

**Industrials**  
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# HSBC Shipping Day

Key themes from HSBC's inaugural shipping day

- ▶ **Dry bulk freight demand driven by Chinese steel production; container shipping demand shaped by developed markets**
- ▶ **Risk of oversupply greater for container ships and larger bulkers; supply of handysize vessels remains restrained**
- ▶ **Capesize drybulker provides greatest leverage on China's commodity demand; handysize more stable in medium term**

**18 April 2008**

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Issuer of report: The Hongkong and Shanghai Banking Corporation Limited

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**On 17 April, HSBC hosted its first annual shipping conference attended by ship builders, ship operators, ship brokers, and ship financiers.**

**Drybulk freight demand should remain robust:** China's continuing expansion of steel production as a result of rapid industrialisation should continue to boost demand for iron-ore imports. US liquidity crisis and China's macro controls will only affect dry bulk demand temporarily. Near-term demand for container shipping on the other hand may be at risk, as a result of the US economy slowdown affecting developed countries' demand and trade of semi-finished/manufactured goods.

**Future supply growth strongest among the larger dry bulk and container vessels:** Post-Panamax segment has highest order books and looks set to provide greatest supply growth within the dry bulk and container segment. In contrast, the dry bulk handysize segment, which has the highest portion of ageing fleet, has a small order book. Supply growth for handysize vessels may be further constrained: almost 50% of new orders have been placed with Greenfield yards, which may not survive tighter credit environment and economy slowdown.

**Drybulk Capesize market provides greatest leverage on China's commodity demand:** Valuations aside, the implication derived from the key themes is that if you are convinced that the commodity boom will continue then you should be focusing on the larger dry bulk vessel market, as it offers the greatest leverage to China's demand for commodities and will not suffer from overcapacity.

**In the medium term, handysize market offers more stability, we believe:** The best place to be when supply growth starts accelerating is the handysize sector, which has limited capacity growth and is less volatile compared to Capesize segment. Furthermore, there is a risk that supply may be further constrained should new deliveries be delayed or cancelled. Container shipping vessels on the other hand are best to be avoided.

## Chinese State Shipbuilding – mounting capacity

Mr Cao Yousheng, Director of state-owned Chinese State Shipbuilding (CSSC), presented on the China Shipbuilding industry, noting that China has emerged as the second-largest shipbuilder in the world from fourth place in 2000. Today, China is the leading builder of bulk carriers, and it is strengthening its positions in other types of vessels, particularly container ships.

China's shipbuilding industry growth has been supported by a 35% annual capacity growth during the past five years. To achieve the status as the number one shipbuilder in the world, China faces both near-term market and long-term structural challenges. Shortages of labour and rising material costs are expected to eat into profits. Over the longer term, China needs to develop capacity for key shipbuilding components such as diesel engines.

Realizing that their cost advantages could quickly erode, the Chinese are focused on increasing its production efficiency. Both technical and market hurdles including product development, production efficiency, economic growth, RMB appreciation, and tight credit will likely cause growth to deviate from the average. According to CSSC, the long-term outlook for the Chinese shipbuilding industry and the company is positive, and both will work diligently to catch up to the South Korean and Japanese shipyards.

## Rickmers Maritime (RMT SP) – Container Shipping Trust

Mr Thomas Hansen, CEO of Rickmers Maritime (RMT SP), presented an overview of its shipping trust business and upbeat long-term view on the outlook of the container sector. Volume growth on the trans-Pacific route is weak due to a slowdown but global demand is expected to remain strong, supported by strong demand on Asia-Europe and Intra-Asia trades.

Vessel supply, which is projected to increase rapidly in the next few years, may also be absorbed by port congestion, infrastructure constraints, and demand for additional ships where liners sail more ships at lower speed to keep fuel costs down.

Liners are ordering mega-size vessels to achieve economies of scale and turning to trust companies to finance a portion of their vessels, especially where they also invest in terminals and infrastructure. Indeed, the share of shipping capacity has increased from 15% in 1993 to 50% in 2007.

Rickmers Maritime believes it will not be affected by short-term fluctuations in the container market given that its fleet of container ships have all been chartered out on long-term contracts (averaging nine years) to blue-chip global liners such as Maersk, Hanjin Shipping, and Mitsui.

## Sinotrans Shipping (368 HK) – positive on dry bulk sector

Mr Tian Zhongshan, Shipping Director and General Manager of Sinotrans Shipping, presented optimistic views on the outlook of the dry bulk sector. US liquidity crisis and Chinese government macro economic control may affect shipping outlook and cause short-term fluctuations; however expansion of China's steel production and import of iron ore from Brazil and Australia should continue to boost demand. Demand for vessels is also expected to remain strong, boosted by South Korea and Taiwan sourcing coal from more distant countries like Indonesia and Australia since China became a net importer of coal.

Sinotans Shipping believes supply growth may be lower than anticipated due to the demolition of older vessels and tighter financing conditions affecting delivery of new builds not yet financed.

## Precious Shipping (PSL TB) – constraint handysize supply

Mr Khalid Moinuddin Hashim, Managing Director of Precious Shipping, presented on dry bulk supply, highlighting that supply growth of handysize vessels may be much lower than anticipated. Indeed, data compiled for the period 2000-2007 comparing shipping brokers' projections of new buildings versus actual delivery of handysize vessels show projections consistently exceeding actual deliveries. A likely cause for this mismatch is the difficulties of trying to collate data in a fragmented industry.

Precious Shipping believes the mismatch will widen in the next few years where there is a significant number being placed with Greenfield shipyards (estimated to represent 36% of current confirmed orders) and these shipyards may not be able to complete or deliver the orders on time. Typically, these shipyards are building ships while expanding their shipyards and financing their expansion using deposits and progressive payments made by ship buyers. Hence they are at risk when ship buyers fail to make progressive payments or cancel orders either because of tightening credit or uncertain economic environment.

Global supply of handysize may also decline further should owners decide to scrap ageing vessels given the rising costs of steel and thus repairs and stricter inspections by classification societies. Precious Shipping highlighted data estimating that almost half of the current global handysize fleet is old, at 27 years and above.

## Jin Hui Shipping (137 HK) – China driving dry bulk demand

Mr Raymond Ching, CFO of Jin Hui Shipping, also presented a positive view on dry bulk sector. Continuing urbanisation and industrialization of China is driving demand for dry bulk freight, creating an insatiable demand for commodities such as iron ore.

Macro control measures introduced by the Chinese government will slow pace of acceleration but the continuation of large key infrastructure project will support demand for steel and iron ore. Requirement for coal by Asian countries as an energy source is also boosting tonne mile vessel demand.

Jin Hui Shipping believes that there is strong potential for further demand growth. China's development is still at early stages and per capita steel consumption is still lagging developed countries; China is also set to become the largest energy consumer in the world.

## HSBC Shipping Services \* – dry bulk cycle peaking in 2008

Mark Williams, director of research at HSBC Shipping Services presented on the global shipping market expressing a positive outlook on dry bulk sector, neutral view on tankers, and concerns on the short-term outlook of the container segment.

Dry bulk demand is expected to remain strong, mainly driven by Chinese appetite for iron ore on the back of rapid steel production expansion. A significant portion of the dry bulk fleet is old and scrapping of older ships together with tighter credit, chronic port congestions, and shortage of newbuild equipment

may result in supply growth in 2008 being slower than projected. However, two-thirds of the order book are scheduled for delivery after 2009, resulting in supply likely to exceed demand growth.

Tanker outlook is neutral, with oil demand growth difficult to ascertain and highly dependent on volume of oil transported, which in turn is influenced by oil prices. However, there is potential for product tanker tonne miles demand to increase as a result of refining activities shifting from the US to the Middle East. At the same time, tanker supply growth is expected to be curbed by regulations requiring single-hull tankers to be phased out.

HSBC Shipping Services are bearish on the outlook of the containers in the short term or next few years. Demand is expected to remain relatively steady with outsourcing of manufacturing activities and imbalances of currency strength. High oil prices have also been instrumental in creating demand for additional ships where liners resorted to slow steaming to keep fuel costs down. Massive supply growth is however threatening rates where there is a high order of ultra-large vessels and there is no pressure valve from scrapping due to small pool of old vessels.

The outlook on shipbuilding appears to be negative, with expanding shipbuilding capacity and interest in contracting likely to wane with economic slowdown and tightening credit. Newly established or virtual shipyards may struggle to fulfil orders and mitigate damage of overcapacity. Worst-case scenario for the yards would be rising cost inflation and falling demand.

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# Disclosure appendix

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