Asia Credit Research

# Ezra Holdings Limited: Credit Update

**Thursday, 01 December 2016**

## More Pain from Perisai

- As foreshadowed, EZRA's 4QFY2016 results were bogged down by various impairments and provisions taken at the EMAS Offshore ("EMAS") level. The Perisai Petroleum Teknologi ("PPT") situation had the biggest impact, though EZRA also took vessel impairments as well as recognized disposal losses.
- Though EZRA reported a net loss of USD418.8mn for the quarter (EMAS restated its net loss at USD323.5mn), as most of the losses generated are non-cash, EZRA remained operating cash flow and free cash flow positive.
- The huge impairments and provisions taken have caused shareholders' equity to plunge sharply q/q (from USD797.8mn to USD378.9mn), causing net gearing to surge from 138% to 300% q/q. In this report, we will try to identify the adjustments made, and to determine which losses are recurring. **We will retain our Negative Issuer Profile on EZRA and the Neutral recommendation on the EZRASP'18s**.

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In our recent reports on EZRA's consent solicitation [1], we have highlighted management's rationale for the covenant waivers:

I) *The weak operating environment and strong headwinds in the foreseeable future could result in further asset impairments as EZRA is preparing its FY2016 results. This could result in more losses being recognized for the fiscal year.*

II) *As PPT was unable to successfully negotiate a favourable outcome with its bondholders, and given the cross defaults that might trigger as a result of a default on PPT's bonds, EZRA may need to assess its investment in PPT as well as the accounting impact that might result from this. Things remain in a state of flux as PPT indicated that (as of 12/10/16) it was in talks with a financial institution to secure financing which may allow PPT to negotiate a mutually acceptable debt restructuring with its creditors (including bondholders).*

III) *In seeking financial flexibility, the EZRA group is currently in discussions with various parties regarding its financial obligations and is reviewing options including the securing of additional working capital, amending the repayment profile of certain financial obligations, extending certain repayment obligations, issue of new securities and the sale of non-core assets and/or refinancing existing loans.*

As foreshadowed, as part of EZRA's recently released 4QFY2016 / full year FY2016 results (for the period ending August 2016), EZRA had taken further asset impairments on its fixed assets, as well as impairments and provisions against its exposure to PPT as well as PPT-related entities. Most of these impairments and provisions were taken at the EMAS level (~75% owned), with EMAS restating its 4QFY2016 net loss from USD98.5mn to USD323.5mn, as a result of the PPT events that occurred after EMAS first reported its 4QFY2016 results on 30/10/16.

[1] OCBC Asia Credit - Ezra Credit Update (20 Oct 2016) & OCBC Asia Credit - Ezra Credit Update (25 Oct 2016)

**Revenue was relatively stable:** EZRA has announced its 4QFY2016 results (for the quarter ending August 2016), reporting USD136.0mn in revenue, a decline of 7.8% y/y. The shipyard division (mainly Triyards) saw revenue increase 6.6% y/y, driven by the contribution from the construction of liftboats, support vessels and tugs during the quarter. The shipyard net order book stood at USD422mn, a decline from USD564mn a year back due to weak demand for newbuilds. For the OSV division (mainly EMAS), revenue declined 3.8% y/y, driven by the weak demand for PSVs and AHTS. The quarter saw a gross loss of USD29.9mn (versus a gross profit of USD16.0mn in 4QFY2015). This swing was largely driven by USD34.5mn increase in COGS y/y, with EMAS reporting USD40.0mn worth of increases. The increases in COGS at EMAS was attributed to the grossing of bareboat costs (post an agency agreement), costs attributed to the modification of certain operating lease arrangements as well as higher depreciation after more sale-and-leaseback vessels were classified as financial lease arrangements.

**Operating losses from impairments and provisions**: EZRA reported an operating loss of USD390.8mn (compared to an operating profit USD28.7mn in 4QFY2016), largely driven by impairments and provisions:

| Impairments / Provisions on | (USD'mn) | Comments |
|---|---|---|
| Fixed assets | 74.7 | Mainly vessels / vessel deposits held at EMAS |
| Assets held for sale | 76.3 | See Note (a) |
| Inventory | 7.7 | Due to obsolescence |
| Associated company | 90.9 | See Note (b) |
| JVs | 43.7 | See Note (c) |
| Derivative FV | 20.8 | FV of PPT put option on SJR Marine (L) Ltd |
| Doubtful debts | 30.1 | See Note (d) |
| Onerous contracts | 26.1 | Impact on COGS mentioned earlier |
| **Total** | **370.3** | |

(a) This relates mainly to the divestment of one of its two FPSO, the Lewek EMAS (held in PV Keez) to Petrofirst Infrastructure 2 Limited ("Petrofirst"). PV Keez is currently held by both EZRA (38.3% direct stake) and EMAS (holds 41.7% stake in PV Keez). In aggregate, the total transaction consideration was USD166.3mn (includes EMAS's share). However, USD120mn worth of the consideration is deferred, contingent on future performance milestones. As such, the upfront consideration was only USD46.3mn. An independent professional valuer determined the fair value of the consideration, resulting in EZRA / EMAS recognizing impairment losses given the current value of PV Keez held on the balance sheet. It is worth noting that EZRA would be receiving USD68.9mn in cash (after adjusting for shareholder loans provided to PV Keez, as well as accrued preference dividends due to EZRA). The long stop date for the transaction has recently been amended to 31/12/16.

(b) This relates to the write-down on EZRA's aggregate stake in PPT, as well as a USD20.7mn impairment charge of USD20.7mn on Intan Offshore Sdn, an associate company that is related to PPT.

(c) This relates to EZRA's other FPSO, the Perisai Kamelia, which is held in the EMAS Victoria (L) Bhd joint venture between EMAS and PPT. EMAS had recognized an impairment of USD46.8mn on the JV during 4QFY2016.

(d) USD8.5mn was due to allowances on receivables due from SJR Marine. The balance related to provisions taken on aging receivables.

As can be seen, the huge operating loss was largely driven by non-cash impairments and provisions. It can also be seen that a sizable amount relates to charges taken on EZRA's PPT and PPT-related exposure. The bulk of the above charges are also non-recurring.

**Cash flow generation positive:** For 4QFY2016, EZRA managed to generate USD35.9mn in operating cash flow (after generating USD44.9mn in operating cash outflow in 3QFY2016). This was largely driven by EZRA chasing its receivables and stretching its payables. After factoring capex, this allowed EZRA to generate USD11.4mn in free cash flow for the quarter. During the quarter, EZRA paid down ~USD60mn worth of net borrowings. As such, total cash fell lower q/q from USD109.5mn to USD62.6mn.

**Leverage surged on impairments**: As a result of the sharp losses recognized during the quarter, EZRA's total equity fell sharply q/q from USD797.8mn to USD378.9mn, causing net gearing to surge from 138% (3QFY2016) to 300% (4QFY2016) even though gross borrowings remained stable. It is worth noting that EZRA would have violated its minimum total equity covenant of USD600mn had it not received the waiver from bondholders.

**A spanner in the works**: It was disclosed that PPT had applied on 20/10/16 to the Corporate Debt Restructuring Committee ("CDRC"), a platform by the Malaysian Government, to help manage PPT's restructuring. CDRC had subsequently accepted PPT's plead for mediation on 09/11/16, and had sent out letters to PPT's creditors (including EMAS) requesting that creditors observe an informal standstill, and to withhold litigation against PPT with immediate effect. PPT now has 60 days (from 10/11/16) to submit a proposal for debt restructuring. PPT's admittance to CDRC would be the earlier of 6 months or upon the signing of the debt restructuring agreement. The standstill agreement had also impacted SJR Marine (L) Ltd, EMAS Victoria (L) Bhd and Intan Offshore (L) Ltd.

We have previously discussed how these three entities are JV / Associates of EMAS, and that the default by PPT had caused the trigger of cross default~~s~~ clauses on the facilities to these three entities[2]. EZRA had originally initiated its most recent consent solicitation to facilitate for the restructuring of its borrowings (both at the parent and its material subsidiaries, including EMAS). As part of its 4QFY2016 filing, EZRA disclosed that EMAS previously reached in-principle agreements with its bankers and was in the process of finalising its refinancing exercise and obtaining additional working capital facilities from the banks. However, as a result of the uncertainties surrounding PPT's developments, the completion of the refinancing exercise and obtaining additional working capital facilities have been delayed.

**Conclusion:** We consider the current situation to be precarious, given how issues at the EMAS / PPT level are impacting on EZRA's ability to manage the situation. The longer EZRA is prevented from resolving the issues at the EMAS level, the harder it is for EZRA to access the additional working capital needed to continue work. It is worth noting that the Triyards business remains profitable while EZRA's subsea division JV has won sizable contracts (such as those with Saudi Aramco). In addition, management has previously reflected that the on-going financial restructurings have been a large drain on management bandwidth. We will retain our Negative Issuer Profile on EZRA and will monitor the situation closely. Our Neutral call on the EZRASP'18 bonds remains unchanged on valuation.

[2] OCBC Asia Credit - Ezra Credit Update (20 Oct 2016)

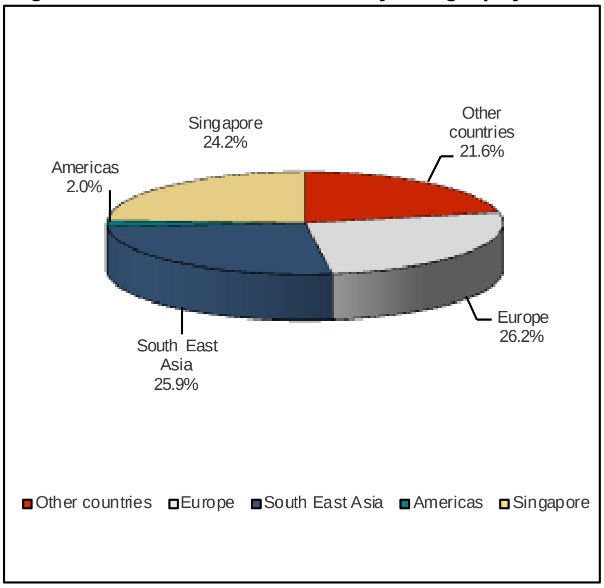
# Ezra Holdings

**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 |

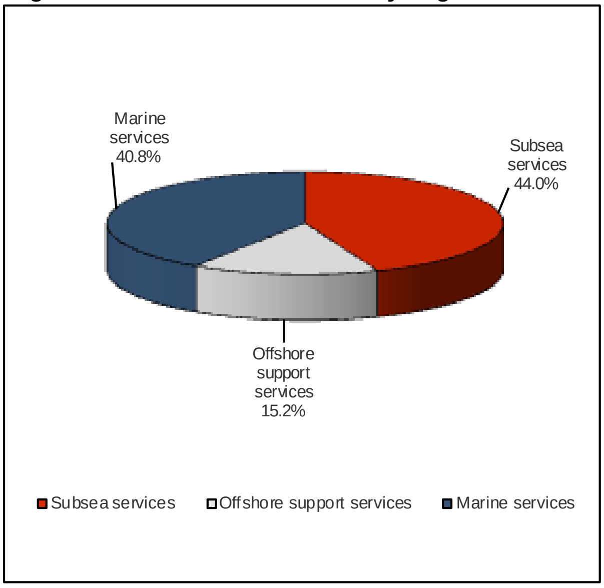
*Source: Company, OCBC estimates*

**Figure 1: Revenue breakdown by Geography - FY2016**




*Source: Company*

**Figure 2: *Revenue breakdown by Segment - FY2016**




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

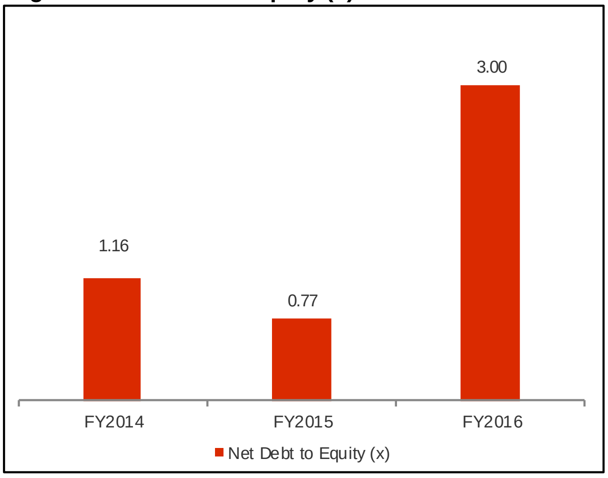
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

**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*