Asia Credit Research

OCBC Bank

Global Logistics Properties: Credit Overview

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- **Global Logistics Properties Limited ("GLP") has announced that it is in discussions with various parties in connection with a possible sale. Substantial shareholder GIC has shown its hand as a motivated seller**
- **GLP's USD bonds have reacted negatively on the back of news that GLP has become a private equity target (spreads have widened 70bps)**
- **We believe the spreads on the USD GLPSP'25s may spike a further 80-85bps to peak and oscillate around key events before stabilising inside of 330bps spread. We think investors should Hold on the GLPSP'25s despite the impending volatility. We think 50-55% of potential spread widening has occurred under our base case and selling now would immediately realise a 9% capital loss (93 from 102 pre-announcement)**

OCBC Credit Research currently does not cover GLP. We have presented this paper as a special interest commentary.

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Background: In December 2016, Global Logistics Properties Limited ("GLP") announced that it was undergoing an independent strategic review of options available for its business. This was done on the back of a request received from its largest shareholder holding ~37% stake, namely, GIC Real Estate Private Limited ("GIC"). In January 2017, the company further announced that it was in discussions with various parties in connection with a possible sale. No definitive transaction has been entered into yet. Per various media reports, first round offers for the company are expected to be received by early-February 2017. Possible bidders reportedly in the process include private equity groups (Warburg Pincus, Blackstone, Hopu/Hillhouse Capital/CIC). Given the scale of the acquisition, a consortium combining some strategic bidder interest is likely. For example, a consortium involving portfolio companies owned by private equity. The exact impact to GLP's credit profile post-transaction is dependent on who the final bidder is and intended capital structure post-acquisition. Our base case assumes GLP's credit rating falls to HY though does not unduly put the company in a stressed situation.

GLP, listed on the Singapore Stock Exchange with a market cap of USD8.7bn (as at 20 January 2017) is a leading manager, developer and owner-operator of logistics facilities. Key geographical segments by revenue contribution are Japan (56%), China (36%), US (6%) and Brazil (2%).While GLP's current credit rating (NR/Baa2/BBB+) does not factor in an explicit uplift due to GIC's ownership, GIC has been an important partner in GLP's growth and held ~51% in the company immediately post-IPO in 2010, with board representation.

With GIC having shown its hand as a motivated seller, we see the likelihood of a deal being done as high. GLP is attractive as an acquisition target, compounded by the lack of sizeable targets and liquidity held by private equity waiting to be deployed in the region.

Figure 1: GLP's USD and SGD Bonds

Issue	Maturity/ First Call Date	Outstanding Amount	Ask Price	Ask YTW (%)	I-Spread	Bond Rating
GLPSP 3.875 '25	4 June 2025	USD 1,000 mn	93.0	4.9	270	NR/Baa2/BBB+
GLPSP 5.5 '49c17	7 April 2017	SGD 750 mn	100.75	1.6	92	NR/NR/BBB-

Note: Indicative prices as at 24 January 2017

Relevant Key Terms

No standardized safeguards on occurrence of M&A: Bondholder protections in the event of merger & acquisition activities ("M&A") are not included as matter-of-course in bond documentation (SGD bond market is no exception). For example: Change of Control puts, mergers covenants, delisting puts (for listed issuers), negative pledges. Such clauses are available to bondholders on a case by case basis and subject to negotiation amongst investors, taking into account pricing and terms.

Mandatory offer likely to be triggered: An acquisition of GIC's ~37% stake by a new buyer (or parties acting in concert) is likely to trigger a mandatory offer. The top 10 shareholders apart from GIC collectively hold ~29% stake. Of these, 8 shareholders are asset managers who would need to consider the deal's merits (ie: pricing likely to take precedence). Two individual shareholders are connected to the company (Mr. Mei, the Co-Founder/CEO of GLP with 1.08% stake and Mr. Fang, a director of GLP's board and Founding Partner of Hopu with 1.6% stake). The remaining shareholding is dispersed and largely institutional-based. A mandatory offer in itself does not automatically mean that GLP will be taken private (acquirer can still keep GLP's listed status unless it breaches the minimum public float of 10%). Given that the possible bidders involve private equity, we assume a delisting of GLP in our base case.

SGD Perpetual Faces First Call in April 2017: In the case of GLP, there is no bondholder's put for the SGD perpetual (outstanding amount of SGD750mn). Nevertheless, the SGD perpetual has a very near term call date in April 2017 (notice to be given by March 2017 if GLP intends to call). The redemption at first call date is at par. Our base case assumes that a deal may stretch beyond April 2017 (in light of bidding tension). The step-up on the perpetual (reset rate of 5-year SOR plus 4.2%) is likely to bring cost of funding beyond 6.2%. As such, we think this step-up sufficiently incentivises GLP to call the perpetual. As at 30 September 2016, cash balances were SGD1.8bn and the company faces short term debt of SGD410mn.

Economic structure incentivises Issuer to Redeem SGD perpetual in a CoC: In the event the perpetual remains outstanding, we think CoC will be triggered. Based on the terms of the perpetual, if the Issuer elects not to redeem at par (after the First Call Date)[1], the distribution rate shall be increased by 5% p.a.

USD bond not subject to explicit CoC protections: There is no CoC put nor an Issuer's right to call the USD GLPSP'25s in the event of a CoC. The Issuer has undertaken that prior to exercising redemption of the SGD perpetual (pursuant to a CoC), it will make an offer to repurchase certain senior debt. We are not privy to the Deed Poll and uncertain if the legality of this undertaking applies to the GLPSP'25s (issued in 2015, after the SGD perpetual was issued). No further publicly available information has come to our attention on this matter. Regardless, our base case assumes that USD bondholders will need to face new shareholder(s) if the deal gets done and we view it probable that the SGD perpetual will be called prior to a CoC being triggered.

Disposal of Material Subsidiaries as an Event of Default provides protection from asset-stripping: This clause protects existing USD bondholders from the bonds being supported by a smaller asset base with lower cash flow generation capacity. The cessation/disposal of Material Subsidiaries (defined as subsidiaries whose total assets are at least 5% of the total consolidated assets) would constitute an Event of Default. We think this reduces the appeal of GLP as a target for corporate raiders. In practice, what this means is that bondholders are likely to get to vote on whether or not they are agreeable to cessation/disposal of key assets (including in the case of disposal of assets into a REIT, IPO/trade sale of key business units). However, certain internal restructuring could take place prior to a disposal, rendering such disposal to fall below the requisite thresholds and circumventing a bondholder vote. This is however not our base case given the negative implications on future fundraising from debt capital markets.

Base case assumes not more than USD2bn in acquisition debt pushdown: Under a typical leveraged buyout scenario, buyer(s) will attempt to push down acquisition debt. The exact quantum will be decided factoring capex requirements, debt servicing needs and growth plans. Our base case assumes that the new buyer is able to push down 2.0x-3.0x of EBITDA worth of debt (USD1.3-1.9bn). In its report dated 7 December

[1] *Redemption @101 if redemption upon a CoC occurs prior to First Call Date on 7 April 2017*

2016, Moody's had opined that GLP's 7.4x[2] net debt-to-EBITDA is stretched for its current credit rating. The current EBITDA/Fixed Charge of 3.0x is manageable. Moody's numbers imply adjusted net debt of USD4.8bn and fixed charges of USD216mn.

No limitation on indebtedness and no financial covenants. Negative pledge does not sufficiently protect USD bondholders from higher debt: In a worst case scenario, a new buyer can attempt to raise additional debt to pay itself special dividends after the acquisition (ie: dividend recapitalisation). In practice, we think it will be challenging for GLP to raise unsecured bonds to fund a large dividend recapitalisation. In addition, the Negative Pledge within the USD bond documentation confer existing USD bondholders the same security package if GLP and its Material Subsidiaries were to offer these on other bonds. Nevertheless, this Negative Pledge appears to carve out bank debt. As at 31 March 2016, USD6.4bn in investment properties was encumbered. We estimate that USD7.2bn in investment properties still remains unencumbered and assuming a Loan-to-Value ratio of 70%, a new buyer may be able to raise up to USD5bn in additional debt for dividend recapitalisations. Our base case assumes dividend recapitalisation within 3 years post-acquisition though contained within USD1bn.

Figure 2: Clauses that can offer bondholder protection in the event of M&A:

Clause	Issue: GLPSP 3.875 '25 Principal outstanding: USD1.0bn	GLPSP 5.5 '49c17 Principal outstanding: SGD750mn
Mergers covenant	None	- CoC clause covers consolidation or merger which results in other person(s) acquiring control over the Issuer or successor entity
Change of control ("CoC") covenants	No change of control put	- No change of control put but the securities may be redeemed (in whole but not in part) at the Issuer's option following the occurrence of a CoC @101 - If Issuer elects not to redeem, distribution rate shall be increased by 5% p.a; this step-up economically incentivises a redemption - Control means (1) ownership or control of more than 50% of voting rights of the issued share capital of the Issuer or (2) right to appoint and/or remove all or the majority of the board members
Mergers covenant	None	- CoC clause covers consolidation or merger which results in other person(s) acquiring control over the Issuer or successor entity
Redemptions triggered by downgrade of credit ratings	None	None
Delisting put	None	None
Financial covenants	None	None
Limitation of Indebtedness	None	None
Negative Pledge	- The Issuer will not permit to subsist (and will ensure none of its Material Subsidiaries) create or permit to subsist mortgage, lien, pledge or charges (collectively, "security") unless the same is extended to the bondholders - However, this only applies to bonds, notes and debentures - Carves out bank debt	None
Disposal of Material Subsidiaries as an Event of Default	- If the Issuer or any of its Material Subsidiaries (contributes 5% of more to total asset) ceases of threatens to cease to carry on	None

[2] *EBITDA adjusted for operating leases and pro-rata share of EBITDA contributions from joint ventures while Debt is adjusted for operating lease, 50% of perpetual securities, and pro-rata share of joint venture debt; total assets adjusted for pro-rata share of joint venture debt. Moody's Last 12 months EBITDA of USD648mn as of September 2016*

	all or any substantial part of its business, this constitutes an Event of Default	

Impact on the USD bond and SGD perpetual: The SGD perpetual is less traded versus the GLPSP'25s and price has stayed relatively constant at 100.75. In contrast, the GLPSP'25s have plummeted with bondholders seeing this news as negative. In November 2016 (prior to company's announcement that it was undergoing a strategic review), the bond was trading above par (102-104) and yielding around 190-205bps. Since 5th January 2017 (when GLP announced it was in discussions with various parties) prices have fallen to 93 and spread widened 70 bps to 270bps (Ask YTM: 4.9%). The GLPSP'25s is still rated at investment grade NR/Baa2/BBB+ with credit rating agencies issuing holding statements.

Key investor concerns behind price drop and commentary:

A) **Exit of GIC:** Given the close relationship that GIC has had with GLP historically, we think some investors have come to give GLP a "GIC premium", which we estimate at up to 40bps based on the pricing of a similarly rated 10 year Asiadollar bond issued in July 2015. We think the "decoupling" from GIC justifies some widening in spreads.

B) **Light covenants:** In our view, GLP's covenants only provide light protection in change of control events. However, this is within the norm of other investment grade Singapore bonds under our coverage and not idiosyncratic to GLP.

C) **Uncertainty surrounding profile of new buyer**: The parties named by the media thus far are private equity firms, heightening concerns that such new buyer(s) may introduce a new capital structure detrimental to the interest of existing bondholders. While private equity buyers have tended to be more aggressive in their use of debt, we think it is far too simplistic in categorizing all private equity acquisitions in the same bucket. The credit profile post-transaction will ultimately depend on the business plan crafted along with capital structure put in place by new owners. In the case of GLP, both Warburg Pincus and Blackstone have pre-existing logistics businesses while Hopu/Hillview Capital/CIC has a Chinese angle that may provide strategic uplift to GLP. Temporally, we would have been more concerned if the USD bond is short tenor.

D) **Potential downgrade to High Yield:** Credit rating agencies have tended to take a conservative view on issuers with a private equity parentage. With the potential risk of a downgrade to HY, we think certain investors (especially those who are not allowed to hold HY in their mandates) have offloaded their holdings as a pre-emption.

Our take on the situation:

We think GLP could still spike another 80-85 bps at announcement of a confirmed deal (from the current 270 bps spread). This factors ~30bps change in shareholding from GIC and 50% increase between pre-transaction to peak, referencing other recent private equity buyout deals. We think yields may oscillate within a 100bps range when significant milestones are announced (eg: commencement of exclusive negotiations, signing of definitive agreements) and as such will be volatile for a period. Upon completion of a transaction, we think the bond will stabilise inside of 330bps spread under our base case.

Our base case assumptions:

- Private equity consortium with a strategic angle as new shareholders
- Higher leverage resulting in a fall from IG to HY but does not put company into a stressed credit situation
- Company is taken private and delisted from the SGX

We have considered the following:

A) Some market adjustment on the back of decoupling from GIC (up to 40bps impact)
B) Two precedent buyout transactions in 2016 concerning publicly listed companies

Item	Description
Deal 1	Public-to-private buyout of Lexmark International Inc. by a consortium comprising Apex Technology (a strategic buyer), PAG Asia Capital (a private equity firm) and Legend Capital Management (Lenovo's private equity/venture capital arm)
Deal Size	USD3.6bn (including debt)
Bond	LXK 5.125 '20s (USD400mn outstanding)
Timeline of Key Events and Impact on Bond	• Strategic review of Lexmark by board announced on 23 October 2015: 270bps • Reportedly received initial bids mid-February 2016: Spikes to 390bps • Enters into definitive agreements on 19 April 2016: Lowers to 300 bps • Deal completed on 29 November 2016: 375 bps • Announces change of control offer to buyback bonds in December 2016
Bond credit rating pre-transaction	BBB-/Baa3/BBB-
Bond credit rating post-transaction	BB/Ba2/BB+
Others	Bond is less liquid, stronger M&A covenants (consummation of merger and occurrence of rating event triggers Change of Control offer @101)
Item	**Description**
Deal 2	Acquisition of ADT Security Services Inc. ("ADT") by Apollo Global Management (a private equity firm), with Koch brother's investment arm as part of the consortium. Apollo intended to merge ADT with its existing portfolio companies Protection 1 and ASG Services at the outset of deal
Deal size	USD15bn (including debt)
Bond	ADT 4.125 '23s (USD699.7mn outstanding)
Timeline of Key Events and Impact on Bond	• One month pre-takeover announcement: 385-444bps • Enters into definitive agreements on 16 February 2016: Spikes to 610 bps • Expiry of "Go-Shop" period on 28 March 2016: moderates to 491 bps • Deal completed on 2 May 2016: moderates further to 388 bps
Bond credit rating pre-transaction	BB-/Ba2/BB+
Bond credit rating post-transaction	BB-/Ba2/NR
Others	Have been subject to takeover rumours in the 5 years running up to takeover offer. Buyers structured deal to maintain credit rating of ADT (and avoid bondholder's rights to accelerate repayment) amidst a challenging financing environment for leveraged buyouts

C) As at 20 January 2017, bullet structure corporate bonds maturing between 1 July 2024 and 30 June 2026 denominated in USD with a HY credit rating by any of S&P, Moody's and Fitch are trading with a median spread of 335bps.

In our view, ~50% of the total widening of spreads between pre-transaction and stabilised spreads has occurred. As such for existing bondholders who can stomach volatility, we would be holding and keeping the carry versus realising the 9% capital loss (from 102 to current price of 93).

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