2 Images

SHIPPING

Date Posted: 15-Oct-2009

JANE'S TRANSPORT FINANCE - OCTOBER 15, 2009

Few bankers see smooth sailing for shipping sector

The 11 months since the last JTF survey of shipping bankers have been stormy for both the financing institutions and borrowers alike. Barry Parker reports

Confidence has returned to the broader banks market. Recovering equity markets have enabled banks to raise money; leading shipping bank DnB Nor Bank was able to replenish its regulatory capital with a massive USD2.4 billion rights offering, a week after BNP Paribas - also a leading maritime provider - raised EUR4.3 billion (USD6.3 billion).

During September, Bank of Ireland raised EUR2.5 billion in two separate deals with maturities beyond the 3Q 2010 maturity date of a government guarantee. Vibrant bond markets have eclipsed previous activity records. In this milder climate, bank funding markets have indeed loosened up.

The Ted spread, the difference between interest rates on interbank loans and short-term US government debt (T-bills), has fallen dramatically from around 100bp, where it stood for much of the first quarter of this year, to below 20bp, actually on the low side of historical bands.

Nevertheless, few shipping industry observers foresee clear sailing. Across most sectors, demand has been battered by the recession and the increasing supply of vessels is a lingering reminder of better times, when shipping banks competed with each other and easily met the industry's capital needs.

Paul Packard, head of maritime industries at Bank of Ireland, tells Jane's: "I believe that the majority of banks, like Bank of Ireland, have moved from a period of survival into a period of stability whereby the raising of capital and liquidity are at least now possible if not either easy or cheap." But Dublin-based Packard is quick to clarify, adding: "The fact that banks are now on sounder footing doesn't necessarily translate into more capital being available for ship finance."

Harris Antoniou, chief executive officer (CEO) of energy, commodities and transportation at Fortis Bank Nederland, described the present situation succinctly in an early October conclave hosted by Mare Forum.

Antoniou says: "A major shift in ship finance is underway," suggesting that more than 50 per cent of the banking market's maritime lending capacity has been removed due to several factors.

Primarily, Antoniou cites pressure from governments, which invested in, or wholly nationalised, institutions that were struggling during the dark days of September and October 2008 to pull back from international lending and support domestic lending.

Other factors contributing to reduced capacity include concentration risk as institutions have merged, as well as problems stemming from aggressive lending during shipping's now-ended boom times.

Packard concurred with Antoniou across the board, emphasising: "Banks with large shipping portfolios - particularly those with increased portfolios as the result of bank mergers - are looking to reduce the amount of capital allocated to ship finance rather than increase their exposure."

Packard adds: "The shipping markets are performing poorly, which is a disincentive to lenders to increase their exposure to the industry, notwithstanding that some very attractive business can be done in the current environment."

Maritime market dynamics

Antoniou's presentation illuminates the dynamics of the maritime market, where the bank share of capital requirements was traditionally 75 per cent. He says: "A severe shortage of bank debt is currently constraining the shipping industry."

The syndicated loan share of shipping's funding, which Fortis

Nederland analysts have pegged at 40.2 per cent, is currently closed, according to Antoniou, while activity across a 36.2 per cent swathe of varied debt and equity flavours is described as "extremely limited". Bilateral lending, direct dealings between banks and borrowers without sell-downs to other participants, are included in this category.

HSH Nordbank, for many years a dominant presence in the market, is regrouping.

According to a spokesman, the Hamburg-based giant is awaiting the results of a European Commission review of its plans for a different structure. Although HSH Nordbank officials cannot speak in detail, the bank still sees ship finance as a core business for the bank.

According to Harald Kuznik, head of shipping at HSH Nordbank: "The shipping area has backing at the bank's highest level - not least because of its importance in the Hamburg region and its international scope." This importance on both fronts was evidenced, according to Hamburg-based sources, by a recent party in Kuznik's honour, attended by more than one 100 notables from the bank's international and domestic client bases.

Peter Illingworth, Singapore-based managing director for crude and liquified natural gas (LNG) tankers at DVB Group Merchant Bank (Asia) tells Jane's: "We do see an increasing number of banks in the market after the initial credit shocks, but some of the biggest players are out."

He also describes a shifting landscape: "Some players are domestically or regionally focused and, in general, there is a flight to quality." The bottom line, according to Illingworth, is that "most shipowners will struggle to get finance".

Illingworth adds: "There is still a deficit of funding. The order book for 2010/ 2011 is still largely unfinanced, and the combination of declining values and deleveraging by banks will mean greater demands on equity."

Antoniou points to a trend toward smaller bank facilities - bilaterals or pre-agreed club deals - with increased pricing and tighter covenants compared to pre-3Q 2008.

A corollary for lending is emphasis on "core clients, core regions, and core sectors", with Antoniou rhetorically asking whether shipping is still a core sector.

He describes the features of a market that has transitioned from a borrowers market to a "bankers' market," characterised by marginstending towards above 300bp, upfront minimums of 100bp, tenors of up to seven years and loan-to-value ratios (LTVs) not exceeding 60 per cent.

Kuznik adds: "The climate has improved slightly in recent months. But the market is facing a small number of transactions, and then only for top-tier names.

HSH Nordbank is very active in situations like refinancing of balloons or taking out pre-delivery financings, or where clients who have to deal with problems need our assistance. "

Market players

Another view from Germany comes from Carsten Wiebers, head of shipping at KfW Ipex-Bank: "We have not seen any improvement in availability of debt finance for ships as of yet. Some market players are still completely absent from the market, others are focusing on managing their existing portfolios."

Joseph Markey, managing director at KeyBanc Capital Markets, adds that the availability of capital to fund deals in the US Jones Act sector has improved in recent months. "Some of the bank-owned lending companies - and one large one - have become more aggressive with lending. But prices remain elevated and will remain so for a while as banks' cost of capital remains high."

Stefan Kuch, head of global shipping at Commerzbank, says: "We can see a slight increase in availability of capital but most banks are not back to lending, but try to give the impressionthat they are back by picking up one or the other deal."

Bearing out interactions among capital infusions, changed bank ownership profiles and a renewed regional emphasis, Packard says: "Bank of Ireland has been able to raise additional capital in recent weeks and, due to the Irish government guarantee, continues to avail of the necessary liquidity.

"Having said that, government support of the bank - warrants equal to 25 per cent of our share capital if exercised in exchange for EUR3.5 million of fresh equity - is focusing minds domestically and we are currently only considering the finance of Irish shipowners.

"We continue to maintain our existing international portfolio which, due to a number of newbuildings delivering over the next three years, will only decrease marginally in size over the period."

Wiebers says: "We selectively continue to do deals in carefully structured transactions." Kuch adds: "Following the takeover of Dresdner Bank by Commerzbank, the shipping activities of the two banks will be merged into Deutsche Schiffsbank, which now is 92 per cent owned by Commerzbank.

This process will take some time. Depending on further development of the shipping markets, the bank will increase its lending activities." But Kuch points out that specifics of the bank's future strategies remain a private matter.

The precise level of industry capital needs is elusive. Delays and cancellations of vessel orders, a particular feature of the drybulk and tanker markets, reduce the need for capital.

The container realm is now bracing for a wave of negotiations with shipyards, following a recent announcement of likely cancellations by French operator CMA CGM, which has three dozen vessels, worth USD3.4 billion, on order from big South Korean builders.

Nevertheless, the funding gaps contemplated are large and likely to exceed USD100 billion annually - not taking cancellations into account - for 2009 through 2011, according to estimates supplied by Fortis Netherlands. Using Dealogic data, estimated bank lending to shipping in 2007 was pegged at USD100 billion, with 2008 showing a decline as credit tightened.

For the first quarter of the current year through 3Q 2009, Fortis estimates industry lending, including syndicated and large bilateral deals, at around USD20 billion, spread over 74 deals with a big bump upward in the first quarter due to a USD6.5 billion restructuring of AP Moller-Maersk debt.

Antoniou describes the market for syndicated debt in the third quarter of this year as basically "at a standstill", with USD2.5 billion of fresh financing and USD1.7 billion of refinance.

Other funding sources, including bonds, export credit agency (ECA) deals and possible private equity infusions, are taking up part of the slack.

Alternative funding

Starting in late June, a host of maritime industry players, including Royal Caribbean in the cruise sector, Malaysian International Shipping Corporation (MISC) in LNG and tanker specialist Euronav raised cash through bond issuance. Eitzen Maritime Services (EMS), whose Norway-based parent Camillo Eitzen Co is possibly being acquired through a shares exchange with

Indonesian tanker giant BLT, has also raised money through bond issues. Diversified Japanese owner NYK Line has filed for - but not yet issued - a massive USD1.1 billion-equivalent issue.

Illingworth highlights the bond market, telling Jane's: "Bonds are attractive because they have a limited impact on cashflow and do not dilute equity."

Packard adds: "We believe that the bond market will fill some of the funding gap but, as we estimate the gap at USD40 billion to USD50 billion in each of the next three years, we would be very surprised if there is sufficient capacity forthcoming from the bond market to take up all the slack."

Illingworth explains further: "If this market [bonds] is available today, and you believe ship values will increase over the medium to long term, they are an attractive product, but I see them as complementary to conventional ship finance." Wiebers expresses a cautious view: "Only a limited number of market players in the shipping sector have access to the capital markets. Therefore the impact is not to be overestimated."

Kuch is in agreement: "Yes, we appreciate the resurgence of the bond market because we expect that the lending capacity of traditional ship finance banks will not be sufficient to provide financing of the existing order book."

He is quick to add: "But from the past we know that the bond market never had a significant impact on shipping. For various reasons the bond market cannot substitute the traditional bank lending market."

Kuznik expresses similar sentiment, telling Jane's: "The bond market has been tapped in a small number of cases; it's making a dent in financing needs, yes, but not having a big impact.

Most shipping companies are not set up to access the bond markets.

They are not rated credits, and most are far from investment grade. In the medium term, we might see more companies think about how to position for accessing the bond markets."

High-yield finance

Markey says that high-yield finance has been making a significant contribution to companies' financing needs, in sectors other than maritime. He says that the financing tool could help "some companies" in the maritime sector.

Wiebers notes that the acquisition timing of assets to be financed - and the associated charter coverage - must be considered: "For those who have (capital markets) access, the cost of bond debt barely creates a viable business case, if based on asset prices for orders placed during the past years, and current charter rates."

Gust Biesbroeck, managing director of transportation at Fortis, said in a recent Capital Link online presentation: "You see the cost of high-yield debt trending down in more appetite for shipping risk in that market and at the same time there is a continued scarcity of capital from the bank market.

"So companies that have access to the high-yield bond market - and that have substantial capital requirements - will probably do well out of diversifying their portfolio sources of capital by including a piece of high-yield debt.

He added: "We strongly believe this is a trend we will see more of in the coming year."

Fortis, with capital market capabilities that allow the bank to benefit from borrower diversification, has assessed the resurgence of the high-yield bond market ahead of the loan markets.

The Dutch bank points to increased appetite for credit risk among the buyers of high-yield debt. As investors have driven down spreads over equivalent maturity US Treasury obligations from nearly 2000bp to around 850bp, the high-yield market sector has rallied.

Antoniou maintains that refinancing of existing debt has been a big stimulus for the bond market, but that the "market is re-opening for acquisition-related financings and for transactions by first-time issuers"

Another development marking the ship finance market is a larger role for the ECAs.

Packard says: "We expect ECAs in major shipbuilding nations to have to step up to the plate to ensure the orders at their indigenous shipyards can be paid for with a commensurate increase in post-delivery finance."

A paradigmatic deal enforcing Packard's observation, signed on 10 August, was the Export-Import Bank of China's USD389 million 12-year credit facility extended to tanker specialist Overseas Shipholding Group (OSG).

The facility is the first financing arrangement that China Eximbank has extended to a US company. OSG said in a news release announcing the deal that borrowings under the facility would be used toward financing three very large crude carriers (VLCCs) and two aframax crude oil tankers constructed in China.

Throughout 2009, covenant waivers have featured in maritime finance, with few foreclosures. Kuch offers: "We are open to discuss with everyone about potential strategies for solving problematic projects.

Up to now we could solve all problems with the help of shipping clients. The strong relationship between the bank and its clients is of great help in troubled times." This positive approach, although unspoken by most bankers, seems to pervade the ship finance sector.

In a recent development, a group of banks lending to containership owner Danaos - which ran afoul of net worth issues after marking down its interest rate swaps earlier this year - agreed in September to extend waivers on around USD900 million of bank credits and guarantees that had been agreed in July and were to run through January 2010.

The extensions, granted by Aegean Baltic Bank, Piraeus Bank and HSH Nordbank, agreed to push the waivers out to the fourth quarter of next year.

In another development, rumours abound among bankers following CMA CGM that that borrower has requested a one-year moratorium on principal repayments.

Driven by hope

Illingworth offers a general view of bank waivers, saying: "In my view, covenant waivers are driven largely by hope - hope that the market will turn up or that companies can successfully raise additional capital."

Markey offers a different perspective, noting the current low ebb for asset valuations. "Some lenders in the transportation sector in general, including marine, are waiting for vessel valuations to rebound before they foreclose. So you may actually see more foreclosures once volumes and rates begin to pick up."

Robin Das, London and Hamburg-based deputy head of shipping at HSH Nordbank, provides a view of covenants subject to ongoing review. "Covenant waivers are agreed after assessing viability of a project. Should market conditions deteriorate significantly, then assessment of the project could change, leading banks to change their approach."

Kuch also points to market vicissitudes, telling Jane's: "To waive a covenant means that the lender thinks that the borrower will recover in near future and the covenant will be fulfilled soon again.

"If the lender cannot see the light at the end of the tunnel he will, and must, act and protect the bank against increasing losses by enforcing all his rights.

"Most ship finance banks have their own research teams that analyse the overall economy as well as the shipping markets, and provide forecasts to decision-makers. The good thing with shipping is, it is highly cyclical and that means that, after a downturn, an upswing will follow."

Selectivity is one strategy for coping with changed market conditions. Packard says: "We have mainly focused on financing a number of smaller niche sectors of the shipping market where tighter supply and demand fundamentals exist.

"We would expect these companies to recover more quickly as the global economy begins to return to growth."

The view is echoed by Markey, who tells Jane's: "We continue to be focused on the Jones Act primarily but are also working with a few great international companies. We are using our balance sheet selectively where we see a broader client relationship across multiple products."

Risk and reward

An interesting angle on the unwinding of the financial crisis - and the need for borrowers to diversify - is the ability for institutional investors to invest in ship finance debt. The risk/reward ratio in bank debt for the shipping sector has improved significantly due to dislocation of financial markets.

According to this line of thinking, bank debt is an attractive instrument compared to other instruments available to investors.

Fortis is partnering with New York-based broker/dealer Sunrise Securities to market public debt.

The new venture plans to package private shipping loans for pension funds and insurance companies - in contrast to a handful of securitisations that closed several years ago, offering investors exposure to synthetic shipping loan portfolios in which the actual loans remained on bank books.

Another aspect of newly found conservatism among shipping financiers is the need to plug gaps between reduced advance rates for debt and scarce equity.

QInvest, a unit of Qatar Islamic Bank, plans to establish a USD200 million fund with Fortis to buy shipping assets, taking advantage of falling prices in the maritime sector.

The five-year mezzanine fund, which will comply with Islamic law, will be invested over the next 18 months and will initially focus on the tanker market.

In mid-February, DVB Bank announced the launch of the DVB Invest Opportunity Fund, an up to USD250 million fund, focused on counter-cyclical and opportunity-driven investments in the shipping and offshore industries.

The fund was launched by the bank's newly established Shipping and Intermodal Investment Management (SIIM) team, to be funded by institutional investors.

Illingworth highlights the market's need for alternative funding sources: "I would say that our leasing product is now more attractive than ever; our funds are able to release liquidity for shipowners, allowing them to take advantage of other investment opportunities." Packard, commenting on developments at Bank of Ireland, tells Jane's: "We are currently considering a number of options both in the wider bank and within the maritime team, mainly in connection to securitisation-type products to reduce the drag on our balance sheet."

What lies ahead, as bankers and shipping companies enter the final quarterof the year?

Illingworth, amplifying his views on covenant waivers, opines: "I fear that banks will have to make tougher decisions at the end of this year, or the beginning of next year, if covenant breaches are still outstanding."

Another concern among bankers is a potential tightening of capital adequacy rules, following on from recent G20 deliberations.

Kuch points out: "Most of the banks have recently implemented rating tools in accordance with the pro-cyclical Basel II rules. Based on its rating, capital has to be allocated to each single financing.

With the financial crises and the worldwide recession, ship values and charter rates decreased significantly. Consequently the ratings for ship finance loans worsen and more capital has to be allocated to the shipping portfolio of a bank."

Packard notes: "This [capital requirements] will affect all types of finance. Possibly ship finance will be more greatly affected as, in the current downturn, it could be viewed has higherrisk than other competing sectors."

Kuch outlines potential consequences. He envisions a situation in which capital injections to a shipping portfolio could be seen as fresh money to the shipping market - but not available for new lending. He adds: "Banks might consider today's capital allocation to the shipping portfolio as the appropriate allocation, which protects the bank against future volatility. Although one might have to allocate only 50 per cent of the appropriate allocation to the portfolio in good times, the return on capital will be calculated on the higher amount. Higher margins and more conservative structures are, to my mind, the necessary consequences."

Sign of the times

Shipping markets are far from homogenous. Wiebers states: "Rather than noticing any turnarounds, we still see substantial differences in how strongly companies in different market segments of the shipping industry are hit by the state of the global economy."

Packard expresses concerns about the worrisome containership market: "It will be interesting to see the fallout from Germany's heavy reliance on the combined KG and container markets. We believe there is a lot of bad news to come out of the German banks in the coming months."

A sign of the times in Germany is an announcement that a new fund, structured as a KG, is being formed by Paribus Capital to invest in distressed KG companies. The new fund is closely tied to prominent German shipping figures, including Henning Winter, a former board member at Deutsche Schiffsbank.

The bad news emerging will provide opportunities for the new money.

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The shipping finance sector is experiencing calmer seas as confidence returns to the markets, but problems stemming from the global financial crisis are still prevalent.
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Euronav, a specialist in liquified natural gas (LNG) tankers, similar to the one pictured, was one of many companies to raise cash through bond issuance.
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