

Shipping

IMPACT ANALYSIS

Plunging BDI to have a limited impact on Indian players

Summary

- The Baltic Dry Index (BDI) has crashed more than 56 per cent in just over a month given decline in trade activity and increase in supply, causing the demand-supply imbalance to widen. CRISIL Research believes that most of the Indian shipping companies are largely insulated from this fall owing to their limited exposure to dry bulk fleet and long-term contracts.

Contents

Sections

Longest fall in Baltic Dry Index in past 9 years	1
Slowdown in China's iron ore imports puts pressure on freight rates	2
Limited presence in dry bulk segment and long-term contracts insulate Indian companies from this drastic fall	2

Figures

Baltic Dry Index (October 2002- July 11, 2010)	1
Baltic Dry Index (May 2009- July 11, 2010)	1
Steel prices	2
Chinese iron ore production and imports	2
Composition of global fleet at the end of 2009	3
Composition of Indian fleet at the end of 2009	3

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Plunging BDI to have a limited impact on Indian players

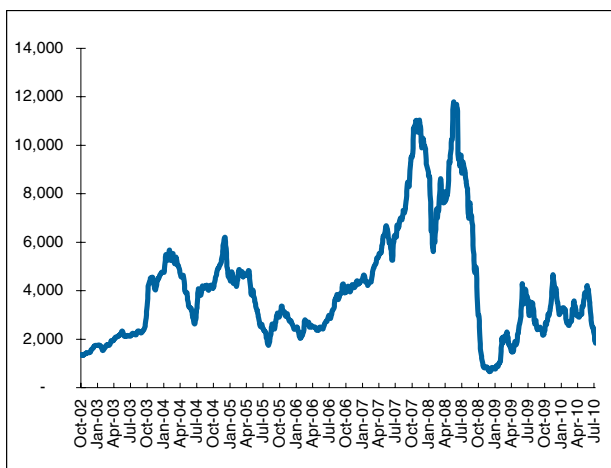
The last one month has been turbulent for dry bulk shippers with the Baltic Dry Index (BDI) falling by more than 56 per cent. Decline in Chinese demand for iron ore and coal and easing port congestion have caused spot freight rates to fall. In addition, increase in supply, on account of delivery of new ships, has caused the demand supply imbalance to widen, putting pressure on spot freight rates.

However, this drastic fall in dry bulk spot freight rates will have a limited impact on the profitability of Indian shipping companies given their low exposure to dry bulk fleet. Moreover, most of the dry bulk fleet is deployed under long-term contracts on time charter rates, which is another factor in favour of Indian shipping companies.

Longest fall in Baltic Dry Index in past 9 years

The Baltic Dry Index, the Baltic Exchange's main sea freight index, which tracks international shipping spot freight rates of various dry bulk cargoes, fell to its lowest level in more than a year on July 13, 2010, hit by a slowdown in freight activity. This has been the longest fall in the last 9 years since August 15, 2001 when it fell for 34 consecutive trading sessions. The current fall in dry bulk freight rates has been continuous for 33 days. This has resulted in the industry's benchmark plunging by more than 56 per cent in just over a month, ending at 1,790 points, the lowest level since May 2009. Before this steep decline, the index had rallied to more than 4,200 points in late May 2010. Volatility has emerged as a feature of the market with Chinese imports a crucial determinant.

Baltic Dry Index (October 2002- July 13, 2010)



Source: CRISIL Research

Baltic Dry Index (May 2009- July 13, 2010)



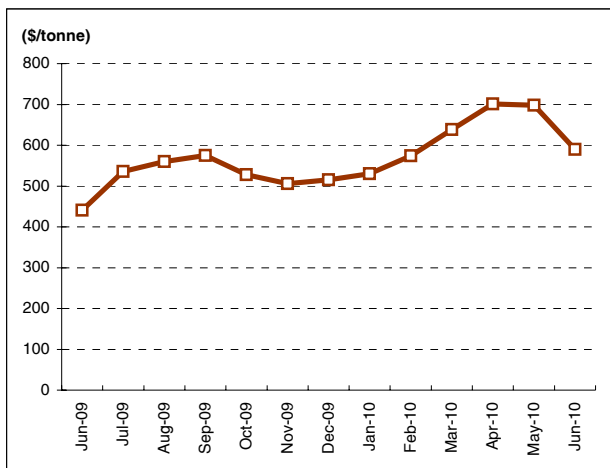
Source: CRISIL Research

Slowdown in China's iron ore imports puts pressure on freight rates

Iron ore is the biggest source of demand for dry bulk shipping followed by coal. Trade of these two commodities together accounted for more than 40 per cent of total dry bulk trade in 2008. Trade levels of dry bulk commodities are highly dependent on Chinese imports of iron ore and coal, as China accounts for over 50 per cent of the total trade in iron ore and coal. In the last 2 months, a decline in steel prices has compelled China to use its own captive iron ore rather than importing high cost iron ore. This has impacted demand for dry bulk carriers and has put pressure on freight rates, primarily for the larger capesize and panamax segments.

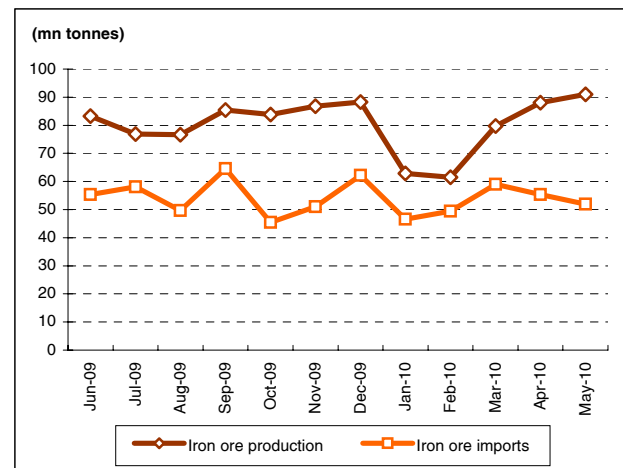
In addition, weaker coal imports into China and fading of South America's grain export season coupled with easing of port congestion have put pressure on freight rates. The impending overcapacity, because of the record number of new ships expected to be delivered, will also exert pressure on freight rates. For 2010 and 2011, the scheduled order book is about 27 per cent and 22 per cent, of the fleet size (as of December 2009).

Steel prices



Source: CRISIL Research

Chinese iron ore production and imports



Source: CRISIL Research

Prices of imported iron ore have declined to \$128 per tonne from \$190 per tonne. At these price levels, we expect China to increase its iron ore imports; consequently, trade levels are expected to improve from their current levels. This will lead to an improvement in Baltic Dry Index and spot freight rates.

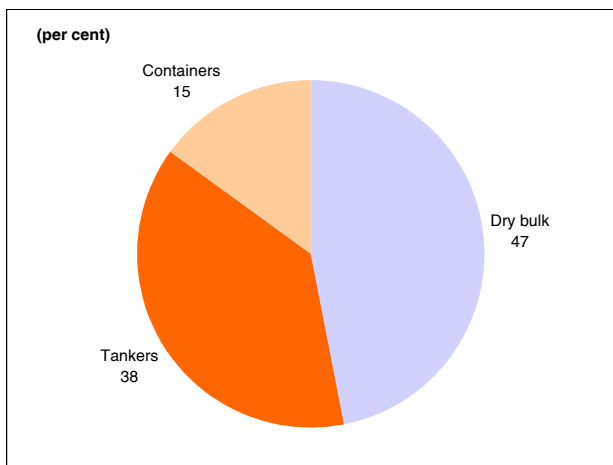
Limited presence in dry bulk segment and long-term contracts insulate Indian companies from this drastic fall

A comparison between Indian fleet and global fleet shows that Indian shipping companies have higher exposure to the tanker segment than global shipping companies. In the tanker segment, which accounts for almost 75 per cent of the Indian fleet, freight rates have been relatively stable. The exposure of Indian shipping companies to dry bulk segment is limited to only 16 per cent vis-a-vis 47 per cent for global carriers. Moreover, private Indian companies such as Mercator Lines, GE Shipping and Essar Shipping are fairly insulated from the fall in dry bulk spot rates, as their ships are largely on long-term contracts on a time-charter basis. Mercator Lines has 80 per cent of its dry bulk fleet on long-term contracts of more than a year. GE Shipping has a limited exposure to the spot market with most of its fleet tied on long-term contracts. Essar Shipping has over 70 per cent of its dry bulk carriers on a long-term contract of more than three years. On the other hand, the Shipping Corporation of India,

which has high exposure to the spot market, faces greater impact.

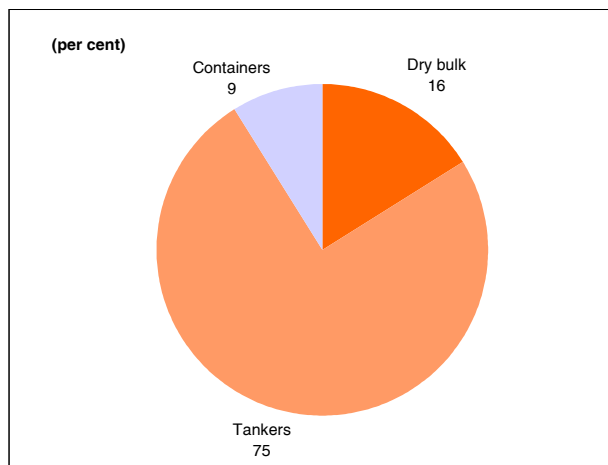
We, therefore, believe Indian shipping companies will be less impacted by the fall in freight rates than their global peers.

Composition of global fleet at the end of 2009



Source: CRISIL Research

Composition of Indian fleet at the end of 2009



Source: CRISIL Research

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