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Business advisers and auditors to the shipping industry

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How much is a ship worth?

Sometime too hot the eye of heaven shines, and often is his gold complexion dimm'd; and every fair from fair sometime declines.



David Chopping

Shakespeare was not thinking about the shipping industry when he penned these lines, but shipping today has reason to reflect on the more prosaic truth behind the words – all good things come to an end. In recent months, many of the world's listed shipping companies

have released their financial statements, those covering the fading of the (not quite) eternal summer of the last few years. It has been challenging. Companies have, amongst other things, had to consider whether their assets are impaired.

Even a brief review of shipping company accounts highlights the number of impairments made. But many relate to items other than vessels and newbuildings. From a sample of 51 US listed shipping companies, nearly 30% have recorded impairment losses, but only half of those have recorded any on newbuildings or vessels. Why?

Under both IFRS and US GAAP, the existence of impairment is determined by comparing the book value of an asset with its recoverable amount. In non-technical terms this is the higher of how much you could get from selling it or continuing to use it.

The starting point for estimating how much you could get from selling a vessel is a broker's valuation. Such valuations have been called into question by some shipping companies, on three main grounds.

Firstly, in a thin market, determining a market price will be tough, so the margin of error increases. Secondly, does a broker valuation really reflect 'fair value'? Fair value is not just the amount you could actually sell something for. It involves assumptions about the depth and quality of the market. If recorded sales are forced sales, then significant adjustments may be required to arrive at fair value. Most brokers would

argue that, notwithstanding this, they have provided fair values. Thirdly, the market has overreacted. A broker may provide a 'fair value', but that is below the 'real' value as the market is discounting future earnings potential too heavily. The efficient market hypothesis tells us that this can't happen. But then the efficient market hypothesis has had its obituary printed in The Times, which also told us there were no mourners.

Whatever grounds a company may use, if broker valuations are below book value, a company can still try to demonstrate that its future cashflow exceeds that value. Here IFRS and US GAAP diverge, with the IFRS test based on the present value of future cashflow, and the US test based on nominal amounts. This means impairments are much less likely under US GAAP.

"Whatever grounds a company may use, if broker valuations are below book value, a company can still try to demonstrate that its future cashflow exceeds that value."

In both cases, there are two main methods of using future cashflow to support a valuation. The first is to take account of factors not reflected in a broker valuation, such as long-term charters at good rates. Secondly, and more controversially, in those cases where companies (those perhaps where summer's lease hath all too short a date) have no such factors to take account of, they can use their own estimates. Where the result of this exceeds book value they can then at least argue there is no impairment. However, under IFRS, this does require an assumption that the market is currently mispricing vessels.

The assumptions will need to be supported, and to survive the sceptical scrutiny of the company's auditor. Only time will tell if such projections were reasonable or unduly optimistic.



The Bottom Line

OSG/Euronav joint venture audit

Moore Stephens has been appointed auditor of two eight-year joint ventures formed as special-purpose vehicles by leading tanker operators Euronav and Overseas Shipbuilding Group (OSG) to cover the acquisition, conversion and sale of two of the world's largest oil tankers as FPOs (Floating Storage and Offloading units).

In February 2008, Maersk Oil Qatar AS awarded service contracts to the Marshall Islands-incorporated OSG/Euronav joint ventures, providing for the sale of two double-hulled ULCCs, the 442,839 dwt TI Asia and the 441,655 dwt TI Africa. The FSOs are expected to begin operating in the second half of 2009 in the Al Shaheen offshore oilfield, north of Doha, Qatar.

OSG is listed on the NYSE, while Euronav is listed on Euronext, the Brussels stock exchange. The accounts are being prepared under US GAAP and, because OSG is a Securities & Exchange Commission registrant, the audit work will be signed off by Mitch Bean, a partner with Goodman & Company, the member of Moore Stephens International in Norfolk, Virginia. Moore Stephens London will carry out audit work as a subcontractor for Goodman & Co.

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Unicorn eyes quality growth

"Accounting has always been an important part of shipping, given the complexities of shipping structures and activities," says Hugh Scheffer, managing director of Unicorn Tankers (International) Ltd (UTI), in London. "The quality and integrity of our accountants is of paramount importance, and we look to them to provide high-level advice."

Moore Stephens acts as UTI's tax consultant and has enjoyed a successful relationship with UTI since the latter was formed in the UK in 2001 as a wholly-owned subsidiary of Grindrod Limited, the Johannesburg Stock Exchange-listed group operating in maritime-related businesses.

The UTI group in the UK owns the group's tanker fleet. It is responsible for buying or chartering in and fixing employment for these tankers. All operations relating to the tanker fleet take place in the London office, and the ships in UTI operate within the UK tonnage tax regime.

The UTI fleet currently consists of seven medium-range product tankers, four chemical tankers, and two intermediate product tankers. The medium range tankers are all chartered out to first class charterers, the chemical tankers are employed in the Stolt Chemical tanker pool, and the intermediate tankers are currently employed in the spot market.

Hugh Scheffer has been with Unicorn since 1974. He started as a seafarer, sailed with the company's ships for eleven years, ending up as master, before switching to an office desk in 1985. Today he is responsible for the growth, employment and disposal of the fleet. He says, "UTI is always on the look-out



Hugh Scheffer – Unicorn Tankers

for opportunities to expand. We believe current market conditions will lead to opportunities that a well-positioned company could take advantage of."

When asked what UTI looks for in its accountancy and tax advisers, Hugh says, "The key attributes are a knowledge of the industry, an established track record of integrity, innovation and forward thinking, the ability to provide a global service, and the expertise to offer a range of services, including, for example, tax and payroll."

"Moore Stephens is able to tick all these boxes, and furthermore has an established track record of shipping industry experience and expertise. We are very happy working with them."

UK overseas dividend tax changes

Although the UK government had been asked to make changes to the tonnage tax regime, the April 2009 Budget made no mention of it. In the current economic climate, it is not surprising that these potentially complex issues have been put to one side. Companies in the shipping sector may in any case have more pressing financial concerns at the moment. As a result, the taxation regime at least continues to be reasonably stable.



Sue Bill

The Finance Bill 2009 does, however, include some provisions which could be of interest to certain shipping groups. There is an exemption from tax for most foreign dividends received after 30 June 2009. In conjunction with this there are consequent minor changes to the rules relating to so-called 'controlled foreign companies' (CFCs). The exemption from the CFC rules which previously applied if the company followed an "acceptable distribution policy" will no longer apply and certain holding company exemptions will also be removed. In addition there is a cap on the deductibility

of interest payable by UK group companies. This will be calculated by reference to the consolidated gross finance expenses of the worldwide group and will apply to accounting periods beginning on or after 1 January 2010. International groups should therefore review their financial structure.

The Treasury Consent regime is also being substantially revised. Previously, advance approval was required for certain transactions involving shares in non-UK subsidiaries. From 1 July 2009, this regime has been replaced by a post-transaction reporting requirement for transactions with a value of £100 million or more.

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Shipping confidence improving

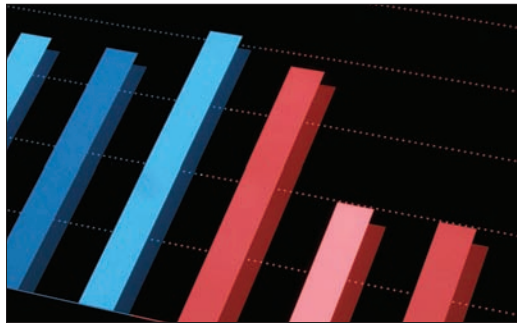
Overall confidence levels in the shipping industry have shown a slight improvement over the past three months, according to our latest Shipping Confidence Survey. But there are high levels of concern about the harmful effects of the glut of newbuildings that will continue to come onto the market over the next year.

The average confidence level expressed by respondents, on a scale of 1 to 10, was 5.5, compared to 5.4 in the previous survey in February 2009. Owners, managers and charterers all exhibited a small increase in confidence in connection with the shipping markets in which they operate.

Quite apart from general uncertainty about the world economy and the state of the freight markets, the most commonly recurring area of concern expressed by respondents involved the newbuilding market. "The weight of the order book is a serious problem," commented one respondent, while another noted, "There is more toxic debt on the newbuilding front still to be revealed".

The survey showed a modest increase in the number of respondents expecting to make a major investment or significant development over the next twelve months. The overall likelihood of such a development was 5.0 out of 10.0 overall, compared to 4.8 in the last survey.

Once again, the survey showed that demand trends were expected to be the single most important factor



"The survey showed an increase in the number of respondents expecting to make a major investment."

likely to affect business performance over the coming year. But respondents also identified the cost and availability of finance as a highly significant factor affecting performance, even though there was a one percentage point fall in the number of respondents who expected finance costs to rise over the coming year.

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Outsourcing can help maximise resources

Running a modern business is a challenging task. There are increasingly more distractions to cope with, more relationships to manage, and consequently often less time available to concentrate on key areas of the business.



David Cockrell

Outsourcing some or all of a company's financial and administrative functions in order to free up valuable time and resources is one way of tackling the problem efficiently and cost-effectively, and the Moore Stephens Business Support and Outsourcing (BSO) team is

ideally placed to help. It provides services to national and international organisations, large and small, embracing every industry sector – including shipping – ranging from start ups, growing businesses, international entities, businesses relocating or restructuring to those that are winding down.

David Cockrell has moved from managing shipping audits to join the BSO team, where he will focus on further developing and delivering outsourced services to shipping clients, who typically require maintenance

of accounting records, monthly management accounts, preparation of annual financial statements under UK GAAP, IFRS, US GAAP, VAT compliance, payroll, business tax and other advice.

He says, "It's a somewhat different world and an exciting challenge, although there are still tight deadlines for almost every assignment. We have taken on some significant clients in the past year or so, including a large container shipowner, a product tanker owner, a national fleet and the UK arm of a European tanker and bulk carrier operator.

"Having the confidence to entrust the running of part of your business to a third party provider is essential. We've found that once clients can see for themselves the level of expertise our BSO team offers and the ways in which we can help, they use us for an increasing range of services."

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We can work it out

Against a background of plummeting freight rates and the worldwide economic downturn, banks are now looking increasingly closely at what they see as failing enterprises.

In the event of a non-performing loan, the bank will typically turn to the management of the borrower for information. But an independent, credible expert is likely to be more successful than the management of the company in getting at the information which the bank wants, analysing the numbers that really matter, and evaluating the business plan.

Moore Stephens' team of industry experts is uniquely placed to offer such a service to banks. We can conduct an independent business review, working alongside lawyers where appropriate, which will provide the bank with the key information it needs to reach an informed decision in relation to its investment, and how best to proceed.

In many cases we can achieve a work-out solution acceptable to all parties. This could involve our specialist Business Support and Outsourcing team, who are able to undertake a wide range of services which are not part of the traditional function of the banking industry.

In appropriate cases, we can also call on our Business Recovery & Rescue team, with its extensive experience of corporate administration and liquidation. Whatever the banks' needs, Moore Stephens is ideally placed to project-manage the entire process.

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Quote

"Predicting wholesale bankruptcies at this stage might best be called alarmist."

Peter Shaerf, managing director of AMA Capital Partners, responding to comments from Paul Slater, chief executive of First International, that more than half of those shipping companies with stock exchange listings could slide into bankruptcy or administration proceedings in the next year.

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Profile: Stephen Adrian

Stephen Adrian has been with the same firm for 29 years, so it would be a hard taskmaster who would deny the Moore Stephens Melbourne director the eight-week sabbatical he is currently engaged on.

Stephen joined Moore Stephens straight from university, where he studied economics and law. He was not attracted to family law or conveyancing, but rather was drawn to the career which Moore Stephens offered in a commercial field which used his legal skills.

Moore Stephens has six member firms in Australia – in Adelaide, Melbourne, Perth, Queensland, Sydney and Sydney West. Stephen is the head of the tax group in Melbourne, which is the largest of those firms. He leads the shipping group and has good exposure to private groups and property. "In Australia, as elsewhere," says Stephen, "the shipping industry can benefit from advice on how best to respond to changes which affect their operations. Just recently, for example, the government effectively abolished income tax exemption for income earned offshore. The Australian shipping industry had been campaigning for a widening of the exemption so that Australian seafarers would be taxed on a similar basis to foreign seafarers. Now that exemption has effectively been removed, and Moore Stephens is to prepare a submission to the government on behalf of its clients."

Stephen says the biggest challenge facing the Australian shipping industry at the moment is the struggle to maintain investment and skill levels. He explains, "Notwithstanding our location, the industry has been contracting. The tax system does not encourage investment. As part of the expert service we offer to clients, we are actively involved with the Australian Ship Owners Association, trying to influence



government policy to stimulate investment here. A tonnage tax regime is under consideration."

Stephen and his wife, Chunnie, have two children – Ethan, aged eight, and Olivia, who is seven. He says, "Both Chunnie and I enjoy both types of skiing, and drink too much wine." The sabbatical on which they are currently engaged will see the whole family travel the 5,600 km by caravan from Darwin to Perth. They are travelling by train from Adelaide to Darwin (The Ghan), a distance of about 5,200 km and then flying home. The road trip lasts for eight weeks and includes visits to the El Questro, the Bungle Bungles, the Argyle Diamond Mines, and Broome, the pearl centre of Australia. Stephen says, "As you can guess, Chunnie is planning to singlehandedly stimulate the economy. You have to work long and hard to get a sabbatical, and we intend to enjoy every minute of it."

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Moore speaking

Delegates to the China Maritime Congress in June this year got two Richard Greiners for the price of one.



Richard Greiner

At the opening session, prior to the start of the conference proper, Richard delivered a presentation entitled, 'Is Tonnage Tax a good policy to attract shipping companies?' Then, during the main conference, Richard presented a paper entitled 'Preparation for IPOs'. This was clearly

value for money for the assembled audience of shipowners, shipbuilders, bankers, lawyers,

consultants, trading companies, and suppliers from all over the world.

And Richard has not finished yet. In October he will present the findings from OpCost 2009 to the Lloyd's List Events 19th International Ship Management Conference in Hamburg. Richard's presentation to the same conference last year in Limassol generated considerable interest in Moore Stephens' unique costs benchmarking tool for the shipping industry, which this year will be the biggest and best to date.

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