Asia Credit Research

OCBC Bank

# Century Sunshine Group: Credit Update

**Wednesday, 13 September 2017**

## Endgame in Sight

- CSG's recently published 1H2017 results were largely as expected. Top line jumped due to both the Shandong Hongri acquisition (effective 01/04/17) as well as ramp up of greenfield capacity, while margins were pressured due to anticipated shifts in product mix. Leverage profile worsened, largely due to the consolidation of Shandong Hongri's borrowings, though absolute levels remain manageable. We will continue to monitor for sustained growth and margin expansion.

- Right after announcing its 1H2017 results, CSG commenced on its corporate reorganization, with the ultimate goal of injecting its magnesium business into its listed subsidiary (GSIL). The consideration to be paid to CSG by GSIL totals HKD1.73bn (~SGD300mn), with HKD1.31bn to be met via the issuance of new shares from GSIL to CSG, and the balance to be met via the issue of a convertible bond by GSIL to CSG. Post the transaction, CSG would increase its stake in GSIL from 51.9% to a range of 60.8% - 72.5% (depending on the conversion of existing convertible instruments).

- As mentioned previously, the reorganization is a credit negative, as CSG will then face HoldCo-OpCo subordination as its magnesium assets would be held indirectly via GSIL. In terms of control though, the founding family of CSG continues to be officers of both CSG and GSIL, while CSG's stake in GSIL would increase. GSIL may also benefit in having better access to capital given its larger scale. The existing financial covenants on CSG's bonds also provide some investor protection. In aggregate, **we continue to hold CSG at Neutral Issuer Profile, and believe that the risk reward profile supports an Overweight on the CENSUN'20s**.

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## A) Background

As previously discussed, Century Sunshine Group Holdings Limited ("CSG")[1] was in the midst of facing several operational developments, on-going corporate reorganization as well as changes to its capital structure.

Way back in March 2015, when CSG first acquired Group Sense International Limited ("GSIL"), management had already indicated that they may restructure CSG's magnesium business into GSIL[2], to develop and differentiate its magnesium alloys and fertilizer businesses in two listed platforms. However, as per HKSE rules, as the acquisition of GSIL was treated as a reverse takeover, there were limitations to CSG's ability to restructure GSIL for 24 months after the change of control. This limitation has since lapsed during 1H2017 and hence CSG has taken steps towards their endgame of the magnesium business being held in its entirety under GSIL.

[1] OCBC Asia Credit – Century Sunshine Group: Credit Update – Transitional Period (17 July 2017)
[2] OCBC Asia Credit – Century Sunshine Initiation Report (16 September 2015).

Several corporate actions taken thus far this year were in support of this corporate reorganization. For example, under the terms of the original CENSUN'18 bonds, should CSG inject assets into GSIL, GSIL would then have to become corporate guarantors to the CENSUN'18 bonds (GSIL was not a corporate guarantor to the CENSUN'18s at the point of issuance). This may hinder the reorganization as GSIL's minority shareholders may object to the provision of guarantee to CSG. The subsequently issued CENSUN'20s do not have the same guarantee requirement in the event of the asset injection.

As such, in this report, we will (1) consider CSG's recent performance, as it is the first period with the consolidated results from the Shandong Hongri ("SDHR", the present name for Hongri Acron) acquisition. This would also set the baseline for CSG's current financial status. We will then (2) consider the proposal by CSG to sell its magnesium businesses to GSIL, as well as analyse management rationale for the transaction. We will finally (3) consider the potential impact of the transaction on bondholders and provide our thoughts on the situation.

## B) 1H2017 Performance Review

- **Acquisition Boosted Revenue, Pressured Margins**: CSG reported preliminary 1H2017 results (which excludes the cash flow statement). Total revenue jumped 23.1% y/y to HKD1.52bn, driven by increase in sales for both its fertilizer as well as magnesium segments. In both cases, the growth was driven by the surge in volume sold. The revenue split across segments for 1H2017 was 56% from Fertilizer, 33% from Magnesium and 10% from Others (such as metallurgical flux and GSIL's legacy electronics business). Looking forward, the fertilizer segment's contribution to total revenue should increase given SDHR's partial contribution in 1H2017 as well as the ramp up of production as operations at SDHR normalize. On the flip side, ASP for both key segments faced some pressure due to anticipated shifts in product mix. These in turn pressured gross margins, which led to group gross margin compressing 5.5ppt to 24.5% (compared to 1H2016). Coupled with higher SG&A expense (+25% y/y versus 1H2016) due to needs as a larger organization, operating profit declined 10.0% y/y to HKD231.8mn.

- **Preliminary Impact of SDHR Less Negative Than Expected**: The fertilizer segment revenue increased 25.4% y/y to HKD855.1mn, in part driven by the consolidation of SDHR's results from April 2017 onwards due to the completion of the acquisition. Sales volume jumped 28.9% to 414,841 tonnes, in part driven by the additional 97,250 tonnes attributed from SDHR and incremental sales of HKD197.0mn during 2Q2017. SDHR has a stated capacity of 820,000 tonnes so CSG was running SDHR at ~50% utilization. This was fair as SDHR produced only 245,000 tonnes in 1H2016 (SDHR was a distressed company facing liquidity issues) or ~30% of utilization. Part of the reason for CSG's acquisition of SDHR was that CSG was confident that with adequate working capital, SDHR would be able to ramp up quickly to its full capacity. One of our concerns was SDHR being a drag to CSG's results. Specifically, due to SDHR's liquidity situation, it generated just HKD17.3mn in gross profit for 1H2016 and a net loss of HKD135.9mn. Comparatively, CSG still managed a fertilizer gross profit increase of HKD8.4mn y/y (+4.5%). This was despite CSG's existing Jiangsu facility generating a revenue decline of 3.5% (due to both production volume decline on new product testing, as well as due to the weaker CNY versus HKD for 1H2017 relative to 1H2016).

- **Niche Margin Defended**: In aggregate, fertilizer segment gross margins compressed from 27.6% (1H2016) to 23.0% (1H2017), largely due to the shift in product mix resultant from the SDHR acquisition (higher contribution from compound fertilizers, which is less lucrative compared to organic fertilizers as well as silicon magnesium fertilizers). Specifically, compound fertilizer volume sold jumped 42.8% y/y to 330,843 tonnes for 1H2017, while organic fertilizer volume sold dipped slightly by 6.9% y/y to 83,998 tonnes. Conversely, the gross margins for compound fertilizers is 19.8% for 1H2017, compared to organic fertilizer (38.2% gross margins). We believe that the preservation of CSG's organic fertilizer margins (roughly unchanged compared to 1H2016) is commendable given the competitive environment. The margin compression from the shift in product mix was anticipated given SDHR's production line (we had flagged this risk in our previous update).[3] Looking forward, we believe that as operations at both the SDHR facility and greenfield Jiangxi facility stabilizes, there would likely be further tweaks in CSG's fertilizer product mix, potentially improving margins and hence cash flow generation. For now though, the segment would likely continue to be capital intensive due to growth, requiring both capex and working capital, while margin compression would mean cash flow generation lagging revenue growth.

- **A Repeat of 2016's Story for Magnesium**: For the magnesium segment, revenue increased 18.5% y/y to HKD503.0mn. This was driven by the surge in volume sold by 38.9% to 22,238 tonnes for 1H2017. As a comparison, CSG's total magnesium segment volume for 2015 was 24,031 tonnes. However, due to the shift in product mix to the more commoditized basic magnesium products (versus rare-earth magnesium alloys), ASP fell 12.4% to HKD 22,349 per tonne. This caused magnesium margins to compress to 25.0% (1H2017) compared to 30.7% (1H2016). It should be noted that the bulk of incremental volume sold was basic magnesium ingots from CSG's Xinjiang production base (4,560 tonnes, held under GSIL). This was consistent with the segment's performance in 2016. As mentioned previously, CSG intention is to ramp up production at its Xinjiang facility focusing on simpler product lines first before starting on more complex products like magnesium alloys. Excluding the Xinjiang contribution, CSG's Jilin plant still managed 17,678 tonnes (+10.4% y/y) for 1H2017.

- **From Ingots to Alloys**: CSG's management had indicated that the phase II expansion of its magnesium plant (+50,000 tonnes annual capacity) at Jilin was recently completed and is expected to commence trial operations in phases through early 2018. Total Jilin magnesium capacity would be 75,000 tonnes when fully ramped up. Management had also indicated that all of the Xinjiang's production for 2016 was just basic magnesium ingots, but with technical enhancement works completed in November 2016, CSG would be ramping up on the production of magnesium alloys at Xinjiang as well. It is worth noting that CSG's rare earth magnesium alloy volume has remained stagnant at ~6000 tonnes at both 1H2016 and 1H2017, likely due to capacity constraints. The gross margin for the rare earth magnesium alloys remains lucrative at 43.7% (1H2017). It was the stated aim of management to boost the revenue contribution from rare earth magnesium alloys. That said, the ramp up of the additional capacity at Jilin was delayed (compared to when it was first discussed in 2015) while Xinjiang was a distressed acquisition, with CSG / GSIL only finishing enhancement works to the production line to produce alloys rather than ingots recently. As such, we expect margin improvement looking forward once product mix stabilizes, but will monitor the situation for execution risk.

- **Bargain Purchase Gains Boosted Profits**: As mentioned earlier, operating profit declined 10.0% y/y to HKD231.8mn. Financing costs also increased by ~HKD10mn for 1H2017 due to higher borrowings. In aggregate, net margin compressed from 10.4% (1H2016) to 8.5% (1H2017). Despite these factors, net profit remained stable at HKD130.0mn on an absolute basis, with CSG benefitted from a HKD41.0mn gain on bargain purchase due to its SDHR acquisition during the period (as a reminder, SDHR was a distressed acquisition by CSG, with CSG paying only a token sum of USD1 for its 50.5% stake in SDHR). As such, the

[3] OCBC Asia Credit – Century Sunshine Group: Credit Update – Transitional Period (17 July 2017)

current period's net profit is not indicative of future performance, and we expect 2H2017 net profit to be weaker until CSG's product mix gets optimized. It is likely that full-year 2017 results would show further margin compression coupled with strong volume growth.

- **Balance Sheet Maintains Buffer**: CSG's leverage profile had worsened slightly with net gearing rising from 21% (end-2016) to 28% (end-1H2017) due to higher borrowings. This was expected given the integration of SDHR's financial results from April 2016 onwards. Specifically, SDHR reported HKD509.4mn in total borrowings as of end-2016. However, the actual increase in borrowings seen for CSG was HKD280.4mn for end-1H2017. This could have been due to CSG using its cash balance to pay down debt. During 1H2017, we saw CSG redeem its SGD125mn CENSUN'18s while issuing its SGD101.75mn in CENSUN'20s. Specifically, cash balance for CSG (consolidated with SDHR) fell HKD170.3mn during 1H2017 to HKD877.8mn. As such, liquidity remains manageable with cash / current borrowings at 1.2x. CSG had also provided some capex projections:

  - 2017: Jiangxi (HKD300mn), Xinjiang (HKD50mn)
  - 2018: Jiangxi (HKD300mn)
  - 2019: Jiangxi (HKD200mn)

  As can be seen above, the bulk of investments are actually for CSG's greenfield Jiangxi fertilizer facility, with a total capacity of 1.4mn tonnes when fully completed. As a reference, CSG generated ~HKD430mn in operating cash flow for 2016.

- **Things to Monitor**: We have mentioned previously[4] that SDHR had existing corporate guarantees provided to two independent third-parties (and received similar guarantees in kind). The guarantees were RMB220mn notional, and were scheduled to expire between July and December 2017. The intention was for SDHR not to renew these guarantees, subject to bank consent. CSG has confirmed that these guarantees still remain, and will provide an update when these are eliminated. We also note the sharp increase in Trade and Other Payables of ~HKD651mn during 1H2017, which management attributed to the start up capital needs of its new Jiangxi production facilities as well as the needs of SDHR. We had expected working capital needs to be a drain on cash given CSG's growth trajectory and will continue to monitor closely.

### C) Proposed Injection of Magnesium Business into GSIL

As mentioned earlier, it is the intent of the founding Chi family / management to inject all magnesium related businesses from CSG into its partially-owned subsidiary, GSIL. The rationale for the reorganization, as disclosed via a joint filing between CSG and GSIL[5], is summarized below:

- **Delineation**: Clear delineation between the core fertilizer business (under CSG) and core magnesium business (under GSIL). Both segments are still in growth trajectory, and the delineation would allow for better management focus on each entity.

- **Two Separate Growth Paths:** Separation allows for more corporate action flexibility, such as M&A activity to consolidate more magnesium capacity (as the industry is still relatively fragmented). In addition, management has indicated that they intend to ramp up organic growth as well via increasing production at Xinjiang from the current 15,000 tonnes to the state-approved

[4] OCBC Asia Credit – Century Sunshine Group: Credit Update – Avoiding Indigestion (29 September 2016)

[5] HKSE – 509, 601 Joint Announcement: Reorganization Plan Involving Direct and Indirect Shareholdings in China Rare Earth Magnesium Technology Holdings Ltd (1 September 2017)

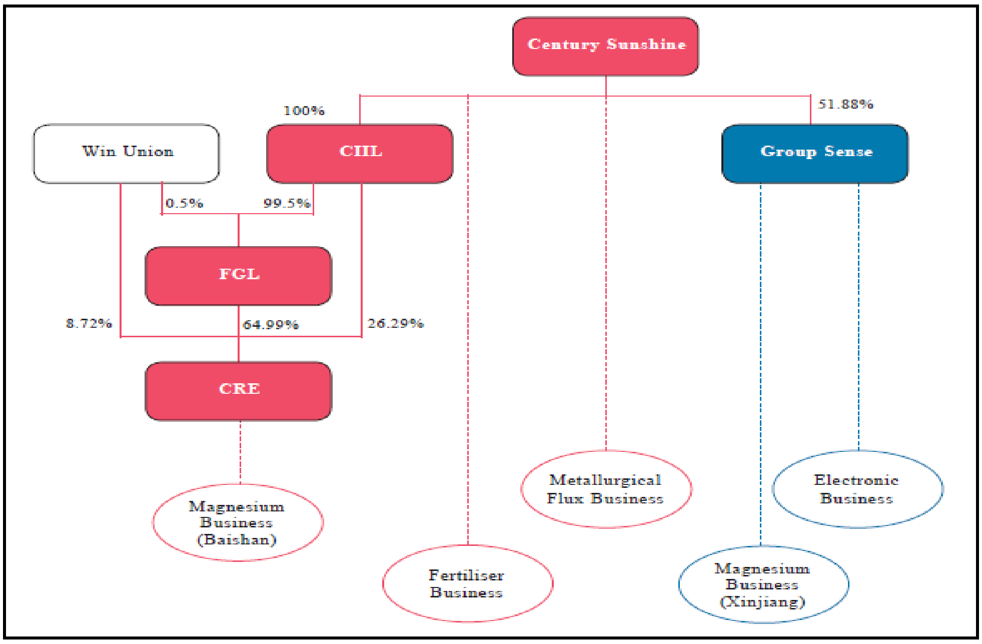
allowance of 100,000 tonnes. The fertilizer business is also focusing on its own growth trajectory, with the Chinese government seeking to encourage the use of more green and ecological fertilizers in China.

- **Financial Flexibility**: Post reorganization, management believes that GSIL's financial flexibility would also strengthen. The increase in assets directly held by GSIL as well as the stronger cash flow would allow GSIL to attract investments and obtain financing at better terms. Management also believes that clear delineation between the two entities would more easily allow each entity to access capital markets to fund their growth. For example, potential strategic investors (end users of magnesium alloy, such as automotive OEM) may be keen to invest in the magnesium business, but not the fertilizer business.

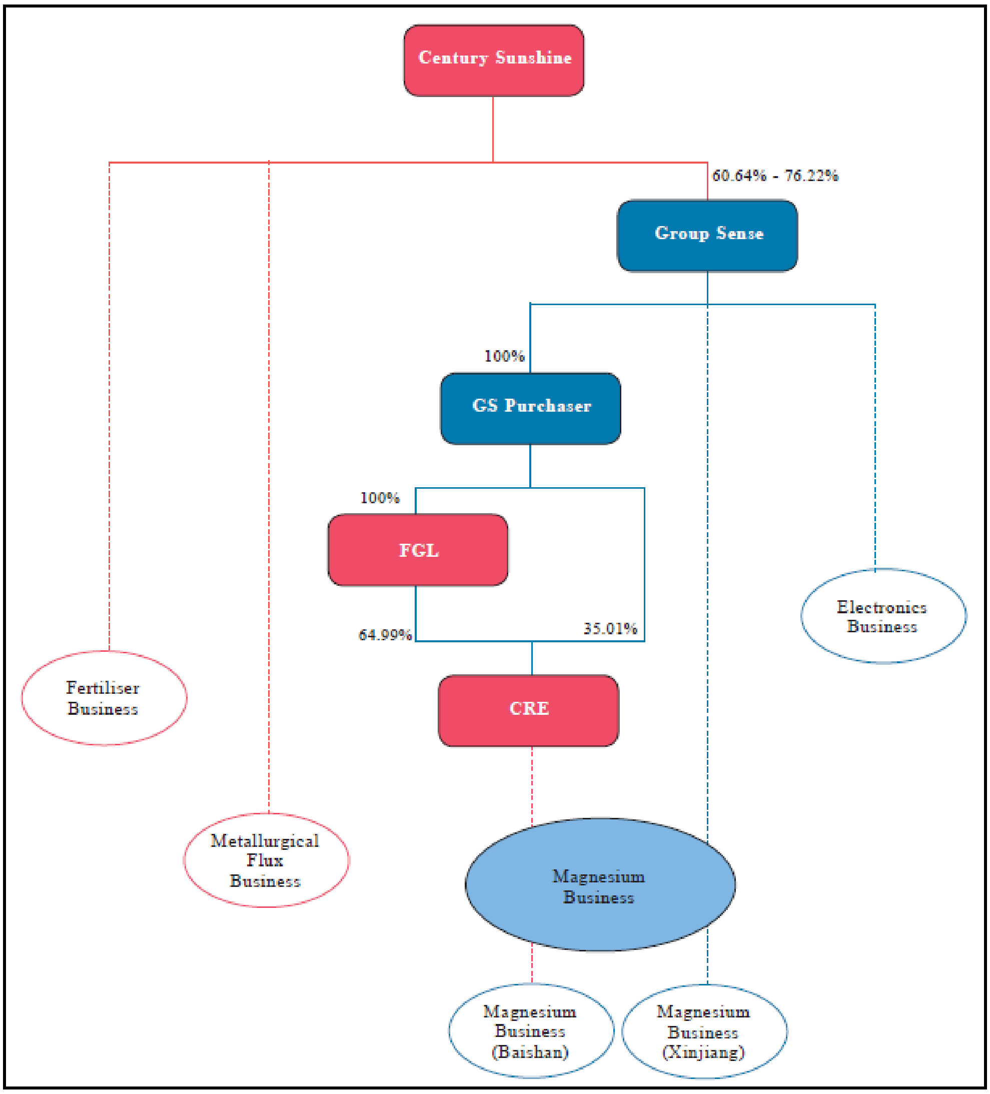
- **Better Valuation**: CSG, as a conglomerate, is likely being valued lower by equity markets due to a conglomerate discount. At current prices, CSG's stock was trading below 0.5x price-to-book. By injecting the magnesium business entirely into GSIL, it is management's hope that the clearer distinction would result in a re-rating of CSG's and GSIL's stock, with the faster growing and higher margined magnesium business being valued more fairly in GSIL (without the drag of CSG's fertilizer business given the sector's current challenges). It is a sum-of-the-parts trade, with transparency driving a higher valuation of both CSG and GSIL in aggregate post transaction despite no real change to underlying operations. It is worth noting that GSIL is already trading at a premium to CSG, at a price-to-book of 2.5x.

In our view, better valuation and financial flexibility are hand-in-hand, as the higher valuation would make subsequent equity financing cheaper. It is worth noting that CSG already has a potential institutional investor for GSIL. CSG issued HKD232mn worth of exchangeable bonds to Wan Tai Investments Limited (an indirect wholly-owned subsidiary of China Construction Bank Corp ("CCB")) in April 2016 with a 3-year maturity. The exchangeable bond converts into ~11% equity on GSIL on a post-diluted basis (at the option of CCB) at an estimated price of ~HKD0.30 per share (lower than the HKD0.385 market price per share and hence increasing the probability of conversion).

**Original Organization Structure**:



**Target Organization Structure**:


Century Sunshine
60.64% - 76.22%
Group Sense
100%
GS Purchaser
100%
FGL
64.99%
35.01%
Electronics Business
Fertiliser Business
CRE
Metallurgical Flux Business
Magnesium Business
Magnesium Business (Baishan)
Magnesium Business (Xinjiang)

*Source: Company*

As can be seen above, in summary CSG will be injecting China Rare Earth Magnesium Technology Holdings Limited ("CRE"), which holds the magnesium facility at Baishan City, Jilin Province, into GSIL. The transaction also involves GSIL buying out minority investor Win Union, which holds a 9.05% effective stake in CRE.

**Transaction Summary**:

1. CRE was valued at HKD1.9bn (~SGD330mn) as of end-August 2017. For 2016, CRE generated HKD190mn in net profit.

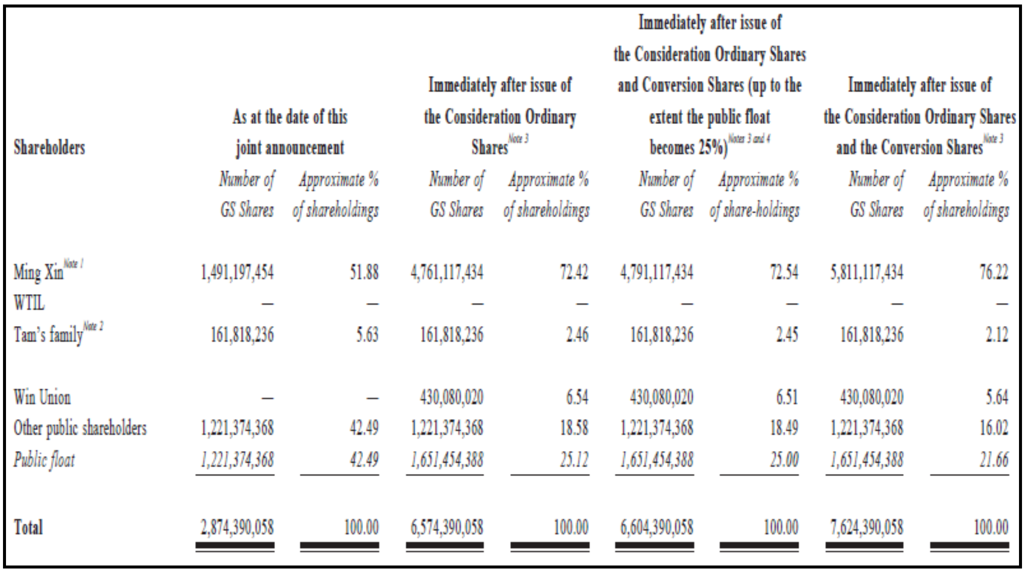
2. **The transaction is non-cash**, with GSIL issuing new shares (HKD1.31bn worth) as well as issuing a convertible bond (HKD420mn,3-year maturity, 4% coupon, HKD0.40 strike price) to CSG as consideration for CSG's effective ~91% stake in CRE. Win Union's stake will be purchased using new shares.

3. The issue price of the new shares of GSIL has been agreed to be HKD0.40 per share (~4% premium to current market price).

4. On a fully diluted basis, CSG would receive 3.27bn new shares in GSIL as

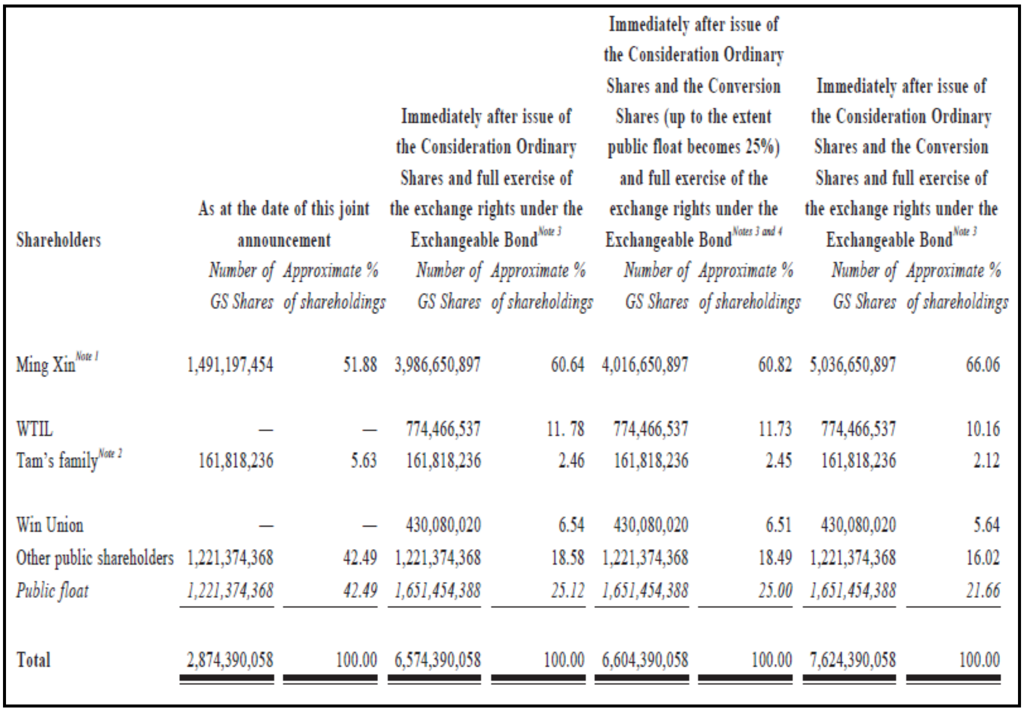
well as a further 1.05bn shares (assuming the HKD420mn convertible bond is converted) and would hold between 60.8% - 72.5% of GSIL (up from 51.9%).

**Impact of Dilution (exclude CCB)**:



| Shareholders | As at the date of this joint announcement | | Immediately after issue of the Consideration Ordinary Shares[Note 3] | | Immediately after issue of the Consideration Ordinary Shares and Conversion Shares (up to the extent the public float becomes 25%)[Notes 3 and 4] | | Immediately after issue of the Consideration Ordinary Shares and the Conversion Shares[Note 3] | |
|---|---|---|---|---|---|---|---|---|
| | *Number of GS Shares* | *Approximate % of shareholdings* | *Number of GS Shares* | *Approximate % of shareholdings* | *Number of GS Shares* | *Approximate % of share-holdings* | *Number of GS Shares* | *Approximate % of shareholdings* |
| Ming Xin[Note 1] | 1,491,197,454 | 51.88 | 4,761,117,434 | 72.42 | 4,791,117,434 | 72.54 | 5,811,117,434 | 76.22 |
| WTIL | – | – | – | – | – | – | – | – |
| Tam's family[Note 2] | 161,818,236 | 5.63 | 161,818,236 | 2.46 | 161,818,236 | 2.45 | 161,818,236 | 2.12 |
| Win Union | – | – | 430,080,020 | 6.54 | 430,080,020 | 6.51 | 430,080,020 | 5.64 |
| Other public shareholders | 1,221,374,368 | 42.49 | 1,221,374,368 | 18.58 | 1,221,374,368 | 18.49 | 1,221,374,368 | 16.02 |
| *Public float* | *1,221,374,368* | *42.49* | *1,651,454,388* | *25.12* | *1,651,454,388* | *25.00* | *1,651,454,388* | *21.66* |
| Total | 2,874,390,058 | 100.00 | 6,574,390,058 | 100.00 | 6,604,390,058 | 100.00 | 7,624,390,058 | 100.00 |

**Impact of Dilution (full):**



| Shareholders | As at the date of this joint announcement | | Immediately after issue of the Consideration Ordinary Shares and full exercise of the exchange rights under the Exchangeable Bond[Note 3] | | Immediately after issue of the Consideration Ordinary Shares and the Conversion Shares (up to the extent public float becomes 25%) and full exercise of the exchange rights under the Exchangeable Bond[Notes 3 and 4] | | Immediately after issue of the Consideration Ordinary Shares and the Conversion Shares and full exercise of the exchange rights under the Exchangeable Bond[Note 3] | |
|---|---|---|---|---|---|---|---|---|
| | *Number of GS Shares* | *Approximate % of shareholdings* | *Number of GS Shares* | *Approximate % of shareholdings* | *Number of GS Shares* | *Approximate % of shareholdings* | *Number of GS Shares* | *Approximate % of shareholdings* |
| Ming Xin[Note 1] | 1,491,197,454 | 51.88 | 3,986,650,897 | 60.64 | 4,016,650,897 | 60.82 | 5,036,650,897 | 66.06 |
| WTIL | – | – | 774,466,537 | 11. 78 | 774,466,537 | 11.73 | 774,466,537 | 10.16 |
| Tam's family[Note 2] | 161,818,236 | 5.63 | 161,818,236 | 2.46 | 161,818,236 | 2.45 | 161,818,236 | 2.12 |
| Win Union | – | – | 430,080,020 | 6.54 | 430,080,020 | 6.51 | 430,080,020 | 5.64 |
| Other public shareholders | 1,221,374,368 | 42.49 | 1,221,374,368 | 18.58 | 1,221,374,368 | 18.49 | 1,221,374,368 | 16.02 |
| *Public float* | *1,221,374,368* | *42.49* | *1,651,454,388* | *25.12* | *1,651,454,388* | *25.00* | *1,651,454,388* | *21.66* |
| Total | 2,874,390,058 | 100.00 | 6,574,390,058 | 100.00 | 6,604,390,058 | 100.00 | 7,624,390,058 | 100.00 |

*Source: Company      Note: Ming Xin is CSG, while WTIL is CCB.*

CSG's final shareholding in GSIL is fluid, given the various convertible instruments on CSG / GSIL's balance sheet. The requirement to retain a 25% public float would also curtail the total conversion of CSG's HKD420mn in convertible bond. Our base case is that CSG would convert most of its HKD420mn convertible bonds into GSIL shares. Beyond this, there are two scenarios: CCB exchanging its HKD232mn in exchangeable bond into GSIL shares, or continuing to hold the bond as debt. The exchange mechanism works with CSG redeeming the HKD232mn in debt with GSIL shares that CSG owns (tentatively 774.5mn shares, subject to adjustments). In the event that CCB participates and becomes a shareholder of GSIL, CCB would own 11.73% of GSIL while CSG would own 60.82% (while deleveraging by HKD232mn as the exchange bond would be extinguished). Conversely, if CCB chooses not to participate, CSG would hold 72.54% of GSIL.

The above transaction is subjected to various shareholder votes at both CSG (very substantial disposal, requiring an EGM) and GSIL (very substantial acquisition, connected transaction, requiring SGM). Circulars for both CSG and GSIL are expected to be despatched by 31/10/17.

### Analysis of the Transaction

In general, from the perspective of holders of HoldCo (CSG) debt, any subordination of cash flows from the HoldCo to the OpCo (GSIL) would be a credit negative, as there would be a subordination of claims for the magnesium business (as GSIL creditors would get first claim). To be clear, GSIL will not be a guarantor to the CENSUN'20 notes. As a reference, the fertilizer business generated HKD161.1mn in operating profits while the magnesium business generated HKD120.9mn in operating profits for 1H2017 (though the Xinjiang part of the magnesium business is already held via GSIL). As such, we should consider the benefits of the transaction to gauge if it balances the credit negative aspect.

- **Non-cash transaction**: A cash payment by GSIL to CSG would have been better, but given limits to GSIL's ability to raise debt, the cash payment would have been raised via equity resulting in dilution to CSG's stake (and impacting CSG's control). The non-cash transaction meant that liquidity at GSIL is conserved while CSG increases its stake (hence control) in GSIL. A potential sticky point would be the GSIL shares being issued at a premium to market (which was already trading at 2.5x book), but may be necessary to obtain GSIL minority shareholder approval given the significant dilution that they are facing. **Net neutral impact**.

- **Potential higher valuation**: Higher valuation on GSIL could mean cheaper equity financing for GSIL which would aid GSIL's expansion efforts. In the worst case, the shares of GSIL held by CSG could be divested for liquidity to meet debt service needs. The higher valuation of GSIL could also result in CCB exercising its option to obtain GSIL shares in exchange for the HKD232mn bond held by CSG. The presence of CCB as a shareholder of GSIL may help GSIL gain even more traction with investors. GSIL would also be less reliant on CSG for funding needs. **Net positive impact.**

- **Managing of risks:** Though CSG loses the benefit of direct cash flows from its magnesium business, it may also be no longer beholden to the borrowings of GSIL. Given that management also intends to aggressively grow its magnesium business, having the two segments separate may help to contain risk. **Net positive impact.**

Beyond the transaction, we should also consider the protections that CSG bondholders currently have, such as financial covenants:

- CSG is required to have a consolidated tangible net worth ("TNW") of HKD1.8bn at all times. We estimate this to be HKD2.75bn as of end-1H2017.

- Incurrence covenant of Gross Borrowings / TNW no higher than 1.5x. We estimate this to be 0.66x as of end-1H2017.

- Restrictive covenant of EBITDA / Interest no lower than 3.0x. We estimate this to be 4.4x as of end-1H2017.

From the founding Chi family perspective, it should be noted that though they are present on the board, as well as hold executive roles of both CSG and GIL, their stake in CSG / GSIL is held directly that the CSG level (Mr Chi Wen Fu holds ~34%). As such, the family faces the same subordination that results for the transaction occurring. This provides some alignment between management and bondholders.

Finally, it should be noted that CSG would continue to hold the fertilizer segment directly. The fertilizer segment continues to be on a growth path as well. In fact, as mentioned earlier, the bulk of planned capex is actually for the fertilizer segment's greenfield facility. Both segments remain important to the Chi family. We believe as well that management had been transparent about their overall intention to restructure the magnesium business into GSIL since 2015 (though the ultimate structure was only recently firmed up). As such, the transaction should not come as a surprise to bondholders.

## D) Conclusion and Recommendation

In summary, we have reviewed the proposed terms for the injection of CSG's magnesium business into its partially owned subsidiary GSIL. Though from a structural perspective, bondholders of CSG would be worst off due to HoldCo-OpCo subordination, we note that bondholders will continue to be protected by covenants at the CSG level, and that alignment with the major shareholder / management is preserved given their holdings at the HoldCo level. In addition, the transaction seems to facilitate CSG's and GSIL's growth path, while potentially allowing more financial flexibility in general. In aggregate, **we will continue to hold CSG at Neutral Issuer Profile,** balancing CSG's still manageable levels of leverage (net gearing of just 28%) versus execution risk given its growth trajectory.

Currently, the CENSUN'20s have traded under water at 99.4 since issuance, given the non-typical exchange scheme (as far as the SGD corporate bond market is concerned) done to refinance the CENSUN'18s, as well as the negative impact of the CSG / GSIL magnesium business reorganization. There was also uncertainty as to the performance of SDHR in 1H2017 given that it was a distressed acquisition. We believe that though the magnesium business transaction still has some ways to completion (the Long Stop Date is 31/12/17), enough details regarding management's intention for the reorganization has been disclosed for us to make an informed assessment of the situation. 1H2017 results have also been as per our expectations. These developments should help alleviate the negative pressure on the bonds. We note that the CENSUN'18s traded tight at a YTM of 6.5% in 2015. For the CENSUN'20s, we believe that a return to par (YTM of 7.0%) would not be difficult given the high carry and short maturity. As such, **we believe that the risk reward profile supports an Overweight the CENSUN'20s**.

# Century Sunshine Group Holdings Ltd

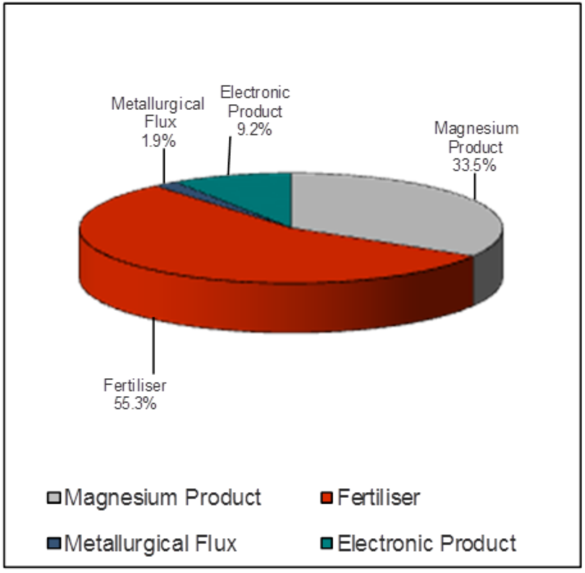
Table 1: Summary Financials

| Year End 31st Dec | FY2015 | FY2016 | 1H2017 |
|---|---|---|---|
| **Income Statement (HKD'mn)** | | | |
| Revenue | 2,515.6 | 2,589.2 | 1,522.2 |
| EBITDA | 629.4 | 636.8 | 306.4 |
| EBIT | 533.0 | 506.6 | 231.8 |
| Gross interest expense | 97.0 | 126.6 | 69.6 |
| Profit Before Tax | 496.9 | 456.9 | 201.9 |
| Net profit | 303.5 | 313.1 | 127.5 |
| **Balance Sheet (HKD'mn)** | | | |
| Cash and bank deposits | 1,452.5 | 901.2 | 877.8 |
| Total assets | 5,421.7 | 5,246.5 | 6,579.3 |
| Gross debt | 1,504.2 | 1,540.6 | 1,821.0 |
| Net debt | 51.7 | 639.4 | 943.2 |
| Shareholders' equity | 3,343.3 | 3,054.5 | 3,331.0 |
| Total capitalization | 4,847.5 | 4,595.1 | 5,152.0 |
| Net capitalization | 3,395.0 | 3,693.9 | 4,274.2 |
| **Cash Flow (HKD'mn)** | | | |
| Funds from operations (FFO) | 399.9 | 443.2 | 202.1 |
| * CFO | 84.3 | 428.6 | NA |
| Capex | 217.3 | 479.0 | NA |
| Acquisitions | 312.4 | 85.5 | NA |
| Disposals | 0.4 | 70.1 | NA |
| Dividend | 21.8 | 59.8 | NA |
| Free Cash Flow (FCF) | -133.0 | -50.4 | NA |
| * FCF adjusted | -466.7 | -125.5 | NA |
| **Key Ratios** | | | |
| EBITDA margin (%) | 25.0 | 24.6 | 20.1 |
| Net margin (%) | 12.1 | 12.1 | 8.4 |
| Gross debt to EBITDA (x) | 2.4 | 2.4 | 3.0 |
| Net debt to EBITDA (x) | 0.1 | 1.0 | 1.5 |
| Gross Debt to Equity (x) | 0.45 | 0.50 | 0.55 |
| Net Debt to Equity (x) | 0.02 | 0.21 | 0.28 |
| Gross debt/total capitalisation (%) | 31.0 | 33.5 | 35.3 |
| Net debt/net capitalisation (%) | 1.5 | 17.3 | 22.1 |
| Cash/current borrowings (x) | 4.1 | 2.8 | 1.2 |
| EBITDA/Total Interest (x) | 6.5 | 5.0 | 4.4 |

*Source: Company, OCBC estimates*

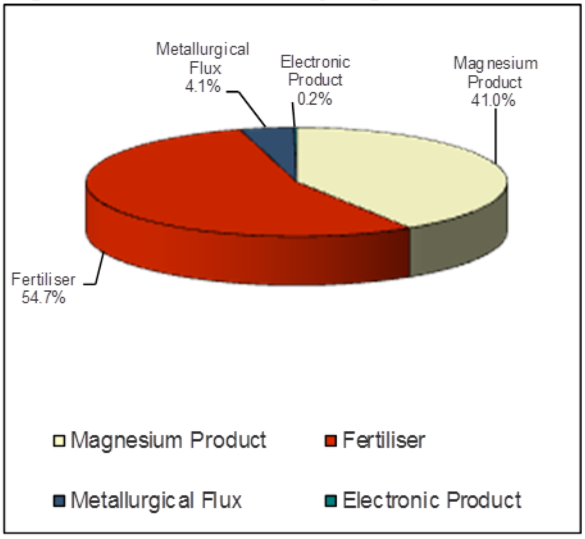
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO before deducting interest expense*

Figure 1: Revenue breakdown by Segment - 1H2017



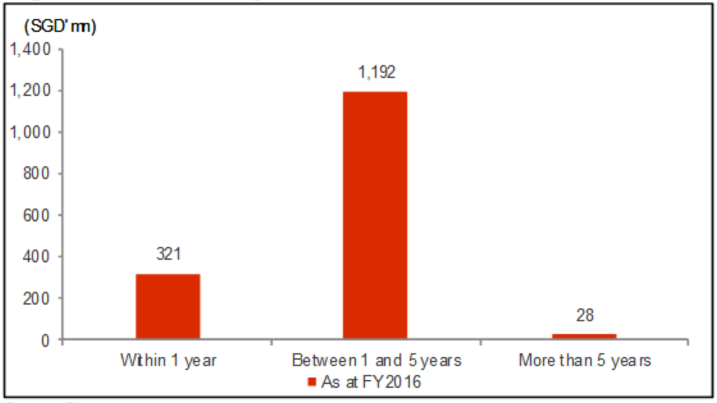
*Source: Company | Excludes Inter-segment Eliminations*

Figure 2: EBIT breakdown by Segment - 1H2017



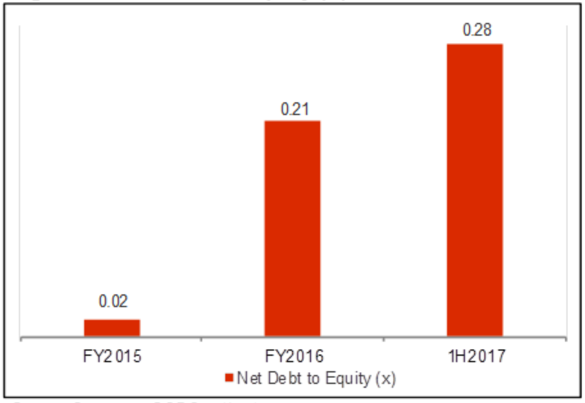
*Source: Company*

Figure 3: Debt Maturity Profile



*Source: Company*

Figure 4: Net Debt to Equity (x)



*Source: Company, OCBC estimates*

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