The Maritime Standard Ship Finance and Trade Conference 2016

Developing the right financial tools for the changing market

Presented by:
Vasudev P. Amonker
Unit Head – Int'l Lending
Corporate Banking Group
Burgan Bank, Kuwait

Current industry status - causes of downturn

Shipping Industry in rough patch since 2008

- **Global slowdown in Trade**.
  - World trade expected to grow slower than expected - just 1.7% in 2016 and forecast for 2017 between 1.8% & 3.1%,
  - Subdued outlook for global trade arising from:
    - Weak import volumes, especially in emerging markets & deceleration of growth in China
    - UK’s vote to leave the EU
    - Sluggish global economic activity amid continued geopolitical tensions
- **Excess Capacity**. Grew by 1.6 Mio TEU in 2015
- **Depressed Freight Rates**. This is natural corollary. Trade slowdown coupled with excess capacity has driven down freight rates to record low levels.

How long the downturn can last?

Industry facing the realities

- Macro economic conditions continue to be challenging.
- Global trade is expected to remain subdued beyond 2016.
- Despite gradual decline in new build order & increased ship scrapping, the capacity overhang to last before the market achieves equilibrium.
- Till that time, market to experience more pains like the Hanjin Shipping incidence.
- A sigh of relief:

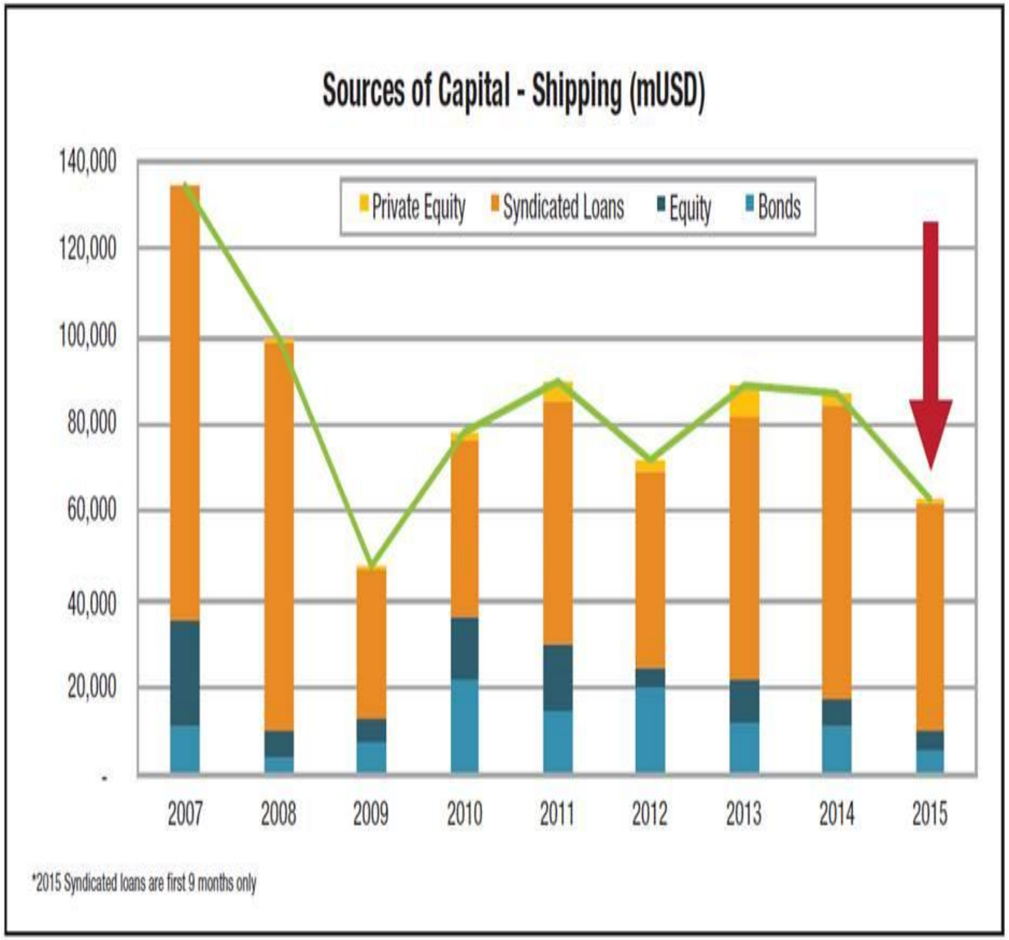
•Spike in freight rates in Q3 2016
•Leaving out oil, most of the commodities pricing looking up.
•India and China have shown strong increase in PMIs.
•Ship scrapping at all time high to reduce pressure on capacity

Non-financial tools for De-risking

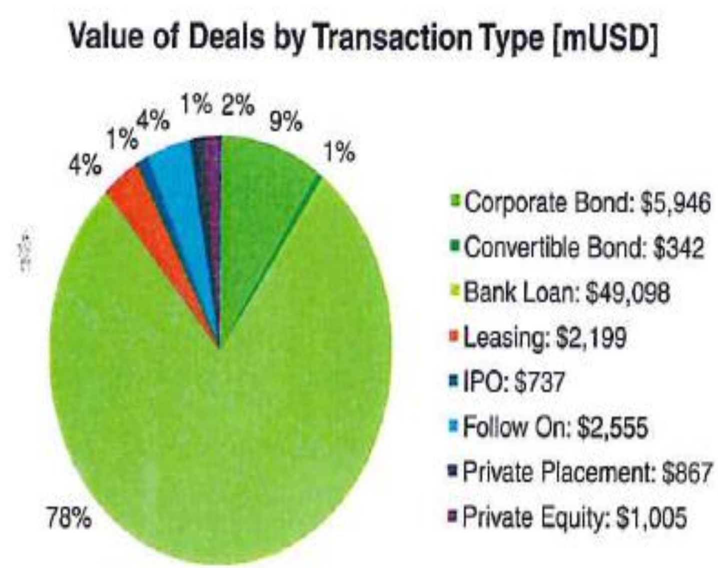
- Consolidating the core business
- Outsourcing non-core activities
- Fleet rationalisation and maintaining flexibility
- Optimizing and synergizing the operational efficiencies
- De-risking the business model with a combination of operational and financing strategies to combine additional equity support.
- **Mergers and Alliances**. Above could be best achieved through consolidation & alliances.

- COSCO with CSCL
- CMA CGM with NOL,
- In progress - Hapag Lloyd with UASC,
- Announced - NYK, Mitsui OSK, Nippon YK, Kawasaki KK.
- On the cards - Evergreen and Yang Ming Taiwanese merger.

Dwindling Sources of Ship Financing



2015 (11.30.15) ANNUAL REPORT



Source : The Marine Money

Challenges in Ship Financing

- **Banks**:
  - Historically, Banks have been providing about 75% finance.
  - Specialized ship financing banks are shying away due to the growing delinquencies and stringent regulatory norms like Basel III.
  - Traditional Banks too imposing stricter credit terms like:
    - Tighter Loan-to-value
    - Stringent financial covenants
    - Larger Minimum cash reserves & equity requirements
  - Bank financing is becoming expensive in the wake of increased sector-specific risks.
- **Equity capital - Private Equity:**
  - chipped into shipping with some opportunistic investments into distressed assets.
  - Interest waning due to low returns.
- **Equity Capital** - **IPOs**:
  - Less attractive due to many due to uncertainties.
  - Hard to tap with stretched balance sheets.

Other alternatives

- **Debt Capital - Bonds**:
  - Second most preferred means of financing after bank finance due to longer tenor despite being more expensive.
  - Islamic Sukuks are a form of bonds preferred by Islamic investors.
  - But Bonds can only act as an alternative to bank finance and not replace it.
- **Export Credit Agencies (ECAs)**:
  - Typically floated by Govt. to encourage investments in the domestic shipping industry like K-Sure in Korea
  - With huge capacity build up, ECAs becoming reluctant to fund further capacity.
- **Sovereign Wealth Funds**:
  - State owned funds with large kitty to invest. But they have always preferred a class of assets with better returns than shipping.

Role of Financial Tools in De-Risking the Shipping Business.

- ➢Sale & Lease-back arrangements:

•Free the Capital through financially divesting a portion of the fleet through a Sale & Lease back

•Structure Senior Secured, Mezzanine debts & Equity components with commensurate market driven returns to attract long term capital in the industry.

- ➢Mezzanine finance to increase capital buffers for greater loss absorption capacity. It gives the lender the rights to convert to an ownership interest in the company in case of default.
- ➢ Accessing Pension funds in developed countries like United States, Japan, etc for off balance sheet financing. (A case study in this regard is attached at the end of the presentation).

Financial tools in the context of The Middle Eastern shipping market

- In this context, it would be of interest to see how these could be used in the Middle Eastern context.
- The Middle East has a big development agenda:

a) Jebel Ali port in Dubai figures 8^{th} in top 10 port cities of the world and looking to improve the ranking.

b) Major GCC states are looking to increase their oil production to support growing budgetary expenditure

c) Qatar has developed a USD 7 Billion Port Hamad which requires large throughput. It is looking to develop LNG Infrastructure.

d) Saudi Arabia is presently engaged in infrastructure spend of over USD 30 Billion to cope with the pressures of growing population.

- All the above challenges require huge shipping tonnage and are a sure recipe for a thriving shipping finance market. Unfortunately that has not happened.

Financial tools in the context of The Middle Eastern shipping market contd.

- Most of the Gulf States have Sovereign Wealth Funds with vast resources at their disposal. But as mentioned earlier, many of these funds have shied away from shipping industry.
- Major banks in the Middle East have shipping desks. But thus far avoided competing with specialized ship financing institutions in the west.
- If the above two sources pool in their resources & develop expertise for establishing a regional ship financing bank, it could compete with the western financiers and attract financing interest from other regions of the world.

THANK YOU!

A case study on a viable Shipping finance alternative contd.

- Debt capital is the 2nd largest source of finance for shipping.
- US markets are sparingly used as a source of debt capital by the maritime sector. Possibly for reasons such as filings under chapter 11 of the US bankruptcy code by a number of international shipping companies since 2008, and the consequent world-wide stay on enforcement proceeding.
- Many US investors are unfamiliar with maritime finance but at the same time expect transparency and financial disclosures. As such they welcome a company with actual or implied credit rating.
- Mindful of the above challenges, one of our clients launched its inaugural US debt capital market instrument with the issuance of "Enhanced Maritime Trust Certificates – EMTC" under Section 4 (a)(2)/Regulation S offering collecting USD 162 Mio in July 2015.

A case study on a viable Shipping finance alternative contd.

- Financing technology utilized in aviation sector, where US investors are familiar, was adopted on the lines of Aviation Equipment Enhanced Certificate (EETC) with maritime finance principles and other structured financing devices.
- EETC transactions provide reliable and deep source of financing for US aviation sector. It has the potential for the investors to acquire trust certificates rated at levels higher than the rating of the corporate issuer.
- EETC offers a high degree of assurance that the investor will be able to recover their collateral in default scenario. The transaction had to be structured as a lease of personal property through the creation of a SPV in Malta to own the vessels.

A case study on a viable Shipping finance alternative

- EETC cross collateralization and cross default features were also incorporated in the EMTC transaction. All these features were necessary building blocks for achieving success in an offering that targeted a new class of investors relatively new to maritime investing.
- EMTC and other structured products like securitization will be integral to accessing the deep pool of capital to be found in US capital markets.