

Asia Pacific shipping

Prolonged oversupply

Name	Ticker	Rec	Mkt cap		Price	PT	Up/ (dn) %	PBR (x)		ROE (%)		Dividend yield (%)	
			(US\$m)	Ccy				2011E	2012E	2011E	2012E	2011E	2012E
China COSCO	1919 HK	UP	4,311	HKD	3.3	2.70	(17.9)	0.7	0.7	(13.9)	(10.6)	0.0	0.0
CSCL	2866 HK	UP	1,933	HKD	1.3	1.00	(22.5)	0.5	0.5	(9.7)	(12.5)	0.0	0.0
CSD	1138 HK	OP	1,940	HKD	4.4	7.30	64.4	0.5	0.5	3.8	5.8	1.4	2.3
Hanjin Shipping	117930 KS	IL	593	KRW	8,070	8,500	5.3	0.4	0.6	(21.3)	(25.2)	0.0	0.0
MISC	MISC MK	IL	8,606	MYR	6.1	6.70	9.8	1.2	1.2	3.1	4.7	4.1	4.1
NOL	NOL SP	IL	2,019	SGD	1.0	1.00	(2.4)	0.7	0.8	(7.9)	(7.9)	0.0	0.0
OOIL	316 HK	OP	2,709	HKD	33.8	47.00	39.3	0.6	0.6	4.7	5.5	2.0	2.2
Pacific Basin	2343 HK	IL	917	HKD	3.3	3.60	8.8	0.5	0.5	1.9	3.3	2.6	3.2
SITC	1308 HK	OP	554	HKD	1.7	2.80	81.3	0.9	0.8	15.4	15.6	6.4	7.1

Share prices as of 24 Nov 2011

Source: Companies, Bloomberg, Standard Chartered Research estimates

- Shipping sector valuations have approached historical troughs, which we think provide good opportunities for long-term value investors. However, we see little improvement in sector fundamentals.
- For the next 12 months, we expect dry bulk shipping will still be troubled by overcapacity and container shipping will be depressed by weak demand. The shipping sector, usually a bull-cycle play, will be hard put to perform without government stimulus or liquidity release.
- We prefer profitable and defensive stocks with cheap valuations. We continue to like CSD and OOIL, and initiate coverage on SITC with an Outperform rating.
- **Container shipping is demand driven:** With a normalised capacity CAGR of 8% in 2011-2013E, macro-led trade demand should drive the sector. While we see likely better trans-Pacific trade in 2012, Asia-Europe rates are likely to remain poor, due to slowing demand, price competition initiated by Maersk and more large vessels being delivered and ordered. Given limited collaborative capacity control this time, we think the sector trough will extend into 2012.
- **Dry bulk shipping – supply moderating in 2013E:** For the next 6–9 months, China's ore imports are likely to weaken on slowing property construction, yet we think demand should improve from Q3 2012 if the country eases its macro tightening policy. With new deliveries decelerating more in 2013, oversupply in dry bulk shipping will likely remain in 2012.
- **Energy shipping:** With the smallest order book among the shipping sub-sectors, tankers have been affected by weak demand from Western countries. We believe product tankers will recover earlier than crude tankers in 2012.
- **Valuations:** Valuations (PBR) for most shipping companies are close to their historical troughs. We believe long-term investors should watch and buy the stocks once they become cheaper than 0.4x PBR. For the next 12 months, we prefer profitable defensive plays with better capital protection: 1) SITC as a strong proxy for growth in intra-Asia trade and China's logistics sector; 2) CSD, whose business is largely secured by long-term contracts; and 3) OOIL, which outperformed its peers in the last three trough cycles on strong yield management.

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Important disclosures can be found in the Disclosures Appendix

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Executive summary

The shipping industry is a textbook case of a cyclical sector. It is now in an extended trough and there appears no light at the end of the tunnel. Shipping stocks have reached trough valuations; however, regardless of where the current point is in the cycle, long-term investors should buy stocks they perceive to be strong long-term survivors. We pinpoint the key trends that will likely dominate the sector in the next few years, the key catalysts most likely to turn it around, and potential Asia outperformers.

Container shipping

- **Freight rates driven by weak economic cycles in the US and Europe:** We believe current low freight rates are largely due to weak consumption in the US and Europe, as our estimated 2011–13 supply CAGR of 8% generally balances out our forecast demand CAGR of 7% during the same period. However, mega vessels, the key capacity growth driver, can only be deployed on long-haul routes, where demand has been hit the hardest by the troubled Western economy. We see no positive signs of a turnaround in demand yet.
- **Capacity competition our largest concern:** Given the advantage of a lower unit cost achieved by operating a larger average fleet size, Maersk (NR) recently initiated price competition to try to squeeze competitors out of the container business or push them off the Asia-Europe routes. This forced other liners to compete by ordering more large vessels in order to reduce unit costs, thus exacerbating the oversupply. We are concerned that the sector has entered a vicious circle.
- **Structural growth for intra-Asia trade:** Despite the weak Western economy, domestic consumption within emerging countries has supported strong intra-Asia trade. Large vessels rarely cascade into the intra-Asia region as they are simply too large to be economical. Asian carriers' intra-Asia business appears to be profitable and is growing.

Dry bulk shipping

- **Capacity adjustments take 2-3 years:** The dry bulk sector has seen unwieldy order book growth accumulation since 2007. While capesize rates dropped below their implied running costs this year, we saw scrapping rates rise to 4%. Given sustained high levels of delivery until 2012, we believe adjustments to supply may take at least another year to happen.
- **In the long run, China needs to import more ore:** We remain confident that China's long-term demand for iron ore and coal will continue to grow. With the declining quality of domestically produced ore – now representing 50% of China's usage – we believe imports will surely grow with replacement demand and the rise of China's economy.
- **China's property tightening to affect short-term demand:** For the next 6–9 months, our concern is slowing steel demand in China, given the macro tightening aimed at cooling the property sector and reducing FAI new projects. Although cheaper international iron ore prices have encouraged more imports, a likely lower steel output in H1 2012 should inhibit bulk demand and the bulk trade.

Energy shipping

- **Demand recovery is key for crude tankers:** Tanker supply growth is mild and capacity concerns have been contained, given the phase-out and vessel conversion of many single-hull tankers in 2010–11. However, tanker demand is driven more by the Western economy and oil consumption has been hurt by oil price hikes since 2006. We believe tanker rates will only improve marginally in 2012.
- **Product tanker to recover:** Product tanker rates held up well in 2011 and we expect rate recovery in 2012, given the constrained supply growth.



- **LNG shipping oversupply:** The global LNG fleet is expanding much faster than LNG trade demand over 2009–11E, despite rising LNG demand and extended trading distance. Deliveries should be severely constrained in 2012 but then it will take a long time to absorb the excessive capacity that has accumulated over the last three years.

Stock recommendations

During a long trough, shipping companies may make losses that are larger and for longer than expected. Although we are comfortable with the valuations and the large discounts to book value, we anticipate forward book value may be eroded by further losses. In our stock picks, we prefer carriers that can protect their capital in a tough operating environment.

- **China Shipping Development (1138HK, OP, HK\$4.44, PT HK\$7.30):** Some 65% of CSD's business is guaranteed by long-term contracts. We expect the company to remain profitable during the dry bulk and tanker cycle trough. The contracts also protect asset value. CSD is trading at 0.5x PBR (cheaper than its loss-making peers), which we think is undervalued.
- **SITC (1308HK, OP, HK\$1.66, PT HK\$2.80):** SITC is a pure intra-Asia container carrier, which has half its profits generated by the logistics business. Its unique business model ensures high utilisation rates for vessels and it has captured well the growth of intra-Asia trade driven by domestic consumption. The share price corrected by nearly 70% since the IPO one year ago during a weaker-than-expected container cycle and we believe 6x PER 2012E is compelling.
- **OOIL (316HK, OP, HK\$33.75, PT: HK\$47):** OOIL has achieved a better yield for its regional competitors due to tight capacity control. It also outperformed its peers in the last three trough cycles and made losses only in 2009. Its strong balance sheet, supported by the sale of the property division in 2010, enables capacity expansion. OOIL, trading at 0.6x PBR, is a safe play for the sector's recovery in the long run, we believe.

Risks

We highlight the following risks to our negative view on the shipping sector:

- Stronger-than-expected global economy, which may boost global trade volume and change market sentiment.
- Material loosening of China's macro policy, which will boost iron ore and steel demand.
- The collapse of iron ore prices, which trigger higher-than-expected ore imports from China.

Fig 1: Earnings and price target changes

Company	Ticker	Rec		Price target		EPS (reporting currency)					
		New	Old	New	Old	New			Old		
						2011E	2012E	2013E	2011E	2012E	2013E
China COSCO	1919 HK	UP	UP	HK\$2.7	HK\$3.6	(0.60)	(0.40)	0.39	(0.59)	(0.14)	(0.44)
CSCL	2866 HK	UP	IL	HK\$1.0	HK\$2.0	(0.23)	(0.27)	0.24	(0.13)	(0.06)	0.27
CSD	1138 HK	OP	OP	HK\$7.3	HK\$7.3	0.23	0.40	0.89	0.33	0.5	0.97
Hanjin Shipping	117930 KS	IL	IL	KRW8,500	KRW35,000	(5,554)	(4,837)	4,398	2,138	4,789	4,067
MISC	MISC MK	IL	IL	RM6.7	RM7.6	0.15	0.24	0.35	0.15	0.24	0.35
NOL	NOL SP	IL	OP	S\$1.0	S\$2.5	(0.07)	(0.09)	0.10	0.16	0.22	0.22
OOIL	316 HK	OP	OP	HK\$47.0	HK\$57.0	0.35	0.38	0.95	0.33	0.70	1.42
Pacific Basin	2343 HK	IL	IL	HK\$3.6	HK\$4.0	0.02	0.03	0.04	0.02	0.03	0.05
SITC	1308 HK	OP	NA	HK\$2.8	NA	0.03	0.04	0.06	N/A	N/A	N/A

Source: Companies, Standard Chartered Research estimates



Fig 2: Container shipping comps

	Rating	Code	Share price	Price target	PBR (x)			PER (x)			Dividend Yield			ROE		
					2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
China COSCO	UP	1919 HK	HK\$3.29	HK\$2.70	0.7	0.7	0.7	(4.4)	(6.7)	6.5	0.0%	0.0%	4.1%	(14%)	(11%)	10%
CSCL	UP	2866 HK	HK\$1.29	HK\$1.00	0.5	0.5	0.5	(4.4)	(3.8)	4.2	0.0%	0.0%	12.8%	(10%)	(12%)	11%
OOIL	OP	316 HK	HK\$33.75	HK\$47.00	0.6	0.6	0.6	12.4	11.3	4.6	2.0%	2.2%	5.5%	5%	5%	13%
NOL	IL	NOL SP	SGD 1.03	SGD 1.00	0.7	0.8	0.8	(11.0)	(9.7)	9.0	0.0%	0.0%	2.0%	(8%)	(8%)	9%
SITC	OP	1308 HK	HK\$1.66	HK\$2.80	0.9	0.8	0.7	6.2	5.6	3.6	6.4%	7.1%	11.1%	15%	16%	22%
Evergreen	NR	2603 TT	NT\$14.70	NA	0.8	0.8	0.7	875.4	31.5	9.7	1.4%	1.6%	2.1%	0%	3%	8%
Yang Ming	NR	2609 TT	NT\$10.80	NA	0.9	0.9	0.9	(5.1)	(18.5)	10.3	1.6%	0.4%	2.1%	(14%)	(4%)	9%
Wan Hai Lines	NR	2615 TT	NT\$13.05	NA	0.9	0.9	0.8	29.0	15.8	12.2	3.4%	3.2%	2.8%	3%	6%	8%
Hanjin Shipping	IL	117930 KS	KRW 8,070	KRW 8,500	0.4	0.6	0.4	(1.5)	(1.7)	1.8	0.0%	0.0%	5.4%	(21%)	(25%)	30%
Hyundai	NR	011200 KS	KRW 23,000	NA	1.4	1.2	1.1	(32.2)	15.3	8.8	1.6%	1.7%	1.7%	4%	12%	16%
Nippon Yusen	NR	9101 JP	JPY 154.00	NA	0.4	0.4	0.4	(29.9)	22.9	7.4	2.1%	2.1%	3.6%	(1%)	2%	5%
Kawasaki	NR	9107 JP	JPY 119.00	NA	0.3	0.4	0.3	(3.9)	(15.3)	10.3	0.2%	1.2%	3.6%	(8%)	(2%)	3%
Mitsui OSK	NR	9104 JP	JPY 220.00	NA	0.4	0.4	0.4	(56.3)	15.0	6.9	1.5%	2.0%	3.1%	(1%)	3%	6%
Sector average					0.7	0.7	0.6	59.6	4.7	7.3	1.6%	1.7%	4.6%	(4%)	(1%)	12%

Consensus estimates for non-rated stocks

Priced at 24 November 2011

Source: Bloomberg, Standard Chartered Research estimates

Fig 3: Bulk shipping comps

	Rating	Code	Share price	Price target	PBR (x)			PER (x)			Dividend Yield			ROE		
					2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
China COSCO	UP	1919 HK	HK\$3.29	HK\$2.70	0.7	0.7	0.7	(4.4)	(6.7)	6.5	0%	0%	4%	(14%)	(11%)	10%
Pacific Basin	IL	2343 HK	HK\$3.31	HK\$3.60	0.5	0.5	0.5	18.6	15.5	11.7	3%	3%	4%	2%	3%	4%
CSD	OP	1138 HK	HK\$4.44	HK\$7.30	0.5	0.5	0.4	15.6	9.0	4.1	1%	2%	5%	4%	6%	12%
STX Pan Ocean	NR	028670 KS	KRW 5,580	NR	0.5	0.5	0.5	(12.8)	32.1	7.3	1%	1%	2%	(4%)	1%	6%
Sinotrans	NR	368.HK	HK\$1.93	NR	0.4	0.4	0.4	9.8	9.1	7.5	1%	1%	1%	5%	5%	6%
Thoresen Thai	NR	TTA TB	BHD 16.50	NR	0.4	0.4	0.4	NA	18.4	9.9	2%	3%	3%	(1%)	2%	5%
PSL	NR	PSL TB	BHD 14.70	NR	0.9	0.9	0.9	18.3	10.4	8.4	4%	5%	6%	8%	9%	12%
Malaysian Bulk	NR	MBC MK	MYR 1.59	NR	0.9	0.8	0.8	13.0	12.4	10.2	6%	6%	7%	7%	7%	9%
Sincere	NR	2605 TT	NT\$25.35	NR	1.0	0.9	0.9	7.9	8.1	8.6	8%	7%	6%	14%	14%	13%
U Ming	NR	2606 TT	NT\$40.85	NR	1.3	1.3	1.3	14.7	17.2	15.6	5%	4%	5%	9%	8%	8%
Sector average					0.7	0.7	0.7	9.0	12.6	9.0	3%	3%	4%	3%	5%	9%

Consensus estimates for non-rated stocks

Priced at 24 November 2011

Source: Bloomberg, Standard Chartered Research estimates



Balance sheet and financing checks

- Vessel value appears to be attractive from a long-term perspective. We see limited downside risks for asset value for most kind of ships. However, assets dumped by distress carriers are possibly to trigger another lag down for vessel prices.
- Net gearing for Korean and Japanese container firms are high. Bulk carriers, however, have relative strong balance sheets, given the sector boom in 2004–08 and earlier locked-in charters.
- According to our ship finance team, ship finance is tight globally. Shipping companies expect higher funding costs next year.

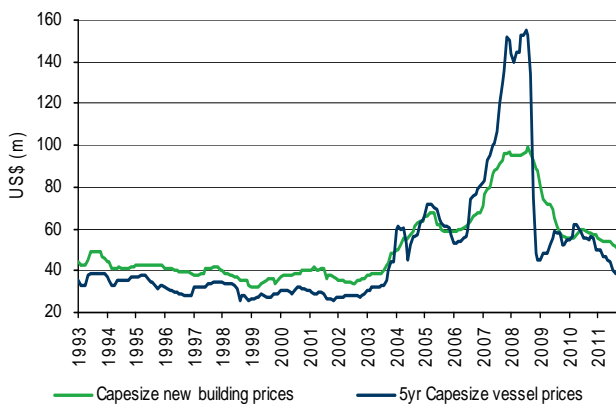
Possibly another slump in vessel value

If more ship owners enter financial distress in the next 24 months, we might see a further slide in vessel value

From a long-term value perspective, we should see limited downside for vessel value after large corrections in 2008. Second-hand vessel prices are highly correlated with freight rates and freight rates have already dropped below the cash breakeven level. If we see more ship owners entering financial distress in the next 24 months, we might see a further slide in vessel value as they dump their assets into the market in exchange for cash.

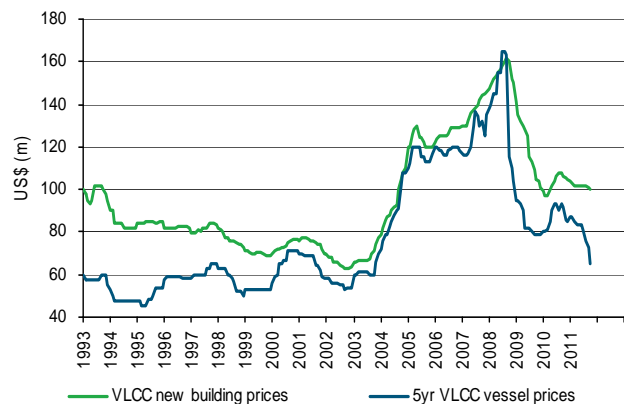
After the financial crisis in 2008, vessel prices have largely corrected. Second-hand container vessel prices declined by about 40% from the mid-2008 peak, while second-hand tanker prices have been slashed 50% and second-hand bulk vessel prices have collapsed by 80%. As dry bulk and tanker rates declined further in 2011, we saw capesize and second-hand crude tanker prices breaking through the 2009 floor.

Fig 4: Capesize vessel prices



Source: Clarksons, Standard Chartered Research

Fig 5: VLCC vessel prices



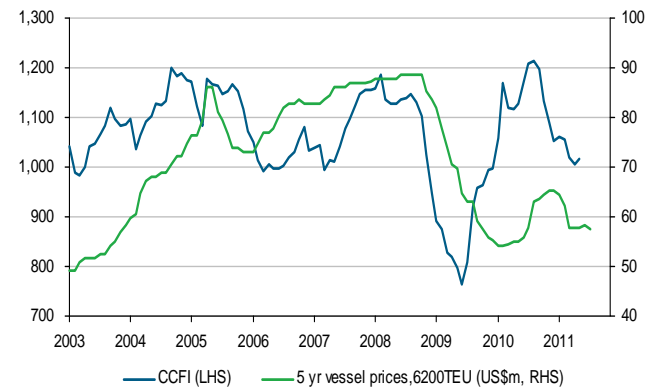
Source: Clarksons, Standard Chartered Research

Reviewing freight rates of the last 15 years and taking inflation into account that second-hand vessel prices have surely undervalued, based on the average return they can earn in the long run, we see limited downside for vessel prices if the sector improves in 2013 as we expect.

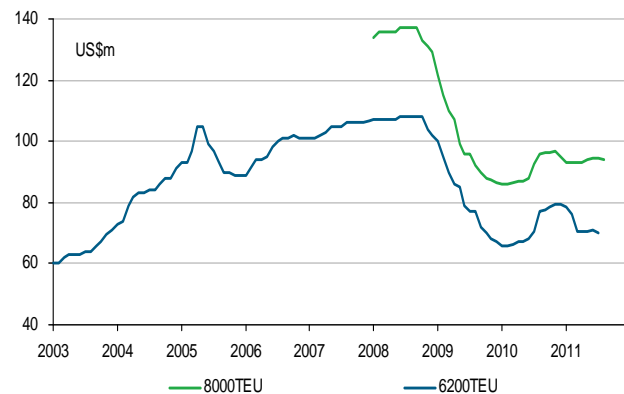
We believe the vessel prices of capesize carriers, VLCCs and containers of 6,000–7,000 TEU are under greater pressure. The first two have suffered excessive deliveries while the latter has a positioning issue as it might lose competitiveness in Asia-Europe or trans-Pacific routes.

We do not think price cuts are an efficient stimulus for ship demand when ship owners are making losses

Shipyards have received very limited orders in the last 12 months. However, their order books are sufficient for the next two years and we do not see them aggressively cutting prices in 2011, particularly at times when steel prices were rising. However, we think it is reasonable to expect container and offshore orders to largely disappear in 2012. New shipbuilding prices are under pressure but we do not think price cuts are an efficient stimulus for ship demand when ship owners are making losses.

Fig 6: Second-hand container vessel prices


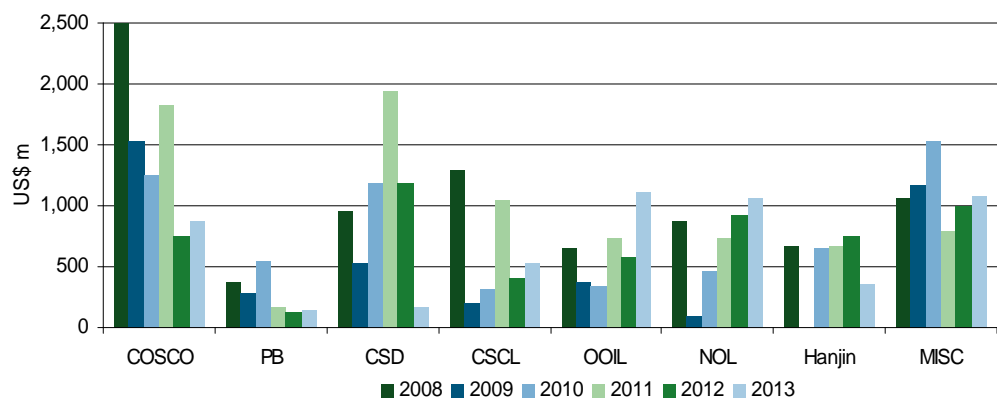
Source: Clarksons, Standard Chartered Research

Fig 7: New container ship prices


Source: Clarksons, Standard Chartered Research

Cash outflow: Capex burden and operating losses

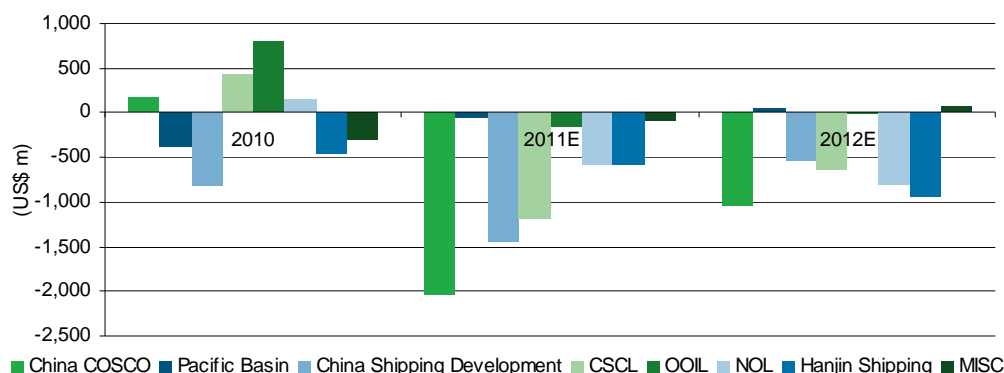
We do not see shipping companies under our coverage cutting capex. We consider them to be relatively strong players in their different shipping segments. They have been taking advantage of cheaper new building prices to acquire vessels. Chinese carriers remain more aggressive ship buyers than other global players. Container carriers are forced to add mega vessels to their fleet to maintain competitiveness.

Fig 8: Capex


Source: Companies, Standard Chartered Research estimates

Carriers are likely to make another yearly loss in 2012. We expect carriers to achieve a certain level of collaboration to boost rates

Carriers are likely to make another yearly loss in 2012. While current freight rates have dropped below the cash break-even level for the dry bulk (before the BDI rebound), container or tanker (before the seasonal rally after September) segments, we believe ship owners would have planned to idle more ships or cut cost to survive. Although the sector will not recover soon, we forecast smaller losses in H2 2012 versus H1 2012 and lower cash outflow for 2012 versus 2011, as we expect carriers will achieve a certain level of collaboration to boost rates or cut spending to protect their cash.

Fig 9: Free cash flow


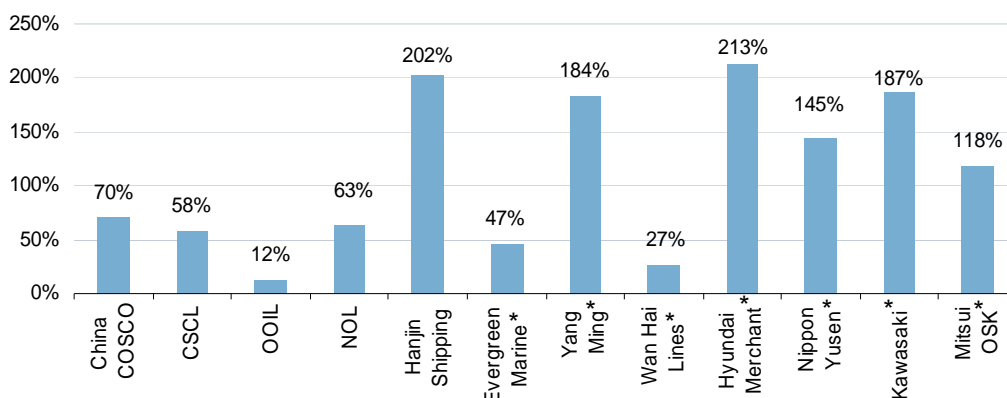
Source: Companies, Standard Chartered Research estimates

Balance sheet review

Any bankruptcies or acquisitions among the top 20 container carriers would significantly and structurally benefit the sector

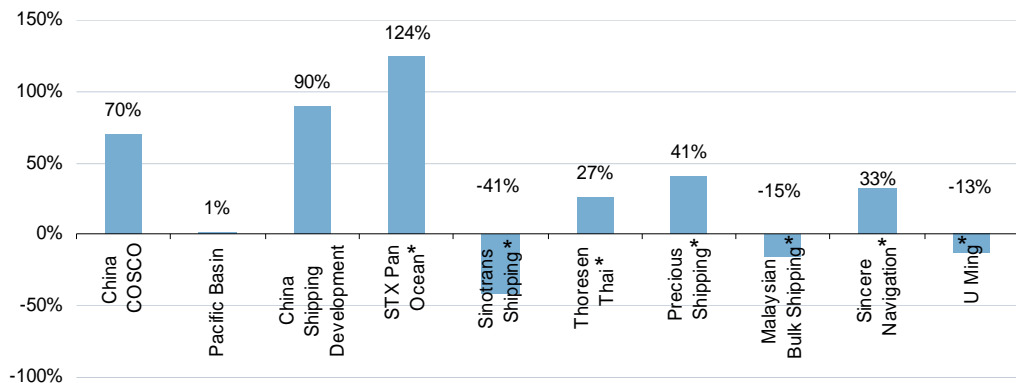
In the container segment in Asia, Yang Ming and the Japanese and Korean carriers have the highest net gearing, based on our and Bloomberg consensus forecasts. We understand CMA CGM and CSAV, two large container carriers, are close to experiencing financial distress yet are still receive funding support from banks. The collapse of any of the top 20 container carriers should significantly and structurally benefit the sector. However, government support has made bankruptcy more unlikely for major carriers. Hapag-Lloyd, which was saved by German banks in 2009, is a typical case.

Strong recovery in demand or disciplined capacity control may be an easier solution to boost freight rates, in our view.

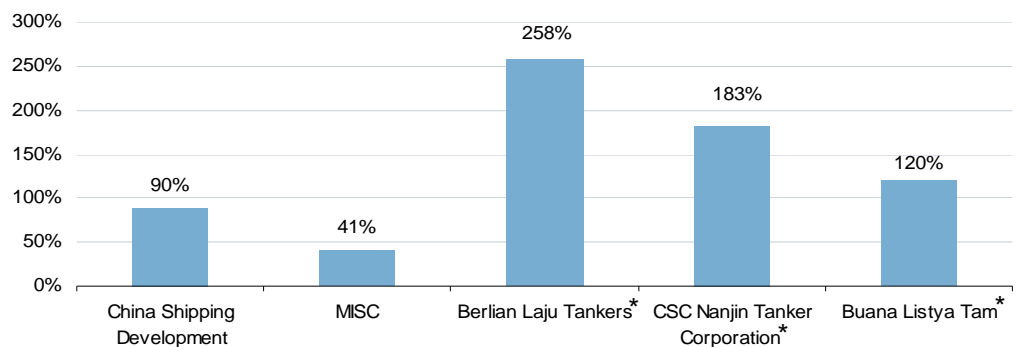
Fig 10: Net gearing, Asian container carriers (2012E)


*Bloomberg consensus forecasts
Source: Bloomberg, Standard Chartered Research estimates

Despite poor dry bulk shipping rates in the last 12 months, Asian listing bulk carriers, excluding STX Pan Ocean, have maintained a reasonably healthy balance sheet with low net gearing. We attribute this to: 1) very strong profits accumulated during the 2004–08 boom; 2) earlier locked-in charters which protect profits; 3) low exposure to chartered-in vessels; and 4) conservative capex plans since most of them are small.

Fig 11: Net gearing, bulk carriers (2012E)


*Bloomberg consensus forecasts
Source: Bloomberg, Standard Chartered Research estimates

Fig 12: Net gearing, tanker operators (2012E)


*Bloomberg consensus forecasts
Source: Bloomberg, Standard Chartered Research estimates

Checks with our shipping finance team

We spoke with our shipping finance team and shipping companies to understand the funding resources in the market. Our conclusions are as follows:

Funding sources to the shipping sector has narrowed and most shipping firms expect a rising funding cost

- **Liquidity is tight:** With a weak shipping market and troubled European banks (which traditionally own large ships on their finance books), funding sources to the shipping sector have dwindled and most shipping firms expect rising funding costs.
- **Selective ship financing:** Banks are now cautious about funding new ships and have been more stringent on criteria such as shipping companies' balance sheets, charter profiles and business models. However, the ship type is not a concern with most segments being weak.

Shipyards in Korea and China are selective when rendering help to customers that fail to pay. The shipyards take ownership of newbuilds ordered by defaulting customers and charter the ships to them until they obtain bank funding to purchase back the ships. The risks are well secured by high down payments.

- **Local bank support:** We believe that in Asia, most local banks continue to support local shipping companies as they are asset-heavy enterprises and usually well connected to the government. We hear of tighter financing for Korea, Hong Kong and Chinese private shipping firms but not for those in other Asian countries.



Container supply: Unit cost competition

- A global container capacity CAGR of 8% over 2011–13E is not particularly high if the global economy were to normalise. The largest concern is the distribution of capacity as mega vessels are deployed only on Asia-Europe routes.
- Liners in 2011 have been competing on unit cost on Asia-Europe routes since Maersk initiated a price war by squeezing high-cost players out of the container business or out of the Asia-Europe trade. Liners have been forced to purchase more mega vessels to lower unit costs, leading to further overcapacity on these routes.
- Without a strong recovery in long-haul demand, capacity discipline by major liners will be necessary – such as enhancing ship idle or sector consolidation – in order to boost freight rates and cure sector oversupply.

Capacity growth decelerating yet is not particularly low

We forecast global container capacity will grow 9%, 8% and 7% in 2011, 2012, and 2013, respectively

We forecast global container capacity will grow 9%, 8% and 7% in 2011, 2012 and 2013, respectively, based on our updated fleet model. More liners have placed new orders between H2 2010 and H1 2011, leading to more deliveries in 2013, although liners are likely to drag some deliveries to 2014, in our view, given the weaker-than-expected global economy, disappointing peak season, and possible more losses to take effect over the next few quarters.

Fig 13: Container capacity growth

'000 TEU	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Order book						1,623	2,003	1,518	1,528	1,656	669
Delays / cancellations						523	632	228	153	331	-
%						32	32	15	10	20	0
Net deliveries	625.3	911.5	1,366.2	1,319.3	1,479.5	1,100.2	1,371.6	1,290.1	1,375.5	1,324.7	834.7
Scrapping	4.0	1.1	22.4	23.8	100.0	337.7	126.7	43.8	108.0	83.5	53.8
%	0.1	0.0	0.2	0.2	0.8	2.6	0.9	0.3	0.6	0.5	0.3
Fleet	7,132	8,044	9,350	10,690	12,151	12,933	14,178	15,424	16,692	17,933	18,714
Net growth (YoY %)	9.5	12.8	16.2	14.3	13.7	6.4	9.6	8.8	8.2	7.4	4.4

Source: Clarksons, Drewry, Alphaliner, Standard Chartered Bank estimates

During the 2001–08 super cycle, global container trade volume had a CAGR of 11%. It was driven by globalisation and the accompanying trend of outsourcing to China. Despite the maturing cycle, we expect over the next few years, we consider a trade CAGR of 7–8% to be no exaggeration. And a container capacity CAGR of 7–8% is not particularly high if global economy were to normalise.

Unit-cost competition triggered a price war

Maersk initiated a price war to gain cost advantage

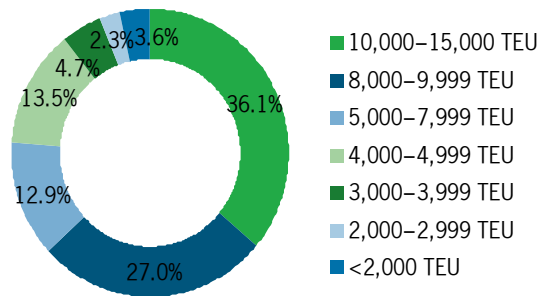
However, the distribution of capacity is our major concern. The concentration of mega vessels on Asia-Europe routes have led to oversupply on these routes since such vessels are hardly deployed on other routes. We worry that carriers have entered a vicious circle and would be forced to order more and larger vessels to maintain unit-cost competitiveness in Asia-Europe trade. Unfortunately, lower unit costs also pull down Asia-Europe shipping rates.

Continued capacity competition in Asia-Europe trade is our largest concern for the sector

We attribute this as a major reason for extremely low Asia-Europe rates in 2011, despite volume growth of 6–7%. Price competition was initiated by the world's largest liner, Maersk, in Q2 2011. Maersk enjoys better economies of scale and lower unit costs than its peers, given its larger average fleet size and sufficient cargo sources to fill large ships. Its profitable margin in Q2 allows Maersk to further cut freight rates strategically to squeeze some competitors out of the Asia-Europe trade (those with vessels smaller than 10,000 TEU) or out of the container business altogether.

We have two worries: 1) that Maersk will maintain its low freight rate strategy until weak competitors are dragged out of the container business by cash flow problems; 2) that all liners will be forced to buy more and larger vessels (+10,000TEU) to stay cost competitive, leading to longer and deeper oversupply not only for Asia-Europe trade but for the container shipping sector.

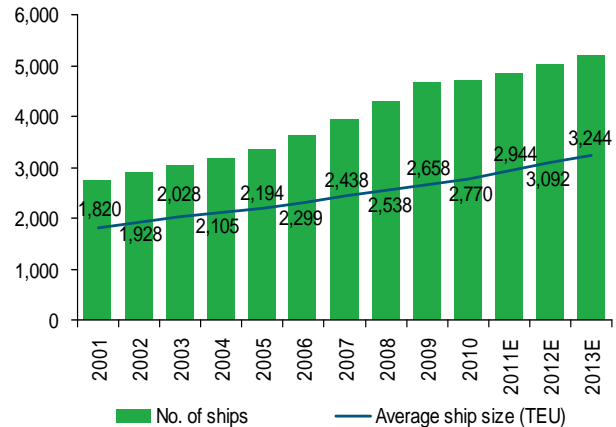
Fig 14: Order book breakdown by size



Legend: segments listed clockwise from top

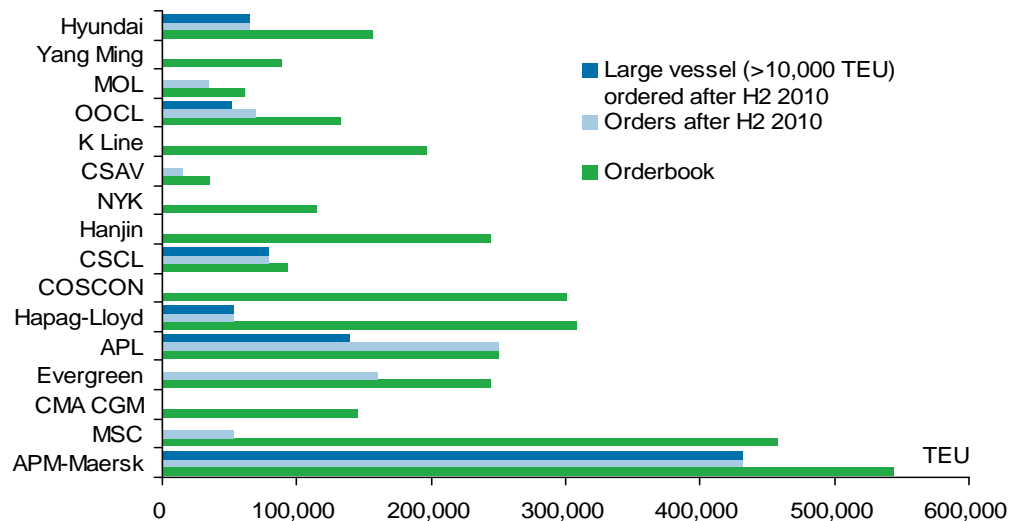
Source: Alphaliner, Clarksons, Standard Chartered Research estimates

Fig 15: Average size of global container fleet



Source: Alphaliner, Standard Chartered Research estimates

Fig 16: New orders by carriers (2010–present)



Source: Companies, Clarksons, Standard Chartered Research estimates

Solutions: Sector discipline or sector consolidations

We believe enhanced ship idle could improve the sector outlook

Without a strong recovery in long-haul demand, we see two solutions to improve the sector's poor profitability. In the short term, container liners should idle more ships to boost freight rates and cut their losses. We believe this type of capacity discipline is required for all major carriers. If the low rates persist long enough, we might see sector consolidation with some carriers entering financial distress or being acquired.

Ship idle

With freight rates, particularly on Asia-Europe routes, slipping below the cash break-even level and some carriers starting to record a negative EBITDA margin from Q3, carriers will need to boost their freight rates to survive. Given the continued weak demand for global trade, liners can only control capacity to reduce the oversupply gap. In the long run, we believe liners should let inefficient capacity idle sustainably to solve sector oversupply.

With the end of the peak season, idle capacity is only 3% now, versus the peak of 11% in Q1 2009. Liners have prepared for their winter programme by dry-docking more vessels in Q4; however, only a few we spoke to plan an exceptional ship lay-up to effectively lower capacity. The sector still lacks capacity discipline, with no carrier willing to withdraw capacity before other competitors do.



Sector consolidation

We believe further sector consolidation is positive for the sector and should raise the liners' pricing power. As of November 2011, the largest 10 container carriers control only a 65% global market share by capacity; increasing industry concentration should help boost sector profitability.

We heard of a few likely sector consolidation opportunities, although they may not happen so soon, according to our channel checks:

- CMC CGM, the world's third-largest container liner, is known in the market to have a cash flow issue. The company held cash of US\$1.7bn as of end June 2011 while also being in debt by US\$5.7bn. It has applied a few measures to ensure cash flow by targeting to reduce spending by US\$400m in 2012, and selling or leasing back its vessels.
- CSAV, Chile's largest cash-strapped container liners, raised US\$430m in a share sale in April 2011 and received approval in October to raise a further US\$1.2bn in another share sale. The major shareholder, the Luksic family, will take the majority of the new shares and continue to support the carriers towards a turnaround.
- The three largest Japanese carriers, Nippon Yusen, Kawasaki and MOL, are studying the prospect of spinning off their container shipping segments and to merge them as one container operator. This plan has been discussed during several trough cycles over the last 10 years but has yet to be executed. Such a move makes economic and strategic sense and we regard it as positive for the sector if realised.

Fig 17: Top 20 container liners – by capacity

Rank	Operator	Current capacity		Order book		% of existing
		TEU	Ships	TEU	Ships	
1	APM-Maersk	2,508,995	657	538,110	50	21.4
2	MSC	2,063,187	477	535,646	47	26.0
3	CMA CGM	1,352,810	403	70,070	8	5.2
4	COSCON	644,410	146	244,168	32	37.9
5	Hapag-Lloyd	642,696	147	132,000	10	20.5
6	Evergreen Marine	615,400	167	308,000	35	50.0
7	APL	607,031	146	300,880	29	49.6
8	CSCL	528,116	148	159,822	19	30.3
9	Hanjin Shipping	482,151	102	243,864	30	50.6
10	MOL	436,124	100	109,620	11	25.1
11	OOCL	412,760	88	132,576	12	32.1
12	NYK Line	412,169	104	61,908	6	15.0
13	Hamburg Süd Group	405,685	116	196,788	31	48.5
14	CSAV Group	388,609	86	36,000	4	9.3
15	Yang Ming Marine	346,981	84	89,038	14	25.7
16	K Line	341,837	79	45,200	5	13.2
17	Zim	327,197	93	153,216	13	46.8
18	Hyundai Merchants	295,249	61	156,075	15	52.9
19	PIL	269,411	143	78,400	22	29.1
20	UASC	231,533	55	104,800	8	45.3

Source: Alphaliners, Standard Chartered Research estimates



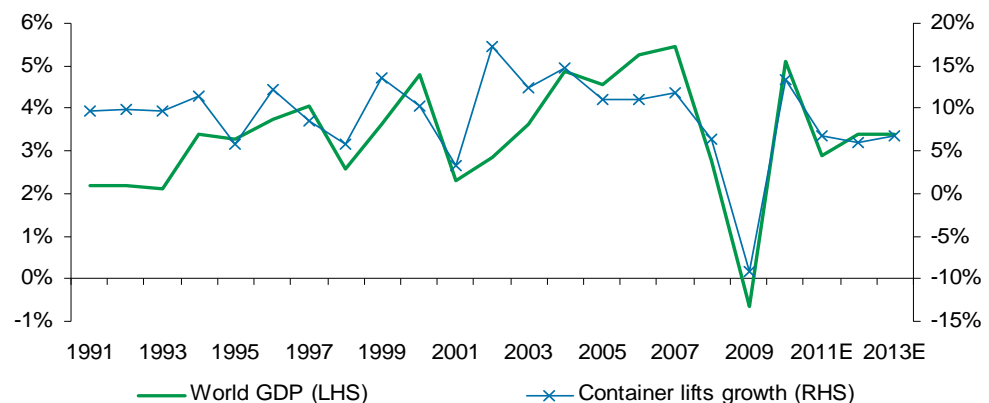
Container demand: Scenario analysis

- Our base-case scenario assumes a weak global economy in 2012, yet without recession assumptions. We believe global container trade will likely grow at a CAGR of 7% over 2011–13.
- However, given the structural change in the global economy, trade demand has gradually shifted to the intra-Asia region. We are likely to see 8–10% growth for intra-Asia trade versus 0–5% growth for trans-Pacific and Asia-Europe trade.
- According to our economic research team, Standard Chartered is more positive on the US economy than the European economy. We expect stronger trans-Pacific trade growth than Asia-Europe trade growth in 2012, due to the low base in 2011, possible inventory replenishment and healthier consumption.

Scenario analysis

The last 20 years has seen no negative container trade growth, excluding 2009, due to the credit crunch and the suspension of credit finance. Based on our analysis of the data for this span of time, container trade growth is equivalent to 3x global GDP growth. While we have experienced two super cycles in the last two decades (containerization and global outsourcing), in the recent two years, container trade growth was roughly 2.5x global GDP growth.

Fig 18: Global GDP growth versus container trade



Source: Companies, Clarksons, Standard Chartered Research estimates

Base-case scenario – 70% probability

We forecast container trade will grow 6.8% in 2011, despite the global GDP forecast of 2.9%, according to our economist. We attribute the smaller multiple to the high base effect in 2010, which was driven by re-stocking. Our economist forecasts global GDP will grow by 3.4% in 2012. Our base-case scenario, under which we conservatively apply a multiple of 1.8x, global trade would grow by 6% in 2012. We also forecast global trade will grow 7% in 2013.

Given the structural changes we expect (please see the next section), we expect intra-region trade, particularly intra-Asia trade, will be the major contributor to growth. We expect intra-Asia trade to grow 10% in 2012 and 12% in 2013, while we are likely to see only 4% growth in trans-Pacific trade and 0% growth in Asia-Europe trade in 2012. However, we understand that liners generate profits mainly from long-haul routes.

Our base-case scenario suggests low freight rates are likely to persist into 2012 before a recovery in 2013, assuming decelerating supply growth, gradual capacity control and an improving global economy in 2013. The market consensus has pegged a future scenario of losses for at least another three quarters to H1 2012; yet we expect only slight rate improvement during the peak season in 2012.

We forecast global trade growth of 7% in 2012 with Asia-Europe and trans-Pacific trade up 3% and 5%, respectively



Bear-case scenario – 20% probability

If the European debt issue worsens and leads to financial distress for more European banks or the US economy enters into recession in H1 2012, as expected by the Economic Cycle Research Institute (ECRI), we may see only flat growth for global trade in 2012 with limited recovery in 2013. Trans-Pacific and Asia-Europe trades are likely to see small negative YoY growth. The bear case implies an even larger loss in 2012 and that low profitability will persist into 2013.

Bull-case scenario – 10% probability

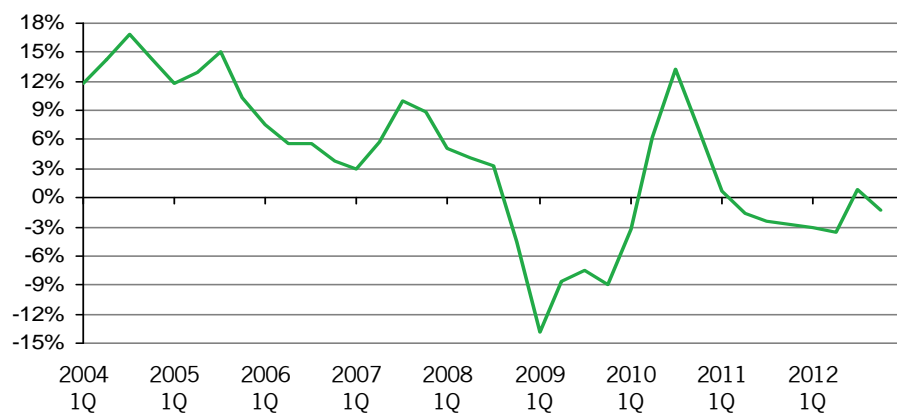
We make three assumptions under this scenario:

- The European debt issue could be amended by a political solution and does not drag down the economy
- The US recovers after a temporary suspension of growth for two quarters
- More liquidity will be released by global central banks

If these assumptions pan out, then global trade growth in 2012 are likely to beat consensus and our expectations. Under this scenario, we forecast container trade growth of 9% in 2012. We might see better-than-expected Christmas sales, Western consumption picking up and another run of inventory replenishment in March- April 2012 after the early Chinese New Year. Of course, Q4 2011 and Q1 2009 would obviously constitute the two dips of this full container shipping cycle.

Our bull-case scenario suggests container liners will turn profitable in 2012 and reach a new profit peak in 2013, before more newly ordered large vessels are delivered in 2014.

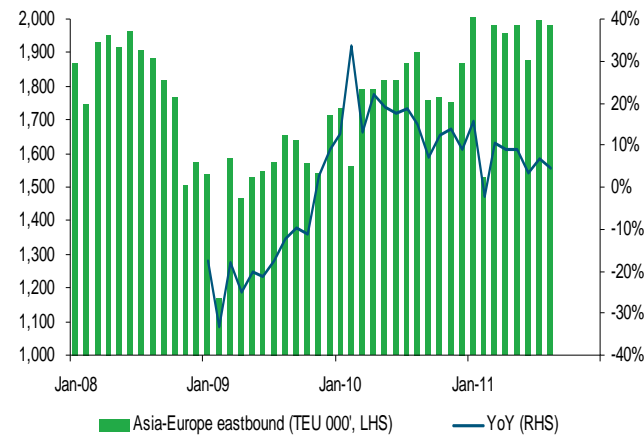
Fig 19: EBIT margin for liners under our base-case assumptions



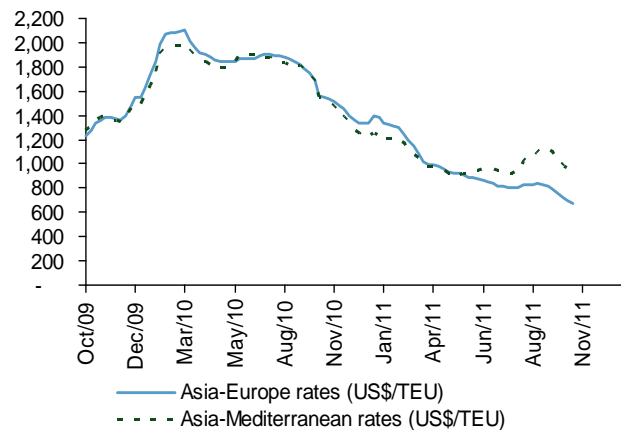
Source: NOL, Standard Chartered Research estimates

Likely better 2012 trade on trans-Pacific than Asia-Europe routes

Our US economists have downgraded their forecast GDP growth yet still believe in a steady and slow recovery in the US economy. They forecast 1.8% growth in 2011 and 2.2% in 2012, guiding to a larger improvement in 2012. While more welfare cuts in the European unions after the debt crisis is likely to further affect consumer spending, European consumption appears more vulnerable than American consumption. Before any policy changes that may affect the economic growth picture (the emergence of precise and less painful solutions for Greece debt and European bank issues or the likely QE3 implemented by the Fed) we expect better trans-Pacific trade than Asia-Europe trade in 2012.

Fig 20: Asia-Europe traffic growth


Source: Container Trades Statistics, Standard Chartered Research estimates

Fig 21: Asia-Europe rates


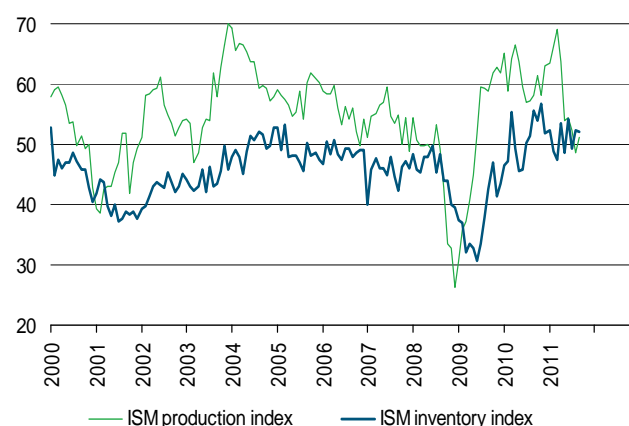
Source: Clarksons, Standard Chartered Research estimates

We see stronger volume growth for Asia-Europe trade than trans-Pacific trade in 2011

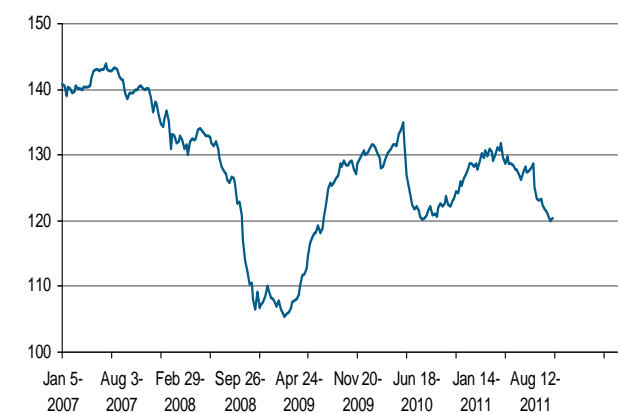
We see stronger volume growth for Asia-Europe trade than trans-Pacific trade in 2011. In the year to August, westbound Asia-Europe trade was up 7% YoY, while eastbound trans-Pacific volume was down 2% YoY. We attribute this to: 1) more aggressive inventory control by US retailers in Q3 2011 after the negative turn in the macro outlook, 2) the higher base in trans-Pacific trade due to re-stocking volumes in 2010; and 3) better demand from emerging European countries and the Mediterranean area.

Although our economists are more positive than the consensus, the overall economic outlook in 2012 remains gloomy. Most leading indicators have guided to weakening consumer confidence, manufacturing orders, employment rates and likely further consumption contraction in the US and Europe. Therefore, we now assume global trade growth of 6% in 2012, lower than our previous forecast of normal growth of 8%. Trans-Pacific and Asia-Europe trades are likely to see 0–5% growth, similar to 1998 and 2001, while intra-Asia trade should grow by nearly 10%, in our view.

In the last 20 years, global container trade has seen no negative growth, excluding 2009, due to a lack of credit finance after the Lehman's bankruptcy. We treat 2009 as an exception and see low possibility of that crisis case repeating in 2012.

Fig 22: US ISM data


Source: Bloomberg, Standard Chartered Research estimates

Fig 23: ECRI Index


Source: Economic Cycle Research Institute, Standard Chartered Research estimates

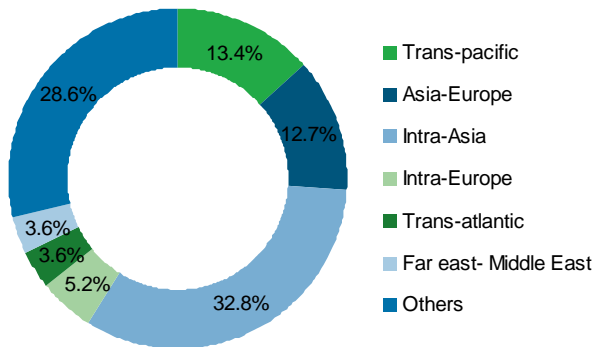
Long term: Structural demand shift

Although overall container trade growth may not be too weak, intra-Asia trade is likely to be the major growth driver, compared with limited growth in the Asia-Europe and trans-Pacific trades.

We see a structural demand shift to intra-Asia trade

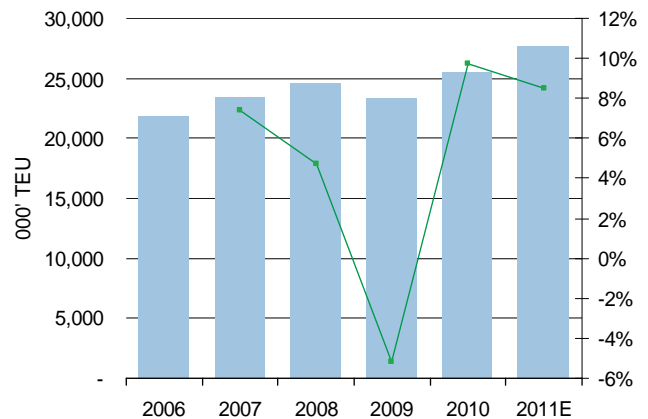
Intra-Asia trade has had the largest container trade routes globally. However, for container liners whose major profits are generated by long-haul routes, intra-Asia is a minor market. Before 2006, liners usually deployed vessels smaller than 2,000 TEU on each intra-Asia route, whose cargo volume was usually limited. However, the growth of intra-Asia long-haul routes – eg China to the Middle East – frequent trade between Asia countries, and the containerization of China's coastal trade, have boosted the market size. Now, vessels of 4,000TEU are operated in intra-Asia trade.

Fig 24: Global trade volume breakdown by route (2010)



Source: Drewry, Standard Chartered Research estimates

Fig 25: Intra-Asia trade volume growth

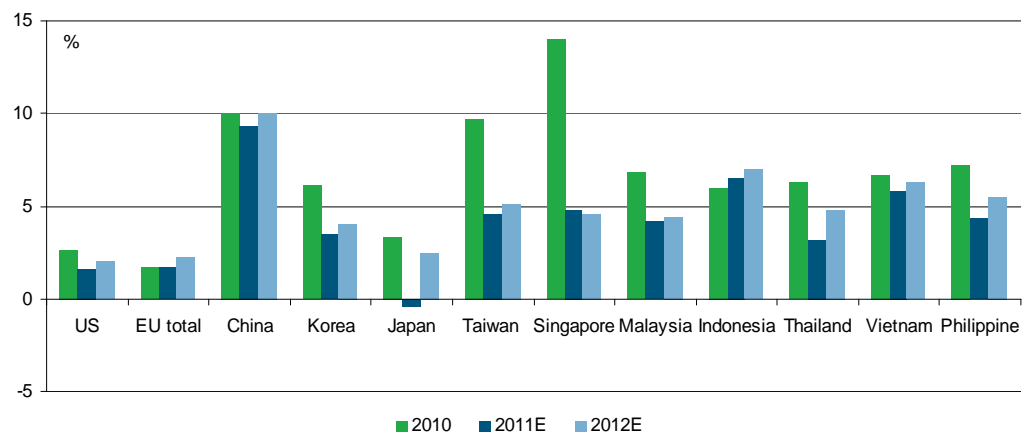


Source: Drewry, Standard Chartered Research estimates

According to Drewry, intra-Asia container trade has been driven by these factors:

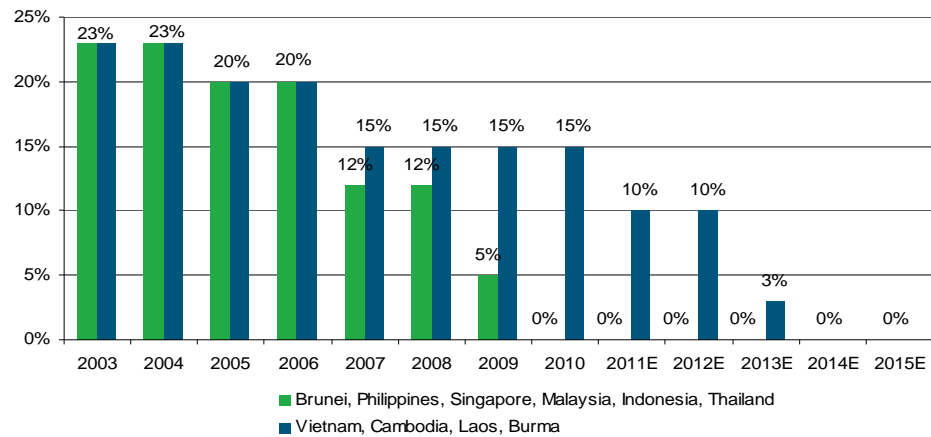
- Rising domestic consumption:** Stronger GDP growth, currency appreciation, salary inflation and large populations have supported the rise in domestic consumption in the Asia Pacific. China targets to transform its economy to be more consumption driven this decade and CIRA forecasts the country's private consumption will contribute 45% of GDP by 2020, up from the current 35%. The rise in domestic demand has also led to more balanced trade in Asia with China importing more necessities produced by neighbouring countries.

Fig 26: GDP growth – Asian countries vs the US / EU



Source: Standard Chartered Research estimates

- Free trade agreements (FTA):** Bilateral agreements to enhance trade partnership between Asian countries include ASEAN FTA, China-ASEAN FTA, Economic Cooperation Framework Agreement (ECFA) between China and Taiwan, Japan-ASEAN FTA and the Korea-China "WTO plus" trade agreement undergoing negotiations. Such FTAs have lowered import and export barriers between countries by reducing tariffs or encouraging subsidies.

Fig 27: Trade tariffs between China and Asean countries


Source: Ministry of Commerce, Standard Chartered Research estimates

- Foreign direct investment:** Multinational corporations (MNC) have heavily invested in Asia. Initially, MNCs outsourced manufacturing to Asia to export goods to Western countries. Components made in the Asia Pacific – and exported to China for assembly – drove intra-Asia trade. Now, MNC products are set to satisfy Asian demand and have enhanced regional trade.



Bulk supply: How capacity is being adjusted

- We forecast dry bulk capacity will grow 13%, 9% and 6% in 2011, 2012 and 2013, respectively, after taking the slippage rate of 30% into our forecasts of 2012 and 2013.
- While there remains capacity of 98.5m dwt set to be delivered in 2012 and the order book still accounts for 39% of the global bulk fleet, we believe oversupply will continue to be the issue for the sector in the next two years.
- Persistent low freight rates below running costs could trigger more scrapping. Scrapping rates have been higher than expected and should reach 4% in 2011 and 2012. Therefore, we are likely to see more balanced supply and demand growth for dry bulk shipping from 2013.
- We continue to believe the handysize segment will outperform other segments, given its ageing fleet and smaller order book.

We forecast dry bulk capacity will grow by 13%, 9% and 6% in 2011, 2012 and 2013, respectively

We update our bulk fleet model and forecast dry bulk capacity will grow by 13%, 9% and 6% in 2011, 2012 and 2013, respectively, versus our previous forecast of 13%, 11% and 8%, conducted at the beginning of 2011. We attribute the key difference to: 1) assuming a slippage rate of 33% rather than our previous 40%, as there were fewer delays and cancellations in 2011 than in 2009, and 2) higher-than-expected scrapping of 4%, triggered by worse-than-expected freight rates and operational environment for dry bulk shipping.

Fig 28: Dry bulk fleet forecasts

Year (m dwt)	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E
Order book						70.0	126.6	137.5	98.5	34.5	9.3
% of cancellations								15%	15%	15%	0%
Cancellations								24.7	14.8	5.2	-
% of slippage						40%	37%	18%	15%	5%	0%
Delayed deliveries								20.6	14.8	1.7	0.5
Delayed deliveries re-delivered									10.3	17.7	9.1
Deliveries	19.7	23.4	25.8	24.5	23.9	42.0	79.8	92.1	79.3	45.3	18.0
Scrapping	0.7	1.1	2.5	0.1	5.1	10.1	6.1	25.3	25.3	7.3	3.6
Fleet	322.3	344.8	368.0	392.8	418.1	458.4	532.2	599.0	652.9	690.9	705.2
Deliveries	6.1%	6.8%	7.0%	6.2%	5.7%	9.2%	15.0%	15.4%	12.1%	6.6%	2.6%
Scrapping	0.2%	0.3%	0.7%	0.0%	1.2%	2.2%	1.1%	4.2%	3.9%	1.1%	0.5%
Capacity growth	6.7%	7.0%	6.7%	6.7%	6.4%	9.6%	16.1%	12.5%	9.0%	5.8%	2.1%

Source: Clarksons, Drewry, Standard Chartered Research estimates

Deliveries turned out to be on track

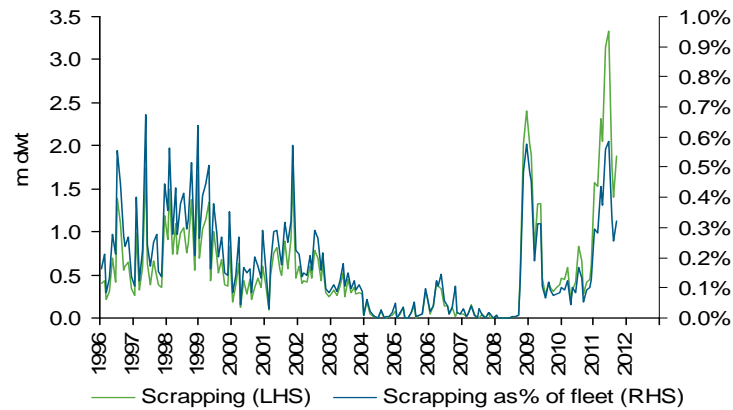
Slippage rates lower than we had assumed

We had assumed a 40% slippage rate at the beginning of 2011 on the 2011 order book of 137.5m dwt for dry bulk capacity – this unreliability of the order book was due to a lack of visibility in 2009–10 as certain information was not fully released to the public, such as cancellations, delays or changes in shipbuilding contracts. Our assumption was in line with the slippage ratio we observed in 2009 and 2010. However, in the year to September 2011, capacity of 71.2m dwt was delivered, representing 86% of our previous estimated full-year delivery capacity of 82.5m dwt. Actual delivery has been rather more on track than we had expected, leading to lower slippage rates. We now forecast delivery capacity of 92.1m dwt in 2011. This implies the quality of order book data is gradually improving after sustained adjustments, surveys and updates by the shipping research institutions in the last two years.

Watch for scrapping rate

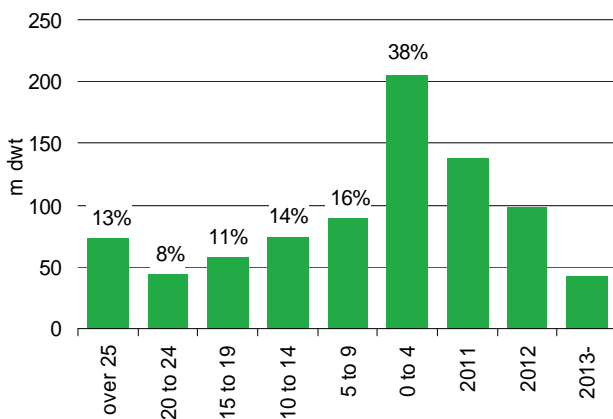
More scrapping than we had assumed

Lower-than-expected freight rates have triggered a higher scrapping rate than we had estimated. This slightly improves supply growth prospects in 2011 and likely in 2012. We forecast capacity of 25.3m dwt will be scrapped each in 2011 and 2012, representing 4% of the global fleet each year.

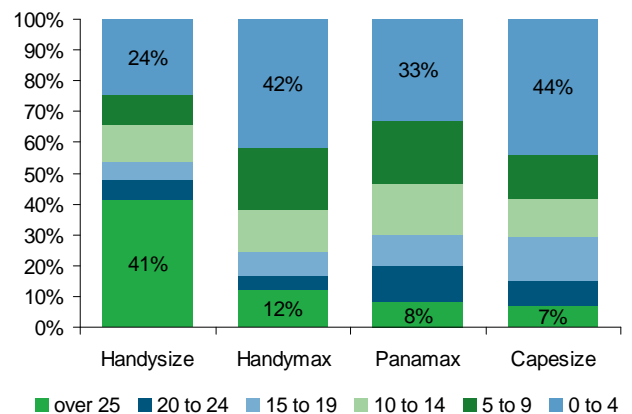
Fig 29: Scrapping


Source: Clarksons, Standard Chartered Research estimates

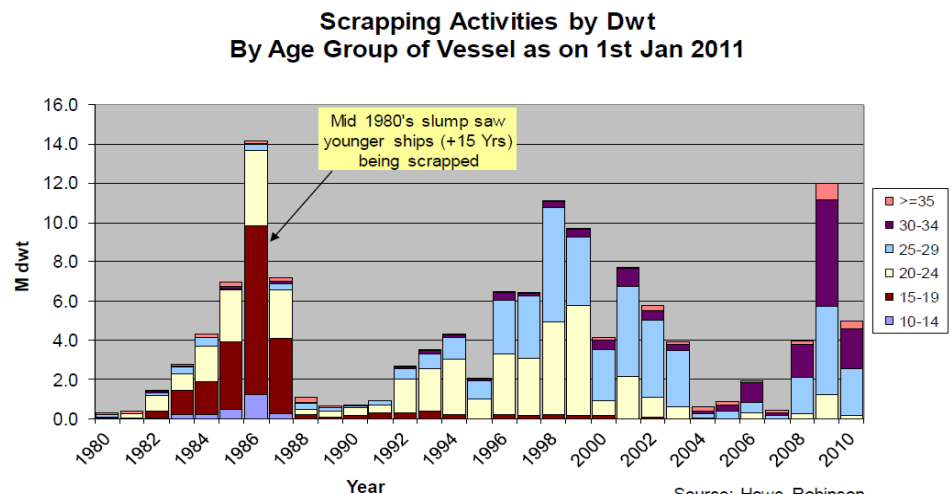
Roughly 13% of the global bulk fleet is over 25 years old, according to our calculations. Although the handysize fleet is the oldest segment, we saw more scrapping of capesize vessels in the year to date since capesize rates had fallen below running costs before the rebound from September.

Fig 30: Global bulk fleet age profile


Source: Clarksons, Lloyd's MIU, Standard Chartered Research estimates

Fig 31: Bulk fleet age profile by vessel type


Source: Clarksons, Lloyd's MIU, Standard Chartered Research estimates

Fig 32: Scrapping activities by age


Source: Precious Shipping, Howe Robinson, Standard Chartered Research

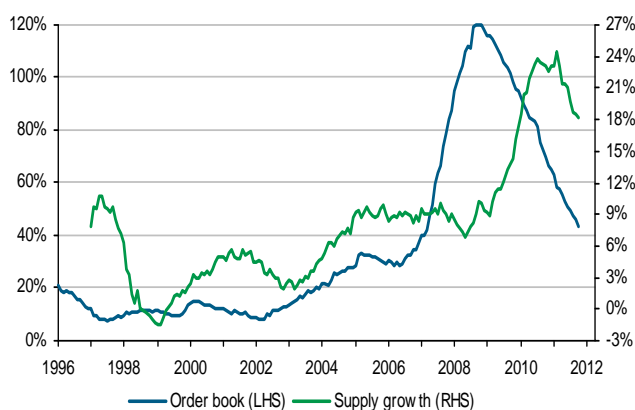
We believe persistently low freight rates are a major trigger of vessel scrapping while fleet age is a minor driver. Thus, scrapping boosted the handysize segment in early 2009 and more capesize vessels were scrapped in the year to date.

Handysize stronger than capesize

Given the prolonged trough cycle for dry bulk shipping, we continue to believe the defensive small vessel segment will outperform capesize.

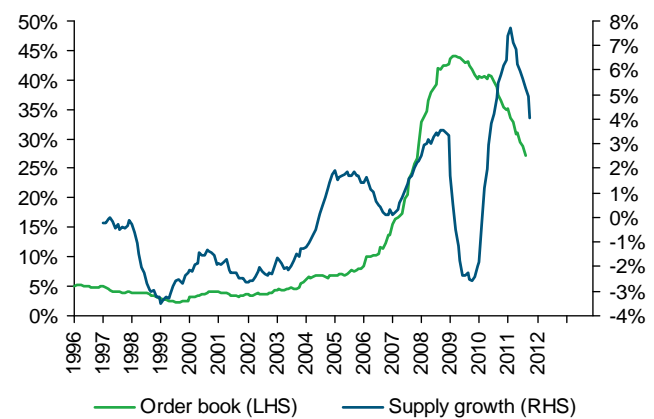
- Vessels over 25 years old represent 41% of the existing handysize fleet, versus 27% on the order book. We argue that the current order book is sufficient only for replacements. We forecast a scrapping rate of 5% each to the total handysize fleet in 2011 and 2012.

Fig 33: Capesize fleet growth and order book



Source: Clarksons, Standard Chartered Research estimates

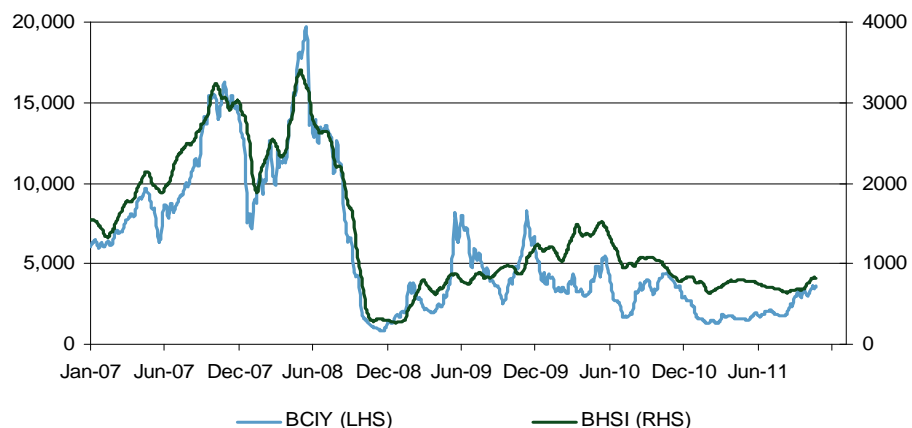
Fig 34: Handysize fleet growth and order book



Source: Clarksons, Standard Chartered Research estimates

- Smaller vessels are built by smaller shipyards, which may lead to more delays due to their technology immaturity and inexperience in production. Smaller vessels are also usually ordered by smaller ship owners who are more likely to cancel their orders under weak freight rates environments given their relatively weak balance sheet and constrained financial resources. According to the deliveries year to date, the slippage rate for handysize vessels could reach 50% in 2011, versus 33% of the total bulk fleet, based on our estimates.
- Given the constraints at some ports and diversified cargoes' handysize carriers, the handysize segment enjoys a better demand-supply balance, which has been diverted from the large-vessel segment, leading to its outperformance in freight rates. This has been the case in 2011 and is likely to continue to 2012, in our view.

Fig 35: BHSI versus BCIY



Source: Bloomberg, Standard Chartered Research estimates



Bulk demand: Steel demand at risk

- Slowing property construction and FAI investment in China started to weaken steel demand from Q3 2011 and should persist into H1 2012. We are conservative on China's steel demand, iron ore imports and dry bulk shipping demand for the next few quarters.
- The BDI rebound in Q3 was driven by seasonality, China's replacement of domestic iron ore by imports after international ore prices corrected, and capacity withdrawal after capesize rates dropped below the cash break-even level for 8 months. We believe the rebound will end when China's steel makers cut more production.
- We believe 1) very cheap iron ore prices and 2) the easing of China's tightening policy are likely to trigger a short-term BDI rebound in 2012, although sector oversupply should persist into 2013.

Short term: Worry over lag effect of China's tightening policy

Current corrections in iron ore prices and steel prices in China may imply its steel demand has started to show some weakness. The sharp decline in property sales and a smaller number of FAI project starts due to China's macro tightening policy indicates we are likely to see lower property and infrastructure construction and weaker steel demand in the next 6–9 months.

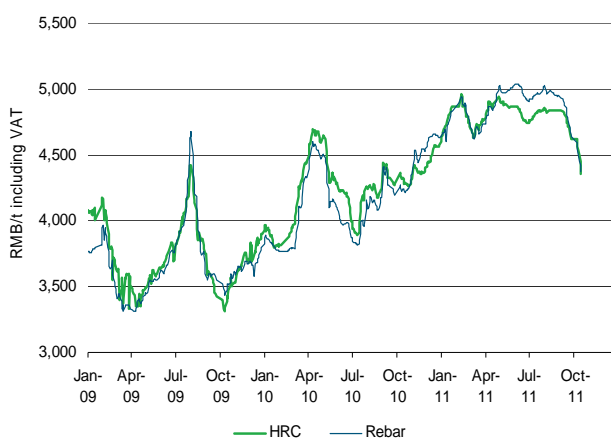
Weakening steel prices signal likely further weakening steel demand

Weakening steel prices

China's steel prices have dropped nearly 20% since late August, followed by iron ore prices falling from US\$180/ton to US\$120/ton. Our steel analyst, Wei Ouyang, indicates that the decline in steel prices is largely due to weaker iron ore prices and, to a lesser extent, slightly weaker steel demand.

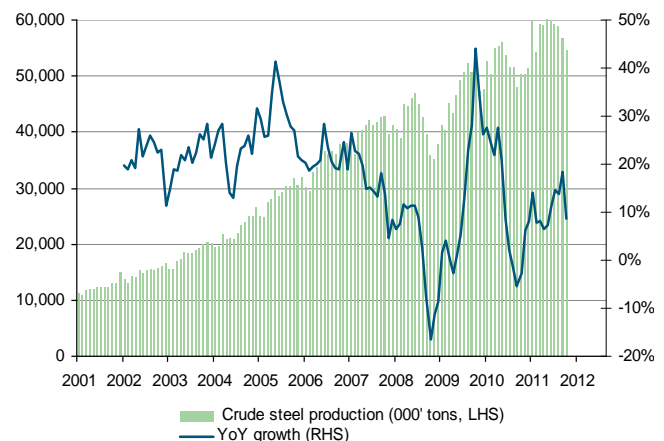
China's steel production stayed strong, up 15% YoY in Q3 and 9% YoY in October, as capacity cuts seriously affected steel mills' economies of scale and costs of production. Lower steel demand eventually led to lower demand for iron ore.

Fig 36: China's steel prices



Source: Bloomberg, Standard Chartered Research

Fig 37: China's steel production



Source: Bloomberg, Standard Chartered Research

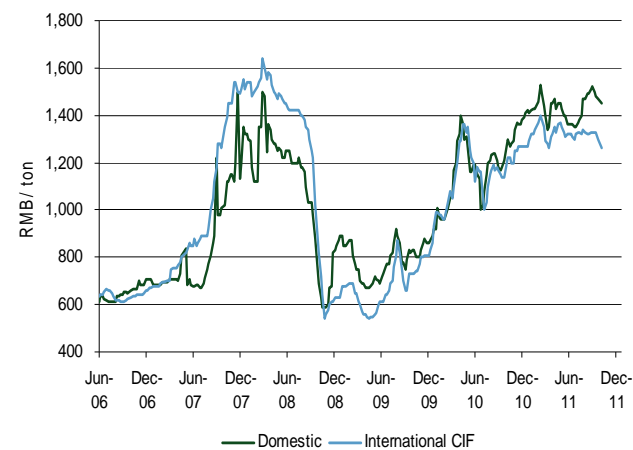
The hike of iron ore inventories:

Capesize rates rebounded significantly in Q3. We attribute the rally to these factors:

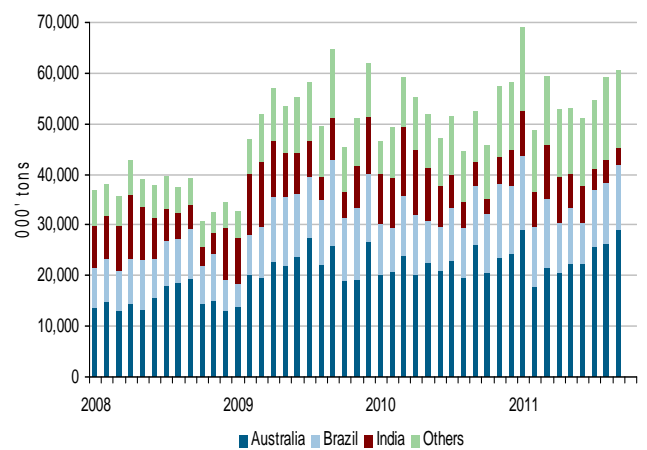
- International iron ore prices were below domestic ore prices, spurring steel makers to import more ore to lower the average raw material costs.
- Ore exports from India have declined due to increasing constraints on exports and the transportation bottleneck in the monsoon season. Ore imported from India represented only 6% of China's total imports in September, down from 15% in Q1. This led to higher sourcing from Brazil and hence increased shipping distance.

Ore inventory at ports is high and needs to be digested

- Ship-owners adjusted capacity with increased ship idle and slow steaming, following the decline in rates to a level below cash break-even since early this year.

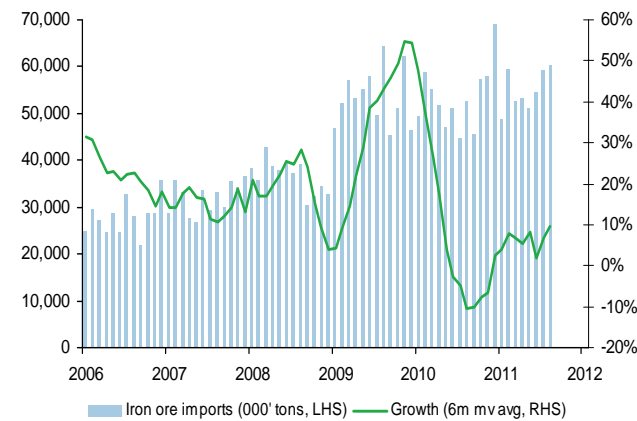
Fig 38: Gap between domestic and international iron ore prices (CIF) in China


Source: Bloomberg, Standard Chartered Research estimates

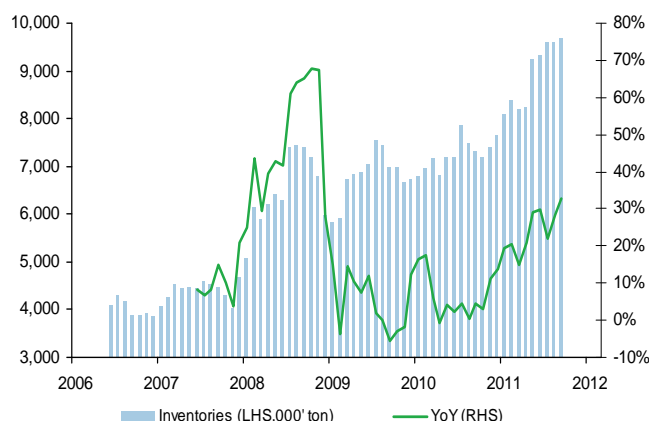
Fig 39: Iron ore imports by country


Source: CEIC, Standard Chartered Research estimates

While the level of steel production was maintained in Q3, steel makers and trading firms had accumulated more iron ore inventory when international iron ore prices were lower. We have seen a rise in iron ore inventories at the port and steel mills levels. They have to clear out the inventories to prevent demand and iron ore prices from weakening further.

Fig 40: China's iron ore imports


Source: CEIC, Standard Chartered Research estimates

Fig 41: China's iron ore inventory at ports


Source: Bloomberg, Standard Chartered Research estimates

Steel demand at risk in 2012

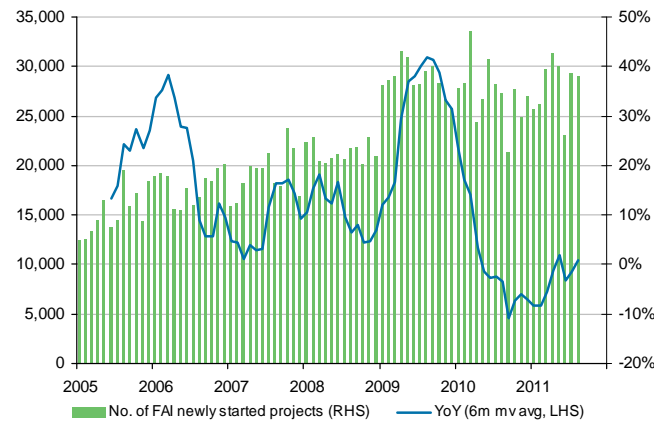
We are likely to see lower property and infrastructure construction and weaker steel demand for next 6–9 months

We believe China's tightening of infrastructure investments and slowing property sales will gradually affect infrastructure and property construction and eventually lower steel demand. Although the tightening policy has been in force for nearly one year, property transactions have slowed more from early Q3 with infrastructure projects approved in the last two years still under construction. Corresponding to strong FAI for the manufacturing sector in 2011, we may not see inhibited FAI growth before H1 2012. Therefore, we are more concerned about iron ore and commodity demand in 2012 while the steel output appears to be resilient in 2011 (11% YoY in the year to September).

Our steel analyst Judy Zhu, from the commodity research team, forecasts China's steel output will grow only 7% in 2012, down from 11% in 2011. She is concerned that slowing growth in floor area starts for commodity buildings since September may indicate weakening in the construction sector. Credit tightness for both the residential property and social housing segments will continue to hurt China's steel demand in 2012E. (Please see *Steel – China's 2012 demand forecast*, published on 22 November 2011.)

Fig 42: China's real estate investment YoY


Source: CEIC, Standard Chartered Research estimates

Fig 43: China FAI projects starts


Source: CEIC, Standard Chartered Research estimates

Long term: China still needs to import iron ore

We remain positive on long-term demand for bulk shipping, as we believe China and India will need more iron ore to grow their manufacturing sector, infrastructure and economy.

China's rising economy, decelerating domestic ore grade and lower ore exports have supported our long-term positive view for dry bulk shipping

- **Lower iron ore prices will trigger more imports:** Iron ore production costs are high in China and high costs have supported domestic iron ore prices. We believe domestic ore production cost hardly drops below US\$80–100/ tons (depending on the energy costs). Therefore, domestic ore production becomes inefficient if international ore prices are below US\$100/ton, as imports are more economical. Cheaper international ore prices will also trigger speculative demand, as steel makers still believe that ore prices, in a long run, will rise.
- **Longer ton miles after India cuts exports:** India is the third largest ore exporter in the world, representing 12% of global ore exports in 2012. We expect India will gradually grow its ore consumption given its under-developed infrastructure. The Indian government also raised resources tax to preserve its ore resources. We expect to see trading distance extending in ore shipping as China needs to outsource ore more from Australia and Brazil.
- **Decelerating grade of domestically produced iron ore:** China's domestic ore grade is low and decelerating, which raises production cost. In a long run, China is likely to look for better quality and cheaper iron ore, and thus to source more ore internationally. Currently, it sources only 50% of its ore usage from imports.

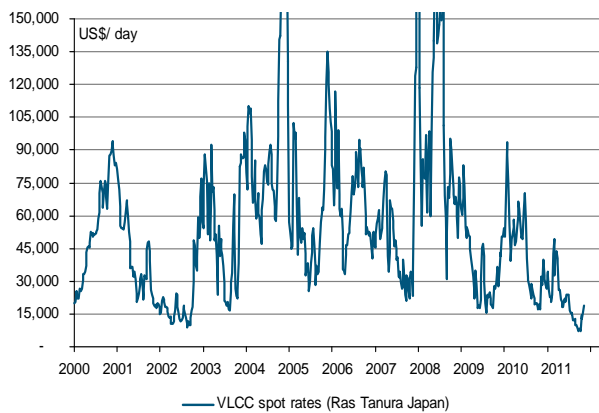
Crude tanker shipping: Weak demand

The oil price hike and weak economy have hurt oil demand and tanker shipping

In Q3 2011, tanker rates dropped to their lowest level since 1997. Supply growth of 6% in 2011 is obviously high yet capacity adjustments by single-hull tankers phase-out and vessel conversions in 2010 were also material. We attribute the poor rates largely to weak demand from OECD countries.

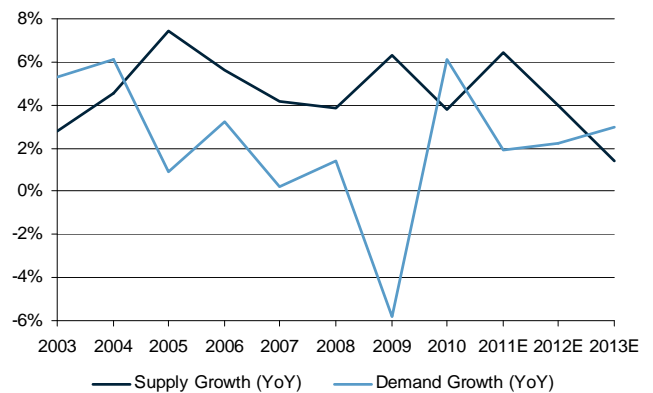
Oil imports from the US and the major four European countries (UK, France, Germany and Italy) are more significant and represent about 40% of global oil imports. Their import volumes peaked in 2006 and gradually declined. We attribute this not only to the poor economy after 2008 but mainly to the rise in oil prices. Between 1990 and 2003, oil cost was US\$19.2/bbl; however, it jumped since 2004 and ran beyond US\$100/bbl in 2008 and in 2011. It is reasonable for us to conclude the price hike has hurt oil demand.

Fig 44: 6 VLCC tankers – average earnings



Source: Clarksons, Standard Chartered Research estimates

Fig 45: Crude tankers – supply and demand



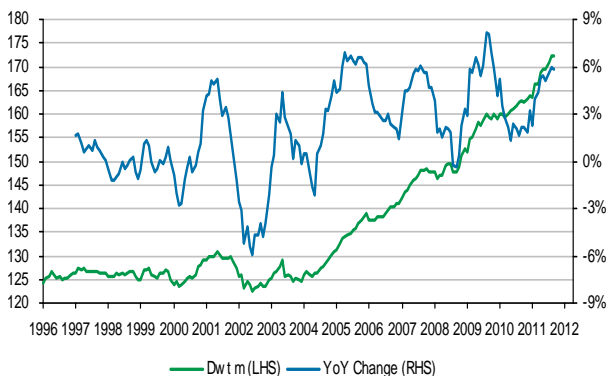
Source: Clarksons, Standard Chartered Research estimates

Tanker rates should see larger recovery from Q4 2012 as supply-demand more balanced in 2013

However, a continued increase in ton miles and sustainable demand growth from non-OECD countries remain positive drivers in tanker shipping. China's crude oil imports were up only 4% in the year to September 2011, as oil prices over US\$100/bbl depressed the imports of commercial reserve and lowered refining production due to thin refining margin. We expect oil imports from China to recover in 2012 as oil prices are softening.

As crude tankers order book represent only 20% of the current fleet and more single-hull tankers have been scrapped, or converted to offshore vessels, or used for storage, we forecast a decelerating supply growth. Tanker rates should see a larger recovery from Q4 2012 as supply and demand will be more balanced in 2013.

Fig 46: VLCC fleet growth



Source: Clarksons, Standard Chartered Research estimates

Fig 47: VLCC order book to fleet



Source: Clarksons, Standard Chartered Research estimates

Product tanker shipping: Limited new deliveries

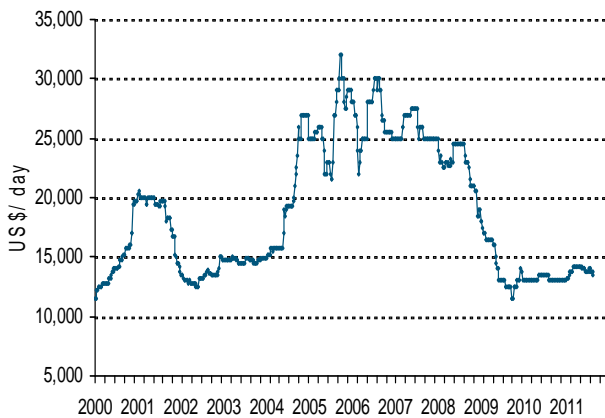
We expect product tanker rates to improve in 2012

Product tanker rates are likely to see larger recovery in 2012, in our view, given fairly constrained supply growth in 2011–13E.

Product tanker rates have been flat since mid 2009. We saw a similar demand issue for product oil and chemicals in the last few years: The weak OECD economy and hike in oil prices, boosting the prices of refining products, have inhibited demand. However, production suspensions by Japanese refineries after the earthquake in March encouraged imports from Japan. Intra-Far East trade, as a result, was up 11% YoY year to Q3. Clarksons forecast a 3% demand growth for global product tanker shipping in 2011.

Constrained supply also supported product tanker rates, which did not collapse like other freight did in 2011.

Fig 48: MR tanker TC rates



Source: Clarksons, Standard Chartered Research estimates

Fig 49: Product tanker supply and demand



Source: Clarksons, Standard Chartered Research estimates

Capacity growth is very constrained in product tanker segment

Product tanker deliveries have decelerated since 2009. Capacity has been digested by single-hull tanker phase-out and vessel conversions. Based on the current order book, we forecast product tanker supply will grow 2% in 2012 and 1% in 2013, assuming 1) aggressive scrapping persisting into H1 2012, and 2) limited new orders to fill the 2013 order book.

While we think the gloomy economy is likely to lead to refineries postponing capacity expansion and weakening oil demand, we see a larger rate recovery in H2 2012 and 2013 as likely. The product tanker segment should improve earlier than other shipping segments, which are pressured by significant overcapacity.

Fig 50: Product tanker supply growth

Year	2003	2004	2005	2006	2007	2008	2009	2010	2011E	2012E	2013E
Deliveries	6.1	7.8	6.7	7.7	9.0	11.8	13.1	9.3	7.9	6.2	3.3
Scrapping	3.3	1.8	1.4	1.6	1.9	0.0	-	-	2.3	2.0	0.9
Conversions/ others	(0.0)	0.3	0.6	0.3	1.0	3.4	1.6	3.9	2.3	2.0	0.9
Fleet	59	65	70	75	82	90	101	107	110	112	114
Deliveries	10.3%	12.1%	9.6%	10.1%	11.0%	13.1%	12.9%	8.7%	7.1%	5.5%	2.9%
Scrapping	5.5%	2.7%	2.0%	2.1%	2.3%	0.0%	0.0%	0.0%	2.1%	1.7%	0.8%
Change	5.0%	9.6%	7.4%	8.2%	8.2%	10.2%	12.7%	5.3%	3.0%	2.1%	1.2%

Source: Clarksons, Standard Chartered Research estimates

LNG shipping: Overcapacity

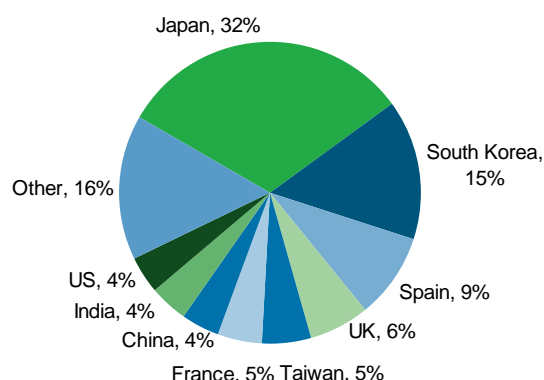
Despite strong demand, the global LNG fleet has expanded much faster than LNG trade growth. Although deliveries would be very constrained in 2012, we believe it takes time to absorb excessive capacity that have accumulated in the last two years.

Despite strong demand, global LNG fleet has expanded much faster than LNG trade growth

Our commodity team is bullish on the outlook for the global LNG industry in the long term. Under our base-case view, we forecast LNG trade will increase from 217.3bcm in 2011 to 270.8bcm in 2015, representing a CAGR of 4.5%. Under our bull case, we forecast LNG trade will reach 335.2bcm in 2015E, or 5.9% CAGR. Demand from Japan, China and India would be the major growth driver. (See our SCout report, *LNG: The second coming*, 20 May 2011.)

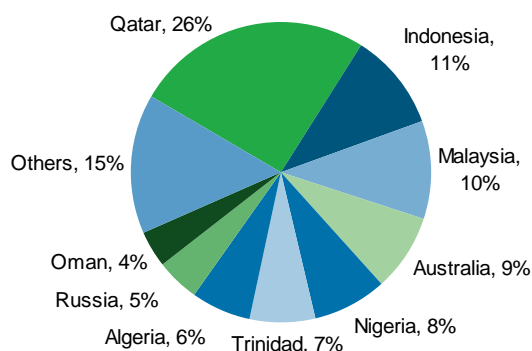
Not only higher LNG demand but also rising necessity of imports/ exports will boost demand for LNG shipping, we believe. During 2006–10, trade volume was up 57%. Some 78% of the incremental volume came from previously LNG exporting countries. The largest LNG consumers, the Asia Pacific countries, have sourced more LNG from other regions. This has increased inter-regional trade and trading distance.

Fig 51: LNG imports by country



Source: Waterborne LNG reports, US DOE, PFC Energy, Standard Chartered Research

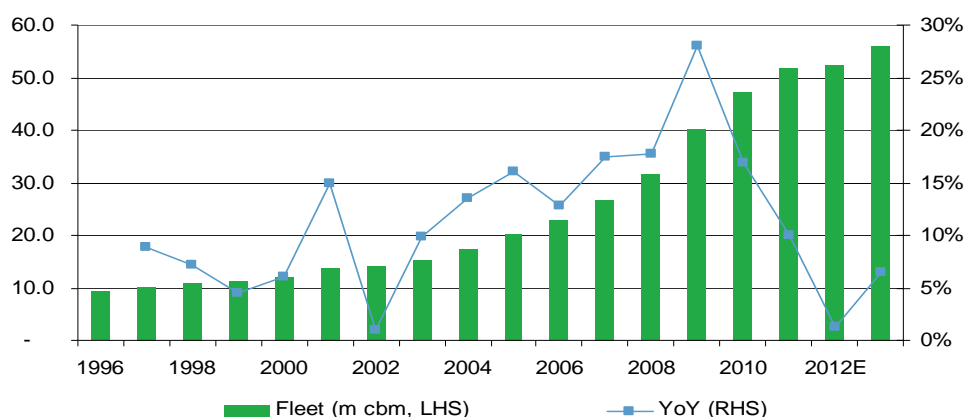
Fig 52: LNG exports by country



Source: Waterborne LNG reports, US DOE, PFC Energy, Standard Chartered Research

The global LNG fleet grew by 28% in 2009 and 17% in 2010, and we forecast 10% growth in 2011. The LNG demand recovery in 2010 and expanding usage of LNG ships as floating degasification or storage vessels only partially absorbed the excessive supply and an expanding spot market attracting small players has intensified competition in the LNG shipping universe.

Fig 53: Global LNG fleet



Source: Clarksons, Standard Chartered Research estimates



China COSCO Holdings

No turnaround signals

- Both dry bulk and container divisions are in oversupply conditions and will not make profits at least until H1 2012
- While supply is a long-term issue, improvement in demand outlook is required to drive COSCO's share price
- Despite a net gearing of 70% 2012E, we do not expect a new share issue for COSCO.
- We maintain our Underperform rating with a new price target of HK\$2.70 (from HK\$3.60).

- **Management cautious on the BDI:** We believe the rebound in the Baltic Dry Index (BDI) will help narrow losses in the dry bulk segment in Q4 2011, which made a segmental loss of RMB 3.6bn in the year to September. Given the oversupply situation, however, management believes the rebound is not sustainable as ship owners are likely to fix charters aggressively if the BDI is above the profitable level of 2,000; this would cap the BDI's upside.
- **Large container order book:** COSCON, China COSCO's container shipping subsidiary, currently has 28 container vessels on its order book and these are set to be delivered before 2014. The weak demand has led COSCON to postpone its delivery schedule, consequentially reducing capacity pressure in 2011–12E. We expect COSCON to make a quarterly loss of about RMB1bn at least in next three quarters.
- **2011 a good year for COSCO Pacific** (CP: 1199HK, IL, PT HK\$11): CP's three segments, ports, container leasing, and manufacturing performed well in 2011. Nansha and Piraeus ports saw a successful turnaround in operations, whilst Yantian and Qingdao ports contributed to strong profits. The shortage of containers has boosted profits in the leasing and manufacturing businesses. Nevertheless, growth is unlikely to be sustained in 2012, in our view.
- **Valuation:** China COSCO is trading at 0.7x PBR 2012E. We do not expect the dry bulk business to recover before 2013. We maintain our Underperform rating with a new PT of HK\$2.7 (down from HK\$3.6 set on 29 August 2011) based on our SOTP valuation.

UNDERPERFORM (unchanged)

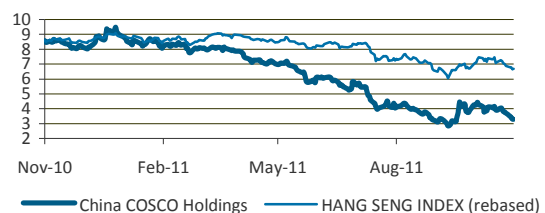
PRICE as at 24 November 2011 **PRICE TARGET**
HK\$3.29 **HK\$2.70**

Bloomberg code	Reuters code
1919 HK	1919.HK
Market cap	12 month range
HK\$33,612m (US\$4,311m)	HK\$2.84 - 9.48
EPS adj est change	2011E -3.5% 2012E -184.4%

Year end: December	2010	2011E	2012E	2013E
Sales (Rmbm)	96,439	85,018	89,473	103,324
EBITDA (Rmbm)	11,165	(2,100)	17	8,871
EBIT (Rmbm)	7,713	(5,753)	(4,006)	4,834
Pretax profit (Rmbm)	9,274	(4,069)	(2,671)	6,128
Net profit adjusted (Rmbm)	6,483	(6,178)	(4,081)	3,988
FCF (Rmbm)	1,203	(12,885)	(6,421)	533
EPS adjusted (Rmb)	0.63	(0.60)	(0.40)	0.39
DPS (Rmb)	0.12	0.00	0.00	0.11
Book value/share (Rmb)	4.55	3.96	3.56	3.89
EPS growth adj (%)	nm	nm	nm	nm
DPS growth (%)	nm	nm	-	nm
EBITDA margin (%)	11.6	-2.5	0.0	8.6
EBIT margin (%)	8.0	-6.8	-4.5	4.7
Net margin adj (%)	6.7	-7.3	-4.6	3.9
Div payout (%)	17.5	0.0	0.0	27.0
Net gearing (%)	22.2	53.1	70.0	66.0
ROE (%)	15.5	-13.9	-10.6	10.5
ROCE (%)	6.7	-4.8	-3.5	4.2
EV/Sales (x)	1.3	1.1	1.2	1.1
EV/EBITDA (x)	10.9	nm	6,043.8	12.4
PBR (x)	1.6	0.7	0.7	0.7
PER adj (x)	12.6	nm	nm	6.5
Dividend yield (%)	1.5	0.0	0.0	4.1

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-22	-19	-62
Relative to Index	-19	-12	-51
Relative to Sector	-	-	-
Major shareholder	COSCO Group (53.7%)		
Free float	25%		
Average turnover (US\$)	11,780,541		

Source: Company, Bloomberg



Fig 54: Sum-of-the-parts valuation

US\$m	OLD	NEW	
COSCON	2012E	2012E	
Market value of vessels (owned+ financial Leased)	3,046	3,641	Update to the fleet in 2012
EV/Fleet multiple	72%	60%	Our multiple is based on an average fleet return of 6.4% in 2011-2013E
Fair value of container fleet	2,195	2,175	
Payment of order book	544	544	More delayed deliveries
Fair value of COSCON	2,739	2,719	
COSCO Pacific			
Container terminal	3,093	3,093	Our updated DCF valuation
Container leasing	793	793	Based on 8x PER 2012E
CIMC	735	735	Based on 8x PER 2012E
Minus: net debt	1,034	1,034	
NAV	3,586	3,586	
Fair value of COSCO Pacific (10% discount to SOTP)	3,227	3,227	10% discount to NAV
Minus: minority shareholders	(1,849)	(1,849)	China COSCO owns 42.7% of CP
CP fair value attributable to China COSCO	1,378	1,378	Our price target of CP is HK\$11/share
COSCO Logistic	1,534	1,244	Based on 10x PER 2012E
Market value of bulk fleet (owned+ financial Leased)	5,435	5,870	Updated fleet profile
EV/Fleet multiple	75%	75%	Larger than expected losses lead us to lower our fleet return to 6.8% from previous assumption of 10%.
Fair value of bulk fleet	4,102	4,430	
Payment of order book	238	238	
Fair value of bulk segment	4,340	4,668	
Minus: net debt	4,790	6,087	
Adjusted net asset value	5,201	3,922	
Fair value	4,681	3,529	10% discount to adjusted NAV
Price target (US\$)	0.46	0.35	No. of shares outstanding: 10,216 m
Price target (HK\$)	3.6	2.7	

Source: Company, Standard Chartered Research estimates



Income statement (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	68,463	96,439	85,018	89,473	103,324
Gross profit	(3,935)	12,386	(1,562)	267	9,351
SG&A	(4,670)	(4,944)	(5,191)	(5,273)	(5,518)
Other income	0	0	0	0	0
Other expenses	2,197	271	1,000	1,000	1,000
EBIT	(6,408)	7,713	(5,753)	(4,006)	4,834
Net interest	(732)	(158)	(293)	(1,239)	(1,471)
Associates	926	1,719	1,977	2,573	2,765
Other non operational	0	0	0	0	0
Exceptional items	0	0	0	0	0
Pretax profit	(6,214)	9,274	(4,069)	(2,671)	6,128
Taxation	(451)	(1,189)	(597)	(401)	(919)
Minority interests	(804)	(1,226)	(1,375)	(1,009)	(1,221)
Exceptional items after tax	0	0	0	0	0
Net profit	(7,468)	6,858	(6,041)	(4,081)	3,988
Net profit adj	(7,883)	6,483	(6,178)	(4,081)	3,988
EBITDA	(2,993)	11,165	(2,100)	17	8,871
EPS (Rmb)	(0.73)	0.67	(0.59)	(0.40)	0.39
EPS adj (Rmb)	(0.77)	0.63	(0.60)	(0.40)	0.39
DPS (Rmb)	0.00	0.12	0.00	0.00	0.11
Avg fully diluted shares (m)	10,216	10,216	10,216	10,216	10,216

Balance sheet (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	44,123	47,249	30,886	23,547	22,611
Short term investments	0	0	0	0	0
Accounts receivable	8,728	10,987	9,686	10,194	11,772
Inventory	1,783	2,117	2,336	2,560	2,819
Other current assets	464	152	152	152	152
Total current assets	55,097	60,505	43,059	36,452	37,353
PP&E	62,464	66,145	74,080	74,758	75,984
Intangible assets	2,273	2,303	2,303	2,303	2,303
Associates and JVs	10,558	15,370	20,825	24,317	27,951
Other long term assets	7,349	5,219	5,219	5,219	5,219
Total long term assets	82,644	89,037	102,427	106,597	111,457
Total assets	137,741	149,542	145,486	143,049	148,810
Short term debt	7,233	5,870	5,870	5,870	5,870
Accounts payable	17,692	20,301	20,911	21,546	22,697
Other current liabilities	2,504	2,278	2,278	2,278	2,278
Total current liabilities	27,428	28,449	29,059	29,693	30,845
Long term debt	53,117	54,927	54,927	54,927	54,927
Convertible bonds	0	0	0	0	0
Deferred tax	3,057	3,510	3,510	3,510	3,510
Other long term liabilities	1,554	1,680	1,680	1,680	1,680
Total long term liabilities	57,728	60,117	60,117	60,117	60,117
Total liabilities	85,156	88,566	89,176	89,811	90,962
Shareholders' funds	41,992	46,509	40,468	36,387	39,776
Minority interests	10,592	14,467	15,842	16,851	18,072
Total equity	52,585	60,976	56,310	53,238	57,848
Total liabilities and equity	137,741	149,542	145,486	143,049	148,810
Net debt (cash)	16,228	13,548	29,911	37,250	38,186
Year end shares (m)	10,216	10,216	10,216	10,216	10,216

Source: Company, Standard Chartered Research estimates

Cash flow statement (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	(6,408)	7,713	(5,753)	(4,006)	4,834
Depreciation & amortisation	3,415	3,452	3,653	4,023	4,037
Net interest	(530)	(636)	(293)	(1,239)	(1,471)
Tax paid	(501)	(284)	(597)	(401)	(919)
Changes in working capital	4,000	328	1,693	(97)	(686)
Others	(9,425)	(874)	0	0	0
Cash flow from operations	(9,449)	9,699	(1,296)	(1,720)	5,795
Capex	(10,729)	(8,497)	(11,588)	(4,701)	(5,263)
Acquisitions	(113)	(3,021)	(3,479)	(918)	(870)
Disposals	425	496	0	0	0
Others	9,558	142	0	0	0
Cash flow from investing	(859)	(10,880)	(15,067)	(5,619)	(6,133)
Dividends	(3,360)	(625)	0	0	(598)
Issue of shares	0	3,955	0	0	0
Change in debt	33,464	1,592	0	0	0
Other financing cash flow	127	(820)	0	0	0
Cash flow from financing	30,231	4,101	0	0	(598)
Change in cash	19,923	2,921	(16,363)	(7,339)	(936)
Exchange rate effect	0	0	0	0	0
Free cash flow	(20,178)	1,203	(12,885)	(6,421)	533

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	-5.7	12.8	-1.8	0.3	9.1
EBITDA margin (%)	-4.4	11.6	-2.5	0.0	8.6
EBIT margin (%)	-9.4	8.0	-6.8	-4.5	4.7
Net margin adj (%)	-11.5	6.7	-7.3	-4.6	3.9
Effective tax rate (%)	-7.3	12.8	-14.7	-15.0	15.0
Sales growth (%)	-47.7	40.9	-11.8	5.2	15.5
Net income growth (%)	nm	nm	nm	nm	nm
EPS growth (%)	nm	nm	nm	nm	nm
EPS growth adj (%)	nm	nm	nm	nm	nm
DPS growth (%)	nm	nm	nm	-	nm
Efficiency ratios					
ROE (%)	-15.8	15.5	-13.9	-10.6	10.5
ROCE (%)	-6.4	6.7	-4.8	-3.5	4.2
Asset turnover (x)	0.5	0.7	0.6	0.6	0.7
Op cash / EBIT (x)	1.5	1.3	0.2	0.4	1.2
Depreciation / CAPEX (x)	0.3	0.4	0.3	0.9	0.8
Inventory days	8.3	8.5	9.4	10.0	10.4
Accounts receivable days	49.6	37.3	44.4	40.5	38.8
Accounts payable days	81.8	82.5	86.9	86.9	85.9
Leverage ratios					
Net gearing (%)	30.9	22.2	53.1	70.0	66.0
Debt/capital (%)	54.7	50.2	52.2	53.6	51.5
Interest cover (x)	-5.2	5.8	-3.8	-2.4	2.7
Debt/EBITDA (x)	-15.1	5.4	-29.0	3,491.7	6.9
Current ratio (x)	2.0	2.1	1.5	1.2	1.2
Valuation					
EV/Sales (x)	1.5	1.3	1.1	1.2	1.1
EV/EBITDA (x)	nm	10.9	nm	6,043.8	12.4
EV/EBIT (x)	nm	15.8	nm	nm	22.8
PER (x)	nm	11.9	nm	nm	6.5
PER adj (x)	nm	12.6	nm	nm	6.5
PBR (x)	2.0	1.6	0.7	0.7	0.7
Dividend yield (%)	0.0	1.5	0.0	0.0	4.1



China Shipping Container Lines (CSCL)

Capacity competition

- Despite a second consecutive quarterly loss in Q3 2011, liners do not intend to collaboratively idle more ships.
- To increase cost competitiveness in Asia-Europe trade, CSCL ordered another eight mega vessels in September. Capacity competition is likely to create more long-term problems for the sector.
- After the share price rebounded by 50%, we cut our rating to Underperform (from In-Line) with a new price target of HK\$1.0 (from HK\$2.0).
- Liquidity released by central banks to boost market valuations and improve consumers' confidence is the key risk to our call.
- **Capacity competition:** CSCL announced that it has ordered eight 10,000 TEU vessels at what we believe are at a cheap price of US\$754m (US\$94.25m/vessel.) CSCL originally had no order book for 2013 and these new vessels are set to be delivered in 2013 for lowering unit costs. We believe Chinese carriers will most definitely join the cost competition game initiated by Maersk in Asia-Europe routes by ordering more mega vessels. This is not good news for the sector.
- **Large losses within expectations:** CSCL posted a sharper quarterly loss of RMB951m in Q3 2011 compared with the Q2 loss of RMB484m. We believe the market had expected liners will not be profitable till at least H1 2012, yet we think the losses are likely to persist longer than the consensus expects. While liners did not achieve cash breakeven in Q3 2011, we hope they will cut more capacity over the next three quarters in order to curtail losses.
- **Balance sheet not at risk:** The new order announced on 1 Nov might imply that CSCL has limited cash flow pressure despite the losses. Assuming the same scale of net loss is extended to 2012, we forecast a net gearing of 58% at the end-2012, which we believe is an acceptable level for a shipping line. We understand the parent China Shipping Group is well supported by government banks.
- **Valuation:** CSCL is more exposed to spot rates and its earnings are usually very sensitive to the cycles, leading to its wider trading ranges historically. We notice that the share price was capped by a 0.5x PBR during the trough cycle before we see signals of an economic recovery.

We cut our PT to **HK\$1.0** (from HK\$2.0 set on 29 Aug) due to larger and longer-than-expected duration of sustained losses. We cut our rating to Underperform after the share price rebounded by 50%. Our new PT implies 0.4x PBR 2012E.

UNDERPERFORM (from In-Line)

PRICE as at 24 November 2011 PRICE TARGET

HK\$1.29

HK\$1.00

Bloomberg code

2866 HK

Reuters code

2866.HK

Market cap

HK\$15,071m (US\$1,933m)

12 month range

HK\$1.01 - 3.96

EPS adj est change 2011E NM 2012E NM

Year end: December	2010	2011E	2012E	2013E
Sales (Rmbm)	34,809	28,437	29,459	39,532
EBITDA (Rmbm)	5,757	(1,121)	(1,217)	4,847
EBIT (Rmbm)	4,382	(2,545)	(2,832)	3,119
Pretax profit (Rmbm)	4,320	(2,684)	(3,110)	2,757
Net profit adjusted (Rmbm)	4,032	(2,729)	(3,115)	2,761
FCF (Rmbm)	2,979	(7,496)	(3,948)	1,355
EPS adjusted (Rmb)	0.35	(0.23)	(0.27)	0.24
DPS (Rmb)	0.00	0.00	0.00	0.13
Book value/share (Rmb)	2.50	2.27	2.00	2.17
EPS growth adj (%)	nm	nm	nm	nm
DPS growth (%)	-	-	-	nm
EBITDA margin (%)	16.5	-3.9	-4.1	12.3
EBIT margin (%)	12.6	-8.9	-9.6	7.9
Net margin adj (%)	11.6	-9.6	-10.6	7.0
Div payout (%)	0.0	0.0	0.0	54.0
Net gearing (%)	8.8	37.2	58.4	52.0
ROE (%)	15.4	-9.7	-12.5	11.3
ROCE (%)	11.4	-6.5	-7.5	8.1
EV/Sales (x)	1.1	0.9	0.9	0.7
EV/EBITDA (x)	6.4	nm	nm	5.6
PBR (x)	1.2	0.5	0.5	0.5
PER adj (x)	7.7	nm	nm	4.2
Dividend yield (%)	0.0	0.0	0.0	12.8

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-12	-31	-59
Relative to Index	-8	-26	-48
Relative to Sector	-	-	-
Major shareholder	China Shipping Group (47.9%)		
Free float	52%		
Average turnover (US\$)	7,759,386		

Source: Company, Bloomberg



Valuation

CSCL reported a sharper-than-expected loss of RMB951m in Q3 2011. We attribute this to low utilisation rates even during the peak season and a sustained slide in transpacific spot rates. Whilst CSCL's regional competitors are more exposed to contract business, particularly in transpacific routes, CSCL was the only carrier under our coverage that reported disappointing results.

Despite lack of demand, we had expected liners to collaboratively idle capacity to boost freight rates and cut losses, as current spot rates cannot cover their variable costs. However, capacity control remains limited and we see more orders being placed in order to maintain cost competitiveness in Asia-Europe routes. This will likely boost capacity in 2013-2014 and we feel that a stronger recovery in demand is required in 2013 to offset further new supply. This may imply a longer-than-expected trough cycle although the stock is already trading at historical trough valuations.

Our new PT of **HK\$1.0** is based on a price/adjusted NAV multiple of 50%, which is derived from a WACC of 10%, long-term growth of 1%, and an average return on fleet of 5.5% in 2011-2013E, as CSCL is likely to incur a larger scale of losses in H1 2012 than in H2 2011. The new PT implies 0.4x PBR 2012E.

Fig 55: Valuation

RMB m	New 2012E	Old 2011E	
Shareholder's funds	23,467	26,973	Sharper-than-expected losses
Minus:			
Book Value of Vessels (owned+ financial Leased)	(32,489)	(30,179)	Updated book value of the fleet
Plus:			
Market Value of Vessels (owned+ financial Leased)	25,515	28,285	We update vessel prices for 2011 and assume a YoY of -5% for container vessel prices in 2012
Payment of Order book	2,308	-	CSCL in October ordered 8 new vessels to be delivered in 2013
Adjusted Net Asset Value	18,801	25,080	
Multiples: Price/ NAV	50%	72%	During the trough cycle, we use an average return on fleet of 5.5% in 2011-2013E, WACC of 10%, and long-term growth of 1% to derive our multiple of 50% by Gordon Growth Model. The multiple is lowered from a previous estimate of 7.4% 2012E as the European debt crisis is likely to drag on, and thereby depress demand; as a result, losses will be sustained in H1 2012.
Fair Value	9,322	17,938	
No. of Shares Outstanding	11,683	11,683	
Fair value per share (RMB)	0.80	1.54	
Fair value per share (HK\$)	1.01	1.99	

Source: CSCL, Standard Chartered Research estimates



Income statement (Rmbm)					
Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	19,740	34,809	28,437	29,459	39,532
Gross profit	(5,745)	5,016	(1,914)	(2,195)	4,007
SG&A	(688)	(840)	(711)	(736)	(988)
Other income	100	207	80	100	100
Other expenses	0	0	0	0	0
EBIT	(6,333)	4,382	(2,545)	(2,832)	3,119
Net interest	(153)	(130)	(195)	(336)	(438)
Associates	37	68	55	57	77
Other non operational	0	0	0	0	0
Exceptional items	0	0	0	0	0
Pretax profit	(6,449)	4,320	(2,684)	(3,110)	2,757
Taxation	(22)	(86)	(26)	(26)	23
Minority interests	(17)	(30)	19	22	(19)
Exceptional items after tax	0	0	0	0	0
Net profit	(6,489)	4,203	(2,692)	(3,115)	2,761
Net profit adj	(6,447)	4,032	(2,729)	(3,115)	2,761
EBITDA	(4,790)	5,757	(1,121)	(1,217)	4,847
EPS (Rmb)	(0.56)	0.36	(0.23)	(0.27)	0.24
EPS adj (Rmb)	(0.55)	0.35	(0.23)	(0.27)	0.24
DPS (Rmb)	0.00	0.00	0.00	0.00	0.13
Avg fully diluted shares (m)	11,683	11,683	11,683	11,683	11,683

Balance sheet (Rmbm)					
Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	6,937	10,648	3,152	2,204	2,731
Short term investments	0	0	0	0	0
Accounts receivable	1,573	1,792	1,464	1,516	2,035
Inventory	874	883	900	938	1,053
Other current assets	128	194	194	194	194
Total current assets	9,513	13,518	5,710	4,853	6,013
PP&E	33,234	33,705	38,898	39,842	41,301
Intangible assets	26	26	26	26	26
Associates and JVs	1,236	1,292	1,292	1,292	1,292
Other long term assets	283	476	476	476	476
Total long term assets	34,780	35,499	40,692	41,636	43,095
Total assets	44,292	49,016	46,402	46,490	49,108
Short term debt	2,433	3,225	3,225	3,225	3,225
Accounts payable	4,815	5,127	5,223	5,448	6,114
Other current liabilities	361	301	301	301	301
Total current liabilities	7,609	8,654	8,750	8,974	9,641
Long term debt	10,133	10,060	10,060	13,060	13,060
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	572	340	340	340	340
Total long term liabilities	10,705	10,400	10,400	13,400	13,400
Total liabilities	18,314	19,054	19,150	22,374	23,041
Shareholders' funds	25,227	29,185	26,493	23,379	25,311
Minority interests	751	777	759	737	756
Total equity	25,978	29,962	27,252	24,116	26,068
Total liabilities and equity	44,292	49,016	46,402	46,490	49,108
Net debt (cash)	5,629	2,637	10,133	14,081	13,555
Year end shares (m)	11,683	11,683	11,683	11,683	11,683

Source: Company, Standard Chartered Research estimates

Cash flow statement (Rmbm)					
Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	(6,333)	4,382	(2,545)	(2,832)	3,119
Depreciation & amortisation	1,543	1,375	1,424	1,615	1,728
Net interest	(143)	(260)	(195)	(336)	(438)
Tax paid	(316)	(60)	(26)	(26)	23
Changes in working capital	1,277	19	407	133	33
Others	(7)	(362)	55	57	77
Cash flow from operations	(3,978)	5,094	(879)	(1,388)	4,541
Capex	(1,414)	(2,115)	(6,617)	(2,559)	(3,187)
Acquisitions	(102)	(110)	0	0	0
Disposals	58	154	0	0	0
Others	147	71	0	0	0
Cash flow from investing	(1,311)	(1,999)	(6,617)	(2,559)	(3,187)
Dividends	(5)	4	0	0	(828)
Issue of shares	0	0	0	0	0
Change in debt	531	757	0	3,000	0
Other financing cash flow	24	(145)	0	0	0
Cash flow from financing	550	617	0	3,000	(828)
Change in cash	(4,739)	3,712	(7,496)	(948)	526
Exchange rate effect	0	0	0	0	0
Free cash flow	(5,392)	2,979	(7,496)	(3,948)	1,355

Financial ratios and other					
Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	-29.1	14.4	-6.7	-7.5	10.1
EBITDA margin (%)	-24.3	16.5	-3.9	-4.1	12.3
EBIT margin (%)	-32.1	12.6	-8.9	-9.6	7.9
Net margin adj (%)	-32.7	11.6	-9.6	-10.6	7.0
Effective tax rate (%)	-0.3	2.0	-1.0	-0.8	-0.8
Sales growth (%)	-43.2	76.3	-18.3	3.6	34.2
Net income growth (%)	nm	nm	nm	nm	nm
EPS growth (%)	nm	nm	nm	nm	nm
EPS growth adj (%)	nm	nm	nm	nm	nm
DPS growth (%)	-	-	-	-	nm
Efficiency ratios					
ROE (%)	-22.8	15.4	-9.7	-12.5	11.3
ROCE (%)	-16.4	11.4	-6.5	-7.5	8.1
Asset turnover (x)	0.4	0.7	0.6	0.6	0.8
Op cash / EBIT (x)	0.6	1.2	0.3	0.5	1.5
Depreciation / CAPEX (x)	1.1	0.6	0.2	0.6	0.5
Inventory days	9.6	10.8	10.7	10.6	10.2
Accounts receivable days	35.5	17.6	20.9	18.5	16.4
Accounts payable days	63.7	60.9	62.2	61.5	59.4
Leverage ratios					
Net gearing (%)	21.7	8.8	37.2	58.4	52.0
Debt/capital (%)	34.3	32.9	35.3	43.4	41.3
Interest cover (x)	-24.9	20.5	-8.6	-7.6	6.7
Debt/EBITDA (x)	-2.4	2.2	-11.9	-12.1	3.4
Current ratio (x)	1.3	1.6	0.7	0.5	0.6
Valuation					
EV/Sales (x)	1.4	1.1	0.9	0.9	0.7
EV/EBITDA (x)	nm	6.4	nm	nm	5.6
EV/EBIT (x)	nm	8.4	nm	nm	8.7
PER (x)	nm	7.3	nm	nm	4.2
PER adj (x)	nm	7.7	nm	nm	4.2
PBR (x)	1.1	1.2	0.5	0.5	0.5
Dividend yield (%)	0.0	0.0	0.0	0.0	12.8



China Shipping Development

Defensive business model

- China Shipping Development's (CSD) business has downside protection given that 65% of its capacity is locked in by contracts.
- It has remained profitable during the trough cycle and this has protected its book value.
- We suggest investors accumulate CSD at the trough of the shipping cycle.
- We maintain our Outperform rating with a price target of HK\$7.30.

- **Domestic oil shipping to normalise in 2012:** CSD's Q3 2011 earnings of RMB112m were disappointing. PongLai 193 in Bohai Bay, China's largest offshore oil field, experienced an oil spill in June, leading to a suspension in production. This affected CSD's domestic oil transportation as the oil produced there is CSD's key source of cargo. Management indicated that volume is unlikely to fully normalise before 2012 as the State Oceanic Administration required the producer to completely clear the spill and block every leakage point. We do not expect strong earnings in Q4 2011; however, domestic oil shipping volumes should recover in 2012.

- **Limited downside for coastal coal contract rates:** The average spot rate for coastal coal shipping YTD was 14% higher than CSD's contract rates in 2011. The hike in fuel costs also constrained the gross margin. Management has indicated limited downside for coastal coal contract rates in 2012 (to be negotiated in Q1 2012). We now assume a flat contract rate growth in 2012.

- **Accumulate at bottom of the cycle:** Investors should accumulate shipping stocks when carriers make losses, trade below 0.5x PBR, or freight rates are at bottom (although investors usually follow the opposite of that). Nevertheless, sharper-than-expected losses and a longer duration of sustained losses may erode shipping companies' book value. While CSD is unlikely to make losses over 2011–12E, we believe its book value is firm and we suggest accumulating CSD's shares at the trough.

- **Valuation:** CSD is currently trading at 0.5x 2012E. We consider the valuation cheap as the company will remain profitable. We maintain our Outperform rating with a PT of HK\$7.30.

OUTPERFORM (unchanged)

PRICE as at 24 November 2011 PRICE TARGET

HK\$4.44

HK\$7.30

Bloomberg code

1138 HK

Reuters code

1138.HK

Market cap

HK\$15,121m (US\$1,940m)

12 month range

HK\$4.36 - 11.20

EPS adj est change 2011E -28.8% 2012E -19.0%

Year end: December	2010	2011E	2012E	2013E
Sales (Rmbm)	11,285	12,330	15,752	19,409
EBITDA (Rmbm)	3,400	2,867	4,130	6,415
EBIT (Rmbm)	1,995	1,041	1,743	3,644
Pretax profit (Rmbm)	2,172	1,135	1,993	4,282
Net profit adjusted (Rmbm)	1,610	840	1,529	3,415
FCF (Rmbm)	(5,632)	(9,180)	(3,304)	5,013
EPS adjusted (Rmb)	0.47	0.23	0.40	0.89
DPS (Rmb)	0.12	0.05	0.08	0.17
Book value/share (Rmb)	6.63	7.05	7.39	8.14
EPS growth adj (%)	69.7	-50.8	72.3	123.3
DPS growth (%)	60.8	-57.7	61.3	108.6
EBITDA margin (%)	30.1	23.3	26.2	33.0
EBIT margin (%)	17.7	8.4	11.1	18.8
Net margin adj (%)	14.3	6.8	9.7	17.6
Div payout (%)	24.3	19.7	20.1	19.6
Net gearing (%)	60.3	74.9	89.6	67.7
ROE (%)	7.8	3.8	5.8	11.5
ROCE (%)	6.0	2.4	3.4	6.8
EV/Sales (x)	4.2	3.0	2.9	2.1
EV/EBITDA (x)	14.0	13.1	10.9	6.4
PBR (x)	1.4	0.5	0.5	0.4
PER adj (x)	21.3	15.6	9.0	4.0
Dividend yield (%)	1.2	1.4	2.3	4.8

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-30	-20	-60
Relative to Index	-27	-13	-49
Relative to Sector	-	-	-
Major shareholder	China Shipping Group (53.7%)		
Free float	46%		
Average turnover (US\$)	6,715,454		

Source: Company, Bloomberg

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Income statement (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	8,730	11,285	12,330	15,752	19,409
Gross profit	1,470	2,354	1,411	2,184	4,168
SG&A	(326)	(359)	(370)	(441)	(524)
Other income	0	0	0	0	0
Other expenses	0	0	0	0	0
EBIT	1,144	1,995	1,041	1,743	3,644
Net interest	(39)	(190)	(417)	(517)	(669)
Associates	61	217	364	677	1,291
Other non operational	30	15	15	15	15
Exceptional items	146	136	132	75	0
Pretax profit	1,342	2,172	1,135	1,993	4,282
Taxation	(278)	(449)	(182)	(399)	(856)
Minority interests	0	(5)	(3)	(5)	(11)
Exceptional items after tax	0	0	0	0	0
Net profit	1,065	1,718	951	1,590	3,415
Net profit adj	949	1,610	840	1,529	3,415
EBITDA	2,215	3,400	2,867	4,130	6,415
EPS (Rmb)	0.31	0.50	0.26	0.42	0.89
EPS adj (Rmb)	0.28	0.47	0.23	0.40	0.89
DPS (Rmb)	0.08	0.12	0.05	0.08	0.17
Avg fully diluted shares (m)	3,405	3,405	3,610	3,815	3,815

Balance sheet (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	2,222	1,062	3,453	1,255	1,582
Short term investments	0	0	0	0	0
Accounts receivable	1,033	1,235	1,349	1,723	2,124
Inventory	350	449	491	627	773
Other current assets	55	0	0	0	0
Total current assets	3,660	2,746	5,293	3,605	4,479
PP&E	28,685	35,386	45,822	50,821	49,074
Intangible assets	0	0	0	0	0
Associates and JVs	1,615	2,574	3,374	4,974	5,124
Other long term assets	6	4	4	4	4
Total long term assets	30,305	37,964	49,200	55,799	54,202
Total assets	33,965	40,710	54,493	59,405	58,681
Short term debt	1,322	2,424	2,424	2,424	2,424
Accounts payable	1,878	2,060	2,519	3,129	3,515
Other current liabilities	30	79	79	79	79
Total current liabilities	3,230	4,562	5,021	5,632	6,018
Long term debt	8,657	12,552	21,552	24,552	20,552
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	405	504	504	504	504
Total long term liabilities	9,062	13,056	22,056	25,056	21,056
Total liabilities	12,292	17,619	27,077	30,688	27,074
Shareholders' funds	21,431	22,579	26,900	28,196	31,075
Minority interests	243	513	516	521	531
Total equity	21,674	23,091	27,416	28,717	31,607
Total liabilities and equity	33,965	40,710	54,493	59,405	58,681
Net debt (cash)	7,757	13,914	20,523	25,721	21,394
Year end shares (m)	3,406	3,406	3,815	3,815	3,815

Cash flow statement (Rmbm)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	1,144	1,995	1,041	1,743	3,644
Depreciation & amortisation	1,072	1,404	1,826	2,387	2,771
Net interest	(216)	(349)	(417)	(517)	(669)
Tax paid	(278)	(449)	(182)	(399)	(856)
Changes in working capital	809	(64)	303	100	(160)
Others	(869)	(147)	511	767	1,306
Cash flow from operations	1,662	2,390	3,082	4,081	6,036
Capex	(3,739)	(8,023)	(12,262)	(7,386)	(1,024)
Acquisitions	(75)	(743)	(800)	(1,600)	(150)
Disposals	205	265	0	0	0
Others	77	55	0	0	0
Cash flow from investing	(3,532)	(8,446)	(13,062)	(8,986)	(1,174)
Dividends	(1,021)	(340)	(579)	(294)	(535)
Issue of shares	0	0	3,950	0	0
Change in debt	3,181	5,258	9,000	3,000	(4,000)
Other financing cash flow	0	0	0	0	0
Cash flow from financing	2,159	4,918	12,371	2,706	(4,535)
Change in cash	289	(1,137)	2,391	(2,198)	327
Exchange rate effect	(10)	(23)	0	0	0
Free cash flow	(2,077)	(5,632)	(9,180)	(3,304)	5,013

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	16.8	20.9	11.4	13.9	21.5
EBITDA margin (%)	25.4	30.1	23.3	26.2	33.0
EBIT margin (%)	13.1	17.7	8.4	11.1	18.8
Net margin adj (%)	10.9	14.3	6.8	9.7	17.6
Effective tax rate (%)	20.7	20.7	16.0	20.0	20.0
Sales growth (%)	-49.3	29.3	9.3	27.8	23.2
Net income growth (%)	-80.2	61.3	-44.7	67.2	114.8
EPS growth (%)	-80.2	61.3	-47.8	58.2	114.8
EPS growth adj (%)	-82.0	69.7	-50.8	72.3	123.3
DPS growth (%)	-68.5	60.8	-57.7	61.3	108.6
Efficiency ratios					
ROE (%)	5.0	7.8	3.8	5.8	11.5
ROCE (%)	3.9	6.0	2.4	3.4	6.8
Asset turnover (x)	0.3	0.3	0.3	0.3	0.3
Op cash / EBIT (x)	1.5	1.2	3.0	2.3	1.7
Depreciation / CAPEX (x)	0.3	0.2	0.1	0.3	2.7
Inventory days	15.6	16.3	15.7	15.0	16.8
Accounts receivable days	38.0	36.7	38.2	35.6	36.2
Accounts payable days	70.1	80.5	76.5	76.0	79.6
Leverage ratios					
Net gearing (%)	35.8	60.3	74.9	89.6	67.7
Debt/capital (%)	32.5	41.4	48.5	50.2	43.6
Interest cover (x)	16.4	9.7	2.4	2.9	5.2
Debt/EBITDA (x)	3.8	3.7	6.8	6.2	3.9
Current ratio (x)	1.1	0.6	1.1	0.6	0.7
Valuation					
EV/Sales (x)	4.3	4.2	3.0	2.9	2.1
EV/EBITDA (x)	17.1	14.0	13.1	10.9	6.4
EV/EBIT (x)	33.1	23.9	36.0	25.8	11.2
PER (x)	27.9	20.0	13.8	8.7	4.0
PER adj (x)	31.3	21.3	15.6	9.0	4.0
PBR (x)	1.6	1.4	0.5	0.5	0.4
Dividend yield (%)	0.9	1.2	1.4	2.3	4.8

Source: Company, Standard Chartered Research estimates



Hanjin Shipping

High gearing despite equity raising

- Hanjin Shipping issued convertible bonds (CBs) and new equity to fund its capex and working capital after a sharper-than-expected loss in 2011. The share capital will increase by 54.3% on a fully diluted basis.
- We do not expect Hanjin's profitability to improve in the short term.
- Hanjin has a fairly high net gearing within the Asia container shipping segment.
- We suggest investors avoid the stock.

- **Dilution from new share issue and CBs factored in:** Hanjin completed an issuance of CBs of US\$150m in July 2011 and an equity issuance of 40m new shares at KRW7,500/share to raise KRW3bn in October. Shares outstanding will increase 54.3% on a fully diluted basis.
- **High capex:** Hanjin plans to receive four owned container vessels, including three of 13,300 TEU and ten bulk carriers in 2012. Whilst all these vessels are currently under construction, Hanjin will face high capex in 2011 and 2012, which we estimate at KRW756bn and KRW791bn, respectively. We believe Hanjin will require additional financing of KRW700bn in 2012 for capex, which would lead to net gearing of 202% in 2012E.
- **Poor outlook:** Hanjin achieved almost the lowest operating margin year to Q3 2011 in the container sector due to its high capacity pressure from many new deliveries in 2011 and high financial gearing. Given the weakness of the global economy, the container rate could hardly improve before H1 2012. Hanjin is likely to post losses at least for the next three quarters.
- **Valuation:** After factoring in a large share capital and weaker-than-expected earnings, we lower our price target to KRW8,500 (down from KRW35,000 set on 16 March 2011), which is based on 75% of price/adjusted NAV. The multiple is derived by lower average return on fleet of 8.0% 2011–13E, a WACC of 10.4%, and long-term growth of 1%. We are cautious on Hanjin's high gearing and maintain our In-Line rating.

IN-LINE (unchanged)

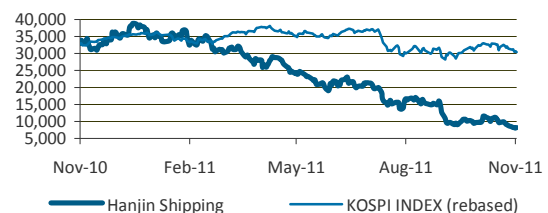
PRICE as at 25 November 2011 **W8,070** PRICE TARGET **W8,500**

Bloomberg code	Reuters code
117930 KS	117930.KS
Market cap	12 month range
W687bn (US\$593m)	W8,070 - 38,880
EPS adj est change	2011E -377.1% 2012E -214.6%

Year end: December	2010	2011E	2012E	2013E
Sales (Wbn)	9,423	9,443	9,672	11,688
EBITDA (Wbn)	967	(198)	(115)	1,205
EBIT (Wbn)	630	(532)	(471)	825
Pretax profit (Wbn)	306	(525)	(548)	723
Net profit adjusted (Wbn)	227	(601)	(635)	577
FCF (Wbn)	(512)	(643)	(996)	571
EPS adjusted (W)	2,673	(5,554)	(4,837)	4,398
DPS (W)	267	0	0	440
Book value/share (W)	29,328	18,609	14,439	18,957
EPS growth adj (%)	nm	nm	nm	nm
DPS growth (%)	nm	nm	-	nm
EBITDA margin (%)	10.3	-2.1	-1.2	10.3
EBIT margin (%)	6.7	-5.6	-4.9	7.1
Net margin adj (%)	2.4	-6.4	-6.6	4.9
Div payout (%)	8.2	0.0	0.0	8.9
Net gearing (%)	107.1	116.1	202.2	133.4
ROE (%)	12.5	-21.3	-25.2	29.7
ROCE (%)	9.5	-7.4	-6.5	10.9
EV/Sales (x)	0.5	0.4	0.6	0.4
EV/EBITDA (x)	5.2	nm	nm	4.0
PBR (x)	1.2	0.4	0.6	0.4
PER adj (x)	10.9	nm	nm	1.8
Dividend yield (%)	0.9	0.0	0.0	5.4

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-17	-52	-75
Relative to Index	-12	-53	-74
Relative to Sector	-	-	-
Major shareholder	Hanjin Shipping Holdings (37.0%)		
Free float	45%		
Average turnover (US\$)	21,198,139		

Source: Company, Bloomberg



Valuation

In the year to September, Hanjin posted an operating loss of KRW363bn. Whilst its bulk segment was profitable, due to COA contracts locked-in for VLOCs, the container segment recorded an operating loss of KRW373bn. Operating margin of -9% was weaker than those of its regional peers.

We attribute the weaker-than-industry performance to Hanjin's capacity pressure. It added three 10,000 TEU vessels and four 8,000 TEU vessels in 2011, and increased capacity by 15% YoY. Given weaker-than-expected trade volume growth, the yield was under pressure whilst utilisation rates were low.

Despite lack of demand, we had expected liners to collaboratively idle capacity to boost freight rates and to cut losses, as current spot rates cannot cover their variable costs. Nevertheless, capacity controls remain limited and we see more orders being placed in order to maintain cost competitiveness in the Asia-Europe business. This has boosted capacity in 2013-2014, and a stronger recovery in demand is required in 2013 to offset more new supply. This may imply a longer-than-expected trough cycle although the stock is already trading at historical trough valuations.

Our new price target of **KRW8,500** is based on a price/adjusted NAV multiple of 75%, which is derived from a WACC of 10.4%, long-term growth of 1%, and an average return on fleet of 8.0% 2011-2013E, as Hanjin is likely to incur a larger scale of losses in H1 2012 than in H2 2011. This implies 0.6x PBR 2012E on a fully diluted basis.

Fig 56: Valuation

Value (KRW bn)	New 2012E	Old 2011E	
Shareholder's funds FY2011E	1,896	2,657	Earnings in 2011 are lower than our expectations.
Minus:			
Book value of vessels (owned+ financial leased)	(5,204)	(4,603)	Hanjin will add 14 vessels in 2012.
Plus:			
Market value of vessels (owned+ financial leased)	4,559	3,927	We update vessel prices for 2011 and assume a YoY of -5% for container vessel prices in 2012.
Adjusted net asset value	1,250	1,980	
Multiples: Price/ NAV			
	75%	136%	Our multiple is derived from average return on fleet of 2011-2013E at 8.0%, a WACC of 10.4%, and a long-term growth of 1%. The estimated return of fleet was lowered from our previous assumption of 13.8% in 2011-2012E due to weaker-than-expected earnings.
	935	2,700	
Payment of order book	182	290	Four vessels on 2013 order book.
Adjusted fair value	1,118	2,991	
No. of shares outstanding			
	131,284	85,085	Capital expanded after new share issue, and we factor in impact from the newly issued CBs on a fully diluted basis.
Adjusted fair value per share (KRW)	8,513	35,149	

Source: Hanjin Shipping, Standard Chartered Research estimates



Income statement (Wbn)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	7,123	9,423	9,443	9,672	11,688
Gross profit	(608)	956	(60)	13	1,410
SG&A	(335)	(326)	(472)	(484)	(584)
Other income	0	0	0	0	0
Other expenses	0	0	0	0	0
EBIT	(943)	630	(532)	(471)	825
Net interest	(178)	(252)	(279)	(304)	(359)
Associates	0	0	0	0	0
Other non operational	(264)	(125)	211	140	175
Exceptional items	(18)	53	76	87	82
Pretax profit	(1,402)	306	(525)	(548)	723
Taxation	11	(30)	0	0	(72)
Minority interests	0	0	0	0	0
Exceptional items after tax	0	0	0	0	0
Net profit	(1,391)	275	(525)	(548)	651
Net profit adj	(1,374)	227	(601)	(635)	577
EBITDA	(595)	967	(198)	(115)	1,205
EPS (W)	(15,744)	3,240	(4,853)	(4,170)	4,958
EPS adj (W)	(15,543)	2,673	(5,554)	(4,837)	4,398
DPS (W)	0	267	0	0	440
Avg fully diluted shares (m)	88	85	108	131	131

Balance sheet (Wbn)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	625	912	944	647	960
Short term investments	89	191	191	191	191
Accounts receivable	621	752	754	772	933
Inventory	231	267	249	258	254
Other current assets	141	201	0	0	0
Total current assets	1,707	2,323	2,137	1,869	2,338
PP&E	5,614	6,082	6,504	6,939	6,914
Intangible assets	6	5	5	5	5
Associates and JVs	0	492	492	492	492
Other long term assets	582	104	104	104	104
Total long term assets	6,202	6,683	7,105	7,539	7,515
Total assets	7,908	9,006	9,243	9,408	9,853
Short term debt	90	1,152	1,152	1,152	1,152
Accounts payable	681	710	796	810	861
Other current liabilities	921	72	72	72	72
Total current liabilities	1,692	1,934	2,021	2,034	2,086
Long term debt	2,516	2,429	2,629	3,329	3,129
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	1,800	2,149	2,149	2,149	2,149
Total long term liabilities	4,315	4,579	4,779	5,479	5,279
Total liabilities	6,007	6,513	6,799	7,513	7,364
Shareholders' funds	1,901	2,493	2,443	1,896	2,489
Minority interests	0	0	0	0	0
Total equity	1,901	2,493	2,443	1,896	2,489
Total liabilities and equity	7,908	9,006	9,243	9,408	9,853
Net debt (cash)	1,980	2,670	2,838	3,834	3,321
Year end shares (m)	88	85	131	131	131

Cash flow statement (Wbn)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	(943)	630	(532)	(471)	825
Depreciation & amortisation	347	337	334	356	380
Net interest	(178)	(252)	(279)	(304)	(359)
Tax paid	11	(30)	0	0	(72)
Changes in working capital	(154)	(198)	304	(14)	(104)
Others	682	(262)	286	227	257
Cash flow from operations	(233)	224	113	(206)	926
Capex	(0)	(736)	(756)	(791)	(355)
Acquisitions	0	0	0	0	0
Disposals	1	59	0	0	0
Others	(22)	(301)	0	0	0
Cash flow from investing	(22)	(978)	(756)	(791)	(355)
Dividends	0	0	0	0	(58)
Issue of shares	0	0	475	0	0
Change in debt	94	680	200	700	(200)
Other financing cash flow	33	360	0	0	0
Cash flow from financing	127	1,040	675	700	(258)
Change in cash	(129)	287	32	(296)	313
Exchange rate effect	0	0	0	0	0
Free cash flow	(234)	(512)	(643)	(996)	571

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	-8.5	10.1	-0.6	0.1	12.1
EBITDA margin (%)	-8.4	10.3	-2.1	-1.2	10.3
EBIT margin (%)	-13.2	6.7	-5.6	-4.9	7.1
Net margin adj (%)	-19.3	2.4	-6.4	-6.6	4.9
Effective tax rate (%)	0.8	9.9	0.0	0.0	10.0
Sales growth (%)	-23.9	32.3	0.2	2.4	20.8
Net income growth (%)	nm	nm	nm	nm	nm
EPS growth (%)	nm	nm	nm	nm	nm
EPS growth adj (%)	nm	nm	nm	nm	nm
DPS growth (%)	nm	nm	nm	-	nm
Efficiency ratios					
ROE (%)	-54.3	12.5	-21.3	-25.2	29.7
ROCE (%)	-14.5	9.5	-7.4	-6.5	10.9
Asset turnover (x)	0.9	1.1	1.0	1.0	1.2
Op cash / EBIT (x)	0.2	0.4	-0.2	0.4	1.1
Depreciation / CAPEX (x)	1,394.2	0.5	0.4	0.5	1.1
Inventory days	10.1	10.7	9.9	9.6	9.1
Accounts receivable days	31.0	26.6	29.1	28.8	26.6
Accounts payable days	34.3	30.0	28.9	30.3	29.7
Leverage ratios					
Net gearing (%)	104.2	107.1	116.1	202.2	133.4
Debt/capital (%)	41.9	50.6	52.4	60.8	55.1
Interest cover (x)	-4.6	2.2	-1.6	-1.3	2.0
Debt/EBITDA (x)	-4.1	3.2	-18.5	-36.0	3.6
Current ratio (x)	1.0	1.2	1.1	0.9	1.1
Valuation					
EV/Sales (x)	0.5	0.5	0.4	0.6	0.4
EV/EBITDA (x)	nm	5.2	nm	nm	4.0
EV/EBIT (x)	nm	8.0	nm	nm	5.9
PER (x)	nm	9.0	nm	nm	1.6
PER adj (x)	nm	10.9	nm	nm	1.8
PBR (x)	0.9	1.2	0.4	0.6	0.4
Dividend yield (%)	0.0	0.9	0.0	0.0	5.4

Source: Company, Standard Chartered Research estimates



MISC Bhd

Cyclical business units still a drag

- We lower our SOTP price target to MYR6.70 from MYR7.60, due to lower EPS expectations and valuation benchmarks.
- The losses at the cyclical business units – liner, petroleum and chemical shipping – have been larger than expected.
- We also introduce new EPS forecasts based on a December year end (previously March), given the changes initiated by the company this year.
- Whilst our new EPS forecast is not strictly comparable with the previous forecasts (March year-end), we are reducing our earnings expectations substantially.

Cyclical business units still in rough patch: Oversupply of Liner, Petroleum and Chemical tankers in the market continue to keep freight rates low, translating to losses for MISC's non-LNG shipping businesses. Q2 profits (EBIT fell 60% YoY) were significantly below consensus and our expectations. The cyclical businesses posted a pre-tax loss of MYR310m (compared to a loss of MYR157m a year ago). MISC is scheduled to take delivery of 15 newbuilds from 2011-2013. We believe that managing this extra capacity in a soft market will be a challenge. We estimate combined pre-tax losses of MYR1,092m and MYR725m for its Liner, Petroleum and Chemicals segments in 2011 and 2012, respectively.

LNG segment – stable but no surprises: With the world's largest LNG fleet of 29 ships at its disposal, MISC's LNG segment has been the largest contributor to earnings. As all of its LNG ships are contracted on long-term time charters, we believe that price flexibility is limited. We model ~MYR1.3bn in annual pre-tax profits from 2011–13.

Offshore marine and heavy engineering to provide some relief: Offshore marine (floating production units) provides reasonably stable earnings and we foresee this trend continuing given the long-term nature of contracts. On the heavy engineering front, its 66%-owned subsidiary, MMHE is likely to benefit from Malaysia's Economic Transform Programme in developing the domestic O&G sector. Both units are likely to contribute a combined MYR800–900m in annual pre-tax profits over 2011–13.

SOTP PT of MYR6.70: The LNG shipping business constitutes about 60% of MISC's enterprise value. The Offshore and Heavy Engineering businesses contribute another 25%. The LNG and Offshore businesses are valued at 18x and 13x three-year forward rolling PER, whilst we use Bloomberg's consensus PT of MYR6.2 for Heavy Engineering (MMHE). The loss-making Liner, Petroleum, and Chemical shipping units are valued at 1.0x 2011 book. Our PT represents a 1.3x PBR, which appears reasonable given MISC's low single-digit ROE.

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| Equity Research |

IN-LINE (unchanged)

PRICE as at 24 November 2011 PRICE TARGET

RM6.13

RM6.70

Bloomberg code
MISC MK

Reuters code
MISC.KL

Market cap
RM27,363m (US\$8,606m)

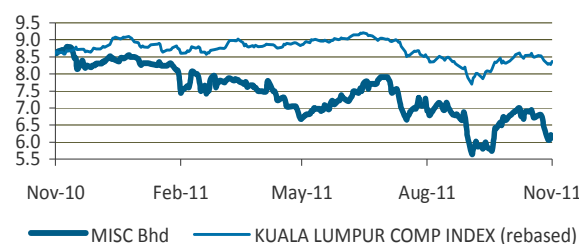
12 month range
RM5.65 - 8.79

EPS adj est change 2011E 12.9% 2012E -

Year end: December	3/2011	2011E	2012E	2013E
Sales (MYRm)	12,326	12,523	12,954	13,526
EBIT (MYRm) - core	2,195	1,058	1,557	2,138
EBITDA (MYRm) - core	3,520	2,383	2,951	3,610
Net profit (MYRm)	1,871	680	1,076	1,540
Net profit (MYRm) - core	948	680	1,076	1,540
EPS (MYR) - core	0.21	0.15	0.24	0.35
EPS change (%)	+17	-28	+58	+43
DPS - net (MYR)	0.35	0.25	0.25	0.25
DPS growth (%)	+0	-29	+0	+0
EBITDA Margin (%)	28.6	19.0	22.8	26.7
EBIT Margin (%)	17.8	8.4	12.0	15.8
Net margin (%)	15.2	5.4	8.3	11.4
Div payout (%)	83.5	164.1	103.7	72.5
BVPS (MYR)	4.9	4.9	5.3	5.3
Net gearing (%)	20.5	34.7	42.0	47.9
ROE (%)	4	3	5	7
ROCE (%)	8	4	5	10
FCF (MYRm)	(895)	(1,933)	(1,134)	(145)
Interest cover (x)	10.1	6.6	7.7	8.0
EV/EBITDA (x) - core	11.3	16.7	13.5	11.0
PBR (x)	1.7	1.2	1.2	1.2
PER (x) - core	40.0	40.2	25.4	17.8
Yield (%)	4.1	4.1	4.1	4.1

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-10	-11	-29
Relative to Index	-9	-9	-26
Relative to Sector	-	-	-
Major shareholder	Petroleum Nasional Bhd (62.7%)		
Free float	37%		
Average turnover (US\$)	1,707,204		

Source: Company, Bloomberg



Income statement

Year end: December	3/2010	3/2011	2011E	2012E	2013E
	MYRm	MYRm	MYRm	MYRm	MYRm
Sales	13,775	12,326	12,523	12,954	13,526
EBITDA (core)	2,501	3,520	2,383	2,951	3,610
EBIT (core)	1,213	2,195	1,058	1,557	2,138
Net interest	(316)	(170)	(261)	(331)	(412)
Associates	37	120	266	270	275
Exceptional items	(21)	923	0	0	0
Pretax profit	912	2,244	1,062	1,496	2,000
Tax	(90)	(17)	(96)	(120)	(160)
Minority	-140	-357	-287	-300	-300
Net profit - reported	682	1871	680	1076	1540
Net profit - core	703	948	680	1076	1540
EPS (MYR) – Reported	0.18	0.42	0.15	0.24	0.35
EPS (MYR) – Adj	0.18	0.21	0.15	0.24	0.35
DPS - net (MYR)	0.35	0.35	0.25	0.25	0.25

Cash flow statement

Year end: December	3/2010	3/2011	2011E	2012E	2013E
	MYRm	MYRm	MYRm	MYRm	MYRm
EBIT	1,213	2,195	1,058	1,557	2,138
Depreciation & amort	1,760	1,288	1,325	1,325	1,394
Cash flow from operations	3,409	3,801	2,235	2,366	2,855
Capex	(4,011)	(4,695)	(4,168)	(3,500)	(3,000)
Others	81	(26)	162	83	34
Cash flow from investing	(3,930)	(4,722)	(4,006)	(3,417)	(2,966)
Dividends	(1,367)	(1,408)	(1,562)	(1,116)	(1,116)
Issue of shares	0	5,203	0	0	0
Change in debt	3,264	2,506	(1,424)	1,160	1,500
Others	5,327	(3,336)	(318)	3	(1,567)
Cash flow from financing	(3,499)	4,884	5,948	1,228	2,351
Change in cash	3,725	7,849	2,644	1,275	1,169
Free cash flow	(602)	(895)	(1,933)	(1,134)	(145)

Business segment

Year end: December	3/2010	3/2011	2011E	2012E	2013E
	MYRm	MYRm	MYRm	MYRm	MYRm
LNG	2,722	2,501	2,401	2,401	2,430
Petroleum	3,061	2,953	2,864	2,921	3,096
Chemical	847	770	777	801	849
Integrated Liner Logistics	2,824	2,359	2,123	2,123	2,250
Offshore	734	681	728	765	803
Heavy Engineering	3,587	3,063	3,629	3,943	4,097
Revenue	13,775	12,326	12,523	12,954	13,526
LNG	1,454	1,453	1,321	1,321	1,336
Petroleum	112	(147)	(315)	(204)	(100)
Chemical	(146)	(177)	(140)	(96)	(42)
Tank Terminals	(1)	52	70	83	100
Integrated Liner Logistics	(1,025)	(578)	(637)	(425)	(225)
Offshore	271	335	335	344	361
Heavy Engineering	342	424	459	503	600
Others	(116)	(40)	(30)	(30)	(30)
Pre-tax profit (core)	891	1,322	1,062	1,496	2,000

Balance sheet

Year end: December	3/2010	3/2011	2011E	2012E	2013E
	MYRm	MYRm	MYRm	MYRm	MYRm
Cash	3,725	7,849	3,353	1,984	1,876
Accounts receivables	2,844	1,994	1,310	1,384	1,445
Inventory/others	814	383	2,082	2,104	2,122
Total current assets	7,384	10,226	6,744	5,472	5,444
PP&E	27,273	28,229	26,819	30,979	32,656
Associates/others	2,100	2,605	4,755	5,025	5,300
TOTAL ASSETS	36,757	41,060	38,317	41,476	43,399
Short term debt	3,104	3,577	1,340	2,500	4,000
Accounts payables/others	3,482	4,037	3,698	3,884	4,053
Total current liabs	6,586	7,614	5,037	6,384	8,053
Long term debt	9,194	10,008	10,008	10,008	10,008
Others	129	215	205	205	205
TOTAL LIABILITIES	15,463	17,024	15,250	16,400	18,069
Net assets	21,294	24,036	23,067	25,076	25,330
Shareholders' funds	20,953	23,662	21,912	23,634	23,588
Total equity	21,294	24,036	23,067	25,076	25,330

Key ratios

Year end: December	3/2010	3/2011	2011E	2012E	2013E
EBITDA margin (%)	18.2	28.6	19.0	22.8	26.7
EBIT margin (%)	8.8	17.8	8.4	12.0	15.8
Effective tax rate (%)	9.8	0.8	9.0	8.0	8.0
Interest cover (x)	6.8	10.1	6.6	7.7	8.0
Current ratio (x)	1.1	1.3	1.3	0.9	0.7
ROE (%)	3.2	4.2	3.1	4.7	6.5
ROCE (%)	4.8	8.2	4.1	5.1	10.2
Net gearing (%)	38	20	35	42	48
Inventory days	10	9	12	12	12
Debtor days	66	53	39	39	39
Creditor days	78	105	108	108	108
Asset turnover (x)	0.4	0.3	0.3	0.3	0.3
PBR (x)	1.4	1.7	1.2	1.2	1.2
EV/EBITDA (x)	15.9	11.3	16.7	13.5	11.0
PER (x)	47.1	40.0	40.2	25.4	17.8
Dividend yield (%)	4.1	4.1	4.1	4.1	4.1
No of shares in issue (m)	3,860	4,464	4,464	4,464	4,465

SOTP

	MYRm
LNG	23,866 18x 3-year rolling PER (peer rating)
Petroleum/chemical/liner	5,569 1.0x PB (loss making segments)
Tank Terminals	1,080 12x 3-year forward rolling PER
Offshore	4,058 13x 3-year forward rolling PER
Heavy Engineering	6,547 Bloomberg consensus PT RM6.2
Enterprise value	41,120
Net cash/(debt)	(7,995)
Sum-of-Parts Equity Value	33,125
10% discount	(3,312) 10% holding company discount
	29,812
Shares in issue (m)	4,464
Target price (MYR/share)	6.7

Source: Company, Standard Chartered Research estimates



Neptune Orient Lines

Valuation more expensive to peers

- Neptune Orient Lines (NOL) outperformed its peers in 2011, due to lower capacity pressure. Nevertheless, more mega ships will be delivered to NOL for the weakest Asia-Europe trade in 2012.
- NOL trading at 0.8x PBR 2012E is more expensive than its regional peers, trading at an average 0.7x.
- We cut our rating on NOL to In-Line with a new price target of S\$1 (from S\$2.30).

- **Christmas order rush not sufficient:** Utilisation rates for trans-Pacific ships have hit 95% in October, up from barely 90% during a disappointing peak season in July to September. This was due to last-minute orders for Christmas from US retailers. Trans-Pacific spot rates, however, sustained declines. This implies that trade volume remains insufficient to meet supply.
- **Conservative on pre-Chinese New Year orders:** The market is now pinning hopes on possible re-stocking orders in mid-January ahead of the Chinese New Year. We believe such orders would only happen if Christmas sales are stronger than expected, as witnessed in the past two years. We are cautious on Christmas sales this year and do not expect aggressive shipments before the Chinese New Year.
- **More capacity to deliver to Asia-Europe:** In 2012, NOL will receive eight 10,000 TEU vessels, which we believe will be placed for Asia-Europe trade. NOL is less-competitive in Asia-Europe trade, for which we expect weaker volume growth in 2012 than trans-Pacific trade. We see larger yield pressure for NOL in 2012 after outperforming in 2011.
- **Valuation:** We revise down our profit forecasts substantially to reflect a weaker-than-expected macro outlook, and cut our PT to S\$1.0 (from S\$2.3 set on 16 March 2011), based on a 0.6x price/adjusted NAV for 2012E. The multiple is derived from a Gordon Growth model with assumptions of a WACC of 10%, long-term growth of 1%, and a return on fleet of 6.4% 2012E. This justifies our rating cut to In-Line (from Outperform), given its more demanding valuation at 0.8x PBR 2012E, compared to regional peers' 0.7x.

IN-LINE (from Outperform)

PRICE as at 24 November 2011 PRICE TARGET

S\$1.03

S\$1.00

Bloomberg code

NOL SP

Reuters code

NEPS.SI

Market cap

S\$2,645m (US\$2,019m)

12 month range

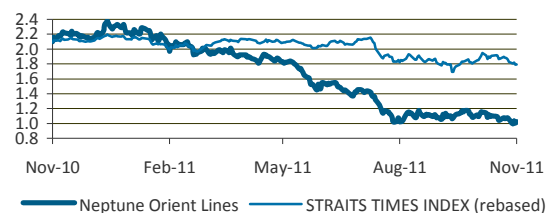
S\$1.00 - 2.38

EPS adj est change 2011E -147.1% 2012E -139.9%

Year end: December	2010	2011E	2012E	2013E
Sales (US\$m)	9,422	9,180	9,919	11,569
EBITDA (US\$m)	864	157	168	762
EBIT (US\$m)	579	(147)	(169)	384
Pretax profit (US\$m)	530	(223)	(250)	284
Net profit adjusted (US\$m)	462	(190)	(226)	257
FCF (US\$m)	160	(583)	(799)	(496)
EPS adjusted (US\$)	0.18	(0.07)	(0.09)	0.10
DPS (US\$)	0.04	0.00	0.00	0.02
Book value/share (US\$)	1.25	1.15	1.07	1.15
EPS growth adj (%)	nm	nm	nm	nm
DPS growth (%)	nm	nm	-	nm
EBITDA margin (%)	9.2	1.7	1.7	6.6
EBIT margin (%)	6.1	-1.6	-1.7	3.3
Net margin adj (%)	4.9	-2.1	-2.3	2.2
Div payout (%)	19.5	0.0	0.0	17.7
Net gearing (%)	11.7	31.9	63.1	77.1
ROE (%)	15.5	-7.9	-7.9	9.0
ROCE (%)	13.1	-3.1	-3.5	7.1
EV/Sales (x)	0.5	0.3	0.4	0.4
EV/EBITDA (x)	5.1	20.2	24.0	6.2
PBR (x)	1.3	0.7	0.8	0.8
PER adj (x)	8.2	nm	nm	9.0
Dividend yield (%)	2.4	0.0	0.0	2.0

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-8	0	-51
Relative to Index	-5	2	-43
Relative to Sector	-	-	-
Major shareholder	Temasek Holdings (38.5%)		
Free float	61%		
Average turnover (US\$)	11,778,289		

Source: Company, Bloomberg



Valuation

We now forecast a slow recovery in H2 2012. Asia-Europe rates have been close to cash breakeven and historical lows for two quarters, and we assume the low rates will be sustained for another three quarters. As trade volume remains weak and freight rates are less likely to improve before the next peak season in 2012 (although it depends heavily on the macro economy, which is highly uncertain at present), we forecast NOL will post an operating loss of US\$119m in H2 2011 vs. an operating loss of US\$18m in H1 2011.

We forecast that NOL will make a normalised loss of US\$190m in 2011 and a loss of US\$226m in 2012. Although demand may continue to weaken in H1 2012 and we assume that freight rates in H1 2012 will be lower vs. H2 2011, we believe that NOL should be able to cut costs due to likely lower bunker prices and lower container and ship leasing costs.

We believe NOL is in a financially better positioned now than in 2008 given the lower pressure from high-cost, chartered-in vessels. NOL was unable to reach cash breakeven for five quarters from Q4 2008 and idled about 20% of its fleet in Q1 2009. Yet, running costs remain covered now.

Our new PT of **S\$1.0** is based on a price/adjusted NAV multiple of 0.60x, which is derived from a Gordon Growth Model with assumptions of a WACC of 10%, long-term growth of 1%, and a return on fleet of 6.4% 2012E. This implies 0.7x PBR 2012E.

Fig 57: Valuation

US\$m	New (2012E)	Old (2011E)	Comments
Shareholders' funds	2,750	3,408	Sharper-than-expected losses in 2011
Minus:			
Book value of vessels (owned+ financial leased)	(3,129)	(2,230)	NOL made up-front payments for 12 vessels ordered in 2011, but to be delivered in 2013-2014
Plus:			
Market value of vessels (owned+ financial leased)	2,535	1,682	NOL will receive eight vessels in 2012
Adjusted net asset value	2,156	2,860	
Multiples: Price/ NAV	0.60x	1.21x	Our new multiple is derived from a Gordon Growth Model, which is based on a return on fleet of 6.4% 2012E, a WACC of 10%, and long-term growth of 1%. Our return on fleet forecast was lowered from a previous estimate of 11.9% to 6.4% in 2012E
	1,299	3,449	
Payment of order book	762	720	
Fair value	2,061	4,169	
No. of shares outstanding (m)	2,580	2,580	
Fair value per share (US\$)	0.80	1.62	
Fair value (S\$)	0.96	2.26	

Source: NOL, Standard Chartered Research estimates

NOL has outperformed its peers fundamentally in 2011 as it has managed its capacity better amidst constrained capacity growth. Nevertheless, NOL will receive eight 10,000 TEU in 2012. Taking the leased capacity to be returned, we forecast NOL will grow capacity by 7.8% in 2012, versus a growth of 3.4% in 2011. We expect a larger capacity pressure for NOL in 2012.

In addition, NOL trades at 0.8x PBR 2012E, more demanding than the sector average of 0.7x now. Although NOL's share price is usually a lead for regional peers, if the sector recovers, we will take a more conservative stand before we see more positive movement on the macro outlook.



Income statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	6,516	9,422	9,180	9,919	11,569
Gross profit	(20)	1,269	560	565	1,228
SG&A	(612)	(690)	(707)	(734)	(845)
Other income	0	0	0	0	0
Other expenses	0	0	0	0	0
EBIT	(632)	579	(147)	(169)	384
Net interest	(52)	(56)	(61)	(87)	(108)
Associates	3	5	6	7	8
Other non operational	(18)	2	(22)	0	0
Exceptional items	(1)	0	0	0	0
Pretax profit	(700)	530	(223)	(250)	284
Taxation	(39)	(66)	(21)	25	(28)
Minority interests	2	3	(1)	(1)	2
Exceptional items after tax	0	0	0	0	0
Net profit	(737)	467	(246)	(226)	257
Net profit adj	(596)	462	(190)	(226)	257
EBITDA	(347)	864	157	168	762
EPS (US\$)	(0.36)	0.18	(0.10)	(0.09)	0.10
EPS adj (US\$)	(0.29)	0.18	(0.07)	(0.09)	0.10
DPS (US\$)	0.00	0.04	0.00	0.00	0.02
Avg fully diluted shares (m)	2,027	2,580	2,580	2,580	2,580

Balance sheet (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	333	977	395	295	247
Short term investments	0	0	0	0	0
Accounts receivable	815	1,082	1,054	1,139	1,329
Inventory	197	244	244	244	244
Other current assets	159	100	105	114	126
Total current assets	1,504	2,402	1,798	1,792	1,946
PP&E	3,509	3,691	4,119	4,705	5,398
Intangible assets	29	25	25	25	25
Associates and JVs	67	77	77	77	77
Other long term assets	231	255	255	255	255
Total long term assets	3,836	4,049	4,476	5,062	5,755
Total assets	5,341	6,451	6,274	6,855	7,701
Short term debt	21	21	21	21	21
Accounts payable	1,010	1,174	1,241	1,347	1,489
Other current liabilities	327	421	421	421	421
Total current liabilities	1,358	1,616	1,683	1,789	1,931
Long term debt	919	1,338	1,338	2,038	2,538
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	223	231	231	231	231
Total long term liabilities	1,142	1,569	1,569	2,269	2,769
Total liabilities	2,500	3,185	3,252	4,058	4,700
Shareholders' funds	2,797	3,222	2,976	2,750	2,956
Minority interests	44	43	45	46	45
Total equity	2,840	3,266	3,021	2,796	3,000
Total liabilities and equity	5,341	6,451	6,274	6,855	7,701
Net debt (cash)	607	382	965	1,764	2,312
Year end shares (m)	2,580	2,580	2,580	2,580	2,580

Source: Company, Standard Chartered Research estimates

Cash flow statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	(632)	579	(147)	(169)	384
Depreciation & amortisation	285	285	304	337	378
Net interest	(52)	(56)	(61)	(87)	(108)
Tax paid	(39)	(66)	(21)	25	(28)
Changes in working capital	(166)	(90)	89	12	(59)
Others	(6)	(20)	(16)	7	8
Cash flow from operations	(610)	633	148	125	574
Capex	(93)	(473)	(731)	(924)	(1,070)
Acquisitions	(8)	(6)	0	0	0
Disposals	27	28	0	0	0
Others	0	1	0	0	0
Cash flow from investing	(73)	(450)	(731)	(924)	(1,070)
Dividends	(42)	(3)	0	0	(51)
Issue of shares	965	1	0	0	0
Change in debt	(388)	407	0	700	500
Other financing cash flow	0	0	0	0	0
Cash flow from financing	587	461	0	700	449
Change in cash	(96)	644	(583)	(99)	(48)
Exchange rate effect	0	0	0	0	0
Free cash flow	(703)	160	(583)	(799)	(496)

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	-0.3	13.5	6.1	5.7	10.6
EBITDA margin (%)	-5.3	9.2	1.7	1.7	6.6
EBIT margin (%)	-9.7	6.1	-1.6	-1.7	3.3
Net margin adj (%)	-9.1	4.9	-2.1	-2.3	2.2
Effective tax rate (%)	-5.6	12.4	-9.5	10.0	10.0
Sales growth (%)	-29.8	44.6	-2.6	8.1	16.6
Net income growth (%)	nm	nm	nm	nm	nm
EPS growth (%)	nm	nm	nm	nm	nm
EPS growth adj (%)	nm	nm	nm	nm	nm
DPS growth (%)	nm	nm	nm	-	nm
Efficiency ratios					
ROE (%)	-28.1	15.5	-7.9	-7.9	9.0
ROCE (%)	-16.9	13.1	-3.1	-3.5	7.1
Asset turnover (x)	1.2	1.6	1.4	1.5	1.6
Op cash / EBIT (x)	1.0	1.1	-1.0	-0.7	1.5
Depreciation / CAPEX (x)	3.1	0.6	0.4	0.4	0.4
Inventory days	9.9	9.9	10.3	9.5	8.6
Accounts receivable days	46.0	36.7	42.5	40.4	38.9
Accounts payable days	58.0	48.9	51.1	50.5	50.1
Leverage ratios					
Net gearing (%)	21.4	11.7	31.9	63.1	77.1
Debt/capital (%)	23.6	28.1	29.6	40.7	44.4
Interest cover (x)	-10.7	9.6	-2.1	-1.8	3.5
Debt/EBITDA (x)	-3.1	1.3	8.7	10.1	3.0
Current ratio (x)	1.1	1.5	1.1	1.0	1.0
Valuation					
EV/Sales (x)	0.4	0.5	0.3	0.4	0.4
EV/EBITDA (x)	nm	5.1	20.2	24.0	6.2
EV/EBIT (x)	nm	7.6	nm	nm	12.4
PER (x)	nm	8.2	nm	nm	9.0
PER adj (x)	nm	8.2	nm	nm	9.0
PBR (x)	1.1	1.3	0.7	0.8	0.8
Dividend yield (%)	0.0	2.4	0.0	0.0	2.0



Orient Overseas International

A stronger survivor

- We expect the company to remain profitable in 2012.
- Tight capacity in 2011 and 2012 should support yield management.
- The company is trading at a cheaper valuation of 0.6x PBR 2012E than the sector average of 0.7x.
- We maintain our Outperform rating with a new price target of HK\$47 (HK\$57).

- **Tight capacity controls until 2012:** We forecast Orient Overseas (OOIL) will grow capacity by only 4% and 2% in 2011 and 2012, respectively, given limited new deliveries and the return for more chartered capacity. Only one 8,888 TEU vessel is set to be delivered in 2012. We believe OOIL could apply better yield management amid tight capacity.
- **Joined capacity competition:** OOIL was in a net cash position after the sale of its property division in 2010. The cash was used for a special dividend and new vessel purchase. Ten vessels of 13,000 TEU ordered in 2011 will be delivered in 2013–14 as management believes smaller vessels (<10,000TEU) would eventually result in OOIL losing its cost competitiveness in Asia-Europe trade. Despite high capex, we forecast net gearing of 11% in 2012.
- **Strong track record:** For the past 10 years (with the exception of 2009), OOIL has not posted a yearly loss whilst competitors made losses in 2001, 2006 and 2009. An operating margin of 6.5% also outperformed its Asian peers in H1 2011. We believe OOIL will remain in a stronger position in this trough cycle.
- **Valuation:** OOIL trades at 0.6x PBR 2012E, below the sector average of 0.7x; yet, the company remains profitable. Our more conservative earning forecasts have led us to cut our PT to HK\$47 (from HK\$57 set on 9 August 2011), based on a 0.83x price/adjusted NAV for 2012E. The multiple is derived from a Gordon Growth model with assumptions of a WACC of 10%, long-term growth of 1%, and a return on fleet of 7.5% 2012E. We maintain our Outperform rating.

OUTPERFORM (unchanged)

PRICE as at 25 November 2011 PRICE TARGET

HK\$33.75

HK\$47.00

Bloomberg code

316 HK

Reuters code

0316.HK

Market cap

HK\$21,121m (US\$2,709m)

12 month range

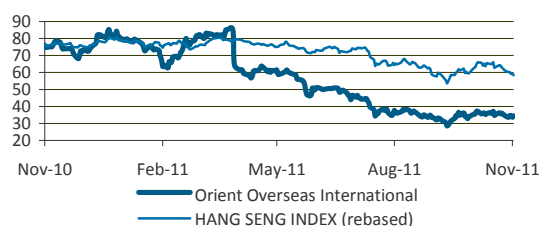
HK\$28.55 - 86.35

EPS adj est change 2011E 4.5% 2012E -45.7%

Year end: December	2010	2011E	2012E	2013E
Sales (US\$m)	6,033	6,034	6,478	7,687
EBITDA (US\$m)	1,160	522	551	988
EBIT (US\$m)	905	243	247	614
Pretax profit (US\$m)	899	240	249	616
Net profit adjusted (US\$m)	857	219	239	592
FCF (US\$m)	801	(144)	(13)	(116)
EPS adjusted (US\$)	1.37	0.35	0.38	0.95
DPS (US\$)	2.84	0.09	0.10	0.24
Book value/share (US\$)	8.91	6.86	7.15	7.85
EPS growth adj (%)	nm	-74.5	9.5	147.3
DPS growth (%)	nm	-96.9	9.1	147.3
EBITDA margin (%)	19.2	8.6	8.5	12.9
EBIT margin (%)	15.0	4.0	3.8	8.0
Net margin adj (%)	14.2	3.6	3.7	7.7
Div payout (%)	95.1	23.8	25.0	25.0
Net gearing (%)	-21.3	10.9	12.1	16.3
ROE (%)	39.2	4.7	5.5	12.6
ROCE (%)	12.8	3.5	4.2	9.9
EV/Sales (x)	0.8	0.5	0.5	0.5
EV/EBITDA (x)	4.4	6.2	6.0	3.6
PBR (x)	1.1	0.6	0.6	0.6
PER adj (x)	5.7	12.4	11.3	4.6
Dividend yield (%)	36.3	2.0	2.2	5.5

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-4	-11	-56
Relative to Index	1	-3	-43
Relative to Sector	-	-	-
Major shareholder	Chee Chen Tung (68.1%)		
Free float	32%		
Average turnover (US\$)	8,288,083		

Source: Company, Bloomberg

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Fig 58: Valuation – 2012E

	New	Old	
Shareholders' funds FY2012 (e)	4,482	4,628	We roll over our valuations to 2012
Minus:			
Book Value of Vessels (owned+ financial Leased)	(3,496)	(3,496)	Higher vessel in constructions as OOIL ordered 10 vessels of 13,208 TEU in 2011
Plus:			
Market Value of Vessels (owned+ financial Leased)	3,192	3,192	We assume flat YoY in second hand vessel prices in 2012. OOIL will have only on delivery of 8,888 TEU in 2012
Payment of Order book	386	235	15 vessels on order book including 5 vessels of 8,888 TEU each and 10 vessels of 13,208 TEU each
Adjusted NAV	4,565	4,559	
No. of Share Outstanding	626	626	
Adjusted Net Asset Value per share (US\$)	7.29	7.29	
Multiples: Price/NAV	83%	100%	Our new multiple is derived from a Gordon Growth Model, which is based on a return on fleet of 7.5% 2012E, a WACC of 10%, and long-term growth of 1%. Our return on fleet forecast was lowered from a previous estimate of 10% to 7.5% in 2012E
Price target per share (US\$)	6.04	7.27	
Price target Estimate (HK\$) 2012E	47.0	56.8	

Source: Company, Standard Chartered Research estimates



Income statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	4,350	6,033	6,034	6,478	7,687
Gross profit	76	1,362	719	760	1,154
SG&A	(418)	(488)	(513)	(538)	(565)
Other income	(0)	31	36	25	25
Other expenses	0	0	0	0	0
EBIT	(341)	905	243	247	614
Net interest	(26)	(16)	(12)	(8)	(9)
Associates	6	9	10	10	10
Other non operational	0	0	0	0	0
Exceptional items	0	0	0	0	0
Pretax profit	(362)	899	240	249	616
Taxation	(14)	(29)	(8)	(7)	(18)
Minority interests	(2)	(8)	(2)	(2)	(5)
Exceptional items after tax	(25)	1,005	0	0	0
Net profit	(402)	1,867	230	239	592
Net profit adj	(393)	857	219	239	592
EBITDA	(131)	1,160	522	551	988
EPS (US\$)	(0.64)	2.98	0.37	0.38	0.95
EPS adj (US\$)	(0.63)	1.37	0.35	0.38	0.95
DPS (US\$)	0.00	2.84	0.09	0.10	0.24
Avg fully diluted shares (m)	626	626	626	626	626

Balance sheet (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	1,225	3,852	1,196	1,124	860
Short term investments	0	0	0	0	0
Accounts receivable	380	455	455	489	580
Inventory	84	96	96	96	96
Other current assets	1,318	153	174	187	214
Total current assets	3,006	4,556	1,922	1,896	1,750
PP&E	3,798	3,860	4,315	4,588	5,316
Intangible assets	53	47	47	47	47
Associates and JVs	64	69	69	69	69
Other long term assets	409	540	545	545	545
Total long term assets	4,324	4,516	4,976	5,249	5,977
Total assets	7,330	9,072	6,898	7,145	7,727
Short term debt	432	248	248	248	248
Accounts payable	601	758	863	928	1,060
Other current liabilities	159	18	18	18	18
Total current liabilities	1,192	1,024	1,128	1,194	1,326
Long term debt	2,136	2,416	1,416	1,416	1,416
Convertible bonds	0	0	0	0	0
Deferred tax	31	40	40	40	40
Other long term liabilities	3	13	13	13	13
Total long term liabilities	2,170	2,469	1,469	1,469	1,469
Total liabilities	3,362	3,493	2,597	2,663	2,795
Shareholders' funds	3,945	5,573	4,292	4,471	4,915
Minority interests	24	7	9	11	16
Total equity	3,968	5,580	4,301	4,482	4,931
Total liabilities and equity	7,330	9,072	6,898	7,145	7,727
Net debt (cash)	1,343	(1,188)	468	540	804
Year end shares (m)	626	626	626	626	626

Cash flow statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	(341)	905	243	247	614
Depreciation & amortisation	211	255	279	304	375
Net interest	(53)	(44)	(12)	(8)	(9)
Tax paid	(0)	2	(8)	(7)	(18)
Changes in working capital	615	(34)	83	19	14
Others	(820)	61	10	10	10
Cash flow from operations	(389)	1,146	590	564	986
Capex	(376)	(345)	(734)	(577)	(1,102)
Acquisitions	0	0	0	0	0
Disposals	34	18	0	0	0
Others	46	(375)	0	0	0
Cash flow from investing	(329)	(698)	(734)	(577)	(1,102)
Dividends	(29)	(325)	(1,511)	(60)	(148)
Issue of shares	0	0	0	0	0
Change in debt	189	105	(1,000)	0	0
Other financing cash flow	(552)	(105)	0	0	0
Cash flow from financing	(393)	(324)	(2,511)	(60)	(148)
Change in cash	(1,111)	124	(2,655)	(73)	(264)
Exchange rate effect	0	0	0	0	0
Free cash flow	(765)	801	(144)	(13)	(116)

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	1.8	22.6	11.9	11.7	15.0
EBITDA margin (%)	-3.0	19.2	8.6	8.5	12.9
EBIT margin (%)	-7.8	15.0	4.0	3.8	8.0
Net margin adj (%)	-9.0	14.2	3.6	3.7	7.7
Effective tax rate (%)	-3.9	3.2	3.3	3.0	3.0
Sales growth (%)	-33.5	38.7	0.0	7.4	18.7
Net income growth (%)	nm	nm	-87.7	3.9	147.3
EPS growth (%)	nm	nm	-87.7	3.9	147.3
EPS growth adj (%)	nm	nm	-74.5	9.5	147.3
DPS growth (%)	nm	nm	-96.9	9.1	147.3
Efficiency ratios					
ROE (%)	-9.7	39.2	4.7	5.5	12.6
ROCE (%)	-5.3	12.8	3.5	4.2	9.9
Asset turnover (x)	0.6	0.7	0.8	0.9	1.0
Op cash / EBIT (x)	1.1	1.3	2.4	2.3	1.6
Depreciation / CAPEX (x)	0.6	0.7	0.4	0.5	0.3
Inventory days	7.4	7.0	6.6	6.1	5.4
Accounts receivable days	34.4	25.3	27.5	26.6	25.4
Accounts payable days	61.4	53.1	55.7	57.2	55.6
Leverage ratios					
Net gearing (%)	33.8	-21.3	10.9	12.1	16.3
Debt/capital (%)	41.8	33.1	28.8	28.0	26.0
Interest cover (x)	-9.7	31.1	8.2	9.6	24.0
Debt/EBITDA (x)	-16.8	2.3	4.2	3.0	1.7
Current ratio (x)	2.5	4.4	1.7	1.6	1.3
Valuation					
EV/Sales (x)	0.8	0.8	0.5	0.5	0.5
EV/EBITDA (x)	nm	4.4	6.2	6.0	3.6
EV/EBIT (x)	nm	5.6	13.4	13.5	5.9
PER (x)	nm	2.6	11.8	11.3	4.6
PER adj (x)	nm	5.7	12.4	11.3	4.6
PBR (x)	0.7	1.1	0.6	0.6	0.6
Dividend yield (%)	0.0	36.3	2.0	2.2	5.5

Source: Company, Standard Chartered Research estimates



Pacific Basin Shipping

Healthier handysize

- Supported by a smaller order book and an ageing fleet, which may trigger higher scrapping rates, Pacific Basin Shipping's (PB) handysize segment is more defensive than other dry bulk segments.
- We believe PB will remain profitable in 2012–13; yet, ROE is unlikely to be high. We lower our price target to HK\$3.60 (from HK\$4).
- We believe PB will weather the trough cycle well given its strong balance sheet and prudent management.
- We are long-term buyers if the share price drops below 0.5x PBR 2012E.

- **BDI rebound offers good window for capacity lock-in:** Until Q3 2011, a total 91% of Handysize vessel days for 2011 (31,370 days) were covered at an average rate of US\$13,450/day. Of the Handysize vessel days for 2012, 32% are covered at US\$13,540/day. The rebound in BDI from August should slightly boost newly locked-in rates in 2012. Nevertheless, given the current supply and demand dynamics, we believe that PB is unlikely to achieve an ROE higher than 5% before 2013 (on a fully diluted basis).
- **Unprofitable RoRo:** Until Q3 2011, 80% of RoRo vessel days for 2011 (1,570 days) are covered at an average rate of US\$20,290/day, whilst 16% of RoRo vessel days for 2012 (2,200 days) are covered at an average rate of US\$27,510/day. Given that the European economy will sustain its weakness into 2012, we believe demand for RoRo will remain depressed. We have factored in a sharper loss for the RoRo segment in 2012 as the three RoRos taken on in 2011 should have a full-year contribution in 2012.
- **Continued hunt for proper vessels:** The strong balance sheet and good read of cycles by management allow PB to purchase more vessels at low prices during trough cycles (as they sold them at nearly the peak). The Handysize second hand vessel prices have returned to levels seen in H1 2010 as "value prices," and we believe that PB should have planned more vessels additions in H1 2012.
- **Valuation:** We trim our net profit slightly to reflect the weak RoRo outlook and lower our target price to **HK\$3.60**. PB currently trades at 0.5x PBR 2012E. Maintain In-Line.

IN-LINE (unchanged)

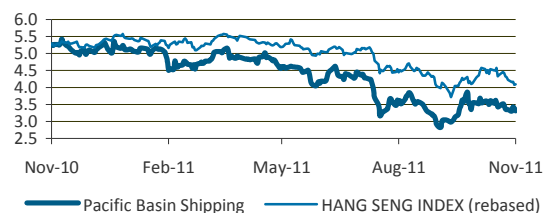
PRICE as at 24 November 2011 **PRICE TARGET**
HK\$3.31 **HK\$3.60**

Bloomberg code	Reuters code
2343 HK	2343.HK
Market cap	12 month range
HK\$7,151m (US\$917m)	HK\$2.82 - 5.42
EPS adj est change	2011E - 2012E -7.1%

Year end: December	2010	2011E	2012E	2013E
Sales (US\$m)	836	749	833	947
EBITDA (US\$m)	192	158	190	219
EBIT (US\$m)	134	72	94	112
Pretax profit (US\$m)	105	31	60	80
Net profit adjusted (US\$m)	102	47	59	79
FCF (US\$m)	(379)	(59)	42	49
EPS adjusted (US\$)	0.05	0.02	0.03	0.04
DPS (US\$)	0.03	0.01	0.01	0.02
Book value/share (US\$)	0.80	0.82	0.84	0.86
EPS growth adj (%)	13.2	-56.6	19.8	33.5
DPS growth (%)	-6.9	-60.6	26.4	33.5
EBITDA margin (%)	23.0	21.0	22.8	23.1
EBIT margin (%)	16.1	9.6	11.2	11.8
Net margin adj (%)	12.2	6.3	7.1	8.4
Div payout (%)	51.1	72.2	50.0	50.0
Net gearing (%)	11.0	2.1	1.4	0.8
ROE (%)	7.0	1.9	3.3	4.3
ROCE (%)	5.9	3.2	4.1	4.8
EV/Sales (x)	1.8	1.3	1.2	1.1
EV/EBITDA (x)	7.6	6.2	5.3	4.6
PBR (x)	0.8	0.5	0.5	0.5
PER adj (x)	13.9	18.6	15.5	11.7
Dividend yield (%)	3.8	2.6	3.2	4.3

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-7	-7	-37
Relative to Index	-2	1	-19
Relative to Sector	-	-	-
Major shareholder	Canadian Forest (10.2%)		
Free float	73%		
Average turnover (US\$)	2,631,194		

Source: Company, Bloomberg

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Income statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	683	836	749	833	947
Gross profit	153	159	111	117	135
SG&A	(12)	(13)	(13)	(13)	(13)
Other income	108	47	(16)	0	0
Other expenses	(116)	(59)	(10)	(10)	(10)
EBIT	132	134	72	94	112
Net interest	(27)	(31)	(31)	(24)	(24)
Associates	7	2	(10)	(10)	(8)
Other non operational	0	0	0	0	0
Exceptional items	0	0	0	0	0
Pretax profit	112	105	31	60	80
Taxation	(2)	(0)	(0)	(0)	(0)
Minority interests	0	0	0	0	0
Exceptional items after tax	0	0	0	0	0
Net profit	110	104	31	59	79
Net profit adj	87	102	47	59	79
EBITDA	173	192	158	190	219
EPS (US\$)	0.06	0.05	0.02	0.03	0.04
EPS adj (US\$)	0.05	0.05	0.02	0.03	0.04
DPS (US\$)	0.03	0.03	0.01	0.01	0.02
Avg fully diluted shares (m)	1,870	1,942	2,059	2,173	2,173

Balance sheet (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	1,049	690	509	521	532
Short term investments	0	0	0	0	0
Accounts receivable	90	111	100	111	126
Inventory	34	40	40	40	40
Other current assets	37	10	10	10	10
Total current assets	1,210	852	659	682	708
PP&E	998	1,519	1,629	1,650	1,683
Intangible assets	0	0	0	0	0
Associates and JVs	53	60	60	60	60
Other long term assets	209	125	125	125	125
Total long term assets	1,260	1,704	1,814	1,835	1,869
Total assets	2,470	2,555	2,473	2,518	2,577
Short term debt	0	0	0	0	0
Accounts payable	115	130	123	138	156
Other current liabilities	65	172	62	62	62
Total current liabilities	181	302	185	200	219
Long term debt	622	509	404	404	404
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	211	199	101	101	102
Total long term liabilities	834	708	505	505	506
Total liabilities	1,014	1,010	691	706	725
Shareholders' funds	1,456	1,545	1,782	1,812	1,852
Minority interests	0	0	0	0	0
Total equity	1,456	1,545	1,782	1,812	1,852
Total liabilities and equity	2,470	2,555	2,473	2,518	2,577
Net debt (cash)	(173)	170	38	26	15
Year end shares (m)	1,929	1,932	2,160	2,160	2,160

Cash flow statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	132	134	72	94	112
Depreciation & amortisation	41	58	85	96	107
Net interest	(27)	(37)	(31)	(24)	(24)
Tax paid	(2)	(2)	(0)	(0)	(0)
Changes in working capital	109	8	4	4	3
Others	(135)	2	(10)	(10)	(8)
Cash flow from operations	118	162	120	160	189
Capex	(275)	(541)	(179)	(118)	(140)
Acquisitions	(24)	(10)	0	0	0
Disposals	105	0	(16)	0	0
Others	16	89	(207)	0	0
Cash flow from investing	(178)	(462)	(403)	(118)	(140)
Dividends	(20)	(50)	(24)	(30)	(40)
Issue of shares	97	0	0	0	0
Change in debt	(121)	(10)	(105)	0	0
Other financing cash flow	127	0	230	0	1
Cash flow from financing	83	(60)	101	(30)	(39)
Change in cash	23	(359)	(181)	12	11
Exchange rate effect	0	0	0	0	0
Free cash flow	(157)	(379)	(59)	42	49

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	22.4	19.1	14.8	14.0	14.3
EBITDA margin (%)	25.4	23.0	21.0	22.8	23.1
EBIT margin (%)	19.4	16.1	9.6	11.2	11.8
Net margin adj (%)	12.7	12.2	6.3	7.1	8.4
Effective tax rate (%)	1.5	0.4	0.4	0.4	0.4
Sales growth (%)	-24.9	22.4	-10.5	11.3	13.7
Net income growth (%)	-73.0	-5.4	-70.5	92.9	33.5
EPS growth (%)	-75.8	-8.9	-72.1	82.7	33.5
EPS growth adj (%)	-78.4	13.2	-56.6	19.8	33.5
DPS growth (%)	-69.5	-6.9	-60.6	26.4	33.5
Efficiency ratios					
ROE (%)	8.2	7.0	1.9	3.3	4.3
ROCE (%)	6.1	5.9	3.2	4.1	4.8
Asset turnover (x)	0.3	0.3	0.3	0.3	0.4
Op cash / EBIT (x)	0.9	1.2	1.7	1.7	1.7
Depreciation / CAPEX (x)	0.1	0.1	0.5	0.8	0.8
Inventory days	42.7	19.9	22.8	20.3	17.9
Accounts receivable days	64.6	44.1	51.5	46.2	45.7
Accounts payable days	94.3	66.3	72.4	66.4	66.2
Leverage ratios					
Net gearing (%)	-11.9	11.0	2.1	1.4	0.8
Debt/capital (%)	27.2	22.6	17.7	17.4	17.1
Interest cover (x)	4.8	4.3	2.3	3.9	4.6
Debt/EBITDA (x)	3.5	2.9	2.9	2.1	1.8
Current ratio (x)	6.7	2.8	3.6	3.4	3.2
Valuation					
EV/Sales (x)	1.6	1.8	1.3	1.2	1.1
EV/EBITDA (x)	6.4	7.6	6.2	5.3	4.6
EV/EBIT (x)	8.3	10.9	13.4	10.7	8.9
PER (x)	10.8	13.5	28.2	15.5	11.6
PER adj (x)	13.9	13.9	18.6	15.5	11.7
PBR (x)	1.0	0.8	0.5	0.5	0.5
Dividend yield (%)	4.6	3.8	2.6	3.2	4.3

Source: Company, Standard Chartered Research estimates



SITC International Holdings

A proxy for strong intra-Asia trade

- We initiate coverage on SITC with an Outperform rating and a price target of HK\$2.80.
- SITC benefits from strong growth in intra-Asia trade and in China's logistics sector.
- It is less cyclical than other container liners with more stable profitability.
- It is trading at 0.8x PBR 2012E, yet an ROE of 16% 2012E makes the stock attractive.

- **Unique business model:** SITC enjoys a unique business model with balanced contributions from the shipping (sea) and logistics (land) businesses. Such a combination helps SITC capture more of the value in the logistics supply chain and to diversify the risks of a cyclical shipping business. With strong execution and positioning, SITC has the potential to be a scaled logistics integrator.
- **Benefits from growth of intra-Asia trade:** SITC is focusing on intra-Asia trade. Its unique business model utilises small vessels to offer highly frequent shipping services between China and Asia Pacific countries. The company benefits from the strong growth of intra-Asia trade (10% in 2012E), driven by rising domestic consumption and the constrained supply of small vessels.
- **A proxy for China's fast-growing logistics industry:** China's logistics sector is a fast-growing but fragmented one, given its low entry barriers and complex regulatory system. SITC is the eighth-largest domestic logistics provider in China, according to Drewry, and is well-positioned to capture the sector's opportunities and growth.
- **Valuation:** Our price target of **HK\$2.80** is based on a sum-of-the-parts valuation as SITC is composed of sea and land businesses. 2011E net cash represents 79% of its total market cap. It is trading at 0.8x PBR 2012E, yet an ROE of 16% 2012E makes it attractive.

OUTPERFORM (initiating coverage)

PRICE as at 24 November 2011 PRICE TARGET

HK\$1.66

HK\$2.80

Bloomberg code

1308 HK

Reuters code

1308.HK

Market cap

HK\$4,316m (US\$554m)

12 month range

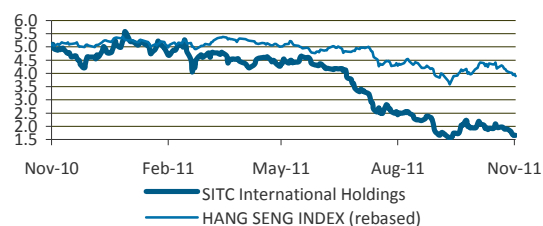
HK\$1.55 - 5.59

EPS adj est change NA

Year end: December	2010	2011E	2012E	2013E
Sales (US\$m)	892	1,095	1,178	1,414
EBITDA (US\$m)	131	95	110	180
EBIT (US\$m)	120	84	94	157
Pretax profit (US\$m)	115	94	105	164
Net profit adjusted (US\$m)	117	90	100	155
FCF (US\$m)	117	39	(141)	93
EPS adjusted (US\$)	0.04	0.03	0.04	0.06
DPS (US\$)	0.02	0.01	0.02	0.02
Book value/share (US\$)	0.21	0.23	0.26	0.29
EPS growth adj (%)	nm	-23.7	11.1	55.3
DPS growth (%)	nm	-10.4	11.1	55.3
EBITDA margin (%)	14.7	8.7	9.4	12.7
EBIT margin (%)	13.5	7.7	8.0	11.1
Net margin adj (%)	13.2	8.2	8.4	10.9
Div payout (%)	35.7	40.0	40.0	40.0
Net gearing (%)	-73.3	-67.6	-36.4	-35.9
ROE (%)	34.4	15.4	15.6	21.7
ROCE (%)	28.7	12.2	12.6	19.0
EV/Sales (x)	1.6	0.1	0.3	0.2
EV/EBITDA (x)	10.6	1.7	3.1	1.8
PBR (x)	2.8	0.9	0.8	0.7
PER adj (x)	13.4	6.2	5.6	3.6
Dividend yield (%)	2.5	6.4	7.1	11.1

Source: Company, Standard Chartered Research estimates

Share price performance



Share price (%)	-1 mth	-3 mth	-12 mth
Ordinary shares	-14	-32	-67
Relative to Index	-10	-26	-58
Relative to Sector	-	-	-
Major shareholder	Resourceful Link MG (55.1%)		
Free float	25%		
Average turnover (US\$)	1,425,642		

Source: Company, Bloomberg

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Executive summary

We initiate coverage on SITC (1308 HK) with an Outperform rating and a PT of HK\$2.80. We like the company for these reasons:

- **Unique business model:** SITC enjoys a unique business with balanced contributions from shipping (sea) and logistics (land) businesses. Such a combination helps SITC to capture more value of the logistics supply chain and diversify the risks of the cyclical nature of the shipping business. With strong executions and positioning, SITC has the potential to be a scaled logistics integrator.
- **Benefits from growth of intra-Asia trade:** SITC is focusing solely on intra-Asia trade. Its unique business model consistently uses small vessels to offer highly frequent shipping services between China and Asia Pacific countries. It benefits from the strong growth of intra-Asia trade (10% in 2012E), driven by rising domestic consumption and the constrained supply of small vessels.
- **A proxy for China's fast growing logistics industry:** China's logistics sector is fast growing, but very fragmented given the low entry barriers and complex regulatory system. SITC is the eighth-largest domestic logistics provider in China, according to Drewry, and is well-positioned to capture the sector's opportunities and growth.

Valuation

Our PT of **HK\$2.8** is based on SOTP valuation as SITC is composed of sea and land businesses.

Valuation based on SOTP method; we use NAV/share for sea business, PER for land business.

Fig 59: Valuation (US\$m)

	Value	Note
Sea business		
Market value of vessels	469	We forecast SITC will own 28 vessels by 2012
Return on fleet	8.3%	
EV/ fleet	81%	The multiple is based on the Gordon Growth Model and is derived from 10% return on fleet, WACC of 10%, and 1% long-term growth
Value of sea business	379	
Land business		
Segmental earnings 2012E	50	Our estimated earnings for the land-based business in 2012
PER multiple	8	The multiple we apply for logistics business in China
Value of land business	403	
Net debt	(259)	Despite high capex, SITC enjoys net cash position after the IPO
Total	1,042	
Fair value (10% discount to SOTP)	938	We apply a 10% discount to conglomerate companies given the inter-company transactions
No. of shares outstanding (m)	2,611	
Adjusted NAV per share (US\$)	0.36	
Fair value per share (HK\$)	2.79	

Source: SITC, Standard Chartered Research estimates

The sea business (container shipping) is cyclical. Given likely net losses made in the trough, we apply an asset-based valuation (price/adjusted NAV) for all shipping companies under our coverage. An earnings-based valuation is usually a good cross-check during the upswing cycle, as share prices are invariably driven by earnings upgrades. Therefore, we usually use PER to cross-check our valuations.

The land business (logistics business) has good growth potential. We believe an earnings-based valuation (PER) is more applicable and easier to compare with peers.

Our SOTP valuation applied a 10% discount for conglomerates, in line with our usual practice. The fair value of the sea business was derived from 0.8x price/adjusted NAV 2012E, which is based on a WACC of 10%, long-term growth of 1%, and a return on fleet of 8.3% 2012E. The fair value of the land business is based on 8x PER 2012E. The multiple is in line with what we had applied for all shipping/port and logistic companies.

Valuation comps

Although earnings in 2011 were weaker than expected, it still outperformed peers

SITC listed in October 2010 at an IPO price of HK\$4.78, which implies 13.7x PER 2010. As the container shipping sector entered into a downward trend in 2011, SITC's share price corrected by nearly 70% from its peak in January 2011. Although earnings in 2011 were weaker than expected, SITC still outperformed its regional peers in terms of profitability. We believe its valuation of 6x PER 2012E is compelling.

Fig 60: Historical PER



Source: SITC, Bloomberg, Standard Chartered Research estimates

Fig 61: Historical PBR



Source: SITC, Bloomberg, Standard Chartered Research estimates

SITC trades at a higher PBR of 0.8x PBR 2012E than those of its peers as it remains profitable and enjoys a much higher ROE of 15% and 16% in 2011 and 2012, respectively. Moreover, it is likely to have net cash of US\$440m by end-2011E, which represents 79% of its current market cap.

Risks

- **Weaker-than-expected economic outlook:** The macro outlook is likely to affect emerging markets' demand and global trade. If Europe and the US economy deteriorate further, intra-Asia trade will also be affected, albeit to a lesser extent compared with long-haul trade.
- **Weaker-than-expected freight rates:** Intra-Asia trade business is always competitive. Although SITC adopts unique strategies in its business operations, its average rates could be hurt by irrational price cuts in the market.
- **Higher-than-expected fuel prices:** Fuel costs represent over 20% of the overall cost of the shipping business, whilst land facilities consume energy as well. Oil prices recovered to nearly US\$100/bbl recently, and a surge in oil prices will hurt SITC's profitability. We have factored in a 14% rise in bunker costs in 2012, in line with our in-house forecasts.



Fig 62: Container shipping comps

	Rating	Code	Share price	Price target	PBR (x)			PER (x)			Dividend Yield			ROE		
					2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E	2011E	2012E	2013E
China COSCO	UP	1919 HK	HK\$3.29	HK\$2.70	0.7	0.7	0.7	(4.4)	(6.7)	6.5	0.0%	0.0%	4.1%	(14%)	(11%)	10%
CSCL	UP	2866 HK	HK\$1.29	HK\$1.00	0.5	0.5	0.5	(4.4)	(3.8)	4.2	0.0%	0.0%	12.8%	(10%)	(12%)	11%
OOIL	OP	316 HK	HK\$33.75	HK\$47.00	0.6	0.6	0.6	12.4	11.3	4.6	2.0%	2.2%	5.5%	5%	5%	13%
NOL	IL	NOL SP	SGD 1.03	SGD 1.00	0.7	0.8	0.8	(11.0)	(9.7)	9.0	0.0%	0.0%	2.0%	(8%)	(8%)	9%
SITC	OP	1308 HK	HK\$1.66	HK\$2.80	0.9	0.8	0.7	6.2	5.6	3.6	6.4%	7.1%	11.1%	15%	16%	22%
Evergreen	NR	2603 TT	NT\$14.70	NA	0.8	0.8	0.7	875.4	31.5	9.7	1.4%	1.6%	2.1%	0%	3%	8%
Yang Ming*	NR	2609 TT	NT\$10.80	NA	0.9	0.9	0.9	(5.1)	(18.5)	10.3	1.6%	0.4%	2.1%	(14%)	(4%)	9%
Wan Hai Lines	NR	2615 TT	NT\$13.05	NA	0.9	0.9	0.8	29.0	15.8	12.2	3.4%	3.2%	2.8%	3%	6%	8%
Hanjin Shipping	IL	117930 KS	KRW 8,070	KRW 8,500	0.4	0.6	0.4	(1.5)	(1.7)	1.8	0.0%	0.0%	5.4%	(21%)	(25%)	30%
Hyundai	NR	011200 KS	KRW 23,000	NA	1.4	1.2	1.1	(32.2)	15.3	8.8	1.6%	1.7%	1.7%	4%	12%	16%
Nippon Yusen	NR	9101 JP	JPY 154.00	NA	0.4	0.4	0.4	(29.9)	22.9	7.4	2.1%	2.1%	3.6%	(1%)	2%	5%
Kawasaki	NR	9107 JP	JPY 119.00	NA	0.3	0.4	0.3	(3.9)	(15.3)	10.3	0.2%	1.2%	3.6%	(8%)	(2%)	3%
Mitsui OSK	NR	9104 JP	JPY 220.00	NA	0.4	0.4	0.4	(56.3)	15.0	6.9	1.5%	2.0%	3.1%	(1%)	3%	6%
Sector average					0.7	0.7	0.6	59.6	4.7	7.3	1.6%	1.7%	4.6%	(4%)	(1%)	12%

Source: Bloomberg, Standard Chartered Research estimates, *Consensus estimates, ** Priced at 11 November 2011

Intra-Asia focus business model

- Intra-Asia trade represents over 30% of global trade and has been growing more rapidly than traditional container shipping routes of transpacific, transatlantic, and Asia-Europe trade. We believe domestic demand in Asia has driven trade growth.
- We saw less overcapacity in regional trade from long-haul routes in 2011. The rising average size of vessels used for long-haul routes has made the re-deployment of such mega vessels to other routes difficult.
- SITC is different from other competitors as its intra-Asia business is not a feeder service; it is more exposed to the China logistic business, has a different regional focus, and has a very different business model.

Focus on intra-Asia trade

SITC's focus only on intra-Asia trade.

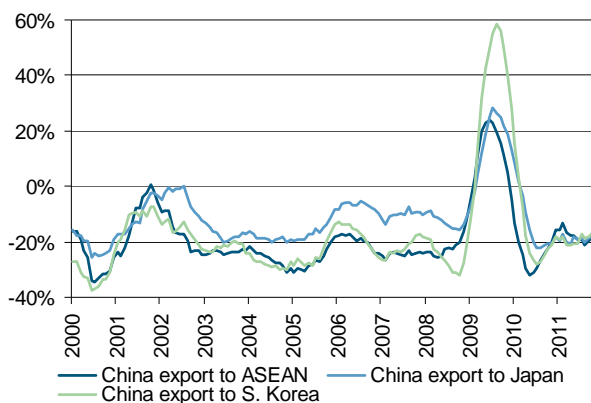
We forecast intra-Asia trade will grow 10%, higher than traditional container shipping routes.

Unlike other major container liners, SITC focuses only on only intra-Asia trade, and we believe it will be benefit from strong Asian domestic consumption growth.

Intra-Asia trade represents over 30% of global trade and has been growing more rapidly than traditional container shipping routes of trans-Pacific, trans-Atlantic, and Asia-Europe trade. In 2012, we forecast intra-Asia trade will grow 10%, whilst transpacific and Asia-Europe trade may grow only 4% and 0%, respectively, based on our base case scenario.

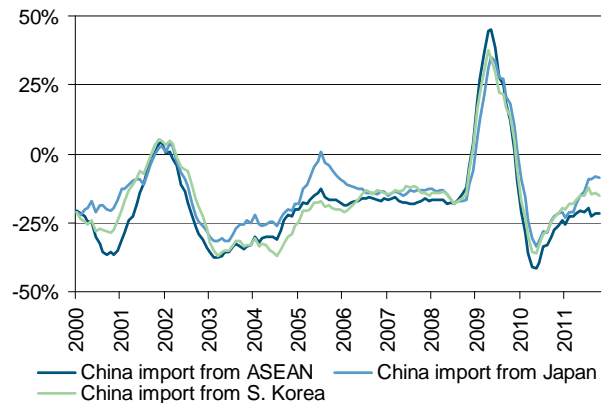
For the past five years (2006-2010,) China's exports (in terms of value) to Japan, Korea, and ASEAN countries increased at a CAGR of 7%, 11%, and 18%, respectively, whilst exports to the US and EU grew at a CAGR of only 9% and 14%. Given the poor outlook on western consumption, the boom in Asia should further support growth of intra-Asia trade.

Fig 63: China's export growth (2000-2010)



Source: CEIC, Standard Chartered Bank Research

Fig 64: China's import growth (2000-2010)



Source: CEIC, Standard Chartered Research

Domestic demand in Asia has driven the intra-Asia trade growth.

Prior to the 2008 financial crisis, China was the centre of global manufacturing. Whilst most assemblies were completed in China and then exported to the US or Europe, a large chunk of components were produced by China's neighbouring countries such as Japan, Korea, and Taiwan and then exported to China for assembly. Such manufacturing supply chains were the key drivers of intra-Asia trade previously. However, post-2008, we noted that intra-Asia trade volume did not slow down significantly due to weaker demand from the US and Europe. We believe domestic demand in Asia has driven trade growth.

At the recent Canton Trade Fair (which we believe is a leading indicator of China's exports for the next six months), transaction value was up 10% YoY and 6% HoH. Although orders from the US and Europe were down 19% HoH and 24% HoH, respectively, orders from emerging markets have offset the decline. This reflects increasing purchasing power from Asian consumers and the potential growth for intra-Asia trade.

Limited capacity cascading

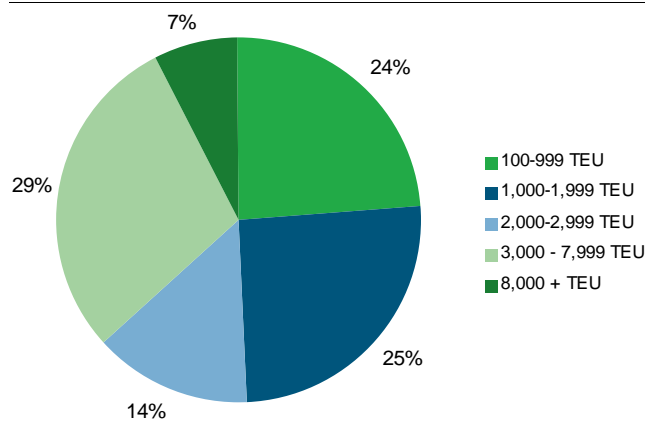
Mega vessels are hardly re-deployed into intra-Asia routes despite oversupply in long-haul routes.

In the past several trough cycles, overcapacity always cascaded into regional trade from long-haul routes. The decline in long-haul rates sequentially dragged intra-Asia rates as liners moved more capacity to regional routes to boost utilisation rates for large vessels used for long-haul routes.

Nevertheless, we saw a lesser extent of cascading in 2011. The rising average size of vessels used for long-haul routes has made the re-deployment of such mega vessels to other routes difficult. Vessels of 4,000-5,000 TEU only could be used for intra-Asia long haul routes and a few on China coastal routes are not yet economical for other smaller intra-Asia trade.

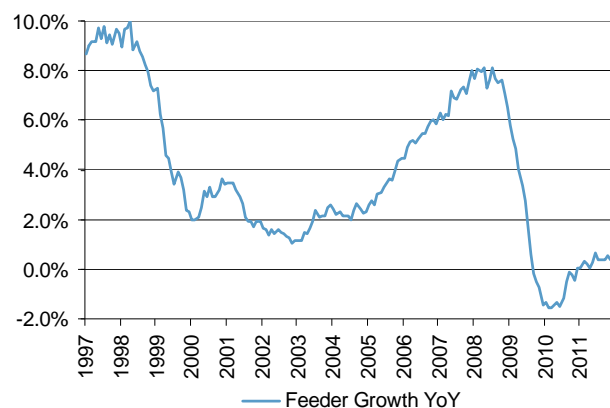
We usually see global container shipping as a whole market without segmentation as capacity (vessels) could be flexibly moved. As characteristic for each trade route is increasingly different from another, we see some possibilities for individual demand/supply balance of intra-Asia trade.

Fig 65: Global container fleet breakdown by vessel size



Source: Clarksons, Standard Chartered Research

Fig 66: Fleet growth for feeder vessels (<2,000TEU)



Source: Clarksons, Standard Chartered Research estimates

Is SITC different from other intra-Asia carriers?

The intra-Asia shipping market is always fragmented with many smaller players. PIL, Wan Hai Lines (2615 TT, NR), and RCL (RCL TP, NR) are considered the largest three intra-Asia focus carriers (with limited exposure to the long-haul business,) according to Drewry. We do not believe that SITC's operations are significantly different from theirs, but we identified the following specifications:

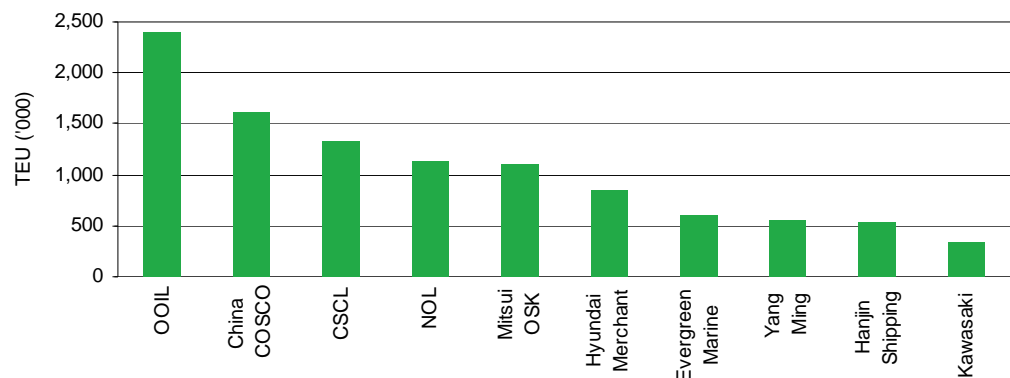
- **SITC not engaged in feeder services:** Over 50% of RCL's revenue is generated by feeder services. RCL moves cargos through small vessels to transshipment hubs (particularly Singapore) and uploads them to large ships heading to the US and Europe. Feeder services and transshipment volume is highly correlated with long-haul trade and benefit less from intra-Asia growth.
- **SITC's service density is higher:** SITC win clients by adding frequency, density, and port calls of service. SITC's smaller average size of fleet implies higher utilisation is required for the vessels to be more profitable. We believe that Wan Hai runs a similar network services model, but with large vessels, lower density, and higher exposure compared with regional countries.
- **SITC more exposed to China logistic business:** SITC, as a mainland company, has more exposure to the domestic logistic business compared with other container liners. SITC could offer more inland logistic services for exporters as a unique position over competitors.

SITC does not provide feeder service as it focuses on short-haul delivery, which has high frequency; it also provides inland logistics services

**Fig 67: Top 10 intra-Asia focus container liners (2009)**

Rank Company	
1	Pacific International Lines
2	Wan Hai Lines Company Limited
3	Regional Container Lines
4	SITC
5	TS Lines Limited (HK)
6	Sinotrans Container Lines Co.
7	Samudera Indonesia Group
8	Heung-A Shipping Co. Ltd
9	Korea Marine Transport Co. Ltd
10	Tokyo Senpaku Kaisha Ltd

Source: Drewry, Standard Chartered Research estimates

Fig 68: Top 10 Asian container liners' intra-Asia volume (2010)

Sources: The Companies, Standard Chartered Research

How SITC competes with long-haul liners?

Global container carriers could be categorised into three segments with different strategies in intra-Asia routes. We believe that SITC does not compete directly with global players given their different business models and route focus.

SITC does not compete directly with global players given different business model and route focus

- **Long-haul revenue model:** Most global container carriers apply different business models from that of SITC. The significant portion of their revenue is generated by long-haul routes, particularly transpacific and Asia-Europe routes. These carriers involve intra-Asia trade, largely for feeder cargo services for their international business, and the feeder services do not generate profits, e.g. in the case of Yang Ming Marine and Maersk.
- **Different regional focus:** Given the expanding definition of intra-Asia trade, now referred to as intra-Asia long-haul routes, such as China and the Middle East, have become new markets for liners. Liners operate intra-Asia long-haul routes in the same way as for other traditional routes. In addition, the China coastal trade route also offers potential, but only to domestic players. These routes are currently not SITC's areas of focus.
- **Different operating model:** Global players such as OOIL and NOL generate material revenue from intra-Asia trade and they directly compete with SITC; however, we believe they run a larger network with more port calls by using larger vessels. SITC consistently uses smaller ships and competes in terms of higher frequency, density, flexibility and higher utilisation rates. Services routes and frequency could be always adjusted by moving capacity to meet market demand and client needs.

Fig 69: Business model comparison between SITC and long-haul carriers

	SITC	Long -haul carriers
Business model	<p>Port A → Port B (Point to point)</p> <p>Port A → Port C → Port B → Port A (Loop)</p> <p>Port A → Port C → Port D → Port E → Port C → Port A (Butterfly)</p>	<p>Hub A → Hub B (Long-haul routes)</p>
Characteristic	<ul style="list-style-type: none"> Point to point: Non-stop one route service from origin to destination Loop services: One route service with multiple stops connected continuously Butterfly network service: Same as loop service, but under several routes 	<ul style="list-style-type: none"> Fill long-haul shipment through various origins
Advantages	<ul style="list-style-type: none"> Able to ship goods frequently within short distance Long-haul hub takes time to consolidate goods from different origins, the point-to-point network eliminates waiting time Different routes can be used within the network, only one route can be used for long-haul shipment The network can be expanded very easily and quickly The network can still operate normally if demand drops at one point 	<ul style="list-style-type: none"> Able to ship goods to far destinations
Disadvantages	<ul style="list-style-type: none"> Ports may not be able to entertain high frequencies of shipments Very difficult to expand network similar to that of long-haul network 	<ul style="list-style-type: none"> Highly dependent on timely shipment from each origin Higher container cost Vulnerable to economic downturn, if demand drops at one point, it may cause imbalance in shipments

Source: SITC, Standard Chartered Research estimates

Logistics business model in China

- China's logistics industry is highly fragmented due to lower entry barriers and a complex regulation system. The immaturity of its services industry and complicated regulatory procedures have made consolidations difficult.
- China's logistics industry is fast-growing with ample opportunities; however, sector integration may take time.
- With an accumulated customer base, strong executions track record and sufficient capital, SITC is potentially the consolidator in China and is one of the best proxies for the fast growing logistic sector in China.

Logistics industry in China

China logistics market is large, fragmented and fast growing

China's logistics market is large, fragmented and fast-growing. Over 700,000 logistics operators are currently registered in China. Logistic companies can be categorised into three types: in-house logistic players, third-party logistics providers and foreign logistics companies. While most state-owned enterprises, having traditionally self-managed their logistics departments, remain the dominant players, foreign players have emerged only since 2001, yet achieved success in some sub-segments, such as FedEx and UPS in the air cargo universe.

Fig 70: Top 10 domestic logistic providers in China

	Company	Descriptions
1	COSCO Logistics Co. Ltd (中国远洋物流有限公司)	A company under the COSCO Group, which provides modern logistics, international shipping agency, international multimodal transport, public freight agency, container terminal management, storage and vessel chartering.
2	China Railway Express Co. Ltd (中铁快运股份有限公司)	An affiliate of the Ministry of Railways, which involves cargo and ticketing services. It also operates delivery and agency services by either sea or air.
3	China Post Logistics Co. Ltd. (中邮物流有限责任公司)	A logistics company that specialises in running and managing postal logistics.
4	COSCO Shanghai International Ocean Freight & Forwarding Company (中远国际货运有限公司)	A company under the COSCO Group that focuses on shipping agency.
5	China Rail Container Transport Corporation (中铁集装箱运输有限责任公司)	An affiliate of the Ministry of Railways, which operates long-haul railroad freight services.
6	China Merchant Logistics Holdings Co. Ltd (招商局物流集团有限公司)	A company under China Merchant Group, which provides trucking and transfer services.
7	China Materials Storage and Transportation Corp. (中国物资储运总公司)	A member of China Cheng Tong Develop Group Ltd, which provides warehouse and logistics services in first-tier cities and key ports.
8	SITC Shipping Ltd (海丰国际航运集团有限公司)	A logistics service provider offering shipping, trucking, freight forwarding, warehousing and a shipping agency.
9	CNPC Transportation Company Limited (中国石油天然气运输公司)	China National Petroleum Corporation, which is engaged in the transportation of natural gas.
10	China Railway Modern Logistics Technology (中铁现代物流科技股份有限公司)	A company under the China Railway Material Commercial Group, which provides logistics services on bulk, steel, fast-moving consumer goods, automotives, and ports and finance logistics services.

Source: Standard Chartered Research

Low entry barrier, multiple regulatory entities, and third parties are not professional enough to provide tailor-made services

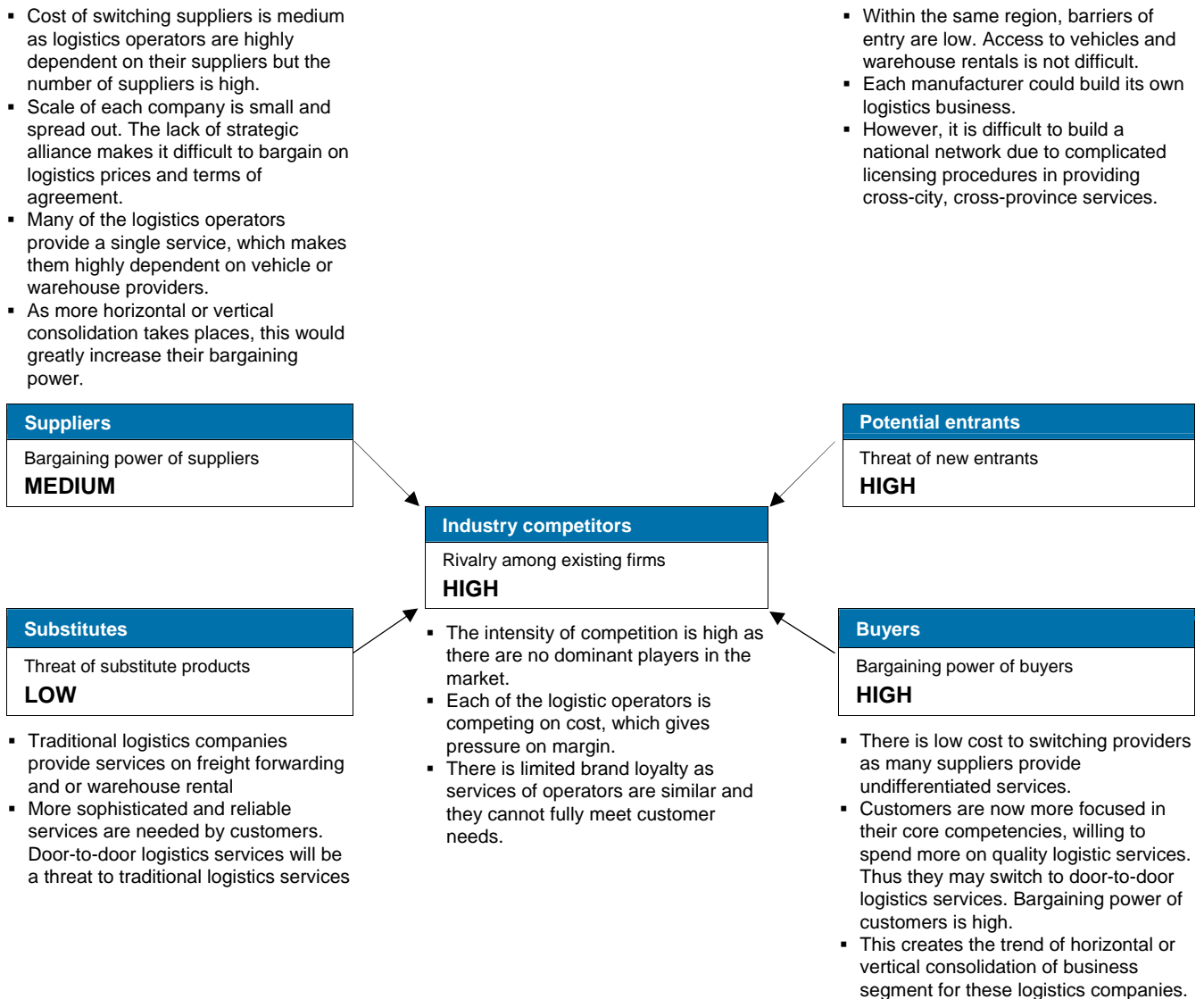
China's logistics industry is highly fragmented with even the largest players counting less than 2% of market share. We attribute this to the following reasons:

- **Low entry barriers:** The logistics business comprises a series of trivial service links. It is easier for smaller players to start a business by offering one or two services on the supply chain. They could survive with a low-cost basis, thus making industry consolidations difficult.
- **Multiple regulatory entities:** China's non-standardised and complicated licensing procedures prompt the entry of several small logistics players. Transport, railways, airlines and trade are regulated by different government departments. Varied licences are required to operate trucking services in different cities and provinces. Cross provinces and cross sub-segment consolidations are also difficult.

- **Immature service industry:** Logistics services should be highly differentiated and highly customised. However, third-party logistics providers are not professional enough to penetrate different industries to provide tailor-made services. Currently, most Chinese enterprises, not only state-owned companies, have to find internal logistics solutions on their own.

Five forces- too much competition

Fig 71: Porter's five competitive forces model



Adapted from: Porter 1980 p.4.
Source: SITC, Standard Chartered Research

We conclude three trends in China's logistics sector:

- **Change in consumer behaviour:** We believe manufacturers will focus more on their core competencies and should gradually outsource the logistic services. They will need more customized and sector specialised logistics services, transforming logistics service providers to be more specialised, diversified and professional.

Change in consumer behaviour, technology upgrade and rising demand for network across the country.

- **Technology upgrade:** Having a better IT system allows logistics operators to differentiate themselves from competitors. Take retailers, for example, such customers may expect logistics companies to provide services such as inventory management, product testing and secondary packaging in warehouse and transportation. A well developed IT system is required to connect the process efficiently.



- **Geographical expansion:** While manufacturers are re-locating to inner provinces to reduce production costs and retailers are building franchises in the faster growing 2nd or 3rd tier cities, logistics services can no longer be centralised in customers' traditional logistics centres in major cities but will diversify more into the newly built sub-warehouses in new economic and technological developed areas. This indicates a rising demand for network logistics and flow management across the whole country.

Competitiveness of SITC

SITC has wide variety of service and broad coverage of business geographically

SITC's land business includes freight forwarding, shipping agency, trucking and warehouse services. It owns a wide range of customers from multinationals or state-owned companies to small manufacturers, trading firms and ship operators. Itochu, Toyota and Tsingtao Beer are their signature clients. The service network is spread over 24 major cities in China, Japan, Korea, Vietnam and Hong Kong.

Fig 72: SITC's logistic business services

	Descriptions
Freight forwarding	Arrange transportation goods from origin to destination for customers. Help select the best freight rates, carriage condition, shipping schedules and ensure cargo pick-up and delivery
Trucking	Provide ground connections between origin and destination or ports
Depot and warehouse	Warehouses located in Qingdao, Shanghai and Vietnam
Custom clearance	Provide direct access to information system of customs
Shipping	Provide port-to-port sea transportation
Shipping agency	Help with vessel entry to or departure from ports; arrange pilotage, berthing, loading and discharge of vessels; sign bills of lading and manage container control.

Source: Standard Chartered Bank Research

SITC has developed competitive advantage through establishing a solid network, unique business strategies and a successful track record.

Strong customer relationship, unique business solutions and good reputation are its core competencies

- **Solid network:** SITC's solid customer relationship builds on its competitiveness. Such a relationship has been further enhanced by joint ventures with customers. Currently, SITC has a JV with Maersk Logistics, Itochu, Tsingdao Beer and Singamas, which helps create or gain market share and enhance its understanding of customers.
- **Unique business strategies:** SITC has very flexible business solutions that are tailored to customers' needs, thus creating customer loyalty. For example, SITC adjusted its port calling and voyage frequency for Toyota to provide on-time delivery. This enhanced the client's inventory management and helped it retain the customer's loyalty.
- **Successful track record:** SITC's strong track record differentiates it from competitors and creates brand loyalty. Its success in depot and warehouse business solutions in Qingdao Logistics Park earned it a market reputation that helps attract potential customers in other regions and retain customer loyalty in existing regions.

Sea-land logistics business model

- We believe integrated logistics services – with higher margin, lower capex and less cyclicity – make for better business than shipping. However, container liners hardly amplify their logistics contributions as cargo attractions are more important to liners.
- SITC enjoys balanced contributions from the shipping and logistics business due to a business model that is oriented towards service margin rather than market share.
- With a strong execution track record and well developed business model, SITC has the potential to be a scaled and integrated logistics provider in China.

Constraints in logistics business for container liners

Third-party logistics (3PL) appears to be a better service model than container liners given their 1) higher margin, 2) less cyclicity, and 3) lower capex. Container liners always intend to increase contributions from the logistics and freight forwarding business yet achieve little success. We believe liners' asset-heavy business model naturally constrains their logistics business from being highly profitable as we saw for integrated logistic providers such as Kuehne + Nagel, TNT Logistics or DB Schenker.

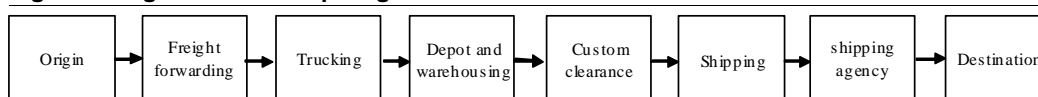
- **Logistics treated as sideline:** Liners' main business remains shipping. Filling vessels to ensure the utilization rates is their daily mission. Logistics is treated as a function of maintaining the relationship and to bring in cargoes and therefore margin is unlikely to be high.
- **More value added by 3PLs:** 3PLs offer more door-to-door, value-added, tailor-made and sector-specialized services for shippers. The services provide expertise to liners.
- **Economies of scale:** Large 3PLs, particularly in Europe, have a very strong and extensive client base. Shippers rely on 3PLs for total logistics solutions, leading 3PLs to be large-scale cargo collectors and distributors. Container liners and all other transportation suppliers have to rely on 3PLs to source cargos, and therefore, have margin taken away by them.

Unique combination

SITC is using an all-in-one business model as the company provides one-stop services which carries customer goods on land and transport them to their destination by sea. Its business model is more like a small 3PL than a container liner, for these reasons:

- The land business makes material contributions to SITC and the business runs under a total profit consideration.
- The sea business started from an asset-light basis with vessels that are consistently small and chartered. SITC was originally more focused on margin than volume.

Fig 73: Integrated “one-stop” logistic service



Source: Standard chartered Research

SITC provides a full “door to door” service to intra-Asia customers, enabling SITC to reap the margins of the whole supply chain. Total solutions allow shippers to reduce the number of suppliers on the logistics chain including freight forwarders, custom agency or warehouse services and save on the commissions charged by intermediaries for these services. At the same time, it gains margin by offering better time coordination, tailor-made services and one-stop services.

We believe the unique business model offers three key benefits to SITC:

Liners' assets heavy business model constrains them from being profitable in logistic segment

SITC's business model is more like 3PL since land business is significant and sea business has light assets base.

SITC's “door to door” service enables SITC to reap margin of whole supply chain



Unique business model captures value in supply chain, differentiate it from competitors and diversify business risk

- **Capture value for the supply chain:** Integrating the logistic services required by shippers/customers allows SITC to capture more value on the supply chain by value added services, removing intermediaries and saving coordinating time.
- **Increase competitiveness:** Having logistics solutions and land business in China distinguish SITC from other shipping liners. More importantly, these enhance SITC's understanding for customers which will increase its long-term competitiveness.
- **Diversify business risks:** Container shipping is a cyclical business with profits affected by fluctuation in freight rates, industry supply, and economic cycles. Land business is relatively stable and should cushion SITC's profitability during the shipping downturn.

Potential to transform into global logistics integrators?

We believe SITC's management is ambitious for being a global 3PL in a long run. Management understands the value of being a logistics total solution provider and has planned to expand both the land and sea business simultaneously. However, while SITC remains a relatively small company, we believe growing into a scaled logistics provider with wider geographical exposure takes a long time.

According to the several large logistics companies we spoke with, they believe dominant integrated logistics players will not appear in China in the short term, given the complexity of industry dynamics. We believe some challenges SITC will face are:

SITC is required to add services and expand geographically to grow into an international logistics integrator

- **Geographical expansion:** SITC enjoys strong positioning of its logistics business in some provinces; regulations and competition have made geographical expansion difficult. We believe SITC should be able to grow with its customers and expand its business through investment or acquisitions after receiving more capital from equity markets.
- **Service expansion:** SITC now focuses on container shipping, freight forwarding and trucking/warehousing business. To transform into a logistics total solutions provider, SITC may need to add services such as a wider range of land transportations, inventory management or even air cargo services by cooperating with third parties or investing into new areas.
- **Balancing sea and land businesses:** SITC has made more investments into vessels after the IPO. It is very likely to grow into another container liner if the marine business grows faster with more investment. The shipping business model is easier to duplicate; however, the logistics-centric model is non-standard and requires more trial and error.

Given the limited good proxies for China's logistics plays in the Hong Kong/China universe, we believe SITC is one of them. While it has a good business model and strong track record in execution, we believe SITC will continue to grow yet it could well develop into a strong, scaled logistics provider.



Financials

In the year to September 2011, SITC increased revenue by 21% YoY to US\$785m. However, net profits were down 13% YoY to US\$647m. Unlike other container shipping companies which made losses for the first three quarters, SITC remained highly profitable due to the support of the land business. Revenue rose not only due to higher volume but also better freight rates in the intra-Asia region, despite the sharp decline in rates for long-haul routes. We attribute the decline in earnings largely due to cost inflation, particularly in the rise in chartered-in costs and bunker costs.

We forecast SITC will earn US\$90m in 2011, down 20% YoY from the net profit of US\$112m in 2010. However, we forecast growth of 11% in 2012.

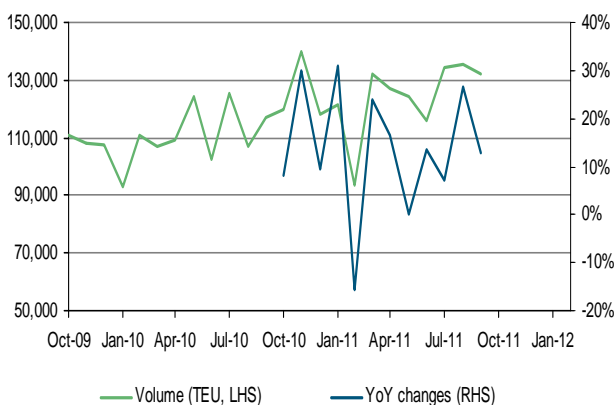
Sea business

We make the following assumptions for the sea business:

We expect SITC sea revenue will have a slight decrease of 2% despite higher shipping volume in 2012

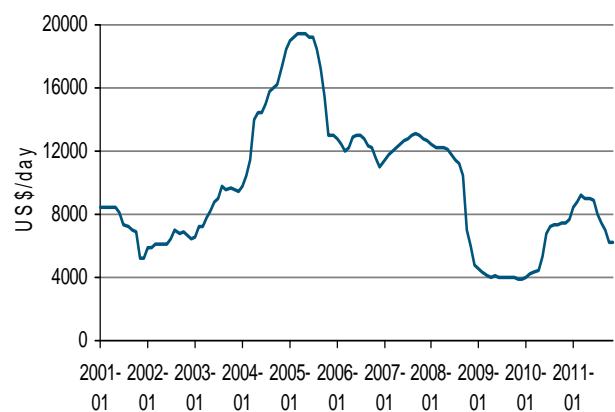
- **Volume:** SITC targets to grow capacity by 15% in 2012 and we forecast at least 10% growth in intra-Asia trade. We forecast it will grow its shipping volume by 12% each in 2012 and 2013. In the year to September, SITC's shipping volume was up 12%.
- **Freight rates:** Given healthy demand growth and constrained supply growth for smaller vessels in intra-Asia trade, we forecast SITC's unit revenue will rise 7% in 2011, despite +50% corrections in Asia-Europe and trans-Pacific rates. We conservatively forecast a 2% decline in SITC's unit revenue in 2012, despite fairly balanced supply-demand dynamics.
- **Charter costs:** The spot charter rates for vessels of 1,000TEU have corrected from the peak of US\$9,000/day to about US\$7,000/day now and we are likely to see US\$6,000TEU early next year. While SITC is likely to return 9 expensive charters after receiving 13 new deliveries in 2012, we forecast leased costs will decline 12% in 2012.

Fig 74: Monthly shipping volume



Source: SITC, Standard Chartered Research

Fig 75: Spot time charter rates (1,000TEU vessels)



Source: Clarksons, Standard Chartered Research estimates

Land business

We make the following assumptions for the sea business:

- **Volume for freight forwarder:** We forecast SITC will grow the volume of its freight forwarding business by 35% in 2011. The higher-than-average growth is due to the acquisition of a few third-party freight forwarders in mid-2010. We forecast more reasonable growth of 15% in 2012, slightly higher than the shipping volume growth.
- **Warehousing:** While SITC is still looking for new warehousing fields and is likely to make new investments in 2012, revenue for warehousing business should be more stable in 2012.



- **Margin:** We attribute the slightly lower margin of land business in 2011 to rising contributions from low margin forwarder agency business. Although the service mix should be more stable in 2012, we believe the logistics margin could be slightly squeezed in 2012 when overall shipping volume is weak.

Fig 76: P&L (US\$m)

Year-to-December	2009	2010	2011E	2012E	2013E
Revenue	694	892	1,095	1,178	1,414
Cost of Sales	(624)	(720)	(967)	(1,036)	(1,202)
Gross Profit	70	172	129	142	212
Other operating income	2	1	10	10	10
SG&A	(37)	(52)	(55)	(58)	(65)
EBITDA	48	131	95	110	180
EBIT	35	120	84	94	157
Interest income (expense)	(1)	(1)	10	10	7
Non-operating gain/ (loss)	0	(5)	0	0	0
Profit before Tax	34	115	94	105	164
Tax	(1)	(3)	(4)	(4)	(7)
Net Profit	33	112	90	101	157
Minority Interests	(0.3)	(0.3)	(0.9)	(1.0)	(2.6)
Net Profit Reported (to shareholders)	32	112	90	100	155
Minus: Exceptionals	0.4	(5.4)	-	-	-
Net Profit Normalised (to shareholders)	32	117	90	100	155
Dividend	0.0	(40.0)	(36)	(40)	(62)

Source: SITC, Standard chartered Research estimates

Balance sheet

We will not see net cash position until 2013 and the company is investing heavily into vessels

SITC was listed in October 2010 and raised about US\$400m. Despite the capex plan for vessel acquisitions, we forecast a net cash position for SITC at least until 2013.

The company targets capex of US\$75m and over US\$200m in 2011 and 2012, respectively, mainly for vessel acquisitions. Investments in land for its logistics have not been fully finalised. SITC is also likely to order more new ships in 2012 for 2013 deliveries.

Fig 77: Balance sheet

USD m	2009	2010	2011E	2012E	2013E
Cash and cash equivalents	66	515	518	337	368
Trade receivables	35	56	69	74	89
Prepayments & Other Receivable	37	18	22	23	28
Bunker fuel	8	12	15	16	19
Other Assets	29	-	-	-	-
Total Current Assets	175	601	623	450	504
Property, plant and equipment (Net)	165	160	224	467	531
Construction in progress	2	34	34	34	34
Investment in associate	0	0	0	0	0
Other non current assets	4	4	4	4	4
Total Non Current Assets	171	200	264	506	570
TOTAL Assets	346	800	887	957	1,073
Account payables	72	93	125	134	156
ST Borrowings	17	13	13	13	13
Tax payable	0	1	1	1	1
Provisions/Other	81	31	31	31	31
Total Current Liabilities	170	138	170	179	201
LT Borrowings	73	66	66	66	66
Other	3	1	1	1	1
Total Non Current Liabilities	77	66	66	66	66
Total Liabilities	247	204	236	245	267
Share capital	-	34	34	34	34
Reserves	7	-	-	-	-
Retained earnings	91	520	574	634	726
Minorities/ Other	2	42	43	44	47
Total Shareholder's fund	100	596.0	651	711	807

Source: SITC, Standard chartered Research estimates

SITC snapshots

SITC is a PRC-based, non-state-owned logistic company that provides integrated transportation solutions

SITC International Holdings Co., Ltd was established in 2006. It is a PRC-based, non-state-owned logistic company that provides integrated transportation and logistic solutions. SITC focuses on servicing the intra-Asia trade market. The company went public on the Hong Kong Stock Exchange in October 2010.

In contrast to the traditional hub-spoke shipping model adopted by many long-haul carriers, SITC provides container shipping services with high frequency and high density to satisfy customer needs. Land-based businesses including freight forwarding, shipping agency, depot and warehousing, while customs clearance, trucking and ship brokerage services offers "one stop shopping" services for shipping customers.

Breakdown of its business lines

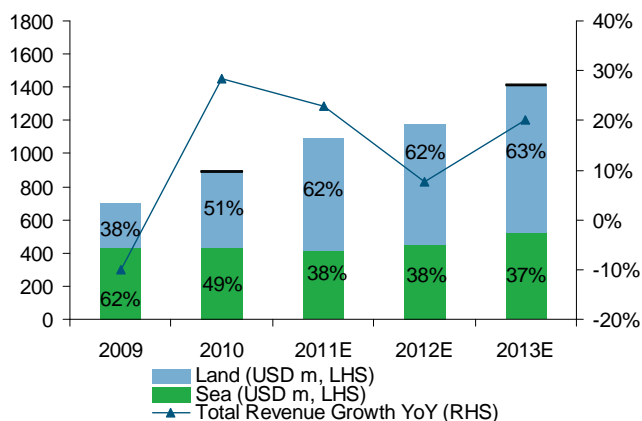
SITC has two segments: land and sea based. Each contributes approximately half of revenue. For the sea business (container shipping) SITC focuses only on the intra-Asia region. Shipping volume is likely to hit 1.5m TEU in 2011, based on our forecasts. It has had a CAGR of 16% for the last five years, versus 3.6% for global container trade. Since 2010, SITC has been actively expanding its south Asia business and added more south Asia routes.

Strong logistics business cushioned profit contractions in shipping in 2011

SITC's earnings growth was particularly strong in 2008–09 due to comparatively strong container rates. At the same time, the company also made strong progress in the land based business by extending its shipping relationship to land logistics. In 2009, 87.4% of the cargoes were handled by both sea and land based services. SITC also planned to add port services to its service supply chain and targets to expand to Qingdao port.

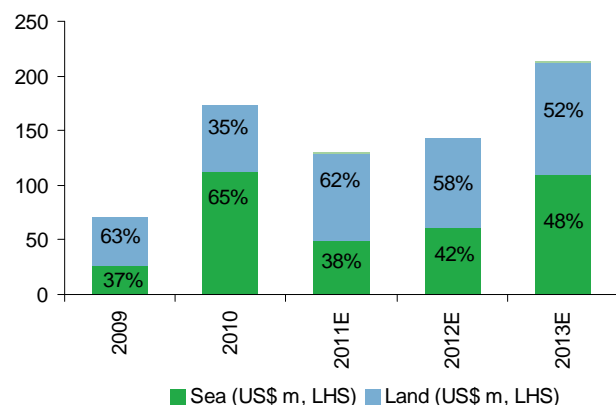
In 2011, we forecast SITC will generate 38% and 62% of the revenue from its sea and land based business, respectively. While cost inflation has hurt the profitability of the cyclical shipping business, acquisitions of a few third-party freight forwarders have boosted the growth of the land based business.

Fig 78: Revenue breakdown (2009–13E)



Source: SITC, Standard Chartered Research Estimate

Fig 79: Gross profit breakdown (2009–13E)



Source: SITC, Standard Chartered Research Estimate

Fleet profile

SITC consistently uses c.1,000 TEU vessels

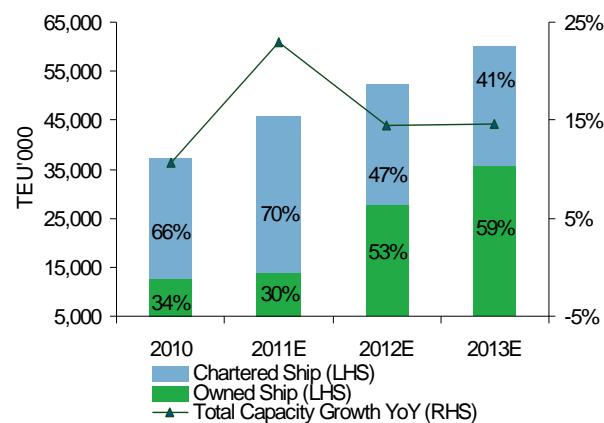
SITC uses a single-type fleet (vessel of c.1000TEU) to operate the shipping business. This has contributed to high space utilization and operating efficiency. As of June 2011, the average age of its vessels was 6.9 years. Among their 49 vessels, 16 were self-owned and 33 were time-chartered. While leased costs made a material impact on earnings, SITC plans to increase owned capacity by ordering more vessels.

SITC targets to raise proportion of owned vessels at least to 50%

SITC targets to increase self-owned vessels to 30 within 3–5 years with a total of 80 vessels. In 2011, it added two second-hand vessels of 1,985 TEU and ordered 13 new vessels to be delivered in 2012. While management believes new shipbuilding prices have limited downside as they are close to builders' costs, SITC is likely to order more vessels in 2013, in our view, although the market outlook remains a concern.

SITC charters vessels usually on a one-year basis. This helps to reduce the risk on increased chartering rates. When chartered costs were high in mid 2011, it shortened the charter contract period into 2–3 months.

Fig 80: Fleet capacity (2010–13E)



Source: SITC, Standard Chartered Research Estimate

Shareholders

Fig 81: Major shareholders 2011

Holders	% of holdings	Note
Resourceful Link Management Ltd	55.07%	A trust set up by the management
Citigroup Incorporation	0.36%	
Peng Xue	0.98%	
Alliance Bernstein Luxembourg SA	0.48%	
Sanford C Bernstein & Co., Inc.	0.41%	
AGF Investment Inc.	0.22%	
Shaopeng Yang	0.22%	
Amundi Luxembourg SA	0.19%	
Japan Fund Management SA	0.15%	
Others	41.92%	Mainly institutional investors

Source: Bloomberg, Standard Chartered Research



Income statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Sales	694	892	1,095	1,178	1,414
Gross profit	70	172	129	142	212
SG&A	(37)	(52)	(55)	(58)	(65)
Other income	2	1	10	10	10
Other expenses	0	0	0	0	0
EBIT	35	120	84	94	157
Net interest	(1)	(0)	10	10	7
Associates	0	0	0	0	0
Other non operational	0	0	0	0	0
Exceptional items	0	(5)	0	0	0
Pretax profit	34	115	94	105	164
Taxation	(1)	(3)	(4)	(4)	(7)
Minority interests	(0)	(0)	(1)	(1)	(3)
Exceptional items after tax	0	0	0	0	0
Net profit	32	112	90	100	155
Net profit adj	32	117	90	100	155
EBITDA	48	131	95	110	180
EPS (US\$)	0.00	0.04	0.03	0.04	0.06
EPS adj (US\$)	0.00	0.04	0.03	0.04	0.06
DPS (US\$)	0.00	0.02	0.01	0.02	0.02
Avg fully diluted shares (m)	0	2,611	2,611	2,611	2,611

Balance sheet (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
Cash	66	515	518	337	368
Short term investments	0	0	0	0	0
Accounts receivable	35	56	69	74	89
Inventory	8	12	14	16	19
Other current assets	66	18	22	23	28
Total current assets	175	601	623	450	504
PP&E	165	160	224	467	531
Intangible assets	0	0	0	0	0
Associates and JVs	0	0	0	0	0
Other long term assets	6	39	39	39	39
Total long term assets	171	200	264	506	570
Total assets	346	800	887	957	1,073
Short term debt	17	13	13	13	13
Accounts payable	72	93	125	134	156
Other current liabilities	81	32	32	32	32
Total current liabilities	170	138	170	179	201
Long term debt	73	66	66	66	66
Convertible bonds	0	0	0	0	0
Deferred tax	0	0	0	0	0
Other long term liabilities	3	1	1	1	1
Total long term liabilities	77	66	66	66	66
Total liabilities	247	204	236	245	267
Shareholders' funds	98	554	607	667	760
Minority interests	2	42	43	44	47
Total equity	100	596	651	711	807
Total liabilities and equity	346	800	887	957	1,073
Net debt (cash)	24	(437)	(440)	(259)	(290)
Year end shares (m)	0	2,611	2,611	2,611	2,611

Source: Company, Standard Chartered Research estimates

Cash flow statement (US\$m)

Year end: Dec	2009	2010	2011E	2012E	2013E
EBIT	35	120	84	94	157
Depreciation & amortisation	14	11	11	16	23
Net interest	(1)	1	10	10	7
Tax paid	(2)	(2)	(4)	(4)	(7)
Changes in working capital	(13)	45	12	1	(1)
Others	14	(19)	0	0	0
Cash flow from operations	46	156	114	118	179
Capex	(14)	(39)	(75)	(259)	(86)
Acquisitions	(0)	0	0	0	0
Disposals	0	1	0	0	0
Others	6	(0)	0	0	0
Cash flow from investing	(8)	(38)	(75)	(259)	(86)
Dividends	0	(40)	(36)	(40)	(62)
Issue of shares	0	385	0	0	0
Change in debt	(21)	(18)	0	0	0
Other financing cash flow	(1)	(0)	0	0	0
Cash flow from financing	(23)	327	(36)	(40)	(62)
Change in cash	15	445	3	(181)	31
Exchange rate effect	(0)	4	0	0	0
Free cash flow	32	117	39	(141)	93

Financial ratios and other

Year end: Dec	2009	2010	2011E	2012E	2013E
Operating ratios					
Gross margin (%)	10.1	19.3	11.8	12.1	15.0
EBITDA margin (%)	6.9	14.7	8.7	9.4	12.7
EBIT margin (%)	5.0	13.5	7.7	8.0	11.1
Net margin adj (%)	4.6	13.2	8.2	8.4	10.9
Effective tax rate (%)	4.4	2.3	4.0	4.0	4.0
Sales growth (%)	-10.1	28.4	22.9	7.6	20.0
Net income growth (%)	-8.3	247.9	-20.0	11.1	55.3
EPS growth (%)	-	nm	-20.0	11.1	55.3
EPS growth adj (%)	-	nm	-23.7	11.1	55.3
DPS growth (%)	-	nm	-10.4	11.1	55.3
Efficiency ratios					
ROE (%)	32.9	34.4	15.4	15.6	21.7
ROCE (%)	18.8	28.7	12.2	12.6	19.0
Asset turnover (x)	2.2	1.6	1.3	1.3	1.4
Op cash / EBIT (x)	1.3	1.3	1.4	1.2	1.1
Depreciation / CAPEX (x)	1.0	0.3	0.1	0.1	0.3
Inventory days	3.8	4.9	5.0	5.3	5.2
Accounts receivable days	17.1	18.7	20.8	22.1	21.0
Accounts payable days	37.1	41.8	41.2	45.7	44.0
Leverage ratios					
Net gearing (%)	24.3	-73.3	-67.6	-36.4	-35.9
Debt/capital (%)	51.2	11.8	10.9	10.1	9.0
Interest cover (x)	19.8	71.7	nm	nm	nm
Debt/EBITDA (x)	2.1	0.6	0.8	0.7	0.4
Current ratio (x)	1.0	4.3	3.7	2.5	2.5
Valuation					
EV/Sales (x)	-	1.6	0.2	0.4	0.3
EV/EBITDA (x)	-	10.6	2.8	4.0	2.3
EV/EBIT (x)	-	11.6	3.2	4.7	2.7
PER (x)	-	14.1	7.4	6.6	4.3
PER adj (x)	-	13.4	7.4	6.6	4.3
PBR (x)	-	2.8	1.1	1.0	0.9
Dividend yield (%)	-	2.5	5.4	6.0	9.3



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As of 30 September 2011

Research Recommendation

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