Hyflux Ltd faces troubled outlook amid poor financial performance

by Toh Yong Hui Desmond

The market capitalization of Hyflux Ltd, a global leading provider of water treatment and infrastructure solutions, tumbled by about 34% after the company posted a net loss for Q3 2017. Correspondingly, the RMI-CRI 1-Year Probability of Default (PD) for the firm rose to more than 160bps, indicating a weak credit profile (see Figure 1). Hyflux Ltd has three main business segments: Municipal, Industrial, and Consumer Business. The company recorded its third quarterly loss in a year due to a weak power market and loss of revenue in its Engineering, Procurement and Construction (EPC) activities.

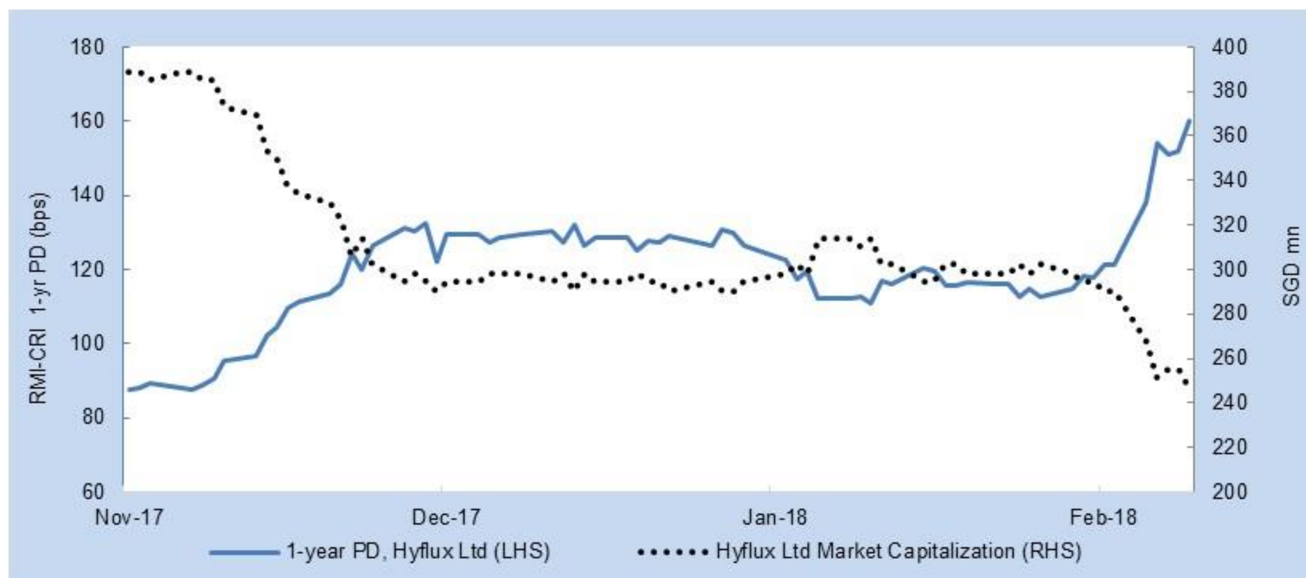

Figure 1: RMI-CRI 1-year PD for Hyflux Ltd (LHS) & Market Capitalization for Hyflux Ltd (RHS). *Source: RMI-CRI, Bloomberg*

In recent years, Hyflux Ltd diversified its business beyond water treatment and expanded into international markets, consequently incurring significant amounts of debt. In 2016, the company secured a SGD 653mn loan facility to finance its TuasOne Waste-to-Energy project, and a USD 185mn facility to finance its Qurayyat Independent Water Project (IWP) in Oman. As a result, total liabilities rose by 17% to SGD 2.53bn in Q3 2017 from SGD 2.11bn a year ago, while its net debt-to-equity ratio surged from 84.86% to 113.20% in the same period (see Table 1).

SGD mn	Q3 2016	Q4 2016	Q1 2017	Q2 2017	Q3 2017
Net Debt/Equity (%)	84.86	81.46	86.34	106.13	113.20
Cash from Operating Activities	-92.0	-75.0	-107.6	-104.60	-59.30
Trailing 12-Month (TTM) EBITDA/ TTM Interest Expenses (X)	3.93	2.98	3.27	2.06	0.99
Net Income	10.3	-26.7	0.8	-25.1	-26.1

Table 1: Financial Data for Hyflux Ltd. *Source: Bloomberg*

In the course of such expansion, however, Hyflux Ltd's profitability actually deteriorated. On November 9, 2017, Hyflux Ltd announced its 3Q 2017 financial results, reporting a net loss of SGD 26.1mn. The company attributed its net loss to its Tuaspring plant, an Integrated Water and Power Project managed by its subsidiary, Hyflux Energy. According to the company, Tuaspring contributed losses of SGD 26.6mn, due to the weak power market in Singapore. In fact, Tuaspring as a whole is a loss-making entity, with its power plant making losses since operations began in March 2016. The performance of Tuaspring is set to worsen in 2018, as the Energy Market Authority (EMA) has planned to fully liberalize Singapore's electricity markets by 2H 2018, giving all consumers the freedom to switch from buying electricity at the regulated tariff from SP Services to buying from electricity retailers that offer packages at different price plans.

Such liberalization is likely to increase competition in Singapore's electricity markets and put downward pressure on power spreads, thus further weakening the profitability of Tuaspring. Although Hyflux Ltd has plans to partially divest up to 70% of Tuaspring at book value, the materialization of such plans is uncertain, as bidders might not be willing to purchase loss-making Tuaspring at book value, and any divestment will require approval from the Public Utilities Board (PUB).

Hyflux Ltd's weak profitability was exacerbated by a plunge in revenue by 60.6% YoY to SGD 98mn. According to the company, the fall in revenues was largely due to lower Engineering, Procurement and Construction (EPC) contributions from the TuasOne Waste-to-Energy project and the Qurayyat IWP, which were in line with their planned construction schedules. Whether such a plunge in EPC contributions would prove temporary, will hinge on the company's ability to win new EPC contracts and replenish its order book. However, for the whole of year 2017, Hyflux Ltd only secured USD 180mn worth of EPC contracts, as compared to USD 550.4mn in the year 2016. Furthermore, the prospect for EPC contributions is bleak, as Hyflux Ltd faces competition from domestic rivals like Keppel Corp in Singapore, and international rivals in the Middle East, and Singapore and Middle East are the two largest markets for Hyflux Ltd in terms of revenue contribution.

	Net Debt/TTM EBITDA (X)	TTM EBITDA/TTM Interest Expenses (X)	TTM Cash Flow from Operations to TTM Total Interest Incurred (X)
Hyflux Ltd	17.19	0.99	-4.72
Keppel Infrastructure Trust	7.29	2.06	0.57
Sembcorp Industries Ltd	5.83	2.50	-1.24
Citic Envirotech Ltd	1.53	6.90	8.53
Moya Holdings Asia Ltd	16.47	2.02	-1.44

Table 2: Financial Data for Hyflux Ltd and its Competitors in Q3 2017. *Source: Bloomberg*

Besides weak profitability, Hyflux Ltd had weak cash flow generation—the company has not generated positive cash flows from operations since 2010 (see Table 1). Consequently, its trailing 12-month cash flow from operations to trailing 12-month total interest incurred is poor relative to that of its industry peers (see Table 2). Such dismal operating cash flows, coupled with its high net debt-to-equity ratio as mentioned earlier, could cause Hyflux Ltd to lose its ability to raise financing at low costs, as banks might no longer be keen to refinance the highly leveraged water project developer. Consequently, Hyflux Ltd might not be able to retire its preference shares with the first call date on April 25, 2018, thus incurring a steep interest rate step-up to 8%. This would cause an increase in interest expenses, and further worsen Hyflux Ltd's credit profile, as the wastewater treatment industry is a capex-intensive one. Besides affecting the company's ability to retire its preference shares, Hyflux Ltd's weak profitability and dismal cash flows cast doubt on its ability to service its debt, which includes a SGD 100mn note maturing on September 7, 2018, and SGD 165mn worth of bonds maturing in 2019.

In the face of such risks, the management of Hyflux Ltd has announced plans such as the divestment of its full interest in the Tianjin Dagang desalination plant in China, and partial divestment of the Tuaspring plant, as part of its asset-light strategy to recycle capital for new investments. In addition, Hyflux Ltd is developing its consumer business, HyfluxShop, which focuses on the health and wellness segment and has growth potential. However, the realization of such plans are fraught with uncertainties, and it is thus questionable whether such moves would lead to a material improvement in the company's credit profile.

Credit News

Investor urges Noble stakeholders to oppose restructuring approach

Feb 10. Goldilocks Investment, Noble Group's major shareholder, is calling on Noble's stakeholders to collectively oppose its restructuring approach. Under the restructuring proposal, Noble will halve its debts of USD 3.5bn by reaching an in-principal agreement with 30% of its creditors. On February 5 2018, Noble rejected Goldilocks' release request of non-disclosure arrangements surrounding discussions on Goldilocks' demands for two board seats. Without that release, the shareholder argued that it could not present a comprehensive picture to the investing public. Goldilocks also questioned Noble's disposal of assets at steep discounts to their book values and decided to continue challenging Noble on the disclosure. (Straits Times)

US stocks suffer one of worst weeks since financial crisis

Feb 10. The US stock market has suffered one of its worst weeks since the financial crisis. By February 10 2018, S&P 500 has closed up 1.5% for 5.2% weekly decline, making it the worst week since January 2016. Investors withdrew record USD 30.6bn from global equity funds and VIX 'fear' gauge retreated to 29 on Friday from week's high of 50. Rising bond yields triggered last week's mayhem, but analysts have attributed much of the blame to the collapse of two complex exchange-traded notes on February 5, and algorithmic trading strategies. The turmoil spread quickly to international bourses. FTSE ALL-World down 6.2% last week and Eurofirst 300 index down 7.2%, its worst weekly fall since euro zone crisis in 2011. Asian markets suffered as well, with Hong Long and Tokyo capping one of the worst weeks in recent history. (FT)

China's HNA reverses buying binge with USD 4bn selling spree

Feb 9. HNA Group Co. is selling buildings across in the US to cut its massive debt. The properties on sale include a skyscraper in New York bought less than a year for USD 2.21bn and some other properties in Chicago, san Francisco and Minneapolis. HNA started as an airline operator and later gained interests in overseas properties. According to Real Capital Analytics Inc., the company owns more than USD 14bn in real estate properties globally. As China clamps down on 'irrational' investments and real estate values languish, HNA is facing a liquidity crunch. HNA had USD 29.3bn of short-term debt as of the end of June this year, which its cash and earning are not enough to cover. Last month, HNA reached a deal of selling its Sydney office building for USD 165mn. In Hong Kong, the company is trying to sell two pieces of land that were purchased just over a year ago. (Bloomberg)

Ezion secures USD 2bn refinancing package

Feb 8. Ezion Holdings has signed binding term sheets with six secured lenders for the refinancing package, which will stretch over six years. The package includes minimal fixed principal repayments, a significant reduction in interest rates for loan facilities and up to USD 118mn in additional revolving credit facilities. In turn, the secured lenders will receive a total of 100mn shares from group chief executive and his family. Ezion expects to lower its overall debt levels by about 40% to USD 1.2bn through refinancing, easing liabilities by as much as USD 371mn and generating new funds of up to USD 486mn. According to the chief financial official of Ezion, the company aims to resume trading in its shares in April. (Straits Times)

China developers retreat from Hong Kong property market

Feb 7. Chinese property developers have retreated sharply from Hong Kong's booming land market, mainly because of Beijing's capital controls and intensified scrutiny of outbound transactions that began in late 2016. According to official data by Standard & Poor's, bids won by Chinese developers have decreased 11% by value since April 2017 from about 50% in the preceding two years. The Chinese government's crackdown on outbound investment aims to stem capital outflows and discipline debt-laden property companies. In addition, Chinese developers are also deterred by the longer development cycle in Hong Kong, as compared that that of mainland China. In response, more joint ventures with big local property developers are to be expected. However, analysts forecast that residential prices will continue to rise in spite of the retreat of these mainland developers. (FT)

Takata, injured drivers reach deal to end US bankruptcy (Channel NewsAsia)

US gunmaker Remington seeks financing to file for bankruptcy protection (CNBC)

Amgen 'looking hard' at striking deals using USD 27bn cash pile (FT)

Regulatory Updates

India bends sub debt rules ahead of health insurance expansion

Feb 12. As the government prepares to extend health coverage to half a billion poor people, Indian state-owned insurance companies are getting a pass from regulators to raise subordinated debt. United India Insurance (UIIC) raised USD 141mn from a maiden offering of subordinated bonds, pricing the 10-year non-call five notes at 8.25%. Normal IRDA (Insurance Regulatory and Development Authority) rules do not allow insurers to service interest if their solvency ratio is below 1.5. However, UIIC, which reported a net loss of INR 19.13bn in 2017 and a solvency ratio of 1.08, was able to issue subordinate bonds by expecting the ratio to be above 1.5 after the fundraising. The adjusted solvency ratio for UIIC was 2.13 as of September 2017. Many banks believe that raising subordinated debt will pave the way for state-owned companies to merge, list and fund the massive healthcare program. (Reuters)

Top central bank researcher says PBOC should take greater role

Feb 11. China's central bank top researcher has called for the People's Bank of China (PBOC) to provide greater supervision over the financial system in the current environment of frequent financial chaos. The head of PBOC's research department suggested that the central bank's overall role should be strengthened rather than just serving as a coordinator. They also expressed the concern that the rights and responsibilities of the central bank are not equal, since PBOC lacks supervision power but assumes responsibility for financial bailouts. On top of that, the institutional legacy of the planned economy separated supervision of financial activities, leading to more serious regulatory arbitrage. At the same time, PBOC did not advocate for major changes in the country's regulatory architecture of one central bank and three regulators. These comments give an indication that government is unlikely to move forward in merging the banking and insurance regulators to create a super-regulator. (Reuters)

Abu Dhabi financial regulator may create framework for virtual currencies (Business Times)

Lawmakers threaten FCA with powers to publish RBS report (FT)

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