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Public players seize control of S&P

Traded bidders leave private owners in the dust, reports **Greg Miller**

Evangelos Marinakis raised eyebrows when he bought VLCC newbuildings at \$96.5M for his Crude Carriers IPO. Competing private bids for the same ships were reportedly in the \$80M range.

A month after Crude Carriers' debut, doubters were silenced. John Fredriksen's Frontline reportedly paid \$105M/VLCC last week (and is apparently offering \$110M for a newbuilding resale). Crude Carriers' VLCCs have immediately appreciated 10%.

But this 'last done' deal trend is deceptive, because private buyers eyeing the VLCCs bought by Frontline were still only willing to



Crude Carriers, led by Evangelos Marinakis (centre), has just bought two more tankers on top of its three-tanker IPO [Photo: NYSE Euronext]

pay in the \$80M range.

It's just one example of a game-changing and possibly permanent shift: private owners may no longer be willing to match prices offered by publicly-traded buyers

deploying their war chests. "The market is bifurcated. Publicly traded companies are setting the direction," asserted Basil Karatzas, projects & finance MD of the New Jersey-based broker

Compass Maritime. Tonnage acquisitions of US-listed public firms have skyrocketed in 2010, with activity accelerating in the past month. Fourteen US-listed companies have announced 51 vessel acquisitions this year at an aggregate price of \$2.5Bn.

Today's public capital usage contrasts starkly to 2009. "Last year was all about fortifying the balance sheet," JP Morgan shipping analyst Jon Chappell told *Fairplay*. "It was about making yourself financially strong in anticipation of a recovery in the market."

"The read-through from all of this new activity is that people think asset prices have bottomed," continued Chappell. "The shift [from balance sheet fortification to acquisitions] is

Public asset buys 2010: acquisitions announced over the past three months by US-listed shipping firms

Listed company	Total price	Assets purchased
Baltic Trading	\$284.2M	4 2009-built Supramaxes and 2 Capesize 2010 newbuildings paid for with IPO proceeds. Future acquisitions to be funded with revolver and follow-ons
Crude Carriers	\$396.7M	2 VLCC newbuildings for 2010 delivery and 1 2006-built Suezmax tanker paid for with IPO proceeds. Subsequently, two 2008-built Suezmaxes purchased using revolver, to be repaid through follow-on.
Diana	\$118M	2 Newcastle (VLCC) bulker newbuildings (delivery 2Q12, 3Q12)

Listed company	Total price	Assets purchased
DryShips	\$64.5M	2 Panamax bulker newbuildings (delivery 4Q11, 1Q12)
Frontline	\$210M	2 VLCCs (built 2009); broker reports that third (newbuilding for May delivery) may be purchased for \$110M
NAT	\$129.5M	2 Suezmax tanker newbuildings (delivery 3Q11, 4Q11); using follow-on proceeds
Navios Acquisition	\$457.7M	11 product tankers and 2 chemical tankers, with options for two additional product tankers, funded through 'blank cheque' IPO and bank debt.

just part of the cycle.” The domination that public players now boast over shipping’s S&P market has never been seen before. In no previous market slump have so many shipping entities had access to public capital.

“There’s a saying: ‘This time, it’s different’. It could be the case that this time, it is different,” Karatzas told *Fairplay*.

“In previous cycles, the majority of the players were private owners using their own money,” he explained. “It was up to private owners to find the sweet spot before they jumped in.”

Today, asset prices paid by publicly-traded owners are priming expectations of sellers of new-buildings and recently delivered tonnage. “Sellers of modern tonnage are holding out for better prices because freight rates are above breakeven, they’re making money, and they know public companies are out there looking,” said Karatzas.

“If I find the right vessels, public companies will pay up for the price. If I find these vessels for private owners, we cannot agree on the price,” he said.

“It’s a complete sea change. The traditional private owners have lost control – and it will never go back to the way it was before,” asserted the managing director of a major London broker who declined to be identified. “You might call

them ‘false’ prices,” the London MD continued, referring to ‘last done’ deals set by publicly-listed players. “But what’s the definition of ‘false’? Public markets drive most commodities around the world. Because of public money, which will now be with us forever, shipping is no longer a private club.”

The rise of public bids

Public asset bids have diverged from private offers for several reasons. First, return expectations differ. Many traditional private players, particularly Greeks, crave distress prices promising massive profits when the market hits its next apex. Public players are focused on deals deemed ‘accretive’ (ie increasing earnings per share). In baseball parlance, private owners swing for home runs, public owners for steady singles.

Public firms also have a structural need to grow, whereas private owners can bide their time. “There are two ways to pay back public shareholders: through income – dividends – or growth,” explained Chappell. “A lot of companies don’t have dividends and may not any time soon, so there is an inherent mandate to grow.”

But Chappell believes that executive optimism, not growth for growth’s sake, is driving public firm asset buying. “I think it’s more about the commentary of

where we are in the cycle. There wouldn’t be growth if it wasn’t at attractive [price] levels.”

‘Publicly traded companies are setting the direction’



Compass Maritime’s Basil Karatzas

[Photo: Greg Miller]

The London broker MD was far less forgiving on public executives’ motivation. “They’ve got to use the money or lose it. If you have to move the money, you have to buy ships,” he said. A parallel dynamic is now at work in China, he explained, involving entities with access to stimulus cash.

“They have to buy ships now or the money goes to somebody else,” he said. Several sources alleged to *Fairplay* that the heart of the discrepancy between listed firms and private owner bidding is so-called ‘OPM’ – other people’s money.

When public firms deploy capital, said Karatzas, “it’s other people’s money so they don’t have to be as careful. If it’s your own money, you think twice.”

According to the London source, whether it’s New York-listed firms or Chinese buyers, “the theme is OPM”. Owners spending their own cash remain unconvinced that “the purchase price is justified in terms of what the vessel is expected to earn”, he said.

“It is a bifurcated market because the private guys aren’t following through if they think prices have moved away from them,” conceded Chappell. “But at some point, the private guy probably has to do ‘last done’ [price] or maybe a small discount to last done. Either that or they’re going to miss this opportunity. Unless they truly believe this is a W-shaped recovery and the market has another leg down.”

But that is exactly what they believe, according to Karatzas. “The publicly-traded companies feel the worst is behind them, but many private owners believe we have not seen the worst of it yet, that this is not the time to

[Source: company releases and broker reports; excludes intra-company drop-down transactions]

Listed company	Total price	Assets purchased
		Seven MR2s and 2 chemical tanker newbuildings via distress deal, for delivery September 2010-4Q12, plus 2 2007-built LR1s and two LRI newbuildings for 4Q11
Navios Holdings	\$55.5M	1 Capesize newbuilding resale (delivery 2Q11)
NewLead	\$112.7M	2 Kamsarmax newbuilding resales (delivery 4Q10/11)
OceanFreight	\$204M	3 VLCC bulker newbuildings (delivery 2Q12, 4Q12, 1Q13); 50% loan from founding shareholder
Paragon	\$41M	1 2009-built Panamax bulker

Listed company	Total price	Assets purchased
Safe Bulkers	\$64.4M	2 Kamsarmax bulker newbuildings (delivery 4Q11, 1Q12) using follow-on proceeds
Scorpio Tankers	\$206.7M	3 Panamax tankers (one built 2001, two 2004) paid for with common shares. Reportedly purchasing four Handysize product tankers (built 2003-2007)
Star Bulk	\$149.5M	2 Capesize bulker newbuildings (delivery Sept/Nov 2011); plus 1 second-hand Capesize (2000-built)
TOTAL	\$2.49Bn	51 vessel acquisitions (29 tankers, 22 bulkers)

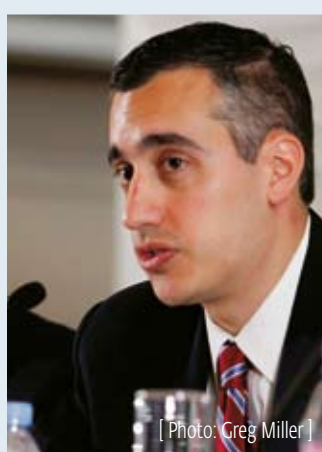
buy,” he maintained. The London source believes traditional private owners will instead pursue an ‘if you can’t beat them, join them’ strategy. “The traditional private owners have now worked out that they must become public,” he said.

While standard ship-mortgage financing remains in short supply for private players, public firms have a plethora of weapons in their capital-raising arsenal: IPOs, follow-on offerings, junk bonds and convertibles among them.

“The existence of public money in the business makes it much harder to predict the factors that would make a market go up or down,” said the London MD. “Normally, it would be gauged on supply and demand, but now, we have a third factor – the supply of money – which can drive a market without the same supply

‘The read-through from this new activity is that people think asset prices have bottomed’

JP Morgan’s Jon Chappell



and demand factors that normally make shipping tick. Shipping will never be the same again.”

Orderbook inflation

The looming danger of OPM-driven deals is to the orderbook. Despite intense concerns about capacity overhang, New York-

listed companies tapping public investors and Chinese interests tapping government cash have shown no reluctance to pile on orders in 1Q10.

Greek owners are reportedly ordering newbuildings with the intention of populating IPOs – another way public capital’s lure is

inflating the fleet. “We have been negotiating ships very aggressively in the last three weeks for [vessel] numbers in double figures purely for IPOs,” confirmed the London source. Another source confirmed that Greek owners had ordered ships for 2011 delivery during the last six months solely for IPO purposes.

Karatzas calls fresh newbuilding orders on top of today’s massive orderbook “schizophrenic”. The London MD was even more alarmed. “The head of my own research department just asked me ‘what is going on with these newbuildings?’ The forward book is still colossal. We’ve got 20 Capes a month coming and Supramaxes coming out of our ears. And yet, to our astonishment, we’ve got yards booking orders left, right and centre.” The culprit, he believes, is OPM – other people’s money. ■

Iron ore and coal find quarterly contract agreements

Increased raw material prices may bring steel price increases

Although no formal agreements have been reached, *China Securities Journal* is citing insiders from local Chinese steel companies saying that several state-owned mills in have accepted a quarterly-based pricing structure.

The FOB contract price of ore supplied by Brazil’s Vale stands at \$110/tonne as agreed earlier this year with Japan and Korean steel makers. Chinese steel mills had been resisting such steep price hikes.

Spot prices for iron ore are currently around \$170/tonne, according to SSY Consultancy & Research, which at current freight levels equates to \$150-

155/tonne FOB for Brazilian ore and \$163-168/tonne for Western Australian. This is about three times higher than the level of a year ago.

China has responded by increasing requirements for iron ore import licences, restricting imports to grades over 60% iron content, and stimulating additional domestic ore mining. These have had the effect of nearly closing off the Supramax trades from the East Coast of India to China.

IHS Global Insight (IGI) says the significance of this announcement is that it appears to indicate that the fragile alliance of Chinese steel companies has failed as mills see their inventories quickly drawn down. IGI also says it is likely that this year will see the benchmark talks end-

ing without a formal agreement – an outcome likely to hasten “the demise of the decades-old iron ore benchmark system that China has been trying to defend.”

Demand for iron ore could

\$170/tonne

current iron ore spot price

\$110/tonne

FOB contract price agreed by Vale with some Asian steelmakers earlier this year

eventually retreat though, as Chinese steel mills’ margins are squeezed. Difficulties in passing increased costs on to end users could see a fight back by mills to lower iron ore prices.

As steel production returns to those nations hardest hit by the global downturn, coking coal demand is also rebounding.

Reports indicate that Japanese steelmakers agreed to a 55% price increase with BHP Billiton from \$129 to \$200/tonne and, significantly, on a quarterly pricing structure that will give producers more benefits from spot price movements. Berthing delays at Eastern Australian ports, particularly for coking coal exports, have climbed above 20 days, according to brokers. SSY reports that coking coal prices have risen 15% above contract levels as a result.

The downside to the congestion for Australia, is that Korean and Japanese buyers are looking to the US for coking coal and to Colombia for steam coal – moves which support tonne-miles. ■