

'Market Leading' thoughts on OSG's demise

New York-based Basil Karatzas, CEO of Karatzas Marine Advisors takes a look at the reasons for OSG's filing of Chapter 11*.

The news of OSG's 'death' (reorganisation for practical purposes) had not come as a surprise, as rumours to its demise had been circulating for some time.

When freight rates have been so close to, or below cash breakeven levels for more than a year, it's a foregone conclusion that cash positions in this sector are running low and pressures are building up.

OSG is neither the only tanker company, nor the only publicly traded company that had to file for protection. General Maritime and Omega Navigation had to seek protection in the US several months ago and TORM and BLT have done similarly overseas.

One can be assured that privately held tanker companies are facing the same reality, but they do not have to 'publicise' their pain, since it's not required by law.

In OSG's case, the significance of the filing rests with the fact the company has never been a myrmidon of the 'tonnage provider' school of thought. In the go-go years of the hot shipping IPO market, a lot of publicly traded companies were effectively financial/beneficial owners of vessels where, in the name of 'core competencies', 'synergies' and 'efficiencies', the technical management was completely outsourced to third parties and the commercial strategy of the vessel management was based on bareboat, or timecharters where the 'commercial management' of the vessels was actually passed on to the charterers.

For certain companies, the management of the vessels was passed on to third-parties at arm's length transactions, but quite often, the vessel management was undertaken by an 'affiliated' company.

OSG had strong and competent in-house management teams based in the US, UK and Greece. On the debate whether to outsource, or keep management in-house, OSG had a clear position; under the traditional 'shipowning' model where ownership and shipping expertise reside under the same roof, both the charterer and the owner benefit in several ways, but mostly by establishing deeper, closer symbiotic relationships where they can feed on each others competencies and expertise.

Another market distinguishing attribute of OSG's strategy was that the company exhibited diversification across both market segments but also market sectors; the company had been active in the crude, product and LNG carrier markets, from ULCCs to Aframaxes to MR2 tankers, from tankers registered under open registries to articulated tank barges (ATBs) trading in the Jones Act market.

In short, the company had many different types of vessels in many different ponds and with enough critical mass in each market and

expectations of good performance that the company routinely described itself as 'market leader' in its communications with its stakeholders.

The filing for bankruptcy protection was precipitated by the recent resignation of an OSG board member over tax considerations; given that OSG has a wholly owned Jones Act subsidiary, the tax structure is more complicated than other shipowners, who are active only in the international flag business.

At the time of the filing, the company had less than \$50 mill market capitalisation and listed assets of \$4.1 bill and liabilities of \$2.7 bill. With a fleet of about 110 vessels under its control of which, around 70 vessels are under ownership and 40 under charter-in/management, 20 of which fly the US Flag, plus a syndicate of more than 20 banks and also bondholders, it is expected to be one of the most complicated reorganisation processes.

The outcome is several months, if not years away, but a likely scenario is for the company to be split between the international flag and cabotage businesses.

In keeping with the strategy of banks in similar situations, the international flag business can be restructured so that the lenders become equity holders and get rewards for their additional risk; the Jones Act business can be sold off in its entirety to another Jones Act player, or get spun off as an independent going concern.

The Jones Act has been one of the few promising segments in shipping in the past year. The least likely scenario is that OSG owned/controlled tonnage will end up on the selling block in a piecemeal fashion.

The fact that a 'market leader' like OSG was brought down in such a manner, may be testament to factors just beyond the ferocity of the business cycle.

Likely, the fall-out of such a high calibre owner will once again start debates as to whether shipowners' management can deliver 'alpha' (outperform the market consistently), whether fleet and segment diversification provides stability in difficult times, or whether strategy and execution really matter.

After all, OSG had been lead by a seasoned banker and the company expanded in the Jones Act market by acquiring Maritrans (and certain of its newbuildings) for a high price but had missed deadlines in an offshore conversion project that gave the right to the counterparty to re-negotiate the original charter at lower levels.

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