Asia Credit Research

ASL Marine Holdings Ltd ("ASL"): Special Interest Commentary

Second act

Monday, 21 January 2019

- ASL is proposing a restructuring of its two SGD bonds (Series 006, the ASLSP '20s and Series 007, the ASLSP '21s) via a consent solicitation exercise ("CSE"). The official launch of the CSE follows three rounds of informal noteholders meetings on 18 September 2018 ("1st informal meeting"), 29 October 2018 ("2nd informal meeting") and 5 December 2018 ("3rd informal meeting"). The key terms in the proposal have been successively improved over the past three meetings, culminating in the official launch terms. There is only one set of proposed terms tabled (rather than alternative options).

- Specifically, ASL intends to extend the maturity of the two bonds by another five years from the current terms and reduce the coupon rates to be paid. As a sweetener, bondholders would also be given warrants that are exercisable into new shares of the company. While we view the new bonds to be a "corrosive exchange", there is neither principal haircut nor a debt-to-equity swap. Existing bondholders will also not suffer from additional structural subordination from the existing structure, albeit with reduced returns and lower bondholder protection versus existing terms as well as the extension of maturity.

- **OCBC Credit Research currently does not cover ASL since ceasing coverage in June 2018. We have presented this paper as a special interest commentary on the back of investor interest.**

- **We recommend noteholders to grant CONSENT to the CSE. Ultimately, recovery values would be highly uncertain in a liquidation scenario, especially with ASL's segments and the marine services industry facing headwinds. While we think the company has been as effective as possible in meeting its obligations to date, its current cash flow profile is unlikely to support the current schedule of obligations. Together with somewhat decent underlying cashflow generation, we think there is merit to providing breathing space. That said, bondholders will be left in the capital structure for longer while ASL's ability to meet any restructured obligations contains risks and requires close monitoring. We suggest investors maintain close tabs on the company and insist as part of this CSE for timely updates from management to allow monitoring of key events to ensure the company performs in line with expectations.**

Background of events leading up to second CSE

- **Not a first time CSE:** Almost exactly 2 years ago in January 2017, ASL completed a CSE to restructure its two existing SGD bonds with original maturity in 2017 and 2018 respectively. The driver for the CSE at the time was ASL's dire liquidity position and the need to extend its SGD bonds by 3 or more years as a condition precedent to accessing a SGD99mn 5-year club term loan facility. The CSE passed and among other terms, the current bond maturity was extended by 3 years with loosened financial covenants although bondholders were offered a higher coupon with progressive step-ups.

- **Here we go again:** Since then, the still weak operating environment and certain idiosyncratic events have now prompted the company to come back to the market to seek consent for a further revision in terms. Amongst a general weakness in business

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conditions that have led to reduced business volumes, lower margins and tighter credit terms from suppliers, ASL was also impacted by the cancellation of shipbuilding projects. These projects comprised oil and gas support vessels (three offshore support vessels and three platform supply vessels) and resulted in total cash outflows of SGD199mn which was funded by debt and increased ASL's debt servicing burden.

Recent Performance / Developments

- **Things haven't changed:** Since our last update, ASL's performance drivers have remained broadly the same. While the ship repair and conversion and ship chartering segments have seen better revenue generation on a higher number of repair jobs and higher utilization rates in its Tug Boats and Barges for infrastructure projects (1Q2019 quarterly revenue increased 20.8% y/y to SGD67.6mn), ASL's profit margins still remain in the red and overall performance continues to be impacted by persistent challenging market conditions and a variety of factors. Margins at the shipbuilding segment have declined as a result of competition, the construction of less specialized and smaller vessels which have lower contractual value, as well as other idiosyncratic evens. Margins also remain under pressure in ship repair and conversion from competition and higher manpower overheads while ship chartering has seen mixed results. While FY2018 performance was improved on higher utilization from tugboats and grab dredgers (barges) deployed in infrastructure projects (that offset the negative contribution from OSV), 1QFY2019 performance was soft on weak charter rates and higher fuel prices. All told, conditions in marine services continue to be tough.

- **Impairments adding insult to injury:** Revenues and margins were not the only things impacted by the industry environment. Of particular note in FY2017 and FY2018 were elevated other operating expenses. These relate to impairments from the rescinding of 3 construction contracts in 4Q2017 and a further 2 in 4Q2018. All of these contracts were secured in 2014 and relate to the construction of three offshore support vessels and 3 platform supply vessels. According to management, this resulted in higher than anticipated borrowings and together with margin pressure and escalating finance costs from higher debt and interest rate step ups, ASL has continued to generate net losses for FY2018 (-SGD71.3mn) and 1QFY2019 (-SGD7.8mn).

- **Cashflows tell a different story:** While ASL's income statement indicates tough times, underlying cashflow generation remains decent. ASL has continued to generate both positive operating cashflow (net of interest service) and positive free cash flow through a mix of managing working capital (lower purchase of inventories and lower payments to suppliers) and managing capital expenditure. Proceeds from asset disposals have also supported free cash flows with the surplus used to meet ASL's interest service obligations and ongoing debt repayment commitments. This has seen ASL's gross debt fall from SGD549.5mn as at 30 June 2017 to SGD502.1mn as at 30 June 2018 and SGD490.1mn as at 30 September 2018. That said, asset disposals and lower capital expenditure are a double edged sword in our view as they are unsustainable and may impact ASL's future profit generating ability and growth prospects. The fall in gross debt has also come at the expense of liquidity with ASL increasingly using cash to meet debt repayments and generating an overall cash outflow of SGD9.0mn and SGD2.3mn respectively for FY2018 and 1Q2019 against inflows in prior periods.

- **But the balance sheet paints the truer picture:** Despite the ongoing reduction in gross debt, leverage has continued to rise due to the faster erosion in ASL's equity base from the net losses and gradual reduction in cash balances. Net gearing has progressively weakened from 136% in FY2017 to 156% in FY2018 and 157% as at 1QFY2019. Rising leverage however is not the immediate or main concern. As ASL's cash balance reduces from an already low level, its short-term debt commitments (including trust receipts) remain high with an average cash/current borrowings ratio of just 0.2x over FY2017-1QFY2019. Although the cash shortfall has slightly improved over time, ASL's liquidity nevertheless remains extremely tight. While scheduled debt repayments are expected to be the same in FY2019 as FY2018, ongoing margin pressures and the lower cash balance will continue to weigh on ASL's ability to meet its future scheduled amortisations, particularly in FY2020 when the rescheduled Series 006 notes become due. This has necessitated the auditors providing various statements in ASL's FY2018 annual report.

- **Material uncertainty related to going concern:** ASL's independent auditor, Ernst and Young LLP ("EY"), provided an unmodified opinion for the company's audited financial statements for FY2018. However, given the group's recent incurred losses and significant short-term obligations classified as current liabilities in FY2018, EY highlighted a material uncertainty relating to ASL's ability to continue as a going concern. EY further opined that the ability of the group to generate adequate cash flows from operations and the continued support from lenders would be critical moving forward. Finally, EY highlighted ongoing financial statement risk given the current weak industry dynamics which could result in further asset impairments from weak demand for certain vessels or negatively impact the recovery of trade receivables, finance lease receivables and goodwill. In our view, this material uncertainty as raised by EY will also continue to cloud ASL's financial predicament.

- **Industry concerns continuing to cloud cash flow generating ability**: Future operating conditions for ASL remain difficult to predict given susceptibility for marine services companies to macroeconomic variables such as global trade, oil prices and regional infrastructure spend, the majority of which are expected to face headwinds in the near future. Economic growth is expected to slow in 2019 and 2020, weighed down by trade war concerns, higher interest rates and other risk events such as BREXIT as detailed in the OCBC Global Outlook 2019. These concerns in particular could impact the global shipping industry. Secondly and in the context of structurally slower economic growth and persisting risk events, oil price growth is expected to remain sluggish in kind following the noticeable fall in 4Q2018. Despite price volatility in 2018, our crude oil price view remains fairly benign into end-2019 at USD65 and USD70 per barrel for WTI and Brent respectively. On the flip side, prospects in infrastructure spending remain positive. Although regional economic growth will slow, it will still remain positive while demand for new and replacement infrastructure is expected to grow. Given these dynamics and the challenges in the past, ASL is moving more towards infrastructure projects and away from oil and gas in terms of industry exposure. Infrastructure & Construction was the largest contributor to total revenues in FY2018 at 52.7% (up from 39% in FY2017). Conversely, the Offshore Oil & Gas Support industry contributed 16.4% (7.0% in FY2017), while Transportation contributed 25% (51% in FY2017). This could explain why utilisation rates increased in 1QFY2019 for towing tugs and grab dredgers as well as OSVs. That said, we still think profitability will remain challenged given the move to lower margin businesses and enduring competition from vessel oversupply.

- **Founders remain engaged:** In the first CSE, we took some comfort that the founding Ang family showed alignment with creditors by injecting equity into ASL. Although not as strong as the first time around, the controlling shareholders will again inject cash into the business although as an interest free loan for SGD5mn and an additional SGD5mn in standby line of credit as opposed to ~SGD17mn in new equity in December 2016. While financial contribution is obviously welcomed and the more so the better, we think an equally important influence that the founders and management have is to engage lenders to support ASL through its time of need. According to management, ASL's lenders remain willing to provide support through the reprofiling of existing debts and the provision of new project and trade lines of up to SGD150mn. This is conditional however on (1) controlling shareholders retaining a majority stake (this affirms that bank lenders view the influence of the founders and management favourably in our opinion); and (2) bondholders amending the terms of the notes (and hence leading us to this point in time).

Details of the Consent Solicitation

Finalised terms: ASL with its advisors has engaged with bondholders over tentative restructuring terms. After receiving investor feedback, the terms were improved for a formal launch of the consent solicitation. A summary of the terms and our views are as follows:

What ASL wants:

- **Access up to SGD150mn of banking facilities:** ASL is proposing to obtain new banking facilities of up to SGD150mn from its principal lenders. These banking facilities are largely envisaged to be in the form of new project and trade lines to continue in its business expansion especially for its shipbuilding business which is capital intensive. Terms are being finalised and conditional on passing the bond CSE. However, to note, any new banking facilities may subordinate the bondholders further.

  Our thoughts: While we are not privy to the specific terms of this new facility, these may include (1) Guarantees from banks which can be used by borrowers to provide credit comfort to customers and suppliers (2) Project lines where loans are typically ring-fenced for the purposes of a particular project. We take comfort that the nature of proposed new facilities is targeted towards business usage rather than paying down competing claims to bondholders (eg: existing bank lenders). With **principal lenders still willing to negotiate the granting of additional facilities**, we see this as a **signal that lenders remain supportive of the company as a going concern despite the challenges**.

- **Re-profiling of bank debt:** Per ASL, principal bank lenders are also agreeable to term out ASL's bank obligations on a 10-year profile, repayable over 8 years (ie: with a 20% bullet repayment in year 8) with effect from 1 December 2018. Per ASL's informal noteholder meeting presentation dated 05 December 2018, the reprofiling is subject to passing of the CSE by February 2019.

  Our thoughts: Similar to the granting of new project and trade facilities, the bank lenders effectively want bondholders' clemency before they would legally complete the deal on their side. In our view, the theme of **"sharing the pain together" is common across restructurings with a winning chance** especially in cases where the aim is to improve the company's survivability as a going-concern. As such, bank lenders wanting bondholders to restructure their terms are acceptable in our view. One caveat though, the bond restructuring is not conditional on bank lenders completing the re-profiling nor providing additional funding. In the off-chance that bank lenders ultimately renege, the bond restructuring (with worse-off terms from existing terms) will still be effective. We note though that these circumstances were similar in the 2017 CSE with extension of ASL's bonds by 3 or more years a condition precedent to bank lenders providing a SGD99mn club loan facility.

- **5-year extension for the bonds from current terms:** ASL is seeking another 5 years extension for both Series 006 (the ASLSP '20s) and Series 007 (the ASLSP '21s). This would bring maturity of the Series 006 to 28 March 2025 and for the Series 007 to 1 October 2026.

  Our thoughts: At time of issuance, these bonds were originally set to mature on 28 March 2017 and 1 October 2018 respectively, **a further extension by 5 years means that bondholders would effectively have agreed to an 8-year extension in total**. An additional 5-year extension to maturity is long, and whether or not the company is able to eventually redeem the bonds is highly dependent on how the company reshapes its business going forward. Similar to the first CSE, this proposed second consent solicitation would also likely constitute as an Event of Default under Clause 10(e) of the bond information memorandum dated (31/03/2014). The company has emphasised that the main reason that impedes its ability to meet the projections from the first CSE was the cancellation of six vessels where construction costs have been incurred. **In our view, the extension is also aimed at allowing the company more time to complete**

asset sales without having March 2020 and October 2021 (ie: the first amended maturity date) as a **sword of Damocles hanging over their head**.

That said, **timing matters in a distressed scenario.** Considering both the re-profiling of bank debt and the proposed 5-year extension for the bonds, it is worth pointing out that whereas previously the banks benefited only in terms of security, they now benefit to an extent on both security as well as timing of repayment.

- **Coupon cuts to 3.0%:** ASL is seeking a reduction of its cost of debt from bondholders (which had been stepped-up from time of the first CSE). The base coupon rate envisaged is 3.0% p.a for both bonds, down 300bps from 6.0% on Series 006 and down 335bps from 6.35% for Series 007.

Figure 1: Summary of Base Coupons

Bond	Original base coupon	Original maturity	1st CSE Coupon	Currently prevailing coupon	Proposed base coupon
ASLSP '20s (Series 006)	4.75%	28/03/2017	5.50% from 28/03/2017 onwards Stepping up by 50bps p.a	6.00%	3.0%
ASLSP '21s (Series 007)	5.35%	01/10/2018	5.85% From 01/04/2017 onwards Stepping up by 50bps p.a	6.35%	3.0%

Source: Bloomberg, Company presentation

Our thoughts: As bondholders are being asked to extend again, it is suffice to assume that ASL's credit profile has not improved since the last CSE two years ago. A **cut in coupon leaves a bitter taste and does not sufficiently compensate bondholders for the credit risk they are taking with ASL**. Given the demise and/or severely impaired smaller marine peers, we see no perfect comparable for ASL. It is worth noting that ASL's proposed coupon is lower than bond yields from Sembcorp Marine ("SMM"), 61%-owned by Sembcorp Industries Ltd (Issuer Profile: Neutral (4)). The SMMSP 2.95% '21s is trading at ~3.8% (180 bps spread above swap) and should SMMSP want to tap the market for longer bonds beyond 2021 maturity, they would need to pay more than 3.8%.SMM is a significantly larger shipbuilder and ship repairer which focuses on different types of vessels. That being said, **ASL has increased the coupon by 0.5% from the initial proposal of 2.5%**, with the additional 0.5% coming from senior management cum major shareholders' salary cuts. **While we think 3.0% is inadequate, this is higher than the 0.25% p.a token coupon offered by Ezion Holdings Ltd** on its straight bonds, which successfully completed its restructuring exercise in end-2017.
Simplistically, we assume:

(i) Company makes Adjusted Core EBITDA Amount of SGD65.0mn in FY2020, this is the amount where ASL is using as baseline for its performance-linked coupon structure (to be explained in the next section below)

(ii) Bond principal stays the same per Bloomberg data (SGD92.5mn for Series 006 and SGD46.3mn for Series 007). 3% p.a coupon will equate to SGD4.2mn in coupons versus SGD8.5mn per currently prevailing coupon rates

(iii) Bank interest rates unchanged, we use the existing FY2020 projected bank interest expense of SGD10.4mn based on the existing bank loan structure

(iv) No asset disposals

We find EBITDA/Interest coverage for ASL much healthier at 4.5x with a reduction in coupons to 3.0% p.a versus EBITDA/Interest coverage of 3.4x where prevailing coupon rates are unchanged, though the **reduction in interest burden is largely due to bondholder's clemency**. While debt repayment would be termed out, therefore reducing the probability of company entering into yet another restructuring in the short term, over time, ASL would likely pay more interest to bank lenders. Principal repayment to bank lenders will be stretched out over a longer period of time at unchanged interest rates (implied as disclosures silent on bank lenders taking an interest rate cut). To be sure, for bondholders, total interest may also increase, though entirely driven by the proposed maturity extension. **<u>In our view, this is a compromised position which bondholders would be taking to get the buy-in from bank lenders.</u>**

- **Deleting two financial covenants:** ASL is seeking to delete two financial covenants, namely, (1) Consolidated total liabilities-to-consolidated tangible net worth of less than 2.75x and (2) Consolidated total borrowings-to-consolidated tangible net worth of less than 2.0x. During the first CSE, the Consolidated total borrowings-to-consolidated tangible net worth was loosened from 1.75x to 2.0x while the third financial covenant, Interest Coverage Ratio was reduced to a minimum of 2.0x compared to 4.0x. The definition of EBITDA was also amended to exclude the impact of impairments / provisions / non-cash flow items.

  Our thoughts: The leverage related financial covenants allow for very considerable debt levels at the company. In effect, company can take two times the debt over equity and liabilities of 2.75x over equity. **<u>Deleting these covenants means taking away a safeguard for bondholders' which restricts company ability to take on too much debt</u>**. At first glance, this looks like an appalling proposal. The reality is that the market value of ASL's equity is significantly lower at SGD34.6mn (as at 18 January 2018) versus its accounting net book value (adjusting out intangibles) of SGD283.7mn as at 30 September 2018. While the market value may not be indicative of ASL's fair value of equity, the actual answer is unlikely to be SGD283.7mn either (we expect company to take further impairments). We think the company is seeking to delete these covenants at one-go (rather than yet another CSE), in the event impairments and/or asset sales trips this covenant down the road. More importantly, **<u>we take it there is no change to the Interest Coverage Ratio</u>** (proposal is silent on this). ASL would still need to come back to bondholders in the event they need more leeway on staying within 2.0x which **<u>allows some "early intervention" by bondholders.</u>**

- **Amending the negative pledge:** Amendment of the Negative Pledge clause to allow ASL to grant any security interest in connection with the grant of project financing and trade lines of up to SGD150mn.

  Our thoughts: For the avoidance of doubt, the **<u>existing security on the SGD bonds</u>** (ie: second charge of club deal pool of vessels) **<u>will stay as it is, with no improvement to the security package</u>**. Exemptions are common among Negative Pledge clauses within the SGD bond space. In a restructuring case though, **<u>any unencumbered assets remaining in the business is key for recovery values (in the event of a future liquidation).</u>** This is especially more so as the business outlook is still challenging. We note that company's intention is to extend security for project and trade lines, indicating that these may consist of future inventory (eg: vessels to be constructed). Notwithstanding company's intention, **<u>our main issue with this proposal is the amendment into "any security interest"</u>** which means a blanket coverage of any assets. Based on our preliminary analysis, there are still unencumbered assets in the business, and while illiquid, there remains some value. **<u>We would much rather prefer a tighter amendment language for the Negative Pledge</u>**.

- **Reduction in Mandatory Redemption to 1.0% p.a from existing 5.0% p.a:** At a 5.0% p.a mandatory redemption rate, we think ~1.5 years of principal have been mandatorily redeemed. The outstanding amounts have dropped from SGD100mn at issuance for the Series 006 to SGD92.5mn while the Series 007 has dropped to SGD46.3mn from SGD50mn. The company is proposing to reduce the Mandatory Redemption Rate to 1.0% p.a.

  Our thoughts: <u>During the first CSE, OCBC Credit Research</u> was of the view that extending maturity and then providing some principal back ahead of the amended maturity is not a concession. Given that we did not see the 5.0% as a concession offered by company, we are not overly perturbed that the company wants to reduce this to 1.0%. **<u>This is likely proposed to term out its current repayment obligation .</u>**

What Bondholders are offered:

- **Seniority is preserved plus no principal haircut:** Unlike the restructuring of Pacific Radiance Limited, where the optimal outcome in our team's view (out of two options) was for bondholders to take a small cash upfront with 85% conversion into shares, with the shares ranking junior to all creditors. Conversely, ASL's sole proposal contemplates no principal haircut with the bonds staying as bonds with creditor rights.

  Our thoughts: ASL bondholders are not asked to swap debt into equity. We think this keeps with the spirit of bond investors' original intention of investing in ASL as a creditor rather than as an equity holder. Morally doing the right thing aside, **preservation of seniority is a highly valuable right (albeit hampered versus existing terms) in light of still uncertain business outcomes**. In the event the company comes back with yet another restructuring, bondholders would still maintain rights to call a liquidation at that point. Minority equity holders in contrast have very little legal say and equity rank last in a liquidation.

- **Cash sweep mechanism extended to bondholders:** The proposal contemplates that when the company's unrestricted cash balance is more than SGD25.0mn, these excess amounts would be transferred out of the company's usual bank accounts into designated bank accounts for the Series 006, Series 007 and bank lenders accounts respectively for partial mandatory early redemption of principal outstanding. 60% of Free Cash will go to bank lenders, ~28.6% to Series 006 and ~11.4% to Series 007.

  Our thoughts: ASL is in the midst of asset sales to shore up its finances, with SGD5.0mn of disposals targeted by end-FY2019 and another SGD91.0mn from sale of vessels in the next few years. In ASL's initial proposal, **no cash sweep mechanism was contemplated for bondholders though this was improved by time of finalised terms**. Taking numbers as at 30 September 2018 and reducing the amounts attributable to bondholders, we take it that bank debt amounts to ~SGD334mn (~72% of gross debt). At SGD92.5mn and SGD46.3mn respectively, Series 006 makes up ~19% of gross debt while Series 007 makes up the remaining ~9%. The cash sweep contemplated for Series 006 bondholders is disproportionately higher at 28.6%. We think the extra is coming from bank lenders. Series 007 would also be getting more than its proportionate share of debt, though at smaller amounts. We are not privy to why Series 006 is being proposed a higher proportion of cash sweep versus Series 007 though one possible reason could be a more co-ordinated pool of bondholders with higher bargaining power. In any case, **we see the existence of a cash sweep mechanism positively as this allows asset sales (if successful) to go towards an earlier redemption** (rather than bondholders waiting out the full 5-year extension). In terms of structural subordination, we estimate that only ~SGD95mn of bank debt (out of SGD351.4mn) as at 30 September 2018 sitting at the same entity as the bondholders (ie: the holding company level), with the rest of the bank debt nearer to operating entities and assets. Despite having higher bargaining power, **bank lenders agreeing for bondholders to share in the cash sweep** is indicative that bank lenders were willing to take some concession to help push a restructuring through.

- **Performance-linked additional coupons:** Both the bonds would start-off with a 3.0% p.a coupon rate, with possible step-ups linked to performance of ASL. As a baseline, the company would use SGD65.0mn of Adjusted Core EBITDA, defined as the earnings of ASL and its subsidiaries before taking into account of interest expense, tax, depreciation and amortisation though adding back certain non-cash flow items (eg: allowance for doubtful debts, impairments, write-offs) and deducting other operating income. Coupon rates will increase by 0.15% p.a for every SGD1.0mn in prior year's Adjusted Core EBITDA Amount above SGD65.0mn, capped at 2.0% p.a and reset yearly.

  Our thoughts: This is an attempt by the company to provide some sharing of the upside with bondholders. More typically we have seen these structures in equity structures and remuneration negotiations. The **existence of performance-linked coupon does not fully compensate for the lowered coupon (capped at extra 2.0%**

p.a) though is a welcome move versus only a 3.0% p.a base rate. In our view, this structure is **more sustainable versus the current +0.50% step-up p.a** regardless of operating environment. Given that the Adjusted Core EBITDA Amount would not be independently verified by a third party, we urge bondholders (and respective advisors) to perform their own calculations to track the coupon rate. As a publicly listed company, ASL would be obliged to continue disclosing quarterly and annual financials.

Figure 2: Illustration of the performance-linked coupon

	Adjusted Core EBITDA (SGDmn)	Base coupon	Additional Coupon Rate	Total Coupon Rate
Any amount below SGD65mn	60	3.00%	0.00%	3.00%
	61	3.00%	0.00%	3.00%
	62	3.00%	0.00%	3.00%
	63	3.00%	0.00%	3.00%
	64	3.00%	0.00%	3.00%
Baseline	**65**	**3.00%**	**0.00%**	**3.00%**
	66	3.00%	0.15%	3.15%
	67	3.00%	0.30%	3.30%
	68	3.00%	0.45%	3.45%
	69	3.00%	0.60%	3.60%
	70	3.00%	0.75%	3.75%
	71	3.00%	0.90%	3.90%
	72	3.00%	1.05%	4.05%
	73	3.00%	1.20%	4.20%
	74	3.00%	1.35%	4.35%
	75	3.00%	1.50%	4.50%
	76	3.00%	1.65%	4.65%
	77	3.00%	1.80%	4.80%
Maximum 0.15% step-up	**78**	**3.00%**	**1.95%**	**4.95%**
Any amount above SGD79mn 0.05% stub to 2.00% p.a	**79**	**3.00%**	**2.00%**	**5.00%**
	80	3.00%	2.00%	5.00%
	81	3.00%	2.00%	5.00%
	82	3.00%	2.00%	5.00%
	83	3.00%	2.00%	5.00%

Source: OCBC Credit Research based on Summary of Principal Terms disclosed by company
Note: (1) Per disclosure, coupons will be up to 5.0% p.a indicating the stub of 0.05% to 2.0% cap will be paid
(2) Applicable Adjusted Core EBITDA will be rounded to the nearest SGD1.0mn

- **Performance-linked Additional Mandatory Redemption**: If the applicable Adjusted Core EBITDA Payment Rate is more than 2.0%, the Issuer shall make a redemption payment at a rate that is equal to half of the [Adjusted Core EBITDA Payment Rate less 2.0%] at every semi-annual interest payment date; capped at 4.0% p.a and reset yearly. The Adjusted Core EBITDA Payment Rate is defined as an increase by 0.15% p.a for every SGD1.0mn in prior year's Adjusted Core EBITDA Amount above SGD65.0mn, subject to a maximum Adjusted Core EBITDA Payment Rate of 6.0%.

  Our thoughts: While the formula for this is relatively convoluted, in a nutshell, the **company is offering a performance-linked Additional Mandatory Redemption that will kick-in when it reaches a significantly stronger footing**. Per company's illustration, Additional Mandatory Redemption would only start kicking-in when Adjusted Core EBITDA Amount reaches SGD79.0mn (21.5% above baseline). In that scenario, the Additional Mandatory Redemption Rate will be 0.10% p.a and including the 1.0% base rate bringing the total mandatory redemption rate to 1.10% p.a. To get to the 4.0% maximum Additional Mandatory Redemption Rate, ASL will need to reach Adjusted

Core EBITDA Amount of SGD105.0mn. In that scenario, the total mandatory redemption rate will be 5.0% (being 4.0% plus 1.0% base rate). Similarly, as base Mandatory Redemption is not a concession, it follows that a performance-linked Additional Mandatory Redemption is also not a concession. Bondholder returns are being eroded by not getting back money on time and in our view, Mandatory Redemption and Additional Mandatory Redemption **serves more as plaster on a wound**.

- **Giving out warrants**: Warrants will be issued to shareholders as well as bondholders. For Series 006 bondholders this will be 462,500 warrants per lot (ie: 2 warrants for every dollar of bonds outstanding)). For Series 007, this will be 578,125 warrants per lot (ie: 2.5 warrants for every dollar of bonds). The exercise price is SGD0.06 per warrant (reduced from SGD0.08 per new share from initial proposal). ~315mn warrants will also be issued to all shareholders (1 warrant for every 2 shares, also at SGD0.06 exercise price per warrant), we assume on a pro-rata basis and including to the Ang family.

  Our thoughts: The proposal is for Series 007 to get 25% more warrants than Series 006 bondholders. Although it seems odd each Series 007 bondholder will be getting more warrants, this could be driven by the longer maturity for Series 007 and to partly compensate for the lower cash sweep. In any case, **warrants at SGD0.06 are more of a sweetener in our view** since the share price of ASL has hovered at SGD0.05 – SGD0.06 per share for the past month. While share price may react upwards from the positive sentiment of a completed CSE, effectively existing shareholders will be diluted by at least 24% (and even more if they do not exercise their warrants). Net-net post-CSE, the share price is uncertain and **in our view, upside from the warrants (if any) will only come at a later stage**. We understand that a warrant exercise is also simultaneously proposed as a way for ASL to raise new equity of up to SGD36.9mn. The meeting for shareholders' approval on the warrants is expected to be held in 4QFY2019. Should a bondholder transfer his/her bonds prior to the shareholders' approval, the bondholder will no longer be entitled to receive the warrants (will go to new bondholder).

Figure 3: Illustration assuming all warrant holders exercise their warrants

	No. of shares	Shareholding	Equity Proceeds (SGDmn)
No. of shares outstanding as at 30 September 2018	629	51%	-
From warrants issued to existing shareholders	315	25%	18.9
From warrants issued to Series 006	185	15%	11.1
From warrants issued to Series 007	116	9%	6.9
No. of shares on a fully diluted basis	**1,245**	**100%**	**36.9**

Source: OCBC Credit Research, Company CSE Information Memorandum
Note: (1) Assumes all warrant holders exercise
(2) The higher stake to be held by Series 006 in totality is due to their larger bond outstanding amount

Figure 4: Summary of terms

Series	Series 006	Series 007
Issue	ASLSP '20s	ASLSP '21s
Amount Outstanding (SGDmn)	92.5	46.3
Proportion of gross debt as at 30 September 2018	~19%	~9%
Base coupon rate	2.5% + 0.5% = 3.0% p.a	
Additional Coupon Rate	+0.15% p.a for every SGD1.0mn increase to prior year Adjusted Core EBITDA Amount above SGD65.0mn; capped at 2.0% p.a and reset yearly	
Additional Mandatory Redemption	Only applicable in situations where Adjusted Core EBITDA Payment Rate is more than 2.0% The Issuer shall make a redemption payment at a rate that is equal to half of the [Adjusted Core EBITDA Payment Rate less 2.0%] at every semi-annual interest payment date; capped at 4.0% p.a and reset yearly. The Adjusted Core EBITDA Payment Rate is defined as an increase by 0.15% p.a for every SGD1.0mn in prior year's Adjusted Core EBITDA Amount above SGD65.0mn, subject to a maximum Adjusted Core EBITDA Payment Rate of 6.0%.	
Notes Redemption Account ("NRA")*	Cash sweep of unrestricted cash above SGD25.0mn into NRAs. Partial mandatory redemption on the subsequent Interest Payment Date if certain payment conditions are met. 28.57% of Free Cash to be swept into Series 006 NRA	Cash sweep of unrestricted cash above SGD25.0mn into NRAs. Partial mandatory redemption on the subsequent Interest Payment Date if certain payment conditions are met. 11.43% of Free Cash to be swept into Series 007 NRA
Warrants	Exercise price: SGD0.06 Exercisable for a period of 5 years from issuance date 462,500 warrants per lot Assume on a fully diluted basis Series 006 bondholders will get 15%-stake in company if all warrants exercised	Exercise price: SGD0.06 Exercisable for a period of 5 years from issuance date 578,125 warrants per lot Assume on a fully diluted basis Series 007 bondholders will get 9%-stake in company if all warrants exercised
Principal Repayment	In full (no haircut)	
Maturity Date	28 March 2025 (ie: 5 year extension)	1 October 2026 (ie: 5 year extension)
Financial covenants	To delete financial covenants (i) Consolidated total liabilities-to-Consolidated tangible net worth less than 2.75x (ii) Consolidated total borrowings-to-Consolidated tangible net worth less than 2.0x	
Negative pledge	Negative pledge to be amended to allow the company to grant any security interest in connection with the grant of additional project financing and trade lines of up to SGD150mn	

Source: Company's Summary of Principal Terms, Informal Noteholder Meeting presentations, CSE Information Memorandum, Notice of Meetings for CSE, company financials, Bloomberg for amount outstanding
*Note: *60% cash sweep to bank lenders*

Other considerations

- **Criticality of asset disposals:** As per ASL's initial proposal from the 2nd informal meeting held on 29 October 2018, net cashflows after interest include the assumption of SGD96mn in asset disposals over 2019-2024. These assets are considered non-core and include idle/old vessels, a shipyard in Guangdong, China and OSVs and PSVs.

- **Our thoughts:** Although we do not expect bondholders to get first access to any disposal proceeds (we understand these assets are secured), we nevertheless see the successful completion of these asset sales as important to the overall restructuring. This is because without them, ASL's debt would be higher compared to the illustration and as a result its interest costs higher. At the same time, liquidity appears tight notwithstanding the restructuring of obligations. Even with the asset sales, as we mentioned previously, bondholders will have to contend with being left in the capital structure for longer

- **Cutting 6 months coupon rate to the new proposed coupon rates:** Post-CSE, bondholders will receive coupons at the lower rate of 3% starting from the upcoming interest payment date for both Series 006 (6% p.a. coupon rate) and Series 007 (6.35% p.a. coupon rate).

  Our thoughts: For Series 006, the currently prevailing coupon rate of 6.0% p.a was expected to be paid on 28 March 2019 while for Series 007, the currently prevailing coupon rate of 6.35% p.a was expected to be paid on 1 April 2019. As the CSE proposes to lower the coupon rate to 3.0% p.a. for the upcoming payment and onwards (instead of adjusting coupon rates from payments subsequent to the upcoming one), we think this is an attempt by ASL to lower its interest expense for 6 months.

- **Approval from Series 007 and Series 006 are contingent upon each other:** The proposal will only come into effect if both set of bondholders passes the Extraordinary Resolutions contemplated in the CSE. In a nutshell, even if one set of bondholders vote "Yes" and the other votes "No", the CSE will be deemed as unsuccessful and terms will stay as the existing ones.

  Our thoughts: Broadly, while the proposed CSE terms are similar for both Series 006 and Series 007, terms are not exactly the same for both. In particular, we think Series 006 is getting a somewhat better deal, considering it has a shorter maturity of 1.5 years versus Series 007. The incremental advantages for Series 006 though is insufficient for us to suggest a "No" vote for Series 007 bondholders.

- **Reps and warranties that the Ang family will hold 51.0%:** The CSE also proposes for Series 007 bondholders to add a representation and warranty that the Ang family will own not less than 51.0% of its issued share capital for the time being. The Ang family owns ~67% in the company currently.

  Our thoughts: We understand that the inclusion is so that both the bonds will contain this representation and warranty. Per company's information memorandum, if the Ang family does not exercise in full their warrants, their stake will fall to 50.8% and this will be sufficient cause that the representation and warranty has been breached. We view this proposal to be technical in nature.

- **Call option:** The previous CSE included a call option exercisable at par by the issuer before the bonds' respective amended maturity dates. The call option for Series 006 will be exercisable from 28 March 2019 and each date falling three months thereafter while the call option for Series 007 will be exercisable from 1 October 2020 and each date falling three months thereafter.

  Our thoughts: For this current CSE, there is no mention of deleting this call option. We assume that the call option still exists although we think it is very unlikely for the bonds to be called in 2019 and 2020 respectively (defeats purpose of this CSE).

Conclusion: Taking the leap

Ultimately the decision to consent comes down to a matter of recoveries and whether this would be better in the short term (via liquidation or a court supervised restructuring) or the longer term through a recovery in the issuer's fundamentals. We have opined in previous restructurings in the oil and gas space that liquidation should be avoided at all costs and this opinion continues to hold in our view. Although there appears some slight improvement in demand in specific industries, asset values are still depressed from vessel oversupply – combined with the fact that most of ASL's vessels are secured means that any potential recoveries to bond holders from distressed asset sales would be severely compromised. Similarly, a court supervised restructuring would be protracted and ultimately costly, diminishing the prospects of recovery over time.

Agreeing to consent also represents a leap of faith given the developing outlook for marine services and ongoing competition that continue to pressure ASL's margins and business volumes. That said, there could just be enough to justify taking the leap. Despite the challenging conditions, ASL continues to generate operating cash flows (including interest service) through managing working capital and has also been managing its investing cash flows in order to meet its debt repayments and reduce debt. In addition, management and the founding Ang family continue to show a commitment to both the business and financial condition of ASL through the injection of equity and shareholder's loans as well as rallying ASL's bankers to continue to provide support and share potential upside with bondholders.

In the end however, the decision is not so much driven by any future certainty but rather that the alternative will likely bring a weaker outcome. In aggregate, <u>we recommend that bondholders accept the proposal by management via the current consent solicitation</u>, and submit the vote by 23/01/19 in order to qualify for the early consent fees. As a reminder, the current timeline for the ASL consent solicitation is to vote by 5pm on 23/01/19 to receive the early consent fee of ~32bps (SGD750 for each principal amount outstanding of SGD231,250), or to vote by 10am / 10:30am (respectively for the Series 006 and Series 007) on 28/01/19 to receive the normal consent fee of ~22bps (SGD500 for each principal amount outstanding of SGD231,250). The actual meeting for the bondholder vote will be held on 30/01/19 at 10am / 10:30am respectively for the Series 006 and Series 007.

Given remaining uncertainty and some information gaps, we think investors should use the CSE process to push for timely updates post CSE from the company on key milestones including:

(1) Successful execution of bank loan reprofiling and new project and trade lines;
(2) Progress of asset sales; and
(3) Underlying performance through adjusted core EBITDA generation by segments and industries to compare to their own calculations.

Analyst Declaration

The analyst(s) who wrote this report and/or her or his respective connected persons did not hold securities in the above-mentioned issuer or company as at the time of the publication of this report.

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