# Shipping & Shipyards

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DBSV downgrades Shipping & Shipyards

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Show me the money!
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· Sources of ship finance shrinking as European banks grapple with debt crisis; shipyards likely to face risks of customer defaults/deferments; new order flows drying up
· Outlook for shipping earnings remains muted as supply overhang is yet to clear
· FULLY VALUED on Cosco Corp and NOL; BUY Yangzijiang for better execution and lower customer default risk

No silver lining yet for the shipping sector. Supply-demand mismatch for all major shipping sectors over the next couple of years will continue to cap vessel earnings and asset values. While container shipping is likely to be the first to recover, new ordering activity is still likely to be subdued given the existing supply overhang. However, we are not calling for a bottom yet, and maintain our FULLY VALUED call on NOL, especially given its stretched balance sheet.

Shipping lenders likely to tighten purse strings. The European banks, traditional lenders to the shipping industry, are grappling with the fallout from the sovereign debt crisis in Europe as well as stricter capital regulations, and appetite for shipping finance is likely to shrink in future. Asian banks are only minor players, and with capital market activity likely to be muted in the near term, asset sales and private equity are the only other options for owners to raise money for capital commitments. We have already seen some high profile bankruptcies like General Maritime in the tanker sector, and with other owners talking of restructuring their balance sheets, the prospects of cancellations and deferments loom for shipyards, as there may be considerable funding gaps for the US$364bn worth of ships currently on order. Going forward, we are also concerned about the ability of owners to find financing for newbuilds, likely limiting new order flows.

Shipyards feel the heat, selective BUY on Yangzijiang. While output in 2011-12 looks stable, book-to-bill ratios at the yards are hovering around 2x and growth beyond 2012 could be affected. In view of the sector headwinds ahead – drying order flow, potential for margin contraction, and heightened default and deferment risk – we advise investors to underweight the shipbuilding sector. Selectively, we have a BUY on Yangzijiang on the back of its undemanding valuations, as well as healthy balance sheet and strong management, which should help it navigate tough times and emerge stronger. We have a HOLD on JES and a FULLY VALUED rating on Cosco, given its disappointing execution track record and a weaker customer profile (higher vulnerability to customer defaults).

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