

PROJECT DIAMOND

MASTERSTROKE

On 9 January 2015, Cheung Kong (Holdings) Limited (Cheung Kong) and Hutchison Whampoa Limited (HWL) announced a major business reorganisation to create two new leading Hong Kong listed companies. The markets cheered the new opportunities and increased robustness expected of the two new firms. Likewise, HWL employees will continue to find stability and opportunity in their future.





f the many superlatives used by breathless financial analysts in the days following the announcement of the reorganisation of Cheung Kong and HWL, the venerable and respected *Financial Times* seems to have encapsulated the move in one word: "Masterstroke"⁽¹⁾.

In an announcement that took the markets by storm, "investors cheer[ed] Li's move to redraw his empire" (from the same *Financial Times* article). The decision to merge the two firms and then spin off their property arms into a second independent company was warmly welcomed by the markets. The main new firm will be named



CK Hutchison Holdings Limited⁽²⁾ (CK Hutchison) and the property firm Cheung Kong Property Holdings Limited (CK Property), both to be incorporated in the Cayman Islands and listed in Hong Kong.

THE RATIONALE

While markets reacted to the 'new' news by driving the shares of both firms to fresh highs, many saw obvious benefits in a long awaited and logical reorganisation. "This reorganisation is far from a surprise and has long been discussed," Andrew Lawrence, an analyst with CIMB Group Holdings Bhd, wrote in a research note on 12 January. "It will make for a cleaner corporate structure..."⁽³⁾

Even famously fierce defenders of minority shareholder rights, like Hong Kong's David Webb, were in favour. "What they are doing is a step in the right direction for transparency and removing conflicts of interest."⁽⁴⁾

Analysts were not lacking for good reasons for the move.

"PROJECT DIAMOND"

The project, in the works since last summer, was code named "Project Diamond"⁽⁵⁾. The word 'diamond' is from the Greek ἀδάμας (adámas), meaning unbreakable. However, a diamond can be cut, polished and properly set to reveal its true value. Indeed, Nomura analysts found treasure in "the unlocking of hidden value embedded in the existing vertical structure."⁽⁶⁾

Vincent Lam, Managing Director and Chief Investment Officer of VL Asset Management Limited, opined that the "share price discount of a holding company is generally 15 to 25 per cent or more."⁽⁷⁾ Changing that structure should remove the discount.

Paul Louie, Head of Property Sector Asia, Ex-Japan, Equity Research at Barclays Asia, cited three benefits to shareholders, including removing the holding company

discount, optimisation of capital structures and raising dividends—always popular with investors.⁽⁸⁾

Goldman Sachs took note of not only economic but also strategic benefits. In a note to clients, they forecast "greater business transparency, better allocation of capital, alignment of management responsibilities and a clearer demarcation of the group's property and non-property divisions." Improved cash flow and ability to increase dividends were also on Goldman's radar.⁽⁹⁾

The Wall Street Journal saw a defensive move against the potential for the US Federal Reserve Bank to raise interest rates, slowing profits derived from real estate holdings around the world. The move would protect Cheung Kong from such moves—and leave it cash-rich, well-positioned to invest in European and other global assets.⁽¹⁰⁾

Chairman Li Ka-shing explains some of the thinking behind the reorganisation, "Cheung Kong and Hutchison have grown substantially in size and scale over the past decade. The reorganisation will place the companies in an even stronger position for future growth and development."

The final arrangements will take some time as shareholders must be consulted about the moves and regulators satisfied that all proper procedures are being diligently observed.

THE FUTURE IS BRIGHT

"This opens up a new chapter for the group," according to David Ng, a Hong Kong-based analyst at Macquarie Group.⁽⁵⁾

The markets agreed with HWL's senior leadership that the move was a natural and welcome progression to allow two of the world's most dynamic conglomerates to plan for a strong future that looks bright for their investors, clients and staff.

1. **Investors cheer Li's move to redraw his empire** Jennifer Hughes, *Financial Times Asia*, 13 January 2015, P. 14.
 2. CK Hutchison was approved by Cheung Kong shareholders 99.7 per cent in favour and listed on 18 March 2015.
 3. **Li retakes Asia's richest person crown** Bloomberg, *China Daily*, 13 January 2015, P. 17.

4. **Investors cheer Li's business revamp** Benjamin Robertson and Sandy Li, *South China Morning Post*, 13 January 2015, B1.
 5. **Billionaire Li gears up for deals after 'Project Diamond'** Vinicy Chan, *Bloomberg*, 11 January 2015.
 6. **Shares in Li firms jump after plans for restructuring** Benjamin Robertson and Peggy Sito, *South China Morning Post*, 13 January 2015, A1.

7. **Li Ka-shing launches sweeping revamp on corporate empire** Ya Shi Zhang, *Xinhua News Agency*, 11 January 2015.
 8. **Li Ka-shing flag flutters on heels of restructuring** Celia Chen, *China Daily*, 13 January 2015, P. 8.
 9. **Greater transparency in Li Ka-shing empire restructuring** K LH, *Dow Jones Newswire*, 12 January 2015.
 10. **Richest person in Asia is building up his defenses** Abheek Bhattacharya, *The Wall Street Journal Asia*, 12 January 2015, P.32.

Sphere answers some of the most common questions that have been asked by the HWL family in the past two months.

WHAT'S THE TRANSACTION ABOUT?

1. Cheung Kong and Hutchison Whampoa have been around for so many years. Why change? Why now?

- You have all been a part of our growth story for the past two to three decades. Cheung Kong and HWL both have now reached a size where it makes strategic and economic sense to carry out this reorganisation.
- We, and many in the analyst community, have recognised the holding company discount for a number of years. However, it wasn't until last summer that a suitable proposal was put together to unlock this value for shareholders by eliminating the layered holding structure of Cheung Kong and HWL.
- The reorganisation will also better position the companies for further expansion in the future.
- This arrangement will enhance investment and financing flexibility for business units.
- Investors of the company will also have greater flexibility and choice to adjust their shareholdings in CK Hutchison or CK Property according to their own individual investment objectives and preferences.

2. Will Hutchison Whampoa Ltd (HWL) cease to exist?

- Of course not. HWL will no longer be a listed company but the name, logo, assets and obligations will all be maintained.
- HWL's contracts, subsidiaries and corporate functions will remain as they were, as will all the staff's contracts and benefits.
- All business contracts and dealings made under HWL will continue to be made under HWL and will all be honoured. In short, it's business as usual.

"The reorganisation will place the companies in an even stronger position for future growth and development."

Chairman Li Ka-shing

3. Will this make the property business smaller?

- On the contrary, by combining the two property portfolios together, CK Property will become an even more powerful player in the property sector.
- The combined property business, CK Property, will be the number one listed hotel owner-operator in Hong Kong, with 12,150 rooms in Hong Kong and a total of 14,680 rooms worldwide. It will have the second largest Hong Kong rental property portfolio and 17 million square feet gross floor area of rental properties worldwide.
- In addition, it will be the top property developer in Hong Kong and the Mainland with a 170 million square feet landbank.

4. Does this mean Chairman Li Ka-shing is retiring?

- Mr Li has no plans to retire yet. Mr Li will remain Chairman and the Li family will remain the largest shareholder of both companies. Following the reorganisation, shareholders can invest directly into the two separate listed vehicles alongside the Li family and can be assured their interests align. As a responsible leader, he has in place a succession plan that will ensure the continuing success of the companies going forward.

WHAT DOES IT MEAN FOR ME?

5. Will this impact my job?

- No. It will be business as usual for everyone in the Group.
- We will continue to grow our respective businesses and most of your reporting lines will not change.
- It may, in fact, provide a clearer picture for your business when it comes to investing in future developments without having to worry about competing forces with sister companies.

6. Will this impact my benefits? Will my current employment terms be changed?

- No. There will not be any changes to your benefits nor any change to your retirement schemes.
- As mentioned, it's business as usual.

7. What should we tell our business partners about this transaction?

- Simple. There will be no impact.
- Our financial strength will not change. Our operations will not change. Our contracts are valid and continue to be so.
- CK Hutchison will still be in over 50 countries with enhanced scale. The reorganisation will see a consolidation of our infrastructure assets that were previously co-owned. As well, CK Hutchison will increase its ownership in Husky Energy to become its largest shareholder. CK Hutchison will benefit from enhanced liquidity and CK Property will have a clean capital structure and a separate fundraising platform as a pure property play.
- Rating agencies have affirmed Hutchison Whampoa's rating following the announcement of the proposed reorganisation. Management has announced there will be no adverse effect to Cheung Kong or Hutchison Whampoa creditors. □