Drewry
Maritime Advisors

Liner Paradise: a new era

BIPC 2020

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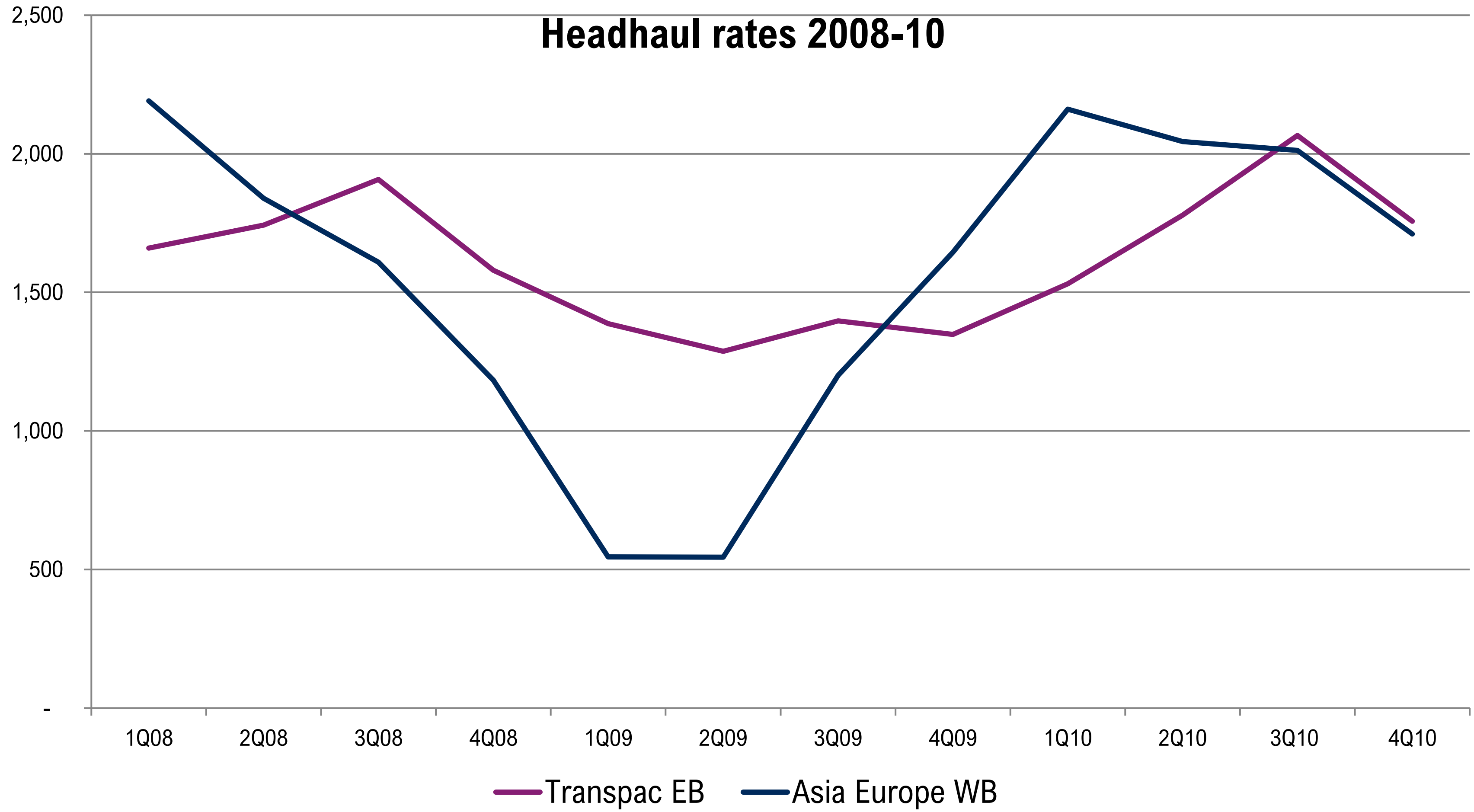
2009 and 2020: compare and contrast

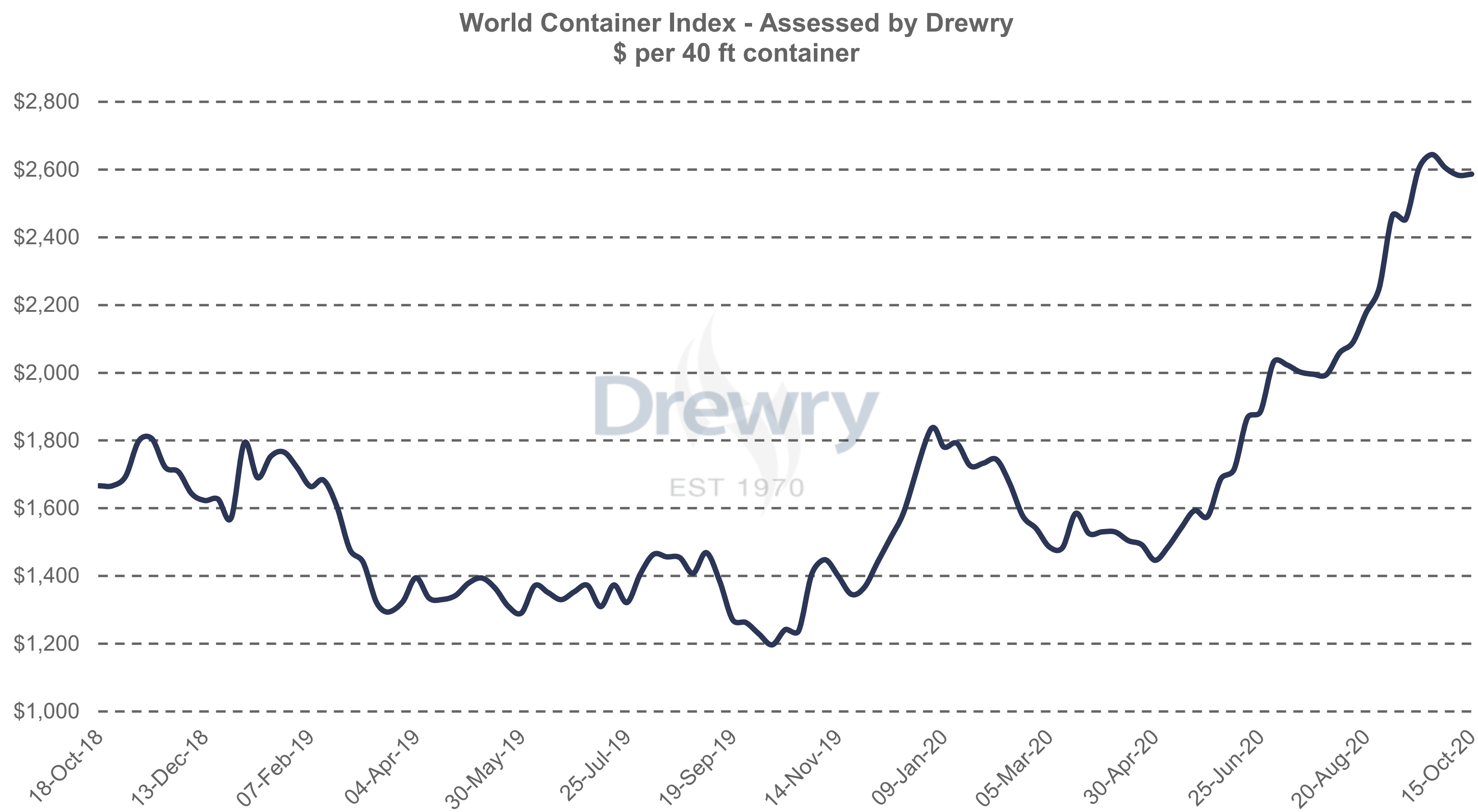
Freight rates: 2008-10

In 2009, freight rates collapsed on the Asia – Europe trade and fell by 32% on the Transpacific trade



Spot the difference

Asia – Europe rates rose sharply in Q4 2019 before eroding to Q2 2020 and recovering. Transpacific rates were stable and are now rising rapidly



Container shipping fundamentals

Liner fundamentals

The liner industry has been unable to make sustainable profits…

Factor	Effect	Comments
Economies of scale	Structural overcapacity	Lines always build bigger vessels to exploit economies of scale. This leads to continual overcapacity
Perishability	Push for short-run contribution – rate erosion	Unused capacity cannot be stored. Lines cut rates in order to boost utilisation
High operational gearing	Push for short-run contribution – rate erosion	Lines' networks represent a high fixed cost burden. The logical response is to maximise utilisation
Commoditised service offering	Limited differentiation of product; price competition	Price is the principal competitive weapon
Fragmented industry	No coordination of capacity development, intense competition	Too many carriers and no dominant carriers to establish market stability
Inelastic demand curve	Falling rates have a limited effect on demand	Seafreight is a negligible element in the landed cost of manufactured goods and makes no difference to end market demand

Liner fundamentals

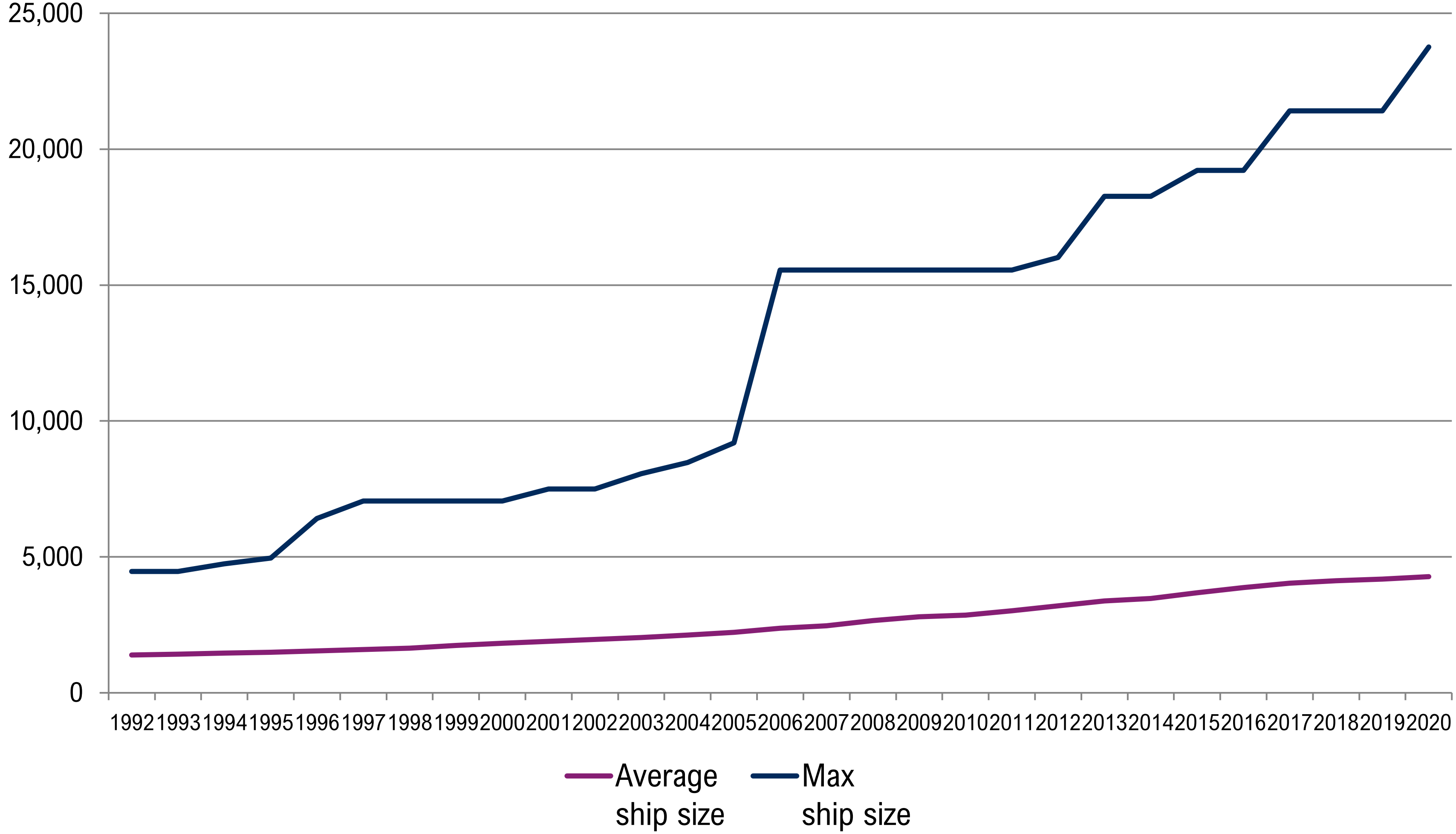
…but it could, with two changes. Have these changes happened?

Factor	Effect	Change?	Comment
Economies of scale	Structural overcapacity	**Economies of scale run out**	**Lines will build to match demand not to chase economies of scale. Pursuit of share is less important**
Perishability	Push for short-run contribution – rate erosion	No	Unchanged
High operational gearing	Push for short-run contribution – rate erosion	No	Unchanged
Commoditised service offering	Limited differentiation of product; price competition	Unlikely	Unchanged
Fragmented industry	No coordination of capacity development, intense competition	**Industry consolidation**	**A small number of large carriers is able to match capacity to demand and promote increased tariffs**
Inelastic demand curve	Falling rates have a limited effect on demand	No	**Rising rates have a limited effect on demand, supporting profitability**

Changes

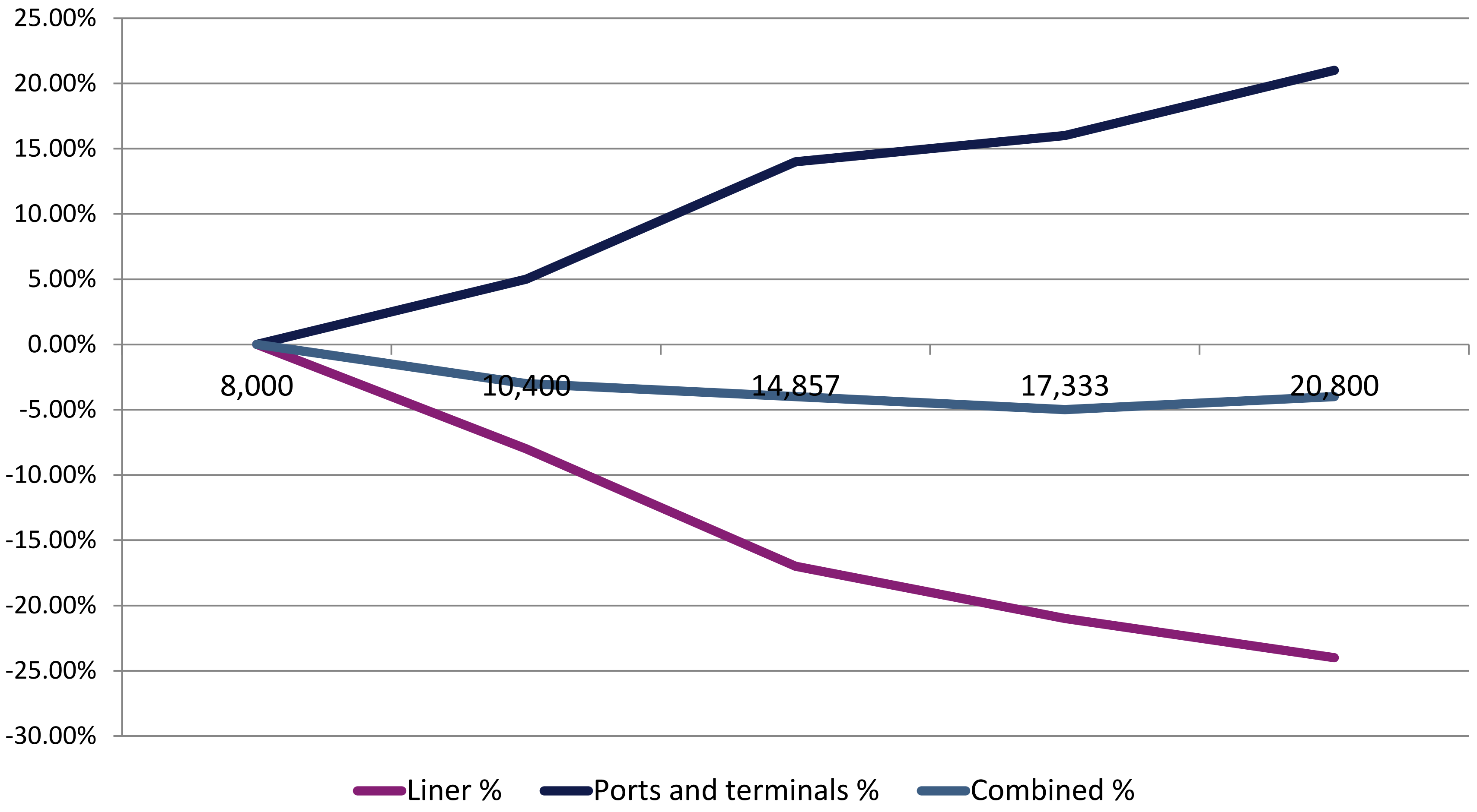
Economies of scale: vessel sizes

Maximum vessel sizes have rocketed since 2005



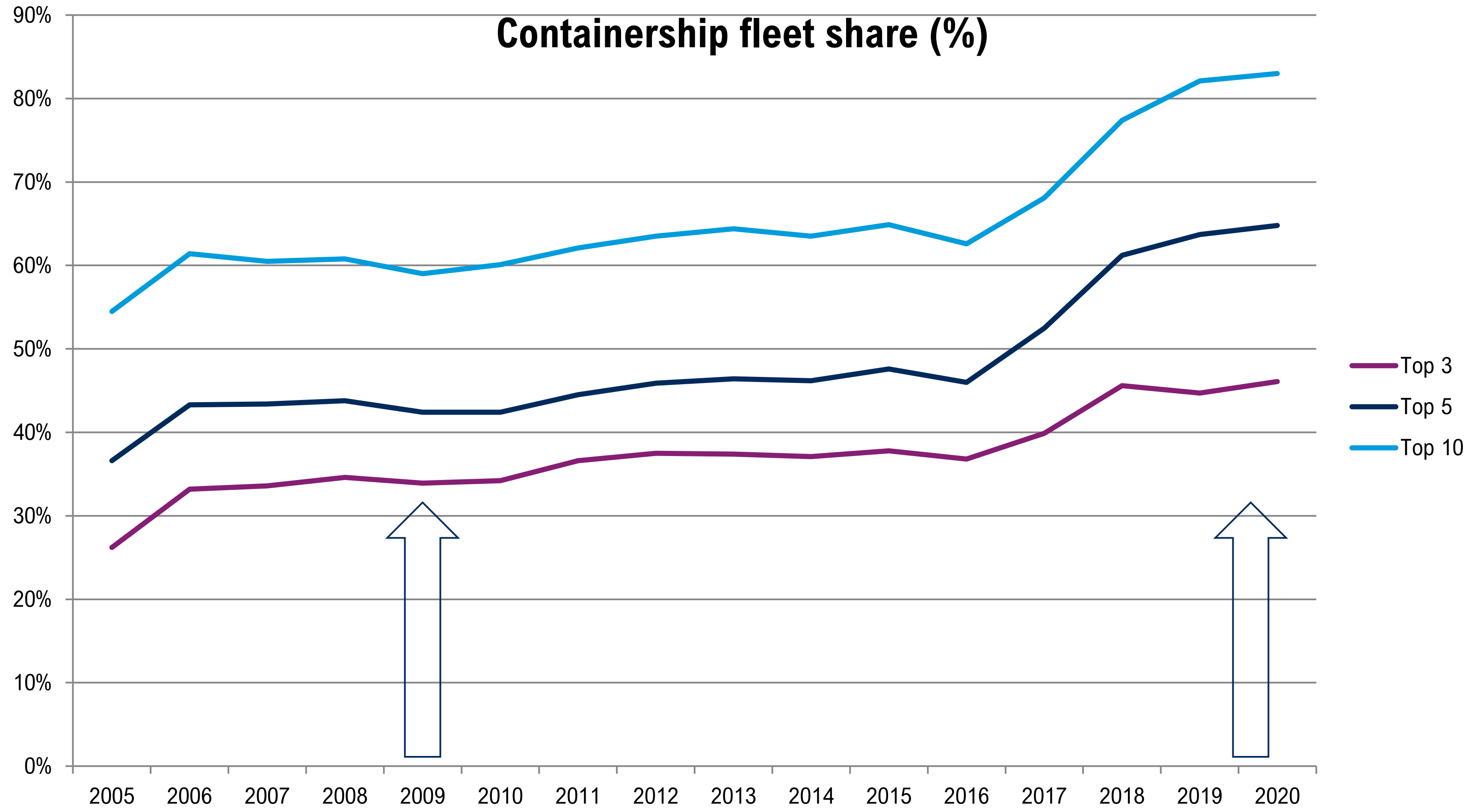
Economies of scale: costs

Scope for vessel economies of scale in 2009 was large; now looks much less. Total system costs show no economies of scale.



Market concentration: lines

Substantial increase in market concentration since 2016, 50% at the level of Top 5.



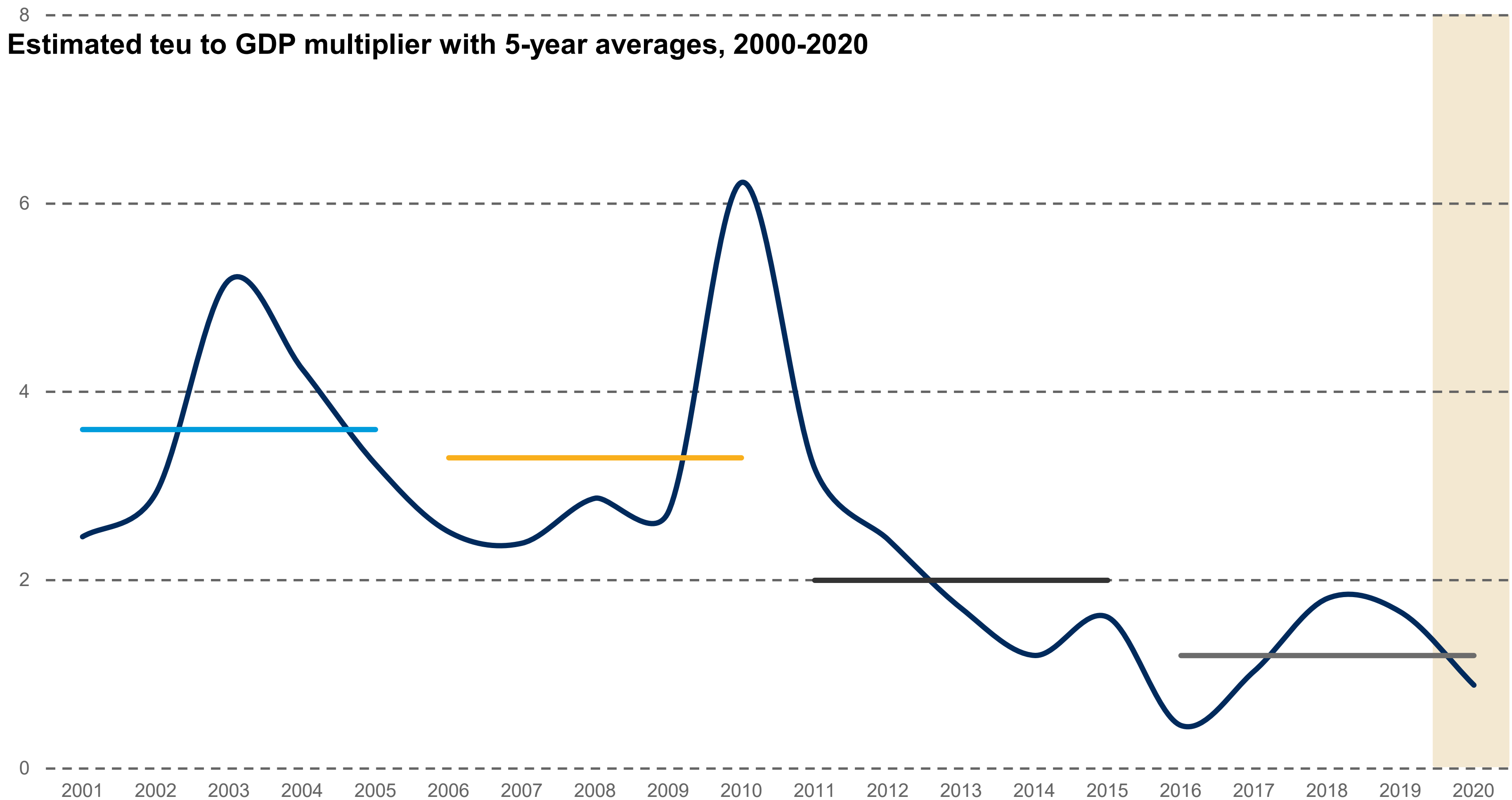
Market concentration: alliances

The concentration of major lines into the three alliances on the main East – West trades has created the structure for effective capacity management

<table>
<tr><th>Shipping Lines</th><th>Previous Alliances</th><th>2016</th><th>Shipping Lines</th><th>New Alliance</th></tr>
<tr><td>Maersk</td><td rowspan="2">P3 Alliance (denied)</td><td rowspan="2">2M Alliance</td><td>Maersk</td><td rowspan="3">2M Alliance (with mergers)</td></tr>
<tr><td>MSC</td><td>MSC</td></tr>
<tr><td>CSCL</td><td rowspan="2">CSCL / UASC</td><td rowspan="2">Ocean 3</td><td>Hamburg Süd</td></tr>
<tr><td>UASC</td><td>CMA CGM</td><td rowspan="7">Ocean Alliance (with mergers)</td></tr>
<tr><td>NYK Line</td><td rowspan="3">Grand Alliance</td><td rowspan="7">G6 Alliance</td><td>COSCO</td></tr>
<tr><td>OOCL</td><td>CSCL</td></tr>
<tr><td>Hapag-Lloyd</td><td>OOCL</td></tr>
<tr><td>NOL</td><td rowspan="4">New World Alliance</td><td>Evergreen</td></tr>
<tr><td>MOL</td><td>NOL</td></tr>
<tr><td>APL</td><td>APL</td></tr>
<tr><td>Hyundai</td><td>Hapag-Lloyd</td><td rowspan="8">THE Alliance (with mergers)</td></tr>
<tr><td>COSCO</td><td rowspan="4">CKYH Alliance</td><td rowspan="5">CKYHE Alliance</td><td>UASC</td></tr>
<tr><td>K-Line</td><td>Yang Ming</td></tr>
<tr><td>Yang Ming</td><td>MOL</td></tr>
<tr><td>Hanjin</td><td>NYK Line</td></tr>
<tr><td>Evergreen</td><td>Independent</td><td>K-Line</td></tr>
<tr><td></td><td></td><td></td><td>HMM</td></tr>
<tr><td>Hamburg Süd</td><td>Independent</td><td>Independent</td><td><s>Hanjin</s></td></tr>
</table>

Liner growth rate

GDP multiplier has declined steadily since 2000 and is no longer a driver of container volume growth. Long term outlook growth is modest with downside risks



Conclusions

Conclusion

Fundamentals have improved but demand growth outlook is uncertain

- Scope for economies of scale is now limited. The liner arms race will abate
- Concentration at the company level and in major alliances has created the conditions in which capacity can be matched effectively to demand
- Stable utilisation will promote higher rates and margins
- Likely changes in trade patterns pose significant risks to growth in deep-sea liner trades
- Low growth should make lines more cautious about capacity expansion

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