
# TED PETROPOULOS: Big schemes are not always beautiful

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"Small shipping companies have left the brunt of change from shipping banks policy, which no longer focuses on small clients," Mr. Ted Petropoulos had stated six months ago during an interview to ELNAVI. The same he believes today as he says that 'the most interesting feature has been the development of a 2-tier structure whereby small owners are facing dearer terms and lack of finance to grow their business."

Mr. T. Petropoulos, the managing director of PETROFIN S.A., is an experienced banker who has worked for a long time in foreign banks with a long shipping tradition. In this issue he speaks about the challenges which are to be faced by the Greek shipping industry in the few years regarding the ship finance environment.

### *How can capital demands in shipping be met today?*

The shipping industry's capital requirements are increasing. This is not so much due to an increase in newbuilding costs bit more due to the higher replacement number of vessels across all sectors, given the relatively high and still rising age of the world's fleet. As such, both loan capital and equity capital requirements are rising. The latter, though more rapidly since there has been a reduction over the years of loan to asset values offered by banks in reflection to the industry's cyclicality and higher risk. As such, the industry's equity capital requirements have risen much faster. In order to attract the required equity capital, the shipping industry must:
a. Offer higher rewards given the inherent risk, and
b. Attract capital from additional sources.

There is no evidence as yet of an increase in the shipping industry's rewards. However, the industry has made definite moves to attract increased loan and equity capital from the international capital markets. In addition, it is expected that institutions (investment, pension, unit funds, etc.) will show an increasing interest in shipping as the industry's risk / reward profile shall become more attractive over the years in order to attract and reward the increased capital required to finance its growth arising from both demand, as well as replacement factors.

### *What are the objectives of the equity issues in the stock market?*

The main objective is to raise capital at the lowest possible cost in terms of dilution to the existing shareholders of a shipping group. In addition, a public company can finance its growth via acquisitions, using new share issues instead of cash. Developing a high price / earnings (PE) ratio for a company's share price provides an inexpensive way to finance growth through acquisitions. Lastly, public companies enjoy a higher quality status, which assists them in obtaining better terms from banks in developing larger and more international joint ventures and to attract quality staff in enjoying economies of scale and so on.

### *Has the high yield 'junk bond' market been firmly closed?*

The junk bond market has not doubt been adversely affected by the numerous defaults. The investors will wish to reassess their criteria and appetite for this type of risk and bond costs are likely to rise. In addition, an issue's structure terms, as well as quality of future issues are likely to be closely scrutinized.

In particular, exit mechanisms will be re-examined and provide the investors with enhanced rights to take over fleets and deal with problems, as they shall occur. The days of 'cowboy' issues are over for the time being. The next issues will as usual pay a dearer price for the failure of the past.

## *Why even owners who are going public, are relying on bank loans?*

Covering all one's capital requirements via equity issues is not efficient. Don't forget that shareholders own part of the business and should share in the profits. In cases where returns on capital employed are substantially higher than the cost of banking loans, it makes financial sense for owners to raise bank loans. The cyclicality of the industry, however, suggests caution and a reasonable ration of bank debt to shareholder's equity.

Stock Markets present an excellent opportunity for growth. Does this apply to the majority of Greek shipowning companies?

Greek shipowning companies have been built up on the family or partnership model. As such, transparency and crystal clear accounting have not been their best features. However, the lure of easy and inexpensive capital has put pressure on greater transparency and an improvement in accounts records and financial forecasting and controls. The development of both the equity and the investment markets has encouraged owners to upgrade and adjust their postures. This process has been assisted by the presence of an ever-growing army of well educated and information friendly middle managers, who feel at ease with these evolving requirements.

## *Shipping banks are more cyclical than the shipping business itself. Is it true?*

It is largely true. The attached published Petrofin research tables amply demonstrate the point. It is not surprising though, since banks react positively or negatively to the shipping market cycles. Such cycles affect both the demand for bank loans, the yield / terms available, as well as, and most importantly, the perceived risk / reward potential of shipping loans over the next few years. Shipping loans compete with other industries' loans and they will only be developed when conditions are at least as favourable as those of other industries. Moreover, shiplending requires a high level of expense and a commitment to the industry. When times are difficult it is not unusual for new banks entering the shipfinance sector to be fewer than when conditions are more favourable.

## *How important is flexibility as key element in a genuine relationship between shipowners and bankers?*

Trust, mutual respect, quality financial information and support are the key elements in a genuine bank-client credit relationship. A commitment to the industry from both parties and a relationship approach are also important. Flexibility in itself is only important in finding ways to address problems as and when they might arise. Banks must show flexibility when adverse factors are market related and exogenous as opposed to client oriented. As such, a market slump should be responded to more flexibility than a management or operating systems failure.

## *How important is it to choose the right syndicate partners?*

The responsibility of choosing the right syndication partner rests with the syndicate leader. They re always leading shipping banks with a wealth of experience and an international quality reputation.

Nowadays, in order to improve on syndication flexibility and to avoid every single minor participant to enjoy a veto, decisions are taken on a majority basis with the leader having the most influence.

Up to mid '98, shipfinance became over-banked and combined with excess liquidity. What are we now experiencing?

Overall banks have developed a more careful lending policy influenced by the recent shipping slump. As such, lending ratios have fallen, yields have risen and lending terms have hardened. However, the most interesting feature has been the development of a 2-tier structure, whereby there is flexibility and competitive finance available for top tier selected clients, where as there is hardly an interest for smaller clients. This flight to quality and size has created a problem for the smaller owner who, in addition to facing a disadvantage due to lack of economies of scale, is also facing clearer terms and lack of finance to grow his business. Over time, banks will realize that big is not always beautiful and that an owner's character and commitment to repay loans are often worth more than the size of an owner's fleet. In addition, over time the above small finance niche will without doubt be covered by fresh and more commercially minded banks.

## *Are you optimistic for the future?*

With vessel values across all sectors being at higher levels than can be justified by the present freight levels, it is a matter of time for either freight levels to rise or for vessel values to retrench. At this point in time, a great deal of a vessel's value is related to the market's expectation of higher freights. Should the freight rates improve, then vessel values will rise to perhaps levels last seen 4 years ago. Petrofin's forecast is for a better market next year for drybulk and container shipping and a tentative recovery fro the tanker sector after some further initial weakening. As such, should our forecasts be realized, vessel values shall continue to show improvements. The improvements are largely demand related, since international trade is expected to grow next year at substantially higher rates of approximately 4-5% per annum. Specifically, many eyes are focused on the Panamax and Capesize sectors and the ability of the market to absorb newbuildings as well as scrapping volumes. The markets are very sensitive to excesses in demand and supply. From a fundamental and cyclical analysis' points of view, however, the next expected move in values and freights is expected to be upwards.

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