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Korea shipbuilders bolstered as consolidation fuels growth hopes

Hyundai Heavy Industries' $2bn Daewoo deal set to help country extend lead over rivals

South Korean shipbuilders got off to a strong start this year, winning large deals for oil tankers and LNG carriers © Bloomberg

Song Jung-a in Seoul February 7, 2019

South Korean policymakers have been keen to consolidate the country's overcrowded shipbuilding industry ever since they began rescuing troubled manufacturers, including Daewoo Shipbuilding & Marine Engineering, over the past few years with billions of dollars of taxpayer money.

But expectations for a major shake-up in the sector were not high, given political difficulties associated with a tough restructuring. So it was seen by analysts as a step forward when industry leader Hyundai Heavy Industries announced a tentative deal to buy second-ranked Daewoo for Won2.1tn ($1.98bn) last month.

Analysts say the deal, which could be the industry's largest acquisition, will help strengthen Korean builders' lead over lower-cost China by reducing overcapacity as they prepare for the return of growth after years of struggle to stay afloat under mounting losses.

“The big three Korean shipbuilders will be down to two. This means less competition when a shipping company is putting in an order for a new-build vessel. Ultimately, that will lead to pricing power, which will allow the Korean shipbuilders to become more profitable,” said Matthew Blumberg, investment analyst at Hayberry Global Fund.

Following the acquisition, the combined Korean entity will become a global heavyweight controlling more than 20 per cent of the market as measured by its order backlog, three times larger than Japan’s Imabari Shipbuilding, the second-largest shipyard globally, with a 6.6 per cent share, according to market tracker Clarksons Research.

The news came as Korean builders got off to a strong start this year, winning large deals for oil tankers and liquefied natural gas carriers. The LNG carrier boom, which follows higher demand for clean energy, enabled Korean shipbuilders to reclaim the top spot in new orders last year for the first time in six years. It has become the industry’s bright spot amid a dearth of orders for offshore oil rigs and production facilities since oil prices slumped in 2014.

The major three Korean shipbuilders are expected to see new orders increase more than 30 per cent this year, according to Nomura.

“They’ve already filled two years of order backlogs, which signals that it is likely to be a seller’s market from now on, rather than a buyer’s market,” said Chung Sung-yop, analyst at Daiwa Securities.

Korean builders clinched 12.6m compensated gross tonnage — an indicator of the amount of work necessary to build a ship — of new orders last year, accounting for 44 per cent of the total global orders, followed by Chinese rivals with a 32 per cent share and Japanese with 12.6 per cent, according to Clarksons.

Analysts expect Hyundai's acquisition of Daewoo will help Korean shipbuilders chase high-priced deals more aggressively as it eases stiff competition among them to cut prices for LNG tankers and very large crude carriers, which Korean shipbuilders have been dominating.

"For those high-value-added ships, competition was more internal among the three major Korean builders, rather than with Chinese rivals who are still focusing on bulk ships and smaller-size container ships," said Choi Jae-hyung, an analyst at Nomura.

South Korean shipbuilders won 75 of the 80 LNG carriers ordered worldwide last year, according to Seoul's commerce ministry. They also accounted for 87 per cent of the very large crude carriers ordered globally.

Another boom year is expected for LNG ships this year, partly driven by China's eco-friendly policies, with Qatar planning to order about 60 new LNG carriers.

But Nomura's Mr Choi said Korea's dominance in the LNG carrier market may lead to overseas opposition to Hyundai's acquisition of Daewoo amid concerns it could further reduce competition in the sector.

Hyundai also faces strong labour resistance to the deal. Unionised workers see the deal as a threat to job security. "A lot of their business portfolios overlap so they will have to reduce their combined capacity and workforce in the long run, which will not be easy politically," said Mr Choi.

Although the industry is gradually recovering from a protracted slump, Korean shipbuilders are not completely out of the woods yet, analysts caution. They won just one deal for offshore energy facilities last year amid low oil prices while a rebound in the container ship market is also unlikely amid the global trade war.

"I am broadly optimistic for the sector's turnround but low oil prices and the slowing global economy remain the key risk factors," said Daiwa's Mr Chung.