The Bulk Carrier Shipbuilding Market ~ a review of the major issues post 2008

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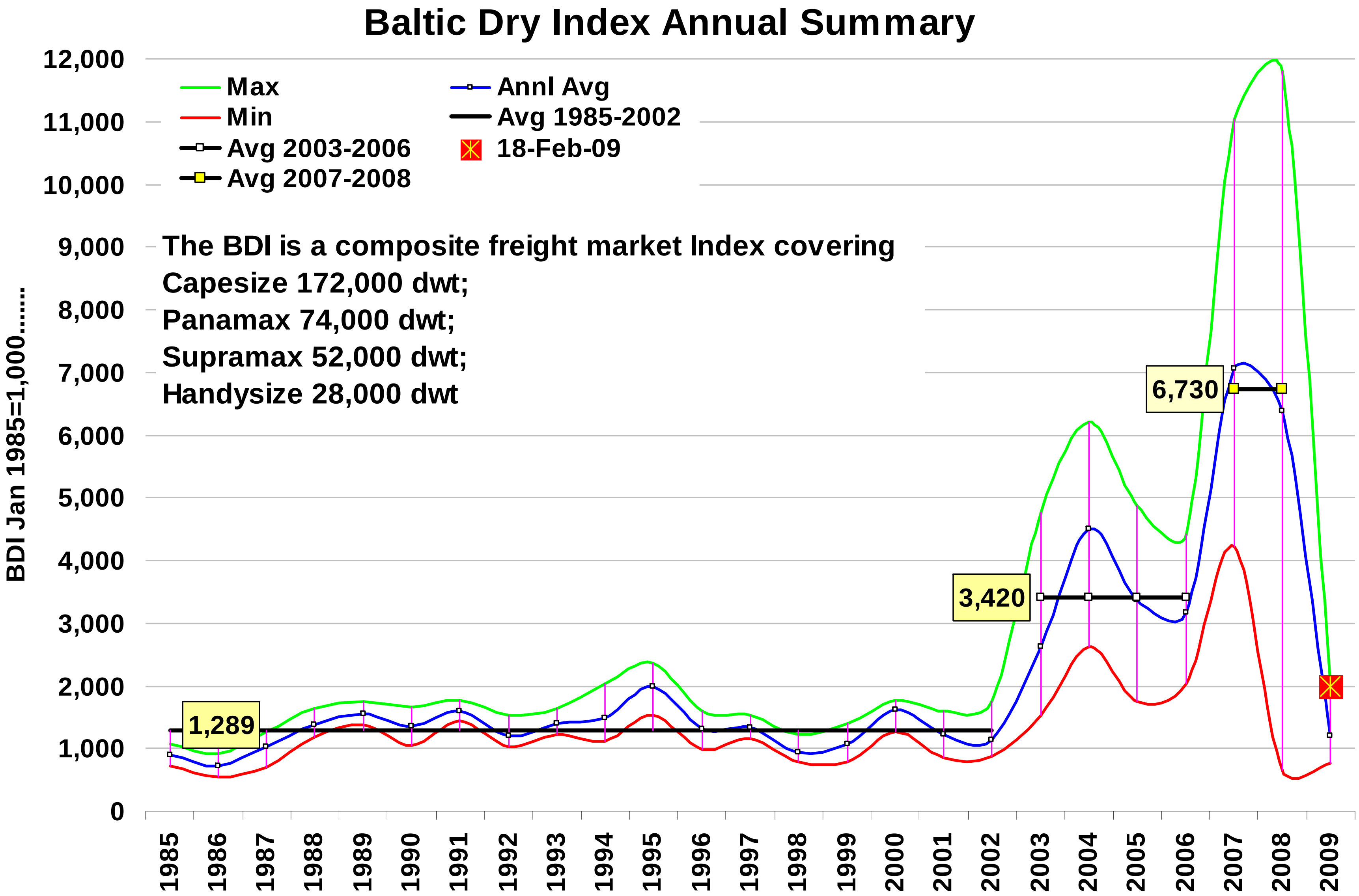
Overview

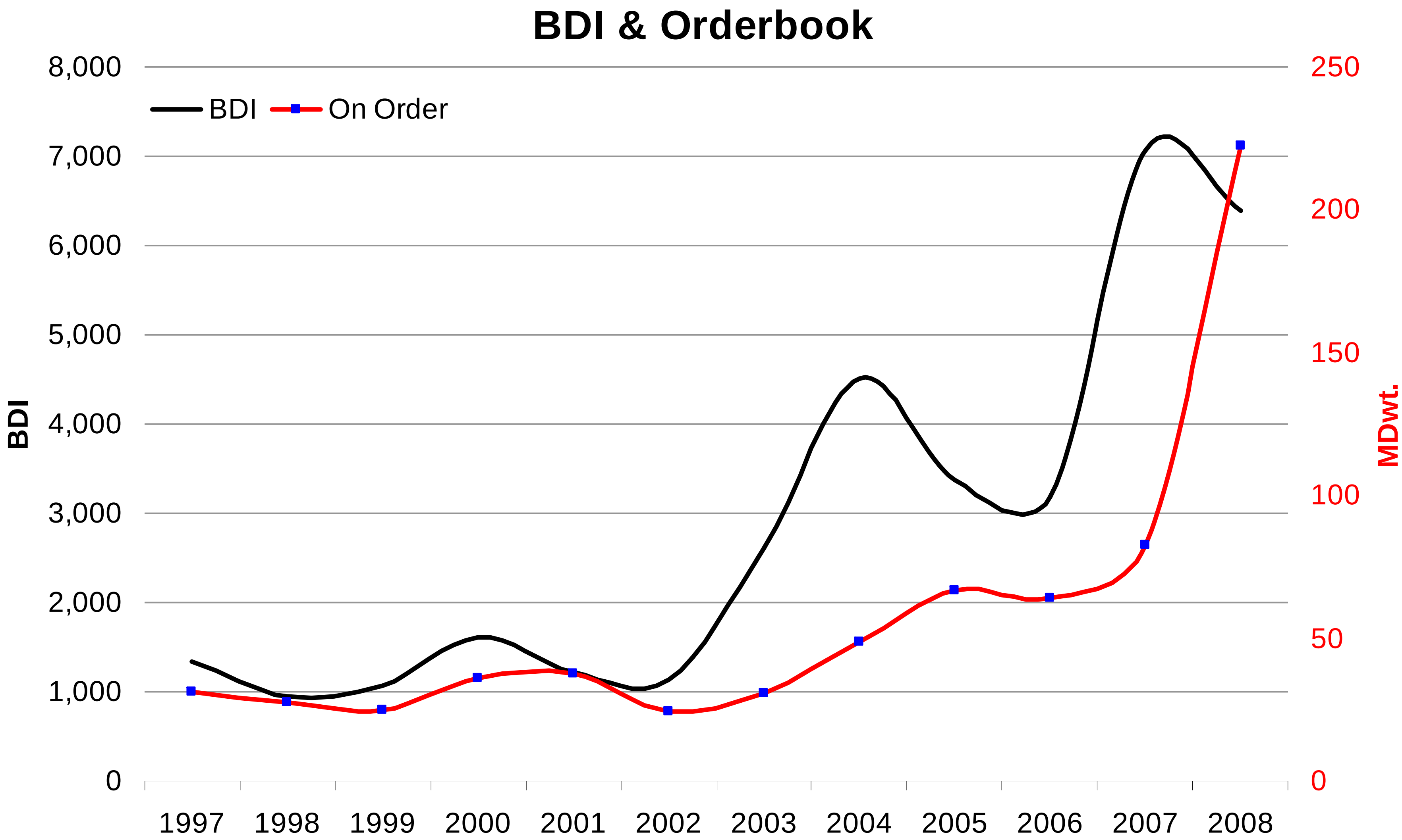
- Freight market collapse in 2008 led to sharp contraction in demand
- This, in turn, impacted world demand for ships and directly to a sharp slowdown in contracting
- It also left many shipyards in a precarious position – worried about payments, future orders and their own credit finance
- Equally, many shipowners are facing great uncertainty and financial difficulties
- Cancellations and delays have become commonplace
- The whole industry faces a period of difficulty and change

Where is the freight market now?

Source: Baltic Exchange



Orderbook responded to increase in freight market



Causes of the collapse

How did we get here?

- The current global economic situation is expected to influence owners, charterers and shipyards for the whole of 2009 and possibly significantly beyond that time – however until the middle of 2008 it was only part of the story.
- The fall in the freight market did not occur *solely* because of the economic situation; rather the economic collapse was the final factor that caused an already very serious situation to become even worse.
- Most shipping analysts had warned of a downturn for <u>at least</u> a couple of years previously due to the size of the orderbook yet when it came to it very few expected the freight market not to see some recover *post*-Olympics – even if not to the record heights as seen in May/June.
- It could be argued that many shipowners shared this view but nearly all were caught out by the extent and severity of the fall.

Causes of the 2008 downturn

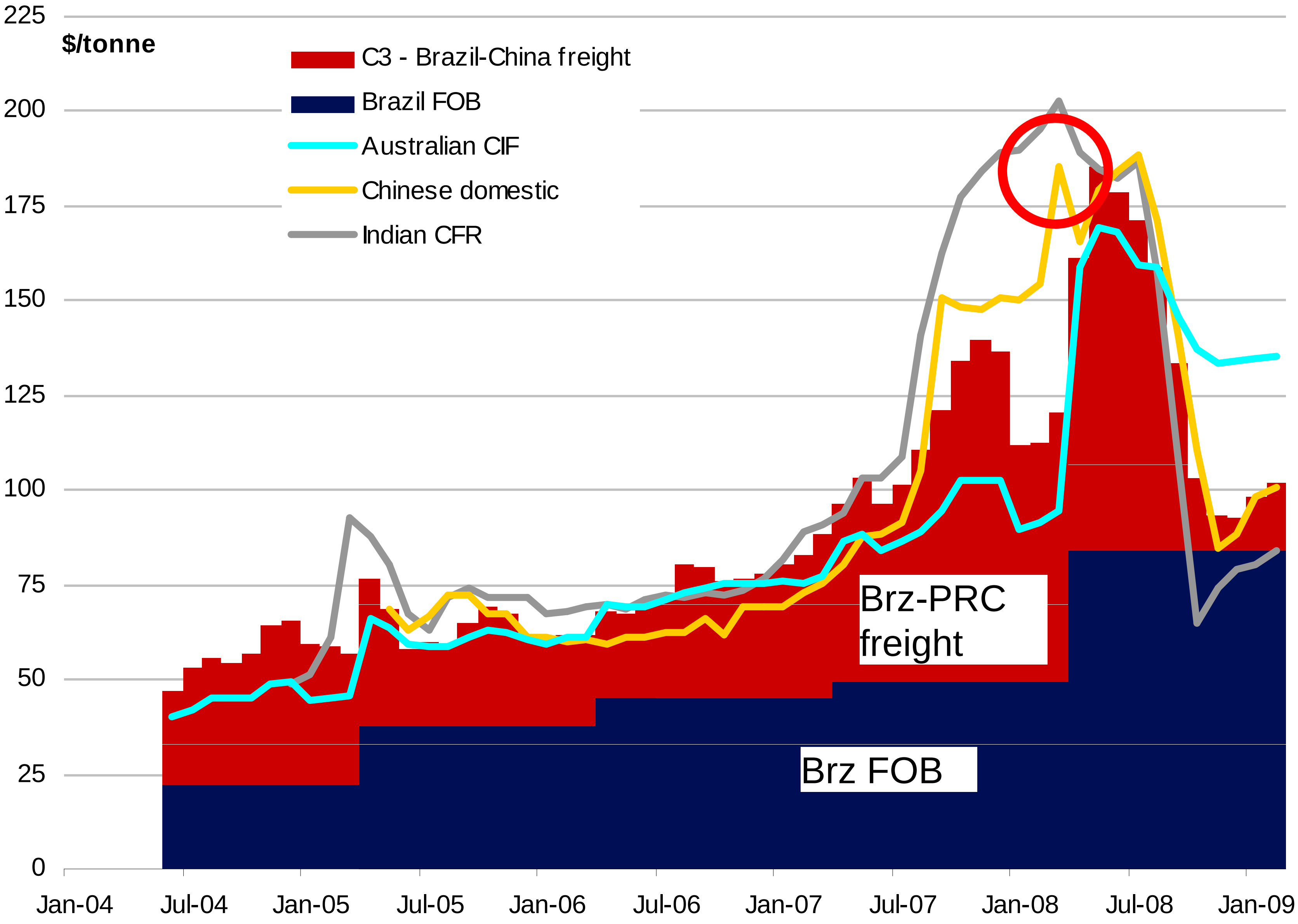
- The *potential* for a downturn had several roots and had been well documented in the public domain:
  - the extra fleet supply from ships being delivered plus extra bulk carriers from tankers converted to VLOCs
  - a complete absence of scrapping of older (or any) bulk carriers
  - a fall in congestion releasing ships on to the market
  - a slowdown – pre-Olympics - in Chinese import demand
- So all of the above were expected and indeed happened yet the rapidity of the fall still was exceptional – as sentiment changed and in certain sectors near panic set in
- Up to that point we had seen record volatility so the June downturn was initially considered not that unusual and simply a market correction – but it was, in fact, far more than that …

“Tipping Points”

The collapse in the market occurred because of *all the previous points* but the additional “tipping points” were:

- the lack – post-Olympics – of any discernible recovery in Chinese demand. A recovery was widely expected by the market and when it failed to emerge impacted sentiment very rapidly which, when combined with the traditional August market slumber, left demand at low levels;
- the fall in commodity prices – in China as domestic supplies squeezed the delivered cost of imports so consumers switched increasingly to indigenous sources (e.g., iron ore and coke) which put immediate downward pressure on freight rates as not so many cargoes were needed – however the ships to carry these cargoes still existed;
- a global slowdown in steel production with knock-on effects for many commodities: iron ore, met coal, coke, scrap, etc.

Fall in demand triggered slide in Chinese domestic prices



and then came the financial crisis….

- The Lehman Brothers collapse;
- A virtual end to inter-bank lending
- International financial crisis
- High street banks collapsing - note also this included Royal Bank of Scotland – a leading shipping bank
- Governments buying Banks (incl. RBS) to prevent total collapse and lend support
- Issuance of long-term government bonds
- Base rates dropping to zero but not the same situation for borrowers with simple shortage of credit keeping rates high

…….and the rest, as they say, is history

Impact on Freight Market

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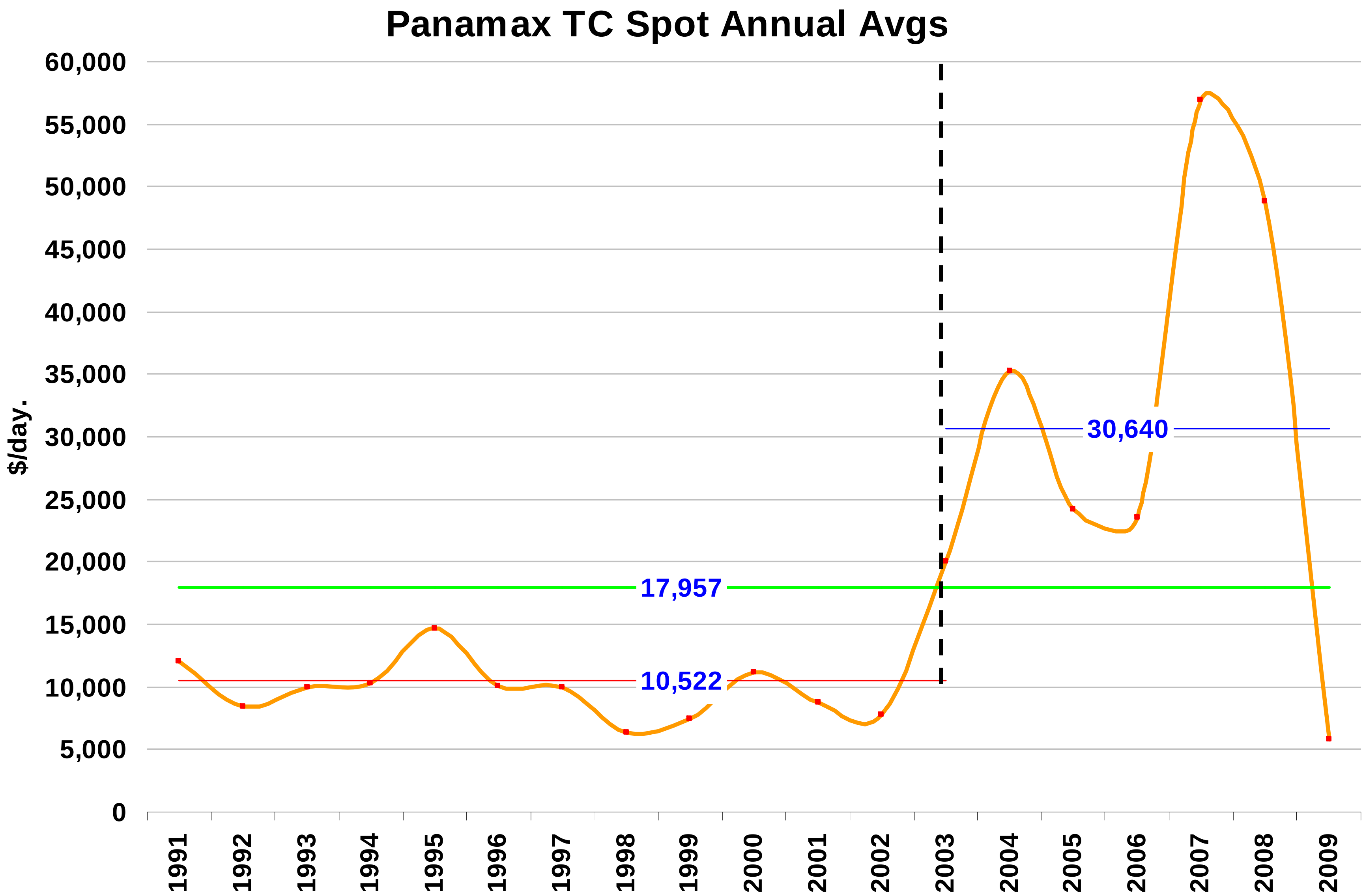
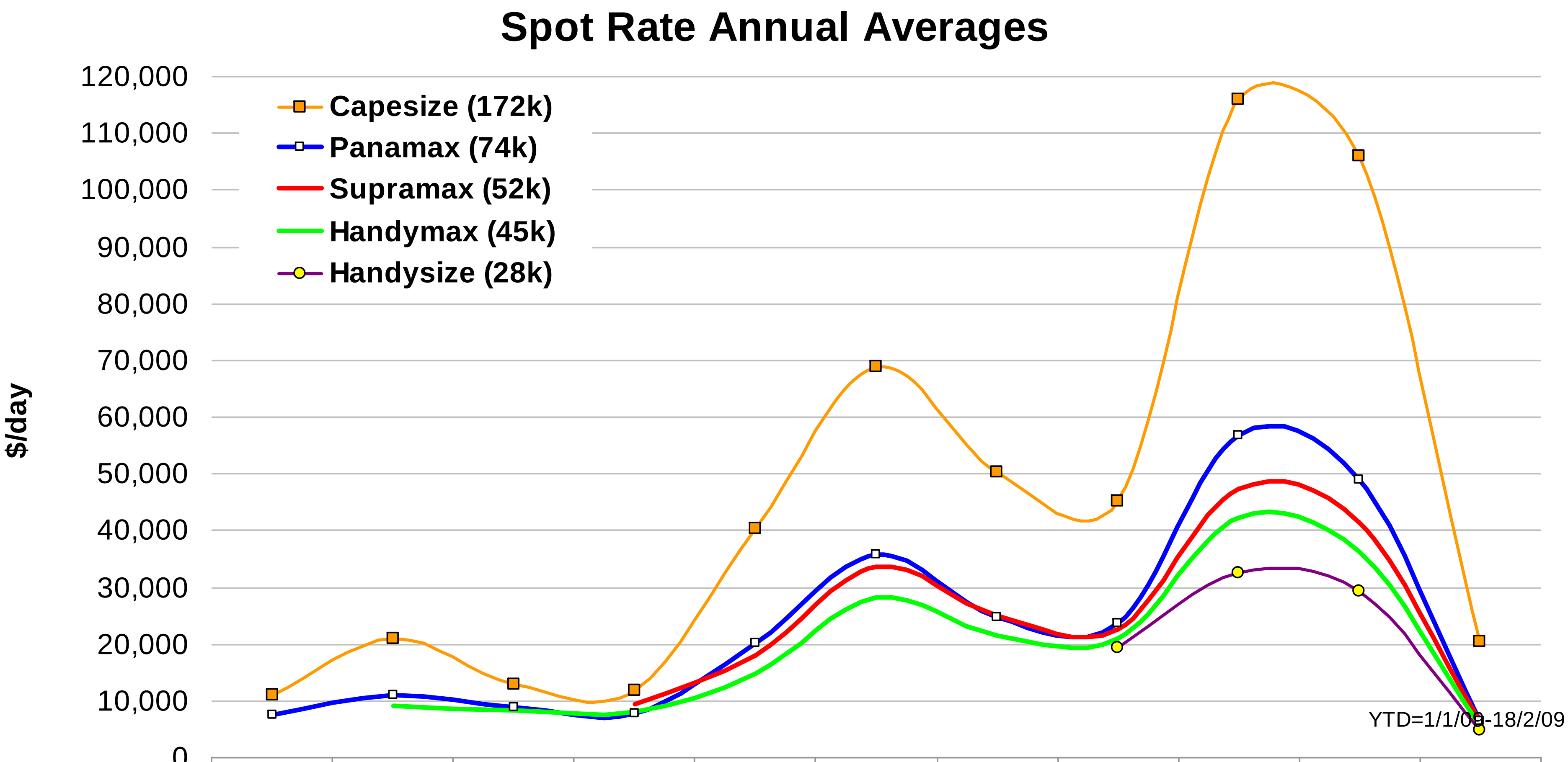
Panamax rates are representative of the fall…



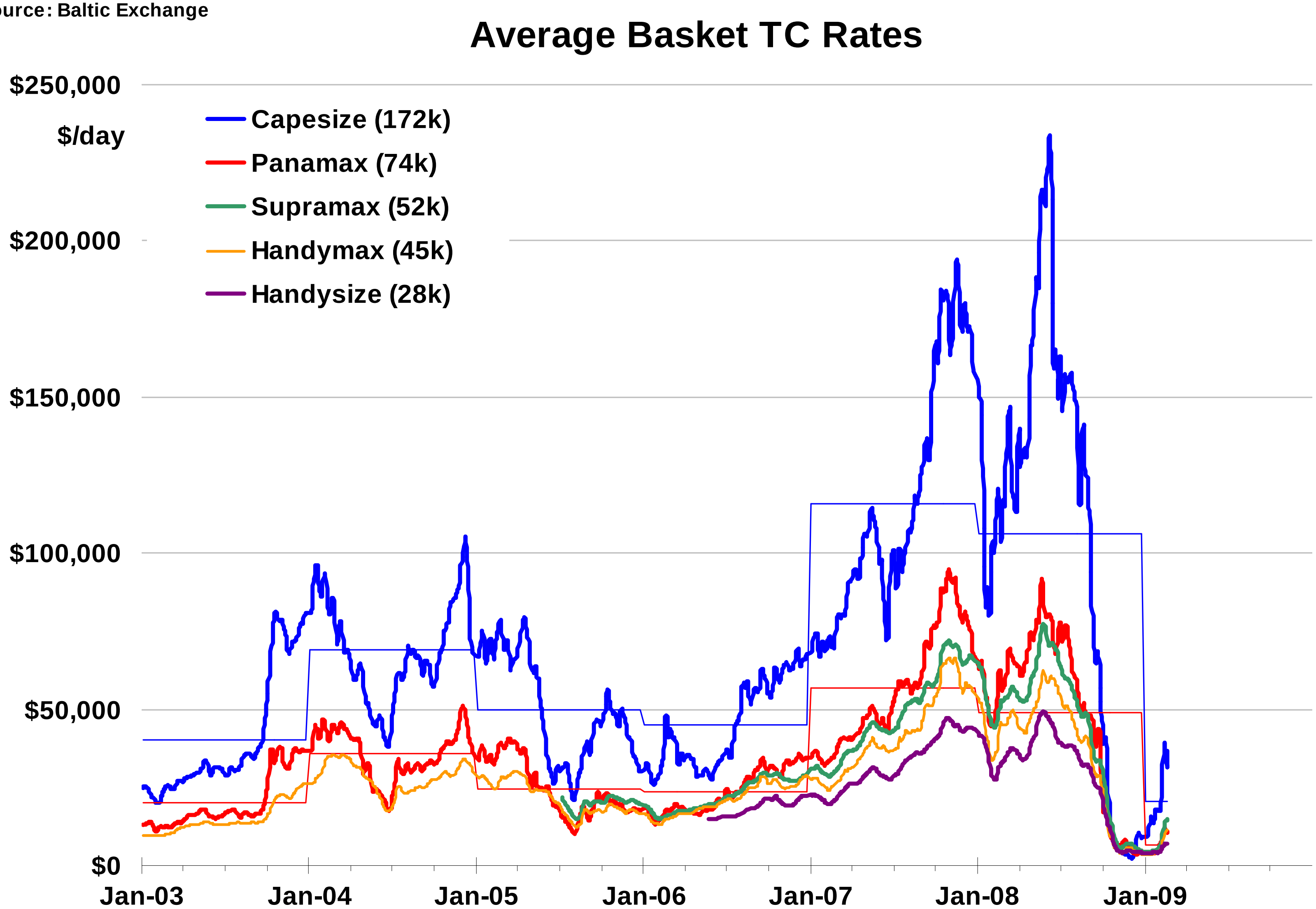
…but all sizes and sectors were affected



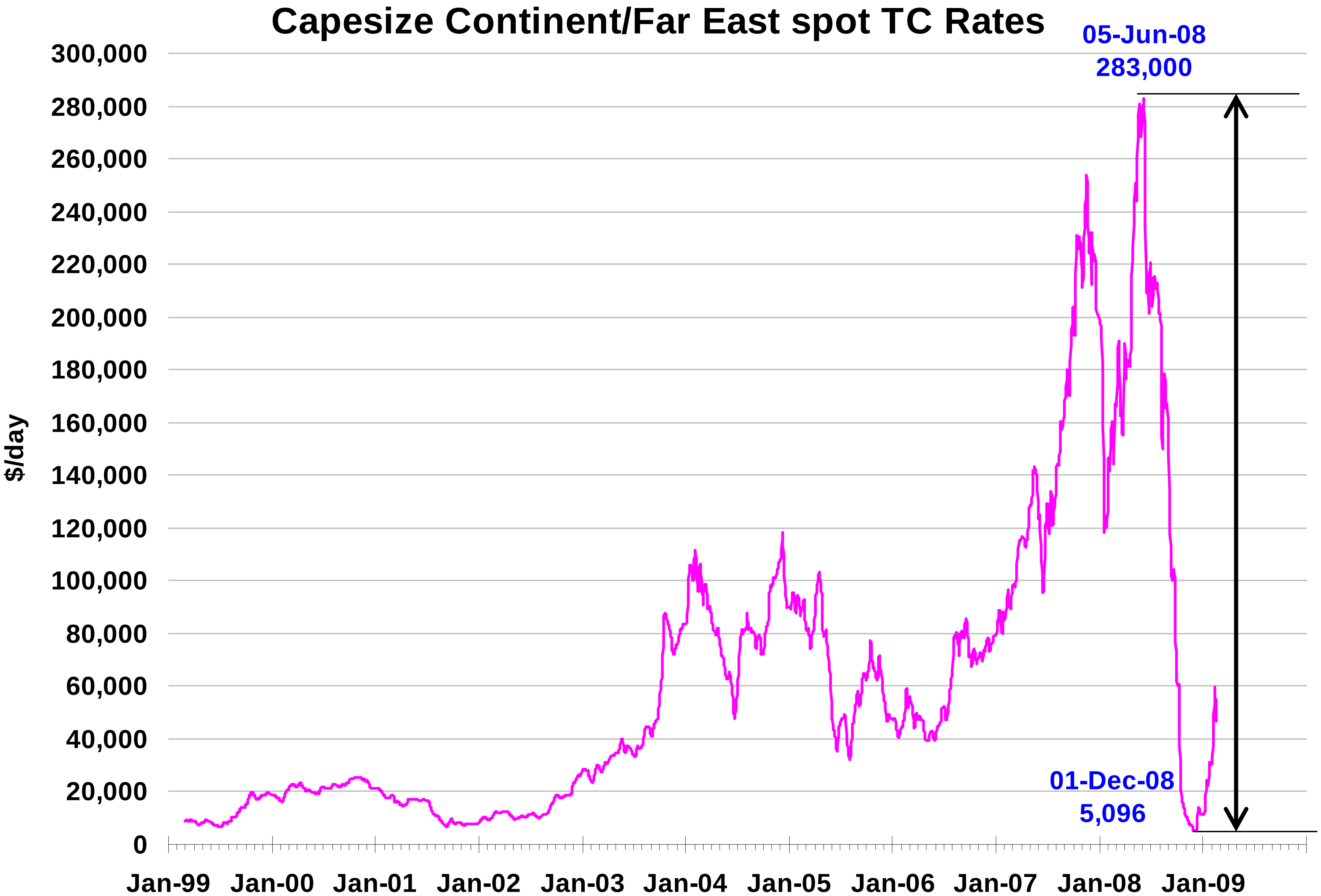
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009ytd
Capesize (172k)	10,922	20,904	12,950	11,918	40,329	69,002	50,344	45,139	116,031	106,025	20,570
Panamax (74k)	7,422	11,102	8,767	7,725	20,063	35,725	24,802	23,778	56,814	49,014	6,577
Supramax (52k)				9,309	18,073	33,696	25,014	22,619	47,446	41,544	6,589
Handymax (45k)		9,053	8,344	7,978	14,810	28,191	21,420	20,940	42,168	36,241	5,658
Handysize (28k)								19,425	32,447	29,278	4,914

The whole market was volatile so a big fall was initially shrugged off; it was not until later that it was apparent that the turning point had finally been reached

Source: Baltic Exchange

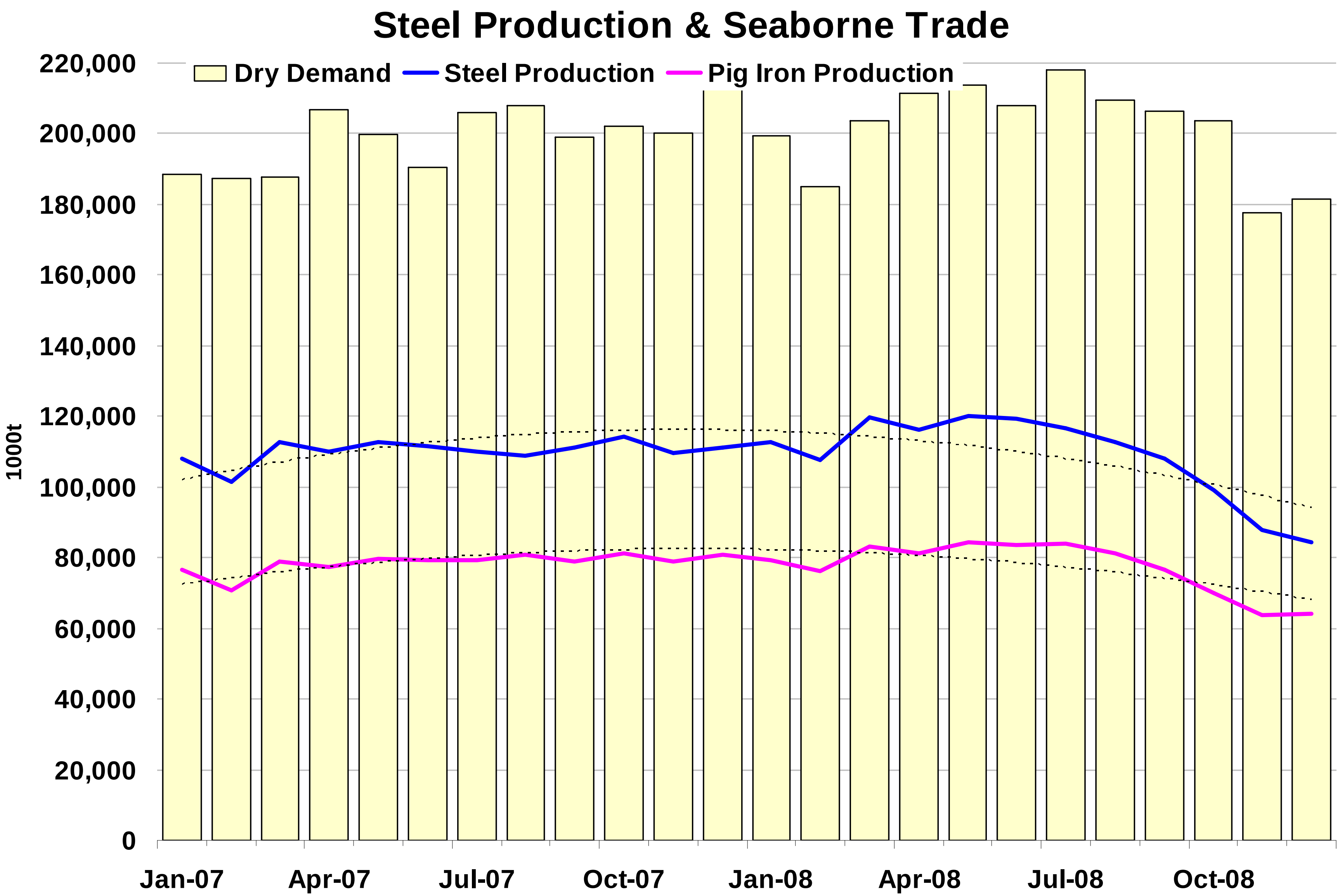


98% fall in earnings just six months

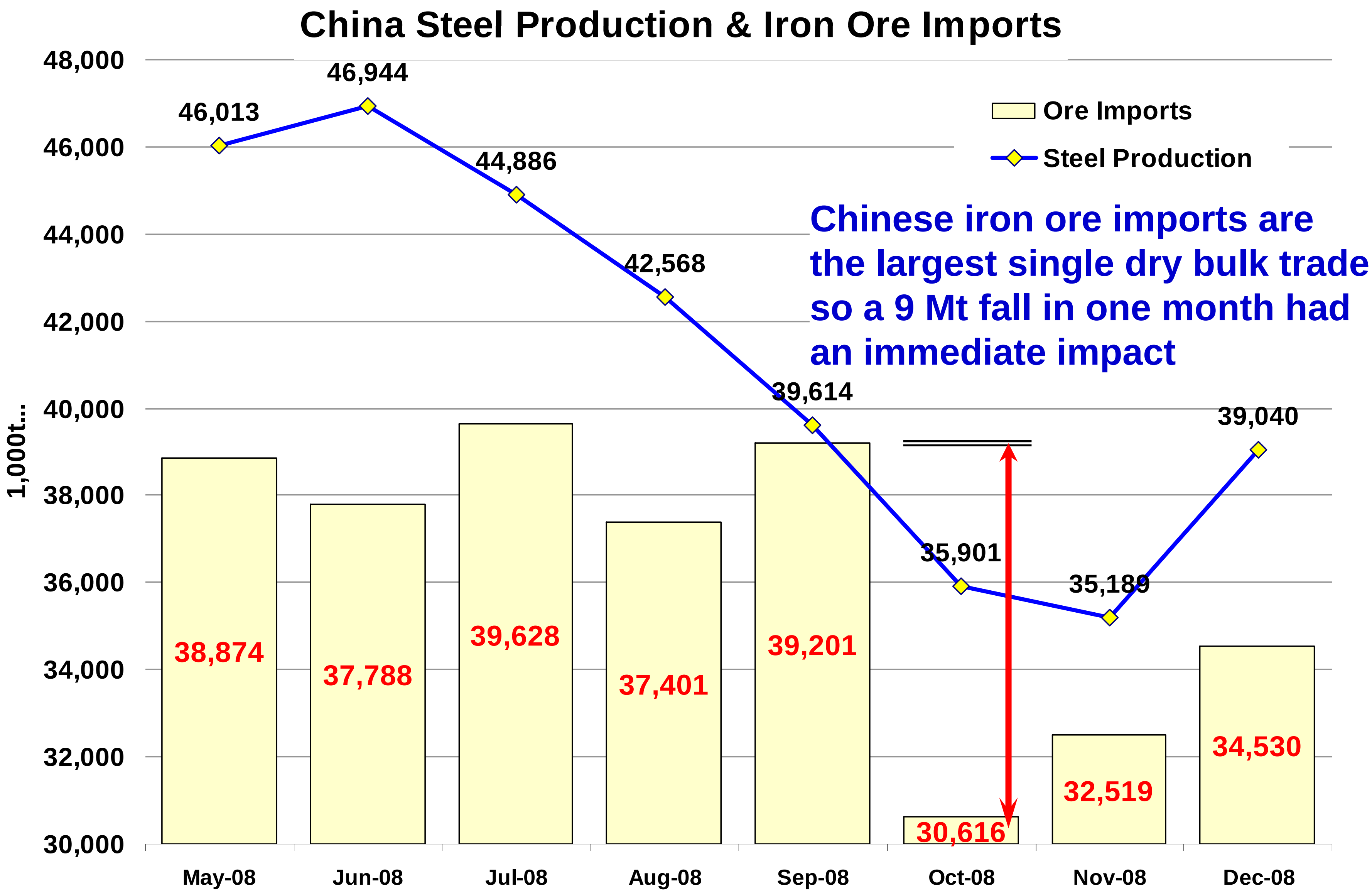


Demand Changes

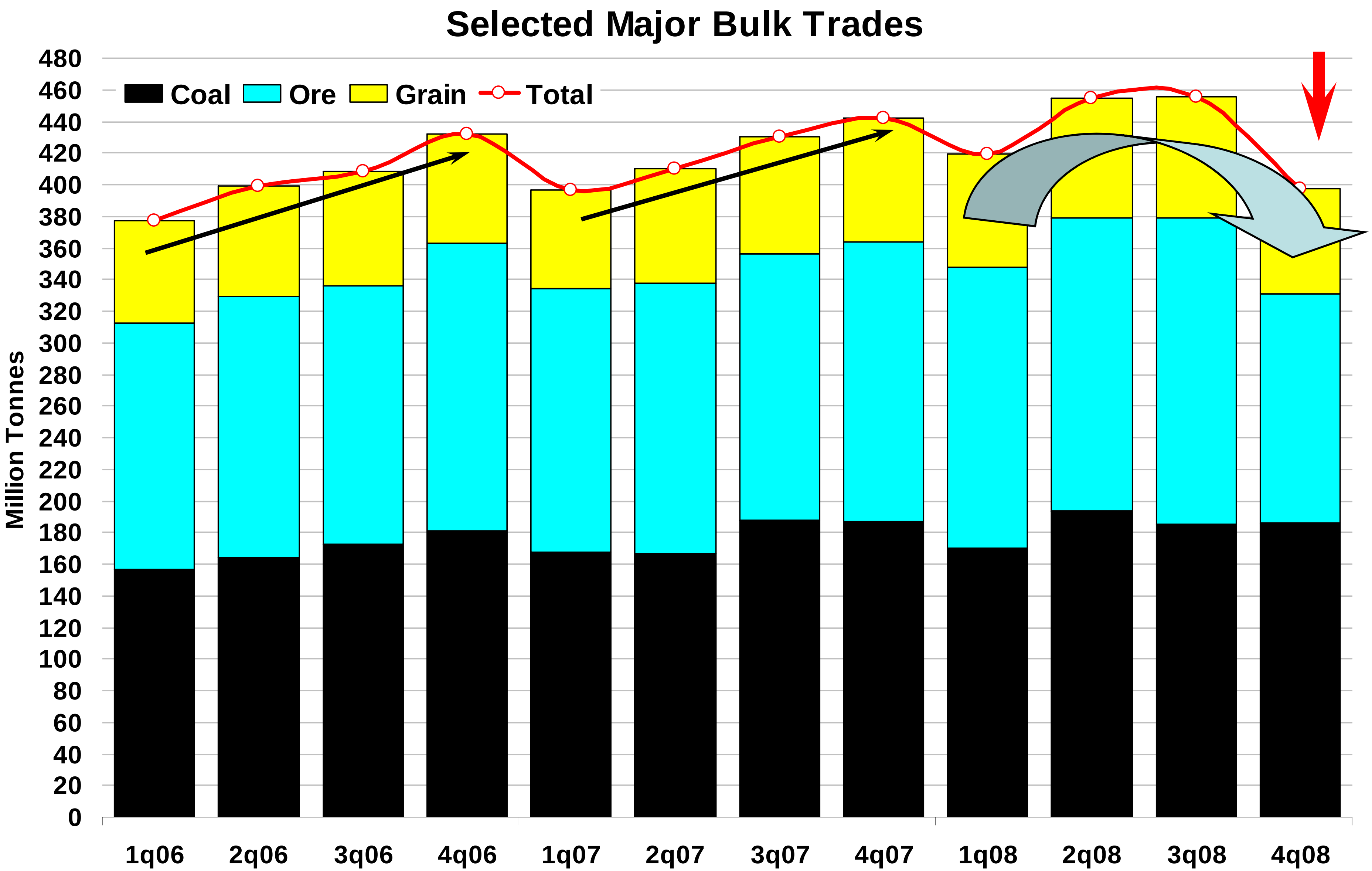
Demand downturn led by steel



Chinese demand collapsed by 9 Mt in October



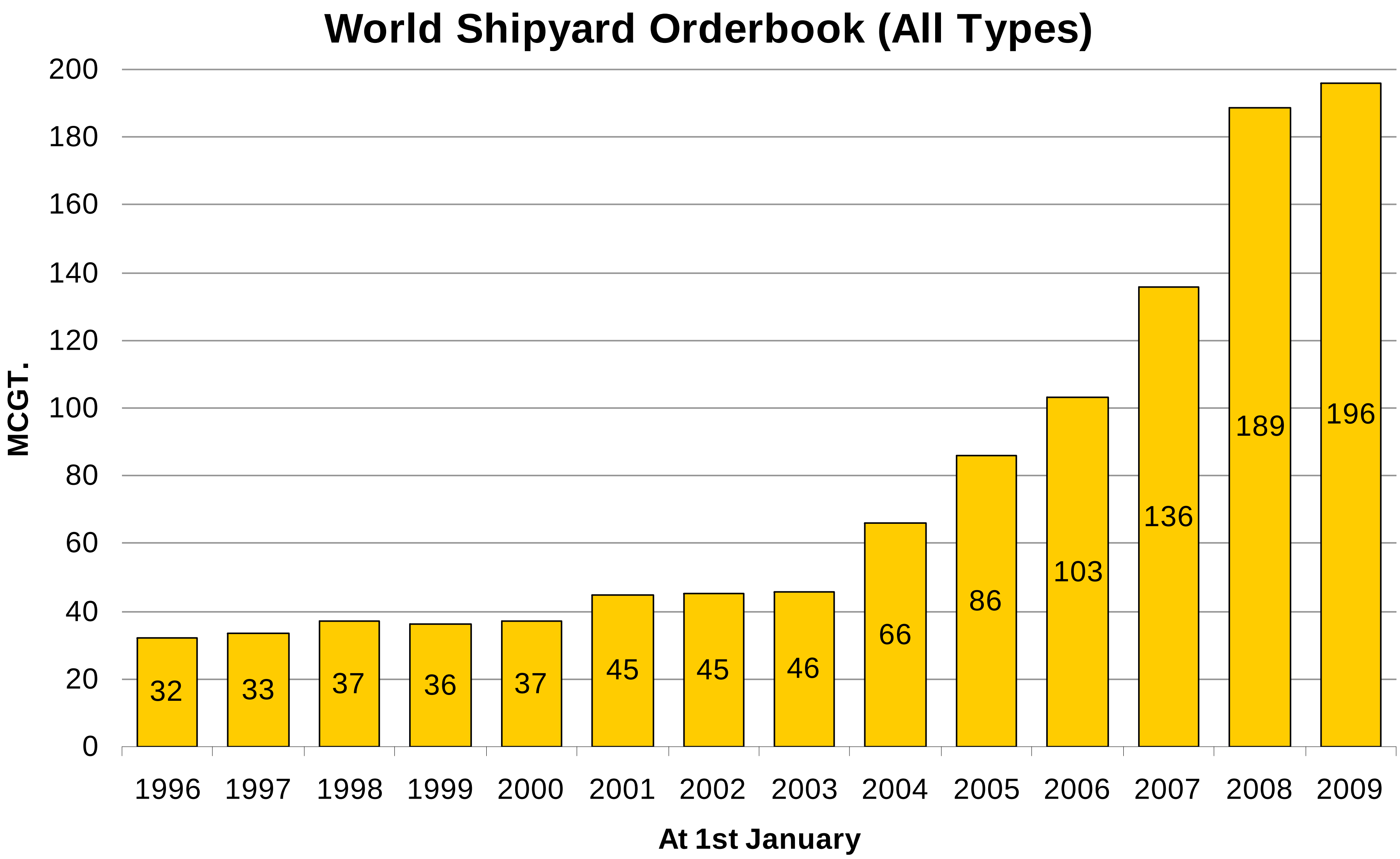
4th Quarter 2009 Slump contrary to seasonal trend



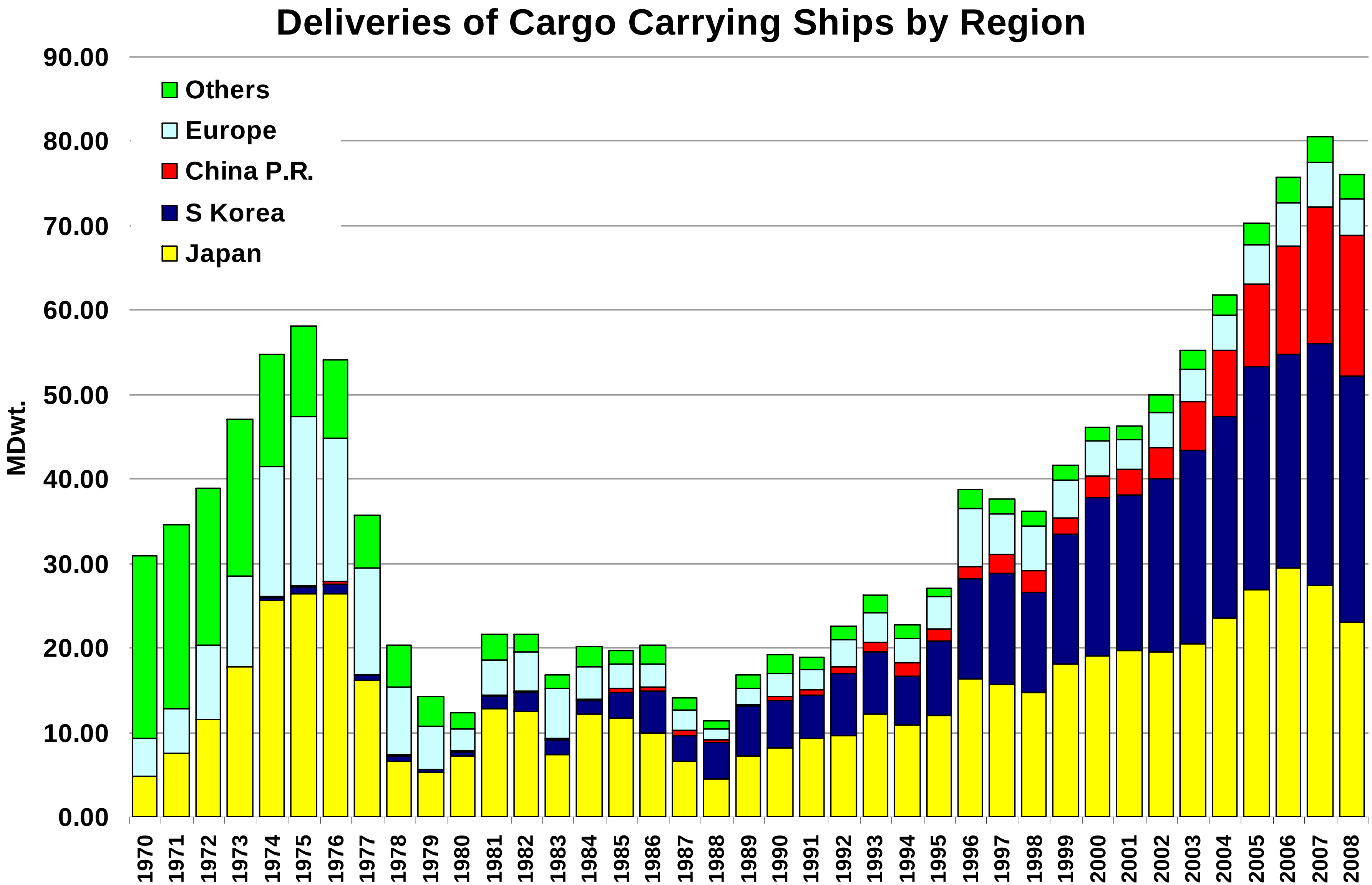
Fleet Developments

with grateful appreciation to Clarkson Research Services for the use of fleet data

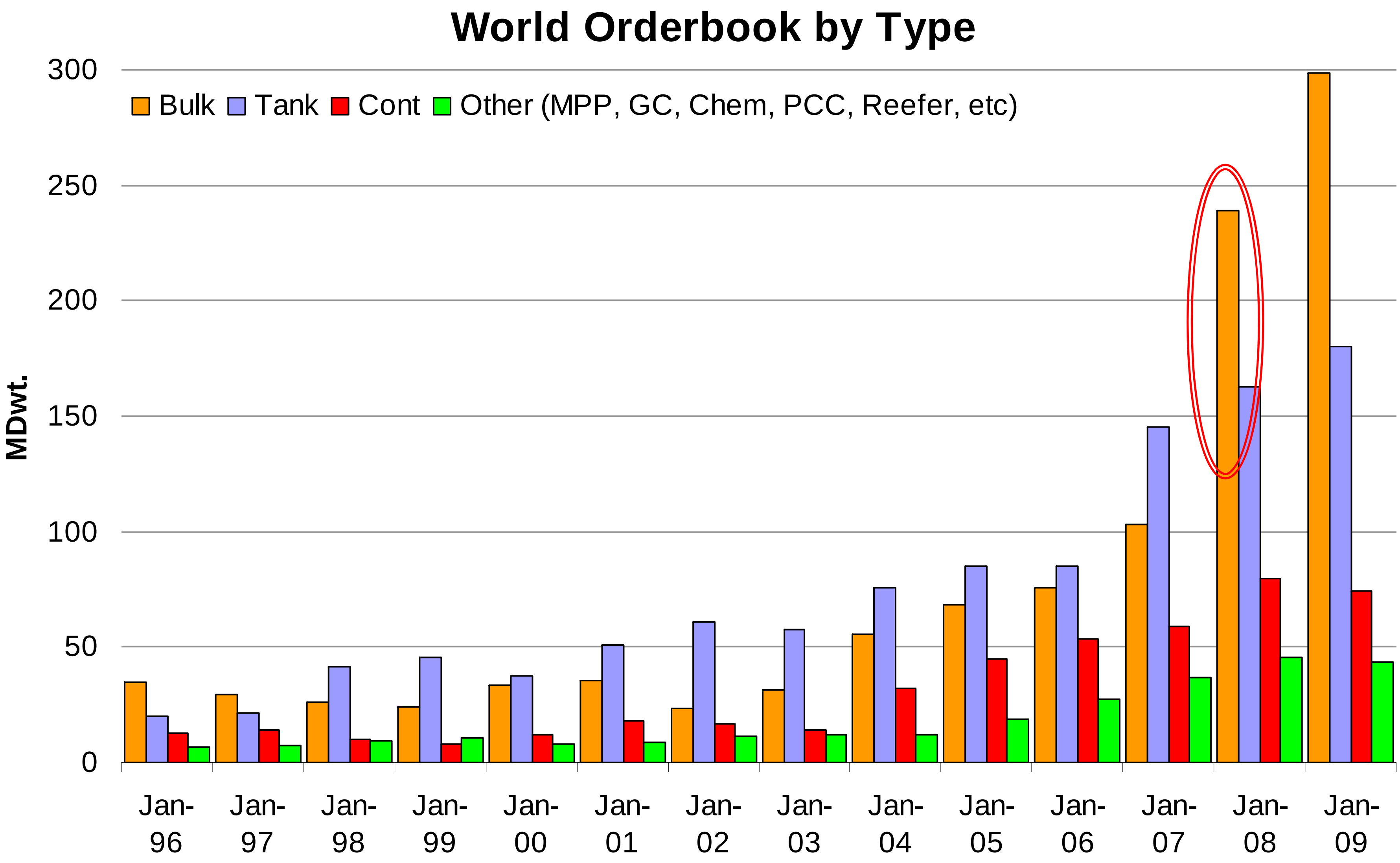
Orderbook is at world record levels



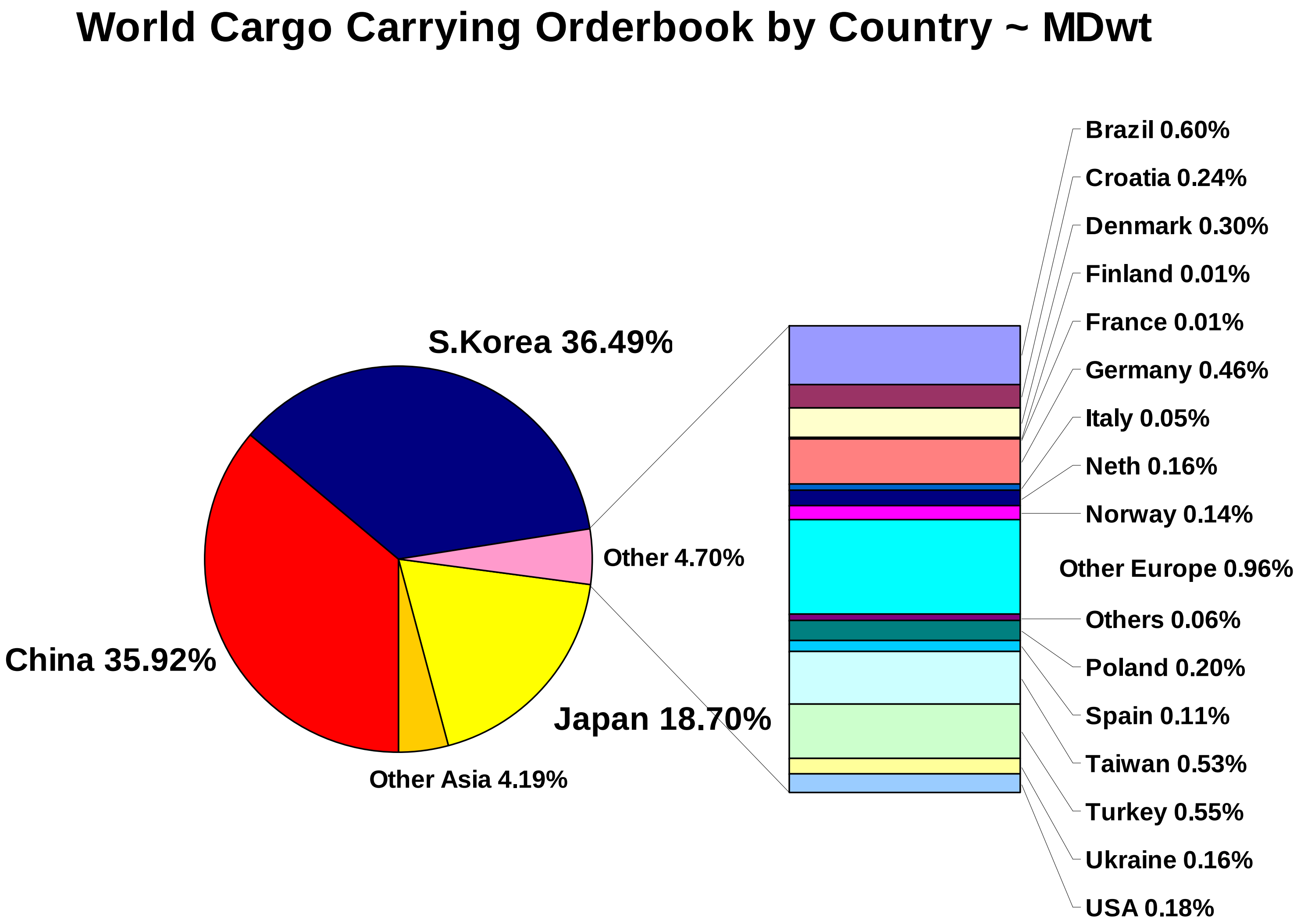
Rapid expansion in deliveries of all cargo types in past 2 decades



In 2008 Bulk orders overtake Tankers for first time in 10 years



China takes lead in orderbook



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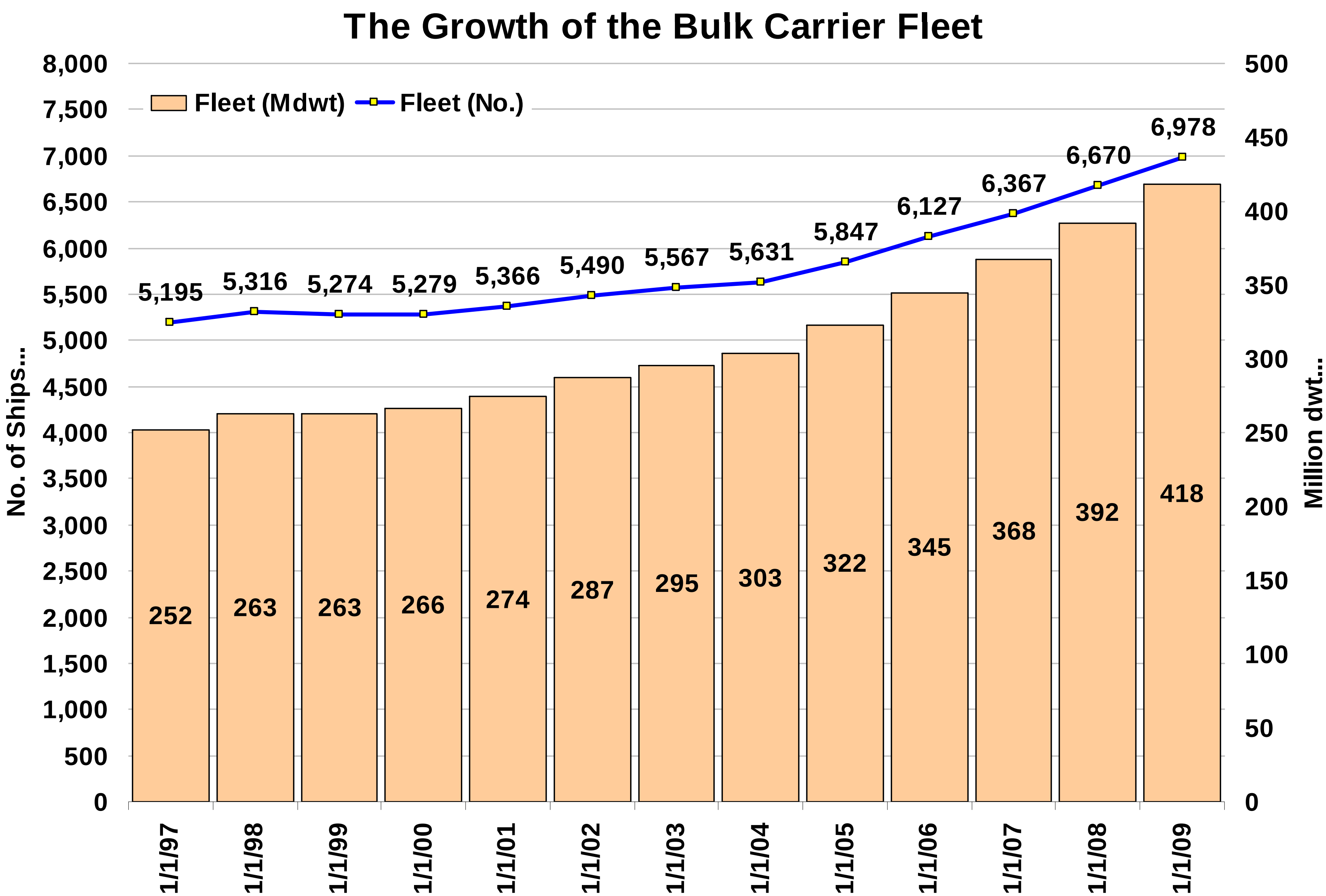
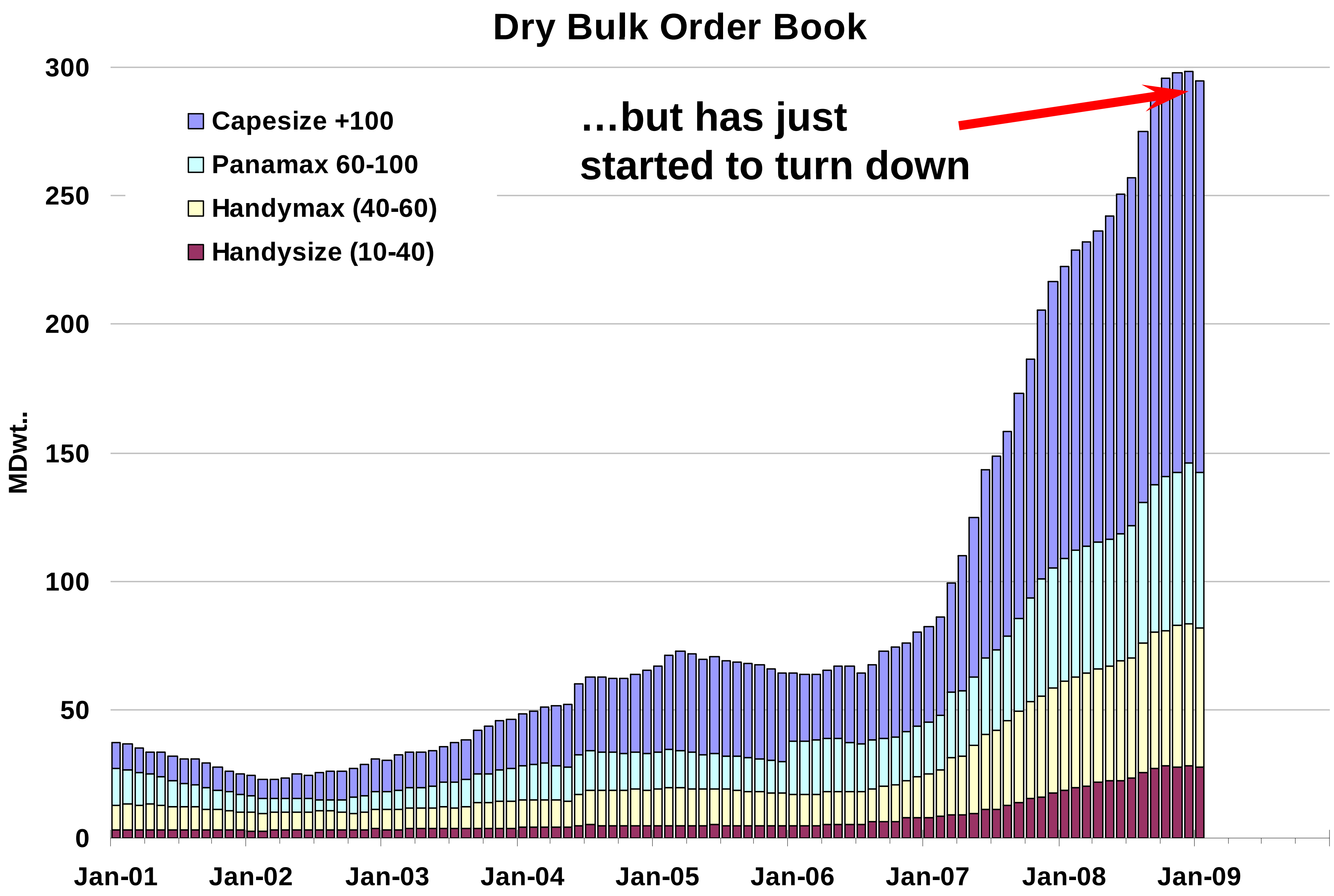
Over 100 Mdwt added in past five years



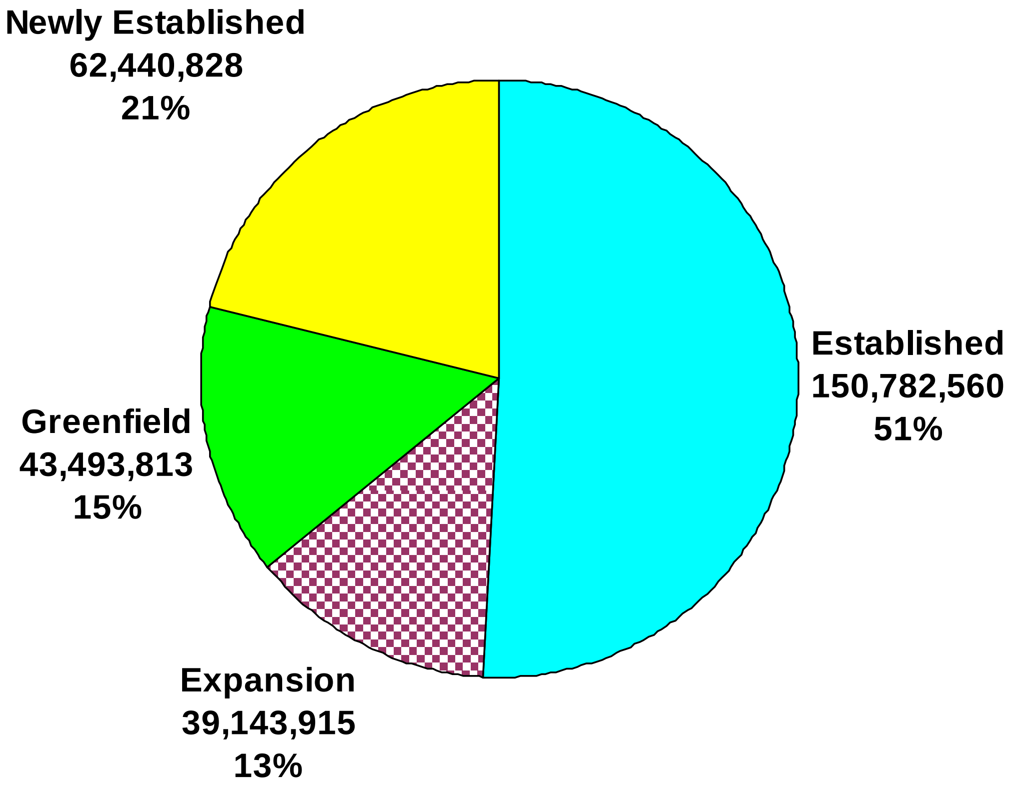
The orderbook had grown relentlessly…



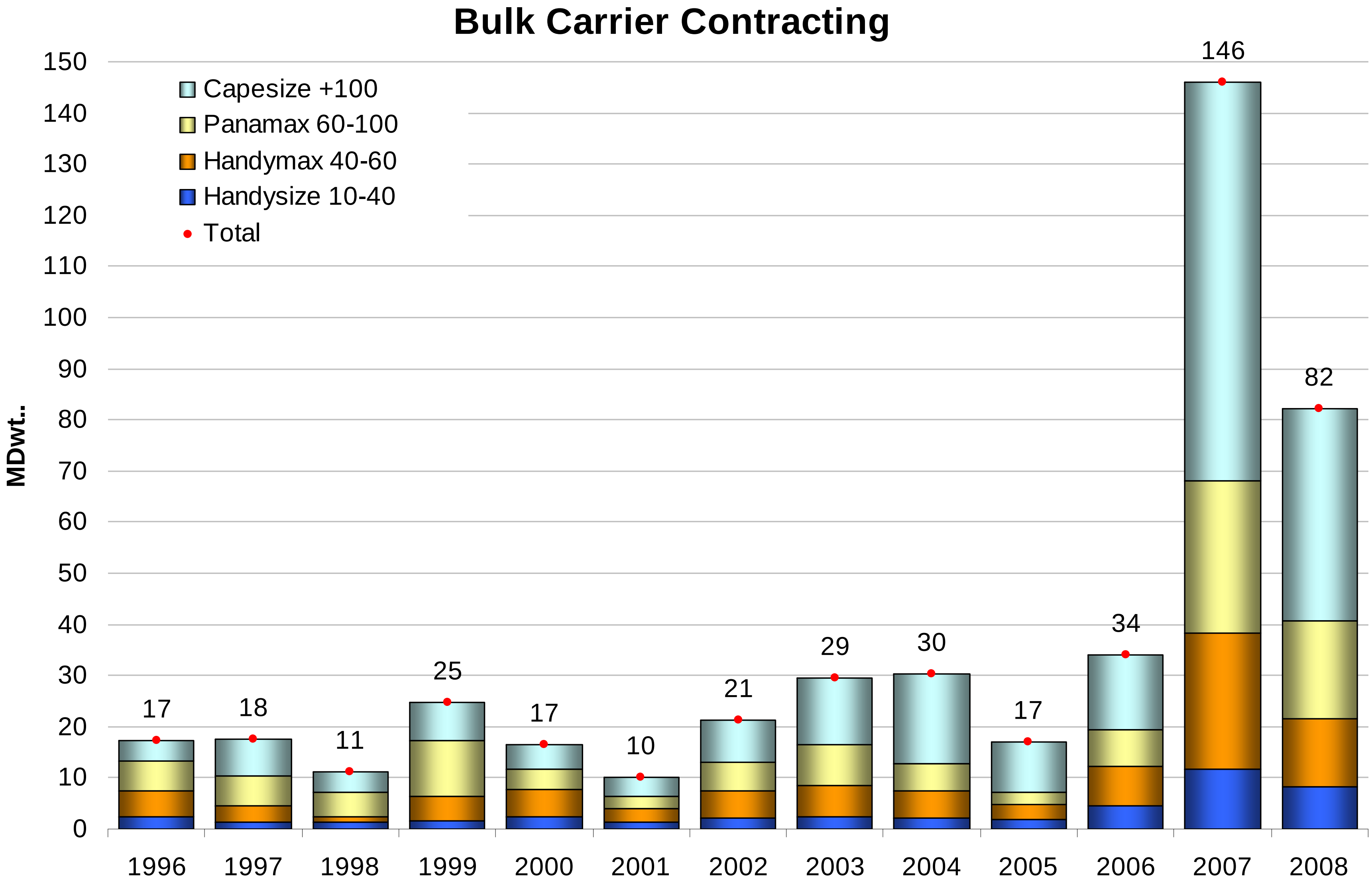
At year end just half of orders at established yards

Bulk Carrier dwt Orderbook @ Shipyards by Status

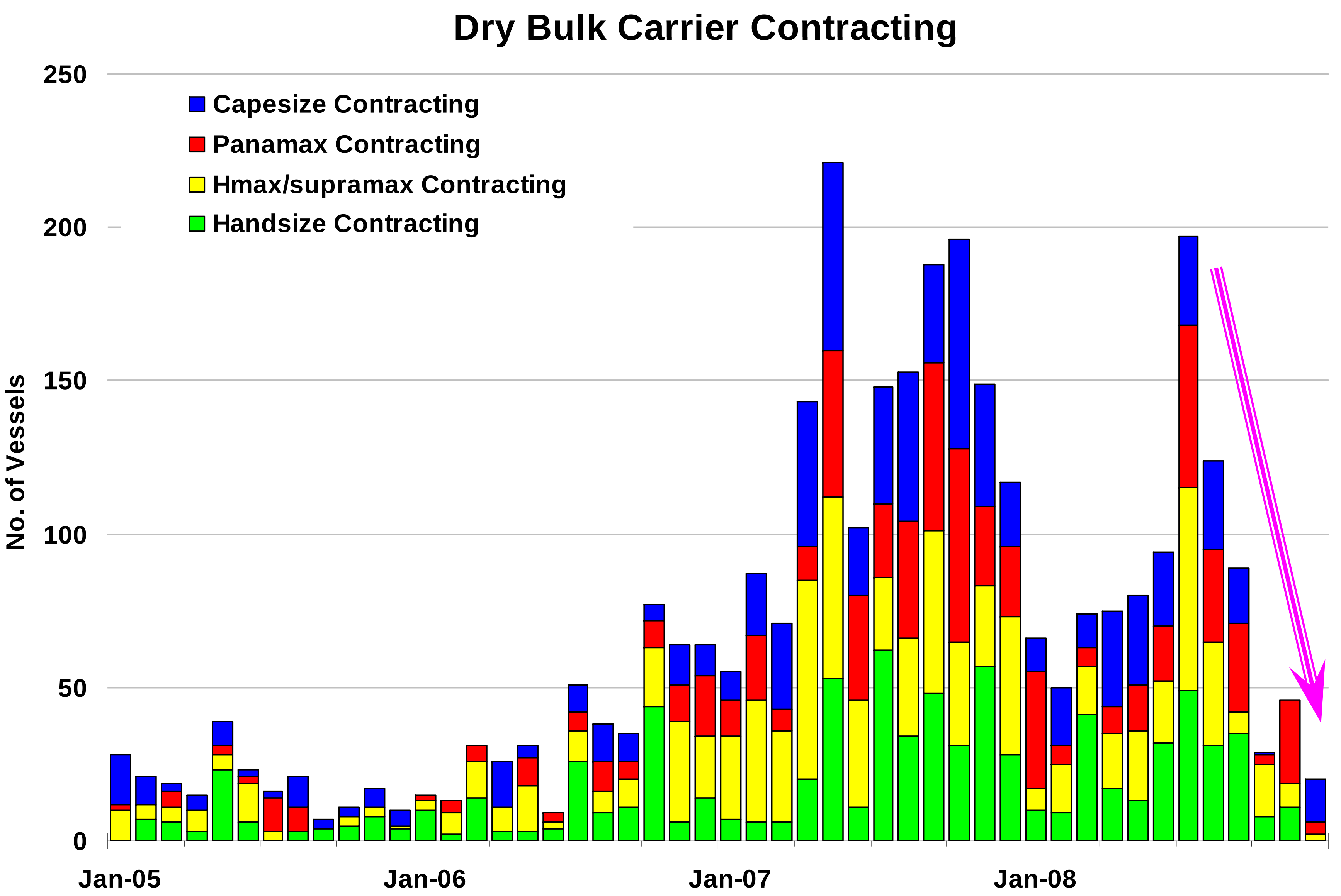
"Newly established" means they have built at least one ship



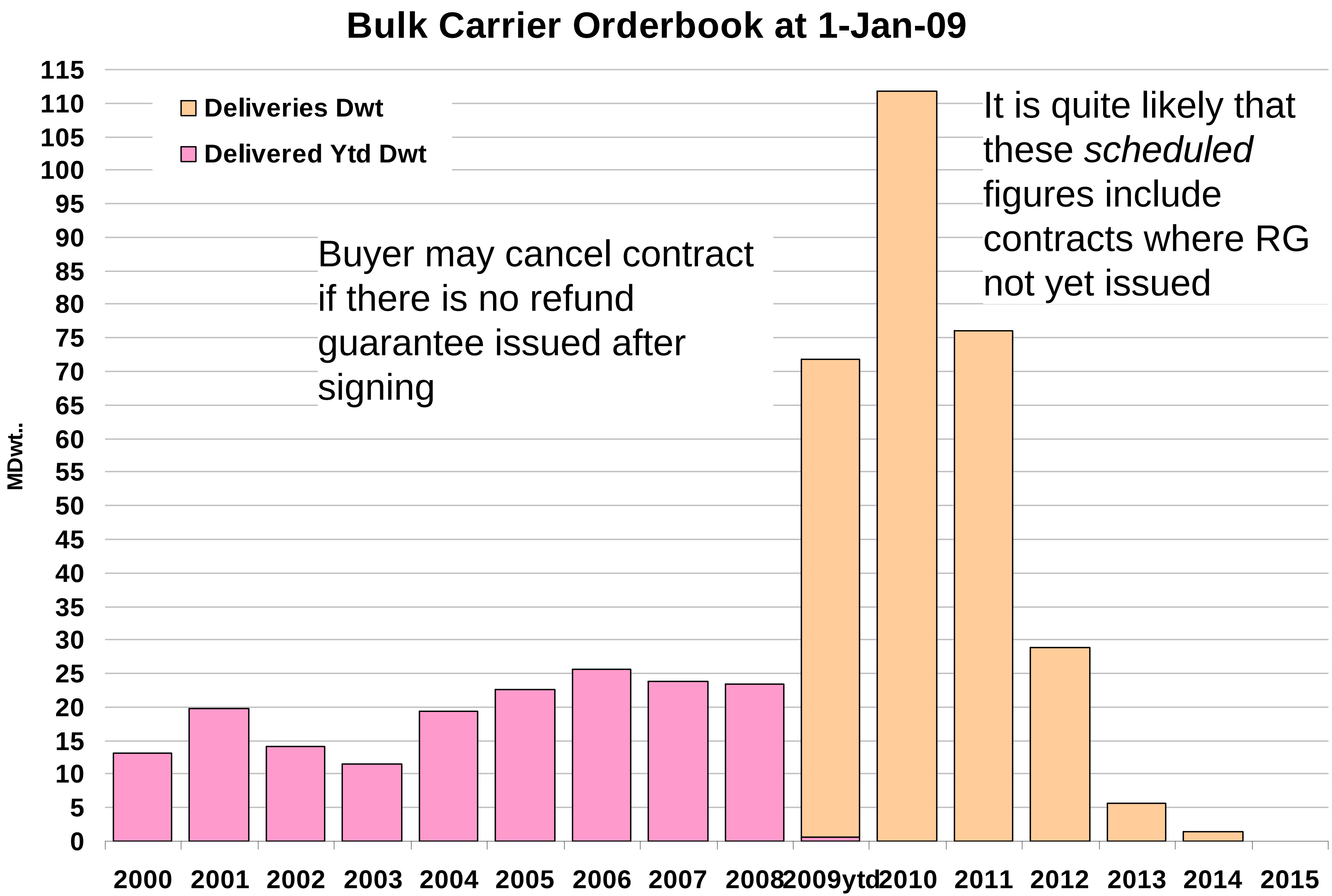
Even though many shipowners were aware of looming overcapacity risk heavy ordering still continued in 2008



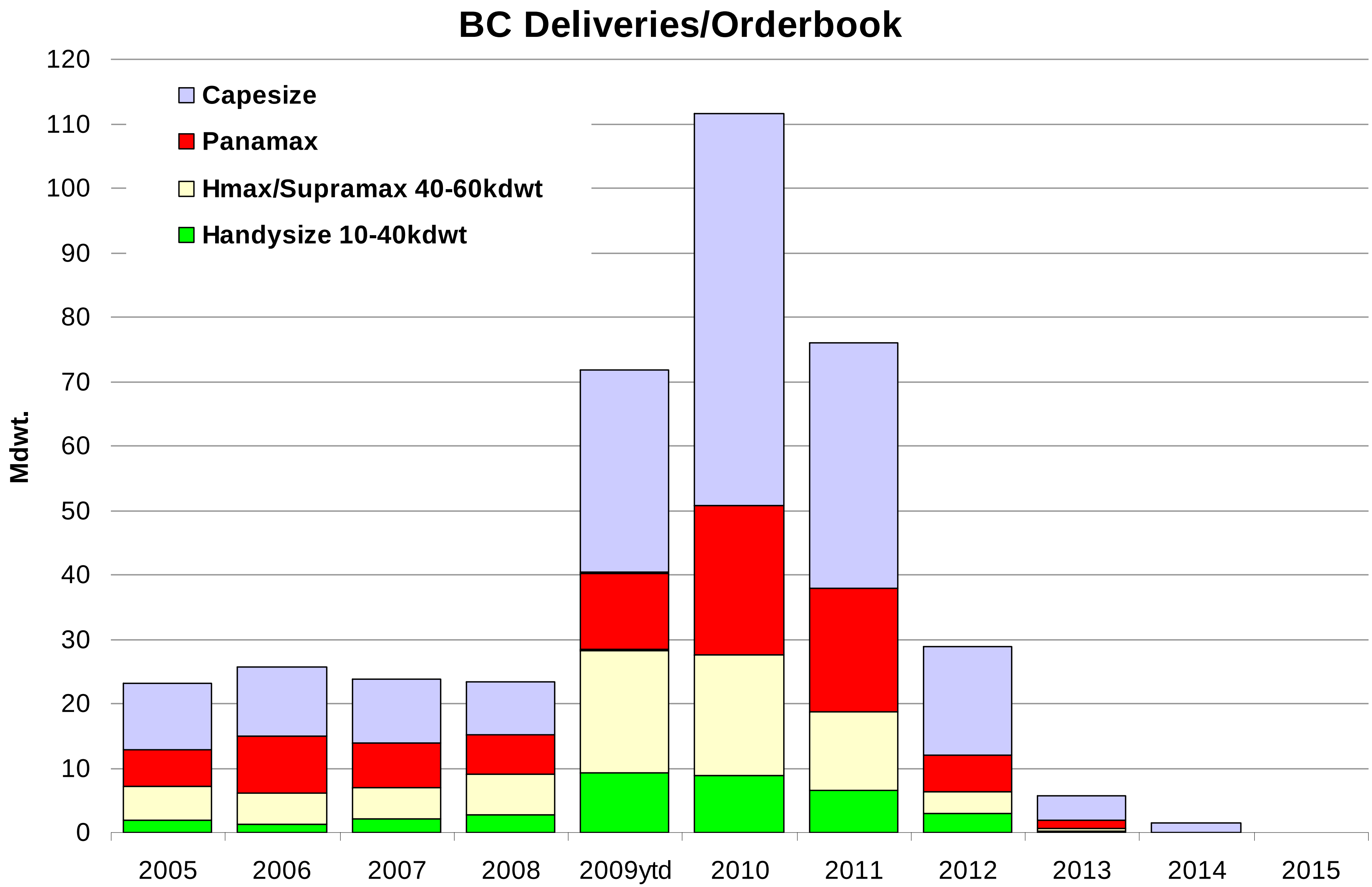
Sharp slowdown in contracting since mid-2008



Latest OB shows bulk of deliveries in next 3 years



Record deliveries scheduled in all sectors



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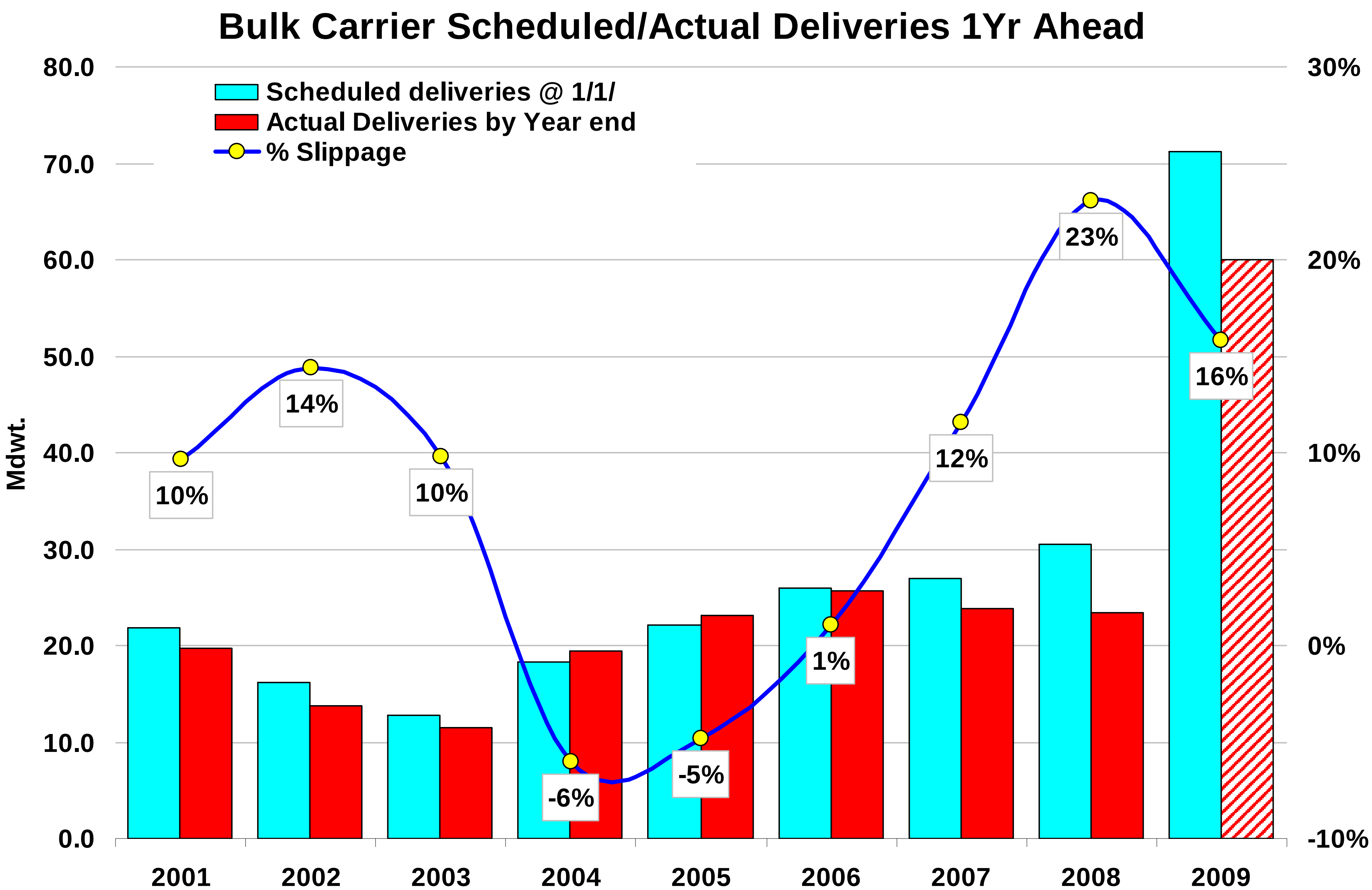
More slippage in 2008 than previously - set to continue



Major Shipbuilders

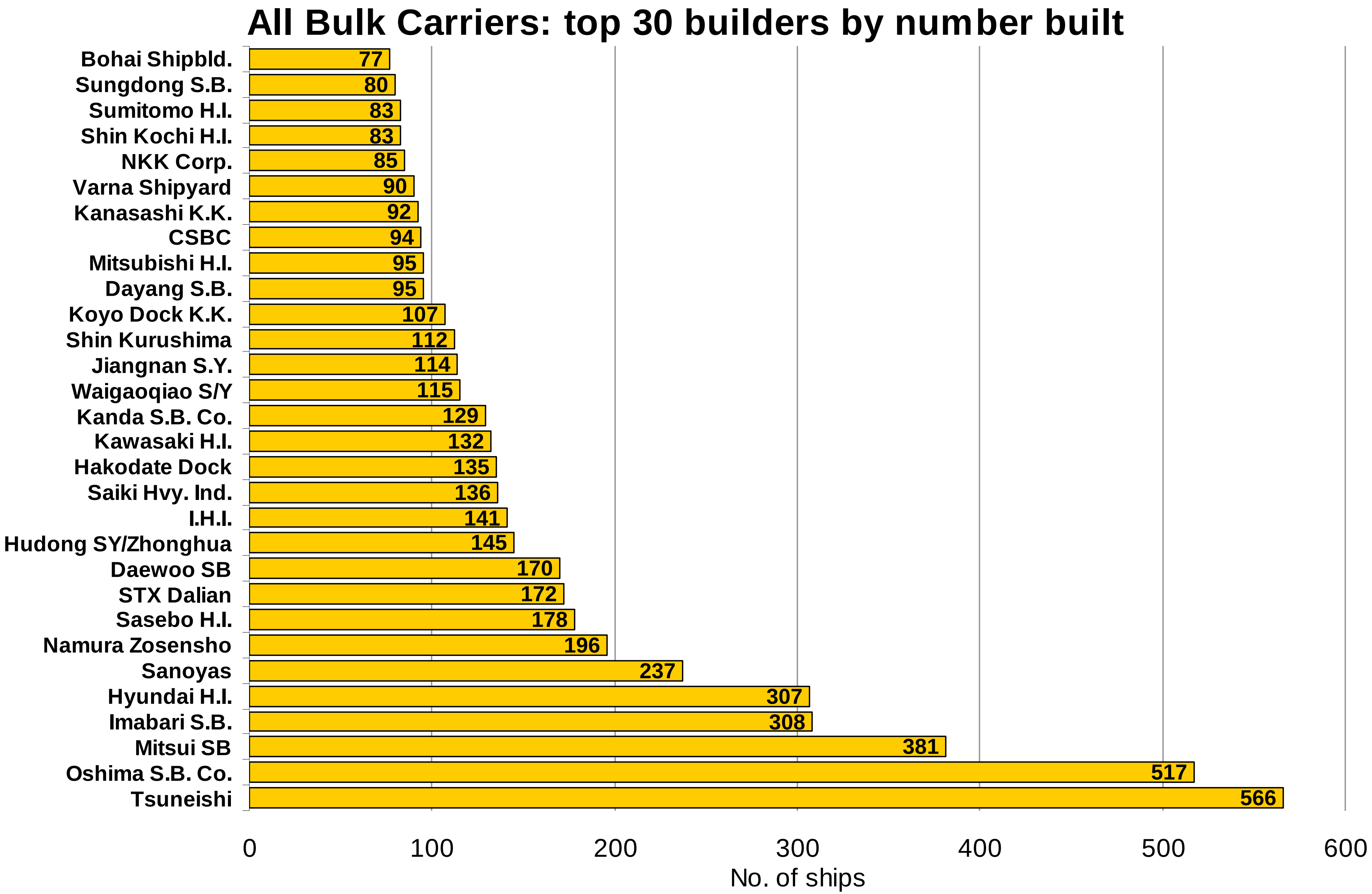
ODENSE Yard, Denmark

Universal's Tsu yard

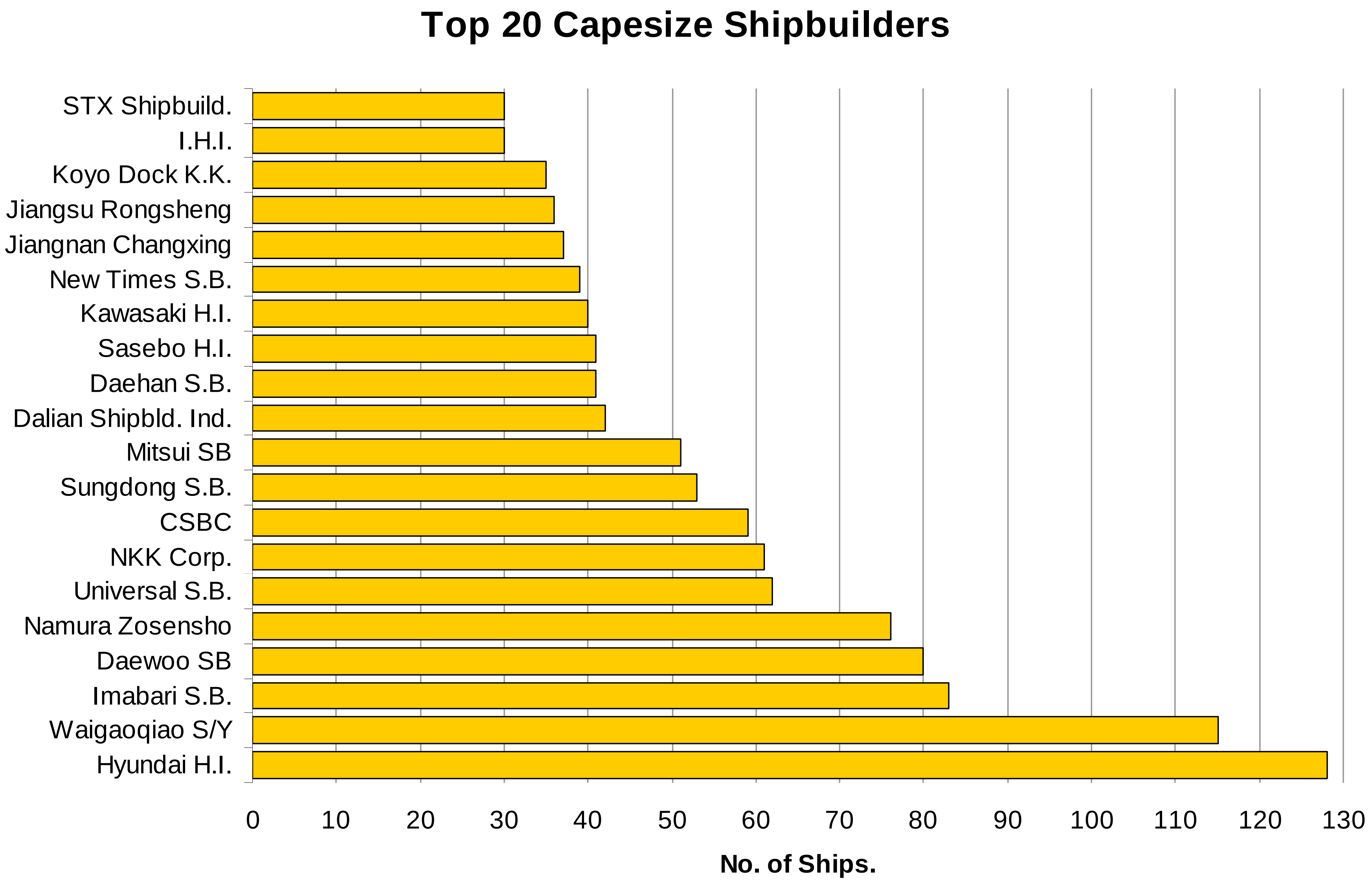
CSSC yard at Waigaoqiao

Block assembly at HHI

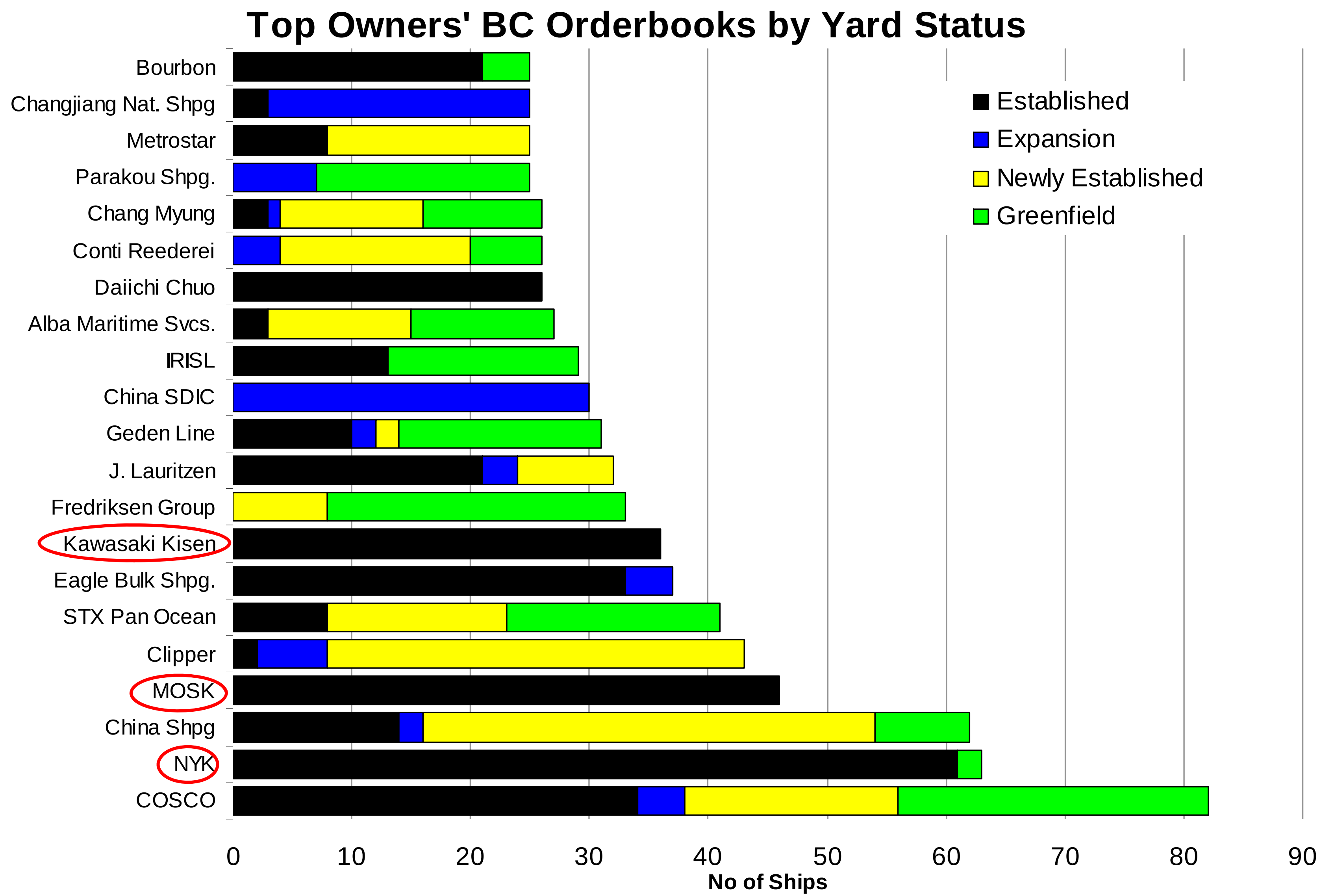
Japanese builders dominate historically



Capes: Korean, Chinese and Japanese builders dominate

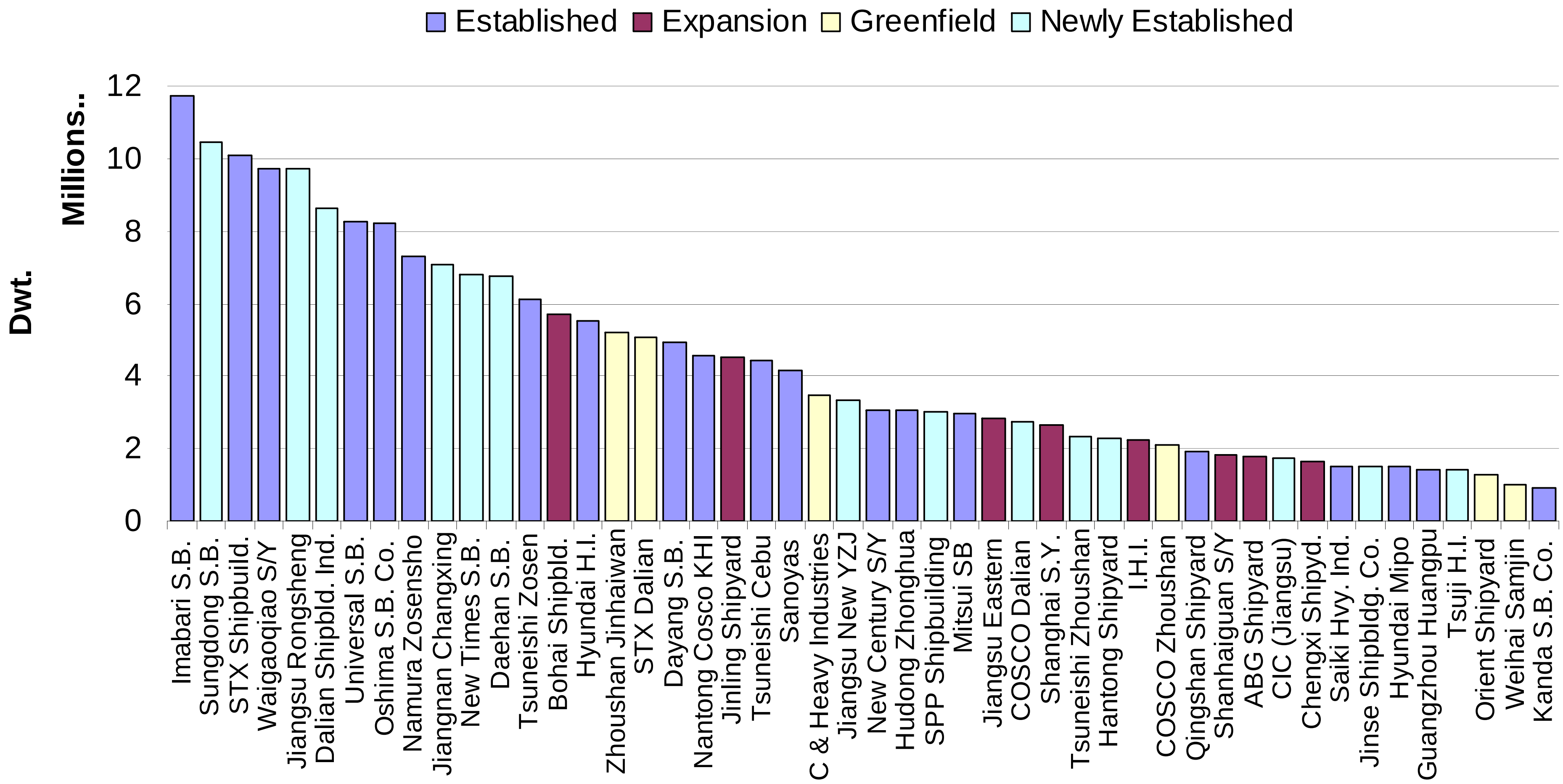


Compare NYK, MOSK & Kawasaki with Chinese owners



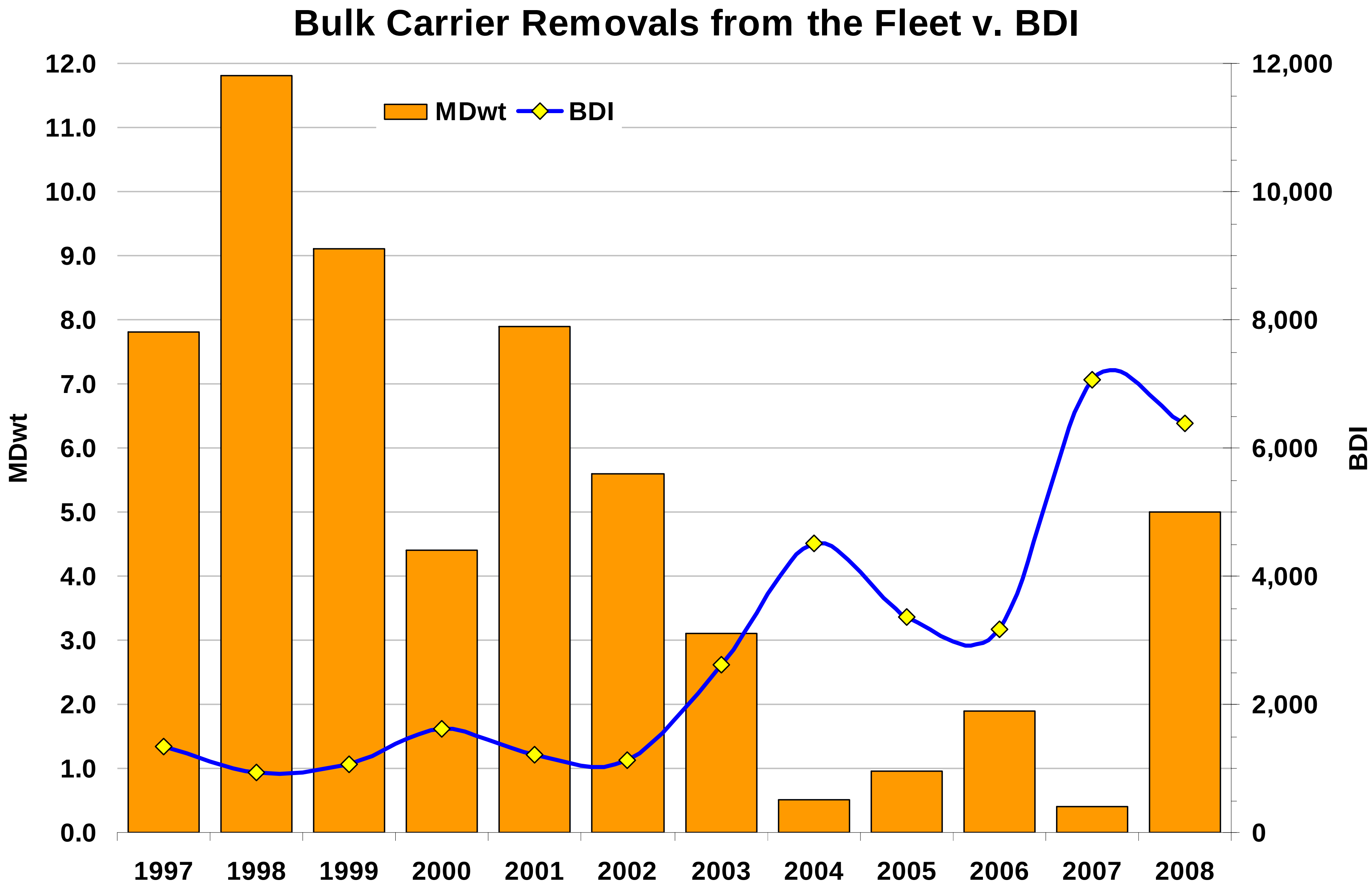
The bulk of orders at top yards seems likely to be delivered

Bulk Carriers on order at top 50 yards by yard status

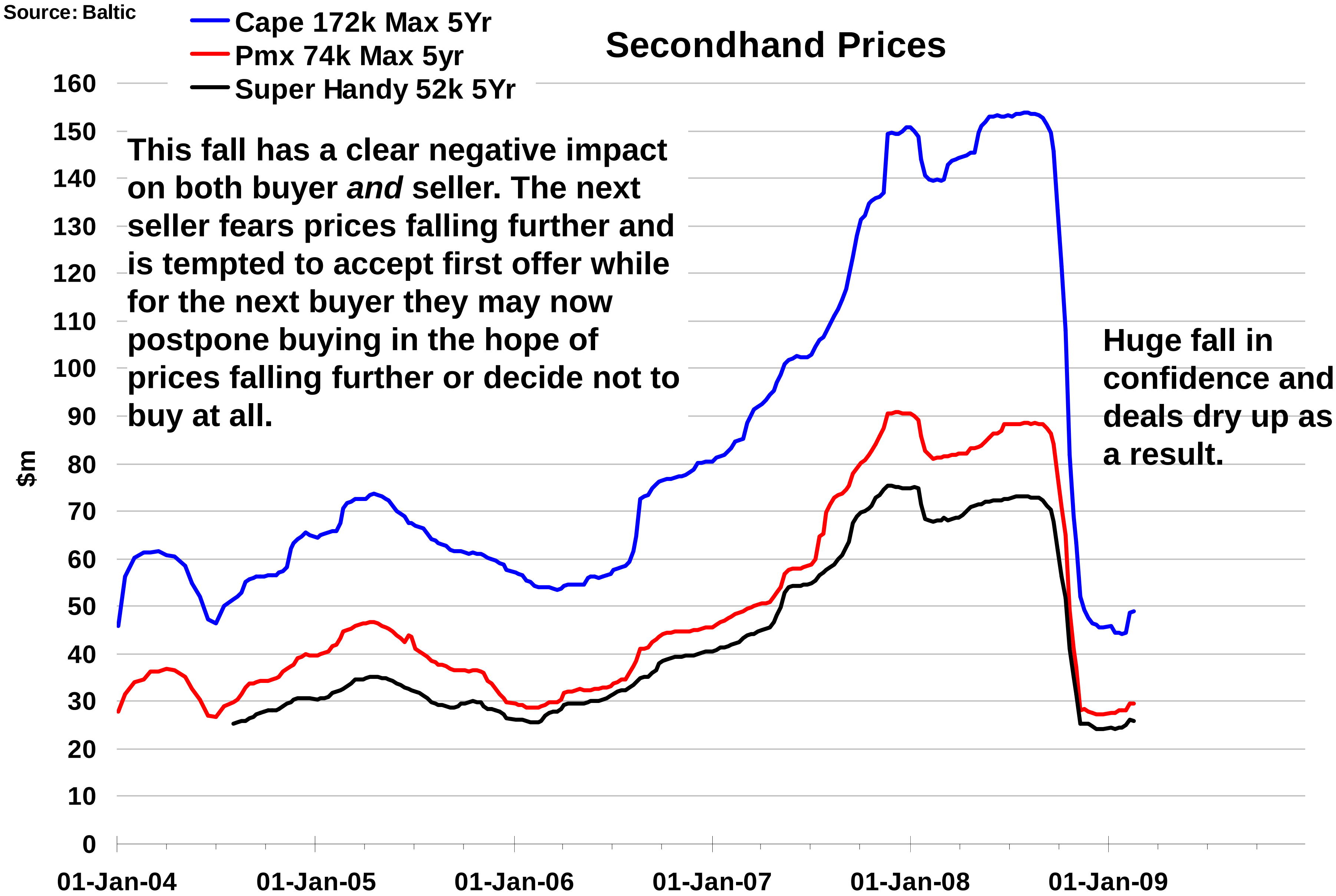


Impact on Ship Prices and Demolition Rates

As BDI has now fallen scrapping will increase sharply

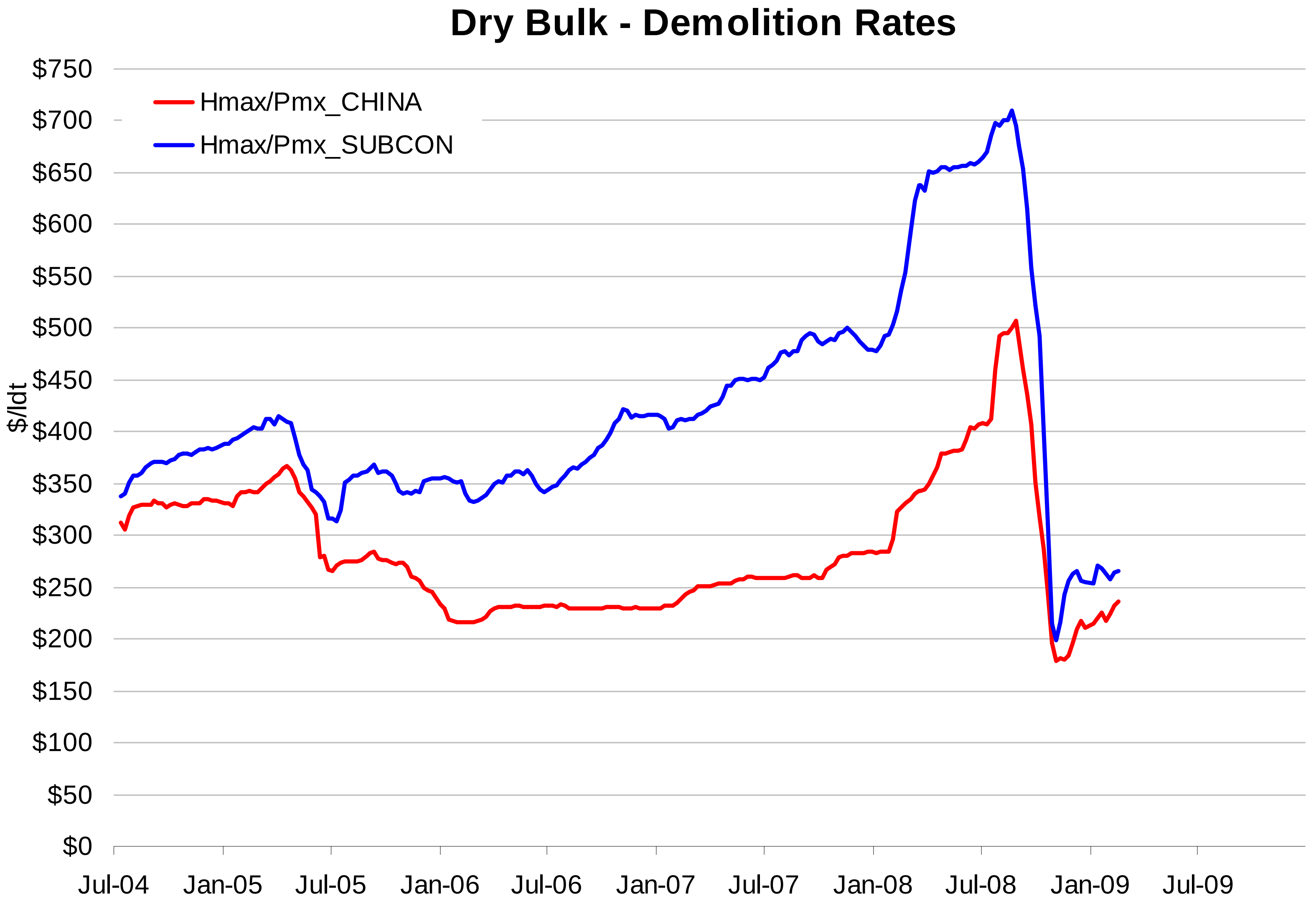


Dramatic fall in second-hand prices…

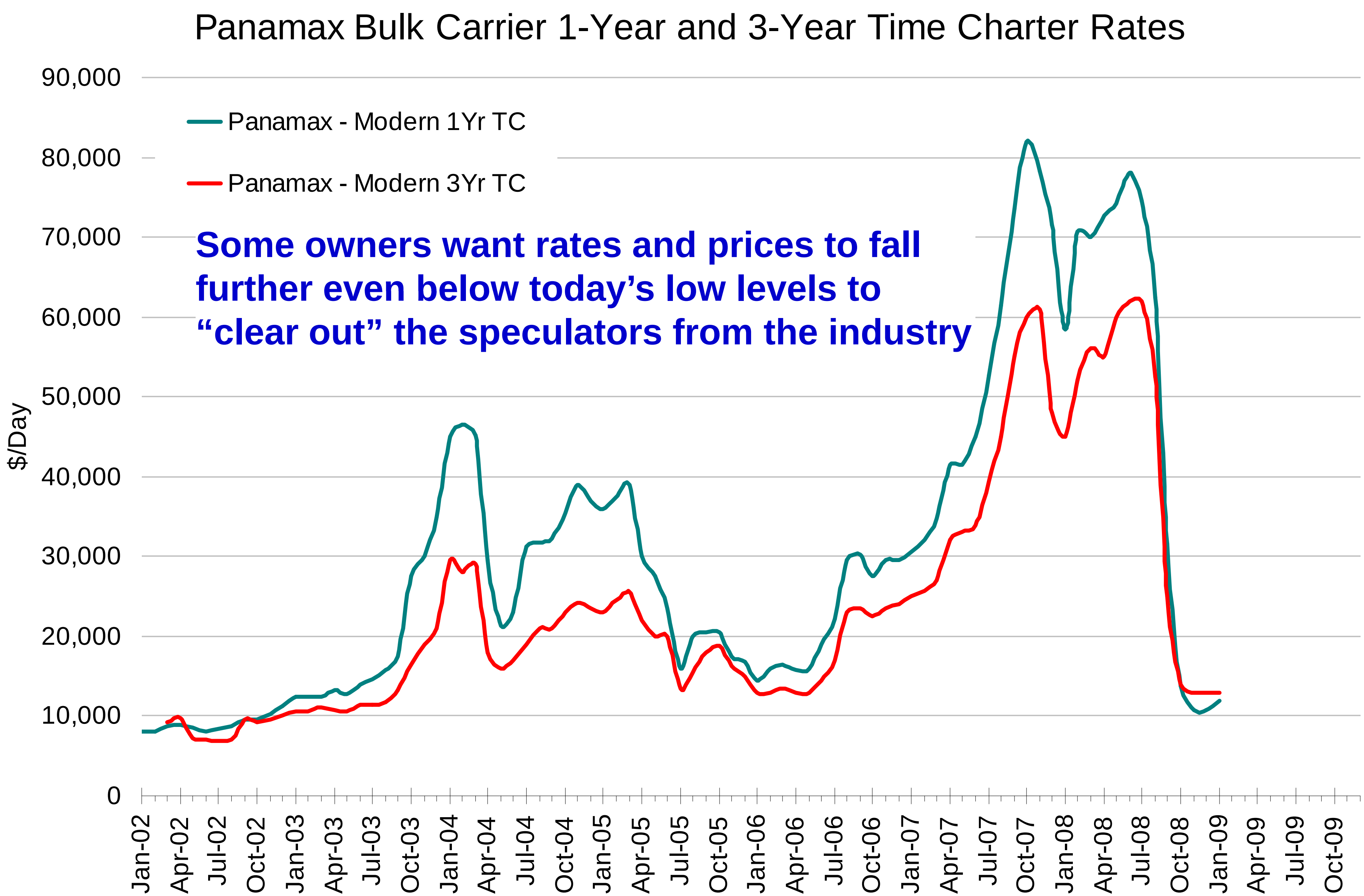


… and in $/ldt rates for demolition

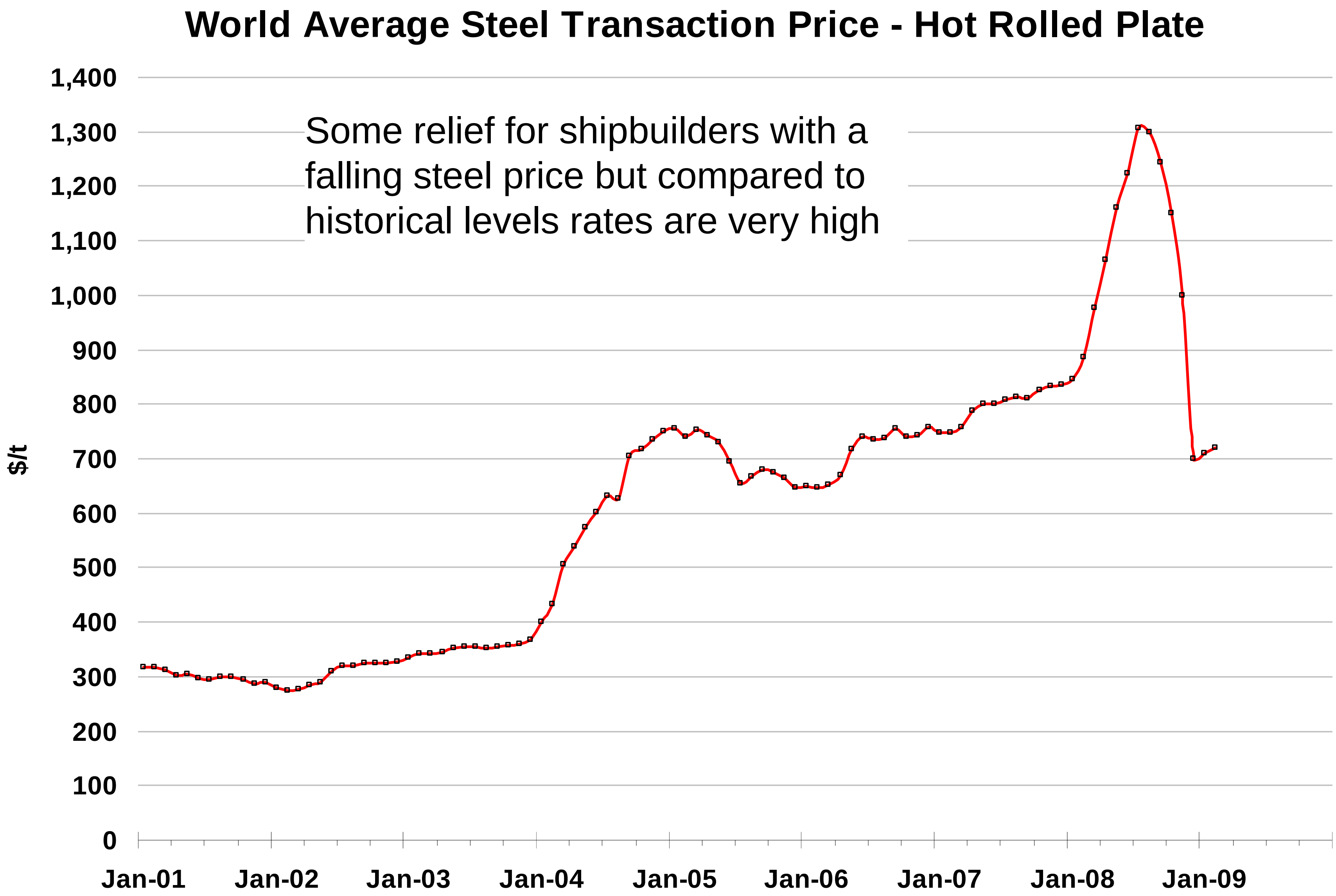
Source: Baltic Exchange



Period Rates do not give assurance to owners



Steel Prices fell after record levels and economic crisis



Issues for the Shipyards

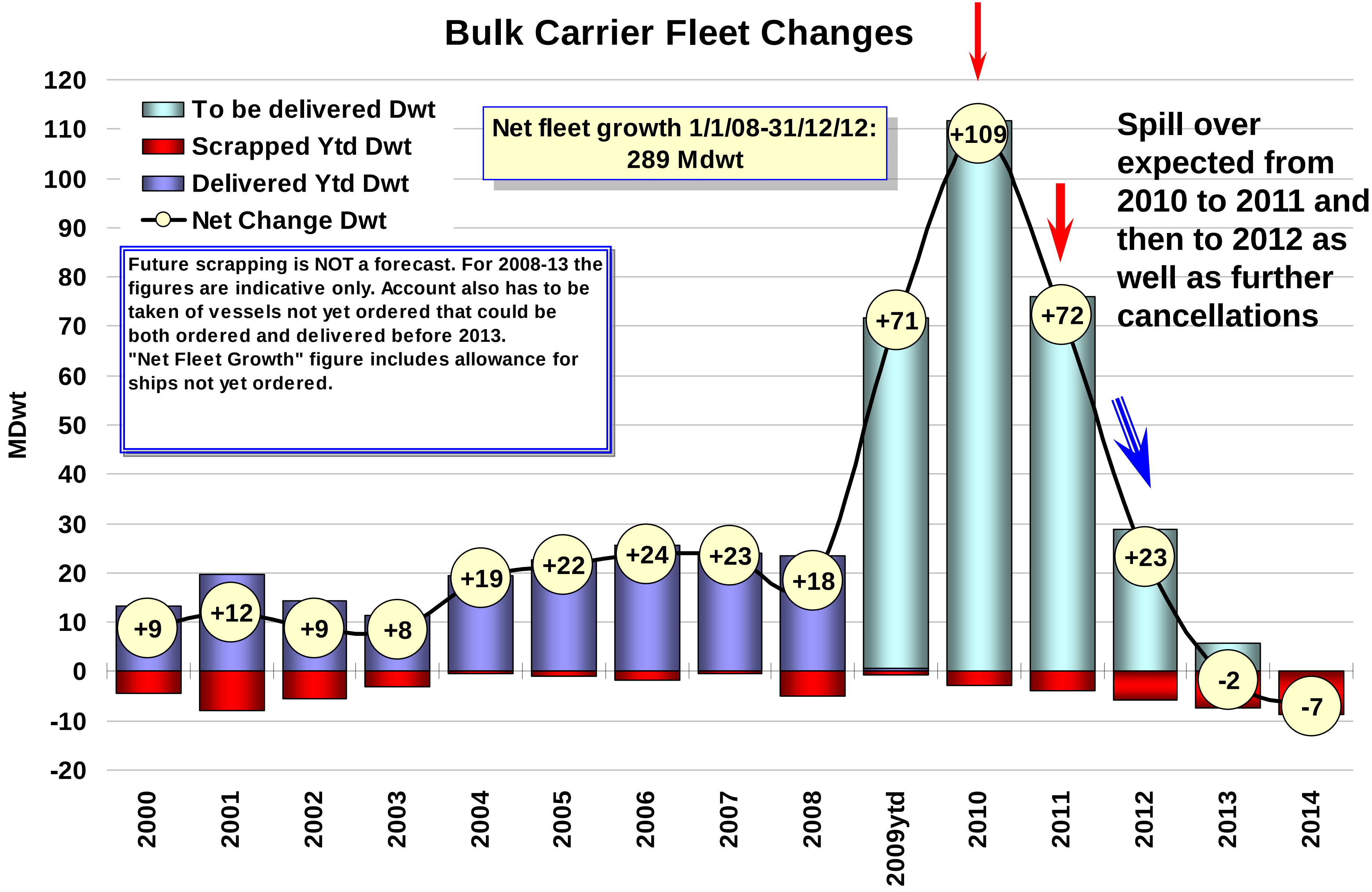
Problems for Shipyards

- Even if there is a significant increase in scrapping this will serve to reduce the fleet surplus not create new orders for shipyards because fleet is/will be oversupplied
- Difficulty in obtaining refund guarantees; some reported cases of owners still waiting for refund guarantee confirmation 18 months after signing contracts
- In some yards there are difficulties in obtaining specific parts needed for building
- In China for CSSC or CSIC (top two Chinese state-owned shipbuilding groups) shipyards orders are relatively secure, as owners are worried about being ‘blacklisted’ (some German owners reported blacklisted)
- Without support from these two state-owned groups, private shipyards may suffer from owners’ renegotiation or cancellation

Quality Issues for Shipyards

- Shipyards now implementing Common Structural Rules (CSRs) which, for new yards, could cause problems
- Some observers are blaming the “speculative” owners who ordered ships for resale with no intention of trading and who have shown minimal interest in supervising their construction
- Reported problems include faulty welds, missing plates, and pipework that needs replacing after weeks at sea
- Small private shipyards also have relatively weaker technical teams which make them more open to owners’ criticism on the technical issues

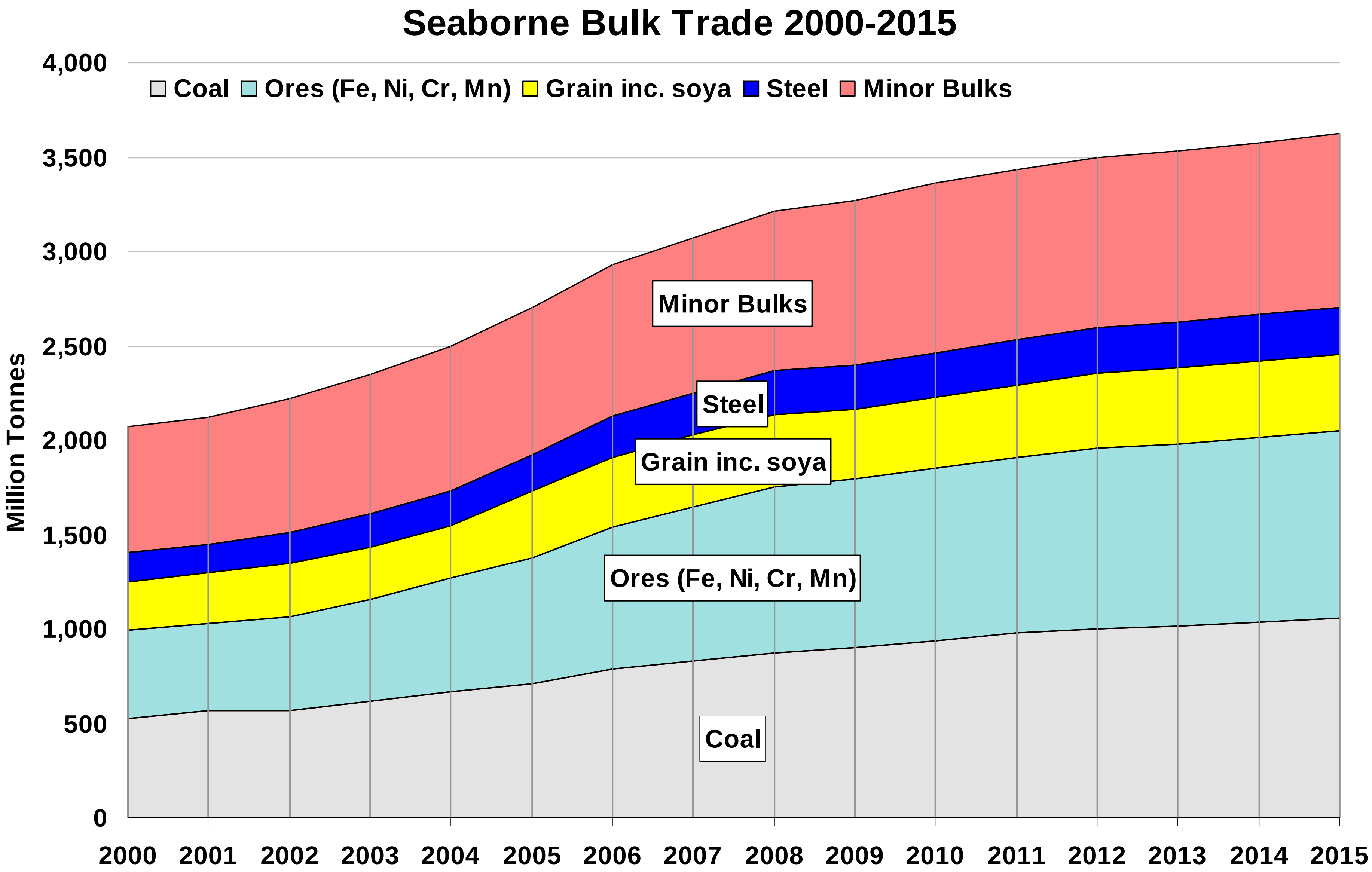
An expectation of increased scrapping and fewer deliveries than *scheduled*



Options for Shipyards

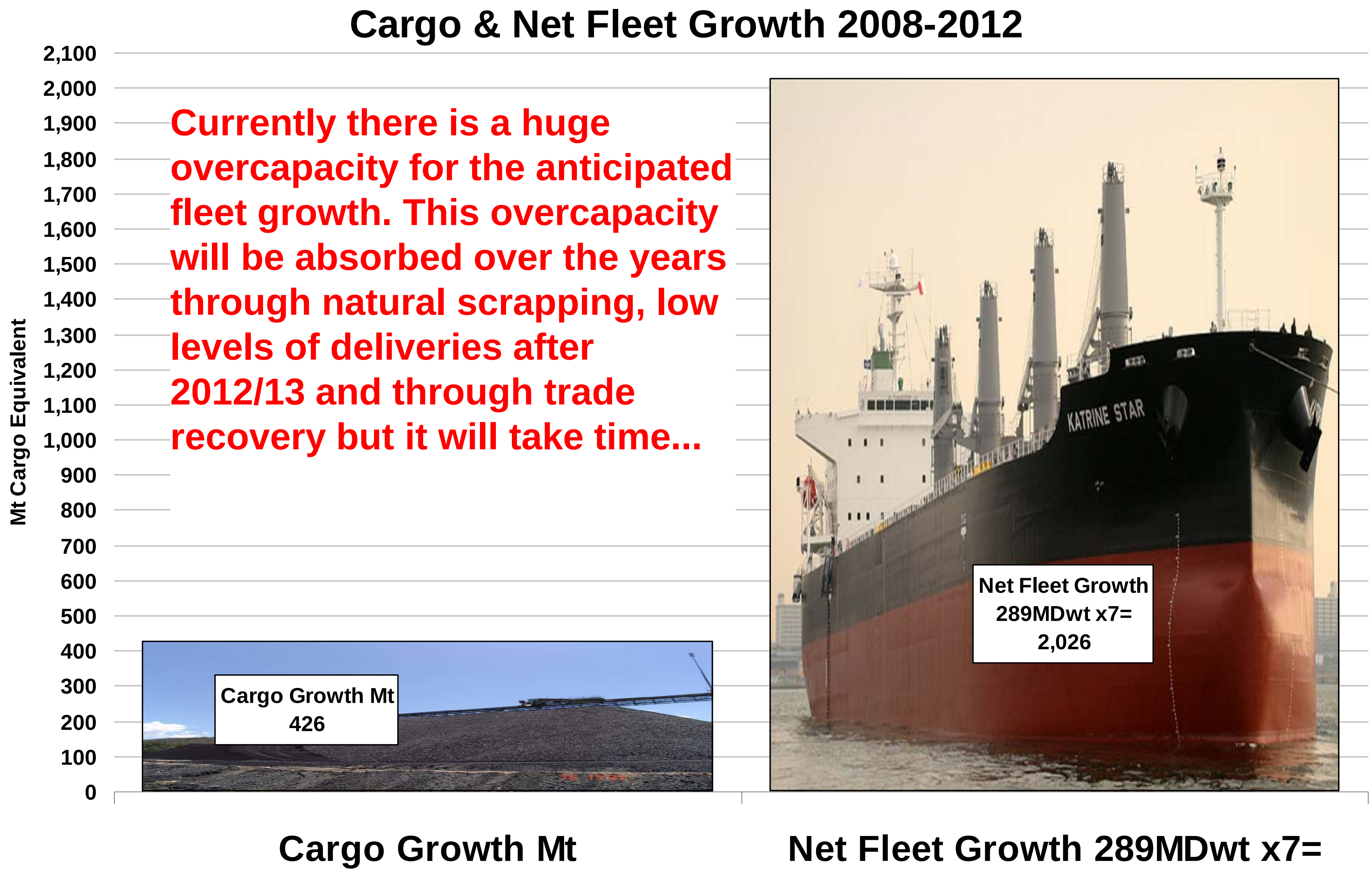
- Contract with 1st class shipowners – but how is this decided?
  - Even if with "1st class owner" this is not a guarantee but is perhaps more reliable
- Consolidation with other shipyards
- Agree new delivery dates
- Agree refund guarantee arrangements
- Risks to Shipyards:
  - Shipowners defaulting
  - Steel plate price
  - Cash flow
  - Fall in contract price
- **Some shipyards considering taking equity in their own newbuildings to help owner take delivery on time. The idea is to Time Charter out for maybe 5 yrs, *not* to become long-term owners.**

Long-term slow-down in bulk trade growth



Net Fleet Change and Trade Growth

Currently there is a huge overcapacity for the anticipated fleet growth. This overcapacity will be absorbed over the years through natural scrapping, low levels of deliveries after 2012/13 and through trade recovery but it will take time...



Assume 50% cut in scheduled deliveries

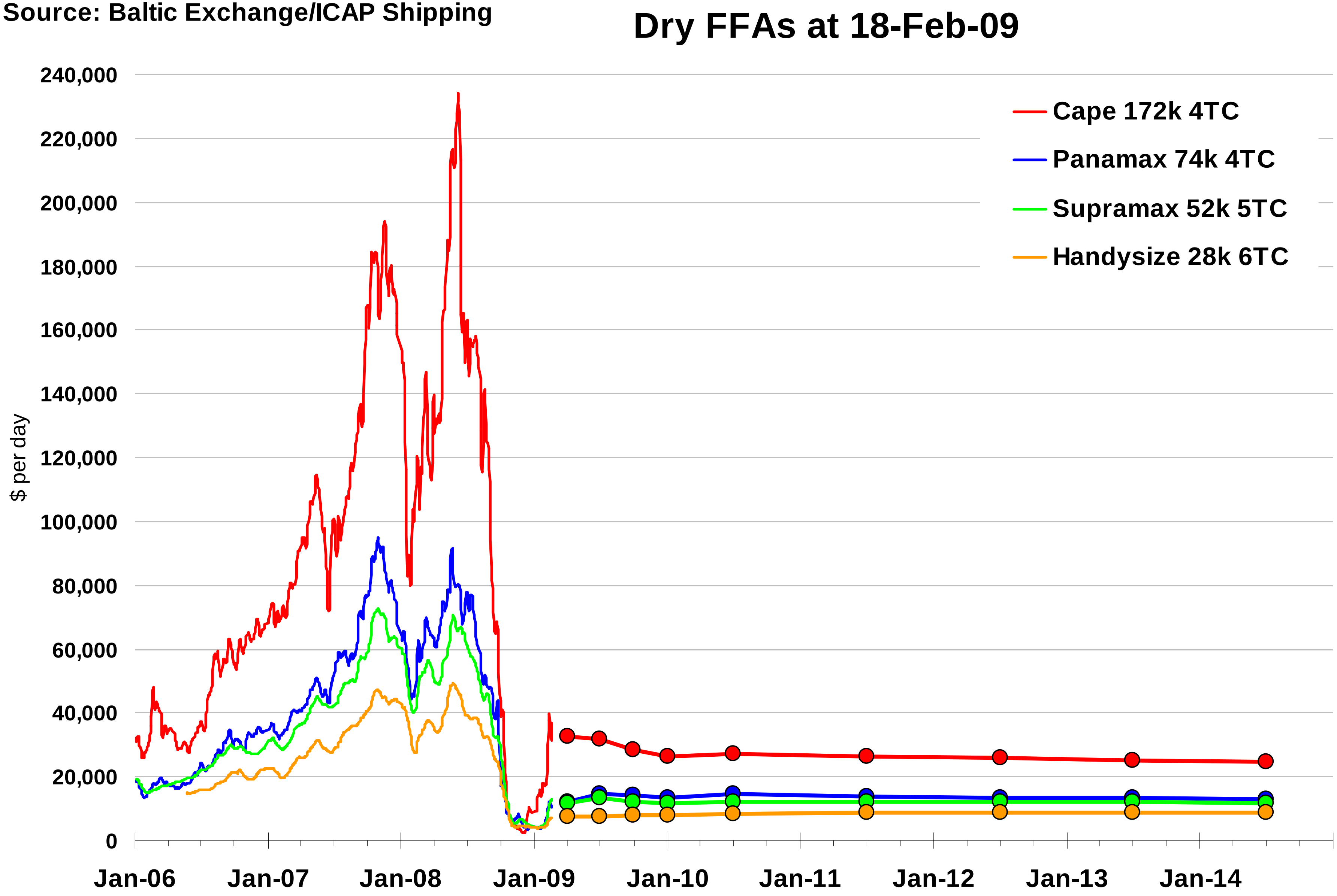
Halving the current orderbook still leaves a large fleet surplus unless we see:

- an exceptional increase in scrapping or trade growth,
- congestion or fleet supply disruption
- other events – natural disasters, war, canal closures, etc, that could cut fleet supply or increase demand unexpectedly

Shipping history is full of such events

Forward Markets

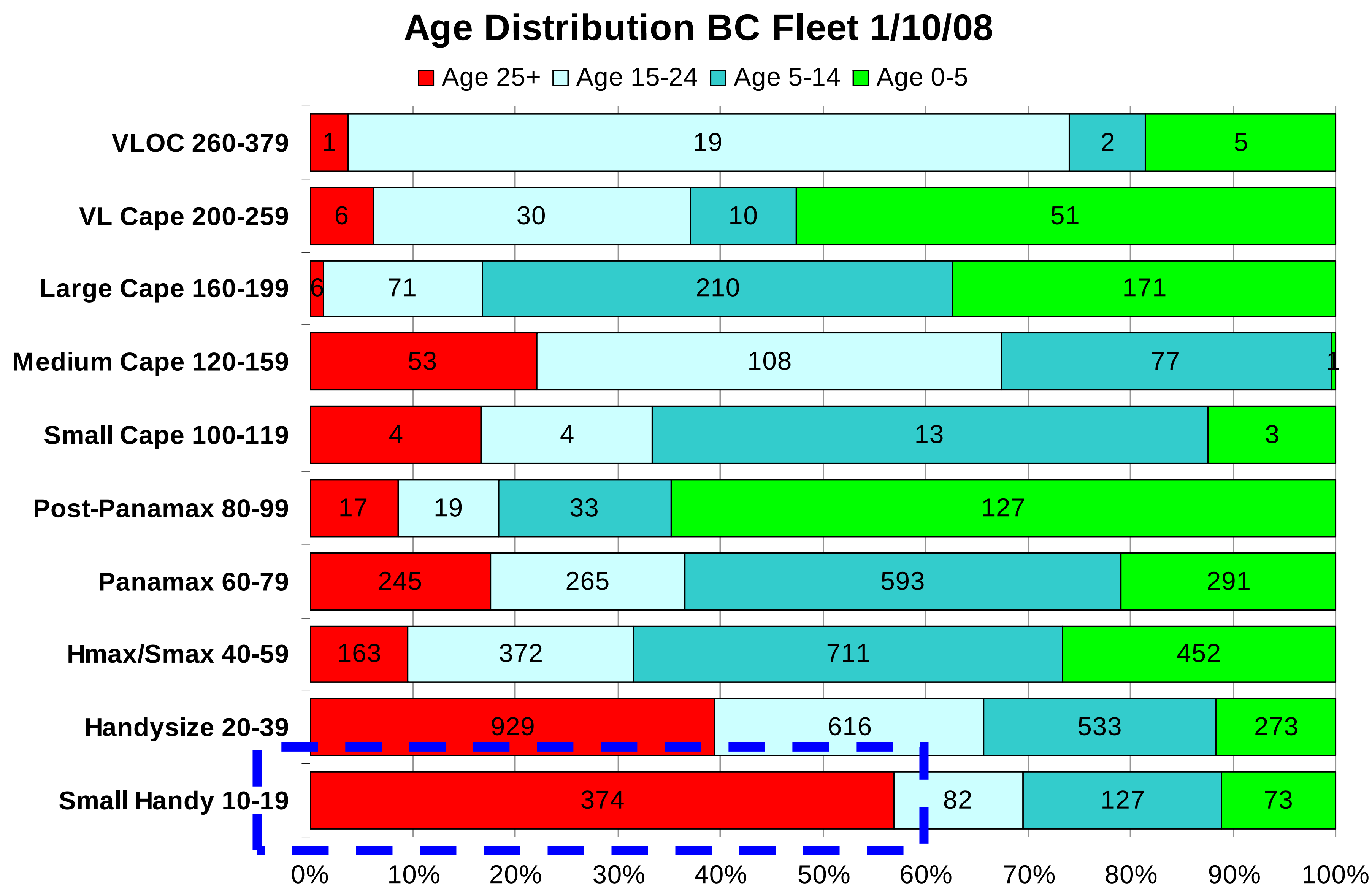
Source: Baltic Exchange/ICAP Shipping



Options for Shipowners in conditions of overcapacity

- Slow steaming/Lay-up
- Scrap older ships
  - in extremis scrap newer ships – it has been done before in 1970s when ships as young as 12 years old were scrapped
- Slow down of ordering of new ships
- Sell ships before taking delivery (use as asset play)
  - an option when prices are rising but clearly less attractive on a falling market
- Refinance as much as possible but is this feasible in current climate?
- Fix ships on long term period
  - The problem was that the speed of the collapse took many by surprise and this option (with very few exceptions) was not considered until it was too late
- **Agree new delivery date with shipyard – can pay premium to delay delivery.**
- **By delaying delivery the owner hopes the market will recover – or, in extreme cases where minimal payment has been made, to hope(!) for the yard to go bankrupt**

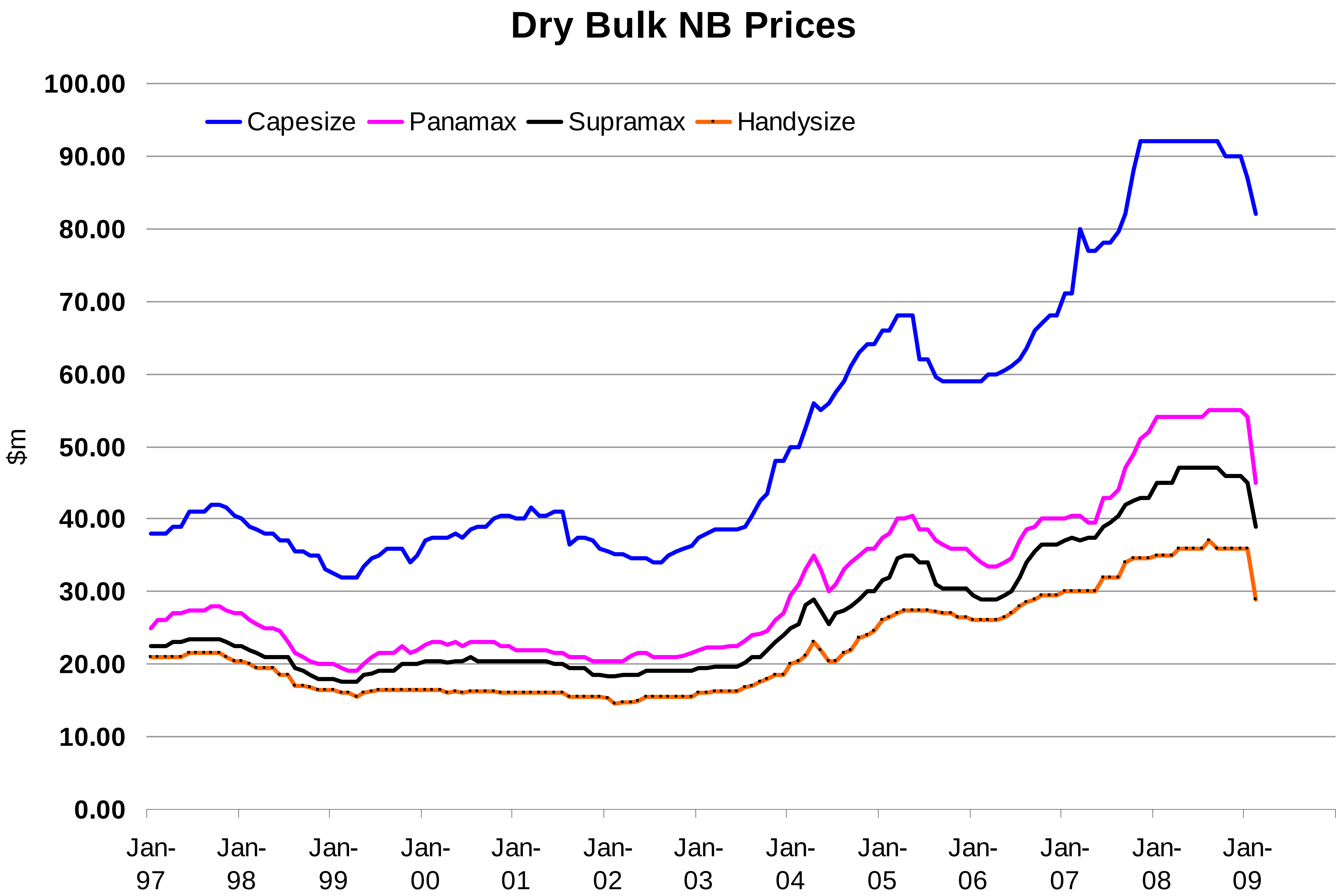
Only sector which is substantially “old” is Handysize



Greenfield sites Rongsheng example

- Rongsheng, as a newly established Chinese shipyard, has received a lot of media scrutiny concerning development progress
- Shipyard construction began on 28 Oct 2005 & started building its first ship on 28 Oct 2006
- Is already one of the biggest shipyards in China, having received strong government support
- However, the yard has slipped a few deliveries, partly due to inexperience as a new shipyard, and also because of shipowners deferring delivery due to economic conditions
- Following the rapid development, Rongsheng is now struggling to attract new orders to fulfil its large building capacity post 2011

NB prices have been slow to react but now dropping sharply



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While NB overhang lasts little reason for sustainable market recovery

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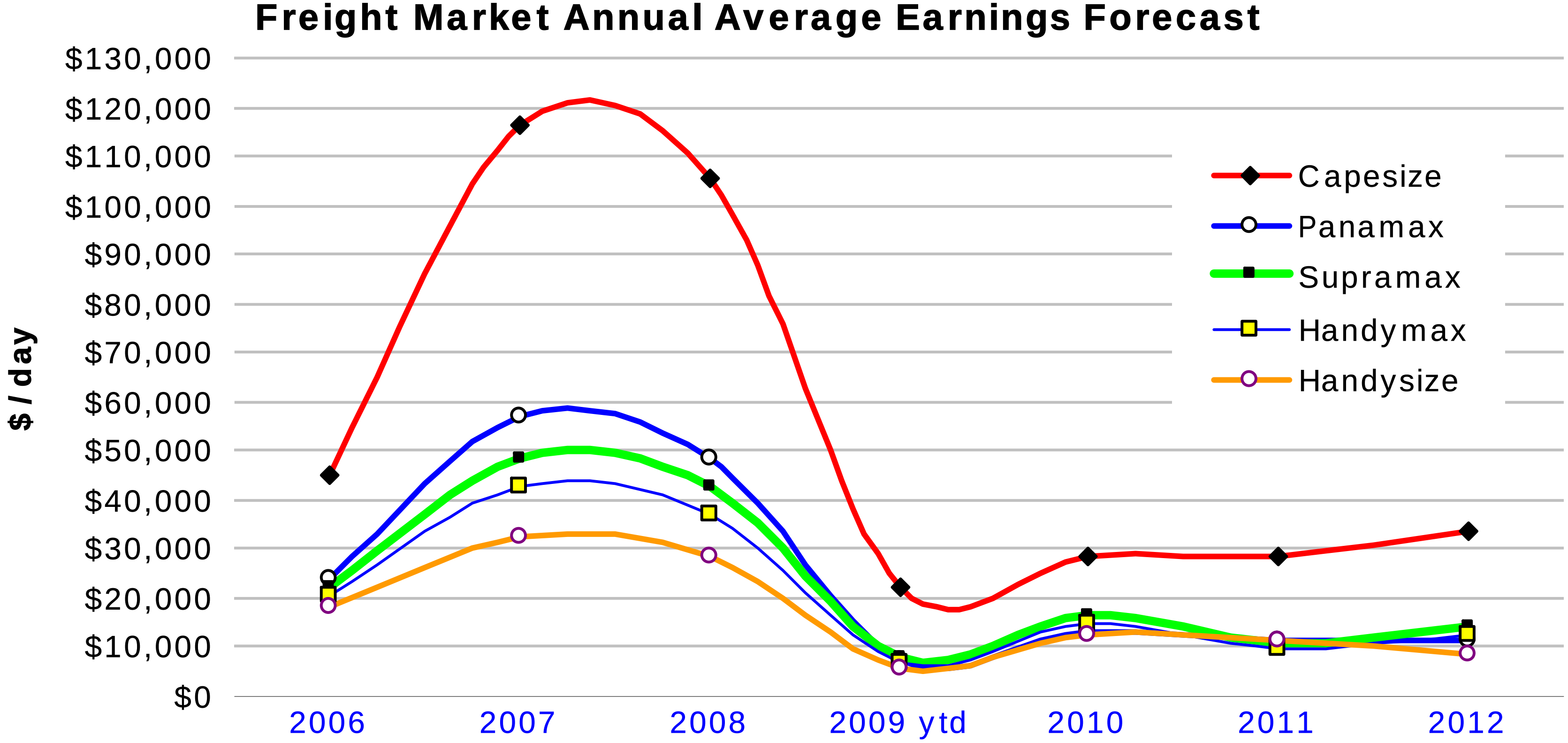

	2006	2007	2008	2009 ytd	2010	2011	2012
Capesize	$45,319	$116,540	$105,390	$22,475	$28,226	$28,665	$33,857
Panamax	$23,858	$56,854	$48,653	$7,248	$12,894	$11,159	$11,395
Supramax	$22,446	$48,424	$42,861	$8,108	$16,778	$10,945	$14,520
Handymax	$20,616	$43,035	$37,274	$7,034	$14,554	$9,495	$12,596
Handysize	$18,327	$32,531	$28,353	$5,550	$12,583	$11,155	$8,575

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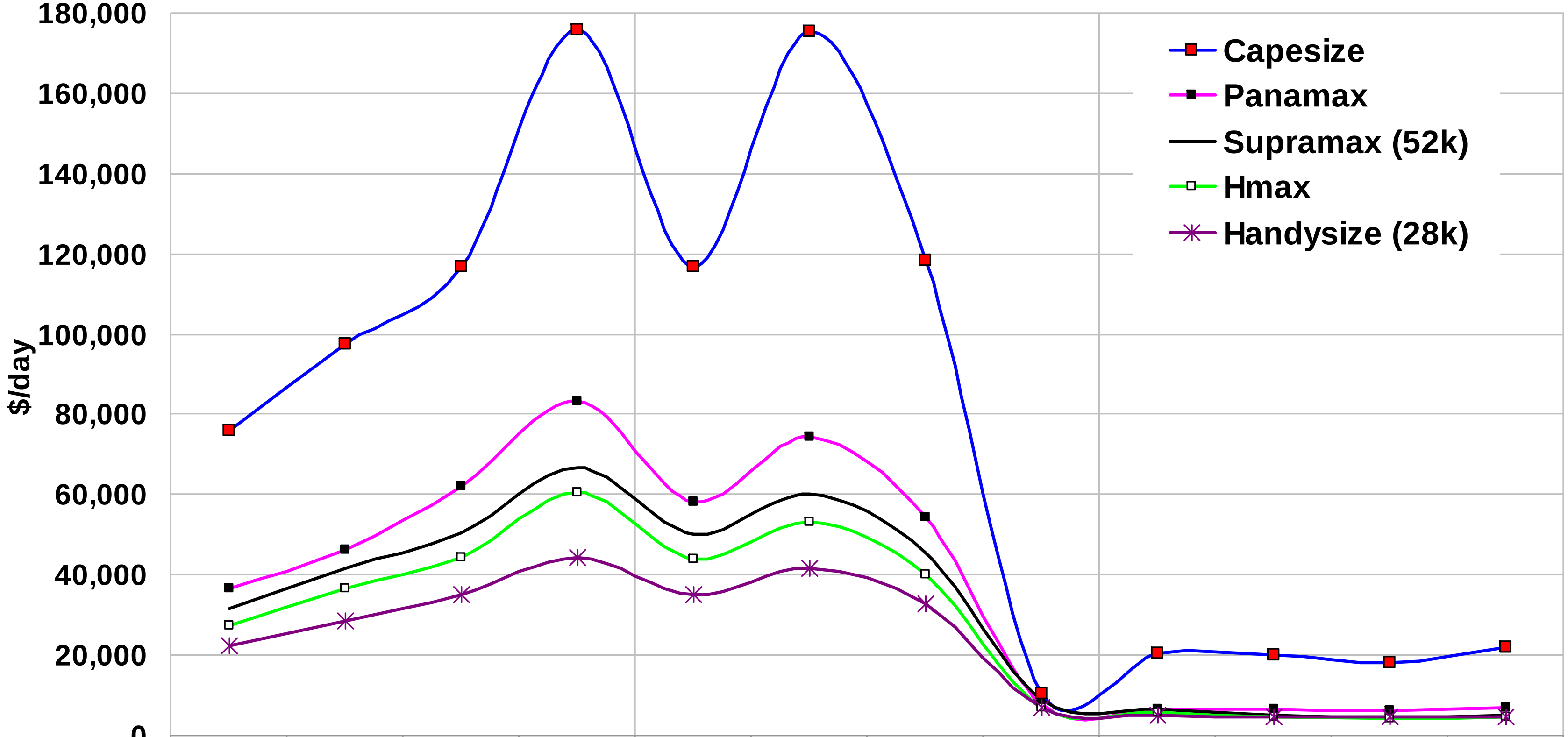
Short term prospects remain weak this year

Quarterly Basket of Average TC Rates



	1q07	2q07	3q07	4q07	1q08	2q08	3q08	4q08	1q09	2q09	3q09	4q09
Capesize	75,905	97,596	116,697	175,867	116,775	175,327	118,166	10,586	20,570	20,000	18,000	22,000
Panamax	36,477	46,337	61,864	83,331	58,339	74,359	54,289	7,740	6,577	6,500	6,300	7,000
Supramax (52k)	31,633	41,578	50,614	66,582	50,268	60,251	45,593	9,040	6,589	5,000	4,800	4,900
Hmax	27,320	36,770	44,501	60,695	43,950	53,032	40,152	6,896	5,658	4,500	4,400	4,450
Handysize (28k)	22,316	28,595	34,904	44,349	35,027	41,817	32,624	6,920	4,914	4,500	4,750	4,600

Conclusion

- A period of extreme turmoil in the shipbuilding industry
- Nearly every shipyard now receives enquiries on possible resales
- Quite possible that many "Greenfield" shipyards will now simply never be built but the example of Rongsheng shows that the potential for rapid capacity increases is still very pronounced. 11/2/09: China announces ban on new shipyards for 3 years and no more expansion of existing yards – also for 3 years. Govt also intends banks to increase trade finance to support export orders.
- Fall in average age of fleet as older ships removed and many new ones delivered
- Newbuilding prices are expected to fall
- Newbuilding orderbook expected to fall steadily, scrapping to increase and contracting to remain at low levels
- Recovery could take significant time to work through the system

The Bulk Carrier Shipbuilding Market
A review of the major issues post 2008

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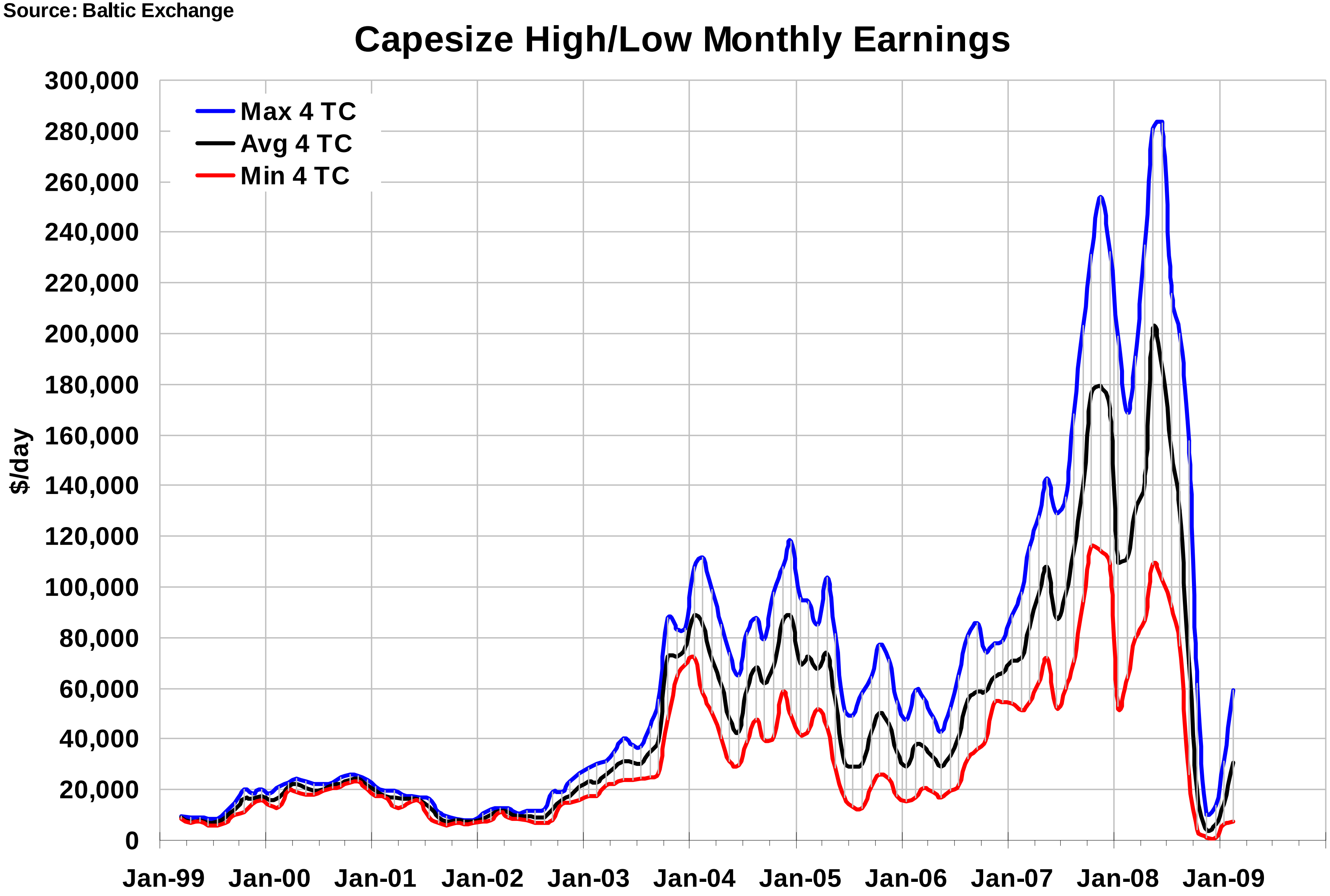
Associate Dean ~ Copenhagen Business School
Head of Consultancy ~ ICAP Shipping Ltd
Copenhagen 19th February 2009

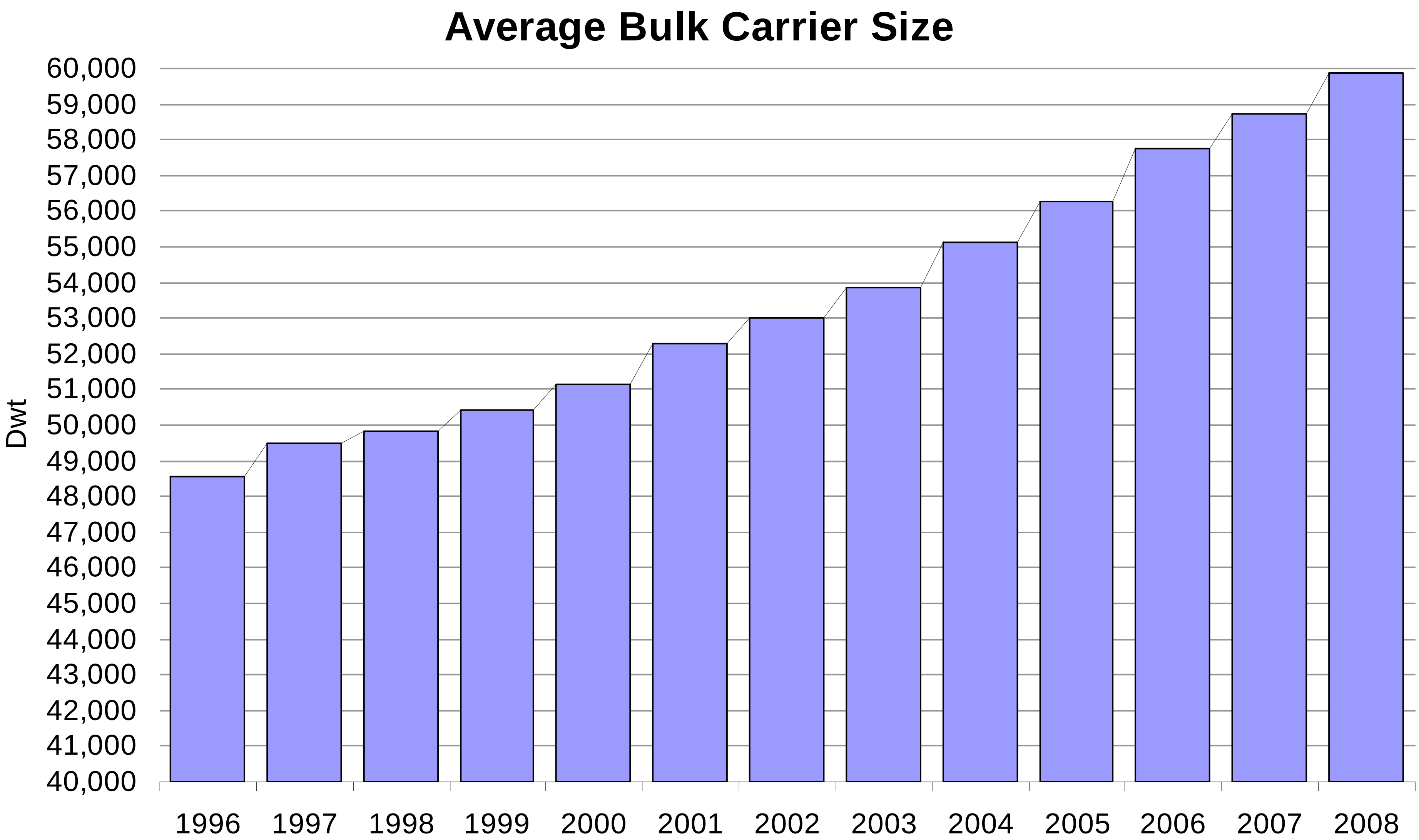
Back-up slides

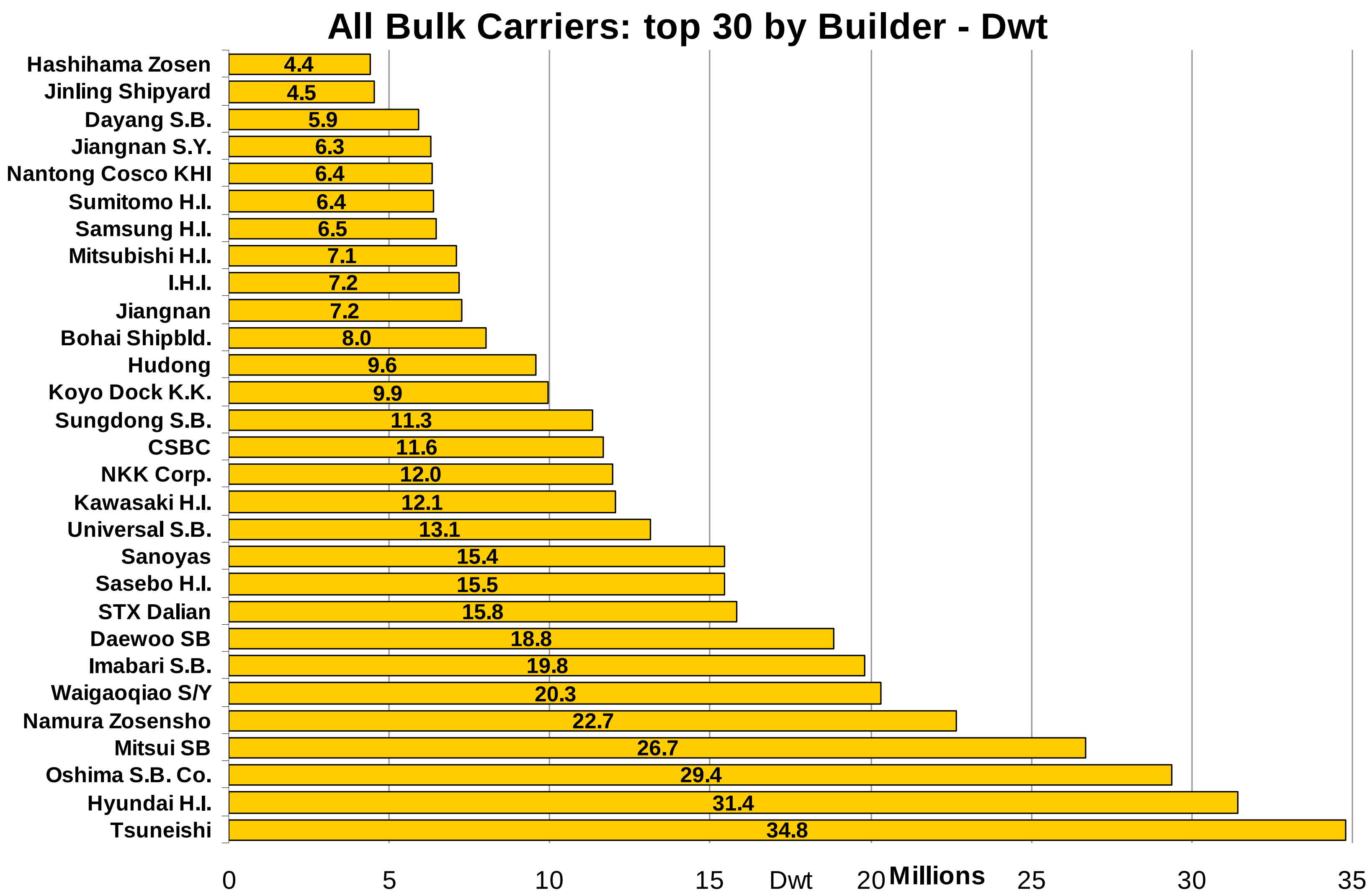
Extreme volatility clearly evident

Source: Baltic Exchange

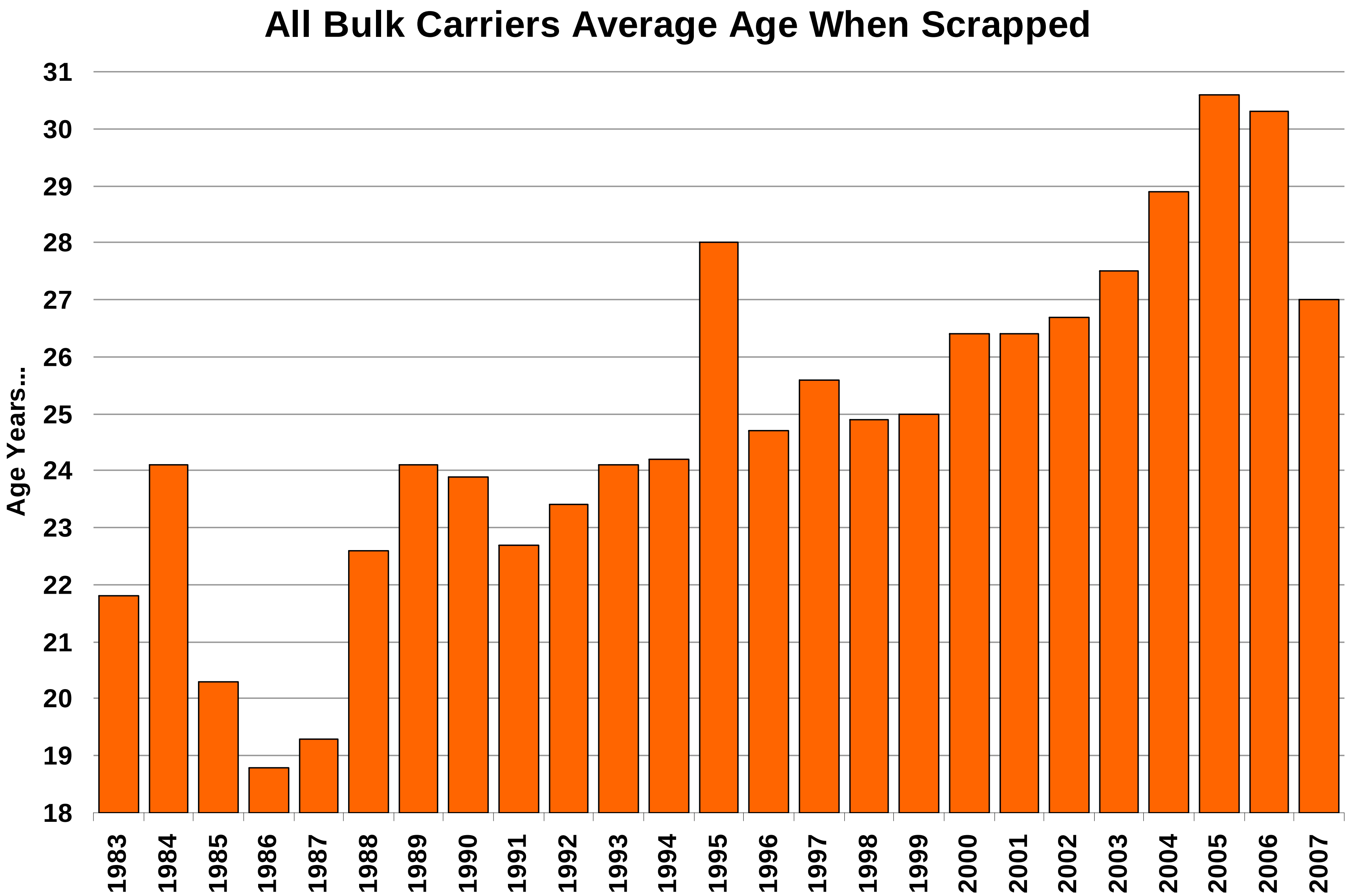


Clear increase in average ship size




All Bulk Carriers: top 30 by Builder - Dwt
Hashihama Zosen 4.4
Jinling Shipyard 4.5
Dayang S.B. 5.9
Jiangnan S.Y. 6.3
Nantong Cosco KHI 6.4
Sumitomo H.I. 6.4
Samsung H.I. 6.5
Mitsubishi H.I. 7.1
I.H.I. 7.2
Jiangnan 7.2
Bohai Shipbld. 8.0
Hudong 9.6
Koyo Dock K.K. 9.9
Sungdong S.B. 11.3
CSBC 11.6
NKK Corp. 12.0
Kawasaki H.I. 12.1
Universal S.B. 13.1
Sanoyas 15.4
Sasebo H.I. 15.5
STX Dalian 15.8
Daewoo SB 18.8
Imabari S.B. 19.8
Waigaoqiao S/Y 20.3
Namura Zosensho 22.7
Mitsui SB 26.7
Oshima S.B. Co. 29.4
Hyundai H.I. 31.4
Tsuneishi 34.8
0 5 10 15 20 25 30 35
Dwt Millions

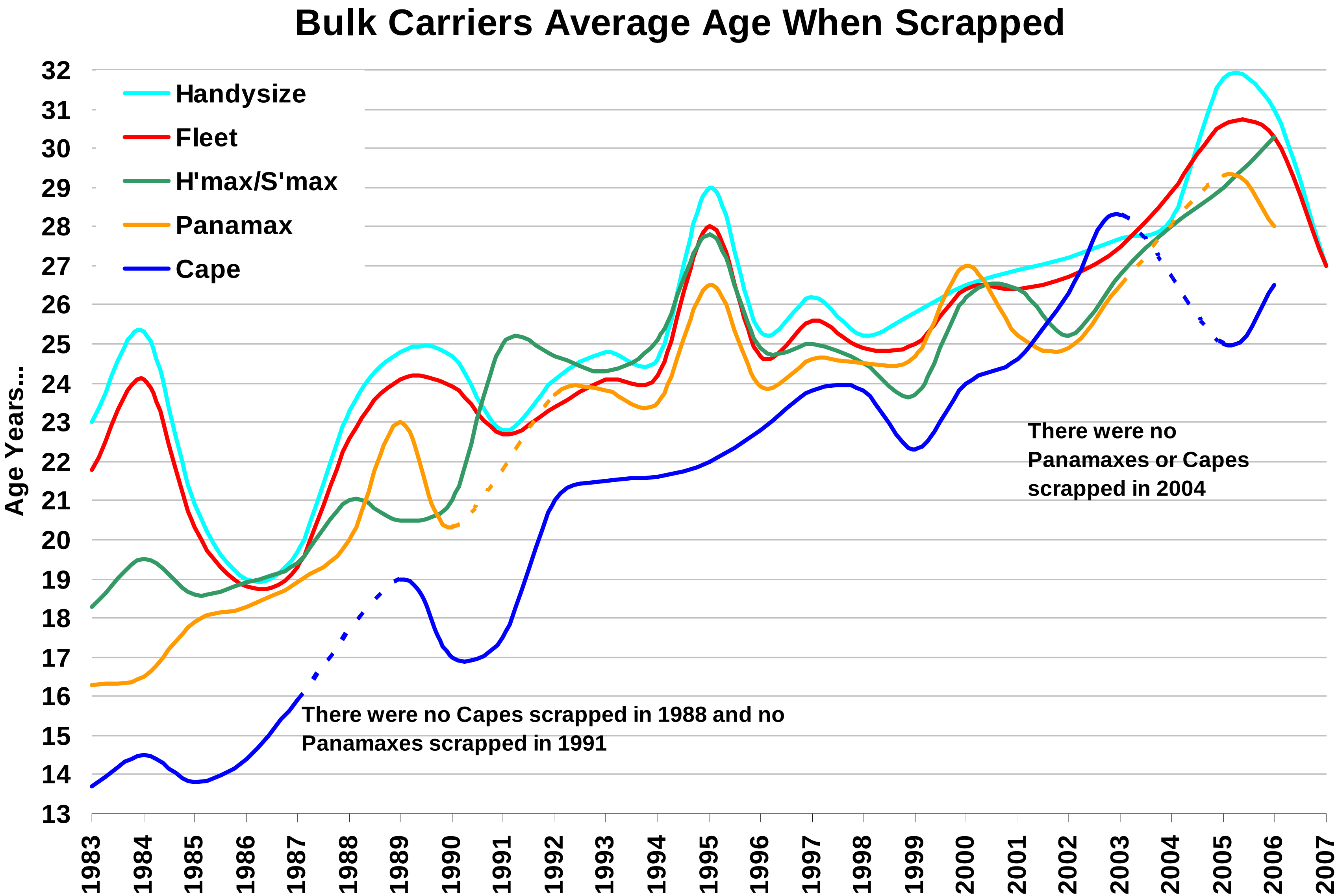
Scrapping Fall in 2007 distorted because of low numbers

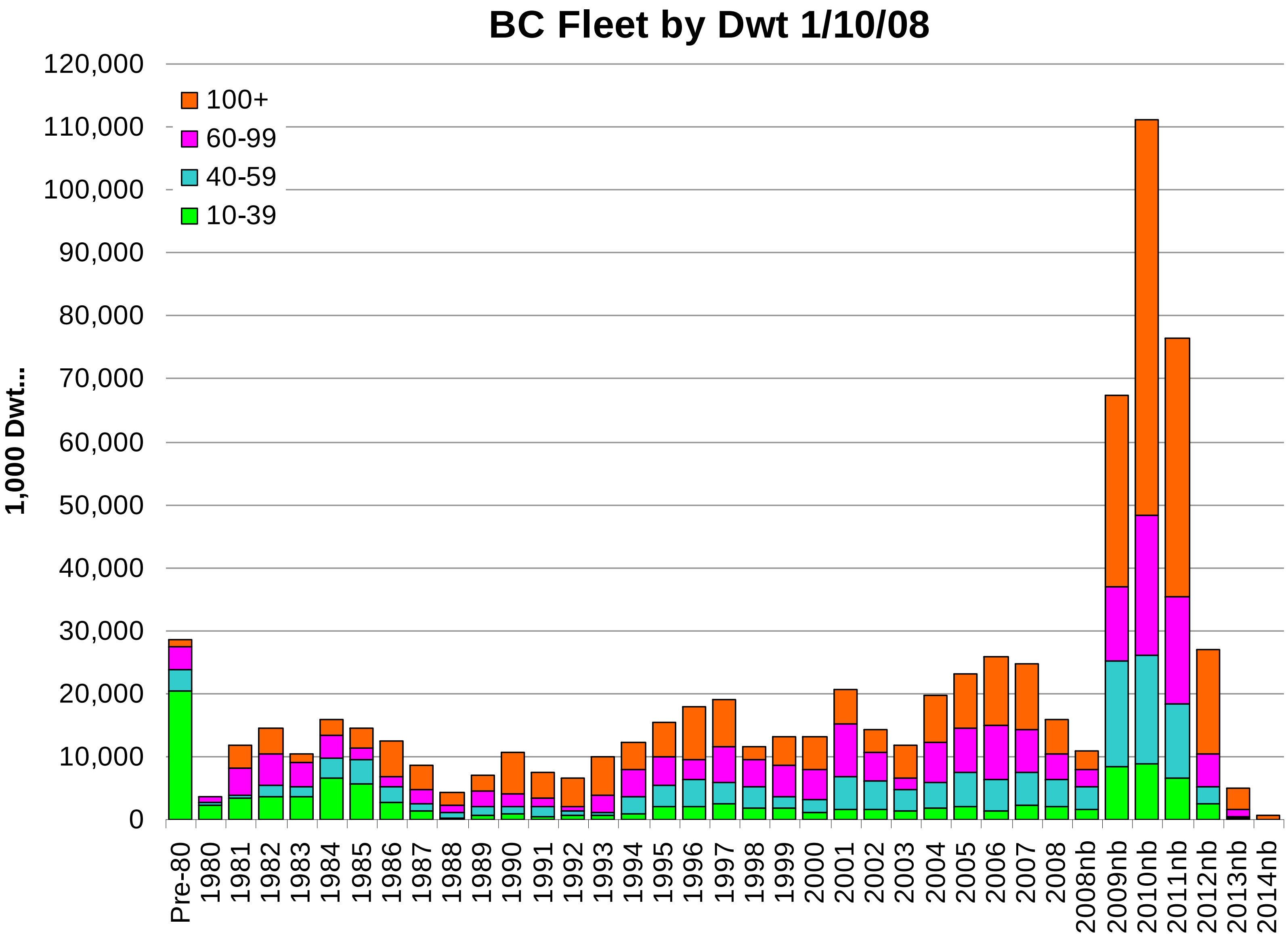


CBS

ICAP

Rising trend of scrapping age – now to come down?




BC Fleet by Dwt 1/10/08
120,000
110,000
100,000
90,000
80,000
70,000
60,000
50,000
40,000
30,000
20,000
10,000
0
1,000 Dwt...
100+
60-99
40-59
10-39
Pre-80
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
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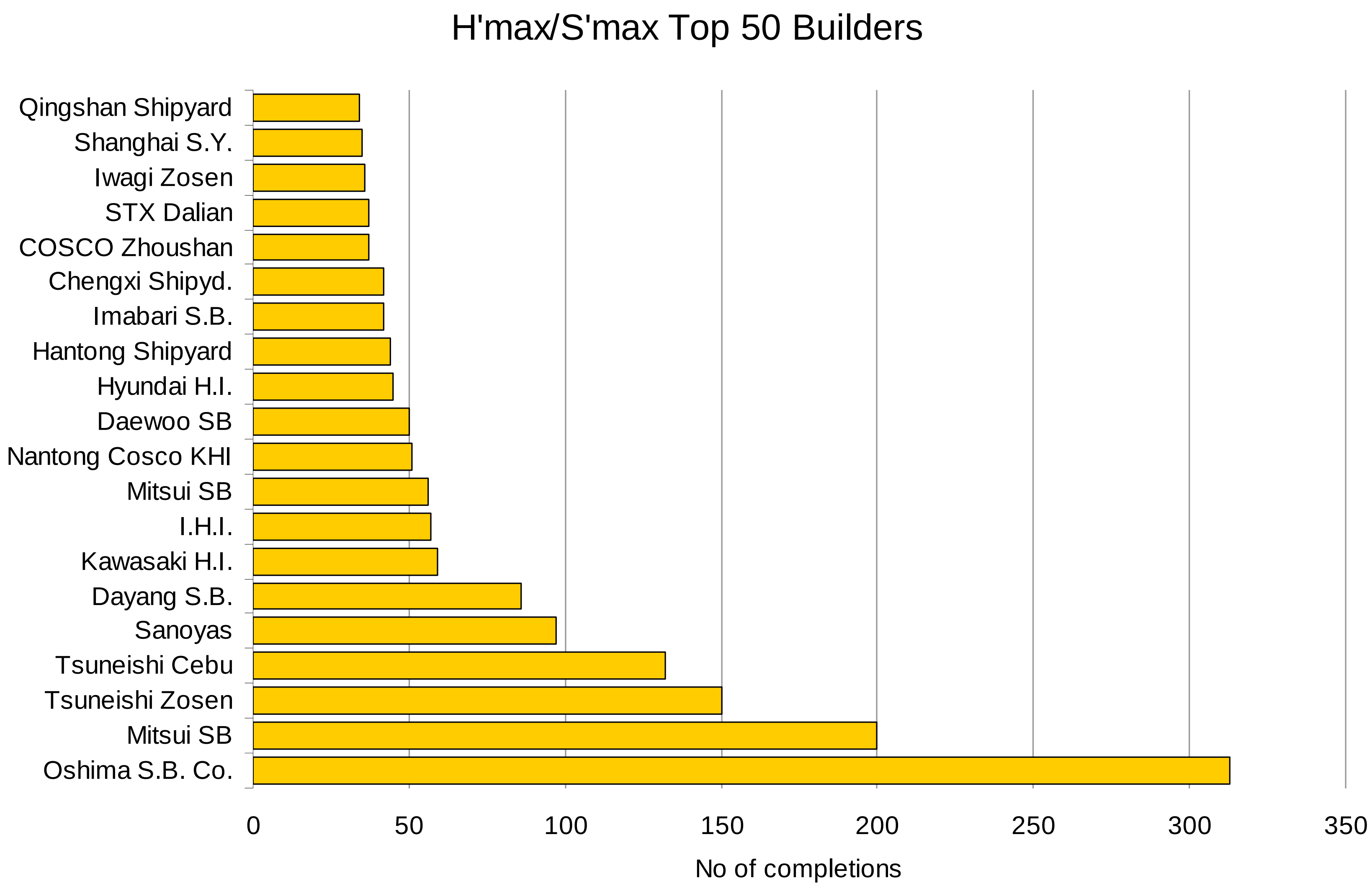
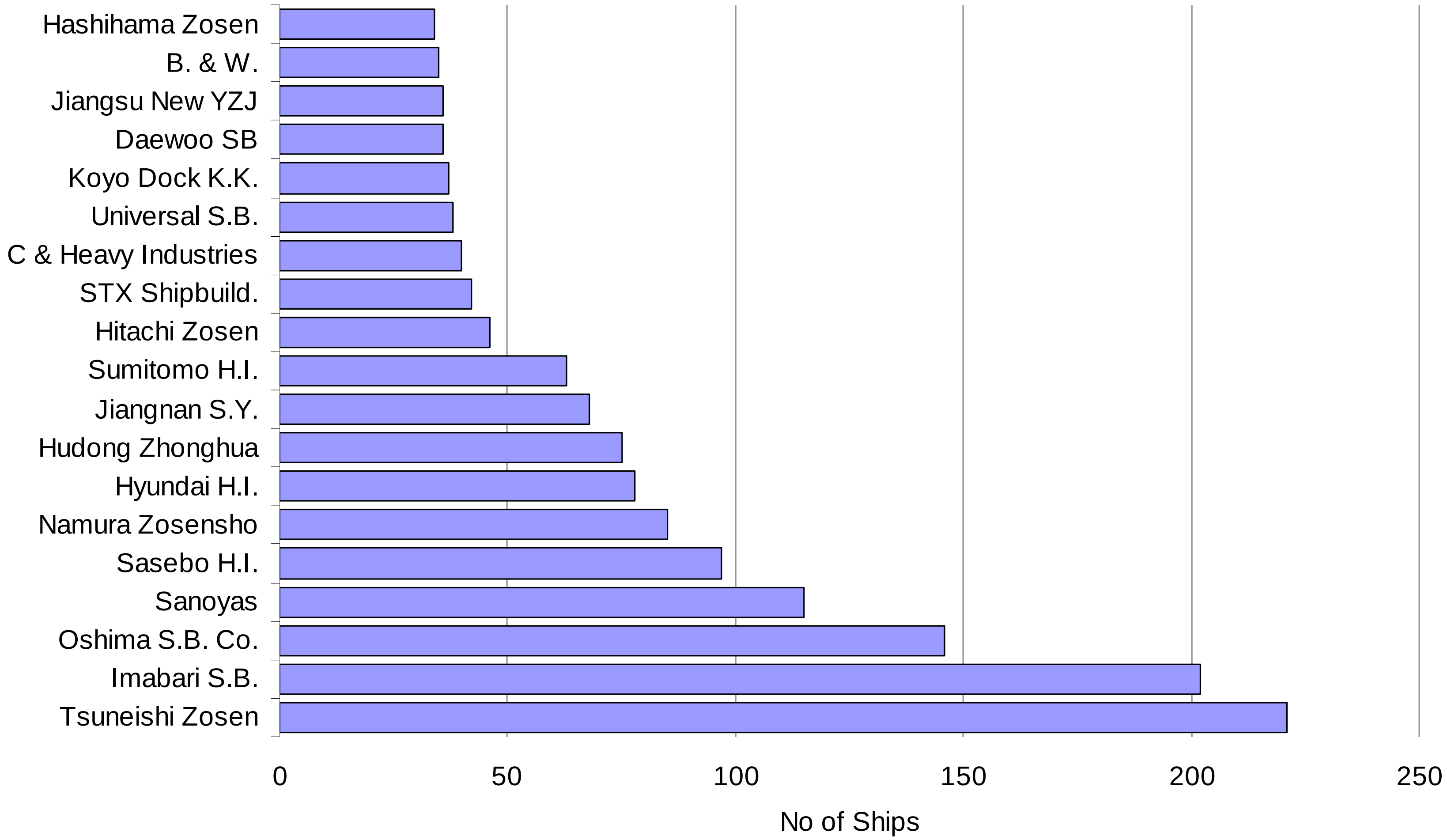
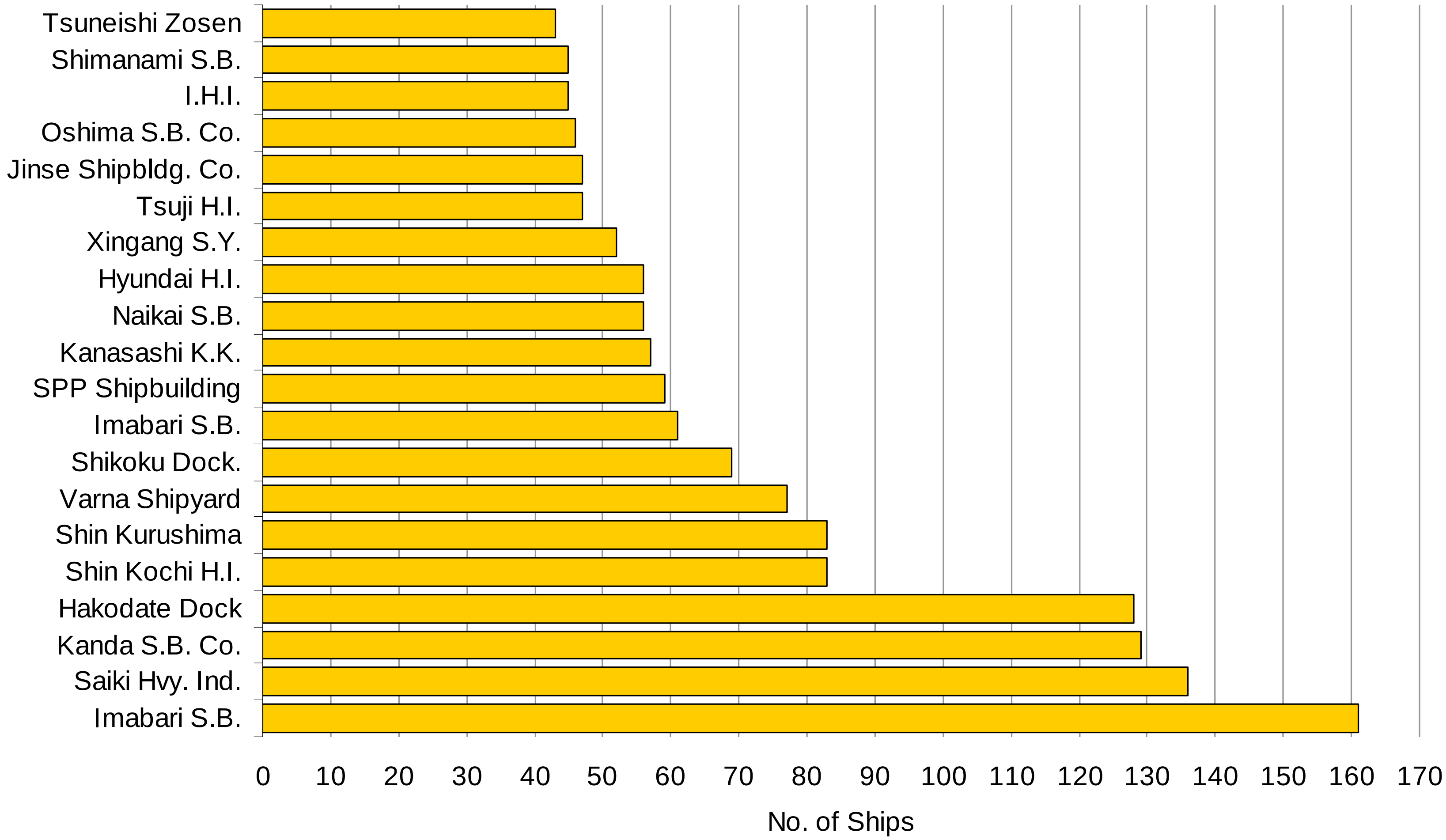
2008
2008nb
2009nb
2010nb
2011nb
2012nb
2013nb
2014nb


H'max/S'max Top 50 Builders
Qingshan Shipyard
Shanghai S.Y.
Iwagi Zosen
STX Dalian
COSCO Zhoushan
Chengxi Shipyd.
Imabari S.B.
Hantong Shipyard
Hyundai H.I.
Daewoo SB
Nantong Cosco KHI
Mitsui SB
I.H.I.
Kawasaki H.I.
Dayang S.B.
Sanoyas
Tsuneishi Cebu
Tsuneishi Zosen
Mitsui SB
Oshima S.B. Co.
0
50
100
150
200
250
300
350
No of completions

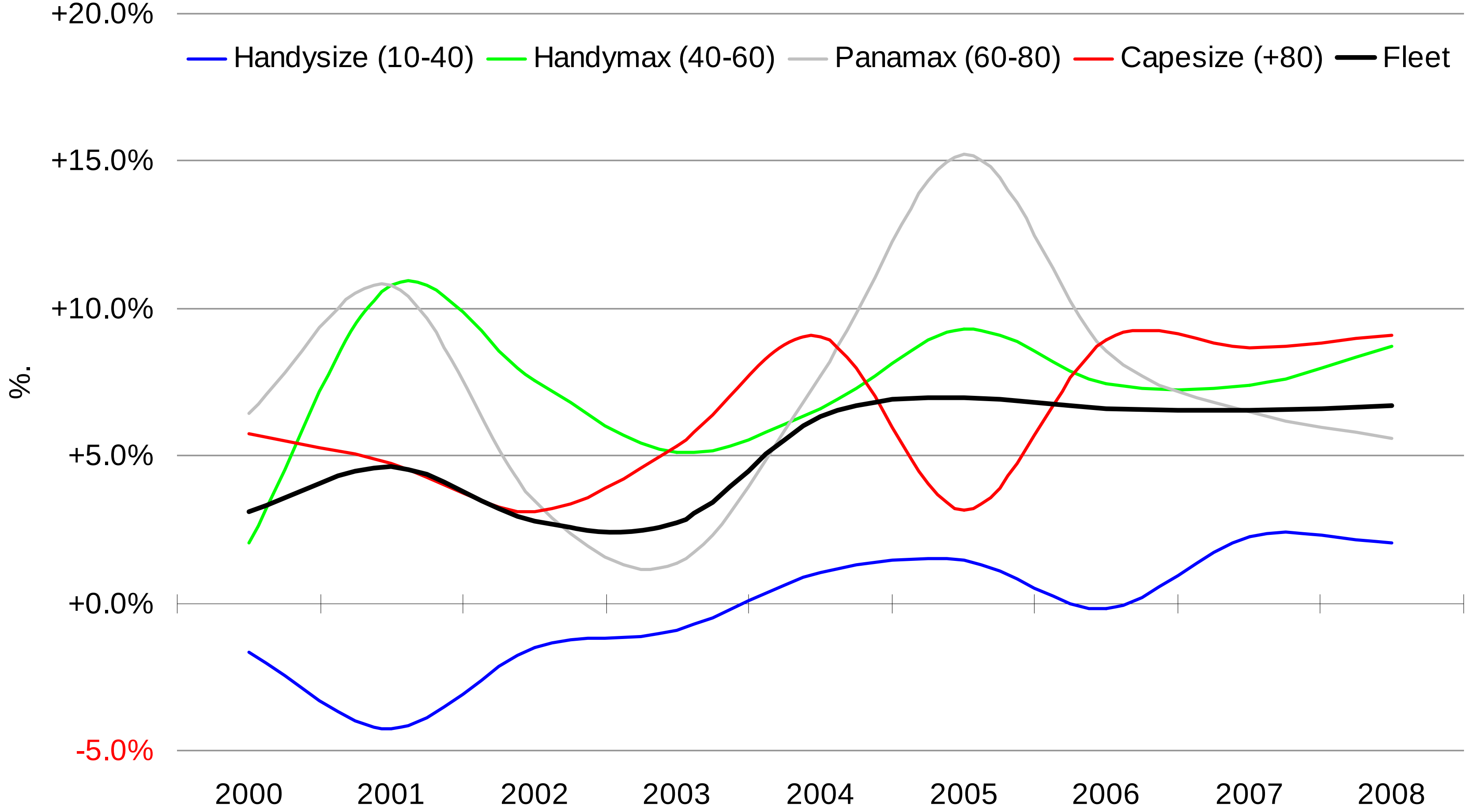
Top 20 Panamax Shipbuilders



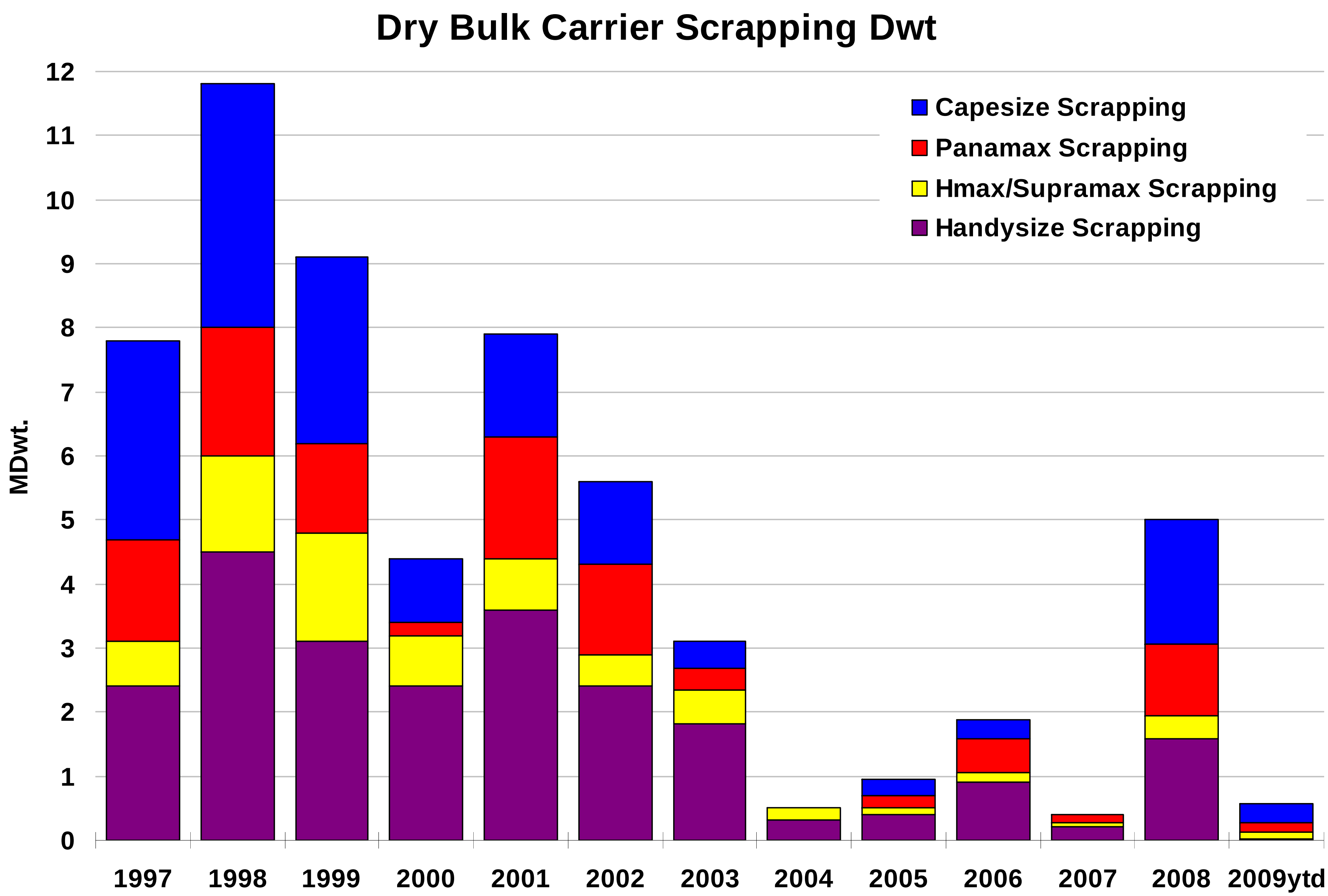
Handysize BC: Top 20 builders



BC Fleet Growth (Dwt) by Sector

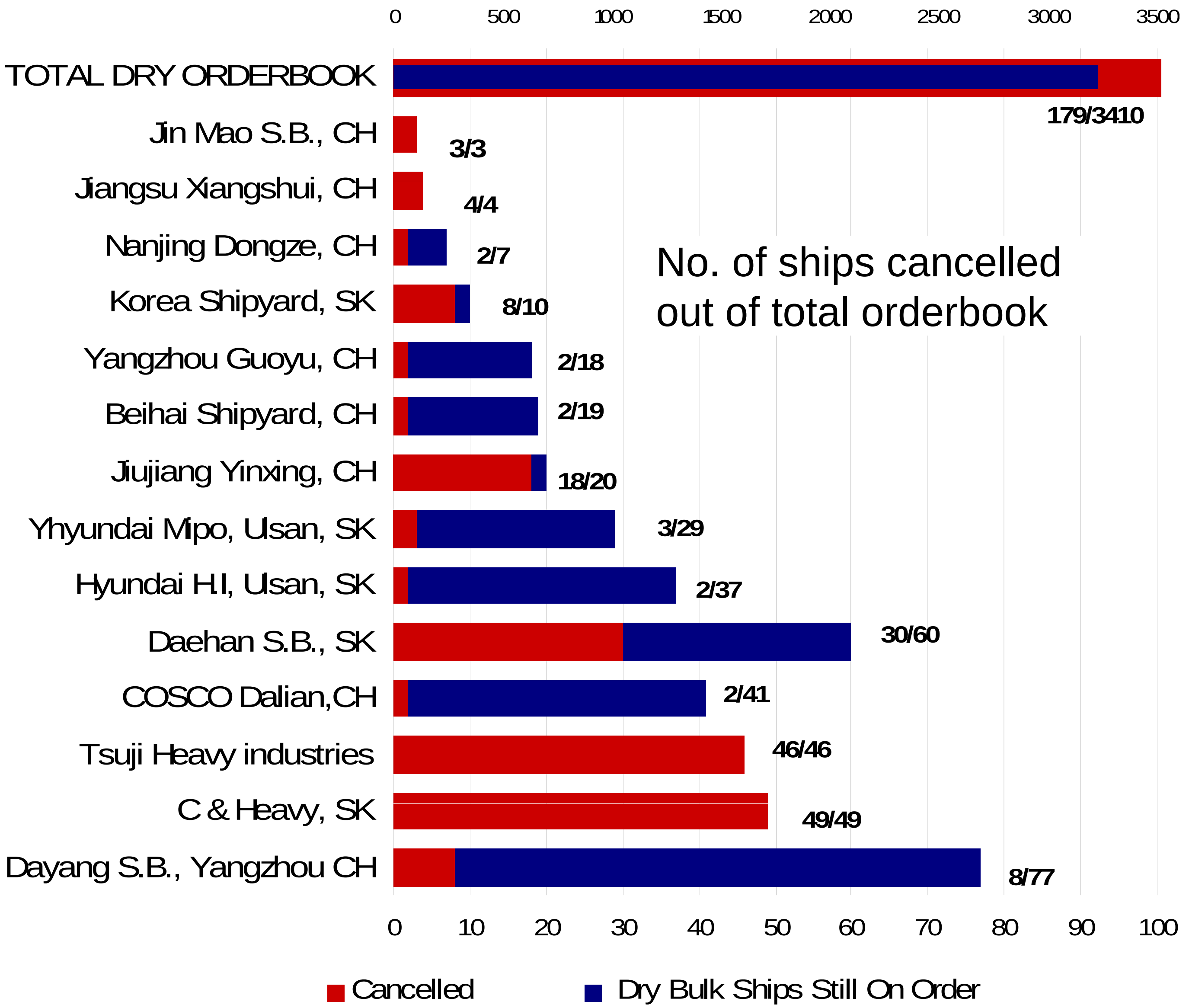


Scrapping virtually ceased in last five years



Cancellations: continuing to feed through daily

Links broken



Cancellations represent only a small proportion so far

Links broken