A YEAR TO FORGET BY LENDERS.

Winter 1996

CONCERNS ABOUT DRY BULK SHIPPING FOR 1997

Nineteen-ninety-five was a year of increasing concern and introspection by the shiplending industry. Competition among lenders continues to be strong for targeted, quality shipping names.

Ted Petropoulos comments on the shiplending scene.

The year ending 1996 has been a difficult one for both shipowners and shiplenders. The success of Greek shipping upto now has rested mainly on the long sustained recovery and growth of dry bulk shipping over the last 10 years. The fall in the BIFFEX index from 2400 in 1995 to 1600. at the beginning of the year and to 1000 in last September despite its subsequent part-recovery, hit owners and bankers hard and undermined their confidence.

Many bankers had come to expect that dry bulk shipping was inherently safer than other shipping sectors and the sharp decline in rates caught them by surprise. Shipping analysts too searched for convincing explanations of why the dry bulk sector fell so fast in the presence of such sound economic fundamentals as continued growth in world trade and demand for shipping and low interest rates.

Even the much "overused" reason of too many newbuildings entering the market could not adequately explain the fall since after taking into account scrapping and losses, the net change in the demand/supply equation was only in the order of 1%-2%. As such, we are left with a "change in expectations" and the "newbuilding orders overhang" to adequately explain the dramatic fall.

However, the realisation that such rather limited surpluses could cause such huge falls in net operating incomes in such a short time came as a nasty surprise to most owners, bankers and "aficionados" of the shipping industry, who saw their forecast "income" assumptions knocked for dead.

The creeping realisation that "things are not going well" affected shiplenders who became increasingly cautious. Rather than looking for new business, both they and their credit departments begun to look into their existing portfolios and to seek out those clients that grew too quickly in 1995.

Aided also by a slowdown in the sale and purchase sector, the declining asset values and even faster falling freight rates shiplending slowed down remarkably in the second half of 1996 although notably it never ceased altogether. For a while, "client pinching" among the major banks became a feature but even this stopped when banks became more cautious.

Another key reason for the slowdown in fresh lending was the disparity between vessel values, (which although lower had not collapsed), and the much poorer net earnings of potential acquisitions. As such, cash flows "did not make sense" unless they were "stretched out" to impossibly long periods or optimistic assumptions were used. The net result of all the above reasons was that lenders begun to cut back loan advance ratios and demanded owners to commit greater sums towards both initial capital and working capital.

Owners too, delayed their purchases on account of the poor market and the uncertain outlook, as well as the increasing tightness of shipfinance terms offered by banks. For the first time in nearly 10 years they could not take advantage of the "equity pockets" normally available in other vessels of their fleet because of the lower values and as such, they could not rely on refinancings. Instead they would need fresh capital, something they were unaccustomed to do and which they found rather painful.

A factor rarely appreciated by too many industry players is that when a market turns sour, operating conditions for shipwoners turn hostile with charterers playing one owner against another, delaying payments and in general taking advantage of their enhanced status.

Added to the above has been the increasing disruption caused by port authority detentions, class, flag and insurance related restrictions, as well as, the erosion of market credit. The latter became more pronounced in the aftermarth of the Adriatic Saga and other more recent shipping company failures that left suppliers of bunkers, lubricants, paints, parts, provisions and other services facing losses.

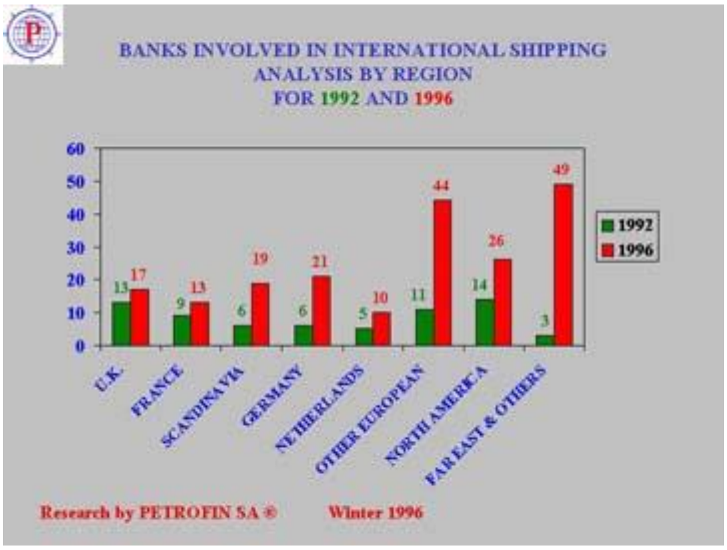
To summarise, therefore, my main observation is that on an actual cash flow basis, shipowners faced a much worse environment than could have been anticipated from looking at the overage fixtures alone. Specifically, net earnings were both reduced and delayed whereas expenses were larger and accelerated. Result: a continuous underperformance between cash flow expectations even in these adverse market conditions and actual money flows.

How have banks reacted thus far to all this gloom and despondency?

Although it is difficult to generalise, on the whole banks have reacted with remarkable restraint and maturity. Where genuine market or other specific factors could explain the slowdown in clients' earnings and where clients could show evidence that they had already "put their hands in their pockets" before they would discuss the position with their banks, most banks have provided effective support. As such, banks have taken a good deal of the strain facing shipowners and have assisted the industry in dealing with the cash flow slowdown.

Admittedly, banks would rather not advertise their "restructuring" successes. However, a quick review of work by Shipping Legal firms strongly supports the above and points to the future should dry bulk shipping conditions continue to be adverse.

TABLE A: Banks involved in international shiplending 1992/1996



As one would expect during periods of difficulty, there have been some notable shipping company failures. Their number, though, remains small given the size of Greek shipping. Examining the reasons for such failures, we can provide the following list of contributory factors, namely:

- *Fleet over expansion over the last 1-2 years coupled with high leverage.*

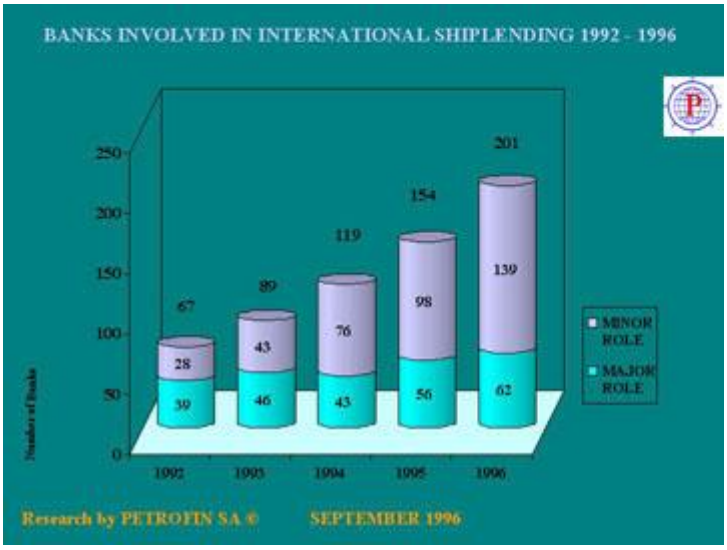
- *Absence of secured employment.*
- *Internal disputes among owners/managers.*
- *Specific factors such as, ITF problems and/or disputes with charterers, detentions, breakdowns, technical failures and so on and*
- *Breakdown in the client-bank relationship.*

It should be noted, though, that in the light of the enormous falls in percentage terms in owners' net incomes, the industry and all its participants have shown remarkable forbearness and fortitude.

No one, among banks and owners, wishes to see a repeat performance of the excesses and over-reaction of the 1980's. This factor plus the comparatively healthier and more liquid state of owners have added to the relative comfort by banks and owners alike, who anticipate that this recession will not be long lived and that their future performance and success will depend largely on how they handle this period of difficulty.

Looking at the composition and activity of banks involved in Greek shipping, we can provide the following picture. Research by PETROFIN, just published, shows that the number of banks involved in International shiplending rose in 1995 to 201 as compared to 154 in 1995, 119 in 1994 and only 67 in 1992 when the research first commenced.

TABLE B: Banks involved in international shiplending between 1992 & 1996 - Major and Minor



This is clear evidence of the increased interest in international shipfinance. The number of banks involved in Greek shipping also rose to 70 from 67 last year, of which 36 have a presence in the form of a branch or a representative office.

The rate of growth of shiplending banks has slowed down partly due to the recent difficulties facing the industry and partly due to cautiousness and competition among lenders. The trend, whereby Greek banks have shown increasing interest in shiplending has continued and has reached the stage where only a handful of banks still resist the sector.

Recent names have been ALPHA BANK and EUROPEAN POPULAR BANK whilst the more traditional names such as NATIONAL BANK OF GREECE and COMMERCIAL BANK OF GREECE are continuing to support the industry. Others, notably EUROBANK, are still cautious but seemingly poised to develop a much larger presence in the market, once conditions allow and they can secure the right profile of client.

Among foreign banks some U.K., Scandinavian and Dutch banks have been most prominent although German, U.S. and French banks continue to support the industry. The loan volumes have stabilised and in many cases fallen as the rate of repayments have exceeded the rate of fresh lending. Every bank has developed its own strategy ranging from a "quite" strategy as characterised by NATIONAL WESTMINSTER, MIDLAND, FIRST NATIONAL BANK OF MARYLAND to a more active strategy such as BANQUE CANTONALE VAUDOISE, DNB and BANK OF SCOTLAND.

The erosion of shiplending credit terms has been halted as banks have tightened their offered terms. Competition is still a feature but has on the whole abated. Negative responses to owners' proposals are now less unusual as are approval delays or "conditional approval" terms. Credit yields have also stabilised and banks are increasingly focusing on their clients' liquidity reserves, vessel maintenance and survey positions and in bringing their clients' files up-to-date.

The above hardening of terms by banks has been welcomed by many who claim that it has been long overdue since the industry had overheated. A mild recession, they claim, would restore shiplending terms and conditions to much more acceptable (to banks) levels, as well as cleanse the industry from participants that had over expanded.

Many view these corrections as helping strengthen the industry and its lenders in the long run. However, are we facing a correction and/or another relatively short term cycle, or a deeper longer lasting recession?

If the former, then both the industry and its lenders would go through it largely unscathed, stronger and wiser. If the later, then success will depend on both banks' and clients' survivability and ability to work well together in difficult markets.

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