Asia Credit Research

Ezra Holdings Limited: Credit Update

Thursday, 24 March 2016

If at first you don't succeed…

- **Second consent solicitation:** In our previous credit update on Ezra[1], we noted that Ezra generated zero EBITDA during 1QFY2016 (ending November 2015), due to large losses in its subsea division. We opined then that Ezra would have a tough time meeting its EBITDA / interest coverage covenant of minimum 1.75x, for the test period ending 1HFY2016 (ending February 2016). With the external environment continuing to be challenging since then, it is not surprising that Ezra is back at the table seeking covenant relief. As 2QFY2016 results (for the quarter ending February 2016) will be released around the middle of April, Ezra is seeking to pre-empt any situation that may arise.

- **The key terms:** In summary, Ezra is seeking to include a cure mechanism to existing terms, to allow the issuer to cure any violation of the existing interest coverage covenants. The mechanism is similar to those introduced in other consent solicitation exercises by Ezra's offshore marine peers, such as Pacific Radiance and Nam Cheong. In the event that Ezra does not pass the interest coverage covenant, Ezra would be required to deposit and maintain an interest reserve account to support future debt service (with the amounts dependent on the time period as shown below).

	Test Periods (financial half-year ended or ending on)	In the event the Interest Coverage Ratio falls below	Interest Reserve Balance (as a multiple of the number of interest periods)	Withdrawal of moneys from the Interest Service Reserve Account
Suspension Test Periods	29 February 2016	1.75:1	2	No withdrawal is permitted.
	31 August 2016	1.75:1	2	
	28 February 2017	2.5:1	2	
Post-suspension Test Periods	31 August 2017	2.5:1 (but no lower than 1.0:1[1]	1[2]	Withdrawal is permitted but only for the purposes of paying amounts due and payable on the Notes.
	28 February 2018	3.0:1 (but no lower than 1.0:1[1])	1[2]	

Source: Company

It should be noted that by the 2HFY2017 test period (ending August 2017), should Ezra generate an interest coverage ratio worse than 1.0x, Ezra will not be allowed to utilize the cure mechanism, and this would cause Ezra to be in technical default. In our view, this is a fail-safe left in place to protect bondholders, rather than allow Ezra to ignore the interest coverage ratio via maintaining the interest reserve

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[1] OCBC Asia Credit - Ezra Credit Update (2 Feb 2016)

account. As part of the consent solicitation, Ezra is also seeking to obtain a waiver for any potential violation of the interest coverage covenant for the test period ending February 2016.

In exchange for the covenant amendments, investors would receive either 50bps in early consent fee if consent is given by 04/04/16, or 25bps in normal consent fee if consent is given by 11/04/16.

- **Developments since the first consent solicitation:** When Ezra initiated its first consent solicitation exercise on 09/11/15, we have considered the situation at that time and recommended that investors agree to the proposals made by Ezra[2]. It is worth considering if the pertinent factors then still hold today:

A) **External environment remains grim:** Since early November 2015, when crude oil prices (Brent) were trading at around USD50/bbl, it has plunged more than 40% to a low of less than USD30/bbl in the middle of January. Though oil prices have since rallied back to above USD40/bbl, the plunge in oil has resulted in further delays to upstream energy projects. Though Ezra is more focused on development and production work (rather than exploration), the slump caused end-clients to defer projects even further. This has hurt Ezra's subsea business during 1QFY2016, and we can expect 2QFY2016 to be similarly pressured. When questioned regarding the general state of the industry, Ezra's management believes that the rest of 2016 looks to remain challenging. The original consent solicitation generated some covenant headroom by relaxing the interest coverage covenant for the first couple of years. Unfortunately, the environment deteriorated so sharply that the headroom was inadequate, hence the need to include a cure mechanism. It is also worth noting that Ezra's peers in the offshore marine space have been making provisions and taking impairments in the quarter ending December 2015. Should Ezra choose to take similar steps in 2QFY2016 (for the quarter ending February 2016) and make provisions given the challenging environment, Ezra's EBITDA (for the purpose of the covenant, this is calculated by starting from consolidated pre-tax profit and adding back interest expense, depreciation expense and non-cash amortisation expense) would be further pressured, heightening the risk of tripping its interest coverage covenant.

B) **Alignment of stakeholders:** Despite the weak environment, Ezra has been judiciously meeting its obligations. In 2H2015, Ezra spent SGD375mn redeeming its EZRASP'15 bonds as well as its perp. To fund it, Ezra did USD150mn rights issue, with the founding Lee family subscribing to their entitlements (~25%). In addition, Ezra just refinanced its SGD95mn in bonds due 21/03/16 (via a SGD100mn loan). Currently, the only bond outstanding for Ezra would be its SGD150mn in bonds due 24/04/18. Ezra had originally considered the sale and leaseback of the Constellation vessel to unlock more liquidity, but instead decided against as the pricing offered was inadequate.

C) **Chiyoda JV:** We continue to consider the Chiyoda JV to be pivotal to Ezra's future performance, as the JV would allow Ezra to unlock some value in its subsea division (infusing Ezra with USD150mn in fresh liquidity), as well as introduce a strategic partner to its subsea division. However, the execution of the JV has been delayed, as both parties were debating the sale and leaseback of the Constellation. As a result, <u>the long stop date of 31/03/16 for the JV is fast approaching</u>. Ezra's management has indicated that they are confident that the JV will be executed in time. As such, it remains our base case that the JV will close on time. That said, we consider the failure of the JV to close to be a huge negative for Ezra, and hence will be monitoring the situation closely.

[2] OCBC Asia Credit - Ezra Credit Update (12 Nov 2015)

- **Recommendation**: In summation, Ezra is back to the table due to the sharp deterioration of the energy industry wiping out the buffer that Ezra received from its initial consent solicitation. The new consent solicitation would provide Ezra's management with more leeway by introducing a cure mechanism that we have already seen in other consent solicitations by other stressed offshore marine issuers. We continue to believe that the Chiyoda JV is crucial to Ezra's future performance, and that it remains our base case that the JV would go through. As such, we would recommend investors to agree to the proposals made in the consent solicitation exercise. As such, investors should accept the offer by 04/04/16 in order to receive the early consent fee. That said, with the long stop date of 31/03/16 for the Chiyoda JV looming, it is highly likely that any negative outcome that occurs would change our view. We are monitoring the situation closely and will provide updates if necessary. We will continue to maintain our **Underweight** on Ezra's Issuer Profile, given the challenging environment, and maintain our **Neutral** recommendation on the EZRASP'18s.

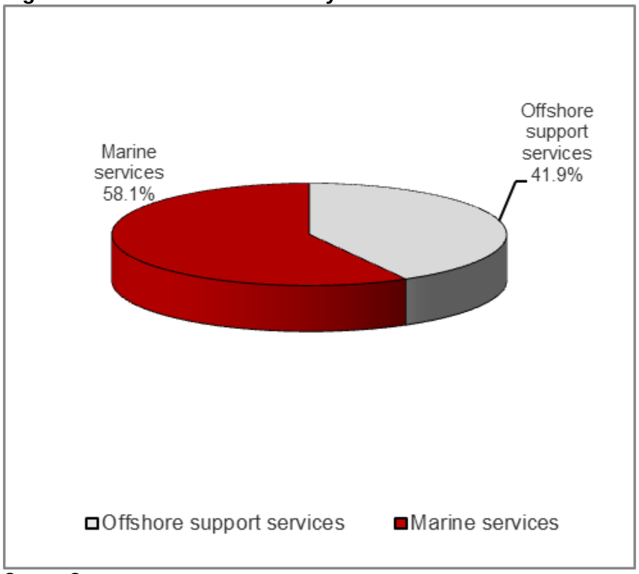
Ezra Holdings Ltd

Table 1: Summary financials

Year ended 31st August	FY2014	FY2015	1Q2016
Income statement (US$ mn)		restated	restated
Revenue	1,488.4	543.8	152.3
EBITDA	141.8	76.3	16.7
EBIT	69.6	7.0	-0.9
Gross interest expense	51.3	52.3	11.2
Profit Before Tax	74.7	79.1	-50.7
Net profit	45.3	43.7	-55.3
Balance Sheet (USD'mn)			
Cash and bank deposits	178.9	417.8	138.1
Total assets	3,363.0	4,177.3	3,818.7
Gross debt	1,551.9	1,470.2	1,214.8
Net debt	1,373.0	1,052.3	1,076.7
Shareholders' equity	1,185.8	1,365.3	1,334.4
Total capitalization	2,737.7	2,835.5	2,549.3
Net capitalization	2,558.8	2,417.6	2,411.1
Cash Flow (USD'mn)			
Funds from operations (FFO)	117.4	113.0	-37.8
CFO	140.1	142.5	12.5
Capex	327.4	320.5	9.7
Acquisitions	0.0	-25.2	0.0
Disposals	8.5	30.3	0.0
Dividend	5.4	0.0	0.0
Free Cash Flow (FCF)	-187.3	-178.0	2.8
FCF adjusted	-184.1	-122.5	2.8
Key Ratios			
EBITDA margin (%)	9.5	14.0	10.9
Net margin (%)	3.0	8.0	-36.3
Gross debt to EBITDA (x)	10.9	19.3	18.2
Net debt to EBITDA (x)	9.7	13.8	16.2
Gross Debt to Equity (x)	1.31	1.08	0.91
Net Debt to Equity (x)	1.16	0.77	0.81
Gross debt/total capitalisation (%)	56.7	51.8	47.7
Net debt/net capitalisation (%)	53.7	43.5	44.7
Cash/current borrowings (x)	0.4	0.6	0.3
EBITDA/Total Interest (x)	2.8	1.5	1.5

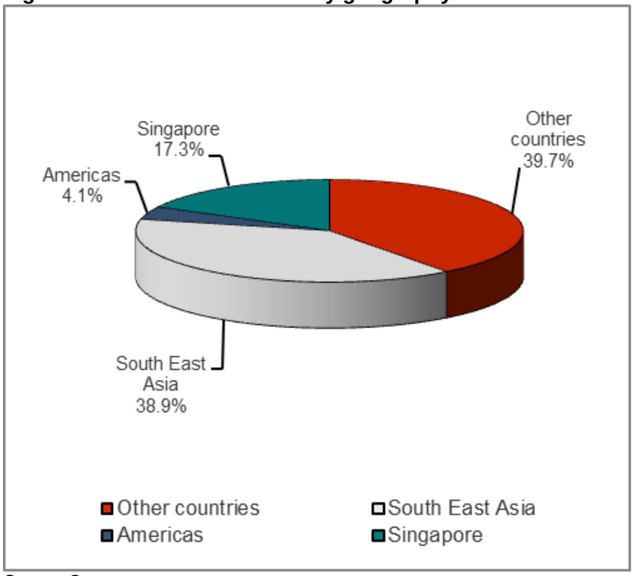
Source: Company, OCBC estimates
**Adjusted FCF = FCF –Acquisitions – Dividends + Disposals*

Figure 1: Revenue breakdown by business – FY2015



Source: Company

Figure 2: Revenue breakdown by geography – FY2015



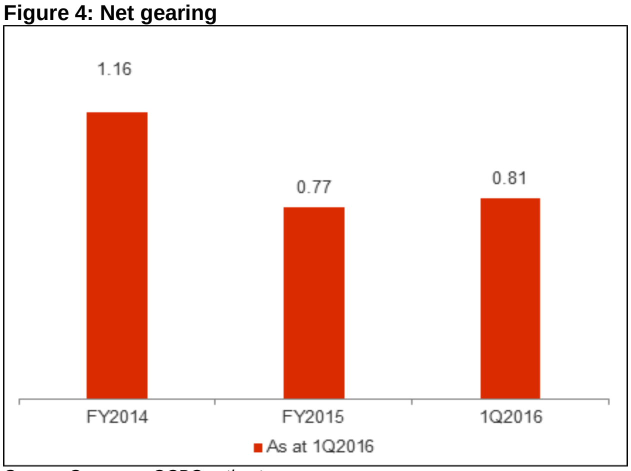
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 30/11/2015	% of debt
Amount repayable in one year or less, or on demand		
Secured	233.9	19.3%
Unsecured	275.1	22.6%
	509.0	**41.9%**
Amount repayable after a year		
Secured	445.1	36.6%
Unsecured	260.8	21.5%
	705.9	**58.1%**
Total	**1214.8**	**100.0%**

Source: Company

Figure 4: Net gearing



Source: Company, OCBC estimates