Asia Credit Research

Credit Update: Century Sunshine Group Holdings Limited ("CENSUN")

Recommendation

- CENSUN had reported a strong set of revenue and EBITDA numbers for 2018. Nonetheless, we expect the pace of growth for both of CENSUN's Fertiliser and Magnesium businesses to slow down over the medium term.
- Interest coverage ratio had improved to 6.6x in 2018 although net debt-to-market value of equity, which we think is a better measure of leverage levels for the case of CENSUN, is elevated at 1.5x. A pulled USD bond deal in 1Q2019 adds to the uncertainty over refinancing in our view.
- **Recommendation:** We **are lowering the issuer profile of CENSUN to Negative (6)** from Neutral (5) on the back of expectations over heightened competition of its businesses and crimping of financial flexibility where it no longer meets Neutral (5) under our Issuer Profile Score ("IPS") scale. We are underweight on the CENSUN 7% '20s which is trading at an ask YTM of 8.7% (678bps above swap). While Aspial Corp Ltd is not a perfect comparable, we hold its issuer profile is similarly at Negative (6). Aspial Corp Ltd has two bonds due respectively in April and August 2020 trading at 611bps and 723bps respectively. At this point we do not think the CENSUN 7% '20s will be called in July 2019 at 103.50.

Issuer Profile: Negative (6)

Ticker: **CENSUN**

Background

Listed on the HKSE in 2004, Century Sunshine Group Holdings Limited ("CENSUN") has two main business segments: magnesium products and fertilisers. The magnesium business is held via CENSUN's 72.4%-stake in Rare Earth Magnesium Technology Group Holdings Limited ("Rare Earth"), a separate HKSE-listed company. CENSUN is ~34% owned by the founder/Chairman while IFC has a ~17% interest (5% direct stake and 12% from collateral for a loan).

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Relative Value:

Bond	Maturity	Net gearing[1]	Ask Yield to Maturity	Spread
CENSUN 7% '20s	03/07/2020	1.5x	8.7%	678bps
ASPSP 5.3% '20s	01/04/2020	3.2x	8.1%	611bps
ASPSP 5.25% '20s	28/08/2020	3.2x	9.2%	723bps

Source: Bloomberg, Indicative prices as at 22 April 2019
Net gearing per latest financial information available, based on net debt-to-market value of equity

Key Considerations

- **Strong revenue reported in 2018 though pace of growth may slow down over the medium term:** Revenue increased by 35.2% y/y to HKD4.7bn, driven by volume and average selling price ("ASP") growth for both of CENSUN's key segments. Specifically, the Fertiliser business saw sales volume increased by 20.5% y/y while ASP grew by 13.8% y/y. Magnesium Product Business saw volume grow 21.8% y/y while ASP grew 11.2% y/y. Reported gross profit margin was relatively steady at 24.5%, with gross profit growing in line with revenue. While CENSUN has managed to report still strong growth in 2018, the pace of growth has declined to 35% y/y (2017 versus 2016 revenue grew by 46% y/y, CENSUN started consolidating Shandong Hongri since April 2017). While CENSUN does not breakdown volumes between fertiliser types, non-speciality fertiliser margins are often much lower at less than 10% based on observations. Whilst CENSUN's still high gross margin is attributable to its specialty fertilisers, we think competitors (particularly large scale market leaders) who are accelerating their push into the specialty space could reduce CENSUN's gross margins down the road.

- **Magnesium business also facing headwinds:** On a standalone basis, Rare Earth reported HKD1.5bn in revenue from continuing operations (up 33% y/y), generating a gross profit margin of 27% in 2018. In July 2018, Rare Earth had disposed of its legacy electronic business for a one-off gain of HKD69.5mn. While Rare Earth's profitability looks to be strong in 2018, CENSUN has disclosed that in recent years there has been excess supply and the growth outlook for the magnesium market is also muted. Chinese magnesium is reliant on automobiles, computer, communication and consumer electronics products. For the first three months of 2019, growth in China auto sales have declined on a y/y basis (eg: March 2019 down 6.9% y/y). Rare Earth has announced a final dividend of HKD0.50 cents (HKD0.005 per share) for 2018, representing only ~15% of Rare

Earth's profit for the year from continuing operations and ~HKD24mn in dividends to CENSUN.

- **Interest coverage still strong:** EBITDA (based on our calculation which excludes other income and expenses) was HKD1.1bn, up 54% y/y. Despite the 4.1% y/y increase in finance cost (including capitalised interest) which was driven by the higher average debt in 2018, we find EBITDA/Interest coverage to have improved to 6.6x from 5.0x in 2017. Based on our estimation, CENSUN's cash conversion cycle on basic working capital items had decline in 2018, indicative of faster cash collection. Despite higher absolute net cash flow from operations (before tax and before interest ("CFO"), CFO as a proportion of EBITDA was actually smaller in 2018 versus 2017 as other types of working capital items had increase, including prepayment of inventory, deposits and other receivables.

- **Net gearing looks moderate but incongruent with market implied levels:** As at 31 December 2018, CENSUN's adjusted net gearing (excludes pledged cash) (net debt-to-book value equity) was 0.38x, somewhat higher than the 0.35x as at 30 June 2018 (31 December 2017: 0.38x). That being said, CENSUN's market value of equity as at 22 April 2019 of ~HKD1.0bn is only ~26% of its end-2018 book value. CENSUN's total assets were HKD7.5bn at end-2018, with HKD3.8bn comprising property, plant and equipment. Of these PPE, HKD1.3bn are construction-in-progress, which in our view limits the marketability of the asset class if not completed. Whilst market value of equity tend to be volatile (past 12 months, CENSUN's equity ranged from HKD0.18 to HKD0.27 per share), we think at this stage it is a better reflection of net gearing and find net debt-to-market value of equity relatively significant at 1.5x.

- **Access to capital markets crimped:** Including exchangeable bonds whose exchange right has lapsed, CENSUN faced HKD1.1bn in short term debt at end-2018, representing 53% of its gross debt against unpledged cash balance of only HKD558.9mn. Cash balance had dwindled from HKD655.7mn at end-2017. In 2018, apart from capex and interest payments, net repayment of debt and loan from non-controlling shareholders amounted to ~HKD133.6mn. Adding to the uncertainty over its refinancing ability; CENSUN pulled a proposed USD bond deal in 1Q2019. This proposed deal occurred in January 2019, and was perhaps ill-timed given broader sector weakness for Chinese industrial companies then. CENSUN's ability to tap capital markets at reasonable cost of funding has been compromised and a credit negative in our view. That being said gross debt-to-EBITDA was lower at 1.9x in 2018 (2017: 2.9x) while capex commitment at end-2018 was lower at HKD179.2mn. In contrast, in 2018, CENSUN spent a significant ~HKD700mn on capex (purchase of PPE) while ~HKD915mn was spent in 2017. Our base case assumes that CENSUN will be cognizant of its cash availability in planning its growth capex and push back capex schedules where need be. These factors should encourage other capital providers (eg: bank lenders) to remain being supportive of the company.

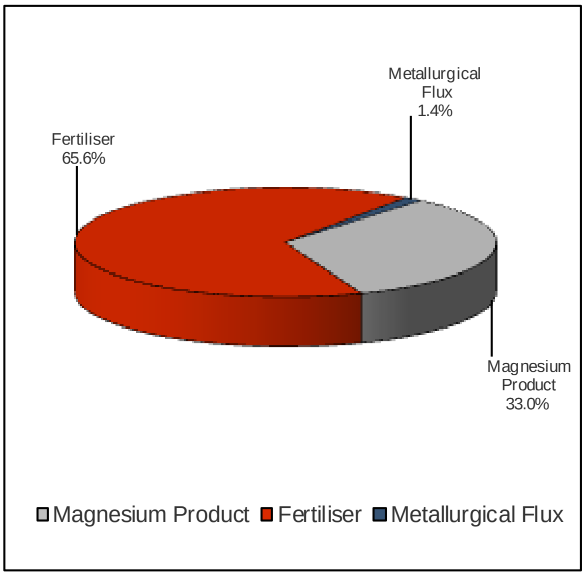
Century Sunshine Group Holdings Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2016	FY2017	FY2018
Income Statement (HKD'mn)	**HKD'mn**	**HKD'mn**	**HKD'mn**
Revenue	2,589.2	3,443.2	4,655.1
EBITDA	635.8	636.0	992.6
EBIT	506.1	479.3	775.1
Gross interest expense	126.6	158.4	164.9
Profit Before Tax	456.9	405.9	723.2
Net profit	313.1	261.6	572.8
Balance Sheet (HKD'mn)			
Cash and bank deposits	901.2	930.9	708.0
Total assets	5,246.5	7,502.3	7,474.6
Short term debt	320.7	626.4	1,087.5
Gross debt	1,540.6	2,047.2	2,065.1
Net debt	639.4	1,116.3	1,357.0
Shareholders' equity	3,054.5	3,653.4	3,956.6
Cash Flow (HKD'mn)			
CFO	522.6	616.0	778.4
Capex	479.0	914.6	699.8
Acquisitions	116.3	-195.5	0.0
Disposals	1.3	10.9	38.5
Dividend	59.8	0.0	0.0
Free Cash Flow (FCF)	43.6	-298.7	78.6
Key Ratios			
EBITDA margin (%)	24.56	18.47	21.32
Net margin (%)	12.09	7.60	12.31
Gross debt to EBITDA (x)	2.42	3.22	2.08
Net debt to EBITDA (x)	1.01	1.76	1.37
Gross Debt to Equity (x)	0.50	0.56	0.52
Net Debt to Equity (x)	0.21	0.31	0.34
Gross debt/total assets (x)	0.29	0.27	0.28
Net debt/total assets (x)	0.12	0.15	0.18
Cash/current borrowings (x)	2.81	1.49	0.65
EBITDA/Total Interest (x)	5.02	4.01	6.02

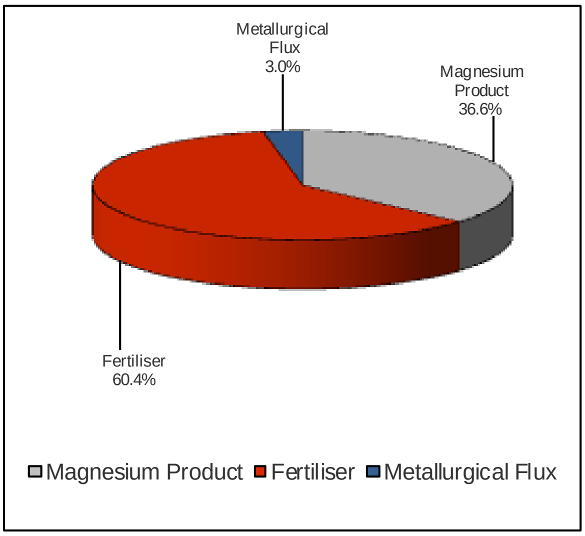
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2018



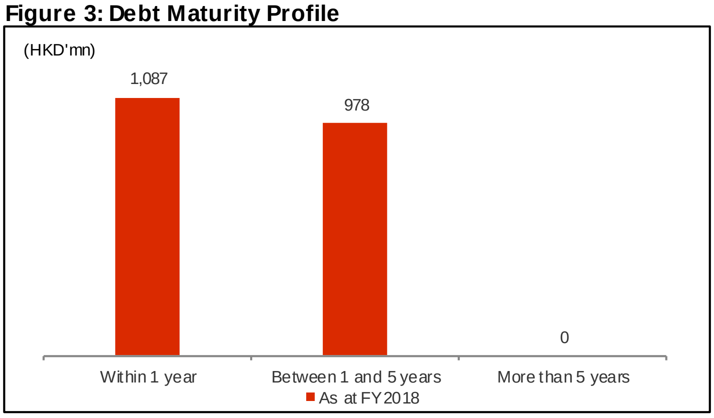
Source: Company

Figure 2: EBIT breakdown by Segment - FY2018



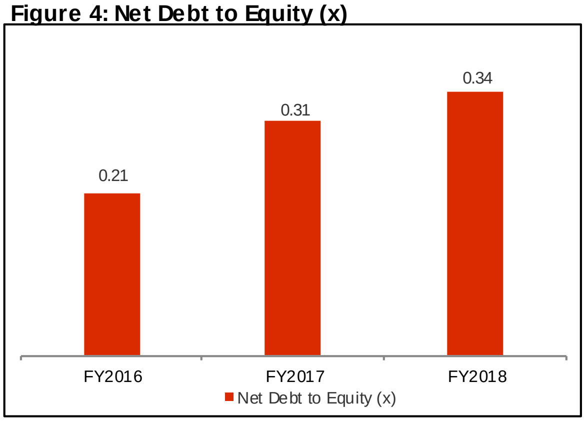
Source: Company

Figure 3: Debt Maturity Profile



Source: Company, OCBC estimates

Figure 4: Net Debt to Equity (x)



Source: Company

OCBC Global Treasury	
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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 financial interests in the above-mentioned issuer or company as at the time of the publication of this report.

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