999 Vanderbilt Beach Rd
Suite 200
Naples, FL 34108

paulslater@firstintl.com
Phone (239) 250-9901

June 2016.

The Shipping Finance Crisis.

It is now clear that the demands for shipping services are way below the availability of the fleets of existing ships in most sectors.

While the tanker markets remain finely balanced, as the price of crude oil does not seem to affect demand, orders for new crude carriers are cause for concern.

The dry-bulk and container sectors are grossly over-tonnaged causing most companies in these sectors to record growing losses.

Most financial analysts and some major shipbrokers now concede that this shipping crisis will continue through the remainder of this decade and maybe well into the next one.

The publicly traded shipping companies provide a window of information on the crisis, but represent less than 25% of total fleet capacity, and are the area where most of the new equity has been invested and lost.

Other companies which are subsidiaries of major industrial companies such as Maersk, Mitsubishi, Hyundai and the Oil Majors, do not publish detailed financial statements but some have recorded financial problems with their fleets.

The Asian shipbuilders are in deep trouble with capacity down by over 50% and the volume of ships on order is at a level last seen in the late nineties. The Chinese will continue to support their shipbuilders, as part of its plan to keep freight rates down on its primary routes, by building new ships for Chinese owners or those chartering ships to Chinese companies.

Thus the shipping industry has reverted to its traditional structure with large private owners and the industrial groups contracting for ship charters on terms that are rarely published, while the new public companies fight for business in the spot markets.

Estimates show that more than $50 billion from Private Equity and Hedge Funds has been invested in the public companies. Another $50 billion has been invested in Germany by the German KGs. These equity funds were supplemented by huge levels of bank finance which was recklessly lent with no secure income streams in place.

The German shipping crisis has created more than $50 billion of non-performing loans in the German banks and an estimate of a similar level of losses in the KG funds. Estimates of the total bank losses exceed $100billion.

The publicly traded shipping companies are today mostly insolvent, generating revenues that barely cover vessel operating expenses, do not cover debt service or generate cash reserves for essential maintenance, and are in many cases managed by the investor funds that do not understand how shipping works.

This summary identifies the crisis but the cause is mostly self-inflicted.

The Chinese industrial boom of the last decade was always temporary and with the appointment of a new government in 2010 the excesses of the previous one were revealed and steps taken to re-balance the economy and centralize controls again away from the Regions.

The shipping industry, fueled by huge amounts of new risk capital and careless bank debt, embarked on a new-building program that enlarged fleet capacity by more than 50% in the dry-cargo and container sectors and by 30% in the products carrier sector.

Large orders for new deep-ocean oil rigs and fleets of offshore supply ships combined, with the ships, to fill the world's shipyards through 2010.

By the time most of these ships were delivered it was obvious that the China boom was over and along with the banking crisis the global economies were heading for another recession.

As the share prices of the public companies dropped more Funds entered the markets buying on the false assumption that ship prices would recover to the heady levels of the last decade. This ignored the fact that voyage revenues were not covering all the operating costs, including maintenance and repair, or generating cash reserves to meet fleet replacement costs.

Ship values continued to decline but instead of closing out the risks by selling the ships, various forms of restructuring were instigated by the Funds which served only to compound the problems. These included: - more Secured Debt; Perpetual Preferred Equity and Reverse Stock Splits, all designed to keep the companies afloat while effectively wiping out the original equity.

As the Funds had no experience or way of increasing voyage revenues they focused on operating expenses, but have adopted measures that can seriously affect the safety and reliability of the ships.

These measures include: cheap or under-paid crews; little or no spare parts on-board; minimal maintenance and no cash reserves for statutory dry-dockings.

The Head of one large dry-cargo company, and an ex-banker, recently boasted the he had got costs down to $4,000 per ship per day. To which one major Greek shipowner commented "which part of the ship is he running?"

Comparatively the Chairman of Nordic American Tankers also stated that his operating costs were $11,000pd. He is a long term shipping expert who does understand the industry.

Consolidation has also been trumpeted but so far the largest one in the dry-cargo sector is a disaster and will likely end in total collapse. Like restructuring these activities generate huge legal and banking fees and so far fail to generate increased revenues.

Charterers are increasingly unwilling to fix ships from most of the public companies on anything more than voyage charters, yet some of the dry-cargo companies still report period charters at rates that fail to cover costs.

The solution is to sell the ships that are not financially viable before their running costs increase and their values decline further with age, pay off the secured debt and distribute the balance, if any, to the equity holders.

This needs to be done soon and certainly by the end of this year as the public share prices continue to decline and the global economic outlook is gloomy.