IT AIN’T OVER TILL THE “OLD” LADY SINGS
EQUITY PRIVATE PLACEMENT DEAL OF THE YEAR

By George Weltman

Transaction: Ridgebury V4 Investments’ $150 million Equity Private Placement
Winner: DNB Markets, Pareto Securities

Never numerous, the transactions that this category honors are always interesting and opportunistic. They tend to be carefully structured, both in terms of risk and reward to meet the needs of sophisticated investors, including both private equity and institutional investors. This year there were two nominations. Clarksons Platou put forth the Scorpio Tankers’ $140 million private placement, which allowed the company to exploit the historical wide spreads between rates and asset values to acquire additional assets with short time to cash flow. Further it allowed the company to strengthen its position as the leading public pure play tanker company.

While the Scorpio transaction was highly successful, we chose the Ridgebury V4 equity private placement as the category winner based upon its strategic approach and careful structuring, which protected the downside while exploiting the upside. Knowing that we could not have said it better ourselves, we provide the background and a description of the transaction from our coverage in Freshly Minted. After all why re-invent the wheel?

“Who Are Those Guys?”

Butch Cassidy and the Sundance Kid repeatedly asked that question about the posse chasing them in the movie of the same name. We change the context and ask the same question of Ridgebury Tankers (“Ridgebury”). Flying below the radar, Bob Burke and his team have pulled off a number of successes. After years of hard work, the company happily convinced Riverstone, an energy and power-focused private investment firm, to partner with them in the formation in 2013 of the company itself with $257 million in committed equity. Then, as a newly formed company, with no name recognition in Oslo, it convinced Norwegian high yield investors to finance its fleet through the issuance of secured bonds. Today it owns and operates a fleet consisting of seven Suezmax tankers, two Aframax tankers and six MRs which trade in leading commercial pools.

With the acquisitive market leaders, Euronav and DHT, busy digesting their own recent acquisitions, Ridgebury saw the opportunity of acquiring older VLCC tonnage, which offered strong cash flows, upside potential and downside risk secured by scrap values. As the owners’ representative for the bondholders, who had acquired the four former BP VLCCs controlled by Windsor Petroleum Transport Corp out of bankruptcy, Ridgebury exploited its insider position and acquired them on behalf of Ridgebury V4 Investments LLC, a newly formed investment partnership. The transaction is structured as a closed-end investment, with the intention to sell the vessels before the 4th special survey in 2020.

To finance the acquisition of the four VLCCs, Ridgebury V4 successfully raised $150 million in an equity private placement through the sale of 7.5 million
shares at a subscription price of $20/unit. With no existing units outstanding, the offering will represent all of the units outstanding upon completion of the transaction. Ridgebury Holdings LLC, as the sponsor, will subscribe for 1.5 million units, representing $30 million or 20% of the private placement, with third party equity investors providing the balance (1.4x oversubscribed). Proceeds will be used to fully finance the four VLCCs, which were purchased for $135 million en bloc, as well as for general corporate purposes including working capital and transaction costs, which consume the remaining balance of $15 million.

With an average age of 15 years, the four 307,000 DWT tankers were constructed at Samsung in South Korea. For most of their lives, the vessels were chartered and maintained by BP, which invested significantly in maintaining the coatings. The vessels have an excellent survey position with one vessel having completed its 3rd Special Survey, two others in process and the fourth scheduled for Q4 2015. The drydockings are budgeted with sellers and buyers sharing equally in the excess or savings above the budgeted amount. Based upon a five-year investment horizon, with the vessels sold at age 20, the company has budgeted intermediate survey costs for the four ships in 2017-8 of $3.5 million with 35 days off hire per vessel. Providing substantial risk mitigation, the four vessels, with an average lightweight tonnage of 42,543 DWT, have an aggregate current scrap value of ~$66 million or 49% of the purchase price. The existing corporate, commercial and technical management service providers will stay in place, with those responsibilities managed respectively by Ridgebury, Frontline Management and Bernhard Schulte.

The corporate strategy is straightforward and is based upon a cash flow approach to benefit from the current strong crude tanker market. Specifically, the company’s sole purpose is to acquire, operate and eventually dispose of the four identified VLCCs with the goal to maximize shareholders’ total return predominantly from excess operational cash flows, supported by assets with low residual value risk. The operational strategy is based upon a lean structure with technical and commercial management outsourced to “best of breed” providers, Frontline Management and Bernhard Schulte. Ridgebury’s role will be to manage the assets with a view to protecting investors against capital loss while targeting a total return of a defined multiple of the equity capital derived from net sales proceeds and dividends. Breaking it down, the commercial strategy will maximize short- and medium-term cash flows through a mix of spot trading and time charters. The financial strategy is focused on minimizing risk which is achieved by a 100% equity capitalization which provides both financial and operational flexibility in the form of low cash breakeven rates. Lastly, shareholders will be rewarded with the distribution of 100% of cash flows in excess of cash reserve requirements in the form of dividends.

Ridgebury has demonstrated an excellent track record of riding the cycle through the investment, cash flow harvesting and divestment periods. It is all about buying and selling at the right time. Simple in concept, but difficult in execution. The company has acquired vessels at market bottom (new assets), as it moves off the bottom (medium age vessels) and during market equilibrium (older vessels). While the company is too young to have had the opportunity to divest and the timing isn’t quite there yet, the company provides as an example from Mr. Burke’s prior life when he and a financial sponsor sold Chembulk for a 250% equity return back in 2007. As for now, robust market fundamentals are supporting a strong market, at least in rate terms, as values have lagged. Current crude tanker earnings are at six-year highs across all sub-segments reflecting structural changes in global supply and demand, which in turn are increasing trading distances. The major driver is non-OECD demand for crude oil, which is expected to increase ~6.8% per annum between 2015 and 2035. However, growing production and declining demand in North America as well as growing refinery capacity in the Middle East and Asia have also been major disrupters.

Moreover, the supply side of the equation is manageable with the VLCC order book close to historical lows at approximately 16.6% of the current fleet. In 2016, 52 VLCCs are scheduled for delivery down from the 2010 peak of 62. However, the fleet is aging, as well, with 90 vessels expected to be scrapped over the next five years, which results in a projected fleet growth of approximately 2.5% and 6.6% in 2015 and 2016 respectively.

This project brings with it a special challenge, specifically the potential for age discrimination, but this is largely irrelevant. According to data provided by Frontline Management, which manages a number of vessels of this vintage, fifteen-year-old VLCCs have been traded actively by major charterers (including S-
Oil, Unipec, Chevron and Shell) on the benchmark trading routes. An elder will tell you that old age is not all that bad and in this instance fifteen-year-old VLCCs offer the best value proposition compared to the newbuild parity line.

The project underwriting is based upon its significant cash earnings potential. Over the anticipated five-year project life, average rates of $40,000/day, the low end, imply a money multiple of 1.3X and an IRR of 7.4 percent. At today’s average VL rates of close to $60,000/day, the money multiple is ~2.3x over the period with an IRR close to 29 percent. From another perspective, older assets, like these, represent a significant payback advantage compared to younger vessels by generating significant cash flow at half the cost of younger assets. Even after assuming an earnings discount (5%) and an Opex (9%) and drydock (75%) premium for older vessels, the payback period is 3.5 years for a fifteen-year-old vessel, based upon similar operational performances and currently expected 2020 values, compared to 7.2 years for a five-year-old vessel.

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In defining the investment opportunity, Ridgebury highlights the low cost investment with immediate access to strong cash flows. Funded with 100% equity, the transaction offers significant upside potential from the distribution of 100% of excess cash flow and asset appreciation, with the downside risk secured by scrap values. In technical terms, it is all about end of life assets providing an asymmetrical return profile.

It pays to have a good investment idea and friends in cold places who can take it to market.

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