

Unclassified

DSTI/DOT/MTC(2004)13



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

01-Jul-2004

English text only

**DIRECTORATE FOR SCIENCE, TECHNOLOGY AND INDUSTRY
MARITIME TRANSPORT COMMITTEE**

**DSTI/DOT/MTC(2004)13
Unclassified**

SHIP FINANCING AND QUALITY SHIPPING

**PRESENTATION MADE BY MR. DAGFINN LUNDE, DVB BANK N.V.
AT THE MTC MEETING ON 24-25 MAY 2004**

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JT00167031

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OECD Maritime Transport Committee Industry Seminar



Ship Financing and Quality Shipping

Presented by
Mr Dagfinn Lunde
Chairman and CEO of
DVB Bank N.V

Welcome!

Topics



page 2

1. DVB Bank – Overview
2. How Does a Shipping Bank Work?
3. Do We Really Care about Quality Shipping?
4. DVB's Involvement in Promotion of Quality Shipping
5. Issues around PSC, Paris MOU, Rules & Regulations ?

Topics



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4. DVB's Involvement in Promotion of Quality Shipping
5. What's still missing and what do we need from you ?

At a Glance



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CORPORATE BANK

- > Listed on Frankfurt Stock Exchange with equity market cap of € 311 million
- > Offices in New York, London, Frankfurt, Rotterdam, Bergen, Piraeus, Hamburg, Hong Kong, Tokyo and Singapore
- > € 8 billion loan book
- > Approximately 550 clients worldwide
- > Approx. 200 professionals specialising in Transport Finance

Aviation Shipping Land Transport Transport Infrastructure

- > Advisory and M&A
- > Structured Asset Finance
- > Distribution and Sourcing
- > Fund Management
- > Capital Markets

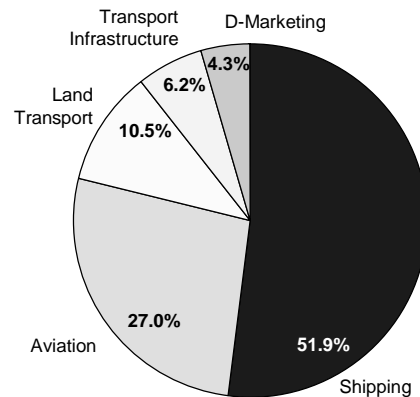
Customer lending portfolio



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in € mn

	31.12.2002		31.12.2003
Shipping	4,425	-10.8%	3,948
Aviation	2,200	-6.6%	2,055
Land Transport	690	+15.9%	800
Transport Infrastructure	270	+73.7%	469
D-Marketing	452	-27.4%	328
Total	8,037	-5.4%	7,601



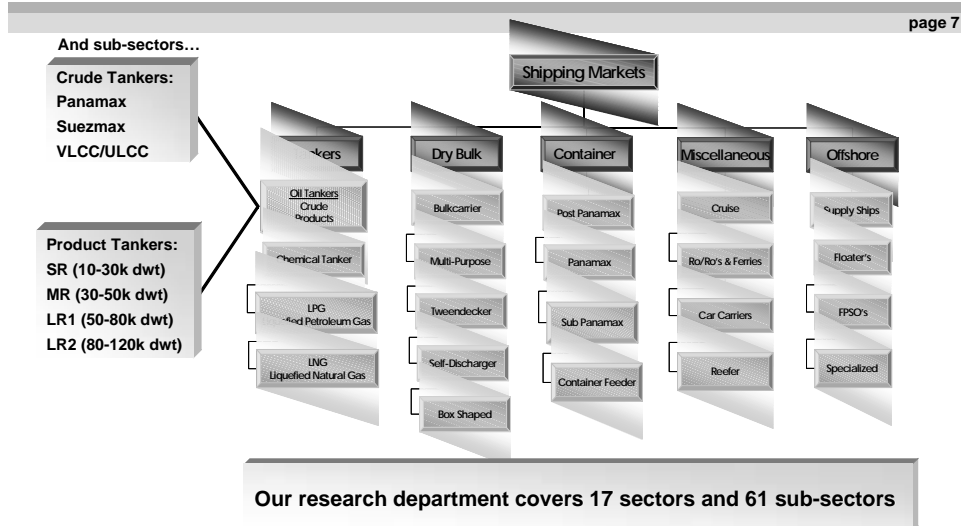
What's So Special about Shipping?



page 6

- ❑ Cyclical markets - both cash flow and asset values
- ❑ Limited community of owners
- ❑ Perceived as high risk
- ❑ Capital intensive
- ❑ International - free competition
- ❑ Commodity nature
- ❑ Mature industry, yet technical obsolescence can still be a factor
- ❑ Low barriers to entry (essentially capital) in major sectors/higher barriers (market expertise/high cost vessels) in specialist areas
- ❑ Influenced by political events and changing regulatory environment
- ❑ Influenced by the general health of the world economy
- ❑ Scrapping of assets is caused by rational behaviour - the ordering of new ships is not!

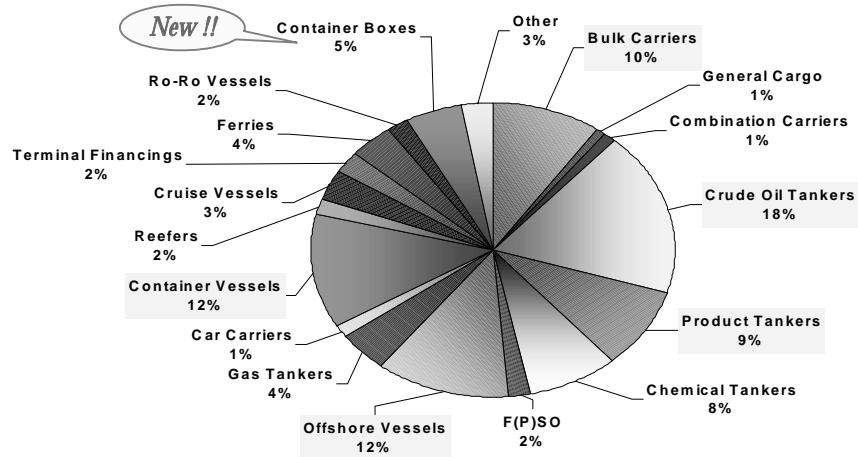
Shipping is an extremely diversified industry



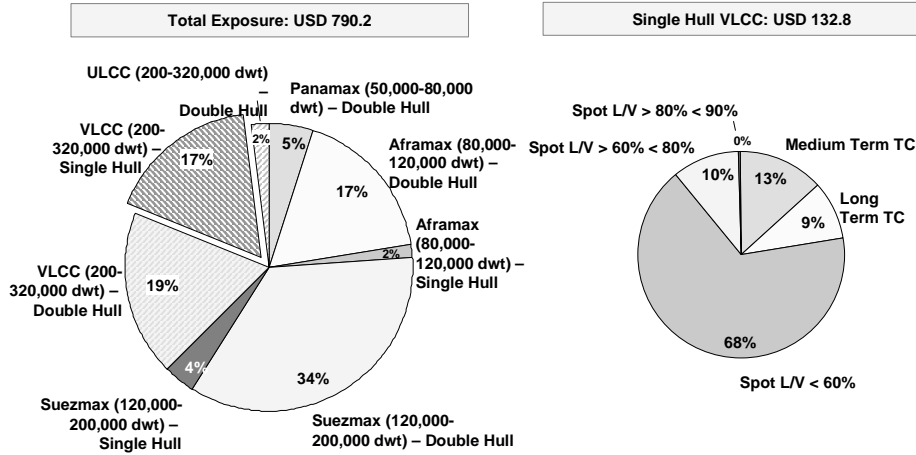
DVB Shipping Portfolio by Sector



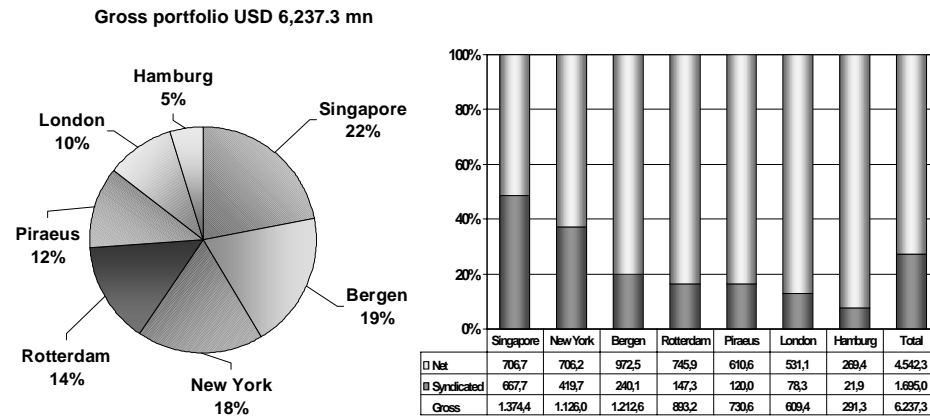
17 main sectors and 61 sub sectors



Crude Oil Tankers By Sub Sector



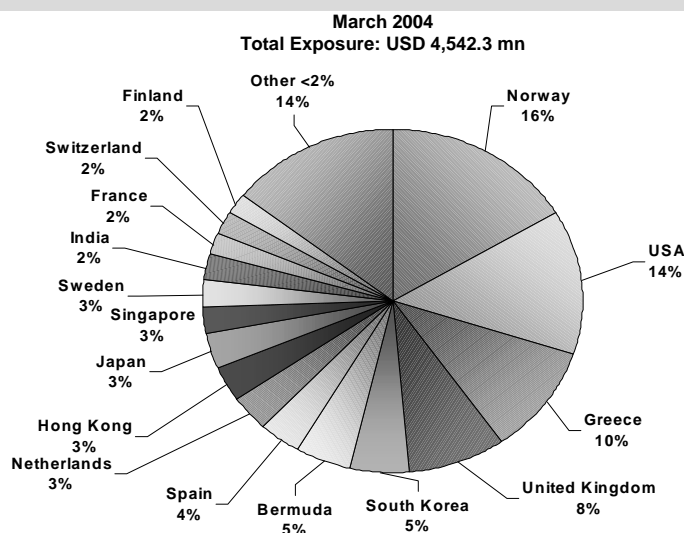
DVB Shipping Portfolio By Managing Branch



DVB Shipping Portfolio By Economic Risk Country



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DVB Shipping - Key Figures



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We have financed over 1000 ships
Number of people involved in shipping: 58

Activity 2001-2003	2001	2002	2003
Gross Managed Portfolio	\$ 5.496 mn	\$ 6.124 mn	\$ 6.415 mn
Net Portfolio	\$ 4.238 mn	\$ 4.623 mn	\$ 4.608 mn
Underwriting	\$ 1.790 mn	\$ 1.723 mn	\$ 1.759 mn
Syndicated to third parties	24,5%	31,6 %	18%
Average deal size	\$ 21.6 mn	\$ 24.3 mn	\$ 19.3 mn
New Transactions	83	71	91
Number of Clients	229	207	212
Gross Interest Income*	\$35.12 mn	\$37.24 mn	\$42.35 mn
Non-interest fees	\$25.98 mn	\$16.26 mn	\$18.96 mn
Gross Income	\$61.01 mn	\$54.70 mn	\$61.31 mn

•Only 5-10 new clients per year
•7-8 clients per Relationship Manager

Monitoring our clients



Value Maintenance Clause (VMC) breaches

Year	No of facilities	Breaches VMC	Average no of days outstanding
2001	411	11	83
2002	417	25	118
2003	421	22	80
2004	398	3	

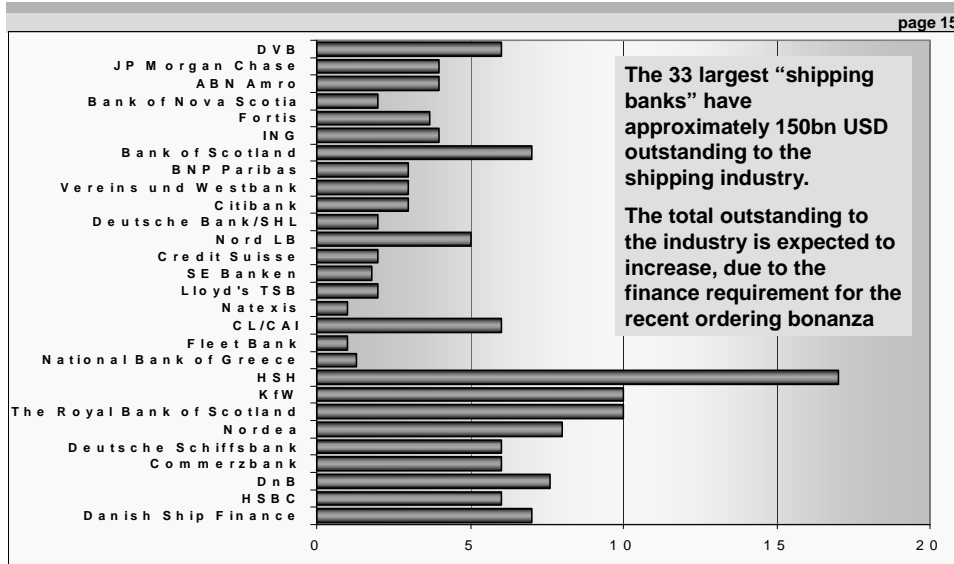
- ✓ We monitor VMC breaches monthly
- ✓ Watch list
- ✓ We require our clients to rectify the breaches

Year	Nbf facilities	Nbf defaults	in%	Total portfolio	Defaulted	in%
2001	411	12	29%	399460120	55300911	1,38%
2002	417	17	41%	435379204	4800014	0,99%
2003	421	5	12%	460793818	292332	0,63%
2004	398	3	0,8%	45232277	288642	0,63%

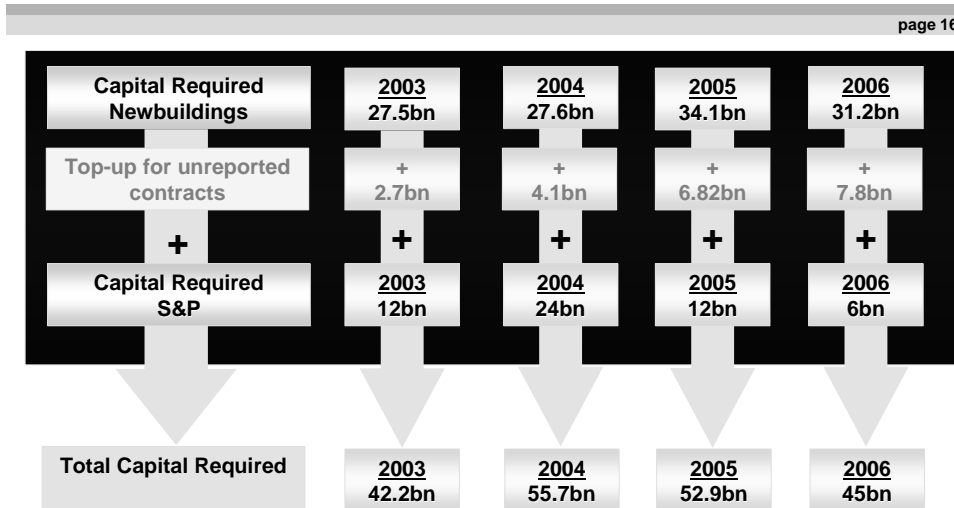
The Landscape Main Competitors by regional office



The Landscape - Competitors by Size



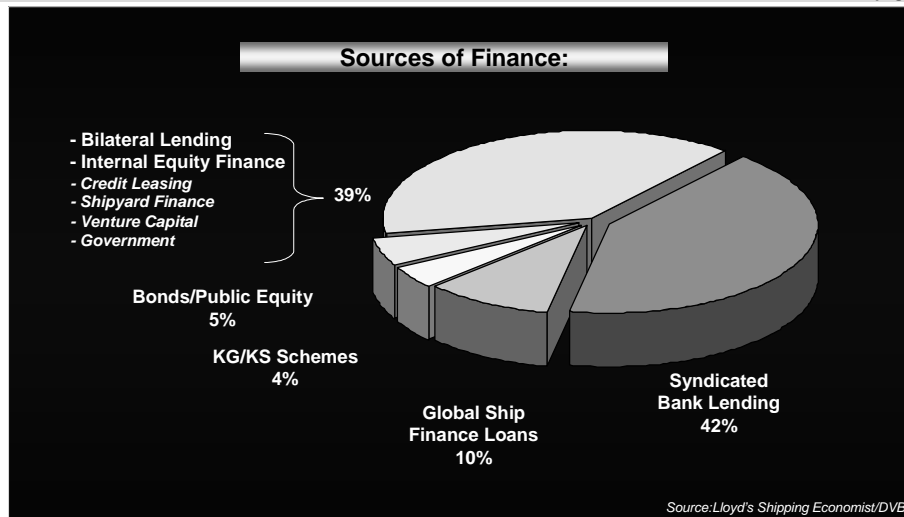
Capital Requirement 2003-2006



Raw data: Clarkson Research / Drewry / MSI

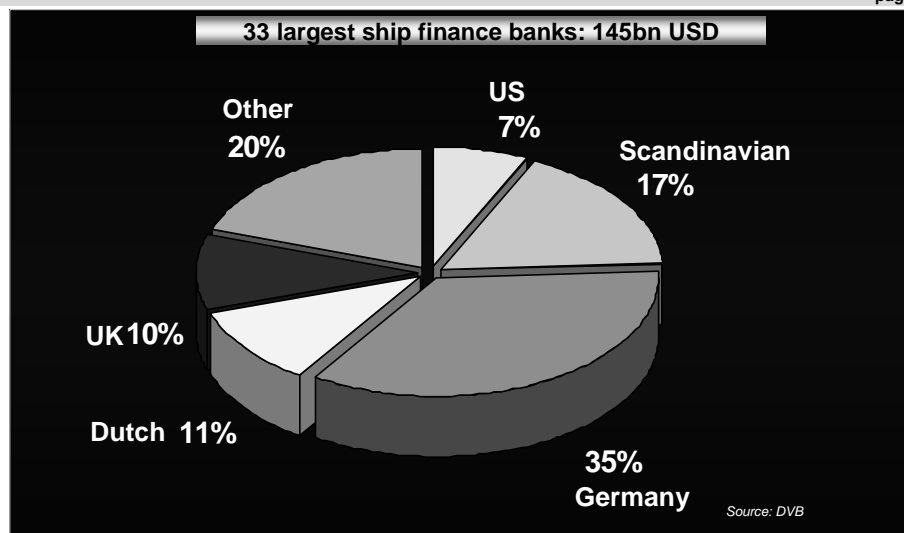
Where does the finance come from

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What areas does the finance come from

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Topics



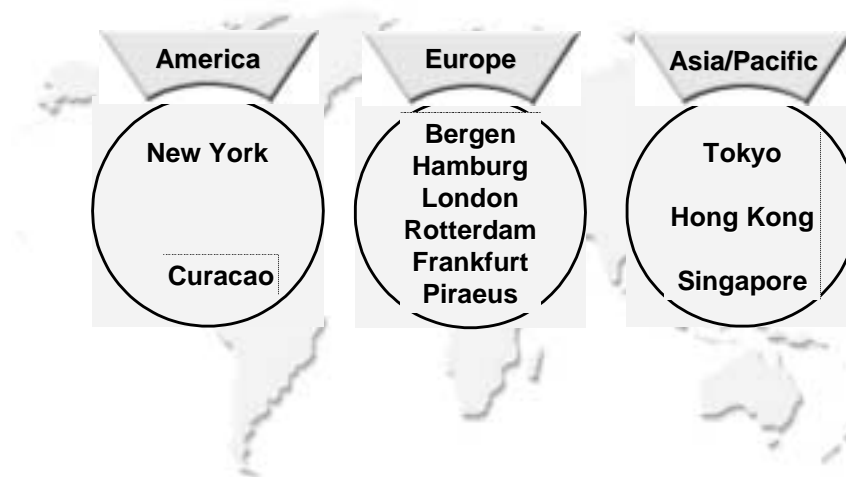
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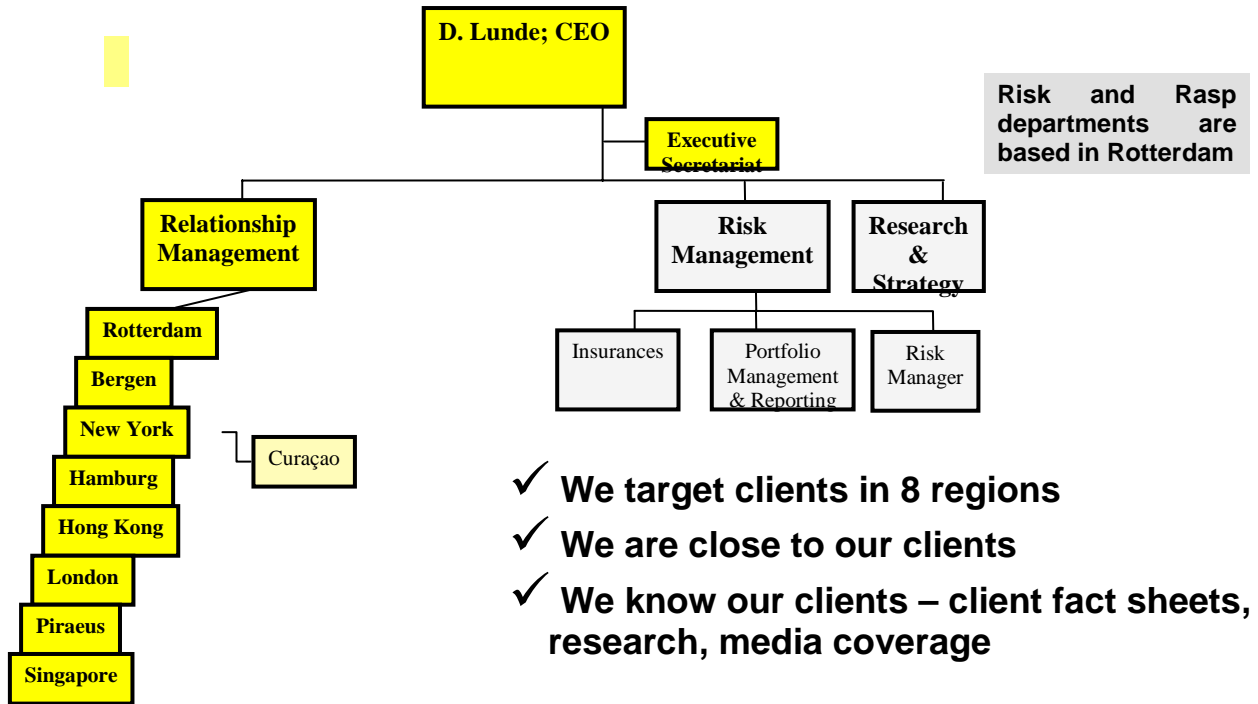
Coverage of DVB Shipping



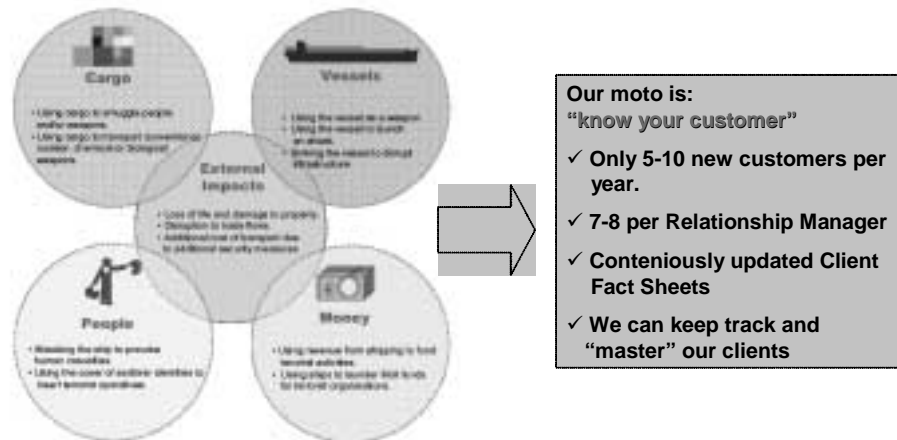
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Organisational Structure



Other Risk Factors from Shipping Being close to our customers !



Source: OECD – Maritime transport Committee: Security in Maritime Transport - Risk Factors and Economic Impact July 2003

Sector Strategic

-  Good Prospects
-  Caution
-  Limited Opportunities



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Bulk Carriers	Car Carrier	Container	Crude Tanker	LNG
VLOC's Capesize Panamax Handymax Handysize caution: top of market	PCC / PCTC no spot market	Post Panamax Panamax Sub-Panamax Handy Feeder not below 500 TEU caution: top of market	Ulcc Vlcc Suezmax Aframax Panamax caution: top of market	LNG but long-term employment
Cruise	Ro-Ro / Ferries	Reefers	Product Tankers	LPG
In General	Ro-Ro Ro-Pax Fast Ferries	In General Main Players	LR (50-120,000 dwt) MR (30-50,000 dwt) SR (10-30,000 dwt) Large orderbook	Vlgc Lgc Mgc Small LPG below 3,500 cu.m
Tugs & Barges	FPSO	OSV	Chemical Tankers	Others
Dry Bulk Barge Container/ro-ro Barge US Tank Barge	In General	PSV: 3k+ dwt PSV: 2-3k dwt PSV: below 2k dwt AHTS: 15k bhp AHTS: 10-15k bhp AHTS: below 10k bhp	In General (Pure Chemical Carriers) bottom of cycle?	General Cargo Conbulk/Probos (with long term contracts) Bulk Cement Carriers

How a deal is underwritten



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Business originates from close contact with present and potential customers

✓ **We prioritize our clients & wind-down smaller ones**



- ◆ **Financing request**
- ◆ **Analysis: market, company, financials, syndication prospects**
- ◆ **Negotiation: terms, security, pricing, duration**
- ◆ **Proposal to credit committee**
- ◆ **Term sheet**
- ◆ **Execution legal documents**
- ◆ **Draw-down**

Transaction Structure



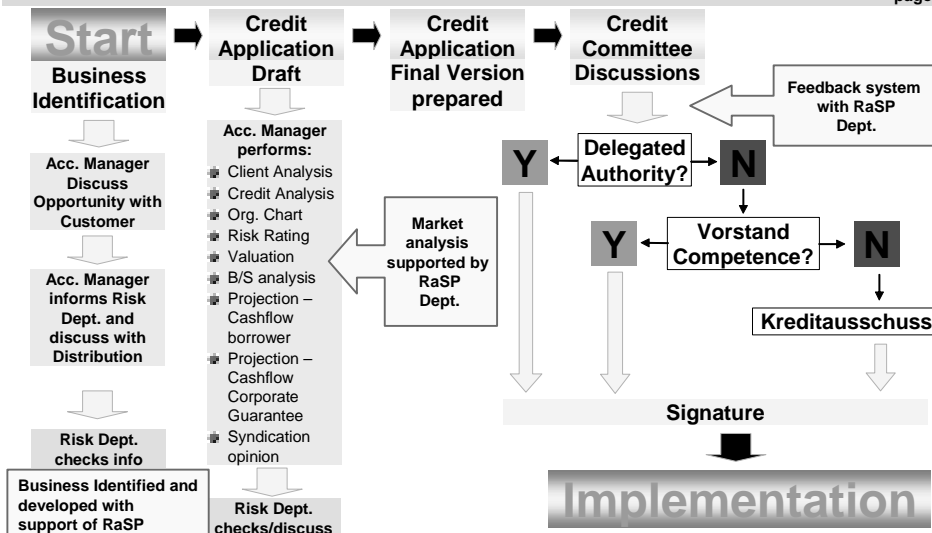
Current Standard Terms for Ship Financing

Loan Tenor:	7 years with a balloon reflecting a 15 year repayment profile.
Jurisdiction:	English or Dutch law. Norwegian law also acceptable.
Transaction size:	USD 20m or above
Interest Margin:	1.125% to 1.75% (average margin these days is approximate 1.5%).
Arrangement Fee:	0.5% to 0.75%.
Agency Fee:	Grid based on Number of Participating Banks (averaging \$30,000 per annum)

Process of a Credit Application



RaSP = Research & Strategic Planning



What does the Credit Committee look for in a transaction



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- ☛ Focus on risk analysis
 - “three ways out“:
 - **Cashflow** – the primary source of repayment from operating cash generation;
 - **Recourse** - proceeds of a guarantee, employment or purchase obligation from a corporate (always guarantee on demand)
 - **Collateral** - proceeds from the sale of vessels (Our ultimate way out)
- ☛ General overview
 - Calculations / earnings-projections
 - Market outlook
 - Financial Condition and Reputation of borrower and corporate guarantor
- ☛ Compliance with Lending Policy and Divisional Lending Guidelines

Topics



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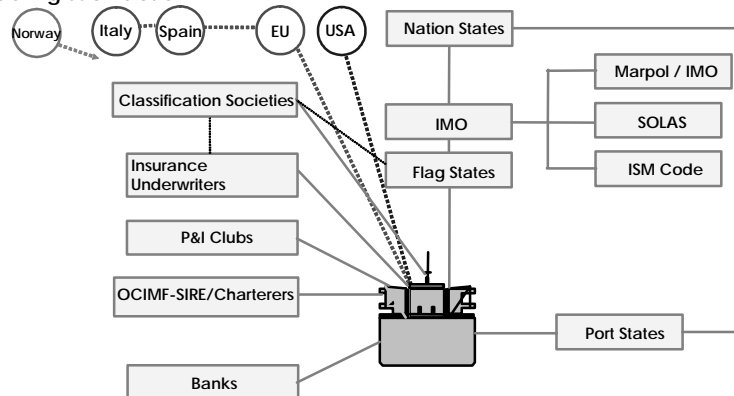
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Legislation and the environment



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The operation of all ships, but especially tankers, is becoming subject to much stricter enforcement of recognised standards by a whole range of different organisations. EU and USA have their own legislation concerning single-hull tankers. Other countries such as Spain, France, Italy, Norway are either implementing their own legislation or are considering such action.



Our focus is our client and his ship !!



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☛ We are in the business of Ship Finance >> Asset Finance

☛ Often it will be Non-Recourse financing

First way out \longrightarrow Cashflow

☛ The Loan will be repaid out of the cashflows generated by the vessel

☛ Hence, we want a profitable owner who can generate cash!!

☛ The more money he makes the safer our investment is !

☛ Regulations create costs and may reduce our clients profitability !

Revenues – Opex – Debt repayment – interest = Cash Cushion

Our focus is our client and his ship !!

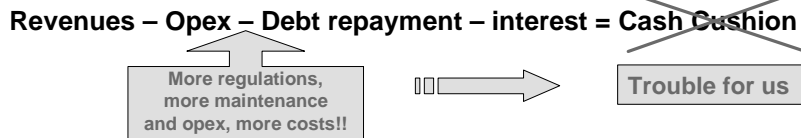


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**Is there really any problem with rusty overaged tonnage?
The bottom line is always more important...it makes money!!**



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2040 dwt tween decker
 Built 1964
 Speed 13 knots @ 4 tons
 Asking price: \$150,000
 Required to renew class: \$ 150,000
 Financing available for 50%
 (\$150,000)

Trading black sea in today's market
 t/c equivalent: \$2,000 per day
 Opex: \$700 per day
Int+principal: \$200 per day
 Free cashflow: \$1,100 per day



A bit old...a bit rusty...but a damn good deal...



So do we really care about quality shipping?



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No, not per se`

However....

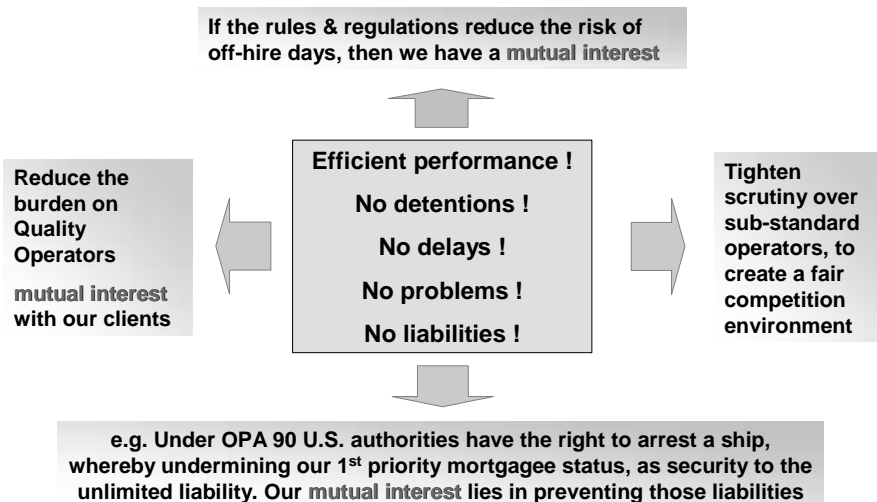
We believe that a good and well maintained ship is a profitable ship and a good collateral and a crew that feels safe and well taken care off is a good crew

We need the ship to be a never-stopping money earning machine

Where are our mutual interests ?



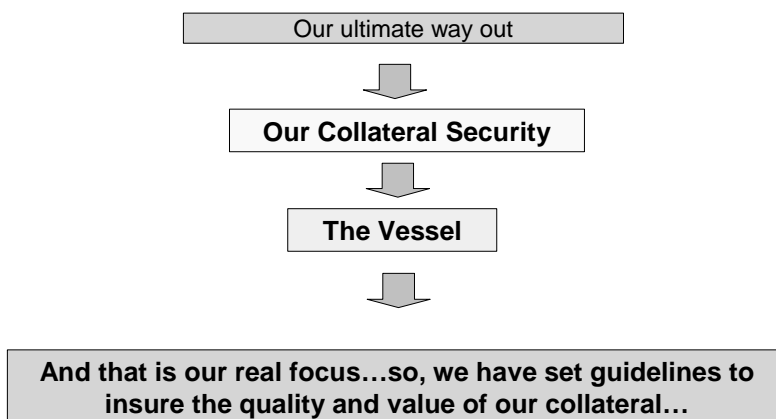
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Our ultimate way out



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Lending Policy and Divisional Guidelines

Implicit and Explicit references to Safety & Maintenance (S&M)



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Criterion	Policy relevant to S&M	Explicit ref	Implicit ref
Security	1 st preferred mortgage on asset financed Naturally value of security directly linked to its technical condition	X	
Age at maturity	Limitations on age at maturity	X	
Initial advance in proportion to vessel value	We reward value, which is assessed by valuers and technical inspections		X
Flag	Flag must be acceptable, mainly due to mortgage procedures but also S&M standards. Pre-approved list with criteria: legal structure, <u>reputation of existing fleet</u> , <u>technical supervision</u>	x	X

Lending Policy and Divisional Guidelines

Implicit and Explicit references to Safety & Maintenance (S&M)



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<u>Criterion</u>	<u>Policy relevant to S&M</u>	<u>Explicit ref</u>	<u>Implicit ref</u>
Class	Only IACS members. No cutting corners	X	
Insurance & P&I Clubs	To protect our interests, but 1 st class insurance will require high level of S&M		X
Minimum value covenants	Again, emphasis on collateral value		X

Credit review policy and monitoring



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<u>Criterion</u>	<u>Policy relevant to S&M</u>	<u>Explicit ref</u>	<u>Implicit ref</u>
Valuations	Frequent intervals – encourages owner to well maintain the vessel		X
Monitoring our collateral			X
Review frequency	Lower ratings (smaller owners, less corporate structure, older vessels) entail more frequent reviews.		X
Criteria for defining Risk Quality Deterioration	Detention, arrest, seizure, etc. Withdrawal of class Failure to maintain insurance	X	
Insurance guidelines	Insurance to be maintained at highest level throughout the loan period		X
Management	We can restrict change of management	X	

The Rating System and the Technical Committee



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<u>Criterion</u>	<u>Policy relevant to S&M</u>	<u>Explicit ref</u>	<u>Implicit ref</u>
Soft Score	Considers qualitative issues such as: management quality, average age of fleet, size of fleet		X
Client type	Quality of management		X
Collateral rating	Loan to Value		X
Technical committee “In-house” technical inspections	Approve surveyors	X	
	Comment/Inspect/ newly financed vessels	X	
	Review instructions to surveyors	X	
	Inform on phase out rules, regulations, technical developments and obsolescence	X	
	Advise CC on technical aspects of fleet Approve technical ship managers		

An other word about our Technical Committee



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- Unique for a financial institution
- Any vessel on our portfolio with a risk rating 1-3 (low!!) will be randomly inspected by “in-house” surveyors
- Vessels will also be inspected on specific request from CC (based on age/type/client/history/records)
- Technical Committee consists of a Master Mariner and Technical Shipping experts.



So, do we really care about quality shipping?



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Yes, we do !!

- ✦ Less detentions, more efficiency >>> better cash flows
- ✦ Less off-hire >>> higher earnings
- ✦ Look for alarm signals – deterioration of S&M usually signals problems
We often check the off-hire history of a ship
- ✦ Lower probability for pollution >>> less risk for consequential liabilities
- ✦ We monitor Port State Control reports, arrests, detentions, deficiencies through daily search of electronic data (e.g. Equasis, Paris MOU)
- ✦ Negligent S&M implies value destruction of our collateral
- ✦ Standardization of S&M issues suggests that the “good” operators among our clients are rewarded vis-à-vis the competition
- ✦ However, this leads as to the problem of “consistency” and uniformity in policies, regulations and enforcement...

Topics



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What have we done to promote quality shipping?



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- Apart of our lending guidelines and credit process...
- We are on the advisory board of Equasis
- We regularly correspond with the board of Paris MOU

We have made the following short-term proposals:

- Standard and uniform training of PSCO – access to new technology to enable efficient, uniform, real-time reporting
- Standardization of forms to create accessible online databases
- Raise the proactive profile of Equasis, sponsor fund raising

At the moment info suffers a time lag of 2-3 months

And for the long-run:

- Establish training centre – incl. electronic training moduls
- Promote the long-term employment of high profile PSCO's
- Add charterers that encourage sub-standard shipping to the "shame list" (next phase to incl. Insurers and possibly banks)

Topics



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What are the main problems with PSC / Paris MOU model?



- ✦ Lack of uniformity and standardization – harmonized criteria
- ✦ We should seek a risk-based approach where quality operators are rewarded vis-à-vis sub-standard
- ✦ Flag states cooperation
- ✦ Corruption of PSCO's in some regions – hampers to whole cause
Corrupted PSCO's should be pinned down !!
- ✦ Do charterers/shippers/receivers truly support the cause?
- ✦ Confidentiality vs. transparency
- ✦ Equasis, being a non-profit organization, is reluctant to provide data to 3rd parties.
Argument: "Data may be used to generate commercial benefit"
Result: The industry is deprived of information that can ultimately improve quality and transparency.
- ✦ Unilateral reaction of governments/legislators may have counter-productive outcomes

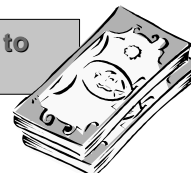
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Long term objectives – require sufficient funds...



- Fund raising via Paris MOU network via planned and coordinated media blitz - planned for October this year
- We have offered our network to promote fund raising and awareness
- Who will contribute? Owners for a start.
Why? Uniform Standard inspections are in their interest
- Classification societies as at will contribute to SOLAS
- P&I Clubs, Insurance companies ??
- And... local MOT's, flag states, etc.

We need you to put pressure on finance ministers to prioritize the cause and provide the funds!!



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A few points to think about



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- Interests meet on occasion: efficient engines reduce costs and pollution.
- Who should regulate?
Government intervention often suffers from inaccuracy, subjective judgements, bureaucracy and political influence.
- "...The situation so far seems to suggest that (maritime safety and environment) problems are technical when looking at their nature, economic when looking at the consequences and political when looking solution." (Shuo Ma, 2002)
- The total benefit in the USA in double-hull tankers preventing oil pollution would be USD370 million per annum, while the total cost USD1.6 billion.
(Kit-Powell *et al*, 1997, similar findings by Brown *et al*, 1996)
- Is regulatory control accident and politically driven?

And some theories



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- The profit-safety argument:
There is a positive relationship between profitability safety in shipping. That is to say, adverse financial condition in the industry are expected to lead to an increase in vessel accidents. Thus, the argument opposes the market solution and favors regulatory control and stringent enforcement.
- The market-response argument:
Shipping companies anticipating a deterioration in their financial conditions following a vessel accident will take safety precautions in a market environment. Thus, the argument favours less regulation and public-sector enforcement.

(Loeb, Tally and Zlatoper, 1994)