Consolidation, New Alliances & Container Shipping Market Outlook 2017

Asian Tank Container Organisation
General Meeting
Shanghai
16 November 2016

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Recurring themes in this industry

- Overcapacity
- Shipping companies struggle to stay afloat
- Governments continue to prop up struggling lines
- Changing regulatory regimes
  - SOLAS VGM
  - EC price signalling proceedings
  - Regulation of Alliances
Industry consolidation - Last 20 Years

From this To This

1996 Capacity Operated in TEU Thousands

2016 Capacity Operated in TEU Thousands (incl pro-forma mergers announced)

- Total containership capacity grew six-fold (6X) in the last 20 years
- CAGR 9.6%

What has changed?

- 17 of the top 30 carriers are gone
  - 11 were acquired by other carriers (incl pending H-L & UASC deal)
  - 1 made voluntary exit (MISC)
  - 2 went bankrupt (Cho Yang & pending Hanjin)
  - 3 Japanese lines to merge (pending KL/MOL/NYK)
Industry consolidation - Last 20 Years

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1996 Capacity Operated in TEU Thousands

2016 Capacity Operated in TEU Thousands (incl pro-forma mergers announced)

- APM-Maersk
- MSC
- CMA CGM
- COSCO
- Hapag-Lloyd+UASC
- J-3
- Evergreen
- Hamburg Süd
- OOCL
- Yang Ming
- HMM
- PIL
- Zim
- Wan Hai
- Hanjin

What has changed?

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- But consolidation and formation of alliances have been ineffective in addressing over-supply
- Market share-based strategies have been biggest threat to sustained sector recovery
- After Hanjin Shipping debacle, low chance of another major bankruptcy
- But uncertain future for: (New Hanjin?), HMM, Zim, Yang Ming, IRISL
- Further consolidation likely in the next 2 years
- Matson – only carrier who downscaled successfully
Industry concentration at a record high

- Top 10 carriers now control 68% of the total market capacity
- Would rise further with Hapag-Lloyd/UASC merger and KL/MOL/NYK merger

- Difficult to predict M&A moves: Driven more by politics than economics
- But continued losses and threat of bankruptcy will drive new consolidation wave
Impact of Japanese liner consolidation

- Greater market concentration
  - Top 7 carriers will control 65% of global fleet and 70% of orderbook
- Pressure on smaller carriers to reach sufficient scale to compete
  - Most at risk are Hamburg Sud/OOCL/Yang Ming/HMM/Zim
  - PIL/Wan Hai expected to remain as niche regional carriers
Hanjin Shipping – a Korean blunder

Likely outcome:
• HMM will continue to operate under intense pressure and limited growth
• Attempts to resurrect Hanjin unrealistic

- Strategic mistake to save HMM while allowing Hanjin to fail
  - Compare alliance membership, brand, coverage, IT, staff, terminals & ship assets
- KDB vs Korean Air: Ego prevailed over common sense
- Foreign creditors failed to understand Korean domestic political dynamics
- Debt restructuring – poorly conducted
- Recoveries from Hanjin liquidation – unlikely for unsecured creditors
New Alliances – Planned service network

Weekly capacity in TEU

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<th>Alliance</th>
<th>Service Network</th>
<th>Weekly Sailings</th>
<th>PSW</th>
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- Status of HMM participation in 2M still not finalised
- Limited options for HMM while time is running out
  - Accept 2M terms / Seek new partnerships / Operate independently
- 2M target transpacific share growth
- THE Alliance affected by Hanjin Shipping withdrawal
Supply growth in 2017 still expected to outpace demand

114 Ships > 9,000 teu (1,597,800 teu) due between Oct 2016 and Dec 2017

9,000-12,000 teu
2M : MSC (16), Maersk (1)
Ocean Alliance : CMA CGM (6), COSCO (5)
THE Alliance : H-L (5)
Others : PIL (2), Charter (18)
Total : 53 ships/563,000 teu

13,000-15,000 teu
2M : Maersk (9)
Ocean Alliance : CMA CGM (6), Evergreen (7)
COSCO (2)
THE Alliance : NYK (4), UASC (2), Yang Ming (2)
Total : 32 ships/452,300 teu

> 18,000 teu
2M : Maersk (7), MSC (7)
Ocean Alliance : CMA CGM (3), OOCL (6)
THE Alliance : MOL (6)
Total : 29 ships/582,500 teu
High scrapping rate and low capacity growth in 2016

• 2016 deliveries expected to fall below 1.00m TEU – 10 year low
• Scrapping expected to reach 650,000 teu – highest ever recorded
  • Net growth of 1.7% is lowest annual growth rate in industry’s history
• But 2017 growth to rebound to 5.0% - based on expected scrapping of 600,000 teu
• Every 200,000 teu scrapped will bring down fleet growth by ~1%
But over-supply has worsened

- Idle fleet – new record high in 2016 (expected to be broken again by end 2016)
- Key drivers
  - Weak demand & no significant peak season demand
  - Slow steaming in abeyance & lack of external factors (eg USWC port strike in 2015)
- Charter rates and freight at record low levels
- Supply overhang since 2009 still not cleared
Current scrapping levels still insufficient to resolve imbalance

- Scrapping is only factor keeping idle fleet lower than it stands
- But still not enough to bring down surplus fleet
- Record in 2016 - YTD 550,000 teu scrapped, to reach 650,000 teu by year end
- Average scrap age 19 years – youngest in history
- 46 panamax ships > 4,000 teu scrapped this year but more panamax ships need to go
Idle fleet spread across all size segments

- 2016 idle fleet capacity ranged from 900,000 teu to 1,600,000 teu (4.5% to 7.8%)
- Capacity overhang has spread across all sizes, but most severe in panamax sector
- Panamax problem has dragged down all other sizes
- Clearing the capacity overhang is key first step to market recovery
- But 1,580,000 teu still due to be delivered in 2017 (4.8% growth net of scrapping)
Supply-demand balance is the only real solution

- Change in active capacity is best measure of containership demand growth
- Containership demand growth has been trending below supply growth since 2H 2016

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<th>Supply Growth</th>
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<td>1Q 2016</td>
<td>1.6%</td>
<td>7.9%</td>
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<td>2Q 2016</td>
<td>1.7%</td>
<td>6.3%</td>
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<tr>
<td>3Q 2016</td>
<td>1.5%</td>
<td>4.3%</td>
</tr>
<tr>
<td>4Q 2016 YTD</td>
<td>-0.1%</td>
<td>2.7%</td>
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- High correlation between freight rates with demand & supply balance
Demand growth – What is needed to clear the supply overhang

• For each 1% of trade growth (uniform across all trades) will translate to 185,000 teu of demand for additional containership capacity (0.9% of current fleet)
• But impact varies by trade – in terms of capacity required, 1% growth in Asia-Europe is equal to 2% growth in intra-Asia and 5.5% growth in Transatlantic
• Low growth on Asia-Europe & Transpacific remain key challenge
Recap - container shipping market developments in 2016

2016 is expected to set several new records:

- Largest consolidations – APL/CSCL/(UASC) and (KL/MOL/NYK)
- Largest liner bankruptcy (Hanjin)
- 3 global alliances formed in 2015/6 set to dominate East-West trades
- First 10,000 teu ship passes through the Panama Canal

But

- Global demand growth at lowest levels since 2009
- Average container freight rates at record low levels
- Freight rate volatility has persisted
- Idle containership capacity at a 6 year high

Even though

- Containership capacity growth at lowest level in history (in % terms)
- Containership scrapping to reach 650,000 teu
- Charter rates for Panamax containerships fall below $5,000 per day
Projections - market developments in 2017

Carriers are not prepared for new low growth environment
Supply growth in 2017 remains biggest challenge for the industry

Carriers need to curb market share ambitions
Failure to do so will result in same outcome as 2016

We are moving in circles
End

Please send any queries to hjtan@liner-research.com

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