Restructuring Deal of the Year
And the Winner Is —
THE GDE GROUP
As a landmark restructuring deal, the restructuring of Guangdong Enterprises (Holdings) Limited (GDE) Group won a number of distinguished awards, including International Financial Law Review’s “Restructuring Deal of the Year 2000” award, Asia Law & Practice’s “Best Restructuring Deal in Asia in 2000” award and International Financing Review’s “Asia’s Debt Restructuring Deal of the Year Award 2001”.

GDE was the window company of the Guangdong Provincial Government, a province with the highest GDP in China. The restructuring of GDE Group is the largest in China’s corporate history as well as the largest at completion in Asia – debt obligations amounted to almost US$6 billion, involved around 200 bank creditors, over 300 noteholders and over 1000 trade creditors. During the heyday of the Group, GDE was the principal shareholder of five companies listed on The Hong Kong Stock Exchange Limited. The market perceived the creditworthiness of GDE to be aligned with that of the Guangdong Provincial Government, and so funding was readily available for investments, ranging from businesses with steady income in the infrastructure and utilities sectors to high risk businesses in the finance sector, leading to a serious lack of focus in the business strategy of the Group.

Prior to the restructuring, the GDE Group was the key Guangdong-owned enterprise group in Hong Kong.

The Group Prior to Restructuring
This article is intended to highlight certain key aspects of the GDE restructuring which may be of interest to accounting professionals. For this purpose, one may broadly classify the restructuring in terms of two camps – firstly, GDE and its subsidiaries (GDE Restructuring) and, secondly, Guangdong Investment Limited (GDI), a listed flagship of the Guangdong Provincial Government in Hong Kong, and its subsidiaries (GDI Restructuring), which may be diagrammatically represented (the names of the entities referred to hereinafter have been simplified) as follows:

The Group after Restructuring
The post-restructuring group structure (the names of the entities referred to hereinafter have been simplified) may be diagrammatically represented as follows:
As part of the restructuring, the Guangdong Provincial Government established a wholly owned enterprise in China, GDH (PRC). GDH (PRC) incorporated in Hong Kong a wholly owned company, GDH (Hong Kong), with GDI as the backbone of the new GDH Group controlling the Dongshen Water Supply Project injected (see the next section on “Injection of Dongshen Water Supply Project”) through GH Water Supply (Holdings), a Cayman Islands-incorporated company, and GH Water Supply (Shenzhen), a Sino-foreign co-operative joint venture.

Another three companies were incorporated in the Cayman Islands – namely, NewCo to hold, e.g. part of the ongoing businesses of GDE; Property Company to hold, e.g. the Hong Kong real estate assets of GDE; and TrustCo to hold, e.g. other assets of GDE not transferred to NewCo or Property Company. Guarantee Company holds certain assets transferred from GDH (Hong Kong) and provides limited guarantees with respect to the debts owed by TrustCo and NewCo.

The non-core businesses of Guangnan were transferred to Guangnan Asset Management Company, with the resultant Guangnan focusing on its food and supermarket businesses.

Injection of Dongshen Water Supply Project

One of the salient features of the restructuring is the injection of the Dongshen Water Supply Project (Water Project), valued at US$2.2 billion, into GDI, which, as a going concern, was an obvious candidate for its listed flagship status. Having an operating history of more than 35 years, the Water Project currently meets over 75% of the water consumption requirement of Hong Kong. The annual revenue generated by the Water Project was estimated to be in excess of HK$2 billion. As the Water Project was at the relevant time a state-owned asset, its injection into GDI entailed corporatising the asset against a background of very stringent regulatory control over the use of state-owned assets in China, necessitating approvals from the relevant authorities of the Chinese Central Government and local governments.

A result of the corporatisation of the Water Project:

• GDH (Hong Kong) received US$100 million cash and HK$14 billion face value Tranche A, B and C notes; and
• GH Water Supply (Shenzhen) was provided with HK$14 billion shareholder loan and HK$6.116 billion in registered capital.

The establishment of GH Water Supply (Shenzhen) as a Sino-foreign co-operative joint venture was intended to create the conditions for GH Water Supply (Holdings), as the foreign investor, to obtain early repayment of its contribution to the registered capital of the joint venture.

Creditors

Under the GDE Restructuring, the creditors were classified into three categories, namely bank creditors, bondholders/noteholders, and non-financial creditors. In a nutshell, the creditors in the first two categories would...
waive all their claims against GDE Camp in exchange for:

- HK$14 billion equivalent face value debt obligations issued by GH Water Supply (Holdings);
- 19% of the ordinary shares of GH Water Supply (Holdings);
- 598.5 million GDI shares (equivalent to approximately 12% of GDI’s total outstanding shares post restructuring);
- 50% of the ordinary shares of NewCo;
- HK$970 million face value NewCo notes;
- 100% of the ordinary shares of Property Company;
- US$260 million face value equivalent Hong Kong Dollar TrustCo notes; and
- HK$775 million cash.

On the basis of certain market rates in discounting various notes and market values of the equity elements, the economic recovery rate for the bank creditors, bondholders/noteholders was estimated to be approximately 62%. On the other hand, had the GDE and Guangnan been liquidated, the creditors would have recovered respectively as little as 11 cents and 15 cents on a dollar.

There were more than 1,000 non-financial creditors whose claims amounted to a total of US$550 million. It was not feasible to explain the structure of the restructuring in detail to non-financial creditors and to negotiate with them one by one. To expedite the restructuring process, the Guangdong Provincial Government and the creditors in the first two categories eventually agreed to pay 85% of the amount of the claims of non-financial creditors, except those which amounted to less than HK$1 million which were paid in full.

GDI Restructuring

Whilst GDI’s creditors were pleased to see the injection of the Water Project into GDI, they were concerned with the debt burden of GH Water Supply (Holdings) in aggregate of HK$14 billion. With GDI being the last in the chain of entities to receive revenue from the Water Project in the form of dividends, its creditors were also concerned as to whether the Water Project would generate sufficient revenue with resultant residual cash flows after servicing all the debts of GH Water Supply (Holdings). Consequently, GDI’s creditors insisted and it was agreed that the HK$14 billion debt of GH Water Supply (Holdings) would be non-recourse to GDI.

To ensure that GDI would continue to be a listed flagship, a comprehensive restructuring comprising a business restructuring and a management restructuring were undertaken in addition to the debt restructuring. The comprehensive restructuring was intended to provide a defined business strategy focusing on GDI’s core businesses, namely, utilities, infrastructure, property and hotels. Proceeds from disposal of non-core businesses would be used to repay certain debts under the GDI Restructuring.

A specified level of the surplus cash from GDI’s operations would be used to accelerate principal repayment. Whilst the residual amount could be used for investment purposes, future investment in non-core businesses should not exceed 10% of GDI’s total net tangible assets. For the purpose of this restriction, “net tangible assets” would not include the Water Project. Surplus cash could also be used for dividend payment.

Under the debt restructuring, repayment of approximately 45% of the indebtedness of the GDI Group was to occur within a five-year period, with the remaining balance to be refinanced. A standard interest rate of HIBOR/LIBOR plus an interest margin of 2.375% (but to be reduced to 2% after reaching a certain debt repayment level) was charged.

A Win-win Outcome

Prior to the restructuring, GDE was the principal shareholder of five companies listed on the Hong Kong Stock Exchange Limited. Its liquidation would have had a substantial negative impact on the Hong Kong economy.

The injection of the Water Project into GDI demonstrates the commitment of the Guangdong Provincial Government to the restructuring of the GDE Group. In return, the creditors supported the restructuring by sharing the economic loss of the GDE Group.

The successful completion of the restructuring of the GDE Group within a two-year period has contributed towards the continued stability of the Hong Kong economy. It also provides an opportunity for loss recovery for the creditors and the Guangdong Provincial Government. All in all, the GDE Group restructuring may be said to have achieved a win-win outcome for all parties concerned.

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The views of the author are personal and do not necessarily represent the views of the Society or the GDH Group.