Making a market

Basil M Karatzas offers a 'seakeeping analysis' of vessel asset prices

Although the second half of 2008 raised sea-changing developments in the shipping industry that brought a vertical dive to the very bottom of the abyss for freight rates, within nine months the markets bounced respectably back to approximately break-even freight levels.

At that stage of the cycle, most companies and shipowners still had working capital aplenty, and the drop to the bottom had been as swift as the ensuing rebound, and thus held out a sliver of hope for a more fundamental recovery.

In addition the "priming" of the world economies and the generous "quantitative easings" was at "full steam ahead" setting, and there were extenuating circumstances in certain market segments. For example, in the first half of 2009, 30% of the VLCC world fleet was tied up for storage projects on behalf of financiers playing the oil contango game and thus artificially maintaining a higher tanker tonnage demand than in actual terms. All these factors meant that vessel asset prices didn't fluctuate as dramatically as one might have expected, at least in a fundamental way. The limited transactions that took place then were from owners who got taken by surprise by the vertigo of the perfect storm, and thus most of those transactions were under distress and usually at rock bottom prices.

Almost three years later, the economic recovery has been agonisingly slow, almost like a slightly leftwards tilted L-shaped graph that some economists had expected. With new vessel deliveries flooding the market on a daily basis, a "jobless recovery" depending on monetary policies running out of funding in the West and a slowing Chinese economy, and a political crisis brewing in the Continent, freight rates have been hovering low, bouncing along the bottom, well below levels sufficient to make payments for interest and amortisation; and, in certain segments, most notably in the crude tanker market, even below vessel daily operating expenses.

While 2008 saw abrupt changes in the markets, since last year the markets have been experiencing the doldrums, a complete apnea as far away from any prevailing winds, tailwinds, tradewinds, westerlies or any type of forward blowing wind as possible. Actually, it seems that headwinds in some shipping segments and crosswinds in other have caused vessels to keep operating at below break-even levels burning cash and depleting working capital for about a year now, and thus have started pressuring downwards asset prices.

Although 2011 started on a even keel and with full sail dreams in terms of vessel pricing, the momentum has been deteriorating ever since, even more so since the end of the summer. The volume of deals has remained subdued overall with a "buyers' strike" in effect for transactions at prices that are not clearly in deep "value-territory" for any type of vessel. "Market noise" has been on an increasing trend with "chat" of circulation in the market of candidate vessels for "distressed" sales or restructurings.

For modern vessels, however, it cannot be said with absolute certitude that asset prices are falling in an "expected", sizeable, quantifiable manner, since the activity for the sale of such vessels is as thin as a spider's web. An obvious limitation of any value assessment for very

ASSET CLASS	JAN 01, 2011		JUNE 30, 2011		OCT 30, 2011	
	PROMPT RESALE	10-YR VESSEL	PROMPT RESALE	10-YR VESSEL	PROMPT RESALE	10-YR VESSEL
TANKER						
VLCC	$108.0	$60.0	$105.0	$58.0	$99.0	$35.0
SUEZMAX	$69.0	$40.0	$70.0	$40.0	$63.0	$25.0
AFRAMAX	$52.0	$28.0	$52.0	$27.0	$52.0	$23.0
MR TANKER	$36.0	$19.0	$38.0	$19.0	$36.0	$19.0
DRY BULK						
CAPE	$59.0	$38.0	$55.0	$35.0	$53.0	$28.0
PANAMAX	$36.0	$28.0	$34.0	$26.0	$33.0	$20.0
SUPRAMAX	$31.0	$24.0	$31.0	$22.0	$29.0	$20.0
HANDYSIZE	$28.0	$21.0	$27.0	$19.0	$26.0	$17.0

Table 1: Selective asset prices. Data source: Karatzas Marine Advisors

modern vessels is that such numbers have more of an "indicative" than "predictive" merit. There have been four transactions for modern VLCCs in 2011, with two of them at the beginning of the year under the auspices of the creditors to a buyer provided with generous financing even by pre-Lehman Bros excess liquidity standards, and two vessels to an industrial buyer six months ago. At least there have been four transactions in the VLCC market that are deemed enough to "make a market". However, there have been zero sales whatsoever for resale suezmax tankers year-to-date and thus any assessments are based in last year's benchmarks when more than $5bn were invested in this particular market sector.

For smaller or older tanker, dry bulk and containership vessels, there has been more activity in the open market and at arm's length transactions than modern, expensive tonnage. Surprisingly enough, since the end of the summer an increased volume of transactions took place for the first and second generation of double-hull tankers, and all such transactions took place at levels significantly below 'last done'. Most of such transactions, in our opinion, do not satisfy the definition of Fair Market Value (FMV) since they mostly took place for either tax reasons (leases) or under the strong 'encouragement' of the creditors.

Based on market data compiled by Karatzas Marine Advisors, Table 1 depicts "market expected" asset prices for prompt resale and 10-year old vessels in both the tanker and dry bulk markets at three points in 2011: during the first week of this year, the end of the second quarter and the end of October of this year. Such data are based on observations from market transactions assumed to represent arm's length asset exchanges taken place under no compulsion either from the buyer's or seller's side.

On Table 2, a basic calculation of percentage changes in asset prices is performed for both prompt resale and ten-year old vessels for the first half of 2011, the period between July and end of October 2011, and year-to-date until the end of the October. The first half of the year has shown that asset prices have held better than the later part of the year; modern vessels, especially tankers, held better than older or dry bulk vessels. MR tankers and supramax and handysize vessels seem to outperformed the remaining sectors in terms of least amount of decline, an observation also verified by the overall optimism (or better phrased, lesser extent of pessimism) in those sectors.

However, year-to-date the situation has been a bit more sober as it seems that modern (prompt resale) tanker and dry bulk vessels lost 6-10% of their value, while ten-year old vessels have dropped in price much more drastically. Ten-year old VLCCs and suezmax tankers lost close to 40% of their value since the beginning of the year, while equally sized dry bulk vessels showed a "better" performance with a loss of only about 26%. Overall, MR tankers for both prompt resale and 10-year old vessels retained their value, a corollary to the fact that the MR tanker was the first to take off like a rocket after Hurricane Katrina and the first to crash down to earth, with most of the pain behind the sector, at least at tonnage supply and demand dynamics are concerned.

Again, these calculations are based on observable data and under the assumption that such transactions are always open market, arm's length transactions, an assumption that has to be questioned in certain circumstances.

Modern vessels have not been transacted as frequently as older tonnage so far this year. A cursory list of explanations may include:

- They tend to have a higher cost basis and therefore their transaction might entail a bigger loss of money (equity and debt) in absolute terms; an equitable percentage drop in price translates to a much higher loss in absolute money for more expensive (modern) vessels than cheaper tonnage.
- Further to this point, modern vessels with high cost basis present a higher risk for price finding as an equitable percentage spread between "bid" and "ask" can translate to a much higher aberration from the market price, a risk not well bearable by buyers.
- At a time when banks are not cheaply funded and have to be conservative with their liquidity, usually modern, expensive vessels are more difficult to be debt financed; banks prefer smaller loans and cheaper vessels rather than concentrating their financing on smaller number of sectors or assets.
- Modern tonnage is usually technologically up-to-standards and therefore provides a lower risk of technological obsolesce and thus better prospects to weather out the cycle and any new regulations that might appear on the horizon.
- Finally, modern vessels, even those with a high cost basis, make much better candidates for restructuring, equity injections, and soft financing than candidates for outright sales in the open market; and, of course, "sales" on such bases are far apart from the parameters for the definition of the Fair Market Value (FMV).

Vessel asset prices have fallen more precipitously for 10-year old vessels than prompt resale tonnage. It's to be seen whether the 'market'correctly discounts a prolonged and anaemic recovery in shipping.

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ASSET CLASS	H1 2011		Q2 2011		Y-T-D 2011	
	PROMPT RESALE	10-YR VESSEL	PROMPT RESALE	10-YR VESSEL	PROMPT RESALE	10-YR VESSEL
TANKER						
VLCC	-2.78%	-3.33%	-5.71%	-3.33%	-8.33%	-41.67%
SUEZMAX	1.45%	0.00%	-10.00%	0.00%	-8.70%	-37.50%
AFRAMAX	0.00%	-3.57%	0.00%	-3.57%	0.00%	-17.86%
MR TANKER	5.56%	0.00%	-5.26%	0.00%	0.00%	0.00%
DRY BULK						
CAPE	-6.78%	-7.89%	-3.64%	-7.89%	-10.17%	-26.32%
PANAMAX	-5.56%	-7.14%	-2.94%	-7.14%	-8.33%	-28.57%
SUPRAMAX	0.00%	-8.33%	-6.45%	-8.33%	-6.45%	-16.67%
HANDYSIZE	-3.57%	-9.52%	-3.70%	-9.52%	-7.14%	-19.05%

Table 2: Percentage changes in asset prices. Data source: Karatzas Marine Advisors