Asia Credit Research

Ezra Holdings Limited: Credit Update

Friday, 17 March 2017

The Clock is Ticking

- The impairments by joint venture ECS's other shareholders, coupled by the subsequent bankruptcy filing by ECS added further pressure and complexities to EZRA's on-going restructuring. More impairments (due to the ECS stake) are likely, and creditors that resulted from contingent liabilities being crystalized have started to take action.

- Given the current circumstances, the various scenarios that we have envisioned indicate that the EZRASP'18s bonds would likely be affected in some shape or form. At the very least, the bonds would be extended, as EZRA would unlikely be able to redeem the bonds at maturity in roughly a year. To survive as an on-going concern and bring in fresh capital, the bonds may even be equitized to deleverage EZRA's balance sheet. In the worst case scenarios, the bond recoveries may be zero.

- We will reaffirm our **Negative Issuer Profile on EZRA**, given the challenges that EZRA faces in restructuring and the compressed timelines. Given 1) the lack of new financial information 2) uncertainty over the direction of the restructuring 3) broad spectrum of outcomes and binary nature of recoveries, **we are withdrawing our recommendation on the EZRASP'18s**.

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Tel: 6349-1886

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Tel: 6349-1810

OCBC Credit Research
Nick Wong Liang Mian, CFA
+65 6530-7348
NickWong@ocbc.com

A) Background

Since we last dived into details regarding EZRA's restructuring efforts[1], much has happened, impacting EZRA itself, as well as its various related entities. The biggest development would be its subsea JV, EMAS Chiyoda Subsea ("ECS"), filing for Chapter 11 bankruptcy protection in the United States[2]. Given the many moving parts, it seems prudent to take stock and consider the various pieces and what they mean in aggregate for bondholders.

B) Pressure is Accelerating

i) **ECS (40% owned)**: The rapid deterioration in ECS was a surprise. EZRA had just completed its transaction with Nippon Yusen ("NYK") on 29/09/16, with NYK being brought on as a strategic investor in ECS. Despite fresh capital injected when Chiyoda Corp ("Chiyoda") and NYK came on board as shareholders of ECS (35% and 25% stake respectively), EZRA's subsea JV, ECS, filed for bankruptcy protection under Chapter 11 in the United Bankruptcy Court in Houston, Texas in late February 2017. ECS, which is a global engineering, procurement, construction, installation and commissioning ("EPCIC") service provider focused on offshore marine work, had been under

[1] *OCBC Asia Credit - Ezra Credit Update (1 Dec 2016)*
[2] *OCBC Asian Credit Daily - 1 Mar 2017*

pressure due to the slump in E&P activity reducing development work. Though ECS currently has over USD1bn in order book across 15 projects to execute, ECS had indicated that the commencement date of many of these projects remain uncertain, pressuring ECS's fleet utilization levels. As such, ECS had been generating losses with EZRA recognizing USD40.3mn and USD74.3mn in losses in FY2015 and FY2016 (fiscal year ending August) respectively. As conditions at ECS continued to deteriorate, Chiyoda and NYK had taken impairments charges on their ECS exposure earlier in 2017[3]. ECS's troubles had spurred trade creditors such as Forland Subsea AS ("Forland") to take action[4] in pursuing their claims. The escalation in creditor actions would have likely driven ECS into seeking bankruptcy protection, in order to continue its restructuring while under the protection of an "automatic stay". The second day hearing for ECS is scheduled for 28/03/17. EZRA had last indicated that it had investment in, shareholder loans (EZRA had provided USD36mn in shareholder loans) to and inter-company balances owed by ECS totalling ~USD170mn. With ECS seeking Chapter 11, EZRA could potentially write off its exposure to ECS. In addition, EZRA had provided certain corporate guarantees which would have been affected by ECS's bankruptcy filing (more will be discussed in subsequent sections).

ii) **EMAS Offshore ("EMAS", 75% owned, listed)**: 1QFY2017 results (ending November 2016) were weak, with EMAS continuing to be pressured by the challenging environment faced by OSV owners. The oversupply situation coupled with muted upstream offshore activity has hampered utilization and charter rates. Revenue fell 15% y/y to USD42.5mn, with losses of USD2.2mn generated during the quarter. Utilization rates have fallen further q/q to 53% (4QFY2016: 55%) for its OSVs & accommodation vessels while net gearing remains elevated at 635%. Meanwhile, uncertainties at Perisai Petroleum Teknologi ("PPT") with regards to the SJR Marine (L) Ltd put option persist, likely hindering attempts by EMAS to refinance its borrowings. Though there was a tentative agreement by the principal bank lenders of EMAS to refinance some of the latter's bank borrowings (as first announced 30/10/16), EMAS was unable to complete the documentation required and had sought an extension of time from its principal bankers (the original target was completion before end 2QFY2017). EMAS had indicated[5] that the ECS bankruptcy filing may have a negative impact on EMAS, and that the failure of its refinancing efforts would lead to going concern issues. It should be noted that EMAS has suspended the trading of its shares since 3 Mar 2017 as EMAS had not been able to release its audited annual report (as required by the Oslo Bors, the other stock exchange that it is listed on). EMAS has also announced that it would be delaying the filing of its 2QFY2017 results as well.

iii) **Triyards Holdings ("Triyards", 61% owned, listed):** 1QFY2017 results (ending November 2016) showed revenue increasing 17% y/y to USD91.2mn. However, margins continued to compress, with gross margins declining to 11.5% (1QFY2016: 18.7%) due to shifts in product mix (likely away from more lucrative liftboats) as well as due to the more competitive environment. As a result, net profit fell by 72% y/y to USD2.1mn. While net gearing of 66% was manageable relative to the rest of the EZRA group as well as other O&M peers, the ratio had worsened (4QFY2016: 60%) as resources are tied up in working capital (the cash gap was funded by additional borrowings). Though Triyards remains relatively healthy, its own cash needs would limit resources that can be streamed up to EZRA. In addition, there are likely some intercompany receivables as well as joint facilities as well. Given the slump in newbuild demand from the oil & gas industry, Triyards faces difficulty replenishing its order book, which has fallen to USD352mn (4QFY2016: USD422mn).

[3] *OCBC Asian Credit Daily – 2 Feb 2017*
[4] *OCBC Asian Credit Daily – 21 Feb 2017*
[5] *EMAS Offshore - DELAY IN COMPLETION OF THE REFINANCING OF FINANCIAL OBLIGATIONS AND PROVISION OF NEW WORKING CAPITAL - 2 Mar 2017*

C) Race against time:

The bankruptcy filing of ECS has led to an acceleration of events. As mentioned earlier, aside from the need to impair its ~USD170mn exposure to ECS, EZRA is also exposed to contingent liabilities that arise from the bankruptcy of ECS. These contingent liabilities are likely a legacy from when ECS was a wholly-owned subsidiary of EZRA.

Specifically[6], though Chapter 11 bankruptcy protection provides a stay on the creditors of ECS, it does not resolve the charter hire liabilities that ECS faces. Furthermore, a substantial portion of these charter hire liabilities are in turn guaranteed by EZRA, amounting to ~USD0.4bn. In addition, ECS had ~USD0.5bn in loans (likely vessel financing, such as those used to fund the Lewek Constellation, which we mentioned previously) owed to financial institutions, which are guaranteed by EZRA. Finally, EZRA had substantial contingent liabilities in relation to performance and/or bank guarantees over projects undertaken by ECS. The amounts are not quantifiable as ECS intends to execute these projects. To be clear, the moratorium afforded to ECS as a result of the Chapter 11 filing does not stay claims against EZRA. EZRA had indicated that in the event that claims against EZRA resulting from the ECS bankruptcy are accelerated, EZRA would immediately face a going concern situation.

Already, there are some signs of ECS creditors taking action on EZRA. EZRA had reported[7] that it received a statutory demand from the solicitors of VT Halter Marine, Inc ("VTH") on 09/03/17 in relation to the payment of USD3.2mn over a loan agreement entered between VTH and ECS. EZRA was the parent corporate guarantor for the loan agreement (as the agreement was made on 26/02/15, when ECS was still a wholly-owned subsidiary of EZRA). EZRA had 21 days from the date of the statutory demand (dated 09/03/17) to make payment else VTH may apply for EZRA to be wound up. On 12/03/17, EMAS had reported that the vessel owner of the Lewek Champion had terminated the bareboat charter of the vessel to EMAS, due to termination events resulting from the bankruptcy filing by ECS. ECS had been the end-charterer for the Lewek Champion, with the vessel originally intended for the Saudi Aramco contracts. As a result of the termination, the vessel owner made a claim against EMAS (specifically the wholly owned subsidiary that holds the charter) as well as EZRA (the guarantor to the charter) for an aggregate sum of USD194.5mn. Both EMAS and EZRA have 15 business days from the Notice of Termination (dated 09/03/17) to make payment. To be clear, other creditors, such as Forland, have already made statutory demands on EZRA previously, with the deadline on the demands expired. Though EZRA continues to engage such creditors, these creditors are at liberty to apply for EZRA to be wound up at Court[8].

Aside from the various creditor actions taken, it should be reminded that the coupon on the EZRASP'18 bond is due on 24/04/17, and totals SGD3.66mn. In aggregate, EZRA and its related companies, EMAS and ECS, are now facing increasing pressure. Though the decision by ECS's board to file for Chapter 11 could be a pre-emptive decision to preserve as much value as possible (ECS had lined up USD90mn in debtor-in-possession ("DIP") financing to allow ECS to continue operations while under bankruptcy protection), the aftershocks have cascaded across EZRA and its other related entities. EZRA's management now has to contend with a war on many fronts, with contingent liabilities to manage, on-going refinancing efforts at EMAS as well as the still unresolved situation with PPT. EZRA's financial statements are now stale, with no new financials since the delayed 4QFY2016 results (for the quarter ending August 2016) were released end-November 2016. On 15/03/17, EZRA's stock went into trading halt, pending the release of announcements. Given the uncertainties, we will now consider the various scenarios that may play out in the near future.

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[6] *OCBC Asian Credit Daily – 6 Mar 2017*
[7] *OCBC Asian Credit Daily – 10 Mar 2017*
[8] *EZRA HOLDINGS - ANNOUNCEMENT IN RELATION TO EMAS CHIYODA SUBSEA LIMITED – 3 Mar 2017*

D) Scenario Analysis

Scenario #1: Status Quo

EZRA managing to negotiate and come to some resolution with each of its creditors, as well as satisfy the creditors of ECS that have filed claims against EZRA. This would be dependent on the continued viability of the projects at ECS. As mentioned, there are some signs of this, with ECS obtaining DIP financing as part of its Chapter 11 filing so that it would be able to continue on with its work. The incentive for creditors to go along with the plan is that EZRA and its related entities are worth more as going concerns, rather than gone concerns. It also assumes that EZRA would be able to get access to fresh working capital for its entities. EZRA had also been able to obtain some cash flow from the PV Keez divestment, in which EZRA and EMAS sold their stake at the Lewek EMAS FPSO (completed on 19/12/16) with EZRA supposedly receiving USD68.9mn in cash as part of the consideration.

Considerations and Implications: That said, with the likely impairment of EZRA's ECS stake (and potentially losing control of ECS through the restructuring) EZRA would potentially have to realize further impairment losses. EZRA already has very little book equity left after its numerous rounds of impairments and provisions taken during FY2016. As of end-August 2016, total equity of USD378.9mn, of which USD146mn was attributable to NCI (the minority shareholders of EMAS and Triyards). The ~USD170mn ECS exposure could wipe out what's left of EZRA's equity. As such, it is highly likely that EZRA would need more equity to support the current status quo. With the many contingent liabilities affecting EZRA, the holding company, and with the holding company having minimal directly held assets, it could be challenging for EZRA to raise equity at the holding company level. As such, in the event that EZRA is able to successfully negotiate with various parties, bring in new capital and largely maintain the status quo, <u>the chance of the EZRA having to extend its EZRASP'18 bonds' maturity is high</u>, as 1) to give comfort to new equity providers as capital injected would be used as working capital to stabilize the company as a going concern rather than to pay down debt 2) senior lenders could potentially require EZRA to get its bond extended as per the restructuring of ASL Marine[9] before being willing to provide additional and/or extend existing borrowings. Like ASL Marine, such a restructuring would likely be done out-of-court via a consent solicitation. It could also potentially be in Court via a scheme of arrangement.

Scenario #2: Restructuring at the HoldCo

As mentioned earlier, EZRA is likely to require more equity if it is to survive as a going concern. Another consideration is that EZRA had already taken sizable impairments and provisions across its various entities through FY2016, that its balance sheet (aside from exposure to ECS) should be more reflective of the current challenging environment. This should provide existing and future investors with some comfort. The caveat is that under a "gone concern" situation, the assets on EZRA's book would be further impacted. To reduce the leverage of EZRA, if fresh equity is not forthcoming, or insufficient, EZRA may need to restructure its existing debt burden to reduce leverage to sustainable levels.

Considerations and Implications: As the bulk of EZRA's borrowings are secured financing (USD830.3mn of USD1197.6bn in total borrowings), <u>if the path for restructuring is equitizing part of EZRA's debt burden, the brunt of it would be taken by</u>

[9] *OCBC Asia Credit - ASL Marine Credit Update (3 Jan 2017)*

EZRA's unsecured creditors, such as the EZRASP'18 noteholders. The restructuring could be similar to the proposal[10] made by Rickmers Maritime Trust ("RMT"), in which RMT bondholders were offered 60% of RMT's equity post restructuring as part of the consideration (in exchange for a 60% haircut on the notional amount of bonds), with the balance 40% notional being extended for 6.5 years. Again, the aim of the restructuring would be to preserve EZRA as a going concern with a more sustainable debt structure, hence preserving value for all stakeholders. In this scenario, it is likely that existing shareholders of EZRA (including the founding Lee family which controls 22.8%) would be severely diluted. Again, the above restructuring could be done out-of-court via a consent solicitation. It could also be done in Court via a scheme of arrangement.

Scenario #3: Saving the Subsidiaries

It is plausible that management may deem it too difficult to save the HoldCo, EZRA. There could potentially be just too many moving parts to tackle simultaneously, with various creditors taking unilateral actions on EZRA to pursue their claims, be it direct or as part of their claims on ECS. The contingent liabilities that arose from ECS's bankruptcy filings are massive at ~USD900mn. The focus would then be to preserve value at the two operating entities, Triyards and EMAS. It should be reminded that Triyards and EMAS both have their own board of directors, as well as fiduciary duties to minority shareholders in those entities, which could limit assets that could be upstream to EZRA.

Considerations and Implications: Should this scenario play out, it is likely that EZRA would file for judicial management. This would result in an automatic moratorium, which would provide EZRA with the time to provide a restructuring proposal. A judicial manager would be appointed to manage the process at EZRA. As the issuer of the EZRASP'18 is the HoldCo though, in this scenario we expect recoveries to be poor for noteholders. There is structural subordination, in which most of EZRA's operating assets are being held at the subsidiaries. Recoveries can only be realized via either the sale of these subsidiaries, or their liquidation (with proceeds being sent up to the parent). In addition, EZRA's capital structure is heavily skewed towards secured debt. These would be satisfied first by collateral. The balance of claims inadequately covered by collateral would be treated as unsecured claims. In addition, it is likely that the various contingent liabilities resulting from ECS's bankruptcy filing would also be treated as unsecured claims as well. As a result, noteholders would be competing with several other claimants over the residue value in EZRA. In addition, judicial management of complex companies such as EZRA would likely take time. For example, Swiber Holdings first applied for judicial management on 05/08/16 (with interim judicial managers appointed), and was formally placed in judicial management on 06/10/16. Since then, Swiber Holding's restructuring proposal has been delayed time and again by the judicial manager, with the current timeline of 21/07/17 (almost a year from Swiber Holding's first Court application) to send creditors a statement of proposals and summon a creditors' meeting. While in restructuring, EZRA would have to provide for the expenses of the judicial manager as well as attempt to carry on its businesses.

Scenario #4: Liquidation

Some of EZRA's creditors may proceed with a winding up petition, on the basis that EZRA was unable to pay its debts. Should EZRA be wound up, a liquidator would be appointed to close down the business, sell off assets and pay off creditors. In this scenario, EZRA would be a gone concern. At the end of the process, EZRA would be dissolved and cease to exist.

Considerations and Implications: Companies are usually worth more as a going concern rather than a gone concern. Existing customer relationships, contracts,

[10] *OCBC Asian Credit Daily - 23 September 2016*

employee / institutional knowledge etc all add to value, which would otherwise be rendered moot in a gone concern situation. For the holders of EZRASP'18, under the liquidation scenario, given the low realizable value of offshore marine assets due to the stressed environment, recoveries could potentially be zero.

E) Conclusion

There is significant uncertainty over how the situation at EZRA would resolve. The risk of coordination failure is material, and the stakes are high. Due to the negative catalyst resulting from the ECS bankruptcy filing, time is now of the essence. EZRA has to find some resolution to the significant amounts of contingent liabilities that were crystalized due to ECS. This only served to complicate the on-going restructuring that EZRA and its related entities are already undergoing. Our scenario analysis has established that in all possible scenarios, the EZRASP'18 bonds would be negatively impacted in some form. Even in the best scenario, it is likely that the EZRASP'18 bonds would see extension to their bond maturities, as it is unlikely that EZRA could afford to set aside the SGD150mn required to redeem the bonds in roughly one year's time. There are also scenarios that the EZRASP'18s could be equitized to reduce EZRA's debt burden, in order for EZRA to survive as a going concern. In the worst case scenario, the EZRASP'18s could recover zero. Furthermore, updated financial results from EZRA are lacking (the most recent numbers reflect a period more than half a year ago), making it difficult to assess the situation. As such, we will reaffirm our Negative Issuer Profile on EZRA. In addition, given 1) the lack of fresh financial information 2) uncertainties over how EZRA would restructure 3) the broad spectrum of outcomes depending on which scenario plays out, as well as the binary nature of the recoveries, we are unable to provide a bond recommendation on the EZRASP'18s. As such, we will be withdrawing our recommendation on the EZRASP'18s.

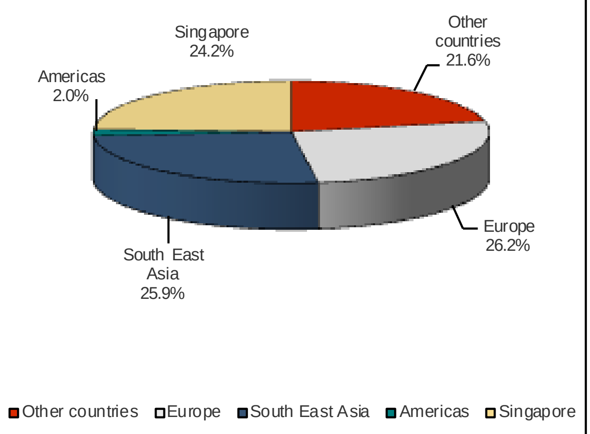
Ezra Holdings

Table 1: Summary Financials

Year End 31st Aug	FY2014	FY2015	FY2016
Income Statement (USD'mn)			
Revenue	1,488.4	543.8	525.1
EBITDA	141.8	76.3	-170.4
EBIT	69.6	7.0	-247.4
Gross interest expense	51.3	52.3	48.1
Profit Before Tax	74.7	79.1	-994.3
Net profit	45.3	43.7	-887.8
Balance Sheet (USD'mn)			
Cash and bank deposits	178.9	417.8	62.6
Total assets	3,363.0	4,177.3	1,936.5
Gross debt	1,551.9	1,470.2	1,197.6
Net debt	1,373.0	1,052.3	1,135.1
Shareholders' equity	1,185.8	1,365.3	378.9
Total capitalization	2,737.7	2,835.5	1,576.6
Net capitalization	2,558.8	2,417.6	1,514.0
Cash Flow (USD'mn)			
Funds from operations (FFO)	117.4	113.0	-810.7
* CFO	100.0	142.5	-51.0
Capex	327.4	320.5	167.1
Acquisitions	0.0	-25.2	0.0
Disposals	8.5	30.3	208.2
Dividend	5.4	0.0	0.0
Free Cash Flow (FCF)	-227.4	-178.0	-218.1
* FCF adjusted	-224.2	-122.5	-9.9
Key Ratios			
EBITDA margin (%)	9.5	14.0	-32.5
Net margin (%)	3.0	8.0	-169.1
Gross debt to EBITDA (x)	10.9	19.3	-7.0
Net debt to EBITDA (x)	9.7	13.8	-6.7
Gross Debt to Equity (x)	1.31	1.08	3.16
Net Debt to Equity (x)	1.16	0.77	3.00
Gross debt/total capitalisation (%)	56.7	51.8	76.0
Net debt/net capitalisation (%)	53.7	43.5	75.0
Cash/current borrowings (x)	0.4	0.6	0.1
EBITDA/Total Interest (x)	2.8	1.5	-3.5

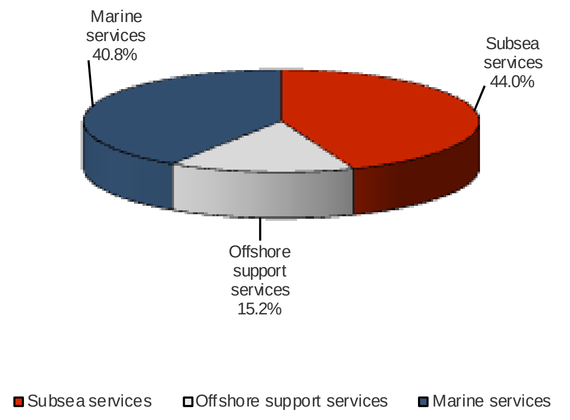
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Geography - FY2016



Source: Company

Figure 2: *Revenue breakdown by Segment - FY2016



*Source: Company | *Revenue excludes Disposal Held for Sale*

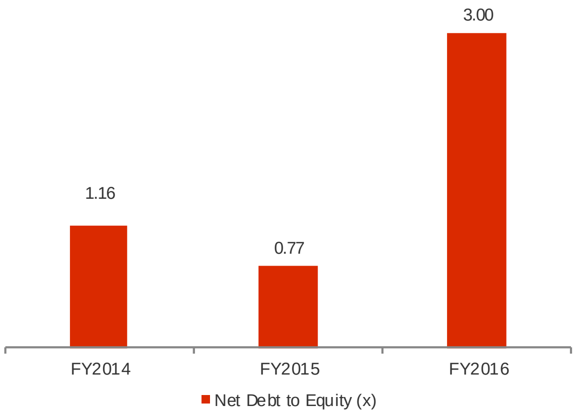
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 31/08/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	819.3	68.4%
Unsecured	365.5	30.5%
	1184.8	**98.9%**
Amount repayable after a year		
Secured	10.9	0.9%
Unsecured	1.9	0.2%
	12.8	**1.1%**
Total	**1197.6**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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