Strategy and Capital at a Moment of Uncertainty

Brian Friedman, President, Jefferies

(Transcript)

Matt McCleery:
Tony, thank you very much, that was definitely inspiring. It’s a pleasure for me to introduce Brian Friedman. Brian is known to many of you, he is the President and Director of Jefferies, and Chairman of the Jefferies Executive Committee. And as I said in my opening remarks, our relationship with Jefferies has been a fantastic one over the years. We have been very fortunate to be partners with them and this event and many endeavors, really since the beginning of my career, which is more than 20 years ago. One of the real reasons that Jefferies has been so committed to shipping, even at a time, at various times when other banks have reduced their activities, really is Brian Friedman.

Brian Friedman has done many things in his career, including, he was actually served as a shipping banker at Furman Selz, which many of you will remember was the predecessor to Jefferies, a predecessor, and took Stolt-Nielson public I believe, in 1988, so I think companies and as an industry, we’re very fortunate to have Jefferies serving this industry, and we’re really happy to have Brian with us today. Thank you Brian and welcome.

Brian Friedman:
I’d love to think I was in high school when we took Stolt-Nielson public. Thank you, and first on behalf of myself and Doug Mavrinac who’s sitting over there, Randy Givens on the research side, Jim Dowling, with whom I’ve partnered in shipping for more years than I want to acknowledge. And everyone else at Jefferies, we thank you for the opportunity to spend a few minutes sharing our thoughts. We also appreciate the opportunity to serve the industry. Matt was kind enough to note that the commitment of Wall Street was probably waning. I’m going to talk a little about what I think it takes to rejuvenate Wall Street and shipping, but it’s time when others are cutting back. We remain fully committed to the industry, we’ve been committed forever. We believe that there’s still a ton of opportunity to build and succeed, and again I’ll talk about how we think that happens. So we appreciate very much your support, and we look forward to serving you for many years to come.

The topic that we threw out is strategy and capital at a moment of uncertainty. I stood here last year and shared, what at the time, were about 10 ideas I had about where the market is and where the world is. And I think on balance it was much more a tale of optimism than pessimism, but if you look at the last year, what’s transpired are trade wars, a continuing pressure toward de-globalization, some amount of economic slowdown, on the political side populism. And when you look and feel the environment, right now there’s a watch on today for what the fed is going to say or not say.

We’re living in a world where macro-themes are driving. And one of the problems for business is that we thrive on some level of visibility, on some level of certainty. You never have total certainty, you never have absolute transparency on the future, but we live to make decisions where the variables won’t
change too much. And the current environment from a macro perspective is making it more difficult to make decisions, more difficult to be confident in your strategy, and to some degree, it makes it a little more difficult to commit capital and to allocate capital. The right strategy for shipping companies and the opportunity to continue to access capital, in our view is going to come down to two driving themes.

The first of these, and I would say these themes come about because they represent where the capital providers want to see their risk and their return. Whether it’s in the private markets or the public markets, arguably whether it’s equity or whether it’s unsecure debt in the leverage finance market, the investors in debt and equity are looking for two things today and I think you’ll see these pervading all industries, and shipping shouldn’t think that it stands apart.

The first of these is scale. If you look at what is being rewarded in the world, its market share, in some cases, its dominance. It is the ability to differentiate yourself and ultimately drive a differentiated return from a market position that is in some way distinctive. The extreme examples are the big tech companies, you know the pressure is actually now the other way, whether they are in fact too big, but if you look at what the markets have appreciated and rewarded, it is their scale and their dominance. It’s very hard in a commodity industry such as shipping to be dominant. I’ve been in a number of commodity industries and I’ve sat with some of the biggest companies in the world, and they’ve had to recognize and acknowledge that even they have trouble dominating or affecting a market that is commoditizing because the last ship that’s available prices it, the last piece of coal that’s available prices it, and the marginal piece ends up pricing all. So it’s a challenge in this industry to gain scale, but if you think of it in capital markets terms, companies where market cap is measured in the billions will have a fighting chance. And companies where market cap is measured in the hundreds of millions, there will be a never ending struggle, and I don’t think it gets better.

The second thing that’s developed in the markets, and again, this is a, for shipping for sure, a meaningful change, is that the market is almost entirely and consistently looking for return on equity and free cash flow. NAV is nice to talk about, it gives people a modicum of comfort, but to say to someone that 85% of NAV you got to buy it, that’s not the world we’re living in. The easiest analogy I can give is the oil and gas industry. If you look at oil and gas in the stock market, it’s gone from being a significant front of the list industry to being a sector that if people don’t have it they don’t miss it. And there’s been virtually no ability to raise new capital, the high yield debt of the oil and gas industry is trading at levels that are half way to distressed even though there actually isn’t distress. So when you look at the markets today, cash flow, whether it’s an actual cash going to the shareholder, or cash flow being used highly strategically, if there isn’t a return on equity, and a sense of free cash flow generation, the public markets are going to struggle to a scribe value. And again I use the energy industry because if you look at it on a private fundamental basis, there is significant value. When you go to the public market, particularly in the US, you may be looking at a half-price sale. That is unusual, but it is sustained, it is real, and it is because, and I use that as the easy industry, it’s an industry where effectively for too long, all of the cash flow was re-invested. And the shareholders are basically saying no. They started saying no the mega companies, they’ve now said no to the smaller higher growth companies, whether it’s through dividends or other means, shareholders want to see the cash.
The shipping industry, to succeed in the public markets, to have access to capital in the public and private markets, in our view, are gonna have to embrace the idea of scale, so mergers, combinations, acquisitions that take the midsize companies up to larger and take the larger companies to ever bigger, that’s gonna be a defining theme of their success and their ability to get evaluation that allows capital formation and continued growth. Similarly, responding directly to the shareholder and being able to demonstrate to the shareholder an ability to generate ROE in cash flow, recognizing that all these businesses have cycles, we can’t invest in the good part and then suffer in the more difficult part. And the more difficult part we have to have the sustainability, and in the good part shareholders have to see return. And that to us is gonna be the change in the environment.

I’m going to stop there because I really think the message for this year is that message, at a time when industrial companies are less favored than tech and biotech, at a time when the market is struggling to get past the macros, and want to even think about the micros to get the attentions of investors, it’s gonna be about scale, it’s gonna be about return on equity, and I would put those two paramount, NAV and a lot of other things we’ve talked about over the years won’t be discarded but they really pale in their importance today.

With that I thank you and wish you a very enjoyable Marine Money Week.

Thank you.