HIGH FINANCE IN THE HIGH SEAS : THE GLOBAL SHIP FINANCING SCENE

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PRESENTATION OUTLINE

- Ship financing (SF) : Features and global scenario.
- Negotiating SF.
- Global trends in SF.
- Crystal gazing : SF outlook.

GLOBAL SCENARIO IN SHIPPING

- Increasing demand for capital.
- Pressure to add tonnage capacity.
- Consolidation – M&As.
- Focus on maritime security, navigation safety, environmental protection.
- Rise in ship prices.
- Rising operating costs.

FEATURES OF SHIP FINANCING

- **High risk, marginal return.**
- **Mismatch between long term needs and short term financing.**
- **Dominated by debt financing.**
- **Case of haves and have nots.**
- **Dominated by traditional financiers.**
- **Growing interest by financiers / investors.**
- **Takes money to borrow money!**

RISKS IN SHIP FINANCING

- Unpredictable earnings / asset values of shipping companies.
- Volatility in shipping sector.
- Change in trade patterns.
- Cyclical nature of ship trading market.
- Uncertain residual value of ships.
- Cross-border risks.
- Huge exposure.

Growing portfolio, lower margins of SF banks

- More SF loans but shrinking margins.
- Shipping companies awash with cashflow.
- Huge liquidity in debt financing market.
- Increasing competition in SF among banks.

Emergence of alternative financing structures

- **Leasing**
- **Sale and leaseback**
- **Asset securitization**
- **Shipping agents**
- **Derivatives**
- **Hedging mechanisms**

Increasingly flexible loan tenure

- **Tenure of SF bank loans : 5 to 8 years.**
- **More banks now willing to lend longer.**
- **Banks more responsive to address timing mismatch between lending / borrowing in SF.**

Cross-border partnerships between SF banks

- Small banks joint venturing with bigger foreign banks in big deals.
- Small banks get to play for bigger stake and get involved in complex deals.
- More complication arising from cross-border risks and multiple jurisdictions.

Growing popularity of hedge funds

- More risky but potentially high returns.
- Less regulated than banks / capital markets.
- Attractive for investors looking for riskier plays.
- Growing popularity of freight derivatives and Freight Forward Agreements as hedging tools.

Development of in-house shipping experts at financial institutions

- **More SF banks setting up shipping desks and dedicated analysts to monitor shipping markets.**
- **Increasing awareness of the importance of understanding shipping risks to structure / rice deals better.**

Shift away from subsidies

- **Less public funds in shipping.**
- **WTO ruling against protectionist policies in shipping / shipbuilding.**
- **Liberalization key to shift away from subsidization in shipping.**

Greater involvement of small to medium sized banks

- **Small-medium sized banks filling up vacuum left by big banks.**
- **Focus on servicing small-medium sized established shipping companies.**
- **Offer small sized debt financing at rates less fine than what big banks can offer.**

Greater interest in shipping IPOs

- Nov 2006 : 180 listed shipping cos. at 37 bourses. Market cap of US$209 bil., owning 35% world fleet.
- 'Glamorous' way of raising finance, convenience in tapping shareholders' funds.
- Investors keen to lap up shipping IPOs.
- Worry over US sub-prime crisis.

Increasing asset play in shipping

- Hive of trading activities / speculation due to good secondhand prices.
- Some vessels fetch higher secondhand prices compared with newbuildings.
- Smaller banks can only finance secondhands as they can be deployed / earn revenue faster than newbuilds.

Increased exposure by merged banking entities

- Merged banks have bigger capital base, more clout, increased appetite for deals.
- What was expensive before is now affordable.
- Pressure to maximize returns and earn fees driving them to risky ventures like shipping.

Emerging private equity investment in shipping

- **Boom in shipping attracting new class of investors i.e. pension funds, insurance companies.**
- **Cross deals between banks and PE houses to structure ship financing deals.**
- **Less conservative approach by some gung-ho PE investors to investment.**

Diversification of products and services among ship financiers

- Shipping banks going beyond 'plain vanilla' financing in wake of rising competition / growing demand for capital.
- Many undertaking portfolio diversification beyond 'traditional' exposures in shipping.

Rising insurance cost

- Specter of accidents due to rising traffic has seen premiums rising.
- Post-9/11 risk perception also contributing to rising insurance cost.
- Higher insurance costs affects ship financing pricing and terms & conditions.

High scrapping prices

- Scrapping provides balance in demand and supply of ships.
- Higher freight rates = less demolition.
- Ships deployed beyond shelf lives as owners capitalize on high demand.
- In chemical, more scrapping activities as owners replace single hull tankers with double hull ones.

SF players setting up branches in key shipping centers

- Major SF banks setting up shop in shipping centers to capitalize on deals.
- Growing awareness of SF players to be where the action is to serve clients better.
- Sign of growing opportunities and rising competition in SF.

Increasing M&A among shipping companies

- **Consolidation, vertical integration towards attaining economies of scale.**
- **Bigger entities arising from M&As require more money, more sophisticated financing.**
- **Major SF banks setting up M&A desks.**

OUTLOOK

- **Good prospect for ship financiers as long as shipping markets continue to grow.**
- **More options and liquidity in SF market but more money needed.**
- **Focus more on client servicing, not just lending / raising financing.**
- **Finer spreads, more flexibility as shipowners are spoilt for choice.**

OUTLOOK

- **Correction due in some shipping segments.**
- **Signs of overheating : overcapacity, fine margins at yards, lower freight rates.**
- **Impact of US sub-prime crisis may lead to market meltdown and credit squeeze.**
- **Introduction of more creative and cost effective SF structures.**
- **Opportunities amid overheating, pitfalls amid profits.**

TIMING IS EVERYTHING!

THANK YOU