

## BIMCO market analysis: 31 May 2016

### The dry bulk market will become profitable in 2019, if ...

The dry bulk market could become profitable again in 2019 – but only if a series of extremely tough and sustained measures are taken by shipowners, year on year.

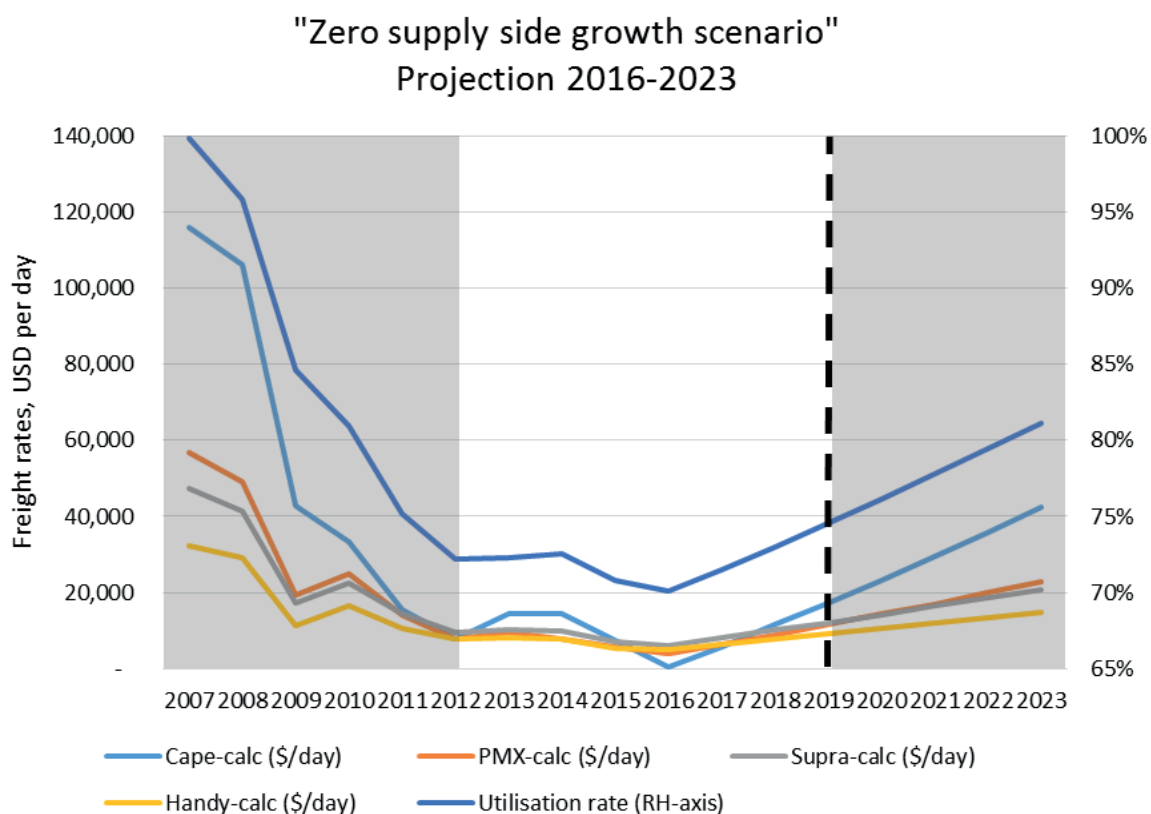
2016 has to be the turning point in addressing the fundamental imbalance of the dry bulk market. We cannot expect any positive surprises from the slow-growing demand side. The enormous overcapacity of ships must be addressed starting now and continuing over at least the next three years.

BIMCO President, Philippe Louis-Dreyfus, says:

*“The dry bulk market is in a terrible condition. A condition that can only be changed by industry actions.*

*Past leaders of the industry have turned things around when needed in the 80s and 90s. It is now time for the current decision makers of the shipowning industry to step up and act decisively together to bring back a profitable market.*

*We really need to demolish an enormous number of ships and refrain as much as possible from building new ships.”*



Source: BIMCO estimates (2016-), BIMCO utilisation est. (2007-2023), Clarkson and Baltic Exchange freight rates (2007-2015)

Note: Net supply growth of 10 million DWT in 2016. Demand growth rate of 0.3% in 2016

### **Where do we come from and where are we today?**

The annual average net fleet growth from 2007 to 2015 was 45 million DWT (8.6% per year), while the demand growth for the same period was 4.5% per year.

BIMCO has modelled the period from 2007 when the dry bulk fleet was at its peak and trading at a utilisation rate of 99.9%. The BIMCO model estimates that the dry bulk fleet was sailing at a utilisation rate of 71% in 2015, and has dropped to 70% in 2016.

In stark contrast to the peak 99.9% utilisation rate in 2007, by 2015 the utilisation rate had dropped to 71%. This left 227 million DWT of excess capacity above the actual demand in 2015. What does 227 million DWT look like?

- 1,260 capesize ships of 180,000 DWT, or 73% of the entire capesize fleet
- all ships built before 2006 within the total current fleet or
- the past five years of dry bulk fleet growth.

### **What help can we expect from the demand side?**

The dry bulk market is heavily reliant on the development in China and is hugely affected by its economic rebalancing efforts going forward.

During 2007-2015, dry bulk demand grew by 4.5% per year as China continued to invest heavily in its housing, construction, and infrastructure sectors. Danish Ship Finance (DSF) estimated for 2015 that China accounted for 38% of global dry bulk demand, including:

- 73% of seaborne iron ore demand
- 21% of seaborne coal demand
- 24% of seaborne grain demand and
- 23% of minor/other bulk demand.

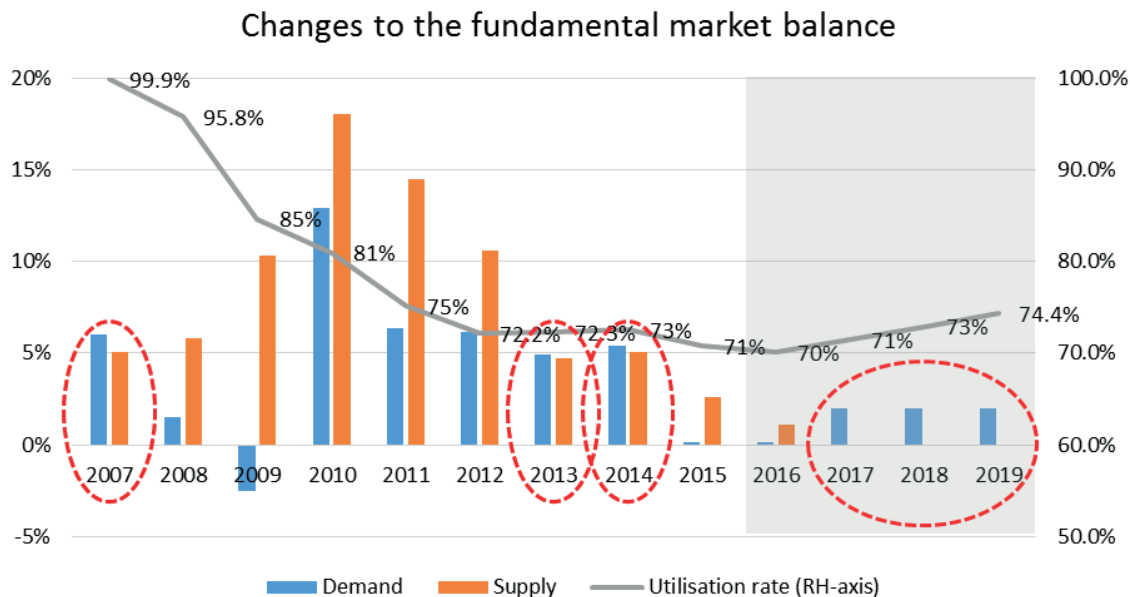
China's economy is now in a transition from export and investment to consumption and services. BIMCO forecasts that this will continue to slow down China's overall economic growth and will dampen dry bulk demand going forward.

Taking this into account, BIMCO's best estimate for demand side growth rate for 2017 through to 2023 is 2% per year.

### **What do we need to do to achieve profitability in 2019?**

With a poor outlook of a 2% growth in demand for the foreseeable future, the dry bulk industry cannot rely on demand growth to save it from its current crisis; owners need to focus collectively on what they can influence, the supply side.

BIMCO has developed a “zero supply side growth” scenario, this requires shipowners to neutralise the delivery of new ships every year by scrapping an equal amount of capacity from the existing fleet. This will stop supply side growth from 2017 onwards as presented in the graph below.



Source: BIMCO estimates (2016-), BIMCO utilisation est. (2007-2023), Clarksons supply and demand growth rates (2007-2015)  
 Note: Net supply growth of 10 million DWT in 2016. Demand growth rate of 0.3% in 2016.

BIMCO estimates that dry bulk shipping breaks even at a utilisation rate of 74.4%, assuming break-even is the point where the freight rates cover the operating costs and finance costs of a ship. This break-even point would then be passed in 2019.

BIMCO President, Philippe Louis-Dreyfus, adds:

*“It is clear that we cannot expect to be helped by growth in demand, the recovery of the market is wholly and exclusively in the hands of us, the shipowners. We must act together and stop the growth in the supply side. The medicine is not going to be easy to take, zero supply growth has been achieved only three times in recent history, in 1986, 1987 and 1998. The task ahead of us is huge and must be sustained year after year.”*

### What do we need to do to get there earlier?

BIMCO has developed the “Best-Best” scenario. Looking at the period from 2007 to 2015, the “best”/lowest level of deliveries and the “best”/highest level of demolitions were selected and applied to all years from 2017 onwards.

The “best”/lowest level of deliveries was 25.08 million DWT delivered in 2008, and the “best”/highest level of demolitions was 33.41 million DWT scrapped in 2012. This produces an annual net contraction of the fleet of 8.33 million DWT from 2017 onwards.

The “Best-Best” scenario brings profitability forward by one year to 2018. It is perhaps not the most likely scenario as the fleet has only contracted in size twice since 1970:

- in 1986 by -0.59 million DWT
- in 1987 by -0.70 million DWT and
- in 1998 by -0.77 million DWT.

### What would we have to do to break even by the end of 2016?

The model assumes a demand growth of 0.3% in 2016 and deliveries of 40 million DWT through the year. In these circumstances, it would require the scrapping of 84 million DWT to bring the utilisation rate up to 74.4% by the end of 2016. This would need to be followed by zero supply side growth in following years to achieve sustainable profitability.

A total of 14 million DWT were sold for demolition in Q1 2016 requiring a further 20 million DWT to be scrapped in Q2 to Q4. Sadly the false dawn of a rising Baltic Dry Index has slowed scrapping and Q2 will struggle to reach 10 million DWT. This leaves an unattainable 60 million DWT to be demolished in the second half of the year.

### A range of scenarios

It is clear that there will be no quick and easy fix for any of the scenarios proposed below.

Scenarios	1st Year of profit	Supply (2017-)	Demand (2017-)
	Util. rate of 74.4%	Growth (rate)	Growth rate
"Best-Best" supply - High demand	2018	-8.33 million DWT	3.5%
"Best-Best" supply - Estimated demand	2018	-8.33 million DWT	2.0%
"Best-Best" supply - Low demand	2019	-8.33 million DWT	1.0%
Zero supply growth - High demand	2018	0	3.5%
Zero supply growth - Estimated demand	2019	0	2.0%
Zero supply growth - Low demand	2022	0	1.0%
1% supply growth - High demand	2019	1.0%	3.5%
1% supply growth - Estimated demand	2022	1.0%	2.0%
1% supply growth - Low demand	Never	1.0%	1.0%
2% supply growth - Estimated demand	Never	2.0%	2.0%

Source: BIMCO estimates

Note: Net supply growth of 10 million DWT in 2016. Demand growth rate of 0.3% in 2016

Philippe Louis-Dreyfus adds, *“Whichever way you look at it, the sustainable recovery of the dry bulk industry is not around the corner.*

*If we can succeed in keeping the fleet size at the present level, while the demand side grows by 2% per year going forward, BIMCO analysts imagine that the dry bulk industry should be profitable by 2019.*

*Failure to do so, by letting the fleet grow by just 1% per year, while the demand side grows by 2% per year will postpone the recovery by an additional three years – to a distant 2022. That is simply not an option – we need action now.”*

### **We need to do this ourselves**

The whole dry bulk shipowning community must work together to realise the demolition of ships and avoid the temptation to order new ships. This will demand a fresh look at the business model in dry bulk shipping.

BIMCO President, Philippe Louis-Dreyfus, says:

*“We need to get rid of a lot of the dry bulk tonnage. But ‘we’ means everyone!*

*I have long advocated scrapping all bulkers over 20 years old and I have none in my fleet. But I don’t seem to have convinced everyone yet in the shipping world! Too bad for the safety of crews, the environment and ... the market!*

*No one is shielded any more, we are all at the mercy of the spot market. To stay in business you need to adapt or leave the industry.*

*I am confident that all players in the industry feel the severity of the downturn. Now they also know where we are, how serious it is and exactly what needs to be done to turn it around.”*

The outlook of years of loss-making freight rates is bound to change the industry. There will be bankruptcies and consolidation of fleets. Successful owners of the future will operate large fleets with the size and scale to be able to adopt a risk management approach to chartering. They will plan to have sufficient ships deployed on longer term charters to ensure that the business has the cashflow to sustain it through future downturns.

Consolidation may, in turn, mean that the larger customers are able to fulfil the majority of their dry bulk shipping requirements from a small number of larger shipowners, this will make it much more difficult for smaller “asset play” owners to survive in the major dry bulk trades.

The next three years will be a game changer, not only for dry bulk shipowners, but also the broader industry.