

Credit Update: Chip Eng Seng Corp Ltd (“CES”)

Recommendation

- On 8 October 2018, the founder and his family sold their stake in CES (29.7% of total issued shares) to Celine and Gordon Tang who acquired the shares on both a personal basis and via Senz Holdings.
- Admittedly, the sale has caught us by surprise given the founder and his family's long association with the company and the recent strategic moves by CES to expand beyond construction and property development into the education sector.
- As far as we can publicly tell, the Tangs have no strategic interest in the education industry, though the Tangs are significant players in the Singapore property development, investment and construction sector via their stakes in SGX-listed SingHaiYi Group Ltd, OKH Global Ltd and Cromwell European REIT.
- The sale has triggered a change of control (“CoC”) event for holders of SGD120mn CHIPEN 4.75 '21s and SGD125mn CHIPEN 4.9 '22s. This gives bondholders the option to redeem the bonds at par plus accrued interest within 60 days from the date of notice at the Redemption Date. As per the Notice of Occurrence of a Change of Control dated 12 October 2018 (“CoC Notice”), the Redemption Date is 11 December 2018.

▪ Recommendation 1: Noteholders to exercise Put Option by 5pm 2 Nov 2018

- We see a variety of reasons why exercising the put makes sense. Given the bonds have been trading below par, the redemption will provide bondholders a positive return. Also, it remains uncertain how the change in ownership may impact the strategic direction of the company.
- We also see better value in other property developer counters including PREHSP 3.85 '20s and OHLSP 5 '19s over CHIPEN 4.75 '21s and CHIPEN 4.9 '22s as in our opinion they offer a better risk return considering spread and tenor and a similar, if not better credit profile.

▪ Recommendation 2: Maintain CES at a Negative (6) Issuer Profile

- While CES has enough cash on hand as at 30 June 2018 to fund the redemption of both bonds if fully put, we think liquidity looks tight and expect CES to seek external financing for this purpose.
- Note CES has not indicated how they will fund the bond redemption in the CoC Notice.
- Following the put exercise, we are likely to cease coverage on CES.

Issuer Profile: Negative (6)

Ticker: **CHIPEN**

Background

Listed on the SGX in 1999, Chip Eng Seng Corp Ltd (“CES”) is a Singapore property developer and contractor of condominiums, HDB flats and commercial and industrial properties. CES owns several commercial and industrial investment properties and two hospitality properties, and is looking to expand into the education sector. CES also has presence in Australia, Malaysia and Maldives.

Background

On 5 October 2018, CES announced that Lim Tiam Seng, Lim Tiang Chuan, Lim Tian Back, Lim Sock Joo, Lim Tian Moh, Dawn Lim Sock Kiang and Kwek Lee Keow entered into a sale and purchase agreement for 186,105,000 shares, representing 29.73% of the total issued shares (excluding treasury shares) of CES at the price of SGD1.08 per share (the “Sale”). Volume weighted share price for the three years before the transaction was SGD0.760.

Name of Shareholder	Title	Relationship to Founder	Initial Shareholding	Resultant shareholding
Lim Tiam Seng	Founder		12.41%	0%
Kwek Lee Keow		Spouse		
Lim Tiang Chuan	Executive Deputy Chairman	Brother	7.06%	0%
Lim Tian Back	Project Director	Brother	3.51%	0%
Lim Sock Joo	Executive Director of CEL Development Pte Ltd	Daughter	4.93%	3.33%
Chia Lee Meng Raymond	Executive Chairman & CEO	Son-in-law		
Lim Tian Moh	Project Director	Brother	3.07%	0%
Dawn Lim Sock Kiang	Executive Director	Daughter	2.46%	0.38%
Lim Ling Kwee	Project Director	Son	3.30%	3.30%
Total			36.74%	7.01%

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Post-completion of the sale on 8 October 2018, Celine Tang and Gordon Tang jointly hold 26.98% of the total issued shares of CES. Separately, Celine Tang holds a deemed interest of 2.75% held by Senz Holdings Ltd, a company in which she is a director. Collectively, the 29.7% is a shade under the 30% mandatory general offer threshold in Singapore. As of report date, the share price of CES had declined to SGD0.755 per share, ~11.78% lower versus the one month volume weighted average price to 8 October 2018.

Following the sale, we estimate that the shareholding of Lim Tiam Seng and his immediate family collectively has decreased from ~37% prior to the transaction to ~7% post the transaction. As the shareholding is now below 25%, this has triggered a CoC event per Clause 6(e)(ii) of the Information Memorandum dated 8 May 2017.

With the CoC Notice issued on 12 October 2018, holders of the SGD120mn CHIPEN 4.75 '21s and the SGD125mn CHIPEN 4.9 '22s can put their bonds back to CES at par, including the interest accrued to (but excluding) the date fixed for redemption. Bondholders have until 5:00pm (Singapore time) on 2 November 2018 to exercise the put option with the date fixed for redemption (or the Redemption Date) being 11 December 2018.

Apart from the shareholding changes, Lim Tiang Chuan and Dawn Lim Sock Kiang have resigned from their respective positions at CES while Chia Lee Meng Raymond has been re-designated from Executive Chairman and CEO to Executive Director and Group CEO.

Celine Tang has been appointed as the Non-Independent and Non-Executive Director and Non-Executive Chairman of CES as of 11 October 2018. Celine Tang, who is the spouse of Gordon Tang, is currently Managing Director of SingHaiYi Group. She has served as the Executive Director of Tang Dynasty Pte Ltd since its inception in 1995 and has been a Director of American Pacific International Capital, Inc. since 2001. She is also the Chairman of OKH Global Ltd.

Lock Wai Han was appointed as an Independent Director of CES and member of the Audit Committee. He has been the CEO and Executive Director of OKH Global Ltd since October 2016.

Key Credit Considerations:

- In 3Q2018, CES bought a property at 51 Pirie Street, Adelaide for AUD14.5mn (SGD14.5mn) and invested in two companies in the education industry – White Lodge Education Group (SGD13.3mn) and Yuanda Information Development (USD14.6mn, ~SGD20.17mn). In the same quarter, CES sold two properties in Australia – Tower Melbourne (AUD55mn, ~SGD55mn) and 242 West Coast Highway Scarborough Pty Ltd (AUD24.5mn, ~SGD24.5mn) for a total of SGD79.5mn. These asset sales more than offset the capital expenditures stated above. As such, we estimate CES' cash and short term deposits up till this point to be around SGD353.23mn, slightly more than what is reported as at 30 June 2018.
- We also estimate that the accrued interest CES will pay out to bondholders should all bondholders put their bonds to be ~SGD2.81mn for CHIPEN '21s and ~SGD3.46mn CHIPEN '22s. Including the SGD245mn principal amount and accrued interest, total payable amount for CES assuming 100% redemption is ~SGD251.27mn. While CES has more than sufficient cash to pay down a full redemption by bondholders, the company will continue to need access to external capital to fund its ongoing projects. Moreover, this requirement is elevated given the potential reduction in cash to fund the put on the bonds.
- In 2Q2018, reported net operating cash flow was negative SGD284.3mn due to working capital expenditure on development properties. That said CES generated positive cash flow for the quarter largely due to financing obtained and lesser debt repayments during the period. Consequentially, net debt-to-total equity surged q/q in 2Q2018 to 1.96x (1Q2018: 1.57x, 4Q2017: 1.54x, 3Q2017: 0.86x) leaving CES with reduced debt headroom under their existing financial covenants. CES is subject to financial covenants such as net debt-to-total equity below 2.75x and secured debt-to-total assets not more than 0.7x. Based on 2Q2018 figures, net debt-to-total equity is 1.96x while estimated secured debt-to-total assets is 0.55x.

Key Credit Considerations (cont.):

- Furthermore, we estimate that ~59% of CES' leasehold land and buildings have been mortgaged to secure bank borrowings and ~98% of its investment properties have been mortgaged to secure banking facilities as at 31 December 2017. While CES has the option to liquidate assets for funding, only ~41% of its leasehold land and buildings (~SGD196.3mn) are unencumbered and asset sales (if any) would take time. At this point, we are inclined to think that CES would attempt to access external financing such as bridging loans to help fund the put.

Recommendations:

We think bondholders should exercise the put option by 5pm on 2 November 2018.

We see a variety of reasons why exercising the put makes sense:

- Given the bonds have been trading below par, the redemption will provide bondholders a positive return.
- The Founder Group's shareholding post sales of ~7%, down from ~37%, was unexpected given their long association with and strong family involvement in the company. Apart from changes in shareholders, Lim Tiang Chuan, brother of the founder and Dawn Lim Sock Kiang, daughter of the founder, have resigned from their respective positions as Executive Deputy Chairman and Executive Director.
- It remains uncertain how the change in ownership may impact the strategic direction of the company. As far as we can publicly tell, the Tangs have no strategic interest in the education sector which CES is expanding into, though companies controlled by the Tangs are involved in property investment, development and construction.

Across the property developer counters, we are overweight on the PREHSP 3.85 '20s, PREHSP 5.95 '21s and PREHSP 3.90 '21s. These offer a decent yield to call for broadly similar tenors compared to CHIPEN 4.75 '21s and CHIPEN 4.9 '22s. We presently rate Perennial Real Estate Holdings Ltd a notch higher at a Neutral (5) Issuer Profile compared to CES. Similarly, Heeton Holdings Ltd is also rated higher at a Neutral (5) Issuer Profile and we are also overweight on the HTOHSP 6.1 '20s and HTOHSP 6.08 '21s. Finally, we see better value in OHLSP 5 '19s given the shorter tenor for a broadly similar credit profile. We presently rate Oxley Holdings Ltd also at a Negative (6) Issuer Profile.

Bond	Maturity	Ask Price	Yield to Maturity	Spread
CHIPEN 4.75 '21	14/06/2021	100.0	4.90%	254bps
CHIPEN 4.9 '22	19/05/2022	100.0	4.75%	248bps
PREHSP 3.85 '20	03/07/2020	97.4	5.46%	333bps
PREHSP 5.95 '20	28/08/2020	100.5	5.67%	350bps
PREHSP 3.9 '21	12/01/2021	95.5	6.08%	387bps
OHLSP 5 '19	11/05/2019	97.8	7.34%	534bps
HTONSP 6.1 '20	08/05/2020	99.8	6.23%	414bps
HTONSP 6.08 '21	19/07/2021	100.0	6.08%	381bps

Source: Bloomberg, Indicative prices as at 15 October 2018

Finally, on the expectation that bondholders put all the bonds, we think liquidity at CES continues to look tight. This is notwithstanding that CES has enough cash on hand as at 30 June 2018 to fund the redemption of both bonds if fully put. Note CES has not indicated how they will fund the bond redemption in the CoC Notice. We expect CES to seek external financing to either fund the put or meet commitments under their ongoing development projects. We think sales execution of major products and continued access to external financing will be crucial to CES's credit profile and are **maintaining the issuer profile of CES at a Negative (6)** but are likely to cease coverage for CES following the put exercise.

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Explanation of Issuer Profile Rating ("IPR") / Issuer Profile Score ("IPS")

Positive ("Pos") – The issuer's credit profile is either strong on an absolute basis, or expected to improve to a strong position over the next six months.

Neutral ("N") – The issuer's credit profile is fair on an absolute basis, or expected to improve / deteriorate to a fair level over the next six months.

Negative ("Neg") – The issuer's credit profile is either weaker or highly geared on an absolute basis, or expected to deteriorate to a weak or highly geared position over the next six months.

To better differentiate relative credit quality of the issuers under our coverage, we have further sub-divided our Issuer Profile Ratings ("IPR") into a 7 point Issuer Profile Score ("IPS") scale.

IPR	Positive		Neutral		Negative		
IPS	1	2	3	4	5	6	7

Explanation of Bond Recommendation

Overweight ("OW") – The performance of the issuer's specific bond is expected to outperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Neutral ("N") – The performance of the issuer's specific bond is expected to perform in line with the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Underweight ("UW") – The performance of the issuer's specific bond is expected to underperform the issuer's other bonds, or the bonds of other issuers either operating in the same sector or in a different sector but with similar tenor over the next six months.

Other

Suspension – We may suspend our issuer rating and bond level recommendation on specific issuers from time to time when OCBC is engaged in other business activities with the issuer. Examples of such activities include acting as a joint lead manager or book runner in a new issue or as an agent in a consent solicitation exercise. We will resume our coverage once these activities are completed.

Withdrawal ("WD") – We may withdraw our issuer rating and bond level recommendation on specific issuers from time to time when corporate actions are announced but the outcome of these actions are highly uncertain. We will resume our coverage once there is sufficient clarity in our view on the impact of the proposed action.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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