

What **China** Means to the Future of **MOL**



China's Rising Demand for Natural Resources and Energy

In March 2004, MOL signed a 20-year contract with Shanghai Baosteel Group, China's largest steelmaker, to operate a 300,000-ton class "very large ore carrier." To be completed in the second half of 2008 or first half of 2009, the vessel will carry iron ore from Brazil to China. This is the fourth ship to operate under a long-term contract between Baosteel and MOL. Excluding its shipping subsidiary, Baosteel had relied almost entirely on the spot market for its ocean transport needs until recently. A senior executive at Baosteel noted that only MOL could provide the required vessels, and that this ability was the key to forming a partnership with MOL. This relationship is still expanding: Baosteel is considering the construction of even more vessels in conjunction with MOL.

In its 2003 annual report, MOL stated that "we also expect better results in dry bulk thanks to the consistent growth in crude steel production



Contract Signing Ceremony with Shanghai Baosteel Group

worldwide, especially in China." MOL then confirmed this outlook by using its own network to gather information in China, and decided to place a large order for Capesize bulkers ahead of other shipping companies—and before tight capacity prompted shipyards to raise prices.

As table 1 shows, China's iron ore imports in 2003 were 148 million tons, 37 million more than in 2002. This growth was responsible for much of the global increase in iron ore shipments as well as for the healthy market conditions for the entire bulker market. As is often the case in countries with economies that have started to take off, China requires huge volumes of steel for massive construction projects. There are now many highways,

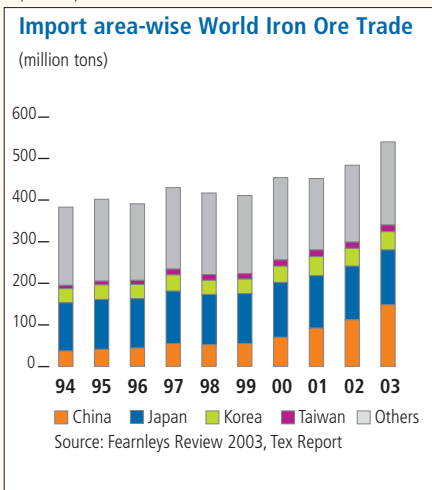
bridges and other infrastructure projects leading up to the 2008 Beijing Olympics and 2010 Shanghai Expo, as well as for development of western regions of the country. Also driving demand for steel are manufacturing, notably for autos and ships (see table 2), and public-works projects requiring water and fuel pipes. The Chinese government is supporting this growth while at the same time keeping the market from becoming overheated by encouraging the closing of unproductive small and midsize steel mills. The resulting growth rate in iron ore imports will most likely not be below the pace at which the supply of bulk carriers rises. Based on its rising need for iron ore along with expectations for bulker rates to remain relatively high, Baosteel decided to enter into long-term contracts with MOL to ensure a reliable flow of raw materials. Baosteel's stance meshes well with MOL's policy of building long-term relationships with trustworthy partners rather than pursuing big short-term profits during the brief periods when rates are unusually high.

The positive outlook for bulkers is not limited to China's steel industry. The highly competitive 35 Capesize bulkers that MOL has ordered (as of May 2004), the first of which was completed in January 2004, are attracting attention among Japanese steelmakers. During the past year or so, MOL has signed a number of medium- to long-term contracts with these companies, MOL's core customer segment for these bulkers.

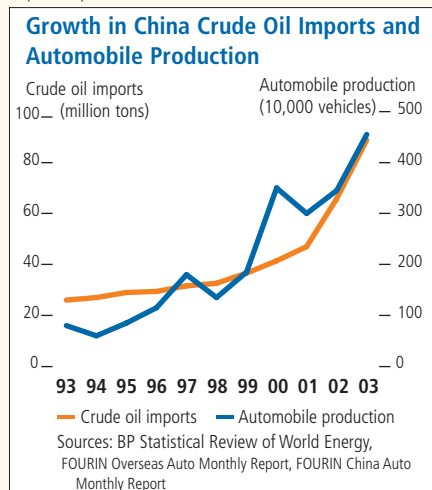
In fiscal 2003, China accounted for only about 1% of iron ore transported by MOL. According to MOL's plans, this share will rise to 5% in fiscal 2006 and 10% in fiscal 2009. Iron ore transport exemplifies MOL's China strategy. While closely monitoring opportunities in this market, MOL aims to reap benefits directly and indirectly from medium- and long-term perspectives. Earnings will be generated in a flexible yet stable manner that does not aim for short-term gains or result in an undue reliance on the Chinese market.

Of course, resources for steelmaking are not the only market sector in China having an impact on global demand for ocean transportation. China has been a net importer of crude oil since 1993. In 2003, China passed Japan to become the world's second-largest consumer of oil. That year, its

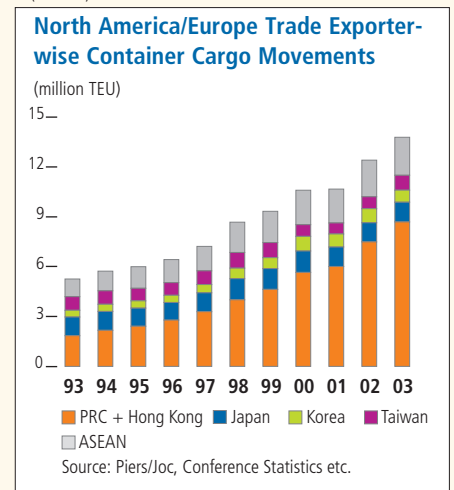
(Table 1)



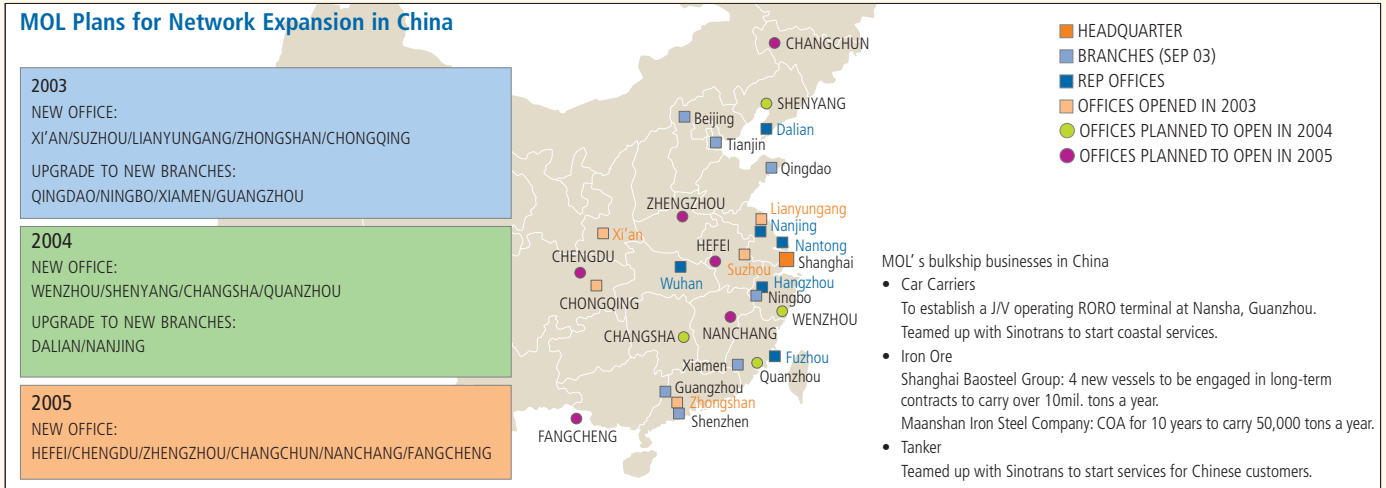
(Table 2)



(Table 3)



(table 4)



crude oil imports were more than 91 million tons (see table 2), 31% more than in 2002. Growth on this scale is one of the underlying factors supporting today's high crude oil prices and tanker rates. With a large fleet of VLCCs, MOL is a major beneficiary of the favorable market conditions. As the first step toward expanding its role in crude oil transport to China, MOL in April 2004 established a 50-50 joint-venture company with China's Sinotrans Ltd. The new company immediately started operations by purchasing a VLCC from MOL.

Besides iron ore, MOL also has its eye on China's rising demand for other dry bulk cargo. In June 2003, MOL became a senior partner in International Handybulk Carriers, which has bases in Hong Kong and Shanghai and is one of the world's largest independently managed pools of handysize bulk carriers. Targeting rising demand in China for wood chips and pulp for papermaking, MOL has begun entering into agreements with Chinese companies to operate the specially designed vessels needed to transport these materials.

Exports From "The Factory to the World" Continue to Climb

MOL's strategy for China is based on a balanced approach covering domestic demand as well as exports. As table 3 shows, shipments of finished products from Asia to Europe and North America have increased by 2.4 times over the past decade. China is obviously the primary source of this growth. In 2003, China, including Hong Kong, accounted for a remarkable 63% of total Asian exports.

Much of this expansion is due to the transfer of factories to China, a trend that is evident in the fact that contracts with importers account for about 80% of MOL's exports from China to Europe and North America. Nothing but a weakening in the economies of importing nations could possibly have an impact on the strength of China's exports. But no slowdown in outsourcing of production to China is likely as long as there are importing nations whose citizens demand inexpensive household goods.

China continues to be a highly cost competitive manufacturer due to the enormous pool of labor in interior regions of the country. Furthermore, China has improved its legal structure for foreign investments and trade to some extent following its 2001 admission to the WTO. And by skillfully managing the foreign exchange issue, China is preserving its position as the factory to the world. According to a foreign direct investment survey by prominent U.S. consulting firm A.T. Kearney, Inc., China was chosen in both 2002 and 2003 as the world's most attractive country for direct investments.

To target the rapid growth in China's finished product exports, MOL is stepping up sales activities in importing nations. At the same time, based on a three-year plan ending in 2005, 29 sales offices (see table 4) are being added in China, including in inland cities. Additionally, MOL is increasing the frequency of calls to Chinese ports by containerships (see table 5) and is participating in the Shanghai Super Express, an innovative high-speed RORO (roll-on/roll-off) service between Shanghai and Japan.

In the car carrier sector as well, MOL is laying the groundwork for future growth. With Sinotrans, MOL in April 2004 established a company to ship cars on domestic routes along the Chinese coast. This joint venture is positioning MOL to help meet projected needs for transporting export vehicles in the future.

(table 5)

Growth in Containership Service in China

2003	May	Started Japan-Taiwan-Hong Kong-southern China service
	May	Started direct service from southern China to U.S. West Coast
	June	Started loop service linking Shanghai and southern China with the U.S. East Coast
2004	Feb	Added Shanghai call to Asia-southern/western Africa service
	April	Started northern China-Philippines-Indonesia service
	June	Added route with first northern China port call to China-southeast Australia service
	June	Started U.S. West Coast service originating in northern China
	July	Started Asia-northern Europe loop service originating in southern China

In the logistics sector, MOL is participating in bonded warehouse projects in Shanghai and Shenzhen. And, as was noted earlier, since most exports are linked to outsourced production and the purchase of finished goods from Chinese suppliers, MOL is reinforcing its ocean consolidation business in Shanghai, Shenzhen and Hong Kong.

Fundamental Shifts in Global Cargo Flows

MOL's ocean consolidation business is an effective means to attract major clients for exports from Southeast Asia as well as China. After all, the regional shifts and growth in ocean cargo movements has been occurring for many years. Initially driven by NIES and the ASEAN countries, shifts were then shaped by China (see table 6). Now, we are witnessing the emergence of India, Brazil and Russia as significant forces in the ocean transport market.

Growth in global ocean cargo movements is shown in table 7. The increases in containers, LNG and coal have all exceed global GDP growth every year, and iron ore volumes surpassed GDP growth as well in 2003. With the end of the Cold War, the socialist economic bloc, which then accounted for about one-third of the world's population, joined the market economy. The greater cross-border trust that resulted also broke down barriers that had prevented the international division of labor. And now south Asia, which has a collective population about the same as China's 1.3 billion, is becoming part of this trend. Furthermore, the rising distances between supply sources and importing nations are pushing up demand for ocean transport. So current trends in global logistics are not limited to China, but are in fact bringing about momentous changes on a global scale.

This is good news for companies like MOL. But success requires the ability to take concrete actions as far ahead of competitors as possible. The steep growth of LNG and container transport in recent years demonstrates the wisdom of MOL's decision to concentrate on these market segments during MOL *next*. In India, a market just now attracting attention, an LNG

carrier managed by MOL delivered that country's first LNG shipment in January 2004. Two months later, MOL established a joint-venture company with a prominent U.A.E. conglomerate to transport crude oil to India. MOL is also expanding its presence in Russia and Brazil for the transport of natural resources and containers.

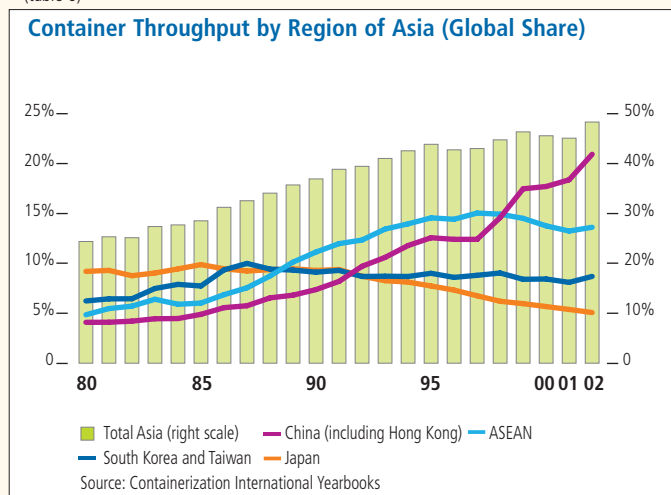
MOL's vision, backed by close ties with Middle East energy exporting nations, extends beyond countries such as China, Brazil, India and Russia. For instance, MOL was the first shipping company to realize what the magnitude of potential growth in U.S. demand for LNG means to the industry. Another example is refined petroleum products. Noting that petroleum imports by the U.S. are projected to rise by 2.3 times between now and 2025, MOL immediately went out to see customers to confirm this trend. This led to the conclusion that imports of refined products would increase as a share of U.S. petroleum imports. This finding led to MOL's placement during fiscal 2003 of a huge order for product tankers.

What China Means to the Future of MOL

Gather information from many sources. Confirm the information through its own network. Make decisions quickly. This is the MOL formula for success in China and elsewhere. One illustration was the prescient decision in 2003 to place a large order for iron ore carriers. Another is the placement of orders for product tankers.

MOL will continue to closely monitor trends in ocean transport, aiming to be the first to take advantage of emerging opportunities. MOL believes that the ability to accurately analyze trends and quickly take appropriate actions is the key to sustainable growth for shipping companies. Within this context, MOL regards China as both an example and major component of the dramatic changes now taking place in global cargo flows. MOL's recent accomplishments in China therefore represent just the first of many steps to be taken worldwide that will establish a sound foundation for sustainable growth.

(table 6)



(table 7)

