Shipping finance: a new model for a new market

Shipping finance has changed beyond recognition in the post-crisis period, with a huge increase in the role of export credit agencies and the emergence of new opportunities in areas such as liquefied natural gas, writes *Valentino Gallo*, global head of export & agency finance at Citi.

Official agency supported financing has been a stable source of funding for the shipping and offshore sectors for many years. However, following the 2008 financial crisis, the support that official agencies, and in particular, export credit agencies (ECAs), have provided has become critically important. Most recent major debt financings – whether for tankers, drilling rigs or floating production, storage and offloading units – have required ECA support.

Many sources of financing have been volatile in recent years, with the European debt crisis disrupting capital markets while banks have recalibrated their exposure to the shipping sector in the wake of the financial crisis and as a result of the changing regulatory environment. Against this backdrop, ECAs have been a stable and reliable partner for many shipyards and ship owners. Moreover, ECAs' increased involvement in shipping-related finance is seen by banks as an invaluable mitigant to capital allocation in a heavily capital intensive sector and a welcome element in clients' overall debt structure.

ECAs operate as a tool of economic policy and have a mandate to support exports. They have teams of shipping and offshore experts who work in the interests of the state but with a commercial mindset and a deep understanding of industry developments and the challenges faced in various shipping and offshore segments. Crucially, ECAs have a countercyclical role and tend to increase activity in times of economic stress.

The combination of economic uncertainty and changes in the financial sector mean that ECAs are now perceived as an indispensable funding source for the shipping industry. The proportion of shipping and offshore-related debt finance involving ECAs has increased from around 10% before the financial crisis to more than a third of all financing currently, with annual volumes totalling around US$15bn a year. Traditional players in the shipping and offshore industries, such as South Korea, China, Norway, Japan and the Nordic countries, have maintained their dominant role largely thorough the support of these governmental and quasi-governmental organisations.

The North America shale gas revolution

The shale gas revolution in North America has resulted in a significant number of sponsors seeking to build liquefied natural gas (LNG) export terminals and related transportation infrastructure. The most efficient way to transport natural gas across the ocean is to liquefy it from its gaseous state into LNG and transport it in specially built ships to natural gas markets around the world.

The business model of North America shale gas is that of a tolling facility in which buyers and sellers arbitrage the low cost commodity available from US and Canadian producers and the higher prices that can be achieved in Asian markets. The price of natural gas in the US is estimated to be less than a third than the price in Europe and just a fifth of the price in Asia. Asia is one of the world's most important export market, with Japan and Korea the first and second largest LNG consumers globally.

In an example of the benefits of free global trade and investment, Asian countries are buying gas liquefied in the US, in LNG plants in some cases partly owned by Asian investors, and transporting it to Asia via international shipping companies which are using Asian built vessels (of the 134 LNG tankers built since 2009, 133 were built in Asia). The purchase of many LNG vessels by international shipping companies has been made possible by financing provided by Asian ECAs.

In July 2013, Citi acted as global coordinator, bookrunner and documentation agent for a US$1.125bn financing agreement for British firm Golar LNG, one of the world's largest independent owners and operators of LNG carriers.

The financing included a US$449.2mn tranche 95% covered by Korea Trade Insurance Corporation (K-Sure), a US$450mn tranche funded by Export-Import Bank of Korea (Kexim) and a US$225.8mn commercial tranche. The financing enabled the purchase of six LNG vessels and two floating storage and regasification units from Samsung in South Korea.

The deal was the first LNG vessel financing supported by Korean agencies without the vessels having charters in place. This allowed Golar to take a more flexible and long-term approach to the LNG shipping market. Moreover, Golar benefited from competitive all-in costs compared to commercial financing and alternative funding solutions.

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Valentino Gallo, Citi

Deep water drilling growth

Another industry where capital expenditure has grown significantly in recent years in North America is offshore energy services. Companies have been investing in oil exploration assets for deep water drilling in the Gulf of Mexico and overseas.

Although ECA support is less critical for the US offshore energy services sector, as there is lending capacity available from capital markets and banks, in certain circumstances it can still prove advantageous to involve an ECA to secure the best possible terms. Citi has worked closely with a number of companies in this market, enabling them to swiftly raise attractively priced finance from a variety of sources.

In July 2013, Citi arranged US$1bn of financing for Houston-based Pacific Drilling, which is a leader in the ultra-deep water drilling sector and operates one of the most modern fleets in the industry. The credit facility was used to support the purchase of two drill ships, built at Samsung Heavy Industries in South Korea, with drilling technologies coming from Norway.

The transaction consisted of two tranches. The first was a commercial tranche for US$500mn and the second a US$500mn facility that was 100% guaranteed by the Norwegian Guarantee Institute for Export Credits (GIEK). The sourcing of sophisticated drilling equipment from Norwegian exporters enabled GIEK to support the financing, which was funded by Citi and Eksportkreditt Norge (the state lending agency for export financing) on a 50:50 basis.

What Citi offers

Citi's global franchise, close links with ECAs and expertise in dealing with them, and industry sector knowledge make it an effective partner for any company seeking to raise shipping-related finance. Citi has a dedicated team in EMEA, the Americas and Asia and has decades of experience with key shipping and offshore ECAs, especially those of China, Finland, France, Germany, Japan, Korea, Italy and Norway, enabling it to deliver competitive solutions for clients. The team works in close co-ordination with partners throughout the bank including the global shipping coverage team to identify, structure and execute export agency financing solutions for shipping and offshore clients. Citi's capabilities enable it to access a variety of traditional and alternative funding sources, including capital markets, the bank loan syndication market and ECA-related finance. This flexibility ensures that funding can be secured regardless of the prevailing market conditions.