Pacific Basin

2019 Interim Results Presentation Transcript

31 July 2019

Speaker: Mats Berglund

Slide 1 – Introduction

Thank you and welcome ladies and gentlemen. My name is Mats Berglund, I am CEO of the company, and I am joined by our CFO Peter Schulz.

Please turn to slide 2 for our Interim Results highlights.

Slide 2 – 2019 Interim Results Highlights

We made a net profit of US$8.2 million, an underlying loss of US$0.6 million and a positive EBITDA of US$101 million.

Weaker dry bulk market conditions early in 2019 negatively affected our results for the half year, but we benefitted from our continued TCE outperformance as well as our competitive cost structure.

We have taken delivery of five modern Supramax vessels and one Handysize in the year to date. Two of the Supramaxes were delivered after the reporting period. We also completed the sale of an older, small Handysize which we committed to sell last year.

These transactions have increased our owned fleet to 115 ships on the water today. Including chartered ships, we operated an average of 230 Handysize and Supramax ships overall during the first half of the year.

In May we closed a US$115 million revolving credit facility carrying a competitive interest cost of LIBOR plus 1.35%. We will be fully repaying our US$125 million convertible bonds in August.

Some of the negative demand disruptions from the first half are easing and market rates in July have been increasing, especially in the Atlantic.

Slide 3 – 1H 2019 TCE Performance & Future Cover

Slide 3. In the weaker market environment, we generated average Handysize and Supramax daily TCE earnings of US$9,170 and US$10,860 per day net.

We covered 56% of our Handysize days for the second half of 2019 at about US$9,050, and 76% of our Supramax days at about US$10,790 per day net. Our cover numbers for the second half of 2019 so far primarily reflect the voyages fixed during the weaker earlier months while the first half actual numbers include voyages from the stronger rates fixed in 2018 and, hence, our forward cover TCEs are slightly lower than our first-half actuals. Regarding our 2020 cover, please note that it is backhaul heavy.

Slide 4 – Disappointing 1H 2019 but PB Continues to Outperform the Market

Slide 4. The blue bars in the graphs represent our average quarterly TCE earnings while the lines represent average quarterly spot market indexes.

You can see clearly that the three-year positive trend from the 45 year low of early 2016 was broken and average Handysize and Supramax spot market rates in the first half of 2019 were 30% and 26% lower respectively compared to the same period last year. However, in comparison, our daily TCE numbers were down only 6% and 7% respectively.

Our outperformance increased in the period as it typically does in a weakening market due to the effect of having cargo contract cover and due to the one to three month lag between spot market fixtures and execution of those voyages. You should assume that in a rising market, as we have seen recently, our outperformance narrows a bit.

Slide 5 – Markets are Recovering

Slide 5 shows the spot market rates in more detail and you can see that 2019 started weaker than the last two years with a more pronounced Chinese New Year dip which significantly impacted market freight rates in all dry bulk segments.

But the market has since gained momentum, especially in July for Supramaxes and larger ships in the Atlantic region.

Slide 6 – Explaining Market Movements in 2019

In slide 6, we explain why the market was weak in the first half and what factors can make it stronger.

In addition to the usual seasonal lull in activity early in the year and especially over Chinese New Year, a few one-off negative demand factors undermined the dry bulk market in the first half:

- the US-China trade war and African Swine Fever both impacted soybean imports to China;
- flooding in the Mississippi River impeded grain exports from the United States; and
- damage to mining infrastructure disrupted Brazilian iron ore exports, while severe weather disrupted Australian iron ore exports.

On the positive side, dry bulk activity is typically seasonally stronger in the second half of the year, and there are several other factors that can continue to drive a market recovery:

- our business continues to see healthy levels of minor bulk growth;
- infrastructure development stimulus in China;
- Chinese steel production is at an all-time high and coal imports to China were strong in the first half;
- iron ore exports from Brazil and Australia have resumed after the first half disruptions;
- we are seeing strong grain volumes out of the Black Sea and East Coast South America; and
- last but not least, reduced supply as ships are taken out of service for scrubber and ballast water treatment system installations, and slow steaming incentives for the majority of ships as they start to burn the more expensive low-sulphur fuel oil.

As you model our performance for the remainder of the year, please remember that:

- there is a lag between spot market fixtures and execution of voyages;
- the recovery is so far more Atlantic centred while we typically have a majority of our ships in the Pacific; and
- we have unusually many ships that will be out of service and in the Pacific for dockings and installations of scrubbers and/or ballast water treatment systems.

Slide 7 – Minor Bulk Expected to Drive Demand into 2020

Longer term, on slide 7, Clarksons estimates total dry bulk demand will grow 1.3% for the full year of 2019 and 3.1% in 2020.

Minor bulk is expected to drive demand in the coming years with Clarksons estimating global minor bulk demand growth of 4.5% for the full year and 4.8% in 2020, and we see growth particularly in Chinese imports of minor bulk such as bauxite, nickel and manganese ores.

The weakness this year is primarily in iron ore and grain, but this is now bouncing back and Clarksons forecasts growth in iron ore and grain again next year, although not as strong growth as in minor bulks.

Slide 8 – Net Fleet Growth Reducing for Handysize / Supramax

Please turn to slide 8 where we look at the supply side.

Clarksons estimates a net increase in overall dry bulk capacity of around 2.7% for the full year.

Scrapping increased to 0.5% of existing dry bulk capacity in the first half, but is still at a very low level.

The supply fundamentals for the Handysize and Supramax segments look more favourable and, as you can see, the line in the right hand graph shows that net fleet growth is on a steadily reducing trajectory from 5.7% in 2015 to an estimated 1.3% for 2020.

Slide 9 – Better Supply Fundamentals for Handysize

On slide 9, we contrast in further detail both the orderbook and age profile of the smaller ships with the larger vessel sizes.

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 vessels, the situation is the reverse.

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. Estimated tonne-mile demand growth of 1.3% for 2019 is outpaced by net supply growth of 2.7%, but Clarksons estimates demand to grow faster than supply again in 2020.

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.

Slide 11 – Secondhand Vessel Values Remain Attractive

Slide 11. Despite weaker freight market conditions, values for modern ships have been relatively stable in 2019.

New ship ordering is expected to be restrained, discouraged by the continued gap between newbuilding and secondhand prices as well as uncertainty over upcoming environmental regulations and their impact on future vessel designs.

We still see upside in secondhand vessel values and, hence, will continue to cautiously grow by looking opportunistically at good quality secondhand ship acquisitions.

I will now hand you over to Peter who will present the financials – Peter.

Speaker: Peter Schulz

Slide 13 – $8.2m Net Profit in 1H19

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

The Group posted a net profit of $8.2 million in the first half of 2019 compared to $30.8 million in the first half of 2018. However, EBITDA increased from US$99.3 million to US$101.1 million due to the adoption of the new lease accounting standard HKFRS 16. Adjusted for these accounting changes, our EBITDA would have been US$78.9 million.

Owned vessel costs increased during the year, mainly because we added more owned vessels to our fleet but we also had slight increases in the per vessel per day costs.

G&A increased by US$2.1 million primarily due to an increase in our staffing overheads, but it has reduced on a per vessel per day basis.

The underlying loss of US$0.6 million was lower than the net profit mainly because the net profit takes into account an US$8.6 million mark-to market gain from our unrealised bunker swaps due to the increase in bunker prices since the start of the year.

Since the underlying result was roughly break-even, the Board has decided not to declare any interim dividend for the period, but will consider a dividend of 50% of net profit for the full year in line with our policy.

Slide 14 – Explanation of New Lease Accounting Standard (HKFRS 16 "Leases")

Now please turn to slide 14. Before moving on to the detailed numbers, allow me to explain the impact of the new accounting standard HKFRS 16 "Leases" on our P&L, balance sheet and cash flow which is important to understand, particularly since we have not restated previous periods.

The new standard requires us to capitalise all our charter-in contracts over 12 months in duration on our balance sheet as "right of use assets" and corresponding "lease liabilities". The right of use assets are depreciated in a straight line over the remaining life of the charter and the lease liability accrues interest and is amortised over the remaining life. Before adoption of HKFRS 16 all long term charter hire-costs were just expensed over the P&L as operating costs.

Charter-in contracts with a remaining life of less than 12 months, which are the vast majority of our charter commitments, are not affected by the new standard and are still treated as operating expenditure in the P&L. In general, charter-out contracts are also not affected by the new standard.

The effect of the adoption of HKFRS 16 on our revenue and net profit is minor but our EBITDA increases as long-term charter-hire costs, which were previously treated as an operating expense, are now accounted for as depreciation and interest. Similarly, in our cash flow statement, operating cash flow increases and financing cash flow reduces, as long-term charter-in costs are reclassified from operating expenditure to interest on and amortisation of lease liabilities.

Slide 15 – Handysize and Supramax Contributions

Now please turn to slide 15. Compared to the first half of last year, our Handysize revenue days decreased by 3% and our TCE earnings fell by 6% to US$9,170 per day resulting in a Handysize contribution of US$21.2 million.

Our Supramax revenue days increased by 5% mainly due acquisitions of Supramax vessels and our TCE earnings dropped by 7% to US$10,860 per day resulting in a Supramax contribution of US$7.4 million.

The otherwise stable Post-Panamax contribution has reduced by US$0.5 million because of the adoption of HKFRS 16.

Slide 16 – Handysize Daily Vessel Costs (P/L)

On slide 16, our Handysize owned vessel costs increased by 2.4% to US$7,590 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 as you can see the cost per day of the long term charters were above market rates and we are losing money on these contracts. 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.

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$540 per day. The blended G&A per day across our entire owned and chartered-in fleet is US$730 per day.

Slide 17 – Supramax Daily Vessel Costs (P/L)

Now please turn to slide 17. Our Supramax owned vessel daily costs increased by 1.6% to US$8,220 per day, again mainly due to higher operating expenses and depreciation costs, partly offset by slightly lower finance costs per day.

As is the case in the Handysize segment, our cost of long term chartered Supramaxes is above market rates and loss making in 2019 so far.

Slide 18 – Significant Operational Leverage

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

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 will not be available in 2019 as these 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. 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 19 – Strong Balance Sheet and Liquidity

Now please turn to slide 19. At the end of June 2019 we had vessel and other fixed assets of US$1.8 billion.

Our vessels were financed by US$1 billion of interest bearing liabilities. Cash and deposits stood at US$314 million, giving a net borrowings position of US$687 million.

At the end of June 2019, our net borrowings were 37% of the net book value of our owned vessels, which is a 3%-point increase on the end of 2018.

Slide 20 – Maintaining Strong Cash Position Following Repayment of Convertible Bonds

Now please turn to slide 20. During the first half of the year, adjusting to include all long and short-term charter hire payments, we had an operating cash flow of US$72 million. This is roughly in line with the operating cash flow in the same period last year despite the weaker market environment since the cash flow last year was impacted by build-up in working capital.

In May 2019 we closed a new US$115.0 million syndicated 7-year reducing revolving credit facility secured against 10 vessels at a very competitive interest cost of LIBOR plus 1.35%. Including this new loan facility, net of scheduled amortisation, we increased our borrowings by US$37 million.

Capex of US$106 million during the half year included 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 4 vessels were added to our fleet in the first half of 2019 plus 2 more in July, and we docked some 22 vessels during the period.

In general 2019 is a major investment year for Pacific Basin. We have chosen 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 a stronger market ahead. Consequently, we will have lower dry docking capex for next year.

Including proceeds of US$6 million from the sale of one of our older Handysize vessels and the payment of US$22 million in dividends, our cash position decreased by US$28 million during the period to US$314 million.

As almost all of the holders of the convertible bonds exercised their right to put the bonds back to the Company at 100% of the principal amount, we paid out US$122 million in July. We have exercised our option to redeem all the remaining convertible bonds for which we will pay the US$3 million balance to bondholders in August. Proforma for this redemption and the additional draw-down on our revolving credit facilities following the delivery of the last 2 Supramaxes in July our cash position stands at US$212 million. 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.

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

Speaker: Mats Berglund

Slide 22 – Our Business Model Continues to Outperform

Thank you, Peter. 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. It takes all the components of our business model listed to the left of this slide to deliver this high utilisation and outperformance.

Slide 23 – Competitive at Every Level

But as shown in slide 23, it is not only on a TCE level that we are competitive.

Our vessel operating expenses are well controlled at US$3,990 per day, driven by the scale benefits and uniformity of our fleet and our sector-leading in-house technical management team.

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

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.

To demonstrate the strength and to quantify the value of our platform, we encourage you to compare those four numbers with other listed dry bulk companies.

Slide 24 – New Regulations Benefit Stronger Companies

Slide 24 provides a quick update on environmental regulatory changes coming.

There are three recently introduced regulations that impact our industry.

The first requires the installation of Ballast Water Treatment Systems. 30 of our owned vessels are now fitted with BWTS and we have arranged to retrofit our remaining Handysize and Supramax ships by the end of 2022.

The second new regulation is the IMO's global 0.5% sulphur limit which takes effect on the 1st of January 2020. We expect the majority of the global dry bulk fleet, especially smaller vessels such as Handysize ships, will comply by using more expensive low-sulphur fuel, and we are not fitting any scrubbers on our 82 owned Handysize ships.

We are preparing thoroughly for this new regulation, including cleaning our fuel tanks, securing availability of good quality compliant fuel and training our crews to ensure compliance and seamless service delivery to our customers.

Some owners of larger vessels with higher fuel consumption, including some Supramaxes, are planning to comply by continuing to burn cheaper heavy fuel oil in combination with installing scrubbers.

We have chosen a balanced approach, with scrubbers successfully fitted and operational on ten of our Supramaxes so far, and we have arrangements in place with repair yards and scrubber makers to install scrubbers on the majority of our owned Supramax vessels.

Including chartered-in ships, we expect 85-90% of our combined Handysize and Supramax fleet will comply by burning low-sulphur fuel. The future fuel price differential is uncertain, but having 10-15% of our overall fleet scrubber fitted provides us some optionality in how we manage our fuel needs to comply with the new rules.

The dry bulk freight market is expected to benefit in the second half of 2019 and early 2020 from many larger ships being taken out of service for several weeks for scrubber installation. We believe the market for smaller dry bulk ships like ours will benefit also over the longer term, as they will consume more expensive low-sulphur fuel and therefore are incentivized to operate at slower speeds which reduces supply.

The third new regulation coming is IMO's ambitious longer-term strategy to cut CO2 and total greenhouse gas emissions from shipping. We believe that these environmental regulations will discourage new ship ordering until new, lower-emissions ship designs become available.

Slide 25 – Our Strategic Direction and Priorities

On slide 25, 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 – 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.

We will continue to grow our owned fleet with quality secondhand acquisitions, and opportunistically but cautiously trading up smaller, older ships to larger, younger ships. We still own a smaller proportion of our Supramax ships so expect us to grow our owned Supramax fleet more than Handysize.

We are still avoiding contracting newbuildings due to their higher price, lower 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 with short- and medium-term chartered in ships.

Again, a very important task this year is to continue to prepare thoroughly for IMO 2020, both technically, operationally, financially and commercially. As already mentioned, we have chosen to do a lot of dry dockings this year, especially in the second half, to install ballast water treatment systems and scrubbers on a majority of our Supramaxes to set us up for what we believe will be stronger years ahead.

Hence, 2019 is a bit of an interim year so far, with a lot of both one-off market disruptions and IMO 2020 preparations causing a pause in the market and earnings momentum. However, we do think it will come back!

Slide 26 – Well Positioned for the Future

Wrapping up, on slide 26, 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 seasonally stronger average freight market conditions in the second half of 2019, and we have seen stronger rates in the last few weeks, especially in the Atlantic. But again, do remember the lag between spot market fixtures and the voyage execution, the differential in market strength between Atlantic and Pacific and that our fleet positioning is more geared towards the Pacific.

Overall, the demand and supply fundamentals for the years ahead look favourable for our Handysize and Supramax segments and we are well positioned to benefit.

Ladies and gentlemen, that concludes the results presentation and lines will now open for any questions you may have – Operator.

[After Q&A]

Thank you all for joining us today, and thank you for your continued support and interest in our company. Thank you very much.