07 January 2014 | Sector Update

Shipping Sector

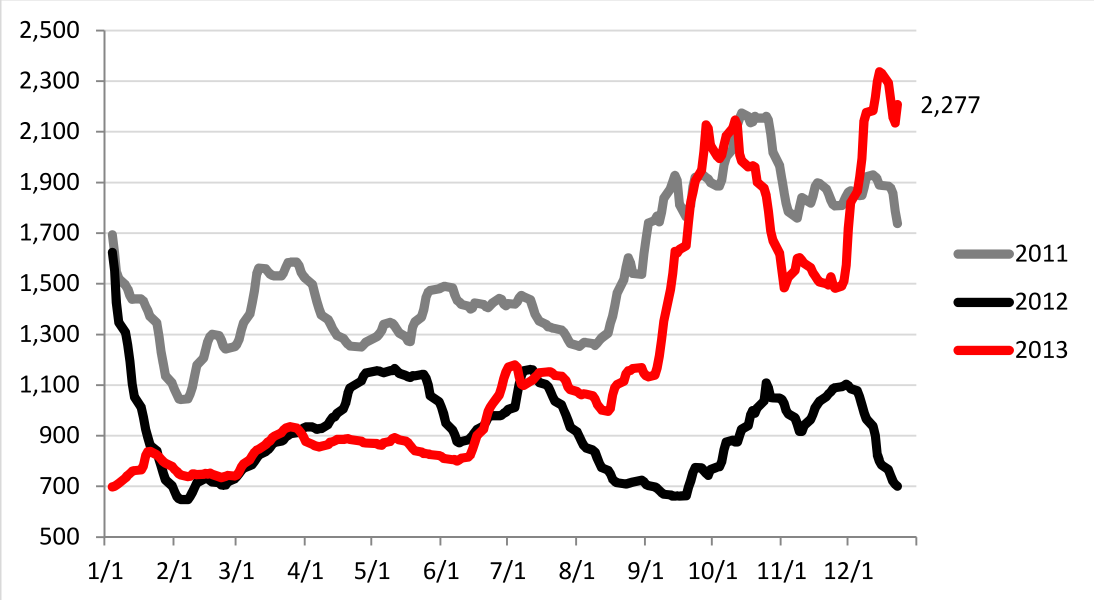
***Maintain* NEUTRAL**

Dry bulk led the recovery of shipping sector

INVESTMENT HIGHLIGHTS

Baltic Dry Index (BDI), which represents the weighted average of chartering rates for four different sizes of dry bulk carriers, maintained its recovery momentum. On year-on-year basis, the BDI posted a gain of circa 327% in 2013 and closed at 2,277 (figure 1) at the end of the year. The improvement was primarily attributable to the ramp up in iron ore stockpiling activities from China in 2H13 that resulted in the tightening supply of available vessels. In the long term, we expect the recovery of dry bulk rates to be sustainable due to China's urbanization and infrastructure projects which remain the main drivers for the demand growth of dry bulk commodities.

Figure 1: Baltic Dry Index (BDI)



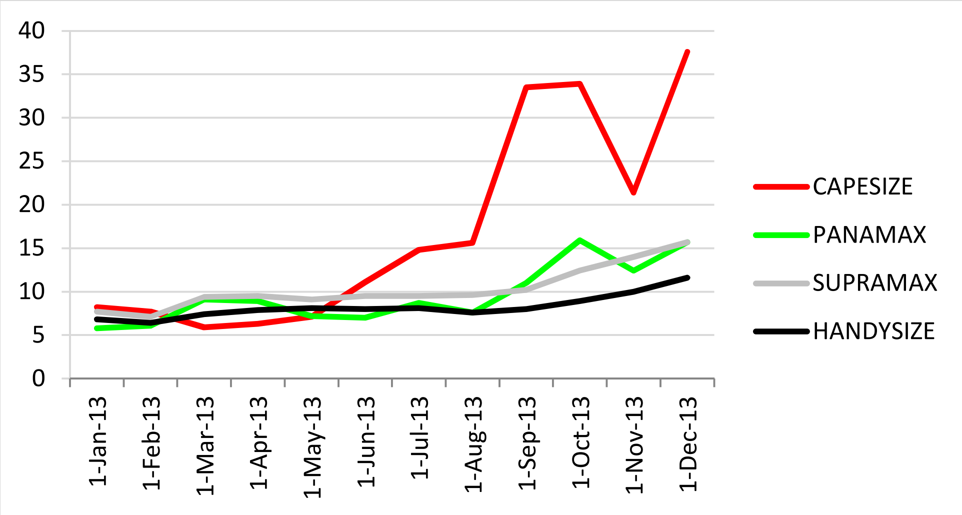
Source: Bloomberg, MIDFR

Dry Bulk Shipping

- **Spike in BDI due to iron ore and coal imports**. With China's global steel production now accounts for circa 50% of global output, the production level of steel in China is likely to have a profound impact on the world's iron ore seaborne trade. As at end of 2013, the total inventories of imported iron ore in China's ports stood at 81.3mmt (figure 4), expanded by +9.8mmt or 13.7% as compared to the first half of the year. China's monthly iron ore and coal imports maintained its upward trajectory (figure 5) with a record import of 77.8mmt in November 2013. We expect the ramping up of steel production in China to support the import demand of iron ore and thus spur the global dry bulk shipping volume higher.
- **Capesize benefited the most in BDI rally**. The spot rate for Capesize class vessels, which is the largest type among the dry bulk carriers with typical hauling of 160,000mt, surged to USD30-40k/day (figure 2) since September 2013 from USD10k/day during the first half of 2013. The surge in Capesize rate had a spill-over effect towards other segments of smaller size vessels which slowly experienced some upward rate movements. We opine that China's urbanization and infrastructure projects would continue to support the demand of dry bulk commodities in the coming years.

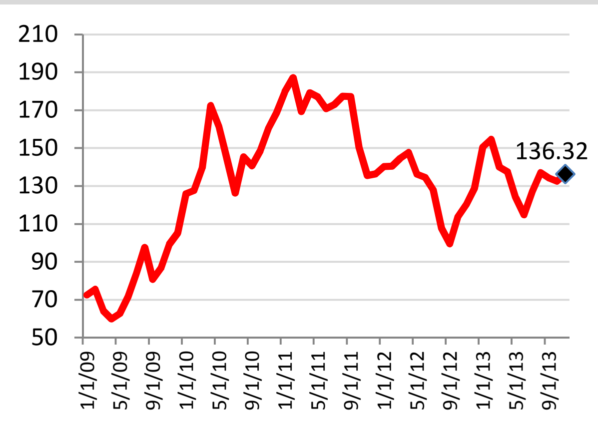
- **Expect softening in iron ore prices**. As the major iron ore producers like BNP Billiton, Vale and Rio Tinto continued to increase their mining production, the supply surplus will exert downward pressure in iron ore price. The price of iron ore is expected to drop by 15% in 2014 (source: Goldman Sachs) based on its current downward-slopping forward curve. This cheaper cost of iron ore imports as compared to China's domestic production would be a positive factor to drive the growth of dry bulk shipping volume.
- **Healthier demand-supply gap**. On the supply side, total deliveries for dry bulk vessels is expected to reach 40-45m dwt in 2014 (source: Platou shipbroker report) while the scrapped tonnage is forecasted at 15m dwt hence resulting in circa 4% net fleet growth. As at end of November 2013, the current orderbook of dry bulk carriers stood at 19.4% from the global total fleet supply of 706m dwt. For 2014, the growth in tonnage demand of dry bulk shipping is expected at 5-7%, outpacing the net fleet growth. The structural glut in dry bulk shipping accumulated in earlier years should ease further with these healthier demand-supply factors.

Figure 2: Weekly Average of Spot rate for Bulk Carriers, (USD'000/day)



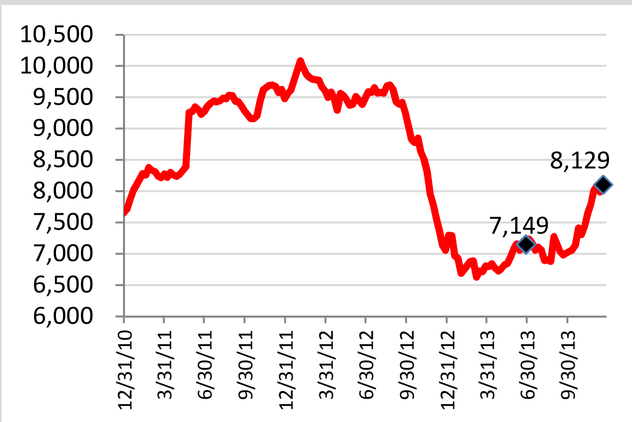
Source: Platou, MIDFR

Figure 3: Tianjin Port Iron Ore Price, USD/pmt



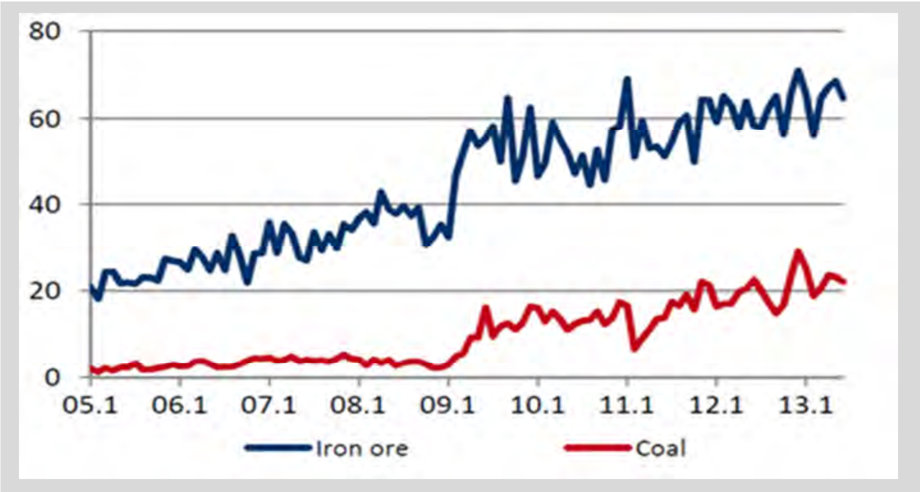
Source: Bloomberg, MIDFR

Figure 4: Weekly Inventory Level of China's Iron Ore, 10,000 tons



Source: Bloomberg, MIDFR

Figure 5: China Customs Iron Ores and Coal Total Imports, mmt

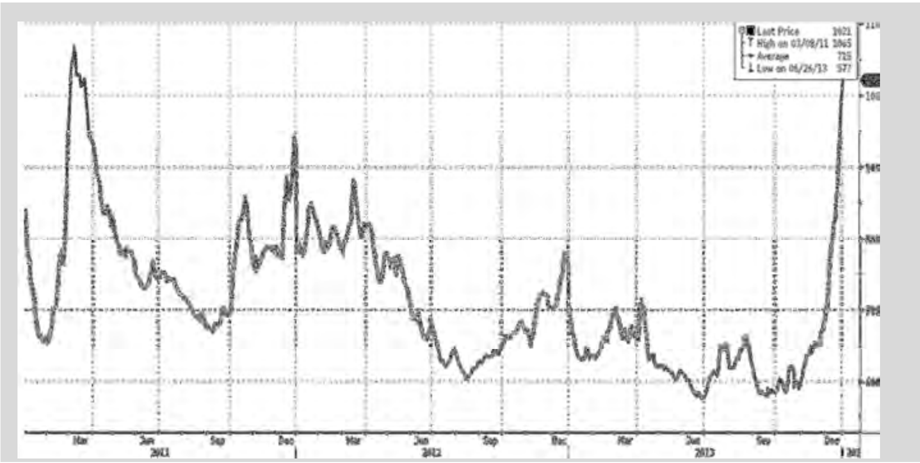


Source: Platou, MIDFR

Tanker Shipping

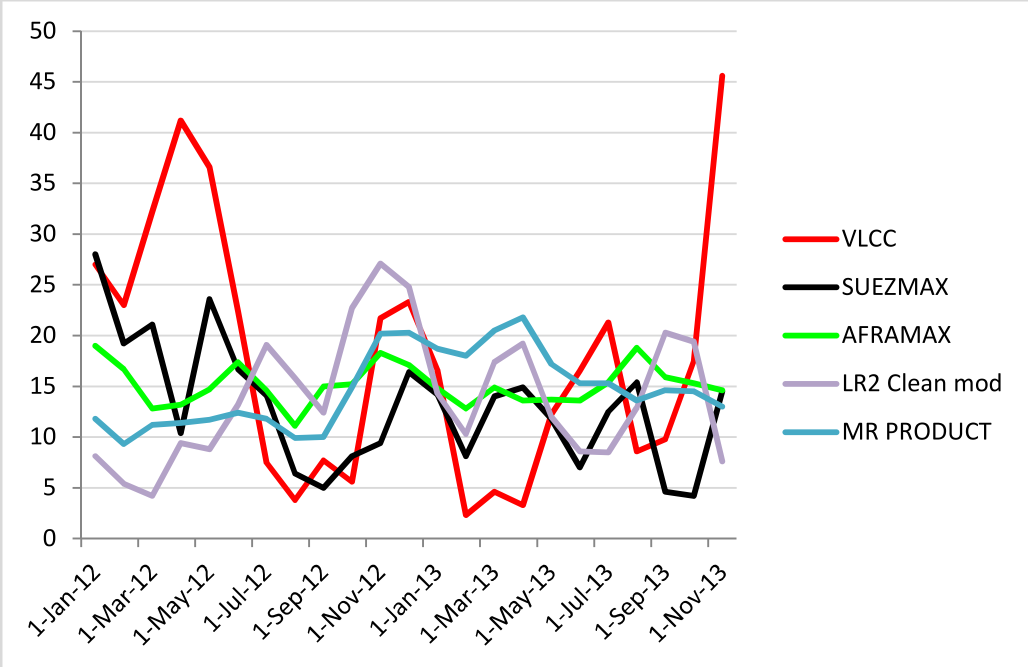
- **Year-end spike in VLCC rate**. Partly driven by the seasonal factor, the Baltic Dirty Index (BDIY) had skyrocketed to 3-year historical high at 1,026 index points (figure 6) in early January 2014. The spot VLCC rate rose to USD40-50k/day in December 2013 from the beginning of the year level at below USD10k/day (figure 7). The smaller sized vessels like Aframax tanker performed relatively consistent at around USD13-15k/day. We view that the daily current VLCC rate of above USD40-50k is unsustainable due to the prevalence of capacity glut.
- **Changing oil transportation landscape**. The falling oil import demand and booming domestic shale oil production in the US have profound impacts on the world oil trade pattern. The crude oil shipments from West Africa to US are declining and the West African's oil is re-routed to developing Asian countries, which caused freight rate divergence between the VLCC and Suezmax tanker. The VLCC will be used more frequently than Suezmax for the route from West Africa to East Asia countries due to economic reason.

Figure 6: Baltic Dirty Index



Source: Bloomberg, MIDFR

Figure 7: Monthly Average of Spot rate for Crude Tankers, (USD'000/day)



Source: Platou, MIDFR

Stock Recommendations:

MISC (Maintain NEUTRAL, TP: RM5.35)

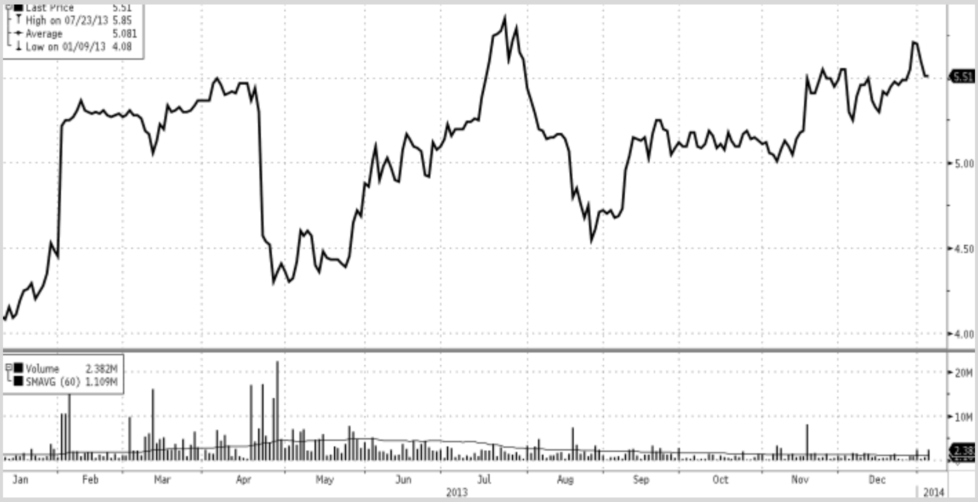
- The crude tanker business remains a drag on MISC's earnings due to vessels overcapacity issue. We believe that recent surge in spot VLCC rate to USD40-50k/day is unlikely to be sustainable as it was driven more by the seasonal factor. Nonetheless, MISC's losses in petroleum shipping will be partially offset by the steady contribution in other segments such as LNG shipping and offshore division. Hence, we reiterate our NEUTRAL stance on MISC with an unchanged TP of RM5.35. Our TP is valued based on the Sum-of-Parts method, which is pegged to FY14 EPS.

Maybulk (Maintain NEUTRAL, TP: RM1.90)

- We expect that Maybulk stands to gain from the upturn in dry bulk shipping cycle in 2014. Hence the operating losses in its dry bulk segment should narrow further. There is no public announcement as yet with regard to the IPO listing of its POSH associates. If Maybulk opts to sell its entire position in POSH group, it can expect to realise 25% gain over its original purchase price based on the original listing agreement.
- We favour Maybulk due to its net cash position and healthy delivery pipeline of vessels which will boost its earnings prospect during the recovery cycle of dry bulk sector. Nonetheless, we view that its share price has already priced-in the positive factors as it is now traded at 24x FY14 P/E as compared to its peers' average of 18.5x. Hence, we maintain our NEUTRAL stance on Maybulk with an unchanged TP of RM1.90. Our valuation is derived from Sum-of-Parts method.

DAILY PRICE CHART

MISC



Maybulk

Chua Boon Kian
Chua.bk@midf.com.my
03-2173 8393

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MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS	
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.