

Four (not so) easy pieces

The Spring Quartet



Tinker, Tailor, Soldier, Sailor, Rich man, Poor man, Beggar-man, Thief – these are the words of a kids’ counting rhyme from 1695 and there are definitely some categories here that we recognise within superyachting. *TYR* interviewed separately a somewhat less rhyming foursome of designer Andrew Winch; broker Darrell Hall of Yachtzoo; a client’s representative, Charlie Baker of 777 Yacht Group, Turkey; and lawyer John Leonida of Clyde and Co. *TYR* asked them to calculate the state of our industry following the first quarter of 2009. Though occasionally disparate, taken together the comments offer sound market intelligence and an idea of what to expect, with help on how to react (or better be proactive), in the coming season or two. The view of owners or prospective ones are missing, but watch this space.

Andrew Winch

TB: We wondered if designers today are in even earlier contact with clients than they were in the past, and so had a good insight into the current state of the market.

AW: The market seems to be more volatile, but at the same time you have to do twice as much work to try and get conclusions on things that people will be happy with, because the goalposts are moving so fast.

I met a client this morning – I'm working for him already doing a big house in London – and he's decided he is going ahead with a large yacht. The broker is in touch with him often, I have to say, and in that case the broker knows far better than I do. I'm discussing the design of the boat with him but he still wants to have a look at and discuss the proposal – he's still looking at it competitively. It's exactly the same contract as I have agreed with him and his lawyers in the past, so he knows exactly what we're doing, but no, he still wants to discuss it all. Literally no stone gets unturned. Now he questions; even though he chose me to do the house because he likes our work, he's now reviewing whether we're the right ones to do the yacht, against competitors (it's a big order, 85 metre). All to be sure he makes the right choice. And we're already doing two 85 metres of our designs and a 70-metre motoryacht, interior, all at Lürssen.

TB: Is that a change from, let's say, a year ago?

AW: I think some clients are always probing but the clients that weren't really probing, that seemed quite happy, are either focused on other business issues at the moment – and when they do want to talk boats the discussions are intensive. In other words, there is no relaxation at the moment. Everybody is intense.

TB: Given your meeting this morning there is clearly still new build interest even after October?

AW: Yes, there is interest, as I said last Monday at The Yacht Report Group's Designer Business Forum in Chelsea Harbour with Terry (Disdale) and Dickie (Bannenberg). We went round on where the market is; Terry interestingly pointed out that when he was at Jon Bannenberg's it was geographically Greek and then America, then Germany, then the Middle East – from there it moved probably to Russia. Now everyone is saying: where next? Well probably Middle East again. It could go Far East, could go India, but to be honest I think it'll be Middle East. The Abu Dhabi show was good; good contacts; good people there, and they're thinking, relatively, big projects. We're probably going to see some new projects, not a great deal but I think we're going to see more refit projects.

TB: Do you think we're going to see owners reduce their quality requirements and look to lower cost yards?



AW: No, I don't actually. I think that the major yards are all reviewing their costs. They have invested in productivity and they the highest quality of staff and training invested, but we are all going to have to look at a reduced market. I've expanded with my clients, not with a greater number of clients but a greater number of projects with existing ones. So I may have a client who comes through the door and asks me one to one – no broker involved – to do a big plane. He then asks me to do a yacht, or asks me to do a house like the client I met today.

TB: Do you think yard prices will come down?

AW: They've got to. They are not achievable any more. Everybody's prices have got to come down, mine included. That's what my discussion today was about. I mean I have to ensure the quality of my team, the quality of my service but I have to look at being economic for the clients, at the same time clients who come to buy Andrew Winch designs, are coming for a standard of quality and a standard of delivery on a project, they don't want a lower one.

TB: They want the same for less money!

AW: An economic project, which is still visibly high quality. That's where we must teach ourselves not to over-complicate a project but make sure that the value can be visible.

TB: That's a greater challenge for you as a designer?

AW: I like it. I don't mind at all. I mean I'm just as excited to design a – call it a simple – project or a very complicated one. You know we are doing some highly specialist projects at the moment. Highly demanding, high end, highly

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individual, yachts, planes and houses. Great. That's what the clients want. Something with a wow factor. But the market has changed; we must not be insane about the value of our product. Nobody needs a boat to do anything other than to enjoy themselves and relax. They might offer it to other people to enjoy themselves or relax, but ultimately it's a pleasure tool, a pleasure toy, and it's for satisfaction, for relaxation and recuperation and reinvigoration, after which they go off to do great business again.

TB: Will we see fewer of the 100 metre plus projects?

AW: No, I think we may see more of them over the next 10 years, maybe another half a dozen.

TB: That's quite a lot.

AW: Exactly and I'd like all of them (laughs).

TB: Are owner-funded speculative multiple builds dead and gone forever?

AW: At the right price, the market will sell on anything. There are shipyards out there, and there will be clients out there, and designers – I hope myself included – who think out of the box and find a package that has a value to it. As soon as you've done that, there'll be a buyer who says I can turn this and make a margin. Now he might need £10 million for his own boat, or £1 million, or he might need £30 million, but if he thinks he can make an extra £10 million ... they are making no money in the market at all at the moment. Everybody is asking where can I make money with my money? We ought to be – the industry ought to be – creative in our thinking; what can we do to produce something where the client can make some money? Because if they don't feel they've got an invested value in their yacht then they're going to think again about the cost of their holidays.

TB: Recently Hein Velema commented that a lot of clients have purchasing plans on hold because they can make more with that money elsewhere?

AW: Yes, but there are people who think they can't make money elsewhere, so why not invest it in something they've always wanted and enjoy the money they've got.

TB: Do you think we're going to see new clients appearing who've actually made money out of the opportunities of this situation?

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AW: There are massive, massive opportunities; last night someone told me they took all their major clients' funding out of the market 12 months ago. And you can't believe the amount of money he's sitting on, waiting to pounce on opportunities. The clients are waiting to feel, that silly phrase that came up this week, the green shoots of growth. They almost feel that Spring has sprung. We're all looking out of the window now and going ah! Nice new buds on the trees, the sun is out, let's go and buy something.

TB: You mentioned China and India earlier; do you see any clients there, or do you anticipate any?

AW: I have contacts in that area, both in Hong Kong, Japan, and China and I wait with interest to develop new markets.

Darrell Hall

TB: Some people are saying at the moment: "The sky is falling; it's a catastrophe; the world of yachting has changed forever." Has it? Or is it just a correction?

DH: Well, there's two ways of looking at it. We always look at things in a different way and I'm very lucky to be working with some very, very optimistic people. I always think of Winston Churchill's quote where he said: "A pessimist sees the difficulty in every opportunity, an optimist sees the opportunity in every difficulty."

So yes, there's been a rapid market correction and the pendulum has swung from one side to the other in a very short time frame; a five-month period. But the market as a whole, for the last four years has been at an unrealistically high level. So I personally believe it's a correction in the market right now.



... the majority of people see this global financial hiccup as only a hiccup. So most of them also think things will get back to normal sooner or later... the yards who were trying to pretend they had abilities that really they didn't will probably disappear.

TB: "Need to sell" versus "would like to sell"; how do you reconcile those two completely different client viewpoints?

DH: Well, this is the job description of a broker! A broker's role is market intelligence. If you aren't actively searching every possible scenario for the correct deals and exactly what your clients are looking for, and scouring under every upturned rock, you're not really doing your job. Gone are the days when you could pick ten boats off a website, put them in front of a potential buyer and try to sell him one. Gone are the days when you could sit behind a desk waiting for the telephone to ring and sell a guy a boat at arm's length. If you're representing the buyer you need to discover exactly what your buyer's needs are, and whatever those needs are, you go out, scour the market and find exactly what he's looking for. I mean we keep a complete detailed report as you guys do at *The Yacht Report* on new build constructions, we know every vessel – well hopefully we think we know – that's under construction, we know those guys who are willing to sell it for a premium or those who would certainly like to sell it in the very near future. Then we have different options available for our client.

TB: Are some owners sticking to what they wanted five months ago, give or take a few per cent?

DH: Those particular sellers aren't really sellers. If they're asking those prices today you know they're not either educated about market conditions or they're just not serious sellers.

TB: Presumably it's a simple numbers game. If I want to sell within the next couple of months I've got to take a hit of X per cent, or if I wait for a year maybe the prices will stabilise or rise. Then it's simply, "How much does it cost me overall to keep that boat an additional 12 months, compared with what I would lose if I sold it now?"

DH: I thoroughly agree with you on that. And those are the options that we're giving owners right now. The guys that need to be liquid immediately need to decide how quickly they want to sell their vessel, and right now it just revolves back to condition and price. If the boat's in a fair condition, and the only thing that's stopping it from selling is the price, then they have to end up taking a hit. I think we're in that scenario until this situation comes to an end. Until recently there have been a lot of buyers getting back into the market merely for speculation; for turning a quick buck then getting

out again. They had lost the pleasure of yachting. Those days are gone right now. I don't think any of us predicted that the gravy train would have come to an end with such a sudden stop. But no more will guys come along and say listen, I want three or six, boats built at a shipyard, I'm going to make a profit so by the time I get my final boat it's going to cost me nothing. We'll probably see a return of owners getting into the market purely for enjoyment.

TB: Is any one segment of the market better or worse off?

DH: Tork, we're in a very fortunate position that our primary focus is large-yacht sales, new construction and charter. And we're still fairly active in that market, for which we're pretty thankful. But we're not really turning our back on any particular segment at this stage of the game because we need to keep cash revolving back into the business. In these troubled times we've taken a different approach to a lot of the larger companies who are now cutting back. We're probably the only company who are expanding; we realise there are opportunities and we've just opened an office in Fort Lauderdale. We're looking at that as an opportunity. We know that if we don't represent our owners both sides of the Atlantic, we're not fulfilling our fiduciary responsibility to them. We're also expanding our office in Monaco and we actually do see the light at the end of the tunnel.

TB: There's a lot of waiting going on at the moment; some are waiting to buy thinking that yard prices will reduce massively – but can they really?

DH: Well, put it this way; I think the shipyards have had an unfair rap in recent years where everybody complained they had raised their prices to crazy numbers. But the shipyards are also held to ransom by the subcontractors. Right now all the sub-contractors' order books are still full, so they're not reducing their prices, hence the shipyards can't reduce their prices so at this stage of the game it's Catch 22 until the supply and demand balance shifts.

TB: What about lowering quality expectations getting the same size for less cost; is this an opportunity for non-NW European yards in, for example, China or Turkey?

DH: Well, again that is advice we can offer our client, then let them call on it. But normally we analyse their needs along the way and when the client comes to you and says I'm looking for a quality Northern European build, very, very seldom do they go back and compromise on that side of it. I think this is true even in the current market. Right now clients are still looking to their financial advisers, they're looking at what's happening in the jet market and the luxury car market and they say you know what, if I just hold on for a little longer the prices are going to drop and I'm going to snap up bargains. On the new build side too. And you know it's not happening right now.

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TB: What do you think is going to happen with charter in the next two seasons?

DH: We're already noticing a dramatic reduction in charter demand. Prices are definitely coming down, we've noticed the owners of charter yachts are becoming a little more flexible with their pricing; they're prepared to go back and negotiate. The other aspect is that a lot of guys who were potentially looking to purchase a boat right now are probably going to go back and charter. So we'll probably lose some of the old charterers but probably pick up a few new ones. But I think the telltale signs will come towards springtime. After people have gone through a really long, hard winter like this last one they're going to be looking to get out and do a bit of boating.

TB: The Med season will be very last minute?

DH: We are currently booking a number of charters but last minute charter bookings are going to occur. And whereas charter boats beforehand were not going to do anything under seven days, you'll find they are already becoming flexible and taking, for example, weekend charters.

The other aspect which I haven't even come to yet is owners of boats are being advised that the best way to lower costs is to completely cut your boat down to skeleton crew; I think is an absolute recipe for disaster.

TB: I totally agree with you. They're going to devalue their asset so fast that you'll see smoke coming off its keel.

DH: Yes, you're an ex-yacht captain, I come from the old school as well. And you know, the owner looks at it and says these are variable costs over here; we can surely cut down on that; we don't need that many people; my accountant is advising me that's the best way to go. But it does irreversible damage to the boat, and it's very hard to get a yacht back on its feet again after it's been neglected for a season.

TB: Darrell, thanks very much.

Charlie Baker

TB: The current state of the market: catastrophe; the world of yachting changed forever; or simply a correction?

CB: Well, obviously there has been a hell of a crisis. Has it affected us where we are at the moment? No. Obviously it will do sooner or later but the projects we have in Europe haven't been affected, some of the smaller vessels in some of the yards we deal with have been, but in the 70 metres area that we have been concentrating on lately, it has not been.

TB: You've still got potential clients coming to talk to you.

CB: Yes, we feel the Turkish yards are an option and at this moment people are coming here. This morning we had enquiries for a 30- and a 50-metre and last week we

had two 70s and one 50-metre inquiry. I would lay big money that nobody in Europe is getting that quantity today (February '09).

TB: Building multiples to sale for profit; dead and gone or just in intensive care?

CB: I think some yards have learned the very painful experience of losing money on those. Some shrewd businessmen – we know several very shrewd ones who made money out of building a series of yachts – but I think that trend is now finished. Yards have become savvy. And I think this crisis might have rearranged a lot of people's sense of how they can buy and sell, and many now acknowledge that they'll not get involved in such large projects.



TB: Obviously there is interest at 60 and 70 metres but you mentioned somebody showing interest in a 30-metre build?

CB: Yes, the 30-metre inquiry actually surprised us. We know that there are dozens of 30-metre used vessels waiting to be snatched up as very good buys at the moment. But this inquiry was part of a package; the owner wants to build two boats at the same time in the same yard. So we'll have to wait and see on that one.

TB: Clients expect new build prices to come down, but unless the yards were padding their prices because of demand, yards don't have a lot of room for manoeuvre, do they?

CB: No. Some yards made money, not all yards made money, and perhaps the crisis, as we said before, many times, is really advantageous because we can't help feeling

that some yards have had a healthy run and now they've really got to give value for that money. Some will stand firm and won't shift; mostly established yards and you've got to take your hat off to them. Perhaps they're the people who don't have to rely on credit; we know quite a few yards in that position. Some won't be held to ransom; the majority of people see this global financial hiccup as only a hiccup. So most of them also think things will get back to normal sooner or later. But I think good will come out of this in many ways and the yards who were trying to pretend they had abilities that really they didn't will probably disappear.

TB: In the past we've seen yards scrabbling to get work and taking low- or no-profit jobs to stay alive – will this happen again now?

CB: I think you're always going to get that element, and you know even an established yard has to keep the workers working. Obviously we don't know the exact financial situation of a lot of yards, but that will happen for sure. Other yards are well stocked up with money in the bank and no debt and they won't price cut.

TB: For clients one approach may be to change quality parameters and consider building in an emerging yard or a zone such as Turkey or the Far East.

CB: I think you've hit it right on the head. We were in a meeting at the beginning of the week and have another tonight regarding advertising and marketing Turkey to bring clients down here. There are marinas which want to attract European boats here and are gearing up for the long term, maybe even have them wintering here. And they're also discussing that the correct infrastructure is in place. I feel a little bit guilty at times because I know a lot of people are struggling but I've been busy, busy, busy.

TB: Finally, what do you think is going to be the long-term effect of this situation on the superyacht industry?

CB: I think a lot of owners who were going to move up may stay; I think a lot of the owners in the smaller sizes may leave the industry. I really believe that people are now looking for value for money, even very wealthy clients with the very big boats. I think they're going to look seriously at size and cost and we've already seen a reduction in size of these giants like the 160-metre vessels; I think some clients are going back to the 70- and 80-metre ones.

TB: Charlie, thanks very much.

John Leonida

TB: Is this a catastrophe and has the world of yachting changed forever, or is it a correction?

JL: This is certainly a shock to the system. But the real catastrophe happened two or three years ago when the market became distorted, with abnormal prices for yachts changing the demand curve from a gentle upward curve



to being almost elastic! That is, whatever the price, the demand for yachts was not checked by price increases. We saw the growth of speculative yacht building. We saw new entrants come into the market where the normal economic barriers to entry seemed not to work. The market became anarchic and uncontrollable both on the building and buying side. The current situation may bring normal market forces to bear.

TB: Are renegotiations of contracts the main part of your work right now?

JL: Absolutely, but also a number of cancellations are being dealt with. We are also beginning to advise clients who are looking to enter the market when the prices find their right level.

TB: Clients expect yard new build prices to fall. Were new build prices padded because of high demand or simply time, materials and profit, that is can yards cut prices?

JL: There was some padding driven by demand for particular build slots. Certain elements of the build became expensive as a result of increased demand, for example interior fit-out, but the core components of yacht construction did not increase as steeply as the headline price. Can yards cut prices? In real terms many already have. Others who have higher margins built into their business models need to recalculate those margins when bidding for new projects.

TB: Non specifically, how much can a yard expect to recoup in a cancelled build with significant engineering design done at various stages, like pre steel cut, midway, 75% complete, and, if a project is put on hold – is it any different?

JL: All of the above is wholly dependent on what the contract says. Essentially the owner is responsible for the losses suffered by the builder as a result of a cancellation, but save in a few circumstances, the owner is a company with nothing to its name but the obligations arising under the build contract. When the contracts were drafted, builders expected a rising market where if an owner dropped out they could sell a project for a higher price. At present if an owner is selling a yacht in build he will try to recoup as much of his pre-delivery instalments as possible. In those circumstances the builder gets what they originally contracted for.

At the pre-steel cut stage, provided (i) the sub-contracts have not been signed for engines, gearboxes and a whole range of other sub-contractors and (ii) the first instalment was significant, the builder will be quietly comfortable, but that is rarely the case.

Where a yacht is part built the builder will obviously keep the instalments he has in hand and he will try and sell the project on for whatever the market will pay. If a builder is selling a partially completed project, they will be calculating the costs of completion; they may be re-negotiating contracts with sub-contractors.

Does the original owner get any money back? Only if the contract provides for it after all the costs of the onward sale have been taken into account.

TB: Are projects really on hold or is that a euphemism for cancelled?

JL: Some really are “on hold”, some are wishing they are “on hold”, but generally a cancellation is a cancellation whatever you call it.

TB: Are there any great deals in such new builds out there?

JL: Depends who is selling and how much everyone in the food chain is willing to be realistic on what they are going to get paid. Owners selling on projects signed at the top of market are suffering the most, and as yet very few are willing to collapse the prices and lose the money they have put into projects. Builders selling abandoned projects are reducing their prices, although almost no one is admitting that they have abandoned projects.

TB: If yes, how does it still cost the same to build a yacht?

JL: Reducing profit margins, re-negotiating sub-contracts, cancelling change orders.

TB: Are we going to see a return to yards taking orders just to keep going even if non-profitable or are breaking even?

JL: If they are imbedded in the industry then that is a possibility, the newer builders without the investment just might pull out.

TB: Is there new build interest still – I hear yes from designers? What about cheaper yards?

JL: Interest is there. It is not about cheapness right now it is about realism and regaining quality. Those who can afford Northern European builds are still going to go there. The owners who are considering new builds are looking to builders who can give them the quality that their millions should command. Those builders who did not expand their production, who did not elevate their prices to meet increased demand or indulge in excessive profit taking and instead built within their capabilities are the yards that are benefiting.

TB: What long-term effects do you see this crisis having on the superyacht industry?

JL : The optimum size of superyacht will shrink. The days of the 80m+ yacht being normal will pass. Clients are already fixing on a size between 50 and 70 metres. This does not mean we have seen the last of the gigayacht, but its appearance will be an increasing rarity. The industry will see a shake-out of many of the new players who do not have sufficient investment in the industry and who saw the industry as a place just to make super profits. The crisis will hopefully see builders and owners refocus on building quality yachts. To paraphrase another writer: “Better, fewer yachts, but better yachts.”

Tork Buckley

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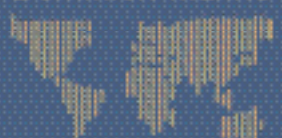
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