

Dry bulk shipping; Can the order book be absorbed?

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The recovery of drybulk shipping in 2009 has been both unexpected and welcome. The BDI index stood at 773 the beginning of 2009 (2/01/2009) and is currently standing at 4107 (4/12/2009). Although a far cry from the peaks of 11623 in June 4th 2008, it, nevertheless restored much needed cashflow and confidence to dry bulk shipping helping both owners and banks.

A number of factors helped to bring about the above turnaround. Briefly, these were

1. Swift recovery of the financing of international trade.
2. Gradual recovery of international trade volumes
3. Robust recovery of demand for drybulk commodities
4. Continuous high growth of China
5. Increase of scrapping
6. Newbuilding delivery delays and some cancellations
7. Increase in ton / mile dry bulk shipping requirements
8. Port congestion
9. Increased port calls per vessel due to an increase in breakbulk cargoes
10. Considerably reduced ship finance for existing newbuilding orders already financed by banks, and
11. Lack of bank interest to finance new building orders that had not been already financed by banks.

Whereas the above turnaround represents excellent news it does contain two worrying factors that may result in the drybulk recovery running out of steam.

These two factors are a) a slowdown in the rate of scrapping and b) a shift by some owners in favour of delaying their newbuilding orders instead of cancelling / walking away from such orders.

To demonstrate the first point, dry bulk scrapping in the first 3 months of 2009 averaged 2.53m DWT per month (SSY), whereas in the third quarter of 2009 (August-October 2009) the monthly average fell to 0.37m DWT per month. It is obvious that the drybulk recovery has already resulted in a marked slowdown in scrapping.

It is difficult to demonstrate with numbers the second point as many newbuilding cancellations and delays are kept secret by both owners and shipyards. However, from discussions with owners, banks and shipping lawyers, the shift is clear and as long as owners still enjoy the support of their banks and are willing to commit greater capital for each order, then the emphasis has been to delay orders.

As a consequence of all the above factors, the estimated dry bulk fleet at the end of 2009 is expected to have reached 455m DWT as opposed to 420m at the beginning of 2009, i.e. a yearly increase of approx. 8.25% in DWT terms.

Interestingly, the above market factors have assisted the market to absorb the above increase in supply in 2009. However, can this continue for 2010 and 2011 given the enormous order book still in place? This is what we shall attempt to tackle and hopefully provide some useful conclusions.

Looking at the supply side, according to SSY (Simpson Spence and Young), and our own research, the total dry bulker fleet is estimated to reach at the end of 2009 445m DWT. Using latest Clarksons' research, the estimated deliveries for 2010 and 2011 currently stand at 76m DWT and 78m DWT respectively. These figures include all the known delays and cancellations to date. However, as it is widely known, there exist numerous cancellations and delays which have not been reported and furthermore, it is expected that more will ensue. However, these shall only be known as and when they shall occur or be reported, during the course of the next year(s).

For the analyst, not having this type of information is very frustrating.

The same applies for the scrapping levels over the next couple of years. Although it is true that the average age of the drybulk fleet is higher than for tankers and containers and that there is a very significant number of overage vessels, in most cases scrapping will also depend on prevailing freight rates and values. As has been clearly observed in 2009, the higher the drybulk market, the lower the scrapping volumes and vice versa.

The only way to proceed in determining further dry bulk supply, therefore, is to work with a set of realistic assumptions in respect of the two most significant factors, i.e. scrapping and cancellations.

In table 1 we have built in three scenarios for scrapping over 2010 and 2011, A at 30m DWT, B at 40m DWT and C at 50m DWT. The choice of these levels is not arbitrary. As time passes, an increasing number of vessels shall need to be scrapped, as time is running out for these old ladies. Moreover, the increasingly more stringent and costly class, port state control and insurance requirements, render overage vessels unwelcome in most areas of the world.

Charterers too increasingly shun overage vessels as their reputation is often put on the line and as they wish to avoid undue complications, such as general average claims, etc.

As a guide, the first 6 months of 2009 resulted in 10.76m DWT of scrapping, hence a biannual total of 40m DWT under scenario B appears reasonable, bearing in mind all the above factors. In scenario A, the total is reduced in reflection of a higher drybulk

market, and in scenario C, the total is increased, in the event of a dry bulk market that reverts to the early 2009 low rates. Based on a dry bulk fleet of 455m DWT, the above scenarios call for scrapping at an annual rate of 3.3% for A, 4.4% for B and 5.5% for C.

Turning to the additional cancellations and delays assumptions for 2010 and 2011, we have also assumed three scenarios: 1 at 15%, 2 at 20% and 3 at 25% of the 2010 / 2011 orderbook. These assumptions include any new orders that may be placed for 2010 / 2011.

It should be pointed out that the primary motivating factor in support of cancellations and delays are the banks who wish to eliminate / reduce their loan exposure. In a recent top bankers' survey conducted by Petrofin Bank Research © involving over 70% of global shipping banks, 11.11% expect cancellations / delays of 15%, 40.74% of bankers expect them to be at 20% and over 44.44% of bankers expect cancellations / delays of over 25%. As such, our assumptions are in line with the above views. Moreover, from information from owners and lawyers, the ability / willingness to cancel / delay rises the further out in time the order is.

Lastly, the state of the dry bulk market itself is likely to directly impact on the rate of cancellations / delays. If the dry bulk market were to stay at close to today's levels, scenario 1 is more likely. Conversely, a deteriorating dry bulk market is expected to boost the levels of cancellations / delays.

The purpose of the above methodology, as shown on Table 1, is to deduce the rate of drybulk supply increase for 2010 and 2011 under the various assumptions.

In the matrix shown, you will observe that the supply increase varies from 11.09% per annum under scenario A1 conditions (least scrapping and cancellations / delays) to 7.2% per annum under scenario C3 (higher scrapping and cancellation / delays).

To conclude, therefore, in order for the market to maintain a demand / supply equilibrium, the demand for drybulk shipping should match or be close to the annual supply growth. Is this likely?

Unfortunately, the news here are not good. In the absence of unforeseen factors, demand appears unlikely to match supply increasing from 7.2% to 11.09% per annum.

In the booming days of 2006 to 2008 with easy and cheap credit, fuelling unprecedented growth rates of international trade, the growth in demand never was above about 6-7%p.a.

The international economy and the banking system are only now re-emerging and are recovering from the most serious crisis of 2008 / 2009. IMF forecasts GDP global growth of 3.1% for 2010. Even allowing for a greater rise in dry bulk commodities and the continuously large rise of international trade is unlikely to exceed 5-6%.

Summarising, readers should realise that already the relatively low dry bulk freight rates in 2009 already reflect a modest disequilibrium between demand and supply. As this disequilibrium increases in 2010 and 2011, the effects on dry bulk freight rates shall be very serious indeed. Only in circumstances of scenario C3 (high scrapping and cancellation / delays) is there a possibility of the demand supply equilibrium not rising significantly, provided of course that the growth rates of international trade shall reach their previous record growth levels.

For an equilibrium to be maintained in the next couple of years, all factors affecting demand should turn out to be at the highest possibly levels and all factors affecting supply, should turn out to be at the lowest possible levels. Even then, other factors, such as congestion, to / mile requirements and fleet efficiency, must continue to occur at today's levels and possibly rise even further.

It all boils down to probabilities. The highest probability that exists for 2010 and 2011, is for a mismatch between demand and supply pointing to lower vessel freight rates and probably values. Vessel values are also affected by other factors such as interest rates, availability of bank finance, market recovery expectations, etc.

Although, shipping often has the capacity to surprise, the odds of drybulk shipping absorbing the current, but reducing, order book, are clearly against. For owners and banks that still have time to decide the fate of their orders, the next year will be critical and everyone's attention shall be drawn to the developing supply portion as 2010 unfolds.

Table 1

Table of data and assumptions for the world bulker fleet					
Total estimated Bulker Fleet, end 2009, in DWT (SSY / Petrofin)	455,000,000	Deliveries for 2010 in DWT (Clarksons):	76,000,000	Total deliveries for 2010 and 2011 in DWT	154,000,000
		Deliveries for 2011 in DWT (Clarksons):	78,000,000		
Scrapping assumptions	A: Scrapping in DWT terms for years 2010 and 2011	30,000,000	Cancellation / delays assumptions	1: Cancellation % for 2010 and 2011	15%
	B: Scrapping in DWT terms for years 2010 and 2011	40,000,000		2: Cancellation % for 2010 and 2011	20%
	C: Scrapping in DWT terms for years 2010 and 2011	50,000,000		3: Cancellation % for 2010 and 2011	25%
Annual growth % of bulk fleet for 2010 and 2011, based on scrapping and cancellation assumptions					
A1	11.09%	B1	9.99%	C1	8.89%
A2	10.24%	B2	9.14%	C2	8.04%
A3	9.40%	B3	8.30%	C3	7.20%

Lastly, the size of the cumulative demand / supply mismatch will determine whether dry bulk shipping shall face a soft or hard landing. Owners and banks are hoping for a soft landing but are bracing themselves for a hard landing. Once bitten – twice shy!