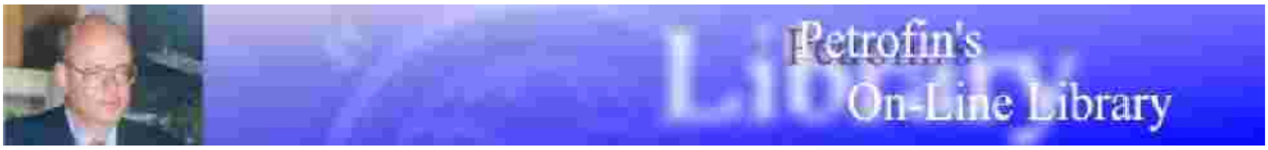
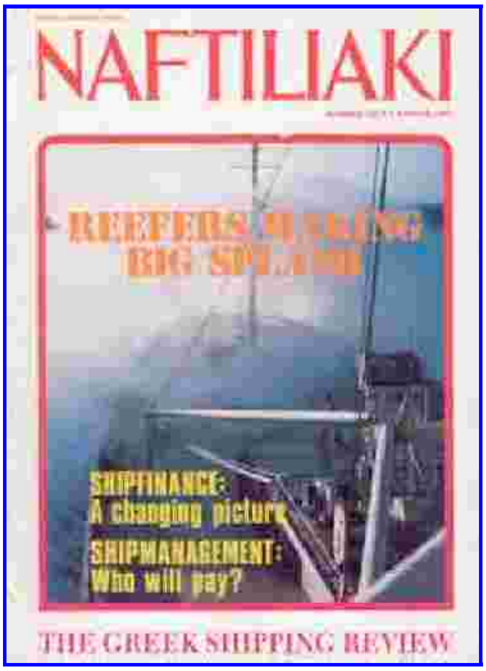


Vessel values may mark time

Interview with Ted Petropoulos, MD, Petrofin, Naftilia Winter 1991



What, do you believe, will be the main features and ou ook for dry cargo shipping in the 1990's?

The seeds of shipping developments in the 90's were sown in the 1980's. I am not referring only to the shipping crisis of 1982 – 1986 and its associated far-reaching effects, but also to the seeds of later devel pments in the world of banking, insurance, shipbuilding and repairs, as well as marine technology. As such, I will seek to reply to your question by identifying the indigenous, as well as exogenous facto hat affect the shipping industry and its performance in the 1990's. For it is a performance from an investment point of view that is and must be paramount to everyone's eyes. The shipping industry, with few exceptions, has generally failed to generate the investment return ecessary to allow the healthy replacement of tonnage to meet the shippin cargo requirements of the 1990's and beyond.

Investment performance will be determined by the differential between vessel income and expenses over the life of a vessel, discounted by the appropriate interest plus risk factor. This investment erformance (expected and actual) must compete favourably against the investment returns of other industries or alternative forms of in ment.

Taking each consistent of the equation in turn and com encing with operating expenses, we observe that these are rising a a much higher "inflation" rate than the prevalent rates either in the USA (the h e country of shipping's currency), or internationally. This is the result no so much of seamen's wages inflation but primarily due to two factors, namely a) maintenance and repair cost escalation and b) insurance and P&I cover cost escalation.

The former is the result of the ageing of the fleet, requiring greater maintenance and repairs, the finite number of yards actively engaged in this work (following the 1980's, which witnessed the disappearance of many small and large yards) and the increasingly strin ent standards imposed by classification societies, national and international legislation and the driving up of prices by yards who have not had the "upper hand" for a long time. At the same time, owners are keeping eir vessels longer since they have work for these at attractive rates, th st of replacement is excessive, borrowings are generally low and technological change has slowed down, giving such vessels a longer life span.

The latter factor, namely hull and machinery insurance d P&I cover, is a cost that has suddenly emerged as a powerful cost fact specially for overage tonnage. The reasons for this abrupt cost escalation lie with the rapidly increasing number of claims, mismanagement and her irregularities associated with Lloyds and its syndicat an underestimation of risks and over competition in the market as a whole, as well as the high cost of repairs.

It is expected therefore that operating costs will rise significantly over the next few years, thus eating into the net operating margins of vessels.

On the income side, the market is showing promise, sin rates have been steady, despite the slow growth in the world GNP, the socio-economic problems associated with the readjustment of the ex-Eastern bloc countries, the international banking crisis and the Third World debt problem. As the world economy recovers, and given the lack of marine n wbuilding orders as well as the increasing age of the fleet, the outloo appears promising.

In a sense, shipping will reap the benefits of the 1980's crisis which unleashed forces that benefit shipping in the 1990's. However, shipping freight rates will have to rise, simply to maintain net operating profit levels, given the already mentioned rise in operating expenses. There is, however, an additional factor that will adversely affect operating margins. This is the cost of borrowing which will undoubtedly rise from the very low historical levels of 5-6% today, towards 10-12%, which represents a more accurate longer term average figure. I doubt if t e inflation problem has been overcome and, no doubt, it will return as the world economy recovers.

Increasing the discount factor in the shipping investm t equation has dramatic effects on the net present value of investmen and renders today's prices as excessive. Furthermore, even taking into account the excessive cost of newbuilding, secondhand tonnage vessels values have risen to the level that discount an awful lot of good factors. In short, either freight rates will rise substantially to overcome the egative factors of increasing rates, or vessel values will be adjusted downwards.

The whole process may be delayed, should world economi growth, international trade and the "peace dividend" all come larger than expected. However, it is possible that having reached these leve ssel values may mark time for a while, simply to catch up with the eco omic fundamentals of the shipping industry.

What other factors do you foresee as affecting the shi ping industry?

In addition to energy costs, barriers to trade, and un redictable world events, I believe there will be profound changes in th ields of the capital structure of the industry, its ability to attract fresh capital and the role of banks. The huge shipping losses of the past have taugh investors to be wary of shipping investments and banks to look for sub antial equity in the financing of vessels / fleets.

I anticipate that the "shipping stigma" will largely disappear, as the industry continues to display relative stability and attractive returns on investments begin to be realized. AS such, shipping will attract substantially more capital from both international and national stock markets, shipping investment funds, private investment ols and individual participants.

On the negative side, there is the international banking crisis, which is linked to loan losses and provisions and the need to i crease banks' liquidity ratios. This will adversely affect the ability of banks to lend the huge amounts of money necessary to finance the shippin industry in the 1990's. It is strange that, for a change, whereas shipping is doing well, many banks willing to do shipping finance, have problems not associated with shipping.

The combination of reduced leverage and high equity from own / third party sources is good for the shipping industry that h ended to over borrow in the past, even though the returns on equity ay be reduced as its result.

The increased bank selectivity of clients and the high file and substance necessary for shipping companies to attract third party funds may drive out the smaller shipowner. This will be a pity, since Greek shipping, in particular, has relied on its large number of smaller shipowners for its overall size, strength, flexibility well as providing a learning ground for the future.

What do you think will be the future role of financial advisory institutions in the 1990's?

Shipping financial services institutions (whether financial advice or brokerage driven) will continue to develop and rise in number, as well as increase their coverage of the market. The simple reason lies with the fact that they "add value" to the shipping industry by assisting both shipowners and banks in taking better and timely decisions based on improved information, analysis and strategy.

As the shipping industry becomes more sophisticated an quires increased standards of management, reporting, investme t appraisal, decision making, financing and organizing structures, the role of the independent advisory financial institutions will becom important ingredient to success.

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