ICRA

SHIPPING INDUSTRY

Sustained Russia-Ukraine conflict over longer period can impact dry bulk and container segments

MARCH 2022

Highlights

ICRA

Click to Provide Feedback

Russia –Ukraine conflict has added to volatility in shipping charter rates.

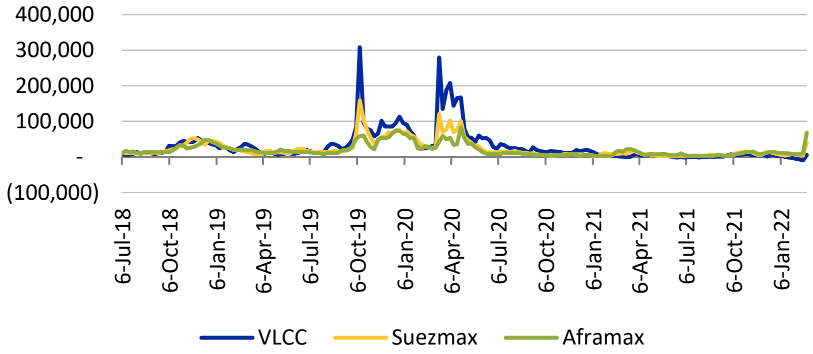
Sustained conflict over a longer period leading to slowdown in economic growth can have adverse impact on healthy charter rates witnessed by container and dry bulk sector

However, the tanker segment where rates have been subdued may benefit from increased demand for long haul oil transport due to extended conflict

- Several large European and American shipping companies are not catering to Russia, in the wake of conflict, even though the sector is not covered under sanctions
- While there has been some impact on charter rates due to the conflict, it is not significant and the impact is higher on short haul trade routes in the vicinity of region.
- However sustained conflict over a longer period leading to adverse impact on economic growth can have adverse impact on dry bulk and container rates, but can support tanker rates if there is increased demand for long haul oil transport
- Supply is expected to outpace demand for container and dry bulk segment in the near term, while oversupply may persist in tanker segment. However, container segment may witness oversupply in medium term due to increase in new orders
- China remains a major driver for the dry bulk segment. In FY2022, while there was some moderation in iron ore imports, it was partly offset by increase in coal demand
- Increase in bunker fuel rates will increase operating costs, but dry bulk and container segment with favourable rates should be able to absorb the increase in costs
- While the premium between low sulphur and high suplhur fuel has increased again, it is still not as high as initially expected during implementation of IMO 2020 and hence scrubber retrofit may not be immediately needed by shipping entities

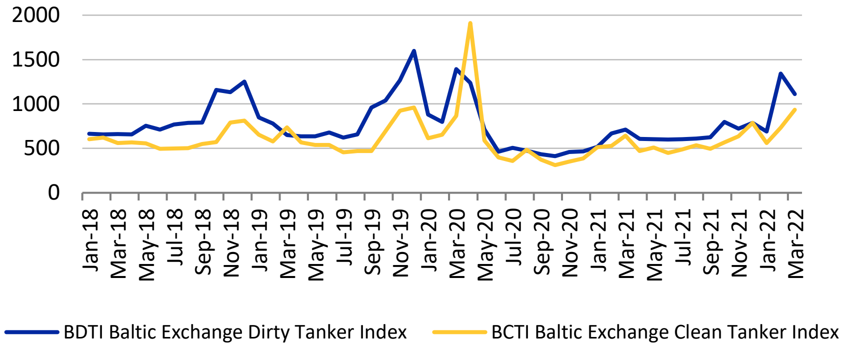
Tanker rates have been subdued

Exhibit: Charter rate trends for key Tanker categories ($/day)



Source: ICRA Research, industry sources and Bloomberg

Exhibit: Crude tanker vs. product tanker index trends



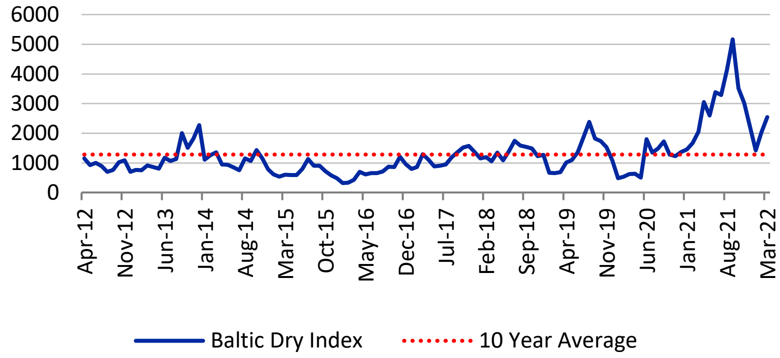
Source: ICRA Research, industry sources and Bloomberg

- Tanker rates had witnessed a sharp increase during March and April 2020, due to contango in oil markets leading to increased demand for storage. However, rates moderated subsequently and has remained subdued despite some recovery in demand since supply continued to outpace demand. The demand also while recovering has been subdued compared to pre Covid levels
- **However, while there has been some uptick in rates in Feb and Mar 2022, partly driven by the Ukraine-Russia conflict. The same has not been significant and the rates continued to be subdued in many trade routes for crude tankers. Moreover, after some initial spike the rates of charter rates for larger vessels like VLCC have witnessed sharp moderation since the biggening of conflict.**
- **However, rates of product tankers have witnessed some uptick since the conflict due to replacement of diesel demand from Russia to Europe with that from Asia**

Dry bulk rates witnessed healthy recovery, but has moderated from high levels in recent months

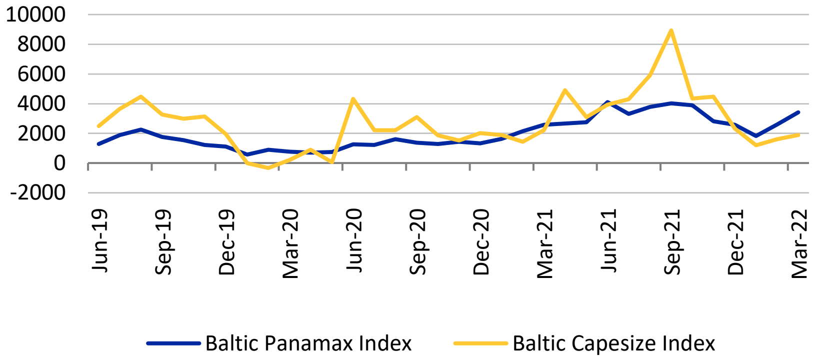
ICRA

Exhibit: Baltic Dry Index Trends



Source: ICRA Research and industry sources

Exhibit: Baltic Index for Key Dry Bulk Vessel Categories

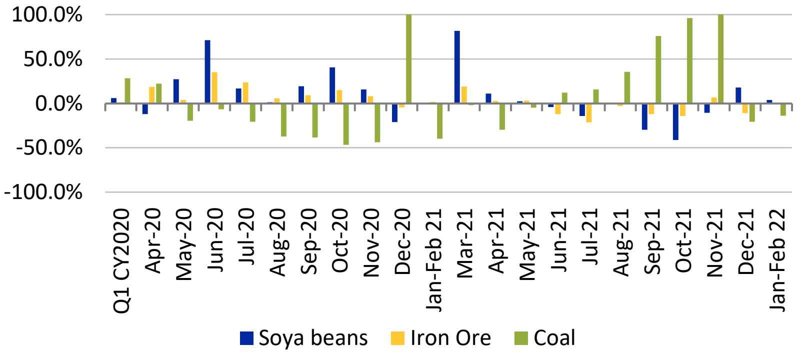


Source: ICRA Research and industry sources

- The dry bulk segment witnessed sharp correction following the Covid-19 pandemic due to the demand decline. From June 2020 onwards, however, there had been recovery in rates, driven by factors like pick up in Chinese demand for iron ore and agri products; pick up in economic activity with easing of Covid-19 related containment measures and increase in coal volumes.
- In CY2021, the rates increased very sharply till Oct 2021 driven by improved demand for minor bulk cargo, some spill-over of cargo from container to dry bulk segment and some pressure on supply due to congestion. However, subsequently there was moderation in rates, although it remained above 10 year average levels. This was also partly due to seasonality in demand due to the Chinese New Year holiday.
- **With the commencement of Russia-Ukraine conflict there has been some pick-up in rates, however, the impact is not expected to be substantial since the region is not a major contributor to global dry bulk trade.**

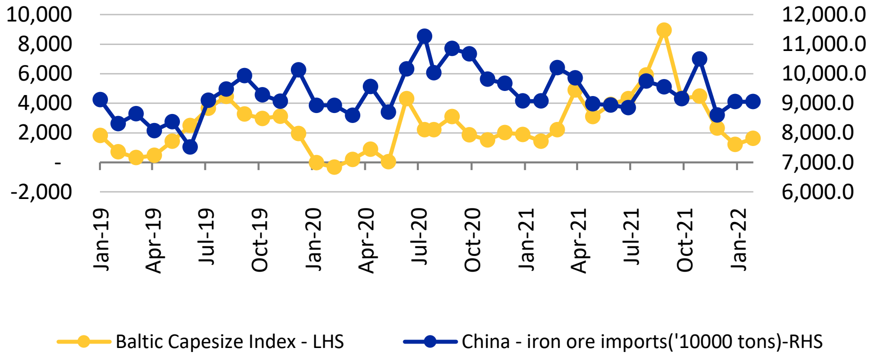
China commodity demand is a major driver for dry bulk segment

Exhibit: YoY % change trend – key commodity imports (China)



Source: ICRA Research, China customs data

Exhibit: Baltic cape size index and Chine iron ore imports are correlated

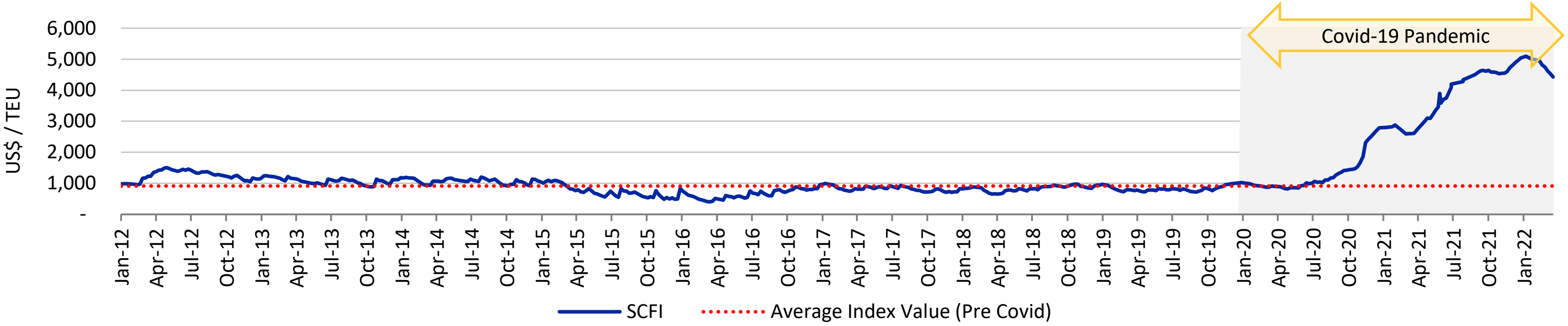


Source: ICRA Research, China customs data, Bloomberg

- The performance of the dry bulk segment is highly correlated to Chinese imports.
- While in FY2021, the coal imports had remained subdued there was traction in iron ore and key agri commodities like soya bean. In FY2022, while there was YoY decline in import volumes for iron ore and soya bean, it was offset by sharp pick up in coal imports till Nov 2021.
- The rats of capsize vessels are highly correlated to Chinese iron ore trade

Container charter rates have witnessed unprecedented increase

Exhibit: Shanghai Containerized Freight Index

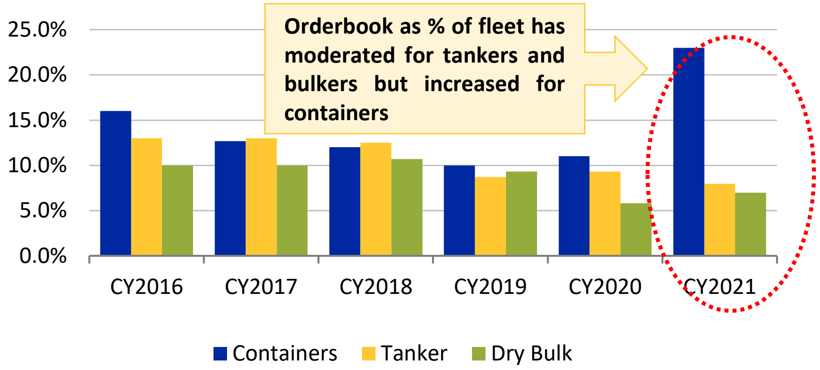


Source: ICRA Research and Industry Sources

- While there was some adverse impact on charter rates during the initial months of Covid-19 pandemic, the rates have witnessed a sharp increase from April 2020 onwards and have reached record highs
- This was driven by a pick-up in demand with easing of containment measures coupled with tight supply conditions created by disruption in trade routes due to pandemic and congestion at ports. Further, due to high consolidation in liner shipping sector, the supply management by players has also aided the rates.
- While there was some moderation in rates since Jan 2022, the charter rates still remain high. The Russia – Ukraine conflict may have some indirect impact on rates due to disruption in trade routes and congestion at ports, however, the extent of the impact remains uncertain at present.

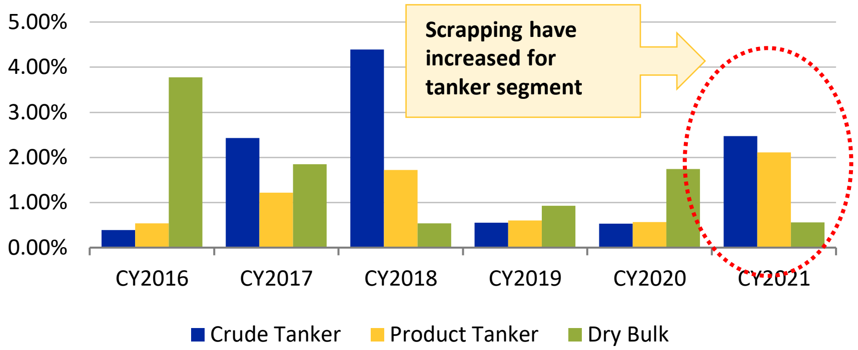
Order booking and scrapping trends

Exhibit: Order-book as % of fleet trends



Source: Industry Sources and ICRA Research

Exhibit: Scrapping as % of fleet trends



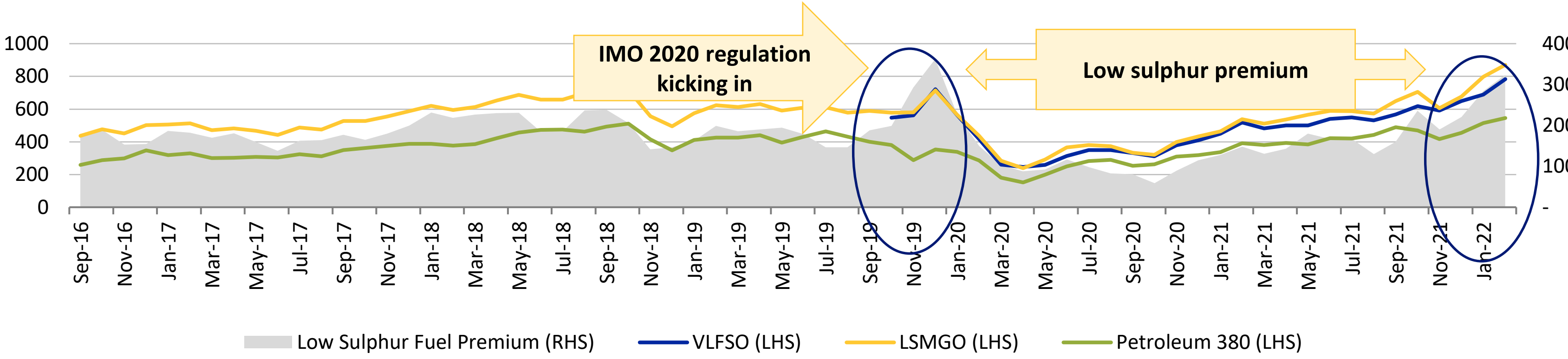
Source: Industry Sources and ICRA Research

- The order book as % of fleet has moderated for tankers and dry bulk segments in the last five years, however containers has witnessed spike in new orders in CY2021
- Scrapping has increased for the tanker segment in CY2021 but had moderated for the dry bulk segment in CY2020.

- **Tanker** - Moderation in new orders and increased scrapping should lead to some supply correction, but in near term supply expected to outstrip supply
- **Dry Bulk –** Moderation in new orders and expected deliveries will result in limited fleet growth in near term
- **Containers –** While there has been spike in new orders, in the near term demand is expected to outstrip supply, although there may be overcapacity in medium term

Increase in bunker prices and low sulphur fuel premium

Exhibit: Trends in bunker fuel prices ($/MT)

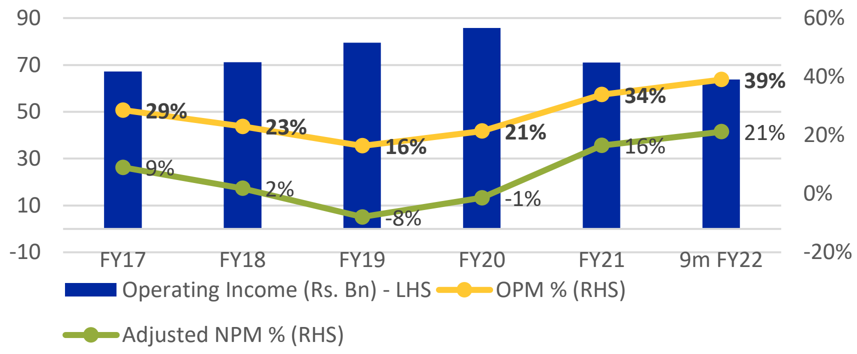


Source: Bloomberg and ICRA estimates

- With the implementation of the IMO 2020 regulations, it was expected that there will be a steep increase in the fuel cost for the shippers due to high delta between low sulphur and high sulphur fuel.
- The delta was also expected to increase with the regulation kicking in as the supply was not expected to match the increase in demand. However, while the delta did increase prior to January 2020, it moderated subsequently due to the adequate availability of low sulphur fuel and the use of marine gas oil.
- Many companies had opted for retrofitting of scrubbers, which will allow the use of cheaper high sulphur fuel, however, with moderation in delta between high and low sulphur fuel the pay-back period for such investments has increased and conversely companies which had postponed the retrofit benefited
- With the increase in bunker fuel rates, the premium has again expanded and the same may put some pressure on profit margin, however dry bulk and container segment where charter rates are healthy will be able to absorb the cost

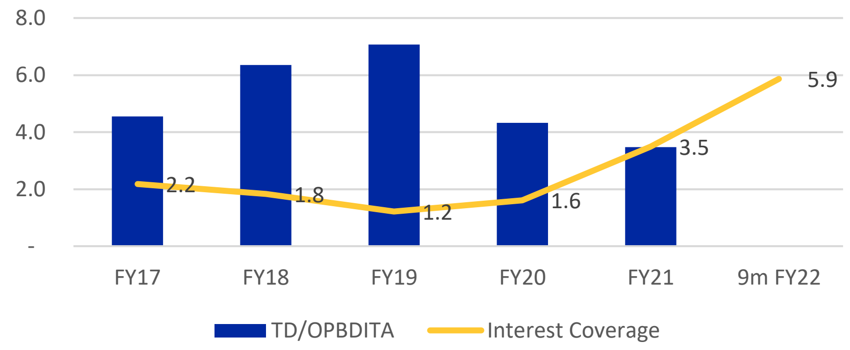
Financial performance of Indian Shippers with diversified fleet has improved

Exhibit: Revenue and profitability trend



Source: Ace Equity; Aggregate of six listed entities

Exhibit: Coverage metric trends



Source: Ace Equity; Aggregate of six listed entities

- Aggregate performance of six listed entities – Great Eastern Shipping, Chowgule Steamships, The Shipping Corporation of India, Mercator, Essar Shipping and Shreyas Shipping
- The aggregate performance has witnessed healthy improvement in FY2021 and 9m FY2021
- However, it is mainly driven by improved performance of GE Shipping and SCI. The fleet profile of the covered entities is skewed towards tankers (product and crude) accounting for ~45%, dry bulk ~27%, containers ~10% and others like offshore accounting for ~19%.
- While the tanker segment benefited from sharp spike in rates in Q1 FY21, although the rates have been subdued subsequently, in the current year companies with diversified fleet with good share of dry bulk segment witnessed improvement and bucked the impact of low tanker rates
- Going forward, in case the tanker rates remain subdued and dry bulk segment also witness moderation, the margins may witness contraction.

Impact of Russia- Ukraine conflict

ICRA

Tanker

- While there was some spike in rates, it was not significant and moderation witnessed in some segments. This was despite Russia accounting for major share in global oil trade
- Rates are higher in specific regions like Baltic, Black Sea etc. which are closer to conflict since many shippers have stopped carrying Russian Cargo
- This has been due to no significant increase in demand for storage or long haul routes, which could be due to availability of inventory and expectation of conflict to be of shorter duration
- However, if the conflict is extended over a longer period, the demand on long haul routes from Middle East to Europe or West African crude may increase leading to some uptick in rates

Dry Bulk

- Unlike oil segment, Russia is not a major driver of global dry bulk trade. However, Russia and Ukraine have high share in several agri products
- There may however be indirect impact on dry bulk rates if there is significant impact on global economic recovery leading to demand slowdown for key commodities like iron ore, coal etc.

Containers

- Direct impact on container shipping rates are expected to be limited
- Many shipping lines like Maersk have stopped services to Russia
- However extended conflict leading to adverse impact on global economic recovery remains a risk

Segment wise outlook

	Tanker	Dry Bulk	Containers
Demand	Demand expected to witness gradual growth	Demand expected to witness growth in line with global economic recovery	Demand expected to remain healthy
Supply	Supply to outpace demand growth in near term	Demand expected to outpace supply growth	Demand expected to outpace supply growth in near term Oversupply risk in medium term
Charter Rates	Expected to remain under pressure in near term, although some recovery may be there	Expected to be supported by favorable demand supply scenario	Expected to be supported by favorable demand supply scenario. Some rationalization from very high levels if congestion issues are normalised
High Bunker Prices	High bunker prices to put pressure on margin	Sustained high charter rates will mitigate margin impact	Sustained high charter rates will mitigate margin impact
Russia-Ukraine Conflict	Sustained conflict leading to increased demand for storage or long haul trade may be favorable	Sustained conflict leading to slowdown in global economic recovery may have adverse impact	Sustained conflict leading to slowdown in global economic recovery may have adverse impact

Click to Provide Feedback

Analytical Contact Details

	Sabyasachi Majumdar	Sai Krishna
	Senior Vice-President	*Assistant Vice-President*
Email	sabyasachi@icraindia.com	sai.krishna@icraindia.com
Phone	0124- 4545 304	022-6114 3435

Business Development/Media Contact Details

	L. Shivakumar	Jayanta Chatterjee	Naznin Prodhani
	Executive Vice-President	*Executive Vice-President*	*Head Media & Communications*
	shivakumar@icraindia.com	jayantac@icraindia.com	communications@icraindia.com
	022- 6114 3406	080 – 4332 6401	0124 – 4545 860

ICRA

Thank You!