Baltic Dry Bulk Investor Indices

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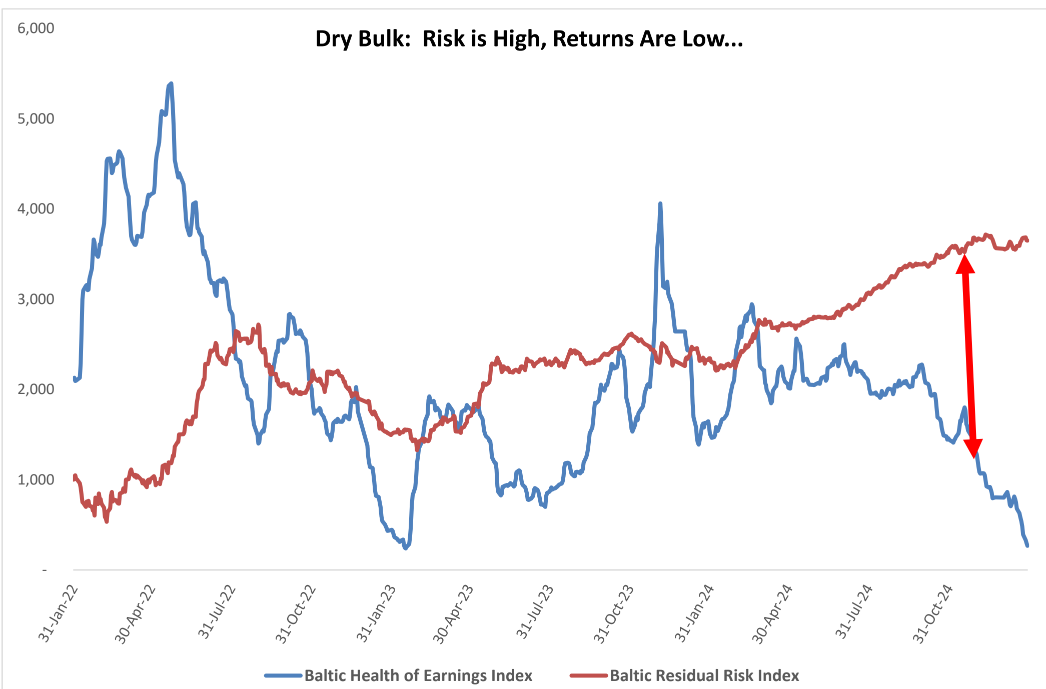
Dry Bulk: Cash, One Can Never Have Enough

When "times are good", shipowners have the luxury of high asset values, but they can also become flush with cash - no doubt a good problem to have. The decision then is: What to do with the cash? Invest? Issue dividends? Investors want cash to be invested, returned in the form of dividends, used to pay down debt, and - if the company is public and dependent on share valuation – spent on stock repurchases. When the market is weak, as it is today, it becomes very hard to raise cash: In our view, much to the chagrin of investors, saving excess cash for a rainy day makes a lot of sense, but it rarely happens.

Today, "times are bad." Since the Baltic Dry Bulk Investor Indices launched in 2022, the gap between the Baltic Residual Risk Index[1] and Health of Earnings Index[2] is at its greatest. While fleet growth has been moderate over the last year, demand and freight rates have been very poor.



[1] Dry sector residual risk index. The average residual risk of Cape (CDRRI), Panamax (PDRRI), Supramax (SDRRI) and Handysize (HDRRI) vessels. Residual risk is ratio of the residual value of the vessel against the recycling value. If the Residual value is lower than the recycling value the index will be negative, indicating a lower risk of the investment.

[2] Dry sector health of earnings index. The average health of earnings of Cape (CDHEI), Panamax (PDHEI), Supramx (SDHEI) and Handysize (HDHEI) vessels. Health of earnings is an index representing the ratio of earnings against running cost. A negative number indicates that earnings are below operating costs.

Recent Freight Rates: Burning Cash for Many

Freight rates are now at levels that are likely below the cash breakeven per day for most shipowners with debt leverage. Should this condition persist, dry bulk shipowners' cash resources could become scarce, asset values may face further pressure, and many may need to raise or sell ships.

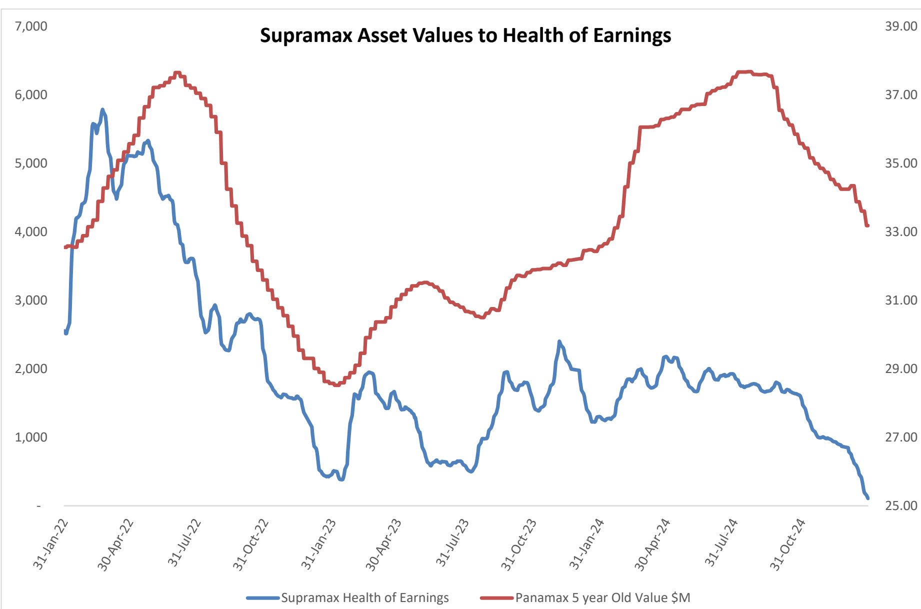
Purchase of 5-year-old secondhand vessel at today's asset values:

	CAPESIZE	PANAMAX	SUPRAMAX
Cash Breakeven/Day	20,848	14,092	12,573
Spot TCE/Day 30 Day Avg	10,381	8,321	8,015
Cash Shortfall/Day	**(10,467)**	**(5,771)**	**(4,558)**
Quarterly Cash Burn	(955,089)	(526,582)	(415,926) [3]

Capesize Breakeven Sensitivity to Leverage and SOFR

		LEVERAGE			
		45%	55%	65%	75%
SOFR	**5.00%**	17,002	19,254	21,505	23,757
SOFR	**4.50%**	16,652	18,826	21,000	23,174
SOFR	**4.35%**	16,547	18,698	***20,848***	22,999
SOFR	**3.50%**	15,952	17,970	19,989	22,007

As we anticipated in our November quarterly update, asset values have been falling, but current freight rates justify asset values falling further. There is some solace in the forecast as interest rates are anticipated by the US Federal Reserve to fall to below 4% by the end of 2025.[4] As noted in the above table, shipowners with floating interest rate debt may get a little break this year.



[3] We assume a 5-year-old vessel purchase at today's asset values. Cash breakeven is computed as OPEX from the Baltic OPEX Assessments, plus estimated G&A expense, debt amortization, interest and fees. For debt, we assume 65% leverage with a 17-year amortization profile, SOFR of 4.35% and margin of 3%.

[4] Federal Open Market Committee (FOMC) Summary of Economic Projections, December 18, 2024

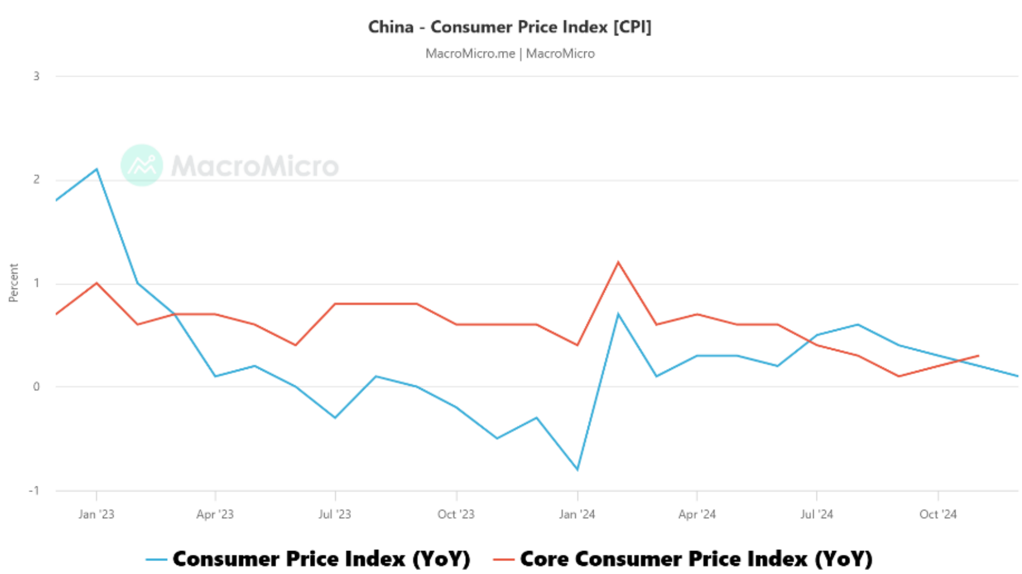
Demand Outlook Remains Stressed…With "Green Shoots"

In our November quarterly update, we anticipated that any improvements in demand would take time to materialise and that freight rates could remain depressed for the coming quarter. This has proven to be the case, and demand uncertainty persists, with the specter of US tariffs further exacerbating this uncertainty.

We agree with most of the textbooks that blanket tariffs are not good. Yet so far, the US tariffs on Mexico and Canada have been put on pause, with both countries agreeing to move more assets to the border to stem both illegal immigration and the fentanyl drug trade.

The US tariffs on China, and China's reciprocal measures, have only recently been announced. Whether negotiations will take place between the nations before further escalation remains uncertain. So far, they are negotiating tools for broader results. The tariffs could well be a transitory, which would be a welcome outcome.

China has been facing deflationary pressures for the last six quarters, and stimulus efforts to date have been unsuccessful in stemming the trend. Furthermore, 900 million (65%) of people in China live below China's middle-income threshold[5] , and China's economy continues to rely heavily on government driven investment for economic growth. If growth is slowing and prices are dropping, it is difficult to stimulate the Chinese consumer to open their wallet and spend, especially as memories of the severe COVID restrictions are so fresh. We speculate that over the last quarter, China may have been holding off on new stimulus until the US tariffs were declared. By doing so, China has a scapegoat to justify announcing more stimulus. If the new stimulus works, it becomes both a patriotic and economic victory for China. If it fails, Beijing can blame it on the US.



[6]

[5] Geopolitical Intelligence Services, "China trapped in a cycle of deflation" by Junhua Zhang, 27th January 2025
[6] MacroMicro, National Bureau of Statistics of China

There are some reasons for supply/demand optimism:

- Fleet growth and the orderbook are not daunting by historical standards.
- Special survey season is upon us, and given the weakness in rates, some special survey congestion may occur, tipping the balance favorably and improving freight rates. For example, 20% of the Panamax sector, where freight rates have really struggled, is in a Special Survey year, up from 16% last year.
- South American grain export season also is upon us and demand appears solid.
- The Simandou Mine in Guinea should be complete by the end of this year. The project has an anticipated production of 120 million tonnes per annum, which is equivalent to approximately 650 Capesize loads per year, extending ton miles and supporting Capesize freight rates.
- FFA rates have improved markedly, though still low since the Lunar New Year.

Never Enough: Raising Cash When One Needs it is Challenging

So, freight rates are bad, and demand is uncertain. As we discussed above, we anticipate that many dry bulk shipowners that have secured leverage are experiencing cash burn. However, similar to the deflation in China, with asset values falling, shipowners would do well to hold on for better times. Meanwhile, potential buyers of second-hand tonnage may prefer to wait and see if values fall further. Public companies have the option to issue equity to raise cash. Unfortunately, most listed shipping companies typically trade well below their net asset value (NAV) per share. Issuing equity below NAV isdilutive to shareholders. Upsetting investors in an already weak market can do long-term damage to a company's share valuation.

Debt leverage enhances returns on investment, but it can also create a "false high." If cash is generated in strong markets but not properly deployed in a balanced manner– whether to pay down debt, issue dividends, or repurchase shares, the downside is the hemorrhaging of cash when freight rates are poor. Investors want a return on their investment, so companies - public or private – cannot simply build a large "rainy day fund" in good times. However, operating without a net is treacherous. There must be a better way.