The **Hamish Norton** interview

In early August, well known investment banker **Hamish Norton** took the reins as a Managing Director at the maritime group at Jefferies & Company. Norton, based in New York. Norton will be overseeing a team numbering nearly two dozen professionals, with offices in London, Houston and Singapore. Following the highly successful Jefferies Shipping Conference, now a two day event due to overwhelming interest in the sector, Janes was able to interview Norton at the firm's headquarters in midtown Manhattan. The discussion ranged from his past- and the innovative structures he developed, to the state of the maritime markets, with an emphasis on how the debt side of the business is being impacted by market developments.

Norton took a non-traditional path into the maritime sector, at the time, gaining a PhD designation in Physics (from the highly quantitative University of Chicago) after a traditional BA (from Harvard University). Always early and an anticipator of trends, Norton was a precursor to the waves of "Quants" and financial engineers now in great abundance in the banking community. He joined what was then Lazard Freres, in 1984, rising to Partner in the mid 1990's, before moving to Bear, Stearns in 2000, where he remained, as Managing Director, until 2Q 2007.

When asked about his early move into the transport sector, he described an environment at Lazard where the new recruits worked on Partners' deals, but developed a specialty on their own time. Norton told Janes: "When I got into shipping- it was extremely unfashionable. That was part of the allure, and the Partners did not have an interest in the sector. As a Vice President, I could develop it. I had no connections to shipping, but when I started at Lazard, one Partner, Jeremy Sillem, who had worked on maritime deals in the 1970s, suggested that many vessels financed in the 1970's would need to be scrapped. Maybe some capital is needed."

Norton focused on the second part of Sillem's advice, and developed unique structures for raising capital in the mid / late 1990's- a time that investors were already beginning to chase opportunities in the technology sector. Two highly innovative transactions, both involving finance of crude oil tankers to be chartered by major oil companies, cemented Norton's reputation as a brilliant financial engineer who could also get the deals done.

Nordic American Tankers (symbol "NAT") raised money through shares and warrants, in 1995, to buy three Korean built Suezmax tankers that went on charter to British

Petroleum. The charters, commencing in 1997 with seven year terms, were indexed to the spot market (offering investors upside as excess cash was paid out) but always with a minimum base bareboat rate of USD 13,000/ day. At the outset, the capital structure did not include debt.

A second deal engineered by Norton was Knightsbridge Tankers (symbol “VLCCF”), which came to life with its IPO in early 1997 when it bought five secondhand VLCC’s that were placed on seven year bareboat charters to oil major Shell International with a similar upside kicker for investors. In contrast to NAT’s outright vessel ownership, VLCCF’s five vessels were first purchased from sellers (with IPO proceeds and bank debt), and, then, sold and leased back, under UK tax leases with NatWest. When Shell did not exercise renewal options on the vessels, VLCCF bought the vessels out of the leases, in early 2004, and converted into an ongoing company. It has recently been linked to the USD 162 million purchase of two Capesize drybulk vessels to be delivered 2009.

More than a decade later, in 4Q 2007, across tanker, drybulk and the containership sectors, it’s all about cash. The industry faces a dilemma where “…if you want to grow, and you want to pay out dividends, then you will need to continually be raising equity capital. This is only sensible if paying the larger dividends gives you a lower cost of equity. The finance textbooks tell you that dividends make no difference in your cost of equity capital. But, we do see that the higher dividend payers trade at higher multiples of earnings, EBITDA and net asset value (NAV). It’s a clear pattern. At least in this market, there’s a tremendous amount of empirical evidence that high dividends cut your cost of equity capital.”

Norton said: “Nordic American, a deal I did in 1995, was the first of the high dividend paying companies. It’s traded above net asset value nearly all of its time as a public company- from late 1997. When it was trading at 105 percent of NAV, the other tanker companies were trading at 30 % - 40% discounts. It’s always had a lower cost of capital (at least as measured by asset value) than any of the other tanker companies.” In discussing the pattern of sourcing the markets periodically, he said: “For Nordic American, it actually pays for them to distribute their excess cash <as dividends>, as opposed to retaining the cash in the company, and then raise equity as needed.”

The low cost of capital has translated a competitive advantage and into company growth. Norton adds: “I think that they’ve grown more on a percentage basis than any other tanker company since 2004- when its bylaws were changed to allow growth..” And, growth was the watchword, as it acquired nine additional vessels during 2004 – 2006, and raised US 375 million in three stock offerings. In October 2004, NAT arranged a USD 300 million credit line, with a group of shipping banks led by DNB Nor, and then upped to USD 500 million, one year later. With a five year term, the 2005 facility is non-amortizing, with interest varying between LIBOR plus 0.7% and 1.2%, depending on loan/value. Along the way, NAT has paid consistent dividends, seeing a floor level of USD 0.30/share during market nadirs such as late 2002, and rising as high as USD 1.88/share, a number reflecting the issuance of more shares, in early 2006.

The low equity cost for dividend payers applies across the sectors, with Norton telling Janes: “In the container group, there is little doubt that Danaos and Seaspan <both listed companies> have a lower cost of capital than the private container outfits. By the way, I think that the aircraft leasing companies have been looking at the shipping companies for inspiration in how to finance their companies. It’s only been lately that a new round of aircraft leasing companies have gone public. Aircastle, which I worked on, would look an awful lot like one of the high dividend container shipping companies. They are using low cost equity to create the most efficient leasing structure for containerships. There’s very little difference between a Danaos and an Aircastle in terms of structure. But, these are completely different from your average transportation leasing company- which pays tax.”

He continued: “Over the past few years, with the outsized returns in the drybulk sector, the cost of equity capital has been massively higher than the cost of debt. But, among the companies, high dividend payers such as Eagle Bulk, Genco Shipping and Diana Shipping have had lower equity costs than their low dividend paying peers.” However, that’s only part of the picture, with Norton continuing: “Low dividend paying drybulk companies, with a lot of debt, have had a lower overall capital cost, so, in drybulk, you were actually better off, with lower overall cost, if you had more debt.”

Janes asked Norton about the implications of dividend policy on dealing with debt: “The dividend payers want to deal with their debt in lumps; bank debt at public high yield shipping companies is non amortizing and it looks a lot like bonds. At low dividend payers, the debt amortizes- as a result, it’s a little bit cheaper, maybe 15 – 20 basis points.” He mentioned a recently announced facility for Eagle Bulk with RBS, that will non amortizing for five years, saying: “Private companies can’t get a deal like that, and the low dividend payers would not like the extra margin.” The same earnings visibility that equity investors covet has brought comfort to lenders; Hamish Norton pointed out: “In cases where longer charters are in place, and sometimes when they are only medium term, we have seen debt terms getting longer. Relative to historical norms, they are going very far; I am not sure how much farther out that they will go.”

Hamish Norton’s move to Jefferies this past summer was very deliberate. “There is a tradition and commitment to shipping here-” Norton tells Janes. “Jefferies was founded in the 1970’s as an Equity Trading shop; it expanded in the late 1990’s into shipping, a time that many banks, including Lazard, where exiting the sector because they thought it was too dangerous.” He added that, “…unlike most other firms which may have a strong team of transportation generalists, they are not maritime industry and product specialists. Contrast that with the team here <at Jefferies> which can get into the underlying financial aspects of a transaction very quickly without being tripped up by the special nature of the industry. This is the largest team of maritime I-bankers around.”

Jefferies’ top management includes Brian Friedman, a longtime shipping investment banker. Partners in the Jefferies Capital, the firm’s private equity arm, besides Friedman, include Jim Dowling, now Chairman of K-Sea Transportation, also known for his many years as an equity analyst- at the old Shearson and then at Furman Selz. Norton added that “Friedman was the banker who put together Pacific Basin Bulk Carriers (in its current incarnation) and K-Sea Transportation." Norton says that his aim now is to fine-tune the maritime team assembled by his predecessor John Sinders (who retired to join the automotive sector) "…and keep it working efficiently on a global basis. The firm is committed to the maritime business through the cycles."

In talking about the cycles, Norton refused to make predictions, saying only "…the cycle will continue to astonish you. It always changes- but so far, the deal structures, so far, do not appear to be influenced by the cycle." Likewise, he refused to be drawn out on issues of counterparty risk, a concern to financiers as charters, and tenors of debt, grow longer. He did say, "There are a lot of long term charters, at this point in the market, with counterparties that are not "AAA" rated. If people really thought the market was at a peak, owners and banks would be looking for highly rated charterers. Lower rated charterers would not be able to charter for long terms. I don't see that right now." Pointing to the burgeoning market in forward freight agreements <see Janes Transport Finance # 332- interview with RBS FFA Specialist Mr. Douglas Garnsey>, he did observe a great increase in the proportion of contracts that are being cleared now, saying: "It's up to 40 percent of the contracts- this number was 15 percent earlier in the Summer. In a high market, people do want protection on their FFAs."

Like the movement of market cycles, shipping is constantly shifting its geographic focus and Norton will again be ahead of the curve: "Besides the dedicated Jefferies professionals in the four offices, there is also a team in Dubai not working exclusively on the sector, but working very closely with it."