



# “Finance and IPO at the dry bulk industry”

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## ***Chapter 1***

### ***1.1 Introduction***

Generally, nothing stands in vacuum. For all aspects of human behavior and for every action, there are a number of past incidents that form the present and help predict the future. Thus, history can be seen as the backbone of all disciplines and it can be used as a tool to understand human behavior. Furthermore, to an extent, by studying history, someone can gain competitive insight into a number of sectors of human activities, like the shipping sector (which is of interest here). In order to achieve this, what is needed is a thorough examination of the shipping finance history's roots. The capital intensiveness of the sector makes it crucial to draw our attention to the financing of the industry.

Transportation of goods by sea is by far the oldest mode of transportation that dates back to ancient times and merchant nations, namely the Phoenician era. Traditionally, shipping has been the cheapest mode of transportation. Given the fact that almost three fourths of the earth is covered by water and due to the low costs of origin to destination infrastructure coupled with the competitive advantage in power (due to friction), two thirds of the world's trade is transported by sea. In numbers, it is estimated that merchant ships are transporting more than \$5 billion tons of cargo per year.

Shipping is one of the most capital-intensive industries worldwide. Its assets have been estimated around \$591 billion (Vergotis, 2001). This number can easily highlight the importance of financing in the shipping sector. At this point, what is needed is an overview of the ways ships have been historically financed and how ship finance has contributed both to the success as well as the problems in the shipping industry, and its cycles.

## ***1.2 Historical Background***

Shipping finance can easily be tracked back to joint ventures and the 16th century. In the 1850s, steam ships made their appearance and started dominating shipping. Back then, most ships belonged to a single owner and in 1848 it was documented that out of the 554 vessels registered in the city of London, 89% were owned by individuals, 8% by partnerships and only 3% were owned by some form of a joint venture. For these very rare cases, a form of fractional ownership was used to divide each ship into 64 shares in which individuals owned only part of a ship (Stopford, 1997, p.195), so control was not that necessary and in fact the market was only mortgaged by 18%.

Following the developments of history and due to the industrial revolution in Britain, a great need to cater the increased demand for raw materials and fossil fuels emerged, which drove to an increase of trade. All these changes led to a remarkable industry growth and not only ships became larger in size but joint ventures became the perfect vehicles to start financing ships. The Limited Liability Act of 1862 in the UK gave limited liability against shipowners. This paved the way for companies to attract investors. However, the structure of the industry did not change dramatically. The largest amount of the industry still remained in the hands of families and few owners. The general picture remained the same. Most companies continued to be self-financed by earnings and had low leverage; this contributed even further to the industry's capital intensive low returns. Stopford (1997) documents that industry's return was only 6% per annum compared to 15% per annum for all other companies in the UK (p.197).

### ***The 1950s and 1960s: Charter backed Finance***

The years between 1950 and 1970 marked a noticeable shift in the shipowners' behavior from conservatism and low returns, into higher returns by increased leverage on ships. The role of Japan and Europe was vital. Their rapidly expanding and growing economies and their need for raw materials led to an increased search of larger ships. A new kind of shipper made its appearance in the market, known as "the industrial shipper". As trade

increased, the shippers aligned their interests with shipowners into taking advantage of economies of scale. Shippers would secure a long-term charter for around 10 years and shipowners in turn would use that as a guarantee to get larger loans to build these larger vessels.

This new form of “charter-backed” finance gave the industry the necessary financial backing to grow, and shipowners gained by enjoying higher returns through operations and even stronger returns through the sale and purchase market (S&P). Norwegians were from the first that took this opportunity to expand and build their fleets, and well known leaders of the industry like Onasis and Niarchos capitalized on such financing to create their shipping empires.

This new form of financing gave rise to what is known as the single ship company, where individual ships are registered offshore through one-ship companies. Flags of convenience for tax and financing purposes were also developed. The rights of these off shore companies were controlled by a holding company, which in turn often used subsidiaries to run its ships. This structure was profitable for both for the shipowner and the financiers, as it helped with the simplification of the loan structure while at the same time creating tax- gains for the shipowners.

This financing method dominated the markets for around 20 years and it reached a point where economies of scale were no longer present, therefore shippers and charterers had no reason to back-up orders made by shipowners. By the end of the 1960s, 80% of the independent tanker fleet and a large part of the bulk carrier fleet were operating in time charter. Meanwhile, price increases were on the rise, severely damaging the long-term charter profits for the shipowners while at the same time charters started becoming unable to meet their commitments. All the above factors combined with the decrease in the demand for oil and drybulk commodities (Iron ore, coal amongst others), led to the 1970s asset backed lending.

### *The 1970s: Asset backed Finance*

Until 1963, the lending market was located in New York. It was during that time that the US congress enacted an interest equalization tax to stop the outflow of capital outside the US. All these changes led to a severe damage for the maritime industry which in turn lost its biggest creditor. These movements led to the creation of the new shipping center which was established in London. All these new developments (namely the early 70s strong market and the move to London) created a number of opportunities and opened the door for many new banks to enter the maritime market. This sector was an unfamiliar territory for these new players. They did not fully understand its cyclical nature but at the same time had access to the Eurodollar (U.S. dollar-denominated deposits at foreign banks or foreign branches of American banks-by locating outside of the United States, Eurodollars escape regulation by the Federal Reserve Board) market and wanted their share in the high profits the industry was making. Thus, banks lowered their margins and their commissions in their attempt to enter the market. This happened at a time when the Suez Canal had brought favorable optimism towards the tanker market, and the bulk trade was also giving superior returns compared to other years.

As price rises and currency exchange rates wiped out profits for banks and shipowners, the latter begun being better off in the spot market in this high rate environment period, while the former started looking for other forms of guarantee, as they found that charter collateral was not suitable. Banks turned their attention to asset backed guarantees with a first mortgage on the hull.

Meanwhile, as oil was reaching \$40 per barrel, the high returns of the oil companies and the ever-increasing leverage provided, gave shipowners and oil companies the opportunity to expand. Banks were providing 80% and even 110% leverage with which oil companies and shipowners were able to build a large enough orderbook to slow down both the dry bulk and the tanker market. Another fact which further amplified the situation was the lack of experience of the banks which were conditioned to support building, in a counter-cyclical ordering rationale. This further escalated the decline in the

shipping industry which lasted all the way until 1986 (apart from a short lived upturn in 1979-80), a time period in which many shipowners defaulted and ship values reached rock bottom, as shipowners were forced to sell in order to raise cash to cover their operating expenses.

Too much credit depressed the market and the high vessel fluctuations that characterized the 70s made many of the banks re-evaluate their strategies.

### ***The 1980s: Assets into play***

The banks that had entered in the previous cycle had gained insight and realized substantial losses, thus had been forced to exit the market by 1983. The traditional banks kept a place in the shipping market, but financing was limited and so new sources of finance were sought upon. A financing vehicle used early on was the self-liquidating ship fund. Companies managed to take advantage of the distressed asset values and took a short term investment strategy in shipping by exiting with liquidation of the company when asset values rose higher. Over the next four years the asset prices of vessels would appreciate to more than four fold and many such companies made substantial profits. However many investors that used such vehicles in “copy-cat” schemes ended up losing money as they were unable to fully understand the cyclical nature of the shipping industry.

As asset values were increasing, the industry started looking for new ways of financing itself, such as equity offerings, which, as assets grew more valuable, became easier to engage in. Although it is estimated that \$600 millions were raised, only very few investors realized the potential positive returns on investment, as they would enter the industry only later in the cycle. At the same period, the Norwegian KS Limited partnership was emerging. These partnerships were quite similar to ship funds but they had also the additional advantage of having tax free profits, if they were reinvested within a certain period of time. However, when asset values peaked and tax advantages abridged, the KS partnerships lost their appeal.

### ***The 1990s to 2000: New Finance Methods***

Throughout the 1990s, the banks, after having suffered losses in the previous decade, became more conservative. This was further enhanced by the new Capital Adequacy Rules put into place by the Bank of International Settlements, following the savings and loan crisis of the 1980s. The need for sounder credit policies and more efficient credit analyses resulted in a new bank approach and a focus on the second-hand market as projects had longer visibility and were thus regarded as safer investments. In the beginning of that particular decade, the industry was characterized by convalescence and the decrease in shipping portfolios made owners examining a number of different solutions and other sorts of finance.

Shipowners showed a turn into less traditional sources of financing such as private placements, public offerings and the bond market later on in the 1990s. Long-term maturities in debt seemed to be the perfect way to hedge against the short lived shipping cycles. This strategy however would soon prove to be disastrous for many shipping firms as the high yielding coupon rates on the bonds were squeezing company cash flows, during the Asian crisis of 1997, causing many of them to go bankrupt. Investors and bondholders were once again the ones to suffer the most financially, as they saw many owners restructuring their firms and buying back their vessels at much lower valuations.

### ***The 2000s: Equity Financing***

The new decade proved to be the decade of equity financing. After shipping rates started picking up in 2000, the market experienced many attempts from a number of shipping companies to once again go public. This time was in the equity markets. Vessel valuations were picking up and investors' confidence was being reestablished in the sector. China and its demand for raw materials was the main force driving the market. Given the circumstances, investors were more than happy to invest into trade with the Far East. This enthusiasm led to an unprecedented total of \$20 billion of market capitalization



in U.S stock markets in the year 2005, which can easily be termed the year of the shipping IPO as more that \$2.9 billion dollars were raised in the U.S capital markets.

ПАВЕЛЪ ТИМО ТЕПАК

## ***Chapter 2: Types of Financing***

### ***2.1. Bank Financing***

The majority of shipping's finance is carried out by large international commercial banks. Given the fact that the shipping industry is generally very capital intensive and ships are viewed as long-term assets, banks have developed term lending or term loans. The term 'term loans' refers to strict legal agreements in which a bank lends a pre-specified amount of money for specific time, with amortization either for the life of the loan or at its maturity. The duration of a loan can vary from 2 to 10 years and in case the borrower is looking for a longer maturity, he then turns to other types of financing such as mortgage banks or leasing companies (Harwood, 1995).

The term 'drawdown' is used to describe the amount of money that is lent. In the loan, the period, the maturity, the purpose, the amortization schedule, the currency and the interest charge are all specified. The margin or spread of the loan is generally quoted above LIBOR (London Interbank Offered Rate). Given the high risks the shipping business has, shipping loans command higher margins than other corporate businesses, ranging from 0.5% to 2% and with both corporate and personal guaranties.

In practice, there are four main types of term loans. First is the Moratoria loan. In this case, a free period of 1-2 years is allowed before the repayment of the loan commences. These types of loans are often chosen in cases of newbuildings or depressed markets. Secondly, there are the so called 'balloon repayments' by which a large final lump sum payment is due at the end of the loan duration, following interest repayment and small capital contributions throughout the duration. The reason of the existence of this type of loan is because of the insufficient cash-flow for a full debt repayment and so as to avoid problems in calculating the vessels residual value. The third form of loan, although generally avoided due to its riskiness, is the Bullet repayment. It refers to the case where the payment of the loan is due at maturity and only interest payment is performed for the

duration of the loan. Finally, the last type of loan is the 'back/front ended' loan. When a buyer anticipates a market downturn, he asks for a back end orientation in which principal payments are greater towards the end of the duration of the loan. On the other hand, a front loaded loan is one where principal payments are greater during the first part of the loan structure. This type of loan was very common during periods of high freight rates (Kendall L.C. & Buckley J.J., 2001). Many of the loans that were issued in 2004 and 2005, given the exceptionally high freight rates at the time coupled with the increased risk on the banks side, were front loaded.

The interest rate above LIBOR has often caused shipowners great dissatisfaction as they are vulnerable to interest rate changes. However, for the last decade there have been many financial instruments developed (options, derivatives and swaps just to name some), in which shipowners can engage in order to prevaricate their interest rate exposure.

Sums of over \$50 million of term loans are generally syndicated by more than one bank because of the size of the loan (Stopford, 1997, p.204). 'Syndications' is a term that means that usually 3-7 banks finance a smaller amount of the whole loan because of the large amount of the loan. The lead manager concept is usually adopted in cases where one major bank, known as 'the managing bank', establishes the syndicate and negotiates all the terms, prepares the necessary documentation and appoints the necessary advisors. The rest of the banks that participate in the procedure are often referred to as "co-managers".

Another type of loan is the 'revolving facility', in which the amounts repaid can be re-borrowed, unlike in the 'term facility'. These kinds of loans are typically useful for companies heavily engaged in the S&P market. In these particular cases, shipowners do not have to renegotiate the terms of the contract each time they engage in such a transaction. Revolving facilities typically have the same terms as term loans.

Banks and shipowners have opposite goals. Therefore, negotiations and bargaining are common factors of the game. More specifically, the bank loan generally depends on the accountability of the borrower, the insight of the bank into the shipping industry and the shipping industry conditions at the time the loan is being negotiated. From the shipowner's perspective, his goal would be to get a small interest rate, long duration, with little or no collateral, as terms on the loan. The bank on the other hand wants high interest rates so as to protect itself from the riskiness of the project. In addition, a bank will look for small durations so it will be able to take on interesting projects as they come by. Someone could assume that many negotiations take place and it is in the interest of both parties to negotiate acceptable and logical terms in order for default to be avoided. The risk-return profile must be thought through by the bank and presented to the shipowner.

Because of the nature of the negotiations, bank and shipowner relationships tend to be personal and long lasting. It is in the benefit of the shipowner to know his banker. On the other hand, the bank should know the shipowner and his past performance. In the case of default such relationships usually lead to restructuring of the loans instead of liquidation, which is usually less appealing to both parties involved.

## ***2.2 Government and Shipyard Credit***

In order to drive demand in the downturn of the shipping cycles and to keep the shipping infrastructure intact, governments in Japan, pioneered a concept providing favorable terms to the shipowner. Back in the 60s Japan managed quite quickly to become the largest shipbuilding nation. However, this development spurred a credit war between Europe and Japan. This led to the OECD Understanding Agreement in which the most favorable terms offered by any particular government to shipowners, were outlined. Nowadays, governments are able to provide up to 80% of the loan value for duration up to 8.5 years and an interest rate of 8% at best (Stopford, 1997, p.216).

The reason that these government “subsidies” were put in place was because of the repayment schedule that was required by the shipyards in which periodical payments had to take place for the cover of the material costs.

This kind of credits are still used in the U.S (Title XI), in Japan (EXIM) and many other countries and provide favorite terms in interest rates, tax allowances and operating subsidies. Lately, such subsidies have eclipsed due to the fact that commercial banks are keener in providing favorable terms to shipowners and the governments are unwilling to take on all the risk.

### ***2.3 Ship Capital Leasing***

A general definition for leasing could be that it is an agreement between the owner of the property (lessor) and the “lessee”, who is the person that is granted use of the assets for a predetermined time (usually 10-25 years) and for a predetermined rate. Leasing in shipping is used to finance the use of a ship rather than its ownership.

There are a number of advantages in this kind of agreements. To name some, leasing offers tax advantages to the lessee and a low fixed cost for operating the vessel. Thus, it helps prevent large debt and equity outflows. On the other hand, there is also an inherent disadvantage. This would be that the lessee does not have ownership of the vessel, thus cannot sell it. From the lessor’s side, the guarantees on the lessee are usually limited, so the lessor usually engages in such agreements only with well regarded companies.

### ***2.4 Public Debt***

Corporate borrowing has a number of advantages over other sources of financing. In terms of equity, it offers retained ownership and lower costs of issuing it. In terms of bank finance, it improves the companies Free Cash Flows (FCF) as only interest and no

principal has to be repaid, on coupon bonds. In addition, in these cases, covenants are usually less restrictive than in bank financing.

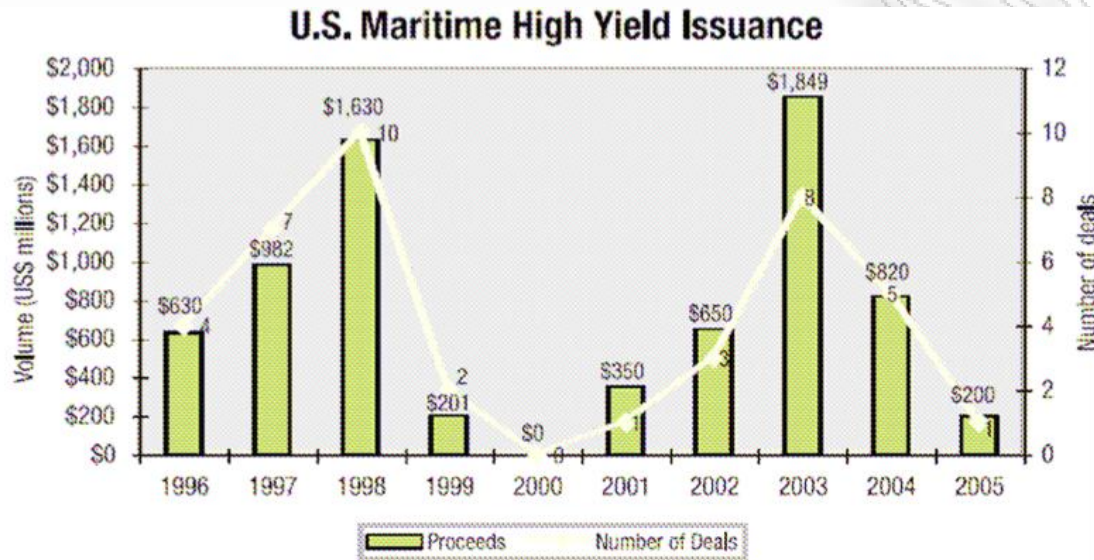
In the past, shipping companies that placed corporate bonds in the markets had to get a rating by a credit agency such as Standard & Poor's or Moody's. This rating would in turn determine the semiannual coupon rate which the company would pay. Given their riskiness, shipping bonds were generally below investment grade and were regarded as High Yield bonds. Generally, bonds are categorized as secured and unsecured, where unsecured bonds are less restrictive to the company.

### Bond Credit Ratings

	Moody's	Standard & Poor's	
Highest Quality	Aaa	AAA	Investment Grade
High Quality	Aa	AA	
Upper Medium	A-1, A	A	
Medium	Baa-1, Baa	BBB	
Speculative	Ba	BB	Not Investment Grade
Highly Speculative	B, Caa	B, CCC, CC	
Default	Ca, C	D	

In 1993, a number of shipping companies approached the public markets, at a time when interest rates were very low and were successful. In the period between 1996 and 1998, there were around 20 companies that tried to do the same however, they were offered very high yields (approximately 9%-13%) and often owned old fleets, which were prone

to market downturns. With the Asian Crisis in 1997 through 1999 many of these companies defaulted on their coupons and either reorganized or liquidated, leaving many investors unhappy and the prospects of raising public finance closed for a couple of years. Historical shipping high yield market issuances are provided in the graph below.



*Source: Marine Money Magazine*

### **2.5. Equity Financing - IPO's**

Shipping equity finance seems like the most interesting way for growing a company fast, efficiently and without incurring any debt. It would bring proceeds that would grow a company fast while also bringing credibility to customers and vendors. The firm will only have to pay back shareholders in dividends which are not mandatory. However disadvantages could be focused on the high costs of issuing equity estimated at around 7% of the proceeds for the investment bankers only. In addition the legal exposure of directors and management is seen as another negative, in the recently passed Sarbanes-Oxley Act, which makes both fully accountable and responsible.

Equity financing in shipping apart from its recent resurgence is uncommon and apart from some K/S funds in Norway and some self-liquidating funds in the late 1970s on Wall Street, has been hard to raise. Many Tanker companies went public in the late 1990s

and early 2000s and opened the window for other companies to follow. However there have been many setbacks in this sort of financing as the shipowners themselves are unlikely and unwilling to give up ownership and open their books. The secrecy and closeness of the shipowner is a well known fact in both the shipping sector and the investment circle. Information on the company would have to become public information and many of the shipowners are unwilling to do so, in addition the companies operating and accounting department would have to change to cope with the various requirements of a public company such as quarterly reports and audits conversion to G.A.A.P accounting. The issue of control also comes into play, as shipowners are less likely to give over control of their company to outside investors. In addition many owners are concerned about tax implications with public company income as shipowners tax haven is said to have caused “allergies” to the sound of the word tax.

The shipping community has had its share of negative publicity with its notorious 1997-1999 defaults in the bond market. Wall Street has remained very cautious when investing and only recently showed uncontrollable exuberance as the shipping sector started being associated with the energy sector and the China and India emerging markets that every investor wanted to be in.

### ***Follow on Offerings***

Follow on offering also referred to as “seasoned offerings”, have two ways in which they can be implemented by “a general cash offering” or by a “rights issue”. The former is an exchange of stocks for cash and the latter is associated with dilution to existing shareholders as the sale of shares is at a discount to market price.

A follow on offering is easier to implement than an IPO is. However, a company must outweigh the costs with the benefits. The costs being that when a company issues stock its price is expected to fall as investors know that it is a prerequisite for the company to be overvalued in order for it to issue stock or else it would look into other sources of financing. If the price dip in stock value is deemed to be very large, companies often



don't engage in follow on offering. In addition investment banks usually lead these kinds of transactions and charge anything for 2% -4% of the total proceeds of the issue.

### ***Private Placements***

Many shipowners rightfully have avoided a Public offering and have opted for a Private Placement because of its simplicity, and the lack of fees and long time process that an IPO may take. Private Placements are placements given to a few investors, usually large institutional investors in which no public information such as advertisements, articles etc can be used. Usually Private Placements are offered to investors who wish to keep the securities; some restrictions on resale apply. The SEC has adopted rule 144A which exempts initial Private Placements for immediate resale to Qualified Institutional Buyers, and unregistered securities are traded to QIB's, or otherwise known as institutional investors. Private placements require a broker in the U.S and can be placed after the public offering of a foreign company in a foreign exchange, with some restrictions on resale of stock abroad. (Harwood, 1995, p.95)

The major advantages of private placements are in that the U.S has a massive private placement market in which the timely process of the IPO and the various fees and expenses associated with it are avoided. In addition many regulatory requirements are avoided after the private placement has taken place. There are minimum regulatory requirements and oversight. Some considerations include a questionable placement fee and illiquid ownership. (Harwood, 1995, p.95)

## ***2.6 Alternative Sources of Financing***

### ***Mezzanine Financing***

Mezzanine financing lies somewhere in between debt and equity. It could involve subordinated debt, preferred shares, convertible bonds or even equity warrants.

Mezzanine finance is usually used by companies that do not have the cash flow history demanded by senior lenders, and for purposed of keeping ownership of the company. Trying to estimate the market we found that Marine Money Magazine estimates that between newly raised mezzanine finance funds, hedge fund/money managers and annual insurance company/finance allocations, the mezzanine market is \$154 billion in the U.S. However, these forms of financing are not common in the shipping markets.

### ***Convertible Securities***

Convertible Securities are usually in the form of either bonds or preferred stock. The value of such financing is highly regarded by hedge fund who profit from the discrepancies of such securities and the underlying stock. The market in the U.S is estimated at \$195 billion by Marine Money Magazine.

Convertible bonds are issued by companies because of their lower cost and lower interest rates that are associated with it, in comparison to equity and debt respectively. If conversion is priced in, such securities sell at a premium to the stock price and so this does not dilute current investors as equity does. This type of financing, has been favored recently by some public tanker shipping companies. The typical terms of convertible bonds are seven years (five year non-callable) with 4% coupon and a conversion premium of about 30%. Some even have terms of 5 years but in such cases conversions command a higher premium.

### ***Operating Leases***

Operating Leases are more flexible than the financial leases. The difference between the capital leases described above and the operating leases have to do with the fact that the lessee can cancel the lease. In addition the lessor assumes the residual value risk because of the shorter term duration of the lease. In this case the lessor is usually required to maintain the lease equipment, incurring his own costs, which are usually incorporated in the lease price.

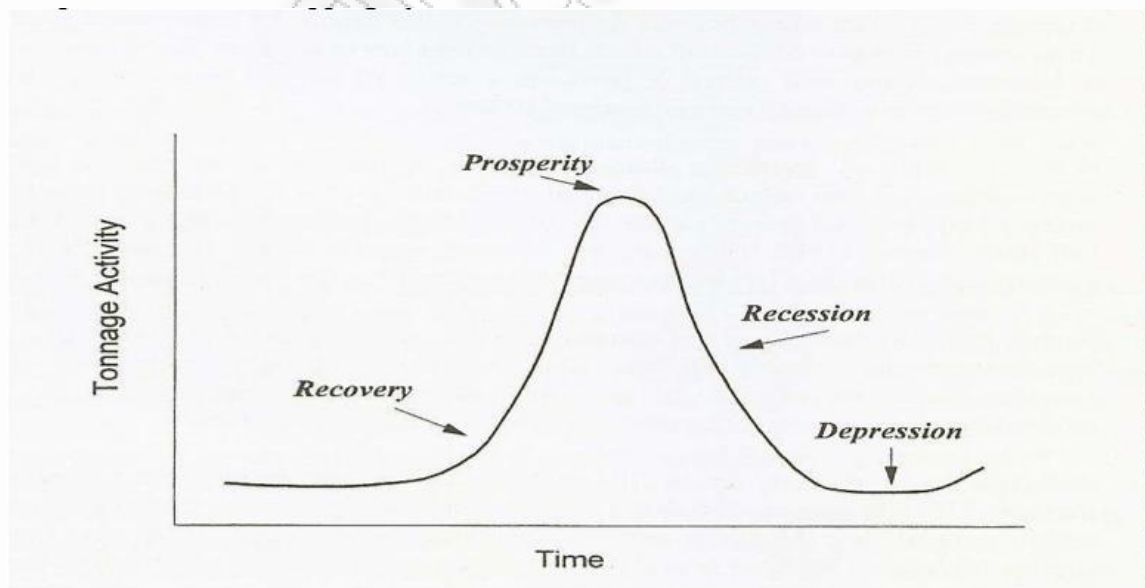
## ***Chapter 3: Drybulk Industry***

### ***3.1 - The Cyclical Nature of the Shipping Industry and the Shipping Investment Cycle***

The nature of the cyclical nature of the shipping investment cycle is linked to the behavior of the major parties in the industry. The banks, shipyards, governments, and most importantly the shipowners and their actions, determine the market rates. The demand and supply balance of the market is ultimately affected by the decisions of the above parties. Demand is affected by world economic growth and the demand for energy and materials. The supply is affected by new building deliveries, scrapings, and the change in trade patterns. However the supply side on a second level is further affected by the availability of finance and government intervention.

The shipping investment cycle shows the effect on the market from a market investment perspective. The shipping cycle and market behavior consists of four phases: prosperity, recession, depression and recovery.

**Investment Shipping Cycle**



*Source: Maritime Economics, Martin Stopford*

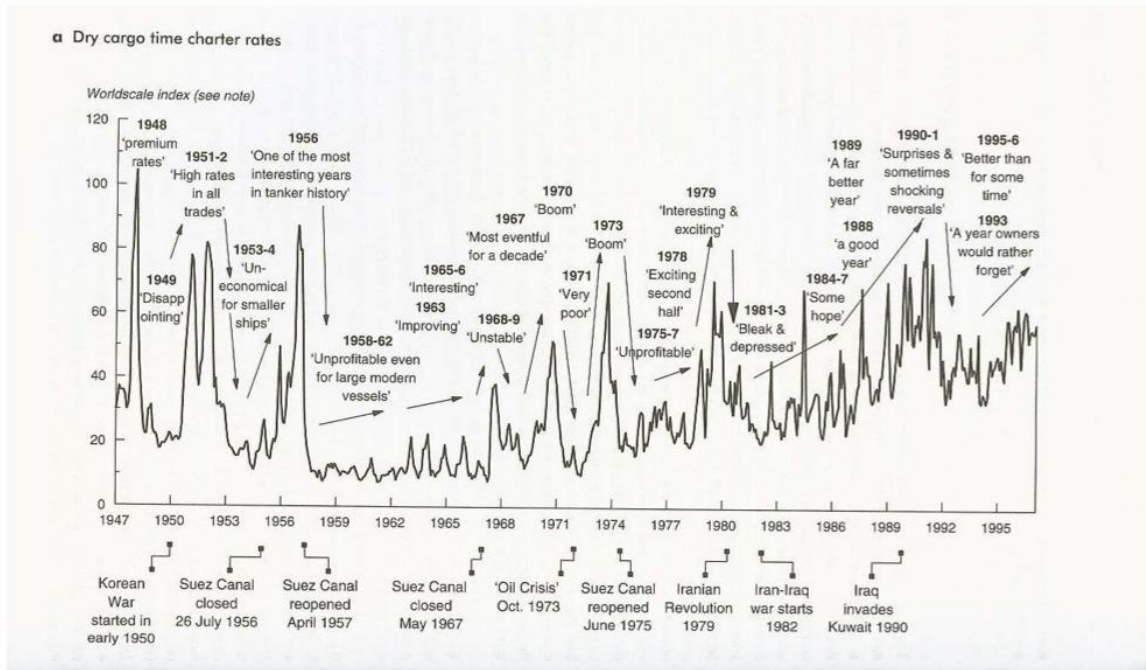
In the prosperity phase the market is characterized by strong freight rates that in turn start affecting the valuation of vessels, which pushes up second hand vessel prices, due to the positive outlook of the future, banks' eagerness to finance, coupled with existence of long-term charters. The second-hand S&P market is strong due to the fact that newbuildings need at least one to two years to be built. Newbuilding demand increases and as the orderbook builds up newbuilding prices are being pushed higher. Scrapping of vessels declines as owners find it profitable to still operate old vessels and lay-ups begin coming back to the market.

This overinvestment during the prosperity phase leads to overcapacity in the sector and the market turns into recession. The overcapacity is further amplified by the time-lag in the delivery of newbuildings and the banks' availability of finance which forces the market into depression. In depression credit is usually reduced and long-term charters are hard to find.

The increase in scrapping and lay-ups of vessels equalize the supply and demand equation and the market enters into the recovery period where rates start to increase once again. Soon thereafter S&P, finance and the newbuilding market start to pick up and the market enters into the prosperity phase once again.

The graph below gives a historical representation of the short term Time Charter (TC) rates in the Drybulk market, and puts a graphic historical perspective to the market and the cyclicity by which it is characterized.

## Drybulk Freight Rates



Source: *Maritime Economics*, Martin Stopford

### 3.2 - Drybulk Industry: An Operational Standpoint

In order to further understand the shipping industry as a business the revenues and costs associated with a shipping operation have to be analyzed. Revenue in shipping is derived from freight. The way in which freight is generated generally depends on the company's chartering strategy. There are three main types of chartering. Namely: Voyage or spot Chartering, Time Chartering (TC), and Bareboat chartering.

Spot Chartering is when a vessel is employed on a single trip voyage or employed for a period of less than six months. A daytime charge is paid by the charterer to the shipowner. The costs of operating the vessel and the voyage costs are paid by the shipowner. This source of revenue is highly volatile as it is directly linked to the Baltic Dry Index (BDI) which is a representation of the supply and demand of vessels and cargo in any given day. Spot charters historically have outperformed TC charters and a large percent of the industry is operated in this kind of manner.

TC chartering can be subcategorized into short term (less than 1 year), medium term (1-2 years) and long term (more than 3 years). The shipowner in this type of charter continues to pay capital and operational costs but the charterer assumes voyage costs and cargo handling costs. TC strategy is used by shipowners that want insurance against market downturns and companies that are more risk-averse. In TC types of strategies Contracts of Affreightment may be used in which ships of a shipowner must complete a number of round trips on a specific route. However the contract does not specify a certain vessel and the shipments are not necessarily spaced in accordance to the round trip time.

Bareboat Chartering or demise chartering as it is otherwise known, is when a shipowner retains ownership of the vessel, however surrenders full operational control to the charterer for a pre-specified daily freight. The shipowner may only retain some general policy influence. In this type of a charter the shipowner is responsible only for capital costs. The typical duration of such a transaction varies from 5 to 25 years. This kind of strategy is generally used in newbuilding transactions and in cases where shipowners believe the Sale and Purchase (S&P) market is ideal for them to engage in such transactions.

A Drybulk shipping company's costs are also a determining factor in a company's operations. There are three main types of costs. Firstly operating costs such as crewing, technical, supplies, insurance and administration which range anywhere from 25%-40% of the total costs. Secondly voyage costs which include Bunker costs, port costs, towage and pilotage costs, canal costs, and cargo related costs which account for around 60% of total costs. Thirdly capital costs or finance costs are also important and depend on the company's capital structure and leverage and usually account for around 30%-40% of the Company's total costs (Stopford, 1997, 161).

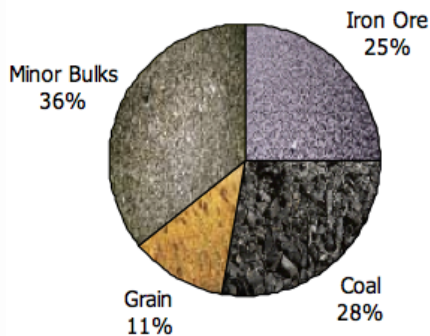
This part serves to acquaint the reader with the operational standpoint of a Drybulk shipping company. In essence however a company's operations and profitability in turn will depend on the charter strategy it chooses and the quality of its management and employees.

## Commodities

The shipping industry is a highly cyclical industry as explained in the previous part of this chapter. The industry highs took place in 1980, 1989, 1995 and most notably in 2004, 2005 and 2007. The industry however has experienced many “depressed” years as shipowners usually add tonnage when the industry is peaking and this results in large overcapacities that keep the market down for many years. One of the most notable recent lows took place, when a strong orderbook along with a depression in Asia, caused freight rates to crumble. This began in 1997 and is widely considered the aftermath to the Asian crisis, in which many shipping companies went bankrupt. This weakness continued until 2000 when rates started to pick up.

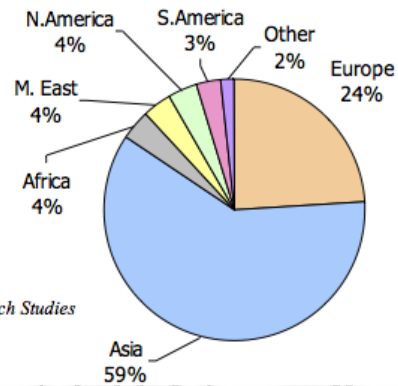
The increasing importance of trade because of globalization has impacted shipping positively as 66% of all international trade is moved by sea. Dry bulk trade accounts for about 40%, and tankers account for another 40% (Goulielmos, 2006). In 2004 approximately 2.5 billion tons of Drybulk cargo were transported by sea. The dry bulk commodities are shipped in large quantities and can be easily stored with little risk of cargo damage. The Drybulk commodities that the industry deals with fall mainly under three large categories. Namely, iron ore, coal and grain which all together account for 64% of the dry bulk seaborne trade. Other less important bulks are subcategorized as minor bulks and include amongst others: alumina, bauxite, fertilizers, rice, sugar, gypsum and cement, all account for the remaining 36% of trade. The two graphs below will show the commodity breakdown and the regional breakdown of trade (Clarksons 2007).

### Seaborne Drybulk Trade Commodity Breakdown



Source: Clarkson Research Studies

### Regional breakdown of trade



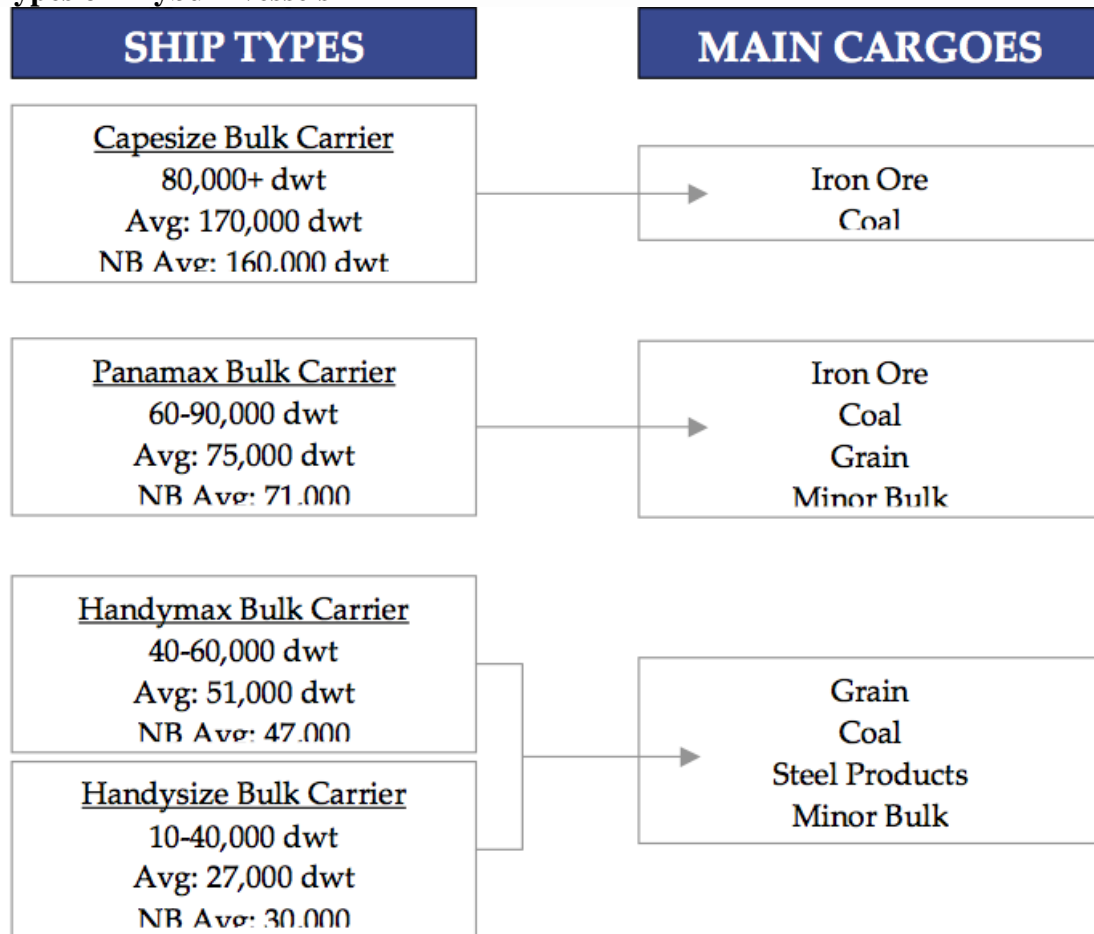
Source: Clarkson Research Studies

The above two graphs show the importance of the three major bulks and Asia. Asia accounts for almost 60% of dry bulk commodities transported and a large part of that is fueled by Chinese demand. The current economic growth in China and in Asia in general resembles industrial development in the U.S and in Europe, which took place 100 to 150 years ago or Japan in that matter in the 60s.

The commodities transported have many uses. Iron ore and coking coal are used for the production of steel which is the most important construction and engineering material in the world. Steel is used for buildings, highways, ships, cars etc. Thermal Coal is used for electricity and energy generation. Grains are used for human consumption, the most important of which is wheat. Other grains like corn, barley, oats and rye are used as animal feed, which also in turn becomes human consumption.



### Types of Drybulk vessels



Source: Clarkson Research Studies

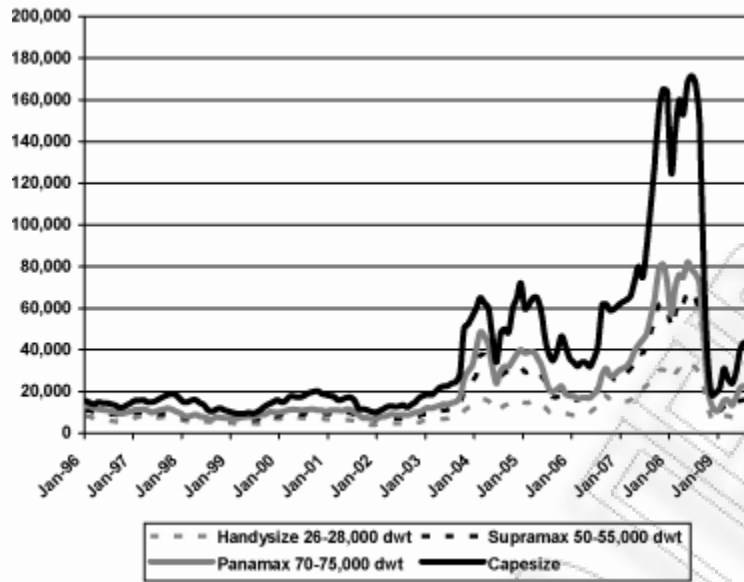
We can induce from the above that the Drybulk fleet vessels have a wide range of deadweight tonnage from 10,000 Dwt to over 180,000 Dwt. In addition there are various port restrictions that take effect on these ships as draft and beam varies. Capesize vessels carry predominately iron ore. Panamax vessels carry predominately coal and grain and the smaller vessels carry predominately minor bulks.

### Supply & Demand

The demand for dry bulk carrier capacity is determined by the underlying demand for commodities transported by them, which in turn is influenced by trends in the global economy. Generally, growth in gross domestic product (GDP) and industrial production correlates with peaks in demand for ocean-going transportation.

Occasionally, a particular economy will serve as the primary driver of the dry bulk carrier market. For example, in 2007, China's demand for commodities increased dramatically due to its preparation for the Olympic Games 2008. At the same time, most developing countries, such as India, Japan, China, South Korea, Africa and South America (Mexico, Brazil) had GDP's reflective of excellent economic growth at industrial and transportation levels. Growth leads to more consumption; consumption is followed by greater demand and supply of goods.

However, the conditions changed dramatically around September 2008. At that time, an unprecedented financial recession began in the US, a major importer/exporter and a key influence on international trade in every sector. Its affects are widespread, evidenced by the current global recession. Consequently, global shipping is facing its worst crisis ever. Dry cargo freight rates have been reduced more than 90% over a short period. The five-year boom has turned to bust. In this sense, demand for transport of commodities to fast growing nations like China and India has been dramatically reduced. Dry cargo vessels, for instance Panamaxs and Capesizes that commanded approximately \$150,000 per day in May 2008, now earn less than 7,000 dollars. Here is a chart with the freight rates for different types of vessels on years:



## Charter Rates

Charter hire rates paid for dry bulk carriers are primarily a function of the underlying balance between vessel supply and demand. Furthermore, the pattern seen in charter hire rates across the different charter types correlates to 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. Conversely, trade in minor bulks is the primary driver of demand for smaller dry bulk carriers. Accordingly, charter hire rates and vessel values for those vessels are subject to less volatility.

In terms of the time charter (T/C) market, rates vary depending on the length of the charter period and vessel specific factors such as age, speed and fuel consumption. Short-term T/C rates are generally higher than long-term charter hire rates. The market benchmark tends to be a 12-month T/C hire rate, based on a vessel five to ten years old.

In the voyage charter market, rates are influenced by several factors, such as cargo size, commodity type, port dues, canal transit fees, as well as delivery and redelivery regions. In general, a larger cargo size is quoted at a lower rate per tonne 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 to regions that include commonly used loading and/or discharging ports 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.

### **Indices**

The prices of all commodities that dry bulk carry are defined by indices. The major index reflecting the market is the Baltic Dry Index (BDI). One of the most significant indices of the economic activity around the world, BDI measures the demand of moving raw materials to production as well as the supply of vessels available to provide transportation. Moreover, other economic indicators, such as consumer spending are heavily dependant upon BDI, as they use this index as a means for examining what has already occurred. In this way, BDI provides important information to all stakeholders, including brokers, traders, charterers and ship owners.

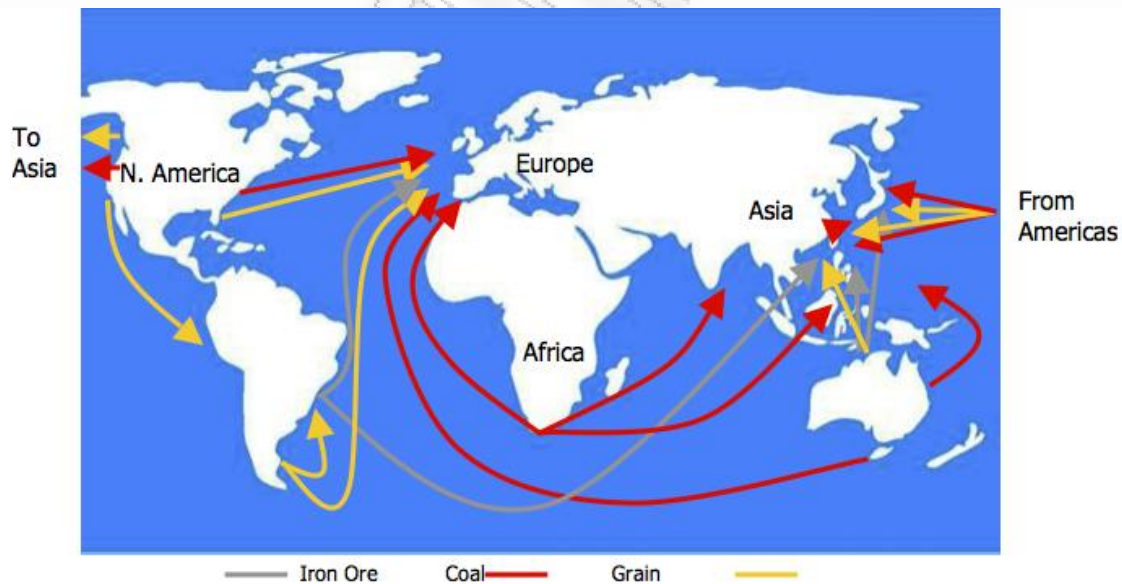
BDI index is divided into four categories: (1) Baltic Exchange Capesize Index, (2) Baltic Exchange Panamax Index, (3) Baltic Exchange Supramax Index, and (4) Baltic Exchange Handysize Index. Each category is divided into routes in order to define certain trade areas and establish specific rates for each area.

## Index Routes

As mentioned, each index includes a certain number of routes, which comprises the total amount of units. For instance, the Baltic Exchange Panamax Index includes four routes in total, whereas Baltic Exchange Capesize Index includes ten routes in total. In other words, routes are defined each time depending on the index. For example, several of 35 indicated routes follow:

- Baltic Exchange Capesize Index (BCI): Gibraltar/Hamburg TA RV (10% of total units)
- Baltic Exchange Panamax Index (BPI): Transatlantic RV (25% of total units)
- Baltic Exchange Supramax Index (BSI): Antwerp – Skaw Trip Far East (12.5% of total units)
- Baltic Exchange Handysize Index (BHI): Passero trip Boston - Galveston (12.5% of total units)

## Drybulk Shipping Trade Routes



Source: Clarkson Research Studies, Fearnleys Research, Dryships Inc

Iron Ore is mainly produced in Brazil and Australia which account for 71% and to a lesser extent in Europe and Asia in which China accounts for excess of 1/3 of all iron ore imports. Coal on the other hand is mined in more than 50 countries with no dependency

in any particular region unlike oil in the Middle East. It is produced mainly in North America, South Africa, Australia and Indonesia and is imported in Europe and Asia. Grain exports on Australia.

### Summary of Trading Routes

Major Coal Trades	Major Grain Trades	Major Iron Ore Trades
Australia – Japan	U.S. Gulf – Latin America	Australia – Japan
Australia – W. Europe	U.S. Gulf – Japan	Australia – China
S. Africa – W. Europe	U.S. Gulf – Asia	Brazil - China
China – S. Korea	Argentina - Brazil	
Columbia – W. Europe		
China - Japan		

Source: Cantor Fitzgerald & Company

This is the orderbook for dry bulk carriers for the next years:

<i>TYPE OF SHIP</i>	2010	2011	2012	2013	2014	*TOTAL ORDERBOOK
CAPE SIZE	354	220	117	35	7	733
80-100,000 DWT	207	192	80	24	4	507
PANAMAX	84	81	42	9		216
SUPRAMAX	464	274	88	9		835
HANDYSIZE	419	276	124	10		828

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### ***Chapter 4: IPOs***

Over the past five years, fleet operators have seen unprecedented earnings. Rising Chinese demand for commodities like iron ore coupled with the shifting trade balance between China and the United States, were matched by a jump in maritime IPOs. While globally there were just four maritime IPOs (totaling \$393 million in 2001), the number jumped to 27, (worth \$6.07 billion in 2005), with \$3.05 billion in U.S. listings. The total slid to 14 IPOs worth \$2.8 billion in 2006, with \$1.4 billion in U.S. listings, as uncertainty over shipping rates on the spot market (Carey, 2007).

Moreover, in 2000, publicly traded tanker firms had a market capitalization of just \$2.5billion when today the figure is in excess of \$21billion. The stock market value of firms operating bulk carriers has soared from almost nothing to about \$6billion (McGroarty, 2006). Shipping companies listed at the Nasdaq, raised about \$1.7billion via IPOs and \$328million in secondary offerings within the last year. According to Lloyd's shipping economist's statistics, Asia had the highest number of listed shipping companies (77, compared with 52 in Europe and 37 in the US). Aggregate market capitalization in Asia was about \$60billion, slightly less than Europe's \$66billion, but well above the \$25billion in the US (Matthews, 2006).

2005 was a record-breaker for initial public offerings of equity securities of shipping and shipping services companies in the US. The uses of proceeds of a large part of the offerings were to finance or refinance the purchase price of vessels prior to repay indebtedness incurred in connection with the acquisition of vessels. Moreover, New York Stock Exchange and size are traded on the Nasdaq National Market. Historically, reasons to choose the NYSE have included perceptions by issuers of greater prestige and a determination that the open outcry auction market conducted by the NYSE is a superior model. On the other hand, reasons to choose the Nasdaq have historically included a desire by issuers to associate with technology and high growth companies and a determination that an electronic order matching system is a superior model. (Jensen, 2005).

To conclude, many US institutional investors and fund managers are expressing interest in shipping. Foreign shipowners should not forego those investors. The US capital markets are open to anyone who can make a good case and who has nothing material to hide (Wolfe, 2006). Therefore, given the aforementioned market trends, there is focus on IPOs that were listed in the US market.

#### ***4.1 - The Process***

Under the Securities Act of 1933, a public listing of shares requires an SEC registration statement that contains the form of a prospectus that must be delivered to U.S investors. If the company's shares are also listed on the NASDAQ, the company becomes a reporting company and falls under the Securities Exchange Act of 1934.

This chapter will deal with the process of raising capital in the public markets. It will also give the advantages and disadvantages of a shipowner going public. We firstly endeavored into the history of shipping finance in chapter 1 and offered the financing methods and needs in chapter 2. We also supplied the fundamentals of the Drybulk industry and trade in chapter 3. We have now come to explain and analyze the IPO theory, and process. The perspective we take starts off with explaining the IPO process in detail across all sectors and we further narrow it down to a specific industry and sector, Drybulk shipping.

#### **IPOs**

From the time a company decides to go public it has to take various steps to comply with the regulations of the SEC and the stock exchange it is listing on. The track record of the company and its management should be intact, although some exceptions exist; in addition the management company should have extensive experience in the sector in which it is going public in. The company needs to elect a board of directors (BOD) with at least two committees in the board, namely audit and compensation. Depending on the



stock exchange used for the listing there are also other requirements for the BOD. The NASDAQ and NYSE require that the BOD have at least three members that are financially literate and at least one independent director must sit on the board at the time of the IPO. Important in this pre-IPO process is the compliance with all SEC and underwriter requirements. In order to do so a firm must engage a public accounting firm with SEC experience that is registered with the Public Company Accounting Oversight Board ( PCAOB) (Nusspickel, 2004).

At this point the company is ready to choose its underwriter which is usually an Investment Bank. The company chooses its underwriter as much as the underwriter chooses the company. It is a best fit scenario in which the goals of both companies have to be aligned. As soon as the underwriter is chosen, the company and the underwriter engage in an organizational meeting in which they exchange ideas on strategy and capital structure and valuation. Due diligence on part of the underwriter takes place and a draft of the registration statement is formed. The role of the underwriter is that of an agent between the SEC and the company. The typical process of completing an IPO will take anywhere from 3 to 6 months. A template of a 3 month timeline will be taken as an example and will be provided in the appendix A for guidance. The underwriter first has to determine whether the issuer qualifies as a foreign issuer or not. If a company qualifies as a foreign issuer, which is the case for most global shipping companies, the issuer will have to file a Form S-1 with the SEC. The form S-1 is almost identical to the form F-1 which is used for U.S companies except that disclosures must also be made as to 5% shareholders and on the compensation of senior management individuals. The issuer may also file a form 8-A which is a simple registration which incorporates almost all of its information from the SEC registration form. The fee of the registration form S-1 is 1/32 of 1% of the total value of the offering.

The registration form is a detailed document in which the proceeds, the dilution, the risks associated with the business, the business itself, the management, the operations and anything that is of importance is clearly outlined in the document. Audited financial statements are required and must be prepared in accordance to Generally Accepted

Accounting Principles (GAAP). This document is sent to the SEC which in turn reviews it and sends back any comments and changes that have to be made. The legal process is very complex and usually very expensive. While the company is waiting for the review and comments of the SEC, which takes anything up to 30 days, it starts preparing for the Roadshow in which the company will sell its story to investors. Once the comments are received the company files an amendment with the SEC and if all comments are resolved, the “Red Herring” or prospectus is prepared and distributed to various interested parties. The Roadshow which usually takes anything from 2-4 weeks is the next step in the process. A possible range of prices is presented and investors start building their own metrics and valuations for the pricing of the stock. The investment bank in turn starts “book building” in which it receives intents of the various investors and interest in the company and the number of stock various investors intend to buy. At the end of the Roadshow and with the “book” hopefully full and the IPO successful, the company prices, at a price at which the investors are happy to pay. Issued stock now starts trading. At this point in time and for a period of close to 90 days the underwriters have a “green shoe” provision, or over-allotment, in which they can buy stock at the initial price. It is usually done for purposes of aligning the interest of underwriters and the company even after the pricing and in order to stabilize the stock.

In addition to this cumbersome and lengthy process the company has to satisfy various criteria of the stock exchanges in which it is listing. For informational purposes the criteria of the NYSE and the NASDAQ listings can be found in an abbreviated version in appendix B and C respectively.

Investment banks are the key in this process as their network of investors and their marketing ability is the one to drive momentum of the IPO. The underwriter also does a lot of due diligence on the company and sets forth the best way for the particular company to go public. Some companies go public as an exit strategy and so management can cash out, others issue high dividends in order to appeal to value investors, other have growth strategies, and all this is taken into consideration while deciding the ideal strategy

the company will follow. The underwriter gets paid a hefty fee of around 6-7% of the total proceeds to do all this.

When the company has finally been successful in raising the money, all its worries are not over. The company now is an open book in terms of all financial, operational and regulatory information that has to be provided on a regular basis. The company has to issue a 10-Q every quarter detailing the company's financial data. In addition every year it has to issue a cumbersome 8-K with its annual financials and performance. The company has to conduct quarterly conference calls, informational Roadshows and is obliged to have regular interaction with analysts and investors.

#### ***4.2 - Pros and Cons of Going Public - A shipowner's perspective***

##### **Advantages**

The insider's knowledge in a firm is larger than the knowledge of individual shareholders. Thus companies issue stock when the equity is overvalued and a voluntary act of issuing equity states that equity is overvalued. At the same time one can argue that the overvalued equity can be seen as a premium, outside investors have to pay, in order to come onboard with the company and take advantage of the management's expertise in that particular industry. Thus firms only issue equity when it is to the advantage of current shareholders. They thus gain a higher valuation which is above Net Asset Value (NAV) and book value, and also usually dilute prospective investors.

One of the most important advantages that insiders or shipowners have is that capital can be raised to spur growth and increase liquidity of ownership of the company. Debt and Private Equity is hardly available in shipping deals. Companies can quickly expand their fleets, engage in consolidation of a highly fragmented industry and take advantage of the economies of scale that large fleets provide. With the financial position of the company improved the company also has the opportunity to raise additional capital in the future

and when it sees fit to grow its business even further. This access to the capital markets makes the company highly versatile in its future funding needs. The concept of “other people’s money” gears companies to become more risky and thus go after higher returns. This opportunity provides the shipowner with incentives to engage in riskier projects in which he would not otherwise engage in and thus gives him more opportunities to expand even further.

Another important advantage is the limited liability that a public investor holds. The owner turns into an investor that only has liability as to the assets of the company and can no longer be pursued personally. In addition liability for pollution accidents, which is one of the problems in the shipping industry, is also limited to the company. Often shipowners see public markets as a way to decrease their risk and exposure.

Cost of capital is mainly associated with the information available on the company. Public companies being that they have heavy disclosure requirements are open to all kinds of information and thus this lowers their cost of capital. This in addition to the liquidity of the securities, gives lenders even more security over their loans.

The public arena also provides shipowners with the ability to use their stock for acquisitions and employee incentive plans. Acquisitions using stock can free cash flows and can be useful for growth instead of issuing further stock. In addition incentive plans by issuing stock options, restricted stock and various other measures can give employees incentives to align themselves with the management and the shareholders and can also attract higher candidate employees to fill the employee positions.

A public company also has more credibility with customers and vendors and banks. Banks see the company as being more official and are more willing to give a loan to a public company than they are to a private, because of the legal contingencies it holds against a public company being more straightforward to act upon. Customers also acknowledge that for a company to go public it has gone through the steps of recognition in the industry and thus is probably one of the well regarded companies in the industry.

For all the above reasons companies decide to go public. Taking all else aside the prestige that a firm gains by going public and the acceptance by the industry could be enough to persuade an owner to go public and open the doors for future growth.

### **Disadvantages**

It is regarded by many owners that the costs of going public outweigh the benefits. The case brought forth is usually the high costs of issuing equity associated with the underwriters, the lawyers and the SEC. Administrative fees, auditing expenses are also high in preparation for going public.

Another disadvantage lies in the confidentiality of the company. Complete financial disclosure is required in the public company and in effect this causes management to devote a lot of time in complying with the various requirements of being public. In addition higher costs are a result of these regulatory, auditing, legal and investor requirements. Increased legal exposure of the company under the recently imposed Sarbanes-Oxley Act also further raises legal and accounting costs and holds the CEO, COO and other directors fully accountable for any misleading statements or fraud that takes place within the company. Many shipowners think that this is a reason in itself not to go public as their secrecy is highly regarded and see no reason to engage themselves in higher responsibility. On the other hand many CEO's see this as their entertainment and delegate all the nitty-gritty work to their employees and just deal with the commercial or investor side.

A hidden cost exists in corporate and personal taxation. Shipping companies are tax free and so even a 15% tax imposed on dividend payout gains is regarded as a lot to many shipowners. In addition laws could change and make public companies accountable to more taxation since many of the shipping operations take place from and to the U.S.

Another disadvantage is inherent in that management is scrutinized and monitored constantly by investors. Shipowners see this as if they are working for someone else rather than themselves and are hesitant to do so.

An indirect cost exists in time that is lost to pursue such an opportunity. Many man hours and a lot of frustration and energy is put into a deal that in the end might not go through if the market is not good. Also indirect costs lie in the under pricing of a stock. If a stock prices at X and trades on the first day at X+a, a is essentially money left on the table that could have been obtained.

#### ***4.3 - IPO Theory: Performance and Pricing***

In order to provide a theoretical perspective to IPOs, studies and financial research are presented to put the reader in context. There are two main factors researched and associated with IPOs, namely: underperformance and under-pricing. Underperformance theory will be presented across all industries and a shipping specific approach will also be taken.

There have been numerous studies performed as to the IPO long term performance and even more to account for the phenomenon of underperformance. Buser and Chan (1987) , examined more than 1000 IPOs in the period of 1981 through 1985 and found that compared to the NASDAQ composite index and over a two year period IPOs underperformed by 11.2%. In the same fashion Ritter in 1991 found that in the period of 1975 through 1984 and over a three year horizon IPOs underperformed companies in the same industry by 15%. Another study by Ritter and Loughran (1995), which had a sample of over 4000 companies in the U.S over the years of 1970 through 1990 found underperformance as well, compared this time to seasoned offerings. Ritter and Welch in 2002, also found underperformance of 7% in the years of 1990 through 1994. Similar studies have been performed in countries outside the U.S in which Ritter and Loughran is one of them and have similar conclusions as to the underperformance of IPOs in the long run.

There has been a couple of shipping specific performance IPO research studies. Grammenos and Arkoulis (1997) looked at 27 shipping companies in various countries over a period of 2 years. They found that the stock market indices of the particular countries outperformed the shipping companies by as much as 36.9%. Shipping IPOs follow suit in underperformance.

Various studies and theories have been developed as to why the case of IPO underperformance is so. Miller in (1977) states, that there is a divergence in the opinion of investors. He states that some investors are optimistic who drive price in the first days of trading, and others are pessimistic. These two opinions converge in the end resulting in a lower price and thus an underperformance. Ritter talks about the windows of opportunity that are present in industries and so investors overpay for these issues, which in turn lead to the company going public being valued correctly and readjust in the long run.

Under-pricing is another phenomenon associated with a firm entering the public markets. There have been numerous studies on this subject and Ritter in (1998) associates this with the role of the underwriter. Because of the increased risk that the underwriter bears if not all shares are sold, making the underwriter purchase them himself, the shares are usually offered with the prospect of a premium by under-pricing. Under-pricing essentially deals with “money left on the table” on the part of the firm as the stock opens higher on the first day of trading, compared to the price at which it priced and so that difference is the money the company could have gained. There are no such studies associated specifically with shipping IPOs.

## ***Chapter 5: The Methodology***

The previous chapters of this paper provided the conceptual and historical background needed for the reader to understand the industry, its drivers, its financing methods and the reasons behind issuing of equity. This chapter will provide the methodology used from a practical standpoint, into analyzing two Drybulk shipping companies and their IPO's.

The analysis brought forth will be subcategorized into two main parts, the IPO company analysis and the post-IPO company analysis. Naturally as the scope of this paper is on IPO's, the IPO part will be the main focus of the analysis. The company brief history and fleet, strategy, IPO valuation will be the three main parts analyzed at the time of the IPO. Post-IPO valuation and strategy will again be looked upon and post IPO stock performance will be examined.

### ***5.1 - IPO***

#### ***5.1.1 - History, Facts and the Fleet***

This first section briefly describes the company. It also provides a summary of the IPO with the date, the shares offered, the proceeds and the offering price. In addition it describes the IPO process and pricing of each individual company and its fleet at time of listing. This part also gives percentages of current shareholders in the company pre- and post-IPO.

The fleet and vessel economics at time of the IPO are provided. The Vessel market value is estimated using Clarkson Research historical prices as a starting point. As Clarkson only gives estimates for 5 and 10 year old vessels a straight line reduction or appreciation in value for older and newer vessels respectively is accounted for. In addition as many companies have publicized the values at which they acquired some or all of their vessels, these values were used when available. Vessel year, Dwt and daily charter rate if



available are also included in this section. When the vessel trades on the spot market this field is left blank. Otherwise information is drawn from the company's prospectus.

### ***5.1.2 - Outlining the Strategy***

This section serves in order to acquaint the reader with the various different strategies used by companies that went public. There are usually four differentiating factors that Drybulk companies used, namely: The company freight rate generation strategy, the sector of the Drybulk trade in which the company operates, the dividend yield and its debt structure.

This section describes the strategy as advertised in the company prospectus. The company freight rate generation strategy is either Spot or TC. It can further be subcategorized into short term TC(<than 1 year), medium term TC(1-2 years) and long term TC(> than 2 years). The sector in which the company operates is either the Capesize, Panamax, Handymax, Handysize sectors or a combination of these. This section also describes the dividend yield of the company at the time it entered the stock market. The dividend yield is estimated by dividing the yearly dividend advertised at time of IPO by the Market Capitalization at time of IPO. This section also provides the Debt to capitalization ratio as a distinguishing factor in the strategy of a company. This ratio is calculated by dividing the total Debt by the market capitalization at time of IPO.

### ***5.1.3 - IPO Valuation***

Valuing a shipping company is an art in itself. There are three ways in valuing a shipping company, namely the Discounted Cash Flows method (DCF), the Net Asset Value (NAV) method and the comparables method. The DCF Method is one way of valuing a shipping company; however, because of the cyclicity of the industry and the unstable Future Free Cash flows generated, this method was quickly eliminated as not being ideal. Instead the NAV and comparables approach to valuation was taken. The objective of the

valuation part is not to establish a price for the stock but was rather used on a comparative basis between the companies that we analyze.

The NAV approach uses the market value of the assets at time of listing and adds any other assets the company may have and subtracts all long term debt. This number divided by the number of shares outstanding gives the company a NAV per share. This NAV can and is used as a measure of determining the success of the IPO rather than valuing the company per say. Time Charters are for simplicity not accounted for in the NAV calculation, as they are usually a small addition or deduction in the vessel values. In addition such data on Historical TC's above the spot market at past points in time could not be found from reputable sources. However the values of the vessels have been rounded up to account for such discrepancies in the NAV calculation.

EBITDA forecasted numbers were obtained by annualizing existing TC rates or assuming a Rate into the future and deducting Operating Expenses (OPEX) all by using 350 year days. OPEX which includes crew costs, provisions, deck and engine stores, lubricating oil, insurance, maintenance and repairs is calculated by dividing vessel operating expenses by fleet calendar days for the relevant time period. In turn EPS was estimated using the same rates.

This section also provides other valuation metrics such as P/E, TEV/EBITDA, P/NAV, and P/Book Value explained in detail below.

-P/E: The price to earnings ratio is calculated by taking the price at the time of IPO and dividing this number by the forecasted forward year (2007) earnings. In the case of the companies with TC strategy analyst estimates from analyst reports were taken. Companies like Dryships where the fleet expanded rapidly were harder to forecast and so Spot rates of \$54,000, \$26,000 and \$21,000 per day for Capesize, Panamax and Handymax vessels were used. And daily Operating expenses of \$650 per vessel were used. P/E represents what the stockholders think about the future earnings and future

prospects of the company. The problem with this ratio is that it is affected by the cyclicity of the industry and thus over a period of time may be biased.

-TEV/EBITDA: TEV was calculated by adding the Net Debt (Debt minus current assets) to the Market Capitalization number at time of issue. EBITDA is calculated by subtracting OPEX from the revenues of each individual vessel and using 350 year days. TEV/EBITDA ratio is a ratio that indicates the valuation of a company in comparison to its generation of revenues.

-P/NAV: Price is obtained from the prospectus and the NAV is calculated using Vessel values as described above. The P/NAV is a market based ratio that has the advantage of comparing apples with apples across all companies. However its main disadvantage is that it is a lagging indicator based on assets values that are cyclical and so may have some distortions over a period of time.

-P/Book Value: Again price is taken from the prospectus at time of pricing and book value is taken from the balance sheet in the prospectus. The P/Book is not a market based ratio and shows the correlation between the balance sheet and the price without taking into account other gains associated with purchases or dispositions of vessels.

## ***5.2 - Post IPO***

### ***5.2.1 - Post IPO***

Post IPO examines how the company grew after its IPO. It outlines the current TC exposure and provides information for the company a year after it went public, and the current situation on 2007. The purpose of this section is to show the reader how the companies progressed after they went public and how the market perceives this progression.

### ***5.2.2 - Stock Performance***

This section illustrates the performance of the stock post-IPO. It gives the reader a sense of the movement after the IPO and provides another point on which the companies can be compared. It is widely accepted that the stock performance is the bottom line of how well a company is doing.

## Chapter 6: Drybulk Companies Analysis

### 1) Dryships Inc. (NASDAQ:DRYS)

#### History, Company Facts and the Fleet

Dryships Inc., ('Dryships'), is a Marshall Islands corporation incorporated in September 2004. At the time of its IPO on February 3rd 2005 the company owned and operated 6 vessels (5 Panamax, 1 Capesize) and had identified eleven Vessels for further purchase bringing the total to seventeen dry bulk carriers, of which two were Capesize vessels, thirteen Panamax vessels and two Handymax vessels. The average age of the fleet was 13 years and its total carrying capacity 1,327,000 Dwt. Dryships outsources both its technical management and its commercial management to an affiliated party, Cardiff Marine Inc., for a fee of \$650 a day per vessel, 1.25% on chartering of vessels and 1.00% on S&P activities.

Dryships was the second company to list on a U.S stock exchange and the first in 2005. It priced at \$18 which was significantly higher than its anticipated price range of \$14-\$16. Dryships also doubled its offering size as increased demand from the investors' side pushed management to take advantage of the opportunity and raise more money. Dryships used its proceeds as equity to acquire vessels. The company may have entered with 6 vessels and identified another 11 but because of its successful IPO it managed to acquire an additional 10 vessels. Only the initial fleet of 17 will be used in the IPO valuation and discussion as it represents the company at the time of the offering. A summary of the offering is presented in the table below.

#### Dryship IPO summary

Ticker	Company	IPO Date	Shares Offered (mm)	Shares Outstand. (mm)	Proceeds (mm)	Price	Days P>Issue
DRYS Equity	DryShips, Inc.	February 3, 2005	13.00	29.68	\$234.00	\$18.00	53

Dryships received an estimated \$205.7 million in net proceeds from its IPO after deducting underwriters' discounts, commissions and estimated expenses

Prior Investors in this deal were actually paid \$0.28 share to keep 53% of the company's stock whereas investors paid \$18.00 per share to retain 47% of the stock.

***Shareholders Investment and Respective Prices Paid***

	Number of Shares	Percent	Amount	Percent	Average Price
<b>Existing Investors</b>	15,400,000	53.0%	-4,374,000	-1.7%	\$ (0.28)
<b>Vessel Seller</b>	1,277,778	4.4%	23,000,004	9.1%	\$ 18.00
<b>New Investors</b>	12,375,000	42.6%	234,000,000	92.6%	\$ 18.00
<b>Total</b>	29,052,778	100.0%	252,626,004	100.0%	\$ 8.51

At the time the company went public it owned 6 vessels and had agreements to acquire an additional 11 vessels. Their details and respective valuations can be seen in the table below.

## Dryships Fleet

### Dryships - Vessels and Economics

Vessel Name	Dwt	Year	Employment Expiration Date	Daily Rate	Market Value
<b>Existing Vessels</b>				\$ -	
Shibumi	166,058	1984	Spot	\$ -	\$ 30,000,000.00
Lacerta	71,862	1994	Spot	\$ -	\$ 33,500,000.00
Flecha	65,081	1982	Spot	\$ -	\$ 14,000,000.00
Strigglä	64,747	1982	Spot	\$ -	\$ 14,000,000.00
Panormos	71,747	1995	Spot	\$ -	\$ 35,500,000.00
Mostoles	75,395	1981	Spot	\$ -	\$ 12,000,000.00
<b>Total</b>	<b>514,890</b>				<b>\$ 139,000,000.00</b>
<b>Identified Vessels</b>					
Iguana	70,349	1996	Nov-05	\$33,700.00	\$ 37,000,000.00
Paragon	71,259	1995	Sep-06	\$30,000.00	\$ 35,500,000.00
Samsara	73,688	1999	Apr-05	\$ 8,600.00	\$ 42,000,000.00
Waikiki	75,473	1995	Spot	\$ -	\$ 35,500,000.00
Lanikai	68,676	1988	Spot	\$ -	\$ 22,000,000.00
Tonga	66,798	1984	Spot	\$ -	\$ 16,000,000.00
Daytona	69,703	1989	Spot	\$ -	\$ 23,000,000.00
Toro	73,034	1995	Spot	\$ -	\$ 32,000,000.00
Alona	48,640	2002	Spot	\$ -	\$ 32,000,000.00
Matira	45,863	1994	Spot	\$ -	\$ 26,000,000.00
Netadola	149,475	1993	Spot	\$ -	\$ 47,000,000.00
<b>TOTAL</b>	<b>1,327,848.00</b>				<b>\$ 487,000,000.00</b>

As we can see Dryships has very little TC coverage as most of its vessels operate in the spot market

### Outlining the Strategy

Dryships strategy focused primarily on the Panamax sector within the Drybulk industry. This gives the company less volatility in rates compared to the larger Capesize vessels and a workhorse in the industry that can carry different kinds of cargo (Iron ore, coal, grain etc.) The company however believes in Capesize vessels and would consider future acquisitions in this type of vessel.

Dryships is strongly positioned in the spot market as most of its vessels have no time charters. Management's decision to pursue such a strategy was because they believed the strong market fundamentals would reward the additional risk they were taking by giving the company higher returns. In addition at the time Dryships was entering the market

freight rates were at their peaks and so the company took advantage of this to sell its story. Dryships had a net debt/capitalization ratio of 37% and along with its strong fleet of 17 vessels and their respective cash flows, would allow the company to take advantage of its size and further consolidate the industry.

### *IPO Valuation*

Dryships entered the market when Drybulk freight rates were booming. In fact Capesize rates were at \$58,125, Panamax rates at \$27,250 and Handymax rates at \$15,185. The strong market along with Dryships's strong spot exposure allowed the company to obtain a high valuation on its vessels that had already been at historically high prices until this time.

### *Dryship NAV at IPO*

<b>NET ASSET VALUE</b>	<b>\$Million</b>	<b>Per Share</b>
<b>Vessels</b>		
PV 6 Existing Vessels	\$139,000,000.00	\$ 4.68
PV 11 Identified Vessels	\$348,000,000.00	\$ 11.73
PV Time Charters	\$ -	\$ -
<b>Total Vessels Net</b>	<b>\$487,000,000.00</b>	<b>\$ 16.41</b>
Other Assets	\$ -	\$ -
Working Capital	\$ 7,000,000.00	\$ 0.24
<b>Total Assets</b>	<b>\$494,000,000.00</b>	<b>\$ 16.64</b>
<b>LT Debt</b>	<b>\$204,749,000.00</b>	<b>\$ 6.90</b>
<b>Net Asset Value</b>	<b>\$289,251,000.00</b>	<b>\$ 9.75</b>
<b>Pricing Premium to NAV</b>		<b>185%</b>

Dryships's strategy, its strong management team, the strong freight markets and the lack of other publicly listed Drybulk companies all attributed to the strong valuation of 185% above NAV.



At the time of its IPO Dryships had a Market Capitalization of \$534 million and a 2006 EBITDA Estimate at \$140.634. The company's NAV per share was calculated at \$9.75 per share. The company's dividend at \$0.80 in 2006 gives the company a yield of 4.4%.

### *Dryships IPO data*

Company	IPO Price	Shares Outstand.(mm)	EMC (mm)	TEV <sup>35</sup> (mm)	EPS	EBITDA (mm)	NAVPS	BVPS	DPS	Debt (mm)	Net Debt (mm)
DryShips Inc	\$18.00	29.68	534.20	731.95	3.72 <sup>36</sup>	140.60	9.75	9.84	0.80	204.75	197.75

A ratio analysis of the above data gives Dryships a valuation of 5.21x EBITDA and a P/E of 4.84x, which proved a strong valuation.

### **Dryships Valuation Metrics**

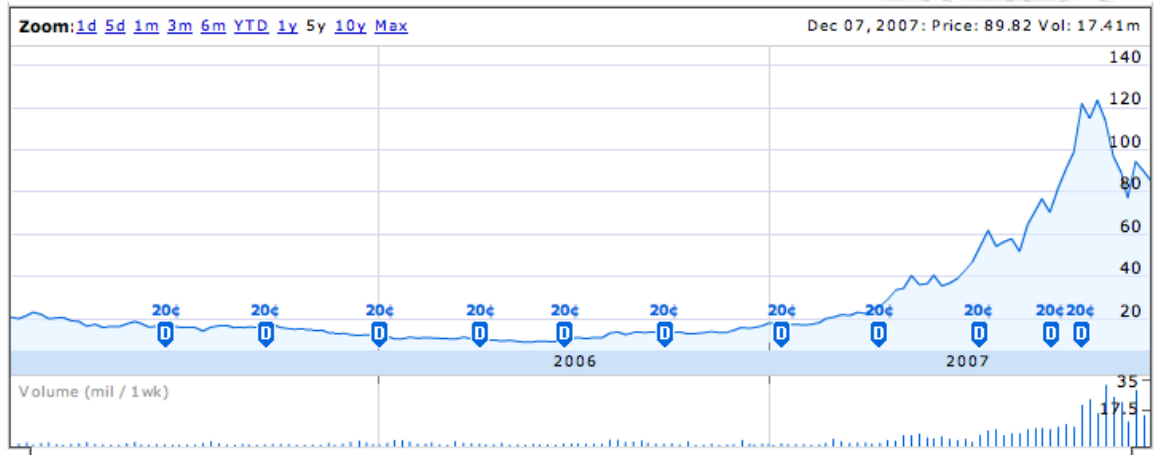
Company	IPO Date	Year	P / E	TEV / EBITDA	P / NAV	P/ BOOK	Yield %	Net Debt/ Equity
DryShips Inc	2-Feb-05	2005	4.84x	5.21x	185%	183%	4.44%	37%

### *Post IPO*

Even from the first year the company went public it purchased an additional 10 vessels. The company paid a total of \$520 million for these vessels with a combination of the excess proceeds generated, more debt and available cashflow from its first few months of operation. The company was able to grow to 27 vessels of which 4 are Capesize vessels, 21 are Panamax vessels and 2 are Handymax vessels with an average age of 11 years. The company has currently purchased another 10 vessels has reduced even more the average age of its vessels and is the second largest Panamax owner in the world in terms of ships and the largest in the U.S.

The company still remained highly geared towards the spot market and had very little TC exposure in 2006, which amounted to about 10% of its fleet. The management remained positive towards market fundamentals of the Drybulk shipping industry and has become a

consolidator of the industry since the freight rates rebounded and the company was able to use its high leverage to dramatically increase its earnings.



### Stock Performance

Dryships traded up for the first 53 days after its pricing and reached a high of \$23.00 per share. Soon thereafter the company's stock traded below its initial pricing of \$18.00 per share and kept trading down.

Looking back at Dryships stock data we find that after 5 days of trading Dryships Stock was up 10.6% and after 30 days the price was up 14%. After six months the price was 22% lower than initial pricing. In 2007 the huge volume increase of the Chinese and partially of the Brazilian market which raised the spot market of the Drybulk industry to the limit (Clarksons 2007), and in correlation with the increase of NASDAQ from 1900 to 2400 units, had a direct effect to the stock price of Dryships which reached 123.5\$ per share on October 28 an increase of almost 700% of the initial pricing in 2005.

## ***II) Eagle Bulk Shipping Inc. (NASDAQ:EGLE)***

### **History, Company Facts and the Fleet**

Eagle Bulk Shipping Inc. ('Eagle') is a newly formed Drybulk shipping company incorporated in the Marshall Islands and headquartered in New York. At the time of its IPO it owned and operated 11 Handymax Vessels with a total carrying capacity of 540,816 Dwt and an average age of 6. Unlike other shipping companies commercial management of the ships is in-house. Technical management (Technical management includes day-to-day operations such as crewing and maintenance) however is outsourced to a third party, V ships, for a fee of \$275 a day per ship. Eagle was the 5th Drybulk company to be listed on an American exchange.

Eagle priced at \$14 per share below the planned \$16-\$18 offering, while at the same time the offering size was increased to 14.4 million shares from the anticipated 13.25 million.

### **Eagle Bulk IPO summary**

Ticker	Company	IPO Date	Shares Offered(mm)	Shares Outstand.(mm)	Proceeds (mm)	Price	Days P>Issue
EGLE Equity	Eagle Bulk Shipping, Inc	June 22, 2005	14.40	26.00	\$201.6	\$14.00	0

The company received an estimated \$185.7 million from the offering deducting underwriters discounts, commissions and estimated expenses. Eagle used \$124.2 million to pay down debt and \$59.3 million to pay off a credit facility by Eagle Ventures. The remaining \$2.2 million was used to pay outstanding obligations and fees.

Management and ownership details in retaining control and the appropriated prices paid are detailed in the table below. The 47% of the company was attained by current investors paying \$3.20 per share. New investors paid \$17.00 per share for 53% of the company.

***Eagle Bulk Shareholders Investment and Respective Prices Paid***

	Number of Shares Issued	Percent	Amount	Percent	Average Price
Existing Investors	12,750,000	47.0%	40,822,278	16.8%	\$ 3.20
New Investors	14,400,000	53.0%	201,600,000	83.2%	\$ 14.00
<b>Total</b>	<b>27,150,000</b>	<b>100.0%</b>	<b>242,422,278</b>	<b>100.0%</b>	

Eagle bulk has an average age of 6 years compared to an industry average for over 15 years for the Handymax vessels. A snapshot of vessels and their economics are provided in the table below.

**Eagle Bulk Fleet****Eagle Bulk - Vessels and Economics**

Vessel Name	Dwt	Year	Employment expiration Date	Daily Rate	Market Value
Cardinal	55,362	2004	March-June 07	\$ 26,500.00	\$ 41,000,000.00
Harrier	50,296	2001	March-June 07	\$ 23,750.00	\$ 38,000,000.00
Falcon	50,296	2001	Feb-June 08	\$ 20,950.00	\$ 38,000,000.00
Hawk I	50,296	2001	March-June 07	\$ 23,750.00	\$ 38,000,000.00
Condor	50,296	2001	Nov 06- June 07	\$ 24,000.00	\$ 38,000,000.00
Shikra	41,096	1984	July-Nov 06	\$ 22,000.00	\$ 15,000,000.00
Kite	47,195	1997	March-May 06	\$ 25,000.00	\$ 28,500,000.00
Griffon	46,635	1995	Feb-April 06	\$ 28,000.00	\$ 25,500,000.00
Peregrine	50,913	2001	Octo 06-Jan 07	\$ 24,000.00	\$ 38,000,000.00
Sparrow	48,225	2000	Nov 06- Feb 07	\$ 22,500.00	\$ 33,250,000.00
Osprey I	50,206	2002	May- Sept 08	\$ 21,000.00	\$ 40,000,000.00
<b>Total</b>	<b>540,816</b>				<b>\$ 373,250,000.00</b>

Eagle Bulk has an average coverage of 19.5 months. In terms of its stream of income in 2005 100% of its days were committed to time charters and 76% of its days in 2006 at an average TC rate of \$23,800 per day.

**Outlining the Strategy**

Eagle bulk focuses on the Handymax sector. The Handymax vessels are versatile in the cargoes (Grain and various minor bulks) that they carry and thus the volatility in rates is the lowest out of the other classes of ships that are larger than them. Eagle Bulk states that it is the single largest Handymax owner in the U.S.

Eagle Bulk's main differentiating strategy is its high dividend, its long-term charter strategy and its focus on the Handymax sector. As previously mentioned 2005 days are covered 100% by time-charter employment and 2006 days are covered by 76%. Eagle is

an attractive dividend yield play. Its 16% dividend yield allowed the company to come to the market at a strong valuation. Eagle also differentiates itself by bringing its commercial management in house. Eagle has a net debt to Market Cap of 35% giving the company room to grow through further leverage.

### *IPO Valuation*

Eagle entered the market when 1yr- time charter rates for Capesize Vessels were at \$36,313, Panamax vessel rates at \$17,188 and Handymax vessels at \$18,063. These rates were depressed compared to market peaks of \$59,000, \$29,000, \$27,000 respectively during the peaks in the months of December 2004 through February 2005. We will look at Eagle Bulk premium to NAV in order to determine the success of its pricing.

### *Eagle Bulk NAV at IPO*

<b>NET ASSET VALUE</b>	<b>\$Million</b>	<b>Per Share</b>
<b>Vessels</b>		
PV Fleet 11 Handymax Vessels	\$373,250,000.00	\$ 14.36
<b>Total Vessels Net</b>	<b>\$373,250,000.00</b>	<b>\$ 14.36</b>
Other Assets	\$ -	\$ -
Working Capital	\$ 9,729,000.00	\$ 0.37
<b>Total Assets</b>	<b>\$382,979,000.00</b>	<b>\$ 14.73</b>
<b>LT Debt</b>	<b>\$136,000,000.00</b>	<b>\$ 5.23</b>
<b>Net Asset Value</b>	<b>\$246,979,000.00</b>	<b>\$ 9.50</b>
<b>Pricing Premium to NAV</b>		<b>147%</b>

Even though market freight rates were depressed Eagle Bulk managed to obtain a full valuation premium to its assets. The well structured company with a high dividend and a modern specialized fleet manage to obtain a high valuation which was due to the way the company positioned itself and its strengths, even though vessel values were down. The



fact that vessel values had not dropped as significantly as the freight rates, allowed the company to sell the market perception of shipowners to investors as positive in the future.

At the time of the IPO Eagle Bulk had a Market Cap of \$500 million and 2006 EBITDA estimates of \$70.60 (calc. using current average TC's (\$23,800) in 2005, Opex \$3500 per day per vessel) million. The company's NAV per share is calculated at \$9.50 and its book value per share is at \$8.76. Its Dividend is forecasted at \$2.28 per share giving a yield of close to 16%. Its forward year EPS is estimated at \$1.75 (calc. with same as the above figures).

### *Eagle Bulk IPO data*

Company	IPO Price	Shares Outstand.(mm)	EMC (mm)	TEV (mm)	EPS	EBITDA (mm)	NAVPS	BVPS	DPS	Debt (mm)	Net Debt (mm)
Eagle Bulk	\$14.00	26.00	364.00	500.00	1.75	70.60	9.50	8.76	2.28	136.00	126.27

A Ratio analysis of the above data gives us a picture of the valuation of Eagle Bulk at time of the IPO. Its price to forward year earnings at 8x and TEV/EBITDA at 7x proves for a strong valuation.

### *Post IPO*

In its IPO Eagle Bulk Shipping Issued 14.4 Million shares at \$14 per share and raised estimated net proceeds of \$185.7 million. Since this offering Eagle Bulk has acquired two additional vessels which were purchased for a combined \$70 million financed by bank debt. These vessels came with charters of 24-26 months at an attractive rate of \$24000 per day. The company on October 28th, 2005 issued additional equity of 6.3 million shares at \$14.5 per share, raising net proceeds of \$81.5 million which it used to pay down debt.

Eagle's Strategy a year after its IPO remained that of long-term charters and had been effective since the spot market in 2006 was much lower than the TC rates the ships were

earning. Eagle in the beginning of 2006 had 88% of its days in 2006 and 31% of its days in 2007 booked on long- term charters.

This strategy although safe, ended up very unworthy. Because of the boom of 2007 the spot market became extremely attractive with freight rates to the limit, and Eagle was bound with its TC's and could not take advantage of the situation and prosper. Most of the companies that did not have any time charter commitments made huge profits during the past year.

The Eagle's management took a huge decision in October 2007 and changed the companies focus completely by selling most of its handymax vessels and acquiring 26 Supramax vessels worth of \$1.1 billion with approximately \$1 billion Contracted revenues.

### Stock Performance

Eagle Bulks stock had traded down after initial pricing however it rebounded and surpassed its initial pricing for the months of September 2005 through December 2005. It then stabilized at around \$14. Unlike other shipping stocks Eagles' stock price remained stable because of its long term-charter strategy approach where current market rates did not affect Eagles income stream.



Source: Google Finance

Looking back at Eagle Bulks data we find that after 30 days its price was down 8.2% and after 6 months its price was up 12.7%. On April 2006 the companies stock was at 13.80 just 1.4% down from initial pricing. Since then it has gradually increased and reached a maximum of \$33.8 in October 2007. The increase of the stock is about 100% which is a rather small increase in respect with Dryship and other companies of the Drybulk sector. That is probably why the mission statement of the company has completely changed, they acquired 26 larger ships in order to enter strong in the Chinas iron ore giant market and grab a piece of the pie.



## ***Chapter 7: Conclusion***

Summing up the advantages to the shipowner in going public we would have to focus on the access that a public company provides to the capital markets. Equity, Convertibles, Debt and other financial instruments are all within the shipowner's reach by being public. The company can now use its stock to acquire companies, give incentives to employees and provide a liquid base for its owners. The proceeds and equity raised, offer advantages and help in the consolidation of the industry and towards future and rapid growth. In addition public companies offer an advantage over private ones in that a project can be accretive to investors even if it is not necessarily one that a private shipowner would look into. This arbitrage allows the shipowner to take advantage of more deals.

However public companies also create some issues. Management decisions are highly scrutinized by investors and analysts who often punish companies that have performed poorly. In addition the increased time and costs spent on the regulatory, auditing, legal and investor requirements are viewed negatively by the shipowner. Also tax associated with equity distributions cause shipowners allergies. In addition, the volatility of the earnings stream a public shipping company has, sometimes makes it hard or even unworthy to raise equity since the price of the stock is many times undervalued throughout the year, and thus does not leave room to take advantage of interesting projects through the public markets. Another disadvantage is in the shipping S&P market in public shipping companies, which is hard to manage as investors are highly 'pushy' when a company has excess cash and always demands a payout that usually takes place to their satisfaction.

Nevertheless it seems that investors and Wall Street have re-evaluated the shipping industry's risk-reward profile and have actively invested in companies that went public.

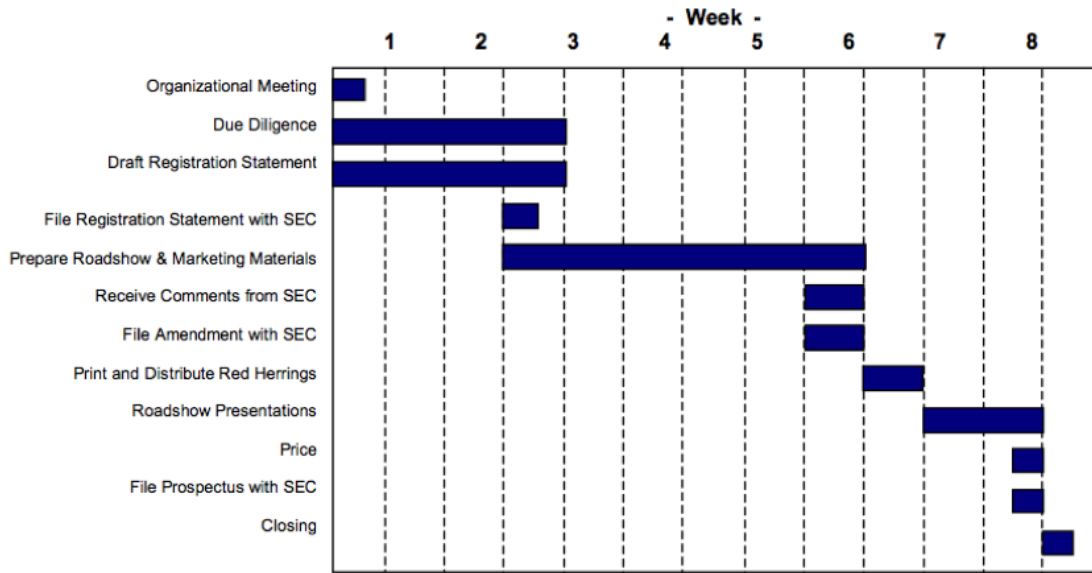
Our focus group was the Drybulk industry because of the sheer number of IPO's that took place since 2005. The Drybulk industry in turn is currently the industry of preference for shipping IPO's, because it has experienced substantial growth over the

past 4 years and also is directly associated with China and the Energy sector which are both two key proponents of the irrational exuberance of investors. It seems hard to imagine that a combination of such sort may present itself again in the shipping market.

The industry is consolidating and it seems as though public companies have major advantages over private companies in that they have more funds amongst others. They command consolidation premiums to their stocks and have achieved them till now.

*Appendix A*

**Graph 21: Initial Public Equity Offering Time Table**



## Appendix B

### NYSE Listing Criteria

Criteria		Requirements	Worldwide	Domestic		
Volume	either	<b>Alternative #1</b> Round-Lot Holders (of a unit of trading, usually 100 shares)	5,000	2,000		
	or	<b>Alternative #2</b> Total Shareholders and Average Monthly Trading Volume (Most Recent 6 months)	2,200 100,000 shares	2,200 100,000 shares		
		<b>Alternative #3</b> Total Shareholders and Average Monthly Trading Volume (Most Recent 12 months) and Publicly Held Shares (not held by insiders)	500 1,000,000 shares 2,500,000 shares	500 1,000,000 shares 1,100,000 shares		
Size	Market Value of Publicly Held Shares: For IPO's Carve-Out & Spin-Offs For All Other Listings		\$60m \$100m	\$100m		
Financial	either	<b>Alternative #1</b> Pre-Tax Income (From Continuing Operations Only) Most Recent Year and Each of the 2 Preceding Years or Aggregate for Last 3 Years and Most Recent Year and All 3 Years Must be Positive Each of the Most Recent 2 Years		\$2.5m \$2.0m or \$6.5m \$4.5m Yes Yes		
			or	<b>Alternative #2</b> if Market Capitalization and Revenues (Most Recent 12 Months Period) then Aggregate Cash Flow for Most Recent 3 Years and All 3 Years Must Be Positive Each of the Most Recent 2 Years	\$100m \$25m	\$500m \$200m \$100m Yes Yes
					<b>Alternative #3</b> Global Market Capitalization Market Cap. (Avg. of the last 6 Months) Revenues (Most Recent Fiscal Year)	\$200m \$100m
	or	<b>Alternative #2</b> if Market Capitalization and Revenues (Most Recent 12 Months Period) then Aggregate Cash Flow for Most Recent 3 Years and All 3 Years Must Be Positive Each of the Most Recent 2 Years	\$200m \$25m	\$500m \$100m Yes Yes	\$500m \$25m Yes Yes	
						<b>Alternative #3</b> Global Market Capitalization Market Cap. (Avg. of the last 6 Months) Revenues (Most Recent Fiscal Year)

## Appendix C

### NASDAQ Listing Requirements

Requirements	Initial Listing 1	Initial Listing 2	Initial Listing 3
Net Tangible Assets (5)	\$ 6,000,000	\$ 18,000,000	N/A
Market Capitalization	N/A	N/A	\$ 75 million
Total Assets (1)	N/A	N/A	\$ 75 million
Total Revenue (2)	N/A	N/A	\$ 75 million
Pretax Income (2)	\$ 1,000,000	N/A	N/A
Public Float (3)	1,100,000	1,100,000	1,100,000
Operating History	N/A	2 years	N/A
Market Value of Public Float	\$ 8,000,000	\$ 18,000,000	\$ 20,000,000
Minimum Bid Price	\$ 5.00	\$ 5.00	\$ 5.00
Shareholders (4)	400	400	400
Market Makers	3	3	4
Corporate Governance	Yes	Yes	Yes

Source: NASDAQ stock exchange

- (1) Under listing Option 3 the Company must satisfy the requirements for only one of the three: Either (1) Market Capitalization or (2) Total Assets or (3) Total Revenue.
- (2) In latest fiscal year or 2 of last 3 fiscal years.
- (3) Public float is defined as shares that are not held directly or indirectly by any officer or director of the issuer and who is the beneficial holder of more than 10% of the shares outstanding.
- (4) Round-lot holders are considered holders of 100 shares or more.
- (5) Total assets (excluding goodwill) minus total liabilities.