# 2019 Annual Results Presentation Transcript

## 27 February 2020

**Speaker: David Turnbull**

**Slide 0 – Cover**

Welcome ladies and gentlemen, and thank you for attending Pacific Basin's 2019 Annual Results conference call.

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

In spite of challenging market conditions, we made a net profit of US$25.1 million in 2019 and we continued to perform well relative to the market.

The Board is recommending a dividend of 2.1 Hong Kong cents per share, representing just over half of our net profit for the full year, which is consistent with our dividend policy.

2020 has started with Coronavirus headwinds and we expect the year to be characterised by initial challenges and continued volatility. As we have shown before, Pacific Basin has what it takes to navigate such turbulence adeptly.

Mats will now present our 2019 results and dry bulk market review. Peter will follow with a review of our financials, Mats will wrap up with our strategy summary, and I will then invite you to ask any questions you may have. Over to you Mats.

**Speaker: Mats Berglund**

**Slide 2 – Solid Performance in Volatile Markets**

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

As David said, 2019 was a volatile and challenging year for dry bulk shipping. The market and our own trading were also heavily impacted by preparations for IMO 2020. Cleaning fuel tanks and switching fuel on all our Handysize ships, and repositioning a majority of our owned Supramaxes to China and installing scrubbers on them is a massive undertaking.

But in challenging times our platform and business model really shows its value and our TCE earnings outperformed the market indices even more than in prior years.

Our ship operating expenses, general and administrative overheads and financing costs remain well controlled and, like our TCE, are also very competitive compared to most of our peers.

In early February 2020, we completed our scrubber retrofit programme with scrubbers successfully fitted, certified and fully operational on 28 of our 35 owned Supramaxes – all substantially on time and on budget, and all completed before the Coronavirus-related delays at shipyards that many owners are now facing.

Minor bulk continues to drive dry bulk demand and is expected to remain resilient once the Coronavirus is contained and normal activity returns.

2019 saw higher net fleet growth than expected due to almost no newbuilding delivery shortfall compared to the scheduled orderbook, and as scrapping remained subdued.

Subject to the Coronavirus effect on shipyard output, we expect dry bulk fleet growth to remain high in the first half of 2020, primarily due to newbuilding deliveries of larger ship types. However, the IMO 2020 effect is causing the speed of the global dry bulk fleet to slow down, effectively reducing supply, and scrapping to date is up significantly compared to last year.

But these market factors are currently overshadowed by the negative effects on China and the world economy of efforts to contain the Coronavirus. While we do not know how long the outbreak will last, we expect to see a rebound driven by catch-up demand and stimulus activity once the outbreak is contained.

We strengthened our balance sheet last year and are very well placed to navigate current volatility, and we are well set up for what we believe will be stronger markets in the longer term.

**Slide 3 – 2019 Results Highlights - Net Profit US$25.1 Million**

We made a net profit of US$25.1 million in 2019, an underlying profit of US$20.5 million and EBITDA of US$230.7 million.

Our results benefited from our TCE earnings outperformance, enlarged owned fleet and competitive cost structure, but were adversely affected by weaker dry bulk market conditions and more off-hire than normal, especially in the second half of the year, due to scrubber installations and a record number of dry-dockings.

We continue to grow our owned fleet with larger, high-quality secondhand acquisitions, focusing especially on adding Supramax ships and growing our Handysize carrying capacity by opportunistically trading up our smaller, older Handysize ships to younger and larger units resulting in an even more efficient fleet with greater longevity.

Consistent with this strategy, in 2019 we took delivery of eight modern secondhand vessels (two Handysize and six Supramax) and sold two older smaller Handysize vessels.

A few additional transactions will soon increase our owned fleet to 117 ships.

We tapped diverse sources of external funding during the year. Peter will tell you more about these funding initiatives, which enhanced further our liquidity position to US$383 million.

**Slide 4 – Strong Outperformance in 2019**

Our Handysize and Supramax net daily TCE earnings of US$9,630 and US$11,720 outperformed the Baltic Handysize and Baltic Supramax spot market indices by 41% and 24% respectively. Average Handysize and Supramax spot market rates declined 17% and 13% year on year. In contrast, our own TCE earnings reduced only 4% year on year.

As at mid-February, we had covered 42% of our Handysize days for 2020 at about US$8,910 and 60% of our Supramax days at about US$11,390 per day net.

**Slide 5 – A Volatile Year Followed by Coronavirus Disruption**

The first half of 2019 was negatively impacted by iron ore supply disruptions in Brazil and Australia, trade war and African Swine Fever effects on Chinese grain imports, and a generally weak US grain export season.

The markets rebounded in the third quarter due to strong South American and Black Sea exports and the return of normal iron ore volumes, which pushed freight rates up to four and five-year highs in our respective segments.

Towards the end of the year, rates weakened as ship owners prepared for IMO 2020 implementation, undercutting each other to secure employment necessary to use up high-sulphur fuel before the year-end IMO 2020 deadline.

Going into 2020, Chinese import activity wound down for the Chinese New Year holidays. The usual rebound following the holidays has not yet materialised due to the effects of containing the Coronavirus outbreak, but the market has stabilised and cargo enquiries are now returning. Note the recent upturn in the spot market graphs albeit from a low level.

**Slide 6 - Pacific Basin Continues to Outperform on Every Level**

We continue to outperform in terms of TCE earnings, and the average TCE premium we generated over the market indices in the last five years is over US$2,000 and US$1,500 in Handysize and Supramax respectively.

The premium we generate over index earnings is driven by harnessing our experienced commercial and technical teams, global office network, strong cargo support and large fleet of high-quality interchangeable ships in ways that optimise ship and cargo combinations for maximum utilisation. As a result, our ships are laden with cargo over 90% of the time and ballasting only 10% of the time.

But it is not only on a TCE level that we are competitive.

Our vessel operating expenses (“Opex”) is well controlled at US$4,080 per day, driven by the scale benefits and uniformity of our fleet and our sector-leading in-house technical management team. Our Opex is inching up, but note that we are still well below our 2014 level of US$4,370 per day.

Our general and administrative (“G&A”) overheads average US$730 per ship per day spread across our total fleet of owned and chartered-in ships. We achieve this competitive G&A mainly through a lot of hard work on our cost structure, scale benefits and efficient systems.

Our financing costs are favourable at US$770 per day per owned ship. 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.

Our earnings and cost outperformance amounts to a Pacific Basin advantage of over US$2,000 per ship per day on average compared to the peers in our segments who publish comparable information.

**Slide 8 – Minor Bulk Demand Growth is Healthy**

Clarksons Research estimates dry bulk demand grew at 0.7% in 2019 mainly due to lower iron ore tonne-miles. Minor bulk demand grew faster at 2.1%, partly due to strong Chinese imports.

2020 has started on a weak note with the usual Chinese New Year seasonal weakness compounded and prolonged by reduced Chinese demand and disrupted logistics caused by actions to contain the Coronavirus.

Despite recent downward adjustments to minor bulk tonne-mile growth estimates for 2020, demand for minor bulk commodities overall remains healthy and we expect a rebound driven by catch-up demand and stimulus activity once the virus outbreak is contained.

Clarksons estimates minor bulk tonne-mile demand to grow 2.5% in 2020 and 3.0% in 2021, while the combined Handysize and Supramax fleet is expected to grow slower at around 1.9% net for 2020 and 0.5% net for 2021.

**Slide 9 – Increased Supply in 2019**

Clarksons Research have corrected upwards their historical newbuild ordering and deliveries records. This is mainly because many shipyards have held contracts and blocks for their own account and then resold these contracts much later to avoid the extra construction costs of Tier III engines and other new regulations.

Clarksons now estimate that the global Handysize and Supramax fleet grew 3.1% net last year, and the global dry bulk fleet overall grew faster than expected at 3.9% net compared to 2.9% in 2018.

Unusually, there was almost no shortfall in newbuilding deliveries compared to the scheduled orderbook which, combined with minimal scrapping, caused net fleet growth to increase.

Scrubber installations took many larger ships out of service for several weeks which helped to moderate fleet supply in the second half of the year and will continue to benefit the market through the first half of 2020.

Clarksons currently estimates overall dry bulk supply to grow at 3.4% net in 2020 and 1.5% in 2021. Again, the global Handysize and Supramax fleet is estimated to grow slower at 1.9% net in 2020 and 0.5% in 2021.

**Slide 10 – However, New Ordering is Reducing**

New ship ordering activity reduced significantly in 2019, concentrated in the larger Panamax and Capesize segments, and is expected to remain subdued going forward.

The commercial case for ordering new ships is weak as the gap between newbuilding and secondhand prices remains high.

This large gap and uncertainty over upcoming environmental regulations and their impact on future vessel designs and propulsion technologies are discouraging owners from ordering new ships with old technology.

**Slide 11 – IMO 2020 is Reducing Average Speed and Effective Supply**

The IMO 2020 global 0.5% sulphur limit took effect on 1 January 2020 and the majority of the global dry bulk fleet, especially smaller vessels such as our Handysize ships, are complying by using low-sulphur fuel.

The higher price of low-sulphur fuel reduces ships' optimal operating speeds, and this trend is clear since the fourth quarter last year

Many larger ships will continue to be taken out of service in 2020 for scrubber retrofits which, combined with the reduced operating speeds of non-scrubber fitted ships, will mitigate effective supply growth this year.

Having scrubbers on 28 of our owned Supramaxes provides us some optionality in how we manage our fuel and, based on the fuel price spreads seen in early 2020, our scrubber-fitted ships are making a significant contribution to our Supramax earnings.

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 – 2019 Financial Results**

Thank you very much Mats. Good afternoon ladies and gentlemen. Please turn to slide 13.

The Group posted a net profit of $25.1 million in 2019 compared to $72.3 million in 2018. However, EBITDA increased from US$215.8 million to US$230.7 million due to the adoption of the new lease accounting standard HKFRS 16. Adjusted for these accounting changes, our EBITDA would have been US$184.9 million.

Owned vessel costs increased during the year, mainly because we added more owned vessels to our fleet, but we also had some increases in the per vessel per day costs, primarily because of higher depreciation on BWTS systems and scrubbers, but also due to crewing, repair and maintenance, BWTS operation and preparations for IMO 2020.

G&A increased by US$1.4 million mainly due to an increase in our staffing overheads, but it has reduced on a per vessel per day basis.

The underlying profit of US$20.5 million was lower than the net profit mainly because the net profit takes into account mark-to market gains from our unrealised bunker swaps due to the increase in bunker prices since the start of the year, partly off-set by vessel disposal losses.

As David has said, the Board recommends a final dividend of 2.1 Hong Kong cents per share. This represents half of our net profit for the full year, consistent with our dividend policy.

**Slide 14 – Handysize and Supramax Contributions**

Compared to 2018, our Handysize revenue days decreased by 4% and our TCE earnings fell by 4% to US$9,630 per day resulting in a Handysize contribution of US$55.4 million.

Our Supramax revenue days increased by 12% mainly due acquisitions of Supramax vessels and our TCE earnings dropped by 4% to US$11,720 per day resulting in a Supramax contribution of US$23.1 million.

Going forward you should expect the proportion of our Supramax contribution to our earnings to increase as a result of our investment in scrubbers on the majority of our owned Supramax ships.

The otherwise stable Post-Panamax contribution has reduced by US$1.4 million because of the adoption of HKFRS 16.

**Slide 15 – Handysize Vessel Costs**

On slide 15, our Handysize owned vessel costs increased by 3.2% to US$7,650 per day mainly due to higher operating expenses related to crewing, repair and maintenance, ballast water treatment systems operation and IMO 2020 preparation. Our depreciation costs were slightly increased because of the installation of ballast water treatment systems.

In relation to chartered-in costs, we no longer have the benefit of onerous contract write backs, and the cost per day of the long-term charters were above market rates. These are gradually expiring and we are replacing them with owned ships at lower breakeven levels and with short and medium term chartered in ships.

**Slide 16 – Supramax Vessel Costs**

Our Supramax owned vessel daily costs increased by 6.1% to US$8,580 per day, mainly due to higher operating expenses and depreciation costs owing to the scrubber installation program, partly offset by slightly lower finance costs per day.

As is the case in the Handysize segment, our cost of long-term chartered Supramaxes was above market rates in 2019.

**Slide 17 – Significant Operational Leverage**

On the next slide, we aim to illustrate our significant operational leverage and how our earnings move in relation to changes in freight rates. The chart sets out our 2019 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.

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 for the next 12 months at any point in time.

In addition to the direct vessel costs, we have G&A which we divide between owned vessels at US$940 per day and chartered-in ships at US$530 per day. The blended G&A per day across our entire owned and chartered-in fleet is US$730 per day.

It is important to remember that our reported 2018 long-term charter-in rates were positively affected by a US$16.1 million release of onerous contract provisions which were not available in 2019 as these provisions were fully written back at the end of 2018. We also incurred more off hire and depreciation costs due to the scrubber installation programme and higher Opex costs in general in 2019.

Our short-term and index vessels are largely used to trade for profit and to optimise the earnings of our core fleet. Both revenue and cost per day largely follow market rate levels. Hence, for the purpose of this analysis, we do not assume any relevant sensitivity for short-term and index vessels from overall movements in the freight market.

**Slide 18 – US$217m Operating Cash Inflow**

With the new HKFRS16 lease accounting changes, the operating cash flow for 2019 was US$217 million. Adjusting to include all long and short-term charter hire payments, we had an operating cash flow of US$174 million in 2019, compared to US$190 million in 2018.

Our net cash flow from investment activities was negative US$144 million in 2019, comprising total capex of US$184 million, which includes cash payments for acquired vessels, regular maintenance capex, dry dockings as well as the installation of ballast water treatment systems and scrubbers. A total of 8 vessels were added to our fleet in 2019 plus 1 more in January 2020, and we docked some 50 vessels during the period. The capex was off-set by disposal proceeds of US$15.5 million from the sale of 3 of our older Handysize vessels as well as interest income and other items.

2019 was a major investment year for Pacific Basin. We chose to do a large number of dry dockings including investments in ballast water treatment systems and scrubbers setting up for what we believe will be stronger markets in the future. Consequently, we will have lower dry docking capex in 2020.

Our net cash flow from financing activities was negative US$202 million in 2019. This mainly comprises the net drawdown on our committed facilities, regular loan amortization, interest costs (including on our lease liabilities) and any dividends paid.

In terms of financing, in May 2019 we closed a new US$115 million syndicated 7-year reducing revolving credit facility secured against 10 vessels at a very competitive interest cost of LIBOR plus 1.35%. In November we closed a new US$50 million unsecured 364-day revolving credit facility at an interest cost of LIBOR plus 0.75% and in December we issued new US$175 million guaranteed convertible bonds with a coupon of 3% per annum maturing in December 2025.

Including the US$125 million repayment of the previous convertible bonds in July and August, repayment of our borrowings and the dividend payment of US$22 million, our cash position reduced to US$200 million at the end of 2019. However, we had undrawn committed facilities of US$183 million at the end of 2019 which means we had available liquidity of US$383 million, which is US$41 million more than at the end of 2018.
This is a strong cash position sufficient to service our debts, meet our capital expenditure requirements and continue to grow our owned fleet should opportunities present themselves.

**Slide 19 – Strong Balance Sheet with US$383m Available Liquidity**

At the end of 2019 we had vessel and other fixed assets of US$1.9 billion.

Our vessels were financed by US$863 million of interest bearing liabilities. Cash and deposits stood at US$200 million, giving a net borrowings position of US$663 million.

At the end of 2019, our net borrowings were 35% of the net book value of our owned vessels, which is a 1%-point increase on the end of 2018.

As previously mentioned our liquidity position at US$383 million is strong.

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

**Speaker: Mats Berglund**

**Slide 21 – Decarbonising Shipping**

Looking ahead, we support IMO's ambitious goals of improving the global fleet's carbon efficiency by at least 40% by 2030 and then cutting our industry's total GHG emissions by half by 2050. This will require research and development of new fuels, engine technologies and bunkering infrastructure that are not yet available and will take time to develop. In the short term, what the industry can and should do to reduce emissions is to invest further in such initiatives that bring incremental energy-efficiency gains and, most importantly, to slow down the speed of existing ships and refrain from ordering new ships with old technology.

In a few years, more detailed regulations will likely be introduced to drive the decarbonisation movement so the industry meets the IMO's emissions reduction goals. To follow and contribute to this development, we have joined the recently formed Getting to Zero Coalition committed to exploring how to achieve these goals.

Meanwhile, we are already among the most carbon-efficient companies in our segment partly because our ships are laden with cargo over 90% of the time. That is a significant advantage compared to the average owner of similar ships which spend more time in ballast.

Additionally, we invest in fuel-efficient secondhand Japanese-built ships, energy-efficiency technologies and fuel optimisation practices that reduce our emissions. And importantly, we carry primarily non fossil fuel commodities that will be the mainstay of global seaborne trade in the long term.

We are well-equipped with an excellent team and good financial health to adapt and cope both practically and financially with compliance and new technology.

**Slide 22 – Our Strategic Direction and Priorities**

On slide 22, we share with you a summary of our key strategic priorities for the medium to longer term.

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

Over the long term, we see upside in secondhand values and continue to grow and renew our owned fleet with quality secondhand acquisitions. We still own a smaller proportion of our Supramax ships, so expect us to grow our owned Supramax fleet more than Handysize.

We are not contracting newbuildings due to their high price, lower return, and because of the uncertainty over new environmental regulations which will impact future vessel designs and technology.

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.

We are investing in further optimisation on our existing ships, and we will invest in low-emission ships in the future when they become technically and commercially viable.

Our empowered local chartering and operations functions continue to be key as they are close to customers, benefiting from best in class centralised support, systems and technology for optimum efficiency.

We keep building our brand, applying long-term thinking, safety, care and quality in everything we do.

Last but not least, we will keep our balance sheet strong, enhancing our ability to take advantage of opportunities to grow our business and attract cargo as a strong partner.

**Slide 23 – Well Positioned for the Future**

Wrapping up, we have worked hard over several years to streamline and focus the Company, and grow our core business. Our outperforming business model, including experienced staff and, very importantly, a much larger owned fleet with an efficient cost structure, position us well for the future.

For Pacific Basin, 2019 was a year heavily influenced by investments and preparations for new environmental regulations, including scrubber installations, optimisation programmes, a record number of dry-dockings and continued acquisitions of quality secondhand ships – all serving to set us up for what we believe will be stronger markets in the longer term.

Having navigated a difficult decade including a 45-year low in 2016, and despite the current turbulence, we are looking forward to a new and much better decade ahead for dry bulk shipping!

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