Asia Credit Research

ASL Marine Holdings Ltd: Credit Update

Tuesday, 03 January 2017

Of Two Minds

- Despite squeezing out a profit for FY2016 and having a fair 1QFY2017, ASL has indicated that its liquidity situation remains dire due to the challenging environment and heavy debt service burden. To alleviate some pressure, ASL had successfully raised ~SGD25mn in fresh equity (with insiders participating in their 67% share) and secured commitment for a SGD99mn 5-year club loan facility.
- However, a condition precedent to the club loan would be the extension of ASL's existing bonds by 3 or more years. ASL had also indicated that it would have had difficulty refinancing the ASLSP'17s when they mature in March 2017. As such, ASL has commenced on a consent solicitation exercise to restructure its existing bonds. To compensate investors, some terms include increasing the coupons of the bonds, as well as providing security.
- In aggregate, though we believe that the additional terms do not adequately compensate bondholders for the **3 year extension**, the alternative would be to chance potential court-driven judicial management should there be an acceleration to ASL's borrowings upon default. We also take some solace in the founding Ang family sinking ~SGD17mn in fresh equity, and that the additional liquidity from the club loan would give ASL time to turnaround, especially with energy prices stabilizing.
- As such, **we recommend that bondholders support the consent solicitation and send in their votes before the 12/01/17 to receive the early consent fee.** We will retain our Negative Issuer Profile on ASL, and will hold the two bonds at Neutral until we get a better sense of the price action post restructuring.

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A) Recent Performance / Developments

Signs of strain: When ASL filed its delayed Annual Report for the fiscal year ending June 2016[1], there were two pieces of information that were disclosed that are meaningful for bondholders. The first relates to ASL's independent auditor's opinion. The auditor, Ernst and Young LLP ("E&Y"), provided an unqualified opinion for ASL's audited statement. However, the auditor also included an 'Emphasis of Matter' in respect of ASL's ability to continue as a going concern. Specifically, E&Y highlighted ASL's SGD362.9mn in current borrowings versus SGD24.7mn in cash balance as of end-June 2016. The auditor also highlighted ASL's ability to continue as a going concern is dependent on the on-going non-underwritten rights issue, successful completion of the club term loan facility and the ability of ASL to generate sufficient cash flows from operations as forecasted. The second information relates to ASL's club term loan. ASL announced that it had signed a commitment letter with various lenders for a 5-year club term loan facility ("club loan") amounting to SGD99.9mn. A condition precedent to the club loan was ASL successfully extending the maturity of its SGD100mn in bonds due 28/03/17 ("ASLSP'17s") as well as its SGD50mn in bonds

[1] OCBC Asian Credit Daily - 12 November 2016

due 01/10/18 ("ASLSP'18s") by 3 years or more, as well as to obtain other related waivers, prior to the first drawdown of the club term loan facility.

1QFY2017 performance improving but still weak[2]: Quarterly revenue increased 27.3% y/y to SGD96.7mn. The shipbuilding segment had a fair quarter, growing 26.7% y/y to SGD46.0mn. The bulk of revenue generated from shipbuilding (~90%) was due to tugs, with demand for OSVs remaining weak. Looking forward, ASL had SGD177mn in shipbuilding order book for delivery till end-FY2018 (with 59% to be recognized in FY2017). This was sharply lower than the SGD342mn reported a year ago, reflecting weak demand. Shiprepair and conversion segment revenue was flattish y/y at SGD14.3mn (some lumpiness in revenue due to recognition only upon completion). Shipchartering segment saw revenue jump 40.7% y/y to SGD27.8mn (and comparable to the previous quarter), driven by stronger demand for tugs (+24.6% y/y) and barges (+37.7% y/y) with ASL benefitting from the commencement of large marine infrastructure projects in Singapore and South Asia during 4QFY2016. Order book for shipchartering stood at SGD145mn.

Margins stabilizing, cash flow generated used to deleverage: Though there was gross margin compression y/y from 15.6% (1QFY2016) to 13.5% (1QFY2017), ASL saw improvements q/q (4QFY2016: 11.2%). Improvements were seen at shipbuilding (gross margins expanding 590bps q/q to 11.3%), and shipchartering (gross margins expanding 450bps q/q to 7.6%). Absent the SGD4.0mn in provisions for doubtful debts and SGD3.9mn in impairment losses on its PPE seen in 4QFY2016, ASL was able to generate a pre-tax profit of SGD1.7mn (4QFY2016: SGD9.5 pre-tax loss). Cash flow improved as well with ASL generating SGD40.0mn in operating cash flow (including interest service) for the quarter (up from SGD24.3mn generated in 4QFY2016), via managing working capital. After factoring capex, ASL was able to generate SGD24.3mn in free cash flow for the quarter (after generating SGD29.2mn in 4QFY2016). Cash generated was used to deleverage, paying down SGD30.4mn in net borrowings during 1QFY2017. As such, net gearing fell from 134% to 125% q/q (it peaked at 140% during 3QFY2016). As part of the quarterly filing, ASL again emphasized on the SGD99.9mn club loan, as well as the need to amend the maturity of its existing bonds.

B) Details of the Consent Solicitation

Finalized terms: ASL announced that it has appointed United Overseas Bank Ltd ("UOB") as the consent solicitation agent, and that UOB will be engaging with bondholders over tentative restructuring terms, which were publically disclosed in a presentation deck[3]. After receiving investor feedback, the terms were sweetened for consent solicitation. A summary of the terms and our views are as follows:

What ASL Wants:

i) 3-Year Extension: ASL is seeking to extend the ASLSP'17s and ASLSP'18s bonds by 3 years. As such, the ASLSP'17s will instead mature on 28/03/20 instead while the ASLSP'18s will mature on 01/10/21.

Our Thoughts: This is the minimum extension required as conditions precedent for the club loan. It is also similar to the extensions seen at Ausgroup Ltd (2 years) and Marco Polo Marine Ltd (3 years). To be clear, **the consent solicitation would likely constitute as an Event of Default under Clause 10(e) of the bond information memorandum (dated 31/03/14).** Specifically, the clause states that an Event of Default is considered to have occurred should "*the Issuer… takes any other step with a view to the deferral, rescheduling or other readjustment of all or a material part of (or of a particular type of) its indebtedness*". As such, part of the

[2] OCBC Asian Credit Daily - 29 November 2016
[3] OCBC Asian Credit Daily - 30 November 2016

consent solicitation actually includes a waiver to any Event of Default that might occur as a result of the consent solicitation (Clause 1(i) of the consent solicitation).

ii) **Loosening Financial Covenants**: i) Ratio of consolidated total borrowings to consolidated tangible net worth ("net gearing") to be increased from a maximum of 1.75 to 2.0 and ii) Interest Coverage Ratio to be reduced to a minimum of 2.0x compared to 4.0x (with the definition of EBITDA amended to exclude the impact of impairments / provisions / non-cash flow items).

Our Thoughts: This is largely in line with the other consent solicitations by ASL's peers in the offshore marine space. Several other issuers have already sought for covenant relief by either easing their financial covenants, building in cure mechanisms in the event of covenant breaches, or outright removing the covenants. The above clause is already an improvement over the tentative terms (with ASL originally seeking to remove the Interest Coverage Covenant outright). We believe this step to be reasonable and pre-emptive, especially with the environment remaining challenging. It is worth noting that there is no cure mechanism should ASL trip its covenants in the future (as such, ASL would still have to revert to bondholders in the event that they again run out of covenant headroom).

What Bondholders are Offered:

i) **Step-up in coupon**: The ASLSP'17 bond will see its coupon revised higher to 5.50% (from 4.75%) from 28/03/17 onwards while the ASLSP'18 bond will see its coupon revised higher to 5.85% (from 5.35%) from 01/04/17 onwards. In addition, both bonds will see a step-up of 50bps per annum (with ASLSP'17s receiving 6.5% and ASLSP'18s receiving 7.85% by their amended maturity date).

Our Thoughts: Though the ASLSP'17 bond will see a slight increase in coupon offered versus the tentative terms, in general we consider the increase in coupon for both bonds to be token relative to ASL's true cost of debt. Most of ASL's offshore marine peers (aside from giants Keppel Corp and Sembcorp Marine) are seeing their bonds trade at mid-to-high teens in yield. That said, the other debt extensions we have seen amongst ASL's peers have also seen low step-up in coupon. In the case of KrisEnergy, we even saw a reduction of both the total coupon as well as of the cash component of the coupon.

ii) **Inclusion of call option, gradual redemption**: The ASLSP'17 and ASLSP'18 bonds will see the inclusion of call options (exercisable at par a year before their respective maturity dates), as well as a 2.5% redemption of bond principal every six months (from 28/03/17 and 01/04/17 for ASLSP'17 and ASLSP'18 respectively). Management indicated that the call option was to allow for the early redemption of the bonds (given the escalating coupon).

Our Thoughts: We believe this concession to be moot. Bondholders were expecting to be paid upon maturity. Extending the maturity, and providing some principal back ahead of the amended maturity is not a concession. The call option (at the option of the issuer) is actually a benefit to the issuer (bond investors usually are compensated with a higher yield if a call option is included) as it limits the bondholders' upside. Should ASL's credit profile improve drastically by the call date, ASL's cost of debt would fall, allowing ASL to call the bond and refinance at a lower rate (depriving ASL bondholders of the higher coupon, or trading the bond away at above par). Comparatively, if ASL's credit risk remains elevated, its cost of debt would remain high, and ASL would be unable to refinance at a lower rate (hence will not call the bond).

iii) Grant of security: A subordinated floating charge over a group of vessels (which will be mortgaged to secure the club loan) will be provided to bondholders. Bondholders will also have an assignment and charge over any excess proceeds of enforcement from the loan security. In essence, the bonds would have rights to the balance of the vessel proceeds after paying down the club loan. In addition, there is a Minimum Valuation that the vessels pledged have to be worth, which is at least SGD100mn (or SGD30mn after 28/03/20 when the first SGD100mn in bonds mature).

Our Thoughts: We consider this term to be crucial for bondholders. Security was not part of the original terms proposed by ASL, but was likely included after obtaining feedback from investors. Without security, bondholders were stuck between allowing new senior secured lenders to encumber what assets ASL had left that was unencumbered (in exchange for an liquidity injection) and potentially impacting recovery values should the environment continue to deteriorate, and taking chances accelerating ASL's debt immediately. Comparatively, bondholders now are at least elevated above senior unsecured claims. No doubt the collateral is currently enough just to cover the club loan. However, it should be noted that **the club loan is amortizing**. The amortization schedule was not disclosed. However, with each reduction in the club loan facility, the excess collateral would benefit bondholders. For example, assuming that the 5-year SGD99.9mn club loan commences on 28/03/17 and amortizes linearly. The loan would have ~SGD60mn remaining after two years. The Minimum Valuation of the security according to the proposed consent solicitation terms would still remain at SGD100mn.

Summary of Terms

	Proposal	Proposed Amended Terms: Series 006 Notes	Proposed Amended Terms: Series 007 Notes
1)	Extension of Existing Notes by 3 years	Matures on 28 Mar **2020**	Matures on 1 Oct **2021**
2)	Step–up of cash coupon of Existing Notes	5.50% Coupon commencing on 28 Mar 2017 and step-up by 0.50% p.a.	5.85% Coupon commencing on 1 Apr 2017 and step-up by 0.50% p.a.
3)	Inclusion of a Call Option (in whole or in part) exercisable 12 months prior to the extended maturity date of each series of Notes and each date falling three months thereafter	Matures on 28 Mar 2020 Call Option **exercisable from 28 Mar 2019 and each date falling three months thereafter**	Matures on 1 Oct 2021 Call Option **exercisable from 1 Oct 2020 and each date falling three months thereafter**
4)	Redemption of 2.5% of the Existing Notes principal every 6 months	Redemption of 2.5% of the Existing Notes original principal every 6 months beginning on 28 Sep 2017	Redemption of 2.5% of the Existing Notes original principal every 6 months beginning on 1 Oct 2017
5)	Amendment of Interest Coverage Ratio ("ICR")	▪ The ICR shall at all times be **at least 2.0 times** on a rolling 12 month basis ▪ Amend definition of EBITDA to include adding back of "***provision for doubtful debts, impairments, write-offs and any other non-cashflow items***"	
6)	Amendment of the "ratio of consolidated total borrowings to consolidated tangible net worth" covenant	The ratio of Consolidated Total Borrowings to Consolidated Tangible Net Worth shall not at any time be more than **2.0:1**	
7)	Grant of Security*	▪ A subordinated floating charge over a group of vessels which are mortgaged to secure the club term loan facility ▪ An assignment and charge over any excess proceeds of enforcement from Loan Security	

Source: Company Consent Solicitation Presentation (29/12/16)

C) Other Considerations and Conclusion

Rights issue completed, club loan buys time: On 19/12/16, it was announced that ASL managed to successfully complete its right issue and raised ~SGD25mn in fresh equity (which included ~SGD17mn from the founding Ang family's participation). Though the amount raised was trivial relative to ASL's last reported total borrowings of SGD565.9mn, we do acknowledge the Ang family showing alignment by injecting some fresh equity into ASL. It is a show of faith in ASL, as should ASL fall into judicial management the newly injected equity would likely be wiped out. In addition, the club loan infusion would provide ASL with some working capital to operate in the tough environment. This would also buy some time for ASL to sell the PSVs and AHTS they have in their books.

Outcome of alternatives uncertain: In the event that the consent solicitation fails to go through, ASL could potentially raise the capital to redeem its ASLSP'17 bonds via aggressive asset disposals (the carrying value of ASL's vessels is SGD391mn as of end-FY2016). However, given the still soft environment for upstream oil & gas activity, coupled with the glut of OSVs in the market right now, vessel sales could be done at distressed levels (potentially sharply below book value). Management had indicated that competition is also pressuring charter rates / values of its other vessel types. In addition, more than 60% of ASL's borrowings are secured. The force selling of encumbered assets by lenders could also impact recoveries for unsecured creditors. Should ASL fall into Judicial Management, the restructuring could be protracted. Swiber Holdings has been in Interim Judicial Management (subsequently Judicial Management) since early August 2016, but the submission of the restructuring proposal by the Judicial Manager has been extended to 23/03/17. The expenses charged by the Judicial Manager, coupled with business disruptions by an on-going restructuring could also impact bondholders' recoveries.

Conclusion: Though we consider the coupon step-up as well as partial redemptions to be inadequate, we take some comfort in the provision of security, as well as from the flexibility that the fresh funds (from the rights issue and club loan) would provide. The environment is such that the offshore marine sector remains challenged, with issuers having limited access to equity markets, and no access to bond markets. As it stands, we would consider the consent solicitation terms to be comparable to the more equitable restructurings that we have seen (such as those done by Ausgroup Ltd and Marco Polo Marine Ltd), particularly after the sweeteners were added to the tentative terms. We would have preferred to see additional upside provided to bondholders (such as via warrants) to compensate for the inadequate increase in coupon. That said the Ang family did blink first by injecting more equity before the consent solicitation to signal alignment. In aggregate, we recommend that bondholders accept the proposal by management via the current consent solicitation, and submit the vote by 12/01/17 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 12/01/17 to receive the early consent fee of 50bps, or to vote by 11am / 11:30am (respectively for the ASLSP'17s and ASLSP'18s) on 18/01/17 to receive the normal consent fee of 25bps. The actual meeting for the bondholder vote will be held on 20/01/17. We will keep our Negative Issuer Profile on ASL and hold the two bonds at Neutral until we get a better sense of the price action post restructuring.

ASL Marine Holdings Ltd

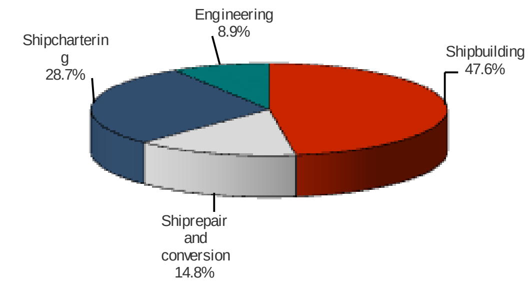
Table 1: Summary Financials

Year End 30th Jun	FY2015	FY2016	1Q2017
Income Statement (SGD'mn)			
Revenue	184.2	364.4	96.7
EBITDA	58.4	83.7	22.8
EBIT	12.5	27.1	7.4
^ Gross interest expense	17.3	21.9	4.5
Profit Before Tax	8.6	0.5	1.7
Net profit	7.9	2.0	1.6
Balance Sheet (SGD'mn)			
Cash and bank deposits	77.9	24.7	36.9
Total assets	1,208.5	1,275.7	1,292.5
Gross debt	542.4	592.2	565.9
Net debt	464.4	567.5	529.0
Shareholders' equity	425.3	424.4	425.5
Total capitalization	967.7	1,016.6	991.4
Net capitalization	889.7	991.9	954.5
Cash Flow (SGD'mn)			
Funds from operations (FFO)	53.9	58.5	16.9
* CFO	105.1	-17.3	40.0
Capex	118.8	97.2	15.6
Acquisitions	0.0	0.0	0.0
Disposals	52.0	9.3	0.0
Dividend	4.2	1.7	0.0
Free Cash Flow (FCF)	-13.7	-114.4	24.4
* FCF adjusted	34.2	-106.8	24.4
Key Ratios			
EBITDA margin (%)	31.7	23.0	23.5
Net margin (%)	4.3	0.5	1.7
Gross debt to EBITDA (x)	9.3	7.1	6.2
Net debt to EBITDA (x)	7.9	6.8	5.8
Gross Debt to Equity (x)	1.28	1.40	1.33
Net Debt to Equity (x)	1.09	1.34	1.24
Gross debt/total capitalisation (%)	56.0	58.3	57.1
Net debt/net capitalisation (%)	52.2	57.2	55.4
Cash/current borrowings (x)	0.4	0.1	0.1
^ EBITDA/Total Interest (x)	3.4	3.8	5.0

Source: Company, OCBC estimates | ^1Q2017's figures exclude capitalised interest expense

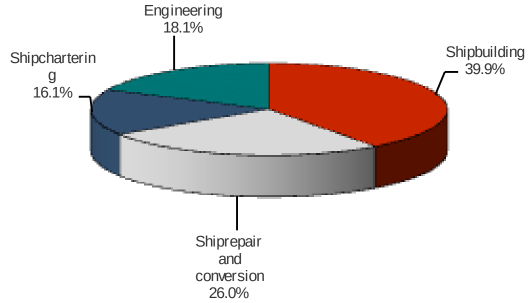
**FCF Adjusted = FCF - Acquisitions - Dividends + Disposals | *CFO after deducting interest expense*

Figure 1: Revenue breakdown by Segment - 1Q2017



Source: Company

Figure 2: Gross breakdown by Profit Segment - 1Q201



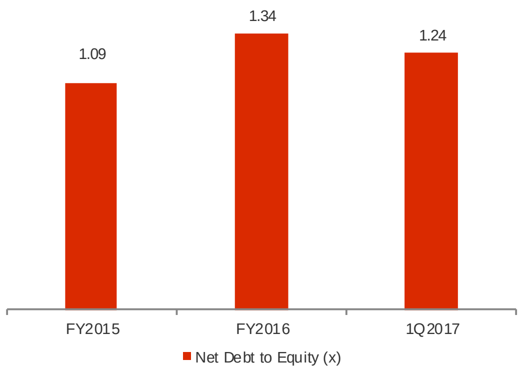
Source: Company

Figure 3: Debt Maturity Profile

Amounts in (SGD'mn)	As at 30/09/2016	% of debt
Amount repayable in one year or less, or on demand		
Secured	205.3	36.3%
Unsecured	142.3	25.1%
	347.6	**61.4%**
Amount repayable after a year		
Secured	168.2	29.7%
Unsecured	50.0	8.8%
	218.2	**38.6%**
Total	**565.9**	**100.0%**

Source: Company

Figure 4: Net Debt to Equity (x)



Source: Company, OCBC estimates

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