Container-shipping firms focus on asset optimisation
Amid high fuel prices, global trade disruption

Asset quality, size and diversification will determine the success of shipping companies in the next 18 months as higher costs, tighter environmental rules and worsening global trade relations risk offsetting buoyant demand and capacity reductions.

Only container-shipping companies with the biggest fleets and most efficient vessels are likely to turn a profit this year and meet longer-term challenges, says Scope Ratings.

Container shipping is a capital-intensive business. A.P. Møller-Mærsk, the industry leader, spends around USD 1bn a year on new ships. When owners have little control over cargo rates, and differentiating one freight service from another is difficult, industry returns depend on asset optimisation – ensuring ships are always at sea and fully loaded.

Right now, one problem owners face is the oil price. Scope expects a rise of around 25% in bunker prices this year compared with 2017, squeezing thin profit margins despite robust global economic growth and buoyant trade, notably in Asia.

“Strong demand is creating a better-than-expected supply-demand balance, but another headwind is the industry’s excess capacity which weighs on freight rates,” says Denis Kuhn, analyst at Scope.

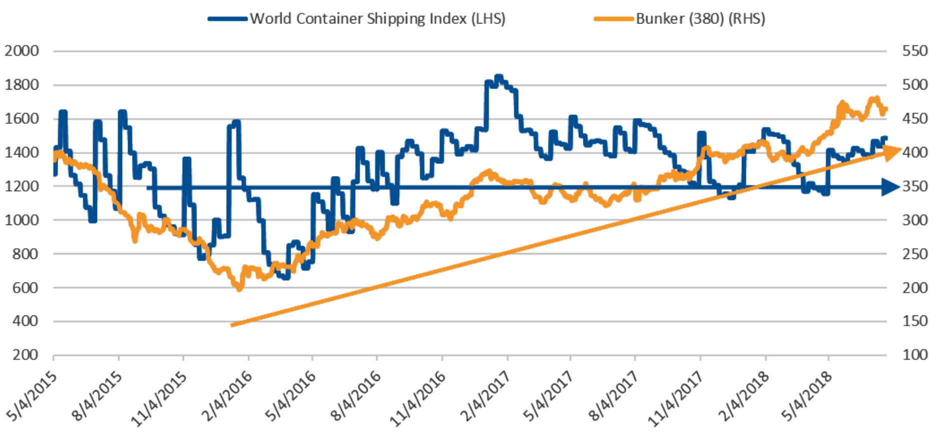
Shipping consultants Drewry recently upgraded its container demand forecast by two percentage points to 6.5% from 4.5% for 2018. Scope had forecast a favourable demand outlook in its 2018 shipping outlook in January. Those supply-demand-fundamentals remain intact.

However, this has not yet translated into visibly higher shipping rates, as supply has also been slightly higher than anticipated, mostly due to less capacity taken out of the industry via scrapping.

“Scrapping should accelerate in H2 and 2019, easing the capacity glut,” says Kuhn. There are a number of factors that support this acceleration in scrapping, including new environmental regulations, capping sulphur emissions from 2020 and toughening up requirements for treating ballast water. Those are powerful incentives for owners to invest in new ships and scrap older ones while keeping up pressure for more sector consolidation.

Increased crude oil and bunker prices and flat shipping rates will continue to put severe pressure on the operating profitability of older, less efficient vessels. See chart below:

Global Container-Shipping Rates vs Bunker Price



Source: Bloomberg

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For this reason, fleet efficiency and quality will become even more important over the next few quarters for container companies to be able to generate operating profits and maintain their credit-risk profiles. Shrinking operating results will drive up leverage (typically measured by Net Debt/EBITDA) and may result in increased borrowing costs for shipping companies.

Credit spreads on many shipping bonds have widened recently amid weaker-than-expected freight rates but could tighten again if liners can mitigate the effect of higher bunker costs via rates increases as well as improved efficiency.

Another topic worrying shipping investors recently has been the growing trade disputes. Longer term, potential disruption to global demand between the world's major economies may hit global trade volumes. But Scope is fairly sanguine about this.

"The net effect for shipping firms from further deterioration in relations between the US and its major trading partners, China and the EU included, could be less dramatic than it first looks," says Kuhn.

Shipping volumes are determined by consumer demand and suppliers' strategies for meeting it. If consumers substitute imports from countries with increased tariffs for cheaper ones from other countries, the impact on overall trade volumes might be modest but will favour operators of large, diverse fleets able to adjust routes quickly to changing trade patterns. Being part of a strong alliance like M2, THE ALLIANCE or OCEAN is essential, in Scope's view, to meet shifting customer demands in a flexible and reliable way.

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