

As shipping continues to boom, global financial markets remain under intense pressure. The implications of the financial crisis for shipowners are profound

Surging finance costs squeeze smaller owners



By Barry Parker,
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If the optimists are to be believed, the global financial crisis is finally winding down. But even if the capital markets return to functioning normally, the environment for ship finance has changed.

“Many of the banks have had severe liquidity issues,” said Harald Kuznik, head of global shipping at HSH Nordbank, which boasts a shipping portfolio of about €34Bn (\$52Bn).

“The consequence is that borrowers

will have to pay more,” Kuznik told *Fairplay*. “This applies especially to the smaller owners. Some may have great difficulties raising money.”

Harris Antoniou, head of shipping, energy and commodities at Fortis Bank, which has a shipping portfolio of \$10Bn, detailed the contagion-like spread of illiquidity at a recent conference. “Financial market dislocation continues, even several quarters later, suggesting more pressure in the pipeline and increased downside risks,” he warned.

“It’s too early to say that the crisis is completely behind us,” said Barry Martin, head of Greek shipping at the Royal Bank of Scotland. “We are seeing deals going through, but clearly, credit has been harder for shipowners to obtain,” he told *Fairplay*.

Martin, who shuttles between Piraeus and London, explained that a major issue for banks is their funding costs. “These days, there is a premium on long-term money – the term liquidity

premium. For owners, this has translated into widening spreads.”

For shipowners, the view forward is indeed unclear. Antoniou said the ongoing liquidity squeeze “is having a profound effect on the shipping market’s cost of debt and its ability to raise capital”.

Antoniou also raised the spectre of capital shortfalls that could prevent financing of the massive orderbook. “Unless there is a dramatic improvement in the inter-bank market, there will not be sufficient bank capacity to finance the sizeable orderbook” – which he sizes at \$635Bn (for 2008-2012 deliveries). A large portion of that orderbook has yet to be financed.

“Following periods of excess, a correction seems inevitable,” Antoniou told *Fairplay*, adding: “The lack of bank funding will have an impact on asset prices as certain owners may not have the financial resources to take delivery of newbuildings. Owners with a strong balance sheet and a fully funded delivery programme will have a significant competitive advantage.”

“Clearly, banks prefer younger ships,” noted Martin. “Today, one must wonder whether prices of ships will come down. This could be very dangerous exposure

Creeping inflation

FORTIS Bank’s Harris Antoniou is a commodity banker who is keenly aware of the dangers that come from lending at the high point in the market cycles.

“Creeping inflation is a risk going forward,”

Antoniou conceded, while pointing out that beyond financial constraints, there are also operational barriers ahead.

As he explained: “What we all have to ask ourselves, even in this ‘euphoric’ environment,

is what constitutes a sustainable growth rate for our industry vis-à-vis the fleet size, and also [what constitutes a sustainable rate for] resources to run it like mariners, spare parts, know-how, etc.”

Jumping the growth hurdle?

for the banks.” He explained that a large overhang of tonnage on order exists, especially in the Capesize sector. Martin believes there could be delivery delays, but was quick to add: “Even with a reasonable amount of delays, there is still a heavy delivery schedule.”

“I suppose that well-capitalised companies will always be able to attract funding albeit at higher cost,” noted Antoniou. “Smaller companies, though, with overly ambitious newbuilding plans, may have a more difficult time.”

Antoniou also stressed shipping’s ties with commodity markets – a differentiator for banks. “In periods of high volatility, risk mitigation tools and horizontal expansion across the value chain creates a sustainable competitive advantage for companies. Fortis’ presence in all three interconnected sectors of energy, commodities and transportation can provide those links.” **F**



AFTER DOLING out available cash to shareholders, high-dividend paying shipowners face barriers to fleet growth in a tighter capital market.

Shipping companies have a conflicted relationship with dividends. Cash payouts attract investors. During the flood of IPOs in 2005-2006, listings were launched on the premise of paying out fat dividends. Indeed, a glance at any brokers’ research report will show companies that pay out as much cash as they reasonably can achieve better valuations than peers paying fixed dividends.

Research by Jefferies & Co shows recent prices for a group of high payout tanker names measured 19.0 x projected earnings, versus 15.4 x earnings for a group of regular fixed dividend payers.

But in a capital-intensive business, dividends deplete a corporate treasury that might otherwise accumulate capital for expansion. And when cash is needed, companies that cut or eliminate a dividend are treated harshly in the markets. In response to cash shortfalls, they might need to source capital at inopportune times.

JP Morgan analyst Jon Chappell (pictured) told *Fairplay*: “There is a line drawn – I draw it around 60% of cash flow – between companies that seek to pay out based on yield considerations, and those that aim for a steady dividend.” He cited a connection between shipping’s IPO surge of 2005-2006 and the mantra of full payout: “The dividend payers tend to be new companies. It was very rare in 2005-2006 if shipping companies were going to market without a yield perspective.”

Generally, steady dividends or distributions are tied to period chartering, even if full payouts are not offered. For example, the rationale of Navios Maritime Partners (NMM), spun out of Navios Maritime Holdings (NM), is that it provides a higher valued outlet for certain vessels. NM retains a large ownership position in NMM, which has the right to purchase vessels from NM placed on charters of three years or more.

General Maritime’s dividend policy has evolved over the past few years to the middle road of a quarterly target. On a recent earnings call, president John Tavlarios explicitly drew the link between chartering and dividend policies, stating: “Placing a large portion of our fleet on time charters at what we believe to be attractive rates supports our fixed annual dividend target.”

The key question for the dividend payers is expansion. According to Chappell: “The only way for the full payers to grow is to go back for more equity.” Among the recent raft of secondary share sales was the ‘granddaddy’ of full payers, Nordic American Tankships, which raised upwards of \$170M to pay down debt and “probably for additional vessel acquisitions”, according to Chappell.

The full payout model has its critics. Danske Bank analyst Johannes Moeller said: “How can a full dividend policy create value to a long-term shareholder if you pay out cash to shareholders (who have to pay dividend tax) and then, a month later, you ask them to buy more issued shares (where you have to pay fees to investment bankers)?”

Expectations are a concern. When a full payer has a terrific quarter, stock is bolstered as shareholders calculate a large dividend into the price. But shipping differs from full payers in sectors with less volatility. New investors may find out about its volatility the hard way. **F**

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