14 September 2018 | Sector Update

Transportation - Ports

***Maintain* NEUTRAL**

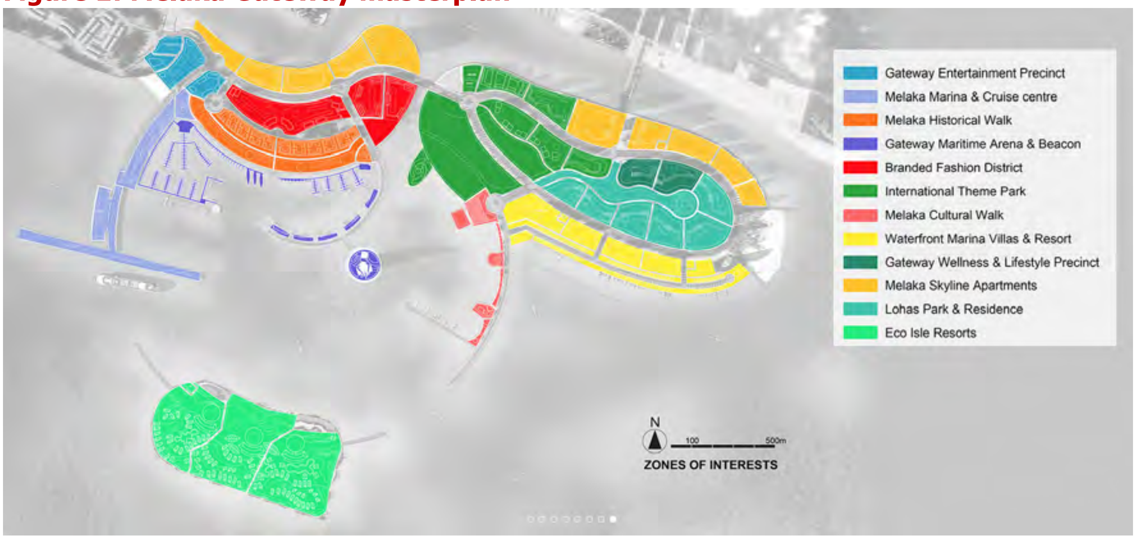
Melaka Gateway - another port in the making

KEY HIGHLIGHTS

- **The Melaka Gateway project is expected to create positive spill-over effects in the local economy**
- **However, we view that it would be overshadowed by the existence of Port Klang and Port of Tanjung Pelepas**
- **Absence of strategic alliance and limited berthing capacity may dampen demand**
- **Melaka Gateway project may lead to oversupply in terms of port capacity which could potentially lead to downward pressure in pricing**
- **Maintain NEUTRAL stance on transportation sector**

Background of the project. The RM43b Melaka Gateway project is a circa 1,366 acre development which will comprise of one island and three artificial islands. It will house the Malacca International Cruise Terminal (Island 1), a commercial city or free trade economic zone (Island 2), a liquid bulk terminal (Island 3) and a multipurpose terminal with a maritime industrial Park (Island 4). The developer of the project is KAJ Development Sdn Bhd ("KAJ") which has appointed China state-owned Powerchina International Group Ltd as its main contractor. The port segment of the Melaka Gateway is scheduled to be completed in 2019 while the other parts of the development are scheduled to be ready by 2025 with the aim of being the largest private marina in South-East Asia.

Figure 1: Melaka Gateway masterplan



Source: Melaka Gateway

Expecting positive knock-on effects on the local economy. The Melaka Gateway ecosystem revolves around the synthesis of real-estate with tourism, industrials and commercial activities. According to the Economic Affairs Ministry, the "*development will contribute directly and indirectly to Malaysia from a macroeconomic standpoint in terms of population growth, job opportunities for skilled and partially skilled workers, GDP growth, GNI, technology transfer and other knock-on effects to the local economy.*" KAJ estimates that the project will generate approximately RM1.2t to the local economy. Meanwhile, it is expect to lead to the creation of job around 40,000 to 45,000 jobs for skilled and partially skilled works within the next ten years. This will continue to support Malacca's GDP growth which was one highest in peninsular Malaysia in 2017 at 8.1%.

Situated between two major maritime hubs. Intra-Asia container volumes are expected to rise from around 31m TEU in 2018 to approximately 34m TEU in 2020. We view that the increase in container volumes could be absorbed by the two major maritime hubs i.e. Port Klang and Port of Tanjung Pelepas (PTP). This will place the container terminal of Melaka Gateway in a disadvantageous position, given that the latter is situated between the two established maritime hubs.

Continuous expansion in shipping capacity. As at end of 2017, utilisation of both Port Klang and PTP hovered around 60-70%. This indicates that both ports have the capacity to cater for increase in container volume. As at end of 2017, PTP underwent a RM1.2b comprehensive upgrading programme in 2017 which comprised of: (i) addition of new equipment such as 29 rubber tyred gantry cranes, 93 prime movers and 8 Triple-E quay cranes and; (ii) dredging works to deepen the draft from 16.0m to 18.5m. All these lead to the increase in the port capacity to 12.5m TEUs from over 10.0m TEUs previously. Meanwhile, Westports at Port Klang has expansion plans for its container terminals 10-19. This will increase Westports current capacity from 14.0m TEUs per annum to 30m TEUs per annum by around 2040.

Table 1: Ports in Peninsular Malaysia as at end of CY2017

Port	Capacity (‘m TEUs)	Throughput (‘m TEUs)	Utilisation rate (%)	Listed holding company
Westports	13.0	9.0	69.2	Westports Holdings Bhd
Northport	5.6	3.0	53.5	MMC Corp Bhd
Port of Tanjung Pelepas	12.5	8.4	67.2	MMC Corp Bhd
Johor Port	1.2	0.9	75.0	MMC Corp Bhd
Penang Port	2.0	1.5	75.0	MMC Corp Bhd
Kuantan Port	0.6	0.1	24.5	IJM Corp Bhd

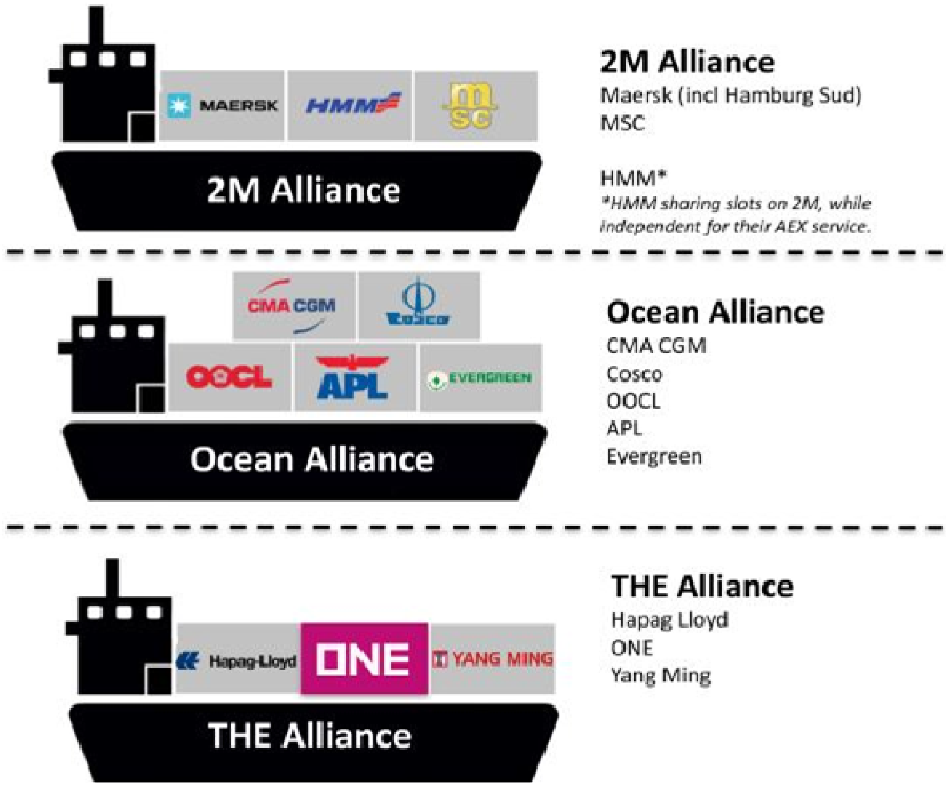
Source: Westports, MMC Corp, Kuantan Port Authority, MIDFR

Figure 2: Westports CT10-CT19 expansion plans

Source: Westports, Google Map

Absence of strategic alliance with major container liners. In relation to the container handling operations of the Malacca Gateway project, Port Klang and PTP already have an established rapport with the major container liners (*refer to Figure 3*). CMA CGM is one of Westports' biggest clients apart from being the secondary hub for the Ocean Alliance in South East Asia while APM terminal; the port operating arm of AP Moller-Maersk group owns 30% of PTP which is also the key regional hub for the 2M Alliance. Moreover, the three major shipping alliances i.e. Ocean, 2M and THE, put a premium on hubs that can offer them benefits of scale, connectivity, competitive rates and equity stakes for container lines in their terminal facilities. Nevertheless, KAJ's strategic partnership with Shenzhen Yantian Port Group and Rizhao Port Group could prove to be beneficial in rerouting some of the shipping demand via the Melaka Gateway.

Figure 3: Group of Ocean Carrier Alliances



Source: AAI Group

Comparatively smaller berthing capacity. Westports' has the ability to handle Ultra-Large Container Vessels (UCLV) slightly above 20,000 TEUs from just 2,900 TEUs when it started operating in 1996 (*refer to table 2*). For instance, CMA CGM's newest and largest flagship vessel, the CMA CGM Antoine de Saint Exupery with a carrying capacity of 20,600 TEUs has made its first call at Westports. As for Port of Tanjung Pelepas, it became the first port in the world to depart a vessel from Maersk with a final load of over 19,000 TEUs, signalling the port's efficiency and productivity to cater major container liners. In comparison with Melaka Gateway's container terminal, it is only able to accommodate vessels up to 12,000 TEUs. Such capabilities can hinder Melaka Gateway from attracting major container liners that usually have vessels of large capacities which in turn lowers the chances of being the port of call of the shipping alliances.

Table 2: Size of container vessels that can be accommodated by Westports

Year	1996	1999	2006	2011	2012	2014	2018
Size of vessels that can be accommodated (TEU)	2,900	6,600	8,400	14,100	16,000	19,000	20,600

Source: Westports, MIDFR

Ensuring supply and demand balance is crucial. While the Malacca Gateway is expected to contribute positively to the state of Melaka, we view that the timing of the project is crucial. This is to ensure that there will be no over oversupply of port capacity in the South East Asian region as excessive supply could lead to downward pressure in pricing which will impact the profit margin of existing port companies.

Maintain NEUTRAL. While the Melaka Gateway project is expected to have positive impact on the local economy, we view that both Port Klang and PTP would serve as stronger contenders. Apart from being situated between the two aforementioned ports, the facility of Melaka Gateway also lose out in terms of berthing capability, container handling efficiency and relationship with major shipping alliance. We opine that Port Klang and PTP would stand a better chance of capturing the growth in the container shipping volume. The expected increase in volume would steam from economic growth in Asia and ASEAN which is expected to remain resilient at +6.5%yoy and +5.3%yoy respectively for 2018, in accordance with International Monetary Funds' latest projection. Our top pick for the port sector lies with **MMC Corporation Bhd (BUY, TP:RM2.13)** premised on its strong construction orderbook of approximately RM15b and resilience of Port of Tanjung Pelepas which offer competitive tariffs compared to regional peers such as Ports of Singapore. Meanwhile, we view that **Westports Holding Bhd's (NEUTRAL, TP:RM3.62)** outlook remain unexciting as we do not foresee much earnings accretion in the next two to four years despite its CT10-19 expansion plans.

Appendix

Island 1: Tourism, entertainment, commercial and property development

Source: Melaka Gateway

Island 2: Free trade economic zone

Source: Melaka Gateway

Island 3: Melaka Gateway Port

Source: Melaka Gateway

Island 4: Maritime Industrial Park

Source: Melaka Gateway

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BUY	Total return is expected to be >10% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >10% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -10% and +10% over the next 12 months.
SELL	Total return is expected to be <10% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >10% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.