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Call her unsinkable

Evan Lorenz writes:

The collapse of the Francis Scott Key Bridge is just the latest jolt to the network of global supply chains. Low water in the Panama Canal and attacks in the Red Sea have cargo ships retracing routes first charted by Vasco da Gama and Ferdinand Magellan. Nor has Russia's invasion of Ukraine exactly helped the smooth functioning of the world's petroleum markets.

But it's an ill wind that blows no one any good. Longer routes are tightening the markets for bulk commodity vessels and petroleum tankers while offering relief to the oversupplied container-shipping market. In preview, *Grant's* is bullish on Navios Maritime Partners, L.P. (NMM on the New York Stock Exchange).

Navios manages a large, diversified fleet of transport vessels. On the water at the end of last year were 77 dry bulk ships (which carry iron ore, coal, grain, etc.), 36 container ships (which transport goods stacked in twenty-foot-equivalent metal boxes) and 36 tankers (29 petroleum-product carriers and 7 very large crude carriers). On order were 10 container ships and 18 product tankers.

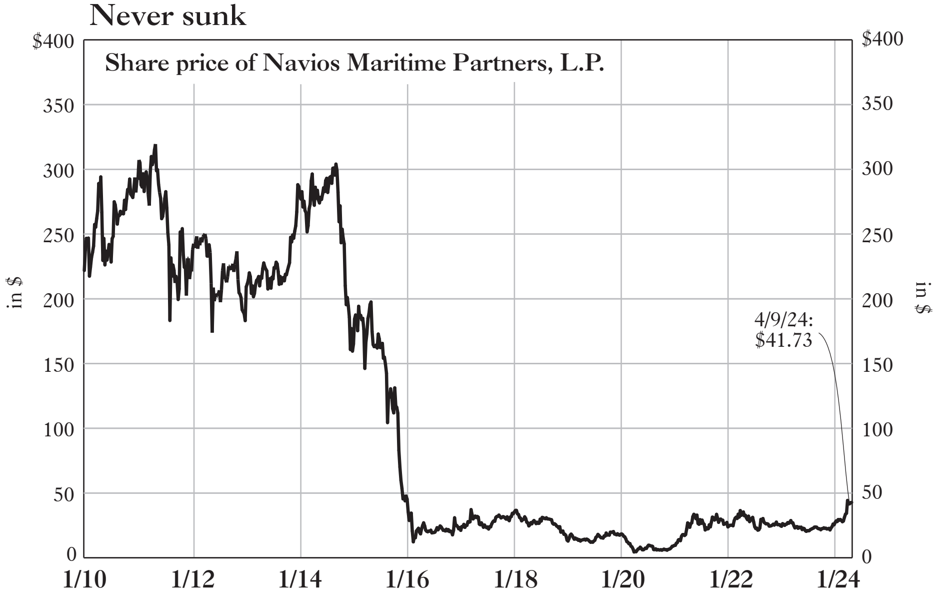
Navios is incorporated in the Marshall Islands (including the World War II battleground Kwajalein Atoll), a typical choice of tax-avoidant shipping businesses, and organized as a master limited partnership, an atypical form of shipping organization. For tax purposes, however, Navios has elected to be treated as a 'C' corporation so investors receive a form 1099-DIV come tax time and not the dreaded K-1. And as the chair and CEO, Angeliki Frangou is the general partner of Navios. Any bet on the company is a bet on her.

Frangou is a fourth-generation Greek shipowner. Educated in the United States, she took her bachelor's degree at Fairleigh Dickinson University and her master's degree, in mechanical engineering, at Columbia University. From 1987 to 1989, she cut her analytical teeth on the trading floor for Republic National Bank, where she worked on, among other products, credit-default swaps.

In 1990, she flew to Rio de Janeiro to tour the *Fulvia*, a 14,000-ton decommissioned bulk freighter. With help from her father, she purchased the rust bucket for $1.5 million. It "was a great investment," she told *The Globe and Mail* in 2013. "I wanted to have my own business, so I took the challenge to reactivate the vessel. I supervised everything. Everything had been stolen. You opened machinery and the parts were missing inside."

In 2004, Frangou raised $197 million in a special-purpose acquisition vehicle called International Shipping Enterprises, Inc. and applied the proceeds to the purchase of Navios Maritime Holdings, Inc. Founded in 1954 as U.S. Steel Corp.'s in-house iron-ore shipping unit, Navios owned 28 bulkers. Frangou founded four additional Navios group companies, giving investors tradable vehicles with which to participate in specific subsegments of the shipping industry: container vessels and crude-oil and petroleum-product tankers.

Never sunk



source: The Bloomberg

Navios Maritime Partners, L.P. at a glance

all figures in $ mns except per share data

	2023	2022	2021	2020	2019
revenue	$1,306.9	$1,210.5	$713.2	$226.8	$219.4
operating income	467.1	525.1	410.6	31.6	64.9
net income	425	567.7	505.9	-67.2	-60.9
earnings per share	14.08	18.82	22.36	-6.13	-5.62
shares	30.2	30.8	23.1	11.2	11.1
cash	240.4	157.8	159.5	19.3	23.4
debt	898.1	863.8	813.8	424.1	400.4
operating leases	298.7	359.0	366.3	13.1	14.2
financial liabilities	963.6	1,081.6	547.9	62.8	88.6
total assets	5,147.6	4,895.7	3,623.3	1,207.3	1,253.5

sources: company reports, the Bloomberg

Easy money and China's seemingly insatiable demand for commodities led to large shipbuilding orders a decade and a half ago. At year-end 2010, for example, new orders for bulkers amounted to 50% of the existing bulk fleet. As shipyards delivered, shipping rates plunged, and vast swaths of the industry filed for bankruptcy protection.

Frangou kept the Navios group of companies afloat while devising transactions to capitalize on distress. There was nothing sentimental about it. Her purchase of credit-default insurance on some of her own overleveraged commodity-exporting customers delivered a $22.3 million windfall to Navios's 2012 other-income line. She purchased ships out of bankruptcy, too, including a fleet of 14 container vessels from Rickmers Maritime A.G. in 2017 and 7 dry bulkers from lender HSH Nordbank A.G. in 2015.

Such constructive opportunism came at a cost, as Frangou raised equity at steep discounts to the net asset values of the share-issuing Navios affiliates. In a series of transactions in 2020–21 she merged the group's subsidiaries into a single entity, Navios Maritime Partners. Against complaints that "some deals have not been that favorable for shareholders," Fredrik Dybwad, who rates Navios a buy for Fearnley Securities A.S., replies that "then again, the market was bad, and you had to do something just to save the company and, following a larger restructuring in the Navios sphere, shareholder returns are now high on the agenda."

Darren Maupin, founder of Pilgrim Global Advisors, LLC, also has an opinion and one to which he is richly entitled. The famously concentrated Pilgrim portfolio is the holder of 15.4% of Navios's shares outstanding. They are the fund's top holding and place Pilgrim behind only Frangou herself as the company's second-largest shareholder.

"We've scrutinized all the transactions," Maupin tells me. "We don't find anything that we think was unethical. There was probably one instance where the loan that she extended [to one of the Navios companies] was a little bit on the aggressive side, but we weren't in her shoes. We actually think she has treated shareholders very fairly from what we've seen."

Constant readers will not have forgotten Maupin. He was the source for our bullish reappraisal of Eagle Bulk Shipping, Inc. and Genco Shipping & Trading Ltd. three years ago. Since that March 5, 2021 issue of *Grant's*, Eagle and Genco have generated returns of 134.7% and 130.8%, respectively, against a 42.2% rise in the S&P 500 (all figures include reinvested dividends).

"We have spent a lot of time with [Navios] management over the last two-and-a-half years and have gotten to know them," Maupin continues. "My opinion—let's see if it is proven out—is that Angeliki Frangou is a brilliant business person. She's the smartest, certainly among public shipowners, and by far the best I've met. She has a mental toolkit that is unequaled, and she understands everything, from derivatives and distressed debt to the details on how to construct a ship. She has an unbelievable breadth and depth of knowledge that I don't know if any other shipowner has."

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Valuation forms another important leg of the bull case on Navios. Even after a 49% year-to-date levitation, the shares trade at 3 times consensus 2024 earnings and 2.8 times next year's guesstimate. Dybwad calculates that Navios's net assets amount to $116 per share versus the current share price of $41.73, which means that the market values the shipper at 36% of NAV. "Peers are trading at 0.8 to 1 times NAV," Dybwad adds.

Why the discount? The MLP organizational structure, controversy over Frangou's conduct a dozen years ago and the wafer-thin Navios dividend may explain most of it. Meanwhile, bulls contend, shipping rates positively must rise to furnish the incentive to upgrade aging fleets. Major oil companies like Chevron Corp. and miners like BHP Group Ltd won't charter ships older than 20 years, and the clock is ticking.

Many vessels are between 10 and 14 years old, as deliveries were concentrated between 2008 and 2014. Not only did the new capacity cause shipping rates to collapse, but it also devastated ship builders; more than half of the then-existing yard capacity is said to have closed.

Capital that might have built new ships was instead diverted to environmental compliance, such as that in response to a 2020 order from the International Maritime Organization to reduce sulfur-dioxide emissions (remediating scrubbers cost $2 million per vessel). New IMO rules, also expected to be stringent, are due in 2030.

Owners are in no hurry to spend money on capital assets with useful lifespans of 20 years in the absence of committed revenue streams. What loosens the owners' purse strings are contracts rich enough to pay for a vessel in five years. The lockdown-driven surge in demand for goods and concomitant port congestion caused precisely this to happen to the containership market. Now the container order book sums to 21.6% of the existing containership fleet, with heavy deliveries expected this year and next, according to a new report from Deutsche Bank A.G.

Net of scrapping, the worldwide container fleet is expected to grow by 8% in 2024 against an anticipated 3.8% rise in demand. On its Feb. 8 earnings call, the shipping and logistics giant A.P. Møller Maersk A.S. said that attacks in the Red Sea have effectively shrunk fleet capacity by 6%–7%. "Nevertheless and regardless of the duration," CEO Vincent Clerc told listeners-in, "we expect that these new deliveries will eventually overwhelm the impact of the Red Sea disruptions and rates will revert towards pre-disruption levels," i.e., lower. Whatever happens, Navios has contracted 90% of its container fleet in 2024 and 70% in 2025 (these figures include new orders).

Tanker operators, too, need acceptable contract pricing and duration to refresh their fleets. "The average age of the product-tanker fleet today is 13 years, with 9% of the fleet 20 years or older," James Doyle, Scorpio Tanker, Inc.'s head of corporate development, told his Feb. 14 earnings-call audience. "By 2026, 21% of the fleet will be 20 years or older. This year's fleet growth is expected to be the lowest…since 2000, at less than 1%."

Since as many as four years can elapse between the time an order is placed and a ship is delivered, the Navios tanker segment appears to be in for smooth sailing, earnings-wise, before supply catches up. The order book for product tankers has grown to 12.5% of the fleet today from 5.5% in March 2022, according to Deutsche Bank, with Navios itself contributing orders for 18 product tankers; some 80% of Navios's existing tanker fleet has locked in pricing for 2024.

The order book is the smallest in the bulker segment, which is the most important factor in Navios's earnings. Here, too, the story is one of aging vessels. "Over 18% of the fleet is 16 years or older," Michael Orr, assistant vice president of finance at Genco, told a March 13 Sidoti & Co. conference. "Combine that with the extremely tight order book of approximately 8%–9% [of the operational bulk fleet]. It gives us good visibility in the coming years in terms of a tight supply picture." He expects net fleet growth of 1%–3% annually over the next two years.

As China is the biggest importer of bulk commodities, the risk to this segment from a deepening Chinese real estate slump is palpable. Even so, the demand for bulkers has continued to grow, four years of Chinese property distress notwithstanding.

"The history of dry bulk is that you've had very few down demand years," says Maupin. "It's almost never happened," although he says he can't rule it out given the size and scope of China's financial problems.

Navios has secured contracts for 41% of its bulkers in 2024. Combining contract coverage across all three shipping segments, 63% of this year's revenues are home free, with the result that a day rate of $491 for its uncontracted vessels would deliver a break-even year. For context, Navios's fleet generated an average of $22,327 in daily revenues in 2023.

Undiversified shipping companies offer the means to capitalize on the cyclicality of one particular kind of vessel. Bulkers and tankers have lately been the place to be, whereas the mini boom in containership deliveries has analysts projecting a 2024 loss for Maersk. Of course, during busts, there is little a monoline fleet owner can do but wait for the cycle to turn.

Diversified operators like Navios can trade around cycles, selling favored ships at high prices and redeploying that cash to buy cheap vessels in unfavored segments. Navios's fleet "is the business I would draw up on a blank piece of paper if you asked me, 'How should I invest in shipping?'" says Maupin. "I would have a diversified fleet, which allows you to invest countercyclically through multiple segments and through multiple cycles."

As of Dec. 31, 2023, the Navios balance sheet showed $657.7 million in net debt and $1.3 billion in lease obligations for a ratio of financial liabilities to trailing Ebitda of 2.4:1. S&P Global Ratings rates Navios a double-B credit, or near the upper end of junk.

The two analysts who cover Navios both say buy, and bears are giving the shares wide berth; short interest sums to 1.1% of the float. Frangou purchased 317,035 shares in February and March at a net cost of $10.5 million, bringing her total ownership of Navios to 16.7%.

Years of balance-sheet repair and the need to fund new builds has meant there has been little remaining cash with which to reward shareholders. Navios's $0.05 per share quarterly dividend works out to a paltry 0.5% of the current share price. Genco, which cleaned up its balance sheet in a 2014 bankruptcy and has placed few new orders, is priced to an 8% dividend yield and has paid out $5.155 per share in dividends over the past 18 quarters versus a current share price of $20.38.

"The main trigger in my eyes is that Navios has a $100 million buyback program which has not been utilized" versus a market cap of $1.3 billion, says Dybwad. "Then you look at the capex structure on the equity installments for the new builds. Around 90% of the equity installments—that's almost the entirety of the program—will be paid during the first half of this year. And then you have Navios generating a lot of cash per quarter, which will allow the company to commence buybacks."

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