INSOL INTERNATIONAL

GLOBAL INSOLVENCY PRACTICE COURSE (ONLINE)

2021 / 2022

Module A: Session 8 Materials – A Case Study

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GLOBAL INSOLVENCY PRACTICE COURSE

Deep Blue Inc Case Study

This session has been designed to debate some of the key issues that might arise in an international cross border restructuring including offshore jurisdictions.

During the session you will be asked to prepare for a meeting with the Board of Deep Blue Inc to discuss the current restructuring proposal that is being developed, the key implementation risks and how these can be mitigated.

Attached is a file note and supporting documentation created by your Managing Director who has recently met with the CEO of Deep Blue Inc. You should treat this as key background information and it is assumed that you will be familiar with this background material at the session.

Note: The material included in this case is fictitious and developed for training purposes only.

Client:	Deep Blue Inc
Subject:	Proposed restructuring of Deep Blue Inc
Author:	A Managing Director
Meeting Date:	4 November 2021
Location:	London
Attendees:	A Managing Director A Director CEO – Charles Aristotle A Partner – MCG Legal A Senior Associate – MCG Legal

Introduction

The purpose of this meeting note is to summarise the information received and issues raised from our meeting with Deep Blue Inc. (the "**Company**" or the "**Parent**") and their corporate legal advisers, MCG Legal.

We are being retained by the Company to provide advice on the restructuring strategy currently being developed by the Company, in order to ensure that the most appropriate strategy is adopted, and all material implementation risks have been identified, considered and mitigated (to the extent possible).

Our understanding is that the Company, Deep Blue North Sea Inc. ("DBNS"), Deep Blue Financing Inc ("**DBF**") and Deep Blue Holdings Inc ("**DBH**") have commenced negotiations with certain key stakeholders.

We are being retained to provide advice on the restructuring strategy.

We understand that the Company is considering the following restructuring options:

- Cayman Islands' JPLs/Schemes of Arrangement;
- US processes including Chapter 15 and 11; and
- Schemes of arrangements, UK Restructuring Plans and English Administrations.

We may be asked to comment and provide our opinion on each of these options at the meeting.

This meeting note covers the following key areas and is aimed at providing background to the current position of the Company and its subsidiaries (together the "**Group**"):

- Overview;
- Debt and security structure;
- Operational overview;
- Current financial position;

- Stakeholder discussions;
- Valuation considerations;
- Intercompany Compromise Agreement ("**ICA**"); and
- Points for discussion at the next meeting.

The following appendices provide further detail on the Group's position:

- Appendix A: a summary of the Group's structure chart;
- Appendix B: a summary of the Group's current capital structure; and
- Appendix C: a valuation summary.

Overview

The Group is an international offshore drilling contractor providing oilfield services for offshore oil and gas exploration, development and production drilling and specializing in the ultra-deepwater segment of the offshore drilling industry.

The Group's operating subsidiaries own a fleet of 15 offshore drilling rigs which, when operating, are contracted out to be used in drilling projects across the world, including in the Gulf of Mexico, Brazil, the UK, Norway and West Africa.

The operations of the Group are held and managed through three separate and independent 'silos' (the "Silos"). Each Silo has a borrower entity, rig-owning entities and various operating and non-operating subsidiaries. The Group's three Silos comprise:

- the DBNS Silo, being a silo sitting under Deep Blue North Sea Inc ("DBNS") and holding 14 subsidiaries (the "DBNS Subsidiaries");
- the DBF Silo, being a silo sitting under Deep Blue Financing Inc ("DBF") and holding 25 subsidiaries (the "DBF Subsidiaries"); and
- the DBH Silo, being a silo sitting under Deep Blue Holdings Inc ("DBH") and holding 13 subsidiaries (the "DBH Subsidiaries").

The Parent is the holding company for the entire group. See structure chart at Appendix A.

The Parent, together with DBNS, DBF and DBH, were all originally incorporated in the Republic of the Marshall Islands. The Parent transferred to the Cayman Islands by way of continuation as an exempted company in April 2021. DBNS, DBF and DBH were registered as foreign companies in the Cayman Islands in August 2021.

The Group employs its drilling units primarily on a day rate basis for periods of typically between two months and three years to drill wells for its customers, typically major oil companies, integrated oil and gas companies, state-owned national oil companies and independent oil and gas companies.

As a result of difficult market conditions and the Group's existing debt burden there is pressure on the long-term sustainability of the Group.

Oil and gas producers globally have reacted to a rapid decrease in oil prices by significantly reducing their capital expenditure budgets, with such spending reductions directed primarily to offshore production where costs to extract oil and gas are generally higher than land-based sources. As a result, oil and gas producers have both (i) delayed entry into new offshore drilling contracts and (ii) in many cases cancelled existing offshore drilling contracts – each of which has led to an oversupply of drilling rigs and corresponding low levels of utilisation and day rates across the sector.

Whilst, oil and natural gas prices have seen an improvement over recent weeks, the Group’s view is that there remains sufficient uncertainty in the oil and gas market to prevent key customers from investing in exploration/development activity. The Group expects oil and natural gas prices to remain unstable with no increase in day rates expected for the foreseeable future which will continue to pressure profitability margins on many offshore oil and gas projects.

Given these dynamics, to reduce costs and minimise negative cash flow, a number of drilling rig owners, including the Group, have warm and cold stacked their rigs. Warm stacked means that the rigs have been ‘laid up’ with a skeleton crew but can be made ready at relatively short notice. Cold stacked means that a rig has been ‘laid up’ and effectively shut down; it takes a lot longer for a cold stacked rig to be made ready. The daily costs of a warm stacked rig are higher than those of a cold stacked rig, but it costs a lot more to make a cold stacked rig ready for operation. Owners wishing to keep their rigs available for immediate use therefore face an extremely competitive environment in which to secure new contracts for their rigs, with day rates for employed rigs having been driven down to levels generally not much higher than their operating cash break-even point.

Debt and security structure

The Group’s operations are financed through a combination of New York law governed term loan and high yield debt at the Parent and silo level, as set out below:

- 5.25% USD 600 million senior unsecured notes issued by the Parent ("**2023 Notes**"), of which, USD 172 million remains outstanding and USD 428 was repurchased by other group entities and is held as treasury bonds;
- 7.5% USD 950 million senior secured notes due 31 March 2022 issued by DBNS ("**2022 Notes**"), of which USD 560 million remains outstanding and USD 390 was repurchased by other group entities and is held as treasury bonds. The DBNS Subsidiaries also granted guarantees and security in connection with DBNS's obligations under this facility;
- USD 2.1 billion senior secured term loan facility dated 12 July 2017 between DBF and certain term loan lenders ("**DBF Credit Facility**"), of which USD 2.03 billion remains outstanding. The DBF Subsidiaries also granted guarantees and security in connection with DBF's obligations under this facility; and
- USD 1.5 billion senior secured term loan facility dated 25 July 2018 between DBH and certain term loan lenders ("**DBH Credit Facility**"), of which USD 1.47 billion remains outstanding. The DBH Subsidiaries also granted guarantees and security in connection with DBH's obligations under this facility.

In addition, the Parent has guaranteed the obligations of DBNS, DBF and DBH of their financial indebtedness ("Parent Guarantee Claims"). The Parent Guarantee Claims were also backed by a share pledge over the Parent's shares in the relevant Silo.

Operational overview

As previously mentioned, the Company was incorporated as a non-resident corporation in the Republic of the Marshall Islands on 10 December 2005 and migrated to the Cayman Islands in April 2021. DBNS, DBF and DBH are each registered as a non-resident corporation in the Republic of the Marshall Islands and as a foreign company in the Cayman Islands. The Company is a public company and the direct parent company of each of DBNS, DBF and DBH. Each of these companies is a holding company whose primary assets are the interests in its subsidiaries. Through various indirect operating subsidiaries, these companies control the Group.

The company also maintains offices in Lagos (Nigeria), Jersey, Rio de Janeiro (Brazil), Mexico City and Stavanger, Norway.

The Parent's board meetings and other administrative functions are now performed in the Cayman Islands. The Parent has leased office premises in Georgetown, the capital of Grand Cayman.

The rest of the Group's administrative functions (human resources, IT, finance, marketing) are managed out of Athens through a management agreement with a management company called SMT Offshore Management Inc, which is a company ultimately owned by Charles Aristotle, the founder and Chairman of the Parent.

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The Company has been listed on NASDAQ since 2004.

Key shareholders (those holding over 5%) are:

- Charles Aristotle: 9%
- Lomond Capital funds and other holding entities / related individuals: 30%

Current financial position

In light of the depressed market, the Group has experienced a significant reduction in revenue over the past year (FY20/21) which has severely impaired the Group's financial condition. The combination of lower margins and reduced contract volumes within the Group, against the costs of servicing its debts and meeting its financial covenants, has significantly affected the Group's cash flow and the Group may soon become unable to pay its debts as they fall due.

Raising new debt financing is not an option for the Group given that it is already significantly overleveraged and given the poor conditions in the industry.

In this regard, the Group reported a US$1.5 billion loss for the third quarter ending September 2021 due to recording a significant impairment on the book value of its rigs. Likewise, raising new equity capital is not an option available to the Group. The Company's share price has fallen from a high of US$30 per share in August 2017 to US$2 per share as at 3 October 2021.

In the absence of a restructuring, the insolvency of the Group may be triggered on the maturity date of the 2022 Notes on 31 March 2022 when an amount of approximately US$560 million (plus accrued interest) is scheduled to become due to the 2022 Notes Creditors.

In this regard, the Group's projected cash flows for 2021/22 demonstrate that DBNS would have an available cash balance of only US$23.0 million which would be insufficient to repay the principal amount of the 2022 Notes of approximately US$560 million. The Parent would also have insufficient assets available to meet its guarantee obligations to discharge this amount.

Stakeholder discussions

Given the Group's financial difficulties and impending events of defaults under the existing debt, the Group engaged financial and legal advisers in mid-2021 to assess the viability of the capital structure and alternatives that may be available to pursue.

We understand that, during the summer of 2021, the Board of the Parent and a number of its creditors formed the conclusion that the debt obligations would need to be amended or exchanged for new debt and/or equity securities. These creditors were made up of the US investment firms, Black Mountain, B. Elliot, Lightstone, and Poseidon who all had holdings in the DBF and DBH term debt, together we refer to them as the **Ad Hoc Committee**. Their combined holdings made up 52% in DBF and 43% in DBH.

The Group’s negotiations with the Ad Hoc Committee continue and it is hoping to reach agreement on a Restructuring Support Agreement (RSA) over the coming weeks.

The restructuring planning has emerged through negotiations conducted by the Group and its advisors with the DBF and DBH term loan lender groups over a number of months. We understand that the DBNS bondholders’ group has also been made aware of the restructuring planning and that attempts have been made to bring them into the process. We are unclear as to the extent that this has taken place.

Valuation considerations / Business plan

The Group’s financial advisers, EC Financial Advisers, together with the management team, produced a draft business plan, in September 2021.

The plan has used, and made reference to, an independent market valuation report to ensure that the assumptions surrounding, for example the rig contracts and spot rates are reasonable.

In its preliminary valuation analysis dated 3 October 2021 (the **Valuation Report**), EC Financial Advisers has calculated an enterprise value (EV) of $1.88 billion for the Group. The “sum-of the-parts” valuations are made up as follows: Parent ($150 million); DBNS ($120 million); DBF ($775 million); DBH ($835 million).

This valuation was prepared to inform the future value of the Group based on the restructured Group’s cash flows, and therefore the debt/equity/cash allocations across the silos in the Group going forward.

This has been calculated using a combination of various valuation techniques such as DCF analysis, comparable companies, and precedent transactions.

EC Financial Advisers has also prepared an analysis outlining the outcome of the proposed restructure for each lender group both in the event the DBNS scheme is sanctioned, and in the event it is not.

This analysis has been presented to the term loan lenders (DBF and DBH lenders) by EC Financial Advisers and to our understanding, they will be agreeing to the proposed transaction structure with complete knowledge of this analysis.

ICA

An 'Intercompany Compromise Agreement' ('**ICA**') is being insisted upon by the Ad Hoc Group of lenders who have advised the Group that a condition of its support of the restructuring was a full compromise of the intragroup payables and receivables. Under the terms of the ICA, all intercompany claims would be released and all Group treasury holdings of the 2023 Notes and 2022 Notes would be cancelled.

Points for discussion at the next meeting

Before we meet to discuss the Board's requirements, please give consideration to the following:

1. Do the Board's restructuring options make sense? Are there better alternatives that should be considered?
2. What are the key issues, concerns and risks for the restructuring plan for:
    a. The Group;
    b. The stakeholders;
    c. Any prospective Insolvency Practitioner/Trustee.
3. How would these risks be mitigated?

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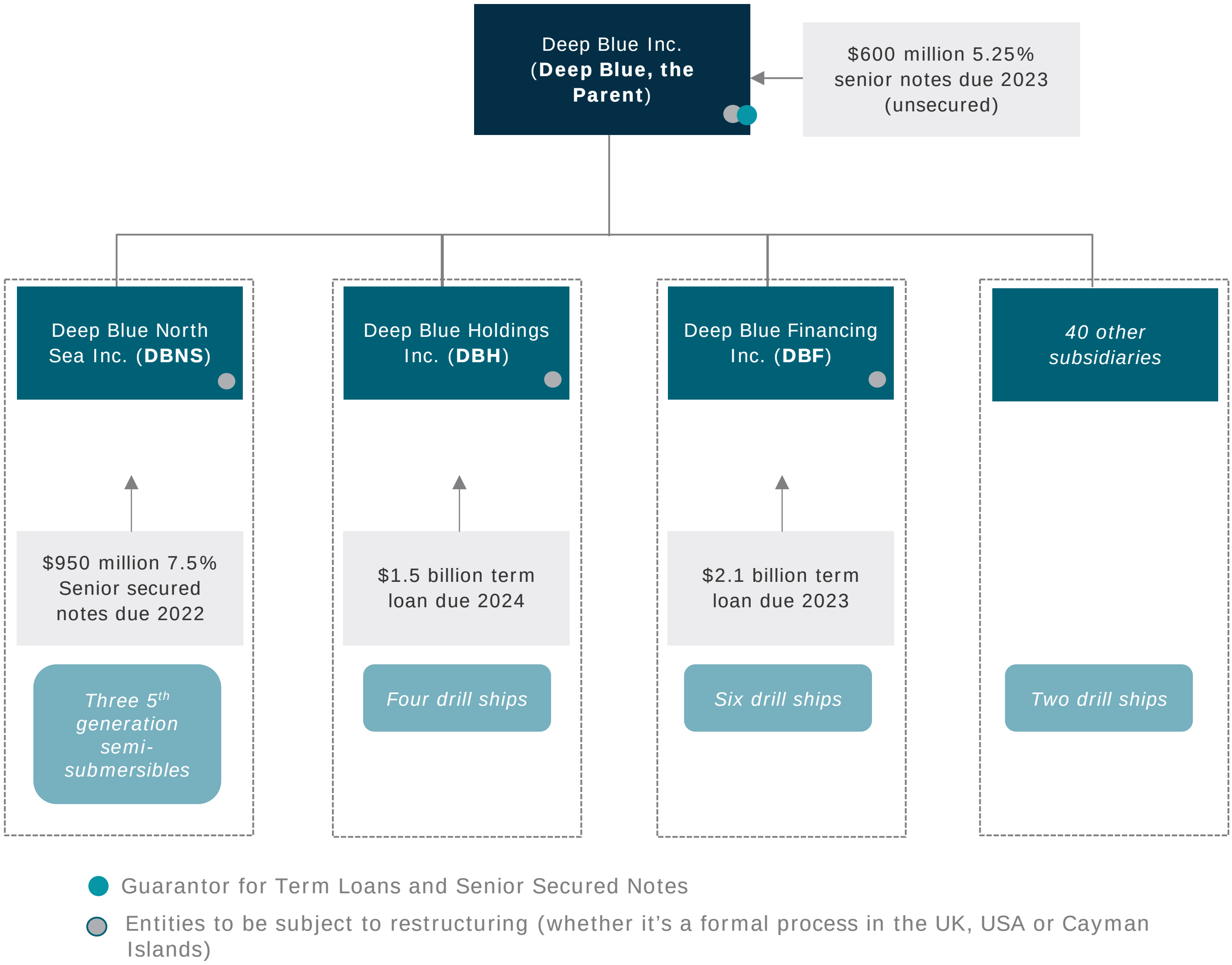
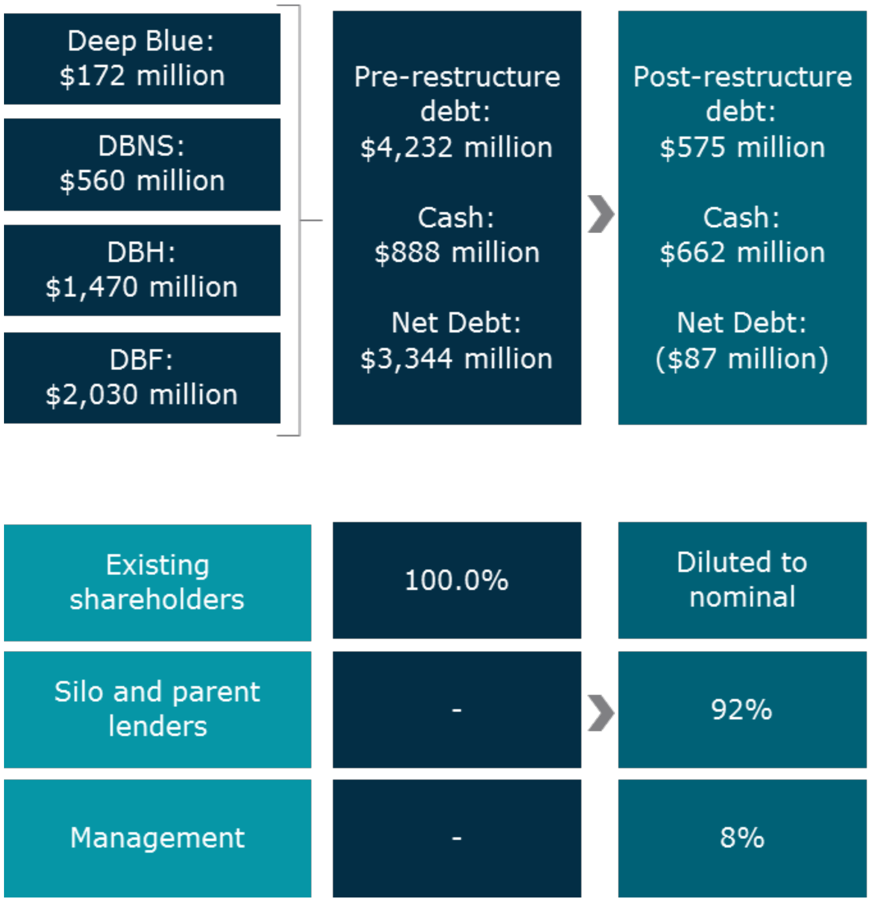
Appendix A: Summarised group structure



Appendix B: Current versus proposed capital structure



Note: the above shows the current outstanding debt.

Current third-party debt

- Parent lenders: ($172 million outstanding; 5.25% senior notes)
- Silo lenders:
    - DBNS lenders ($560 million outstanding; 7.5% senior secured notes)
    - DBH lenders ($1.47 billion outstanding; term loan)
    - DBF lenders ($2.03 billion outstanding; term loan).
- The Silo lenders have security in their respective silos and also guarantees against the Parent to the full value of the outstanding debt.

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Proposed structure

- Current debt of approximately $4.2 billion would be converted to:
  - $575 million new debt
  - $662 million cash (excluding early consent fees)
  - 100% (less Management equity) equity in the Parent which, in turn, will control 100% of the three silos (DBNS, DBH and DBF).

Appendix C: Valuation summary