

CWT Limited: Credit Update

Wednesday, 11 October 2017

In The Bag

- HNA Group is buying CWT and there is no change of control on CWT bonds.
- CWT will become a subsidiary of HNA Group's Hong Kong-listed arm and likely be delisted from the Singapore Stock Exchange.
- HNA Group can influence the strategic direction of CWT, including further expansions and acquisitions.
- CWT senior management to stay for at least three years and we expect day-to-day operations to be kept mostly intact.
- CWT bondholders are structurally superior versus debtholders at HNA Group with regards to CWT's assets and business.
- CWT's standalone credit risk is manageable in our view. However, we are lowering CWT's issuer profile to **Negative** from Neutral, on the back of lingering uncertainties that financing concerns and rising funding cost at HNA Group may entangle the credit profile of acquired companies (including CWT).
- **Recommendation:** Since our Underweight call on the CWT bonds in June 2017, the CWTSP curve has widened 90-100bps. On 4 October 2017, we had lifted both the CWTSP'19s and CWT'20s to Neutral. For bond investors who are comfortable with taking HNA Group risk, CWT's current entry point is attractive. The CWT'19s which matures in 1.5 years is trading at a spread of 329bps while the CWT'20s are trading at 387bps. Adjusted for maturity, the CWT' 19s and CWT' 20s provide a good pick-up against AVOL '22s and GATSW '22s. Both these bonds are issued by companies acquired by HNA Group and rated by credit rating agencies at the B+ to BB level.

- **Background:** On 9 April 2017, HNA Belt and Road Investments (Singapore) Pte Ltd (a wholly-owned subsidiary of HNA Holding Group Co. Limited) ("HNA HK Listco") made a pre-conditional offer for CWT. The pre-conditions have been satisfied and a formal offer launched on 7 September 2017. The offer became unconditional in all respects on 22 September 2017 and the offer period was extended to 2 November 2017. As at 10 October 2017, the Offeror and parties acting in concert owns, control or has agreed to acquire ~87.75% of CWT. HNA Group expects CWT to benefit from China's Belt and Road Initiative as rising infrastructure investments across Europe, Central Asia, South Asia, the Middle East and Africa is likely to drive future demand for commodities and logistics services.

CWT operates in four key segments, namely Logistics Services, Financial Services, Commodity Marketing, and Engineering Services. Prior to the offer, CWT was controlled by C&P Holdings Pte Ltd ("C&P"). C&P is majority owned by the Loi, Liao and Lim families. As part of the transaction, C&P would pay a one-time bonus to Mr. Loi Pok Yen (current CWT Group CEO and Director of C&P) as recognition for his efforts on the strategic review and subsequent sale of C&P shares in CWT. To ensure business continuity, the Offeror would retain the senior management team of key business units. Mr. Loi and CWT's Group CFO is agreeable to a three year employment term under the new owner. Other senior management personnel identified would also be retained for three years.

Figure 1: CWT SGD Bonds

Issue	Maturity / First Call Date	Outstanding Amount (SGDm)	Ask Price	Ask YTW (%)	I-Spread	Bond Rating
CWT 3.9% '19	18 April 2019	100	99.075	4.54	329	NR/NR/NR
CWT 4.8% '20	18 March 2020	100	98.89	5.29	387	NR/NR/NR

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Note: (1) Indicative prices as at 10 October 2017

Figure 2: Timeline of key events

Key Event	Timeline
HNA HK shareholders approve deal	7 September 2017
Formal offer announced	7 September 2017
Offer declared unconditional in all respects	22 September 2017
IFA letter to independent directors issued	2 October 2017
Closing date	2 November 2017 (as of report date)
Final settlement date	Within seven business days after the closing date
Delisting	Assuming all shareholders tender their shares, a delisting process can occur within four weeks of final settlement date

What does the takeover mean to CWT bondholders

Change in major shareholders may drive bond price volatility on the downside: There is no Change of Control put nor an Issuer's right to call the CWT bonds. HNA HK Listco (the new indirect parent company of CWT) is 57.1% owned by Hong Kong HNA Holding Group Co. Limited and 9.73% owned by HNA Group (International) Company Limited. These two entities are in turn indirectly owned by HNA Group Co., Ltd ("HNA Group"). The remaining shares of HNA HK Listco are held by public shareholders.

Since 2Q2017, HNA Group has been in the limelight for a multitude of reasons, chiefly related to concerns over the group's opaque organizational structure, uncertainty surrounding identity of ultimate owners, sustainability of leverage profile and regulatory scrutiny over its acquisitions. Additionally, the financing ability of the HNA Group was also thrown into question as certain lenders and investment banks had reportedly stopped working with the group. What we do know for certain is that the Offeror is being advised by two major financial institutions on the CWT deal and one of them has provided confirmation that the Offeror has sufficient financial resources to complete the deal.

Unlike certain issuers which may benefit from ownership uplifts (eg: state-supported banks, infrastructure and defence providers), the ownership structure of CWT has not historically weighed on its bond prices. CWT is moving away from being owned by "neutral" owners. The negative sentiment surrounding HNA Group is likely to weigh on CWT bond prices going forward, especially on the downside. We had observed bond prices of HNA Group's acquired subsidiaries also reacting when negative headlines emerge. We use Avolon Holdings Limited ("AVOL") as an illustration. AVOL, an aircraft leasing company, was acquired by HNA Group in September 2015 and in January 2017, the USD-denominated AVOL 5.25%'22 was issued. Yields on this bond and the similarly-USD denominated SANYPH 6.0%'19s (issued by HNA Group (International) Company Limited had a +10% correlation from issuance date to 3 October 2017. Correlation though, was a high +80% in the period from June 2017 to end-July 2017 when noise surrounding HNA Group rang the loudest. With headlines reduced in August and September 2017, the correlation between the AVOL and SANYPH bonds has subsided.

CWT becomes subsidiary of HNA Group's Hong Kong listed arm and likely to delist: Regardless of whether or not more shareholders tender their shares, CWT is on track to become a subsidiary of the HNA Group post-settlement. The deal is unconditional and 87.75% of shares have been tendered. On 2 October 2017, the Independent Financial Advisers to the Independent Directors of CWT's board ("IFA") opined that the offer price to shareholders is fair and reasonable and the independent directors are recommending shareholders to accept the offer. There is a very high likelihood that HNA Group can gather more shares over the next few weeks, allowing it to delist CWT from the Singapore Stock Exchange ("SGX") easily. Assuming a delisting does happen; public disclosures by CWT would be lower

(though still available via its Hong Kong listed parent). Hong Kong listed companies are only required to disclose semi-annual financials versus SGX's quarterly financials. Additionally, as a private subsidiary, CWT would no longer publish standalone financials. This is not an immediate concern given CWT's status as the largest operating business of HNA HK Listco. Nonetheless, this can change if new businesses/assets are injected into HNA HK Listco.

Figure 3: Headline financials

1H2017 in SGD'mn	HNA HK Listco	CWT
Revenue	23	5,192
Profit/(loss) before tax	(3)	97
Total assets	1,080	3,780
Gross debt	303	1,053
Total equity	677	926

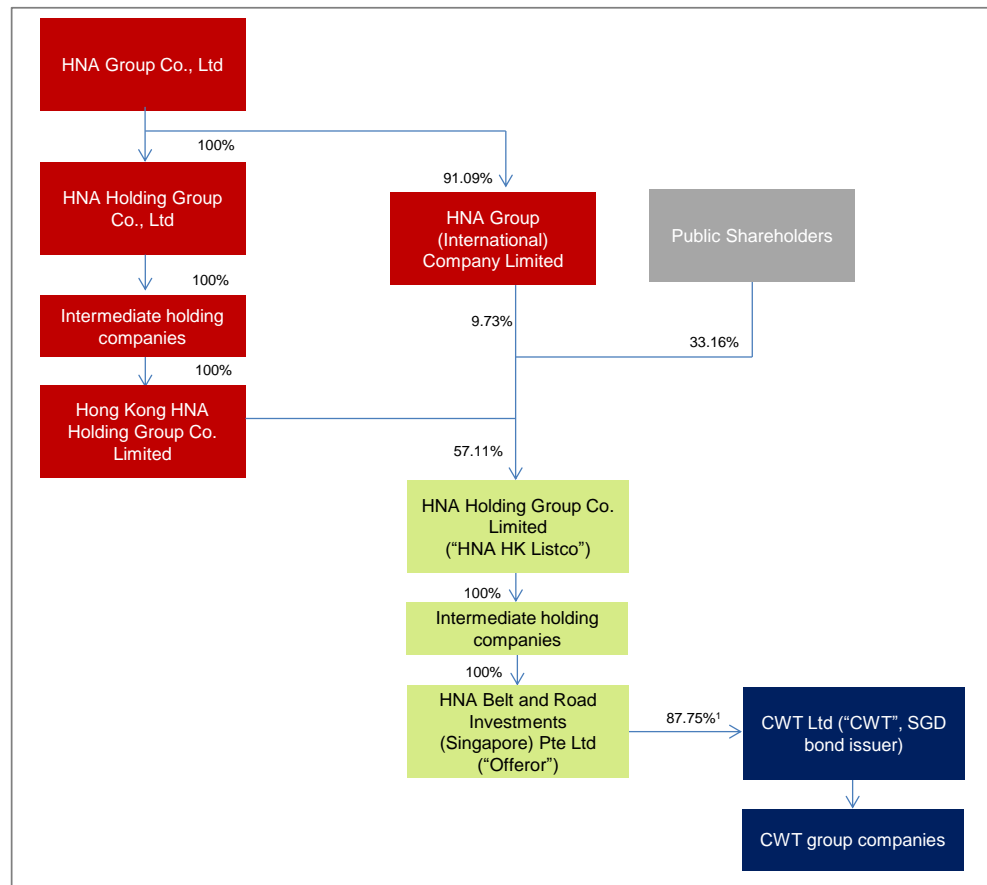
Note: Assume exchange rate of SGD1.00: HKD5.748

Source: HNA HK Listco and CWT financials as at 30 June 2017

Advances to related parties possible: CWT's bond documentation does not block CWT and its subsidiaries to advance monies to related parties. These would include CWT's new relatives within the HNA Group, if it opts to do so. While advances to related parties are booked as an asset of CWT, this could prove problematic in the event new owners prioritize CWT's ability to borrow more (eg: to be on-lent to HNA Group companies) versus maintaining CWT's standalone financial standing. Swissport is an airport services operator based in Switzerland, acquired by HNA Group in February 2016. Swissport lent USD100mn to a related party on 28 June 2017, repaid on 7 July 2017. On 24 September 2017, the Financial Times reported that a separate EUR400mn (~USD472mn) 90-day loan to a related party was approved by the board of Swissport. As at 31 December 2016, Swissport's loans to related parties were minimal at EUR2.1mn (~USD2.5mn). The new related party loans in 2017 are likely beyond routine business operations.

CWT bondholders structurally superior to HNA Group's debtholders with regards to CWT's assets and business: HNA Group is buying CWT as a whole and there is no intention for major changes to CWT's existing business as yet. HNA Group's corporate structure is more opaque versus CWT's existing structure. This is unsurprising, given the privately-held nature of HNA Group and the rapid expansion since 2H2015 which led to a high number of entities being folded into the group. Despite the higher opacity, CWT bondholders would continue to sit nearer the operating businesses and assets of CWT versus existing debtholders of HNA HK Listco and its parent companies. The takeover announcement indicates that the Offeror has entered into arrangements where all its present and future CWT shares have been pledged for financing. HNA Group had similarly taken loans against shares of acquired companies historically. Share pledges are frequently used by major shareholders to raise funds and are in itself not unique to HNA Group. While the use of share pledges can cause the credit profile of holding companies to deteriorate, all things being equal, this arrangement is credit neutral to CWT bondholders. In the off-chance where the new parent is unable to fulfill its financing obligations, CWT's bondholders would be facing lenders and/or financial investors who have taken CWT shares as collateral. We take comfort that whoever is holding CWT shares as collateral is economically incentivized to see CWT remain solvent.

Figure 4: Simplified Corporate Structure



Note: (1) Offeror has entered into financing arrangements where security interests over all its present and future shares in CWT has been created in favour of Madison Pacific Trust Limited (as security agent)
Source: Offer announcement, OCBC Credit Research

Negative pledge helps: Subject to certain carve-outs and barring a ballooning of interparty related transactions within the CWT group (including future entities), CWT's Negative Pledge clause offers some protection on an on-going basis for CWT's bondholders. The Negative Pledge restricts CWT and its principal subsidiaries from creating any security over their respective assets and properties. As at 30 June 2017, secured debt was 23% of CWT's total tangible asset. The remaining tangible asset amounts to SGD2.8bn, providing a 13.7x coverage to total unsecured debt (inclusive of the two SGD bonds outstanding).

Financial covenants cap leverage that can be raised at CWT: We take comfort that financial covenants on CWT's bond documentation would continue to provide bondholders with protection against attempts by new shareholders to over-lever CWT. Specifically, CWT has covenanted that it will at all times ensure that (A) Consolidated Tangible Net Worth shall be at least SGD300mn (B) Consolidated Net Debt to Consolidated Tangible Net Worth shall not exceed 2.0x and (C) EBITDA-to-Net Interest Expense shall be at least 2.0x. The specific definition of capitalized terms is captured in the Trust Deed (unavailable publicly). Based on our estimations, as at 30 June 2017, CWT's consolidated tangible net worth was SGD811mn while net debt-to-consolidated net worth was 1.0x. CWT reported net finance income of SGD11.8mn in 1H2017.

...but contingent liabilities may expand: The financial covenants may not cover corporate guarantees, a contingent liability item that is off-balance sheet. As such, while headline debt numbers may be under control, CWT may take on higher levels of corporate guarantees under new shareholders. For example, providing guarantees to other entities within the broader HNA Group or for future acquisitions. Should CWT fail to pay on guarantees for indebtedness, this constitutes an Event of Default.

- **Recommendation:** CWT's standalone credit risk is still manageable in our view. However, we are lowering CWT's issuer profile to **Negative** from Neutral, on the back of lingering uncertainties that financing concerns and rising funding cost at

HNA Group may entangle the credit profile of acquired companies (including CWT).

We have considered the following:

- A) AVOL '22s are trading at an SGD-implied ask yield of 4.23%, spread of 240bps. This bond is issued by Avolon's subsidiary, Park Aerospace Holdings and guaranteed by Avolon. This bond is rated at BB/Ba3/BB.
- B) GATESW '22s are trading at an SGD-implied ask yield of 4.87%, spread of 314bps. This bond is issued by gategroup Finance Luxembourg SA, guaranteed by parent company gategroup Holding AG, a catering, hospitality and logistics company focused on airlines acquired by HNA Group in December 2016. gategroup Holding AG is rated at B+/B1/NR.
- C) With the exception of CWT, we do not currently cover entities within the HNA Group.

CWT Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2015	FY2016	1H2017
Income Statement (SGD'mn)			
Revenue	9,931.6	9,251.9	5,192.2
EBITDA	199.8	174.7	105.7
EBIT	152.1	129.3	82.9
Gross interest expense	51.0	56.3	25.0
Profit Before Tax	131.7	104.8	96.6
Net profit	108.9	73.6	80.2
Balance Sheet (SGD'mn)			
Cash and bank deposits	310.3	344.3	273.5
Total assets	4,549.8	5,412.5	3,779.9
Gross debt	1,427.4	1,871.4	1,052.5
Net debt	1,117.1	1,527.1	779.0
Shareholders' equity	868.1	904.0	925.7
Total capitalization	2,295.5	2,775.5	1,978.1
Net capitalization	1,985.1	2,431.1	1,704.7
Cash Flow (SGD'mn)			
Funds from operations (FFO)	156.6	119.0	103.0
* CFO	317.3	-62.9	621.2
Capex	259.1	504.2	31.7
Acquisitions	0.0	0.0	0.0
Disposals	28.2	211.1	236.8
Dividend	46.2	40.2	20.3
Free Cash Flow (FCF)	58.2	-567.1	589.4
* FCF adjusted	40.1	-396.2	805.9
Key Ratios			
EBITDA margin (%)	2.0	1.9	2.0
Net margin (%)	1.1	0.8	1.5
Gross debt to EBITDA (x)	7.1	10.7	5.0
Net debt to EBITDA (x)	5.6	8.7	3.7
Gross Debt to Equity (x)	1.64	2.07	1.14
Net Debt to Equity (x)	1.29	1.69	0.84
Gross debt/total capitalisation (%)	62.2	67.4	53.2
Net debt/net capitalisation (%)	56.3	62.8	45.7
Cash/current borrowings (x)	0.4	0.2	0.5
EBITDA/Total Interest (x)	3.9	3.1	4.2

Source: Company, OCBC estimates

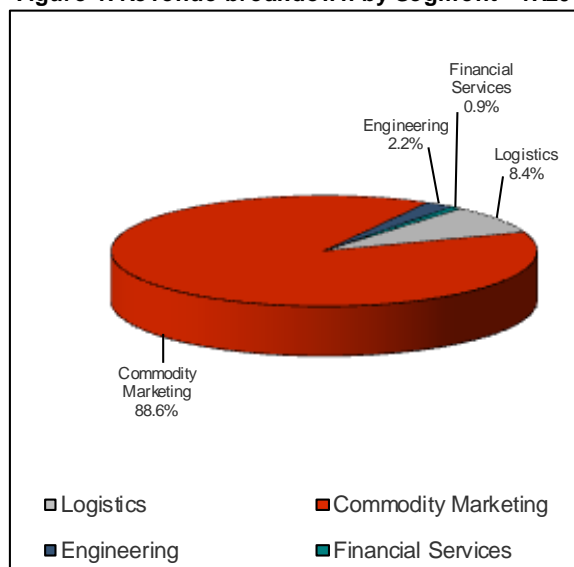
*FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO before deducting interest expense

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 31/06/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	592.5	56.3%
Unsecured	5.1	0.5%
	597.6	56.8%
Amount repayable after a year		
Secured	253.5	24.1%
Unsecured	201.4	19.1%
	454.9	43.2%
Total	1,052.5	100.0%

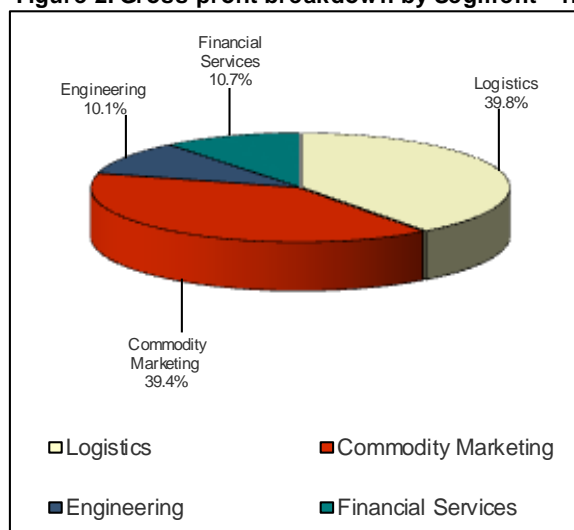
Source: Company

Figure 1: Revenue breakdown by Segment - 1H2017



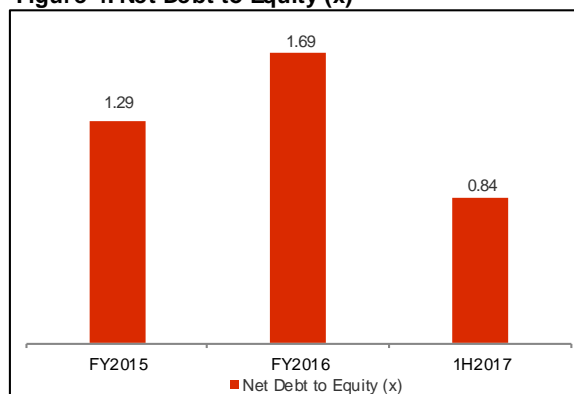
Source: Company | Excludes Inter-segment Eliminations and one-off items

Figure 2: Gross profit breakdown by Segment - 1H2017



Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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