Overview

Ship recycling firmly on 2012 agenda

Shipping industry will continue to use demolition to counteract huge fleet growth this year but what lies ahead for the market?

Demolition drive: the continued weakening of charter rates in the last year saw 2011 become the third biggest year ever for demolition with 41m dwt sold for scrap. *GMS*

Liz McCarthy

WHETHER shipowners have got young, old or mixed age fleets, scrapping will be at the forefront of their minds at the moment.

They are either considering selling old inefficient vessels, which are having difficulty securing work in the charter market, or are hoping that their peers will get rid of some tonnage to bring down the huge fleet growth created by record newbuilding deliveries over the past three years.

With many companies reporting large amounts of red ink on their balance sheets during the full-year financial results season last month, you would be hard pushed to find one that is not looking at cost-cutting in increasingly competitive markets, particularly when 380 cst bunker fuel is averaging over $700 a tonne.

The continued weakening of charter rates in the last year saw 2011 become the third biggest year ever for demolition with 41m dwt sold for scrap, according to Braemar Seascope. This was not far off the 43m and 44m dwt dismantled in 1986 and 1985, when the shipping industry was coping with similar fundamentals.

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> **Braemar Seascope**

But in contrast with 30 years ago, the majority of ships sold last year for recycling were bulk carriers not tankers, at 24m dwt. Back in 1985 only 8m dwt of bulkers were scrapped compared with 25m dwt of tankers.

Some in the industry say this shift was a contributing factor that helped ensure bulker freight rates averaged out at healthier levels than the tanker markets last year.

Over the course of 2011, the Baltic Exchange reported an average time charter rate of around $15,639 per day for capesizes — the largest bulk carriers. By comparison, the largest tankers, very large crude carriers, earned an average $8,525 per day on its benchmark Middle East-Asia route.

So the big question is if owners will continue to offload their ageing tonnage if earnings stay at this level or even deteriorate?

Shipbroker Braemar Seascope, part of London-listed Braemar Shipping Services, thinks they will.

"If past experiences are anything to go by, steel traders can look forward to a bumper 2012 for the supply of vessels for recycling," it says. "If macroeconomic conditions in 2012 continue to underwhelm, and scrap prices stay at their recent high levels, this year could easily surpass 1985 as a peak year for demolition."

In the last few months, Braemar's demolition team has brokered five Mitsui OSK Lines-owned tankers for recycling at green facility Shree Ram Group of Industries in India, some as young as a 1998-built very large crude carrier, as the Japanese giant made a conscious effort to counteract fleet growth.

As the saying goes, every little helps, and it is hoped that other owners will adopt this view in the coming months rather than cling onto the ever-optimistic attitude of an earnings spike being just around the corner. After all, at least one VLCC is expected to enter service every week this year — so something needs to be done.

For the tanker market, and large crude vessels in particular, the International Maritime Organization's phase out of single-hull tonnage has drastically reduced the pool of ships that would traditionally be considered demolition candidates.

However, the unofficial preference from major oil companies to not hire ships older than 15 years of age has reduced chartering options for older vessels and put pressure on secondhand asset values — many are now not worth much more than scrap prices.

As dire earnings continue to hit companies' cash flow, it is expected that when expensive third and fourth special surveys are due for tankers in the next year or two, owners will choose to sell the ships for demolition rather than pay out millions of dollars to keep uneconomic vessels on the water.

These special surveys have to be conducted by classification societies every five years and involve a far more thorough inspection of the ship, its machinery and fabric, than annual ones, according to BIMCO. They invariably require time in a drydock with the ship out of service, which in turn makes them costly and as ships get older the inspections become more stringent.

The argument for disposing of ageing ships approaching special survey deadlines also applies to other shipping sectors as well.

"We're definitely seeing younger tonnage," says Steve Wansell, general manager for cash buyer Mideast Shipping & Trading. "A few years back if a shipowner had to put a ship into drydock, he'd knock on his bank's door and ask for $4m to get it through drydock and have it rolled onto his loan. Now you're finding that banks are not supporting this and are saying owners have to pay for it out of their own cash flow, and because ships are not generating decent cash flow to cover loans, interest and make profit, owners are being squeezed.

"We're seeing a lot of big owners that are now selling a lot of tonnage. We're talking about some of the big stock-listed owners, they just don't have the money."

So with more ships being marketed for demolition, who is benefiting from these additional sales?

For shipbreakers, the huge supply of vessels is great news as they are inundated with tonnage and can lower offers accordingly.

With steel prices and finance markets squeezing demand in certain recycling regions though, which can cause scrap rates to quickly change direction, it is increasingly challenging for cash buyers that act as the middle men of the industry — purchasing vessels off owners and selling them onto yards.

"A lot of people think you must be making a lot money right now but the reality is that actually it is more challenging because the price is moving so quickly," says GMS president and founder Anil Sharma.

Having worked in the cash buying sector for around 20 years, Dr Sharma says that the ship recycling market is going through the most interesting period he has ever seen. The shipping downturn seen since the financial crash of late 2008 has created so much business that he has more than doubled his staff count.

"People want to know what will happen to scrap and shipowners want to know how to plan. Everyone is talking about residual values, and the market is holding pretty well," Dr Sharma says.

Indeed the ship recycling market has become attractive enough that private equity funds are reportedly looking into investing in the sector, according to industry sources. This reflects a general pick up in non-traditional finance sources investigating if they can make cash out of the maritime sector.

But beyond financiers, brokers, breakers and cash buyers there are also a number of maritime services benefiting from the boom in ships being sold for recycling.

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This includes flags that register ships for last voyages when cash buyers in particular buy vessels on 'as is' basis, which involves taking ownership at a designated place and sailing the ship to its dismantling destination.

An example is St Kitts and Nevis International Ship Registry. It says that at the end of last year it started to see a notable rise in the number of customers requiring vessels to be flagged for a single voyage for demolition. With the right documentation, forms and certificates such transactions can take place within a few hours.

There is no doubt the ship recycling industry is warming up for another bumper year or two of volumes and if owners play their cards right deciding to sell ships for demolition could not only boost their balance sheets but also help bring down overcapacity that is crippling chartering markets. ■

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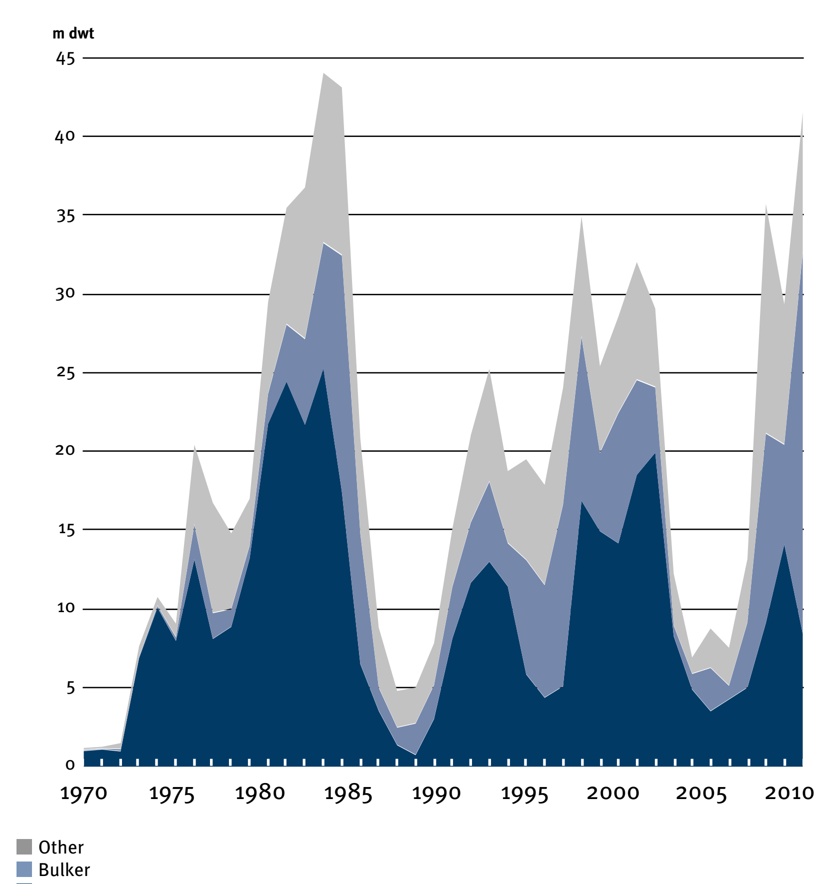
FORTY YEARS OF DEMOLITION
Is another spike still to come?



Source: *Braemar Seascope*