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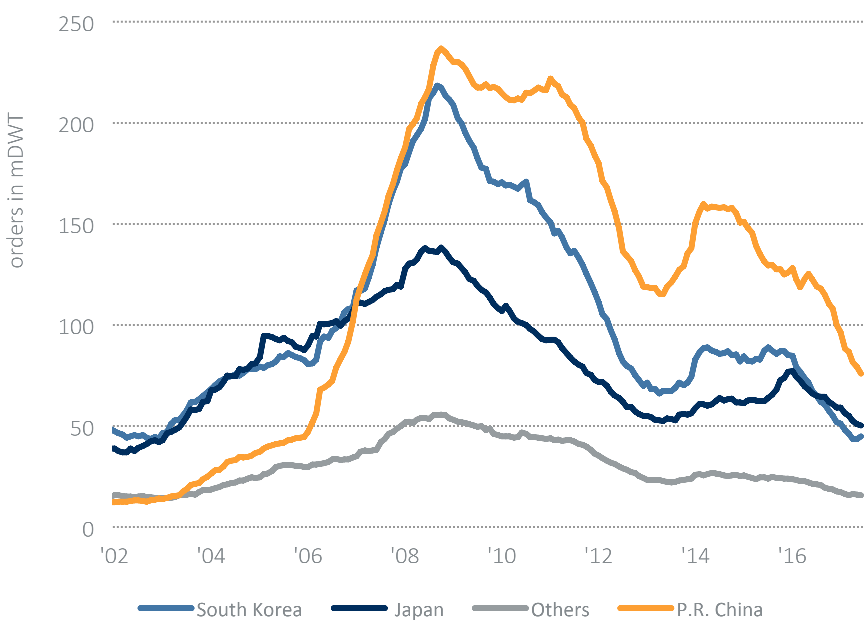
SHIPYARDS' STRUGGLE FOR SURVIVAL

SPECIAL: SHIPYARDS' STRUGGLE FOR SURVIVAL

Since the beginning of the crisis in 2008, most shipping sectors suffer from overcapacities, sometimes combined with low demand for transportation in their respective segment. Unsurprisingly, this has left its mark on the shipbuilding industry which has been facing diminishing demand for new ships, postponement of deliveries and falling newbuilding prices compared to the pre-crisis period. In such downswing, yards tried to brace against dwindling cash reserves with drastic restructuring measures, waves of layoffs and spinning-off non-core businesses. Even state-owned shipyards could not fully evade such development. However, the forces of economics have played out somewhat differently in the three major shipbuilding nations.

CHINA SURPASSES ESTABLISHED SHIPBUILDERS



Source: Clarksons 06/2017

CHINA'S FIGHT FOR MARKET SHARE

Of the three major players China, Japan and South Korea, particularly China has pushed aggressively for an increasing market share since 2005. This was made possible by substantial direct and indirect subsidies from the Chinese government which had declared shipbuilding as a key industry.

The graph above shows that although the three nations followed the same pattern of rise and fall in the orders, it was most pronounced in the case of China. The Chinese orderbook nearly quintupled between 2005 and the market high in 2008, closely followed by orders placed in South Korea and, to a lesser extent, in Japan. China's rapid gain in market share was further fostered by cheap production costs and abundant availability of capacities for the shipowners' insatiable hunger for newbuildings. Thus, the term 'green-field yard' is closely connected to this period when new Chinese yards sprang up like mushrooms. Unable to compete with China in terms of pricing, established quality builders in South Korea and Japan lost market shares and some decided to set up joint ventures in China.

POST-BOOM ORDERING ACTIVITY DOWN TO 2004 LEVEL

With the massive supply overhang in many shipping sectors becoming evident in 2008, the ordering activity stunted, reaching a temporary low in 2013. By then, newbuilding orders had decreased by 51% in China, 70% in South Korea and 62% in Japan. After a brief revival in 2014, the downwards spiral has continued till today. Ordering of Chinese newbuildings has reached a new low, amounting to merely DWT 76m of today. This is only slightly higher than the DWT 45m and DWT 50m orders currently in South Korea and Japan respectively. Altogether, the ordering activity has shrunk to DWT 186m which is the same level as in 2004.

NEWBUILDING PRICES STILL FALLING

Consequently, newbuilding prices started to drop dramatically due to the lack of ordering activity. The Clarkson Newbuilding Price Index lost 26% within 12 months after the high in 2008. Although there were some signs of recovery in 2013/2014, the market continued its fall subsequently, reaching its 13 years historical low in 2017 as depicted in the graph to the right.

NEWBUILDING PRICES STILL FALLING

Source: Clarksons 06/2017

CHINA'S 'WHITE LIST'

China's massive expansionary policy targeting the market share led to a surge in the yard capacity in the boom period. The number of shipyards reached about 1,600 which even by Chinese standards was too high to maintain in the subsequent crisis. To get rid of the overcapacities, China's Ministry of Industry and Information Technology in 2014 released its first so-called 'White List' of 51 shipyards which would be extended extra support by the government. Such white-listed yards had to comply with certain conditions to benefit from government support provided, inter alia, in the form of exporting tax rebates and bank loans.

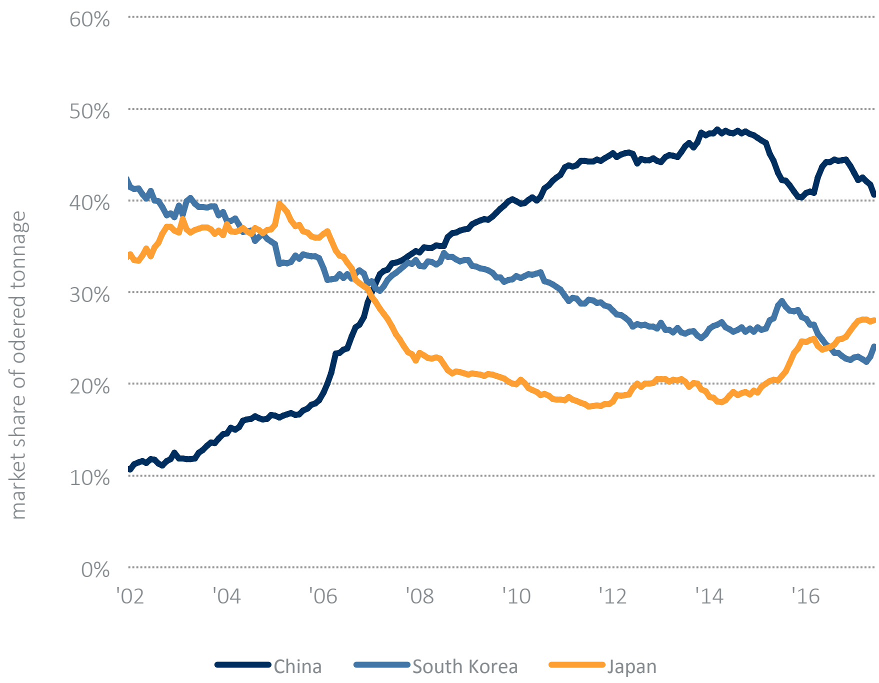
Since then, the list has been regularly updated and the criteria revised. Meanwhile, the ministry has released its fourth White List comprising 70 shipyards. The commercial importance of this list becomes evident in Clarksons' estimations according to which 90% of the shipbuilding output in 2016 have been delivered from the White List-yards. Market expectations have it that the number of listed yards will be reduced to 59, reflecting the government's continuing aim to curtail capacity overhang.

SOUTH KOREAN YARDS EQUIPPED WITH SUBSTANTIAL AID

Shipbuilding is one of South Korea's most important industries with a significant share in its gross domestic product and domestic workforce. Amidst shrinking orders, falling newbuilding prices and postponed deliveries, South Korea's shipbuilding sector has been forced to undergo drastic consolidation and restructuring measures. After having incurred huge losses for the past few years, the 'Big Three' shipyards, Daewoo Shipbuilding & Marine Engineering, Hyundai Heavy Industries and Samsung Heavy Industries, plan to reduce their workforces by around one third by 2018 and operations by 23%, besides spinning-off their non-shipbuilding businesses, as reported by the government last year. STX Offshore & Shipbuilding, once Korea's fourth largest shipyard, had to file for receivership.

To help local shipbuilders, the South Korean government in October last year announced plans to support orders of 250 or more vessels by 2020 by spending KRW 11tn or approximately USD 9.6bn. Further, the shipbuilders' portfolio is likely to focus on large container ships, oil tankers, and LNG carriers in the future. As of late, South Korean shipyards are reported to apparently return to profitability, helped by rising deliveries, cost-cutting measures and new orders.

JAPAN'S REVERSING MARKET SHARES AS OF LATE



Source: Clarksons 06/2017

JAPAN BENEFITS FROM EARLY REORIENTATION

Japan was faced with the loss of market share due to rising competition even before the shipping boom reached its high. Thus, Japanese shipbuilders were compelled to implement consolidation and efficiency measures and to reorient their businesses earlier than their competitors in South Korea and China. Further, Japan's shipbuilding industry turned early to focus on more technology advanced vessels to differ from China and South Korea. Consequently, despite massive government support and restructuring efforts in those countries, Japan's shipbuilders have managed to increase their market share from its low of 18% in 2011 to 27% as of today, as shown in the graph above.

A helping hand has been offered by the weakening Japanese Yen whilst the highly valued Yen in previous years had undermined Japanese shipyards' competitiveness.

Presently, Japanese builders fear that South Korean and Chinese yards, in their struggle for survival and backed by massive governmental support, might accept orders at sub break-even prices. However, stricter environmental regulations concerning the ballast water management systems and the new global sulphur cap would provide an opportunity to Japan's yards to stay competitive due to their capability in ecoships, according to Shigeru Murayama, president of the Japan Ship Exporters' Association.

CONTRACTING PICKING UP, ALBEIT AT A LOW LEVEL

This year, the placing of newbuilding orders at various yards has induced some optimism that the yards' financial situation would improve and shipowners would expect markets to tighten in the future. The table on the next page reveals that new contracts in the four main segments dry bulk, tankers, containers and gas tankers in the three major shipbuilding countries collapsed to only 273 in 2016, down from 1,009 contracts in 2015.

This year till date, contracts for 184 newbuildings have already been signed. Extrapolated for the whole year 2017, we believe that this could result in a number fairly above last year's.

Of the three shipbuilding heavyweights, China leads in absolute numbers. However, only South Korea has managed to secure more new contracts in 2017 compared to the previous year. With regard to the type of vessel to be built, while China has managed to clinch a good number of orders for both bulkers and tankers, South Korean contracts clearly focus on tanker and gas carrier newbuildings. With the lowest number of contracts, Japan seems to be in the rearguard, although it steadily gained market share during the past five years.

A SILVER LINING ON THE HORIZON

Although the development of newbuilding prices draws a grim outlook and the struggle for market shares remains unabated, the gently ascending number of contracts leaves some hope for the ailing shipbuilding industry. However, the survival of many shipyards depends not only on their respective efficiency, cost-reduction and concentration on core competencies, but also on the extent of government support.

While reducing overcapacities is still a core topic, the Chinese government within its scope of the 'White List' remains committed to its shipbuilders. Shipbuilding in South Korea with its substantial impact on the overall economy is also likely to retain its priority for receiving government support. Japanese players seem to be less prone to state aid. But, they already underwent a severe change process shortly after the shipping boom ended and recently managed to overtake rival South Korea in the run for ordered tonnage.

The financial markets seem to believe in the shipyards' future. As deteriorated fundamentals should already be priced-in and government support and individual restructuring measures begin to unfold their full impact, yards' stock prices have risen like phoenix from the ashes, making over 20% since the start of the year.

NEWBUILDING CONTRACTS BY TYPE AND COUNTRY

IN NUMBERS	JAPAN			SOUTH KOREA			CHINA		
	2015	2016	2017	2015	2016	2017	2015	2016	2017
BULK	213	9	12	0	1	3	65	33	36
TANKER	181	25	7	110	41	54	133	58	44
CONTAINER	38	17	0	53	4	0	130	65	11
GAS	32	9	1	47	10	14	7	1	2
TOTAL	**464**	**60**	**20**	**210**	**56**	**71**	**335**	**157**	**93**

Source: Clarksons 06/2017

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