Asia Credit Research

Hyflux Ltd: Special Interest Commentary

Monday, 22 October 2018

- Hyflux Ltd ("HYF") announced that it has entered into a Restructuring Agreement with SM Investments (owned by Indonesia-based Salim Group and Medco Group).
- SM Investments has agreed to inject new capital into the HFY holding company in the form of new common equity (SGD400mn), shareholders loan (SGD130mn) and super-priority working capital financing (SGD30mn).
- The equity and shareholders loan deal is subject to various stakeholder approvals, including offtakers given Change of Control provisions within the various offtake/concession agreements.
- Existing senior unsecured debtholders (including the SGD bondholders), perpetual and preference shareholders would need to agree to a restructuring deal before the new common equity and shareholders loan would come in.
- Thus far, the media has only reported one other potential deal, namely that a sole bidder had put in a bid for Tuaspring at below amounts owed to its secured lender. In our view, this would have left nothing on the table for stakeholders at the holding company level.
- Versus a liquidation or a forced sale of Tuaspring, directionally, we think this is a positive development for HFY's bondholders as well as perpetual and preference shareholders. It is too early though for us to comment on recovery values as the proposed form of a restructuring deal has not been laid out.
- While new cash into HFY from the SM Investment deal is welcomed, this amount appears heavily conditional and is insufficient to pay out all the amounts owed to various stakeholders. There is still a significantly large cash gap which would need to be reduced via other means. We think at least part of the principal amount on the perpetual and preference shares would need to be equitized.
- With many moving parts and stakeholders (including near-term discussions with its Tuaspring lender), we expect the reorganisation to take time to complete.

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

Background: On 22 May 2018, Hyflux Ltd ("HYF") announced that the company and five of its subsidiaries have applied to the High Court of Singapore to commence a court supervised process to reorganise their liabilities and business. As of report date, HFY and four of its subsidiaries are under moratorium that will last until mid-December 2018 (unless extended by the court). While the remaining entity Tuaspring Pte Ltd ("Tuaspring") is not under moratorium, HFY and Malayan Banking Berhad ("Maybank") as the sole secured lender of Tuaspring has entered into an agreed forbearance period (extended until 29 October 2018). Subsequent to the in-principle extension, on 18 October 2018, HFY announced that it has entered into a Restructuring Agreement with SM Investments Pte. Ltd. ("SM Investments") where SM Investments would inject new capital into holding company (ie: HFY itself).

SM Investments is owned by the Salim Group and Medco Group. The Salim Group owns a diverse range of investments in South East Asia comprising power generation and electricity distribution, water and wastewater treatment as well as oil and gas. In Singapore, the Salim Group is the major shareholder of Singapore Stock Exchange-listed Gallant Venture Ltd and via its stake in First Pacific Company Limited, also controls PacificLight Power (a power generation and electricity retailing company in Singapore). The Medco Group is centred around PT Medco Energi International Tbk, which owns assets in upstream oil and gas, gas pipelines, power generation and mining. Both groups view this investment into HFY as a strategic fit for their existing business footprints.

Treasury Advisory

Corporate FX & Structured Products

Tel: 6349-1888 / 1881

Interest Rate Derivatives

Tel: 6349-1899

Investments & Structured Products

Tel: 6349-1886

GT Institutional Sales

Tel: 6349-1810

OCBC Credit Research

Ezien Hoo, CFA

(65) 6722 2215

EzienHoo@ocbc.com

Relevant Key Terms of the Restructuring Agreement

New capital injection: (1) SGD400mn of new cash for a 60%-stake in the enlarged capital base of HFY. The number of enlarged share base has not been fixed, although the proportion of control has been determined at the outset (2) SGD130mn in shareholder's loan (terms and conditions undisclosed in the announcement) (3) SGD30mn in interim super-priority working capital financing to cover the time period before the completion date of the proposed investment. This SGD30mn of "rescue financing" is intended to be senior to all other debt at HFY.

Completion of Conditions Precedents: These would need to be fulfilled before the SGD400mn of common equity and the SGD130mn in shareholder's loan would come in. The key ones are: (a) Necessary approvals from existing shareholders, SGX on the listing of new shares (b) Approvals by offtakers, namely the Public Utilities Board, National Environment Agency and Energy Market Authority given change of control provisions in various licenses and offtake/concession agreements and (c) A full and final settlement of outstanding unsecured debt, preference shares, perpetual securities, contingent debt and trade debt through either amendment or redemption. In our view, this means that existing senior unsecured debtholders (including the SGD bondholders), perpetual and preference shareholders would need to agree to a restructuring deal before the SGD530mn would come in. As yet, restructuring deal terms have not been laid out. For the avoidance of doubt, the SGD30mn of super-priority working capital is not subject to these conditions precedent.

Other matters: Management retention shares may be allotted and issued to key management team members to ensure business continuity. While terms have yet to be agreed to, this opens the door for management to be allotted part of the remaining 40% stake post-restructuring. While management retention shares conceptually is common across restructuring situations, it is worth noting that in the event of a debt-to-equity swap, any amounts allocated to management would mean less to creditors and other stakeholders. SM Investments also undertakes that it will use reasonable efforts to assist HYF to obtain more working capital and trade facilities as required. We would reasonably expect SM Investments to have its own banking relationships and this indicates an intention on the part of SM Investments to share this accessibility to banking networks with HFY.

Figure 1: Timeline of key events

Key Event	Timeline
22 May 2018	HFY and five subsidiaries applies to High Court of Singapore to commence a court supervised process to reorganise their liabilities and business
19 June 2018	Court hearing • HFY and four subsidiaries enters into a 6 month moratorium period
6 July 2018	Tuaspring's secured lender Maybank and company reached a forbearance agreement • HFY to sign a binding bid with a buyer/investor for Tuaspring by 15 October 2018 • Maybank refrains from commencing enforcement proceedings against Tuaspring during this period
19 and 20 July 2018	Townhall sessions with bondholders, perpetual and preference shareholders
29 August 2018	Company confirms that while it is in reorganisation, coupon and distribution payments on outstanding bonds, perpetual and preference shares would not be paid
2 October 2018	Media reports surface that there has been only one bidder for Tuaspring and the bid price does not cover amounts owed to secured lender
5 October 2018	Company shared that in parallel with the sale of Tuaspring, the company is also talking to strategic investors for investments into the whole business
8 October 2018	Status conference held to provide an update on reorganisation progress as required by court in granting the

	moratorium • Next interim creditor update to be held on 31 October 2018
12 October 2018	Company shares the following: • Tuaspring sale process requires pre-qualification by the offtaker, two parties were pre-qualified of which one has put in a bid • Continues to negotiate with strategic investors for investments in the overall business (with/without Tuaspring)
15 October 2018	Maybank gives in-principle approval on extending deadline to sign up a bidder for Tuaspring by 29 October 2018
18 October 2018	Announces that Restructuring Agreement has been signed with SM Investments

Where to from here

Given this material development, HYF is reportedly now using the two week extension granted to 29 October 2018 to engage with Maybank on the sale process of Tuaspring. Given the struggles with this sales process, and this proposed investment, we expect HYF to negotiate to maintain ownership of the plant based on a more sustainable capital structure going forward. Reportedly, SM Investments and HFY management would also like to maintain ownership of Tuaspring.

According to HFY's town hall presentation, there are SGD900mn in preference shares and perpetual securities and SGD803mn in senior unsecured debt at the HFY holding company level while the proposed Restructuring Agreement indicates only SGD530mn in new cash infusion (from the equity investment and shareholder loan) that can be used towards (1) Settling outstanding unsecured debt, preference shares, perpetual securities, contingent debt and trade debt and (2) Satisfying working capital needs of the group's business. Minimally, the SGD530mn would need to be used to repay the SGD30mn in super-priority working capital financing.

While we do not have the latest figures for trade debt and contingent debt, as at 31 March 2018, trade and other payables for the group was SGD498.2mn while as at 31 December 2017, a net provision of SGD31.3mn was set aside for claims on delays in project completion (ie: a contingent liability).

We expect some form of restructuring package to be forthcoming in coming weeks. It is still too early to comment on what proposed form this package could take and thereby we are unable to comment on recovery values. Apart from cash, restructuring packages can take various forms, for example, a debt-to-equity swap, existing securities exchanged into new types of debt issued by HFY, or less commonly in the SGD bond space, existing securities can also be exchanged into debt issued by the new investors. Nonetheless, we maintain the view that at least part of the perpetual and preference share principal amounts would need to be equitized. Our view is premised on the following (1) New cash coming into the holding company is insufficient to pay out all the principal of these stakeholders and unsecured debt ranks senior to the perpetual and preference shareholders (2) For a company to continue as a healthy going concern, the post-restructuring capital structure will need to be altered with a more sustainable debt load. Net-net, we see it unlikely for the principal amount (even if intact) to be paid fully in cash.

It is also worth recapping that the perpetual and preference shares are already considered as equity in the financials of HFY though in practice, senior unsecured debtholders may find it more palatable to support a restructuring with outright common equity buffer. In the case of HFY, the proposed new equity and shareholder loan injection is lower than the senior unsecured debt amounts and should this class of creditors get equitized (at least in part), it goes to reason that those more junior than them would need to be equitized as well. SM Investments may also prefer these hybrid securities to be restructured too, as these securities currently sit senior to common equity and would continue to sit above their SGD400mn common equity too, if not restructured. In any case, given the conditional nature of the Restructuring Agreement and then multiple stakeholders involved and their varying incentives, we expect the resolution of this restructuring to be prolonged.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.