10 September 2014 | Sector Update

Shipping Sector

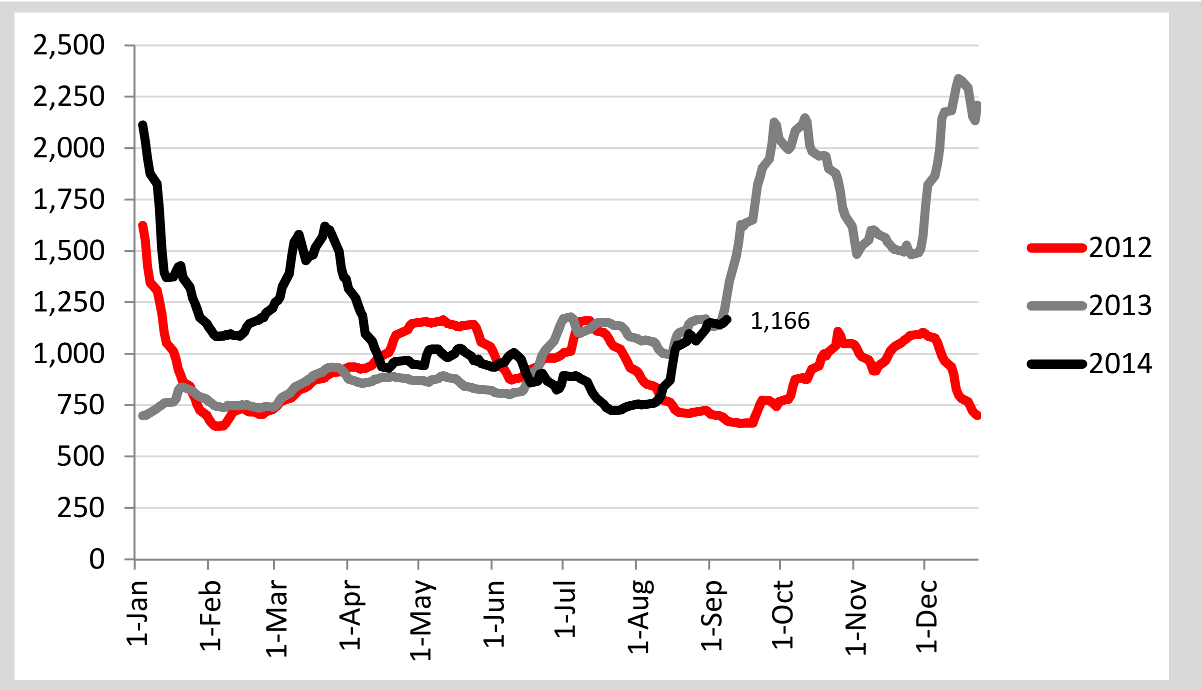
Stable outlook amid stronger fundamentals

***Maintain* NEUTRAL**

INVESTMENT HIGHLIGHTS

- We expect the recovery in BDI rates to be more sustainable towards end of FY14, driven by the seasonality factor and possibly higher 2H14 iron ore shipments by Vale.
- The BDTI rates eased towards end of August, albeit well above levels seen in 2Q14. We expect the tanker rate to improve again during the winter period.
- We maintain our NEUTRAL stance on MISC with unchanged TP of RM6.53. Reiterate our BUY stance on Maybulk with unchanged TP of RM2.02.

Figure 1: Baltic Dry Index (BDI)

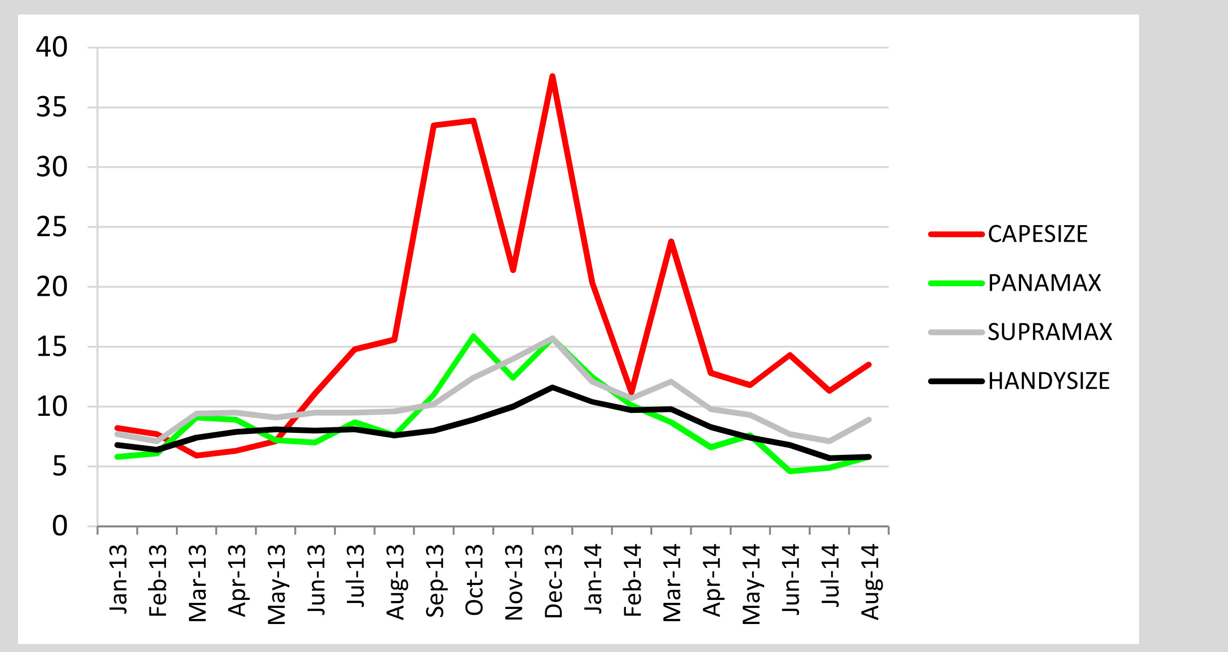


Source: Bloomberg, MIDFR

DRY BULK SHIPPING

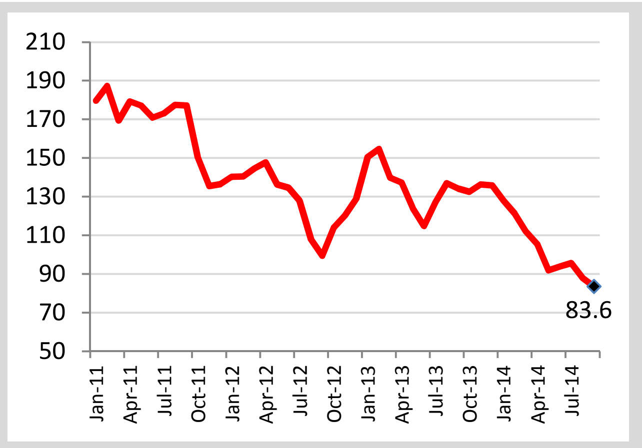
- **Subdued BDI performance over 2Q-3Q14**. The performance of dry bulk market had been subdued in 2Q14. Among the contributing factors were lower trade demand growth by reduced coal shipment to China and Europe, and impacts of the Indonesian ban of bauxite and nickel ore exports. Year-to-date, the dry bulk fleet expanded +4.6%yoy to 739m DWT, with the forecasted growth of >5%yoy by end of FY14 *(source: Platou)*. Driven by the seasonality factor and possibly higher 2H14 iron ore shipments by Vale, we expect the recovery in BDI rates to be more sustainable towards end of FY14.
- **Capesize topped the dry bulk freight rate**. The largest type of dry bulk vessels, Capesize, which is designed for hauling iron ore, earned the highest freight rate, with the average spot TCE of US$13.8k/day in August FY14 (figure 2). While the freight rate for Panamax was the worst performer, at a mere US$5.8k/day. Due to correlation and substitution effects, the weak Panamax rate dragged down both, the Supramax and Handysize rates, to trade below US$10k/day.

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



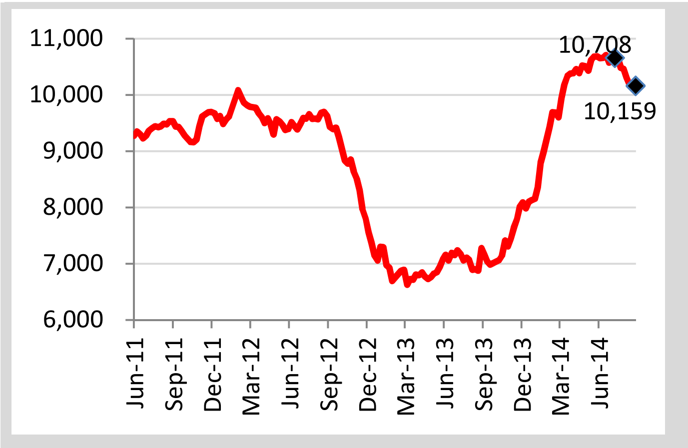
Source: Platou, MIDFR

Figure 3: Tianjin Port Iron Ore Price, US$/mt



Source: Bloomberg, MIDFR

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



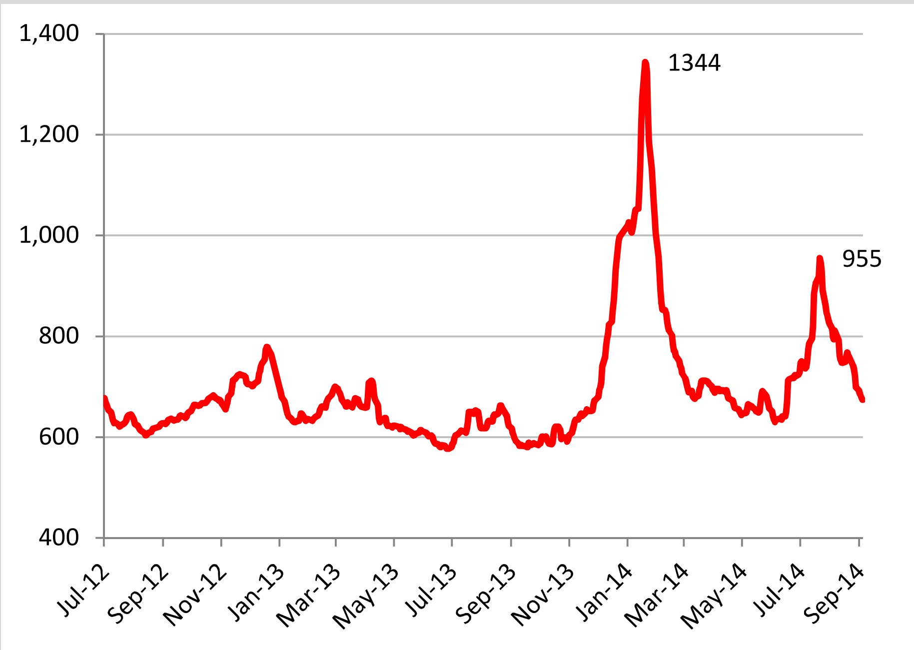
Source: Bloomberg, MIDFR

- **Rising iron ore imports in China**. As of 5 September 2014, the benchmark pricing of imported iron ore dropped to a four-year low at US$83.6/mt (figure 3). Taking advantage of the falling price of seaborne iron ore, China's iron ore imports surged +18.8%yoy to 235mmt in 2Q14. The weekly total inventory level of iron ore at China's port reduced slightly to 10.2mmt as of 29 August from the recent high of 10.7mmt as of 20 June (figure 4). This would last for 4.3 days of the import demand. As such, the abundant supply of cheap iron ore and steady steel demand should support the Capesize freight rate.
- **China government outlines shipping modernisation plan**. China's shipping industry, which comprises circa 240 firms, carries only 25% of the nation's total trade and lags behind other foreign players such as A.P. Møller-Maersk, CMA-CGM, MSC and etc. Under the new policy, China will introduce tax reform and other regulatory measures to push shipping firms to modernise their fleets. The government would encourage firms to retire their older fleets, thus reducing available vessel supply. This should bode well for the recovery in freight rates.

TANKER SHIPPING

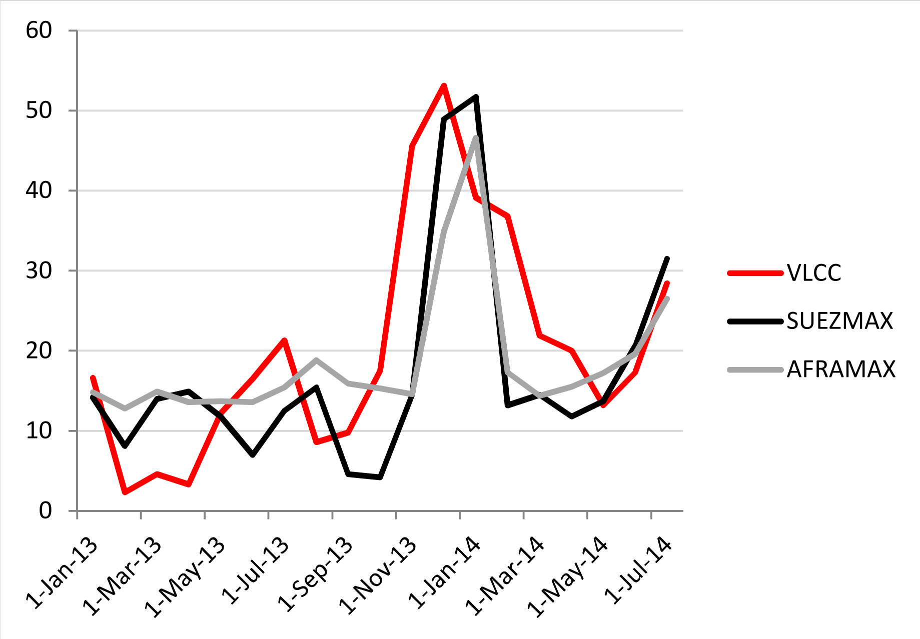
- **Another round of tanker index rally in 3Q14**. Over 4Q13-1Q14, the severe winter in North America sparked the rally in Baltic Dirty Tanker Index (BDTI). Subsequently, the index retreated to its year-to-date lowest point of 630 (as of 20 January) from its year-to-date highest point, 1,344 (as of 5 June). Nonetheless, the index surged +51.6% to 955 points (as of 22 July) from the year-to-date lowest point. This second rally was attributable to the combination of factors, namely: (i) threat of supply disruptions from the unrest in Iraq; (ii) summer seasonal refinery maintenance finishing earlier than usual; and (iii) record-high crude oil inventories in US gulf which resulted in a shortage for onshore storage capacity. Meanwhile, the average year-to-date index was higher by +22%yoy at 781 points.
- **Rally eased off towards the end of August**. For July-August 2014, VLCC and Aframax tankers' average TCE improved to above US$20k/day (figure 6) from the previous 2Q14's weak average TCE of US$10-20k/day. The Suezmax freight rate was more volatile with average TCE of US$31.5k/day but ended on a weak note at US$19.3k/day in August. Overall, the tanker freight rates eased towards end of August, albeit well above levels seen in 2Q14. We expect the tanker rate to surge again during the winter period.
- **Lifting of US crude oil export ban may have profound impacts on tanker market**. Thanks to the boom of domestic shale oil production, the US is the third largest global crude oil producer today. The existing restrictive crude oil trade policy has put a discount on the domestic crude oil price. Should US lift the four-decade-old export ban, it will help the country to realise its growth potential for crude oil production as well as redraw the landscape of global oil transportation.

Figure 5: Baltic Dirty Tanker Index



Source: Bloomberg, MIDFR

Figure 6: Monthly Average of Spot rate for Crude Tankers, (USD'000/day)



Source: Platou, MIDFR

Stock Recommendations:

MISC (Maintain NEUTRAL, TP: RM6.53)

- The recent surge in tanker freight rate in 3Q14 bodes well for MISC's petroleum division and we believe this could lead to lower operational losses. The division incurred a quarterly pretax loss of US$31m in 2Q14 compared to pretax gain of US$11m in the previous quarter. We believe the group may benefit from the lifting of crude oil export ban in the US as it still maintain a sizable fleet of Aframax in the country.
- We expect tanker rates to normalise back to US$10-20k/day levels once the demand starts to improve as utilisation rate of tanker vessels are at 85-88% while fleet growth thus far in FY14 has slowed to <1.0%yoy. Hence, we maintain our NEUTRAL stance on MISC with unchanged TP of RM6.53. Our valuation is premised on Sum-of-Parts method.

Maybulk (Maintain BUY, TP: RM2.02)

- The high iron ore inventory levels in China would limit the short term upside potential of the drybulk rates. Nonetheless, we expect the index to rebound when winter season kicks in. Despite the weaker note in May-August, the index inched up to >1,100 in September from 700 levels in August. This should give some relief to the operational losses faced by Maybulk. For 2Q14, the group incurred operational loss of RM7.3m in dry bulk segment due to the weak charter rate and expanded dry bulk fleet number.
- The contribution of POSH associate dropped >50%yoy in 2Q14 due to the JV partner issue in Mexico. The POSH group is currently expanding its OSV fleet, especially in deeper waters. We believe that the contribution of its associate should recover subsequently once issues with its Mexican JV partner are resolved. Hence, we reiterate BUY stance on Maybulk with unchanged TP of RM2.02, derived from Sum-of-Parts method.

Figure 7: 2Q14 Core Profit Comparisons (RM'm)

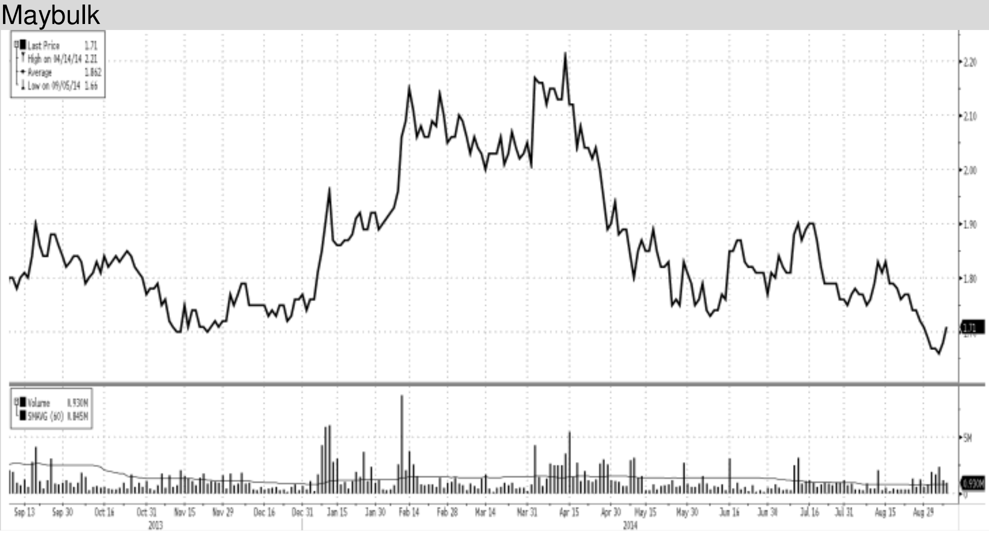
Company	2Q13	3Q13	4Q13	1Q14	2Q14	%QoQ	%YoY	Forecasted FY14-EPS growth (%)
MISC	267.3	396.8	501.6	486.4	336.0	-30.9%	25.7%	6.4
Maybulk	13.9	6.0	7.8	25.7	(3.5)	-113.7%	-125.3%	36.2

Source: Companies, MIDFR

DAILY PRICE CHART

MISC

Maybulk



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

DISCLOSURES AND DISCLAIMER

MIDF AMANAH INVESTMENT BANK : GUIDE TO RECOMMENDATIONS

STOCK RECOMMENDATIONS	
BUY	Total return is expected to be >15% over the next 12 months.
TRADING BUY	Stock price is expected to *rise* by >15% within 3-months after a Trading Buy rating has been assigned due to positive newsflow.
NEUTRAL	Total return is expected to be between -15% and +15% over the next 12 months.
SELL	*Negative* total return is expected to be -15% over the next 12 months.
TRADING SELL	Stock price is expected to *fall* by >15% within 3-months after a Trading Sell rating has been assigned due to negative newsflow.
SECTOR RECOMMENDATIONS	
POSITIVE	The sector is expected to outperform the overall market over the next 12 months.
NEUTRAL	The sector is to perform in line with the overall market over the next 12 months.
NEGATIVE	The sector is expected to underperform the overall market over the next 12 months.