Sea freight

H2 2017

The second half of 2017 saw a huge contrast in fortunes for vessel operators at either end of the size spectrum: just as the news was unrelentingly positive for owners and operators of small and handysize reefer units between July and December, so it remained unforgivingly negative for the large sector.

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It is no coincidence that the principal reasons behind the divergence are the way business is conducted and the way the market is structured in each segment. Smaller tonnage is heavily dependent on seasonality and volatile spot demand, and as such, is out of reach of the liner services offered by the carriers. Indeed, without the specialized reefer, some of these trades would not exist.

On the other hand larger tonnage, a significant percentage of which is employed in less seasonal/more secure period business, is more vulnerable to conversion – especially now that investment in infrastructure has been made at ports of origin and destination. However there are also incidences, particularly in the seasonal Southern Hemisphere trades, where the large reefer is currently just as indispensable as the small unit. This is the next challenge for the carriers.

Other than the erosion of market share held by the specialized reefer, the transformation of the functionality of the reefer charter market is the most significant consequence of the inexorable rise of the container lines in the reefer business. A decade ago, as many as 10 to 20 ships per week were fixed for prompt, spot cargoes during the February to May peak season. This figure reduced to between 5 and 15 per week for most of the rest of the year. In contrast, to date this year there have been fewer than 20 spot fixtures to bananas in total, and fewer than 10 to Chile, South Africa and Argentina combined. The business has changed, and with it, the rules.

While the forthcoming crisis in the large segment will, to some degree and in the short term, be resolved by demolition, it is the lack of slated newbuildings that must be concerning charterers of smaller units. Come January, the average age of the vessels in the 200-300'cbft category will be 28, and those in the 300-400'cbft will be 27. To date, only Seatrade has committed forward; the operator has a markedly different strategy for the replacement of its smaller units, which work predominantly in the GreenSea operation, than it does for its larger units.

The mood was set for the second half in late July, when Canary Island tomato charterer Fedex opted to switch modes into a third party container service for the seasonal business. The Canary Island tomato export business was one of the longest established specialized reefer trades: in its heyday some 300K MT of tomatoes were shipped into the UK and N Cont between November and end April.

As the reefer industry lamented the loss of the Canary Island tomato business to the carriers, it transpired that the reason behind the decision to switch was related to factors outside the control of either mode. Put simply, there is no longer enough export volume to justify chartering specialized reefer vessels. The decline is partly due to increased competition from both mainland Spain and Morocco, but principally down to the spread of plant diseases, which have reduced crop yields. In 2016/17 the Canary Islands shipped a total of 55K MT of tomatoes, a figure 6.7K MT lower than 2015/16. In order to make the trade viable, reefer vessels need a load factor above 55% – last year the average was less than 50% – hence the switch!


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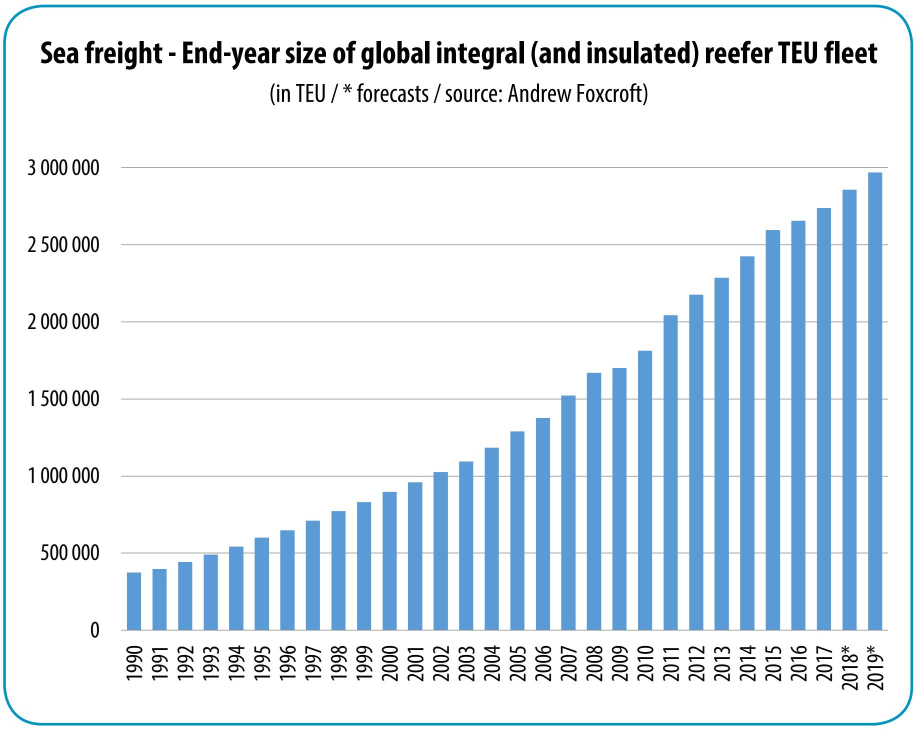


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Meanwhile, the most significant event that took place in the second half of the year was reefer operator Seatrade's decision to close its New Zealand office. The implications and consequences are now playing out.

The move came about as a result of the merger of its Meridian service to northern Europe via Peru, the Caribbean and United States with the Panama Direct (PAD) service operated by CMA CGM. Seatrade acknowledged that the service was making significant losses on a stand-alone basis. As a result of the merger, the Seatrade New Zealand personnel have since been integrated into the CMA CGM organization.

The Meridian was to be a flagship service for the operator's six, fully cellular 2 200 TEU Colour Class newbuild units, three of which have subsequently been sub-chartered into the service. The Meridian was launched in January this year, originally with a 10-day frequency, offering the fastest and most direct service on the trade route. At the time Seatrade was keen to emphasise that the service would run completely independently and free of alliance commitments with other carriers. However in July, Seatrade decided to join forces with CMA CGM. The new service brought together CMA CGM's PAD, Seatrade and Marfret with a total of 13 vessels (6 CMA CGM, 6 Seatrade and 1 Marfret), each with a minimum 600 reefer slots, and doubled the number of port calls that the Meridian offered. The launch of the service was scheduled for October. So, what started out as a bold project less than 12 months ago turned into something of an 'own goal' embarrassment for Seatrade. Not only did it lose a trade that it had held for two decades, but the operator also inadvertently containerized a trade route perhaps 4-5 years earlier than would otherwise have happened!

Predictably, and mostly through no fault of its own, the reasons for the failure are rooted in pricing: rates were reported to be so low that even on a 100% load factor in the high season, the voyage was barely breaking even. And how could a relatively small container vessel make money making so many ports calls under the revised 13-vessel schedule? If reports are accurate, then CMA is also likely to be losing money on the service. But this is hardly a consolation: with deeper pockets and therefore also a longer time horizon over which to build market share, the carrier can well afford to loss lead strategically.

Given that the Meridian service was already containerized, the net impact on the specialized reefer market is limited to the surplus three vessels that Seatrade now has either to integrate into its other services, or sub-charter – two of the three surplus units have yet to be delivered. Does the abandonment of the Meridian service cast doubt on the viability of the Colour Class model? The Meridian experience demonstrates that a fully cellular liner service run by a minnow, third party operator will always be vulnerable to attack from the sharks in whose tank it is swimming.

Seatrade will rightly point out that there is other interest in the Colour Class units from independent charterers such as Africa Express Line (AEL), which took the Orange on charter for six months last year. When the Orange was subsequently absorbed into the Meridian service, AEL replaced the vessel with the containership Mimmi Schulte into what has become a 5-vessel string from Cameroon, the Ivory Coast and Ghana to the UK and N Cont. If a Colour Class vessel works successfully for AEL, why should it not work for other majors that have containerized their banana business?

In a broader sense, it would be interesting to know whether the carriers foresaw the ongoing bloodbath in reefer rates during the process of containership industry consolidation over the past 18-24 months. The process has seen operational costs vastly reduced and profitability restored on the back of increased dry business. It's probably fair to say that the specialised reefer business had hoped for a more logical approach to pricing from the carriers: instead, confronted with a huge increase in competitive slot capacity and the lines undercutting each other and the reefer on price in order to fill their ships, the reefer mode looked a lot more vulnerable at the start of December than it did in September.

In this context, Seatrade clearly had no better option but to surrender what it had created. Somewhat ironically, the Meridian decision was a win-win: Seatrade turned a loss into a profit, while CMA CGM obtained a key cargo that it would otherwise not have been able to secure. However the relative ease of the capture will inevitably have caught the attention of those other carriers such as Maersk Line, MSC and Hapag Lloyd who have a strong reefer strategy.

Partly as a result of the Seatrade decision, the mood among reefer industry stakeholders appears to have shifted, perhaps decisively. If CMA can grab the New Zealand reefer business, what else could be on offer? And should a further trade loss occur, what would the consequences be?

The answer to the first of these questions came in early December when reefer Cool Carriers announced the termination of its Coolman banana service from Colombia, Costa Rica and the Dominican Republic into the UK and N Cont. The operator blamed the lethal combination of retailers driving down the cost of bananas and the container lines offering what it claimed must be sub-economic returns on the trade in order to secure the business.

It is public knowledge that reefer ships are old, asset values are low and that pricing on some reefer liner services has become close to unsustainable. The carriers also know that change is coming – it must be, given that reefer tonnage is not being replaced. With a rationalised containership industry recovering and the reefer industry weak, the carriers scent blood. It would not be a surprise to see the lines pounce, and soon. But how would this work and what would they target?

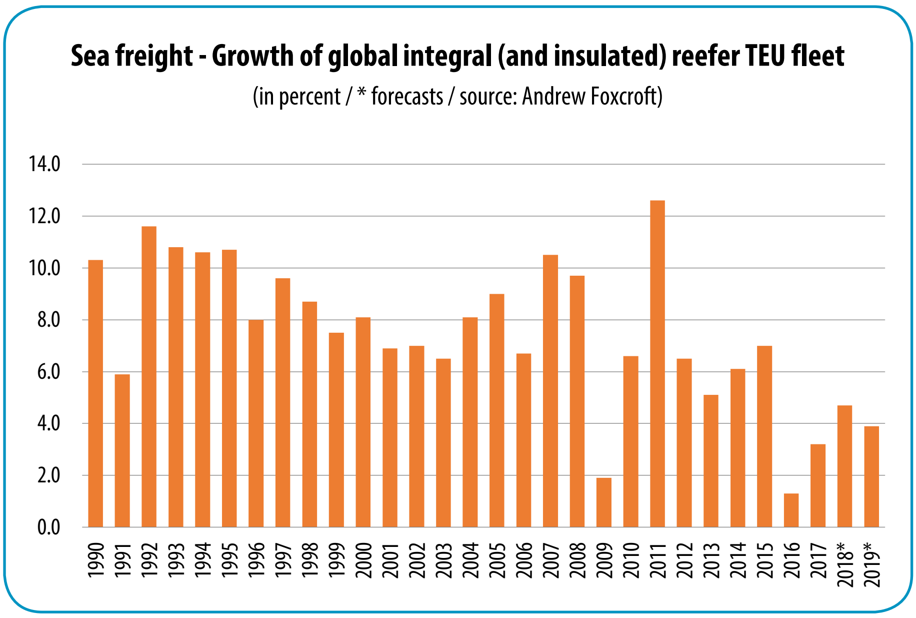
The assumption must be that the carriers are interested in hardware: they have enough of their own capacity to fill not to worry about managing a mode over which they have no operational or marketing experience. Equally they have no interest or incentive to prolong the lifespan of the rival mode! It is the cargo that the lines are after, and possibly some of the software. The question they will presumably be considering is which liner and/or seasonal services that have so far resisted the temptation to switch modes, can be converted the most easily. And possibly also, which personnel could best fashion the transition. Under these circumstances, CMA has stolen a march on its competitors, purely because it has been the first to establish a dialogue with the largest reefer operator with the most cargo.

The sudden acceleration towards the inevitable begs the question. Can the trend be reversed? Well, clearly not! OK, but can it be slowed? Perhaps, but only with the support of charterers and cargo interests, most of whom to date have been willfully complicit in the demise of the mode. The end game has begun!

Is it all bad news? Absolutely not! The steep decline in fortunes of the large segment contrasts sharply with the success of the small units, which in early December were on course to deliver the highest second half Time Charter Equivalent average yields on record. While this segment too has its challenges, the outlook is much more favourable.

This is because the market for the smaller and handysize units is niche enough not to attract the attention of the carriers on the one hand, and so significantly different and logistically difficult to service that it is relatively immune to the scrutiny of the lines and large units alike, on the other. However if the carriers continue to force the large units out of their core trades, there must be a danger that some capacity will cascade down into the space occupied by the small vessels.

The other factor that will accelerate a decline is the lack of investment in newbuilding. The average age of the smaller

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units is higher even than that of the larger ships. Unless someone starts building ships, charterers won't have the luxury of a choice!

Forecast

Extraordinarily, the month of November ended with various charters, pool agreements and renewals for 2018 still to be concluded. While there is too much tonnage chasing a shrinking cargo volume, charterers have looked at their results in 2017 with disappointment and are viewing 2018 with trepidation – not least because ever more competitive containership capacity is due to be delivered. The net capacity of the global containership fleet is set to expand by 7.1% in 2018, provided none of the deliveries of the 78 ships over 10 000 TEU totalling 1.2m TEU are postponed.

There is an argument to suggest that the tipping point for the large reefer is approaching significantly faster than many predictions made even only several months ago. It looks as if 2018 will start with a number of large vessels out of contract: with no spot market on which to tramp, these units have an ever diminishing number of options. It would not be a surprise to see a sudden surge in demolition activity! ■

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Reefer containers

The estimated total numbers of units manufactured for 2017 is 194 000 TEU, which is up from last year's confirmed figure of 155 000 TEU. Given that the industry needs to retire approximately 110 000 TEUs this year, the net impact on the total fleet size is for growth of 3.2%, the third lowest net increase on record after 2016 (1.6%) and 2009 (1.9%).

From 2018, the industry will need to start replacing a minimum of 200 000 TEU (100 000 units) just to replace what will be lost. But, with demand for reefer capacity growing and the specialized reefer mode in the advanced throes of terminal decline, there is already a burgeoning need for a step increase in the manufacture of units.

Given that the specialized mode is so much more efficient in moving reefer product than the third party carrier alternative, the loss in specialized reefer capacity will need to be over-compensated for in the production of reefer boxes. In numerical terms, total annual production will need to be 200 000 units-plus, within 3-4 years. At USD15 000 per container this is an investment of USD3bn annually. In order to make this happen, the reefer trade will need to be significantly more profitable for the container lines and reefer lessors than it is today.

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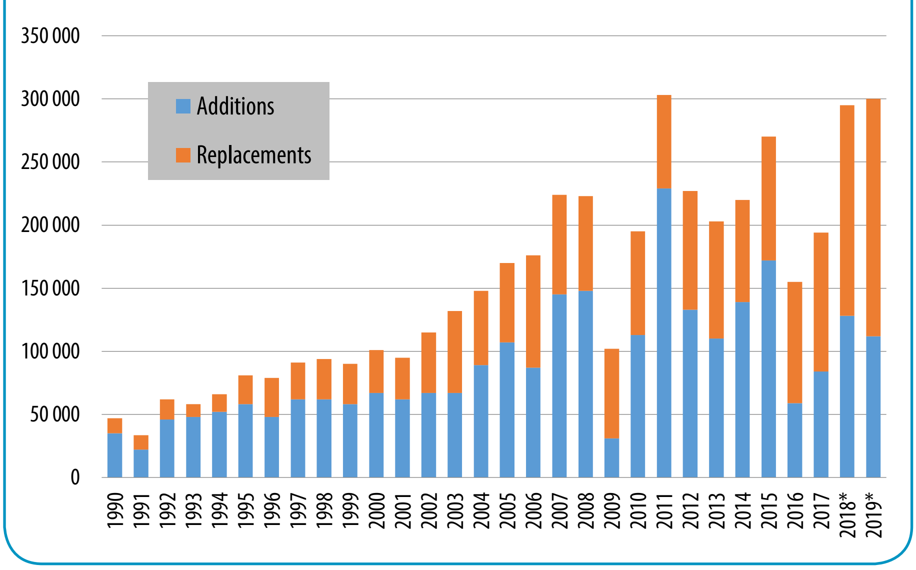

Sea freight - Additions and replacements of global integral (and insulated) reefer TEU fleet (in TEU / * forecasts / source: Andrew Foxcroft)