Equipment finance, enabling strategic focus

Is finance following your growth and change at the same relative cost?

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Demand for Port capacity in Europe is projected to grow at 5.2 per cent per year in the coming five years, while GDP will only grow at a third that rate. In Asia, port demand will rise an estimated nine per cent per year, compared with GDP growth of 7.4 per cent. Globalisation of Trade continues to fuel demand for Port Activities in Producing (Asia) and Consuming (Europe + Americas) countries. Increased demand affects the dynamics of stevedoring companies. The need for efficient inter-modal inland and feeder networks affect the way stevedoring companies apply their equipment. With this dynamics, equipment finance like the operational reliability of your equipment is important. Is Equipment Finance enjoying the right attention from decision makers?

Financial Market involvement in the sector, both from the Equity and Debt side is driving the need to have a competitive financial performance. Data on financial performance is becoming a commodity and the analysis is a matter of applying basic financial skills. With this it is important to realise that measurement of performance in absolute terms, i.e. are you making money, is no longer sufficient. The relative financial performance of a stevedoring activity is part of the Transportation Value Chain and determines the sustainability of the activity. The business is quickly lost if your competitor outperforms you on operational efficiency and cost.

Why are volumes increasing? Why are Investors keener to invest today? What is an Asset Conversion Cycle? Who supplies funding? What characteristics have the products and what is the cost?

Volumes

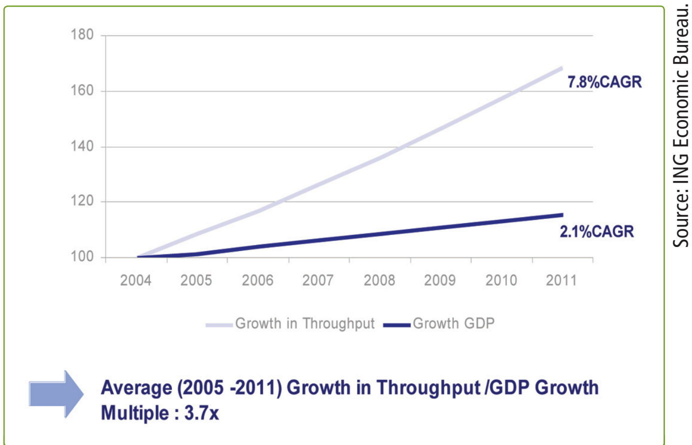
Demand for the Transportation Value Chain (all transportation costs between producer and consumer) is driven by GDP and the difference in unit production costs. Products with a long life cycle benefit from low production and transportation costs, while products with a short life cycle benefit from short time-to-market and production is usually moved near consumer markets.

Stevedoring capacity demand can be expressed as a multiple of GDP; producing countries 1.2 times GDP and consumer markets like Europe and North America respectively 3.7 and 2.4 times GDP. These are robust figures.

Equipment Finance is needed from the embellishment phase onwards, thereafter Equipment Finance is needed for expansion, replacement or simply refinancing needs.

The 24 recorded M&A transactions in Global Ports during 2005-2006 show a trend. Transaction volume of US$ 17.2 b indicates financial visibility. Intrinsic value, forecasted volumes and perceived efficiency improvements motivate goodwill payments and values have moved from five times EBITDA to 10-15 times EBITDA.

What are the main drivers for consolidation? These are: strong global networks, expertise, stable relationships, being reliable partners for the Major Lines, and open and integrated systems with the Logistic Service Providers.



European growth in throughput/GDP growth.

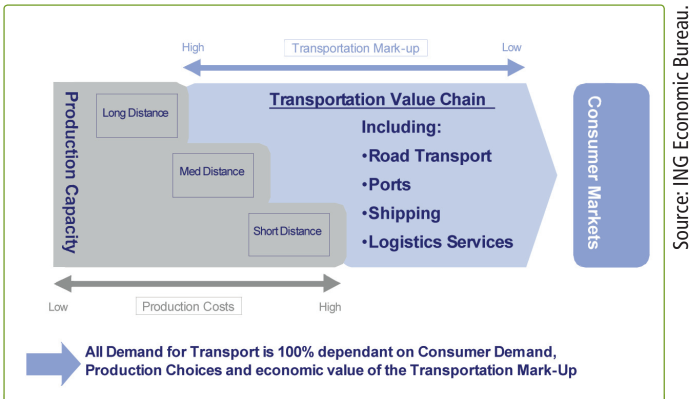
Flexibility and Scalability are the drivers for growth and a sustainable product offering.

Asset conversion

Financial partners analyse size and speed with which the cash is moved. Starting with cash obtained from equity and or debt, the money is being used for assets to run the operation. Once the invoice is paid, cash is again available for the next cycle. Financial rewards in the form of interest or dividend payments reflect the risk that the source of funding is requiring from the operation.

Finance mechanisms

Each product has its own profile in risk, reward, tenor, flexibility, documentation, ownership, tax and scalability. If financing the asset is seen as a necessary evil, the outcome could become an obstacle for growth. The product offering becomes less competitive because the financing structure prohibits management to adapt to changes.



The transportation mark-up.

TABLE 1: MAIN DIFFERENCES BETWEEN THE FINANCIAL PRODUCT PROVIDERS				
	Impact on Balance Sheet	**Scalability & Flexibility**	**Risk Spread**	**Cost**
Equity	Significant impact on Return on Capital (RoE). Weighs down the Balance Sheet	Low	N.a.	No results-no cost, high results are streamed up to shareholders at their discretion
Corporate Loan	Affects Leverage and Cost of Capital. Weighs down the Balance Sheet	Slightly moderate	Matches perceived risk	Interest funding costs + risk spread
Financial Lease	Low. Start Up capital requirement. Weighs down the Balance Sheet	Moderate	Matches perceived risk	Interest funding costs + risk spread. Tax advantage possible
Operational Lease	No assets on the Balance Sheet and low start up Capital Requirement	High	Matches perceived risk	Interest funding costs + risk spread (high) + servicing cost (high)

A standard rule of thumb is that the source of financing matches adequately the depreciation of the asset.

For Equipment Finance we identify the following sources: Equity, Corporate Loans and Lease. Leasing is being provided by the Financial Services community and Vendors. The difference between Financial and Vendor Lease is the source.

Operational Lease includes a Financial Lease and has additional components like maintenance, remarketing and a different ownership structure.

Equity investors. Ownership of the assets is entirely with the company. The equity investor takes ownership of the company. Upsides are channelled to the Equity Investor by means of dividend and valuation of the shares. The Equity Investor does not require a margin or funding payment on the value of the investment. Operational risk is with the company. Assets can be pledged to others to secure additional funding. Flexibility is limited. Equity Investor looks at the investment in relative terms to Risk-Free investments like Government Bonds + a mark-up. The Equity Investor is likely to approve additional funding by means of Equity if returns are sufficient.

Corporate Loan Providers, usually commercial banks. Asset ownership remains with the borrower. Ownership of the asset can be pledged in favour of the Corporate Loan Provider (CLP). A pledge provides security to the CLP in case the Asset Conversion Cycle slows down or stops. If the Asset Conversion Cycle is no longer sufficient to cater for debt service, foreclosure is likely to follow. The CLP will repossess the equipment and convert it to cash by means of a sale. The Asset Conversion Cycle risk is carried by the CLP, the asset valuation risk is carried by the borrower. Flexibility is moderate and subject to the Asset Conversion Cycle over time. In case of a robust Asset Conversion Cycle the CLP will be more willing to lend. The CLP requires an agreed repayment schedule, in line with the depreciation of the Equipment and based on the forecasted cash flow.

Financial Lease Providers are very similar to CLP. The main difference is the Asset Conversion Cycle requirement. Both Financial Lease and CLPs base their decision on the Asset Conversion Cycle and value of the Equipment, the Financial Lease Provider puts more emphasise on the remarketing value of the Equipment compared to the CLP.

Operational Lease Providers are providing a mix of products and services tied to the Equipment, combined in one product offering. Main difference with the other Providers is that ownership of the Equipment remains with the Operational Lease Provider. An Operational Lease is highly scalable and flexible but also costly.

Main differences between the Financial Product Providers can be summarised in Table 1.

Conclusion

Robust demand is the current basis for growth in Global Terminal Operations. In the current corporate environment Equipment Finance should not become an obstacle for growth. Flexibility of the financial products and sources of funding are needed to allow management to quickly implement changes and be flexible and scalable.

Equipment and Equipment Finance is shifting from a standard long term perspective as the industry standard into fast developments and requires increased flexibility from the operators.

Financial visibility and better data access make absolute and relative performance comparison by financial analysts a new element in the competition. Clients, Competitors, Investors and Financial Service and Product Providers can better analyse and compare the financial performance. Excellent Balance Sheet and Cash flow management is of paramount importance in the current market. M&A opportunities will be created by imbalances in financial performance.

Equipment Finance is best served with a pro-active approach. Financial sources and products need to support the business, while management of the Stevedoring Company is driving the business forward.

ABOUT THE AUTHOR

Dirk Jan van Swaay is Focus Sector Head within ING Wholesale Banking and responsible for client relationships and business development with companies in the Transportation & Logistics sectors globally. Starting his banking career in 1980 Dirk Jan has worked in several countries in structured finance, asset management and risk management functions.

ABOUT THE ORGANISATION

Wholesale Banking Clients manages and builds relationships with clients ranging from mid-sized companies in our Benelux home markets to large corporate, institutions and governments worldwide. We are a committed partner to our clients and strive constantly to help them overcome the challenges they face. Our consistent and uniform client coverage model supported by a sector-based client approach enables us to offer our clients the financial solutions they need for success. And at the same time will differentiate us more and more clearly from our closest competitors.

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