Shipping suffers from broken covenants and impairments

The global financial crisis has led shipping company chiefs to focus on raising funds as well as remaining compliant with existing financial covenants. **Barry Parker *reports***

"You can drive a truck through our loan covenants," said Morten Arntzen, chief executive officer (CEO) of 40-year-old Overseas Shipholding Group (OSG), during the company's recent investor conference call as he explained the enduring viability of OSG's successful business model and financial strategy.

In spite of his mixed modal metaphors, Arntzen and his team have created an exemplar of financial management at a time when many newer companies are struggling to husband what reserves they have, rearrange the timing of capital expenditures and raise additional funding.

Arntzen, a one-time banker who, before joining OSG five years ago, rose to a leadership role in Chase Manhattan's transport group prior to its combination with JP Morgan, provided important insights into the relationship between the banking crisis and the dismal state of maritime markets. A key message in Arntzen's talk was that strong shipping companies, such as OSG, with flexible financing strategies will have abundant opportunities to buy far cheaper assets as the markets shake out over the next several years.

In setting the stage for this view, Arntzen told listeners: "Your company has a challenge if you entered this period with bank financing to raise, no term cover, looming debt maturities and unfinanced newbuildings." He added: "There is simply no new bank financing available for the industry worldwide right now. This is what is driving second-hand vessel values down."

Covenant obligations

In reviewing OSG's finances, Arntzen said: "There has been increased interest by investors across the board on covenant obligations," which are uniform across multiple OSG debt facilities. Arntzen explained that OSG's borrowings are mainly unsecured — with pledged collateral equating to only 28 per cent of net book value — freeing OSG from the shackles of loan-to-value (LTV) calculations bedeviling many shipping company borrowers.

A central aspect of discussions across the industry centres on capital available to fund vessel acquisitions, mainly newbuild vessels on order. Between 2009 and 2011, OSG expects to take delivery of 29 vessels, necessitating anticipated net capital requirements of USD526 million. Arntzen suggested that covenants allow OSG to raise an additional USD965 million of debt on newly acquired vessels or newbuildings, and USD275 million of additional secured debt against OSG's existing fleet. Based on net worth covenants, OSG could absorb as much as USD1.2 billion of losses or shareholder-friendly dividends or distributions.

For OSG, yearly amortisation of the company's USD1.4 billion of debt averages only USD29.7 million in each of 2009, 2010 and 2011. By comparison, some USD367 million of cash was generated from operations in 2008. With prospects of further vagaries in the capital markets, Arntzen suggested that "OSG is well positioned to capitalise on opportunities without going to the equity or debt capital markets for funding". These markets may not be there.

The merits of a disciplined and conservative business approach and financial strategy have been shown in the drybulk space by Diana Shipping. The company's financial health contrasts sharply with peer companies that have renegotiated debt packages and cancelled vessel orders to equilibrate likely funds sources with funds required for investment capital expenditures.

Simeon Palios, CEO of Diana Shipping, tells *Jane's*: "The credit facility that we have in place is certainly well below the lending capacity of Diana today. Of course, this is something that other banks know and we believe they would be willing to support us for future deals. In such a difficult environment companies like ours are the preferred borrowers for the banks that wish to stay in the ship lending business."

Diana, with two capesize vessels priced at USD60.4 million each and scheduled to be delivered in 2010, has lined up a USD300 million facility with Royal Bank of Scotland (RBS) — more than sufficient for taking out the vessels' pre-delivery payment (PDP) finance at the time of delivery.

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Morten Arntzen
CEO of OSG

Steering into headwinds

The examples of OSG and Diana, perhaps benchmarks for independent shipping companies, are atypical. Other companies, seeking to build scale, have come up against headwinds.

Seaspan Corporation, an owner of 35 containerships mainly leased on long-term contracts, rapidly built up its book of new vessel orders since its 2006 initial public offering (IPO). The box carrier arranged several large syndicated credits — including a USD1.3 billion facility led by banks Citi and Fortis, which were among a group of six mandated lead arrangers — and a USD920 billion loan spearheaded by DnB Nor and four mandated lead arranger banks.

By the end of 2008, remaining instalments on Seaspan's 33 undelivered vessels totalled USD2.1 billion. Seaspan was remarkable in expanding its lender base beyond traditional European banks to include the Asian institutions of Export-Import Bank of China (Cexim) and Industrial and Commercial Bank of China (ICBC). During the company's fourth quarter 2008 (4Q08) conference call, Sai Chu, Seaspan's chief financial officer (CFO), said: "We have secured bank debt financing for all of the remaining 33 newbuildings. We have no debt maturities until 2015," thereby skirting one of Arntzen's criteria for challenges.

Nevertheless, Seaspan still faces an equity funding shortfall. The approximately USD500 million to USD600 million needed until mid-2012 already reflects the deferral of several vessel