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Briefing: Investing in maritime assets and the impact of Covid

In a guest Insight WFW's Lindsey Keeble, London Partner and Global Maritime Sector Co-Head; and Jim Bell, London Partner and Global Aviation Sector Co-Head review how the shipping sector has fared during 2020 and the parallels between shipping and aviation as an asset class.

While there are some simple analogies to make between financing of, and investing in, aircraft and ships, the structure of the shipping market differs in many respects. Ownership of the assets and the diversity of asset classes are important to understand when looking at how the financing of, and investment into, the industry has evolved.

In some sub-sectors of the industry tonnage owners are large multi-national companies such as in the container shipping market, with sophisticated companies holding diverse interests in logistics, ports & terminals and a focus on the global supply chain. Other areas such as LNG and oil exploration require significant investment and you will see larger listed companies (or joint ventures between major players). Outside of these sub-sectors, the majority of shipowners are family-run or otherwise privately owned. Other key players are the charterers (the "end-users") such as the large commodities houses or oil & gas companies who will charter tonnage either for specific voyages or for longer-term charters where there is an established export need.

Unlike in aviation where you have a handful of manufacturers, the shipbuilding industry is fragmented with the majority of shipbuilders (outside of the cruise industry) spread across Asia. There are a number of different ship types and sizes designed for the various sub-sectors of the industry leading to diversification of assets and a wider ability for asset plays.

Shipping during Covid

Different sub-sectors of the shipping industry underwent c.10+ years of restructuring during and since the onset of the financial crisis. The financial performance of deep-sea shipping has, broadly, not been noticeably impacted by the Covid pandemic. This is due to the underlying sectors of industry which shipping supports. Shipping links into the global supply chains and revenues are aligned to demand for commodities, oil & gas and consumer goods. The container shipping industry is currently enjoying a boom not previously seen this century. The main impact of Covid on shipping, which should not be ignored, has been on seafarer welfare - with crews being unable to disembark or be replaced leading to a crisis of a different kind for the industry.

Clearly, the cruise and passenger ferry sectors have been acutely affected in much the same way as the aviation industry as they rely on income from tourism and holidaymakers. Most of the cruise lines have benefited from the ECA debt holiday extended by the European ECAs who have supported the European built cruise ships. A number have also benefitted from a previously unencumbered fleet to enable them to raise funds in the debt capital markets.

Maritime restructurings - doing “better” deals in the new normal

Shipping has always been highly cyclical and there have been significant downturns. Before 2008/09 downturns have mainly been met with arrests and enforcement strategies – with new funding available to finance buyers of distressed tonnage. This all changed with the financial crisis, we saw the perfect storm of a shipping downturn and a global financial crisis. Much like the current aviation industry, lenders could not simply enforce against one underperforming customer and back a different customer – or look to another bank to refinance them – the liquidity was not there. In addition, the assets are generally considered more illiquid than aviation assets, and residual value risk is generally with the shipping company (and so there is not an equivalent operating lessor market). Loan to value covenants were breached and many shipping loans were underwater, with banks facing a huge write down if they wanted to exit.

This led to our involvement in an intensive and lengthy period of Coordinating Committee restructurings, working out shipping debt. Enforcement has less often been a viable option and we have been involved in a number of transactions where assets have had to be placed into protective ownership. Some shipping companies have availed themselves of Chapter 11 protection in the US (with “pre-packs” (involving an agreed restructuring plan between the debtor company and its key secured creditors being successful, whereas all debtor companies which have filed for such protection without previously having reached an agreement with their key secured creditors suffering a freefall, wiping out all shareholder equity) as well as EU insolvency regimes, such as Italy & France. While there have been bankruptcies, restructuring and consolidation in all sectors, this has not been particularly driven by Covid. Some of the lessons learned in the shipping sector might help to present a blueprint for dealing with some of the issues currently faced in the aviation sector.

Increasing financial sophistication

The financial crisis led to a sea change in the way the shipping industry has financed itself. Historically, the majority of shipping was financed with debt from relationship banks, with newbuild projects benefitting from ECA support. Some owners have also financed themselves in the Norwegian or US Bond markets, often using Norway as an entry point due to the ease of execution and documentation. Structured products in shipping have tended to be around using tax lease structures, such as UK / French and Spanish tax lease products.

The banking crisis saw many 'shipping' banks exit such as RBS, Commerzbank and HSH Nordbank; other reduce their portfolios significantly. We advised a number of private equity funds entering the shipping space – mainly buying shipping loan portfolios but also funding equity in JV arrangements with shipping companies, and more latterly advancing new loans to shipping companies who have reduced access to funding. This went some way to fill the funding gap left by the commercial bank exit.

The other notable new entrant has been the Chinese leasing houses (and other lessors offering sale & leaseback structures). However, these are, for the most part, full pay-out finance leases where the shipping company retains the residual value risk. True operating lessors are less common in shipping – in part due to the assets being less interchangeable and the residual value risk – but also because of strict liability regimes relating to pollution and operational matters.

We do see further changes afoot for the funding of the maritime industry. Having the largest dedicated maritime practice globally, WFW recently commissioned an extensive research project in relation to ESG in shipping which is being published in February. The pressure to find the reported c.$1.4trn needed to transition to a greener industry arguably places pressure on governance and the capital structure of shipping companies. We see the need for further institutional money to fund the shipping space as banks retract and many companies are considering collaborations to fund new technology.

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