

Changing tack

by
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ROCKETING refinancing costs have put the banks on alert. Liquidity and risk premiums will remain an issue for shipping clients beyond the sub-prime crisis.

Finance used to be easy to obtain with net interest margins hitting record lows, not least for German shipowners who have some of the largest banks in the maritime world right on their doorstep. But that was before summer 2007, when the US sub-prime sector melted down, sending shockwaves through the world of Western finance and forcing interbank and syndication markets to a halt.

More than \$900Bn has been slashed off balance sheets worldwide, the IMF has estimated. Many shipowners were caught off guard and cruelly reminded of the perils of not sealing finance at the outset of a newbuilding order. Financing costs went up overnight as liquidity dried up because banks lost trust in each other, thwarting earlier project calculations and causing an outcry among German KG houses and shipowners.

But the banks were perfectly right in doing so, argued Hans-Joachim Weinberger, head of ship finance at federal state bank Nord LB. It used to be common practice for owners to file an application for funding at the outset of a newbuilding project or a planned acquisition of a second-hand vessel to get their bearings on prospective of loan costs. But Weinberger pointed out: "Many of them refrained from signing a standby credit, so there was never a real commitment."

Given plentiful debt capital and availability of cheap loans at any time, owners were keen to avoid paying the customary commission charged for a standby loan facility. "KG houses, shipyards and ship finance arrangers used the savings to bolster their own profits," he said. "Some of them saved on commission payments over four years."

What used to be a cost edge has turned into a disadvantage, which is jeopardising new KG ship projects, some of which are based on very optimistic assumptions.

High ship prices and rising operating costs are already enough risk; if loan costs go out of control as well, financial safety margins can easily be wiped out. Shipowners will not be able to escape rising interest margins, even if they continue to apply delaying tactics, Weinberger warned. **F**

Enticing fresh liquidity

New shipping indices will allow institutions and individuals to bet large, Barry Parker reports. They could also provide owners with more hedging flexibility

The enormous strength of the shipping sector, particularly in dry bulk, has attracted interest far beyond the bounds of traditional shipping investors. Unlike in the early private commodity funds, whose deals were put together around actual vessels, the attention spans of today's hyperactive hedge funds are far shorter. They want investment ideas reduced to soundbites and near-instant execution.

An irony of the past two years is that investors have intensively focused on the Baltic Dry Index, but could not readily trade it. As rates gyrated in late 2007 and early 2008, investors realised that stock prices of most of the dozens of listed shipping companies were not directly tied to the BDI or constituent indices.

To meet demand for a readily tradable and market-responsive instrument, investment specialists at UBS, Dahlman Rose and elsewhere are creating new vehicles. UBS's hybrid derivatives trading executive director, Ilija Murisic, said his company has succeeded in offering "instruments for trading weather and carbon. We've seen a great deal of inter-

est in freight, so our group is now launching the Blue Sea Index and a group of sub-indices."

As with weather, investors can range from big institutions to individuals, he told *Fairplay*, adding that clients "wanted to have a simple way to access the market. We set out to make an investable index – not a reference index – and we wanted to simplify a lot of complicated information into a macro view.

"The industry's story, with the China growth, is very compelling."

Buyers and sellers will be trading on projected values, with quarterly intervals, priced with input from FFA brokers. Murisic explained that "prices will be sourced for different ship sizes for the most liquid FFA routes".

The UBS market studies revealed that port congestion played a major role in the ups and downs of dry freight, so Murisic and his product designers developed a weighted 'congestion factor', using data from raw material ports.

"The congestion factor adds leverage. We want our index to over-perform the FFA market," said Murisic. **F**

'[Clients] wanted to have a simple way to access the market'

Ilija Murisic (above)

Exploiting those 'arbs'

TRADERS seek to profit from arbitrage opportunities, exploiting a difference between two items that should be closely priced. The imperfect information of shipping markets presents frequent arb openings.

Freight traders exploit such differentials when lining up timecharter equivalent of voyage freight against the actual cost of a timecharter ship on that route, or when chartering a ship because of a wider gap between cost, insurance

and freight and freight on board. With FFA markets blossoming, JP Morgan shipping analyst Jon Chappell has published research guiding his clients toward opportunities, given that FFA rates exceed rates implied in publicly traded share prices. "In the tankers, to exploit the arbs, I recommended buying OSG shares," he said. **F**