

2011 ANNUAL REVIEW & OUTLOOK

EXECUTIVE COMMENTARY

required by the new ECA regulations, is expensive, and the necessary refining capacity is somewhat limited. Total costs, therefore, will increase. Carriers must start acting now to minimize the impact of these challenges on their businesses, profits and customer relationships.



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OVER THE PAST YEAR, the container liner industry has enjoyed an unprecedented, and one may argue unexpected, resurgence in volumes in almost all trades. Although the emerging market trades were among the first to recover, the real story for 2010 has been the incredible success of the traditional long-haul lanes to the United States and Europe.

Unfortunately, because of acute equipment shortage and uncertain forecasts for cargo demand, supply was kept in check for the first half of the year, resulting in high ocean freight rates.

Faced with limited options, shippers have lobbied for regulatory reform. However, because of the ample amount of idled capacity available on the open markets, the gap in supply was quickly mitigated by new entrants and services.

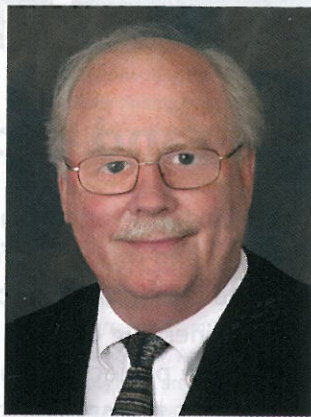
Market dynamics, under the current framework, allowed for a rapid return to a more balanced supply and demand scenario. Most importantly, all stakeholders - ship-

pers and carriers alike - need to understand that the volatility in cargo volumes over the past several years is the exception, rather than the long-term rule.

As such, the industry must endorse a stable regulatory framework, as opposed to making sudden and drastic changes affecting shipper and carrier relationships.

In 2011, the deferred orderbook, notably ships of the post-Panamax variety, will begin to be delivered to many carriers. The industry will face the challenging task of balancing the tenuous supply and demand dynamic, whether it is replacing chartered tonnage with new deliveries, or targeting markets that have adequate cargo growth for the coming year.

One could argue 2010 was only a temporary respite from the longer-term supply-and-demand challenges for the container sector. In addition to adjusting to the volatile financial markets, including exchange rates and bunker costs, carriers will need to more efficiently adjust deployment so that the long-term financial health of players is not jeopardized.



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THERE WILL BE many changes in how ocean freight is purchased in 2011, because of carrier and shipper experiences during 2010.

Rates are the most visible result

of freight/service contracts, but there won't be as much pressure on rates in 2011 as there was in previous years. I believe rates peaked in most trade lanes by late 2010, so shippers will want to minimize any cost increase surprises. Carriers will seek to maintain their market shares at newly profitable revenue levels.

Shippers will no longer accept standard carrier boilerplate contracts, especially when it comes to automatic general rate increases or other clauses that could unilaterally change agreed negotiated rates. Transit time, rotation and other service profile matters will take higher priority in contract agreements. Carriers will listen because they want to ensure maximum usage of their ships.

SHIPPERS ARE SEEKING TO AMPLIFY THEIR VOICE IN DEALING WITH OCEAN CARRIERS, SUCH AS BY FORMING OR JOINING SHIPPERS ASSOCIATIONS.

That doesn't mean there won't be pushback from carriers. Rationalizing capacity and slow-steaming have proved to be excellent tools in reducing costs, and have helped carriers overcome the horrendous financial results of 2009. However, carriers purchase ships to deploy them, not to lay them up in sheltered harbors. New ships - at a few hundred million dollars each - only earn revenue when they are sailing with cargo aboard.

Shippers' worst fears were reached with the unprecedented uniformity of pricing actions in 2010 - some permitted legally by joint agreements, others enacted in follow-the-leader pricing practices. While these pricing coincidences have invited legislation to eliminate carrier antitrust immunity, changes won't happen for a few years yet. More immediately, shippers are seeking to amplify their voice in dealing with ocean carriers, such

as by forming or joining shippers associations.

Both shippers and carriers will make major changes in how freight is bought and sold in 2011, and we should finally see more balance to freight service contracts.

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ANCIENT ORIENTAL PHILOSOPHY told us anything that went to extremes would reverse. Container lines' unexpected recovery in 2010 after a disastrous 2009 is a good example.

The quicker-than-expected recovery of cargo volume in early 2010 produced some unprecedented actions and issues: aggressive rate restoration after \$15 billion in collective carrier losses in 2009; shipper complaints to the government about space and equipment shortages; government investigations and establishment of a communications platform for carriers and shippers; and review and study of the Shipping Act.

Carriers idled capacity - more than 1,000 ships totaling 12 percent of global capacity were parked by late 2009 - and then some returned to the market sooner than expected as carriers were anxious to repair the financial damage while pricing services at a profitable level.