

European Shortsea Congress

# How the shipping industry is managing in the current downturn

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# Agenda

- Introduction
- Recent performance by sub-sector
  - Container carriers
  - Dry bulk
  - Tankers
- Current issues affecting the shipping industry
- Measures to be taken
- Concluding Remarks



# Introduction

## The King of crashes

“Shipping has got itself a global reputation as the super crashing market, in a world where there is tough competition for this title”

**“Cash is king and, despite the crash, shipping still has what it takes, so we have to wait a bit”**

Martin Stopford, Clarkson Plc



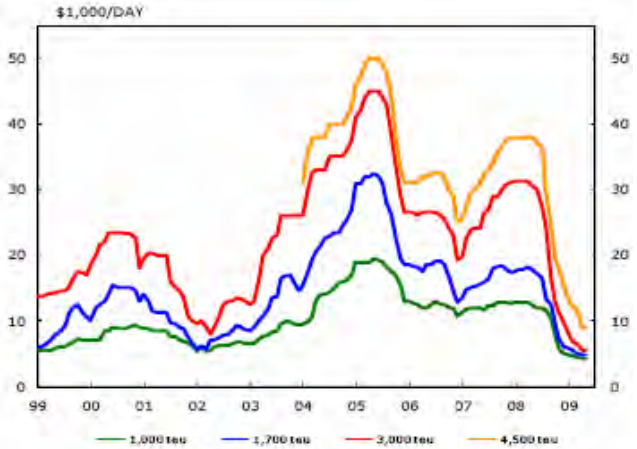
Recent performance by sub-sector

# Container carriers

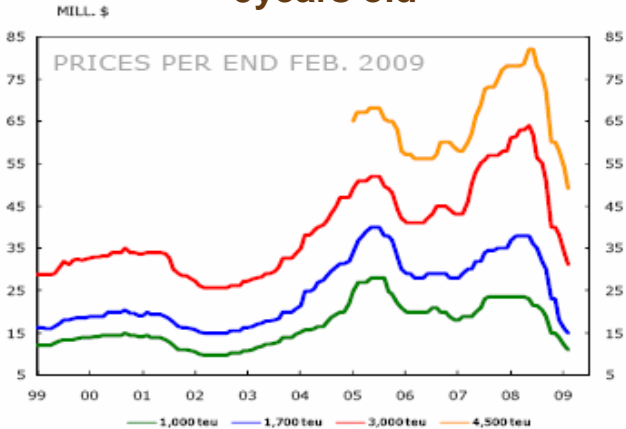
## The containership market has led the way into the downturn

- The first sector to experience the impact of the current crisis has been the container carriers since available credit in the market disappeared (initially experienced as an inability of companies to obtain letters of credit) and demand for consumer goods declined rapidly.
- As a result box charter rates shrunk across the spectrum of size ranges and, while a large number of vessels have been placed in lay-up, this has not halted the decline.
- Vessel values in the second-hand market have followed a similar trend as a result of the lower demand and new vessels being delivered from a substantial orderbook (currently at approximately 45% of the existing fleet by capacity).

### 12 Months T/C Rates for Container Ships



### SH Values Container Ships 5years old

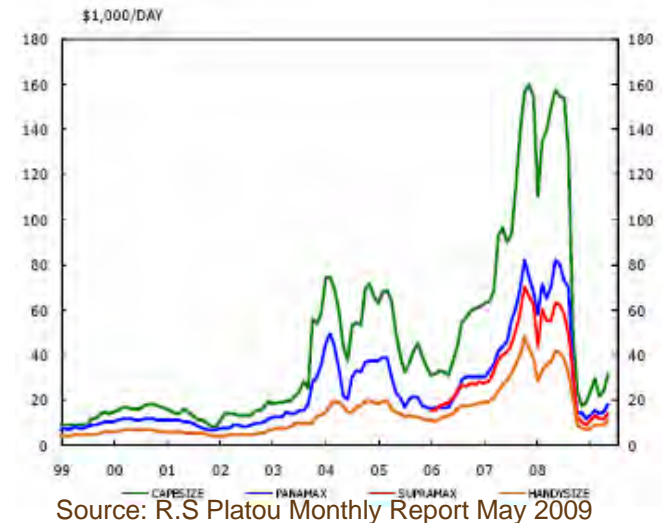


Source: R.S Platou Monthly Report May 2009

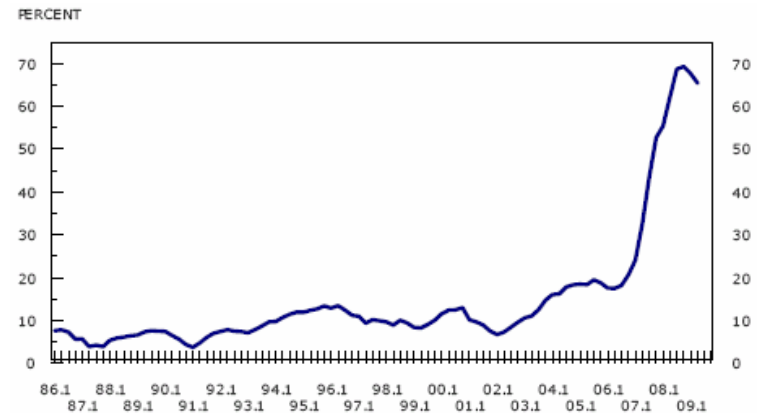
## Uncertainty & Volatility

- Year 2008 was the most volatile year ever in dry bulk shipping. The financial market collapse and lack of available credit in the market resulted in a dramatic drop in dry bulk freight rates which tumbled for all segments to just \$4-5,000 per day in the final quarter of 2008.
- Recently freight rates have shown an upswing, mainly for Capesize vessels. This is mainly a result of a strong Chinese activity in iron ore and coal imports. In other segments freight rates also rose but more moderately.
- The dry bulk sector built up a large order book over the last 2 years and currently stands at around 65% of the capacity of the current fleet having peaked at around 70%.
- In the current environment, it is expected that the number of vessels on order that will eventually be delivered will be significantly lower, mainly as a result of tight credit both from the owners' side and from the yards.

## 12 Months T/C Rates for Bulk Carriers



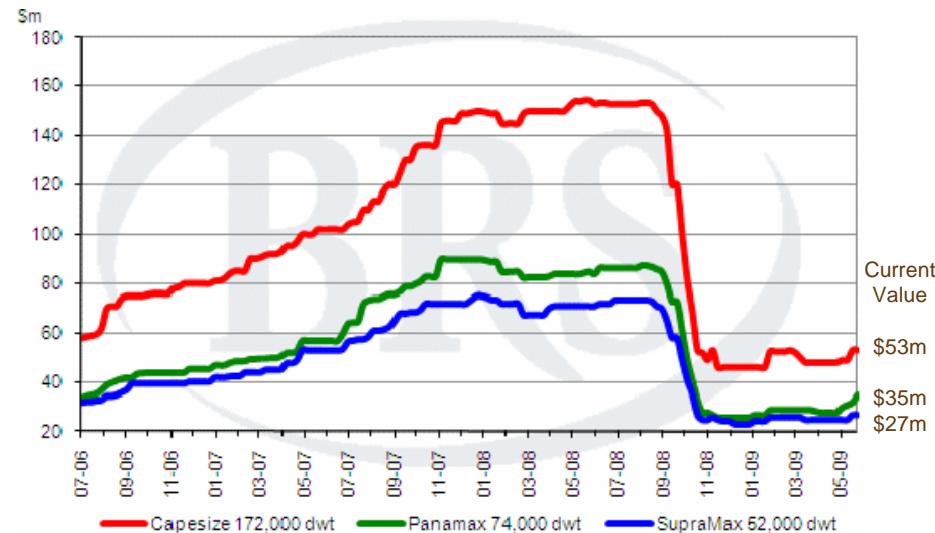
## Orderbook in Percent of existing fleet



## Second-hand dry bulk vessel values remain far from their peak in July 2008

- The sale and purchase market followed a parallel trend with the freight rates. From record high prices in June and July 2008, vessel values collapsed in the final part of the year.
- Ship-owners saw their equity evaporate, as the value of their fleets fell considerably, with declines exceeding 60% in some segments.
- Comparing the second hand prices from the end of July 2008 till end of May 2009, we can see that the price of a 5 year old Capesize dropped from \$155m to \$53 million and 5 year old Panamax from \$90 to \$35million.

### Dry Bulk Carriers Second Hand Prices 5 yrs old ships



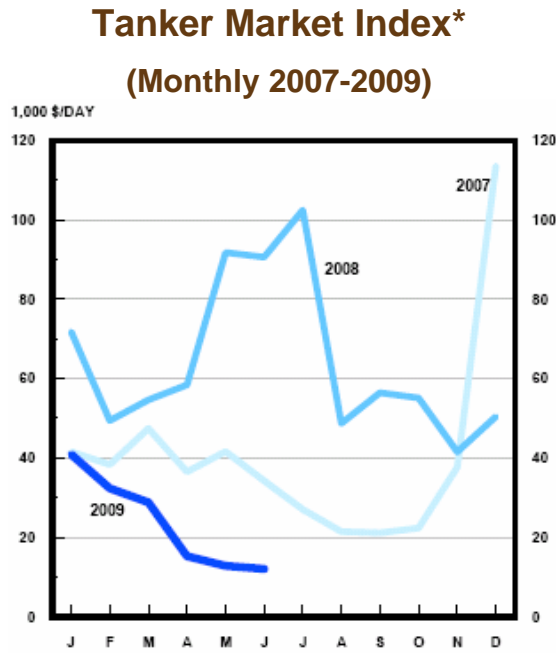
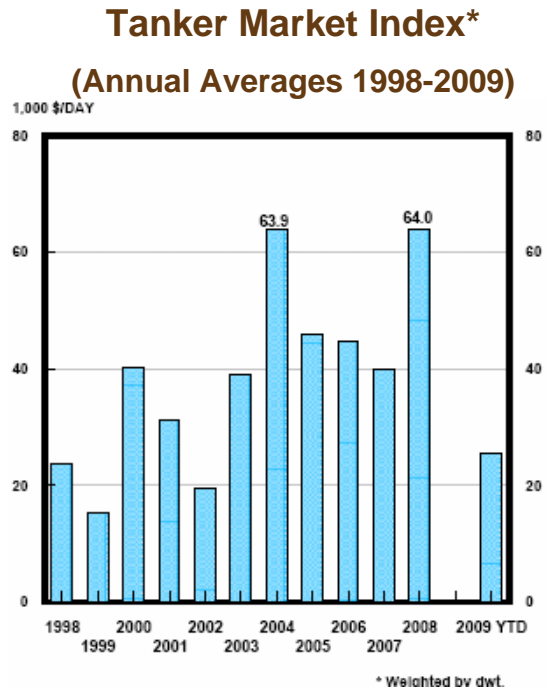
\* dwt = deadweight tonnes

Source: BRS

# Tankers

The tanker sector is now also facing the downturn, although it was the last to feel the impact

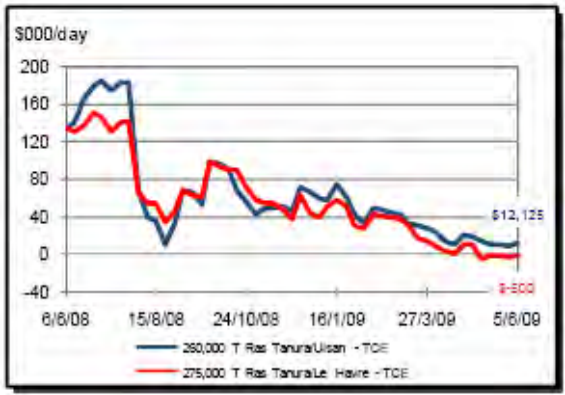
- With economic growth slowing down in key oil consuming regions, the IEA is forecasting lower global oil demand in 2008 and 2009, the first two consecutive years of demand contraction since 80's, reflecting the severe economic situation. This has, of course resulted in production cuts and although the contango in the market towards the end of 2008 kept some vessels employed as floating storage, its impact has now disappeared.
- The late months of 2009 proved to be difficult months for tanker returns with escalating bunker prices and softening rates conspiring to take returns in some trades to approaching zero levels.



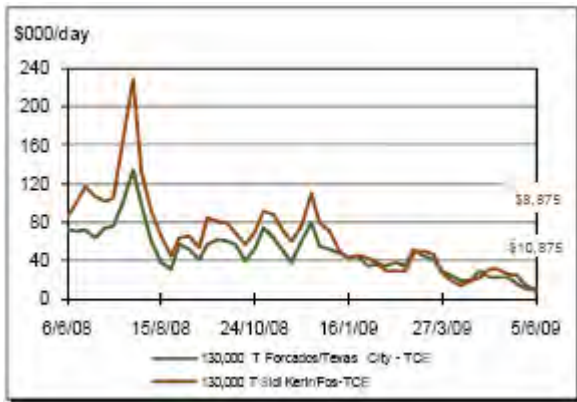
## Currently, crude tanker owners failing to breakeven

- Overall, 2008 was a good year for tanker owners with rates at historical high levels following three years of moderate rates (which lagged behind the peaks of the dry bulk sector in the same period).
- Current rates, however, indicate that 2009 will be a tough year for tanker owners and is likely to continue to be so for some time as a significant number of vessels on order are due to be delivered in the next 2-3 years, which will surely exceed demand.
- Although the tanker sector was the last to feel the impact of the economic crisis, it may also be the last to return to profitability.

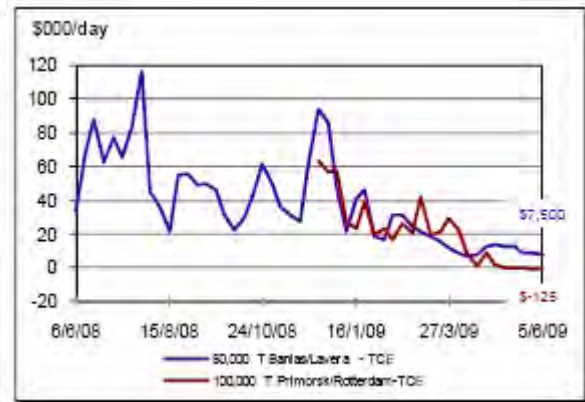
**VLCC Average Daily Net Returns**



**Suezmax Average Daily Net Returns**



**Aframax Average Daily Net Returns**



Source: BRS, June 5th

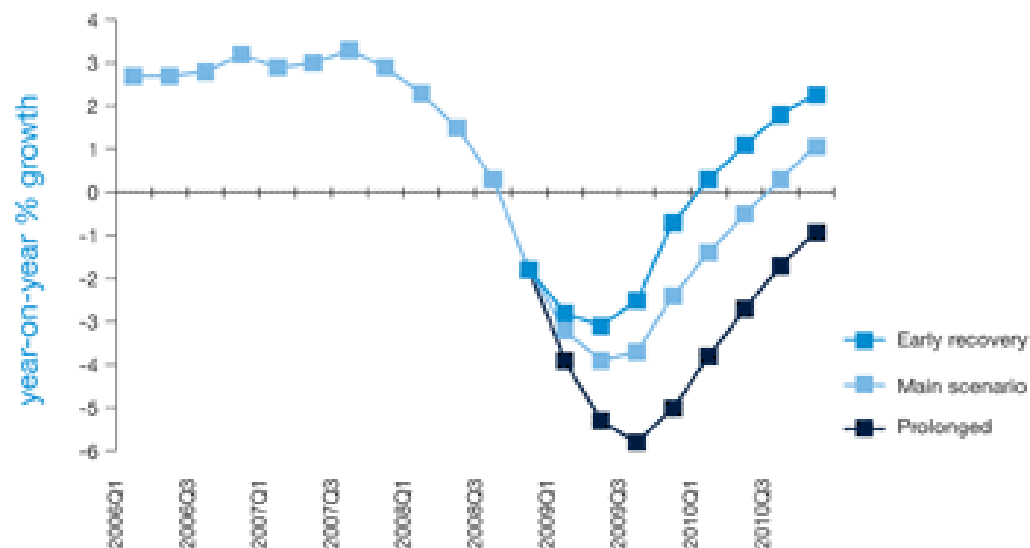
After three successive quarters of negative growth the UK continues to be in deep recession – with differing views as to how long it will last .....

### Summary of UK economic prospects

Indicator	HM Treasury forecasts (Nov 08)		Independent forecasts (Feb 09)		PwC forecasts (Mar 09)	
	2009	2010	2009	2010	2009	2010
	GDP	-1.25 to -0.75	1.5 to 2	-2.7	0.50	-3.25
Consumer spending	-1.5 to -1	1.25 to 1.75	-2.1	-0.2	-3	-0.75
Investment	-8.25 to -7.75	2.25 to 2.75	-9.6	-1.9	-11.5	-3.5
Man. Output	-3.25 to -2.75	1 to 1.5	-6.6	0.40	-8.5	-1.5
CPI (Q4)	0.50	2.25	0.40	1.80	0.50	1.75

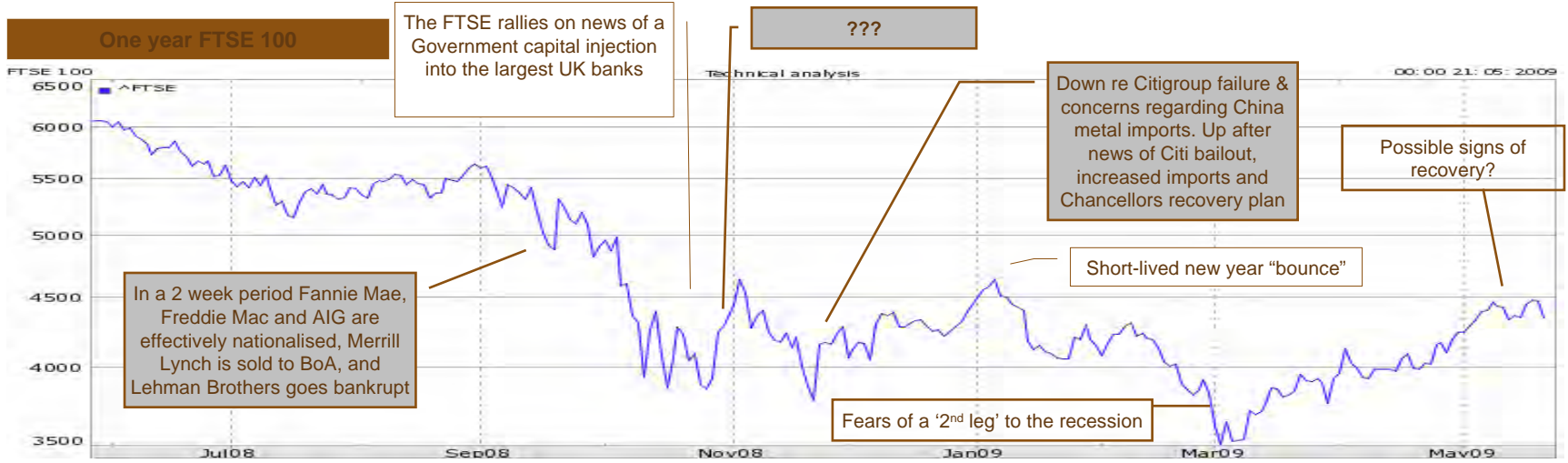
Source: Pw C economics

Figure 1.2 - Alternative GDP growth scenarios



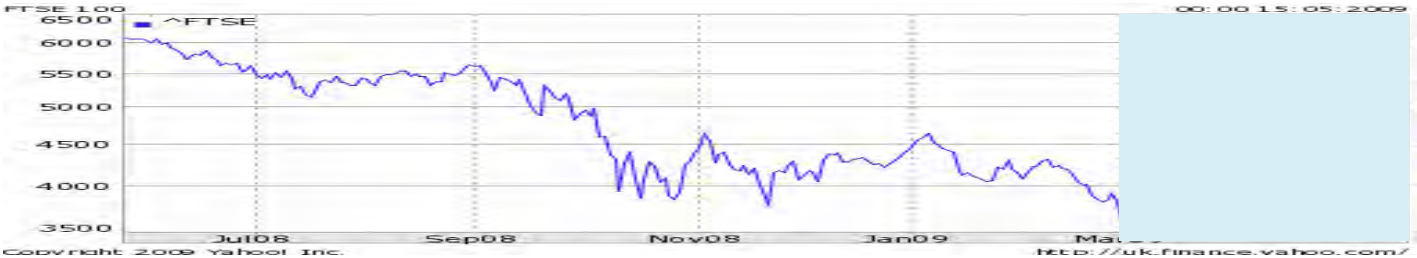
Source: ONS, PricewaterhouseCoopers

In early March 2009 the FTSE dropped to a six year low upon concerns of a more prolonged and severe recession, but are possible signs of recovery on the horizon?

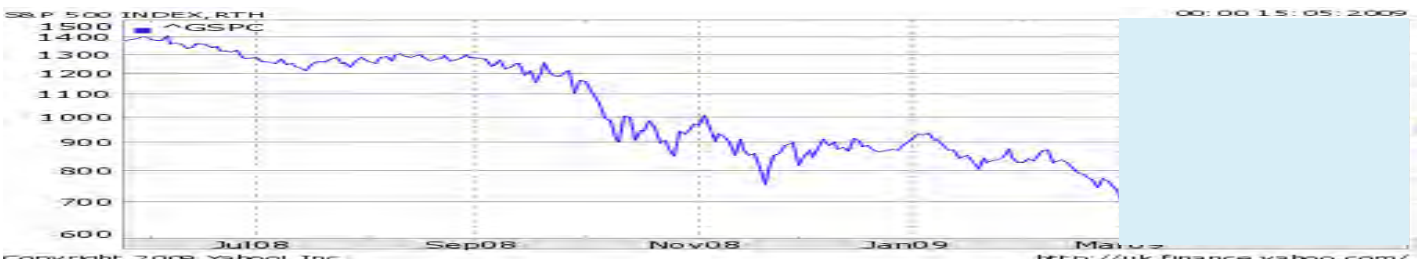


The worst of the economic downturn could be over...

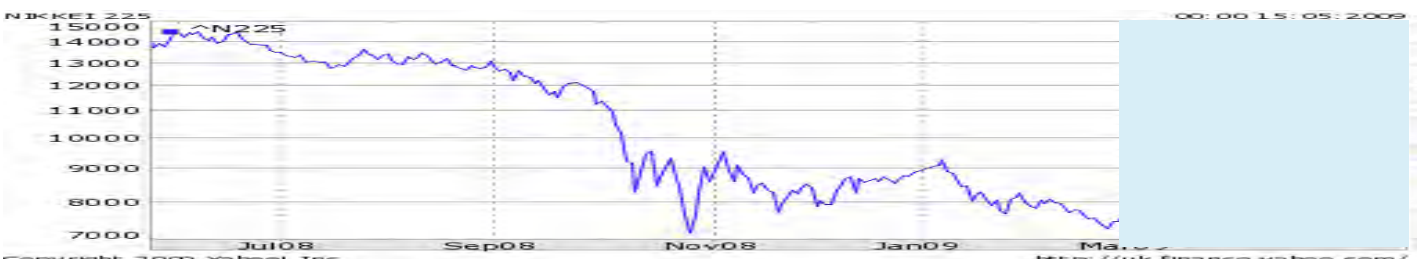
**FTSE 100**



**S&P 500**

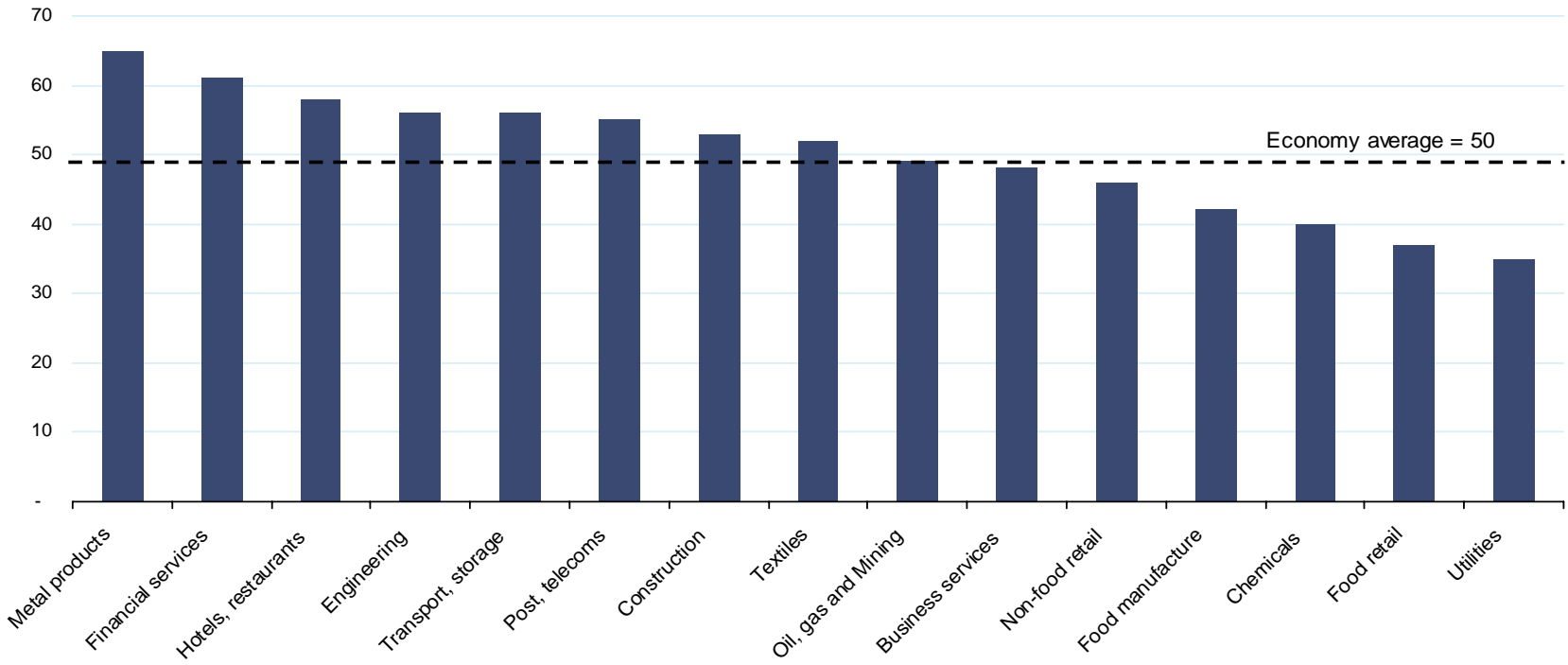


**Nikkei 225**



# Survival of the fittest - some sectors of the economy are more vulnerable than others but all will be affected to some degree by the downturn.

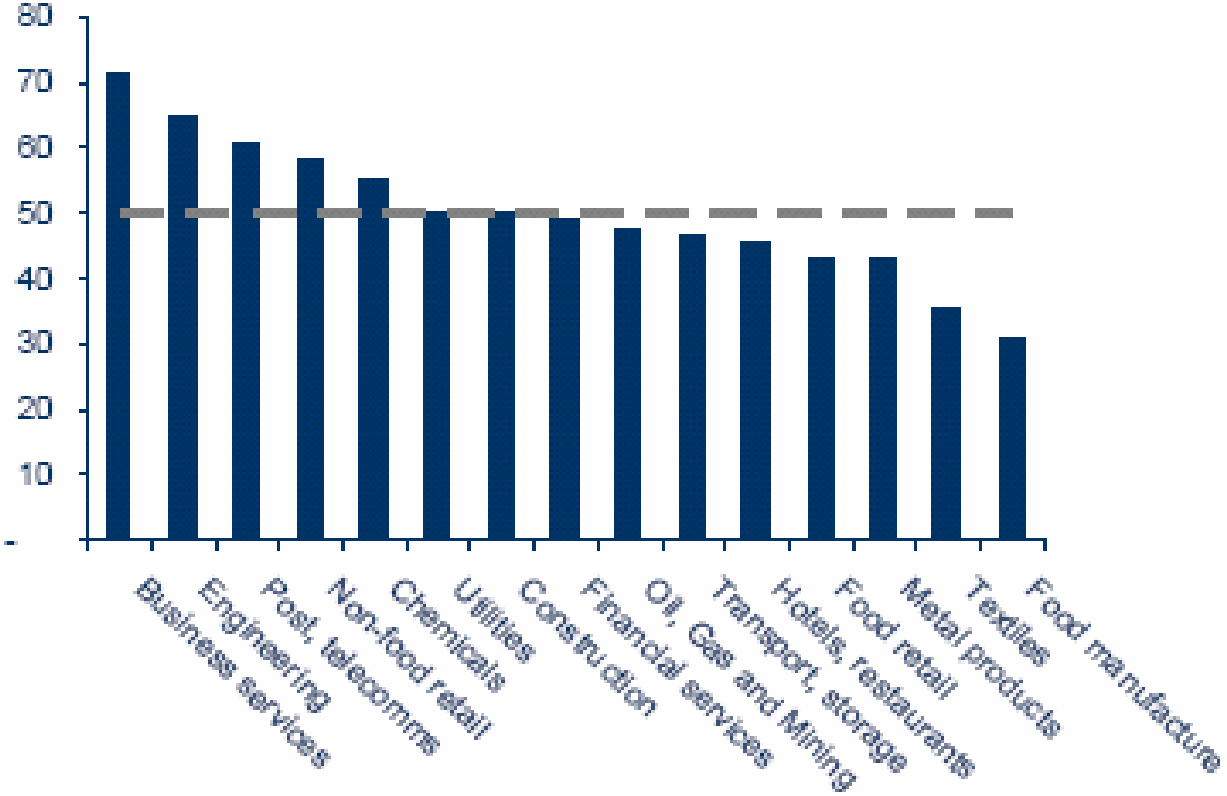
PwC Sector Vulnerability Index



Source: PwC analysis using data from ONS and Datastream

The PwC up-turn index suggests Business Services and Engineering sectors will be the first to benefit from the eventual up-turn

PwC up-turn index



Source: PwC analysis



Current issues affecting the shipping industry

The current market has given rise to several significant issues

### **Breach of loan to value covenants**

- The decline in vessel values across all sectors has resulted in numerous breaches of loan covenants leading owners to seek waivers and restructure loan obligations, often at much higher interest margins.

### **Poor financial performance**

- The last half of 2008 has proved to be very challenging directly impacting the bottom line. This matter was further impacted by impairment provisions taken on vessels (again as a result of value decreases). The current year 2009 is likely to be worse since the first half of 2008 was exceptionally good.
- Owners are focusing more on the bottom line and have all entered into cost cutting measures.

### **Cancellation of newbuilding orders**

- Tight credit and access to finance is forcing companies that failed to secure finance for their newbuilding programs to cancel orders. However, this may also be driven by economics if the price agreed with the yard greatly exceeds current vessel values.
- Some companies find it easier to walk away from contracts even if it means losing instalments already paid.

The current market has given rise to several significant issues

### **Cancellation/renegotiation of charterparty agreements**

- Some charterers that are locked into agreements at much higher rates than the current market have negotiated with owners to accept changes to their charterparty agreements while some have cancelled their contracts.

### **Significant increase in disputes**

- Inevitably the renegotiation of contract terms between yards/banks/charterers and owners has given rise to many ongoing and costly disputes that are testing the relationships between these parties.

### **Counterparty risk**

- With such dramatic changes in the economic environment, counterparty risk has increased significantly resulting in delays in payment of obligations and, ultimately, defaults.



Measures to be taken

## Measures to manage the downturn

- **Development and maintenance of robust financial forecasts**
  - Availability of timely and accurate cash forecast information aligned with the business strategy
- **Integration of risk management to the financial forecasts development process**
  - Identification of key forecast risks and development of appropriate responses
  - Formalized risk assessment process
  - Perform sensitivity analysis based on key variables
- **Maintenance of adequate available sources of liquidity**
  - Companies will need to secure that adequate funds are available to address liquidity requirements
  - Identification of ways to preserve cash and of tapping available sources of capital
- **Aggressively managing cash flows**
  - Cost containment and discipline over capital investments and capital expenditure
  - Reduction of daily running costs by improvements in centralized procurement and better use of technology and business process outsourcing

Measures to be taken

## Measures to manage the downturn

- **Assessment and monitoring of credit exposures**
  - Exercise of tight credit control policy
  - Assessment of counterparty risk associated with financial position of counterparties and existing contract terms
- **Building public trust**
  - Act responsibly and proactively
  - Be transparent



Concluding Remarks

There are many more challenges ahead. Acting quickly and responsibly can make a difference!

- The shipping boom of recent years led to significant returns and generated substantial wealth. This may have shielded some companies in the first few months of the downturn.
- As time goes by, companies with liquidity problems will likely fall victim of the current market which could cause a domino effect as counterparties will fail to meet their own obligations and seek to secure recovery of monies owed to them.
- This is the time for Boards and CFOs to be proactive and make a realistic assessment of their companies' position early on, so as to address possible situations that may create issues going forward.
- Companies that are well positioned financially are expected to be on the lookout for potential opportunities. Any proposals to such companies need to be carefully structured, be based on strong fundamentals and have a clear strategy on how potential risks can be addressed.
- The right investment made at the right time at the right price can boost stakeholder returns and form the basis for long term growth and prosperity.
- Either way, management is being put through the test and only the well prepared will steer their companies away from harm's way and set course to exploit opportunities that lie ahead.

Concluding Remarks

Thank you!

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