

# DRY BULK SHIPPING SECTOR: CONDITIONS, TRENDS AND DYNAMICS IN YEAR 2016

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**CONTENTS**

1. SHIPPING INDUSTRY PROFILE	5
2. DEVELOPMENTS OVER THE PAST YEARS	7
3. DEMAND SIDE	7
4. SUPPLY SIDE	7
5. NEW BUILD ACTIVITY	8
6. FREIGHT RATES	8
7. SECTOR COMPANIES	8
8. WHERE THE SHIPPING INDUSTRY STANDS NOW	10
9. "WISE-THINKING" STEPS FOR SHIP OWNERS AT THIS PERIOD OF TIME	10
10. FUNDAMENTAL QUESTIONS IN THE SHIPPING INDUSTRY	11
11. SWOT ANALYSIS	12
NOTES	13
DISCLOSURE STATEMENT	14

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# DRY BULK SHIPPING SECTOR

## 1. SHIPPING INDUSTRY PROFILE

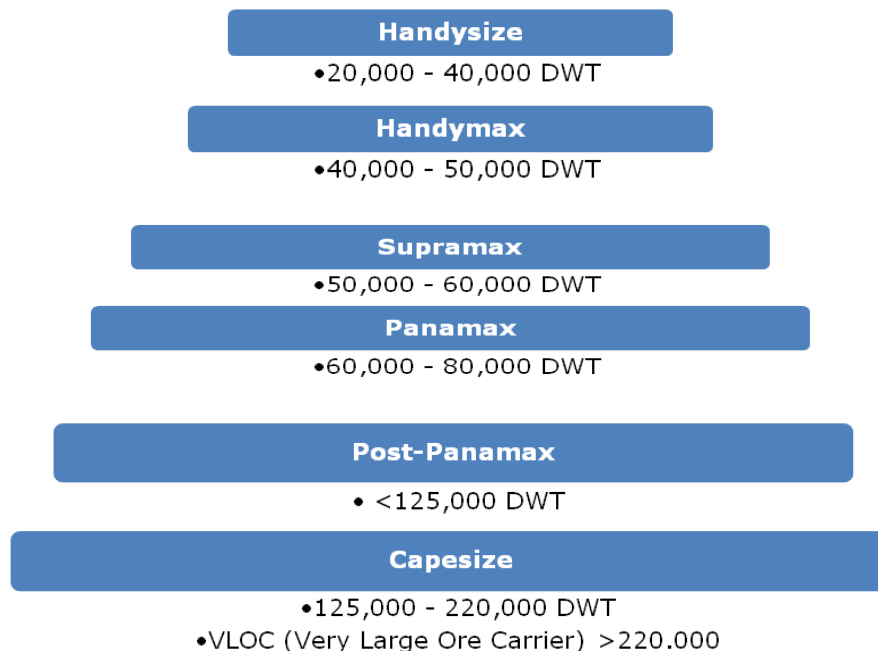
Dry bulk carriers or “bulkers” make up 35% of the world fleet by gross tonnage. Dry bulk vessels transport either major bulks such as iron ore, coal and grain, or minor bulks including steel and forest products, bauxite, alumina and fertilizers.

The major types of bulk carriers are the following:

- Handy's (10,000—39,999 DWT)
- Handymax, Supramax, Ultramax (40,000-64,999 DWT)
- Panamax (65,000-84,999 DWT)
- Post-Panamax (above 120,000 DWT)

Informatively, apart from the dry bulk carriers the other three types of ships, distinguished by the cargo they carry, are the tankers and gas carriers, container vessels, and specialized vessels (oil & gas).

### General Bulk Carrier Sizes



As noted, the dry bulk shipping is a separate sector from the conventional cargo and mainly deals with low value, high volume commodities such as the following:

- Iron ore
- Metallurgical coal

## DRY BULK SHIPPING SECTOR

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- Major food and feed grains
- Steel products
- Forest products
- Bauxite, alumina, cement, fertilizers

As it applies with the world trading activity and the shipping industry in general, dry bulk shipping is sensitive to the cycles of the international economies and the demand forces existing for the goods it carries. The crisis of 2008 and the subsequent credit crunch contracted substantially the shipping demand which in turn reduced prices (charter rates) for bulk carriers. Since then, any recovery progress in the shipping industry has been slow and with many obstacles. However given the current especially low pricing in the sector, the longer term view of the industry could be characterized as positive. This is due, among others, to the rising global population, the role of the emerging economies, as well as the status of shipping as a safe carrier. The world shipping fleet accounted for 55,000 vessels and the dry bulk sector represented 45% - 50% of sea borne trade in years 2014 - 2015.

Charter rates for dry bulk ships are affected by vessel age, speed and fuel efficiency, and cargo-size. Smaller vessels receive higher rates than larger ones. Charter rates are generally available on the basis of a long-term contract (which protects the carrier against market changes) or at a spot rate (which exposes the carrier to the market volatility). Charter prices are also highly influenced by supply and demand factors, based on the supply of vessels and the demand generated by trading conditions and international commodity prices and requirements.

The market is monitored by The Baltic Dry Bulk Index ("BDI"), which is an index of daily charter rates issued by the London-based Baltic Exchange. It provides an average index for 23 shipping routes measured on a time charter basis of current freight rates for Handysize, Supramax, Panamax, and Capesize Dry Bulk carriers, carrying a wide range of commodities. The Index achieved an all time high of 11,793 points in year 2008 and an all-time low at 498 points in November 2015.

### Baltic Dry Bulk Index over the past 10 Years



Source: [www.cnbc.com](http://www.cnbc.com)

## 2. DEVELOPMENTS OVER THE PAST YEARS

The major developments of the Dry Bulk Sector during the past years can be highlighted as follows:

- Conditions were stable in years 2013 - 2014 whereas a downturn occurred in 2015 – 2016
- During the period considered there was an unbalanced supply – demand equation (too many vessels for too few shiploads)
- The sector companies demonstrated an especially weak financial performance (on operating level)
- Reduced demand for iron ore and coal from both China and India also negatively affected the sector
- The annual average net fleet growth during the period 2007 - 2015 was 45 million DWT (8.6% per year), while the demand growth for the same period was 4.5% per year
- The sector demonstrated unfavorable trends in 2016 except for a recent spike in charter rates
- In a great part of the year 2016, vessels demolitions stood at 40 million DWT whereas new fleet entrance settled at 50 DWT

## 3. DEMAND SIDE

The major factors affecting demand in the sector and the related developments are the following:

- The demand of the international economies for the products which the dry bulk sector carries
- In general, companies have limited control over the demand side of the equation
- According to recent views, the dry bulk market is heavily reliant on the development in China and will be hugely affected by its economic rebalancing efforts going forward

## 4. SUPPLY SIDE

The major factors affecting supply in the sector and the related developments are the following:

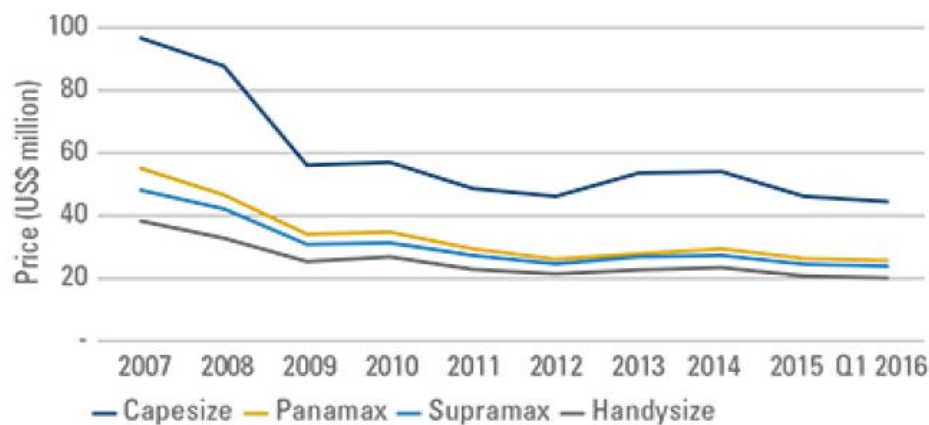
- Oversupply remains the greatest industry wide problem
- However recently, it has been an end to double digit fleet growth
- Due to the poor economic outlook, many ship owners are delaying the delivery of their vessels, pushing the time of delivery into the year 2017 and possibly at a later year
- Even more, cancelation of orders is also a reality creating in turn serious problems to the ship building industry
- Over the past few years, abundance of existing 20-plus year old vessels offered potential for sustained high demolition

- In terms of new building there is little ordering activity and the same is expected for the next couple of years
- With regard to the latest developments, less and less dry bulk vessels have been heading for scrap since the beginning of the summer 2016 and following the steadier course of the freight market during the past couple of months

### 5. NEW BUILD ACTIVITY

The new build activity contracted to 2.3% of the fleet in 2015 and was expected to remain at low territory in 2016. On the other hand, the fact that building costs have declined by 50% on average since 2007 has become an attractive proposition going ahead.

#### Dry Bulk New Build Prices, Period 2007 - 2016



Sources: Bloomberg, International Sector Surveys

### 6. FREIGHT RATES

As noted earlier, charter rates (or freight market prices) are historically sensitive to world economic growth and are unfavorably affected by any systemic shocks occurring in the world economy. The shipping industry experienced its stratospheric heights in years 2007 – 2008 and then pricing crashed up until recently. At this point, no significant medium-term pricing relief is expected for the industry.

### 7. SECTOR COMPANIES

The companies within the industry are in a critical path since they have to solve a very tough equation which stands for the so called “Weak Pricing + Costly Operations + High Debt Loads = Distress”. In other words most companies in the sector are finding it hard to serve their operations and debt obligations given the

## DRY BULK SHIPPING SECTOR

current pricing levels. The weak pricing is demonstrated by the reduced revenues of the companies, whereas according international surveys, two thirds of the total sector companies have presented negative operating cash flows.

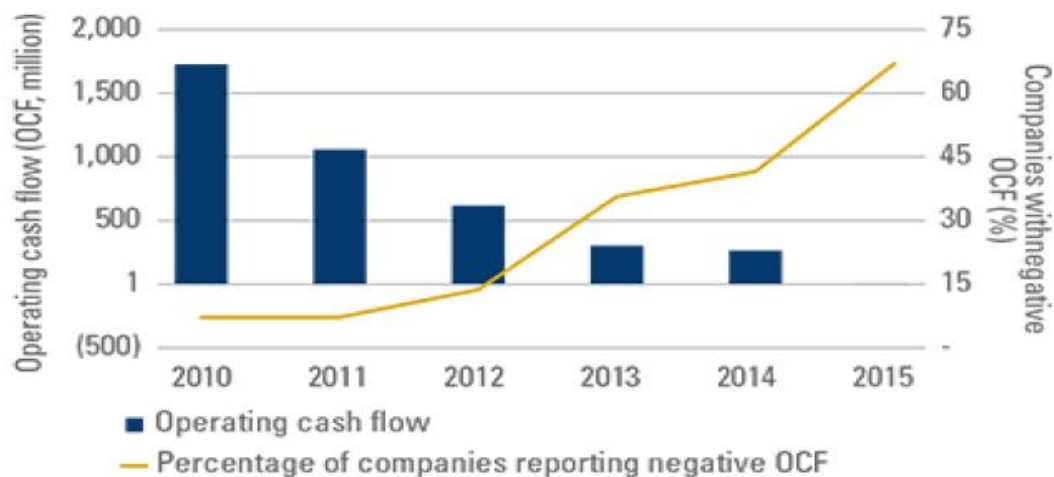
### Dry Bulk Industry Financial Results

All companies	US\$ millions						Year-over-year change				
	2010	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
Revenue	6,093	5,905	5,316	5,667	5,893	4,839	-3%	-10%	7%	4%	-18%
EBITDA	1,773	1,364	721	581	169	-115	-23%	-47%	-19%	-71%	-168%
EBIT	1,207	713	61	-49	-437	-1,014	-41%	-91%	-181%	790%	132%
Cash from operations	1,753	1,073	624	306	267	59	-39%	-42%	-51%	-13%	-78%
Net income	1,073	-42	-969	-542	-234	-2,828	-104%	2,207%	-44%	-57%	1,109%

Sources: AlixPartners, S&P Capital IQ, Yahoo! Finance

Moreover, it is indicative that industry revenue dropped 15%, but EBITDA slid 120%—into negative territory. Income losses went from \$542 million in 2013 to \$2.8 billion in 2015.

### Sector's Operating Cash Flows, Period 2010 – 2015



Sources: Bloomberg, Clarksons Research, Morgan Stanley, AlixPartners

There has also been substantial increase in the financial leverage of the sector companies to an extent that such structure cannot be effectively managed any longer. In fact, the leverage usually forms part of a company's operating model.

## **8. WHERE THE SHIPPING INDUSTRY STANDS NOW**

The shipping market, and particularly the dry bulk sector, are in a wait and see mode, despite the recent spike of charter rates which by the way was unjustifiable to most market observers. Although it is difficult to predict if it is sustainable and how it will affect vessel prices going forward, on the other hand it is clear to most observers that the bottom of the market occurred in Q1 2016.

With regard to corporate actions, any notable fleet reduction under these circumstances would happen only through consolidation in the sector, meaning via mergers and acquisitions, and in such a case new alliances would lead to the termination of new orders. On the other hand, in the present financial environment there is no so much capital available for funding corporate actions as the above mentioned.

## **9. “WISE-THINKING” STEPS FOR SHIP OWNERS AT THIS PERIOD OF TIME**

There are some steps ship owners could make at this stage in order to minimize their risks given the uncertain economic and sector environment:

- Form possible alliances in order to retain a wide range of future options (meaning alliances with equity owners, creditors, vendors, employees)
- Minimize any possible item in their operating cost structures
- Reduce or terminate their build orders in order to preserve capital resources and time capacity
- Seek opportunities for M&A consolidation
- Place as permanent and fundamental priority the organization's ability to operate its fleet above running costs
- Focus on good quality tonnage that creates an operating flexibility in unfavorable market periods

## 10. FUNDAMENTAL QUESTIONS IN THE SHIPPING INDUSTRY

### Why Buy a Ship Now?

- The merchant marine fleet has been renewed to a great extent
- Since the crisis of 2008, purchasing prices for carriers have declined by 90%
- The deflationary environment makes investment opportunities even more attractive bringing them to the bargain level
- The above is combined by the fact that many companies and banks are trying to exit the sector leading to an oversupply of opportunities and thus bargains in the market continuously increase
- Significant opportunities have arisen for purchasing renewed tonnage at very low prices
- Looking at the historic cycles of the market, it is possible that the market is currently quite close to the bottom and thus the potential for recovery is “open”
- The timing is good for investors who have a medium to long-term horizon
- The low market conditions over the last 5 years resulted in many vessels beyond 20 years of age or younger been scrapped and many new-building orders to be cancelled. Besides that, the placement of new orders is close to zero and this is a good sign for the dry bulk sector.

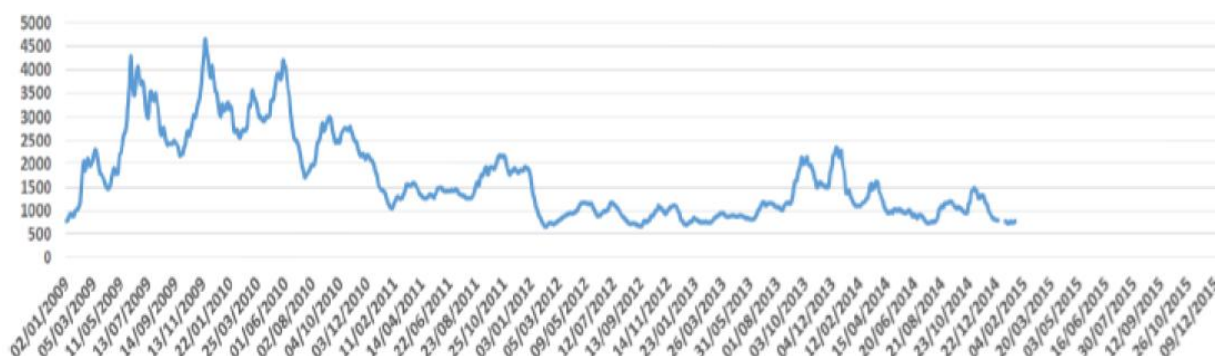
### Why Buy a Bulk Carrier -Handymax or lower tonnage- at this point in time?

- This type of vessels performs much better on economic downturns or periods of economic stabilization
- Bulk carrier vessel prices are sensitive to charter market. Any rebound in the latter will multiply the benefit to the former
- The attractiveness of bulk carriers is also due to the wide range of the cargoes they can carry
- The products of a bulk carrier enjoy sustainable demand over the longer run in the global economy
- It is a liquid market given the number of transactions realized in 2016
- In the dry bulk sector, the major investment opportunity lies in the smaller size vessels (30,000-40,000 dwt) where fleet growth from 2016 to 2017 is expected to be the lowest of all other sectors having suffered rapid expansion over the past few years and in the (50,000-60,000 dwt) mid-size vessels that have proven through the years to be the driving force of the market

### The Baltic Dry Index Performance during Shipping Cycle 1996 – 2002



### The Baltic Dry Index Performance during Shipping Cycle 2009 - 2015



## 11. SWOT ANALYSIS

### Strengths

Very low purchasing costs of vessels compared to one decade ago  
 Vessels have been renewed to a large number thus increasing the trading ability of such a portfolio of assets over a longer time horizon

### Weaknesses

Supply of vessels still exceeds demand

### Opportunities

Once economic conditions improve, there will be a good timing for the sale of vessels

### Threats

Whether the market of vessel prices is close or far from its bottom cannot be still estimated

**NOTES**

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## DISCLOSURE STATEMENT

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