

**SHIPPING & LOGISTICS**

## Update

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**The tragic offshore drilling spill's impact on shipping: Drilling will continue, but expect more regulation, increased tanker demand**

- **The tragedy of the Deepwater Horizon has near-term and long-term impacts.** While the explosion and loss of the Transocean-owned/BP-hired semi-submersible deepwater drill rig has been dominating the news, it is still too early in its development to understand all of its implications. In the near term, the tragic loss of life and impact on the environment and fishery outweigh all other concerns. In the long term, how drilling is regulated globally, either by port states such as the U.S., or by the International Maritime Organization and others, is likely to change markedly.
- **Don't expect drilling to stop.** The world is still reliant on oil and will be for decades to come, most likely. The world's incremental oil supply today is largely located in two places – the Middle East and globally offshore. Much of the offshore opportunities are in deepwater (4,000 ft depths or more) locations. We would expect that drilling globally will further emphasize the best and newest technology. We note that Dryships (DRYS, BUY) has two deepwater rigs working today (one for Petrobras in the Black Sea and the other with Tullow offshore Ghana) and four ultra-deepwater drillships on order due for delivery in 2011, which do not currently have contracts, two of which remain largely unfinanced. While rig hire day rates have declined in 2010, the price of oil is rising, as will, in our opinion, the demand for their new ultradeepwater rigs. Also, Teekay (TK, HOLD), which has a strong reputation in the sector and has very modern offshore assets, has a significant offshore shuttle tanker business and has recently signed an updated lucrative contract for its FPSO Foinaven.
- **Should oil price contango steepen, tanker storage opportunities may increase.** We note that the oil price curve has steepened in recent weeks and may steepen further given the ongoing events in the U.S. Gulf. Given that it costs approximately \$0.90/month to store a barrel of crude and the three month spread to spot prices is ~\$4.60, the arbitrage window for storage is open, but not offering a huge return. Should that widen, that would mean increasing demand for storage of crude and refined products on tankers, particularly VLCCs (very large crude carriers). Companies that we cover that have VLCCs include Overseas Shipholding Group (OSG, BUY) and Frontline (FRO, SELL).
- **New drilling regulations could be supportive of ton-mile demand for tankers.** Over the long term we expect drilling in the Gulf of Mexico to remain robust, but we are also confident that there will be, at the very least, substantially increased regulatory scrutiny. This may slow the pace of drilling and offshore production in the Gulf of Mexico, leading to increased U.S. demand for crude from longer distances, increasing ton-mile demand, constricting supply and supporting freight rates. We would expect this impact to be short lived, but small spikes in demand can lead to large spikes in tanker spot freight rates. Tanker companies in our coverage that have spot tanker exposure rank as Nordic American Tankers (NAT, HOLD), FRO, OSG and then TK.
- **Cargo port operations/storage should continue normally.** While the potential impact on the environment and the regional fishery is the primary concern, we do not expect a substantial impact on cargo ships coming in and out of the region, particularly for grain exports from New Orleans. Those that have storage facilities in the port areas in the U.S. Gulf of Mexico region, such as Westway (WWAY, BUY) have long-term contracts and we do not expect an impact on their business.

TICKER	RATING	PRICE	PRICE TARGET	52 WEEK		EPS			P/E	
				HIGH	LOW	2008	2009E	2010E	2009E	2010E
<b>NM</b>	BUY	\$6.94	\$9.00	\$7.38	\$3.57	\$0.53	\$0.56 A	\$1.03	12.4	6.7
<b>ANW</b>	BUY	\$26.24	\$39	\$33.93	\$13.25	\$0.94	\$1.07 A	\$2.02	24.6	13.0
<b>BALT</b>	BUY	\$13.92	\$18	\$14.20	\$13.25	NM	NM A	\$0.67	NM	20.8
<b>DAC</b>	HOLD	\$5.05	NM	\$6.15	\$2.93	\$1.80	\$1.23 A	\$1.02	4.1	5.0
<b>DSX</b>	BUY	\$15.32	\$21	\$18.52	\$12.01	\$2.97	\$1.55 A	\$1.63	9.9	9.4
<b>DRYS</b>	BUY	\$5.78	\$11.00	\$10.70	\$4.90	\$10.18	\$1.08	\$0.96	5.3	6.0
<b>EGLE</b>	BUY	\$5.78	\$7.00	\$9.18	\$4.10	\$1.44	\$0.66 A	\$0.52	8.8	11.2
<b>FRO</b>	SELL	\$36.50	\$14.00	\$37.04	\$19.89	\$7.29	\$1.28 A	\$1.38	28.5	26.4
<b>GNK</b>	BUY	\$23.16	\$30	\$28.26	\$17.05	\$6.93	\$4.73 A	\$3.75	4.9	6.2
<b>GLNG</b>	BUY	\$12.99	\$16	\$13.42	\$5.37	\$(0.15)	\$(0.22)	\$0.92	NM	14.2
<b>NAT</b>	HOLD	\$31.24	NM	\$36.95	\$27.89	\$3.63	\$0.12 A	\$0.86	NM	36.4
<b>OSG</b>	BUY	\$50.06	\$54	\$51.39	\$29.70	\$13.05	\$(0.58) A	\$1.18	NM	42.5
<b>SSW</b>	BUY	\$11.71	\$16	\$13.00	\$5.24	\$1.19	\$0.97	\$1.32	12.1	8.9
<b>TK</b>	HOLD	\$25.05	NM	\$27.35	\$13.90	\$4.10	\$(1.21) A	\$0.79	NM	31.7
<b>WWAY</b>	BUY	\$3.90	\$6.00	\$5.99	\$3.75	\$0.58	\$0.15 A	\$0.24	26.6	16.0

Source: Lazard Capital Markets estimates

## VALUATION & RISKS

### DRYSHIPS INC. (DRYS)

**Risks** include related party transactions, issuance of equity, inability of DryShips to charter or finance its drillships, collapse of dry bulk market, default of charterers.

**Reiterating BUY and \$11 price target.** DryShips still has risks in its model; however, we believe that investors will react positively to the announcement of drillship charters over the coming quarters. Our 12-month price target is based on DRYS trading at 7-8x our 2011 EPS estimate of \$1.45, an EV/EBITDA of 7x, a premium to its valuation today against 2010 consensus P/E of 6x due to DRYS becoming viewed as more of a driller (drillers typically get better cashflow valuations than dry bulk players) than a dry bulk player in the coming years.

### OVERSEAS SHIPHOLDING GROUP (OSG)

**Risks** include oil production cuts, default of charterers' obligations, technical/environmental problems, or protracted global recession.

**Reiterating BUY and \$54 price target.** OSG boasts a strong balance sheet, built-in growth, a sustainable dividend, and an attractive cashflow valuation. Our price target of \$54 equates to 11.5x 2011E EPS, 8x EV/EBITDA, and a 3.25% yield, the upper midpoint of its historical P/E range (between 5x and 20x), which it has exceeded in the past, and is a discount to the S&P 500 trailing averages.

### **FRONTLINE LTD (FRO)**

**Risks** include new financing of capex, tanker rates improving on higher oil demand, large short interest ratio, and environmental liability.

**Reiterating SELL and \$14 price target.** Frontline has a quality management team and a good fleet and has managed its balance sheet well during the recession. However, the stock remains at a historically high cashflow (23x our 2011 EPS estimate) valuation and a historically low current yield of 4.3%, when it typically averages a yield closer to 10% plus. Our \$14 price target equates to an 8.5x 2011E P/E, and an 8.5% yield on our forecast 2011 dividend, more in the middle of its historical yield valuation range.

### **WESTWAY GROUP (WWAY)**

**Risks** include loss of a key customer, liquidity and acquisition costs/integration.

**Reiterating BUY rating. Our \$6 price target** is based on a premium to our base-case and a discount to our high-case DCF models, and represents 14x 2011E EPS and 5.5x EV/EBITDA on 2011 estimates, a discount to the S&P 500.

## ANALYST CERTIFICATION

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Please go to <http://research.lazardcap.com/pricecharts> to view price charts for companies mentioned in this report.

DISTRIBUTION OF INVESTMENT RATINGS (AS OF 04/30/10)					
OVERALL DISTRIBUTION			BANKING CLIENT DISTRIBUTION*		
BUY	HOLD	SELL	BUY	HOLD	SELL
59%	38%	3%	17%	6%	0%

\* Indicates the percentage of each category in the Overall Distribution that were banking clients of Lazard Frères in the previous 12 months.

RATING	GUIDELINE (return targets may be modified by risk or liquidity issues)
BUY	Expected to produce a total return of 15% or better in the next 12 months.
HOLD	Fairly valued; total return in the next 12 months expected to be $\pm 10\%$ .
SELL	Stock is expected to decline by 10% or more in the next 12 months.

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