LSE 2008 stocks article	

The shipping stocks have proved to be one of most volatile sectors, in a year when the overall equity markets experienced a wild ride. Shipping veterans have been stunned by the quickness of the market's turnaround, and the extent of its fall. As the crisis unfolds, investors are worried about ship values, performance of charterers, ability to pay dividends, and a host of other issues.

To some extent, the sector's dismal performance reflects the meteoric rise it had undergone prior to the first week of June, 2008, when the Baltic Dry Index (BDI) peaked at 11,689 points. In December, after a 94% decline to the upper 600's, things were dramatically different than they were in June. On an earnings conference call, Mr. Ion Varouxakis, the President and CEO of Nasdaq listed Freeseas ("FREE"), with nine drybulk carriers, set the stage for the environment facing listed companies, telling investors and analysts: "We expect to take advantage of attractive acquisition opportunities which may arise only once in a generation."

By most measures, the BDI and the shipping shares have fallen harder than the overall market- which has crumbled by 40% - 50% between late May to late November, 2008. Viewed on a one year basis, the Marine Transportation Index (composed of 42 listed shipping equities) tracked by Dow Jones (publishers of the Wall Street Journal) has plunged 61.7% in the one year period prior to early December 2008 versus a 43.8% slippage for a broader group of industrial stocks in the same timeframe. Compared to other transportation modes, shipping's fall is dramatic, trucking stocks were down 15.0% and railroads down 19.0%. But the unprecedented collapse of the shipping stocks must be put in the context of the shipping sector's performance in 2007, when it was one of the top performing industry groups, alongside energy raw materials and commodity related issues generally.
http://online.wsj.com/public/npage/all_industries.html?bcind_compidx=&debug=&bcind_period=1yr

Table here of price development? This is in addition to the data sent over on Dec 1

		31-Oct 2007	31-Dec 2007	30-May 2008	8-Dec 2008
Dryships (dry bulk)	DRYS	$ 115.50	$ 75.82	$ 92.54	$ 7.17
year to date					-91%
General Maritime (tanker)	GMR	$ 25.06	$ 22.20	$ 26.66	$ 13.25
year to date					-40%
Seaspan (container)	SSW	$ 28.98	$ 21.57	$ 24.94	$ 7.94
year to date					-63%
Peabody Coal (coal)	BTU	$ 51.88	$ 61.34	$ 73.71	$ 18.44
year to date					-70%
BHP Billiton (iron ore)	BHP	$ 85.48	$ 68.61	$ 83.27	$ 35.23
year to date					-49%
Potash Company of Saketchewan	POT	$ 122.31	$ 143.53	$ 198.72	$ 61.33
year to date					-57%

By other measures, shipping shares have become cheap, as they were prior to the big runup in 2007. Two ratios widely used to gauge a share's attractiveness are the price to earnings ratio (P/E) and the price to cash flow (P/CF). The "P" is the share price in the market, the "E" is reported earnings per share. For capital intensive companies, "CF", which does not include depreciation (which lowers earnings), is a better measure of company results. For the broader marketplace, Barrons calculated the P/E of the Standard & Poors 500 index to be 19.0 x.

http://online.barrons.com/public/page/9_0210-indexespeyields.html

An early December Jefferies & Co. research report put the average P/E ratio for a composite of drybulk stocks at 1.3 x (down from 8.0 x as recently as July), and put the P/CF ratio at a meager 1.0x (down from 6.2x in July), based on likely earnings for 2008. Tankers were faring slightly better, with a group of tankers followed by Jefferies' analysts providing a P/E ratio 3.3x (and 5.0x for full dividend payers) and P/CF at 2.1x (and 3.1x for the yield oriented payout group). These numbers were down dramatically from mid July 2008, when tanker P/Es were 13.3 and 15.0x (high yield) and tanker P/CF stood at 6.6 x and 7.3x (high yield).

In the minds of many investors, "shipping" is synonymous with the Baltic Dry Index (BDI), a measure compiled by the Baltic Exchange from brokers' daily estimates of dozens of dry bulk freight rates and daily hires. The BDI's reach has extended beyond shipping. Among equity and commodity market investors, the BDI has become imbued with a near-iconic status as a barometer of the international industrial economies. The BDI's fall from a precipice presaged, and then mirrored, declines in prices for oil, coal, iron ore and other industrial commodities.

In retrospect, equity markets had peaked in October, 2007, a time coincident with the first of two tops for the BDI, and several months after the first inkling of looming troubles stemming from the U.S. property markets. Equities continued downward as concerns about a pending recession began to take hold, but shipping (as proxied by the BDI), traditionally a lagging indicator, made a last gasp in the Spring of 2008, fueled by Chinese ore stock-piling and a speculative fervor in the drybulk markets. In September 2008, the mood quickly shifted. Not only did the post Olympic bounce (hoped for by many shares investors) fail to appear, but recession fears spread rapidly across the very raw material markets that had fueled shipping markets, especially drybulk, since 2003.

When the credit market turbulence of September, 2008 came to the fore and spread to equities, the ebbing share price tide did not always distinguish among shipping sectors, nor did it spare those listed drybulk or container shares with charter books extending outward well into the future. Drybulk shares were hurt the most, with tanker shares hurt least. Dryships ("DRYS"), once a darling for "momentum" investors, fell 95.5% in the year prior to late November 2008. A number of its peers also posted declines of 90% or more. Over the same late November 2007 to 2008 timeframe, Nordic American Tankships ("NAT"), a dividend payer with low financial leverage (and therefore an absence of competing calls on cash generation) was down a mere 14%. Where drybulk owners had substantial "revenue visibility" (through charters employing their fleets through 2010, 2011 and beyond), investor concerns shifted to re-chartering risk, and, more ominously, the risk of defaults on the current charters. The fear, in the minds of analysts and investors, was that charterers who signed two, three and even longer deals could re-negotiate (a practice not seen since the mid 1980s). Either way, the result would be vessels re-chartered at a fraction of their healthy hires under charters inked before the plunge.

The BDI, which had already lost more than 50% from its May highs, accelerated downwards as bigger picture credit concerns seeped into the demand side of the shipping markets. Concerns emerged about the ability, or willingness, of funds-strapped financial institutions to honor letters of credit on shipments of commodities with drastically reduced values, leading to the potential of reduced demand as shipments could be cancelled.

The second peak in drybulk's double top, in May 2008, saw two Initial Public Offerings, as optimism about the sector brightened. Britannia Bulk (with a core business serving customers in the Baltic coal trades, complemented by a timecharter operation business) raised $125 Million in mid June, following Safe Bulkers (with a fleet of Panamax and Kamsarmax bulkers on charters) successful $190 Million IPO in late May. The two IPOs provide a study in contrasts. Safe Bulkers has remained out of the news, with its vessels continuing to earn charter hire (at healthy rates reflective of the strong markets in early 2008) and the shareholders receiving a targeted quarterly dividend of $0.475/share for 3Q 2008. Safe Bulkers' roster of period charterers, on 11 existing ships and two to be delivered, include solid names such as Bunge Corporation and Daiichi.

At Britannia Bulk, matters quickly moved out of hand, as it filed for receivership a scant five months after its IPO, at which time the company was valued at more than $400 Millon. The catalyst was a crunch in its timecharter business, with vessels exposed to spot rates in free fall. At mid year, Britannia Bulk had 53 vessels on charter (nine of which were ice class), contrasted with an owned fleet of 22 vessels (13 of which were bulk carriers). The crunch was complicated by inopportune timing of fuel hedging, where Britannia Bulk "locked in" through buying fuel hedges to cover Britannia's fuel exposure under contracts of affreightment (COAs). As fuel prices dropped afterwards, the net impact was an uncompetitive fuel cost, above the suddenly much lower bunker prices. A speculative purchase of FFAs, which subsequently fell in value, also contributed to losses in 3Q 2008.

At the time of its IPO, Britannia Bulk entered into a five year credit facility for up to USD 170 Million (at Libor plus 175 b.p.) with Lloyds TSB and Nordea's Danish office, and had drawn down approximately USD 158 Million through late October. The banks, who asserted a claim that the borrower had undergone a material adverse change, then demanded an acceleration of repayment. Use of IPO proceeds included the repayment to bond investors who had purchased $185 Million of 11% senior secured debt, in November, 2006. It is unlikely that Britannia Bulk equity holders will see their investment returned.

In the circuit of late October and early November conference calls with investors discussing results for 3Q 2008, a number of listed entities were expressing general concerns about potential charterer defaults. One listed company directly impacted was Star Bulk Carriers ("SBLK"), which had launched its IPO in late 2007, after coming to life through the mechanism of a Special Purpose Acquisition Corporation (SPAC). In October, the well known time charter operator Industrial Carriers Inc (ICI), which had filed in Greece for insolvency, gave back the 1993 built 175,000 tonner "Star Beta"- which had been fixed by SBLK to ICI for $106,500/day through 1Q 2010. Subsequently, SBLK re-fixed its "Star Beta" on a short term charter with iron ore behemoth Vale at rates of $15,000/day (first 50 days) rising to $25,000/day (balance of 2 – 4 month period) plus a ballast bonus.

Discussions about potential charterer defaults have permeated the markets, with the Baltic Exchange recently hosting a meeting to deal with this subject. Analysts assessing default risk have distinguished between "freight merchants" such as ICI, with no raw materials business to buttress the shipping activities, contrasted with end users (Bunge Corporation and Vale would certainly qualify, along with BHP and Cargill- organizers of the Baltic Exchange meeting). The CEO of Diana Shipping ("DSX"), a stock now viewed favorably due to low leverage and substantial charter cover, told analysts: "It's important to charter ships to end users because they have the urgency to move their own cargoes. We believe by sticking with them we have a better chartering position." Diana has recently placed its 2004-built Panamax "Errato" on a one year time charter to Cargill at $15,000/day.

The volatility in the equity markets has added to the challenges for SBLK's Greek sponsors. Taiwanese owner Nobu Su resigned from the company's Board in October 2008, after months of legal battling over the value of shares assigned to him at the time of SBLK's emergence as a listed company. Su, whose sale of 8 vessels from Taiwan Maritime Transport to the inchoate SBLK, had soured on drybulk and turned his attention to the tanker markets. During the year, Mr. Su's investment in Star Bulk had been reduced, from an initial level at 30% (in late 2007) to a stake closer to 5%, through private sales to Greek company directors.

In early November, 2008, SBLK filed regulatory documents presaging the possible sale of 4.6 million shares, either through a secondary offering, or a private placement. These shares consist of 3.8 million still held by a company nominated by Mr. Su, and another 0.8 million due to be issued to Mr. Su's nominee in 2009. While Mr. Su had argued SBLK should buy the shares back at a prices then north of $14/share, the market price for SBLK shares in November had dipped to $3/share.

Another shoe that could drop, in an environment of dramatic declines in ship values, concerns a breach of loan covenants on bank debt. In rising markets, and even steady markets, loans outstanding could comfortably remain in a permissible range; typically banks require a "loan / value" ratio of between 50% to 65%. In the short term, companies which have used bank debt to finance fleet expansions are now at risk of running afoul of the loan / value ratio as unchanged loan values are suddenly larger in proportion to diminished fleet values. Another secondary offering, for the benefit the company (contrasted with SBLK's offering- where an investor is selling shares), albeit with a severe dilutive effect, has been announced by DRYS. One way for borrowers to cure breaches is top repay debt; offerings of shares, albeit at dramatic discounts, may be one channel of raising such cash.

DRYS included requisite cautionary language about possible covenant breaches (not specifically the loan/ value), in its prospectus issued in connection with the fresh equity raise for up to 25 million shares. The trade press quickly picking up on the wording, and security analysts subsequently highlighted the potential for a loan/ value breach. DRYS's peers Eagle Bulk ("EGLE"), Genco Shipping & Trading (GNK), and Excel Maritime (EXM) were tarred by the same brush; with equity analysts questioning compliance with the loan/value strictures in credit agreements. As a practical matter, however, a technical breach does not automatically lead to an instant foreclosure by shipping lenders (who would presumably use judgment about the market, rather than acting immediately based on the ratios). Discussions of foreclosure also beg the questions of exactly who will the buyers be- perhaps FREE and companies with ample war-chests for acquisitions.

At a time of falling freight markets of early 2006 (a time not characterized by frozen credit conditions), DRYS speedily renegotiated a credit package with HSH Nordbank when faced with the potential for violating a ratio then in effect. Still, market analysts expressed concern over the pricetag on nine Capesize vessels due to be acquired by DRYS from Cardiff Marine, a private company tied to DRYS Chairman, for an implied aggregate price of $1.168 Billion (in the form of shares and assumption of debt).

Dividends have grown in importance over the past few years. Many of the listed shipping companies, especially those coming on the scene during 2005 – 2006, were using high dividend payouts and distributions to attract investors. Shipping companies, in a highly capital intensive business, have always had an uneasy relationship with payouts to investors (whether they are dividends from shares, or distributions from partnership structures). Cash conservation is suddenly a priority throughout the marketplace, with stated reasons emphasizing tight cash flows and the need to squirrel away cash (which might not be available from banks) for a coming climate of consolidation. As a consequence, dividend policy is now undergoing scrutiny across the spectrum of listed maritime companies.

Perhaps the credit crisis provides a blessing in disguise for drybulk owners whose capital structure could benefit by their retaining cash in the business. At one extreme, Diana Shipping (DSX) has chosen to forego the dividend following 3Q 2008, citing the need to build up its warchest. In the middle- SBLK has split the dividend into a cash and shares component, while Freeseas has cut its dividend, also citing the need to build up its dry powder for possible acquisitions. At the other extreme, Nordic American Tankers (“NAT”), one of the original full payout entities, actually raised its 3Q 2008 dividend to reflect the strong tanker markets during the recently completed quarter. Double Hull Tankers (“DHT”), also benefiting from the strong tanker markets in 3Q, also increased its outlay to shareholders, to $0.30/share (up from $0.25/share).

DSX’s CEO, Simeon Pallios, told investors that: "By suspending our dividend we free up cash to make investments such as vessel acquisitions, which would deliver significant returns over the next several years," noting that the decision to cut the payout was not taken at the urging of banks. Shipping loans often prohibit dividend payments (without lender consent), where a borrower has breached loan covenants- which is not the case at DSX, with debt at approximately 17% of its $1 Billion balance sheet.

Paragon Shipping (PRGN), a steady payer with a fleet of 12 Handymaxes, Supramaxes and Panamaxes all on period charters (with 90% coverage already on the books for 2009), continued to pay its $0.50/share quarterly share, but cautioned on its conference call that it could reduce its dividend going forward. Like its peers, it too noted that acquisitions may be available in a nearby market expected to stay weak. GNK continued paying its $1.00/share quarterly target dividend, but explicitly mentioned that its Board would look closely at dividends going forward. In reporting its 3Q 2008 results, GNK said: “The Board determined to pay the target dividend based on the Company's cash flow for the quarter. If market weakness and uncertainties persist, the Board will continue to take a particularly close look at the Company's dividend policy and target. In making future dividend decisions, the Board will review such factors as market conditions, Genco's upcoming cash needs and potential opportunities which may arise given the current market.”

Freeseas’ Mr. Varouxakis spelled out the new attitude about dividends: “Our Board has determined that the company's strategy must adapt to the new reality. Retaining cash will add to our financial flexibility in order to aggressively take advantage of the opportunities as they are presented.” The announcement continues: “Therefore, our Board has decided to revise our dividend policy. The dividend shall now represent 50% of distributable cash flow, after taking into consideration the company's expenses, debt service, and reserves including reserves for further capital investments into the shipping sector..”, The company then went on to announce a dividend of $.075 /share for 3Q 2008, down from the $0.175/share paid in previous quarters. Similarly, SBLK’s 3Q 2008 $0.36/share dividend is being divided into an $0.18/share cash component, and the balance in newly issues shares.

It is noteworthy that industrial shipping companies like DSX stand in marked contrast to consumer dependent cruise shipping behemoths Carnival Corporation (“CCL“) and Royal Caribbean International (“RCL“) to suspend their dividends. In the statements of both of these players, motivation for the moves is cash savings at a time of massive newbuilding programs in the face of likely revenue downturns at both at both.

Dividends’ metrics are now indicative of their state of flux. The P/E data (presented earlier using Jefferies & Co. analysis) demonstrate that full payout companies achieve higher valuations from investors. As the market has changed, one feature of the dramatic decline in the stock price are the outsized dividend yields on the shipping stocks. In the broader equity market, as proxied by the Standard & Poors 500 index, the dividend yield for 2008 was expected to be very close to 3.4%.

An early December 2008 research report by Morgan Stanley revealed that a composite of nine New York listed tanker stocks was yielding 18.4% based on likely 2008 dividends. A similar sampling of drybulk issues was yielding 33.5.9%. At end March, 2008, the comparable yields were 6.7% (tankers) and 8.7% (drybulk) respectively.

These high yields (computed by dividing the annualized dividend by the recent share price) can be interpreted in multiple ways. Where the dividend is viewed as sustainable, the high yield could be suggesting a potential rise in the offing for the stock price (causing the yield to slide down towards the broader sector’s measure). Given the changed conditions in the shipping markets as described, a more likely interpretation, inferred from the market’s valuations of the stocks, is that the periodic dividend payments will not be sustainable, either by management’s choice or by market circumstances.

Yield Table

Stock	Symbol	Dividend* Annual	Price 8-Dec	Yield	
TBS Bulk Shipping	TBSI	$ -	$ 6.13	0.0%	
Dryships	DRYS	$ 0.80	$ 7.17	11.2%	
Navios Maritime Holdings	NM	$ 0.27	$ 2.30	11.7%	
Safe Bulk	SB	$ 0.62	$ 4.09	15.2%	IPO mid year
Euroseas	ESEA	$ 0.93	$ 4.52	20.6%	
Excel	EXM	$ 1.20	$ 5.01	24.0%	
Navios Maritime Partners LP	NMM	$ 1.26	$ 4.88	25.8%	
Star Bulk	SBLK	$ 0.72	$ 2.12	34.0%	
Diana	DSX	$ 3.31	$ 9.62	34.4%	has suspended dividend going forwar
Genco	GNK	$ 3.85	$ 9.06	42.5%	
Paragon	PRGN	$ 1.88	$ 4.11	45.6%	
Eagle Bulk	EGLE	$ 2.00	$ 4.36	45.9%	
Seaspan	SSW	$ 1.90	$ 7.94	23.9%	
Danaos	DAC	$ 1.86	$ 5.20	35.8%	
Global Ship Lease	GSL	$ 1.46	$ 2.50	58.4%	
Overseas Shipholding Group	OSG	$ 1.50	$ 38.43	3.9%	
TK	TK	$ 1.14	$ 15.71	7.3%	
Tsakos Energy Navigation	TNP	$ 1.80	$ 19.29	9.3%	
General Maritime Corp	GMR	$ 2.00	$ 13.25	15.1%	
Nordic American	NAT	$ 4.89	$ 32.19	15.2%	
Teekay Offshore Partner LP	TOO	$ 1.65	$ 9.51	17.4%	
Teekay LNG Partners LP	TGP	$ 2.18	$ 9.98	21.8%	
Double Hull Tankers	DHT	$ 1.15	$ 5.03	22.9%	
Frontline	FRO	$ 8.25	$ 30.98	26.6%	
Teekay Tankers	TNK	$ 2.79	$ 9.12	30.5%	
Omega Navigation	ONAV	$ 2.00	$ 6.39	31.3%	
OSG America LP	OSP	$ 1.31	$ 4.15	31.6%	

GNK and Navios Maritime (NM) are both is illustrative of another noteworthy trend, have both cancelled unchartered vessels that had been slated for future deliveries. GNK, stressing potential opportunities to acquire vessels from distressed sellers, forfeited a $53 Million deposit that had been paid to Turkish sellers on six resales, valued at $530 Million, of vessels under construction. The loss of the deposit (that had been funded through GNK's credit line) makes good business sense. An initial calculation, by analysts at New York-based Dahlman Rose, puts a current value (post market collapse) of some $ 300 Million on the six ships- three Capesize and three Handysize. From a vessel value perspective, the forfeited amount pales in comparison to the $ 230 Million implosion in values of these six ships.

Analysts at Jefferies & Company noted that the salutary impact on GNK's projected debt to capitalization ratio (a measure of financial leverage), set to decline from a proforma 61% for 2009, down to 54%. Jefferies' analysts had estimated that $ 477 Million of liquidity will be freed up through reduced capital expenditures. In mid November, GNK subsequently cancelled a $ 320 Million five year credit facility that had been executed several months earlier (with a lending group led by Nordea), to partially fund the six ship purchase. GNK is among the drybulk names that analysts will be watching closely from the loan/ value perspective.

At NM (which has also adjusted its quarterly dividend downwards, effective in 4Q 2008) cancellations totaled 12 vessels to be delivered in the future, all unfixed. These include three Capesize bulkers (ordered by Navios at prices of roughly $110 Million each, for delivery 2009 and 2010) and nine other vessels (six Kamsarmaxes and three Handysize bulkers, all for delivery in 2010 - 2011) that were to have been chartered in. With large unpaid balances still due on the three Capesizes, NM estimated a savings on capital expenditures of $265 Million. The cancellation fee was a minimal $1.5 Million. Some $72 Million paid to a Korean yard (????? the Shungdong Shipbuilding yard????) will be applied against other ships on order at the same yard.

The containership owner sector, where the business model revolves around lengthy timecharters (and even bareboat leases), is also likely to experience turmoil. Seaspan ("SSW"), with 34 ships on the water and an equal number still on order, placed its newly delivered 2500 TEU "CSCL Santiago" on a 12 year timecharter to China Shipping Container Lines. On its recent conference call, its Chairman noted that its own charters are solid, but talked about the likelihood of newbuild cancellations throughout the liner sector, suddenly plagued by overcapacity in the face of a recession. Neptune Orient Line ("NOL"), an end user of containerships (in contrast to SSW, Danaos and Global Ship Lease- who own vessels chartered out to liner companies) has been featured in the trade press with reports of job cuts and pending vessel layups.

Share buybacks are another feature of the equity markets- these typically emerge when the equity markets are valuing shares at prices that are below the Net Asset Value (NAV) of company shares. NAV is computed by taking the value of the fleet and subtracting debt outstanding (with some fine-tuning). When companies see their shares priced well below what they perceive as their true value, based on metal less debt, they will sometimes purchase their shares back.

Buybacks have the short term effect of bolstering the stock price with fewer shares outstanding in the open market, leading to a potentially higher EPS number, with earnings unaffected by the buyback (unless it is financed with additional interest bearing debt). The Board of DSX approved a plan to purchase up to $100 Million of shares (more than 7 million shares based on prices at the time of the announcement) through the end of 2009. The Board at NM, which had recently completed a similar program worth $50 Million, has now authorized an additional $25 Million buyback program. Analysts at Dahlman Rose calculated NM's NAV at just under $5.00/share after considering the cancellations, more than double its recent stock price.

As dividends receive less emphasis, at least in the drybulk sphere, "value" (what is the stock worth, rather than how much does it pay out) assumes a greater importance. In the context of NAV computations, the cancellation of newbuilding orders at GNK and NM will raise the NAV in cases where the value has dropped dramatically. In the case of NM’s Capesizes (now worth roughly $65 Million each based on recent sales), the Dahlman Rose analysts attributed an NAV pickup of $2.00/share to the cancellations.

The NAV measure, dependent on a correct estimate of ship values, will increasingly play a role in the recommendations of Wall Street firms. Jefferies, with a specialist focus on the maritime sector, recently put a “Buy” recommendation on Aries Maritime (“RAMS”), a company that has seen difficulties across its tanker and container fleets. A Jefferies report summarized as follows: “We continue to believe that there is significant underlying value in Aries Maritime despite the less than robust operational and financial performance of late as the Company trades at a 90% discount to our NAV estimate based on last published asset values.” Conversely, Morgan Stanley’s caution on the drybulk sector referred to potential negative NAVs on many of the leading drybulk players: “With no NAV or dividend support for most dry bulk names anymore and the expectation that rates will linger around cash operating costs at least through 1Q09, even the most optimistic of dry bulk investors are likely getting jittery, in our view.”

So, what of the future? Famed business writer Michael Lewis, best known for his “Liar’s Poker” (describing his experiences at Salomon Brothers, now part of Citigroup, prior to the Crash of 1987) has now edited a book called “Panic: The Story of Modern Financial Insanity”. In a late November 2008 interview in the Wall Street Journal, Lewis said: “We have entered a period of risk aversion unlike anything we've seen in our lifetime. Investors will be too wary for a while.” He added: “The next rich wave will be those who figure out where the value is.” But value in the maritime context will depend on ship prices in synch with the real market prospects, hardly the case at present. Clearly, the maritime sector may once again prove attractive to investors, but only after “value” can be accurately assessed.