Hyflux Ltd: Credit Initiation Report

iFAST Research Team ***Wednesday, 6 September 2017***

Debt Programme: S$1,500,000,000 Multicurrency Debt Issuance Programme

Issues	Maturity	Currency	Amount Issued	Payment Rank
HYFSP 6.000% Perp/Callable 2018 Pref (SGD)	Perpetual	SGD	500MM	Jr Subordinated
HYFSP 6.000% Perp/Callable 2020 Corp (SGD)	Perpetual	SGD	400MM	Jr Subordinated
HYFSP 4.250% 07Sep2018 Corp (SGD)	07-Sep-2018	SGD	100MM	Sr Unsecured
HYFSP 4.200% 29Aug2019 Corp (SGD)	29-Aug-2019	SGD	100MM	Sr Unsecured
HYFSP 4.600% 23Sep2019 Corp (SGD)	23-Sep-2019	SGD	65MM	Sr Unsecured

Source: Bloomberg, iFAST compilations

Summary and Conclusion

Issuer Profile: Negative

- **We are initiating Hyflux Ltd with a Negative issuer profile**, judging the company's credit profile as speculative and subject to material default risk. Barring a large asset sale, the company is unlikely to deleverage significantly over the next few years, which means credit ratios will continue to remain under pressure. Despite the company's weakening credit fundamentals, the Hyflux bonds have generally posted decent returns over the past twelve months.
- **We deem Hyflux's overall financial risk profile as Highly Leveraged and its overall business risk profile as Satisfactory.** We think Hyflux's working capital and liquidity condition is inadequate, and the company will almost certainly have to rely on asset sales and/or refinancing to meet its short-term obligations. In this regard, we view the announced plans to divest the Tianjin Dagang desalination plant and the Tuaspring IWPP as potential credit positives.
- The two Hyflux perpetual securities are offering some of the highest yield spreads available in the SGD perpetual bond market. We assigned a Neutral rating on the HYFSP 6.000% Perp/Callable 2018 Pref (SGD) and Underweight rating on the HYFSP 6.000% Perp/Callable 2020 Corp (SGD).
- We assigned a Neutral rating on the HYFSP 4.250% 07Sep2018 Corp (SGD), but we Underweight the HYFSP 4.200% 29Aug2019 Corp (SGD) and HYFSP 4.600% 23Sep2019 Corp (SGD). We think the pricing of the two Hyflux bonds maturing in 2019 do not compensate investors sufficiently for taking on the company's increasing credit risk.

Company Profile

Hyflux is an environmental solutions company which specialises in water treatment and energy. The precursor to Hyflux, Hydrochem (S) Pte Ltd, was founded in 1989 as a small water treatment company with a start-up capital of S$20m and three staff. The company was listed on the Singapore Stock Exchange (SGX) since January 2001, and upgraded to the SGX mainboard in April 2003. Hyflux has a market cap of S$389m as at 29 Aug 17.

A specialist in water treatment, Hyflux was ranked as the largest desalination plant developer by awarded capacity in 2016 by Global Water Intelligence (GWI). Its track record includes landmark projects such as the Tuaspring Integrated Water and Power Project (IWPP), the Qurayyat Independent Water Project (IWP) and the Tianjin Dagang Desalination Plant. Hyflux's key markets in this segment are Singapore, China and the Middle East and North Africa region (MENA).

Hyflux ventured into the power generation and waste-to-energy markets in 2011 when it entered a service concession arrangement with the Public Utilities Board (PUB) for the Tuaspring IWPP. The power generation facility has been operating since March 2016. In 2015, Hyflux signed an agreement with the National Environment Agency (NEA) to construct a waste-to-energy (WTE) plant under a Design-Build-Own-Operate scheme. When completed in 2019, the plant will have the capacity to process 3,600 tonnes of waste per day and generate 120 MW of electricity. In addition, Hyflux is in the midst of negotiating the contract for the USD500m Ain Sokhna IWPP.

As of 30 Jun 17, Hyflux has an order book valued at S$2.95 billion, including the Ain Sokhna IWPP which is pending contracts finalisation. The order book comprises of S$1.13 billion of engineering, procurement and construction (EPC) contracts, and S$1.82 billion worth of operations and maintenance works, which should provide steadier earnings relative to the project-driven EPC activities.

Hyflux separates its primary business into two reportable segments—municipal and industrial. The company provides the infrastructure solutions described earlier to municipalities and governments. Besides that, Hyflux also sells liquid separation applications (i.e. water treatment solutions) to industrial customers such as the pharmaceutical, biotechnology, food processing and petrochemical oil-related industries. Lastly, the company launched its consumer product portfolio via the ELO brand in late 2015, featuring a line of oxygen-rich products comprising drinking water, baths and a skincare range. The consumer business is categorised under "other operations" and has not contributed meaningful revenue yet.

Quality of Management and Ownership *(Satisfactory)*

Ms Olivia Lum leads Hyflux's executive management team as Executive Chairman and Group Chief Executive Officer. Ms Olivia Lum is also the founder and substantial shareholder of the company, holding 34% of ordinary shares. She established Hydrochem (S) Pte Ltd, the precursor to Hyflux Ltd, in 1989 with just two staff at the age of 28. The management team and board of directors have since grown to comprise of seasoned executives from various industries and with distinguished track records in both private and public sectors.

As Ms Olivia Lum and her executive management team took Hyflux from a water specialist to a provider of integrated environmental solutions, the company has won many awards for innovation and entrepreneurship. Ms Lum has received many accolades for her entrepreneurial achievements such as the Ernst & Young World Entrepreneur of The Year 2011. Hyflux is regarded by most people as a Singapore success story today, serving as the symbol for Singapore's journey towards water-sufficiency.

Hyflux's financial policy has clearly gravitated toward more aggressiveness since it was listed on the SGX mainboard in April 2003. The debt-fuelled expansion took the company's debt-to-assets ratio from 5.8% in FY03 to 36.9% in 2Q17, excluding perpetual securities from debt. Nonetheless, management has signalled a possible change of course as they embark on an asset-light strategy, which continued this year with the announced plans to divest the Tianjin Dagang desalination plant in China and the Tuaspring IWPP in Singapore. We also took some comfort from the fact that a number of the Hyflux directors have meaningful stakes in Hyflux shares and perpetual securities, valued at several times their annual compensation (see Table 1).

Table 1: Directors' Interests (as at 21 Jan 17)

Name of Director	Direct Interest	Deemed Interest
	Ordinary Shares	
Olivia Lum Ooi Lin	267,351, 211	-
Teo Kiang Kok	-	375,000
Gay Chee Cheong	3,000,000	-
Christopher Murugasu	1,095,468	180,000
	HYFSP 6.000% Perp/Callable 2018 Pref (SGD) - Retail	
Olivia Lum Ooi Lin	8,020	-
Teo Kiang Kok	3,000	-
Gay Chee Cheong	4,860	-
Christopher Murugasu	2,880	-
	Perpetual Securities	
Olivia Lum Ooi Lin	1,000,000	-
Teo Kiang Kok	200,000	-
Gay Chee Cheong	-	500,000
Christopher Murugasu	400,000	-
Simon Tay	500,000	-
Gary Kee Eng Kwee	-	500,000
Lau Wing Tat	50,000	-

Source: Company Annual Report 2016

Financial Analysis *(Financial Risk Profile)*

We see Hyflux's overall financial risk profile as ***Highly Leveraged*** considering the below analysis and factors, and the quality of its management and ownership.

- **Pretax Interest Coverage *(Highly Leveraged)***

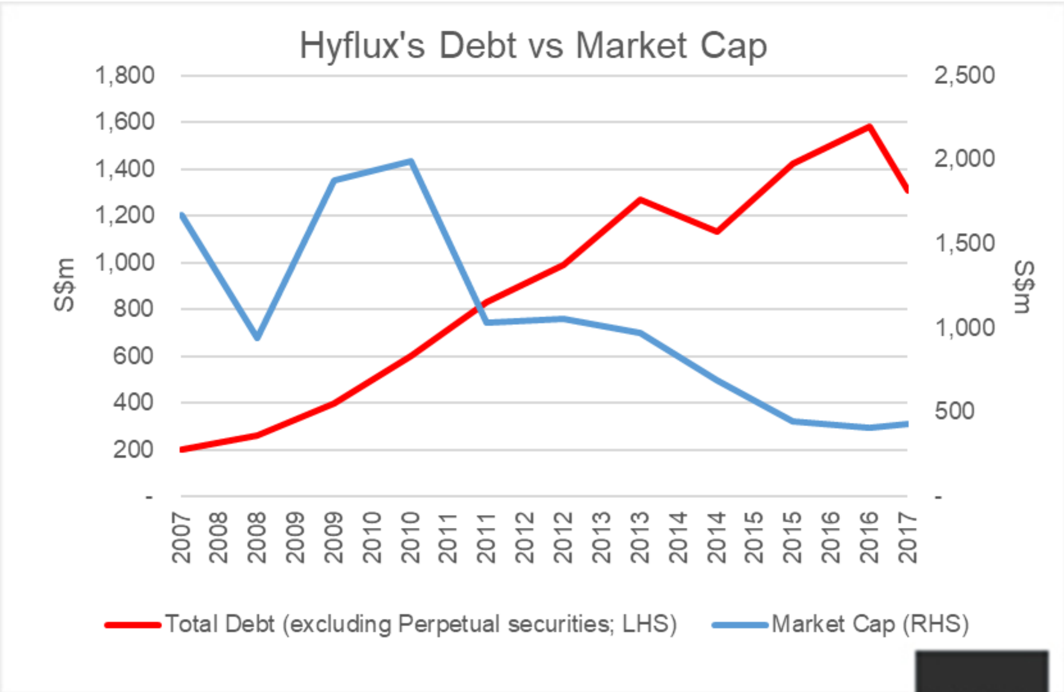
  Interest coverage ratio (EBIT/interest) has been on a steady decline over the years, standing at a paltry 0.9x in the financial year ended 31 Dec 16 (FY12: 4.7x). The company's ability to service its financial obligations would look even weaker if adjustments to the interest incurred were made to add the 6.0% interest payment on the existing S$900m perpetual securities classified as "dividend" under accounting rules. Including the interest on Hyflux's perpetuals, the company's interest coverage ratio would sink to 0.5x in FY16, and 0.1x in 1H17. Hyflux's position in this regard is unlikely to improve in the second half of the year as management has guided for losses in 2H17.

- **Leverage (*Aggressive)***

  Even before accounting for the large amount of perpetual securities outstanding, Hyflux's balance sheet appears unsustainably stretched by any standards. Debt-to-EBITDA climbed to 13.4x in FY16 (FY15: 10.6x) from 8.0x in FY12, as the company took on additional borrowings to finance capital-intensive projects under the Design-Build-Own-Operate model. Similarly, Hyflux's debt-to-market cap ratio more than tripled to 3.4x in 2Q17 (FY16: 3.9x) from 0.9x in FY12, as the market value of Hyflux moved in an opposite direction to its indebtedness (see Chart 1).

  The company's debt-to-total capital was largely stable over the same period (2Q17: 53.8%), as it included all of the perpetual securities under equity rather than debt. However, if we count the perpetual securities as debt, Hyflux's debt-to-EBITDA, debt-to-market cap and debt-to-total capital ratios would jump to dizzying levels at 23.4x, 6.8x and 88.3% at the end of 2016. Including the perpetual securities in total borrowings, the lenders and quasi-equity holders of Hyflux which have extended S$2.2 billion of funding to the company as of 30 Jun 17, are looking at only ~S$235mn of value represented in shareholders' equity.

Chart 1: Rising Debt Level versus Falling Market Valuation



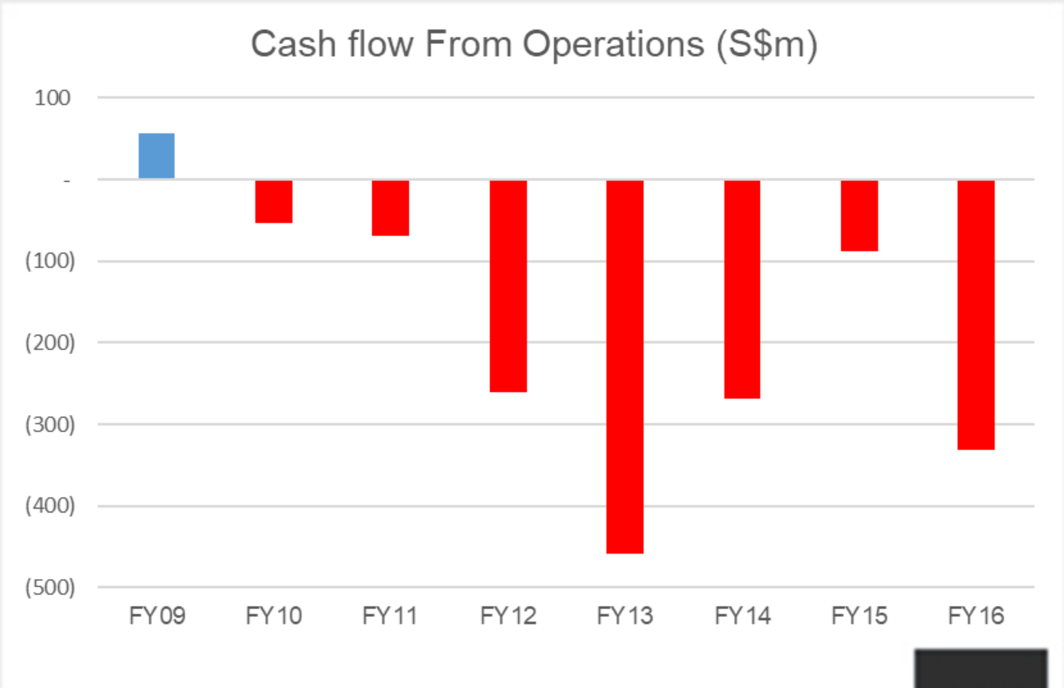
Source: Bloomberg, Company reports

- **Cash Flow *(Highly Leveraged)***

The payment of the coupon for the perpetual securities alone works out to S$54m annually (6% coupon rate on S$900m of outstanding perpetual securities). That money has to come from somewhere and in recent years Hyflux has not been able to generate cash flows anywhere near that level. Hyflux's business has been burning cash since 2009, which was the last time it generated positive cash flows from operations (S$56.1m). In the eight years since then, Hyflux has haemorrhaged a yearly average of S$218.4m in cash flow from operations (see Chart 2).

The company is seemingly looking towards the monetization of assets to provide some breather to its cash flow issues, as it claimed to adopt an asset-light strategy. Earlier this year the company completed the divestment of its 50% equity interest in Galaxy NewSpring Pte Ltd for USD136.5m). But judging from its track record, investors should not bet solely on the asset monetization factor to provide much respite to the over-leveraged balance sheet.

Chart 2: Negative Operating Cash Flow Since 2010



Source: Company Reports

- **Net Assets/ Quality and Saleability of Assets *(Highly Leveraged)***

Hyflux's leverage ratio as measured by its debt divided by total assets stood at 36.9% at the end of June 2017, an improvement from the 41.2% in FY16 (FY15: 46.9%). But there are a couple of adjustments that should be made in our opinion in order to arrive at a more accurate view of the company's financial condition.

Again, a prudent credit investor should add the outstanding perpetual securities to debt. In addition, there are S$1.1bn of "intangible assets arising from service concession arrangements", which originated from Hyflux's service concession arrangement with PUB (the Tuaspring IWPP) These assets represent the group's right to operate the plants and to sell the water to PUB and electricity to the national grid. At the end of the concession period (25 years), the title to the plants will be transferred to PUB.

We see this accounting treatment as effectively bringing forward at least a substantial portion of future profitability from the PUB contract. Due to the number of estimates required to arrive at the fair value of the intangible assets (e.g. expected water and wastewater volume, supply of electricity, fair value of the construction services) and the fact that these projections are done for a very long time horizon, we think the value of these intangible assets are rather speculative.

If we apply an arbitrary 50% discount to these intangible assets, Hyflux's debt (including perpetual securities) divided by total assets would be 83.8% at the end of 2016. Nevertheless, Hyflux has announced in February that it is exploring a partial sale of the Tuaspring plant, and the intangible assets have since been moved to the "assets held for sale" category. As such, the company's adjusted debt-to-total asset ratio fell to 61.9% in 2Q17.

- **Working Capital *(Significant)*; Liquidity *(Inadequate)***

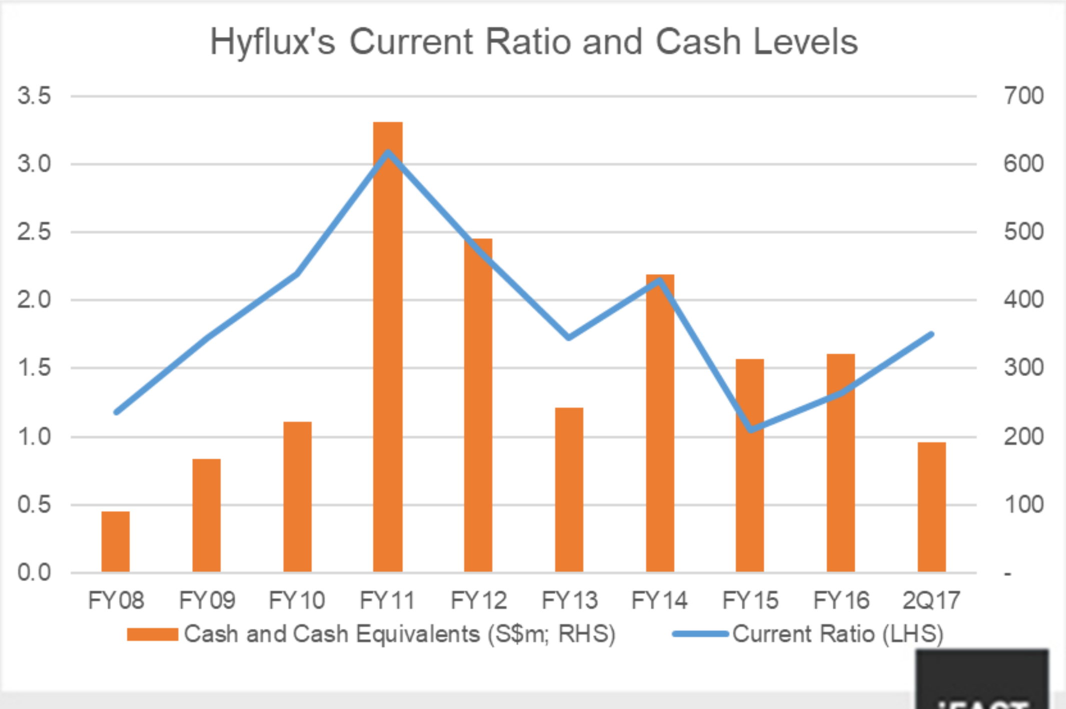
In line with the deteriorating balance sheet, Hyflux's liquidity has declined over the years, as the current ratio dropped from 2.4x in FY12 to 1.8x at the end of 2Q17, although the latest number was an improvement to the 1.3x recorded in FY16 (FY15: 1.1x). Similarly, cash and equivalents sank to S$191.1m (including S$87.4m of restricted cash) from S$490.5m over the same period.

Investors should note that out of the S$2.3 billion current assets on Hyflux's balance sheet, S$1.7 billion represent assets held for sale, for which no buyers have been announced yet. Furthermore, 38.7% or S$87.4m of Hyflux's cash (S$191.1m) at the end of June 2017 was restricted cash and pledged deposits set aside for funding purpose.

As at the end of 30 Jun 17, S$620.1m of current liabilities (excluding S$664.6m of liabilities held for sale) will come due within a year. This is on top of the S$400m HYFSP 6.000% Perp/Callable 2018 Pref (SGD) which is callable on 25 Apr 18, failing of which a punitive 2% step-up in the coupon rate will kick in.

Taking into account the above considerations, we see Hyflux's working capital and liquidity condition as "inadequate". The company will almost certainly have to rely on asset sales and/or refinancing to meet its short-term obligations. We are unsure how far the name familiarity and high-yielding issuances can take Hyflux in its quest to keep refinancing/borrowing, but investors should be aware of the significant risk of the divestments not going through and that the game of musical chairs might stop abruptly.

Chart 3: Liquidity Deterioration



Source: Bloomberg, Company Reports

- **Profitability *(Fair)***

Hyflux averaged a 5.7% return on equity over the five years ended 31 Dec 16, which was largely dragged down by the poor results in FY16 (ROE: -7.5%) due to the weak Singapore power market. As mentioned in a previous section, we believe a substantial amount of future profits has already been booked in the company's accounts, in the form of the intangible assets arising from service concession arrangements. In addition to the S$1.1bn of intangible assets, Hyflux also recorded S$905.2m of financial receivables as of 2Q17, which represent future guaranteed minimum payments to be received from Hyflux's municipal clients over the contract period (ranges from 20 to 30 years). Given the long concession period, we think investors should ascribe at least some level of fair value risk (the eventual realisation may deviate from the stated value) to these receivables.

As debt constitutes a large part of Hyflux's balance sheet, return on invested capital would be a better measurement of the company's profitability than ROE. Hyflux's profitability as measured by its five-year average ROIC as of 31 Dec 16 is a lower 3.9%. For comparison purpose, Bloomberg data indicates that Hyflux's peers in the water utilities industry (56 in Asia Pacific) achieved a median 5-year average ROE and ROIC of 9.6% and 5.8%, respectively.

- **Amortization/Maturity Schedule; Capital Structure *(Weak)***

  At the end of 2Q17, 15.4% (S$201.7m) of borrowings owed by Hyflux will come due within a year, with an additional S$400m of the HYFSP 6.000% Perp/Callable 2018 Pref (SGD) preference shares callable in April 2018. Bloomberg data indicates that the company then has one senior unsecured bond (S$100m) maturing in 2018, two senior unsecured bonds (S$165m) maturing in 2019, and several senior unsecured loans and first lien loans coming due from 2021 onwards. As of 30 Jun 17, Hyflux's balance sheet was funded by S$1.3 billion of debt, S$887.4m (book value) of perpetual securities (comprising of the HYFSP 6.000% Perp/Callable 2018 Pref (SGD) and the S$500m HYFSP 6.000% Perp/Callable 2020 Corp (SGD)), and just S$235.2m of equity.

- **Negative Pledge, Financial and other Covenants *(Vulnerable)***

  Hyflux is required under the financial covenants of its S$1.5 billion Multicurrency Debt Issuance Programme to maintain:

  - consolidated total tangible net worth (TNW) of not less than S$300m;
  - consolidated net borrowings to TNW of not more than 1.5 times; and
  - aggregate of consolidated unencumbered cash and consolidated EBITDA to consolidated interest expenses of at least 3 times.

  We view the above covenants as weak and insufficient to protect the company's bond investors. The TNW measure as defined in the programme documentation actually includes the intangible assets arising from service concession arrangements. In addition, the net borrowings calculation excludes perpetual securities.

  Furthermore, Hyflux conducted a consent solicitation exercise in January 2015 to loosen certain bond covenants and essentially weakening the safeguards for bond investors (e.g. broaden the interest cover covenant to include the unencumbered cash position in the numerator). Hyflux has actually conducted a previous round of consent solicitation in 2013, with details undisclosed. We view these exercises to diminish the safeguards in the bond programme as a sign of fiscal imprudence at Hyflux and that the company may be approaching the default triggers.

- **Other Qualitative Factors *(Satisfactory)***

  Hyflux's revenue is predominantly derived from providing infrastructure solutions to municipalities and governments. The municipal sector contributed 84% (FY16: 92%) or S$145m (FY16: 912m) in 1H17. Industrial and other operations made up 15% (FY16: 7%) and 1% (1%) of the remaining revenue in the first six months of this year. The company has a significant concentration risk as revenue from a single customer in the municipal segment arising from service concession arrangement represented S$477m or 48% of total revenue in 2016.

  Hyflux's consumer business, which is included in other operations and encompasses wellness and lifestyle appliances and the ELO range of products, has not provided meaningful contribution to the company's sales. However, management highlighted in the latest financial statements that the segment has generated good growth in the past two years, and the group is exploring a separate listing of the division.

  The Singapore market continued to be the biggest market for Hyflux contributing 62% (FY16: 68%) or S$106m (FY16: S$677m) of the company's revenue in 1H17. Revenue from the MENA region was 28% (FY16: 26%) or S$49m (FY16: $252m) in 1H17, mainly contributed by the Qurayyat IWP. Hyflux's China market made up 8% (FY16: 5%) or S$14m (FY16: S$49m) of the total revenue in 1H17. Rest of the World accounted for 2% or S$4m and 1% or S$9m to the total revenue in 1H17 and 2016 respectively.

  Hyflux has a significant net exposure of approximately S$234m to the US dollar (FY15: S$106m), mostly due to its loans and borrowings and trade payables. The company's sensitivity analysis for 2016 indicates that a 10% strengthening of the USD against SGD would have cut profit before income tax by a substantial S$23m.

Industry Considerations *(Business Risk Profile)*

We see Hyflux's overall business risk profile as ***Satisfactory***, considering the below analysis and factors.

- **Economic Cyclicality *(Strong)***

  Hyflux's main business is to provide infrastructure solutions including water, power and waste-to-energy to municipalities and governments. For the services provided by Hyflux, the company receives guaranteed minimum payments from the concession grantors over the concession period. The rates for this kind of contracts are typically fixed at a level that ensures the service provider would be able to recover a fair return on investment while keeping the infrastructure well maintained. As such, this segment should theoretically exhibit highly defensive earnings and low cyclicality.

  The power business of Hyflux, although categorised within the utilities sector, is fundamentally very different from the defensive nature of regulated utilities. As an independent energy producer, Hyflux's fortune in this segment is tied to the supply and demand of electricity, and the fluctuations of the commodity markets. As such, we expect the company's power business to be highly cyclical and correlated to economic growth.

- **Growth Prospects *(Strong)***

  According to a UBS report in 2016, the global water market is estimated at around USD 500 billion to USD 600 billion a year, and is expected to see annual growth of ~7% as projected by Bank of America Merrill Lynch. The demand for water is widely predicted to increase significantly in the years ahead, with the Organisation for Economic Co-operation and Development projecting water demand to increase by 55% globally between 2000 and 2050. Also, the World Economic Forum ranked water crisis as the top global risk to industry and society over the next decade in the 2016 edition of the Global Risks Report (number three in the 2017 report).

  The growth in water demand will likely be driven especially by the Asia Pacific market, as the region should continue to see a climb in manufacturing and construction activities and rapid population growth. The United Nations World Water Development Report 2017 highlighted that two thirds of the world's population currently live in areas that experience water scarcity for at least one month a year, with about 50% of the affected population living in China and India. Along with the long-term population growth trend, we expect the annual growth of the water market to maintain at a rate higher than global GDP growth. The market for industrial water treatment should grow faster than the overall water market, as GWI predicted the sector to expand by more than 50% in 2015-2020.

- **Competition *(Weak)***

  Hyflux's infrastructure business competes with both domestic and international companies. Management has guided for a challenging outlook in 2017, with strong competition for the limited number of viable projects up for tender. The open tender framework for most public infrastructure projects introduces a highly competitive environment for the operators. Globally, legislation has moved toward promoting competition in public procurement and pushing for a reduction in the average duration of contracts. We do not anticipate pressure from municipal clients to decrease in the years ahead. Furthermore, we have not observed any evidence of Hyflux having sustainable competitive advantages in extracting profitability from these projects, although as previously mentioned the company was ranked as the largest desalination plant developer in 2016 by GWI. As reported in its latest financial statements for 2Q17, Hyflux has bidded for projects with a total contract value of S$1.8 billion, pending tender results.

- **Research and Development/ Technological Changes *(Satisfactory)***

  In February 2017, Hyflux signed a Memorandum of Understanding with the Nanyang Environment and Water Research Institute to collaborate on research in biomimetic membranes. The increase in global demand for clean water has driven the growth in membrane-based water and wastewater treatment technologies. The research and consulting firm Frost & Sullivan forecast the global membrane wastewater treatment technology market to grow at a CAGR of 10% globally to reach USD 12.07 billion by 2020.

  Hyflux also signed an agreement with Changi General Hospital in February 2017 to embark on two human clinical trials studying the effectiveness of the company's ELO products on diabetic patients. Hyflux will commit up to S$2.5m in cash and in kind to the study. Last year, the Dermapro Skin Research Centre in South Korea completed a clinical study on the efficacy of the ELO Gel.

- **Sources of Supply (*Satisfactory)***

  Hyflux highlighted in the information memorandum for its debt issuance programme that it faces supply risk in relation to its water supply. The company's seawater desalination plants requires seawater to produce desalinated water. If the seawater is polluted by contaminants such as those from industrial discharge or oil spills, Hyflux may not be able to desalinate the seawater (or desalinate at the specified standards). Hyflux's water treatment facilities face the same risk to their water supplies, namely the risk of pollution or contamination of the water source.

- **Degree of Regulation/ Government Influence *(Satisfactory)***

  Hyflux's water-related infrastructure businesses are often regulated, and its operations are dependent on the policies of the respective national, city or provincial governments. As reported in Hyflux's debt programme documentation, a significant part of the company's businesses involves environmental applications of its proprietary membrane technology. As such, the demand for these environmental solutions is heavily dependent on the policies of the municipals. In addition, Hyflux derives a substantial portion of its revenue from the MENA region and China, which pose higher legal and political risks than those of more developed nations. Nonetheless, we have not observed material cost of regulatory compliance, nor evidence of applicable regulations posing a competitive disadvantage to the company relative to its foreign-based competitors.

- **Labor *(Satisfactory)***

  We have not observed any incident of strikes reported by the company. Hyflux's senior management team comprise of Ms Olivia Lum (Executive Chairman & Group CEO), Ms Lim Suat Wah (Group Executive Vice President & Group Chief Financial Officer), Mr Wong Lup Wai (Group EVP & Group Chief Operating Officer), and Mr Cheong Aik Hock (Group EVP). Turnover of the senior management team has been moderate. Mr Lim Swee Kiang, who served as Group EVP since October 2011, left the company in March this year.

- **Accounting *(Satisfactory)***

  No red flags observed. The large amount of intangible assets (FY16: S$1.1bn) arising from service concession arrangement and the treatment of perpetual securities (as equity rather than debt) was accounted for in accordance with accounting standards. With regard to the former, the external auditor has concluded that management's accounting treatment and estimates were appropriate. Management has also provided adequate disclosures in the footnotes to the financial statements, which allow adjustments to be made for the purpose of analysis.

- **Event Risk *(Strong)***

  Management has signalled a possible reversal of their aggressive debt-fuelled expansion as they claimed to be embarking on an asset-light strategy. The change of course has continued this year with the announced plans to divest the Tianjin Dagang desalination plant in China and the Tuaspring IWPP in Singapore. As at 30 Jun 17, Hyflux carried S$1.7 billion of assets held for sale on its balance sheet (against S$665m of liabilities held for sale), which are largely made up of the two mentioned projects. We see the deals (if completed) as huge credit positives, especially If Hyflux succeeds in disposing these assets for anywhere close to their current book value.

Bond Pricing and Recommendation

Hyflux has a number of debt securities outstanding, and they have generally posted decent returns over the last year. Despite the weakening credit fundamentals, Hyflux has enjoyed favourable access to capital markets, relying on investor familiarity with its household brand name and high yield to continually tap the debt market for refinancing. But the credit environment can tighten at a short notice, and access to refinancing becomes restrictive. Investors should ensure they are being adequately compensated for taking on the company's credit risk.

Table 2 provides a summary of the Hyflux bonds and perpetual securities. Our credit opinion on the securities has taken into consideration our negative issuer profile on Hyflux, the attendant credit risk and the prevailing pricing of the securities. We assigned a Neutral rating on the HYFSP 6.000% Perp/Callable 2018 Pref (SGD) and HYFSP 4.250% 07Sep2018 Corp (SGD), and we Underweight the HYFSP 6.000% Perp/Callable 2020 Corp (SGD) and the two bonds maturing in 2019.

Table 2: Hyflux Bonds and Perpetual Securities

Security Name	Maturity	Outstanding Amount (SGD mn)	Ask Price	Ask YTW (%)	Z-Spread (Ask; bps)	Credit Opinion
HYFSP 6.000% Perp/Callable 2018 Pref (SGD)	Perpetual	400	97.175	8.131	575.3	Neutral
HYFSP 6.000% Perp/Callable 2020 Corp (SGD)	Perpetual	500	95.968	7.655	623.6	Underweight
HYFSP 4.250% 07Sep2018 Corp (SGD)	7-Sep-18	100	97.950	6.405	526.4	Neutral
HYFSP 4.200% 29Aug2019 Corp (SGD)	29-Aug-19	100	96.314	6.213	489.6	Underweight
HYFSP 4.600% 23Sep2019 Corp (SGD)	23-Sep-19	65	97.300	6.024	471.1	Underweight

Source: Bloomberg, iFAST compilations

At YTW of 7.7% and 8.1%, the two Hyflux perpetuals are certainly providing some of the highest yield spreads available in the SGD perpetual bond market. Bloomberg data indicates that among the 46 SGD-denominated perpetuals outstanding as at 4 Sep 17, only two offer higher or similar spreads. The first is the EZISP 7.000% Perpetual Corp (SGD) issued by Ezion Holdings Ltd, which is currently in financial revamp and having negotiations with bank lenders and creditors about its financing and capitalisation structure. The EZISP 7.000% Perpetual Corp (SGD) is trading at a huge discount from par and offers a spread of ~12,339bps over swaps. The second is the VIBGSP 7.350% Perpetual Corp (SGD), which is trading at a spread of ~623bps. The issuer Vibrant Group has just announced earlier this week that it will be redeeming the bond in full on the first call date of 11 Oct 17. We mentioned in August that Vibrant Group is likely to refinance the perpetuals via a new bond issue in the near future, and highlighted earlier some of the investment merits of the company's bonds.

We think investors considering the two Hyflux perpetuals should skip the HYFSP 6.000% Perp/Callable 2020 Corp (SGD). The HYFSP 6.000% Perp/Callable 2018 Pref (SGD) is the better choice in our opinion, trading at a yield-to-call of about 10.8% (Z-spread: 969bps), if we assume it would be called on the first call date of 25 Apr 18. Should Hyflux's credit profile fail to improve in the near future and it choose not to redeem the HYFSP 6.000% Perp/Callable 2018 Pref (SGD), an investor would at least be compensated with higher coupon payments at an earlier date relative to the HYFSP 6.000% Perp/Callable 2020 Corp (SGD). The coupon reset for the HYFSP 6.000% Perp/Callable 2018 Pref (SGD) kicks in on the same day as the first call date, increasing to 8% p.a. if the security is not redeemed by Hyflux on 25 Apr 18.

While we do not see any direct comparables in the SGD high-yield bond market, we think the two Hyflux bonds maturing in 2019 are overpriced relative to what is available in the market, especially the HYFSP 4.600% 23Sep2019 Corp (SGD) which is thinly traded due to its small issue size (S$65m). In fact, the pricings of the two Hyflux 2019 bonds look expensive against the company's own HYFSP 4.250% 07Sep2018 Corp (SGD), which is trading at a higher YTW of 6.4%. Investors of the Hyflux 2019 bonds are not compensated for bearing greater interest rate and credit risk by extending the maturity. Investors seeking to earn similar credit spreads and yields should look elsewhere.

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