Equity Beat
midf RESEARCH

24 February 2015 | Sector Update

# Shipping Sector (BDI)

***Maintain* NEUTRAL**

## *Baltic Dry Index Hits Multi-Decade Low*

## INVESTMENT HIGHLIGHTS

- **The Baltic Dry Index ("BDI") hits a 27-year low of US$522 on 16/2/2015 which we attribute to: (1) a slowdown in China's manufacturing; (2) easing commodity imports despite lower prices; (3) shorter shipping routes preferred; and (4) robust newbuilding activities of dry bulk fleet.**
- **The only company under our coverage with substantial exposure to the dry bulk shipping segment is Maybulk. While industry outlook for the sector remains uncertain, we believe the earnings risk has been amply priced in. Maintain BUY on Maybulk with TP: RM1.72.**
- **BDI hits 27-year low of US$522.** We highlighted in our sector update in Dec 2014 that dry bulk shipping industry outlook remains bleak arising from unfavourable industry dynamics. Fast forward two months and the BDI recently hit a 27-year low of US$522 (Figure 1) with all four carrier sizes seeing a decrease in rates (Figure 2). This also superseded the previous low of US$554 in Jul 1986 and is -53% below the average price of US$1,105 in FY2014.
- **Slowdown in China manufacturing.** The decline, in our view, has been mostly attributed to the weak economic outlook for China. Evidently, HSBC/Markit manufacturing purchasing managers' index (PMI) for China in Jan 2015 was at 49.7, indicating a contraction in factory activity (Figure 3).
- **Iron ore imports continued to ease despite lower prices.** China's steel consumption remains subdued amidst a softer real estate market which was reflected by a -5.1%yoy decline in newly built house prices in Jan 2015, a fifth consecutive monthly decline. Despite the imported iron ore benchmark price declining to US$67.39/mt in Jan 2015 (Figure 4), China's total iron ore imports declined -9.5%mom to 78.6mmt (Figure 5) while iron ore inventories eased to 91.3mmt as of Feb 2015 indicating a drawdown in supplies (Figure 6).
- **Closer source for iron ore.** We observe that China still prefers to import the bulk of its iron ore from Australia as opposed to Brazil (Figure 8). In addition, Brazil has just recently sorted out issues pertaining to the docking of its very large ore carrier ("VLOC") - the Valemax - which was previously not allowed to dock in China. Recall that the inclination of China importing its iron ore from Australia weighs on BDI rates as the Australia-China route is three times shorter than the Brazil-China route and thus commands lower rates.
- **Dry bulk fleet newbuilding orders still robust.** As of Feb 2015, the dry bulk fleet on order and under construction remains robust with 1,260 vessels on order (+13.54% of existing fleet) and 334 vessels under construction (+3.59% of existing fleet). This further exacerbates the overcapacity (in the form of dead weight tonnes, DWT) after an expansion of +4.4%yoy increase in DWT which outpaces the dry bulk trade growth of +4.0%yoy in FY14 (source: Clarksons). In FY15, fleet capacity growth is expected to grow +5.1%yoy and outpace the dry bulk trade growth of +3.7% by a larger margin.
- **Bumpy outlook for BDI.** Moving forward, we believe the above factors could remain a drag on the BDI. However, reprieve for the BDI could potentially be from: (1) China reheating its factories after the Chinese New Year holiday season; (2) India absorbing iron ore and coal supply due to local restrictions imposed on mining; (3) Alliances between dry bulk shipping carriers to enhance bargaining power with cargo owners; and (4) Increased demolition activity on older dry bulk vessels due to depressed freight rates.

**Figure 1: Baltic Dry Index (BDI)**

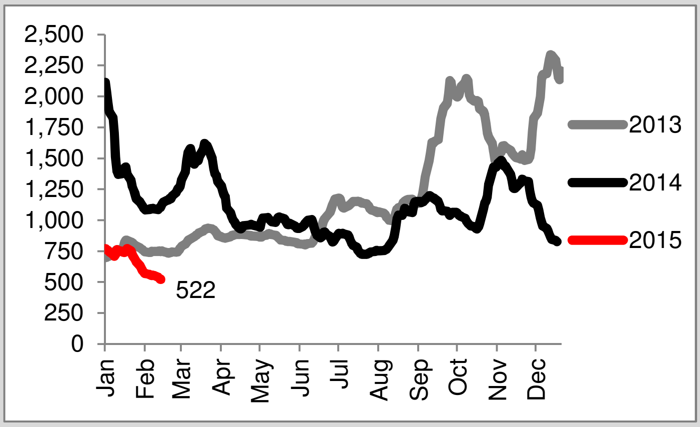
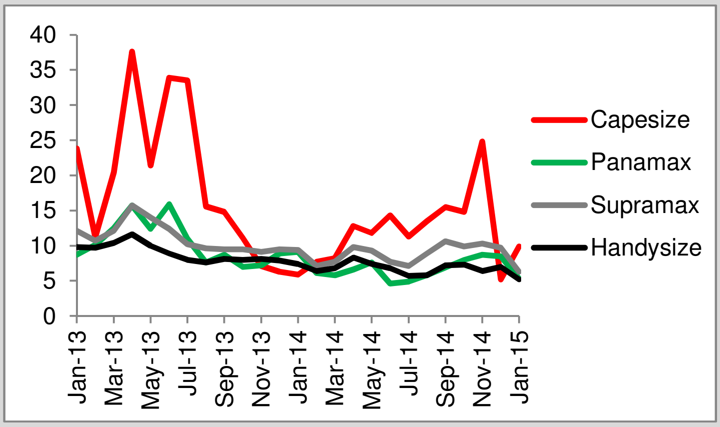



**Figure 2: Monthly Average Spot rate for Dry Bulk Carriers, (US$'000/day)**




*Source: Ship Brokers Reports, Bloomberg, MIDFR*

**Figure 3: HSBC Manufacturing China Final PMI**

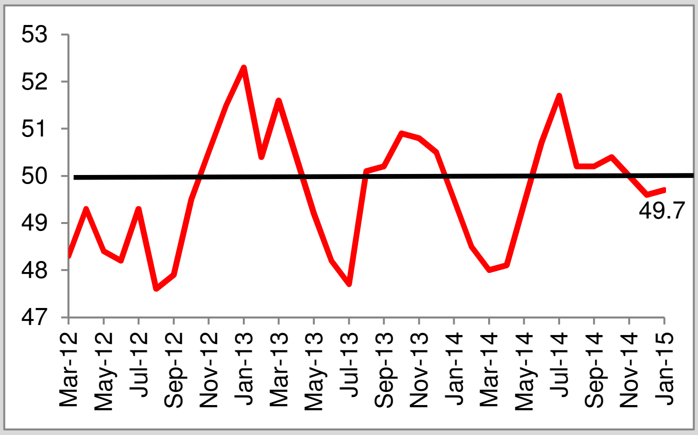
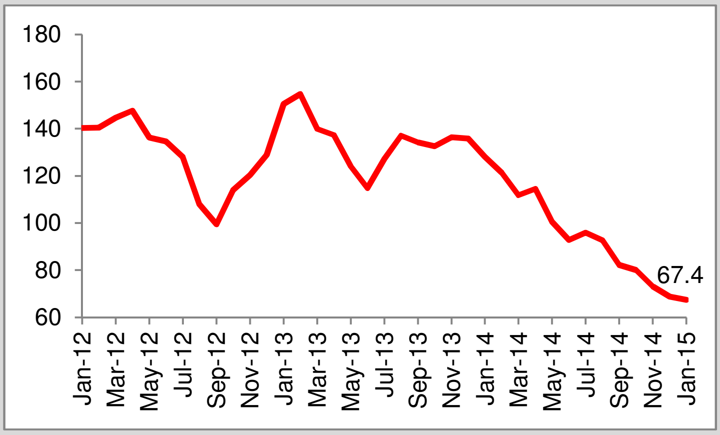



**Figure 4: Tianjin Port Iron Ore Price, US$/pmt**




*Source: HSBC, Bloomberg, MIDFR*

**Figure 5: China Volume of Commodity Imports - Iron Ore & Concentrate (Million Metric Tonnes, MMT)**

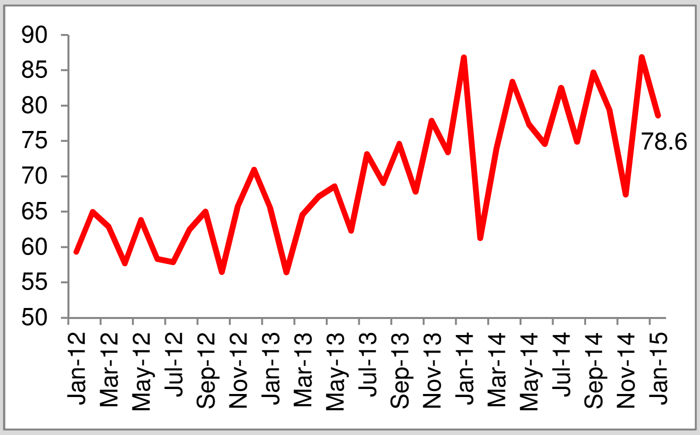
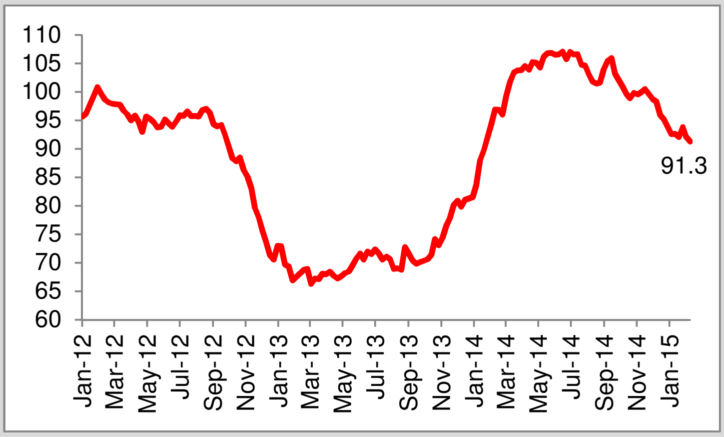
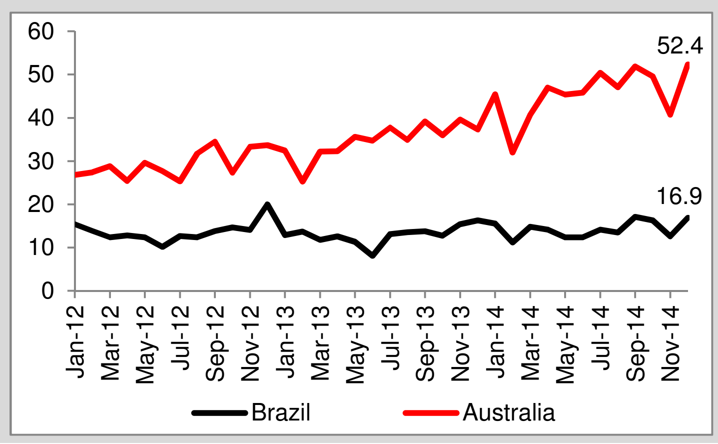



**Figure 6: Weekly Inventory Level of China's Iron Ore (Million Metric Tonnes, MMT)**




*Source: Bloomberg, MIDFR*

**Figure 7: China Customs Iron Ore Imports – Brazil/Australia (Million Metric Tonnes, MMT)**




*Source: Bloomberg, MIDFR*

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|---|---|
| **STOCK RECOMMENDATIONS** | |
| BUY | Total return is expected to be >15% over the next 12 months. |
| TRADING BUY | Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow. |
| NEUTRAL | Total return is expected to be between -15% and +15% over the next 12 months. |
| SELL | *Negative* total return is expected to be -15% over the next 12 months. |
| TRADING SELL | Stock price is expected to *fall* by >15% 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. |