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Shipping bankers set course for calmer financial waters

Barry Parker

A fresh semblance of normality is returning to the ship finance marketplace after the disruptions that began in mid-2007. Barry Parker reports from New York

At a recent shipping finance conference in New York, one of the central concerns on delegates' minds was finding sources of funding for the outsized vessel orderbook.

Back-of-the-envelope calculations by Ronny Bjornadal, senior vice-president and global head of syndicated loans at Norway-based Nordea Bank - buttressed by data from shipping market analyst company Marsoft - suggests overall capital requirements of between USD500 billion and USD600 billion will be needed by the maritime sector over the next three years. Bjornadal suggests that about USD450 million of debt would be required over the next four years to fund existing orders.

Michele Bougery, managing director and head of advisory and mergers and acquisitions at DVB Bank, working with estimations of payment profiles as well as potential refinancing activities, has fine-tuned calculations of the funding gap. Bougery, who joined DVB in 2007 from BNP Paribas, suggests that USD100 billion to USD150 billion of debt would be needed in each of 2009 and 2010 to fund orders.

For publicised orders, the amounts reduce for 2011 and beyond. Much imprecision surrounds these types of calculations as vessel prices have risen dramatically.

As indicated by commercial bankers, rising asset values have pushed down the ratios of loans to vessel market values. By comparison, with estimates of future capital needs, Bjornadal forecasts that the shipping finance debt of the 29 largest commercial banks is currently of the order of USD350 billion.

In the heady days of the seamlessly flowing banking system, shipping banks could likely raise the industry's USD100 billion to USD150 billion annual requirement through interbank markets. But nine months into the credit crunch, commercial bankers appear deeply troubled about the ability to meet the huge demand for funds.

The question remains as to whether all of the ships on order will be delivered, with the consensus of analysts being that the order bulge of 2009 and 2010 may slip, postponing rather than eliminating the funding requirement. The central paradox is that the thriving but capital-consuming shipping industry - described by some insiders as an attractive asset class - continues to butt up against uncertainties in the financial markets. Bank debt, a mainstay of shipping finance, must adjust to the prevailing conditions.

At times, certain credit funding mechanisms were effectively at a standstill - certainly up until sometime late in the first quarter of 2008 - leading to difficulties for banks' own funding, and in syndicating risk to erstwhile partners, each with its own problems. The response from the banking community, according to Harald Kuznik, executive vice-president and head of shipping at HSH Nordbank, and Rory Hussey, managing director of syndicated finance at ING Bank, has been to increase margins to compensate for uncertainties in funding. Kuznik says: "It is easier said than done."

Funding gap

Hussey offers the example of spreads for good borrowers, rated within the lower band of investment-grade credits, rising from 55bp to 90bp. Unlike a year ago, with banks lamenting difficulties in properly differentiating between strong borrowers and weaker credits, Hussey says that "further down the quality curve, there is a wider gap".

In addressing the matter of a proper benchmark for spreads, both Kuznik and Hussey state that the traditional Libor benchmark has not properly reflected bank borrowing costs.

Hussey, while noting continuing enhancements to the British Bankers' Association's rate-determination process, says: "Libor has been deflated. It is below a bank's true borrowing costs." He adds: "The increase in margins does not reflect a change in risk pricing for shipping but, rather, the wider margins reflect banks' needs to compensate for this Libor uncertainty." Nicholas Pitts-Tucker, general manager and co-head of international and structured finance at Sumitomo Mitsui Banking Corporation (SMBC) Europe, says that shipping industry borrowers need to understand bank liquidity concerns that "may yet come from new quarters" and "might continue to disrupt syndication efforts".

Clubbing together

"Liquidity costs are not dealt with in the Basel II regulations," Pitts-Tucker says, adding that many future equipment deliveries in a less attractive asset class - such as aircraft - remain unfunded.

Sai Chu, chief financial officer (CFO) at Seaspan Corporation, says: "Funding costs for Chinese banks have gone up 200bp." Seaspan concluded a USD920 million credit facility in August 2007 - at the beginning of the credit crunch - with banks that included SMBC, Export-Import Bank of China and Industrial and Commercial Bank of China (ICBC).

As banks attempt to return to a normal financial environment, transactions will feature mandated lead arranger groups or club deals, in which syndication risk is reduced as participation by banks in large transactions is agreed in advance, with limited selldown. Hussey cites four recent examples of well-executed syndications, including a USD750 million financing package at the end of 2007 to support the acquisition by Berlian Laju Tanker of Chembulk, in which DnB Nor, Fortis Bank, ING and NIBC participated.

In April, the USD1.4 billion in aggregate facility was completed for the acquisition by Excel Maritime Carriers of Quintana Maritime, in which Deutsche Bank, DVB Bank, GE Capital Corporation, HSH Nordbank and Nordea Bank Finland were lead arrangers, and Credit Suisse, Fortis Bank and National Bank of Greece acted as co-arrangers.

In the following month, the USD1.2 billion revolving credit facility completed, with Nordea as facility agent, for Prosafe, the Norwegian owner and operator of semi-submersible service rigs, and a major owner and operator of floating production and storage vessels outside the North Sea.

Major deals

The fourth deal Hussey mentions is the still-in-process USD3 billion financing for BW Group, with proceeds divided equally between BW Gas and BW Offshore. Illustrative of the club approach, underwriters on this deal include Danske Bank, Deutsche Bank, DnB Nor, Fortis Bank, HSBC, HSH Nordbank, ING Bank, Nordea Bank, Oversea-Chinese Banking Corporation (OCBC), Svenska Handelsbanken and Swedbank.

Nordea's Bjornadal puts syndication in its broadest context: "Our customers have good projects. We need to keep the pipeline open for them." His comment reflects an often-repeated stance, although there is one basic difference: big outfits will get bigger.

George Economou, who is chief executive officer (CEO) of Dryships, a company currently in the process of sourcing bank debt to fund the construction of drillships on order, says: "The big owners, which are large public companies, will continue to get money. Smaller owners may not be supported."

Sophocles Zoullas, CEO of supramax drybulk specialist Eagle Bulk Shipping, which in 2007 landed a USD1.6 billion facility led by Royal Bank of Scotland (RBS) to fund expansion, adds: "The strong companies can get capital; for Eagle, it is good." On the tanker side, Paul Durham, CFO at Tsakos Energy Navigation, describes his company's healthy cash build-up: "We could raise finance very easily if we needed to. It is not a problem."

Similar sentiments were voiced by Marco Fiore, CEO of D'Amico International Shipping, and Felipe Menendez, CEO of Ultrapetrol, who comments: "Good industries will attract capital." Among the shipping debt providers, there have been no absolute winners - although some banks have lost less than others. Institutions with diverse funding pipelines have avoided blockages. In this context, Bjornadal mentions Nordea's capability to issue covered bonds in Sweden. ING's Hussey says that, in relative terms, the Greek and Nordic banks were less affected by subprime woes. Andreas Povlsen, managing director for global shipping at BTMU Capital Corporation, suggests that his institution has seen a post-credit crunch shift: "We typically provide subordinated and junior debt, but we are now looking at more senior-debt deals where the pricing makes sense." Povlsen states that if major banks have pulled back due to liquidity concerns, there is and will continue to be an increased requirement for mezzanine finance. He adds that owners may need to come up with more equity to secure financing.

Another approach to bridging the funding gap came from Hamish Norton, managing director at Jefferies & Co, who hints: "High-yield unsecured debt may again play a role in funding underneath shipping equity."

Price increase

Ship values have risen off all the charts - they are now exceeding any historical price comparisons. This anomaly may actually help to close the funding gap and contribute to diminishing potential capital shortfalls, provided that bankers maintain a conservative approach. The banking panelists actually point to the brimming corporate treasuries at shipowning companies as a possible source of the equity needed to fund fleet growth. Bjornadal said: "Our clients' accumulated surpluses are on deposit." In a similar vein, Pitts-Tucker says: "The industry may help the banks decrease the cost of liquidity."

Financiers seeking to plug the funding gap may look towards equity. Norton says the equity capitalisation of 41 listed shipping companies in United States markets is about USD44 billion - three years after the boom in initial public offerings (IPOs). Unlike commercial banks, they do not appear daunted by the industry's USD50 billion or so of annual equity requirements. Craig Fuehrer, managing director at Deutsche Bank, suggests: "With good returns over the past few years, investors will fund the industry." Eric Schless, managing director at Wachovia Capital Markets, adds: "The markets will be there to fund the gap." Yet, recent evidence suggests that shipping equities are not immune to occasional headwinds. The recently completed Safe Bulkers deal, led by Credit Suisse and Merrill Lynch, was wrapped up below its initial pricing range, as it came to market amidst several secondary offerings by established maritime companies.

Market concern

The challenges connected with the recent Britannia Bulk offering led Joseph Giacobbe, managing director at Banc of America Securities, to remark: "On the deal just done, there were challenges out there. The markets are not fully open to the sector." The very visible market indices and the forward market have raised concern among listed shipowners, including those in the tanker and container trades. These shipowners worry about the undue influence that wild swings in the widely followed Baltic Dry Index (BDI) have had on share prices. The Britannia Bulk IPO came to market just as the BDI was in the midst of a sharp downdraft. Ultrapetrol's Menendez points to the security aspect of "cleared" freight swap transactions for capesize bulk carriers, at rates that would support rapid paydowns of bank debt. Duncan Dunn, director at SSY Futures Ltd, describes a drybulk market where more than half of its USD100 billion turnover is cleared, mainly through the London-based LCH-Clearnet consortium. On a macro basis, the "de-leveraging" that Nordea's Bjornadal describes has created a pool of capital that could partially soak up the potential shortfall, whether through direct investment in tonnage or by way of private equity-like intermediation. Another theme that recurred throughout the event was "trusted borrowers with good track records", which several commercial bankers and borrowers mention when ticking off attributes of transactions that could be readily funded. In the investment banking context, this same theme perhaps provides a glimpse of the future contours of equity recycling.

Such deals may fill the funding void identified by commercial bankers, albeit through a different channel