Private equity becomes key

Difficult times call for fresh approaches to financing transport businesses. Barry Parker reports on new sources of funding available to the sector.

As the maritime industry sets up for a possible move off its cyclical floor, the secretive world of private equity is becoming more visible. Likewise, deeper pocketed cargo interests and state entities – whether in the form of sovereign wealth funds or guises of "rescue" vehicles – are also watching the market cycles, preparing for entry into shipping markets ahead of an upturn.

History shows that such a turn is not a question of "if" but rather of "when" the market's lengthy curve will swing upward. Market analysts have a variety of views on the trajectory of a future move upward, with allusions to 'U' shapes, 'V' shapes and 'L' shapes and its timing. There are green shoots emerging – even for shipping – but it must be viewed in the context of overwhelming overcapacity.

Over the past few months, there has been a steady murmur of private equity massing on shipping's sidelines. A cross-section has been mentioned in *Jane's*, including investment teams at Greenbriar Equity Group, DVB Bank, JP Morgan, Seabury Group and within Germany's Dohle Group. A panel focusing on alternative financing at an upcoming conference in London contains a complement of senior executives from financial investors Castle Harlan, Kohlberg Kravis Roberts (KKR) and Fortress Investments. The panel is rounded out by shipping stalwarts from recently formed Finamar, Eurofin and Tufton Oceanic.

Nature of investments

Equity analysts have grown more bullish on the downtrodden drybulk sector in recent months. Whether one believes that the upturn is real or not, a central question for financiers and investors is: What is different on this trip through the cycle? Depending on the answers, the nature of investments going forward may be different.

The research team at New York investment banking boutique Dahlman Rose, noting a pickup in Chinese imports of steel-related iron ore and thermal (steam) coal, stated collectively to *Jane's*: "We believe ship values are set to increase on the recent strength in charter rates." The bank team, led by analyst Omar Notka, has been quick to emphasise the salutary impacts of a rising freight market on asset values – and possible improvement in loan-to-value (LTV) covenants.

The team added: "Based on implied returns from current spot rates, we believe drybulk vessel values could see increases of 20 per cent, with additional increases possible should the firming continue. Such a move would have a significant impact on the highly levered structures of many within the drybulk group, and would lead to much higher equity valuations."

> **'The rapid rise in rates and forward sentiment has kicked the sale and purchase market into high gear'**
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> **Morgan Stanley**

Researchers at Morgan Stanley, led by Ole Slorer, are also positive on the sector, pointing to: "a series of data points suggesting improvements in the debt and credit markets, as well as positive sentiment on China-centric Asia".

The Morgan Stanley view echoes that of Dahlman Rose on the asset market. Morgan Stanley said: "The rapid rise in rates and forward sentiment has kicked the sale and purchase market into high gear." Debt providers are also seemingly sharing such optimism; shipowner DryShips has now cemented additional covenant waivers, this time on USD86 million of debt from lender DnB Nor.

Naysayers have called the new-found optimism a "bear trap" – a rally that might prove to be without foundation and therefore short-lived. Forward freight rates (FFAs) from the Imarex market suggest an abundance of caution. Spot US dollar-denominated day rates for capesize, panamax and smaller vessels are all well above forward "settle prices" for the second half of 2009, 2010 and beyond.

Janos Koenig, chief financial officer of Eurofin Group, a boutique investment bank and adviser, provided additional perspective. "It's perceived by some to be the time for investment now, but it's not clear whether prices have bottomed out yet. Will the recovery come in 2010, or in 2011? Nobody can say with certainty."

A veteran of shipping markets since the 1970s, Koenig explained: "Based on the forward prices the market does not believe in the recovery yet, at least in drybulk. Yet, it has risen well off the bottom. In historical terms, the rates we are seeing now would have been good rates. Compared to those of a year ago, the current rates are a pittance – people became accustomed to much higher rates. In that context, prices have gone down."

He said that the large war chests built up by owners during the good times meant that they can continue to service debt; this, coupled with banks providing waivers (with increased margins), rather than taking decisive actions, has kept ship prices above distressed levels. He told *Jane's*: "For these reasons, I don't think we have seen a real bottom yet."

Credit constraints

What is different about this cycle for shipping are the constraints on credit. Veteran shipping banker Bote de Vries, now at the helm of consultancy Finamar, told *Jane's*: "At this point in the shipping cycle the interesting part is that equity is not the limiting source of capital. An impressive number of equity funds are active or in the process of becoming active. Most of them are in the USD100 million-plus range. The return requirements these funds target are mostly high in the 20 per cent to 25 per cent range."

Finamar's story reflects the retrenchment of bigger institutions, with de Vries commenting further: "Quite a few banks left shipping, and the main banks have a strong focus on their core clients. For equity funds, the room to get senior debt is very small. All equity funds are chasing a small group of banks these days and senior debt is the limiting source of capital for shipping."

Koenig explained: "There is a real need for finance. One of the roles we play is that we are an outsourced finance department and we talk to many banks. Right now, there is quite a lot of

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