CITICS 中信証券國際 CITIC Securities International

China Shipping Sector

Watch for short-term trading opportunities

NEUTRAL

(reiterate)

Investment Highlights

- **The BDI has fallen 60% YTD due to seasonal weakness.** The Baltic Dry Index (BDI) fell from 1,738 points at end-2011 to 680 points as of yesterday, down over 60% YTD. The decline is in line with the industry's seasonal weakness during the months that contain the: (i) CNY holiday; and (ii) cold weather. Overcapacity and high coal and ore inventory (piling up in 4Q11) are also reasons for the decline.
- **Short-term rebound expected.** At its current level, the BDI is close to its bottom of 663 points (recorded on 5 Dec 2008) following the outbreak of the 2008 US financial crisis. Having declined by over 60% YTD, the BDI is now below ship-owners' breakeven points, indicating that further downside is limited. We forecast that the BDI will rebound in late Feb 2012E when production resumes after the CNY holiday season. (For reference, the BDI logged YTD declines of 9% and 29% by the end of Feb in 2010 and 2011, respectively).
- **Weak industry fundamentals unchanged.** 2011 witnessed: (i) consistently high oil prices; (ii) the deteriorating European sovereign debt crisis; and (iii) a slowdown in global economic growth. In 2012E, these negative factors will remain intact. From the perspective of supply-demand fundamentals, 2012E supply is forecast to remain at its peak and increase by 10.4% YoY, while the growth in demand from global bulk trade will ease to 3.2% YoY as China's economic growth slows. Given ample capacity supply, bulk freight rates will remain under pressure. Based on our model, we forecast that the BDI will average 1,550 points in 2012E (flat growth vs. 2011's average of 1,549 points).
- **Watch for short-term trading opportunities.** Overcapacity will remain a problem and the large number of new-ship deliveries will keep freight rates low in 2012E. Therefore, we reiterate our NEUTRAL rating on the sector. However, in our view the sector-wide decline in share prices in the past years has already discounted most of the negatives. With this in mind, investors are advised to watch for short-term trading opportunities based on: (i) possible revival of the US economy (as reflected by positive US economic data, e.g. PMI, unemployment and housing prices, etc); (ii) sector re-rating on improving industry fundamentals driven by policy changes in China's banking (e.g. reduction in RRR) and real estate sectors (relaxation of restrictions) – both could stimulate steel production, which in turn would boost ore imports.
- **Stock picks:** Investors who bet on the theme of (i) a revival of the US economy: focus on CSCL (02866.HK) and OOIL (00316.HK), both of which are pure container shippers; and China COSCO (01919.HK; 48% of revenue came from container shipping in 2010) as prime beneficiaries of a recovery in US trade; and (ii) a sector re-rating: buy counters such as China Shipping Development (01138.HK; 2012E P/B: 0.7x), Pacific Basin (02343.HK; 0.6x) and Sinotrans Shipping (00368.HK, 0.5x) for their attractive low P/B valuations.

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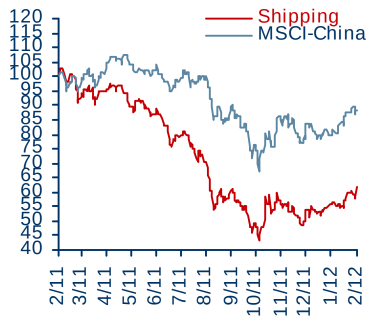
Relative Performance



Source: Bloomberg, CSI

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Investment rating system

Performance of stock or sector relative to MSCI-China over next 6 months after research publications

	Rating	**Remark**
Stock rating	Buy	Relative performance over MSCI-China Index >20%
	Overweight	Relative performance over MSCI-China Index 5% ~ 20%
	Hold	Relative performance over MSCI-China Index -10% ~ 5%
	Sell	Relative performance over MSCI-China Index > -10%
	NR	Not rated
Sector rating	Outperform	Relative performance over MSCI-China Index >10%
	Neutral	Relative performance over MSCI-China Index -10% ~10%
	Underperform	Relative performance over MSCI-China Index > -10%

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