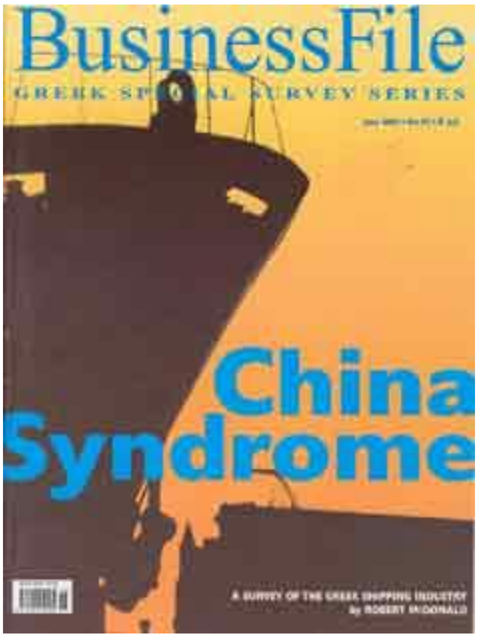
FINANCING



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The strong shipping markets of recent years have seen a return to an emphasis on traditional relationship banking, i.e., a shipowner comes to a bank and takes a loan and in turn the bank gets a concomitant proportion of his other business. With equity markets in decline, the willingness of shipping groups to list on stock exchanges or to issue bonds is temporarily in abeyance. The new aspect to the traditional relationship is, that with ship costs soaring, particularly on the second- hand market, banks with large exposures, are more likely to do syndicated or club deals to spread their risks.

The volumes outstanding are vast compared to the relatively small Greek financial market, so foreign banks (many of them specialists in ship-lending) continue to dominate the market.
At the end of 2003, bank lending to the beneficial owners of Greek vessels stood at $26.5 bn, according to a study published in April by **Petrofin Bank Research**.

Loans outstanding to the Greek shipping sector, end 2003

Banks	No. of banks	Portfolio ($ bn)	% of total
Foreign banks with a Greek presence	10	10.1	39.6
Foreign banks without a Greek presence	29	9.8	38.3
Greek banks	15	5.6	22.1
Total	54	25.5	100.0

Source: Petrofin Bank Research, April 2004

Of this nearly 80% was in loans extended by foreign banks and just 20% by locals. The Greek presence was increasing in nominal terms, but was more or less static as a percent- age of the total market.

According to the **Petrofin research**, just three of the top 10 banks (in terms of total exposure) were Greek[47]- National, Alpha and Piraeus Bank.

Top 10 ship-lending banks, end 2003

Bank	Loans outstanding	Committed but undrawn	Total ($ mn)
Royal Bank of Scotland	3,500	1,000	4,500
Deutsche Schiffsbank	2,100	390	2,490
HSH Nordbank	2,100	234	2,334
National Bank of Greece	998	381	1,379
Alpha Bank	1,000	200	1,200
Credit Agricole Indosuez	1,000	100	1,100
HSBC	850	75	925
Piraeus Bank*	806	114	920
Credit Suisse	550	350	900
KfW	854	16	870

*Including the portfolio of the Hellenic Industrial Development Bank (ETVA) acquired in a privatisation sale.

Source: Petrofin Bank Research, April 2004

But exposure is not necessarily a full reflection of activity in the sector. For example, Citibank and ABN-AMRO, which rank respectively thirteenth and sixteenth in total outstandings, rank respectively first and third among banks acting as lead managers of syndicates. Their local branches are the focus of their groups' global business in shipping. The strategy is to secure earnings through commissions and fees rather than through interest. By contrast, the Royal Bank of Scotland (RBS) and HSBC, respectively first and seventh in the exposure list, make a point of not syndicating loans.

A new development in the market, according to Petrofin, has been the willingness of Far Eastern banks, particularly in Korea, to offer financing as part of packages to try to attract new building orders to local yards.

More recently, Chinese banks have been making overtures for the same reason.[48]

"There are cultural, commercial and informational difficulties to be overcome," the report says, but with the Chinese offering spreads on loans that could be as much as 0.5% below those of their western bank counterparts, more adventurous Greek owners might consider booking with them. According to Dimitris Anagnostopoulos, senior vice president and head of Greek shipping for ABN- AMRO the value of Greek new- building orders currently stands at somewhere around $8 bn - possibly higher. The financing is about $3 bn owners and $5 bn banks.

"This is a big challenge to the banks. They don't lend just for fun, they evaluate the risks and the fact that they are supporting the Greek fleet is proof that they consider it a good risk.

"...It shows also the conversion of Greek shipping companies into modern shipping companies with a corporate structure under the new generation [often the second and third generation of traditional shipping families].

"Piraeus has become a shipping centre. You have everybody here - Lloyd's [insurers and classification], Clarkson [analysts] and all the major shipping law firms in the world. Take the example of our bank. Basically, they consider Greece as the centre of expertise for ABN-AMRO... That's why we get transactions advising other units of the bank around the globe which is proof that this is the area for shipping."

The bank is nevertheless cautious regarding its exposure. "It is not prudent for a bank to take the entire amount when you talk about transactions of $200 mn… You cannot have three customers and each customer representing 30% of your portfolio."

Alexander Tourkolias, general manager, corporate and investment banking, National Bank of Greece is another who subscribes to such a policy. His portfolio, of close to $1.4 bn covers 100 'names' and some 250 ships.

"Syndicated activity has increased because we finance younger vessels and newbuildings, so you need to share the risk with other lenders. Placement capacity has become more difficult... because there are a lot of banks seeking to place."
With traditional relationships, banks would sometimes allow portfolio managers to be more flexible than with other clients in order to secure their other business. But with the increasing complexity of financial services and the pending new risk ratings under the Basel II regulatory regime, it is rare today that a bank will be the exclusive financier of a fleet. Indeed, most don't want to be.

"You might have a relationship which has grown," says Anagnostopoulos, but after a certain point you cannot provide capital bilaterally and you have to bring in some other banks to share it. You then have the risk that those banks get to know your customer as well."

But there are also contractual and courtesy protocols in the banking community under which banks share out the earnings. The lead arranger gets a bonus but then one syndicate member will get the documentation fees, another the operating fees, and so on.
"The way the market is structured by practice through the years," says Anagnostopoulos, "is that we have competition from one side to get the deal and from the other side there is excellent co-operation between the lenders There is a pie which is shared with a minimum amount of aggravation in the competition area."

To an outsider, lending to shipping looks risky because of the lack of public financial information available. But while owners may not make their balance sheet details public, they keep detailed accounts for their bankers.

"They deliver to us financial statements," says Tourkolias. "They may not produce these regularly on the Internet but we don't complain.

"As their bankers they give us a lot of clear information. But if there is not a requirement [to publish], they don't... ..Shipping is a family business by definition a personal business."

Companies that listed or issued bonds were required by law to publish a considerable amount of detail about their activities, a transparency factor that prevented many of them from entering equity markets when they were booming. But now that markets have turned down and there is little value to be had from share appreciation, a number of shipping groups have delisted and returned to their original reticence.
"Those who decided to go this way [into financial markets] have proved that they can make it," says Tourko- lias. "But once this kind of business has been terminated, then they reverted because there is no cultural change."

Tourkolias says that as a banker he has a vast amount of "objective" information available to him to allow him to make his lending judgements - vessel prices, freight market movements, scrap prices, etc.

"You can rely on very objective data to get a decision but this does not mean that companies should not pay more attention to ... the transparency levels that regulators would be happy for."

One of the phenomena of the soaring rates in the market is that owners are able to pay down the investments on their loans earlier.

A classical structure might have been a $20 mn loan on a vessel with a l2-year tenor and a so-called balloon of 30%. This would have meant annual payments of just under $1.7 mn with an additional one-off payment of $6 mn in year 12. In a soft market, that figure would often be refinanced for another three or four years.

At the rates prevailing in recent markets, a shipowner could theoretically make profits out of a vessel, sufficient to pay back such a loan in just two years. According to George Xiradakis, managing director of the ship-financing consultancy, XRTC Ltd., the average age of a Greek shipping loan has fallen to six years.

"One owner has been building Panamaxes over the last 10 years taking delivery of two or three every 18 months and is now selling out the old units at about today's newbuilding costs at the same time he has got a newbuilding programme running," says Jim Slater of S&E Consultants.

"So basically he is turning over his fleet - getting into state-of-the-art stuff, taking capital profit out of the older stuff and still getting these huge earnings."

The demand for ships, particularly in the dry cargo trades, has driven the price of ready vessels to what Slater terms "crazy" levels; 1980s-builtdry cargo vessels are said to be selling at several times the price they could command at the bottom of the market. The question is what will happen when the market turns?

Some people who have "taken a punt" on today's market lasting another 18 months to two years will get their fingers burned if it turns down earlier. If it lasts, they will have paid off the vessels, still made a profit, and be able to realise the scrap of their 'old ladies'.

However, many Greek owners have been sellers of older tonnage and at the same time are holding off buying at today's inflated prices with the result that their earnings keep piling up with little place to put them (outside of property) given that equity prices are depressed. Slater's partner, Steve Edmundson, believes that this means that when the next down- turn does come, ship prices will not fall as steeply as they have during previous cycles.

"Prices are now hitting the roof. They [shipowners] ...have got their mattresses stuffed with money. When the market does come down, they will have to do something with it and they are going to say 'Oh, this is cheap, so I'll buy' because it is half the price, a third of the price that it was.

"That's why I don't think it will go down to the absolute collapse levels that we have seen in the past because there is so much cash floating around this time."

Despite their cash resources, owners are still looking to banks for financing and getting it, though not necessarily more cheaply.

"There is no question," says Tourkolias, "that shipping companies' credit risk has improved over the past three years mainly due to the flourishing freight markets.

Some of them have tried to seek recognition of this by asking more competitive rates.

"But as banks have to struggle to make a decent return on shipping assets, particularly with the new capital requirements that are coming into place through Basel II, you have to increase your resistance. If you want to maintain a proper allocation of funds for shipping business you cannot give up on your rates."

In the last good market, banks were competing with one another to see just how closely they could pare their margins and there were reports of some offering Libor plus 0.6%. Today is said to be difficult to get Euribor plus 1 %.

Anagnostopoulos emphasises that regulatory practices under Basel II rules will require bankers to have a risk-weighting profile of their loans that will take into account not only credit risk, but market and operational risk. Shipping will be considered as ‘object finance', which will mean assessing the loan according to the cash flow it generates.

“It will depend on a variety of things, says Anagnostopoulos, "the tenor the loan, if the client has a corporate structure in his company, the ancillary business that you have with the customer.

A variety of things go into a formula and the formula produces your return and it is up to the policy of the bank to define what is the minimum return requirement accepted across the board to commit the funds.

"Some banks don't have that sophistication, so they measure with Libor, but I can tell you that you might find a relationship [loan] that carries a margin of 1.5% over Libor and is making an economic loss according to Basel II rules and you could find a relationship where you can lend at 75 basis points but you make economic profit on your capital employed.

Anagnostopoulos says that the reserve levels that will be required to be maintained by banks that have a poor record on non-performing loans will be very critical in determining margins and should stabilise the market by driving out lenders preparing to shave margins recklessly to gain market share.

"A hanky-panky banker will not be allowed to operate, or will be allowed to operate only under very strict rules and penalties, if they don't comply."

This climate makes it increasingly difficult for new entrants to the shipping market to get financing. Most larger banks today won't look at the old-style, one-ship start-up by a captain coming ashore.

"There are some smaller banks which might accommodate [such a customer]," says Anagnostopoulos. "But definitely you have to pay a higher margin for that.

"There are some smaller boutiques and advisers that can help you polish your presentation to optimise the request. But it is becoming more and more difficult for smaller owners to have access into the money pool that larger companies have."

According to Xiradakis of.XRTC, a start-up company would be unlikely to get cover from more than 60% of the asset value of its vessel and it would be expected to start with a time charter attached. The minimum rate would be Euribor plus 1.75%.

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[47]Greek participation has been growing with seven of the top 25 now Greek. But as the size of portfolios has grown, the rate of increase has slowed.

[48]Chinese yards currently have about 6% of world capacity compared to 28% for the Koreans but have been vigorously seeking to expand their market share.
