Shipping finance lagging behind the recovery of Shipping

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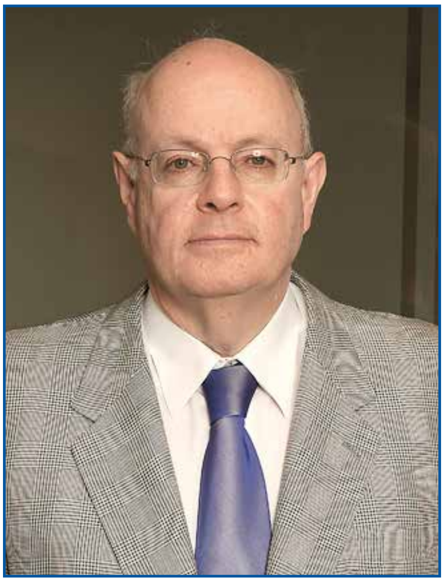

Banks witnessed, after a long and arduous road since 2009, a useful shipping recovery in 2013 in both vessel values and cash flows via higher freights. Although the recovery was erratic and not evenly spread among the various shipping sectors, it had a pronounced beneficial effect on the quality of the banks' loan portfolios and in bank's borrowers' ability to meet their (often restructured) loan obligations. Confidence grew among banks that shipping was on the way to recovery and this was felt even more by borrowers and private equity funds.

Dry bulk lead the way with a 12-month (March 2013 to March 2014) recovery of 41.4% in vessel values and 52.3% in freights (from Shipping Intelligence Inc. – 1st April 2014, below). With overall shipping confidence rising to record heights (Moore Stephens) and with the sector's progress picking up, one would have expected banks to be rushing headlong into new shipping loans and for competition to among banks grow.

With rare exceptions though ,this is not, however, what happened and the question is: why?

The answer lies with the banks themselves. Commencing with their shipping exposures, many banks had nurtured weaker clients in the hope of such a recovery. The process of recovery, though, could not work miracles overnight. It simply takes time to work out difficult loans and improve the health of a bank's loan portfolio. The recovery needs to be sustained and the recent fall in dry bulk freights demonstrated the still volatile nature of the recovery. In addition, from a common shipping approach by the boards of major banks to be cautious to achange, involving a willingness to expand, one needs time.

A second factor is that many shipping banks had what they believed to be a higher than desired overall shipping exposure and needed time to reduce it to acceptable levels via client loan repayments.
A third factor is that banks had set up very strict criteria for lending resulting in too few potential loan transactions meeting such requirements

However, there were other more significant reasons for the banks' lack of ship lending appetite. It relates to the fundamental weakness in the liquidity and capital ratios of European banks in the light of Basel III and the new ECB regulatory overview of all E.U. banks. Banks simply lacked the financial resources and the risk appetite to step on the gas pedal. European banks especially found themselves bracing for the ECB loan review and proving their financial robustness. In a world of doubt, to banks, profitability came second to financial strength. As the majority of shipping banks were European (72% of global ship finance in December 2013), Petrofin Bank Research (c) the difficulty of European banks had a pronounced and adverse effect on Greek ship lending.

To add insult to injury, three of shipping champions of previous years i.e. RBS, HSH and Commerzbank were under immense pressure to downsize their shipping portfolios and/or leave ship lending altogether.
During this time, some banks stood out for either lending counter-cyclically or standing their ground as ship finance providers. These were mainly DVB, ABN AMRO, Credit Suisse and ING among European banks and China Exim, CDB, and Korean Exim, from the Far Eastern banks.

A classic West-East divide took place with shipping credit being more readily available in the Far East, where a large number of small to medium banks supported local clients. The same was not true in the West for any but the biggest and often publicly quoted companies.

For Greek ship finance, in particular, it had been most hit as the biggest lenders exited the market at precisely the time when Greek newbuilding orders and second-hand purchases accelerated. With the Greek banks unable to provide new ship finance and caught by the difficulties of European banks as a whole, Greek owners turned to the remaining few active lenders, to Far Eastern lenders (linked only to shipbuilding orders) and, increasingly, to US private equity funds (PEFs).

As the finance gap widened, PEFs were for many Greek owners often the only way to take advantage of what promised to be a healthy shipping recovery. PEFs were not only active but often scoured Greece for opportunities to co-invest and lend to Greek owners believing that the anticipated shipping recovery would provide them with the high returns they have been seeking. The result was an explosion of Joint Ventures most of which investing in eco-friendly vessels of new designs that is hoped will be the vessels of the future.

Characteristically, according to Tufton Oceanic data, on a global basis between January 2002 and January 2014, the share of global mortgage lending of the world fleet and orderbook fell from 43% to 36%. The above was even more pronounced in Greece. There are no hard data for the Greek shipping exposure by PEF, but we believe that there are over 40 Joint Ventures in place today. With interests primarily in drybulk and then

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The SHIPPING INTELLIGENCE INDEX FLEET is a group of fifteen ships representative of the world fleet. (Details below.)

The values shown below were derived from a statistical analysis of thousands of actual ship sales and charters.

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*** INDEX FLEET TOTAL RESALE VALUE (In Millions of $US).**

BULK CARRIERS: Current== $ 188.3	TANKERS: Current== $ 169.6
BULK CARRIERS: 1 Mo Ago= $ 189.7	TANKERS: 1 Mo Ago= $ 150.5
BULK CARRIERS: 6 Mo Ago= $ 140.5	TANKERS: 6 Mo Ago= $ 139.2
BULK CARRIERS: 1 Yr Ago= $ 133.2	TANKERS: 1 Yr Ago= $ 145.6

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*** INDEX FLEET TOTAL 6-12 MONTH T/C RATE (In Thousands of $US/Day).**

BULK CARRIERS: Current== $ 143.7	TANKERS: Current== $ 109.0
BULK CARRIERS: 1 Mo Ago= $ 134.5	TANKERS: 1 Mo Ago= $ 100.3
BULK CARRIERS: 6 Mo Ago= $ 134.2	TANKERS: 6 Mo Ago= $ 88.0
BULK CARRIERS: 1 Yr Ago= $ 94.3	TANKERS: 1 Yr Ago= $ 91.1

tankers , and to a lesser extent, container vessels.

This explains the paradox of a 6.5% annual fall in Greek shiplending (Petrofin Bank Research (C) at a time when the Greek fleet grew to record levels of 3901 vessels and 291 DWT (Lloyd's Fairplay) and Greek newbuilding orders exceeded 375 vessels.

Provided the shipping recovery continues, (a big 'if'), it is expected that PEF interest shall wane in 2014/2015 as the opportunity to invest at a low point in the cycle falls away. In addition, over the last months, Chinese ship lending and, especially, lending to non-Far East owners has stumbled due to Chinese credit restrictions. These two developments will be counteracted by the increasing confidence and financial ability of Western banks (European and North American) which will be attracted by the high loan yields of Greek shipping based on modern eco design vessels.

It is anticipated, therefore, that mortgage lending will slowly pick up globally, as well as in Greece, in 2014/2015.

A factor that may help Greek owners is the economic recovery of Greece which had cast a shadow over the last 4 years. In addition, Greek banks too have, at long last, started the long road to recovery. It is anticipated that all 5 Greek ship lending banks will channel funds into shipping once their financial condition shall permit, as shipping is high on the list of preferences. The recent capital increases by Piraeus bank, Eurobank and National bank of Greece have demonstrated Greek banks recovery.

A Greek ship finance recovery in 2014/2015, will come at the right time as newbuilding orders are delivered and finance shall be increasingly needed. With most orders being placed in 2015 and 2016, the timing of ship finance demand and supply appears opportune.

Of course a big question is overhanging the shipping market. It is whether the shipping recovery witnessed thus far will continue or stall. It is a tough call, as the fundamentals, as well as the once again rising order book, do not support such a sustained rise. On the other hand, shipping, despite the still oversupply position, has been able to absorb the oversupply tonnage through slow steaming, increasing port congestion and longer routes between commodity exporting and importing areas

Vessel values have risen on the wake of a euphoria that has taken hold of shipping. It remains to be seen if such high expectations shall be met, as currently a non alignment has appeared between vessel values and freights.

In the meantime, banks are clearing out their loan books, are selling loans to hungry recovery funds and are preparing themselves for more active ship lending in the years to come. The recent shipping recovery has provided many banks with a much needed opportunity to do some "house cleaning" and weed out lesser credit.

To summarise, ship financing banks are lagging behind the recovery of shipping markets. This is not an unusual phenomenon as the shipfinance cycle often lags behind shipping cycle.