



The Bottom Line

Business advisers and auditors to the shipping industry

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Opportunity knocks – or just knocked out

Everyone in shipping entered 2008 holding their breath, wondering how long shipping's best ever market run could continue. Shipping was in uncertain times. We enter 2009 with at least one certainty – the good times are over for now. The easy money has dried up, old ships have been scrapped or are laid up and there are no prospects of markets going up any time soon.

Does this mean that shipping should despair? Not at all. In a cyclical industry, sensible players make money whichever way the market moves. For many people in shipping, a sharp downturn in freight rates and ship values is the sound of opportunity knocking, rather than the prospect of a knock out.

So who will be knocked out? And who will prosper over the next year?

Newbuilding order cancellations are growing quickly, so it is certain that some shipyards will never be built, and others will take a hit. Even the major yards are struggling with finance, and smaller yards trying to get into the market cannot secure guarantee finance. So although steel prices are falling, energy prices are falling, wage expectations are falling and interest rates are falling, it looks like a tough time for shipbuilders in general. The exception will be the major groups and yards in niche areas such as cruise ships, LNG and more complex vessels, which will emerge from the trough having seen lower cost competition die before it could grow.

Shipping banks are short of cash to lend and that doesn't seem likely to change. Although shipping is still a solid big-ticket business, many banks that came into shipping in rosier times will not relish the workouts they will face in 2009, and will walk away. So expect to see fewer banks in shipping, lending more carefully, at higher margins, and for shorter tenors. Shipowners who have been around for a while will recognise this as a good thing, especially as higher margins will be offset by lower interest rates as interbank rates come more into line with central bank rates.

And shipowners? Every sector will find cashflow a problem. Every sector will struggle with ship valuations and loan covenants. And there will be casualties. But look again and you can see why there is still optimism amongst owners. The lower markets should rein in spiralling crew costs. Scrapping of old tonnage is



"Whatever is happening in the world, shipping is still a good business to be in."

increasing and will increase faster as the year progresses. And owners have made a lot of money in the last few years, so they are sitting on a lot of equity. Interest rates everywhere have plummeted. Put companies and newbuilding orders in trouble together in the same room as an owner with equity and access to low-rate finance and you see assets moving from an over-exposed and perhaps inefficient owner to a more prudent, solid operator.

Yes, 2009 will be a rough ride for everyone. But those who watch their cashflow and who have not over-extended themselves in the boom, or who sold out before the peak (and there were a lot who did) will see this as a chance to expand, or to buy back into shipping. Whatever is happening in the world, shipping is still a good business to be in.



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Planning for pension changes

From 2012, UK employers will need to automatically enrol the majority of their staff in a pension scheme and pay a minimum contribution of 3% of salary.

From that date, assuming that employees do not elect to opt out, employers must set up a scheme for all those staff aged between 22 and the state pension age and earning more than the national insurance threshold. A contribution of 8% of earnings within the national insurance band, between £5,435 and £40,040 for 2008/09, must be paid, with the employer paying at least 3%. Employees can choose to contribute to their own scheme or the new UK government personal accounts, or a combination of both.

Employers currently paying more than 3% in pension contributions may consider reducing this to offset the cost of adding additional members to the scheme, while firms currently paying less than 3% face a double-whammy – the need to boost their payments, plus the increase arising from higher membership levels.

Although the changes do not take effect until April 2012, early planning is advisable. For more details contact:

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GSL relishing NYSE listing

The freight markets in the containership sector, like those for other tonnage types, may currently be depressed, but Global Ship Lease, the Marshall Islands-registered containership lessor, is performing in line with its business plan, after recently being launched on the New York Stock Exchange.

Ian Webber, CEO of GSL, explains, "Clearly, it would be preferable if the markets were buoyant, but as an owner and not an operator we are not directly exposed to volatility in freight rates or cargo volumes. We have a stable business plan, with \$1.8 billion of locked-in revenues for the next nine-to-ten years, plus our operating costs are largely capped for the next couple of years."

In August 2008 GSL, then a subsidiary of France's CMA CGM, merged with Marathon Acquisition Corp, a blank check company already listed in the US. The transaction was effectively a reverse takeover, which created GSL as the NYSE-listed vehicle it is today. From CMA CGM's perspective it realised its objective of a billion-dollar sale-and-leaseback deal via the US public markets. Ian Webber says, "The NYSE listing places us on the same platform as our major listed competitors, in one of the world's largest and deepest-capacity public markets."

GSL closed 2008 with a fleet of sixteen ships. In July, it plans to buy a further vessel, plus two more in fourth-quarter 2010, bringing the fleet to nineteen ships, with a healthy average age of around six years.

Ian has extensive experience of the containership trades, having been CFO of CP Ships for ten years



Ian Webber, CEO of GSL

prior to joining GSL at its inception in May 2007. He also understands what a shipping company needs from its accountants, in which capacity Moore Stephens provides accounting outsourcing services, and tax and regulatory compliance advice such as Sarbanes-Oxley. He says, "We require a proactive service by people who know the shipping industry, who can respond flexibly to our needs and, indeed, anticipate our requirements rather than just react to requests. We want a first-class level of service for a realistic fee. Moore Stephens has greatly assisted our transition from private subsidiary company to being NYSE-listed and has easily met our expectations."

No news may be good news

The fact that the Pre-Budget Report issued by the UK government last November does not include any measures which significantly affect the shipping sector could be regarded as good news for the industry.

Although the government has been asked to make changes to UK tonnage tax, the report made no mention of it. Possible changes to the tonnage tax regime could have included an amendment to the EU flagging rules excluding ships time-chartered into the fleet, and clarification of the position with regard to the changes proposed in January 2008 which were later withdrawn. But these are complex issues to resolve as they depend on agreement with the European Commission.

The Pre-Budget Report does, however, include some provisions which may be of interest to shipping. For

example, the Finance Bill 2009 is likely to include an exemption from tax for most foreign dividends, in conjunction with which there will be continued consultation on the options for reform of the rules relating to so-called 'controlled foreign companies' (CFCs). The government has also announced a review into the position of the UK's crown dependencies and overseas territories as offshore financial centres. An exemption from tax for most foreign dividends may be helpful for multinational groups, but it remains to be seen how CFCs will be taxed.

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Stop Press

The Government has announced that the Financial Year 2009 will not be an "excepted year" for the purposes of the UK tonnage tax EU flagging rules. This means that the EU flagging rules which first applied for the year commencing 1 April 2008 will also apply for the year commencing 1 April 2009.



Accounting in the current market

In the current market, accounting may not be at the forefront of owners' minds. But with many shipping companies having financial years that ended in December, many accounting issues will need to be addressed soon.

Here are ten points that owners and operators may need to consider.

- 1. Broker valuations:** Before worrying about how to account for vessel values, you first need to know what they are. This is likely to prove more difficult than in the past, with brokers more reluctant to provide valuations at all, and adding more caveats to those valuations they do provide. Directors (and auditors) cannot be more confident in valuations than those who provided them, so caveats and limitations on valuations may need to be disclosed in financial statements;
- 2. Impairment:** With falls in vessel values, many owners will need to consider impairment. Whatever accounting policy is adopted, vessels will always need to be written down if they are worth less than their current carrying value. Market values will always be the starting point for such assessments. In limited circumstances, it may also be possible to look at future income streams, although this will usually apply only to vessels with long-term fixtures;
- 3. Residual values:** Not quite as much of a problem as the previous points, but IFRS require residual values to be redetermined annually. With scrap prices below those of previous years, this is likely to increase depreciation charges;
- 4. Newbuildings:** Impairment issues may arise just as much with newbuildings as delivered vessels. Additionally, consideration will need to be given to yards' abilities to deliver and companies' abilities to continue to finance newbuildings;
- 5. Loan covenants:** Companies must consider whether they continue to comply with all covenants in loan contracts at the balance sheet date. If there are breaches they must consider any accounting implications. For example, breaches may make amounts payable current. Even where breaches have been remedied before accounts are prepared this will not affect the accounting. This must reflect the position at the balance sheet date;
- 6. Charterer default:** While connected with impairment, consideration also needs to be given separately to the risk of charterer default. Shipping companies usually have limited exposure to receivables, but any potential for default on longer charters could have a considerable impact on vessel values and profitability;
- 7. Derivatives:** In addition to the risks and potential for default associated with conventional trading,



there is also the counterparty risk associated with FFAs and other derivatives, particularly for OTC instruments. This will need to be taken into account both for the purposes of valuing such instruments, and in deciding on appropriate disclosure;

- 8. Onerous contracts:** A contract is onerous where the unavoidable costs of meeting that contract exceed the economic benefits expected to be received under it. So, for example, an onerous contract might arise where a vessel was chartered in at high rates, but can only be fixed out at lower rates. Provision must be made for expected losses under the charter; and
- 9. Narrative disclosures:** While not directly an accounting issue, and very dependent on the nature of the company and the jurisdiction from which it operates, many companies will be required to provide a narrative summary of their position and prospects. This may be a requirement of local law, arise due to a listing or simply be best practice. Such disclosures need to be comprehensive, balanced and realistic.

And then the big one.

Financial statements are usually produced on the basis that the company is a going concern, that is, it will be able to continue to trade for the foreseeable future. Directors need to decide if this is appropriate, taking into account any circumstances that might call this into question.

Just as importantly, even where the directors do ultimately consider the company is a going concern, the financial statements have to disclose all the significant uncertainties the directors considered in reaching this assessment.

Financial statements will make for interesting reading over the next few months.

Sticking to basics

Now is not an auspicious time for shipping to be looking to borrow money. But for those who are, it is important to remember that the old values count for as much in a bad market as they do in a good one, perhaps even more so.

There are still banks that are lending money for the best projects, although equity and due diligence requirements have increased. But in order to be in a position to even sit down with them and talk credibly about funding, first make sure that you have a well-written, easy-to-understand business plan that sets out a clear path to profitability and positive cash flow.

Emphasise your Unique Selling Point, and why you believe you will succeed and be able to comfortably service your debt obligations in a difficult and competitive market. Know the strengths of the people in your company, and convey them to your prospective funders. Be positive. And, above all, be realistic and don't ask for too much.

If you are unsure how much to ask for, consult a professional business adviser, preferably one who specialises in shipping. And while you're there, ask them to have a look at your business plan.

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Quote

"The increasingly extensive global financial and economic crisis seems to have brought the more than five-year long 'super-cycle' in the market to an end."

Danish operator Norden, reporting a 38% 3rd quarter 2008 drop in profits just after returning over 70 short-term-chartered bulk carriers.

Who to contact

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January 2009

Profile: Michael Kotsapas



Michael Kotsapas was born in Nicosia, Cyprus, and came to London to study at the London School of Economics in 1998. Having completed his studies, he joined Moore Stephens in September 2001. He said he wanted a "challenging career", and that is what he now has.

Michael qualified as a chartered accountant in 2004, and today is an Associate. He provides assurance and advisory services to global corporates and international

private clients in the shipping, aviation and property sectors. His client portfolio includes companies listed on the Oslo, New York and London stock exchanges as well as private clients. In addition to statutory audit services, Michael advises clients on the implementation and compliance with International Financial Reporting Standards, UK GAAP and US GAAP, and on other technical matters. "Typically," says Michael, "we are dealing with large, global, public and private companies with turnovers ranging from \$100 million to \$1 billion."

"2008 was an amazing year," explains Michael. "We have been extremely busy which, given the current economic downturn, is a good thing. The main reasons why we have so much work are increasing compliance and audit regulation and additional demand from clients for advice over and above the traditional audit, to ever tighter deadlines."

Michael enjoys the great variety involved in his work, and relishes the opportunity which it affords him to travel. He has visited places such as Greece, Norway, Belgium and Switzerland.

When he isn't working, Michael enjoys sports, these days mostly as a spectator rather than as a player and he regularly attends football matches at Stamford Bridge stadium. Travel is also one of his great passions, and he admits that, between business and pleasure, his carbon footprint is "not great". But there are other places where his footprint does attract critical acclaim.

Michael's real passion is Greek dancing. He is a professional Greek dancer who, as part of a dance group in Cyprus, travelled extensively as a performer. He has taught Greek dancing at the LSE and at other universities and colleges and knows the best tavernas in London where you are likely to listen and dance to Greek and Cypriot music.

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International growth continues

Moore Stephens International is firmly established as one of the world's leading accounting and consultancy associations – and it is still growing.

Over the past twelve months, Moore Stephens International achieved 18.7% growth in fee income, from \$1,884 million to \$2,237 million. Its member firms currently employ 21,244 members of staff in 647 offices worldwide, compared to the corresponding figures for 2007 of 19,279 and 621, and it has increased its coverage over the same period from 95 to 98 countries.

Moore Stephens Senior Partner, Richard Moore says, "The planned development of Moore Stephens International is based on providing strategic geographical coverage and on regional initiatives designed to grow and develop quality services for our many international clients, not only in shipping, but across all our chosen markets ."

