ALPHABULK

WEEKLY NEWSLETTER

INSIDE THIS ISSUE:

The Alphabulk Weekly Newsletter offers topical analysis of all the important issues affecting the Dry Bulk Market.

We hope you find the publication informative and useful. We welcome comment and feedback, which can be transmitted by replying to the email received or to
alphabulkteam@axsmarine.com

TOPIC OF THE WEEK

Star Bulk's 61,347 dwt Star Lutas (built 2016) sold this year in a sale and lease back deal

Sale and lease back transactions are…back

THERE are only a very small number of things that are sure things in life. Common wisdom has it that tax and death are two of them.

Well, if you are brave enough to venture into shipping then you can add another two: the emergence of shipping pools and sale and lease back transactions when the market is poor.

Let us deal first with pools. The story is simple: a number of owners are in self-inflicted pain due to having too many expensive ships on their books. Strangely, many owners think bringing their collective misery together will make things better so they create pools.

However, you could argue that improving efficiency in a bad market which has been caused by a ship/cargo mismatch is the last thing you should do, as more efficiency will result in an even poorer market!

In some markets, of course, pools have their merits. The main example is in tanker markets with very narrow laycans where owners often used to factor in as many as 5 or even 10 days waiting time in their calculations so as to be sure not to miss the cancelling.

By pooling their ships together, owners are able to "kill" or at least reduce the waiting time, as the more ships are under the same commercial control, the greater the chance to have a ship available for the right laycan. This is a perfect example of a good reason to enter into a pool agreement: simple logistics, leading to additional revenues.

This is rarely the case in the dry bulk market, where pools are often a marker of a bad market. Entering into a pool in these circumstances is akin to a number of one legged people who think that by teaming up they will run faster!

On the positive side, no dry bulk pools have been announced in recent times, so we will move on to the second subject, sale and lease back deals. Indeed, these have made the headlines recently.

Topic of the Week *continued*

Unveiling its Q2 results, Star Bulk Carriers Corp announced it had entered, or was about to enter, into 16 sale and lease back transactions. This will add to one previously signed, meaning that soon Star Bulk Carriers Corp will have 17 of its ships leased back from the buyers of these ships.

Before we go any further into these transactions, let's take a bird's eye view of Star Bulk Carriers Corp. The company was formed in 2005 as Star Maritime Acquisition Corp, a blank check company which raised $200 million through an IPO which was to be used within two years. Some 2 years later, Star Maritime morphed into Star Bulk Carriers which started trading on the NASDAQ exchange under the ticker SBLK in December 2007 after the acquisition of a fleet of dry bulkers from TMT.

At the time of writing this article, Star Bulk's shares closed at just south of $7. On the first day of trading back in 2007, they closed at $15.34. At first glance, a halving of the share price after all these years of bad market does not seem bad. Except for the fact that, corrected for reverse splits, in fact the shares were trading at the equivalent of $1,100 on their first day of trading!

So, a drop of 99.4% since launch, which is normal for a company which is carrying retained "earnings" of -$1 billion as of 31 December 2019. Thus, since inception the company has accumulated a enormous deficit of $1 billion! The **below Figure 1 graph** shows its annual and cumulated earnings over the period.

Earnings skew

In 13 years of annual earnings (including year-to-date for 2020), just 3 have been in the black (2008, 2013 with $2 million, and 2018) yielding an average annual profit of $66 million in those 3 years. Meanwhile, the remaining 10 years in the red have yielded an average annual loss of $115 million. That is exactly the kind of earnings skew a company doesn't want! Today, Star Bulk Carriers runs a fleet of 116 ships in all dry bulk segments barring Handysize. The **Figure 2 pie chart below** gives the segment split, with the number of ships in each segment.

The average age of its fleet is 9 years, while the average of each segment is shown in the **Figure 3 chart overleaf.** So, on to the recent sale and lease back transactions. The main reason why we are interested in these types of transaction is that they can often be a negative indicator.

We can cite ABC (P&O Bulk), which sold and leased back all its ships in the mid/late 1990s, only to subsequently disappear after selling the fleet en bloc to Zodiac to avoid bankruptcy.

Figure 1: Star Bulk annual and cumulated earnings in $ million

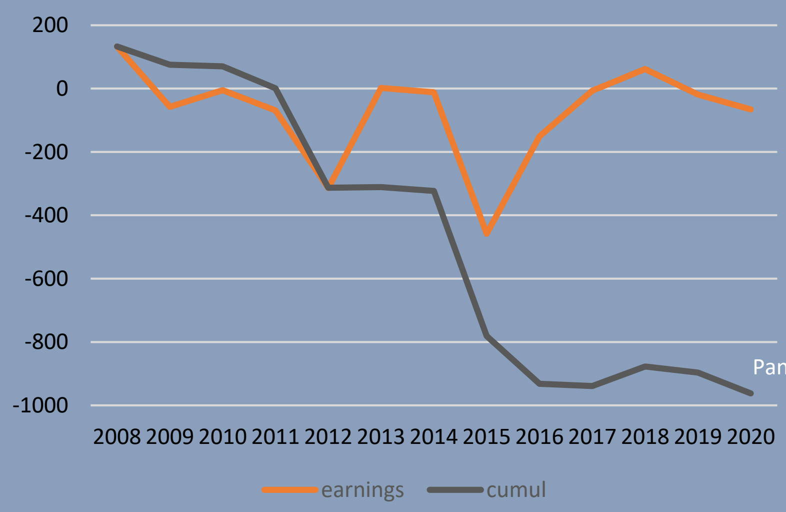
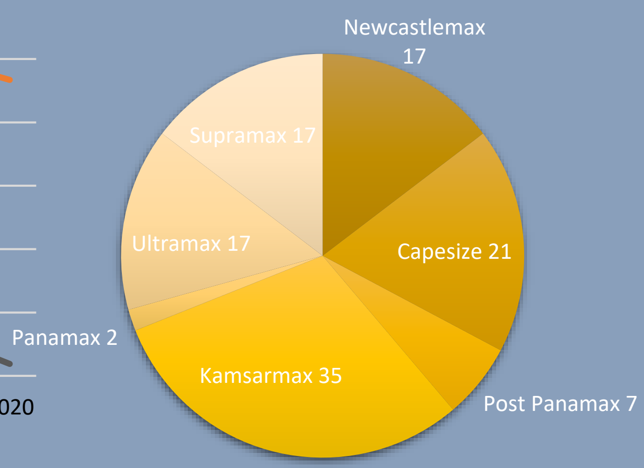


Figure 2: Star Bulk number of ships per segment



Topic of the Week *continued*

For the younger readers, Bourbon sold and leased back a third of its fleet of offshore supply vessels to a Chinese leasing company before defaulting on the…first payment, sending the company straight into restructuring.

Indeed, many of these transactions end badly for the reason that the seller is in need of cash, and thereby sells the assets at a higher value than the market against an inflated bareboat rate.

The sales proceeds usually give the company a bit of breathing space, while the buyer may be convinced by the great return generated by the inflated bareboat rate – not necessarily the correct credit analysis.

Market prices

The **Figure 4 pie chart below** gives the number of Star Bulk's transactions per segment.

At this stage, we can make one conclusion already: if 17 vessels are sold and leased back (more than half of the company's Ultramax fleet) this however represents only 14% of the company's fleet. This is not a sign of desperation. It remains to be seen if more similar transactions will be announced in the months to come.

Now, what about the value of the vessels sold? It is difficult to ascertain the exact value from the company communications, but based on anecdotal evidence such as three unnamed Newcastlemax vessels sold en bloc to a "Chinese financial institution" for $92.6 million (just under $31 million per ship) or the sale of the Star Lutas, a 2016-built Ultramax, for $16 million, we would conclude that the prices are not inflated compared to market price.

We are unable to comment regarding the level of hire to be paid by Star Bulk for these vessels on lease back as the company has not communicated on this subject. But it is an easy guess from the lack of communication, combined with the targeted returns of the buyers, that these transactions will result in an increase in the break-even level of the ships.

Taken in totality, and despite the lack of information published on the deals, our conclusion is that these sale and lease back transactions do not fall into the "negative indicator" category. Instead, they are more likely to be a simple balance sheet restructuring exercise due to the fact current liabilities far exceed current assets.

Our only question is why not simply sell these 17 ships outright rather than lease them back?

Figure 3: Star Bulk fleet and segment average age

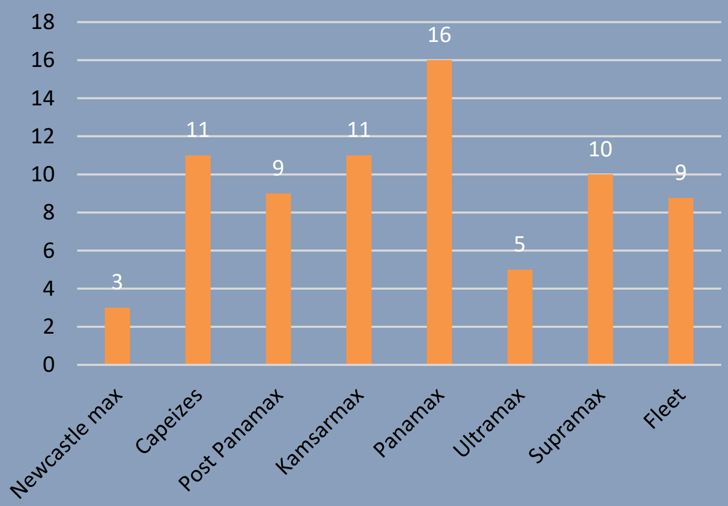


Figure 4: Number of Star Bulk sale and lease back transactions per segment