Do public shipping companies have any real equity left?

To recover, the industry needs smaller, more efficient players to emerge

Paul Slater

Danish owner Norden has taken a substantial asset impairment charge of $300m, representing some 11% of its fleet book value.

IN MY previous articles, I outlined the current problems facing the shipping industry and suggested that the great shipping recession will continue for several more years.

I also suggested that most of the shipping banks had contributed to the debacle through irresponsible lending and were now struggling to extricate themselves as asset values continue to decline.

It is astonishing that lenders and investors still do not see the connection between declining charter income and declining asset values, and continue to buy shares in companies that have negative equity if their ships are marked down to current market values.

It could be argued that ships are effectively current assets not fixed assets as they can be bought or sold in days in a highly efficient sale and purchase market.

Thus the balance sheets of most shipping companies that capitalise the cost of their ships and financially depreciate them over a lifetime of 25-28 years do not reflect the true value of the companies.

The US Securities and Exchange Commission has recently moved to require companies to show by way of note the annual shortfall between market values and book values of the ships: one assumes that in better markets a surplus would also be noted.

This is in a rudimentary stage and requires standardisation of the valuation methods and consistent reporting by all the public shipping companies.

There is a complete lack of consistency here, as some companies have taken an impairment charge in their accounts, some have followed the SEC request, but in different ways and some have done nothing. At the moment, it is impossible to compare one company's balance sheet with another's.

A recent survey showed that among the most significant companies are Excel, Eagle and OSG: all are reporting continuing losses and, in OSG's case, this is the 12th consecutive quarter of losses.

Excel is looking at a massive restructuring with a reported asset value shortfall of $1.6bn representing 62% of its book value.

Eagle, which is also in restructuring discussions with its main bank RBS, reports a shortfall of $667m or 37% of its book value.

The most worrying case is that of OSG, which has not shown a profit in three years, refuses to take any impairment change, has a large fleet of tankers of various sizes, most trading in the spot markets and has lost 90% of its share value since mid-2008.

With a current market capitalisation of just $335m and an asset value shortfall of $667m, the company has an effective negative equity value and $2bn of debt.

Moreover, the management has disclosed no plan other than waiting for the tanker markets to recover and there have been no management changes. The Recanati and Fribourg families who founded the company have bought stock all the way down from $30 per share in March 2011 and now show large losses on their investments.

While the company continues to pay a dividend it is difficult to see any value in the stock and, as most tanker experts predict the current markets will continue through 2015, it will need to shrink its fleet, reduce or stop its dividend, reduce its debt and cut its overhead to survive.

Eagle faces mounting criticism for its executive compensation. It still has to answer old lawsuits for past excesses. Once again, an over-large fleet of expensive ships, trading in effectively a single market, in which numerous other owners with cheaper costs are working, does not offer much hope for a speedy recovery.

RBS has to resolve its issues this year and without a significant injection of new equity from the founders, it may well foreclose and liquidate.

Excel is a similar mess with a huge fleet of loss-making ships, reported at $211m in 2011, a market cap of only $125m and debts of $1bn, approximately the same as its reported fleet market value. Again, the banks will find it difficult to continue without a significant investment of new equity.

Meanwhile, across the Atlantic, Norden in Denmark took a substantial asset impairment charge of $300m, representing some 11% of its fleet book value. This was probably done under International Financial Reporting Standards.

Excel, As Eagle and OSG report continuing losses, the outlook for world trade suggests a recovery is years away. *Bloomberg*

Several companies have tapped the equity markets with follow-on issues but they have been small and not well received. Existing shareholders in Navios and Tsakos, for instance, have seen their share values decline far more than the share increase percentage. Were these issues big enough and why buy more ships at the moment are among the questions being asked by investors.

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Capital Product Partners completed a private placement of some $140m on an expensive convertible basis, enabling it to defer debt repayments until 2016 and continue to pay its dividends. This is another indication of no recovery in the next three years, but again further reduces equity values.

At times like this and with the public company values at or near their all-time lows, one would expect some aggressive mergers and acquisitions.

John Fredriksen, for instance, could buy OSG — he has looked at doing so previously — with the interest on the interest of his capital.

The main reason for the lack of merger and acquisition activity is that the equity values of most public companies are inconsistent and, in some cases, totally unrealistic.

With ships trading predominantly in the spot markets, the companies have no brand or franchise value and no future contractual revenue and are crippled with huge debts on ships whose values have declined sharply from when they were ordered.

Restructuring inside or outside the bankruptcy courts has happened in a few cases and others are in negotiation. But with banks converting debt to equity and virtually wiping out the existing equity, we will have shipping companies owned by banks or private equity firms trying to compete with well-established private shipowners with plenty of capital.

Banks have never wanted to own or manage ships and private equity companies do not have the knowledge or experience to do either. New owners or managers are reluctant to take over ships if the banks continue to maintain their existing debt levels, as even the interest costs are unaffordable in the present markets.

The banks have to face the music and reduce the outstanding loans to a level where the ships can trade profitably with quality management, proper maintenance and cash reserves for drydockings and unscheduled repairs.

Nickel-and-diming on operating costs by inexperienced investment managers is a recipe for disaster as ships operate 24/7 in the most hazardous and unfriendly environments and need experienced, properly paid crew to run them.

If the freight markets continue to trade at present levels — and unless they double or triple by 2015, even the restructured debts will not be serviced — the equity will have a nominal value.

Smaller, more efficient companies that are not trying to control markets but provide a quality service to cargo owners provide the way forward and these can emerge without using public equity.

Industrial shipping is the carriage of cargoes for commercial customers, preferably on a regular basis, ordering new ships to meet the customers' changing requirements.

The ships that have been bought or ordered for unspecified trade in the spot markets have caused the vast oversupply that needs to be worked out before any new orders are placed.

The lack of bank finance and absence of new equity sources will help to stabilise the markets, but the economic outlook for world trade suggests any recovery is many years away. ■