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Access to capital: a strategic weapon in down markets

All areas of the shipping sector are hunting for money - wherever it is available, writes Barry Parker

The headline on the Financial Times' Alphaville blog on 2 September, 'Prepare for shipping wars', was definitely an attention-grabber, suggesting that container industry behemoth AP Moller-Maersk was bolstering its war chest in anticipation of a pricing battle in the container-shipping sector.

Throughout this sector of the shipping market, losses have been staggering: Maersk Group reported a loss of USD540 million for the first half of 2009 (1H09), versus a profit of USD2.5 billion for the comparable 2008 period. Earlier this summer, Maersk took a measure of great significance, setting in motion a plan that would lead to the closing of its shipyard at Odense, Denmark, where the giant Emma Maersk-class 13,000 teu vessels were built, and the sale of the Baltija Shipyard in Lithuania.

Great Dane

Taking a 'big picture' view, Nils Andersen, chief executive officer (CEO) of AP Moller-Maersk - the world's largest container-shipping line - talked about postponements of capital investments in the face of the "worse than expected" financial crisis - now a year old - but was quoted as saying: "We believe that we will emerge as a stronger company on the other side of the crisis."

Bloggers, as well as investors, were intrigued by both the path through the maelstrom - with Andersen alluding to a coming price war - as well as the financial vehicle for returning the company to profitability.

After indicating in its financial results announcement in late August that "financing of the group's newbuilding programme for ships and rigs is considered to be substantially in place", Maersk surprised analysts in early September by announcing a DKK9.2 billion (USD1.76 billion) issue of Class B non-voting shares. Closely controlled but listed entities, such as Maersk B on the Copenhagen Stock Exchange, have been able to raise funds. The new Maersk issue will provide app¡roximately 5.7 per cent of share capital while keeping voting control in the hands of insiders, who hold

A-shares. A connection not made by the bloggers, however, is the appeal of commodity-related equities; inc¡reasingly Maersk has been building up the group's energy-related businesses to complement its core container-shipping activities.

Financial realities

Wording from the tight-lipped Danish giant hinted at a reason for raising the money and showed Maersk to be impacted by the same broader financial realities facing others in the containership sector. Between January and June, capital expenditure (capex) of USD4.2 billion exceeded cashflow from operations, which totalled USD2.7 billion. In the same period a year earlier, company-wide cashflow of USD4.6 billion exceeded USD4.1 billion of capex.

Andersen's remarks demonstrated that even Maersk was impacted by: "limited access to bank loans, which traditionally has been the company's main source of capital". Andersen reiterated that committed investments were funded, but added the following coda: "The world economy and the loan markets are unusual. Proceeds from the treasury sale will, in [themselves], reduce the company's loan requirements and at the same time increase the company's attractiveness as a potential future bond issuer."

Maersk-watchers would conclude that a bond issue could be in the offing amidst a continued dearth of syndicated bank finance. Since Maersk also indicated that 2H09 results would probably be in line with those of the January-June period, capital markets for debt may likely play a role in bridging a cash gap of roughly USD1.5 billion - assuming the bank market remains static.

Andersen, answering an analyst's question about whether potential bond initiatives were a result of dissatisfaction "with Deutsche Bank and Royal Bank of Scotland and all the other international shipping banks reducing their facilities", replied to the contrary: "No, we cannot complain about the banking support that we are getting." He went on to acknow¡ledge difficulties in the banking market and the recent strength in the bond market. "When we look at the future, we are considering whether it makes sense to broaden our financial base so we can tap into more sources."

Earlier this year, Maersk had agreed to a forward start facility with a group of six banks, essentially affirming availability of funds to refinance Maersk's massive USD6.5 billion bank credit that was originally agreed in 2005. Maersk has not gone to the equity market since its listing in the early 1980s; nor has it gone to the public debt markets, so the company remains unrated.

Money matters

The collective psyche of chief financial officers (CFOs) of shipping companies has been indelibly altered by the traumas of the past 12 months. If and when Maersk floats a debt offering, the company will join a growing roster of shipowners that have followed advice from bankers: take money when it is available, even without particular capex or acquisition activity in mind.

Most recently, Euronav, the listed Belgian tanker owner, managed to raise USD125 million that the company has earmarked for general corporate purposes. The unsecured bonds, due in 2015 and with a coupon of 6.5 per cent, are convertible into shares at a premium of 25 per cent above the market price of the shares in early September. Euronav owns or charters 23 large tankers, 19 of which trade in the Tankers International Pool. Add¡itionally, the company, in a joint venture with New York-based Overseas Shipholding Group (OSG), is converting two large tankers into floating storage and offloading (FSO) vessels that will be chartered to Maersk Oil Qatar for eight-year terms, commencing later this year.

Jane's spoke to Hugo De Stoop, CFO of Euronav, about the role that bonds can play in ship finance. According to De Stoop: "The banking crisis affected many sectors, but shipping has relied on bank finance more than other sectors. We view bonds as diversifying our funding sources, rather than replacing bank funding." He went on to explain that: "If you are a public company, it's good to tap alternatives. The chances of bank markets, capital market debt and the equity markets all shutting down at the same time is unlikely. We would never rely 100 per cent on any one of the sources."

Capital of China

The impact of the finance crisis, and yet another reminder of the emergent Chinese financing power, was evident in mid-September when OSG announced a ground-breaking 12-year, USD389 million credit from the Export-Import Bank of China, secured against five tankers recently delivered to OSG from Chinese shipyards. Market thinking is that OSG is now firmly positioned to be tapped, if and when Chinese yards are forced to seek strategic partners, for completing - and eventually operating - partially built vessels that might be abandoned by finance-strapped owners. In remarks at a Jefferies & Co conference, Morten Arntzen, CEO of OSG, suggested that such funding is available to companies that might not desperately need it, before quickly noting the abundance of vessel-buying opportunities that might now emerge.

Maersk has USD6 billion in outstanding commitments for vessels and rigs, including a substantial number of containerships to be built in South Korean shipyards, and USD3 billion for oil and gas terminals. Sixteen 7,450 teu containerships are being built by Daewoo for delivery in 2010-12, and nearly two dozen 4,500 teu ships are to be built at Hyundai for delivery in 2011-12.

Maersk is comfortable with its funding profile going forward. At mid-year, net interest-bearing debt totalled USD19.3 billion. According to a presentation by Andersen two weeks prior to the share issue, the average maturity profile of loan facilities exceeds five years, with no covenants and no major refinance needs until mid-2012 - the maturity date of the USD6.5 billion facility. Andersen repeatedly maintained that the company's position was satisfactory to fund investments already in place, and that "the rest of the loan facilities will cover whatever shortfall there may be". He acknowledged, however, that "our situation is slightly unusual ... we are basing ourselves mainly on ship financing and export credit in addition to traditional bank facilities."

Andersen then added: "Look¡ing into the long term, we don't know how the financial crisis will impact the banking facilities and availability for the period of our long-term refinancing."

Analysts and industry-watchers have wondered what has changed in Maersk's corporate thinking on fund-raising. Why raise the equity? Lower pricing on box moves, a result of meeting competition head on, plays a role, with Andersen characterising competitors' rate-lowering actions as "immature". He added that: "We have taken the decision to follow the rate cuts so we did not lose market share."

Besides girding for further price competitiveness - with the winners in such battles usually possessing the biggest war chests at the outset - Maersk has also signalled, importantly, that it would look to acquire assets. Containership market experts suggested that Maersk would look beyond the glutted containership market as it seeks asset-buying opportunities, pointing out the considerable headaches involved in the integration of P&O Nedlloyd into Maersk Line during 2005-06.

Selected niche opportunities exist in the container-shipping business. Maersk will launch a feeder service linking fast-growing Vietnam to the US West Coast via Hong Kong at the same time that the company ration¡alises other services.

Dog eat dog

But Maersk's diverse business portfolio - with roughly 40 per cent of revenues derived from container-shipping, 20 per cent from oil and gas, and roughly 10 per cent each from tanker and terminal businesses - points to possible acquisitions in transport-related business sectors outside the company's core business. Strategically, Maersk may well use the current environment to swoop in on targets in a big way, enhancing scale rather than sweeping up indi¡vidual crumbs from distress sales.

Earlier this year, Maersk completed its roughly USD 473 million acquisition of Brostrom, a Swedish tanker owner - creating the largest player in the product tanker sector - but was forced to take a significant USD156 million write-down due to impairments of both vessel values and charter contracts. From a finance perspective, consolidations such as Maersk/Brostrom and Teekay-Torm/OMI create companies where greater scale translates to financing advantages. This contrasts with the 'pool' approach, prevalent in the tanker trades, which provides commercial muscle but not necessarily financing scale as ships remain in the hands of smaller owners.

The Danish giant's situation - Maersk aggregates 1.93 million teu capacity - contrasts sharply with that of its competitors, which, for the most part, are seeking to tread water rather than bolster portfolios. As Andersen commented: "Most container lines are sailing with significantly negative cashflows."

Statistics bear this out. At the recent Jefferies & Co shipping and offshore services conference, Brian Sondey, president and CEO of container lessor TAL International, citing statistics developed by shipping services specialist Clarksons, said that 446 million teu are expected to move in box trades during 2009, down from 498 million teu in the watershed year of 2008, following a compounded annual growth rate of 9.9 per cent from 1985 until 2008.

The travails of Hapag-Lloyd - sixth in the world's container league with 468,000 teu, according to AXS Alphaliner - continue. Maritime analysts might keep a weather eye on developments in aviation finance law concerning the implications of state aid. Reports are emerging that the World Trade Organisation (WTO) has now ruled that European loans to Airbus violated rules concerning government subsidies to the European aircraft manufacturer's business. The course of the Hapag-Lloyd saga may be impacted, depending on the wording and nuances of the WTO ruling.

A rescue package being discussed for Hapag-Lloyd - which, like Maersk, had integration issues with its 2005 acquisition of CP Ships for more than USD2.1 billion - includes a component of government aid. A key part of the potential solution would be EUR1.2 billion (USD1.7 billion) of state guarantees, much in the form of a backstop financing on debt that would come in from a group of commercial banks led by HSH Nordbank. A EUR75 billion German bailout fund, which has already aided the shipbuilding sector, could be tapped.

Another speaker at the Jefferies conference, Sai Chu, CFO of Seaspan Corporation - a large listed owner of containerships on charter predominantly to Asian carriers - commented: "We also have vessels on to Hapag-Lloyd and CSAV [Chile-based Compañía Sud Americana de Vapores], both of which approached us regarding re-negotiation of rates." After explaining Sea¡span's response, which was to point to the existing contract, he added: "Both are important in their own countries, and both are expected to complete their restructurings in the next few months." Of Seaspan's 40 ships currently on the water (another 28 are on order), nine are chartered to Hapag-Lloyd and two to CSAV.

Industry-wide, market conditions have allowed large box carriers to boost container rates. Andersen pointed out: "Even though rate increases are sticking, they are not sufficient to bring rates significantly above the levels seen in 1Q09 [first quarter of 2009]." But most of the big carriers are continuing to support massive newbuilding programmes - with mega-ship prices in the order of USD130 million per ship - even if it means putting newly delivered ships into layup.

South Korean assistance

The support of South Korean export credit agencies (ECAs) alluded to by Maersk's Andersen has boosted the huge order books of major carriers. Privately held Mediterranean Shipping - second in league tables with 1.5 million teu of capacity - continues to take deliveries; the third of eight 13,000 teu containerships was delivered to the carrier from Samsung earlier in the year. Besides expecting a further dozen mega-vessels from South Korean shipyards, Mediterranean Shipping has committed to take several dozen vessels from third-party shipowners, mainly German and Greek.

CMA CGM of France, aggregating 1.06 million teu, no longer maintains ratings on outstanding bonds, following a public spat with ratings agencies. The containership operator is also reportedly still assessing the demands of Korean Export-Import Bank (Kexim) that it should top up equity in shipowning companies that will be taking newbuilds now valued at reduced levels.

Putting diverse pieces together, the French carrier's recent announcement that it would begin selling unspecified assets to meet financing needs may be tied to these closed-door discussions with Kexim. The company's orders of owned vessels to be delivered from South Korea include two dozen vessels of between 8,400 teu and 13,000 teu.

Lucky break

Evergreen Marine, fourth in size among container operators, is unique in that it has no newbuildings on order. Evergreen's reserves will enable the company to withstand losses of USD143 million in 1H09.

Recent developments at listed Glo¡bal Ship Lease (GSL), a company that leases ships to CMA CGM, provide insight into difficulties caused by asset valuations as relate to CMA CGM - which initially sponsored GSL. After several tense months, GSL reached an agreement with a group of lenders led by Fortis (Nederland), the agent, with participation by five other banks, on its USD800 million facility.

After a breach of contract earl¡ier this year, loan-to-value (LTV) covenants are waived until late 2010. The next test is due in April 2011, while the margin, originally ranging from 0.75-1.10 per cent depending on leverage, is increased to 2.50-3.50 per cent, depending on LTV. Importantly, the bank group is funding GSL's scheduled purchase of a 6,600 teu vessel from CMA CGM, which has now been chartered back to sellers for 12 years, enabling GSL to validate its business model of steady returns over lengthy periods. As expected, GSL's dividend payments will be suspended - with the freed-up cash being applied to debt paydowns. Additionally, in a move to ease calls on GSL's cash, CMA CGM has agreed to delay monetising its USD48 million holdings of GSL preferred shares, which had been slotted for mandatory redemption in August 2011, until 2016.

At the Jefferies event, Ian Webber, CEO of GSL, who was CFO at CP Ships prior to its acquisition by Hapag-Lloyd, explained that the covenant waiver facilitated the vessel purchase, and also that GSL's plans include taking delivery of two newbuildings purchased from a German owner that would be delivered into charters to Zim Israel Navigation Co in 2010. All GSL charters to date are with sponsor CMA CGM, which remains a large shareholder.

Webber stressed that GSL's bank negotiations were independent of privately held CMA CGM, but he pointed out that most of the banks in the GSL syndicate are also lenders to CMA CGM. He said: "We are now going to pay down debt as aggressively as we can ... Now we have stability with our credit facility, and have a great platform to look for additional capital."

Big is beautiful

Webber stressed the important role of owners of large vessel capacity, citing a statistic that 51 per cent of large-carrier tonnage in 2008 was owned by charter owners such as GSL, Sea¡span and Danaos. Such owners, inc¡luding KG companies, owned only 15 per cent in 1994. "Liner companies need an off-balance sheet source of capital," he said.

Seaspan's Chu picked up a similar theme, suggesting that the difficult market - and capital constraints facing customers, the carriers - provides "an opportunity for us; the leasing model has stayed intact". In talking about Seaspan's own finances, he explained: "We have a competitive advantage due to our access to Chinese financing; 70 per cent of our revenues are from Chinese carriers [Cosco and China Shipping Container Lines]."

The revenue side has improved for at least one third-party owner, with a fleet diversified across market sectors. Phillip Clausius, CEO of Singapore-based FSL Trust, an owner of two dozen vessels leased out under lengthy bareboat charters, told the Jefferies audience: "Operators are starved for capital. We can now charge more for our services. The pricing power has turned our way and we are now price-setters." Clausius, with deal experience in the German market, said that the owning of vessels by carriers is "a more difficult argument to make in a capital-scarce environment". Shipyard capex is not an issue for FSL, which typically purchases an owner's existing vessel - or one constructed by the owner - and then charters the vessel back to the seller on bareboat terms for a period of 10 years or longer.

Clausius referred to the trust's un¡levered return target of at least 10 per cent, adding: "Our returns float up and down with the bank debt market." FSL recently announced that it had secured a waiver until 2Q11 on LTV covenants on its USD515 million credit facilities. At the end of June, USD501 million had been drawn on the credits, comprised of three syndicated facilities. Margins, which had been set at between 100bp and 120bp over the three-month Libor, will rise to 170bp during the waiver period.

The waivers come with an agreed repayment schedule on the facilities that had originally been non-amortising. Initially, USD250 million had been due in 2014. The balance under the facilities - divided into two credits of USD200 million and USD65 million, the latter with a different syndicate - had been due in 2012. Because the credits are revolvers, re-borrowing will be permitted from 3Q11 onwards, after conclusion of the waiver period.

Change of plan

FSL's experience with the bank debt market has chastened the company's thinking on financing strategies. Launched originally as a marine finance company in 2002, its backers consisted of German containership operator Schoeller Holdings and two tiers of financiers that included HSH Nordbank, as an equity investor and mezzanine funds provider, and BTM Capital at the mezzanine level. Since FSL's switch to the Singapore-listed trust structure, modelled on real est¡ate investment trusts (REITs) in early 2007, Schoeller has remained a large holder. The trust's two lending syndicates now include combinations of German and Asian institutions.

Institutional investors seem to agree with FSL's actions - up to a point. Within days of the covenant waiver, the trust raised SGD41 million (USD28.6 million) of units in a private placement. Following book-building efforts, FSL had cut back its offering from an intended SGD57 million.

Clausius told the Jefferies audience: "All companies need to fundamentally rethink their funding sources." He added: "The bond market might be helpful to us - it's part of the thought process that we are going through." n

Has transport finance finally bottomed out?

In New York, the conference season exploded in the week after Labor Day, with multiple events crammed into the shortened working week. The mood was not quite upbeat but clearly better than a 'we are still here' attitude. Indeed, speakers at Jefferies & Co's conference and other events suggested that transport finance may have bottomed out.

Tasos Aslides, chief financial officer (CFO) of Euroseas, an owner of smaller container vess¡els chartered out to carriers, showed graphics indicating that sector's point along a cyclical floor. Aslides, whose role includes analysis of investment proposals, acknowledged: "Investments made now [in smaller vessels] will look good five years out. The question is: how long until it turns upward?"

On the tanker panels, Jeff Pribor, CFO of General Maritime Corporation (GMR), stressed: "We are at a point of inflection. You will see us looking closely at opportunities." Reminiscent of comments from Nils Andersen, chief executive officer (CEO) of AP Moller-Maersk, about the metaphorical "other side", Morten Arntzen, CEO of tanker operator OSG, told the Jefferies audience that OSG would emerge from the recession "as the winner".

As summer winds down, a handful of important themes have emerged:

Take the money when you can raise it, even without a specific new project

Certainly Maersk and OSG were both considered well resourced already. Yet Maersk issued shares as the market window opened, and OSG was the beneficiary of a paradigm-setter - debt from Export-Import Bank of China.

Question: Will the strong get stronger?

Market bottom creates buying opportunities

As Pribor indicated, large shipping fortunes are made from properly timed asset purchases. An emerging question, however, is whether owners like GSR and OSG will compete with financial buyers for distressed assets.

Question: As buyers pile in, will the bottom be artificially raised above equilibrium levels?

The energy and natural resources angle attracts finance

Buoyant oil prices, and indeed renewed strength in commodity markets, seem to be fuelling prospects for shipowners, directly or indirectly, which are attracting finance.

Question: Will diversified shipping companies become more prevalent, where resources/

energy holdings complement some other core business? What about project finance, or shipping finance that is more closely linked to the commodities being moved?

The bond market is now open for shipping companies

Over the summer months, we have reported on activity in the corporate debt markets; this is likely to continue. Pribor, in detailing possible additions to GMR's funding mix, said: "We are told that we could easily issue a bond if we needed to."

Question: Will non-industrial shipping companies be able to tap this source?

Importance of Asian finance

This recurring theme bears continued emphasis. Many traditional Western shipping banks are still treading very cautiously as they rebuild. Ironically, problems at these institutions were not caused by shipping losses, but Asian finance has clearly stepped into the breach. Question: Is this a permanent shift in the funding landscape?

The 'schadenfreude' factor: the pain of others is our gain

Arntzen has said: "A lousy tanker market will push distressed owners over the cliff; OSG has the discipline and resources to pursue distress opportunities." Owners of chartered-out containerships express similar sentiments, and expect to provide more leasing services to customers still in pain.

The USD64 billion question concerns timing: yes, it's a good time to buy, but do buyers have the staying power for a long holding period?
