

## HSH Nordbank's Sovcomflot Deal



In late November, HSH Nordbank AG, with deep roots in Germany- but with an international reach in providing funding to the shipping industry, announced the signing in Hamburg of a fifteen year \$434 Million loan to Sovcomflot, the largest Russian shipping company to fund the purchase of three Ice Class tankers and three product tankers. JTF spoke to **Mr. Harald Kuznik**, HSH Nordbank's Global Head of Shipping, about the Sovcomflot deal in particular and then about the bank's views on the industry generally, and trends going forward.

HSH Nordbank was formed in June 2003 as a result of the merger of two German Landesbanks- the Hamburgische Landesbank and the Landesbank of Schleswig Holstein (LB Kiel). While its home turf is in Northern Germany (in fact, its headquarters is shared between Hamburg and Kiel) and the Baltic Sea, it is active internationally in the transportation segment, including shipping, aircraft, rail, logistics and real estate. By any measure, it is the world's largest shipping bank. Mr. Kuznik told JTF that the size of its shipping portfolio was €25 Billion (equating to approximately US \$30 Billion), consisting of €21 Billion of loans on the books, and another €4 Billion of commitments.

Its portfolio includes 2,500 vessels. Its breadth spans shipping markets in Asia, Europe and North America; it will be strengthen the sales force for North America Shipping Clients on December 1, by bringing aboard ING shipping veteran Mr. Hugh Baker. New ship finance business of €7 Billion was booked during the first nine months of 2006. As the shipping industry has become more corporatized, and demands more than plain vanilla shipping loans, the bank "is increasingly positioning itself as the lead arranger in complex financing structures," according to its recent reports.

According to Kuznik, "...standard ships- that is tankers, bulk carriers and containerships, comprise 80% of our deal flow. These are certainly an important element in our security as they are easier to sell if there's a problem. But, of course, we are also involved in LNGs, LPG vessels, and, as you see here, iced classed tonnage. But, we are not driven by a certain type of vessel. If the project is right, and we trust in the manager, then we can do the transaction."

In Mr. Kuznik's words, his bank is approaching the Sovcomflot transaction "much like a project financing. It is similar, in many ways, and uses the same basic



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principles as some of the big LNG financings.” Officially, HSH Nordbank is the Mandated Lead Arranger- and is providing Senior Debt; another German bank, Norddeutsche Landesbank Girozentrale, is a co lender.

The LNG deals are classic project deals, where the finance is supported by the cash flows from the activities of a particular gas train, sometimes from wellhead at origin all the way through regasification facilities at the receiving end- with limited recourse to the corporate shareholders in the entity’s promoter. For example, Qatargas III, well known to shipping people because of its charters of tonnage to be operated by Qatar Gas Transport Company Ltd (Nakilat) in the past year, is a joint venture whose shareholders include Qatar Petroleum (68.5%) and ConocoPhillips (30%)- which will be marketing the gas into the U.S.



The arctic oil ports of Russia (CNIMF)

In the Sovcomflot deal (where ING Bank NV advised the borrowers), three 70,000-dwt ice-class shuttle tankers, being built at Samsung (Korea) were ordered in late 2005 and are to be delivered between December, 2007 and March 2009. The three

ships will be chartered by Naryanmarneftegas, a strategic joint venture between ConocoPhillips and Lukoil. They will move oil from the Timon Pechora Basin out of the **Varandey oil port** (in the North of European Russia, above the Arctic Circle) on Russia’s Barents Sea, to European destinations.

In addition, the finance will also fund three MR 1 product tankers (47,400 dwt.) under construction at the Admiralty Shipyard, in St. Petersburg, to be delivered during 2007 and 2008, similar to other vessels in the fleet- trading in its exports. Unicom Ship Management, Sovcomflot subsidiary based in Cyprus, will provide technical management of these ships. Intended employment is not known, but inferences can be drawn from charters on sister vessels. The “Tavrichesky Bridge”, a sister to the three vessels, delivered last month into a period time charter, to oil company Total. Teekay Shipping took a sister delivered in Spring 2006, “Teatralny Bridge” on period charter. Other MR vessels in Sovcomflot have been taking oil products into United States ports.

Mr. Kuznik, based in Hamburg, talked in terms of “a pretty straightforward loan to Sovcomflot, which will see their highly specialized ships employed by the J.V. < Naryanmarneftegas>. The most important item is the security of the project’s cash flow stream- it provides our security; the end users have invested heavily in the project and its land based infrastructure.” While details of the underlying charter to the JV were not revealed, he hinted at a long term, saying: “These ships will most likely be in <the Varandey trade> for longer than the term of the



finance. The sponsors of this project have invested a lot of money in it.” The charter is a time charter, but “...reflects the environment that the ships are operating in...”

The six ships will fly the Russian flag, which HSH Nordbank does not see as a problem- “We are familiar with the challenges of this flag, and the bank has experience financing vessels of other companies flying flags of the ex Soviet Union,” said Kuznik. Quite emphatically, he added, “Look at the economics of the transaction and the cargo stream underlying it. The Western World is hungry for energy and <Russia> can deliver it.” Likewise, he was not put off by the Russian yard building the three smaller vessels, telling JTF that “Sovcomflot has a long tradition of taking ships from the Admiralty Yard and putting it on charter to major players- they are building sophisticated tonnage including chemical carriers. The tonnage they build is fit for the trade, and we have financed German owners with ships from this yard.”

HSH Nordbank could not comment on charter rates, interest rates and transaction terms- but did say that “Concerning the Panamaxs, we needed to be comfortable that the ships could take and offload the cargo. The rates being paid are above those for regular Panamaxs, and the premium reflects the special design of the vessels and higher operational costs. These are all covered in the parameters of our financial modeling of the project. One of the strengths of Sovcomflot, and a major consideration in our doing this deal, was their experience with ice-class-ships.”

In some seasons the premium on ice class MR vessels could be \$10,000/ day, according to peer company discussions with investors on recent conference calls, compared to spot rates pegged by analysts at \$25,000- \$30,000/ day (the level that Russian charterer Litasco took an iced class Handy for three years). Typically, on maritime project financing, long term “time charter” rates are calculated to include variable components for technical management.

In speaking about HSH Nordbank’s strategies, Mr. Kuznik emphasized the importance of not going after fads in the market, and backing projects that did not make economic sense, telling JTF: “We have not seen so many LNG deals in the past year; some banks staffed up and set up desks for this specialty, but we did not. Besides, talking about LNG, we would not be able to finance if you don’t get a decent return on equity- especially over long terms like 20 – 25 years.” He reiterated the bank’s sector-agnostic views: “We’re not afraid of specialized ships, although it is sometimes harder to evaluate them as collateral. But we don’t see as many deals in the specialized sectors.”

But HSH Nordbank, like other institutions, is keenly aware of the market and its sentiments. The good times in the industry have had a number of consequences-



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more public offerings, and, as companies coffers have filled, more prepayments and outright repayments of loans. The industry strength is behind a broadening of the bank's presence in shipping markets. In addition to expansion in New York, HSH Nordbank is reducing its shareholding to 15% of Aegean Baltic Bank in Athens, "...because we need to run our own show and be masters of our destiny." and opening a local representative office.

Talking about IPO's, including the recent and very successful offering by containership behemoth Danaos (... a company with whom we have had a good relationship for a long time...), Kuznik was pragmatic: "Our opinion is that shipping IPO's are here to stay. The investor base is getting broader, and the IPO companies have better financial stability than companies that were financed by bonds in the late 1990s" He noted that a mid November €150 Million shares offering on the Hamburg Stock Exchange, "Marenave Schiffahrts AG", was recently launched in Germany. Marenave, developed jointly by HSH Nordbank and Hamburg based funds packager Konig & Cie for institutional investors, is a blind pool that will invest in container vessels and tankers. According to Kuznik, the Singaporean Pacific Shipping Trust (an investor in containerships) provides further support for the bank's positive view on IPOs. However he was cautious about the fuel behind some IPOs, secured bank debt with delayed amortization, or bond-like, bullet repayments of principal, saying: "...such debt would only be available for very strong credits."

The repayment dilemma facing the shipping segment was noted in HSH Nordbank's 9 month report dated November 21, 2006, which stated: "the large cash reserves of many shipping companies led to substantial repayments." (which were counteracted by the large volume of new shipping business). Mr. Kuznik highlighted the impact of repayments on the bank's two groundbreaking securitization vehicles, where loans of approximately \$1.6 Billion were packaged into two "Ocean Star" investment vehicles in 2004 and 2005, telling JTF: "We have needed to replenish \$1.1 Billion of loans into these transactions."

Given the repayments, no fresh securitization initiatives are on the horizon; however, if HSH Nordbank were to create an additional synthetic instrument for investors, "it would be along the same lines as the first two And the rating agencies and investors are comfortable with our approach." HSH Nordbank's approach differs markedly from that of other banks that have talked about the tail wagging the dog, where the securitization business actually drives the choice of shipping transactions (and possibly pushes an institution towards loans for assets like FPSO's and LNGs).

Given the US \$30 Billion and 2,500 vessel basket of shipping loans to choose from, finding suitable replacements will not be very difficult.

