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Ocean Yield (OCY NO, OYIEF)- 4Q18 Update

There are several positive items this week for Ocean Yield – key among them is a likely new contract for the FPSO. We are maintaining our neutral rating until that contract converts from an option to an actual deal, which could happen in May. We maintain our belief that the company can pay its dividend during 2019 but would need to resolve the FPSO situation – new contract or sale – to justify the current level longer-term.

- New Option for 15-year contract on FPSO with Aker, to work on a new field in Ghana after modification. This will also be a bare-boat charter, which means Ocean Yield will not be paying the crew and other operating expenses.

- The *Connector* has been idle since December 5 is expected to sign a new short-term contract this month. This is a seasonally slow period and Ocean Yield sees increasing demand for the vessel and will seek a longer-term contract at a higher rate soon.

- Payments on vessels with Solstad should resume in June 2019 – *Far Senator* started a new contract in January.

- Cash needs for the next 12-months are forecast to be lower than our original forecast

- Impairments for several issues all appear to be one-time in nature largely related to FPSO and decommissioning it from India

Potential New Deal for FPSO – under Option

Aker is the largest shareholder in Ocean Yield at 61.7%. Aker is an energy company and is developing a new field in Ghana. After several successful test wells, it intends to submit a long- term development plan for the fields to the government by the end of March. Part of their plan is expected to employ Ocean Yield's FPSO under a 15-year bareboat charter.

Aker has an option on the vessel until May 1 – that can be extended 30 days. In return, it will pay Ocean Yield $3 million for the option. If it is extended past May 1, the option payment is $50,000 per day or up to $1.5 million. Also, as a bareboat charter, Aker will be responsible for operating costs of the vessel – employees, fuel, maintenance. Aker will hire the employees on the FPSO through the May 1 option period. The total vessel operating expenses have been about $3 million per quarter for the FPSO. Those will transfer off Ocean Yield's income statement.

The FPSO will also need modification work done. That would begin if the contract is picked up. The cost could be as much as $230 million and Ocean yield expects to borrow that money for the investment using the contract and the value of the vessel. The contract would reflect the rising book value of the vessel $240 million + $230 million in modifications and maintain the same type of return in the 13%-15% ROE range. The vessel is currently debt free and could emerge as essentially 50% leveraged.

Actual work and oil production are expected in 2021 and that should add to the company's cash flow as that occurs. In prior years, the FPSO was producing about $115 million in EBITDA but had some sizeable debt payments, which netted cash flow of about $40 million per year for Ocean Yield. A rough estimate based on the discussion on the conference call would be the value of the FPSO would be $470 million earning 13%-15% or $60-$70 million in revenue. There would be no crew or operating costs so EBITDA should be $60-$70 million per year. Interest expense and debt payments would be in the $25-$30 million range and net cash flow could be about $30-$40 million per year.

That is a forecast based on one press release and a few comments in the conference call at this point. It would appear that if this option is exercised, the largest question mark surrounding Ocean Yield would be lifted.

The Connector's Outlook Is Brightening Too

4Q and 1Q are seasonally slower times for cabling and offshore work. Since its contract was prematurely canceled in 2017, the Connector has worked a series of short-term charters and also been idle for periods of time in 2017 and 2018. The last charter ended in early

December. On the call, the company said it expects to announce a new short-term contract within a few days.

The goal is to wait for more of the offshore market to improve. That is happening. Solstad, Seadrill, Diamond Offshore are all announcing new contracts for rigs and support ships. The Aker deal in Ghana would be evidence of that too along with Brazil starting to drill again. Ocean Yield wants to sign a long-term charter for the Connector believes that time will come.

This is a vessel that was earning over $60,000 per day in the past or essentially $20 million per year. With a series of contracts for 1-5 months at lower rates followed by idle time – that has been essentially producing about one-third of its past cash flow.

It sounds like 2019 will start slowly for the Connector but it may finish the year with a brighter cash flow outlook. We are not going to speculate on timing, but the company did sound more upbeat about the future. The Solstad Charters also have been impacted by this market and as previously announced, Ocean Yield agreed to waive 6-months of charter rates on two vessels here. Solstad put one of those vessels on a charter in February. While this 6-month hiatus will cost Ocean Yield about $4.4 million in EBITDA in early 2019, the worst of the news in this area for the Connector and Solstad charters may be past the company.

The Cash Needs for 2019 Are Coming in Below Our Forecast

The company has funded the bulk of its capital spending needs at this point and we believe the cash needs for 2019 will come in below $350 million vs. our previous forecast of about $400 million:

The Dividend is $30.4 million per quarter	$121.6
Debt due is $190.9, but over $100 will refinance	$83.5
Interest expense incurred now will rise in 2019	$96.0
Remaining capital spending for new vessels	$19.0
Demobilization costs for FPSO (reserved)	$26.1
Total	$346.2

The company's largest portion of debt maturing is $107.4 million on the SBM Installer that is under fixed contract until 2025 with a floating rate after that. The company intends to refinance the debt on the vessel. Its remaining capital spending on new vessels has been financed too, leaving only $19 million in cash outflow. Demobilizing the FPSO out of India will be complete soon and the company has a reserve of $26.1 million remaining there – we assumed it would consume the entire amount.

Against this total, the receivables owed by Reliance to wind down the FPSO contract have been negotiated and Ocean Yield will receive $25.9 million. It has the $3 million payment from Aker coming. It also has $142 million in cash and liquidity available. That totals $170.9 million.

EBITDA in the 4Q has the FPSO charter out and came in at $70.8 million. There was $1.6 million in operating expense for the FPSO that will transfer to Aker. The quarter also had the Connector operating for two months – that will remain lumpy in 2019. The $70.8 + $1.6 gives them an annualized EBITDA of $290 million. From that, subtract the $4.4 million for 6-month deferral to Solstad and estimate a worse case for the Connector and take out another $5.6 million. That leaves the company with $280 million in EBITDA plus $170 million in liquidity or $450 million.

The recent delivery of a Suezmax tanker and the VLCCs coming this year in Q2 and Q3 will add to EBITDA as will the Chemical tankers that arrived in 4Q18 and only had a partial impact on last quarter's EBITDA. This further assumes no additional cash for the FPSO if the contract option is exercised. It also assumes another poor year for the Connector – where it produces one-third of past levels.

We're staying neutral because the company can limp along in this manner and see improvement throughout 2019 and into 2020 while maintaining the dividend. However, the FPSO deal is key to longer-term success in sustaining the dividend. If the option is not exercised, we would still question the current dividend's sustainability until the company finds a way to produce a higher cash flow figure or monetizes that vessel for cash.

Several Impairments are One-time and Appear to be Clean Up Issues

We are the first to attack charges as admitted mistakes. However, there is a difference in our view between announcing a write-down of an acquisition made 9 months ago and adjusting reserve accounts that relate to a decade old project. The company took several charges in the 4Q and the bulk of them relate to end of the FPSO's Indian project:

FPSO Goodwill Charge	$9.8
Write off of Contract A/R	$19.5
Boost in Demobilization Reserve	$9.1
Solstad related charge	$13.4

The deal in India lasted over ten years and involves oil and gas drilling and clean-up plus truing up long-term reserves. With no contract, the company wrote off the remaining goodwill on the FPSO. The vessel is still worth $240 million and is likely to be modified in a substantial way. With no cash flow coming in at the moment, the $9.8 million charge is reasonable and conservative in our view.

Reliance in India owed a collection of items relating to completing the contract. The two sides negotiated a $25.9 million cash settlement that will be paid shortly. The maximum amount that accrued on Ocean Yield's books over several years was over $45 million so in closing out that deal and speeding the collection, Ocean Yield wrote off the remaining $19.5 million of receivables related to contingencies.

Moving the FPSO involves some work on the site, unhooking all the cables and transferring the ship. The company has a reserve now of $26.1 million to deal with these costs after adding $9.1 million to the estimate. It also appears to make the $25.9 million cash payment coming from Reliance at worst case a wash. If the demobilization comes in under budget, it will produce net cash to the company.

So, the bulk of the impairments relate entirely to ending the FPSO contract and closing out the contingencies of that project.

The impairment on the two Solstad charters reflects the 6-month holiday on charter revenues. The reduced cash flow resulted in an impairment to the ship values. That's non-cash and we do not believe this has a material impact.

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