Shipmanagement and Finance into the next decade

Interview with Mr. Ted Petropoulos of Petrofin S.A.

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"GREEK SHIPPING must develop into fewer and larger shipowning and shipmanagement groups that can operate fleets efficiently, invest new technology and systems."

These are the views expressed by Mr. Petropoulos an experienced banker who has worked for a long time in foreign banks with a long shipping tradition.

Mr. Petropoulos who is now the managing director of PETROFIN S.A. speaks to ELNAVI about the whole range of challenges which are to be faced by the Greek shipping industry in the next few years. In this issue we present the first part of his interview.

How do you see the future of shipping in the next century when quality and new technology are expected to play already role?

Greek shipping enjoys a rich tradition and deep know-how. Moreover, it continues to be the main focus of attention for a nation with limited alternatives. Thus the aptitude, knowledge, commitment, risk-taking and sheer entrepreneurships have projected Greek Shipping to the number one position among shipping nations. Can, however, the above qualities coupled with the legendary Greek investment intuition be sufficient to keep Greek Shipping in the top position in the 21st Century?

There has always been competition in Shipping. However, this has intensified across all levels. After many years of disinterest and neglect, "traditional" shipping European nations such as, Holland, UK, Germany etc., are beginning to wake up to the need to a) protect their remaining shipping sector, b) to create a friendlier environment in order to support future investment and c) encourage the possible return of shipping interests that had emigrated towards friendlier heavens, e.g. Cyprus, ex – British colonies etc. in the previous years. These incentives are primarily tax-driven. They are, however, also linked to greater co-operation with the State and support by National Banks. Thus, a trickle of companies are beginning to return to Holland and Germany and this trend will, undoubtedly, continue. The promotion of their national flag by such countries has also been skillfully put forward via other developments such as, increases regulation, port inspections, emphasis on quality of management, modern vessels and bank preference from the benefits of some of the above developments, their combined effect is helpful to such nations and potentially harmful to Greek interests.

Greek shipping, however, has grown over the last decades on slightly different criteria, as outlined earlier. Moreover, a main quality of Greek Shipping has always been its ability to operate efficiently and inexpensively relatively older tonnage. The emphasis on quality, fleet youth and new technology (primarily in the fields of IT, ISM, communications and preventive maintenance) is a challenge to Greek Shipping to which it must respond quickly. As PETROFIN research has shown last year, of the 926 shipmanagement companies operating in Greece, only 30 or 3.2% had fleets of 9 years or younger and only 55 or 5.0% had fleets of 14 years or younger. Although age is not the only criterion of quality, it is nevertheless an important element. Moreover, age has become the main criterion of shiplending over the 1990s and as such, must be treated with respect.

Greek Shipping has already begun to adapt rather than to challenge the above developments and restrictions. The recent dry cargo slump has provided Greek owners with the opportunity to begin to acquire relatively inexpensive both newbuildings, as well as, a quality modern tonnage.

The old saying of "if you can't beat them, join them" does apply. However, in order to effectively compete, Greek Shipping must develop into fewer and larger shipowning and shipmanagement Groups that can operate fleets efficiently, invest in new technology and systems, hire quality staff and even more importantly, find the capital resources and financial backing to develop such modern and larger quality fleets. In addition, the necessary management financial, operating and technical information systems must also be developed alongside with more corporate and professional management structures in order to compete more effectively.

The Greek traditional family shipping business has always been the back bone of the Greek shipping industry. Which, do you think will be the shape of the modern Greek shipping company next century (staff, structure, management style)?

Although Greek Shipping shall continue to be family – driven, the traditional family shipping business model shall slowly disappear. Already, family businesses wishing to operate a handful of vessels in a traditional manner are on the defensive. They need to explain and argue their survivability to Banks, charterers and the market as a whole.

Greek traditional shipping businesses are thus faced with a dilemma and have 3 main alternatives to choose from i.e. either a) expand rapidly via rapid acquisition of modern tonnage, b) expand the size of their operations via joining forces with other firms, or c) seek to survive in their existing family form against odds.

Expansion via rapid acquisition of tonnage is more attractive since it is also coupled by the prevailing investment opportunities due to the current shipping slump. This may also explain the recent enormous increase in buying interest for 10-15 years old built dry bulk tonnage that has always been the backbone of such family shipping firms. However, such rapid expansion requires a substantial capital commitment and does entail high risk in the event that market expectations of a recovery do not materialize.

Expansion via joining forces with other similarly sized and run shipping family firms is an obvious alternative but does run against the spirit of Greek entrepreneurship, which has for a long time stood for individual decision making rather than collective deliberations and decisions. In the event that the current slump shall continue for a long time, which shall put into jeopardy the very survival of these family firms, then the amalgamation alternative shall begin to be favoured.

In addition to the above, the younger generations of family members have grown in an environment where there are alternatives to shipping investments that may offer equally or more attractive investment characteristics. Thus, we have seen some evidence that the younger Greek family members are hesitant to commit capital to shipping when the risks / rewards do not justify such actions. An example of the above can be found in the recent Lygnos case where the surviving family members did not commit capital to saving the shipping business when under pressure from the market and banks for substantial equity injections.

PETROFIN has predicted that there shall be a substantial and significant reduction in the overall number of Greek Shipping firms over the next decade. The speed of this consolidation will largely depend on the performance of the shipping market, since an early recovery across all sectors may temporarily delay this process. Furthermore, the continuous preference of Banks for larger shipping companies shall also play an important role in this consolidation process.

As the size of each shipping company increases and management departs from the strict family model so will their structure and nature of staff change. Increasingly, outside highly qualified family members, the style of the Shipmanagement Company itself will change and shall become more professional. Greater use of outside consultancy finance shall be used in order to enhance the potential of each shipping Group.

Already, younger professionals have eagerly adopted IT as their operating style and are thus closer to the main market trends of new technology, increasing regulations and compliance, ISM, preventive maintenance and so on. This management style shall become more open within the shipping company itself and information shall be shared. Whereas decision making will still rest in the hands of individuals (singly or jointly), the process of investment appraised and analysis shall increasingly bring the younger generation and middle management into such investment decisions. As the management style, staff and size of Greek Shipping companies change, so will Greek Shipping begin to adopt a corporate structure that has the additional advantages of being able to tap into developing US Capital style of products and services.

The process and effects of raising "public" capital shall further distance the traditional Greek family firm from the development of main stream Greek Shipping. After all, Greek Shipping firms shall need to prove the attractiveness of shipping investments to outside investors who have an abundance of investment alternatives.

The cyclicality of the shipping market, low returns and big losses in crisis periods have been made bank involved in shipping feel tired. Do you consider likely an eventual massive withdrawal from the shipping sector?

This is a very opportune question. Shipping is a major component of transportation, which itself is a very significant sector in the world economy. As such, shipping cannot be ignored for long by the banking community. However, the current emphasis and strategy of Banks have been to a) promote fee related products and services (which are viewed as risk-free) and b) conserve their capital and as such, generate greater earnings per share for their shareholders. Since shipping is 100% risk weighted for capital purposes, banks shall continue to favour other forms of lending unless shipping yields and the prospects of market recovery change the balance in favour of shiplending.

Since shipping is a capital – intensive business with a voracious appetite for funds and as its cyclicality and boom to bust conditions have become legendary, increasingly banks downgrade their commitment to shipping but rarely depart altogether. Instead, they seek to develop "niche" positions within shipping is such fields as syndicators, advice and structuring of mergers and acquisitions, new products and services etc.

Invariably, during a shipping market slump some Banks experience losses e.g. DNB. However, thus far, shipping banks have weathered the market storm pretty well and large losses have been largely contained. As such, according to PETROFIN Research, although the number of active shiplending banks has reduced from 201 in 1996 to 161 in 1998 and the trends is continuing, the numbers will no doubt start to rise again once the shipping markets shall begin to recover. In addition, numbers in themselves may be falling rapidly but shiplending capacity itself is falling at a much slower pace.

Any maritime bank withdrawal can be viewed as a temporary phenomenon since loan margins and terms shall thus improve and will create the conditions for a return "en masse" of banks. It is said that Shipping Bank memories are short and that Banks repeat their mistakes of the past thus paying the price. This is an oversimplification as Banks have shown in this shipping slump that past lessons have not been forgotten. In additions, the emphasis on client quality, size and selectivity is further proof of Banks' adaptability and response to the cyclicality of the shipping market.

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Which will be Banks' stance vis-a-vis owners with small number of ships, new shipowners and owners of aged ships?

Small shipping companies have felt the brunt of change from shipping Banks policy, which no longer focuses on small clients. Where clients have developed a good record with their Bank, they may continue to enjoy some flexibility from their Bank due to this client relationship. In cases, however, where their Bank may be leaving or de-emphasising the shipping sector, the process of identifying alternative banks has become difficult. We at PETROFIN try to assist in this process and reduce the above degree of difficulty by addressing the concerns of banks and enhancing the quality of such shipping proposals.

As banks themselves become larger via mergers and take – overs, so do their minimum lending criteria rise. As such, both the size of the transaction, as well as, the size, structure and quality of clients have become more important and small shipping companies often find themselves out in the cold or do receive very harsh terms from banks.

The problem has become acute with the hostile attitude of banks towards newcomers. Even where such newcomers are form within the shipping industry itself and wish to enter the market at a low point in the shipping cycle, invariably all banks will find it difficult to obtain credit approval for such fresh clients wishing to enter or re-enter shipping unless there shall be other exceptional or mitigating circumstances.

The same applies for small owners with overage tonnage or clients wishing to acquire further overage tonnage.

It is self evident that the barriers to entry for shipping are rising fast across all sectors as banks, insurers and chartereres couple with increased regulation and minimum fleet size consideration are all pulling the shipping industry towards greater consolidation.

Which Banks do you expect at this stage to quit the Piraeus Shipping market for what reasons?

There has been a tendency for foreign Banks with a limited presence to reconsider their position in Greece. This is not only as a result of the current shipping slump and low levels of activity but also due to the overall corporate strategies of such Banks on a worldwide basis. Let me explain this remark further.

International Banks have joined in a frenzy of consolidation whereby Regional Banks wish to become National Banks and National Banks wish to become International Banks. The strongest development has been in International Banks wishing to become Global players e.g. DEUTSCHE BANK, ING, HSBC etc. They feel that unless such banks enjoy a top Global position, they might as well withdraw from smaller sectors and commit their resources elsewhere.

Coupled with all the above factors has been the development within the Greek banking market itself. Driven by competition and consolidation, as well as, the eventual eradication of same lucrative business such as Foreign Exchange (due to the Euro) and the need to develop a large Greek presence in order to efficiently compete, smaller foreign Banks have begun to leave Piraeus e.g. CREDIT LYONNAIS, NATIONAL WESTMINSTER etc. They could not justify the investment resources needed to develop into bigger players in the Greek market in the face of the prevailing competition and alternatives in other countries / sectors.

This trend will continue but need not be feared by the market since a) shipfinance can be obtained from banks operating outside Greece and b) shipping has attracted Greek Banks that wish to develop an active presence in this key sector for Greece. As such, the investment in Greek Shipping shall continue but will involve fewer foreign players with a presence in Greece in the next 5 years.

Which is the relationship between Bank finance and bond issues which have recently made their appearance?

Both loans and bonds represent a shipping company's obligations used in financing their shipping assets. Their main differences are that bonds tend to be longer term, have a higher annual cost, are expensive to issue, require excellent market timing, are inflexible, involve more parties than the traditional Bank – client relationship, are bureaucratic and time consuming for the management of the shipping company and may be available at the wrong time in the shipping cycle. However, they do offer interest only payment terms and allow shipping companies to a) enjoy higher leverage and b) achieve rapid expansion and grater economies of scale.

Bank lending and bond issues have both an element of competitiveness and complimentarity. Past bond issues did prepay shipping loans (much to the relief of Shipping Banks who witnessed their subsequent III performance). However, they do also represent another tool in the arsenal of shipping companies in their drive towards the build – up of large and modern fleets. The risk / reward criteria of Bank lending and bonds are different and as such, the element of competition is small. However, it does represent a further reduction in shiploan demand for Shipping Banks by major shipping companies who represent the very target of their marketing.

Shipping bankers, however, themselves, have distanced themselves from High Yield bonds by saying that they represent expensive and opportunistic borrowings that may be available only for limited periods of time, whereas they (Banks) provide consistent, inexpensive and responsible financial support to sound, quality and less aggressive shipping companies.

Lastly, Banks have commented that the combined bond issues over the last 5 years represent a tiny fraction of banking shiplending volumes.

Our opinion is that corporate "shipping paper" of investment (e.g. ELETSON) rather than "junk" grade shall increasingly by used by the large shipping companies as shipping joins the ranks of all the other industries that have followed the same road. As such, both investment grade bonds and junk bonds are here to stay.

How do you see Banks' attitude during the current difficult period and what are your suggestions to overcome present problems?

With the exception of a couple of mainly US based shipping Banks, all Banks have performed admirably during this shipping slump. It seems that the lessons from the past have indeed been learned. As such, patience and restructuring of repayment terms have dominated Bank – client relationship.

Most Banks have been trying to work with their clients to "weather the storm". As such, shipping companies' failures have been mainly linked with the failure of the shipping companies' management to co-operate successfully during this trying period with their Banks. No doubt there are numerous exceptions, but on the whole since Banks have tended not to look for trouble, the owners of keeping the relationship gong has largely fallen on the shoulders of shipowners. This "truce", however, cannot last forever. As values and cash flows have disintegrated, Banks are increasingly behaving as "owners". It is only natural that if a shipping company exists only with the support of a Bank, that the Bank itself shall increasingly "call the shots".

In the event that the shipping slump lasts for a further 1 – 2 years (coupled with a further slowdown in the world economy and international trade) then the supportive attitude of Banks may indeed change. As the age of their collateral increases and cash flow problems multiply, their patience will begin to wear thin. Even when shipping departments may be still supportive, their senior management may feel less willing to wait forever. In conclusion, therefore, bank reaction to the shipping crisis has been excellent thus far but the crisis is not yet over.

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