LLoyd's List - Insufficient working capital the cause of Hanjin Shipping's fallout

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FINANCE

SC Lowy co-founder Soo Cheon Lee says Hanjin’s collapse is a good lesson for the industry

IT is not the first time that a South Korean shipping company has gone into bankruptcy, but none of the previous collapses has had such a big impact on the industry as Hanjin Shipping.

Of course, one can argue that the earlier bankruptcy cases, such as Korea Line‘s and STX Pan Ocean‘s were mostly in the bulk carrier segment, whereas Hanjin has its main business in liner shipping—a sector that serves a much more complex supply chain.

But on top of that, the difference between Hanjin and its predecessors, is that the company was not prepared—namely due to a lack of working capital–before it filed for court receivership on August 31, after months of restructuring efforts led by creditors.

That is the view of Soo-Cheon Lee, co-founder & CIO of Hong Kong-based fixed income specialist SC

Lowy. Mr Lee was the key figure behind the restructuring and financing measures that eventually helped both Pan Ocean and Korea Line emerge from bankruptcy and eventually be sold.

"As a shipping firm, no matter in the bulk or container business, you'll have to pay ports for vessels to berth and unload cargos. You'll have to pay bunker suppliers for the fuel. These are the essential working capital," Mr Lee told Lloyd's List in an interview.

This was the kind of crucial capital that South Korea's largest shipping line lacked, which directly led to the current turmoil rippling through the logistics industry.

As of Sunday, only 28 of Hanjin's 97 container vessel had offloaded their cargoes at terminals worldwide, said the South Korean government. The rest have remained stuck at sea for fear of being arrested by creditors or simply because the carrier was unable to pay the port charges, despite a number of designated 'safe haven' ports.

This has caused huge disruptions and damages along the value chain, not least the millions of dollars of losses faced by cargo owners as well as Hanjin's vessel charterers.

"Korea Line and Pan Ocean had enough working capital on hand when they filed for bankruptcy," said Mr Lee.

But Hanjin had little cash when it filed—hence the reason for its incessant requests to shareholders for help ever since. Still, the aid money Hanjin has received so far is short of the estimated Won300bn ($272.0m) needed to discharge its customers' cargo.

To date, the embattled shipping line has banked a total rescue funds of Won50bn ($45.3m)—Won10bn donated by its former chairwoman Choi Eun-young and Won40bn by the Hanjin Group chairman Cho Yang-ho, according to a Hanjin Shipping spokesperson.

The other Won60bn agreed upon by its largest shareholder Korean Air and Won100bn pledged by the government are both still undecided, the spokesperson added.

While earlier media reports suggested there might be a communication breakdown between the Korean government, Hanjin and its creditors, the scarcity of working capital shows that clearly the bankruptcy filing was not well planned.

In hindsight perhaps, it seems that if Hanjin had learned from the antecedents, today's chaos could have been alleviated, if not avoided.

An eventual liquidation?

The top priority now is still to unload the cargo from the vessels, but the question is who is going to foot the rest of the bill?

The Korean court and authorities have been doing a great job in leading the initiative in expense settlements so that at least some of the Hanjin vessels have managed to offload their cargoes in South Korea, the US and Spain. But the efforts are unlikely to continue without further funding support.

While the government in Seoul seems firm on its stance that the issue should be resolved on a commercial basis, odds that a private sector player will step in and bridge the funding gap are also small, because the carrier appears to have little collateral left to offer based on its assets.

“When you lend some money to someone, you need the kind of assurance that you will be paid back.” Mr Lee said.

But prospects for Hanjin, which has Won 6.6trn in assets versus Won6trn in liabilities, look bleak.

Moreover, with all the angry customers and massive damages incurred, the franchise value of Hanjin’s brand name has also taken a serious blow. The best timing for rescues by possible ‘white knights’, such as Maersk Line and Hyundai Merchant Marine, seems to have passed.

Even SC Lowy, with enough financial savvy to take on the position as major creditor for Korea Line and Pan Ocean during their early stages of restructuring, caution has gained the upper hand, Mr Lee said.

Some players, however, are more keen to take the risk. The Korea Economic Daily reported on Wednesday that an American fund had proposed a loan of Won300bn at an annual interest rate of about 10% to the distressed shipping line. But Hanjin rejected the offer, citing the loan conditions were too strict for the company and the court to accept.

If the crisis persists for another two or three weeks without fresh liquidity injections, the current court-led rehabilitation will likely fail and Hanjin will slide into liquidation, Mr Lee said.

That would be a disastrous scenario for Hanjin’s vessel charterers, though perhaps a big relief for the carrier itself and the Cho family who ultimately controls the company.

Owners who have vessels on charter with Hanjin might be forced to chip in their own money to discharge the cargoes on board, as they must free the ships first before any redeployments can be made.

A lesson to learn

The pain, brought by Hanjin upheaval, has not only been felt by its counterparties, but also by Korea’s shipping industry as a whole.

Sources from other Korean shipping firms told Lloyd’s List that clients have already started to question their credibility following Hanjin’s collapse.

Nevertheless, the market will continue to see struggling shipping companies enter into restructuring or even bankruptcy in the coming two to three years, Mr Lee said.

But he stressed that the Hanjin incident should be taken as a big lesson for the industry.

“Restructuring is not a bad thing, but you should be prepared and do not just pull the plug overnight”.

In the highly-cyclical shipping industry, a timely restructuring–though painful in many cases—would help the company in question restore normal operations, enabling it to thrive again when a market turnaround comes, according to Mr Lee.

“It’s better to survive together than die together,” he said.