2018 Interim Results Presentation Transcript

27 July 2018

Speaker: Mats Berglund

Slide 1 – Cover

Good afternoon ladies and gentlemen, and welcome to Pacific Basin's 2018 Interim Results earnings call.

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

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

Please turn to slide 2 for our Interim Results highlights.

Slide 2 – 2018 Interim Results Highlights

The minor bulk freight market strengthened again in the first half of 2018 which, combined with our continued outperformance and larger owned fleet with competitive cost structure, enabled us to record much improved results year on year.

We made a net profit of US$30.8 million compared to a US$12 million net loss in the first half of last year, and our EBITDA improved 75% to $99.3 million.

In view of the recovering market conditions and our return to a meaningful level of profitability, we are recommencing dividend payments. The Board has declared an interim dividend of HK 2.5 cents per share, in line with the dividend policy of paying out at least 50% of net profits excluding disposal gains for the full year.

As announced in May this year, we acquired a further five modern vessels, including four funded 50% by equity, which will grow our owned fleet to 111 ships by January 2019. Having more than tripled our owned fleet since 2012 we now own approximately 50% of the ships we typically operate overall.

We continue to maintain good control of our owned vessel operating expenses which were kept substantially flat at an average of US$3,810 per day.

In June we closed a US$325 million 7-year secured revolving credit facility, which significantly extends our overall amortisation profile, further enhances our funding flexibility and reduces our already competitive owned vessel P&L breakeven levels.

As at 30 June 2018, we had cash and deposits of US$317 million and net borrowings of US$657 million, which is 36% of the net book value of our owned vessels at mid-year.

Despite on-going trade tensions, we remain cautiously optimistic for a continued market recovery, although with some volatility along the way.

Slide 3 – 1H2018 Performance & 2H2018 Cover

Our Handysize and Supramax net daily TCE earnings of US$9,750 and US$11,730 were up 23% and 32% year on year, and outperformed the Baltic Handysize and Supramax spot market indices by 19% and 11% respectively.

As at 24 July, we had covered 54% of our Handysize days for the second half of 2018 at US$9,610 and 67% of our Supramax days at US$11,010 per day net.

Slide 5 - Freight Market Continues to Improve

Market rates in 2018 are so far following a similar seasonal pattern as the last two years with a short seasonal decline at the start of the year, recovery after Chinese New Year with a stronger March and April and a bit of summer weakness thereafter. But, as you can see in the graphs, the solid year-on-year improvements continue. The Atlantic market is starting to show promising signs, particularly in the Supramax segment, as you can see in the graph on the right.

Handysize and Supramax spot market rates averaged US$8,200 and US$10,560 per day net respectively in the first half of 2018, representing 24% and 32% improvements in average spot market earnings year on year, and the strongest first-half rates since 2014 and 2011 respectively.

Slide 6 – Dry Bulk Demand in 2018

Complete demand data for the first half of 2018 is not yet available, so we show in this slide Clarksons Research's full-year volumes forecast by commodity.

Clarksons estimate that overall dry bulk tonne-mile demand grew in the first quarter but slower compared to a year ago mainly due to reduced Brazilian iron ore exports.

However, key positive drivers in the first half included 3% and 4% increases in Brazilian export volumes and United States export sales of grain and other agricultural products, supported by record soybean volumes from Brazil and corn sales from the US. US coal exports also grew strongly to a five-year high in April.

Pacific demand benefited from increased trade in bauxite, nickel ore, copper concentrate, forestry products and other minor bulks in which we specialise.

In spite of a 7% growth in steel output to all-time high levels, Chinese steel exports declined 14% primarily due to strong domestic demand and high prices. Warm weather in China contributed to increased electricity generation driving 9% year-on-year growth in coal imports in the first half, and Chinese imports of minor bulks grew 8% (excluding bauxite and nickel ore for which data is not yet available). But indications are for strong growth in nickel and bauxite as you can see on the graph, and Indonesia is back to exporting large volumes.

US-related trade dispute actions to date impact only a small fraction of the trades in which Pacific Basin is engaged. Total US soybean exports to China in 2017 represented only about 0.6% of total dry bulk seaborne trade, and commodity trading patterns tend to shift rather than cease as a result of trade tariffs.

The trade conflict between the US and its key trading partners might get resolved but may also escalate. This uncertainty weakens sentiment which could undermine trade, and a global trade war could impact global GDP and dry bulk demand.

China has recently increased stimulus measures to counteract a potential slowing in Chinese GDP.

All things considered, we continue to believe that any negative impact the protectionist actions have on the dry bulk trade will be largely outweighed by positive dry bulk supply fundamentals and continued global dry bulk trade growth overall.

For the full year, Clarksons Research estimate 3.4% growth in tonne-mile demand. Fundamentals are more favourable for our Handysize and Supramax segments with minor bulk tonne-mile demand estimated to expand by 4%.

Slide 7 – Newbuilding Deliveries Continue to Reduce

As expected due to the declining orderbook, newbuilding deliveries in the first half of 2018 reduced to about 15.4 million deadweight tonnes – or 1.9% of existing dry bulk capacity, the lowest level since 1988.

Scrapping reduced to 0.3% of existing capacity due to the much improved freight market conditions.

As a result, overall dry bulk capacity grew 1.6% during the first half of the year, and note that newbuilding deliveries are typically significantly slower in the second half of the year.

New ship ordering was limited, with most new orders being for large bulk carriers. Handysize and Supramax new ship ordering is down to an historic low of around 1%.

Slide 8 – Handysize and Supramax Orderbook at Historically Low Levels

On slide 8, you will see that total dry bulk new ship deliveries in the first half of 2018 fell short of scheduled deliveries by 29%, and by 39% in our combined Handysize and Supramax segments.

Looking ahead, newbuilding deliveries are set to continue to shrink.

Scheduled deliveries for this year are smaller than they were for last year, and we expect actual deliveries will be around 27 million deadweight tonnes compared to 38 million deadweight tonnes in 2017.

In the right hand graph, you'll see that the combined Handysize and Supramax orderbook has reduced to 5.5%, the lowest level since the 1990s, and scheduled deliveries in our segments (before any shortfall) are 2.1% for 2019 and 1.5% for 2020 onwards, significantly smaller than for dry bulk overall.

Slide 9 – Better Fundamentals for Handysize

On slide 9, 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 among the dry bulk segments and more older ships, pointing to a better balance between new deliveries and scrapping going forward for the smaller ships.

Slide 10 – New Regulations

While we are on the subject of the supply side, we would also like to touch on new regulations.

Following a comprehensive assessment of available Ballast Water Treatment Systems, we have committed to retrofit 50 of our owned vessels with a system based on filtration and electrocatalysis, and nine of our ships are now fitted with BWTS. We are negotiating systems for our remaining 50+ owned vessels and remain well positioned to complete implementation across our owned fleet by 2023, one year ahead of the IMO's mandatory schedule.

The global 0.5% sulphur cap takes effect on 1 January 2020, which owners can comply with by burning more expensive low-sulphur fuel oil or by burning cheaper higher sulphur fuel and installing exhaust gas cleaning systems, so called "scrubbers".

We lobbied for a mandate for everyone to burn low sulphur fuel as this would be an environmentally more effective solution and supporting a level playing field, lower speeds and lower emissions (including CO_2). However, it appears there is now no scope to change the rules, and some owners of larger vessels (including some Supramax owners) are planning to install scrubbers.

We continue to assess both the low sulphur fuel and the scrubber options, but continue to believe that the vast majority of the dry bulk fleet (especially smaller ships like Handysize vessels) will comply by using low sulphur fuel.

On a new front, the IMO announced in April 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. The easiest first step to decrease carbon emissions is by reducing speed, but we believe these new IMO targets will in due course lead to the accelerated development of new fuels, engine technology and vessel designs that are not offered or practical today.

The uncertainty about these existing and coming regulations makes it very difficult to order new ships and this helps to keep the supply side limited.

We believe that, combined, these regulations will over time encourage scrapping of poor quality ships and be positive for the supply-demand balance and benefit larger, stronger companies with high quality fleets that are better positioned to adapt and to cope practically and financially with both compliance and new technology.

Slide 11 – Favourable Dry Bulk Supply and Demand Outlook

In slide 11, we show Clarksons' yearly demand and supply levels combined in one chart.

For the full year, and as mention in slide 6, Clarksons estimate 3.4% growth in tonne-mile demand for dry bulk overall which is above the 2.5% expected net growth in global dry bulk capacity.

Again, fundamentals are relatively more favourable for our Handysize and Supramax segments with minor bulk tonne-mile demand estimated to expand by 4% this year against combined Handysize and Supramax net capacity growth of about 2%.

Slide 12 – Improved Outlook Supports Vessel Values

The improved freight market conditions and more optimistic sentiment supported sale and purchase activity and increased vessel values in the year to date.
Newbuilding prices have increased 7% over the period to US$23.5 million for a Handysize today. That's an average yard price, and in Japan you would need to pay around US$25 million.

Clarksons Research currently values a benchmark five year old Handysize at US$16 million – up 14% since the start of the year.

Note that the value of a typical 5-year old ship is still nowhere near the price of a newbuilding which is typically the case in a strong market. Hence, we still see upside in secondhand values, in parallel with a continued gradual freight market recovery.

The large gap between newbuilding and secondhand prices along with the uncertainty about new regulations, continues to discourage new ship ordering which bodes well for the supply-demand balance in the longer term.

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

Speaker: Peter Schulz

Slide 14 – Significant Improvement in 1H2018 Financial Results

Good afternoon ladies and gentlemen.

The Group's underlying profit improved to a positive US$28 million in the first half of 2018 compared to a loss of US$6.7 million in the same period in 2017.

The improvement in underlying profit was driven by better dry bulk market rates, combined with our continued outperformance and larger owned fleet with a competitive cost structure.

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

Our G&A overheads increased due to an increase in our staffing overheads.

Charter costs increased due to the increased cost of chartering in short-term vessels in a rising market.

The profit attributable to shareholders of US$30.8 million was higher than our underlying profit due to:

- US$4.4 million of non-cash mark-to-market income mainly on our bunker swaps, off-set by
- a US$1.6 million write-off of loan arrangement fees relating to refinanced loans upon closing of our new 7-year revolving credit facility.

Slide 15 – Improvement in Both Handysize and Supramax

We generated a Handysize contribution of US$38.4 million driven by a 23% improvement in TCE earnings to US$9,750 per day.

We generated a Supramax contribution of US$15.8 million driven by a larger owned fleet and a 32% improvement in TCE earnings to US$11,730 per day. This increased contribution was despite a 10% year-on-year decrease in our Supramax revenue days because of fewer short-term chartered 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 16 – Handysize – Owned Vessel Costs Reducing

On slide 16, you can see our Handysize owned vessel costs reduced to US$7,380 per day, benefiting mainly from a reduction in finance costs, but also in operating expenses and depreciation.

Our cost of inward chartered Handysize ships increased to US$9,170 per day as the charter market strengthened.

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

Our overall G&A overheads increased to US$690 per ship per day (for both our Handysize and Supramax ships) due primarily to an increase in our staffing overheads spread across a smaller total fleet comprising fewer chartered-in ships partly offset by a larger owned fleet.

Slide 17 – Supramax – More Owned Ships with Lower Daily Cost

The story is similar for Supramax where our owned vessel costs reduced to US$8,090 per day, due mainly to a reduction in finance costs.

Our cost of inward chartered Supramax ships increased to US$11,740 per day, again reflecting stronger charter rates in the improving freight market.

Slide 18 – Competitive Owned Vessel Break-Even Levels

Slide 18 shows the current break-even level on our owned Handysize and Supramax ships of approximately US$8,300 and US$9,000 per day respectively including G&A overheads. We allocate $900 in G&A overheads per day on our owned vessels.

Comparing these levels to our TCE earnings actually achieved in the first half of 2018, you can see that Handysize (above break-even at US$9,750) contributed about US$1,400 per day, and Supramax contributed about US$2,700 per day.

Our covered rates so far in 2018 are well into profitable territory.

Slide 19 – Strong Balance Sheet and Liquidity

At mid-year we had vessels and other fixed assets of over US$1.8 billion, consisting of 81 Handysize vessels with an average book value of US$14.9 million and an average age of 10.3 years, and 26 Supramax vessels with an average book value of US$21.9m and an average age of 6.5 years.

Our vessels were financed by US$974 million of interest bearing liabilities. Cash and deposits stood at US$317 million, giving a net borrowings position of US$657 million.

Our net gearing was 36% in relation to the net book value of our owned vessels. We maintain as a KPI that net gearing should remain below 50%.

Slide 20 – Extended Repayment Profile & Reduced Cost of Funding

In the first half of 2018, the Group generated operating cash flows of US$72 million on the back of better freight market conditions.

As Mats mentioned, in June we closed a US$325 million 7-year reducing revolving credit facility secured over 50 of our owned ships, which refinanced six existing credit facilities and raised an additional US$136 million of fresh capital on previously un-mortgaged vessels at a competitive interest cost of Libor plus 1.5%.

This new facility significantly extends our overall amortisation profile, further enhances our funding flexibility and reduces our already competitive P&L breakeven levels.

Including the effects of the refinancing, our borrowings increased by US$91 million after we drew down net US$145 million under our new committed loan facilities, while making net repayments of US$54 million of secured borrowings and revolving facilities. Our average interest rate is 3.8%.

Capex of US$78 million during the period included cash payments for our five vessel acquisitions.

We have further capex commitments in the second half of 2018 of US$36 million, of which US$22.5 million will be paid in shares and US$13.5 million in cash. In 2019, our capex commitments of US$14 million will be settled fully with shares. All our commitments relate to modern secondhand vessels, and we do not have any owned newbuildings on order.

In addition to our cash balances of US$317 million, we will have 6 unmortgaged ships with a total market value of about US$120 million.

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

Speaker: Mats Berglund

Slide 22 – Our Business Model Continues to Outperform

We recap our business model on slide 22. 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 23 – Well Positioned for a Recovering Market

As shown in slide 23, 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 now well positioned for a recovering market.

Based on our current fleet and commitments (and all other things being unchanged, including our G&A and the margin on our operating business, etc.), a change of US$1,000 per day in annual average TCE market rates would be expected to change our net results by about US$35-40 million per year.

Slide 24 – Our Outlook and Strategy

The favourable outlook for widely-spread global dry bulk trade growth bodes well for demand, and supply is expected to be kept in check by the continued gap between newbuilding and secondhand prices and the uncertain impact of new regulations on ship designs, both of which cause many shipowners in our segments to refrain from ordering new ships.

Clarksons Research estimates that tonne-mile demand for minor bulks this year will grow at double the pace of expansion of the combined Handysize and Supramax fleet. We continue to believe that any negative impact the on-going trade conflict has on the dry bulk trade will be largely outweighed by positive dry bulk supply fundamentals and continued global dry bulk trade growth overall.

Hence, we remain cautiously optimistic for a continued market recovery in our segments, although with some volatility along the way.

We see upside in secondhand vessel values and will continue to look at good quality secondhand ship acquisition opportunities as prices are still historically attractive, resulting in reasonable breakeven levels and shorter payback times.

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.

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

End.