

Report Shipping Finance Forum

The need to consolidate



The need in the shipping industry for sources of alternative financing has increased significantly over the past few years. Although financing has always been crucial to the shipping sector, it is a subject that has come even more to the fore over the past six months. In 2008, hedge funds and private equity parties showed virtually no interest in the shipping sector; in 2009 they were all present in that market.

Nowadays, they are well versed in the material, know the market and conclude major deals, particularly in the United States. In addition, many other forms of alternative financing that have not previously been used by the shipping sector have now become relevant.

The Shipping Finance Forum, organized by Deloitte and AKD, held in Rotterdam, arose from a desire for dialogue on this theme in an international group of business owners, bankers, private investors and other interested parties. The meeting drew a full house of interested parties, who listened as the speakers explained the role of banks, the position of shipping companies, the approach of private equity parties and other options to attract financing. The form was brought to a close with a panel discussion in which all guests were invited to participate.

The following pages provide a summary of what was discussed during the afternoon.

I trust you will find this report interesting reading.

Deen Sonneveldt
Dutch Shipping Leader

The State of Bank Finance in Shipping. Where do we Stand?



Gust Biesbroeck (Global Head of Transportation, ABN Amro)

Although banks have traditionally acted as the primary financiers of the shipping industry, the current crisis has undermined that position. According to Biesbroeck, there are other issues. The shipping sector is struggling with overcapacity. There are too many ships and too many shipbuilders. These shipbuilders notice the effects of banks offering less funding and taking part in fewer transactions. This reserve is caused partly by the economic climate, but also by the fact that banks have to satisfy more stringent rules on capital demands. Furthermore, technology is progressing rapidly. Sustainability is becoming more important and this is having an impact on the criteria that shipbuilders are required to meet.

In general, the demand for transport is rising. This also applies to the shipping sector, which is not well equipped to respond. The banking crisis has meant that banks are withdrawing from the shipping sector. That situation is here to stay and will lead to consolidation by employing economies of scale.

There is no lack of money in the world, which is why alternative forms of financing are being sought. So where can a ship owner turn?

The first option is to go into American bonds. Some shipping companies have taken advantage of that opportunity with success. In addition to the United States, Norway, Hong Kong and Korea also provide such opportunities.

The second option is to become listed on the stock exchange. At present, this is not an easy path to pursue, but that should change as the market consolidates further. New York is the first choice, but there are also opportunities in Oslo, Singapore and Hong Kong.

Private equity was already active in the shipping sector and is in the throes of making a comeback. The shipping sector can make use of this. Private equity parties are market savvy and can help business owners develop their companies. This comes with a price tag, but it may - potentially as an interim solution - be a good option.

Those who are considering having new ships built may decide to have them constructed in China, Korea, Norway or Finland. These countries give export subsidies that could form a significant element of the financial mix.

Private Equity: Alternative Financing Concepts for the Shipping Industry



Till Hufnagel (Managing Director, Goldman Sachs)

“Many shipping companies are still family-owned and in our experience don't like partner shareholders”

Goldman Sachs is a traditional private equity party with a regained interest in the shipping sector. The investor shows a particular interest in alternatives to support the shipping sector.

Hufnagel and Questa consider consolidation to be crucial for the shipping sector, and this is exactly what seems to be happening. Cooperation with ship owners is essential in this development. Goldman Sachs has selected a number of areas in which it is particularly active.

One of them is recapitalisation. This especially occurs in the event of liquidity problems, e.g., because a company has placed an order for new build. What's more, Goldman Sachs will invest in support of economies of scale. The crisis offers opportunities to this end, as more ships and companies are up for sale. This offers other companies a one-off opportunity to expand.

The specialised ship market is the final element. Various niches are available where Goldman Sachs can help new companies to grow and realise new concepts.

Traditional financing has become scarcer on all those markets. Goldman Sachs is keen on investing through joint ventures. Sometimes they will act as a separate partner in addition to the shipping company. If so, Goldman Sachs will not become a shareholder of the existing company.

In other cases owners are open to new internal partners. Goldman Sachs is then willing to become a new shareholder, in exchange for participation in the decision making. Goldman Sachs applies these structures in the offshore oil and gas sector, too. Although not traditional shipping, it has a similar need for private equity. If possible, Goldman Sachs responds to this need.

The State of the CV Market



Cor Vermeulen, CEO Universal Marine

This is not the first crisis that the shipping sector is undergoing. Vermeulen knows what he is talking about. He started his practical experience as a crew member on international shipping lines, and rose up the ranks to captain. In 1982 he bought his first ship. Despite the gloomy economic period he sold it a year and a half later at a profit. He then purchased a bigger vessel before ordering two more around 1990. The ships sailed to ports in the United States and Canada. The crisis in Asia during the nineteen nineties caused more companies to divert their attention to the United States and the competition subsequently increased. Together with a few partners, Vermeulen established Universal Marine, made the transition to the cv market and around the turn of the century began leasing ships, which he had built in China.

The credit crisis brought new problems. Banks started to withdraw, creating a need to tap into alternative sources of financing. This was met with success, although the market continues to be difficult to this day. Expenditure is falling, and the market value of the fleet is too low in proportion to existing loans. There is a need for new investors who are willing to share a percentage of the profits.

In Vermeulen's opinion, ordering new ships now is a good idea since they are less costly at the moment. However, doing business with reputable and trustworthy financiers is vital. Since banks have become unwilling to lend, the future lies with private equity parties.

Alternative Capital for the Shipping and Offshore Oil



Sean Durkin (President, Northern Shipping Funds)

“We do everything the banks won’t do.”

Sean Durkin

When talking about alternative funding, Northern Shipping Funds occupies the space between banks on one side and private equity on the other. Northern Shipping Funds operates close to home and is primarily active in America, Europe and the Middle East. Durkin stresses his company’s long-term vision. He feels the shipping sector is ready for consolidation. It is increasingly difficult for small owners to compete with the large players. The regulatory burden increases, while the access to banks diminishes. The need for alternative sources of capital will only grow.

The current market is going through a bad spell. The economic prospects are poor, the value of assets is diminishing and there is overcapacity. Banks are incapable of providing funding. Using the capital markets is an option, but that requires sufficient economies of scale. Although the shipping sector is starting to consolidate, this process has only just been initiated.

Apart from Northern Shipping Funds and private equity, says Durkin, there are no new capital providers. So, what course should a ship owner set? Shipping is a cyclical business, and according to Durkin we have just about reached the lowest point of the cycle. Bad news for the smaller companies in particular. Just like the offshore rig and oil service companies experienced in the nineties, they will merge and cooperate in the near future, until the survivors are big enough to benefit from the capital markets.

Durkin concludes that the shipping sector is, unfortunately, underfunded. A situation that is unlikely to change until parties turn up that handle risk differently from the banks.

Northern Shipping Funds has positioned itself in that niche by looking for financing outside the shipping sector, and taking it upon themselves to show them the ropes in the shipping sector. This turned out to be a successful approach, and other parties could follow this example.

Initial Public Offering



George Syllandavos and Akis Tsigarakis (founders, Nautilus)

George Cambanis, Global Shipping & Ports Leader at Deloitte, introduces both other speakers by recalling the rising popularity of American capital providers in 2004. Cambanis himself then got to know the value of initial public offerings (IPOs). Out of all Greek companies listed on the American stock exchange, Deloitte assisted 40% with their IPO.

Becoming listed has its advantages, but it has a downside as well. Issues such as financial reporting, transparency and risk management are subject to strict requirements. You need a convincing story if you want parties to invest funds in your shares. The entire team working on an IPO, including lawyers, auditors and banks, should run smoothly. The timing, too, should be right. So, the preparation requires a lot of work. Many shipping companies do not have the right background to fulfil the requirements that have been implemented on Wall Street. Ship owners and investors are on different wavelengths sometimes.

Tsigarakis and Syllandavos explain how they assist companies in becoming listed, in order to profit from primary shares emissions. Nautilus approached the

problem in two steps. They incorporated a company that they introduced at the stock exchange, serving as a vehicle to raise investments. Next, Nautilus approached investors, and then went on to search for a project in which they could invest those funds – with the approval of the investors. Nautilus thus raked in 48 million dollars, allowing them to merge with partners, which thus gained a foothold on the stock exchange. This is how Tsigarakis and Syllantavos introduced an American shipping company to the stock exchange in 2007. A successful transaction, which was followed up.

The benefit of this approach for the investors is they have a guarantee: if no suitable project is found within a certain term, they will be refunded their capital. In the event that a project is found where other investors do show interest, then they can replace the original investors.

Shipowner panel discussion

The discussion focuses on several points on which the previous speakers already touched. The need for consolidation is also felt in the hall. For small companies it represents a necessary leap forward, now that investors are more interested in big companies.

Although private equity parties do invest in small shipping companies with less cashflow, one objection is that niches are less flexible. Small companies are also more susceptible to a client base with its own financing problems. This lack of liquidity does mean that consolidation is easier said than done.

As one panel member said: "We're in a crisis because there was too much trust and easy money, and the only way out of that crisis is too much trust and easy money." Easy money no longer exists. It is the same everywhere, not only in the shipping sector.

Banks are faced with the problem that the ships they financed have not only dropped in value but are also earning less.



Has the market become nervous enough to start looking at private equity? That question has generated a number of answers. Private equity itself is certainly ready, but still sees a great deal of imbalance in the shipping industry. When the moment is right, says a participant, they will be willing to invest. "Preparation is the name of the game."

Others doubt whether private equity parties are genuinely suited to investing in the shipping sector. The financing terms that private equity operates are relatively fixed. Timing (when one invests and withdraws) is vital for any private investment. That timing is made more difficult by the cyclical nature of the shipping sector. Private equity is not fond of the risks attached to shipping. In addition, Americans are less willing to invest their money in a ship that may be doing business with Iran. Private equity would rather invest in a successful company with an opportunity for listing on the stock exchange, than in assets. The investments that private equity parties started making in 2009 have not all been successful.



From left to right: George Cambanis (Global Shipping and Portleader & IPO specialist), Deen Sonneveldt (Dutch Shipping Leader, Deloitte), Hans Feringa (President, Stolt-Nielsen), Carel van Lynden (Partner, AKD), Bart Otto (CEO, Flinter), Bastiaan Kooistra (Manager Customer Finance, Damen Shipyards) en Herman Marks (Commercial director, Vroom).

Asiatic countries are more optimistic and therefore more inclined to invest. However, Western governments have also jumped into the hole that banks allowed to open up. The danger is that shipping companies will survive artificially and that the overcapacity in the sector will only increase.

The present crisis will also pass, however. The European shipping industry will be able to expand again once parties have booked their losses and written them off. This is already happening behind the scenes: via auctions and under pressure from banks assets are being sold cheaply on the market and are being bought by the more robust companies. Thus, consolidation is taking place.

In a consolidated market investments will rise again. One advantage is that in a few years the current lull will lead to new, improved ships that meet modern-day standards. They will be more efficient, environmentally friendly and sustainable. Parties who currently have the funds and vision to invest in innovative, next-generation ships will win in the future.

Presentations

The presentations are available on www.deloitte.nl/shipping or you can click on the links below:

State of bank finance in shipping

Mr Gust Biesbroeck (Head of Transportation, ABN AMRO)

Private Equity

Mr Jean-Christophe Germani and Mr Till Hufnagel (Managing Directors, Goldman Sachs)

State of the CV market

Mr Cor Vermeulen (CEO, Universal Marine)

Alternative capital for the shipping and offshore oil service sectors

Mr Sean Durkin (President, Northern Shipping Funds)

Initial Public Offering

Mr Akis Tsirigakis and Mr George Syllantavos (Founders, Nautilus)

Shipping Strategies for going public

Mr George Cambanis (Global Shipping & Ports Leader, Deloitte)

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