Index-linking rises as freight rates slip

Leading carriers focus on long-term charters linked to Baltic Exchange dry bulk indices

Barry Parker – New York

FLEET lists of the larger New York-listed companies show a rise in the number of long-term charters agreed at rates linked to Baltic Exchange dry bulk indices.

Three capesize vessels in the fleet of Genco Shipping & Trading are on charters tied to the Baltic Capesize Index, five panamaxes are tied to the Baltic Panamax Index and eight supramax or handymax bulk carriers are tied to the analogous indices.

Eagle Bulk Shipping, which is focused on geared 50,000 dwt-60,000 dwt bulk carriers, shows eight vessels on charters linked to the Baltic Supramax Index.

Low freight markets have helped spur the move to index-linked charters, based on either composites or groups of individual routes quoted by the Baltic Exchange.

Over the past five months, dry bulk market rates have slipped below historical averages, opening up a chasm between the low hires bid by charterers and the daily cash breakevens needed to cover owners' daily operating costs and capital costs.

In such cases, there is no meeting of minds between owners and charterers. The minimum hire that an owner can prudently accept for anything other than temporary periods is well above what is on offer from the big operators and raw material charterers who might take ships for a year or more. For shipping people, the bottom line is stark: much of the period chartering activity dries up.

One marquee deal, concluded by Excel Maritime Carriers as the dry bulk market was in free fall in December 2010, illustrates these points. As the markets were plunging, it fixed seven kamsarmax bulk carriers, whose charters with Bunge Corp had expired, on charters at levels linked to the Baltic Panamax Index, with minimum floor rates.

Traders suggest that the settlement mechanism on such a deal could reflect the premium hires obtainable by kamsarmaxes over the slightly smaller panamaxes.

Period commitments, a form of financial hedging, are a critical component of portfolio management for listed shipping companies that often tout their "revenue visibility" to investors, especially where they have committed to pay dividends.

When Excel's deal was announced, chief financial officer Pavlos Kanellopoulos said that the fixtures "significantly increase the visibility of our cash flow generation", adding that the floor rate enabled Excel to protect its downside and achieve its breakevens.

The analysts at the large investment houses have also taken notice of indexed charters. Jefferies & Co shipping analyst Doug Mavrinac describes Eagle Bulk as "moderately leveraged to the dry bulk shipping spot market with a number of index-linked contracts".

Morgan Stanley's Ole Slorer, in looking at Excel Maritime, positioned the owner as "a leveraged play on the Baltic Dry Index".

For the shipowner, the indexed mechanism postpones the need to have that all-important meeting of the minds necessary to conclude period business.

Excel's Mr Kanellopoulos points to this other key aspect of indexation, saying: "These charters allow us to monetise 100% of the upside in market rates through the index linked element."

Owners expecting any forward freight agreement prices to increase can wait before locking in, which they would do by selling a "strip" of quarterly contracts matching the spot exposure, in this case, the end of 2011 and early 2012.

In mid December 2010, when Excel fixed the kamsarmaxes, three elements of a possible strip — the second-quarter, third-quarter and fourth-quarter 2011 panamax time-charter composites — would have been worth around $21,000 per day, $19,300 per day and $18,740 per day, respectively. By mid March 2011, these had slipped in value.

A different species of shipping company — the spot market player with little or no financial leverage, and offering investors the maximum prudent dividend payouts — also benefits from the indexation mechanism.

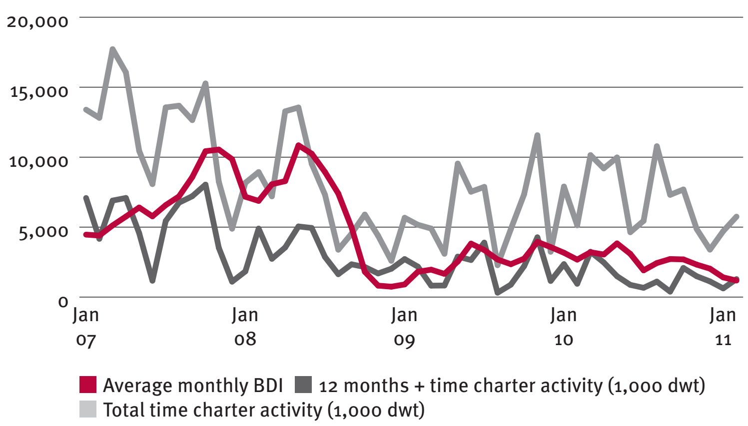
The fleet list of one such entity, Baltic Trading, shows that its nine vessels (two capesize, four supramax and three handymax bulk carriers) are all on indexed charters.

With this new breed of charter, relationships with well-known and trusted counterparties may remain in place (as they would in a period charter), with revenues mimicking a fleet being traded spot.

In positioning for a possible move upward in the market, where investors will be rewarded with fat payouts, there is no better story to be telling. ■

A LOWER BDI MEANS FEWER PERIOD TIME CHARTERS

2007-2011



Source: Drewry Shipping