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Latest trends and developments in International ship finance – Addressing the on-going impact of the credit crunch

presented by

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MD

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Presentation outline

1. The wider banking picture
2. The status of global ship finance
3. Is there enough capacity to handle ship finance and newbuilding financing?
4. How long will the credit crunch continue, and what are the risks to shipping?
5. Are the changes in terms and margins a permanent or transient change? Do higher margins impact on loan quality?
6. How long can banks continue to support problem clients if the crisis continues?
7. Summary and conclusions

1. The wider banking picture

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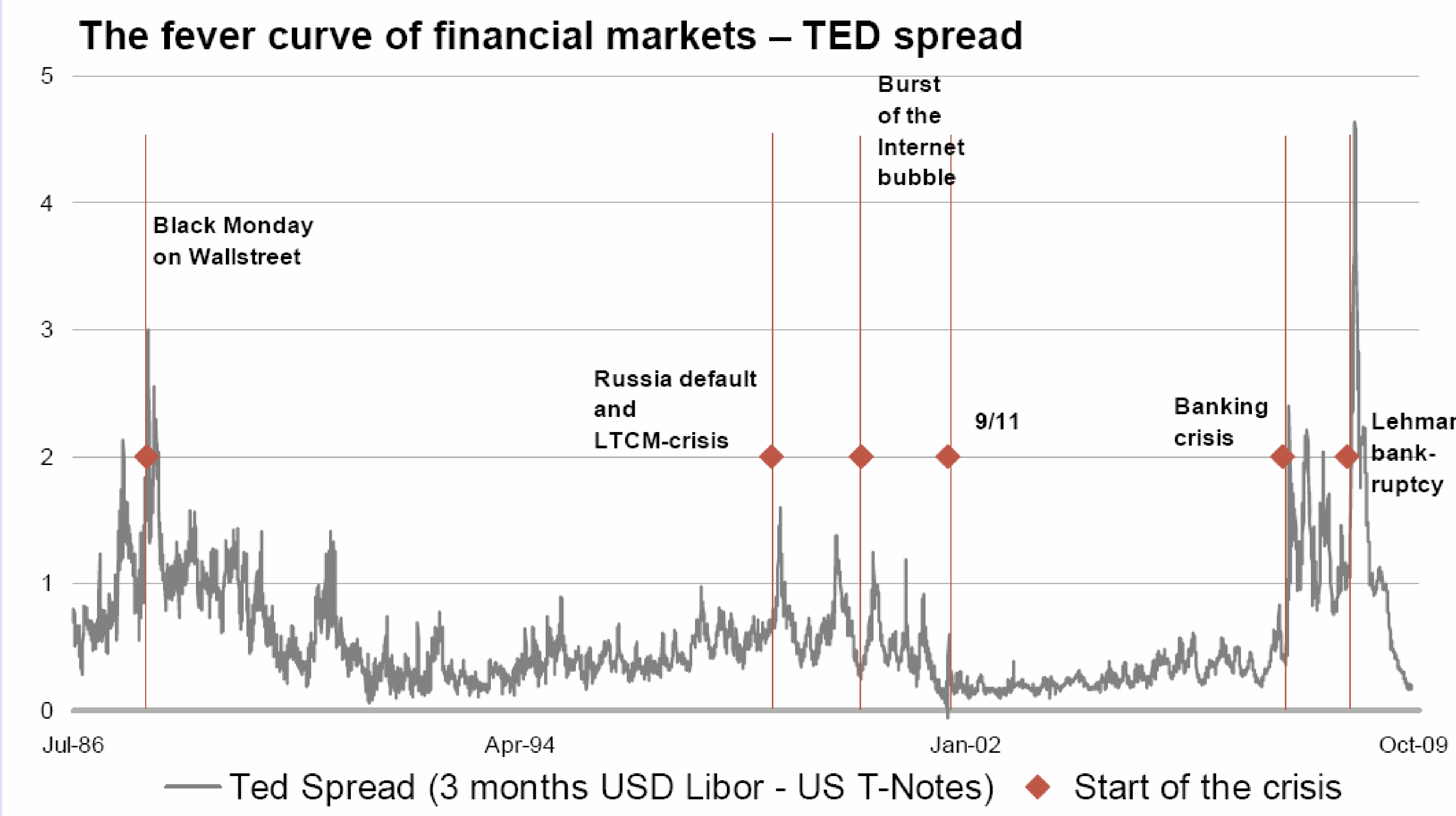
-The international banking / liquidity crisis is being dissipated as evidenced by:

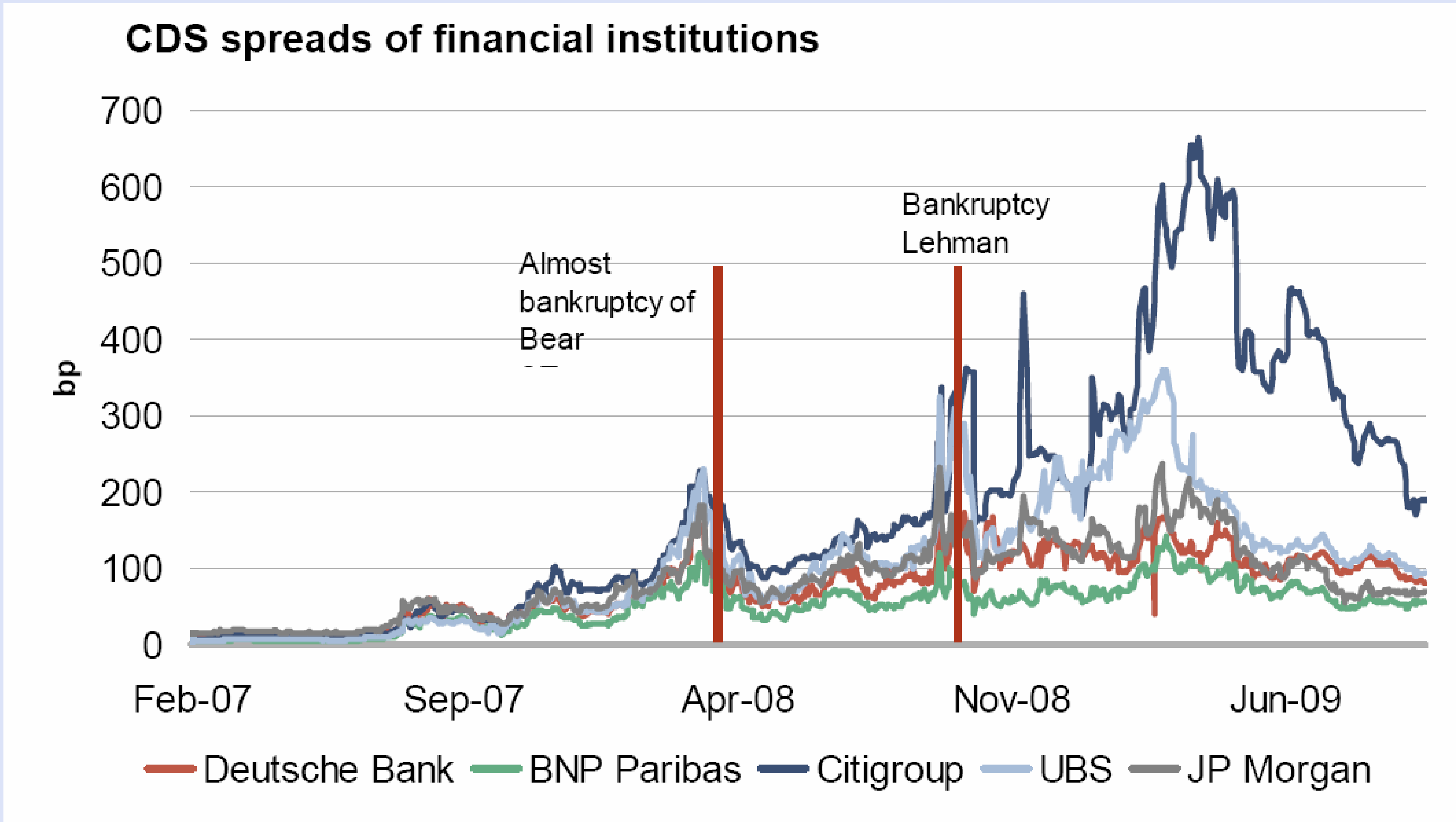
– restored inter-banking spreads

1. The wider banking picture



Source: Bloomberg, HSH Nordbank Economics & Research 29.10.2009

1. The wider banking picture



Source: Bloomberg

29.10.2009

1. The wider banking picture

– greater system liquidity

–return to normal in the inter bank market

– return of private depositors

– reduced need for (and commencement of repayments of) state / central bank funds

– the healing process has begun but

<u>it is not over yet</u>

1. The wider banking picture

-The global economic recession has stopped

– signs of anaemic economic recovery in the West

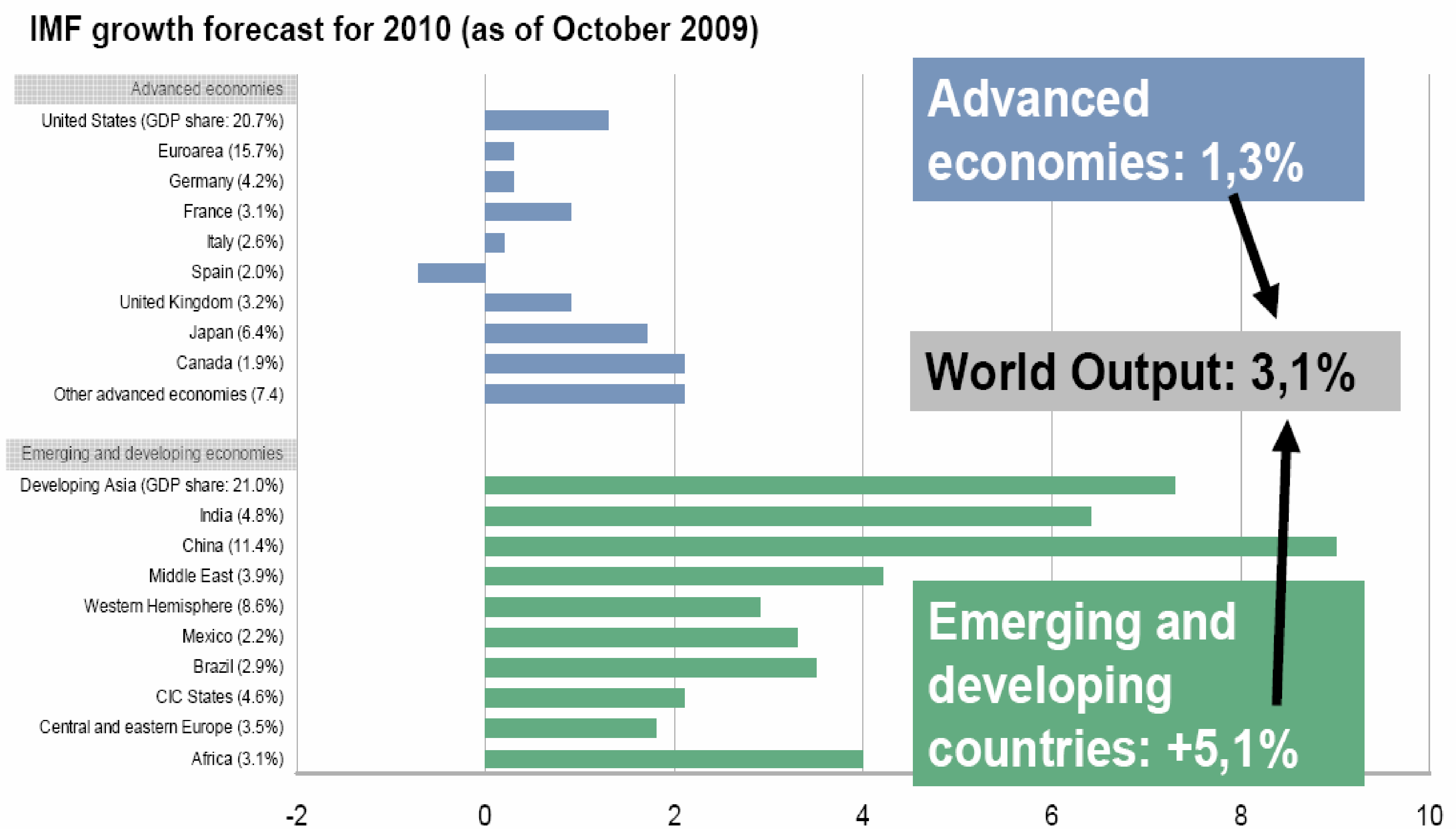
– strong growth by China (8%)

– however, continuing risk of deflation, and

– concern of a ‘W’ recovery, however

– IMF forecasts world economic growth of over 3% for 2010 .

1. The wider banking picture



Source: IMF, HSH Nordbank

1. The wider banking picture

-Consumer confidence still low but has started to improve

– spending still reduced

– concerns over rising unemployment

– high credit card, real estate and other corporate sector loan provisions / losses – retail trade still in recession.

-Mixed international bank results

– retail banks still feeling the brunt

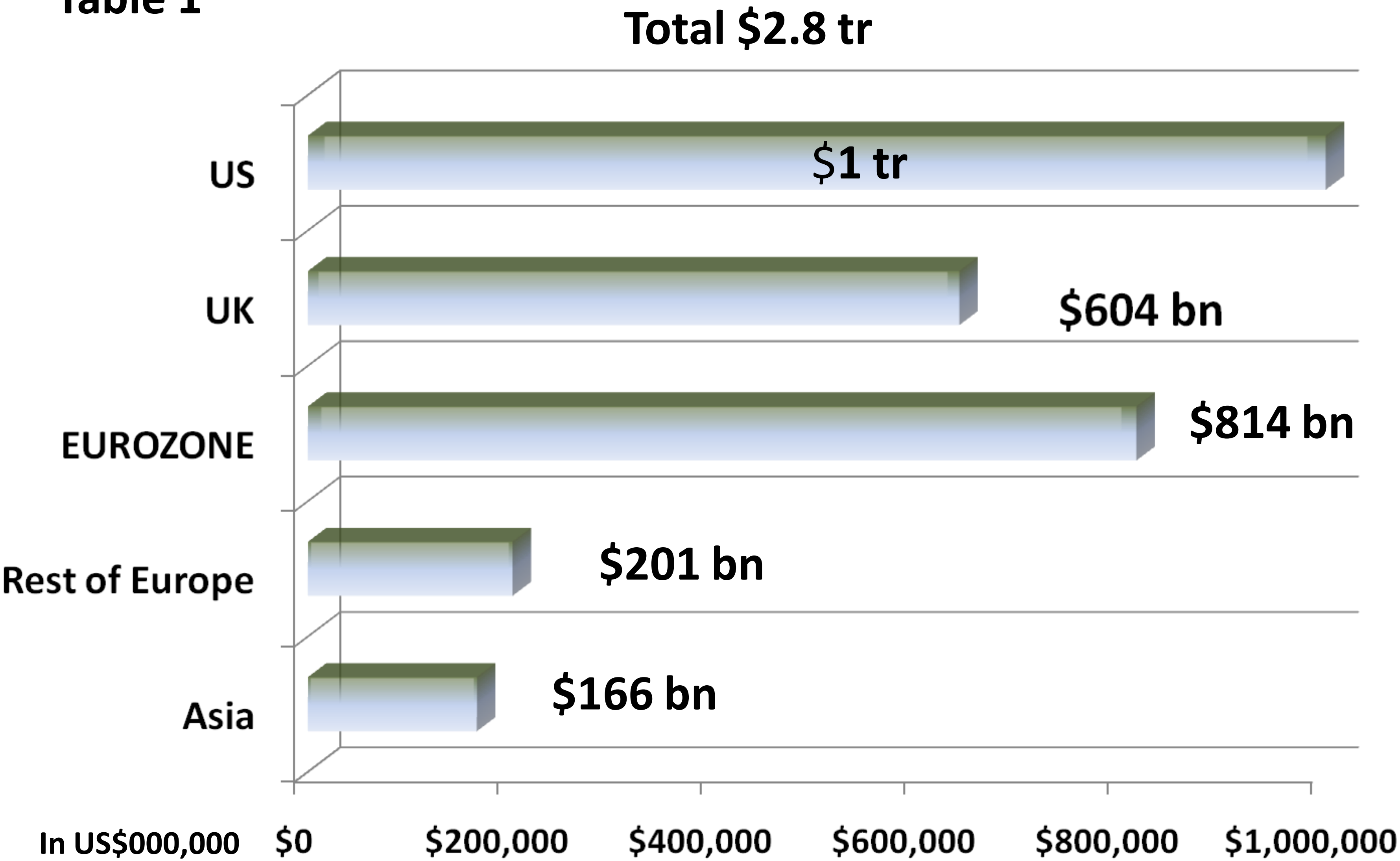
– wholesale / investment banks turnaround to massive profits.

1. The wider banking picture

-IMF revised forecasts of total losses / provisions for the world banks' to reach $2.8 tr for the period 2007 – 2010 (Tables 1, 2 and 3 below)

2007-2010 total estimated bank losses and provisions

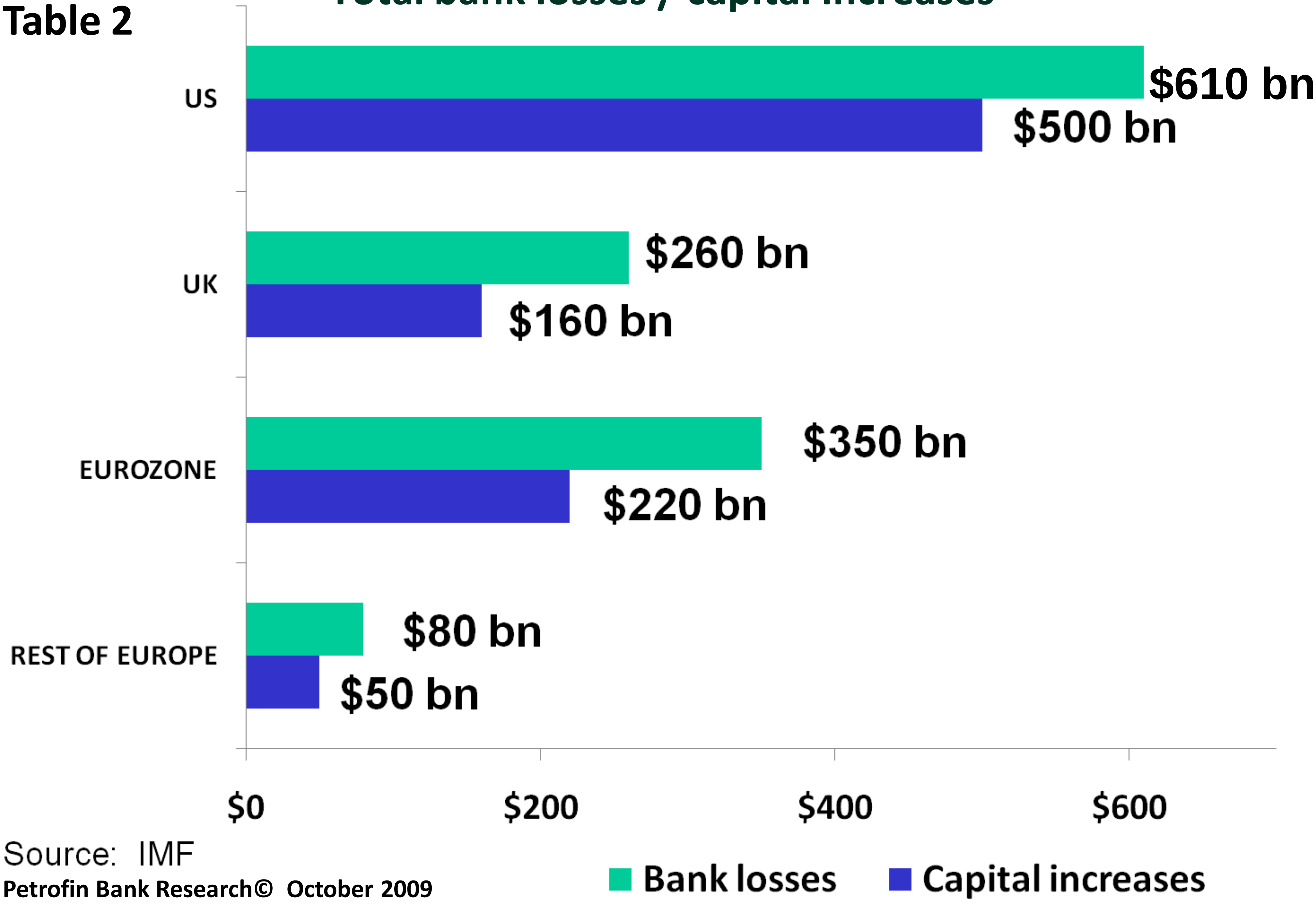
Table 1



Source: IMF

2007 – 1st half 2009
Total bank losses / capital increases

Table 2



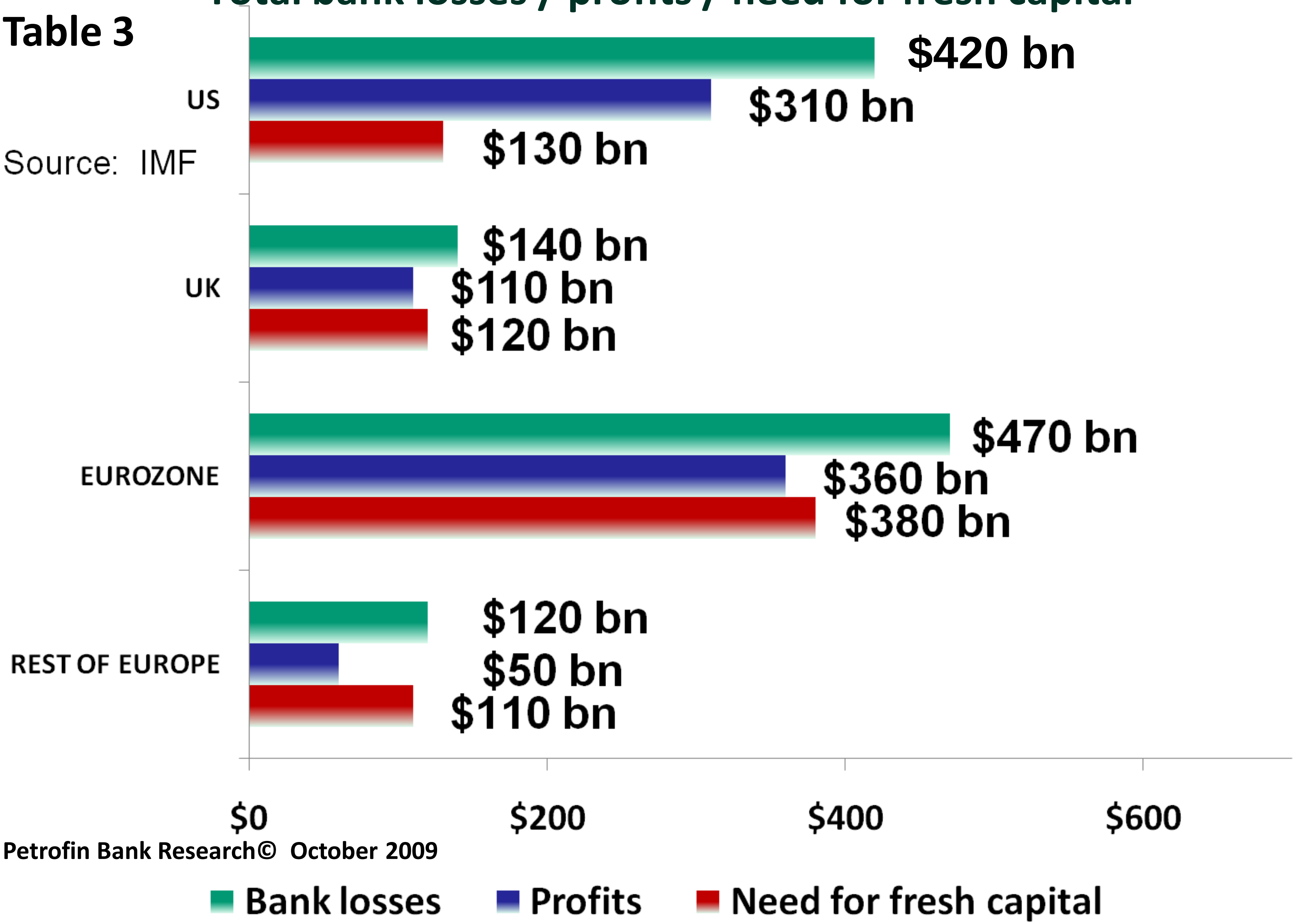
Source: IMF

Petrofin Bank Research© October 2009

2nd half 2009 to end 2010
Total bank losses / profits / need for fresh capital

Table 3

Source: IMF



1. The wider banking picture

-For the period July 2009 to end 2010 further provisions / lending for the US/European banks of $1.15 tr are expected whilst bank profits are anticipated at $0.94 tr.

-Fresh capital of $0.84 tr is required to meet capital adequacy ratios by the end of 2010.

1. The wider banking picture

-Banks intend to use the bank stock rally and increasing investor confidence to tap the stock markets for the required capital and to repay state / central bank loans and eliminate them as shareholder.

-Far East banks not affected, have maintained growth and are keen to exploit western bank weaknesses / opportunities.

-Increasing prospects of the banking system having recovered from 2011 onwards.

-Banks will need to re-commence active lending by 2011 to improve their returns on capital employed theirshare prices to facilitate future capital expansion and acquisitions.

2. The status of global ship finance

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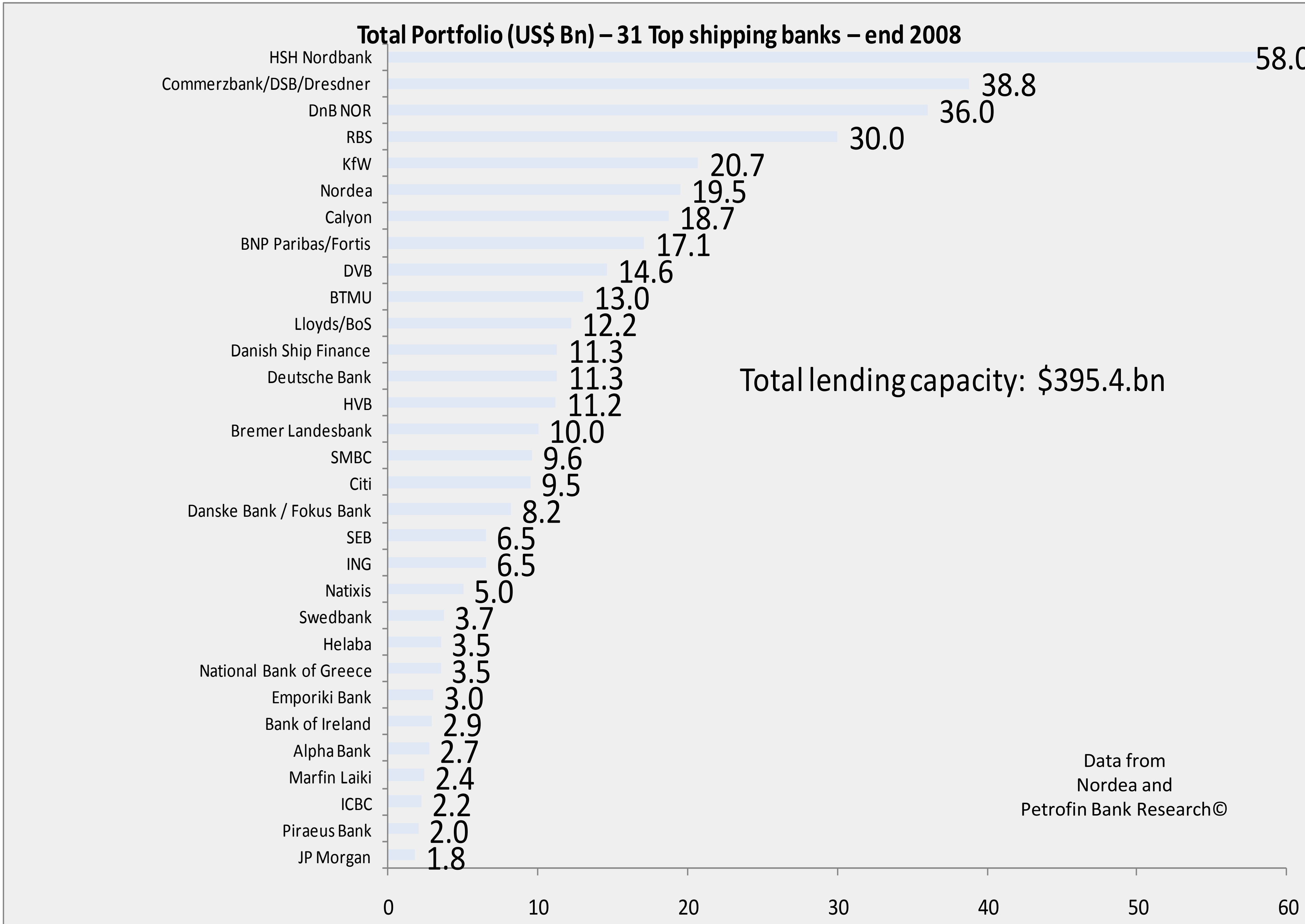
- **Global ship lending figures (drawn and committed) at the end of 2008 estimated at $450bn (excludes offshore sector).**

- **The top 31 shipping banks and the end of 2008 had a total loan portfolio of $395.4bn or 87.9% of the total (see Table 4)**

Table 4


Total Portfolio (US$ Bn) – 31 Top shipping banks – end 2008
HSH Nordbank 58.0
Commerzbank/DSB/Dresdner 38.8
DnB NOR 36.0
RBS 30.0
KfW 20.7
Nordea 19.5
Calyon 18.7
BNP Paribas/Fortis 17.1
DVB 14.6
BTMU 13.0
Lloyds/BoS 12.2
Danish Ship Finance 11.3
Deutsche Bank 11.3
HVB 11.2
Bremer Landesbank 10.0
SMBC 9.6
Citi 9.5
Danske Bank / Fokus Bank 8.2
SEB 6.5
ING 6.5
Natixis 5.0
Swedbank 3.7
Helaba 3.5
National Bank of Greece 3.5
Emporiki Bank 3.0
Bank of Ireland 2.9
Alpha Bank 2.7
Marfin Laiki 2.4
ICBC 2.2
Piraeus Bank 2.0
JP Morgan 1.8
Total lending capacity: $395.4.bn
Data from
Nordea and
Petrofin Bank Research©
0
10
20
30
40
50
60

2. The status of global ship finance

- **The above totals may underestimate the contribution of Far Eastern and Middle Eastern banks which do not make their figures available.**

- **2009 witnessed a severe drop in fresh lending as well as a significant reduction of loan commitments.**

2. The status of global ship finance

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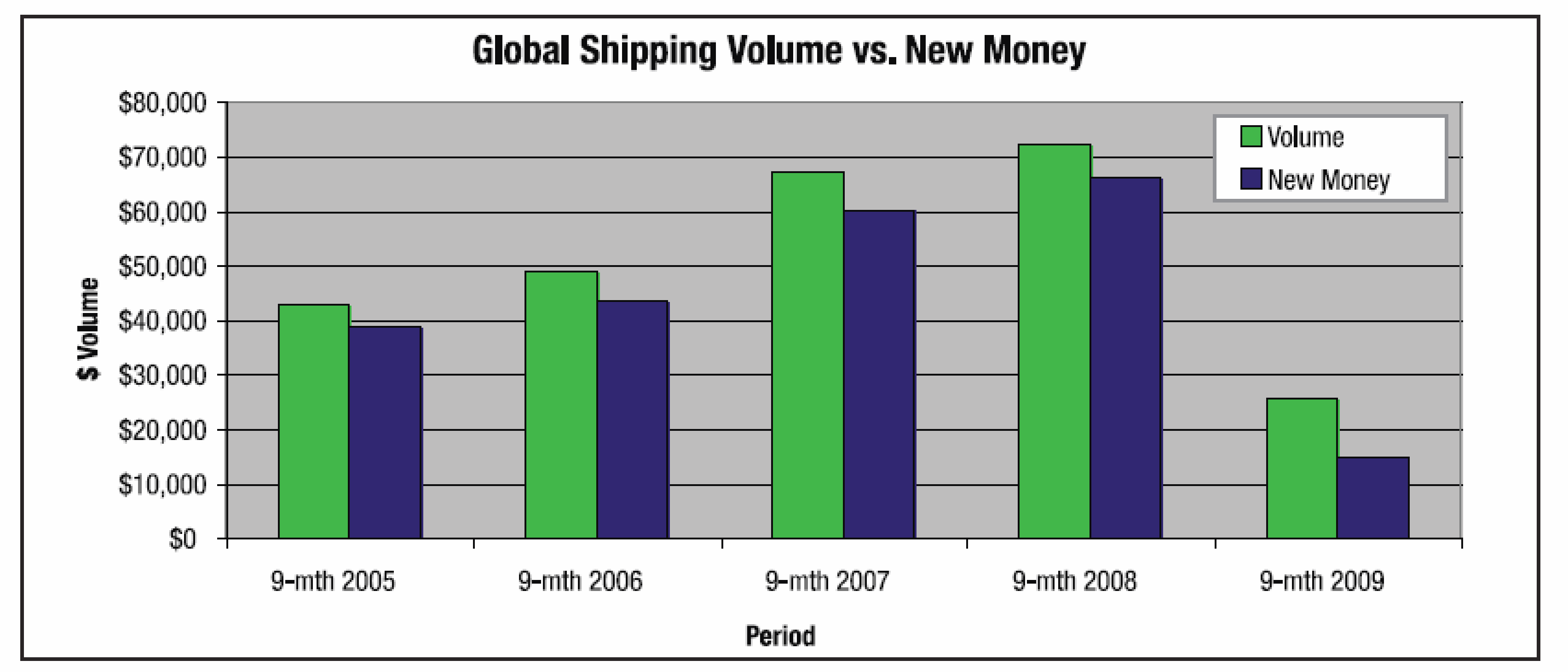
- Global shipping volumes for syndicated loans in the first 9 months of 2009 fell from $72.2bn in the corresponding figures for 2008 to $25.6bn (Table 5)

Table 5



Source: Marine Money Freshly Minted – October 8th 2009

2. The status of global ship finance

- Of the top 31 shipping banks, 7 banks, representing $171.1bn or 43.3%, are expected to significantly downscale their loan portfolios.

-Furthermore, 11 banks, representing $78.5bn or 19.9%, appear to note a neutral / unclear policy towards ship finance

- 13 banks, representing $145.8bn or 36.8% have credit capacity and / or the commitment to increase their lending (subject to market conditions)

2. The status of global ship finance

-It is projected that at the end of 2009, global lending shall have been reduced to approx. $410 to $420bn, mainly as a result of

a. newbuilding cancellations eliminating banks commitments
b. reductions of committed facilities for newbuildings that are progressing
c. utilisation of the natural run off of the loan book via repayments, vessel sales, pre-payments.
d. marked slowdown in fresh lending

2. The status of global ship finance

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- Banks have exploited client asset cover breaches and / or restructures and / or limited fresh lending to increase their loan portfolio yields.

-Bank losses and to a lesser extent loan provisions, have been minimised. Thus far, this conciliatory approach has been winning strategy, but is still too early in the shipping cycle.

-Banks are keeping a weary eye on the newbuilding order book, the rate of newbuilding deliveries and the level of scrapping. Recent Clarksons' figures point to an approx. 29% drop of the rate of deliveries down to levels of 2006.

2. The status of global ship finance

-Banks have been primarily occupied with their own capital adequacy and liquidity problems. Emphasis, thus far, has been to monitor shipping loan performance and assess loan provisions.

-The drybulk recovery in 2009 has supported banks' conciliatory approach. However, the large fall in tanker vessel values and earnings and the collapse of the container market is of growing concern.

-Widespread belief in the shipping industry that banks' attitude to waivers, restructures and non-performing loans shall harden in 2010.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-It is anticipated that the global newbuilding order book for the period 2010 to 2013 (4 years) at the end of 2009 shall have reduced to $450bn as a result of deliveries within 2009 and cancellations.

-It is projected that newbuilding cancellations (non-deliveries) and / or delays shall average at least 25% over the period reducing the order book over the 4-year period to approx $337.5bn.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-However, the order book is inflated based on today's values despite the possibility of recovering vessel values over the years

-It is estimated that 50% of the world (remaining) order book has already obtained committed finance of approx. 70% based, however, on market values and not on contract values.

-Consequently, assuming an average 30% value adjustment to the $168.75bn order book that has been financed, it results in $82.7bn finance, i.e. representing a reduction from currently committed finance, i.e. a reduction of loan commitments to the existing global loan book of approx $35.4bn over the period.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-Assuming max 60% leverage on the unfinanced 50% of orders estimated to be valued at $168.75bn results in fresh finance of $101.25bn.

-However, despite the current shipping crisis, it is expected that fresh newbuilding orders for a variety of ship types, shall be placed within the 4-year period estimate at approx. $50bn, which if financed at 70% would result in additional newbuilding requirements of $35bn.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-To conclude based on the above rough assumptions the additional newbuilding finance over 2010-2013 is analysed as follows:

•Finance for the non-financed orders	$101.25bn
•Minus reduction of existing loan commitments	$ 35.4bn
•Plus finance for fresh newbuilding orders	$ 35bn
Total required for finance	$101.65bn

-Based on a 2009 end global loan book of $410 to 420bn the above would represent approx. 25% in additional finance requirements over the period.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-Global second-hand and resale market for first 9 months of 2009 amounted to $10.7bn (www.gmoundreas.gr) or a projected approx. $14.25bn for 2009. We anticipate 50% new finance minus 25% sellers finance being retired being the equivalent of approx. $3.6bn for 2009.

-Over the 4-year period, based on increasing S&P activity, we anticipate additional finance requirements of $25bn.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-We project for 2010 – 2013 a further $50bn for

a) mergers and acquisitions

b) additional net finance due to refinancings

c) additional shipping finance raised for shipping purposes based on additional non-shipping assets

In summary, we anticipate organic additional finance requirements of approx $75bn over the 4 year period

3. Is there enough capacity to handle ship finance and newbuilding financing?

-Therefore, total estimated fresh new finance requirements of approx $177bn over 4 years, requiring a further approx 42.5% of current global loan totals

-Due to the severe cash flow squeeze across all sectors and despite owners injections of new capital, the natural run off of the global loan book, (via repayments) is assumed at approx 8% to 10% p.a. or approx. $33bn p.a. to $41.5bn p.a.

-Consequently, existing loan portfolios run-off could cover between $132bn to $166bn of the above new finance requirements should the run-off continue at current levels

3. Is there enough capacity to handle ship finance and newbuilding financing?

-However, It is anticipated that the above natural run-offs shall be higher over the years and especially from 2012 onwards.

-Consequently, assuming that retiring debt is channelled into new lending, the additional ship finance global requirements are not excessive from a loan demand point of view.

3. Is there enough capacity to handle ship finance and newbuilding financing?

-Turning to the loan supply side, the determination / appetite of existing lenders appears weak, as

a) At least 7 banks with over $170bn by loan volume and potentially others are either exiting ship finance or significantly reducing their exposure

b) higher loan loss provisions likely to sway banks against ship finance

c) overcapacity problems due to large order book have not been overcome yet

3. Is there enough capacity to handle ship finance and newbuilding financing?

d) the recovery prospects for all sectors and the container sector in particular are poor

e) European banks' champion role in ship finance may be reviewed as losses / provisions bite and appetite is reduced

f) shipping industry has failed to anticipate, protect and support itself and the banks from both the shipping crisis and over ordering as well as its effects, i.e. re-establishing ship finance, once again as a high risk industry

3. Is there enough capacity to handle ship finance and newbuilding financing?

-It is thus expected that lending capacity by western banks shall actually reduce at a time when the shipping industry's fresh requirements are anticipated to require their continuing presence at about current volume levels or a small increase.

-So, who will cover the shortfall?

-new lenders (maybe from the Far East?)?

-more owner capital (private and via stock markets)?

-more private equity capital (funds, institutional, etc)?

4. How long will the credit crunch continue?

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-In the short term (1-2 years) and despite high loan margins, market affected by:

-Low values and poor earnings

-High loan provisions

-Loan demand exceeds supply

-Banks still recovering from banking crisis

-Poor prospects of new entrants (other than Far East)

4. How long will the credit crunch continue?

-In the medium term (3-5 years):

-Improved values and earnings

-Reduction of order book

-Healthier loan book

-Reducing / no loan provisions

-Stronger banking sector – healthier prospects

-Influx of new lenders

-Shipfinance risk / reward attractive again compared to other types of lending

4. How long will the credit crunch continue?

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-Consequently, credit crunch conditions are expected to ease significantly within the next 2-3 years with the recovery process commencing approx one year earlier

5. Are the changes in terms and margins a permanent or transient change? Do higher margins impact on loan quality?

-Pre-crisis pricing levels far too low to cover inherent risk involved

-Banks used over-leverage to over-lend

-Bank competition fierce for top clients

-Above conditions need considerable time to reoccur

5. Are the changes in terms and margins a permanent or transient change? Do higher margins impact on loan quality?

-Banks need to de-leverage

-Banks need time to clean up loan portfolios and re-consider ship lending in a positive light

-Very unlikely for pricing levels within the next 3-5 years to revert to near pre-crisis low levels.

-New lending capacity to remain relatively scarce for at least 2-3 years depending on market conditions and prospects

5. Are the changes in terms and margins a permanent or transient change? Do higher margins impact on loan quality?

-Credit pricing models will need to reflect loan losses and provisions. Loan pricing may soften but expected to remain well above pre-crisis levels. Therefore, a permanent change.

-As lending capacity and competition shall increase in 3-5 years, margins shall soften further and strict lending parameters shall once again be relaxed.

-Lastly, high bank margins adversely affect the net cash flow of loans and ability of owners to maximise loan repayments utilising cash flow

-Some ideas of increasing bank returns without affecting net cash flow

6. How long can banks continue to support clients if the crisis continues

Key loan determination

1. The importance of cash flow adequacy
2. Ability to achieve at least a partial loan reduction
3. Additional collateral / liquidity support
4. Age of collateral
5. Quality of relationship
6. Quality of management
7. Asset cover consideration
8. Transparency

6. How long can banks continue to support clients if the crisis continues

Other considerations

a. Bank loan provisions / capital adequacy

b. Shipping loan portfolio status

c. Ability to handle problem loans / work outs

d. Ability to show loan portfolio reductions and / or enhanced security position

e. Who is making the credit decisions

f. Basel II considerations

g. Ability to keep loan portfolio / clientele

h. Bank attitude to shipping risk

6. How long can banks continue to support clients if the crisis continues

Home truths

I. Banks recognise cyclical nature of industry

II. Banks do not rush in to foreclose

III. Historically, patience has paid dividends

IV. Foreclosures often associated with older vessels and / or a breakdown in bank-client relationship

V. Switching owners / managers: a costly business

VI. Additional capital may sway banks to switch support

VII. Ultimately enhanced recovery schemes will be considered

9. Summary and conclusions