Challenges ahead for container shipping industry

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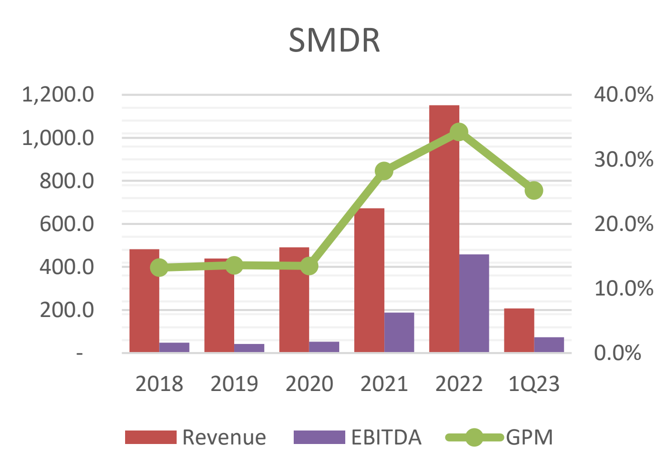
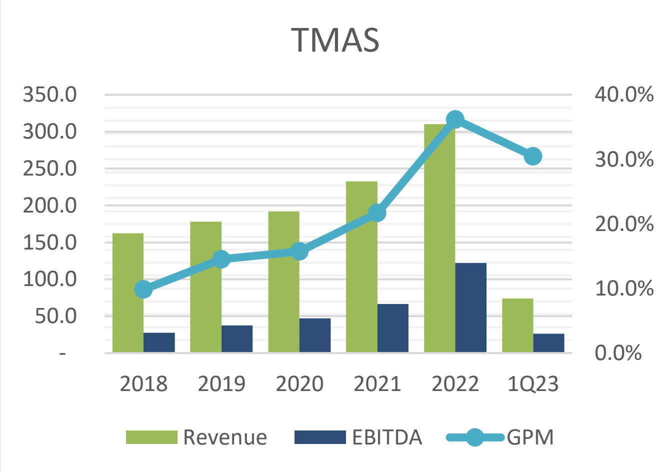
The global shipping industry is one of the most crucial components of international trade, playing a vital role in the transportation of goods worldwide. The industry is highly sensitive to global economic growth, yet it has experienced record-breaking revenues during the pandemic. The shipping industry was relatively immune to lockdowns, with demand remaining high due to the surge of new normal including increasing online purchase. In 2021, vessels on charter remain limited due to social restrictions and lockdown due to global port congestions while demand has recovered, further straining the availability of vessels. In 2022, demand for the shipping industry keep increasing led to ship shortage and push the freight rates to soar to unprecedented levels, setting a record in the container shipping industry.

As a maritime nation, Indonesia has a robust shipping industry that has played a crucial role in its economic development over the years. The industry has been supported by various factors, such as the Sea Toll Program and commodity price growth, which have contributed to its growth and development. The Sea Toll Program has been a significant contributor to the growth of the Indonesian shipping industry, aiming to reduce the price disparity between major islands and remote islands across Indonesia by building new container ports in smaller areas and increasing subsidized ship routes to remote ports. This initiative has made shipping more accessible and affordable, enabling goods to reach even the most remote areas of the country. Moreover, the shipping industry has been a vital transportation link between Indonesia's domestic and international customers for various commodities. It has provided a reliable and efficient means of transporting goods, contributing to the country's economy. Additionally, the industry is supported by the cabotage principle that requires 51% ownership of ship companies in Indonesia to be owned by Indonesian companies which helped to promote the growth of local shipping companies.

Table 1 – Revenue, EBITDA and GPM

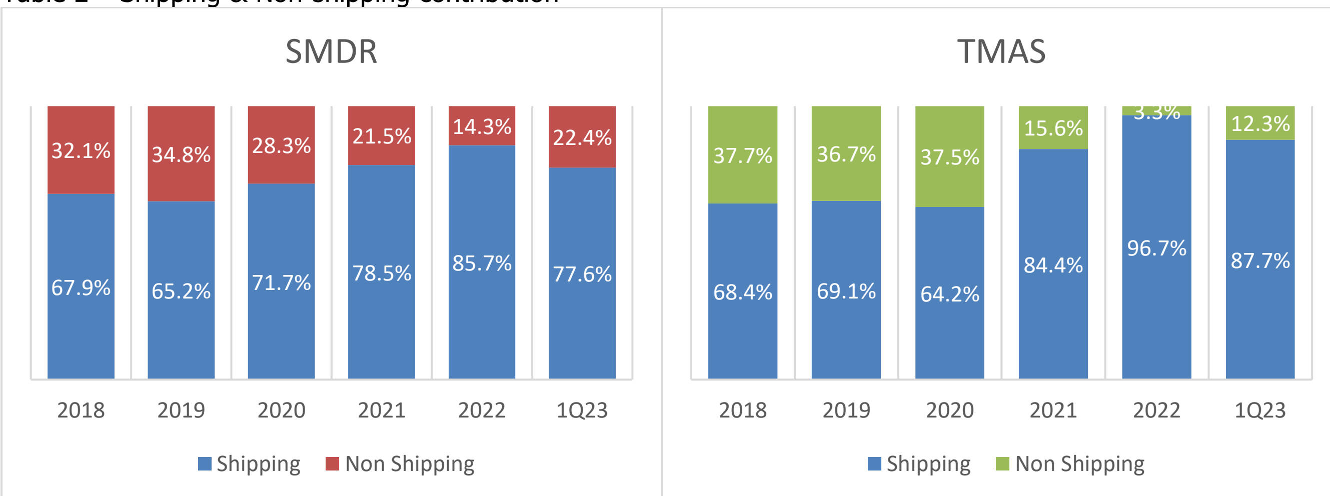




Amid the pandemic, the domestic container shipping market in Indonesia has witnessed a surge in revenue, in tandem with the global market's trend of a high vessel charter rates. Consequently, container shipping companies have recorded the highest increment in revenue and operating profit over the past 5 years. The listed shipping companies' revenue has doubled, indicating less impact from the pandemic as shown in the table 1 above of PT Samudera Indonesia Tbk. (SMDR) and PT Temas Tbk. (TMAS). In addition, we view companies that have more owned vessels than chartered from third parties generally have thicker gross margins. With thick margins, companies have more resilience to inflation risks in operating expenses, and bunkers (fuel prices).

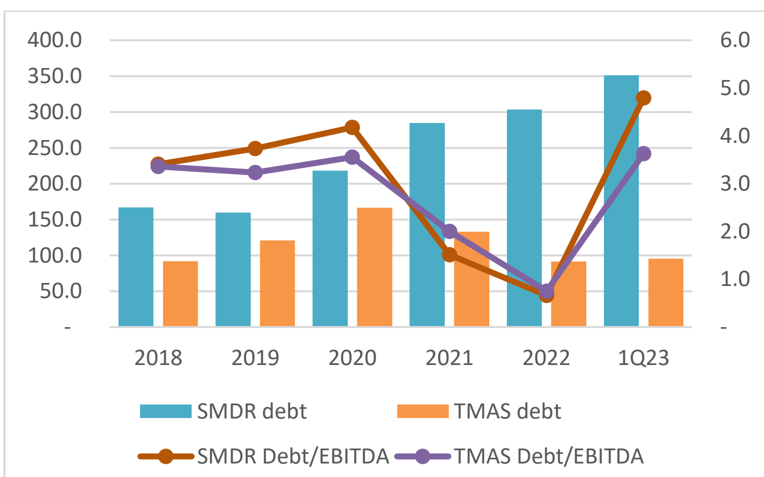
In addition, on container shipping services, shipping companies usually have integrated business such as stevedoring and logistic services as part of revenue diversification (table 2). Although non-container shipping business contribution is less than 40% but it will provide the company with revenue cushion during a low freight rate period.

Table 2 – Shipping & Non-shipping contribution



Despite the revenue growth, there has also been an increase in debt during the pre-pandemic as shown in table 3, with the majority of the capex for additional vessels being financed by external borrowings to meet surging demand. We view earnings visibility as difficult to predict due to the volatility of freight rates and also the short-term nature of the contracts (generally of up to 12 months). Therefore, lower than projected freight rates may adversely affect the company's financial ratios, including leverage ratio and interest coverage ratio. This risk will be higher if the vessel relies on spot rates as such rates will fluctuate according to market supply and demand.

Table 3 – SDMR and TMAS adjusted debt and leverage



Given these circumstances, it is crucial for shipping firms to maintain a balance between expanding their fleet and managing their debt obligations effectively. They need to keep a close eye on the market trends and consider the feasibility of long-term contracts to reduce the risks associated with short-term contracts. A prudent approach to managing debt and contract renewals is vital to sustain growth and profitability in the highly competitive shipping industry.

Despite its economic importance, the shipping industry is not immune to challenges, both domestic and foreign. One such challenge is the regulatory framework imposed by the International Maritime Organization (IMO), a specialized agency of the United Nations responsible for the safety and security of shipping and the prevention of marine pollution. In the past three years, the IMO has issued two significant regulations that have impacted the shipping industry. The IMO 2020 mandates a significant reduction in the sulfur content of marine fuels used by ships worldwide. This regulation came into effect on January 1, 2020, and set a limit of 0.50% sulfur content on marine fuels, down from the previous limit of 3.5%. The IMO 2023 is a set of requirements focusing on energy efficiency and greenhouse gas emissions from ships. These regulations are part of a long-term strategy to achieve a 40% reduction in emissions by 2030 and 70% by 2050.

While these regulations are aimed at reducing the environmental impact of the shipping industry, they also imply additional costs for bunkering and adapting new environmentally friendly technologies. The container shipping industry must invest in new technologies, such as low-sulfur fuels and scrubbers, to comply with the regulations. These investments require substantial capital expenditure, which may be challenging for some companies, particularly smaller ones. Moreover, the shipping industry must also contend with challenging competitive environments. Competition in the industry is fierce, and companies must be able to offer competitive rates to secure profitability. Additionally, geopolitical tensions and trade disputes can impact the industry, particularly for countries like Indonesia that rely heavily on exports.

In conclusion, the shipping industry is a critical component of Indonesia's economy, but it faces both domestic and foreign challenges. We see the shipping industry as moderately high risk due to its inherent operating challenges as mentioned above, but despite the high risk, we are of the view that it has a stable outlook over the next 12-18 months given the robust demand amid favorable freight/charter rates. We project 2023 profitability will be lower than all-time high in 2022, as freight rates started to normalize but will remain slightly above pre-pandemic levels.