AND WHERE WOULD YOU INVEST?

A brief look at a container sector with Thomas Söderberg

Editors' Note: The following discussion on the containership sector was conducted with Thomas Söderberg, CEO of Tribini Capital Limited, which has successfully raised funds for the purchase of three fully employed containerships. Mr. Söderberg and his team have diligently developed a platform for the growth of the company, and while they enjoy an insightful understanding of corporate structures, fund raising and the capital markets, Mr. Söderberg likes to remind listeners that, "We believe that it is very important to buy the right ships, calling the exact bottom of the market and investing just before take-off is not possible, but with the right ships we do not have to worry."

Marine Money: Not everyone can afford a 12,000 TEU containership. What is the ship size that is likely to survive and thrive in the future? Recall that the Panamax was everyone's favorite and we know how appealing they are today.

Thomas Söderberg: Trades are always changing and with them the size of the ships needed. I am giving my age away when I say that I have been in the industry so long that even the big lines were running 2700teu ships in the Europe-Far East trade when I started. Today, the first 18,000teu ships have entered that trade. The 2700s where unattractive for some years when they were replaced by the bigger panamaxes, but found a new life in the North-South trades and again later as regional traders and feeders – and like that, there is a constant evolution in all existing trades and the new ones that are emerging. We are obviously comfortable with the prospects for the regional traders/feeders of 1000-3500teu where we are investing. We have no doubt that the emerging markets with their growing populations will become a larger and larger factor for containerized transportation, and that because of the on-shore infrastructure in many of those countries, there is no alternative to many small ports with limited facilities. In the developed and connected world, you can easily truck or rail containers hundreds even thousands of kilometers to the large ports where the new mastodon ships are calling. However, in large parts of the up and coming world like Asia, for instance, the geographical structure is different. These landscapes range from archipelagoes like Indonesia and the Philippines, for instance, or long coastlines with mountainous hinterland like Vietnam (3000km of coastline) and Malaysia, making it very hard if not impossible to build anything close to the Europe and American onshore infrastructure; so, consequently, the goods will have to be shipped in and out of many small ports. This will create an increasing need for the smaller feeders especially the geared ones, as simple economics will dictate that there is not enough money to build sophisticated ports in all these locations; in addition, the smaller volumes will not justify the investments either, so therefore, there will be an increased need for the smaller geared ships.

MM: A merger of Hapag Lloyd and CSAV is rumored, which is a brilliant combination of East-West and North-South trade routes. Is this the future and will M&A activity be on the increase?

Söderberg: There is no doubt that trading the main hauls is a scale business, so some degree of consolidation is bound to take place. That said, there seems to be a natural cap to how big liner companies can be before they start losing customers. Maersk, for instance, has merged twice, but within a few years of these mergers was reduced to the same market share as before the mergers. One can always argue it was poor implementation, retention, increased competition, etc., but there are also other factors; especially, the very big shippers that do not want to put too many eggs in one basket and will always have a limit as to how much of a percentage of their cargo they will let one company carry. I am not sure what is the latest on that rumored Hapag Lloyd-CSAV merger, but, as my old professor at London Business School always said, "There is no such thing as a merger," and I do not see either of these two companies as being financially strong enough to be the dominating party in a takeover, so I do not think it is going to materialize.

MM: The containership suppliers play a crucial role in this capital intensive industry, but even they have suffered from growing pains and a shift in vessel size preference. Their balance sheets are stuffed with less than desirable ships which presumably at least have been paid down. Where are these ships heading? Do they cascade heading somewhere else or are they scrapped as obsolete?

Söderberg: That is an interesting question and I am not sure it is one I can answer comprehensively without it getting very longwinded and twisted, so I think I will stick to the highlights. Whilst certain sizes sometimes happen to fall a little out of favor, they more often seem to have comebacks and reappear in new trades within a period of time. It is more the ships that don't suit the environment that have problems and end up on the beaches. We have an excellent 16 years old 2000teu vessel that is fuel efficient, shallow and well maintained, and that is well liked in the market. At the same time you have seen a 12 year old ship of the same size that went for scrap. She was built for speed, meaning that she had a larger engine and consequently higher consumption; plus, she was designed for the higher speed, meaning she was a deeper ship which is harder for the regional liner operators to use in the smaller trades. It is therefore more a question about finding the good ships within their respective sizes - they will always have a future. With fuel cost often being 3-4 time the TC hire these days, that is obviously the most important factor by far, but things may change so one need to pay a lot of attention to other design futures and keep a close dialogue with the end-users to be sure that what you "have on the shelf" is what the customer wants.

MM: Is the Panama Canal expansion moot as a result of the shift to jumbo ships?

Söderberg: Given that only one in eight panamaxes transited the canal on a regular basis prior to the expansion, I am not sure how big an influence it will have in the short run. It will, to some extent, depend on the pricing by the canal authorities but until there are more ports that efficiently can handle the real large jumbo ships, I believe that will be the limiting factor for how many of them will be transiting.

MM: The market is not great and the credit of the major liner companies, many of which are private, is stretched. Rates have yet to improve and the EU is investigating them. Yet the Koreans are ordering ships against CMA CGM bareboat charters. Is this the same wishful thinking that is taking place in the VLCC market?

Söderberg: Wow, that was quite a mouthful……. It is a highly cyclical business, but despite that margins are paper-thin and we have had a "poor" market for the last few years, we have not seen anybody throwing in the towel. Maersk have been showing decent numbers lately, CMA CGM has been upgraded by Moody's, so if that is how they are faring given the poor circumstances, maybe you are being a little harsh on this sector. Sometimes I am actually more impressed how agile the industry is and how fast it reacts, adjusts and adapts to new situations and environments. In terms of guessing what they are thinking in the VLCC world, I will have to pass.

MM: What is the appetite in debt and equity circles generally for the container sector?

Söderberg: On the debt front the market changed dramatically earlier in the year. From having been very scarce, to put it mildly, prior to the summer, quite a few financial institutions suddenly got an appetite for debt financing, possibly driven by the very limited downside there is on the values and now we are even seeing various sorts of subordinated debt structures showing up on the scene. We are, as mentioned, just about to venture out looking for fresh equity, so I will answer that question in a few months' time. We have been testing the water on a regular basis lately, and shipping does unfortunately still seem to have a reputation for being high risk with a lot of bad stories to its name, so, we are spending a lot of time trying to educate potential investors that this has nothing to do with container shipping, that is, the bulkers and tanker guys they are thinking of. The fact that we will not promise a yield seems to deter a lot of potential investors. We have as mentioned a little free cash flow on our existing ships but I much prefer to keep that for a rainy day or "invest" it in better upkeep/upgrading of the vessels knowing that a dollar spent wisely today is several dollars saved at the next docking; so we are not doing it to deter the investors, rather, improve on their total return, and I am sure that we eventually will find some investors that appreciate that. We do of course listen to what the investors are saying, and will be paying a yield as soon as we are comfortable that the recurrent income can justify doing so, which I think could be the scenario already next year. But then, shipping never does what you expect it to do.

MM: What does the tonnage provider of the future need to look like in terms of overhead? Management company? Tonnage mixes? Client mixes? Cost of finance? Acquisition costs?

Söderberg: I think, as in the past, they will come in many different forms and shapes. I think that we will see an increasing number of providers of large tonnage on long-term charter contracts to the liner companies as we have seen Seaspan doing. That is, in my book, more financing and "property" than actually shipping, and with the access to cheap capital being the key factor. That structure should match well with the long money from the pension funds as long as they are comfortable with the counter party risk. Liner companies do really not have to own ships; that is not essential to their business. Just look at the forwarding industry, they are doing well without. In our space - the below 3500teu vessels – the market is driven less by the scale of the big ships, but a need for the liner companies to have the flexibility to upgrade and downgrade vessels in the various regional services depending on the fluctuations in the trade flows, so, consequently our contracts are of a much shorter duration. This makes it more risky, more volatile and the point of entry so much more important – but it opens the opportunity for an interesting asset pay (play?), which you don't find with the big ships. The inelasticity of a market with a 2 years lead time on the supply side and a demand side that fluctuates between 0% and 15% annually is bound to be out of sync on a fairly regular basis – leaving some very interesting opportunities to be explored.