Taramasalata and Gravlax

Leasing of the non tax driven variety continues to occupy the “Deals” pages in the shipping press. An important player in Scandinavia, Glitnir, the re-branded name of Iceland based Islandbanki, has been near the center of recent activity. Glitnir Marine Finance A/S (“GMF”), jointly owned by the bank and a trio of K/S market veterans, been building on its initial business of packaging of K/S companies for the energy services sector. Its activities now include the packaging of DIS (“Indre Selskap”) companies, which differ from K/S companies because investors are “silent” partners- albeit with limited liability, rather than “limited” partners, and arranging a High Yield Marine Fund- which will provide mezzanine debt for shipping investments.


Intermediation of funds for maritime investments is finding new avenues, with the activities of Glitnir, and others. In early July, GMF exploded on the world scene with the announcement by listed company Quintana Maritime (“QMAR” on Nasdaq) that it would be selling seven Panamax dry bulk carriers built circa 1995 – 1997 and leasing them back under bareboat charters.

The attractions for QMAR, the seller, are multiple- Quintana can continue to exert full technical and operational control over these drybulk ships through the bareboat charter medium. Indeed QMAR points out that “these vessels will remain in <our> fleet over the next eight years,” ie until the oldest are reaching twenty years of age. Yet, the average age of “owned” tonnage, an important metric when peer companies are contrasted in road show presentations and analyst reports, will be reduced.

An important motivation for QMAR is the ability to better manage its liquidity and to pare down debt tied to its vessel ordering program. The seven ships being sold comprised its original fleet prior to its USD 735 million blockbuster purchase of seventeen “Kamsarmax” vessels in mid 2006. At that time, Quintana entered into a new USD 735 Million 8.25 year senior secured revolving credit, led by Fortis Bank, replacing a facility of USD 250 million, In May 2007, a time of record high charter rates, QMAR entered into a USD 310 million commitment to purchase four Capesize bulk carriers delivering in 2010, through a partnership two months after again increasing the Fortis facility- this time to USD 865 million. The partnership, with cargo interests, entitled QMAR to an off balance sheet treatment. Liquidity was still a consideration because QMAR is required to kick in cash for progress payments. Besides the four partnership vessels (two of which had been fixed on charters with French behemoth EDF Trading)

All the while, QMAR had been paying dividends to shareholders and chartering its seventeen Kamsarmax vessels forward on a forward basis through 2010, per agreement with their charter, Bunge Corporation. At the end of March, 2007, USD 799 million was outstanding under the revolver- with a weighted average interest rate of 6%. QMAR filings reveal that the borrower was in compliance with all covenants, but had received a waiver of its minimum liquidity covenant through end 2007 when its facility was bulked up to USD 865 million.

With the sale and leaseback, the lion's share of USD 250 million net proceeds will be allocated towards paying down debt- QMAR was expecting to pay down approximately USD 185 Million on the revolver, and hold on to the remain proceeds, roughly USD 65 Million. Additionally, subject to negotiations with lenders, it was anticipating reductions in mandatory repayments of debt beginning in the second half of 2007, all the way through the facility's maturity in 2014. In this case, liquidity was trumping earnings accretion. Company Chief Financial Officer Paul Cornell did not provide a detailed computation but, in characterizing the use of cash generated from the vessel sales, talked about "the insignificant dilution resulting from this use of proceeds" not bringing about a material reduction in earnings per share in the second half of 2007.

Three of the seven Panamaxes will be placed into Norwegian DIS companies, organized by GMF, that will, in turn, charter the vessels back to QMAR for a fixed eight year term with further options. Per Olav Karlsen, Managing Partner at GMF, told JTF, that the DIS was preferable to the KS because "The DIS format is more flexible on three fronts- from a regulatory standpoint, in terms of statutory capital requirements and with distribution of dividends." In each of the three deals, a DIS company will pay QMAR upfront, USD 36.5 million each for two 1997 built vessels, and USD 34.5 million for a sister built 1995. For the three Panamaxes, Norwegian marketplace was able to provide the much needed liquidity, and the long charter term- without removing operational control from QMAR.

An investment memorandum for one of the companies, "**Iron Man** DIS" revealed the inner workings of one such deal. Based on the USD 36.5 million paid to the sellers, the DIS company borrows USD 26.3 million from DVB Bank AG, at a margin of 100 – 120 over LIBOR (depending on loan/value ratio), for eight years (but with a twelve year profile). QMAR will be chartering, under a "Hell or High Water" bareboat, at USD 12,950/day for the first seven years, and USD 12,000 in year eight. The DIS will then need to secure another charter for years 9 – 12.

Norwegian partnership structures will traditionally sweeten equity returns through sellers' credits, typically 10% of the purchase price. In this situation where bringing cash to sellers was paramount, Glitnir will be pulling out an alternative from the financiers' toolkit- mezzanine debt, also described as a "Shareholders loan". For "Iron Man DIS", the indicative capital structure includes mezzanine debt of just under USD 5.5 million. Contributed equity of USD 5.6 million rounds out the DIS funding. GMF hopes to offer a "matching function", whereby shareholders can sell their shares to potential buyers.

GMF is presently engaged in an initial money raise of between NOK 100 – 300 million (equivalent to approximately USD 17.5 to 52.5 million) for equity in the "Glitnir High Yield Marine Fund" (GHYM). The fund's objective is "to provide investors with the opportunity to invest in a diversified portfolio of high yielding loans secured on shipping and offshore assets." A subscription memorandum adds that "the fund will invest in a broad range of mezzanine type facilities….always on a secured basis." GMF's Karlsen told JTF: "It is not yet completely decided whether the GYHM will be providing the mezzanine debt for the DIS companies. The High Yield Fund, will probably not close until the end of September." One tweak that Karlsen is no doubt addressing is the timing difference between GHYM (itself structured as a DIS), with its projected life of eight years (according to its sales Memo), versus the twelve year project life of the "Iron Man DIS". Nevertheless, the GHYM has agreed on its first investments- secured mezzanine debt provided to Volstad Maritime AS, an owner of offshore service vessels, priced at 10% interest with returns to the fund supplemented by a profit sharing split.

Karlsen talked about GMF's goal of a secondary market in Mezzanine fund shares, adding that, "Furthermore, it is a prerequisite for taking up any of these <Mezzanine fund> shares that there are sellers at the time we have closed it." He further explained to JTF: "If someone invests in a partnership unit, they also participate in the mezzanine debt. But, when we close the deal, we separate the two tiers- the equity and the mezzanine. Holders are free to sell the instruments individually."

The subtle distinction between the KS and the DIS has implications to the bankers, according to a shipping banker from DVB, who told JTF: "It's actually better, because in a DIS, the uncalled capital can be pledged to the Lender, which is not the case in a KS". In response to the same question, GMF's Per Olav Karlsen chimed in: "In a deal like the Quintana project, the DIS will in reality have only one creditor, ie the Bank," contrasting the situation with that of a KS where "the uncalled capital shall serve as security to all creditors." In the Iron Man deal, uncalled capital is USD 3.6 million.

In the Norwegian market, it is not uncommon for vessels to be bought or sold with charters attached, presenting some knotty problems for bankers. The DIS has the right to sell the vessel to new owners (with the Quintana charter attached). The DIS agreement contains a clause enabling a sale to be triggered if supported by 25% or more of the shareholders. Under these circumstances, according to the DVB banker, "The debt is then to be repaid in full, but, not necessarily- the DVB debt could continue if we approve the buyer, and the buyer then goes into the DIS shoes."

The USD 5.5 million subordinated debt, at priced 9.0%, is non-amortizing during the eight year fixed charter period, and is then repaid during years 9 -12, with a USD 3.3 million balloon at the end. Subordinated debt could add challenges for the bankers, but it is structured here in a way that fully protects DVB. The DVB banker tells JTF: “We are happy with the residual risk at the end of the eight years, which is lower than that for the mezzanine investors. The mezzanine facility only gets repaid at the end of the eight year bareboat.” When asked about any peculiarities of the relevant intercreditor agreement, given the novelty of a mezzanine fund (versus a pure secondary lender), the DVB banker said that provisions here were no different from other such agreements, commenting that: “…the mezzanine tranche is fully subordinated to the senior loan.” Investors in the subordinated debt facility in “Iron Man DIS” also have the potential to participate in the proceeds from a vessel sale, once equity investors have secured a 16% rate of return.

Different groups of investors have varying appetites for residual value risk. In the Norwegian market, traditionally, the back end is of paramount importance. . QMAR’s Chief Executive Officer Stamatis Molaris had expressed a concern about “mitigating the residual value risk of <our> pre 2000 built fleet” by “exploiting the current positive market valuations” of company vessels. Norwegian investors have historically been more comfortable than others with valuations of older vessels, and this optimism has translated into competitive pricing on sale/ leasebacks in non tax driven KS structures. As a point of comparison, twenty year old Panamax vessels were priced at around USD 5 million until early 2003; with the market’s strength in 2004 to present, their values have moved into the USD 10 – 15 million range.  Norwegian investors are projecting such values forward, as inferred by the sensitivity table in the investment memorandum, which shows a range of returns based on price and charter rate parameters. A base case range of equity returns ranging from 14.4% to 18.0% around a USD 9 – 11 million residual value (and commensurate charter rates following the eight year fixed term with Quintina).

Glitnir Bank, in Norway, is also an emerging player in shipping finance. Per Olav Karlsen told JTF that “Glitnir Bank’s main activities in the marine sector are with offshore related companies- with particular focus on the North Sea and Norwegian companies in the sector.” However, its role is expanding, with Karlsen commenting: “Glitnir Bank is starting to take some positions in conventional deep sea shipping- at this time, mainly as a participant in syndicates.” But, “intermediation” takes many forms. The mezzanine fund, which could reach NOK 900 million (nearly USD 160 million) in size, being organized by GMF, has negotiated a loan facility for up to NOK 300 million with Glitnir Bank, with this leverage (33%) enabling the fund investors to receive a higher IRR. The securities arm of Glitnir has been a participant in some high profile deals, including a role as Manager is Sea Production Ltd.’s USD 180 million private placement earlier this year.