Shipping Finance

REVIEW 2009/10

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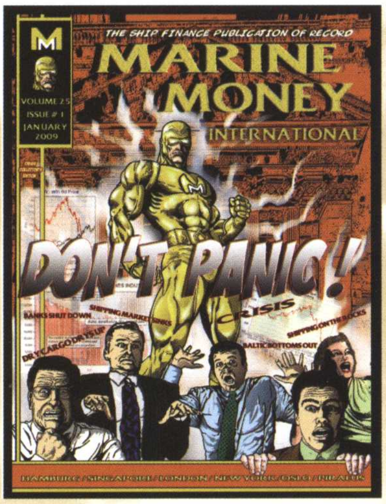

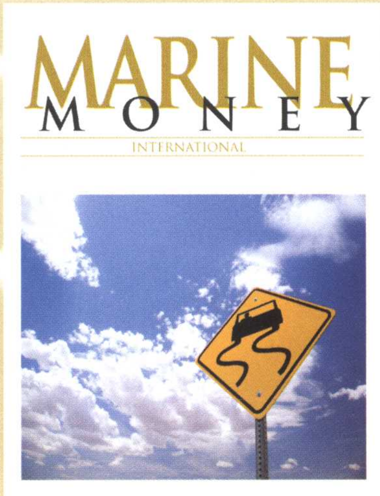

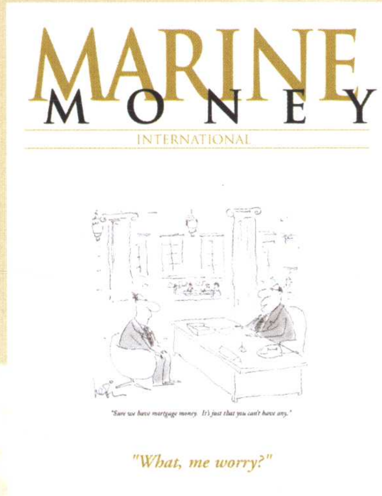

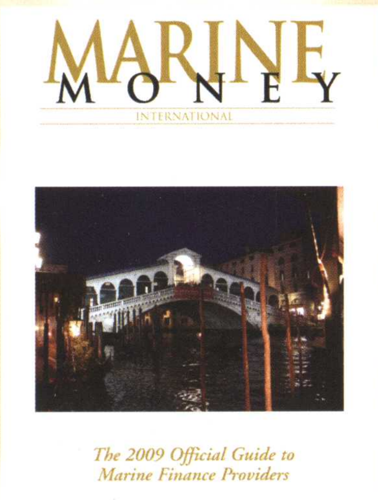

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Foreword

By Jim Davis CBE K(DK)
Chairman, International Maritime Industries Forum

Last year my Foreword was indeed gloomy but events throughout 2008 and subsequently have confirmed that I erred on the optimistic side.

What very 'interesting' times we live in on our crowded planet. There has never been an economic confusion to equal this one. It requires clear thinking and cool considered action to try and sort it out.... and it will take a long while. The last two decades' high life of over borrowing/spending has probably gone forever. But how does this now affect the marine industries? In previous articles I have mused that shipping in general seemed to have assumed that it had a prosperous life of its own while the rest of the world, developed and undeveloped nations, was in a state of economic and gathering turmoil. Sadly that assumption has been proved quite wrong.

The super-boom in shipping and shipbuilding always had a terrifying sense of unreality about it. Not least was a widely held and incredible belief that the boom itself was the norm and that any down turn would be just a temporary blip until 'normality' returned. But in the space of just a few months we have seen the charter rate of a capesize bulker fall from US$200,000 (even once US$400,000) a day to an achievable rate of around US$2,000. Consequently the increasing unease has seen owners looking fearfully at their forward commitments for newbuildings. The chokingly full order books of shipyards are starting to look frail indeed and there look like being mass cancellations; some believe as many as 60% of anticipated deliveries in 2009/2010/2011 may never happen. However let us look at individual trades.

- Dry Bulk. As referred to above the crash in freight rates of particularly the capesize monsters has already occurred. Last year I pictured the queues of vessels outside for instance Newcastle, New South Wales waiting for their loading berths. The picture today would be very different with the Chinese having – temporarily? – a pause in their ore imports. Yet 100% of the current capesize fleet is on order! Panamaxes and handysize are faring slightly better, both 'enjoying' daily rates of between US$5,000 and US$8,000. The dark spectre of charterers trying to renegotiate existing contracts is a further concern.

- Tankers. The wet bulk market has by comparison with dry held up pretty well. The phasing out – not least by charterers – of single hulled tankers has meant that the mass of newbuildings has had slightly less effect on the market than it otherwise would have.

- Containers. A combination of the over-supply of ships, sluggish growth of trade (1.7% growth in 2008 and 2.8%, even 0% or –10% in 2009) and soaring operating costs (bunkers, crew etc) combine for a gloomy future indeed. I have been anticipating this debacle for years but the euphoria of the last decade blinded judgement and realists were branded as 'gloom mongers'.

- Ferries. Considering the economic worries, cross Channel links are reportedly holding up quite well and encouragement must be taken by the ordering by P&O Ferries (alias D P World) of two very large passenger cargo ships for the Dover/Calais route. The northern part of the North Sea dominated by Stena and DFDS presents a rather less healthy picture. The Baltic shows encouraging stability, even growth, however.

- Cruising. One dabs at a tear at the departure from the seas of QE2, a ship that in her 41 years has, like Canberra before her, attracted an astonishing number of admirers and travelling fans. Her departure coincided with an unprecedented year of introduction of new, much bigger ships. The North American/European market grew in 2007 by 17%. The total European cruise passenger market is estimated at 4 million. (I vividly remember my final year, in 1972, of running the P&O summer cruising when the passenger total was 44,000!)
The major operators undoubtedly are having to discount their fares heavily on both sides of the Atlantic but numbers have been maintained and the operators are reasonably confident. It appears that the cruising public has taken aboard (literally!) that cruising is the best value, complete holiday package – 'The holiday with everything'. Even more significant is that amid all the mandatory saving and belt-tightening, the man in the street's holiday is the very last thing he is prepared to give up.

- Car Carriers. Recently, I saw in the Panama Canal the very significant numbers of car carriers passing through. I think they were outnumbered only by container ships. Also very large numbers of these ships are joining the market and are on order. With the catastrophic drop in new car sales there is revealed a massive over-supply of both cars and these specialist ships. One reads that in Bremen alone there are some 90,000 cars in semi-permanent storage in the port. Also one 2,500 vehicle vessel has been chartered as a temporary car park while the manufacturer strives for alternative storage space. A poor market indeed for quite a while one must assume. The sad story of the plight of the great car giants in the US, Europe and even Japan is well documented with its distressing effect on employment.

• Ecology. Ecological concern over the conflicting influences of CO_2 and sulphur will further promote inter governmental 'action'. Thus the fuels themselves and the machinery of ships will need to conform to new legally enforced requirements. The opportunity for the maritime community presented by this is to institute a well ordered and presented PR movement to demonstrate the eco-friendly position of shipping when compared with other forms of transport (notably road). Parenthetically, is slow steaming ('big, fat and slow') now here to stay? I have for decades been supporting the concept of the 'pipeline' as opposed to high speed projectile-like freight vessels.

• Manning. Much has been said and written – though rather less done – about the need to attract and train young people to 'go to sea'. The profession has changed beyond recognition during my lifetime; it has lost much of its unique attraction and cachet. ("*Only sailors – jack tars – see the world.*") How very different it is today. Crews are small; port time (often at a miserable terminal) is short, etc. The working life cycle of seagoing still needs to be re-approached so that the young can enjoy their years until, say, their mid-30s, in the highly responsible shipboard life before coming ashore as trained 'transportants'. Ship people have become far more akin to airline pilots and must be awarded more defined leave, pay and conditions. This is an old hobbyhorse of mine.

To be added to these thoughts is the disgraceful criminalisation of captains and officers (e.g. *Hebei Spirit* by the Korean government), replicated sadly by other nations for different 'offences'. Hardly an incentive to those contemplating a life at sea.

• Regulation. The industry is becoming awash with international and national regulatory rules. One is not railing just against this nanny type behaviour but at the steady growth of different authorities in dreaming up 'rules' and individually enforcing them. IMO should be the only arbiter of maritime behaviour, backed by its constituent sovereign states.

• Safety. In our 'blame society' day-by-day attention is being directed at identifying just who can be named as being responsible for any and every act. Owners, flag states, classification societies, insurers, port authorities and financiers can individually or severally be enthusiastically accused of negligence.

In reality shipping has an enviable safety record and though complacency must be resisted this record should be fiercely presented to the public. Personally I have been surprised at the weak response from the industry who have frequently adopted a tremulous, "Yes we must do better", attitude to inaccurate criticism.

• Piracy. With hijacking becoming positively regular in the Gulf of Aden (more than 40 this year) and the West African Coast on top of many previous occurrences in the Malacca Straits, it becomes imperative that governments should get together and enforce police activity through combined naval presence. A UN fleet under a unified command needs to be set up with clear rules of engagement and the right to deal summarily with pirates if necessary with the legal 'right of hot pursuit' even into territorial waters. It is appropriate that the IMO through Efthimios Mitropoulos its excellent Secretary-General is taking the initiative on this.

• Hope for the future. I must end with at least a measure of hope: "This too will pass" is an Oriental maxim that applies to the world's present economic and shipping plight. My own suggestion is therefore that we must indeed be calm and clear sighted in the realisation that our little planet is the home of 6.5 billion humans who need food and energy which must and will be provided.

We in shipping must with the rest of the world live through a very severe 2009 and maybe 2010.

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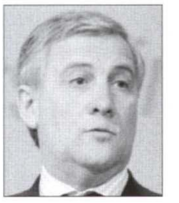
Towards a European maritime transport space without barriers

By Antonio Tajani, Vice President of the European Commission

Maritime transport has an importance that goes far beyond just shipping goods from A to B. It is vital to Europe maintaining its position as key player in an increasingly globalised economy. The maritime transport system accounts for 40% of freight exchanges between EU Member States and for 80% of freight exchanges with third countries.



Up until recently the shipping sector has expanded considerably. In 2007 alone the gross weight of seaborne goods handled by main ports in the EU grew by more than 2.3%. There has been a significant increase in the number of ships in operation, both in the international markets and in the short sea trades. The EU is well placed to take advantage of any growth in shipping with its 1,200 trading ports and 100,000 kilometres of coastline. European shipping companies have invested vast amounts of resources in the renewal and expansion of the fleet in order to sustain the expansion of world trade. But to fully unlock the advantages maritime transport has to offer, more work needs to be done to remove the barriers that companies are facing by creating a European maritime transport space without barriers. The European Commission has proposed and will be proposing a raft of measures to make this happen.

Opportunities and threats

Shipping boasts a number of clear advantages as a mode of transport. Short sea shipping can be considered the most environmentally friendly mode of transport as it has comparatively low external costs and higher energy efficiency. It is also a very safe way of transporting, which induces infrastructure costs that are much lower that those for land transport. Plus it is very cost-effective and on some routes can offer a quicker alternative to road transport.

However, there are still many barriers preventing operators from taking full advantage of these benefits. In spite of the creation of the single market in 1993, maritime transport continues to be subject to complicated administrative procedures. For example, while lorries can drive unhindered throughout Europe, goods shipped between ports as close together as Antwerp and Amsterdam are considered to have left the territory of the European Union. Consequently, maritime transport between Member States involves many documentary checks and physical inspections by customs, health, veterinary, plant health and immigration control officials. The administrative procedures for maritime transport are complex, redundant and not harmonised between Member States or ports, so operations for incoming and outgoing vessels to and from ports are slowed down, leading to higher costs and delays in loading and unloading operations.

In addition maritime transport presently suffers as a result from the current economic crisis. It has led to a substantial reduction of sea-borne trade and at the same time financial constraints make it more difficult for the capital-intensive maritime transport sector to operate.

The role of the European Union

To overcome the problems related to maritime transport, solutions need to be found at a European level. The single market gave a boost to road transport within the EU and the same must be done for shipping. With the right measures, Europe will continue to offer attractive conditions for creating a vibrant shipping business model based on the core values of sustainable development, fair competition in open markets, and high environmental and social standards.

On January 21, 2009 the Commission presented the main strategic goals for the European maritime transport system up to 2018. The Communication examines the issues involved and proposes far-reaching measures. An important part of the strategy is to establish a single European maritime transport area. It is crucial in ensuring the effective development of the 'motorways of the sea' – key sea routes between the Member States of the EU. Combined with other modes of transport, they should provide regular, high-quality services which offer an effective alternative to transporting goods only by road. The motorways of the sea represent a cleaner, more cost-effective solution for transporting freight and will reduce congestion at the main bottlenecks on Europe's roads. What is more, they also provide effective, viable links to the remoter regions of Europe. A whole network of motorways of the sea will have to be established to absorb a significant portion of the growth expected for road freight traffic. At the same time, short-sea shipping will have to continue improving its performance.

Having a European maritime transport area also involves eliminating or reducing the numerous administrative procedures which apply to goods shipped by sea between European ports. It will make shipping more attractive, efficient and competitive, while contributing to a higher protection of the environment at the same time. What is also needed is the general use of ship tracking systems that national authorities will be able to use to monitor the area to ensure that ships are operating correctly. This will prevent an increase in fraud resulting from the lifting of controls.

Reducing the administrative burden

This year the Commission will amend the Regulation laying down provisions for the implementation of the Community Customs Code so that ships transporting goods directly from one EU port to another will be exempted from administrative formalities. Their cargo will be given the customs status of Community goods so that documentary proof regarding this will not be required.

The Commission will also examine the possibility of granting facilitation to ships sailing between ports in the EU but making a call in a port located in a third country or a free zone, in particular for regular shipping services and in order to further enhance short sea shipping and the motorways of the sea. Goods loaded during this call will have to be clearly identified using electronic means under the modernised Customs Code. For non-EU goods, formalities would remain unchanged in relation to the current situation.

Another measure to cut back on red tape will be to simplify the reporting formalities for ships arriving in and/or departing from ports. When a vessel calls in a port, the ship's master or the agent of the shipping company has to provide about 200 pieces of information to various administrative services. This includes data which may have to be repeated about 20 times. The Commission proposal will require the use of electronic data transmission systems for data exchange, while paper-based documents will be abandoned at the latest in 2013. This measure will pave the way for setting up National Single Windows, which will allow traders to lodge information with a single body to fulfil all import or export-related regulatory requirements.

Currently, traders need to interact with a variety of people at ports to carry out all the necessary administrative procedures. This makes maritime transport slower, more expensive and less reliable. Establishing a single desk, where all paperwork will be dealt with, will be highly beneficial. Also vessels and authorities should exchange information in an electronic format as much as possible.

Facilitating the exchange of information

EU legislation prescribes the mandatory fitting of vessels with equipment permitting to monitor maritime transport, which will make it easier to exchange information. Under this legislation, the carriage of Automatic Identification System (AIS) is mandatory for almost all categories of ships. Vessel Traffic Services/Vessel Traffic Information and Management Systems (VTS/VTMIS), using information from AIS, coastal radars, and radio communications are deployed to monitor traffic in specific locations. In 2006, the EU made the Long Range Identification and Tracking of Ships (LRIT) compulsory for ships of 300 GT and upwards, available from January 2009.

These systems will pave the way for the introduction of an e-Maritime environment for goods and for navigation, which will improve the competitiveness of the sector and provide substitution solutions to present administrative controls and documentation checks. In this context, the deployment of an integrated maritime surveillance system for monitoring movements of ships at sea will further improve vessel traffic monitoring.

The European positioning system Galileo will play an important part in the deployment of e-Maritime systems. New applications and services developed on the basis of this future satellite-based system enhanced by land-based stations will improve the safety of navigation in all weather conditions along European coasts or in ports. It will support the enforcement of rules adopted by the International Maritime Organisation, notably those on long range identification and tracking, as well as provide opportunities for further development of administrative simplification.

Several port community systems are already in place or about to be implemented in the EU and each one fulfils a different objective. There are also several networks for sharing information on vessels traffic between Member States. It is hence necessary to carry out an EU-wide integration of these systems within this framework, including the SafeSeaNet network. The integration of the maritime surveillance systems will provide a much more enhanced tool for the monitoring of vessels and traffic tracking. The development of a seamless transport document flow, which is the objective of the Commission e-Maritime project, will ultimately reinforce the ability of short sea shipping to compete on more door-to-door corridors.

Other areas for improvement

The Commission is also working on proposals that will benefit the transport of animal products and live animals as well as the transport of dangerous goods. When transporting animal products and live animals within the EU, documentary checks are currently still needed when unloading in ports with a border inspection post if the maritime service is not a regular and direct line between ports that are both in the EU. This is to address the risk of goods from a non-EU country being presented accidentally or fraudulently as goods of Community origin, exposing the Community to significant risks to public and animal health.

Through specific guidelines the Commission will encourage more effective and faster clearance of animal and plant products in maritime transport between Member States. There are possibilities for fewer checks, especially documentary checks. There are overlaps in such checks leading to delays and higher costs in clearance. Similarly, there are indications that the best practices of some ports offer opportunities for more effective controls, without compromising safety. These best practices will be introduced in guidelines on the procedure to apply to animal and plant products carried by seaborne transport.

There might also be scope to simplify rules for the transport of dangerous goods without compromising the level of safety and security. The Commission intends to consult with the stakeholders of transporters of dangerous goods for all transport modes, with a view to presenting a proposal to implement harmonised simplified rules.

What Member States can do to help

Member States have an important role to play also in establishing a European maritime transport space without barriers. The various port inspection bodies that monitor compliance with customs, tax and health regulations and the conformance of plant and animal products often act without coordination, thus generating costs and delays which could easily be reduced. The Commission calls on the Member States to review and simplify their practices in these areas, which often come under the responsibility of local authorities. Member States should invite local authorities to improve the operational co-ordination by making sure that the sequence of the different administrative steps does not create unnecessary delays.

National language requirements often represent a bottleneck to the development of short sea shipping. Member States are encouraged to assess the feasibility of using one single language for all maritime administrative documents and procedures. This has already proved to work well in the Baltic region where countries agreed to use English for maritime administration.

In addition Member States are invited to create a regulatory framework which would permit easier pilotage exemptions. This regulatory framework should consider allowing shipmasters who do not speak the country's native language to obtain pilotage exemptions. The conditions for obtaining a Pilot Exemption Certificate (PEC) should be reasonable and not contain elements of protectionism. The solution will be a simplification of the existing regulations, allowing all operators carrying frequent shipping services to apply for pilot exemption in a much easier way.

Another recommended measure is to physically separate, where possible, short sea shipping and other types of traffic in ports. The benefit of this measure would be a more rational management of port traffic and a speeding up of vessels' turnaround times in ports.

Reaping the benefits

While the first ships enabled man to discover what lied beyond its shores, they now allow us to reach out to the world outside the European Union. Shipping is still essential to moving large quantities of goods from one continent to another. If the EU is to embrace globalisation and play a leading part, European companies will need to be able to take to the waves without encountering undue complications or unnecessary barriers.

Creating a barrier-free maritime transport area in Europe will do so much more than just give a boost to the economy. Certainly, companies will see their costs and delays slashed significantly, leading to higher profits and more job security for their staff. Removing administrative hurdles will stimulate trade between Member States while having an EU-wide system for exchanging information will help to keep the waves safer for everyone.

Reducing the administrative burden will also make maritime transport more competitive. More traders will recognise its advantages and swap the road for the waterways. This is important as far as climate change is concerned. Maritime transport's low impact on the environment means it has to be considered as part of any plans to combat global warming. It would be difficult to meet post-Kyoto CO_2 targets without encouraging the use of shipping for moving goods.

The Commission has realised all of this, which is why it has come up with a comprehensive vision on all aspects of maritime transport. As everything is interconnected, it will not suffice to focus on just part of the picture. Provided everything is done to remove current barriers, maritime transport will continue to generate wealth for Europeans in a sustainable way. The world beyond our shores is still worth exploring.

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Back to basics – as offshore financing enters deeper waters

By Amar Banwait and Xi Chen, Société Générale

It will not have escaped many that the financing landscape has changed drastically over the last six to twelve months, during which time we have witnessed collapses of financial institutions, banking giants retreating from financing activities and contagious nervousness amongst investors. In the meantime however, the requirement for financing of offshore sector assets is unabated, with demand for deepwater drilling, in particular, at an unprecedented level. Despite the impressive pipeline of potential offshore sector assets to be financed in the market, many deals are foundering on the rocks leaving some of the following basic questions unanswered: Which financings get done, which fail and why? What is the optimal "bank-able" structure? How do we ensure that an offshore sector asset financing succeeds in today's banking market?

Strong covenants, shorter tenors, lower gearing, materially higher pricing and a flight to quality and simplicity are some of the basic requirements of banks who have an oversupply of projects in which they are being asked to invest their limited capital. This article will attempt to address the above questions and, more importantly, highlight the various challenges that the asset owner has to address when sourcing financing in the current environment.

The fundamentals and financing needs are still going strong

Despite the dramatic drop in oil price over the last nine months which is jeopardising the economic viability of some (mostly shorter term) projects, oil and gas industry experts still believe the fundamentals to be strong in light of:

- sustained long term demand, particularly from emerging countries; and
- declining production: a recent study by CERA/IHS estimated that the world's fields' production is currently declining at an alarming annual rate of 4.5%.

The general consensus is that medium term oil price will return to the previous US$100+ level, as shown in Figure 1 by Bloomberg compiling forecasts from 32 market analysts as of March 2009.

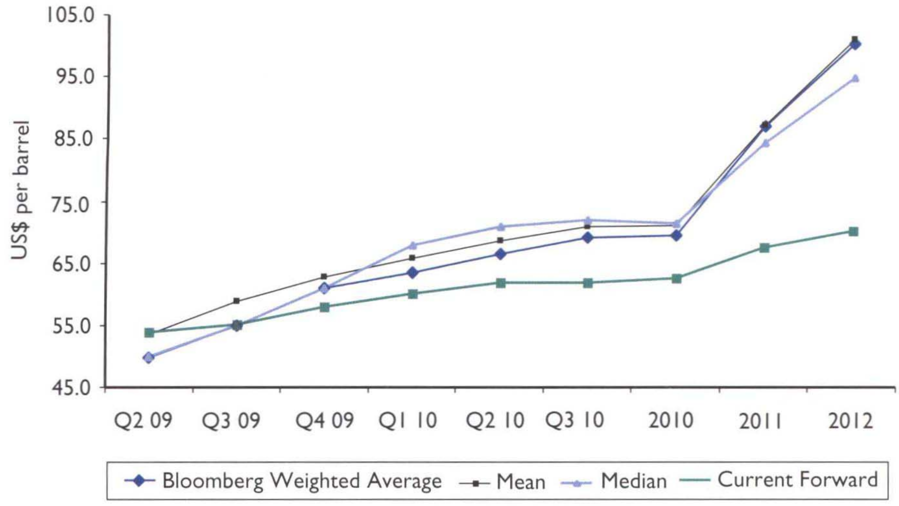
There is no doubt that continuing exploration and production is essential to avoid a crisis in hydrocarbon energy supply and the outlook for the deepwater offshore industry is particularly strong. Indeed, with the onshore and shallow-water regions having been heavily explored over the past decades, the major recent discoveries are primarily in deepwater (e.g. Tupi offshore Brazil). According to some independent industry research, deepwater production is expected to almost double between now and 2012, requiring more than US$100bn of deepwater investments. Furthermore, these investments require financing! And financing will present one of the toughest challenges for asset owners in the current financial environment.

The global financial turmoil means banks' capital remains a scarce resource

The same offshore deal that was two to three times over-subscribed 18 months ago (in 2007) may struggle in 2009 to attract more than a couple of relationship banks. Banks are declining to accept requests to enter into transactions in unprecedented number. This applies to deals based on structures previously accepted by the bank market and, indeed, risks that were deemed market standard. This rejection of certain transactions is not necessarily a reflection on the fundamentals of the offshore sector, which has not been materially impacted by the short term drop in oil price as the financings are underpinned by fixed rate long term charters, but because of the financial crisis impacting banks' appetite and ability to lend.

The traditional "syndication"-style financing where one or more banks would underwrite a transaction has now been largely replaced by "club-deal" strategies putting together a banking group from the limited number of commercial banks still open for business.

Figure 1: Nymex WTI price forecast – Bloomberg Composite



Source: Bloomberg

Unfortunately, given the huge cost of deepwater rigs (up to US$1bn each), the club-deal approach is far from straight-forward. The combination of banks' reduced commitments on individual projects, variability in each bank's specific requirements, lower market liquidity and the uncertain and constantly changing market conditions, these club deals can lead to extended and difficult negotiations.

The question of risk sharing between the charter, the asset owner and the lenders as well as of which risks (and at what level) banks are now prepared to take, are more than ever at the heart of these discussions.

"Flight to quality and simplicity"

In this environment, where banks are capital constrained, there is an increased focus on client relationships, as banks seek to use their limited funds to support core clients. However, relationship-driven transactions of any significant size based on off-market terms are unlikely to clear the market. On the contrary, banks are cherry-picking high quality, low risk, less complicated deals where the probability of success is high.

Below, we highlight a number of areas on which we believe lenders are focusing:

Counterparty

Clearly, under these limited recourse offshore transactions, the primary source of repayment is from the cash flows under the charter contract on which the asset is to be deployed and so a key analysis for financiers is the quality of that contract and the creditworthiness of the underlying charterer. Ideally, the employment contract needs to be underpinned by an "investment grade" corporate whether that be the charterer or, as has sometimes been the case, the upstream company's parent or third parties.

Construction risks

The successful construction of these extremely complex and capital intensive assets within budget and to specification under their employment contracts is a significant risk and one which attracts a lot of attention from banks' credit committees.

Lenders are increasingly favouring transactions that contain a completion guarantee, typically from the creditworthy asset owner or where there is a refund guarantee under a shipbuilding contract. Such contracts typically come at a significant additional cost, but this can drive the difference between the success and failure of a transaction.

However, we should stress that we still consider that engineering, procurement and construction ("EPC") contracts to provide acceptable risks to lenders, although in the absence of a completion guarantee such contracts will require significantly more information such as credentials of the project engineering teams, track records for various equipment providers and the shipyard together with the employment of a technical adviser being necessary to help lenders assess the potential cost-overruns risks and their mitigants as well as providing a contingency estimate for additional costs that may arise. The technical adviser should be