Devaluation of Indian rupee spoils scrapping party

Demolition prices have dropped dramatically in recent weeks

A SEVERE devaluation of South Asian currencies led by the Indian rupee against the US dollar has triggered a dramatic crash in ship recycling prices during the past six weeks.

Compass Maritime Services, a market-leading scrapping brokerage in the US which handles one scrapping deal a week on an average, believes we have not seen the market bottom yet, a fact partly influenced by the impending onset of the monsoon.

"Prices have been falling materially on a daily basis, and we expect the trend to continue," says Compass partner Terry Chance.

"This has caused a very shaky and unstable environment. In the short term, we expect it will be difficult to find buyers for run-of-the-mill or less desirable kinds of ships, such as small bulkers and reefers."

Nonetheless, the magnitude of the shipping industry's current woes, characterised mainly by anaemic freight rates and weak revenues, is expected to keep demolition volumes relatively high regardless of scrap prices, Mr Chance adds.

Even for a notoriously mercurial market such as ship scrapping, the sudden change in climate has been dramatic. As late as early May, all expectations were centred on a "bumper year" for scrapping in 2012, with some experts even projecting that volumes would top the all-time high of 9m ldt recorded in 1985.

Figures from EBM Shipbrokers in London show that 518 vessels totalling around 5.5m ldt had been scrapped in the first five months of 2012. At this pace, the 1985 record could be comfortably broken.

The steady exodus of ships to the subcontinent this year was aided by historically firm prices, with demolition yards in India paying $520-$530 per ldt during the spring on immediately delivered ships, while China paid $430-$440 per ldt.

However, the final scrapping volume for 2012 has now been thrown into question, after the Indian rupee crashed almost overnight to Rs56 against the US dollar in the second week of May. This accelerated a steady slide that had already set in during the second half of 2011, which the currency had begun at Rs44.

This year alone, the rupee has lost more than 10% of its value, and current economic forecasts from the country offer no cheer. Currencies in Pakistan and Bangladesh have fared no better.

Mr Chance says Indian scrap prices at the beginning of June, when this story was written, had declined to $410-$420 per ldt for the "good stuff" such as promptly delivered large tankers, while China was paying $370-$380 per ldt for prompt bulkers.

The sudden U-turn in market sentiment was partially a function of "pent-up" supply of ships into Bangladesh in the period after that country's markets opened up again after being shut for six months because of environmental reasons.

"That tsunami of ships had helped boost the market, but that supply has now normalised. We expect that prices will fall even further in June," Mr Chance warns. "We expect business on international scrapping to decline, at least until we see some stability. Right now, the feeling is down, down, down."

An interesting sideshow to this larger picture is the reported plight of some cash buyers in the falling price environment. One expert believes that cash buyers in the subcontinent have built up a "huge stockpile" of ships that they purchased on an "as is" basis, in hopes of cashing them out at a profit as rates firmed in the first half of this year.

This boot may now be on the other foot. In fact, the current decline in scrap prices could partly be a function of such trapped cash buyers monetising their ships at any price the demolition yard might offer them — in effect, a vicious cycle that contributes to further price declines.

While this part of the jigsaw has no direct bearing on mainstream shipping, Compass partner Bart Lawrence has identified a critical area where current price developments will hurt the average shipowner intending to scrap tonnage.

According to Mr Lawrence, after a vessel is sold, the shipowner "is always punished when the market is falling, but never rewarded while it is going up".

"Therefore, someone who sells at $390 per ldt today, but with the ship not expected to reach the scrap yard for another month, should be prepared to accept a lower price upon delivery," Mr Lawrence says. "You will be surprised with the number of minor problems with a ship that the scrap buyer will manage to find when rates are falling. This is sometimes used to negotiate the previously agreed price downwards."■

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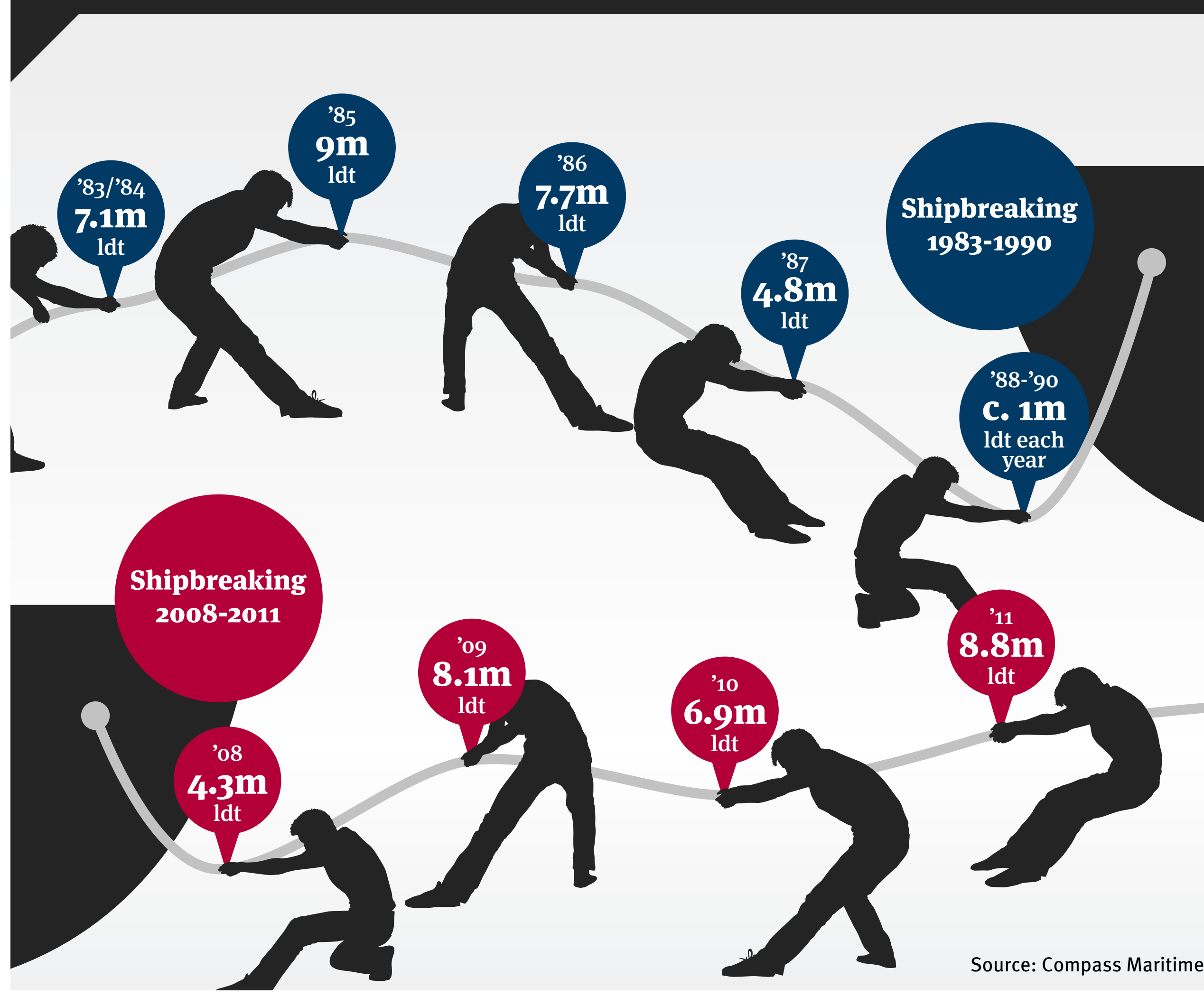
Terry Chance, Compass Maritime

SHIPBREAKING – HISTORICAL TRENDS



... but no disastrous decline in scrapping volumes is expected

DESPITE what Compass Maritime Services partners Terry Chance and Bart Lawrence call "negative vibrations" in the scrapping market right now, the main message to the industry is not necessarily that scrapping volumes are poised for a steep fall.

However, shipowners better be prepared to adjust their expectations on scrapping revenues downwards for the second half of the year.

This is particularly crucial for distressed borrowers and their lenders, who may have agreed plans for reorganisation or liquidation based on a hypothetical scrap price that the lenders might receive upon repossessing their assets.

Owners who can afford to wait will wait, but in cases where the banks are in charge, forcing the liquidation of ships, they will suddenly find that their ability to dictate terms will not work in South Asia's scrap yards.

Nonetheless, Mr Chance and Mr Lawrence still expect that the number of ships sent for scrapping will remain materially unchanged in the longer term, as long as the freight markets remain depressed.

"The price paid by the scrap yard never drives the number of ships scrapped, it is the other way round," Mr Lawrence says.

"The supply of scrap ships is primarily dependent on freight rates, not the scrap price. The only way scrapping will slow is if commodity transport volumes increase."

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Statistics bear this out. As rates improved after the mid-1980s recession, volumes scrapped swiftly declined from the 1985 all-time peak of 9m ldt to 4.8m ldt in 1987. In 1988-1990, as world economies recovered, scrapping amounted to a mere 1m ldt for each of the three years.

Likewise, annual scrapping totalled a mere 1m ldt a year in the mid-2000s, in the heady days before the current recession.

Since 2008, however, volumes scrapped came in at 8.1m ldt in 2009, 6.9m ldt in 2010 and 8.8m ldt in 2011, regardless of scrap prices.

Even if 2012 does not break the 1985 record, the final tally for this year will be impressive nonetheless — in fact, 5.5m ldt has already been demolished through to June.

Mr Lawrence says: "Scrapping will continue to help solve the industry's problems of ship over-supply and loss-making operations. The only paradigm shift we are advising owners to be ready for in the coming quarters is lower scrap prices."■

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