

## CWT Limited: Credit Update

Thursday, 20 April 2017

### Time has not kill this deal

- HNA Group has announced a pre-conditional voluntary general offer to acquire CWT. Follows almost a year-long exclusive negotiation between controlling shareholders of CWT and HNA Group.
- No change of control on the bonds and CWT is likely to delist from SGX post-being acquired.
- Assuming a deal gets done; CWT will be subsumed as an indirect subsidiary of HNA Group via Hong Kong listed-HNA Holding Group Co. Ltd.
- CWT bonds have widened 40-90bps since 4 April 2017 when we downgraded the curve to Underweight. We see this immediate price move as a reaction over the uncertainty surrounding HNA Group's acquisition announcement.
- In our view, the CWT'19s is trading at fair value and see fair value of the CWT'20s at 20-30bps wider.
- We are lifting the curve back to Neutral.
- We are keeping CWT's issuer profile at Neutral, though may adjust this downwards should credit profile of HNA Holding Group Co. Ltd deteriorate.

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- **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") announced a pre-conditional voluntary general offer ("VGO") to acquire all the issued and paid up ordinary shares in CWT. This follows almost a year-long exclusive negotiation between controlling shareholders of CWT (namely C&P Holdings Pte Ltd ("C&P")) and a subsidiary of HNA Group Co., Ltd ("HNA Group") in relation to C&P's shareholding in the company. It was first made known in August 2015 that C&P was considering a strategic review of its business and assets.

CWT, listed on the Singapore Stock Exchange, has a market cap of SGD1.4bn (as at 17 April 2017) and was listed in April 1993. CWT is a provider of integrated logistics and supply chain solutions. The company operates in 4 key segments, namely Logistics Services, Financial Services, Commodity Marketing, and Engineering Services. CWT started as a private arm of the Port of Authority Singapore ("PSA")<sup>1</sup> in 1970 to provide warehousing and container trucking services to support container terminal services. In 2004, C&P acquired control of CWT when it bought out PSA's stake in the company. Privately-held C&P is majority owned by the Loi, Liao and Lim families. It was founded in 1970 by Mr. Loi Kai Meng (father of Mr. Loi Pok Yen, CWT's current CEO) and Mr. Stanley Liao (father of Mr. Liao Chung Lik, a board director).

In a show of support for the deal, the C&P and other shareholders (collectively holding a 65.1%-stake in CWT) have given irrevocable written undertakings to tender their shares upon HNA making the VGO. Our colleagues at OCBC Investment Research are recommending shareholders to accept the offer, once the VGO is made by HNA upon the pre-conditions being met. HNA intends to delist CWT from the SGX once public float falls below 10%.

**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	99.25	4.30	287	NR/NR/NR
CWT 4.8% '20	18 March 2020	100	100.00	4.80	320	NR/NR/NR

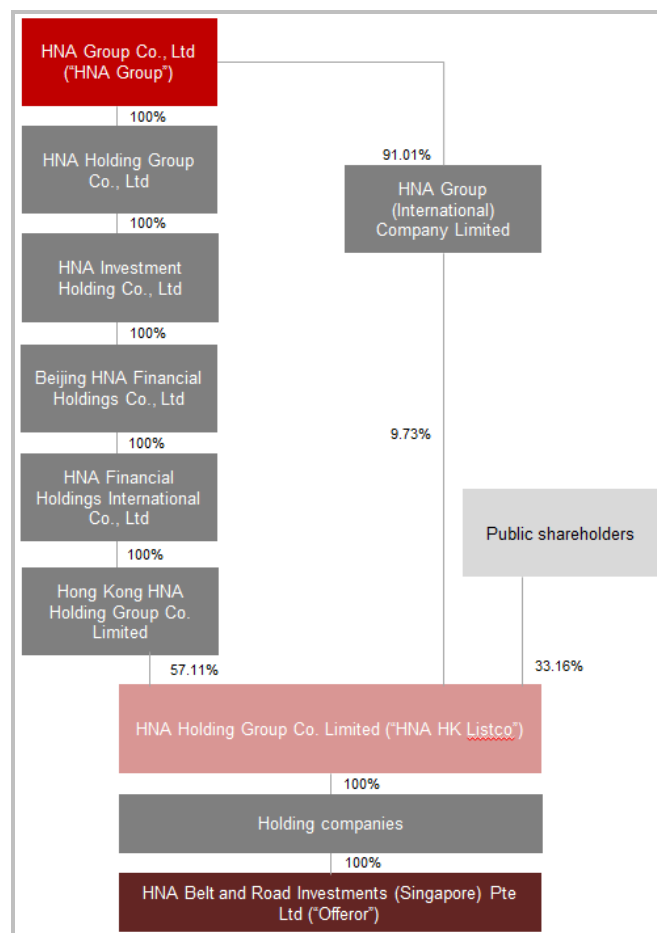
<sup>1</sup> Corporatised and renamed as PSA Corporation Limited in 1997

Note: (1) Indicative prices as at 19 April 2017

## Relevant Key Terms in the Pre-conditional Voluntary Offer

**Acquirer:** The Offeror in the VGO is HNA Belt and Road Investments (Singapore) Pte Ltd, a wholly-owned entity of HNA HK Listco. HNA HK Listco is listed on the Hong Kong Stock Exchange with a market cap of HKD3.1bn (~SGD564mn) as at 19 April 2017. HNA HK Listco was at one time Shougang Concord Technology Holdings Limited (a joint venture between Shougang Concord International Enterprises Co. Ltd. and Cheung Kong (Holdings) Limited), which HNA Group gained control of via a backdoor listing in 2013. Currently, HNA HK Listco's main businesses include the operation of golf clubs, provision of hotel and leisure services and the leasing of office properties. In 2016, HNA HK Listco acquired 8 golf courses in the USA and an office building in Canary Wharf, London. In FY2016, HNA HK Listco was still loss-making at HKD59.4mn though this has narrowed significantly from a HKD235.6mn loss in FY2015. Based in Haikou, Hainan (China), HNA Group is a privately held conglomerate with sprawling business interest spanning across airlines, airline services, leasing, tourism, hotels, logistics, industrials, financial services and property. Fortune magazine puts HNA Group's total assets in FY2015 at ~USD95.3bn though to date, this should have exceeded USD100bn post a series of acquisitions. HNA Group has been highly acquisitive in the past 18 months. Recent completed acquisitions by the group include Ingram Micro Inc for USD6bn and a 25%-stake in Hilton Worldwide Holdings Inc. The company was established in 1993 as a joint venture between the Hainan provincial government and a group of private individuals. Mr. Chen Feng is the Chairman of HNA Group's board of directors.

## HNA Group Basic Corporate Structure



Source: Pre-conditional VGO announcement

**Pre-conditions:** A formal offer will not be made unless and until the pre-conditions are fulfilled or waived by the Offeror on or before 9 September 2017 (or other dates as the Offeror and the CWT may determine in consultation with the Securities Industry Council). In our view, the conditions are fairly standard in light of a transaction of this nature.

- (A) **Anti-trust:** In the event that the consummation of the VGO trigger mandatory merger control filing requirement, filings will need to be made and accepted by relevant regulators in China, European Union, Japan, South Africa, Turkey and Taiwan respectively. The deal will only go ahead if the relevant regulators has issued a decision confirming that (1) They will not conduct further review of the VGO or (2) Allowing the consummation of the VGO without conditions or (3) Allowing the consummation of the VGO with conditions reasonably satisfactory to the Offeror or (4) All applicable waiting periods under the regulations in respect of the review has expired.
- (B) **No Material Adverse Effect:** Any event that results or is likely to result in a reduction by more than 15% in the consolidated net asset value of CWT as at 31 December 2016 of SGD874.2mn<sup>2</sup> constitutes a Material Adverse Effect. Changes arising from currency translation, changes/events affecting the economy in general, shipping industry and industries CWT operate in, the foreign exchange market, legal or regulatory changes affecting CWT's business are not considered as Material Adverse Effect. The clause also carves out the change arising from payment of the FY2016 proposed final dividend as announced on 24 February 2017 (ie: shareholders entitled to retain this dividend). The offer price of SGD2.33 will be reduced if there are further dividend or return of capital announced.
- (C) **Shareholders of HNA HK Listco approving the deal:** The acquisition of CWT by HNA HK Listco constitutes a Very Substantial Acquisition<sup>3</sup> and hence requiring shareholders' approval.

**Financing of the deal:** HNA HK Listco has stated that it intends to fund the acquisition of CWT via a combination of (1) Its own internal funding sources (31 December 2016: HKD1.1bn in cash balances) (2) External financing and (3) An interest-free unsecured fund of not more than SGD1.4bn to be granted by HNA Group's associates (as defined in the Hong Kong Listing Rules) to HNA HK Listco. In practice, we think this would mean an interest-free loan from entities which HNA Group has control over. Hong Kong HNA Holding Group Co. Limited and HNA Group (International) Company Limited, the two immediate shareholders (collectively holding 66.8%-stake in HNA HK Listco) have given undertakings to HNA HK Listco that they have sufficient financial resources and shall provide the required funds to HNA HK Listco or the Offeror to satisfy the offer. In December 2016, based on a voluntary disclosure, Hong Kong HNA Holding Group Co. Limited pledged a 56.1%-stake (out of its 57.1%-stake) in HNA HK Listco in favour of certain lenders as security for certain banking facilities or guarantees. However, the purpose and quantum of the facilities involved were undisclosed and we have no further information whether the shares are still pledged. The media has reported that two non-Chinese banks are involved in providing acquisition debt to HNA Group for the CWT deal. As it stands, we have no evidence to suggest that HNA Group would face difficulties in raising financing for the transaction.

**Key management stay for 3 years:** The Offeror intends for the senior management team of CWT's key business units to remain in CWT's employment. This move is in tandem with HNA Group's strategy of retaining management in acquired businesses. Mr. Loi Pok Yen (the current CWT CEO and one of shareholders who had given undertakings to tender shares held) and Mrs. Lynda Goh (the Deputy CEO and Group CFO) will agree to a fixed employment term of 3 years. In addition to monthly salary and variable annual bonus (linked to EBITDA of CWT), upon completion of 3 years' service, Mr. Loi and Mrs. Goh will each be paid an additional retention bonus equal to the average bonus of the 3 year period. CWT's longest tenured bonds, the CWTSP'20s mature in March 2020, before the employment terms are up. Other senior management personnel have been identified by CWT and the Offeror and offered retention bonuses.

<sup>2</sup> Equivalent to total equity less minority interest

<sup>3</sup> Applicable percentage ratios as defined under the Hong Kong Listing Rules (Rule 14.07) exceed 100%. The listing committee has determined that this acquisition is not subject to reverse takeover rules

**Delisting from SGX:** It is the Offeror's intention to delist CWT from the SGX if public float falls below 10%. As the Offeror is a wholly-owned subsidiary of HNA HK Listco, effectively, CWT would be subsumed as an indirect wholly-owned subsidiary of HNA HK Listco (and an indirect subsidiary of HNA Group). Assuming the deal had been completed as of the date of this report, CWT will be the largest operating business of HNA HK Listco by profits and total assets. Nevertheless, as HNA Group has been highly acquisitive, HNA HK Listco's business profile may change by the time the CWT deal is completed.

We take comfort that there is a high possibility of key management team being held intact and CWT continues to be part of a listed entity (eg: availability of public disclosures). There have been no indications of a company break-up as yet where the bonds will be supported by a smaller asset base.

### **Relevant Key Terms in CWT Bonds**

**CWT bonds not subject to Change of Control ("CoC") protections:** There is no CoC put nor an Issuer's right to call the CWT bonds in the event of a CoC. Bondholders will need to contend with HNA HK Listco (and implicitly, HNA Group) as CWT's new shareholder, assuming the VGO goes through. Since OCBC Credit Research's initiation of coverage on CWT in 2015, our issuer profile on CWT had been continuously premised on the underlying strength of CWT's business and does not factor in parental support. HNA Group's credit profile is likely to weigh on CWT bond prices in the near term before reaching a new equilibrium. Prior to the offer announcement, bonds issued by HNA Group's offshore bond issuing entity (ie: HNA Group (International) Company Limited) have historically traded wider than CWT's. We think this is in part due to HNA Group having a more complex and evolving corporate structure. The company is also privately-held, with lower public disclosure requirements and a more levered credit profile vis-à-vis CWT. It is however, significantly larger by assets, more diversified and possess very strong access to the bank debt market.

**Disposal of Material Subsidiaries as an Event of Default provides protection from asset-stripping:** This clause protects existing bondholders from the bonds being supported by a smaller asset base with lower cash flow generation capacity. The cessation/disposal of Material Subsidiaries (defined as subsidiaries whose (1) Net profit is at least 15% of CWT's consolidated net profit or (2) Whose net assets are at least 15% of CWT's consolidated net assets) would constitute an Event of Default. In practice, what this means is that bondholders are likely to get to vote on whether or not they are agreeable to cessation/disposal of key assets. While the separate subsidiary-level financials are not publicly available, we estimate that each of CWT's business segments are individually material. Currently, there is no indication that a "break-up" of the CWT's businesses is being contemplated by HNA Group. Our base case assumes that CWT in its entirety gets absorbed into the HNA Group.

**Financial covenant protects CWT bondholders: As long as the CWT bonds remains outstanding, the company 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
- (C) EBITDA-to-Net interest expense shall be at least 2.0x

These financial covenants are not affected by a change in ownership of CWT. These limit the amount of leverage that can be taken at the CWT level and offer protection against attempts by new shareholders to lever up CWT.

**Negative pledge offers some protection on a going-concern basis:** CWT has also covenanted that it will not and will procure that its principal subsidiaries will not create any security over their respective assets and properties unless under normal course of business or approved by bondholders. This Negative Pledge though carves out (1) Up to 10% of Consolidated Tangible Net Worth for loan facilities extended by banks and other financial institutions and (2) Any security created in

connection with any inter-company loan extended by any member of the CWT to another member of the CWT group, provided that the security is required by law. Should assets be used as security on inter-company loans, existing SGD bondholders will get lower recovery in a liquidation scenario. As at 31 December 2016, secured debt made up 84% of total debt and is 29% of total assets.

**Contingent liabilities may expand:** While financial covenants protect bondholders against overleveraging of on-balance sheet debt, the covenants may not cover corporate guarantees (a contingent liability item). This is pertinent in the event new shareholders use CWT group (CWT and subsidiaries) to provide cross guarantees to other entities (eg: within the broader HNA Group or for future acquisitions). A failure by CWT or any of its principal subsidiaries to pay (when properly called upon to do so) on guarantees for indebtedness constitutes an Event of Default. This clause carves out aggregate amounts below SGD30mn. In our view, there is a fair chance for CWT to be an acquirer itself in the future with new subsidiaries folded into the CWT group. For example, HNA Group acquired Avolon Holdings Limited (“Avolon”), an aircraft leasing company in September 2015 for USD2.6bn. Subsequently in April 2017, Avolon completed the acquisition of the aircraft leasing business of CIT Group for USD10.4bn. HNA Group intends to expand into logistics as it diversifies from tourism and property.

- **Recommendation:** We are maintaining CWT’s issuer profile at **Neutral**, though may adjust this downwards should credit profile of HNA Holding Group Co. Ltd deteriorate. We think the CWT’19s is trading at fair value and see fair value of the CWT’20s at 20-30bps wider.

**We have considered the following:**

- A) HNA HK Listco’s 9.7%-shareholder, namely HNA Group (International) Co. Ltd is the main offshore issuing entity of the HNA Group. The USD300mn SANYPH 6.0%’19, issued by HNA Group (International) Co. Ltd and guaranteed by the HNA Group is unrated. It is trading at a 357bps spread and an SGD-implied Ask YTW of 4.9%. There are no bonds issued by HNA HK Listco.
- B) In 2015, HNA Group acquired Avolon via its Shenzhen-listed unit, Bohai Financial Investment Holding Co. Ltd (“Bohai”, formerly Bohai Leasing Co., Ltd). Avolon’s USD1.75bn bonds, the AVOL’22s is trading at a spread of 247 bps and SGD-implied Ask YTW of 4.3%. This bond is issued by Avolon’s subsidiary, Park Aerospace Holdings and guaranteed by Avolon. It is rated at BB-/B1/BB.
- C) Narrowing down a valuation range using these two bonds, we think the CWT bonds should trade between a spread of 250bps and 360bps in USD terms. We put fair value towards wider-end given that (1) CWT bonds are unrated and (2) Per S&P, both Bohai and Avolon operate more as “standalone subsidiaries” (while having HNA Group as indirect parent) and both have independent members on their board of directors. There is still uncertainty as to how much operational independence CWT would have.
- D) Adjusting to SGD-equivalent terms, we think the CWT’19s is trading around fair value while the CWT’20s may trade tighter by 20-30bps.
- E) We do not currently cover entities within the HNA Group.

# CWT Ltd

**Table 1: Summary Financials**

Year End 31st Dec	FY2014	FY2015	FY2016
<b>Income Statement (SGD'mn)</b>			
Revenue	14,194.4	9,931.6	9,251.9
EBITDA	203.4	199.8	174.7
EBIT	162.7	152.1	129.3
Gross interest expense	61.2	51.0	56.3
Profit Before Tax	131.6	131.7	104.8
Net profit	112.4	108.9	73.6
<b>Balance Sheet (SGD'mn)</b>			
Cash and bank deposits	342.0	310.3	344.3
Total assets	4,356.6	4,549.8	5,412.5
Gross debt	1,430.6	1,427.4	1,871.4
Net debt	1,088.6	1,117.1	1,527.1
Shareholders' equity	791.5	868.1	904.0
Total capitalization	2,222.1	2,295.5	2,775.5
Net capitalization	1,880.1	1,985.1	2,431.1
<b>Cash Flow (SGD'mn)</b>			
Funds from operations (FFO)	153.0	156.6	119.0
* CFO	237.1	317.3	-63.4
Capex	113.7	259.1	503.9
Acquisitions	20.5	0.0	0.0
Disposals	5.3	28.2	211.1
Dividend	23.4	46.2	40.2
Free Cash Flow (FCF)	123.4	58.2	-567.3
* FCF adjusted	84.8	40.1	-396.4
<b>Key Ratios</b>			
EBITDA margin (%)	1.4	2.0	1.9
Net margin (%)	0.8	1.1	0.8
Gross debt to EBITDA (x)	7.0	7.1	10.7
Net debt to EBITDA (x)	5.4	5.6	8.7
Gross Debt to Equity (x)	1.81	1.64	2.07
Net Debt to Equity (x)	1.38	1.29	1.69
Gross debt/total capitalisation (%)	64.4	62.2	67.4
Net debt/net capitalisation (%)	57.9	56.3	62.8
Cash/current borrowings (x)	0.4	0.4	0.2
EBITDA/Total Interest (x)	3.3	3.9	3.1

Source: Company, OCBC estimates

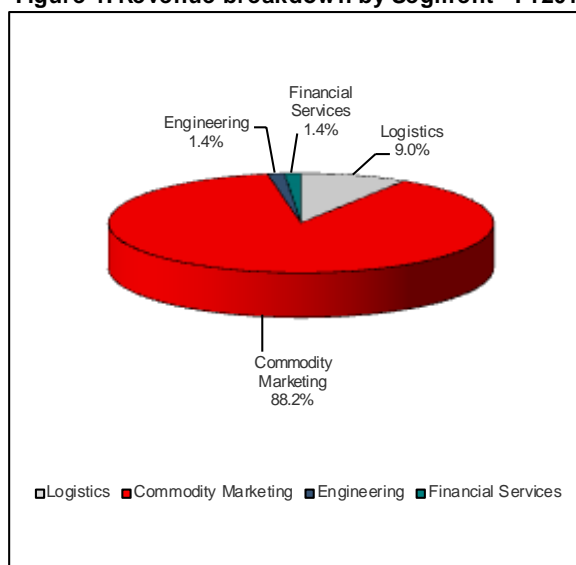
\*FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | \*CFO after deducting interest expense

**Figure 3: Debt Maturity Profile**

Amounts in (SGD'mn)	As at 31/12/2016	% of debt
<b>Amount repayable in one year or less, or on demand</b>		
Secured	1,402.7	75.0%
Unsecured	102.3	5.5%
	<b>1,504.9</b>	<b>80.4%</b>
<b>Amount repayable after a year</b>		
Secured	165.3	8.8%
Unsecured	201.2	10.8%
	<b>366.5</b>	<b>19.6%</b>
<b>Total</b>	<b>1,871.4</b>	<b>100.0%</b>

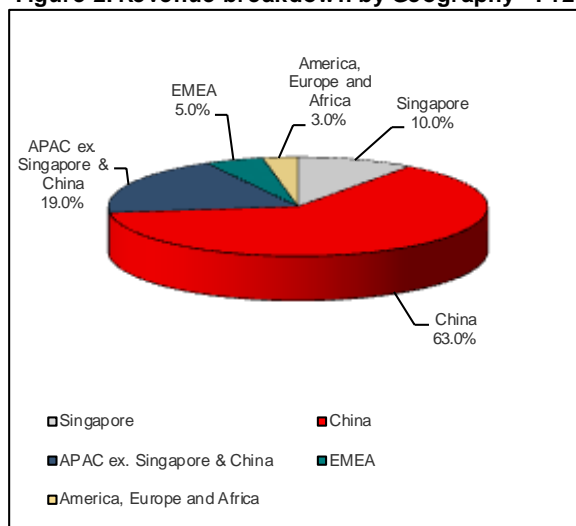
Source: Company

**Figure 1: Revenue breakdown by Segment - FY2016**



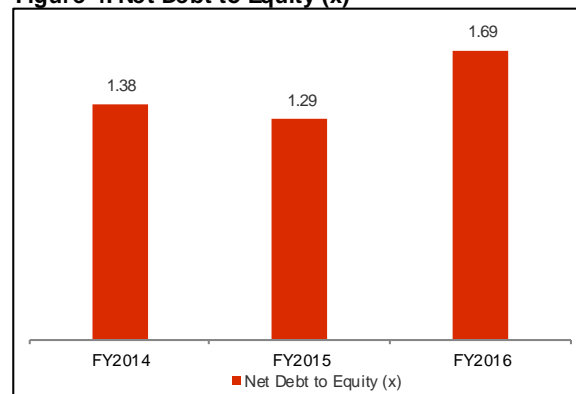
Source: Company

**Figure 2: Revenue breakdown by Geography - FY2016**



Source: Company

**Figure 4: Net Debt to Equity (x)**



Source: Company, OCBC estimates

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