Baltic Dry Bulk Investor Indices

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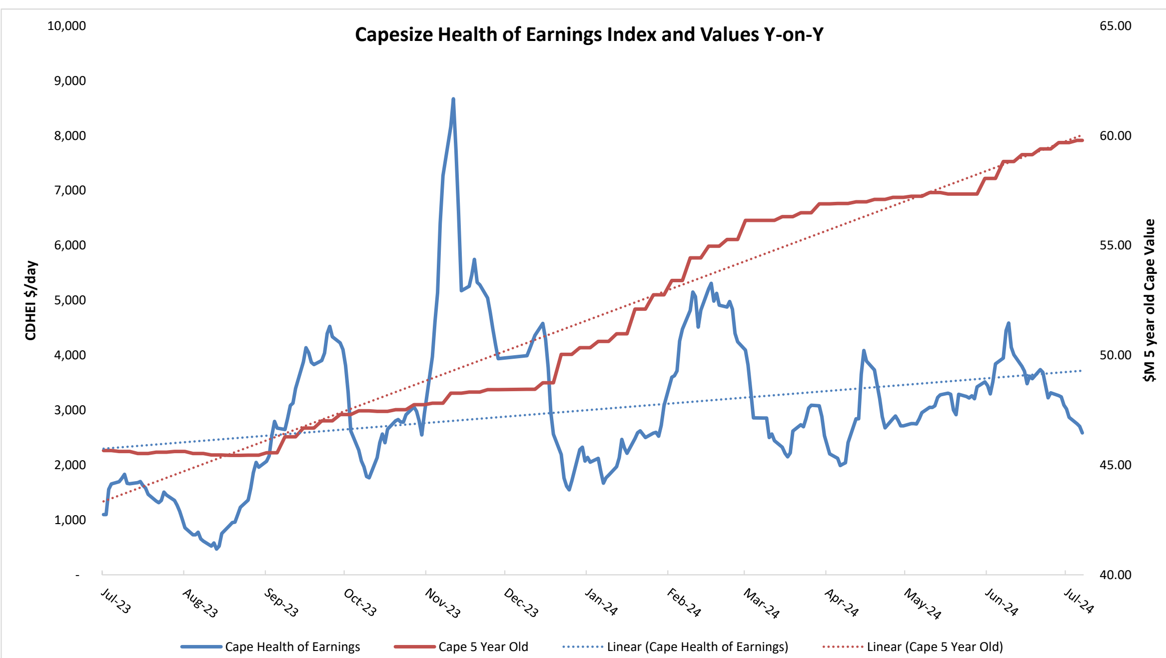
Summer Swoon, Upward Trend; Buyers Hold All Risk

Despite some strong quarters in the last five years, the dry bulk sector has suffered through mostly mediocre to poor freight rates since 2008. However, over the last year, there have been some reasons to be optimistic. Asset values have climbed with slow fleet growth and a low orderbook profile have made it appear that there would be a period of sustained stronger rates “just over the horizon” where you will find riches beyond your wildest dreams. However, for freight rates, the journey to this “horizon” has been long and there appears yet more sailing to go.

Often in dry bulk there is a “Summer Swoon”. The market is in between the peak grain seasons, and, to simplify things dramatically, the northern hemisphere, where 90% of world population resides, has summer seasonal impacts. Yet, there are positive one-year indications that things are not as bleak as they seem during the current swoon.

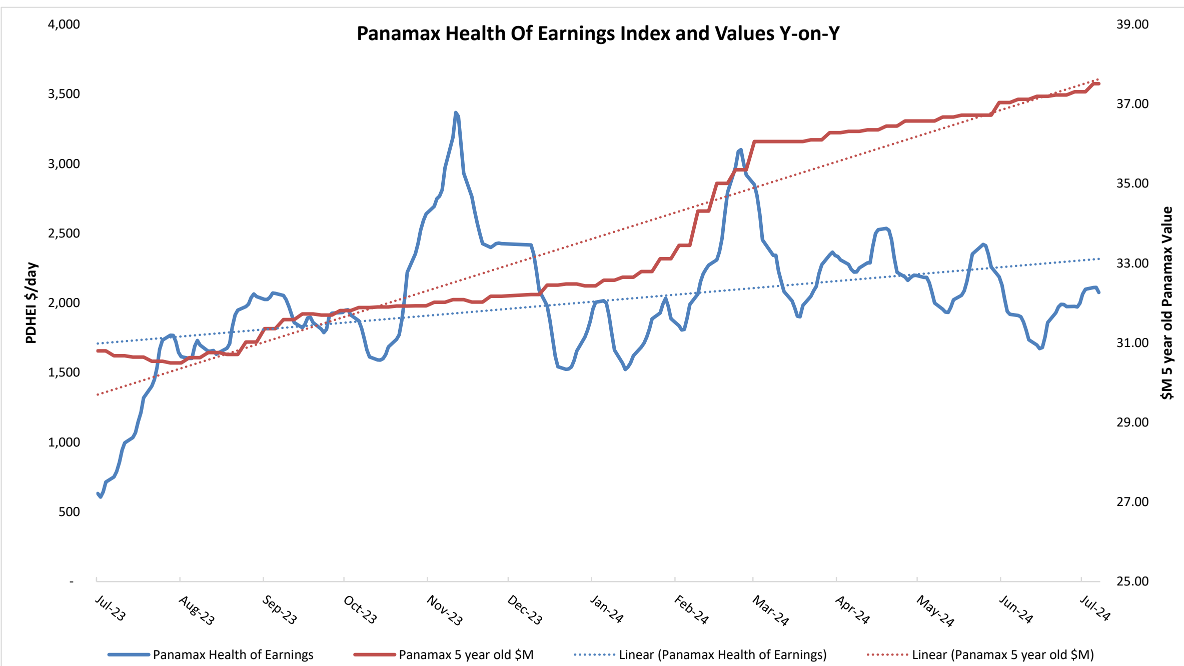


In the Capesize market, the one-year trend has been improving asset values and improving Health of Earnings[1] overall. The graphic above appears to show that five-year-old asset values have improved

[1] The Baltic Exchange publishes the Baltic Health of Earnings index on every trading day for each major cargo vessel type. It shows the ratio of earnings against cost with a negative number indicating that earnings are below operating costs. The Health of Earnings Index is highly correlated to freight rates, however takes in to account increases in OPEX over time.

faster than rates. However, maybe not. If we assume that one can acquire a five-year-old Cape for $59.8 million, lever it at 65%, then the estimated year-one cash-breakeven would be $22,120/day[2]. While the Baltic Capesize spot timecharter equivalent (TCE) is below that today at $19,712/day, the average for the trailing 12 months has been $22,839, slightly above cash breakeven. When one factors depreciation, this still would result in a notable loss on the income statement. Decidedly, this is not exciting, yet "cash is king", not depreciation.

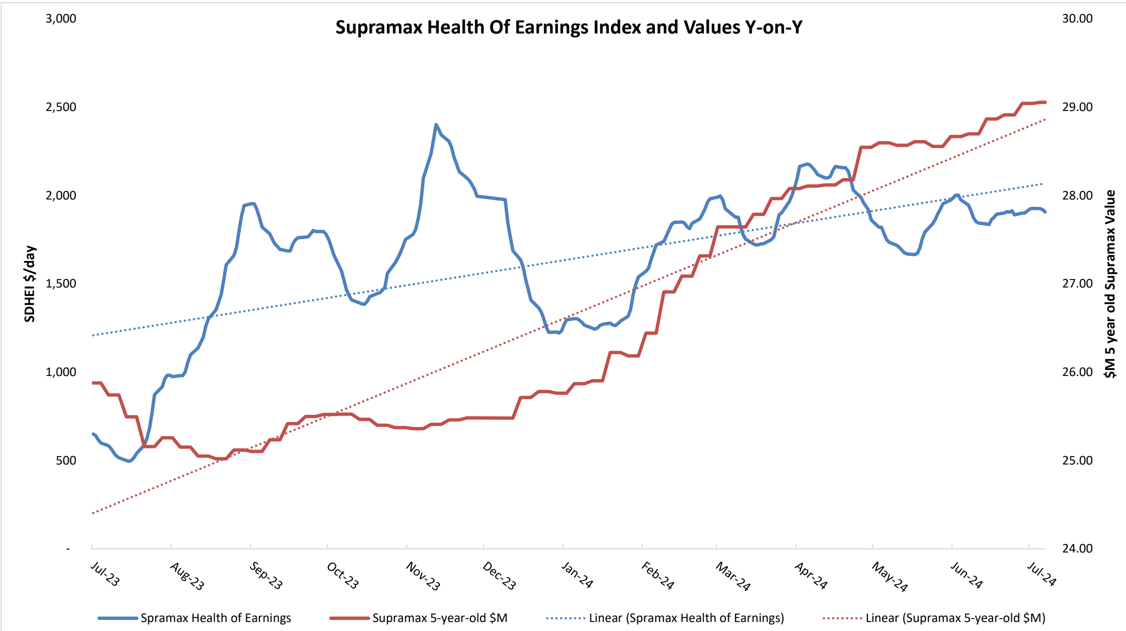
Of course, investing today is forward looking and past market performance is in the past. The trend is tempting. The Baltic Capesize spot TCE average is $19,712 today versus $15,533 one year ago, a 27% increase. There are many factors to any trend and banking on another 27% increase in rates year on year is foolish, although the freight rate improvement is a positive fact. Another fact to consider is that the Capesize orderbook is relatively low, historically. While there has been more ordering of late across all the major dry bulk cargo ship types, the orderbook remains low and ships take time to deliver. Buyers today recognize the trend of slowly improving rates and an attractive supply/demand profile over the coming 36 months in our view.



The Panamax bulker market has also had upward sloping trends year on year. Our estimated cash breakeven for a five-year-old Panamax purchased today at $37.5 million is $15,750/day[3]. Today the Baltic Panamax spot TCE is $15,649, just below cash the above-noted breakeven, and the average for the trailing 12 months has been $15,328. Year on year the Baltic Panamax spot TCE average is up 74.6% versus $8,964 one year ago during the 2023 "Summer Swoon". Again, buyers of five-year-old Panamax tonnage today are witnessing an upward trend in freight rates and a low orderbook

[2] Cash breakeven is computed as OPEX, plus G&A expense, debt amortization, interest and fees. On a five-year-old Capesize we assume 65% leverage with a 17-year profile, SOFR of 5.35%, Margin of 3%.
[3] Cash breakeven is computed as OPEX, plus G&A expense, debt amortization, interest and fees. On a five-year-old Panamax we assume 65% leverage with a 17-year profile, SOFR of 5.35%, Margin of 3%.

historically, hence asset values have steadily increased over the year, but freight rates have not offered a robust support of the asset values.



The trailing 12-month trend in the Capesize and Panamax sectors also appears in the Supramax bulker space. Our estimated cash breakeven for a five-year-old Supramax purchased today at $29.1 million is $13,610/day[4]. Currently the Baltic Supramax spot TCE is above that $17,060/day and the average for the trailing 12 months has been $15,567; both well above cash breakeven for a five-year-old purchase today using our assumptions for cash breakeven. Year-on-year the Baltic Supramax spot TCE average is up 81.2% versus $9,413 seen during "Summer Swoon" of 2023 one year ago. In this case the average rate over the last year and the current rate better justifies the increase in five-year-old Supramax asset values over the Capesize and Panamax sectors.

It is important to note that Supramax vessels are "geared" (with cranes and grabs), have many more route combinations than Capesizes and Panamaxes with a far wider range of charterers and credit counterparties. Supramax ships are also more intensive to operate on a day-to-day basis than the larger types and take more wear-and-tear due to more port calls as compared to the larger dry bulk sizes, hence OPEX and maintenance OPEX per deadweight ton is much higher than in the Capesize or Panamax sectors. The required expertise in the sector (even if simply acquired) can be a barrier to entry for a new investor and may partially explain the better asset value to freight rate relationship in the Supramax space over the larger sizes that operate on more commoditised routes with well-known charterers with generally better credit quality.

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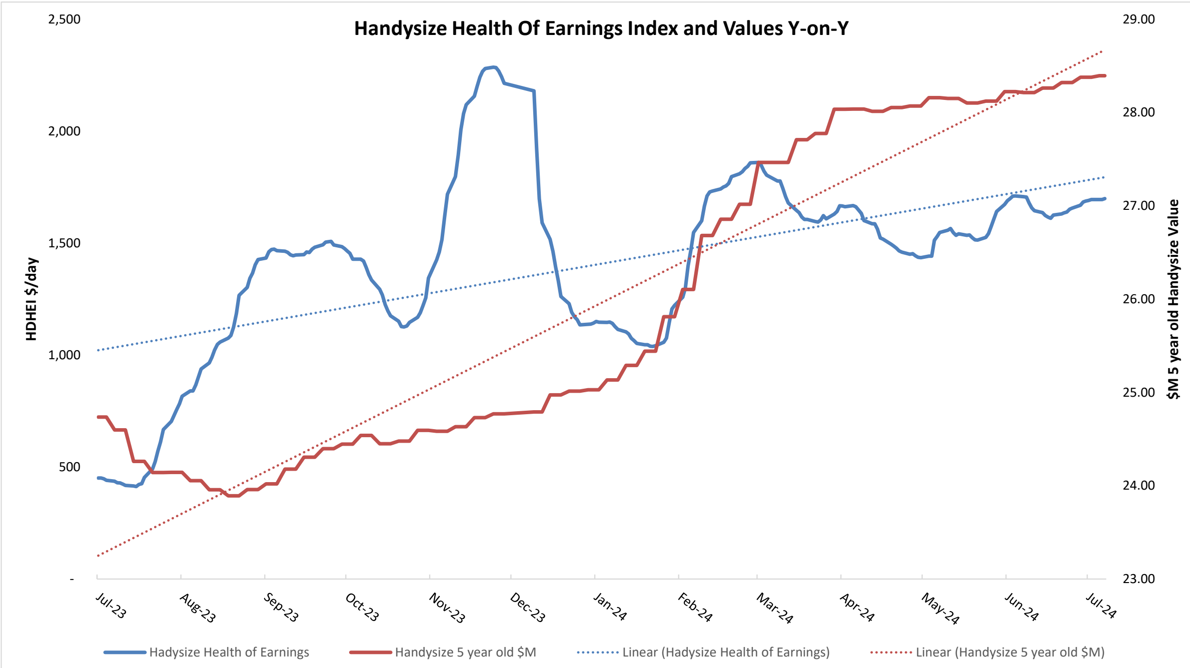
[4] Cash breakeven is computed as OPEX, plus G&A expense, debt amortization, interest and fees. On a five-year-old Supramax we assume 65% leverage with a 17-year profile, SOFR of 5.35%, Margin of 3%.



The Handysize sector has similar but even more pronounced and intensive exposure to the operating factors that impact Supramax ownership over the larger Panamax and Capesize classes. Still, the overall year-long dry bulk trend continues for Handysize bulkers. Our estimated breakeven for a five-year-old Handysize purchased today at $29.4 million is $13,260/day[5]. The Baltic Handysize spot TCE is effectively equal to our estimated breakeven at $13,708/day today, the average for the trailing 12 months is $12,051. Year on year the Baltic Handysize spot TCE average is up 93.3% versus the $7,090 seen during "Summer Swoon" one year ago.

Positive Trends…yet 100% of the Risk on the Buyers

There are positive trends and attractive supply/demand dynamics in dry bulk shipping. Those who bought less expensive dry bulk ships in recent years are doing better than these rather simplified snapshots of the five-year-old asset investors today. However, if one believes that the trend in asset values and rates will continue and wants to invest today, freight rates, despite the trends, offer little or no justification for the investment against our breakeven assumptions.

There is a simple way to lower cash breakeven: lower leverage on the investment, increasing equity investment. Yet, debt remains cheaper than equity, and lower leverage means a higher weighted average cost of capital and a lower return on equity. Dry bulk ship investing continues to be a calculated gamblers' market.

[5] Cash breakeven is computed as OPEX, plus G&A expense, debt amortization, interest and fees. On a five-year-old Handysize we assume 65% leverage with a 17-year profile, SOFR of 5.35%, Margin of 3%.