Current Marine Asset Pricing Trends, Other than at "Half-pricing"

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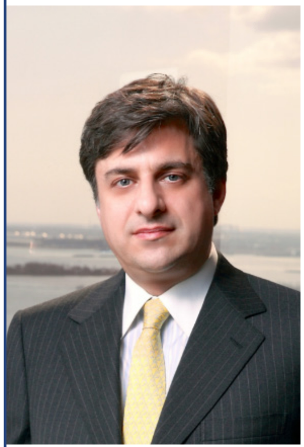

Since early in 2020, besides upending lifestyles and mandating for surrealistic life situations (i.e. video-link weddings and funerals), the COVID-19 pandemic has posed many business-related questions in many industries that require an answer. For a professional in the field of valuation, and specifically in the field of marine appraisals, value-related questions at the age of COVID-19 can be both very practical and also very philosophical at the same time.

For starters, COVID-19 changed (negatively) demand for travel and commuting which translated into lower demand for fuel and energy, which brough ballooning energy inventories, which, in turn, at least initially, led demand for tanker vessels to skyrocket (to be utilized as storage space). With COVID-19, consumer demand has dropped overall, but more critically, new consumer trends have made their appearance and even have shaken certain sacrosanct credos for the logistics management science (i.e. just-in-time (JIT) inventory is "bad" now, etc.). As companies and shippers are working on building up inventories—demand for warehousing space has skyrocketed—future imbalances likely will "shave" any future spikes in freight rates. Already, several indirect variables affecting marine asset values have been implied so far in several market sectors.

There has been the case of two cruise ships on contract to be sold in January 2020 at appr. $120 million en bloc (with the typical 10% down-payment of the purchase price lodged in an escrow account), and, the buyer walking away (and forfeiting their deposit) when COVID-19 became an issue; the same vessels were still in the market in July 2020 with $18 million en bloc asking price and no takers. A handful of twenty-year old cruise ships were sold for scrapping, but again, there was the case of a similarly aged and sized cruise ship that was sold at more than $30 million in the summer of 2020. Apparently, several parties here seem to have a very divergent view of value, or at least, "price" in the cruise ship market alone.

When asked to provide marine appraisals these days, several factors have to be given consideration, and, on occasion, a judgement call may have to be made. The sales comparable method reigns supreme when it comes to appraisals, as always, but when there is a thin market with few sales, whether clustered at a new baseline or scattered all over the map like the cruise ships earlier, one has to look further for more information. The income approach method for valuation cannot really provide much clarity, as with COVID-19 as a novel risk, future earnings and cash flows are even more unpredictable than before, allowing for a wider range of estimates and values. And, true to its typical critique, the replacement cost method may provide even more historically driven estimates at the age of COVID-19.

Looking further into the current market, with an eye on the market comparable method, the following observations may be drawn:

- Buyers—Having recently canvassed closely the market for the sale of a Jones Act tank barge and having talked to many owners (as prospective buyers), there is uncertainty where the market is heading, and whether demand will be recovering soon. In general, there is a "wait and see" approach to any acquisitions at present; few companies said explicitly that they are not buying any asset at present, with the majority of them taking a non-committal approach. However, there have been many companies who would have been buyers if opportunistic pricing was offered. For that particular transaction, while there was zero interest at the asking price (estimated as the FMV just before COVID-19 at which FMV tentative offers had been submitted four months earlier), there were more than a dozen buyers at prices at 40-50% of the estimated FMV. But, there were a few more bidders between the previously-estimated FMV and the "half-price" crowd. For a seller keen to close a deal (more or less under compulsion to sell), clearly there was a deal to be done, and a fresh price data point, at some discount point to FMV. On the other hand, for a seller under zero compulsion to sell at any discount at all, no deal and no new price benchmark would be. Besides these two extreme points (a sale at an FMV pre-COVID-19 established and a sale at a "half price"), there are several reasons for a seller not no capitulate and sell, some based on the transaction specifics, and some on the specific market (market segment) and also the type and age of the asset itself.

- On the market segment—As a vivid example with offshore drilling, whereby it would appear that that multi-billion offshore projects with sophisticated drillships that could drill several miles below the seabed are just too capital intensive and extremely high sunk costs, a seller would have to make a market call on whether there are any recovery prospects, their timing thereof, etc. The flexibility of the shale oil with its relatively low capital demands and sunk costs has the potential to substitute offshore drilling, at a time when renewables are growing fast their market share of energy production (at the expense of traditional energy companies). Really, for a seller of drillships, the decision to accept any buying offers at any level is mostly predicated on the market prospects in which the asset operates, the deep-water offshore drilling market. Thus, valuing a drillship at present is a thankless task: two years ago, a modern drillship was bought at auction at just $50 million, while its replacement cost new—of that very same asset five years earlier—was a whopping $750 million. Offshore drilling contracts are few and in-between these days, and usually shorter than one year in duration (instead of the five-ten contracts available a decade ago), so the buyer was effectively valuing the asset as if at a high stakes gambling table in Las Vegas. And, the seller had accepted, for whatever reasons, such analysis.
- On the asset type (storage costs)—A drillship costs more than $50,000 per diem to be stored, thus, "buying" a year's optionality comes at an approximate cost of $18 million. A dry bulk hopper barge on the other hand can cost as little as $50 per diem to store, thus, a seller not happy with the current market, could rather cheaply buy a few more months in the hope of obtaining pricing levels approximating pre-COVID-19 levels. Although still there are few data-points of barges and other "simplistic" marine assets, one would think that there will be few sales at "distressed" levels (the plethora of opportunistic buyers showing up at 40-50% level of the estimated FMV mentioned for the tank barge earlier).
- On the asset type (obsolescence)—Again, starting with a drillship at one extreme, a highly sophisticated vessel that mostly depends on technology and software rather than on marine engineering; accordingly, such vessels are subject to every type of obsolesce, ranging from technical to functional obsolesce, and even if the offshore drilling market comes back, drillships idling for several years may be just too out-of-date to command a fair price. On the other extreme, a hopper barge conceptually is a steel double-hulled floating open box with no engine and not much equipment to deteriorate. Only their steel plate can get rusty with the weather, but, again, for the river and fresh-water barges, that's relatively a small worry. Obsolesce is getting more critical however for older assets approaching the end of their total economic life, let's say barges around thirty years of age, when the steel plates have been wasted enough over time to allow for minimal thickness, thus having minimal margin for error. Accordingly, assets with little risk of obsolesce (and lower standards of maintenance and regulatory compliance) allow for their owners enough flexibility to not capitulate and accept distress level pricing.

COVID-19 has been affecting marine assets, mostly negatively, generally via lower demand for cargo and shipment thereof, and the resulting lower freight market. As such, buyers do not feel compelled to step up and buy assets at pre-COVID-19 price levels. Sellers, on the other hand, have a more sophisticated decision to make before settling at current asset pricing, which pricing may be purely opportunistic. Sellers have to consider factors like the type of the asset and associated variables such as market recovery prospects, asset storage costs, obsolesce considerations, etc., and the sellers' collective assessment of such factors likely to be setting the market per marine asset class, at lease for the next few months; and, sellers need keep looking for buyers who pay $30 million to buy a cruiseship in the summer, and the tank barge buyer who closed the purchase at materially above the "half price". That applies to marine asset appraisers, too, to pay attention to the price comparables that are not opportunistic.

About the Author

Basil M Karatzas, ASA, is the Founder and CEO of Karatzas Marine Advisors & Co. (www.karatzas.com), a ship-brokerage and shipping finance advisory firm based in New York.

Basil, a native of Greece and resident of the United States, holds a college degree in chemistry and biology, an MBA in International Business and Finance from Rice University in Houston, and he is also a graduate of the Owner President Program from Harvard Business School (HBS) and an alumnus of the school. Basil is an Accredited Senior Appraiser (ASA) in Machinery and Technical Specialties by the American Society of Appraisers, a Fellow of the Institute of Chartered Shipbrokers in the UK, member of the Baltic Exchange in the UK, and member of several professional associations and societies.

Along with the professional team of Karatzas Marine Advisors & Co., Basil serves both the US and the international maritime community as a ship broker, a shipping finance advisor and vessel appraiser. Clients include both operational and financial shipowners seeking ship brokerage and shipping industry expertise worldwide in the segments of dry bulk, tanker, containership, offshore, brown water and Jones Act assets. In a financially challenging market, Basil and his team have also placed transactions and sourced capital on behalf of international shipowners. In his capacity as a vessel appraiser, valuations prepared by Basil and the firm have been utilized for SEC filings and IPO offerings, as well as for loan documentation and litigation.

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