SPECIAL FEATURE

Date Posted: 30-May-2008

JANE'S TRANSPORT FINANCE - MAY 29, 2008

Shipping springs into life

Barry Parker

As spring blossoms throughout Northern Europe and New York, shipping markets are attracting interested investors. Barry Parker reports

Widely watched indicators are pointing to boom times for shipowners in the drybulk and tanker sectors.

The Baltic Exchange's composite of four timecharter trip routes for capesize bulk carriers is rated at USD211,000 per day, bolstered by a surge in Brazil ore moves.

Under timecharter contracts, fuel price risk is passed onto the lessee. For the ubiquitous panamax vessels, earnings are pegged at USD88,000 per day, while supramaxes are worth nearly USD70,000 per day. Tanker markets are also strong, particularly for bigger vessels in trades tied to long-haul moves of crude oil.

Not surprisingly, equity investors have been diving back into the waters. Most notably, Nordic American Tankers (NAT), raised roughly USD170 million in a secondary offering, aimed at paying down borrowings under an outstanding credit. Only a month earlier, the owner of 12 suezmax tankers, with two more under construction, had extended the term of its existing USD500 million credit by three years, out to third quarter 2013 (Q313).

The non-amortising facility, with approximately USD115 million drawn as of mid-April, was led by DNB Nor, Nordea Bank, and Fokus (Danske Bank). The margin above Libor varies between 70bp and 120bp, depending on the ratio of the loan to security pool value. Where the amounts outstanding under the facility are less than 50 per cent of the pool of secured ships, the lowest margin applies.

Prudence pays

NAT has attracted a loyal investor following through the company's policy of paying out maximum amounts of cash as prudently as possible. But minimal reserves of cash necessitate maximum flexibility in the company's financing. Ideally, an open equity market window will allow NAT to pay down its debt after returning to the equity markets. For financing construction of new vessels, the facility's provisions enabling repayment and subsequent redrawing are ideally suited for NAT.

In late 2009 and early 2010, when the two newbuild vessels deliver, NAT will need to fund back-loaded shipyard payments aggregating some USD154 million, presumably from this credit.

In recent weeks, Seaspan - a lessor of containerships to major liner companies, Double Hull Tankers - a lessor of ships to Overseas Shipholding Group (OSG), and Teekay Gas Partners - a partnership with crude oil tankers and gas carriers, have also been tied to recent secondary capital raises. As with NAT, each of these entities seeks to pay out a large proportion of their cashflows in the form of dividends (or, for Teekay Gas Partners, partnership distributions). NAT, with a preference for spot charters - unlike the other entities that are more period minded - has thrived in the rising markets.

When equity windows are open, dividend-payers are eager to substitute fresh equity for bank debt, thereby reducing the call on cashflows required to service debt. Skillful financial management is required in the face of dynamic equity and debt marketplaces.

For the shipping banks, tectonic shifts that occurred over the past nine months may have permanently altered the landscape. Harald Kuznik, HSH Nordbank's executive vice-president and global head of shipping activities, tells *Jane's*: "After Christmas holidays, the banks were really not sure where the market was. Indications were given to customers with a very wide range of pricing. In part, this reflected banks' uncertainties about liquidity in the markets.

"But it's better in recent weeks. Our view is that things have brightened up and the fog has cleared," Kuznik tells *Jane's*, adding that "shipowners have come around to the notion that liquidity costs have gone up. From the banks' point of view, liquidity is a scarce commodity that must be managed carefully".

A Fortis presentation by Harris Antoniou, who manages the bank's shipping, commodities and energy activities, outlines several phases to the crisis, beginning with a liquidity crisis in Q307 that morphed into a full-blown banking "crisis of confidence" by the Q407, feeding back on each other in what he called a "vicious circle of confidence". Antoniou, speaking to an audience in the Greek market, describes a situation where interbank funding costs have soared amidst financial market dislocation and lingering uncertainties regarding sub-prime losses.

As a consequence of these types of market developments, new avenues for the sourcing of bank funds will be required, with HSH Nordbank's Kuznik emphatically telling *Jane's*: "The London interbank rate [Libor], is no longer the proper basis for pricing shipping transactions; at some junctures, banks cannot get funding based on the Libor rate. The market is grappling with the question of what rate should replace Libor as a base for pricing shipping loans. Shipowners still want to price on a Libor standard but they realise that it does not reflect a significant cost - the liquidity element."

Alternative funds

So far, there is not one replacement for Libor - in discussing transactions in the German domestic market. He adds: "There are many transactions with pricing keyed off the banks' own funding costs."

In some ways, the market's travails have led to a situation in which company risk is more properly priced than it was in Q207, a time of narrow spreads across a wide spectrum of borrowers. A year ago, a number of prominent bankers, including Kuznik, were expressing the view that differentiation according to company credit quality was missing from loan pricing. That has changed now. Kuznik says: "The credit ladder now distinguishes between the top credits - which might be getting 80bp or 90bp over Libor and the merely acceptable credits that could now be getting 150bp or 160bp over [Libor]."

Another change in the market has been the move towards club deals, where participation among a group of banks is agreed in advance on their participation, in contrast to syndications in which a large bank, such as HSH Nordbank, will underwrite a credit and then apportion it among participants after the fact.

Kuznik describes HSH Nordbank's 2007 experiences as follows: "We were highly successful in the first half of the year. We did close to EUR12 billion [USD18 billion] of new business. Because the newbuilding market was moving very quickly, our customers needed their money fast to put down deposits. So we ended up underwriting a lot of business. In our case, we did not have our own liquidity problems, but we did have difficulties with syndications."

He explains that HSH Nordbank faced a situation where "the market had gone" when it was time to seek participation from other institutions that were unable to allocate their own liquidity into deals originated by the Hamburg-based bank. A consequence of this was that HSH Nordbank's allocation of capital into shipping grew very fast. "We could not offload the portions we had expected to," Kuznik says, adding, "now, the syndication risk is shared from day one. The banks agree to work together - each takes its own syndication risk."

Seeking backers

The presentation by Fortis' Antoniou picks up on similar themes. He says that "banks will benchmark their shipping portfolios against their non-shipping client base and will need to significantly increase margins to compete internally for capital". In analysing the competitive landscape among the various banks, Antoniou stresses that banks able to source funds outside the interbank markets - for instance, through retail networks and private banking, both of which enable deposits to be gathered - would be at an advantage relative to competitors.

Kuznik describes the USD1.1 billion MPC Capital transaction, announced in early May, as "a hybrid between traditional deals and the club style. We undertook syndication risk for part of the loan". In that deal, mandated lead arranger HSH Nordbank will provide USD427 million - around 40 per cent - of the financing.

Other banks participating in the deal are joint lead arrangers Calyon and Dresdner Kleinwort as well as co-arrangers Bayerische Hypo- und Vereinsbank and Deutsche Schiffsbank.

Nine 13,000 teu mega-container vessels are slated to enter into 12-year charters with Hanjin Shipping following delivery from a Korean shipyard in 2011 and 2012. At delivery, the ships will be dropped down into KGs offered to investors through MPC. Analysts have estimated that more than USD5.3 billion was raised for shipping through KGs in 2007.

Grace and favour

Another change in the banking markets concerns principal repayments. Kuznik offers that deals are still being done in which amortisations kick in after some grace period but that "five years [of grace] is a no go".

Capital Product Partners (CPP), a listed entity on the US Nasdaq market, entered into a USD350 million credit package. According to regulatory filings, DNB Nor, with USD75 million, and a trio of Greek banks are also participating in the credit with an aggregate USD185 million. Drawdowns are being divided into USD110 million - in two tranches - to refinance debt on four vessels to be acquired from CPP sponsor Capital Maritime, a private company, and a USD250 million third tranche that will finance additional dropdown vessels in the future.

The traded partnership CPP acquires the vessels from the private company after charters have been arranged, and, at that time, the credit is drawn down. So far, two vessels have joined the CPP fleet, financed through a combination of USD46 million drawn under tranche A - which allows for up to USD57.5 million - and CPP shares issued to Capital Maritime.

The financing takes the form of a five-year revolving credit - with re-borrowings allowed up until March 2013 - at which time outstanding amounts under the three tranches are converted into a term loan that repays with quarterly installments over five years down to a 50 per cent balloon payment. Margin is 110bp over Libor. A reading of the fine print reveals a market disruption clause, aimed at dealing with the types of market discontinuities described by bankers Kuznik and Antoniou. Drawdowns can be suspended if a majority of banking participants are unable to obtain Libor quotes or, if the facility agent fixes a rate and participants feel it does not reflect funding costs. Loan documents also outline a path for negotiating an alternative interest rate if the Libor quotes are unobtainable after an advance has been made.

In talking to *Jane's*, Kuznik says that the decision to offer a grace period came with "a trade off against leverage at the outset". Loan covenants include a liquidity requirement, a minimum 2.0-times EBITDA-to-interest ratio and a maximum total debt-to-vessel market value of 72.5 per cent.

HSH Nordbank completed another important Greek transaction, leading a USD204 million club deal, joined by two Greek banks, in providing finance for Primera Maritime, a Greek operator taking delivery of seven supramax (57,000 dwt) bulkers from a Chinese shipyard. The vessel series, ordered in 2006 at roughly USD30 million per vessel, are delivering this year and in 2009.

The market value of prompt "on-the-water" comparable vessels exceeds USD80 million per vessel, implying a conservative debt-to-market value of around 40 per cent on these new bulkers.

In today's charter markets, a one-year charter rate well above USD60,000 per day is possible, implying a yearly cashflow approaching USD20 million in the first year and possibilities for rapid repayment.

Looking ahead

The interview with Kuznik concluded on a forward looking note, with a suggestion that more transactions could be announced in coming weeks.

Kuznik also offers views on the equity markets: "We are now seeing more deals that are tied to possible stock offerings," but he was quick to point out that the overall state of the stock and financial markets - not the booming freight markets - is the big driver in determining whether such deals could come to fruition.

Perhaps a harbinger of stabilised financial markets was a regulatory filing for Safe Bulkers: a drybulk-owning company planning to list on the New York Stock Exchange. Seeking to raise between USD200 million and USD250 million, the Haji-Ioannou family linked shipowner has eight ships under construction and 11 vessels currently trading.

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