

## Shipping industry seeking alternative financing

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The shipping industry is still reeling under overcapacity, low freight rates, and lack of bank financing. As companies are struggling to mitigate cost pressures and secure the funding for new vessels to stay competitive, alternative financing is gaining momentum.

### Bank lending to shipping dries up

Shipping companies have been borrowing bank loans for several decades, using vessels as collateral. Although shipping is a cyclical industry, bank financing has remained consistent even during slowdowns. By 2012, the industry's debt amounted to US\$500 billion, 80 percent of which was financed by European banks.<sup>1</sup> However, the financial crisis of 2008 battered the banking sector and consequently curtailed its lending capacity. Since then, banks have gradually pulled out of the shipping industry.

- As per Marine Money International, in 2008, Germany's HSH Nordbank, one of the world's largest ship financiers, had a shipping portfolio worth US\$58 billion. By 2013, the bank significantly reduced lending to the sector, and reduced its portfolio by 40 percent.<sup>2</sup>
- In 2013, Royal Bank of Scotland (RBS) decided to restructure part of its US\$15 billion shipping book.<sup>3</sup>

Although the financial crisis put pressure on banks to a great extent, lending was further stifled because of strict norms, such as Basel III, which followed the crisis. For instance, Basel III requires banks to maintain additional capital buffers, failing which the institution's lending capabilities would be restricted.<sup>4</sup>

As a result, by 2014, the share of bank lending to the shipping industry reduced to 63 percent from 84 percent in 2008.<sup>5</sup>

### Emergence of alternative financing

The shipping industry is capital intensive. The retreat of bankers from the industry and persistent low freight

and charter rates have forced shipping companies to reconsider how they plan to deal with the situation. These companies are undertaking certain initiatives such as increasing the energy efficiency of their fleet in order to reduce transport unit costs and disposing noncore assets. However, cost-cutting initiatives alone may be insufficient in light of several debt restructuring deals and bankruptcy announcements.<sup>6</sup> Further, despite the existing overcapacity, shipping companies are focusing on investing in very large and energy efficient new vessels to reduce costs.<sup>7</sup>

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In such a scenario, it has become crucial to fill the finance gap. Shipping companies are increasingly exploring alternative financing options. The change in the financing landscape can be gauged by the latest Lloyd's List's categorization of top financiers in shipping; among the top 10 ship financiers, at least four belong to alternative funding organizations.<sup>8</sup>

### Growing importance of Asian export credit agencies

Export credit agencies (ECAs) provide a stable source of finance to the shipping industry. ECAs are distinguished by their relationship with government regulatory bodies. For instance, the world's largest ECA, the Export Import Bank of China (CEXIM), is governed by the Chinese government. As the global shipping industry's lucrativeness remains subdued, the importance of ECAs has increased.<sup>9</sup> Before the financial crisis, ECAs accounted for approximately 10 percent of shipping and offshore-related debt finance; now, their share has increased to more than 33 percent, amounting to US\$15 billion a year.<sup>10</sup> In July 2015, CEXIM provided financing worth US\$1 billion to French liner CMA CGM.<sup>11</sup>

ECAs by and large focus on supporting their domestic shipbuilding industry, where they lend financing to shipping companies which order new vessels at their domestic shipyards.<sup>12</sup>

The emergence of new opportunities, such as building liquefied natural gas (LNG) export terminals, has further increased the importance of ECAs.<sup>13</sup>

- In 2014, CEXIM financed the construction of 46 offshore equipment and vessels in China by providing a loan worth US\$1 billion.<sup>14</sup>

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### Shipping industry explores capital market

Similar to ECAs, capital markets are a viable financing alternative for shipping companies. Capital markets give an added advantage to shipping companies as they are able to issue debt with longer maturities and fixed interest. According to a Dealogic estimate, capital market financing — with the issuance of equity and bonds — accounts for 30 percent of the total financing extended to the shipping industry. The institutionalization of shipping finance will ultimately trigger and require improved reporting and corporate governance structures of companies, enhancing transparency for potential new finance partners.

“It used to be about ‘I know your father,’ or the shipowner at the top investing on gut instinct or a roll of the dice ... now they have to file reports in Manhattan,” said Adrian Economakis, Strategy Director at data provider VesselsValue.com.<sup>15</sup>

Traditionally, as institutional investors preferred liquid investments in shipping, initial public offers (IPOs) became popular among investors. Shipping IPOs are again picking up pace after slowing down considerably during 2008–09.<sup>16</sup> However, as freight rates remain low, the attractiveness of IPOs, especially by companies within commodity shipping, such as tankers and dry bulk, is considerably low. For instance, in 2014, Wilbur Ross withdrew an IPO for Diamond S Shipping Group Inc.,

a tanker company in which his firm, WL Ross & Co., is the largest shareholder, as the price was too low.<sup>17</sup>

As shipping companies are struggling with low freight rates and oversupply, private equity (PE) firms are focusing on opportunistic investment options. PE funds, particularly US-based funds, are targeting distressed assets sales by banks.

- Oaktree Capital Management is creating funds worth US\$10 billion focused specifically on the shipping industry and real estate market.<sup>18</sup>
- In March 2014, Kohlberg, Kravis & Roberts (KKR) bought a portion of Berlian Laju tanker loan provided by BNP Paribas and Nordea, for US\$130 million.<sup>19</sup>

PE funds provide flexibility in extending credit. They also extend loans to riskier projects that banks are restricted from providing. In fact, funds such as KKR and Blackstone Group have been able to effectively occupy the space left vacant by banks.<sup>20,21</sup> According to Tufton Oceanic estimates, over January 2012–January 2014, PE funds invested US\$32 billion in the shipping industry.<sup>22</sup>

However, the possibility of high PE investment affecting the demand-supply equilibrium by creating oversupply is a growing concern, as shipping companies are investing heavily in buying new vessels. The impending overcapacity is expected to make PE exit less profitable. “Shipping is not a get-rich-quick business. By virtue of the



capital that the private equity funds are pumping into shipping, they are in effect destroying the very prospects that they are chasing,” said Jan Engelhardt, Chief Financial Officer, Stolt Nielsen.<sup>23</sup>

### The path ahead

The financing landscape will depend on the performance of the shipping industry. As oversupply continues to affect the industry, shipping companies are expected to focus on remaining profitable through partnerships and mergers. Currently, four major alliances within the container liner shipping, occupy 96 percent market share on the major trades. Collaboration among companies will not only provide access to larger vessels and growth markets but will also open new network routes and increase the ability to utilize the additional capacity.<sup>24</sup> A survey conducted by HSH Nordbank, published in February 2015, indicated that of the non-Asian companies that moved their businesses to Asia, 79 percent suggested that the major reason behind the move was proximity to the growth market.<sup>25</sup>

- In April 2014, Germany-based Hapag-Lloyd AG and Chile-based Compañía Sud Americana de Vapores (CSAV) signed a merger contract that gave Hapag-Lloyd increased access to the growth market.<sup>26</sup>
- In 2014, the CMA CGM Group signed a strategic partnership agreement — “Ocean Three” — with UASC and China Shipping Container Lines (CSCL). Ocean Three will help these liners provide its customers an attractive network for the East / West market.<sup>27, 28</sup>

“On the main trades between Asia and Europe (and) Asia and the U.S., there will be more consolidation, as these loops will increasingly be serviced by very large vessels that can carry up to 20,000 containers. It isn’t easy for a smaller operator to either buy or fill such ships,” said Farid Salem, Group Executive Officer, CMA CGM.<sup>29</sup>

The focus on growth markets is further heightened by an increased number of collaborations between the majority of European banks and Asian financial institutions to establish themselves in the Asian growth market. The collaborations enable Asian companies to finance newbuilds and purchase new ships. For instance, HSH Nordbank collaborated with EXIM Bank of Korea to finance Korean and international shipping companies, and provided export financing, loan syndication and refinancing.<sup>30</sup>

Along with collaborative financing, speculations indicate that bank finance to the shipping industry may bounce back by 2016 based on expectations of shipping recovery.<sup>31</sup> However, the anticipated recovery may witness cautious efforts by banks, as most banks, particularly European banks, are still not very active in the shipping sector of their domicile countries.<sup>32</sup>



## Source

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