Lloyd's List

A SPECIAL INVESTIGATION

lloydslist.com | Monday May 26, 2014
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The hidden loans that sank Nanjing Tanker

A special Lloyd's List investigation goes behind Nanjing Tanker's great wall of obfuscation to examine how off-balance-sheet syndicated loans brought the Chinese tanker giant to its knees

The following investigative article is published in collaboration with **Caixin**, a Beijing-based business publication owned by Caixin Media. The collaboration with Caixin represents a first for Lloyd's List with any publication, and, more importantly, a first for Lloyd's List in China, now the key centre of global shipping. Caixin is dedicated to producing independent investigative news and analysis of China's markets, politics, businesses, culture, environment, media, and law. A Chinese language version of the story by Lloyd's List reporter Jing Yang and Caixin Media reporter Wu Jing is published simultaneously on Caixin New Century Weekly magazine and caixin.com. Copyright of both English and Chinese version is co-owned by Lloyd's List and Caixin Media.

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NANJING Tanker Corp, China's first state-owned enterprise to lose its stock market listing following four years of consecutive losses, has been withholding information about a massive amount of debt in the form of long-term, off-balance-sheet loans drawn between 2005 and 2008, a Lloyd's List investigation reveals.

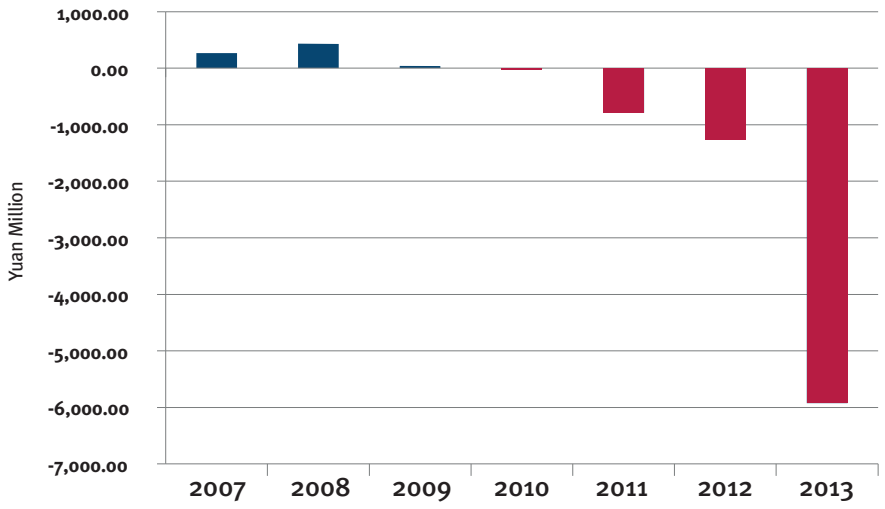
Some $1.3bn in loans was funnelled into Nanjing Tanker by 19 banks in 11 countries to fund the Chinese carrier's fleet expansion during the shipping market boom. Commitment to the borrowing, which financed 10 very large crude carriers and 10 medium-range product

tankers, is one of the major reasons the company is now facing insolvency.

The 20 vessels and the debt obligations attached to them amount to a non-disclosed book — a kind of shadow balance sheet — worth at least $3.5bn (Yuan21.6bn), overwhelming the size of the company's existing balance sheet. However, Nanjing Tanker, 55% owned by state giant Sinotrans & CSC Group, never made a full disclosure to the Shanghai Stock Exchange regarding the 20 off-balance-sheet transactions, all of which were priced during a rising market and contracted on terms that carry non-negotiable payment obligations and cannot be cancelled.

As of late-April, the company was effectively in default of the off-balance-sheet loans, in addition to carrying arrears on its balance sheet.

NANJING TANKER NET PROFIT



Source: Company disclosure, compiled by Lloyd's List

Shanghai delisting

Backed by a national mandate to serve crude imports **[see Comment, Page 7]**, Nanjing Tanker leapfrogged to the top ranks among the world's tanker players in less than a decade. However, the company now appears to have overextended itself and taken on obligations it could not meet.

Nanjing Tanker, which recorded four annual losses between 2010 and 2013, is undergoing a 30-trading-day transitional period to settle its shares on the secondary market. Its last day on the exchange is slated to be June 4.

Listed in the Shanghai Stock Exchange in 1997, Nanjing Tanker's share price closed at Yuan0.7 on Friday, compared to the peak of Yuan14.52 in 10 January 2008. Nanjing Tanker is the world's sixth-largest tanker owner by fleet size, according to Clarksons. The company operates some 87 vessels totalling 8m dwt, including 19 VLCCs, 33 MR product tankers, and chemical and asphalt tankers, its website shows. It has two VLCCs on order at state-owned Guangzhou Longxue Shipyard.

It is controlled by China Changjiang National Shipping (Group), which merged with Sinotrans Group to form Sinotrans & CSC in 2009, the country's third-largest shipping and logistics conglomerate after China Ocean Shipping Group and China Shipping Group.

The string of losses has saddled Nanjing Tanker with debt. As of end-March, the company reported negative Yuan2.4bn in equity and Yuan15.7bn ($2.5bn) in total liabilities.

The Yangtze River-based company announced in April 29 it had defaulted on Yuan1.2bn in principal, interests and financing leasing hires, and that it was "actively negotiating with relevant parties for an appropriate solution to the [default] problems".

However, a two-month long Lloyd's List investigation shows the company's true level of debt goes well beyond what is shown on its balance sheet and that even some of its creditors are in the dark about its true debt position.

Nanjing Tanker declined Lloyd's List's invitation to comment on the story, citing sensitivity during the delisting settlement period.

The invisible off-balance-sheet leases

Nanjing Tanker's roots stem back to 1993 when it was founded as a coastal and inland river carrier for crude, product and chemicals. An asset swap and private placement by its parent, Nanjing Changjiang Tanker Co in 2007, transformed it into a VLCC and MR tanker operator.

Among the assets swapped from the parent company were 10 MR tankers and four VLCCs financed via syndicated loans to special purpose vehicles, whose function is to hold the legal title of the vessels and service the borrowing and repayment of loans.

But in Nanjing Tanker's stock exchange filings throughout the years, it lists the SPVs, registered in offshore tax havens, only as counterparts in charterparties, which appear as long-term time charters on Nanjing Tanker's books.

The same model was replicated in December 2007 and September 2008 in transactions that funded six more VLCCs and brought the total number of vessels off-balance-sheet to 20.

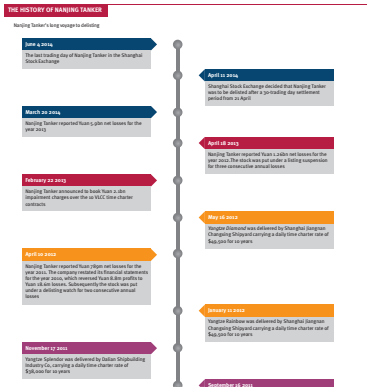
All of the 20 vessels are Hong Kong-flagged and held in 18 SPVs registered in Panama and the British Virgin Islands. The SPVs are registered as non-Hong Kong companies under Hong Kong Company Ordinance, together with their mortgage and charge details.

Records at Hong Kong Marine Department and Companies Registry reveal the structures and financiers of the long-term time charters.

Between 2005 and 2008, Calyon Asia Shipfinance, Societe Generale Asia, Royal Bank of Scotland and BNP Paribas acted as facility agents for financing of the 20 vessels and as security trustees, or mortgagees, of these vessels after delivery.

In particular, Calyon, now known as Credit Agricole Corporate & Investment Bank, facilitated loans for two VLCCs: *Yangtze Pearl* and *Yangtze Spring*; and five MR Tankers: *CSC Brave*, *CSC Progress*, *CSC Amethyst*, *CSC Crystal* and *CSC Cyanite*.

Societe Generale Asia arranged loan for three VLCCs: *Yangtze Bravery*,



Timeline of events

Download an **EXCLUSIVE** Lloyd's List graphic detailing the timeline of events in the Nanjing Tanker story at **www.lloydslist.com**

Yangtze Rainbow and *Yangtze Diamond*; and five MR Tankers: *CSC Peace*, *CSC Friendship*, *CSC Risingsun*, *CSC Auspicious* and *CSC Coral*.

RBS administered deals for two VLCCs, *Yangtze Rhyme* and *Yangtze Fountain*; and BNP Paribas for *Yangtze Star* and *Yangtze Crown*.

Fifteen other banks, from China, Japan, South Korea, Singapore, Ireland, Netherland, Canada, Sweden and Germany, also subscribed to the loans at different portions, which together amount to $1.3bn in principal, according to a compilation of company records.

Mayer Brown JSM and Norton Rose acted as solicitors for the four security agents, or mortgagee banks, Companies Registry records show.

While it is not mandatory to disclose the full newbuilding contract prices with the Hong Kong Companies Registry seven out of the 20 vessels include this information. The 29,700 dwt *Yangtze Splendor* and *Yangtze Bravery* were contracted at $116m; the 31,000 dwt *Yangtze Rainbow* and *Yangtze Diamond* at $121.9m, with the loan financing 80% of the newbuilding costs. For the 46,000 dwt *CSC Risingsun*, *CSC Auspicious* and *CSC Coral*, all held in one SPV, the newbuilding price was $40m each and the loan covered 90% of the total cost.

The rest of the costs were funded by Nanjing Tanker, governed under a subordinated loan agreement and appeared as advance charter hire, a current assets account, on the company's balance sheet.

NANJING CHARTERED TANKERS

Name	dwt	Registered owner	Mortgagee	Technical manager
Yangtze Pearl	29,000	Agate Shipping	Calyon Asia Shipfinance	CSC Najing Tanker
Yangtze Spring	297,557	Crystal Shipping	Calyon Asia Shipfinance	CSC Najing Tanker
Yangtze Rhyme	297,573	Aldebaran Shipping	Royal Bank of Scotland	NW Shipmanagemnet
Yangtze Fountain	297,580	Betelgeuse Shipping	Royal Bank of Scotland	NW Shipmanagemnet
Yangtze Star	318,218	Nappa Shipping	BNP Paribas	NW Shipmanagemnet
Yangtze Crown	317,960	Napoleon Shipping	BNP Paribas	NW Shipmanagemnet
Yangtze Splendor	297,058	Nanjing D One Shipping	SocGen Asia	CSC Najing Tanker
Yangtze Bravery	296,951	Nanjing D Two Shipping	Société Générale	CSC Najing Tanker
Yangtze Rainbow	318,506	Nanjing W One Shipping	Société Générale	NW Shipmanagemnet
Yangtze Diamond	299,999	Nanjing W Two Shipping	Société Générale	NW Shipmanagemnet
CSC Brave	45,853	Opal Shipping	Calyon Asia Shipfinance	NW Shipmanagemnet
CSC Progress	45,791	Jasper Shipping	Calyon Asia Shipfinance	NW Shipmanagemnet
CSC Peace	45,886	Nanette Shipping	Société Générale	NW Shipmanagemnet
CSC Friendship	45,800	Nancy Shipping	Société Générale	NW Shipmanagemnet
CSC Risingsun	45,904	Nantalis Shipping	Société Générale	NW Shipmanagemnet
CSC Auspicious	45,851	Nantalis Shipping	Société Générale	NW Shipmanagemnet
CSC Coral	49,997	Nantalis Shipping	Société Générale	NW Shipmanagemnet
CSC Amethyst	49,967	Olivine Shipping	Calyon Asia Shipfinance	NW Shipmanagemnet
CSC Crystal	49,982	Citrine Shipping	Calyon Asia Shipfinance	NW Shipmanagemnet
CSC Cyanite	49,982	Garnet Shipping	Calyon Asia Shipfinance	CSC Nanjing Tanker

Source: *Hong Kong Marine department; Lloyd's List Intelligence*

The charterers' obligation

The deals all bear unusual aspects in international ship finance practice.

CSC Oil Transportation, a Singapore-registered subsidiary of Nanjing Tanker, is shown as original buyer of the vessels. The shipbuilding contracts were later novated between CSCOT and each of the SPVs, with the SPVs the buyer, and CSCOT, or in some occasions its parent Nanjing Tanker, as construction supervisor.

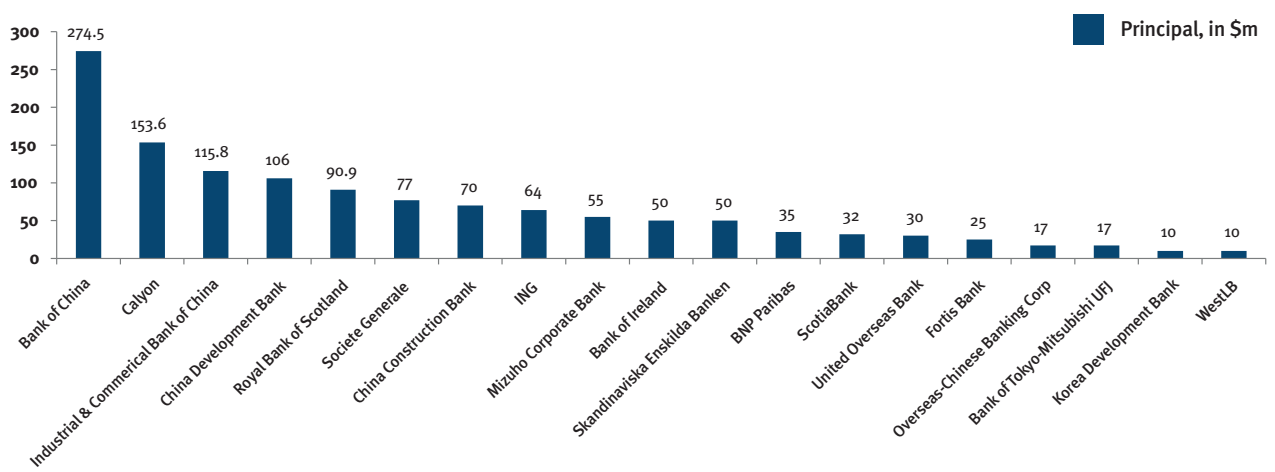
While novation is not unusual, CSCOT and Nanjing Tanker, and in some cases various Singapore-registered subsidiaries of CSCOT, were named as co-time charterers of the vessels, in conjunction with management contracts signed between the SPVs, CSCOT and Nanjing Tanker, which stipulated CSCOT and Nanjiing Tanker as both technical and commercial managers of the vessels.

In addition, CSCOT and Nanjing Tanker each serve as sales agent and standby sales agent, obliged to sell the vessels for the SPVs, the registered shipowners, at the end of the charter period.

Footnotes to Nanjing Tanker's annual reports show the 20 vessels carry a 10- or 12-year charter periods, which are, in effect, the periods of the loan agreements.

The pre-delivery tranche of the loan was secured by refund guarantee in favour of the SPVs, with the post-delivery tranche, payable upon delivery

NANJING TANKER OFF-BALANCE-SHEET LENDERS



Source: *Hong Kong Companies Registry, compiled by Lloyd's List*

of the vessels, secured by 100% of the financed assets, or the vessels, together with the insurance coverage taken out for the vessels.

Twenty-one clauses list grounds for default. Except for various stipulations on payment obligations and status of the vessels, "any material adverse change in the financial condition of the time charterers" and failure of payment to the time-charterers' "creditors generally" both amount to default. Any breach would enable the lenders to terminate the contracts and the resort to securities.

In essence, the payment obligation features a hell-or-high-water clause normally seen in vessel chartering, meaning that payments must be made regardless of any difficulties the debtor may encounter.

Who is the real owner?

Except for the stipulation of co-time charterers — as opposed to the more commonly used standby charterers clause — the structure also carries some components rarely adopted by Chinese state carriers in sourcing financing, although not uncommon in international ship finance practice.

Non-Hong Kong companies registered at the Companies Registry are not obliged to disclose shareholders information, only directors. Corporate information at offshore tax havens is inaccessible to the public.

However, three ship financing sources familiar with the transactions told Lloyd's List the SPVs are ultimately held by a charitable or orphan trust registered in the British Virgin Islands.

The trustees are BVI-licensed lawyers and the beneficiary is a charity. The trust owns a holding company, which owns the SPVs. Directors of the holding company are a mixture of lawyers at registration locations of the SPVs, such as the BVI and Panama, and one or two Nanjing Tanker executives.

"There is little cash flow between the SPVs and the trust, which ensures the vessels' earnings are split between Nanjing Tanker and the lenders," said one source.

"As the vessels are held in a charitable trust, technically the vessels have no beneficial owners."

Still, such an arrangement does not exonerate Nanjing Tanker, on the surface the time-charterer, from obligations to the vessels, according to another source.

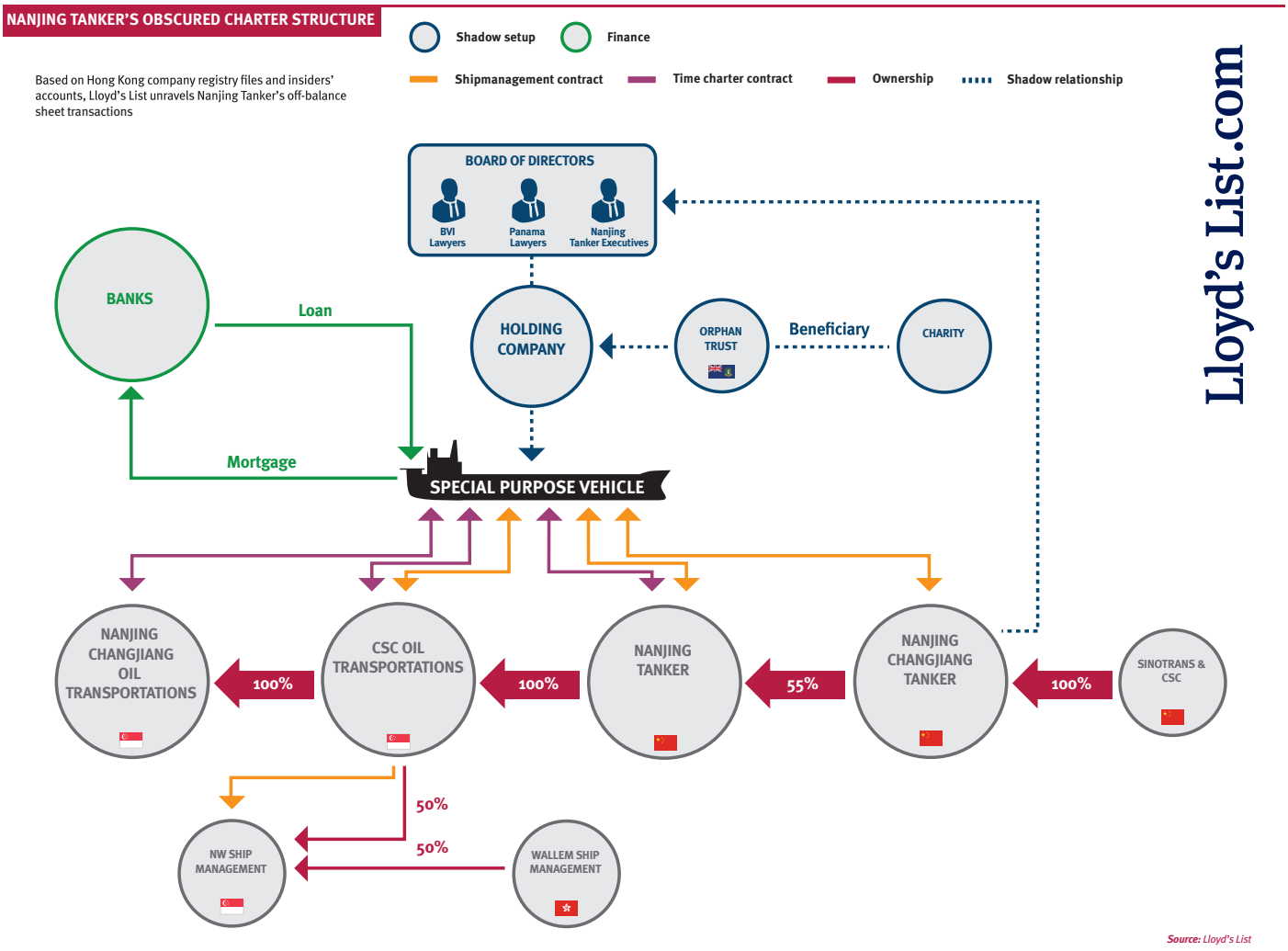
"Banks never want to legally or beneficially own any vessels due to the risk involved, and Nanjing Tanker wanted to make the deal off-balance-sheet. Still, the vessels have to be owned by some entity. So a charitable trust structure was brought in to be the beneficial owner. But no matter what the structure is Nanjing Tanker still holds all the obligations," according to a Hong Kong-based ship financing expert.

"Banks in general provide companies with lending only, and shun ownership in ships, or the financed assets, due to concerns over liabilities, which can be enormous. In the case of crude oil tankers, the obvious concern is liability for pollution caused by an oil spill.

"So SPVs are set up to limit liabilities and separate ownership. Orphan trusts are typically used to deliver an efficient tax structure, or in shipping finance, to finance assets through a leasing structure without creating any of the liabilities of ownership.

"In these instances, it's common to establish a trust, which will own an SPV, and for the financiers to lend into the SPV. The SPV will earn a small profit, which will be passed on to the trust, and probably donated to charity."

In the SPVs, banks can finance up to 80%-95% of the newbuilding cost, on condition that equity is in place. Equity is typically paid in the form of advance rentals from the charterers into the SPVs or the holding company of the SPVs, according to the expert.



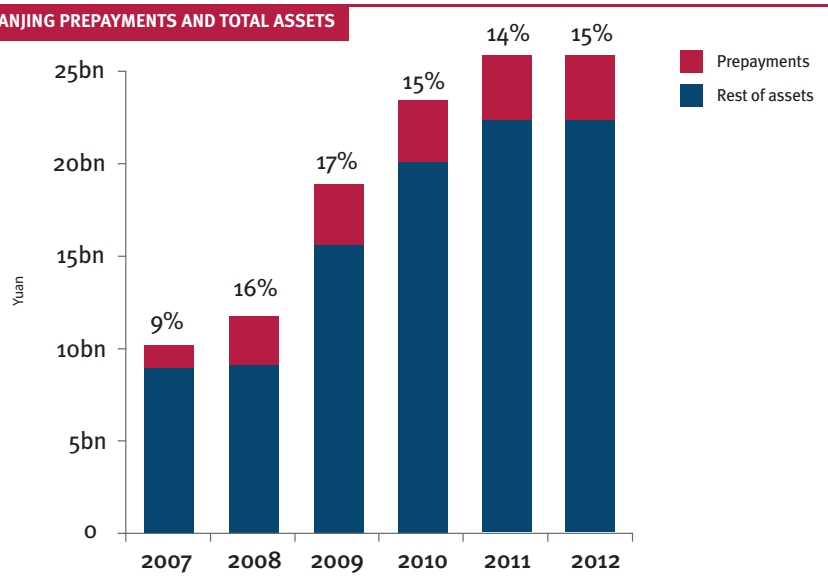
"Without seeing the actual contract, a reasonable assumption can be drawn that the time charterer could well be the beneficial owner of the vessels. It may not be stated in an evident way, but obligations will be on the charterers."

Formerly known as Nanjing Water Transport Industry Co. Ltd, Nanjing Tanker embarked on the transformation to become a deepsea operator, after the opening of a 973 km long Sinopect oil pipeline in 2006 that eclipsed its business of carrying oil into China's hinterland.

Also in 2006, the company signed a 10-year COA with Sinopec to deliver crude imports into China, which armed the company's aspiration to grow.

A Hong Kong-based ship finance source familiar with the deal said: "Nanjing Tanker wanted to expand fleet size after securing the COA with Unipec. This involves more operation overseas, so it makes sense to have set-ups overseas like this. It also exerts much less pressure on balance sheet."

NANJING PREPAYMENTS AND TOTAL ASSETS



Source: Company disclosure, compiled by Lloyd's List

Regulatory hurdles

According to a third source, the purpose of the structure is to "blur the identity of the real shipowners".

The entire structure, including the arrangement of a time charter together with a management contract, appears like "an attempt to get around regulatory approval in China", said the ship finance expert, who is not involved in the deals.

"When offshore banks want to lend to onshore companies, such a structure is applied primarily to sidestep regulations in China," he said.

One of the uncommon elements in Nanjing Tanker's charter arrangement is the dual contract set-up. In each instance that a charterparty was signed together with a commercial and technical management contract. Combining both may constitute a bareboat charter.

Such an arrangement, according to the expert, may be an attempt to evade regulatory approval.

"This is a grey area of regulation. Regardless of operating or finance leases, bareboat charters are viewed as leases, therefore financing activities, which are the target of regulation by Chinese authorities.

"If an onshore company does a bareboat charter back to PRC, it has to obtain a leasing licence from banking and foreign exchange authorities. Without such a licence, the onshore lessee cannot make payments to an offshore lessor. Even if the lessee is an offshore subsidiary of an onshore company, it still has to obtain approval from [the State Administration of Foreign Exchange] for foreign exchange quota that provides guarantee to the offshore subsidiary."

However, regulatory hurdles can be bypassed if the leases are dressed up in time charters. "If the onshore company does a time charter back to China, even if such charter has financing purpose included, the time charter will still be treated as a commercial contract, therefore there bears no need of approval from relevant authorities," the expert said.

In July 2012, Nanjing Tanker and Wallem Shipmanagement formed a 50-50 joint venture in Singapore, NW Shipmanagement. Records at Singapore Accounting and Corporate Regulatory Authority show CSCOT, Nanjing Tanker's local subsidiary and one of the co-time charterers, is the direct shareholder of NW.

NW is the technical manager of six VLCCs and nine MR tankers out of the 20 off-balance-sheet vessels, according to Lloyd's List Intelligence. The remaining five are managed by Nanjing Tanker itself.

The true level of indebtedness

In December 2013, Nanjing Tanker announced it booked Yuan2.1bn impairment charges on the charters, citing "an increasing likelihood that the foreign shipowners would terminate the contracts".

In a supplement announcement in February, Nanjing Tanker disclosed charter rates of the 10 VLCCs, six at $38,000 per day and four at $49,500 per day. Although the timecharters were signed between May 2007 and September 2008, actual exercise of the contracts could not commence until the vessels hit the water between October 2008 and April 2012, after the tanker market collapsed.

The VLCC time charter equivalent rates skyrocketed to over $140,000 per day in May 2008 but plummeted a year later, according to the Baltic Exchange. VLCC TCE averaged at $12,255 per day in the first quarter of this year. The operating cost for a VLCC in 2012 stood at $10,350 per day, according to Moore Stephens.

Unlike normal time charters, in which the shipowner pays for capital and operating costs of the vessel, and the charterer pays for voyage costs, the time charter hires paid by Nanjing Tanker to the SPVs, according to one ship finance source, is "in truth repayment of principal and interest".

Based on the disclosed daily rates, Nanjing Tanker is bound to service a total of $1.7bn debt over 12 years from October 2008, when the first vessel was delivered. Interest costs for the 10 MR newbuildings remain unknown, but another figure disclosed by the company may provide a gauge of the size of the company's book kept in the dark.

Also in December 2013, the company said it had agreed to purchase all of the 20 vessels at the expiry of the time charters, a common attribute in categorising a lease as finance lease under International Financial Reporting Standards.

Nanjing Tanker said it would start accounting for the 20 charters on its balance sheet and estimated that the purchase will expand both its total assets and total liabilities by $910m (Yuan5.7bn).

Between 2007 and 2013, Nanjing Tanker paid a total of Yuan16.1bn in debt repayment dressed up as advance rentals. The combination of both figures, amounting to Yuan21.8bn ($3.5bn), is the rough size of the company's shadow book over the course of 15 years, from the year first vessel delivered to the year the charter period ended on the last vessel delivered. In contrast, as of end-2013, Nanjing Tanker reported total liabilities exceeding total assets by Yuan2bn. Among the Yuan15.8bn total liabilities,

Nanjing Tanker is China's first state-owned enterprise to lose its stock market listing. *© 2014 AP/Xinhua/Wei Ming*

Yuan6.4bn is due in a year. Branches of Industrial and Commercial Bank of China, Bank of China and China Construction Bank are listed as the top five creditors by the size of outstanding arrears.

Lloyd's List Intelligence data show the 10 MRs and 10 VLCCs were delivered between April 2007 and April 2012, implying that the loans remain outstanding for between three to eight years.

All of the three banks have exposure in the off-balance-sheet charters, too, as shown in Companies Registry records.

However, the hidden off-balance-sheet debt is not only a blind spot for the public, but also for some of its other creditors.

Banks and leasing companies were also eager to have Nanjing Tanker in their portfolio, some of them blindfolded by an obsession with state-owned enterprises, which are regarded as unlikely candidates for bankruptcy. As a result, due diligence processes sometimes may be nothing more than a formality.

Two of the company's domestic creditors, both of whom requested anonymity, confirmed to Lloyd's List that they were not aware of the scope of Nanjing Tanker's off-balance-sheet obligations.

"When we decided to do business with Nanjing Tanker, due diligence was indeed not thorough enough. Their off-balance-sheet exposure and borrowings in foreign currencies were never raised as a point for examination," said one of the creditors.

"The popular mindset among China's financial institutions is it can do no wrong to lend to state-owned enterprises, especially a company like Nanjing Tanker that has business of national, strategic importance. Companies of this kind automatically enjoy high internal credit ratings. Deals are often closed with repayment guarantees from the parent group, sometimes with collateral."

Both sources said Nanjing Tanker had taken a hard line against domestic creditors. "The company is adamant to us it would never default on foreign banks. In the meantime, they attempt to shed or evade some debts owned to domestic creditors," said one source.

Nanjing Tankerannounced it had been late on Yuan1.2bn payments as of end-April 2014, including principal, interests and finance lease hires. So while the company is striving to meet the bumper off-balance-sheet obligation, it has effectively been defaulted too, based on the events of default stipulation in Companies Registry mortgage documents.

In addition to bank borrowings, Nanjing Tanker has nine vessels on long-term sale and leaseback with three bank-affiliated leasing companies.

CMB Financial Leasing, a subsidiary of China Merchants Bank, Minsheng Financial Leasing and CDB Leasing between them have one aframax, two panamax crude tankers, two MR product tankers and four chemical tankers bought from and leased out to Nanjing Tanker for eight to 10 years between 2009 and 2012.

Auditor's alarm

Nanjing Tanker never made an adequate disclosure of the expensive charters or the obligation it is bound to honour under the loan agreements.

Despite the company's announcement at end-2013 that it would bring the 20 vessels back to the balance sheet, its latest financial reports as of end March showed such a change was yet to be reflected. According to a previously cited source, Nanjing Tanker was requested by its auditors to bring the 20 vessels under spotlight. The company's auditor, ShineWing Certified Public Accountants, has repeatedly questioned Nanjing Tanker's accounting treatment on the 20 charters.

Since 2007, the year that Nanjing Tanker rejigged its fleet and inherited the time charters from its parent company, the size of its prepayment account, mostly advance rentals to the SPVs, has been ballooning.

The company reported Yuan921m in prepayments at the end of 2007, which

*FOOTNOTE: International Financial Reporting Standards categorise audit opinions into unmodified and modified. When financial statements of the company under audit reflect a "true and fair view", the auditor issues an unmodified opinion. If the financial statements fail to provide a true and fair view, the auditor report modified opinion that can fall into one of three categories: qualified opinion, adverse opinion and a disclaimer.

accounted for 9% of its total assets and 28% of its current assets. By the end of 2012, the same account increased to Yuan3bn, constituting 15% of its total assets and 57% of its current assets, an analysis of its financial reports show.

The leasing deals also consume a sizeable amount of cash, taking up an average of 24.5% of the company's annual operating cash outflow between 2007 and 2013. Its operating cash flow was never in the black during the six years, and averaged Yuan145.7m.

In the 2012 annual report, ShineWing issued a qualified opinion over the prepayment account of CSCOT, the Singapore-registered subsidiary that co-time charters the 20 vessels.*

ShineWing said it could not complete the external confirmation process for CSCOT's Yuan3bn prepayments made to the "foreign shipowners" — Nanjing Tanker's euphemism for the SPVs — therefore, it failed to obtain sufficient appropriate audit evidence on which an unqualified opinion is based.

Similar modification recurred in the 2013 annual report. ShineWing issued a qualified opinion over Nanjing Tanker's Yuan2.1bn provisional charges on the 10 VLCC time charters, citing its inability to gather adequate audit evidence to assess the impact of the provisions on the company's balance sheet.

The auditor's predicament has continued into this year. Interviewed in Beijing last week, Sinotrans & CSC Group spokesman Xu Jiandong said: "The auditors said in the group president's office today that they are again going to issue a qualified opinion regarding the prepayment account held by Nanjing Tanker's Singaporean subsidiary, saying that they were again unable to gather enough auditing evidence to issue an unqualified opinion."

Listing compliance

Nanjing Tanker never made a thorough announcement regarding the 20 off-balance-sheet transactions and the scale of its commitments. Such debt obligation is almost certainly a major contributing factor to the delisting.

Over the years, the 20 off-balance-sheet time charters only appear in the footnotes of Nanjing Tanker's annual reports, with information on vessel names, charter periods, commencement date of charters, and contracting parties, which are the SPVs.

The company did not disclose the charter rates of the 10 VLCCs until February as a supplement to its earlier announcement to book the Yuan2.1bn impairment charges.

However, the Shanghai Stock Exchange stipulates companies are obliged to disclose "major transactions" that could have a material impact on companies' operation or earnings, and the bourse has a standard template covering a wide array of information to guide how a disclosure shall be made.

There are five quantitative criteria that define what constitutes a material transaction, benchmarked to a company's total assets size, revenue, or earnings in the latest financial year. For example, if the value of a transaction exceeds 50% of the company's revenue stated in the last annual report and is over Yuan500m in absolute value, such transaction is deemed as material and should be disclosed

According to both the Companies Registry records and Nanjing Tanker's supplemental announcement in February, the carrier signed four timecharter contracts on 3 September 2008 for four VLCCs — *Yangtze Splendor* and *Yangtze Bravery* at $38,000 per day, and *Yangtze Rainbow* and *Yangtze Diamond* at $49,500 per day. The charterparties cover 10 years from the day the vessel is delivered.

A rough calculation suggests the four vessels could cost Nanjing Tanker $638m (Yuan4.364m), 2.1 times the revenue it made in 2007, qualifying as a material transaction defined by the listing rules.

"Nanjing Tanker's disclosure on these time charters is not adequate. The company's business is concentrated on tankers. The chartered-in tonnage comprises a significant proportion in its main business and has material impact on its revenue and earnings," said a Beijing-based industry source familiar with listing compliance for Chinese shipping companies.

Nanjing Tanker also omitted the fact that it is one of the co-time charterers in the arrangement made with the

COMMENT

A fetish for state enterprises

AS A state carrier, the growth of Nanjing Tanker epitomises China's ascendance as the world's largest energy consumer and crude importer over the past ten years.

According to China Customs, between 2006 and 2013, the country's total crude imports jumped from 145.2m to 281.9 m tonnes, or from 2.8m to 5.4m barrels per day. More than 90% of the imports are through seaborne transport. China's daily tonnage demand rose from 1.3 VLCCs in 2006 to 2.4 VLCCs in 2013.

During the same period, Nanjing Tanker's deepsea fleet leapt tenfold from 740,000 dwt to 8m dwt.

"Nanjing Tanker is indeed a special case. It is entrusted with the national strategic initiative to build up China's owned VLCC fleet and increase the share of Chinese tonnage in crude imports," said one ship finance source.

Although China, a member of the World Trade Organisation, does not promulgate a cargo reservation policy for national tonnage, debates and campaigns in the political and industrial domain for closer pacts between national shipowners and national cargo owners have increased perceivable in recent years. China Shipowners' Association, for example, has repeatedly demanded national cargo owners to refrain from building up their own fleets and outsource shipping to the state carriers.

In 2006, at the start of China's 11th five-year plan, Chinese-owned tonnage carried only 10%-20% of the country's total crude imports, according to Nanjing Tanker's public filings.

Due to informal policy initiatives and government hand-outs, the ratio improved to 47% in 2013 but, as Lloyd's List reported in February, still lags behind the target of 80% set in the 12th five-year plan, which ends in 2015.

From the 11th five-year plan, tie-ups between energy majors and national shipping companies gained momentum.

In 2006, Unipec, now the world's top VLCC charterer, signed long-term COAs with Nanjing Tanker, Cosco Dalian and CSD. In the same year, CMES, the shipping arm of conglomerate China Merchants Group, floated its shares in Shanghai with Sinopec its second-largest shareholder.

In the 10-year bumper contract that Nanjing Tanker secured from Unipec, the two parties agreed to increase cargo and shipping volumes pro rata.

Between 2006 and 2008, Unipec would dedicate 2.5m-3.5m tonnes of oil per annum to Nanjing Tanker's vessels, with an extra of 1m-2m tonnes should Nanjing Tanker add a new VLCC to its fleet.

The scale will increase to 7m-8m tonnes in 2009, 11m-13m tonnes in 2010, and eventually to 18m tonnes per year from 2010 onwards, according to Nanjing Tanker's exchange statement.

Continued on Page 8

Continued from Page 7

However, freight rates in the COAs are index-linked, according to Nanjing Tanker's statement, which meant it was still exposed to freight market fluctuations.

Compensation schemes

The COAs have a compensation scheme shared by shippers and carriers, according to SWS Research analyst Amos Zhang.

"The industry norm is to benchmark contract rate to World Scale index with a two-way subsidy scheme. For example, spot rates will be exercised when between WS65 and WS135. When spot rates drop to below WS65, oil majors subsidise 60% of the discrepancies to shipowners, who absorb the remaining 40%; when spot rates rise to above WS135, shipowners rebate half of the extra gain to cargo owners and retain the other half," said Mr Zhang.

In 2014, the corresponding TCE rate of WS65 is $50,000-$51,000 per day on Baltic Exchange TD3 Middle East Gulf-Japan route, and $155,000-$158,000 per day for WS135.

Entering in the 12th five-year plan, national shipping companies and shipyards established a rapport. It is rare for state carriers to place orders at non-state shipyards, be they Chinese private or foreign yards, except for tonnage beyond the technical reaches of Chinese state shipbuilders.

According to a source close to state-owned shipping companies, state carriers can claim cash rebates from the government when ordering tankers at state yards. As a result, it is also uncommon to see national carriers source alternative financing for newbuildings, especially tankers, such as that which Nanjing Tanker opted for.

However, Nanjing Tanker's 20 time charters were arranged during the 11th five-year plan, before these funds were earmarked.

The subsidies are realised at a group level and later funnelled to the affiliated listed companies' through indirect means, hardly traceable on their financial reports, the source added.

Peer-to-Peer review

The status of Nanjing Tanker as an SOE operating in a strategic industry made it popular in the capital markets. It was a component of the Shanghai Composite Index since its listing in 1997 and was only screened out when the delisting was confirmed this year.

In early 2011, the company managed to complete a Yuan2.5bn private placement to fund several VLCC newbuildings, despite its unimpressive financials and higher-than-average price-to-earnings ratio and the market's overall lukewarm sentiment for shipping stocks, according to Caixin Media.

Nanjing Tanker did not divulge chartering costs when reporting operating expenses and the interest on the off-balance-sheet loans on the 20 tankers remains unknown. Lloyd's List is therefore unable to quantify the impact those charters have on Nanjing Tanker's earnings over the years.

However, a peer-to-peer comparison with China Merchants Energy Shipping and China Shipping Development — which along with Nanjing Tanker share Unipec as their largest customer — indicates Nanjing Tanker has been recording extraordinarily high operating expenses.

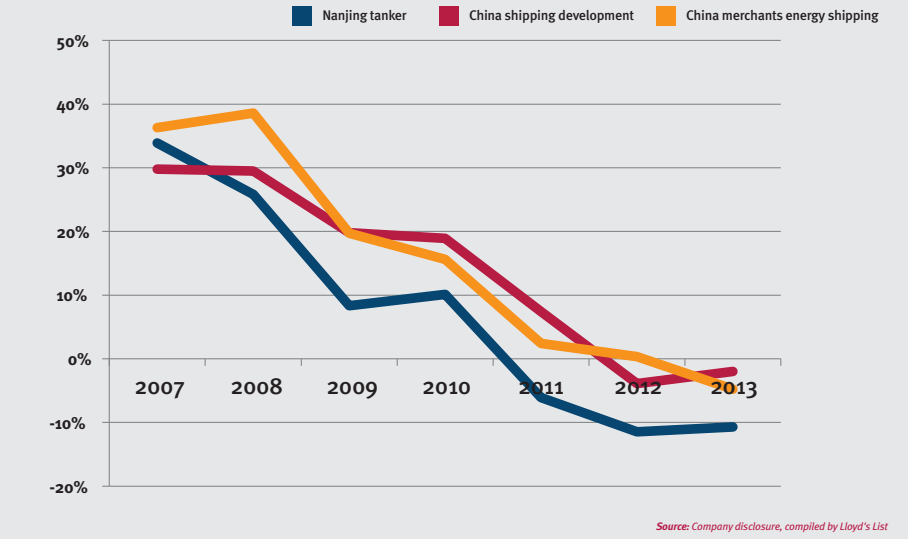
The Baltic VLCC TCE was hovering well below vessel operating costs from the second half of 2010 to the first half of 2013, spending eight quarters deep in the red. Despite headwinds that brought down long-term players such as Frontline, Torm and Overseas Shipping Group, CSD and CMES, both operating in tanker and dry bulk, have largely withstood the tempest.

Both companies reported their first annual losses last year and quickly rebounded to profit in the first quarter of this year.

In the tanker segment, CSD reported negative 3.9% and negative 2% operating profit margins in 2012 and 2013, and CMES recorded negative 4.8% operating profit margins in 2013. Other years were positive.

In contrast, Nanjing Tanker started posting operating deficits for its oil tanker fleet since 2011, with loss margins at 6.1% in 2011, 11.5% in 2012 and 10.7% in 2013. The company also continued to sail in the red in the first quarter, with Yuan255.7m net losses, in spite of a budding recovery that lifted many other tanker companies out of red during the same time.

LISTED CHINA TANKER COMPANIES PROFIT MARGIN



Source: Company disclosure, compiled by Lloyd's List

SPVs, saying all 20 vessels are chartered by its Singapore subsidiary CSCOT.

Separately, Nanjing Tanker also failed to disclose what qualifies a connected transaction.

According to the CR records, Liu Yibin, a senior executive of the company and its parent CSC Group, is one of the three directors at Aldebaran Shipping and Betelgeuse Shipping, the registered owners of the 29,700 dwt *Yangtze Rhyme* and *Yangtze Fountain*.

Mr Liu, now chairman of Nanjing Tanker Supervisory Committee, was the company's deputy general manager and chief accountant in 2007, when the company signed the contracts with Aldebaran and Betelgeuse.

Under the listing rules, such a link constitutes a connected transaction and necessitates a separate announcement.

Decline and fallout

Nanjing Tanker's delisting has sparked a public outcry in China and disillusioned small shareholders who once hoped Beijing would bail out the company. Since late March, minority shareholders, some of who lost life time savings to the stock, have repeatedly gathered and protested at the office buildings of China Securities Regulatory Commission, Shanghai Stock Exchange and Nanjing Tanker's headquarter, according to domestic media reports.

Some of them have entrusted lawyers to gather evidence of the company's wrongdoings such as false or misleading statements to investors. But so far no case has been accepted by courts.

Nanjing Tanker's ultimate parent, Sinotrans & CSC Group, also appears to have lost track on the company's concealed debt.

"Personally I'm not aware there are foreign banks lending to Nanjing Tanker," Mr Xu told Lloyd's List in Beijing last week.

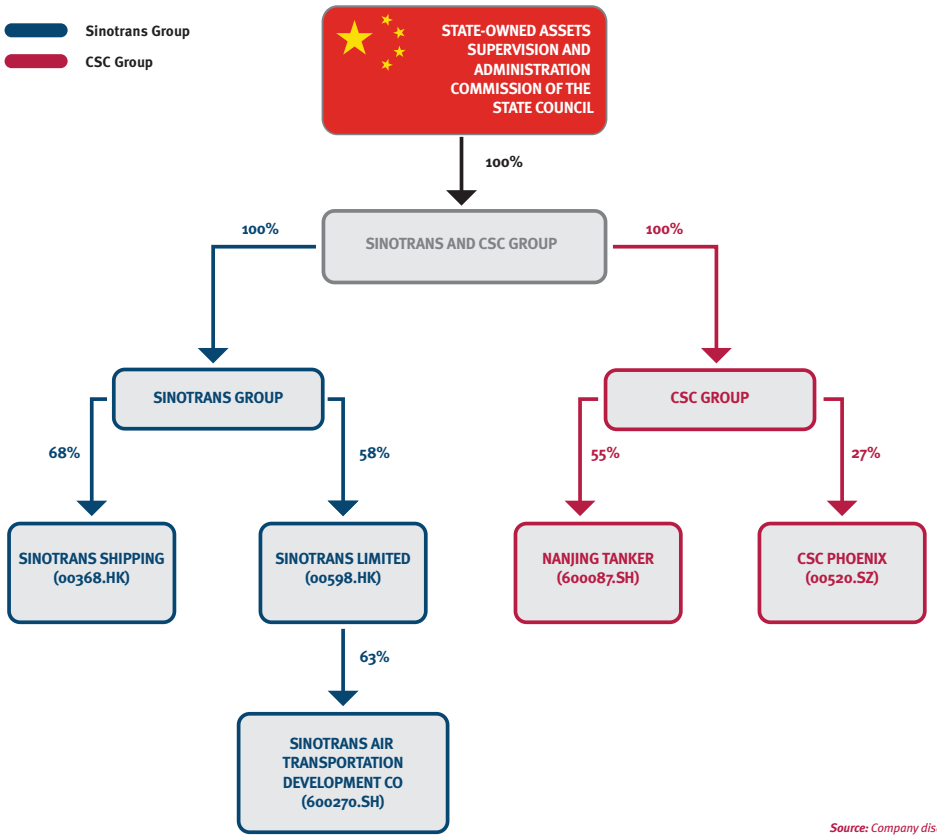
"At the group level, we've taken into account possible off-balance-sheet obligations held by Nanjing Tanker. The company is undergoing a transitional period. In principle we will take a market approach in any decisions to be made. We need to insulate the group from the contagion of [Nanjing Tanker's] crisis," said Mr Xu.

Choreographed by the State Council, Sinotrans and CSC merged in January 2009 to create the third-largest maritime and logisitics conglomerate in China, however, the marriage has so far produced unbalanced results. Sinotrans subsidiaries, such as Hong Kong-listed Sinotrans Shipping and Sinotrans Limited, have performed much better than those companies from the CSC side.

An executive at Sinotrans & CSC told Lloyd's List that the CSC Group companies, such as Nanjing Tanker and CSC Phoenix, ordered or chartered many ships during the height of the shipping cycle and before the merger. "The integrated group management is in the dark," he said.

"As the Sinotrans side of management took control of the entire group after five years' infighting, there will be more hidden bombs detonated in the CSC companies , which were sowed during market height."

SINOTRANS & CSC GROUP STRUCTURE



Source: Company disclosure

Yet another haircut?

The collapse of Nanjing Tanker amounts to a double whammy for some of the largest financial institutions in China, some already taking haircuts in the ongoing restructuring of CSC Phoenix, Nanjing Tanker's sister company.

Under pressure from creditors, CSC Phoenix entered court-administered restructuring in November. A debt reduction plan was reached in February. After debt-to-equity swap and capitalisation of common reserves, ordinary creditors will see only 11.6% arrears paid up, compared to 1.9% repayment rate under a liquidation scenario, according to stock exchange filings of Shenzhen-listed CSC Phoenix, once China's biggest dry bulk cabotage operator.

The sources, both of whom had exposure in CSC Phoenix fallout, said the parent group "drew benefits" from the restructuring of the dry bulk company and that is now seeking similar way out for Nanjing Tanker.

"It seems to them that it is viable to have financial institutions pay for the mistakes they made," one of the sources said.

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Published by Informa UK Ltd.

THE HISTORY OF NANJING TANKER

Nanjing Tanker's long voyage to delisting

June 4 2014
The last trading day of Nanjing Tanker in the Shanghai Stock Exchange

April 11 2014
Shanghai Stock Exchange decided that Nanjing Tanker was to be delisted after a 30-trading day settlement period from 21 April

March 20 2014
Nanjing Tanker reported Yuan 5.9bn net losses for the year 2013

April 18 2013
Nanjing Tanker reported Yuan 1.26bn net losses for the year 2012.The stock was put under a listing suspension for three consecutive annual losses

February 22 2013
Nanjing Tanker announced to book Yuan 2.1bn impairment charges over the 10 VLCC time charter contracts

May 16 2012
Yangtze Diamond was delivered by Shanghai Jiangnan Changxing Shipyard carrying a daily time charter rate of $49,500 for 10 years

April 10 2012
Nanjing Tanker reported Yuan 789m net losses for the year 2011. The company restated its financial statements for the year 2010, which reversed Yuan 8.8m profits to Yuan 18.6m losses. Subsequently the stock was put under a delisting watch for two consecutive annual losses

January 11 2012
Yangtze Rainbow was delivered by Shanghai Jiangnan Changxing Shipyard carrying a daily time charter rate of $49,500 for 10 years

November 17 2011
Yangtze Splendor was delivered by Dalian Shipbuilding Industry Co, carrying a daily time charter rate of $38,000 for 10 years

September 16 2011
Yangtze Crown was delivered by Shanghai Waigaoqiao Shipbuilidng Co, carrying a daily time charter rate of $38,000 for 10 years

June 10 2011
Yangtze Star was delivered by Shanghai Waigaoqiao Shipbuilidng, carrying a daily time charter rate of $49,500 for 10 years

March 2 2011
Nanjing Tanker reported Yuan 8.8m net profit for the year 2010

February 9 2010
Nanjing Tanker Corporation reported Yuan 4.2m net profit for the year 2009

January 12 2010
Yangtze Fountain was delivered by Jiangnan Shipyard, carrying a daily time charter rate of $38,000 for 12 years

May 26 2009
Yangtze Rhyme was delivered by Jiangnan Shipyard, carrying a daily time charter rate of $38,000 for 12 years

March 2 2009
Nanjing Tanker reported Yuan 596m in 2008 net profit

January 6 2009
Yangtze Spring was delivered by Shanghai Jiangnan Shipyard, carrying a daily time charter rate of $38,000 for 12 years

January 2009
Sinotrans Group China Changjiang National Shipping Group merged to create Sinotrans & CSC Group

October 10 2008
Yangtze Pearl was delivered by Shanghai Jiangnan Changxing Shipyard, carrying a daily time charter rate of $38,000 for 12 years

September 15 2008
Lehman Brothers filed for chapter 11 bankruptcy protection, marking the onset of the global financial crisis and the worst shipping industry depression in decades

September 3 2008
Nanjing Tanker signed loan agreement, time charter contract and Shipmanagement contract for four VLCCs, *Yangtze Splendor, Yangtze Bravery, Yangtze Rainbow* and *Yangtze Diamond*

March 5 2008
Nanjing Tanker reported Yuan 369.8m in 2007 net profit

December 21 2007
Nanjing Tanker signed loan agreement, time charter contract and shipmanagement contract for two VLCCs, *Yangtze Star* and *Yangtze Crown*

December 17 2007
Nanjing Water Transport Industry Co. completed assets swap with parent group, repositioned as a deepsea tanker operator. Company name was changed to Nanjing Tanker. Parent Nanjing Tanker was renamed as Nanjing Changjiang Tanker

June 11 2007
Nanjing Tanker signed loan agreement, time charter contract and shipmanagement contract for two VLCC, *Yangtze Rhyme* and *Yangtze Fountain*

May 16 2007
Nanjing Tanker, parent of Nanjing Water Transport Industry Co. signed loan agreement, time charter contract and Shipmanagement contract for *Yangtze Pearl* and *Yangtze Spring* two very large crude carriers

April 30 2006
Nanjing Water Transport Industry Co. signed a 10-year contract of affreightment with Sinopec to carry crude imports into China

June 12 1997
Nanjing Water Transport Industry Co. floated its shares in Shanghai Stock Exchange

1993
Nanjing Water Transport Industry Co. was founded, based in the City of Nanjing and specialised in transporting oil and chemicals along the Yangtze River to China hinterland. It is part of China Changjiang National Shipping (Group) Corporation

Source: *Lloyd's List; public information*

Lloyd's List

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Nanjing Tanker responds to 'hidden loans' inquiry

Debt-ridden Chinese giant continues to dodge key issues after stock exchange demands answers

Nanjing Tanker argued that its previous filings fulfilled its obligations of adequate disclosure.

NANJING Tanker Corp, the debt-ridden Chinese state carrier, has denied any wrongdoing in the way it has accounted for 20 off-balance-sheet leases, after a Lloyd's List investigation triggered an inquiry by Chinese regulators, *writes Jing Yang*.

The Shanghai Stock Exchange, where Nanjing Tanker is listed until Wednesday, formally requested clarification from the company regarding 20 charter deals after Lloyd's List revealed on Monday that Nanjing Tanker had built up a shadowy book worth at least $3.5bn (Yuan2.18bn) in both assets and liabilities, overwhelming the size of its existing balance sheet.

Previous filings

In response to the bourse today, Nanjing Tanker said in a filing that it had not hidden any information that should have been disclosed under listing rules.

In the statement, Nanjing Tanker, the first state-owned company to lose a listing status in China's stock market, argued that its previous filings fulfilled its obligations of adequate disclosure. However, as Lloyd's List reported, all of the company's past filings omitted key details of the 20 time charter transactions, which are in truth loan agreements to finance 10 very large crude carriers and 10 medium range tankers.

The 20 charters, all contracted at fixed rates prior to the 2008 financial crisis, are one of the major reasons that the company is now reeling over insolvency.

Nanjing Tanker in effect borrowed $1.3bn in principal to finance the 20 newbuildings and actual repayment could amount to $3.5bn (Yuan21.8) in the course of 15 years, all outside its existing balance sheet, as Lloyd's List revealed.

Senior executive

Nanjing Tanker also responded to questions regarding its failure to disclose a connected transaction.

The Lloyd's List investigation revealed that Liu Yibin, a senior executive of the company and its parent CSC Group, was one of the three directors at Aldebaran Shipping and Betelgeuse Shipping, the registered owners of the 29,700 dwt *Yangtze Rhyme* and *Yangtze Fountain*.

Mr Liu, now the chairman of Nanjing Tanker supervisory committee, was the company's chief accountant between 2006 and 2008, when the leasing contracts were signed.

Under the listing rules, such a link constitutes a connected transaction and necessitates a separate announcement.

In a six-page statement, Nanjing Tanker said: "When serving as director of the shipowning companies, Mr Liu Yibin, as a representative of the time charterer, ensured the exercise of the time charter contracts, prevented

Continued on Page 2

Continued from page 1

the chartered vessels from being sold or chartered to other parties, and protected the charterer's interest. He did not perform duties as a director on a daily basis, he never attended board meetings of the shipowning companies, or participated in operational matters. Neither did he take any remuneration from the shipowning companies."

Mr Liu resigned from Aldebaran and Betelgeuse in April last year, Nanjing Tanker added. "The company has no shareholdings in the two shipowning companies."

The clarification from Nanjing does not, however, address the requirement under Shanghai Stock Exchange rules that when companies have transactions with a connected party, the transactions should be disclosed immediately, if the value of the transaction exceeds 5% of the company's last audited net asset value and exceeds Yuan30m in absolute value.

As Lloyd's List reported, *Yangtze Rhyme* and *Yangtze Fountain* were time-chartered to Nanjing Tanker for 12 years at $38,000 per day. The two contracts combined are valued at $332.88m (Yuan2bn), surpassing Nanjing Tanker's net asset value at the end of 2006, which was Yuan1.5bn.

Moreover, in the latest filing Nanjing Tanker continues to avoid crucial issues involving the charter deals, which involve non-cancellable and non-negotiable charter hire payments.

These payments are in fact repayments of principal and interest, as Lloyd's List revealed.

The company also fails to address the offshore set-ups that ultimately hold the 20 vessels and the fact that the company is also a co-time charterer of the vessels, together with its Singapore-registered subsidiary.

As Lloyd's List reported, the vessels are ultimately held by an orphan trust registered in the British Virgin Islands, which holds the legal title of the ships while passing all obligations and risks to Nanjing Tanker, on the surface, the time charterer.

Read the full report on the hidden loans that sank Nanjing Tanker at *http://www.lloydslist.com/ll/incoming/article442023.ece*