2018 Annual Results Presentation Transcript

28 February 2019

Speaker: David Turnbull

Slide 0 – Cover

Welcome ladies and gentlemen, and thank you for attending Pacific Basin's 2018 Annual Results conference call and live webcast.

My name is David Turnbull, Chairman of Pacific Basin, and I am joined by our CEO Mats Berglund and our CFO Peter Schulz.

We are pleased to report that Pacific Basin delivered a strong performance in 2018. The Company generated significantly larger operating cash flows and our strongest earnings since 2010.

In view of our return to a meaningful level of profitability, the Board is recommending a final dividend of 3.7 Hong Kong cents per share. Combined with the 2.5 cents interim dividend distributed in August, this represents half of our net profit for the full year, which is consistent with our dividend policy.

Despite a weaker than expected start to 2019, the long term fundamentals for our minor bulk segment look encouraging. And while we are bracing ourselves for increased freight market volatility in 2019, as we have shown before, Pacific Basin has what it takes to navigate such turbulence adeptly.

Mats will now present our 2018 results and dry bulk market review. Peter will follow with a review of our financials, Mats will wrap up with an outlook and strategy summary, and I will then invite you to ask any questions you may have. Over to you Mats.

Speaker: Mats Berglund

Slide 2 – 2018 Annual Results Highlights

Good afternoon ladies and gentlemen. Please turn to slide 2.

We made a much improved net profit of US$72.3 million in 2018 and EBITDA of US$215.8 million.

The freight market strengthened again in 2018 which, combined with our larger owned fleet, high laden utilisation, continued TCE outperformance and competitive cost structure, enabled us to record these much improved earnings.

We continue to maintain good control of our owned vessel operating expenses which were kept substantially flat at a very competitive US$3,850 per day.

We acquired seven modern vessels during the year including four funded 50% by issuing shares, while selling one older vessel. These transactions have increased our owned fleet to 111 ships on the water at the end of January and grown the proportion of our owned ships, especially in Supramax. Two of the seven vessels purchased and one sold during the period are scheduled to deliver by end March 2019.

We also closed competitively-priced revolving credit and bilateral term loan facilities amounting to US$365 million. Peter will tell you more about these shortly.

In 2018, Pacific Basin won Dry Bulk Operator of the Year at the Lloyd's List Global Awards, and we won the Customer Care Award at the International Bulk Journal's IBJ Awards. These awards specifically acknowledged our commitment to quality operations and our commitment to placing customers at the focal point of our business.

Slide 3 – 2018 TCE Performance & 2019 Cover

Slide 3. Driven by strong growth in minor bulk demand against a muted increase in global Handysize and Supramax capacity, 2018 Handysize and Supramax spot market rates continued to recover from the cyclical low in 2016.

Our Handysize and Supramax net daily TCE earnings of US$10,060 and US$12,190 increased 21% and 27% year on year, and outperformed the Baltic Handysize and Baltic Supramax spot market indices by 22% and 12% respectively.

As at mid-February, we had covered 44% of our Handysize days for 2019 at about US$9,370 and 63% of our Supramax days at about US$10,570 per day net.

Slide 4 – Three Years of Improving TCE

Slide 4. The blue bars in the graph represent our average quarterly TCE earnings against average quarterly spot market earnings. Our outperformance increased during the year both on Handysize and Supramax, and our fourth quarter TCE earnings were our highest since the winter of 2013/2014.

Slide 5 - Weaker Start to 2019

Please turn to slide 5.

2019 has started weaker than the last two years with a more pronounced Chinese New Year dip, compounded by the US-China trade conflict, Chinese restrictions on coal imports, and recent iron ore infrastructure disruptions in Brazil that undermined sentiment further.

However, as the graphs for 2019 clearly show, the seasonal recovery is now firmly underway.

Slide 6 – Minor Bulk Expected to Drive Demand in 2019

Slide 6. Despite disruptions to some US-China trade, minor bulk tonne-mile demand increased by 5.3% in 2018. In contrast, total dry bulk demand growth (including both the minor and major bulks) slowed to 2.9% in 2018 due to stagnant trade in grain and iron ore.

In 2019, we expect continued solid growth in minor bulk demand and we expect grain to bounce back to positive growth again.

A trade deal between the United States and China could provide the market with a further boost, but we must not ignore the possibility that a protracted trade conflict could further undermine global GDP growth and consequently overall trade and dry bulk demand.

Slide 7 – Better Supply Fundamentals for Handysize/Supramax (I)

Please turn to slide 7. As expected due to the declining orderbook, newbuilding deliveries in 2018 reduced to about 28 million deadweight tonnes – or 3.3% of existing dry bulk capacity, the lowest level since 1992.

However, scrapping reduced to almost zero due to the much improved freight market conditions, meaning that the overall fleet growth of 2.9% was fairly stable compared to 2017.

After accounting for estimated delivery shortfalls, Clarkson estimates actual deliveries of 3.8% in 2019 with scrapping remaining low at less than 1%, giving an expected net increase in dry bulk capacity of around 3%.

It's important to remember that scrapping cannot go any lower than today's levels and there is potential for scrapping to increase due to the growing number of old vessels and the increasing burden of environmental regulation.

The supply fundamentals in our Handysize and Supramax segments look more favourable and, as you can see, the line in the right graph shows the net fleet growth is on a steadily reducing trajectory from 5.7% in 2015 to an estimate of almost zero for 2020.

Slide 8 – Better Supply Fundamentals for Handysize/Supramax (Cont)

On slide 8, we contrast in further detail both the orderbook and age profile of the smaller ships with the larger vessels.

Handysize benefits from the smallest orderbook and the highest percentage of older ships, pointing to a better balance between new deliveries and scrapping going forward, while for Capesize and larger the situation is reversed.

Slide 9 – New Regulations Benefit Stronger Companies

Slide 9 provides a quick update on environmental regulatory changes.

There are three new regulations that impact our industry.

The first requires the installation of Ballast Water Treatment Systems. Fourteen of our owned vessels have already been fitted with Ballast Water Treatment Systems and we have arranged to retrofit the balance 97 of our ships with a system based on filtration and electrocatalysis by the end of 2022.

The second is the IMO's global 0.5% sulphur limit which takes effect on 1 January 2020. Ship owners will have to comply either by using more expensive low-sulphur fuel, or by continuing to burn heavy fuel oil in combination with installing exhaust gas cleaning systems or "scrubbers".

We expect the majority of the global dry bulk fleet, especially smaller vessels such as our Handysize ships, will comply by using low-sulphur fuel. This should have a positive effect on the supply demand balance as higher fuel costs encourage ship operators to slow down.

However, some owners of larger vessels with higher fuel consumption, including some Supramaxes, are installing scrubbers to take advantage of expected lower cost of heavy fuel oil.

As we cannot risk being competitively disadvantaged, we are well prepared and have arrangements in place with repair yards and scrubber makers to install scrubbers on our owned Supramax vessels. These arrangements include fitting and testing scrubbers on Supras to gain experience early and to evaluate the equipment both technically and operationally.

Thirdly, in April 2018, the IMO announced an ambitious strategy to cut total greenhouse gas emissions from shipping by at least 50% by 2050 (compared to 2008) and improve average CO_2 efficiency by at least 40% by 2030 and 70% by 2050.

There is much uncertainty about how the market will eventually comply with these targets and the legislations that will in due course be implemented to achieve them. The easiest first step to decrease carbon emissions is to reduce speed, but our view is that these new IMO targets will also lead to the development of new fuels, engine technology and vessel designs that are not available or practical today.

Continued….

We believe the IMO's greenhouse gas reduction targets and eventual regulations will discourage new ship ordering in the short and medium term until new technologies and ship designs become available.

We expect all these major new environmental regulations to be positive for the supply-demand balance and benefit larger, stronger companies with high quality fleets that are better positioned to adapt and cope both practically and financially with compliance.

Slide 10 – Favourable Minor Bulk Supply and Demand Outlook

In slide 10, we show Clarksons' yearly demand and supply levels for the overall dry bulk market in the chart on the left. Tonne-mile demand growth of 2.9% was evenly matched by net supply growth in 2018 and, for 2019, demand is estimated to grow slightly slower than supply. Again, this is mainly due to weak iron ore demand.

On the right are two graphs showing the same demand and supply data separated out for the minor bulk and major bulk segments.

As you can see, it looks more favourable for the smaller segments with demand growing significantly more than supply.

Notwithstanding the weaker start to 2019 compared to last year, we have seen a recovery in minor bulk freights rates since Chinese New Year, whereas the Capesize market has continued to struggle.

Please bear in mind, however, that other factors can have a significant influence on market freight rates, such as bunker fuel prices and ship operating speeds, dry-docking off-hire to comply with new regulations, port congestion, market sentiment, etc.

Slide 11 – Secondhand Vessel Values Remain Attractive

Slide 11 shows that the improved freight market conditions supported vessel values in 2018.

The large gap between newbuilding and secondhand prices and uncertainty over future ship designs continue to discourage new ship ordering, and we still see upside in secondhand vessel values. Hence, we will continue to look opportunistically at good quality secondhand ship acquisitions as prices are still historically attractive.

I now hand you over to Peter who will present the financials, and I will be back afterwards with a wrap-up.

Speaker: Peter Schulz

Slide 13 – Significant Improvement in 2018 Financial Results

Good afternoon ladies and gentlemen. Please turn to slide 13.

The Group's underlying profit grew to US$72 million in 2018 compared to US$2.2 million in 2017, and EBITDA increased to US$215.8 million.

Owned vessel costs increased in absolute dollars during the year as we added more owned vessels to our fleet, but reduced slightly on a dollar-per-day basis.

G&A increased by US$5.4 million reflecting increasing staffing costs.

The profit attributable to shareholders of US$72.3 million was higher than our underlying profit due to a US$12.7 million income from the write-back of onerous contract provisions. We decided to write back the remaining provision in light of improving long-term market fundamentals. This write back was largely offset by a US$11.7 million mark-to-market loss on our unrealised bunker swaps due to falling bunker prices in late 2018. Both of these are non-cash items.

As David has said, the Board recommends a final dividend of 3.7 Hong Kong cents per share which, combined with the interim dividend gives full-year dividends of 6.2 cents. This represents half of our net profit for the full year, consistent with our dividend policy.

Slide 14 – 2018 Improvement in Both Handysize and Supramax Segments

Slide 14. Our Handysize revenue days decreased by 6% but our TCE earnings improved by 21% to US$10,060 per day, outperforming the market by 22% and resulting in a Handysize contribution of US$85.5 million.

Our Supramax revenue days decreased 13% but our TCE earnings improved by 27% to US$12,190 per day resulting in a Supramax contribution of US$42.1 million.

The revenue day reduction reflects an increase in our owned fleet, offset by fewer, primarily short-term chartered-in Supramax ships, mainly due to lower Chinese steel export volumes.

The Post-Panamax contribution remained stable as the two vessels in this segment are on fixed rate long-term charter-out contracts.

Slide 15 – Handysize – Good Control of Owned Vessel Costs

On slide 15, you can see our Handysize owned vessel costs were brought down to US$7,410 per day, supported mainly by reductions in finance costs and depreciation.

Our cost of inward chartered Handysize ships increased to US$9,440 per day as the freight market improved.

The break-out table shows our chartered vessels daily cost split between short-term, long-term and index charters.

Slide 16 – Supramax – More Owned Ships with Lower Daily Cost

Slide 16. Our acquisitions of Supramax vessels increased our owned Supramax vessel days by 21% to 9,420 days and reduced our owned vessel daily costs by US$120 per day, mainly due to lower finance costs.

Our cost of inward chartered Supramax ships increased to US$11,950 per day, again reflecting the improvement in the freight market.

Slide 17 – Significant Operational Leverage

On page 17 we aim to illustrate how our earnings move in relation to changes in freight rates. The chart sets out our 2018 Handysize and Supramax TCEs per day compared to the all-in costs per day, depending on whether a vessel was owned or chartered-in on a long-term or short-term basis.

The daily costs seen here are inclusive of estimated G&A costs per day. For 2018, we divide our G&A costs between owned vessels at US$950 per day and chartered-in ships at US$540 per day. As mentioned earlier, the blended G&A per day across our entire owned and chartered-in fleet is US$740 per day.

Our owned and long-term chartered-in vessels have largely fixed costs and an increase or decrease in achieved freight rates will directly impact the underlying profit. We say that for each US$1,000 change in daily TCE, the underlying profit and operating cash flow of the Group will change between US$35–40 million, taking into account that we typically have 20-25% long-term forward cargo cover at any point in time.

If you are trying to estimate our underlying profit for 2019 based on changes in TCE per day, it is key to remember that our reported 2018 long-term charter-in rates were positively affected by a total US$16.1 million release of onerous contract provisions which will not be available in 2019. Onerous contract provisions are non-cash items excluded from our EBITDA calculations, and so our EBITDA will not be impacted. As mentioned, our remaining onerous contract provisions were fully written back at the end of 2018.

Our short-term and index vessels are largely variable costs which depend on the freight market level when the charter was entered into. We use short-term ships to either support our core cargo business where using an owned or long-term vessel is suboptimal or to make money from pure operating positions.

There is not a direct correlation between the margin on these ships and the level of the freight market. Often we have seen margins increase in falling markets and vice versa. Hence, for the purpose of this analysis, we do not assume any relevant sensitivity in this business from movements in the freight market.

Slide 18 – Strong Balance Sheet and Liquidity

Slide 18. At the year-end we had vessel and other fixed assets of US$1.8 billion, consisting of 82 Handysize vessels with an average book value of US$14.6 million and an average age of 10 years, and 27 Supramax vessels with an average book value of US$21.3 million and an average age of 6 years.

Our vessels were financed by US$961 million of interest bearing liabilities. Cash and deposits stood at US$342 million, giving a net borrowings position of US$619 million.

At the end of 2018, our net borrowings were 34% of the net book value of our owned vessels, which is a slight reduction on 2017.

Slide 19 – Extended Repayment Profile and Reduced Cost of Funding

Please turn to slide 19.

In June 2018 we refinanced a number of smaller bilateral facilities and took the opportunity to leverage our then un-mortgaged ships with a US$325 million revolving credit facility. The 7-year reducing revolver has an 11 year profile and a margin over LIBOR of 1.5%.

Towards the end of the year we extended another bilateral facility by US$40 million on the same attractive terms as the revolver. These initiatives significantly extended our overall repayment profile, provided us with increased flexibility and lowered our already industry leading cost of funding.

With these refinancings, net of scheduled amortisation, we increased our borrowings by US$76 million.

Capex of US$128 million during the year included cash payments for acquired vessels as well as regular maintenance capex, mainly routine dry dockings. A total of 5 vessels were added to our fleet in 2018 and we docked some 33 vessels.

Thanks to our operating cash flow of US$190 million and the refinancings, our cash position increased by US$97 million to US$342 million during the year, despite investing significantly in growing our owned fleet and reinstating dividends.

In July 2019 the holders of our Convertible Bond will have the option to put the bond back to the Company at 100% of its principal amount of US$125 million. We have sufficient liquidity to fully pay back the bonds should the bond holders exercise their put option.

In addition to our existing cash balances, we have 8 unmortgaged ships with a total market value of about US$147 million.

I'll now hand you back to Mats for his wrap-up.

Speaker: Mats Berglund

Slide 21 – Our Business Model Continues to Outperform

We recap our business model on slide 21. This is a strong platform that continues to deliver a 90%+ laden versus ballast ratio and a premium over index earnings. I will not go through this in detail but will just emphasize that it takes all the components of our business model listed to the left in this slide to deliver these results.

Slide 22 – Competitive at Every Level

Slide 22. It is not only on a TCE level that we are competitive.

Our vessel operating expenses ("Opex") is well controlled at US$3,850 per day, driven by the scale benefits and uniformity of our fleet and our sector-leading in-house technical management team.

Our general and administrative ("G&A") overheads average US$740 per ship per day spread across our total fleet of owned and chartered-in ships. We achieve this competitive G&A primarily through a lot of hard work on our cost structure, scale benefits, efficient systems and our focus back to only our core business.

Our access to capital and cost of capital also represent a significant advantage, as our fleet is financed through long-term secured facilities at the most competitive cost in our industry and because we focus on primarily good quality secondhand Japanese-built ships rather than newbuildings.

Slide 23 – Our Strategic Direction and Priorities

On slide 23, we share with you a summary of our key strategic priorities for medium to longer term.

We will maintain our business model as a fully integrated ship owner and operator with a strong focus on safety, cargo and customers, with an office network that keeps us close to customers all around the world.

We will continue to grow our owned fleet with quality secondhand acquisitions, and opportunistically trading up smaller, older ships to larger, younger ships.

We are still avoiding contracting newbuildings due to their high price, low return, and because of the uncertainty over new environmental regulations and their impact on future vessel designs.

We will continue to reduce the number of ships we take in on long-term charters, replacing them with owned ships and short- and medium-term chartered ships.

A very important task is to continue to prepare thoroughly for IMO 2020, both technically, operationally, financially and commercially.

Last but not least, we will keep our balance sheet strong. Our healthy cash and net gearing positions enhance our ability to take advantage of opportunities to grow our business and attract cargo as a strong partner.

Slide 24 – Well Positioned for the Future

Slide 24. Wrapping up, we have worked hard over several years to streamline and focus the Company, and grow our core business.

With our outperforming business model, including experienced staff, and very importantly, a much larger owned fleet with competitive cost structure, we are well positioned for the future.

We expect to see increased volatility in 2019, influenced by uncertainty about the trade conflict and slower economic growth, but also by compliance preparations for the 2020 sulphur cap leading to tighter supply. The demand and supply fundamentals for the years ahead look favourable for our segments.

Thank you for joining us today, and thank you for your continued support.

Speaker: David Turnbull

Thank you Mats.

Ladies and gentlemen, that concludes the results presentation. Lines will now be open for any questions you may have.