Container shipping in 2017: A bridge to recovery?

May 10, 2017
Montreal, Quebec

Mark Szakonyi
Executive Editor, JOC.com
The Jounal of Commerce.

As 2017 gets going, a new world begins

- Unprecedented pace of consolidation of shipping lines in 2016.
- Could continue into 2018.
- CMA CGM + APL; China Shipping + Cosco; Hapag-Lloyd + UAS; Maersk + Hamburg Sud; 3J lines.
- Industry went from 20 global shipping lines to 13.
- Why so much consolidation in such a short period of time? Financially driven.
- Freight rates at unsustainable levels.

- Capacity-driven market. Six straight years of carrier overcapacity (globally).
- About 7% over-capacity in 2017.
- Hanjin bankruptcy a gut-wrenching event for carriers and shipper.
- Yet overcapacity remains: 150 vessels of 10,000-22,000 TEUs coming on line.
- Carriers/alliances trying to differentiate themselves with reduced transits between port pairs and time-definite services.

Where does the industry stand today?

Three new, larger alliances with more leverage over BCOs and terminal operators:

- **THE Alliance**
  29% of trans-Pacific volume
- **Ocean Alliance**
  41% of trans-Pacific volume
- **2M + Hyundai**
  21% of trans-Pacific volume (with bigger ships)

Wild card: four independent carriers (Zim, Matson, Wan Hai, SM Line)

Biggest impact of independents on PSW services to POLA-POLB

Spot rates and service contracting

- SCFI spot rate to West Coast — $1,375/FEU or +62 percent over 2016 rate of $849.
- East Coast — $2,436/FEU or +41 percent over 2016 rate of $1,732.
- Time of uncertainty as trade reacts to Hanjin bankruptcy, new alliances.
- Spot rates should move according to normal seasonal trends.
- Service contracts higher than in 2016, but barely at compensatory level.
- Compensatory rate to West Coast about $1,200-$1,300/FEU to West Coast.
- Snapshot of contract rates at present: $1,000-$1,100 biggest accounts; $1,200-$1,300 mid-size accounts; $1,400-$1,500 smaller shippers.
- East Coast AWS goal of carriers: $2,000-$2,200.

What is driving carrier and shipper behavior today?

CARRIERS

- Stop the bleeding and stay in business.
- Carriers globally lost in aggregate $10 billion in 2016.
- Last year of industry-wide profitability was 2010.
- Carrier cost-cutting has gone as far as it can go.

SHIPPERS

- Financial solvency of core carriers.
- Securing lowest rate in its bracket no longer the top goal of shippers.
- Efficiency of maine terminals where core carriers call.
- Are shippers ready to pay premium rates for premium service? NO.

The positive story on the TP market…

- "The early signs are completely different than what we saw last year." *— Michael White, president of Maersk Line North America*

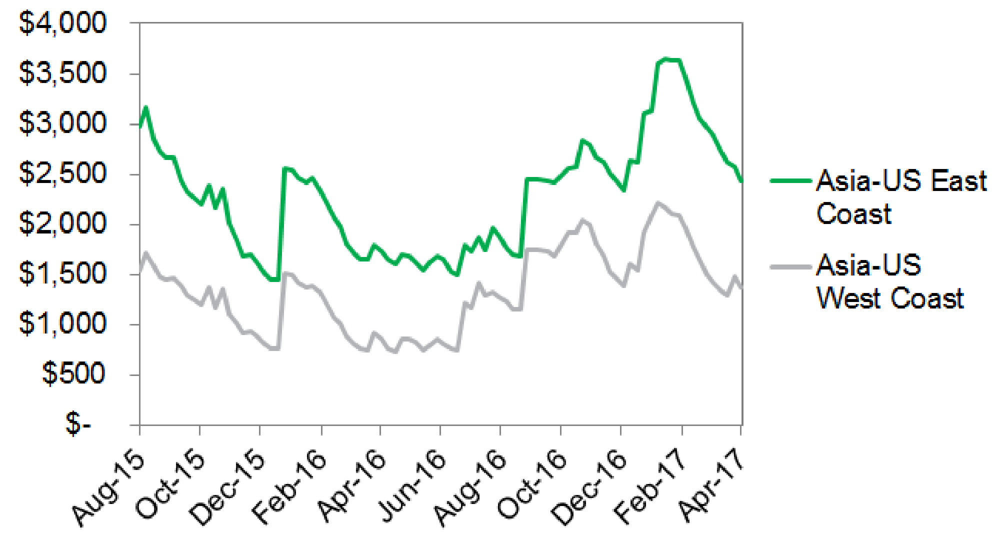
- "The latest read on key indicators such as freight rates, ordering activity, idle capacity management, scrapping, and charter rates suggest stable to improving trends, which bode well for sector earnings" *— JP Morgan*

- "I do see a real chance of a sustainable recovery in 2019, provided the capacity restraint can be preserved for another 12 months." *— Alphaliner's HJ Tan at TPM*

- "I do feel that in 2016 we found the bottom." *— Dave Arsenault, the former US president and CEO of Hyundai Merchant Marine*

Trans-Pacific spot rates trend higher

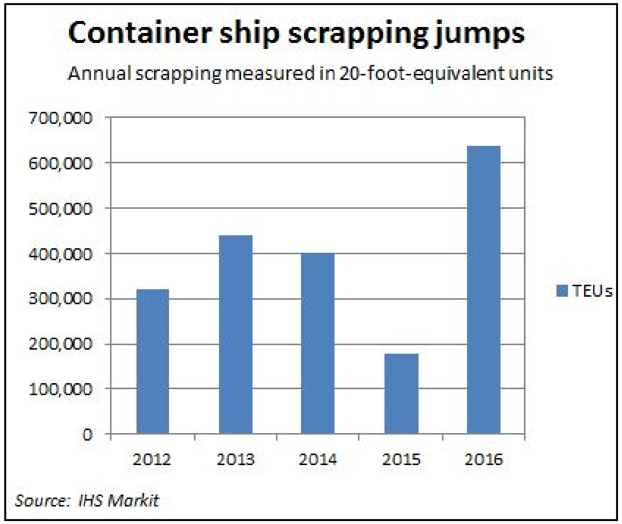
SCFI rate per 40-foot-equivalent unit

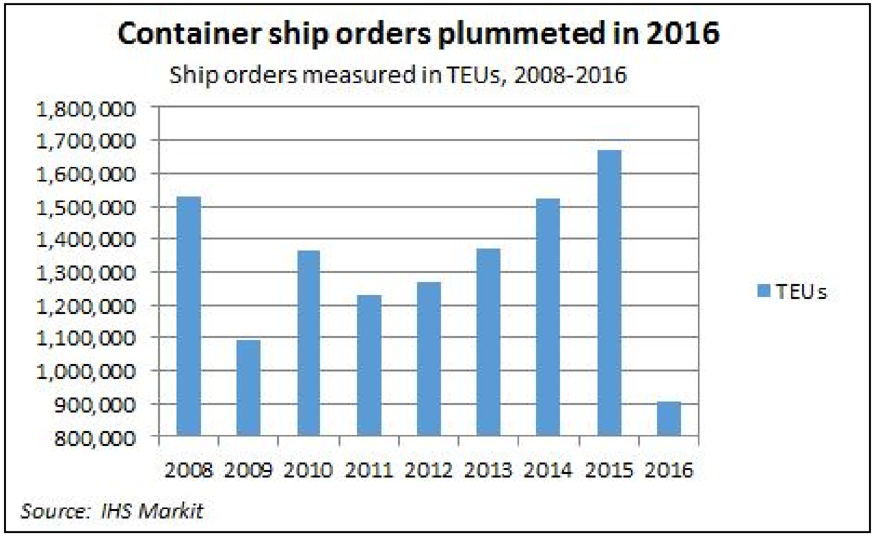


Source: Shanghai Shipping Exchange © IHS Markit

Fundamentals are starting to change, but is it enough?

- Container ship scrappings were way up in 2016 and are forecast to be up higher.
- New orders way down, but lines still scheduled to take possession of 150 ships of 10,000-22,000 TEUs next two years
- Alphaliner projects capacity growth of 4%/year next two years
- Bottom line: Alphaliner sees a recovery in 2019; Maersk is saying 2022





A growing role for NVOs

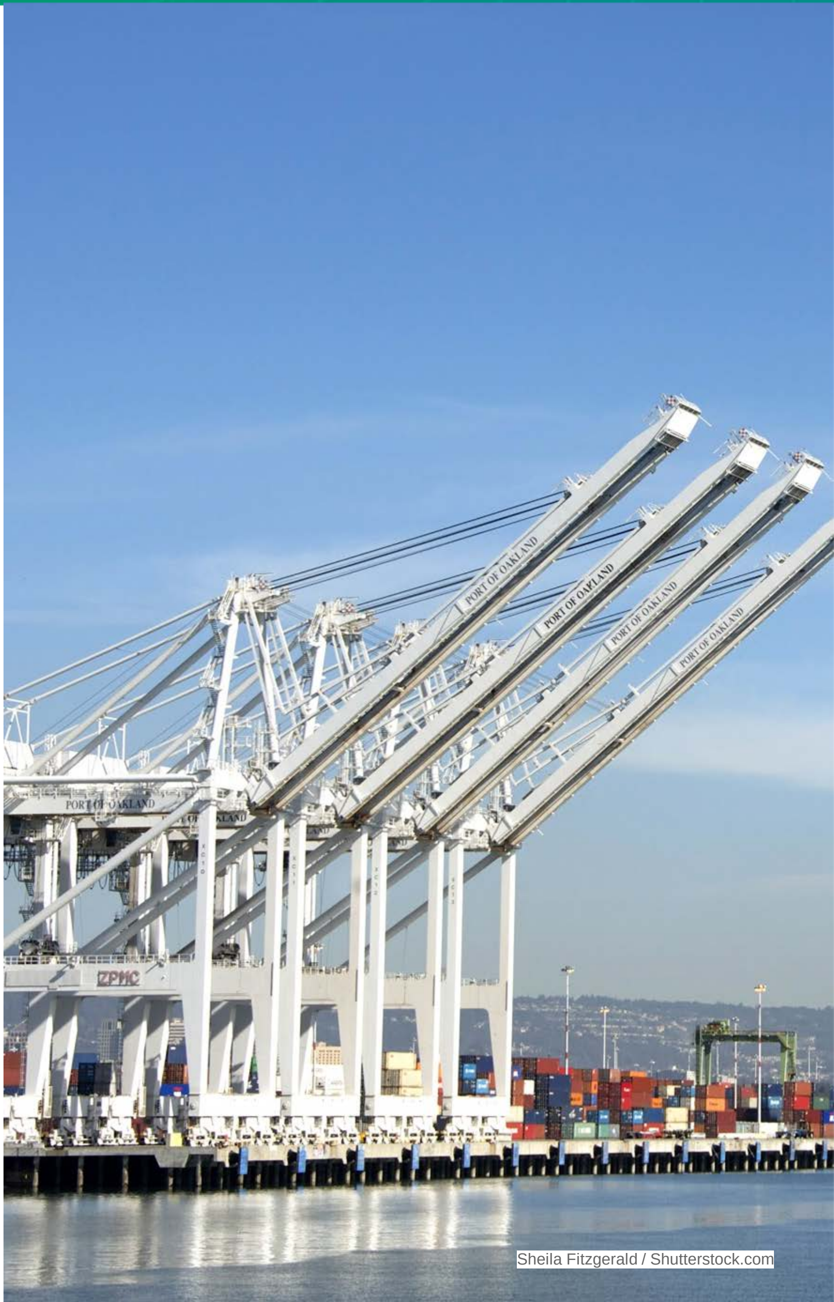
- The share of US imports from Asia handled by NVOs has risen to 43 percent in 2016 from 29 percent in 2006
- Since NVOs have contracts with most of the carriers, they are better able to deliver space to customers than individual carriers are during peak periods
- The larger NVOs are negotiating with carriers much earlier in the contract cycle in order to secure favorable space allocations and rates
- Carriers increasingly need to work with NVOs as carriers reduce sales staff to cut costs
- The better NVOs offer end-to-end, value-added services such as tracking and tracing, IT support, equipment procurement, etc., in order to secure business from BCOs

Operational & logistical challenges from alliances

- Ports on both coasts are challenged by the container exchanges of 2,000 to 10,000 per vessel call.
- Each vessel in an alliance arrangement can carry containers belonging to five or more lines — a logistical nightmare for terminal operators, truckers and IEPs.
- As alliances concentrate vessel calls at certain terminals, those operators must invest in taller cranes and stronger wharves in order to handle the mega-ships.
- Yet the alliances are also forcing terminal operators to compete for their business in terms of price and operational efficiency.
- The lines are under pressure from BCOs to call at the most efficient terminals and avoid the least efficient.

The most efficient terminals will win the business

- Vessel, yard and gate efficiency are crucial to attracting and keeping business.
- This involves staying ahead of curve in infrastructure development and cargo-handling processes.
- West Coast ports clearly have the deepest harbors, shortest transit times from Asia and most extensive and efficient intermodal rail services to the interior.
- The ports are combining terminals to create larger, modern facilities capable of handling the larger container exchanges from vessels.
- But ports can’t simply build their way to prosperity. Process improvements are crucial.

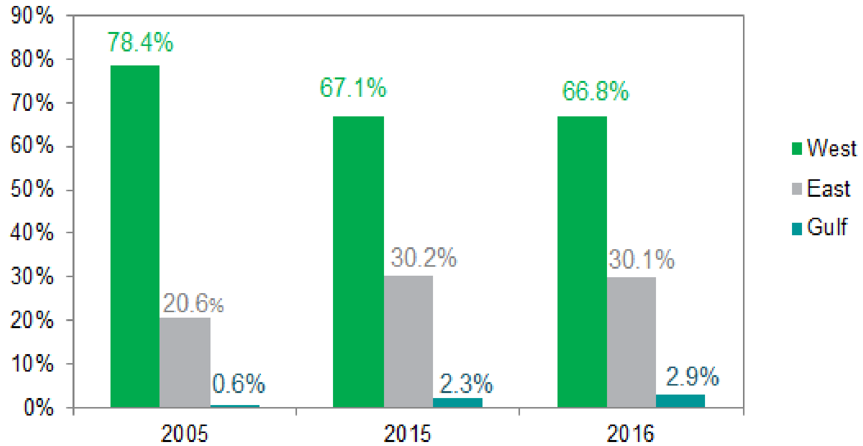


Sheila Fitzgerald / Shutterstock.com

The battle for market share - let the games begin!

Alliances, regulations, labor concerns could speed shift of cargo away from US West coast

Coastal market shares of Asian imports to the US



Source: *IHS Markit/PIERS*

© 2017 IHS Markit

- Completion of the Panama Canal expansion last June equalized the access of both coasts for mega-ships (up to 14,000 TEUs).
- Bad news for West Coast ports is that this development could accelerate a trend that has been underway for the past 15 years, since 2002 West Coast labor disruptions.
- West Coast market share of US imports from Asia dropped from 78.4 percent in 2005 to 66.8 percent in 2016.
- East Coast market share of Asian imports increased from 20.6 percent in 2005 to 30.1 percent in 2016.
- Gulf Coast’s market share quadrupled from a very low base, 0.6 percent in 2005 to 2.9 percent in 2016 and should increase further with five weekly services now from Asia.
- Vancouver + Prince Rupert now 4.4% share of US imports from Asia

Labor stability on both coasts crucial to market share

- We should know by summer if PMA and ILWU are able to agree upon a contract extension.
- Current contract will expire on July 1, 2019. Goal of employers is to extend it several years beyond that date.
- Key requirement to make the contract extension possible: restrict the negotiations to only wages and benefits.
- On East Coast, ILA is not really keen on a contract extension.
- Contract with USMX set to expire in fall of 2018.
- Jurisdictional issues, chassis M&R, key demand of ILA.
- Thinking is that ILA will agree to contract extension only if PMA-ILWU agree first, which would force an agreement on the East Coast to preserve market share.

Every sector of supply chain has access to technology

- Do you have excess space in your warehouse? Technology can help you fill it.
- BCOs, ocean carriers and terminal operators all have excellent data on their internal movement of of parts and finished products.
- However, these parties do not or cannot share it with their partners in the supply chain.
- All of the stakeholders need a common platform that will allow them to share information.
- GE Transportation accomplished this task internally for GE Corp. They linked 400 facilities around the world through a single portal, saving the corporation $40 million/year.
- POLA and GE Transportation attempting to do the same in the port environment.

Conclusions

- The next 18 months will see profound change in the port and shipping industry.
- International trade has matured since most of the outsourcing to China is done.
- Get ready for 3-4 percent annual growth in container shipping.
- The exciting developments will be in how the freight moves, which lines will carry it, which ports will process the cargo and how it arrives more efficiently at destination.
- Mega-ships, super post-Panamax cranes, carrier alliances, terminal automation and digitization of the supply chain are happening right now.
- West Coast, Canadian, Gulf and East Coast ports are competing aggressively for this cargo.

Thank you for attending!

JOC EVENTS | SHIPPER ROUNDTABLES

Mark Szakonyi
JOC.com Executive Editor

Office: 202-872-1234
Cell: 202-251-7069
mark.szakonyi@ihsmarkit.com
Szakonyi_JOC