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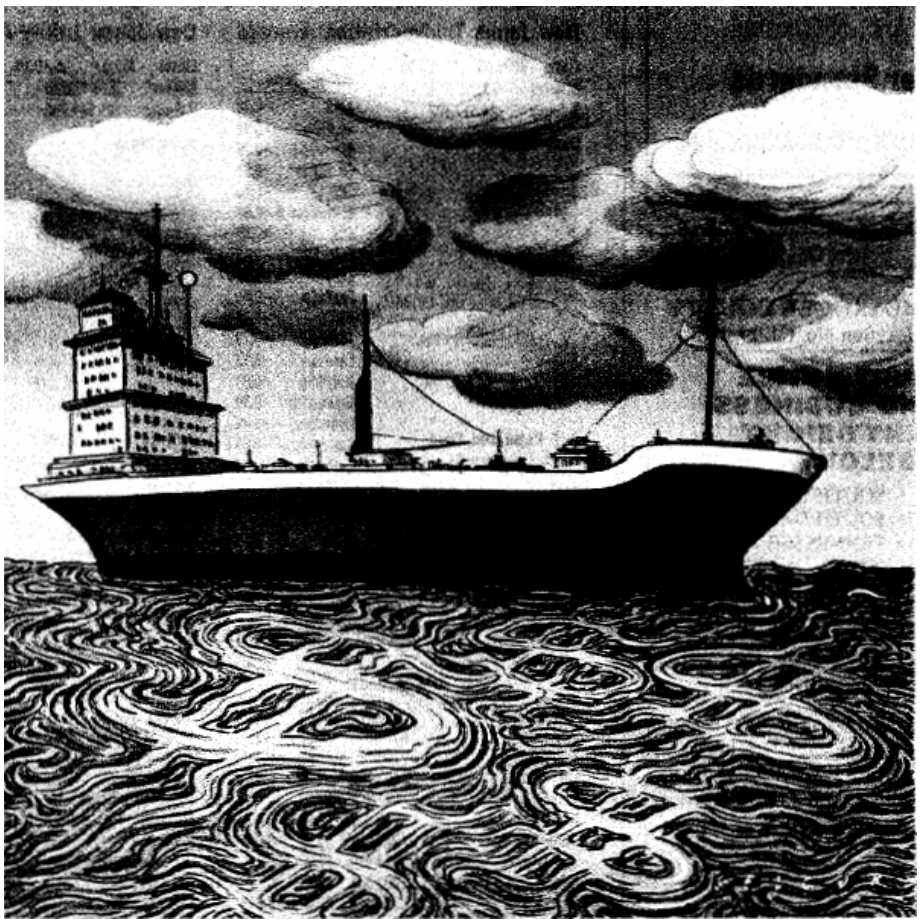
RAISING EQUITY IN THE US CAPITAL MARKETS



A CASE STUDY FOR A DRY BULK SHIPPING COMPANY

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UNDER REVIEW

Chapter 1
The Initial Public Offering In The US Stock Exchange

1.1 The Capital Markets

Capital markets are the complex of institutions and mechanisms through which intermediate-term funds (loan of up to ten years maturity for example) and long-term funds (longer-maturity loans and corporate stocks) are pooled and made available to business, governments, and individuals, and instruments already outstanding are transferred. As in the case of the money market, the capital markets are local, regional and national in scope.

Because they deal with instruments representing longer-term funds, the capital markets involve capital in the economic sense. Funds rose through debt instruments by business and individuals are invested in fixed assets and inventories. Admittedly, the proceeds of government bonds and corporate shares are used to finance a variety of expenditures and types of assets. This usage of terms in turn suggests a distinction between the capital markets, or markets for longer-term funds, and the money market for short-term funds (obligations with a year or less to maturity)[1].

The instruments that represent funds supplied to and obtained from the capital markets are either debt instruments-personal and corporate notes, or equity instruments such as corporate stocks that are sold to raise new funds. There are three

[1] Traditionally, the money market has been described as the market for shopt-term debt, with a year or less to maturity, and the capital market as dealing in long-term funds, both debt and equity. These designations leave a category of intermediate-term money represented by debt with from one to five or ten years to maturity. Transactions involving such debt are included in our concept of capital market activity.

types of public equities: common stocks, preferred stocks and American Depositary Receipts ("ADRs")[2]. Some reasons[3] why someone to access the capital markets are:

- Ø Ready source of funds.
- Ø Cheap source of funds.
- Ø Makes future capital raising easier.
- Ø Provides a liquid market for company securities and "currency" for acquisitions and employee's incentives.
- Ø Alignment of interests between companies and investors.
- Ø Cash out entrepreneur and early stage investors.

1.2 Why Go Public?

In general going public raises cash, and usually a lot of it. Being publicly traded also opens many financial doors:

- Because of the increased scrutiny, public companies can usually get better rates when they issue debt.
- As long as there is market demand, a public company can always issue more stock. Thus, mergers and acquisitions are easier to do because stock can be issued as part of the deal.

[2] A negotiable certificate issued by a U.S. bank representing a specified number of shares (or one share) in a foreign stock that is traded on a U.S. exchange. ADRs are denominated in U.S. dollars, with the underlying security held by a U.S. financial institution overseas, and help to reduce administration and duty costs on each transaction that would otherwise be levied. This is an excellent way to buy shares in a foreign company while realizing any dividends and capital gains in U.S. dollars. However, ADRs do not eliminate the currency and economic risks for the underlying shares in another country. For example, dividend payments in euros would be converted to U.S. dollars, net of conversion expenses and foreign taxes and in accordance with the deposit agreement. ADRs are listed on the NYSE, AMEX or Nasdaq.

[3] Seward & Kissel, LLP, Tapping the United States Capital Markets – Public Offerings, Presentation for Summer Associates, June 2004

- Trading in the open markets means liquidity[4]. This makes it possible to implement things like employee stock ownership plans, which help to attract top talent.

Being on a major stock exchange carries a considerable amount of prestige. In the past, only private companies with strong fundamentals could qualify for an IPO and it wasn't easy to get listed. Often when companies go public, the issue is solely intended to raise new capital for the company. But there are also occasions when no new capital is raised and all the shares on offer are being sold as a secondary offering by existing shareholders. For example, in 1998 Du Pont sold off a large part of its holding in Conoco for $4.4 billion.[5]

Some of the biggest IPOs occur when governments sell off their shareholdings in companies. For example, the British government raised $9 billion from its sale of British Gas Stock, while the secondary offering of Nippon Telegraph and Telephone by the Japanese government brought in nearly $13 billion.[6]

Instead of going public, many successful entrepreneurs may decide to sell out to a larger firm or they may continue to operate successfully as private, unlisted companies. Some very large companies in the United States are private like Bechtel, Cargill and Levi Strauss. In other countries it is more common for large companies to remain privately owned. For example, since 1988 there have been only 70 listings of new, independent, nonfinancial companies on the Milan Stock Exchange.[7] In their analysis Pagano, Panetta and Zingales (1998) state that the likelihood of an IPO is

[4] The degree to which an asset or security can be bought or sold in the market without affecting the asset's price. A high level of trading activity characterizes liquidity.
[5] This is the largest U.S. IPO, but it is dwarfed compared with the Japanese telecom company NTT DoCoMo, which sold $18 billion of stock in 1998 and handed out $500 million in fees to the underwriters.
[6] Richard A.Brealey- Stewart C.Myers, Principles of Corporate Finance, McGraw-Hill, 2003, page 406.
[7] M.Pagano, F.Panetta, and L.Zingales, (1998), "Why Do Companies Go Public? An Empirical Analysis, "Journal of Finance, Vol.53, pp.27-64

increasing in the company's size and the industry's market-to-book ratio. Companies appear to go public not to finance future investments and growth, but to rebalance their accounts after high investment and growth. IPO's are also followed by lower cost of credit and increased turnover in control.

Drawing from the cost of capital literature (e.g., Scott (1976) and M&M (1963)), it is reasonable to argue that firms conduct a public offering, when the external equity will minimize their cost of capital. In a discounted valuation framework, the decreased cost of capital will increase the present value of future cash flows and hence the value of the company. Closely related to the cost of capital line of reasoning, Myers and Majluf (1984) and Myers (1984) argue for a pecking order of financing. They assert that firms will rely on financing in the order of cost – beginning with internal equity, proceeding to debt financing, and then finally to external equity when other cheaper sources of financing have dried up.

Several theories suggest that IPOs facilitate the cashing-out of insiders. For example, Zingales (1995) and Mello and Parsons (1998) argue that an IPO creates a public market for the firm's shares so shareholders can convert to cash at a later date. Ang and Brau (2003) demonstrate that sometimes insiders sell personal shares in the IPO for personal gain in a partial cash-out. Additionally, Black and Gilson (1998) argue that the IPO gives Venture Capitalists[8] the opportunity to exit and provides an attractive harvest strategy.

A couple articles argue an IPO facilitates merger and acquisition activity. Zingales (1995) argues that an IPO can serve as a first step in having a company taken

[8] Venture capital is money and resources made available to start-up firms and small businesses with exceptional growth potential. Venture capital often also includes managerial and technical expertise. Most venture capital money comes from an organized group of wealthy investors. This form of raising capital is increasingly popular among new companies that, because of a limited operating history, can't raise money through a debt issue. The downside for entrepreneurs is that venture capitalists usually receive a say in the major decisions of the company in addition to a portion of the equity.

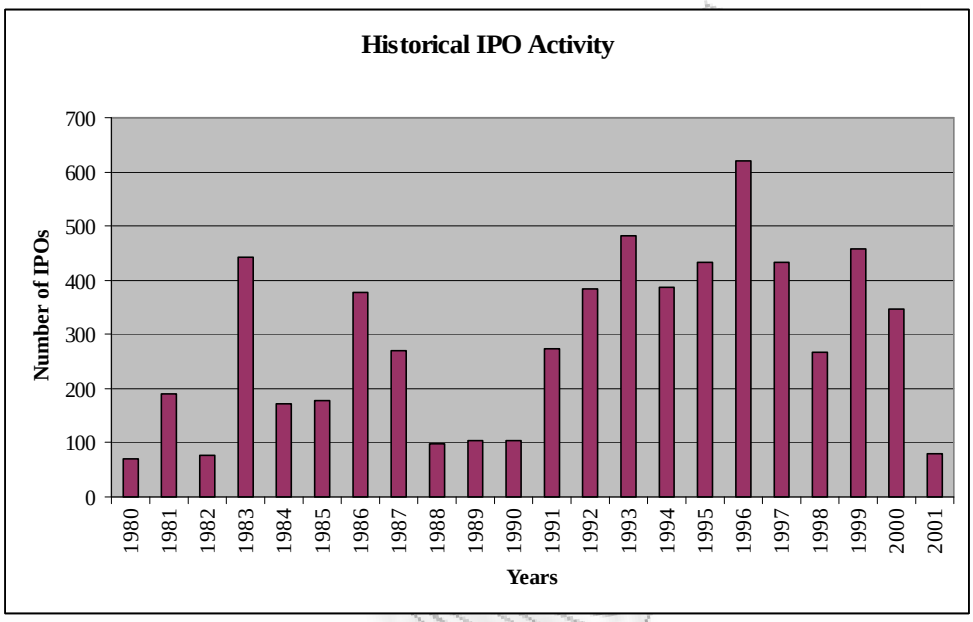
over at an attractive price. Brau, Francis, and Kohers (2003) suggest that IPOs may be important because they create public shares for a firm, which may be used as a "currency" in either acquiring other companies or in being acquired in a stock deal.

The last camp of theories suggests strategic reasons for IPOs. Chemmanur and Fulghieri (1999) argue that IPOs serve to broaden the base of ownership of the firm. Maksimovic and Pichler (2001) argue that firms may conduct an IPO to capture a firstmover advantage. They also suggest that an IPO can increase the publicity or reputation of the firm going public. Finally, Bradley, Jordan, and Ritter (2003) show that analyst recommendations are often biased upward after an IPO. Following this observation, an analyst following may motivate some firms to conduct an IPO. From empirical evidence why firms go public was founded that the most important motivation in today's marketplace is to create public shares for use in future acquisitions. Minimizing the cost of capital is not among the three most important motivations for going public.

UNEINGESCHRÄNKTE

1.3 The Initial Public Offering

Graph 1Historical IPO Activity



Source: Ritter, Jay Rial and Welch, Ivo, (2002), A Review of IPO Activity, Pricing and Allocations, Yale ICF Working Paper

IPO is an acronym for Initial Public Offering[9]. This is the first sale of stock by a company to the public. A company can raise money by issuing either debt (bonds) or equity. If the company has never issued equity to the public, it's known as an IPO. Companies fall into two broad categories: private and public. A privately held company has fewer shareholders[10] and its owners don't have to disclose much information about the company. Anybody can go out and incorporate a company: just put in some money, file the right legal documents, and follow the reporting rules of your jurisdiction. Most small businesses are privately held. But large companies can be private too. Well-known firms such as IKEA, Domino's Pizza, and Hallmark Cards are all privately held. It usually isn't possible to buy shares in a private company. You

[9] The first sale of stock by a private company to the public. IPOs are often smaller, younger companies seeking capital to expand their business.
[10] Any person, company, or other institution that owns at least 1 share in a company. A shareholder may also be referred to as a stockholder

can approach the owners about investing, but they're not obligated to sell you anything. The IPO activity is cyclical. Demand-side explanation suggests that start-up firms with good projects cannot get private funding and they use IPO for raising capital, such as the case of internet firms during 95'-98'. Supply-side explanation suggests that during some time periods investors and institutions that invest in IPOs have excess funds to invest. A time periods with a lot of IPOs is called "hot issue period". If a hot issue period is driven by supply-side then it may be advantageous for a new firm to go public. If a hot issue period is driven by demand for funds then a new firm may be better off delaying to go public - competition for funds.

Public companies, on the other hand, have sold at least a portion of themselves to the public and trade on a stock exchange[11]. This is why doing an IPO is also referred to as "going public". Public companies have thousands of shareholders and are subject to strict rules and regulations. They must have a board of directors[12] and they must report financial information every quarter. In the United States, public companies report to the SEC[13]. In other countries, public companies are overseen by governing bodies similar to the SEC. From an investor's standpoint, the most exciting thing about a public company is that the stock is traded in the open market, like any other commodity. If you have the cash, you can invest. The players in a public equity offering are: the issuer, the managing underwriter, the selling syndicate, the stock

[11] A market in which securities, commodities, options, or futures are traded. The NYSE, Nasdaq, and Amex are some examples of stock exchange.

[12] A group of individuals who are elected by stockholders to establish corporate management policies and make decisions on major company issues, such as dividend policies.

[13] A government commission created by Congress to regulate the securities markets and protect investors. In addition to regulation and protection, it also monitors the corporate takeovers in the United States. The SEC is composed of five commissioners appointed by the President of the United States and approved by the Senate. The statutes administered by the SEC are designed to promote full public disclosure and protect the investing public against fraudulent and manipulative practices in the securities markets. Generally, most issues of securities offered in interstate commerce, through the mail, or on the Internet, must be registered with the SEC.

exchange, the lawyers, the auditors, experts, financial printer, the SEC staff and the transfer agent. The entire above are responsible for a successful initial public offering.

Table 1 Basic steps for a successful initial public offering[14]

Preparation	Registration / Listing	Execution
Bookrunner selection[15]	File Registration Statement confidentially with SEC	Print and distribute "red" herrings
Select law firms and accounting firm	Prepare listing application	Research analyst presentation to sales force
Due diligence[16]	NYSE application	Sales force dry-run with management
Modify corporate structure, as necessary (see p.72)	Respond to SEC comments	Roadshow[17] presentations
Modify Board of Directors / Corp. governance, as necessary	File amended registration statement with audited financials	Invitation of Underwriting syndicate
Implement any modifications to any option / share plans	Respond to SEC comments	Develop institutional and retail "books" of demand
Transaction structuring (see p.63)	File publicly with SEC	Determine initial public offering size[18]
Refine business plan and strategy(see p.66)	Define the appropriate investor base[19]	Determine appropriate mix of retail and institutional allocation
Valuation analysis (see p.83)		Pricing[20]
Develop marketing story		Closing
Documentation preparation		Aftermarket trading support
Co-manager selection		
Year-end audit (see p.78)		
Meet exchange		
Undertake appropriate branding activities (industry conferences, one-on-one meetings with investors/research analysts)		

[14] According to author's view.

[15] The company should select an underwriter. A company's relationship with an underwriter should then be formalized through a mutual "letter of intend".

[16] The underwriter with the accountant and the lawyers begin a thorough investigation of the company. The underwriter will examine a company's management, operations, financial condition, performance, competitive position and business plan. Other factors open to scrutiny are labor force, suppliers, customers, creditors, and any other parties that have a bearing on the viability of the company as a public entity and could affect the proper, truthful, adequate disclosure of its condition in the prospectus. The accounting firm will examine financial information and such specific documents as contracts, billings and receipts to ensure the accuracy and adequacy of financial statements. Due diligence is a time-consuming and demanding process which is a crucial step in the assembly of a thorough and accurate profile of the company.

[17] The company and the investment banking team should design and present the "road show", a series of meetings held with potential investors and analysts in key cities across the country. The "road show", which consists of fairly elaborate formal presentation on the company's operations, financial condition, performance, markets, products and services, is delivered by the company's top executives, who are then available for questions. Requiring extensive travel and long hours, the road show can be exhausting for the company management, but it remains an integral and worthwhile part of the IPO process. By providing management an opportunity to meet with potential investors face-to-face, the

Once a firm has made the decision to enter the capital markets, its first task is to hire an underwriter or investment bank[21]. The underwriter selection process is driven by a very small set of selection criteria that focus on the underwriter's reputation and IPO process expertise. As has been already mentioned the underwriters play a triple role. First they provide the company with procedural and financial advice, then they buy the issue, and finally they resell it to the public. A company could theoretically sell its shares on its own, but realistically, an investment bank is required - it's just the way Wall Street works. Underwriting is the process of raising money by either debt or equity (in this case we are referring to equity). You can think of underwriters as middlemen between companies and the investing public. Among the biggest underwriters are Goldman Sachs, Merrill Lynch, Credit Suisse First Boston, Lehman Brothers and Morgan Stanley.

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road show allows the company to communicate key information to investors and to showcase the managerial talent and expertise that will be leading the company.

[18] The investment banking team should also consult with management regarding the offering size, taking into consideration how much capital the company needs to raise, the desired degree of corporate control and investor demand. Often the more shares outstanding, the greater the liquidity of the stock, which will increase institutional interest.

[19] After the preliminary prospectus has been filed with the SEC and is available for circulation among potential investors, the underwriter should assemble the "syndicate", consisting of additional investment bankers who will place portions of the offering to achieve the desired distribution. The underwriter is also responsible for accumulating "indications of interest", solicited through its efforts as well as the syndicate's from institutions and brokers that have approached their clients. These give assurance that the IPO is viable and help to determine the final number of shares to be offered and the allocations to investors.

[20] Just before the underwriting agreement is signed, on the day before the registration becomes effective and sales begin, the offering is priced. The investment banker should recommend a price per share for management's approval, taking into account the company's financial performance and competitive prospectus, the stock price of comparable companies, general stock market conditions, and the success of the road show and ensuing expressions of interest. While the company will want to price the offering as high as possible, an offering that does not sell or sell completely will not be in its best interest or in the interest of investors who find the share price declining in the market immediately after their initial purchase. In fact, investors look for at least a modest increase in the market price to reassure them about their investment decision.

[21] A financial intermediary that performs a variety of services. This includes underwriting, acting as an intermediary between an issuer of securities and the investing public, facilitating mergers and other corporate reorganizations, and also acting as a broker for institutional clients. Alan C.Shapiro in his book Modern Corporate Finance uses the term Investment Banker and the process where the investment banker buys the entire issue and then resells it to the public, underwriting. Brealey – Myers in their book Principles of Corporate Finance use the term Underwriters as the financial midwives to a new issue. In our analysis both terms have been used for the same purpose.

The company and the underwriter will first meet to negotiate the deal. Items usually discussed include the amount of money a company will raise, the type of securities to be issued, and all the details in the underwriting agreement. The deal can be structured in a variety of ways. For example, in a "firm commitment" the underwriter guarantees that a certain amount will be raised by buying the entire offer and then reselling to the public. In a "best efforts" agreement, however, the underwriter sells securities for the company but doesn't guarantee the amount raised. Also, investment banks are hesitant to shoulder all the risk of an offering. Instead, they form a syndicate[22]of underwriters (Co-manager selection). One underwriter leads the syndicate and the others sell a part of the issue.

Once all sides (underwriters, lawyers, accountants etc.) agree to a deal, the investment bank puts together a registration statement to be filed with the SEC[23]. This document contains information about the offering as well as company info such as financial statements, management background, any legal problems and plans for the future. The SEC then requires a "cooling off period," in which they investigate and make sure all material information has been disclosed. Once the SEC approves the offering, a date (the effective date) is set when the stock will be offered to the public.

During the cooling off period the underwriter puts together what is known as the red herring.[24] This is an initial prospectus containing all the information about the company except for the offer price and the effective date, which aren't known at that

[22] A group of bankers, insurers, etcetera, who work together on a large project.

[23] The rules governing the sale of securities derive principally from the Securities Act of 1933. The SEC is concerned solely with disclosure and it has no power to prevent an issue as long as there has been proper disclosure. Some public issues are exempt from registration. These include issues by small businesses and loans maturing within nine months.

[24] A preliminary registration statement that must be filed with the SEC describing a new issue of stock (IPO) and the prospects of the issuing company. There is no price or issue size stated in the red herring, and it is sometimes updated several times before being called the final prospectus. It is known as a red herring because it contains a passage in red that states the company is not attempting to sell their shares before the registration is approved by the SEC.

time. With the red herring in hand, the underwriter and company attempt to hype and build up interest for the issue. They go on a road show - also known as the "dog and pony show" - where the big institutional investors[25] are courted.

Graph 2 IPO Timetable

	Week															
Activity	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
Initial Meeting and Due Diligence	■	■	■													
Draft F-1 and Prepare Audited Financials		■	■	■												
SEC Filing				■												
Draft Roadshow Presentation					■	■	■									
Receive SEC Comments								■								
Respond to SEC Comments/Print and Circulate*									■	■	■	■	■			
Roadshow														■	■	
F-1 Effective and Public Offering															■	
Closing																■

* Timing could be shorter or longer depending on the extent of S.E.C. comments.

As the effective date approaches, the underwriter and company sit down and decide on the price. This isn't an easy decision: it depends on the company, the success of the road show, and most importantly, current market conditions. Of course, it's in both parties' interest to get as much as possible. During the road show the investors give their reactions to the issue and indicate to the underwriters how much stock they wish to buy. Some state the maximum price that they are prepared to pay, but others maybe want to invest so many dollars in the company at whatever issue

[25] A non-bank person or organization that trades securities in large enough share quantities or dollar amounts that they qualify for preferential treatment and lower commissions. Institutional investors face less protective regulations because it is assumed that they are more knowledgeable and better able to protect themselves.

price is chosen. These discussions with fund managers allow the underwriter to build up a book of potential orders.[26]

The underwriters are committed to buy a specific amount of the company's shares, but sometimes they chose to sell more stocks to investors than they are able to sell. If the stock is proved unpopular with investors and traded below the issue price, the underwriters can buy back these stocks in the marketplace. This helps to stabilize the price and gives the underwriters a profit on these extra shares that they sell. In reverse, if the stock at the end of the first day exceeds the price that the underwriters were though to be and they have chosen to sell more than what has been agreed then they suffer a heavy loss because they are obliged to buy shares at a hire price. For these situations companies provide underwriters with a called green shoe option,[27] which allows them to buy an additional amount of shares from the company. This ensures that the underwriters are able to sell the extra shares to investors without fear of loss. The option is usually for an additional 15 percent of the security offering, the maximum allowed. As with any option, the green shoe provision benefits the holder. If the security rises in price immediately after the offering, the underwriter can exercise the option and purchase additional securities from the Company and then sell them at a gain. In most situations, however, the underwriter will exercise the option in order to deliver securities against a short position. This short position is occasioned by satisfying demand for the security in the original and after-market.

Successful underwriting requires financial muscle, considerable experience, and an established reputation. The table below shows that the major investment banks and large commercial banks dominate underwriting in the United States. Foreign

[26] The managing underwriter is therefore often known as the bookrunner.
[27] An option that allows the underwriting of an IPO to sell additional shares to the public if the demand is high. So named because the Green Shoe Company originally used it in an offering.

players are also heavily involved in underwriting securities that are sold internationally.

Table 2 The top managing underwriters January 2001 to September 2001. Values include global debt and equity issues.

Underwriter	Value of Issues (in billion $)	Number of Issues
Merrill Lynch	**353**	**1.566**
Citigroup/Salomon Smith Barney	**334**	**1.039**
Credit Suisse First Boston	**252**	**996**
JP Morgan	**232**	**818**
Morgan Stanley Dean Witter	**211**	**656**
Lehman Brothers	**193**	**660**
Goldman Sachs	**189**	**598**
UBS Warburg	**172**	**690**
Deutsche Bank	**166**	**573**
Banc of America Securities	**125**	**571**

Source: Thomson Financial Investment Banking/Capital Markets (www.tfibcm.com)

Underwriting is not always fun. On October15, 1987, the British government finalized arrangements to sell its holding of BP shares at £3.30 a share.[28] This huge issue involved more than $12 billion and was underwritten by an international group of underwriters who marketed it in a number of countries. Four days after the underwriting was agreed, the October crash caused stock prices around the world to nose-dive. The underwriters unsuccessfully appealed to the British government to

[28] The issue was partly a secondary issue (the sale of the British government's shares) and partly a primary issue (BP took the opportunity to raise additional capital by selling new shares.

cancel the issue.[29] By the closing date of the offer, the price of BP stock had fallen to £2.96, and the underwriters had lost more than a billion dollars.[30]

As someone can see, the road to an IPO is a long and complicated one. Individual investors aren't involved until the very end. This is because small investors aren't the target market. They don't have the cash and therefore hold little interest for the underwriters. If underwriters think an IPO will be successful, they'll usually pad the pockets of their favourite institutional client with shares at the IPO price. The only way for someone to get shares (known as an IPO allocation) is to have an account with one of the investment banks that is part of the underwriting syndicate. But don't expect to open an account with $1000 and be showered with an allocation. You need to be a frequently trading client with a large account to get in on a hot IPO.

It's hard enough to analyse the stock of an established company. An IPO company is even trickier to analyse since there won't be a lot of historical information. The main source of data is the red herring, so someone has to make sure he has examined this document carefully, looking for the usual information, but also paying special attention to the management team and how they plan to use the funds generated from the IPO.

We have described that underwriter as filing a triple role – providing advice, buying the new issue, and reselling it to the public. In return they received payment in the form of a spread, that is, they are allowed to buy the shares for less than the

[29] The government's only concession was to put a floor on the underwiters' losses by giving them the opportunity to resell their stock to the gornment at £2.80 a share.
[30] Richard A.Brealey- Stewart C.Myers, Principles of Corporate Finance, McGraw-Hill, 2003, page 409.

offering price at which the shares were sold to investors.[31] Underwriting spread on an issue amounts about to 7% of the total sum raised from investors. Since some of the costs incurred by underwriters are fixed, someone would expect that the percentage spread would decline with issue size. This partly is true. However, Chen and Ritter found that with almost every IPO between $20 and $80 million the spread was exactly 7%.[32]

Table 3 Cost of an IPO[33]

Sample Costs of an IPO	
SEC Registration Fee	**$ 30,000**
Printing & Engraving Expenses[34]	**250,000**
Legal Fees & Expenses	**750,000**
Accountants' Fees & Expenses	**200,000**
NASD Filing Fee	**30,000**
NYSE Filing Fee	**150,000**
Blue Sky Fees & Expenses	**15,000**
Transfer Agent's Fees & Expenses[35]	**15,000**
Miscellaneous Costs	**210,000**
Total Fees & Expenses	**$ 1,650,000**

[31] In the more risky cases the underwriter usually receives some extra noncash compensation, such as warrants to buy additional common stock in the future.

[32] H. C. Chen and J. R. Ritter, "The Seven Percent Solution," *Journal of Finance* 55 (June 2000), pp.1105-1132.

[33] After considering the relevant section "Other expenses of issuance and distribution" of various prospectuses of companies already exercised an IPO and without including the cost of Underwriters.

[34] Print preliminary and final registration statement/prospectus. In this point we have to mention that the company should select an experienced financial printer, one who is familiar with SEC regulations governing the graphic presentation of a prospectus and has to print sufficient quantities under severe time constraints.

[35] A trust company, bank or similar financial institution assigned by a corporation to maintain records of investors and account balances and transactions, to cancel and issue certificates, to process investor mailings and to deal with any associated problems. Because publicly-traded companies, mutual funds and similar entities often have many investors who own a small portion of the organization, require accurate records and have rights regarding information provision, the role of the transfer agent is an important one. Some corporations choose to act as their own transfer agents, but most choose a third-party financial institution to fill the role.

1.3.1 The Lockup Period

If you look at the charts following many IPOs, you'll notice that after a few months the stock takes a steep downturn. This is often because of the lockup period. When a company goes public, the underwriters make company officials and employees sign a lockup agreement. Lockup agreements are legally binding contracts between the underwriters and insiders of the company, prohibiting them from selling any shares of stock for a specified period of time. The period can be anything from 3 to 24 months. The minimum period stated under Rule 144 (SEC law) is 90 days but the lockup specified by the underwriters can last much longer. The problem is, when lockups expire all the insiders are permitted to sell their stock. The result is a rush of people trying to sell their stock to realize their profit. This excess supply can put severe downward pressure on the stock price.

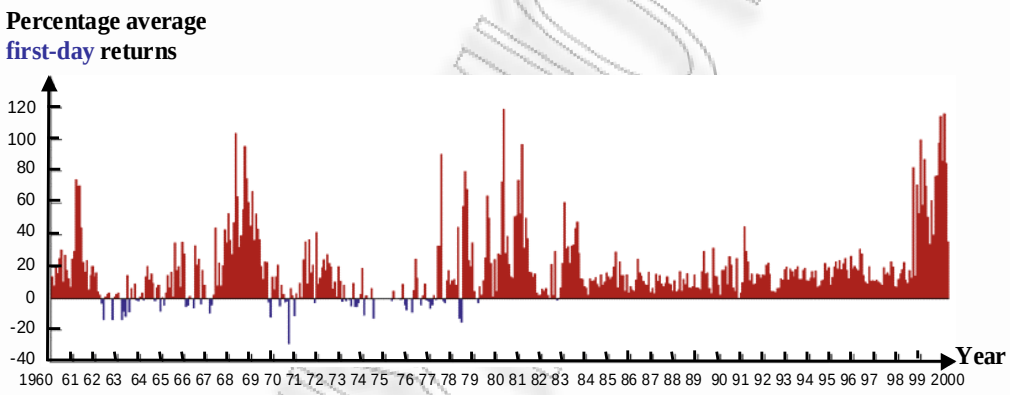
1.3.2 Underpricing

Perhaps the most widely known facet of IPO security behaviour is that of underpricing. On average, firms that conduct an IPO leave extra money on the table because the price that the firm's shares are offered to the public is below what the market is willing to pay for the shares, as evidenced by first-day closing prices. The topic of underpricing has been the focal point of many financial economic papers. In this section, we will briefly (and chronologically) list some of the leading reasons advanced for the existence of underpricing. For a more detailed survey, we would direct the reader to Ibbotson and Ritter (1995).

Baron and Holmstrom (1980) and Baron (1982) argue that underwriters exploit their superior knowledge of the market and underprice issues to minimize

marketing effort and to ingratiate themselves with buy-side clients. Beatty and Ritter (1986) argue that underpricing exists due to the non-transparency or uncertainty about the private firm which chooses to go public. That is, because firms are not transparent and there is a lot of uncertainty surrounding the valuation of the IPO, offering prices are generally biased under unknown future market price. Rock (1986) also argues that the uncertainty or risk of the IPO drives underpricing and that uninformed investors must be compensated for taking the risk of the IPO.

Graph 3 Average first-day returns

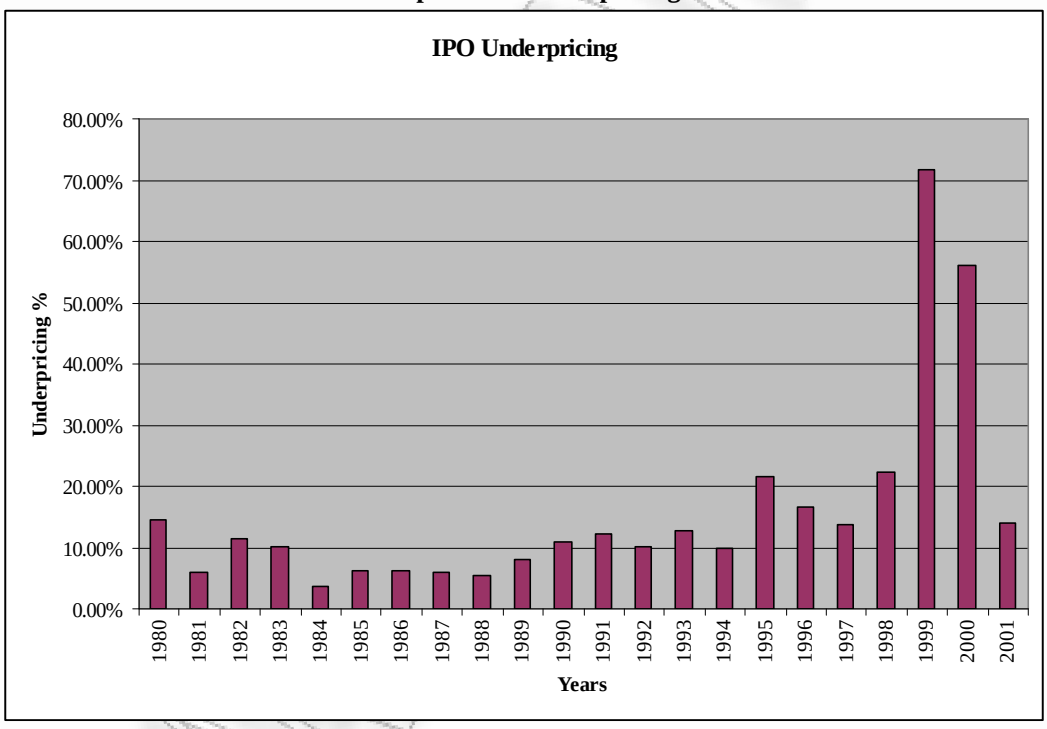


Benveniste and Spindt (1989), Benveniste and Wilhelm (1990), and Spatt and Srivastava (1991) argue that underpricing is a reward to sophisticated investors for divulging accurate valuation information during the book-building process. Tinic (1988), Hughes and Thakor (1992), and Drake and Vetsuypens (1993), advance the idea that underpricing serves as a protection against possible future litigation from investors. Welch (1992) models the idea that underpricing can cause a domino or cascade effect among investors that ultimately raises the demand for the issue. Booth and Chua (1996) argue that underpricing helps ensure a wide base of owners to increase the liquidity of the newly public firm. Along similar lines, Brennan and

Franks (1997) agree that underpricing allows for a wide base of owners but argue the motivation is to entrench management.

Siconolfi (1997) suggests that underpricing permits the practice of spinning, the enriching of executives of prospective investment bank clients. Stoughton and Zechner (1998) argue underpricing allows for the creation of a blockholder that can increase monitoring. Along similar lines of Siconolfi (1997), Aggarwal, (2002), Fishe (2002), and Krigman, Shaw, Womack (1999) argue that underpricing allows for the practice of flipping[36] by favored investors.

Graph 4 IPO Underpricing



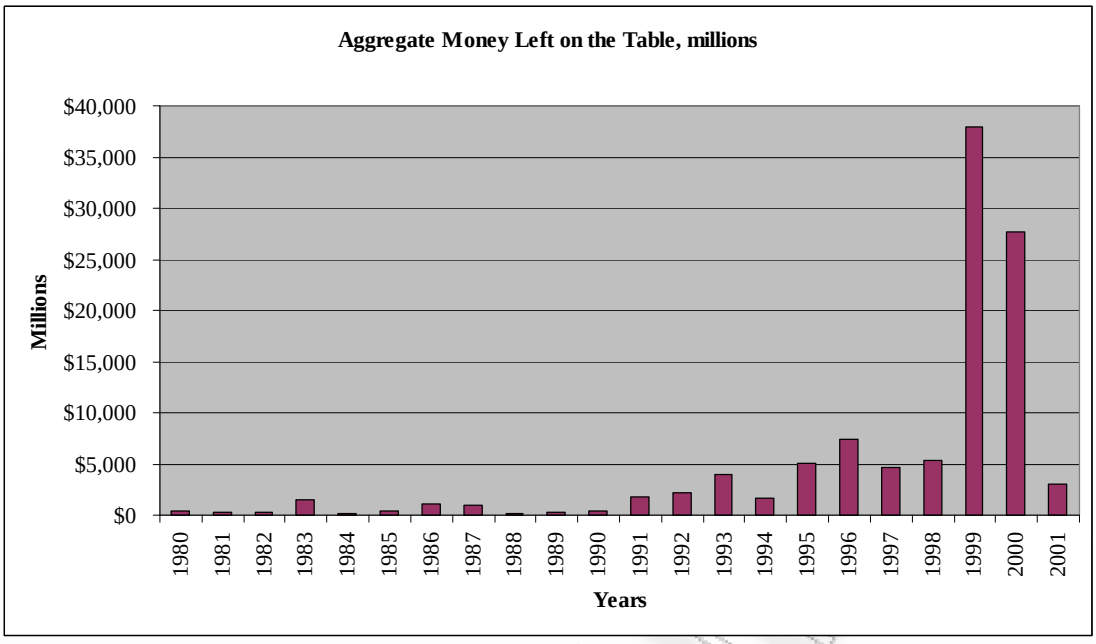
Source: Ritter, Jay Rial and Welch, Ivo, (2002), A Review of IPO Activity, Pricing and Allocations, Yale ICF Working Paper No. 02-01

[36] Flipping is reselling a hot IPO stock in the first few days to earn a quick profit. This isn't easy to do, and you'll be strongly discouraged by your brokerage. The reason behind this is that companies want long-term investors who hold their stock, not traders. There are no laws that prevent flipping, but your broker may blacklist you from future offerings or just smile less when you shake hands. Of course, institutional investors flip stocks all the time and make big money. The double standard exists and there is nothing we can do about it because they have the buying power. Because of flipping, it's a good rule not to buy shares of an IPO if you don't get in on the initial offering. Many IPOs that have big gains on the first day will come back to earth as the institutions take their profits.

Pulliam and Smith (2000, 2001) assert that underpricing allows underwriters to receive quid pro quos from buy-side clients. Habib and Ljungqvist (2001) argue underpricing allows for cost savings in other areas of marketing the issue. Boehmer and Fishe (2001) demonstrate that underpricing increases the after-issue trading volume of the stock. Ljungqvist and Wilhelm (2002) argue that underpricing enriches friends and family through directed share programs. Loughran and Ritter (2002) advance a behavior theory that issuers are pleasantly surprised with the amount they can raise in the IPO and are not significantly concerned with the underpricing. Finally, Demers and Lewellen (2003) argue underpricing brings attention to the stock on the opening day. From empirical evidence on underpricing is stated that Chief Financial Officers are well informed regarding expected underpricing. They perceive the IPO process to be generally rational, attributing most underpricing to market uncertainty and the need to reward investors for taking the risk of the IPO. CFOs report little concern that underwriters are gaming the IPO process for their own benefit.

Graph 5 Aggregate money left on the table

UNDER PEER REVIEW



Source: Ritter, Jay Rial and Welch, Ivo, (2002), A Review of IPO Activity, Pricing and Allocations, Yale ICF Working Paper No. 02-01

When the offering price is less than the true value of the issue securities, investors who buy the issue get a bargain at the expense of the firm's original shareholders. These costs of underpricing are hidden but nevertheless real. For IPOs they generally exceed all other issue costs. Whenever any company goes public, it is very difficult for the underwriters to judge how much investors will be willing to pay for the stock. Sometimes they misjudge demand dramatically. For example, when the prospectus for the IPO of Netscape Stock was first published, the underwriters indicated that the company would sell 3.5 million shares at a price between $12 and $14 each. However, the enthusiasm for Netscape's Internet browser system was such that the underwriters increased the shares available to 5 million and set an issue price of $28. The next morning the volume of orders was so large that trading was delayed by an hour and a half and, when trading did begin, the shares were quoted at $71, over five times the underwriters' initial estimates.

It is admitted that the Netscape issue was unusual but researchers have found that investors who buy at the issue price on average commonly realize very high

returns over the following weeks. For example, a study by Ibbotson, Sindelar, and Ritter[37] of nearly 15,000 U.S. new issues from 1960 to 2000 found average underpricing of 18.4 percent. The table 4 shows that the United States is not the only country in which IPOs are underpriced. In Brazil the gains from buying IPOs have averaged nearly 80%. China's initial returns have averaged 257%.

Someone might think that shareholders may prefer not to sell their stock for less than its market price, but many investment bankers and institutional investors argue that underpricing is in the interests of the issuing firm. They say that a low offering price on the initial offer raises the price of the stock when it is subsequently traded in the market and enhances the firm's ability to raise further capital.[38] Skeptics respond that investment bankers push for a low offering price because it reduces the risk that they will be left with unwanted stock and makes them popular with their clients who are allotted stock.

UNDER REVIEW

[37] R. G. Ibbotson, J. L. Sindelar, and J. R. Ritter,"The Market's Problems with the Pricing of Initial Public Offerings", *Journal of Applied Corporate Finance* 7 (Spring 1994), pp.66-74

[38] I. Welch, "Seasoned Offerings, Imitation Costs and the Underpricing of Initial Public Offerings,"*Journal of Finance* 44 (June 1989), pp. 421-449.

Table 4 Average Initial Returns in world stock exchanges

Country	Source	IPOs	DATE	Average Initial Returns
ENGLAND	Dimson;Levis;Ljungqvist	3.122	1960-2001	18,4%
AUSTRALIA	Lee-Taylor & Walter	381	1976-1995	12,1%
AUSTRIA	Aussenegg	83	1984-2002	6,3%
BELGIUM	Rogiers-Manigart-Ooghe;Manigart	86	1984-1999	14,6%
BRAZIL	Aggarwal-Leal & Hernandez	62	1979-1990	78,5%
FRANCE	Husson&Jacquillat;Leleux&Muzyka ; Paliard & Belletante ;Derrien & Womack;Chahine	571	1983-2000	11,6%
GERMANY	Ljungqvist	407	1978-1999	27.7%
DENMARK	Jakobsen & Sorensen	117	1984-1998	5,4%
SWITZERLAND	Drobetz,Kammermann & Walchli	120	1983-2000	34,9%
GREECE	Kazantzis & Thomas; Nounis	338	1987-2002	49,0%
U.S.A.	Ibboston-Sindelar & Ritter	14.840	1960-2001	18,4%
JAPAN	Fukuda,Dawson&Hiraki, Hebner&Hiraki,Pettway&Kaneko, Hamao,Packer&Ritter	1.689	1970-2001	28,4%
INDIA	Krishnamurti & Kumar	98	1992-1993	35,3%
SPAIN	Ansotegui & Fabregat; Otero	99	1986-1998	10,7%
ISRAEL	Kandel-Sarig & Wohl;Amihud, Hauser & Kirsh	285	1990-1994	12,1%
ITALY	Arosio,Giudici & Paleari ; Cassia, Paleari & Redondi	181	1985-2001	21,7%
CANADA	Jog & Riding; Jog & Srivastava; Kryzanowski & Rakita	500	1971-1999	6.3%
CHINA	Datar & Mao; Gu and Qin (A shares)	432	1990-2000	256,9%
KOREA	Dhatt, Kim & Lim; Ihm; Choi & Heo	477	1980-1996	74,3%
MALAYSIA	Isa; Isa & Yong	401	1980-1998	104,1%
MEXICO	Aggarwal-Leal & Hernandez	37	1987-1990	33,0%
NEW ZELAND	Vos & Cheung; Camp & Munro	201	1979-1999	23,0%
NIGERIA	Ikoku	63	1989-1993	19,10%
NORWAY	Emilsen-Pedersen & Saettern	68	1984-1996	12,50%
HOLLAND	Wessels,Eijgenhuijsen & Buijs	143	1982-1999	10,2%
PORTUGAL	Ljungqvist, Jenkinson & Wilhelm Alpalhao & Duque	21	1992-1998	10,6%
SINGAPORE	Lee-Taylor & Walter;Dawson	441	1973-2001	29,5%
SWEDEN	Rydqvist;Schuster	332	1980-1998	30,5%
TAIWAN	Lin & Sheu; Liaw, Liu & Wei	293	1986-1998	31,1%
THAILAND	Wethyavivorn & Koo-smith; Lonkani & Tirapat	292	1987-1997	46,7%
INDONESIA	Hanafi; Ljungqvist & Yu	237	1989-2001	19,7%
POLAND	Jelic & Briston	140	1991-1998	27,4%
SOUTH AFRICA	Page & Reyneke	118	1980-1991	32,7%
TURKEY	Kiymaz;Durukan	163	1990-1996	13,1%
FINLAND	Keloharju;Westerholm	99	1984-1997	10,1%
PHILLIPPINES	Sullivan & Unite	104	1987-1997	22,7%
CHILE	Aggarwal,Leal&Hernandez; Celis & Maturana	55	1982-1997	8,8%
HONG-KONG	McGuinness;Zhao & Wu Ljungqvist and Yu	857	1980-2001	17,3%

Source: Ritter, J.R., (2003), Differences between European and American IPO Markets, European Financial Management, Vol. 9, pp. 421-434

Ultimately, the IPO process is fairly well understood and rationally managed. The decision and the timing to go public depend heavily on the trade-off between control and opportunity for return. Private companies have not found the potential financial returns large enough to pursue an IPO. By contrast, firms that have successfully gone public have identified the opportunity, weighed the costs, and worked with credible intermediaries to manage the process in an appropriate and timely manner. They report that the barriers to going public are manageable and appear to be satisfied with the outcome. Finally, CFOs at companies that withdrew from the IPO process indicate that they were anxious to go public until market conditions changed, reducing the return and the desire to proceed.

1.4 The world financial system and types of finance in shipping

Looking back, a simple historical review can teach us on many ways of financing shipping, showing how the financial techniques employed have changed from one decade to another. Raising ship finance is essentially a matter of persuasion, so a good starting point for someone is to answer two basic questions regarding "where does the money to finance ships come from" and "what do businessmen have to do to get it"?

Looking below the Table 5[39] someone can easily understand the world financial system, the source investment funds, the markets and the "arrangers".

Ø **Investment funds come from savings:** the money comes from corporate or personal "savings" which need to be invested. Nowadays about 80% of savings end up in the hands of professional investment managers such as insurance companies,

[39]Martin Stopford, "Maritime Economics", Second Edition, Routledge, London 1997. page 201

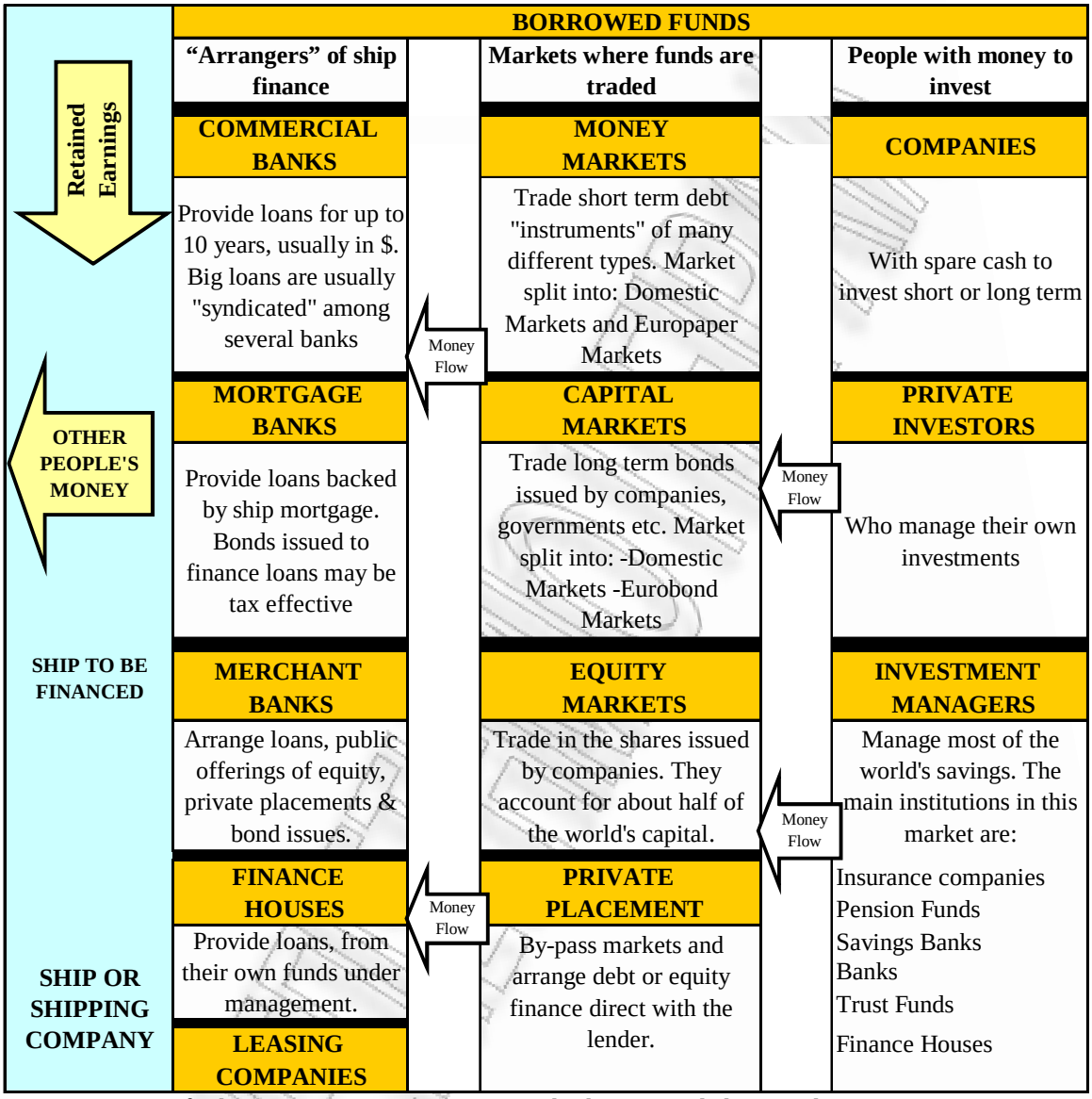
pension funds, savings banks, finance houses, trust funds and commercial banks who take money on deposit, so called "institutional investors"[40].

Ø **Investors and lenders:** someone can invest the money, or he can lend it. The investor commits his funds to a business venture in return for a share of profits. Usually he only gets his money back by selling his "equity" stake in the business to someone else. In contrast, the lender advances money for a predetermined period in return for regular interest payments. By the end of the agreed period the "debt" must be repaid in full. This is an important distinction for anyone trying to raise finance because investors and lenders see the world from a very different perspective. Investors take risk for profit, so they are interested in the upside.

Ø **Private placement of debt or equity:** one method open to "fund managers" by placing funds directly with companies who need finance. The lender, who might be a pension fund or an insurance company, negotiates a financial agreement to suit both borrower and lender. The structure of this agreement could be either dept or equity. This method although it is widely used appears practical difficulties such as the administrative task of analyzing detailed investment proposals, the loan or investment is not liquid and after the transaction is placed, there is little the investor can do to adjust his portfolio of such loans and investments. In practice this market is only accessible to shipping companies of investment grade quality.

[40] These investors are spread around the financial centers of Europe, North America and the Far East. Their investment behavior is restricted and to some extent determined both by the regulatory framework within which they operate (which is different in Tokyo, London and New York) and the policies implicit in their own particular business. For example liquidity is less important to institutions such as life insurance companies, which invest huge amounts of money for the "long haul". On the contrary, liquidity will be of prime importance to the corporate treasurer investing spare cash, which he may need to draw on at any time. Other implications are the currency in which assets are held and commitments must be paid.

Table 5 Where the money comes from to finance ships



Sourse: Martin Stopford, "Maritime Economics", Second Edition, Routledge, London 1997. page 201

Ø **The financial markets buy and sell packaged investment funds:** the world financial system has succeeded in developing markets, which trade investments as commodities. In these markets investment "packages" are bought and sold in a standardized form called "securities"[41]. Securities markets are strictly regulated to

[41] Martin Stopford, "Maritime Economics", Second Edition, Routledge, London 1997, page 203

ensure that the rules are followed. There are three different markets trading in different types of security:

- ***Money Markets***: trade in short-term debt (less than a year). The market consists of a loose network of banks and dealers, who deal in anything, which is sufficiently standardized and credit-worthy to be traded.[42]
- ***Capital Markets***: trade in longer-term debt finance instruments known as "bonds" or "debentures". Borrowers issue bonds, via a dealer, which repay the holder a specified sum of money on a prescribed maturity date, e.g. in 10 years. Interest is payable by redeeming coupons attached to the bonds and reflects the credit rating of the issuer (less than BBB are known as "high yield bonds"). In order to make them readily tradable, publicly issued bonds have to be highly standardized.[43] Dealings in offshore funds are referred to as the "Eurobond" market.
- ***Equity Markets***: traded in equity shares (also known as securities or stocks). This allows credit-worthy companies to raise capital by means of a 'public offering" on the stock market. To raise capital in this way a company must follow regulations (for example, laid down by the SEC in the United States) and convince the shareholder that the investment will be a good one.[44]

The job of the markets is to channel funds to where they can be used most productively. The markets are highly regulated. To raise capital a shipping company

[42] For example treasury bills, short-term tax-exempts, certificates of deposit, commercial paper, bankers acceptances or short-term euro currency deposits. Because it is an efficient market, at any given time there is a standard price for a given combination of liquidity, risk and yield.

[43] To achieve this there are various regulatory requirements designed to provide security for the purchaser of the bonds. In order to issue the bonds a company must have a credit rating, for example, by Standard and Poors in the USA. The quality of this rating determines the risk associated with the bonds – bonds issued by companies rated less than BBB are popularly known as "junk bonds" and they attract higher rates of interest. Naturally, many financial institutions hold portfolios of long dated bonds.

[44] Usually this demands evidence that the company has a profitable trading record in an industry, which is considered to have a profitable future.

must achieve recognized standards of "credit-worthiness". Companies who wish to borrow money in the Money and Capital markets must first obtain a credit rating. Credit rating agencies such as Standard & Poors and Moodys regularly monitor the performance of companies and publish a rating of their credit worthiness. This means that purchasers of bonds and commercial paper have a guide to the company's credit worthiness. They look up the issuing company's credit rating. In short, the markets act as a sophisticated "risk filter".

1.4.1 Financing ships with equity

The shipping company is seeking investors who will take a stake in the company, sharing the risks and receiving the rewards. Currently there are four types of financial structure used for raising equity:

Ø **Owner equity and cash flow finance:** the first and most obvious way of financing ships is with equity derived from the owner's private resources, the earnings of other ships he owns, or possibly direct investment by close friends or members of the family. Most shipping companies finance at least part of their activities from internally generated equity, though the proportion varies enormously.

Ø **Public offering of equity:** shipping companies can also raise equity by arranging a public offering on one of the stock exchanges around the world. New York, Oslo, Hong Kong, Singapore and Stockholm are all used for public offerings of shipping stock. A prospectus is drawn up offering shares in the company, to be listed on a specified stock exchange. The listing of equity is very important because it gives investors liquidity in the sense that they can buy or sell shares at any time. (See paragraph 1.3 for detailed description of the initial public offering process).

Ø **Partnership structures:** during the late 1980s substantial amounts of partnership capital raised through the Norwegian K/S limited partnerships. It is

estimated that during that period about half of the Norwegian shipping industry operated through K/S companies and during 1987/9 investors of K/S partnerships committed equity of $3 billion. This type of financial structure offered investors tax advantages. In the early 1990s these tax benefits were much reduced and the K/Ss, which had obtained a mixed reputation after a series of losses, fell out of favour.

Ø **'Ship funds' and private placement of equity:** a Ship Fund is an investment vehicle designed for the specific purpose of allowing equity investors to invest in merchant ships. As an investment it proved extremely successful but it faced two problems. First, the equity must be raised before the ships can be purchased, facing the organizers with the difficult task of finding good quality ships at very short notice. Second, their commercial and management structure is ambiguous. They are not shipping companies because they have a limited life, but they are charged with running ships over a fairly long period. Both these problems arise from the perception of ships as commodities, in terms of ongoing management they are complex engineering structures. Efforts to 'package' them as commodities brought a whole range of risks which neither the organizers nor the investors in ship funds had anticipated. Only two or three of the ship funds produced a commercial return for investors. The table in the next page indicates the traders of ship finance equity for the period June 15, 2004 to July 30, 2004. It is obvious that Jefferies & Company, Inc. is the top trader of ship finance equity with far distance from the second trader. Actually Jefferies is a well known firm, specialized in shipping. During the time these lines were written the status of many equity deals were as the table below indicates:

Table 6 Various equity deal table as of December 2004

Issuer	Underwriters/Advisors	Amount (US$ M)	Status
OMI	Jefferies	$72	Done
Dry Tank	Cantor Fitzgerald, DZ Financial Markets	$100	In progress
Teekay LNG	Citigroup, UBS, Jefferies, Deutsche	$133	In progress
Teekay Shipping		circa $154	Authorized
Ship Finance International		$5+	Done
Siem Offshore	Deutsche Bank, Pareto, Fonds Finans	$175	
NAT	Bear Stearns, UBS, DnB NOR	$120 (including shoe)	Done
Arlington Tankers	UBS, Jefferies, Bear Stearns, Fortis, HSBC	$229	Done
Excel Maritime	Cantor Fitzgerald	up to $200	In progress
International Shipping Enterprises	Sunrise Securities	circa$102	In progress

Sourse: Freshly Minted, Marine finance weekly by Marine Money, Issue 2, December 2, 2004

UNDER EMBARGO

1.6 Shipping Companies & Capital Markets

Many shipping companies in developed shipping countries such as the USA, Japan, South Korea, Norway and Greece, have floated their shares on the stock exchanges. Sloggett (1984) confirms that such countries encourage their shipping companies to offer their shares to the public in the stock exchanges.

According to the pecking-order process of Myers (1984), firms prefer internal financing, issuing debt and issuing equity, respectively in order to finance their investments. Myers and Majluf (1984) state the rationale that the firms are often reluctant to issue equity to fund new investments.

As Nielson (1976) state that Pareto optimality may cause people to invest on the risky assets in the stock exchange market. Those assets may cause their investors to make an abnormal return or to lose the money they invest which is preferred by the risk lover investors. Also they note that the allocative efficiency of the capital market is not influenced and the capital market is perfectly competitive. But on the other hand, if the market is not rich enough in instruments for authorizing a Pareto optimal arrangement, firms may not be able to have Pareto optimal decisions. Nielson (1975) finds out that efficiency of capital markets and the Pareto optimality of capital markets is available only if the capital market is complete. Furthermore, as stated by Danthine and Donaldson (2001), in a Pareto efficient allocation of any resources, it is not possible to make someone better off without making someone else worse off.

In the shipping industry, stock markets are too risky, unpredictable and unreliable to warrant for people (Branch, 1988). Shipping market can be individually grouped like bulk, cargo or cruise ship in itself; the asset prices may vary cross-sectionally too. Lorange and Norman (1972) have demonstrated that the shipping industry has a higher level of uncertainty compared to other industries. Alike Erdogan

(1996), Kavussanos, et al. (2003) calculate the systematic risk coefficients (β) for shipping firms. Both studies prove that most of the betas are less than 1. In contrary to the Branch, small betas mean that the systematic risk level of the shipping firms is comparatively less. However, this does not necessarily mean that the unique or unsystematic risk will be less. Finally, Leggate (2000) highlights that an extremely high demand for capital to replace ageing assets against a background of contraction of traditional credit facilities. Regarding the mentioned literature and the risky behavior of the shipping industry, it is logical to distinguish that maritime firms have not been very close to the capital markets.

1.6.1 Maritime Industry in World Stock Markets

Firms have been very motivated to offer their shares in stock exchanges especially since 1980s. However, maritime firms have lagged behind the other industries' firms. While in a few well-known capital markets hug shipping firms in their lists, maritime firms are absent in the remaining markets.

Table 6 Water Transportation Companies in Stock Exchanges

Stock Exchange	Market Value (USD)	Total Market Cap. (USD)
Oslo Stock Exchange	**4,3 B**	**110,7 B**
NYSE	**19 B**	**11,9 T**
Athena Stock Exchange	**1,35 B**	**107.5 B**
Tokyo Stock Exchange	**16.9 B**	**3.3 T**
London Stock Exchange	**8,68 B**	**2,5 T**

Source: All data is received separately from related official web sites of exchanges.
1: Transportation companies are included. Data is as of March 2004.
2: There are 29 stocks in this industry as of March 2004.
3: Passenger shipping, Shipyards, Transport Related Services, Transport Rental Services, and Freight Forwarding are included. Data is as of March 2004.
4: Marine transportation firms are included. Data is as of the end of March 2004.
5. Shipping and Ports firms are included. Data is as of March 2004.

As seen from Table 8, the share of shipping firms in terms of market capitalization is 3.8% for the Oslo Stock Exchange, 0.16% in the NYSE, 1.25% in the Athena Stock Exchange, 0.5 % in the Tokyo Stock Exchange, and 0.3 % in the

London Stock Exchange. In any case, the total capitalization of those firms in main five stock exchanges is USD 50, 23 billion.

From the valuation perspective, although the share prices of the water transportation companies increased dramatically since the Iraq invasion in 2003, existing market prices of this industry is relatively low, compared to the other transportation industries as per Table 9. In case that the price-to earnings ratio of water transportation will rise to the level of Airline Industry, the expected prices for shipping firms shares would increase about 50%. Besides, the market-to-book value ratio confirms this valuation. The ratio of the transportation industry is 3.69, while it is 1.37 for the water transportation sector.

With the increasing popularity of the water transportation as mentioned earlier, the use of equity financing has become more attractive to the shipping firms for the last few months.

Table 7 Sub-Industry Comparison of Market Characteristics in Transportation

Industries	P/E	Market to Book Value
Air Courier	**24.26**	**2.52**
Airline	**30.98**	**4.04**
Misc. Transportation	**44.2**	**4.86**
Railroads	**14.77**	**1.26**
Trucking	**21.75**	**5.06**
Water Transportation	**19.57**	**1.37**
Transportation Sector	**23.14**	**3.69**

Source: Marine Money, February 2004.

Table 8 Main Equity Deals from Shipping Companies in 2003

Date	Company	Size (US$ M)
Nov-03	OMI	Up to $57 mm
Nov-03	NOL	$308 mm
Oct-03	Malaysian Bulk Carriers	$100 mm
Oct-03	STX Shipbuilding	approx. $60 mm
Oct-03	Star Cruises	$180
Jul-03	Golar LNG	$57
Jul-03	Modec International	$26
Feb-03	Noble Group	SGD 45
Feb-03	Sinotrans	441.3
Feb-03	Teekay	144

Source: Marine Money, Vol.20, No.2, February 2004, p.37.

As we can see clearly from the table 10 above, during the year 2003 the trend of finance in shipping was through public offerings of equity. In the next paragraph we will try to analyse the main reasons for this trend and we will also try to explain the main characteristics which will guide us in our decision to sell part of our Shipping Company in the US capital markets.

1.6.2 The IPO Choice in Financing of Maritime Firms

Unseasoned new issue or initial public offering (IPO) is the first public equity issue that is made by a company. In this choice of financing, firms need to decide the amount of required capital, the change in leverage, and the cost of capital. Especially in perfect markets, there would be no need for the analysis of selection between the financing tools according to Modigliani & Miller (1958). However, under imperfect conditions of today's markets, firms cannot be indifferent about the cost of capital and timing for the selection of different capital resources.

Considering the pecking-order process, as firms increase the use of initial financial resources, they will need the following ones. For instance, if a firm is already using only bank credits, it will seek the possibility of issuing bonds and stocks, respectively.

Table 9 A Pecking Order Process for Maritime Firms

Existing Shareholders Capital (Paid-in Capital)
Bank Credits +Leasing
Internal Capital Sources (Retained Earnings)
Bond Issue
Mezzanine Finance[45]
Equity Finance

To start up a firm, first of an entrepreneur will need his/her own capital for paid–in capital. During the first years of the company the firm uses short-term credits. Depending upon the industry type, either in short run or in long run the firm may look for new shareholders to share its partnership in the company. Besides the advantages of going public, the disadvantages arise from the cost, ownership and corporate governance reasons. Provided that the ownership and corporate governance problems

[45] "Mezzanine finance lies between the balcony senior debt and basement equity." See. Ross, et al. (2002, p.575) and Stopford (1997, p.206).

are eliminated, more maritime firms can spontaneously enter the equity market. The only obstacle in this case may be the inadequacy of the funds in the capital market.

1.6.3 Overview of U.S. capital markets

Many financial analysts have stated that we are covering a very exciting time to access U.S. capital markets. A review what we have seen in shipping over the last 4 years can easily convince us that this is the case. We have seen a rapidly growth in equity markets as well as in senior notes. As the table below shows during the year 2004 we had one IPO but three Follow-ons. Average returns in equity investors have received from the market are phenomenal with normal corporate companies to receive about 100% in year 2004, and yield oriented companies to receive about 250% in the same year. Many of the investors, the previous year they did not even think of invest in shipping, but the last four years due to the low interest rates, the decreased tax on dividends and the low volatility in equity markets became such that industry dynamics are such that investors are willing to invest both debt or equity.

The Price/Net Asset Value index for normal corporate companies in 2001 was 82% and in 2004 became 123%. On the other hand, for yield-oriented companies the same index from 209% in year 2001 became 228% in year 2004. Thus, the market capitalization of industry and the weekly trading volume has growth over four times from 2001 to 2004.

Regarding the senior notes, the best market issues were in 2003 with five new issuances. As we can see the interest rates are turning down for B rated and BB rated which is very attractive for growing companies who need cash flow to reinvest their money. Moreover, senior notes have flexible covenants that's why are ideal for growing companies.

Table 10 Overview of U.S. tanker Capital Markets

		2001	2002	2003	2004
Equity					
	Number of IPOs	2	1	0	1
	Number of Follow-ons	0	1	0	3
	Average Return Normal Corporate Companies	-12%	1%	102%	94%
	Average Return Yield Oriented Companies	-13%	4%	16%	256%
	Price/Net Asset Value - Normal Corporate Companies	82%	101%	113%	123%
	Price/Net Asset Value - Normal Yield Oriented Companies	209%	225%	165%	228%
	Market Capitalization of Industry (millions)	$ 3,983	$ 3,480	$ 4,482	$ 12,794
	Weekly Trading Volume (millions)	114%	62%	111%	466%
Senior Notes					
	Number of new issuances	1	0	5	1
	Average Yield				
	B Rated	NA	NA	7.41%	6.98%
	BB Rated	8.68%	8.26%	6.94%	6.76%

Source: 6th Annual Marine Money Greek Ship Finance Forum, The U.S. Capital Markets – A Summary, October 2004

As we have already mention the timing to access the U.S. capital markets is three to four months depending from the parties involved such as the lawyers, accountants, etc. The cost for underwriting fee is approximately 7% and legal and other expenses are about $1.5 million. The difference between normal corporate and yield oriented is that the IPO valuation is lower in normal structure ranging between 100 and 120% rather than in yield oriented which is between 130% and 150%. In this point we have to mention that if structured as a yield–oriented company, dividend policy would be to distribute substantially all of the company's cash flow. This is very attractive to some shipowners, they trade the cost benefit and retain their cash. This is the reason why lately we see more people be yield oriented. In senior notes, the timing of an issuance is approximately six weeks depending on availability of audited financial information. The cost varies between 2.5% and 3.5% depending on offering size and rating. They have 7.5% to 9.5% coupon depending on size and leverage.

The company size requirements for an IPO depend from the EBITDA.[46] EBITDA is earnings before interest, taxes, depreciation and amortization, and it portrays the total operating cash flow of a company. To the extent that all such cash flow can be dedicated to debt service, EBITDA is appropriate to use in the numerator of the coverage ratio. However, certain capital expenditures may be necessary to keep the business operating. To the extent that these expenditures approximate depreciation and amortization, EBITDA is not a good measure of the cash available for debt service. As the below table shows for normal corporate the minimum EBITDA is $50-60 million and for yield oriented is $20-25 million. The market capitalization is $200 million and the offering size $50 million. For senior notes EBITDA can be lower.

Table 11 Company size requirements

IPO		
	Minimum EBITDA	
	Normal Corporate	$50 to $60 million
	Yield Oriented	$20 to $25 million
	Market Capitalization	$200 million
	Offering Size	$50 million
Senior Notes		
	Minimum EBITDA	$10 to $15 million
	Pro forma Credit Statistics	
	Net Debt/EBITDA	5.0x or less
	EBITDA/Net Interest	2.0x or greater

Source: 6th Annual Marine Money Greek Ship Finance Forum, The U.S. Capital Markets – A Summary, October 2004

There are two types of company structures as the table 14 below indicates. The one of normal corporate structure and the other one of yield oriented structure. In both types of company structure we recognize positives and negatives aspects. Some of the positive aspects of the corporate structure are: the lowest execution risk, the kind of this structure is more familiar to investors, there is a significant demand for

[46] This is defined as earnings before interest, taxes, depreciation and amortization.

institutional investors, the potential growth through retained cash flow and management incentives.

Table 12 Structure overview

	Corporate Structure	Yield Structure
Charter Structure	Ø Spot Ø Time charters Ø Bareboat charters	Ø Spot Ø Time charters Ø Bareboat charters
Dividend Policy	Ø Optional Ø Fixed or variable Ø Can be changed	Ø Dividend substantially all cash, less reserves Ø Can be changed
Leverage	Ø Can be highly levered	Ø Relatively unlevered
Growth	Ø Highest growth because cash flow is retained	Ø Growth funded by equity and debt offerings Ø Can use undrawn facility for acquisition financing
Valuation	Ø P/NAV of 100% to 120% Ø TEV/EBITDA of 5.0x to 7.0x	Ø P/NAV of 130% to 150% Ø Equity yield 11% to 14%

Source: 6th Annual Marine Money Greek Ship Finance Forum, The U.S. Capital Markets – A Summary, October 2004

In addition, advantages of yield structures are: potentially higher valuation throughout cycle, allows accretive acquisitions, less execution risk, this kind of structure has existed for seven years in the shipping industry, significant institutional and retail demand and last the lowest cash breakevens. On the other hand the negative aspects of the corporate structure are, the lower valuation, the valuation may be limited by the Net Asset Value, requires active management and higher breakeven rates depending on leverage. Regarding the disadvantages of yield structures are: the assets deplete if cash is not reinvested, growth funded by additional share offerings and significant number of bareboat charters may cause company to be a passive foreign investment company, which will limit institutional investments.

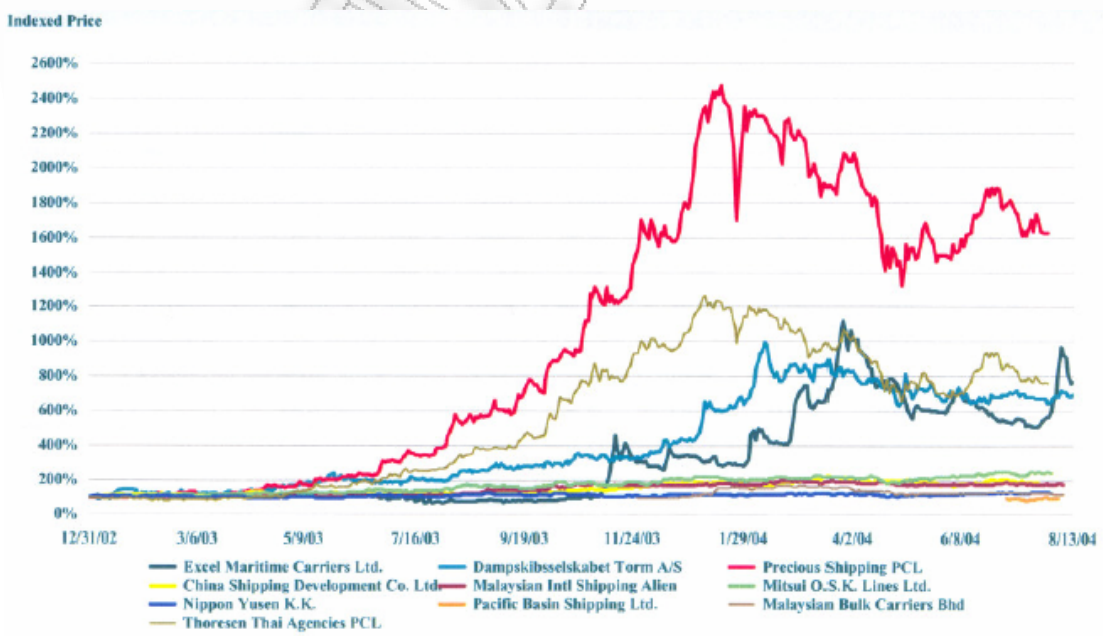
Table 13 Relative pricing of public US shipping companies

	Price/EPS			Price/Cash Flow			TEV/EBITDA		
	2003	2004E	2005E	2003	2004E	2005E	2003	2004E	2005E
Oil Tankers									
OMI Corporation	11.5x	6.5x	7.2x	7.6x	5.0x	5.2x	9.6x	5.8x	5.6x
Stelmar Shipping	12.6x	7.8x	5.4x	7.0x	4.8x	3.8x	10.4x	8.4x	7.2x
Tsakos Energy Navigation	9.9x	6.0x	6.4x	5.9x	4.3x	4.5x	9.0x	6.5x	6.5x
TORM	14.3x	6.0x	6.0x	9.8x	4.8x	4.8x	12.9x	6.1x	6.0x
Container/Dry Bulk									
CP Ships	18.7x	11.1x	9.2x	8.4x	5.7x	5.6x	8.6x	7.1x	6.7x
Norden	12.9x	4.0x	4.9x	11.8x	4.3x	4.5x	13.7x	3.6x	4.0x
Average	**13.3x**	**6.9x**	**6.5x**	**8.4x**	**4.8x**	**4.7x**	**10.7x**	**6.2x**	**6.0x**

Sourse: Jefferies & Company Inc., August 2004

As the table above with the relative pricing of US public shipping companies indicates, adding common multiples such as P/EPS, P/CF and TEV/EBITDA, some of the shares look pricy on 2005 multiples. This goes for CP Ships and OMI Corporation. On the other hand if we take into account the share performance of dry bulk shipping companies all over the various stock exchanges we see that the performance of stock for some companies (e.g. Precious Shipping PLC) since January 1, 2003 till August 12, 2004, reach 1525% change.

Graph 6 Dry Bulk Company Public Market Performance



Sourse: Lehman Brothers, Equity Market Alternatives, Presentation August 2004.

1.6.4 Advantages & Disadvantages

The private company, which has gone public, obtains the benefits of public trading of its securities, namely:

- ***Increased liquidity of the ownership of the company.***

This is clearly one of the most important advantages of going public. Shipping involves mainly the owning and operating of vessels. These vessels are assets that can be sold rather easily. In a sense vessels are viewed as liquid assets however undoubtedly shares can be traded in an easier manner something, which gives more comfort to the shareholders.

Going public makes it easier for company shareholders to sell their shares by creating a public market for the company's stock. Shareholders who register their shares in the company's offering hold freely tradable shares once the offering is completed. Even the shares that are not registered in the offering become more liquid. Because of the offering and the periodic reporting requirements it imposes on the company, they often qualify after a prescribed period of time to sell limited numbers of their shares under Rule 144[47]. If they want to sell more shares than Rule 144 permits, they can benefit from easier and less expensive methods available for registering their shares that are available to public companies.

- ***Higher valuation, above net asset and book value.***

In the shipping industry this is something that has a great importance for the shareholders. Further to the liquidity of the shares there might be the case where the net asset value of the company is less that the market capitalization of the company. Of course history has shown that usually shipping company's shares have been traded

[47] www.sec.gov/about/forms/rule144.pdf

at a lower price than their net asset value. However we believe that in the following years, investors will realize that shipping is an industry where in a well structure company an added value can be found and worth higher than their net asset and book values.

- ***Access to the capital markets: equity, convertibles and debt securities***

By entering the capital markets automatically the company "gets closer" to various financial instruments. In a volatile market such as shipping being able to do that is a considerable advantage towards the other shipping companies. Access to cash at times when are needed was always a great obstacle that shipping companies had to overcome.

Most public offerings raise a significant amount of equity capital and thus dramatically improve the company's net worth and debt-to-equity ratio. This, in turn, makes it easier for a company to borrow money from commercial lenders at competitive interest rates. Also, an existing public market for the company's stock makes it easier for the company to sell additional equity. If the company's stock does well (that is, increases in price), the company can offer for sale additional shares of stock or a new class of stock.

- ***Lower cost of capital due to disclosure and liquidity of securities***

Stakeholders of a shipping company gone public view favorably the disclosure and the liquidity which results in a lower cost of capital. Going public is often triggered by management's belief that it can raise more money and get a better price for its stock by selling to the public than to a venture capitalist or other private investor. When this is true, a public offering can raise money at less cost and with less dilution of management's shareholdings.

Going public becomes cost effective for most companies when they finally meet the profile required to attract institutional investors to the offering. While these profiles vary according to market conditions and offering company industry, it generally requires sustained growth and profitability over a significant period of time, a company valuation of at least $10 million, and prospects for continued growth at a rate greater than the industry average. When a company matures to the point of meeting this profile, its ability to attract institutional investors often boosts the price of its stock high enough to make going public the most economical way to raise capital.

- ***Ability to make acquisitions using the company's stock***

The market created by going public makes it easier for a company to expand through acquisitions and mergers. Because registered shares can be converted into cash, a public company can often use its stock instead of cash to acquire a company or other valuable property. With the proper deal structure, the use of shares instead of cash can ease the immediate tax burden of the seller caused by the sale of his company and, thereby, make the acquisition easier and less expensive to close. Liquid stock also increases the value of a company's stock and option plans, making it easier for a company to attract and retain the key employees it needs to help it grow.

- ***Improved company image.***

Stakeholders of a shipping company gone public view favorably the disclosure and the liquidity. Going public, with all the financial disclosure and investor relations planning it requires, usually attracts the attention of the business and financial press. Free publicity, coupled with the perception that going public is a significant milestone of success, enhances a company's image. This improved image can make it easier for

management to deal with suppliers and customers. Many privately held companies that compete with public ones find their customers and suppliers reluctant to deal with them on equal terms because of their lack of operating history and the confidentiality of their financial data. Going public can erase this distinction and make it possible for the company to compete more effectively.

- ***Use of stock incentive plans to attract and retain key employees.***

Many companies use stock and stock option plans to attract and retain talented employees. It is increasingly common to recruit and compensate executives with a combination of salary and stock. Stock in a public company can be issued as a performance based reward or incentive. This reward could be deemed desirable if the stock has a public market. Stock can be instrumental in attracting and keeping key personnel. Also, certain tax advantages are a consideration when issuing stock to an employee. Generally, capital gains taxes are lower than ordinary income taxes. Owners and employees may have specific restrictions relating to the liquidity and sale of the stock. A public offering can create a market for the company's stock. This market can result in liquidity and reward for the company's employees. A stock plan for employees demonstrates corporate good will allows employees to become partial owners in the company where they work. An allocation of ownership or division of equity can lead to increased productivity, morale and loyalty. This type of compensation is a way of connecting an employee's financial future to the company's success.

- ***Eliminates liability – pollution accident – for shareholders.***

In the shipping industry pollution is a gigantic fear for which of course all the protection can be taken through insurances, however the corporate structure of a public company eliminates liability for the shareholders.

Disadvantages

- ***Less confidentiality, complete financial disclosure is required***

Going public forces a company to prepare and distribute to potential investors a complete description of the company, its history, its strengths, its weaknesses, and its future plans. Detailed disclosures of financial information are required. Information about the shareholdings and compensation arrangements of management and holders of large blocks is made public. All of this information must be updated and supplemented in reports required by the Securities and Exchange Commission. Once information is filed, it becomes readily available to competitors, employees, customers, suppliers, union organizers and others.

- ***Management devotes additional time to public company operations***

Going public subjects a company to a number of periodic reporting requirements with the Securities and Exchange Commission. These requirements include annual and quarterly financial reports (on forms 10-K and 10-Q) as well as prompt reporting of material events that affect the company (on form 8-K). For most companies, these and other reporting requirements[48], which force the company to maintain audited financial statements, increase the company's cost of doing business by imposing more stringent accounting practices and by making additional demands on management's time.

[48]www.sec.gov/info/edgar/forms/edgform.pdf

· ***Higher costs to comply with regulatory, auditing, legal requirements and investor relations Expense.***

Going public is expensive. The underwriter's discounts alone can amount to as much as 6 to 10 percent of the total proceeds of the offering. (In a $10 million offering, this can be as much as $1 million.) Other expenses, which include the underwriter's out-of-pocket expenses (typically not included in the underwriter's discount), filing fees, transfer agent fee, legal fees, printing fees, and accounting fees can add another $200,000 to $500,000 to a company's cost of going public. Most of these expenses must be paid at the closing of the offering.

Going public also subjects a company to annual and quarterly financial reporting requirements imposed by the Securities and Exchange Commission. Complying with these requirements increases the company's costs of doing business. Time and money are required to generate the information necessary for these reports.

- ***Management is scrutinized and monitored by investors and analysts***

A public offering can reduce management's control over a company if outsiders obtain enough stock to elect a majority of the company's board of directors. Whenever this is true, outside shareholders can remove members of the management team. (This is not a risk inherent only in public offerings, however. Any sale of voting stock to raise money reduces the percentage ownership of management. Sales of a majority of the company's voting stock to a few private investors, in fact, may make management's ability to retain control less certain than a public offering, which distributes those same shares to a greater number of investors. The larger number of shareholders in a publicly held company can make concerted action by the outsiders

more difficult.) Public companies are more susceptible to unfriendly takeover because their shares are easy to accumulate.

Even managements that retain voting control over their companies find that going public subjects them to pressures that can affect the way they run their businesses. Many entrepreneurs find that shareholder expectations and the quarterly reporting requirements of the Securities and Exchange Commission combine to create significant pressures on a company to continually improve its performance on a quarter by quarter basis. Failure to meet these shareholder expectations can cause the market value of the company's stock to decline, making it more expensive for the company to raise money or acquire other companies using its stock. This pressure to meet short-term goals can tempt management to forgo necessary long-term planning when it includes present-day sacrifices that will be reflected in the company's quarterly reports.

- ***Restrictions on stock sales*.**

Only those shares registered and sold in the offering become freely tradable. Unregistered shares remain subject to the same trading restrictions as they were before the offering. Moreover, the Securities and Exchange Commission imposes additional restrictions on the ability of major shareholders and company insiders to sell company stock.

Chapter 2

The International Dry Bulk Shipping Industry

Before proceeding in analyzing our case study (see next chapter), we will present the industry overview for orientation purposes regarding the shipping environment, in which our Company is specialized. The information and data in this section of the dissertation relating to the international dry bulk shipping industry is taken from Drewry databases and other sources available in the public domain. The marine industry is a vital link in international trade, with oceangoing vessels representing the most efficient, and often the only method of transporting large volumes of basic commodities and finished products. In 2003, approximately 2.3 billion tons of dry bulk cargo was transported by sea, comprising more than one-third of all international seaborne trade. Dry bulk cargo is cargo that is shipped in large quantities and can be easily stowed in a single hold with little risk of cargo damage. Dry bulk cargo is generally categorized as either major bulk or minor bulk. Major bulk cargo constitutes the vast majority of dry bulk cargo by weight, and includes, among other things, iron ore, coal and grain. Minor bulk cargo includes products such as agricultural products, mineral cargoes, cement, forest products and steel products and represents the balance of the dry bulk industry. Other dry cargo is categorized as container cargo, which is cargo shipped in 20 or 40 foot containers and includes a wide variety of finished products, and non-container cargo, which includes other dry cargoes that cannot be shipped in a container due to size, weight or handling requirements, such as large manufacturing equipment or large industrial vehicles. The balance of seaborne trade involves the transport of liquids or gases in tanker vessels and includes products such as oil, refined oil products and chemicals. The

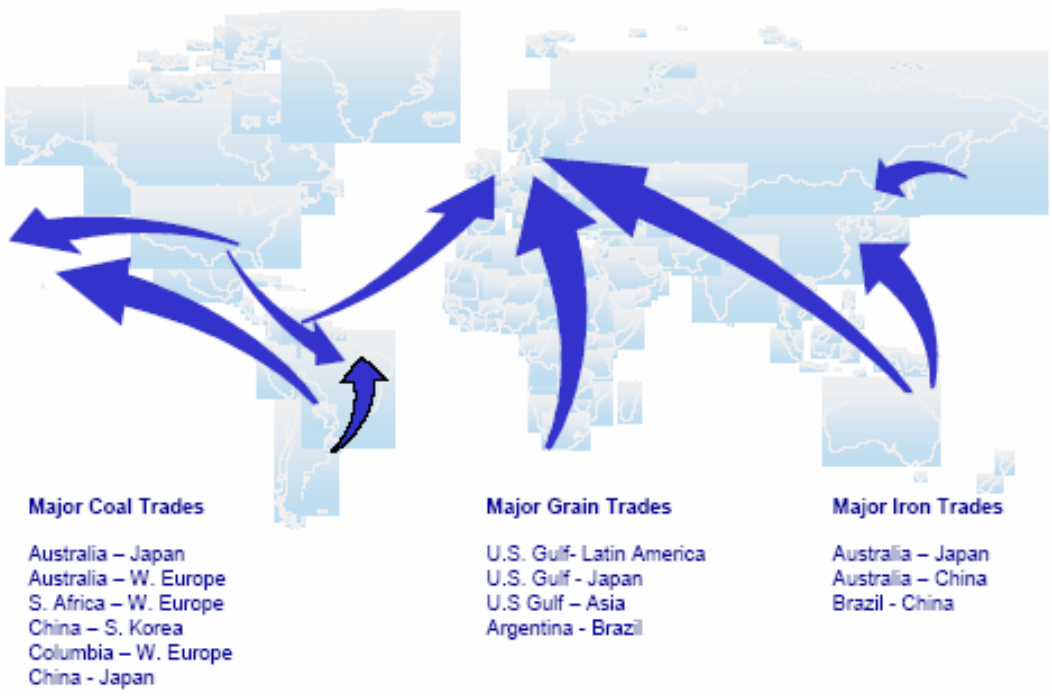
following table presents the breakdown of the global bulk seaborne trade by type of cargo in 2003 and the map after that represents the major global dry bulk trade routes.

Table 14 Breakdown of the global bulk seaborne trade

	Weight (In million of tons)	Contribution (percent)
Dry Bulk		
Major Bulk		
Coal.....	**597**	**10.0**
Iron ore.....	**573**	**9.6**
Grain	**215**	**3.5**
	1,385	**23.1**
Minor Bulk	**917**	**15.3**
Subtotal	**2,302**	**38.4**
Other dry cargo		
Containers cargo	**815**	**13.6**
Non-container cargo.....	**480**	**8.0**
Subtotal	**1,295**	**21.6**
Tanker cargoes (oil, gases, chemicals)	**2,400**	**40.0**
Total.....	**5,997**	**100.0**

Source: Drewry

Graph 7 The major global dry bulk trade routes



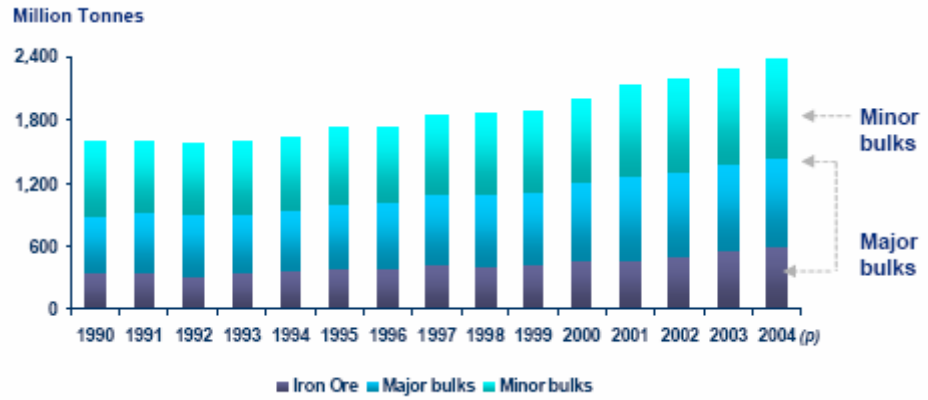
Sourse: Drewry

2.1 Demand for Dry Bulk Carriers

The demand for dry bulk carrier capacity is determined by the underlying demand for commodities transported in dry bulk carriers, which in turn is influenced by trends in the global economy. Seaborne dry bulk trade increased by slightly more than 2% annually during the 1980s and 1990s. However, this rate of growth has increased dramatically in recent years. Between 1999 and 2003, trade in all dry bulk commodities increased from 1.97 billion tons to 2.30 billion tons, an average annual increase of 5.1%.

The following graph illustrates the growth in demand for dry bulk shipping capacity for the periods indicated.

Graph 8 Demand for dry bulk shipping capacity



Source: Drewry

One of the main reasons for the resurgence in dry bulk trade has been the growth in imports by China of iron ore, coal and steel products during the last five years. Chinese imports of iron ore alone increased from 55.3 million tons in 1999 to more than 148 million tons in 2003.

With construction accounting for around 55% of Chinese steel consumption, changes in construction investment patterns can have a significant knock-on effect on

steel demand and production and thus iron ore demand and imports. Key figures to look out for then are those that indicate China's expenditure on infrastructure development, and three significant indicators point to slowing growth this year and nest. Whilst fixed asset investment is due to hit a record 8.8 trillion Rmb in 2005, up from 6.9 Rmb this year, the rate of growth is slowing from 26.7% in 2003 to 22% and then 15% for 2004 and 2005 respectively. A very similar pattern is expected in bank loans, which are vital for private sector enterprise development. Hit by October's rise in interest rates, loan growth is expected to fall from 2003's 21.4% to 16.4% this year and then decline further to 15% next year, when total bank loans are forecast to be 21.3 tn Rmb. To further constrain potential construction growth there is also expected to be little or no growth in utilised foreign direct investment next year, which is forecast to stay at 2004's level of $60bn, having growth by 12.1% this year over 2003's level.

The following table illustrates China's gross domestic product growth rate compared to the United States' gross domestic product growth rate during the periods indicated.

Table 15 Comparison China's and United States's gross domestic product growth rate

Years	China GDP Growth Rate %	U.S. GDP Growth Rate %
1981 – 1985	10.1	2.6
1986 – 1990	7.8	2.6
1991 – 1995	12.0	2.3
1996 – 2000	8.3	4.1
2001 – 2003	7.9	1.9

Source: Drewry

Demand for dry bulk carrier capacity is also affected by the operating efficiency of the global fleet, with port congestion, which has been a feature of the market in 2004, absorbing additional tonnage.

In evaluating demand factors for dry bulk carrier capacity, it is important to bear in mind that dry bulk carriers can be the most versatile element of the global shipping fleets in terms of employment alternatives. Dry bulk carriers seldom operate on round trip voyages. Rather, the norm is triangular or multi-leg voyages. Hence, trade distances assume greater importance in the demand equation.

2.2 Dry Bulk Carrier Supply

The global dry bulk carrier fleet may be divided into four categories based on a vessel's carrying capacity. These categories consist of:

- Capesize. Capesize vessels have carrying capacities of more than 150,000 dwt. These vessels generally operate along long haul iron ore and coal trade routes. There are relatively few ports around the world with the infrastructure to accommodate vessels of this size.

- Panamax. Panamax vessels have a carrying capacity of between 60,000 and 80,000 dwt. These vessels carry coal, grains, and, to a lesser extent, minor bulks, including steel products, forest products and fertilizers. Panamax vessels are able to pass through the Panama Canal making them more versatile than larger vessels.

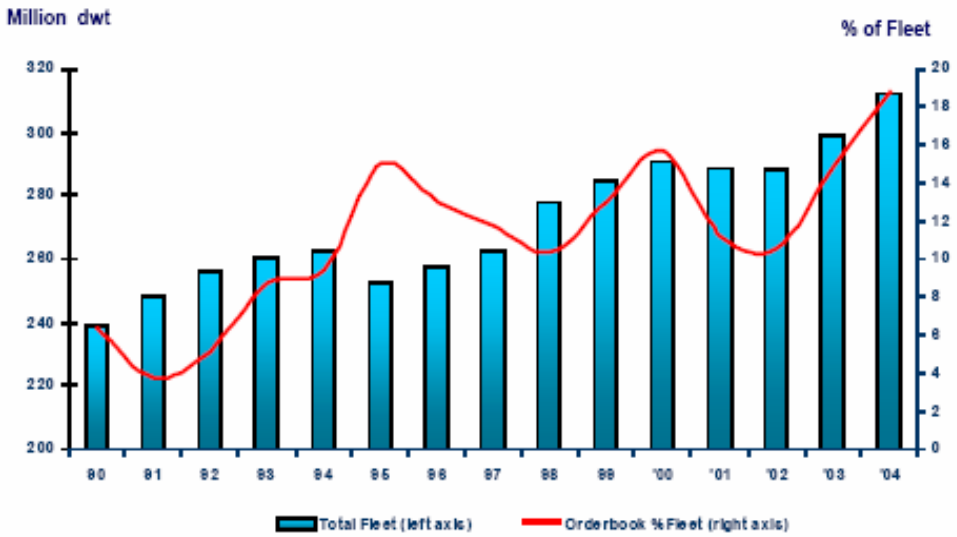
- Handymax. Handymax vessels have a carrying capacity of between 35,000 and 60,000 dwt. These vessels operate along a large number of geographically dispersed global trade routes mainly carrying grains and minor bulks. Vessels below 60,000 dwt are sometimes built with on-board cranes enabling them to load and discharge cargo in countries and ports with limited infrastructure.

- Handysize. Handysize vessels have a carrying capacity of up to 35,000 dwt. These vessels carry exclusively minor bulk cargo. Increasingly, these vessels have operated

along regional trading routes. Handysize vessels are well suited for small ports with length and draft restrictions that may lack the infrastructure for cargo loading and unloading.

The supply of dry bulk carriers is dependent on the delivery of new vessels and the removal of vessels from the global fleet, either through scrapping or loss. The following chart illustrates the supply of the global dry bulk carriers for the periods indicated.

Graph 9 Supply of dry bulk carriers



Sourse: Drewry

As of September 2004, the global dry bulk carrier orderbook amounted to 58.8 million dwt, or 18.8% of the existing fleet, with most vessels on the orderbook expected to be delivered within 36 months. The following table illustrates the size of the global dry bulk fleet as of September 30, 2004 and the dry bulk carriers for which newbuilding contracts have been entered into as of the same date.

Table 16 Global Dry Bulk Fleet as of September 30, 2004

	Current Fleet			Order Book		
	No. of Vessels	Dwt. (in millions)	% of Fleet	No. of Vessels	Dwt. (in millions)	% of Fleet
Capesize	703	104.3	33.4	184	26.7	24.9
Panamax	1,150	80.9	25.8	262	18.1	22.9
Handymax	2,051	86.2	27.6	287	12.9	14.8
Handysize	1,885	41.2	13.1	52	1.1	2.5
Total	5,789	312.6	100.0	785	58.8	18.8

Source: Drewry

The level of scrapping activity is generally a function of scrapping prices in relation to current and prospective charter market conditions, as well as operating, repair and survey costs. The following table illustrates the scrapping rates of dry bulk carriers for the periods indicated.

Table 17 Scrapping rates of dry bulk carriers

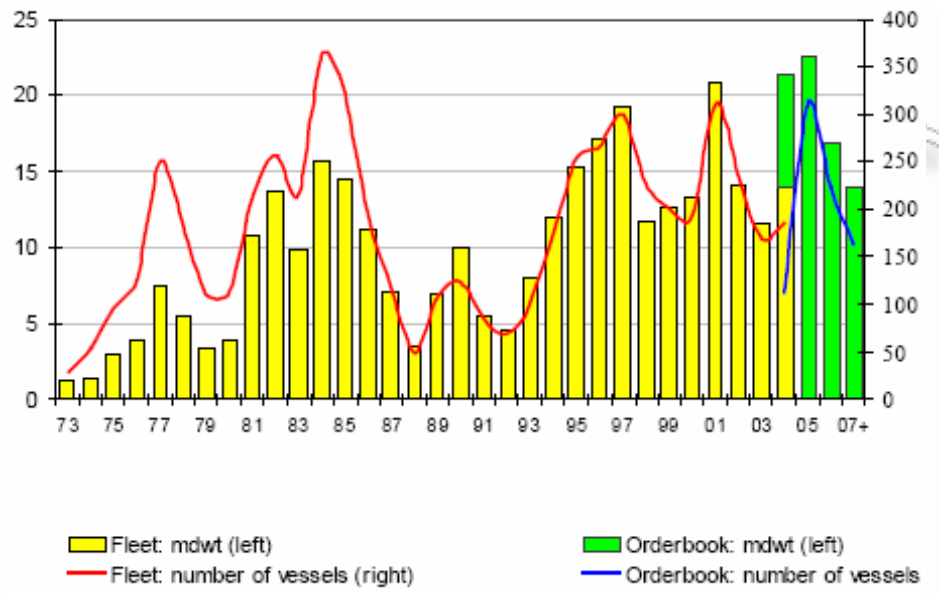
	1999	2000	2001	2002	2003	2004[49]
Capesize						
No. of vessels.....	13	4	3	8	2	1
Dwt (in millions).....	1.2	0.5	0.4	0.9	0.3	0.1
Panamax						
No. of vessels.....	45	11	28	18	7	1
Dwt (in millions).....	3.0	0.7	1.9	1.2	0.5	0.9
Handymax						
No. of vessels.....	53	40	40	25	29	_
Dwt (in millions).....	2.2	1.5	1.5	0.9	1.1	_
Handysize						
No. of vessels.....	66	50	62	64	25	4
Dwt (in millions).....	1.5	1.2	1.4	1.6	0.6	0.1
Total						
No. of vessels	177	105	123	115	63	6
Dwt (in millions)	8.3	3.8	5.2	4.7	2.4	0.3

Source: Drewry

The average age at which a vessel is scrapped over the last five years has been 26 years. However, due to recent strength in the dry bulk shipping industry, the average age at which the vessels are scrapped has increased. The following chart illustrates the age of global dry bulk fleet for the periods indicated.

[49] Through November 2004.

Graph 10 Dry bulk fleet age profile – November 2004



Sourse: Drewry

2.3 Charter Hire Rates

Charter hire rates fluctuate by varying degrees among dry bulk carrier size categories. The volume and pattern of trade in a small number of commodities (major bulks) affect demand for larger vessels. Therefore, charter rates and vessel values of larger vessels often show greater volatility. Conversely, trade in a greater number of commodities (minor bulks) drives demand for smaller dry bulk carriers. Accordingly, charter rates and vessel values for those vessels are subject to less volatility.

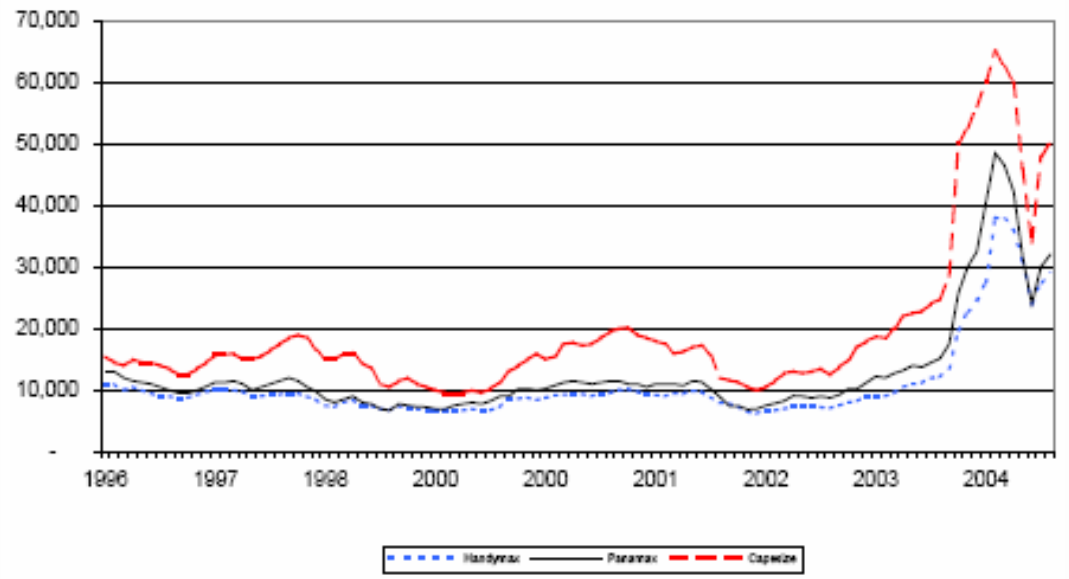
Charter hire rates paid for dry bulk carriers are primarily a function of the underlying balance between vessel supply and demand, although at times other factors may play a role. Furthermore, the pattern seen in charter rates is broadly mirrored across the different charter types and between the different dry bulk carrier categories. However, because demand for larger dry bulk vessels is affected by the volume and

pattern of trade in a relatively small number of commodities, charter hire rates (and vessel values) of larger ships tend to be more volatile than those for smaller vessels.

In the time charter market, rates vary depending on the length of the charter period and vessel specific factors such as age, speed and fuel consumption. The following chart shows one year time charter rates for Handymax, Panamax and Capesize dry bulk carriers between 1996 and 2004.

Graph 11 Time charter rates

(in U.S. dollars per day)

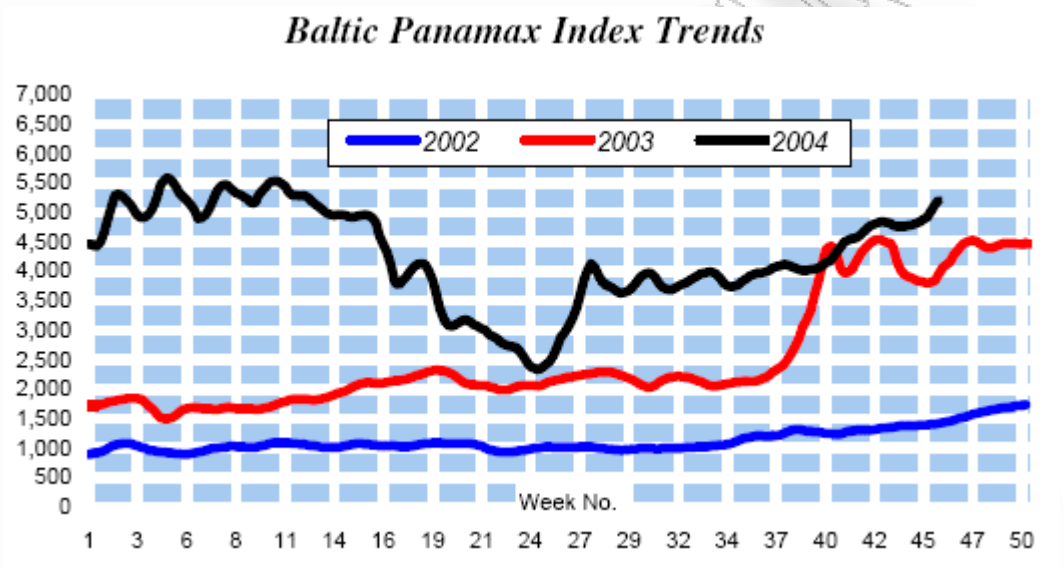


Source: Drewry

In the voyage charter market, rates are influenced by cargo size, commodity, port dues and canal transit fees, as well as delivery and redelivery regions. In general, a larger cargo size is quoted at a lower rate per ton than a smaller cargo size. Routes with costly ports or canals generally command higher rates than routes with low port dues and no canals to transit. Voyages with a load port within a region that includes ports where vessels usually discharge cargo or a discharge port within a region with ports where vessels load cargo also are generally quoted at lower rates, because such

voyages generally increase vessel utilization by reducing the unloaded portion (or ballast leg) that is included in the calculation of the return charter to a loading area.

Graph 12 Baltix Panamax Index Trends

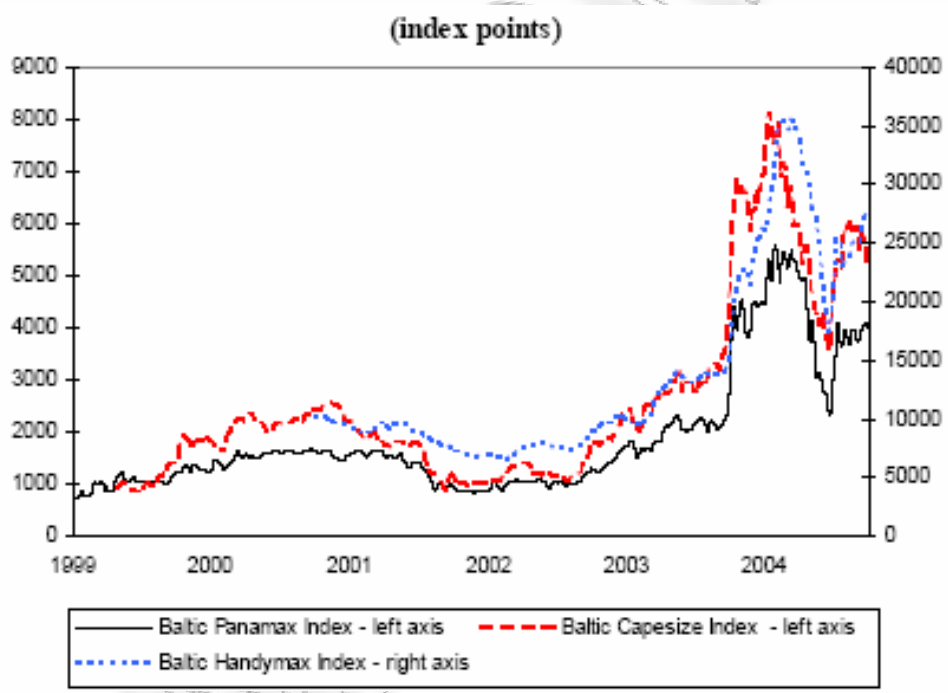


Sourse: Clarkson Research Studies

Within the dry bulk shipping industry, the charter hire rate references most likely to be monitored are the freight rate indices issued by the Baltic Exchange. These references are based on actual charter hire rates under charter entered into by market participants as well as daily assessments provided to the Baltic Exchange by a panel of major shipbrokers. The Baltic Panamax Index is the index with the longest history. The Baltic Capesize Index and Baltic Handymax Index are of more recent origin. On Monday 29th November the BCI broke through its previous record high of 8154, a figure set on the 16th January this year. Just over a week later the index sat at 8911, which looks to be the summit of autumn's bull run with the index declining by 700 points during the week that followed. Latest earnings are $104,311 per day for a modern vessel.

The Panamax market also set a new record high during the past month, with the BPI reaching a peak of 6110 on the 1st December against the 5586 set at the start of February. This saw earnings peak at $47,086 per day, 6% higher than in February. Unlike the larger vessel sizes, the Handy market has not reached its spring peak. Given that earnings have been moving sideways recently and that the BHMI has now started to drop, it would seem unlikely that a new high is going to be reached over the next few weeks. Current average earnings are $33,813 per day for a modern 45,000 dwt vessel.

Graph 13 Baltic Exchange Freight Indices



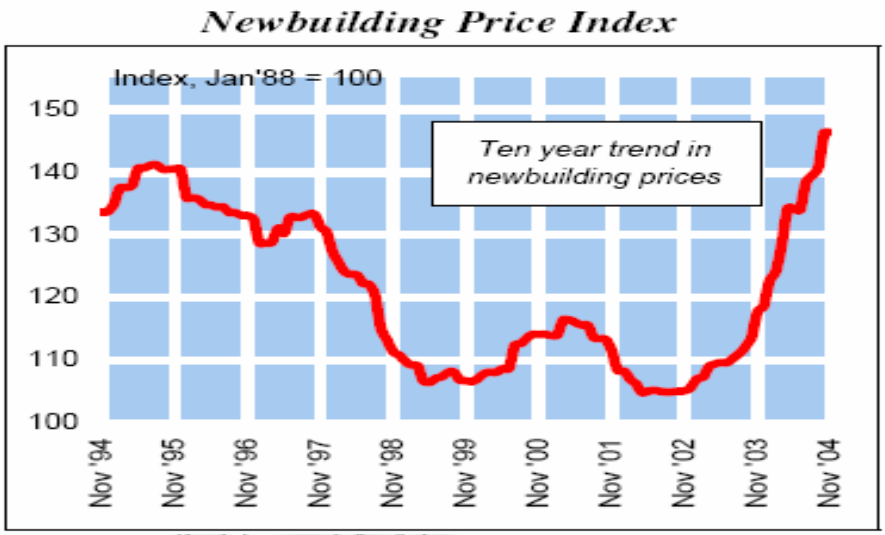
Source: Baltic Exchange

As expected, all assessments of dry bulk charter hire rates show a similar pattern. In 2003 and 2004, rates for all sizes of dry bulk carriers strengthened appreciably to historically high levels. According to Drewry, the driver of this dramatic upsurge in charter rates was primarily the high level of demand for raw materials imported by China.

2.4 Vessel Prices

Vessel prices, both for newbuildings and secondhand vessels, have increased significantly during the past two years as a result of the strength of the dry bulk shipping industry. Because sectors of the shipping industry (dry bulk carrier, tanker and container ships) are in a period of prosperity, newbuilding prices for all vessel types have increased significantly due to a reduction in the number of berths available for the construction of new vessels in shipyards.

Graph 14 Newbuilding Price Index

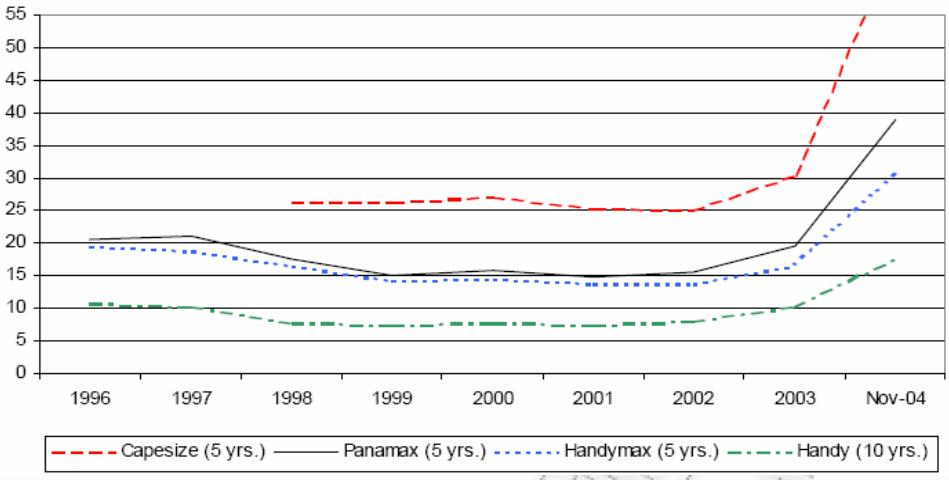


Sourse: Clarkson Research Studies

The following graph present the average prices for both secondhand and newbuilding dry bulk carriers for the periods indicated

Graph 15 Secondhand Vessel Prices

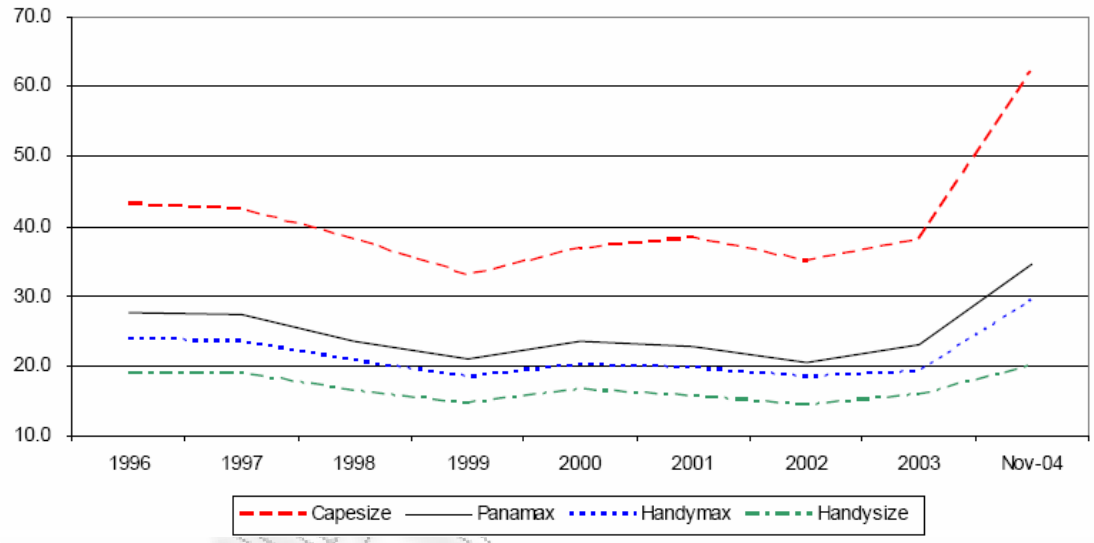
(in millions of U.S. dollars)



Source: Drewry

Graph 16 Newbuilding Prices

(in millions of US dollars)



Source: Drewry

In the secondhand market, the steep increase in newbuilding prices and the strength in the charter market have also affected vessel prices. With vessel earnings running at relatively high levels and a limited availability of newbuilding berths, the ability to deliver a vessel early has resulted in a premium to the purchase price. Consequently, the market has witnessed secondhand prices for five year old Panamax and Capesize dry bulk carriers reaching higher levels than those being "nominally quoted" for comparably sized newbuildings.

Chapter 3

A case study

In the first chapter of this dissertation we indicated some basic characteristics in order a shipping company to enter the U.S. capital markets. Thanks to a strong charter market, low interest rates, decreased tax on dividends and low volatility in the equity markets, ships are now worth more to Wall Street for their cash flows than their net asset value. In this chapter we will prove how today shipowners can issue equity at very strong valuations and eliminate residual value exposure while retaining commercial and technical control of vessels.

3.1 Factors, which have, influence our choice for Dragon's IPO

The shipping industry pays no tax on income or capital gains[50] and therefore receives no tax benefit from interest deductions. The long-term average rate of return on a new ship is approximately equal to the interest rate on a fixed-rate bond. The average dividend yield paid on shares trading in the US is below 2% and there is a large unmet demand for dividend paying shares. US tax law[51] has recently been changed so as to accord corporate dividends a preferential tax rate of 15%, rather than the normal ordinary income tax rate of 35%. The two most prevalent high-dividend structures in the US, real estate investments trusts and master limited partnerships, are specifically not entitled to the 15% tax rate.

While most dry bulk and tanker shares are trading at the moment at some premium to net asset value, for instance Nordic American and Knightsbridge trade at the highest premiums in the industry, 218% and 170% of Net Asset Value,

[50] These are the benefits of a holding company existing under the laws of the Marshall Islands, Panama, Liberia e.t.c., the company is not subject to tax on international shipping income, however, it is subject to registration and tonnage taxes. This is a common practise in shipping.

[51] United States federal income tax matters are based on the Internal Revenue Code of 1986. In the case that a stock of a foreign corporation is "primarily traded" on the New York Stock Exchange, this corporation is subject to the regulations under Code Section 883.

respectively[52]. While virtually all dry bulk and tanker equities trade at a discount to Net Asset Value (except in particularly robust markets as exist today), the shares of Nordic American and Knightsbridge have traded above NAV for 90%-95%[53] of their existence. Shipping company shares generally have small market capitalizations, small numbers of holders and poor liquidity. These properties create a vicious cycle, which causes the shares to trade at a low valuation, makes it difficult to issue new equity, and therefore keeps the market value low, restricts the number of holders and inhibits liquidity. Shipping company share offerings usually appeal exclusively to a small group of specialist investors, limiting the size of the offering and compounding the problems of market capitalization and liquidity. In 1999, at the worst part of the Asian recession, every major US investment bank decided to close down its shipping-related activities. The reason was the extremely poor performance of shipping equity and debt, due to the effects of leverage in a bad market.[54]

3.1.1 Proposed transaction

Dragon Shipping Inc. is one of the few shipping companies which, will be enthusiastically received by the US equity markets, and would be able to use its listing to grow and consolidate in those sectors of the shipping market which it chooses to participate.

For the above reason, we have created a structure, which we believe addresses the desires and issues outlined above, while providing some additional advantages to the shipping company which wants to go public. We propose a large initial public offering of equity for Dragon, sufficient to repay all of its outstanding debt. We believe we can accomplish this offering at a premium to NAV. This premium will be determined by the market. Dragon will articulate a policy of paying as dividends

[52] July 2004
[53] By July 2004
[54] Someone can see this extremely poor performance in Graph 6 of page 43 in the current document.

essentially all of its cash flow, less reserves for drydocking and prudent contingencies. This policy is similar to that of Nordic American.

Dragon would establish a line of credit, perhaps equal to 50-60% of its asset value. This line would be such with a moratorium of five years for any amounts drawn. When Dragon will find an attractive acquisition, it would draw on the line overnight, and make the acquisition. When convenient, Dragon would take advantage of the equity market to raise money to repay the line. By issuing equity above NAV and purchasing assets at NAV, Dragon would increase dividend per share with almost every acquisition[55], regardless of the point in the shipping cycle at which the acquisitions were made. In other words, vessel aquisitions can be accretive to the earnings and dividends per share. After being public for one year, Dragon could take advantage of its ability to file a "shelf registration" to issue equity within two weeks of its decision to do so, further increasing its flexibility. The more acquisitions of good assets made by Dragon the higher the dividend per share. Given current conditions, an aggressive acquisition program would be good for every shareholder.

With a strong balance sheet allows the company to be very aggressive in weak markets and permits the company to reap the rewards of the spot market. There would not be any preferred shares own by existing or new shareholders. Participating in new issues that the Company may decide from time to time would be an option for the existing shareholders. Being listed gives the flexibility to the shareholders to increase

[55] For example, we have a fleet of 5 ships of US$10 value each, which they earn US$2 each. The NAV of our company will be US$50 (5*10) and the earnings US$10 (2*5). We assume Market Cap of US$70 and number of shares 5, so the price of our stock will be US$14 per stock. Assuming we buy one more vessel of the same value (US$10) and of the same earnings (US$2), now our NAV stands at the US$60 and our earnings at US$12. We have to issue 0,71 shares (Value of new acquisition/price=10/14=0,715) for the purchase of our new asset. The new purchase will add to the earnings per share because before the new aquisition we had US$2 earnings per share (10/5=2) whilst including the new acquisition we earn US$2,09 per share (12/5,715=2,09) that is 0,09 cents per share more. The purchase of the new ship was accretive to the dividend per share. In other words existing shareholders even with the addition of the new shares issued they will receive a greater dividend than before.

their position as they may choose. Based upon the closely held number of shares, and the projected strong balance sheet, takeover concerns should be minimal. The offering would be a combined institutional and retail offering.

3.2 Analysis of "DRAGON SHIPPING INC."[56]

3.2.1 Establishment of Dragon

Company Dragon, is a Marshall Islands company that owns and operates dry bulk carriers that transport iron ore, coal, grain and other dry cargo along worldwide shipping routes. Its' operating fleet consists of seven modern Panamax dry bulk carriers that, as of September 30, 2004, had a combined carrying capacity of more than 525,000 dwt and a weighted average age of 3.1 years. During 2003 and the six month period ended June 30, 2004, the company had a fleet utilization of 99.8%. For each of the aforementioned periods the vessels achieved daily time charter equivalent rates[57] of $12,833 and $25,765 and they generated revenues of $25.3 million and $30.2 million, respectively.

The intention of the company is to expand its presence in the dry bulk shipping market. In furtherance of this objective, Dragon entered into newbuilding contracts with a Japanese shipyard for the construction of two new Panamax dry bulk carriers that have a carrying capacity of 73,700 dwt each, and have entered into a purchase agreement with **"CAPES COMPANY"** to acquire a secondhand Capesize dry bulk carrier with a carrying capacity of 169,883 dwt. The expectation of the company is that the first of the new Panamax dry bulk carriers will be delivered in March 2005 and that the second will be delivered in May 2005. The expectation for the delivery of the Capesize dry bulk carrier is in March 2005. Upon the delivery of

[56] All characteristics of the "Dragon" are fictitious and any similarity to an existing company is entirely coincidental and unintended by the author.
[57] See summary consolidated financial and other data in the present document.

these carriers, as of May 2005, the combined fleet will consist of nine Panamax dry bulk carriers and one Capesize dry bulk carrier that will have a combined carrying capacity of 842,296 dwt and a weighted average age of 3.6 years. Dragon believes that the addition of these vessels to the current fleet will be accretive to the earnings and dividends per share.

3.2.2 Competitive Strengths

Dragon possesses a number of strengths that provide the company with a competitive advantage in the dry bulk shipping market:

- Dragon owns a modern, high quality fleet of dry bulk carriers. Operating fleet consists of seven Panamax dry bulk carriers that were built after January 1, 2001 and that, as of September 30, 2004, had a weighted average age of 3.1 years. Upon the delivery of the two new Panamax dry bulk carriers and the acquisition of one secondhand Capesize dry bulk carrier, as of May 2005, the fleet will consist of ten dry bulk carriers that will have a weighted average age of 3.6 years. The vessels are built to conform to exacting industry standards and have obtained all requisite certifications. Dragon believes that owning a modern, high quality fleet reduces operating costs, improves safety and provides the company with a competitive advantage in securing favorable time charters. Dragon maintains the quality of the vessels by carrying out regular inspections, both while in port and at sea, and adopting a comprehensive maintenance program for each vessel.

- The fleet includes two groups of sister ships. Each group has been built based upon the same design specifications and, therefore, uses substantially the same parts and equipment. The belief is that maintaining a fleet including sister ships enhances the revenue generating potential of the fleet by providing the company with operational and scheduling flexibility. The uniform nature of sister ships can also improve the operating

efficiency by allowing the fleet manager to apply the technical knowledge of one vessel to all vessels of the same series, and creates economies of scale that enable the company to realize cost savings when maintaining, supplying and crewing our vessels.

- Dragon has an experienced management team. The management team consists of experienced executives that have demonstrated ability in managing the commercial, technical and financial areas of the business. These executives have an average of more than 30 years of operating experience in the shipping industry, including experience operating large and diversified fleets of dry bulk carriers and other vessels.

- The benefit from strong relationships with members of the shipping and financial industries. Dragon developed strong relationships with major international charterers, shipbuilders and financial institutions that is the result of the quality of the operations, the strength of the management team and the reputation for dependability. There is a belief that these relationships will enable Dragon to continue to grow the business while maintaining relatively high utilization rates.

- Dragon have strong balance sheet and will not have any indebtedness outstanding as of the completion of the offering. There is an intention to use a portion of the net proceeds from this offering to repay all of the outstanding indebtedness. Dragon expects that the repayment of all of the outstanding indebtedness will further strengthen the balance sheet, increase the amount of funds that Dragon may draw under its credit facility in connection with future acquisitions and enable Dragon to use cash flow that would otherwise have been dedicated to servicing debt for other purposes, including funding operations and making dividend payments.

3.2.3 Business Strategy

The main objective is to manage and expand the fleet in a manner that enables Dragon to pay attractive dividends to its stockholders. To accomplish this objective, Dragon intends to:

- **Continue to operate a high quality fleet**. Dragon believes that the ability to maintain and increase its customer base will depend on the quality of the fleet. Dragon intends to limit the acquisition of ships to vessels that meet rigorous industry standards and that are capable of meeting charterer certification requirements. At the same time, Dragon intends to maintain the quality of the existing fleet by carrying out regular inspections of the vessels and implementing appropriate maintenance programs for each vessel.

- **Strategically expand the size of the fleet**. Dragon intends to grow the fleet through timely and selective acquisitions of vessels in a manner that is accretive to earnings and dividends per share. Dragon expects to focus the dry bulk carrier acquisitions primarily on Panamax and Capesize dry bulk carriers. The Panamax dry bulk carriers are subject to relatively less volatility in charter hire and are able to access a greater number of ports and carry a broader range of cargo compared to larger carriers. Capesize dry bulk carriers offer economies of scale due to their increased cargo carrying capacity and offer relatively stable cash flows due to their generally being employed on longer term time charters compared to smaller carriers. Dragon intends to continue to monitor developments in market conditions regularly, and may acquire other dry bulk carriers when those acquisitions would, in Dragon´s view, present favorable investment opportunities. Dragon may also consider acquisitions of other types of vessels but do not intend to acquire tankers. Dragon intends to capitalize on the

experience and expertise of the management team when making acquisition related decisions and expect to continue to place an emphasis on sister ships.

- **Pursue an appropriate balance of short-term and long-term time charters**. Dragon historically has chartered the vessels to customers primarily pursuant to short-term time charters. While Dragon expects to continue to pursue short-term time charter employment for the Panamax dry bulk carriers, Dragon have entered into a three year time charter for the Capesize dry bulk carrier that is scheduled to commence upon delivery of the vessel to the company in March 2005. Dragon believes that employing short-term time charters generally increases its flexibility in responding to market developments and assists in optimizing the amount of charter hire that is paid, particularly during periods of increasing charter hire rates, while long-term time charters provide Dragon the benefit of relatively stable cash flows. Dragon will continue to strategically monitor developments in the dry bulk shipping market on a regular basis and adjust Dragon's charter hire periods according to market conditions. The company may in the future extend the charter periods for one or more other vessels in its' fleet (including for periods of up to several years) to take advantage of the relatively stable cash flow and high utilization rates that are associated with long-term time charters. Given the size of the fleet, Dragon believes that adding one or more additional long-term time charters to its charter portfolio will reduce the potential exposure to the adverse effects of any market downturn without materially affecting the ability to take advantage of short-term market opportunities.

- **Maintain a strong balance sheet with low leverage**. Dragon intends to use a portion of the net proceeds from this offering to repay all of the outstanding

indebtedness[58]. In the future, there is an expectation to draw funds under the new credit facility to fund vessel acquisitions and intend to repay the acquisition related debt from time to time with the net proceeds of equity issuances. While the leverage will vary according to the acquisition strategy and the ability to refinance acquisition related debt through equity offerings on terms acceptable to Dragon, there is an intention to limit the amount of indebtedness that it is outstanding at any time to relatively conservative levels. Dragon's belief is that maintaining a low level of leverage will allow maintaining a strong balance sheet and will provide with flexibility in pursuing acquisitions that are accretive to earnings and dividends per share. Dragon believes that maintaining a low level of indebtedness will allow remaining competitive in adverse market conditions, particularly when compared to competitors who are burdened with significant levels of debt.

- **Maintain low cost, highly efficient operations**. Dragon believes that is a cost-efficient and reliable owner and operator of dry bulk carriers due to the strength of the management team and the quality of the vessels. Dragon intends to work closely with Dragon Services S.A. to actively monitor and control vessel operating expenses without compromising the quality of the vessel management by utilizing regular inspection and maintenance programs, employing and retaining qualified crew members and taking advantage of the economies of scale that result from operating a fleet of sister ships.

- **Capitalize on Dragon's established reputation**. Dragon has an established reputation in the dry bulk shipping market for maintaining high standards of performance, reliability and safety. Dragon's intention is to capitalize on this reputation in establishing and maintaining relationships with major international charterers who

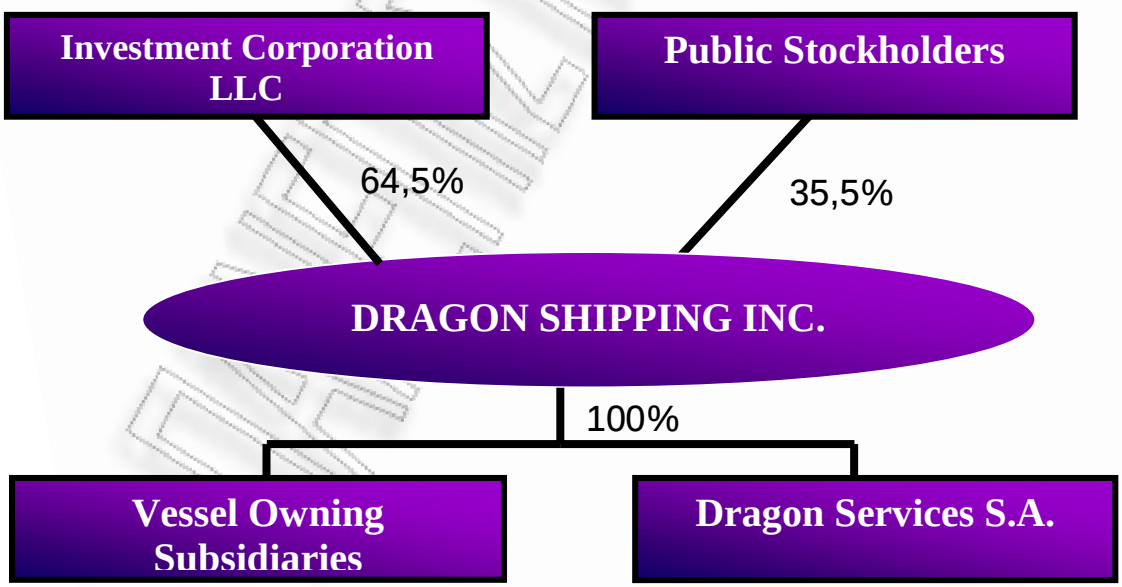
[58] See summary consolidated financial and other data in pages 79-80 in the present document.

consider the reputation of a vessel owner and operator when entering into time charters and with shipyards and financial institutions who consider reputation to be an indicator of creditworthiness.

3.2.4 Corporate structure

Dragon Shipping Inc. is a holding company incorporated under the laws of the Marshall Islands in March 2005. Dragon became a wholly-owned subsidiary of Investment Corporation LLC, or Investment Corporation, a Marshall Islands limited liability company. Investment Corporation is owned by management and outside investors. Investment Corporation currently owns 100% of the outstanding common stock of Dragon Shipping Inc., and after giving effect to the offering, will own approximately 64,5% of the outstanding stock and public stockholders will own 35,5% of the outstanding stock. The following chart illustrates the corporate structure after giving effect to the offering:

Graph 17 Corporate structure of Dragon Shipping Inc.



The commercial and strategic management of the fleet is provided in-house by an affiliated entity “Dragon Services S.A.”, which we refer to as DS or the fleet

manager, a Panamanian company that was formed in September 2004 and maintains its principle offices in Athens, Greece. Each of the vessels is or will be owned by Dragon through a separate wholly owned Panamanian company. Mr. Fertidis, the Chairman and Chief Executive Officer control DS. There is an intention of acquisition of the fleet manager no later than 12 months from the date of this offering. Upon the acquisition of DS, the fleet manager will become a wholly owned subsidiary and will conduct the entire management of the fleet in-house.

3.2.5 Current fleet

Dragon's fleet consists of dry bulk carriers that transport iron ore, coal, grain and other dry cargoes along worldwide shipping routes. Dragon's operating fleet is composed of seven modern Panamax dry bulk carriers that, as of September 30, 2004, had a combined carrying capacity of more than 525,000 dwt and a weighted average age of 3.1 years. According to Drewry, the average age of the world's Panamax dry bulk carrier fleet was 13 years as of November 30, 2004.

Dragon intends to expand its presence in the dry bulk shipping market. In furtherance of this objective, Dragon have entered into newbuilding contracts with the **"Huan Hun"** in Japan for the construction and delivery of two new Panamax dry bulk carriers that have a carrying capacity of 73,700 dwt each. The total purchase price for these vessels is $40.6 million and is payable in instalments. As of June 30, 2004, Dragon had paid $12.2 million of the purchase price with advance payments that have the benefit of a refund guarantee from the Bank of Japan. Dragon expects to pay the balance of the purchase price with a portion of the net proceeds from this offering and to receive the first vessel in March 2005 and the second vessel in May 2005. In addition to the newbuilding contracts for two new Panamax dry bulk carriers, Dragon have entered into a purchase agreement with "CAPES COMPANY"

for the purchase of one secondhand Capesize dry bulk carrier built in 1999. The purchase price for the Capesize vessel is $63.5 million, of which there was a payment of $6.3 million on November 19, 2004. Dragon will pay the remaining $57.2 million, plus an additional one-time expense of approximately $0.8 million for initial provisioning, stores and spare parts, upon delivery of the vessel with the proceeds from this offering. There was also a commission paid equal to two percent of the purchase price. There is an expectation to take delivery of the vessel in March 2005.

Upon the delivery of these vessels, the fleet will consist of nine Panamax dry bulk carriers and one Capesize dry bulk carrier that will have a combined carrying capacity of 842,296 dwt and a weighted average age of 3.6 years as of May 2005. There is a strong belief that the addition of these vessels to Dragon's fleet will be accretive to its earnings and dividends per share. The following table presents certain information concerning the dry bulk carriers of the fleet.

Table 18 Dragon's fleet information

Vessel	Operating Status	Dwt	Age (1)	Time Charter Expiration Date	Time Charter Rate (U.S. dollars)	Sister Ship (2)
Ship 1	Delivered January 2001	75,200	3.7 years	March 12, 2005 to May 12, 2005	$ 41,000	A
Ship 2	Delivered February 2001	73,150	3.6 years	Jan. 10, 2005 to Jan. 20, 2005	$ 38,000	A
Ship 3	Delivered March 2001	75,336	3.5 years	Nov. 25, 2005 to Jan. 25, 2006	$ 37,300	A
Ship 4	Delivered May 2001	73,882	3.5 years	Aug. 19, 2004 to Nov. 4, 2005	$ 30,650	A
Ship 5	Acquired May 2003	73,420	3.7 years	Nov. 3, 2005 to Jan. 18, 2008	$ 32,500	A
Ship 6	Acquired July 2003	74,100	3.7 years	Dec. 10, 2004 to Feb. 10, 2005	$ 18,750	A
Ship 7	Delivered August 2004	74,032	0.08 years	Aug. 5, 2005 to Oct. 20, 2005	$ 31,000	B

Ship 8	Delivery expected March 2005	73,021	—	—	—	B
Ship 9	Acquisition expected March 2005	165,315	5.4 years	Feb. 2008 to April 2008	$ 47,500	—
Ship 10	Delivery expected May 2005	72,114	—	—	—	B

(1) As of September 30, 2004.

(2) Each dry bulk carrier is a sister ship of each other dry bulk carrier that has the same letter.

Each of the vessels is owned, or will be owned following delivery to Dragon, through a separate wholly-owned Panamanian subsidiary. Dragon charter its Panamax dry bulk carriers to customers primarily pursuant to short-term time charters, although have entered into a longer term time charter for the secondhand Capesize dry bulk carrier that there is an expectation to be acquired in March 2005. A time charter involves the hiring of a vessel from its owner for a period of time pursuant to a contract under which the vessel owner places its ship (including its crew and equipment) at the disposal of the charterer. Under a time charter, the charterer periodically pays a fixed daily charter hire and bears all voyage expenses, including the cost of bunkers and port and canal charges. Subject to any restrictions in the contract, the charterer determines the type and quantity of cargo to be carried and the ports of loading and discharging. The technical operation and navigation of the vessel at all times remains the responsibility of the vessel owner, which is generally responsible for the vessel's operating expenses, including the cost of crewing, insuring, repairing and maintaining the vessel, costs of spares and consumable stores, tonnage taxes and other miscellaneous expenses. In connection with the charter of each of the vessels, Dragon pays commissions ranging from 1.25% to 6.25% of the total daily charter hire of each charter to third party ship brokers and to the charterers, depending on the number of brokers involved with arranging the charter. Dragon also

pays a commission equal to 2% of the total daily charter hire of each vessel charter to the fleet manager.

Dragon strategically monitors developments in the dry bulk shipping market on a regular basis and adjust the charter hire periods for its vessels according to market conditions. Historically, Dragon has primarily employed short-term time charters that have ranged in duration from three to twelve months. There is a belief that the short-term nature of those charters provides the company with flexibility in responding to market developments and has assisted Dragon in optimizing the amount of charter hire fees that were paid, particularly during periods when charter hire rates have increased. As contemplated by the business strategy, Dragon may in the future extend the charter periods for some of the vessels in its fleet to take advantage of the long-term cash flow and high utilization rates that are associated with long-term time charters. In this respect, Dragon has fixed a three-year time charter for the Capesize dry bulk carrier that has agreed to purchase commencing on delivery of that vessel to Dragon, which is expected to occur in March 2005. Given the size of the fleet, Dragon believes that adding one or more additional long-term time charters to its charter portfolio will reduce Dragon's potential exposure to the adverse effects of any market downturn without significantly affecting the ability to take advantage of short-term market opportunities. Dragon's vessels operate worldwide within the trading limits imposed by Dragon's insurance terms and do not operate in areas where United States, European Union or United Nations sanctions have been imposed.

3.2.6 Customers

Dragon's assessment of the charterer's financial condition and reliability is an important factor in negotiating employment for the vessels. Dragon generally charters the vessels to major charterers, trading houses (including commodities traders), major

producers and government-owned entities rather than to more speculative or undercapitalized entities.

3.2.7 Crewing and Shore Employees

Dragon crew the vessels primarily with Greek officers and Philippine officers and seamen. The fleet manager is responsible for identifying the Greek officers, which are hired by the vessel's owning subsidiaries. Philippine officers and seamen are referred to the fleet manager by Philippine S.A. and Marine Services Inc., two independent crewing agencies with whom DS has had arrangements since January 15, 2001 and July 1, 2004, respectively. The crewing agencies handle each seaman's training, travel and payroll. Dragon ensures that all seamen have the qualifications and licenses required to comply with international regulations and shipping conventions. Additionally, Dragon's seafaring employees perform most commissioning work and supervise work at shipyards, subcontractors and drydock facilities. Dragon typically man its vessels with more crew members than are required by the country of the vessel's flag in order to allow for the performance of routine maintenance duties.

The following table presents the average number of shoreside personnel that were employed by the fleet manager on Dragon's behalf and the number of seafaring personnel employed by Dragon's vessel owning subsidiaries during the periods indicated:

Table 19 Seafaring and shoreside personnel

	Year Ended December 31,		
	2001	**2002**	**2003**
Shoreside	24	21	19
Seafaring.....	85	83	130
Total.....	109	104	149

3.3 Summary Consolidated Financial and Other Data

The following table sets forth the summary consolidated financial and other operating data[59] of Dragon. The summary consolidated financial data in the table for the three years ended December 31, 2003 and for the nine month periods ended September 30, 2003 and 2004 are derived from audited consolidated financial statements[60]. Operating results for the nine months ended June 30, 2004 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2004.

Table 20 Summary consolidated financial data

	As of and for the Year Ended December 31,				As of and for the Nine Months Ended September 30,	
	2001	2002	2003		2003	2004
	(in thousands of U.S. dollars, except for fleet data, share and per share data and average daily results)					
Income Statement Data:						
Voyage and time charter revenues (1)	11,359	11,942	25,277		16,528	45,387
Voyage expenses (2)	1,494	946	1,549		954	3,087
Vessel operating expenses (3)	3,432	3,811	6,267		4,036	6,767
Depreciation (4)	2,347	3,004	3,978		2,777	3,666
Management fees (5)	456	576	728		512	660
General and administrative expenses	1,433	1,544	1,593		1,163	1,357
Operating income (6)	2,197	2,061	11,162		7,086	29,850
Interest and finance cost (7)	(2,690)	(2,001)	(1,680)		(1,066)	(1,408)
Foreign currency gains (losses) (8)	17	(5)	(20)		(10)	(2)
Interest income	84	21	27		20	73
Net income (loss)	(392)	76	9,489		6,090	28,513
Basic earnings (loss)per share (9)	(0.11)	0.02	0.37		0.25	1.03
Weighted average basic shares outstanding (10)	3,683,333	4,297,161	25,340,596		24,579,068	27,625,000
Diluted earnings (loss) per share	(0.11)	(0.00)	0.37		0.25	1.03
Weighted average diluted shares outstanding	3,683,333	18,416,667	25,340,596		24,579,068	27,625,000

[59] Some of the NYSE listing standards are: the aggregate cash flow or income for the last 3 years should not be less than $100 mm each.
[60] In conformity with U.S. generally accepted accounting principles.

	As of and for the Year Ended December 31,			As of and for the Nine Months ended September 30,	
	2001	2002	2003	2003	2004
	(in thousands of U.S. dollars, except for fleet data, share and per share data and average daily results)				
Other Financial Data:					
Cash and cash equivalents	1,310	1,867	7,441	6,259	8,661
Total assets	83,903	80,291	135,122	112,159	158,160
Long-term debt (including current portion)	58,051	54,154	83,256	68,705	93,469
Total stockholders' equity	23,118	23,482	48,441	41,180	61,100
Net cash flow provided by operating activities	5,131	5,451	15,218	8,864	33,060
Net cash flow (used in) investing activities	(53,011)	--	(52,723)	(49,470)	(25,739)
Net cash flow provided by (used in) financing activities	47,993	(4,894)	43,079	44,469	(6,101)

Fleet & Other Data: (11)					
Average number of vessels (12)	3.2	4.0	5.1	4.3	6.0
Number of vessels at end of period	4.0	4.0	6.0	6.0	7.0
Weighted average age of fleet (in years).....	0.8	1.8	2.9	2.3	3.3
Fleet utilization (13).....	98.9%	99.9%	99.6%	99.50%	99.8%
Time charter equivalent (TCE) rate (14).....	8,661	7,532	12,812	11,980	25,269

(1) Revenues are generated from voyage and time charter agreements. Time charter revenues are recorded over the term of the charter as service is provided (this is a simple calculation of dollars per day rate multiplied by a specific period of days). Under a voyage charter the revenues and associated voyage costs are recognized on a pro-rata basis over the duration of the voyage. Probable losses on voyages are provided for in full at the time such losses can be estimated. A voyage is deemed to commence upon the completion of discharge of the vessel's previous cargo and is deemed to end upon the completion of discharge of the current cargo. The revenues are driven primarily by the number of vessels in the fleet, the number of days during which the vessels operate and the amount of daily charter hire rates that the vessels earn under charters, which, in turn, are affected by a number of factors, including: the duration of the charters, the decisions relating to vessel acquisitions and disposals, the amount of time that we spend positioning the vessels, the amount of time that vessels spend in dry-dock undergoing repairs, maintenance and upgrade work, the age, condition and specifications of the vessels, the levels of supply and demand in the dry bulk shipping industry and other factors affecting spot market charter rates for dry bulk carriers.

(2) Voyage expenses include port and canal charges, bunkers, commissions charged by third parties (charterers and brokers) and commissions charged by a related party (fleet manager). Port and canal charges and bunker expenses primarily increase in periods during which vessels are employed on voyage charters because these expenses are for the account of the vessels. Demurrage income represents payments by the charterer to the vessel owner when loading or discharging time exceeded the stipulated time in the voyage charter and is recognized as incurred. Voyage expenses = Port charges + Bunkers + Commissions charged by third parties + Commissions charged by a related party + Others

(3) Vessel operating expenses include crew wages and related costs, the cost of insurance, expenses relating to repairs and maintenance, the cost of spares and consumable stores tonnage taxes and other miscellaneous expenses.

(4) Depreciation is computed using the straight-line method over the estimated useful life of the vessels, after considering the estimated salvage value. Each vessel’s salvage value is equal to the product of its lightweight tonnage and estimated scrap rate. Management estimates the useful life of the Company’s vessels to be 25 years from the date of initial delivery from the shipyard. Second hand vessels are depreciated from the date of their acquisition through their remaining estimated useful life.

However, when regulations place limitations over the ability of a vessel to trade on a worldwide basis, its useful life is adjusted to end at the date such regulations become effective.

(5) Every shipowning company have a management agreement with the Manager (in our case study is “Dragon Shipping”), under which management services are provided in exchange for a fixed monthly fee per vessel, which is renewable annually. In our case study, the Manager charges the shipowning companies 2% commission on all time and voyage charters.

(6) Operating income results deducting from the voyage and time charter revenues, the expenses such as voyage expenses, vessel operating expenses, depreciation, management fees and the general and administrative expenses.

(7) Fees incurred for obtaining new loans or refinancing existing ones are deferred and amortized to interest expense over the life of the related debt using the effective interest method. Unamortized fees relating to loans repaid or refinanced are expensed in the period the repayment or refinancing is made. The amounts in the accompanying consolidated statements of operations are analyzed in interest on long-term debt, amortization and write-off of financing costs and financial instruments.

(8) The functional currency of the Company is the U.S. Dollar because the Company’s vessels operate in international shipping markets, which primarily transact business in U.S. Dollars. The Company’s accounting records are maintained in U.S. Dollars. Transactions involving other currencies during the year or nine month period are converted into U.S. Dollars using the exchange rates in effect at the time of the transactions. At the balance sheet dates, monetary assets and liabilities, which are denominated in other currencies, are translated to reflect the year-end or nine month period end exchange rates. Resulting gains or losses are reflected separately in the accompanying consolidated statements of operations.

(9) Basic earnings (losses) per common share are computed by dividing net income (loss) available to common stockholders by the weighted average number of common shares deemed outstanding during the year or nine month period. Diluted earnings (losses) per common share, reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised.

(10) The weighted average shares outstanding are computed by multiplying the total number of shares deemed outstanding for the specific period by the number of days of the specific period divided by the number of calendar year days.

(11) The fleet and other data presented above does not give effect to the delivery of the Ship 7, which was acquired in August 2004 and is currently operating under a time charter, or the sale of the Ship 8, which, as of June 30, 2004, was a newbuilding Panamax dry bulk carrier under construction for Dragon. In October 2004, prior to the delivery of the Ship 8, Dragon entered into a memorandum of agreement to sell the vessel to an unaffiliated third party on its delivery to Dragon for a total purchase price of $42 million. Dragon elected to sell the Ship 8 rather than include it in the operating fleet in order to take advantage of strong market conditions and to sell the vessel at a favorable price. In November 2004, Dragon took delivery of the Ship 8 from the shipyard and thereupon delivered the vessel to the buyer.

(12) Average number of vessels is the number of vessels that constituted the fleet for the relevant period, as measured by the sum of the number of days each vessel was a part of the fleet during the period divided by the number of calendar days in the period.

(13) The calculation of fleet utilization is made by dividing the number of the operating days during a period by the number of the available days during the period (for the year 2001, the operating days of the fleet are 1,126 and the available days of the fleet are 1,139 which means the fleet utilization=1,126/1,139=98.8%). The shipping industry uses fleet utilization to measure a company's efficiency in finding suitable employment for its vessels and minimizing the amount of days that its vessels are off-hire for reasons other than scheduled or guaranteed repairs, vessel upgrades or special surveys. Operating days are the number of available days in a period less the aggregate number of days that vessels are off-hire due to any reason, including unforeseen circumstances, and are used to measure the aggregate number of days in a period during which the vessels actually generate revenues. Available days are the number of the ownership days, which are the aggregate number of days in a period during which each vessel in the fleet has been owned by Dragon, less the aggregate number of days that the vessels are off-hire due to scheduled or guaranteed repairs, vessel upgrades or special surveys and the aggregate amount of time that Dragon spend positioning the vessels, and are used to measure the number of days in a period during which vessels should be capable of generating revenues.

(14) Time charter equivalent rates, or TCE rates, are defined as the voyage and time charter revenues less voyage expenses during a period divided by the number of the available days during the period, which is consistent with industry standards (for the year 2001, TCE=(11,359,000-1,494,000)/1,139=8,661). TCE rate is a standard shipping industry performance measure used primarily to compare daily earnings generated by vessels on time charters with daily earnings generated by vessels on voyage charters, because charter hires for vessels on voyage charters are generally not expressed in per day amounts while charter hires for vessels on time charters are generally expressed in such amounts. The following table reflects the calculation of our TCE rates for the periods presented.

Table 21 Calculation of TCE rates

	Year Ended December 31,			Nine Months ended September 30,	
	2001	2002	2003	2003	2004
	(in thousands of U.S. dollars, except for fleet data, share and per share data and average daily results)				
Voyage and time charter revenues	11,359	11,942	25,277	16,528	45,387
Less: voyage expenses	(1,494)	(946)	(1,549)	(954)	(3,087)
Time charter equivalent revenue	9,865	10,996	23,728	15,574	42,300
Available days	1,139	1,460	1,852	1,300	1,674
Time charter equivalent (TCE) rate	8,661	7,532	12,812	11,980	25,269

3.3.1 New Credit Facility

Dragon have accepted a commitment letter from Last Bank to arrange a $230.0 million secured revolving credit facility, which believes will provide Dragon with the necessary liquidity in order to proceed with potential vessel acquisitions or for working capital requirements. A fee of $100,000 was paid upon Dragon's acceptance of the commitment letter, and a fee of $1.2 million will be payable upon the date that Dragon will sign the loan agreement. A commitment fee of 0.375% per annum will accrue on the amount of the undrawn balance from the date of sign the commitment letter and will be payable one month in arrears and on the date of the

drawdown. The maturity of the credit facility will be ten years. Interest on amounts drawn will be at a rate of 1.0% per annum over LIBOR for interest periods of one, three, six or twelve months. The new credit facility will remain available up to the amount of $210 million for a period of five years and thereafter the amount available for drawing will be reduced by $13.5 semi-annually over a period of five years with a final reduction of $75 million at the time of the last semi-annual reduction.

The new credit facility will contain, among other things, financial covenants requiring Dragon to ensure that: the aggregate market value of the combined fleet at all times exceeds 130% of the aggregate principal amount of debt outstanding under the new credit facility, the total assets minus the debt will not at any time be less than $200 million and at all times exceed 35% of the total assets; the earnings before interest, taxes, depreciation and amortization will at all times exceed 2.0x the aggregate interest due at a particular period; Dragon maintain $0.75 million of working capital per vessel. For these purposes, the total assets are defined to include the current assets, as set forth in the consolidated financial statements, and the tangible assets, as measured by their market value.

3.4 Financial model

At the beginning of the chapter we created the shipping company “Dragon Shipping Inc.” with all the proposed structural, financial, legal and managerial characteristics. We made our assumptions, which are very important and will be used for the valuation of the company in order for the underwriters to be able to sell the specific amount of shares desired by both Dragon and underwriters in the U.S. Capital markets. The price targets are based on several methodologies, which may include, but are not restricted to, analyses of market risk, growth rate, revenue stream, discounted cash flow (DCF), EBITDA, Earnings Per Share (EPS), cash flow (CF),

free cash flow (FCF), EV/EBITDA, P/E, PE/GROWTH, P/CF, P/FCF, premium (discount)/average group EV/EBITDA, premium (discount)/average group P/E, sum of the parts, net asset value, dividend returns, and return on equity (ROE) over the next 12 months.

The price, value of, and income from, any of the financial instruments mentioned in this analysis can rise as well as fall and may be affected by changes in economic, financial and political factors. If a financial instrument is denominated in a currency other than the investor's home currency, a change in exchange rates may adversely affect the price of, value of, or income derived from the financial instrument described in this analysis.

For this dissertation we have created a model in order to calculate the value of the company. A company that wishes to raise equity needs to have a similar financial model to evaluate the actual value of the enterprise. Of course there are always unknown factors that should be taken into account in the form of assumptions. The importance and the number of the assumptions play a vital role in the final result. The accuracy of the results of every model is highly depended and risk associated with any assumptions taken.

The model assumes that an IPO will raise approximately USD$193 million most of which will be used to repay the existing fleet and a follow-on offering on the 01/01/2006 will raise another $265 million, which will be used for the purchase of further tonnage. Of course this will have an effect in the valuation of the company but not for the earnings based calculation as this will remain the same for the year 2005. It is the company's decision to become a yield generating one i.e. gives as a dividend almost the entity of its free cash flow as we have already discussed.

Table 22 Use of Proceeds

IPO	01-Feb-05	
Debt	92,716	
Panamaxes	28,408	
Cape	57,150	
Use of funds	**178,274**	
Legal fees	1,800	
Undewriting fees	13,554	7.00%
Total offering	**193,628**	

UNDER NDA

Table 23 Basic Assumptions of our scenario

Basic Assumptions					
Start Date (Yr. 0)				30-Sep-04	
Investment period (Years)				5.50	
	2004	2005	2006	2007	2008
Libor:	2.40%	3.01%	3.75%	4.17%	4.60%
Interest on cash:				1.00%	
Margin on pre-delivery:					
Useful life	Containers:		Dry:	25	years
Scrap				$ 150.00	per lwt
Operational period		99.1%	of days available:	362	days/year
Commission (spot)				5.00%	
Dry-dock days			*days off-hire*	*expense*	
	vessel's age:	< 15 yrs	8		
	vessel's age:	> 15 yrs	15		
Management fees & expenses		$ 15,000	per month, plus	2.00%	of gross income
DSS acquisition	Date:	01-Jan-06	Price:	$ 20,000,000	
G&A expenses, fixed		$ 3,500,000	including DSS:	$ 7,500,000	per annum
G&A expenses, variabl	Bareboat:		T/C & spot:		per day
Inflation effect	Expenses:	2.5%	Revenue:	2.5%	per annum
Collection period				0.9	days
Days of inventory				3.6	days
Days payable				20.0	days
Other current assets as % of total expenses				4.3%	
Other current liabilities as % of operating, G&A expenes				10.0%	
Annual Cash reserve				$180,000	per vessel
Minimum cash balance				$1,000,000	
Growth scanario	(0: No, 1:Yes)	0	*Existing fleet*		
Terminal value (1: assets, 2:continuing)		2	growth rate:	2.0%	
Multiples	EBITDA:	x 9.0	Earnings:	x 9.0	

Risk assumptions			
Risk-free rate (10yrs US Treasury)		4.40%	(Nov 07, 2004)
Historical Risk-premium:		4.50%	
Liquidity premium		0.50%	
	Total Risk Premium:	*5.0%*	
Beta		0.70	(average NAT, VLCCF)
	Unlevered cost of equity:	*7.9%*	kue=rf+b*risk premium
	Debt to Market Cap		debt= 0%
LIBOR (10 year swap)	4.82%	Margin:	1.20%
	Cost of debt:	6.02%	
	Cost of equity (levered):	*7.9%*	kle=kue+(D/E)*(kue-kd)*(1-t)
Tax rate:			
	WACC:	7.90%	
	Discount Rate:	7.90%	

The most important assumption is the one regarding the revenues of the company. Our model is based on the assumption that some of the vessels have been fixed already. That means that a number of Dragon's vessels are already chartered for a period as per Table below. Our model calculates total revenues using those existing time charterers where they exist and where they do not exist, we assume that the vessel will earn an amount equal to the Forward Freight Agreements, as per the following tables. For any other period that the FFA's do not exist we have assumed that the vessels will earn the 5years average rate adjusted for inflation.

Table 24 Dragon's vessels fixed employment

Fleet List		Fixed Employment												
		1st fixture					2nd fixture				3rd fixture			
	Owned Vessels	Type	Starting	Expiring	Rate	Commission	Type	Expiring	Rate	Commission	Type	Expiring	Rate	Commission
1	Panamax 1	T/C	02-Apr-04	12-Mar-05	41,000	5.00%	T/C	12-Mar-08	24,000	5.00%				
2	Panamax 2	T/C	17-Jun-04	03-Dec-04	20,800	5.00%	T/C	15-Jan-05	38,000	5.00%	T/C	15-Jan-08	22,582	1.25%
3	Panamax 3	T/C	30-Nov-03	27-Dec-04	27,250	5.00%	T/C	24-Dec-06	37,200	6.25%				
4	Panamax 4	T/C	25-Aug-03	07-Aug-04	15,700	5.00%	T/C	31-Dec-04	30,500	5.00%	T/C	19-Aug-05	30,650	5.00%
5	Panamax 5	T/C	10-Nov-03	03-Dec-04	21,000	5.00%	T/C	04-Dec-05	32,500	5.00%				
6	Panamax 6	T/C	10-Feb-04	10-Jul-04	50,000	5.00%	T/C	10-Feb-05	18,750	5.00%	T/C	10-Feb-08	24,000	5.00%
7	Panamax 7	T/C	01-Sep-04	05-Oct-04	30,000	5.00%	T/C	05-Aug-05	31,000	5.00%	T/C	05-Aug-08	24,000	5.00%
8	Panamax 8	T/C	25-Feb-05	25-Mar-08	23,000	5.00%								
9	Panamax 9	T/C	26-Apr-05	31-May-08	23,000	5.00%								
10	Capesize	T/C	15-Mar-05	15-Mar-08	47,500	5.00%								
11	Panamax Sold													

Table 25 Analysis of FFA's prices according to Clarkson

CLARKSON		FFA Report	29-Dec-04
Average of the 4 BPI TCs	Bid	Ask	Mid
Q1	36,500	37,500	37,000
Q2	34,500	35,500	35,000
Q1+2 05	35,500	36,500	36,000
Q3+4 05	29,000	29,500	29,250
Cal 05	32,250	32,750	32,500
Cal 06	20,500	22,500	21,500
Cal 07	15,750	16,750	16,250
Average of the 4 BCI TCs			
Q1 05	68,000	73,000	70,500
Q2 05	60,000	66,000	63,000
Q3 05	50,000	58,000	54,000
Q4 05	44,000	52,000	48,000
Cal 06	32,000	37,000	34,500
Cal 07	23,000	30,000	26,500

Table 26 Dragon's earnings based on the Forward Freight Agreements

Sensitivities	
Earnings	0.0%
Op.Ex.	0.0%
Market Values	0.0%

Spot Earnings & Running Cost Assumptions										
			Direct Op.Ex.	Earnings (FFA market)						5-yrs avg.
			4Q 2004	4Q 2004	1Q 2005	2Q 2005	3Q 2005	4Q 2005	2006	2007	Long-term
	from	*to*									
Dry	Dwt		*USD/day*			*USD/day*					
Handysize	-	35,000									
Handymax	35,001	45,000									
Ultra-Handymax	45,001	55,000									
Panamax 60K	55,001	65,000									
Panamax 74K	65,001	80,000	3,950		37,000	35,000	29,250	29,250	21,500	16,250	15,761
Capesize 150K	80,001	150,000									
Capesize 170K	150,001	200,000	5,300		70,500	63,000	54,000	48,000	34,500	26,500	26,687

* For the period following 2007 spot earnings are based on the 5-year average, adjusted for inflation.

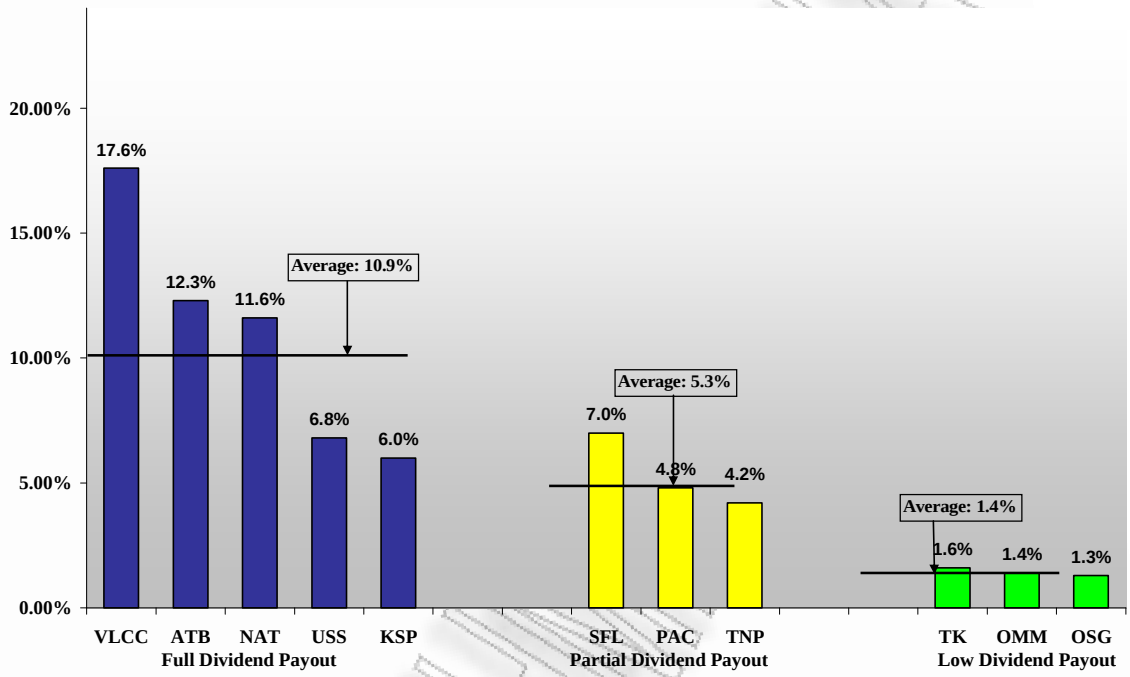
The Operating Expenses (Opex) are assumed to be for the first year USD$3,960 for the Panamax vessels and USD$5,300 for the Capesize vessels adjusted for 2.5% every year. In addition to the Operating Expenses we have the General & Administartive Expenses equal to $3.5 million per year (see Basic Assumptions). For the purpose of our model we have assumed that there is an agreement of the company to purchase the Management Company (Dragon Services S.A.) in a year's time at the price of USD$20 million[61]. That means that after the management company become part of the group, Dragon will cease to pay USD$15,000 per month per vessel plus 2% on the revenue of each vessel. On the other hand, the General & Administartive Expenses will increase from USD$3.5 million to USD$7.5 million per year. There are some other assumptions, which are self-explanatory and described on the table of basic assumptions above.

In the following tables we can see the projected financial statements for the company on a pro-forma basis. On the income statement we can see the possible dividends[62] the company can pay each year. The income statement projections are very important on the yield-based evaluation[63] of the company especially for the first year. A potential investor can easily calculate the probable yield on his investment with some certainty for the first year and by comparing the other yields that similar companies offer in the stock exchange he/she can realize the actual value of the investment. Investors also are interested to know the possible EBITDA of the company for each year and the dividend yield. Again by comparing with the other

[61] As we have already mentioned in our case study in detail, a debt will be used to raise this amount.
[62] In this point we should define that the full dividend payout is the policy of paying dividends which are substantially equal to EBITDA or EBITDA less a reserve for the fleet maintanance and renewal. The partial dividend payout has to do with dividends that are significant relative to net earnings. Low dividend payout concerns dividends which are small relative to net earnings.
[63] The dividend yield is defined as dividend per share/share price. This ratio shows the relationship of the capital gain side of the investment through share prices with the income side of the investment through dividends.

companies in the peer group[64] we can evaluate the attraction in investing in Dragon's stock at a specific price.

Graph 18 Analysis of comparable companies on dividend yield[65]



[64] We should note that there can be no assurance that Dragon's dividend yield will in fact be equal or similar to those of any of the comparable companies described in this graph. We note that the category of full dividend payout policy includes Arlington Tankers (NYSE:ATB), Nordic American Tanker Shipping Ltd. (NYSE:NAT), US Shipping Partners LP (NYSE:USS) and K-SEA Transportation Partners LP (NYSE:KSP), the category of partial dividend payout policy includes Ship Finance International Ltd (NYSE:SFL), Pasific Basin (HK:PAC) and Tsakos Energy Navigation Ltd. (NYSE:TNP) and the category of low dividend payout policy includes Teekay Shipping Corp. (NYSE:TK), OMI Corp. (NYSE:OMM) and Overseas Shipholding Group Inc. (NYSE:OSG).

[65] General Maritime Corporation, Presentation of January 2005.

Table 27 Pro forma income statement

	31-Dec-03	31-Dec-04 2004	31-Dec-05 2005	31-Dec-06 2006	31-Dec-07 2007	31-Dec-08 2008	31-Dec-09 2009
PRO FORMA INCOME STATEMENT	*(in USD thousands)*						
Revenue from vessels		63,803	97,945	95,371	85,675	66,803	62,538
- Commissions		(4,367)	(6,731)	(4,635)	(3,977)	(3,328)	(3,127)
Net Revenues		59,436	91,214	90,735	81,697	63,475	59,411
Direct vessels operating expense		(9,570)	(13,813)	(15,570)	(15,959)	(16,403)	(16,767)
Dry-dock expense		-	-	(3,665)	-	(2,999)	(1,412)
Management fees		(975)	(1,646)	-	-	-	-
General and administrative expenses		(1,086)	(4,451)	(7,820)	(8,027)	(8,228)	(8,434)
EBITDA		47,806	71,304	63,681	57,711	35,846	32,798
Depreciation		(5,124)	(9,357)	(10,269)	(10,269)	(10,269)	(10,269)
Operating Income		42,682	61,947	53,412	47,442	25,577	22,529
Interest expense		(2,155)	(667)	(1,735)	(1,822)	(1,894)	(1,768)
Interest income		95	55	21	18	37	23
Other financial income (expense)	-	84	(1,200)	-	-	-	-
Profit from sale of assets		20,460	-	-	-	-	-
Earnings before taxes	-	61,166	60,135	51,698	45,638	23,721	20,785
Tax		-	-	-	-	-	-
Net Income	-	61,166	60,135	51,698	45,638	23,721	20,785
Dividend distribution		49,620	68,155	63,753	54,238	33,791	28,018
IRR	10.50%		(581,845)	63,753	54,238	33,791	678,018
Assumed share price			$ 13.02	$ 13.02	$ 13.02	$ 13.02	$ 13.02
Earnings per share, basic			$ 1.20	$ 1.03	$ 0.91	$ 0.47	$ 0.42
EBITDA per share			$ 1.43	$ 1.27	$ 1.15	$ 0.72	$ 0.66
Dividend per share			$ 1.36	$ 1.28	$ 1.08	$ 0.68	$ 0.56
Dividend yield			10.5%	9.8%	8.3%	5.2%	4.3%
Dividend growth				*-6.5%*	*-14.9%*	*-37.7%*	*-17.1%*
Weighted average number of shares, basic			50,000,000	50,000,000	50,000,000	50,000,000	50,000,000

Table 28 Pro forma Balance sheet

	31-Dec-03	31-Dec-04 2004	31-Dec-05 2005	31-Dec-06 2006	31-Dec-07 2007	31-Dec-08 2008	31-Dec-09 2009
PRO FORMA BALANCE SHEET	*(in USD thousands)*						
Assets							
Cash & Equivalents	8,399	1,315	3,098	1,312	3,239	2,215	2,827
Accounts relievable - trade	78	184	261	242	216	153	159
Inventories	366	726	1,028	954	851	604	626
Other current assets	229	639	1,044	1,086	1,039	1,322	1,135
Current Assets	9,072	2,864	5,430	3,595	5,344	4,293	4,747
Advances	8,642	19,036	-	-	-	-	-
Vessels at Cost	*126,032*	147,283	251,878	251,878	251,878	251,878	251,878
-Accumulated Depreciation	*(9,329)*	(14,390)	(23,747)	(34,016)	(44,285)	(54,554)	(64,823)
Net Book Value	*116,703*	*132,893*	*228,131*	*217,862*	*207,593*	*197,324*	*187,055*
Net Fixed Assets (book)	125,345	151,930	228,131	217,862	207,593	197,324	187,055
Other non-current Assets	705	646	646	20,646	20,646	20,646	20,646
Total Assets	135,122	155,440	234,207	242,103	233,583	222,263	212,448
Liabilities & Equity							
Current portion of Long-term debt	6,027	-	-	-	1,333	2,667	2,667
Accounts payable, trade	602	553	837	858	880	902	924
Other current liabilities	2,133	1,494	2,438	2,367	2,427	2,487	2,549
Current Liabilities	8,762	2,047	3,276	3,226	4,640	6,056	6,140
Long-term debt, net of current portion	77,229	92,716	-	20,000	18,667	16,000	13,333
Shared Capital	34,000	34,000	212,274	212,274	212,274	212,274	212,274
Profit (Loss)	15,131	26,678	18,658	6,603	(1,997)	(12,066)	(19,300)
Shareholder's Equity	49,131	60,677	230,931	218,877	210,277	200,208	192,974
Liabilities & Shareholders' Equity	135,122	155,440	234,207	242,103	233,583	222,263	212,448
	-	-	-	-	-	-	-
Number of vessels, year end	6	7	10	10	10	10	10
Ownership days		2,318	3,341	3,650	3,650	3,660	3,650
Days available		2,318	3,341	3,594	3,650	3,612	3,634
Operating days		2,309	3,311	3,562	3,618	3,580	3,602
Utilization rate		99.57%	99.11%	99.11%	99.11%	99.11%	99.11%
% of fixed days		100.0%	95.2%	79.9%	70.0%	18.2%	0.0%
Fixed EBITDA		14,547	73,828	59,576	52,354	13,035	-
Average age		3.3yrs	3.7yrs	4.7yrs	5.7yrs	6.7yrs	7.7yrs
Average TCE rate		27,520	29,316	26,536	23,472	18,495	17,209
Overhead per ownership day		889	1,825	2,142	2,199	2,248	2,311
Average Break-Even		6,297	6,214	8,052	7,134	8,619	8,820
Assumed Market Cap		650,818	650,818	650,818	650,818	650,818	650,818
Debt outstanding		92,716	-	20,000	20,000	18,667	16,000
Dept to Total Capitalization		*14.2%*	*0.0%*	*3.1%*	*3.1%*	*2.9%*	*2.5%*
EBITDA interest coverage		x 22.2	x 106.9	x 36.7	x 31.7	x 18.9	x 18.6
EBITDA margin		80.4%	78.2%	70.2%	70.6%	56.5%	55.2%
ROA		42.1%	30.9%	21.7%	19.2%	10.4%	9.6%
ROE		111.4%	41.2%	23.0%	21.3%	11.6%	10.6%

On the other hand, an important number that can be derived from the model described herewith is the valuation of the company based on a discounted cash flow basis. For each year the probable cash flow is discounted with a rate in our case 7.9%[66] (see Risk Assumptions above for the calculation of this figure). Our Discounted Cash Flow analysis assumes a WACC of 7.9% and a long term growth rate of 2.0%. By adding those for each year together with a

[66] Once we have computed costs of individual components of the capital structure, we need to weight them according to some standard and calculate a weighted average cost of capital (WACC). The weights should correspond to market values of the various forms of financing that Dragon, intend to employ. Because we are trying to maximize the value of the firm to our shareholders, market-value weights, as opposed to book-value weights, are consistent with this objective. The 7.90 percent represents the weighted average cost of the method of financing according to market-value proportions.

terminal value in 2009 we can see the value of the company on a Discounted Cash Flow basis.

Table 29 Project cash flow

		31-Dec-03	31-Dec-04 2004	31-Dec-05 2005	31-Dec-06 2006	31-Dec-07 2007	31-Dec-08 2008	31-Dec-09 2009
Project Cash Flow	*(in USD thousands)*			NPV $ 632,023				
Revenue on a timecharter basis				97,945	95,371	85,675	66,803	62,538
- Commissions				(6,731)	(4,635)	(3,977)	(3,328)	(3,127)
Net Revenues				91,214	90,735	81,697	63,475	59,411
- Vessels operational expenses				(13,813)	(15,570)	(15,959)	(16,403)	(16,767)
- Dry-dock expense				-	(3,665)	-	(2,999)	(1,412)
- Management fees				(1,646)	-	-	-	-
- General and administrative expenses				(4,451)	(7,820)	(8,027)	(8,228)	(8,434)
- Depreciation				(9,357)	(10,269)	(10,269)	(10,269)	(10,269)
Profit before taxes				61,947	53,412	47,442	25,577	22,529
- Taxes	0.0%			-	-	-	-	-
Profit after taxes				61,947	53,412	47,442	25,577	22,529
- Changes in Net Working Capital				446	0	257	110	243
+ Depreciation				9,357	10,269	10,269	10,269	10,269
+ IPO proceeds, net				85,558	-	-	-	-
- Vessels acquisition				(85,558)	-	-	-	-
+ After tax Vessels disposal				-	-	-	-	-
Cash Flow after taxes				71,750	63,681	57,968	35,956	33,042
+ Final Recovery in Net Working Capital				-	-	-	-	(1,056)
+ Final After tax proceeds from investment				-	-	-	-	-
Free Cash Flow of assets				71,750	63,681	57,968	35,956	31,985
Cumulative Cash Flow				71,750	135,430	193,399	229,355	261,340
Discounted Cash Flow	7.90%			67,773	55,747	47,031	27,036	22,289
Cumulative Discounted Cash Flow				67,773	123,519	170,550	197,586	219,876
	Final Free Cash Flow							*34,210*
+ Terminal value at 7.90%	*growth rate = 2.0%*				-	-	-	412,148

Finally, a valuation of the company can be done based on the Net Asset Value. That is if we add all the assets values and deduct any liabilities. What an investor should do in such a case is to examine again the peer group in order to compare the market capitalizations and the NAVs of the companies.

Table 30 Dragon's fleet after the proposed acquisitions

	Owned Vessels	Type	Dwt	Flag	Lwt	Built	Age	Dry-dock Date	Dry-dock Expected cost	Ownership	Current Market Value
1	Panamax 1	Dry	75,311	Liberia	11,409	Jan-01	3.7 yrs	Jan-06	450,000	100%	41,000,000
2	Panamax 2	Dry	75,247	Liberia	11,473	Feb-01	3.6 yrs	Feb-06	450,000	100%	41,000,000
3	Panamax 3	Dry	75,336	Liberia	11,384	Mar-01	3.5 yrs	Mar-06	450,000	100%	41,000,000
4	Panamax 4	Dry	75,211	Liberia	11,408	May-01	3.3 yrs	May-06	450,000	100%	41,000,000
5	Panamax 5	Dry	75,172	Liberia	11,548	Jan-01	3.7 yrs	Jan-06	450,000	100%	41,000,000
6	Panamax 6	Dry	75,106	Liberia	11,715	Jan-01	3.7 yrs	Jan-06	450,000	100%	41,000,000
7	Panamax 7	Dry	73,630	Liberia	12,405	Sep-04	0.1 yrs	Sep-09	450,000	100%	45,000,000
8	Panamax 8	Dry	73,700	Bahamas	12,417	Feb-05	-0.3 yrs	Feb-10	450,000	100%	45,000,000
9	Panamax 9	Dry	73,700	Bahamas	12,417	Mar-05	-0.5 yrs	Mar-10	450,000	100%	45,000,000
10	Capesize	Dry	169,883	France	20,850	Feb-99	5.7 yrs	Feb-04	800,000	100%	63,500,000
11	Panamax Sold	Dry	74,000	Liberia	12,467	Nov-04	-0.1 yrs			100%	
12	Panamax 10	Dry	70,000		11,000	Jun-97	7.3 yrs		450,000	0%	
13	Panamax 11	Dry	70,000		11,000	Jun-97	7.3 yrs		450,000	0%	
14	Panamax 13	Dry	70,000		11,000	Jun-97	7.3 yrs		450,000	0%	
15	Panamax 14	Dry	70,000		20,000	Jun-97	7.3 yrs		450,000	0%	
16	Cape 2	Dry	170,000		20,000	Jun-97	7.3 yrs		800,000	0%	
17	Cape 3	Dry	170,000		20,000	Jun-97	7.3 yrs		800,000	0%	
18	Cape 4	Dry	170,000		20,000	Jun-97	7.3 yrs		800,000	0%	
19	Cape 5	Dry	170,000		20,000	Jun-97	7.3 yrs		800,000	0%	
			916,296		139,493		3.4 yrs				445mln

We can conclude the following: (i) based on a DCF basis the company is valued at USD$632,023 million, (ii) based on NAV basis the company is valued at 445,5 million, and (iii) based on the earnings of the company for 2005 those multiplied by 9 which is the norm of the peer group gives us a value of USD$541,233 million.

Now the company has to decide at what Market Capitalization should sell its shares. Let's say that the company decides to try and sell part of their shares at a price that makes the Market Cap USD$540 million, which is an average price of the three methodologies that we used for the valuation. On the following table we can see at the

column Premium how much higher or lower of the various values we have found the final Market Cap represents. By selling at a Market Cap of USD$540 million that represents only 85% of the value of the company on a DCF basis, but 121% on a NAV basis and 99% on an earnings basis.

Table 31 Dragon's valuation

	Equity value	premium
Market Cap	540,000	100%
DCF basis	632,023	85%
NAV basis	445,500	121%
x9.0 Earnings	541,233	99%

To close with, it depends on the company's policy and strategy to decide in which way the valuation will be done. Of course, there always exists the dialog with the underwriters for the best valuation. But in general if we decide a price for our company then we easily determine the price of our stock after the offering. For example our Company intends to issue 50,000,000 shares, so at a market cap of US$540 million the price of our stock at the closing should be negotiated at a range of US$11-13/share. Finally, it is the investors' demand for our stock which will determine the final price of the stock within the range of US$11-13/share.

If investors have confidence in a company's ability to pay the promised dividends based on a combination of long-term charters to high quality customers and a structure that guarantees the distribution of the entire free cash flow then the company can price based on yield. In our case in the table 27 of pro forma income statement, where we estimate for the year 2005 a dividend distribution of US$68,1 million therefore with an issuance of 50,000,000 shares we estimate a dividend of US$1,36 per share, which in an assumed price of US$13 corresponds to a dividend yield of 10.5%, rather than being restricted to the normal measures of asset value or cash flow.

The risks with investing in Dragon are those specific to the company and those associated with the shipping sector. Company specific risks include but are not limited to: interest rates, credit spreads, accidents, failure to execute growth startegy, re-charter risk, poor acquisitions and of course the political and economic condition of regions where their ships operate. The shipping sector is cyclical industries that is volatile and carry's risks that affect all ship-owners. Risks to the shipping sector include but are not limited to: GDP growth, world steel production levels, coal and route congestion and accessibility and size of the fleet.

3.5 The activity of shipping firms in the US since autumn 2004

Shipping firms raised an unheard of US$4 billion in the US since autumn 2004. Looking the activity in the following tables we see that 19 companies exercised an IPO, 6 companies exercised follow-on offerings, 5 companies are in progress of a "Blank Cheque" Deals or SPACs (Special Purpose Acquisition Companies) and 4 were abandoned from their try to raise equity. We can easily notice that the sector of dry bulk is mostly active in both IPOs and follow-on offerings rather that the tanker sector. Although the performance of recent IPOs seems negative for most of the companies we see some other such as Arlington Tankers, Teekay LNG Partners, Aries Maritime, Eagle Bulk Shipping, Horizon Lines and Double Hull Tankers to give from 7% till 15% returns not to mention the revenues from the distribution of dividends.

One of the main reasons why we saw so many shipping IPOs during 2005 was a convergence between very strong capital markets and very strong freight markets. There is a strong belief that in 10 years timeframe, the percentage of tonnage owned or operated by publicly-listed companies worldwide will rise to around 70% from 30% today. Others predict a commensurate rise in merger and acquisition activity in

2006 as IPOs begin to fade. The fact, however, is that the rates today and the rates we are likely to see in 2006 are higher than the historic average, so shipping as a sector might continue to grow on the stock exchanges.

ΠΑΝΕΠΙΣΤΗΜΙΟ ΠΕΙΡΑΙΑ

Table 32 Shipping and Shipping related equity offerings in New York autumn 2004 to date

Shipping & shipping-related equity offerings in New York Autumn 2004 to date									
Date effective	**Issuer**	**Category**	**Amount**	**Offer price**	**Market Price***	**Analyst reports**	**Rating**	**Date**	**Target price**
October 29	US Shipping Partners	Tanker	$133.5m	$22.25	$21.62	-	-	-	-
November 5	TOP Tankers	Tanker	$128.5m	$15.50	$12.76	Cantor Fitzerald	Buy	Aug 24	$23.00
						Hibernia Southcoast	Buy	Nov 22	$19.00
November 5	Arlington Tankers	Tanker	$229m	$20.00	$21.03	Fortis	Hold	Nov 18	$23.00
						Jefferies	Buy	Nov 17	$26.00
						Cantor Fitzerald	Buy	Aug 24	$21.00
February 4	Dryships	Dry bulk	$269m	$18.00	$12.61	Hibernia Southcoast	Buy	Dec 22	$22,00
						Dahlman Rose	Buy	Nov 15	$22,00
						Jefferies	Buy	Nov 15	$30,00
						Cantor Fitzerald	Buy	Aug 24	$20,00
March 17	Excel Maritime	Dry bulk	$123.88m	$21.00	$11.38	Hibernia Southcoast	Buy	Dec 22	$18,00
						Dahlman Rose	Buy	Nov 23	$19,00
						Bear Stearns	Peer perform	Aug 3	-
March 18	Diana Shipping Inc.	Dry bulk	$210.38m	$17.00	$12.34	Dahlman Rose	Hold	Dec 22	$13,00
						Jefferies	Buy	Aug 3	$21,00
						Citigroup	Buy	Dec 5	$33,00
May 6	Teekay LNG Partners	LNG	$132m	$22.00	$29.17	Wachovia	Outperform	Nov 9	-
						CSFB	Outperform	Nov 2	$17,00
June 6	Aries Maritime	Mixed	$153m	$12.50	$13.34	Fortis	Buy	Nov 18	$17,00
						Jefferies	Buy	Nov 2	$18,00
						Bear Stearns	Peer perform	Aug 2	$14,00
June 23	Eagle Bulk	Dry bulk	$201.6m	$14.00	$15.40	Citigroup	Hold	Aug 2	$11,00
						Dahlman Rose	Sell	Dec 22	$13,00
						UBS	Buy 2	Nov 22	$17,50
June 27	TBS International	Tweendecker	$81.6m	$10.00	$6.67	Jefferies	Buy	Nov 11	$17,00
						Merrill Lynch	Buy	Aug 4	$15.00
						Dahlman Rose	Buy	Dec 22	$17.00
July 18	Quintana Maritime	Dry bulk	$195.5m	$11.50	$9.57	Fortis	Buy	Nov 18	$17,00
						Jefferies	Buy	Aug 26	$16,00
						Morgan Stanley	Equal weight-V	Oct 12	-
						Dahlman Rose	Buy	Dec 22	$25,00
July 22	Genco Shipping	Dry bulk	$247m	$21.00	$17.08	Morgan Stanley	Equal weight-V	Oct 12	-
						Jefferies	Buy	Nov 4	$28,00
						Citigroup	Buy	Nov 9	$23,00
						Dahlman Rose	Buy	Dec 22	$24,00
August 9	Seaspan Corp.	Container	$600m	$21.00	$20.03	Fortis	Buy	Nov 18	$22,00
						Merrill Lynch	Buy	Nov 9	$21,50
						UBS	Neutral 2	Oct 17	$21,00
September 28	Horizon Lines	Jones Act box	$125m	$10.00	$12.48	UBS	Neautral	Nov 7	$13,00
October 7	American Commercial	Jones Act barge		$173.25	$21.00	$31.00	-	-	-
October 7	StealthGas	LPG	$116m	$14.50	$11.98	-	-	-	-
October 13	Double Hull Tankers	Tanker	$192m	$12.00	$13.20	Citigroup	Buy	Nov 25	$12,00
						UBS	Buy	Nov 22	$14,50
October 13	TAL International	Container lease	$207m	$18.00	$20.32	-	-	-	-
October 19	Trico Marine Services	Offshore support		$93.6m	$24.00	$25.40	-	-	-

* Prices at closing December 23, 2005

Table 33 Shipping and shipping related follow-ons in New York autumn 2004 to date

Shipping & shipping-related follow-ons in New York Autumn 2004 to date									
Date effective	Issuer	Category	Amount	Offer price	Market Price*	Analyst reports	Rating	Date	Target price
						Bear Stearns	Peer perform	Aug 3	-
November 19	Nordic American	Tanker	$104.63m	$38.75	$28.94	Dahlman Rose	Hold	Dec 22	$42.00
						Jefferies	Hold	Oct 18	$35.00
March 4	Nordic American	Tanker	$173.25m	$49.50	$28.94	As above	As above	As above	As above
						Bear Stearns	Peer perform	-	$14.00
October 28	Eagle Bulk	Dry bulk	$79.75m	$14.50	$15.40	Citigroup	Hold	-	$11.00
						Dahlman Rose	Sell	Dec 22	$13.00
						UBS	Buy 2	-	$17.50
						Bear Stearns	Peer perform	-	-
December 7	Diana Shipping Inc.	Dry bulk	$67.5m	$13.50	$12.34	Dahlman Rose	Hold	Dec 22	$13.00
						Jefferies	Buy	-	$21.00
December 9	Maritrans	Tanker	$78m	$26.00	$26.82	Cantor Fitzerald	Buy	-	$34.00
						Citigroup	Buy	-	$33.00
November 18	Teekay LNG Partners	LNG	$109.6m	$27.40	$29.17	Wachovia	Outperform	-	-

* Prices at closing December 23, 2005

Table 34 Shipping and shipping related IPOs that were abandoned in New York autumn 2004 to date

Shipping & shipping-related IPOs that were abandonded in New York Autumn 2004 to date						
Date Issuer	Issuer	Category	Exchange	Form	Amount	Mid-pricing
June 24	Capital Maritime	Tanker	NYSE	F-1	$150m	$15.00
August 29	Cavan Maritime	Dry bulk	Nasdaq	F-1	$100m	-
october 5	Golden Energy	Mixed	Nasdaq	F-1	$150m	$20.00
November 17	Aegean Marine Petroleum	Bunkering	NYSE	F-1	$150m	$15.00

Table 35 Shipping and shipping related “Blank Cheque” Deals announced in New York autumn 2004 to date

Shipping & shipping-related "Blank Cheque" Deals (Special Purpose Acquisition Companies) announced in New York Autumn 2004 to date			
Date	**Issuer**	**Target**	**Amount**
	ISE	Navios	$180m
	Rand Acquisition	Grand River	$54m
	Trinity Partners	FreeSeas	$26m
	Star Maritime	Unknown	$189m
In progress	Manhattan Maritime	Unknown	$114m

UNDER TWO FEET

Summary

In our attempt to bring dry bulk shipping and the capital markets together we concluded that there are numerous factors that influence the success of raising equity in the US capital markets. The appetite of the capital markets, the international dry bulk shipping industry and the proposed transaction with all the basic steps for the preparation, registration and execution of an IPO play a vital role for the valuation and therefore the market capitalisation of the company. We have to mention that there is usually a difference of opinion between the management of the company and the underwriters for the best price of the company's stocks. Usually, the role of the underwriters is that of "sell as low as you can", on the other hand the role of the company is that of "sell as high as you can". Somewhere in the middle they will find the right price of the offered stock. Of course, the final decision and influence on the price have the investors, who affect the demand of the stock and therefore, the price of the stock.

Selling shares of a shipping company to Wall Street is a difficult case, which is influenced on the one hand by the various risk factors of the shipping environment such as the seasonal volatility in charter rates, changes in demand, changes in production of or demand for dry cargo, generally or in particular regions, greater than anticipated levels of dry bulk newbuilding orders or lower than anticipated rates of scrapping, changes in rules and regulations applicable to the dry bulk industry and numerous other. On the other hand, the volatile environment in the stock exchanges around the world always influenced by political, social and economical factors appoints the investment in shipping stocks twice harder.

Shipping company is a normal business which transports cargo from point A to point B and produces work done. In addition to that it has real asset that it can be

easily liquidated, in other words, sold. The essence to that is that it was a pity for so many years shipping to be restricted from the various stock exchanges around world because of lack of information from the serious institutional shipping buyers. Of course there is the volatility of the shipping market, similar to the volatility of other markets, such as, real estate but generally information in respect of shipping nowadays is wide and many people know things about shipping comparable with previous years which make the marriage between shipping and stock exchange efficient.

It is author's view that companies with strong profile like Dragon can stand the competitive circumstances in the capital markets and the Wall Street. We assumed that Dragon possess a modern, high quality fleet which reduces operating costs, improves safety, and provides the Company with a competitive advantage in securing attractive time charter contracts. Maintaining a balanced chartering strategy provides the company with stable cash flow, high fleet utilization rates and flexibility to respond to market developments. In our case study the fact that the vessels were employed in time charters resulted in steady cash flows, predictable earnings that allow for further expansion and backing from financial institutions. A company which maintains a strong balance sheet with little or no debt positions the company to pursue acquisitions opportunities that arise maintaining at the same time its dividend policy due to the strong balance sheet. All these allow being profitable even in bad markets.

All the above were some key elements that a shipping company should pay attention to in the case of an Initial Public Offering and the raising of equity on the US Stock Exchanges. Up to now, eight Greek-owned shipping companies, mostly dry bulk operators, have raised about Dollars 1.5bn the last year through IPOs, mainly on

the Nasdaq.[67] Greek operators of bulk carriers have benefited from sustained strong demand in China, and, to a lesser extent, India, for commodities such as iron ore, coal and steel products. The Greek-owned fleet, which accounts for about a quarter of maritime trade worldwide, has undergone substantial renewal, with companies investing more than Dollars 12bn since 2000 in new vessels.

Investors lately are very attracted from the yield in shipping stocks compared to the other sectors and are prepared to take the risk involved for high dividends. We assume that many marriages between stock exchange and shipping companies will take place but only those with strong character and strategies will be able to overcome the difficult times. Let's hope that ship owners will take the chance and a new chapter for shipping finance will evolve.

[67] According to data presented by Ernst & Young, during the 7th Annual Marine Money Greek Ship Finance Forum on the 6th of October 2005 in Athens.

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