INDIAN SHIP BREAKING INDUSTRY

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Outlook for domestic ship-breaking industry turns negative with volatile scrap prices and falling rupee; however, Ship Recycling Act to be a long-term positive for the industry

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Executive Summary

South Asian countries remain preferred destinations for ship breaking industry

Since 1993, the ship breaking industry has been concentrated mainly in five countries--India, Pakistan, Bangladesh, China, and Turkey. The activity level in these 'top-five' countries varies year to year and depends on the number of ships available for scrapping. These countries have regularly shared 97–98% of the end-of-life tonnage for the last 15–20 years. Turkey is the smallest of the top-five recycling states in terms of the annual tonnage recycled through ship breaking.

Shipbreaking is mostly carried out at South Asian yards as the manpower cost there is low and environmental and health regulations less stringent than competitors elsewhere, especially the primary rivals—China and Turkey. Shipbreaking in India, Pakistan and Bangladesh accounted for 80 to 90% of the global output during the past three calendar years.

India and Bangladesh continue to dominate the shipbreaking market

India and Bangladesh, with natural geographical advantage of high inter-tidal gradient, favourable weather conditions and low manpower costs, continue to remain the market leaders in terms of both volume and number of ships broken. During CY2016 to CY2018, India scrapped the maximum number of ships, but Bangladesh undertook more breaking activities in terms of gross tonnage (GT), indicating that it was the preferred destination for large vessels. Bangladesh is the preferred destination for demolition of large vessels as compared to India due to presence of large-sized ship breaking yards, relatively lax environmental/health regulations and higher ship procurement cost. In CY2019, Bangladesh remained the topmost buyers of ships and maintained its position of demolishing the maximum tonnage.

Low ship breaking activities in China following ban on import of foreign vessels

China accounted for 9-20% of the total tonnage dismantled during CY2015 to CY2017. China has banned import of foreign vessels for breaking purpose in a bid to control environmental pollution. The new measure of banning imports was announced in April 2018 and implemented from Dec 31, 2018. Although Chinese breakers cannot import foreign-flag vessels, they can still buy Chinese-flag vessels for demolition. Evidently, the market share of China in terms of the total number of ships dismantled declined to 4% in CY2019 from 12% in CY2017.

Tanker demolition witnessed a significant increase while the dry bulk carrier demolition declined in CY2018

Demolition of dry bulk carriers and tankers accounted for 40% and 31% of the total tonnage dismantled in CY2017, respectively. During CY2013 to CY2017, dry bulk carriers accounted for 40-75% of the total tonnage demolished across the globe. However, the contribution of dry bulk carrier demolition to the total tonnage declined to 13% in CY2018 from 40% in CY2017 due to improvement in freight earnings. Despite the trade tension between the United States of America and China, the dry bulk seaborne trade grew by 2.6% in CY2018 over CY2017. Although Chinese import of US grain and soybeans declined, the dry cargo market remained balanced as non-Chinese buyers took advantage of the heavily discounted US grain prices, while China took advantage of the other suppliers.

On the contrary, the contribution of tanker demolition to the total tonnage increased to 69% in CY2018 from 31% in CY2017 due to a combination of factors such as low freight rates, high scrap prices, an aging tanker fleet and the impact of upcoming vessel regulations. During H1CY2018, the crude tanker freight market remained sluggish due to a strong voluntary compliance with OPEC/ non-OPEC production cuts and additional unplanned output reductions.

Ship breaking involves social and environmental hazards; implementation of EU Ship Recycling Regulation in 2018

Ship recycling is considered as one of the most dangerous activities in the world as it involves high accidents and disease incidences compared to other industries. In an attempt to tackle the social and environmental hazards associated with this industry, various governments and international organisations have established laws and policies such as Basel Convention, The Hong Kong International Convention and EU Ship Recycling Regulation (EUSSR). EUSSR was implemented on December 31, 2018. According to the regulation, the demolition of all large sea-going vessels sailing under an EU flag can take place only in yards included in the European List of ship recycling facilities. Currently, the list includes 34 shipyards, including 30 facilities located in 12 Member States of the European Union and in Norway, 3 facilities in Turkey and 1 facility in the United States of America.

Recent Ship Recycling Act to provide fillip to Indian ship breaking industry

The Government of India ratified the HKC in November 2019 and the Ships Recycling Bill 2019 was passed by the Indian parliament on 9th December 2019. The Recycling of Ships Bill, 2019, became an Act after receiving the assent of the President of India on 13 December, 2019. The Government decided to bring this Act to provide for the regulation of recycling of ships by setting certain international standards and laying down the statutory mechanism for enforcement of such standards. The implementation of this Act will streamline existing ship recycling norms and also help in restriction and proper treatment of hazardous materials on board and the waste produced, post recycling. It will raise the profile of Indian ship recycling industry as being environment friendly and safety conscious and will go a long way in establishing India's position as the market leader.

Declining steel prices owing to demand slowdown in key consuming sectors

As a major portion of a ship breaker's revenue comes from the sale of ferrous or mild steel (MS) scrap, its revenue and profitability are vulnerable to fluctuations in domestic steel prices. The domestic steel prices declined till FY2016 as a result of dumping of steel into India by China at significantly lower rates. However, from FY2017 onwards, the steel prices started rising, following the imposition of anti-dumping duty on Chinese steel products coupled with the improvement in overall steel demand and rupee appreciation. Further, the steel prices started declining May 2019 onwards because of trade tensions between the US-China and slowdown in key sectors such as automobile, housing, construction and infrastructure, which negatively impacted the domestic steel prices. Further, the evolving macro situation surrounding the coronavirus outbreak has resulted in mounting steel inventories in affected nations, and supply chain disruptions in key steel-consuming sectors like auto, consumer durables, and renewable energy. Given the risk of delayed deliveries due to bottlenecks in production, logistics, and port handling capacity, as well as the perceived risk of coronavirus infection from import consignments, resulting in stringent scrutiny by port customs authorities, traders reportedly remain averse to booking fresh steel shipments from affected countries. Further, a prolonged outbreak accentuates the risk of a global recession, then global steel demand and international steel prices could further come under pressure.

Profitability remains vulnerable to movements in foreign currency exchange rates as purchase transactions are typically denominated in USD

The profitability of ship breaking companies remains exposed to fluctuations in foreign currency exchange rates as purchase transactions are denominated in foreign currency. However, the scrap is sold typically in the domestic market and realisations are denominated in INR. The vessel purchase transaction is typically denominated in USD and is generally backed by 90-270 days of letter of credit. As it takes around three to six months on an average to completely dismantle a ship of around 10,000 LDT, the revenue remains piecemeal in nature. Hence, the ship breakers face an inventory risk with ships that are in the process of dismantling because of the time lag between the purchase of the ship and the sale of scrap, given the high volatility in steel prices. In recent times, India faces additional challenges from the Coronavirus epidemic as there are growing limitations on docking of ships from virus hit nations. This has further impacted the scrap price, which has remained volatile in the recent past and lead many buyers to withhold their decision as they fear further fall in prices.

INDUSTRY OUTLOOK: NEGATIVE

The ship breaking industry faces turbulent times due to less remunerative scrap prices/steel plates prices, which coupled with falling rupee has impacted the industry. Though it gathered some momentum at the start of CY2020 following the implementation of the International Maritime Organisation (IMO) regulations from January 2020, weakness in the international shipping markets further aggravated by the coronavirus, has dampened sentiments. The ship recyclers are shying away due to overall weak industry scenario with volatile scrap prices along with tighter bank sanctions on Letters of Credit, adding to their challenges. Further, the ship sellers are increasingly becoming conscious about the social and environment impact and are looking for green / HKC compliant recycling facilities of reputed cash buying counterparties with a proven track record. The overall challenge in India is further aggravated by stiff competition from Bangladesh, wherein steady demand is observed from its end-user industry which yields favourable incentive to the Bangladeshi ship breakers compared to Indian counterparts. India, however, fares better in terms of compliance with green recycling standards, which also adds to cost pressures compared to Bangladesh. In recent times, India faces additional challenges from the Coronavirus epidemic as there are growing limitations on docking of ships from virus hit nations. This has further impacted the scrap price, which has remained volatile in the recent past and lead many buyers to withhold their decision and wait before offering fresh buy as they are fearing falls in future. Therefore, in the current scenario with volatile scrap prices, restriction on beaching of vessels and weakening rupee against the USD, the procurement cost is expected to rise. This coupled with unsettling sales/scrap prices, the margins for ship breakers are expected to remain under pressure in the near term. Nevertheless, the recent Recycling of Ships Bill 2019, is expected to make India a globally preferred green vessel destination and will also lead to procurement of green vessels at more competitive prices, which at present remains high in comparison to other compliant nations, thereby increasing competitiveness of Indian ship recycling players in comparison to other Asian peers.

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