Asia Credit Research

OCBC Bank

Pacific Radiance Limited: Credit Update

Wednesday, 07 February 2018

Preferring Clarity

- PACRA has formally launched the restructuring of its bonds, after holding two rounds of informal noteholder's meetings which updated on the company's circumstances. In summary, PACRA intends to conduct an out-of-court restructuring of its bonds via a consent solicitation. Specifically, PACRA seeks to redeem the SGD100mn in bonds with shares, at a rate of SGD1 notional for 3.8 new PACRA shares (implying shares issued at SGD0.263 per share versus the current market price of SGD0.114 per share). A separate resolution seeks to waive potential events of defaults / financial covenants breaches as well as facilitate the payment of the bond's March coupon.

- The current restructuring only focuses on the bonds. There were no details provided on how the other stakeholders (bank lenders, shareholders) will be restructured. Management attributed this to discussions with secured lenders and shareholders needing more time. PACRA is also seeking to delay the filing of its 4Q2017 results and hence no new financial results may be forthcoming.

- At present, the trade-offs look unbalanced for noteholders to agree to the redemption terms:

  1. Noteholders will be taking a huge implied haircut of over 50% based on current market prices, as well as give up their seniority protection as senior unsecured creditors by becoming equity holders.

  2. Given the huge haircut on the bonds, it is curious that existing shareholders are only diluted by ~35%. Furthermore, based on other restructurings seen, capital raising via rights issue or warrants would likely be part of the process, further diluting the equity stake that noteholders receive.

  3. Noteholders are effectively flying blind without knowing the other aspects of the restructuring. Comparatively, for the other recent restructurings in the O&M space, the restructuring plans are either more holistic (if haircuts are required on noteholders) or noteholders benefit from remaining (at least in part) senior unsecured creditors.

- **Recommendation: We recommend noteholders REJECT Resolution #1 of the consent solicitation (to allow redemption of the bonds via new shares issued). Noteholders deserve better information about the overall restructuring plan as well as how other stakeholders are committing to the reorganization before taking both sizable haircuts and structural subordination. We recommend bondholders ACCEPT Resolution #2 (waivers of events of default / financial covenants / release of March coupon from escrow) as PACRA may fail its financial covenants come 4Q2017 results and trip PACRA into technical default.**

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A) Current Situation

Background

PACRA had first announced working closely with its major lenders to assess its debt position as well as the appointment of advisors to review its overall capital structure during its 2Q2017 results release in August 2017 (refer to OCBC Asian Credit Daily (14 Aug 2017)). This was not long after it had received access to government-backed IE Singapore and Spring Singapore financing facilities (refer to OCBC Asian Credit Daily - 9 Jun 2017) totalling SGD85mn in June 2017. Tentative terms for their intended restructuring were shared during the 2nd informal noteholders' meeting (refer to OCBC Asian Credit Daily - 22 Jan 2018) before finalized terms were announced as part of their on-going consent solicitation exercise ("CSE", refer to OCBC Asian Credit Daily - 2 Feb 2018). This report will consider PACRA's operating conditions, recent performance, terms of the CSE as well as conclude with our recommendations.

The OSV market remains weak but bottoming out

Crude oil prices have rallied decisively from June lows, with Brent prices staying above USD60/bbl for the last three months. The stabilization of crude oil prices have reinvigorated upstream activity, with energy companies revisiting offshore energy assets. For example, Exxon Mobil had won 10 blocks in the September 2017 bid round in Brazil. These were all deepwater reserves such as the Compos Basin. It was the first time that Exxon Mobil returned to Brazilian exploration in five years[1]. The return of interest to deepwater exploration would be a balm to offshore service providers such as contract drillers and OSV operators / owners. Cost inflation for onshore unconventional assets (such as shale) has also made offshore energy resources more attractive.

However, the offshore support vessel ("OSV") oversupply situation still persists. Tidewater, one of the world's largest OSV operators, reported (as of 04/12/17)[2] that though there are roughly ~2,000 OSVs working in support of exploration or production work, there are still ~3,500 OSVs chasing for those jobs. As such, things in the interim would remain pressured, with charter rates for OSVs suppressed due to competition. As such, there would be a need for utilization levels of OSVs to climb higher first (to at least ~70%), before meaningful improvement to charter rates can be seen. In other words, revenue recovery would occur first before profitability. There are signs of activity recovery with tendering activity picking up.

With offshore upstream activity looking to pick up, Tidewater reported that the consensus view is for another ~450 OSVs worth of work to enter the market over 12 – 18 months due to the increase in offshore rigs deployed. Furthermore, Tidewater expected that older OSVs, such as ~600 OSVs that are 25 years or older, will no longer be competitive. This would help reduce the oversupply situation, even with the ~200 OSV newbuilds expected to enter the supply in the next few years.

Recent performance

The most recent results for PACRA would be its 3Q2017 results released in November. With PACRA currently seeking to delay the filing of its 4Q2017 results, it is likely that noteholders will have to content with stale results when considering PACRA's restructuring proposal. We have previously reviewed PACRA's 3Q2017 results, but will summarize it below for ease of reference.

For 9M2017, revenue declined 15.0% y/y to USD48.7mn, with utilization and charter rates remaining weak for PACRA's fleet. On a q/q basis though, 3Q2017 revenue was flattish. This was driven by the OSV division's revenue increasing 10.6% q/q, likely due

[1] Exxon Mobil – 3Q2017 earnings call
[2] Tidewater – Cowen Energy & Natural Resources Conference

to seasonal factors with activity sustained before slowing down into the winter months. The commencement of PACRA's new shipyard segment also helped mitigate the slowdown seen in its subsea division. With PACRA heading into the quieter winter season, 4Q2017 and 1Q2018 OSV division results are likely to weaken due to seasonal factors. Profitability remains weak with PACRA still generating a gross loss of USD9.5mn for 9M2017, though improving over the USD17.2mn gross loss generated during 9M2016.

Given continued gross losses, cash flow generation remains poor with negative USD24.4mn in operating cash flow (including interest service) seen during 9M2017 despite the sharp cut in capex as no further vessel deliveries were taken in 2017. The cash gap was funded by additional borrowings. During 3Q2017, PACRA was only able to generate net cash due to vessel divestments and the informal debt standstill (which reduced bank loan repayment). Even then, net gearing surged higher to 195% (2016: 161%) due to losses generated. Furthermore, as part of PACRA's year-end review, further impairments on its fleet are expected, which would worsen net gearing.

Looking forward, PACRA benefits from having a young fleet of 72 vessels with an average age of 6 years. Even then, management reported 36 vessels in layup status to reduce maintenance cost. We are also wary of the USD156.4mn in amounts due from related companies (aggregating both current and non-current amounts). Some of these amounts relate to vessel sales from PACRA to its associates / joint ventures. PACRA had previously taken some allowances on these amounts during the 2016 fiscal year. Finally, it is also worth noting the bank borrowings (~USD444mn) heavy nature of PACRA's liabilities versus the SGD100mn (~USD75mn) in bonds. These bank borrowings are secured, and most are likely to be related to vessel financing.

B) Summary of Terms

For the restructuring of PACRA's SGD100mn PACRA'18 bonds, it is seeking to restructure out-of-court via a consent solicitation (versus a court-driven process such as Swissco's Judicial Management or Nam Cheong Limited's ("NCL") Scheme of Arrangement). That said, should there be an attempt to subsequently restructure PACRA's bank borrowings, we believe that PACRA could follow the path of Marco Polo Marine ("MPM") and conduct a Scheme of Arrangement to restructure its other creditors, such as the bank creditors (after utilizing a CSE to restructure its bonds). The CSE consists of Resolution #1 and Resolution #2. It should be noted that the waiver of events of default resulting from the attempted bond restructuring, as well as the waiver of events of default from the potential breach of financial covenants are common to both resolutions.

Resolution #1

- To allow for the full redemption (at PACRA's option) of the bonds via the issuance of new PACRA shares. The conversion price is SGD1 notional for 3.8 PACRA shares (or for a SGD250,000 bond, 950,000 new shares will be provided to redeem the bond). The issuance of new shares is subject to shareholder approval, and the shares have no lock-up period.

- To allow PACRA access to the two coupon payments (SGD4.3mn) currently held in escrow to be paid out as a Consideration Fee.

Resolution #2

- In the event that Resolution #1 is not passed, to waive events of default (as mentioned earlier).

- To allow PACRA to access the escrow to make the SGD2.15mn bond coupon payment due 01/03/18.

C) Analysis of the Proposal

I) Restructuring details are incomplete:

Currently, PACRA has only provided public details about how it intends to restructure its bonds. There were no details regarding how the bank lenders, existing shareholders or new investors are going to participate in the restructuring. To be fair, PACRA's management stated that they need more time for discussions with bank lenders and investors. This doesn't change the fact that noteholders are forced to face an incomplete picture today.

There are two key elements for stakeholders to consider when making decisions in a restructuring: 1) how existing liabilities will be managed 2) how new capital is raised so the company can survive going forward. Without clarity on the two elements, noteholders' ability to make an informed decision will be impaired. In particular, given that noteholders will be given only common shares to redeem the bond, further dilution to noteholders' equity stake would be a big risk.

As per other restructurings (Ezion Holdings ("EZI"), NCL, MPM) new capital via new investors, rights issue or warrants are likely to be part of the restructuring. Noteholders would highly likely be diluted further:

EZI: Details were shared regarding the rights issue that EZI intends to do (which allows noteholders to consider the impact of dilution). Though there may be further dilution from incoming strategic investors, or warrants to bank lenders, EZI noteholders are protected as the option to convert into equity is at the noteholders' choice[3].

NCL: Details on the expected rights issue (as well as participation by the controlling shareholder) was shared[4]

MPM: By the time noteholders were voting for the CSE, there were details on the incoming new investors, shares to be issued to creditors as well as warrants to existing shareholders so the expected dilution was clear.

In the case of **PACRA**'s CSE, there are no further details regarding likely potential dilution from new investors, rights to existing shareholders or even to other creditors.

II) Premature to give up protection as a creditor

Given the lack of information regarding the rest of the restructuring, it is questionable for noteholders to give up the protection of being a creditor, in exchange for the risk of being a shareholder. In the other recent restructurings, noteholders were better positioned:

EZI: The conversion to equity is at the option of the noteholders (for the applicable class of restructured bonds)

NCL: Only 35% of notional (the unsustainable portion) was equitized. The balance remains senior unsecured debt.

MPM: Though MPM noteholders received an implied haircut of ~71%, 50% of their recovery was in cash while the balance was in shares (with the impact of dilution clear).

[3] OCBC Asia Credit - Ezion Credit Update (24 Oct 2017)
[4] OCBC Asia Credit - Nam Cheong Credit Update (6 Dec)

In the case of **PACRA**, not only is the implied haircut sizable at >50%, the consideration is entirely in shares. In the event that PACRA's restructuring fails (such as the failure to come to an agreement with bank lenders) noteholders (now shareholders) will be poorly positioned in a liquidation, or court-driven restructuring.

III) "Consideration Fee" already belongs to noteholders

The SGD4.3mn held in escrow is in the Interest Service Reserve Account ("ISRA") which was previously created to give comfort to noteholders in exchange for easing PACRA's financial covenants in October 2015. This was to give noteholders certainty over the coupon payments. It is not incremental to the shares provided in redeeming the bonds in Resolution #1.

IV) Delayed financials provide no comfort

PACRA has filed to SGX for a delay to the filing of its 4Q2017 as well as 1Q2018 financials. It is curious that PACRA used "*An extension will therefore allow the Group to release its financial results after the main terms of the Restructuring are finalised and presented to all stakeholders, enabling the stakeholders to better assess the financial impact of the Restructuring*" when noteholders (who are stakeholders) are expected to vote on the CSE and have a material impact on their holdings without the benefit of updated financials.

Comparatively, EZI announced its 3Q2017 results during the process of its own CSE, NCL sent its Scheme of Arrangement documents to creditors after it released its 3Q2017 results. Only MPM had delayed its 4QFY2017 results (ending September 2017) by about a month, but the details provided to noteholders during the restructuring were a lot more comprehensive.

V) Is the conversion ratio defensible?

At SGD1 notional for 3.8 new PACRA shares, noteholders will be issued shares priced at SGD0.263 per share, in exchange for debt forgiveness. This compares to the closing price of SGD0.121 per share (as of 06/02/18). Based on the last closing price, <u>noteholders are receiving a haircut of ~54% on their notional immediately</u>. Furthermore, as mentioned earlier, noteholders (now shareholders) will no longer benefit from protection as a creditor.

Sizable haircuts have occurred in recent restructurings. What is key is that in <u>situations that creditors, such as bondholders, have sizable haircuts, existing shareholders of the issuer should be diluted significantly</u>. This makes logical sense, as in a liquidation, should creditors be impaired, shareholders would be wiped out. There are many examples of this in recent restructurings:

> **NCL**: 65% of scheme debt (including bonds) remains senior unsecured debt. For the 35% debt forgiveness, creditors will receive 47% of NCL shares post restructuring (including the dilution for the rights issues). Haircut of ~24% on the notional. There was clarity in what the controlling shareholder was willing to commit in fresh capital (at the point of restructuring), as well as the price in which the controlling shareholder would participate at.
>
> **EZI**: No haircut to notional. Conversion to equity at noteholders' option.
>
> **MPM**: Huge haircut of ~71.3% to noteholders. This was not surprising as it was implied that even secured lenders took haircuts (and received equity). Still, noteholders received 50% of recoveries in cash, while the balance was in shares created at SGD0.035 per share. This compares with new equity raised

at SGD0.028 per share, and the last closing price for MPM at around SGD0.50 per share in April 2017 (before MPM's shares were suspended). It should be noted that existing shareholders of MPM were diluted down by 90%, with the founding Lee family's stake down from ~60% to 6%. The dilution numbers do not include the warrants which existing shareholders receive (though these were disclosed during the CSE).

Tidewater Inc: For Tidewater, which went through pre-package Chapter 11 restructuring mid-2017, existing shareholders had their original stake wiped out (the original equity was worth zero and cancelled) and received 5% stake in the new entity while creditors (both lenders and noteholders) received 95% stake on top of receiving some cash, warrants and restructured debt[5]

In the case of **PACRA**, despite noteholders (a creditor) receiving an implied haircut of ~54%, they would only control ~35% of PACRA post restructuring. In other words, existing shareholders are only diluted ~35%, with the controlling Pang family stake reducing from ~68% at present to ~44%.

The trickier situation is that if secured lenders are required to receive haircuts as well (such as implied in the MPM situation), it would only be acceptable to secured lenders if existing shareholders are greatly diluted (as in the case of MPM's restructuring). If noteholders have already been equitized at that point in time, they would be further diluted in this scenario. Without knowing PACRA's intent for the rest of its capital structure, noteholders are in a vulnerable position.

D) Recommendation

In aggregate, we recommend that noteholders **REJECT Resolution #1**. At present, the trade-offs look unbalanced for noteholders. Noteholders will be taking a huge implied haircut of over 50% based on current share prices, as well as give up their seniority protection as senior unsecured creditors by becoming equity holders. Given the huge haircut on the bonds, it is curious that existing shareholders are only diluted by ~35%. Furthermore, based on other restructurings seen, capital raising via rights issue or warrants would likely be part of the process, further diluting the equity stake that noteholders receive. Noteholders are effectively flying blind without knowing the other aspects of the restructuring and deserve better information before making a decision. Key would be how other stakeholders are committing to the reorganization.

We would, however, recommend that noteholders **ACCEPT Resolution #2**. This is specifically to facilitate the payment of the bond's coupon on 01/03/18 as well as to waive events of default arising from the restructuring attempt, as well as to waive possible technical default from PACRA violating its financial covenants when it finally publishes its 4Q2017 results.

[5] https://finance.yahoo.com/news/tidewater-announces-entry-restructuring-support-103300370.html

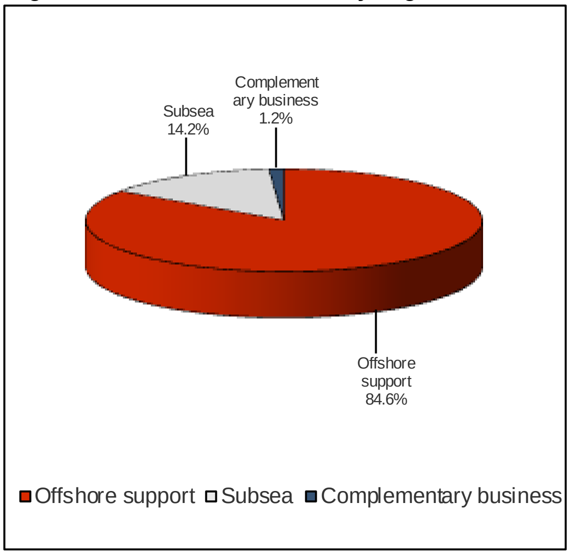
Pacific Radiance Ltd

Table 1: Summary Financials

Year End 31st Dec	FY2015	FY2016	9M2017
Income Statement (USD'mn)			
Revenue	121.8	69.4	48.7
EBITDA	26.7	-21.7	-1.9
EBIT	0.4	-52.8	-24.8
Gross interest expense	12.1	16.6	14.2
Profit Before Tax	5.3	-118.2	-35.0
Net profit	3.7	-118.8	-36.0
Balance Sheet (USD'mn)			
Cash and bank deposits	43.1	50.6	36.8
Total assets	916.6	904.3	880.2
Gross debt	399.4	514.6	526.6
Net debt	356.3	464.0	489.8
Shareholders' equity	416.0	289.0	250.8
Total capitalization	815.4	803.6	777.4
Net capitalization	772.3	753.0	740.6
Cash Flow (USD'mn)			
Funds from operations (FFO)	30.1	-87.7	-13.1
* CFO	24.4	-44.0	-24.4
Capex	161.6	126.3	2.0
Acquisitions	3.4	0.0	2.0
Disposals	7.6	57.1	11.9
Dividend	17.9	6.5	0.0
Free Cash Flow (FCF)	-137.2	-170.3	-26.3
* FCF adjusted	-151.0	-119.7	-16.4
Key Ratios			
EBITDA margin (%)	21.9	-31.2	-3.9
Net margin (%)	3.1	-171.2	-73.8
Gross debt to EBITDA (x)	14.9	-23.7	-209.6
Net debt to EBITDA (x)	13.3	-21.4	-195.0
Gross Debt to Equity (x)	0.96	1.78	2.10
Net Debt to Equity (x)	0.86	1.61	1.95
Gross debt/total capitalisation (%)	49.0	64.0	67.7
Net debt/net capitalisation (%)	46.1	61.6	66.1
Cash/current borrowings (x)	0.5	1.0	0.3
EBITDA/Total Interest (x)	2.2	-1.3	-0.1

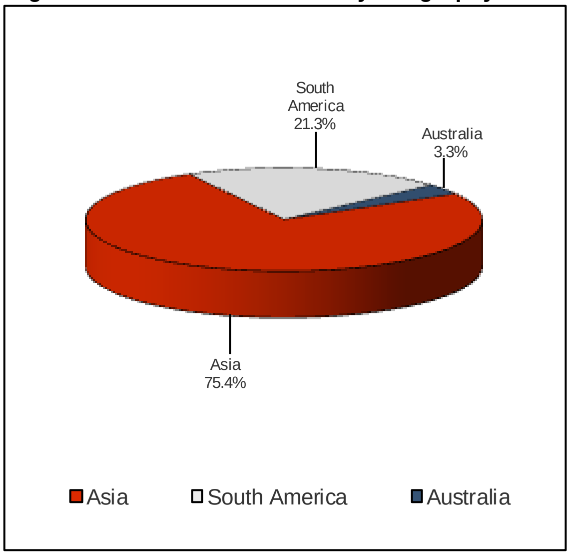
Source: Company, OCBC estimates

Figure 1: Revenue breakdown by Segment - FY2016



Source: Company

Figure 2: Revenue breakdown by Geography - FY2016



Source: Company

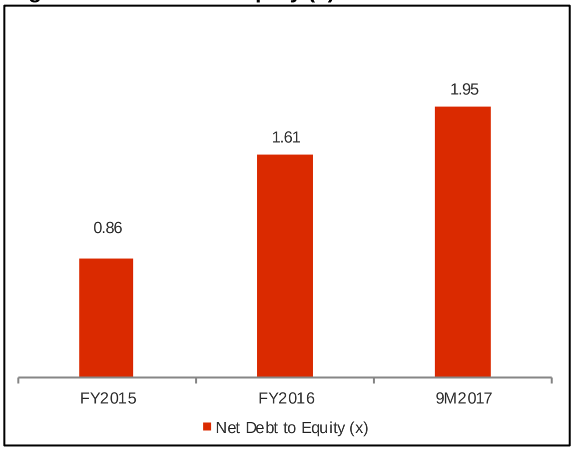
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 3: Debt Maturity Profile

Amounts in (USD'mn)	As at 31/09/2017	% of debt
Amount repayable in one year or less, or on demand		
Secured	59.0	11.2%
Unsecured	73.7	14.0%
	132.7	**25.2%**
Amount repayable after a year		
Secured	393.9	74.8%
Unsecured	0.0	0.0%
	393.9	**74.8%**
Total	**526.6**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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