

# Client Alert.

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December 14, 2012

## **New Financing Channels for PRC-Listed Companies: A Closer Look at Gemdale's Innovative Debuts on the Offshore RMB Dim Sum and USD Bond Markets**

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### **INTRODUCTION**

The international capital markets for publicly listed Chinese companies are typically only available to Chinese companies whose shares are listed on overseas stock exchanges. These overseas-listed Chinese companies can tap the international bond markets by issuing either USD-denominated bonds, synthetic bonds, or CNH bonds (commonly referred to as dim sum bonds). For Chinese companies listed on domestic PRC stock exchanges, however, the international bond markets were closed. This, however, is no longer the case. In July 2012, Gemdale Corporation ("Gemdale") (金地(集团)股份有限公司), the third largest real estate developer listed on the Shanghai Stock Exchange, made a debut issue in the offshore RMB bond market by issuing three-year dim sum bonds with a total value of RMB1.2 billion. Subsequently in November 2012, it made another debut on the international USD bond market by issuing its five-year fixed rate bonds with a total value of USD350 million. Gemdale's RMB and USD bond offerings represented the first case of a purely PRC-listed company tapping the offshore RMB bond markets and USD bond markets, respectively, and were both largely considered unprecedented by the market. This Alert briefly examines the structure employed by Gemdale, which may serve as a template for other PRC-listed companies to raise capital overseas.

### **FURTHER BACKGROUND**

Largely due to disclosure differences in content, language, and format, as well as differences in accounting standards in the PRC, coupled with the hurdles of government approvals and other regulatory obstacles in the PRC, it is, practically speaking, difficult for Chinese companies that are listed only in the PRC domestic markets to tap international bond markets. In contrast, Chinese companies that are listed in Hong Kong or other overseas markets already have readily available public disclosure in the English language, such as annual reports, periodic announcements, and financial statements prepared under the International Financial Reporting Standards (IFRS), all of which make the preparation of the offering circular—the key document for the offering and sale of bonds—less time-consuming, thus allowing an issuer to seize the market window quickly, which is essential to the success of a bond offering.

The successful debuts of Gemdale's RMB and USD bonds have proven that practical execution hurdles can be overcome. The acceptance by international investors of financial statements prepared and presented in accordance with the PRC Generally Accepted Accounting Principles (PRC GAAP) is also an important factor to the success of the offerings. Although it has long been acknowledged by the accounting profession that PRC GAAP to a large extent is very similar to IFRS, international investors are generally more familiar with the presentation of financial statements in accordance with IFRS and normally require that the financial performance of the issuers is disclosed and analyzed in accordance with IFRS. Gemdale has shown that international investors are accepting financial disclosure based on PRC GAAP.

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## SUMMARY OF GEMDALE'S TWO BOND OFFERINGS

Gemdale is focused primarily on real estate development, especially of residential properties, and also offers property management services. In both of its bond offerings, Gemdale introduced an innovative offering structure which featured a combination of a subsidiary guarantee provided by various offshore subsidiaries, a keep-well agreement, an undertaking of equity interest purchase and a fixed charge over an interest reserve account. This structure allowed Gemdale to raise capital overseas, obtain credit ratings for both bond offerings, and minimize the need to obtain certain approvals from the PRC regulatory authorities.

**Dim Sum Bond Offering.** In July 2012, Gemdale, through its wholly-owned overseas subsidiary, Gemdale International Holding, Ltd., a special purpose entity formed for the purposes of offering the RMB bonds, raised RMB 1.2 billion through an issuance of guaranteed bonds in the offshore CNH markets with a coupon rate of 9.15%, due in 2015. The bonds received a credit rating of Ba3 from Moody's and a credit rating of BB- from Standard & Poor's, both of which are high yield credit ratings. Due to its high yield credit ratings, the yield rate of 9.15% for Gemdale's RMB 1.2 billion dim sum bond issuance can be considered high among all offshore dim sum bonds offered in Hong Kong as of its issue date in July. However, Gemdale's funding cost is relatively low compared to the prevailing interest rates for domestic project loans available to PRC property developers at that time, which reportedly were as high as 25% per year, or underground borrowings, which can average 5% a month. Furthermore, the interest rates of onshore PRC trust loans, another typical alternative funding source for PRC property developers, were reported to be averaged around 14 to 15% in the past year.

In terms of investor sentiment, the July bond issuance was, on the whole, well-received by investors, with many market commentators remarking that the issuance signified a general return of interest shown by investors toward dim sum bonds. Indeed, the issuance received almost four times more bids than what was originally expected. In terms of investor breakdown by origin, Hong Kong investors claimed 63% of the issue, Singapore 31%, Europe 5%, and others 1%. In terms of investor identity, fund managers purchased 41%, private banks purchased 39%, banks and hedge funds purchased 19%, and companies purchased the remaining 1%.

**USD Bond Offering.** The November 2012 issuance by Gemdale International Investment Ltd., another subsidiary of Gemdale, consisted of five-year fixed rate bonds of USD 350 million (due 2017), with a coupon of 7.125%. Similar to the Gemdale RMB bond offering, the issuing entity was also a special purpose vehicle formed for the USD bond offering. The USD bonds were rated Ba3 by Moody's and BB- by Standard & Poor's, the same as Gemdale's RMB bonds, and attracted considerable investor interest, with 89% of purchases coming from Asia. Around the same time, SOHO China Ltd., a large Chinese property developer that is listed on the Hong Kong Stock Exchange, issued two tranches of USD bonds; one was the five-year USD 600 million 5.75% senior notes (due in 2017) and the other tranche was the ten-year USD 400 million 7.125% senior notes (due in 2022). SOHO's USD bonds were rated Ba1 by Moody's and BB+ by Standard and Poor's, also high yield ratings, but two notches higher than Gemdale's. Earlier this year in August 2012, Guangzhou R&F Properties (广州富力地产股份有限公司), another large Chinese property developer listed on the Hong Kong Stock Exchange, also tapped the international USD high-yield bond markets by issuing USD 238 million 10.875% senior notes due in 2016, which formed a single series with the USD 150 million 10.875% senior notes due in 2016 that were issued in April 2012.

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## AN OVERVIEW OF THE STRUCTURE OF GEMDALE'S TWO BOND OFFERINGS

Gemdale employed the same innovative structure in both of its dim sum and USD bond offerings. Both types of bonds were issued through offshore special-purpose vehicles. Both issuances were guaranteed by Gemdale's wholly-owned offshore subsidiaries, including its offshore intermediate holding company, which was initially established as a sales office in Hong Kong to sell Gemdale's property projects to overseas customers and has since developed as an offshore holding company for Gemdale's property projects in China, as well as serving as an important funding vehicle in the overseas markets. Both of the issuers in the two bond issuances are wholly owned subsidiaries of this intermediate holding company.

Although Gemdale's USD bonds have high yield ratings, it is interesting to note that it did not adopt the traditional high yield senior note structure and covenant package commensurate with such a structure. Instead, its USD bonds used the same covenant structure as that of its RMB bonds. Rather than a conventional guarantee between the issuer and the onshore parent corporation, the two bond issuances each utilized both a "keepwell agreement," a "deed of equity interest purchase undertaking," and a fixed charge on an interest reserve account to create a more innovative structure.

The keepwell agreement essentially functions as a commitment by Gemdale to avoid the risk of insolvency, requiring it to ensure that the intermediate holding company has sufficient liquidity to meet any payment obligations under the bonds. Initially, keepwell agreements were used by Chinese state-owned enterprise borrowers such as CNPC and Sinochem in their dim sum bond offerings, but such arrangements have become more common in the dim sum market this year. Gemdale was the first property company from China to adopt such an arrangement. The keepwell agreement structure was utilized largely to avoid certain hurdles in respect of offshore guarantees put in place by the PRC regulatory authorities. Under PRC laws and regulations, onshore parent companies in the PRC are not permitted to guarantee offshore bond issuances without first obtaining approval from the PRC State Administration of Foreign Exchange (SAFE), whose approval can take a lot of time to receive; furthermore, under a traditional guarantee structure, offshore subsidiaries are not permitted to remit the proceeds from the bond issuances back into China. The keepwell arrangement gives investors some comfort and offers PRC companies a more efficient way of raising funds offshore, although enforcement of the keepwell agreement in the PRC has not been tested.

To solve the concern that offshore investors do not have recourse to Gemdale's onshore assets, both types of Gemdale bonds adopted a feature of the deed of equity interest purchase undertaking. Under the undertaking, should an event of default occur, Gemdale is obliged to purchase the equity interests of "target subsidiaries" (i.e., the direct or indirect PRC-incorporated subsidiaries of the intermediate holding company), at a purchase price high enough to meet any outstanding debt obligations under the bond issuance. Following the exercise of the repurchase option, Gemdale must execute the relevant equity interest transfer agreement or agreements with the relevant transferors and file for the necessary PRC regulatory approvals. Similarly, such an equity interest purchase undertaking has alleviated the need for PRC approvals. Generally speaking, approval from the PRC National Development Reform Commission (NDRC) is required when a PRC company wants to lend money to an overseas subsidiary or otherwise provide it with more funds. Since the deed of equity interest purchase undertaking in both bond issuances deals only with onshore assets being purchased by an onshore buyer (i.e., Gemdale), such asset acquisitions would be considered an onshore intra-group transfer which would not require NDRC approval. Should the repurchase be exercised, only the approval of MOFCOM and SAFE would be needed, along with registration of the transfer of the relevant equity interests (as required under the deed of equity interest purchase undertaking) with the appropriate Administration of Industry and Commerce (AIC). As commented by S&P, although neither the keepwell agreement nor the equity repurchase undertaking are being viewed as a guarantee, they

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have provided further reassurance to investors and demonstrated the parent company's strong commitment to its subsidiary.

In addition, each of the two Gemdale bond issuances is secured by a fixed charge given by the issuer over an interest reserve account, and each issuer is required to deposit a minimum amount equivalent to the aggregate interest for two interest periods payable under the bonds into such an interest reserve account. The issuers are obligated to maintain this minimum amount in the interest reserve account at all times prior to the interest payment date falling immediately before the maturity date of the particular bonds.

## LISTING

Both the RMB and USD bonds are listed on the Singapore Stock Exchange (SGX-ST) and are made available to investors outside the United States in reliance on Regulation S under the US Securities Act. Gemdale will make available its annual and quarterly financial statements as required by the rules of SGX-ST.

## CONCLUDING THOUGHTS

As discussed above, Gemdale's unique structure reduces regulatory burdens and gives PRC-listed companies a way to tap into offshore bond markets, bring offshore proceeds onshore for domestic use, obtain a bond rating, and raise their general profile and reputation. Gemdale's structure could serve as a template especially for PRC onshore property developers, which must otherwise contend with restrictions levied on financing and guaranteeing offshore entities. The template and debt financing path could also prove a viable alternative for mainland companies without overseas listing platforms to raise capital abroad.

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