Financing opportunities for the smaller owner in today's booming market.

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According to our published Petrofin Research © 2004, there are 466 owners with fleets of 1-4 vessels and consisting primarily of older vessels.

For a long time, shipping banks had not shown real interest in the smaller owner preferring instead to concentrate on the medium to large owners who are investing in either newbuildings or young tonnage. In addition, as a result of bank mergers, acquisitions or withdrawals, the remaining banks engaged in shipfinance are larger, have considerably larger loan portfolios and hence interested only in larger size loan transactions. Furthermore, large owners with larger and more sophisticated financial services requirements were of greater interest to banks seeking to sell such fee-earning services.

It is said that nature abhors vacuums and the same has applied to shipfinance. The vacuum has gradually been covered by a plethora of banks targeting smaller owners. Such banks have analysed that smaller owners would be willing to pay higher spreads and fees for loan transactions and ancillary business as they had reduced choice.

Although bankers always argue that there is a correlation between owner size and inherent shipping risk, the attractiveness of higher loan yields may compensate such risk especially when vessel values and cashflows are especially strong.

Basel II criteria for credit risk rating have now become the norm for all shipping banks / loans and this may have actually been of benefit rather than a hindrance to these banks that have entered shipping or expanded into the smaller owner finance market. The specific credit rating of a smaller owner / smaller transaction can now be quantified and composed against that of a larger owner / larger transaction. The results, however, do not always support the larger owner / larger transaction taking into account bank reward.

So, who are the new banks entering the Greek smaller owner shipfinance market?

Some are either new or fairly new banks such as First Business Bank, Aegean Baltic Bank and Omega Bank. Some are existing banks that have re-emphasized financing to the smaller owner lender such as Egnatia bank, Eurobank and Laiki bank without though ruling out larger transactions for their larger established clients. Some are small foreign banks, such as Cornèr bank and others who see good opportunities in combining shiplending with private banking.

Lastly, there are the big banks who, although not targeting small clients, can lend and earn higher yields to existing small clients they have known for a long time and who may hold substantial cash deposits with them and run their day-to-day operations through them.

As the shipping market and vessel values and earnings have substantially increased over the last couple of years, even smaller owners have begun to look more prosperous and worthy of attention. After all, given their older fleets and relatively low borrowings, most should have not only repaid all their old loans by now but may have built up substantial cash reserves unless of course they have used it all by buying and higher value assets which may have increased instead the specific client's credit risk.

Most banks nowadays engaged in smaller owner shipfinance are positive about their experience and results. They all, however, stress the need to know their clients well and to turn out substandard names or loan transactions as well as to keep their eyes on the market in case it may dramatically fall.

Bankers in the small shipfinance segment are more sensitive to market swings as the average age of their mortgaged vessels is higher and their residual trading life correspondingly lower. In addition, older vessel values are the first to be decimated in a sharp market fall as is the case with their earnings.
Having established that there is increasing bank appetite for lending to the smaller Greek owner, the question becomes should smaller owners buy vessels at today's huge prices? The simple answer is no. Since shipping is a cyclical industry vessel prices will fall sooner or later. Patience will be rewarded but is rather boring! Most owners' blood is boiling when they see and calculate profits at today's

freight rates if only they had more vessels to use and if only the good market could last.

Owners' views are divided on the longevity of the good market. The same applies to bankers. Most, however, will admit that we are unlikely to see the very low vessel values and charter rates of 2002 as newbuilding costs have risen, there is still a marked lack of newbuilding spaces and of course the ever present Chinese factor that renders all analysis a tortuous process of relative weightings and timings.

Investing in young and very expensive tonnage today even if the good market would last for 1-2 years would still be a high risk proposition. Those brave enough to have a view on the longevity of the good market could buy older vessels and pay them off or sell them before the market would turn.

History is full of such decisions that turn out to be idiotic when market sentiment turns, of course. Like a game of musical chairs some may find a seat and make good money if they are nimble enough. Some will not. Good luck anyway.

Banks, especially those lending to smaller owners, would wish to see substantial asset / loan and net cashflow / loan debt service cover, as well as evidence of owner liquidity and commitment to apply it in difficult times. In simple terms, banks would not wish to take even a small part of owners risk.

Chartering an expensively purchased older vessel to quality charterers for 1-2 years does reduce the investment and banking risk. It does, however, tend to go directly against the grain of smaller owners buying older vessels seeking highest spot earnings and maximum short-term profitability. However, although period charter rates are lower than spot rates at present, they do offer the possibility of obtaining higher finance and as such the return on capital employed may not be as bad as initially thought and it is a more secured transaction.

Many smaller owners still prefer to take the risk and keep their operating flexibility as well as ability to sell prompt vessels without the burden of period charters.

As is always the case with such decisions, there is no instant right or wrong investment decision. Since the market outlook is uncertain, smaller owners should run sensitivity analyses and cashflow calculations using different assumptions to verify their ability to keep servicing the debt even in extreme conditions, when compared to those prevailing today.

Financial advisers may assist owners in their search for a balanced and better investment and banking strategy. Such strategy should be under continuous review and assessment bearing in mind among others each owner’s strengths and weaknesses as well as risk aptitude, financial leverage, liquidity and fleet employment position. The answers of such analyses may surprise owners and will certainly assist them in their decisions.

For a change all market sectors are buoyant and all owners, irrespective of size are enjoying the good market. Also, this time, there are more banks willing to assist smaller owners to acquire vessels. The winners and losers will be there for all to see in a couple of years’ time. Shipping risk and opportunity have never been in such abundance in the past as they are now.

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