Shareholder Friendliness

Contributed by

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By late August, freight markets were settling down, though many of the swap (forward freight agreements or FFA) positions continued to show expectations of strength. If broker reports are to be believed, asset prices are holding on to gains that have been made in past months. Ostensibly, this is all good. But, then again, anecdotal evidence from various private equity buddies says that they've have backed away from deals because of price appreciation seen in vessels earlier this year. So, there are projects and there are deals, but maybe we may be seeing a pause, while everyone re-groups. Traditionally, the end of summer means back to school, back to work, and all that; shipping markets may see some of the same mentality.

We have seen prominent shipping companies organize "shareholder friendly" buy-backs in markets of this type. The rationale for buy-backs varies depends on circumstances- but generally, companies will cite the very high class problem of having extra cash on hand, and not having good projects to invest in. That's an oversimplification; some investors may see tax advantages, compared to receiving dividends, in getting paid for their shares. From the company point of view, fewer outstanding shares means a lower denominator when computing "per share" measures such as cash flow and bottom line earnings. Then, there are some financial engineering constructs- like buying in shares to backstop future issuance under convertible debt. But, above all, the buybacks also show confidence in company prospects, and company management may have better insights than those looking in from the outside. The two most prominent names in the shipping press undertaking buybacks (or getting ready to), lately, have been Scorpio Tankers and Maersk.

Scorpio, a specialist in the product tanker sector, has faced headwinds as the product tanker sector has remained in the doldrums. As its newbuild vessels have begun to deliver from the yards, the "MR" (medium range) size class, designed to haul refined products, has missed much of the 2014 action that's occurred in the crude oil sector. Personally, I like the product sector (no secret to readers of my other articles), however, the markets will do what they do.

However slow the MR market is, the company has been very active in the finance front. Scorpio has recently raised a trove debt, through a nearly $54 million "baby bond" financing in the Spring, after authorizing a share buyback of up to $100 million. A few months later, another program was announced, this one for $150 million. These buybacks come at a time that new financing arrangements have brought in cash well in excess of immediate needs. In April, for example, Scorpio closed on a $300 million funding deal with a Korean export credit agency (ECA), which included a $125 million bond issue with principal and interest payments guaranteed by the ECA (which, when applied to an outstanding bank facility, dramatically lowers the effective borrowing cost). In June, $360 million of convertible notes were issued (with more than 10 million shares, worth upwards of $90 million, have been purchased in connection with the note issuance). Shipping journalists have hinted that Scorpio's financial finesses may be transferable to other parts of its group beyond the tankers.

With Maersk, everything is bigger and more audacious than anything else done by others- the exception being the three company liner alliance, P3, now scaled back to a P2- more on that later. The guys with the big blue boxes have talked about a buyback of as much as $1 Billion (with a B) in share re-purchases. Stock markets liked the move- Maersk parent shares rose after the announcement.

Even after taking a hit of $1.7 Billion (with a B) on oil related assets, Maersk is contemplating profits this year of more than $4.5 billion (also with a B- with its guidance recently raised from a mere $4 billion). On the cash front, a clean-out of non core business has brought in $2.8 billion. Staggering! I suppose that, unlike product tankers (a sector where the big blue vessel owner is still active, after its de-accession of VLCCs, to Belgian owner Euronav for $980 million of more cash, earlier in the year), Maersk recognizes that its real core- big container vessels, might be immune from the laws of supply and demand. Container vessels are different from bulkers and tankers (sorry, F. Scott Fitzgerald) when you get into mega line haul trades, So if oversupply brings about lower costs per slot of container capacity, to which Maersk attributes its successes- then maybe there **are** more projects to invest in.

So, then we get to the fun part. There have been rumors in the market that Scorpio (not the tanker part) might be getting into the containership game. Specifically, the trade press has been reporting that Scorpio, in conjunction with Chinese investors, has ordered, or will be ordering, five vessels with specs comparable to the Triple-E 18,000 TEU megaships in service to Maersk now in the Far East to Europe trades. Other reports have Scorpio then leasing these vessels to Mediterranean Shipping (MSCs), Maersk's soon to be partner in the P2 alliance- quickly hatched after Chinese regulators nixed the P3 alliance (which would have also included CMA-CGM, another container giant). Since Scorpio's tanker arm has demonstrated its skill in working with the Korean Export Import Bank (KEXIM) and driving down borrowing costs, maybe a similar deal, with long term finance could be worked out. If Maersk provides any guidance, Triple-E's are throwing off buckets (boxes?) of cash- enough to fund $1 Billion of shareholder friendliness. So maybe Scorpio could get in on some of that action- and share some of it with investors. When leveraged up, a long term lease to an MSC entity, on the Triple-E or similar vessels (offering a decent cash on cash return on a circa $160 million investment) would provide healthy bond like returns on whatever equity Scorpio might put up. If it's true, it sounds like a good deal to me; let's hope that they put it into a public vehicle so we can all feast on the low slot costs. Now, that would be shareholder friendly.