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Morgan Stanley Asia Limited+

Andy Meng
Andy.Meng@morganstanley.com
+86 21 6279 8504

Karen Zu
Karen.Zu@MorganStanley.com
+86 21 6279 7042

Kate Zhu, CFA
Kate.Zhu@morganstanley.com
+852 2848 6843

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Industry View
In-Line

Initiation

China Shipbuilding

Initiating Coverage: Global Leader, China-Made

We initiate coverage of the China Shipbuilding industry with an In-Line view: In the long run, we are positive on China's shipbuilding industry and expect it to surpass Korea and become the global leader. **In the medium term,** we are concerned that the industry cycle may peak in light of the potential global recession. **In the short term,** we expect Chinese shipbuilders to continue posting respectable earnings growth despite rising material costs and accelerated RMB appreciation.

Global Leader, China-Made: Given their cost-cutting advantage, Chinese shipyards are taking market share from Korea and Japan through rapid efficiency improvement, aggressive capacity expansion, and new product diversification. We believe this trend will continue, and we expect China to become the world's largest shipbuilding country by 2015.

Shipbuilding cycle near the peak: The total order book as a percentage of the world's fleet has jumped to 40% for tankers, 56% for bulk, and 60% for containers, implying more than 10% compound annual growth for the world fleet, surpassing the single-digit growth of seaborne trade. Also, a US slowdown, followed by a global recession, could cause shipbuilding demand to weaken. Our medium-term industry view is bearish.

Strong backlog supports growth until 2010: We believe that Chinese shipbuilders can keep delivering growth, thanks to their more than three-year order backlog and continuous capacity expansion. Risk of order cancellations is low, as the down payment ratio is high.

Investment Strategy: Despite our medium-term bearish view, we see limited risk of a growth shock in the shipbuilding industry. We advise investors to focus on short-term catalysts such as new orders and M&A activity. Yangzijiang (YAZG.SI, S$2.1, OW-V) is our top pick in the China Shipbuilding industry.

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Investment Case

Summary & Conclusions

We initiate coverage of the China Shipbuilding industry with an In-Line view. **In the long run,** we are positive on China's shipbuilding industry and expect it to surpass Korea and become the global leader. **In the medium term,** we are concerned that the industry cycle may peak in light of the potential global recession. **In the short term,** we expect Chinese shipbuilders to continue posting respectable earnings growth despite rising material costs and accelerated RMB appreciation.

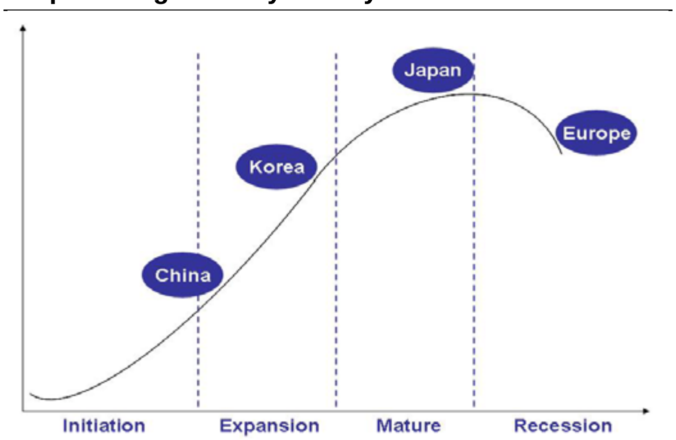
Despite our medium-term bearish view, we see limited risk of a growth shock in the shipbuilding industry. We advise investors to focus on short-term catalysts such as new orders and M&A activity. Yangzijiang (YAZG.SI, S$2.1, OW-V) is our top pick in the China Shipbuilding industry.

Up-cycle of China Shipbuilding Industry

China's shipbuilding industry is enjoying an up-cycle, we believe. Given their cost-cutting advantage, Chinese shipyards are taking market share from Korea and Japan through rapid efficiency improvement, aggressive capacity expansion, and new product diversification. We expect this trend to continue.

Exhibit 1

Shipbuilding Industry Life Cycle



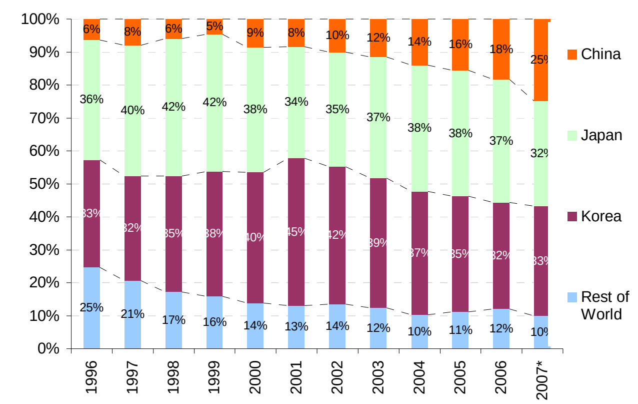
Source: CSERC, Morgan Stanley Research

Taking More Global Market Share

We believe that the global shipbuilding industry is relocating from Europe and Japan to Korea and then to China, which has been gradually taking market share in the past 10 years. China's global market share increased from 6% in 1996 to 18% in 2006. Korea currently has the largest shipbuilding industry in the world; however, its leading position is likely to be challenged by China in the next decade. In 2007, China received approximately 50% of all new shipbuilding orders in the world, lifting its global market share to 25%. We expect China to surpass Korea and become the largest shipbuilding country in the world by 2015.

Exhibit 2

China Shipbuilding: Taking More Market Share



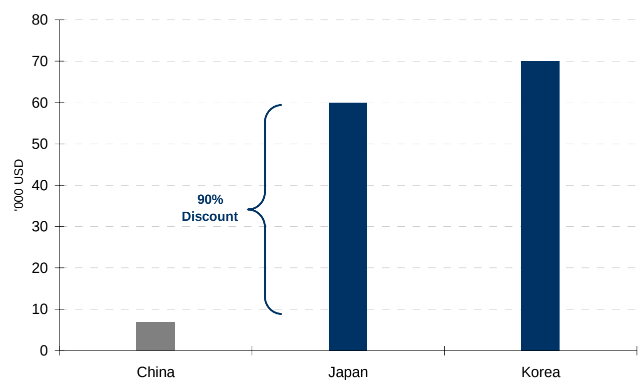
Source: Clarkson, Morgan Stanley Research

Enjoying Significant Labor Cost Advantage

Shipbuilding is a labor-intensive and heavy-machinery-reliant industry. With the change in economic growth models, advanced countries tend to retreat from such businesses while developing countries consider shipbuilding a strong growth driver. The global shipbuilding relocation from Europe to Japan, and then to Korea, supports this view.

Given China's nascent profile in the shipbuilding industry life cycle (Exhibit 1), we expect it to become the next destination for industry relocation. Low labor cost is the key driver of such relocation, we believe. The average annual salary for a full-time employee in a Chinese shipyard is less than US$10,000, versus US$62,000 in Japan and US$70,000 in Korea. What's more, Chinese shipbuilders usually employ a significant number of subcontracted laborers and production workers who entail much lower unit cost. Taking Yangzijiang's shipyards as an example, its number of subcontracted laborers is more than double its headcount of formal employees, which creates a significant cost advantage for the company. Overall, with improvements in production efficiency and technical know-how, China's low-cost advantage should help it beat Japanese and Korean competitors. We see the relocation as an inevitable trend.

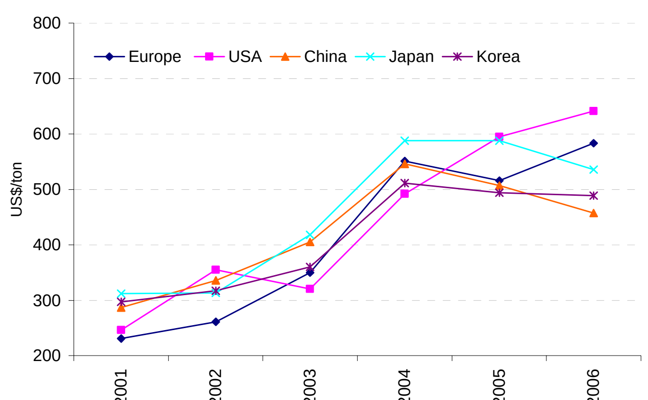
Exhibit 3
China Holds Labor Cost Edge



Source: CSERC, Morgan Stanley Research

In addition, China holds a cost edge in land, raw materials, overhead, and financing, as well as outsourcing. Steel prices, for example, are 10-15% lower in China than in Korea.

Exhibit 4
Chinese Steel Is More Price-Competitive

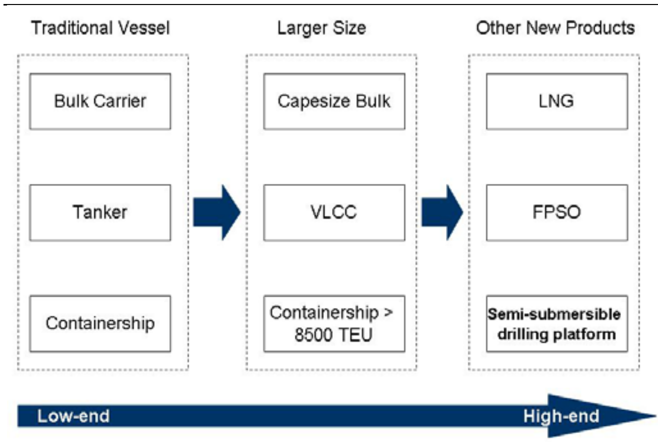


Source: CRU, SBB, Morgan Stanley Research

Rapid Efficiency Improvement
Thanks to continuous process improvement and facility upgrades, Chinese shipyards are very quickly boosting their efficiency. In 2006, the average construction cycle of berths and docks was shortened by 6 days and 21 days, respectively. Moreover, 90% of finished ships built by CSSC and CSIC (China Shipbuilding Industry Group) advanced the time of delivery in 2006. Hudong Zhenhua and Dalian shipyards shortened their production cycles by 10-15% per annum. As one of the largest private shipyards, Yangzijiang has also improved its operating efficiency quickly, shortening its ship-berth per 2,500 TEU containership from 120 days to 80 days within two years. We believe that in the long run, China will catch up with Korea in production efficiency and become more competitive in the global market.

Delivering More High-end Vessels
We see continuous upgrade of product mix with more high-end vessels being built in China. In 2005, the Hudong Zhonghua shipyard built the first LNG carrier in China. In 2006, the Dalian shipyard started to build the first semi-submersible drilling platform. In 2007, Hudong Zhonghau delivered the first 8,530 TEU containership, while Waigaoqiao shipyard delivered an FPSO of 300,000 DWT. By moving up the value chain, Chinese shipbuilders will become more competitive in the global market, we believe.

Exhibit 5
China: From Low-end to High-end Market

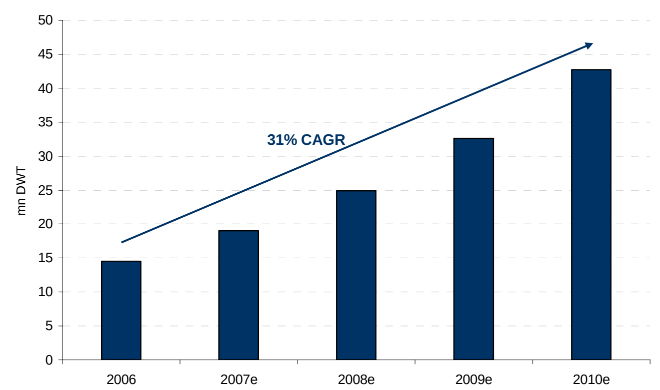


Source: CSERC, Morgan Stanley Research

Aggressive Capacity Expansion in China
We see aggressive expansion of shipbuilding capacity in China and expect total capacity to exceed 42 mn DWT by 2010; that would represent more than 40% of global shipbuilding volume in 2006.

Exhibit 6

China's Capacity Expanding at 31% CAGR



Source: CSIRC, Company Data, Morgan Stanley Research

Enjoying Strong Government Support

In August 2006, the State Council approved the Long-term Blueprint for the Shipbuilding Industry, highlighting the following growth targets: 1) state-owned shipbuilding capacity to reach 23 mn DWT with production volume of 17 mn DWT by 2010; 2) shipbuilding capacity to reach 28 mn DWT with production volume to reach 22 mn DWT by 2015.

The central government has already implemented several favorable policies to boost industry growth, including: 1) **financial support to hedge RMB appreciation** – Taking Guangzhou Shipyard as an example, the government awarded a special loan of US$400 mn to the company in 2006, helping it hedge the RMB appreciation risk. 2) **support for domestic shipbuilders** – The government is encouraging domestic shipping companies to order oil tankers from Chinese shipbuilders. 3) **lower financing cost** – China shipbuilders also enjoy a low cost of financing compared with most overseas competitors, due to the preferential interest rates provided by PRC government-backed banks to promote the domestic shipbuilding industry. 4) **raising the barriers to entering the shipbuilding industry** – The government plans to launch a licensing system to control capacity expansion. 5) **cancellation of the tax rebate on block exports** – This will increase costs for foreign shipbuilders that set up block factories in China to take advantage of the low labor costs.

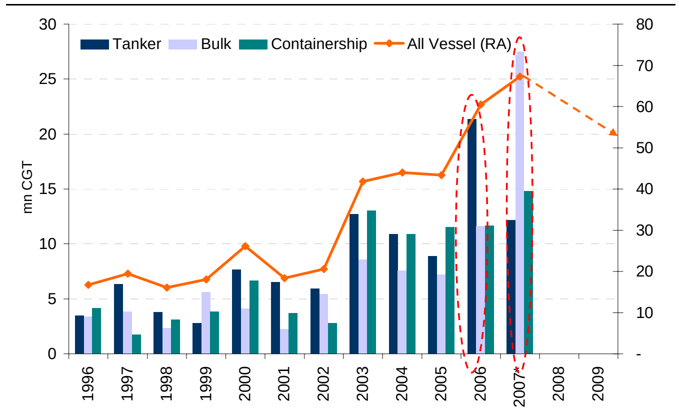
Shipbuilding Cycle Close to the Peak

The total order book as a percentage of the world's fleet has jumped to 40% for tankers, 56% for bulk, and 60% for containers, implying more than 10% compound annual growth for the world fleet, surpassing the single-digit growth of seaborne trade. Also, a US slowdown, followed by a global recession, could cause shipbuilding demand to weaken. Our medium-term industry view is bearish.

After the new order peak for tankers in 2006 and bulk carriers in 2007, we expect shipbuilding new orders to slow down from 2008. We believe that the positive demand outlook has already been priced in, with the order backlog at a historical high. Further upside to new orders will be limited, in our view.

Exhibit 7

Shipbuilding New Orders to Slow from 2008



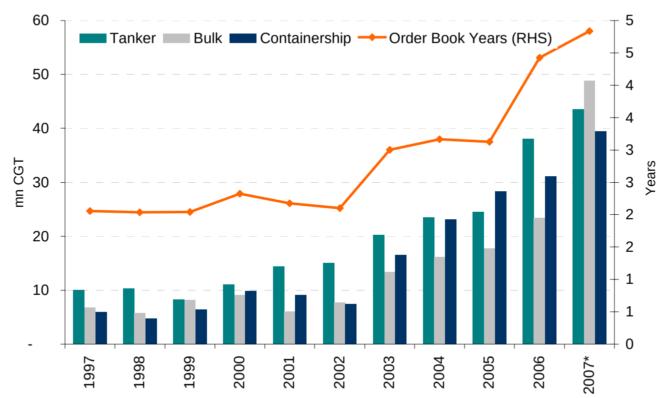
Source: Clarkson, Morgan Stanley Research

Order Book Years: A Double-Edged Sword

We view the high order book years as a double-edged sword. **On the positive side**, the historically high order book years secure production for a longer time, giving shipbuilders more bargaining power in the market. **On the negative side**, order book years greater than four indicate that the cycle is approaching the peak and there is mounting risk of an industry-wide correction.

Overall, we believe the long order backlog can secure the growth of the Chinese shipbuilding industry until 2010 at least. There is limited risk of orders being cancelled, as the current down-payment ratio has reached 20-30% during contract signing and a further 20% when block building kicked off.

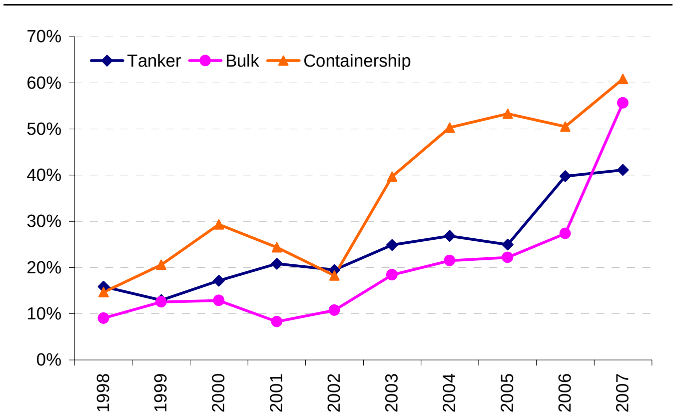
Exhibit 8
Order Backlog and Order Book Years



Source: Clarkson, Morgan Stanley Research

Industry Correction Likely in the Medium to Long Run
We believe an industry-wide correction is highly likely in the medium to long term. The total order book as a percentage of the world's fleet has jumped to 40% for tankers, 56% for bulk, and 60% for containers, implying more than 10% compound annual growth for the world fleet, surpassing the single-digit growth of seaborne trade. As delivery of the current large order book can refresh nearly half of the world's fleet, we see demand weakening after this boom cycles through.

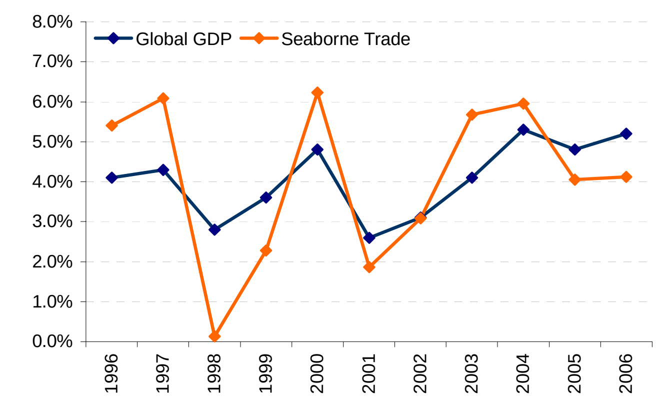
Exhibit 9
Order Backlog as Percentage of World Fleet



Source: Clarkson, Morgan Stanley Research

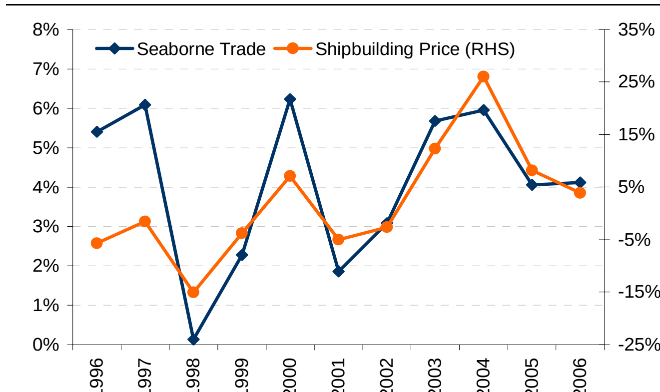
US Slowdown Casts Another Shadow
We believe that a US slowdown, followed by a potential global recession, could cause shipbuilding demand to weaken in the medium to long term. In the past 10 years, fluctuations in shipbuilding price and volume have generally mirrored the course of global seaborne trade, which is ultimately driven by global GDP growth. Morgan Stanley's US economics team is now forecasting a mild recession in 2008 due to the credit crisis and the bursting of the US housing bubble. In such a scenario, the shipbuilding industry is likely to suffer a slowdown in new orders as well as a price correction. Although most shipbuilders' order backlogs can support their production for the next three years, we believe that investors are forward-looking and that shipbuilding stock prices are likely to experience a de-rating amid such bearish sentiment.

Exhibit 10
Global GDP Growth vs. Seaborne Trade Growth



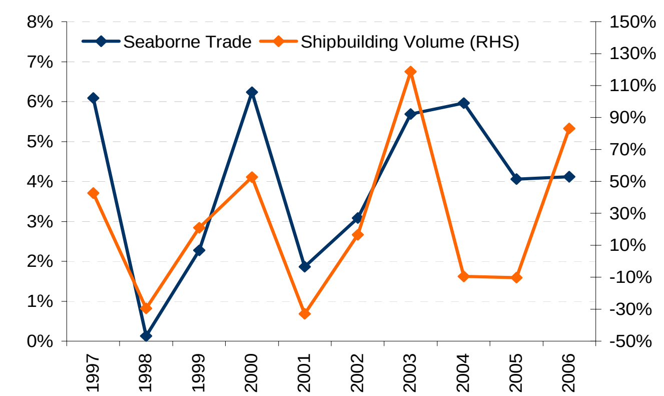
Source: Bloomberg, Clarkson, Morgan Stanley Research

Exhibit 11
Seaborne Trade Growth vs. Shipbuild. Price Change



Source: Bloomberg, Clarkson, Morgan Stanley Research

Exhibit 12
Seaborne Trade Growth Vs. Shipbld. Volume Chg.



Source: Bloomberg, Clarkson, Morgan Stanley Research

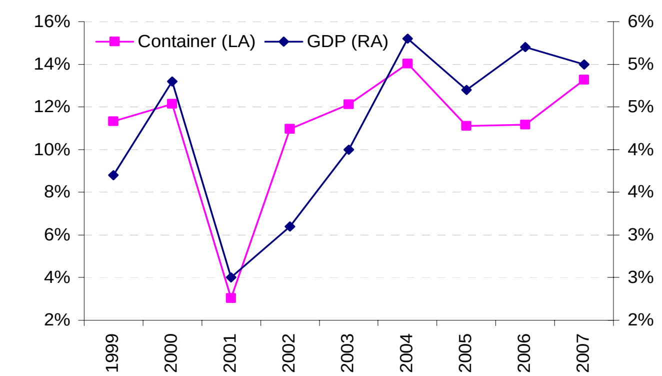
Containerships – China's Secular Catch-Up

We see secular growth opportunity as China is taking market share from Korea and Japan, yet it still lags in the containership segment, implying better growth potential. Currently, China has only around 19% market share in containerships, vs. 28% in tankers and 47% in bulk carriers.

Although our demand and supply analysis suggests there is over-capacity risk in the long run, we believe that China's growing competitiveness will help it squeeze out other competitors and fill in order backlog. However, we don't expect China to be a counter-cycle player in terms of new shipbuilding price, as this is a global industry where no individual producer holds pricing power.

Containership Demand: Double-Digit Growth to Continue
Thanks to continuous globalization, international container seaborne trade posted a 10.2% compound annual growth rate from 1996 to 2006, while global GDP registered a CAGR of 4.2%. Although global GDP growth is likely to slow from 5.1% in 2007 to 4.3% in 2008 and then recover to 4.9% in 2009, the overall global economic outlook remains robust. According to estimates from Drewry, the global container seaborne trade is likely to continue to enjoy a 10% CAGR from 2007 to 2010.

Exhibit 13
Global GDP vs. Global Container Trade

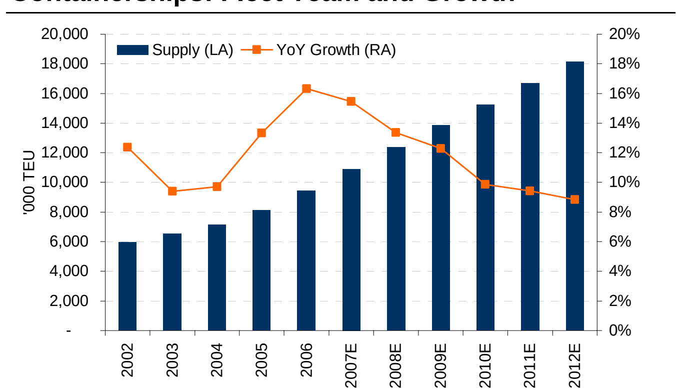


Source: Clarkson, Morgan Stanley Research

Rapid growth in emerging markets is a major driver of the world seaborne trade. In 2006, 35% of global container demand came from the Far East, while 14% came from South East Asia, 6% from the Middle East, and 7% from Latin America.

Containership Supply: Strong Delivery in 2008 and 2009
According to Clarkson, the world containership fleet registered a 12.8% capacity CAGR from 2002 to 2007. We expect an 11.8% capacity CAGR from 2008 to 2010, as 1) the order backlog has reached 6.3 mn TEU, or 60% of the current world fleet; 2) scheduled delivery is 1.5 mn TEU in 2008 and 1.6 mn TEU in 2009, implying 13% and 12% YoY growth, respectively; 3) scale of demolition is likely to be only around 80-90 mn DWT per annum.

Exhibit 14
Containerships: Fleet Team and Growth

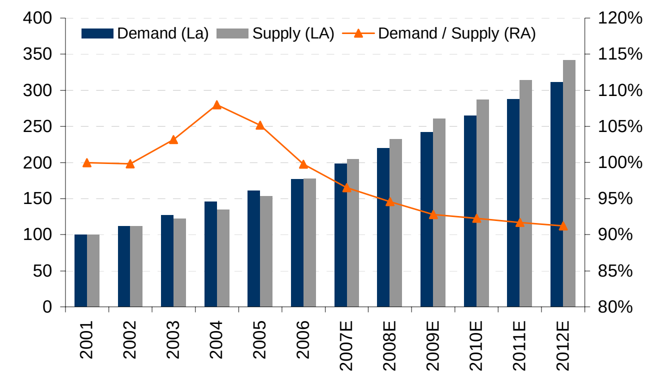


Source: Company data, Morgan Stanley Research

To assess the overall demand and supply situation going forward, we index the demand and supply data from 2001 to 2007, setting the data for 2001 as a benchmark of 100. We calculate the **Demand/Supply ratio** and observe that it increased to 108% in 2004 but then decreased to 97% in 2007.

Combining the demand and supply growth outlook, we extend our calculation to 2012, when we see this ratio falling further, to 91%. This trend implies that growth in vessel supply will surpass demand growth. **There is long-term overcapacity risk, rather than supply tightness, in the containership segment, we conclude.**

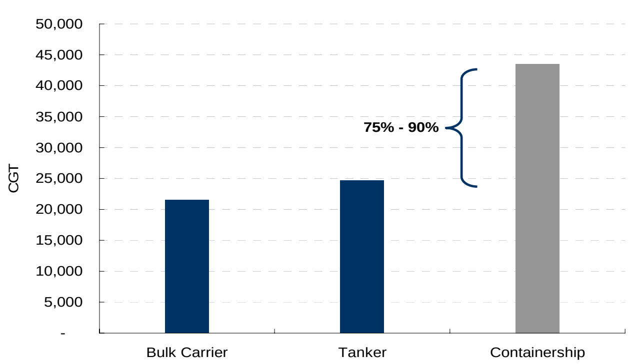
Exhibit 15
Containerships: Demand/Supply Analysis



Source: Company data, Morgan Stanley Research

Building containerships involves more production complexity than building bulk carriers and tankers does. The shipbuilding industry uses compensated gross tonnage (CGT) as a benchmark to compare the actual production volume regardless of the type of vessel. For instance, a containership of 90,000–100,000 DWT loading capacity will have a CGT of 43,500 tons, while a bulk carrier and a tanker of similar loading capacity will have CGT of only 21,500 tons and 24,600 tons, respectively.

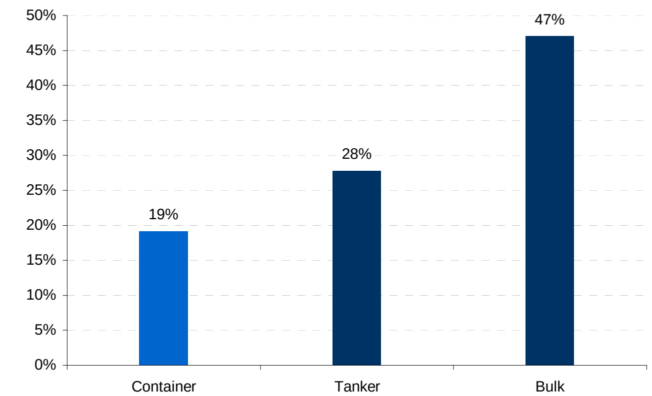
Exhibit 16
Containerships Entail Higher Production Complexity



Source: Company data, Morgan Stanley Research

This increased production complexity amounts to an entry barrier, and we believe it helps to explain why China underperformed in the containership segment in the past.

Exhibit 17
China Lags in Containership Market Share



Note: By DWT of order backlog. Source: Clarkson, Morgan Stanley Research

Panamax Containerships: Sustainable Outlook

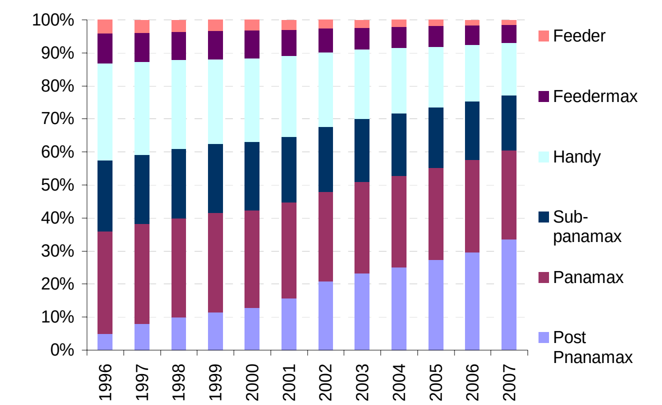
We believe the panamax containership segment will continue to enjoy sustainable growth from 2008 to 2010 for the following reasons:

- ***Benefit from double-digit demand growth:*** Holding 27% transportation capacity, Panamax is one of the key segments in the containership industry deemed to benefit from double-digit demand growth from 2008 to 2010.

- ***Positive near-term sentiment:*** 1) The current second-hand shipbuilding price of panamax containership exceeds the new shipbuilding price, indicating strong demand and limited downside risk for the new-build price; 2) time charter of Panamax containership is rebounding, implying better demand in the shipping market; 3) new contracting stood at 386k TEU up to Nov. 2007, which is equivalent to the new orders in 2006.

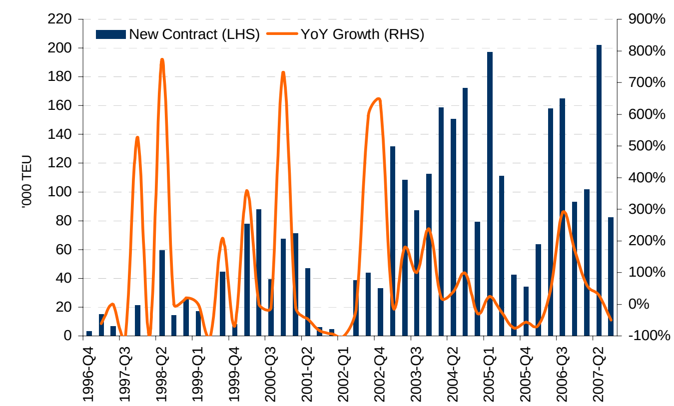
- ***Long-term confidence still robust:*** 1) Order book/world fleet ratio decreased from 49% in 2005 to 46% in 2006 but recovered to 50% by 2007, suggesting that confidence in panamax long-term outlook remains robust; 2) order book years continue to be historically high, suggesting that the shipbuilder holds more bargaining power in the market.

Exhibit 18
Panamax Fleet as % of Total Containerships



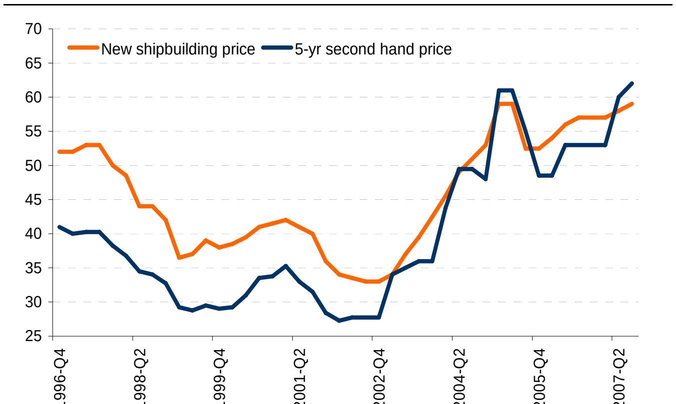
Note: Data as of 2007 by DWT. Source: Clarkson, Morgan Stanley Research

Exhibit 21
Panamax Containerships: New Order Trend



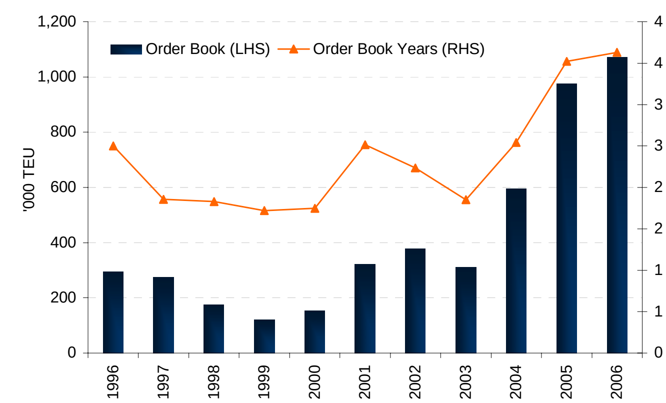
Source: Clarkson, Morgan Stanley Research

Exhibit 19
Panamax Containerships: Price Trend



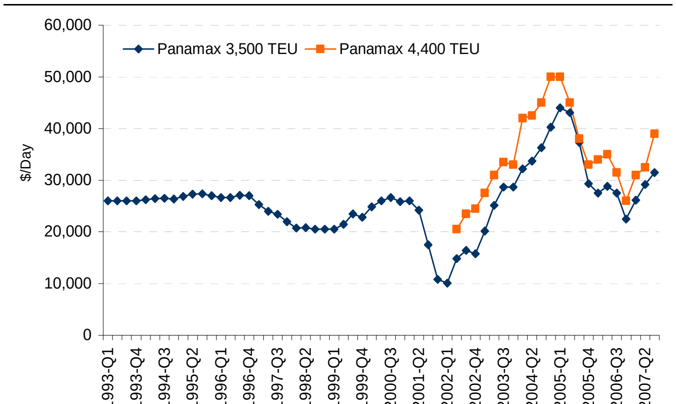
Source: Clarkson, Morgan Stanley Research

Exhibit 22
Panamax Containerships: Order Book Years



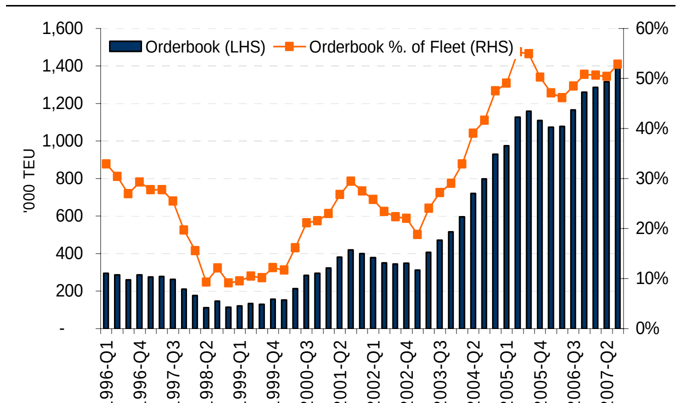
Source: Clarkson, Morgan Stanley Research

Exhibit 20
Panamax Containerships: Time Charter



Source: Clarkson, Morgan Stanley Research

Exhibit 23
Panamax Containerships: Order Book vs. World Fleet



Source: Clarkson, Morgan Stanley Research

Bulk Carriers – 'Boom' Until 2010

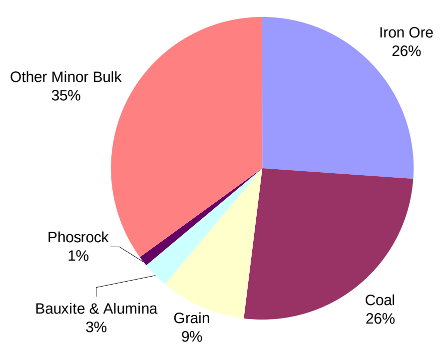
We are positive on the outlook for bulk carriers in 2008 and 2009, as the demand and supply analysis suggests robust growth. Although the freight rate is likely to correct after the surge in 2007, we believe the supply tightness will last in 2008/09, and we expect the strong deliveries in 2010 to reverse the industry sentiment.

On the demand side, we forecast growth of 9.6% in 2008, 7.1% in 2009, and 7.5% in 2010. China's demand for iron ore could continue to support growing seaborne trade, while the high oil price (oil shortage) could boost the coal trade.

On the supply side, we expect deliveries of bulk carriers to reach 30.4 mn DWT in 2008, 47 mn DWT in 2009, and 56 mn DWT in 2010 while the total fleet grows by 6.4% in 2008, 9.4% in 2009, and 9.9% in 2010.

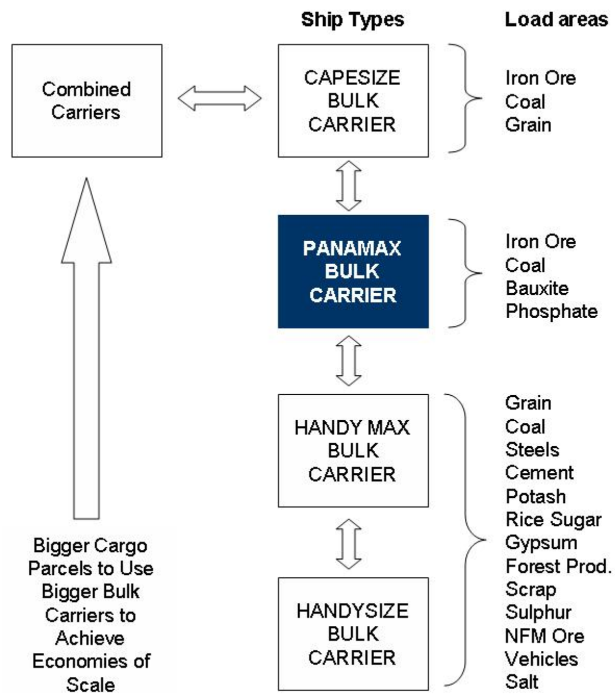
Panamax bulk carrier is our top pick in bulk carrier segment, as 1) it will continue to benefit from the large-scale trend in the industry; 2) more orders are likely for panamax bulk carriers than for capesize bulk carriers; 3) replacement demand for panamax bulk carriers as fleet ages is higher than for capesize bulk carriers; 4) near-term industry sentiment is positive.

Exhibit 24
Major Bulk Cargoes in Global Seaborne Trade



Source: Company data, Morgan Stanley Research

Exhibit 25
Bulk Carriers: Major Cargo Transported



Source: Clarkson, Morgan Stanley Research

Bulk Demand: Robust Growth to Continue

We forecast that demand for bulk carriers will grow by 7.5-9.6% from 2008 to 2010, based on the following analysis of the seaborne trade trend for major bulk cargoes:

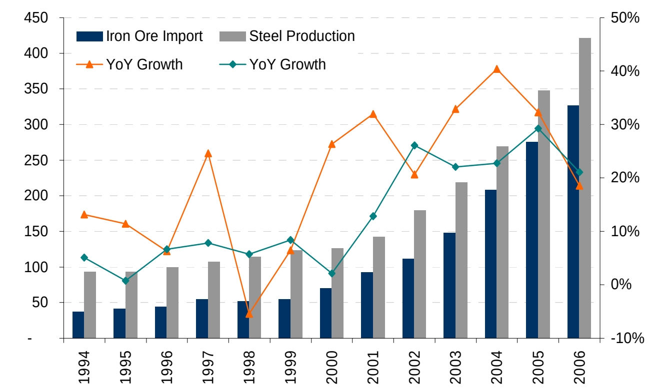
- **Iron Ore:** Taking 26% bulk cargo market share, iron ore continues to be one of the key growth drivers of global bulk seaborne trade. Thanks to China's surging appetite for steelmaking, world seaborne trade for iron ore is expected to reach 762 mn tons in 2007, up 5.7% YoY. We expect 7.7% growth in 2008, 8.2% in 2009, and 8.3% in 2010.

- **Coal:** Total world coal exports are expected to reach 726 mn tons in 2007, representing 2.7% YoY growth. Morgan Stanley's commodity shipping analyst, Ole Slorer, believes that rising crude oil prices could boost the coal trade. We therefore expect total coal exports to post annual growth of 6.2-6.5% from 2008 through 2010.

- **Grain:** World seaborne trade in wheat grains and coarse grain is expected to reach 270 mn tons in 2007 and rise to 280 mn tons in 2008, 286 mn tons in 2009, and 290 mn tons in 2010, according to Drewry shipping consultants. We forecast a 5% CAGR from 2008 to 2010.

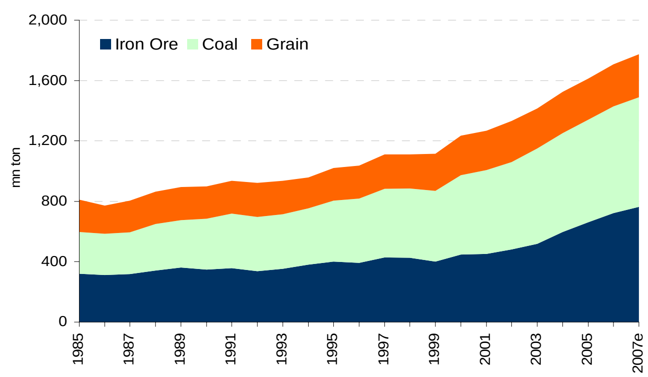
- **Bauxite/Alumina and Phosphate Rock:** Bauxite/ alumina is the raw material in aluminum manufacturing, while phosphate rock is widely used in the production of fertilizer. Drewry forecasts demand growth of 3-6% per annum from 2008 through 2010.

Exhibit 26
China: Surging Iron Ore Imports



Source: CEIC, Morgan Stanley Research

Exhibit 27
Growing Seaborne Bulk Trade

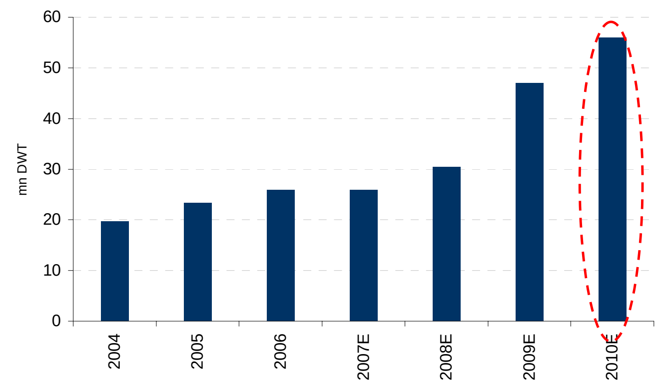


Source: Clarkson, Morgan Stanley Research e = Morgan Stanley Research estimates

Bulk Supply: Strong Delivery in 2010

As of Nov 2007, there were 6,610 bulk carriers in the world with nominal capacity of 386.4 mn DWT. According to Clarkson, total order backlog for bulk carriers has reached 217 mn DWT, or 56% of the global fleet. We expect the delivery of bulk carriers to reach 30.4 mn DWT in 2008, 47 mn DWT in 2009, and 56 mn DWT in 2010 as the total fleet grows by 6.4% in 2008, 9.4% in 2009, and 9.9% in 2010 (Exhibit 29). As we know some tankers are being converted into bulk carriers, the actual fleet capacity is slightly higher than our current estimate.

Exhibit 28
Bulk Carriers: Delivery Peak in 2010



Source: Clarkson, Morgan Stanley Research E = Morgan Stanley Research estimates

- **Capesize** fleet is expected to be 130 mn DWT in 2007, and we forecast that it will reach 138 mn DWT in 2008, 153mn DWT in 2009, and 171 mn DWT in 2010.
- **Panamax** fleet is expected to be 108.5 mn DWT in 2007, and we forecast it to reach 116 mn DWT in 2008, 125mn DWT in 2009, and 138 mn DWT in 2010
- **Handymax** fleet is expected to be 77 mn DWT in 2007, and we estimate that it will reach 84.5 mn DWT in 2008, 96mn DWT in 2009, and 106.5 mn DWT in 2010.
- **Handysize** fleet is expected to be 75.4 mn DWT in 2007, and we project it to reach 77.4 mn DWT in 2008, 80.9 mn DWT in 2009, and 84.4 mn DWT in 2010.

Dry Bulk Supply / Demand Analysis

Exhibit 29

Dry Bulk Supply: *Tanker Slots Converting to Bulk. We see modest upside to our 2010 supply expectations*

Unit: mn Dwt	2004	2005	2006	2007E	2008E	2009E	2010E	07 YTD
Contracting								
Capesize	16.1	13.1	24.1	70.0	23.0	15.0	6.0	**65.9**
Panamax	9.6	7.8	10.3	25.0	11.0	10.0	6.0	**25.8**
Handymax	6.3	5.2	10.1	27.0	12.0	10.0	6.0	**22.6**
Handysize	2.2	2.6	5.1	10.0	5.0	3.0	2.0	**8.8**
Total	**34.2**	**28.7**	**49.6**	**132**	**51**	**38**	**20**	**123.1**
Deliveries								
Capesize	7.4	8.8	10.9	9.8	9.9	18.0	22.0	**7.6**
Panamax	6.3	7.2	8.6	7.7	8.5	11.0	16.0	**5.4**
Handymax	4.1	5.4	5.0	5.9	9.0	13.5	13.5	**4.1**
Handysize	1.9	1.9	1.4	2.5	3.0	4.5	4.5	**1.7**
Total	**19.7**	**23.3**	**25.9**	**25.9**	**30.4**	**47**	**56**	**18.8**
Deletions/Scrapping/Losses								
Capesize	0.0	0.1	0.8	0.5	2.0	3.0	4.0	**0.0**
Panamax	0.0	0.0	0.5	1.0	1.0	2.0	3.0	**0.2**
Handymax	0.1	0.0	0.1	0.5	1.5	2.0	3.0	**0.0**
Handysize	0.5	0.9	1.1	1.0	1.0	1.0	1.0	**0.3**
Miscellaneous removals	0.0	0.0	0.0	0.0	0.0	0.0	0.0	**0.0**
Total	**0.6**	**1**	**2.5**	**3**	**5.5**	**8**	**11**	**0.5**
Orderbook								
Capesize	28.3	32.9	46.0	106.2	119.3	116.3	100.3	**98.0**
Panamax	21.5	23.3	25.0	42.3	44.8	43.8	33.8	**45.5**
Handymax	15.1	15.7	20.8	41.9	44.9	41.4	33.9	**39.4**
Handysize	4.6	5.1	8.9	16.4	18.4	16.9	14.4	**16.0**
Total	**69.5**	**77**	**100.7**	**206.8**	**227.4**	**218.4**	**182.4**	**198.9**
Fleet								
Capesize	102.2	110.8	120.9	130.2	138.1	153.1	171.1	**128.5**
Panamax	86.4	93.7	101.8	108.5	116.0	125.0	138.0	**106.9**
Handymax	61.3	66.7	71.6	77.0	84.5	96.0	106.5	**75.7**
Handysize	72.5	73.6	73.9	75.4	77.4	80.9	84.4	**75.3**
Total	**322.4**	**344.8**	**368.2**	**391.1**	**416**	**455**	**500**	**386.4**
Average Period Fleet Growth (%)	***3.4%***	***6.9%***	***6.8%***	***6.2%***	***6.4%***	***9.4%***	***9.9%***	***5.0%***

Source: CRS; company data; Morgan Stanley Research

Exhibit 30

Dry Bulk Demand: *Recent China data suggest upward revisions. Oil shortage could boost coal trade.*

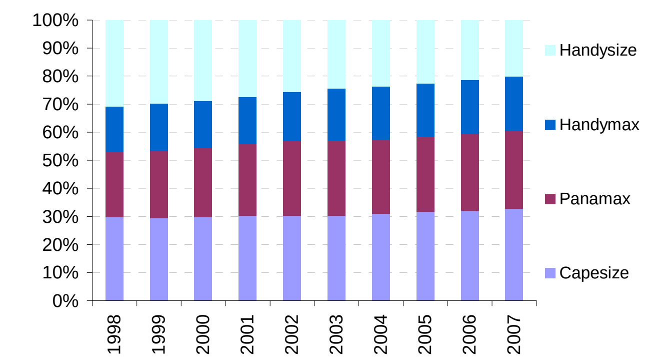
	2004	2005	2006	2007E	2008E	2009E	2010E
Crude Steel Production (mn ton)							
World	1,066	1,139	1,239	1,320	1,404	1,477	1,548
Change (y/y)	*10%*	*7%*	*9%*	*7%*	*6%*	*5%*	*5%*
World (ex-China)	788	786	820	838	865	884	904
Change (y/y)	*5%*	*0%*	*4%*	*2%*	*3%*	*2%*	*2%*
Iron Ore Demand - Seaborne Market	**597**	**661**	**721**	**762**	**821**	**888**	**962**
Change (y/y)	***15.0%***	***10.7%***	***9.1%***	***5.7%***	***7.7%***	***8.2%***	***8.3%***
Total Coal (Exports)	**654**	**680**	**707**	**726**	**771**	**821**	**874**
Thermal coal	*474*	*498*	*522*	*532*	*565*	*601*	*640*
Coking Coal	*180*	*182*	*185*	*194*	*206*	*219*	*233*
Chg (y/y)	***3.0%***	***4.0%***	***4.0%***	***2.7%***	***6.2%***	***6.5%***	***6.5%***
Grain (mn ton)	**275**	**271**	**280**	**287**	**300**	**314**	**329**
Chg (y/y)	*n.a.*	*-1%*	*3%*	*2%*	*5%*	*5%*	*5%*
Bauxite/Alumina (mn ton)	**66**	**68**	**69**	**70**	**73**	**77**	**80**
Chg (y/y)	*n.a.*	*3%*	*1%*	*1%*	*4%*	*5%*	*4%*
Phosphate Rock (mn ton)	**31**	**31**	**31**	**31**	**32**	**34**	**35**
Chg (y/y)	*n.a.*	*0%*	*0%*	*0%*	*3%*	*6%*	*3%*
Minor Bulks (mn ton)	**846**	**853**	**894**	**914**	**957**	**1001**	**1048**
Chg (y/y)	*8%*	*1%*	*5%*	*2%*	*5%*	*5%*	*5%*

Dry Bulk Demand *(mn DWT)*	**2004**	**2005**	**2006**	**2007E**	**2008E**	**2009E**	**2010E**
Capesize	91	95	104	119	131	140	150
Chg (y/y)	*n.a.*	*4%*	*10%*	*14%*	*10%*	*7%*	*8%*
Panamax	77	80	88	100	109	117	126
Chg (y/y)	*n.a.*	*3%*	*10%*	*14%*	*10%*	*7%*	*8%*
Handymax	55	57	62	71	77	83	89
Chg (y/y)	*n.a.*	*3%*	*9%*	*13%*	*10%*	*7%*	*7%*
Handysize	67	65	66	71	78	83	89
Chg (y/y)	*n.a.*	*-3%*	*2%*	*7%*	*10%*	*7%*	*7%*
Total	**290**	**297**	**321**	**361**	**395**	**423**	**455**
Growth (y/y)	***9.6%***	***2.3%***	***8.1%***	***12.4%***	***9.6%***	***7.1%***	***7.5%***
Utilization	**93%**	**89%**	**90%**	**95%**	**95%**	**93%**	**91%**

Source: Company data, Morgan Stanley Research

Benefit from the large-scale trend: Capesize bulk carriers (the largest ones) increased their share from 30% in 1998 to 33% in 2007, while panamax bulk carriers (second-largest) raised their share from 23% to 28% and handysize bulk carriers (smallest) saw their share drop from 31% to 20%.

Exhibit 31
Panamax Bulk Carriers Taking More Share



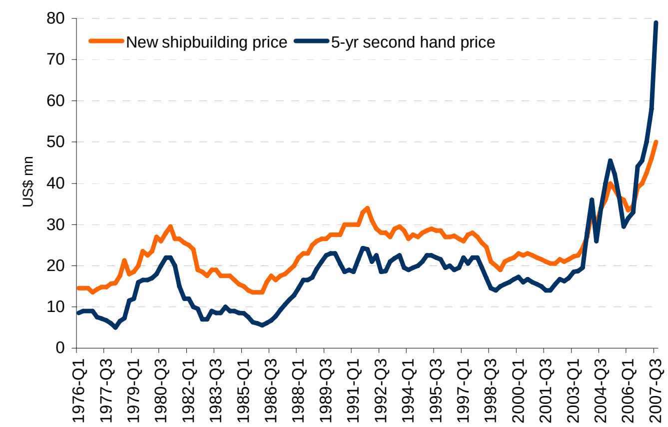
Source: Company data, Morgan Stanley Research

More orders likely for panamax than for capesize: We see greater demand for panamax bulk carriers than for capesize, as capesize bulk carriers have accounted for 54% of total new bulk contracts in 2007 versus 21% for panamax bulk carriers. Panamax bulk carriers are likely to catch up with capesize in the future, as the historical fleet scale trend suggests that more panamax bulk carriers are being used than capesize vessels (fleet scale ratio between panamax and capesize has risen from 0.78 in 1998 to 0.84 in 2007).

Better replacement demand for panamax: More than 325 panamax bulk carriers are over 20 years old, while only 130 capesize bulk carriers are that old. Considering that these vessels are designed for 20–25 years of use, we see more replacement demand for panamax bulk carriers than for capesize.

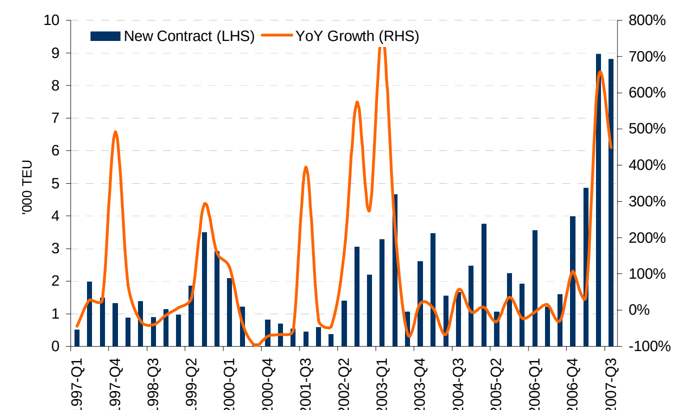
Positive near-term industry sentiment: The current second-hand price of panamax bulk carriers has been 158% of the new shipbuilding price, which is a historical high, while the Baltic Panamax Index (BPI) has surged more than 180% in the past year. Both indicate strong demand for panamax bulk carriers in the spot market. Order books are at historical highs, reflecting shipbuilders' bargaining power in the market.

Exhibit 32
Panamax Bulk: Price Trend



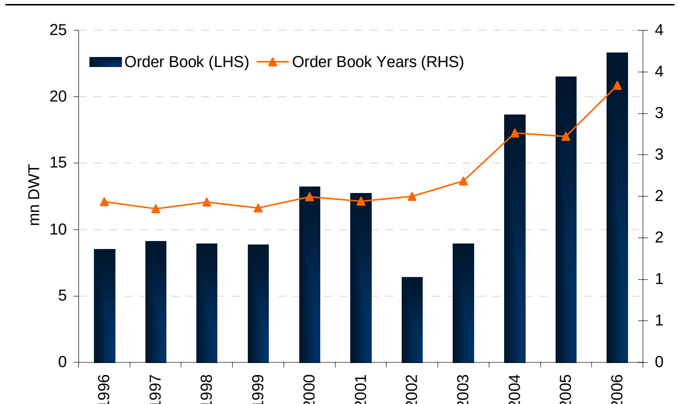
Source: Clarkson, Morgan Stanley Research

Exhibit 33
Panamax Bulk: New Order Trend



Source: Clarkson, Morgan Stanley Research

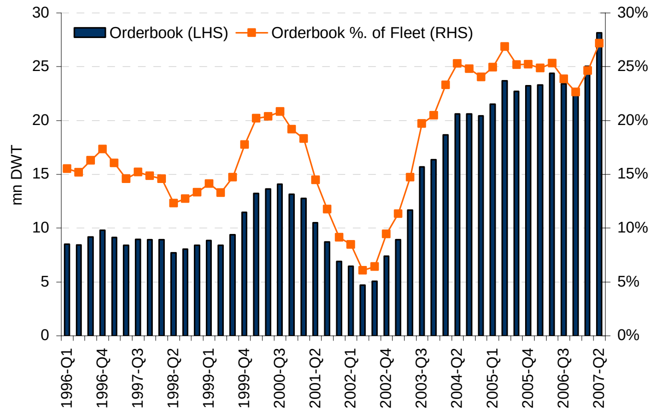
Exhibit 34
Panamax Bulk: Order Book Years



Source: Clarkson, Morgan Stanley Research

Exhibit 35

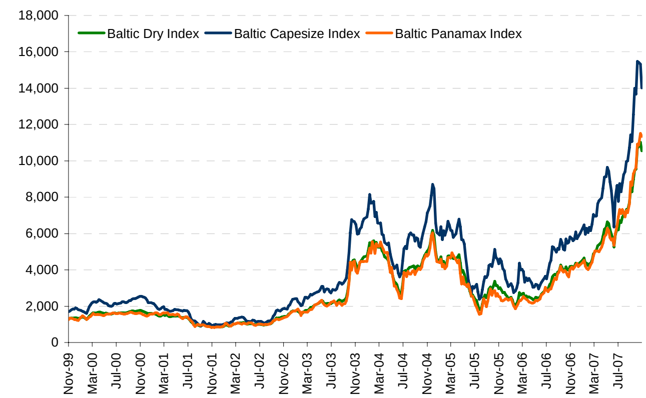
Panamax Bulk: Order Books vs. World Fleet



Source: Clarkson, Morgan Stanley Research

Exhibit 36

Baltic Panamax Index



Source: Clarkson, Morgan Stanley Research

Exhibit 37

Appendix 1: China Shipbuilding Capacity Expansion

Newbuilding Site	Province	Capacity Goal	Status	Group
Changxin Island	Shanghai	4.5	Under construction & marketing berths - Phase 1	CSSC
Nansha Longxue	Guangdong	2.12	Under construction & marketing berths - Phase 2	CSSC
Qingdao Haixi	Shandong	3	Under contruction	CSIC
Dalian Lushun	Liaoning	1	Under contruction - Initial Stage	COSCO
Fujian Quanzhou	Fujian	1.48	Under construction & marketing berths - Phase 1	Joint Venture
Weihai Shipyard	Shangdong	0.58	Under construction & marketing berths - Phase 1	Local
Nantong Rongsheng	Jiangsu	3.5	Under construction & marketing berths	Local
Masteck Shipyard (Jimo)	Shangdong	1.1	Under construction	Joint Venture
Guangxi Longmen	Guangxi	0.1	Under construction	Local
Yangzhou Longhua	Jiangsu	0.05	Under construction	Local
Jiangsu Sugang	Jiangsu	0.1	Under construction	Joint Venture
Shuntian Shipbuilding	Jiangsu	0.5	Under construction	Local
Guoyu Shipbuilding	Jiangsu	0.5	Under construction	Local
Shentaosha	Jiangsu	0.1	Under construction	Joint Venture
Huanqiu Shipbuilding	Jiangsu	0.4	Under construction	Joint Venture
New Times	Jiangsu	1	Under construction & marketing berths	Local
Hengcheng Shipbuilding	Zhejiang	0.2	Under construction	Local
Dinghen Shipbuilding	Jiangsu		Under construction	Local
Bohai	Liaoning	1	Under construction & marketing berths	CSIC
NACKS	Jiangsu	2	Under construction & marketing berths	Joint Venture
Waigaoqiao	Shanghai	1.5	Under construction - Phase 2	CSSC
Xiamen Shipbuilding	Fujian	0.3	Under construction - Phase 2	Local
New Yangzijang	Jiangsu	1	Under construction & marketing berths	Local
Qingshan	Hubei	0.15	Under construction	Local
Jinlin Shipyard	Jiangsu	0.58	Under construction	Local
Changxing Island	Shanghai	3.5	Need approval - Phase 2	CSSC
Xingang	Tianjin	3	Need approval	CSIC
Chongming	Shanghai	1.5	Need approval	CSSC
Dalian Lushun	Liaoning	1.4	Need approval - When finished	COSCO
Fujian Quanzhou	Fujian	1.12	Need approval - Phase 2	Joint Venture
Weihai Shipyard	Shandong	0.42	Need approval - Phase 2	Local
Shanhaiguan	Hebei	1	Need approval	CSIC
Shenzhou Shipbuilding	Zhejiang	3.6	Possible	Local
Donghong Shipbuilding	Zhejiang	0.2	Possible	Local
Yichun Wujiazui	Jiangsu	4	Possible	Local
Wuchang Shipyard	Shandong		Possible	Local
Xiamen Shipbuilding	Fujian	0.3	Need approval - Phase 3	Local
DSIC	Liaoning	2	Need approval	CSIC

Source: Company data, Morgan Stanley Research

Exhibit 38

Appendix 2: Historical and Near-term Global Shipbuilding Growth

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007E
World GDP	4.1	4.2	2.8	3.7	4.9	2.6	3.1	4.1	5.3	4.9	5.1	4.9
World Seaborne Trade (mn ton)												
Total Dry	3,055	3,258	3,262	3,334	3,598	3,652	3,851	4,051	4,313	4,502	4,719	4,911
Total Oil	1,960	2,059	2,062	2,103	2,174	2,228	2,210	2,352	2,470	2,565	2,610	2,607
Total Gas	104	119	120	130	143	143	146	159	170	179	207	247
Grand Total	5,119	5,436	5,444	5,567	5,915	6,023	6,207	6,562	6,953	7,246	7,536	7,912
Growth												
Total Dry (%)	0	7	0	2	8	2	5	5	6	4	5	4
Total Oil (%)	5	5	0	2	3	2	-1	6	5	4	2	0
Total Gas (%)	8	14	1	8	10	0	2	9	7	5	16	19
Grand Total (%)	2	6	0	2	6	2	3	6	6	4	4	5
Total World Fleet (mn dwt)												
Bulkers	265.5	272.8	282.1	279.4	281.8	289.2	300.0	306.6	313.7	332.7	354.4	377.3
Tankers	282	285.8	287.9	293.0	304.5	311.8	307.1	311.7	320.6	337.1	360.8	381.6
Cellular	44.9	50.0	56.5	62.2	64.7	70.3	77.7	84.8	91.4	99.6	111.4	128.0
Gas	17.4	18.1	18.7	19.1	19.9	21.2	21.6	22.3	23.8	25.4	26.9	27.1
Grand Total	610	627	645	654	671	693	706	725	750	795	854	914
Growth												
Bulkers (%)	5	3	3	-1	1	3	4	2	2	6	7	6
Tankers (%)	3	1	1	2	4	2	-2	1	3	5	7	6
Cellular (%)	12	11	13	10	4	9	11	9	8	9	12	15
Gas (%)	22	4	3	2	4	7	2	3	7	7	6	1
Grand Total (%)	5	3	3	1	3	3	2	3	3	6	7	7
Total Orderbook (mn dwt)												
Bulkers	35.4	30.1	26.5	24.3	33.5	35.4	24.0	31.9	56.3	70.6	75.9	89.4
Tankers	20.5	22.0	42.4	46.4	41.2	52.4	64.8	61.0	78.2	91.0	86.7	136.6
Cellular	13.0	14.1	9.9	8.2	11.8	18.3	17.0	14.0	32.7	45.5	53.6	58.1
Gas	2.0	1.8	2.3	2.5	2.2	2.8	4.6	5.2	5.1	10.0	14.2	17.3
Grand Total	71	68	81	81	89	109	110	112	172	217	230	301
Total Deliveries (mn dwt)												
Bulkers	17.7	19.1	11.7	13.1	13.3	20.5	14.3	11.8	19.7	23.4	26.0	25.1
Tankers	12.1	8.2	13.2	20.1	21.4	14.2	23.4	30.5	28.1	29.7	26.3	24.4
Cellular	5.5	7.1	7.2	3.5	5.8	8.1	8.3	7.1	8.2	11.9	16.9	16.9
Gas	0.9	0.7	0.5	0.8	1.4	0.5	1.1	1.9	2.0	1.6	2.7	0.4
Grand Total	36	35	33	38	42	43	47	51	58	67	72	67
Total Demolition (mn dwt)												
Bulkers	9.4	8.7	14.1	10.1	5.1	8.9	7.4	4.5	0.8	1.0	2.2	2.2
Tankers	6.0	3.5	6.5	16.6	13.9	15.9	17.1	19.5	8.2	4.1	3.1	3.6
Cellular	0.4	0.5	1.6	1.0	0.3	0.6	1.2	0.5	0.1	0.0	0.3	0.3
Gas	0.0	0.1	0.0	0.1	0.1	0.1	0.5	0.4	0.4	0.1	0.1	0.2
Grand Total	16	13	22	28	19	25	26	25	9	5	6	6

Source: Clarkson Research Service, IMF, Morgan Stanley Research E = Morgan Stanley Research estimates

MORGAN STANLEY ModelWare	**Morgan Stanley ModelWare is a proprietary analytic framework that helps clients uncover value, adjusting for distortions and ambiguities created by local accounting regulations.** For example, ModelWare EPS adjusts for one-time events, capitalizes operating leases (where their use is significant), and converts inventory from LIFO costing to a FIFO basis. ModelWare also emphasizes the separation of operating performance of a company from its financing for a more complete view of how a company generates earnings.

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(as of November 30, 2007)

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Total	**2,316**		**723**		

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Morgan Stanley

The Americas
1585 Broadway
New York, NY 10036-8293
United States
Tel: +1 (1) 212 761 4000

Europe
25 Cabot Square, Canary Wharf
London E14 4QA
United Kingdom
Tel: +44 (0) 20 7 425 8000

Japan
4-20-3 Ebisu, Shibuya-ku
Tokyo 150-6008
Japan
Tel: +81 (0) 3 5424 5000

Asia/Pacific
Three Exchange Square
Central
Hong Kong
Tel: +852 2848 5200

Industry Coverage:China Shipbuilding

Company (Ticker)	Rating (as of)	Price (12/10/2007)
Andy Meng		
China State Shipbuilding Co. Ltd (600150.SS)	O (01/30/2007)	Rmb219.52
Guangzhou Shipyard Intl. Co., Ltd. (0317.HK)	O (02/07/2007)	HK$47.2
Guangzhou Shipyard Intl. Co., Ltd. (600685.SS)	O (02/07/2007)	Rmb78.03

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