Asia Credit Research

Ezra Holdings Limited: Credit Update

Thursday, 21 July 2016

A Bitter Pill

- **First quarter to reflect post-Chiyoda results:** EZRA reported 3QFY2016 results for the quarter ending May 2016. It is the first offshore marine issuer under our coverage to report (partial) calendar 2Q2016 results. Like the previous quarter, the challenging environment continued to pressure performance. In particular, the OSV division (mainly EMAS Offshore, "EMAS") continued to be plagued by poor utilization and lease rate pressure. The shipyard division (mainly Triyards, "ETL") fared better, though we expect the winning of new orders to be challenging going forward. Finally, it is also the first quarter to report EZRA's numbers post the completion of the Chiyoda JV on 31/03/16. As a result, there were some one-off impacts on EZRA's financials that need to be accounted for.

- **OSV difficulties:** EMAS (~75% owned) reported USD35.1mn in revenue for 3QFY2016, down 40.8% y/y. Despite the recovery of oil prices from the lows seen in January, oil majors have continued to delay capex and trim expenses. As a result, demand for OSVs remained weak. Coupled with looming newbuilds and vessel redeployments adding to supply, the sector continues to face both charter rates and utilization pressure. EMAS was not spared, with utilization rates falling from 67% (end-1QFY2016) to 51% (end-3QFY2016). PSV and AHTS demand continue to be weak, while accommodation vessels demand has also started to soften. Despite trimming COGS by 10.7% (mainly crew wages), certain costs (such as insurance) are sticky, resulting in EMAS generating a gross loss of USD12.4mn for the quarter (3QFY2015: gross profit of USD6.0mn). Management indicated that they will focus on improving vessel utilization, targeting ASEAN and West African markets. Currently, 78% of vessels are in Asia-Pacific, while the rest are in West Africa. The order backlog for OSVs is USD400mn (average contract duration of 2.5 years). We expect the difficult environment to persist for the rest of 2016.

- **Shipyard stable, but client risks loom**: ETL (~61% owned) reported USD82.1mn in quarterly revenue, up 28.3% y/y. Revenue was supported by work-in-progress on vessels including four liftboats and two multi-purpose support vessels. Gross margins have compressed though to 16.9% (3QFY2015: 22.1%), in part due to timing on revenue recognition as well as due to the shift in product mix (non O&G vessels are likely to command lower margins). Currently, ETL reported USD482mn in net order book, of which 22% are non-O&G related. Looking forward, given the stress seen in the offshore marine industry, there is some chance that ETL's clients may seek to delay the delivery of their orders, or even attempt to cancel the order outright. We have already observed order delays and cancellations impact other ship and rig builders. Aside from potential client stress, we believe that it may be difficult for ETL to win new orders, particularly for O&G vessels.

- **Disposal loss dragged down overall performance**: EZRA's consolidated results are now largely EMAS and ETL combined. Total revenue declined 9.7% y/y to USD125.7mn, with the gains at ETL unable to offset the slump at EMAS. Similarly, EZRA generated a slight gross loss of USD0.6mn, largely driven by the USD12.4mn gross loss generated at EMAS. EZRA however swung into a sharp

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operating loss of USD235.8mn compared to an operating profit of USD2.4mn a year ago. Administrative expenses surged to USD46.7mn (3QFY2015: USD18.1mn), largely driven by USD25mn in allowances taken on doubtful debt. In addition, EZRA also recognized USD181.3mn disposal loss upon the sale of 50% of its subsea division to Chiyoda. Excluding these non-recurring items, operating losses would be trimmed lower to USD29.5mn for the quarter.

- **Painful infusion**: As disclosed in the circular to shareholders (26/11/15) regarding the Chiyoda JV, after EZRA recapitalized EMAS AMC (the subsea division) via converting intercompany payables into equity, the book value of the net asset of EMAS AMC was USD553.6mn based on end-FY2015 numbers. As such, 50% would be USD276.8mn. However, as the total consideration paid by Chiyoda for 50% ownership of EMAS AMC's subsea assets was USD180mn, EZRA had to recognize a realized loss of USD96.8mn upon the sale of 50% of its subsea division to Chiyoda. In addition, EZRA would likely have to impair its remaining 50% stake in its subsea division. Furthermore, additional adjustments would have had to be made, as the transaction closed on 31/03/16, while the book value of EMAS AMC mentioned was based of end-FY2015 (ending August 2015) figures. All these factors would have totalled to the USD181.3mn in disposal losses recognized during the quarter. It is worth noting that EZRA has already received the USD144.5mn cash in net proceeds from Chiyoda (USD30mn was retained at the JV level as fresh working capital).

- **Impact on credit profile mixed**: EZRA generated negative USD44.9mn in operating cash flow (largely caused by USD40.5mn in working capital needs and USD15.6mn in interest paid). Coupled with USD58.1mn in capex, this drove free cash flow to negative USD103mn for the quarter. In addition, EZRA paid down net USD142.7mn in borrowings (including the SGD95mn in bonds maturing in March 2016). The cash gap of ~USD245mn was met by USD144.5mn in proceeds from Chiyoda, USD45.0mn in fixed asset divestments, and the balance was from EZRA's cash balance. It should be noted that due to the net loss generated during the quarter (largely due to the disposal loss recognized), EZRA's shareholder equity shrunk sharply q/q from USD1044mn (end-2QFY2016) to USD798mn. As such, even though gross borrowings fell, net gearing increased sharply q/q from 110% to 138%.

- **Another strategic investor getting involved**: On 10/06/16, it was announced that EZRA has entered into a conditional framework with Nippon Yusen Kabushiki Kaisha ("NYK") for the sale of 10ppt of the EMAS CHIYODA JV. Chiyoda Corp will also be making a 15ppt sale of the JV to NYK. Post the transaction, EZRA, Chiyoda and NYK would own 40%, 35% and 25% respectively of the EMAS Chiyoda JV. EZRA would receive USD36mn in cash from NYK for its 10ppt stake sale of the EMAS CHIYODA JV. EZRA would use the proceeds to extend USD36mn shareholder loan to the EMAS CHIYODA JV post closing. The long stop date for the transaction is 30/09/16. NYK is one of the world's largest shipping lines, generating USD19bn in annual revenue. It is worth noting that both NYK and CHIYODA are part of the Mitsubishi conglomerate. EZRA believes that the transaction would help improve the JV's scale, broaden the JV's network of clients, partners and vendors as well as strengthen the financial position of the JV.

- **Asset divestments to continue**: On 01/07/16, EZRA announced that it has entered into an agreement to divest one of its two FPSOs, the Lewek EMAS. The purchaser is a fund jointly managed by First Reserve (a PE fund) and Petrofac (O&G service provider). Lewek EMAS is currently held by both EZRA (38.3% direct stake) and EMAS (41.7% stake). In aggregate, EZRA will be receiving USD68.9mn in cash (actual part of the consideration is USD46.3mn after adjusting for shareholder loans to the Lewek EMAS entity, as well as accrued preference dividends due to EZRA) as well as USD120mn in deferred consideration for a total consideration of USD166.3mn (includes EMAS's share). Subject to closing conditions, the transaction is expected to close during 3Q2016. It should be noted that the deferred consideration is dependent on charter extensions on the Lewek EMAS beyond December 2020, and hence will not be realized for some time. Based on the total consideration of USD166.3mn, EZRA would recognize a disposal gain of USD2.8mn (based on last reported 2QFY2016 results). In aggregate, we believe that the FPSO disposal is a credit positive for the company, generating additional liquidity of USD68.9mn in cash. That said we recognize that a significant part of the consideration is deferred.

- **In summary, playing the long game**: Although we recognize the attempts by management to right size EZRA's balance sheet, generate liquidity via stake and asset divestments as well as bringing on strategic investors, EZRA's financial statements are likely to be in flux for at least the next two quarters given the FPSO divestment and NYK investment. The OSV division would also likely continue to face a challenging environment. As such, we will retain EZRA's Negative Issuer Profile. We continue to Overweight the EZRASP'18s, given the steps taken by management to infuse EZRA with fresh liquidity. Given the general lack of liquidity for the smaller offshore marine issuers, it is highly likely that any positions established have to be held to maturity. With the EZRASP'18s maturing in 21 months and yielding ~15% (YTM) we believe the risk-reward profile of the bond to be attractive.

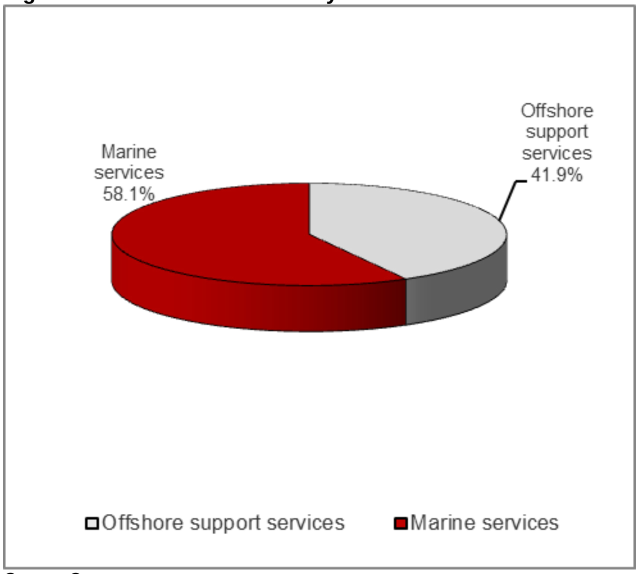
Ezra Holdings Ltd

Table 1: Summary financials

Year ended 31st August	FY2014	FY2015	9M2016
Income statement (US$ mn)		restated	restated
Revenue	1,488.4	543.8	389.2
EBITDA	141.8	76.3	-92.7
EBIT	69.6	7.0	-146.0
Gross interest expense	51.3	52.3	33.4
Profit Before Tax	74.7	79.1	-577.8
Net profit	45.3	43.7	-548.1
Balance Sheet (USD'mn)			
Cash and bank deposits	178.9	417.8	109.5
Total assets	3,363.0	4,177.3	2,320.5
Gross debt	1,551.9	1,470.2	1,210.9
Net debt	1,373.0	1,052.3	1,101.4
Shareholders' equity	1,185.8	1,365.3	797.8
Total capitalization	2,737.7	2,835.5	2,008.7
Net capitalization	2,558.8	2,417.6	1,899.2
Cash Flow (USD'mn)			
Funds from operations (FFO)	117.4	113.0	-494.8
CFO	140.1	142.5	-86.9
Capex	327.4	320.5	143.9
Acquisitions	0.0	-25.2	0.0
Disposals	8.5	30.3	207.7
Dividend	5.4	0.0	0.0
Free Cash Flow (FCF)	-187.3	-178.0	-230.8
FCF adjusted	-184.1	-122.5	-23.1
Key Ratios			
EBITDA margin (%)	9.5	14.0	-23.8
Net margin (%)	3.0	8.0	-140.9
Gross debt to EBITDA (x)	10.9	19.3	-9.8
Net debt to EBITDA (x)	9.7	13.8	-8.9
Gross Debt to Equity (x)	1.31	1.08	1.52
Net Debt to Equity (x)	1.16	0.77	1.38
Gross debt/total capitalisation (%)	56.7	51.8	60.3
Net debt/net capitalisation (%)	53.7	43.5	58.0
Cash/current borrowings (x)	0.4	0.6	0.2
EBITDA/Total Interest (x)	2.8	1.5	-2.8

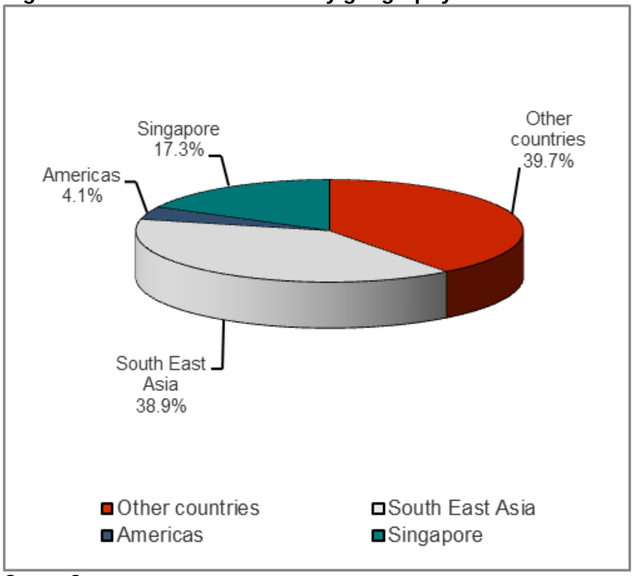
Source: Company, OCBC estimates
**Adjusted FCF = FCF –Acquisitions – Dividends + Disposals*

Figure 1: Revenue breakdown by business – FY2015



Source: Company

Figure 2: Revenue breakdown by geography – FY2015



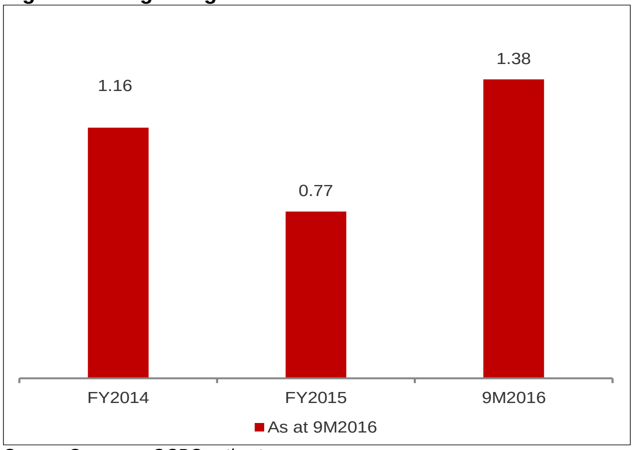
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 30/06/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	257.9	21.3%
Unsecured	266.4	22.0%
	524.2	**43.3%**
Amount repayable after a year		
Secured	503.9	41.6%
Unsecured	182.8	15.1%
	686.7	**56.7%**
Total	**1210.9**	**100.0%**

Source: Company

Figure 4: Net gearing



Source: Company, OCBC estimates