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New players jumping into ship finance for boxship owners

By Stas Margaronis, AJOT

Matt McCleery, president of *Marine Money*, a ship finance publisher, says that the entrance of U.S. private equity investors into container ships and other shipping will provide market discipline and potentially higher freight rates.

He told the *AJOT* that financiers such as JP Morgan, Oaktree and others have become the new players in financing container ships. "This is causing a rationalization, a decrease in tax depreciations and resulting in pricing that is likely to reflect the truer cost."

The result he says, "may not be good for shippers" because the cost of shipping a container is likely to rise.

McCleery is the author of two novels, 'The Shipping Man' and 'Viking Raid' which offer comprehensible (and entertaining) introductions to the world of marine finance.

He says U.S. equity funds are replacing the old German KG Funds (limited partnerships) that had been financing new container ships for many years and providing tax write-offs to German investors. The KG's have declined in influence since the 2008 Crash.

As they search for profitable equity investments, U.S. investors have focused on container shipping as stable and an essential form of international transportation and the global economy.

Profitability is made evident by improvements in the price of the bulk carrier and tanker trades, McCleery said.

"For example, if you ordered a bulker or tanker in 2012 at $30 million, and you placed a 20% down payment at $6 million, you would have realized a 100% profit because the price for that same ship has gone up $6 million from $30 million to $36 million in 2013."

A similar, but less dramatic price increase is occurring in container ships because the price of ships went way down as a result of overcapacity and the post 2008 recession.

"People…buying ships now are benefiting from the counter cyclical nature of shipping where the time to invest is when the market is down and where you have a case of buying low and selling high," he said.

The pace of investments in newbuildings and acquisitions is evident in one week of news reports in April, published by 'TradeWinds' the shipping publication:

• Chinese Cosco Holdings is 'likely' to order five 14,000 teu container ships from a Chinese shipyard taking advantage of Chinese government subsidies to obtain a low price. The estimated price per ship is $125 million.

• New shipbuilding prices are projected to increase by 10% in 2014, according to the French new shipbuilding broker Barry Rogliano Salles..

• Maersk Line has chartered two 9,000 teu vessels under construction from Pappas Oceanbulk and its private equity partner Oaktree Capital Management. Maersk also extended the charter for eight 13,000 teu vessels, five from UK's Zodiac Maritime Agencies and three from Singapore-based Eastern Pacific Shipping. The 9,000 and 13,000 teu ships may transit the widened Panama Canal and be deployed at smaller ports in Latin America and India.

• Oaktree Capital Management has acquired six 50,300 ton product tankers from a German KG group scheduled for delivery in 2015, valued at about $225 million for all six vessels.

• The New York investor Wilbur Ross recently established the Transportation Recovery Fund which announced it is buying two new large tankers from a Philippine shipyard paying slightly less than $100 million per ship.

• Former Overseas Shipholding Group chief executive Morten Antzen is teaming up with former Credit Suisse banker David Herman to "hunt' for new tanker deals.

McCleery says, "Registrations for the Marine Money Conference taking place in New York in June have exceeded our expectations because of the number of new U.S. funds that are attending for the first time."

More Cautious Views

A more cautious outlook was projected by the U.S. law firm Mayer Brown. The firm produced an advisory paper: "Rough waters ahead: Non-Performing Shipping Loans-solutions are available."

The paper notes a parallel to the 2008 real estate collapse: "The current shipping industry situation is very similar to the crisis in the real estate industry in the last decade, which resulted in many banks selling distressed, non-performing and non-strategic real estate loan portfolios primarily to international private equity investors."

A European project finance consultant told the AJOT that asset prices of ships are going up far faster than charter rates to hire them. This is causing concern about the possibility of a bubble.

The consultant said that smaller carriers and operators "are teaming up with sometimes naïve U.S. investors who buy and sell ships with mixed results." These include Greek shipping companies and German operating companies teaming up with U.S. pension funds and private equity funds. Right now, these investments succeed because the price of a container ship is still low relative to the price before the 2008 crash.

Greek shipowners, for example, have been very successful in buying low and selling high.

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Maersk

The consultant noted that Maersk Line, the mega container carrier, has been successful in cutting costs and remaining competitive in the container business. This has been helped by building larger ships to offset higher fuel costs. Maersk ordered a fleet of mega-container ships that have the capacity of carrying 18,000 teus. The effect of this investment is that larger carriers are following Maersk's lead and smaller ships of under 10,000 teus are being scrapped because they lack the economies of scale to compete with the larger ships.

The challenge for Maersk now is that the mega container ships have to sail full: "The real challenge for Maersk is whether they can run the 18,000 teu ships at full capacity, because if they run at 50% capacity, it's a catastrophe," the consultant said.

China

The underlying driver for all the new business is China

The global container trade is being driven by both its imports and exports and relies on the strength of the Chinese economy.

The consultant said iron ore exports from Brazil and Australia have driven the demand for building more bulk carriers: "This market is being driven by the Chinese construction market which requires steel in the construction of high rise buildings and where growth rates are averaging about 7% per year. If that growth slows down from say 7% to 3% then there will be a collapse in the bulk carriers market because there will be too many vessels."

The consultant noted that tanker owners are hoping to offset losses from decreased U.S. oil imports with increased imports from China. He is concerned Chinese demand for imported oil may not offset the decrease in U.S. oil imports. The U.S. decline is the result of new domestic oil and gas discoveries.

He says the Chinese are hoping to avoid a downturn by making a major investment in infrastructure such as the railroads, but this may not offset the decline in housing and construction.

Many people are looking at China and saying "what's going on there looks very much like Japan in 1989 when the construction and housing market collapse led to a long period of deflation," he says.

The consultant says an underlying cause for speculative financing is the U.S. Federal Reserve's low interest policy. He says that as yields on safer bonds go down, investors are driven into the stock market to try and recoup their losses:

"This is driving stock prices up as investors use cheap money to make risky investments. You have overvalued stocks and equity investors flush with money putting their money into shipping because the temporary returns on investment look good. What they are missing is the bigger picture of China and the history of shipping in which there are only a few good years and then over capacity drives prices down and you have bad years."

The consultant pointed to the bankruptcy of many German KG shipping funds which he said drove up the price of ships to an unsustainable level before 2008. At the time, the KG funds could count on German bank approvals. The German banks did not fully evaluate the viability of shipbuilding projects. This was similar to the bad loan approvals of U.S. banks that contributed to the 2008 Crash.

"Everybody thinks the markets can only go up but it was only a few years ago that the 2008 Crash taught us otherwise," he said.

In Matthew McCleery's first book '*The Shipping Man*,' the fictional hero, a New York hedge fund manager is enticed into shipping by the collapse of shipping rates as reported by the Baltic Dry Cargo Index. Believing low prices will yield big profits, he is hoodwinked into buying a cheap, old ship from a wily Greek shipowner after a drinking bout at a Greek resort. The acquisition causes the hedge fund manager to lose his hedge fund and his ship. He is rescued by a Norwegian tanker owner who is in trouble himself and needs a clever financial salesman to sell a $300 million junk bond. The hero succeeds by selling the bond issue to a group of U.S. investors. A key element in the sale is convincing the investors to accept an optimistic charter rate for hiring the ships that may or may not materialize.

The message here? Shipping is not for everyone.