2016 Interim Results Transcript

29 July 2016

Speaker: Mats Berglund

Slide 1 – Cover

Good afternoon ladies and gentlemen, and welcome to Pacific Basin's 2016 Interim Results earnings call.

My name is Mats Berglund, CEO, and I am joined by our CFO Andrew Broomhead.

I will start with an overview of our results and business activities before Andrew talks you through the financials. I will then invite you to ask any questions you may have.

Slide 2 – 2016 Interim Results Highlights

In extraordinarily weak market conditions, dry bulk market freight rates fell to record low levels early in the year which impacted our results. We made a net loss of US$49.8 million and a positive operating cash flow of US$7.7 million in the first half of the year.

Our combination of ships and cargoes to achieve maximum utilisation enabled us to generate average Handysize and Supramax daily TCE earnings that again significantly outperformed the Handysize and Supramax indices.

We completed a one-for-one rights issue in June raising new capital of US$143 million net, and as of June 30, we had cash and deposits of US$406 million.

We consider the rights issue to have been an equitable way to strengthen our balance sheet and liquidity position in a year when we are repaying 230 million of convertible bonds and when issuing a new CB would have been very expensive. We already repaid 106 million of convertible bonds in April, and expect to repay another 124 million in October.

The new rights issue capital enhances not only our ability to navigate the protracted challenging environment, but also our ability to attract cargo and to carefully assess and potentially purchase secondhand vessels at low prices.

We remain focused on safe and cost-efficient operations and scale benefits, which have contributed to a further reduction in both our daily Handysize vessel operating costs and shore-side G&A expenses compared to last year.

Our limited remaining towage activity is focused in the Middle East where our remaining tugs and barges have a net book value of about US$18 million and continue to be marketed for sale. Our towage disposals in the year to date have generated cash proceeds of US$12 million.

Slide 3 – Our Performance in 1H 2016 & Cover for 2H 2016

Our Handysize and Supramax daily TCE earnings of about US$6,100 and US$5,900 outperformed the Handysize and Supramax spot market indices by 56 and 29% respectively.

The market for Supramax vessels was especially weak resulting in our average Supramax rates unusually falling below our Handysize rates. This has since normalised with current Supramax TCEs now back above Handysize.

As at 27 July, we had covered 58% of our Handysize days for the second half of 2016 at about US$7,700 and 65% of our Supramax days at about US$8,000 per day.

Slide 4 – Our Cargo Systems Business Model & Ability to Outperform

Unlike the Capesize and Panamax segments, our Handysize and Supramax segments are diverse in terms of cargoes, customers and geography. This, together with our global office network and high quality fleet of substitutable ships, enables us to combine cargoes and achieve over 90% of all our days at sea with cargo.

This is how we generate our TCE premium which represents a significant earnings advantage when multiplied across our large fleet. The trades in which these geared ships are deployed are operationally intense, and having skilled people and operational expertise really makes a difference.

Our average Handysize and Supramax TCE premium over the past five years is about US$2,400 and US$1,800 per day respectively.

Slide 5 – Extreme Low Spot Rates in 1Q 2016

Baltic dry bulk freight market indices declined in early 2016 to new record lows for all bulk carrier types which, in February, all recorded TCE earnings of less than US$3,000 per day. That is below cash operating expenses, and conditions are estimated to have been as poor as those of the early 1970s, some 45 years ago. Rates were undermined mainly by a general seasonal and Chinese New Year slowdown in demand, lingering oversupply of dry bulk tonnage and lower Chinese imports of coal.

Increased activity after mid-February supported improved market freight rates. The improvement was more notable in the Atlantic where key drivers included strong exports of long-haul South American agricultural products. China has also been resilient with continued high levels of steel exports, and bauxite and copper concentrates imports.

Rates have improved a bit further since mid-year, partly due to an unexpected recovery in Chinese coal imports, but it is important to note that market freight rates remain historically low and below P&L break-even levels.

Slide 6 – Handysize Vessel Values

Clarksons Platou now value a benchmark secondhand Handysize at US$9.3 million which is down 28% since a year ago. A newbuilding is rated at US$19.5 million, down 8% since last year. Note that the value difference between Japanese and Chinese built ships remains significant. Values have stabilised recently on improved market sentiment.

The all-time large gap between newbuilding and secondhand prices continues to discourage new ship ordering activity which will benefit freight market fundamentals in the longer term.

Slide 7 – Minor Bulk is Not So Minor

Analysts often focus on iron ore and coal and the fact that the long-term outlook for those segments is challenging. However, the cargoes we focus on – minor bulks and grain – together represent 48% of global dry bulk volumes and are still expected to grow albeit at lower pace than before.

Minor bulk demand is less dependent on China and has a more diversified geographical, cargo and customer profile. As mentioned, this allows for the combination of trades to achieve higher laden utilisation, which is exactly our strategy and how we can deliver value over average market earnings.

Slide 8 – Chinese Dry Bulk Imports Growth in 1H 2016

Global dry bulk demand statistics for the first half are not yet available. However, we have data on Chinese imports. Chinese dry bulk imports, representing about 30% of global demand, increased 7% year on year, driven mainly by improvement in iron ore and coal imports compared to the weak first half of 2015. An increasing percentage of the steel produced in China is exported and China’s exports of steel grew 9%. Chinese imports of seven key minor bulks increased by 5 million tonnes or 4% year on year.

Slide 9 – Self-Correcting Supply Factors

All-time low freight earnings encouraged 1.8% of existing dry bulk capacity to be scrapped in the first quarter. That's the highest level of scrapping in over 30 years.

Scrapping slowed in the second quarter and, in the half year overall, shipowners opted to delete 2.8% of total dry bulk capacity.

New ordering for most dry bulk ship types was very small in the first half, with new orders substantially limited to thirty Valemax ore carriers dedicated to Vale's own iron ore export trades and primarily built to replace an ageing fleet of large ore carriers, many of them converted VLCCs.

For the first time since the 1980s, we observed a meaningful number of vessels withdrawn from the market early in the year for short-term idling or longer-term lay-up.

There has been minimal net growth in the dry bulk fleet overall since the seasonal surge in new ship deliveries in January.

Slide 10 – Dry Bulk Supply & Orderbook

New ship deliveries in the first half represented 3.6% of existing dry bulk capacity. That's a record shortfall of 52% compared to the scheduled orderbook for the period, and full-year deliveries are projected also to fall significantly short.

In view of the continued orderbook shortfall and slippage, we expect new ship deliveries in the full year 2016 to be similar to last year's 49 million deadweight tonnes.

We expect the absence of new ordering to result in significantly reduced new ship deliveries from next year onwards, and these positive supply-side reactions to the challenging market will contribute to a healthier market in time.

Slide 11 – Dry Bulk Supply & Demand

In slide 11 we show Clarkson Platou's yearly demand and supply levels combined in one chart. They estimate dry bulk demand in 2015 to have marginally contracted year on year, with a forecast for modest growth in 2016 and further year-on-year improvements in 2017 and 18.

Key drivers of the demand improvement include a healthy outlook for minor bulks and continued growth in long-haul grain shipments.

And with lower, if any, fleet growth in 2017 and 2018, the supply and demand balance should improve.

I will revert with a wrap-up but now hand you over to Andrew who will present the financials**.**

Speaker: Andrew Broomhead

Slide 12 – 2016 Interim Financial Highlights

The Group reported an underlying loss of US$61.6m due to a record low weak first half dry bulk market.

The loss attributable to shareholders of US$49.8 million was impacted by:

- US$13.7m of non-cash mark-to-market income mainly on our bunker swaps (used to hedge our fuel exposure on forward cargo cover) and
- US$1.9m book loss from the sale of towage assets

Slide 13 – 1H16 Pacific Basin Dry Bulk

Analysing our dry bulk results:

Our Handysize revenue days decreased by 12% while our Supramax days increased with 39%. The record low first half dry bulk market brought down the achieved TCE earnings of both our Handysize and Supramax vessels.

Handysize TCE earnings decreased 23% to US$6,080 per day and outperformed the market by 56%, whilst blended daily costs reduced by 7%. This resulted in Handysize contributing with a loss of US$ 30.2 million

Our Supramax TCE earnings decreased by 37% to US$ 5,910 per day and outperformed the market by 29%. The blended daily costs reduced by 24% as we chartered in more short term vessels at more favourable rates. The overall Supramax contribution was a loss of US$ 6.8 million.

Slide 14 – 1H16 Daily Vessel Costs – Handysize

Handysize blended operating costs of US$7,300 per day decreased 8% compared to 2015 due to both improved cost efficiencies for owned vessels as well as improved costs for chartered vessels as we have redelivered expensive time charter vessels.

The proportion of owned to chartered vessel days increased to 54% compared with 2015.

The break out graph shows the different chartered daily cost split between short-term, long-term and index charters.

Slide 15 – 1H16 Daily Vessel Costs – Supramax

We continue to make use of a significant portion short-term vessels which are able to make a good contribution to our service and our results even in the weak market.

Supramax blended operating costs of US$6,370 per day decreased 22% compared to 2015 which is due to significantly lower charter-in vessel rates which dropped to US$5,750 per day.

Our owned vessel opex increased by 4% due to a few one-off repair and maintenance costs

For both Handysize and Supramax, our daily overheads reduced 9% to US$680 reflecting the focus on reducing our cost of doing business.

Slide 16 – 1H16 Balance Sheet

Our owned fleet includes 70 delivered Handysize vessels with an average book value of US$15.9m and an average age of 9.4 years, and 16 delivered Supramax vessels with an average book value of US$22.2m and an average age of 7.4 years.

At the end of June, cash and deposits had increased to US$406m. With a net borrowings position of US$466m, its giving a net gearing of 29%, reduced from 35% at the end of last year due primarily to the repayment of convertible bonds and the capital raised via the rights issue.

We remain in compliance with our loan covenants.

We maintain as a KPI that net gearing should remain below 50% - a number that we believe is conservative in an asset intensive industry.

Slide 17 – Borrowing and Capex

We have US237m of capex commitments spread over the coming 12 months. This will be funded by our remaining undrawn Japanese export credit facilities of US$238m, with a further $34 million of other secured borrowing facilities we will draw down.

In October 2016 we expect the put of the US$124 million 2018 Convertible Bonds based on all bondholders exercise their right to redeem the bonds at 100% of the principal amount. This is to be funded from the recent rights issue proceeds.

Slide 18 – Cash Flow

The Group generated operating cash flows of US$8m for the period and raised US$143m of cash after expenses through the rights issue. As well we received US$14 million of cash proceeds from Towage sales and other non-core assets.

Capex of US$48m during the period included vessel payments for 1 Handysize delivered during the period and instalments for another 4 Handysize and 3 Supramax newbuildings.

Our net decrease in borrowings of US$55m reflects:

- 2016 CB principal repayments of US$106m
- Net repayment of US$22m of bank borrowings and revolving facilities
- Drawdown of US$73m under our Japanese export credit facilities for 4 delivered new buildings during late 2015 and first half 2016

The overall result was an increase in our cash balances to US$406m at the period end. And now I would like to hand back to Mats.

Speaker: Mats Berglund

Slide 19 – Our Position & Strategy

To wrap up, the first half of 2016 saw extraordinarily weak dry bulk market conditions, but increased activity since February has supported improved market freight rates and the very negative sentiment of earlier this year has tempered in recent weeks.

For the market to improve further, it’s important that scrapping remains at high levels and our industry must scrap older ships and ships of poor design. They are not making any money in this market and it’s not worth investing further in such ships by way of expensive drydockings and the retrofitting of new ballast water treatment systems. They should go for scrap to shrink the oversupply.

This ongoing scrapping, practically no new ship ordering and a shrinking orderbook will together lead to a gradually healthier supply/demand balance. But the timing of a more substantial recovery is hard to predict and we are managing the Company for a continued weak market in the medium term.

We are driving further cost savings, conducting our business efficiently and safely and continuing to work hard on combining ships and cargoes to maximise our utilisation and margins. We are not entering into any new long-term charters, relying instead on our growing fleet of owned and low-cost short-term chartered in ships.

Our cash position, the successful rights issue, our robust business model and our solid track record in terms of service delivery and high vessel utilisation, all contribute to the strong corporate profile that sets us apart as a preferred, strong, reliable and safe partner for customers and other stakeholders.

We are well positioned to navigate this extremely weak market and to benefit from a cyclical upturn when it comes.

Thank you for listening, and I now invite you to ask any questions.