

# Straight Across the Strait

## Who wins in the Taiwan-China shipping deal?

*By Steven K.C. Poh*

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**H**OW WILL TAIPEI'S RECENT direct-shipment deal with Beijing affect marine stocks? Last week the two governments agreed to let vessels with foreign flags sail between Kaohsiung, the island's main port, and the mainland cities of Fuzhou and Xiamen. From March or April, the ships will be allowed to carry cargo being transshipped through Kaohsiung. As of last week, 14 companies have applied to offer the service.

For Oliver Lee of BZW Asia Research in Taipei, the likely winners in the new arrangement are "companies with feeder capacity to ship cargo out of Xiamen and Fuzhou to Kaohsiung, and then long-haul capacity to move cargo on to the final destination." Chinese exports to the U.S. and Europe make up the bulk of that traffic. Amy Lin, a Taipei-based analyst with Daiwa Research Institute, notes that many Taiwan shipping companies have long registered many of their vessels in other countries.

Initially, however, the deal is likely to boost Taiwan stocks in general rather than shipping counters alone. Cross-strait tensions have been a depressing factor in the market for nearly two years now, so the perception of improving ties created by last week's agreement should help sentiment. "It signifies a softening of tensions," says James Wang, senior analyst with Peregrine Securities in Taipei. "A consensus of this nature is very important for investors in Taiwan." Adds Jean-Louis Morisot, regional transportation analyst at Goldman Sachs in Singapore: "The agreement effectively means the end of a five-decade ban."

For Wang, "the immediate impact to any shipping stock's bottom line is very minor." But the deal will boost cross-strait shipping, he explains, and Taiwan marine enterprises will gain from reduced costs and increased opportunities. Sentiment will drive the initial positive impact on shipping stocks, which lagged the market in December, says Morisot. "This initial stage of the offshore transshipment plan paves the way for the opening of all other major mainland ports [like Shanghai, Tianjin, Dalian and Qingdao] and should create a momentum that will be hard for politicians on either side to stop."

In terms of earnings, the move translates into heaps of savings for shippers. Daiwa's Lin compares the unloading fee for each container: \$210 in Hong Kong vs. \$70 in Kaohsiung. By transshipping through Taiwan, Evergreen Marine will be able to save as much as \$10.5 million a year. Lin expects container lines rather than bulk carriers to be the main beneficiaries in terms of new business.

In the short term, cross-strait cargo won't see a sharp increase, but business may pick up as freight charges dip due to the shorter direct route. Lin feels prices could fall further if more smaller lines enter the market, since Beijing has imposed no limit on the number of ships plying the strait. Hence, she concludes, "we don't expect the revenue of short-haul shippers such as Wan Hai Lines and Uniglory Marine to increase much."

Nonetheless, in the long term, opportunities for container liners, says Lin, will increase along with China's burgeoning foreign trade, particularly with the U.S. and Europe. "Moreover, as the number of companies setting up plants in China increases, demand for container shipment will continue to grow," she points out. "Evergreen Marine and Yang Ming Marine, the two major long-

haul container liners in Taiwan, will be the biggest winners in China's shipping market. And since Uniglory serves as Evergreen Marine's feeder, it will benefit as well." She also expects the rise in shipments to boost loading factors and efficiency of carriers, while lowering costs per TEU or 20-foot equivalent unit of containers.

Lee likes Yang Ming Marine because it is bidding for the rights to build a second container terminal in Kaohsiung. The winner is expected to be announced in March. If Yang Ming gets the rights, its handling capacity at the port would double to 700,000 TEUs a year, Lee predicts. "This would put the company in a strong position to capitalize on increasing trade through Kaohsiung. Selling at 25 times 1998 [forecast] earnings and 14 times 1999, we're calling a buy on the counter." Another Yang Ming fan, Chris Hsieh of Taipei's Nomura Securities Investment Advisory, expects earnings to keep rising, "fueled by increasing revenue and non-operating income. And rising cash flow will enhance the company's ability to support future expansion, greatly offsetting investors' downside risks."

Morisot's top pick is Evergreen Marine. Currently trading at about 19 times 1997 earnings, Evergreen is perhaps the world's most profitable and efficient container liner. What's even more appealing, says the Goldman Sachs analyst, is that the counter is a "powerful play on Asian trade recovery as 86% of its income is Asia-related." Nomura's Hsieh, however, offers a contrarian view: "While we expect the company to remain a world power in maritime shipping, its earnings growth will be slowed by poorer investment returns in the wake of aggressive moves into new ventures, the most expensive of which is EVA Air, which has yet to turn in an operating profit in its five years in business."

For shipping firms in other Asian countries, the direct-links agreement is not expected to do much to improve their profitability. But South Korean shippers are apprehensive that the China-Taiwan pact will just increase competition for China business. "It's not good news for Korean shippers," says Sohn Soo Yeon, an analyst at ING Baring Securities in Seoul. "With South Korea looking at increasing trading volume with China, this latest agreement will definitely change things quite a bit. Taiwan will now be a very serious competitor."

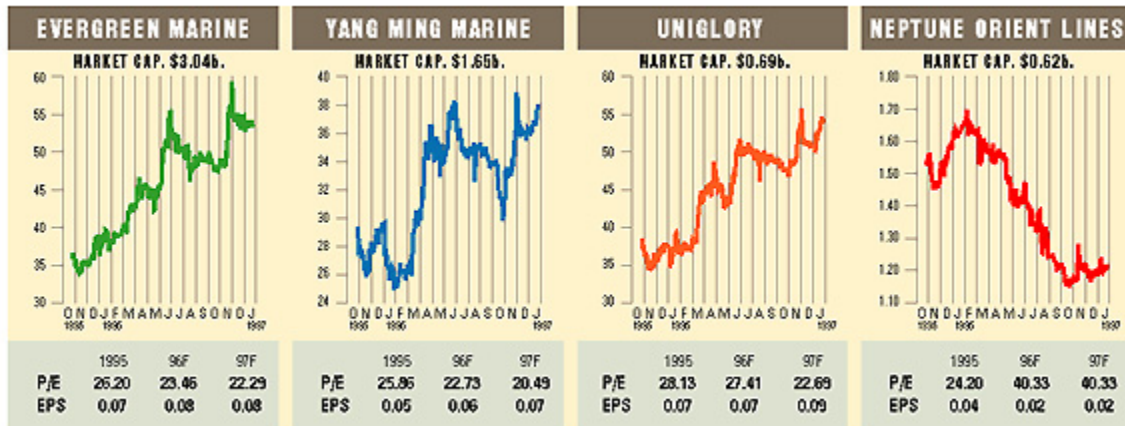
Other shippers see no good news in the expected decline in China shipping charges. Even without the cross-strait deal, freight rates are not likely to improve in the medium term, says Yong Yin Fui of Nikko Research Center in Singapore. He blames overcapacity and competition from East Asian liners like South Korea's Hanjin Shipping and Taiwan's Evergreen. "In their attempts to capture market share, these liners have been undercutting the market to offer more competitive rates," says Yong. Sohn sees Hanjin as a long-term buy at its price of 11 times 1997 earnings. She expects the won to strengthen, the South Korean economy to rebound and freight rates to rise next year. Yong isn't so bullish on rates in the next few years. "If you bring charges up, you have to empty ships," he says. "The industry will probably undergo further consolidation and rationalization. To survive the shakeout, players are likely to merge their operations or be acquired by larger firms."

With the bearish outlook on shipping rates, the Nikko analyst is putting a sell signal on Singapore's Neptune Orient Lines (NOL). "Overcapacity and keen competition in the market have eroded NOL's profits," he says. "Losses from its liner business, particularly on the major transpacific and European routes, have resulted from declining freight rates." In Singapore, Janice Chua of Vickers Ballas Investment Research agrees: "Growth will be capped by the intense competition and continued weak rates."

Analysts are also concerned about the impact of the China-Taiwan deal on Hong Kong, whose ports have long benefited greatly from the ban on direct links. Will cheaper Kaohsiung grab business from Hong Kong's container handlers? Matthew Mo of the territory's Jardine Fleming Securities is not particularly worried. He watches Wharf (Holdings) and Hutchison Whampoa, which operate container terminals. Mo notes that transshipment through Hong Kong -- the kind of

business that Kaohsiung could steal -- has already been falling as a share of total cargo handled by the territory, from 14% in 1994 to 8% last year. That means the likely impact of competition from Taiwan is correspondingly less.

Still, Hong Kong container-terminal operators are tipped to lose 10% to 15% of their combined earnings as transshipments shift to Kaohsiung. But companies like Hutchison Whampoa and unlisted COSCO Pacific are well hedged. They have port operations in China itself -- which would gain from the direct Taiwan links.



All figures in U.S. dollars except share prices, which are in local currencies. Sources: Datastream, First Call/World Equities and Asiaweek Research