Shipping in Crisis?

Distressed asset funds circle shipping but fail to find prey

The industry's long anticipated fire sale did not happen, but distressed asset hunters are still out there waiting

Picking over the bones: have funds now given up on the promise of distressed shipping assets and moved on to richer pickings elsewhere, or are they just biding their time and holding on to their money? *Shutterstock*

RICHARD MEADE

IT was not supposed to be like this. By now the shipping industry should be mired in bankruptcies, consolidation and takeovers. Penniless shipowners should be handing over vessels at fire sale prices to distressed asset funds and bankers should be desperately foreclosing on loans that breached every covenant under the sun.

But the crisis has not panned out as expected and, as far as the distressed asset funds are concerned, shipping simply did not get sufficiently distressed.

Funds hastily established to cash in on the downturn have not managed to find the deals they had imagined, but they have not disappeared either.

While some have modified their expectations and channelled their interest into more realistic private equity deals, others are simply biding their time in the firm belief that, as prices improve, banks will ironically be more willing to foreclose.

The vultures, it seems, have not stopped circling yet.

"We all thought that the distressed asset funds would have a field day in the shipping market," said Allen & Overy head of shipping finance David Smith. "But there simply have not been the distressed assets to buy."

The simple truth is that things were so bad that banks have been very reluctant to foreclose, preferring to waive breaches and sit it out. While prices were at rock bottom and nobody was buying, they did not want to take the hit then on their already badly scarred balance sheets.

Those banks that did want to dispose of portfolios, or at least parts of them, have not yet been prepared to discount their prices sufficiently to get the distressed asset funds interested. Again, the banks did not want to take the hit to their balance sheets and P&L accounts of writing down loan recoveries.

So far, so familiar, but the unanswered question for many is, what happens next for those funds that have so far failed to buy up distressed assets?

The distressed asset funds still exist, or at least are still being marketed. While very few of the fund managers are willing to talk on the record it is understood that of those funds that did close with enough money to operate, very few have made any significant purchases.

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Certainly there have been distressed sales. Tufton Oceanic's purchase of Allocean Charters Singapore (now renamed ACS Shipping) from a bankruptcy in July 2009, counts as a distressed transaction by any definition. However, Tufton's dedicated distressed asset fund is yet to make a single purchase.

Given the overwhelming lack of available deals being conducted it is likely that questions will soon start to be asked over exactly what value such funds have added in the last two years, and what returns they have been offering to their investors. As one banking analyst put it to Lloyd's List: "Is the business model simply to keep the managers in green fees and gin and tonics?"

While there is some anecdotal evidence to suggest that some funds have now given up on the promise of distressed shipping assets and moved on to richer pickings elsewhere, many believe that the industry has maintained its interest, albeit in a moderated capacity.

Banking insiders insist that there are still funds out there biding their time and holding on to their money. Several suggest that now things have improved a little, the banks may be more willing to foreclose.

While this may seem superficially counterintuitive, the thinking within some funds is that prices have gone up so the hit will not be as great for the banks and their balance sheets will be healthier so they can absorb a bit of pain. There are certainly still many shipowners who would be in default but for the waivers that were ubiquitously granted to stave of foreclosure in the last round of negotiations. But when those waivers, most of which were given for specified periods only, expire, those shipowners still will not be able to make their loan to value covenants.

The assumption in such a scenario is that the banks may decide to bail out now rather than extend the waivers in the hope it might get even better. Those with portfolios to sell may well soon get pressure from management to get assets off balance sheet and get sanction to take a loss in order to do so. Whether such logic is enough to maintain distressed asset fund manager's attention for long remains to be seen, but they are not alone in sensing a shift in mindset.

According to lawyers dealing directly with the banks, there has been a noticeable change in the attitude when it comes to dealing with restructurings. Shipping bankers have openly admitted that many of the problems that sparked the creation of distressed asset funds in the first place have not yet gone away.

"Many of the opportunistic distressed asset hunters initially underestimated just how big the shipping banks were and that they would have the balance sheet strength to carry on," said DVB Bank's head of shipping asset management, Keith McRae. "But many of the problems and the 'distress' haven't gone away and until incomes improve or values go up the exit routes are still not there for many banks."

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But while distressed asset deals may not have materialised in the volume that fund managers initially anticipated, many finance experts suggest that this interest did not disappear, it was simply moderated and focused opportunistic deals at more realistic rates

Pointing to a slew of private equity deals over the past 12 months estimated to be worth close to \$2bn, many financiers suggest that the private equity interests behind many of the funds have not lost their appetite for 'value acquisitions' in shipping.

Instead there has simply been a change in mindset after the initial slew of 'pie in the sky' offers were rejected and distressed asset funds realised that banks were not prepared to concede the 25%-30% discounts that some investors had imagined.

"We have seen well over \$1.5bn of private equity deals in shipping, probably closer to \$2bn, and private equity has never been more active in commercial shipping. But they are certainly not seeing what they were originally looking for," managing director of AMA Capital Partners, Peter Shaerf told Lloyd's List. "I would hesitate to describe any of these deals as distressed, but they are all being done by people who originally wanted to get into that space."

Whether this private equity interest remains more than an ephemeral presence in the industry looking for opportunistic buys remains open to question. Should the predicted banking exit materialise, few doubt that interest would not return but for the moment it seems that most of the true vultures who were seriously looking at shipping have concluded that the rich pickings imagined are just not there.

As Eurofin chief executive Anthony Zolotas put it: "When they smell blood the private equity groups can pull together serious money. We can only assume that other opportunities will have caught their attention now, but that doesn't mean to say they won't be back if they smell blood again." ■

An insider's view: why funds did not get the deals they were after

DISTRESSED asset funds seemed like a good idea at the time, but so far it seems that the banks have not needed them, *writes Richard Meade*.

For many in the shipping finance sector the crisis simply did not pan out as expected. Throughout 2008-2009, senior banking executives and financiers repeatedly told Lloyd's List that a long hard recession, with rates and values rumbling along below the long term averages, was on the cards. Some predicted an eighties-style depression in shipping and at least one banker felt it would be so bad that in November 2008 he sought and got a transfer into another business area.

It was out of this climate that distressed asset funds were born with the stated aim of cherry-picking from a mass of distressed tonnage. Indeed many of the funds were telling investors that prices would go below the long term average, and they would buy a five-year-old vessel cheap and sell it as a ten-year-old for twice the price.

But the distress never really materialised.

"The vultures were circling but the banks did not move," said one US finance expert. "Most were still making enough in terms of revenue even if the loan to value had crashed. What were they going to do, foreclose on Genmar, on Eagle Bulk? Of course not. It would not have made sense."

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> **US finance expert**

Ultimately the fact that the sectors collapsed in a cascade fashion was very useful to banks.

According to at least one senior banking analyst, lenders learned a lot in the first months of the dry bulk collapse about waivers, educating nervous credit committees, and appraising the owners and the counterparties — who were the good eggs and who were not.

"We were ready for the other sectors and applied the newly learned/revived techniques to those," said the analyst. "If it was a 80s-style collapse we would have learnt these things anyway, but it would have only been too late. So hurrah for the dry bulk team conceding a goal so early on, we were able switch formation and stay in the game."

The golden rule of banking is 'don't lose money', so a banker that arrests a ship creates a loss, unless the ship sells for more than the outstanding debt — which never happens.

According to one banking insider, generating a loss is an unspeakable act in the ear of the remuneration committee, and it is one that will be remembered come bonus time. Therefore the ships never came on the market. Besides loans done in the boom were at cutthroat margins. Waivers and other dispensations brought in big fees. Some facilities are now making more under current conditions than pre-crisis. Why sell the golden goose at a loss? ■