

LLOYD'S SHIPPING ECONOMIST

15th Annual SHIP FINANCE CONFERENCE

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**Financing Solutions for the
Small and Medium-sized Owner**

presented by

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MD

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The International Shipowning Industry



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- **According to Lloyd's Register, there are over 88,000 vessels of ALL types constituting tonnage in excess of 570,000,000 GT**
- **Owners are estimated to number approximately 13,000 world-wide today.**
- **Ownership is most dispersed in the drybulk and coastal sectors and more concentrated in the tanker and container sectors.**

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- **Significant consolidation is taking place in all shipping sectors.**
- **According to the latest Petrofin Research © in 2002, the Greek Shipowning industry alone accounted for 4,142 vessels owned by 749 Shipowning Groups. Whereby 488 owners own fleets of 1-4 vessels and 128 own fleets of 5-8 vessels, i.e. 82.2% of the owners' total.**

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- **Using approximately the same definition of size, it is estimated that on a worldwide basis there are over 8,500 small-to-medium size owners running fleets of 1-9 vessels.**
- **Without doubt, small and medium owners do represent an enormous market.**



Characteristics of small and medium-sized owners

- **Operate older vessels, e.g. for Greek owners 92.4% of 1-4 vessel fleets are 15 years or older**
- **Family rather than corporate style of management and structure**
- **Reduced chartering and operating efficiency as well as options**
- **Higher operating, insurance, procurement and finance costs due to small scale**



Characteristics of small and medium-sized owners

but also

- **Greater management flexibility, swifter communications and quicker decision making**
- **Greater persistence, obstinacy and commitment**



Banks' attitudes to small and medium owners

Perception that smaller owners represent:

- **Higher financial risk due to their lower liquidity and greater financial dependency per vessel**
- **Higher operating and management risk due to smaller fleet and slimmer management**
- **Higher crewing risk**
- **Higher maintenance costs and general running costs due to reduced economies of scale**



Banks' attitudes to small and medium owners

- **Higher disruption risk to vessels due to PSCs, regulations, etc.**
- **reduced chartering ability, i.e. greater reliance on spot markets**
- **Older vessels associated with potentially lower quality**
- **Fewer recovery solutions / options in a bad market**

Banks' attitudes to small and medium owners



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Also

small owners / credits are:

- **more time / labour intensive**
- **require, according to new Basel II, considerably higher bank capital allocation**
- **less interested in bank non-risk products and services**
- **more dependent on bank assistance at times of financial difficulty**



Banks' attitudes to small and medium owners

➤ *But also:*

- **Higher loan yields, reduced lending percentages and more favourable loans terms**
- **Higher client loyalty**
- **Greater personal commitment to overcoming problems**
- **Smaller exposure per client**



Banks' attitudes to small and medium owners

- **Shipping, in general, including small to medium clients in particular, have gone through the last shipping slump with few problems**
- **Banks, always keen to differentiate their strategy may view the small to medium owner niche as offering an opportunity**
- **Finance is, however, more readily available for young vessel purchases**

Overcoming barriers to obtaining traditional finance



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- **Comprehensive and honest presentation**
- **Demonstrate full credit history**
- **Full background of the principals, their experience, record, performance and performance**
- **Demonstrate in-depth management and experience**
- **Outline investment, operational, financial and chartering strategies**



Overcoming barriers to obtaining traditional finance

- **Explain choice of vessels, build-up of fleet**
- **Concentrate on younger vessels, in good condition and of standard specification and design**
- **Demonstrate financial commitment and liquidity, including, if necessary, net worth statements and provision of personal guarantees**
- **Provide comprehensive list of references**
- **Demonstrate good fleet operating record, i.e. no claims, off-hire, idle time, breakdowns, etc.**



Overcoming barriers to obtaining traditional finance

- **Provide market analysis justifying vessel purchase(s) and projected cashflow assumptions**
- **Avoid small vessels below 10-15,000 DWT, unless specialized**
- **Identify likely banks, develop relationships, open bank accounts and develop client history**
- **Keep loan requests modest**
- **Seek finance for more than one vessel**
- **Secure, if possible, initial time charters**

Overcoming barriers to obtaining traditional finance



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- **Provide audited accounts, management information reports and analysis**
- **Address bank's concerns positively**
- **Meet bank's senior management to promote confidence / familiarity**
- **Utilise banks products and services**
- **Seek other bank clients to speak on your behalf**
- **Seek professional advisory support**



Overcoming barriers to obtaining traditional finance

- **Develop multiple banking contacts in order to maximize probability of success and to obtain better terms**
- **Emphasize quality**
- **Remember that most small owners do enjoy shipfinance to a greater or lesser extent.**



Non-traditional finance solutions available to small and medium-sized owners

- **Specialized Lenders**
- **Mezzanine Finance**
- **KG/KS finance**
- **Shipyard schemes**
- **Public floatations, e.g. ASE**
- **Bareboat Hire Purchase**
- **Loan transfer**
- **Engine Manufacturers Finance**
- **Financial Insurance products**
- **Pooling, mergers and acquisitions**
- **Ship Investment Funds**



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Non-traditional finance solutions available to small and medium-sized owners



Bareboat Hire Purchase

- **Not a widely used method**
- **B/b entails:**
 - ✓ «Leasing out» of a vessel normally by a large/sophisticated corporate shipping company, who thoroughly vets the proposed b/b charterer
 - ✓ **Obligation to buy at the end of the bareboat period**
 - ✓ **Bareboat hire is paid out in monthly in advance and it includes interest at predetermined rates**
 - ✓ **A residual amount is normally left at the end of the bareboat period, which is well short of the vessel's residual trading life**

Non-traditional finance solutions available to small and medium-sized owners



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Bareboat Hire Purchase

- ✓ **The b/b manager manages the vessel taking full responsibility for its performance**
- ✓ **Owner has right to inspect vessel throughout the b/b period and ensure proper maintenance**
- ✓ **Insurance terms and quality specifically set/approved by owner at cost of b/b charterer**
- ✓ **Vessel price normally higher than market value by 5-10%**

Non-traditional finance solutions available to small and medium-sized owners



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Bareboat Hire Purchase

- ✓ **The bareboat charterers will incorporate the interest in the whole amount which needs to be worked out as there is a tendency to inflate it. There have been cases where the interest was calculated at 15% p.a. but nowadays it is closer to 4-6% per annum or variable**
- ✓ **Down payment is normally less than the equivalent requested for bank finance, i.e. 15-20% of vessel's underlying price**
- ✓ **Documentation is based normally on a Barecon A or other Bareboat agreements adjusted to reflect the individuality of the transaction**



Non-traditional finance solutions available to small and medium-sized owners

Bareboat Hire Purchase

✓ The option to purchase at any point during the bareboat term can be negotiated. This means that the vessel can be bought off at any suitable moment.

✓ As bareboat schemes increase the fleet and vessels thus acquired tend to be of younger and more bank-acceptable age, there is the possibility that the owner may be rendered financeable and, thus, obtain bank finance in due course in order to repay the residual. The ability to manage the vessel will have already been proven to the Bank



Non-traditional finance solutions available to small and medium-sized owners

Bareboat Hire Purchase

Important!

✓ Bbhp's are more likely during periods of market slackness when sellers cannot achieve their sales at prices they have selected.

✓ Bbhp has been often used by banks seeking to recover their loan exposure after foreclosure whilst keeping "ownership" of the vessel(s)



Non-traditional finance solutions available to small and medium-sized owners

Loan Transfer

- ✓ **This involves the substitution of one owner for another utilising the same bank.**
- ✓ **It does, however, still call for new loan documentation and credit approval**



Non-traditional finance solutions available to small and medium-sized owners

Loan Transfer

Advantages

- ✓ **Facilitates a vessel's sale by a seller and its purchase by a buyer**
- ✓ **Since it does not involve an increase in loan exposure, bank approval can be easier to obtain**
- ✓ **There is often a loan reduction as a bank sweetener**



Non-traditional finance solutions available to small and medium-sized owners

Loan Transfer

Disadvantages

- ✓ **Full documentation cost which may be prohibitively high for a small loan residual transaction**
- ✓ **Tends to be short-term and thus onerous for new owners**
- ✓ **Seller may request a premium**
- ✓ **Some banks require the continuance of personal guarantees of the sellers**



Non-traditional finance solutions available to small and medium-sized owners

Engine Manufacturers' Finance

Example: Caterpillar Finance Services

- ✓ *Up to 75% of new vessel cost*
- ✓ *Up to 75% of used vessel acquisition and conversion cost*
- ✓ *Up to 12 years*
- ✓ *Fixed or variable interest rate loans*
- ✓ *Standard documentation and security including first preferred ship mortgage*
- ✓ *Collateral vessels must have MAK or Caterpillar engines*
- ✓ *Competitive pricing*

Non-traditional finance solutions available to small and medium-sized owners



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Ship investment funds

- a) Can consider equity, quasi-equity and / or mezzanine participation*
- b) Highly selective*
- c) Require newbuildings or very young vessels*
- d) Require exit strategy and suitably secure employment*
- e) Minimum size of deal \$5m+*
- f) Return targets: 15-20% p.a. for equity
10-15% p.a. for mezzanine*

Non-traditional finance solutions available to small and medium-sized owners



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Ship investment funds

Examples:

- *DVB / NNI (NFC Shipping Funds I+II)*
- *AMA*
- *Tufton Oceanic*
- *Great Circle Capital*
- *Fortis (Maas Capital) backed by NIB/GATX)*
- *Citicorp*
- *Astrolabe (shelved)*

Non-traditional finance solutions available to small and medium-sized owners



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Financial Insurance Products

- ✓ **Shipmortgage Indemnity Products (top-up)**
- ✓ **Credit enhancement insurance products**
- ✓ **Residual Value Insurance**

- ✓ **Provided by specialised insurance brokers (MFR (Heath Lambert), Centre, Rattner Mackenzie) in conjunction with selected banks**

Non-traditional finance solutions available to small and medium-sized owners



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Financial Insurance Products

- ✓ **Applicable for new and second-hand vessels**
- ✓ **Insurance covers risk of loss caused by borrower's inability / default up to a certain amount**
- ✓ **Insurance normally up to 7 years**
- ✓ **Insurance guarantee may raise loan-to-value up to 85% or higher**
- ✓ **Indemnity usually up to \$10m per vessel or \$50m per risk**

Non-traditional finance solutions available to small and medium-sized owners



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Financial Insurance Products

- ✓ Insurers work with selected banks to offer joint finance to the borrower
- ✓ Client of the insurer is the bank and not the client
- ✓ High “due diligence” requirements
- ✓ Costs vary but for a 5-7 year loan involving a 15-20% top-up range between 20 to 30 basis points per annum on the whole loan for the applicable period
- ✓ Scheme replaces need for mezzanine finance
- ✓ Non-refundable fees

Non-traditional finance solutions available to small and medium-sized owners



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Financial Insurance Products

Example

- ✓ **Product carrier worth \$37m**
- ✓ **Bank willing to finance up to 65% or \$24.05m**
- ✓ **Insurance indemnity up to 85% or \$31.45m by providing a \$7.4m indemnity over 7 years**
- ✓ **Single premium of 7% or \$518,000. Assuming an average loan during the 7-year period of \$24m the indemnity costs 31 basis points on the whole loan amount**
- ✓ **Policy covers loss up to \$7.4m during the period**
- ✓ **Policy pays upon liquidation of loan the bank's loss up to the insured amount**



Non-traditional finance solutions available to small and medium-sized owners

Financial Insurance Products

✓ Pros

- ✓ Relatively inexpensive
- ✓ Fixed premium / cost
- ✓ No equity risks
- ✓ Does not require other security
- ✓ Standard product documentation

Cons

- ✓ Scrutinization
- ✓ Selectivity
- ✓ Limits potential banks
- ✓ Under extreme circumstances may encourage lenders to call in a loan secured by policy, thus eradicating owner's equity / involvement



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

Small to medium owners are facing strategic dilemmas to either:

- a) Remain independent*
- b) Dispose of older tonnage and try to survive by owning even fewer younger vessels*
- c) Merge with other small-to-medium owners, or*
- d) Enter into pools or associations*

Consolidation pressures and economies of scale are forcing owners to seriously consider mergers and/or pools / associations



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

Difficulties associated with mergers and acquisitions

- **Character differences among principals**
- **Differences in management styles, systems and procedures**
- **Differences in strategic and tactical goals**
- **Personnel related problems; dismissals, clashes, prejudices**
- **Syndrome of Conqueror/Vanquished**



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

cont. Difficulties associated with mergers and acquisitions

- **Loss of freedom and flexibility**
- **Reduced commitment – growing indifference**
- **Slower decisions; investment, financial, operating**
- **Problems with succession, nepotism**



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

cont. Difficulties associated with mergers and acquisitions

- **Historically involve only employment pools and not owning / operating pools and / or associations**
- **Loose structures tend to be ineffective**
- **Lack of long term commitment by participants weakens effectiveness**
- **Savings / Benefits: rather inconclusive**
- **Limited success thus far**



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

Is there a better model for the small owner?

The short answer is ***YES***



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

The Petrofin concept / model

The aims of the concept / model are to:

- **Develop the benefit of economies of scale usually obtained in mergers and strong associations**
- **Maintain the positive elements of individuality, flexibility and commitment that characterize smaller owners**



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

The Petrofin concept / model

The aims of the concept / model are to:

- Reduce friction and areas of potential conflict
- Provide a long term framework for development and exploitation of market opportunities, and
- Render the small owner more financeable and increase his investment returns through better investment decisions, upgraded management, enhanced income and reduced costs.



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

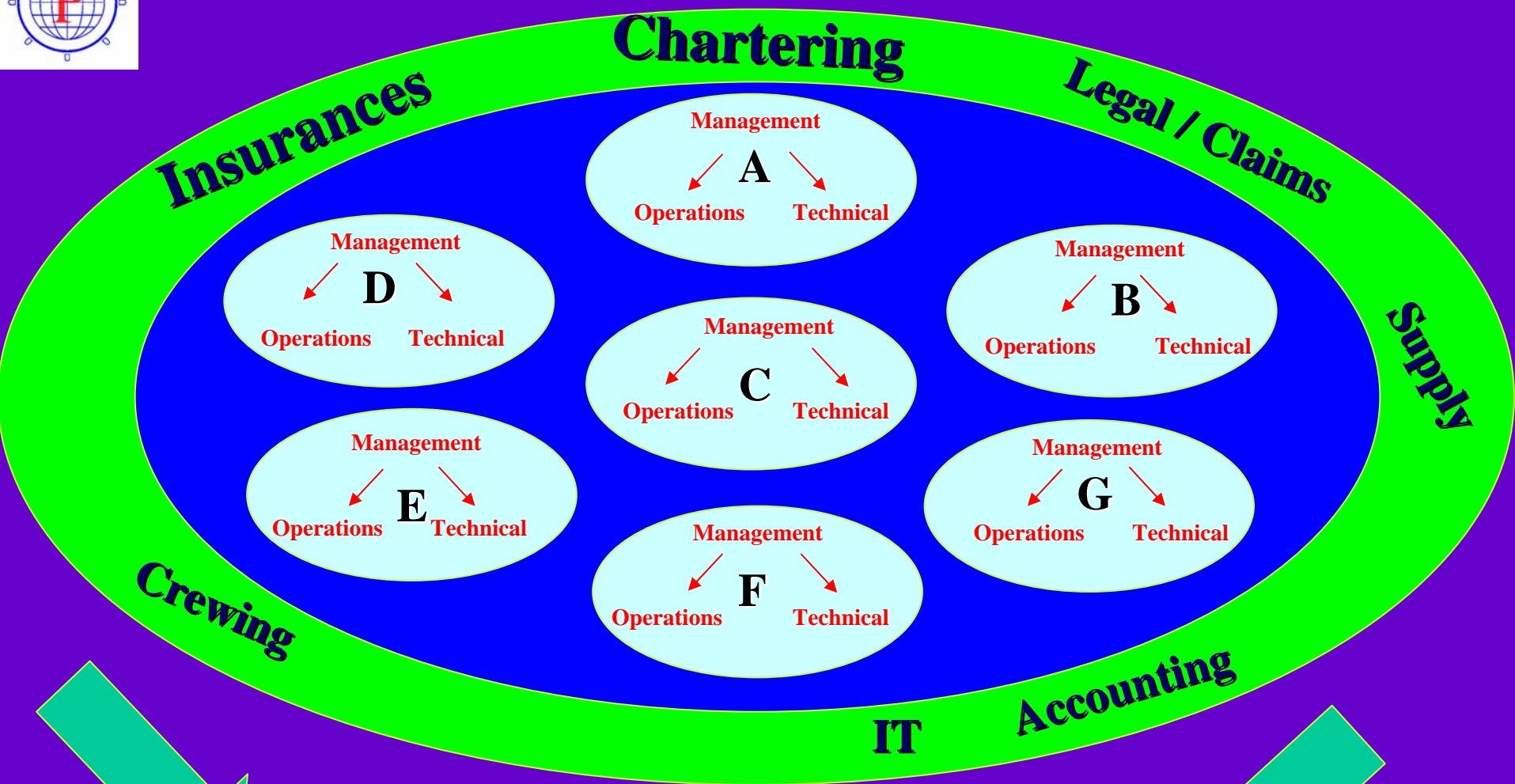
Pooling of small owners as an alternative to Consolidation

We believe that the ability of the small owner to manage his fleet will be preserved and enhanced if the following model is applied:

- **Pool together 8-10 small owners owning fleets of, say, 2-3 vessels each**
- **Shared ownership of Management company BUT individual shipowning interests remain intact**
- **These owners can finally take advantage of economies of scale, AS WELL AS improve their image to shipfinance banks**



PETROFIN POOLING MODEL FOR SMALL OWNERS



Financial Planning
Economies of Scale
Quality Upgrading

Financeability for
fleet renewal /
survival



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

Pooling of small owners as an alternative to Consolidation

- **The Pool retains individual Management decisions, Operations and Technical activities**
- **A strong PERIPHERAL set of services by well established professional departments is provided for the benefit of all pool members in the areas of: Accounting, Crewing, Insurances, Chartering, Legal / Claims, IT, Financial Planning, and Supply.**
- **These peripheral departments are owned by the pool, have strong managements, charge pool members at rates that are competitive and cover their breakeven costs and are staffed by professionals hired for each function.**



Non-traditional finance solutions available to small and medium-sized owners

Pooling, Mergers & Acquisitions

OVERALL BENEFITS

- **Exploitation of some economies of scale**
- **Quality upgrading of departments**
- **Better financial planning**
- **Enhanced financeability for fleet renewal / survival**
- **Improved status with banks, suppliers, investors, etc.**
- **Better investment returns**
- **Pool costs kept to a minimum**
- **Independence – commitment – flexibility preserved**
- **Enhanced investment and financial opportunities**



Projections for the next decade

- **Cost of shipfinance will rise, especially for small owners**
- **Borrowing cost to large corporate clients may fall**
- **Small-to-medium owners will find shipfinance more differentiated but not impossible**
- **Higher loan yields will attract new entrants to shipfinance**
- **Development of 'niche' financial insurances, specialized small owner banks, institutional backed investment funds**



Projections for the next decade

- **Owner consolidation set to continue**
- **Development of merger schemes between small owners**
- **Small owners shall counteract lender preferences by emphasis on quality, age of fleets, specialization and secured employment**
- **Small-to-medium owners shall be provided with access to capital markets via institutional pre-floating support from 'niche' financial institutions**
- **Small-to-medium owners shall increasingly become selected 'targets' by specialized banks and institutions**