THE ART OF SALE DECISIONS

By Ted Petropoulos
Head
Petrofin Research ©

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A lot has been written about the art of vessel purchase decisions. Supported by IRR (internal rate of return) and NPV (net present value) analyses, as well as an assessment of the selected sector cycle position, purchase decisions can be made with some supportive evidence. The uncertainty over such decisions lies with an appraisal of future income and vessel values, with all the risks this carries.

However, assumptions can be made as to future trading and value conditions, as well as interest rates, which affect the financial cost of such purchases involving finance. These can vary and form part of the investment's sensitivity analysis.

The key element underlining purchase decisions is 'counter cyclical play'. This is an area, where Greeks , Norwegians and Danes amongst others, as well as Far Eastern owners, have performed quite well up to now.

A purchase decision can also be influenced by the amount of capital and / or finance required, which would determine the number of vessels to be acquired and the timing of such decision.

A purchase decision is often a leap of faith, as it demands a high commitment by an owner. In addition, the opportunities offered by other sectors, where an owner has competency, should be assessed, so that enhanced decisions can be made.

A sub-segment analysis and other issues (technical, shipbuilder, specification), which also impact such decisions, shall not be explored in this article, even though they have integral importance.

Returning to the subject matter of this article, we will now look at the similarities and differences associated with sale decisions.

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Under normal circumstances, a sale decision is easier in as far as a sale produces a clear result. This result should cover the return of capital and the determination of profit (if any) achieved, as well as the actual generated IRR achieved. Nevertheless, there are numerous factors that need to be considered, the main ones of which are the following:

1) Whether to sell, if a sale results in an overall loss of capital or paltry investment returns. Under these circumstances, an owner will be tempted to hold on to the investment with uncertain implications. In the event the investment demands further capital losses for upkeeping, these implications become more complex and time sensitive.

2) The 'greed' factor. This is a significant factor in as far as most owners would tend to delay a sale decision (especially if the asset has not produced satisfactory results) in the hope that freight rates and vessel values will continue to rise or, at least, hold at the prevailing levels. Owners are risk takers by their very nature, since they opt for a high risk investment, such as in shipping with all its uncertainties, hence, the 'greed' factor, otherwise known as a "better opportunity down the road" is quite deep seated.

3) There is a tendency for the majority of owners to give a higher probability to markets staying as they are. This inclination is supported by brokers' analyses, which tend to forecast either "more of the same" or a mild rise of the market. Although there are some instances, where brokers' research points out to a sale decision, experience shows that most forecasts tend to be pretty flat.

4) The 'minimum fleet' considerations. It is common for owners (especially those involved in one shipping sector) to wish to keep the size of their fleet in order to support their management costs and to maintain economies of scale. Sales, therefore, are often seen as 'negative' decisions for the office and not just an opportunity to realise a

profit or reduce risk. Minimum fleet considerations weigh heavily on owners' minds.

5) What to do with the cash? Owners are looking for investment opportunities and wish to keep their capital invested and earning high returns. Many owners are unhappy with holding on to excessive cash for long periods of time. The issue of what to do with the cash becomes stronger when an owner has not identified suitably alternative investments to replace the asset he or she is contemplating liquefying that inevitably weighs on the sale decision.

The exception is owners believing that a market has peaked and they are involved in only one shipping sector. Their willingness to hold cash increases in anticipation of better re-entry opportunities, down the road.

6) Opportunities in other sectors. Where an owner is diversified into more than one shipping sector, opportunities in other sectors may be grasped. For example, strategic decisions of diversified owners to enhance their LNG fleet, whilst selling dry bulk vessels. In the event that the owner is a single segment owner, this fact raises considerable concerns for owners who lack the will to pursue such alternatives. It should be noted that owners strongly prefer to be investors as well as managers of vessels instead of investors only.

7) Financial hardship. Where there may be loan breaches or potential breaches and underlying lenders of vessels become financially pressed, owners may be forced to sell some or all of their vessels to relieve finance related predicaments. Such pressures may well unduly affect an owner's sale decision.

8) Regulatory, technical or environmental considerations. In periods where there are major changes in the industry e.g. IMO 2020, vessels may need to be sold if they cannot meet such regulatory, technical and /

or environmental changes or the cost of doing so is prohibitive. Such changes may also prompt vessel renewals with younger, more modern vessels that would meet all the anticipated requirements and being, at the same time, attractive to charterers.

9) Sales dictated by loan balloon issues. Most loans have loan periods significantly lower than the vessel's trading life, hence the existence of a last balloon loan repayment that can often be high. With banks and lenders in general focusing on younger vessels, the ability to find lenders to refinance such balloons may be very limited. Under such circumstances, owners may well be forced to sell.

10) Scrapping prices. High scrap prices induce owners to sell vessels close to the end of their useful trading life. In contrast, low scrap prices, which also affect older vessels' residual market values, dissuade owners from selling "until better days".

The above 10 factors form the key sale determinants and owners need to consider all of them in reaching their sale decisions. Often, the success of owners would depend on their ability to sell assets primarily at opportune times, thus realising their investment potential and switching to other opportunities. This is vital, as it is well known in shipping that successful sale and purchase decisions often strongly outweigh trading profits.

Owners should concentrate on identifying investment opportunities in other size, types or ages, which would heavily influence sale decisions. It is vitally important for owners to have a free hand in such decisions and not be pressed by liquidity or finance considerations.

In conclusion, sale decisions are often as difficult and perhaps more so than purchase decisions and the success of owners increasingly rests on their ability to sell assets at the right time, thus yielding maximum returns. Over time, owners become quite skilled in such decisions and many develop them into an art.