Lloyd's List

Year of tough decisions

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- by Steve Matthews

NEXT year will be a crunch year for shipping and ship finance as companies must adapt to lower vessel values and earnings.

Decisions will need to be made over the financing of newbuilding orders. Many shipping banks face restructuring their portfolios and deciding whether they are able or willing to resume providing new debt finance.

Year of tough decisions

Following the banking crisis, banks drew in their horns with regard to lending to shipping. They are now in the process of setting their strategies in the light of the reorganisation and prioritisation that has taken place. In the context of continuing uncertainty in shipping markets, this is likely to mean that the number of banks actively lending to shipping will remain limited throughout 2010.

Those that are still lending will remain cautious over to whom they lend and the terms on which they lend. The expectation of a continuing shortfall in debt finance has already resulted in more maritime firms looking at alternative funding sources, especially the capital markets.

Speaking at a Fortis Bank Nederland transport seminar in Rotterdam last week, Clarksons Research managing director Martin Stopford said that the main challenge was getting shipping companies back to a condition in which they could trade and invest profitably.

The big fall in asset values had caused owners and ban or problem, but “the single biggest problem is financing the orderbook”, he said.

“There is still a big overhang of orders, many of them ordered at high prices. The time is approaching when the talking has to stop and decisions have to be made about what to do.”

Some major shipbuilders have large commitments and face their own dilemmas in trying to maintain cash flow.

“Reducing the orderbook by cancellations is not easy. W t happens depends on how negotiations go between yards and owners,” Dr Stopford said.

He estimated the total value of the orderbook at about $423bn. For ships ordered in 2008 when prices peaked, the largest proportion of investors was based in Europe.

Some owners were not making stage payments to shipbuil ers and intense negotiations are taking place. Shipping banks were generally supporting owners in seeking to r duce exposure. This could reduce the total finance requirement for newbuildings.

Petrofin Bank Research managing director Ted Petropoulos said that the global shipping loan portfolio at the end of 2008 was about $450bn. He estimated that a combination of reduced lending, existing loan run-offs and some cancellations would reduce that global figure to about $410bn-$420bn by the end of this year.

Since the global financial crisis hit just over a year ago, there have been some encouraging developments. The threat of the global banking system crashing has receded. Improved stability and government and central bank support has restored some confidence.

As a result, inter-bank spreads have almost returned to normal. However, most banks are still in the process of rebuilding their capital base to reduce the need for external support. Most will require more fresh capital in 2010, with most likely to come from the capital markets through rights issues and other placements.

Several leading shipping banks are among those still needing to recapitalise and reduce their exposure, and therefore are not in a position to increase lending to shipping. Some of this shortfall is being picked up by banks in the Middle East and Asia, where the problems were not so acute, but th funding is limited and well short of what is needed to fill the gap.

The result is that new lending to shipping this year w down sharply and syndicated lending virtually ceased, while average loan deal sizes fell considerably. The number of banks actively lending to shipping fell, due to some banks withdrawing altogether and others being absorbed throu h mergers and acquisitions.

The ongoing process of restructuring and recapitalisation among shipping banks means that their ability to increase lending in 2010 is likely to remain limited.

Mr Petropoulos reported that of 31 shipping banks responsible for a large majority of the global ship lending portfolio, seven indicated they expected to downsize their shipping portfolios, 11 expected to remain about the same and 13 anticipated having some credit capacity or a commitmen o increase lending to shipping.

Even with cancellations of orders and reduced finance requirements, there is still likely to be a shortfall of bank lending to shipping for the next one to two years, with gradual r covery beginning only from 2011, depending on whether shipping markets begin to recover and increase earnings.

There will be some long-term changes to pricing levels for ship lending and fe s, which will become more significant when central bank base rates begin to rise.

Banks are also likely to be more cautious and less tolerant with regard to waivers. Shipping spreads will not return to the levels they were in early 2008, when banks were competing fiercely for business and market share.

A survey of bankers covering some 27 banks representing some $287.7bn of ship lending expected non-performing loans to reach at least 9% next year, with German bank — with a large proportion of containership loans — facing particular problems. Some 42% of survey responses expe d ship finance activity to resume in six to 12 months and 31% in one to two years. A majority of 59% expected th global ship finance portfolio to reduce by up to 10% in 2010.

However, there was an inconsistency in that when asked bout their own bank's shipping portfolios, they were less pessimistic, with 31% expecting their bank's portfolio to increase in 2010, 30% to stay the same and 26% to reduce by up to 10%. Two-thirds expected that the number of active shipping ban would reduce by 10%-20% in 2010.

While the general picture for bank lending to shipping ne of a slow and cautious recovery during the next year or two, there are big differences among individual banks, depending on their circumstances.

Some are still heavily dependent on government support and will take some time to restore their independence. These include leading shipping banks such as Royal Bank of Scotland and HSH Nordbank. While both have indicated that they are still doing shipping business, their shipping portfolios are more likely to shrink than rise in the short term.

HSH Nordbank is downsizing, but says it expects its shipping business to ride through the downturn, even though it has more than doubled its loan loss provisions for shippin and is heavily exposed to container shipping. It is likely to be at least 2011 before its restructuring is complete.

Other banks are in the process of major restructuring, such as Fortis Bank Nederland merging with ABN Amro and taking over its Dutch shipping portfolio. This merger is like to be completed in the second half of 2010. In November, the Dutch government announced it was putting a further €4.4bn ($6.4bn) into ABN Amro to assist with the merger, involving its Dutch assets following the acquisition by Fortis, Roya k of Scotland and Santander just before the banking crisis hit.

Fortis Bank Nederland has indicated it is in a positio to increase its ship lending activity next year and is looking to re-establish its credentials as an international lender to shipping.

In the US, Citigroup is to repay the final $20bn of US government funding from the Troubled Asset Relief Program, financed by a $17bn share issue.

Norwegian bank DnB NOR is making a NKr14bn ($2.4bn) rights issue. The bank said that it was “raising the funds to buffer its balance sheet against anticipated higher ca ital adequacy requirements in the banking sector after deciding against tapping the Norwegian state’s banking sector rescue fund”. It also risks bigger losses on loans to the shipping industry, which has been hard hit by falling freight p ices in the global downturn.

DnB NOR head of shipping and offshore Harald Serck-Hansen said the bank had done some transactions this y ar and had kept its shipping and offshore portfolio stable in dollar terms, at about $25bn.

He said exchange rate trends and the share issue should give the bank capacity to do some new business in 2010 plus the proceeds of normal loan repayments.

Some other leading shipping banks, such as DVB Bank an another Norwegian bank, Nordea, are not dependent on state support and have maintained ship lending activity, albeit with a more cautious approach and tighter lending terms.

Although the worst may be over for most shipping banks here is little expectation of any significant increase in overall lending in 2010, although some banks have indicated th y are planning to increase their portfolios. Shipowners seeking finance will continue to face a challenging task to se e bank loans. If they do find funding, it will be at higher spreads and on tougher terms.

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