Article for NAFS
Ted Petropoulos
July 2013

Vessels of mass destruction

A lemming is a short rodent best known for mass migrations falling off a cliff. For humans, it is a person who unthinkingly joins a mass movement which is on a headlong rush to destruction.

You may well ask what does this have to do with shipping? Well there is close relevancy. Allow me to continue with my lemming story for a little while longer.

Rumour has it in lemming land that the promised land lies beyond the cliff. Not only will there will be rich pickings and plenty of lying in the sun, but it is well known that golden parachutes will soft land lemmings after their fall off the cliff. However, a number of lemmings have been speaking out against the whole idea by arguing that there is no proof of either a promised land or golden parachutes. So what will happen? Will the clever lemmings that jump off the cliff be the lucky ones that get the golden parachutes or will they fall to their early death followed by all the rest of the lemmings? Some predictions follow.

One would have thought that with vessel cash flows decimated and barely above operating expenses' breakeven, that owners would think twice about ordering more loss making vessels. Moreover, with the relatively scarce finance and an uncertain future, it would appear sensible to wait a little and until the outlook for shipping becomes less hostile.

Traditionally, Greek owners in the past would buy modern second hand vessels during a shipping recession from those foolish enough to have ordered before the crunch. However, the game has changed and Greek owners have been at the forefront of new building orders over the last decade or so. Thus they have been paying the currently available vessel prices for vessels that would be delivered often years away. This represents a substantial change in the risk profile of Greek owners.

To give but a small example, essentially via new building orders, the Greek dry fleet has grown in DWT capacity from 97,818,808 in 2008 to 124,813,467 in 2012, ie an increase of 27.6%.

Admittedly, as a consequence of the prolonged shipping recession, Greek orders (all types) did slowdown in 2012 from 185 in 2011 to 116 in 2012 *(Source: from Golden Destiny as reported in Newsfront Greek Shipping Intelligence)*. However, over the last months the rate of order flow has accelerated. The number of new buildings averaged 0.78 per day in the first quarter of 2013 , rose to 0.95 per day in April / May and to 1.53 in June. Currently, in the first six months alone of 2013 there are about 120 new orders confirmed and about 54 options *(Source: Newsfront Natiliaki-Greek Shipping Intelligence)*. It should be noted that in this market, a lot of deals are being negotiated, but these negotiations can drag on for months. Also, not all order are detected in the system.

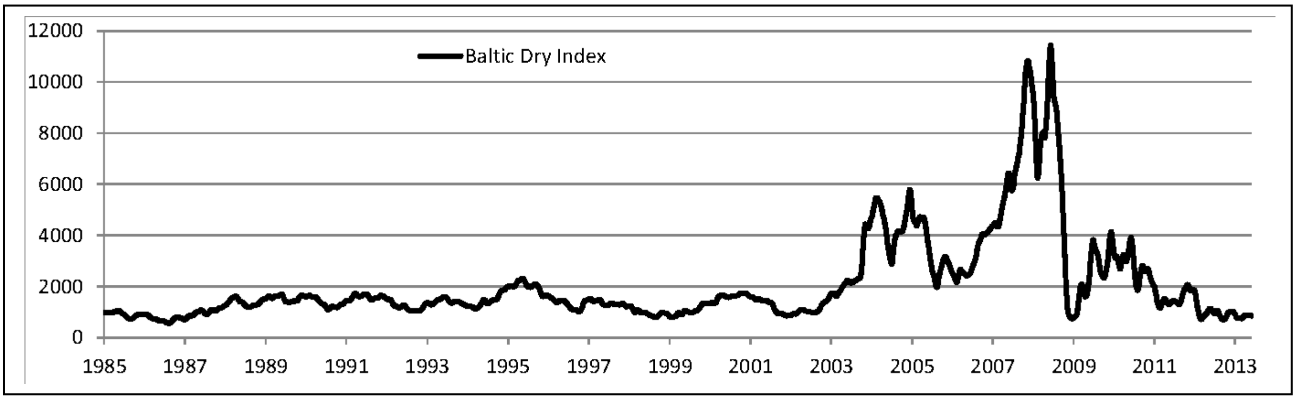
So what do our Greek owners know that they are placing such massive orders?

Article for NAFS
Ted Petropoulos
July 2013

As a result of the massive over ordering that has taken place from 2007 onwards and with the development of the equally massive Chinese shipbuilding capacity, the dry bulk market has been operating in surplus supply conditions since 2009. Despite a healthy rise in shipping demand over the period, slow steaming and ports congestion, the presence of a substantial surplus is all too apparent in the low charter rates . Please see below a graph of BDI over the last 30 years to see how low freights are. The numbers are not inflation adjusted and as such operating costs are now substantially higher that what they were in the 80s, thus rendering the current recession much deeper.

Undoubtedly, the reason behind the rush of orders has been EXPECTATIONS. Clearly those that have placed the orders during what has been the worst shipping recession for years, expect golden pickings in the future which would justify the risk. After all, they reckon that by the time their vessel order shall be delivered, the market would surely have changed. But will it?

BDI – 1985-2013



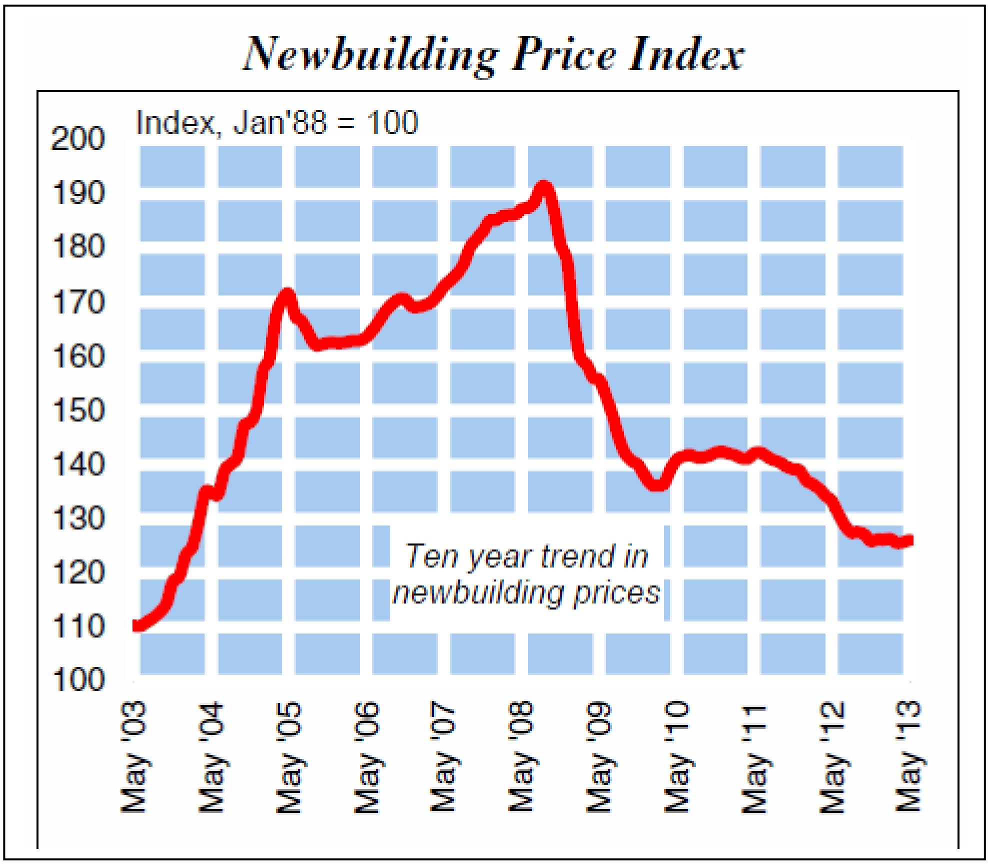
Source: CapitalLink

In addition to a widespread expectation that the worst is over, orderers have found another powerful reason to place an order. They have been promised, though not guaranteed by Far East shipyards, that the new vessels shall be super economical and would be preferred by charterers and would earn substantially more income than previous technology vessels. To boot, the new vessels would comply with all the existing and forthcoming regulations and there would be economies of scale in ordering a number of identical vessels . Furthermore, they expect newbuiding related finance to become more plentiful and cheaper and often local bank or export finance is available when linked to the order.

Lastly, vessel prices have been falling (please see graph below) and this provides another strong incentive for placing orders.

Article for NAFS
Ted Petropoulos
July 2013

Source: Clarkson's Shipping Intelligence – Issue no 1,077 -28th June 2013



The list of advantages appears powerful, but is it convincing?

There are today modern vessels that are larger and more efficient than older vessels but are still running at a loss. **Efficiency, age and size are no substitute for a weak market**.

Annualized net growth of the dry bulk fleet has fallen from 14.61% in 2012 to 7% in the first half of 2013. However, the growth in capacity is still outpacing the increase in demand estimated at about 5 % pa in 2013.

Without a contraction of the large capacity surplus, a meaningful recovery is hardly possible. It would take a number of years for the surplus to be eradicated. Evidence of such a recovery will be detected by a reduction of slow steaming.

Article for NAFS
Ted Petropoulos
July 2013

The biggest danger is that by placing such a high number of orders (as has been evidenced in the first half of 2013), which will be delivered one way or another and add to capacity, Greek owners risk and delay the very recovery they have been expecting.

So is this a make or break decision by risk loving Greek owners who know best? A quick search of who is placing the orders reveals a long list of the biggest and shrewdest of Greek names. Are these respected ,knowledgeable and financially able owners heading for the cliff or the promised land? One presumes that they have done their analysis and are happy with the breakeven rate required to pay for such investment. One also presumes that they have the financial adequacy to withstand the need to self-finance the orders and/ or to cover a period of negative cash flow.

So there you have it. Ordering decisions are not supported by conventional analysis and it does look that many Greek owners are heading for the cliff taking everybody else with them. However, Greeks have not always followed conventional thinking and they each have their own tale of success or failure . One thing is clear, this is not a game for the faint hearted but for the bold and committed.

I promise readers to revert in 2-3 years' time to see how our adventurous Argonauts have fared.