

Rebound

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A sustained reduction in newbuilding contracts has at last begun to move the order book into closer balance with an improving demand picture. But despite some major market indicators moving into improving trajectories, shipyard prices may continue to fall. Too many yards still have too little forward cover, and even those considered high quality facilities must be considered at risk of closure.

In terms of earnings, most shipping sectors remain at or near the bottom of the cycle – or are just nudging up to the foothills of improvement. Not surprisingly we expect some improvement in one year time charter rates, though this may not be evidenced in all sectors for another two years, on an annual average basis. However, after a painful decade in which the shipping industry has suffered from a fundamentally unhealthy supply position, the newbuilding order book is finally starting to improve.

Fleet supply

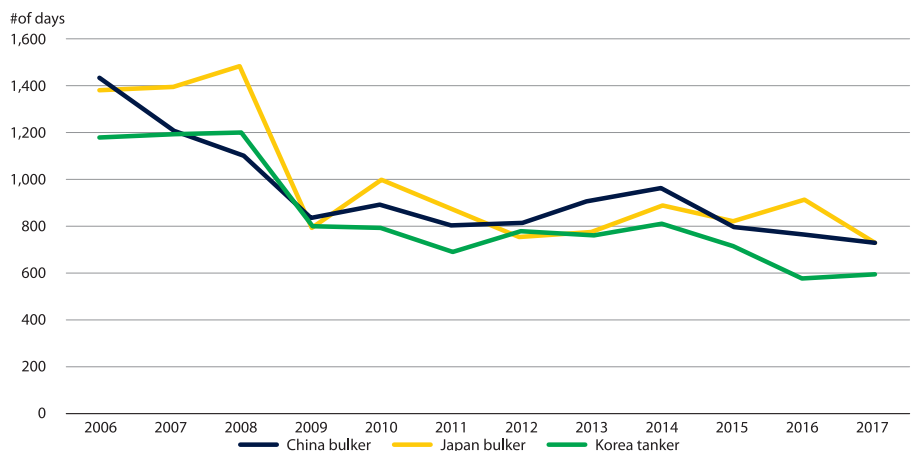
Comparing the situation from mid-2015 with the order book today, our analysis shows that buying levels across all the main sectors have come down significantly. Ro-ro owners in particular have been reticent in ordering new tonnage – due to high newbuilding prices, uncertainty over environmental regulations such as the Emission Control Areas, as well as lower trade growth. Nevertheless, more orders are now being placed, and the same holds true for ro-paxes and cruise ships, two other sectors which have been depending on older tonnage.

Looking at tanker and container fleet growth between 2017 and 2020, the

average annual growth rate is between 2.4% and 2.6%, respectively. For dry bulk, we're forecasting fleet growth rates to be under 1% on an annual average basis. The dry bulk order book is currently equivalent to all the existing tonnage over 20 years old, and is starting to get back into territory where we can see some balance between supply and demand. Here, in terms of contracting,

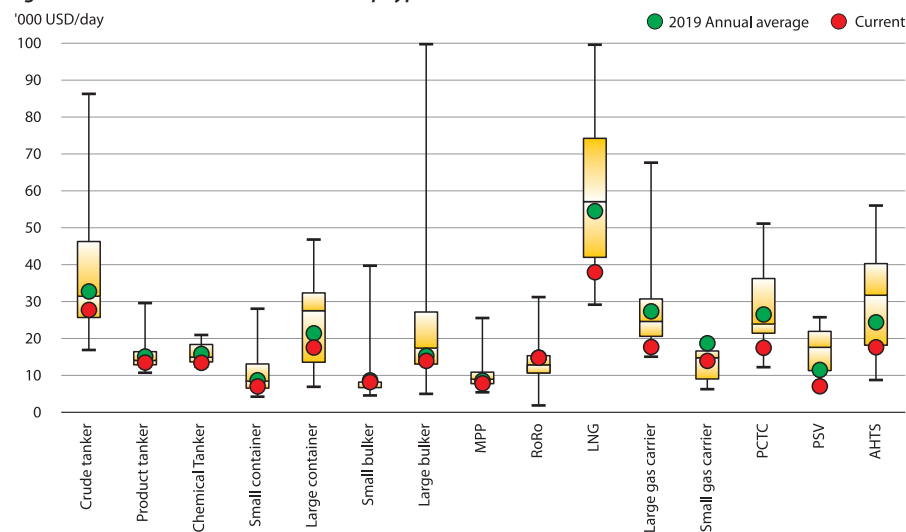
since the first quarter of 2016 there has only been around five million gross tonnage, quarter-on-quarter. This includes the Valemaxes ordered last year, which gave the totals a shot in the arm. This year, we've also seen a lot of Very Large Crude Carriers ordering, but, in aggregate, contracting remains low and we're not forecasting it to come back to 2015 levels until early next decade.

Fig. 1. The average number of days between ordering and receiving a bulker or a tanker from a Far East shipyard in 2006-2017



Source for Figs. 1-2: MSI

Fig. 2. Time charter rates for different ship types



Earnings and prices

As to earnings, apart from the crude and product tanker sectors, which are coming down off the peak of the cycle, most other sectors remain at the bottom or are approaching the foothills of a recovery. Even so, this has been enough just about to cover breakeven costs. A breakdown of the current one year time charter rates versus aggregated daily operational expenses (OPEX), along with part of the financing costs, shows that, across the board, second-hand prices are also at around breakeven levels. Looking forward, it's perhaps unsurprising, given the position in the cycle, that for most sectors we expect to see some improvements over the next two years. In terms of the historical distribution of earnings, the position of current one year time charter rates is in general towards the bottom end of the historical distribution (Fig. 1). By 2019, however, we can see that in all instances rates will be above today's level.

Newbuilding prices are fundamentally driven by the interplay between forward cover, i.e. the relationship between shipyards' capacity and their order book, along with the yards' costs. By analysing activity at the shipyards, we can see that they will remain woefully underemployed in 2018. The only facilities looking relatively healthy on a historical basis are European, where cruise ship orders placed in the last 12 months will keep them busy for some time to come.

In South Korea, if we express the scheduled output by shipbuilding region as a percentage of the maximum of the last five years, the country is at around 100% of its output this year. Looking to 2018 – only around six months out – we can see that the country's Tier 1 yards will reach

the level of approximately 50% utilisation only. Those yards remain severely underemployed and will continue to price low to attract new orders.

China is looking a little better at its Tier 1 yards, though there is still a large swathe of Tier 2 yards that have no orders. The same goes for Japan. There has been a lot of talk about the "Chinese White List", but, upon closer look, it is apparent that it has been a long time since many of the whitelisted yards have taken any orders. In fact, only around 30 out of 71 in total have taken an order within the last 365 days, and the vast majority are state-backed. Those which have not taken an order can probably be factored into a reduction of effective shipyard capacity in the next five years.

Lastly, crunching the numbers on individual contracted vessels also supports the idea that the time between placing an order and taking delivery is shortening quite quickly. When placing a tanker order at a Korean yard, for instance, an owner can expect to wait around 600 days for delivery, whereas this figure was double at the top of the boom markets (Fig. 2).

Further to fall

So, where will newbuilding prices go? We expect the shipyard costs to decline marginally in 2018, largely driven by commodity prices and the reduction in steel plate prices, before we see some uptick in



Founded in 1986, Maritime Strategies International (MSI) is an independent research and consultancy firm based in London. The company is focused on maritime economics and econometric modelling, providing a comprehensive range of advisory services, including forward valuations market forecasts for all shipping sectors. MSI asset price forecasts are used by ship finance providers holding 40% of all shipping bank debt. For more info please visit www.msilt.com



2019 and 2020. But we also think shipyard forward cover will fall further in 2018, as deliveries outstrip contracting. As far as newbuild prices in general are concerned, we don't believe the bottom of the price cycle has been reached yet. On an annual average basis, we believe that newbuilding prices will fall by up to 5% in 2018. Obviously, this will be partly dependent on the shipyard and vessel type, but, all in all, we don't think the industry has quite hit the bottom.

Combining this with our second-hand price forecast, we don't expect to see much of a sustained recovery across the sectors until 2019 or 2020. Where the actual bottom of the second hand-price cycle is depends very much on the sector. Based on our quarterly forecasts for second-hand prices, we think Capesize vessels will actually come off and the bottom of that cycle will be in the first quarter of 2018. Tankers will hit the bottom a little later, but we think we've already seen the bottom of the second-hand price cycle for container ships.

Naturally, even the best market prospects come with caveats, but it is possible to run a number of different ship types through our online valuation service, which will spit out a fair market value for a forward view of newbuilding and second-hand prices, earnings, and OPEX. For instance, assuming that an investor buys a five-year old vessel today and either sells it next year or in 2019-2020, based on the current analysis, the best returns are to be found in the Aframax tanker and the mid-sized container ship sectors, as well as the more specialised car carrier market. ■