



# The Bottom Line

Business advisers and auditors to the shipping industry

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## Going green – with envy?

We live in interesting times. As we enter 2010, shipping is going about its business to the tune of background music which has two big recurrent themes. One is that the public and the media don't like bankers very much, and the other is that the global shipping industry is going to be punished for being slow to sign up to the frenzied rush to cut global carbon emissions.

What makes this interesting is that the best thing to be in shipping today is a shipping banker. And shipping is already the greenest of all forms of transport. Globally, it is a whole lot greener right now than it has ever been as a large proportion of the fleet is going into lay-up, the scrapping of old tankers is reaching record levels, and those ships still working are doing so at slow and very economical speeds.

The people looking with most envy at shipping bankers are the Korean shipbuilders. For the first time in a decade, shipping bankers can get a decent and certain return on their dollar. Credit is restricted, loan pricing is up strongly and no banker now has to look for an excuse to turn away marginal business. Stronger clients and higher margins point towards happier bankers, even more so where the banks foreclose on the weakest borrowers.

In the shipyards, the shortage of credit is being used by shipowners to push back delivery dates and renegotiate contracts. The effect is less profound in China, where Chinese banks and the government are taking up the slack. The big European yards are expecting big cruise orders, as the global economy begins to look up. But in the world's leading shipbuilding nation, South Korea, there will be the reverse as work dries up and mass lay-offs become necessary.

What about shipowners? Most of them expect tough markets for the next year. But a growing global economy, booming scrapping and a fast-diminishing orderbook overhang may mean that the markets will be less tough than expected. Combine that with record low global interest rates, and things don't look too bad for owners who are not over-extended.

Things don't look too green, either, when it comes to the consumer view of shipping, so this year shipping will see more green costs forced on it. IMO will act slowly, and it will be some time before we see a shipping carbon tax or trading scheme, but there are already pressures from charterers to measure the green performance of ships. They have to do that, because they want to be able to tell the end-consumer how



green their supply chain is. The result will be that older and less fuel-efficient ships will find it harder to get charters, and will face lower rates, while forward-looking owners will have to invest in a green agenda.

2010 will be a tough year for shipping, and toughest of all for the yards. But it will be a year of opportunity for anyone with cash and access to finance, as they pick up cheap assets from failing projects. And it will also be the first year in which we will see a new kind of shipping finance, as cautious but forward-looking bankers begin to enquire about the environmental performance of ships and companies they are being asked to fund. Then we shall see a lot of people going green, and those without access to credit looking green with envy at those who have it.



### Effective risk management can make the difference

**Even in good times, it is impossible for shipping companies to eliminate risk entirely from their business. In difficult times, it is even harder.**

Robust risk management can help protect businesses from both the expected and the unexpected, and Moore Stephens' shipping sector-specific approach to providing governance, risk and assurance services (GRA) enables businesses to feel more confident in an uncertain market, and actually to profit from it.

Moore Stephens' GRA team uses its specialist shipping knowledge to help companies achieve their risk management, internal audit, corporate governance and IT assurance objectives, making the business stronger and more profitable. We provide assurance on the governance and control environment, carry out high-level assessments of governance frameworks, and deliver reports on internal controls.

Moore Stephens' GRA team can help shipping companies manage risk in a way that will improve understanding within the business, increase transparency, and improve controls to monitor and manage strategic and operational risk. We have helped a number of shipping businesses, including an Oslo-based listed shipping company, for whom we carried out an independent assessment of the adequacy and effectiveness of key controls in its chartering, operations, finance and forward freight agreements departments. Another recent assignment comprised an assessment of the operating effectiveness of the internal financial reporting controls of a new global shipping venture.

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## Patience and nerve required

At this time of year, many shipowners and their accountants will be preparing their annual accounts.



David Chopping

Looking at the environment within which they are operating, the truth is that not too much has changed over the past twelve months. Money is still expensive, and difficult to borrow, which is imposing a discipline that Mr Micawber would doubtless have been proud of, but

which is of little comfort to those who might see an opportunity in the market, lacking only the necessary initial investment to make it work.

Operating costs are still increasing, including insurance and P&I premiums, and shipping companies are worried about everything from supply and demand and competition to fuel costs. Moore Stephens recently surveyed a broad cross-section of shipping industry professionals worldwide about future trends in operating costs. The responses, predominately from owners and managers in Europe and Asia, revealed an expected overall increase in operating costs for 2009 and 2010 of between 4% and 6%, with perhaps a slight levelling-off in 2010, compared to 2009. And more than a quarter of respondents identified finance costs as the most significant factor likely to affect operating costs in 2010.

The general economic indicators are slowly improving in most parts of the world, but the markets are still very weak. Newbuilding cashflow is becoming an issue of increasing importance, with shipyards enduring a toxic orderbook crisis, not knowing whether to carry on building regardless, to renegotiate and spread the orders over a longer period, or to cancel and restructure. And you know things are bad when one of the world's leading containership and bulk operators posts its first annual loss in over a hundred years.

It is always said that shipping is a cyclical industry, and it is. It's just that the current cycle is not one you would want to be in. But while today's shipping companies and investors are likely to find little solace in the knowledge that things could be worse, the fact is that they could be, and indeed were, back in the 1970s. Shipping recovered then, and it will recover

again. The industry faces the prospect of flatter demand, but the slimmed-down orderbook will help, as will the discipline imposed by the need to balance the books to the satisfaction of both shareholders and financiers.

Shipowners and operators enter 2010 with many of the same problems they encountered at this time last year, not least, knowing the value of what they hold, and with the prospect of impairment hanging over them. The rules on how to account for vessel values have not changed in the past year, and opinion remains divided on the merits of such initiatives as the Hamburg Shipbrokers Association's Ship Evaluation Standard. This has been pilloried in some quarters, but one of the basic tenets of which, to include in ship valuations some element of the revenues that are expected to be obtained in the future, is supported by the relevant accounting standards. In determining how far this approach can be taken, consideration has to be given for example as to whether the vessel is under charter with a reputable and creditworthy operator.

*"Operating costs are still increasing, including insurance and P&I premiums, and shipping companies are worried about everything from supply and demand and competition to fuel costs."*

What has changed is that owners will have to look at any forecasts they made last year to support the carrying values of their vessels. Those who got it right before will be well placed to adopt a similar approach this year. Those who did not will have a little more explaining to do.

Overall, the past year has not been a good one for shipping, but not as bad as some had feared. Patience will be a virtue to be greatly admired over the coming months, as will nerve and the ability to maximise assets and resources.

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## Confidence levels hold up

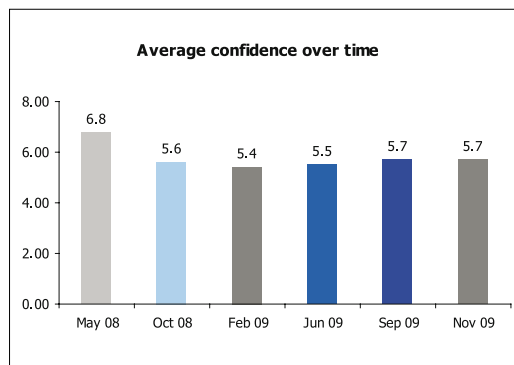
Overall confidence levels in the shipping industry stabilised over the three-month period up to the end of November 2009, according to the latest Moore Stephens Shipping Confidence survey. But the depression in freight rates seems likely to persist amid continued concerns about the level of newbuildings set to enter the market over the next two years.

On a scale of 1 to 10, the average confidence level expressed by respondents in the markets in which they operate was 5.7, the same as in the previous survey in August 2009. Charterers showed the most significant drop in confidence over the latest three-month period, while a significant change was evident in Asia, where confidence was down from 5.9 to 5.7.

Once again, the survey revealed a continuing level of concern over newbuildings, typified by the comment that "there is only enough cash to fund half the orderbook, so something has to give".

Respondents' expectations of making a major investment or significant development over the next twelve months remained unchanged at 5.1 overall out of a possible 10.0. Owners were the most confident, while charterers emerged as one of the more pessimistic on this occasion at 5.0, a rating which they shared with ship managers. Expectations were significantly down in Asia, from 5.4 to 5.0, and marginally up in Europe.

For the fourth successive survey, respondents identified demand trends as the most important factor likely to affect their business performance over the coming year, followed by competition and the cost and availability of finance. Tonnage supply and operating costs, however, featured more frequently in respondents' answers this time than on any occasion in the previous twelve months.



Owners, charterers, managers and brokers all expected finance costs to rise over the next twelve months. The biggest percentage points rise was recorded by ship managers, from 46% to 51%. There was also a commensurate fall (from 14% to 9%) in the number of respondents overall anticipating lower finance costs during the coming year.

So far as the freight markets are concerned, there was a general consensus among respondents that there was very little scope for increasing rates at the moment.

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## Incentives to succeed

In shipping, as in other industries, keeping your best people happy can be the difference between success and failure. Proper motivation and reward are central to that objective, and employers and employees alike need to know what are the most cost-effective and tax-efficient options available.

Of all the various employee share initiative schemes out there, Enterprise Management Incentives (EMIs) are the most attractive of the tax-favoured options available in the UK. They provide an individual limit of £120,000 to the value of options, including Company Share Ownership Plans. There is a company limit of £3m applied to the value of options. The company must be independent, it cannot have gross assets that exceed £30m, and it must have fewer than 250 employees. No income tax or national insurance contributions are payable if the exercise price is not less than market value at the date of grant.

However, stringent conditions have to be satisfied for a shipping company to be eligible to grant EMI options.

The next best alternative is the Company Share Option Plan. This is open to all companies but the value of options which can be granted to each employee is limited to £30,000 and the option has to be held for 3 years before it is exercised in order to enjoy beneficial tax treatment.

So if you are a shipping company (particularly a young, growing one) with able and experienced staff, and you don't want to lose your best people to a competitor, contact us now for further advice.

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## Tonnage tax changes

Without any announcement or prior consultation, HMRC has recently made changes to its guidance on the UK tonnage tax regime.

The strategic and commercial management tests have been changed so that they are stricter. For example, on the strategic management test, the following comment has been added: "For strategic management to be in the UK, the UK directors and key personnel must have effective power to make strategic decisions without recourse to any other body outside the UK." On the commercial management test, there is the comment that, "It is unlikely that a company will qualify for tonnage tax if technical management of the ships is not in the UK."

Less interest received will be regarded as within tonnage tax. For example, HMRC considers that interest on a security deposit to secure a loan to a shipping company will not be within tonnage tax, and that interest on a deposit made as part of a sale and leaseback transaction will only be within tonnage tax if the sale and leaseback was entered into to provide working capital.

HMRC has said that a ship, or a shipbuilding contract, that is disposed of before being operated within tonnage tax may not be a tonnage tax asset.

No changes have been made to the legislation, only to HMRC's view of the legislation.

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### Quote

***"The order book is still too high, at about 44% of the fleet."***

Martin Stopford, Clarkson Research Services Managing Director, addressing the recent Moore Stephens OpCost seminar in London.

### Who to contact

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## Profile: Duncan Gregory

Duncan Gregory was born in Northampton, but has never lived there. This differs from most people who, if they were not born in Northampton, have never been there. Thereafter, most of his formative years were spent moving from one English town to another as the family went wherever father's bank-manager career took them.



Duncan Gregory

Duncan studied mathematics at Lancaster University and, on graduating, started a three-year chartered accountancy training contract with a Group A firm in Bournemouth. On completion and fully qualified, he moved with the firm to London. He joined Moore Stephens as a corporate finance

director in January 2005, and became a partner in 2007.

Duncan specialises in transactional work, typically mergers and acquisitions, flotations, company disposals and large fund-raising projects. His expertise covers issues such as due diligence, valuations and advisory work.

He has worked closely with the Moore Stephens' shipping team on a variety of shipping-related assignments, a number of which have been billion-dollar projects, typically involving shipyards and large fleets of vessels. Duncan enjoys his work, and particularly his involvement with shipping. "Shipping

is such an international industry," he says. "I like that, and I like the fact that every transaction is different, as are each of the parties to the project." He anticipates an ever-growing involvement in shipping, as clients continue to look for new business opportunities, even during the current economic downturn.

Duncan enjoys working at Moore Stephens. He likes the culture of the firm, and its international focus, which allows him to travel, principally to the Far East, the Middle East and Europe. And travel is one of Duncan's passions outside work, too. He likes going to exotic or unusual places, witness the fact that his holiday destinations in the last three years have included North Korea, Chernobyl, Colombia and Guatemala.

Duncan's other passions are football and heavy metal music. His adopted home town is Southampton and, despite everything, he remains an ardent Saints fan. This is bad luck. His heavy metal interest extends to both listening and playing. He has played in various bands over the years, and owns ten guitars. He reckons to attend fifteen-to-twenty gigs each year, some of them overseas. His record is three in one week. He has seen Metallica play in Spain and Germany, and he saw Alice in Chains recently. Bad luck again.

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## The devil's dictionary

The first in a series looking at classic and alternative definitions of shipping and accountancy terms.

**A** is for average.

### Textbook definition

In shipping, 'average' is a term which denotes the partial loss of the subject matter insured.

### The alternative definition

Shipping is the only industry where you are allowed to throw away things which don't belong to you. Others include house clearance and certain types of husbandry. There are three types of average, including General Average, which relates to the sacrifice of property for the greater good. Everybody pays for everything under General Average, including Napoleon, who made all his Generals out of mud. Napoleon is sometimes confused with Nelson, but Napoleon wore his hat like this, while Nelson wore his hat like that.

For thousands of years, hardly anybody has asked how owners treat General Average in their accounts. Recently it has been included in the debit column because it would have little else, especially anything at all, to accompany it on the credit side, and would therefore stick out more. As shipping slowly returns to profitability, this will not change at all.

There have been many General Average law cases, none more famous than the one before. The York-Antwerp Rules govern all General Average claims on ships sailing from York to Antwerp, but not the other way round. Finally, some charter parties include a New Jason Clause, which reads from left to right.

All this is a mystery to accountants, who refer to 'mean' rather than 'average', and who insist on dividing everything into 365, which doesn't work in shipping, especially in a leap year. This is very mean.