Speech by Mr. Stephen Pan at the 28th Annual Dinner Party of Institute of Seatransport

Stephen Pan

Ladies and gentlemen, it is a great honour for me to be invited to speak at the very auspicious 28th annual dinner. As all locals would know 28 means “easy fortune” and when reflecting over this I was wondering whether we should have had our 28th dinner some 8 or maybe 10 years ago when the sentiment was very positive and indeed one can say profit was easy. After all, the good food and good wine who would keep track of which anniversary.

I will try to share with you tonight my own reflections on the shipping industry over the years. First of all I take it we here tonight all agree that there was never “easy fortune” in shipping. It is one of the most demanding industries where a momentary lapse in focus and attention by someone, be it on the bridge, in the engine room, signing a loan document or a charter party could cost the owner millions.

The oil crisis in the late 70’s resulting in global inflation and the consequent extreme contraction of money supply with LIBOR at above 20% led first to the collapse of the VLCC market. Slowing economies became pervasive and soon all sectors of shipping were struggling for survival. Western European shipyards shut down and Japanese yards went through a period of severe and painful capacity reduction. Many an unlucky owner had to go through financial restructuring and lost a significant part of his wealth. Those more unlucky ones lost everything.

Memories in shipping, as with many other things in life, are short. Today despite record low interest rates, which are less than the spread some owners paid in the post ***oil- shockko*** 80’s, the industry is in crisis again.

If however we look at shipping from another perspective, that of the end user, we can indeed come to the very different and obvious conclusion that over time shipping has been providing a safe and cost effective service to world trade with constantly improving standards.

Reading any of the shipping journals some 20 or 25 years ago one would see abundant reports of shipping accidents caused by allegedly the poor quality of third world seafarers, serious structural failures from neglect on the part of the shipowner or faulty and inadequate design as approved by Classification or Flag States, ships running aground due to failure of sophisticated equipment from lack of proper crew training. Hardly a day went by without one form of crisis or another and the industry was often accused of a lack of a “Health Safety and Environment” culture.

These accidents and major incidents no longer monopolize the headlines. Shipping embraced HSE culture with gusto. The then so-called third world seafarers rose to the challenge having now become the mainstay of personnel both on board and ashore. Pollution has come down from “gallons” to “teaspoons” to “trickle” per millions ton-mile. When you look the size, diversity, complexity and demands of the industry on an international basis this improvement should be something we should all be proud of and be telling the world about.

Despite all these achievements shipping is always at the sharp end, or butt end, of the stick when things go wrong. It is always the fault of the industry be it shipowners, shipbuilders, classification societies or shipmanagers. The shipowner always pays is an age-old saying which has not yet been proven wrong. Sometimes I feel we are like sheep in wolf's clothing , philanthropists dressed as profiteers rather than the wolf in sheep's clothing or the buccaneering image that we are often described by the media.

In my personal view where we have really failed is not in the operational or technical side of shipping but in our collective role as businessmen and investors. We have failed miserably by allowing a long term essential capital intensive industry to become something akin to what one would call a dotcom-era speculation game.

The demand side for shipping has certainly not been one of boom and bust. It is poor decision making on a grand scale on the supply of shipping capacity which created the boom and bust cycles with which this industry is so closely identified. Investment decisions by shipowners are often prompted by emotion, by gut feel, by wanting to stay ‘ahead’ of the competition. Whether your competitor’s decision is right or wrong does not really matter. Competition is good and healthy but not when it cuts your own throat and benefit others as an industry. Your neighbor investing in a taxi cab probably has more acumen and made his investment decision with better knowledge and information of the marketplace than many of us who invest in multi-million dollar ships.

Much of the recent boom is predicated on China’s rapid economic growth. Even when the leadership in Beijing was reviewing the viability of continued breakneck GDP growth orders for new ships and capacity expansion in China’s shipyards, mostly private ones, continue apace. China with her growing economy and large population often turn futurologists and economists into magicians overnight. Multiply anything by 1.3 billion people and you get a very large number. But whether we are talking about China or any developing country there will always be social, political and economic constraints on growth which make long term predictions difficult.

Technology and innovation are often said to be the long term driver of economic growth. As recent as 5 years ago Peak Oil and the increased dependence of US on imported energy was to lead to a new era in oil and gas transportation. Who would have envisaged the US is now looking at exporting LNG , that Apple and Lenovo are looking at moving some manufacturing back to USA?

We often forget investing in a ship requires a 20-25 years investment horizon. Optimistic predictions on economic growth therefore, even if they are accurate, may not translate into corresponding growth in world seaborne trade. We have had a much longer boom cycle than anticipated and I would like to proffer that this is a direct result of China's rapid growth and the rest of the world's inability to cope with this high speed growth. This gap is however closing rapidly.

I do not wish to inundate you with statistics as to the losses incurred by shipbuilders, shipowners, ship financiers and all those involved in the industry in the last few decades. The point I wish to make is these losses are often not seen as object lessons in history but as positive evidence of the industry's resilient strength, something to be proud of. After all the trials and tribulations we are still around. We even manage to attend dinners and conferences once in a while, talking the market up or down as it suits our fancy. People in shipping, like old sailors, not only never die they don't even fade away.

Given that we do not have a 'boom and bust' demand cycle in shipping, the 'long deep troughs and sharp short peaks' characteristics of the freight markets can only be due to one of oversupply and/or the untimeliness of supply. As investors in ships and shipbuilding we have not properly assessed the changing dynamics of the market place. We tend to predict demand based on static assumptions. We underestimate innovation, technology and productivity; we underestimate the capacity of shipyards. We overestimate the levels of scrapping as market responds to upturns. In VLCCs for example, one often forgets that once the owner has spent money on the necessary special survey, it is not difficult to convince oneself to trade the vessel until her next survey due date. If you look at current shipyard capacity it is likely the entire world fleet can be replaced in less than a decade, with a little overtime.

The shipbuilding industry's decision making ability and market assessment is no better. The biggest problem with shipping is the better the freight market the higher the risks. If one orders a VLCC today for example, one would probably take delivery within 12 to 15 months. Had any owner ordered the same VLCC at the top of the market, he or she would probably have to wait 30 months or more. The shipyard would then also need to take into account inflation of materials and labour costs amongst other business risks. The end result is both orders will be delivered at approximately the same time but with a very large price difference.

The message for more rationale decision for the shipbuilders is they must appreciate shipowners, and hopefully their financiers, do not really want cheap ships. They want profitable ones. What they also want is that their competitors do not get them any cheaper.

One often reads about new business paradigms, even Mr. Greenspan subscribed to it and look at the results. To me the two paradigms which have so far hold their ground are supply and demand and business cycles. Perhaps the latter is nothing more than the time gap response to supply and demand.

Keep in mind if supply is less than demand prices will go up. So why do so many owners want to go on an ordering binge to ensure that supply will be more than demand ?

Fundamentals will dictate that capital will flow into investments that are perceived to be profitable. Rapid expansion in capacity puts a lid on prices and therefore asset values. You cannot convince rational investors to invest in assets that are unlikely to appreciate much in value with low or negative operating margins to boot. Shipping is a long term business and maintaining asset values are fundamental in underpinning the stability of any log term investment. Cornering a potentially unprofitable market is not a very sensible long term business strategy. If one reads recent press reports it seems Maersk has arrived at the same conclusion.

One of the major changes in bulk shipping in the last 25 years is the growing absence of long term charters with major industrial concerns. What is this telling us? Big oil, big mining and big steel are no longer as confident of estimates of long term supply and demand and they have successfully passed this risk on to the shipowners. When the market is very low, they may come in for a longer term deal usually at a rate which locks in a loss for the poor shipowner for many years to come.

I was on a panel at a shipping conference just after the Lehman collapse. One major owner who had over leveraged his business commented that the financiers offered too much and too cheap money and the shipbuilders were offering prices one cannot refuse. He was suggesting that shipowners, shipbuilders and financiers should take collective responsibility. My comment was the shipowner signed on the dotted line, no one forced the owner into this so the primary responsibility must rest with the shipowner.

Are financiers and bankers too easy when lending to shipping? The answer is probably yes. The reason is I guess again because of the efficiency of the industry. If you are in manufacturing and want to borrow US$10m to build a new plant your banker will likely require a lot of analysis and paperwork, it will also take some time to obtain approval. In a good market you can easily find funding for a US$200m LNG carrier. To bankers the shipping loan and mortgage arrangements are standard and efficient. Much easier to put US$200m on the loan books by funding a big ticket shipping project than 20 projects involving industrial plant and machinery.

The simple fact is bankers and financiers are there to lend, shipbuilders are there to build ships. It is at the end of the day the shipowner who signs on the dotted line and increased the supply. We need to be reminded that less supply always means higher price everything else being equal. The industry survives not because we are resilient or that we have strength in our collective wisdom or financial resources, or our conviction and stubbornness to stay in the business. We are here because shipping, like agriculture, is essential and there are no alternatives to ships. We must appreciate that over the years we are probably one of the most subsidized industry. The key difference is the subsidies in shipping comes mostly from the private sectors rather than the public ones. Even governments got smart at our expense.

It is often said that economists are ones who know all about profits but can’t really find any. Accountants know next to nothing about profits but manage to find them everywhere. Profits to shipping are like the Cheshire cat. Sometimes you see it and sometimes you don’t. It is always smiling and beckoning, but most of time it is not really there. The shipping industry is very much like Alice in Wonderland. We all happily mire in it oblivious to the fact that everyone else is having a good time at our expense.

As I mentioned earlier, growth in the world seaborne trade has been steady over the last few decades with the usual business cycles affecting highs and lows. Yet no other essential industry has been so inept in adapting to the ever present business cycles. So theoretically the market should not behave the way it does but sentiment and poor decision making makes us as an industry, unprofitable or less profitable than it should be.

To end on a positive note and before I upset more in the audience I must make the point that Asian owners are much more prudent in managing their business affairs, this is why we are seeing so many old friends here tonight. I have no magic solutions, just points to ponder.

Will you now join me in a toast to the Institute of Seatransport and to Shipping.

Thank you.

(Mr. Stephen Pan : Chairman of World-Wide Shipping Agency Ltd.)