Shipping Industry - Key Success Factors

BUSINESS RISK ASSESSMENT

Fleets Profile
The analysis covers thorough assessment on the shipping company's overall fleet profile and the seaworthiness. The main objective analysis is to assess the company's capability in delivering the quality of service at reasonable cost. Some parameters that can be used in the assessment include number of fleets, capacity, age, type of ships, flagship, insurance, hull structure and acquisition cost. It is true that larger number of fleet owned by a shipping company cannot automatically exhibit the strong business, but it can enable the company to capture the larger business opportunity and reach large economic scale. Larger number of fleet should also provide the company to have stronger bargaining power to the suppliers. Maintenance expenses could also be more efficient. More fleets also often reflect the company's capability to diversify the business. Number of fleet is not always in line with capacity as it depends on the size of the vessels. It is not necessary that having larger size of the vessels has better competitive advantage as it depends on the market segment where the company is involved. Younger fleets often offer better quality of service and low maintenance cost. On the other hand, the older vessels with good maintenance also can have advantage from low depreciation cost. The variety of type of vessels is also important to enable the company to tap more diversified business segments, avoiding too much reliance on certain market segment. The Company's certification and compliance on numerous international and domestic regulation as well as safety and environmental issues will reflect reputation and permit access to worldwide ports. The Company's replacement program, regular maintenance including dry docking activity and scrapping requirements are also important.

Product and Market Attractiveness
Characteristic of market segments that are being served by a company is also important to analyze its business strength. PEFINDO views that liquid cargo segments in general is less competitive than dry cargo segment. Liquid cargo itself consists of many sub-segments that may have different characteristic. The market segment selection is very important as a shipping company usually has limited flexibility to shift from one segment to another. The flexibility should be more limited if the product to be transported requires very specific specification. Other than products, the segments also could be differentiated by route. Demand for shipping service with the same products could differ among the route as some routes requires specific specification unless the transportation would be less efficient. The analysis on the segment would include that on demand and supply, price cyclicality, competition, etc. Each segment has different risk in term of business cyclicality. Segments where the customers prefer to have long term contract should offer more stable revenue. Long term contract would be rare for the segment which faces over supply condition.

Diversification
It is believed that a company with more diversified revenue source should have more stable revenue stream as compared to those who are reliant on only a single revenue source. Revenue sources could be differentiated by market segment (product transported), route (geographic diversification), customer base, and mixture of long-term contract, short-term contract and sport market. The flexibility to shift the business also should receive a credit to minimize the adverse impact from the deterioration of certain revenue source. Diversification of the suppliers of vessels and other materials is also important to reduce the company's dependence and to enhance the bargaining power.

Operating Management
As none of the players can control the freight rate, a shipping company has to operate efficiently as only efficient company will have more buffers for the declining freight rate. The analysis on operating margins (EBIT and EBITDA) is also assessed by comparing the company's ratios with other players in the same industry or other industry with similar characteristic, which is important in analyzing the company's
competitiveness. The analysis is helpful to measure operating efficiency. Cost structure is often related or in line with the fleet profile. Old fleets will carry low depreciation cost but bear high maintenance cost and other operating cost, vice versa. A company with younger fleet of vessels is not always more efficient than those with older vessels. In addition to quality of maintenance which can make old vessels still operate efficiently, the utilization of the vessels’ capacity also play very important role. PEFINDO also assess the management’s commitment on quality of service, which can be measured by its capability to comply any of domestic, regional and international regulation. High operating risk for certain segments, such as chemical, oil, gas and other flammable or poisonous material will require the company to carry very strict operational procedure and safety.

FINANCIAL RISK ASSESSMENT

Financial Policy
The analysis includes a review of management's philosophy, strategy and policies toward financial risk (historical, current and future). It also includes examination of management's financial targets (growth, leverage, debt structure and dividend policy), hedging and other policies in an effort to reduce the company's overall financial risk (historical vs. future). The company's track record on fulfilling its previous financial obligations is also examined to determine the degree of its commitments and willingness and consistency to pay obligations on a timely basis.

Capital Structure
The analysis covers careful examination of the company's historical, current and projected leverage (total and net debt in relation to equity and EBITDA), debt structures and composition (rupiah vs. foreign currencies, short-term debt vs. long-term debt, fixed rate vs. floating rate). Management of its liabilities is also thoroughly reviewed.

Cash Flow Protection and Liquidity
The analysis covers thorough reviews of the company's cash flow generation and capability to meet its short-term and long-term financial obligations. The degree of its debt-servicing capability level is measured by the company's interest and debt coverage ratio. The degree of its liquidity in fulfilling its short-term liabilities relative to its sources of cash is also thoroughly assessed. The sources of cash are assessed, which include cash balance, estimated cash from operations, unused credit facilities, and other sources of cash. The uses of cash other than short-term liabilities, such as capital expenditure, are also assessed.

Financial Flexibility
The analysis covers combined evaluations of all the financial measures above to arrive at an overall view of the company's financial health. Analysis of other related factors or figures that are not specifically examined above, such as insurance coverage, restrictive covenants in loan/bond agreements or parental linkage and support, are also covered. Other analytical tasks covered are the evaluation of the company's options under stress, including contingency plans and other capabilities and flexibility to deal with various adverse scenarios. Shareholder support and commitment are also greatly considered.
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