Asia Credit Research

Ezra Holdings Limited: Credit Update

Tuesday, 25 October 2016

Between a Rock and a Hard Place

- The evolving Perisai Petroleum Teknologi ("PPT") situation, coupled with likely impairments on EZRA's assets due to the challenging environment, could potentially cause Ezra to violate its financial covenants.
- Though we are reluctant regarding certain aspects of the consent solicitation, we do acknowledge that time is of the essence, and that management indeed requires the flexibility to negotiate with all its stakeholders, and that this is the current optimal path for bondholders.
- As such, **we recommend that bondholders support the consent solicitation and send in their votes before the 02/11/16 to receive the early consent fee.** Our Negative Issuer Profile on EZRA and the Neutral recommendation on the EZRASP'18s are unchanged.

THIS REPORT SHOULD BE READ IN CONJUNCTION WITH THE REPORT "EZRA HOLDINGS LIMITED: CREDIT UPDATE – 20 Oct 2016".

Treasury Advisory
Corporate FX & Structured Products
Tel: 6349-1888 / 1881
Interest Rate Derivatives
Tel: 6349-1899
Investments & Structured Products
Tel: 6349-1886

GT Institutional Sales
Tel: 6349-1810

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

A) Informal Meeting Details

EZRA has disclosed the presentation deck[1] shown to bondholders during the informal bondholders' meeting held this morning. The information helped to provide context with regards to management intent. The important details are as follows:

1. **Management expects environment to remain challenging:** Though energy markets have stabilized, management still expects offshore capex spending by E&P companies to be 0 – 10% lower in 2017 than 2016. Deferred project awards, declining charter rates and capacity oversupply would affect financial performance and fleet utilization for the next 18 – 24 months.

2. **Strategic investors and asset disposals as planned**: The investments by Chiyoda and NYK into its subsea division have been completed. The sale of the Lewek Emas FPSO to Petrofirst Infrastructure 2 Limited has been completed as well, with the disposal expected to improve gearing levels and improve cash flows.

3. **Managing cash burn**: EZRA's OSV chartering division, EMAS Offshore ("EMAS") is committed towards reducing cash outflow and improving competitiveness. To do this, management is seeking to restructure vessel financing, to reduce the principal service portion of the loans further in the future to preserve cash during the down cycle.

4. **Distressed peers impacted EZRA's plans**: Swiber Holdings liquidation / judicial management, as well as the potential Chapter 11 bankruptcy filing by Tidewater, a large OSV player, has affected EZRA's capital raising plans.

[1] SGX Filing – EZRA Consent Solicitation Exercise – S$150m Notes due April 2018. 25- Oct-2016 Presentation

B) Management Rationale

As a recap, management is seeking for:

I. **Waiver of financial covenants**: EZRA is seeking to waive any current as well as future potential breaches of its financial covenants. This includes EZRA's interest coverage (EBITDA / Interest Expense), minimum consolidated total equity and maximum net gearing (net debt / equity) financial covenants[2]. Waivers are being sought for any breaches till the 24/04/18 (the maturity date of the EZRASP'18s).

   Our Thoughts: With regards to the waiver of financial covenants, management's elaboration is largely consistent with our initial thoughts[3]. In summary, EZRA is concerned that the potential asset impairments that EZRA may have to take given the challenging environment would consume the covenant headroom that it currently has. EZRA is also concerned that depending on the outcome of the PPT situation, EZRA may have to assess its investments in PPT as well as the JVs that EMAS has with PPT. These may also lead to further impairments. As such, we believe that EZRA could likely trip its financial covenants upon the disclosure of its full-year FY2016 results (ending August 2016), and without the financial covenant waivers this would lead to a technical default.

II. **Waiver of event of default upon attempts to restructure indebtedness**: This specifically relates to the Event of Default under Condition 10(e) of EZRA's MTN programme, which in summary considers any attempts towards restructuring material indebtedness (which includes bonds, loans etc) at both EZRA and its Principal Subsidiaries (which covers both EMAS and ETL) to constitute as an event of default, hence allowing bondholders to accelerate and demand immediate repayment. In this report, we will describe this as the "**right to accelerate**".

   Our Thoughts: EZRA's management has indicated that the waiver on occurrence of Event of Default for deferral, rescheduling or readjustment of debt relates specifically to facilitate negotiations, including current discussions at its OSV chartering subsidiary EMAS with its bank lenders on securing additional working capital facilities, amending debt repayment profiles and extending repayment obligations. EZRA indicated that the attempts to negotiate with bank lenders without the waiver could lead to a breach of this clause. Management had indicated that they hope bondholders would provide this waiver pre-emptively, and that frequent requests for waivers for each instance of potential breach is not practical. We believe that EZRA could be attempting to resolve potential cross defaults that arise in the joint ventures that EMAS has with PPT as well, due to the PPT default.

   As we mentioned in our previous report, we consider this "right to accelerate" to be an important bondholder protection. Though management's current focus seems to be restructuring the vessel financing at the EMAS level, as well as potentially resolving the issues resulting from the PPT default, going forward should EZRA choose to attempt to restructure the EZRASP'18 bonds, bondholders would not be able to consider such attempts to be an Event of Default and demand for immediate bond repayment, should they provide this waiver. That said, it should be noted that such bond restructurings (provided it is done out-of-court) can only be conducted via a consent solicitation exercise, and would still require bondholders' approval.

[2] OCBC Asia Credit - Ezra Credit Update (12 Nov 2015)
[3] OCBC Asia Credit - Ezra Credit Update (20 Oct 2016)

C) Balancing the Trade-offs

As it stands, there are two possible scenarios depending on how the consent solicitation plays out:

I. The Consent Solicitation Fails

- EZRA could trip its financial covenants when it discloses its financial results. This would result in EZRA going into technical default.
- This could make it difficult for EZRA to negotiate with its bank lenders. It is likely that EZRA's loan facilities have cross default clauses as well.
- EZRA could potentially return to bondholders with better terms to obtain consent. However, with the current limited liquidity that EZRA has (EZRA reported USD109.5mn in cash as of end-May 2016, but this is likely to be lower now given that 5 months have passed), it is unlikely that EZRA would be able to provide much liquidity to satisfy bondholders.
- In addition, in the best case, EZRA would have to renegotiate with all its bank lenders to cure the cross defaults that arise. In the worst case, bank lenders may choose to accelerate as well. Do remember that EZRA last reported USD1.2bn in total borrowings, of which the EZRASP'18 bonds consist of just ~USD110mn. The recoveries in a jump-to-default and liquidation scenario are uncertain, given likely poor recoveries on asset sales.
- Timeliness is also an issue. It is likely that EZRA's management would have a harder time dealing with the aftershocks of the PPT default without these waivers. We note that PPT only attempted to restructure its bonds at the end of August 2016.

II. The Consent Solicitation Passes

- Bondholders would give up their right to accelerate in the event should EZRA decide to negotiate on the restructuring of the bond's maturity, coupon or principal (amongst other things) in the future.
- That said any future out-of-court bond restructuring would still have to go through another consent solicitation exercise, with bondholders retaining the right to decline via the exercise.
- The leeway provided by the waivers would help management have the flexibility to resolve the urgent issues of managing the PPT default / restructuring as well as to potentially improve operations via restructuring the vessel financing.
- There would less likely be acceleration in the near-term, allowing the company some breathing room to improve operations / turn cash flows positive, before the bonds mature in roughly 18 months.

D) Gauging Alignment

Given that EZRA is asking bondholders to give up material protections, and not being able to compensate bondholders beyond a token amount, we can only determine if management has been doing what it can, and that there is alignment between all stakeholders. The last two years, EZRA has:

- Conducted a rights issue in July 2015, raising SGD202mn. The founding Lee family participated in their entitlement, injecting SGD49.9mn in fresh equity into the company.
- Brought on Chiyoda as a strategic investor in EZRA's subsea division, raising USD150mn. Subsequently brought on NYK as well, raising USD36mn.
- Sold one of its FPSO, the Lewek EMAS, for ~USD68.9mn in cash upfront (for EZRA and EMAS in aggregate), with proceeds to be received in the near future.
- Gone through two rounds of consent solicitations before, to obtain financial flexibility to operate through the weak environment.
- With proceeds raised from the rights issue, asset sales and strategic investors,

paid down SGD225mn in bonds due September 2015, SGD150mn in perpetual securities in September 2015 and SGD95mn in bonds due March 2016. Currently, the SGD150mn in bonds due on April 2018 are the only bonds outstanding.

- Paid SGD3.7mn in bond coupon due on 24th October 2016.

In aggregate, EZRA's management has been taking steps to generate liquidity and making good on its debt service despite the difficult environment. To be clear, it is still possible that EZRA may have to return to bondholders in the future to restructure, given the uncertain environment. That said, we believe that bondholders still have a say in any potential restructuring.

E) Recommendation

In aggregate, though we are hesitant regarding the waiver of an event of default upon attempts by EZRA to restructure indebtedness, we acknowledge the urgency of the situation given the issues happening at PPT, as well as the financial flexibility needed to negotiate with EZRA's bank lenders over EMAS's vessel financing. We also believe that providing management with some leeway would be the optimal outcome for bondholders, versus risking debt acceleration should the consent solicitation fail. Particularly given the uncertainty arising from the PPT situation and the overall still challenging environment, the recoveries in the event of liquidation are uncertain at best.

As such, we recommend that bondholders accept the proposal by management via the current consent solicitation, and submit the vote by 02/11/16 in order to qualify for the early consent fees. As a reminder, the current timeline for the EZRA consent solicitation is to vote by 5pm on 02/11/16 to receive the early consent fee of 10bps, or to vote by 10am on 07/11/16 to receive the normal consent fee of 5bps. The actual meeting for the bondholder vote will be held at 10am on 09/11/16. We will keep our Negative Issuer Profile on EZRA and the Neutral call on the EZRASP'18 bonds unchanged.

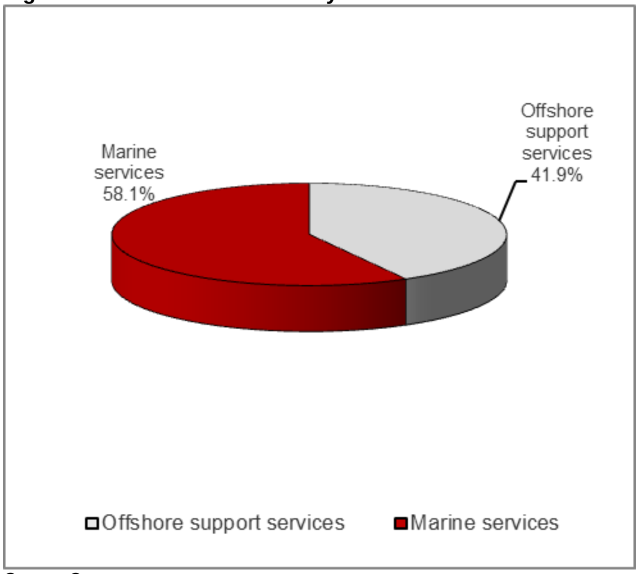
Ezra Holdings Ltd

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

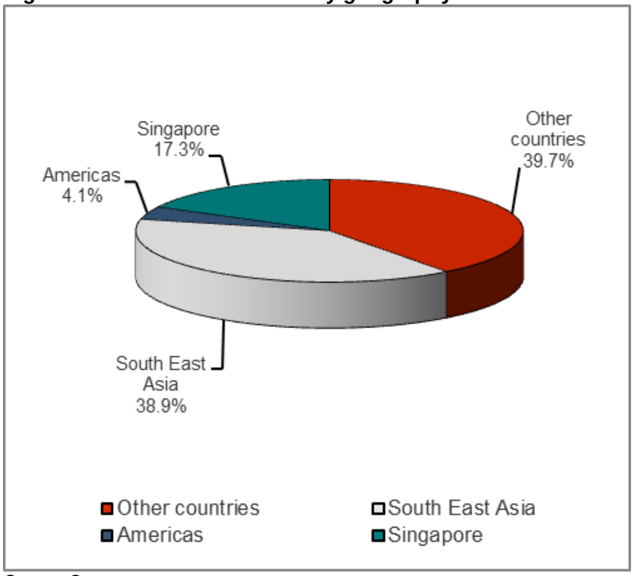
Source: Company, OCBC estimates
**Adjusted FCF = FCF –Acquisitions – Dividends + Disposals*

Figure 1: Revenue breakdown by business – FY2015



Source: Company

Figure 2: Revenue breakdown by geography – FY2015



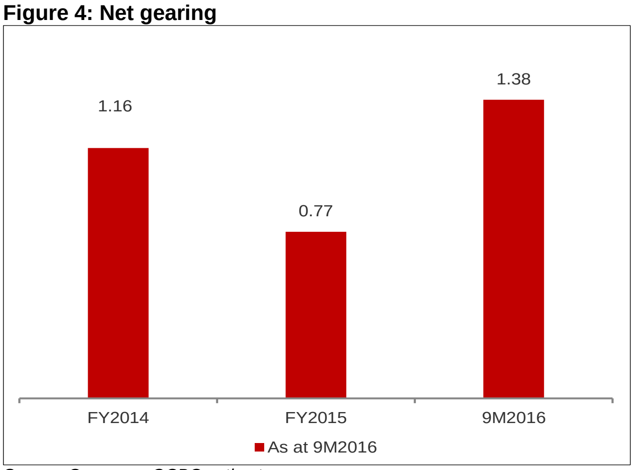
Source: Company

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