Baltic Investor Indices

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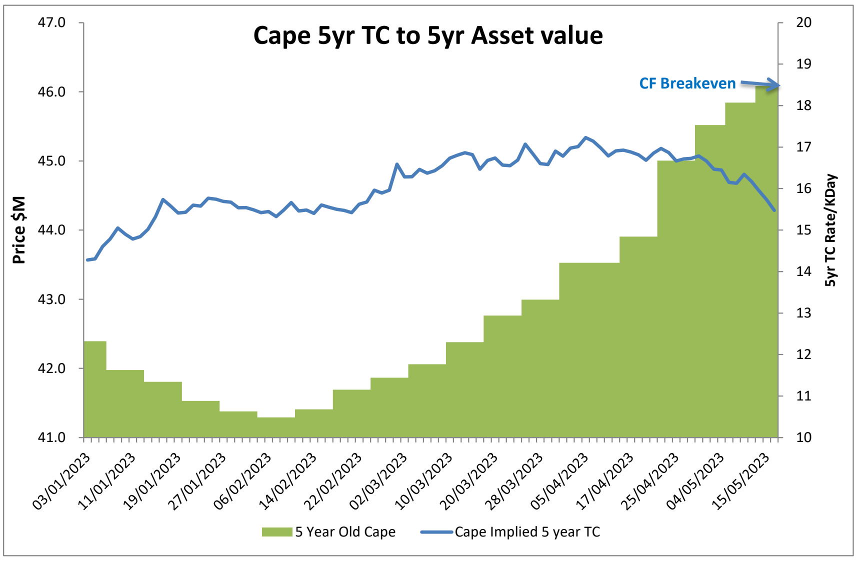
Hey 2023, do freight rates support asset values or the other way round?

Yes, as most will point out, generally freight rates in dry bulk drive ship asset values. However, for the 2023 year to date, in many cases asset values have risen to levels that equal or exceed estimated cash-flow breakeven levels. We view this as a bullish sign. However, given the extreme volatility of the dry bulk markets historically and the number of variables in today's macro-economic and geo-political environment, one cannot rule anything out.

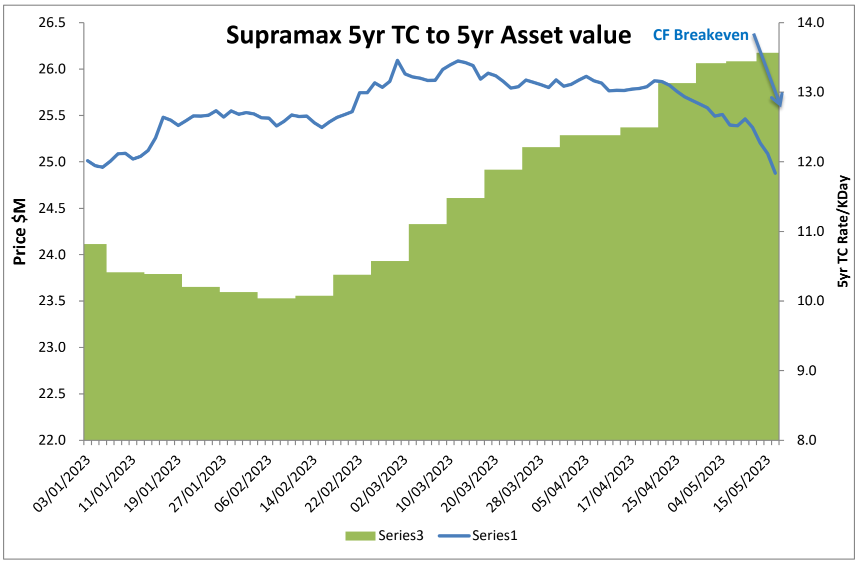
To look at this condition, we used the [Baltic Investor Indices] data for five-year old dry bulk ship asset values, and the implied five-year time charter rates. Using data from the Capesize five-year-old price (the Baltic CDISPA) and the Capesize Implied five-year Timecharter rate (the Baltic CDITC) as an example, we note that the estimated cash breakeven today would exceed the Cape implied five-year timecharter rate and indeed exceed the average 2023 Cape spot rate.

We estimated the cash breakeven for a five-year old Cape to be its current estimated price US$46 million, levered at 65% (17-year profile for amortisation) at an interest rate of 8.75% (note three-month SOFR is at ~4.80%) with OPEX of US$5,983/day (based on the Baltic Exchange Operating Expense Indices) corporate General & Administrative expenses (G&A) of US$750/day (we note a number of public companies are higher than this) would have a cash-flow breakeven of approximately US$18,530/day in the first year after acquiring this five-year old Cape at that price. The current Cape implied five- year time charter rate is US$15,475/day. While the spot rate today is more robust at US$19,033/day, it has averaged 11,654/day for 2023 .



Of course the above cash breakeven calculation makes many assumptions, but we believe those assumptions to be reflective of current market conditions for Capesize vessels and the finance market. One could use less leverage, but equity is more expensive than debt and given recent freight markets, a traditional dry bulk owner may lack the cash for a low-leverage acquisition. One could purchase an older vessel at a lower price, but older vessels are less efficient, subject to the tightening Carbon Intensity Indicator (CII) requirements and are harder to finance.

When we apply the same assumptions to the Panamax, Handymax and Handysize sectors, we achieve a similar result: Asset values are out pacing time-charter rates…for now. Here is the Supramax example:



There are many reasons to justify these 2023 rate-to-value conditions: The dry bulk orderbook is at historic lows; lead-times for newbuilds are 24-36 months; newbuild prices are rising due to inflationary pressures on cost of inputs; yard capacity is scarce (though the container ship order frenzy appears over); and secondhand dry bulk inventory available for sale is also scarce. With fewer traditional banks financing transactions, debt capital is more challenging to source than in the past decades. As well, decisions surrounding environmental efficiency and vessel propulsion are fundamentally more complicated decisions than they have been in the past. All of the above are supply aspects that can help to push dry bulk ship asset values higher.

However global dry bulk demand is typically harder to predict. The tragic war in Ukraine remains disruptive. US and European interest rates may stabilize over 2023 and possibly decline over 2024 and the probability of a deeply disruptive recession in the West appears to be low, but it remains a distinct possibility. China, the biggest importer of dry bulk commodities, wants to return to 5% growth after easing COVID restrictions and loosening monetary policy. However, China is the largest importer of iron ore and iron ore prices have softened of late. As well, political tensions around Taiwan are rather elevated as compared to years past.

Dry bulk demand has increased at a 20-year compound annual growth rate (CAGR) of 3.9%[i] and has had only three years where demand contracted: 2009 post financial crisis; 2020 impacted by COVID globally; and 2022 with the war in Ukraine, China still in COVID lockdown and the ending of most COVID stimulus in the West. Barring a substantial geo-political and/or macro-economic shock, we anticipate the world will still grow as will dry bulk import demand. With the orderbook at very low levels, newbuild prices increasing, environmental requirements such as CII restricting the speed of older vessels, and the expansion of ton-mile demand, global dry bulk demand growth should exceed dry bulk fleet capacity growth over 2023. Thus freight rates, without large extraneous shocks, should justify asset values going forward over 2023 and beyond, and that is welcome to those who own dry bulk vessels today.

[i] Clarksons Research Shipping Intelligence Network