Seizing the initiative

“I expect 2017 to be one of the most significant years for shipping because it will be a year of transition for many sectors of the industry. The signals already suggest a transformation from optimism to realism. This outlook reveals why.” – Richard Clayton, Chief Correspondent, Maritime & Trade – IHS Markit

The prolonged downturns in the dry bulk sector, which began in 2008, in the offshore sector, which began in late 2014, and in the container shipping sector, which has been gathering momentum over the past five years, are expected to be exacerbated by the tanker sector in 2017 as excess supply of tonnage overwhelms an uncertain world’s capability to consume fossil fuels.

Since 2008 the shipping industry has run down its financial reserves, built up serious levels of debt, pushed future investment into the background, and questioned the long-term legacy of state support for the shipbuilding industry in the east. In the west, marine insurance premiums have been falling at an alarming rate and might no longer adequately cover some of the larger claims.

Bankers across northern Germany are reporting losses, while New York financiers are expressing anxiety about returns on their investment. In the south, hopes for economic development in Africa and Brazil (as well as in the major economies of China, India, and Russia) no longer appear likely to generate new business in 2017.

If the signals picked up over 2016 are accurate, we must expect casualties – indeed, some high profile casualties – over the coming year. I hesitate to follow what has become accepted practice among shipping analysts to anticipate market upturn in “18 months’ time”. As a senior shipping executive told me at a lunch recently, “Everyone says the shipping downturn will end in 18 months; the trouble is, they have been saying that since 2008.” How can shipping leaders position their business so as to avoid becoming another casualty? What are the practices that reveal a likely candidate for casualty in 2017? Will 2017 be a year of retrenchment or a year of renaissance?

This overview will not offer a forecast of when certain freight rates will cross specific lines. In an ideal world, shipping would experience regular cycles in which periods of profitability replenish the finances to provide a cushion against the bumpy ride ahead. Some analysts have picked out these cycles throughout the past 200 years – with understandable interruptions for war, famine, and disease. They ask whether 2017 will be the year the markets turn up again, or whether the rhythm of regular cycles has been broken for good.
2017 Outlook: ‘A Year of Transition’ for the Global Maritime Industry

Signals of retrenchment

Pain in the past is often a useful pointer to pain in the future for container shipping. In August 2016 it was reported that China COSCO, the state-owned containers-to-bulk business formed from the merger of COSCO and China Shipping, had posted a loss of USD1 billion for the first half of the year. In part this reflected the cost of disposing non-core activities; however it also reflected three concerns for 2017.

First, China’s economy has slipped from the break-neck expansion of 2002-2014 to a more mature incline, which means demand for container and dry bulk capacity will slow in line with this curve; secondly, excess shipping capacity will still weigh heavy on the industry into and beyond 2017; and thirdly, China COSCO has lost the benefit of generous government subsidies for scrapping ships. At the end of June 2016, China COSCO operated an integrated container ship fleet of more than 300 vessels at a time when demand has been, at best, flat. Many of these ships will be recycled before 2020; ironically, the price of scrap steel will continue to be depressed next year by excess steel production from... China.

Hanjin Shipping’s filing for bankruptcy protection at the end of August 2016 underlined these points. Although the business is a division of a South Korean family-controlled conglomerate, the trigger for the operator’s liquidation came when government-backed Korean Development Bank took the decision that Hanjin Shipping would not be able to repay its creditors. Its debt had grown to an eye-watering USD5.5 billion. Not all of that would be required by creditors in 2017, but the shortfall was significant.

Denmark’s Maersk Line had seen profits from continuing business slide from USD2.3 billion in 2014 to USD1.3 billion in 2015. In anticipation of a further fall, and aware that the container shipping sector is unlikely to see an increase in demand throughout 2017, AP Møller-Mærsk seized the initiative to launch a strategic review. When Maersk Line CEO Søren Skou concluded his analysis in September, the chairman of AP Møller Holding, Ane Mærsk Mc-Kinney Uggla warned against the danger of being “static in a dynamic world”. The AP Møller Group is to be split between containers and logistics in the light blue corner, and energy in the other light blue corner. Maersk has acted in anticipation of another difficult year in container shipping, and it has also revealed its understanding that the energy sector – especially the offshore exploration and production sector – will continue to be uncompetitive against Middle Eastern production.

China COSCO, Hanjin Shipping, and Maersk Line have responded to another year of low freight rates by restructuring, either forced or managed. Signs of retrenchment in container shipping will not be assessed in 2017 by reference to the rates available for transporting boxes from one port to another, but by reference to the level of debt, the timeline for repayment of that debt, the degree of reliance on government support, and the psychology of the business – by which I mean whether the decision-makers are leaders able to manage a change in direction before the situation becomes acute, or whether their decisions are forced upon them.
Tanker shipping has enjoyed a period of increasing demand after the fall in the price of oil in the autumn of 2014, however that might change in 2017. Essentially, the drivers of growth in 2015 and into 2016 – increasing volume shipped out of the Middle East, inventory building around the world, port and terminal congestion, and floating storage – have ended. With high inventories being wound down, demand for tanker shipping is expected to weaken in 2017.

Meanwhile, OPEC member nations have reached agreement to reduce output in a bid to lift the oil price from mid-US$40s to mid-US$50s. This followed economic downturn in Venezuela, Nigeria, Russia, and even in Saudi Arabia itself. If political infighting among OPEC’s members is dampened, 2017 might see a rise in oil price, and further decrease in demand for tankers. However, there are questions about whether OPEC’s influence is as strong as it used to be, and whether producers who take opposing political views can bury the hatchet.

The third reason for concern about the coming year for tankers is that newbuilding deliveries have finally caught up with demand. As has been clear from the dry bulk and container sectors, increased capacity leads to intense competition, and reduced rates. At a time of falling demand, tanker shipping must anticipate a year of retrenchment in 2017.

### Signals of renaissance

A year of transition will be positive for some companies, even as it will be negative for others. What signals have there been to suggest there will be a change of focus within the industry? Companies responded to stress in 2015 and 2016 in one of two ways: they reduced costs wherever possible, concentrated on core activity, made redundancies, and tightened procedures in an effort to “get through this”. Others took a different approach. They recognised the need for change, identified partners and skills they required to help them achieve a new goal, and built a new business with a fresh set of objectives.

The low point in dry bulk shipping might have been reached in the first quarter of 2016, when the Baltic Dry Index dredged levels never seen before. The graph has risen significantly since then, and the end of the year 2016 has seen a turn of sentiment in the Capesize, Panamax, Supramax, and handysize sectors. The dry market is driven by sentiment, so owners, brokers, financiers, and shipbuilders will all be watching for steady growth beyond breakeven levels.

According to IHS Markit, the Capesize fleet (including Very Large Ore Carriers) is 4.6 million dwt bigger than at the end of 2015 which is just about 15 extra vessels in net growth. The age profile will be a little younger – at 7.1 years from 7.4 years at end 2015 – and there is an (scheduled deliveries – many will not be delivered) expectation of 9.5 million dwt more Capes to be delivered in 2017, with almost nine million dwt more in 2018. One hundred and ten Panamax vessels were scrapped in 2016, contracting the fleet by 20 ships to a little bit more than 155 million dwt in capacity; the age profile shifts to 8.2 years from 8.5 years at end 2015. The newbuilding orderbook has eleven million dwt Panamax scheduled for delivery in 2017 and 2.6 million dwt in 2018.

The greatest expansion will take place in the Supramax/Ultramax sector, where 182 vessels were delivered in 2016, so far while only 9 vessels were removed for scrapping, so the fleet grew by more than 10 million dwt so far, adding about 5% of capacity since the end of 2015. Like the Capes and Panamax fleet, the Supra fleet age profile stands at about eight years. Orderbook for Supramax/Ultramax fleet stands at about 11 million dwt in 2017 and a bit more than 3 million dwt for 2018. The Handysize fleet, with the oldest profile at 10 years, net added just 10 ships or just over 1 million dwt in 2016. So for the dry bulk fleet in 2016, IHS Markit expected 561 ships of more than 45 million dwt to be delivered, 416 vessels of 34 million dwt to be removed, and a fleet growth of 197 vessels of 11 million dwt. The total fleet growth is expected to be between 1 and 2%, which is certainly encouraging sign among stronger growth of trade particularly iron ore and coal exports to China.

The overall fleet is becoming younger, which is good, and we know of 33 million dwt scheduled for delivery in 2017 and just 13 million dwt ships for delivery in 2018. These figures are fluid, given the state of the market and the state of the shipbuilding business, but it paints a picture of a sector that has survived the worst downturn in working memory, and is much more aligned to global demand for dry bulk commodity trading than at any time since the financial crash. Dry bulk shipping is expected to view 2017 as a year of renaissance.
Among the many announcements made by shipping businesses in the second half of 2016, the decision by Hamburg’s Peter Döhle Schiffahrts and Sirius, a crew management specialist from Genoa, offers insight for the coming year. The two businesses are to merge their expertise in the recruitment, training, and management of Filipino seafarers. Two of the senior managers got chatting over coffee at a shipping conference and realised that the people management issues they were dealing with could be tackled more effectively if they worked as a team. Forecasts of a shortfall in the number of skilled and qualified crew are accepted within the industry, so a commitment by both sides to invest in training programmes and courses made a great deal of sense.

Peter Döhle general manager Roy Machart explained: “This co-operation starts from the determination to manage the market and not be managed by it.” The Peter Döhle/Sirius co-operation echoes Ane Mærsk Mc-Kinney Uggl and her urging not to become “static in a dynamic world”. MOL president and chief executive Junichiro Ikeda in his address to employees earlier in 2016, put it like this: “We can no longer rely solely on idealistic approaches like willpower and individual legwork. We must restructure our organisations and systems to get the job done.”

Machart, Uggl and Ikeda revealed the most basic signal of a company that plans to grow in 2017: they are seizing the initiative before they are overwhelmed by external factors. It sounds obvious, although 2017 is likely to be dominated by companies that are pushed into taking decisions they hadn’t fully researched and executed comfortably.

The year ahead is expected to be characterised by better prospects for private companies than for state-run or state-funded companies. States that have grown affluent on the proceeds of oil and gas will always be vulnerable to changing fortunes of price, and businesses that have grown in line with the transport of crude oil on behalf of national energy companies will endure a tough 2017. Private businesses are usually more agile and flexible, seeking partners, changing direction. New technology – especially propulsion, communications, and data analytics – require investment with a long view.

Shipping businesses are far more likely to have been established over many decades, they have traditional values, they are reluctant to change, they respond to events; which is why smaller companies, unburdened by decades of tradition, unencumbered by accumulated debt, will thrive in 2017.

Maritime regulation will feature significantly in 2017: companies that are in step with investment in emissions reduction and ballast water treatment will benefit over companies that have left it until the last minute to comply. Implementation of the ballast water convention kicks in on 8 September 2017, but ship owners will only have to meet requirements when their vessels are in for a five-year survey. A decision in favour of 2020
for a global cap on sulphur in fuel will mean proactive owners will plan a strategy in 2017, whether to install a scrubber, opt for distillate fuel, or go for one of the alternatives: LNG, biofuel, or methanol. IMO’s next reassessment of EEDI, the Energy Efficiency Design Index will be taken in 2022, but 2017 will show how well ship owners are meeting requirements. There is little sense in making regulations so stringent that struggling companies can’t comply, however more progressive companies will act as a guide for future decisions.

One sector I believe will see much change in 2017 is shipping services. The years 2015 and 2016 have seen ship financiers lose their appetite for shipping, but they have not walked away completely. A healthier dry bulk sector, and companies looking to invest in innovation could attract funding from banks that have a pedigree in maritime. Companies with an expertise in cyber security and in the ship registry business should do well, together with companies in fuels and lubricants for an increasingly energy-efficiency conscious planet, as well as companies involved in crew management as the number of trained and experienced officers decline.

The significance of state support in the shipping industry is probably most pronounced in shipbuilding, where vessel construction became strategic at a national level for Japan in the 1970s and 1980s, for South Korea in the 1980s and 1990s, and for China in the 2000s.

Japan’s determination to corner the market in dry bulk shipbuilding suffered since 2008 as owners responded to weak market rates by cutting back on newbuilding orders. A regulation-driven surge of ordering in 2015 was swiftly snuffed out, and 2017 is expected to follow 2016 having been a period of minimal activity. South Korea’s progression to container ships, gas carriers, and high-spec oil and gas drillships and processing facilities has been undone by the collapse in ordering since September 2014. And China’s dependence on state subsidies to undercut competitors’ prices has unravelled as the state’s own finances ran thin.

The result is that shipbuilders in all three nations face a tough 2017: Japan’s ageing workforce and Korea’s rising wages mean surviving businesses are expecting to suffer a skills shortage, while China’s reliance on subsidies will open the door for rival bidders. I believe this will be a real year of transition for shipbuilding. We should expect casualties among established names; and we should also anticipate opportunities for builders in Southeast Asia, Eastern Europe, and maybe even Brazil.

So for businesses with the courage to meet and manage customers’ needs, 2017 will offer signs of renaissance.
2017 Outlook: ‘A Year of Transition’ for the Global Maritime Industry

Retrenchment, renaissance, and realism

As an industry, commercial shipping has suffered a prolonged downturn with few pockets of encouragement. Partly, this is the result of an overly optimistic spirit determined to see revival in even the most difficult times. Hope of revival has underpinned newbuilding orders that have had the effect of killing off any revival there might have been. The year ahead looks different because the sentiment has turned from optimism to something more realistic. Where are the signs that realism will be the watchword for 2017?

The first is that financially-stressed shipbuilders are planning to restructure. Some are planning to end shipbuilding altogether. With fewer shipyards competing for business, the unsustainable pricing seen over the past five years will have to end. Further, Asian governments will stop subsidising their yards in order to maintain employment. That will also raise prices, and higher vessel prices will require higher freight rates.

The second is that shipping’s global commitment to reducing emissions into the air and water will drive investment in abatement technology, cyber connectivity (and cyber security), energy efficiency, and manpower training. The additional cost will also have to be covered by higher rates. Failure to ensure global commitment through enforcement of regulations will be met by protest from companies that have followed advice, so enforcement will also feature in 2017 and 2018.

The third is that most of the necessary retrenchment has already been achieved. It was a period of pain, but without it there cannot be a period of renaissance. What I am anticipating for 2017 is a year of realism when memories of retrenchment temper the excesses of renaissance. For dry bulk this could be a year of turning, for tankers a year of slowing, for containers a year of consolidation, for offshore another year of reflection, and for regulators a year of implementation.

Author:
Richard Clayton, Chief Correspondent Maritime & Trade, IHS Markit

For more information www.ihs.com/maritime_trade

About IHS Markit

IHS Markit (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide. The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 85 percent of the Fortune Global 500 and the world’s leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

Copyright © 2016 IHS Markit. All Rights Reserved