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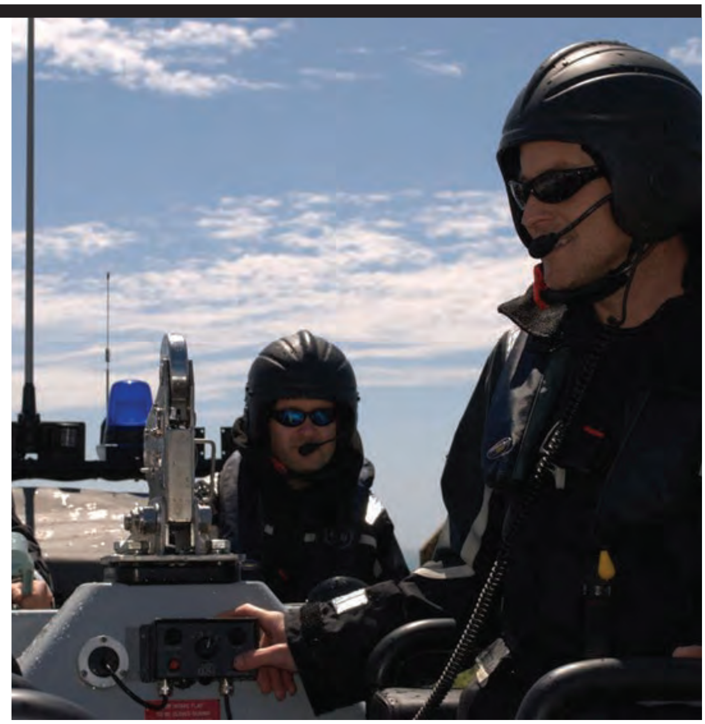
Fireboats: Multi-Missioned & Making Waves

Communications: Increasingly Important for Workboats

CAD/CAM: Designed for Efficiency

Innovative Products & Boats: The Best of 2015



Credit: Drumgrange

Features

ON THE COVER

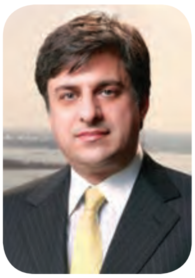
In late November, the Fire Department of the City of New York (FDNY) welcomed its newest fireboat the William M. Feehan, built by Metalcraft Marine. Feehan was an FDNY firefighter lost in the September 11 World Trade Center attacks. The FDNY fleet was out in force on the Hudson River to celebrate the new arrival. Our fireboat coverage begins on page 30.

(Photo: Greg Trauthwein)

Trailblazing Transactions in the Jones Act Market

The supply chain and logistics comes full circle.

By Basil Karatzas



Karatzas

Taking a look from the bridge of a ship in port, little more than the presently lower trading activity can be seen: ships sailing high on the water, huge containerships half-empty with containers, idling barges at the end of the bay. The slower trading activity is discernible to the cognizant observant, but there are several more undercurrent movements, so to speak, that have, to date, received little notice.

In the September issue of ***MarineNews***, the changing seascape for extending credit in the brown water and Jones Act markets was discussed, where ever bigger banks and financiers have been looking for well-established and ever bigger operators and asset players to finance, leaving the traditional 'mom-and-pop' owners with few options to obtain financing. The flip side of the changing financial industry is that the shipowning structure has already been shifting, in interesting ways. Probably it's too early for the changes to be sensed by the smaller, local owners of a handful of barges or tugs in the brown water market where the industry is highly fragmented and in need of 'consolidation,' in financial parlance. However, at the top end of the market with the big players and the expensive assets, for the Jones Act product tanker market, two transactions that took place in the last twelve months are likely the trailblazers of things to come.

Looming Large in the Porthole

The Jones Act tanker market is 'boring,' one may be tempted to say by international tankers standards, although there is nothing boring or routine in shipping, as there are only ninety-seven tankers and large barges (ITBs/ATBs) in this market. The trade for crude oil consists of 12 crude tankers transporting crude oil from Alaska to the continental US, and product and chemical tankers and barges transporting petroleum products along the Gulf and Atlantic coasts. Quite often, integrated oil companies and end users either employ these vessels directly or indirectly on long term charters. The biggest excitement in this market happened ten years ago when OSG exploited Aker Philadelphia's phoenix-like aspirations and placed an order for ten Jones Act products tankers at an average cost of $89 million each and bareboat them for the long-term, reflecting an overall daily rate of $50,000 pd (including OpEx). The second excitement of the decade came almost two years ago when oil major ExxonMobil chartered a Jones Act products tanker for one year at $120,000 pd, a rate which was almost twice as high as the historic long-term average.

Most of the shipping assets in the Jones Act market are owned by US-domiciled shipping companies that do not own the cargo but just offer transport services to the cargo owners and end users – sort of the truck drivers delivering goods when and where the customer desires. Crowley, Kirby, OSG America, Keystone are names that typically stand out in this market.

Driving the Truck

Post-Lehman-Brothers, institutional investors have looked and eventually invested in the Jones Act tanker market, mostly enticed by the limited and protected market, the constrained availability of shipbuilding capacity by a handful of shipbuilders in desperate need of survival (who also managed to pull a political level or two), and special financing and tax considerations that made such projects enticing from the financial point of view. The fact that shale oil came from nowhere and caught everyone by surprise was the least expected bonanza that made these projects even more profitable than the initial projections. These financial owners had vessel management arrangements with US-based vessel owner and managers. Blackstone has been the primary investor in this industry, but there were also lesser names involved, such as Alterna Capital.

Thus, whether shipowners or financial owners, shipping assets so far in the Jones Act market have primarily owned and operated by companies with shipping as their core business; they just provide the seaway transport of the cargo, if and when the customer calls, with little other involvement in the value chain. There are some variances, but overall, all these players had the same common denominator in terms of market exposure and volatility, cost of capital, access to cargoes, to name a few. They all were competing for the same business without a strategic advantage, and they have almost similar access to resources.

Sea Change

In 2014, two interesting transactions took place. The Jones Act products tanker MT *'American Phoenix'* was sold to Genesis Energy for $157 million, a Houston-based refinery and logistics company in the energy industry. The vessel was financed and controlled by the private equity fund Alterna Capital who had a management agreement with a Jones Act vessel operator to manage the vessel, thus in every respect the ownership structure fit the description of the typical 'shipowner' with no competitive advantage in the cargo (energy) business. They just shipped crude oil and condensates by sea, if and when the customer called. However, Genesis Energy is a refinery company with preferential access to cargo, and this has been their first entreaty to the shipping markets. It arguably made strategic sense to be able to transport internal cargo, as well as that of their clients, enhancing their logistics services to their clients.

Separately, also in early 2014, Kinder Morgan acquired a series of Jones Act tankers newbuilding contracts at $142 million per vessel contract by American Petroleum Tankers (APT), a company controlled by the private equity fund Blackstone. And, in 2015, Kinder Morgan acquired the last four of the series of the newbuildings on order by a company affiliated with the same investment group. Kinder Morgan is better known for their 84,000-miles of domestic pipelines, 164 terminals, and the procurement of logistical services such as storage in the energy industry. A new entrant to the Jones Act market, Kinder Morgan's core business had been transport by pipeline, storage and logics in the energy industry.

In other words, Kinder Morgan is almost the exact same type of buyer as Genesis Energy for the tanker MT *'American Phoenix'*, a logistics company in the energy industry with preferential access to cargoes. By entering the shipping industry, they are aiming at getting an easier access to cargoes and offering their clients a wider line of services: not only refining and storage, but also delivery of the cargo by increased means in many more destinations.

This new type of buyer can offer to the cargo owner the option to buy crude product at the production site, transport it to the refinery, store it if necessary, have it refined, store it again if necessary as a petroleum derivative, and then deliver on demand to effectively any destination in the US. The traditional Jones Act shipowner would had been involved only in the two transport links and only when those two links were by sea; otherwise, the whole chain may have been largely unknown to them.

The flip side of the changing financial industry is that the shipowning structure has already been shifting, in interesting ways. Probably it's too early for the changes to be sensed by the smaller, local owners of a handful of barges or tugs in the brown water market where the industry is highly fragmented and in need of 'consolidation,' in financial parlance.

Nobody Rides for Free

Genesis and Kinder Morgan paid strong prices for their Jones Act tanker acquisitions, which more or less happened at the top of the shale oil boom, because of the market, but also because the acquired tankers had a much higher value (earnings potential) as part of their core strategy than what any shipowner would have been able to extract (and thus pay) by simply employing the ships on demand of the behalf of charterers. This new type of buyer has been using a different metric to reach value, which allowed them to out-compete traditional shipowners.

While shipowners offer 'commodity shipping' – the taxi on demand, and whoever is available or cheapest gets the fare – logistics companies, higher up in the value chain, offer the the taxi service that can help you run errands, stop at difference places, etc. Given the nature of the buyers and the generation of their earnings from logistical services which can be more predictable than earnings from shipping, it's not surprising that both buyers were both publicly listed and as Master Limited Partnerships (MLPs) where the cost of capital is lower than privately held companies, and actually lower than many other forms of publicly listed companies.

MLPs typically are low cost and risk capital structures where earnings are generated from long terms contracts (actually the pipeline industry has been the 'mother' of MLPs since once a pipeline is laid, there is minimal additional expenses by the tolls are very predictable). MLPs also enjoy certain tax benefits not available to other capital structures, whether in the private or the public space.

Both transactions are not just a coincidence for the Jones Act market. Clients get to expect more than partial fulfillment of their uni-modal transport needs from one supplier; there is demand for higher value offering, and in this case, two very sizable logisitics companies managed to offer them.

As customers and charterers demand more from the same counterparty, smaller, local owners with limited services will be facing headwinds. And, the bigger the provider and the wider the range of services they can offer to a larger customer base, makes them even more attractive to the financiers. It's where the supply chain comes full circle.

KARATZAS MARINE ADVISORS & Co.

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