

The Perspective of Investment in Shipping and Logistics

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Good afternoon, ladies and gentlemen,

It is extremely interesting to talk about investing in China today here in New York. I must say, this forum has proved itself to be an excellent platform to meet and facilitate discussion between members and non-members of the Metropolitan Club. I am happy to see so many friends coming in to explore business opportunities in China.

Due to the increasing free flow of funds, labor and commodities, China has become a place where most of the Fortune 500 companies have stepped in to explore investment opportunities. I know that there are many institutional investors, private investors and multi-national companies that have, or are ready to invest money in China, in search of good returns. As you know, COSCO has been in the shipping and logistics business for 45 years. Today, I would like to take this opportunity to share with you our experiences in developing business in China, especially in the shipping and logistics sectors.

- **(Globalization creates huge demand for shipping and logistics services)**

Globalization of the world economy has led to fundamental changes of the international economic framework. The economy today is experiencing more trade activity, growth of cross-border investments, and there is higher dependence between different countries. In terms of global trade patterns and the economic environment, we are experiencing three structural changes.

The first is an international industrial structure change. Mainly due

to the cost of resources and labor, developed countries are more focusing on technological development, leaving the manufacturing and processing to the developing countries. Most Asian nations and NIEs such as BRICs countries are in the process of industrialization.

The second change has to do with investment patterns. Globalization has facilitated the free flow of capital to where it can be best used and yields the best returns. Nowadays the total capital flowing overseas is close to 8 trillion dollars. In the past, developed countries tend to invest amongst one another, but now they are allocating more of their investment into promising developing countries, such China, India etc. We can see that many foreign investors have already begun to reap their “fruit” and realize substantial gains.

Following the above change in investment patterns, the global trade structure is also changing gradually. Asian countries have seen their share in global trade increasing as a result of economic growth and an increasingly open economy. Back to twenty years ago, Asia was largely regarded as a region exporting raw materials. But today, Asia has become the factory of the world by importing huge amounts of raw materials from all over the world, processing them, and then exporting manufactured goods to other places. Developed countries are importing most of their daily consuming products from NIEs.

● **(Opportunities for shipping)**

The shift in world trading patterns created a strong demand for transportation. However, the global shipping industry was not prepared for such sudden fundamental change, the supply of shipping was very tight due to the insufficient investment in the shipping industry. So starting from the second half of 2003, the shipping market started to boom, all three major shipping sectors – container, dry bulk and tanker, started to rise tremendously.

The years of 2004 and 2005 have already been marked as milestones

in shipping history. To put this in conventional finance terms, the global shipping industry was enjoying a “bull” market. The potential demands for international shipping were the major factors revitalizing this traditional industry. All major shipping companies have shown significant growth. In particular, many container shipping companies, which had been struggling through a period of operating deficits, were able to book exceptionally large profits. We could see heavy order book for new buildings, expansionary projects of major shipping lines, and exceptional cash flow to this industry.

According to Lloyd’s List, IPOs of shipping companies in the international capital markets jumped from 313 million dollars in 2003 to 4.4 billion dollars in 2005. Year 2005 could be described as “the Year of Shipping IPOs”. Meanwhile, in the capital markets, shipping stocks performed better than the Standard & Poor Index based on research report of Merrill Lynch, for example, in May 2006, the break bulk companies’ stock price increased by 445%, tanker companies’ stock price increased by 216.8% and container companies’ stock price increased by 88.3%, compared with that in May 2003. Ship financing is becoming more and more active now, the German “KG” scheme and the UK Lease market has shown unprecedented activity. Merger and acquisition activity within the shipping industry has increased dramatically, as companies strive to achieve both vertical and horizontal integration.

● **(China’s role)**

During this unprecedented boom, China was the attention of all. With an average economic growth rate of 9.4% over the past 25 years, China’s GDP is currently ranked No.4 in the world. In 2005 the growth rate was 9.9% with GDP reaching 2.23 trillion dollars. Although this accounts for just 4.4% of the world’s total, the country’s contribution to the growth of world economy was around 17%. China’s economy is heavily dependent on trade. Some would argue that our dependence on foreign trade to be around 70 %. In

2005, China's total value of foreign trade reached 1.422 trillion dollars with an annual growth rate of more than 23%. Though China only accounts for 7% of the total world trade in terms of value, its volume plays a far greater role for shipping market, given the levels of resources and energy imports as well as manufactured product exports. It is estimated that, in 2005, China contributed more than one third of the global growth of cargo trade. For example, China's imports of iron ore account for more than 40 % of the whole world's exports.

● **(Looking to the future)**

Shipping is a cyclical business. The accumulated unbalance between supply and demand pushed the shipping industry to optimum profitability in 2005. But, with increasing investment into the industry, the tight supply/demand balance has relaxed, and the summit achieved last year will not be easily repeated this year or the next. So the question is how and where the shipping industry will go?

In my personal view, the shipping industry will maintain sustainable development in the coming years, though the growth would not be as rapid as that in 2005. The reason lies with the future outlook of global economy and trade. The International Monetary Fund predicts that the global economy will grow at an annual rate of 4.2% during 2006-2010, relatively higher than the past five years. The three major economies, US, Japan and European Union are recovering; developing countries, headed by BRICs, still show great potential of development. In the case of China, we are expecting a 9% growth of GDP and 25 % increase of trade this year. With the wide-spreading free trade practice, seaborne trade will maintain sound growth. For sure, high oil prices, trade friction and other unforeseen factors will continue to create volatility within the industry.

● **(Where are the opportunities for investment?)**

Here I would like to share with you some profitable growth

opportunities for shipping and logistics industry in China. I do believe that this topic would be of great interest to everybody sitting here in this room.

One of the investment opportunities would be with energy and resources transportation. Presently, China is the top consumer of iron and steel, copper and iron ore, the largest soy bean importer, the second largest consumer of crude oil and aluminum, etc. Furthermore China has started to build up its own strategic oil reserves. By this June, the first shipment of LNG (Liquidized Natural Gas) tankers will be delivered to Guangdong. China will attach greater importance to the development of the national tanker and bulk carrier fleet to meet the ever increasing demands for energy and resources, as well as pipe transportation.

Insufficient port facilities have become a bottleneck to the development of shipping. Quite a few major ports in the Far East, North America, Australia, and South America have experienced serious congestion. The deployment of larger vessels and the growth of trade between Asia and the east coast of America have led to the expansionary project of Panama Canal, which would cost an investment of 5.25 billion US dollars. Although having 8 “mega ports” with an annual capacity of over 100 million tons each, China still suffers from inefficient distribution and service. It has been reported that Chinese ports are now experiencing the worst congestion in the past 20 years. As a response to this situation, China’s 11th Five-Year-Plan will see the construction of five large coastal port clusters, which are located along the Yangtse River Delta, the Pearl River Delta, the Bohai Rim, the Southeast coast and the Southwest coast. During the same period, large-sized and specialized terminals such as crude oil terminals, LNG receiving facilities, iron ore terminals and car carrier terminals will be constructed.

Apart from specialized terminals, the specialized fleet is also in high demand. As China has started to export cars and trucks, there will be potential opportunities for car carriers; demand for carriers of timber will be derived from the demand of pulp and paper; China, as the largest producer of cement, will demand specially designed carriers for its export of bagged and bulk; huge investments in infrastructure will produce demand for asphaltum imports.

While China's inland infrastructure has developed quickly, it is still insufficient to support the current pace of trade development. According to estimations by the Chinese government, the total transportation and logistics cost corresponds to 20% of GDP in China, while only 10% in the United States. The American Chamber of Commerce reports that the cost of logistics in China makes up at least 16% of overall product prices. Moreover, it often costs more and takes longer for a container to be shipped from Sichuan Province to Shanghai than from Hamburg to Shanghai. Restrictions of inland transportation and logistics facilities will become an obstacle for future growth. So in the 11th Five-Year plan period, a total of 10 billion RMB will be invested to improve the Yangtze River navigation route, modernize the "golden waterborne channel" and better meet the demand of economic development along the river. The investment will be used to upgrade shallow waterways, integrate information of navigation routes, equip dredgers and the maintenance of ships, construct and update hydrological systems as well as to improve the adaptability of navigation routes. Another example would be the Grand Canal dredging and navigation improvements. Furthermore, port facilities along the rivers would be further improved. This explains why there has been substantial foreign investment flowing to the central and western part of China.

Another invest opportunity is in the ship building and repairing industry. Europe has transferred its shipbuilding industry to Asian countries. China now ranks the third largest ship building country,

delivering vessels totaling 12.12 million DWT last year, which was a 42% increase compared with year before. The Chinese government is aiming at becoming the largest shipbuilding country in the world by the year of 2015. At the moment there are about 70 shipyards in China, the majority of them are now able to offer newbuildings with high quality and competitive prices. China's ship building industry is currently improving its competitiveness to gain more market share. Furthermore, China's ship repairing industry is beginning to take up the leading market share in the world. Ship repairing is a labor, capital intensive industry. In order to be a major player in the world ship repairing market, China intends to upgrade its competitiveness by adding capacity, improving conversion capabilities and marine engineering projects, such as FPSO (Floating Production, Storage & Off-loading).

Facing the changing business environment, shipping companies have adopted two integration approaches in their business models, horizontal and vertical. "Horizontal integration" could be done through carriers' alliances or mergers and acquisitions to enlarge their operational scale and reduce costs. Three major mergers were announced last year. However, even greater changes have been observed through vertical integration. By consolidating with upper and lower stream resources in the supply chain, ocean carriers are able to provide integrated or one-stop services. This is also the case with terminal operators; we have seen a lot of press coverage regarding this. These consolidations have had a significant impact on the shipping and logistics industry. All these integrations require involvement and encouragement from investors.

Shipping is an ancient industry, but with the development of science and technology, shipping is changing. Containerization has already changed our trading practices. The second revolution of shipping, I would like to name, is likely to be information technology. With large vessels and more complicated network systems handling

millions of boxes and parcels, shipping lines and logistics providers need to integrate and handle information. [The streamlining of this information will also facilitate the operations of foreign exchange and commodities traders through a more efficient and user-friendly platform]. To reduce trading costs, portals and E-market place have been developed. With the increasing use of E-commerce, carriers, shippers, brokers, forwarders, agents, custom houses and stevedores can communicate more easily and promptly. As a result, investments in IT implementation by either shipping lines or independent investors have become popular.

● **(Introducing Cosco)**

Finally, I would like to say something about my company. We started our business from 4 small ships in 1961 and have grown our business to become the world's second largest shipping company with a fleet of nearly 38 million tons in terms of DWT capacity. We now keep the largest fleet of bulk carriers with very strong market operation ability. Our containers business was listed in Hongkong last year and very competitive in China related markets. Other ships include tankers, multi-purpose ships, heavy-lift carrier and project cargo carriers. LNG carriers will be added to our fleet soon. In addition, our terminal operations, shipbuilding and ship repairing businesses are performing quite well. COSCO Pacific, is now the fifth largest terminal operator. In ship repairing business; we are building new dry docks and new repairing facilities in key coastal areas of China. We only started our ship building business 10 years ago through a joint-venture, but it has achieved significant performance results, the key indicators of its productivity and technology are widely used as a benchmark in China.

COSCO controls seven listed companies, which are listed on the Singapore, Hong Kong, Shanghai, and Shenzhen stock exchanges. The listed assets accounts for more 50% of the group's total assets.

To improve the service to customers, COSCO has invested heavily on IT infrastructure. Five years ago we spent one billion RMB to build our container business IT system-IRIS-2 (Integrated Regional Information System). Now the system has been fully integrated and is operating well, enabling our customers to manage their cargo at their own desk.

COSCO is open to cooperation. In the liner business, we formed “CKYH” to share capacity with three Asian carriers. Now “CKYH” has already become the largest shipping alliance in the industry. We are developing strategic partnerships with cargo interests. A lot of well known companies are our strategic partners, such as Wal-Mart, GM, BAOSTEEL, etc. At present, COSCO is trying to implement two fundamental transformations, which is, to be a shipping-based global logistics operator, and a multinational corporation.

At last, before ending this speech, I would like to say, shipping and logistics may be challenging, but full of opportunities. The Shipping and logistics industry is critical to China. A more open and dynamic shipping and logistics market in China is now ready to welcome investors all over the world to come and further investing. COSCO will be happy to cooperate with all of you.

Finally I would like to promote World Shipping (China) Summit 2006. Together with Drewry shipping and Journal of Commerce, we successfully held 2004 and 2005 annual conferences. This summit also got support from BIMCO, INTERTANKO, INTERCARGO and other organizations. This year, on November 2nd and 3rd, the summit will be held in Shenzhen, China with the topic of “Managing Changes”. We would like to welcome all of you to be there.

Thank you very much.