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**ANALYSING THE MAIN
PROSPECTS AND TRENDS FOR
WORLDWIDE SHIPPING FINANCE**

IIR LONDON CONFERENCE, LONDON 30/09/1998

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**1. SHIPPING INDUSTRY RELATED
FACTORS AFFECTING SHIPPING FINANCE**

- VESSEL EARNINGS : FALLING, DRY BULK IN SLUMP
- VOLATILITY OF EARNINGS : HIGH, INCREASING
- IMMEDIATE PROSPECTS : MEDIOCRE TO POOR
- QUALITY OF EARNINGS : FALLING, PAYMENT DELAYS,
DISPUTES,
CHARTERERS BANKRUPTCIES
- PATTERNS OF TRADE : CHANGING (STRONG ROUTES
NOW WEAK ROUTES)
- OVERALL VESSELS' TRADING : LACK OF CARGOES
POOR RATES
POOR PROSPECTS

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**1. SHIPPING INDUSTRY RELATED
FACTORS AFFECTING SHIPPING FINANCE**

- OPERATING EXPENSES: RISING MODERATELY,
CREWING: INCREASINGLY DIFFICULT
TO MAINTAIN QUALITY AND
COMMITMENT
- INSURANCE COSTS: FALLING
- TECHNICAL AND
OPERATING COSTS: RISING DUE TO ISM,
CLASS,
PORT INSPECTIONS,
SALVAGE ASSOCIATION

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**1. SHIPPING INDUSTRY RELATED
FACTORS AFFECTING SHIPPING FINANCE**

- FLEET OPERATING EFFICIENCY: FALLING DUE TO DELAYS,
INSPECTIONS,
MULTI-CARGOES,
PART CARGOES,
LONGER S/S AND D/D TIME
REQUIREMENTS,
DISPUTES

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1. SHIPPING INDUSTRY RELATED FACTORS AFFECTING SHIPPING FINANCE

- NEWBUILDING ACTIVITY : HIGH Especially in larger tankers, dry buk and container vessels
- SCRAPPING VOLUME : Increased; problem with ship breaking capacity
- SCRAPPING PRICES : FALLING reached very depressed levels
- LAY UPS : RISING, ESPECIALLY RECENTLY
- INTEREST COST : STEADY, PROSPECTS OF REDUCTIONS

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1. SHIPPING INDUSTRY RELATED FACTORS AFFECTING SHIPPING FINANCE

- VESSEL VALUES : Falling at accelerated pace
- S & P : Substantially down due to sellers / buyers mismatch
- OVERAGE VESSELS S & P ACTIVITY : DEAD; MANY SELLERS, NO BUYERS, NO FINANCE
- SHIPPING COMPANY FAILURES : RISING, INCREASING RUMOURS
- HIGH YIELD DEBT ISSUES : UNCERTAINTY, HIGHER COST, FEWER ISSUES

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2. NON - INDUSTRY FACTORS AFFECTING SHIP FINANCE

<u>FACTORS</u>	<u>RECENT TRENDS / CONCERNS</u>
<ul style="list-style-type: none"> • FAR EAST CRISIS : 	<p>Continuing and deepening, structural problems in Japan, knock on effect for regional economies, mismatch btw exports / imports, company failures</p>
<ul style="list-style-type: none"> • RUSSIAN CRISIS : 	<p>STILL EVOLVING STRUCTURAL PROBLEMS</p>
<ul style="list-style-type: none"> • LATIN AMERICAN CRISIS : 	<p>Developing, low commodity prices</p>
<ul style="list-style-type: none"> • INTERNATIONAL CAPITAL AND STOCK MARKETS : 	<p>Extreme volatility, crisis mentality, uncertainty, caution, fear</p>

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2. NON - INDUSTRY FACTORS AFFECTING SHIP FINANCE

<u>FACTORS</u>	<u>RECENT TRENDS / CONCERNS</u>
<ul style="list-style-type: none"> • WORLDWIDE ECONOMIC GROWTH : 	<p>Falling, uncertain prospects, fears of zero growth or even recession</p>
<ul style="list-style-type: none"> • INTERNATIONAL INVESTOR CONFIDENCE & PROSPECTS : 	<p>Falling, poor. Flight to quality and liquidity</p>

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2. NON - INDUSTRY FACTORS AFFECTING SHIP FINANCE

<u>FACTORS</u>	<u>RECENT TRENDS / CONCERNS</u>
<ul style="list-style-type: none"> • FAR EAST BANKING : • INTERNATIONAL BANKING : 	<p>Paralysed, Japanese bank poor debts, Korean banking crisis, knock-on effect to other banks, reduced lending and overall activity</p> <p>Increased concern over international economy, Far East, Russian and Latin American risk exposure, increased provisions, lay-offs, re-focussing, defensive postures</p>

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2. NON - INDUSTRY FACTORS AFFECTING SHIP FINANCE

<u>FACTORS</u>	<u>RECENT TRENDS / CONCERNS</u>
<ul style="list-style-type: none"> • INTERNATIONAL TRADE : • COMPETITION : 	<p>Slowing down as growth economies, China, Japan, Tiger economies, Russia faltering or falling</p> <p>Increased competition to shipfinance by other sectors offering better quality risk / reward characteristics and prospects</p>

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MAIN CONCLUSION

- Shipping slowdown/crisis now being made deeper and longer by international economic, banking and investor crises affecting many key regions of the world
- Prospects for shipping across all sectors especially bleak
- Prospects for overage vessels - virtually nil

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3. HOW HAS SHIPFINANCE BEEN AFFECTED BY INTERNATIONAL AND SHIPPING CONDITIONS AND TRENDS

- Shipping banks' portfolios face a significant erosion of quality due to falling vessel values and diminishing earnings
- Shipfinance activity has fallen to very low levels
- Increased use of restructures in order to gain time
- Rising number of foreclosures, shipping company failures and forced sales (especially involving overage vessels)
- High % of loans in default
- Shipfinance for older vessels has virtually disappeared
- Only high quality companies enjoy access to competitive shipfinance and terms, usually involving newbuildings

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3. HOW HAS SHIPFINANCE BEEN AFFECTED BY INTERNATIONAL AND SHIPPING CONDITIONS AND TRENDS

- More information required for loan monitoring causing strain with clients
- Flight to quality and size by shiplending banks
- More stringent and scrutinised lending by banks
- Greater use of loan covenants, emphasis on liquidity and asset quality
- Falling lending ratios and increased spread/fees required by banks in new lending
- In view of the recent adverse economic factors and prospects, a number of banks are re-evaluating their longer term commitment to shipfinance

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3. HOW HAS SHIPFINANCE BEEN AFFECTED BY INTERNATIONAL AND SHIPPING CONDITIONS AND TRENDS

- Increased uneasiness among shipping banks personnel over the length of the recession in shipping and their future
- The majority of banks are increasingly wary of entering into new loans and / or new lending relationships with small to medium owners even when these involve modern vessels
- Increased concern shown by shipping banks towards Far East charterers' ability to meet their commitments
- Shipping banks are continuing to emphasize non-risk products and services especially now that shiplending activity has virtually disappeared.

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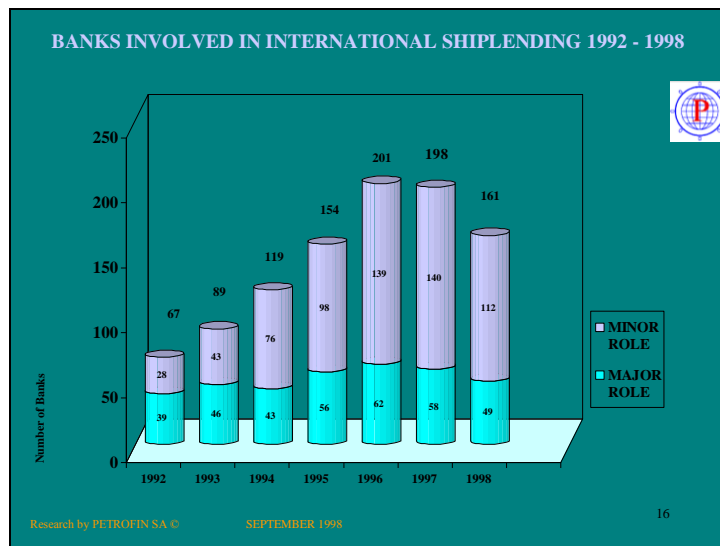


BANKS INVOLVED IN INTERNATIONAL SHIPLENDING
1998 (1997)

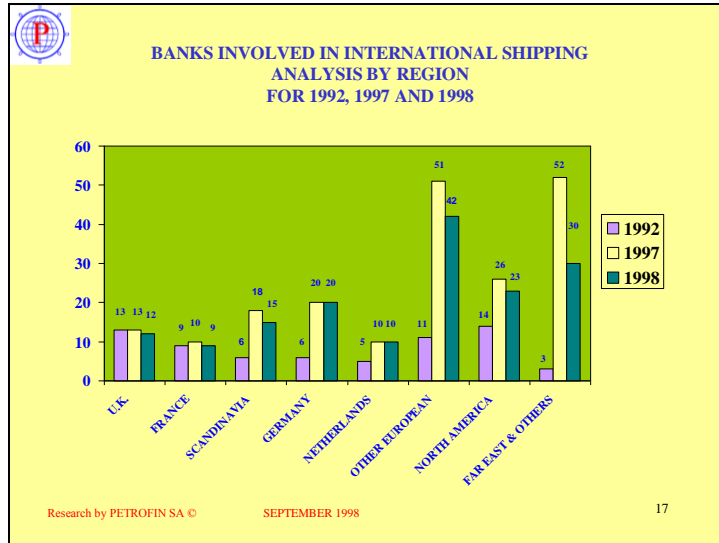
COUNTRY/REGION	MAJOR ROLE	MINOR ROLE	TOTAL	%
UNITED KINGDOM	5 (6)	7 (7)	12 (13)	7.5 (6.5)
FRANCE	5 (6)	4 (4)	9 (10)	5.5 (5)
SCANDINAVIA	4 (5)	11 (13)	15 (18)	9.3 (9.1)
GERMANY	8 (8)	12 (12)	20 (20)	12.4 (10.1)
NETHERLANDS	5 (5)	5 (5)	10 (10)	6.2 (5.1)
OTHER EUROPEAN	5 (5)	37 (46)	42 (51)	26.1 (25.7)
EUROPEAN SUBTOTAL	32 (35)	76 (87)	108 (122)	67.1 (61.6)
NORTH AMERICA	10 (11)	13 (15)	23 (26)	14.2 (13.1)
FAR EAST & OTHER NATIONALITIES	7 (12)	23 (38)	30 (50)	18.6 (25.2)
TOTAL	49 (58)	112 (140)	161 (198)	100 (100)

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WHAT OF THE FUTURE?

- There are increasing concerns and forecasts that the worldwide economy will slide into recession
- Should the above turn out to be accurate, then the effect on shipping will be long and pronounced. Recovery as such will be delayed and forecasts are already talking of a recovery from the year 2000 and beyond
- Recovery scenarios obviously vary from shipping sector to sector, with dry bulk and container ships being the worse affected
- In view of the prolonged shipping slump and the long time necessary for the scrap industry to absorb overage tonnage, vessel values are expected to fall further and approach those experienced in the 1982-1986 major shipping slump.

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WHAT OF THE FUTURE?

- Freight rates, especially for the large dry bulk vessels may have bottomed, being now close to operating expenses levels. Difficult to see how long before freight rates shall begin their recovery.
- Shipping banks' loan portfolio will continue to weaken as values fall and poor net cash inflows continue.
- Banks' patience and willingness to continue restructuring debt will be increasingly tested, especially for loans involving overage vessels
- Banks' central credit committees are likely to demand swifter progress and more drastic action.

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WHAT OF THE FUTURE?

- The number of vessels arrests / auctions and shipping company failures will rise, due to increased pressure from banks and creditors, poor cash flow, lower resale and scrap values
- The number of active shiplending banks is expected to continue falling throughout 1998 / 1999 and to stabilise thereafter.
- Flight to quality and alternative risk / reward lending opportunities for international banks will reduce shiplending.
- In view of the international crisis, banks' capital ratios will be hit. Consequently, shipping, being a high capital oriented industry, will bear the brunt of their reduced interest.

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WHAT OF THE FUTURE?

- Increased bank mergers and acquisitions throughout the world and especially in the Far East and other problem areas. This will reduce the number of active banks, strengthen their capital ratios and, hence, their longterm shiplending capacity.
- Lower US interest rates will greatly assist shipping and will allow room for shiplending banks to wait for a recovery.
- The shipping industry is highly fragmented. Acceleration of the trend towards larger shipowning companies as a result of bad market forces and pressure from banks

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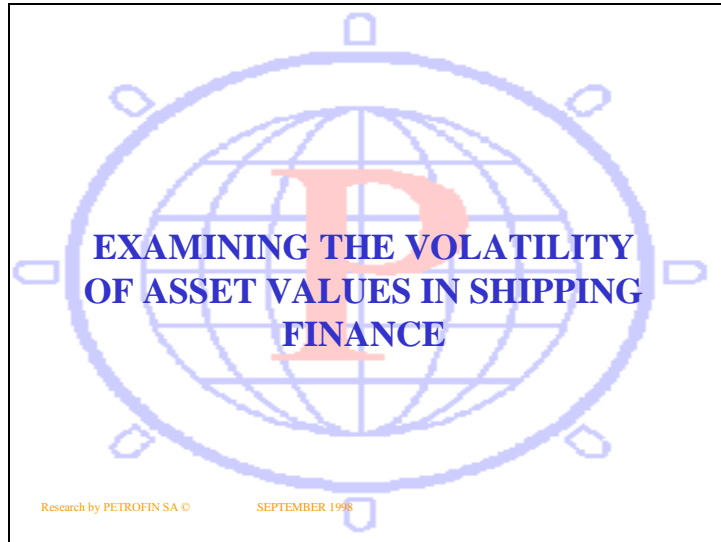


WHAT OF THE FUTURE?


- The adverse economic and shipping related conditions will provide enormous opportunities for financially sound shipping companies to acquire cheap modern tonnage
- Consequently, there are good opportunities for committed shiplending banks to select good clients and build quality loan portfolios with attractive terms and conditions
- Shiplending terms and conditions are expected to continue to harden, thus providing much better risk / reward characteristics for shiplending in the future.

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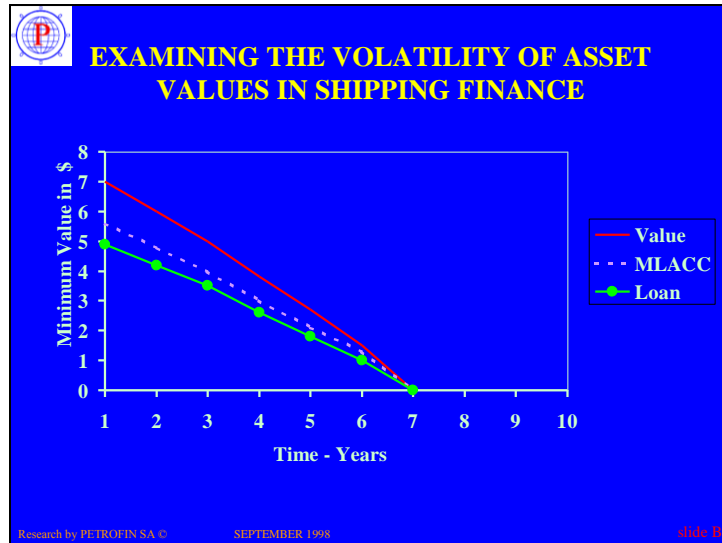


**EXAMINING THE VOLATILITY OF ASSET
VALUES IN SHIPPING FINANCE**

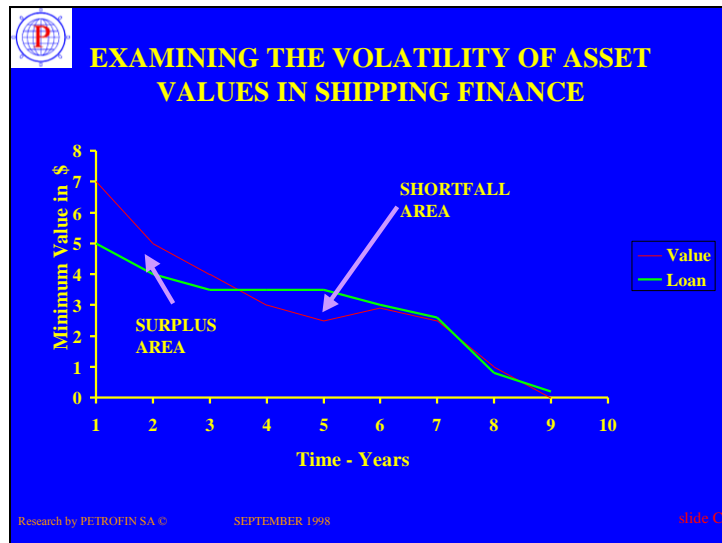
- Shipping loan facilities contain minimum loan asset cover covenants (MLACCs) usually ranging between 120-150%.
- It is expected that as the assets become older and, hence, lose their intrinsic value, the loan shall be repaid using the asset(s)' net cash flow.
- The minimum required values of the asset(s) therefore are anticipated to fall as the loan progresses in line with the repayment.
- Breaches of the MLACC entitle the lender to demand either a part prepayment of the loan or the provision of additional (acceptable to the lender) collateral so as to restore the MLACC.
- Problems arise at a time of a shipping slump when anyone or a combination of the following may occur: a) values fall significantly and / or b) net cash flow is insufficient to maintain the loan repayment schedule and / or c) borrower does not have the ability / willingness to provide additional security or part prepay the loan.

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EXAMPLES OF FALLS IN VESSEL VALUES
\$ MILLIONS

VESSEL	TYPE	BUILT	1997 AVERAGE	AUGUST 1998	% FALL
280,000	Tanker	1993	65	56.5	13.1
280,000	Tanker	1975	15	11	26.7
140,000	Tanker	1993	44	40	9.1
140,000	Tanker	1975	6.5	4	38.4
30,000	Tanker	1993	23.5	20	14.9
30,000	Tanker	1974	4.5	2.5	44.4
68,000	Panamax	1993	22	14.5	34.1
60,000	Panamax	1975	4.3	1.6	62.8
38,000	Bulk Carrier	1993	16	12	25
35,000	Bulk Carrier	1977	4.5	2	55.5

Source: CLARKSON RESEARCH 28/08/1998 slide 5

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- RECOMMENDATIONS / POTENTIAL SOLUTIONS**
- Avoid loans involving older vessels due to limited remaining useful life which reduces time needed for overcoming problems
 - Older vessels require higher repairs and s/s related expenses as a % of their value
 - Accept older vessels only if
 - a) sufficient income and / or
 - b) part of a larger and more modern fleet and / or
 - c) part of a diversified fleet and / or
 - d) very favourable short term market prospects and / or
 - e) Client enjoying high liquidity and / or
 - f) Client has own cargoes i.e. contracts of Affreightment or end user and / or
 - g) Client has other source of earnings and / or unaffected collateral
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RECOMMENDATIONS / POTENTIAL SOLUTIONS

- Price loan accordingly
- Time is of the essence. As such, press client for additional loan comfort at first hint of trouble
- Set a wide MLACC. Move decisively immediately upon a breach

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