Ship recycling market is facing a tough year but stakeholders see some positives

2014 started strongly for the ship recycling market with plenty of activity in all sectors and by June vessel recycling rates had climbed to over USD 500 per Light Dead Weight (LDT). The traditionally strong end of the year, however, proved mostly a washout, with rates driven down to around USD 400 caused by an influx of cheap Chinese steel billets into the Indian subcontinent.

It is a depressed situation that has continued into the first quarter of 2015 with several vessel recycling sales fixed at below USD 350/LT (a drop of 30% in nine months!) per LDT, hardly surprising when scrap steel is on offer in the USD 250 - USD 275 per tonne Free On Board (FOB) range via Indian and Pakistan ports.

The world's second-largest economy is cooling and what is more, in contrast to past years, Beijing seems relaxed about the slowdown, leaving Chinese steel producers with a shrinking domestic market and consequently a surplus of product which is now finding its way to the export markets.

The Indian and Pakistan governments have both announced their intention to impose extra duty on the subsidised Chinese steel, but so far there are no confirmations when this tax will be introduced. Until such time as a penal tax is imposed recycling rates look likely to head further south and the appetite for ship recycling will decline as a result.

There is little doubt that there is pent up supply of owners wishing to scrap ships, especially from the beleaguered dry bulk sector, but many will probably opt to try to ride out the storm until markets improve, gaining any employment for their ships or in the absence of fixtures idle the ships in hot or cold lay-up until markets improve.

According to Petroula Karagianni, Dubai-based risk manager at Global Marketing Systems (GMS), the world's largest cash buyer of ships for recycling, much depends on how deep the pockets of owners are, as to whether they need to recycle ships now or can continue trading at a loss.

"It all depends on the cash flow of the owner whether they can wait for the market to improve," said Karagianni.

GMS keeps a continuous dialogue with owners from its offices around the world and will try to create a solution to the owners' needs with a specific vessel. The services include a range of products, from buying ships for recycling on simple 'as is where is' terms providing owners with prompt access to cash, to buying ships for trading, or to a cash infusion into a vessel.

Sellers also have the advantage that the contract is 'locked in' and not subject to the whims of a recyclers' yard, some of whom are notorious for walking away from a deal at the last minute. As a buyer with a proven track record and about 3,000 deals, GMS underwrites the market risk for owners. As a result, ships are almost always sold via cash buyers like GMS.

Additionally, funds from the sale of the vessel are paid in cash and not subject to the complexity of a letter of credit, a very important point for owners who are not experienced with the banking systems of India, Pakistan and Bangladesh.

Although Turkey is becoming a bigger player, India, China, Pakistan and Bangladesh remain the so-called 'big four' in ship recycling and accounted for over 90% of all ships recycled in 2014.

However, a state subsidy of USD 150 per Gross Registered Tonnes (GRT) granted to Chinese-flagged ships at the nations recycling yards has skewed the balance of activity which means that international flagged ships are virtually excluded from recycling in China – unless an owner is prepared to accept a discounted price of USD 225 per LDT!

The Chinese scrapping subsidy which lasts until the end of 2015 (there are rumours that it could be extended) has undoubtedly been a further drag on the ship recycling markets in Asia and together with the combination of cheap Chinese steel imports all seem to add up to a rather pessimistic outlook for the ship recycling industry in the near and mid-term future.

But shipping is a cyclical industry and since the 2008 global financial crash volatility has swung wildly with the supply /demand equation shifting often from quarter to quarter, instead of the pre-crisis much slower year-to-year norm.

It follows that shipping people tend to be optimists, seeing the glass half-full scenario of the prospect of a bull market in a downturn rather than an indefinite continuation of a bear market. London-headquartered Clarksons Research Services is a shipping analyst and in its blog it suggested another reason why ships will continue to be scrapped despite the existence of depressed rates.

The blog says: "In practice ships only get scrapped when investors believe they can never make a profit. The limited capital tied up in an old ship is underwritten by its scrap value, and trading in the hope something will turn up does not cost much. The problem is the repair cost. By 30 years old the bills are bigger and the future limited, so even well maintained ships bow out at the sixth special survey, while their neglected contemporaries disappear at the fourth or fifth."

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Jamie Dalzell, Shanghai-based trader at GMS believes that the market may now have bottomed out but concedes "we have said that before" and also admits that the past months have been "terrible," with GMS having taken financial hits on some deals.

GMS, says Dalzell, is a long-term player having been in the ship recycling business for over 20 years, and has consequently ridden out many previous downturns of this nature.

Founded by Dr. Anil Sharma in 1992 GMS has done much to improve the reputation and transparency of an industry that is generally regarded as 'murky'.

Working conditions have improved significantly at many Indian subcontinent yards, says Dalzell.

However, regulation, such as the adoption of the Hong Kong Convention (HKC) for the Safe and Environmentally Sound Recycling of Ships in 2009, has also contributed to a vast clean up of the industry.

CAN OWNERS DICTATE WHERE THEIR SHIPS GO TO BE RECYCLED?

"Absolutely yes," says Dalzell. "During our negotiations we recommend yards to owners that comply with our Green Ship Recycling programme, and if they wish we take them there for a visit to see at first hand the high standards."

He added that a visit to the recycling yard by a shipping line representative was becoming more common as owners take more notice of their environmental responsibilities.

The current much low cost of bunkers could extend the life of some cargo vessels that were previously regarded as uneconomic in terms of fuel economy.

On the flipside, if shipping lines dispense with slow steaming due to lower fuel prices, fewer ships will be required and therefore more vessels could be earmarked to make their final voyage to the recycling yards.

One way or another ship recycling will continue and possibly increase as the average age for recycling a ship comes down with more eco-friendly technology advanced new builds being delivered.

JLT has developed a strong trading relationship with GMS through our ability to provide innovative insurance solutions in this demanding sector. We would like to thank GMS for their invaluable input and support in providing the interview and content for this article.

GMS Leadership

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