Upcoming tsunami – Part 1: container lines

A dramatic disruption is on the horizon for container lines and, in turn, for ports and shippers. This article discusses the ocean carriers. The reasons for much of what is happening rest with the lines. We will try to condense key, complex issues here.

Long-term carrier viability — with low rates of return, losses over an extended period of time, and escalating costs — summarizes the reality. Global container volumes, not rates, have driven revenues. Now these volumes have fallen. Reducing costs is essentially focused with ultra-large vessels and their lower operating and slot costs. But not all carriers have these ships — or have small activity with them. This is against a background where supply (ships/containers) exceeds demand. At the same time, with the losses and demand/supply, carriers continue to invest in mega-ships. And this sets up the tsunami.

Some will point at Maersk, CMA CGM, and OOCL. They made money in 2014; so what's the problem? One of these three made over $2 billion; the other two made into the hundreds of millions. In terms of the industry, carriers made less than $4 billion — less than a 2.5 percent rate of return. Those returns are not sustainable for many carriers. Imagine what shipping may be like if there are 10 container lines with plus-90 percent of capacity — and plus-90 percent of the volumes.

Let us step back and examine the most profitable carrier — Maersk Line. How are they making the kind of money they do when others cannot? They have a 14 percent rate of return in Q1 2015. The next carrier is CMA CGM at 11 percent. Then the numbers fall lower to nominal numbers and even losses. Since not all carriers are public, getting good financial data is difficult.

- For starters, they have a 10-year head start on cost-cutting. Cost-cutting is mandatory given continuing falling rates and soft demand. They did this with people and, especially with the mega-vessels in the Asia-Europe trade. This is important. They understand how to operate these ships. This has additional significance against the background of greater supply than volumes and the global slowdown.
- They also do something that almost no one else does — revenue management. That has meant, in some instances, walking away from business that did not meet a certain revenue level for the activity. The revenue management is combined with developing round-trips that generate better margins. An interesting point here is how — after refusing volumes at rates they felt were unattractive — other lines jumped to get it.

Maersk seems to be unique with what it's doing. Some carriers have tried on the cost-side, but without the depth and results. Many lines pursue almost any and all freight — not walk away from it — even if they lose money at it.

Some of this — "any freight is good freight" — comes from carriers having invested in ultra-large ships to achieve lower operating costs. This is not a new action. For decades, the lines have been buying larger and larger ships — all with the premise of lower operating costs.

Now with all the ship capacity and carriers wanting targeted vessel utilization, they seek more loaded containers on each vessel. Doing this also complements the market share game that carriers do; cutting rates is the primary method for increasing market share.

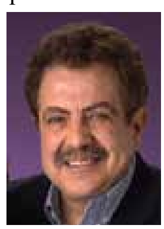
Increasing volumes per vessel improves utilization and capacity management. The difficulty in doing these increases with soft demand. Lines engage in a classic breakeven game with high capital cost assets. The goal is to get more containers on each ship. This can achieve vessel breakeven — and more. The way to get that volume is to reduce rates to attract more containers. The only problem is the price reduction moves the breakeven point out further, continuing the cycle and struggle.

Filling ships for the sake of a theoretical capacity utilization that creates magical financial results is a short-term approach that has been repeatedly used. Carriers doing this are using decades-old practices and seem intent on proving Einstein's definition of insanity.

Container lines have also aligned into various operating alliances. These are supposed to improve operating costs. But alliances have added to service issues with customers. Blank sailings and poor on-time performance have caused complaints about schedule integrity and performance reliability. The alliances tie into the service problem. Carriers with "good" performance are in alliances with others that do not have good on-time execution. This situation creates problems with customers who have contracts with and/or utilize certain carriers are forced to use those that they do not want to use. Such customers need dependable service to manage supply chains. All this raises questions as to what customers are buying — and compounding problems with trying to increase rates.

The ultra-large ships bring the problem of what to do with the ships they are replacing. Carriers tend to cascade their ships into other trades to make way for the newer, bigger ones in the east-west trades. The net of the cascading has been adding more capacity than is being removed or scrapped.

Inferring from information of public firms, our conjecture is three-fold: One, which carriers will go out of business? Two, assuming carriers with no or nominal ultra-large fleets as likely to go under, would these firms file bankruptcy? What is the incentive to acquire their assets? Three, will such bankruptcies remove enough capacity to achieve any viable industry revenue benefit? How fast will all this take place? Who will survive? Stay tuned.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