

## Issuer Profile:

Neutral (5)



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## Ticker:

CELSP

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# CITIC Envirotech Ltd (“CELSP”)

## Recommendation

- On 6 November 2019, CEL and its immediate holding company CKM (Cayman) Company Limited (“Offeror”) jointly announced that the Offeror has presented a formal proposal to seek the voluntary delisting of CEL, subject to fulfilment or waiver of the pre-condition including approvals and requisite filings with the government and regulators including the National Development and Reform Commission, Ministry of Commerce and State Administration for Foreign Exchange within four calendar months.
- The Offeror is an indirect wholly-owned subsidiary of CITIC Environment Investment Group Co Ltd (“CITIC Environment”), the environmental services arm of CITIC Limited, a conglomerate which is majority controlled by CITIC Group, a central government state-owned enterprise, which also plays a role in executing public policy objectives.
- Assuming that the transaction is successful, 77.9%-stake of CEL would be indirectly owned by CITIC Environment while 22.1%-stake will be retained by CEL’s current second largest shareholder. We see a good likelihood that CEL would be taken private, with the company delisted as per intended by the Offeror.
- Ordinarily, we view it to be a credit negative event when a SGD-denominated issuer is facing delisting due to the lack of public disclosure as an unlisted issuer, among various reasons. Though for the case of CEL, net-net we think this is a credit positive event for CEL as it increases the alignment of interest between CEL and CITIC Limited which had been aiding CEL’s credit profile. We are maintaining our issuer profile of Neutral (5) of CEL which does not factor in further state support beyond improvement in financial flexibility from its CITIC Limited parentage. Post delisting, there is no continuing obligation of CEL to publicly disclose material information including financials and as such we may cease coverage of CEL at that point.
- There is no perfect comparable for this issuer in the SGD-space though among perpetuals with shorter first call dates and an issuer profile of Neutral (5), CELSP 3.9%-PERP is trading at a YTC of 6.56%, we see the likelihood of a call at first call as good and are Overweight this perpetual.

## Relative Value:

Bond	Maturity / Call date	Adjusted net gearing	Ask YTC	Spread
CELSP 3.9%-PERP	19/10/2020	1.4x	6.56%	517bps
SCISP 3.7%-PERP	22/06/2020	1.3x	3.72%	231bps
OLAMSP 5.5%-PERP	11/07/2022	1.7x	4.84%	346bps

Indicative prices as at 7 November 2019 Source: Bloomberg  
Adjusted net gearing based on latest available quarter; assuming 100% of perpetual as debt, excluding lease liabilities

## Background

- CITIC Envirotech Ltd (“CEL”) is an integrated water treatment solutions provider focusing on the Chinese market. CEL operates in three main business segments: Engineering, Treatment and Membrane system sales.
- CITIC Limited holds a deemed 56.36%-stake in CEL while China Reform Fund Management Co., Ltd (“CRF”), a state-backed private equity firm has a deemed interest of 22.12%-stake in CEL (via investment funds). 0.6%-stake is owned by individual founders of the company while ~21%-stake is held by the public. As at 7 November 2019, CITIC Limited has a market cap of USD38.9bn.

## Key Considerations

- **No delisting put:** CEL has a sole perpetual outstanding, the CELSP 3.9%-PERP with an outstanding amount of SGD240mn and faces first call date in October 2020. There is no delisting put for this perpetual and perpetual holders would be holding a perpetual issued by an unlisted entity when the delisting comes through. In our view, the change of control clause also does not apply in this situation given that the Offeror is a CITIC Limited entity. Ordinarily, we view it to be a credit negative event when an issuer is facing delisting due to the lack of public disclosure, among various reasons. For the case of CEL, we think this is negated due to the transaction resulting in stronger alignment of interest with CITIC and the perpetual remains likely to be called.
- **Stronger alignment of interest with CITIC:** CITIC Limited would indirectly own 77.9% of CEL versus the current ~56.4%, with the higher ownership stake implying increased economic alignment between CITIC Limited and CEL. Already we have seen [CEL benefitting from broader access to external banking relationships and related party financing via CITIC Finance Company Limited](#) since October 2018. More recently in September 2019, CEL also announced that it has entered into a conditional agreement with a [CITIC Group associate company in Kazakhstan](#) which signals further cooperation with the broader CITIC Group. The remaining ~22.1%-stake would continue to be deemed held by CRF, the state-back private equity fund. While we do not have the full ownership structure of CRF, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) of the Qingdao Municipal Government ("Qingdao SASAC") has a deemed ~22.1%-stake in CEL through CRF, via voting powers and ownership interests in other entities.
- **Perpetual likelier to be called:** The SGD-denominated CELSP 3.9%-PERP comes with a high step-up margin of 500bps if not called in October 2020 and we think CEL would be more economically incentivized to redeem and/or replace the perpetual during that time. Based on today's forward swap rates, the perpetual distribution rate will rise to ~8.8% p.a if not called. For the avoidance of doubt, CITIC Limited does not explicitly guarantee the obligations of CEL. That being said, with CITIC Limited's cost of funding being lower (for example, its USD-denominated senior bonds maturing in April 2021 is trading at 2.77%), we see the likelihood of CITIC Limited supporting a redemption and/or replacement as good, if required.
- **No "moral obligation" for unlisted entity to pay dividends:** As an unlisted entity CEL may stop paying dividends to its shareholders which would mean there is no obligation for CEL to pay distributions to its perpetual holders (ie: the dividend stopper and dividend pusher becomes moot). While this is a possibility, in our view, this is a tail-risk event as non-payment of its perpetual distribution may lead to reputation risk for broader USD-bond funding at CITIC Limited in our view, with this issuer having USD8.0bn of senior bonds outstanding vis-à-vis SGD240mn (~USD177mn) of perpetual outstanding at CEL.
- **.....though dividends were already uncertain even as a listed entity:** Furthermore, CEL's ability to generate free cash flow continues to be constrained due to its high spending on project wins while historically dividend payment frequency had been irregular. In 9M2019, CEL had paid only SGD23.0mn in cash dividends (9M2018: SGD65.3mn) to its shareholders. Even assuming that the company remains listed, there is no certainty that CEL would continue paying dividends, making the dividend stopper and dividend pusher less useful in our view.

### Explanation of Issuer Profile Rating / Issuer Profile Score

**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 into a 7 point Issuer Profile Score scale.

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

**Please note that Bond Recommendations are dependent on a bond’s price, underlying risk free rates and an implied credit spread that reflects the strength of the issuer’s credit profile. Bond Recommendations may not be relied upon if one or more of these factors change.**

### 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.

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#### 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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