THE DAILY CHECK-IN WITH GOLDMAN SACHS

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Liz Bowyer: Hi, Ed.

Eduard van Wyk: Hey, Liz. How are you?

Liz Bowyer: Good, thanks. You cover some of our biggest shipping clients in Goldman Sachs's investment banking division. The recent incident in the Suez Canal really focused the world's attention on shipping lanes and some of the pitfalls of modern shipping. Explain what's happening in the industry.

Eduard van Wyk: In recent years, the industry has undergone a number of very significant changes. The first important one is consolidation. You know, historically this industry has been incredibly fragmented, and that's led to lots of capacity in discipline. You know, people just order too many vessels for the amount of trade there is to move around. After lots and lots of consolidation, we now have a much more organized industry.

In addition to that, the size of container vessels have also been increasing very dramatically. Now, the size of a container vessel is basically measured in terms of how many 20-foot equivalent containers they can carry. That's basically a steel box that measures about 33 cubic meters. And to put that in simple language, it basically means you can fit the contents of a 3-bedroom house in one of these containers. So shipping lines have been using ever, ever larger vessels because it lowers the unit cost of moving the goods around, and these vessels were ordered at a time when fuel prices were increasing and trade was also increasing, particularly in terms of the Asia-Europe route.

So today we have a situation where the largest container vessels can carry approximately 24,000 of these 20-foot equivalent boxes. Whereas in 2007, they could only carry about 8,000. So that's a three and a half times increase in terms of size just over a 15-year period.

Liz Bowyer: And so talk about some of the challenges that these factors present.

Eduard van Wyk: Imagine something that is basically the size of the Empire State Building, and then imagine steering that on water. You know, it's not like driving a car where the road is fixed. When you're steering a vessel, both the vessel and the service zone in which you are steering it is moving. That makes it very hard to maneuver these very large vessels, particularly in narrow waterways like the Suez Canal.

The Suez Canal is one of a number of global what they call chokepoints in the supply chain. These are areas where the supply chain can become clogged. And the Suez Canal is subject to particularly weather risk, particularly high winds. And that's exactly what led to this particular incident, which happened to the ship called the *Ever Given*.

Liz Bowyer: So this obviously has significant implications for the delivery and receipt of goods around the world. To fully appreciate that, explain what global trade flows look like.

Eduard van Wyk: So seaborne trade accounts for approximately 80-90% of global trade. This is largely a consequence of globalization, and also the general assumption is that it will continue in that sort of range. Container shipping accounts for about 60% of seaborne cargoes, and it has been growing at a rate of approximately 5% over the last 20 years on a compound basis. That's roughly one and a half times GDP over that period.

Now, the vast majority of these volumes go between Asia and Europe and also between Asia and the US. There of course are other very important trade lanes, but these two together account for the vast majority of trade via volume. And it's really important to remember that there's a trade imbalance. In other words, we import more from China than what we send to China. That trade imbalance is roughly two to one. And so again, very important to bear that in mind if you think about the flow of these goods.

Now, if you look at the Suez Canal in particular, trade that goes through the Suez Canal is really affecting the Asia-Europe trade. On average, 19,000 vessels pass through the Suez Canal every year, and that's all related to European trade. There's of course knock-on impacts on sort of US East Coast trading. But if you bear in mind the two thirds of anything that goes by vessel into the US comes through the West Coast, you can see that the Suez Canal blockage really means much more for Asia-

Europe than it means for Asia-US.

Liz Bowyer: And then of course the challenges that you're describing have been compounded by the pandemic. Explain how that's affected the global flow of goods.

Eduard van Wyk: So when the pandemic hit, generally shippers started to preserve cash. They started to protect working capital, which just means that people ordered less goods in terms of inventory and started running their inventories down. You know, at the same time, if you remember, that all of the flights were grounded. And so if you bear in mind that lots of freight go by aircraft then the vast majority of that actually goes in the bellies of these passenger aircraft. So that's also capacity that was taken out of the market.

However, the consumer continued shopping, right? I mean, as one of the CEOs of the container shipping companies says, you know, everybody ordered new sneakers and everybody ordered new flatscreen TVs. And that just means that the volumes never declined. So whilst we took lots of freight capacity out of the market, the volumes never declined. And that put a huge amount of strain on the supply chain.

So if you combine that with the restocking of inventories as well as sort of social distancing and increasing infection rates particularly for port workers, you can see how that can very quickly snowball into some very significant blockages in the supply chain.

Liz Bowyer: So what's one example?

Eduard van Wyk: So the port of Los Angeles is one thing I would point out. Ordinarily the waiting time for a container vessel in Los Angeles is about two days. That means it takes two days to get in and out in terms of loading and unloading. Today, that has kind of expanded to six days. And the reason for it really relates to rising infection rates among dockworkers as well as needing to observe social distancing rules.

In addition to that, there's also a real shortage of drivers for trucks to take their containers away. And there's also a rail capacity problem in terms of railways taking containers away. And look, ultimately this is a very practical industry. Things arrive there to be unpacked there, to be moved away. And if you can't do it, they start stacking up and it causes a huge amount of congestion. And so remember, the shipping lines operate network business. So if you have a problem in one part of the network, it tends to have a ripple effect that goes all the way through your operations globally.

So stepping back, the pandemic had a really fundamental impact on the West Coast ports of the US. And so impacts, remember all that trade arriving from China into the West Coast ports. Whereas the Suez Canal blockage has had a much more fundamental impact on top of the pandemic on the Asia-Europe trade.

Liz Bowyer: So Ed, in your work in investment banking at Goldman Sachs, how are you advising our clients on how to navigate these issues?

Eduard van Wyk: Look, most of our industrial clients rely on global supply chains operating very efficiently because from manufacturing perspective in particular they operate what's called just-in-time supply chains. And it's just what it says. Things arrive just in time. It means they arrive days before they are needed for manufacturing purposes.

Now, estimates vary but we think at the moment the delays in the supply chain are approximately two to three weeks. Our advice is really very practical, and I would sort of point three things out. Number one, plan further ahead. Some clients are telling us that they are planning 10-20 days further ahead than normal. Secondly, diversify your supplier base. Don't put all your eggs in one basket. And thirdly, you should choose fulfillment partners very carefully. Favor scale and experience where you can.

Liz Bowyer: But just given the complexity of the challenges that you've described, how do you think things might evolve in the months and years ahead?

Eduard van Wyk: I would distinguish between the impact in the Suez Canal and also just some of these more global pressures that I talked about either. To reposition vessels and basically get things flowing again following the Suez Canal blockage was estimated to take approximately 7-14 days. And that seems to have all been cleared up by now.

I think when you think about the broader supply chain blockages I talked about earlier, I think that's going to take a bit longer. Estimates vary, but I think it's probably going to carry on all the way through the second quarter of this year and possibly even well into the third quarter.

Look, let's see. In the meantime, I think we can see our container shipping clients doing extremely well. Their businesses are performing very well. They're generating positive cash flows off the many years of, frankly, very hard work.

Liz Bowyer: Thanks, Ed.

Eduard van Wyk: Thank you so much for having me.