Presentation

Operator:

Ladies and gentlemen, thank for standing by and welcome to the Pacific Basin Shipping Q1 Trading Update Conference Call. Today's call will be presented by Mr. Mats Berglund, Chief Executive Officer and Mr. Andrew Broomhead, Chief Financial Officer for Pacific Basin Shipping. At this time, all participants are in a listen-only mode. There will be a presentation followed by question-and-answer session. (Operator Instructions) I must advise you that this conference is being recorded today, Wednesday, 22nd April 2015. I would now like to hand conference over to your first speaker today, Mr. Mats Berglund. Thank you, please go ahead.

Mats H. Berglund, Chief Executive Officer:

Thank you, welcome everyone. Thanks for calling in and for your interest in our company. As mentioned, with me in the room here today, I have our CFO, Andrew Broomhead. Following our AGM today, we would like to give you a brief update on the first quarter trading, the latest supply and demand developments and the company's position going forward.

We will be brief and then most importantly give you a chance to ask any questions you might have. We made $8,100 per day in the first quarter on our Handysize and $9,800 per day on our Handymax, outperforming the very weak first quarter spot index rates by about 60%. These earnings that we are making are slightly below our disclosed breakeven levels on a P&L basis, but above EBITDA breakeven levels.

Mortgage rates have generally been falling over the last five years to record low levels year-to-date 2015. But we have outperformed index rates by an average of about $2,300 per day over this 5.5 year period. Thanks primarily to our business model with cargo contracts scale and high utilization rates of our fleet.

G&A for the first quarter reduced to $14 million from $19 million in the first quarter last year, and a relatively small remaining towage activities were marginally profitable in the first quarter. For the remaining three quarters of the year, we are 46% covered at about $9,500 per day for Handysize and 53% covered at about $10,100 per day for Handymax. Vessel values have come down to very low levels, particularly for second hand ships.

Due to the uncertain market situation with slowing Chinese imports, we are managing for a continued weak market in the medium term. This means that we are neither buying nor long-term chartering ships and all focus is instead on reducing costs, squeezing the maximum that we can out of our existing cargo system and making a margin on short-term operating activity. In a strong market everybody can get a cargo, but it is in times like this that we really need good people with skill, relationships and good performing fuel-efficient ships.

The recent market weakness can primarily be explained by much lower coal imports to China, and by the continued reduction in bauxite and nickel shipments due mainly to the continuing Indonesian ban on exporting unprocessed minerals. We are also still in a slightly oversupplied market due to the large global dry bulk fleet growth during the period 2010 to 2012.

There are some positive developments, such as more coal imports into India and construction material into the US, but the tonne-mile effect of this is overshadowed by the large reduction of coal imports to China.

In the longer term though, we remain positive about minor bulk demand, such as agriculture imports to China and expect minor bulks to peak later in the economic cycle, as compared to major bulks such as iron ore. The only positive thing with the weak market and the negative sentiment is that the dry bulk fleet growth is slowing and new vessel ordering has pretty much come to a complete stop.

Scrapping is up significantly and a lot of Chinese shipyards are closing down. These are markets self-correcting factors and the global net fleet growth has actually been flat for the last few months. It will take some time before these factors have an effect on the market, but it is important to remember that this is a cyclical market and upturns are typically driven by unexpected events.

The Group had $363 million of cash at the end of 2014, borrowings of about $1 billion and net borrowings ratio to net book value of the assets of 40%. It's important for us to plan for the repayment of our $210 million convertible bond in April 2016, about a year from now, and also – with the current weak markets – for the put to us and the repayment also of our $124 million convertible bond in October 2016.

So we are issuing a new convertible bond, and the timing was partly opportunistic since our share price went up from about HK$2.50 to HK$3, but it is to help fund the repayments of the existing convertible bonds that we are issuing this new $125 million convertible bond due 2021 with a coupon of 3.25% and a conversion price of HK$4.08 per share. This conversion price is 37.5% above the share price on the day that was HK$2.97 a share. This convertible bond is already placed in the market on these terms with the investors committed, but it's subject to shareholder approval and we will be having an SGM, Special General Meeting for this purpose, that is planned for around May 22nd. Issuing this new convertible bond is consistent with managing for a continued weak market in the medium term and to make sure that we safely sale through this period of weak market conditions.

To wrap up this introduction, I would like to highlight that we have transform the company over the last three years. From a balance sheet with about $1.6 billion of long-term assets, of which $1 billion was in our core dry bulk business and $600 million three years ago in three other businesses (RoRo, Towage and Terminals) where we were small and marginal players without any competitive edge.

We were already strong in Handy Dry Bulk back then, but we were relying very much on shorter dealings ships with only 25% of our fleet owned. It has been a painful process, and as you have seen in last year's P&Ls, but we have now sold out of these other activities and instead we now have about $2 billion invested in our core and strong Handysize and Handymax business, including new billings with own ships comprising a significantly larger portion and getting close to about 50% own ships of our fleet.

In spite of more total assets, we have significantly lower G&A. We are now well structured in my view with all our resources, both management and capital, fully focused on our core drybulk business where we have a strong platform and competitive edge as the world's largest Handysize owner and operator.

Thank you very much again for calling in and we now would like to invite you to ask any questions you may have.

Questions & Answers

<u>Question 1</u>

Operator:

Your first question today comes from the line of David Sexton from Lloyd's List. David, please go ahead.

David Sexton:

Hello. I'm just interested in finding out to what extent can Australia replace Indonesia with the thoughts of the smaller metal, such as bauxite and nickel ore?

Mats H. Berglund, Chief Executive Officer:

Yes, that's a good question. Australia is the main replacement country instead of Indonesia for bauxite, not much nickel, but bauxite is coming out of Australia, but it's not making up for all of the lost Indonesian trade. It's about 50% of what it used to be, and majority of the bauxite into China is coming from Australia, not much nickel. The nickel is coming primarily out of the Philippines, but not too much now because it’s rainy season there, that's also seasonally very low at this point. So there has been replacement of the Indonesian nickel and bauxite, but not making up more than roughly 50% of what it used to be.

David Sexton:

Thank you.

Question 2

Operator:

Your next question today comes from the line of Paul Dewberry from Bank of America Merrill Lynch. Paul, please go ahead.

Paul Dewberry:

Hi, good afternoon, thanks for the call guys. Just a question really with your full cover, I mean, obviously you could run half of your remaining base through rest of the year, locked-in respective rates even higher than you achieved in first quarter, I'm just really wondering in terms of the split, is that heavily skewed to 2Q or is it generally spread pretty evenly through the remaining three quarters of the year?

Mats H. Berglund, Chief Executive Officer:

Thanks, Paul. It's generally always higher percentage cover in the near future than in the more distant future. So yes, it's higher covered in the Q2 than in Q3 and Q4.

Paul Dewberry:

Okay, thanks.

Question 3

Operator:

Your next question today comes from the line of Karthik Chellappa. Karthik, please go ahead.

Karthik Chellappa:

Yeah. Thank you very much for the opportunity. Couple of questions from my side.

Firstly, is there any floor level below which we probably don't want to be covering our revenues for 2015 for both Handysize and Handymax?

And the second question is on the new CB issuance. How do we see the coupon rate on this new CB at 3.25? It seems to be fairly high relative to our previous CB issuance. And I'm also curious to understand why management did not explore other options like maybe bank debt, which will probably not have a dilutive impact. Thank you.

Mats H. Berglund, Chief Executive Officer:

Thank you. Is there a floor at which we will not take cargo contracts, but each cargo contract is evaluated on its own, because it may be a very important ingredient in a chain of cargos, so to speak. Our signature feature in the company, is a very high utilization rate, so we don't have a specific dollar per day number. There may be a cargo contract that's incredibly important, and complements other cargos and we may be willing to go lower on such a contract and then another one.

But at these levels where we hesitate to take cover, competition is extremely stiff for cargo contract these days. Shippers are getting used to the low spot rates unfortunately, and they shy away from entering into cargo contract and prefer to pay the even lower spot rates.

We're proactively trying to encourage them to take cargo contracts and also offer to help them lock in the lower bunker contracts, because it's historically extremely low total transportation cost for the shippers now, not only are freight rates at all-time lows, but also bunker prices have come down by almost half. So that's as specific as we can be on the floor on cargo cover.

On the CB coupon, we wanted to push up the conversion price a bit higher than normal to eliminate the dilution to existing shareholders. So you are right, the coupon is a bit higher than on the previous months, and the reason is that we are at the low point in the shipping cycle, and we don't want to issue any equity related instrument necessarily at this point, but at least we wanted to push up the conversion price.

There are really no regular bonds available to shipping companies, that would be extremely expensive with a very, very high interest rate. And bank mortgages, we are exploring and Andrew, maybe you want to comment a bit more on that, but we have disclosed that we are also doing bank mortgages on the remaining unmortgaged secondhand ships. But you should know that the outstanding is $334 million of convertible bonds, and this bond is only 125, so we will do bank financing as well, but we felt we at least should do some convertible bond at this time to safeguard our cash situation and the ability to repay these convertibles in 2016. Note that the 2018 bond may not be put to us, but we have to plan for that. It would be irresponsible not to plan for having to repay that 2018 bond in 2016 when the owners have the right to put it to us.

Karthik Chellappa:

Okay, thank you very much and all the best.

Mats H. Berglund, Chief Executive Officer:

Thank you.

Question 4

Operator: Your next question today comes from the line of Raymond Yap from CIMB. Raymond, please go ahead.

Raymond Yap:

Hi, gentlemen. Just like to ask a couple of questions. One is that, Mats, you mentioned just now that you wanted to reduce costs. Could you tell me how that is going to be achieved?

And you also mentioned that another strategy you have is to try and get a margin on short-term chartering activity, is that always possible or is this sometimes -- that is sometimes happen that your short-term chartering strategy works to the negative, as and -- you do actually make a loss or is it almost always a guarantee profit? So, I just want to understand the mechanics of that?

Also, you talked about the towage operations being marginally profitable in the first quarter. I'd like to ask, if this profit is sustainable and if the structure of the business now in such that no longer be expecting the losses that we saw in the previous years.

And finally, you also mentioned that the rate that you've locked in so far for the first quarter and for some part of the second and the fourth quarter were actually below the P&L breakeven, the cost that you disclosed on a daily basis for 2013. Yes, I can see below those costs, but of course your chartered costs will also come down with the weaker market, as well as whatever you have lost in is also at the lower level relative to the year before. So would it be fair to say that you perhaps were a little bit alarmist on that? Thank you.

Mats H. Berglund, Chief Executive Officer:

On the cost reductions, we are focusing on that across the board, that goes to our whole P&L, so to speak. G&A cost reductions have been possible due to reducing overall senior management cost and by getting out of the non-core activities. It's easier to manage one Dry Bulk business unit than four business units that we had three years ago including RoRo and Towage and Terminals. We are focusing a lot on reducing administrative costs. We are not reducing on customer efforts and attentions in this market. As I mentioned, you really need good people to get cargos, and you need the infrastructure that we have, the relationships and the cargo contracts and skilled people.

So we are trying hard to save on the right things and not on the wrong things, but we are trying to use our scale to lower our costs of lubricants, insurances and also of course on our chartering contracts – we're trying hard to improve the terms of our chartering contracts. We are also redelivering -- we're not extending long-term or medium term charters and everything that we take in is short, and as you mentioned, that lowers the total chartering cost.

On the question on the margin, on the operating activity. In an ideal world, we make a margin on that in strong market as we do in short markets, though it can go wrong at times. But it's possible to make a margin there also in a weak market, because we combine a cargo and a ship, so we had disclosed that we are continuing with our short-term charters. You should not expect that to disappear, because we're using our cargo relationships et cetera to make a margin also in these very weak markets. But the medium and long term ships are not extended, and we are not growing the overall fleet any more.

Towage, you're asking what does the future has to bring. The majority of the remaining towage activity as you know is in the Middle East. I'm not going to make a specific forecast there, because it's difficult to do, but we are marginally profitable there. We also continue to benefit a little bit from the few remaining charters in Australia and they will expire.

But the Middle East market is the most important going forward, and we have two activities there. We are in the construction market, which remains fairly strong with tugs and barges carrying aggregate et cetera. So they’re building a lot in the Middle East, and that market remains fairly, healthy. But we also have a few anchor handlers supporting the oil and gas market, and the oil and gas towage market in Middle East is weak due to the low oil price and a lot of oil and gas projects in the Middle East are put on hold.

So we're in one market that's reasonable and another market that's weak at the moment. But you should expect a lot less volatility and we're seeing the risk of big losses there much reduced due to our repositioning of this business. It's much smaller and what we have left is in the Middle East.

In the Middle East we have international crews on the tugs and they are a much, much lower cost than in Australia. In Australia you have Australian crews which are five times as high as international crews. So if you don't have employment in Australia, you're very exposed, and we are out of that market significantly.

Your last question was about the forward cover we have that's lower than breakeven. I was really referring to our actual earnings in the first quarter when I was referring to lower than breakeven et cetera. The future, as you correctly point out, it's only the locked-in portion and both our revenue and our costs will change depending on how the market rates will be. So the spot portion of revenue that's coming in is at a lot lower levels than the fixed rate, so revenue will be lower with what we know now, and costs will also come down. So my intention was not to sound alarmist, but just to be factual and informative and factual on what cover we have.

We do also disclose, as you know, our inward charter commitments and what costs they are at, but that's only for the non-index linked portion. Index ships and short-term charters in , are now coming in at lower cost levels. So you're correct in saying that the cost will also come down a bit. That's about as much as we can say there I think, does that answer most of your questions?

Karthik Chellappa:

Yes, very much. Thank you.

Mats H. Berglund, Chief Executive Officer:

Thanks.

<u>Question 5</u>

Operator:

Your next question comes from the line of David Sexton from Lloyd's List. David, please go ahead.

David Sexton:

Yeah, hello. Just a quick question, what opportunities do you see by way of agricultural commodities that going forward in next 12 months or so?

Mats H. Berglund, Chief Executive Officer:

I think we're optimistic about continued long-term growth in China's imports of primarily soybeans that they're importing, and we think that will go on. They are changing their eating habits in China, there's continued urbanization, they don't have enough land and water to grow their own crops and they need to import in an increased fashion going forward in our view.

So, yes, we're positive and optimistic about continued imports of agricultural products to China. Also of other minor bulks, such as nickel and copper et cetera, because it tends to go into more consumer-driven products than the major bulks. And it's not only infrastructure driven, so to speak, it's also driven by consumer-driven products.

David Sexton, Analyst:
Thank you.

Ending

Operator:

There are no further questions on the line, and that does conclude our conference for today. We thank you all for your participation. You can now disconnect.