RATING ACTION COMMENTARY

Fitch Rates CK Hutchison Holdings' Proposed Notes 'A-'

Mon 04 May, 2020 - 下午 11:20 ET

Fitch Ratings - Seoul - 04 May 2020: Fitch Ratings has assigned a rating of 'A-' to CK Hutchison International (20) Limited's proposed US dollar-denominated guaranteed notes, which will be issued in two tranches. The proposed senior unsecured notes will be unconditionally and irrevocably guaranteed by CK Hutchison Holdings Limited (CKHH, A-/Stable) and rank pari passu with other senior unsecured borrowings of CKHH. CK Hutchison International (20) Limited is a wholly owned subsidiary of CKHH.

CKHH's ratings and Outlook reflect its strong business profile, underpinned by high business and geographical diversification with stable cash flow generation from its high-quality ports, retail, infrastructure, energy and telecommunication businesses, as well as the company's proven track record of strong financial discipline through the cycle.

KEY RATING DRIVERS

Impact from Coronavirus Outbreak: Fitch expects CKHH's earnings and cash flow to deteriorate due to the coronavirus pandemic. We believe the retail, port and energy segments will be most affected by restrictions to contain COVID-19 in many countries and the volatility in oil prices. We expect the impact to be most severe in 1H20, and retail and port operations to improve from 2H20, with China's economic activity gradually recovering from March and plans to slowly ease lockdown measures in the US and Europe in the coming months. Nevertheless, it will take time for these businesses to recover to pre-outbreak levels.

Fitch expects the impact on the telecom and infrastructure segments, which accounted for around 60% of Fitch adjusted EBITDA in 2019, to be limited. These businesses are less correlated with economic cycles and there is a large proportion of regulated business in the infrastructure segment, which generates stable returns.

Telecom Business to Grow Modestly: We expect CK Hutchison Group Telecom Holdings Limited (CKHT, BBB+/Stable), which consolidates CKHH's telecom businesses in Europe and HK, to have modest revenue growth and stable profitability with ongoing pricing pressure, especially in Italy, to be mitigated by network integration at Wind Tre and strict operational discipline, which includes prudent spectrum investments in 5G auctions.

Lower but Stable Returns in Infrastructure: Regulatory resets in the infrastructure segment are becoming more stringent, especially in the UK. The new pricing period for UK water utilities, which begins in 2020, offers lower allowed returns and a tougher-to-achieve incentive package. We believe these changes are likely to result in weaker cash flow generation for the operators and reduce their ability to pay dividends.

Fitch believes UK gas and electricity operators will face similar challenges as their new price periods begin in 2021 and 2023, respectively. However, we think the risks are mitigated as the impact on the dividend inflow of CK Infrastructure Holdings Limited (A-/Stable), the key entity for CKHH's infrastructure segment, will be staggered over the next few years, and we expect the company to continue to generate stable cash flow over the next two to three years.

Temporary Increase in Leverage: With the negative impact of the pandemic on earnings and cash flow, Fitch expects CKHH's FFO adjusted net leverage to temporarily increase above 4.5x, the level at which Fitch would consider negative rating action, in 2020. However, we expect net leverage to fall within our guidelines after 2020 as we expect earnings to gradually improve from 2H20. We also expect the company to manage its capex needs to minimise the negative impact on the company's free cash flow, which is supported by its track record of conservative and prudent financial management policy.

Capital-Intensive Business: CKHH's port, infrastructure and telecommunications businesses push up leverage, which constrains the overall ratings. There is also an element of structural subordination of cash flows, especially in the infrastructure assets, as there is debt at the asset-owning level and the operating cash flows of these businesses can only be accessed via dividends. However, cash generated from other segments, the newly established CKHT and the dividend inflow can comfortably cover the parent company's interest burden, which mitigates the structural subordination risk.

DERIVATION SUMMARY

CKHH's ratings are supported by its business diversification by geography and segment, which provides stable cash flows and supports its strong business profile. A solid record of conservative and prudent financial management and a coherent strategy also support the business profile. There are few peers with similar business models as CKHH is a conglomerate with infrastructure, port, retail and telecom segments. However, CKHH is somewhat comparable with CLP Holdings Limited (CLPH, A/Stable), although CLPH - an integrated and largely regulated utility through its key Hong Kong business, CLP Power Hong Kong Limited (A/Stable) - has a stronger business profile, and historically a more robust financial profile.

KEY ASSUMPTIONS

Fitch's Key Assumptions Within Our Rating Case for the Issuer

- Fitch-adjusted revenue to fall by 9% in 2020, rise by 8% in 2021 and increase by a low single digit after

- Fitch-adjusted EBITDA margin of 23%-25% in 2020-2022

- Dividend increase of 2% per year in 2021-2022

- Capex of HKD29 billion in 2020 and HKD35 billion in 2021

- No major acquisitions or disposals in 2020-2022

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Provided the business profile of CKHH remains unchanged,

- FFO adjusted net leverage of 3.5x or less on a sustained basis; and

- Positive free cash flow (FCF) after acquisitions and dividends on a sustained basis

Factors that could, individually or collectively, lead to negative rating action/downgrade:

- FFO adjusted net leverage exceeding 4.5x on a sustained basis;

- Substantially negative FCF after acquisitions and disposals;

- Significant changes in business mix and capital-structure management adverse to its credit risk profile;

- Weakening quality or decreased quantity of recurring cash

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Strong Liquidity, Access to Funding: CKHH's ratings are also supported by its robust liquidity profile and ease of access to capital. Reported cash and cash equivalents were HKD137.1 billion at end-December 2019 (2018: HKD135.4 billion) exceeded short-term debt of HKD43.7 billion, and debt maturities are well-laddered. The company has strong access to capital markets and good banking relationships, with unused committed credit lines of HKD7.5 billion at end-December 2019.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

DATE OF RELEVANT COMMITTEE

26 November 2019

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY/DEBT	RATING		
CK Hutchison International (20) Limited			
senior unsecured	LT	A-	New Rating

VIEW ADDITIONAL RATING DETAILS

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

- Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)
- Corporate Hybrids Treatment and Notching Criteria (pub. 11 Nov 2019)
- Country-Specific Treatment of Recovery Ratings Rating Criteria (pub. 27 Feb 2020)
- Corporate Rating Criteria (pub. 02 May 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

- Corporate Monitoring & Forecasting Model (COMFORT Model), v7.7.0 (1)

ADDITIONAL DISCLOSURES

- Dodd-Frank Rating Information Disclosure Form
- Solicitation Status
- Endorsement Policy

ENDORSEMENT STATUS

CK Hutchison Holdings Limited	EU Endorsed
CK Hutchison International (20) Limited	EU Endorsed

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