Is the glut of global newbuilding orders in general, and Chinese orders in particular, expected to lead to a sustained dry bulk slump for the foreseeable future?

by Ted Petropoulos – published in Nafs

April 2015

The last 7 years have not been easy for the dry bulk sector. Freights have been erratic and generally in a downward direction. So have vessel values. Other than a spike in 2013 (created by a false hope of an early recovery in dry bulk fortunes), as I currently write this article, the BDI is at its lowest level since 1986 and still falling with all dry bulk vessels' spot earnings below operating expense level.

It is not surprising that this monumental slump has taken place as bulk trade (wet and dry) since 2008 has grown by 21% whereas tonnage supply has surged by 54%, thus creating a large tonnage surplus to requirements. Even last year, by which newbuilding orders started to ebb, dry cargo trade grew by 3.7%, whilst the fleet grew by 4.4% and yet, the order flow did not stop until very late in 2014.

Is this investor madness? What did they think when ordering? Can a whole industry be so wrong?

There is another example of such enormous miscalculation which occurred with VLCC over-ordering in the early 1970s, which caught the larger tanker industry by the 1973 and 1979 oil prices rises. However, there was an excuse then, as the oil price rise had not been anticipated. Nevertheless, it lead to a huge VLCC tanker slump, that lasted for 15 years and which saw the loss of fortunes and fall of the mighty names into dust.

Are we about to face the same scale of catastrophe? Is this market different?

For many ordering owners, the eco ship design was heralded to be the vessel of the future and one that would outclass the non-eco vessels and create a dual market. This prompted them to invest hugely into these vessels whose price appeared reasonable in the light of the precious high vessel prices during the last dry cargo boom. Many, now, of course, lament their decision, as neither the dry bulk recovery has occurred, nor have these eco vessels enjoyed the promised bounty in terms of higher charter rates from charterers. The collapse in the price of oil, down to about $45 per barrel, has reduced the eco premium substantially.

So, is the dry bulk industry and its investments a giant albatross and will the industry face continuous 'cash burning' conditions for many years to come?

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The short answer, in my opinion, is that dry bulk is not necessarily doomed to a prolonged bad market. To put it another way, there is no doubt a huge problem of overcapacity facing the industry but a recovery may well be achieved in the next few years rather than a decade provided further orders shall be contained.

Before addressing the problem in greater detail, let us look into the current dry bulk order book.

As of the end of January 2015, the total dry bulk order book stood at 1,954 vessels of 162.7m DWT (Clarkson's World Fleet Register). This represents a massive 21.4% of the existing and quite sizeable fleet. Moreover, 48% of the total is due to be delivered in the next 11 months, i.e. a staggering 78m DWT or 10.25% of the existing fleet. Out of this total, 46m DWT is accounted by Chinese ship yards, involving 632 vessels.

The position does not improve much in 2016, as there is still a massive 66.9m DWT global order book, of which Chinese yards account for 45.6m DWT. (Clarkson's Shipping Intelligence Weekly and Clarkson's World Fleet Register).

In Table 1 you will see how the Chinese order book is spread out. Increasingly, the average bulker DWT is growing from 73,685 DWT in 2015, to a massive 104,389 DWT in 2017, implying that most of the forward orders have been for capes. Greek and Chinese owners are competing for top position in this race. There is some evidence of an order slowdown in Chinese yards, as China's Ministry of Industry and Information Technology reported a 14.2% fall to 59.95m DWT for the whole of 2014 with the latest months showing a steeper slowdown. There was some evidence toot that the completed tonnage by Chinese yards in 2014 fell by 13.9% compared to 2013. However, this did not prevent the Chinese order book to still grow by 13.7% y/y to 148.9m DWT at the end of 2014.

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Table 1

Chinese Yards Bulker Orderbook			
Built year	**No of Bulkers**	**DWT**	**Avg Bulker DWT**
2015	**632**	**45,936,731**	**72,685**
2016	**479**	**45,575,356**	**95,147**
2017	**86**	**8,977,422**	**104,389**
2018	**5**	**746,000**	**149,200**
Totals	**1202**	**101,235,509**	
Feb-15	**Clakrson's World Fleet Register**		

World Yards Bulker Orderbook			
Built year	**No of Bulkers**	**DWT**	**Avg Bulker DWT**
2015	**1019**	**78,038,777**	**76,584**
2016	**734**	**66,893,178**	**91,135**
2017	**188**	**16,452,987**	**87,516**
2018	**13**	**1,342,600**	**103,277**
Totals	**1954**	**162,727,542**	
Feb-15	**Clakrson's World Fleet Register**		

So, is China leading the race to oblivion in dry bulk shipping, as well as in global shipping?

What we can anticipate, though, is a significant delay, as owners will not be in a rush to accept delivery of their vessels. We would assume that the delaying factor will result in a reduction of at least 10% of the fleet and as high as 15% per annum over the next two years. Based on total, 2015-2016 orders of 145m DWT, this would reduce the total deliveries over the period by about 14.5m DWT to 21.75m DWT.

Then we need to consider how many cancellations will take place for deliveries in 2016, whereby, the down payment may not have been sufficient to ensure that the vessels would be built. We can only offer a guestimate here and assume that about 10m DWT will be affected in 2016, as it is too late to cancel 2015 deliveries. Then, we have possible conversions into tankers, which are showing signs of vigour at present. An analysis by Clarkson's Capital Markets has revealed that only 49m DWT of the order book has been placed at yards with the ability to convert dry orders into wet ones. The estimate suggests that a maximum of between 10m and 15m DWT could be converted. As these conversions cannot take place for 2015 deliveries, I assume that there will be a 5m DWT conversion in 2016.

For the critical 2015-2016 years, therefore, we have an adjusted increase in capacity down from 145m DWT to 108.25m DWT to 115.5m DWT or equivalent to 14.22-15.17% increase over the period, based on a total dry bulk fleet of 761.3m DWT at the end of 2015.

We now turn to the scrapping market. Here, the scrap price has recently tumbled from 420 $/LTD to 365 $/LTD. However, due to the new regulations coming into effect on 1/1/2016, as well as the poor market, many vessels will head for scrapping. The total scrapping per annum has fallen from 33.4m DWT in 2012 to 23.3m DWT in 2013 and only 16.1m in 2014, but is showing a resurgence in January 2015 with 4.2m DWT scrapped in one month alone.

It is safe to assume that on the back of the poor markets and high drydocking and special survey costs, the scrapping of dry bulk vessels shall grow to the 2012 levels of approximately 30m DWT per annum. Should this occur, then this would reduce the total fleet increase by a further 60m DWT, down to 48.5m25m DWT to 55.5m DWT. These tonnage estimated increases represent a 6.33-7.3% increase over the 2-year period, which is encouraging. Now, these numbers are much more manageable. The tonnage rise in 2015 is expected to be slightly higher than in 2016, as the cancellation/conversion impact would affect more 2016 orders but against that we must consider that 2015 scrapping may be higher than 2016, due to the new regulations.

The above predictions are guestimates and may be affected by a number of factors, such as the state of the dry bulk market, the ability to delay and/or cancel orders, and scrap prices. If correct, though, a 2-year tonnage increase of 6.3-7.3% seems high but manageable and far smaller than the increase implied by viewing the order book alone.

Turning to the demand side, current dry bulk growth estimates for 2015 and 2016 are for 4-5% in 2015 and 5-6% in 2016, i.e. a total of 9-11% over the 2-year period. This is based on continuous benefits from quantitative easing and a relatively low price of oil, as well as a growth recovery in China as a result of a credit expansion programme. Should the above dry cargo demand scenarios materialise, then it is possible that in 2015 and more so, in 2016, we shall witness the first years of demand marginally outstripping supply. Such a development would undoubtedly result in a partial recovery of dry bulk freights to levels that would exceed operating expenses resulting in the dry bulk industry having a marginal but positive cash flow with which to address loan and interest obligations. Conditions, though, are not expected to encourage or justify new orders which would delay further such recovery or make it a false dawn.

Just before we all rejoice that a recovery is nigh, we should mention that the low price of bunkers may encourage less slow steaming, which alone may negate/delay the market's recovery. In addition, there will still be those that with itchy fingers dying to place forward orders in a quest for glory and the elusive Eldorado of shipping last seen in 2007.

To conclude, the industry has the potential to achieve the beginnings of a partial recovery, provided it does not once again shoot itself on the foot by further orders. Did someone say deja vue?