The state of financial health of Greek shipping. What financial burden does the enormous Greek newbuilding order book pose to Greek owners and banks?

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By Ted Petropoulos

MD, Petrofin S.A.

We are currently living through the biggest banking crisis since the Great Depression. Poor investment and credit decision on a massive scale have affected all banks to a varying degree, depending on their individual exposures. This has resulted in an unprecedented erosion of banking capital, which has reigned in the ability of banks to continue financing their large and expensive organization via increases in both lending and risk taking additional exposures. In addition to increasing layoffs and a pronounced slowdown, banks developed mistrust of each other's financial health and interbank liquidity dried up. There was the usual 'flight to quality' seen in every financial crisis. Hence the need for central banks to temporarily abandon their tight monetary policies aimed at controlling inflation and the need to pump huge amounts of short-term liquidity into the banking system.

The most exposed or friendless banks, e.g. Northern Rock, Bear Sterns, etc. had to be bailed out to cushion the shock to the system. Others faced the risk of being swallowed up by their competitors.

To fight off the banking crisis, banks had to seek additional capital from Far East and Middle East investors, dismiss tainted bank managements, develop tighter operating plans, reduce costs and carefully control new credit and investment risk.

One significant by-product of the crisis has been the re-evaluation of credit risk with banks insisting on higher yields and stricter lending terms.

The shipping industry which has thus far escaped largely unscathed the impact of the banking crisis, has nevertheless started to be affected. Although, on an industry level the fundamental demand and supply positions remain supportive for the next couple of years, banks have begun to focus increasingly on the perceived risks of the industry's huge newbuilding order book and the possibility (relatively high probability) that the increasing supply of vessels shall drive freights lower and send shipping into recession with plunging values and shrinking vessel cash flows. Shipping banks caught in a pincer between the banking crisis and the supply risks facing shipping, have begun to examine critically whether they should continue increasing their lending into shipping at this juncture of time. There is evidence that many banks have slowed down or even stopped their fresh lending, e.g. HSH, RBS and many others. This act, coupled with shipping portfolios' natural runoff via repayments, has resulted in a significant slowdown in the rate of growth of shipping credit.

This slowdown could not have arrived at a worse moment for the industry, as it had to finance its newbuilding order book. Many owners had failed to secure pre-delivery and post-delivery finance. These owners had expected that the days of easy and cheap credit would last forever.

As uncovered owners ran to the banks to secure finance over the the last six months, they found an increasingly frosty reception and a significantly higher cost than they expected. Moreover, many had placed orders in the firm expectation of eventually securing 80% or higher finance and some had expected not to put up much capital in the expectation of higher newbuilding prices. As such, their capital resources appeared less than the new capital requirements. So, what is going to happen and how vulnerable is Greek shipping and the owners with uncovered finance for the newbuildings?

Let us look first at some numbers. According to Clarkson's, the current world fleet consists of 50,696 vessels of about $1,088.7mn DWT and a total value of $1.1 trillion. According to Clarkson's, as of 1st April 2008, the ships on order were 8,754 of 510.5m DWT.

Indeed Clarkson's value the newbuilding order book at $488bn of which $300bn refers to orders payable within the next 2 years. In a recent article, Clarkson's were quoted as estimating that the $300bn figure has to be compared to the total US credit card debt market of $915bn. Furthermore, the total shipping investment between 1990-2000 stood at only $200bn! Claskson's also estimated shipping industry's earnings at approx. $100bn per annum.

Interestingly, if the fleet is worth $1.1tr and has $100bn annual earnings, the Price to Earnings ratio (P/E) is only 11 times earnings, which is hardly excessive when compared to the P/E ratios of other industries.

Within the context of the above colossal statistics, Greek shipping represents a significant force.

According to Petrofin Research © about to be published, the total number of Greek (flag and interest) ships at the beginning of 2008 was 4,545 of every type and size, totaling 222,368,310 tons DWT. As such, in comparison to the Clarkson figures, Greek shipping represents 9% in terms of number of vessels and 20.4% in DWT terms. According to just published Petrofin Bank research © the total drawn, outstanding loans provided to Greek owners by banks as of 31/12/2007, are $45.37bn. Please note that we refer to actual exposure and not commitments (which stand for a further $21.56bn). Consequently, using the Greek fleet numbers of 4,545 vessels , is $9.98mn per vessel on average. The average DWT per vessel of the Greek fleet is 48,926 tons DWT. Since the average age of everything that floats under Greek interest is 18.4 years old, then, it is obvious to see that the above bank exposure per vessel of $9.98m is close to being covered by its scrap value.

Although the fleet consists of every type, size and age of vessel, the above loan average per vessel hardly appears excessive, especially bearing in mind the high average DWT per vessel of the Greek fleet.

Another useful indicator would be the Greek fleet's asset cover ratio, i.e. ratio of total value over bank debt.

There are no Greek fleet value figures available. However, if the world fleet is valued at $1.1trillion by Clarkson and the Greek fleet accounts for approximately 15% of the world fleet (using an average number of vessels and DWT), then the value of the Greek fleet could be estimated at approx $165bn. If so, then the gearing of the fleet is approx. 27.5%, i.e. total bank debt / total value. If only 27.5% of the value of the Greek fleet is debt, then Greek shipping is not over-borrowed.

A third measure would be to seek to determine the Greek fleet's annual cash flow, net of operating expenses and interest. Once again, there is no reliable analysis. However, as a guesstimate, and using our own analysis, I would estimate the net cash flow to be approx. $19bn per annum, using current fleet income averages, operating expenses and bank interest cost.

Using the figure of $19bn, then the current total of Greek fleet bank debt can be repaid in approx 2.4 years if current incomes continue. Once again, using the above as a guesstimate only, Greek shipping's cash flow appears well capable of repaying bank debt.

Furthermore, Greek owners have built up their liquidity substantially, especially over the past 5 years, enjoying record cash flows, as well as profits from re-sales.

To conclude, therefore, on the question of whether Greek shipping is over-borrowed, it would seem that taking into account the fleet's value, income, debt obligations and liquidity, Greek shipping as a whole, is in sound financial condition and well placed to meet future challenges and opportunities.

According to Nafitliaki, Greek newbuilding orders (actually contracted) currently stand at 1,054 vessels of 49.9m tons DWT. This represents 12% of the world newbuilding orders, in number of vessels and 9.77% in DWT terms.

In value terms, Moundreas estimate the value of the Greek newbuilding orders at approx. $32bn. If correct, then the order book would represent approx. 17.7% of the current value of the Greek fleet. As such, the Greek fleet as a base in DWT and number of vessel terms, appears well capable of absorbing the above order book. Indeed, to a large extent, the current fleet is largely financing the required installments of the fleet on order.

According to Petrofin Bank Research ©, the total bank undrawn loan commitments as of 31/12 2007 stood at $21.56bn. We estimate that 80% of this figure represents newbuilding related finance, i.e. $17.25bn. If so, assuming that the $32bn Greek order book value requires finance of approx 70% i.e. $22.4bn, then it would appear that approximately 77% of the Greek order book, has already been secured. This could leave a further approx. $5.15bn in additional finance to be arranged over the years. Compared to the total current bank exposure of the Greek fleet of $66.941bn, the above additional requirement spread over the next few years appears not to present a problem. In addition, as the current fleet debt is being runoff, banks could easily cover the required finance by utilizing loan repayments in their existing financed fleets.

Consequently, it can be well argued that current concern over both the health of Greek shipping in the event of a market slowdown, as well as the non availability of newbuilding finance are to a large extent groundless. Of course, the situation need reviewing at frequent intervals, especially if the ordering spree continues.

Thus, Greek owners need not rush now to secure finance of the newbuilding order fleets. They should allow the current banking crisis to blow over, effect installment payments using their spare liquidity and obtain post delivery finance closer to each vessel's delivery date.

Seeking finance at this time can 'seriously damage the financial health and pockets of Greek owners' as loan terms are currently expensive and owners will probably require to refinance such loans at the first opportunity once market conditions shall normalize.

It makes sense, therefore, for banks to seek to secure new finance from quality clients at this time, when the balance of power has shifted in their favour.