it is likely that there will continue to be a supply of NPL's coming from the cleaning up of the above institutions either prior to sale or as a result of the sale. In addition to this, the ongoing difficulties faced by the real estate sector is likely to lead to a pull back in the sector by banks and ongoing default issues. Added to this, the problems faced by the construction and ship building sectors suggest that Korea is likely to remain an active NPL market over the next couple of years.

India: An expanding market

Portfolio sales dominate the non-performing loan market in India, with the public auction route being the most preferred sale technique used by sellers. Buyers have included many of the foreign special situation investors together with local AMC's. Indian banks still prefer to take the lead in work-out/restructuring negotiations and as such, over the past 12 months few single credit deals have been executed. As highlighted in the table below, portfolio sales of over US\$1.0 billion in outstanding principal balance have been taken to market with varying success.

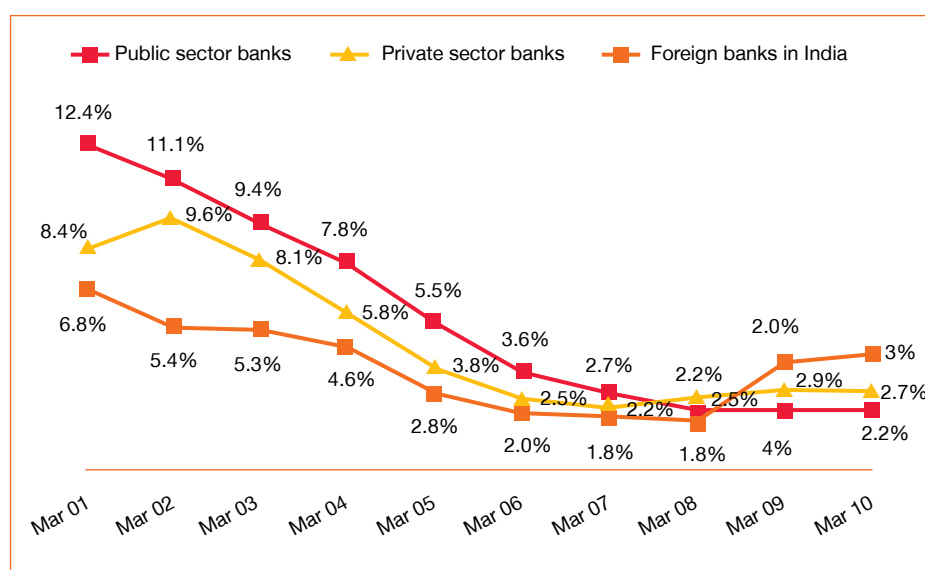
Table 7: 2010 NPL deals

Sr. No.	Seller	OPB	Month of Sale	Buyer	Type
1	SIDBI	3.1	March-11	Failed	Corporate NPL
2	Central Bank of India	36.4	February-11	In progress	Corporate NPL
3	Uco bank	22.1	February-11	In progress	Corporate NPL
4	Punjab & Sindh Bank	12.1	February-11	Failed	Corporate NPL
5	Corporation Bank	39.6	February-11	In progress	Corporate NPL
6	State Bank of India	53.2	January-11	In progress	Corporate NPL
7	State Bank of Travancore	9.6	January-11	Asrec	Corporate NPL
8	Central Bank of India	82.7	December-11	Partly Closed	Corporate NPL
9	Dena Bank	110.3	December-10	In Progress	Corporate NPL
10	Vijaya bank	22.1	December-10	Failed	Corporate NPL
11	IOB	74.2	December-10	JM Financial	Corporate NPL
12	Uco bank	51.0	November-10	Asrec	Corporate NPL
13	Karnataka Bank	44.1	October-10	Arcil	Corporate NPL
14	State Bank of India	73.0	October-10	Failed	Corporate NPL
15	Syndicate Bank	Not available	October-10	Not available	Corporate NPL
16	Central Bank of India	62.4	September-10	Phoenix, Arcil, JM financial	Corporate NPL
17	ICICI Bank	397.1	April-10	Phoenix ARC	Retail NPL
18	IOB	2.5	May-10	Phoenix ARC	Corporate NPL
19	PNB	2.4	June-10	Phoenix ARC and others	Corporate NPL
Total		1,097.7			

Source: PwC

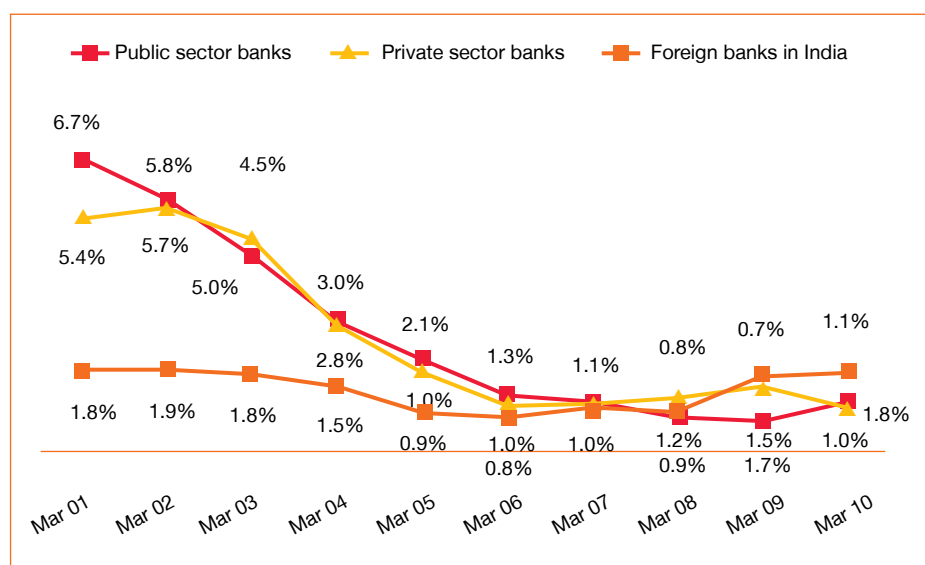
Asset quality of Indian Banks has been steadily improving as is evident from the declining gross/net (NPA) levels from FY2001. However, the financial crisis affected the Indian banking system with a marginal upturn in NPA ratios in recent years. Analysts expect gross NPA levels of approximately 3% in FY2011. However, on an overall basis, given expectations of strong economic growth, the NPA ratio is not a key cause for concern in the banking sector.

Graph 4: Gross NPA ratio



Source: Reserve Bank of India (RBI) report on Trends and progress of banking in India.

Graph 5: Net NPA ratio



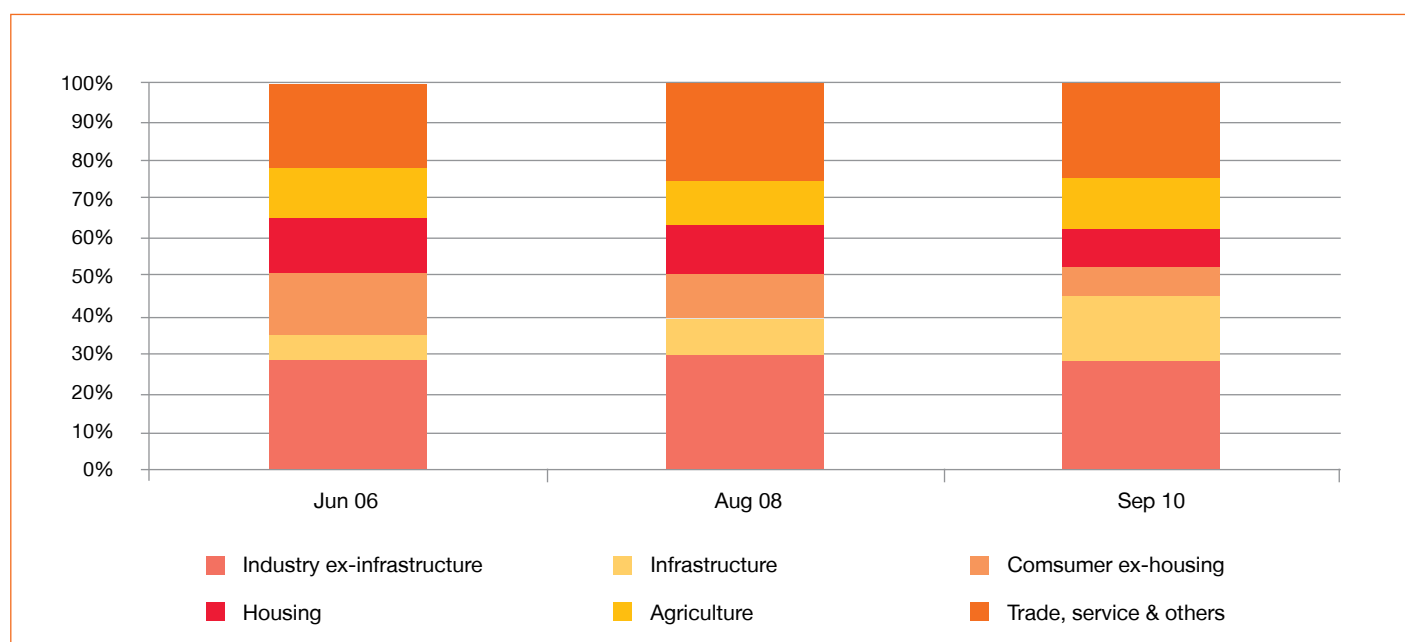
Source: Reserve Bank of India (RBI) report on Trends and progress of banking in India.

Loans by the Scheduled Commercial Banks (SCBs) to the real estate, commodities and capital markets sector account for 19.6% of total SCB credit. Of these three sensitive sectors (as defined by the RBI), the real estate sector alone accounts for 16.6% of total bank credit, as highlighted in the graph below. As a result, the Central Bank has tightened the lending criteria for these loans along with other credit tightening measures like increased provisioning and capital adequacy requirements. Local banks have looked to reduce exposure, however foreign banks have quite aggressively expanded into this sector over the past 12 months.

The outlook on real estate in India is stable with a negative bias. The overall demand improved in FY2010 and is likely to remain stable in FY2011 but the impact of the rising interest rates coupled with the increased real estate prices post FY2010 may dampen demand for residential properties. Oversupply in the commercial space is also a likely cause for concern.

In terms of a sector-by-sector analysis of SCBs in India, the growth in infrastructure is the most obvious standout and has been driving credit growth for the past couple of years. This is expected to continue to drive growth. The RBI has made a number of concessions to banks to boost credit to the infrastructure sector including takeout financing, relaxed asset classification norms, enhanced exposure ceiling for infrastructure lending etc. There are some concerns over the sensitivity of the sector to losses on account of project delays, rising input costs as well as interest rate sensitivity. However, it is largely expected that credit losses on viable projects would be manageable on account of the acute demand for infrastructure in the country.

Graph 6: Sectoral distribution of credit



Source: RBI report – Trends and progress of banking in India.

The following table provides an analysis of the top 20 banks in India gross advances and NPA levels. The top 20 banks comprise approx 80% of total advances by SCB's in India.

Table 8: Top 20 banks analysis

(USD in Billions)	Gross Advances	Gross NPA	Net NPA	Gross NPA %	Net NPA %
State Bank of India	141.2	4.3	2.4	3.1%	1.7%
Punjab National Bank	41.5	0.7	0.2	1.7	0.5
ICICI Bank Ltd	41.3	2.1	0.9	5.1	2.1
Bank of Baroda	38.9	0.5	0.1	1.4	0.3
Bank of India	37.8	1.1	0.5	2.9	1.3
Canara Bank	37.6	0.6	0.4	1.5	1.1
IDBI Bank Ltd	30.7	0.5	0.3	1.5	1.0
HDFC Bank Ltd	28.0	0.4	0.1	1.4	0.3
Union Bank of India	26.8	0.6	0.2	2.2	0.8
Axis Bank Ltd	25.7	0.3	0.1	1.1	0.4
Central Bank of India	23.7	0.5	0.2	2.3	0.7
Syndicate Bank	20.2	0.4	0.2	2.2	1.1
Oriental Bank of Commerce	18.6	0.3	0.2	1.7	0.9
UCO Bank	18.5	0.4	0.2	2.0	1.1
Indian Overseas Bank	17.8	0.8	0.4	4.5	2.5
Allahabad Bank	15.9	0.3	0.1	1.7	0.7
Corporation Bank	14.1	0.1	0.04	1.0	0.3
Indian Bank	13.9	0.1	0.03	0.8	0.2
Andhra Bank	12.5	0.1	0.02	0.9	0.2
State Bank of Hyberabad	11.7	0.1	0.06	1.2	0.6
Total	616.4	14.3	6.6		

Source: Capitaline

While there have been recent fears of growth slowing down on the back of inflationary pressures and higher borrowing costs, the credit outlook on most industrial sectors has improved. This has led to a reduction in the asset quality concerns. In our previous issue, we talked about the cascading effect of restructured loans turning into NPLs. Analysts expect the consequential impact to be muted, on account of the relatively healthy domestic revenue growth. The systemic gross NPL ratio is also expected to start reducing after peaking at 3% in March 2011.

On the face of it, the banking system does not appear to be under NPL pressure. The ability to close transactions may remain a concern as value expectation gaps persist and banks are unlikely to sell at valuations lower than their expectations. On the retail NPL side, while banks remain keen to explore these transactions, issues relating to lack of information on collection trends and valuation issues make the consummation of these transactions difficult. However, with the increased frequency of successful sales particularly in corporate NPLs, it is anticipated that the NPL market will pick up as banks continue to actively manage their NPL exposures.

Thailand: Sales continue, despite political uncertainty

Despite the Thai political unrest in 2010, the market had four or five multi tranche deals, with a total estimated outstanding principal balance of US\$1.6 billion. The unrest however effectively stalled many of the deals and pushed closing in to the second half of the year as highlighted in the table below.

Table 9: Selected NPL portfolio sale transactions in Thailand in 2010

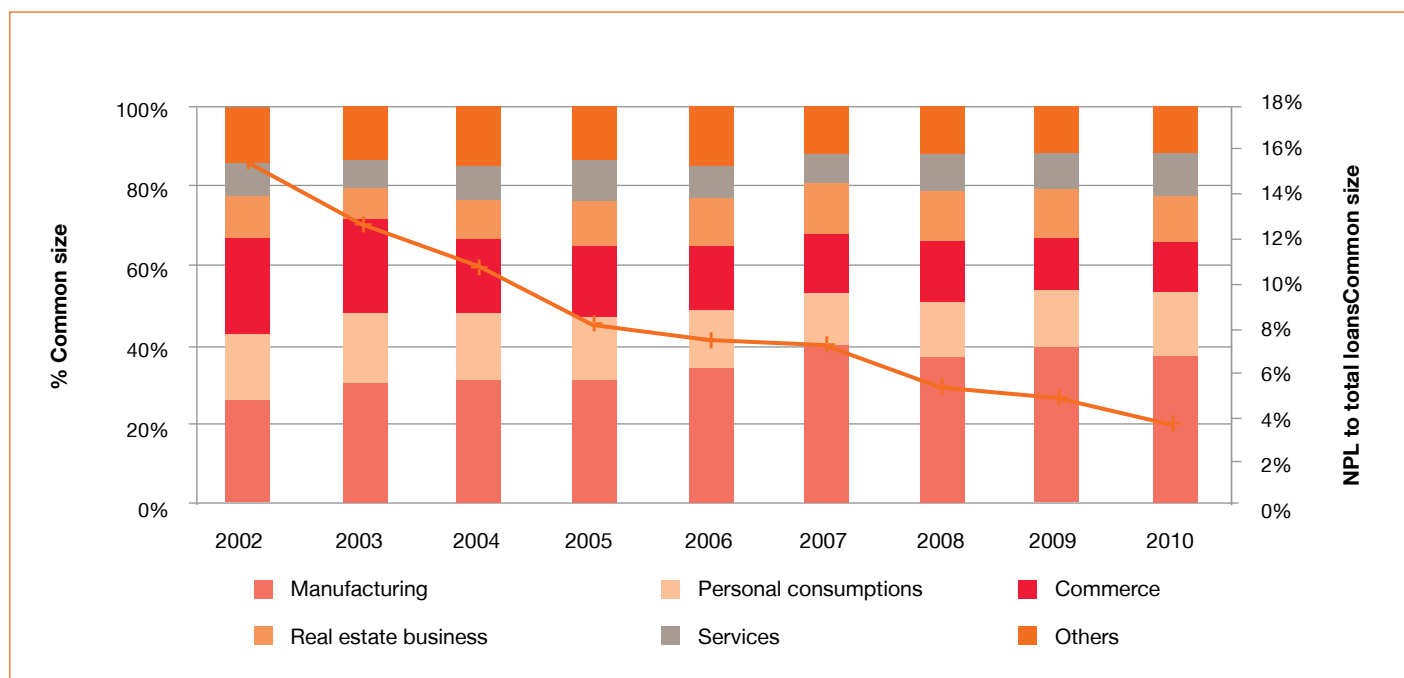
Seller	OPB	Month of Sale	Buyer	Type
Lehmans	550	Oct 2010	Confidential	Multiple
VTB	450	Nov 2010	Confidential	Multiple
Bank of Ayudhya	250	Oct 2010	Standard Chartered/ other(s)	Multiple
Siam Commercial Bank	125	Nov 2010	Confidential	Multiple
Bank of Ayudhya	250	Jul 2010	Bangkok Commercial Asset Management/ other(s)	Multiple
Total	1,625			

Source: PwC (USD in millions)

The interesting aspect to the portfolio NPL market in Thailand as compared to Korea and Taiwan, is that international investors are actively participating against the local buyers. International investors that do not have servicing platforms set up in country are then seeking the support of the local AMC's to provide servicing. In addition to the portfolio sales, there has been an active trading of single credits where banks are no longer willing to support the borrower and/or are fatigued by extended restructuring periods that are often associated with Thai restructurings.

As a result of Thailand's active participation in the NPL market over the past eight or so years combined with the economic recovery leading to debt restructurings and increased loan repayments, the percentage of NPL's have reduced from approximately 16% in 2002 to the current level of 4% at the end of 2010. Graph 7 on next page demonstrates this decline as against the relative segment split of loans by sector.

Graph 7: % Common size by sector and % gross NPLs to total loans



Source: Bank of Thailand

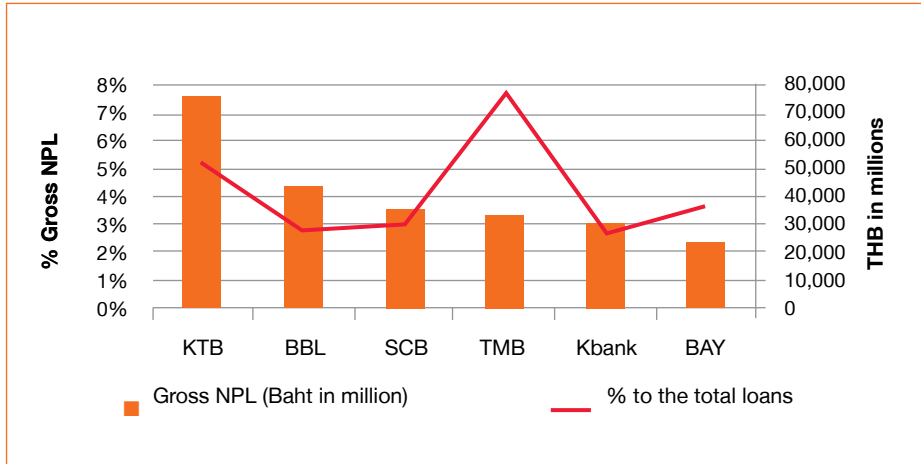
The next two graphs highlight where future potential NPL portfolio deals may be sourced. The most active participants in the portfolio sales market have been the locally registered banks and as such NPL levels have continued to lower. This compares to the finance companies that are yet to fully embrace this option of disposal and hence NPL levels have actually been increasing since 2005.

Graph 8: % Gross NPLs to total loans by type of financial institution



Source: Bank of Thailand's website

Graph 9: Gross NPLs of selected major commercial banks as of 31 December 2010



Source: Bank of Thailand's website and audited financial statement of each bank

The average percentage of gross NPLs to total loans for the selected major commercial banks is 4.2%. TMB has the highest gross NPLs percentage of 7.7%. This is primarily as result of TMB continuing to work through the increased number of NPL's that were part of the merger with IFCT and DTDB which was completed in 2004.

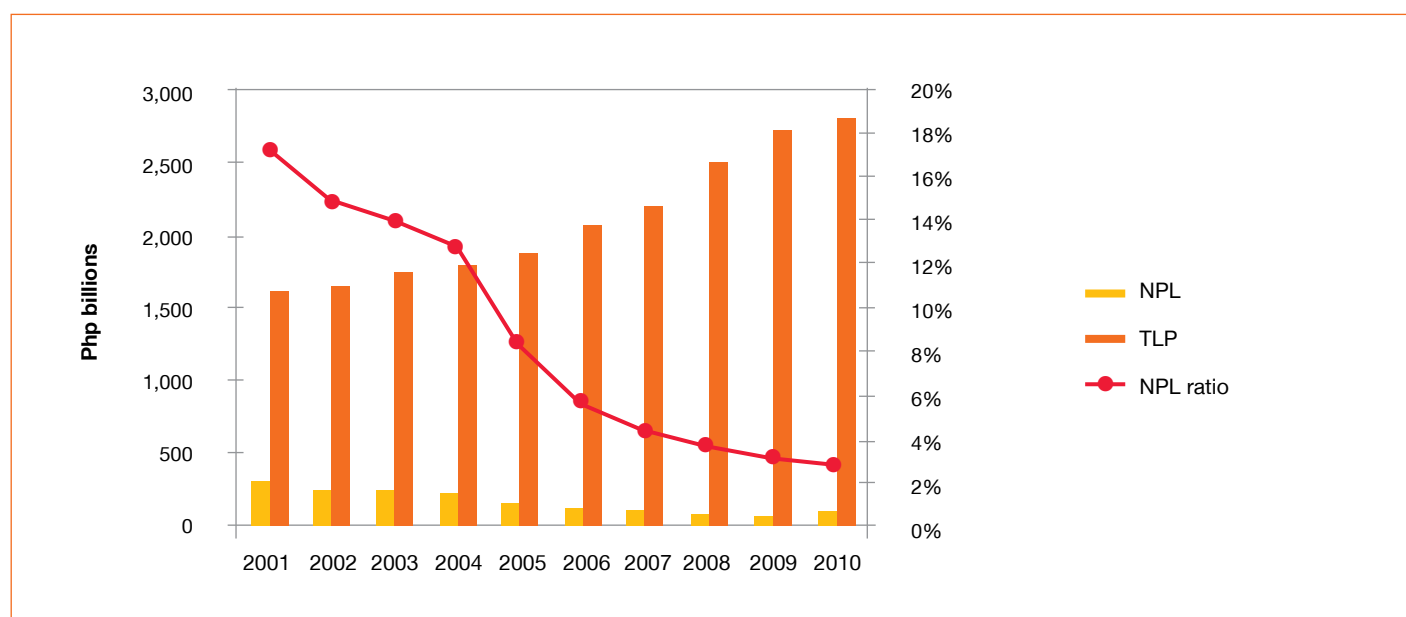
As for the future, we anticipate that there will be a couple of NPL portfolio sales in 2011 as banks continue to clean up their balance sheets. Economically the Thai economy is performing well with the World Bank forecasting gross domestic product growth of approximately 3.7% for 2011. Therefore we do not see a major upturn in new NPL's during the year sales. However potential political unrest associated with upcoming elections later in the year may dampen the prospects of getting deals away near the back end of the year.

Philippines: All quiet and the prospects for 2011 are not great

The Philippines has been very quiet for a number of years or essentially since the end of the expiration of the law that encouraged banks and financial institutions to dispose of bad assets through SPV structures in 2008. There were no significant sales during 2010 with only minor secondary sales between local asset managers.

As with many Asian economies, the Philippines came through the global financial crisis relatively unscathed as evidenced by the continued reduction in NPL's. This is highlighted by the graphs and tables in this section.

Graph 10: Universal and commercial banks – Total loan portfolio vs NPL ratio



Source: Bangko Sentral ng Philipinas statistics

NPL ratios and total absolute NPLs have been shrinking for several years. In particular, the latest data shows that Universal and Commercial banks—the largest players in the banking system—and Rural and Cooperative banks have shrunk their ratios to 2.9% and 10.0% respectively. The table below highlights the five largest banks in the Philippines and their NPL levels and coverage ratios. All with the exception of Unibank have seen improving NPL ratios.

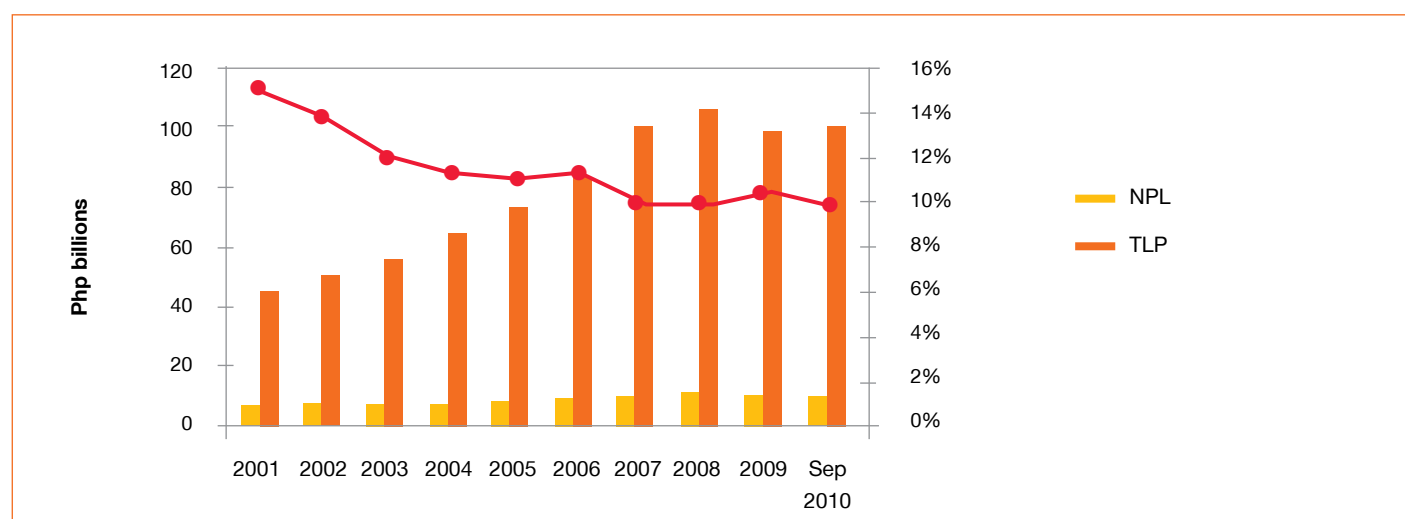
Table 10: NPL analysis of five largest banks

Bank	2010			2009		
	NPL ratio	Total loans millions of pesos	NPL cover	NPL ratio	Total loans millions of pesos	NPL cover
Banco de Oro Unibank, Inc.	3.37%	516,665	115.47%	3.24%	480,258	112.40%
Metropolitan Bank & Trust, Co.	2.02%	362,930	89.64%	2.22%	370,190	68.73%
Bank of the Philippines Islands	1.75%	421,427	70.85%	2.55%	345,257	54.25%
Land Bank of the Philippines	2.85%	193,991	153.57%	2.98%	184,897	160.99%
Rizal Commercial Banking Corporation	2.24%	141,802	136.90%	3.78%	135,848	58.97%
Total	2.49%	1,636,815	109.60%	2.85%	1,516,450	92.10%

Source: Business World 4th Quarter Banking Report 2009 and 2010

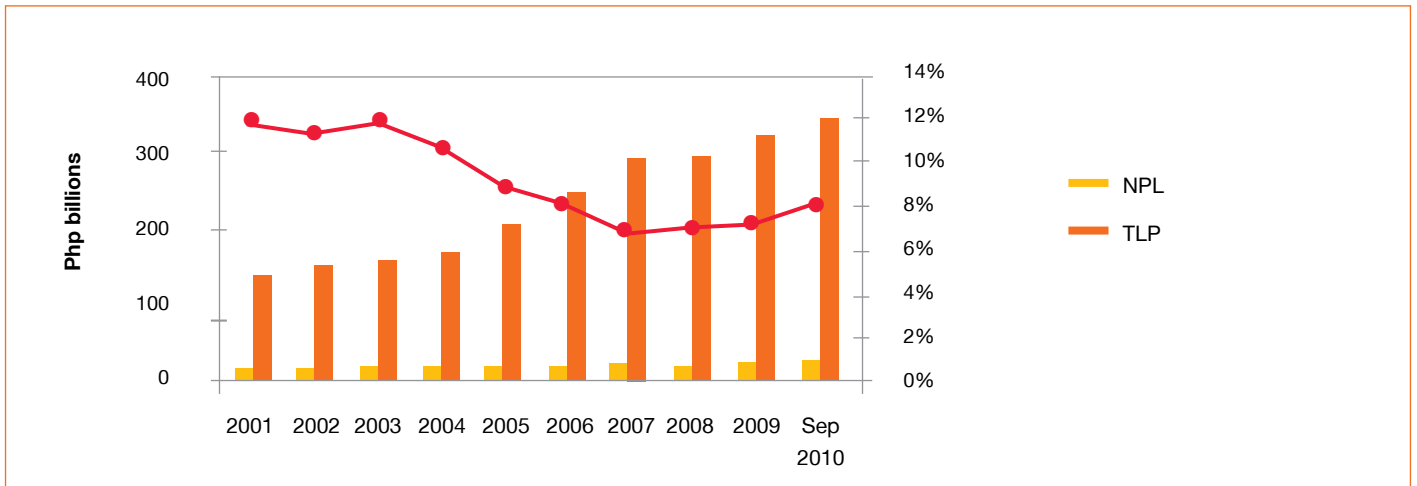
However thrift banks are the exception to the trend, with NPL ratios rising to 8.2% and rural and cooperative banks having NPL ratios consistently around the 10% level for the past four years.

Graph 11: Rural and cooperative banks – Total loan portfolio vs NPL ratio



Source: Bangko Sentral ng Philipinas statistics

Graph 12: Thrift banks – Total loan portfolio vs NPL ratio



Source: Source: Bangko Sentral ng Pilipinas statistics

Furthermore from March 2010 to September 2010, NPL ratios for credit card receivables improved from 7.99% to 6.71% while NPL ratios for auto loans improved from 8.24% to 7.33%.

Looking forward we do not expect to see significant NPL sales in the near term in the Philippines. However, certain sectors present challenges for the local banks such as loans to commercial real estate will need to be monitored. NPL ratios for commercial real estate loans increased from 8.58% to 11.21% during the six months ending September 2010. As a percentage of the total loan portfolio of commercial banks, non-performing real estate loans comprise only 0.67%. The electronics sector was greatly affected by the global financial crisis in 2009. The sector bounced back in 2010 with export growth of more than 35%. Further recovery is expected in 2011, though uncertainty exists for the second half of the year due to disruption of its supply chain as a result from the earthquake and tsunami in Japan.

The central bank, Bangko Sentral ng Pilipinas (BSP), raised interest rates in March 2011, the first time since the middle of 2009. The BSP raised the overnight borrowing rate by 25 basis points to 4.25. The lending rate was raised to 6.25%.

The BSP has issued a directive for local banks to adopt a minimum criterion for capital that are non-equity in nature as is set out in Basel 3. The other components of the standard such as capital buffers, specified leverage ratios and liquidity ratios are not scheduled to be implemented in the near future.

China: An unhappy hunting ground

The China NPL market continues to be extremely quiet, with few if any transactions by the four government-owned AMCs to foreign investors over the last two years. As a result, the only investors that remain in the market appear to be those that are servicing the rumps of portfolios acquired three to four years ago. The China NPL market has long been fickle, but never in the past ten years have we seen such pessimism from investors on market opportunities.

While we certainly hope things will turn around, we are not confident we will see any meaningful sales activity anytime soon. For starters, as the AMCs have stopped disclosing their inventory of NPLs, it is not clear what the AMCs have to sell. And whether they have acquired any new portfolios in the near term is unclear.

Are China's NPLs decreasing?

When we look at the NPLs of China's Big-5 banks over the past six years (see table below), we see a dramatic improvement in their NPL levels. Much of this improvement can rightly be attributed to the cumulative impact of improvements in credit risk management policies at the country's banks however much of it also has to do with the significant increase in overall lending over the past few years. Total assets of the banking institutions according to the China Banking Regulatory Commission ("CBRC") have increased over by 50% from the end of 2007 to 2009. Therefore on their face, the figures in the table below seem very encouraging and have given investors confidence in the China banking industry. Indeed Chinese banks continue to report record earnings.

Table 11: NPLs of China's Big-5 banks *

Year	Amount of NPL (Rmb billion)	NPL ratio (%)
2005	1,072	10.49%
2006	1,053	9.22%
2007	1,115	8.05%
2008	421	2.81%
2009	363	1.80%
2010	308	1.31%

Source: CBRC website

* China's Big-5 Banks include Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank and Bank of Communications.

However whilst the relative percentage of NPLs have gone down quite significantly over the past three years gross loans have also increased significantly. Following the global financial crisis, Beijing initiated a credit stimulus program that saw banks extend Rmb9.6 trillion (US\$1.4 trillion) in new loans in 2009—more than twice the total lending for 2008—and another Rmb7.96 trillion (US\$1.1 trillion) in 2010. We believe it is reasonable to expect that following this level of new lending over such a short period of time, that an increase in NPLs over the coming years is likely as credit underwriting standards naturally get relaxed and companies that ordinarily might not qualify for loans manage to obtain them. As a result, we would expect to see the NPLs to flow through the system in the coming years. However as to what level of NPLs it is difficult to estimate.

As Beijing tries to scale back credit to reign in inflation, a new set of questions are emerging: How much of this new lending will go bad, and where are the troubled sectors? History would suggest that following massive upticks in lending, a greater-than-normal level of NPLs will follow. This is because during lending sprees credit underwriting standards naturally get relaxed and companies that ordinarily might not qualify for loans manage to obtain them. We cannot say how much of the stimulus lending will go, or already has gone bad.

One probable source of NPLs are loans to government related sponsors of the public works projects, many of which became more active to take advantage of government measures to stimulate the economy in 2008–2009. Under Chinese regulations, local governments and municipalities can't borrow directly from banks or otherwise issue bonds to fund their infrastructure and public works projects (or the real estate speculation that some have conducted on the side). They can however set up investment vehicles called Urban Development Investment Corporations (UDICs) to raise funds on their behalf. While most of the loans to UDICs are secured by property, others are unsecured and/or backed by guarantees issued by the municipal governments behind the UDICs. As many of these projects such as toll roads, subways and commercial properties are not yet cash flow generative it is unclear when and how the underlying loans will be repaid.

The Chinese authorities realise UDICs are potential sources of NPLs and in late 2009 the Ministry of Finance instructed municipal governments to stop providing guarantees for bank debt and announced plans to nullify all guarantees already provided. In addition, the CBRC has ordered banks to reassess all loans to UDICs and to cease additional funding if adequate security is not provided.

Does China have a looming NPL problem? The CBRC is rightly worried that the UDICs could pose a problem, but at this point they appear to be accepting the banks' reported figures. Fitch Ratings takes a more pessimistic view, seeing "a high likelihood of significant deterioration in the asset quality in the Chinese banking system in the next three years." In an April 2011 report they estimate NPLs at Chinese banks at closer to 6%, largely due to significant lending to UDICs.

Looking ahead

Our view is that the CBRC's iron grip on China's banks will help to keep NPLs in check, and even a doubling of NPLs to around 3% can be adequately managed. So where does this leave NPL investors? Pretty much where they are today, sitting around with few opportunities to chase. The banks may in due course be required by the CBRC to segregate the NPLs of the UDICs, but even if so, due to their political significance, these are unlikely to be sold to foreign investors. Of course the UDICs won't be the only borrowers producing NPLs following the great stimulus-prompted lending spree of 2009–2010, and the banks may well begin reporting non-UDIC related NPLs—particularly real estate related NPLs—in greater numbers. While this may cause more loans to be transferred to the AMC's, based on their actions over the past few years we suspect they won't be offering these 'fresh' NPLs up to the foreign investor community; rather, they will be kept with the local AMCs.

Pakistan: An untouched NPL market, the new frontier?

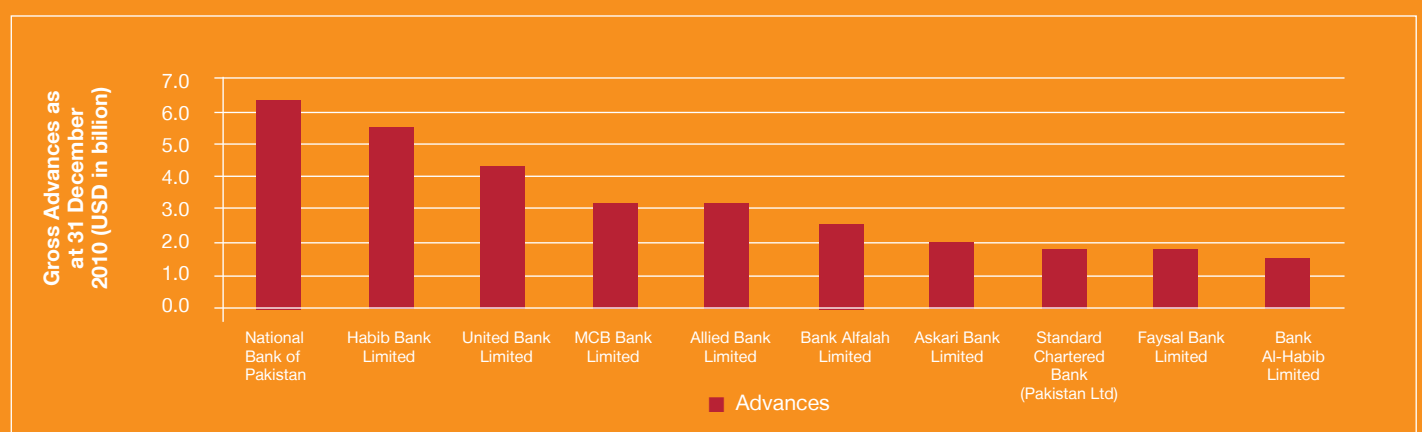
As part of this edition of Portfolio Advisory Group Asia, we provide an insight into Pakistan. This is an undeveloped market from an NPL perspective and we believe may present buyers with opportunities in the near future. Of course, the market presents plenty of difficulties, however both the size of the country and the size of the potential NPL opportunity means we believe many buyers may need to consider the investment hypothesis.

The aim of the following overview is to provide a brief snapshot of the Pakistan market both from a demographic and financial perspective to give potential investors an insight into the market, the regulatory environment and the size of the opportunity from an NPL perspective.

Pakistan has a population of over 166 million which is over 96% Muslim. The population has been estimated to grow by approximately 2% per year since the last census in 1998. Gross domestic product (GDP) growth rate for FY2009/2010 was approximately 4.1% and based on 2008/2009 GDP statistics, approximately 21% of the GDP is agricultural based, 24% industrial and 55% service based (of which 58% is transport and wholesale and retail related). In terms of employment, approximately 45% of the population are employed in agriculture, 13% manufacturing, 15% commerce and 14% services (based on 2007/2008 statistics). The stated unemployment rate is 5.5% and the current inflation rate is in the low teens. The major export of Pakistan is textiles and textile related products. *

In terms of the banking sector, there are over 30 banks in Pakistan, however the top five local banks have approximately 50% of the market share (top ten banks have approximately 74%). Foreign banks have only 4% of the market with the largest being Standard Chartered Bank (Pakistan) Limited.

Graph 13: Top 10 banks by gross advances

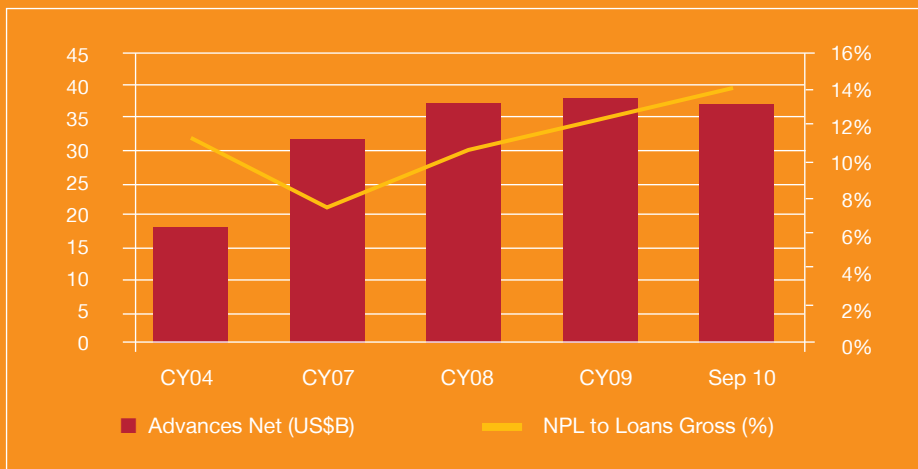


Source: Financial Statements of Banks

* Data sourced from Pakistan Statistical Yearbook 2010.

Over the past six years total assets at banks have increased by 118% with net lending increasing from US\$18.5 billion at the end of 2004 to US\$37.2 billion in September 2010. As highlighted in the following table whilst loan growth has slowed over the past couple of years, NPLs have steadily been increasing to a high of 14% in September 2010. This puts total gross NPLs at approximately US\$5.8 billion as of September 2010.

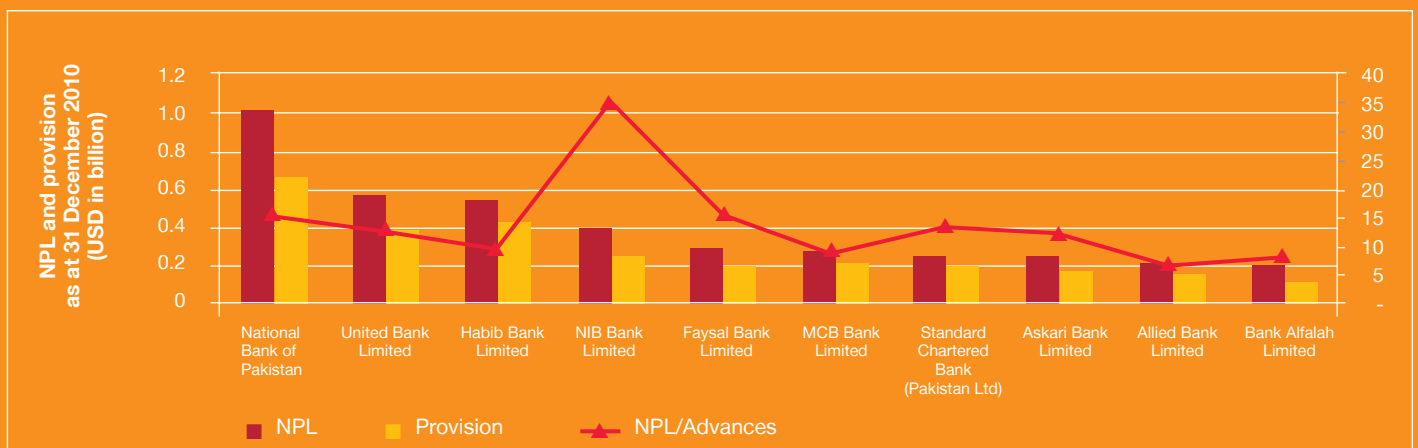
Graph 14: Total advances and NPLs



Source: Quarterly Performance Review of the Banking Sector September 2010, SBP

The following table provides a breakdown by the top ten banks in Pakistan by total value of NPLs. Most of the large banks have NPL's in the range of 10% to 15% with the one notable exception being NIB bank that has NPLs running at just over 35%.

Graph 15: Top 10 banks by NPL



Source: Financial Statements of Banks

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