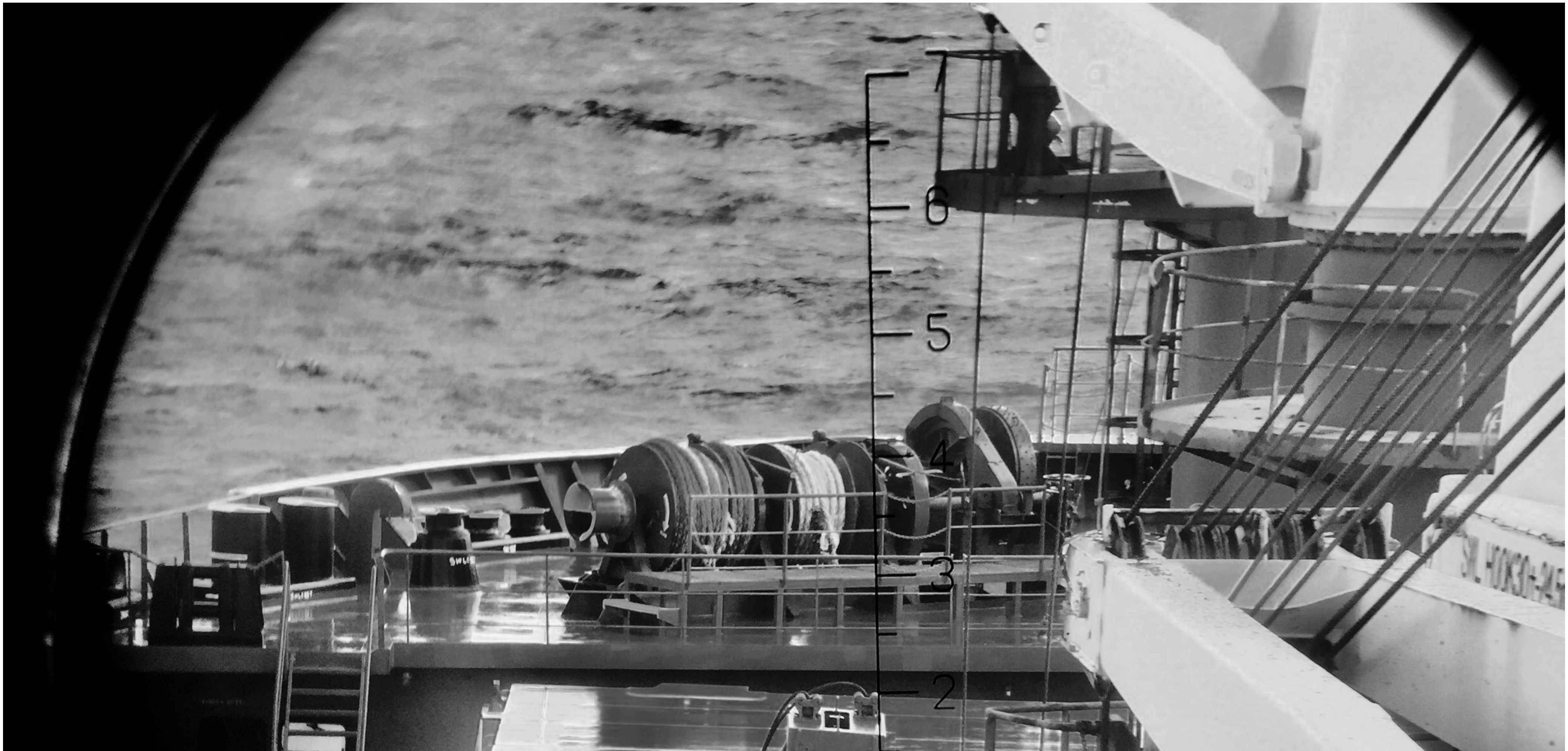


Institutional Capital and the Shipping Markets: Why has the gap not been bridged?

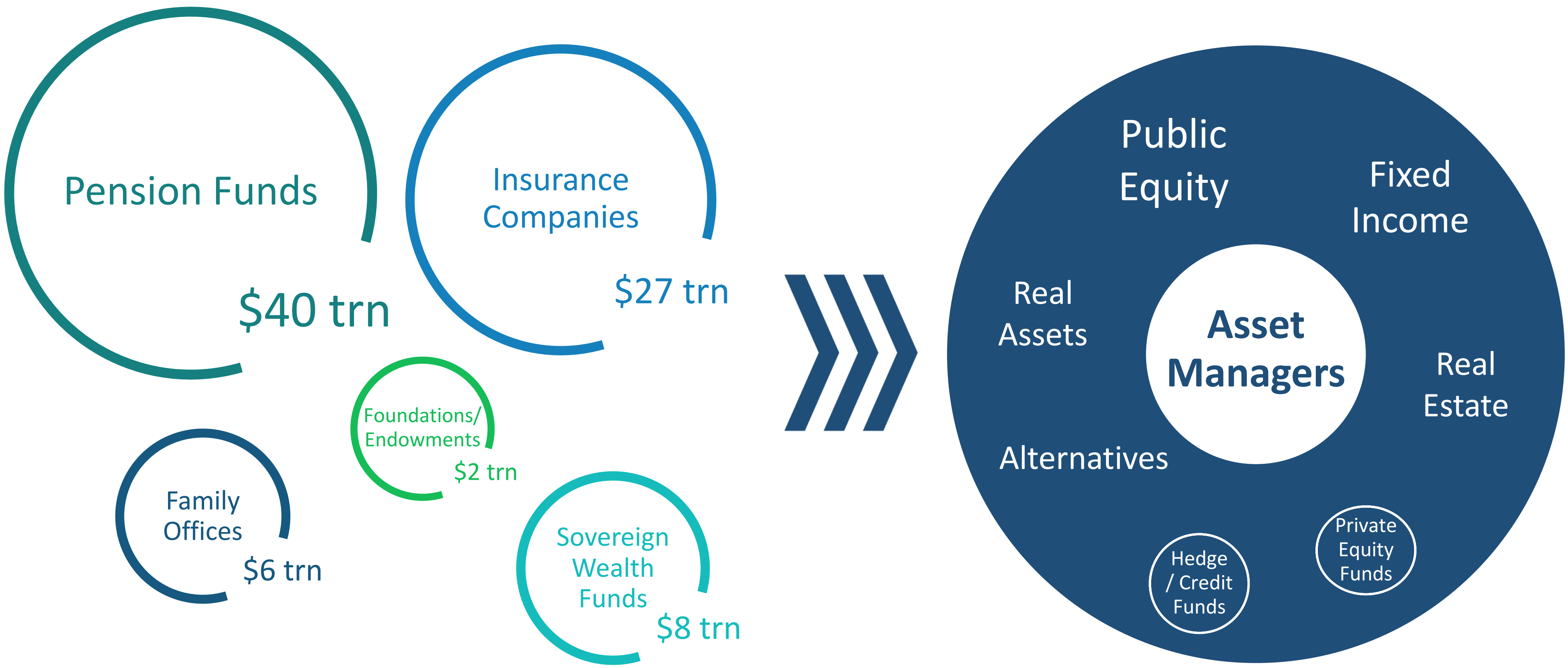
Marine Money

January 2020

marine capital

Institutional investors

The ultimate source of capital

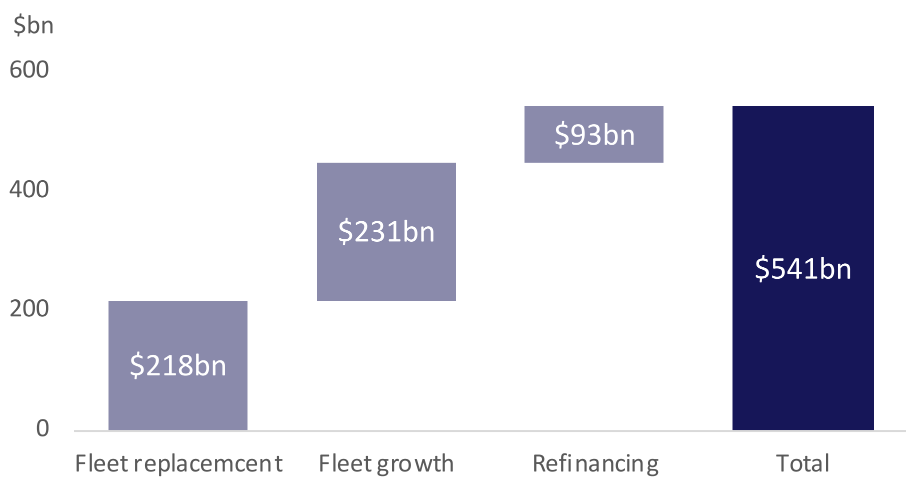


Source: Preqin, OECD. Willis Towers Watson, Campden Wealth, P&I

Industry has significant capital requirements

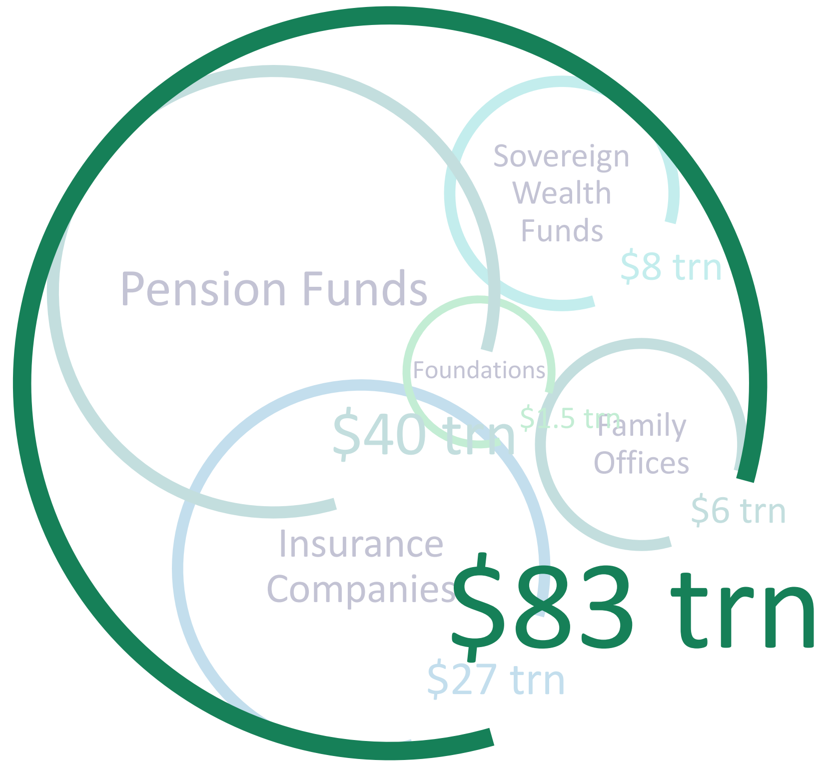
Which institutional investors are ideally placed to provide

The marine industry needs more than $0.5trn[1] in capital between 2020-2025



Decarbonisation will require additional capital

This is 0.6% of the current AUM held by institutional investors



Sources: Marine Capital, Clarkson Research Services

1. Based on 2% fleet growth, renewal of ships over 25 years and conservative refinancing requirement

Institutional investor requirements

Pension Funds

- Access to steady, uncorrelated long-term cashflows
- Desire for very limited exposure to any residual value risk
- Requirement for scale (ability to deploy significant capital)

Sovereign Wealth Funds

- Strategic as well as investment return perspective
- Invest in both long-term and short-term transactions
- Requirement for scale?

- ESG
- Transparency
- Fees
- Liquidity

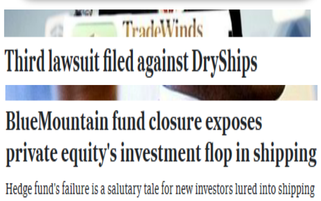
Insurance Companies

- Constrained by solvency regulatory requirements
- Focus on long-term debt/debt-like investments
- Credit quality a key consideration

So why has the gap not been bridged?

Criteria not being met (from institutional perspective)

Poor publicity

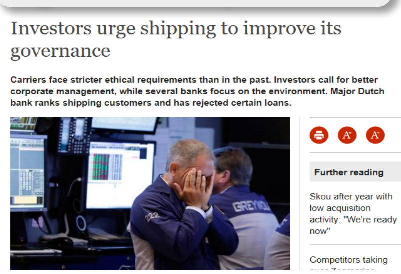

TradeWinds

Third lawsuit filed against DryShips

BlueMountain fund closure exposes private equity's investment flop in shipping

Hedge fund's failure is a salutary tale for new investors lured into shipping

Substandard governance practices


Investors urge shipping to improve its governance

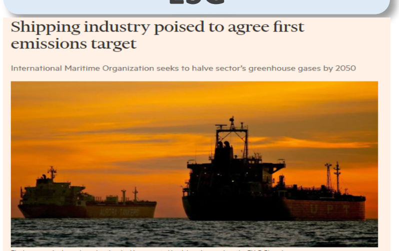
Carriers face stricter ethical requirements than in the past. Investors call for better corporate management, while several banks focus on the environment. Major Dutch bank ranks shipping customers and has rejected certain loans.

Further reading

Skou after year with low acquisition activity: "We're ready now"

Competitors taking

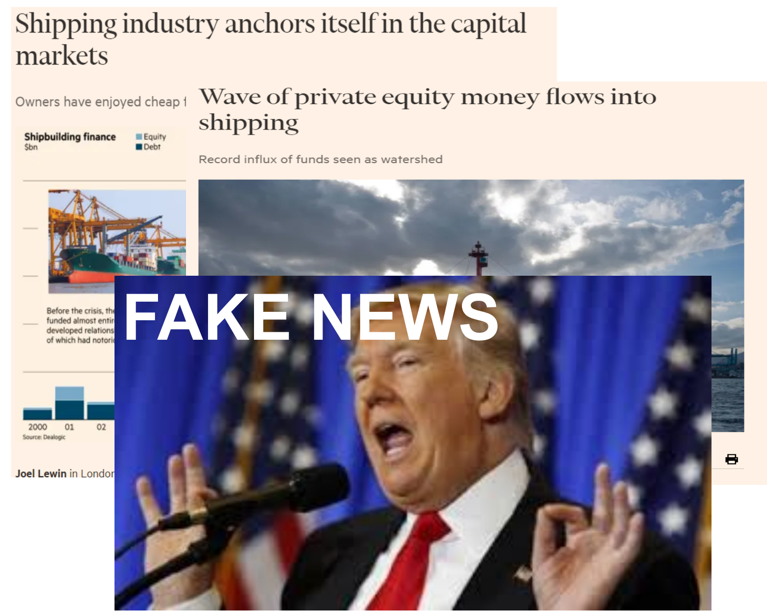
Lack of alignment on ESG


Shipping industry poised to agree first emissions target

International Maritime Organization seeks to halve sector's greenhouse gases by 2050

Final compromise is much weaker than had been wanted by delegations such as the EU © Bloomberg

Doors not being opened…


Shipping industry anchors itself in the capital markets

Owners have enjoyed cheap f

Shipbuilding finance

$bn

Equity

Debt

Before the crisis, th funded almost entir developed relations of which had notori

2000 01 02

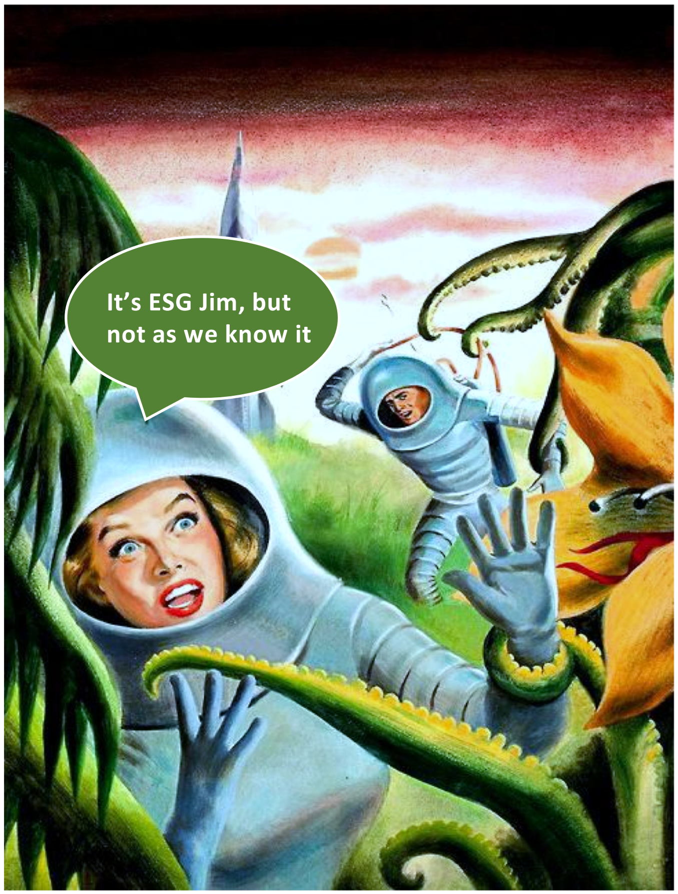
Source: Dealogic

Joel Lewin in London

Wave of private equity money flows into shipping

Record influx of funds seen as watershed

ESG – are we on the same page?



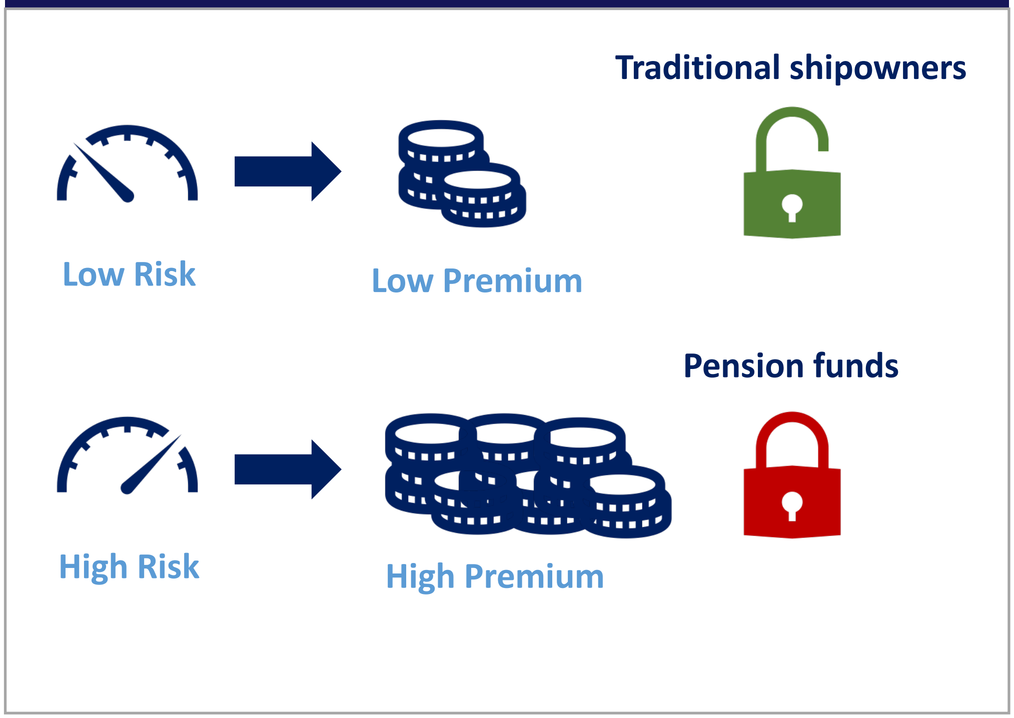
Source: Pinterest, The Impacter

The charterer’s dilemma

- Charterers expect owners to accept high residual value exposure…
- …particularly when the energy transition makes future-proofing assets challenging
- But increasingly pool of shipowners with meaningful capital is narrowing…
- …are charterers cutting corners on governance to retain existing business model?
- High quality ship management does not have to be an in-house product
- Using ‘loose equity’ keeps the door shut on institutional capital

The lender’s dilemma

Risk-Rating Models



- Poseidon Principles aligning lending criteria to ESG principles but…
- …shipowners assigned high rating despite lack of balance sheet support
- Institutional capital assigned lower rating
- Correct pricing of credit risk of existing equity sources?
- Existing models should not be used to prejudice new equity sources

What’s the solution?

- More transparent industry business practices: major end-users must take the lead
- Chartering managers must be judged/incentivised on a wider range of criteria than simply P+L and using more fuel-efficient assets
- Banks can facilitate institutional participation rather than looking for new ways to fund small pool of existing clients – re-jigging of risk-rating models
- Greater ESG alignment: Poseidon Principles are a start but investors likely to oblige all participants to take further steps
- Institutional investors have to see that this is a ‘proper’ industry in which to participate (public equity markets have NOT been helpful proving grounds…)
- Hell-and-high-water elements can be split out from OPEX risk in long-term contracts; myths built around operating capability must be dispelled

Something's gotta give?

- Large scale fleet renewal
- Market needs funding from new sources
- Institutional capital potentially available
- Pressure to change existing models is increasing (decarbonisation, governance, shrinking pool of traditional capital…)

Move to a more balanced risk sharing model

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