Recovery with a difference

SHIP FINANCE OVERVIEW

Winter 1999

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Nineteen - ninety - nine was a year of increasingly better fortunes and prospects for banks and their clients alike. Bank consolidation and client selectivity, however, have given a different flavour this time round. Ted Petropoulos, Managing Director of Petrofin S.A., reviews both the international and Greek shipfinance scenes and comments on their main trends and prospects.

Shipfinance started the year poorly with modern day "Cassandras" monopolising sentiment. However, quite remarkably given the severity of the downturn, bankers had kept their cool and foreclosures were kept to low levels. In addition, banks showed remarkable flexibility and realism as well as loyalty to hard pressed clients, those, however, that had maintained both the stream of financial information and healthy contact with them. As such, the shipfinance industry was marking time awaiting for the hoped recovery.

The recovery commenced shyly in the spring and gathered momentum as the year progressed. Dry bulk led the way followed by the container sector with only the wet and reefer sectors continuing to drift.

Reasons for the recovery

The underlying reasons for the recovery can be found in the continuing robust growth of the US economy, a sharper than anticipated recovery in the Far East as well as modest recoveries in Japan and Europe. By the end of 1999 OECD forecasts for next year and beyond showed world economic growth forecasts rising to levels of 3.5-4% per annum with correspondingly higher growth forecasts for international trade.

The recovery in commodity prices is also a good omen for future recovery and the year is ending with the positive impact of China's entry in the World Trade Organisation.

Newbuilding rush

Fuelled by the rapidly improving progress in the drybulk sector in general and the handymax to cape size segments in particular, the S&P activity took off with Greeks leading the way. This time though, it has been newbuilding orders that have dominated the news as Greeks and others rushed to take advantage of what seemed to be "too good to refuse" newbuilding prices for dry bulk vessels.

Already the Panamax order book has reached 19.6% of the current fleet total with Capesize and Handymax following at 11% and 7.8% respectively (Clarkson Statistics) and the Handysize trailing at 2.9%. At the same time, bulk carrier scrapping volumes have slowed down by 22% made up though by a 133% increase in tankers. As such, we have a classic race, involving good demand prospects on the one hand against massive newbuildings and uncertainty over scrapping on the other. With the market remaining finely balanced and sensitive to relatively small surpluses or shortages, the next years will be fascinating.

Already, newbuilding prices have begun to firm and it is hoped to slow down the race of newbuilding orders.

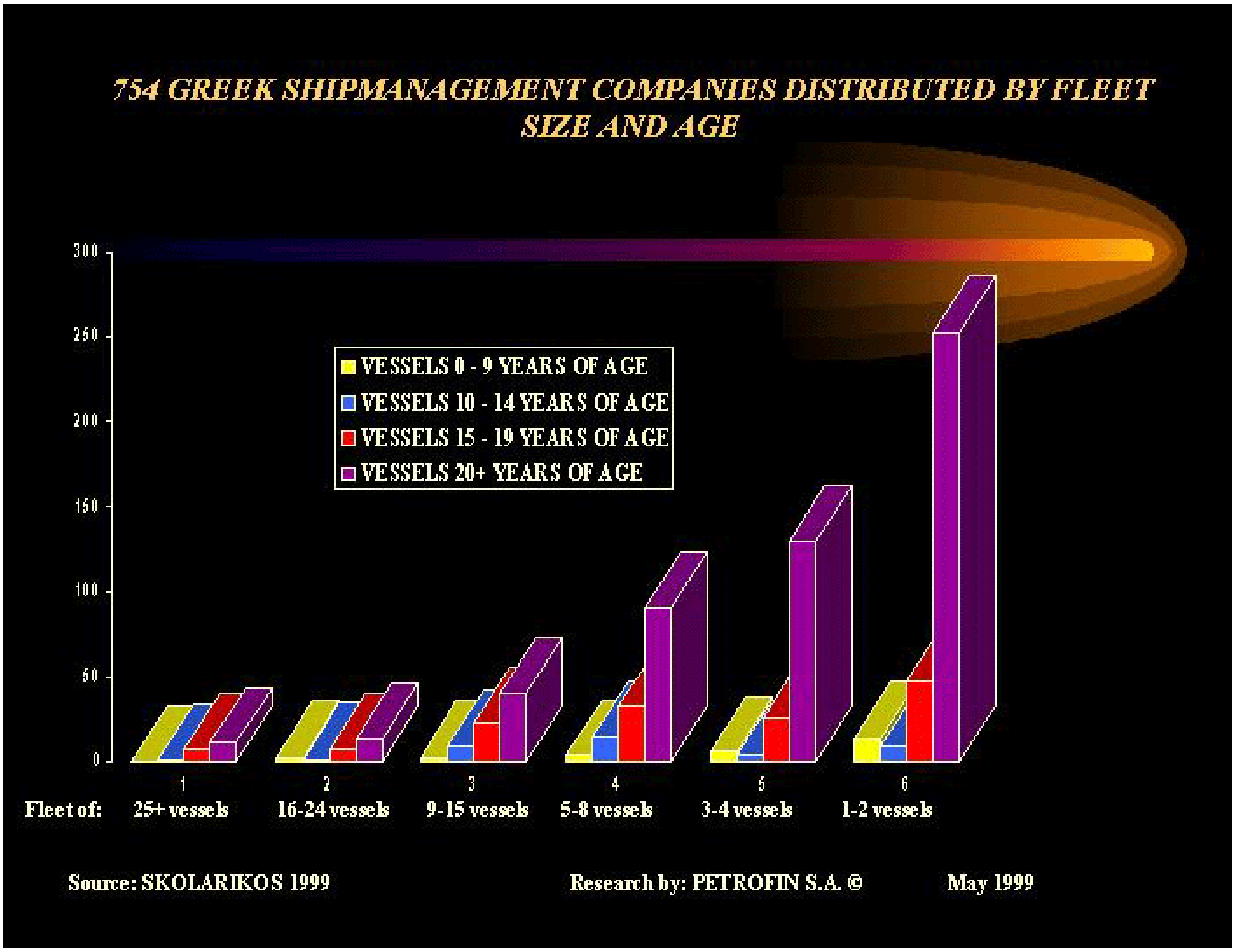
Shipping banks' reaction

Turning to the evaluation of the shipfinance market, shipping banks exude an air of cautious confidence about the market and its prospects. As vessel prices in the drybulk side of their portfolios have risen, their confidence has grown in asset to value terms. However, the same does not apply to cashflows. Tankers display t/c earnings weaken across all sectors (down year to year from 2.5% for 30,000 DWT vessels to 10% for VLCCs.), whereas drybulk has shown considerable increases from 10% for handysize up to 40% for capesize vessels.

Shipping banks have thus grown more confident. However, they are keen to point out that their "wait and see" attitude worked best only for younger vessels over the last few years. In addition, they claim to have faced fewer difficulties from their larger clients who operate substantial fleets and thus enjoy economies of scale, more sophisticated management and reporting systems. As such, in addition to an emphasis on younger vessels, there is a significant shift away from the smaller clients who have simply become unfinanceable.

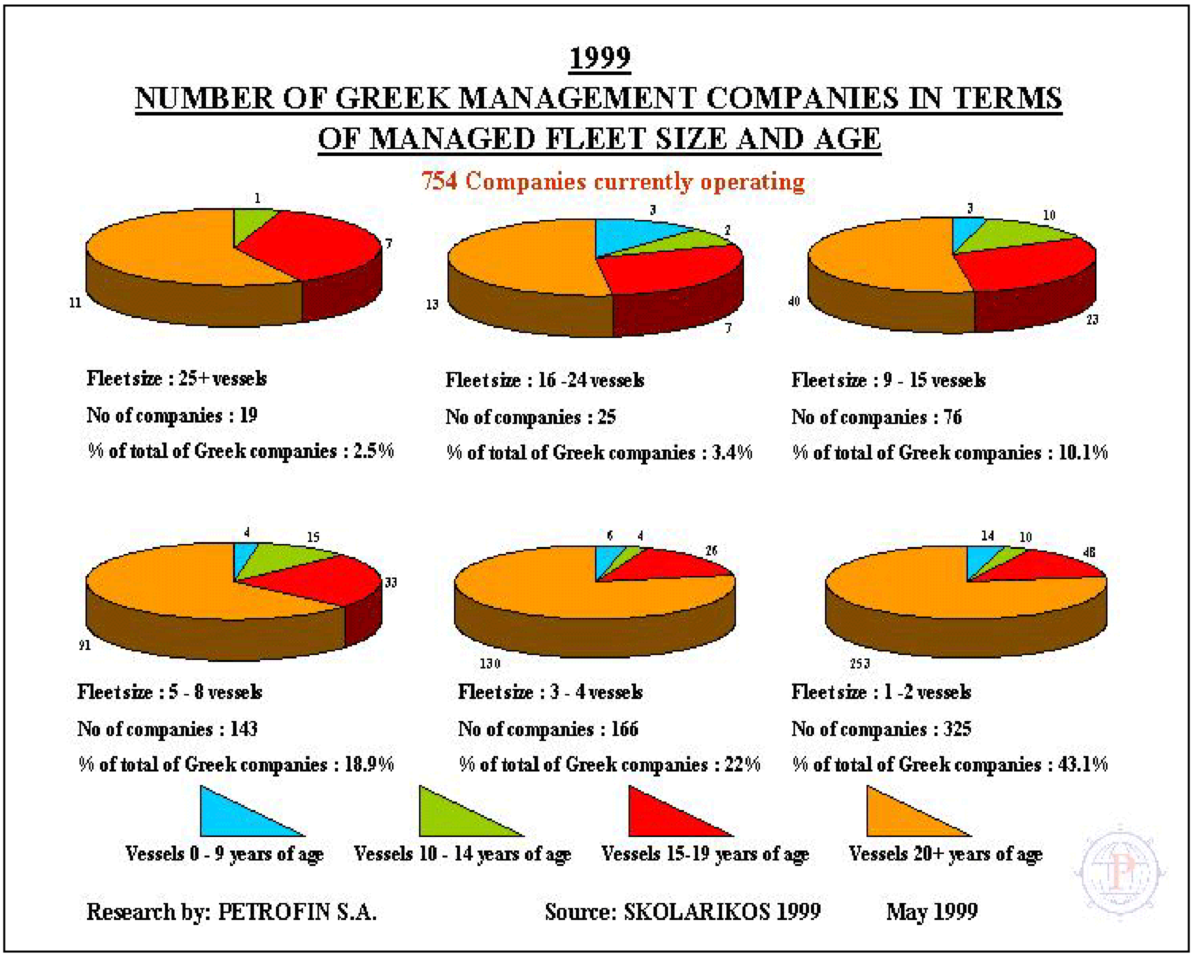
This has significant implications for the smaller owner who forms the backbone of the Greek shipping industry. Recently published statistics by *Petrofin Research* showed that in 1999 there were **325 Greek shipping companies operating 1-2 vessels and account for 43.1% of the total number of Greek shipping firms (754). The figure for 3-4 vessels is also significant at 166 firms accounting for 22% of the total.**

TABLE A: Greek Shipping Companies by Fleet Size and Age



The shift to larger client size and quality has been uniform among all banks and this has created a significant vacuum in the industry. It is doubtful, however, given the current attitude of shipping banks and especially of their credit committees, whether new banks will rush to fill in the vacuum in the short term. After all, if you can satisfy your budget with newbuilding finance or syndications at higher yield than have been possible for years and in large loan amounts, why spend time, effort and incur risk in order to finance smaller owners and smaller transactions.

TABLE B: Greek Shipping Companies by Fleet Size and Age



The second key development is linked to the increasing mergers and acquisitions across the international and national banking scenes, which has severely reduced the overall number of banks. In addition, the resulting bigger banks have tended to push up their minimum client and transaction requirements even further.

It is also quite common for banks undergoing such mergers and acquisitions to restrict their shiplending until a new combined policy shall be established. Where a non shipping bank acquires a bank with an active shipping presence, this often results in the acquiring bank's management reviewing / curtailing shipfinance, which is an area they do not understand and which they may perceive as risky.

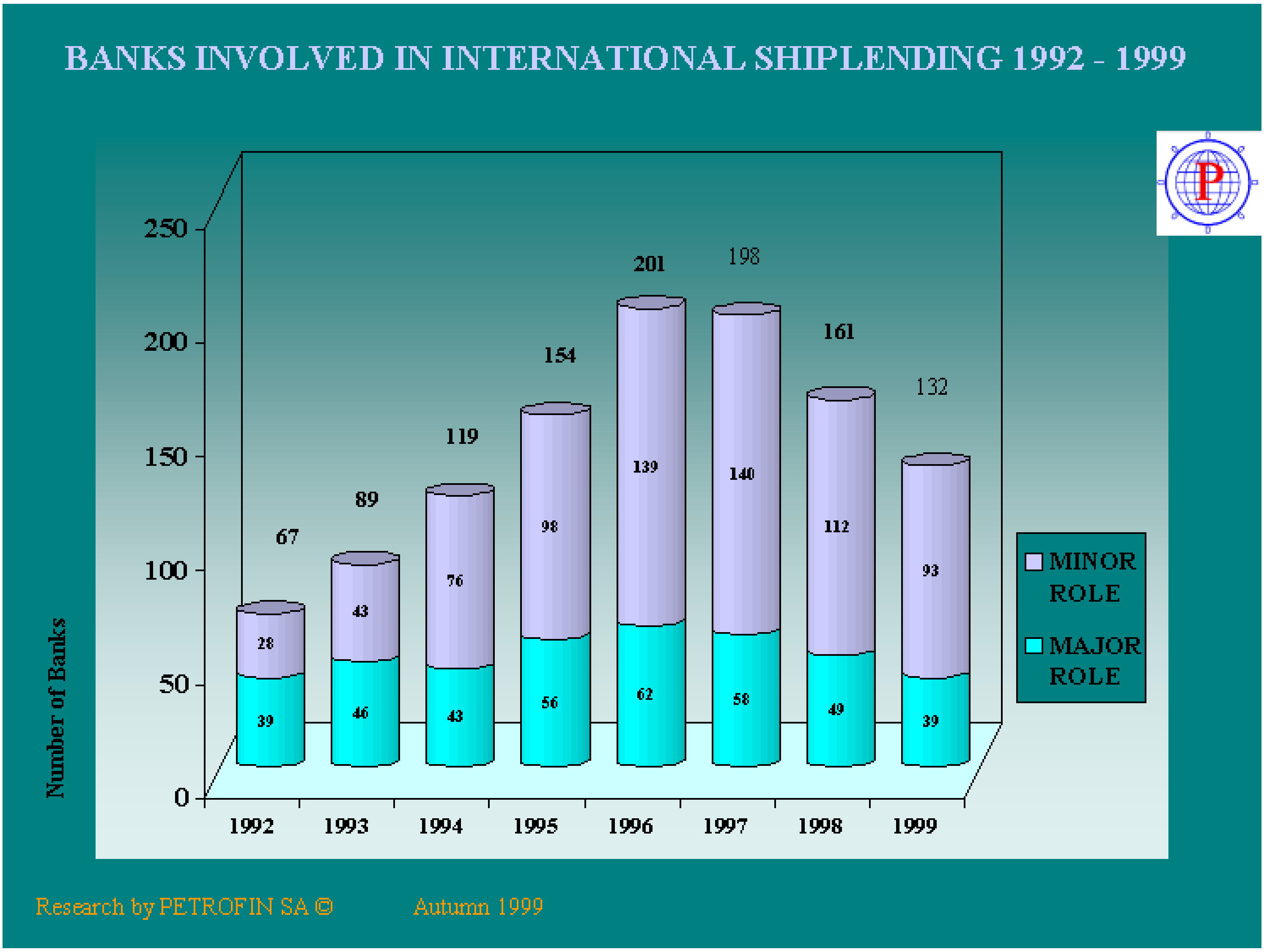
International Shipfinance Activity

Let us now look at the latest evidence in respect of international shipfinance activity. Latest *Petrofin Bank Research* published this autumn (see Table C) shows that the fall in the number of shiplending banks can be attributed to the following factors:

- *the record number of incidences of Bank consolidation in the banking industry through mergers and acquisitions;*
- *the poor risk / reward offered by shipping;*
- *the pronounced shipping slump since 1997;*
- *the greater emphasis shown by banks to risk free products and services;*
- *the heavy capital requirements of the shipping industry and the 100% equity risk weighing on shipping loans;*
- *the relative attractiveness of other lending sectors that compete with shipping.*

Due the above, banks that have a higher shiplending involvement as a percentage of their lending assets are being considered by the market as "higher risk" banks. As such, the emphasis has been to reduce each major shiplending bank's dependency on shiplending.

TABLE C: Banks involved in international shiplending 1992-1999

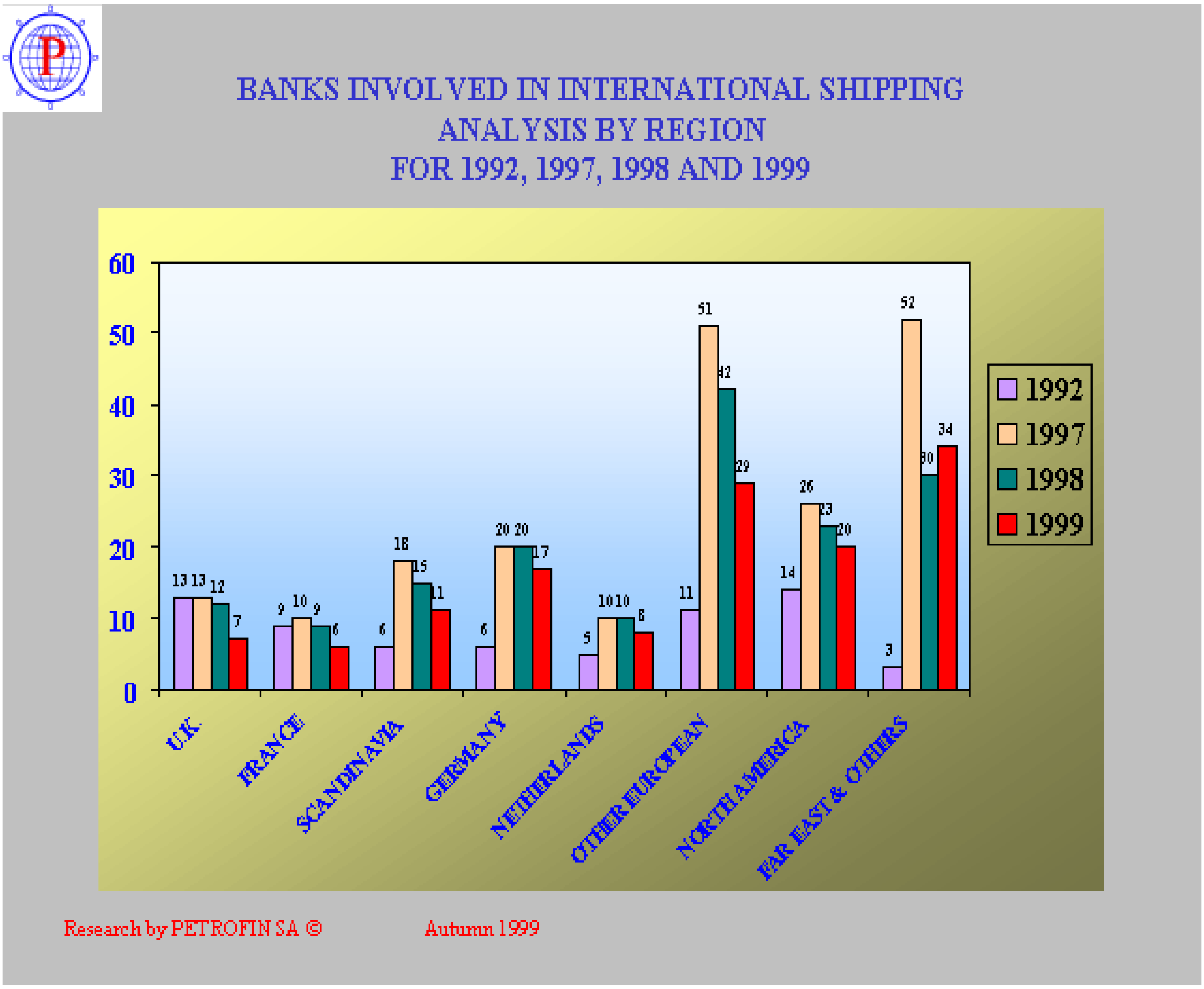


The number of active minor shiplending banks has also fallen from **112 banks in 1998 to 93 banks** in 1999. The same factors apply for the above fall, including the relative unattractiveness of the shiplending sector over the past years, which has

- *reduced the number of new entrants and*
- *encouraged the exit of a number of banks who had low commitment to the industry in the first place.*

A more detailed analysis by country / region is shown in Table D. It is interesting to note that the European subtotal consisting of all European Banks has fallen from **32 major banks** in 1998 to **26** in 1999 and from **76 minor banks** in 1998 to **52** in 1999.

TABLE D: Banks involved in international shipping - Analysis by region



As this represents a major fall, it would seem that the Asian crisis had had an initial major impact on the Far Eastern banks, which was later followed by the European banks as the shipping crisis intensified.

In Table D we may observe the relative performance over the years by country / region. As you will see, Germany and the Netherlands continue to be the main providers of ship finance and their numbers have remained largely the same. However, the UK continues to decline in importance followed by France and Scandinavia.

Interestingly enough, the effects of the Far East crisis seem to have abated, as the number of Far Eastern banks has actually risen from **30** in 1998 to **34** in 1999, still though significantly down from the 52 banks in 1997.

The bank numbers shown are for commercial shiplending banks and do not cover the significant new-found interest in shipping by US and European Investment Banks. Their role in funding transactions is minor and short term and, as such, they do not add to shiplending capacity as such. They are, however, significant in attracting long term funding to the industry via the Capital markets.

Main players in shipfinance

The main shipfinance locomotives continue to be the German and Dutch banks. However, the recent intensive mergers and acquisitions in the above countries and throughout Europe has led to some curtailment of activity and doubt over their shipfinance strategy for 2000 and beyond.

To mention a few examples we refer to DG bank's acquisition of Rabo Bank / Nedship, ING's offer to acquire CCF, the rival bids for NatWest from Bank of Scotland and Royal Bank of Scotland, BNP's bid to acquire Paribas and Societe General and so on. Merger activity has also intensified in Japan where weaker regional banks are being swallowed by the large international banks.

There have been some notable departures from the international shipfinance scene. For example, Commerzbank retrenched its position from London back to Germany and Credit Lyonnais sold its Greek portfolio and retrenched back to Paris.

It is noteworthy that Greek banks that had until 1995 shown little interest in International shiplending, *have now increased their numbers, as well as loan portfolios*. However, in Greece also the number of shipping banks is beginning to be influenced by bank consolidation, eg. The consolidation of Egnatia bank and the Bank of Central Greece; also of Prime bank which is the result of the consolidation between MacThrac, NatWest and Piraeus banks.

Commenting further for the Greek market, the main shipfinance banks continue to be RBS, ABN, Nedship and National Bank of Greece. Alphabank and to a lesser extent Eurobank have also stepped up their shiplending activities. The rest of the banks have maintained a low profile. The future of such banks as ANZ Grindlays and Bank Cantonale has been under a cloud throughout the year.

DNV's Greek shiplending out of the Piraeus office apparently consists of only 8 clients, which begs the question as to the future of the representative office unless its management is allowed to commence shiplending to Greek owners once again.

It is not surprising that overall shipping credit yields have hardened over the year, which pleases banks looking for higher returns than have been available thus far. This hardening of yields has been seen across all sectors and sizes of transaction, which is indicative of a mild credit squeeze. It is expected that the above development shall cease, as competition between banks for quality clients/businesses shall intensify.

To conclude, therefore:

The prospects for the international shipfinance market appear better than for some years now. The robust growth of international trade and the overall nature of the world's fleet provide good support for the shipping industry and shiplending banks.

However, as banks flex their investment banking arms and seek large corporate type of lending opportunities, the nature of shiplending will continue to show financial changes. Through continuing bank consolidation, we foresee future diminution in the number of shiplending banks. However, overall shipping capacity is not expected to diminish. It shall continue to be directed though to the clients that continue to form the strategic targets of shiplending banks.

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