OCBC Bank

Ticker:
CENSUN

Ezien Hoo, CFA
+65 6722 2215
EzienHoo@ocbc.com

Century Sunshine Group Holdings Limited ("CENSUN")

Where to from here?

- **On 3 July 2020, CENSUN announced that it had defaulted on the SGD101.75mn SGD-bond (ie: the CENSUN 7.0% '20s) as the company had not been successful in refinancing the bonds.**
- **The company has also received demands from two bank creditors for the repayment of borrowings of CENSUN and its subsidiary (guaranteed by CENSUN) amounting to ~HKD51.0mn.**
- **CENSUN had been facing an unresolved maturity wall as captured in our credit update dated 11 November 2019. On 4 March 2020 CENSUN along with nine other issuers under our coverage were placed on a monitor list of companies with stretched liquidity amidst the COVID-19 outbreak.**
- **A proposed convertible bond issue announced in April 2020 to raise HKD300mn which we had seen as credit positive did not come through. We lowered the issuer profile to Negative (7) from Negative (6) on 15 June 2020 and last held the company's issuer profile at Negative (7). Given the default, we officially ceased coverage of CENSUN on 4 July 2020, though we will continue monitoring the situation.**
- **The company is exploring debt restructuring options via a court-supervised provisional liquidation regime under Cayman Islands law. On 9 July 2020, the company announced that the court hearing has been fixed for 14 July 2020 (Cayman Islands time).**
- **While provisional liquidators will be appointed (assuming court approves), we expect board and existing management team to continue with day-to-day control of the business and direct the debt restructuring process.**

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

Disclaimer: Please note that the following reflects our interpretation of the terms in the information memorandum and other public fillings. Where legal, financial or other professional advice is required in relation to any particular matter, please seek advice from your own legal, financial or other professional advisors.

Background

- Listed on the HKSE with a market cap of HKD261mn as at 9 July 2020, Century Sunshine Group Holdings Limited ("CENSUN") is an investment holding company. Together with its subsidiaries, it has two main business segments: magnesium products and fertilisers, focusing on the Chinese market.
- The magnesium business is operated by Rare Earth Magnesium Technology Group Holdings Limited ("REMT"), a separate HKSE-listed company with a market cap of HKD658mn as at 9 July 2020. CENSUN has a 72.3%-indirect stake in REMT.
- CENSUN's founder/Chairman has a deemed interest of ~35% in the company (direct stakes and via his shareholding in Alpha Sino International Limited ("Alpha Sino")).
- The International Finance Corporation ("IFC") has a ~17% deemed interest in the company via a 5% direct stake and 12%-stake held as collateral for a loan granted by the IFC to a subsidiary of CENSUN. The collateral has been pledged by Alpha Sino, the substantial shareholder. The remaining shareholding interest is dispersed.
- CENSUN, the listed entity, is incorporated in the Cayman Islands and the SGD bonds are issued by CENSUN.

Key Considerations

- **First SGD-bond default in 2020:** On 3 July 2020, CENSUN announced that it had defaulted on the

SGD101.75mn SGD-bond (ie: the CENSUN 7.0% '20s) as the company had not been successful in refinancing the bonds. The company added that on 24 June 2020 and 30 June 2020, it had received demands from two bank creditors for the repayment of borrowings of CENSUN and its subsidiary (guaranteed by CENSUN) amounting to ~HKD51.0mn plus interest accrued. In a separate announcement, REMT announced that it has received a demand from one of its bank creditors for the repayment of borrowings of REMT (and subsidiaries guaranteed by REMT) amounting to ~HKD22.9mn plus interest accrued. It is unclear if the ~HKD22.9mn at REMT and subsidiaries forms part of the ~HKD51.0mn at the CENSUN level given that REMT is a subsidiary of CENSUN. CENSUN and REMT did not disclose the identity of subsidiaries which were subject to the bank creditor demands (ie: we do not know with full certainty if any onshore entities are implicated). However, as the affected borrowing amount was quoted in HKD, these are far likelier to be offshore debt rather than onshore debt.

- **……though company has been facing an unresolved maturity wall:** CENSUN-consolidated cash balance (inclusive of cash at REMT) was HKD823.1mn as at 31 December 2019, with the bulk of the cash located onshore. Per company's 26 May 2020 disclosure, unsecured offshore debt of CENSUN-standalone (excluding REMT) amounting to HKD794mn is subjected to repayment or refinancing between June 2020 and December 2020, this was dominated by CENSUN 7.0% '20s with an outstanding amount of SGD101.75mn (~HKD565mn). In November 2019, we had opined that CENSUN was facing a large maturity wall in the form of HKD1.1bn in mostly bank debt coming due in the 12 months from 30 June 2019 to 30 June 2020 with the CENSUN 7.0%' 20s due soon after. Based on our preliminary analysis then of short term uses and sources of funds, CENSUN was facing a gap of HKD1.2bn (a gap of HKD844mn if it defers all capex).

- **On-going support from other capital providers was crucial:** Rather than fully paying down its obligations, a sizeable amount of CENSUN's upcoming obligations (including bank debt) would have needed to be refinanced/rolled-over. With bank creditors demanding repayment, we think this is indicative that the company has lost the support from a number of its bank lenders, which is likely to aggravate a debt restructuring process without new sources of external financing. As a point of note, CENSUN's external auditors, HLB Hodgson Impey Cheng Limited, did not flag going concern issues in its latest available independent auditor's report of the company dated 16 April 2020.

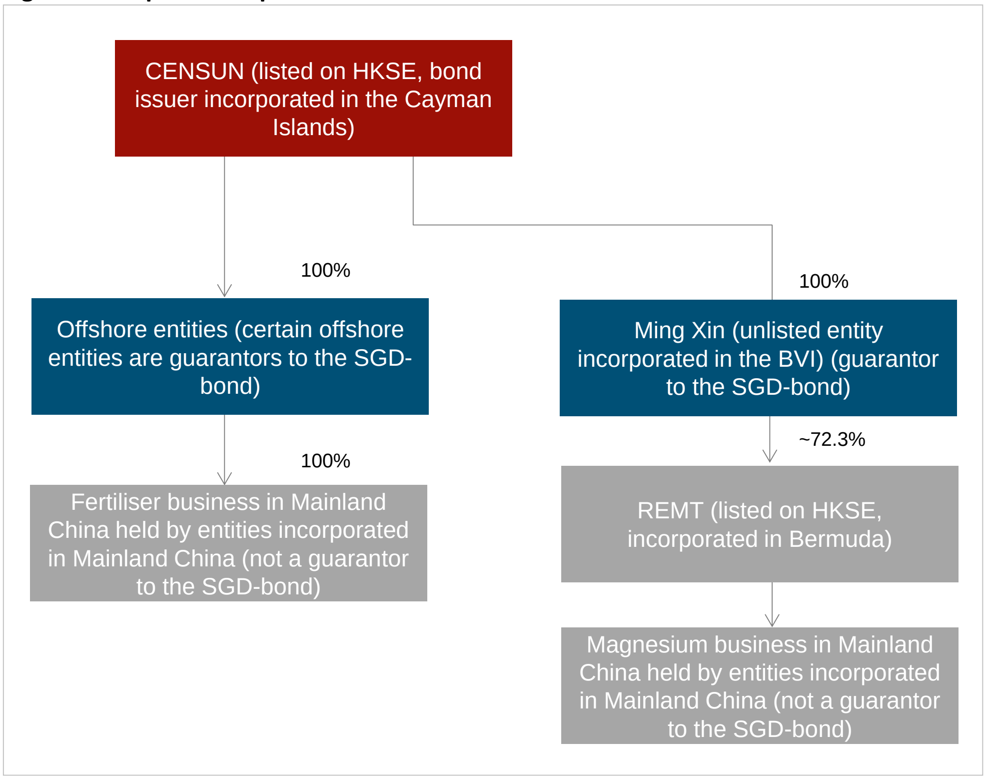
- **Proposed convertible bond did not come through:** In April 2020, CENSUN announced a proposed convertible bond issuance of HKD300mn (with HKD230mn intended to partly refinance offshore borrowings), to be subscribed CENSUN's founder/Chairman. This convertible bond along with the cash balance would have been just enough to cover the near-term debt due and the convertible bond would have been a credit positive in our view. However, on 12 June 2020, the company announced the postponement of the Extraordinary General Meeting that was intended to seek shareholder's approval for the company to issue this convertible bond, with no new date proposed then. In May 2020, it was disclosed that the subscriber had entered into a facility letter with Hang Seng Bank for a secured loan facility of up to HKD300mn, which was intended to be used to finance the subscription of the convertible bond. At that point, negotiations on the security package were still on-going. We are not privy as to what had occurred on this facility letter for the proposed convertible bond, though the issuance of the convertible bond did not come through. On 3 July 2020, CENSUN announced the termination of the subscription agreement for this convertible bond. Per company, in light of the payment default on the SGD-bonds and the application for the appointment of joint provisional liquidators, the conditions set out in the subscription agreement is not expected to be fulfilled. Termination of the proposed convertible bond is within expectations in our view in light of the default.

- **Could the company have raised straight equity financing instead?** On 22 April 2019, we raised that the company's market implied net gearing was incongruent with net gearing based on book value as at 31 December 2018. The market cap for CENSUN on 22 April 2019 was HKD1.0bn, implying a net debt-to-market value of equity of 1.5x versus net gearing of 0.38x. Since 22 April 2019, there were no large variations in market value of equity until the global outbreak of COVID-

19 in March 2020. While theoretically listed companies may raise straight equity for funding, CENSUN's straight equity is thinly traded and there would be no downside protection for the equity investor unlike the convertible bond which was proposed to be issued with an 8% p.a interest rate. Difficulty in raising straight equity in our view is compounded by CENSUN's lack of dividend payment to shareholders since 2017.

- **The SGD-bonds are structurally subordinated ("HoldCo-OpCo subordination"):** Common across Chinese high yield issuers, CENSUN's offshore bonds are issued by an offshore entity (in this case, CENSUN the listed entity incorporated in the Cayman Islands) although the main assets and business operations are located in Mainland China. The CENSUN 7.0% '20s is guaranteed only by certain offshore subsidiaries of CENSUN. None of the Mainland China incorporated subsidiaries are guarantors. These offshore guarantors are generally investment holding companies which in turn hold the Mainland China operating entities (either directly or indirectly). The bonds are ranked senior unsecured and ranks *pari passu* with other senior unsecured lenders at the bond-issuing entity CENSUN. However, all creditors at that entity are structurally subordinated to the assets and business operations held by entities incorporated in Mainland China.

Figure 1: Simplified Corporate Structure



Source: OCBC Credit Research

- **Where would recoveries come from?** Hypothetically, should CENSUN go into liquidation, we think bondholder's recoveries may be in the form of shares in CENSUN and the guarantors (ie: the offshore investment holding companies). Recoveries via other means may still be possible although in our view these are likely to only happen in a negotiated outcome where there is a willingness for existing and/or new shareholders to see the company continuing as an on-going concern, rather than liquidation. For example, CENSUN owns a piece of industrial land in Shandong (formerly where one of its production facilities sits). Per company, value of the land is expected to be more than RMB2.6bn (valuation as at 30 June 2019) post conversion into commercial use although the eventual net proceeds to CENSUN is yet to be determined. We understand from company that monetization of this land could be via joint venture with a residential property developer. Ordinarily we would expect companies to use assets as collateral for fundraising, however it does not appear to be the situation here. We think recoveries from this property development project, if any, is an upside case (rather than base case) given that property development takes time to completion.

- **Preliminary recovery value:** There have been no updated financial statements since 31 December 2019 though CENSUN historically announce preliminary semi-annual financials towards the end of August. We present a preliminary recovery value below based on CENSUN-consolidated total assets as at 31 December 2019 (except for cash). Total asset (excluding cash) has increased to HKD7.0bn as at 31 March 2020 from HKD6.8bn as at 31 December 2019, though no specific asset breakdown was provided as at 31 March 2020.

  Recovery values (based on asset values) for debt holders will be highly reliant on the valuation of CENSUN's property, plant and equipment. It is worth noting though that in the best of times asset valuation in a distress scenario is uncertain. In the midst of COVID-19, this is even more uncertain as this is compounded by reduced mergers and acquisition activities. The lack of comparable market data means it would be harder for buyers and sellers to come to an agreed valuation, in our view. As a recap, historically the company's market value of equity has been lower than its net asset value (albeit with thin trading volume). **<u>For this preliminary recovery value, we assume that the company's audited financials are representative of its asset values where there is nothing untoward</u>**.

  We do not see Scenario 1 (with no haircut on asset values) as likely; **<u>we think haircuts will be extremely severe in a liquidation scenario, amplified due to HoldCo-OpCo subordination</u>**. For Scenario 2, assuming CENSUN continues as a going concern under a negotiated outcome (for example capital injection by a distressed buyer), we think recoveries could be at 40% (HKD0.40 for every HKD1.00 of bonds) even with sizeable haircuts, **<u>though we caution that actual recoveries may differ significantly from our assumed numbers due to the lack of independent valuation reports</u>**. We take a 50% haircut on mining rights, right-of-use assets, inventories and PPE assuming that in a distress scenario, the value which can be sought on such assets would fall (eg: higher bargaining power by buyers). We take a 75% haircut on trade and bills receivables as company has disclosed that its business had been negatively impacted with liquidity also hampered by an extended account receivables collection period among its customers. On 8 July 2020, the company shared that based on the unaudited management accounts for CENSUN-consolidated for 1Q2020, reported revenue was HKD546mn. For FY2019, reported revenue was HKD4.3bn (on an equal basis, HKD1.1bn per quarter). As disclosed by the company, we note that unaudited CENSUN-consolidated cash number as of 31 March 2020 has fallen to HKD470.2mn (from HKD823.1mn as of 31 Dec 2019). Excluding the SGD-bond, total debt had fallen to HKD1.5bn as at 31 March 2020 and then HKD929.5mn as at 30 June 2020 (31 December 2019: HKD1.62bn). This may indicate that cash was utilized to pay down debt, rather than debt being refinanced/rolled-over in 1H2020.

- **Table 1: Preliminary recovery value**

Assets (values in HKD mn)	31 December 2019	Scenario 1 (No haircut to asset values)	Scenario 2 (Assuming asset value haircuts)
Cash	823.1	470.2	470.2
Right-of-use-assets	287.4	287.4	143.7
Mining rights	428.5	428.5	214.3
Property, plant and equipment ("PPE") – leasehold land and building	1,055.2	1,055.2	527.6
PPE – plant and machinery	1,629.1	1,629.1	814.6
Inventories	471.8	471.8	235.9
Trade and bills receivables	461.4	461.4	115.4
Total	**5,156.5**	**4,803.6**	**2,521.6**
<u>Creditors and liabilities to be repaid</u>			
Total debt (excluding SGD-bond)	1,623.7	929.5	929.5
Trade and bills payables	291.9	291.9	291.9
Accruals and other payables	217.1	217.7	217.7

Contract liabilities	363.1	363.1	363.1
Income tax payables	22.4	22.4	22.4
Credit facilities granted to an independent third party	49.1	197.0	197.0
Deferred revenue	68.3	68.3	68.3
Other payables	47.0	47.0	47.0
Deferred tax liabilities	159.2	159.2	159.2
Total	**2,841.8**	**2,295.5**	**2,295.5**
Remaining assets/(shortfall)	2,314.7	2,508.1	226.0
SGD-bond (in HKD mn equivalent)	565.0	565.0	565.0
Recovery (HKD per HKD1.00 worth of bond)		**4.4**	**0.4**

Note: (1) Tabulated from CENSUN's audited financial statement for FY2019, unaudited management account total assets as at 31 March 2020 and including OCBC Credit Research estimates.
(2) Total debt as at 31 December 2019 includes lease liabilities amounting to HKD7.8mn for CENSUN-consolidated. It is unclear if company's provided total debt number as at 30 June 2020 includes lease liabilities.
(3) We exclude PPE- construction in progress as in our view this is of little value until completion. As at 31 December 2019 this was HKD1.1bn.
(4) We exclude Prepayments, deposits and other receivables as we think these assets are hard to claw-back.
(5) We exclude the land value at Shandong Hongri in the preliminary recovery analysis.
(6) As at 31 March 2020, credit facilities granted to an independent third party amounted to HKD197mn.

- **Entering into provisional liquidation under Cayman Islands law:** The company is exploring options to restructure the group's debts and proposes to implement a management led restructuring by taking advantage of a court-supervised provisional liquidation regime in the Cayman Islands. The company contemplates a restructuring that may involve:

  (a) Filing for the appointment of provisional liquidators to key subsidiaries of CENSUN incorporated in the British Virgin Islands ("BVI")
  (b) Equity restructuring to facilitate the raising of cash from third party investors through an equity issue
  (c) Debt restructuring that may involve refinancing and/or a compromise or arrangement of the debts and liabilities for the group
  (d) Potential investment in REMT from one or more third party investors and potential disposal of non-core business/non-operating fixed assets and
  (e) Implementation of further cost control measures.

These measures though will take time though the company is in discussion with a third party who has expressed an interest in participating alone and/or with other investors.

- **Do not expect much change in day-to-day control for now:** CENSUN is planning to use a court-supervised provisional liquidation regime in the Cayman Islands known as provisional liquidation for the restructuring. The provisional liquidation allows for a moratorium prohibiting the commencement or continuance of any proceedings against the company without the court's permission. On 2 July 2020, a winding up petition has been filed together with an application for the appointment of joint provisional liquidators and on 9 July 2020, the company announced that the court hearing has been fixed for 14 July 2020 (Cayman Islands time). CENSUN's board of directors will retain management of the company and we expect them to drive the restructuring process, while the joint provisional liquidators will monitor, supervise and oversee the implementation of the restructuring, including maintaining the listing of the company. Ming Xin Developments Limited ("Ming Xin", a wholly-owned subsidiary of CENSUN and the immediate holding company of REMT holding ~72.3%-stake of REMT), is a guarantor of the affected bonds. Ming Xin is incorporated in the BVI. REMT who has received a bank creditor demand is also pursuing a provisional liquidation application to the Supreme Court of Bermuda. While we do not purport to be legal experts, we note that Cayman Islands, BVI and Bermudan legal systems have their basis on English law and allows for multi-jurisdictional debt restructuring. The SGD-bonds are governed by Singapore law. We expect the board and existing management team to continue with day-to-day control of the business and direct the debt restructuring process.

- **What are the next steps:** Earlier, we had expected CENSUN to trigger a consent solicitation exercise to resolve its upcoming SGD-bond maturity (eg: extension of bond maturity), which is still detrimental to bondholders, albeit one that constitutes an out-of-court debt restructuring rather than in-court restructuring. However, CENSUN had officially defaulted on the bonds and is going into in-court restructuring. **Post 3 July 2020, we have clarified that the five business days grace period only applies to non-payment of interest but not the principal**. Due to this default and the proposed appointment of provisional liquidators, certain other debt is now immediately payable on demand. Under the trust deed, the trustee at its discretion and (1) if so requested in writing to the trustee by an amount representing not less than 25.0% in principal amount of the bonds or (2) directed by an extraordinary resolution at a the meeting of the bondholders (subject in each case to be indemnified or pre-funded), shall give notice to the company that the notes are immediately due and repayable. **Bondholders may write in to the trustee together with proof of holding to be counted towards this 25.0%**.

- **Unity in numbers:** Given that CENSUN has applied for provisional liquidation, we expect the company to present to creditors a restructuring plan in due course though no timeline has been provided. Based on observations from previous debt restructurings, we urge bondholders to connect and form a block rather than stay disparate to improve prospects of recovery. CENSUN consolidated total debt was HKD1.5bn as at 30 June 2020. Of the HKD1.5bn, HKD675.7mn was offshore debt and HKD818.8mn was onshore debt. Outside of the SGD-bond, we think the remaining offshore debt was ~HKD111mn, which is likely to be considered in the same class of creditors as the SGD bondholder in a debt restructuring process. Onshore debtholders are closer to the business and operating assets in Mainland China and in our view are likelier to have higher recoveries versus offshore debtholders in a liquidation scenario. Apart from other entities within the group, CENSUN-consolidated is also the guarantor for credit facilities granted to an independent third party for ~HKD197mn as at 31 March 2020. We consider this off-balance sheet debt.

- **Table 2: Key Headline Numbers**

FYE December (HKDmn)	Total Asset	Total Liabilities	Total Debt	Cash
CENSUN consolidated as at 31 December 2019	7,627.6	3,357.7	2,188.7	823.1
CENSUN consolidated as at 31 March 2020 (unaudited)	7,437.4	3,240.8	2,084.0	470.2
CENSUN consolidated as at 30 June 2020 (unaudited)	NA	NA	1,494.5[1]	NA
CENSUN-standalone as at 31 March 2020 (unaudited)	2,304.5	870.6	NA[3]	33.3
CENSUN-standalone as at 30 June 2020 (unaudited)	NA	NA	NA	0.2
REMT consolidated as at 31 December 2019	2,554.3	1,166.4	872.5	254.8
REMT consolidated as at 31 March 2020 (unaudited)	2,437.4	1,086.0	NA	153.8
REMT consolidated as at 30 June 2020 (unaudited)	NA	NA	443.9[2]	NA

Source: Compiled by OCBC Credit Research from company fillings and publicly available financials

Note: (1) Total debt of CENSUN-consolidated as at 30 June 2020 was HKD1.5bn, consisting of HKD675.7mn of offshore debt and HKD818.8mn of onshore debt.

(2) Total debt of REMT-consolidated as at 30 June 2020 was HKD443.9mn, consisting of HKD298.5mn of offshore debt and HKD145.4mn of onshore debt.

(3) While the total debt figures for CENSUN-standalone as at 31 March 2020 was not provided, we infer that bulk of total liabilities (>80%) would consist of debt.

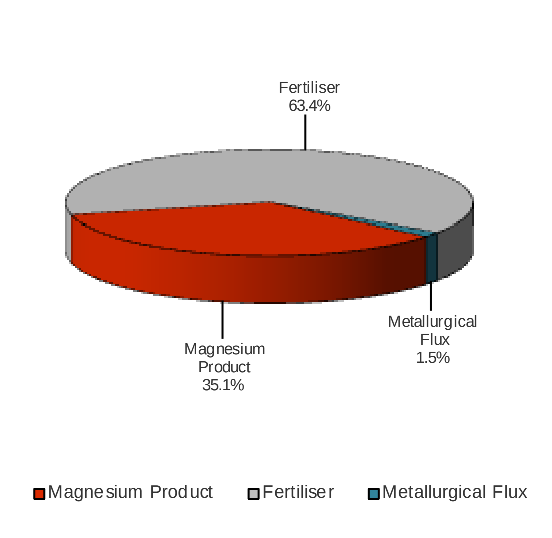
Century Sunshine Group Holdings Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2017	FY2018	FY2019
Income Statement (HKD'mn)	**HKD'mn**	**HKD'mn**	**HKD'mn**
Revenue	3,443.2	4,655.1	4,314.4
EBITDA	636.0	992.6	876.6
EBIT	479.3	775.1	657.2
Gross interest expense	158.4	164.9	153.7
Profit Before Tax	405.9	691.8	591.6
Net profit	261.6	572.8	428.3
Balance Sheet (HKD'mn)			
Cash and bank deposits	930.9	708.0	823.1
Total assets	7,502.3	7,474.6	7,627.6
Short term debt	626.4	1,087.5	1,646.8
Gross debt	2,047.2	2,065.1	2,188.7
Net debt	1,116.3	1,357.0	1,365.7
Shareholders' equity	3,653.4	3,956.6	4,269.9
Cash Flow (HKD'mn)			
CFO	616.0	778.4	518.9
Capex	914.6	699.8	431.8
Acquisitions	-195.5	0.0	0.0
Disposals	10.9	38.5	74.5
Dividend	0.0	0.0	0.0
Free Cash Flow (FCF)	-298.7	78.6	87.1
Key Ratios			
EBITDA margin (%)	18.47	21.32	20.32
Net margin (%)	7.60	12.31	9.93
Gross debt to EBITDA (x)	3.22	2.08	2.50
Net debt to EBITDA (x)	1.76	1.37	1.56
Gross Debt to Equity (x)	0.56	0.52	0.51
Net Debt to Equity (x)	0.31	0.34	0.32
Gross debt/total assets (x)	0.27	0.28	0.29
Net debt/total assets (x)	0.15	0.18	0.18
Cash/current borrowings (x)	1.49	0.65	0.50
EBITDA/Total Interest (x)	4.01	6.02	5.70

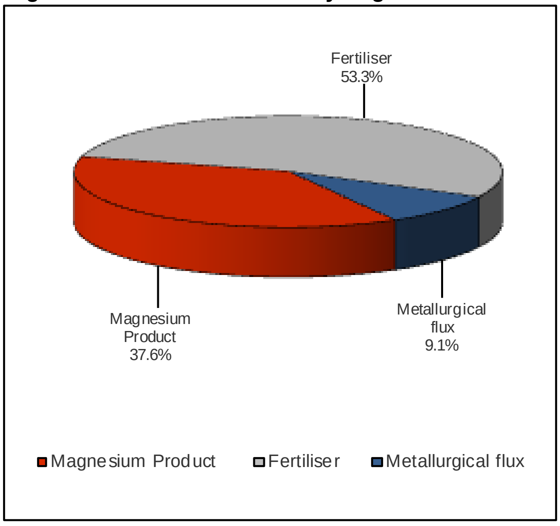
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2019



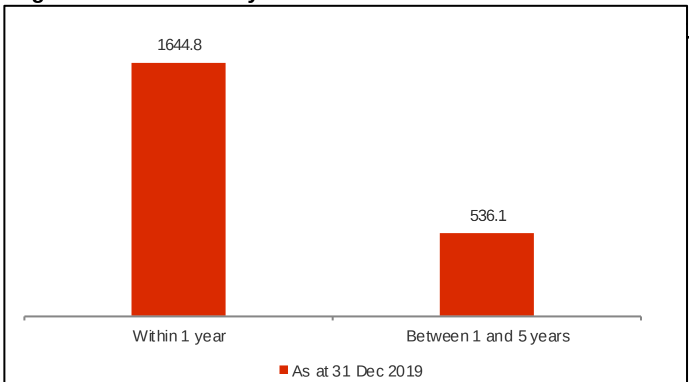
Source: Company

Figure 2: Asset breakdown by Segment - FY2019



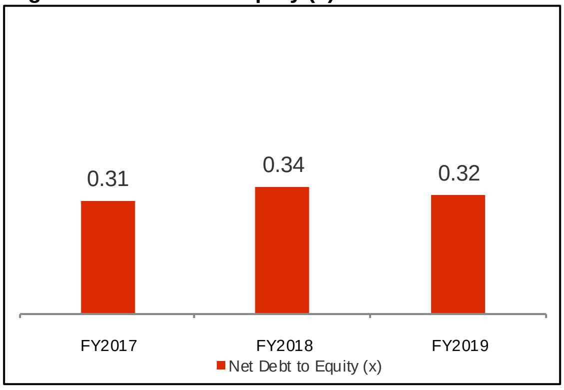
Source: Company

Figure 3: Debt Maturity Profile



Source: Company, OCBC estimates | Excludes lease liabilities

Figure 4: Net Debt to Equity (x)



Source: Company

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 bond represents **better relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Neutral ("N") – The bond represents **fair relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

Underweight ("UW") – The bond represents **weaker relative value** compared to other bonds from the same issuer, or bonds of other issuers with similar tenor and comparable risk profile.

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.

Treasury Research & Strategy

Macro Research

Selena Ling
Head of Strategy & Research
LingSSSelena@ocbc.com

Tommy Xie Dongming
Head of Greater China Research
XieD@ocbc.com

Wellian Wiranto
Malaysia & Indonesia
WellianWiranto@ocbc.com

Terence Wu
FX Strategist
TerenceWu@ocbc.com

Howie Lee
Thailand, Korea & Commodities
HowieLee@ocbc.com

Carie Li
Hong Kong & Macau
carierli@ocbcwh.com

Dick Yu
Hong Kong & Macau
dicksny@ocbcwh.com

Credit Research

Andrew Wong
Credit Research Analyst
WongVKAM@ocbc.com

Ezien Hoo
Credit Research Analyst
EzienHoo@ocbc.com

Wong Hong Wei
Credit Research Analyst
WongHongWei@ocbc.com

Seow Zhi Qi
Credit Research Analyst
ZhiQiSeow@ocbc.com