

Ship Finance

KG funds still struggling despite rise in freight and charter rates

The KG market remains under pressure: short of capital, locked into cut-price, long-term charters and owning the sort of ships that are yet to benefit from the upswing



PATRICK HAGEN AND KATRIN BERKENKOPF

RISING freight and charter rates as well as higher secondhand ship prices represent good news, and not only for the directly affected containership lines or tramp owners.

Beleaguered KG companies are also benefiting from the positive spin emanating from the shipping markets. That is understandable: the KG industry needs to revive the confidence of small investors in their business model. But unlike box lines, which are already in the black again, the KG industry has still a lot of problems to solve.

There is some encouraging news. The number of shipping funds launched by KG houses reached 12 in the second quarter of 2010, compared with only three in the first quarter, according to analysts Feri.

"In line with the emerging recovery in shipping markets, investors are beginning to trust shipping again," says Wolfgang Kubatzki, who focuses on KG funds at Feri.



A KG fund vessel, the 2,741 teu *Cape Manuel*, owned by König: despite the sector's problems, funds are benefiting from positive spin emanating from the shipping markets.

German ship finance expert Jürgen Dobert was more cautious. "We see a recovery of shipping markets, but the crisis has not been completely overcome," he says. "It would not be honest to mix these two things. But KG houses in particular have an interest in suggesting that everything is back to normal."

The German KG industry has been squeezed from two sides during the crisis. On one side, a number of existing KG shipping funds stood on the verge of collapse due to the breakdown of charter rates. This problem has receded as investors injected fresh capital into the funds. In addition, a number of opportunity funds are

ready to invest money in stricken funds — at very favourable terms for the investing party.

On the other side, KG houses ordered a lot of vessels before the crisis, which they wanted to have funded by small investors. But this source of capital has dried up, which leaves the companies in the hands of the banks.

"Many KG houses are still depending on a drip feed from the banks," Mr Dobert says.

Charter markets have surged in recent weeks but for a number of reasons the problems of the KG industry have not diminished. For one, the upswing has affected larger ship sizes and most of the existing German KG funds have

invested in smaller sizes. Hermann Ebel, managing owner of KG house Hansa Treuhand, expects that it will take through 2010 and 2011 for these ships to not only earn operating expenses, but also to be able to pay interest and principal.

In addition, not all KG-financed ships are benefiting from the recovery of charter markets. Some are locked in long-term charter contracts they agreed on during the bottom of the market. Some even gave options at very low rates, so they will certainly suffer regardless of market developments.

"Many KG vessels trade in pools," Mr Dobert adds. "That means that a higher rate for a single vessel will be shared and

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Jürgen Dobert
German ship finance expert

thus it will be some time until pool rates rise significantly."

On the other hand, such pools have also saved ships during the crisis.

"The financial problems of many KG vessels are still not solved," says Mr Dobert.

That corresponds with data collected by accountants PricewaterhouseCoopers for the German shipowners' association VDR. About 1,000 vessels are in financial trouble of some kind, of which about 200 would need government aid, according to VDR. ■

Secondary market offers low prices on fund shares

INSTITUTIONAL or private investors looking for shares in existing KG funds can profit from low prices on the secondary market. Prices are rising again, but it is still clearly a buyers' market, write Patrick Hagen and Katrin Berkenkopf.

The secondary market for KG shares is still quite young. It developed to its full bloom during the recent shipping boom. Investors who want to dispose of shares in KG funds nowadays have a variety of channels through which to sell.

"There is still not enough demand," says Wilfried Beneke, head of Beneke AG which, among other activities, brokers the sale of secondary KG shares. He points to the high soft costs of KG funds, which are regularly criticised. Less funds would have liquidity problems now if soft costs had been lower right from the outset, he believes. For the secondary market, Mr Beneke expects price levels to remain modest.

That is of course to the liking of those financiers selling funds that invest in secondary market shares only. "While actual ship prices are rising, prices on the KG secondary market remain low," says Hesse Newman Capital board member

SFI SHIP FUND INDEX
January 2000 - June 2010



Source: Börsen AG

Marc Driessen. On average, prices are one third below the record levels of 2008, he says.

The company is collecting equity for a secondary market fund. It has, in the past months, acquired shares in 50 KG funds. Apart from the low prices, such funds now enjoy another important advantage compared to the conventional KG fund — they do not need any bank loan, but rely solely on equity.

One indicator for the recovery of shipping funds is the SFI Index. It was launched in mid-2009 by the stock exchange organisations in Hamburg and Hannover. The index was

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calculated back to a base value at the start of 1997 and is updated monthly. It reflects the development of a virtual portfolio of shipping funds, investing in ships of different sizes and segments.

Because secondhand ship prices were not published at the time the index was launched, it has since been recalculated. During this process it became evident that the index level, during the crisis, was much lower than originally anticipated. It reached its lowest point in nine years last November, but has since climbed steadily.

Still, Jürgen Mohr, managing owner of the newly founded Concycle, recommends that investors do not buy KG shipping shares on the primary markets. Concycle will launch a secondary market platform in August and offers consulting services to owners of shipping fund shares.

"Investors can only act anti-cyclically by using the secondary market," Mr Mohr says. ■

Newcomers Orange Ocean optimistic about model's future

WHEN it became clear KG financing companies would be hit hard by the shipping crisis, many commentators predicted a consolidation of the industry. But that did not materialise. On the contrary, newcomers who had set up shop just before the crisis managed to establish themselves, write Patrick Hagen and Katrin Berkenkopf.

One of them is Orange Ocean. The Hamburg-based financier was set up in 2007 by Olav Killinger and Claudia Humme, both with a background in shipping and ship financing.

"We decided to focus on bulkers and that was just right," Ms Humme says. The company is now offering its seventh fund. All of the ships are of the handysize or supramax size. She would not say how many ships are still on order. Mr Killinger adds that the young company bought a pair of supramax bulkers direct from the yard this year to take advantage of favourable prices.

Almost parallel to the establishment of Orange Ocean, the two managers founded a new shipmanagement company called United Seven, which now manages six bulkers built in China and Vietnam.

"We feel the close connection between financier and owner is an advantage, particularly at a time where you see situations when the



Claudia Humme and Olav Killinger: Orange Ocean founders say they made the right decision by focusing on bulk carriers.

two are parting ways," says Ms Humme. They argue that being an owner and a financier gives more independence in choosing the really viable projects and having a close grip on them.

The two do not see any disadvantage in being newcomers during the crisis, both when it comes to convincing investors of their projects, and when bank financing is needed. They are very optimistic about the future of the KG model.

"It is good when the investors actually become a bit more critical," says Mr Killinger. "There are still attractive investments to make, but you have to work even

harder to convince the investors," he says with regard to the whole industry.

Young companies that have a small orderbook are likely to be in a better position than competitors, which have to find financing solutions for newbuildings bought at market highs. They can benefit from lower newbuilding or resale prices compared to those agreed during the boom and thus will be able to launch funds with a better perspective. In addition, KG companies that have other ship types than containerships in their portfolio also have an advantage — as boxships are still a no-go on the KG market. ■