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Total VLCC scrapping value could reach $1bn, says GMS chief executive

THE TOTAL TRANSACTION value of very large crude carrier scrapping may reach a record $1bn this year, according to GMS chief executive Anil Sharma.

With weak freight earnings, firm demolition rates and the tightening International Maritime Organization environmental regulations, as many as 30 VLCCs were sent to junkyards in the first-half of this year, based on estimates of GMS, the world's largest cash buyer of ships for recycling.

If the pace of scrapping stays the same for the rest of the year, total values of VLCC scrap deals could reach the $1bn mark on assumption of demolition rates of $425 per light displacement tonne, Mr Sharma told Lloyd's List.

"That will probably be the highest on record," Mr Sharma said.

The large scrapping volume has created financing issues for some cash buyers with low-cash reserves, as liquidity requirements for ship recycle deals are rising because of stricter environmental regulations in major shipbreaking nations such as India, Pakistan and Bangladesh, according to Mr Sharma.

In the past, cash buyers usually only needed to fund the down payments in scrap deals because shipowners would deliver their vessels to the shipbreakers directly. The cash buyers would receive the payments from shipbreakers before completing the full transaction with the owners.

Now, shipbreakers only accept scrap vessels after they are cleaned, so cash buyers often have to take delivery of the ships at separate locations and bear the costs of cleaning, crew, insurance and reflagging on some occasions, Mr Sharma said.

"There are greater capital requirements," Mr Sharma added.

Lately, the funding gap has been filled by some private equity firms. According to Mr Sharma, the financing is generally required on a short-term basis, which is less risky when compared with newbuilding deals.

"It is of limited risk. Demolition rates can fluctuate, but they are not likely to be as much as newbuilding values during the periods of deal maturities," Mr Sharma said. "It is a good sign that more private equities are in scrap finance."

WHAT TO WATCH

Five risks to check: Crude tankers

IT was supposed to be a short, shallow bottom for crude tanker markets. Instead, daily time charter equivalent earnings have stayed below breakeven levels for several quarters, with no immediate end to owners' woes in sight.

Analysts have continued to revise down their predicted spot earnings for this year even as they still forecast decent recoveries in 2019. In our latest quarterly survey, aframax earnings are expected to average per day in 2018, suezmax earnings average $13,383 and very large crude carriers $17,001.

Previously, average aframax earnings were forecast to be $14,266 per day, suezmax $15,918 and VLCCs $20,324.

The case of crude tankers is perhaps the best scenario in which to show unexpected risks to the supply chain that can hit owners hard. It is not too difficult to calculate how many vessels will be delivered or estimate how many will be scrapped; but guessing how Donald Trump's policy shifts will affect trade flows is a completely different game, for example.

The collapse of Venezuelan crude exports, in part due to the US sanctions, has contributed to the tanker woes along with oversupplied tonnage and the output cut led by the Organisation of the Petroleum Exporting Countries. Some of those factors will remain in place in the next nine to 12 months, and Mr Trump will still be sitting in the White House.

As things may become worse before actually getting better (a phrase that has been repeated in the tanker industry for months), we believe it necessary to look at the five most significant risks for crude shipping. This time, perhaps bulls will have a better idea on what has gone wrong.

Iranian sanctions

Mr Trump's diplomatic stance towards Iran is a robust example of how an external factor can put a large chunk of international tanker business at risk.

In May, Washington decided to reimpose secondary sanctions that effectively ban foreign entities dealing with Iran from dollar business and the US market. While there is a grace period of 180 days for the energy and shipping sectors, some companies such as Total have started to withdraw from its Iran-related businesses.

The shift of US policy came as Washington withdrew from the 2016 international nuclear deal, having alleged Tehran committed violations by continuing to develop nuclear weapons. Although European countries, Russia and China have vowed to stand by the deal, early signs of Iran maintaining its exports are not promising.

With US secondary sanctions, the European Union's oil embargo and restricting the International Group of P&I clubs from providing cover for tankers carrying Iranian crude, Iran's crude exports collapsed by more than 50% to 1.1m barrels per day in 2012-15, according to a Congress study. It is possible that the exports can fall from 2.3m bpd to 2.6m bpd to that level, or even lower.

While the EU is unlikely to restrict purchases of Iranian crude itself, IG has warned that continued coverage after the grace period is unlikely. In addition, China, India and some US allies in Asia continued to buy Iranian crude in 2012-15 because they received waivers from the White House for the sanctions while getting insurance from non-IG entities. Given that Mr Trump is taking a much tougher stance than his predecessor, Barrack Obama, such waivers are unlikely to be easily