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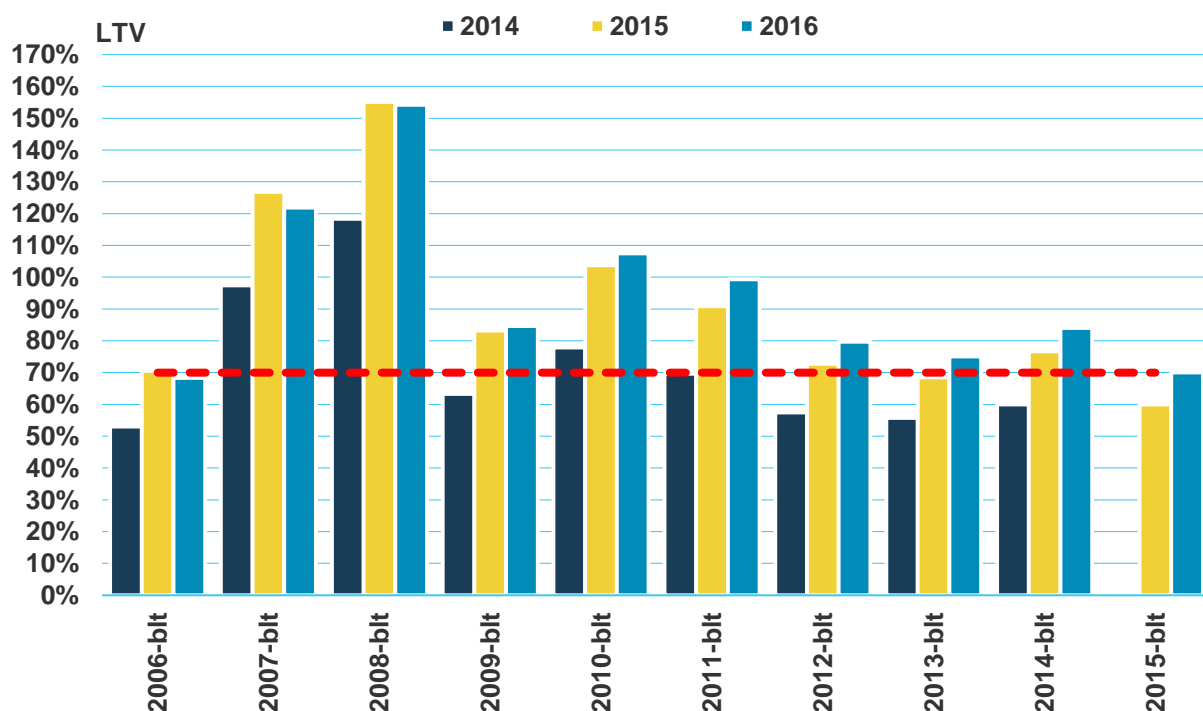
Dry Bulk Market – failing the stress test?

Next year will see an increase in stress on shipping loans as a result of plummeting asset values, with further consolidation and restructuring inevitable, according to the latest MSI quarterly research report.

The decline in second-hand bulker prices has been relentless and by mid-November values were at their lowest average levels for 15 years. Having spent most of the year to October ranging between \$30-35m, five year-old Capesize vessels were being assessed at \$27-28m compared with just under \$50m 12 months ago, representing a 45% fall in the space of a year. Five year old Panamaxes are being assessed at 32% lower, Supramax 35% and Handysize 38%.

In the past, shipping lenders have typically taken action to protect their exposure once a loan to value ratio exceeds 70%, typically through minimum liquidity covenants. The pressure on lenders to protect their exposure extends beyond internal risk processes – regulatory pressure is also weighing on banks' shipping portfolios due to the downturn in both earnings as well as expected asset values.

The Chart below shows MSI's assessment of LTV for a series of 75 k Dwt Panamax bulkers built each year from 2006, assuming traditional payment profiles incorporating an original LTV at purchase of 60% for a loan of 10 years.



Taking the 2006-built vessel as an example, we estimate a 75 k Dwt resale in 2006 was worth \$43.9m, and the scrap price for a similar-sized vessel \$4.9m. On this basis we assume the owner borrowed 60% of the cost to purchase the vessel in 2006 (\$26.3m), with a repayment profile of 10 years and a balloon payment of \$4.9m at the end (2016).

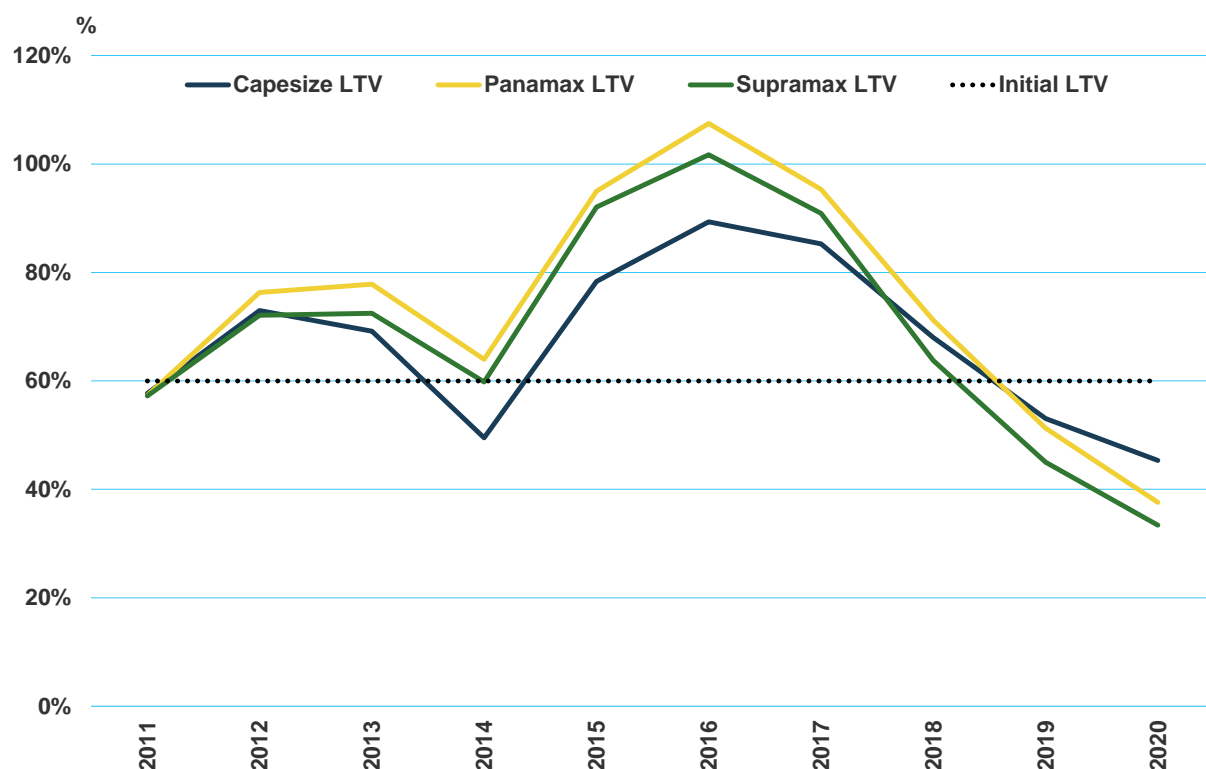


By 2014, the owner would have repaid \$15.0m of the principal, leaving an outstanding loan of \$11.3m; we estimate the value of the vessel in 2014 (at 8 years old) to have been \$21.3m - this corresponds to an LTV of 53%. Similarly in 2015 the outstanding debt would have dropped to \$9.1m, and the value of the vessel to \$13m, corresponding to an LTV of 70%; we forecast an LTV for this vessel of 68% in 2016.

Importantly, whilst in 2014 all but the 2007/08/10-built vessels had LTVs on average below 70%, our forecast implies LTVs will exceed 70% for all but the 2006-built ship in 2016.

In addition, MSI constructed three loans at a typical 60% LTV for 5 year old Capesize, Panamax and Supramax vessels issued in 2011. The period and profiles of the loans would be a good proxy for at least some of the loans issued to finance the ~450 second-hand transactions in 2011. The loan profile is set at 10 years, terminating in a balloon repayment set at the expected scrap value of the vessel, with no credit enhancements.

The LTV profile for the three loans are illustrated in chart below with the reference (60%) starting LTV. Excessive LTVs (over 80%) are projected for 2016 and 2017 for the three vessel types with periods where the LTV goes above a 100% (negative equity). In cases like these one may easily find lenders approaching owners to inject more equity in a low rate environment with cash-strapped owners forced to sell parts of their portfolios to fulfil their debt covenants.





This analysis may underestimate the complexity of debt in shipping, but it does serve to highlight the market's overall predicament; the change in debt pressure from 2014 till now. With earnings barely covering operating cost for even modern vessels, and pressure building from lenders on the basis of an increase in aggregate LTVs, it is likely we will see further consolidation and restructuring over the next 12-18 months, and potentially an increase in bulkers being arrested for non-payment.

The latter will have a negative impact on vessel values next year because not only will this bring about an increase in the number of sales candidates, but a significant share of arrested vessels would be sold at auction. From our database of over 640 vessels sold at auction historically we can see that sales through this process typically attract a discount of around 20% to fair market value (the latter being calculated through our vessel valuation models).

In any case, MSI expects bulker second hand prices to fall next year on average when compared with 2015 for all benchmarks from Capesize to Handysize. The sharp price correction in Q4 this year is a major factor behind the change to our outlook; downwards pressure on newbuild prices will also weigh heavily on vessel values despite a potential uplift to Capesize earnings on the back of stronger iron ore trade.

About Maritime Strategies International

Since its inception in 1986, Maritime Strategies International (MSI) has established itself as one of the shipping industry's foremost independent research and consultancy firms. Our success is built on a strong focus on maritime economics and econometric modelling. We provide a comprehensive range of advisory services, including forward valuations market forecasts, reports and commercial consultancy services for all shipping sectors. MSI asset price forecasts are used by ship finance providers holding 40% of all shipping bank debt and we provide analytical and methodological support to give the context and credence to our results.

The MSI Dry Bulk market analysis was produced using MSI's proprietary forecasting models and expert technical analysis. The full quarterly report is available on request and MSI experts are available for interview. For further information and interviews, please contact Neville Smith, Mariner Communications.