

Hyflux Ltd: Special Interest Commentary

Friday, 01 February 2019

- Hyflux Ltd (“HYF”) held its second town hall meeting on 18 January. Amongst other things, HYF provided an indicative restructuring timetable for the provision of a restructuring plan and finalization of the restructuring process.
- With developments building momentum and following investor enquiries, we have endeavoured to opine on some key questions with regards to the HYF restructuring process.
- This commentary follows previous ones published in [May 2018](#) and [October 2018](#) on announcements by HYF of its court supervised re-organization process and Restructuring Agreement with SM Investments Pte Ltd.

OCBC Credit Research currently does not cover HYF. We have presented this paper as a special interest commentary. In some parts, we have reiterated relevant parts of our [Singapore Credit Outlook 2019](#) to help answer the questions raised below.

Question 1: What are the challenges to the Restructuring timetable?

As per [HYF disclosures](#), a restructuring plan is expected to be proposed by mid-February along with the filing of a court application to convene a scheme meeting to vote on the proposal sometime at the end of March. While formal terms have yet to be announced, **the likelihood of a relatively smooth process remains highly uncertain in our view.**

Several conditions that led to successful restructurings in the past in the SGD space, in our view, have yet to be present in HYF’s Restructuring. In examples from recent restructurings in the offshore oil and gas support services sector, restructuring terms needed on-going refinement to placate different classes of creditors. As an example, [ASL Marine Holdings Ltd’s recent consent solicitation](#) process was conducted through 3 informal meetings and various revisions in terms over an almost five month period to achieve a successful outcome. Negotiations in successful restructurings have often been done with the co-operation of creditors to ensure that the restructuring proceeds smoothly and the concerns of each creditor class are adequately addressed. In most cases, these restructurings have involved two creditor classes – secured bank lenders and unsecured bond holders, both somewhat aligned and alike in terms of profiles within their own groups.

HYF’s circumstances however are more complicated due to the numerous creditor classes. HYF’s highly leveraged balance sheet contains many levels of external capital that are subject to the debt moratorium, including unsecured bank borrowings, senior bondholders, preference shares and perpetual securities. In addition, although holders rank equally amongst each other in their respective creditor class, the breadth of creditors is wide in terms of absolute numbers and profile (from senior secured and senior unsecured lenders to sophisticated individuals to retail investors), with divergent creditor rights and seniority in ranking. With the exception of unsecured bank lenders (some of whom have formed a collective group), interests and interactions of other creditor classes appear to be fragmented so far. This has now created a problem with HYF having to engage with multiple classes of creditors with vastly different profiles to pursue a restructuring.

Adding on to the complexity, the concerns of each creditor class will need to be balanced against the interests of other stakeholders, for example, SM Investments Pte Ltd (“SMI”, the proposed strategic investor) and to some extent the secured lenders, particularly at Tuaspring. We note the heavy conditions attached to the Restructuring Agreement (e.g. full and final settlement of various classes of creditors while SMI injects SGD400mn of new cash) given the vastly different position of SMI.

Treasury Advisory

Corporate FX & Structured Products

Tel: 6349-1888 / 1881

Interest Rate Derivatives

Tel: 6349-1899

Investments & Structured Products

Tel: 6349-1886

GT Institutional Sales

Tel: 6349-1810

OCBC Credit Research

Andrew Wong

+65 6530 4736

WongVKAM@ocbc.com

Ezien Hoo, CFA

+65 6722 2215

EzienHoo@ocbc.com

Wong Hong Wei, CFA

+65 6722 2533

wonghongwei@ocbc.com

Seow Zhi Qi

+65 6530 7348

ZhiQiSeow@ocbc.com

This dispersion of interests (and bargaining power) has likely reduced the effectiveness of HYF's debt moratorium in our view and is likely to impede the provision of an acceptable restructuring plan for all parties within the timetable proposed. We have already seen demonstrative actions by secured and senior unsecured bank lenders who have sought to protect or ensure that their position in the capital structure is not compromised in the restructure. For example, while Tuaspring's sole secured lender has extended the timeline on its forbearance period, the lender has not waived its rights to liquidate the Tuaspring entity. Not coincidentally, certain senior unsecured lenders have also been negotiating with the company on proposed restructuring terms. This ultimately will be to the detriment of certain creditors, namely those most junior.

Question 2: Are all creditors equal?

HYF has already indicated that different classes of creditors will be treated differently, particularly in liquidation. As per the company's presentation, the complexity of the corporate and capital structure and the assumed crystallisation of contingent claims may result in only a 3.8% to 8.7% recovery for HYF's senior unsecured obligations. By extension, junior obligations (ie: perpetual security and preference share holders) would get nothing, in line with their junior rank within the capital structure.

In a restructuring through a scheme of arrangement however, prospects for junior creditors can be improved with a negotiated outcome reached where all creditor classes benefit in different forms. A challenge to the junior creditors though is that the bargaining power of senior creditors is much stronger. This is because of their relatively stronger recovery in a liquidation which becomes a powerful negotiating tool in a restructure. Additionally, the allure of continued banking support typically also weighs as a consideration.

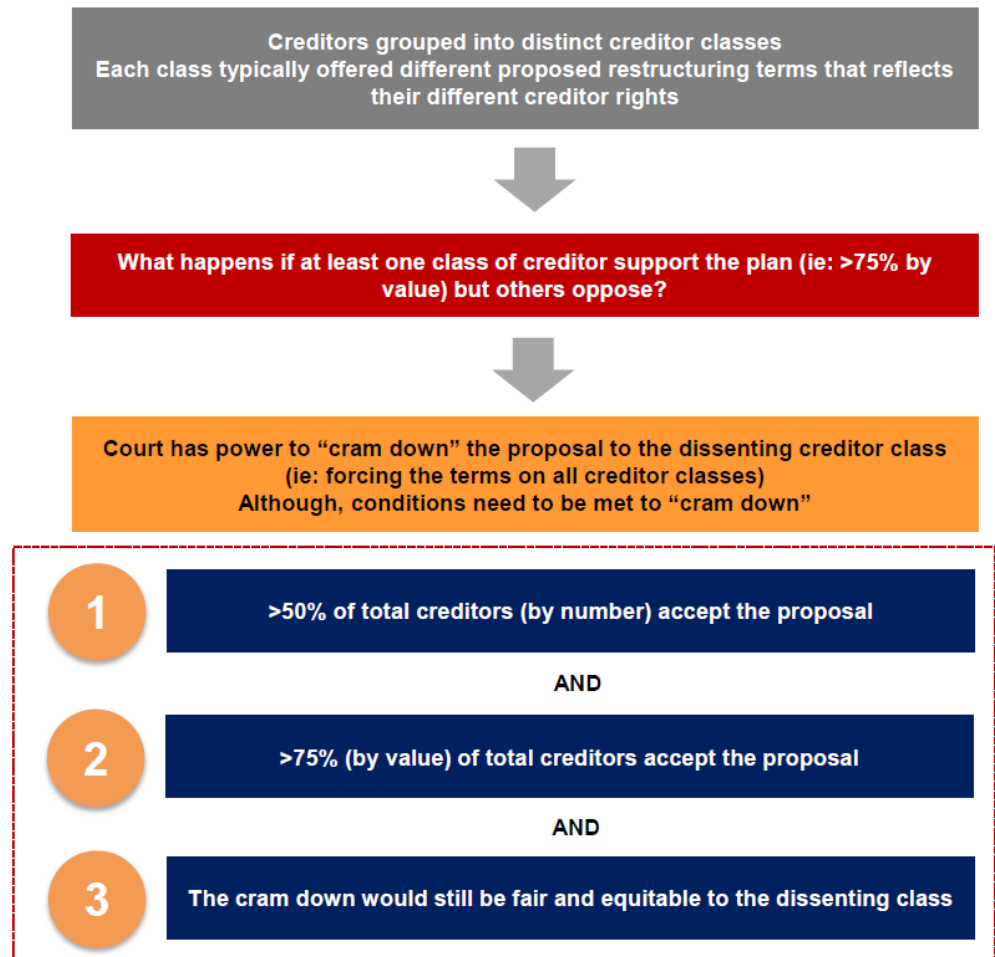
That's not to say that junior creditors have no say in a restructuring outcome...

Senior creditors will be dependent on junior creditors supporting a restructuring proposal if they prefer to achieve a better return via a restructuring over absorbing bigger losses in liquidation. For this to occur, senior creditors will need to give concessions to the junior creditors. This will be a delicate balancing act between the different creditor classes. No two restructurings are alike so the form of any agreement very much depends on the idiosyncratic circumstances of the company in distress as well as the make-up of the senior and junior creditors. At the end of the day, it could come down to a game of chicken as creditors work towards the best outcome possible.

Disclaimer: Please note that the following reflects our interpretation of the amendments to the Companies Act. It should not be taken to provide a holistic review of all the amendments, nor should it be taken as a legal opinion. Where legal or other professional advice is required in relation to any particular matter, please seek advice from your own legal or other professional advisors.

... though unity may be crucial

As we previously discussed on changes to the Court's restructuring process, the Court now has the power to "cram down" the proposal to a dissenting creditor class by approving the proposal and forcing the terms on all creditor classes. To reiterate, two of the conditions allowing the court to "cram down" include (1) a majority in number of creditors to be bound by the proposal have agreed to the proposal; and (2) that these majority of affirming creditors total more than 75% in value in affected claims (in aggregate across all creditor classes). This may provide a tricky situation for the restructuring process should for example most of the perpetual and preference share holders vote against the proposal while other classes are in support. This is given the number (more than 34,000) of perpetual and preference shareholders and that they hold SGD900mn in subordinated unsecured obligations, representing ~30% in total value of affected claims including the SGD915mn in contingent creditors per company's presentation. The final condition allowing the court to "cram down" is that the cram down would be fair and equitable to the dissenting class. This will be interesting to follow if it is tested given the lack of precedent and uncertainty in alternative options.



Question 3: What has happened to HYF’s asset values?

In our [May 2018 Special Interest Commentary](#), we had tabulated a preliminary recovery value in a liquidation scenario which showed positive recovery value for SGD bondholders and zero recovery for perpetual and preference shareholders. We also commented that Tuaspring was the single most important asset that would affect recovery values on the perpetuals and preference shares, though unfortunately was the hardest to assign a valuation with much certainty.

There now appears a gap in the balance sheet between what was last reported and what is possibly available in liquidation. Without up to date financials and further information, it is hard to quantify the differences. Our key assumptions and what we know so far are presented below:

Key OCBC Credit Research assumptions in May 2018	Commentary based on what we know so far
Tuaspring	
<p>Ownership Tuaspring is an integrated water and power plant. Although the electricity glut may persist, we assumed Tuaspring can be sold as the water portion is valuable given its strategic nature. Although key uncertainty is timing and pricing.</p> <p>Likely asset-level ownership approval at Tuaspring-level.</p>	<ul style="list-style-type: none"> • Bidders for Tuaspring need to be pre-qualified by PUB. One of two pre-qualified bidders submitted a bid. <ul style="list-style-type: none"> ○ Neither identity nor bid price was officially disclosed. ○ Media reported this was Sembcorp Industries Ltd. • Separately, Hyflux entered into an agreement with a consortium comprising The Salim Group and Medco Group (“SMI”) in which SMI will acquire an enlarged 60% stake in Hyflux. • Proposed investment by SMI is premised on Tuaspring staying as part of company.

	<ul style="list-style-type: none"> • SMI investment (where new shares intended to be issued) will result in Change of Control under the agreements between project entities (eg: Tuaspring and TuasOne Waste-to-Energy (“TuasOne”)) and their respective offtakers in Singapore, hence also needing regulatory approval.
<p>Valuation Estimated that Tuaspring (Book value as at 31 Mar 2018: SGD1.5bn) can be sold for SGD553mn, representing a 62.5% write down from book value.</p> <p>Liabilities at Tuaspring stay at SGD567.5mn, hence sale proceeds insufficient to fully pay down liabilities at Tuaspring.</p> <p>This implied a total shortfall of ~SGD191mn to repay all creditors and zero recovery for perpetual, preference share holders and shareholders.</p>	<ul style="list-style-type: none"> • Net book value (asset value minus liabilities) as at 31 March 2018 for Tuaspring was SGD902.4mn. • Maybank is the sole secured lender at Tuaspring and the largest creditor at that entity. Per Maybank disclosures, total exposure to Tuaspring as at 30 June 2018 was ~SGD602.4mn. <ul style="list-style-type: none"> ◦ We note Maybank has taken SGD106.3mn in loan provisions – which we infer to be mainly due to Tuaspring. • SMI’s offer does not value Tuaspring directly but comprises SGD400mn equity injection and SGD130mn shareholder loan. • Proposed restructuring deal by SMI is conditional on the full and final settlement of unsecured debt, SGD bonds, perpetuals and preference share, contingent debt and trade debt: <ul style="list-style-type: none"> ◦ In our view, “full and final settlement” means existing creditors will lose their rights to claim in the future if they agree to the restructuring proposal.
<p>Others Nil</p>	<ul style="list-style-type: none"> • Retail tranches of perpetuals and preference share were in part used to fund Tuaspring.
Concession and other assets	
<p>Service concession Concession agreements relate to supply of waste treatment services and treated water to local governments for periods of 20-30 years.</p> <p>SGD1.2bn from sum of financial receivables and intangible assets arising from service concession receivables as at 31 March 2018.</p> <p>We did not adjust the book value of service concession to arrive at our preliminary recovery value analysis.</p> <p>Company can sell its other concession assets rather than having the on-going concession agreements terminated.</p>	<ul style="list-style-type: none"> • No specific reference was made to “financial receivables” and “intangible assets arising from service concession receivables” in affidavits, nor in the liquidation scenario. <ul style="list-style-type: none"> ◦ This in our view also includes future receivables from the uncompleted projects of Qurayyat and TuasOne. • Offtakers have step-in rights in the event of liquidation <ul style="list-style-type: none"> ◦ It is unclear to us if company will receive any compensation in the event of step-in and this would affect recovery values.
<p>Other assets Other assets amount to ~SGD684mn as at 31 March 2018. These include trade receivables, amounts due for</p>	<ul style="list-style-type: none"> • Per 14 June 2018 affidavit, completed projects have a net book value as follows as at 31 March 2018: <ul style="list-style-type: none"> ◦ Tianjin Dagang: SGD139.8mn

<p>contract work, inventories, property, plant and equipment, associates and joint venture.</p> <p>We did not adjust the book value of other assets to arrive at our preliminary recovery value analysis.</p> <p>Other assets include: 47%-stake in Magtaa 30%-stake in SingSpring 25%-stake in Tus Water</p>	<ul style="list-style-type: none"> ○ Magtaa: SGD54.9mn ○ SingSpring: SGD25.3mn ● Uncompleted projects net book value as at 31 March 2018: <ul style="list-style-type: none"> ○ Qurayyat: SGD96.2mn ○ TuasOne: SGD21.4mn ● We could not find further mention of Tus Water's net book value although it was disclosed that company owns 25%-stake in this associate. ● 50%-stake in PT Oasis Waters Limited was sold for cash of ~SGD30.4mn in November 2018.
Cash	
<p>Unrestricted cash of SGD168.1mn as at 31 March 2018, arrived at after excluding cash at Tuaspring and restricted cash balance.</p>	<ul style="list-style-type: none"> ● On or about the date of moratorium application, cash was ~SGD280mn although ~SGD224mn not immediately available for use due to: <ul style="list-style-type: none"> ○ Amounts put into debt service reserve accounts (as required by project-level lenders). ○ Fixed deposit accounts (as required by banks on performance bonds). ○ Constraints on repatriation of monies back to Singapore.
Other key assumptions	
<p>Project finance lenders to be paid first versus holding company capital providers</p>	<ul style="list-style-type: none"> ● Subsidiaries, joint ventures and associates directly holding infrastructure projects/assets are not part of the moratorium. ● Maybank has extended its forbearance on its claim over Tuaspring multiple times.
<p>As concession agreements are non-public, we were not certain if the act of seeking court protection is sufficient grounds for customers (ie: offtakers) to seek a termination of its concession agreements, though in our experience, liquidation is sufficient cause for contract termination.</p> <p>We assumed that company sought legal advice on this matter before proceeding with court application for its moratorium.</p> <p>Contingent liability as at 31 December 2017 of SGD31.3mn.</p>	<ul style="list-style-type: none"> ● Per company's presentation slides as at 18 January 2019 (using information as at 31 August 2018), assuming all contingent claims gets crystallized in a liquidation scenario, SGD915mn senior unsecured obligations will be added: <ul style="list-style-type: none"> ○ No breakdown provided as to the nature of such contingent claims. ○ In our view, the higher the contingent claims, the lower the recovery values for other classes
<p>Audited consolidated financial statements of the company and including subsidiaries (the "Group") that are properly drawn up so as to give a true and fair view of the consolidated financial position, consolidated financial performance, consolidated changes in equity and consolidated cash flows.</p> <p>Company's latest available audited financial statements were for the financial year ended 2017 and publicly</p>	<ul style="list-style-type: none"> ● Company applied for voluntary court moratorium in May 2018 and entered into moratorium after. ● Affected SGD debt capital market issuances total ~SGD1.2bn: <ul style="list-style-type: none"> ○ Three tranches of SGD senior unsecured bonds, with SGD265mn outstanding (excluding accrued interest). ○ One tranche of retail perpetual securities with SGD500mn outstanding.

released in April 2018, which puts out an unqualified opinion.	<ul style="list-style-type: none"> ○ One tranche of retail preference share with SGD400mn outstanding.
On-going regular publicly available financials	<ul style="list-style-type: none"> ● Company has been granted a waiver from releasing its 2Q2018, 3Q2018 and full year 2018 financial statements until 30 June 2019 or before lifting suspension. ● With date of a scheme meeting to decide on SMI's proposal indicated for March 2019 and moratorium ending in end-April 2019, investors would need to work with stale financial statements in deciding whether or not to support the proposed restructuring.
Others Nil	<ul style="list-style-type: none"> ● Per Maybank, a secured lender to TuasOne, no overdue payments from TuasOne. ● Company expects a net cash inflow to the company post-completion of TuasOne (targeted in 2019). <ul style="list-style-type: none"> ○ Inference in our view, TuasOne is a performing asset

Sources: Company annual report, unaudited financial statements, affidavits, Maybank presentation, company presentation, OCBC Credit Research

HYF's balance sheet is a mix of an unregulated or merchant business (power generation) with an asset (water supply) operating under a long term concession with the government through PUB, the national water agency. In our view this was a possible structural weakness given the potential for an uncompetitive merchant business to jeopardize the provision of critical water supply, which ultimately contains the most value strategically. Financially, we would expect critical water supply to also have profits that are less variable versus merchant power. Further, it could be that this strategic value may have constrained the financial value for Tuaspring given the need for bidder pre-qualification by PUB as the offtaker. Although the prequalifying criteria for PUB are unknown, this step likely reduced the potential bidding pool, marketability of the asset and hence ultimate sale value.

All told, the combination of an engineered capital structure through use of quasi or hybrid equity to perceptually lower leverage together with potentially vulnerable asset prices appear to have led to a somewhat unrepresentative balance sheet, which is now coming to light as we progress through the restructuring process.

Question 4: What is the likelihood of government intervention?

As prospects for a smooth restructuring appear to be diminishing, so has the suggestion of government intervention risen in kind. This is given the nature of HYF's business and market misconceptions of HYF's strategic importance to and relationship with the government. Given its role as asset owner and operator under concession of Tuaspring (the largest desalination plant in South East Asia) and the SingSpring desalination plant (Singapore's first desalination plant where HYF owns 30%-stake) which together can meet around 25% of Singapore's water needs, investors appeared to have previously made the connection that the government would have an incentive to support HYF in times of need. This was perhaps logical given the function and high profile launches of these desalination assets as well as the government's ownership in other key infrastructure assets including electricity transmission and distribution (SP Power Assets Ltd), ports (PSA Corp Ltd), rail (SMRT Ltd) and airports (Changi Airport Group).

In general, strategic importance and hence the probability of government support can be determined on two fundamental principles – the connection of the entity with the government (either through direct ownership or reputational risk) and whether the entity can be easily replaced. As it stands, there is no direct government ownership in HYF

(there was indirect ownership in the past through Temasek Holdings Pte Ltd although the amounts appear immaterial in our view) and operating of desalination plants is not unique to HYF. In fact the PUB itself is the owner and operator of Singapore's third desalination plant, the Tuas Desalination Plant (built by HSL Constructor Pte Ltd), which opened in June 2018 while the 4th (Marina East Desalination Plant) will be built, owned and operated by Keppel Infrastructure Holdings and the 5th (Jurong Island Desalination Plant) will be built, owned and operated by a consortium of Tuas Power and Singapore Technologies Marine. The longer that time goes on, the clearer it becomes that HYF's business or industry is strategically important to the government, and not HYF itself as a company.

The way forward

All told, although progress has been made, there is still clearly a longer and more challenging path ahead. The willingness of creditors to come to the table will likely only be possible if there is sufficient value in the company to compensate all levels of creditors in some way or form. However with asset values uncertain, a lack of updated financial information and a possible plan that includes equitization, we think creditor willingness will be further compromised than it already is. HYF's application to obtain super priority rescue financing was adjourned to January 2019 with the exact date to be scheduled, likely due to objections from other lenders who would rank junior to the rescue financing and given that the super priority rescue financing was part of SM Investments restructuring agreement. This agreement could be faced with significant challenges to implementation, particularly given its heavily conditional nature and need for approvals from various stakeholders.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons held securities in the above-mentioned issuer or company as at the time of the publication of this report.

Disclaimer for research report

This publication is solely for information purposes only and may not be published, circulated, reproduced or distributed in whole or in part to any other person without our prior written consent. This publication should not be construed as an offer or solicitation for the subscription, purchase or sale of the securities/instruments mentioned herein. Any forecast on the economy, stock market, bond market and economic trends of the markets provided is not necessarily indicative of the future or likely performance of the securities/instruments. Whilst the information contained herein has been compiled from sources believed to be reliable and we have taken all reasonable care to ensure that the information contained in this publication is not untrue or misleading at the time of publication, we cannot guarantee and we make no representation as to its accuracy or completeness, and you should not act on it without first independently verifying its contents. The securities/instruments mentioned in this publication may not be suitable for investment by all investors. Any opinion or estimate contained in this report is subject to change without notice. We have not given any consideration to and we have not made any investigation of the investment objectives, financial situation or particular needs of the recipient or any class of persons, and accordingly, no warranty whatsoever is given and no liability whatsoever is accepted for any loss arising whether directly or indirectly as a result of the recipient or any class of persons acting on such information or opinion or estimate. This publication may cover a wide range of topics and is not intended to be a comprehensive study or to provide any recommendation or advice on personal investing or financial planning. Accordingly, they should not be relied on or treated as a substitute for specific advice concerning individual situations. Please seek advice from a financial adviser regarding the suitability of any investment product taking into account your specific investment objectives, financial situation or particular needs before you make a commitment to purchase the investment product. OCBC and/or its related and affiliated corporations may at any time make markets in the securities/instruments mentioned in this publication and together with their respective directors and officers, may have or take positions in the securities/instruments mentioned in this publication and may be engaged in purchasing or selling the same for themselves or their clients, and may also perform or seek to perform broking and other investment or securities-related services for the corporations whose securities are mentioned in this publication as well as other parties generally.

This report is intended for your sole use and information. By accepting this report, you agree that you shall not share, communicate, distribute, deliver a copy of or otherwise disclose in any way all or any part of this report or any information contained herein (such report, part thereof and information, "**Relevant Materials**") to any person or entity (including, without limitation, any overseas office, affiliate, parent entity, subsidiary entity or related entity) (any such person or entity, a "**Relevant Entity**") in breach of any law, rule, regulation, guidance or similar. In particular, you agree not to share, communicate, distribute, deliver or otherwise disclose any Relevant Materials to any Relevant Entity that is subject to the Markets in Financial Instruments Directive (2014/65/EU) ("**MiFID**") and the EU's Markets in Financial Instruments Regulation (600/2014) ("**MiFIR**") (together referred to as "**MiFID II**"), or any part thereof, as implemented in any jurisdiction. No member of the OCBC Group shall be liable or responsible for the compliance by you or any Relevant Entity with any law, rule, regulation, guidance or similar (including, without limitation, MiFID II, as implemented in any jurisdiction).

Co.Reg.no.:193200032W