Global container shipping & ports - presented at the 11th Annual Hong Kong Ship Finance Forum

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Container shipping
Demand growth to outweigh supply growth in 2019-20…

We expect the demand-supply gap to turn favorable only in 2019e

- We forecast 4.2% demand growth in 2018e vs 4.3% nominal fleet growth of and 5.0% active fleet growth
- With negligible latent idle fleet, we expect 2019-20e active capacity growth to be lower than demand growth

Global container shipping demand-supply: The gap should turn favourable in 2019e

Source: Clarksons Research Services, HSBC estimates
...as order book to annual demand reaches new low

...and implies supply equivalent to 2 years of annual demand and scrapping

- Despite some new orders we expect orderbook to remain under 12%

Orderbook as a percentage of fleet is at historical lows; current orderbook implies supply equivalent to about 2 years of annual demand and scrapping.

Note: We have used 1.3% annual scrapping rate based on 15-year average during 2002-17.
Source: Clarksons Research Services, HSBC estimates
Freight rates – deflationary trend likely to continue…

Contract rates are flat to higher y-o-y in 2018 despite weaker spot rates

- Container freight rates have followed a deflationary trend in the past two decades
- As of March end, the CCFI is down 1% y-o-y compared to 21% decline in the SCFI

Container freight rates have followed a deflationary trend: The CCFI has declined at 2.6% CAGR during the 10 years 2007-17

In 2018 y-t-d, while SCFI (spot rates) has deteriorated sharply y-o-y, CCFI (contract rates) has been flattish
…despite recent M&As, competition is unlikely to abate

Top 20 players of 2014 have been reduced to just 11 now

The top seven container shipping lines have 79% of the market, up from 54% in 2013…

…and new environmental regulations could accelerate the consolidation process

But competition in key East-West routes of Asia-Europe and Transpacific is still moderately competitive

Herfindahl Hirschman Index (HHI) – concentration has increased but Asia-Europe and transpacific are still only moderately competitive

Note: Interpreting HHI score – A score of less than 1,000 is considered a competitive market place; a score of 1,000-1,800 is considered a moderately competitive market, and a score greater than 1,800 implies a highly concentrated market.

Source: Alphaliner, HSBC
Trade protectionism – not new

US-China trade partnership with no alternatives

- Trade protectionism is not new; share of Far-East to North America trade capacity is just 16%
- Industry participants see negligible impact and expect trade tensions to most likely lead to trade to take different routes.
- HSBC economists expect both countries to negotiate.

China’s containerised exports to the US by commodity in USDbn (2017)

- White goods, 45%
- Household, 13%
- Clothing, 10%
- Machinery, 10%
- Head, Foot & Leatherware, 6%
- Toys and Sports, 6%
- Electronics, 5%
- Iron & Steel Products, 2%
- Plastics, 2%

Source: Clarksons Research Services

Container shipping: Fleet deployment by capacity (1 February 2017)

- FE-N. Am, 16%
- ME/ISC, 14%
- Oceania, 12%
- Africa, 9%
- ME/ISC, 8%
- Lat Am, 13%
- Intra-Europe, 4%
- Intra-FE, 4%
- Unassigned, 2%
- Idle, 2%
- FE-Europe, 21%
- Eur-N. Am, 4%

Source: Alphaliner
Environmental regulations

Disruptions ahead

2. A lower cap of 0.5% on sulphur emissions from 1 January 2020 vs. the current limit of 3.5%

Key challenges

- Opex set to increase; we estimate low sulphur cap alone to result in additional annual fuel bill of USD25bn
- About 4m TEUs or 20% of existing container ships to be over 15 years of age by 2020 and become likely scrapping candidates due to expensive regulatory environment

Container shipping fleet: Roughly 20% of the fleet is 13 years or older

Scrap value of a 15-year old 3,750 TEU vessel is not much different from its resale value (USDm)

Source: Clarksons Research Services, HSBC
Ports sector
Global Ports: Common challenges, diverging strategies

Port operators face two common challenges

1. Maturing throughput growth in home base vs the need to chase risky expansion overseas
2. Fewer but bigger customers due to shipping sector consolidation
Operators have turned cautious on portfolio expansion

- With structurally slower demand growth, the strategy of ‘build capacity and they will come’ no longer holds good
- APMT has guided capex discipline and even divestments to optimize portfolio while ICTSI prefers brownfield projects
- Chinese operators – CM Port and CS Ports are positioning their recent investments in line with China’s Belt and Road initiative (BRI)
Global Ports: Shipping consolidation – mixed impact

Ports aligned with shipping lines to benefit

- **ASP diluted** even for O&D as merged lines paid the lowest common tariffs and received greater volume discounts
- M&A and alliances reshuffle led to better volumes for **ports aligned with shipping lines** (CS Ports, APMT, PSA)

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**CS Ports: Contribution from Ocean Alliance as % of total throughput for CS Ports subsidiaries**

- **PCT**: 66% (FY17), 53% (FY16)
- **Xiamen**: 80% (FY17), 34% (FY16)
- **Nansha**: 32% (FY17), 21% (FY16)
- **Lianyungang**: 59% (FY17), 45% (FY16)

Source: Company data

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**Maersk Line: Breakdown of operating costs (2017)** – Terminal costs are the biggest component

- Terminal costs, 32%
- Vessel costs, 27%
- Bunker cost, 14%
- Inland transportation, 12%
- Containers and equipment, 5%
- Administration and other costs, 9%

Source: Company data
IFRS 16: Bringing operating leases on to the balance sheet

Negative in the near term as it increases leverage and finance cost

- In the first few years, interest costs rise but decline in later years – so neutral impact over the term of the lease
- No impact on cash flow but leverage will increase

### IFRS 16 – implications on income statement and balance sheet

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<thead>
<tr>
<th>Income statement</th>
<th>From IAS 17</th>
<th>To IFRS 16</th>
<th>All leases</th>
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<tr>
<td>Revenue</td>
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<td>Operating expenses</td>
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<td>Lease expense</td>
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**EBITDA**

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<td>Depreciation and amortisation</td>
<td>Depreciation</td>
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**EBIT**

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<tr>
<td>Net finance cost</td>
<td>Interest cost</td>
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**Profit before tax**

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<th>Balance sheet</th>
<th>Finance leases</th>
<th>Operating leases</th>
<th>All leases</th>
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<tr>
<td>Assets</td>
<td>✓</td>
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<tr>
<td>Liabilities</td>
<td>✓</td>
<td>-</td>
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<tr>
<td>Off balance sheet obligations</td>
<td>-</td>
<td>✓</td>
<td>Only leases &lt; 1 year</td>
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Source: CMA CGM, HSBC
IFRS 16: Container shipping leverage set to rise

Lines with relatively higher share of chartered fleet are more vulnerable

Container shipping: Mix of owned vs chartered fleet (April 2018)

Source: Alphaliner
Global shipping and ports: Share price performance (including dividends) in 2017

Source: Thomson Reuters Datastream

Global shipping and ports: Share price performance (including dividends) in 2018 YTD

Note: Priced as of 3 April 2018
Source: Thomson Reuters Datastream
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