

# PIREAS 2007

## "The Metamorphosis of Shipping."

### PUBLIC V PRIVATE : WHICH ROAD TO TREAD

by Tom Jackson - Chairman, TOP TANKERS INC.

Standing here before you today, surrounded by many youthful faces, I feel that I may have reached what is often referred to as a 'certain' age.

I clearly remember our first television back in the early 1950s. It flaunted a hazy, polka-dotted, black and white flicker that sometimes passed itself off as a picture. Black and white was the order of the day for TV back then. Life's choices were so much simpler. The good guys wore white hats and the bad ones wore black hats. If there was a particularly nasty character who you knew instinctively could not be trusted - he was the one sporting the moustache!

Shipping has a long and distinguished history - pre-dating my old television set by a few millennia. Its foundations are entrepreneurial spirit and flexibility, independence, dedication and hard work. The 'ROAD' universally travelled by Shipping was the traditional family orientated, single ship-owning company structure encompassing a small to medium sized fleet, surrounded by a concrete wall of secrecy, and a nebulous moat of conservatism.

But times are changing.

#### QUESTIONS

Aren't the old fashioned, tried and trusted ways of 'own equity' and 'bilateral bank mortgage finance' the best?

Aren't the current Shipowners satisfied with going about their business in the same way as previous generations?

Why let 'OUTSIDERS' see what 'YOU' are doing in 'YOUR' Company?

So, what is the ANSWER?

Quite simply, each shipowner must make his own decision as to where he sees his Company going ... Where it will be 5 or 10 years down the road.

For some the answer may well be simple. Stay put! And grow your Company organically one ship at a time.

However, for other Owners there are valid and persuasive reasons to consider accessing the ocean of Investment Capital available for shipping - particularly in the U.S.

When talking about Investment Capital we generally mean either raising Private Equity from Investment Funds, Hedge Funds, or High Net Worth Individuals, or accessing the Public Markets through an Initial Public Offering - an IPO - or a Special Purpose Acquisition Company, normally referred to by its acronym of SPAC.

Let's just take a quick look at a Company which goes Public by way of an IPO or a SPAC, or seeks Private Equity.

<b>IPO</b>	<b>SPAC</b>	<b>PRIVATE EQUITY</b>
Large number of Initial Investors	Limited number of Initial Investors	Very Limited Investors
Liquidity - High Publicly Traded Shares	Liquidity - Limited Publicly Traded Shares	Illiquid Not Traded
Valuation: Multiples of EBITDA & Premium to NAV	Sponsors - 20% (Owner)	NAV
Easier to raise further Capital	Discretion to Invest	Want to see an 'EXIT' Strategy e.g. - an IPO
	Faces a "Warrant Overhang"	Tend to want 'Control' and Seat on Board
Transparency SEC Regulated	Transparency SEC filings	Measure of Transparency
Speed - slow 6 months plus	Speed - medium 3-4 months	Speed - fast 2-3 months
Cost-wise - Expensive	Less than an IPO	Less than SPAC
Underwriters/Brokers Fees - Expensive 6-7%	Expensive 6-7%	More Expensive 7-10%
Amount raised depends on 'Pricing' at the end	Funds in Bank before Project is identified	Investors Commit to Participation Amount
	A 'Bet' on Managements Ability to find a 'Suitable' Target	

And while today for ease of reference I will refer to the U.S. my general comments are equally applicable to European Markets.

So what are the Advantages for the Shipowner in raising external Investment Capital?

#### **ADVANTAGES OF INVESTMENT CAPITAL**

1. It can provide the Owner with a Sizable 'War-chest' for new acquisitions which would be impossible to achieve through normal organic growth.
2. It increases considerably the pre-IPO Net Asset Value of the Company.
3. The Shipping Market views such an Owner as a 'Bigger' Player. It provides economies of scale and a bargaining chip in all areas of commercial discussions, and it enables the Shipowner to negotiate superior terms and conditions with its Financiers.
4. It offers the potential for substantially enhanced returns.
5. Subsequent Offerings allow additional funds to be more easily raised for further rapid expansion.
6. It has appeal for those seeking a more Corporate orientated organization, and where it is felt more appropriate to place the running of the Company in the hands of experienced Executives so that future generations benefit from the 'Investment' as pure Shareholders without the responsibility and burden of day-to-day Management.
7. It helps on the 'Road' to Consolidation in the Industry.

But nothing comes without a price and I would like to mention four issues which may cause some Owners to think twice:

#### **1. Attitude / Perspective.**

The Owner must realize from the outset that the Company is no longer his or her personal property. We now have a clear and distinct separation of shareholder and executive function. The Owner is an employee - who also happens to have shares in the Company. This can be a difficult concept to accept.

#### **2. Potential Loss of Control.**

Invariably the Owner, either immediately, or at some not too distant time, will own less than 50% of the Company, which theoretically could result in loss of control. Although, in practice a much smaller percentage will normally - and given forward planning - be sufficient to maintain day-to-day control over a Public Company.

#### **3. Cost.**

Running a Public Company is much more expensive than a private family-owned operation. It will cost around \$2-3m - excluding Underwriters Fees - to take a Company 'Public' through an IPO, and a minimum of \$2m per annum extra in General and Administrative Expenses thereafter. A SPAC comes in a little cheaper - with a start-up cost of less than \$1M.

#### **4. Bureaucracy / Time Consuming.**

Complying with all the necessary rules, regulations, and directives, results in an extremely bureaucratic and time-consuming operation, this includes, but is by no means limited to compliance with Sarbanes-Oxley or SOX as it is called.

As regards Cost and Bureaucracy - there is little doubt that the American Market is far worse than its European counterparts. However, despite this the U.S. remains at the forefront for investment in shipping because, quite simply, European Markets still do not appear to have the high level of Initial Investor appetite necessary to make the numerous sizable deals work and then the subsequent sustained Investor interest to provide positive stock liquidity.

Anyway, let's take an Owner who has decided that he likes the idea of accessing outside capital. There are some basic concepts to consider:

What I like to refer to as the 'S' Words.

## **STATUS - SIZE - STRUCTURE - STRATEGY - STORY - SPEED - S'TIMING**

### **Status.**

Status can be a 'nasty' word - because it conjures up connotations of exclusivity and snobbery.

However, what I mean here by 'STATUS' is somewhat different. Any owner wishing to access the Capital Markets must have a 'NAME'. A name that the Underwriters and Brokers in New York can look at and say:

YES!

This is an Owner who has the ability to raise funds.

This is an Owner we want to be associated with.

This is an Owner who has the right sort of operation.

And the Owner and/or the Executives and/or the Company must have a strong track record in shipping evidencing a history of successful financial stewardship.

Don't forget: these Underwriters have their own agenda! If a deal fails to cross the finishing line they will not get their commission, and after all that's what they are in it for. Not for the Shipowners' big, beautiful eyes! Well not normally, anyway!

Another word which is significant here is what the Americans like to refer to as 'Chemistry'. There has to be 'Chemistry' between all the parties - the Owner - Underwriters - Investors - each has to trust, like, and get on well, each with the other.

### **Size.**

Size of existing fleet and new fleet after the Deal is consummated is important. To start with a small fleet and end up with a fleet only marginally larger makes life going forward both complicated and difficult. In these circumstances you risk falling back into the realm of pure 'Organic' growth with the added handicap, as I have already mentioned, of substantially higher G & A Expenses.

If I may just give one example which illustrates the importance of size:

A Dry Bulk Company which shall remain nameless, but for argument's sake let us call 'WETSHIPS' launched an IPO in February 2005 with an Initial Fleet of 6 vessels, seeking to increase to 17 post-IPO. Today the Fleet has risen to a total of 35.

Additional annual G&A Expenses of minimum \$2M spread over such a fleet equates to less than \$160 per ship per day - no problem. Spread the same extra cost over a mere 5 vessels and you have an additional expenditure of almost \$1,100 per ship per day - big cost - potentially big problem!

### **Structure.**

The Company must be solidly structured as a Corporate Entity, fully encompassing Corporate Governance Best Practices.

Corporate Governance is a multi-faceted subject.

To put it simply: It encompasses the relationships among the many players involved in the Company's business, and the goals for which the Corporation is governed. It includes the shareholders, management, the Board of Directors, and others such as employees, suppliers, banks, the environment and the community at large.

An important part of Corporate Governance deals with transparency, accountability, responsibility, fiduciary duty, and mechanisms of auditing and control.

### **Strategy.**

Have a defined Strategy in place.

What's your 'Game Plan'?

What are the Company's Short-term Objectives and Long-term Goals?

The Underwriters will provide sound advice on what can be achieved at the IPO stage and at what level. Listen to them carefully. But DO remember that their prime objective is to make the Deal saleable. As they already have the Shipowner on board as a Client they may become more concerned about what the Investors will be prepared to buy into. And this may not necessarily be the best available scenario for the Owner!

### **Story.**

A famous British comedian and entertainer of the 1950s and 60s by the name of Max Bygraves used to start his act with the words 'I Wanna Tell You A Story'. The story he had in mind at the time was a 'Parmithi' or 'Fairy Story'.

Well, in this respect the times have most definitely changed, and the Underwriters and Investors want to listen to a really 'GOOD STORY' - a solid story - one that makes sense - a story that is logical, factual, well thought out, and based on independent market analysis and projections. A story they can literally 'Buy Into'!

Private Equity Funds like to buy into ships just prior to, or even concurrent with, IPO's so that they are able to seize the arbitrage that exists between vessel values in the Private Sector versus the Public Market.

Wall Street wants commodities - and Shipping is just another commodity like paper clips, or feta cheese, or hairspray - and Investors are willing to pay a certain price for them, and in response a variety of experienced Underwriters are creating these commodities, packaging them, tying them up with bright, colourful ribbon, and bringing them to market.

Do all Companies seeking to raise funds simply regurgitate the same 'old' STORY?

Absolutely . . . . NOT!

A straight comparison of Public shipping deals, 'each to the other' is practically impossible.

- For some fleets are sector specific while others offer diversification.
- Some fleets comprise modern vessels while others are more mature, and some positively old.
- Some have period time charter coverage, while others are exposed, for better or worse, to the SPOT market.
- Some pay out substantial dividends while others pursue a more conservative route, conserving their capital for further growth and fleet renewal.

And so in each case the 'GOOD STORY' changes.

### **Speed.**

Speed is absolutely essential when trying to access US Investment Capital.

While the window of opportunity may be open today, how long will it be before the cold wind of indifference slams it shut, and the Shipowner, quite literally, has 'Missed the Boat'!

### **S'Timing.**

The S'Timing of any approach is vital to its success.

External factors which are positive for raising capital are:

High Current Freight Market in the Sector concerned.

Good Future Freight Market Prospects for that Sector.

High Share Price of Peers in the Sector.

Booming Stock Market generally.

Low Interest Rate regime.

It is interesting to note that for Dry Bulk Companies - ALL of the above are currently in play.

The bottom line is that when it comes to IPO's - Investors like to buy into a market that has a positive momentum and the chance for a quick profit against the background of optimistic prospects.

Three internal financial factors govern the pricing of an IPO:

1. What premium over the 'NAV' of the Company are Investors prepared to pay?
2. What multiple of 'EBITDA' - are Investors prepared to pay?
3. How does the proposed Share Price of the new IPO Company compare with the Share Price of its 'PEERS' already trading on Stock Markets as regards 'RETURN' on Investment? For why should an Investor put its money into a new, unknown, unproven, Company - unless it is doing so at a discount to those already on the Market, and known, and with a proven track record.

The NAV of a Private Shipping Company is effectively its fleet asset value less Bank Debt. Let's take a theoretical Company with a pre-IPO NAV of \$100m. If this Owner achieves an IPO sale of shares equivalent to the Owners existing stake in the Company at 2 times its NAV - then it will result in a Premium of \$100m or 100% over its pre-IPO value.

If the Owner gets a 'PREMIUM' over the Company's NAV then it stands to reason that the Investors suffer 'DILUTION'. Let's take a quick and simple look at DILUTION for the New Investors.

#### Pre-IPO

- Net Asset Value - \$100m  
Owner has 10m shares
- Share Net Tangible Book Value - \$10 each

#### Post-IPO

- 50% of Company sold - \$200m
- New Investors 10m shares - \$20 each
- Share Net Tangible Book Value - \$15 each
- Share New Investors Dilution - \$ 5 each

Let's face it, the higher the premium to 'NAV', and the higher the multiple of 'EBITDA', the greater the Dilution for the Investors. So what makes Initial Investors want to buy something for \$20 when it is only worth \$15?

In the IPO world many Initial Investors - particularly Hedge Funds - buy deals simply to flip them for a quick profit. These Investors do not care if they overpay at the IPO stage so long as someone else is close on their heels and will pay more once the Deal starts trading on the Stock Market.

Fundamental to making an IPO attractive to both Shipowners and Investors is 'Valuation'. The founder Shareholders need to believe that they are getting an attractive enough valuation on their assets to make it worth selling, and Investors need to feel that there is still some future upside, normally based on the earnings potential over the short-term. Invariably it is a delicate - but highly achievable - balance.

Deals have been done on very favourable terms for Shipping Companies over the last three years. So companies now positioning themselves to enter the U.S. Capital Markets should take considerable encouragement from these recent experiences.

For anyone who is considering the path to the Public Market or Private Equity I would offer the following words of advice:

1. Investor appetite is undoubtedly there for Owners who can demonstrate a successful track record.
2. Be Sector Specific - aim for either pure Tanker, or Dry Bulk, or Container - it makes for an easier sale.
3. Avoid convoluted structures.

4. Have a clear, concise, distinctive, and BUYABLE, story.
5. Your Company will be judged against its PEERS - it must offer a better return - otherwise why should Investors choose your Company as a home for their money?
6. Experienced and respected professional management is essential.
7. Do you want to be a Growth Company or a Return driven Company offering a regular dividend. It is possible to be both - but it helps to have a decided emphasis from the outset.
8. Push for the best possible Deal - but at the same time do not be unrealistic as to what you can achieve. Both Parties have to be winners for a Deal to be successful in the long-term.
9. Take time to reach a Decision on 'the Road to Tread' - prepare the groundwork in advance - and then act quickly.
10. Appoint the Right Advisors.

Let me finish by leaving you with a famous naval anecdote of an Irresistible Force paradox meeting an Immovable Object: Supposedly a collision almost occurred off the coast of Newfoundland in 1995 between the American navy and the Canadians.

At the end of a heated and bitter verbal exchange as to who should alter course to avoid the potential collision the American vessel issued its final demand:

'THIS IS THE AIRCRAFT CARRIER USS LINCOLN, THE SECOND LARGEST SHIP IN THE UNITED STATES' ATLANTIC FLEET. WE ARE ACCOMPANIED BY THREE DESTROYERS, THREE CRUISERS, AND NUMEROUS SUPPORT VESSELS. I DEMAND THAT YOU CHANGE YOUR COURSE 15 DEGREES NORTH, THAT'S ONE FIVE DEGREES NORTH, OR COUNTER-MEASURES WILL BE UNDERTAKEN TO ENSURE THE SAFETY OF THIS SHIP'.

The Canadians reply was both quick and to the point:

This is a lighthouse. Your call!

Today we are fortunate in witnessing the Irresistible Force of 'Shipping' meeting the Highly Receptive Audience of the 'American Investment Community'.

Just 'Mind Your Course' as you navigate your chosen road around the 'Rocks of Indecision'!

Thank you Ladies and Gentlemen.