23 December 2014 | Sector Update

Shipping Sector

***Maintain* NEUTRAL**

Dry Spell Ahead For Dry Bulk; Winter Wonder For Tanker Segment

INVESTMENT HIGHLIGHTS

- We remain NEUTRAL on the shipping sector as we expect the industry outlook to be mixed. Select rates within the tanker segment (i.e. Petroleum and LNG) are expected to improve although we see this being largely offset by further deterioration in the dry bulk and chemicals segments. Notwithstanding, we are Neutral on MISC while we have a Buy call on Maybulk.
- Overall, we are cautious on the outlook of the dry bulk segment, remaining flat going into 1Q15 due to lower factory activity amidst the seasonally slow period in conjunction with the Chinese New Year festival. Furthermore, we believe the potential slowdown in China's economy could see rates remaining depressed.
- On the flipside, we expect the BDTI to improve due to continued weakness in crude oil prices encouraging trade activities. Furthermore, a colder-than-expected winter season in the northern hemisphere, similar to end-2013 and early-2014 could boost rates. The possible lift in US' sanction on the crude oil exports after almost four decades may provide an additional boost to the index.
- We have a Neutral call on MISC with a positive bias. While the industry dynamics seem to favour MISC over Maybulk, we believe this has largely been priced in. However, we foresee further upside to our earnings forecasts should prevalent conditions continue to favour MISC such as: (i) depressed bunker fuel; (ii) weakness in the ringgit against the dollar; (iii) tanker rates trending higher; and (iv) renewal of LNG contracts which are set to expire over 2015-17.
- Meanwhile, we have a Buy call on Maybulk. While industry dynamics for the dry bulk sector looks bleak, we believe the market has more than priced in the earnings risk. We see operations stabilising with the weaker ringgit against the dollar while lower bunker fuel price is favourable to its operating costs.

Dry Bulk Shipping

- **BDI has fallen from its high in November.** The Baltic Dry Index (BDI), the weighted average of the freight rates for the four different sizes of dry bulk vessels, has tapered off from its year-to-date peak of 1,484 in early November 2014 to 827 as at 18 December (Figure: 1). The year-to-date average BDI has fallen by -8.5%yoy to 1,111.6 due to weak rates across all carrier sizes (Figure: 2). The decline, in our view, has been mostly attributed to (i) the weak economic outlook for China, the world's largest importer of dry bulk goods such as iron ore, coal and copper, as well as (ii) weighed down by overcapacity.
- **Potential slowdown in China.** The flash HSBC/Markit manufacturing purchasing managers' index (PMI), a leading indicator, fell to 49.5 (<50 indicates contraction) in December 2014 from November 2014's reading of 50 (Figure: 3). This follows announcement by chief economist of the People's Bank of China indicating that GDP growth could decelerate to +7.1% in 2015 should the current slowdown in real estate investment continues.
- **Declining iron ore imports and drawing down of inventories.** We believe China's steel consumption is easing due to softer real estate market which was reflected by the -0.5%yoy decline in home price index in November 2014, the seventh consecutive monthly drop. We note that total imports in November 2014 reduced -15.1%mom to 67.4mmt (Figure: 5) despite the imported iron ore benchmark price eased to US$73.13/mt, near its 5-year low of US$68/mt (Figure: 4). Meanwhile, China's iron ore inventory level have eased to 98.3mmt from 103.2mmt at the end of September 2014 while steel products export has increased indicating that inventories have been drawn down (Figure: 6).
- **Closer source for iron ore.** Since October 2014, Australia's iron ore exports to China has increased +21.7%yoy as the latter imposed a sanction on mega iron ore vessel – the Valemax (Figure: 8). This weighs on BDI rates as the Brazil-China route is three times the distance of the Australia-China route hence commands higher rates.
- **Dry bulk tonnage growth has outpaced demand.** As of October 2014, the dry bulk fleet expanded +4.9%yoy to 746.4mil DWT outpacing tonnage demand growth of +4.4%yoy by end of FY14 (source: Platou). We believe the overcapacity situation will likely spill over into FY15.

KINDLY REFER TO THE LAST PAGE OF THIS PUBLICATION FOR IMPORTANT DISCLOSURES

Figure 1: Baltic Dry Index (BDI)

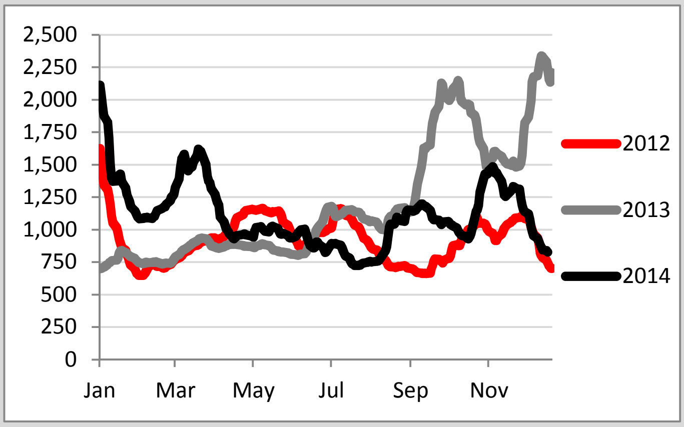
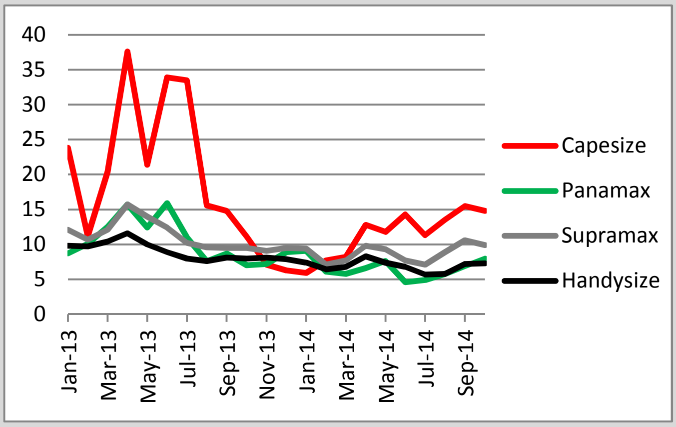


Figure 2: Monthly Average Spot rate for Dry Bulk Carriers, (US$'000/day)



Source: Platou, Bloomberg, MIDFR

Figure 3: HSBC Manufacturing China Final PMI

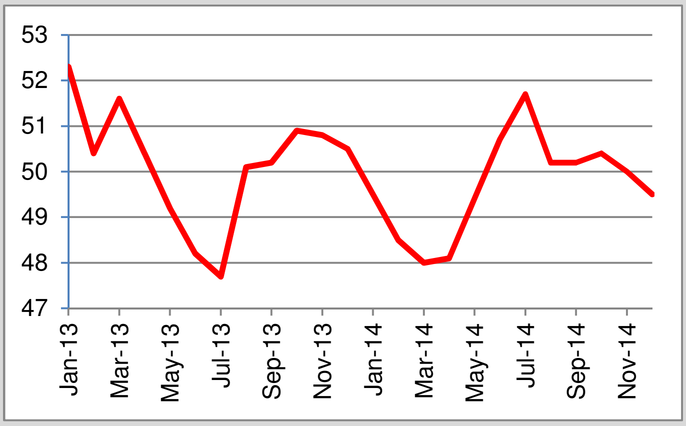
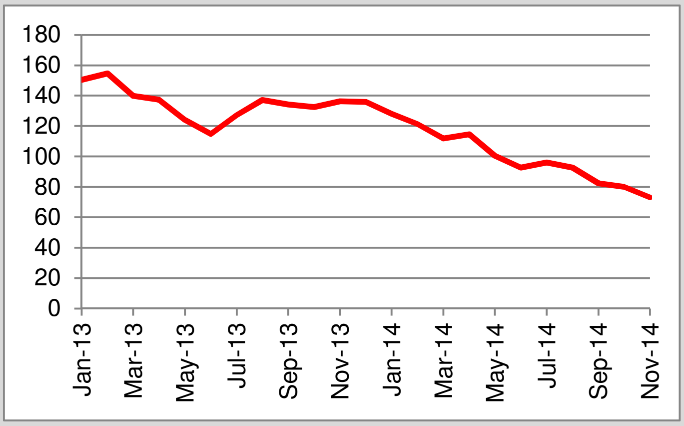


Figure 4: Tianjin Port Iron Ore Price, US$/pmt



Source: HSBC, Bloomberg, MIDFR

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

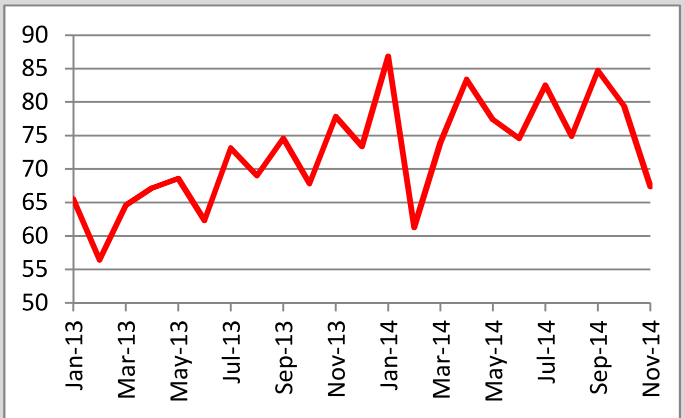
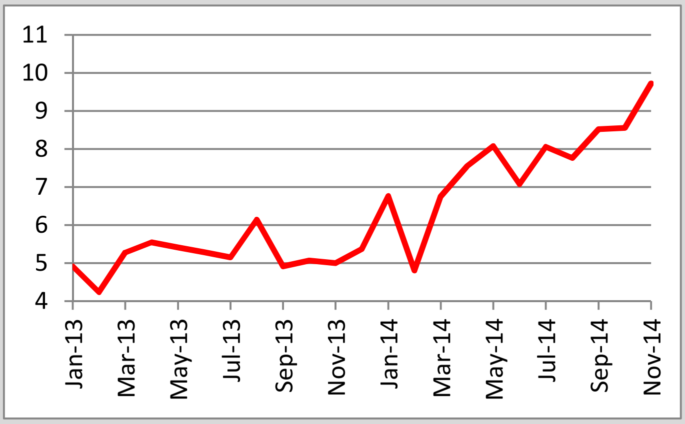


Figure 6: China Volume of Commodity Exports - Steel Products (Million Metric Tonnes, MMT)



Source: Bloomberg, MIDFR

Figure 7: Weekly Inventory Level of China's Iron Ore (Million Metric Tonnes, MMT)

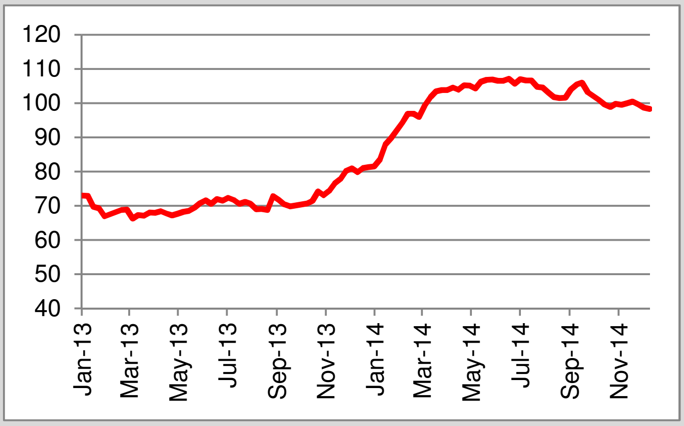
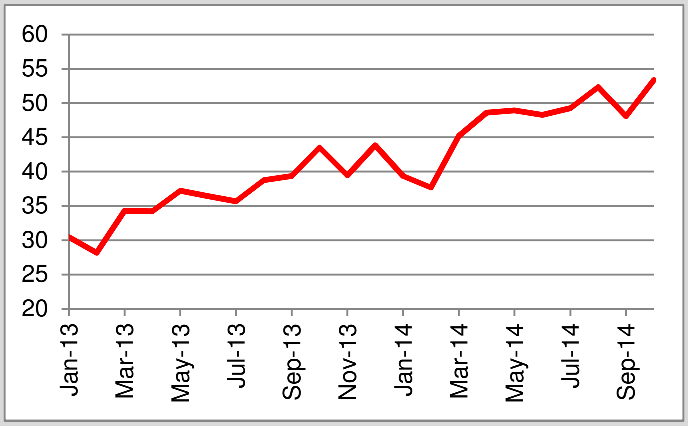


Figure 8: Australia Iron Ore Exports to China Total Volume (Million Metric Tonnes, MMT)



Source: Bloomberg, MIDFR

Tanker Shipping

- **BDTI showed strong gains.** The Baltic Dirty Tanker Index (BDTI) rebounded strongly off of its low point of 605 on September 2014 to peak at 975 in November 2014 before subsiding to current level of 888 (Figure: 9). We attribute the gains in the BDTI to the declining Brent Crude prices (Figure 10) which encourages shipment volumes.
- **Pickup in all tanker sizes.** After a lull in prices in September 2014 at US$15.5k/day, the VLCC rates surged +89.7%mom to US$29.4k/day in October 2014. The Suezmax and Aframax rates followed the VLCC's lead, rising +102.9%mom and +45.5%mom respectively. For the clean tanker segment, gains were less pronounced, up +16.1%mom and +12.0%mom for the LR2 Clean and MR Clean tankers respectively (Figure: 11).
- **China stockpiling activities driving up rates.** We believe China's stockpiling of crude oil import has yet to be reflected in the official figures as the China Customs crude oil imports showed a decline with the latest reading in October 2014 stood at 24.1mmt from 27.6mmt in September 2014 (Figure: 12). However, we observe that the Dirty VLCC Arabian Gulf to Far East Tanker rates have spiked +74.6%mom to US$84.1k/day as of 18 December from US$48.1k/day as at end October 2014. This implies a major pick up in tanker shipments from the Middle East to the Far East (Figure: 13).
- **BDTI to trend upwards.** Looking ahead, we expect the BDTI to trend higher due to (i) continued weakness in crude oil prices encouraging seaborne trade activity; (ii) a colder-than-expected winter season in the northern hemisphere, similar to end-2013/start-2014, which saw BDTI soared to 1,344; (iii) US reaching a breakthrough in legislature allowing the export of crude oil for the first time in almost four decades.

Figure 9: Baltic Dirty Tanker Index (BDTI)

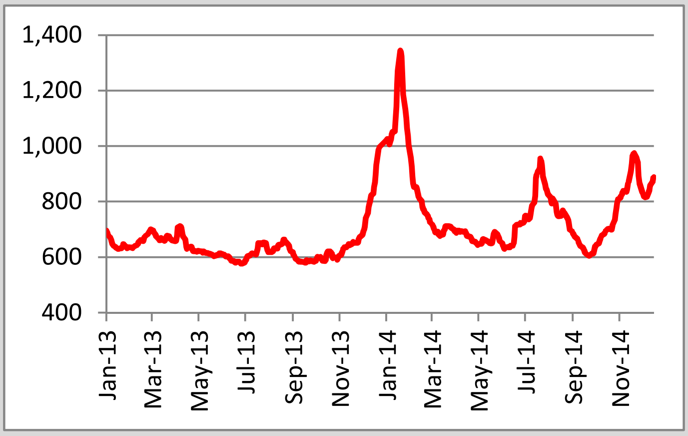
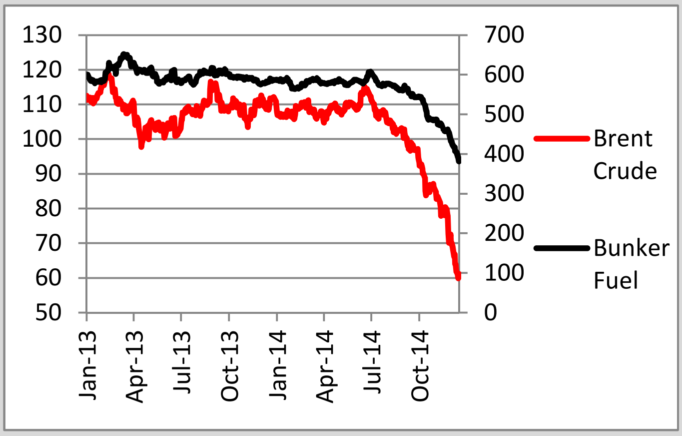


Figure 10: Brent Crude Oil/Bunker Fuel (US$/bbl)



Source: Bloomberg, MIDFR

Figure 11: Monthly Average of Spot rate for Crude Tankers, (US$'000/day)

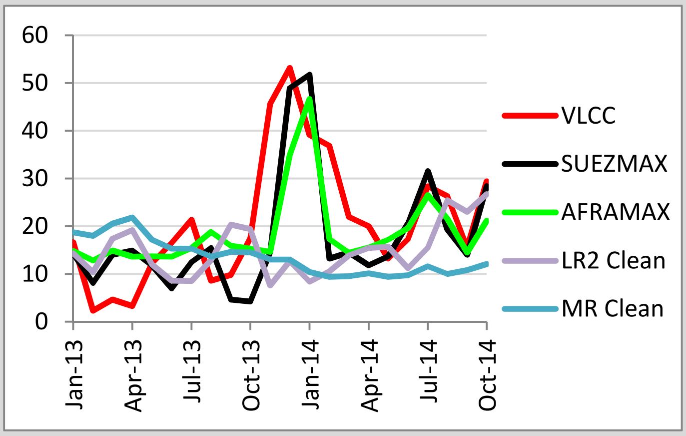
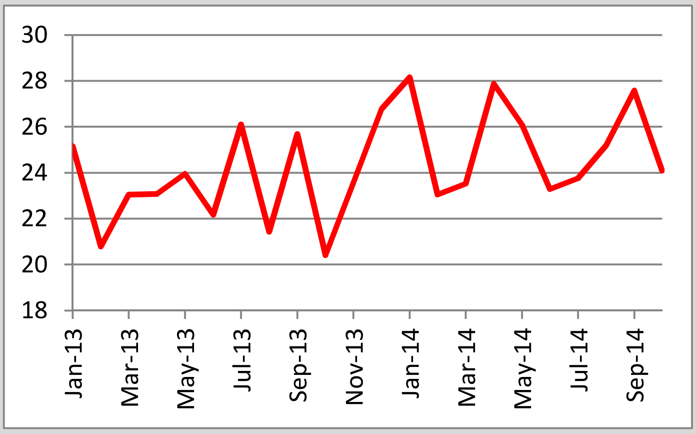
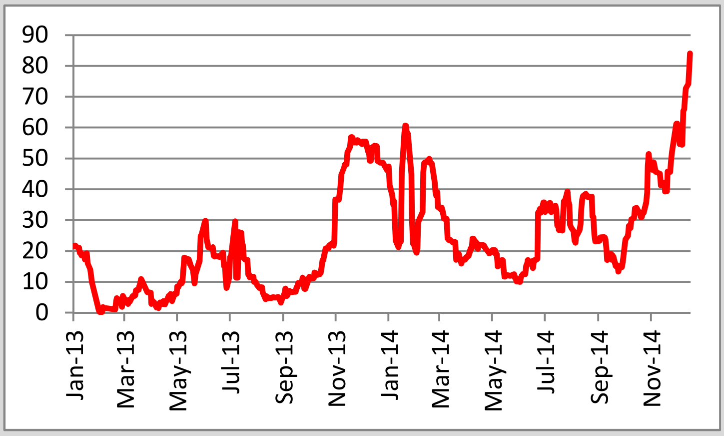


Figure 12: China Customs Crude Oil Total Imports Quantity (Million Metric Tonnes, MMT)



Source: Platou, Bloomberg, MIDFR

Figure 13: Dirty VLCC Arabian Gulf to Far East Tanker Rate, (US$'000/day)



Source: Bloomberg, MIDFR

Container shipping

- **Flattish container shipping rates.** Container rates, measured in twenty foot equivalent units (TEU) remained flat in October 2014 compared to September 2014 due to seasonally slower growth in container movements (Figure: 14).
- **Fleet capacity growth outpacing import growth.** Year-to-date, US container imports rose more than +4%yoy while European imports registered a +6%yoy growth. However, charter market rates remained flat for all sizes due to strong container fleet capacity growth of +5.4%yoy, especially in the 8,000-9,999 and 10,000+ TEU fleets which have grown +11.4%yoy and +27.2%yoy respectively.
- **Container rates to hold steady.** Moving forward into 1Q15, we expect the significant overhang in tonnage within the container sector to limit any upward strength in charter rates.

Figure 14: Average Twenty Foot Equivalent Unit Charter Rates In US$1,000/day

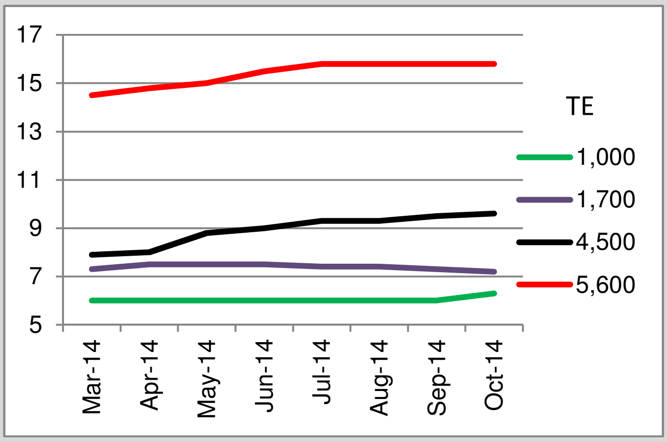


Figure 14: USD:MYR Exchange Rate

Source: Platou, MIDFR

Stock Recommendations:

MISC (Maintain NEUTRAL, TP: RM6.80)

- With the improved freight and utilisation rates for the petroleum tanker division, we expect segmental losses to narrow further or breakeven at best. However, we foresee further upside to our earnings forecasts should prevalent conditions remain favourable for MISC such as: (i) depressed bunker fuel; (ii) weakness in the ringgit against the dollar; (iii) tanker rates trending higher; and (iv) renewal of LNG contracts which are set to expire over 2015-17. At this juncture, we have a SOP-derived TP of RM6.80 for MISC while we are NEUTRAL on the stock with a positive bias.

Maybulk (Maintain BUY, TP: RM1.72)

- We maintain our BUY call on Maybulk with a TP of RM1.72. Year-to-date, Maybulk's share price has fallen by 63%. We believe the selloff is overdone as we believe earnings risks such as lower anticipated dry bulk charter rates and lower contribution from its 20% SGX-listed associate, POSH Group, have been more than reflected at the current share price levels. The weaker Ringgit against the US Dollar and lower bunker fuel prices could also lend support to Maybulk's earnings.

DAILY PRICE CHART

MISC

Maybulk

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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.