Asia Credit Research

OCBC Bank

CWT International Limited: Credit Update

Monday, 16 July 2018

Selling and leasing back crown jewels

- **CWT International Limited ("CWTI") announced a proposed sale of five warehouses in Singapore amounting to SGD730mn (~HKD4.3bn) to Mapletree Logistics Trust.**
- **These warehouses are owned by CWTI's wholly-owned subsidiary CWT Pte Ltd ("CWT SG") and CWT SG's subsidiaries (collectively "CWT SG Group").**
- **CWT SG bondholders sit closer to the assets at CWT SG Group and we maintain that bondholders should be structurally superior to CWTI debtholders in so far as those assets are concerned.**
- **Based on CWT SG's public information, disposal of material subsidiaries that meet certain net assets or net profit threshold is an Event of Default. This clause exists to protect bondholders from asset stripping.**
- **Assuming the deal goes through, CWT SG Group will see some credit deterioration, though likely still within its financial covenants.**
- **We expect significant asset sales including sales and leaseback beyond ordinary course of business to be put through a bondholder's vote.**
- **Despite the short-term liquidity boost, we think the group has hampered its future access to funding markets by doing a deal without seeking bondholders' approval. For now, we are maintaining the issuer profile of CWTI at Negative (6) and continue to monitor the developments. We also maintain our 3 May 2018 underweight call on both the CWT SG bonds.**

- **Recommendation:** Our analysis of this development is by necessity constrained to public information. Certain information, including the standalone CWT SG Group financials, Trust Deed and carve-outs within the relevant clauses (if any) are only available to bondholders. As such we are unable to opine on whether this proposed sale-and-leaseback is in breach of its bond terms and continue to urge bondholders to seek legal advice on protections/remedies afforded. Admittedly though, as any reasonable bondholder would, we were taken aback that the proposed transaction does not contemplate a bondholders' vote, given the following:

  (i) The proposed sale in aggregate is considered a Very Substantial Disposal under Hong Kong listing rules (where CWTI is listed) and this sale would require CWTI shareholders approval. CWTI shareholders approval is a Condition Precedent to the proposed transaction.

  (ii) As at 31 December 2017, the Logistics segment of CWTI reported HKD10.7bn (~SGD1.9bn) in assets vis-à-vis SGD730mn for the warehouses.

  (iii) Proposed buyer obliged to provide CWT SG with a minimum USD100mn (~SGD136mn) bridge loan upon written notice. Though if deal completes, sums advanced can be used to offset purchase consideration.

  (iv) Indicatively, 75% of use of proceeds from the sale of CWT SG Group assets can be used towards debt repayment at the broader CWTI group.

Figure 1: CWT SG SGD Bonds

Issue	Maturity/ First Call Date	Outstanding Amount (SGDmn)	Ask Price	Ask YTW (%)	I-spread
CWTSP 3.9% '19	18-Apr-2019	100	95.20	11.02	933
CWTSP 4.8% '20	18-Mar-2020	100	84.66	15.60	1,374

Note (1): Indicative prices as at 16 July 2018

- **Background:** On 5 July 2018, CWT International Ltd ("CWTI"), the parent

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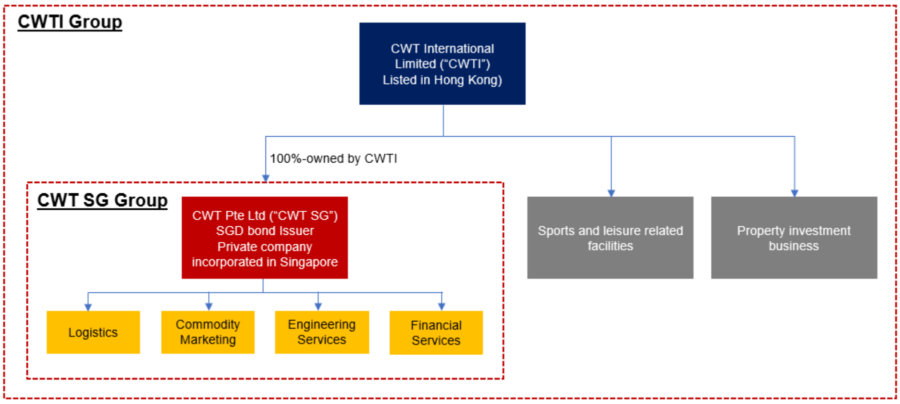
company of CWT Pte Ltd ("CWT SG") announced the proposed sale of five of its ramp-up warehouse properties in Singapore. The properties are proposed to be sold to Mapletree Logistics Trust ("MLT") under sale-and-leaseback transactions where CWT SG Group will lease back all the space. We hold MLT's issuer profile at Neutral (4). While it was shared earlier that CWTI was looking at a potential sale-and-leaseback of warehouses in Singapore, it was interesting that the eventual proposed buyer was MLT given the historical close ties between CWT SG Group and Cache Logistics Trust ("CACHE" / unrated), a competing logistics REIT to MLT, also listed on the Singapore Stock Exchange.

A) Simplified Corporate Structure



B) Relevant Key Terms

Consideration: CWT SG Group will be paid SGD730mn in cash as consideration for the warehouses. MLT will pay an estimated aggregate consideration of SGD778.3mn, made up of the SGD730mn payable to CWT SG Group and SGD48.3mn of balance lease terms payable to JTC Corporation ("JTC", a statutory board). Another SGD27.6mn in transaction costs is estimated, which may bring MLT's total acquisition cost to SGD805.9mn. The SGD730mn represents a 3.3% discount to an independent property valuation as at 27 June 2018 and 0.5% premium to book value of the assets. MLT has paid a 20% deposit to CWT SG Group's solicitors upon the signing of the conditional sale and purchase agreements ("SPAs") on 4 July 2018, though refundable if the transaction is terminated. MLT is proposing to buy the warehouse assets and not entities holding the assets.

Key Conditions Precedents:

(i) JTC approval.

(ii) The proposed sale in aggregate is considered a Very Substantial Disposal under Hong Kong listing rules (where CWTI is listed). This sale-and-leaseback would require CWTI shareholders approval. We do not expect CWTI shareholders to object given the unlocking of cash for the group.

(iii) CWT SG Group's written confirmation that an existing right of refusal granted in favour of a REIT in relation to the sale of the properties is not being exercised or has lapsed. This Condition Precedent has been fulfilled at time of transaction announcement.

Sale-and-leaseback: MLT view the warehouses currently owned by CWT SG Group as quality assets with unique specification. Post-sale, CWT SG Group will become the Master Lessee of the warehouses and use all the space for its day-to-day business operations. The Master Lease agreements to be entered into ranges from 5 to 10 years. We note that CWT SG Group will also become MLT's single largest tenant post-transaction (assuming deal goes through), contributing 9.5% of total gross revenue. Prior to the transaction, CWT SG Group was not featured in MLT's top ten tenant list. This may indicate that MLT, an experienced asset-owner, being comfortable with CWT SG Group and its underlying operations despite the change in shareholding and subsequent delisting. While CWT SG Group leases out certain space to sub-tenants, these only make up a third of rents payable to MLT. Bulk of MLT's rents hinge upon CWT SG Group's continued ability to run its logistics business.

Figure 2: Assets under the proposed sale-and-leaseback

Location	Seller (specific entity)	Type	Consideration (SGD mn)	Book value as at 31 Dec 2017	Lease Terms	First Year Rent Payable to MLT (SGD mn)
6 Fishery Port Road	CWT SG	Temperature controlled and ambient warehouse	244.0	237.7	10 years	15.2
52 Tanjong Penjuru	SM Integrated Transware Pte Ltd	Chemical and ambient warehouse	179.0	171.3	10 years	11.6
4 Pandan Avenue	CWT Project Logistics Pte Ltd	Chemical and ambient warehouse	117.0	130.2	5 years	8.4
5A Toh Guan Road East	CWT Logistics (S) Pte Ltd	Ambient warehouse	115.0	108.7	6 years	8.2
38 Tanjong Penjuru	CWT SG	Chemical and Ambient / Registered office of CWT SG	75.0	78.6	10 years	5.0
Total			**730.0**	**726.5**		**48.4**

Source: CWTI and MLT announcements and analyst presentations

Bridge loan to be provided by proposed buyer: While two of three additional principal terms disclosed looks standard, the SPAs also set out an obligation by MLT to provide a bridge loan of at least USD100mn (~SGD136mn) in aggregate to CWT SG upon written notice from CWT SG. The detailed terms and conditions (eg: whether any interest will be charged, tenor, tranches etc) have not been agreed upon, though broad intentions have been disclosed (1) Should any such amounts remain outstanding at time of completion, the intention is for MLT to offset amounts advanced under the bridge loan against the sales consideration to be paid (2) If the transaction does not complete/aborted, the amounts disbursed to CWT SG shall be refunded to MLT. Should (2) happen, effectively MLT would have lent money to CWT SG with CWT SG being obliged to pay back the sums. As far as we are aware, the provision of a bridge loan by buyers is not typical among sales-and-leaseback transactions within the Singapore Industrial REITs space. Nonetheless, we can imagine why such a term may have been included given the tight liquidity situation at CWTI. In our view, MLT could have also agreed on such atypical terms as the warehouses would have seen considerable bidding interest from other buyers.

New Right of First Refusal ("ROFR"): As part of the proposed sale, CWT SG has granted MLT the ROFR to acquire 47 Jalan Buroh which is subject to the prior right of refusal to JTC. Effectively, MLT has the right to buy if JTC's right lapses/not exercised. The property is a mega-logistics complex.

C) Indicative Use of Proceeds

CWTI has disclosed the following indicative use of proceeds from the sale-and-leaseback:

(i) ~5% for rental guarantee payable to MLT under the terms of the Master Lease agreements to be entered by CWT SG Group.
(ii) ~20% repayment of mortgage loans over the warehouses. We note that MLT is proposing to buy the warehouses clean without any debt attached to it.
(iii) Remainder for repayment of CWTI group's financing (ie: CWTI, other entities owned by CWTI and CWT SG Group).

Assuming net proceeds of SGD721mn is received, after paying (i) and (ii), SGD540.8mn in remaining cash would be available for repayment.

D) Implied cost of funding

As yet, we do not know if the acquisition debt taken by CWTI to buy CWT SG has been repaid and/or refinanced. USD300mn (~SGD409mn) was due in May 2018 and another USD261mn (~SGD356mn) will come due in September 2018. What we do know is that wholly-owned subsidiaries such as CWT SG generally can transfer cash upwards to its parent company (eg: via dividends, advances).

For the first year, the total rent to be paid by CWT SG Group to MLT is estimated at SGD48.4mn. Since assets are monetised to get upfront cash, the scheduled rents can be seen as the cost that CWT SG Group has to bear under the sales-and-leaseback transaction. We do not know if the SGD540.8mn in remaining use of proceeds will be retained at CWT SG Group or used for other purposes. Hypothetically, if (1) The cash is not retained at CWT SG Group but transferred to CWTI and (2) CWTI uses the cash to repay the acquisition debt owed, it then stands to reason that CWT SG Group would be part-financing its parent company at 6.6% p.a cost to buy itself.

E) Relevant clauses that exist to protect bondholders

Clause	Issue: both the CWT SG SGD bonds	OCBC Credit Research Commentary
Financial covenants	(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	CWT SG's financial statements are no longer public post-delisting though this should be available to bondholders annually. We take some comfort that financial covenants should protect CWT SG from being overly levered.
Disposal of Material Subsidiaries is an Event of Default ("EoD")	The Issuer or any of its Principal Subsidiaries ceases or threatens to cease to carry on all or a material part of its business (except, in the case of a Principal Subsidiary only, for the purposes of a reconstruction, amalgamation, reorganisation, merger or consolidation on terms approved by the Trustee before such cessation or threat to cease) or any disposal that is in breach of Clause 15.25 of the Trust Deed is an EoD	This clause exists to protect bondholders against asset-stripping, though certain types of sale transactions may be carved out. Net-net, given that certain information is non-public (ie: Trust Deed) and only available to bondholders, we are unable to opine whether or not this clause has been breached. We urge bondholders to seek legal advice on protections/remedies afforded.
Negative pledge	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 SG to another member of the CWT SG Group, provided that the security is required by law	As assets are not allowed to be pledged (unless approved or per normal course of business), this clause aims to protects bondholders' priority of claims over issuer's assets.

F) Scenario: Deal completion

In a scenario where the deal is allowed and reaches completion, bondholders would be holding a weaker credit with heightened uncertainties over future asset protection. EBITDA margins are likely to fall given that CWT SG Group would be paying rental expense on its previously owned property assets. The issuer will also see contribution from Logistics segment fall as a proportion of total EBITDA. While

CWT SG Group will no longer be recording depreciation expenses on these warehouses, this is inconsequential to cash flow.

Scenario assumptions:

- CWT SG Group consists of Logistics, Commodity Marketing, Engineering Services and Financial Services and these businesses have not substantially changed since CWTI's acquisition of CWT SG Group.
- MLT buying only the five warehouse assets and not taking over any mortgage debt associated with these assets.
- Additional rental expense of SGD48.4mn to be paid to MLT.
- SGD144.2mn from sale proceeds used to repay mortgage debt on warehouse properties, reducing debt levels at CWT SG Group.
- Cost of debt of 3.2% p.a. Assumed interest expense is reduced as mortgage debt on the warehouses is paid down.
- SGD540.8mn to be transferred to CWTI, rather than retained by CWT SG Group.
- In June 2018, CWT SG Group sold stakes in the managers of CACHE Logistics Trust. Assume that SGD52.2mn of cash from sales is transferred to CWTI rather than retained at CWT SG.
- No other sale of assets. CWT SG Group continues to hold six warehouse facilities and other assets in Singapore.

Figure 3: Proforma Financials for FY2017

SGD mn	Logistics	Commodity Marketing	Engineering Services	Financial Services	Others	Total
Revenue	935.4	10,943.8	110.7	1,060.3		13,050.2
Interest income	3.2	13.0	0.4	6.7		23.3
Interest expense	(16.2)	(24.2)	-	(3.5)		(43.9)
Depreciation & Amortisation	(91.6)	(6.2)	(1.7)	(0.3)		(99.9)
Gains /(loss) on disposal of PPE	56.5	-	-	-	NA	56.5
Profit before tax	47.5	17.0	16.0	14.8		95.3
Adjusted profit before tax	(9.0)	17.0	16.0	14.8		38.7
EBITDA	95.5	34.5	17.3	11.9		159.2
Assets	1,862.3	1,741.8	71.1	958.1		4,633.3
Debt	291.0		880.0		200.0	1,371
EBITDA margin						1.2%
Logistics EBITDA contribution to total EBITDA						60.0%
Gross debt-to-asset						30%
Gross debt-to-EBITDA						8.6x
EBITDA/Interest coverage						3.6x

Source: OCBC Credit Research analysis, CWTI annual report, CWT Ltd quarterly financial statements up until 30 September 2017

Note: (1) Segmental results annualized from 7 September 2017 to 31 December 2017
(3) Debt under "Others" refer to the two SGD bond outstanding
(4) EBITDA does not include the one-off gains/(loss) on disposal of property, plant and equipment

Figure 4: Proforma Financials Assume Deal Completion

SGD mn	Logistics	Commodity Marketing	Engineering Services	Financial Services	Others	Total
Revenue	935.4	10,943.8	110.7	1,060.3	NA	13,045.3
Rent expense due to the sales and leaseback	(48.4)	-	-	-		(48.4)
Interest expense reduction	4.6	-	-	-		4.6
EBITDA	51.7	34.5	17.3	11.9		115.4
Assets	1,135.8	1,741.8	71.1	958.1		3906.8
Debt	146.8	880.0			200.0	1,226.8
EBITDA margin						0.9%
Logistics EBITDA contribution to total EBITDA						45%
Gross debt-to-asset						31%
Gross debt-to-EBITDA						10.6x
EBITDA/Interest coverage						2.9x

Source: OCBC Credit Research analysis

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