

Staying afloat in rough waters: conquering mark-to-market valuation challenges

By Javier Navarro, freight risk solutions manager, Triple Point Technology

How confident are you that you know – really know – the true value of your business on any given day? Are you 100% certain that the methods and tools you're using to calculate your fleet's mark-to-market value are providing accurate results?

If you have to stop and think about your answers to either of these questions, then your company's future may be at risk.

In the turbulent seas of the shipping industry, understanding the true market value of your fleet is the difference between sinking and swimming. Volatility related to the number of available cargoes and vessels, operating expenses such as bunker fuel costs, and other variables mean that a fleet's value has the potential to swing wildly from one day to the next.

Performing frequent mark-to-market (MTM) valuations is an integral part of doing business, and is critical to ensuring the financial health of a commercial shipping operation. However, due to the highly unpredictable nature of the industry, the complexity of calculating freight rates, and flaws inherent in popular valuation methods and tools, companies often end up with inaccurate numbers. This provides an erroneous picture of financial standing that can result in lost profits, faulty decision-making, and ultimately the demise of an entire business.

Fully understanding the challenges associated with calculating accurate MTM valuations and how to address them is critical to staying afloat in the rough waters of the cutthroat shipping industry.

Challenge 1: Freight rate adjustments

The value of commodities in most markets is transparent – easily determined at any point in time by looking at an index such as NYMEX. On the other hand, in the shipping industry, the freight rates that play a large part in determining a fleet's MTM valuation are not so crystal clear.

The indices for freight rates, which are provided on the Baltic Exchange, only take into account certain "standard" vessel sizes and a limited number of "standard" routes. In reality, very few vessels are of a standard size or perform standard voyages. This presents a challenge for operators and charterers, who, in order to determine accurate freight rates, have

to use complex formulas to "adjust" the indices to account for the proper vessel sizes and routes. This is frequently done using antiquated spreadsheets, which is a very dangerous method for calculating freight rates. Spreadsheets are prone to human and formula errors that cause inaccuracies, which in turn affect the MTM valuation of the entire portfolio. Overvalue the fleet and there will be a very rude awakening when an unexpected event requires funds which, to the company's surprise, don't exist.

Challenge 2: Calculating the value of multiple voyages

Another component of MTM valuations is the number of voyages that a vessel is expected to make. It's often uncertain as to what a vessel's activity will be. If there is only one trip, then usually it's clear what voyage will be undertaken. If there are multiple voyages, a valuation must be made using a best guess on what the subsequent voyages will be. This uncertainty, compounded with the use of spreadsheets, can make producing an accurate MTM valuation exceptionally difficult.

Challenge 3: Maintaining objectivity

Perhaps even worse than performing calculations with antiquated spreadsheets is performing calculations based on subjective information. Some companies perform MTM valuations using numbers based on personal and often skewed views of the market. It should go without saying that this subjective input can result in very inaccurate numbers that obliterate all hope for a valid MTM valuation.

Challenge 4: Determining how long to keep a vessel

Unlike the previous challenges, this one is a result of having inaccurate MTM valuations. Time charter contracts specify the minimum and maximum time a charterer will use a vessel. The accurate market value of a vessel must be known in order to determine whether it should be kept for the minimum contracted time, or longer. If the data driving the valuation is faulty, then the resulting decision is likely to be faulty as well, and a charterer may end up hanging on to a vessel that is losing money.

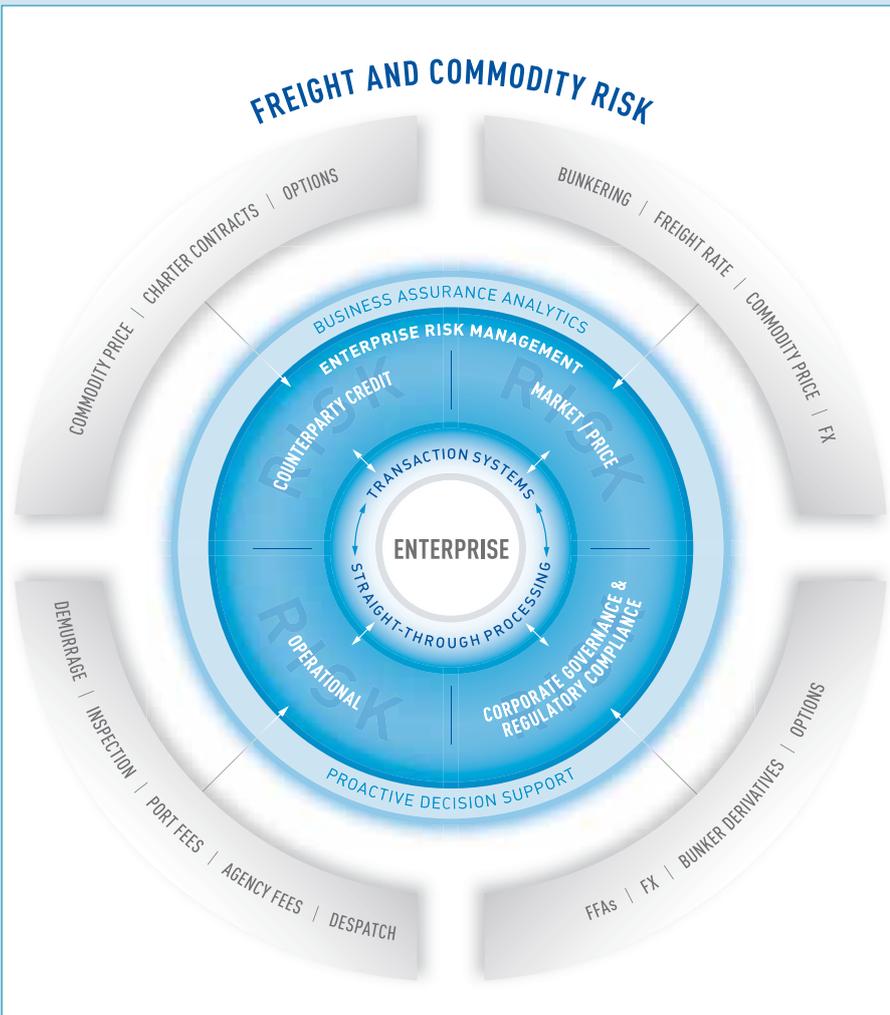
Furthermore, many companies will limit themselves to using the simplistic in-the-money/out-of-the-money calculation to drive valuations rather than other, more complex methods that are more accurate – purely because the more complex methods are difficult to manage in a spreadsheet. Companies using the in- and-out-of-the-money calculation stand to lose a significant amount of capital, especially when the market is close to the level of the contracted hire rate, because the formula is not sophisticated enough to effectively account for the frequent swings of the market.

The solution

The good news is that charterers and operators can maximise profitability and minimise exposure to risk with chartering and vessel operations solutions that are designed specifically to address these challenges.

Softmar Chartering and VesselOps™ from Triple Point Technology® is the leading software solution for comprehensively managing freight risk, chartering and vessel operations on one integrated platform. Error-prone spreadsheets are eliminated, enabling companies to operate with a complete picture of enterprise position and exposure. The solution also empowers charterers and shipowners to make more informed and proactive decisions, streamline day-to-day operations, and protect profits by providing a global view of vessel movements, market cargo availability and existing cargo commitments. With Chartering and VesselOps, the commercial maritime community can:

- **Quickly and accurately determine freight rates:** Optimised for dry cargo, gas, tanker and parcel operations, Chartering and VesselOps can calculate freight rates quickly and accurately with just a few mouse clicks. "Non-standard" individual routes can be saved in the system and used to drive valuations based on any combination of cargoes, vessels, load, and discharge operations on a voyage and/or time charter relet basis.
- **Easily value multiple consecutive voyages:** Chartering and VesselOps handles consecutive voyages and voyage/time charter combinations with ease. A unique "next open voyage" feature uses



sophisticated and unique logic to adjust the MTM value of a voyage based on best available information.

- Quickly determine how long to keep a vessel:** Automatically and accurately calculate whether you are in- or out-of-the-money, or apply physical option intrinsic valuation calculations with the click of a button in order to determine whether to keep a vessel or turn it in for another one. Intrinsic valuation calculations are performed by the system as if they are call options, since there is the right, but not the obligation, to extend the time charter duration for a certain price. In addition, Chartering and VesselOps provides a wide range of other features and functions designed to provide fast access to actionable information that manages supply chain margins and enterprise risk, including:
 - Comprehensive chartering management:** Manages all pre-fixture activities of a commercial operation, including voyage estimating, cargo management and vessel management. Chartering and VesselOps allows an unlimited number of ports and cargoes per voyage and displays all key information on a single screen.

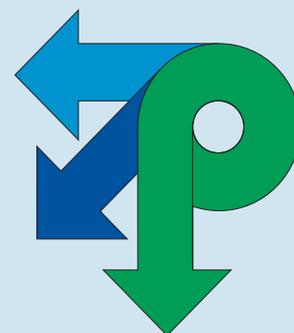
- Extensive vessel operations management:** Chartering and VesselOps effectively manages all post-fixture activities of a commercial operation and enables operators to keep track of day-to-day operations: arrival, departure, loading, discharging, bunkering and disbursement accounting. Schedules can be maintained manually or retrieved directly from the vessel reporting system. A P/L summary is automatically maintained, showing the variance between actual and estimated charges. A detailed breakdown of individual charges can be viewed with one click. Voyage results are updated in real-time as new information is entered.
- Complete freight risk management:** Analyse position including vessels, Freight Forward Agreements, Contracts of Affreightment, cargo bookings, cargo relets and options. See where you stand with a consolidated view of total physical and paper freight risk exposure, MTM analysis, and long/short position. Calculate option premiums specifically aimed at the shipping industry and perform MTM based on the next open voyage. Traders can monitor

portfolios in real-time as daily prices and forward curves are published. The solution automatically recalculates the forward book value and provides an expected P/L based on forward expectations. Advanced technology automatically analyses the potential profit or loss before an agreement is made to transport cargo.

Protecting the bottom line

Accurate MTM valuations are critical to protecting profits and remaining competitive in the maritime industry. However, many companies are unwittingly jeopardising their bottom lines and incurring significant enterprise risk by using inaccurate information to determine their fleets' value and make important business decisions. Companies that don't know their fleets' true value operate in dangerous waters, risking lost profits that could ultimately cause their entire business to go into an irreversible decline. In order to minimise risks, maximise profits and remain competitive, commercial owners, charterers and operators must embrace technology solutions that ensure accurate MTM valuations and provide complete transparency across enterprise operations.

Used daily by over 2,500 shipping industry personnel worldwide to control fleets of five to over 250 vessels in the tanker, gas and dry markets, Softmar Chartering and VesselOps from Triple Point Technology is the shipping industry's leading solution for controlling costs and risk. With Chartering and VesselOps, charterers and operators have fast and easy access to accurate information for better decision-making, increased operator productivity, and ultimately a bigger bottom line.



TRIPLE POINT
TECHNOLOGY
Tel: +1 203 291 7979
E-mail: info@tpt.com
www.tpt.com