AlixPartners

2024 CONTAINER SHIPPING OUTLOOK

Appetite for Disruption

When does constant turmoil become business as usual?

If the container shipping industry is the subject of discussion, the answer is, “You’re looking at it.”

In recent years, container lines (and the shippers that depend on them) have contended with a global pandemic; ongoing wars in the Middle East and Ukraine; labor actions and threatened labor actions; labor shortages; piracy; tightening fuel and environmental regulations; volatile and rising costs (including the cost of capital); drought in the Panama Canal; and ***catastrophic maritime mishaps***—to name just a few of the events and conditions driving rate volatility, wreaking havoc with sailing schedules, and testing the determination and financial stamina of carriers and shippers alike. The fact is, container lines have had to deal with one thing after another as a matter of course. And as we shall see, they have evolved strategies and tactics that have enabled them to weather the down times inevitable in a highly cyclical industry—and even to profit from the shocks, reversals, and contingencies endemic to the business. When an industry operates in environment in which “it’s always something,” that “something” becomes the foundation of profitability management.

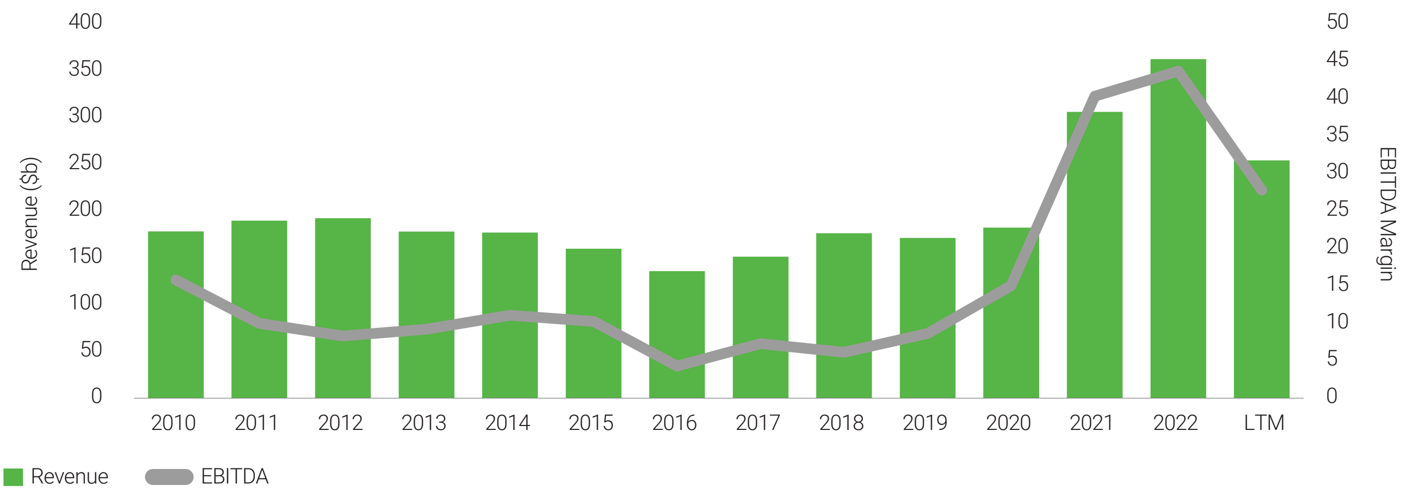
The container shipping industry’s 2023 financial performance reflects the resilience and adaptability that operators have cultivated to survive. The business press, understandably, focused in 2023 on carriers’ dramatic post-pandemic collapse in revenues, which dropped 30% to an aggregate $254 billion from $362 billion a year earlier. Receiving less attention was an equally significant story: carriers remained profitable in 2023 and earned relatively high marks on most measures of financial health. And even as revenues plunged and margins tightened, carriers continued to invest in new, more environmentally sustainable vessels and propulsion systems, upgrades to port facilities, and acquisitions in adjacent industry subsectors.

These carriers’ performance in highly unfavorable conditions demonstrates how they have evolved a range of strategies to weather the ups and downs of the business cycle and cope with unexpected and unpredictable adversities (we’ll look more closely at those strategies later in this report). And they have had plenty of adversity to cope with: The war in the Middle East, to cite one prominent example, has all but eliminated the Red Sea and the Suez Canal from the route map of the major container lines. Traffic has been rerouted around the Cape of Good Hope, in the process creating persistent equipment and space imbalances; degrading reliability; driving steep rate increases for cargoes originating in Asia; hampering the growth of the fastest-growing trade route between Asia and the U.S. East Coast; and stoking a disastrous rise in CO2 emissions. Rates will likely remain high until the reshuffling of assets is complete, and container shipping will skirt the Red Sea and Suez Canal until the Houthis run out of rockets, missiles, and drones—whenever that might be.

The financials: Healthy, but for how long?

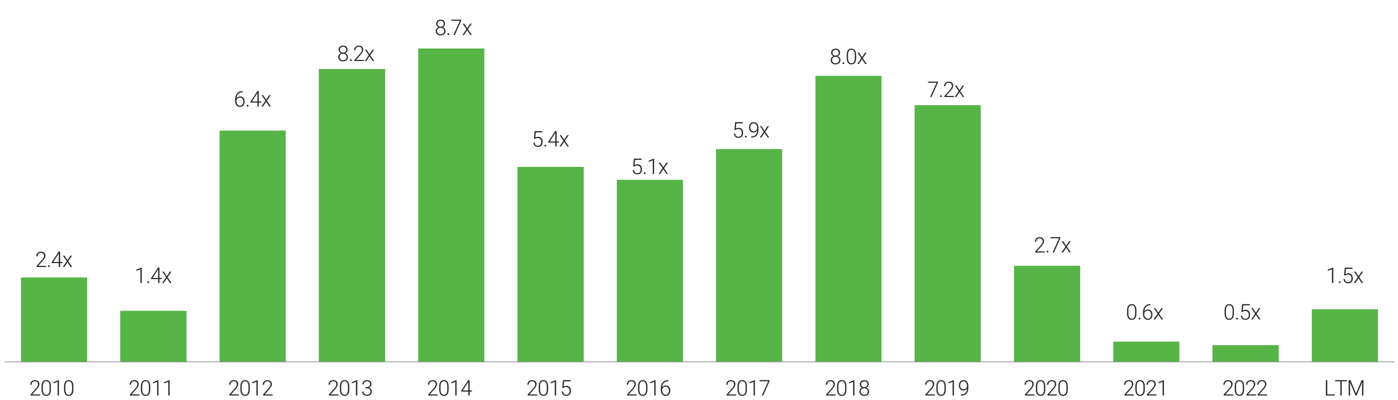
The 15 liner companies in our sample—consisting of every major carrier that publicly reports its financial results—are in reasonably sound condition despite the retreat in revenues. They posted aggregate 2023 EBITDA of $71 billion, down from $158 billion the prior year, a margin of 28%, against 44% in 2022. [Figure 1] Carriers have been busily deploying the financial windfall they reaped during the pandemic; the $22 billion in 2023 CapEx investments that they reported was the largest total since 2012. Yet there is plenty left in the vaults: At $83 billion, their cash balances are 3.7 times greater than their average balances during the past 10 years. The carriers' aggregate debt expanded modestly, to $87 billion from $76 billion the prior year, while interest coverage is a healthy 15%—far below the 44% coverage ratio of 2022, but still well above the skimpy ratios that prevailed from 2010 through 2019.

Figure 1: Revenue vs EBITDA



The industry's health is evident in a range of other financial vital signs as well: The aggregate debt-to-EBITDA ratio is 1.2, a far cry from the heavily leveraged days before COVID-19. [Figure 2] CapEx in 2023 came to 25% of cash flow, up from 2021-22 but considerably below the levels prevailing from 2010 through 2019. Cash from operations soared to 34% of revenue, a fourfold improvement from the prior 10-year period. And the industry's Altman Z-score, which gauges the likelihood of a company's insolvency within the next 12 months, stands at 2.63, comfortably above the score of 1 that signals imminent trouble.

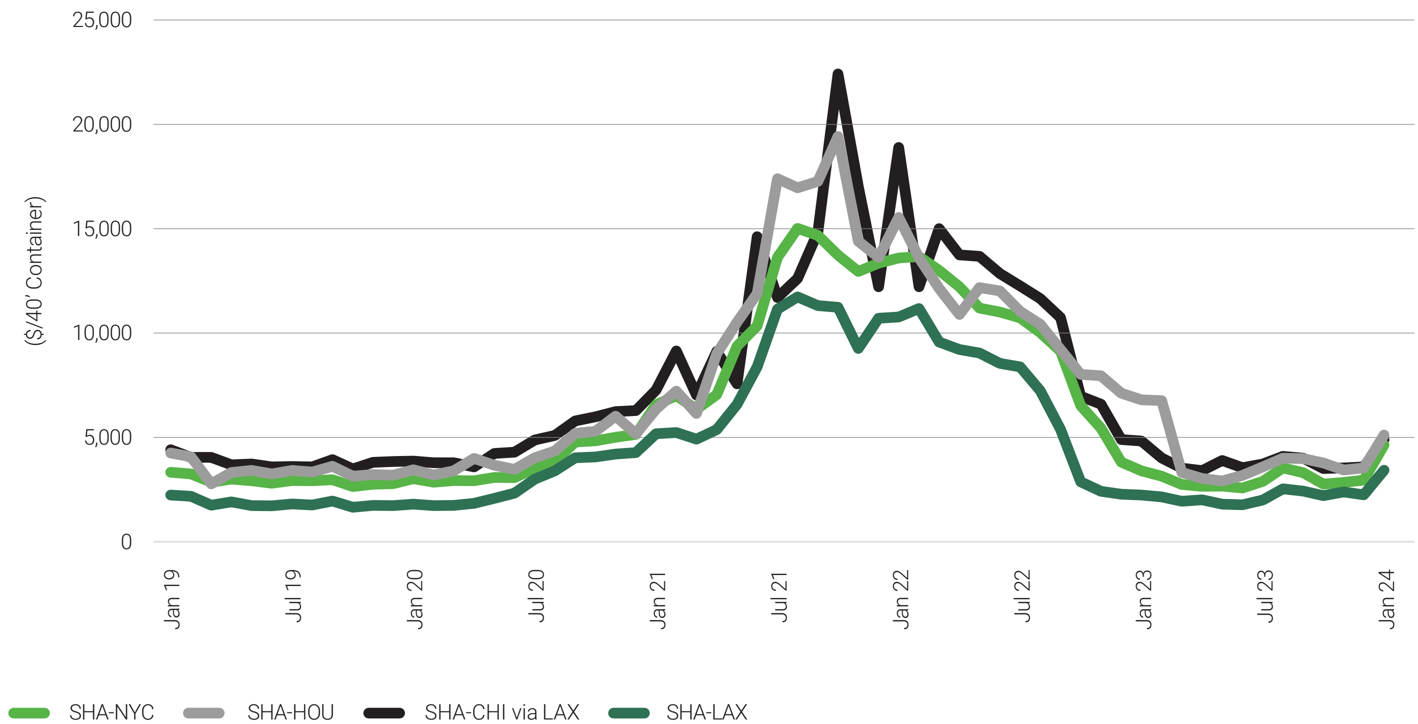
Figure 2: Leverage ratio



An end to overcapacity?

As container lines reroute sailings and reposition assets to adapt to the virtual closure of the Red Sea and the Suez Canal, the persistent oversupply of container ships that has weighed on freight rates since 2022 has all but evaporated—at least temporarily. At year end 2023, total capacity stood at 27.8 million TEU (twenty-foot equivalent units, a standard, approximate measure of cargo capacity), up around 8% from 2022's total of 25.8 million TEU. [Figure 3] An additional 2.0 million TEU is due to come online in 2024, and 1.5 million in 2025, although deferred deliveries and scrapping may pull that number downward. By contrast, container trade in 2023, as measured in TEU miles, was flat after falling 5% in 2022. Under normal conditions, the inexorable growth in capacity, combined with sluggish trade growth, would act as a check on runaway rate increases. But since when has anything about the container shipping business been normal? The attacks on shipping in the Middle East have redrawn the route maps, extended the lengths of sailings, and set rates on a steep upward curve.

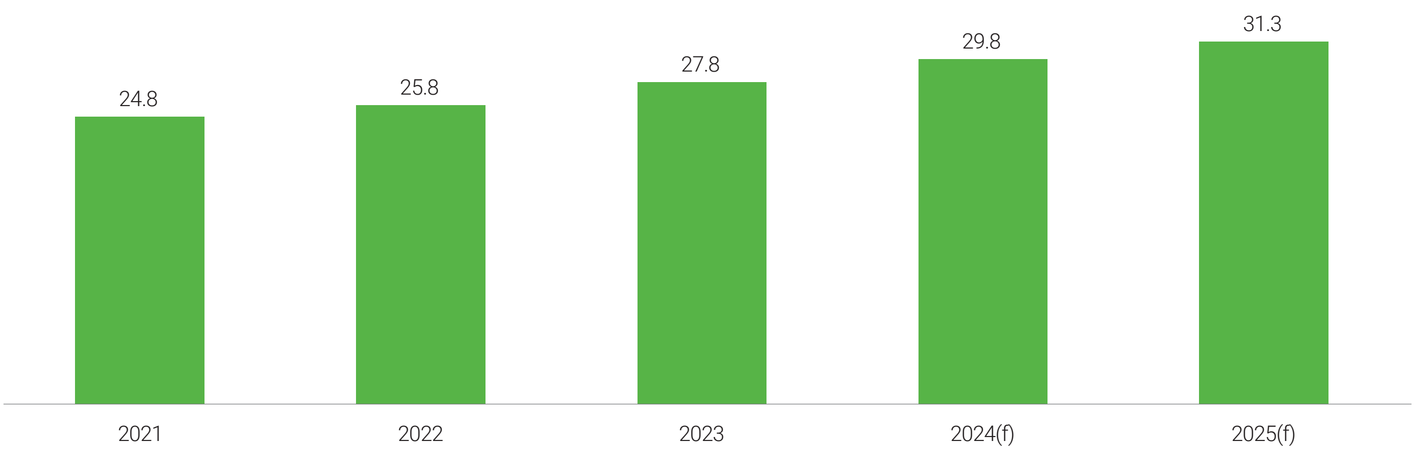
Figure 3: Transpacific eastbound ocean rate evolution



Rates climb out of their trough

Ocean shipping rates, which began to drop in mid-2022, ticked upward as 2023 drew to a close and have continued their ascent in 2024. [Figure 4] Driving the rise is the war in the Middle East. Attacks on shipping by Houthi rebels have eliminated the Red Sea and Suez Canal as viable trade routes, with profound effects on the entire ocean shipping ecosystem. In recent years, many carriers bound for the U.S. East Coast (USEC) began to route most of their sailings through the Suez to take advantage of the shorter distance between Southeast Asia and the USEC. With the outbreak of the war, however, carriers have rerouted those sailings through the Panama Canal, which is already experiencing drought-related congestion along that route, driving reliability downward and rates upward. Carriers dependent on the Suez for their USEC-bound cargoes will likely see volume declines, while carriers bound for the U.S. West Coast (USWC) will likely use intermodal services to move their cargoes to their final destinations.

Figure 4: Ocean capacity evolution (TEU M)



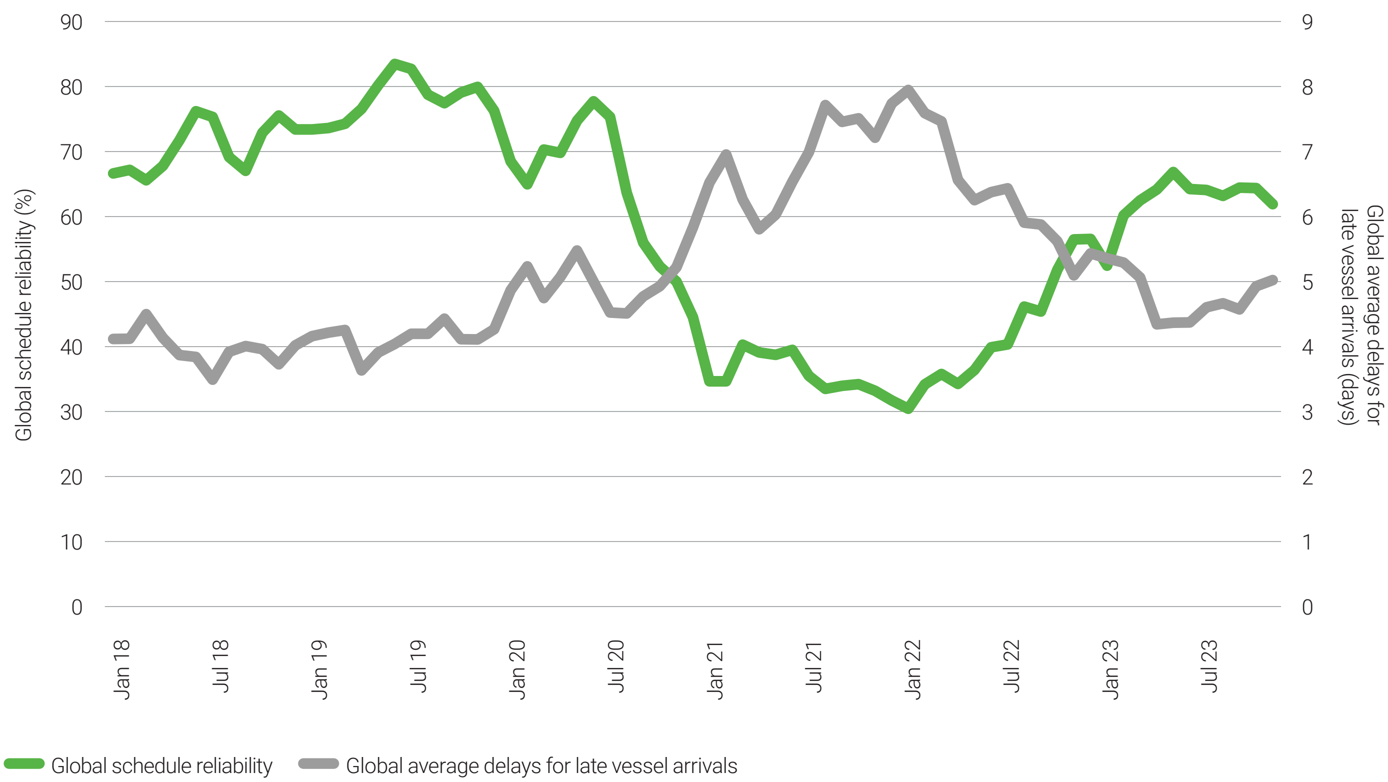
Meanwhile, the war in the Middle East has forced sailings between Asia and Europe as well to re-route around the Cape of Good Hope, adding 30% more distance to sailings that account for 30% of the world's capacity, and absorbing the bulk of the industry's excess TEU. A lengthy shutdown of the Red Sea-Suez Canal route thus gives carriers a bit of breathing room at a time when seasonal declines in volumes would usually stifle any rate increases.

The churn in the ocean carrier alliances that have become a feature of the industry will exert counterpressure on any rate increases. The breakup of the 2M alliance, Hapag-Lloyd's departure from THE alliance, and the subsequent formation of the Gemini Cooperation alliance with Maersk will most likely leave the industry with three alliances, plus MSC. The Ocean Alliance's somewhat surprising announcement of continued cooperation through 2032 will require a strategy shift for the remaining members of THE Alliance or a potential vessel sharing agreement between THE Alliance and MSC. If MSC remains independent, this reshuffling will result in four distinct cooperatives competing for volume on the key head-haul trades, which will act as a brake on rate rises.

Wrestling with reliability

The pandemic-powered spike in shipping volumes and rates was accompanied by a dramatic decline in schedule reliability. At the lowest point, a mere 30% of vessels arrived on time at their destination port. Since then, reliability has leveled off at an on-time arrival rate of about 65%, roughly 5-10% below the pre-pandemic norm. [Figure 5] Further improvements will be hard to come by, and in fact will likely deteriorate, as long as the Red Sea remains a no-go zone and container lines have to reshuffle assets and take the long way around. Reliability will also suffer as long as carriers continue to blank (that is, cancel) sailings in a bid to accrue additional cargoes and avoid costly underutilized sailings.

Figure 5: Global schedule reliability



Carriers are nonetheless taking steps to improve reliability. Maersk, for example, now offers to move goods across the isthmus of Panama via the Panama Canal Railway, offloading cargoes on one side and reloading them on the other. Carriers including Evergreen, OOCL, and Cosco have publicly committed to improving trade flows and initiated operational improvements. And the Gemini alliance of Maersk and Hapag-Lloyd is aiming for 90% reliability when it launches in 2025. That target, if Gemini can hit it consistently, could be a compelling value proposition to shippers, and a strategic differentiator for the alliance members.

Net zero: barriers to progress

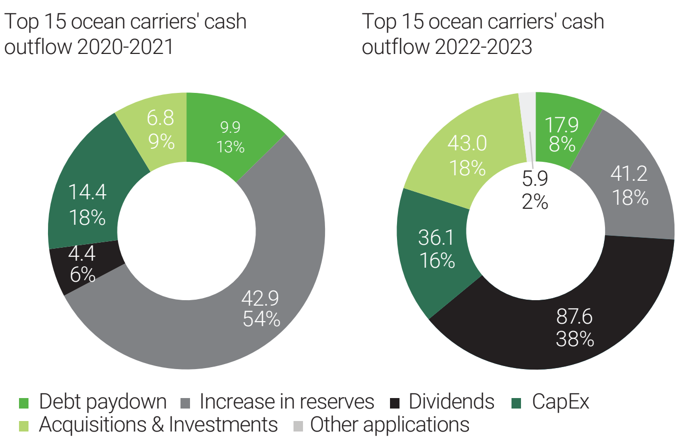
The container shipping industry's CO2 emissions, which rose to some 230 million tons in 2023 (out of a total of roughly 1 billion tons for all maritime shipping), are dangerously high and climbing. Far from declining on the way to a mandated 20% reduction in CO2-equivalent emissions by 2030, the industry's combined emissions will rise sharply in 2024 as liners forgo the Red Sea for the Panama Canal, which will add roughly 30% to the length of their voyages. The worst-case projection has industry emissions approaching 350 million tons by 2050, barring concerted intervention by governments, shippers, consumers, and industry groups. Even targeted investment and conversion to alternative-fuel propulsion systems will not be sufficient to achieve the mandated 20% reduction by 2030, but net zero by 2050 remains within reach—barely—if 5% to 17% of the industry's fleet is converted to zero-emission fuels (such as ammonia, methane, or hydrogen) by 2030 and 84% to 93% is converted by 2050.

Reaching that goal will require up to $1.4 trillion in investment, with the cost burden borne by both carriers and energy suppliers and, ultimately, by shippers and end-users. But none of the required investment and emissions reductions will occur without powerful incentives and sanctions to change the behavior of carriers and shippers alike. That won't happen easily or overnight. Cross-border regulatory changes are difficult to formulate and coordinate, especially given the diverging approaches to climate change mitigation among different governments and the disparate priorities they assign to the issue. And container shipping is not a top-of-mind priority even for climate activists, since most oceangoing activity takes place out of sight of consumers and consequently claims little of their attention.

Carrier strategies: a taxonomy and comparison

To determine and assess the different competitive strategies of the carriers in our sample, we compared the cash outflows of the top 15 carriers during two different time periods, 2020-21 and 2022-23. [Figure 6]

Figure 6: Top 15 Ocean carriers' cash outflow overview ($B)



We then identified three activities from which we can infer, in broad outline, the carriers' varying strategies: paybacks to shareholders (in the form of share buybacks and dividends) and debt reduction; M&A investments; and vessel orders and investments in the core business. Using those indices of strategic intent, carriers can be grouped into three broad categories. The first includes carriers that prioritized paybacks to shareholders and debt reduction and made few acquisitions and capital investments. The second category includes carriers that have invested heavily in newbuilds and in their core business (and in at least two cases, took on debt to do so) rather than rewarding shareholders and reducing debt. Finally, there is a group of carriers that conserved their cash and refrained from fleet expansion and other capital projects.

Analysis of the financial performance of the liners in each category shows that, at least in the short term, the carriers in the first category (those that prioritized shareholder rewards and debt paydowns) posted the best returns. These players in 2023 posted wider margins, more favorable debt-to-earnings ratios, lower leverage, higher cash positions, and better Altman Z-scores than their rivals in the other two categories. But a winning strategy in an oversupplied market may work against the operators in the first category when the cycle turns, and freight rates rebound. At that point, players that expanded capacity or waited on the sidelines may be positioned to claim an outsized share of a growing revenue and profit pool.

Whatever picture may emerge in the long term, our analysis suggests that container lines, rather than merely reacting to fluctuations in the macroeconomic cycle, are learning to turn those ups and downs to their advantage. But the upturn in an extended period of rate volatility will test the strength of their commitment to their course they have chosen—not to mention the stability of their finances.

1 CARRIERS

2 SHIPPERS

3 3PLS AND FORWARDERS

4 INVESTORS

5 REGULATORS AND POLICYMAKERS

Implications for stakeholders

1 **CARRIERS:** Additional TEU capacity will come online in 2024, and carriers will learn to cope with disruption in the Middle East, which will eventually bring a halt to the current round of rate increases. The negative impact on carrier finances could be considerable. It remains to be seen whether carriers will stick with their chosen strategies or make mid-course corrections, but it is safe to say that the time for distributing large rewards to shareholders has passed. All that seems certain is that five years from now, the companies in our sample will look even more differentiated from each other than they do today.

2 **SHIPPERS:** Today's rate increases may be short-lived, but that's no reason for complacency on the part of shippers, most of whom are still highly exposed to ocean shipping because of the international character of their supply chains. Shippers seeking to de-risk their operations and mitigate the impact of higher rates will need to reduce their dependence on ocean transport—and that calls for a Plan B.

3 **3PLS AND FREIGHT FORWARDERS:** Integrate, integrate, integrate. Rather than occupy the middle of the market, as third-party logistics providers and freight forwarders historically have done, they are cultivating close ties with carriers. In some cases, those relationships will develop into acquisitions; in others, partnerships and strategic agreements will be the keys to building resiliency and maintaining profitability. Short-term rate volatility will continue to benefit subsectors that thrive on uncertainty, such as brokers.

4 **INVESTORS:** Although the market has cooled since the blistering days of 2021-22, there is room both for equity investors seeking short-term rewards, and for those pursuing long-term value plays. Fixed-income investors will find distressed-debt opportunities. And now that earnings multiples have returned to earth and cash remains plentiful, financial investors and strategic acquirers alike are on the hunt, contributing to what's likely to be a lively deal flow in 2024 and 2025. The most salient risks are the uncertain macroeconomic outlook, and global geopolitical tensions.

5 **REGULATORS AND POLICYMAKERS:** The government sector is crucial to the development and implementation of incentives and sanctions to accelerate fleet decarbonization, police predatory surcharges and improve schedule reliability. The industry's high visibility during the pandemic has drawn regulators' attention, and as regulators grow more familiar with carrier operations, they are enlarging their roles in the container shipping ecosystem. Europe is ahead of other regions in developing a new regulatory regime for container shipping—and may even be moving too fast for some businesses to follow.

What's ahead:
More turbulence, as usual

Despite an observed trend towards normalization across the industry, the ocean shipping market shows no sign of returning to the relatively placid conditions that preceded the 2020 pandemic. But most carriers, having shored up their financial positions and cultivated strategic flexibility, are prepared for choppy seas. Shippers, meanwhile, are prioritizing adaptability, agility, and optionality in their supply chains, and some are already reaping the benefits.

Middle-market players continue to capitalize on volatility and uncertainty, creating value for customers through hedged offerings. Port operators and larger infrastructure players have invested in efficiency and scale, which should produce more stable results going forward. Policymakers and regulators are intervening in the market more aggressively, a trend that will likely intensify.

As to the macroeconomic and geopolitical environment, the only constant is continued turbulence. That is not altogether a bad thing. Most players in the global logistics space are learning to turn volatility and sudden reversals to their advantage. In a world where "it's always something", that ability to spot and seize sudden opportunities may be the most valuable survival skill of all.

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ABOUT US

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These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

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Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.