Leadership

Dealmakers of the Year
“WHAT, ME WORRY?” – I’M PARTNERS WITH JOHN FREDRIKSEN
THE EQUITY PRIVATE PLACEMENT DEAL OF THE YEAR

Transaction: Flex LNG Limited - $300 million Equity Private Placement
Winners: DNB Markets, Pareto Securities, ABN AMRO, Arctic Securities, Fearnley Securities, SEB

While New York will remain the center of capital markets activity, wary investors there left a void which needed to be filled. Where US investors saw risk, Scandinavians saw opportunity to put money to work in familiar spaces, with the result that equity markets took on a distinct Scandinavian flavor this year. Scandinavian investors took a risk on approach investing heavily in equity private placements in the shipping and offshore sectors, to the tune of ~$2.1 billion, but favored the offshore, investing the larger portion, $1.2 billion, there seeing greater opportunity.

There are shipping companies and then there are John Fredriksen’s shipping companies. With apparently unlimited resources, Mr. Fredriksen, sponsor nonpareil, creates new investment opportunities while developing, supporting, and warehousing investments for his existing controlled companies. Among his major publicly traded holdings, Frontline, Ship Finance, Golden Ocean and Seadrill are well-established and functioning quite well. It was time to complete the line-up with a full-fledged LNG carrier company. To that end, Mr. Fredriksen, dropped down his five remaining privately controlled LNG carriers to Flex LNG, making it a force to be reckoned with.

To finance the equity portion of acquisition, Flex LNG chose to issue shares overnight in a private placement in order to take advantage of the current market conditions. Although different transaction alternatives were considered, the company concluded that the private placement structure would best meet the common interest of the company and its shareholders, taking into consideration the limited discount, pre-announced and broadly marketed placement, transaction risk, availability and expected terms of alternative transaction structure and financing sources.

Significantly oversubscribed (skewed towards high quality Norwegian investors), the private placement was successfully placed, raising gross proceeds of approximately NOK 2,464 million (~$300 million based on an exchange rate of USD/NOK 8.21), through the sale of 172,938,947 new shares (47% of outstanding shares pre-offering) at a subscription price of NOK 14.25 per share, a discount of 5% from the previous close, but a 26% premium to NAV and an 8% premium to VWAP. Despite a tumultuous market, as the US stock indices fell (DJI down 3.15%) and the size of the deal relative to the market cap, the shares held up closing at NOK 14.15, a reflection of the strong underlying fundamentals of the LNG market and the backing of a highly reputable sponsor.

In addition to fully underwriting the transaction, Mr. Fredriksen’s Geveran Trading Co. Ltd., the company’s largest shareholder, pre-subscribed for and was allocated the share
equivalent of $100 million, leaving it with a 44.6% ownership interest down slightly from -50% pre-offering.

The proceeds of the private placement partially financed the acquisition of five newbuilding 5th generation LNG carriers with deliveries in 2020 and 2021, bringing Flex LNG’s fleet to thirteen. Of the five vessels, three are ME-GI with full reliquification systems and two X-DF. The latter is code for the most fuel efficient and technically advanced LNG carriers. While many transfer vessels at current value, Mr. Fredriksen offers his at a price discount. The purchase price of each vessel is $180 million, including supervision implying a yard cost of $177.5 million, a price significantly below the latest shipyard newbuilding quotes of -$182 million. In addition, the ME-GI vessels are equipped with the full reliquification systems, which increases their cost by $6 million to $186 million each. The discount to investors is further magnified by the share offering discount. In addition, the payment terms are highly favorable with 30% upfront and the balance at delivery, a further benefit passed on to the company.

And now for something completely different. The runner-up transaction gave Flex LNG a run for the money. With practiced legerdemain, ADS Crude Carrier (“ADS”) and Artic Securities packaged a project, which, in its individual elements, seemed all wrong and made it right – a relatively low-risk opportunity for investors to take a position on older tonnage and the opportunity afforded by IMO 2020.

ADS was initially conceived as a platform to simply acquire quality VLCCs older than 15-years as the convergence of secondhand and scrap values drove asymmetric risk/reward. Additionally, the ADS team has a strong history of successful shipping projects and together they jointly believed Q3/Q4 2018 to be an inflection point in the tanker cycle. But a closer look at the numbers suggested that the math related to scrubbers works better on older tonnage giving far greater savings and the shortest payback. As a result, ADS evolved into a platform for older vessels with scrubbers, to reap the benefits of both an improving tanker market as well as the spread between MGO and HFO.

As the vessels are 16-years of age, the vessels are assumed to be scrapped in 2020, at which point ADS Crude Carriers will cease to exist. But in the interim, the favorable debt terms, low leverage and no amortization, allow for almost 100% of free cash flow from operations and proceeds from vessel scrapping to be paid out to investors through quarterly dividends since no cash is required for fleet renewal.

ADS agreed to acquire the three 299,200 DWT VLCCs, Front Page, Front Stratus and Front Serenade, all built in Hitachi in 2002 for an en bloc price of $67.5 million, a premium of 24% over the current residual scrap value. To fund the project, the company raised the NOK equivalent of -$58 million in a private placement to Norwegian investors, international institutional investors and US QIBs as defined in rule 144A and arranged a $30 million non-amortizing secured loan. Proceeds will be used to fund the purchase price of the vessels, upgrade the vessels with scrubbers and for general corporate purposes including working capital, legal expenses, start-up costs and fees.

While the result of that that trade will be determined in the future, Ship Finance, the owner of the vessels, received immediate gratification from the divestiture. It pared its aging VLCC fleet from eight to five, all on charter to Frontline and receives net proceeds of $77.6 million, including interest bearing notes totaling $10.1 million from Frontline as compensation for termination of the charters. Believing in the opportunity or, perhaps less generously, seeing a need to grease the wheels, Ship Finance reinvested -$10 million of the proceeds for a 17% interest, becoming the largest share-holder in the newly formed acquiring company.

Three VLCCs escape the breaking yards. While that cannot be good for the general welfare of the sector, no one said shipowners or investors were altruistic. This is a unique moment giving rise to a unique opportunity, which investors have seized upon. Structured to minimize the risks of trading older tonnage, it is a bet on refinery infrastructure, the price spread between two fuels and the cost to the charterers of employing compliant vessels. The calculations show immense riches falling through to owners in terms of savings, but it is likely that charterers will seek to share in those through cheaper rates. Offering somewhat less savings due to higher consumption, the company’s vintage VLCCs do have the competitive advantage of a lower capital cost to make up some of the difference. How all these variables will play out is uncertain, but that’s what makes a horse race.