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WH Group under scrutiny in wake of cancelled Hong Kong IPO

By Josh Noble in Hong Kong

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WH Group's ditched Hong Kong listing has drawn fresh scrutiny over the structure and rationale behind its $7bn takeover of Smithfield Foods – the largest ever US acquisition by a Chinese company.

The Sino-US pork producer, now the leader in both markets, abandoned its planned initial public offering this week, having failed to win over investors – despite already cutting the deal size in half.

WH Group – formerly known as Shuanghui International – blamed deteriorating market conditions, while analysts pointed to poor sentiment towards China and the outbreak of a deadly pig virus in the US.

Though investors did show interest, many were "simply not on the same page as the company" when it came to valuation, said one person with knowledge of the sale process.

However, some have raised doubts over WH Group's longer-term prospects, and questioned the thinking behind the Smithfield buy. WH Group had pitched itself as a global leader tapping rising Chinese consumption, but investors instead responded to two separate businesses – one in the US and one in China – bolted together and creaking with debt, say bankers.

"It's like buying a house, ripping out the bathrooms and kitchen, and trying to flip it for a premium six months later," said one senior equity banker.

Investors also expressed concerns that a trimmed deal would simply store up trouble down the road, by raising only a slice of the money needed to pay off debts. Further capital raising and shareholder sales would then be inevitable – creating a major overhang for a company seeking a valuation in line with established US peers.

The original case for purchasing Smithfield was to create one international company that could capitalise on cheap pork in the US by selling it into China, the world's biggest consumer of the meat. Smithfield's higher-margin pork products – such as ham and sausages – were also seen as a neat way to gain exposure to rising wealth and changing eating habits in China.

When announcing the deal in September last year, Wan Long, now chairman of WH Group, pointed to numerous advantages of combining the companies.

"Together we look forward to utilising our individual strengths – including Shuanghui's extensive distribution network in China, and Smithfield's leading production and safety protocols – to provide safe, high-quality products to consumers worldwide," he said at the time.

But the company has yet to prove to investors that its plans will work, having completed the takeover only six months before attempting to list. Management has not yet been integrated, while Smithfield products are still some months away from arriving on Chinese supermarket shelves.

WH Group borrowed about $4bn to finance its purchase of Smithfield, much of which is not due to be repaid for years. Most of it was lent by Bank of China, although a chunk of about $1.5bn – originally a bridge loan from Morgan Stanley – has now been placed with US investors as five-year and seven-year debt. The company had sought a listing to help pay off some of its loans, largely because of the chairman's own distrust of debt, according to two people with knowledge of the process.

Though the debt was borrowed at relatively cheap rates, the failure to attract new equity investment leaves the company with tens of millions of dollars a year of debt-servicing costs, and leaves private equity investors trapped for the foreseeable future.

Peter Fuhrman, chief executive of advisory firm China First Capital, describes the episode as one of the "most expensive IPO duds in history", and believes the Smithfield deal was actually an attempt by private equity investors to bulk up the company to help provide an exit to their holdings in the original China-only business.

Those investors include Goldman Sachs, Temasek and New Horizon. However, CDH Investments, a Chinese private equity house, is by far the largest outside shareholder, and thought to have been a key driving force behind the deal.

“WH Group was created by the banks and PE firms to hold the assets of American pork producer Smithfield Foods bought last year in a leveraged buyout,” Mr Fuhrman wrote on his blog. “Now we have this sorry spectacle of the PE firms, together with partners, having seemingly thrown more money away in a failed bid to rescue the original Shuanghui investment from its unexplained illiquidity.”

Those familiar with the cancelled float say that WH Group is almost certain to return at a later date, with a new deal likely to involve a far smaller syndicate than the 29 bookrunners it hired first time round.

Attention will now shift to the company’s first-half earnings. Last year WH Group made a net loss of $67m, largely caused by share-based awards given to two executives worth almost $600m, according to its listing prospectus. Shares in the Chinese business – listed in Shenzhen under the name Henan Shuanghui Investment & Development – are down by a quarter so far this year.

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