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Results are a mess of our own making

Shipping can rise from the doldrums only if it learns from past mistakes

THE results of public shipping companies for the year 2011 are about to be revealed, but there will be few positive surprises as the wet and dry charter markets have continued to be unprofitable through the fourth quarter of 2011 and, in many cases, have worsened since.

Before we forget, the charter rates for fixtures made in the fourth quarter of 2011 will appear in the owning company's results for the first and second quarters of 2012. With all the BDI indexes dropping to their lowest levels in history and some shipowners chartering ships for the fuel cost we can expect sharply worse results in 2012.

Public companies represent less than 25% of the world's fleet but the charter markets have no such limitations, except that an unknown percentage of fixtures go unreported.

That being said, what do we learn from the published information?

Most modern tankers and dry bulk carriers are losing cash every day they trade at current market rates. Vessel operating costs have been cut using cheaper, less experienced crews and with maintenance reduced to a bare minimum to slow cash outflows.

These practices are expedient in the short term, but as the shipping recession enters its third year, the risks escalate and ship performance quality declines sharply.

Across the industry thousands of ships were over-priced when delivered and carry too much debt to ever be financially efficient in normal markets.

Investors and banks made it possible for shipping companies to acquire large numbers of ships of all types, irrespective of the management's past expertise, on the wildly false assumption that the boom markets of the last decade would continue ad infinitum.

Thus many balance sheets are now full of over-valued ships that in many cases owe more debt than their current value. This has rendered net asset values meaningless. Investors have departed the sinking companies, leaving them to be traded on rumours by the short-term traders.

Only in a bull market are ship values determined without reference to revenues from their charter contracts. Ships, after all, only generate revenues when they carry cargoes and are paid to do so. The rest is about profits from selling the ships when values run up, but these periods are usually short-lived.

When the last boom peaked in 2005-2006, hundreds of ships of all types had been ordered with no clear understanding of where they would trade, whose cargoes they would carry or at what price.

This has created the youngest fleet of all types in modern history, delivering 40% more capacity than the markets need. Many of these ships were ordered without relevance to fuel efficiency or slow steaming, which have become the norm today.



Hundreds of newer ships are grossly overvalued and come with too much debt attached. Shutterstock

Add to this the fact that with China joining the shipbuilding club, we have enough active capacity to rebuild the entire fleet every seven years.

The suggestion by some that we should scrap ships at 15 years old is palpably ignorant, as well-maintained ships with experienced management and crews can operate for at least 25 years.

There have been few, if any, technical or mechanical changes in ship design, apart from size, that would render older ships obsolete. But the next generation of ships, to be delivered from 2014 onwards, will focus on smaller engines, slower speeds and more fuel-efficient hull designs.

Ironically we now have tankers and containerships running at slow speeds that make their large engines an extravagant investment. Many of the very large ships in the water today may be rendered obsolete and scrapped.

The simple dry bulk carrier has been created in numerous "max" sizes, bought at very high prices by new shipowners when simple cheap panamax can carry cargoes efficiently and at a lower cost.

Various modified types of product tankers have been brought into service when existing standard design ships can service the trade more economically.

We have a large number of ice-class product tankers that trade uneconomically and inefficiently in regular markets, when the ice trades themselves are very obvious and very limited.

Simple research, such as talking to established wet and dry bulk cargo owners, would have shown that the high levels of return were completely unsustainable beyond a very short time.

China, which drove the boom, entered the shipbuilding markets. By 2010, it had matched South Korea's capacity, which then became a major factor in ending the boom.

The current fleet and orderbook delivering through the next two or three

years is so far in excess of market requirements that many new Chinese shipyards are closing and South Korea has slashed its prices to stay in business.

Hundreds of ships delivered from 2005-2010 are grossly over-valued in many companies' balance sheets and are unable to trade profitably because of the debt attached to them.

Instead of looking backwards at what has happened, we need to look to tomorrow's opportunities to see what can be done to restabilise this industry.

Shipping will outlive my grandchildren's great-grandchildren and beyond, and the world will increase its dependence on seaborne services as underdeveloped nations develop and global trade expands.

Shipping is a service industry that is mostly subservient to its customers, but it periodically shows extraordinary arrogance in seeking to dictate its own destiny. Although this is often referred to as cyclical, it does not cover any regular timeframe.

Out of this mess comes the opportunity to create a more efficient shipping industry, much larger operators working closely with cargo owners to develop economic long-term operations which benefit both parties.

As large hedge funds circle the industry to bottom-fish for distressed assets we will see a new round of speculative investment that still expects returns of more than 25% that simply will not materialise.

The public markets will not entertain shipping IPOs for some years to come and shipping debt will remain elusive and expensive.

These facts will help to minimise further fleet growth. We can only hope that this means the industry will return to ownership that understands all the dimensions of shipping and who are not just in it to make a fast buck. ■