Baltic Dry Bulk Investor Indices

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Dry Bulk freight rates: Only the beginning of sustained rally or just a “head-fake”?

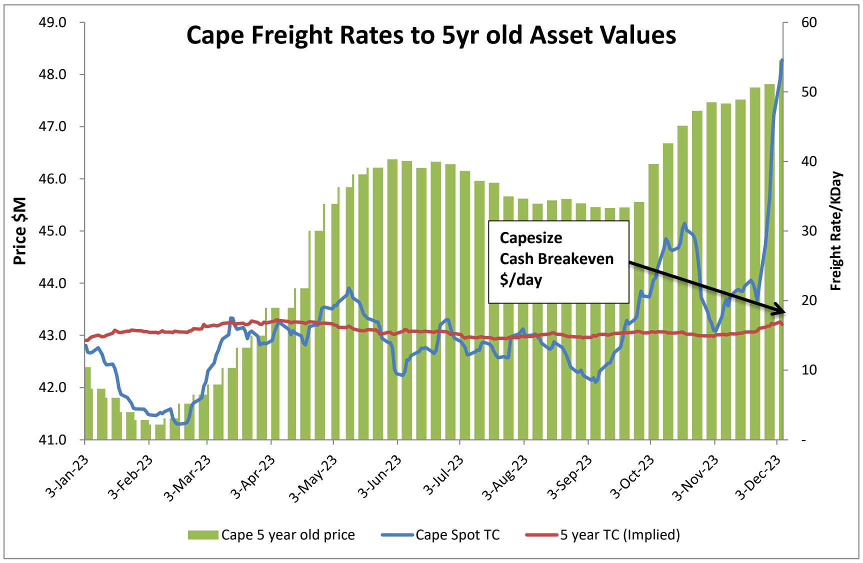
Recent weeks have seen a welcome improvement in dry bulk freight rates, which are now at a 12 month high. However, given that rates remain well below 2021 highs and have been in the doldrums for most of 2023, it appears premature to read too much into recent weeks.

That said, recent rate performance has compelled us to revisit a discussion that we presented earlier in the year in which we discussed the interesting disconnect between relatively firm asset values and poor freight rates. Spot freight rates were well below the assumed cash breakeven of the asset values at the time and this prevailed up until late September 2023. As such, if one bought a dry bulk ship (Supramax, Panamax, Capesize) in 1Q23 using traditional leverage, one likely would have burned some cash (effectively paying a higher price for the vessel) for most of the year … until today.

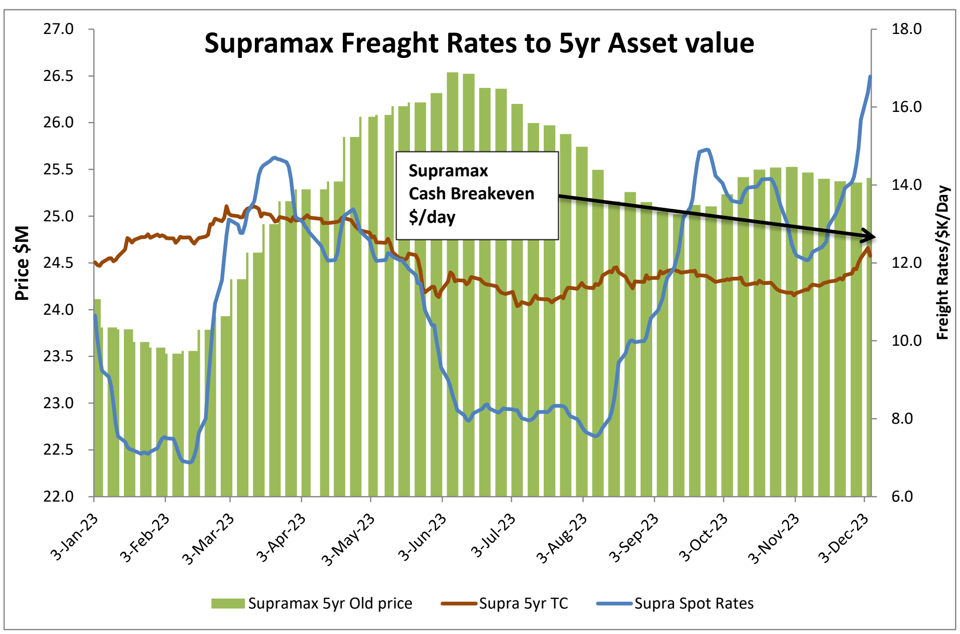
Not easy to be a dry bulk buyer in 2023

The Capesize sector is the easiest snapshot to analyze, given their volatility within the cycle driven by their size and long-distance routes. Using data provided by the Baltic Investor Indices (BII), Cape spot freight rates have only begun, in recent weeks, to justify five-year old asset values, which have been trending higher throughout the year. However, it has been a challenging year. In 2023 to date, spot rates have averaged $15,250 over 2023, roughly 17% below an estimated Capesize cash breakeven of $18,300.[1] While Capesize asset values are correlated to Cape spot rates at 0.66x over 2023, freight rates did not cover the cash breakeven for the balance of the year.

[1] Assumes average five-year-old Capesize value of $45M (2023 average price as opposed to current price of ~$48M), OPEX of ~$6,100/day, G&A of $750/day, 65% leverage, 17 year loan profile, 8.75% interest)



As another example, Supramax spot timecharter rates have averaged about $10,950 over 2023, roughly 13% below an estimated Supramax cash breakeven of $12,500.[2] As opposed to the Capes where spot rates and asset values are correlated, Supramax freight rates and asset values have had almost no correlation over 2023 at 0.13x. There is not much to infer from that data point, as one year is not a large data set for a correlation. However, asset values have consistently outpaced freight rates over 2023, making the Supramax sector a very challenging market … unless, of course, one has a bullish market view.



[2] Assumes average five-year-old Supramax value of ~$25.2M (2023 average price as opposed to current price of ~$25.4M), OPEX of ~$5,300/day, G&A of $750/day, 65% leverage, 17 year loan profile, 8.75% interest)

Never say: “This time it is different”

In our view, the core reason for asset values staying firm in 2023 in a weak freight rate market is that the vessel orderbook and fleet growth outlook are at 20-year lows. We all know what happened 20 years ago: the dry bulk market commenced on a relentless five-plus year bull freight market. Investors appear to be pointing at the supply side and not some unspecified demand element that is going to change the dynamic of dry bulk shipping.

Which brings me to note an old investing rule: never say, “This time, it is different”. While that is good advice, there are very distinct differences in today’s dry bulk freight market compared to 20 years ago. Firstly, China faces real economic pressures and is not the juggernaut of dry bulk demand growth that it was two decades ago.

Secondly, 20 years ago, fleet age and environmental impact was not a concern. Today, 24% of the dry bulk fleet is over 15 years of age and facing tougher EEXI restrictions and other carbon regulations, as well as possible ‘slow-steaming’ regardless of market conditions, which could well constrict supply.

Thirdly, propulsion technology demands and other newbuild input costs are increasing. Order prices are firming. As a result of these technological advances, currently constrained yard capacity in response to a strong market may be challenged to expand capacity in a timely manner.

More than a “head-fake”: The facts justify the firm asset values, for now

While Chinese demand is a concern, there is wide anticipation of further economic stimulus in China over 2024. It also appears that the West is approaching a more accommodative monetary policy over the next 24 months and, with the orderbook at a 20-year low and with older vessels to be increasingly constrained by environmental requirements, the supply side appears to be quite bullish.

This time it is different, very different: asset values do not appear to want to slide, barring a deep collapse in demand. The deeply cyclical nature of dry bulk shipping with volatility within the cycle has taught us that freight rates will have periods of weakness in 2024. However, as indicated by asset values, today it appears investors are “going long” with dry bulk tonnage based on the supply data and outlook, and are betting on freight rates having higher highs and higher lows in the freight markets over the next 24-36 months.