18 March 2024 | 14 Pages

GZ R&F Properties (2777 HK)

A decision tree on the disposal of its London property

Event: On 6 February 2024, R&F (the "Seller") and London One (the "Buyer") have entered into a LOI where R&F will sell its entire stake of its London property project namely One Nine Elms (the "Property") to the latter.

Effect to R&F: Upon completion, R&F will be able to cancel no less than US$800mn (equivalent to about HK$6.25bn) and potentially up to US$2.8bn of its outstanding Senior Notes through an Exchange Offer (the "Offer") initiated by the Buyer. The final amount would depend on the participation interests of the Noteholders. R&F will also be able to transfer the underlying loan amounted to GBP820mn to the Buyer. In addition, R&F will realize a non-cash disposal gain of no less than HK$3.08bn and up to HK$18.7bn depending on the interests to the Offer.

Latest development: According to the transaction circular and information provided to Noteholders, it is noted that there will be an event coming up in May 2024 which may trigger a default on the project loan. Furthermore, the Review letter dated 27 February 2024 from BDO, the company's auditor, indicates that "*a material uncertainty exists that may cast significant doubt on the Target Group's ability to continue as a going concern*". Therefore, there is an urgency for the Noteholders to unite and to protect this piece of asset being taken into receivership.

Long stop date: 31 May 2024 is the long stop date, being the deadline for entering into the Definitive Agreement between the Seller and the Buyer (the "Transaction").

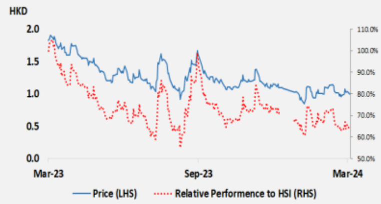
Our view: In a nutshell, the Offer is in substance a rescue plan initiated by certain Noteholders holding substantial amount of R&F Notes. By approving the consent solicitation and the sale and participating in the Offer, participating Noteholders will be able to secure an about-to-complete property that could possibly generate near-term cash flow in order to improve their overall recovery rate on the money they invested. However, if too many investors choose not to respond to the consent could result in an immediate default of R&F and sending it to liquidation.

In terms of benefit to R&F, the sale would put an end to its obligation to come up with additional financing necessary to finish the project while the company is seriously cash strapped with pretty much no flexibility in obtaining additional financing. It also provides an exit to R&F at a gain instead of risking the Property being taken into receivership and eventually be sold at an unknown valuation after a lengthy and unclear timeline. For equity holders, the sale can substantially reduce R&F's interest burden and borrowings thus increase its chance of weathering thru this financial crisis. In view of the recent development of mainland developers such as Evergrande (3333 HK) and Country Garden (2007 HK), large creditors can be much less patient than before.

Last price (18 Mar 24)	HKD 0.99
HSI	16,720.9
Mkt cap (HKDb/USDb)	3.71/0.48
Avg 6M daily trading volume (USDk)	1,016
Free float	43.01%

Source: Bloomberg

Share Price Performance



Source: Bloomberg

Share Price Performance	1M	6M	12M
Absolute (%)	(10)	(33)	(48)
Absolute (USD,%)	(10)	(33)	(48)
Rel. to HSI (%)	(13)	(27)	(37)

Source: Bloomberg

Company background

Guangzhou R&F Properties Co., Ltd. operates real estate businesses. The Company provides housing renovation, housing loans, real estate brokerage, property management, and other services. Guangzhou R&F Properties also operates hotel management.

Source: Company data, Sunwah Kingsway Research

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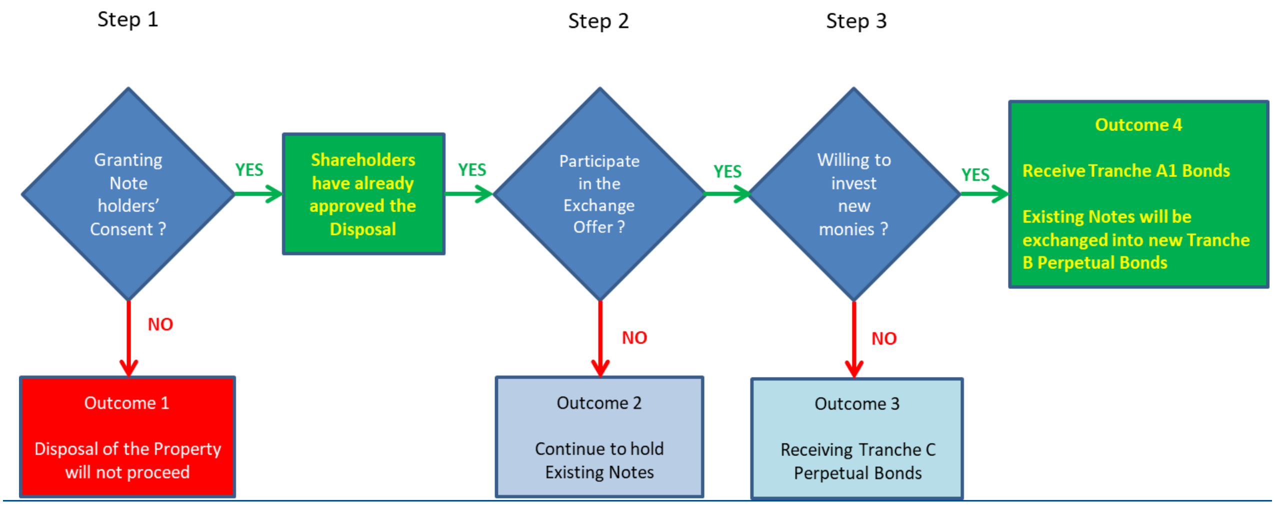
A walk-through of the Transaction and the Offer

Outlined below is a decision tree and a walk-through of the necessary decisions that Noteholders shall make regarding the Transaction and the Offer.

Figure 1: Decision tree of the Transaction



Source: Company data, Sunwah Kingsway Research

Key decisions to be made by the Noteholders

Step 1. This consent solicitation seeks Noteholders' consent to remove certain terms and conditions that will allow the disposal plan to proceed.

Step 2. R&F's shareholders have already approved the disposal on 18 March 2024. As soon as the Consent is granted, the Transaction will go ahead and the Offer will be launched. Eligible Noteholders will then be invited to participate in an Exchange Offer. It is important to note that, **ONLY** those Noteholders who voted "For" in the consent solicitation will receive a consent fee of 0.5% (for granting consent on or before 28 March 2024, the consent fee will become 0.25% afterwards until 2 Apr 2024) based on their principal amount. There will be **NO** consent fee to those voted "Against" in the consent solicitation even if the Transaction eventually completes.

Step 3. Eligible Noteholders participating in the Exchange Offer will also be given an option to inject further cash.

Should a Noteholder choose to **IGNORE** the consent solicitation and not respond, they will have foregone the possible consent fee but at the same time sending the company to Scenario 1, which to be discussed later.

Analysis on various outcomes from the decision tree

Consent ☑ Offer ☒ New money ☒

For Noteholders that vote "For" to the consent, the next decision is whether to participate in the Offer or not. Should they decide not to join the Offer, that will put them into Scenario 2.

Scenario 2 – Noteholder who approves the consent but chooses **not** to participate in the Offer.

Effects to	
Noteholder:	● Will receive an consent fee on their principal value ● Will remain a Noteholder of R&F
Subsequent risk profile	● Will be isolated from the future performance of the Property ● A healthier financial position for R&F ● Notes repayment will depend on R&F's future performance
The Property:	● The Buyer will assume all outstanding project loans ● No longer owned by R&F
R&F:	● Will record a disposal gain of at least HK$3.08bn and up to HK$18.7bn depending on the participation interest to the Offer ● Will cancel at least US$800mn and up to US$2.8bn of existing Notes depending on the participation interest to the Offer ● Unload the relevant loans to the Property of about GBP820mn

And for those that want to explore the opportunities from the Offer, they should consider Scenario 3 (Exchange for Perpetual Bonds without new money) and Scenario 4 (Exchange for Perpetual Bonds with new monies).

Consent ☑ Offer ☑ New money ☒

Scenario 3 – Noteholder chooses to participate in the Offer but **not** intend to inject additional money.

Effects to	
Noteholder	● Will receive an consent fee on their principal value ● Existing Notes will be exchanged for new Tranche C Perpetual Bonds ("C Bonds") at discount through an Unmodified Dutch Auction ● Existing Noteholders can elect discount ranging from 20% to 90% with allocation priority based on the largest discount and continuing on a descending order ● Existing Notes not exchanged into C Bonds will remain as R&F's Notes
Subsequent risk profile	● Priority and distribution of sales proceeds will be after A Bonds and B1 Bonds ● C Bonds will rank the same with B2 Bonds and receive 20% of the repayment allotted to that ranking ● Upon full repayment of all Perpetual Bonds, C Bonds will have a 10% profit sharing of the residual proceeds ● Notes not exchanged into C Bonds still subject to R&F's risk profile ● Repayment of the Perpetual Bonds is supported by London One sales proceeds ● C Bonds may be cleared through the facilities of Euroclear/Clearstream
The Property	● There will be fresh capital (from issuance of A Bonds) to ensure the completion of the Property as well as to support its operations and sales and marketing activities ● London One intends to sell the Property within three years
R&F	● Will record a disposal gain of at least HK$3.08bn and up to HK$18.7bn depending on the participation interest to the Offer ● Will cancel at least US$800mn and up to US$2.8bn of existing Notes depending on the participation interest to the Offer ● Unload the relevant loans to the Property of about GBP820mn

Consent ☑ **Offer** ☑ **New money** ☑

Scenario 4 – Noteholder chooses to participate in the Offer and willing to inject additional money

Effects to	
Noteholder	● Will receive an consent fee on their principal value ● Existing Notes are exchanged for new Tranche B Perpetual Bonds ("B Bonds") at a dollar for dollar ratio (to be equally split into B1 Bonds & B2 Bonds) ● New funds will subscribe to Tranche A1 Perpetual Bonds ("A1 Bonds")
Subsequent risk profile	● A1 Bonds will entitle to the highest priority in the repayment order among all newly issued Perpetual Bonds ● B1 Bonds ranks after A1 Bonds in the repayment order ● B2 Bonds will rank the same with C Bonds and receive 80% of the repayment allotted to that ranking ● Upon full repayment of all Perpetual Bonds, B2 Bonds will have a 90% profit sharing of the residual proceeds ● If the A Bonds subscriber not able to fulfill the new money payment, their A1 Bonds will become A2 Bonds which will have a lower repayment ranking than B1 Bonds ● Repayment of the Perpetual Bonds is supported by London One sales proceeds ● A/B Bonds are transferrable
The Property	● There will be fresh capital (from issuance of A Bonds) to ensure the completion of the Property as well as to support its operations and sales and marketing activities ● London One intends to sell the Property within three years
R&F	● Will record a disposal gain of at least HK$3.08bn and up to HK$18.7bn depending on the participation interest to the Offer ● Will cancel at least US$800mn and up to US$2.8bn of existing Notes depending on the participation interest to the Offer ● Unload the relevant loans to the Property of about GBP820mn

In the case that the Transaction cannot proceed, Scenario 1 will kick in and it is considered the least preferred option among the four.

Consent ☒ Offer ☒ New money ☒

Scenario 1 - Step 1 fails, i.e. not able to obtain Noteholders' consent. The proposed disposal will be terminated.

Effects to	
Noteholders	● Continue to hold Existing Notes
Subsequent risk profile	● Financial health of R&F likely to further deteriorate
The Property	● Considering the development progress of the Property and the much-delayed schedule, the risk of missing certain sales milestones related to the project loan is very high. ● According to a consent solicitation note, the project loan is subject to high default risk in May 2024. Considering the present financial strength of R&F, it is unlikely that it can come up with the necessary funding to fulfill the loan. ● In the case of default, the Property may be put into receivership with interest expenses escalating without construction progress.
R&F	● May lose control of the Property to the secured lenders on the project loan. ● Will expose to an unknown realization price of the Property with a lengthy and unclear timeline ● Interest and fees involved could be enormous and R&F may have no control of ● Defaulting on the project loan and the possible loss of control of the Property could trigger cross-default on the Notes and other borrowings ● Considering the present financial situation of R&F, keeping the Property may only increase the chance of another round of debt restructuring or in the worst case, send R&F into liquidation

The Perpetual Bonds

Through the Exchange Offer, certain existing R&F Notes due 2025, 2027 and 2028 will be exchanged for Perpetual Bonds issued by London One. These newly issued Perpetual Bonds will have no maturity date and non-interest bearing.

Assuming fully issuance of the new Perpetual Bonds, London One will have a bond schedule as follows:

Figure 2: Bond schedule of London One

	USD'mn	GBP'mn
Tranche A1 Bonds		840
Tranche B1 Bonds	400	320
Tranche B2 Bonds	400	320
Tranche C Bonds	200	160
		1,640

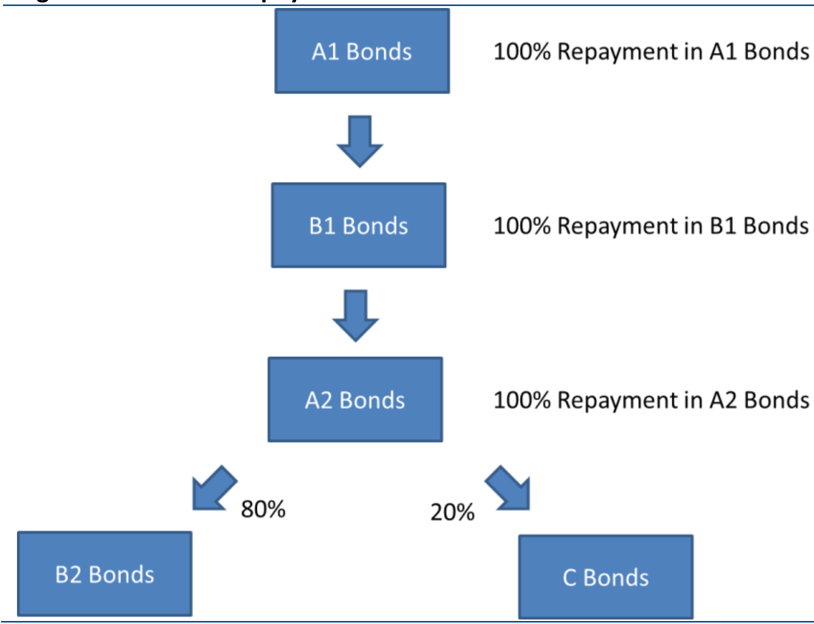
*GBP/USD @ 1.25

Source: London One, Sunwah Kingsway Research

Priorities of payment

The payment priority will be in a waterfall method as described below.

Figure 3: Priorities of payment



Source: London One, Sunwah Kingsway Research

Note: A2 Bonds is optional and only be triggered should A1 Bonds subscribers fail to fulfill subsequent capital call.

Profit sharing

Upon full repayment of A1, B1 and A2 Bonds, and until only 0.1% of the B2 Bonds and C Bonds principal amount is outstanding, there will be a profit sharing scheme where the residual proceeds will be split between B2 Bonds and C Bonds at a 90:10 ratio.

Proforma financial position of the Target Group

Based on the unaudited financials of the Target Group as of 30 September 2023, a back-of-the-envelope proforma adjusted financial is as follows:

Figure 4: Proforma adjusted financial position of the Target Group

	Target Group Unaudited 30 Sept 2023		Proforma adjustments		Proforma London One	
	RMB'mn Note 1	GBP'mn	GBP'mn Note 2	GBP'mn Note 3	GBP'mn	GBP'mn
Assets						
Properties under development	8,848	966			966	1,340
Other receivables and prepayments	62	7			7	7
Derivative financial instruments	87	9			9	9
Cash	146	16	840	(632)	224	224
Total assets	9,144	998			1,206	1,580
Liabilities						
Amt due to an immediate holding company	8,104	885	(885)		0	0
Trade and other payables	61	7			7	7
Borrowings	5,792	632		(632)	0	0
Perpetual Bonds	0	0	1,640		1,640	1,640
Total liabilities	13,958	1,524			1,647	1,647
Net assets	(4,814)	(526)			(441)	(67)

RMB/GBP @ 9.16

Note 1. Extracted from circular dated 27 Feb 2024
Note 2. The adjustments for the acquisition of Target Group by London One
Note 3. The repayment of outstanding project loans after issuance of the Perpetual Bonds

Source: Company data, Sunwah Kingsway Research

It is believed that the new capital is largely for repaying the project loans and fees necessarily to ensure that the Property will be ready for pre-sale in around June 2024. Thus, the possibility of an additional cash call is low. In this case, the paybacks of the Perpetual Bonds will very much depends on the total proceeds from the sale of the apartment units and eventually the disposal of the hotel.

Analysis of the potential payout

Below are two situations which assume the property valuation can be fully realized in cash and be available for repaying the Perpetual Bonds. It is for illustration purpose mainly as the actual repayment ratio varies depending on the Noteholders' acquisition costs.

Valuation at GBP1.34bn

Based on the Property valuation report, it is estimated that the Property will have a gross development value of GBP1.34bn upon completion. Assuming this will also be the net proceeds from the Property, in this case, it is expected that A1 Bonds and B1 Bonds will be fully paid off. However, the total proceeds will not be adequate to payback B2 Bonds and C Bonds in full. As such, for Noteholders that have invested additional money, their repayment ratio is estimated to be about 88% of the original investment. For C Bonds holders, their potential repayment ratio would range from 18% if they submit for a 20% haircut to the face value.

Figure 5: Repayment ratio based on a valuation of GBP1.34bn

Payout summary	Outstanding amount GBP'mn	Proceeds available for distribution GBP'mn	Distribution ratio	Payment received GBP'mn	Repayment ratio
Potential total proceeds from property sale		1,340			
Tranche A1 Bonds	840	1,340	100%	840	100%
Tranche B1 Bonds	320	500	100%	320	100%
Tranche B2 Bonds	320	180	80%	144	45%
Tranche C Bonds	160		20%	36	23%
	1,640			1,340	

Repaymen ratio analysis		Original investment GBP'mn	Payment received GBP'mn	Repayment ratio	Compare to current Note price
					4.5%
A1 + B1 + B2 Bonds		1,480	1,304	88%	Better off
Sensitivity analysis to C Bonds depending on			36		
	20% discount	200		18%	Better off
	40% discount	267		14%	Better off
	60% discount	400		9%	Better off
	80% discount	800		5%	Better off

Source: London One, Sunwah Kingsway Research

Valuation at GBP1.64bn

In the case that the total proceeds reached GBP1.64bn (22.4% upside from the base case), being the total amount of outstanding Perpetual Bonds, the repayment ratio of A/B Bonds would reach 100% whereas C Bonds can see significant improvement of over 4 times.

Figure 6: Repayment ratio based on a valuation of GBP1.64bn

Payout summary	Outstanding amount GBP'mn	Proceeds available for distribution GBP'mn	Distribution ratio	Payment received GBP'mn	Repayment ratio
Potential total proceeds from property sale		1,640			
Tranche A1 Bonds	840	1,640	100%	840	100%
Tranche B1 Bonds	320	800	100%	320	100%
Tranche B2 Bonds	320	480	80%	320	100%
Tranche C Bonds	160		20%	160	100%
	1,640			1,640	

Repaymen ratio analysis		Original investment GBP'mn	Payment received GBP'mn	Repayment ratio	Compare to current Note price
					4.5%
A1 + B1 + B2 Bonds		1,480	1,480	100%	Better off
Sensitivity analysis to C Bonds depending on			160		
	20% discount	200		80.0%	Better off
	40% discount	267		60.0%	Better off
	60% discount	400		40.0%	Better off
	80% discount	800		20.0%	Better off

Source: London One, Sunwah Kingsway Research

Valuation > GBP1.64bn

For any valuation above GBP1.64bn, that will likely trigger the profit sharing scheme, where B2 Bonds and C Bonds will split the residual proceeds in a 90:10 ratio. That would bring the repayment ratio of A/B Bonds to over 100% and provide more upside to C Bonds.

Comparing to Existing Bonds

By comparing to the current prices of the Existing Notes, the potential recovery of participating in the Offer for A/B Bonds seems to be far more attractive than status quo. For the C Bonds participants, the consent fee and the future cash flow are much more definite and viable than holding on to the current ones.

Figure 7: Prices of Existing Notes, 18 March 2024

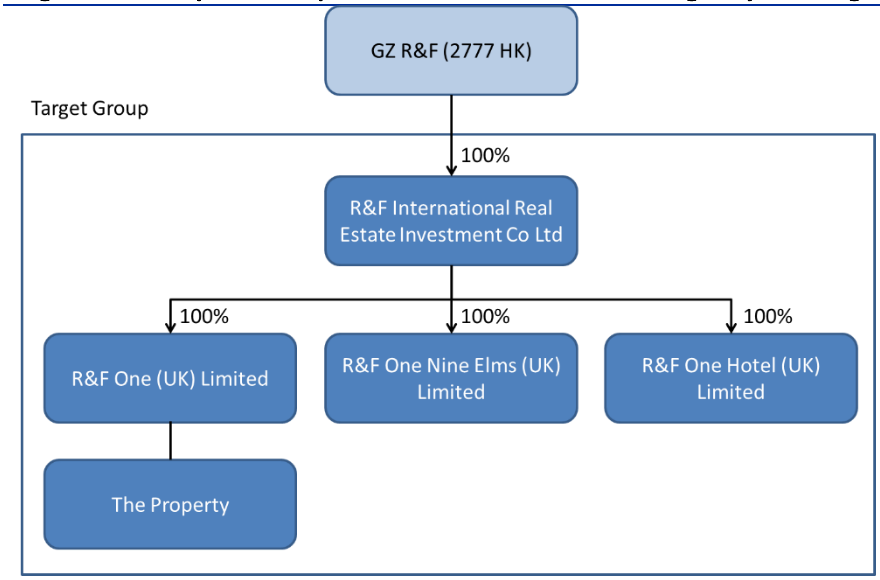
Name	↑Ticker	Coupon	Ask Px	Maturity
	GZRFPR			
Easy Tactic Ltd	GZRFPR	6.500	4.645	07/11/2025
Easy Tactic Ltd	GZRFPR	6.500	4.514	07/11/2028
Easy Tactic Ltd	GZRFPR	6.500	4.534	07/11/2027

Source: Bloomberg

Background of the Transaction

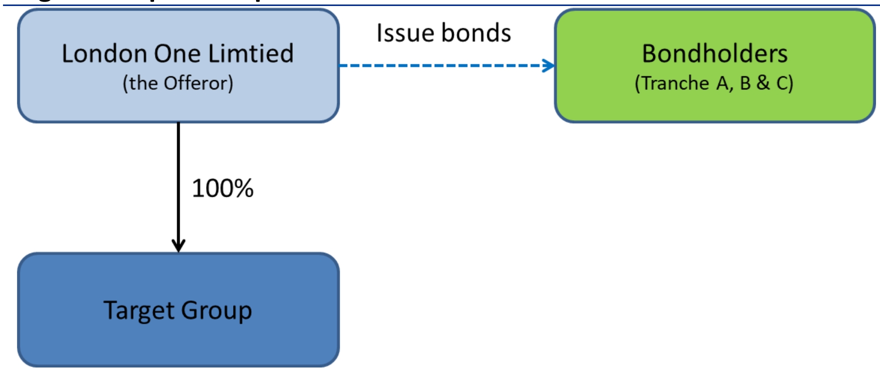
On 6 February 2024, R&F and London One have entered into a Letter of Intent such that R&F will dispose its entire interests in the Target Group to London One where Mr. Cheung Chung Kiu is the sole owner of latter. As of 31 December 2023, the Target Group had a net liability value of about HK$6.188bn (equivalent to approximately RMB5.608bn).

Figure 8: A simplified corporate structure chart involving only the Target Group, before the Transaction



Source: Company data, Sunwah Kingsway Research

Figure 9: Upon completion of the Transaction



Source: Company data, Sunwah Kingsway Research

The Property

One Nine Elms

Nine Elms, London SW8 5NQ

The project is a large-scale, mixed-use development on the South side of the River Thames near Vauxhall. Upon completion, it will comprise two towers namely River Tower and the City Tower. The 57-story City Tower will offer 334 private residential units on the high floors and 57 affordable housing units in the lower floors. The River Tower will be 42-story tall containing 103 private residential units on the high floors while a 203-room luxury 5-star hotel will take up the lower floors. Based on the latest information, the hotel will be named Park Hyatt London and managed by the Hyatt International.

According to Kroll Advisory, the market value of the Property is amounted to about GBP1.01bn as of 31 December 2023 considering the project development status. The gross development value of the project is valued at about GBP1.34bn.

Figure 10: CGI of the proposed development (left); site photo as of October 2023 (right)

Source: Kroll Advisory valuation report, Wikipedia

The site is located in the heart of an emerging building cluster of Vauxhall Nine Elms Battersea Opportunity Area (VNEB). VNEB is a large regeneration area in London, spanning 561 acres along the South Bank of the Thames from Lambeth Bridge to Chelsea Bridge. It has a close proximity of about 400m to Nine Elms station, London's latest subway extension of the Northern line extension to Battersea. It is also just minutes away from the Vauxhall station and the newly relocated US Embassy.

Figure 11: The Property is at prestige location

Source: Google map

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