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MARKET FOCUS

ANALYSIS

Gridlock may negate Asia's cheap labour

Paul Berrill

London

The backlash against relying on container shipping as a cheap and efficient way of outsourcing production to Asia is building a head of steam.

"Companies that rush overseas in search of low unit production costs may be walking into a strategic trap," warns economic market analyst Boston Consulting Group.

In a new report titled "Surviving the China rip tide" and subtitled "How to profit from the supply-chain bottleneck," Boston Consulting says the gridlock beginning to haunt US, and to a lesser extent European, ports and inland transport systems can make delivery of goods take twice as long as expected. "Unit production cost is only one part of a very complex picture to consider in outsourcing. As supply chains lengthen, they incur hidden direct and indirect costs," said the report.

Manufacturers and retailers are having to spend more on ordering earlier, carrying more inventory, extending planning horizons and shipping priority products by expensive airfreight to overcome delays. And they warn that because of the cost and time to develop new terminals, things will get worse before they get better.

Boston Consulting says issues like lost sales from delayed deliveries and increased write-downs of stock are rarely included in the sums done by those who look for large savings in production costs in China. "It's easy to underestimate the hidden costs in long supply chains," it said.

In theoretical costings by Boston Consulting, China retains a price advantage over production in Mexico for US markets but, in Europe, it can be cheaper to produce in eastern Europe than to ship from Asia. If delays mount as fleet expansion outpaces port growth, then the advantages in manufacturing in cheap locations closer to home increases.

Boston Consulting suggests a number of strategic options for shippers but adds one last sting in the tail for carriers. Describing problems outsourcing to China as a developing non-tariff trade barrier, it said: "The best strategy for US protectionists may lie not in quotas or tariffs but in the active backing of environmentalists' efforts to hinder port expansion."



VLCC MARKET FORTUNES: Tonnage supply will become the deciding factor.

Photo: Keizou Hirohashi

Tonnage surplus threatens VLCCs

Owners looking to gain from the end of single-hullers may be in for a bumpy ride.

Geoff Garfield

London

Signs point to a "painful transition" to a fully double-hull VLCC fleet, says a new report.

Freight rates will inevitably come under pressure because of record newbuilding deliveries and single-hull tankers continuing to trade.

German-Dutch transport bank DVB warns in its latest VLCC-market outlook that single-hull ships could "act as an anchor and weigh down the entire market".

Using Lloyd's Register/Fairplay data, the bank's research and strategic-planning department says there are currently 183 VLCCs on order, some 39% of the existing fleet, as compared with 123 vessels (27%) one year ago.

Some 33 VLCCs will be delivered in 2007, 45 in 2008 and peaking at 62 in 2009. Not since



VLCC CONSTRUCTION: Currently there are 183 units on order. Photo: Jonathan Boonzaier

the 1970s have so many entered the market at the same time and all before the 2010 phase-out deadline of Marpol 13G.

The market faces moving into oversupply, says DVB. Charterers will have plenty of tonnage to choose from, especially as the regulations will not force single-hull tankers out of the water.

Flag administrations can allow them to continue trading to the age of 25 years, with a drop-dead date up to 2015.

"Consequently, the size of the tanker fleet becomes a moving target, depending on the speed of the SH [single-hull] phase-out, which in turn will be dictated by

market conditions and the possibilities of finding employment," said DVB.

But the current VLCC market offers little incentive to scrap single-hull ships, of which there are currently 154 with an average age of just under 16 years.

"On the contrary, we have seen SH [single-hull] VLCCs change hands at prices around \$42m," said DVB.

Average break-even earnings required for such a vessel — given the possibility to extend the trading life to five years from the date of purchase — is \$25,000 to \$30,000 per day. This is well below average earnings over the

past five years of \$55,845 per day.

One "mitigating" factor is the potential removal of some vessels for conversion projects. At least seven VLCCs have been sold over the past 18 months for floating production and/or storage units and recently there has been talk of converting others to dry-bulk carriers.

Although "tonnage supply will become a deciding factor for VLCC market fortunes in the next few years", DVB notes that contracts for newbuildings have now slowed down.

Owners are trading more carefully in view of the large orderbook, long lead times at yards and uncertainty over post-2010 market developments.

But the mixed news for owners contracting or selling tonnage is DVB's rider that "the mixture of slowing markets, reduced ordering and expanding yard capacity also points to a gradual decline in vessel prices both for newbuildings and secondhand vessels".

On the upside, DVB says that post-2010 it expects the large potential to remove single-hull VLCCs will contribute toward eventually bringing the market back into balance.