SHIPPING

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Business connections

The financial well-being of many shipping companies has become tied to government-linked finance. Barry Parker examines the interplay in finance between vessels and cargoes

In late August, South Korean steelmaking behemoth Posco inked a 20-year contract for hauling in excess of 2 million tonnes of Brazilian iron ore annually into South Korea, on vessels to be delivered to Hanjin Shipping in 2011.

Revenue for Hanjin is estimated to total USD1.1 billion over the life of the contract. However, although impressive, the deal is hardly novel for either side as Hanjin already services Posco on multiple contracts. It simply provides further proof of shipping's emergent raw material dynamic.

Hanjin, a diversified company, has taken big losses on its container shipping activities, including closing Senator Lines, a German-based aff¡iliate. The company recently reported an outsized loss of USD325 million for the second quarter of 2009 (2Q09), USD200 million of which was due to ongoing container operations. Indeed, analysts at Seoul-based investment manager Mirae Asset Group have said that "aggressive borrowing continues to raise concerns" in their analysis of Hanjin. The analysts point to cash-raising through sales of vessels that have aggregated some KRW300 billion (USD241 million) and KRW35 billion of treasury stock. Perhaps because of its non-container activities, Hanjin gained the sector's best rating - a 'neutral' designation - from Nomura International (HK), against a backdrop of 'reduce' ratings on its Asian peers.

Samsung Securities (Seoul) gave Hanjin an outright 'buy' rating in mid-August, citing upturns in the Chinese container freight indices (especially the Pacific sub-index) and then proclaiming that "the worst is over".

Struggling container sector

However, throughout the container sector the word 'rescue' has loomed large. The ongoing saga of Hapag-Lloyd has now seen its investor group, which owns 56 per cent of the beleaguered carrier, agree on an increased cash contribution as the container shipping specialist girds to secure finance from a trio of

German banks, with the imprimatur of a state guarantee on the majority of the credit risk. According to the city of Hamburg - part of the investment consortium - the total injection now on offer is EUR923 million (USD1.3 billion).

Zim Lines, a subsidiary of Tel Aviv-listed Israel Corporation and a leading container carrier, has also been struggling as it lines up an infusion of up to USD350 million of funding. Zim, currently taking deliveries of the first 8,400 teu and 10,000 teu vessels in a 12-ship newbuilding programme, ann¡ounced that, absent an injection, it was on a path to burn through USD1 billion of cash through 2012. Shareholders of parent company Israel Corporation were not able to muster needed support for an initial USD100 million contribution into Zim, a company that also leases vessels in from the Ofer Group, Israel Corporation's majority shareholder. Like Chile-based CSAV, another struggling line, the heavily indebted Zim has offered lessors, including Ofer, an equity stake in return for reductions in lease rates.

These dismal container trades are, for now, decoupled from dry and tanker trades in which government-linked finance has enabled Hanjin Shipping and others to continue to order large vessels.

Sale and purchase broker Compass Maritime highlighted an order by

National Iranian Tanker Co (NITC) for a dozen large tankers, priced at between USD95 million and USD100 million each. Six vessels are to be built at Shanghai Waigaqiao Shipbuilding (SWS) and six at an unnamed yard - probably Dalian Shipbuilding Industry Co (DSIC).

According to Compass: "The interesting part of the story is that in the midst of a dearth of bank lending to shipowners, financing will come from the government-controlled Export-Import Bank of China [China

Eximbank]." Compass added that China won a shootout against South Korean shipyards to gain the order. Market sources have hinted at a possible structure in which the vessels will be ordered by a Chinese owner, against the backing of long-term charters from NITC.

'Industrial shipping' deals

Paul Slater, chairman and chief exec¡utive officer of Naples, Florida-based ship finance specialist First International Corporation, when interviewed by Jane's talked about the importance of "industrial shipping" deals, where ships are built/chartered against long-term commitments by creditworthy companies or sovereigns, such as Posco, to import raw materials. Slater, a pioneer in the business, used asp¡ects of project finance when he raised more than USD200 million of debt finance to build six product tankers that were placed on charter to oil major Shell in the mid-1990s.

Slater said that asset speculators buying ships based simply on the idea that the values will go up "must take a sharp knife to their expectations". Besides the drybulk market's turn southward, he noted the continued carnage on the container side, and a possible gathering storm in the medium-range tanker sector, where he draws on his experience as a shipowner.

With a lull still apparent on the commercial banking front for shipping, the role of Asian governments explicitly supporting shipbuilding has now come to the fore. Slater alluded to a series of other deals where transportation is bundled into commercial aspects of a commodity deal - or has the potential to be. China Eximbank has been discussing a debt package of as much as USD6 billion to Australian miner Fortescue, a scourge of shipowners that was suspended from Baltic Exchange membership after having backed away from term freighting contracts earlier in the year. To put Fortescue's situation in context, Brazil's Petrobras sourced USD10 billion of debt from the China Development Bank, tied, indirectly, to a long-term arrangement in which oil would be supplied to Sinopec, the large Chinese refiner.

One European owner tapping Chinese funding sources is IM Skaugen, a Norwegian chemical and gas tanker owner and operator of ships in the Gulf of Mexico lightering trades, currently operating a fleet of about 35 vessels. IM Skaugen, a quintessential 'industrial shipowner', has a substantial newbuilding programme in China, and that activity enabled the owner to line up a USD32 million facility in 1Q09 with Chinese banks, as well as a USD35 million credit placed with Scandinavian lenders.

A bright spot on the commercial banking front, suggesting banking confidence in vertically integrated raw materials supply chains, saw Noble Group, a Singapore-based commodity trader - also involved in ship management and limited shipowning - sign a USD1.8 billion mandate with a 10-bank group of syndicators. The new facility, targeted for a September closing, will extend an existing USD1.2 billion of unsecured credit, and augment it with an additional USD600 million of 364-day funds.

But Noble's strategy bundles transportation into broader commercial activities, which, increasingly, include owning processing facilities. Earlier this year, Noble raised USD40 million from International Finance Corporation, which will form part of a funding package for a grain processing and shipping facility in Argentina. The project had already gained USD120 million in funding from the Inter-American Development Bank (IADB). In early August, Noble - which describes its business as building "supply pipelines" - agreed to buy a group of fuel terminals in the midwestern United States in a bankruptcy auction, supporting its petrochemical and fuels business. Noble has moved on from being an 'asset-light' commodity player; the company's substantial ocean freight programme relies on both in-chartered and owned shipping tonnage.

Blurred borders

The borders between financial players, commodity merchants and shipowners have become increasingly blurred in recent years, a development that brings some conster¡nation to Slater, who noted that Barclays Capital has now created a shipping com¡pany to complement its energy trading businesses.

Slater said: "When the grain companies built up large fleets in the 1960s and 1970s, at least they had physical cargoes that they were covering or hedging. When the big financial houses enter the freight markets, they may be dealing with derivatives where there are no physical deliveries - and that's where it causes concern." The Noble grain facility in Sante Fé, Argentina, was previously owned by the one-time grain powerhouse Andre Group, which owned a fleet of ships complementing its grain trading business.

With bank finance restricted, the pendulum may move away from the independent sector of shipping. Besides the large raw material producers or consumers, trading companies have also moved into transport businesses to support their cargo movements. Glencore International, a private company with a USD61.3 billion balance sheet and a BBB- rating from Standard & Poor's (S&P), has been an operator of product hauling tankers through its ST Shipping subsidiary in conjunction with the Italian D'Amico group. In 2007, the Glencore/D'Amico joint venture (dubbed 'Glenda') moved into asset ownership with orders for more than a dozen vessels.

Owning vessels exposes one-time trading companies to additional challenges; Glenda has sought to cancel some of its newbuildings. The return of some USD58 million in shipyard deposits and interest on two of these Glenda ships, ordered from South

Korea's SLS yard and then substantially delayed, is currently the subject of arbitration. Like Noble, Glencore has also invested in commodity-producing assets.

One trader, Morgan Stanley, went into the ship management business in a big way. Morgan Stanley, active in oil and products trading, acquired tanker pool operator Heidmar in 2006. Two years later, at the height of the oil markets, Morgan Stanley sold off half to companies controlled by shipowner George Economou, whose tankers had been long-time participants in Heidmar's vessel pools.

Project-linked financings are not the only source of industry funding. In his interview with Jane's, Slater touched on other potential directions for shipping finance, at a time when "a large number of shipping companies are rowing on, without adequate reserves to weather a further market decline". When asked about financing sources, Slater talked about both private equity and high-yield bonds. He told Jane's: "First of all, the underlying arrangement, with the price of the vessel and cargo coverage, needs to be viable." Reflecting on developments in the finance markets, he said: "Private equity investors have been eying shipping, but have not been able to achieve the returns that their investors seek." Bankers have consistently mentioned 20 per cent to 25 per cent hurdles on private share investments. Slater continued: "One route may be that private equity investors provide debt; it fills the bank-funding vacuum, and it enables the funds to offer their shareholders the types of yields they expect." He acknowledged that such deals would not likely be widespread: "The same underlying concerns about shipping companies' ability to service debt would apply."

Bond market activity

By late summer, the bond market activity that has been a hallmark of the broader capital markets has now spilled over into the maritime sector, albeit with a natural resources slant. Slater suggested that commercial banks would be likely to welcome this development, in which proceeds of public market debt offerings could be used to pay down bank debt. However, again Slater offered a reminder that any underlying deal must be sound, "particularly as the bondholders would get a secondary position, behind the bank debt". He added: "It may be appropriate for listed companies with healthy balance sheets and ships with real revenues coming in."

Potential 'industrial' issuers stand in marked contrast to the crop of asset players that raised debt during the industry's 1997-98 high-yield flurry. Most of those issues supporting hastily assembled fleets often lacked sufficient coverage and were restructured after missing interest payments.

Investors have gained confidence in high-yield bonds across industries. As an example, a EUR315 million Fortescue secured bond due in 2013 with a 9.75 per cent coupon, which reportedly traded at 51 during 1Q09, is now above par, fuelled in part by the news of the Chinese financing. During late 2Q09 and into 3Q09, a series of public debt market shipping deals emerged. Maritime-linked bonds issued in August have included US offshore services company Hornbeck, which placed USD250 million of senior bonds due in 2017, with an 8 per cent coupon and priced to yield 8.5 per cent; and Norwegian offshore owner Havila Shipping, which raised NOK300 million (USD49.8 million) in a three-year issue. Hornbeck's notes, rated Ba3 by Moody's Investors Service and BB- by S&P, saw extra demand from investors; the issue was initially sized at USD200 million.

In an August filing, Hornbeck pointed to the importance of contract coverage, stating: "Twenty-one of our OSVs [offshore vessels] are currently operating long-term contracts with expiration dates ranging through June 2012. Notably, of the 10 new-generation OSVs yet to be placed in service under our fourth OSV newbuild programme, five of such OSVs have already been committed to multi-year contracts while they are still under construction."

The Havila deal, likewise, shows the importance to investors of contract cover, even though bond commitments are not secured by charters; Havila has entered into three charters, which the company values at an aggregate NOK200 million, including a three-year deal with the Angola unit of oil major Total.

Hornbeck's projected use of bond proceeds supports Slater's contention, with the company stating its intention "to use USD200 million of proceeds from the sale of the senior notes to repay debt currently outstanding under its revolving credit facility". Although Hornbeck is allowed to re-borrow under its USD250 million bank credit - funded by a seven-bank group of lenders led by Wells Fargo - it has effectively moved the maturity on USD200 million from September 2011 under the credit out to September 2017. In the first half of 2009 (1H09), Hornbeck drew down USD60 million on the credit line; at mid-year, expected requirements for Hornbeck's construction programmes totalled USD130 million, through to the end of 2010. EBITDA for the first half of 2009 was a comfortable USD109.7 million.

Investment grade credit

In a much larger deal - an investment grade credit - Hong Kong-based Swire Pacific MTN Financing Ltd, a unit within Swire Pacific (which is rated A3 by Moody's and A- by S&P), issued a 10-year Eurobond with a 5.50 per cent coupon with a parent company guarantee. The issue, with a margin of 190bp over 3.125 per cent US Treasury notes due on 15 May 2019, was reported to be heavily over-subscribed. As other markets have sagged, nearly 30 per cent of Swire Pacific's aggregate 1H09 profit came from its marine services group, which includes 87 vessels in the offshore and salvage sectors. Swire Pacific, the corporate parent of Dragonair, is also a 42 per cent shareholder in Cathay Pacific Airways.

Another Asian deal sees Singapore offshore vessel owner Swiber in the process of raising USD100 million of five-year bonds, convertible into common shares.

Most recently, IM Skaugen, in the midst of optimising its forward com¡mitments to pay debt tied to the construction of eight gas carriers in a

Chinese yard, has issued NOK500 million of floating rate notes - the company's fourth bond issue within the past year. In July, the company described itself as "one of very few companies which have been able to issue new bonds in the Norwegian bond market". The margin on the latest unsecured debt issue, this one maturing in July 2011, is 600bp above the three-month Libor. Norwegian kroner repayments have been swapped into US dollars.

An IM Skaugen mid-July financial filing offered insights into the company's financial strategy: "The improved macro-economic outlook in 2Q has driven credit spreads down, and the spreads in the Norwegian high-yield bond market have continued to tighten sharply over the last months. The market is still at extremely elevated levels, but is considerably down from the all-time-high level seen in March this year."

IM Skaugen describes its capex programme as fully financed. The right side of the industrial owner's balance sheet bears out Slater's opinions on the inter-relationship of bonds and bank debt; the company's capital programme has included both.

IM Skaugen's financing strategies have also included partnerships and sale/leasebacks - a medium well suited to the company's business mix. Following a successful association with lessor GATX - which partnered on ownership of six ethylene carriers in a company called Somargas, delivered from Chinese shipyards in 2002-03 - a second joint venture, Singco Gas, was put in place in 2007 to fund construction of refrigerated gas ships with liquefied petroleum gas (LPG) and liquefied natural gas (LNG) capabilities. As IM Skaugen has funded repayments on its maturing bonds - which, in turn, have funded vessel construction - the company turned to the Teekay organisation, a long-time partner in the Skaugen Petrotrans lightering business in the Gulf of Mexico. Through adroit sales of vessels, with subsequent charters back, IM Skaugen projects that it will raise USD67 million in 2009 and USD54 million in 2010 through sales of five small LPG traders to Teekay LNG Partners LP, one of three partnerships packaged by Teekay Corporation. An investor presentation shows one vessel leased on a 10-year term and four to be delivered into 15-year charters.

Don't miss the boat

The bond market openings available now could potentially close at any time. Slater's First International has joined a consortium with the capability to offer turnkey restructuring services to the industry. He told Jane's: "We are recommending that company boards take a look at restructuring possibilities sooner rather than later. There may not always be market windows for public debt - so that leaves you with equity. We can offer a dis¡passionate view, extremely privately. I believe that equity is available for industrial shipping projects."

Even IM Skaugen, clearly a success story in weathering storms, took highly conservative measures inclu¡ding postponing and not cancelling gas carrier vessels set to be built in China. Other owners have abrogated deals, forfeiting deposits in the process. Shipbroker Compass Maritime hinted at the dynamics of recycling Chinese shipyard slots in its latest report. The New York sale/purchase specialist told clients: "We have pre¡viously reported that delayed and cancelled newbuildings in China will go to Chinese shipowners and this week it was announced that a ship¡owning company has been est¡ablished called Roxen Shipping of

Beijing to take over cancelled newbuildings at Rongsheng Heavy Industries of China." The company purchased the suezmax tanker Roxen Star for around USD70 million after a Greek owner walked away when the ship missed its delivery date.

Ship recycling has taken on a distinctly industrial pallor, with possible links to the finance world - although so far only speculative. Oil market observers put Roxen Star in the West Africa/China oil service for Sinopec. Compass also hints that the same entity will acquire four large tankers cancelled by Frontline in 2Q09. Backing for the new entity has been the subject of speculation, but observers have tied Roxen Shipping's ownership to holders of Rongsheng Shipyard. Investors in the yard, best known for a 12-ship order in 2008 from Brazilian miner Vale, include private equity players tied to Goldman Sachs and DE Shaw.