

THE IMPORTANCE OF CHANGE IN THE TRANSPORTATION INDUSTRY

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At 99th NITL Annual Conference

Ladies and Gentlemen :

Good Morning.

It is my great honor to be invited by the National Industrial Transportation League (NITL), Intermodal Association of North America (IANA) and Transportation Intermediaries Association (TIA) to speak here. First of all, on behalf of COSCO, I would like to give my warmest congratulations to the opening of the meeting and wish you all a great success.

I would like to quote one of the great innovators of the transportation industry, Henry Ford, when he said:

“Coming together is a beginning”

“Keeping together is progress”

“Working together is a success”

We obviously have a good beginning, as we have all come together at the start of this conference. As long as I keep your interest for the next 25 to 30 minutes, it looks like we will achieve some progress today. Success however is a little more difficult to achieve. Shippers and carriers have to work together to move cargo in the supply chain from one area to another. The ease and harmony in which we work together however should be improved. Despite the industry

buzzwords like “partnership”, the reality is that historically, our working relationship has been almost totally dictated by supply and demand and can be compared to roller coaster ride. Some years the shippers are on top and can demand rate decreases while other years the carriers take that place and can achieve rate increases. On a roller coaster ride there are some people who will be feeling exhilarated, while others will be feeling the horrible effects of motion sickness. It is not a very stable model for a good working relationship. I would like to change the pattern of shipper – carrier working relationships from a roller coaster like relationship to a relationship similar to a highly tuned sports car on a newly paved, even road.

In a highly tuned sports car, you know what to expect. Now this may not sound as exciting as the roller coaster ride but in the end a more predictable relationship will benefit both shippers and carriers in planning, building for the future and improving the global supply chain.

I. The World Shipping Industry Thrives on Change

Starting from the turn of the Century, the world economic arena has experienced a tremendous transformation. The business climate appears to be different from what we encountered in the past, as global integration and regional cooperation are becoming the mainstream. Cyclical rules in the market over a decade ago are no longer adaptable today. What we are actually witnessing is change. As far as

the shipping industry is concerned, there are at least three remarkable changes that are worth mentioning.

A. World Economic and Trade Structures have undergone dramatic changes with demand

As a result of globalization, since the mid 1990's, world economic and trade activities are experiencing three structural changes. The first one is national industrial structural change. Service industries are booming quickly in developed countries, but their traditional manufacturing industries are moving overseas. The second happens to cargo structure. Primary products of bulk raw material continue to grow steadily, along with high value high tech products. The third change is in trading region structure. The gravity of world trade is moving towards Asia Pacific. Asian countries are growing their shares in global trades as a result of economic growth and a more open economy. Twenty years ago, Asia was largely regarded as a supplier of raw materials; today, Asia has become the factory of the world.

Global industrial restructuring has had a profound impact on the international shipping industry. To be more specific, global industrial restructuring led to changes in world trade patterns that created strong shipping demands, causing the driving force of shipping to shift from the West to the East. China no doubt has become one of the main engines of this change.

B. Change of the Cyclical Nature in the Shipping Market

One of the notable phenomena, which affects the shipping industry currently, is the dynamic change of the cyclical nature in the market. There are at least two things to be cited. One is that the new emerging economies are inclined to have an increasing powerful impact on the world shipping arena while developed nations grow steadily. It goes without saying that BRICS, especially China, play the extremely important role in the course of the change. The sustained prosperity of the world economy has already lengthened the boom of the shipping industry and the exciting story is supposed to be on in the near future. As we may recall that from the second half of 2003, the shipping market recovered and has been keeping at a very good level. For China Factor, when China's "Three Golden Holidays" arrive, container freights always tend to plummet due to the expected sharp decline in demands for shipment, and dry bulk freight always follows the monthly imports of iron ore to China. The other thing is that the fluctuation in a shipping cycle tends to be violent. For example, with regard to dry bulk, the market could drop to 2000 BDI and jump back to 4000 within only 3 months. As a result, transactions in the market appear to be active with a lot of speculations. The fluctuations mean great challenges to shipping operators.

C. New Business Model is Gaining Strength in the Shipping World

The third item I'd like to point out is something about conceptual changes in business model in the shipping world.

First of all, in order to cover our shippers' increasing demand, a wide range of cooperation between different sectors of shipping is popular and encouraged. Because of global integration, our shippers, especially those top 500 companies, are expanding their business world widely, a single carrier can never cover, so shipping industry needs to cooperate. This is changing our business model. Pool is a good example of active cooperation in bulk shipping. In box business, cooperation between carriers, such as slot sharing agreements, trade organizations, alliances, even it goes further to alliance cooperation, is encouraged. The Grand Alliance and the New World Alliance was reported to have teamed up with agreement to cooperate in transpacific trade. No wonder, expansion of the service coverage economically is sure to be another basic reason for the action.

Secondly, multi-faceted operations have now dominated the shipping world. Suffering from unprecedented setbacks of financial performance mainly caused by Sep 11th, many ship-owners have come to the realization that the maritime industry is a capital-intensive industry, with relatively low expected returns and high risks and safety concerns. Shipping is perhaps the most international of all the world's great industries and one of the most dangerous. In an effort to avoid poor returns and to regain

profitability, many ocean carriers have focused much of their attention on consolidation of the Supply Chain and offering value-added services. As a result, many ocean carriers have started to be involved in investments in land-based facilities. Furthermore, cooperation between shipping companies and logistics companies, even integration through M&A, is welcome by our customers. Some of the shipping lines are setting their strategic goal as a consolidated logistics provider. Terminal is another example, in order to improve our service, shipping lines are driven to investment into terminal business. Based on our shipping, COSCO is now the fifth largest terminal operator in the world. Niche markets, as well as niche businesses, have therefore been widely explored.

Thirdly, as a consolidator of resources, shipping lines tend to shape themselves in public in a variety of roles. They might be a shipowner, a carrier, an operator, a charter, a logistics service provider, a service contractor, or even a broker, a cargo forwarder. Social funds are pouring into this industry, so we saw many IPOs and combination of shipping and capital market. As the industry grows, expansion seems to be the strategy for all shipping lines.

Fourthly, e-commerce becomes popular nowadays. Thanks to the development of technology, money, information, cargo flow could be finished easily with the help of IT. Now, more and more ocean carriers follow the suit of providing e-services through the website. The potential market is huge and

attractive as the business can be settled down in a safe, efficient and economical way.

Fifthly, co-competition has been widely accepted. In modern society, the everlasting difference among business players is nothing but interest. Confrontation among business rivals always comes second and will easily be broken up when there is some benefit ahead for both sides. From this point, business rivals in the past are likely to turn into friends or customers nowadays. Cooperation in the course of competition is now functioning and gradually becomes a new style in the world shipping arena.

In short, a successful global carrier has to look at the fusion of traditional shipping businesses as well as shipping related business to expand and thrive. Ocean carrier's business has therefore been broadened from the traditional seaborne trade, to the total solution of the supply chain to meet customers upgraded requirements. Those who dominate the supply chain may eventually lead the shipping world.

II. Shipping Industry Dedicates itself to Contribution

We live in a global society which is supported by a global economy; that economy simply could not function if it were not for the shipping industry. In fact, shipping industry contributes a lot in the implementation of international trades. Figures from IMO show that there are more than 45,000

merchant ships trading internationally today, and transporting every kind of cargo. These ships are registered in over 150 countries or regions. Shipping in the 21st century underpins international commerce and the world economy as the most efficient, safe and environmentally friendly method of transporting goods around the globe. Statistics show over 90% of world trade is carried by sea and over 50% of the trade value is generated by seaborne trade. Without shipping, the import and export of goods on the scale necessary for the modern world would not be possible. Seaborne trade continues to expand, bringing benefits for consumers across the world through lower freight costs. Thanks to the growing efficiency of shipping as a mode of transport and increased economic liberalization, the prospects for the industry's further growth appear to be strong.

Apart from that, shipping also helps promote the friendship of different nations. On April 18, 1979, a COSCO ship, MV LIU LIN HAI, flying the flag of the People's Republic of China, sailed into the Port of Seattle. This was the first Five-Star cargo ship calling U.S. port in last 30 years. The vessel's 'Ice-Breaking' voyage not only resumed the trade business between US and China, but also acted as a bridge to establish a friendship between the people of the two sides. In this case, ocean shipping has made a great contribution to the world peace and stability.

III. Facing Challenges

In spite of the positive factors mentioned above, the global shipping industry also faces some great challenges.

The first challenge comes from insufficient infrastructure investment, especially port, terminal and its distributions system. The surge in volumes globally puts pressure on ports, terminals and intermodal systems because this healthy world trade is testing the limits of transportation networks. One of the predominant reasons for the lag-behind of this kinds is somewhat that some decision-makers underestimate the rapid development of international seaborne trade. They are not ready for the change. Take US as an example, every year there are approximately 22,000 calls at U.S. ports, according to World Shipping Council. Together with labor and environmental issues, port congestion happens frequently. Accompanied by the breakthrough in shipbuilding technology, super post-panamax vessels, VLCCs, VLOCs are easily built, this makes fleet expansion easier. Although initiatives such as Pier Pass in the Los Angeles basin are helping to shift some port traffic to less congested night and weekend hours, problems of port congestion cannot be solved so easily, as the investments in fundamental construction are presumed to be insufficient. This happens to European ports as well.

The second challenge would be high price of energy. We are in an era of expensive oil. So rising bunker costs are one of the major challenges for us. Though BAF is introduced and collected, it is difficult to offset the increase of bunker cost.

Then comes to the third challenge. Security, safety and environmental issues cause great attention by carriers. The sea has always been a potentially hazardous and dangerous working environment. And ship operators today also have to be efficient and effective as new factors and pressures arise. Goods in transit are carefully factored-in to the supply chain and must be delivered within a very precise timeframe. Ships have become a key component in a complete door-to-door transport network. More than ever before, safety and security are intertwined and inseparable. The overall safety record of shipping has been improving steadily for many years. The number and percentage of losses began to dip significantly in 1990s and have continued on a downward curve ever since, thanks to the consecutive and large amount of investment in shipping sectors and more funds are expected to spend to keep it running smoothly. These will absolutely increase carriers' operating costs and sharply deteriorate their limited profit margin.

Following would be the trade imbalance. The year 2005 showed a widening of trade imbalance in most of the mainland-related routes. The problem in the Sino-US trade, for example, seems to have plunged into serious trouble. According to PIERS, the mainland China-to-US cargo volume in 2005 increased by about 24% to 7.4 million TEUs when compared to the same period a year ago. In the meantime, less than 1.6 million TEUs reported in the backhaul. This means that the imbalance of E/W ratio in the Sino-US trade has widened in just one year from 3.8 to 4.5. It

is safe to say that trade imbalance has inevitably caused a sharp increase in carrier's operating costs, this trend unfortunately will very likely continue.

More challenges come from the volatility of ships' prices and ocean freights. Compared with 3 years ago, a 5000 TEU ship could cost us 20 million US dollars more nowadays, 30% up. All ship types are at very high price and we can not get a space from shipyard for newbuilding till 2009. Ocean freights are not stable. For container trade, freight of this year for Transpacific Eastbound has got a 1/3 cut compared with last year, despite the tremendous growing demand. Bulk business is undergoing a more volatile market, as I mentioned before. The unstable market makes the carriers more risks and they can not sustain a stable profitability.

IV. Prosperous Future Expected

A. World Economic and Trade Climate Continues to be Healthy

Recovered from 2002, the world economy has kept a relatively robust momentum over the past 4 years. According to the latest forecast by IMF, global GDP growth in the United States is expected to 3.4% and the majority of developed economies in the European Union and Japan are likely to speed up their economic drive. If these predictions are correct, it is going to be another robust year following the figure of 5.3 % over the past 30 years. World merchandise

trade registered a growth of 6% in the volume of goods traded last year. Although the trade momentum seemed to be reduced year-on-year, it is still above the average annual growth rate of 5% over the past 10 years. In 21st century, the economic globalization has created a close-knit social framework in the globe. No nation is fully self-sufficient. They have been closely connected and they have to depend on each other.

B. China's Economic Drive Keeps Robust Momentum

China's economy has witnessed a robust momentum. Since the 1990's the country's economy grew at an average rate of some 10% per year over the past 15 years. In 2005, the country's soaring growth continued with a GDP growth rate of 10.2%, despite attempts by the government to cool the economy. China's total trade in 2005 surpassed US\$1.4 trillion, making China the world's third-largest trading nation after the U.S. and Germany.

In 2006, China's economy keeps improving. According to preliminary estimation, the country's GDP in the first three quarters of this year was around US\$1.8 trillion, a year-on-year increase of 10.7%. Investments into the infrastructure are still increasing, despite the efforts of cooling down. So when you come to Beijing, you can see the whole city is under construction, so the map publisher decided to renew the city every month, even with this, the city map can not catch up with the changes.

China's foreign trade enjoyed rapid growth in the first 9 months of this year. The total value of imports and exports increased nearly one fourth during the period to hit US\$1,272.6 billion, generating a trade surplus of US\$109.85 billion. Experts predict that China's GDP is likely to maintain an average annual growth of some 9% over the next five years and the total value of China's foreign trade will surpass US\$2.7 trillion in 2010.

In short, the fundamental drive for China's economy ---- investment, consumption and trade, looks healthy and positive. That's the key to the point. Starting from 2006, government authorities make great efforts to launch the campaign of the construction of New Suburb areas. In consideration of great efforts to get rid of existing imbalance in the development nationwide, potential demands are huge and it really takes time to accomplish. Therefore, outlook for the business atmosphere in the mid and long run looks promising.

C. Sino-US Trade Ties Remain Stable and Healthy

On October 17, the US population officially hit the 300 million mark. It is a historical event for the US and also good news for the Sino-US shipping industry. Over the past 27 years, the establishment of diplomatic relations between our two nations, together with the rapid development of the bilateral trades, has brought fruitful results for shipping players.

The United States and China are both great nations. Economic and trade ties have remained stable and healthy over the last 20 years. In 2005, total two-way trade between China and the U.S. grew from US\$33 billion in 1992 to over US\$285.3 billion. The United States is China's second-largest trading partner, and China is now the third-largest trading partner for the United States (after Canada and Mexico). U.S. exports to China have been growing more rapidly than to any other market. U.S. imports from China grew 18% in 2005. The total trade volume of the two nations is expected to hit US\$300 billion in 2010.

D. Sino-US Maritime Cooperation has Achieved positive Results

Since the US and China concluded a bilateral maritime agreement on December 8, 2003, shipping services between our countries have expanded rapidly. In 2005, China's container traffic continued to rise. Mainland's seaborne trade volumes in terms of TEU were reported to increase by 15% last year. Among them, over 9 million containerized cargos moved between China and the US. The latest figures released by PIERS indicate that Sino-US trade volume now accounts for an estimated market share of 57% in the transpacific trade.

Terminal operations both in China and US are also believed to be beneficiaries from the boom of bilateral trades. The

container throughput in the US was supposed to increase by 8% to around 60 million TEUs last year. Chinese mainland ports handled a total of 75.8 million TEUs last year, up to 23 percent from a previous year.

V. What shall we do next?

1) Overall Cooperation is the Key

As I have mentioned previously, for the future of the supply chain and our industry, now is the time to change the relationship between shippers and carriers. The current roller coaster like paradigm may make a traffic director or steamship executive look good or bad in a particular year, but in the long run, this is hurting our industry. Players in the transportation industry, indeed the whole supply chain industry, should realize that the establishment of a cooperative relationship with a new pattern of multi-win results is in the best interest of industries that we are all in.

As a carrier, COSCO is ready to cooperate with all port, terminal operators, railway and truck operators to provide a full stream service to our customers. Let's work together to build a stronger shipping industry and supply chain.

2) Help Each Other to Get a Sustainable Return out of our Business

We know many of you are cross boarder traders, you are expanding your business world widely seeking a cost-efficient, high quality production. In this regard, we are always at your service. We are consolidating resources to give you a reasonable, reliable, long-term support to your business growth. As a reward, we need your support as well. Ships can not sail without cargo, we are going to acquire a long-term business relationship with all of you. The mutual support could assure us a stable return out of our business.

3) Let's Stand together to Face the Challenges

Players in the shipping world should realize that the establishment of a cooperative relationship and new pattern of multi-win results is based on the principle of the maximum interests of the industry, not the victory of individual, or the partial and short-term success. Organizations in the region or the shipping world should take initiatives to strengthen communication and cooperation, protect the common interests. To create a stable and healthy world in global shipping industry, that's the key to success.

The early bird catches the worm. Let's take initiatives and jointly face up to the upcoming opportunities and challenges. Let's get together and take immediate action to change with the changing world.

Thank you very much.