



MONDAY 14th MAY – MORNING

SHIPPING FINANCE

Time allowed – three hours

Answer any FIVE questions – all questions carry equal marks

Please read the questions carefully before answering

1. It has been said that the best time to set up a shipping company is not when the market is doing well and rates are at a peak, but instead during a trough, when everything looks bleak and the world economy is 'in a dreadful mess'. To what extent do you agree or disagree with his opinion? In your answer you may wish to discuss, but without being restricted to, the behavior of asset values, levels of scrapping and lay-ups, freight rates and anticipated future trends, and the attitudes of lenders and investors (cautious or optimistic or over-optimistic, depending on the phase of the cycle).

2. In the context of **ALL** the following scenarios, discuss the type or types of loan which you would consider appropriate for a shipping company borrower. With regard to each loan, discuss the risks to both borrower and lender may be subject and, where appropriate, any covenants which may be included to protect the lender against such risks.
 - i. A chemical carrying shipping company has a lucrative charter party with a global chemicals manufacturer. However, the charter party will end within the next year and, with a looming world recession, it is anticipated that the demand for chemicals will fall in the following few years. The company already has in place a plain vanilla loan, interest payable on which is LIBOR-referenced. The owner is concerned about the risk of rising interest rates and falling revenues.

 - ii. A shipowner trading in a difficult freight market anticipates that after the next two years there should be an improvement in conditions and a return to strong profits. The company is currently covering operational expenses but will not be in a position to service additional debt for a while, at least not until the market recovers. However, the owner would like to purchase additional distressed sale vessels while prices are low.

 - iii. A shipowner is expecting an upturn in the freight market soon and with it a significant improvement in the prices achievable for vessels which it holds. For now, it is possible for the company to continue covering operational expenses and paying a rate of interest, but lower than that which it is already paying on its outstanding debt and which is currently causing financial stress.

PLEASE TURN OVER

3. Answer **BOTH** parts.
 - a) Identify and discuss the purposes of the main terms in a parent corporate guarantee in respect of a loan made to a subsidiary.
 - b) Discuss the procedure that must be followed for the taking of a corporate guarantee, and the practical steps that a lender should take before accepting such an arrangement.

4. Answer **ALL** parts.
 - a) Discuss the advantages of a convertible bond from the perspectives of both an investor and an issuer, over a simple plain vanilla bond.
 - b) Discuss the consequences, in terms of the signals given to the investment market, of a convertible bond which has either not been capable of conversion, or which was convertible but the option has not been exercised by investors (a so-called busted convertible).

5. Answer **BOTH** parts.
 - a) A diversified ship owning company wants to borrow a large amount of money in order to finance an expansion of its fleet. The Chief Executive Officer (CEO) is considering either applying to one of the company's existing lenders for a new loan, or alternatively raising a syndicated loan. As Chief Finance Officer (CFO) to the company, prepare a briefing note for the CEO, addressing all relevant issues including, but not restricted to, the following: the advantages of a syndicated loan over a plain vanilla loan and the concerns which may be expressed by the company's bank when approached for the full funding (you may wish to briefly discuss the Basel capital adequacy ratios in this context)
 - b) The criteria for appointing the lead manager to a syndicated loan issue.

6. Discuss the various forms of security that can be offered by a shipping company to potential lenders. In the context of each type you should describe the risks associated with it and how, if at all, these can be avoided or reduced.

7. Discuss the factors, including environmental, which should be taken into account by a lender when evaluating an application to finance the purchase of a vessel or vessels. To what extent do these factors differ in terms of objectives and methodology from those of a classification society?

8. Answer **ALL** parts:
 - a) Explain the required characteristics of cash flows for them to be suitable for securitisation. In addition to the cash flows transferred to the special purpose vehicle (SPV), what other assets may be used to collateralise the issue?
 - b) With the use of a diagram, illustrate the direction of the cash flows in a typical securitisation, and its participants.