Oversupply of vessels to rule the market for at least three more years says analyst

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Dry cargo demand fundamentals are falling back in terms of offering proper comfort to ship owners and alleviate oversupply issues, as Chinese iron fixtures are on a downward trend with port stockpiles of iron ore, coal and steel being at elevated levels.

According to Maria Bertzeletou, Analyst of Research & Valuations Department with shipbroker Golden Destiny, tonnage oversupply will most probably remain a headache for owners for another three years, since demolition activity, though elevated in recent months isn't enough to ease pressure on freight rates. Following is the full interview arranged by Hellenic Shipping News Worldwide

Having entered the second quarter of the year, traditionally a high volume one for dry bulk trade, how do you see demand shaping up?

Nowadays, dry cargo demand seems to be not enough to balance with the hefty orderbook. Unpredictable events from the start of the year have impaired the demand side; floods in Australia, South Africa and Brazil, tropical cyclone hitting Queensland and the massive tsunami of Japan with radiation leaks. Nevertheless, the BDI still holds its pace even the accelerating supply growth. The first quarter of the year closed with the BDI average value standing at 1,365 points, down by 54% compared with the first quarter of 2010. The current fundamentals do not seem to offer a lot of comfort and alleviate the oversupplied issues. Chinese iron ore fixtures are on a downward trend with port stockpiles of iron ore, coal and steel being at elevated levels.
However, Chinese imported during the first quarter of 2011, 22.08 mt of iron ore more than the first three months of 2010 and the dry market may experience a record activity by the summer as Chinese and global steel production normally begins to see seasonal increases during this period. Furthermore, Chinese thermal coal fixtures are expected to increase by the end of May as ongoing maintenance to the Daqin railways continues to result in destocking at major coal ports, but the relative low price of domestic coal compared with international coal cargoes is likely to restrain the surge in imports. The demand for grain and minor bulk cargoes is going to remain at relevant moderate levels allowing smaller size vessels, supramaxes and handysizes to find more support than larger size vessels along with the lift of Karnataka iron ore exports' ban by the end of April.
Overall, China's gross domestic product increased 9.7 per cent, down slightly from 9.8 per cent growth in the fourth quarter of 2010, but still faster than most economists had predicted. The hefty port stockpiles have started to reduce the last 5-6 weeks, which provides more support for a stronger second quarter. Even though there are grounds to feel that the demand would be shaped at firmer levels as we entered the second quarter, the dry sector still faces significant vessel supply-related pressure and only if Chinese commodities' demand surpasses previous year levels there would be a good resistance from the demand side against BDI falling below the 1,000 points mark.

How has the Japan disaster affected freight markets so far? Do you see further repercussions and how will they impact freight rates in the coming months?

After an 8.9 magnitude earthquake and consequently a tsunami hit a large and industrial part of Japan, about 180 miles north of Tokyo on March 11th, the dry market undoubtedly has experienced a constant fall with the BDI hovering below the 1,500 points mark. Larger size vessels, capesizes and panamaxes have seen the biggest losses with time charter earnings lingering below $8,000/day and $14,000/day respectively. However, we feel that the natural disaster of Japan is not the only cause for the downward spiral of the freight market, but a string of all the aforementioned events. The demand side has been

fragile from the beginning of the year and the natural disasters have worsened even more the overall status. Although the disruptions on cargo demand we believe that the catalyst factor of today's recession is more the supply growth rather than demand contraction. The supply side has been damaged during the period 2004-2008, with frenzy newbuilding activity in the years of 2007 and 2008, and the shipping market seems that still has not paid the sins of the past.
The radiation leaks from the Fukushima disaster, one of the largest nuclear plants of Japan, has hit trading activity and put limits on Japanese food shipments. There are ongoing worries for the future of the world trade after the latest announcement from Japan raising its assessment for the accident at the Fukushima to the most serious level on a 7-step international scale, equivalent to the 1986 Chernobyl disaster. Even though the side effects of the natural disaster may currently seem bleak, the long term prospects are more promising for the outlook of the shipping industry in terms of imports and exports of raw materials. Japan is a big economy and its importance in the world trade and economy is vital with big macro economic impacts that could derail worldwide recovery.
Expectations suggest that a robust demand from Japan will drive the dry and wet market at higher earnings once the reconstruction begins. In the wet market, the immediate effects of the earthquake are likely to cause a drop in oil demand, but on the long run the disruption of Japan's nuclear power plants could spur demand for LNG, petroleum and crude imports for energy consumption at higher than those seen in earthquake, as Japan is the world's largest oil importer, behind US and China, and the top importer of thermal coal and LNG. Approximately there are 55 nuclear reactors in Japan and roughly a third of Japan's electricity is normally derived from nuclear power. Currently, there is no any time frame for when Japan's nuclear reactors will come back online. The Fukushima Daichi nuclear power plants that will be closed for an indefinite period of time, is Japan's fourth largest nuclear power plant and has an installed capacity of approximately 4,100 megawatts. More than 30% of Japan's refiner capacity, or 1.4 million barrels per day, has been shut down, although some capacity could return according to agencies report. This has forced Japan to sell crude oil that it cannot process into refined products and import products that are in deficit, such as diesel and gasoline.
In the dry market, reports of five steel mill closures in Chiba, Heihin, Muroran and Kimitsu will likely reduce iron ore imports by as much as 20-25m tones and coking coal by 10m tones. While ports remain closed and the current impact on dry bulk commodities' demand appears negative, it is expected that once ports reopen and the country begin its restructuring will result in increased chartering activity, since Japan is the world's second largest customer for dry bulk commodities after China. The reconstruction of Japan will stimulate the demand for steel, iron ore and coking coal and increase the imports for the two main dry commodities of trade growth, iron ore and coal. Capesize demand will be the biggest beneficiary, whether the additional steel demand will be met entirely by Japanese production or partially by China, Korea and/or Taiwan. Finally, the anticipated increase of Japanese demand for LNG will bring new employment opportunities for gas carriers as LNG imports are likely to climb in the near future to cater nuclear outages.

Are the floods in Australia, in the beginning of the year still impacting the dry market and to what extent?

The natural disaster of Japan seems that didn't stimulate the same fall in the dry market as the flooding in Queensland. The dry market experienced, since the collapse of Lehman Brothers, one of its worst plunges in January, as the BDI was flirting with the 1,000 points barrier. The index from 2,995 points in September 2010 dropped to 1,043 points on 4th February 2011, the lowest since the bottom lows of December 2008 at 663 points. The damage is estimated to be enormous, one of the worst floods in Queensland State for the last 40 years, with coal exports being one of the biggest casualties. The floods may have cost coal producers, including BHP Billiton Ltd., Rio Tinto Group and Xstrata Plc a $2,3 billion in lost sale.
It is true that the dry market has not found its pace from the floods in Australia, but we have to say once more that there is a series of other significant factors that hamper the full rebound of the index above the 1,500 points mark and its increasing trend towards the 2,000 points level. However, Australia has not still fully resumed its supplies for iron ore and coal, which distresses even more the already oversupplied dry market and the fragile demand side. According to the Australian Bureau of Statistics, February trade data showed a 17% y-o-y decline in coal exports to 17.2 mt, the lowest monthly volume since February 2010. Meanwhile, Australian iron ore exports fell in February to a 2 year low of 28 mt, down 16% m-o-m. As Australian export volumes continue weak and iron ore / coal prices remain at their current highs, Chinese seem that are not buying and therefore imports are floating at low levels. Australian iron ore exports, which accounted for 40.8% of 2010 iron ore volumes, are currently estimated to be 30% lower than last year's levels as a result of damage to the mines and transportation infrastructure from the recent q4/q1 flooding and weather damage. The weak export volumes continue to pressure the Pacific market and have flooded the Atlantic with available tonnage. Restoration of the infrastructure and mines in the second quarter could help increase exports and lower iron ore prices. Unless Australian export volumes resume at substantial levels, it is high likely that the dry market will not experience a substantial increase in rates especially for capesize and panamax tonnage, as the currently stockpiled Chinese iron

ore is around 79.85 million of tons close to the all time high of 81.1 mt reached in late February.

During the past few weeks we've witnessed a slight retreat in terms of new building ordering for dry bulk vessels, with the opposite occurring in the container sector, which seems to have been returning to shipyards. Do you believe that as we move forward we'll see fewer orders for dry bulk carriers? Why have owners turned to container ships?

During 2010, more than 280 kamsarmaxes estimated to have been ordered, holding around 26% of the total number of bulk carriers reported on order (more than 1,500 bulk carriers reported to have been placed by Greek and foreign investors in Chinese and Korean yards). The continued growth on the dry market supported by solid Chinese demand, spurred positive market sentiment and pushed the ordering activity in the bulk carrier segment at remarkably high levels after the low levels of 2009. The trend towards the kamsarmax segment was frenzy given that the already oversupplied capesize and panamax segment seemed to be an old fashioned investment. Thus, bulk carriers proved to be the most popular vessel type for ordering in 2010 with containers being left in the last rankings.
However, the remarkable rebound in the container segment after the 2H of 2010 due to carrier's discipline on supply side, via the slow steaming policy, postponement of new vessel's deliveries and laying up of fleet, changed the scene. 2011 begun with a negative sentiment in the bulk carrier segment after the severe flooding in Australia and ordering activity seems to have been on a downward trend. During the year to date, 149 bulk carriers estimated to have been ordered, down by 16% compared with the 1q of 2010, with kamarsmaxes orders being around 28, placed mostly by foreign investors and less by Greek owners. On the other hand, container orders evolve week by week to even more fashionable investment as the short term prospects are not so comforting for the dry players and the BDI struggles to stabilize above the 1,500 points mark. During January-March 2011, more than 70 containers estimated to have been contracted, when at similar period in 2010 only 19 units reported on order. There has been also a movement of a Greek listed company to switch its kamsarmax orders to panamax containers. The switch of newbuilding trend towards containers could be explained by the short term bleak outlook of the dry as the future prospects seem more promising in the container segment for the forthcoming 2-3 years. The revival of consumer demand growth on the back of government stimulus packages and restocking of inventories has lifted the charter market at higher levels from the bottom lows of 2008 and has boosted investor's confidence in the segment. As long as the consumer demand remains robust and the world economy will not experience another double dip on the short term, the container segment will experience again years of prosperity. On the other hand, in the dry market the heavy orderbook, more than 50% of the existing fleet for larger size vessels, and the relentless vessels' deliveries are going to distress the segment for at least the next two years. Containership ordering is highly likely that will continue to drive the newbuilding business for the rest of the year. The total orderbook has shrunk significantly and there is currently room for the newbuilding business to develop in the panamax and post panamax segments of 3,000-7,000 TEU size vessels. In addition, the demand from major liner operators for very big ships seems to be fairly firm in an effort to maximize their economies of scale.
We feel that as we move towards the second quarter of 2011, the ease of ordering activity in the bulk carrier and tanker segment will continue since the prospective buyers will realize that their interest will be more served by increasing their fleet with modern secondhand units instead of contracting newbuilding business that will lead anyway in increased volatility of freight markets. Nevertheless, it is anticipated that offshore vessels, gas tankers and containers will step in as most attractive segments for newbuilding business in 2011.

What about demolition activity? Will it be higher this year, compared to 2010, thus helping alleviate part of the pressure from the current oversupply of vessels?

Overall, the demolition business appears to follow an upward trend from the beginning of New Year, in terms of volume of transactions and scrap prices. Reported demolition transactions in the bulk carrier segment are on rise with capesizes being on the spotlight as the most popular scrap candidates, since they suffer the highest losses showing earnings near above or below breakeven levels. The first quarter of the year closed with 183 vessels estimated to have been headed to the scrap yards, equaling a total deadweight of 7,6 million of tons. During the year to date, bulk carriers seem to hold the lion's share of scrapping business, 35% of the total demolition activity, while general cargo follow grasping 23%.
Dry market's plunge has stimulated owner's decision for scrapping their overaged units, which has pushed scrapping business for bulk carriers 170% higher from January-March 2010. Scrap prices are hovering at robust levels from the end of 2010, with demo countries paying more than $450/ldt for dry and wet cargo, while Bangladesh's current opening may lead the market at levels excess of $500/ldt. However, if the dry markets' plunge becomes even more persistent with more and more vessels headed to the scrap yards of India and Bangladesh, the oversupply of ships available for scrapping may lead

eventual to a correction of scrap prices downwards.
It is worth mentioning that bulk carriers' demolition activity had showed again strong levels of growth during the first quarter of 2009, when 90 vessels had been reported for scrap with 74% of the total volume of demolition transactions being recorded in the handysize segment. During the year to date, 65 bulk carriers reported to have been headed to the scrap yards, equalling a total deadweight of 4,4 million of tons with capesizes being on the spotlight along with handysizes, holding 30% and 45% respectively of the total demolition activity.
The current demolition trend is towards more to bulk carriers and general cargo, whilst in the tanker segment scrapping activity is down by 62% from the first quarter of 2010. In the bulk carrier segment, there is definitely a lot of room for more scrapping business to be evolved in the future due to the excessive number of vintage tonnage. Preliminary data statistics reveal that the existing fleet of overaged bulk carriers, more than 25years old, surpass the 1,400 vessels.
Overall, scrapping business will probably linger at the strong levels of 2010 & 2009 and may even be at higher levels than those seen in 2010, if bulk carriers' demolition transactions continue at the current high pace. 2011 seems to close at higher levels of scrapping activity for dry vessels than those seen during 2009, provided the BDI continues its constant fall and capesizes earnings hovering below breakeven levels.

Speaking of oversupply, how are deliveries been progressing so far in the year?

On the newbuilding front, deliveries are accelerating with some reports indicating that 5 vessels hitting the water every day, whilst others report that one cape is being delivered every other day. There is likely to be an oversupply of ships for at least the next three years given the thirst of China for more orders, in order to transport its raw materials, and the fact that ongoing deliveries are scheduled till 2014 with bulk carriers' orderbook estimated to be almost 50% of the existing fleet. Bulk carriers' orderbook is the most hefty comparable with tankers and containers, and during 2009 a lot of renegotiations for delayed deliveries took place that now seems to come into the surface. Bigger ships are the ones to suffer the most with "orderbook to active fleet" ratio being close to 60% for capesize vessels, 32% for very large crude carriers and 92% for large containerships above 8,000 TEU. Thus, the short-medium term challenge for the industry seems to be more the supply growth than the demand.
However, it is difficult to estimate with accuracy the extent to which the global orderbook has shrunk and even more difficult to make projections about the number of vessels that are going to be delivered or cancelled and the growth of the fleet in the coming years. The number of cancellations is not indicative factor and both yards and owners are extremely reluctant to make public the outcomes of the many negotiations that have taken place.

In terms of second hand ship purchasing activity, how have things evolved during the first quarter of the year? Are Greek ship owners still the leading force?

Despite the severe unrest in Libya and natural disasters that still influence the shipping environment, the secondhand ship purchasing activity for the first quarter has resumed at quite substantial levels with 298 vessels reported to have changed hands, equaling a total invested capital region $5,5 bn. Bulk carriers and tankers are holding around 60% of the total activity and containers 11%, in terms of reported number of transactions. The most overweight sector seems to be the tanker with a total invested capital region $7,2 bn. During the first quarter of 2010, the secondhand ship purchase activity was standing 35% higher from the current levels, since the buying trend for bulk carriers was 82% more intense than nowadays. It is true, that bulk carriers seem to have lost their popularity as the freight markets do not show signs of stability towards healthier earnings, especially for larger size vessels, and even though asset prices have been revised downwards there is still possibility for further correction downwards.
On the other hand, asset prices in the tanker sector seem to have reached their bottom lows, and tankers' buying trend stands at similar robust levels of previous year. Containers' secondhand purchase activity has indicated a slower pace given that asset prices have picked up from the bottom lows of 2009 and newbuilding units have turned into more popular investments. Overall, secondhand purchase activity for the first quarter of the year, in terms of reported number of transactions, lingers to the levels of the first quarter of 2009, showing 12% more intense buying and 62% higher invested capital. We feel that buying momentum may step in more aggressively from the second quarter and onwards as secondhand prices will be even more alluring with a lot of investment opportunities in the bulk carrier and tanker segment.
As far as Greek owners is concerned, 37 vessels estimated to have gone to Greek hands during the first quarter of the year, equal a total invested capital region $829 million. Their buying interest has been centered in the bulk carrier and tanker segment with containers still holding a large share of their activity. However, their buying activity has been on a low track since the beginning of New Year and they seem once again to adopt "the wait and see" approach for their future investments either in the

secondhand or newbuilding market. Their buying activity is estimated to be 40% down from the first quarter of the year, when 62 vessels had gone to Greek owners equaling a total invested capital region $1,7 bn. During the year to date, Greek owners seem to have lost their high pace of activity and being one breath behind Chinese owners, who have also slowed down their purchase plans. We hold an optimistic view that Greek owners will retrieve their purchase plans once the sellers face even more pressure from the freight market and their financiers making secondhand asset prices more in line with the freight market.
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