Update: Foresea Holding S.A.

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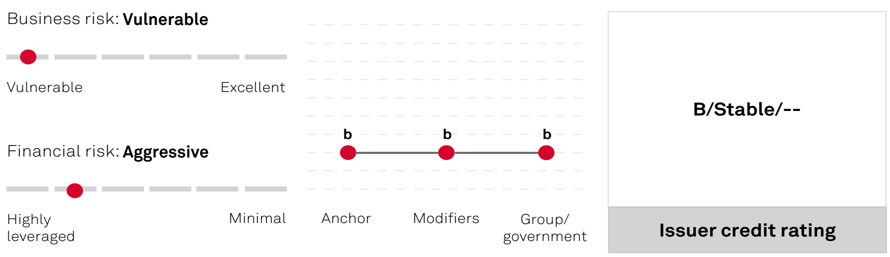
Ratings Score Snapshot



Credit Highlights

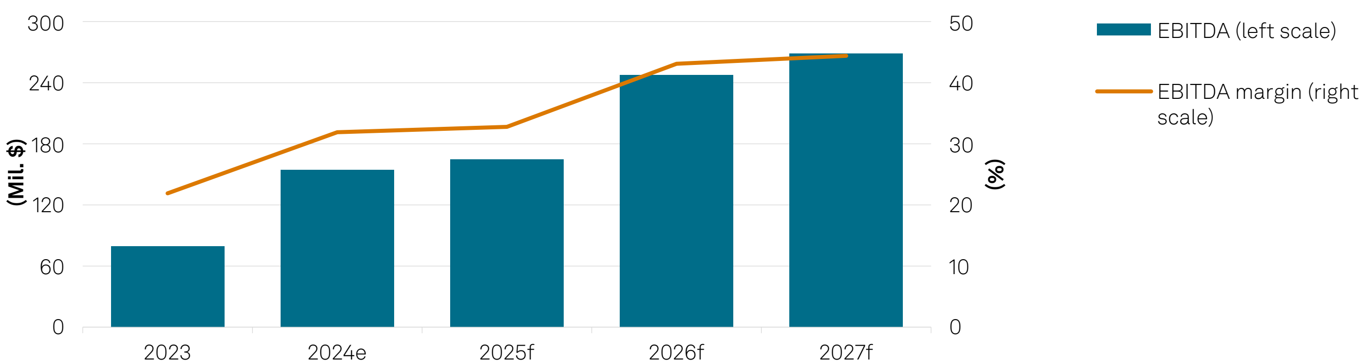
Overview

Key strengths	Key risks
Solid operating margins, with high uptime rates.	Limited geographic diversification.
Relatively low leverage, with gross debt to EBITDA below 2.0x.	High client concentration.
	Competition risks on contract renewals and new bids with Petrobras.
	Inherent industry volatility.

Foresea Holding S.A.'s operating fleet is 100% contracted and has maintained high uptime rates. As of June 2024, Foresea's fleet of five floaters was fully contracted, and most of the contracts can be extended, while the company continues to participate in new bids from Petroleo Brasileiro S.A. - Petrobras. Foresea has a track record of operating with high uptime rates: It registered an uptime rate of 96% in the first half of 2024, and we forecast an average of 94% in the next two years.

With that and the expectation of higher average prices in new contracts (in line with industry tailwinds), we project that the company will have an EBITDA margin of 30%-34% in 2024 and 31%-35% in 2025, and an EBITDA margin above 40% from 2026 on.

Foresea Holding S.A.--EBITDA and EBITDA margin



e--Estimate. f--Forecast. Source: S&P Global Ratings.

A solid, stable $1.4 billion backlog provides revenue visibility for the next few years. Foresea last year signed a three-year contract with Petrobras, adding approximately $450 million to the backlog and keeping the Norbe VIII drillship contracted until late 2027. We believe the company is relatively well positioned to keep signing new contracts with Petrobras considering the companies' mutual long-standing relationship and Petrobras’ large capital expenditures plan for the coming years, which includes drilling campaigns.

Because of its light capital structure and comfortable liquidity position, Foresea will meet its volatile capex requirements. Foresea has only one debt issuance in its capital structure: $300 million secured notes due 2030 at 7.5%, with a bullet principal payment and quarterly payable cash interest. In addition, the company has been generating increasing cash flows that are sufficient for meeting capex needs without incurring additional debt. We forecast that Foresea’s capex will peak at about $100 million in 2024 before dropping to $60 million-$65 million in 2025 for equipment maintenance and upgrades between contracts.

We expect gross debt to EBITDA of 1.5x-2.0x in 2024-2025.

Outlook

The stable outlook reflects our view that Foresea will increase its cash flow with continued high uptime rates and a fully contracted fleet in the next few years. The company has a comfortable capital structure for supporting investments and meeting new contracts. We expect it to post a debt-to-EBITDA ratio of about 2.0x in 2024 and a ratio closer to 1.5x in 2025.

Downside scenario

We could lower our ratings on Foresea if the company faces longer-than-expected maintenance stoppages (which would reduce uptime), or if it employs an aggressive growth strategy financed with debt and not accompanied by new contracts. In this scenario, we would see credit metrics deteriorate, with an EBITDA margin below 25%, debt to EBITDA above 3x, and funds from operations (FFO) to debt below 30%, on average, over two years--all while free operating cash flow remains negative.

We could also lower the ratings if the company demonstrates aggressive financial policies in terms of leverage and liquidity.

Upside scenario

In our view, the potential for an upgrade is limited in the next 12-18 months considering the company’s smaller size relative to its peers.

We could raise the ratings in the future if the company increases scale with a larger number of assets and more diversification, more in line with the company's 'B+' rated peers. In this scenario, we would also expect to see controlled leverage, with debt to EBITDA below 2x and FFO to debt above 45% consistently.

Our Base-Case Scenario

Assumptions

- Average inflation in Brazil of 4.3% in 2024, 3.8% in 2025, and 3.5% in 2026.
- An average foreign exchange rate of Brazilian real (R$) 5.30 per US$1 in 2024, R$5.47 per US$1 in 2025, and R$5.52 per US$1 in 2026.
- A 100% contracted fleet in 2024 and early 2025.
- Renewal of Foresea's contracts as they come due, thanks to solid demand in the industry and the company's strong relationship with Petrobras.
- A contract with Prio S.A. to manage the semisubmersible rig Hunter Queen, consisting of cost plus a daily fee for a 365-day period (with the possibility to renew for another year).
- Day rates of $200,000-$300,000 for the semisubmersible drilling rig Norbe VI and the drillships Norbe VIII and Norbe IX in 2024 (with the Norbe VIII day rate increasing to $350,000-$400,000 in 2025), and day rates of $300,000-$350,000 for the drillships ODN I and ODN II, aligned with signed contracts.
- A varying number of operating days per year depending on maintenance stoppages between contracts.
- An uptime rate of approximately 94%, assuming a somewhat conservative forecast (versus the historical rate of 97%).
- An improved EBITDA margin in 2024-2025 from 2023 due to fewer maintenance stoppages, as the fleet is fully located.
- Capex mostly directed to special periodic surveys and upgrades for new contracts in 2024 and 2025.
- Dividend payments in coming years from rising cash flows.

Key metrics

Foresea Holding S.A.--Forecast summary

(Mil. $)	2023a	2024e	2025f
Revenue	363	450-500	480-530

Foresea Holding S.A.--Forecast summary

(Mil. $)	2023a	2024e	2025f
EBITDA, adjusted	80	140-170	160-190
Funds from operations	16	120-140	130-160
Capital expenditures	100	~100	60-65
Adjusted ratios			
Gross debt/EBITDA (x)	3.5	1.5-2.0	1.4-1.8
Funds from operations/debt (%)	5.7	40-50	45-55
Free operating cash flow/debt (%)	(24)	(20)-(5)	(10)-0
EBITDA margin (%)	22	30-34	31-35

All figures are adjusted by S&P Global Ratings unless stated as reported. a--Actual. e--Estimate. f--Forecast.

Company Description

Foresea is one of the largest pure-play operators of ultradeep water rigs in Brazil, with a 14% market share as of June 2024. The company operates a relatively young (about 13 years old) fleet of six floaters--four drillships and two semisubmersibles--in Brazil's main offshore basins. The fleet can work on a wide variety of well interventions: exploration, completion, well testing, workover, and abandonment.

The company has over 44 years of experience in the sector. It rebranded as Foresea as a result of the spin-off of its prior holding company, Ocyan S.A. The main shareholders, with a 92% stake, are the company's previous bondholders, and Ocyan has maintained a 6.5% stake. Management holds the remaining 1.5%.

Liquidity

We view Foresea's liquidity as adequate. We expect cash sources to exceed cash uses by close to 2.0x for the next 12 months, and we expect sources minus uses to remain positive even if EBITDA were to decline by 50% from our forecast. The company's light capital structure and extended debt maturity profile, in our view, will give it the flexibility to deploy capex as expected.

Principal liquidity sources

- Cash position of $153.4 million as of June 30, 2024.
- Forecast cash FFO of about $110 million for the 12 months starting June 30, 2024.

Principal liquidity uses

- Working capital needs of about $55 million in the next 12 months.
- Capex of about $80 million in the next 12 months.

Covenant Analysis

Requirements

Foresea’s senior notes have financial covenants of incurrence. The covenants require gross debt to EBITDA below 3.5x and a minimum cash position of $50 million.

Compliance expectations

We expect sufficient cushion (close to 50%) on the debt-to-EBITDA ratio in coming years due to the company’s relatively low leverage.

Environmental, Social, And Governance

Environmental factors are a negative consideration in our credit rating analysis of Foresea, in line with our view on its peers. We expect that, over time, the accelerated adoption of renewable energy sources will reduce demand for fossil fuels. In addition, the industry faces an increasingly challenging regulatory environment that includes limitations on drilling activities in some jurisdictions.

Given its exposure to the offshore market, Foresea also faces greater environmental risks than onshore operators. More challenging operating conditions, such as strong waves and winds, make Foresea more susceptible to operational disruptions and damage to equipment.

Social factors are a negative consideration in our analysis of Foresea, in line with how they're considered in our analysis of most offshore drilling operators, because we consider deepwater operations to be more prone to fatal accidents (due to the inherent risks). Even so, the company has recorded few accidents in recent years.

Governance factors are a moderately negative consideration, given Foresea's recent out-of-court restructuring plan due to high debt amid the industry downturn.

Issue Ratings--Recovery Analysis

Key analytical factors

The rating on Foresea's $300 million senior secured notes due 2030 is 'B+', with a recovery rating of '2' (rounded estimate: 85%). The issue rating is one notch above the issuer credit rating given the collateral package and our expectation of substantial recovery (considering our cap on recovery ratings for entities under Brazilian jurisdiction).

The collateral package includes a first-priority lien on substantially all of the material assets of the issuer, guarantors, and certain other subsidiaries of the issuer.

Our hypothetical default scenario contemplates a prolonged deterioration of cash flow stemming from a significant decline in capital spending for offshore oil and gas exploration and development, as well as decreasing demand for offshore-drilling service providers.

We evaluate Foresea on a discrete asset-value basis, which is consistent with our treatment of other contract drilling companies.

We assume a 5% annual depreciation rate and a 50% realization rate on the company's drilling equipment.

Simulated default assumptions

- Simulated default year: 2027
- Jurisdiction: Brazil

Simplified waterfall

- Net enterprise value (after 5% administrative adjustment): $535 million
- Secured debt: $300 million (senior secured notes)
- Recovery rating for senior secured notes: '2' (rounded estimate: 85%)

Rating Component Scores

Foreign currency issuer credit rating	**B/Stable/--**
Local currency issuer credit rating	**B/Stable/--**
Business risk	**Vulnerable**
Country risk	Moderately High
Industry risk	Moderately High
Competitive position	Vulnerable
Financial risk	**Aggressive**
Cash flow/leverage	Aggressive
Anchor	**b**
Diversification/portfolio effect	Neutral (no impact)
Capital structure	Neutral (no impact)
Financial policy	Neutral (no impact)
Liquidity	Adequate (no impact)
Management and governance	Moderately Negative (no impact)
Comparable rating analysis	Neutral (no impact)
Stand-alone credit profile	**b**

Related Criteria

- Criteria | Corporates | General: Corporate Methodology, Jan. 7, 2024
- Criteria | Corporates | General: Methodology: Management And Governance Credit Factors For Corporate Entities, Jan. 7, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- Criteria | Corporates | General: Recovery Rating Criteria For Speculative-Grade Corporate Issuers, Dec. 7, 2016
- Criteria | Corporates | Recovery: Methodology: Jurisdiction Ranking Assessments, Jan. 20, 2016

- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (as of September 26, 2024)*	
Foresea Holding S.A.	
Issuer Credit Rating	B/Stable/--
Senior Secured	B+
Issuer Credit Ratings History	
15-Sep-2023	B/Stable/--

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings credit ratings on the global scale are comparable across countries. S&P Global Ratings credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.