STRATEGY

Macro ▪ Singapore

China Shipping and Ports

Potential winners from easing trade tensions

Joel Ng / 65 6202 1192 / joel.ng@kgi.com
Chen Guangzhi, CFA / 65 6202 1191 / guangzhi.chen@kgi.com

- The World Trade Organisation (WTO) recently downgraded trade volume growth to only 1.2% in 2019, substantially lower than the 2.6% growth forecast made in April 2019. The WTO cited escalating trade tensions and the slowing global economy as key reasons for the downgrade.
- Expectations are mixed for the trade talks between the US and China that wraps up tomorrow (11 October). Regardless, we highlight stocks that would benefit, even in the event of a partial trade deal.
- For one, easing trade tensions will benefit trade flows between the two countries. We see trade-related companies, such as Chinese ports, as a good play.
- China is the largest oil importer on the back of surging refining capacity. A partial deal may include the easing of sanctions imposed upon units of China's COSCO Shipping Corp, which has fuelled steep rises in oil tanker rates.

Recovery of global trade in 2020. Even with the recent downgrade of global trade growth in 2019, the WTO expects a recovery in 2020 as both monetary and fiscal policies are implemented to offset the current global slowdown. The WTO expects world trade volumes to grow 1.2% YoY in 2019 and to recover to 2.7% YoY in 2020. The trade organisation did add a caveat that their forecasts are dependent on the return to normal trade relations between China and the US.

Figure 2: Global trade volume growth (YoY % Change)

	2015	2016	2017	2018	2019P	2020P
Volume of world merchandise trade[2]	2.3	1.7	4.6	3.0	1.2	2.7
Exports						
Developed economies	2.4	1.0	3.6	2.1	0.4	2.2
Developing economies[3]	1.7	2.3	5.6	3.5	2.1	3.4
North America	1.1	0.3	4.2	4.3	1.5	3.6
South and Central America[4]	-0.4	0.7	3.0	0.6	1.3	0.7
Europe	2.9	1.2	3.7	1.6	0.6	1.7
Asia	1.4	2.3	6.8	3.8	1.8	3.8
Other regions[5]	3.2	2.9	1.6	2.7	0.9	2.5
Imports						
Developed economies	4.2	2.0	3.3	2.5	1.6	1.2
Developing economies[3]	0.6	1.3	6.8	4.1	1.1	4.3
North America	5.4	0.1	4.0	5.0	2.9	2.1
South and Central America[4]	-8.4	-8.8	4.6	5.2	-0.7	4.5
Europe	3.5	3.1	2.9	1.1	0.4	0.9
Asia	3.9	3.6	8.3	5.0	1.3	3.9
Other regions[5]	-4.3	-1.9	2.5	0.5	2.6	4.3

Source: WTO, UNCTAD

Asia trade. Import demand in Asia has slowed down and has weighed heavily on major manufacturing countries such Japan and South Korea. Among the major regions, the WTO expects import volumes in Asia to only increase by 1.3% YoY in 2019, a significant slowdown from 8.3% in 2017 and 5.0% in 2018. On a slightly positive note, Asian export and imports growth in 2020 are expected to recover to 3.8% and 3.9% respectively. Monetary and fiscal stimulus implemented in 2019 will likely have an effect on economic growth towards the end of 2019 and into 2020.

Figure 1: Stocks highlighted in this report

Company Name	BBG Ticker
Cosco Shipping Energy Transportation	1138 HK
Cosco Shipping Ports	1199 HK
China Merchants Port Group	001872 CH

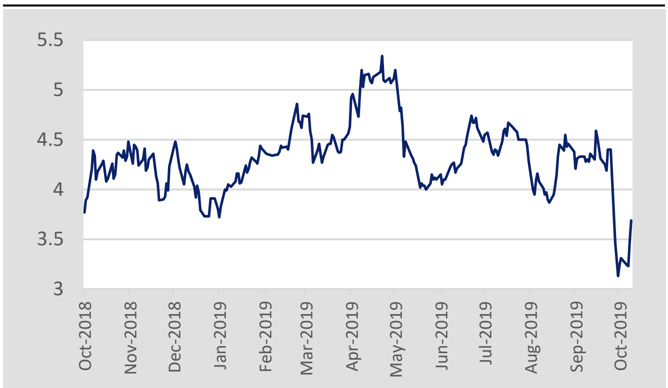
Source: KGI Research

US sanctions on China tankers. Shares of Cosco Shipping Energy Transportation (1138 HK) plunged by as much as 30% - to its lowest level since July 2012 - after the US sanctioned its tankers. The US had disclosed that the company had shipped illicit Iranian oil in violation of US sanctions.

However, we are of the view that its shares now offer an attractive risk-reward return in light of two key factors. First, China is the largest importer of crude oil, which is driven in part by the rise of oil refining capacity in the country. Oil refining capacity is on an uptrend, according to S&P Global, with 40mn tonnes/year of capacity to be commissioned this year, while another 26mn tonnes/year is under construction. Second, the Chinese government has included the lifting of sanctions on the Cosco units as part of the trade negotiations currently underway.

The scenario with Cosco Shipping Energy is similar to what transpired with ZTE Corp (763 HK) in 2018 when the US lifted the trading ban on the company. ZTE's share price subsequently recovered to trade at pre-sanction levels.

Figure 3: Cosco Shipping Energy Transportation (1138 HK) share price



Source: Bloomberg, KGI Research

Risks: There are still significant risks that could weigh on global GDP growth. Among them are Brexit uncertainty and the return of trade-related hostility between China and the US.

China ports. In Oct-19, the Shanghai International Shipping Institute issued the 3Q19 China Shipping Prosperity Report. The shipping market in China turned positive in 3Q19, with the China Shipping Prosperity Index mildly increasing to 108.74, and the China Shipping Confidence Index increasing to 108.34.

The Bulk Shipping Climate Index significantly increased by 24.64 points to 124.83, and the confidence index surged by 55.53 points to 162.38. We believe the upturn was mainly driven by bulk shipping activities and crude oil transportation. The US has been increasing oil exports and freight costs for these routes are higher than those from the Middle East due to longer distances, which are usually two to three times more. The recent sanctions on COSCO have further boosted charter rates.

On the other hand, the container shipping climate index increased by 17.54 points to 111.81 while its confidence index was flat at 76. We note the resilience of the container segment despite the weak outlook amid the trade tensions and global economic slowdown. Part of the resilience could be explained by front loading activities ahead of the new tariffs that are to take effect.

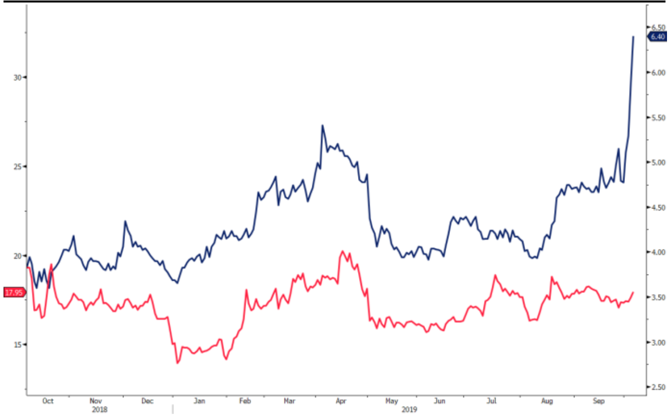
Meanwhile, the Port Climate Index remained flat at 104.17 but the Port Confidence Index markedly increased to 113.33. The further improvements in shipping activities should therefore lead to improvements for Chinese port volumes, whose shares have lagged behind those of shipping stocks.

Attractive P/B valuations of Chinese ports. Shares of Chinese ports have declined since the escalation of trade tensions between the US and China. Valuations are now attractive, while share prices are supported by their 5-10% dividend yields. We also notice that the share prices of the Chinese ports have lagged the performance of the Chinese shipping companies, which have historically been closely correlated.

Figure 4: Baltic Exchange Dirty Tanker Index (BDTI Index)

Source: Bloomberg, KGI Research

Figure 5: China Merchants Energy Shipping (601872 CH, Blue line) vs China Merchants Port Group (001872 CH, Red line)

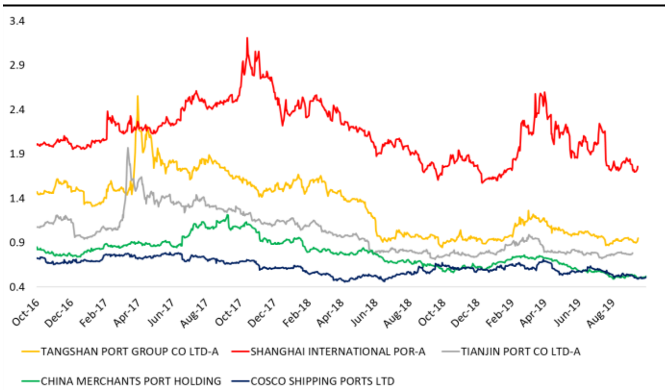


Source: Bloomberg, KGI Research

Figure 6: Cosco Shipping Holdings (1919 HK, Red line) and Cosco Shipping Ports (1199 HK, Blue line)

Source: Bloomberg, KGI Research

Figure 7: PBR is trading at a three-year low



Source: Bloomberg, KGI Research

KGI's Ratings

Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.