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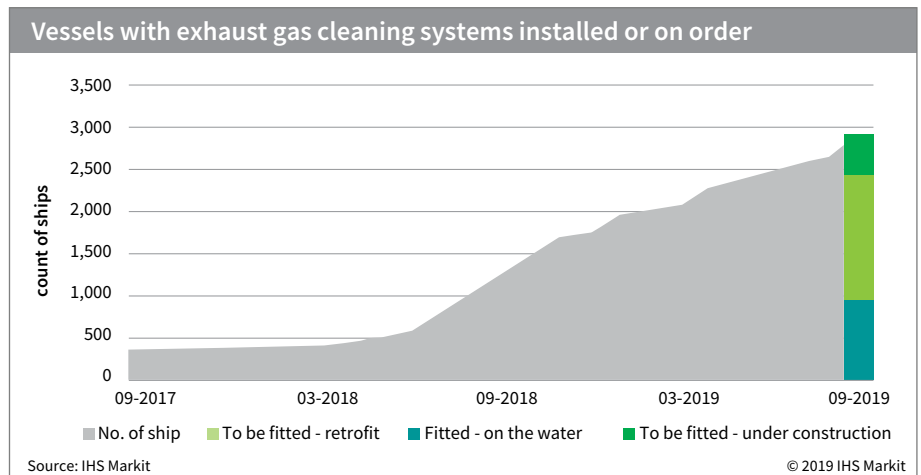


Climate and Sustainable Finance

Is the tide turning towards greener shipping?

Undoubtedly, IMO 2020 implementation will be in focus for the shipping industry this year. The fuel specification change is one of the most profound changes that the shipping industry has been faced with for quite some time. The majority of the shipping market has been quite upbeat about the consequences of IMO 2020, as fleet supply contraction influenced by scrubber retrofitting in some shipping markets, potential removal of fleets with high compliance cost and potential intensification of slow steaming due to anticipated high cost of VLSFO, is expected to further tighten fleet supply.

We should also bear in mind that IMO 2020 is only one of the environmental issues that shipping is facing, and that curbing CO2 footprint is one of those long-term items that will stay on the agenda for the time being. Cost of compliance for the fleets is likely to only increase in the next decade or so, with already a high burden of compliance cost for the upcoming years, bearing in mind fleets have to comply both to the new fuel specification rules but also the ballast water treatment convention as well.



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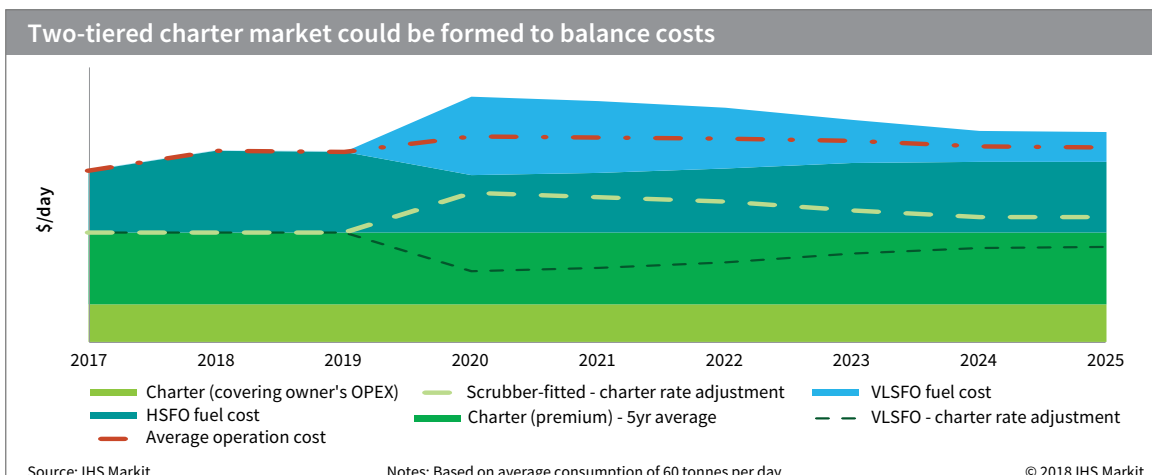
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We have to talk about IMO 2020 - Majority of fleet is expected to comply by using compliant fuels despite stronger uptake in scrubber adoption in the last 12 months

- IMO uphold their long-held position that there will be no delay to IMO 2020 implementation.
- Question remains over open-loop scrubbers, as the opposition seems to grow and IMO indicated that further investigation of open-loop scrubbers environmental impact is expected to be instigated.
- Preparation for IMO 2020 is gearing up with many ship operators preparing individual ship implementation plans, instigating discussions with fuel suppliers and testing VLSFO fuels.
- Significant uptake of scrubber installations in the last 12 months. There is a substantial number of announcements, mainly from large operators, about scrubber orders and installations.
- Commodity fleets seem to be in focus, particularly within retrofit candidates.
- However in recent months reports grew of scrubber installation delays and many shipowners reported that their retrofitting programs maybe falling behind schedule.

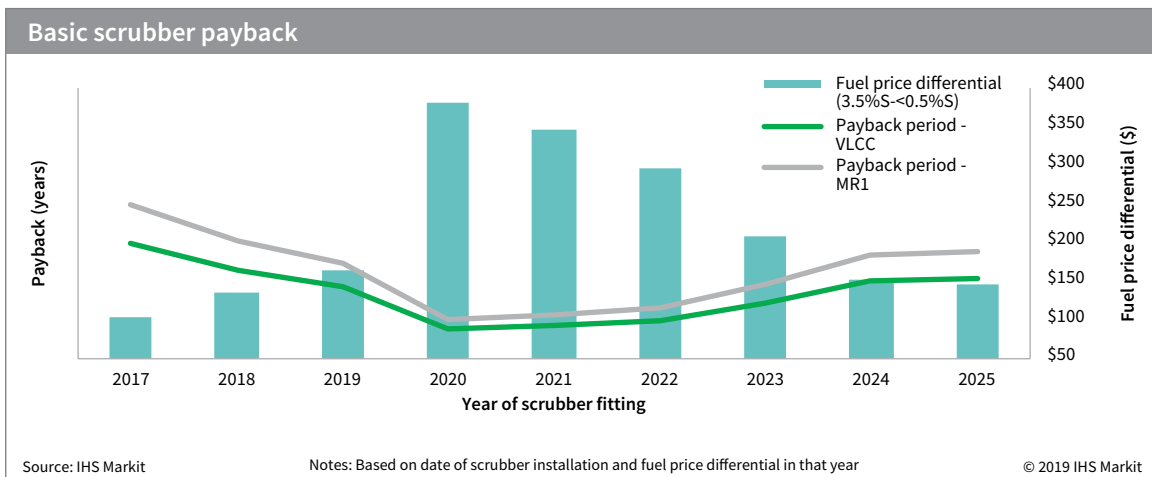
The market will see adjustments in charter rates to dampen the affects of changes in fuel costs

- The charter rates are likely to change, with scrubber fitted ships commanding a premium over their unfitted counterparts.
- Rates for non-scrubber fitted vessels may fall, being less attractive to a charterer due to fuel differential, although this is going to be highly dependable on general market conditions, such as supply and demand. During those times of stronger scrubber retrofits and tightening of the fleet supply, overall freight rates are expected to firm.
- The likelihood of a two-tier charter market seems to be unavoidable in most sectors, with eco and scrubber vessels commanding premiums over older, less-efficient and non-scrubber fitted vessels.



Scrubbers are here to stay but they are not the only option – further opportunity to incentivize renewal of some older fleets

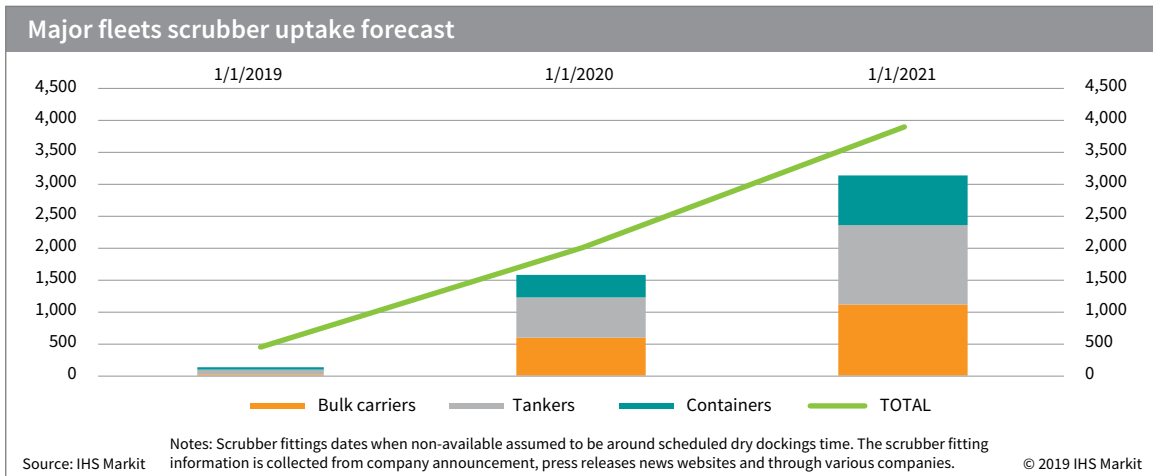
- Capesize vessels are recorded as consuming around 40 tonnes of bunker a day; with a scrubber fitted, these vessels, which would typically consume approximately 10,000 tonnes annually, could see an annual saving of USD two million on a differential as low as USD 200 per tonne between VLSFO and HSFO, compared with the cost of the scrubber, which in the current market is estimated to be around USD two-three million.
- Scrubber retrofits are expected to cause two tier markets, particularly in larger vessel sizes such as VLCC/ Suezmax and Capesizes. The fleet with scrubbers and eco ships are expected to command premiums over the rest of the fleets for the obvious reason of fuel economics, which have also been reflected in chartering markets so far.
- As fuel differential is generally expected to be narrowing, the scrubber economics may not remain as advantageous as at of the times of high VLSO and HSFO differentials. More efficient/younger vessels might be able to match or exceed the scrubber economics, which begs the question, would we see intensification of demolition and more importantly are we going to see higher activity on ordering more efficient vessels in the next year or so?



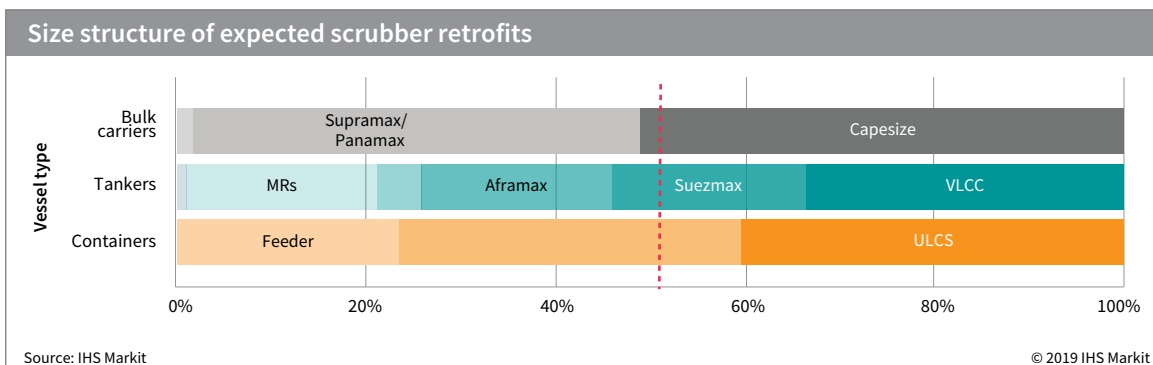
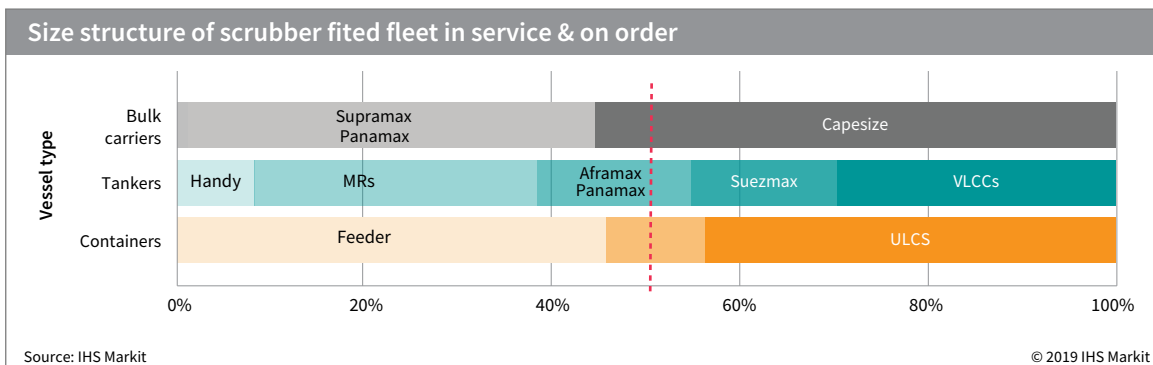
Scrubber uptake is set continue in the next wave of scrubber installations throughout 2020 – as current capacity is mainly booked

- Scrubber adoption started slow last year, with mainly fleets from non commodity fleets such as cruise and passenger vessels being among the first to adopt scrubber technology. Reports are mounting as of recently about scrubber retrofitting delays. This makes us believe that the scrubber ready fleet will be at level just north of 2,000 ships come January 2020.
- Either way, scrubber adoption is expected to continue, and a second wave of installations is expected to be coming this year and we would expect that the major commodity fleets to have north of 3,000 units equipped with scrubbers by January 2021. All together we would expect to see north of 3,500 units equipped with scrubbers by the same date. These numbers are obviously a combination of newbuildings expected to

be delivered in the next period plus the number of vessels we would expect to be retrofitted with scrubber technology.

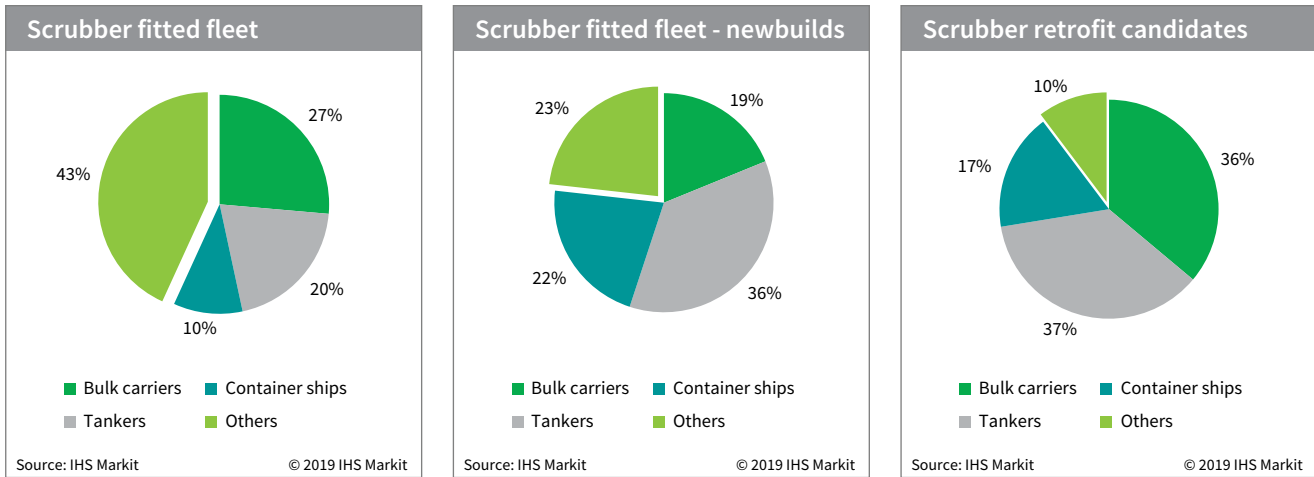


Majority of vessels are larger in size but there is more interest in scrubber retrofits among medium sizes – specific to operational requirements etc



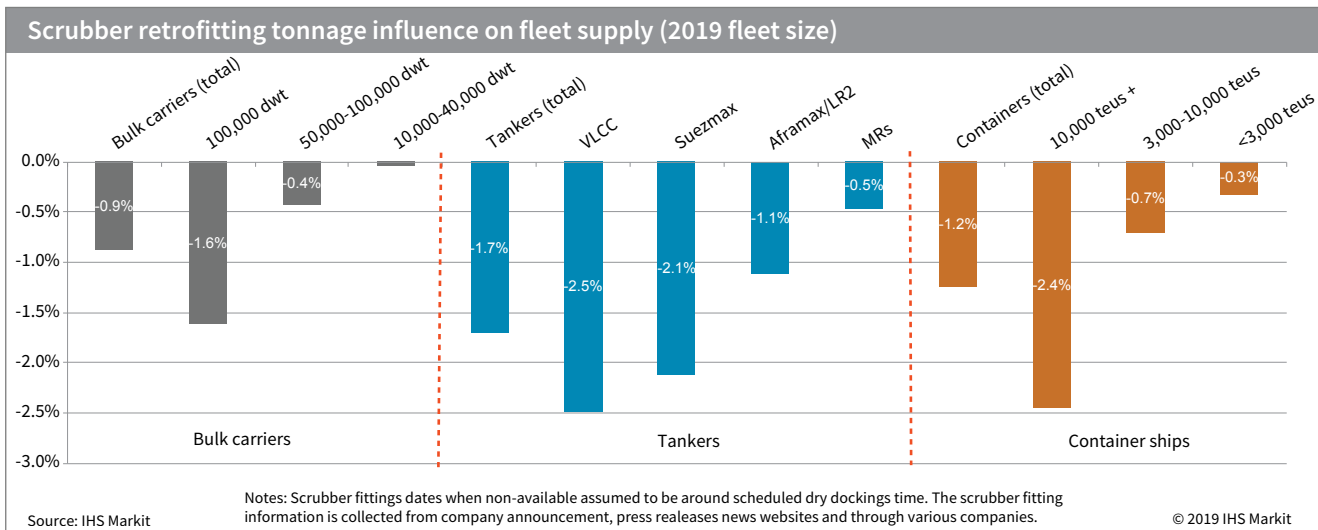
Economies of scale plays its role in the decision making process for scrubber retrofitting and fitting. The fact that larger ships are usually the biggest guzzlers, and these are employed on longer routes, seems to be influencing the current situation that about 50% or more of vessels scheduled for retrofitting are coming from the larger units such as Capes, VLCC/Suezmax and ULCS.

Scrubber retrofits and newbuildings shifted towards large commodity fleets such as Tankers, Containers and Dry Bulk as deadline looms



Early adopters of scrubber technology are passenger and cruise sectors that have to spend quite some time around ECA areas. However as IMO2020 got closer, we noticed a much stronger switch towards commodity fleets, mainly newbuilding and retrofitting candidates.

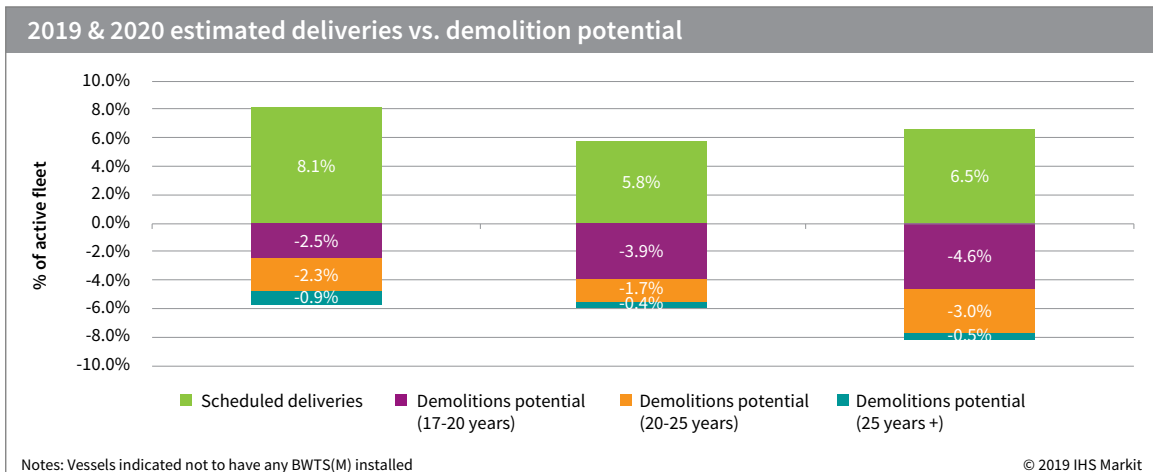
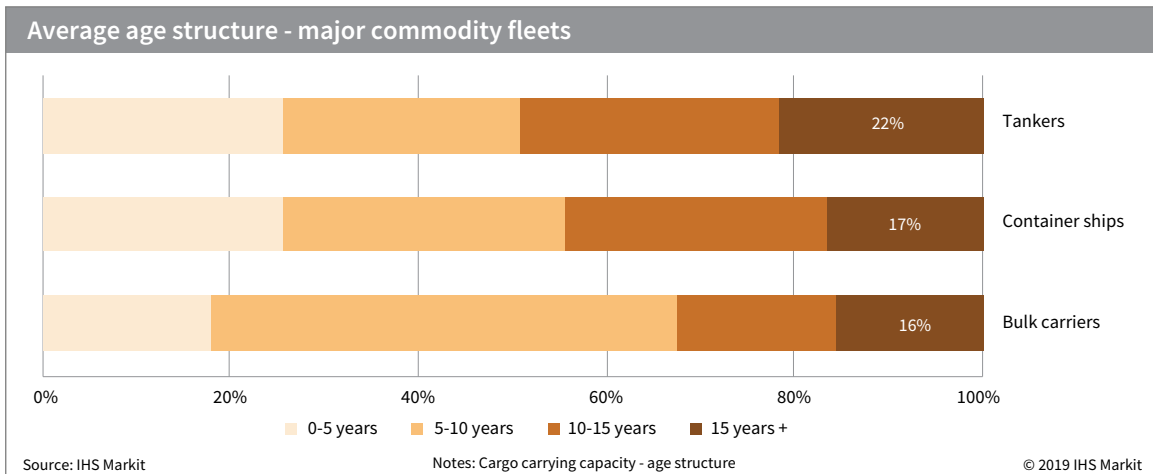
Supply tightening is expected to happen as scrubber adoption is expected to continue; the effect will be stronger on the larger fleets



Many operators decided to go with a multi-year scrubber retrofiting program for their fleets. Taking into account the fleet that we noted and is currently expected to have a scrubber retrofitted, fleet supply contractions on annualized level are expected to be about 1% to 2% of the 2019 fleet size. More amplified effect on the fleets is expected to be on larger vessels such as Capes/ULCS and in particular VLCCs and Suezmaxes, where the number of scrubber candidates is high. Inevitably the effect will be dampened by delays in scrubber retrofiting, as well as the fact that the retrofits taken into account maybe installed at a later stage.

Demolition potential seems to be outweighed by the fleet scheduled for delivery in the next 12 months or so, but there is some potential for renewals

Major commodity fleets age structure suggests that only 15-20 years of current fleet capacity is 15 years or older. Heavy spates of demolitions and newbuilding orders in the last few years left us with relatively young fleets. Major demolition candidates are vessels that are regarded to have high cost of compliance, so that is vessels that are obliged to invest in BWTS as well as cover costs for upcoming dry docking or special surveys. These vessels are usually 17 years or older, which may find it very hard to compete with younger more efficient/scrubber fitted fleets.



Effect of IMO 2020 on fleet tightening – Scrubber retrofits and removals of older fleets is expected to have some influence on fleet tightening

- One thing on the mind of the shipping community these days and in connection with IMO 2020 is exhaust gas cleaners/scrubber retrofitting on the existing fleets. The argument is that retrofitting scrubbers on the existing fleet of vessels will take out certain capacity in the market while the retrofits are done so supply of ships would tighten and the freight rates would go up as a consequence of ship supply tightening.
- We have already observed some effects of scrubber retrofitting on ship supply in VLCC and Capesize markets, which added to fleet supply tightening in recent months and has reflected stronger freight rates. For the reason that large vessels are bigger consumers, usually employed on longer routes, the majority of scrubber retrofits are going to be coming from these segments, inevitably amplifying the influence on the fleet supply tightening in these fleets.
- Recent reports suggest scrubber retrofitting is getting delayed, but also postponed in recent months, as the IMO 2020 deadline is approaching. This can also influence fleet supply towards the end of this year and beginning of next.
- Expected fleet tightening due to scrubber retrofitting is something that is anticipated to firm freight rates in the period of more intensive scrubber retrofitting. This however is probably going to discourage demolitions, although there has been quite a lot of talk about demolition intensification.
- Commodity fleets had gone through a heavy spate of newbuilding orders and demolitions in the last decade, with bulk carriers and container sector demolitions peaking in 2016 as freight rates were very poor, and older and inefficient vessels had to be taken off the fleet. The tanker sector suffered a similar fate more recently in first half of 2018. Notably, this years' demolition candidates were sold mainly for storage activity with IMO 2020 approaching, some of the vessels have been dedicated to store fuel oil.
- When the capacity of demolition candidates is contrasted with capacity on orderbook, we can see that the potential demolitions will be largely neutralized by capacity being delivered.

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