Tanker owners weather stormy economic conditions

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That 2011 has been a tough year for shipowners is well documented, with earnings across all sectors coming under varying degrees of pressure. The flow of new ships into the market has continued to outpace demand, and the inevitable result is lower spot freight rates, as competition for business increases. Add to the mix net increases in bunker costs over the year to date, and owners' margins in some sectors have been reduced to zero, and have even at times slipped into negative territory.

Focusing on the crude tanker market as an example, estimates have suggested that the fleet will expand at up to twice the rate of demand in 2011. Tanker rates are at their lowest since 2008 in broad terms, and as tankers ordered in happier economic times through 2007-2008 enter the market this year, they are finding returns falling far below the necessary levels to repay the debts incurred. Breakeven levels on Suezmaxes (130-145,000 tons) and Very Large Crude Carriers or VLCCs (260-280,000 tons) ordered three to four years ago have been calculated in the US$46-48,000/day range, based on timecharter equivalent measures. Falling Worldscale spot rates and increased costs have led to earnings coming down to around US$2-3,000/day in the middle months of this year, leading many to predict bankruptcies among owners.

The industry's confidence level has slumped, and coupled with the increased post-credit crisis struggle to find funds for new investment or to shore up existing operations, the pressure on owners is intense. There has not yet however been a major cull among ship owners and as shipping company shares have been low for some time without their becoming the prey of creditors or of acquisitive companies, there have at least been some cautious suggestions that most shipping companies will manage to ride out the current storm.

Beyond current financial woes, one of the clouds hanging over tanker markets is the growth of the Chinese shipping fleet, and the stated aim of the Chinese government that by 2015 half of oil imports into China will be carried on Chinese-built tonnage. It is estimated that China's oil demand for oil imports will increase as a percentage of total consumption from around 50 per cent to 65 per cent, but that the increase in its VLCC fleet will be sufficient to cover the increased demand, and to meet the government's target comfortably.

Growth in the Chinese fleet is already being felt by owners traditionally working the Mideast Gulf-China route, among them European owners in Greece and Norway. So while increased demand from both China and India should help the shipping market, this may be somewhat offset by China's huge expansion of its own VLCC fleet.

One of the routes ship owners could take to relieve the oversupply in the market is to increase the scrapping of tankers well before they reach the 15-year cut-off point where a vessel is deemed properly to be 'old'. The global fleet is, however, now relatively young, after a round of scrapping of single-hull ships in 2009-2010 took a large number off the market, while the rate of new build has only increased in the past few years.

Just two years ago, around 35 per cent of the world fleet was less than ten years old, and now up to 65-70 per cent of the total are under ten years old, which clearly limits the prospects for using an earlier cut-off point for taking ships into the demolition yards. While there is still a market for ships up to 25 years old, most oil companies have already taken the step of not chartering or receiving vessels which are more than 15 years old. But, despite this, the rate of new ships coming into the market has still markedly reduced the average age of ships employed in the international oil trade. Falling prices for older ships for demolition also weakens owners' incentives to scrap them, and the number of ships of all sizes heading for demolition is set to fall in 2011.

As awareness grows of the part the shipping industry must play in the goal of reducing emissions – and as costs have risen due to higher bunker fuel costs – slow-steaming has become more prevalent. More than 200 ship owners have slowed their vessels down from 25 knots to 20 knots. At least one ship owner has adopted the super-slow steaming approach, reducing ship speeds to 12 knots, with fuel consumption and therefore emissions reduced by up to 30 per cent.

An incidental by-product of slow-steaming is that the increased duration of voyages increases a vessel's utilisation over time. While this means fewer journeys undertaken, it does help to alleviate the oversupply situation, particularly in relation to long-haul routes, and has been used by some owners as a means of improving employment rates of their ships. The loss of potential earnings is offset – in theory at least – by decreased costs and a reduction in the time spent idle waiting for the next charter party to hire their ship.

As rates on many routes for both clean and dirty tankers reached critically low levels in the summer months, talk of laying up ships re-emerged. This involves taking them out of the market for maintenance or into dry dock, to wait for better times. In practice, few owners have done this because they still have an incentive to keep ships moving, even on slim or non-existent margins.

Some years ago when more of the global fleet was owned by oil majors, the laying up of vessels was more commonplace. But now, with owners in many cases in debt to financial institutions, their creditors take the view that a small repayment on their loan is better than nothing at all. In some cases ships are fully paid for when they come into the market, and owners are not compelled by financial backers to keep their ships moving. But while in theory laying up a ship and taking it out of circulation could be a reasonable response to poor margins, in practice most owners appear to take a dogged approach, put their heads down, and try to stay in the game.

Looking ahead to possible structural changes in the shipping market, the expansion of the Panama Canal has been much vaunted as good news for tanker owners, as it widens the range of ships able to make use of the canal. Larger ships should be able to take advantage of increased Latin America demand for products, and the higher demand from China for crude. Crude exports from Venezuela and Brazil to the US west coast would also become logistically easier, as well as to Asia generally. But improved logistics may prove academic, if demand for the grades of crude available does not line up with the preferences of refiners in the respective regions, and if canal transit tolls were to rise significantly in order to recoup from the market the cost of expansion.

The growing problem of piracy

Piracy represents a growing problem for owners, as attacks have increased in number overall this year, as well as specifically those on oil tankers. In the first half of 2011, the International Maritime Bureau's (IMB) Piracy Reporting Centre said that 100 out of 266 piracy attacks were targeted at oil tankers. The total of 266 was an increase of 70 over the same period in 2010, but the proportion of the total accounted for by tankers was more or less unchanged, at 37 per cent. Somali pirates carried out 163 of the total 266 attacks, placing them at the top of the league table in terms of the proportion of attacks attributed to them. Ship owners have been faced with higher costs both to insure their ships, and to increase the security of crew and cargo at sea. Armed guards on ships are now commonplace, and while the piracy problem continues to mount, there has been some evidence that the steps taken by owners are having a positive impact.

The IMB Piracy Reporting Centre research showed that while the number of attacks by Somali pirates has increased, the number of successful hijackings fell in the first half of 2011, compared with the same period in 2010. Increased naval intervention and the processes which contribute to 'vessel hardening' – the steps taken on board to repel attack – are thought to be behind the fall in the pirates' success rate in the first half of the year.

Another small positive for the tanker market in 2011 which could contribute to a longer-term reversal of fortune is the slower than expected rate of deliveries of new ships to the market. Taking VLCCs as an example, around 47 were due for delivery in the first half of 2011, but estimates suggest only around 34 came into service. In some cases plans were put on hold, and in others plans were changed. Several VLCC orders have been converted into orders for LNG ships for example, reflecting the relative strength of that market against crude oil. In general across the tanker sector, new orders are shaping up to be lower this year than the average for the past two decades. This should eventually see a narrowing in the gap between ship supply and demand growth.

If, and it remains a large 'if', some bankruptcies do result from the year's travails, this could allow for a period of consolidation and companies merging to create a more coherent market. One of the reasons the markets struggle in tough economic times is widely felt to be the huge spread of owners with different agendas, differing approaches to best practice. A less fragmented market in terms of ownership of the fleet would probably be beneficial long term.

But bankruptcies may not result on any meaningful scale. Owners taking the long view – which holds that the market operates on a 25 year cycle, not a five year plan – will hunker down, and try to find a way to get through hard times. There remains plenty of despondency, not only among owners, but more widely among brokers and even charterers of oil tankers. Depressed demand obviously means less business and less commission for brokers. Even charterers, once they take a step back from their immediate aim of getting the best deal on a given day, will concede that a sickly shipping market ultimately harms everyone, not least because slow demand points to a wider malaise in the international market for oil, but also because the market needs strong owners who maintain high standards within the industry, all of which comes at a cost. ■