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Cut your overheads or risk going under

As the outlook worsens in all sectors and China takes a stranglehold on the market, only the strong will survive

AS WE go through this season of financial reporting the results for 2010 show a seriously worsening situation in all shipping sectors in the fourth quarter of 2010, continuing into the first quarter of 2011.

Even the temporary resurgence in the container markets in mid-2010 has now dissipated. The disaster in Japan, combined with the sharp slowdown in China's manufacturing industries and the very slow recoveries in the economies of Europe and USA, will have seriously negative impacts on the longhaul container markets.

The rise in the trading prices of crude oil to over $100 per barrel and the corresponding spike in petrol prices to over $4 per gallon in the US will have a sharp downward effect on oil movements and weaken the crude tanker and products markets further.

The long-distance movements of iron ore have slowed as China's demand has stalled and the continuing delivery of newbuildings into an already over-tonnaged market will keep the dry markets on the floor for at least the next two years.

Japan will have to develop new sources of electricity to replace the 20%-plus that has been destroyed by the earthquake/tsunami disaster. This is likely to involve increasing imports of coal and liquefied natural gas but it may be years before the new facilities are in place to use these fuels.

Meanwhile, Japan will have to sharply economise on its electricity consumption, which will have a negative impact across its manufacturing industries.

Shipping needs to be concerned about the huge financial problems faced today by some European nations. Greece, Ireland and Portugal have all had to be rescued by the other members of the EU and more are likely to also need help.

In the USA there is not only a national problem of excessive government expenditure by a careless new administration, creating a $4trn deficit, but two thirds of the 50 states are also facing serious budgetary issues.

The inevitable outcome will be large reductions in public spending and increases in taxation.

This will slow any economic recovery and stifle any growth in demand by consumers as they also deal with personal budgetary issues.

All these national and regional governments are going to have to shrink their economies before they can embark on any new growth. This is much like pruning fruit trees or roses, which is periodically essential for their future growth.

Gambling on rising ship values or that the freight markets will recover to their former levels in the near future is no longer a viable business model

Nothing in the tank: crude trading at over $100 per barrel will depress the markets.

Of even more concern is China's behaviour with respect to shipping and shipbuilding. By heavily subsidising its shipbuilders, with large packages of debt being offered to foreign shipowners who order vessels from Chinese yards, the country will maintain the oversupply of tonnage and thereby keep freight rates depressed.

Additionally, the Chinese are providing generous financing for domestic owners to build new ships for international trade. Many of these ships will be classed by the Chinese classification society CCS and will be built more cheaply and to a lesser standard than those ordered by foreign owners.

These are similar to programmes that the Japanese introduced in the 1970s and 1980s, only on a much larger scale, and which kept bulk freight rates depressed for a decade.

Shipowners cannot ignore these facts and the enduring fundamentals of the industry any longer. Gambling on rising ship values or that the freight markets will recover to their former levels in the near future is no longer a viable business model.

The independent shipowner is now being squeezed between charterers' desire to reduce their shipping costs and the similar aims of the world's largest user of seaborne transport.

Shipping needs to do its own pruning now.

- Stop ordering new ships unless they have long-term charter commitments.
- Sell those ships that have no charters and are trading in the spot markets and losing money every day.

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- Lay up those ships that cannot cover their costs of operating and debt service, until they can be sold.
- Slash overheads and erase all payment of commissions and management fees to companies related to shareholders or management and their families and friends.
- Cease paying dividends and preserve surplus cash for at least the next two years.

Only the most conservative of owners with large cash reserves behind them will survive these markets, while those with the highest leverage will go under. ■