A Key Player in US Ship Finance

There are now rumblings of the “credit crisis” causing the international ship lenders to pull back, with one major institution said to be not writing new business until year-end. A major milepost will be the upcoming Teekay Tankers spinoff, with the market swirling with rumors. At the recent Marine Money Americas conference, some bankers were insisting that USD 800 million of secured debt had been committed- at an attractive margin, while others insisted that the deal is in a “slow steaming” mode due to bankers’ nervousness. Additionally, a sluggish international tanker market, so far defying historical patterns of 4Q strength, is said to be causing resistance on the deal.

Though not within earshot of UK Chancellor **Alistair Darling**’s calls for a return to “good old-fashioned banking”, a group of institutions with lengthy histories in maritime finance have never deviated from the UK Chancellor’s dictates. Institutions such as KeyBank, headquartered in the U.S. Midwest, provide finance, principally in the form of debt, but also leasing of maritime assets, as well as those for other transport modes. While growing through a series of early 1990’s mergers, the “Bank” (the commercial lender) had the foresight to join with regional investment bank McDonald Investments Inc. (re-branded as KeyBanc Capital Markets, with a “C”, for regulatory reasons).

Mr. Joe Markey, the Director and Team Leader of KeyBanc Capital Markets- the institution’s investment banking arm based in New York, talked to Janes about his activities. Typical customers are mid-sized companies moving freight around North America. His institution has met the needs of borrowers in exceedingly capital intensive businesses, bringing some flair to a sector not known for innovative transactions.

Markey, joined by colleague Steve Vitale, explained that KeyBanc Capital Markets- which includes an investment bank and commercial bank, works closely in concert with KeyBank Equipment Leasing- “…that’s a big part of our differentiator. When we go into deals, we can offer a package that combines the commercial banking elements, conventional lending, a big leasing platform, and also the intellectual firepower of the investment bank. We can play a big role in distribution as well.” Many of KeyBank’s customers are moving refined petroleum, and chemicals, in both brownwater (on the inland waters) and bluewater (deepsea) trades.

Through its leasing group, Key has arranged a preferred ship mortgage on a multipurpose vessel for **Global Container Lines** (GCL), which operates vessels in Indian Ocean trades and, with its acquisition of m/v “**Global Patriot**”, in the U.S. export routes. In describing its relationship with GCL, Markey said: “They operate world-wide- with

a hub in New York, and we have gotten to know the management well." Vitale talked about recent deals arranged by KeyBank's leasing company, a bareboat charter on tugboats for Moran Transportation Company (owned by Mormac Marine), a synthetic lease on tank barges for Reinauer, with its familiar colors in New York harbor. Both techniques enable the borrower to keep assets off its accounting balance sheet; in the synthetic lease, the borrower gains the tax benefits of ownership, ie depreciation.

KeyBank has played an important role in funding East Coast oil barge operator **K-Sea Transportation Partners**- an MLP (Master Limited Partnership- a format suggested to K-Sea by Markey's team along with bankers from UBS). KeyBank has had a long history with K-Sea, cemented at the time of its IPO in early 2004. Since going public, K-Sea's funding has been buttressed by a senior secured revolving credit facility with KeyBank (and a group of lenders including LaSalle Bank, Citibank, Citizens Bank of Pennsylvania, Wachovia and HSBC). The credit was originally capped at USD 50 million. As K-Sea grew through selective acquisitions of equipment, the loan's size was raised to USD 120 Million and then again, to USD 155 million, in late 2005. (picture from www.highseasmarineart.com)

At that time, K-Sea had paid off approximately USD 37 million in obligations under Title XI (US Government Guaranteed) long term debt, refinancing under an amendment to the existing revolver. Importantly, four tank barges that had been initially financed with guaranteed debt were added to the collateral pool under the expanded revolving credit- led by KeyBank. At that time, preferred ship mortgages (where the lender gains senior ranking under U.S. maritime laws) was added to the security revolver's security package.

"The relationship with K-Sea actually came from our energy bankers, who cover the "Mid-Stream"- the supply chain for energy," Markey said, adding that "MLPs are more common on that space." He described how K-Sea, formed through the agglomeration of several smaller New York oil barging entities, had basically outgrown its previous asset-based lenders. He told Janes, "…of course, we look at collateral, but we also look at the cash flow <EBITDA>, we look at the management, and where they want to take the business." This combination of commercial bank and investment bank is unique, with Markey saying telling Janes that in addition to the lending aspects, described in this article, the I-Bank, KeyBanc, played a leading role in the equity side, adding that: "our MLP analysts are also following the company".

In the year since K-Sea's IPO, the "Jones Act" markets for tankers and large barges have benefited greatly as older equipment has been retired. K-Sea, with a history of steady increases in its distributions to investors, has recently undertaken a major expansion of its towboat and barge fleet as it executes its business strategy, a key tenet of which is the the ability to "pursue acquisitions and other expansion opportunities". Its USD 430 million balance sheet (at mid 2007) was already moderately leveraged, with equity of USD 153 million, when it agreed to acquire two entities.

KeyBank's recent activities supporting K-Sea provide examples of how this mid-sized institution (Markey says that "our assets are approximately USD 97 Billion") can support a company's growth objectives. He told Janes, "We can do it all, right in house, with the lending business, the leasing company and the investment banking capability."

The public record of Summer, 2007 regulatory filings shows the depth of support that lenders provided to K-Sea, facing a happy problem in that its hoped for "expansion opportunities" came quickly, and were bunched up. K-Sea's acquisitions, owning 11 tank barges and 14 tugboats, expand K-Sea's reach to the U.S. Pacific States (including Alaska and Hawaii), at a cost of USD 203 million (with the cash portion amounting to USD 169 million). Not long before, in 2Q 2007, K-Sea had entered into a contract for a newbuilding articulated tug barge (ATB), with 2009 delivery, for a price circa USD 70 million. And, shortly before the latest spree, K-Sea had committed to a ten tank-barges order (deliveries 1Q 2008 thru 2 Q 2011), worth USD 100 million. With only USD 13 million advanced so far on the 10 vessel package, capital requirements for these barges under construction stood at USD 87 million.

In the August 2007 restatement and amending, the credit was expanded to USD 175 million, with its term pushed out from five to seven years. Joe Markey said that: "The preferred mortgage gave us some comfort in pushing the term out." Regulatory filings reveal that equipment from the recent acquisitions has now joined the collateral pool. Equipment securing the line of credit must be worth at least 125% of amounts outstanding under the line. Interest can be tied to either the US Prime Rate/ Federal Funds rate, or LIBOR-with margins ranging from 0.75% to 1.50% (depending the ratio of total funded debt to EBITDA), with lowest margins if the ratio is below 2x, and highest margins when the ratio exceeds 3.5x. The covenants forbid a measure above 4x). In discussing leverage generally, Markey expressed concern at maritime credits that other banking institutions have done at substantially higher leverage (some exceeding 6 x).

But, in mid August, USD 166.4 million was outstanding under the restated line, so clearly more funding was required. Joe Markey said: "This where the strength of the KeyBank model shines through- the client is a growing mid-sized company, where we know the management and, because of our relationship, we can do a little bit extra for our customers."

To assist in funding the new 2007 acquisitions, K-Sea borrowed USD 60 million on a bridge basis in August, 2007, in a commitment "that we took on ourselves- outside of the syndicate", in Steve Vitale's words. The bridge was meant to tide K-Sea over, and to be repaid from a secondary equity offering that was in the works. K-Sea's secondary offering was part of a trend where numerous listed entities, basking in the glow of their respective markets, were embarking on such offerings.

The creativity and accommodation were not limited to the bridge loan. Even within the context of the revolver, the bank creatively solved a pair of problems by bifurcating the credit facility into a USD 175 million component (with the seven year term) and a USD $45 million portion with a 364 day maturity (with KeyBank, LaSalle and Citi participating in this part). Joe Markey told Janes: “While the trend these days is for longer maturities, we’ve seen banks going out as long as ten years, this was a case where it made sense to move towards a quicker repayment.” With the rapid paydown in the first year, accounting rules enabled the borrower, K-Sea, to amortize its underwriting costs over the seven year life of the facility. The 364 day feature also reduces KeyBank’s reserve requirements; no “un-used fee” applies for loans of under a year’s duration.

A month later, in September- K-Sea raised USD 138 million in the follow-on equity offering of 3.5 million Limited Partnership units, priced at $39.50 each, led by Lehman, Citi and UBS. Proceeds of the offering were earmarked for paying down USD132 million of the freshly added debt (from drawdowns under its existing line of credit with KeyBank, the bridge loan and the short term credit). Equity proceeds were earmarked for repaying both the bridge and the 364 day loan in their entirety, as well as working down about USD 27 million outstanding under the revolver. If the underwriters exercise their “Greenshoe” option to take additional units, proceeds will be applied towards further repayments of the revolver.

With the bridge and the 364 day credit both repaid, K-Sea can increase borrowings under the short term line by USD 75 million- to a total of USD 250 million. Unlike other transportation MLP’s (all of whom are under pressure to pay out cash distributions), K-Sea is not “warehousing” equipment under construction. With K-Sea’s extensive orderbook, it will likely need to raise additional finance prior to deliveries of equipment. Markey indicated that the “holistic” approach of debt and equity may also have enabled KeyBank to come in with lower fees that those in competing debt proposals.

This corner of the market for industrial equipment finance in North America is alive and well, populated by KeyBank and competitors such as CIT Group (which provided the lion’s share of K-Sea’s finance, including construction finance on the four Title XI barges, prior to its IPO). GE , Bancamerica, and AIG are also active in the space. As far as the “credit crisis”, KeyBanc’s Steve Vitale said that: “We stick with people we know, and we apply common sense, avoiding sectors such as blue water drybulk with the big swings. “Yes”, Vitale told Janes, “…our part of the market is cyclical, like all maritime finance. Whatever happens in the markets, though, we are well insulated.”