Weathering the financial storm

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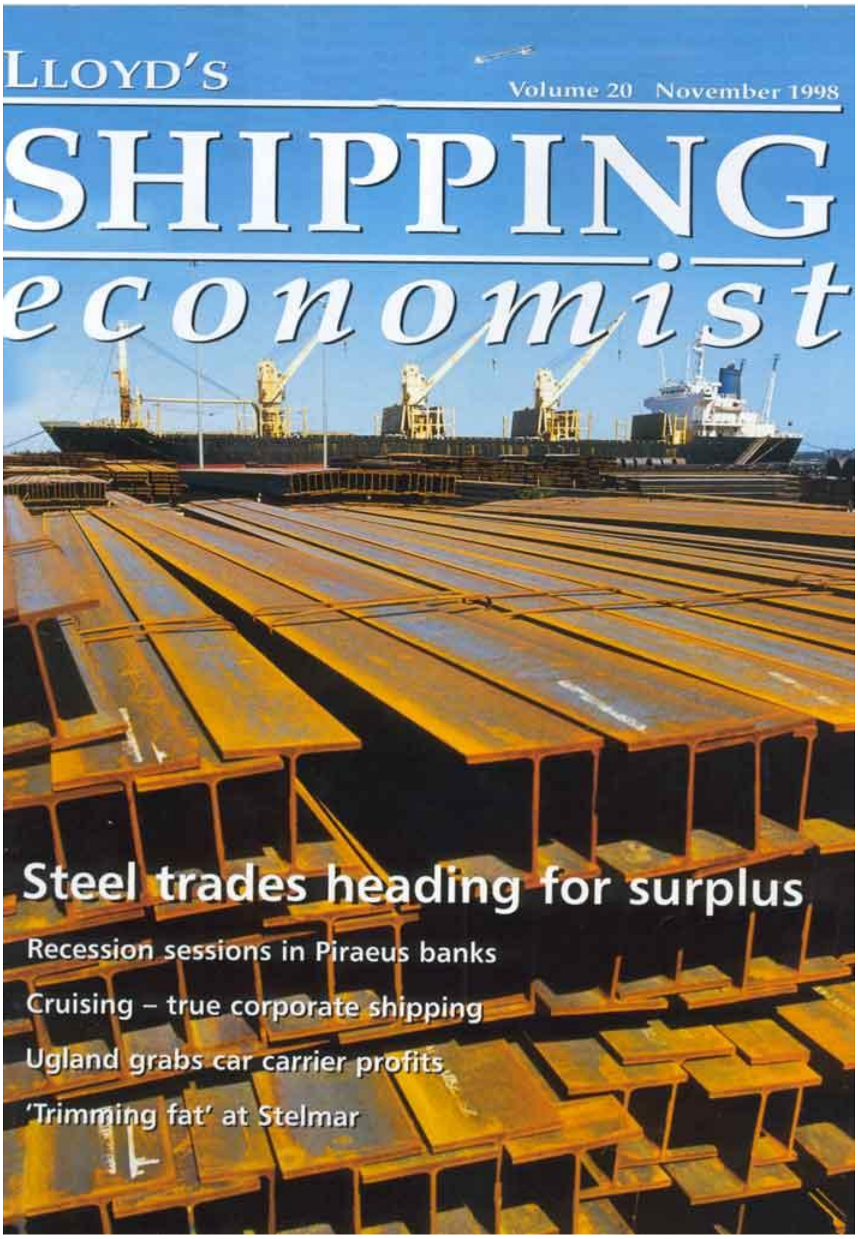


In the wake of the Asian crisis Greek shipping operators hope financial institutions keep faith with them in the coming months

There have been turbulent times since May last year when LSE, on a visit to Piraeus, found the long-established players in the market under attack from the expansion policies of other shipping banks as well as younger rivals, who saw the maritime industry as one which could increase returns in a tight lending market.

Since then the Mediterranean shores have seen the US investment banks arrive to offer Greek owners the chance to refinance fleets or plan for rapid expansion into the middle- and upper-tiers of shipowning.

Other European banks have arrived in Greece to offer loans at cut-throat prices, and with weakened terms and covenants that have caused raised eyebrows among Piraeus regulars. However, the time has come for a thorough review of existing portfolios and a check on the performance of various loans that may have been made at the top of the market.

Bank/owner relations

One of the most vital aspects for the banks is how they tackled the relationships with owners who may have had different ideas. **Ted Petropoulos, managing director of Petrofin,** said: "The first two definitive signs of the downturn came in 1996. We calculate a ratio of buyers and sellers, defined as those who are ready, willing and able to buy or sell. This showed us that the market sentiment had turned negative for our clients between 1996-97."

It did not appear that things were going too badly – until the Asian crisis demonstrated what was happening globally and what could happen locally. The day-to-day impact on Greek banking business has been varied, but everyone admits that it has been very strong.

"Shipping finance activities have been reduced to very low levels," said Mr Petropoulos. "The finance going on is strategic; that is to say, it is directed mostly towards new vessels on either time charter or contract of affreightment basis or replacing older sold tonnage. New deals represent about one fifth of our current business. Now we have to deal with lot of problems, potential problems and Greek-style merger and acquisition activity."

Greek M&A activity usually comes in the form of joint ventures. For advisers such as Petrofin there is also an increased amount of advisory work for shipping funds and banks with troubled portfolios. Christos Kokkinis, shipping head at Alpha Credit Bank, says that there have not been any 'major accidents' yet.

"It appears that banks have behaved quite maturely this time," he said. "All the banks are monitoring their portfolios quite carefully, but on a day-to-day basis they will still do business with their loyal customers. If they move we have to be there for them."

Mr Kokkinis said that there were groups inspecting vessels, but there is no high-quality tonnage being sold. "Good vessels hold their values, and there is liquidity around. It will return when the vessels become available and global uncertainty recedes," he said.

Nicholas Karellis, head of Midland's Greek shipping office said: "Our business has not been affected. We have more incremental business due to our acquisition of the Barclays portfolio, but in all 1998 has been a good year for us in terms of fees. Our provision for losses is tiny, 0.15% of the total portfolio." This is hardly crisis management, but Midland has the reputation of being fairly 'risk averse'.

It may be fair comment for individual banks to deny they are experiencing any problems, but there is no doubt that problems do exist. One way of spotting them is to see which banks made loans to owners who bought at the end of 1997. This could be considered the top end of the market for vessel values when compared with freight rates.

Under pressure

The minimum loan to asset value covenants must be under pressure, and committees may begin asking if there is value left in these loans that can now be claimed. The order of the day seems to be reschedules and deferments, in order to avoid foreclosures.

"Certain customers have found themselves in difficulty, but it is not that unique in a market like this," said Ian Fisher, commercial credit manager of Royal Bank of Scotland in Piraeus. “Security and liquidity covenants are under pressure, and in a very few cases we have asked for additional security. Foreclosure is a very expensive and time consuming exercise that most of us want to avoid.”

Mr Fisher believes that this is a very extreme measure, but added: “No doubt there are rumours in Greece that some owners have been foreclosed on by banks, but it is very few though.” RBS believes that we are looking at a downturn, but not on the scale seen during the 1980s. “Lots of owners have been prudent and maintained high levels of liquidity this time round. Owners are in the most part well prepared,” said Mr Fisher.

Each shipping sector has experienced downturns at different times. However, the Greek shipowners have had a traditionally high exposure to dry bulk. Different banks have different exposures to the sectors; therefore the worries are not uniform. Sensible risk management implies a split between tankers, containers and dry bulk which RBS believes is happening for both banks and shipowners.

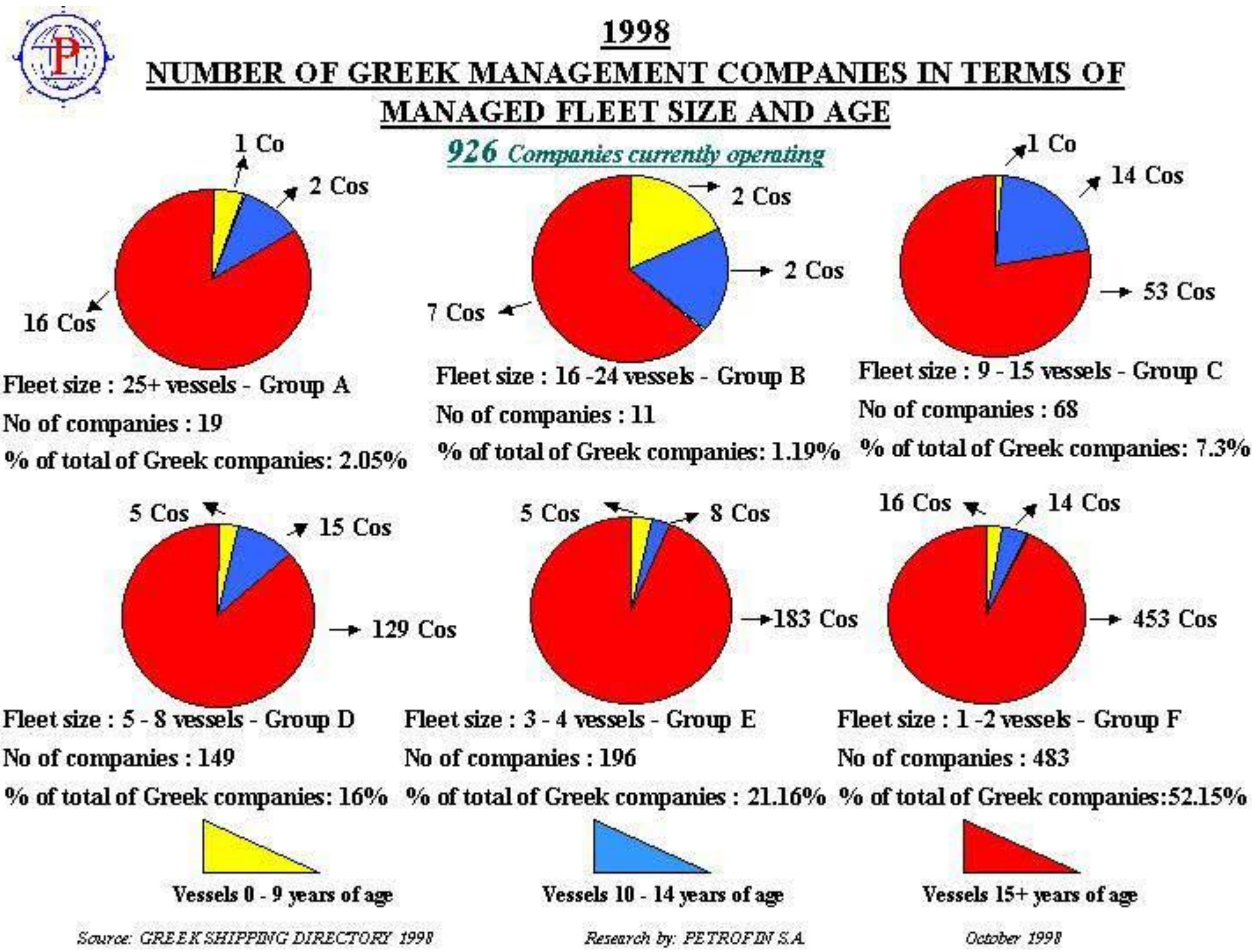
Dry bulk exposure

“The Greek fleet is more diversified now. Historically it has been heavily weighted towards dry bulk, but it is gently moving away from this. It is expected that the wet market will not be so robust next year though,” said Mr Fisher.

“Most of the Greek fleet still concentrates on the dry cargo market as spot operators,” said Nick Vouyoukas, of Scotiabank in Greece. “Naturally Greek shipowners suffer from reduced vessel values and tight cashflows. I believe that this is the same problem for any spot dry cargo operation, irrespective of nationality. On the other hand every other shipping sector, maybe with the exception of cruises, is suffering, whether it is reefer, tankers or containerships.”

When asked whether dry bulk downturns are more acute at the moment for Greek owners, Mr Petropoulos said: “With the exception of the Far East this is true. Greece has been hit hard because of its age profile and its market profile.” Petrofin’s research bears out Mr Petropoulos’ analysis: in a 1998 market survey of 926 ship managers in Greece, 453 have only one or two vessel operations.

Greek Shipmanagement Companies by Managed Fleet Size and Age



This demonstrates that over 50% of Greek owners could be considered marginal. On top of this, 90% of the vessels owned by this sector of the Greek fleet are over 15 years old. “This is the most suspect area of the industry. It is over-age and in dry bulk,” said Mr Petropoulos.

Larger owners are thought to have prepared for this eventuality with liquidity and will be in a position to consolidate if they have the desire to purchase older tonnage. But this may be unlikely as much of it is already available, even though the sale and purchase market is still silent for the most part.

“The severity of the problems very much depend on when you lent into the dry bulk market,” said Mr Kokkinis. He believes that loans extended in 1995 “will have some follow through”, but those who extended the majority of their portfolios in the last six months are “the lucky ones”.

“People are cautious, but not panicking. In the previous crisis, owners could hardly cover operating expenses, but today it is possible for most owners to make interest repayments. Everyone is affected but owners who can put their hands in their pockets can still get deals done,” said Mr Karellis.

When asked if there had been a change in the types of business proposals that owners were coming to the banks with, Mr Petropoulos said: “Bonds and IPOs have vanished from the Greek markets. Sale and leaseback is much more prevalent from the Far East. These deals are still at unrealistic prices though.”

Emphasis on liquidity

Despite the decrease in vessel values the percentage of finance offered has decreased. The emphasis is firstly on liquidity, then the level of equity, followed by the age of the assets in question. Banks such as RBS do not approach sale and leaseback and, in particular, bond issues. "Some of our owners looked at them [and did them], but there are very few bond deals floating around today," confirmed Mr Fisher.

"The business proposals are not so different now as our deals tend to be traditional shipping finance. There are many more newbuilding proposals at the moment and a definite move towards younger fleets." This has been triggered by the implementation of ISM, the increased burden of port state control and commercial maintenance costs. "If you begin with a vessel that is wholly acceptable to inspections the maintenance costs are lower and the headaches less," said Mr Fisher.

Speculative newbuilding projects have landed on more banks' desks, according to Mr Vouyoukas. These relate to the competition among yards and the currency weakness of the Far East. Sale and bareboat charter-backs with Korean owners have also been agreed, while Scotiabank has considered a "small number" of high-yield bond issues via Scotia Capital Markets in New York, "but the owners did not proceed due to the deteriorating capital market conditions", said Mr Vouyoukas.

Flexible banking

It is felt that the flexibility of banks in the mortgage-backed lending arena will make or break some deals, but the owners that chose bond deals are finding that the flexibility of bond holders may seriously block escape routes. The bond market did have a competitive effect on Greek business, but it came and went. Owners may well see that loan finance is a very flexible and prudent form of finance, particularly in a market downturn when banks can adjust repayments and possibly even terms.

The banks and owners have now put together strategies to weather the slump in both the shipping and global finance markets. Mr Petropoulos says that the banks are in the process of restructuring their current loan portfolios. "This is their goal at the moment and it is being achieved," he said. Banks are remaining selective and cautious in financing new projects.

The implication is that lending officers are joining forces with existing clientele and putting together deals in anticipation of the collapse of asset values or the widespread selling of younger tonnage at distress prices. "That might be the case," said Mr Kokkinis. "They [the owners] are not eager to buy today. Liquid owners are not in a hurry. Strategically, if it takes a year then so be it. We have 30-40 customers that have not bought anything in two to three years."

Owners are also coming to the banks that are not showing signs of nerves and asking them to begin or renew relationships. With owners talking about fleet renewal programmes, the banks are obviously only too keen to offer terms to get the business for the whole fleet. However, Mr Petropoulos said that while big names might be renewing fleets, the majority of Greek owners are not necessarily in the position that the banks believe they are.

"Banks are hardening across the board. This is mainly on the older vessels as banks have given up on an older vessel market recovery," he said. Damning indeed. "There are mostly terminal scenarios for older vessels. Banks will only help younger tonnage." If Mr Petropoulos' figures are correct, then foreclosure could be potentially imminent for a raft of Greeks.

If the bottom of the freight market has been reached, then perhaps the much vaunted concept of counter-cyclical lending can begin. One experienced banker commented that he believed that counter-cyclical lending was a phrase bankers used to intellectualise a coincidental phenomenon from the past.

Certainly, indications are that counter-cyclical lending is not necessarily something banks genuinely consider. “It works for owners and not for banks. The system does not reward long-term ship finance players who lend to the bottom of the market,” said Mr Petropoulos.

“People didn’t predict the start [of this recession], so they can’t predict the end. Much depends on the Far East,” said Mr Fisher. This indicates the lack of motivation for speculative projects in the current market. As was described in LSE (October, p29 ‘Equity markets suffering’) vessel values have not as yet dropped sufficiently, but the more relevant fact seems to be the Greek insistence that no deals will be done until the Far Eastern shipping companies roll over, leaving their new tonnage ripe for the picking.

Mr Petropoulos, in common with many others in the shipping community, believes that we are at the bottom of the market in the dry cargo sector in terms of rates. “In 1999 we will see modern tonnage from the Far East available at low prices,” he said. Mr Karellis said that he is optimistic in the long term, but there was more pain expected in the coming three to four months.

This opinion is widely echoed across the market. “BFI should remain between 850-1100 over the next year, but panamaxes have lost 50% of their value in 12 months for certain aged vessels,” he said.

The competition among banks in Greece has been cut-throat for some time, but the current market conditions have led to an easing in the potentially damaging situation. “Up to mid 1998 we saw cut-throat competition from a number of overseas banks,” said Mr Vouyoukas. The newcomers were very flexible in loan covenants and accepted low price/return on equity for their shareholdings. There has been a change of scenery as credit squeeze is becoming evident, with marginal lenders withdrawing and existing lenders consolidating. It seems reasonable to expect that the asset/balance sheet growth of most banks will be limited.

The investment bankers seem to have disappeared as quickly as they arrived. Most people believe that the US investment banks will return when the market allows, but they only seem to appear when problems arise from existing deals. Mr Petropoulos said that he had noticed an increase in delegations from the US and overseas, but they did not appear to be carrying out marketing for new clients. In terms of competition he said: “The competition for the top tier is still cut-throat, but deals are being turned down for the small- to medium-sized owners.

Opportunities

“I don’t believe that the US banks are as committed to shipping as the European banks. The latter look for relationships for the most part, whereas the US banks, with the exception of Chase and Citibank, look for capital opportunities compared with other industry sectors. People in these banks are knowledgeable, but the boards see better risk/rewards elsewhere,” said Mr Petropoulos.

Although these points are not specific to Greece, it seems to be as prevalent in this market as anywhere else in Europe. Reports suggest that spreads over Libor have increased as much as 30% for US banks, compared with less than 10% in Europe. It is heavily rumoured that two medium-sized US banks are actively discussing an exit from shipping.

One of the signs to look for when a bank is heading out of the market is not that hard to detect. If a bank does not bend in any respect and chooses to use its credit terms in a bad market such as today’s, it is inviting a foreclosure scenario. One would assume it was seeking an exit.

Prices for shipping loans have drifted upwards again in Greece, but Mr Fisher does not see this as a bad thing for banks or owners. “OK, it is not ideal for owners, but pricing must be done according to risk. Over recent years, there wasn’t an appreciation of risk. Owners will accept that pricing should reflect risk,” he said.

With the growing trend of multi-banking occurring more readily in Greece today, owners are more likely to play banks off against each other. “One is always cognisant of market pricing, otherwise you will lose market share. It doesn’t mean that you are going to like it, but you must know it. We have tried to move with the market, but we have not been leading it downwards,” he said.

Bankers in Greece believe that the majority of shipowners are prepared for a downturn and have liquidity to support current shipping investments. Mr Vouyoukas said: “It will be a matter of testing their personal commitment in the business. Unquestionably a number of shipowners without extra resources and a small number of large shipowners with highly leveraged fleets and weak cashflows may be the next victims of the shipping crisis.”

Mr Fisher added: “There are very few people throwing their hands up in horror yet. There are few people in sack-cloth-and-ashes mode.” Mr Petropoulos was not so sanguine in his appraisal: “Owners were prepared for a short recession, not one that lasted from 1996 to 2000. Time charters have run out or been handed back. The banks are toughening and there will be trouble.”

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