

SHIPPING

**FUTURE
OPERATING
COSTS REPORT**

OCTOBER 2019



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RESULTS

Vessel operating costs are expected to rise by 2.5% in 2019 and by 2.7% in 2020, according to our latest survey.

KEY FINDINGS

Responses to the survey revealed that insurance is the cost category likely to increase most significantly in both 2019 and 2020. In the case of protection and indemnity insurance, the predicted increase is 2.0% for each of the years under review, while hull and machinery insurance costs are expected to rise by 1.9% in both 2019 and 2020.

The cost of both dry docking and of repairs and maintenance is expected to increase by 1.8% in 2019 and by 1.9% in 2020, while expenditure on crew wages is predicted to rise by 1.9% in 2019 and by 1.8% in 2020. Other crew costs in those years, meanwhile, are expected to increase by 1.8% and 1.7% respectively.

The increase in expenditure for spares is expected to be 1.6% in 2019 and 1.8% in 2020. Meanwhile, projected increases in lubricants are 1.6% in each of the two years under review, while those for stores are 1.3% and 1.4% respectively.

The predicted overall cost increases for 2019 were highest in the container ship sector, where they averaged 3.7%, heavily influenced by expected increases in both protection and indemnity and hull and machinery insurance costs. Predicted cost increases in the bulk carrier market in 2019, meanwhile, were 2.3%, as opposed to 2.5% in the tanker market and 2.6% in the offshore sector.

A slightly different picture emerges in respect of 2020, where the highest operating cost increases are those amounting to 3.8% which are expected in the offshore sector. Operating costs for container ships, meanwhile, are expected to rise by 3.0% in 2020, and for bulk carriers and tankers by 2.7% and 2.1% respectively.

The cost of regulatory compliance was high on the list of concerns cited by respondents to the survey. One respondent said, "2020 is all about environmental regulations and the demand for - and cost of - fuel." Elsewhere it was noted, "The shipping market will be dominated by the cost of new regulations, not least that relating to compliance with the IMO Sulphur 2020 regulation." Another respondent simply said, "New regulations will have an increasing effect on costs".

Crew costs were the other factor uppermost in the minds of respondents, one of whom commented, "Manning

will continue to be a painful area for ship operators." Another respondent observed, "Rising wage costs now represent a real threat to our business model." Another respondent noted, "Over the next two years we expect to see a trend towards higher salary payments", while yet another pointed out, "We anticipate seeing a stronger dollar in 2019/2020, and that will affect our main cost of paying seafarer wages."

The cost and availability of finance was another issue raised by a number of respondents, one of whom said, "Finance - or a lack thereof - is driving consolidation as part of a trend towards creating mega-companies. The market is being eroded by capital providers and hedge fund managers who shun efficiency in favour of scale." Another respondent noted, perhaps portentously, "In the last 8 years we have managed to keep operating cost increases below 2% thanks to a soft insurance market, cheaper bank rates, and a fall in demand for increased crew wages."

COST TYPE	2019	2020
	%	%
Crew wages	1.9	1.8
Other crew	1.8	1.7
Lubricants	1.6	1.6
Stores	1.3	1.4
Spares	1.6	1.8
Repairs & maintenance	1.8	1.9
H&M insurance	1.9	1.9
P&I insurance	2.0	2.0
Management fees	1.1	1.0
Dry docking	1.8	1.9
Total operating costs	2.5	2.7

RESULTS

Continued

FACTORS INFLUENCING OPERATING COSTS

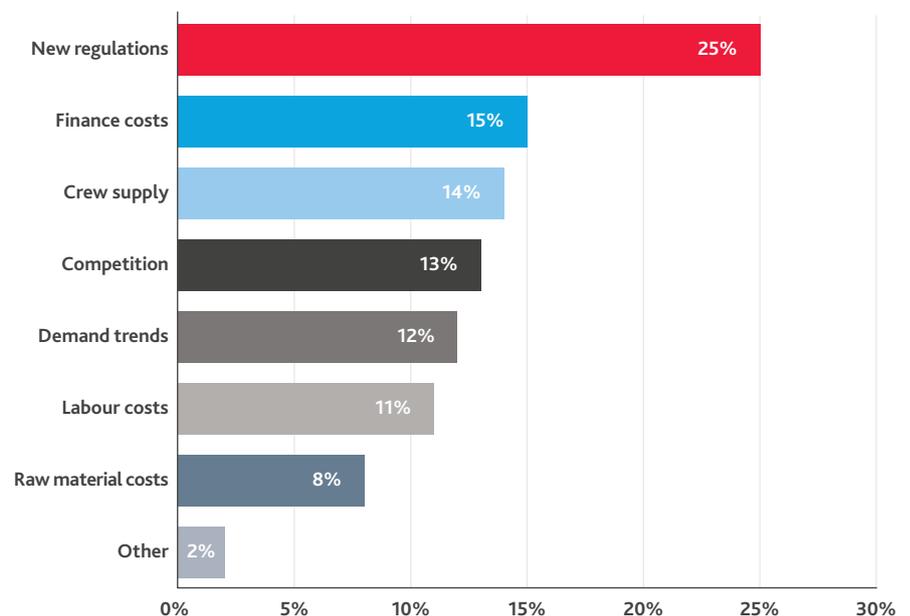
We asked respondents to tell us about the factors that would most affect operating costs, by asking the following question: Which three of the following factors will most influence the level of vessel operating costs over the next 12 months? Please rank your three chosen factors in order of priority (1, 2, 3).

Overall, 25% of respondents (up from the figure of 23% recorded in last year's survey) identified the cost of new regulation as the most influential factor likely to affect operating costs over the next 12 months. Finance costs featured in second place with 15%, compared to 18% last year. In third place was crew supply at 14%, up from 12% last year. Next came competition, down from 15% to 13%, followed by demand trends, 12%, and labour costs, 11%, compared to last year's figures of 10% and 8% respectively. Raw material costs, meanwhile, were up by one percentage point to 8%.

CONCLUSION

The predicted 2.5% and 2.7% increases in operating costs for 2019 and 2020 respectively compare to an average fall in actual operating costs in 2018 of 1.8% across all main ship types recorded in the recent BDO OpCost study.

There were some interesting predicted cost increases in the individual market sectors. The increases in the container ship sector for 2019, for example, were the highest in every single individual category of expenditure with the exception of dry docking and management fees. The cost of hull and



machinery insurance for container ships is predicted to increase by 4.8% in 2019 and by 3.3% in 2020. For protection and indemnity insurance, the comparable predicted increases are 4.1% and 3.3% respectively. By way of comparison, increases in protection and indemnity and hull and machinery insurance costs in the tanker sector for 2020 are predicated at 1.3% and 1.2% respectively.

One year ago, overall expectations of operating cost increases for 2019 averaged 3.1%, so the fall now in such expectations to a predicted figure of 2.5% must be regarded at first blush as good news. But this must be tempered by the knowledge that some significant items of big-ticket expenditure – notably those relating to the cost of complying with new regulations – are waiting in the wings.

It is clear that shipping is well aware of the need to achieve regulatory compliance on a scale not previously envisaged or encountered by previous generations of the industry. This is only the third time that the cost of new regulations has been included in our Future Operating Costs Report, but for the second successive year it has emerged as the factor deemed most likely to have a significant influence on operating costs.

This is not surprising, given that the immediacy of IMO's Sulphur 2020 regulation is enshrined in the name of the regulation itself, while the time is fast approaching for owners to make a decision on the respective merits of Ballast Water Management Convention compliance solutions.

RESULTS

Continued

Shipping and its regulators have demonstrated their ongoing commitment to improving the industry's carbon footprint, but it is clear that this will come at a price, as will the continuing drive towards greater innovation and technical excellence. A cleaner, greener and more efficient shipping industry will ultimately impact favourably on both operating costs and investor appetite. But, perversely, the process of attaining environmental and technical proficiency will add to such costs in the shorter term.

Experienced owners and managers are well-used to optimising operating cost efficiencies, witness the respondent who noted how for some years now the combination of a soft insurance market, cheaper finance and a decline in crew costs had helped to keep expenditure under control. Current indications are that the influence of such factors is declining and on their own they are unlikely to be enough to stay ahead of the game in the coming years.

Finance is available for viable projects, but will not come cheap. Crew costs are likely to go up rather than down in the short term. And, perhaps most significantly of all, insurance outgoings are predicted to rise over the next two years at a rate not seen for some time. There have certainly been a number of recent indications that the prolonged soft insurance market conditions in both the commercial and mutual sector may soon start to change. The reasons for this are not entirely clear, but may

involve the recent deterioration in technical performance by both the Protection and Indemnity Clubs and hull and machinery underwriters, which could in turn lead to a firming of the rates which owners are required to pay. Then again, we have seen before how difficult it can be to make premium increases stick, particularly in the commercial market.

Shipping faces some major challenges over the next two years as it seeks to position itself as an environmentally aware, technically savvy industry. It must expect fluctuations in the level of operating costs caused by a variety of factors ranging from movements in oil prices to shifts in levels of manpower, from fluctuations in the value of the dollar to the ramifications of geopolitical developments around the world. The movement in some costs is easier to map and predict than in others. The movement in others still, such as the cost of regulation, is becoming easier to predict as implementation deadlines draw ever closer. The movement in yet others, such as the cost of fighting cyber-crime, can only be guessed at for the moment.

One thing is clear. The cost of operating effectively and profitably in the modern shipping industry must be met chiefly by revenues generated from day-to-day operations. Shipping remains an optimistic industry but, if the evidence of the freight markets is to be believed, it may not be charging enough for the unique service that it provides.



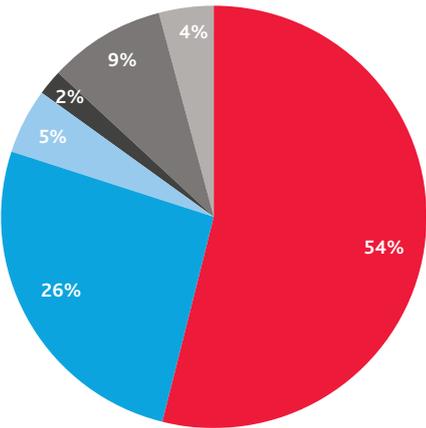
RESPONDENT DETAILS

We contacted key players in the shipping market internationally over a 28 day period in September 2019, asking them to complete a short web-based questionnaire so that they could share their views with us.

We are extremely grateful to those who responded. We asked respondents to provide information on their business type, headquarters' location and sector most relevant to their operations to help us analyse the responses.

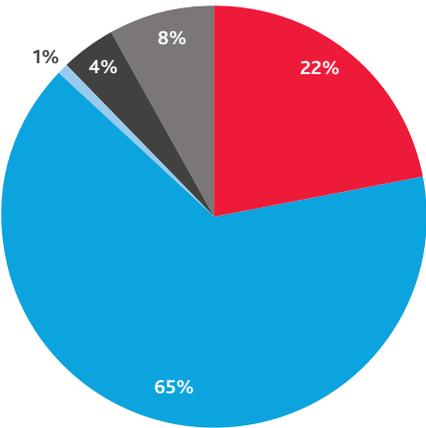


BUSINESS TYPE



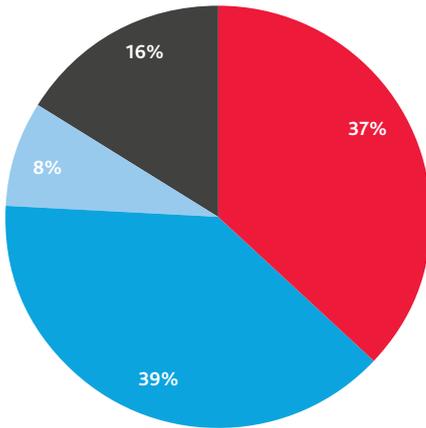
- Owner
- Manager
- Charterer/operator
- Broker
- Professional adviser
- Other

HEADQUARTERS' LOCATION



- Asia
- Europe
- Latin America
- North America
- Rest of the World

SECTOR



- Bulkers
- Tankers
- Container ships
- Offshore

Our commentary on the survey relates to statistics derived from the responses received. We believe the respondents represent a cross-section of the industry and, therefore, that our analysis is a good representation of the shipping industry as a whole, but it is not possible to guarantee that this is the case.

ABOUT BDO

BDO AND THE SHIPPING INDUSTRY

The BDO Shipping team delivers a wealth of knowledge and expertise to clients in the shipping industry. The merger of BDO UK and Moore Stephens LLP has extended our reach and brought new expertise and resources to add to our shipping experience. We continue our longstanding association with the shipping industry and place clients at the heart of what we do.

The extent of our experience is demonstrated by a net book value of vessels acted for in London that exceeds US\$10 billion. We work with BDO International member firms and offices in all of the main global shipping locations.

We keep ahead of all developments in the shipping industry and produce focused articles and publications that truly add value to your business.

We advise a range of clients including:

- ▶ Banks
- ▶ Charterers
- ▶ Container lines
- ▶ Cruise lines
- ▶ Logistics operators
- ▶ Maritime organisations
- ▶ Operators
- ▶ Owners
- ▶ P&I clubs
- ▶ Ports and port agents
- ▶ Private equity
- ▶ Ship brokers
- ▶ Ship managers
- ▶ Shipping funds
- ▶ Shipping pools.

WHY BDO SHIPPING?

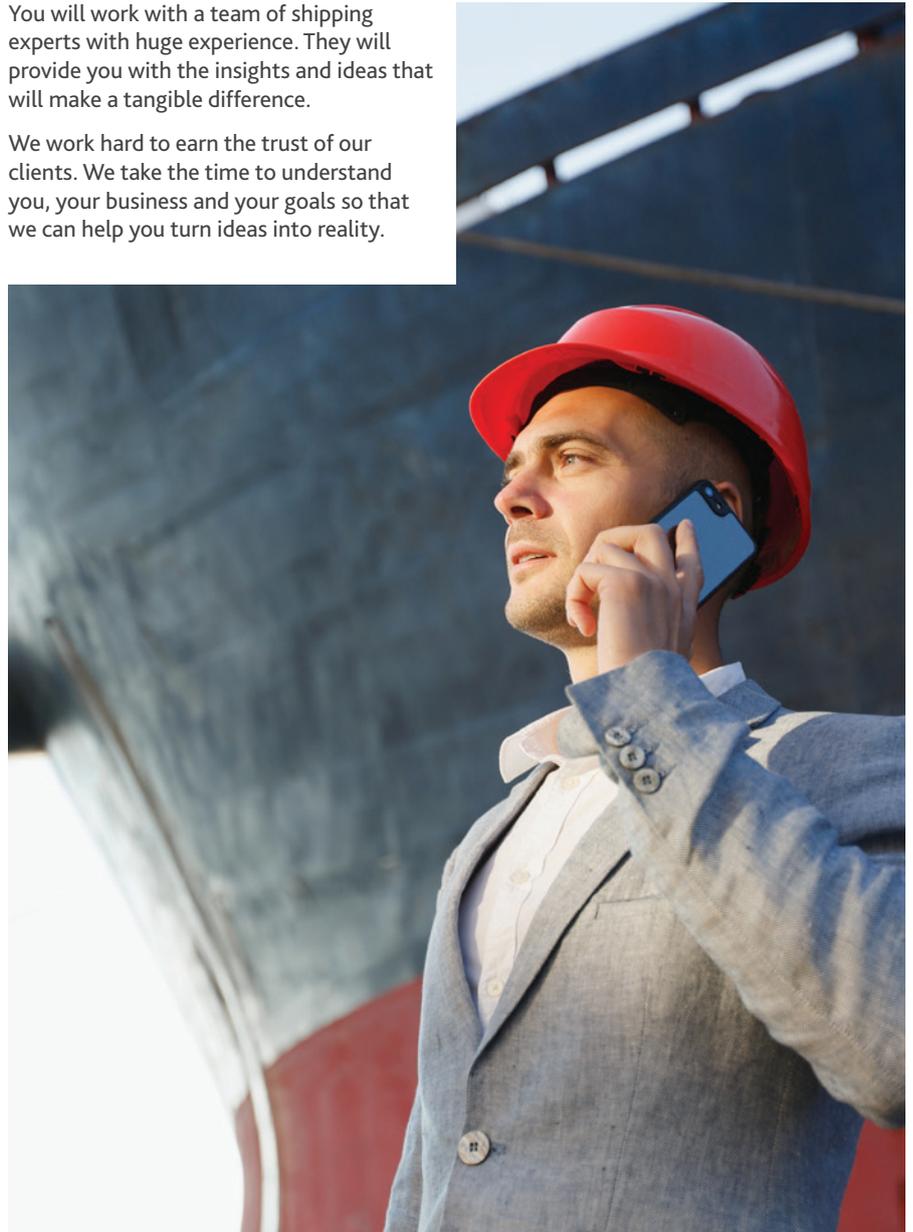
BDO is the fifth largest global accountancy and business advisory firm with a presence in every major global financial and shipping centre. Whether you already operate internationally or are looking to expand into new markets, we will be there with you.

You will work with a team of shipping experts with huge experience. They will provide you with the insights and ideas that will make a tangible difference.

We work hard to earn the trust of our clients. We take the time to understand you, your business and your goals so that we can help you turn ideas into reality.

OUR VALUES

Our people are empowered to be flexible and invest time in getting to know you and your business. This is what enables them to deliver the insights and ideas that will make a difference to your business.



APPENDIX 1

COST INCREASE DATA BY SECTOR

Cost increase data by sector (Bulkers, Tankers, Container Ships and Offshore) for both 2019 and 2020 is provided in the tables below.

EXPECTED COST INCREASES FOR YEAR ENDING 31 DECEMBER 2019

COST TYPE	BULKERS	TANKERS	CONTAINER SHIPS	OFFSHORE
	%	%	%	%
Crew wages	1.6	1.6	3.2	2.5
Other crew	1.6	1.4	3.0	2.7
Lubricants	1.4	1.2	3.4	2.1
Stores	1.2	0.8	2.8	2.0
Spares	1.2	1.3	3.3	2.4
Repairs & maintenance	1.9	1.5	2.8	1.9
H&M insurance	1.6	1.6	4.8	2.0
P&I insurance	2.2	1.1	4.1	2.7
Management fees	1.1	0.8	1.5	1.7
Dry docking	1.8	1.5	2.5	2.6
Total operating costs	2.3	2.5	3.7	2.6

EXPECTED COST INCREASES FOR YEAR ENDING 31 DECEMBER 2020

COST TYPE	BULKERS	TANKERS	CONTAINER SHIPS	OFFSHORE
	%	%	%	%
Crew wages	1.6	1.4	2.8	2.8
Other crew	1.5	1.1	3.0	2.8
Lubricants	1.4	1.3	3.2	2.2
Stores	1.2	0.9	2.5	2.8
Spares	1.7	1.2	2.8	3.0
Repairs & maintenance	2.1	1.2	2.7	3.0
H&M insurance	2.0	1.2	3.3	2.7
P&I insurance	2.1	1.3	3.3	2.8
Management fees	0.9	0.6	1.8	1.9
Dry docking	2.2	1.1	2.7	2.7
Total operating costs	2.7	2.1	3.0	3.8

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