Report Shipping Finance Forum
Who is picking up the tab?
The need for consolidation was an important theme during the first forum in 2011. At that time, it was unclear whether we were at the bottom of the cycle or on our way to the top. In 2013, it seems that the situation has worsened for many companies. Consolidation has yet to take place sufficiently and enormous overcapacity exists. Financing for reorganisation is no longer approved as easily; increasing regulatory pressure is playing a role in this. Less funding is available from the traditional shipping banks and this will remain so in the near future, which means that alternative sources of capital will need to be found. In every case, however, the criteria for the predictability of cash flows are more stringent. Pressure is growing to increase transparency and work with multi-annual contracts.

At the same time there are companies in existence such as Peel Ports, which have been successfully making headway in securing financiers, either by way of shareholders or private equity. Transforming obstacles into opportunities and optimising these chances has forged a future for the shipping industry.

On the following pages you will find a compelling report of what was discussed that afternoon.

I hope you will find this report interesting reading.

With kind regards,

Deen Sonneveldt
Dutch Shipping Leader
Ship finance in today’s environment

For over 45 years, NORD/LB has been developing the Ship Financing business segment into a strategic core segment. Over the long tradition of engagement for the maritime industry, NORD/LB has grown through the cycles into one of the leading global ship financiers.

Market environment

“We are all on the same page when it comes to the market environment, I think. Things cannot get much worse. Due to the slow recovery process the global economy is still in, the environment for shipping and ship finance remains challenging. With the depressed freight rates and rather high bunker costs, most of our shipping companies are in cash negative positions. Coupled with falling asset prices, more and more companies are finding themselves in distress. Because of the new tonnage that was imposed on the market before the new prices were introduced, supply and demand may not strike a balance for several more years in this industry.

Various European banks are under pressure to reduce shipping exposures due to capital and funding constraints, de-risking, focus on core businesses and regulatory impacts. The withdrawal of HSH Nordbank and Commerzbank alone would leave a substantial funding gap. Therefore, the industry is in desperate need of alternative funding sources. Most companies are midcaps with rather underdeveloped governance. They are or should be open to intelligent capital and consolidation.
We are seeing increasing support from government authorities for the industry (State banks in China, Korea, Germany etc). Sophisticated investors may benefit from such schemes.

At the moment, it will take us until the year 2019 to match the time charter rates of benchmark vessels such as containers, bulkers and tankers to the 10-year average.

**Bank’s perspective on ship finance**

Looking at the scope of European Banks, we find a restricted access to USD funding. There is a strong know how regarding shipping. The risk appetite is limited. Due to capital constraints, EC and EBA requirements the ability to invest is restricted. There is a reduction or exit of the overall volume. European banks have an unlimited focus concerning geography or sector.

**Impact of regulations on the business**

Basel II introduced a rating-dependent approach to capital requirements. For example, the rating of a vessel of 3,500 TUE, constructed in 2007 during Basel II makes 4 on the rating grid. In a Basel III environment and due to the crisis the rating for this vessel can go up to 15. This is the impact of the crisis on deal parameters. During a crisis you have to make sure you have an extra buffer, or a buffer buffering your buffer. During a crisis you have to raise an extra layer on capital. You should reflect this new world in your deal.”

Streamer: You should reflect this new world in your deal.
Who is picking up the tab?

EXMAR has its headquarters in Antwerp and is a leading independent LNG and LPG Carrier Owner and Operator. In addition, it is a provider of industrial marine and energy logistical solutions for transport, regasification and liquefaction within the oil and gas industry.

Nuytemans begins his presentation by showing a clip of a famous Swiss skier, who has won a prestigious skiing competition in 2011 for the fifth time in a row. In 2012 he skies down a slope similar to the competition course on a pair of wooden skis, using decades-old equipment. Using this gear makes it impossible for him to match his own results. No matter how skilful you are, Nuytemans tells us, you continually have to look out for new solutions or you will never be able to meet the requirements. This is the situation our shipping industry is in at the moment.

Chronic oversupply

“People always talk about the shipping market as a whole. But there’s a huge difference between coastal traders, LNG vessels and so on. The most important point I want to make — and if I had a solution I would give it to you — is that there has always been a chronic oversupply of ships in the shipping industry, but at this point we have crossed the line. Someone is going to have to pick up the tab for the severe market surplus.”
Playing field
Bank Loans have traditionally satisfied 75% of external funding requirements. The number of active shipping banks has reduced and ticket levels have decreased. Banks have been occupied with restructuring rather than new business. As a result, a shortage of bank debt is currently constraining the shipping industry, an industry that is heavily dependent on the banking market. There are examples of private equity funds such as OMERS (Canada) and WL Ross & co that are investing in the shipping industry. “Still small potatoes compared to the overall size of the shipping banks”, Morten Arntzen, CEO of OSG said in 2012. At this moment OSG has filed for protection under Chapter 11.

“This is one of the most capital-intensive industries I know, and yet uniquely it is highly fragmented. It has not become oligopolistic, despite being inherently global and capital-intensive. We anticipate that this will begin to change as we go through the extremely traumatic period that we’re in.”

Willbur Ross (WL Ross & co)
Many larger industrial companies who control a sizable fleet are looking to minimize the asset exposure on their balance sheet. Off-balance sheet financing has again become very popular. Norwegian Limited Partnership (KS) as a structure is an example of an agreement that can benefit the ship owner.

The Norwegian K/S structure
To be considered a single purpose limited partnership (kommandittselkap (KS)) under the Norwegian Companies Act (NCA); the KS must consist of one general partner and several limited partners. The general partner must hold a minimum share of 10% in the KS and has unlimited liability towards the company’s creditors. The limited partners’ obligations are limited to each partner’s share of the total committed capital, (including bank guarantee) of the KS. However the limited partner’s hold a joint liability towards the KS if one the other limited partners default on their obligations.

Case study
An interesting example of a company that has benefitted from an off-balance sheet financing, making use of the Norwegian K/S structure is a Box Carrier Corp. (BCC). For a description of the procedure click here.
Mr. Carlton Siddle, moderator, kicks off the discussion: “In 2008 everybody believed that by now we would be out of the crash and there was an acceptance of restructuring as a need at that time. Do you think the banks should change their regime on that point at this moment, or should they continue?”

Mr. Dimitris Koutsopoulos: “On the Greek side, the banking sector was in need of consolidation. The capitalization of the bank was scheduled for September 2012; we hope it will be finalized by May this year. The banks haven’t done anything but wait and extend the facilities. No additional money has been brought into the market. It’s a very unstable market. Things are changing, but it will take time.”

Mr. Oscar Snijders: “In the Dutch market multiple structures were foreclosed, the damage is done. Losses on the banks’ side, on the other hand vessels still in the market at a much lower entrance cost and therefore disturbing competition. We are now facing a new challenge: who is going to pay up and who is going to fund that?”

Mr. George Cambanis: “In 2008 we assembled a group of people that are close to the bank, have access to the bank and can actually do that ‘White Knight’-service for us and bring the banks and the ship owners to some logical solution to the problem.”

Siddle continues: “It comes back to the prolonged depth of the depression that has hit the shipping industry. People have been prepared to put their company cash into it, but those resources are running dry and so is the appetite to invest. We need a change of attitude from the banks, so we can work from a bilateral position instead of working with banks that have completely different agenda’s. Historically the lenders were all on the same page; nowadays banks from different countries work from a completely different statement.”

The Ship restructuring panel has an urgent message to convey to all parties in the shipping industry. “There is a great need for restructuring on the side of the banks as well as on the ship owners’ side.”
True value of assets
“The individual banks have to realize the true value of the assets rather than what they pronounce it to be in public pronouncements. The portfolio impact is so significant for them as individual banks. You can actually get them to be more malleable around the negotiating table.”

“Rushing into massive impairment is a short term answer, it’s going to bring a void in finance, which is totally unacceptable.”

“There needs to be a greater attitude of self-help from the supply side here, because we have a number of issues around obsolescence. We have the green agenda, we have relatively young vessels being chosen by charter counterparties over older vessels, all of which leads us to ask of the banks: What is the true economic model you should be using to assure repayment of your debt?”

An urgent plea form the audience: “We have failed to see the consequence of really being in this cycle for the last four or five years. This is caused, in my opinion, by the fact that there are lots of ship owners who are basically in default or bankrupt. They don’t pay full interest or instalments to the same banks that have clients that do pay full interest. The banks are competing with their own clients as long as they keep this ship involvement virtually alive. Any take-up in the market will be delayed substantially because we have warehouses full of vessels that have no actual owner but the bank. If we don’t stop this warehousing we will find that a lot of good owners that do pay interest, who are suffering, are competing with a different agenda and on a totally different cost base. If the banks and the owners are not willing to face the consequences of the mess they created themselves, we are not going to resolve this market.”

Overcapacity
The panel agrees. “There is this recognition that there is a ‘zombie’-population out there. The banks are not recognizing what they would do traditionally; that is, to not authorize a loan. If you cut away a lot of the dead wood there are lots of shipping companies which probably have vessels 50 + years old, where the value isn’t likely ever to return. And yet action has not been taken. We haven’t seen a shifting volume in scrapping, although you would expect the industry to correct itself. There are owners that can take the decision to scrap, and there are banks that can also enforce the decision to scrap, rather then taking a warehouse. Ordering more vessels doesn’t help. That’s just a further prolonging of the same issue. Considering all of those things combined, I think there are measures which could still be taken now to avert an extended depression.”

Mr. Johan Werbrouck: “There are a couple of pioneers now that are looking for platforms that they can use as an anchor to consolidate. A large number of small entities are very disposed, bitten by the offshore business years ago. They are trying to find consolidation. Not so much in shipping, but in the services technology around it.

Private Equity
“Let’s invite alternative sources of finance to bridge the gaps to get into recovery into the centre rather than stick to the same stakeholders. The answer right there has got to be our friends in private equity, who have billions of Euros to invest, and yet there are only two or three active participants that are doing deals.”
Last year, Gust Biesbroeck, Global Head of Transportation at ABN Amro, was one of the speakers at the Shipping Forum. At that time, he noted that the position of banks as financiers of the shipping industry was under pressure, that the shipping industry itself was challenged by overcapacity, and that the criteria for sustainability and transparency were becoming more stringent. In the run-up to the Shipping Finance Forum in 2013, Deen Sonneveldt (Dutch Shipping Leader at Deloitte) inquires into the current state of the shipping industry. Biesbroeck now sees “more than a glimmer of hope”.

Deen Sonneveldt: “How is demand and supply developing in the shipping industry as a whole?”

Gust Biesbroeck: “Last year many old ships went to the breakers and a relatively small number of new ships were built. Almost no one has the available capital to order ships and the banks are unwilling to cooperate. Despite this, there is steady growth on the demand side. The demand for tankers is the only aspect that is lagging behind, as the United States is again producing its own oil. Transportation to China may be needed in the future, however. In the short term, no major conjunctural recovery is therefore anticipated, although the seeds have certainly been sown.

The traditional shipping banks will continue to have fewer funds available. This will remain the case for the time being, which means that other sources of funding will need to be sought. Private equity is one example. There are also opportunities in the Middle East and China. In all cases, however, the predictability of cash flows is subject to more stringent criteria. Financiers are amping up the pressure for greater transparency and working with multi-annual contracts.”

Deen Sonneveldt: “Have all parties encountered difficulties in obtaining sufficient financing?”

Gust Biesbroeck: “The majority of smaller parties have successfully managed to secure financing from local banks and the larger shipping companies have not encountered any problems. The medium-sized segment of the market has been hit the hardest, however. They are too large to be served by one or two banks, and not organised sufficiently to play the capital markets. Furthermore, the companies that use their ships – Esso, Exxon, Unilever – are behaving differently. Several years ago they were attentive primarily to the lowest cost, but nowadays the carbon footprint is also a factor, together with other aspects of sustainability. Shipping companies need to be strategic partners that are able to offer everything. In my opinion, this is an important trend.”

Deen Sonneveldt: “The result, a consolidation of the medium-sized market, is already visible. What do you envisage will happen in this area?”

Gust Biesbroeck: “The financing forms are adapting to the new situation. In Norway, where everything revolves around the shipping industry, the bond offering is growing. This is partly due to the fact that shipbuilders have neglected their relationship with the banks, or because tier banks have stopped offering their services. There are only a few banks that finance the shipping industry, including ABN Amro, and furthermore primarily French, Swedish and American banks. Asian countries are offering a great deal of export financing, which is why Chinese banks are trying to increase their influence. This may well be the year of reckoning.”

Deen Sonneveldt: “Have we reached the deepest point yet? Do you see any light at the end of the tunnel?”

Gust Biesbroeck: “We are certainly entering the depths now, but the mood is better than it was during the 1980s. What we currently have is a financial problem. Once this has been resolved, an enormous innovative force will be unleashed in the Netherlands. Our banks are relatively robust, and this is becoming increasingly more important. Fixed assets are a problem here, but the banks are not failing as a result. Even Greece is experiencing some export.”
Who is picking up the tab? Verslag Shipping Finance Forum

Shipping Finance from a shipbuilder’s perspective

The influence of the government
Damen Shipyards Group is a Dutch company with a worldwide export share totalling 75% of turnover. They are also seeing a general trend of increasing difficulty when it comes to shipping finance. The criteria for what would be labelled as a good project have become stricter. Damen considers the relationship with the Dutch government a very important one. The government supports pre-delivery guarantee schemes, and guarantees working capital for export projects through Atradius, the Dutch export credit agency. Export financing is a major tool for Damen, mostly based on clients’ corporate securities and Atradius facilities.

Dutch Ministry of Finance and Atradius
Atradius issues credit risk insurance cover on behalf of the Dutch Ministry of Finance to the financing bank. Banks are willing to offer long-term finance based on Atradius (= Dutch State) credit risk insurance cover. In the event of a default under the loan the Dutch Ministry of Finance will pay out under the insurance policy and compensate the bank for the losses.

The conditions concern political and commercial credit risks such as Dutch & OECD requirements for export credits; restrictions concerning down payment percentages; the duration of the tenor and a minimum of Dutch content of 20%. The premium depends on the country of residence of the Damen customer; the type and financial standing of the customer, the terms of the loan and the guarantees offered. The premium is compensated by a lower bank margin.

New developments: Export Finance
The Dutch Government and Atradius have responded in several ways to the credit crisis and lack of financing options by:

• Introducing a more flexible country policy and less guarantee requirements for Dutch export transactions.
• Revising Dutch content requirements: now 20% instead of 50%.
• Introducing the Export Krediet Garantie (EKG), enabling banks to attract long-term funding from pension funds and other investors.
• Introducing the Working Capital Insurance Facility for Dutch exporters.
A response to various opportunities

The Peel Ports Group is Britain’s second largest group of ports, strategically located to serve the whole of the United Kingdom.

Five major gateways handle a broad spectrum of international trade amounting to more than 65 million tons of cargo a year. At the centre of the Group are the Port of Liverpool and the Manchester Ship Canal, now one continuous water highway forming a single port facility of major strategic significance forged under the banner of Peel Ports. The Ports are close to key UK population centres.

Change in strategic vision

By the end of March 2011, due to the recession, volumes had fallen however the financial performance had been protected and improved as a result of securing internal efficiencies and cost savings. The Group decided to undertake a strategic review and a 10-year business plan was developed, driven from all the businesses looking at their opportunities for growth. Significant growth potential was identified with an investment requirement of £700m. The shareholders were supportive, and a major refinancing was completed in December 2012 to further these plans.

Liverpool 2

One of the key strategic growth drivers is Liverpool 2, the Development of a new in-river container terminal at Liverpool. The fact that the Port of Liverpool can’t be considered by some customers because of the vessel size constraints led to the development of Liverpool 2. Peel Ports’ strategy is to deliver an efficient ship to door logistic service to maintain a competitive position using inland transport efficiencies where possible.

Liverpool has some natural advantages which are as follows: 65% of UK population is within a 150 mile radius of the Port; 50% of containers end up closer to Liverpool than traditional UK deep sea ports and the Port of Liverpool and Manchester Ship Canal form a 44 mile water highway into the heart of NW England.

Liverpool 2 will accommodate vessels up to 13,500 TEU

- Caters for two 380-meter long vessels to berth simultaneously
- 1.5 m TEU annual capacity
- 854 meters of riverside quay length
- 17 hectares of hard standing storage
A Call for Consolidation

Marc Nuytemans starts the discussion: “It’s difficult for anyone to talk about the entire shipping industry. East of Suez it’s a whole different world than for instance in South America. This makes consolidation much more difficult.” One of the participants comment: “it’s one thing to be saying we have a large oversupply; we need to get rid of all those ships. That can be the conclusion, but if it will become reality, that’s another thing. There’s a lot of resilience in the industry.”

“Well, we are living in a world where consolidation definitely took place,” Yntze Buitenwerf remarks. “Going back to 1995 there were 40 ship operators in specialised reefer industry, only 22 of them were left. Today there are only 8 left, consolidation mostly through mergers. We saw that owners that were specialised in reefer shipping also had another sport, such as containers and bulk carriers. People didn’t leave the industry just because they could not stand.

The interesting thing is we seem to go back to the basics of living, to the primary necessities of life according to Maslow. So we are willing to skip a vacation, but we do want to eat fresh bananas. It comes down to logistics. Our industry is consolidated, but it is also changed to shipping into the distance. We went through a period of strong consolidation. Last year 15% of the total world fleet of specialised reefers was scrapped. And it was not scrapped because of age, but for economic reasons. Since that moment, we saw the market doubling immediately.”

Eco ships and ultra eco ships

“We are interested in eco ships but only if the investment in the eco ship can be recuperated, earned back;” Marc Nuytemans remarks. “There may be an advantage in the costs of fuel, but the slightly higher investment costs make it even more difficult to get finance.”

“People who are interested in eco ships, mostly are worried about costs,” Yntze Buitenwerf adds. “That’s the only driver. Our company transports specialised goods only. This means: being fast is very important. You have to burn a lot of fuel. These huge ships go from eco to eco-eco, to super eco, to ultra eco, what have you. They drift over the oceans more or less, and by the time they reach New Zealand, the pineapple will have a shelf life of only seven days. That’s not good enough. Did you know that 40% of all the fruit that is imported into Europe, ends up in the waste bin.”

“The scrapping has always taken place in India, and now in China, because of the condition of standard vessels are not according to our regulations. We have to ask ourselves, do we want that here? Would you want to adopt that, talking about the environment?”

Hans Voorneveld
“Many of these ship owners thought: if our pockets are deep enough, we can make it. But the bottom has been reached.”

Hans Voorneveld
worries me what this eventually will mean to our children, what will happen to future generations.”

Herman Marks points out: “A lot of the overcapacity in shipping is basically used for slow steaming. So the fuel prices have gone down significantly because of overcapacity. There is more to slow steaming than you think.” Marks continues: “The eco investments are driven by regulations or society, or it should bring money for the owners, seems to be the opinion. Above that, regulations often bring about negative consequences for the environment. If you are allowed to fill a container completely, or only two-thirds, that of course has an effect on the amount of fuel needed to transport the freight.”
What are the major changes that Cpt. Marc Nuytemans referred to during this 2nd Shipping Finance Forum? I think there are a number of major changes. For one, not so long ago an eco ships were considered an impossibility. Now the ships are here, they burn less, and are going to pose a problem for some ship owners. I was with a client in January; they placed a big order for new tankers. Why were they ordering when there is this huge oversupply of ships? They need to renew their fleet; they need more pirate-resistant vessels. The requirements are continually changing.

The second major change is the increasing exploitation of shale gas. The patterns of fuel transportation and the routes of the tankers are changing. These changes will affect us.

My work takes me all over the world, to ports such as Singapore, Hamburg and New York. This gives me the opportunity to speak to lots of ship owners and large commodity companies. These companies have come to understand that cargo is king. Currently, they can either buy vessels now, or lock vessels in for the longer term and take advantage of the low prices. A lot of these commodity companies are buying ships and transport the goods themselves. This will also affect us.

We’ve talked about private equity and mezzanine finance. They are taking all shapes and forms, and they are necessary for shipping finance today. I think our guests have shown us some interesting developments this afternoon.

Kind regards,

George Cambanis
Global Shipping & Ports Leader
Contact
For more information you can contact:

Deen Sonneveldt
Dutch Shipping Leader
+31 6 5134 9490
dsonneveldt@deloitte.nl

Judith Stout
Manager
+31 6 1098 0285
justout@deloitte.nl

George Cambanis
Global Shipping Leader & IPO specialist
+30 6 9443 05760
gcambanis@deloitte.gr
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