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Executive Summary

Despite the threat of further sanctions hanging over it, the outlook for Iran's maritime sector looks positive. From the port perspective, container volumes at the port of Bandar Abbas defied the downturn, with y-o-y growth of 10.3% in 2009; further growth of 8.65% is projected by **BMI** in 2010.

Container throughput outperformed **BMI**'s estimates for total trade in 2009, with our country risk team estimating that total trade fell by 2.9% y-o-y. We believe that container throughput's resistance to the downturn stems from cargo associated with Iran's key sector, oil production. Container growth tends to also tie in with strengthening consumer demand.

The most obvious downside risk to our forecast remains the threat of further sanctions, which if implemented are likely to hit the trade sector and therefore shipping. Iranian shipping line **Islamic Republic of Iran Shipping** (IRISL) has already been directly hit by sanctions from both the US and UK and companies associated with the global maritime sector appear to be wary of the reputational costs of involvement in Iran's port and shipping sector. We have previously noted a similar trend in the maritime sector, with port developer **Hamburg Port Consulting** (HPC) pulling out of a contract to renovate the Iranian port of Bandar Abbas and French container line **CMA CGM** going out of its way to put distance between itself and the claims from Iranian newspaper the Tehran Times that the company's vessel *Simba* pulling into the Iranian port of Bushehr was the start of significant operational activity by CMA CGM in Bushehr.

Although some states and companies might be keen to distance themselves from Iran's trade and shipping sector, others appear to be still willing to do business. The major development over the quarter has been the announcement that Brazil and Iran plan to launch a shipping line together. The plan ties in with growing trade relations between the two nations, with Iran importing Brazilian beef and sugar and Brazil indicating an interest in the phosphate and urea trade from Iran. The Islamic Republic of Iran has started pushing for a further cementing of this trade alliance with the country's government pushing for a trade agreement with Mercosur.

These warming trade relations tie in with a trend of improving political relations between the two countries, which our country risk team has noted. Brazil's president, Luiz Inácio Lula da Silva, is due to visit Tehran in May 2010, following a trip by the Iranian president, Mahmoud Ahmadinejad, to Brazil last year. Brazil has also been less tough than other nations on the issue of Iran's reported desire to develop nuclear weapons, with the country among the group of states that tend to abstain from voting in the UN on the issue.

SWOT Analysis

Iran Shipping SWOT	
Strengths	▪ The port of Bandar Abbas managed to defy the global downturn in shipping, posting positive growth in 2009. ▪ Iran's location on the Gulf allows it access (via the Straits of Hormuz) to major shipping lanes heading both east and west. ▪ Iran's ports feature as ports of call on Maersk Line, IRISL, MOL and Evergreen services. ▪ Iran's navy is involved in protecting Iranian vessels from pirate attacks in the Gulf of Aden.
Weaknesses	▪ Iranian President Mahmoud Ahmadinejad has announced a ban on the purchase of foreign vessels by Iranian companies. This could have a negative impact on fleet expansion. ▪ The reputation of Islamic Republic of Iran Shipping Lines (IRISL), Iran's national maritime carrier, has been tarnished by reports that vessels that it has chartered have been exporting arms illegally. ▪ Foreign companies have distanced themselves from operating in Iran's maritime sector, with HPC pulling out of a contact to renovate the port of Bandar Abbas.
Opportunities	▪ A gradual recovery in Iran's trade volumes is forecast to begin in 2010. ▪ Iran has launched its first domestically produced container vessel. ▪ The country is planning to privatise its ports, with operational contracts to be awarded for 20- to 40-year periods ▪ Kuwait has earmarked a specific port for Iranian imports following an improvement in trade ties between the two nations. ▪ Iran is pushing for a trade agreement with Mercosur on the back of warming political and trade relations with Brazil.
Threats	▪ The threat of conflict in the Straits of Hormuz remains, and Iran has said that it will close the straits if it is attacked by the US or Israel. ▪ Further sanctions imposed by the international community could increase the damage visited on Iran's trade. ▪ The US Treasury Department has sanctions in place against the IRISL and 18 of its affiliates. ▪ The UK Treasury has ordered the ceasing of all business between UK financial services and the IRISL. ▪ Israel has displayed its ability to place diplomatic pressure on foreign countries dealing with Iran, a recent example being HPC's decision to abandon a project at Bandar Abbas.

Global Overview

Container Shipping Overview

Core Views

- Strong recovery in Q110 not indicative of a trend for the full year
- Shipping lines to continue pursuing cautious strategies
- Oversupply still a threat
- Bailouts threaten sectors recovery

Blip Or Strong Recovery?

The question that all those who follow the container shipping sector are trying to answer is whether the growth that has been witnessed over the quarter is due to restocking or an indication of a recovery. As with most arguments in the container shipping sector, shippers and the carriers have taken opposing sides, with their agendas obvious. As **BMI** has no agenda, we let our data forecasts and analysis do the talking. First, however, let's explore the background to this debate, which centres on the direction the container industry will take over the next year.

The debate kicked off with the CEO of **Maersk Line**, the largest container ship operator and so an industry bellwether, stating that the growth seen in Q110 was due to restocking, and that for it to be a recovery 'we need to see retail sales and consumer spending increase again'. This view was backed by a poll held by International Freighting Weekly, a journal for shipping industry professionals, which reported that 70% of its 280 polled readers had sided with the shipping line's view of restocking not recovery.

Shippers, unsurprisingly, take a polar opposite view to the carriers, with **Ceva Logistics**' chief operating officer, Bruno Sidler, asserting that a recovery rather than restocking is afoot. He has said that it is not warehouse demand, but rather direct shipments to customers that backs this view.

BMI notes that both sides have their own agendas to push. By claiming re-stocking, shipping lines have an excuse to manage their capacity and withhold adding extra vessels from service, backed by the argument that by releasing more capacity into the market they will be back to the same position they were in at the beginning of 2009, when oversupply led to rate falls. This contraction of capacity has led to lines being able to create a scarcity of supply, which in turn has enabled lines to push rates up as the supply-demand equilibrium is in suppliers' favour. It is shippers who have been hit by the rate hikes, and they complain that ships are standing idle when they could be brought back into use. For these ships to be brought back online, however, shippers need to persuade lines that the recovery is sustainable.

Q110 Indicates A Recovery, But Is It A Reliable Indicator?

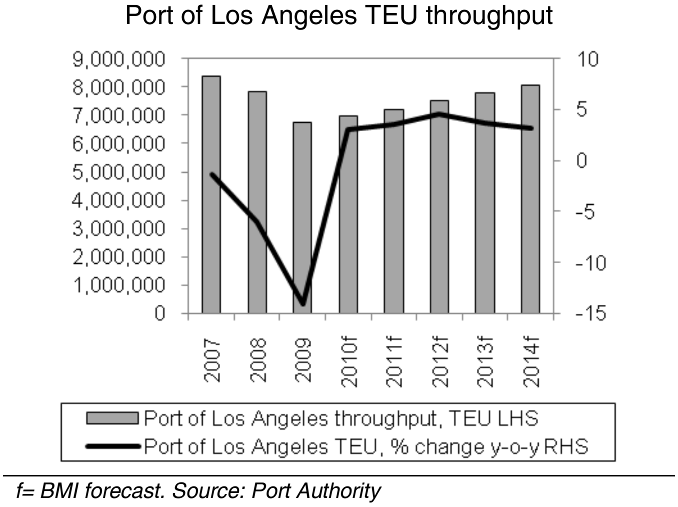
Indications in Q110 display a sector in the midst of a recovery, with shipping lines extolling a positive outlook for 2010 and ports throughout the world recording year-on-year (y-o-y) growth. **BMI** is cautious about the extent of the recovery, as throughput figures in Q109 plunged so dramatically that any increase would spell a recovery in y-o-y throughput analysis terms. **BMI** therefore explores Q110 figures in comparison with Q108 figures to determine the extent of the recovery. We also point to our year-long container throughput indicators for the world's bellwether ports. The forecasts take into account **BMI**'s country risk trade estimates for the whole year, which even out the extent of the recovery. The general global trend indicates increased throughput compared with 2009, meaning the beginnings of a recovery, but not a complete one, with few ports managing to recapture their pre-downturn box volumes.

Transpacific - The Major Container Bellwether

China's main container ports have all posted y-o-y growth in Q110, with the country's main box port posting a throughput increase of 14.6%. The ports of Shenzhen, Guanghou and Qingdao posted y-o-y growth of 26.7%, 28.2% and 9% respectively in the first quarter. Chinese ports' container throughput reached 28.8mn in Q110, up 21% on Q109, but more interestingly up 6% on the same period in 2008.

The US container port bellwether of Los Angeles has also managed to pull itself out of the downturn, with the port handling 1.6mn 20-foot equivalent units (TEUs) in Q110, a y-o-y increase of 7.94%. Unlike its Chinese peers, the port is still some way off a full recovery, with the port's Q110 throughput of 201,207TEUs below the Q108 throughput figure.

Back In Positive Territory, But Still Some Way To Go



f= BMI forecast. Source: Port Authority

BMI is forecasting y-o-y box throughput growth for the whole of 2010 at China's main container port of Shanghai. We project that the port will handle 27mn TEUs in 2010, a y-o-y increase of 10.58%, but a growth that is not enough for it to reclaim its pre-downturn throughput of 28mn TEUs in 2008.

China's container throughput is being driven by the country's export demand, with export volumes set to grow by 14% in 2010. The growth has been encouraged by the returning demand of the US, whose imports are forecast to increase by 7.3% in 2010.

BMI's whole-year forecasts for the port of Los Angeles display a projected box throughput growth of 3.04% to 6.9mn TEUs. As already mentioned, the uptick in container volumes is being driven by the USA's returning import demand, which in turn is at the macro level being driven by a more positive retail outlook for the country. The National Retail Federation (NRF) estimates that US retail industry sales (excluding automobiles, gas stations and restaurants) will grow by 2.5% y-o-y for the whole of 2010, bolstered by growing consumer confidence in the housing market and on the employment front.

A full recovery is, according to **BMI**'s projections, still some way off for container throughput at US ports, as volumes at the port of Los Angeles fell by 14% in 2009. We forecast that the port will not be able to recover its pre-downturn throughput until 2014.

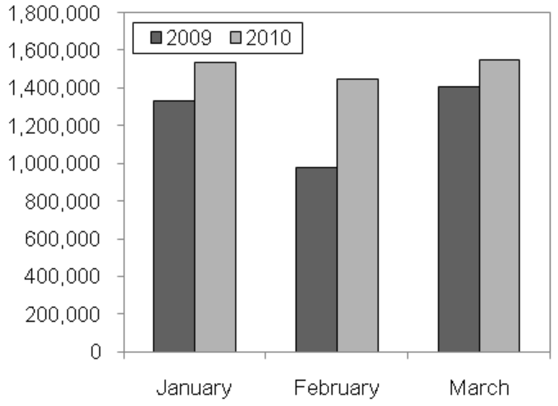
Asia-Europe - Another Gauge Of Container Shipping

The other main bellwether of the container shipping market, the Asia-Europe trade route, further highlights the view of a recovery in the box shipping sector. The route has seen rates increase over the quarter, with shippers complaining of too few ships and their cargo being rolled. The European Liner Affairs Association (ELAA) data displays a y-o-y increase in trade between Asia and Europe in Q110 (see chart).

This recovery can also be viewed in terms of throughput growth in Europe's main ports. Europe's largest container port, the Dutch port of Rotterdam, posted a y-o-y growth of 21% in Q110. Another developed European port bellwether, the Belgium port of Antwerp, Europe's second largest container facility, also posted y-o-y growth in Q110, with an increase of 15.9%. A further growth highlight at the port of Antwerp was the 2.013mn TEUs handled in Q110, just short of the 2.075mn TEUs handled in Q108, a period when shipping was booming.

Don't Judge A Year By One Quarter

Q110 Asian Imports And Exports To And From Europe (TEU)

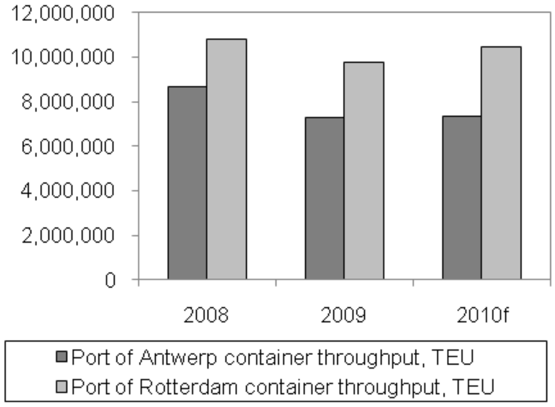


Source: ELAA

It is not only the developed European ports that are experiencing an upturn in volumes, Russian ports are also feeling the positive effects of the beginning of a recovery in global freight volumes, with container volumes through the country's main facility of St Petersburg growing y-o-y by 39.7%

Recovery-Yes. Full Recovery-Unlikely

European Container Bellweathers



f=BMI forecast. Source: Port Authority

As with transpacific trade, **BMI** highlights that the container shipping boom in Q110 is unlikely to be maintainable for the whole year, and that although the beginnings of a recovery are afoot a full recovery in the space of a year is unlikely.

This view is supported by our port throughput projections for the above mentioned ports. For the port of Rotterdam, we forecast a y-o-y throughput growth of 7.4%; as box volumes plummeted by 9.67% in 2009, it will be another year before a full recovery is made. The port of Antwerp is forecast by **BMI** to cater for 7.4mn TEUs in 2010, a miniscule y-o-y throughput growth of 0.6%. In terms of container growth at the port of St Petersburg, we forecast a respectable y-o-y increase of 11.8% growth. Despite this projected double-digit increase, the growth will have little impact on the colossal decline in throughput that the port recorded in 2009 when volumes fell by 32.2%. In fact, **BMI** asserts that it will take until 2013 for the port to recover to its pre-downturn box throughput volumes.

Companies Changing Strategies - An Indication Of Recovery?

The changing strategies implemented by shipping lines over the quarter back the view that compared with last year the container shipping sector is looking up. We assert, however, that the tactics are and will remain cautious.

At the nadir of the downturn shipping lines were cutting capacity in a bid to decrease oversupply in the market, which had forced freight rates to record lows. A number of tactics were implemented, including scrapping, but the most popular was to idle vessels, the rationale being that unlike scrapping, laying up vessels was not a final solution, but rather a stop-gap until volumes improved. In the second half of 2010 the idling tactic took off, with vessels being anchored off ports. Singapore was a popular choice, with just a skeleton crew being maintained on vessels. Idled vessel volumes continued to increase, but over the last quarter they have dropped considerably. At first glance this may appear to be a major sign of volumes picking up. While **BMI** believes that returning trade growth has indeed played a part in the demand for more vessel capacity, the decline in laid up vessels is mainly due to the developing trend in the box shipping sector of slow steaming.

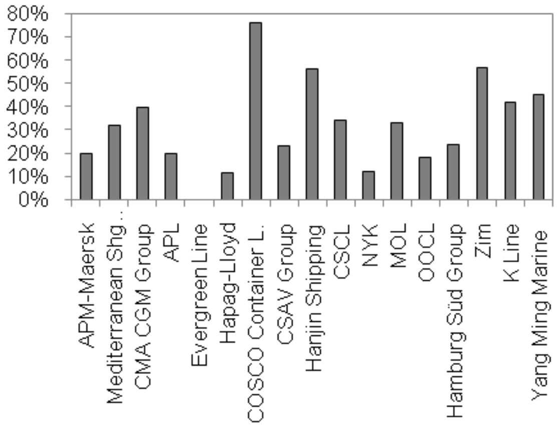
The popularity of slow steaming underlines the point that demand in the container sector is still a considerable way off the boom period in 2007 and 2008. In those years the emphasis in the container sector was on speed, with a number of companies launching express routes as shippers demanded goods as soon as possible and a mood of 'I needed this delivery yesterday' permeated the industry. Slow steaming not only saves money on fuel, but has also enabled shipping lines to decrease their idle capacity, with more ships being added to rotations so that schedules are kept to.

Coupled with this strategy has been an industry-wide strategy of rate increases. Shipping lines are managing their vessel volumes much more strictly, with vessels being brought from lay up to fulfil slow-steaming activities rather than the adding of capacity or new routes. This is ensuring that capacity is held at manageable levels, and is allowing shipping lines to push through rate hikes as demand is being artificially restricted.

This strategy has, unsurprisingly, been condemned by shippers, and with freight rates out of Shanghai to Europe and the US reportedly reaching US$2,700TEU in February, shipping lines were accused of acting like a cartel. The Asian Shipping Council called upon the Chinese government to act and protect the country's exporters as rates were climbing despite the fact that overcapacity existed in the market and was being withheld.

Over Supply Still A Concern

Top 20 Container Lines' Orderbook as a % of Existing Fleet



Source: AXS Alphaliner

Upbeat projections from the major shipping lines in 2010, with statements from some players that they have returned to profit in the first quarter, indicate that the rate hikes are being accepted by shippers and that they are having the desired effect on carriers' bottom lines.

Another interesting indicator that points to the beginning of a recovery is that lines are changing their mid-term strategies in terms of managing volume. While last year a number of carriers got on the phone to the shipyards as soon as the extent of the crisis was realised in a bid to push back orders, this year there has been much less emphasis on this strategy. AXS Alphaliner expects the pace of new-build deliveries to quicken in H210, with a total of 1.5mn TEUs due to be delivered in the whole of 2010.

Carriers' attitudes to overcapacity appear to be changing from seeing it as a threat that would haunt it over the mid term to more of a short-term issue, if reports of shipping lines being expected to start ordering in

Q111 are to be believed. In fact, one line appears to be ahead of the game, and is hoping to add capacity to its fleet by 2012, as it is planning to start ordering in 2010. Taiwan-based **Evergreen Marine** has stated that it plans to double its container fleet with a 100-stong vessel order. It is believed that 12 vessels could be ordered this year, with South Korea's **STX Offshore and Shipbuilding**, China's **Nantong COSCO KHI Ship Engineering** and Taiwan's **CSBC Corporation** all reportedly having been approached by Evergreen regarding the contract, with negotiations expected to commence next few months.

In **BMI**'s view Evergreen does not know something that the other players don't. The company has been just as cautious as its peers in the downturn. The line's strategy of expanding now, rather when a recovery is certain, appears to have been chosen because the downturn caused price declines for new builds at shipping yards. By ordering now, Evergreen will be able to expand its fleet much more cheaply as it will be buying at the bottom of the market, whereas its peers bought at the top of the market. It should also be noted that the carrier has been absent from the shipyards for about six years, so unlike its competitors did not have to weather the downturn with the extra worry of finding funding to pay for ships on order.

Another measure of a sector's health is whether it is attracting new players or whether the sector is mainly populated by old players that are hanging on for better times or decreasing their exposure. In relation to this, the global container sector is exhibiting contradictory evidence. So far, the old guard appear to be staying put and have no plans to expand: **A.P.Moller Maersk**, the parent company of container bellwether **Maersk Line**, has stated that it would invest in its oil and gas and terminal operations rather than its container shipping sector. We have also seen other major players trying to lessen their exposure to the box sector. Japan's **NYK**, for example, is downsizing its container shipping operations in favour of expanding its presence in other markets. This strategy was exemplified in February 2010 when the company changed some of its new-build shipping orders from container ships to dry and oil tankers.

The contradictory developments in the sector emerge from the fact that new entrants are continuing to break in to the sector, indicating that some feel that there is still room to turn a profit, in what many consider to be a swamped market. The newest entrant, **The Containership Company** (TCC), launched its first route (a transpacific service) in April 2010. The line's operational model is based on that used by budget airlines, with the line believing that it can fill a market niche of offering price cuts and speed, while other lines hike rates and slow steam. Another possible new entrant in the mid term is Greece's dry bulk operator **Diana Shipping**, which has announced over the quarter that it has become a stakeholder in a new company that plans to buy container vessels over the next 12-18 months.

BMI believes that the container line market holds attraction to new entrants, as although demand is uncertain, entry into the market is relatively easy with low start-up costs on the back of the downturn, with entrants able to buy or charter vessels at distressed prices. **BMI** believes that entrants need to find a niche to operate from, such as catering for a specific market, which has few competitors, or else challenging the current model of the container shipping sector. This after all would not be the first time that a new blood has taught the establishment a thing or two.

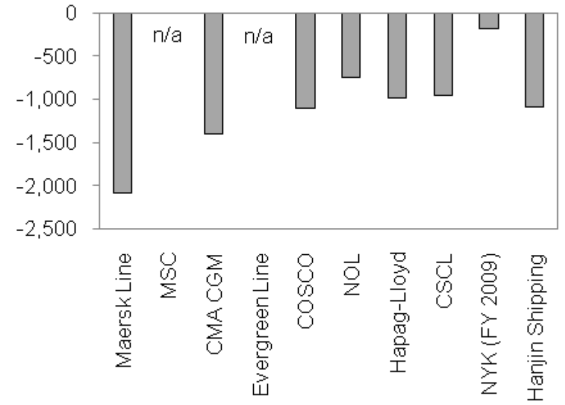
2009 Financial Results - Just How Bad Did It Get?

Even with the beginnings of a recovery afoot in the container shipping sector there is still a long way to go. The tough operating environment that container lines faced in 2009 has been well documented, but only now can the true extent of the damage be seen in companies' full-year results. The majority of lines have posted huge losses, with the total loss of the top-10 container operators (excluding MSC and Evergreen Line) standing at US$8.5bn.

According to **BMI**'s research, only one shipping line involved in the container transport business managed to stay in the black over 2009: Japan's **Mitsui OSK Line** (MOL), which recorded a 2009 financial year (FY09) profit of US$137.5mn. **BMI**, however, notes that this result should be viewed sceptically, as although it was a profit it was a year-on-year (y-o-y) decline of 90%. Also, the result should not be compared directly with other shipping lines, as the carrier is not as exposed to the box sector as other lines. Only a small portion of its revenue is attributed to container operations, as it is more centred on bulk trade.

The Losers

2009 Top Ten Container Line Losses (US$mn)



Source: BMI Research

BMI also warns that comparing Japanese lines' results with lines that announce results by calendar years can also cause disparities. NYK, for example, appears on our chart to have weathered the downturn relatively well, with a loss of just US$187.5mn. Japanese lines measure their financial results from April 1 to March 31 and therefore their results are unrepresentative of the full extent of the 2009 downturn, as FY09 misses the first and toughest quarter in 2009 and takes into account Q110, when a recovery began to emerge.

BMI has included the top-10 container lines in the chart to highlight the extent of the downturn and illustrate the tough recovery that is ahead of them. Carriers are already upbeat, with many in the list stating that the year ahead will see a recovery. French liner **CMA CGM** has already announced its estimated results for Q110, with figures indicating that the line is on the road to recovery. The carrier's revenue is estimated to be up 30% y-o-y to US$3.2bn, with an expected net profit of US$270mn in Q110.

The company's return to profit has been attributed to a recovery in both rates and freight volumes. The number of containers carried by CMA CGM in Q110 reached estimated 2.1mn TEUs, y-o-y growth of 22%. Encouragingly, this figure is a 4% increase on the carrier's Q108 freight volume.

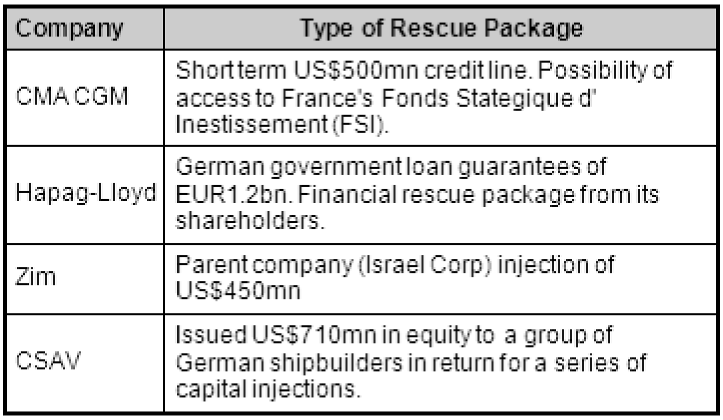
BMI's warning to container lines chimes with that of other industry observers: Q110 is likely to have been a blip, and y-o-y recovery, although likely, is not assured. It is still too early to determine the strength of this recovery. We are therefore encouraged by lines that are not taking these very early, and in our opinion deceptive, recovery signs for granted. Maersk Line's parent A.P. Moller-Maersk, for example, cut costs by US$2bn in 2009, and has announced plans to further trim costs in 2010, with a planned saving of US$500mn floated for the year.

Threats To The Sector Going Forward

A major annoyance for some container lines, and in **BMI**'s view a threat to the sector's recovery, is the bailouts by governments, banks and parent companies that allowed distressed carriers remain afloat in 2009. As we have previously asserted, the bailouts did not allow the market's natural forces play out, so the re-adjustment of capacity that would have happened through companies going bust did not play out. This has meant that the threat of overcapacity in the future still holds.

Bailing Out

Container Lines' Rescue Packages



Company	Type of Rescue Package
CMA CGM	Short term US$500mn credit line. Possibility of access to France's Fonds Stategique d' Inestissement (FSI).
Hapag-Lloyd	German government loan guarantees of EUR1.2bn. Financial rescue package from its shareholders.
Zim	Parent company (Israel Corp) injection of US$450mn
CSAV	Issued US$710mn in equity to a group of German shipbuilders in return for a series of capital injections.

Source: BMI Research

The bailouts also created an unfair advantage for some lines, essentially giving them a leg-up. This view is cemented by data from AXS Alphaliner that reveal that lines that received financial bailouts were able to increase their market share. The consultancy offers Chile's **CSAV** as an example: the company faced being one of the first casualties of the downturn before German ship-owners steeped in with an equity package. Following that, the line increased its operated capacity by 46%, with its market share increasing over a 12-month period from 2.1% to 3%.

Dry Bulk Overview

Core Views

- Chinese monetary tightening to hit demand hard
- India to become key market for dry bulkers
- Oversupply a continued threat to freight rates
- Volatility of BDI to continue

Q210 saw a return of nervousness to the dry bulk shipping market, which had enjoyed a relatively safe passage over the past few months, courtesy of China's seemingly incessant demand for iron ore, coal and other raw materials. As reported in **BMI**'s Q210 outlook, the first three months of 2010 saw imports of iron ore and coal keep up with the pace set in 2009 as shipments of iron ore and coal rose by 20.5% and 36.4% year-on-year (y-o-y) respectively, the latter largely due to extreme weather conditions that saw northern China suffer its coldest winter in decades.

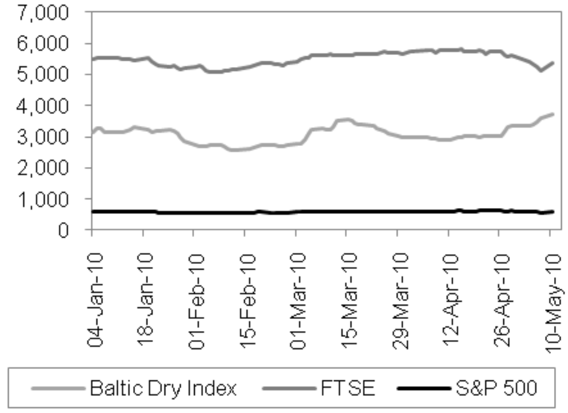
The Baltic Dry Index (BDI), which aggregates freight rates earned by dry bulk carriers worldwide, suffered a volatile start to the quarter, hovering around 3,000 points for the first four weeks of May, in contrast to solid performances from major equity markets including the FTSE 100 and the S&P 500.

In May 2010, the China Iron and Steel Association (CISA) was forced to concede defeat in its attempts to force an industry-wide boycott of miners **BHP Billiton**, **Rio Tinto** and **Vale** - which together control more than 68% of global iron ore shipments - and to accept calls to move from an annual to a quarterly pricing system for iron ore, which will better correlate with spot market prices.

CISA's u-turn on the new contract arrangement further highlighted the

Cutting a Volatile Path

BDI vs FTSE 100; S&P 500



Source: Bloomberg

market's dependency on Chinese importers as freight rates rallied, gaining 11% in just three days at the end of April. However, the jury is still out on the potential long-term impact of the supply agreements on the dry bulk sector.

China finds itself backed into a corner. Massive expansion in the country's steel production capacity has seen the republic import ever-greater quantities of iron ore from abroad, and today more than half of China's iron-ore demand is met through imports, primarily from Brazil and Australia. However, the country's influence on the global iron ore market, which in 2009 allowed it to almost single-handedly dictate the cost of imports, has waned as industrial production in Japan, South Korea and other major import markets has started to recover.

Though ultimately short-lived, April's boycott underlined the extent to which the dry bulk shipping sector remains largely reliant on demand from China for spot market fixings. While China's influence on the global iron ore market is not what it was in 2009 when it swelled to 66%, it still remains the largest single exporter of the material by some measure and talk of a boycott, coupled with uncertainty surrounding the eventual outcome of the contract disputes, saw the Baltic Dry Index (BDI) slump by 44% in the month ending April 15.

While some observers have hailed the outcome of the talks as a positive development for the dry bulk sector that will benefit from a thriving mining industry, we caution that China's lingering resentment of the new pricing agreement will see it shun, where possible, deals with the three mining majors that over the past 18 months have proved a life-blood to the dry bulk sector. Though having played ball and accepted the 90-100% price increases that have resulted from the new pricing system, China has made no attempt to hide its opposition to what it calls the 'monopolistic' hold over the industry by the three main producers. If anything, the outcome of the price negotiations will intensify calls by China's Metallurgical Industry Planning and Research for companies to increase investment in mining operations overseas.

Indeed, there was evidence to this effect in May 2010 when Seatrade Asia revealed three or four Chinese steel producers were considering acquiring a Russian iron ore mine owned by **Alrosa Co**. located in the country's South Yakutia province some 300km from the Chinese border. The news will concern carriers given the long-term potential for a major development of overland freight networks that would reduce China's dependence on seaborne trade for supplies.

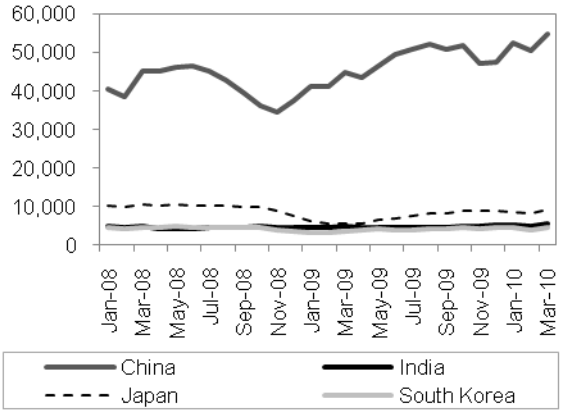
Monetary Policy to Pinch Demand

One of the most promising indicators from Q210 was a rebound in global steel production. According to figures released by the World Steel Organisation (WSO), total output grew by 29% year-on-year (y-o-y) over the quarter, reflecting recoveries internationally in metal-hungry sectors such as construction, car production and shipbuilding.

Among the most encouraging increases were those seen in Japan and South Korea, both traditionally major iron ore consumers, where steel output rose by 51% and 29% respectively. Iron ore shipments to Japan increased by 43% over the quarter to reach 32.4mn tonnes from just 22.6mn in Q208.

Steel Climbing

Steel Output of Major Producers (tonnes 000)



Source: World Steel Association

While signs of returning demand in China are positive news for our overall demand outlook, the continued correlation between Chinese demand shocks and dry bulk freight rates presents a worrying picture for H210, where we forecast a marked contraction in Chinese shipments.

As highlighted in **BMI**'s Q210 overview, the development expected to put the demand side of the market under most pressure is likely to be that of Chinese monetary policy. The People's Bank of China has employed a series of measures aimed at cooling the country's overheating property sector, and in May announced a 0.5% rise in banks' cash-reserve requirements, the third such increase this year. Tightening measures are likely to put the brakes on Chinese economic growth, and **BMI** forecasts output to average 8.8% in 2010, having peaked at 10.7% in Q409. The effects of the measures are expected to be further evidenced in 2011, when we project growth to slow to 7.5%.

With the hikes aimed primarily at cooling the country's overheated property market, the measures are expected to have a detrimental effect on demand for both steel and iron ore. China's construction sector is the country's single largest steel consumer, devouring 50% of total output. Moreover, we are concerned that a reduction in lending ability across the banking sector will result in a contraction in credit growth across other major drivers of steel and raw material demand such as shipbuilding and other heavy industry. This scenario is reflected in our projections for China's industrial production index, which is expected to average 8.8% in 2010, falling to 7.5% in 2011.

With the demand-led raw-materials import boom seen over the past 18 months likely to draw to a close in H210, **BMI** cautions that the dry bulk operators are likely to start to face increased challenges with a potential supply-demand imbalance expected to put downward pressure on freight rates.

Oversupply Threat Cannot Be Ignored

The possibility of a further dip in rates is exacerbated by ongoing supply-side concerns. In our Q210 overview, we highlighted the threat of a new-build overhang, reflecting the continued impact of over-ordering by companies during the shipping market's boom period leading up to the collapse of 2008.

As previously mentioned, the biggest fear is that 2010 will turn out to the 2009 that never was, in other words the setting for a major depression throughout the market. While a significant increase in demand for shipments may stave off a complete collapse in freight rates, ship owners and observers are increasingly pessimistic about the year ahead.

Cited by Seatrade Asia, Tim Huxley, CEO of **Wah Kwong Maritime Transport Holdings**, summed up the fears held by a growing number of ship owners. 'The next year might just be what we feared 2009 would be. I think we have just delayed the problem,' he said.

According to figures provided by the Baltic and International Maritime Council (BIMCO), Q110 saw a steady rise in new-build tonnage coming online, with 16mn deadweight tonnes (DWT) delivered compared with just 1mn DWT of scrappings, resulting in a 3.5% net increase in total fleet capacity.

This is itself a considerable increase, but analysis of the total number of new orders due for delivery up to 2014 illustrates a far bigger problem emerging. According to estimates by ship brokerage firm **WeberSeas**, between 2010 and 2014, 2,912 dry bulk carriers are due for delivery, peaking in 2010 and 2011 when 1,356 and 1,028 new ships are contracted to come online respectively. In 2012, 441 vessels are due for delivery - still twice the number seen in 2009, while in 2013, 87 ships are set to come online.

There is also evidence to suggest that the global dry bulk orderbook is actually expanding. A number of companies have revealed plans to build their fleets after a period of consolidation during the downturn. In April, **China Ocean Shipping (Group) Co**. (COSCO) said the company planned to take advantage of rising demand from Asia to buy 'quite a few' dry bulk carriers in 2010.

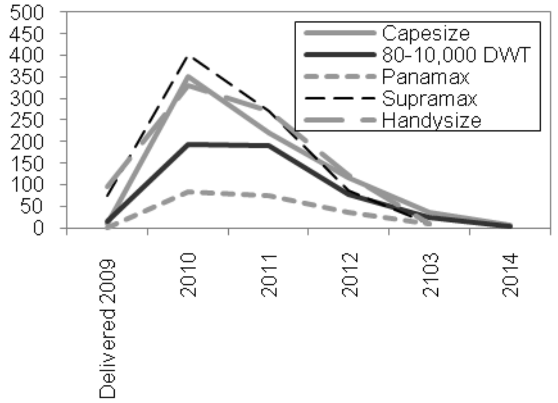
Seepage of capacity from other sectors of the shipping industry is also a concern, namely signs that companies are converting orders for liners into bulk carriers. In February it was revealed that Japanese shipping line **Nippon Yusen KK** (NYK) was to make adjustments to orders for five container ships placed with South Korean shipyard **Hyundai Heavy Industries** (HHI) with the orders converted to three Capesize bulk carriers and two LR2 oil product tankers. The changes will see the delivery date for the vessels pushed back six months to June 2012 and will increase the cost of the order by US$1.47mn. The company has also reportedly converted an order for two box ships with Japanese builder **IHI Marine United** (IHIMU) into very large crude carriers (VLCCs).

BMI believes the move is part of the company's plans to downsize its container shipping operations in favour of expanding its presence in other markets. In a break with its previous policy of preserving its owned container fleet, in January 2010 the company publically revealed plans to cut more than half of its box fleet by 2015. NYK's president, Yasumi Kudo, quoted by International Freighting Weekly (IFW), said: 'The part of our container fleet that constitutes such long-term fixed assets will be slimmed down to half the number of vessels and its total space capacity will be trimmed by two-thirds by 2015.'

Other major lines appear to be following suit and viewing the dry bulk sector as a safe haven in which to expand capacity. In March, rival Japanese line **Mitsui OSK Lines** (MOL) announced details of its mid-term expansion programme, which aimed to take profit from an increase in demand across the Asia-Pacific region. Worryingly, MOL's growth strategy is likely to include an increased focus on the Chinese dry bulk market in particular, and the company has begun marketing increasingly to prospective Chinese clients, signing a long-term contract of affreightment with Chinese steel manufacturer **Jiangsu Shagang** in October 2009 and strengthening its relationship with rival firm **Baosteel Group Corporation**.

Deliveries To Peak In 2010?

Global Dry Bulk Orderbook By Type Of Vessels And Date Of Contracted Delivery



Source: WeberSeas, December 2009

As of April 2010, MOL operates the world's largest dry bulk carrier fleet, managing 375 ships with a total deadweight tonnage (DWT) of 31.03mn DWT. The fleet is due to expand rapidly over the next few years, with an additional 76 ships to come online between 2010 and 2012, roughly three times the number due to be delivered into its container shipping unit. According to China Shipping Online, in February 2010 the company broke its 18-month ordering ban by placing an order for two Capesize vessels with Japanese shipyards.

While the influx of capacity from the container sector illustrates the relative strength of the dry bulk market over the past 12 months, we believe the decision of major lines to increase their focus on the sector threatens its stability over the short to mid term, particularly as demand levels appear likely to slow this year and next.

India To Take The Baton From China?

India's emergence as a major driver of global dry bulk shipping demand has not gone unnoticed by the industry's major players. With Rio Tinto having agreed its first iron ore sale to India in December 2009, Q110 saw Japanese line NYK underline its growing interest in the Indian market, signing a joint venture

(JV) agreement with TM International, a dry bulk shipping subsidiary of Indian steel producer **TATA Steel**, acquiring a 26% stake in the firm.

The company's approach supports **BMI**'s bullish outlook for the Indian economy, which we forecast to grow by 7.8% in 2010 in reach terms. Increased industrial output (the country's industrial production index is expected to grow from 7.7% in 2009 to 13.5% this year) will support robust demand for imports of raw materials including iron and steel (+ 22.7% y-o-y) and ores and metals (+22.2%).

BMI believes India's insatiable demand for coal is one of the main factors driving NYK's interest in the sector. Growing demand from the country's energy sector, coupled with falling output from coal mines, saw India's thermal coal imports double to 60mn tonnes in 2009, and are forecast by state-owned miner **Coal India Ltd** to reach 100mn tonnes by 2012. The demand for coal is expected to drive importers to cast their nets ever further afield for supplies, and in March, the country's largest coal importer, Adani Enterprises, signed its first-ever supply deal with the Colombian market, with supplies to be sourced from the country's Cerrejon reserves, which are owned by **BHP Billiton**, **Anglo American** and **Xstrata**.

NYK's interest in the market is expected to come at the expense of the company's Japanese focus. The general manager of NYK's bulk shipping unit, Kazuo Ogasawara, cited by Bloomberg, said the company will aim to reduce the proportion of goods it ships to Japanese customers in favour of increased sales to the Chinese and Indian markets. Iron ore and coking coal shipments to Japan currently comprise 60% of the company's total dry bulk deliveries in volume terms and are expected to fall to 40% by 2015.

Hedging against Volatility

The ongoing volatility of the dry bulk freight spot rate is encouraging shipping lines to continue to pursue stable, long-term shipping contracts. **BMI** expects this trend to continue and to be centred on the Asia region, as the major suppliers of and customers for coal are located there. This offers long-term opportunities for dry bulk shipping lines such as South Korea's **Hanjin Shipping** and **STX Pan Ocean**.

Hanjin Shipping's coal deal sees the shipping line catering for the transport needs of **Korea Midland Power Company**, with a contract worth US$162mn to ship 19.5mn tonnes of coal over a 15-year period. The coal is to be shipped from Indonesia, Australia and Canada. STX Pan Ocean has won a coal-transport contract with the Indian Coal and Oil Company, which should see 10mn tonnes of the commodity shipped per year. In the case of Hanjin Shipping, the 70,347DWT *Hanjin Tacoma* is expected to be deployed for the US$162mn Korea Midland Power Company deal, while the STX contract will see an 80,000DWT bulk vessel deployed.

While the long-term outlook for the dry bulk sector appears healthy, particularly given the assurance of greater clarity in the iron ore pricing structure, **BMI** cautions that there is likely to be a period of painful readjustment in the supply-demand imbalance in the sector over the next few months. As highlighted, a major concern is the market's continued dependency on Chinese demand. Our bearish outlook for Chinese industrial output over H210 and 2011 suggests that shipments or iron ore, coal and other industrial materials to the country are unlikely to continue grow at the pace seen in 2009.

We expect China's diminishing import needs to be partly offset by increased demand from other key markets such as Japan, South Korea and, increasingly, India; however, with a noticeable net increase in tonnage capacity expected in 2010, this is unlikely to be sufficient to prevent the sector from experiencing fluctuating overcapacity, leading to further freight rate volatility over the coming months.

Liquid Bulk Sector Overview

Core Views

- Seasonal demand factors to see rates slip in Q310
- Negative economic scenarios to weigh on crude recovery
- Supply-demand balance on a knife-edge
- Political risk a growing threat to major supply routes

Q210: Slender Recovery Wanes

The positive indicators that greeted liquid bulk operators at the start of 2010 appear to be on the wane. In Q110, With global demand for crude and refined oil products faring well off the back of an unseasonably cold Northern Hemisphere winter, the Baltic Dry Tanker Index (BIDY) - the main gauge of freight rates for crude tanker operators - rose to its highest level for 12 months.

Since then, however, the index has gradually trended downwards, largely as a reflection of seasonal trends - there is traditionally a natural reduction of demand in Q2 as temperatures rise and refineries undergo seasonal maintenance - slipping by 24.8% from its January high of 896 points to 674 points in mid-April. Having trended higher since the start of the year, shares in the US's two largest supertanker operators, **Frontline** and **Overseas Shipping Group** (OSG), fell sharply at the start of May, possibly as the result of concerns surrounding weaker crude demand over the year ahead.

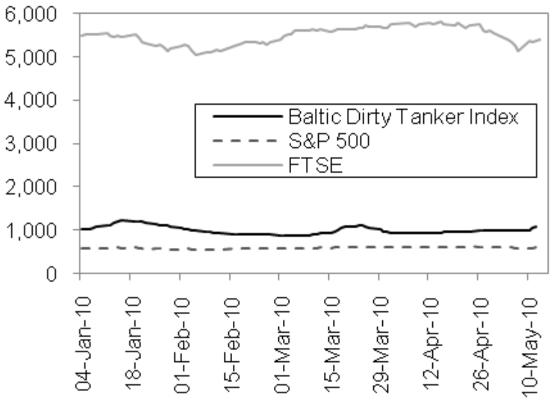
Supply-Demand Balance Looking Precarious

Central to our bearish outlook for the liquid bulk sector over the coming months is **BMI**'s core view that macroeconomic conditions in OECD regions with deteriorate in H210, which will have a detrimental impact on consumption levels in major imports such as the US and other states. Continued unrest in the eurozone in particular has led **BMI**'s oil and gas analysts to downgrade their oil supply and demand forecasts for 2010, with OECD European demand set to recover by just 19,000 barrels per day (0.15%) this year. Meanwhile, North American demand, which, due to restocking, accelerated rapidly towards the end of 2009, has shown signs of flagging in recent weeks, and we forecast an expansion in consumption of just 70,000b/d (0.33%) in 2010. When combined, the demand scenario for the OECD market in 2010 looks bleak, with contraction of 0.21% expected from 2009's already weak consumption volumes.

As outlined in our previous analysis, the strongest growth this year will undoubtedly come from developing markets, which over the past few months have seized the baton from their OECD counterparts in consuming an ever-greater share of global production. Indeed, in 2010, the lion's share of consumption growth is pencilled to come from Asia (2.17%), Latin America (1.58%) and Africa (1.72%), culminating of a total non-OECD growth of 3.23%.

Volatile Times

BIDY vs FTSE; S&P 500



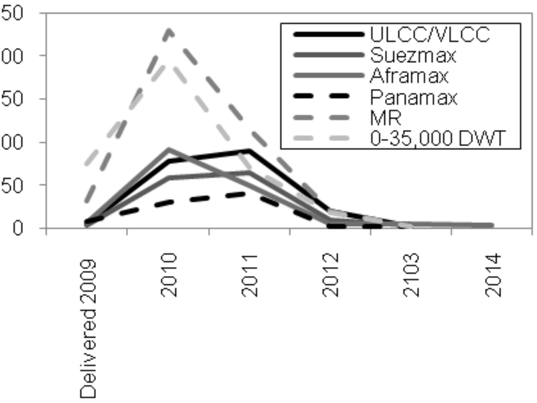
Source: Bloomberg

However, when combining all the various regional estimates, we forecast total global demand growth of just 1.6% in 2010, leading to an increase in production of just 1.96%. We caution that such a small increase in output is unlikely to lead to a significant increase in tanker fixings over the next few months, even if 2.88% of these output gains are forecast from the OPEC nations, which account for the lion's share of crude oil exports.

In our view, these slight increases in shipment volumes are unlikely to be enough to offset a marked increase in fleet capacity projected for this year. In 2009, **BMI** drew attention to the growing supply overhang looming over the liquid bulk sector, and we remain cautious about the effect that a growing global fleet is likely to have over the long-term, with tanker owners having displayed the same trend for over-ordering at the peak of the market as operators in the dry bulk and container markets.

Supply Overhang Looming

Global Liquid Bulk Orderbook By Anticipated Delivery Date



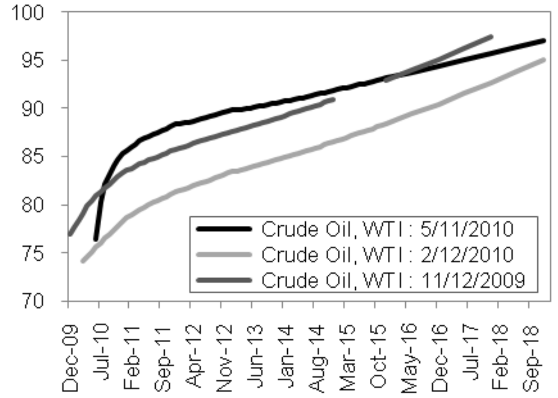
Source: Weberseas

According to figures provided by the Baltic and International Maritime Council (BIMCO), Q110 saw a 1.3% rise in global fleet capacity with 11.7mn deadweight tonnes (DWT) delivered and 5mn DWT scrapped or converted into other vessels. Over the year as a whole, the size of the liquid bulk fleet is projected by BIMCO to expand by 6%, with an inflow of 38mn DWT offset by 13mn DWT recycled, much of this due to the ongoing phase-out of single-hulled tankers in accordance with the stipulations of the International Maritime Organisation (IMO). Significantly, these estimates assume that 33% of new-build deliveries scheduled for 2010 will not take place. The trend of energy companies and traders using tankers to store crude offshore proved a boon to the liquid bulk sector in 2009, providing income for otherwise unemployed vessels and narrowing the oversupply of ships in circulation. The majority of ships were stationed off the Mexican Gulf where they were waiting for an upturn in US demand to boost prices before offloading to refineries.

However, as the contango in forward curves for crude and refined oil products has narrowed, floating storage volumes have trended downwards, with data from BIMCO suggesting the number of tankers used for storage declined from 128 vessels in January 2010 to 112 by the end of February. As spot oil prices move in line with futures, there is a risk that an additional drop in demand for storage will further unsettle the already fragile supply-demand balance within the tanker sector and will lead to a potentially damaging increase in the number of ships actively in circulation.

Narrowing Contango Spells Danger For Storage

NYMEX WTI Forward Curve



Source: Bloomberg

One of the most visible trends highlighted in **BMI**'s analysis over recent quarters has been China's increasing dominance of the crude oil market. Rapid economic growth and industrial expansion has seen Chinese oil demand increase apace in recent years, rising from around 4.7mn barrels per day (b/d) in 2000 to 8.0mn b/d in 2008 as the republic has cast its net ever further field and search of supplies. 2009 was no exception and, despite a dip in the first quarter, crude imports rose by 14.3% over the year to 203.8mn tonnes.

However, the increasing expectation of a slow-down within heavy industry and other fuel-hungry sectors due to a tightening monetary supply has lead to growing uncertainty surrounding Chinese import volumes going forward. In 2010, The People's Bank of China has introduced measures aimed at cooling the country's overheating property sector, and in May announced a 0.5% rise in banks' cash-reserve requirements, the third such increase this year. Tightening measures are likely to put the brakes on economic growth, and BMI forecasts output to average 8.8% in 2010, having peaked at 10.7% in Q409. The effects of the measures are expected to be further evidenced in 2011 when we project growth to slow to 7.5%. This scenario chimes with our projections for China's industrial production index, which is expected to average 8.8% in 2010, falling to 7.5% in 2011. The immediate concern will be what effect the measures will have on crude oil demand.

In 2010, our oil and gas analysts forecast shipments to China to grow by 8% y-o-y (down from 12% growth in 2009) and by 9% in 2011. With further tightening measures likely to occur in H210, however, there is potential for downgrades to our forecasts.

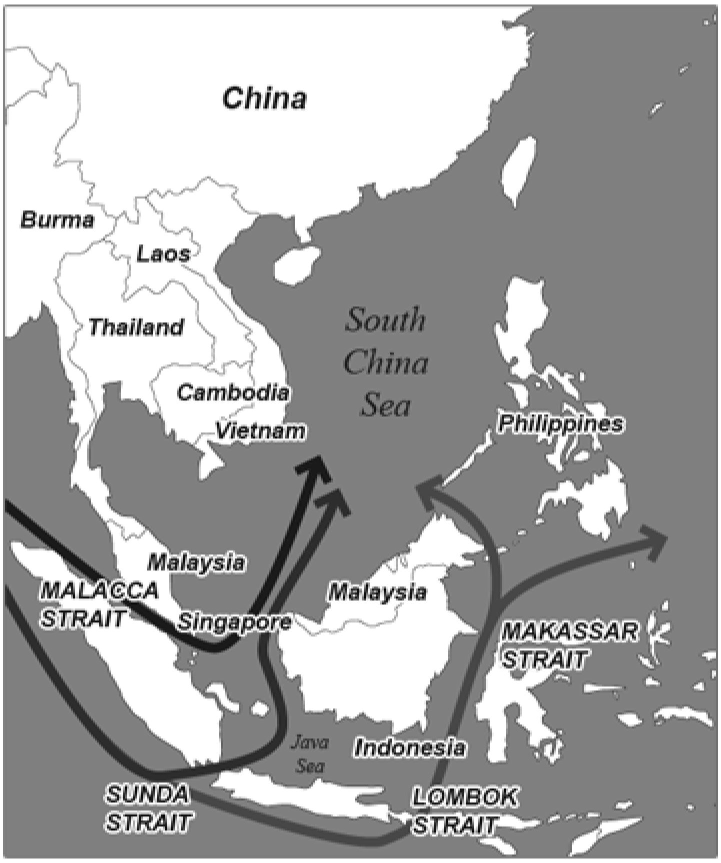
Escalation Of Political Tensions Threatens Major Supply Routes

The warning issued by the Singaporean authorities on March 4 about a potential terror attack on oil tankers passing through the Malacca Strait drew attention to the growing security fears facing liquid bulk operators across Asia. Home Affairs Minister Wong Kan Seng did not say who would orchestrate such attacks, but Islamist militants have for many years been believed to favour targeting the Strait to disrupt global shipping. The Malacca Strait is crucial in this regard, because around 40% of world trade passes through it. Malacca is the main channel between East Asia and South Asia, the Middle East, Europe, and Africa

Added to the mix has been a continued upward trend in incidents of piracy reported in the Gulf of Aden and in and around the Malacca Straits. A report by the ICC's International Maritime Bureau's Piracy Reporting Centre (IMB PRC) shows the number of incidents reported worldwide in 2009 reached their highest level since 2003, increasing by 39% y-o-y. The increase was driven by incidents in Somali waters - off the Gulf of Aden and the Indian Ocean. 217 attacks were reported, an increase of 95% y-o-y.

Lifelines

The Malacca Strait And Its Alternatives



Source: BMI

International navy forces patrolling the area appear to have been successful in curtailing pirate attacks in the Gulf of Aden. Indeed, according to the IMB PRC, in 2009, the proportion of attacks by pirates that resulted in a hijacking of the vessel was 22%. In 2008, the pirates' success rate was considerably higher at 38%. However, the flipside of the coin is that pirates are believed to have moved their operations further into the Indian Ocean where they remain a potent threat to Chinese and other Asian supply routes.

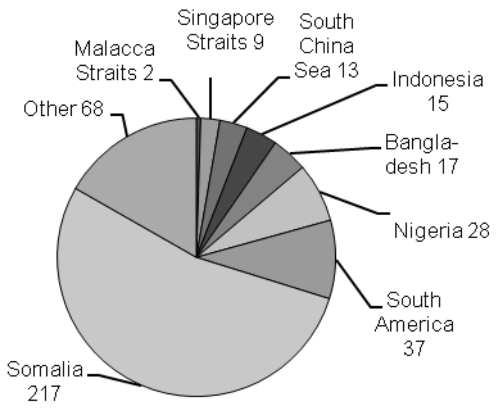
One of the major long-term concerns for tanker operators will be that these increasing threats are serving to intensify China's search for alternative supply routes overland, threatening what is fast becoming one of the most lucrative markets for the tanker sector. The Malacca Strait is especially important for China and Japan, since 80% of Chinese oil imports and 90% of Japanese inbound crude shipments pass through it. Defence planners in Beijing and Tokyo have long feared that terror attacks, piracy, or interdiction by hostile navies could choke off their trade and oil supplies

With China eager to secure long-term, reliable access to oil reserves in Central Asia and the Middle East, the republic has been actively pursuing alternative supply routes overland, via ports and rail-links scattered across the Indian Ocean. Of the 'string of pearls' that make up China's maritime assets across the region, Myanmar could potentially be the most important, because it provides China's landlocked inner provinces, such as Yunnan, with access to the Indian Ocean, bypassing the Malacca Strait. China's tendency to look towards alternatives to the all-water routes that currently comprise the large part of its supply chain will concern liquid bulk operators. More worrying still will be Chinese interest in Pakistan's port of Gwadar. From Gwadar, Middle Eastern oil could be transported by a proposed 2,000km road and rail link to Kashgar in China's Xinjiang province. This would bypass Malacca and indeed the bulk of the Indian Ocean sea route.

Added to an already volatile geopolitical scenario is increasing international hostility towards Iran, the world's fourth largest exporter in 2008. In recent weeks, political observers have suggested that the US has come closer to winning over Russian and Chinese support for a renewed batch of UN economic sanctions against Iran. Companies wary of the reputational costs and financial penalties of doing business with Iran have been steadily cutting their links. India's **Reliance Industries**, the country's largest private refiner, has decided not to renew its oil import agreement with NIOC for FY10, further reducing Iran's pool of customers. A drop in sales has led to an increase in floating storage in the Middle East region and industry sources have suggested that between 11 and 19 very large crude carriers (VLCCs), each with a capacity of 2mn barrels (bbl) of crude, and possibly one Suezmax carrier, with a capacity of 1mn bbl, are currently filled with Iranian crude and in floating storage. Two VLCCs are believed to be in the Red Sea, near the Egyptian port of Kidi Serir, where crude oil priced off the Platts Iranian Heavy and Iranian Light assessments is loaded for delivery to the Mediterranean market. At least eight VLCCs are believed to be in the Persian Gulf, with

Aden: Enter At Your Peril

Reported Incidents Of Piracy In 2009 By Location



Source: ICC International Maritime Bureau's Piracy Reporting Centre (IMB PRC) another VLCC located near Singapore. As a result, it can be surmised that 22-39mn bbl of Iranian crude is currently in tanker storage. With US pressure to impose sanctions on the Middle Eastern state likely to intensify over the coming months, **BMI** warns of the growing threat to one of the world's largest oil exporters.

Oil Shook Up: The Road Ahead

A volatile period is expected for liquid bulk operators in Q310 as shifts in balance between supply and demand balance lead to fluctuations in freight rates. As highlighted, the immediate concern for companies is likely to be a swelling orderbook. Although cancellations, deferrals and the phasing-out of single-hulled vessels should help to avert catastrophe, there is still a very real risk that the amount of new tonnage coming online in 2010 will end up overwhelming the projected gain in global oil demand which is forecast at just 1.6%.

There are other factors to take into account as well, not least a potential slowdown in imports to China, which until now have helped offset a sluggish recovery in demand in the West. Added to dwindling macroeconomic sentiment is an increasingly perilous geopolitical environment for liquid bulk operators and all these factors combined lead us to believe that the outlook for companies over the next few months will be extremely testing.

Industry Trends And Developments

Geopolitics and developments within Iran's shipping sector continue to go hand in hand this quarter with a further round of sanctions on the Islamic Republic looking likely. The US appears to have pulled off a diplomatic coup, with China agreeing, in April 2010, to work with it on a potential new round of sanctions against Iran.

This uncertainty over sanctions may go some way to explaining why Iran has started storing millions of barrels of crude oil in tankers off its Gulf coast. Reports at the end of April suggest that at least 15 tankers are idled in the vicinity and are believed to be being used for storage. If reports are correct, 30mn barrels of oil are being stored offshore, and the number of vessels being used matches that of a similar strategy implemented by Iran in 2008. **BMI** believes that if this tactic continues then pressure may be placed on vessel supply, which would see freight rates for oil tankers climb higher.

As previously stated, Iran's storage tactic is in part a response to uncertainty surrounding further sanctions on Iran. **BMI** notes that while there are no indications that sanctions against Iran's crude customers are being considered, customers of Iranian products are jittery. This has been previously noted in the oil and gas sphere, where companies wary of the reputational cost and the penalties of doing business with Iran have been steadily cutting their links. Several leading oil companies, including **Royal Dutch Shell**, **BP**, **Petronas** and **Lukoil**, have stopped selling gasoline to Iran, as have international commodity traders **Glencore**, **Vitol** and **Trafigura**.

We have previously noted a similar trend in the maritime sector, with port developer **Hamburg Port Consulting** (HPC) pulling out of a contract to renovate the Iranian port of Bandar Abbas and French container line **CMA CGM** going out of its way to put distance between itself and claims from Iranian newspaper the Tehran Times that the company's vessel *Simba* pulling into the Iranian port of Bushehr was the start of significant operational activity by CMA CGM in Bushehr. The French container line denied it had struck a deal with the Iranians, and declared that the berthing of the *Simba* at Bushehr was 'exceptional' and increased activity at the port was not planned.

As the international community mulls further sanctions to tie the hands of Iran in its perceived development of nuclear weapons, it is an opportune moment to investigate how current Iranian sanctions are affecting the country's shipping sector, a project that the anti-proliferation group the Wisconsin Project on Nuclear Arms Control took up in April 2010. The NGO alerted the shipping community to the fact that Iran's **Islamic Republic of Iran Shipping Lines** (IRISL) has implemented strategies to make the detection of its vessels harder to track.

The US Treasury Department imposed sanctions on IRISL in 2008 following reports that by providing logistical services to Iran's Ministry of Defence and Armed Force Logistics (MODFL), IRISL's actions were part of a broader pattern of deception and fabrication used by Iran to advance its nuclear and missile programs. The sanctions saw a ban placed on all transactions between US citizens and IRISL and a US freeze of all IRISL assets under its jurisdiction. To help US shippers ensure they had no dealings with IRISL, the Treasury Department's Office of Foreign Assets Control (OFAC) publishes a list of IRISL's fleet.

The problem that has arisen is that IRISL has been changing the names of its fleet. Since the US sanctions on IRISL came into force, 80 vessels from the fleet have changed their names. Half of these alterations have seen Iran removed from the name of the ship, with *Iran Navab*, for example, becoming *Apollo*.

The Wisconsin Project warns that these name changes do not always appear on the OFAC's blacklist, so US freight forwarders and shippers who are chartering vessels would not be warned off a potential charter by searching by name alone against the OFAC's blacklist. Therefore, they could be flouting US sanctions. The only way to be sure is for shippers to check a vessel's IMO number. Unfortunately, this number does not always appear on cargo documents such as letters of credit.

The name-change strategy is not the only tactic IRISL has implemented to hamper the tracking and detection of its vessels. The Iranian shipping line has been moving the nominal ownership of vessels to shell companies in Malta, Germany and Hong Kong. IRISL already had operations in these countries, but these have now expanded, with the Wisconsin Project reporting of 'newly formed companies of **Jackman Shipping Company**, **Newhaven Shipping Company**, **Lancing Shipping Company**, **Oxted Shipping Company** and 10 others, each of which is now the new registered owner of an IRISL vessel.'

Another strategy used by IRISL has been to pass the management of its vessels to another company. **Soroush Sarzamin Asatir** is now listed as the ship manager for an increasing number of IRISL's vessels.

OFAC has responded to the Wisconsin Project saying that it was already aware of IRISL's tactics of name and ownership changing and that the agency 'deliberates carefully about the timing of its public designations… [it] may choose to delay a public identification to allow for additional surveillance or to secure cooperation with foreign allies'.

While IRISL's strategy indicates that the shipping company can get around US sanctions, **BMI** believes that this very fact shows that the sanctions are affecting the company's operations. The company may not necessarily be trying to outwit US sanctions by confusing US freight forwarders and charters with name changes, but may be attempting to distance the name IRISL from shipping operations internationally. It could again be a case of shippers being mindful of the cost to their reputations should they choose to use the Iranian line for the transport of their goods. **BMI** notes that IRISL's name has been tarnished by sanctions by the US and UK. There have been high-profile instances of the firm flouting sanctions: in 2009 US warships intercepted a ship chartered by IRISL that was bound for Syria and found to be carrying munitions. In another incident, Israeli commandos boarded a vessel off Cyprus and found illegal arms - IRISL was later named as the shipping agent.

On the maritime as well as on the political front it appears that Iran is looking for allies and may have found them in Brazil. Iran and Brazil have agreed to launch a shipping line. MOJ News reports Ali Ezzati, the director of planning and international studies at the IRISL, as stating that the 'Iran-Brazil shipping line will be launched with the aim of expanding trade between the two countries'.

BMI notes that the plan for the joint shipping line comes on the back of increasing trade links between the two countries. Earlier in April 2010 during a visit to Iran by the Brazilian minister of development, industry and trade, Miguel Jorge, along with 86 businesspeople from Brazil, a US$6mn deal was signed by Brazilian trading company **Angural Trade** to ship 2,000 tonnes of Brazilian beef to Iran. Brazil also indicated that it was willing to import Iranian fertiliser, with Agência de Notícias Brasil Árabe (Anba) quoting Jorge as stating 'we have the world's foremost agriculture, and we import lots of fertilisers. Presently, nearly 70% of our fertiliser imports come from an Asian country. Iran is a manufacturer of phosphate and urea, which are of interest to us.' Trade between Iran and Brazil is currently one-sided, as Iran's reserves of oil and gas hold little interest for Brazil, which boasts it own reserves. Trade is therefore heavily centered on Brazilian food exports to the Iran, mainly beef and sugar. However, Iran is pushing for further trade links with Brazil, with the Iranian government pressing for a trade agreement with Mercosur during Jorge's visit to Tehran.

Improving political relations between the two countries have been noted by **BMI**'s country risk team. Brazil's president, Luiz Inácio Lula da Silva, is due to visit Tehran in May 2010, following the trip by the Iranian president, Mahmoud Ahmadinejad, to Brazil last year. Brazil has also been less tough than other nations on the issue of Iran's reported desire to develop nuclear weapons, with the country among the group of states that tends to abstain from voting in the UN on the issue.

Market Overview

Port of Bandar Abbas

Overview

The Port of Bandar Abbas is located on Iran's southern coast at a latitude of 27° 8' 27" north and a longitude of 56° 12' 24" east. The port is situated on the Persian Gulf near the Strait of Hormuz, and offers access via the straits to the east and west via the Suez Canal. The port is one of Iran's major maritime facilities on its 2,700km coastline and is the most important Iranian port in term of containerised shipping, as it handles 90% of the country's total container throughput.

Shipping
The port is a deepwater facility. The approach channel to the port is navigable for two ocean-going vessels at a time and has a draught of 13.5m, allowing the port to accommodate the Post-Panamax class of vessel. The main global shipping lines call into the Port of Bandar Abbas, with **Maersk Line**, **CMA CGM**, **MSC**, **K-line**, **Evergreen**, **COSCO**, **NYK** and **MISC Berhad** some of the companies stopping off at the port.

Congestion
Container throughput has been steadily increasing at the port of Bandar Abbas. In 2007, the number of 20-foot equivalent units (TEUs) handled at the port reached 1.7mn, year-on-year (y-o-y) growth of 22%. With the new container terminal coming online in February 2008, the port beat its 2007 figure by 16% and passed the 2mn TEU mark. The port defied the downturn, posting a throughput increase of 10.3% in 2009. We do not expect congestion to be a problem at the port in the mid term; the port is expanding its capacity to meet demand, with a 6mn TEU expansion project in the pipeline.

BMI does, however, caution that congestion could become an issue that the Port of Bandar Abbas may have to face in the future. The port is listed at number 60 out of the 100 busiest ports worldwide, according to Cargo Systems, which compiles a list based of the total throughput at global ports. According to Container Management Journal, the facility is the most important port in the Persian Gulf region after the UAE's Jebel Ali port in terms of container operations. The port is attracting major shipping companies, which will increase throughput further, with MSC announcing in 2008 that it has chosen the Shahid Rajaie container terminal at the Port of Bandar Abbas as its hub for the Middle East and the Persian Gulf operations. The Iranian Ministry of Roads and Transportation has announced plans for the Shalid Rajaie port complex, as well as the Bandar Imam Khomeini, to become hub ports by 2015 and cater for container transhipment, a plan that could heighten the risk of congestion.

Terminals

The Port of Bandar Abbas consists of two sections: the Shaid Rajaie Port and the Shahid Bahonar Port. The Sharhid Rajaie Port is the newer of the facilities and handles all container throughput. The Shahid Bahonar complex caters for general cargo.

Shahid Bahonar

The Shahid Bahonar section of the port offers berths that cater for general cargo. The facility has a maximum draught of 10m and a total berth length of 1,000m, allowing it to handle ships of 30,000 tonne capacity.

Sharhid Rajaie

The Sharhid Rajaie Port complex boasts two container terminals, which are operated by **TideWater Company** under the supervision of the Iranian Ports and Maritime Organisation.

Container Terminal 1 has a total of nine berths. Berths four to eight vary in depth, with the shallowest being 11.70m and the deepest being 12.5m. These four berths offer gantry cranes. Berths 15-18 of Container Terminal 1 offer mobile cranes and have draughts of between 12.80m and 13m.

The first phase of the second Shahid Rajaie container terminal began operations in February 2008 and currently offers a handling capacity of 1.5mn TEUs per annum. The terminal has a quay length of 850m and a draught of 17m. It is serviced by eight super Post-Panamax gantry cranes and 18 rubber-tyred gantry cranes and offers a container yard of 67 hectares.

Expansions And Developments

Phase one of a major expansion project, building a second container terminal at the Shahid Rajaie port complex, came online in February 2008, which has increased the total container throughput at the port to 1.5mn TEUs. The second phase of development is now under way, and is scheduled to become operational in 2010, boosting capacity to 3.5mn TEUs. Another phased programme of development is also in the pipeline after that, with plans to increase throughput further to 6mn TEUs.

BMI warns that the further development of the terminal mentioned above could face possible delays after German supply chain logistics consultancy **HPC** pulled out of a contract it had signed with the port following Israeli diplomatic pressure.

A contract between HPC and the Bandar Abbas port operator Tidewater Company was agreed on January 9 2010, according to the Fars News Agency. The Fars News Agency reported Tidewater Company's managing director, Abdolhamid Malahzadeh, as stating that HPC was set to replace the Singaporean firm **Overseas Port Management** (OPM) as the port's manager, as OPM's contract was coming to an end.

Following the contract between HPC and Tidewater being announced, Israel's ambassador to Berlin, Yoram Ben Ze'ev, told officials at the German Foreign Ministry and the German chancellor's top aides that Iran had used the port of Bandar Abbas for exporting weapons to Hezbollah in Lebanon and Hamas in the Gaza strip, according to a report in the Israeli newspaper Haaretz. Ben Ze'ev stated that weapons found on the *Francop* vessel, which was seized by Israeli Defence forces in the Mediterranean, had disembarked from the port of Bandar Abbas.

The Israeli ambassador to Germany was reported by Haaretz as stating that the German company's contract to renovate the Iranian port was viewed by the Jewish state as 'German assistance to an Iranian arms deal with terror organisations, and a violation of U.N. Security Council resolutions'. The paper reports that German officials contacted HPC and that the contract with the Iranian port has been terminated.

The contract's cancellation is bad news for the development of the port of Bandar Abbas. The port is in southern Iran and handles 90% of the country's container throughput. The port is operated by Tidewater, but a separate concession manages the Sharhid Rajaie port. **BMI** fears that the planned second phase of development of the port's second container terminal could now be delayed after HPC pulled out of the contract. **BMI** also warns that the episode highlights that the Iranian port's pool of potential contractors is limited, as Israel has already shown that it will intervene and use its diplomatic influence where it can to hamper the development of a port that it feels plays a role in Iran's alleged illegal weapon exports.

Multi-Modal

The Port of Badar Abbas offers road connections to Iran's major cities and is 1,563km away from the capital of Tehran. The port is 35km away from the Bandar Abbas International Airport.

Industry Forecast

Container Throughput

Throughput growth at the Iranian port of Bandar Abbas looks set to continue in 2010 after the port defied the downturn, posting year-on-year (y-o-y) growth of 10.3% in 2009. According to port authority data, the port of Bandar Abbas handled 2.2mn 20-foot equivalent units (TEUs) in 2009, up from the 2mn that the port handled in 2008. The growth marked the port out as one of the major performers of 2009, which saw downturns in throughput at many ports worldwide. It should be noted that the port's throughput growth in 2009 did, however, display a weakening of growth compared with the port's previous years' figures, when in 2008 box volumes increased by 16% and in 2007 container throughput grew by 22.3% y-o-y, indicating that while weathering the downturn well the port was not wholly immune.

In 2010 we forecast the port's growth to continue with a y-o-y increase of 8.65% forecast to bring the port's annual throughput to 2.397mn TEUs. **BMI** projects that growth will level off in the mid term with y-o-y throughput growth of 6% forecast for the rest of the mid term (2011-2014). If realised, the port will be handling 3mn TEUs per annum by 2014.

BMI warns of risk potential to these forecasts. Further international sanctions would have a negative impact on throughput, and negative publicity about the port of Bandar Abbas and the **Islamic Republic of Iran Shipping Line** (IRISL) being used for the alleged transport of weapons will no doubt tarnish the reputation of Iran's port sector.

Trade

In terms of growth, the port of Bandar Abbas managed to outpace Iran's total trade, with the country's total trade estimated by our country risk team to have decreased by 2.9% in 2009, brought on by an estimated import decrease of 2% and an estimated fall in export volumes of 4%. Trade is expected to pick up again in 2010, with growth of 2.56% forecast for 2010. Over the mid term we expect total trade to increase by an estimated yearly average of 4.56%.

Iran's main export is petroleum. The country's main imports are raw materials.

Iran's main export destinations are China, Japan, Turkey, South Korea and Italy. The country's main import partners are China, UAE, Germany, South Korea and Russia. Iran's geographic position on the Gulf allows it access (via the Straits of Hormuz) to the main shipping lanes heading both east and west.

Table: Major Port Data

	2007	2008	2009	2010f	2011f	2012f	2013f	2014f
Port of Bandar Abbas container throughput, TEU	1722513	2000230	2206476	2397374	2544714	2698852	2860105	3028805
Port of Bandar Abbas container throughput, TEU, % y-o-y	22.33	16.12	10.31	8.65	6.15	6.06	5.97	5.90

Source: Tidewater, BMI. e/f = BMI estimates/forecasts. Forecasts assume existence of spare capacity and the correspondence of national trade trends at local port level.

Table: Trade Overview

	2007	2008e	2009e	2010f	2011f	2012f	2013f	2014f
Imports, real growth, % y-o-y	6.75	4.00	-2.00	3.00	5.00	5.00	5.00	5.00
Exports, real growth, % y-o-y	5.25	4.00	-4.00	2.00	4.00	4.00	4.00	4.00
Total Trade, real growth, % y-o-y	6.07	4.00	-2.90	2.56	4.56	4.56	4.56	4.57
Imports, US$bn	56.58	68.53	58.25	66.99	73.69	79.59	84.36	89.42
Import growth, % y-o-y	13.12	21.12	-15.00	15.00	10.00	8.00	6.00	6.00
Exports, US$bn	97.40	100.57	75.91	94.17	99.82	107.48	113.74	123.95
Export growth, % y-o-y	28.07	3.26	-24.52	24.05	6.00	7.68	5.82	8.98
Total trade, US$bn	153.98	169.11	134.16	161.16	173.51	187.07	198.10	213.37
Total trade growth, % y-o-y	22.14	9.82	-20.66	20.12	7.66	7.81	5.90	7.71

Source: National statistical authority, BMI. e/f = BMI estimates/forecasts.

Table: Key Trade Indicators

	2007e	2008e	2009e	2010f	2011f	2012f	2013f	2014f
Agricultural raw materials, imports, US$mn	322.1	287.8	245.7	328.0	391.0	446.5	491.5	539.1
Agricultural raw materials, imports, % y-o-y	23.68	-10.66	-14.62	33.47	19.23	14.19	10.07	9.69
Agricultural raw materials, exports, US$mn	272.5	244.3	208.6	245.0	264.0	274.6	283.2	297.3
Agricultural raw materials, exports, % y-o-y	23.33	-10.37	-14.61	17.44	7.76	4.00	3.14	4.97
Ores and metals, exports, US$mn	1,440	1,130	965	1,267	1,361	1,487	1,591	1,760
Ores and metals, exports, % y-o-y	-5.81	-21.50	-14.61	31.31	7.38	9.32	6.96	10.62
Ores and metals, imports, US$mn	146.8	115.2	98.2	154.0	196.5	233.8	263.8	295.7
Ores and metals, imports, % y-o-y	-5.32	-21.55	-14.72	56.81	27.57	18.97	12.86	12.08
Iron and steel, exports, US$mn	1,100	867	741	935	999	1,084	1,155	1,267
Iron and steel, exports, % y-o-y	-5.70	-21.23	-14.47	26.21	6.81	8.52	6.51	9.73
Iron and steel, imports, US$mn	1,234	972	830	1,623	2,234	2,691	3,061	3,454
Iron and steel, imports, % y-o-y	-5.71	-21.26	-14.57	95.45	37.68	20.47	13.76	12.82
Manufactured goods, exports, US$mn	7,926	8,176	6,232	7,671	8,117	8,721	9,214	10,019
Manufactured goods, exports, % y-o-y	30.51	3.15	-23.78	23.10	5.81	7.44	5.66	8.74
Manufactured goods, imports, US$mn	7,333	12,236	8,019	11,603	14,352	16,771	18,730	20,806
Manufactured goods, imports, % y-o-y	10.61	66.87	-34.47	44.71	23.69	16.85	11.68	11.09
Fuels, exports, US$mn	58,604	91,689	42,827	57,033	60,105	64,270	67,671	73,222
Fuels, exports, % y-o-y	11.26	56.46	-53.29	33.17	5.38	6.93	5.29	8.20
Fuels, imports, US$mn	2,025	3,144	1,506	2,007	2,507	2,946	3,303	3,680
Fuels, imports, % y-o-y	24.56	55.21	-52.11	33.29	24.90	17.54	12.09	11.43

Source: UNCTAD, BMI. e/f = BMI estimates/forecasts.

Table: Main Import Partners

	2002	2003	2004	2005	2006	2007	2008
Imports from China, P.R., Mainland (US$mn)	1,046	2,550	2,762	3,628	4,927	8,017	9,337
Imports from United Arab Emirates (US$mn)	2,152	2,395	2,757	3,659	4,381	5,168	6,766
Imports from Germany (US$mn)	3,777	3,318	4,900	6,067	5,674	5,438	6,298
Imports from Korea (US$mn)	894	1,956	2,348	2,355	2,815	3,592	4,247
Imports from Russia (US$mn)	874	1,451	2,081	2,123	2,085	3,253	3,911

Source: IMF Direction of Trade Statistics.

Table: Main Export Partners

	2002	2003	2004	2005	2006	2007	2008
Exports to China, P.R., Mainland (US$mn)	2,133	3,014	3,961	6,178	9,042	12,118	20,019
Exports to Japan (US$mn)	4,311	6,764	7,515	9,362	9,887	11,599	16,587
Exports to Turkey (US$mn)	837	1,692	1,783	3,154	5,115	6,013	7,454
Exports to Korea (US$mn)	1,214	1,677	2,214	3,214	4,590	5,893	7,364
Exports to Italy (US$mn)	1,620	1,946	2,466	3,316	4,467	5,182	5,269

Source: IMF Direction of Trade Statistics.

Company Profiles

A.P. MØLLER-MAERSK

Strengths

- As the world's largest container shipping line, Maersk Line has a greater share of global seaborne container volumes than any other carrier.
- Its large, expanding fleet offers it the ability to capture trade volumes.
- Maersk Line is part of A.P. Møller-Maersk, a diversified company with activities in the oil and gas and terminal-operating sectors that synergise with its shipping operations.

Weaknesses

- With such a large fleet, Maersk is constantly running the risk of overcapacity, which could prove a drain on resources if business slows.
- Its presence in the oil and gas and terminal-operating sectors means that Maersk risks an over-reliance on the sector as an integrated whole. This could be dangerous if one sector's activities fail to hedge the other - for example, if oil prices are at odds with bunker prices.

Opportunities

- The company's share sale has allowed Maersk to build up an acquisitions war chest and enables it to cover its debt.
- The shipping sector has proved lucrative in the past two decades, with trade volumes growing year-on-year (y-o-y) since 1982. Despite the downturn, the mid- to long-term opportunity for trade growth is ever present, and Maersk is well positioned to capture these volumes.

Threats

- The company trades in kroner, which means that it is vulnerable to changes in the US dollar.
- Although the group operates in the oil and gas sector, disparities in the price of oil and bunker costs threaten profits.
- Should A.P Moller Maersk's CEO, Nil Smedegaard Andersen, pursue his pledge to move away from shipping, Maersk Line could be sidelined in favour of the group's oil and terminal operations.

Company Overview

The **A.P. Møller-Maersk Group** is a highly diversified group with a major presence in the shipping sector. The company was formed in 1904 in the Danish town of Svenborg and has since grown to become one of the most recognised shipping conglomerates in the industry. The group employs around 110,000 people in 130 countries and also has activities in the oil and gas and retail sectors.

The A.P. Møller-Maersk Group is the parent company of world's largest container shipping line, according to data from AXS-Alphaliner. Its container liner division - **Maersk Line** - accounts for roughly 15% of total global 20-foot equivalent unit (TEU) capacity. The group has a terminal-operating division, **APM Terminals**, which operates over 50 terminals worldwide, including those at the Port of Tacoma and the Port of Los Angeles in the US, as well as the Port of Zeebrugge in Belgium and the Port of Mumbai in India.

The A.P. Møller-Maersk Group also operates in the tanker sector, transporting crude oil, refined products and gas under the brand names of Maersk Tankers and Svitzer, with a combined tanker fleet of more than 800 vessels. Its **Maersk Supply Service** division operates 50 offshore support vessels. The company has also diversified into LNG shipping, with the company's Maersk LNG unit boasting a fleet of six vessels.

Performance

2009 Full Year

Perhaps somewhat unsurprisingly given the tough operating environment, Denmark's A.P.

Moller Maersk, the parent company of the world's largest container line, Maersk Line, posted a net loss of US$1.02bn.

The loss compares with the US$3.4bn profit that the group posted in 2008. The loss has been attributed by A.P. Moller Maersk's CEO, Nils S Andersen, to 'historically low rates and low demand'. Andersen did, however, note that things could have been a lot worse, with the company managing 'to limit the loss by saving around US$2bn'. Tradewinds reports that analysts had been predicting less of a decline - a yearly decrease in profits of US$919.4mn was predicted.

A.P. Moller Maersk's worst-performing unit was its container subsidiary Maersk Line. The liner unit posted a loss of US$2.09bn, with its revenue falling y-o-y by 28%, a result that has been blamed on 'tough market conditions with falling freight rates and volumes'.

A.P. Moller Maersk's other shipping activities were also hit by the economic downturn, with the company's tankers, offshore and other shipping activities managing to post a profit, but down by 76% on the US$1.147bn the segment recorded in 2008. The decline has been attributed by Maersk to 'impairment losses on property, plant equipment and intangible assets, as well as lower gains on sale of ships and rigs,' and the global decline in the demand for oil.

Out of A.P. Moller Maersk's maritime operations, one sector stands out as having weathered the downturn well. The company's terminal operating unit, APM Terminals, posted a profit increase of 46% y-o-y from US$302mn in 2008 to US$442mn in 2009 despite the unit's decline in revenue of 3.1% y-o-y. A.P. Moller Maersk lists the reasons for this growth despite the downturn as being 'cost-cutting measures and geographical reorientation of activities'.

2008 Full Year

In March 2009, AP Moller Maersk announced its 2008 full-year results. The results were better than the company's forecasts, and were up on 2007's figures. However, the Denmark-based company stated that it was cautious about 2009, as the downturn is affecting all areas of its highly diversified business. AP Mollar-Maersk's 2008 results were better than expected, with the group reporting a net profit of US$3.5bn, an increase of US$3.4bn on the 2007 figure and an improvement on the company's predictions, made on February 5 2009, that its profit for 2008 would be US$3.4bn.

The yearly results of Maersk Line were impressive. Profit after tax reached US$205mn in 2008, up on 2007's US$106mn. This growth has been attributed to high freight rates in the first half of 2008.

Comapany Strategy

Container

Maersk Line is the market leader in the container sector, operating a fleet with a capacity of over 2mn TEUs and boasting a market share of 14.8%, according to AXS Alphaliner data. The carrier is by some way the market leader, with second-placed MSC holding a market share of 11.2%.

Maersk Line's fleet is roughly half chartered, with chartered vessels making up 45.6% of the carrier's total operated fleet. Maersk Line's chartered fleet is made up of smaller capacity vessels compared with the line-owned fleet. Chartered vessels number 341, with a total capacity of 940,504TEUs, compared with the larger capacity owned fleet of 208 vessels with a total capacity of 1.12mn TEUs.

The company plans to hold on to its market share, with the line having a new-build orderbook as of April 2010 of 64 vessels, with a total capacity of 406,868TEUs (19.7% of the company's existing fleet). In terms of vessel numbers the orderbook is the container shipping sector's largest. In terms of box capacity, the line's orderbook is the third largest.

Tankers

Maersk Tankers operates one of the world's largest tanker fleets. In January 2009 the company merged with **Brostrom**, when Maersk acquired 97.3% of its shares and 98.3% of the votes in the company. The acquisition saw Maersk increase its tanker fleet from 146 to 241 vessels. Maersk announced a streamlining and restructuring strategy to integrate Brostrom into its operations in March 2009. The restructuring initiative means that vessels of 25,000 deadweight tonnes (DWT) or fewer belonging to both Brostrom and Maersk will trade under the Brostrom name and be managed from Brostom's headquarters in Gothenburg, Sweden. Vessels from both companies of over 25,000DWT, excluding tonnage managed out of Brostrom's office in Paris, will be managed by Maersk Tankers' Handytankers operation, which is managed from Copenhagen in Denmark.

LNG

Maersk has been operating in the LNG shipping sector since 1973 and boasts a fleet of two team propulsion LNG carriers and six Dual Fuel Diesel Electric (DFDE) propulsion ships. Maersk LNG brought its final new build vessel online in January 2010.

Maersk LNG is currently not a major player in the LNG shipping sector. The top five LNG shipping companies, in terms of fleet size, are: **Mitsui O.S.K. Lines** (MOL), **Shell**, **Malaysia International Shipping Corporation Berhard** (MISC Berhard), **Nippon Yusen Kaisha** (NYK) and **Golar LNG**. However, Maersk LNG is going head to head with MOL to provide tonnage for an LNG project in Papua New Guinea.

Terminals

APM Terminals (APMT), AP Mollar Maersk's container operator, boasts operations in 34 countries. The company's terminal portfolio of 50 terminals is diversified across all regions, with 12 terminals in Europe, nine in the MEA, 17 in Asia, 11 in North America and three in Latin America.

Trends & Developments

A.P. Moller Maersk

Having cut costs by US$2bn in 2009, A.P. Moller-Maersk is planning further trimming of costs in 2010, with a planned saving of US$500mn floated for the year. The company's CEO, Nils Smedegaard Andersen, is quoted by the Journal of Commerce (JOC) as stating 'we are not cutting to just survive but to become more competitive,' Andersen warned that finding areas to cut costs in 2010 would be harder than in 2009, but that smaller cuts would be made.

It appears that the company has already started implementing these cuts, with Lloyd's List reporting in February that Maersk had laid off 40 employees from its technical vessel operations office in Rotterdam. The jobs have been moved to Maersk's operations in Newcastle and Singapore.

Despite A.P. Moller-Maersk's plans to continue cutting costs, it appears that things are looking up for the group with the Danish investment bank **Danske Equities** forecasting that the company's container shipping line Maersk Line will post a profit (estimated to be US$916.89mn) in 2010, on the back of growing freight rates. A.P. Moller-Maersk, however, is more cautious, stating that while the container shipping market 'has been more active than expected in 2010,' the line has attributed this to restocking, and believes that recovery will slow as the year progresses. The carrier believes that it will take three to four years until the supply-demand equilibrium is restored, which would indicate that a full recovery has taken place and that the sector is once again experiencing growth.

While the company's main priority will remain a return to profitability and growth, A.P. Moller-Maersk's shipping units are looking to their priorities in the long term, which is likely to see further emphasis placed on green shipping. In preparation for this, A.P. Moller-Maersk is already investigating ways to enhance its environmental credentials, pledging to cut its CO_2 emissions by 20% before 2017. The company, despite boasting an oil and gas division, has launched a biofuels project, with the company's container vessel the *Maersk Kalmar* running tests on a biofuel blend.

Maersk Line

BMI has noted a new trend in Maersk Line's service strategy over the quarter of the company launching new routes to cater for particular products for specific markets. The first indication of the new tactic came in March 2010, when the line launched its first direct service between South America and Russia. The ECUBEX service links Ecuador to the Russian port of St Petersburg and was viewed as Maersk Line's attempt to cater for Russia's banana import market, with an estimated 180,000 tonnes of the fruit projected to be imported by the country every month.

The second example of Maersk Line developing a route for a specific commodity came in April 2009, with the container line entering into the shellfish trade by making the Canadian port of Halifax a call on the carrier's NA4 route. The stop-off sees the company trying to gain access to the trade in 15,000 tonnes of lobster that is transported from Canada to Europe each year. The lobster trade's transport needs are currently catered for by air freight, but Maersk Line believes that with newly designed reefer containers from the Danish firm **Aqualife Maersk Line** it will be able to take a percentage of the crustacean trade from air freight.

BMI believes that this new trend of catering for specific product will to continue as Maersk Line heads into more niche markets, with little competition, where it can stake its claim before other competitors arrive and so boost its service portfolio and its profit.

In other developments over the quarter Maersk Line has made service adjustments to its Far East-West Africa over the quarter, with the company's FEW1 route offering Nigeria's Tin Can Island as a port of call, rather than the port of Apapa. The port of Apapa remains Nigeria's port of call in the carrier's FEW2 service. Maersk Line states that the reason for the change is a wish to 'offer customers the best possible coverage'. The change suggests that increased shipper demand is stemming from Tin Can Island, and the call will mean importers and exports will be able to transport goods from Tin Can rather than transporting them by road or rail to Apapa.

In an indication that Maersk Line is feeling the sector-wide volume pick up on Asia-Europe routes the company is re-lauching its ME3 service from India, via Middle Eastern ports to the Mediterranean. The service was temporarily suspended in 2009 because of slackening demand, a consequence of the downturn.

Another pocket of demand that Maersk Line, along with other carriers, has spotted over the quarter is Vietnam. Maersk Line will from May add the country to its Trans-Pacific 6 (TP6) service, linking it to America's west coast. **BMI** notes that over the quarter the Grand Alliance has also announced plans to link Vietnam with US west coast ports. It is, however, Maersk Line that will be the first to use Post-Panama box vessels to Vietnam.

Maersk Line has called for improved relations between shippers and the line, with the company's chief executive, Evid Kolding, calling for a 'new, efficient, less volatile and sustainable industry'. To achieve this, Maersk Line is trialling a new system to improve relations. The company is tackling a situation that has caused animosity between shippers and carriers, with carriers complaining when shippers make 'ghost bookings' and do not deliver cargoes at the specified time and place and shippers complaining that carriers are taking on extra bookings and are rolling cargo.

The situation is a vicious circle, with shippers booking extra space in case their cargo gets rolled and shippers taking extra bookings to fill capacity in case shippers do not show. Maersk Line is trialling a system that it hopes will put an end to this practice by imposing a no-show charge of US$10 on every container that is booked on a specific sailing but does not show at the dock. The trial, which was announced in March 2010, is due to be launched in May on the carrier's TP-8 service (trans-pacific service) from the ports of Los Angeles and Oakland. The pilot scheme will not only penalise shippers for no-shows, but will also punish Maersk Line if it rolls a shipper's cargo to a later booking, with the carrier having to pay a US$10 fine.

BMI expects this scheme, if it proves successful, to be rolled out over Maersk Line's service network; in an indication that the carrier is already preparing for a roll-out of this scheme, the carrier has stated that it will charge a US$100 no-show fee on shippers that book the carrier's South China to Middle East service but then do not load their cargo. We believe that as a market leader, schemes launched by Maersk Line are watched carefully by the carrier's competitors, and are in many cases copied.

Like other global operators, Maersk Line has been keen to push up rates in a bid to return to profitability. Over the quarter the carrier increased rates on its Mediterranean and Transatlantic services, with freight rates being hiked by US$400 per TEU and US$500 per 40-foot equivalent unit (FEU).

Maersk Tankers

Maersk Tankers is looking to the future and finding new areas to build up expertise. The company believes that a potential shipping market could develop from carbon capture and storage (CCS) systems, with companies looking into the transportation of carbon that has been captured to its final storage place. Maersk has said that its participation in finding a $C0_2$ transport solution makes sense as 'innovation has always been important; we were the first to include double-hulled vessels in the fleet back in 1992. Today we want to pioneer CO_2 transport.' **BMI** believes that Maersk's strategy to develop its expertise in this new area will allow the company to carve out a market share in a sector that holds great development potential.

Maersk LNG

A.P. Moller Maersk is expecting strong growth from its liquid gas shipping unit in the future, with Port News reporting Maersk LNG's group head, Paul Carsten Pedersen, as stating that it is 'the fuel of the future', as it emits less CO_2 than coal and because there are large volumes of gas available around the world. Maersk LNG has been building up its fleet, but the unit is still much smaller than other LNG shipping companies.

BMI was encouraged by reports that originated in China that the unit was in negotiations for a joint venture with China Shipping (Group) Company for LNG transportation. We noted at the time that such a venture would give Maersk LNG access to China's growing LNG import market. These reports, however, turned out to be false, with Pedersen stating that a 'joint venture LNG enterprise is absolutely a mare's nest,' as quoted by Asiasis. Pedersen admitted that Maersk LNG and China Shipping (Group) Company had reached a preliminary agreement, but it had not been implemented. **BMI** believes that should A.P. Moller Maersk wish to increase its operations in the LNG shipping field, such a strategy of teaming up with another line to cater for a country with either large LNG export or import needs would be the way to grow.

APM Terminals

The quarter has seen APM Terminals both expand and decrease its port holdings. On the expansion front, the terminal operator has concentrated its operations in developing countries. In March 2010, APM Terminals was named the preferred bidder for the concession to operate the Liberian port of Monrovia.

APM Terminals has pledged to invest US$120mn in the port's development over the 25-year concession period. The company plans to upgrade the facility's container and break-bulk operations. Under the terms of the concession, APM Terminals will develop a new quay wall and add a new berth at the port. The aim is for the port's capacity to be increased from 50,000TEUs per annum to 75,000TEUs per annum and 75,000 tonnes of general cargo. To help realise this, APM terminals will purchase ship-to-shore equipment.

BMI notes that the port of Monrovia fits into APM Terminals' Africa operations, which are centred on the region's western coast; APM terminals operates six ports in the region. The port of Monrovia caters for 80% of Liberia's trade, and trade has been increasing in recent years. The port of Monrovia already features as a port of call on one of Maersk Line's container services, the WAF7, which links the port to other African ports and the Spanish port of Algeciras.

The port has also expanded its operations in Latin America with the company acquiring shares in the Terbusa grain terminal at the country's largest port, Buenos Aires. APM will spend US$10.9mn on the purchase, which will expand the company's existing operations at the Port of Buenos Aires, according to Container Management Magazine (CMM). APM currently operates Terminal 4 at the port, which is equipped to handle containers as well as break bulk and project cargo. Currently state-owned, Terbusa has been disused for several years since the break-up of Argentina's National Grain Board in 1991.

BMI believes APM's purchase reflects the company's growing appetite for investing in less developed, potentially high-growth shipping markets such as those in Latin America, Africa and South East Asia.

While expanding in some emerging markets, the company has been decreasing its exposure in others, with APM Terminals not renewing its lease on its container terminal at the Taiwanese port of Kaohsiung. Martin Gaard Christiansen, CEO of APM's Asia Pacific operations, said the move was part of a company-wide strategy to 'optimise' its terminal network. At the time of the announcement, **BMI** noted that the company's decision was partly influenced by a desire to focus its interests on Xiamen International Port, some 500km to the east of Kaohsiung on mainland China, where it owns a 50% stake in the US$380mn Songyu container terminal.

Mediterranean Shipping Company

Strengths

- MSC is the second largest container shipper in the world, and is thus well placed to weather the current financial turmoil.
- The company is scrapping to decrease its overcapacity and make room for its new-build fleet.
- The company has a forward-thinking strategy, with the delivery of the largest vessel ever classed by Germanischer Lloyd, demonstrating its commitment to future developments, notably the expansion of the Panama Canal.
- The company is not averse to chartering. This has permitted the shipper to expand its fleet.

Weaknesses

- The company's focus on Mediterranean trades may leave it more vulnerable than its competitors to declines in Asia-Europe trade.
- With such a large fleet, MSC is constantly running the risk of overcapacity, which could prove a drain on resources if business slows.
- The company has the largest container new-build order book globally - a weakness in the current environment of overcapacity.

Opportunities

- The shipping sector has proved lucrative in the past two decades, with trade volumes growing year-on-year (y-o-y) since 1982. Although the downturn will negatively affect the company, the mid- to long-term opportunity for trade growth is ever present, and MSC is well positioned to capture these volumes.

Threats

- The global economic downturn has proved detrimental to trade volumes and, subsequently, shipping volumes. The crisis was particularly acute in Asia-Europe trades, forcing MSC to cut capacity.
- The company is scrapping some of its fleet, which will leave it reliant on chartering vessels if it wishes to retain its market share. This could become costly when the shipping environment improves and charter rates increase.

Company Overview

Mediterranean Shipping Company (MSC) was founded in 1970 in Geneva, Switzerland. It launched its first service between the Mediterranean and South and East Africa in the mid-1970s. In 2003, the company became the second-largest container shipper in the world, and now operates a box capacity of approximately 1.5mn 20-foot equivalent units (TEUs) with 378 vessels. The Mediterranean remains a key transfer point for cross-continent cargo, demonstrated by the shipper's ownership of its first box terminal at the Port of Valencia, Spain.

MSC provides better coverage of direct port calls than any of its competitors. The carrier operates 200 direct and combined services weekly, calling at approximately 335 ports. The carrier has 390 offices across 146 countries, and employs more than 30,000 staff.

According to the carrier's website, 'MSC has also invested in crew training, shipyards, container workshops, ship planning centres and dangerous cargo management centres'. In 1989, MSC acquired **Lauro Lines**, and began expansion into the cruise industry. The business accounts for about 5-7% of MSC's total revenues.

Performance

Container Shipping

Volumes: At the beginning of 2010, MSC had a total slot capacity of 1.49mn TEUs, up from 1.42mn TEUs in 2008.

Financials: Not available.

The impact of the downturn on MSC is unknown as the shipping line, as a private company, is not required to release financial reports. Aponte did, however, indicate that like its peers MSC has struggled in 2009, stating that 'the big operators will come out very strong… we will all recover our losses in 2010'.

Fleet: MSC figures show that the carrier operated 378 vessels in 2009, 32 fewer than in 2008. The number of containers that the company shipped decreased by 2% from 10.5mn TEUs in 2008 to 10.289mn TEUs in 2009.

Company Strategy

Containers

MSC has developed to become the second-largest container line in the world, boasting a market share of 11.2% in April 2010, according to AXS Alphaliner data.

The company looks likely to remain in second place, as it is 3.6% off the leader, **Maersk**, but still some way above **CMA CGM**, which is in third position with a market share of 7.5%.

As with all the major players, MSC will be keen to hold on to its market share, which is considered to be a way of grading global container lines. Despite the downturn, MSC edged closer to the top spot in 2009 and it will no doubt continue to snap at Maersk Line's heels.

According to AXS Alphaliner data, in April 2010 the company-to-charter-vessel ratio is almost even, with owned vessels making up 201 of the 403 ships operated, and MSC chartering the other 202 vessels. The company's owned vessels are, however, of a larger capacity, with owned vessels making up 834,845TEUs of the 1.56mn TEUs operated by the shipping line, compared with the 725,542TEU that that the firm charters.

Like its peers, MSC ordered during the boom period. In fact, the company holds the largest orderbook in terms of box capacity at 563,949TEUs; in terms of vessels the company's orderbook stands at just 47 vessels, the fourth largest orderbook, which indicates that the company's orderbook is made up of larger-capacity vessels. MSC's expansion strategy will see just 36.1% of its current operating fleet added as new builds. The company appears to be managing its fleet increase by scrapping older vessels to make room for the new tonnage.

Terminals

MSC owns and operates a terminal at the Port of Valencia, in Spain. The shipper was reported by Lloyd's List in June 2008 to have thus far invested US$188mn in expanding the terminal's infrastructure since it took control of the facility in February 2007. **BMI** believes that this will increase MSC's productivity at the terminal, and help to boost revenues. We expect further investment in the facility in 2010.

The company is transferring its operations from its old transhipment hub of Tercat at the Port of Barcelona to its Valencia facility.

Trends & Developments

MSC took a stand over the quarter and leapt to the defence of the container shipping sector as a whole, challenging complaints about rate hikes and the lack of capacity on some routes. MSC's CEO, Gianluigi Aponte, said that blame for the situation should be shared equally, stating that shippers had taken advantage of overcapacity during the downturn, saying 'shippers are not that deep - they worry always who will ship for US$50 less. The shippers are concerned solely by the price.'

He also denied claims that MSC had been one of the carriers to slash its rates, which led to a price war with rates reportedly falling to near zero on Asia- Europe services in 2009. American Shipper reports that some shippers they talked to said that MSC had cut rates, but Aponte described the tactic as crass and said it was 'irresponsible for a company in our business to lower rates,' as quoted by the Financial Times.

BMI notes that this outburst by Aponte marks a change in strategy for MSC, which does not normally hit the headlines and appears to guard its privacy.

On the rates front MSC has continued its strategy of rate hiking over the quarter as container lines try to push rates higher after their fall in 2009. The routes that MSC has hiked rates on this quarter have been US-Far East and US-Europe, two major shipping lanes. The company also announced hikes on its Asia-Europe services, but removed its US$100TEU peak-season surcharge from the route in March 2009. Rates were also hiked on MSC vessels from Spanish ports heading to the Middle East and the Far East.

In terms of managing its fleet, MSC continued its tactic of scrapping, which won it first place in a 2009 survey on the strategy, this quarter sending its *MSC Pioneer* to an Indian breakers' yard in February 2010. The ship was one of the smaller classes of vessels in MSC's cellular fleet, with a capacity of fewer than 1,500TEUs.

The news follows reports in November 2009 that Indian breakers had bought two MSC vessels, the 8,730TEU *MSC Immacolata* and the 1,923TEU *MSC Zanazibar*. This followed a report published by Paris-based consultancy AXS Alphaliner in August 2009 that MSC had topped its 2008 scrapping list and had at that point scrapped 20 vessels in 2009.

BMI notes that scrapping has been a major part of MSC's strategy to weather the downturn and has cut the cost of operating its fleet during a time of slack demand, while also tacking the issue of overcapacity, not only in MSC's fleet, but also in the global container fleet.

The company, while decreasing its capacity through scrapping, is also bringing in new vessels to replace the old. MSC expanded its fleet over the quarter through a charter. The *MSC Savona* has been hired from its German owner Claus Peter Offen and is a new build with a capacity of 14,000TEUs. The charter demonstrates MSC strategy of using larger vessels on its routes, with the *MSC Savona* expected to be placed on the shipping lines Asia-North Europe Silk Service.

Finally, MSC's strategy over the quarter has concentrated on adapting its services to the changing demands of the market. MSC has not launched any new services over the period but has been tweaking its existing services to better cater for its clients changing needs. The major changes have taken place on the shipping line's US services, with the company using container ships with a capacity of 8,085TEUs on its westbound Asia to east-coast service, the largest class of vessel ever to have been deployed on the east coast.

MSC was reported by the Journal of Commerce to be using the vessels temporally on services from Asia to the US via the Suez Canal. **BMI** believes the move marks a trend that will see the use of all-water services (going directly into east coast ports) rather than US overland routes from US west coast ports. The tactic marks a change in shippers' demands, with the onus now on the cost rather than time. The cost saving to the shipper by transporting goods solely by sea rather than partly by rail or truck is estimated at about US$75 per TEU, depending on the size of vessel. In terms of time, the all-water route is longer, with land routes offering a saving of seven to eight days, but **BMI** notes that given the weak state of the US consumer market, shippers are not so pressed by the time constraints that they faced in the boom period.

Another indication of MSC's expanding US strategy came later in the quarter, when the shipping line added the southeast US port of Charleston to its all-water Asia-US service. The call links Charleston with ports in China, South-East Asian ports and ports in the Middle East.

CMA CGM

Strengths

- The group has the third largest container fleet in the world.
- CMA CGM has acquired a number of diversified subsidiaries, catering for different markets across the globe.
- Its terminal operating business, Terminal Link, supports the growth of the shipping division and the group's subsidiaries.
- Its multi-modal divisions also bolster growth, providing the customer with an integrated 'door-to-door' service.
- The company is reported to have returned to profit in Q409.

Weaknesses

- With such a large fleet, the risk of over-capacity is ever-present.
- CMA is not as diverse as competitors such as Maersk, COSCO and China Shipping, which operate services in the bulk and tanker sectors as well.

Opportunities

- The three-pronged acquisition of US Lines, COMANAV and Cheng Lie Navigation Ltd. offers the opportunity to capture traffic volumes to and from three different regional markets.
- The shipping sector has proved lucrative in the past two decades, with trade volumes growing year-on-year since 1982. Despite the downturn, the mid- to long-term opportunity for trade growth is ever present, and CMA CGM is well positioned to capture these volumes.

Threats

- The company is continuing to restructure its debt.
- The company's huge orderbook is still a threat, despite plans to cancel 15 new-build orders.
- The company must ensure it does not place the importance of its market share above that of its recovery.

Company Overview

CMA CGM is the world's third-largest shipping line. Compagnie Générale Maritime (CGM) was formed in 1977 with the merger of the Messageries Maritimes (MessMar) and the Compagnie Générale Transatlantique (Transat). Compagnie Maritime d'Affrètement (CMA) was founded the following year, 1978.

In 1996, CMA CGM was privatised, and the following year made its first acquisition, of **Australian National Lines** (ANL). This was followed by a spree of acquisitions, beginning with UK-based **MacAndrews** in 2002. In 2006, CMA CGM purchased **Delmas**, an African shipping line previously owned by **Groupe Bolloré**. The acquisition propelled CMA CGM to third place in the world's container shipping lines, and strong growth enabled it to make three purchases in 2007, with the acquisition of Taiwan-based **Cheng Lie Navigation Ltd**., Moroccan line **COMANAV** and US-based **US Lines**.

The group has operations in container line shipping, with a special focus on reefer cargo, and also operates in the tourist industry, through its subsidiary **Croisières et Tourisme**. **CMA CGM Logistics** operates 14 offices in China, Europe and the Middle East, and the group also owns **TCX Multimodal Logistics**, a bonded warehouse company that operates in many French ports. CMA CGM's multimodal subsidiaries include **French River Shuttle Container**, ocean freight forwarder **LTI France**, **CMA Rail** and **Progeco**, the repair arm of CMA CGM's container business. **Terminal Link** is the group's terminal operating business.

Performance

2009

2009 was tough year for CMA CGM, with credit agency **Fitch** downgrading CMA CGM's debt rating to BB- in June 2009. This downgrade followed **Standard and Poor's** downgrading of the company's credit rating to BB- in March 2009. In June, Lloyd's List reported that CMA CGM will no longer allow its debt to be rated by the three main agencies (Standard & Poor's, **Moody's** and Fitch) as the line accuses the agencies of failing to understand the container shipping industry.

Jaquae Saadé, CMA CGM's founder, was quoted in Le Figaro in March 2009 as stating that 'the low point is behind us' and that 'the year 2009 should show a progressive pick up in exchanges, albeit at very modest proportions'. Saade is quoted as forecasting CMA CGM's sales to reach about US$16bn in 2009. The company is reported to have returned to profit in Q409

H109

CMA CGM posted a loss of US$515mn.

2008

CMA CGM announced its 2008 financial results in April 2009, revealing an 87% fall in its year-on-year (y-o-y) profits. The company launched a strategy to cut its operating costs by US$600mn.

According to Lloyd's List, CMA CGM posted a profit of US$124mn in 2008, compared with US$966mn in 2007. The company's revenues increased by 28% from US$11.8bn in 2007 to US$15.1bn in 2008. In volume terms, CMA CGM also posted an increase - shipping 8.9mn TEUs in 2008 compared with 7.7mn TEUs in 2007.

Lloyd's List reports that although the container shipping industry as a whole will see the line slide into the red, CMA CGM is confident of weathering the storm. The company's chairman and founder, Jacques Saade, has said 'the major players will emerge stronger than ever'.

Company Strategy

As with all the major players, CMA CGM will be keen to hold on to its market share, which is considered a way of grading global container lines. The company does, however, face a debt burden of US$5bn, which should be the company's first priority.

CMA CGM has developed to become the third-largest container line in the world, boasting a market share of 7.5%, as of April 2010, according to AXS Alphaliner data. The company will likely hold on to this position as it is some way off the market share of **MSC**, which holds second place with a 11.2% share, and some way above its nearest challenger, **APL**, which holds a 4.2% share in the global container market.

According to AXS Alphaliner data in April 2010, the company's owned-ship/charter-vessel ratio shows that the company is more reliant on chartered vessels to make up its fleet numbers than the top two container lines. CMA CGM operates 86 owned vessels (with a capacity of 342,631TEUs) and 281 chartered vessels (with a capacity of 703,645TEUs). **BMI** notes that by operating a majority of chartered vessels the company is able to adapt its fleet size depending on the market environment. However, a reliance on chartering vessels does expose the company to price fluctuations in the chartering market.

CMA CGM's long-term strategy is one of expansion, which is in line with holding on to its market share as its peers also expand their fleets. According to AXS Alphaliner, the company's new-build orderbook stands at 53 vessels (449,293TEUs). In terms of vessel orders, this is the second largest fleet in the top 100 global container lines after **Maersk Line**. In terms of box capacity, the fleet is also the second largest after MSC. Owned vessels make up 42.9% of the company's existing fleet, but a number of new vessels are due online over the coming years, which will greatly increase CMA CGM's owned fleet, which could see the number of vessels chartered by the company drop, depending on the economic environment.

Trends & Developments

The beginning of the quarter saw a new CEO take over the reins in the form of Philippe Soulie. Farid Salaem, Rodolphe Saade and Jean-Yves Schaprio were appointed executive officers. Jacques Saade stepped down from the CEO position to make way for Soulie, but keeps the position of CMA CGM's chairman, a role that removes him from the day-to-day running of the shipping line and allows him to focus on the company's strategy.

BMI notes no major changes in the company's strategy despite this managerial change, with news about the company over the quarter continuing to be dominated by its debt, the cancelling of some of its new-build fleet, and the continuation of a tactic of hiking rates.

Following its creditors' decision in December 2009 to extend the carrier a US500mn credit line, the shipping line received its first instalment to tide it over, a US$80mn cash injection in February 2010, to be used to improve the company's cash flow. It is unknown how many installments the US$500mn will be made out to CMA CGM in or when the next one will be given, but the shipping line has stressed that it 'is not unduly anxious about it at the moment, as its operating results continue to improve'.

The major news surrounding the company over the quarter centred on reports that the Qatar's Investment Authority (QIA) has offered to invest US$1bn in the indebted French shipping line. AFP reported an unnamed source as stating that 'CMA CGM is in discussion with the Qatar fund'. The shipping line has refused to comment on the reports. French magazine La Lettre de l'Expansion reports that the QIA has offered investment in the form of loan guarantees.

BMI warns that the reports of Qatar's interest in the shipping line have yet to be substantiated, and we note that the shipping sector got unduly excited in 2009 following reports that Qatari investment fund QInvest was to invest in Polish shipping yards at Gdansk and Szczecin. It later emerged that QInvest was just the advisor on the deal, and the unnamed buyer failed to meet the payment deadline for the yards, with the deal falling through.

BMI notes, however, that Qatar's interest in investing in the shipping sector has been increasing. In November 2009 QInvest and the Netherlands' **Fortis Bank** joined forces to launch a Shariah-compliant ship-financing fund. The two companies have committed US$50mn to the five-year mezzanine fund and are seeking US$100mn from investors in the Middle East. The US$200mn shipping fund is to be used to provide financing to investors and ship-owners that have struggled in the downturn.

If the reports are correct and the investment moves ahead, CMA CGM may not have to rely on other investors. In November 2009 the line's founder, Jacques Saade, called upon investors, both private and employees at the line, to buy shares within the shipping company. Since then news sources have reported interest from **Apollo Management**, **Butler Capital Partners**, **Louis Drayfus**, US bank **Goldman Sachs** and French transport company **Bollore**. There is no news yet on whether CMA CGM has been successful in its drive to find investors. The official deadline for investor interest was March 17 2010.

BMI notes that the investor situation did not look too bright following the last update from CMA CGM. In February 2010 the Financial Times reported the line's finance director, Jean-Yves Schapiro, as describing the potential private equity investors who had displayed an interest in CMA CGM as being 'too greedy.' Schaprio stated that making a deal with investors was turning out to be impossible as 'they made offers that were unacceptable'.

If all else fails the company might still be able to tap into France's EUR20bn (US$27bn) Fonds Stategique d'Inestissement (FSI). The company will not be able to secure conventional state aid but is pushing ahead with the FSI strategy, with the Financial Times quoting Schapiro as stating 'we [are trying] to persuade the French strategic fund… this is what we spend our days, our weeks, our months doing. We are trying to persuade them that it's a wonderful opportunity to be part of CMA CGM.'

There is currently no update on the progress of CMA CGM's request for aid from the FSI and no indication of whether it will be successful. **BMI** does note, however, that in December 2009, Shipping Online quoted the FSI as stating that 'CMA CGM fits in with France's FSI mission, which was established by the French state to meet the capital requirements of companies that bring growth and competitiveness to the economy.' At the time the Journal of Commerce (JOC) quoted France's transport secretary, Dominique Bussereau, as stating, 'the government can't be indifferent to what is happening to CMA CGM…it preoccupies us'. However, the French government will hold off from offering aid to the line until the second phase. Busssereau said '[CMA CGM] must first resolve its debt problem with the banks'.

With CMA CGM's debt predicament now widely known, some have been looking back in an effort to understand how France's major container line managed to get itself into this predicament. The carrier has blamed the global financial crisis, which affected all container lines, and a price war that broke out, with lines undercutting each other's rates, ensuring losses industry wide. With CMA CGM plummeting so far into the red, the company was unable to pay the final installments for its considerable new-build fleet orderbook.

French newspaper the Libération, however, reported that another strategy implemented by CMA CGM led to the company's woes. The news source accused the line of speculating and losing US$1bn on the oil-price derivatives market. The newspaper report was quoted by IFW as stating that the 'group's classic oil-price hedging activity developed into a speculative investment on a sizable scale in 2008, with disastrous consequences'. CMA CGM responded by saying that the newspaper's report was 'old news already made public'.

With CMA CGM's colossal new-build orderbook bearing the brunt of the blame for the shipping line's dire straits, it is understandable that having received financial backing from its creditors the company's first priority has been to tame its orderbook. According to CMA CGM's executive officer, Rodolphe Saade, the line is in talks with Korean yards to delay or cancel orders for 30 ships; at least 15 of these are planned cancellations. CMA CGM's founder, Jacques Saade, has previously stated that the company's planned cancellation of some of its new-build fleet would centre on vessels with a smaller TEU capacity, and would not include the super fleet of eight vessels with planned capacities of 13,000-13,500TEUs.

The strategy has bought the line into conflict with some its shipyards. In February South Korea's **Hanjin Heavy Industries** issued the French liner with an ultimatum: the carrier had until February 23 2010 to pay for one of its new builds or the ship would be sold to another owner. The yard has already resold one of CMA CGM's new-build orderbook to another client, with the Journal of Commerce reporting that the *CMA CGM Kessel* was sold to **Cardiff Marine** for US$41mn and had been chartered to the Mediterranean Shipping Company (MSC).

Over the quarter the company has made the most of the uptick in trade by continuing its strategy of hiking rates. The company has laid out plans to increase rates on 11 trade routes over April and May 2010. The company has reportedly returned to profitability and will need to keep rates up to get the company back on track.

Another positive development over the quarter was that the company launched a new feeder service. In January 2010 the company launched a feeder service from the German port of Hamburg with stops at the Danish ports of Fredericia and Copenhagen, the Swedish port of Halmstad and the Polish port of Szczecin. The service, which offers a capacity of 658TEUs, ties in with CMA CGM's ocean services, which use Hamburg as a hub. **BMI** believes that this strategy displays CMA CGM's desire to participate further in the full delivery of containers from one port to another by expanding its feeder operations.

Despite this good news, which along with the company receiving a US$500mn credit line and reporting a profit in Q409 indicates a brighter future for the line, the company was embroiled in two scandals over the quarter. The first concerned being implicated in a North Korea arms-trading scandal. AP reported that South Africa has filed a report with the UN after authorities in Durban confiscated two box containing tank parts bound for North Korea. The containers had been on board the CMA CGM vessel the *CGM Musca* and had been loaded at the Chinese port of Dalian.

The second scandal involving CMA CGM came to a head later in the quarter with CMA CGM's subsidiary **DELMAS** denying accusations levelled against it by Global Witness and the Environmental Investigation Agency (EIA) that it was transporting rare timber from Madagascar and so was facilitating the destruction of forests in the country. CMA CGM issued a statement saying 'the group transports goods in strict compliance with national and international regulations. Timber exports from Madagascar are carried out within a rigorous legal framework, defined by the relevant Malagasy authorities.'

Evergreen Line

Strengths

- The carrier has significant investments in several major container terminals worldwide. This means it has better control of overall handling costs than many of its peers.
- Evergreen operates one of the most globalised route networks, with strong coverage of major Latin American and Middle Eastern ports in addition to its core Asian, US and European services.
- The company's route-sharing agreements allow Evergreen to decrease capacity while still meeting its clients' demands.

Weaknesses

- With a large container fleet and little diversification into other the sectors, the risk of over-capacity is ever-present.
- The company's flagship services are Asia-orientated, so a shift in the dynamics of this region would make Evergreen vulnerable.

Opportunities

- The company's plan to scrap vessels will allow it to decrease capacity at a time of low demand in the container sector. If the company decides to initiate a new-build program during this time, Evergreen will boast one of the youngest and most modern fleets in the container sector.
- The line is well placed to take advantage of cargo growth due to the opening of direct routes between China and Taiwan, with a new service - the Taiwan Strait Service - under way, two major terminals in Kaohsiung under its operation and a raft of new services in the planning stages.
- The pairing of Evergreen with Hutchison Port Holdings in the Italian port of Taranto could have a positive impact on the performance of the terminal. The terminal has the capacity to handle 2mn 20-foot equivalent units (TEUs) on an annual basis, but as yet has only reached throughput of 892,303 TEUs.
- The company has invested in the Port of Rotterdam, Europe's biggest container facility, and in London Thamesport. This will strengthen its operations, creating a wider global spread.
- The company has been expanding its intra-Asia route portfolio in partnership with China's CSCL and COSCON, a strategy that places the company at the forefront of what is expected to be a new major demand market.

Threats

- The current economic climate is expected to have a continuing impact on Evergreen's business, as demand for container trades is forecast for a later recovery than other sectors such as dry and liquid bulk.
- The opening of Taiwan-China direct sea routes, coupled with decreased spot market freight rates, is likely to encourage an influx of container competition in this regional market.

Company Overview

Taiwan-based carrier **Evergreen Marine Corp** was founded in 1968, beginning its life as a container shipping service linking the Far East with the US west coast. In 1984, the carrier launched its flagship 'round the world' service, which was later scrapped in favour of east-west/west-east 'pendulum' services.

It operates across 80 countries and has 240 service locations that operate vessels on main routes and feeder services.

The company's main sea routes focus on the delivery of goods from Asia, particularly Taiwan, Hong Kong, China, Korea and Japan. The carrier operates to and from US east and west coasts, South America, Europe, the Mediterranean, the Middle East and Africa. Evergreen also provides a container service between the east coast of South America and the east coast of the US, and a service linking Panama with the US west coast. The carrier also provides regular feeder services in the Caribbean and the Indian sub-continent.

Evergreen is also engaged in the port-operating sector, with terminals including the

Taichung Container Terminal, the Kaoshiung Container Terminal, the Colon Container Terminal and the Taranto Container Terminal in southern Italy - in which Hutchison Port Holdings also has a stake.

The company also acts as a shipping agent, and is involved in the distribution of containers.

Performance

Q309

Evergreen Marine posted a US$80mn net loss over the quarter, compared with the US$45.5mn profit that the company made in Q308. The loss over the quarter brought Evergreen Marine's total net loss for the year so far to US$224mn.

Q209

Taiwan's Evergreen Marine posted a US$60mn loss in Q209. The Q209 loss marks the third straight quarterly loss for the Taiwanese container line and, in comparison with the company's profit of US$25mn in Q208, highlights just how tough 2009 has been on the container shipping sector's bottom line. The loss comes on the back of a decline in the company's Q109 revenue, which recorded a year-on-year (y-o-y) decline of 38.5%. The one upside of Evergreen Marine's Q209 result is that the loss is less steep than the company's Q109 decline, where the company reported a loss of US$83mn.

Q109

Evergreen Marine released its first quarter results in April 2009, reporting a net loss of TWD2.74bn (US$83mn), significantly below the majority of analysts' expectations. The results represented a sharp decline from the TWD367.11mn (US$11.2mn) profit margin recorded in Q108 and illustrated a further deterioration in performance since the company's poor Q408 results. Total revenue for the first quarter was TWD3.63bn (US$109.8mn), down from the TWD6.11bn (US$186mn) recorded in Q108, a 38.5% y-o-y fall.

2008 Full-Year

Evergreen reported a net income of TWD639.26mn (US$18.8mn) for 2008, down from TWD10.38bn (US$305.3mn) in 2007, a y-o-y fall of 93.8%. Revenue declined by 19.4% y-o-y to TWD22.43bn (US$659.6mn) in 2008, compared with TWD27.84bn (US$818.7mn) in 2007.

Company Strategy

Container Shipping

Evergreen Line's aim is reportedly to become the world's largest container line within the lifetime of its chairman and founder, the 81-year old Chang Yung-Fa. If this is its aim the company's strategy should no doubt be one of expansion, but the company has stayed away from the shipyards for about six years, meaning the company has in fact fallen down the market share ratings. On the plus side, this has enabled the company to weather the downturn, while its competitors had the extra worry of funding new-build orders and struggling with overcapacity as the orders came online.

Now, with the container shipping sector looking up, Evergreen is pushing ahead with its expansion strategy, with a much-reported plan of ordering 100 vessels over the mid term.

The company as of April 2010 is operating a fleet of 148 vessels, a total capacity of 551,490TEUs and holds a market share of about 4% according to AXS Alphaliner. The shipping line's owned-to-charter ratio is weighed in the owned vessels' favour, with the company boasting a fleet of 87 vessels (319,263TEUs) compared with 61 charter vessels (232,227TEUs).

Terminals

Evergreen has interests in a number of container terminals located at major ports across the world. The company's key domestic operations include the Taichung Container Terminal, at the Port of Taichung, which offers two berths with a draught of 14m, as well as the Kaoshiung Container Terminal at the Port of Kaoshiung, which offers three berths with depths of 15m and a handling capacity of 2.7mn TEUs per year. Evergreen also has significant investment in the Colon Container Terminal, located at Panama's Colo Solo port, and the Taranto Container Terminal in southern Italy, which is jointly operated by **Hutchison Port Holdings**.

Trends & Developments

Evergreen Marine is heading back to the shipping yards after an absence of about six years with the carrier lining up shipbuilding candidates for a colossal orderbook, which is to start with 12 new box ships of 7,000-8,000TEUs. The shipyards that are reported to have been approached are South Korea's **STX Offshore and Shipbuilding**, China's **Nantong COSCO KHI Ship Engineering** and Taiwan's **CSBC Corporation**. The yards are reported to have until the end of April 2010 to quote their prices for the order, with the ships due for delivery in 2012.

This appears to be just the beginning of Evergreen's new-build plan, with reports soon following that the company's chairman and founder, Chang Yung-Fa, had announced plans for an orderbook of 100 box ships. American Shipper reports the breakdown as follows: 32 8,000TEU vessels, 20 7,024TEU ships, 20 5,364TEU vessels and 20 or more 2,000TEU feeder ships. **BMI** notes that the potential new builds fit in with Evergreen's previous order strategy, with the company shying away from the trend of new, larger vessels of up to 14,000TEUs, with the Financial Times reporting that Chang is 'a noted skeptic about the industry trend towards far larger ships, believing that the need to fill them would end up driving down earnings'.

What is interesting about Chang's announcement about potentially placing orders for 100 new ships is that it is not the first time the founder has laid out such a plan. In 2009 he announced the same plan for 100 box-ship orders and a plan to spend US$5.5bn to have them delivered in 2012. Evergreen, however, was quick to pour cold water on this announcement, with the Journal of Commerce quoting Evergreen Line's spokesperson Barbara Yeninas as saying 'there is no concrete schedule for a new shipbuilding program… Evergreen continues to monitor the price of shipbuilding and global market conditions… Once it becomes reasonable and timely, such a new shipbuilding program will commence.' The company has not published any view on Chang's claims, indicating that it is now 'reasonable and timely' for the shipping line to begin ordering.

BMI believes that Evergreen Marine's decision to re-enter the new-build ship market is understandable and well timed. The company has fallen behind it competitors: as recently as 2002 it was the world's second-largest container fleet. It has since fallen to fifth position, behind **APL**, with the company losing the title of largest container line in Asia. Evergreen fell behind after its peers began expanding their fleets. As mentioned, the company has not placed any new orders for about six years, presumably because Chang claims to have predicted the downturn as early as 2006, with Evergreen beginning downturn preparations by cutting back on new-build orders at the height of the market, when other carriers were planning significant fleet expansions.

BMI believes that Evergreen's decision to begin ordering now will place the company in a strong position to reclaim fourth position and maybe climb even higher in terms of market share. The United Daily News has reported that 'the 81-year-old [Chang] hopes to steer Evergreen into becoming the world's largest container line in his lifetime'. **BMI** notes that by waiting for the boom to pass, Evergreen will be able to expand its fleet at a cheaper rate than its competitors, which bought at the top of the market, as shipping yards have suffered over 2009, with just one box ship order being placed, and so will no doubt be prepared to offer Evergreen a good deal. In terms of finding employment for its new fleet, **BMI** believes that Evergreen has timed this well as its peers are currently bringing online new vessels, with the threat of overcapacity in the container shipping sector still lurking. The average time for the completion of a new build is 18 months, so if Evergreen orders now we believe its vessels will be entering into a market where demand has returned.

An indication that Evergreen believes that the worst is behind it and that the global shipping sector is looking up became evident this quarter through the company's service changes. In April 2010 the carrier announced that it planned to re-instate its US West Coast-Asia/Mediterranean service (UAM), which it withdrew from service last year due to the downturn and falling demand. It appears that demand for such a service, which is a 20-port pendulum route, is returning, with JCTrans quoting an Evergreen spokesperson as saying 'Evergreen re-introduces its pendulum UAM service as the preparation for the expected recovery of the global economy.'

The service, which is to be re-launched in May, will take the place of Evergreen's Asia-Pacific-Northwest-Coast and Far East Mediterranean services, which it brought online in October 2009 as a stop-gap for the UAM service.

Evergreen is preparing for a recovery through the re-launch of UAM, but the company is still cautious. The service will operate using the tactic of slow-steaming - a common strategy as carriers try to save cost on fuel and use up their spare capacity by adding another vessel to routes. As a result of this the new UAM service will take 14 weeks rather than the previous 13 weeks. Also, the company will be using smaller vessels, albeit one more of them, with a capacity of 5,300TEUs rather than the previous 5,700TEUs vessels.

Other service changes indicate that Evergreen is moving into more niche markets, a strategy that **BMI** has suggested will allow companies a quicker recovery from the downturn as the competition will not be as fierce as on the major trade lanes of Trans-Pacific and Asia-Europe.

The company is, however, being cautious and exploring new trade lanes in partnerships with other companies, a wary attitude that has no doubt been fostered by the downturn. Evergreen's new routes see the line linking up with fellow Taiwanese shipping line **Wan Hai Lines** and Malaysia's **Simatech Shipping** on a service out of Sri Lanka's Colombo port to

East Africa's ports of Kenya, Dar es Salaam and Tanzania. Evergreen has also been expanding its inter-Asia credentials with a link-up with **China Shipping Container Lines** (CSCL) on a service between China, the Philippines and Thailand. The service further cements Evergreen's developing partnership with China's two main container operators, CSCL and **COSCON**, which has been developing since relations thawed in 2008.

Evergreen's positive outlook for 2010 stretches into its predictions for the company's financial standing for the year, with the carrier aiming to return to profit after losses in 2009. Reuters reports an Evergreen spokesperson as stating 'the surging demand to replenish depleted inventory has led to several rounds of successful rate increases and substantially improves the profit outlook of the container shipping industry'.

Like its peers, Evergreen has continued its strategy of hiking rates in order to 'bring freight rates back to sustainable and viable levels'. Over the quarter the line concentrated on lifting rates on the typically lower-demand return-route loop. For example, on the Europe and Mediterranean to Far East and Indian Sub-Continent/ Middle Eastbound loop a rate hike of US$250 per TEU was due to come into effect from May 1 2010, following the same hike on the same route on April 1 2010.

In an effort to pull up rates on the company's Northern Europe-USA routes, Evergreen has announced two hikes effective from July 1 2010 and another on October 1 2010. Both hikes will see TEU and 40-foot equivalent unit (FEU) rates raised by US$350 and US$450 respectively.

China Ocean Shipping (Group) Company (COSCO)

Strengths

- COSCO is highly diversified, with operations in the container, dry bulk, tanker, terminal operating, logistics, shipbuilding and finance sectors. This should support sustained growth and stability.
- The carrier has a good relationship with the Bank of China, which has provided the company a source of credit since the 1960s.
- COSCO's investment in a number of shipyards allows the company flexibility in adapting its order book to the economic climate.

Weaknesses

- COSCO's container line holds the largest orderbook relative to current fleet capacity of the world's 10 largest liners, putting it at increased risk of fielding excess capacity and resulting in significant financing obligations.
- The company's core business, its container shipping arm, is reliant on China's export sector for growth and has relatively little diversification into domestic and coastal shipping.

Opportunities

- The opening of direct shipping routes between China and Taiwan is likely to provide long-term growth opportunities for COSCO's container and bulk shipping lines. COSCO is also rumoured to be eying investment in the port of Kaohsiung.
- China's growing raw material demands are expected to drive long-term demand for dry bulk shipping services.

Threats

- Vessel operating costs are expected to rise in 2010 as the world economy emerges from recession with rising fuel prices and labour costs eating into companies' bottom lines.
- Overcapacity remains a major threat, particularly within the container shipping market, and the decision to re-activate idled vessels too soon would undermine the company's ability to introduce much-needed rate-hikes.

Company Overview

China Ocean Shipping (Group) Company (COSCO) dates back to 1961. The group was originally engaged in transport solutions and did not become a shipping company until 1993. In 2005, the company issued an initial public offering (IPO), and now trades on the Shanghai and Hong Kong stock exchanges. **China COSCO Holdings Company Limited** is the flagship and integrated platform of COSCO. The group owned by the People's Republic of China.

COSCO is the world's second largest integrated shipping company, with a strong presence in all major cargo shipping sectors including container shipping, dry bulk and liquid bulk, as well as terminal and logistics operations and shipbuilding.

COSCO Container Lines Company Limited (COSCON) is one of the world's biggest container shipping lines and is the largest Chinese carrier, narrowly outgunning rival line **China Shipping Container Lines** (CSCL) in terms of fleet capacity. The company also has a major presence in the dry bulk shipping sector, with a number of subsidiary firms under its control. Liquid bulk shipping is another core activity and the group has a growing presence in the oil, chemical, LPG and LNG shipping markets.

Performance

2009

COSCO released its 2009 full-year financial results in April 2010, revealing a CNY7.54bn (US$1.1bn) net loss. The result represented a sharp deterioration in performance over the previous year (2008), when the company reported a profit of CNY10.8bn (US$1.7bn), and was below the group's previous earnings forecast of a CNY4.99bn (US$730.7mn) deficit.

The group's total revenues for 2009 were CNY7.47bn (US$1.09bn), down from CNY11.59bn (US$1.7bn) in 2008 - a year-on-year (y-o-y) fall of 51.9%.

The company attributed the loss to a significant decrease in earnings from its core container and dry bulk shipping operations due to the global economic downturn and contraction in international trade. Revenue from dry bulk sales fell by 61.8% y-o-y to CNY27.37bn (US$4bn) following a 7.4% decrease in freight volumes. Income from the group's container shipping division, COSCON, meanwhile, fell by 43% y-o-y to CNY21.2bn (US$3.1bn) as cargo liftings decreased by 9.6%. The sharpest contraction was seen on Asia-Europe routes, where volumes decreased by 22%, while transpacific volumes fell by 10%.

The performance of COSCO's terminal operations division, **COSCO Pacific**, was somewhat better, and the company reported a profit for 2009 of US$172.5mn, a y-o-y decrease of 37%. Meanwhile, the unit's revenues over the year increased, rising by 3.4% to US$349.4mn.

Company Strategy

Container Shipping

As of April 2010, COSCON is the seventh-largest global operator of container vessels, according to **AXS-Alphaliner**'s (AXS) rankings of the world's largest container fleets. The firm is the largest Chinese shipping line and second in Asia only to **Evergreen Line**.

Q210 saw COSCO expand its presence on the container shipping sector, allowing it to increase its market share from 3.3% to 3.5% between January and April 2010. The increase in market share was the result of an expansion in the company's overall shipping capacity, rather than a net increase in vessels. Over the quarter, the number of vessels in the carrier's fleet fell from 135 to 132 ships, which included a fall in the number of ships owned by the company from 93 to 88. Meanwhile, the total capacity of the COSCON fleet grew from 453,876 20-foot equivalent units (TEUs) to 479,906TEUs. This suggests that the company has removed older, smaller capacity vessels from its fleet in favour of bringing large ships online.

According to AXS Alphaliner data in April 2010, the company to charter vessel ratio is almost even at 43.4%, with owned vessels making up 88 of the 132 ships operated and chartered vessels accounting for the other 44 vessels. The company's owned vessels make up 271,727TEUs of the 479,906TEUs operated by the shipping line, compared with the 208,179TEUs that are chartered.

COSCON's ambitious expansion strategy, instigated during the boom period, has left the company with a larger orderbook than many of its peers. As of April 2010, the company is due to take delivery of 50 vessels, equivalent to 387,736TEUs of shipping capacity. At 80.8%, the ratio of new-build capacity relative to the carrier's existing capacity is significantly higher than the average of 31.1% shared by the 10 largest container lines.

Dry Bulk

COSCO's dry bulk shipping division has undergone rapid growth in recent years, in line with China's increasing raw material needs. According to the most recent figures released by the carrier, COSCO operated 439 dry-bulk ships as of December 31, with another 30 on order. The fleet includes Capesize, Handymax and Panamax vessels.

The company's dry bulk operations are conducted mainly through **COSCO Bulk**, **COSCO Qingdao**, **COSCO Hong Kong** and **COSCO Shenzhen**. Business is primarily focused on the transportation of major raw materials - iron ore and coal - which accounted for 45% and 29% of total cargoes in H109 respectively. Grain was the third most important cargo, representing 15% of total freight carried.

According to company data, the fleet is split almost symmetrically in terms of vessel numbers between owned and chartered ships. This fairly even split allows the company room to adjust the supply of ships according to outside demand by terminating or delaying charter contracts.

At about 19% of existing capacity, COSCO's dry bulk division has a considerably smaller orderbook relative to its current fleet than its container division. The relative lack of vessels on order is partly attributable to negotiations held with shipyards in July 2009 that resulted in the company cancelling eight new builds with a cost saving of US$299mn.

Tankers

While COSCO's liquid bulk division currently constitutes a relatively small proportion of its total operations, it represents one of the company's fastest growing areas of business and has developed in line with China's increasing demand for imported crude and liquid natural gas (LNG) to meet the country's energy needs.

Following an aggressive fleet expansion strategy, the company almost doubled the size of its tanker fleet since 2006 and, according to the most recent company data available, operates 11 very large crude carriers (VLCCs), 10 Panamax tankers, four Handysize tankers and six liquid petroleum gas (LPG) ships. A further three vessels are due to be delivered in 2010, according to the original strategy outlined by the company.

The majority of the fleet is managed by **Dalian Ocean Shipping Company** (COSCO Dalian), which has an expansive route network covering more than 300 ports across 70 countries. **BMI** expects COSCO's tanker division to continue to be one of its fastest growing core businesses over the next few years.

Terminals

COSCO is China's largest port operator and the fifth largest container port operator in the world, according to Drewry Shipping Consultants. Terminal operations are managed by the group's subsidiary **COSCO Pacific**. As of June 30 2009, COSCO operated 89 container berths internationally with an annual handling capacity of 48.15mn 20-foot equivalent units (TEUs). COSCO has operations at the Chinese ports of Dalian, Yingkou, Tianjin, Qingdao, Shanghai, Taicang, Zhangjiangang, Nanjing, Yangzhou, Ningbo, Xiamen, Quanzhou, Shenzhen, Guangzhou and Hong Kong as well as major ports is the US, Belgium, France, the Netherlands, Italy, Singapore and Egypt. The company also has smaller investments in a number of other overseas ports.

The company's terminal operations have fared better than its core shipping divisions of late, despite recording a 37% y-o-y fall in net income in 2009. **BMI** believes that COSCO is well placed to expand into this area given the expected long-term growth of the container port sector in developing regions such as southern Asia, Africa and South America.

The division's liquidity has been boosted following the sale of its stake in **COSCO Logistics**, leaving it well placed to pursue future opportunities for growth.

Trends & Developments

News of COSCO's disappointing 2009 full-year financial results dominated the quarter and, following the announcement, the company has put in place a number of recovery measures and is hopeful of returning to profitability in 2010. The company's president, Zhang Liang, is quoted as saying 'The full recovery has yet to come but we are on the road to recovery'. Of immediate concern after sustaining a loss of more than US$1bn has been to replenish cash flow and, following the earnings announcement, the group revealed plans for a CNY10bn bond sale, which would be used to repay bank debt and to provide working capital for the coming months.

BMI believes the poor performance of COSCO's container and dry bulk shipping operations in recent months has persuaded the company to expand its presence in other, less saturated areas of the commercial shipping market. Indeed, April's bond sale followed news, in March 2010, of a share issue worth CCNY3.9bn (US$571.3mn), which will be used to expand its fleet of multipurpose and heavy-lift ships. The Guangzhou-based subsidiary will reportedly acquire 18 multipurpose and heavy-lift vessels, in addition to the 50,000 deadweight tonne (DWT) semi-submersible vessels it already has on order. The orders are expected to be placed with COSCO's shipbuilding subsidiary **COSCO Shipyard**.

Nevertheless, while remaining cautious in regard to the immediate outlook for the sector, COSCO's management has begun to target revenue growth from both its dry bulk and container divisions. In a March interview, Zhang announced plans for a series of rate increases across the group's box shipping services in order to raise rates above break-even levels. 'I'm full of confidence about on-going annual contract negotiations' he said, before reiterating his commitment to the Transpacific Stabilization Agreement (TSA), which aims to introduce a series of coordinated rate hikes on Asia-US container routes over the next few months.

Since the announcement, COSCON has begun to increase capacity on some of its transpacific services, a sure sign that demand is returning. In April, the carrier began the phasing-out of its existing North China-US Southwest service. The service comprised six 5,500TEU vessels and will be replaced with six 7,500TEU carriers that will reactivated from the company's idled fleet. The move represents a cautiously optimistic stance by the company, which, aware of the continued overcapacity on many major container trades, remains conscious that the decision to reactivate new vessels would jeopardise its rate-hike plans. The carrier is also wary of the potential impact a large-scale reactivation would have on its operating costs and, with fuel prices likely to continue to head upwards over the year, we expected the company to continue with its strategy of slow steaming vessels which, according to the company's management, will reduce bunker fuel usage across the whole of its fleet by 180,000 tonnes a year.

In Q210, there were hints too of growth for the company's dry bulk division. After taking the decision in June 2009 to cancel an order for eight new-build bulk carriers, Zhang suggested the company may look to take advantage of a recent drop in ship valuations by acquiring a series of new or secondhand vessels in 2010. He also said the division would use the recent fall in chartering costs to spend money on chartering in dry bulk carriers.

With demand for dry bulk shipping continuing to recovery strongly after its decline in 2008, **BMI** believes the sector offers COSCO an opportunity to expand capacity and to increase revenues. However, we caution that there are continued threats to the sector; not least the potential for the government's efforts to tighten domestic money supply leading to raw material imports declining over the coming months.

Hapag-Lloyd

Strengths

- The company has expertise in the transportation of dangerous goods, the shipment of special cargo and stowage.
- The company has a large global presence, with offices across the world and shares in two terminals: the Montreal Gateway Terminal and the Container-Terminal Altenwerder GmbH.

Weaknesses

- Hapag-Lloyd now operates in only one cargo market, the container market.
- The company had to rely upon state aid to see it through the downturn.

Opportunities

- Its association with Grand Alliance carriers enables it to enter into vessel-sharing agreements or jointly operated services with ease.
- The company has won state-backed loan guarantees.

Threats

- The company's state aid package must be passed by the EU competition authority.
- Gains in the US dollar against the euro, in which Hapag trades, could erode profits.

Company Overview

Hapag-Lloyd has a 160-year history, dating back to the foundation of German lines Hamburg-Amerikanische-Packetfahrt-Actien-Gesellschaft (Hamburg-America Line, or Hapag) and Norddeutscher Lloyd (NDL) in 1847 and 1857 respectively. The two lines merged in 1970 to form Hapag-Lloyd AG. In 1997, the line became a subsidiary of German tourism giant **TUI AG**, which purchased 100% of shares in Hapag-Lloyd to become its sole shareholder in 2002. In 2005, Hapag-Lloyd acquired Canadian liner **CP Ships**. In March 2009 TUI sold Hapag-Lloyd to Germany-based **Albert Ballin Consortium**. The consortium holds a 56.67% stake in Hapag-Lloyd and is made up of the City of Hamburg (40.67%), **Kuhne Holding AG** (26.55%), **Signal Iduna** (12.61%), **HSH Nordbank** (8.4%), **M.M. Warburg Bank** (8.4%) and **HanseMerkur** (3.36%). As per the sale agreement, TUI keeps a 43.3% stake in Hapag-Lloyd.

The company has stakes in two terminals: a 25.1% share in Hamburg's Container Terminal Altenwerder GmbH and a 20% stake in Montreal Gateway Terminals. The company's stake in the Hamburg terminal is to be offered as collateral for the company's financial-aid plan.

Performance

Q110

Hapag-Lloyd posted a revenue decline of 27.7% in the first quarter of its new financial year (October 2009 to December 2009). The decrease has been attributed to year-on-year (y-o-y) declines in the container line's transport volumes and freight rates. The German shipping line's turnover fell from EUR1.586mn (US$2.3mn) in Q108/09 to EUR1.146.9mn (US$1.6mn) in Q109/10. As well as the decline in freight volumes and rates, the weakening of the US dollar against the euro was cited as a reason behind the fall in revenue.

In Q1 of the new financial year, transport volumes fell 13.2% from 1.31mn 20-foot equivalent units (TEUs) in Q108/09 to 1.14mn TEUs in Q109/10. Freight volumes were down 15.5% from US$1,619 per TEU in Q108/09 to US$1,368 per TEU in Q109/10. It should be noted that while the y-o-y freight volumes and rates have declined, when compared quarter-on-quarter (q-o-q) the levels have increased as Hapag-Lloyd has engaged in rate hikes to push freight prices higher and has been aided by the uptick in volumes on global trade routes, such as Asia-Europe, which saw improved container volumes in the last three months of

2009.

2009 Full Year (January 2009-September 2009)

In December 2009 the shipping line posted a loss of EUR675mn (US$981mn) compared with the line's EUR212mn (US$308mn) profit in 2008. The line's 2009 yearly results were measured from January 2009-September 2009 following a decision by the line's former parent and now major stakeholder, TUI, to shorten its financial year from January-December to January-September. For year-on-year (y-o-y) comparison data for the first nine months of 2008 is used.

The loss was due to a fall in revenue y-o-y of 29% from EUR4.6bn (US$6.6bn) in 2008 to US$3.3bn (US$4.7bn) in 2009. The company's poor financial performance was to be expected after the harsh market conditions that all container lines faced in 2009. Hapag-Lloyd's transport volumes fell 17.4% y-o-y from 4.2mn TEUs in the first nine months of 2008 to 3.5mn TEUs in 2009. In the same period, freight rates also decreased, with a fall of 22.8% y-o-y, from an average of US$1.581 per TEU in 2008 to US$1,220 per TEU in 2009. In a press statement, Hapag-Lloyd said, 'transport [volumes] in the Far East and Atlantic trade lanes in particular suffered from the adverse effects of the decline in demand for consumer goods'.

2008 Full Year

In March 2009, Hapag Lloyd posted its 2008 full-year financials. The company's profit was recorded as US$285mn, up from its 2007 profit figure of US$239mn. The company's revenue was also up to US$8.4bn - growth of 4.3% on 2007's figure of US$8bn. Hapag-Lloyd's cargo volumes also grew in 2008, increasing to 5.54mn TEUs.

Company Strategy

Container

Hapag-Lloyd currently holds a market share within the global container market of 3.8%, placing it sixth in AXS Alphaliner's rankings. The company operates, as of April, a fleet of 125 vessels, with a total capacity of 533,171TEUs. Of this, the company has kept a balanced strategy of owned and chartered vessels, with 46.1% of the company's fleet chartered. Hapag-Lloyd's owned fleet stands at 60 vessels, with a total capacity of 287,185TEUs. Chartered vessels make up a slightly larger number at 65 ships, but their capacity is smaller at a total of 245,986TEUs.

It appears therefore that Hapag-Lloyd's strategy has concentrated on developing a larger owned fleet and using charter vessels with less capacity to fill the gap. This relatively balanced charter to owned ratio allows the line a lot of flexibility, enabling it to decrease its fleet or increase it with charter vessels.

In terms of owned fleet expansion, Hapag-Lloyd holds a relatively small orderbook of just eight vessels, with a total capacity of 70,000TEUs, accounting for 13.1% of the company's existing fleet. This is the smallest new-build fleet orderbook in AXS Alphaliner's top 10, and with other competitors close behind it, Hapag-Lloyd may have to relinquish its sixth place position.

Trends & Developments

Hapag-Lloyd's loan guarantees - part of a strategy that enabled the German shipping line to stay afloat in 2009 - have come under EU scrutiny. The Financial Times Deutschland reported in February 2010 that the EU regulator does not think that the state loan offered by the German government in 2009 to prop up Hapag-Lloyd was appropriate, as according to EU rules it gives the shipping line an unfair advantage. The European Commission (EC) has also queried the loan's category, stating that it does not believe that Hapag-Lloyd fits the aid category for 'small companies'.

Toward the end of the year, Hapag-Lloyd's very existence hung in the balance, with TUI's chief executive, Michael Frenzel, stating in a company press release that 'The effects of the global recession threatened the very existence of Hapag-Lloyd. As the largest single shareholder and former parent, we felt obliged to do everything in our power to help save Hapag-Lloyd.'

TUI, along with members of the Albert Ballin consortium, launched an investment drive to raise EUR2.6bn. Along with contributions from its shareholders, Hapag-Lloyd also gained approval from the German government for a state loan guarantee worth EUR1.2bn.

The government loan guarantee has, however, been a bone of contention within the shipping sector. **BMI** noted in its Container Shipping Overview Q110 that state aid is ensuring that the make-up of the global shipping sector stays the same. We believe that companies that would otherwise have struggled and lost market share, or perhaps even gone bust, have been able to retain their market share as they are being propped up. Understandably, this has incensed other operators that are unable, unwilling or do not need to call upon state aid, and they are frustrated that the natural economic order has not been allowed to play out, meaning their rivals are being given an unfair advantage.

Lloyd's List quoted Denmark's Maersk Line's chief executive, Eivind Kolding, warning that 'state bailouts of shipping lines could delay a very necessary restructuring of the container shipping industry'. The comment followed the Danish Shipowners Association (of which Maersk Line's parent AP Moller Maersk is the largest member) calling upon the EC to link state support for shipping lines with a reduction in the line's fleet. In December 2009, another party joined in the condemnation of shipping lines receiving state aid: the Shippers Voice, a forum for shippers and individuals in the freight transport industry. Andrew Tail, managing partner of the Shippers Voice, is quoted by Eye For Transport warning against state aid: 'If governments now decide to prop the sector up, what kind of message does that send out?... If governments start handing out state aid to these ship companies, it will send out the same message it did to the banks: Don't worry about making any bad investment decision because the state is here to bail you out so that you can make more bad decisions in the future.'

The latest update on state aid to Hapag-Lloyd came in March 2010, with Lloyd's List reporting that the EC's verdict was reported to have been delayed for at least a month.

In the background the continued discord between Hapag-Lloyd's former parent TUI and a member of the Albert Ballinn consortium has rumbled on, with Klaus Micheal Kuehne stating that he wanted TUI to sell its 43% stake in Hapag-Lloyd. He is quoted by the Handy Shipping Guide as saying 'the mix of investors at the moment bothers me'. Kuehne also indicated that he might be prepared to increase his 15% stake in Hapag-Lloyd.

Kuehne's expansion plans have been frustrated, however, with TUI stating that it had rejected the offer by Kuehne's company **Kuehne & Nagel International** to buy 10% of the container line from the tourism giant. The reason that TUI gave, according to Cargo news Asia, was that TUI hoped to sell larger chunks of its stake in Hapag-Lloyd, and that TUI's chief executive, Micheal Frenzel, 'calculates it has better chances for sale if Kuehne's stake in Hapag-Lloyd is as small as possible'.

In terms of service upgrades this quarter, Hapag-Lloyd has kept to its strategy of moving into new markets with partners. In March 2010 the Grand Alliance, of which Hapag-Lloyd is a member along with NYK and OOCL, announced plans to add a stop off in Vietnam's Cai Mep deepwater port on the company's South China Sea Japan Express (SCX).

Another link-up this quarter saw the German line partnering up with **Hanjin Shipping**, **CCNI**, **Wanhai Lines** and **Zim** on a new 11 vessel service from Asia-South Africa East Coast (via South Africa). Hapag-Lloyd is to provide one of the vessels for the service, which will use 4,200TEU ships.

BMI believes that this strategy is a reflection of Hapag-Lloyd wishing to cover as many markets as possible, but remaining wary about the operating environment and so exploring new routes with partners.

Hapag-Lloyd has had a busy quarter in terms of hiking rates. **BMI** can understand why the company, like its peers, is continuing with this strategy, with shipping lines asserting that they must push for profitability after the rate declines in 2009 led to huge losses industry wide. According to **BMI** research, Hapag-Lloyd announced five rate hikes on various routes over the quarter including North America to Asia services and Europe to Latin America routes.

Neptune Orient Lines (& APL)

Strengths

- Neptune Orient Lines operates key terminal facilities on the US's west coast: the ports of Los Angeles, Seattle and Oakland. This ensures that US brand APL has a prime presence in key US markets and provides key ports of call for the group's container shipping line.
- The Singapore government maintains a 67.4% stake (as of November 2006) in the company through its investment company Temasek Holdings, and its interest introduces an element of stability to the company's operations.

Weaknesses

- Despite extensive debt repayments in 2009, the company still holds a sizeable loan book.
- The group operated a high-cost base at its Oakland offices until it moved to Phoenix, Arizona, in September 2009. Although this may help the group to recover some of its weakened profits, the desert location is further from its Los Angeles terminal and the coastline from which its vessels operate.
- The group is primarily Asia and US focused, and relies heavily on major trade lanes, with a limited presence in less established markets such as Africa and Latin America.

Opportunities

- The company's rights issue has shored up the company's finances, giving it the funding it requires to pay off debt and to launch an acquisition drive in 2010 if it so wishes.
- The company's Taiwanese terminal is well placed to take advantage of new direct shipping routes to China.
- NOL/APL's association with The New World Alliance (TNWA) carriers enables it to enter into vessel-sharing agreements or jointly operated services with ease.
- Recent expansion into emerging markets including Vietnam, Oman and Pakistan may present future opportunities for strong revenue growth linked to the growing trading power of these nations.

Threats

- Continued weak transpacific trade growth will put increasing financial pressure on NOL in 2010, which is particularly sensitive to trade fluctuations in this market.
- The company's decision to reactivate idled vessels and to increase its chartered fleet leaves it vulnerable to the threat of overcapacity, though it has taken measures to safeguard against this such as slow-steaming.
- In 2010, a weakened US dollar may affect profits, although it could act to stimulate trade volume growth.

Company Overview

Singapore-based **Neptune Orient Lines** (NOL) was formed in 1968, but assumed its current form in 1997 when it merged with **American President Lines** (APL). Today, NOL remains the holding company listed on the Singapore Stock Exchange, with APL its container shipping brand. The Singapore government maintains a 67.4% stake (as of November 2006) in the company through its investment company **Temasek Holdings**.

NOL began life as Singapore's national shipping carrier, three years after the country became an independent state. The Singapore government-owned company at first operated just five vessels, and achieved its first profit by the mid-1970s when its fleet had expanded to 20 vessels. It held a US$105mn initial public offering (IPO) in 1981. The group diversified into tanker operations in the early 1990s under the brands American Eagle Tankers (AET) and Neptune Associated Shipping (NAS).

US-based APL dates back to 1848. The company, originally called the Pacific Mail Steamship Company, began to focus on container shipping in the 1950s.

Since the merger, NOL has continued to direct its business towards the container market, divesting tanker subsidiaries **AET** and **NAS** in 2003. It established **APL Logistics** in 2001 in a bid to strengthen product supply chains and also operates a terminal operating business, **APL Terminals**.

Performance

2009

In 2009 NOL reported a net loss of US$741mn, down from a profit of US$83mn. Total revenues fell by 30% year-on-year (y-o-y) to US$6.52bn, compared with sales of US$9.29bn in 2008.

The group's container shipping business, APL, accounted for most of the deficit, reporting a core EBIT loss of US$731mn, compared with a profit of US$73mn in 2009, as the company's revenues fell by 31% y-o-y to US$5.5bn.

Container volumes carried by the company decreased by 7% y-o-y to 2.3mn 20-foot equivalent units (TEUs), down from 2.5mn TEUs in 2008. Average revenue per 40-foot equivalent unit (FEU) decreased by 25% over the year, though the carrier's vessel utlilisation capacity remained constant at 89%.

NOL's terminal operating division reported core EBIT of US$32mn, a y-o-y decrease of 56% as revenues fell by 13% to US$503mn. The company's throughput fell by 13% y-o-y to 1.95mn TEUs, while average revenue per TEU fell by 0.8% to US$258.

Company Strategy

Container Shipping

Bucking the trend of other major Asian lines such as NYK and MOL, NOL expanded the capacity of its container shipping fleet significantly over the past few months as it looks to adapt to an improving operating environment for the sector.

As of April 2010, NOL/APL was the fourth largest operator of container vessels, according to **AXS Alphaliner**'s rankings of the world's largest container fleets. According to the same rankings, the line is the largest container line based in South East Asia. The company operates 146 vessels with a combined capacity of 586,269 TEUs, equivalent to a market share of 4.1%.

The figures point to a significant increase from January with an additional eight ships coming into circulation while total capacity has increased by 7.5% from January's 545,119TEUs.

The adjustment is part of a concerted effort by the company's management to expand its capacity on the back of an improvement in trade demand from Asia and Europe and the company was reportedly the first major international line to bring idled ships back into service. Following Q1's increase in capacity, in March 2010, Company CEO Ron Widdows said the carrier would charter an additional 10 containerships in 2010 and also put its 10 remaining idled vessels back into circulation in June. NOL/APL's container shipping volumes increased 37% y-o-y in the four weeks ending March 6 to 189,100 FEUs.

While capacity is returning to pre-downturn levels, the company is expected to continue with its policy of slow-steaming vessels over the next few months. Widdows has indicated that 90% of the company's ships will be kept at slow speed, a move that is expected to reduce fuel costs by up to 30%.

BMI expects the company to keep faith with its new-build programme, shunning the example set by other lines that, in 2010, have continued to cancel orders for container ships or have converted box orders to orders for other types of vessels. As of April, NOL/APL has 14 vessels due for delivery with a capacity of 116,992TEUs. This is equivalent to 20% of the company's existing fleet, though it has reportedly delayed to 2012 the delivery of some of the vessels.

Terminals

NOL's terminal operating division, APL Terminals, ranks among the world's leading container terminal operators, with facilities located in East Asia and the US. NOL's terminal division is directly linked to its container shipping line, which contributes approximately two-thirds of the terminal's total cargo volume.

The company has investments in nine terminals worldwide: four in the US (Los Angeles, Oakland, Seattle and Dutch Harbour); two in Japan (at the ports of Kobe and Yokohama); one at Kaohsiung port, Taiwan; one at Saigon Port in Ho Chi Minh City, Vietnam; and one at Thailand's Laem Chabang port. The combined capacity of NOL's terminals is about 6.2mn TEUs a year. In spite of the global economic downturn, the company has continued to expand its global network of terminals and, in early 2009, announced a 50:50 joint venture with the Port of Salalah, Oman, to operate a new container terminal at the port. When completed, the terminal will have two berths with an annual capacity of 1.6mn TEUs, capable of accommodating container vessels with a capacity of more than 10,000TEUs. The terminal is expected to begin operating from 2011.

Trends & Developments

NOL was active in Q210 amid signs that the company was ready to reassert itself on the global stage after a period of consolidation during the downturn. Perhaps more so than most other major lines, the carrier has reacted positively to an apparent thawing in conditions within the container shipping sector.

Following the release of the company's 2009 financial results in April, NOL CEO Ron Widdows was upbeat about his company's prospects for the year ahead. Speaking on the company website, he said 'In early 2010, there have been improvements in volumes and asset utilisation in NOL's principal markets. In addition, freight rates have stabilised and trended upwards in some trades. If these conditions continue, better business performance is possible'. However, Widdows quashed talk of an immediate recovery with his assertion that the company would remain in the red for the first half of the year at least.

To offset the company's US$741mn loss, sustained over 2010, the CEO attested that the carrier has introduced a series of 'aggressive steps' to reduce its cost base. In particular, the carrier made significant adjustments to its capital expenditure over 2009. Meanwhile, a rights issue, launched in summer 2009, was declared a success as the issue was oversubscribed with 104.5% applications. NOL has stated that its aim for the rights issue was to raise funding so that it could pay off its debts and to use for potential investment opportunities.

There was plenty of positive news for the group over the quarter, however, including news of a continued recovery in the number of containers shipped, which increased by 37% y-o-y during the four weeks ending March 6, while average freight rates rose by 8% to US$2,575 per FEU. The increase followed a 63% gain in container volumes, achieved in the period

December 26 2009 to February 25 2010.

The company has responded positively to this apparent increase in demand, and revealed plans to expand its fleet capacity by 7% in 2010 by adding up to 20 ships to its fleet. The carrier is expected to charter 10 new vessels as well as returning about 10 ships from lay-up. **BMI** also expects NOL to reignite its fleet expansion programme and, in March, the company secured a US$300mn loan from **Sumitomo Mitsui**-led syndicate to help fund new-build acquisitions.

Additional steps have also been taken to this end, and March saw the launch of a new wholly owned subsidiary called **Triton Shipping**, which will begin operating with two 10,000TEU vessels ordered in July 2007. The purchases were financed by a US$150mn loan from the Bank of **Tokyo-Mitsubishi**, guaranteed by NOL. A further two vessels are expected to be delivered to the company at a later date.

Another ambitious move by NOL has been to expand its emerging market presence and, in March, APL Logistics, a 100% owned subsidiary, began operations at a new custom-built container freight station (CFS) facility at Port Qasim in Karachi. The facility, controlled by APL Logistics, will consolidate the company's operations in three locations into one dedicated centre in order to save costs and improve transit times. The port is a major import terminal for the Pakistani market, which comprises some 180mn people, and handles manufactured products, fuels, minerals, chemicals and machinery as well as other consumer and industrial goods.

China Shipping (CSCL)

Strengths	▪ China Shipping (CSCL) is a relatively young company, and as such has a fleet of vessels whose average age is less than five years old. ▪ The company has been one of the fastest growing international liners of the past decade. ▪ The company has multi-modal operations, with a container freight rail segment to capture goods from ocean to land transport. ▪ CSCL has a large presence in China's domestic coastal shipping market, and is active at more than 30 ports in northern and southern China. ▪ The company is owned by the Chinese government and as such benefits from a strong relationship with the country's major banks, which are stated-owned.
Weaknesses	▪ The large majority of China Shipping's routes are directed to and from China, which means the growth of the company is dependent on the growth of the country, and in particular, the strength of its exports sector. ▪ The company is exposed to fluctuations in the US dollar, as most of its revenues and operating expenses are accrued in the currency. ▪ Whereas other major liners offer diversified businesses, CSCL operates in only one cargo market, the container market, which is forecast to have a slower recovery from the downturn than either the dry or liquid bulk sectors.
Opportunities	▪ The opening of direct shipping routes between China and Taiwan is set expected to drive growth in CSCL's intra-Asia trade revenues over the long-term, with several new ports having been added to the original quota of ports authorised to offer cross-channel links. ▪ The company aims to expand its operations on the Yangtze River. The river carries about one-third of all of China's coastal and inland trade, which makes it a good source of potential growth for shipping companies.
Threats	▪ With rival carriers starting to expand their fleets, the company is at risk of losing further market share over the coming months. ▪ The growing supply of vessels on major international container trade lanes heightens the problem of overcapacity, and is likely to continue to place downward pressure on rates in 2010.

Company Overview

China Shipping Container Line (CCSL) was established in 1997, and is part of the **China Shipping (Group) Company** (CSG). The company is controlled by the Chinese government.

China Shipping became a company with limited liability in 1997, and in June 2004 it listed 2.4bn overseas public shares on the Hong Kong Stock Exchange. In late 2007, the company issued 2.3bn domestic public shares on the Shanghai Stock Exchange.

The company is registered in Shanghai and is involved in owning, chartering and operating container vessels. It has several subsidiaries, including container storage and transport firms **Yangpu Cold Storage**, of which it acquired 60% in 2008, and **Yangshan International**, in which it acquired a 25% stake in the same year. The company has approximately 3,000 employees and 3,402 contracted crew members from subsidiaries of its parent company.

CSCL operates domestic coastal routes and international container line services from China to Japan, Korea, South East Asia, Europe, the Mediterranean, the US, West Africa and the Persian Gulf. The carrier is a dominant player in the Chinese freight market, which provided 20% of total revenues in H109. CSCL asserts that it has an average 50% share in a 'significant number of domestic ports'.

The company also operates multimodal transport, including a container railway line, **China Shipping No. 1**, which transports ocean-going goods across land to key Chinese markets, and is a majority shareholder in a number of domestic container terminals.

Performance

Volumes: At the beginning of 2010, CSCL had a total slot capacity of 461,379TEUs, compared with 493,016TEUs in 2008.

Financials

CSCL released it 2009 full-year financial results in April 2010, reporting a net loss of CNY6.49bn (US$950.31mn). The disappointing results compare with a net profit of CNY134.7mn (US$19.7mn) earned by the company in 2008. The loss stemmed from a 43.4% year-on-year (y-o-y) decrease in total revenue, which fell to CNY19.94bn (US$2.9bn) from 2008's CNY35.25bn (US$5.2bn). The company attributed the loss to the effects of the global economic downturn and a contraction in trade volumes; however, it is optimistic of a recovery in its financial performance in 2010, and is forecasting revenue growth of 31% y-o-y.

Despite the heavy slide in profits, the results indicate a slight improvement in performance in Q409 on the previous three quarters of the year, having recorded a loss of US$775mn during Q109-Q309. The company reported a loss of US$175mn in Q409, compared to an average quarterly deficit of 238mn over the year.

Company Strategy

Since its inauguration in 1997, an aggressive growth strategy has seen CSCL move among the 10 largest container shipping lines in the world, boasting a market share of 3.1% as of April 2010, according to AXS Alphaliner data.

Efforts to manage the impact of the global economic downturn, however, have seen the company's standing within the industry slip. Though still ranked ninth globally in terms of its container shipping capacity, in Q110, CSCL slipped one place in the ranking and saw its market share fall from 3.4% to 3.1% over the period, having been overtaken by **Hanjin Shipping**.

Over the next few months, the company is at risk of being overtaken by 10th-placed CSAV, which has a market share of 3%, however, with a marked recovery in Chinese trade volumes seen over the past few months, there are signs that CSCL is growing its capacity, returning idled ships into circulation. The carrier is likely to be keen to hold onto its market share to take advantage of China's export growth and to put pressure on the country's largest box carrier, **COSCO Container Lines**, which has a market share of 3.4%.

According to AXS Alphaliner data in April 2010 the company-to-charter-vessel ratio is almost even at 42.8%, with owned vessels making up 71 of the 121 ships operated and chartered vessels the other 50 vessels. The company's owned vessels make up 250,099 of the 437,564 20-foot equivalent units (TEUs) that are operated by the shipping line, compared with the 187,465TEUs that the firm charters.

CSCL's expansion strategy, instigated during the boom period, has left the company with a sizeable orderbook, equivalent to 16 vessels or 140,500TEUs of capacity - 34.4% of its existing fleet capacity. This is consistent with the average of 31.1% shared by the 10 largest container lines.

To make room for new vessels, there are indications that CSCL has permanently removed a significant proportion of its owned fleet from service over the past six months. Figures provided by AXS Alphaliner show that, between October 2009 and April 2010, the net reduction in the company's vessel was just one ship. The net change in the company's total shipping capacity over this period has also been relatively minimal at just 23,815TEU - a decrease of 5.1% - suggesting that smaller vessels have been scrapped in favour of adding large ships to the fleet.

Trends & Developments

Q210 was dominated by CSCL's announcement of its 2009 full-year financial results which revealed a net loss of US$950mn over the year.

The carrier's disappointing financial performance in 2009 contrasts with the cautiously optimistic stance of the company management. In March, the chairman of CSCL parent company **China Shipping (Group) Company**, Li Shaode, issued a statement declaring that an upturn in global trade volumes meant that the worst had passed for the commercial shipping sector. Despite his increasingly bullish outlook, Shaode remained doubtful that the industry would recapture what he called the 'Golden Times' between 2003 and 2007. Significantly, his outlook for the container shipping market remained cautious, and he asserted that growth from the sector would be modest in comparison with high-growth markets such as liquefied natural gas (LNG) and ro-ro shipping.

Shaode also called for greater cooperation between shipping lines to tackle future downturns in market conditions as well as calling on the Chinese government to reduce taxation on domestic shipping companies to bring levels in line with other maritime states such as Singapore.

Despite its apparently cautious approach, CSCL's actions over the quarter have hinted that it is to break with the downsizing strategy pursued that, at its height, saw capacity on its container fleet fall by about 18% during Q409. Early indications suggest a more aggressive approach and, following a series of rate increases on the carrier's transpacific services in January 2010, in April CSCL introduced a General Rate Increase (GRI) on its transatlantic service between Israel and the US and Canada of US$400 per TEU and US$500 per 40-foot equivalent unit (FEU).

This move was followed by a rate hike of US$250 per TEU on Asia to West Africa shipments introduced by CSCL and the eight other member lines of the Asia - West Africa Trade Agreement (AWATA). A further US$250 per TEU rise is expected in July 2010.

BMI expects CSCL to continue to push for further rate hikes in 2010 as the global economy continues to recover from the downturn and customers find themselves in a position to pay higher shipping costs as their own profit outlook improves. Much depends, however, on the resilience of the container shipping industry as a whole in pushing for higher rates rather than dropping rates or leaving them untouched in return for opportunities for increased business. **BMI** cautions that conditions within the container shipping market are likely to remain challenging over the full year, which may hinder the company's ability to introduce the hikes.

Other developments over the quarter reinforced the sense of the company's growing confidence. In March, CSCL entered into a joint-venture (JV) shipping agreement with Taiwanese line **Evergreen Marine** to launch an intra-Asia container service, calling at the ports of Shanghai, Ningbo, Manila, Laem Chabang and Hong Kong. As well as strengthening ties between the Chinese and Taiwanese shipping industries following 2008's cross-strait shipping pact, the agreement underlines the recovery in demand for shipping services in the region.

Finally, as a further promotion of its commitment to its shipping operations in the Asia Pacific region, CSCL confirmed that it will continue to use the Westports Malaysia container Terminal at Port Klang as its transhipment base in Southeast Asia - a strong indication that the carrier plans to resume its standard pre-downturn operations as soon as possible.

Nippon Yusen Kabushiki Kaisha (NYK)

Strengths

- Nippon Yusen Kabushiki Kaisha (NYK) offers diverse services in bulk, tanker, car carrier and container markets.
- NYK is a member of the Grand Alliance (GA), allowing it to adapt to market changes more swiftly than some of its competitors.
- The company has long-term contracts of affreightment with major clients in the metals and mining sectors in China and India.

Weaknesses

- The company is exposed to foreign exchange rates, as it trades in Japanese yen, with appreciation likely to hurt export volumes as well as shipments.
- NYK operates a bloated ro-ro fleet consisting of 116 designated vehicle carriers, the largest worldwide, which leaves it exposed to declines in car sales.

Opportunities

- The company has identified potential long-term growth opportunities in the auto export sectors in both India and China, and has a growing presence in both markets.
- Projected long-term growth in raw material demand from China and India should boost the company's dry bulk operations.

Threats

- NYK's decision to downsize its container shipping fleet is likely to result in a substantial loss of market share and will leave the company more reliant on income from bulk shipping for the majority of its revenues.

Company Overview

Nippon Yusen Kabushiki Kaisha (NYK Group) was established in the 1870s with the foundation of the Tsukmo Shokai Shipping Company. The carrier initiated Japan's first overseas liner service, establishing a route from Yokohama and Shanghai. The company, then called Mitsubishi Kisen, merged with Kyodo Unyu Kaisha, another Japanese company, in 1882. This created NYK, and the merged entity began operations on October 1 1885. In 1964, the company merged with Mitsubishi Shipping Company, and the group became one of the largest shipping companies in the world, with a capacity of 2.3mn deadweight tonnes (DWT).

The company is one of the largest container shipping companies in the world. NYK offers container transport, car transport, logistics and terminal and harbour transport under its global logistics package, with bulk and energy transport forming a separate division. It has the world's second-largest bulk fleet and the world's third-largest fleet of crude oil tankers. Following its acquisition of **Ceres Terminals Incorporated** in 2002, NYK became the ninth-largest terminal operator in the world, with 26 terminals in Asia, North America and Europe.

Performance

FY09

NYK released its FY09 financial results in April 2010, reporting a 30% to JPY1.7trn (US$18.2bn), which resulted in a net loss of JPY17.7bn (US$187.5mn), compared with a net profit of JPY56.2bn (US$596.2mn) earned in FY08.

The company's container shipping unit was the worst hit of its core business divisions with revenue falling by 36.5% year-on-year (y-o-y) to JPY376.7bn (US$4bn), which led to a recurring loss of JPY55.4bn (US$587.6mn).

NYK's bulk shipping business reported a recurring profit of JPY36.6bn (US$388.2bn) against revenues of JPY733.4bn (US$7.8bn), a y-o-y fall of 132.3%.

Company Strategy

Container Shipping

In the past few months, NYK has sought to reduce its presence in the container shipping sector as part of its strategy to meet the limited growth opportunities within the market. In February 2010, the company revealed that it had made adjustments to an order for five container ships, which was converted to three Capesize bulk carriers and two LR2 oil product tankers. **BMI** believes the move is part of the company's plan to downsize its container shipping operations in favour of expanding its presence in other markets. In a break with its previous policy of preserving its owned container fleet, in January 2010 the company publicly revealed plans to cut more than half of its box fleet by 2015. NYK's president, Yasumi Kudo, quoted by International Freighting Weekly (IFW), said: 'The part of our container fleet that constitutes such long-term fixed assets will be slimmed down to half the number of vessels and its total space capacity will be trimmed by two-thirds by 2015.'

Signs of a reduction in NYK's box shipping capacity have been particularly evident over the past quarter. According to AXS Alphaliner, as of April 2010 the company operated 92 container vessels with a combined capacity of 354,177 20-foot equivalent units (TEUs), placing it 11th among the world's largest container lines. These figures represent a significant adjustment from January 2010, when the company had 106 ships with a capacity of 407,300TEUs, and, in capacity terms, is a reduction of 15.3%. The company's market share has also contracted over the period, falling from 3.1% to just 2.5% of the container shipping market.

As mentioned, NYK has made significant adjustments to its orderbook. In January 2010, the carrier had 19 new builds due for delivery, equivalent to 101,944TEUs or 25% of its existing cargo capacity. As of April, NYK's orderbook stands at just nine vessels or 52,899TEUs. At just 14.9%, this is the second lowest new-build ratio of the 20 largest container shipping lines.

Bulk Shipping

Despite the expansion of its container shipping division in recent years, NYK's dry bulk unit remains the company's core business division as it is the largest contributor to overall revenue, comprising 42% of total income in the 2008-2009 financial year. The division is split into three sub-divisions: car carriers, dry bulk and tanker. NYK is a strong market player in each of these sectors, operating the world's second-largest bulk fleet and the world's third-largest fleet of crude oil tankers as well as the largest ro-ro fleet.

NYK's dry bulk division, in particular, is likely to be an area of growth over the next few years as the company looks to downsize its box shipping unit and to capitalise on an expected rise in Chinese and Indian raw material imports. According to company data, NYK operates 41 Capesize carriers and has a further 24 vessels on order.

Terminal Operations

NYK has enhanced its shipping operations by moving into the terminal operating sphere. The company is ranked ninth among global terminal operators and owns 26 terminals across Asia, North America and Europe.

NYK expanded into the US port operating market in 2002, when it acquired **Ceres Terminals Incorporated**. Since then NYK has extended its terminal portfolio into operations in the US, the east coast of Canada and the Gulf of Mexico.

The company appears to have put expansion plans on hold during the downturn, and has walked away from a project to develop a terminal at the US port of Tacoma.

Trends & Developments

In Q210 NYK continued to carry out significant restructuring of its business as part of the group's Emergency Structural Reform Project. One of the main aims of the programme has been to expand NYK's presence in the energy and natural resources shipping sector by developing business links with companies within the oil and mining sectors. To achieve this aim, the company has made the strategic decision to strengthen its presence in Indian and China to tap into the countries' fast-growing raw material and transportation sectors.

The general manager of NYK's bulk shipping unit, Kazuo Ogasawara, is quoted as saying that the company will aim to reduce the proportion of goods it ships to Japanese customers in favour of increased sales to the Chinese and Indian markets. Iron ore and coking coal shipments to China currently comprise 20% of the company's total dry bulk deliveries in volume terms, while Japanese shipments account for 60%. By 2015, the company may increase its China focus to 50% of total shipments, while Japanese deliveries may fall to 40%.

BMI has been tracking the company's activities over the past few months and notes that the carrier has been steadily shifting its exposure away from the domestic market and towards developing Asia. In December 2009, the company agreed a 20-year contract of affreightment with mining firm **Rio Tinto**. Under the terms of the agreement, NYK will transport 2.7mn tonnes of iron a year to China from Western Australia between 2013 and 2033. The company has also strengthened its relationship with Chinese and Indian steel mills, including China's **Baosteel** and **Wuhan Group**, and India's **Tata Steel**.

NYK's growing relationship with Tata, in particular, has been an important development over the past few months. The company is India's largest private steel company and, in March 2010, NYK acquired a 26% stake in **TM International Logistics** (TMILL), a subsidiary of the company that provides steel-related logistics and harbour operation services. The move follows the 2007 establishment of **Tata NYK Shipping Pty** Ltd, a joint venture with Tata.

NYK's increased focus on the Chinese and Indian markets underlines the relative strength of the countries' raw material demand in contrast with developed states such as Japan. While Japanese steel production fell by 26% y-o-y in 2009, according to the country's Iron and Steel Federation, Chinese customs data show a 13.5% increase in China's output, leading to record iron ore imports, which grew 42% y-o-y.

Besides India and China, NYK has also shown a growing interest in smaller emerging markets. In May, the Grand Alliance, whose members include NYK, Hapag Lloyd and OOCL, added Vietnam's Cai Mep port as a port of call on their South China Sea Japan Express container service. The service comprises eight 6,000TEU vessels and will provide one of the first direct services between the US west coast and Vietnam. The decision reflects growing demand from the US for Vietnamese exports of textiles and clothing.

The company's decision to expand its presence in emerging Asia has been to the detriment of developed markets such as Europe. Besides actively downsizing its presence in the Japanese market, in January NYK followed compatriots **MOL** and **K-Line** in terminating its membership of the European Liner Affairs Association (ELAA), an organisation representing 26 containers lines operating on European trades.

The decision also reflects NYK's shrinking presence within the container shipping sector as a whole. While choosing to expand its presence in certain niche markets such as Vietnam, Q210 saw the company continue to downsize its overall box shipping capacity and, in April 2010, the line was highlighted by AXS as one of seven major Asian carriers to have recycled or scrapped a combined 282,000TEUs in the 15 months beginning January 2009 - 16% of their combined fleet.

With NYK continuing to order new vessels for its dry bulk division (the company took delivery of a 300,000DWT ore carrier in March), **BMI** expects the downsizing of its container shipping operations to continue over 2010.

Hanjin Shipping

Strengths

- Hanjin is South Korea's largest shipping line and has long-term contracts with several major Korean firms, including KOGAS, POSCO and KEPCO.
- The company is part of the world's biggest shipping alliance, the CKYH Alliance, which it formed with COSCO, K Line and Yang Ming. Cooperation on key long-haul trade lanes minimises costs and means rapid adjustments may be made in the case of market volatility.

Weaknesses

- The company's flagship services are Asia-orientated, with 13% of its operations Intra-Asia, 31% Asia-Europe and 52% transpacific, leaving the line particularly susceptible to the slump in the region's trade volumes.
- Hanjin's container line holds a large orderbook relative to many of its major competitors, with an additional 257,698 20-foot equivalent units (TEUs) of capacity awaiting delivery.

Opportunities

- The South Korean government has launched an emergency shipping fund through state asset-management firm KAMCO, which will buy ships of domestic lines and lease them back in order to provide cash flow to struggling companies.
- Recent expansion into more niche, potentially high-growth regions, notably Vietnam and the Middle East, may prove lucrative.

Threats

- The container shipping market is only beginning to recover and rising freight costs, without the subsequent rises in freight rates, would again erode container lines profits in 2010.

Company Overview

Hanjin was formed in 1977 and merged in 1988 with **Korea Shipping Corporation**, becoming **Hanjin Shipping Company**. Until 2009, the company was part of the Hanjin Group, and has several subsidiaries, including **Keoyang Shipping**. Hanjin's previous German subsidiary, **Senator Lines**, discontinued its services in February 2009 as a result of deteriorating market conditions.

In September 2009, Hanjin Shipping Company split into two separate companies: **Hanjin Shipping**, which retained control of the group's core shipping businesses and terminal operations; and **Hanjin Shipping Holdings**, which manages the subsidiary operations including logistics and ship management.

The company is South Korea's largest shipping line, and operates about 60 container line and bulk services. It has a fleet of roughly 200 vessels, including containerships, bulk vessels and liquefied natural gas (LNG) carriers. The company has three regional headquarters, 200 offices and 30 local corporations.

The group established its terminal operating division, **Hanjin Pacific**, soon after it was founded. During the 1980s and the 1990s it opened terminals in Long Beach, Seattle, Kaohsiung, Kwangyang and Hamburg. Today it has 12 dedicated terminals, including facilities at Long Beach, Tokyo, Kaohsiung and Busan. The division is planning to open new facilities in Vietnam and Jacksonville in 2011.

In 2001, the **CKYH Alliance** was formed, with Hanjin joining **COSCO**, **K-Line** and **Yang Ming** to share capacity on key trade lanes. The alliance enables Hanjin to offer a broader coverage and express services, and the alliance has plans to jointly develop new terminals in the future.

Performance

Full-Year 2009

South Korea's largest shipping line, Hanjin Shipping, recorded a 35% year-on-year (y-o-y) drop in revenues in 2009 as sales from the company's core container and dry bulk operations fell heavily. According to TradeWinds, in 2009 Hanjin posted a net loss of US$1.09bn on revenue of US$5.62bn. The results compare with a profit of US$323mn posted in 2008, when revenues were US$8.57bn for the year. Sales from the carrier's container and dry bulk shipping operations both fell substantially, declining by 35% and 41% respectively.

Hanjin expects to return to profitability in 2010. A statement released by the company said: 'the sales environment will be improved by the increase in container traffic due to the gradual economic recovery from the US and Europe. Therefore [the] 2010 business target has been confirmed as "financial stabilisation by operating in the black"'.

BMI believes that Hanjin's performance in 2010 will depend on a number of factors. The company has a large container shipping division, which, in our opinion, will struggle to remain profitable over 2010. As part of the company's strategy to lessen the effects of the downturn, Hanjin has taken to slow-steaming ships and introducing rate hikes on its services where possible. So far, these measures appear to have had some effect; the company's overall Q409 results showed some improvement, with net losses lessening from US$338mn to US$271mn over the quarter.

However, risks to both sales and operating costs remain in 2010. Bunker fuel costs are expected to rise over the year, and other operational costs such as port fees and canal tolls are also increasing. Hanjin's ability to offset rising costs through rate hikes may be undermined by a worsening supply-demand imbalance within the box shipping sector as a wave of new-build deliveries leads to a growing oversupply of vessels. Hanjin itself has publically denied reports that it will seek to defer a proportion of its liner orders and is expected to continue to take deliveries over the year.

While demand is recovering, the recovery appears to have slowed across major trade routes as a sharp initial upturn, led by importers rushing to restock inventories in H209, has levelled out.

We expect the company's dry bulk business to show a stronger recovery as industrial output recovers in key markets such as South Korea and Japan. However, the potential for a decrease in Chinese imports in H210 (due to government measures to tighten money supply), may yet lead to a further dip in global demand.

Q309

The company recorded a net loss of US$338mn in Q309 - slightly up from the US$329mn loss recorded in the second quarter. The loss dampened news of an increase in revenue, which rose by 10.7% quarter-on-quarter (q-o-q) to US$1.44bn from US$1.3bn in Q209. The company's container shipping division reported an operating loss of US$177mn, despite an 18.6% increase in cargo volumes and a rise in average freight rates.

H109

Hanjin had a poor start to 2009, recording an operating loss of US$400mn for the first half the year. While sales picked up in Q209 from the first quarter, increasing by 2.5%, higher fuel and operating costs saw the company's Q2 net loss rise to US$223mn from US$177mn in Q1.

The company's container line was the worst-performing arm, contributing US$342mn to the total deficit over the first half of the year. Although total container volumes increased by 22.7% q-o-q to 771,354TEUs in Q2, revenue per TEU was considerably dented as freight rates continued to plummet, with average earnings of just US$888 per TEU compared with US$1,043 in Q1. Meanwhile, Hanjin's bulk division also saw a decline from Q1, with sales falling by 4.2% q-o-q, culminating in an operating loss of US$516mn over H109 as a whole.

Company Strategy

Container Shipping

Hanjin Shipping's market share of an estimated 3.2% places it in eighth position in AXS Alphaliner's top 100 container fleet league, as of April 2010. With a fleet capacity of 439,164TEUs, Hanjin is sandwiched in between the two main Chinese container lines. Hanjin Shipping is close to catching up with the league's seventh-placed shipping line, **COSCON**, which boasts a capacity of 474,806TEUs, but Hanjin is also close to being caught up with, as **CSCL** boasts a fleet capacity of 437,564TEUs, just 1,600TEUs below Hanjin's fleet.

Hanjin's fleet of 98 vessels is mainly chartered, allowing the company to quickly change its fleet size by returning vessels to their charters or hiring more. As of April 2010 AXS Alphaliner reports that of Hanjin Shipping's 98 strong fleet, just 18 are owned (95,488TEUs) and 80 (343,676TEUs) are chartered.

Hanjin Shipping's strategy has been one of expansion, with the carrier currently boasting a new-build orderbook of 27 vessels, 257,698TEUs. This places Hanjin Shipping in fifth place in terms of the size of its orderbook, and the company's orderbook stands at 58.7% of the company's operating fleet.

BMI notes that the company, with its reliance on charters, will be able to return chartered vessels to make room for the delivery of vessels from its new-build fleet, should the environment in the shipping sector be depressed. On the other hand Hanjin Shipping can keep up its charters and still bring online its new vessels, should the shipping market prove stable. In this situation Hanjin Shipping will be able to expand its fleet and possibly move up the league table.

Dry Bulk Shipping

Dry bulk shipping is another of Hanjin's core strengths. According to the most recent company data available, Hanjin operates a sizeable bulk fleet consisting of 18 owned bulk vessels, including 13 Capesize ships ranging from 150,000 deadweight tonnes (DWT) to 207,000DWT in size, three 100,000DWT to 149,000DWT vessels and one 38,393DWT Handymax carrier. The company also frequently uses the services of chartered ships, tailoring its chartered fleet depending on the level of demand.

The majority of Hanjin's dry bulk fleet is contracted under long-term contracts of affreightment to the company's major clients, **Pohang Iron & Steel Co** (POSCO) and **Korean Electric Power Co**. (KEPCO). The main cargoes carried by the fleet include iron ore, coking and steaming coal and steel.

Tankers

The company's tanker division comprises two classes of DDP tankers - Very Large Crude Carriers (VLCC), Aframax and Very Large Gas Carriers (VLGC) - and LNG tanker divisions. The latter operates four LNG carriers that transport LNG from Indonesia, Oman and Qatar to Korea under a long-term contract with KOGAS, the Korean state-owned LNG importer.

Container Terminals

As a group, Hanjin is increasingly expanding into the terminal-operating sector and currently operates 12 designated container facilities worldwide with a combined handling capacity of 6mn TEUs a year. Terminal operations are managed by subsidiary firm Hanjin Pacific, and core facilities are in Asia, where it manages seven terminals including four in South Korea (two at the Port of Busan, one at Pyongtaek and one at Gwangyang), two in Japan (Tokyo and Osaka), and one at the Taiwanese port of Kaohsiung. Hanjing also operates terminals at three US ports (Seattle, Long Beach and Oakland) and three in Europe at the ports of Antwerp, Rotterdam and Algeciras in Belgium, the Netherlands and Spain respectively.

Hanjin also has two further terminals in development. These are located at the Port of Jacksonville in the US, and a share in a new container port currently being built at Cai Mep, near Ho Chi Minh City in Vietnam.

Trends & Developments

Containers

Hanjin Shipping expanded its Mexico coverage over the quarter, with the South Korean shipping line pulling in to two Mexican ports on its China American Express Service (CAX). The ports of call are the Asian container hubs of Shanghai, Gwangyang and Busan, with stops in the US port of Long Beach and the Mexican ports of Manzanillo and Ensenada. The service, which is weekly, uses five 5,500TEU vessels. Hanjin lists its reasons for expanding into the Mexican market as a desire to diversify its portfolio of routes from Asia to the US South West and an expectation of growing demand from Mexico.

Other changes to Hanjin's service have seen the shipping company expand its capacity on certain routes. The company's trans-pacific service, PSX, has had the size of vessels working on it increased once again to 7,500TEUs from 5,500TEUs. American Shipper reports that the move should be seen as a 'return to the normal capacity on the service and not as additional capacity'.

Hanjin's services changes have not only been of the company's own doing: as a member of the CKYH Alliance along with COSCO, **K-Line** and **Yang Ming**, Hanjin's joint shipping services have also been revised. In May the alliance is to launch its Pearl River-Southeast Asia Suez Express service to America's east coast along with MOL. The service will operate nine 5,500TEU vessels. The vessels for the service are being supplied by MOL and K-Line, with the other partners able to purchase slots on the vessels.

The alliance has also reactivated the fifth loop of its Asia-North European service (NE5)

The quarter also saw Hanjin go into partnership with **CCNI**, **Hapag-Lloyd**, **Wanhai Lines** and **Zim** on an Asia-South America East Coast service via South Africa. The service will operate eleven 4,200TEU vessels: three from Hanjin, three from Zim and two each from

Wanhai Lines and CCNI.

Hanjin's service strategy over the quarter indicates that the company is diversifying its routes. In the Mexican market, where the line feels most confident, Hanjin is prepared to go it alone and add extra calls to an existing service. For larger routes changes or new launch routes Hanjin is happier to team up, either with its traditional alliance partners though the Grand Alliance or even with new partners. **BMI** believes that this cautious approach of expanding its services via partnerships stems from the impact of the downturn, not just on Hanjin Shipping Line, but the global container sector as a whole. Shipping lines have launched services together as a form of protection, expanding their services while sharing out the cost of operating a service.

As a member of the CKYH Alliance Hanjin has been displaying its green credentials along with its alliance partners over the quarter. In the first part of the year the shipping consortium announced it would slow-steam on its routes. The strategy of slow steaming, which saves fuel by ships travelling at slower speeds, has gained in popularity over the last 12 months, with lines keen to save on bunker prices, while also tackling the problem of overcapacity (lines normally have to add another vessel to a loop if it is slow steamed, so as to continue to meet the time schedule of the service).

To further hit home its green drive, CKYH Alliance announced in April 2010 that it was updating its name to CKYH- the Green Alliance, which the consortium states 'embodies its strong determination on environmental protection'. The alliance members 'will take further measures such as eco-steaming for energy saving and emission reduction etc'.

Finally, over the quarter Hanjin Shipping has, like its peers, continued its rate-hiking strategy, announcing at the beginning of 2010 a price plan for the whole of the year, with the goal of lifting rates on its North America-Europe service by at least US$900 per TEU. The rate hikes of US$300 per TEU and US$400 per 40-foot equivalent unit (FEU) are scheduled for April 1 2010, July 1 2010 and October 1 2010.

In March the company raised its rates on its Canada-Asia shipments by US$160 per TEU and US$200 per FEU.

BMI notes that rate hikes continue to be a popular tactic in the container shipping sector as lines try to push rates up to ensure profit after rates plummeted in 2009, leaving carriers out of pocket.

Terminals

The quarter has seen Hanjin expanding its terminal portfolio through its own initiatives and those of others. In terms of the company's planned expansion strategy, Hanjin is planning to launch its newest terminal facility, the TOTAL Terminal International Algeciras (TTI Algeciras). Hanjin won the contact to operate the TTI Algeciras in 2008, for an operating period of 30 years. The terminal boasts three berths and with a draught of 17.5-18.5m, and will be able to cater for container vessels with a capacity of 10,000TEUs.

BMI notes that the launch of TTI Algeciras will be the first milestone in Hanjin Shipping's expansion into the African shipping market. The port's position on the Straits of Gibraltar offers Hanjin Shipping a hub for expanding its services into North Africa and the rest of the continent. TTI Algeciras is Hanjin's first foray into the southern European port sector, with the shipping line already operating two terminals (at the ports of Rotterdam and Antwerp) in northern Europe. **BMI** notes that Hanjin is developing a global network of terminal hubs, rather than concentrating its development in one region, like some other terminal operators. The shipping line is picking one major port for each region or country.

Hanjin also somewhat unexpectedly picked up an expansion to its terminal portfolio when **APM Terminals**, the container terminal division of **AP Moller-Maersk Group**, did not renew the lease for its two container berths at the Taiwanese port of Kaohsiung. The two container berths (piers 76 and 77) will now, with APM's exit, pass to Hanjin. This will see Hanjin's operations at the port grow to three berths, giving the operator a container handling capacity of 1.5mn TEUs per year at the port.

Mitsui OSK Lines (MOL)

Strengths

- Mitsui OSK Lines (MOL) has the largest dry bulk fleet in the world, owing to the implementation of an expansion strategy that began early in 2002.
- The company is a member of The New World Alliance with APL and Hyundai Merchant Marine, which was formed in 1998.
- The group has strong presence in the world's biggest emerging market, Asia.
- The group is relatively diversified, with a fairly even spread of revenues between containerships and bulkships and with a pool of interests in other businesses such as LNG.

Weaknesses

- MOL has a large fleet, which means profits may not be sustainable in periods of weak demand.

Opportunities

- The company is reported to have locked in sustainable rates for its core dry-bulk division, having negotiated long-term contracts with key clients in the steel and mining sectors.
- Long-term growth in liquefied natural gas (LNG) demand should benefit MOL, which currently operates the world's largest LNG tanker fleet and is planning to increase its presence in the sector.
- The group has a growing emerging market presence and was one of the first major shipping lines to enter the promising Vietnamese container shipping market.

Threats

- Global crude oil demand is expected to remain weak in 2010 as a result of the slow economic recovery.
- Container trades will continue to be depressed throughout 2010 because of high capacity within the sector and a sluggish recovery in Western consumer demand.

Company Overview

Mitsui OSK Lines (MOL) is a major international shipping group with a diversified network of interests across virtually all areas of the maritime sector.

The company came into being in 1964 when Mitsui Steamship Company - a division of Mitsui & Co - merged with OSK Lines, which was founded in 1884. In 1968, the company sent its first container ships on the Japan-California route.

The New World Alliance was formed in 1998, when MOL teamed up with **APL** and **Hyundai Merchant Marine** to operate services jointly on key trade lanes.

The group has the world's largest fleet of dry bulk carriers with a combined deadweight tonnage (DWT) of 31.03mn DWT, and operates the second largest oil tanker fleet, totalling 13.8mn DWT.

The company is also a dominant player within the container shipping industry, and is ranked 12th in AXS-Alphaliner's ranking of the top 100 global container lines.

Besides merchant shipping, MOL also operates in a number of other sectors, including logistics, cruise ships, real estate, construction, trading, marine engineering, finance, insurance, IT, telecommunications and manufacturing. The liner's terminal operating division is called TraPac, and operates facilities in the US ports of Jacksonville, Oakland and Los Angeles. The company also operates terminals at Tokyo, Yokohama, Osaka and Kobe in Japan, and Laem Chabang in Thailand, and is set to begin operating in Vietnam from 2011.

Performance

Financial Year 2009

In April 2010, MOL released its results for the financial year ending March 31 2010, revealing a sharp fall in profits. Net income fell by 90% year-on-year (y-o-y) to JPY13bn (US$137.5mn) from JPY127bn (US$1.3bn). Total revenue for the financial year fell by 27.7% y-o-y to JPY1.35trn (US$1.43bn) from JPY1.87trn (US$19.2bn).

Container Shipping

MOL's container division was the worst affected of its core business areas, and recorded a loss of JPY57bn (US$603mn). The unit's revenues fell by 31.9% to JPY466bn (US$4.97bn) from JPY640bn (US$6.6bn).

A notable contraction in cargo volumes was seen on the carrier's major shipping routes. The carrier's transpacific liftings fell by 4.4% y-o-y to 802,000 TEUs while Asia-Europe liftings fell by 21.6% to 543,000TEUs.

Bulk Shipping

The carrier's bulk shipping division, which accounts for about three-fifths of group revenue, suffered a 27.7% decrease in revenue, which fell to JPY722bn. The unit's ordinary income fell by 68.6% to JPY67bn.

Company Strategy

Container Shipping

MOL is one of a number of major Asian shipping lines to have significantly trimmed its fleet over the past 18 months. As part of a deliberate streamlining programme, the company reduced the capacity of its box fleet by 15% in 2009 through scrapping and laying up ships. The company has been content to let its standing within the sector fall. According to figures provided by AXS Alphaliner, between May 2009 and January 2010 MOL's market share fell from 2.7% to 2.5%, causing the company to fall from 11th to 12th in the rankings of the largest global container shipping lines.

In 2010, MOL's reduction of its fleet appears to have levelled out, and, as of April, the company's market share had remained constant at 2.5% while its shipping capacity rose slight to 92 ships or 351,890TEUs. This suggests that the company, in the past few weeks, has tentatively begun to reactivate a proportion of its idled fleet as trade volumes recover.

Over the next few months **BMI** expects MOL to continue to closely regulate its box capacity, and the company has stated its intention to continue to slow-steam vessels to limit possible oversupply and to negotiate deferrals of new-build deliveries where possible. The company's orderbook, as of April, stands at 23 vessels with a combined capacity of 131,929TEUs. At about 37% of the fleet's existing capacity, the company's orderbook is roughly equivalent to the average of 31.1% shared by the 10 largest container lines.

Dry Bulk Shipping

In contrast to its container shipping division, MOL's dry bulk shipping business has been the focus of a major expansion programme: the company aiming to profit from an increase in demand across the Asia-Pacific region. MOL's growth strategy is likely to include an increased focus on the Chinese dry bulk market in particular, and the company has begun marketing increasingly to prospective Chinese clients, signing a long-term contract of affreightment with Chinese steel manufacturer **Jiangsu Shagang** in October 2009 and strengthening its relationship with rival firm **Baosteel Group Corporation**.

As of April 2010, MOL operates the world's largest dry bulk carrier fleet, managing 375 ships with a total deadweight tonnage (DWT) of 31.03mn DWT. The fleet is due to expand rapidly over the next few years, with an additional 76 ships to come online between 2010 and 2012, roughly three times the number due to be delivered into its container shipping unit. According to China Shipping Online, in February 2010 the company broke its 18-month ordering ban by placing an order for two Capesize vessels with Japanese shipyards.

Dry bulk operations are maintained by three subsidiary firms: Bermuda-based **Gearbulk Holding** and Japan-based **Mitsui OSK Kinkai** and **Daiichi Chuo Kisen Kiasha**.

Tankers

Liquid bulk is another sector where MOL is expanding rapidly, owing to the growing fuel transportation needs of China and other emerging Asian states. The company has the world's second largest fleet of crude and refined oil tankers, operating 195 carriers. The company plans to add heavily to the division over the next few years with an additional 38 ships due for delivery between 2010 and 2012.

MOL also has a significant interest in the liquefied natural gas (LNG) shipping sector with 76 vessels - the most of any company worldwide. A further six ships are due to come online between 2010 and 2012, which is likely to allow the carrier to carry out a contract to provide shipping services to ExxonMobil's Papua New Guinea LNG project, which it was rumoured to have signed in March 2010.

MOL's liquid bulk operations are managed by subsidiary firms including **Tokyo Marine** and Asahi **Tanker Company**, based in Japan, as well as Hong Kong-based **MS Tanker Shipping**.

Trends & Developments

In March 2010, MOL announced a new mid-term management plan, titled 'Gear up MOL'. The plan outlined the company's strategic aims for its operations over the next few years with a view to achieving JPY5.5trn in consolidated revenues and JPY245bn in consolidated net profits between FY10 and FY12.

One of the key initiatives outlined in the plan was the decision to restructure the company's container shipping business, which has proved a considerable drag on the group's profit margins over the past 18 months. As part of the measures announced, the company said it would continue its strategy of slow-steaming box carriers in the short term in order to limit capacity and to reduce costs. Looking longer-term, the company has revealed its objective of repositioning the geographical focus of its container shipping business with a greater focus being placed on emerging markets, and in particular the emerging Asia, Africa and South America regions.

Over the past quarter, MOL has shown signs of making moves to this end and, in March 2010, made a series of changes to its African container shipping service in order to create a more stable, regular service. The company added an additional port of call, Durban to its Mozambique Zuid Africa Service (MZX), while also establishing a new Angola Shuttle service (AOS) to cater for the growing trade needs of the Southern African state. As part of the change, the service will also be upgraded from every 10 days to a weekly service.

South-East Asia has also been recognised as a potential high-growth market, and in May the group moved towards establishing a new Vietnam-based terminal operation company at the port of Cai Mep by launching a new all-water service between South China/Vietnam and the US East Coast. The service, which will be operated in partnership with K-Line, will provide nine 5,500TEU vessels, with MOL contributing two of the ships.

The carrier has also bulked up its South American presence and, in March, added new ports of call to its Asia-east coast South America service (CSW), reflecting the growing demand for container shipping services in the region and increasing ties between Asia and Latin America.

With MOL keen to limit the overall growth of its container shipping fleet, **BMI** believes the company's expansion into new, high-growth markets will come at the expense of its services to more traditional destinations. Indications that the group will look to downsize its presence in the European shipping market were perhaps evident in April, when the company was forced to defend its decision to exit its involvement in the European Liner Affairs Association (ELAA), the main organisational body representing container shipping companies in the continent. The news may have been incidental were it not for the fact that it had swiftly followed the announcement of the carrier's withdrawal from the Transpacific Stabilization Agreement (TSA) in 2009. MOL's resignation from both groups seems to confirm the geographical restructuring currently taking place within the company.

As well as increasing its emerging market presence, MOL has also been active in shifting its focus towards high-growth sectors of the commercial shipping sector. In March 2010, **BMI** was alerted to unconfirmed reports that the carrier had been awarded the shipping tender for **ExxonMobil**'s Papua New Guinea (PNG) LNG project. The project, which is due to start exporting LNG in 2014, could treble PNG's exports and more than double its GDP.

News source Asiasis cited unnamed 'insiders' who have stated that 'MOL has beaten out **AP Moller-Maersk** in a tender for two existing ships'. The tender was launched in April 2009, and originally requested bidders able to offer five LNG vessels. Two of MOL's LNG vessels are now expected to be contacted to ExxonMobil's US$15bn PNG LNG project. ExxonMobil holds a 33.2% stake in the project, with the government of PNG holding a 16.6% stake. Nippon Oil has 4.7% and Oil Search and Santos, an Australian explorer, have 29% and 13.5% respectively. The project was granted final approval in December 2009, and exporting of gas is due to begin in 2014. According to **BMI**'s oil and gas team, the project should revolutionise both the PNG economy and the energy sector in the country.

BMI believes that MOL will transport LNG to Tepco and Osaka Gas, which has signed a 20-year agreement for 1.5mn tonnes of LNG from the project per annum. It is unlikely that MOL will cater for the LNG shipping needs of Sinopec, as China wishes to meet its own LNG transport requirements and has been developing an LNG fleet. In 2004 the Hudong-Zhong Shipbuilding (Group) began construction on the country's first-ever LNG carrier; the Dapeng Sun is now in operation and has been joined by four other Chinese LNG vessels. Further expansion of China's LNG fleet is likely to meet Sinopec's transport needs for the PNG LNG contract.

Key to MOL's thinking will be the fact that the market is relatively underdeveloped, with just

322 LNG vessels in circulation worldwide, compared with 4,448 container ships, according to data compiled by Bloomberg. A lack of market saturation leaves room for expansion, allowing the company to build on its status as the largest operator within the industry.

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