A NOVEL APPROACH TO PAY CHARTER HIRE

INNOVATION DEAL OF THE YEAR

Transaction: Use of General Mandate to issue shares to satisfy operating lease obligations
Winner: Pacific Basin Shipping Limited

Shipping is not renowned for its creativity but instead for its preference for simplicity. Nevertheless, there have been breakthrough moments as capital became scarcer and shipping risk fell out of favor. This year there were a number of nominations in this category.

Into a traditional ECA financing for two cruise ships, Citibank injected an earlier tailor made structured receivables financing facility, which utilized an orphan SPV as the borrower in the pre-delivery financing of up to four years. The financing structure used for the Edge vessels being constructed for Royal Caribbean Lines ("RCCL") provides an efficient and cost effective solution for the pre-delivery period coupled with a conventional post-delivery structure. The shipbuilder, STX France, entered into a shipbuilding contract with RCCL and simultaneously entered into a pre-delivery agreement with the Cayman Orphan SPV, who in turn entered into a delivery date agreement with RCCL.

The 16-year credit facility is documented through a single agreement for both pre-delivery and post-delivery financing. In addition, the Euro secured pre-delivery funding to the SPV novates to USD unsecured post-delivery funding to RCCL.

In this year’s winning transaction, Pacific Basin found a new purpose for an equity issuance solving a difficult problem. In addition to its owned fleet, Pacific Basin expands its fleet strategically by chartering-in vessels for short to long-term periods. Unfortunately, ten of the long-term chartered-in vessels were concluded in a higher rate environment and the company was losing significant cash flow on the charter-outs.

To stop the bleeding, the company in October 2016, reached an agreement with the shipowners to issue to them new Pacific Basin shares in return for a significant reduction in charter-hire rates on the ten long-term chartered ships. As a consequence of this arrangement, the company will save over US$12.5 million in charter-hire cash outflows over two years commencing 1 November 2016, thus enhancing its ability to preserve cash and maintain its balance sheet strength in the protracted weak dry bulk market.

Under the general mandate granted by its shareholders at the 2016 annual general meeting, Pacific Basin issued to the shipowners almost 80 million new shares, representing approximately 2% of the existing issued share capital of the company. Priced at HK$1.218 per share, total proceeds were approximately HK$97.4 million, which represents the sole consideration for the charter hire reduction of $12.5 million over the two-year period. The transaction was documented as addenda to the original charter parties and as part of the agreement the shipowners agreed to a 90-day lock-up. The issue price represented a discount of about 5.6% to the closing price on the last trading day immediately prior to the addenda execution date, and a premium of about 1.4% to the average closing price for the 10 trading days immediately prior to the date of the addenda.

Clearly the issuance of shares is not by itself innovative. It is the fact that the company was able to negotiate a transaction where the shipowners agreed to accept the shares in lieu of a portion of the charter hire obligation that makes this deal stand out. While slightly dilutive to the existing shareholders, the transaction saves existing cash improving liquidity and the balance sheet and is therefore in their interest in the long run. By proactively continuing to reduce cash costs, the company enhances its already sound position from which to continue to manage its business for a weak market in the medium term.

Lastly the transaction speaks to the strength of Pacific Basin’s relationships with its tonnage providers, their trust in its financial strength, and their belief in the longer term prospects for Pacific Basin and its shareholder value.