

By Ted Petropoulos
Head
Petrofin Research
www.petrofin.gr

Zombies riding the storm

For Nafs – February 2013

A new and very descriptive word has crept into shipping terminology in recent months: Zombie shipping companies.

What is a Zombie then?

A Zombie is defined as a company that is kept alive by the support of its banks. It may help readers to explain further that when firms are kept alive by the consent and support of their banks, auditors qualify their statements in the production of the firm's audited accounts, as it affects the firm's status "as a going concern". This is different to a firm simply restructuring its debt obligations.

In practical shipping terms, it means a shipping company whose fleet's cash flow is unable to meet its principal and sometimes even interest loan obligations and where the value of its fleet is well short of its loan obligations and relies on its banks to keep it alive by continuous loan restructures, unwillingness to foreclose on loans, willingness to waive financial covenant and asset cover violations, allowing the build-up of unpaid bank obligations and so on.

Banks often allow shipping companies to carry on despite their non-adherence to the terms of its loans (original or restructured) because the alternative of foreclosing in a bad market would realize substantially more losses for the banks. So, banks keep the patient (shipping client) barely alive until either the market would revive or a better opportunity might arise to terminate the relationship or transfer the vessels to another client with a lesser loss to the bank.

With the whole shipping market in deep trouble, with rare exceptions, and with shipping cash flow often barely covering fleet operating expenses, a large number of shipping companies have been increasingly drawn into the "zombie" zone. Often, such entry into the zombie zone can be delayed by adequate liquidity and / or unencumbered assets from previous good years and by having performing period charters at attractive rates. However, the longer and deeper the crisis, the quicker such buffers shall be used up, thus rendering such companies zombies.

The question, therefore, is, are you and/ or the shipping company you are working in, a zombie? Moreover, does the firm itself and its principals realize their zombie status?

Mr Yamasato recently in Lloyd's list referred to a spotter's guide to zombie companies focussing primarily on publicly quoted companies whose financials are known. I shall concentrate on the private sector, although the methodology adopted can also be readily adapted for the public sector.

I have devised, therefore, an easy test for all readers able to answer some key questions, to carry out and find out for themselves. I hasten to add that such test is indicative and not

By Ted Petropoulos
Head
Petrofin Research
www.petrofin.gr

definitive or exhaustive. However, the questions being asked, represent to me the main determinants of whether a firm is or is in danger of becoming, a zombie.

In addition, by carrying out this test at regular intervals, one may see how the rating (score) evolves over time, as well as the speed of change.

Banks too may find the test useful in their analysis. Moreover, they may well wish to modify it by adding questions or changing the rating of each answer.

So please have a go and see for yourselves.

There are 11 questions and the maximum possible score is 100. In my view, a score of over 60 points implies a firm well and clear into the zombie range. A score of 40-60 implies a firm that is very close to being or becoming a zombie firm. A score of 20-40 implies a firm that is well outside the zombie zone that should however, keep monitoring its position and taking whatever steps it can not to increase its zombie status risk. Lastly, a firm with only 0-20 points is not at risk and this is especially important during this deep and long shipping crisis.

A zombie firm may indeed survive as long as its bankers continue to support it. In order to recover, though, and lift itself outside the zombie zone, it shall require an improvement in the shipping market and a recovery of its fleet cash flow and fleet values. Additionally and sometimes as an alternative, a recovery, may be achieved by the injection of fresh capital or additional collateral or a conversion of debt for equity by the financing banks.

The management of a zombie firm too may assist in its survival. This is done by being transparent and communicative to its banks, by being a good vessel manager, keeping administrative and vessel running costs low but not at the expense of ship maintenance and in maximizing fleet earnings. Timely sales may be considered at the early stages of a difficult market if they reduce the overall debt burden. If possible, acquiring vessels at low cost near the bottom of the market will be very helpful, but is often difficult to obtain bank support, as banks may also find it difficult to justify the additional risk to a zombie company. Still, there are many possibilities available internally and in the market for zombies to improve their status.

We all know that shipping is a highly cyclical industry and that it is a question of time for a recovery to take place. The aim of every zombie or near zombie shipping firm is to survive and benefit from such recovery.

ZOMBIE TEST

- 1) **Income Protection**
 % of income over the next 2 years, covered by time charters or COAs (contracts of affreightment)

0 - 10%	10 - 30%	30 - 50%	over 50%	
10 p	5 p	2 p	0 p	

- 2) **Ability to service interest obligations**

0 - 20%	20 - 50%	50 - 75%	75 - 100%	over 100%
10 p	7 p	5 p	3 p	0 p

- 3) **Ability to service principal obligations**

0 - 20%	20 - 50%	50 - 75%	75 - 100%	over 100%
5 p	3 p	2 p	1 p	0 p

- 4) **Asset cover ratio (current vessel prices)**
 Asset / loan

25 - 50%	50 - 75%	75 - 100%	100 - 125%	over 125%
10 p	5 p	3 p	1 p	0 p

- 5) **Loan restructures effected over the last 5 years / per bank loan**

2 +	2	1	0	
5 p	3 p	2 p	0 p	

- 6) **Increase in average bank loan margins**

over 300%	200-300%	100-200%	0 - 100%	no change
------------------	-----------------	-----------------	-----------------	------------------

10 p	7 p	5 p	1 p	0 p
------	-----	-----	-----	-----

7) Committed / available cash liquidity over total bank debt

0 - 5%	5 - 10%	10 - 15%	15 - 20%	over 20%
10 p	3 p	2 p	1 p	0 p

8) Availability of unencumbered (non-mortgaged assets) over total bank debt

0%	Up to 10%	10 - 20%	over 20%	
10 p	5 p	2 p	0 p	

9) Increase of trade and crew debt over the past 2 years

over 50%	30 - 50%	10 - 30%	0 - 10%	reduction
10 p	5 p	2 p	1 p	0 p

10) % of bank relationships still active in shipping

0 - 10%	10 - 30%	30 - 50%	50 - 75%	75 - 100%
10 p	5 p	3 p	1 p	0 p

11) Offhires and claims during the past 12 months due to breakdowns and disputes with charterers as a % of gross income

over 20%	15 - 20%	10 - 15%	5 - 10%	0 - 5%
10 P	7 p	5 p	2 p	0 p

1. Over 60 points: Zombie status
2. 40-60 points: Serious risk of Zombification
3. 20-40 points: Medium risk of Zombification
4. 0 - 20 points: Low risk of Zombification