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Insight

Going round in circles

Shipping cycle phases: from P/E to PE in a New York minute

Basil Karatzas – New York

LIKE each generation that has its own sex symbols and buzzwords, phases of the business cycle can be defined by their own artifacts. Nowhere has this been more apparent than in shipping.

In shipping finance, under the backdrop of the constantly ebbing and flowing availability of bank lending, the late 1990s were characterised by the "high yield" bonds that were issued to finance vessel fleet acquisitions and corporate growth. A decade later, the public (mostly equity) markets were an integral part of the shipping business vocabulary when shipping initial public offerings were the dreamboats to aspire to. Fast forward a few years later and past the Lehman collapse, and the phrase "private equity" and its acronym PE have been getting certain attention in shipping circle conversations.

PE funds have the flexibility to deploy funds in many asset classes across industries and borders, and under versatile financial structures. Some of these funds have mostly been defined by their "master of the universe" attitude, their exceptional political connections, their deep pockets and their often "grave dancing" inclination of picking up assets at close to salvage value.

After the Lehman Brothers shake-up, more or less every buyer, including PEs, had been looking for asset purchases at ultimately distressed levels; after all, it was the time of tectonic stresses to the financial system, of rapid de-leveraging and a complete aversion to any type of counterparty risk. It was the time when everybody was expecting that banks would be foreclosing and auctioning off vessels on an industrial scale because of loan-to-value covenants breaches, initially, and then defaults on making interest and principal payments on shipping loans. However, distressed sales never gathered any critical mass.

There is still interest in investing in shipping assets. *Shutterstock*

The ensuing lack of debt financing and the weakness of the freight market, the threat of tonnage oversupply and the threat of technological obsolescence from the eco-design improvements, have overall caused asset prices — some years after the dust settled from the Lehman Brothers shock — to decline to very competitive levels, at least as compared to peak cycle pricing.

Almost four years into the downcycle now and with a better degree of clarity than in the first days of the precipitous decline, there has been a new target and strategy re-evaluation by most PE funds in reference to market recovery, investments in shipping and vessel acquisitions.

We have heard comments that despite all the noise PE funds have been making, they have been ultimately short of investing in shipping assets. However, more than 10 PE funds based in the US in the last three years have invested approximately $4.5bn in shipping assets alone. By comparison, there were about $3.7bn "high yield" bonds issued in 1997 and 1998, and approximately $7.8bn in shipping IPOs in the US between 2004 and now; and about $250bn has been extended as new shipping loans by banks globally in the same interval. Again, the absolute number of actual PE investments in shipping assets is very respectable so far, and on track to outpace the US shipping IPO market. Moreover, we are still at the early phases of PEs' attention and initiating investments in the shipping industry.

Having been actively involved in advising and also sourcing and originating transactions on behalf of financial institutions, we are aware of PE funds with at least $4bn in committed capital and earmarked to be invested in shipping assets and projects with reasonable investment prospects. There is also an "infinitely" higher number than the above mentioned figure interested in getting invested in distressed shipping assets (at almost salvage pricing for 10-year-old vessels) or distressed shipping debt (at 30 cents on the dollar) or in mezzanine finance or project finance where levered returns are at least 20%.

What has changed? Distressed sales of modern vessels are not forthcoming; this is more or less a foregone conclusion. On the other hand, asset prices at today's levels make sense from a historical point of view; they offer reasonable prospects for double-digit returns for investments that have an investment horizon of five years or so. As long as there is no requirement for an annual yield from the investors, and there is structure flexibility, patience and mainly a strategic and well thought-out entry to the market, shipping provides compelling investment opportunities. Moreover, the private equity funds have taken note of the industry.

Unlike public equity investors, who usually have a much shorter investment horizon and look mainly for solid corporations to invest in, private equity can take the longer view and can consider investments ranging from projects to co-investments and joint ventures with smaller owners.

There is still tremendous interest in investing in shipping assets and a great deal of such interest originates from US-based funds. Unlike a decade ago when acronyms like P/E (price to earnings) were in vogue, in today's market the same two letters (as in PE for private equity) still make business sense. ■

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The Last Word...

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Down with the kids

THE NAUTICAL Institute recently presented a seminar focused on young seafarers, and on the little blighters' challenge of acquiring two very different beasts: traditional and technological seafaring skills.

The Generation Y: Professional Navigators seminar was held at Trinity House. The seminar stimulated a lively debate, mainly around the attitudes of different generations towards the use of marine technology.

Other key issues for young seafarers included the need for a structured career path, proper training and mentoring and how best to achieve a work-life balance. Last Word would have dearly liked to have been present for the third item, but had to get back to the newsroom to file.

Also of note was the how the yoof do not really seem to get it.

One particular concern for many of the young attendees was the average length of time they were expected to spend at sea and the impact this had on their family and social life.

Nautical Institute chief executive Philip Wake said: "It is absolutely vital that those of us with more extensive maritime experience make a genuine effort to engage with today's younger generation of seafarers.

"There is much we can learn from one another, particularly in the area of technology and navigation. We also need to understand their expectations and aspirations in a maritime career which, in fact, are little different to [those of] each of the previous generations."

In other words, message to the younger generation about seafaring: deal.

Philip Wake on shipping's Generation Y: "There is much we can learn from one another."

Plain sailing for Titanic II

TITANIC II is moving ahead smoothly, no icebergs in sight, with the appointment of John Eaton as director for events.

Eaton has worked in the international hotel business for more than 35 years in Europe and the Asia-Pacific region.

Eaton will be involved in Titanic II's feasibility studies through to concept, planning, development, pre-opening and final launch.

Titanic II is scheduled to launch in 2016, sailing from China to the UK before making a maiden passenger voyage that retraces the ship's ill-fated 1912 journey to New York.

The ship is being built at CSC Jinling Shipyard. Finnish-based Deltamarin is providing technical advice.

Mythical insurers?

The third Shipping and the Law conference held in Naples on Monday was a magical opportunity for the great and the good of Italian maritime law to get together and chew the fat over the latest and most pertinent issues currently affecting the shipping industry. When the International Group's David Baker was introduced to present his thoughts on the ever pressing Insurance Directive, it was noted that people behind the IG actually exist and are not just mythical creatures. Good to know, but Last Word was particularly tickled by the image of Andrew Bardot as a unicorn. ■

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