Vedanta Resources

Event Flash - Liability Management Exercise

We Recommend Noteholders Give Consent

LARA:	Very High Risk	**Moody's:**	Caa2 (Negative)
Credit Bias:	Negative	**S&P:**	CC (CreditWatch Negative)
ESG:	Adequate	**Fitch:**	Not Rated

Trade Recommendation: "Hold" the VEDLN notes

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December 20, 2023

Event

Vedanta Resources (VRL) launched a consent solicitation for an extensive liability management exercise last week. VRL has four USD notes outstanding, the VEDLN 13.875 2024s (January 2024 notes), 6.125 2024s (August 2024 notes), 8.95 2025 notes and 9.25 2026 notes. VRL is seeking consent from all noteholders of the four bonds to extend the maturities of three of the bonds (the January 2024, August 2024 and 2025 notes) to 2027-2028 (see details below). There will be no haircut on the principal. The coupon for the August 2024 notes and 2025 notes will be increased to match that of the January 2024 notes (13.875%).

Despite their new maturity of 2027-2028, the three amended bonds will maintain their tenor seniority over the 2026 notes through a springing maturity mechanism. If the 2026 notes are not refinanced by December 2025, the amended bonds will have to be redeemed on 20 April 2026. The refinancing of the 2026 notes cannot have any guarantee from VRL's subsidiaries until a security over brand fees (see below) is created for the amended January 2024 and 2025 notes. There cannot be any cash repayment for the 2026 notes until 100% of the amended notes are redeemed.

The brand fee is calculated based on 3% of Vedanta Ltd's (VEDL) revenues, 1.7% of Hindustan Zinc's revenues, and between 0.75% and 3% of the forecast revenues for the rest of VEDL's subsidiaries for that particular fiscal year. The net brand fee is calculated after deducting 15% of withholding tax from the gross brand fee payable.

Entity	FY23 Revenue (USD mn)	Brand Fee (Basis FY23 Revenue, USD mn)
Vedanta Ltd (Standalone)	8,478	254
Hindustan Zinc Ltd	4,124	70
Other Subsidiaries	3,236	61
Estimated Brand Fee (post accounting for withholding tax)		327

Source: Company

The funding for the upfront redemption will come from USD 1.25 bn of new secured financing facilities (new financing). The facilities will be secured against brand fees (royalties), a guarantee from Vedanta Holding Mauritius II (VHML II), as well as a capped guarantee of USD 250 mn from TSHL Box. VHML II owns 13.26% of VEDL. Twin Star Holdings Limited (TSHL) and Welter Ltd together make up TSHL Box, which owns a 43.13% stake in VEDL.

The January 2024 notes and 2025 notes (both guaranteed by TSHL Box) will receive security over the brand fees when the new financing (which is secured against brand fees) is repaid. The January 2024 notes will have 100% priority through a waterfall over the other amended bonds.

The amended August 2024 notes will receive a significant 775 bps pickup in the coupon rate to 13.875%, in line with the coupon for the January 2024 notes. The notes will also receive an 82.1% guarantee from TSHL Box, including a negative pledge over any security, assets or VEDL shares owned by it. This guarantee coverage will increase up to 100% on a priority basis when the TSHL Box debt is repaid. The repayment profile of the amended August 2024 notes will be spread over two years to avoid high repayment obligations in a single year, reducing refinancing risk. The repayment schedule will match that of the amended 2025 notes.

The amended 2025 notes will receive a substantial 492.5 bps pickup in the coupon rate to 13.875%, in line with the coupon for the January 2024 notes. The repayment profile of the amended 2025 notes will be spread across two years to avoid high repayment obligations in a single year, reducing refinancing risk. The repayment schedule will match that of the amended August 2024 notes. They will have priority of payment over the amended August 2024 notes, but will rank lower than the amended January 2024 notes.

The structural credit enhancement for the amended notes does not include the upstreaming of restricted payments (including dividends, share buybacks, certain investments or the redemption of subordinated debt) from VRL and its subsidiaries, as long as the VRL credit rating remains below B-. Once VRL attains a B- rating, restricted payments of up to only USD 15 mn annually will be permitted.

Terms of the Liability Management Exercise

Bond (VEDLN Corp)	Jan 2024	Aug 2024	2025	2026	Total
Maturity	1/21/2024	8/9/2024	3/11/2025	4/3/2026	
Amount outstanding (USD)	1,000	950.9	1,200	600	3,751
Early consent fee (pts)	2	2	2	0.75	
Late consent fee	0.25	0.25	0.25	0.25	
Upfront redemption (%)	53%	6%	16%		
Upfront redemption (USD)	530	57	192		779
Remaining (new Notes) (USD)	470	894	1,008		2,372
Upfront demanded by AHG (%)	75%	0	25%		
Upfront demanded by AHG (USD)	750	0	300		1,050
Old coupon	13.875	6.125	8.95		
New coupon	13.875	13.875	13.875		
Old seniority	Guaranteed	Non-guaranteed	Guaranteed	Non-guaranteed	
New seniority	Guaranteed	Guaranteed	Guaranteed	Non-guaranteed	
Old security package	TSHL Box	N/A	TSHL Box	N/A	
New security package	TSHL Box + Brand fees	TSHL Box	TSHL Box + Brand fees	N/A	
Amortisation schedule	N/A	9th Aug'27 – USD 298mn 9th Aug'28 – USD 298mn 9th Dec'28 – USD 298mn	9th Aug'27 – USD 336mn 9th Aug'28 – USD 336mn 9th Dec'28 – USD 336mn		
New maturity	1/27/2027	12/9/2028	12/9/2028	N/A	

Source: Company, Lucror Analytics

VRL is seeking the following amendments in the bond documents for the three bonds as well as the 2026 notes as part of the liability management exercise (no change in absolute debt cap at TSHL Box, according to the bond documents):

Covenants	Current Level	Proposed Level	Testing Period
FCCR at VRL level	3.5x	1.75x	Sep'23 / Mar'24 / Sep'24
		2.00x	Mar'25 / Sep'25
		2.25x	Mar'26 / Sep'26
		2.50x	Mar'27 onwards
Attributable Leverage at TSHL Box	5.5x	6.00x	Sep'23 / Mar'24 / Sep'24 / Mar'25
		5.50x	Sep'25 onwards

Source: Company

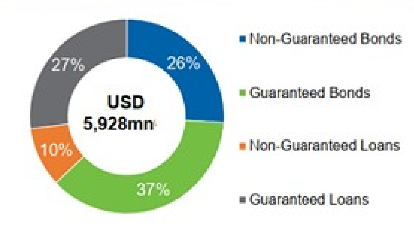
There will be a debt limit at TSHL Box, which will be based on the following (until no demerger activity takes place at the VEDL level):

- (USD 2.65 bn x ownership stake held by TSHL Box in VEDL / 38.14%) excluding any intercompany loans; and
- (USD 3.1 bn x ownership stake held by TSHL Box in VEDL / 38.14%) including intercompany loans.

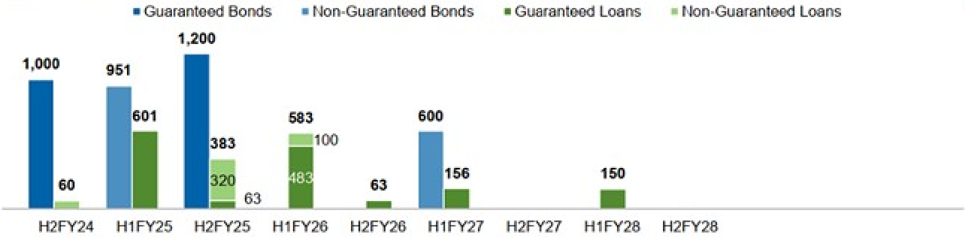
In case of any demerger activity, the aforementioned debt cap formula at TSHL Box will be adjusted (and re-adjusted until such time as all demergers have taken place) to reflect the relative market cap of the demerged entities as compared to the other demerged entities/VEDL.

Debt Maturity Before and After the Liability Management Exercise

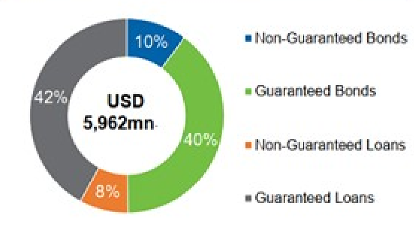
VRL Debt Profile (Jun'23)



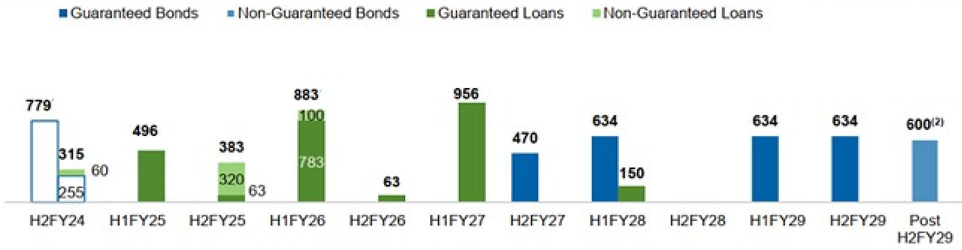
Current Debt and Bond Maturities Schedule



Pro-Forma VRL Debt Profile



Pro-Forma Debt and Bond Maturities Schedule



Source: Company

Timeline

- 13 December 2023: Transaction announcement.
- 15 December 2023: Publication of H1/23-24 results.
- 26 December 2023: Record date.
- 27 December 2023: Early bird deadline.
- 2 January 2024: Voting deadline.
- 4 January 2024: Bondholders' meeting date.
- 28 January 2024 (the January 2024 notes will mature on January 21st): Potential adjourned bondholders' meeting.
- No later than 29 January 2024: Consent fee settlement date.
- No later than 7 February 2024: Upfront principal redemption date.

VRL's H1/23-24 Results

VRL released its H1/23-24 results a day after the launch of the liability management exercise. The numbers were essentially the same as those released by VEDL in November, but presented in USD instead of INR. VRL held an earnings call, during which management mainly discussed the liability management exercise and debt refinancing plan. The highlights included:

- Consent is also required from the 2026 noteholders for the liability management exercise, with a threshold of 50.1%.
- In terms of FY 2024-25 loans, VRL has USD 496 mn due in H1 and USD 383 mn due in H2. Out of the loans due in H1, USD 200 mn will be repaid to Trafigura and is backed by the same brand royalties backing the new financing. The rest of the loans due in H1 will be repaid now as part of the liability management exercise to Oaktree. Management plans to refinance the loans due in H2.
- Management expects to close some asset sales by FYE 2023-24, with these being the only ones being pursued for now. These will likely include the steel business, as well as part of the iron-ore business that could be integrated with the steel asset.
- The amortisation schedule of the new financing is made up of USD 150 mn maturing in May 2024 and USD 300 mn in April 2025, with the balance maturing at the end of the facility as a bullet.
- Management did not answer a question about the cash level at the holdco. We believe that the cash levels are minimal (close to zero).
- There is an ongoing formal process in Zambia to remove the provisional liquidator of Konkola Copper Mines (KCM), reinstate the KCM

Board and return the asset to VRL, which management expects to be completed in two to three months. Thereafter, the asset would effectively be back to its pre-2019 regime. VRL has committed to invest USD 1 bn in the asset over the next five years, with the investment very marginally weighted to the first two years. The base metal business that has been carved out as part of the VEDL demerger does not include KCM yet.

- VRL needs 75% of secured lenders' consent for the demerger. The lender base is concentrated among a few large vendors, with the initial feedback from all lenders being positive.

- There is no time-based covenant for the asset sale in the loan documents.

- Management reiterated its guidance for less than USD 5 bn of debt in VRL in two years.

VEDL Announces Dividend Payment

On 18 December 2023, VEDL's Board approved a second interim dividend of INR 4,089 cr (USD 492 mn) for FY 2023-24, with 63.71% or USD 313 mn of that slated to go to VRL. The record date will be December 27th. We expect VRL to receive the cash just before the maturity of the January 2024 notes.

S&P Downgrades Ratings to CC

Immediately following the launch of the liability management exercise, S&P downgraded its rating on VRL to CC from CCC, while maintaining its negative credit watch. The agency considers this a distressed transaction due to a high default risk without the transaction, inadequate compensation for bondholders, as well as priority given to a new private credit facility. S&P will likely further downgrade its rating on VRL to Selective Default and on the three USD notes to Default, as: [1] the bondholders are likely to receive worse terms (lengthened maturity) than originally promised, despite the better terms in the security package and/or higher coupons; and [2] if the deal falls through, S&P foresees high risk of a conventional default on the USD 1 bn January 2024 notes. S&P believes that the priority access for the new private credit facility to key cash flows will weaken bondholder security.

After the deal, S&P expects to revise VRL's ratings upwards. That said, this will likely be at the CCC level initially, due to remaining debt obligations.

Ad-hoc Bond Group Challenges Terms of Liability Management Exercise

An ad-hoc bond group (AHG) has challenged the terms of the liability management exercise and asked noteholders to vote against the proposal, reported Bloomberg. The liability management exercise requires two-thirds of votes cast at the meeting, with a quorum of at least two-thirds by principal outstanding for each bond.

AHG is led by Oaktree and Avenue Capital, and holds the blocking vote (more than 25%) for the January 2024 notes and 2025 notes. The group earlier demanded upfront payment of 75% for the January 2024 notes, 25% for the 2025 notes and zero for the August 2024 notes. The AHG also demanded that the coupon rate should be increased to VRL's current borrowing rate (c. 18%).

In addition, AHG suggested an exchange ratio of 1:1.3 for the remainder of the two guaranteed notes (January 2024 and 2025 notes). This would mean that for every USD 1 of the old notes that is not repaid upfront, the noteholders will receive USD 1.3 of the new notes.

After the launch of the liability management exercise, AHG claimed that the company failed to include any of the feedback from its proposal to revise the terms of some bonds. Therefore, the exercise does not represent the best possible terms for the notes, according to AHG. In addition, the group alleged that VRL has consistently refused to engage with it in a meaningful way, despite multiple attempts to explore a consensual transaction.

Key Takeaways & Comments

In our opinion, the terms of the proposal are mixed. The upfront payments were lower than those requested by the AHG, while the coupon rates were lower than the group's demands. There was also no exchange ratio indicated to increase the principal of the exchanged portion. That said, the suggestion for an enlarged principal is not common, and we believe it to be excessive.

The consent fees of USD 20 per USD 1,000 in principal amount are more attractive than the USD 5 commonly seen in other cases (e.g. in the tender offers at discount by Indonesian real estate developers).

We find the terms of the new amended notes better than the original, due to the improved security package and/or higher coupons.

The timeline is very tight. Failure to receive the requisite consent may lead to the company defaulting on the January 2024 notes. The new financing cannot be used to repay the January 2024 notes if the liability management exercise does not go through. In this case, there would be no time for VRL to come up with a revised proposal before the maturity of the January 2024 notes.

We acknowledge the company's efforts in terms of the improved security packages and higher coupons. We recommend that noteholders accept the proposal and provide consent.

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