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A FEW THOUGHTS ABOUT CONSOLIDATION IN SHIPPING

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A FEW THOUGHTS ABOUT CONSOLIDATION IN SHIPPING

WHAT CAN WE LEARN FROM THE AIRLINE INDUSTRY?

The US airline industry is a great example of the successful consolidation of an industry which had for many years suffered from overcapacities and fragmentation. Too many airlines were operating too many aircrafts covering too many airports leading to fierce competition, low utilization/passenger load factors and huge losses. Major airlines went through bankruptcy and consolidation was inevitable.

Today the two leading US airlines, South West Airlines and Delta Air Lines each have a market share of 21% of the US airline market. The top 10 airlines share among them 96.6% of US airline traffic. The benefits of a consolidated market are high load factors of 95%, strong earnings and significantly-improved balance sheets. The "hard" truth is that highly capital-intense industries, like the airline and shipping industries, with relatively high fixed costs, can only operate profitably in the long-term if continuously high utilization of assets can be achieved.

IS THERE ANY CONSOLIDATION IN THE SHIPPING INDUSTRY?

Supply management is key and this can only be achieved through consolidation. Hence, consolidation in shipping is an ever-recurring topic at shipping conferences and among public and private equity circles. Each announcement of a merger between two prominent shipping companies is welcomed as another step towards overdue consolidation. But do these mergers really contribute to consolidating a fragmented industry? Let's look at a few more recent examples.

FIRST EXAMPLE, STAR BULK CARRIERS: "NEW $1BN STAR IS BORN"

In July 2014 Nasdaq-quoted Star Bulk Carriers merged with privately owned Oceanbulk. Oceanbulk founded by Petros Pappas had 15 vessels in the water and ordered a further 26 newbuildings with the substantial financial support of PE fund Oaktree. The merged company became the largest US-listed dry bulk owner with a total capacity of 11.7m dwt (including orders), a fleet of 65 vessels on-the-water, and 100 vessels on a fully delivered basis.

TABLE 1: TOP TEN DRY BULK OWNERS

RANK	OWNER / GROUP	DWT	MARKET SHARE (DWT)	NO OF VESSELS	MARKET SHARE (NO OF VESSEL)
1	NIPPON YUSEN KAISHA	23,056,190	2.8%	244	2.2%
2	COSCO GROUP	22,254,935	2.7%	272	2.5%
3	K-LINE	16,402,674	2.0%	145	1.3%
4	MITSUI O.S.K LINES	16,074,607	1.9%	130	1.2%
5	FREDRIKSEN GROUP	13,272,923	1.6%	110	1.0%
6	CHINA SHIPPING GROUP	12,602,771	1.5%	168	1.5%
7	BERGER BULK LTD.	11,417,317	1.4%	52	0.5%
8	STAR BULK CARRIERS	11,069,400	1.3%	94	0.9%
9	PAN OCEAN CO LTD	8,747,368	1.1%	69	0.6%
10	NISSEN KAIUN K.K.	8,603,055	1.0%	93	0.9%
	TOP 10	143,501,240	17.3%	1,377	12.6%

Source: Clarksons Research, 2015

Oaktree currently holds 58% in the new company. Post-merger, Star Bulk had a market cap of approximately USD 1bn (which has since fallen to USD 350m). Tradewinds greeted the deal with the headline: "New $1bn Star is born". But did the deal significantly effect a move toward consolidation in the dry bulk carrier market?

According to the table on the previous page (figures as per Jan. 2015), upon delivery of its newbuildings, Star Bulk would be among the top 10 dry bulk owners. However, the company would control just a small fraction of the total dry bulk vessel supply. None of the top owners, including the three big Japanese owners, or COSCO, control a significant portion of total vessel supply (in dwt). No single owner has any "clout" in comparison to the relatively few "big guys" who are chartering the vessels.

In terms of overall size (*i.e.* total fleet size including other sectors like containers or tankers, measured in dwt) Star Bulk ranks only 4th among the shipping companies controlled by Greek interest after fully privately owned Angelicoussis Group, listed Navios Group, and partly public Dynacom Group.

SECOND EXAMPLE, DRY BULK POOL: "OPPORTUNITY TO TAKE MARKET LEADERSHIP"

In response to a Baltic Dry Bulk Index at its lowest in 30 years and unsustainable freight rates, five leading capesize operators have established a joint chartering platform, Capesize Chartering. Bocimar, C Transport Maritime (Livanos/Monaco), Golden Ocean, Golden Union and Star Bulk Carriers are combining their chartering activities for a combined fleet of 80 capesize carriers. However, with a total capesize carrier fleet of almost 1,900 vessels (including orders) a chartering platform of 80 vessels (4.2% of the total fleet) can hardly be considered the critical mass required to make an impact on freight rates. Big global charterers like Rio Tinto, Fortescue, Vale, Cargill, and Vitol ED&F have many options to charter a vessel from a large fleet of underutilized vessels operated by owners willing (and used to) to accept the price/rate they are offered. Owners will remain price-takers as long as the supply side is not more rationally managed.

THIRD EXAMPLE, TANKER MARKET: "A TANKER GIANT IS BORN"

In February 2015 General Maritime and Navig8 Crude Tankers announced their merger that will "create one of the world's largest owners of VLCCs" according to TradeWinds. The new entity, Gener8 Maritime will include Navig8's 14 and Genmar's 7 VLCC orders, with a total fleet of 7 VLCCs in the water and 21 VLCCs on order with a market cap of approximately USD 1.4bn. But where does the merged company stand in relation to its peers and the market? The UL/VLCC market is more consolidated than the bulker market: the top ten control 44% of the supply versus 17.3%. However, each of the owners has very little market leverage considering that the number of charterers in the large tanker market are few and very powerful. Although, something bigger could be in the making. In October 2014 John Fredriksen-controlled Frontline and the VLCC pool operator Tankers International (TI) announced a 50/50% joint venture, VLCC Chartering. VLCC Chartering controls a combined fleet of about 60 VLCCs, or slightly less than 10% of the total VLCC market. Interestingly, Euronav, with a fleet of 24 VLCCs, is the largest partcipant in the TI Pool.

Also noteworthy is that the low profile, privately owned Greek Angelicoussis Group has a larger market presence than its listed non-Asian peers. Also in terms of total crude carrying capacity, the merged Gener8 Maritime will only marginally impact the fragmented ownerships of crude tankers.

BUT THERE ARE GOOD EXAMPLES IN NICHE MARKETS.

It is well known in the shipping industry that the ship owner's worst enemy is another ship owner who is ordering more ships. Like Martin Stopford recently mentioned: "Don't play the cards, play the players!" Consolidation, as the example from the airline industry proves, is the only way to break the boom and bust cycles. Consolidation in shipping has not really happened mostly for the same reasons: low barriers to entry in commodity shipping, low cost of ca

TABLE 2: TOP TEN UL/VLCC OWNERS

RANK	OWNER / GROUP	DWT	MARKET SHARE (DWT)	NO OF VESSELS	MARKET SHARE (NO OF VESSEL)
1	CHINA MERCHANTS GRP	12,937,397	6.1%	42	5.8%
2	NIOC	11,474,376	5.4%	37	5.2%
3	MITSUI O.S.K. LINES	9,810,100	4.7%	32	4.5%
4	ANGELICOUSSIS GROUP	9,681,023	4.6%	31	4.3%
5	BAHRI	9,715,133	4.6%	31	4.3%
6	GENER8 MARITIME	8,760,682	4.2%	28	3.9%
7	FREDRIKSEN GROUP	7,923,583	3.8%	26	3.6%
8	EURONAV N.V.	7,627,790	3.6%	24	3.3%
9	COSCO GROUP	6,969,582	3.3%	23	3.2%
10	NIPPON YUSEN KAISHA	6,633,443	3.1%	22	3.1%
	TOTAL	91,533,109	43.5%	296	41.2%

Source: Clarksons Research, 2015

pital, and shipyards selling slots at whatever it takes to fill capacity. After the 2008 market meltdown, a chance for consolidation by large private companies was prevented by many banks' inability to foreclose on vessels and let them go to financially strong groups.

Examples in the shipping industry exist which prove that consolidation works for the benefit of owners: Car Carriers, RoRo Ships and Parcel Tankers. In these markets, owners are not merely tonnage providers, but have managed to become part of their clients' logistics chain. Instead of offering a homogenous service, owners in these niche markets provide additional services (*e.g.* door-to-door delivery, logistics services, freight handling, commissioning, quality control) which strengthen the relationship with charterers and improve pricing power.

Owners in these markets have fared much better during the crisis; new ships are mostly ordered on the back of long-term contracts or new services. It is worth noting that the niche markets in shipping have attracted little capital from PE and public equity sources. Most likely their business models or trading history were not appealing enough or did not provide the stuff for asset plays and value recovery sales pitches.

WE NEED MORE CONSOLIDATION… MUCH MORE CONSOLIDATION

The consolidated airline industry has generated strong profits for the last couple of years, however, there is no rush to order new aircrafts and establish new services. The airlines' most important guideline for investments is the passenger load factor. They would fly with one plane at 95% load factor rather than operating two aircrafts each with a 60% load factor. It seems so simple …

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