Alternative Financing Techniques for the Shipping Industry

Stuart Gelfond, Partner
Vasiliki Tsaganos, Partner

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High Yield Notes

High Yield: Key Advantages

- Provides access to additional capital in situations where the issuer has large outstanding debt loads or is otherwise not regarded as "investment grade" by the rating agencies.
- Typically unsecured. Secured deals are becoming increasingly popular.
- Long term maturity (typically 7-10 years) with no amortization.
- No maintenance covenants.
- Typically grants the ability to incur additional debt as long as the coverage ratio limit is met on a pro forma basis.
  - There are often limits on additional secured debt.
- Can be used as leverage to gain additional financing.
  - Incurring additional junior unsecured debt should increase the capacity to incur additional senior secured bank debt.
- Can be structured as senior, senior unsubordinated or subordinated.
- Can be used to finance acquisitions of business that do not have hard assets sufficient to cover their overall secured debt financing.
- Does not limit acquisitions of companies so long as the issuer of high yield debt can incur additional debt.

High Yield: Key Disadvantages

- Long Term Call Protection: Industry standard is 5 years of call protection for 10 year notes, lesser periods for shorter terms. Between 5 and 8 years they are redeemable only at a premium.
  - Call protection limits the Company's ability to adjust debt structure via redemption without paying a significant premium.
- Restrictive Covenants: Most high yield indentures contain a large number of covenants which can severely restrict the ability of the issuer to incur further debt, particularly secured debt, sell assets and take other actions.
  - This can often pose serious issues because it is difficult to gain consent from multiple public investors who always seek payment for amendments, even minor technical ones.
- SEC Filer Requirement: Typically the Company is required to become an SEC filer and become subject to SEC requirements.
  - Some deals do not require a foreign investor to become an SEC filer but require the Company to provide similar information to investors on a quarterly and annual basis.
- Change of Control Puts: Holders will typically have a 101% put right which is triggered by a change of control.

Private Investment in Public Equity (PIPEs)

PIPEs: Key Advantages

- Speed: Unless a shareholder vote is required, PIPEs transactions can close as quickly as 7-10 days after the receipt of definitive purchase commitments.
- Minimal Review: PIPEs can provide a very quick source of financing, because they involve limited due diligence review and review by the SEC, if any, occurs after the sale.
- Choice of Investors: A PIPE allows the Company to direct a large number of shares into the hands of specifically selected institutions or other preferred investors.
- Limited Disclosure: A PIPE usually requires very little disclosure of information that is not already publicly available, as the private placement memorandum will generally include only the Company's 1934 Act filings, and no projections.

PIPEs: Key Disadvantages

- Dilution: The issuance of the new shares may have unanticipated dilutive effects, especially in "death spiral" or "toxic convert" transactions, though these are less common today.
- Deeper Discount: The private shares are traditionally sold at a larger discount to market value than if sold in a traditional underwritten public offering.
- Churning and Flipping: PIPE Investors may not hold on to the shares for the long term, as many PIPEs purchasers are hedge funds and short sellers.
- Scrutiny: The filing of the registration statement may draw additional scrutiny to the Company and to the Company's 1934 Act filings.
- Approval: If the PIPE is large enough it may require shareholder approval.

Mezzanine Financing

Mezzanine Financing: Key Advantages versus High Yield

- No market risk, in many transactions the mezzanine lenders will enter into a binding term sheet before closing or in connection with an acquisition.
- Established relationships with mezzanine lenders provide a potential source of reserve capital for the future.
- Relatively easy to amend covenants as there are only a few investors.
- No filings needed with the SEC.
- Raises capital while owners maintain control of their business (as opposed to equity issuances).
- Outstanding mezzanine financing can sometimes encourage senior lenders and banks to provide greater credit as they see mezzanine lenders as “equity” partners who are able to support the issuer.

Mezzanine Financing: Key Disadvantages versus High Yield

- Higher Interest or Dividend Payments must be offered in order to offset the greater level of subordination as compared to senior debt.
- Historically mezzanine financing required the issuance of some form of equity kicker, usually warrants, creating the potential for additional ownership down the road, but recent deals have not.
- Often contain stricter covenants on the ability to incur additional secured debt.
- Often greater informational requirements.
- Historically the covenants resembled bank covenants, but recent deals have provided for more high yield style covenants.
  - However, in mezzanine deals with maintenance covenants, certain parts of the financing documentation will be conformed to match that of the senior credit agreement, including specific cutbacks on the allowed debt baskets.

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Master Limited Partnerships (MLPs)

MLPs: General Introduction

- A Master Limited Partnership, or MLP, is a publicly traded limited partnership (PTP). Traditionally, they tend to be concentrated in specific industries; early ones were concentrated in the energy sector to take advantage of tax benefits, but more recent ones have also expanded into the shipping industry due to high demand for MLP equity.
- The MLP structure is most appropriate for businesses with a stable and predictable cash flow because they are required to make minimum quarterly distributions to all unitholders.
- Many companies that have formed MLPs have been placing an increasingly higher percentage of their assets in MLPs.
- The MLP is normally a holding company that conducts its operations through one or more operating subsidiaries.

MLPs: Key Advantages

- Trade at higher multiples than the common shares of companies in the same industry, as distributions tend to be higher than typical corporate dividends.
  - At times MLPs trade at a significantly higher multiple than corporations in the same industry.
  - MLPs often have a high percentage of retail investors versus institutional investors.
- Sponsor GPs of MLPs receive large amounts of profits via “Incentive Distribution Rights”
  - This is a carried interest (a share of the MLPs distributions in excess of a base distribution).
  - It typically starts at 20% and as distributions on the limited partner interest increase it can reach as high as 50%.
- MLPs also receive more favorable regulatory treatment, such as limited corporate governance standards under NYSE stock exchange rules.

MLPs: Key Disadvantages

- Minimum Quarterly Distribution requirements mean that a regular amount of earnings must be paid to investors irrespective of performance.

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Special Purpose Acquisition Corporations (SPACs)

SPACs: Key Advantages for Issuers

- Access to public markets: A SPAC allows a prospective issuer access to a broader, more liquid and more stable pool of public capital than is available in the private world.
- Continued access to the capital markets: Because a SPAC is already public before any business combination and remains so afterwards, it can more easily access the public capital markets going forward than a private equity company which has yet to register publicly.
- Investors are more likely to invest in SPACs because they give the investor substantial additional incentives.

At The Market Offerings

At The Market Offerings: General Overview

- ATM programs are a type of equity offering under the U.S. securities laws.
- Increasingly popular alternative to large public underwritten offerings in volatile markets.
- ATMs enable companies to sell equity through one or more registered broker-dealers in a series of public, registered transactions effected over an extended period of time at then prevailing market prices.
- Company has the ability to raise capital on an incremental basis.
- Company must be public (registered with SEC and listed on an exchange) and eligible to use a short form registration statement – at least one year after an IPO.

At The Market Offerings: General Overview (cont'd)

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- Company enters into a sales agency agreement with a broker-dealer who agrees to sell shares on behalf of the Company from time to time, as instructed, subject to a maximum number of shares and/or maximum offering price.
- The sales agency agreement provides for the periodic delivery of auditor's comfort letters, opinions of counsel and bring-down diligence.
- The commitment is "best efforts" – no "firm commitment" on the part of the investment bank to sell a specific amount of securities or at a specific price.

Rule 144A Equity Offerings

Rule 144A Equity Offerings: Key Advantages

- Companies/sponsors can take advantage of favorable market opportunities by eliminating timing delays and uncertainty in the SEC review process.
- Companies can avoid detailed SEC line-item disclosure requirements and ongoing reporting obligations and proxy rules of the 1934 Act.
- Companies do not have to comply with Sarbanes-Oxley and NYSE/Nasdaq corporate governance requirements, potentially providing time and cost savings.
  - Companies are not required to have an independent board.
- The Rule 144A trading platforms are intended to make privately placed stock more liquid and the market more transparent, potentially reducing the valuation discount of unregistered securities.
- The Rule 144A trading platforms are expected to allow issuers to monitor their number of shareholders, which will help them to maintain their exemption from registration under the 1934 Act by ensuring that they have fewer than 500 shareholders.

Rule 144A Equity Offerings: Key Disadvantages

- SEC registered public offerings provide the most liquidity and likely best valuation.
- Issuers with equity listed on an exchange cannot use Rule 144A for the same equity.
- Resales are restricted only to QIBs.
- Stock as a currency for acquisitions is likely not available.
- Buyers of Rule 144A equity may require SEC registration rights.

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