

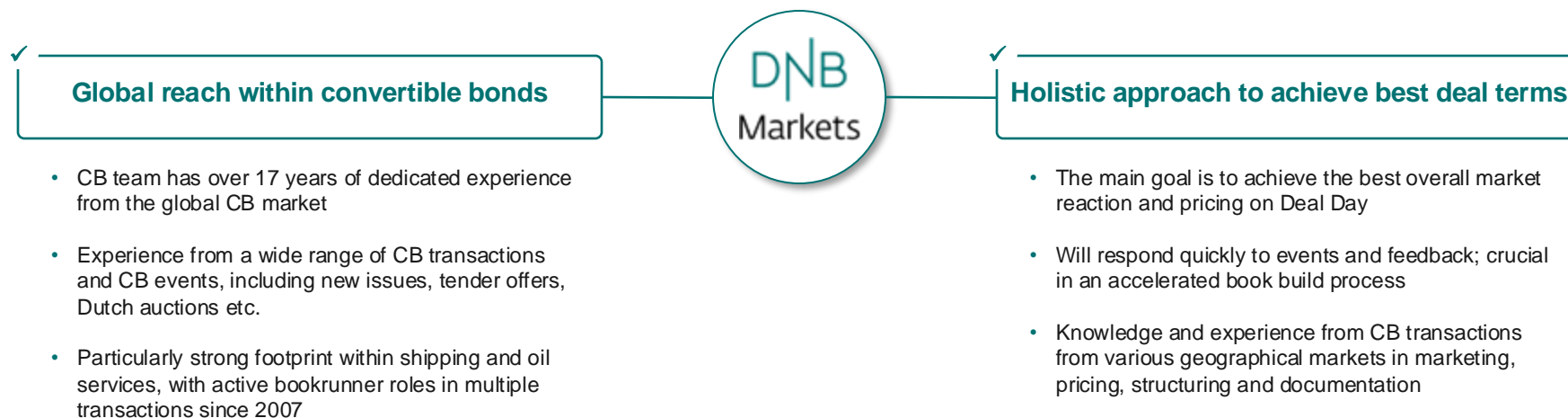
# Pros and cons of convertible bonds as a financing source for shipping and offshore companies



DNB Markets | Investment Banking Division  
Marine Money Asia – 25 September 2024

# DNB Markets has a dedicated convertible bond team

Experience in structuring, bookrunning and market making convertible bonds since 2007



## Convertible Bond Team



**Nils Christian Myhre**  
*Head of equity-linked capital markets*

### Selected experience:

- 20 years of investment banking experience from Pareto Securities, ABG Sundal Collier and DNB Markets
- Advised on >40 CB transactions since 2007

### Key tasks:

- CB pricing, structuring and documentation



**Lars Schöldström**  
*Head of CB sales & trading*

### Selected experience:

- 18 years of investment banking experience from JP Morgan, SEB, ABG Sundal Collier and DNB Markets
- Advised on >40 CB transactions since 2007

### Key tasks:

- Coordinate DNB's convertible bond sales
- Responsible for CB sales and trading activities

## Maritime & Energy Investment Banking



**Joachim Jaeger Skorge**  
*Managing Director & Regional Head of Investment Banking, APAC & M.E.*

### Selected experience:

- 26 years of investment banking experience with DNB Markets in New York, Oslo & Singapore
- Transaction experience from leading more than 100 successfully closed transactions with clients such as BW Group, Idan Ofer Group, MOL, Keppel, Seatankers, Aker etc












**Alphonse Low**  
*Associate*

### Selected experience:

- 3 years of investment banking experience from ABN ARMO and DNB Markets
- Transaction experience within capital markets and M&A in the maritime sector

# DNB's CB team has placed convertible bonds within shipping and offshore since 2007

Company	Year	Amount (m)	Coupon (%)	Premium (%)
 Borr Drilling	2023	USD 250	5.00%	32.5%
<b>BW OFFSHORE</b>	2019	USD 300	2.50%	37.5%
 Pacific Basin <small>With you for the long haul</small>	2019	USD 175	3.00%	32%
 Borr Drilling	2018	USD 350	3.875%	37.5%
Golar LNG	2017	USD 402.5	2.75%	35%
<b>SFL</b>	2016	USD 225	5.75%	22.5%
 SIEM	2016	EUR 250	2.25%	27.5%
BW Group  BW LPG	2014	USD 250	1.75%	32.5%
 GOLDEN OCEAN	2014	USD 200	3.07%	32.3%

Company name	Year	Amount (m)	Coupon (%)	Premium (%)
<b>SFL</b>	2013	USD 350	3.25%	33%
subsea 7	2012	USD 700	1.00%	30%
<b>SFL</b>	2011	USD 125	3.75%	35%
Golar LNG	2012	USD 250	3.75%	25%
FRONTLINE	2010	USD 225	4.50%	30.97%
Seadrill 	2010	USD 650	3.375%	30%
subsea 7	2009	USD 275	3.50%	37.5%
Seadrill 	2009	USD 500	4.875%	35%
 GOLDEN OCEAN	2007	USD 200	3.625%	40%

# Why should shipping and offshore companies issue convertible bonds in the first place?

<b>Low coupon</b>	<ul style="list-style-type: none"><li>▪ Typically 3% to 5%-points lower coupon compared to high yield bonds</li></ul>
<b>Equity raised at premium</b>	<ul style="list-style-type: none"><li>▪ Dilution is not certain and historically only 1/3 of CBs were converted to equity</li><li>▪ None of the shipping CBs DNB has placed over the years were converted to equity</li><li>▪ Bloomberg's Global Marine Shipping index is near its all-time-high (from 28<sup>th</sup> May 2024)</li></ul>
<b>Unsecured debt without covenants</b>	<ul style="list-style-type: none"><li>▪ No financial covenants</li><li>▪ No dividend restrictions</li><li>▪ Unsecured debt</li></ul>
<b>Flexibility at Maturity</b>	<ul style="list-style-type: none"><li>▪ Option to meet any conversion request with a Cash Settlement Option and avoid dilution</li><li>▪ Option to deliver the underlying shares at Maturity - irrespective of stock price and top-up to 100% using cash</li></ul>
<b>CB market sentiment</b>	<ul style="list-style-type: none"><li>▪ Valuation in today's CB market is exceptionally good, CB issuance from the shipping and offshore sector would see a wall of capital</li></ul>
<b>Execution</b>	<ul style="list-style-type: none"><li>▪ Swift execution once authorizations are in place</li></ul>

# Comparing convertible bonds VS. straight debt and VS. raising equity

## CB vs. straight debt

## CB vs. raising equity



### Advantages of CBs

- ✓ 3% to 5%-points lower coupon per year provides reduced financing costs
- ✓ Unsecured debt without covenants
- ✓ New set investors / Diversifying funding sources

- ✓ Dilution [40]% above current stock price
- ✓ Dilution is NOT certain, historically only 1/3 of CBs are converted to shares at maturity



### Disadvantages of CBs

- ❖ Potential dilution after [5] years
- ❖ Stock price impact on Deal Day
- ❖ Complicated to understand CB valuation

- ❖ Convertible bonds are mainly debt instruments
- ❖ Default on non-payment of coupons

A convertible bond has two outcomes: 1) Low coupon debt, or 2) Future dilution at a premium to the current stock price

# Key parameters for terms and investor demand in a CB

- parameters that influence the complexity of pricing, structuring and placing of the convertible bond

## OPTIMAL SITUATION:



“OK” credit quality

Market cap above US\$ 500 to US\$ 1bn

Enough stock borrow available

Liquid stock (minimum US\$ 3-5 mill per day)

High stock price volatility

CB size: Minimum US\$ 100 million

Stock covered by multiple equity analysts

## CHALLENGING SITUATION:



Weak credit profile/Unable to issue HY bonds

Market cap below US\$ 500 million

Limited stock borrow available














Illiquid stock (below US\$ 2 million per day)

Limited stock price volatility

Small CB size

Limited analyst stock coverage

# Example: An offshore company that checks all the relevant boxes on CB investors' wish list

	Optimal situation	Challenging situation
<b>Credit profile</b>	<ul style="list-style-type: none"> <li>Public credit ratings from S&amp;P and/or Moody's </li> <li>Unsecured bonds outstanding </li> <li>Investment Grade credit rating</li> </ul>	<ul style="list-style-type: none"> <li>No credit ratings</li> <li>No bonds outstanding with similar risk</li> <li>Non-Investment Grade credit rating </li> </ul>
<b>Volatility profile</b>	<ul style="list-style-type: none"> <li>Liquid stock trading minimum \$10-50 million per day </li> <li>Availability of stock borrow at low cost (GC rate) </li> <li>Volatile stock – above 30-35% </li> <li>Liquid options market </li> </ul>	<ul style="list-style-type: none"> <li>Illiquid stock trading less than \$5 million per day</li> <li>Limited stock borrow available</li> <li>Limited stock price volatility – below 30%</li> <li>Limited equity options market</li> </ul>
<b>Business profile</b>	<ul style="list-style-type: none"> <li>Strong equity story in an attractive sector </li> <li>Stock is covered by reputable equity analysts </li> <li>Well known / repeat issuer of CBs</li> </ul>	<ul style="list-style-type: none"> <li>Limited growth potential / unattractive sector</li> <li>Limited stock coverage by equity analysts</li> <li>No history in the CB market </li> </ul>
<b>Deal profile</b>	<ul style="list-style-type: none"> <li>Index inclusion of the bond (min \$400m/€375m) </li> <li>Deal size larger than \$100 million </li> <li>Listing of the CB on an Exchange </li> </ul>	<ul style="list-style-type: none"> <li>No index inclusion of the CB</li> <li>Deal size below \$100 million</li> <li>No listing of the CB</li> </ul>

# Key choices in a convertible bond

Decision	Alternatives				Consideration
Size	USD 100 – 1,000 million				<ul style="list-style-type: none"> <li>Sizing up to USD 1,000 million is typically easily digestible for the CB market</li> </ul>
Status	Senior Unsecured	Subordinated			<ul style="list-style-type: none"> <li>Most CBs are senior unsecured status</li> </ul>
Maturity	3y	5y	6y-8y	10y	<ul style="list-style-type: none"> <li>5 years is most common, but many durations are possible</li> </ul>
Conversion premium	20-30%	30-35%	35-40%	40-45%	<ul style="list-style-type: none"> <li>There is a trade-off between coupon vs. premium</li> </ul>
Call protection	Callable	Not callable			<ul style="list-style-type: none"> <li>Hard No-Call provides the lowest coupon</li> <li>A provisional call option provides additional flexibility</li> </ul>
Investor put option	Yes	No			<ul style="list-style-type: none"> <li>A “put” adds investor flexibility and is particularly common in Asia</li> </ul>
Dividend protection	Yes	No			<ul style="list-style-type: none"> <li>Full adjustment of the conversion price over dividend is most common</li> </ul>
Stock borrow facility	Yes	No			<ul style="list-style-type: none"> <li>Sometimes a stock borrow facility is required to achieve best deal terms</li> </ul>

# Investors in the CB market

## CB outright funds



Outright demand: ~40%

- Predominantly international funds with a global focus
- Dedicated long-only funds, “buy and hold” with no hedging
- Focus on the equity story and to protect capital through debt investment
- Less enthusiastic to wide credit risk and happier with Investment Grade credit

## CB hedge funds



Hedge fund demand: ~60%

- Invest on a hedged basis, mainly through equity hedging
- Less credit-sensitive and more open to investing into wider-credit issuers
- Have a strong preference to invest in profiles with high convexity, convertible into underlying stocks with high levels of volatility and liquidity

# Common misconceptions about convertible bonds

1

A convertible bond will lead to a continuous stock pressure in the stock!



- **NO!** There will be some stock selling related to the execution of the CB at issue. During the life of the CB, delta adjustments do occur as investors adjust their hedge according to the theoretical delta. As such, the existence of a convertible bond will also provide some stock support when the stock price falls, as CB investors reduce their hedge and buy-back shares. The dynamic hedging during the life of the CB is typically only a fraction of the company's daily stock liquidity

2

CB investors make money by "shorting" the stock!



- **NO!** Outright CB investors (40%) DO NOT hedge at all. Hedge funds do invest on a hedged basis but will always retain a net long investment in the company. At issue, for an investment of \$100 in a CB, a hedge funds will typically be short stock worth \$35-40, leaving a net long exposure of \$60-65. ALL CB investors will achieve the best returns when investing in performing companies

3

CB investors will convert to shares once the stock price reaches the conversion price!



- **NO!** The only point in time investors will convert a CB to shares, is just before maturity, and only if "parity" (the value of the underlying shares) at that time is more than 100%. There is always a seniority, optionality and coupon benefit in a CB versus the underlying stock. Therefore, a CB will trade above "parity" during the life of the bonds, ensuring no early conversions by rational investors

4

The conversion price of a CB will "cap" the stock price!



- **NO!** There is zero empirical evidence that the conversion price of a CB will have such an effect on the underlying stock, just as the clearing price in an equity placement does not prevent a stock from rising through that level

5

Issuance of a convertible bond will send a negative signal about the underlying stock!



- **NO!** Issuing convertible bonds is one of the most efficient ways to raise a significant amount of unsecured capital.

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