

TOC Asia 2011

Tianjin, 15 –17 March 2011

Into China's Interior...

(A Holy Grail for Global Capitalism ... flawed as it is)

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Broad Themes – Forget Consensus Views...Asia/China ‘de-coupling’ ...Beware War/Instability Risks Rising...

Disclaimer: We don't believe forecasting is much more than educated guesswork when looking at macro beyond 6-12 months. Nonetheless we strive to model from the bottom up while tracking macro and micro data that educate our analysis. We focus on weaving in and out of the data we see in past, present, and near future

The world is a different place (and it certainly is not flat): Many large banks have lost credibility after their bailouts. Gold and precious metals have done well because of serious doubts regarding fiat currency systems. The dollar's weakness is a variant of this loss of faith. Investment decisions and business strategies must consider this changed world for now. ... The dollar may be a little oversold

Decoupling is a process: The US and Europe have not got the memo. Individuals in OECD countries may have written the memo on how total accumulated clout by this or that country is being diluted every day, but leaderships have let it sit on their desks, while too many members of society have frittered away their energies. At the same time China and many Asia and other developing countries, have continued to move forward, despite their own challenges. Decoupling is a state of mind as well as process. At some point, it will be measured in total influence measured by groups (socio-ethnic; organizations; clusters), with Asia rising up ranks rapidly. Less understood will be the impact in day to day changes (US military reach; hollowed out purchasing power of average American; lower real disposable income of Europeans; quality of second-tier and below schools in US; ongoing troubles of US transport system; debt/GDP ratios rising; taxes...)

There is an ongoing need to balance one's views between truth as one sees vs truth as market sees

This Conference Topic: Moving into China's Interior

- **Regular updates**
- **Theoretical underpinning for switch to China inland**
- **The challenges ... (political; economical; longer supply chain...)**
- **Some specific numbers**

Updater

- Recall at TOC Shanghai in 2010 we took a more positive view of containers, characterized by tightness and some market imbalance constraints (less capacity and containers)
- We also flagged continued good news for the Transpacific partly due to structure of US consumer and pockets of consumption support
- A lot of end '09 - 2010 rebound momentum is now fading in 2011 and we need to search for the REAL RUN RATE ex the crisis rebound (assuming no crisis repeat or no continued QE programs to QE5 ++...; more people are saying Bernanke & Co have to go)
- China import growth did see continued inbound spikes relative to export growth, but there is a need to look at volumes vs values

China Exports vs Imports, Jan '97 – Feb '11

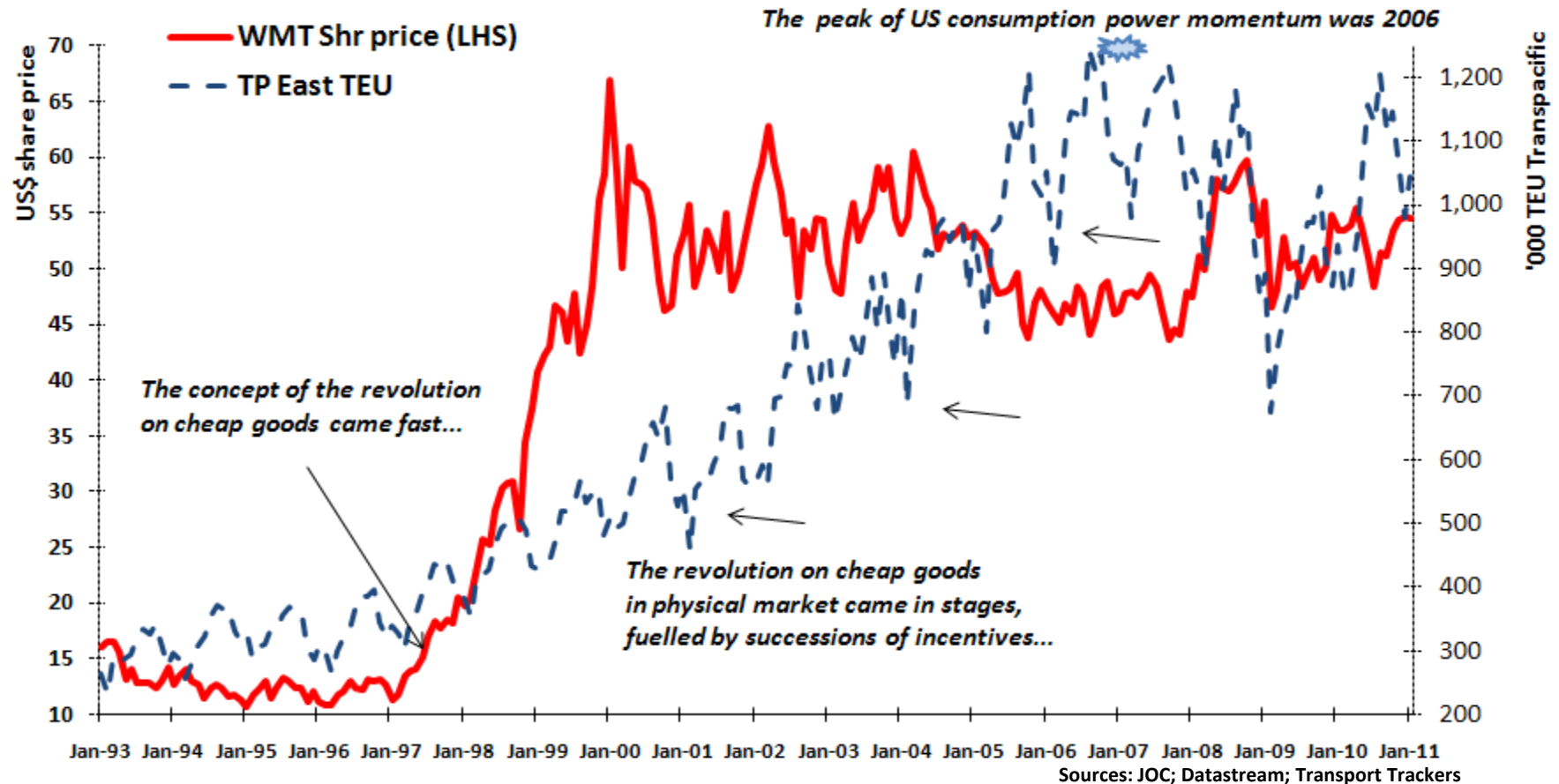
- The import surge in Feb '11 was CNY related and driven by higher commodity prices (which were partly driven by China... and partly by the Fed)

Trade balance...



Source: Bloomberg

1000 Words from this Picture: Wal-Mart vs Market

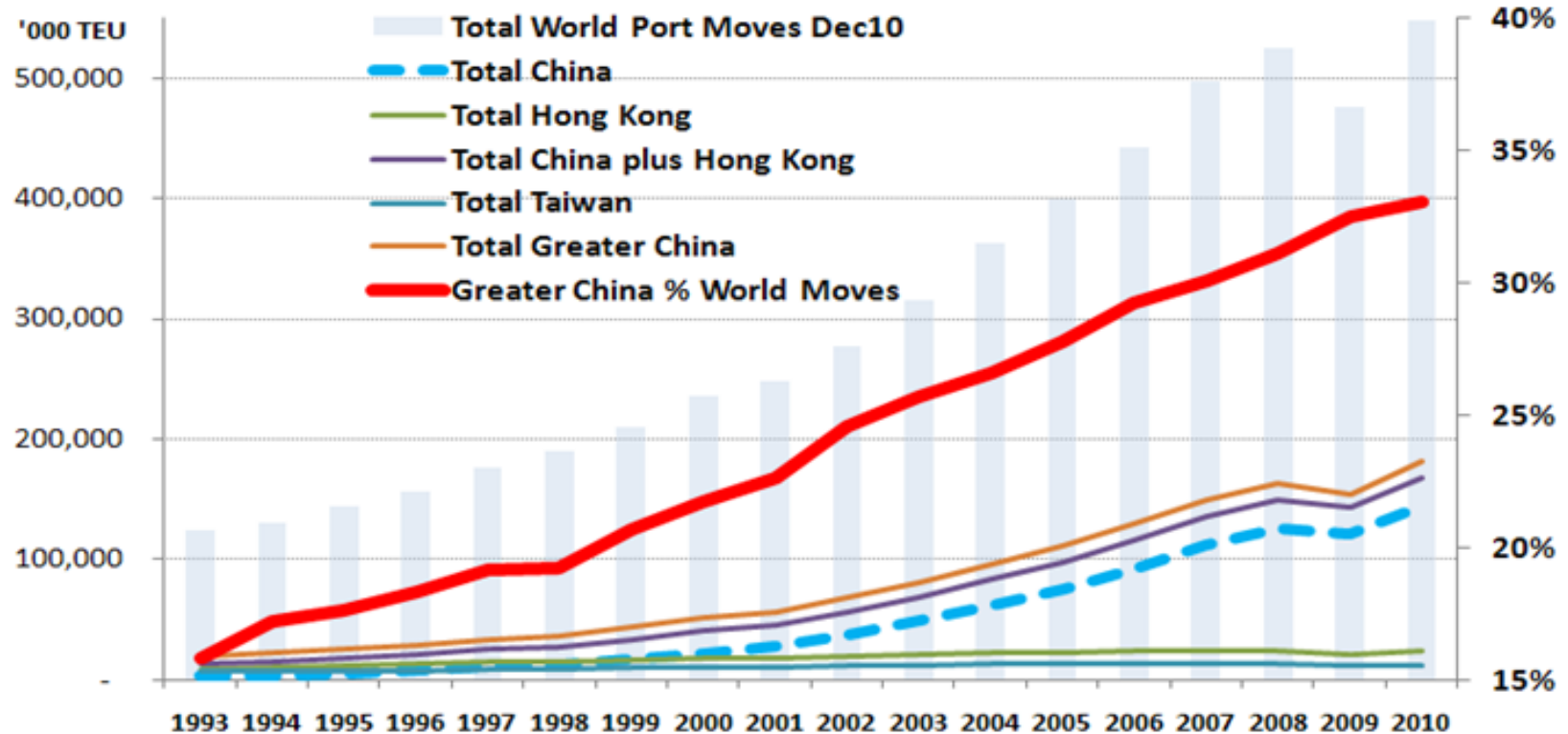


- The China cheap goods story was popularized by Wal-Mart in many respects
- Growth in the pipeline of cheap goods from China to US likely hit point of exhaustion around 2006
- So where will new growth come from?
- It must come from cheap goods or cheap goods and transport ... unless it comes from western countries reinventing themselves as producers of cheap goods

China Port Growth Prognosis: Reversion to a Mean...

- **From 1995 to 2010 Total China average port growth is 25%... Shanghai region 23% (last 5yrs: 13%)...Pearl River ex-HK 31% (last 5 yrs: 13%)**
- **For China+HK+Twn average growth was 14% against world ports, as measured by Drewry for most part, was 9-10%**
- **In same period HK port average has been 5% (and even that...)**
- **So we are looking at China about 25% and global about 10% growth, which has seen greater China ports make up one-third of world port reported moves**
- **In the last 2-3 yrs China port moves have been more in line with world moves ... with exception of smaller ports which are still in buildout phase**
- **The trend will be small ports can plot their own future if they are in the right growth channels for the next phase of growth**

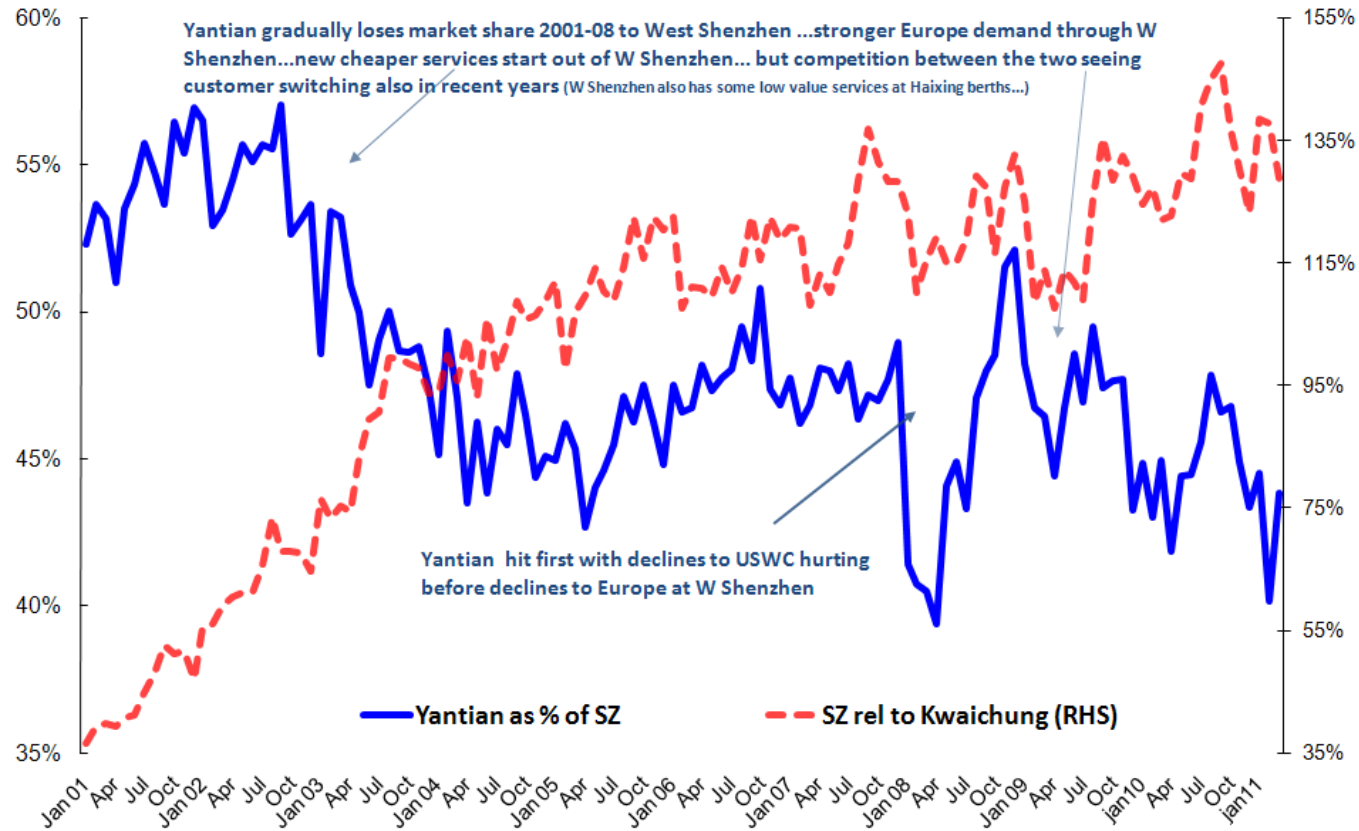
We've Seen This Story Many Times...



Source: Ports; Transport Trackers

- Greater China (including the slow growth parts) went from 16% (1993) to 33% (2010) of world port moves...implying it is harder and harder to grow faster than rest of world as you take up that larger share...But China will be shifting its trading patterns in coming years...**

% of Shenzhen Update... Yantian Stable in 40-45% Range



Sources Ports; Transport Trackers

China Top Container Terminals '000 TEU 1995 – 2010

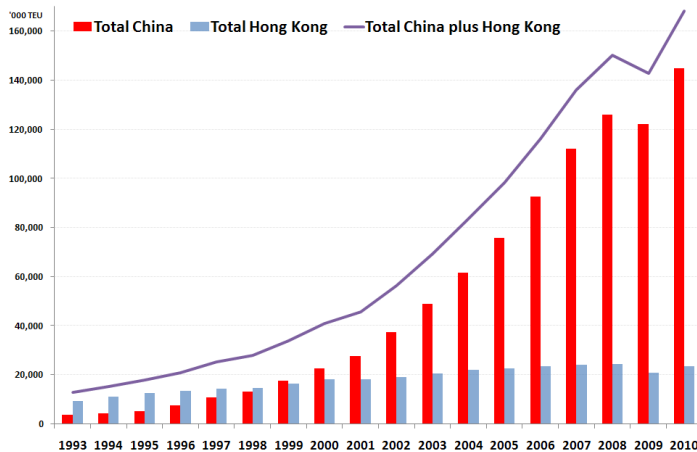
	1995	2000	2010
Shanghai	1,527	5,612	29,069
Shenzhen	257	3,993	22,510
Guangzhou	220	1,427	12,550
Ningbo	160	902	13,144
Tianjin	700	1,708	9,142
Qingdao	600	2,116	12,012
Dalian	370	1,011	5,242

The Problem for Mature Ports Like Shenzhen

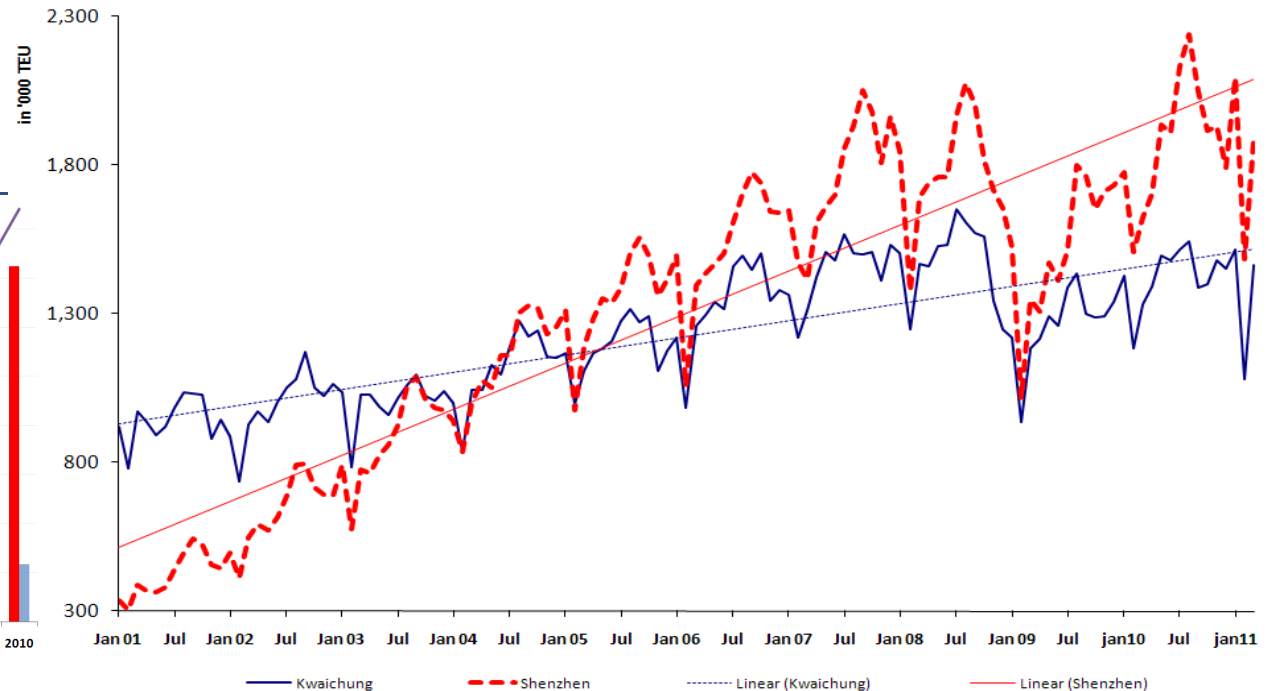
- Shenzhen's growth took off as it took market share from Hong Kong (red line bottom right)
- Next stage is not so much same growth but deepening of infrastructure services as S China manufacturing prices itself out of China market – raising port charges in Shenzhen and keeping HK competitive (or not) key
- Wal-Mart type buyers benefited immensely from places like Shenzhen...This story was over a little while ago (but the next stage could also be exciting for different reasons)
- **Why did KS Li extract value from S China ports now? (A: ... because he could and it was good)**

Shenzhen growth will slow too!

China 2010 145m TEU



Shenzhen Terminals at approx 2m TEU/month while Kwaichung at approx 1.5m TEU/month

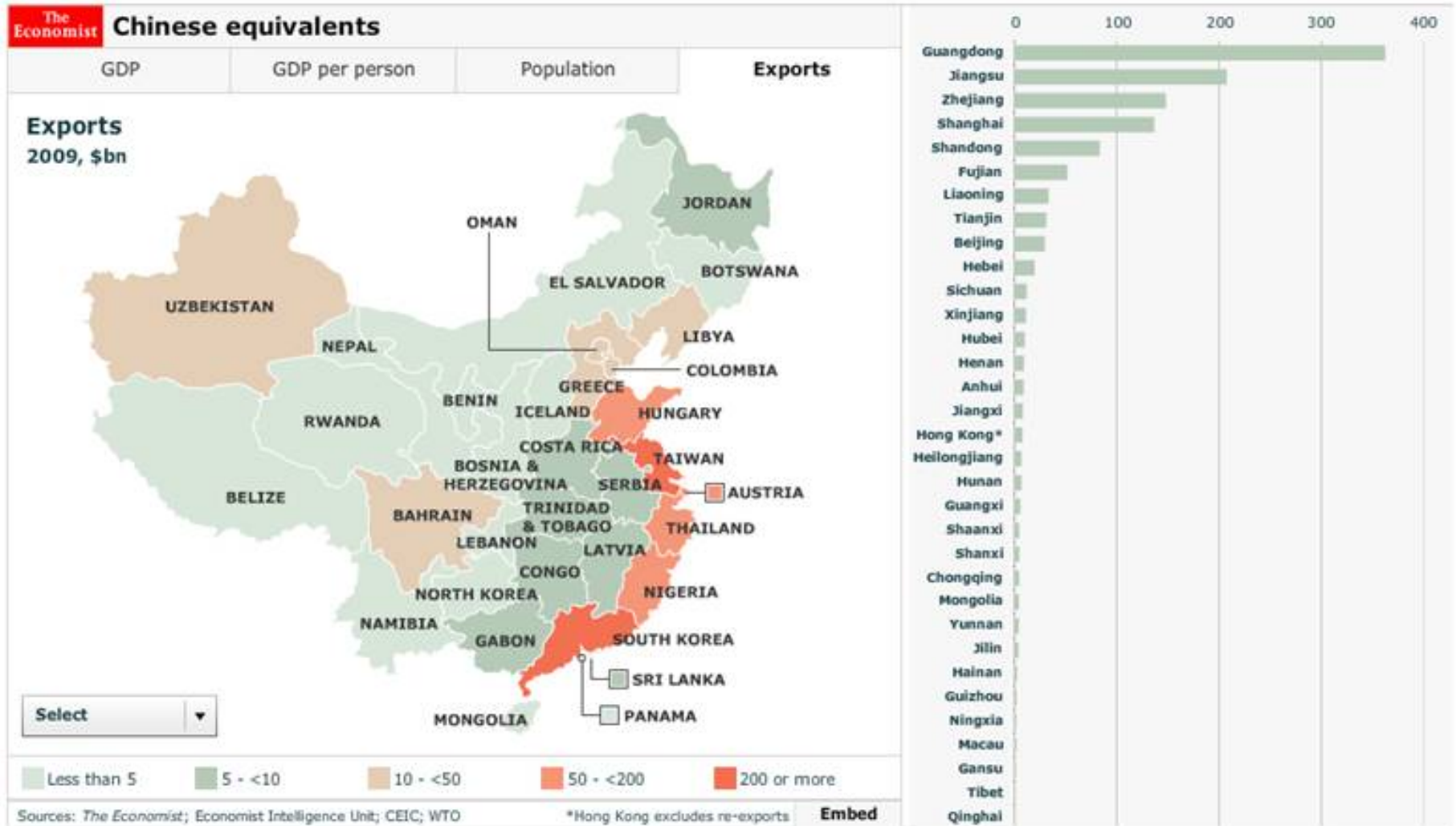


Why Did KS Li Sell Down HK+Shenzhen Ports in Sing IPO?

Some obvious questions...

- What does KS Li (also on behalf of Hutchison shareholders...) know that investors don't see re. S. China ports, or is he being a nice guy selling down about 75% in about 50% of cashflows (HK + Shenzhen portion of global) in the largest port operator in the world?
- Of course investors are getting relatively stable cashflow 100% pass through to dividends, sold to them at about 17x cashflows, if we use the 6% distribution yield as a guide... And of course the Singapore trust structure allows for retained control....
- But what will be the pattern of cashflow growth from S. China in coming years? How flat will it be? Could it be negative? Will S. China further lose its competitive edge to other parts of China? What about global growth coming down from previous 10% containerization levels?

China Current Coastal Export Power Graphical Representation



While on the Subject...

Economist cover 10 Mar 2011: Bamboo Capitalism



- The Economist's latest on the rise of capitalism in China...the key is always State vs private sector
- "Bamboo capitalism will have to change..." ...OK, got that one...
- About 70% of GDP from non-state controlled companies [using all agri and two-thirds of services as guide]...another estimate adds 75-80% of all profits are in private sector
- ...But they chose not to talk about foreign enterprises and their contribution to GDP or role this time round...
- OUR VIEW: Capitalism, and migration of export industry production machine is critical to what happens in developing inland China... There is nothing more important for success of China leadership than success of development of inland China – which needs support from foreign owned enterprises as well...

Check Out the Export & Import Top Cities 2010

Nanjing #3 in terms of USD total value of declared trade

...Hangzhou #12...Chongqing #15...Chengdu #17

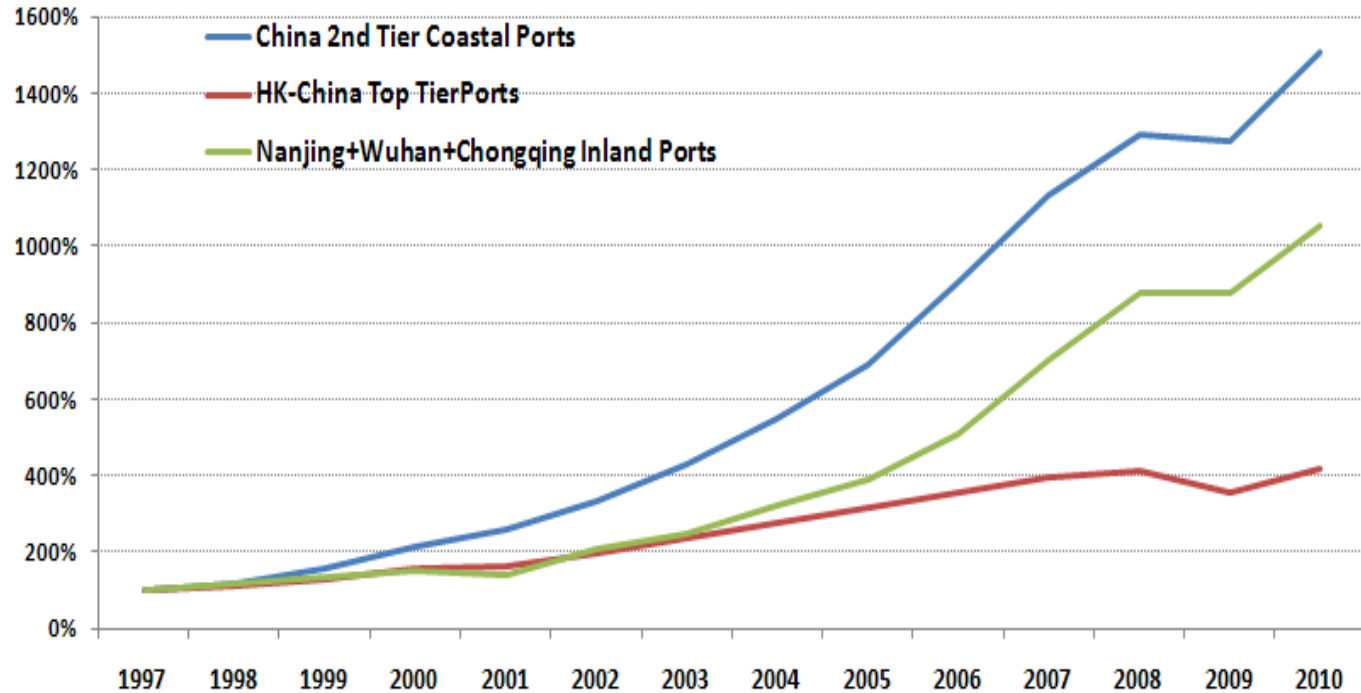
关别	单位：百万美元，%			
	出口		进口	
	金额	同比	金额	同比
全国合计	1,577,932	31.3	1,394,828	38.7
上海海关	423,191	30.3	261,307	37.3
深圳海关	286,033	31.9	189,511	39.6
南京海关	131,610	35.0	156,756	34.4
青岛海关	112,662	33.8	126,024	42.8
宁波海关	100,526	37.4	60,837	38.9
黄埔海关	91,979	23.3	89,105	37.6
天津海关	79,441	30.2	84,669	34.2
广州海关	56,217	31.0	52,672	37.5
厦门海关	53,074	33.7	32,054	48.4
大连海关	45,975	31.2	52,354	40.5
拱北海关	39,687	21.3	26,386	18.8
杭州海关	25,784	62.7	38,829	43.1
北京海关	25,329	21.0	46,572	27.6
乌鲁木齐海关	15,868	-0.3	11,717	86.0

关别	单位：百万美元，%			
	出口		进口	
	金额	同比	金额	同比
重庆海关	4,809	64.3	4,011	22.3
哈尔滨海关	4,211	57.2	2,006	38.6
成都海关	3,882	-0.3	11,238	51.3
南昌海关	3,558	50.5	6,148	63.7
昆明海关	3,529	44.7	1,740	10.5
湛江海关	3,107	42.1	18,115	46.6
长沙海关	2,452	24.7	4,100	34.5
西安海关	2,321	85.3	4,907	49.8
沈阳海关	2,153	24.8	4,750	40.8
海口海关	2,040	23.4	7,988	18.5
合肥海关	1,764	60.0	8,713	123.0
呼和浩特海关	1,399	47.3	3,825	54.1
长春海关	1,138	3.3	6,203	35.8
郑州海关	1,107	25.2	4,114	19.5
满洲里海关	869	30.2	8,941	46.1

Source: China Customs

3 Yangzi River Ports vs China 2nd and Top Tier Ports

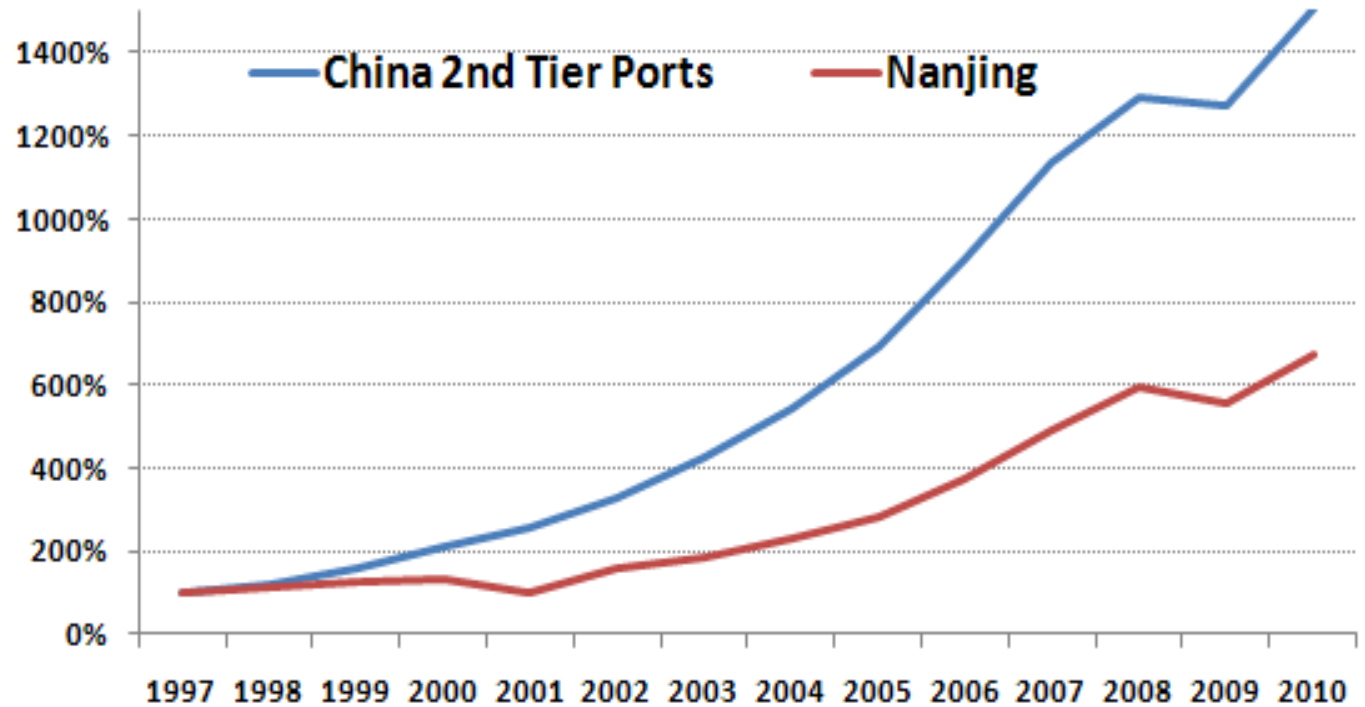
- HK-China Top Tier essentially S. China + Shanghai ... 'relatively flat'
- 2nd Tier ports including Dalian, Ningbo, Qingdao, Tianjin, Guangzhou & Xiamen have the best historical growth profile
- The Yangzi ports of Chongqing, Wuhan and Nanjing are more volatile and so far have underperformed 2nd Tier ports
- 2010 growth for all Yangzi ports officially at 9.08m TEU in 2010 (6% of China) and were +26% against China +19%
- Of 9.08m TEU, 2010 TEU foreign trade listed as 3.6m TEU and +19% on '09
- 2011 forecast is +20% growth to 11m TEU – 2m TEU more boxes going through Yangzi ports



Sources: Ports; Transport Trackers

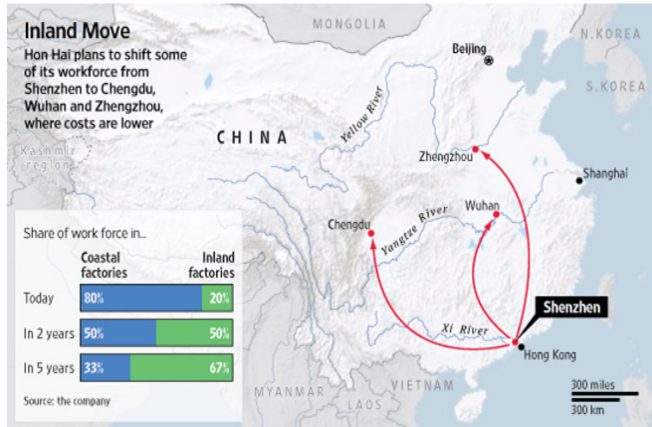
Nanjing vs China 2nd and Top Tier Ports

- Nanjing has underperformed 2nd Tier ports ...
- What will it take to catch up?



Sources: Ports; Transport Trackers

Movement of the People...



Source:WSJ

<http://www.la-croix.com/article/index.jsp?docId=2457605&rubId=4079>

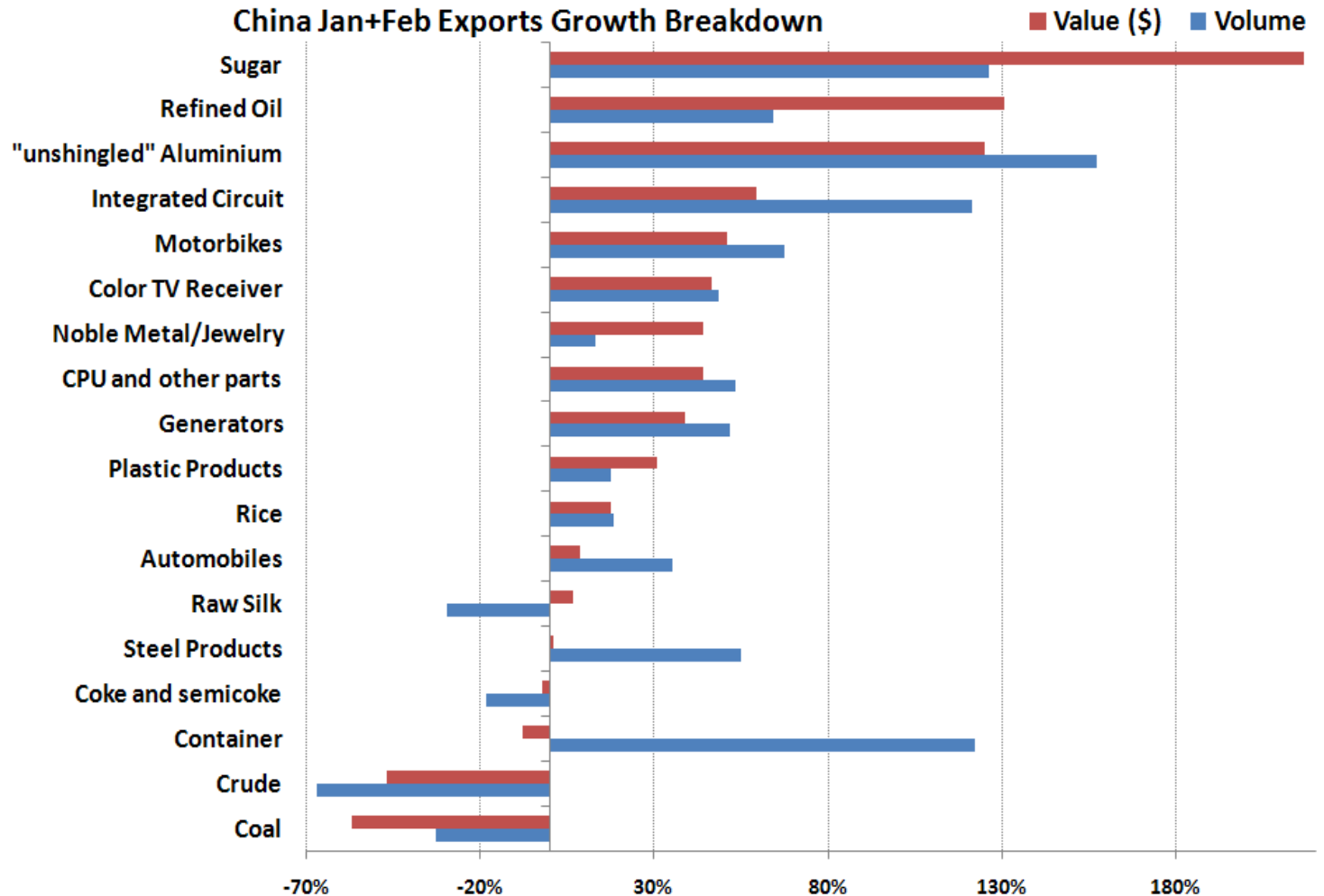
<http://www.taipeitimes.com/News/biz/archives/2010/08/03/2003479495>

Reworking China from the Inside

- One trend highlighted by several (XRG and others) is the big move inland... and the dismantlement of factory dorms and the re-integration of these workers into city life
- Food inflation in early '11 running 10+% and wages +10-20% in S. China (Guangdong minimum wage +19%)
- For instance, some Foxconn (Honhai) workers migrating to Henan (Zhengzhou). If built out, this will be a big movement of people, given the firm has some 0.8m employees
- But also, in general, some Dongguan or even Shenzhen workers may stay closer to home. Workers will put down roots in cities and suburbs instead of dorms. It will take several years. But it will change consumption patterns and contribute to increased retail sales in its own way
- Implications for changes in consumption and transport patterns are numerous
- Supply chains will be lengthened, with some communication points more difficult ... and with potential for upgrades

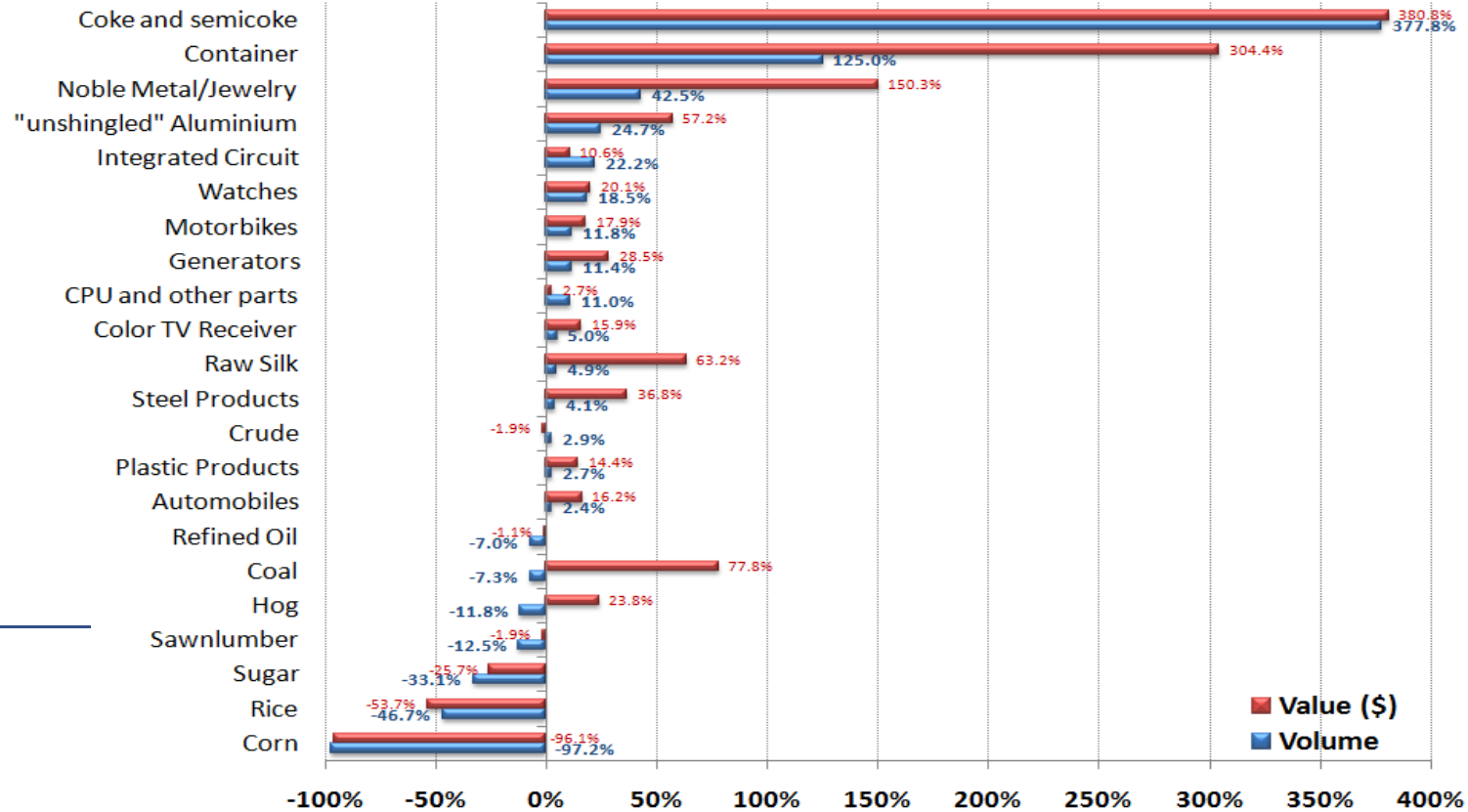
What China Exports Look Like Jan-Feb 2010

1Q10 View: China Exports and Imports Feb10 Update– We looked at the volumes vs value rather than merely the value. Exports volume growth for sugar and petroleum products is a lot less by volume than value. Note the volume of container exports is up about 120%... Note crude oil and coal exports are down, which is and was expected...



Sources China Customs

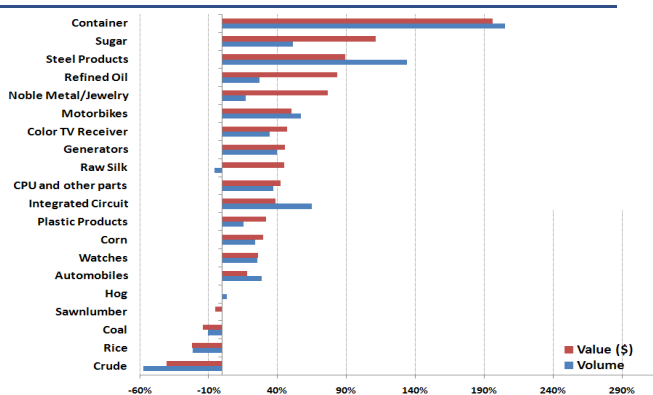
What China Exports Look Like Jan-Feb 2011



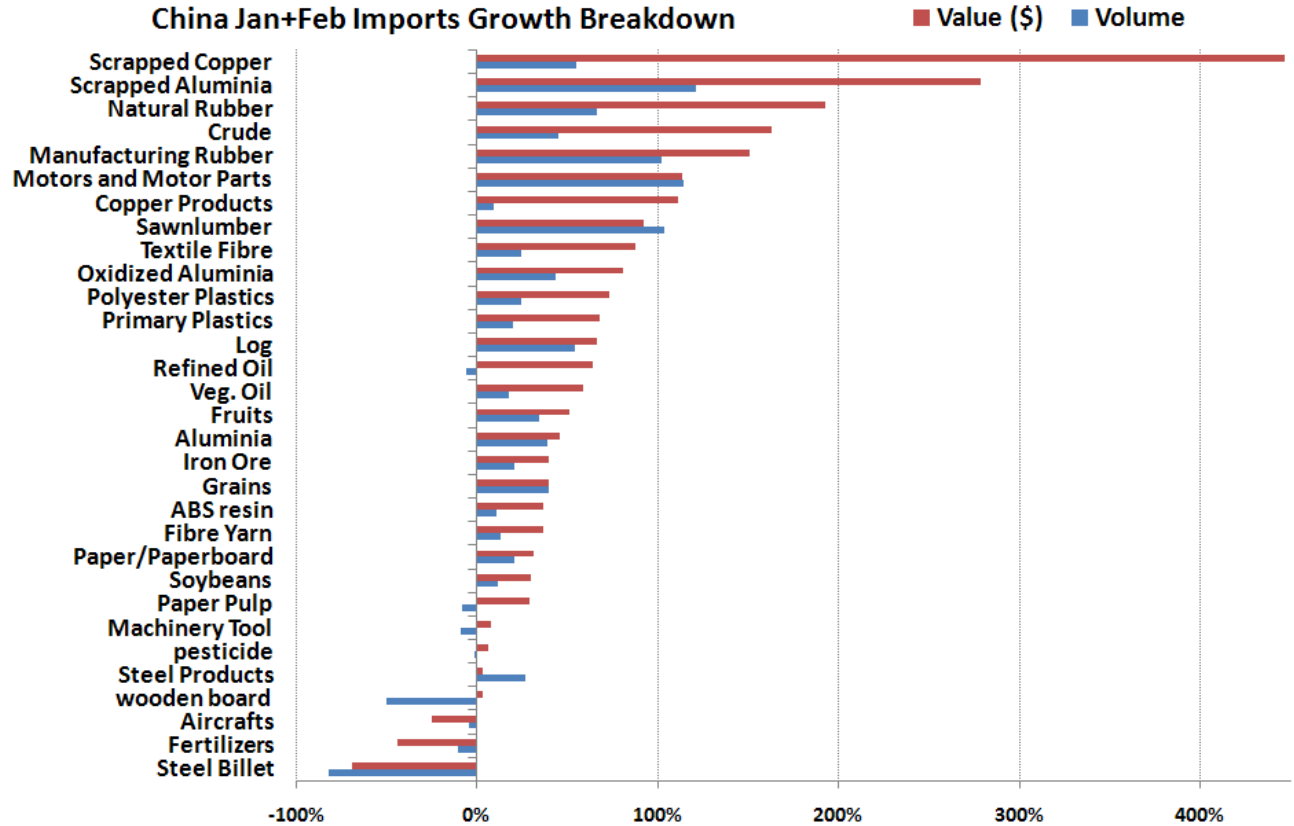
Sources China Customs

Value (\$) Volume

China Exports Jan-Aug '10

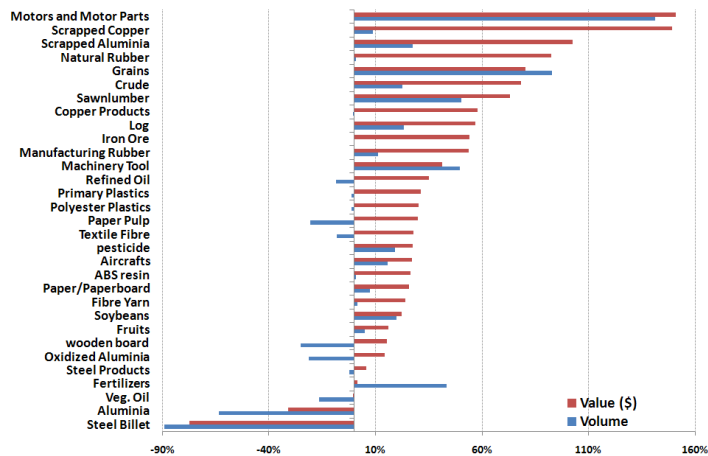


What China Imports Look Like Jan-Feb 2010



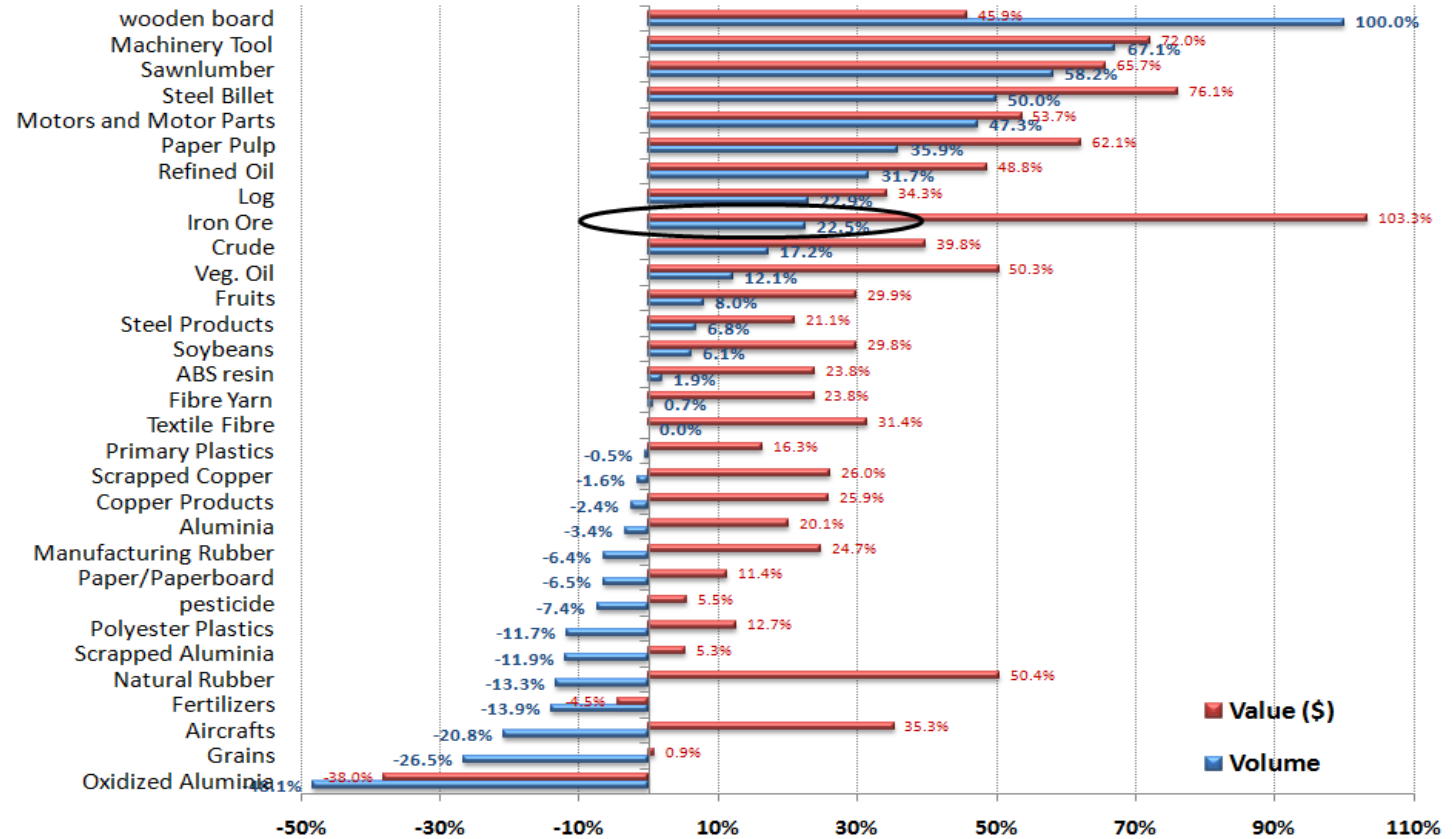
Source: China Customs

China Imports Jan-Aug '10



What China Imports Look Like Jan-Feb 2011

On the imports side, the problem is commodities price inflation with items like iron ore far higher in import value terms than volume terms...Textile fibers cost over 30% more to import this year compared to same time last year



Source:China Customs

Back Page Selections ...

China Ports in Perspective, 1995 - 2010

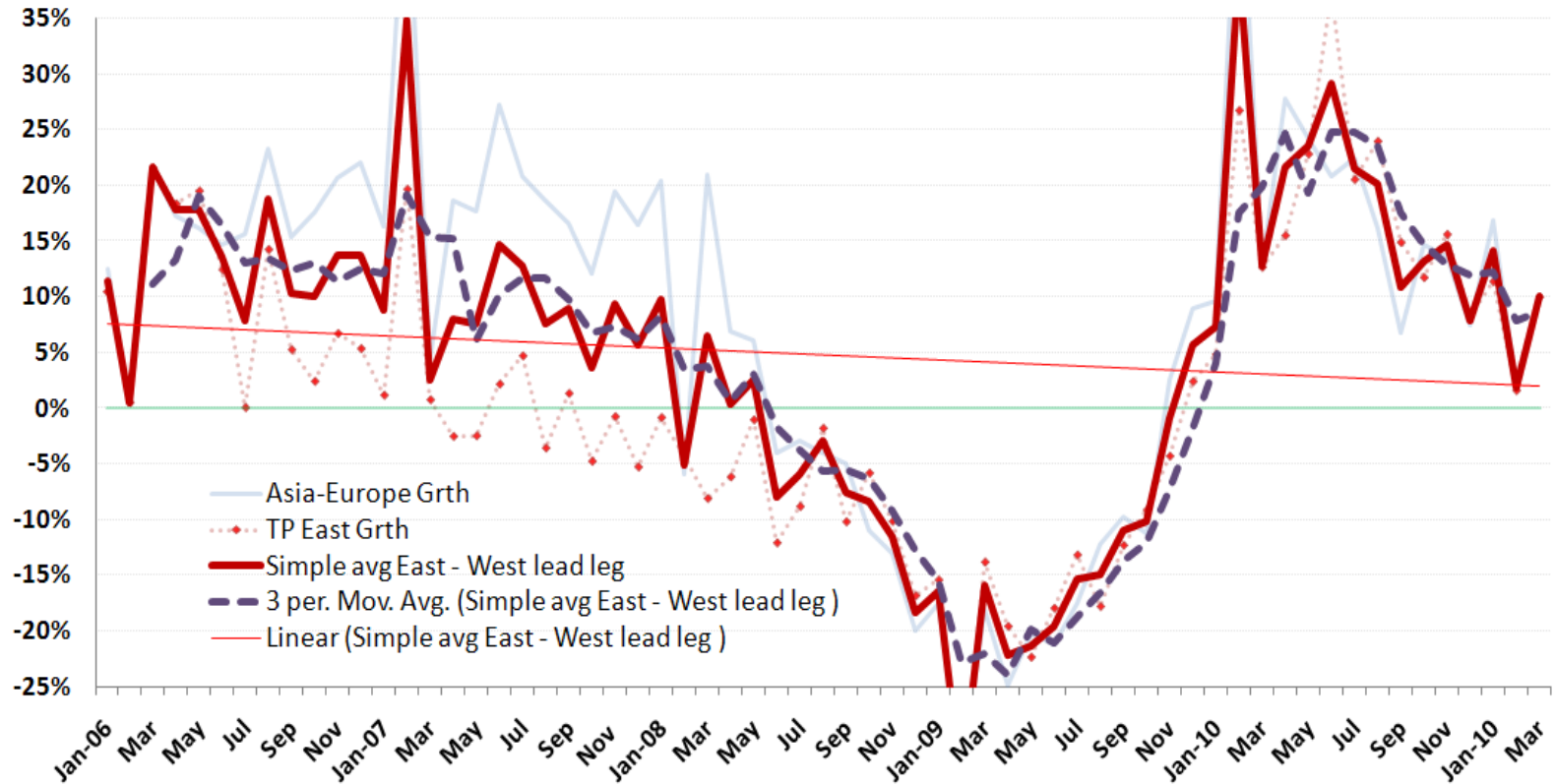
in '000 TEU	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
China top 9 (10)	3,793	17,654	21,246	28,740	36,918	47,672	58,579	73,714	89,175	97,974	91,603	107,889
Total top China ports	4,893	19,082	22,768	30,730	39,172	50,709	62,693	78,724	95,490	105,488	98,613	116,619
Total China TEU '000 (not adj for small internal ports)	5,160	22,680	27,500	37,210	48,700	61,600	75,640	92,524	112,000	126,000	121,970	144,710
Total China Coastal ports (mn tons)	802	1,256	1,426	1,666	2,011	2,437	2,891	3,362	3,859	4,296	4,755	5,445
Total China Exports in US\$m	148,780	249,200	266,100	325,600	438,230	593,326	761,953	968,960	1,217,760	1,428,539	1,201,946	1,578,400
Total China Trade in US\$m	280,860	474,290	509,650	620,770	850,990	1,154,555	1,421,906	1,760,410	2,175,359	2,561,961	2,205,822	2,972,760
Total China plus HK	17,710	40,778	45,486	56,351	69,149	83,532	98,242	116,063	135,998	150,248	142,953	168,259
Total Taiwan	7,670	10,427	10,541	11,609	12,071	12,978	12,791	13,108	13,727	12,971	11,710	12,740
Total Greater China	25,380	51,205	56,027	67,960	81,220	96,510	111,033	129,171	149,725	163,219	154,663	180,999
Total World port moves 3Q/4Q10 (ests)	144,200	235,621	247,526	276,557	316,029	362,793	399,368	442,400	497,700	524,700	475,900	548,000
Total China as % of World	3.6%	9.6%	11.1%	13.5%	15.4%	17.0%	18.9%	20.9%	22.5%	24.0%	25.6%	26.4%
Total Greater China as % of World	17.6%	21.7%	22.6%	24.6%	25.7%	26.6%	27.8%	29.2%	30.1%	31.1%	32.5%	33.0%

Sources Ports; Transport Trackers

Market Vol Direction...Deceleration from Rebound High

Core East – West Trades...Asia Outbound

2010 rebound was assured, 2011-12 run rate 4-8% long haul?...not 10%?...2011 initial growth 5% not 8%?



Extra Credit (Oct 2010 un-revised, except where noted)

- Total world financial assets about **\$180trn** (**\$200trn end 2010 estimates**)
- Total world GDP around **\$60trn**
- Total cost of financial crisis **\$60-200trn**, according to Andrew Haldane
- Total global derivatives outstanding about **\$600trn**, according to some, down from about **\$700trn** pre-crisis
- Net derivatives position estimated at about **\$30trn** by GC
- Total mkt cap of equities worldwide about **\$50trn**, according to current prices
- Total mkt cap of a typical pan-Asia fund's addressable universe: **US\$ 12.4trn**, according to SL
- US national debt about **\$14trn**, but some claims rise to **\$100trn** based on unfunded liabilities
- World consumes **\$2.3trn/year** of oil in 2010E, approx, based on about 85mpd and recent avg prices
- Iron ore in 2010E **\$200bn/year** approx, based on about 1.6bn tons
- Steam coal approx **\$60bn** on 630m tons moved and coking coal **\$60bn** on 280m tons, on shipping ests
- Total coal market value annually **\$600+bn** range (7.2bn tons one est)
- Steel output in final shapes estimate at about +/- **\$1.0trn/year**, based on about 1.4bn tons '10E (China 0.64bn)
- World fleet delivered and orderbook are about **1+\$trn**, based on rough estimates
- Total copper production in 2010E **\$147bn/yr** based on Simon Hunt estimate
- Total asset value of US agricultural land, including buildings worth about **\$1.8trn** w/ low debt (**2007 \$2.2trn**)
- All gold mined worth about **\$7trn**, w/ about 20% ratio un-mined to mined, based on many discussions...
- All silver mined based on 40bn ounces is worth about **\$800bn** (**\$1.3bn Mar 11**), based on market prices/websites

Key Trade Relationships Checklist (2009-10)

- ✓ Dollar down → commodities run... CHF, JPY, CAD, AUD, etc rise/defensive
- ✓ Low interest rates → stimulates growth & commodities
- ✓ Banks tighten credit → marginal projects collapse/face strain
- ✓ Bank flood of paper → money supply & liquidity rise
- ✓ Pump Priming → resurgence of inflation
(risk is too much inflation even if escaping deflation initially desirable...lots of debates here)

- ✓ Shipyard output up → steel plate demand and prices up
- ✓ Shipyards overproduce → lag effect, but net capacity up
- ✓ Net ship capacity up → utilizations fall, rates/earnings fall
- ✓ Ship earnings fall → scrapping rises...scrap steel supply rises
- ✓ Net capacity down → utilizations, rates/earnings rise

- ✓ Deflation means less dollars in a box (We got this from China for a long time)
- ✓ Inflation means more dollars in a box (we don't even remember what this is in terms of impact on box contents since this was in 80s when containerization...)
- ✓ **CURRENT OBSERVATION OCT 2010/MAR 2011: Dollar is a little oversold due to QE2 fears (which has helped gold ... and other precious metals make successive highs). The problem is dollar has been used and abused by the Fed/US officials as part of a kick start US economic engine/save US financials... strategy...No shift yet but debate over when interest rates start to rise remains active....**

Structural vs Cyclical

Current long term

- ✓ \$ decline (despite cyclical rebounds)
- ✓ Rise in deficits globally
- ✓ Rise in asset prices and commodities
- ✓ Manufactured goods deflation
- ✓ Rise of China, Asia... "new" economies

Next facet of the long term shift (... a shift in the mix)

- ✓ US consumer/government more restricted by balance sheet (despite some cyclical rebound)
- ✓ More rapid development of new cities and clusters in China (away from coastal China and Guangdong...but sometimes slow changes...)
- ✓ Move away from Western Banks and Western Shipowners to Asian and others

Three Main Parts to Ideas/workflow....

- Matt Flynn (Flynn Consulting) and Charles have cooperated on projects since the mid-90s. Matt worked at Dow Jones and Lloyds List as a reporter, before starting his firm as well coordinating Worldyards as MD. Worldyards is a standalone shipbuilding database and product, and has worked with TT as research partner. Flynn Consulting has a fully staffed Shanghai office as well as access to a global team of economists
- Demetrius Yuen (PS Central) worked together at Kerry Securities in the early-90s, and kept in constant contact as Demetrius worked for Standard Chartered and then Hutchison Ports...before founding PS Central in 2H09
- Gavekal relationship has grown over the last few years, including cooperation on a few seminars and projects. Transport Trackers join Gavekal Research morning meetings and contribute ideas on the periphery of Gavekal global macro work

Transport Trackers....Who We Are

- TT works exclusively for core clients
- We channel the thinking power of many contributors
- We convert industry work into equity applications
- Our research is group think averse
- Long term mission to increase industry transparency
- TT website is introductory portal (industry role for expressing basic views)
- One good idea/project a year pays our fees
- Asset valuations and cashflow are two most important features
- Macro series track back to 70s/80s in most cases
- Model portfolio for internal use and discussions
- Flynn Consulting ad hoc studies
- PS Central new project
- Contributors and core team due diligence
- Deal and corporates independent advisory