The Last 30 Years in Shipping Investment – What Have We Learned?

Martin Stopford, President CRSL 20 June 2017
Fitzcorraldo
Directed by Werner Herzog
An inspirational film for all shipping investors who are in search of the true meaning of "the shipping investment cycle".

See your shipping investment climb to the heights then crash into the trough.

Share the euphoria of success and the pain of the collapse.

I gave “shipping cycles” a whole new meaning.
AGENDA

1. The shipping investment cycle
2. Seatrade International Ship Finance Forum 1987
3. Investment 1986-2016
4. A word about investment cycle economics
5. The investment cycle 2017-2046
1. The Shipping Investment cycle
Two ship investment cycles that lasted 30 years

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Twenty four VLCCs please!!
There’s easy money on Wall Street guys, sorry about the bond. Is 30 cents/$ OK?
Hey guys, oil companies are offering time charters. Lucky I’ve still got a few TCs. Sorry Mr Banker, sir I can’t pay a cent!
Sir, our fleet of new Supramaxes is a unique opportunity.
Oh Sh**t. Lucky LIBOR’s .5%. Let’s order some. Past the trough? No cash? Time to invest, shipmates.

Who needs TCs when you can borrow 105% against the asset?

Newbuilding contracts % fleet (dwt)

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Two shipping Investment cycle mountains to climb
Recap: Investment Supercycle 1 1956-1986

Contracts placed as % world fleet (dwt)

1973 peak
1974/5 Very rapid collapse
1986 trough

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Recap: Shipping Supercycle 2 1986-2016 – different shape

Contracts placed as % world fleet (dwt)

- Much more ordering in trough than previous cycle
- 2016 Trough?


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Interest rates had a big impact on the two supercycles

This chart shows that interest as % earnings (new Panamax bulker) was very different in the two super-recessions.
2. The Seatrade International Ship Finance Forum..December 1987

What bankers thought at the trough of SUPERCYCLE 1
Session 1 - A market diagnosis: What went wrong and why?

Discussion leaders:
- Boris Nachamkin
  Bankers Trust
- Olaf Peters
  Schiffhypothekenbank Zu Lubeck
- Michael Revell
  Retired. Formerly Marine Midland Bank
- Bernard Kruyne
  Bank of America


Speaker:
- Dr Martin Stopford
  British Shipbuilders
A market diagnosis – what went wrong?

The same problems were mentioned repeatedly: –

1. Too much shipbuilding capacity!
2. Too much government intervention!
3. Too many owners ordering too many ships!
4. Too many overage and substandard ships!
5. Too many charterers/shippers eager for short-term gain at the expense of the industry's future!
6. Too many banks, lending too much money.
7. Too much support for speculators.
8. Charters only as good as shipper & owner.

Boris Nachamkin
Bankers Trust gave His view on what went wrong
Reasons why “things went wrong"

1. Inadequate collateral and not recognising the distinction between a loan to a business and the industry risk.

2. Inadequate information about the operators of the company - "if all the facts have been known, much of the business should not have been done".

3. The industry should pay more attention to statistics "it takes a strong character to turn down business".

4. “Banks too interested in marketing and neglect the basic disciplines. People acted hastily.”

Bernard L Kruyne
Bank of America
gave his views

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What to do about it (consensus view)

1. Banks and other financial institutions should not finance speculative newbuildings and insist on a larger equity participation by the owner (50%).
2. Shipowners should not order vessels except where a clear commercial need is established and take positive action to accelerate scrapping of uneconomic tonnage.
3. Shipbuilders should bring capacity in line with existing requirements.
4. Governments should eliminate subsidies.
5. Underwriters should refuse to insure substandard ships.
6. Classification societies should not permit any lowering of standards for competitive reasons.
7. Charterers and shippers should recognize that whatever the short-term benefits, uneconomic freight rates cannot be in the long-term interests of efficient transport.

Jim Davis, Chairman of IMIF

Jim Davis, banker and President of IMIF
Was a member of the afternoon panel
Conclusions - where the banks were in Dec 1987

1. “In 1979 to 1981, a period viewed by many as a permanent recovery, between 200 and 250 banks were involved in ship financing. Can 200 to 250 banks all have mature and qualified ship finance units?“

2. By 1985 the number of shipping banks had dropped below 50 and in 1986 no more than a handful, say 12 to 15 banks, were actively looking for new business.”

3. “With pockets of optimism in, many banks were back in the hunt. They talk about lending only 40 to 50% instead of 80 to 90%. This is an important 1st step, but the jury is still out.”

4. "It's the banks not here that really matter“

Basel I, issued in 1988, aimed to create a bank asset classification system.

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3. The Investment cycle
1987-2016

This was the mother of all cycles. Some investors made a killing, others got killed. Just a matter of timing.

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In 1988 the press said “the speculative element has gone”

- A 1988 Euromoney article spoke of “stringent financing terms”
- But analysts were predicting a shortage of shipbuilding capacity
- And where would the industry find the $10-$14 billion a year to finance fleet replacement?
By 1992 investors & commercial banks were at it again

By 1990 the lenders were back to their old ways and by 1992 the markets were slipping back into recession with too many deliveries.

Dressing to suit business

By Rupert Morris

Red can be very successful if it is not too bright. If you wear a grey or blue suit, people like a bit of flesh-coloured pink, or camel, or cream. Men can wear very conservative suits, but their tie will tell you a lot about them — that’s their chance to show their character.

And how about the shocking pink and lime greens so popular on the Paris catwalks, and with controversial MP Jeremy Gorman?

It’s all a bit of a mystery and in front of stage lights. You can mix and match your clothes, which is why it’s called ‘mix-and-match’.

Source: Daily Express 1992
Investment 1987-2017:

- Very active lending up to 80%
- 1990: Commercial banks lending up to 80%
- 1992-7: Several IPOs
- 1994: German KG market takes off
- 1996-8: Many companies issuing Junk bonds
- 1997: IPOs in Oslo, Wall Street & funds active
- 2009-2016: Shipbuilding credit & Asian leasing companies active
- 2009-2016: Low interest rates & high levels of investment continue

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Investors do what they want, but they do it within an economic framework and must have some sort of rationale.

4. A word on investment cycle economics

Why am I a shipping investor?

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External investment should add value

- Between 2000 and 2017 the industry ordered for about $1.7 trillion of new ships.
- Net earnings of roughly $1.6 trillion could have covered this investment.
- External investors/lenders must know HOW THEY ARE ADING VALUE - funding speculation just reduces returns.
- Maybe new technology companies?
5. The investment cycle 2017-2047?

As we head into Supercycle, how do you find the best investments? Here are some suggestions.

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Heading into Supercycle 3

- Fewer banks, low interest rates
- KG system in collapse (it financed half container fleet so what now?)
- Tougher banking regulations
- World economy recovering But...
- About 23% surplus ship capacity
- Lots of shipbuilding capacity and support programs very busy
- Massive pool of investor funds looking for any half plausible investment
- Asian leasing companies very active

The forecast? I’m still working on my supercycle forecasting model ....

It’s time we faced reality my friends, We’re not exactly rocket scientists
The lesson is that, in Supercycle 3, shipping will need investors who can lead sea transport into new territory.

It’s the goal of investment that matters.

I built my opera house in the end and got Enrico Caruso to sing there.
The End

In 2047 will investors be pushing ships up hills in the Brazilian jungle? Or moving shipping into the digital age? It’s your decision. Enjoy!

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