GOLDEN DESTINY

This Week's News: A snapshot on the economic and shipping environment

Week ending 9th December 2011

ECONOMIC ENVIRONMENT

The threat of eurozone contagion seems more serious as we move towards the end of 2011 following the Standard & Poor's warnings for downgrading six triple A members of the eurozone. The economic and political uncertainties of the zone pushed the US rating agency to announce that is placing Germany, France, Netherlands, Austria, Finland and Luxemburg on "credit-watch negative", meaning that there is a one-in-two chance of downgrading their top notch ratings, from triple A to AA+, within 90 days. The summit of European Union leaders at the end of the week will have a remedial impact on the debt crisis as the S&P move signals the need of France and Germany to follow decisive actions for the eurozone's rescue. Potential downgrades of Germany and France would affect the European Financial Stability Facility, the bailout fund for struggling euro member countries that has funded rescue packages for Greece, Ireland and Portugal, pouring the single currency bloc in a speedy recession for 2012.

The Organization for Economic Co-operation and Development highlights the eurozone debt crisis as the biggest threat to the global economy slashing its growth forecasts to 3.4% in 2012 from 3.8% this year, when in May was predicting that the world economy will grow 4.2% this year and 4.6% in 2012. European leaders need to provide "credible and large enough firepower" to halt the sell-off in the eurozone sovereign debt market or they will risk a severe recession, according to the chief economist of the Organization for Economic Co-operation and Development. In its economic outlook, the OECD cut its 2012 forecast for economic growth to 1.6% for its 34 member states from 2.3% six months ago and for Europe to 0.2% from 2.0%. The OECD calls European Central Bank to play a bigger role in debt crisis to save the euro.

Under the euro chaos, France and Germany have reached a comprehensive agreement on new fiscal rules for the troubled eurozone to set up a fiscal union and impose budgetary discipline imposed by the European Central Bank, including a commitment not to force private sector bondholders to take losses on any future eurozone bail-outs. On the other hand, Italy plays an important role on the future of euro, implying a Greek-style economic collapse. Italy's new government has adopted a package of emergency austerity measures aiming to raise more that 10 billion euros ($134 billion) from a property tax, a new levy on luxury items, and increase in pension ages. Italy's Prime Minister Monti said that Italy is ready to do what it has to do, but Europe must not fail to do its part.

In Greece, the green light for the release of the 6th installment of the EUR 110billion loan from the EC-IMF-ECB has been given, while the International Monetary Fund agreed also to provide a EURO 2,2 billion ($2,95 billion) aid disbursement as a part of the three year IMF-EU bailout package to avoid potential bankruptcy. According to OECD, Greek GDP is expected to shrink by 6.1% in 2011 and a further 3% in 2012 before the economy starting to grow by 0.5% in 2013.

In the meantime, Japanese investment bank Nomura has reduced its exposure in the eurozone periphery by 75% during the past two months signaling the growing risks of holding eurozone government debt amid the euro debt crisis. The bank has cut its exposure to Greece, Ireland, Italy, Portugal and Spain from $3,55 billion at the end of September to $884 mil. Furthermore, Britain's banks have also proceeded to similar cuts. According to data compiled by the Financial Times, the big four UK banks cut interbank loan volumes by more than 24% to £10,5 billion in the three months to the end of September, the sharpest reductions were in the volumes of loans to Greek and Spanish banks, to limit periphery eurozone lending.

In U.S., the unemployment rate fell unexpectedly to 8.6% in November, the lowest in two and a half years, while the employment growth accelerated with U.S. employers adding 120,000 jobs, compared with economists expectations of 125,000 new positions. The positive sentiment for a U.S. accelerating pace of growth comes in contrast with Fitch warning to downgrade the US credit rating if no credible agreement would be reached over the next two years to tackle the mounting debt crisis. The decision of Fitch aligns with other rating agencies that have already revised their outlook with Standard & Poor cutting US rating to double A in August with a negative outlook and Moody's Investors Service preserving US triple A with a negative outlook.

In emerging countries, China eased its monetary policy by cutting its bank reserve requirements by 0.5% for the first time in nearly three years, which implies that the country puts its economic growth at the top of its agenda despite the inflationary pressure. The move will free up region 390 billion yuan (about $61 billion) in funds for the banks to lend. China's quarterly gross domestic product have shown a 9.1% annual growth in the third quarter from a 9.5% in the second quarter, while there are predictions that China's GPD growth will drop to 7.7% year-on-year in the first quarter of 2012 and just 6% quarter on quarter.

SHIPPING MARKET

The shipping environment faced a stormy 2011 and shipping players seem ready to face one more difficult year. The scenario of consolidation between major shipping groups has emerged strongly this month in the struggling tanker and container segments as a response to the glut of vessels and the slump of the freight markets. The LNG segment appears to be one of the most secured shipping investments under the current market fundamentals for the period 2012-2015, while we can say that dry bulk operators have their own dynamics for survival with China lifting the demand growth for the main dry bulk commodities. China's National Development and Reform announced that China will add 390 million tons of additional iron ore capacity by 2015, while it is possible that Chinese iron ore imports will fetch 1,06 billion tons during that period. The tight ship-financing conditions in European bank lending will be the challenge for all shipping players, but not an obstacle in their willingness for investments as there are always windows opportunities for owners who have the expertise to float in shaking waters.

In the dry market, the sentiment is vague as we move towards the end of the year with capesize earnings breaking again the barrier $30,000/day and the BDI standing 84% above the lowest point of the year, 1,043 on February 4th. Capesize earnings continue to lift the market as Chinese iron ore demand shows strong levels even the high port stockpiles being recorded every week. Approximately 97,2 million tons of iron ore is currently stockpiled at Chinese ports, only slightly below the 98,1mt record level, according to Commodore Research. However, China's ore appetite grows as November closed with a sharp rise of annual iron ore imports. China's National Bureau of Statistics showed that Chinese iron ore imports totaled more than 560m tones for 2011, 11% increase year-on-year. On the other hand, Chinese demand for imported thermal coal has weakened during the last weeks due to a constant rise in port and power plant stockpiles, but it is expected to rise again towards the end of this month on the peak of winter demand season.

The index closed today at 1,922 points, up by 3% from last week's closing and down by 8.2 % from a similar week closing in 2010 when it was 2,095 points. The highest rate increase has been in the capesize segment, BCI up 8.4% w-o-w, BPI up 0.7% w-o-w, BSI down 7.8% w-o-w, BHSI down 3.3% w-o-w.

Capesizes are currently earning $32,617/day, an increase of $3,258/day from a week ago, while panamaxes are earning $13,682/day, an increase of $92/day. At similar week in 2010, capesizes were earning $25,375/day, 22% lower than the current earnings, while panamaxes were earning $18,873day, 38% higher than the current levels. Supramaxes earnings have fallen below $13,000/day, still trading at lower levels than capesizes and panamaxes, by earning $12,857/day, down by $1,369/day from last week's closing. At similar week in 2010, supramaxes were getting $17,458/day, hovering at discounted levels from capesize and panamax earnings. Handysizes are trading at $ 8,597/day; down by $263/day from last week, when at similar week in 2010 were earning $12,150/day.

In the **wet market**, VLCC segment is still under severe pressure even though we are in the peak of winter demand with brent crude prices floating above $100/barrel, adding additional strains on the beleaguered tanker operators. Consolidations, lay-ups, intense scrapping activity, halt of newbuilding orders are some of the key solutions to the current trembled waters of the industry. This week, rumors circulated in the market that Japan-based MOL became the first owner to scrap a double hull VLCC to an Indian scrap yard for $490/ldt. However, what is noteworthy is that a large percentage of VLCC fleet is not overaged and the demolition prospects are very limited. Japan's three leading shipping companies, Nippon Yusen KK, Kawasaki Kisen Naisha Ltd and Mitsui O.S.K. lines are reducing by 10% their supertanker fleet, from 90 vessels to 82, under the current weak growth of crude oil shipments and the increase of the VLCC fleet. Sources suggest that the VLCC fleet totaled at 570 vessels worldwide at the end of September, about 70 more than in 2007. One more adverse factor in the VLCC outlook is China's intentions to control the transportation of 50% if its crude oil shipments till 2015. China is planning to boost its VLCC fleet, currently standing at 56, by ordering 80 more supertankers.

In November, oil tanker company General Maritime Corp filed for Chapter 11 bankruptcy protection with a New York court as a part of a restructuring agreement that includes a $175 million equity investment from Oaktree Capital management and extensions on debt repayments. Company's chief financial officer said in a statement that their operations are strong, but continued macroeconomic weakness and reduced tanker rates have diminished their cash flow and their ability to comply with certain covenants. Financial institutions are expecting more bankruptcies to follow as victims to the glut of new ship deliveries and the constant slide of the freight market. As a movement to the current overcapacity, struggling freight rates and high bunker prices, four oil shipping firms, Denmark's A.P. Moller-Maersk, Japan's Mitsui O.S.K. Lines and two Singapore based firms, Samco Shipholding, Ocean Tankers, are combining their supertanker fleets to launch a 50-ship VLCC pool with operation due to begin on February 1st.

In the **gas market,** the LNG buoyant sentiment seems that will continue in 2012 as the prospects for high Japanese LNG demand are very positive with the International Energy Agency estimating that Japan will need to spend $3bn per month on additional oil and LNG in 2012 if the country's nuclear output falls to zero next year. The executive director of the IEA, said in Reuters that Japan will need an extra 460,000 barrels per day of oil and 30bn cu.m of gas in 2012 if the country continues to opt against nuclear power. One more strength in the LNG market is given by the firm rise of China's natural gas imports to 86.5% in the first 10 months of the year.

The Norwegian shipping firm Hoegh LNG has boosted its activities in floating liquefaction, regasification and shipping projects, due to expectations of growing global LNG demand. The firm predicts that about 30 regasification projects will be awarded within 2012, while LNG demand will outpace existing liquefication capacity, meaning that low cost, flexible and quickly deployable floating technology will become increasingly attractive. The firm believes that the LNG shipping market will remain tight for at least two to three years, as new vessels are under construction, expecting high chartering rates for the spot and medium term LNG markets.

In the **container market**, the Shanghai Container Freight Index remains below $1000/TEU since September with the Asia –Europe rates loosing 33.6% of their strength. Overall, rates continue to decline on all major rates with a significant downward pressure on asset values, while the demand outlook for growth of imports in U.S. and European economies is negative under the current debt sovereign risk. The Shanghai Container Freight Index closed last week at $838/teu, down 1.2% week-on-week and 275 points lower than similar week's closing in 2010, when the index was $1,125/TEU with the USWC and USEC rates outperforming better than the weak European routes.

As a response to the constant slump in the freight market and the significant high bunker cost, MISC, Malaysia's largest shipping company and the 29th largest line in the world, is planning to exit from the container business over the next six months. Furthermore, CMA CGM and MSC have announced the formation of an alliance for several key trade routes, including Asia-Northern Europe, Asia-Southern Africa and all of the South American markets, to combine their services and deploy larger, more efficient tonnage to service those routes.

In the **shipbuilding industry,** Chinese shipyards are facing a challenging year as the contracting activity of dry bulk carriers and tankers is standing at significantly lower levels from 2010 with South

Korean shipbuilders being in the frontline by building vessels with technological advances. Chinese shipbuilders are mainly producing bulk carriers, but they have to develop their technologies to construct more specialized units, such as post panamax containerships, LNG, offshore units, in order to survive in the current market conditions. As a step forward in the shipbuilding industry, China plans to enhance its competitiveness through consolidation of its shipyards. The government is going to encourage mergers, acquisitions and reorganizations among Chinese shipbuilders, said Guo Yanyan, s senior official at the Ministry of Industry and Information Technology. According to the plan, industrial consolidation will see China's 10 biggest shipbuilders account for more than 70% of the country's domestic shipbuilding production, while small and medium-sized companies will be encouraged to develop specialized shipbuilding techniques.

In the **shipping finance**, the tight European bank lending opens opportunities for Chinese banks to emerge as strong financiers to European shipowners that are lacking of cash liquidity and have willingness to expand their fleet. In 2009, the Industrial and Commercial Bank of China and the Bank of China provided shipping finance of $16,9 billion, 5% of the global share, according to Marine Money Date. Chinese banks will take an important role in the shipping finance industry during the next decade, but they have to enhance their professionalism and services to global standards. George Xiradakis, managing director of XRTC, said that China Development Bank needed 17 months, much longer than the international practice of 1-2 months, to provide financing to Greek owners due to lack of ship financing experts in the bank, Qiu Jun, vice senior manager of the shipping finance department at the Bank of Communications, agreed that Chinese banks lack adequate professional staff, risk assessment and an understanding of shipping business compared with their Western counterparts. However, there are doubts if China could be the remedy in the ship-financing gap as Chinese banks are very keen to work together with owners who have newbuilding plans in Chinese yards.

In terms of ship financing deals, FSL Trust Management Pte. Ltd. (FSLTM) has successfully entered into a Loan Agreement with its syndicate of eight lenders for a 6-year amortising term loan of US$479.6 million, secured against its current portfolio of 25 vessels. The new term loan facility is provided by a syndicate of banks led by ABN Amro Bank N.V., Singapore Branch and Oversea-Chinese Banking Corporation Limited as Mandated Lead Arrangers and Bookrunners. The other Mandated Lead Arrangers are The Bank of Tokyo-Mitsubishi UFJ Co., Ltd. ("BTMU"), UniCredit Bank AG, Singapore Branch ("UniCredit"), Sumitomo Mitsui Banking Corporation, Singapore Branch, The Korea Development Bank, ITF International Transport Finance Suisse AG and KfW IPEX-Bank GmbH. Under the new term loan facility, FSL Trust will make quarterly loan repayments of $11 million, which will progressively reduce its outstanding loan balance and reduce its refinancing risk at the loan maturity in 2017. The drawdown of the loan is targeted before the end of this financial year.

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