Anatomy of Ship Finance

Singapore

5-8 March 2018

Organised by

Cambridge Academy of Transport

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Cambridge Academy of Transport

Registration Form

ANATOMY OF SHIP FINANCE

SINGAPORE • 5–8 MARCH 2018

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Family name ______________
Company position ______________

Company name ______________

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Nature of business ______________

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❑ Enclosed is a cheque ❑ Please invoice my Company ❑ I wish to pay by Credit Card (details below)

Course Fees: The fee of **USD3,600** includes all documentation, lunch on each day and coffee/tea breaks. Payment can be made by cheque, bankers draft or inter-bank transfer. Cheques should be made payable to Cambridge Academy of Transport in US Dollars drawn on a bank in the United States. Bank details for inter-bank transfers are:

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Course Programme

Anatomy of Ship Finance – Singapore

5-8 March 2018

Course Leader

Trevor Law · Former Senior Vice President · DVB Bank SE · UK

Monday 5 March

Welcome and Preview of Programme **0815-0830**

During this introductory session, the aims of the programme will be reviewed leading into the scene setting session that follows. The Ship Finance Business Game and the week's lectures will be previewed.

INTRODUCTION & SOURCES OF SHIP FINANCE

Session 1

Introduction to Ship Finance: Where Does the Money Come From? **0830-0945**

The aim of this lecture is to provide a broad overview which will "set the scene" for the many detailed lectures provided by experts during the week. The lecture will outline the various types of financing available to the shipowner from governmental and private sources and explain their relevance to owners considering either newbuilding or second hand tonnage acquisitions. Concentrating on the commercial debt market, a detailed description will be given of the various risks considered and analysed by the commercial banker when faced with a loan application.

The impact on shipping finance and world trade of the Basle Accord will also be addressed. The Accord dictates the capital adequacy ratios of the banks in most of the World's major trading countries and lays down more severe debt/equity ratios than has been common in recent decades. In addition, the lessons learned by the finance community during the shipping crisis which began in late 2008 will be considered prior to the application of the Basel 3 Accord in 2019.

Session 2

Commercial Bank Finance **1000-1115**

This lecture will outline the various types of financing available to the shipowner from governmental and private sources and explain their relevance to owners considering either newbuilding or second hand tonnage acquisitions. Concentrating on the commercial debt market, a detailed description will be given of the various risks considered and analysed by the commercial banker when faced with a loan application.

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There has been considerable talk in the market about foreclosures and loan restructurings. But it appears to be the case that the current shipping crisis has not seen the same level of bankruptcies as in the previous major shipping crisis of the mid-1980s. None-the-less, problem loans exist and it is how the lender identifies and then deals with a borrower who is on the ropes which will be addressed.

Session 3
Private Equity & Hedge Funds: What's the Deal? 1130-1230

Private equity has a fickle relationship with shipping, although it must be said that virtually all shipowners will have some equity position in their fleets. However, the private equity we are considering in this session is new money coming in to the industry from non-traditional sources. These investors will only be attracted in to shipping investments when the market conditions and the future prospects align in such a way as to suggest a significant return on the investment. They are unlikely to be long-term players in the business, but their investment horizon is generally much longer than a hedge fund which often moves in and out of markets relatively quickly.

While the investor profile of hedge funds and private equity funds may look similar, it is the focus of the investments that are likely to determine how best to describe the fund. A hedge fund will look to a variety of investments which are liquid – thus allowing more scope for frequent entries and exits to suit the fund managers perception of opportunities. Private equity funds will generally acquire whole companies or a substantial stake in the companies hoping to influence its future trading success. During the session, the lecturer will:

- describe private equity from a maritime perspective
- draw a distinction between hedge funds and private equity
- provide some examples from real life and what has been seen in practice

Session 4
Public Equity and Bonds: The Capital Markets 1330-1445

All capital markets have a wide choice of investments and will follow yields and trends from one sector to another. Shipping has always been peripheral to these sources of funds, representing only a tiny fraction of available private and public capital.

Whether or not shipping has made a rational coupling with the capital markets can only be judged after a suitable period of time has elapsed, but some of the lessons learned from the early beginnings of the relationship can be told. This session will highlight the main features of capital market funding and draw some specific conclusions based on recent experiences

Session 5
Export Credit Agencies and their Increasing Importance 1500-1615

During the past five decades, a considerable volume of financing for ship purchases has been concluded with government assistance. Most usually these transactions were for newbuildings and in particular newbuildings from shipyards located in the country providing the financial assistance. In the early days of Japan's expansion as a shipbuilding powerhouse, many of these schemes were put in place to protect the yards operating in high cost countries, for example in Europe. As a consequence of what appeared to be unbridled government interference with the workings of a "free" market, the OECD stepped in to lay down some ground rules.

That, of course, is all history. Today, the main movers of shipbuilding activity are Korea and China, and it will not be a surprise to learn that these two governments also offer financial incentives to bolster their shipbuilding industries. This session will consider the types of funding available and how the financial package is structured. While there are many advantages to taking cheap money, shipowners must also recognise that there are also disadvantages.

Session 6
Ship Finance Business Game: Handouts and Assignments 1630-1745

In anticipation of the Business Game that the participants will begin shortly, this session will provide a brief overview of what to expect and hand-out the various documents which form the backbone of the Game.

The Game is divided into five rounds, each representing consecutive years in the evolution of the Game, with the current year being Year 1. During each round the Bank or Shipping Company will enter into loan agreements with an opposite Owner or Bank, and have the freedom to choose whichever opposite team they so decide to engage with for this year. Following the conclusion of a mutually acceptable loan agreement, Teams will complete the Loan Term Sheet and pass the details of the agreement to John Doviak who will enter the relevant figures into the Game Model spreadsheets. In the case of shipowners, any sale and purchase transactions and chartering decisions will also have to be recorded.

At the end of the session representing a single year, with transaction details correctly entered, the Game model will provide an accurate summary of all the bank and shipowning companies finances. At each of these successive stages, the model will have incorporated the latest "Market Factors" for the year being analysed. Market factors for each successive year include freight rates, vessel values, interest rates and scrap prices. On the basis of each year's results, banks and owners will then decide what actions they wish to take in the following year. After all five rounds of the Game are completed, the final position of the banks and owners will be revealed, with the winner in each category being the team that has achieved the best return on their initial (starting) equity.

Tuesday 6 March

Session 7
Daily Review **0815-0830**

Session 8
Fundamentals of Leasing **0830-0930**
With the exception of some exceptionally high valued assets financed within tax heavy markets, leasing has never been a main providing of funds for ship acquisition. However, it does have its place in the plethora of funding methods available to an owner and should be included in a study of the ship finance sector. The session will therefore cover the following topics:

- types of lease and why lessees use leases
- how tax leasing works
- the good times for uk leasing
- what went wrong
- principles of lessee accounting
- leasing and ship finance today

Session 9
Ship Finance Business Game: Briefing Session **0945-1030**
Having received the Game documentation the previous evening, this final briefing session is intended to allow any questions arising amongst the teams to be answered.

Session 10
Business Game: Investment Decisions - 1 Jan 2018 **1030-1300**
Participants will be divided into teams with some teams taking the role of bankers and the other teams the role of shipowners. At the outset of the Game, Owners will need to raise finance in order to meet their various commitments and the bankers must offer loans into the market or face closure. This first session imposes on the two sides the need to "do a deal" or more than one if it makes business sense. Subsequent session sof the game will advance by one year each time and the trading results of banks and owners will be revealed following publishing of the previous year's market report.

The teams of owners and bankers must now negotiate amongst themselves to produce a loan agreement and accompanying "term sheet". Emphasis during the negotiation should be on the covenants sought and agreed. Details from the loan agreements and term sheets will be entered into a spreadsheet for each team and these will be updated at each annual interval of the Game. Each successive stage in the Game will bring the teams back together at the 1st January to decide on their next years' investment strategy. The Game Organisers will produce each team's year end results as at 31st December based on the evolution of a simulated market.

Session 11
Workshop: Identifying Risk Factors in Shipping Debt **1400-1500**
Lending money for ship purchases is a risky business. Vessel value risk, the most obvious, is but one of many risks facing the shipowner and his financier. In this workshop session, participants will group into small teams to identify as many risks as possible that a bank could encounter during the term of a shipping loan. Teams will also be asked to suggests ways that each identified risk might either be lessened or removed entirely.

Session 12
Marine Insurance: What Lenders and Investors Should Know **1515-1615**
Shipping has many risk factors and a number of these have already been mentioned earlier in the course. Included amongst these risks are:

- Exchange rates
- Bunker prices
- Interest rates
- Sale & Purchase markets
- Freight rates
- Economic issues

Missing from this list, and perhaps the hidden risk from the perspective of a banker or investor lending to a shipowner, is insurance. Most shipowners are likely to have three forms of cover:

- Hull & Machinery Insurance (H&M) to cover mainly physical losses to the asset (the hull and its machinery)
- Protection & Indemnity (P&I) for liability risks, and
- War Risk Insurance to cover losses which are excluded from the above two basic policies

Following a brief review of how each of these insurances work and the risks that each covers, the session will look at how the expected cover for losses can go wrong. It is for this reason that two other forms of insurance exist:

- Mortgagees Interest Insurance (MII), and
- Mortgagees Additional Perils (Pollution)

How each of these works, their relationship with owners' main insurance policies and the protection they provide to lenders will be explained.

Session 13
Business Game: Investment Decisions - 1 Jan 2019 **1615-1815**

Wednesday 7 March

Session 14
Daily Review **0815-0830**

Session 15
Business Game: Investment Decisions - 1 Jan 2020 **0830-1000**

Session 16
Key Factors Regarding Security in Debt Structures **1015-1115**
Any debt transaction is accompanied by a wealth of documentation which is intended to clearly spell-out the relationships between the parties and to provide protection for the lender. This session will review recent developments, highlighting the following:

1. Structure of security
2. Implications of flag for mortgagees
3. Mortgage requirements and registration; dual registration problems
4. Insurances, reinsurance's, brokers and captives
5. Earnings, charter-parties, pooling

6. Covenants; subordination of second mortgages; events of default
7. Priority of maritime liens; pollution claims
8. Impact of insolvency laws; risks for owners and mortgagees
9. Work-outs and enforcement
10. Asset sales

Session 17
Capital Constraints & Credit Risk **1130-1230**

Banking has changed considerably in recent years, particularly since the financial crisis following the collapse of Lehman Brothers in 2008. Eight years on has brought with it an increase in political and regulatory intervention in the activities of banks and other financial institutions. The main thrust of today's regulatory controls is to create a financial resilience to enable banks and other financial institutions to withstand any future major financial shocks.

This session will focus on:

- Risk categories with special regard to
- Bank's product risk spectrum
- Cash risk management tools
- Fraud
- Sanctions
- KYC (Know Your Customer)
- AML (Anti-Money Laundering)
- AB&C (Anti-Bribery & Corruption)
- Geopolitical risks
- Portfolio management
- Basle 1, 2 and 3, the latter of which will be phased in in 2019

Session 18
Business Game: Investment Decisions - 1 Jan 2021 **1330-1500**

Session 19
Cashflow Analysis **1500-1615**

This lecture will review how a cashflow analysis is carried out and how financial risks can be quantified, focusing on the practical use of cashflow analysis in support of loan/investment decisions. It will review cashflow forecasting methodology and the practicalities of developing input assumptions including:

1. OPEX - Operating Expenses
2. Freight rates
3. Scrap values
4. Operating days per annum
5. Repair and maintenance costs

One of the most important reasons for a cashflow analysis of a transaction is to be able to undertake "what if" assessment of the deal. Shipping is a volatile business and few financial deals are immune to the vagaries of the spot market. The better deals, however, are robust enough able to withstand these fluctuations without threatening the fabric of the transaction.

Session 20
Valuing Ships in the Open Market **1630-1745**

Any public offering or debt finance requires a valuation to be placed on a ship or fleet. This valuation is particularly important in a major placing where the value of the fleet will appear in a "prospectus", the accuracy of which is covered by numerous stock exchange regulations in the major financial centres. Although important, it is not only for major stock market flotations that ship valuation is sought. This session will:

- review the many uses to which valuations are put
- show how a valuation is undertaken
- highlight the factors that need to be taken into account in preparing a valuation

- point out the many pitfalls that threaten the accuracy of a valuation, and
- discuss the problems which may arise during and as a consequence of the valuation of a ship or fleet.

Thursday 8 March

Session 21
Daily Review **0815-0830**

Session 22
Business Game: Investment Decisions - 1 Jan 2022 **0830-1000**

Session 23
Reposessions: Anatomy of Loan Failures **1000-1115**

All loans carry with them a risk, and it is to the covenant package that a banker looks for protection in the event that the transaction turns sour. What actually happens before, during and after a creditor exercises any lien or other authority is a mystery to most borrowers and lenders - and most hope never to go through such an experience. None-the-less, problem loans do exist and it is how the lender identifies and then deals with a borrower who is on the ropes which will be addressed.

This session will therefore focus on the consequences of the recent shipping recession which began with the collapse of the freight markets at the end of 2008. Lenders, especially the commercial banks, were exposed to the risks of the markets as the valuations of their shipping portfolios fell in parallel with the charter markets. Traditionally, banks could enforce their mortgage and repossess the ship. But the dynamics of the banking market well outside the control of the shipping sector have had a significant impact on the action (or some would say, inaction) of the banks.

How do shipowners view the pressures exerted upon them by their lenders; what is the market practice for dealing with shipowners unable to pay as contracted; what are the signs of an owner in trouble? These and other issues will be covered during this session.

PERSPECTIVES ON THE LENDING SCENE

Session 24
View from a Deep-Sea Shipowner **1130-1230**

In the world, the Indian subcontinent is a geological wonder. In the south of the country it has the vast Indian Ocean with no hindrance to wind flow, which provides all the moisture needed to sustain itself, and in the north it has more than 2000 km of Himalayan mountain range with average height of 20,000 ft above sea level. The Indian Ocean precipitates moisture on the subcontinent, as the Himalayas act as a great wall to prevent its escape. This “monsoon” rains gives India a unique opportunity for economic growth but at present only a part of it is being harnessed.

India’s future growth will impact greatly on the economic well-being of the World, and also influence the need for ships to meet its expected seaborne trade growth. These issues will be considered during the session to reveal the importance of India’s future to that of the World generally.

Session 25
View from a Liner Trade Operator **1330-1445**

Are mergers and acquisitions back on the container industry agenda? This question will be examined in the wake of a 10 year lull of such activity and the staggering fact that container shipping remains remarkably fragmented, with the top five operators accounting for less than half the global market.

This presents considerable opportunity for further consolidation. The speaker was a contributing researcher in the Drewry White Paper on “Consolidation in the Liner Industry” and will highlight a number of the outcomes of the research. Here is just one extract from the study which should give financiers hope and concern:

"The financial pressure on the industry players, and in particular on weaker carriers, is intensifying daily as rates plumb new depths. Consolidation may be a route to survival for some, allowing lines to combine to create scale and to realise synergies....The benefit to the industry as a whole is considerably greater if lines pursue growth through acquisition rather than continuing to build new and larger tonnage, which the industry does not need. On the other hand, consolidation as a strategy for individual shipping lines entails considerable risk that the targeted benefits will not be achieved. Much depends on how effectively the task of consolidating the two businesses is managed."

Against this background, the speaker will develop a picture of the container business today highlighting the following:

- What is 'container shipping' and how does it sit alongside "liner shipping"?
- Who are the main players in the container industry?
- Financial performance of the container lines
- The 'laws' of supply and demand and their brutal application to container freight rates
- The drive for scale economy in the container industry
    - Vessel size
    - Alliances
    - Mergers and Acquisitions

Session 26

Business Game: Results **1500-1545**

THE FINAL PERSPECTIVE

Session 27

Shipping Market Outlook **1545-1715**

Forecasting shipping markets plays a crucial part in analysing ship finance risk. It is however, notoriously difficult because the vagaries of international politics combine with a complex web of economic factors to determine the demand for goods which in turn stimulates the demand for shipping services. One major commodity, grain, is further influenced by weather and agricultural practices, and in recent years export volumes have varied by as much as 30% over a six month period. The supply-side of ships may be easier to predict during boom periods as ship-yards are in full production, and order book product is essentially predetermined. During slack periods as seen during much of the late 70's and 80's, the decision of owners to invest are more difficult to predict and are influenced as much by psychological factors (the hunch that the market is turning) as by econometric analysis.

In this session, the lecturer will look at a number of shipping market sectors highlighting the driving forces which will determine the demand-supply balance in the coming years. These indicators will serve as a basket of market fundamentals which need to be observed and understood in order to more confidently take decisions in the decade ahead.

Session 28

Conclusion **1715-1730**