Fitch 2018 Outlook: Global Shipping

Nascent Rebound But No Firm, Widespread Recovery Yet

Sector Outlook and Rating Trajectory

Fitch's Sector Outlook: Negative (Unchanged)

Fitch's global shipping sector outlook remains negative as we do not expect a material improvement in market fundamentals in 2018, given lingering overcapacity. Both container and bulk segments show signs of a revival, but the longevity of this trend remains uncertain due to limited adherence to capacity discipline in the sector. Improving market sentiment and a focus on scale and vessel size have stimulated new orders. The supply and demand dynamics are likely to support container, bulk and LNG rates, but tanker rates could remain under pressure.

Rating Trajectory: Down

Most of the companies in our shipping portfolio are on Negative Outlook/Watch. However, the Negative Outlooks/Watches do not reflect the sector fundamentals but rather company-specific issues, including the underperformance of non-shipping business segments, M&A or Qatar's diplomatic dispute. Conversely, Sovcomflot is on Positive Outlook, which reflects the fact that the delivery of new LNG and offshore vessels will be completed in 2017 and the company will fully benefit from longer-term contracted revenue from 2018.

Rating Distribution Weighting: Sub-Investment Grade

Most of the ratings in our shipping portfolio are sub-investment grade, which reflects a higher-than-average risk profile. This is due to the volatility of shipping markets (both freight rates and asset values), a high level of industry fragmentation, high operating leverage, highly capital-intensive operations and poor earnings visibility for many sub-sectors.

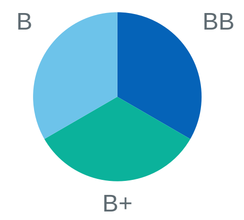
What to Watch

- Consolidation in container shipping
- China's GDP growth and commodity imports: a material slowdown in imports will affect most of the shipping segments
- OPEC production cuts and rising US oil exports for tanker shipping
- Fuel price: a significant rise will have an adverse effect on shipping companies' financials
- Order books for vessels and scrapping levels

Angelina Valavina, Senior Director

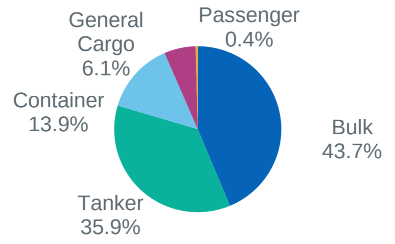
"The overcapacity in shipping undermines the current rebound in dry bulk and container shipping rates and puts in doubt its longevity. Only prudent capacity management could reverse sector fundamentals and lead to a sustainable recovery in freight rates. The credit metrics of container and bulk shipping companies show some relief, but tanker companies are under pressure."

Global Shipping - Rating Distribution



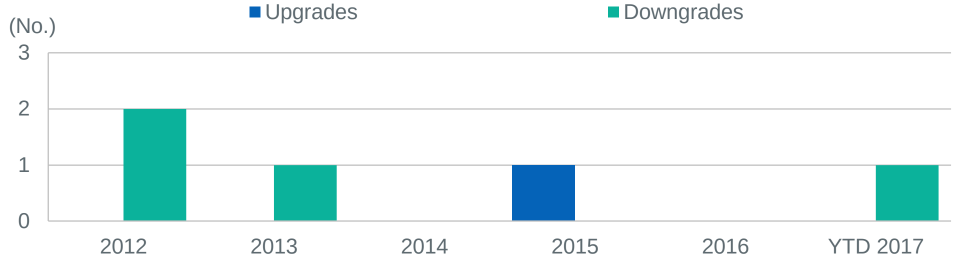
Source: Fitch

Global Fleet by Ship Type (Based on Million DWT), at end-2016



Source: Institute of Shipping Economics and Logistics (ISL)

Global Shipping - Rating Actions



Note: Excluding Watches or Outlook changes
Source: Fitch

Sector Forecast

Leverage Trend: Steady

We expect leverage metrics in 2018 to remain broadly in line with 2017 levels as the shipping companies in our coverage continue investing despite the challenging market environment. The companies are well placed at their rating levels based on their credit metrics, except for Soechi. Its FFO-adjusted net leverage could remain higher than 4.0x, the level above which we would consider negative rating action, until 2018, given a lack of cash flow visibility for its shipyard business. This is captured in its Negative Outlook.

Cash Flow Generation: Diverse

We forecast a marginal increase in cumulative cash flow from operations (CFO), but the dynamics of individual cash flows are diverse. We expect the profitability and CFO of tanker shipping companies to be under pressure. However, both Sovcomflot and Soechi have a high share of long-term contracts which should provide visibility on their cash-flow generation. Container and dry-bulk shipping companies' margins and CFO should continue to perform fairly well.

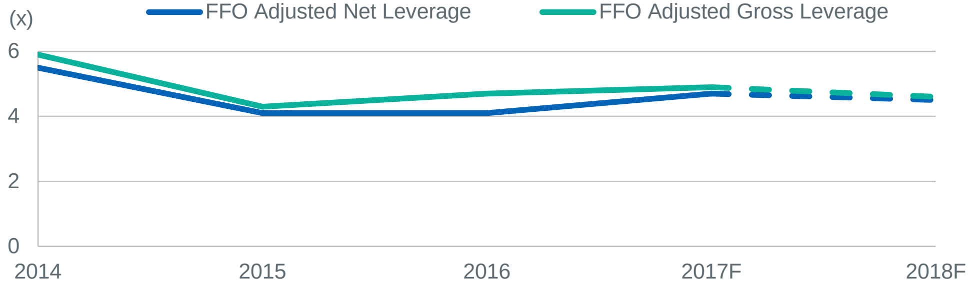
Liquidity Position: Manageable

The liquidity profile of larger, financially stronger shipping companies (Sovcomflot, Maersk Line, CMA-CGM, Hapag-Lloyd) tend to be manageable as they have large cash balances and/or good access to secured or even unsecured funding. The banks remain cautious in terms of their exposure to shipping but secured financing remains available supporting ambitious vessel purchases. Smaller, financially weaker companies (Yang Ming, Soechi) face tighter liquidity.

Potential Disruption to Sector: Surge in Global Trade Protectionism

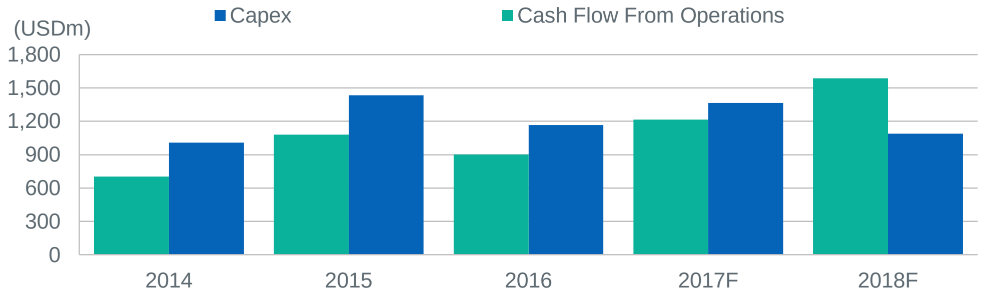
Free global trade is vital for shipping development. Around 80% of world trade in goods is carried by the international shipping industry. Shipping is a global sector and is fairly liberalised compared to other industries. While some protectionist measures may support operations of certain shipping companies, for example cabotage laws, a greater level of protectionist measures in world trade or shipping practices can adversely affect shipping activities.

Global Shipping - Median Leverage Metrics Dynamics



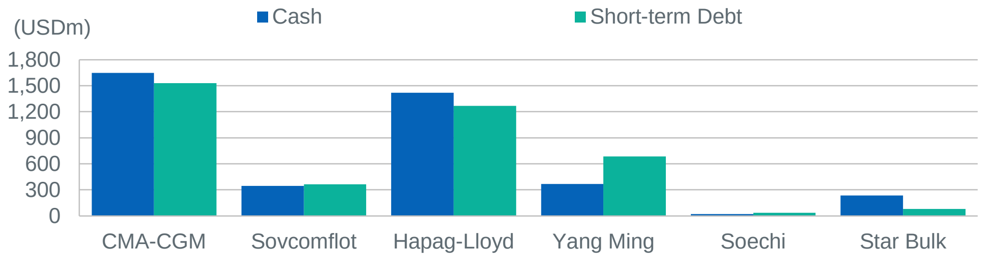
Source: Fitch

Global Shipping - Operating Cash Flow and Capex (Cumulative Basis)



Source: Fitch

Liquidity Position of Selected Shipping Companies, 9M17[a]



[a]Data for Soechi for 1H17 and for Yang Ming for 2016

Source: Companies data, Fitch

Sector Fundamentals

Container Shipping Recovery Can Still Be Elusive

Container shipping freight rates have increased in 2017, but their sustainable recovery depends on continuous and consistent capacity discipline in the industry. Freight rates are volatile and many previous rate hikes turned out to be short-lived when the supply and demand imbalance returned into focus. In the medium term, continuous consolidation in the sector should lead to more prudent capacity management and support freight rates.

According to the IMF, global trade growth accelerated to 4.2% in 2017 (2.4% in 2016) and is expected to reach 4% in 2018. This should support container transport volumes growth at over 4.5% in 2017 and 2018. However, supply growth has increased since 2016 and is expected at about 4% in 2017 with further acceleration to over 5.5% in 2018 again exceeding demand growth. New orders were low in 2016-2Q17 but surged in 3Q17 including mega ships.

Back to Oversupply in Tanker Shipping Again

We anticipate low oil tanker rates over 2017-2018 due to a large number of vessel deliveries, which will contribute to overcapacity. A marginal increase in demand for tankers along with moderation in capacity growth in 2018 may provide some support for tanker rates preventing their further fall, but we do not anticipate their sustained increase. However, we expect spot LNG rates to recover further in 2018 due to a slowdown in new deliveries.

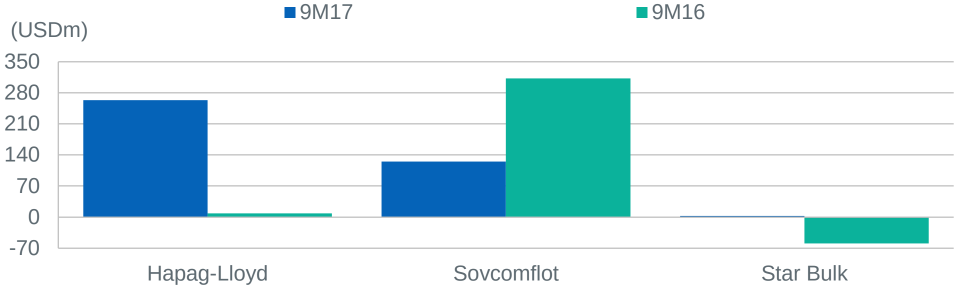
We expect capacity to increase by 5%-6% in 2017 and a further 4% in 2018. Demand growth will probably trough in 2017 due to high global oil inventories and OPEC production cuts. We expect rising global oil consumption, higher US exports and gradually moderating oil inventories to drive a small increase in tanker demand of about 4% in 2018, potentially matching supply growth.

Uncertain Longevity of Revival in Dry Bulk

A moderate expected increase in dry bulk volumes of 2.7% in 2018 coupled with a low vessel supply growth at 1.2% should provide support for dry bulk freight rates. The Baltic Dry Index has risen by 75% in 2017 year to date, underpinned by a recovery in demand growth from zero growth in 2015 and modest supply growth since 2014. New orders for dry-bulk vessels remained low in 2015-2017. China will remain the key driver for dry-bulk commodity imports and trade.

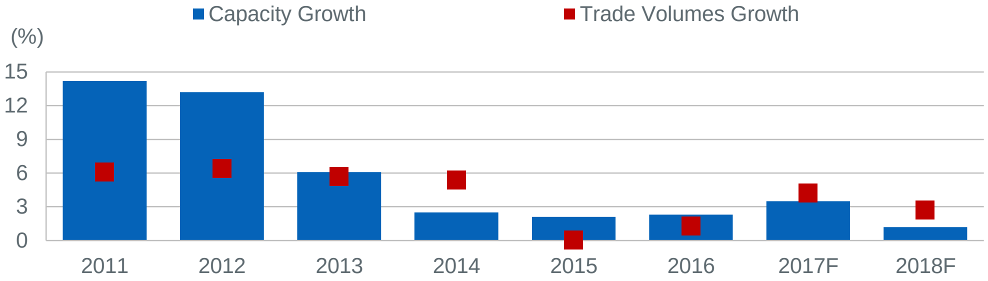
The continuous adherence to capacity management will determine the sustainability of freight rates increase.

EBIT Dynamics of Companies from Various Shipping Segments



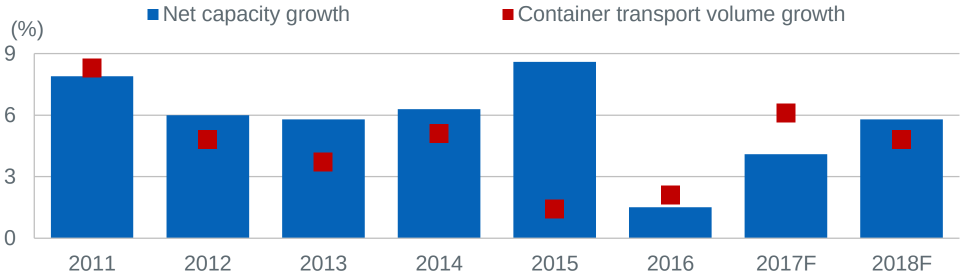
Source: Companies data, Fitch

Dry Bulk Shipping - Supply and Demand Dynamics



Source: Pan Ocean, Fitch

Container Shipping - Supply and Demand Dynamics



Source: Hapag-Lloyd, COSCO, Fitch

Key Rating Triggers for Select Issuers on Watch, Positive or Negative Outlook or CCC or Below

Issuer	IDR	Outlook/Watch	FFO Adjusted Net Leverage 2016 (x)	FFO Adjusted Net Leverage 2018F (x)	Key Downgrade Trigger	Key Upgrade Trigger
Nakilat Inc.	Senior bonds: 'A'; Junior bonds: 'A-'	Rating Watch Positive (RWP)	n.a.	n.a.	n.a.	The RWP reflects the publication of the Exposure Draft: 'Government Related Entities Criteria'. Fitch expects to resolve the RWP within the next six months upon finalisation of the exposure draft period.
PAO Sovcomflot	BB	Positive	4.1	4.5	FFO adjusted net leverage above 5.5x and FFO fixed charge coverage below 2.5x on a sustained basis; evidence of weaker state support.	FFO adjusted net leverage well below 4.5x and FFO fixed charge cover above 3.5x on a sustained basis; evidence of stronger state support.
PT Soechi Lines Tbk	B+	Negative	3.6	3.9	Inability to reduce FFO-adjusted net leverage to 4x or lower by 2018; FFO fixed-charge cover below 3x on a sustained basis.	Future developments that may lead to a revision in the Outlook to Stable include the Issuer not meeting any of the negative rating sensitivities.

Source: Fitch

Outlooks

fitchratings.com/outlooks

Related Research

What Investors Want to Know: Global Tanker Shipping (November 2017)
Fitch: Tanker Shipping Oversupply to Keep Rates Low in 2018 (November 2017)
What Investors Want to Know: EMEA Transportation: Airlines, Shipping, Land (July 2017)
Fitch: Container Shipping Freight Rates Rise, Capacity Still Key (June 2017)
What Investors Want to Know: Container Shipping (June 2017)
What Investors Want to Know: Container Shipping Chartbook (June 2017)

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