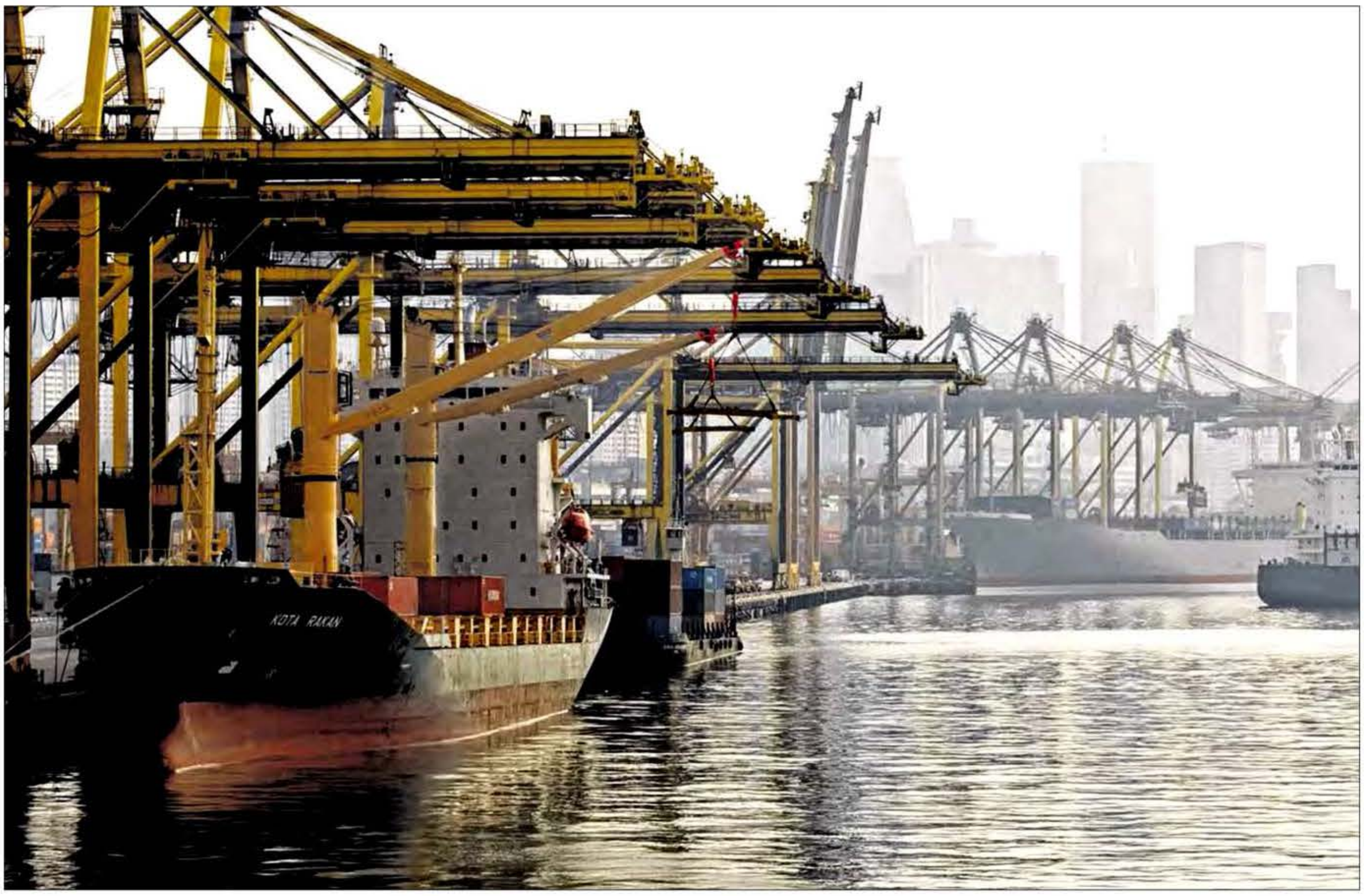
Publication: The Business Times, p 16
Date: 19 May 2014
Headline: A layman's guide to the shipping industry



All at sea: *Ships remain loaded with 90 per cent of the world's transported goods, and there would be no world trade or commerce without ships.* PHOTO: BLOOMBERG

A layman's guide to the shipping industry

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THERE would be no world trade or commerce without ships. Ships of various stripes and uses have been around for thousands of years. Even shipping's faster cousin – air transport – has been unable to usurp sea transport as the largest carrier of cargo; ships remain loaded with 90 per cent of the world's transported goods.

Vital as shipping is to world commerce, it is an ancient mercantile trade that comes with a web of customs, jargon and particular economic dynamics that may daunt a layman hoping to understand the industry.

There is an upside to untangling the mess: A basic understanding about merchant shipping can give insight on the trajectory of the recovery of world trade, consumption patterns of commodities, and the dynamics of one of China's core economic drivers, its shipbuilders.

Few other industries except finance can claim to cover the global economy as comprehensively.

The barometer of the world economy

Ships, by virtue of the fact that fixtures for cargo happen every day and its ubiquity in shipping cargo, provide an almost real-time reading of the fluctuations of consumption and trade in the world economy.

The most widely observed index in shipping is the Baltic Dry Index (BDI).

Published by the Baltic Exchange in London, it functions as an indicator of the ups and downs of the price of shipping raw materials by sea.

The BDI is based on international shipbrokers submitting current freight costs for four different sizes of bulk carriers and different types of commodities.

Investors, brokers and traders alike look religiously to the BDI to provide an almost real-time reading of the fluctuations of consumption and trade in the world economy.

On the other hand, the BDI has also been criticised for inaccurately capturing factors extraneous to macroeconomic activity such as local government ship-loading policies.

Container indices have emerged as alternative readings of trade patterns, as new markets began to blossom economically.

For instance, with a rising middle class in the African continent beginning to demand a higher standard of life, containerisation of durable goods from export markets such as China and South Korea have been on the increase as well.

The Shanghai Container Freight Index has thus become a guide to the ebb and flow of trade between these emerging economies.

Post-2008 oversupply and the stock market

Attuned as it is to the supply and demand patterns of consumption and export, the shipping industry struggles with its own supply-demand mismatch of ships to world cargo.

The inherently cyclical industry has roiled many a listed shipping stock because of the great difficulties in timing the ordering, building and delivery of ships with the boom times in freight.

The most dramatic downturn was only six years ago.

This was precipitated by – but by no means caused by – the global financial crisis.

A perfect storm of events had been brewing since the turn of the millennium.

Starting in the early 2000s, ship supply was extremely tight. Accordingly, rates shot through the roof.

This sparked off an ordering frenzy among the ship owners.

When demand sharply shrank at the time of the global financial crisis, a chain of ugly consequences ensued.

What was once an undersupply of ships morphed into a nightmarish oversupply, defaults and write-offs.

The impact on shipyards

The downturn rippled through the shipbuilding industry triumvirate: the Chinese, South Korean and Japanese shipyards.

These titans were reaping rewards from the boom years from 2004 onwards since charterers and owners were keen to cash in on the sky-high charter and sub-charter rates and rushed to order ships.

The yards, in turn, charged a premium as slots in their yards filled up.

Expansion plans were in full swing, and many yards mushroomed across the Chinese coast.

For a while, their order books were healthy and growing, helped by shipping banks' lax borrowing requirements.

The shipyards sometimes doubled up as financiers.

The global financial crisis changed the dynamics quickly.

Owners and charterers started to cancel their existing orders and shelved their own fleet expansions.

The shipbuilders also scrambled to find buyers for these ships and had to find ways to boost orders, dangling financial incentives and re-jigging their ship designs to be more eco-friendly and fuel-efficient so that new buyers would bite.

Given that Chinese shipbuilders employ a large workforce, the order slump was greeted with great alarm.

Lay-offs and yard closures were necessary for the recovery of the shipping industry, but was also an issue that had to be sensitively and actively managed by the state lest it faces the problem of an army of out-of-work yard workers.

Of interest to Singapore investors are the measures implemented by Cosco Corporation and Yangzijiang Shipbuilding, two large China-based shipbuilders listed on the Singapore Exchange.

Their stock prices took a hit as a result of the shipping crisis.

In order to maintain their bottom line and attractiveness, they began to seek alternative means of revenue by getting into high-return microfinancing, property development and marketing of eco-ships.

Only time will tell how their fortunes fare.

The downturn and the container industry

The container industry, a main component of cargo shipping, mounted one of the most surprising responses to the downturn.

Usually when a supply crisis hits, shipping companies would alleviate the oversupply, either by laying up or idling ships on open sea or sending older vessels to the scrapyards.

However, this time around, container lines began to commission the building of not merely more ships but mega-sized ships – effectively increasing, rather than decreasing, capacity.

These were controversial measures that sparked great concern that the shipping industry was merely entrenching itself in a never-ending competitive ordering spree that would further delay recovery.

But boards of many container lines insisted that these giant ships would help reduce costs for container lines as soaring fuel costs were a major reason for their lack of profitability.

Singapore listed shipping trusts and lines such as Neptune Orient Lines and Rickmers Maritime were part of the pack of companies who opted for larger ships.

The final scorecard on this measure has yet to be determined since more of these ships are still coming on stream.

The effects are already being felt: Ports around the world have had to invest in changing their infrastructure and deepen their harbours to accommodate these larger and heavier ships.

Container lines are starting to merge, bringing glimmers of hope of a more robust and sustained recovery in one of the most competitive and essential parts of the shipping industry.

The long view

The recovery of the shipping industry has been uncertain and sluggish. The volatility of shipping stock prices and their quarterly performance have spooked many investors.

Yet, considering that mercantile shipping has had unbelievable longevity in trade, the headwinds are ultimately transient.

One must not forget that the very long view has to be taken if one wishes to dig into shipping investments.

More than ever, it is necessary to keep an eye on the indices and rates, and another on market consolidation and measures.

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Containers, bulk carriers and tankers

THREE main categories of merchant ships exist today.

Bulk carriers convey unpacked commodities and are typically built to convey "wet" products such as oil or chemicals, or "dry" bulk such as grains or ore.

Bulk carriers are often identified by shorthand names ending with the suffix "-max". Examples include Panamaxes or Suezmaxes. These merely describe the size of the bulk carriers as some ports like the Suez Canal or the Panama Canal require ships to conform to certain dimensions in order to pass through these channels.

Container ships may also carry commodities but in packaged formats.

Cargo is packed into twenty-foot long or forty-foot long metal containers that are lifted on to container ships (also known as "box ships" for that reason).

Container ships have become a favoured form of shipping goods because of the container's flexibility in storing any type of cargo or goods, so long as they are packaged.

Sizes of container ships are often identified by the number of boxes that they can carry on board fully loaded. Thus, a 18,000 twenty-foot equivalent unit ship is simply a container ship that can carry 18,000 twenty-foot long containers worth of cargo.

Finally, **tankers** are specially built ships to store liquids or gases in bulk.

With the geopolitics of energy standing in the way of getting cross-border pipeline projects started, oil and gas tankers are the main means that populations living in areas removed from fuel sources get their power.