

## IN CONVERSAZTION WITH DVB

CEO of DVB Bank, Mr Wolfgang Driese and Member of the Board of DVB Bank and Head of Shipping Division, Mr Dagfinn Lunde were in Singapore last month and we were very happy to have the opportunity to spend some time with the two affable gentlemen, who shared with us their take on the turmoil that the shipping industry has been through.

Mr Driese is credited with transforming DVB from an unknown generalist domestic German bank into a global player with a specialisation in international transport finance. Mr Lunde carried out a successful reorganisation of DVB's shipping division in January 2008, and "sectorised" the previous regional sales team into ten groups focusing on key shipping sectors: Container Box Group, Cruise & Ferry Group, Crude Oil & LNG Tanker Group, Chemical & LPG Tanker Group, Container Vessel Group, Dry Bulk Group, Floating Production Group, Offshore Drilling Group, Offshore Support Group and Product Tanker Group. Ship financing now makes up a substantial chunk of 54.2% in DVB's lending portfolio, with a total value of USD 13.88 billion as at 30 September 2009.

Today, the bank is a leading specialist in international transport finance not only in shipping, but also in aviation and land transport. What makes DVB unique is its in-depth expertise in the shipping industry - every sector team is staffed with specialists who have a comprehensive view of a specific market. DVB has two other specialist teams - Shipping Asset Management ("SAM") and Restructuring Unit Shipping ("RUS") that work closely with all its sector teams. The SAM team is tasked to take control of ships whenever there is any foreclosure of mortgages, operate these assets and subsequently sell them off when the market recovers. The RUS team on the other hand is a dedicated unit established within the Credit Shipping department with a focus on leading both corporate and loan restructurings, and providing the sector teams the necessary assistance on the restructuring cases.

We provide some excerpts from the press talk.

Marine Money: Would you agree that this is the worst crisis that the shipping industry has been through? If so, what are the lessons you have learnt in the crisis that you would like to pass on to bankers and shipowners?

Mr Lunde: This is not the worst shipping crisis ever. The worst shipping crisis ever was in the 1930s after the Great Depression. You could walk with dry feet in most of the rivers in England with laid-up ships. The second worst crisis in shipping was in 1986 when the market came lower than where we are today. Back then, we did not experience the brutal freefall that we have gone through recently, but we were in a worse position in terms of demand and supply dynamics. Demand went down for a long time in most sectors because we had a very bad recession after the oil crisis. Liquidity completely disappeared and the values for almost all ship types were at scrap.

As for the current crisis, interestingly enough we did expect the downturn, but not the magnitude of the fall in demand triggered by the financial crisis.

Mr Driese: The shipping crisis came partly from the financial market crisis and the unavailability of trade finance. There was a standstill for a couple of months and nothing moved. This is a new experience - a new version of the crisis that we have never seen it come so brutally. The second question was on lessons. What can we teach to the youngsters?

Mr Lunde: Bankers never learn.

Mr Driese: Do you want to be quoted on that?! They think they know better and don't believe in your grey hairs.

Mr Lunde: That is what I learnt from the thirty years in my career (\*laughs\*). One lesson would be that you can't foresee everything and there will always be surprises. If you are in the wrong asset type with the wrong people, you are dead. We need to finance the right ships and the right people who have the market power, a good understanding and closeness to the cargoes. After all, it is the moving of cargoes that brings in the cash. A ship without cargoes has no value.

Our people know the traders and the oil companies on the oil side, and the cargo owners and the raw material people on the dry bulk side to really understand where the flow needs to go.

Mr Driese: We are also seeing the trend of more and more people with regular cargo flows looking into shipping. They were hurting so badly during the high markets that they need to hedge a part of their transportation requirements. We are seeing new players in the various markets. The question is whether to rely on third parties for capacity or be less dependent and take the opportunity of the depressed asset prices.

Mr Lunde: This happens after every peak and bottom. This is a typical cyclical development.

Mr Driese: Another lesson would be to remind people a simple thing that this is a cyclical industry. We saw the madness of owners in 2007/08 when the market went crazy, far ahead compared to historical levels and yet, people still believed that this would continue. There was a strong belief that this is a one way road, although most shipowners have had the experience of market downturns. It was not just about a new generation that has never seen a crisis. People forget that easily.

Mr Lunde: I agree, but this was different from the normal. The high period lasted longer (and higher) than previously for a couple of reasons, which is also interesting to analyze. The upswing started with too little yard capacity needed for the normal fleet renewal process. Then the LNG wave came where people started to build LNG ships for projects and the offshore boom came. The yards found themselves lacking capacity for

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a longer period. Normally, a peak lasts for one or two years in shipping but this time it lasted three to four years. When it passed the second year, people started to believe that this is a paradigm shift.

Mr Driese: One might argue that shipping companies do not have the corporate structure, the wisdom of research and whatever. But if we look at the big corporations in the aviation industry, the traditional owners made the same mistakes! Is an order book of 40% of the flying fleet healthy? I do not understand why people think that the world has changed.

Mr Lunde: I like this quote “Those who cannot learn from history are doomed to repeat it.”

Marine Money: Do you think there is anything that can be done to convince people..?

Mr Lunde: No. May we go back to the normal shipping cycles – one or two high years and six or seven year lows. That has always been the tradition.

Mr Driese: Something can be done. I think we have a finance industry, including us with a lot of young people who have never experienced a down cycle. Now that people are facing these problems, they will not forget easily. I still have a certain belief that bankers will not forget that easily. The problem is to say more often “no” in an extended cycle. It is hard when everyone is doing it. Why aren’t we not doing it? And to stand up and say I don’t care. This is our responsibility. This is our balance sheet. This is our equity. I don’t want to put these at risk. The bigger mistakes are being done when you are following the crowd.

Speaking for DVB, we have hired many youngsters over the past few years. They will not forget so quickly. I always say learning in banking is an expensive exercise, but at least I think we will get a return on our investment. Sending textbooks around explaining that this is a cyclical industry is different when you experience it yourself. Mother can tell you not to put your hand on a heated pot, but once you have done it, you will never forget.

Marine Money: How do you measure the effectiveness of DVB’s unique sectorisation strategy? What are the disadvantages and how do you overcome them?

Mr Lunde: We were able to test the effectiveness of this sectorisation strategy for a few years on three sector teams - Floating Production Group, Container Box Group and Cruise & Ferry Group before applying the model to the rest of the sectors. We are able to earn more money on each dollar lent. That is very clearly proven. We were lucky it happened just before the crisis. Although when we entered the crisis, we have more people and it is more costly but we have more control of the sectors we are in. Our specialists have more control of their portfolios and in my mind, this made us more resilient when the problems came. I can talk to one person and know the whole global situation in that sector. If you think about it, previously we had

seven regional directors who were doing everything within their region. It was much more complicated and the knowledge base was not anything near what was needed.

Mr Driese: The customers see that we have a broader experience and deeper knowledge base. You really can talk business with us.

Mr Lunde: On the flipside, this is clearly a more expensive model in terms of people and travelling expenses.

Mr Driese: But we are supporting the airline industry – a key sector in DVB’s lending portfolio. (\*the room breaks into laughter\*)

Mr Lunde: But I think the costs are clearly justified. The structure was originally designed for marketing and building up expertise, but it turned out to be one that control risks better in this crisis.

Marine Money: As a German bank, your shipping exposure is surprisingly less German. How much is German?

Mr Driese: Less than 5% across all sectors and divisions. We always see ourselves in the global business, identifying transactions on the global map

Mr Lunde: Sorry to say we are not really a German bank.

Marine Money: So you are not very much involved in what is going on in Hamburg?

Mr Lunde: We have 10% of our shipping portfolio in container ships and not so much in the German market.

Mr Driese: We always see ourselves in a global business, looking at the global map and identifying the most suitable transactions. There is no idea of having any kind of national duty to call on German shipowners. Firstly, they didn’t bother because they had enough service providers. Secondly, pricings were extremely low and advance levels were extremely high. If you compare these to international businesses, why should I do that? Fortunately we didn’t.

Mr Lunde: The picture has changed. We were the only bank who had done newbuildings in containerships last year. The risk and reward profile is more attractive now.

Marine Money: When would you expect the container shipping market to recover?

Mr Lunde: It is not possible to answer that question across the board. We will have to look at the type and size of the ship. If you look at the bigger ships, we don’t think the market will come back before 2013 or 2014. If you look at the smaller vessels (under 2,000 TEUs), we expect the market to come back within two years.

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Volumes are picking up in the regional trades. There are very few ships on order and many old ships are being scrapped. The ships in the middle category (4,000-6,000 TEUs) will have a big problem. Those ships are supposed to go into the regional trades but they are too big for many harbours. There is no use for these ships anymore and those will be laid up for a long time. It will take an enormous growth in trade before they come back. The 8,000 - 12,000 TEUs ships will take away the cargoes because they are so much more efficient. That is not a nice picture.

In 2005, we realised that the competition to finance container vessels was very very tough. We decided to go into financing container boxes. While we have 10% of our portfolio in container vessels, we have roughly about 7% in container boxes. At that time, we doubled our earnings on the same amount of dollar. That was a very nice move.

Let's not forget that we are also very big in equity investments through our funds. We have 84 ships in our funds. About 20% of our assets are offshore related and we have a number of small containerships. We have a similar spread as our portfolio in the lending side. Typically our funds adopt the bareboat sale and leaseback structure. We do not take operational risks if we can avoid them. The average amount invested is close to USD 4 million.

Marine Money: What about this financing gap for the newbuilding orderbook?

Mr Lunde: What was the gap in 2009? All the ships that came out were financed. There were a lot of delays but that was on purpose. There was no gap. In the beginning of the year, everyone was talking about a USD 300 billion gap and how much we need to finance the orderbook. That has been solved by the export credit institutions, the banks behind the shipyards, the capital markets and on top of that, private equity. In today's political climate, export credit institutions get more budget and authority to do more lending. Finland is offering 95% financing for cruise ships which has never happened before. You need just 5% commercial lending. Financial markets are always flexible so that you never end up with a real gap. It is a gap from the commercial banking point of view. That of course has reduced.

Mr Driese: All these delays and scrap vessels have helped a lot. The real gap is on the refinancing existing exposures when they become due and on any secondary trades. That is one of the reasons why we have so depressed second hand values. If there is a buyer, he will have to bring in mainly equity because the commercial banking side has financed the newbuildings. The commercial banks that have provided the pre-delivery financing will most likely have to finance the post delivery phrase as well. There is very little capacity left for someone who is buying at these assets at relatively inexpensive terms.

Mr Lunde: Interestingly enough, the reduction in balance sheets that have been forecasted in the banks is not coming in the form of the sale of their portfolios. The pricing in the previous portfolio was so low compared to today's market that there will be an enormous discount. That is a lot of money.

Marine Money: Are you seeing a greater degree of price competition among the banks for the top names in shipping?

Mr Lunde: Yes, there is more capacity from the commercial banks on the energy side and also the best corporate names. Pricings on those names have clearly gone down which we don't like. In general, the risks in our financial markets were wrongly priced for a long time and hopefully people have learnt a bit from their experience.