Pacific Basin

# 2021 Q3 Trading Update Call Transcript

**13 October 2021**

**Speaker: Martin Fruergaard**

## Slide 1 – Introduction

Welcome ladies and gentlemen and thank you for attending Pacific Basin's 2021 Third Quarter Trading Update call. My name is Martin Fruergaard, CEO of the Company, and I am joined by our CFO, Peter Schulz.

Please turn to slide 2.

## Slide 2 – Highest Average Monthly Freight Indices in 13 Years

The dry bulk freight market continued its strong upward trend in the third quarter. Handysize and Supramax monthly average market freight rates reached 13-year highs in September, driven by robust global demand for commodities and reducing fleet growth, aided by fleet inefficiencies.

The upward trend was briefly interrupted by the seasonal reduction in Australian grain exports in July and the impact of Hurricane Ida on US grain exports in September.

Market rates have continued to rise in October, although Supramax rates stabilised early in the month due to marginally increased tonnage availability in the Pacific and the recent National Day holidays in China. However, Supramax rates are again improving on increased Chinese demand for coal.

Please see slide 3.

## Slide 3 – Our Strongest Quarterly TCE Performance Since 2008

Our core business generated average Handysize and Supramax daily TCE earnings of US$24,350 and US$36,270 net per day in the third quarter, representing our strongest quarterly TCE performance since 2008.

Our TCEs improved with each month, and the progressively stronger fixtures in the third quarter will benefit our fourth quarter earnings.

If you apply our September TCEs and other already published data to our model on slide 18, you will see the model showing an underlying profit in the range of US$90-92 million for September.

We have covered most of October at US$29,070 and US$40,200 net per day for Handysize and Supramax respectively and, with over 30% of our core vessel days still uncovered in the fourth quarter overall – mainly in December – we have significant opportunity to add cargo fixtures to our book at what we expect will be strong market spot rates.

Please turn to slide 4.

**Slide 4 – Relative Market Performance**

Due to the sharp market rise and the 1-3 month lag between fixing and executing voyages, our relative performance has lagged the spot market for most of 2021.

Our Supramaxes have now caught up and are again outperforming the BSI index, supported partly by a current scrubber benefit of around US$800 per day.

Our Handysizes will need more time to catch up, for a couple of reasons:

- The BHSI rose more sharply than the BSI during the period; and
- We have a higher proportion of lower-paying backhaul cover in our Handysize cargo book secured in earlier, weaker markets.

Our operating activity margin has increased significantly, partly due to our decision to take in tonnage early in the market recovery – especially Supramaxes.

Please turn to slide 5.

**Slide 5 – Minor Bulk was a Key Demand Driver in the Third Quarter**

Global minor bulk loadings in the quarter grew about 13% compared to the same period last year, which is consistent with the increased levels of trade and enquiries we have observed in recent months. Demand for construction materials was the main driver, in particular demand for cement and clinker, steels, aggregates and forest products.

After a strong first half year for the global grain trade, grain loadings reduced in the third quarter due to Hurricane Ida delaying the start of the US grain export season. What the graph does not show is that US grain exports are now picking up, which we expect will support dry bulk demand in the fourth quarter.

Coal volumes in 2021 are significantly increased compared to last year when coal exports were hard hit by lockdowns, and coal demand is now additionally supported by power shortages in key countries (including China and India) and a short supply of gas ahead of the northern hemisphere heating season.

Growth in iron ore trades was limited by cargo availability in Brazil and Australia. Curbs on Chinese steel production have caused iron ore prices to fall, but the Capesize freight market has not been impacted and has instead strengthened to levels last seen in 2009, supported by renewed strong Chinese demand for iron ore at today's significantly lower ore prices.

Please turn to slide 6.

**Slide 6 – Grain and Coal Likely to Drive Fourth Quarter Demand**

Our segments are also benefitting marginally from exceptionally strong container rates which are driving some commodities and even containers to be shipped in geared bulkers, and also driving multi-purpose vessels away from bulk cargoes in favour of containers.

In addition, the strain of increased cargo throughput combined with Covid-related protocols in ports is resulting in congestion in many ports around the world, particularly in China. This has further constrained the availability of tonnage to meet global demand for dry bulk shipping.

Looking ahead, we expect demand especially for minor bulks, grain and heating coal in the fourth quarter and going into 2022 to be broad based and supported by healthy economic growth and continued stimulus in many countries.

Recent uncertainty over China's real estate market, steel production curbs and energy curbs has caused jitters in the financial markets, but we have not yet observed any connected impact on dry bulk demand (other than reduced iron ore prices). Nevertheless, we will monitor developments in China closely.

With a historically low orderbook, and IMO rules forcing slower operating speeds from 2023, the long-term outlook for dry bulk shipping remains positive.

Please see slide 7.

**Slide 7 – Net Fleet Growth Well Below 2% in 2022**

Dry bulk net fleet growth has moderated further, and is forecast to grow 3.4% year on year in 2021 and less than 2% in 2022 because of the slower pace of newbuilding deliveries and despite minimal scrapping.

Please turn to slide 8.

**Slide 8 – Historically Low Orderbook For Dry Bulk**

The total dry bulk orderbook has further reduced to 6.5% of the existing fleet, which is the smallest it has been in decades and significantly more favourable than other shipping segments. The Handysize and Supramax orderbook is even lower at 5.1%.

We are optimistic that dry bulk supply will remain under control. Despite some new ordering in the very strong market, we believe the dry bulk orderbook will remain at historically low levels until zero-emission-ready ships become commercially viable. We expect this to take several years still, although we strongly support initiatives that seek to accelerate the transition to zero- emission shipping and make zero-emission-ready vessels the default choice by 2030.

Please see slide 9.

**Slide 9 – Strong Spot Market Driving Up Vessel Prices**

Clarksons' benchmark five-year old Handysize values have increased around 70% since the start of the year - and over 80% for Supramaxes - supported by the firmer freight market and vessel sales activity. Newbuilding prices increased around 30% and are still well above second-hand prices, and shipyards are filling up with orders for non-dry bulk ship types, which limits scope for new ship ordering in our sector before 2024.

We continue our strategy to grow our owned fleet of Supramax ships by acquiring high-quality, modern, second-hand vessels, and to sell our older and less-efficient Handysize ships and replace them with younger and larger vessels. This is resulting in an even more efficient fleet with greater longevity, and we are now benefitting from the larger earnings upside that these bigger ships enjoy in strong markets.

We have taken delivery of five modern second-hand Ultramax ships and five Handysize ships in the year to date, and one further Ultramax is expected to join our fleet in the fourth quarter.

We are likely to slow our vessel purchasing as asset prices approach historically high levels. We will continue to look to sell some of our smaller, older Handysize ships, thereby crystallising value and further optimising our fleet to more easily meet tightening environmental regulations.
Please turn to slide 10.

**Slide 10 – We are Well Positioned to Meet IMO GHG Reduction Goals**

We have a programme of carbon intensity reduction initiatives designed to ensure our existing ships can continue to trade for the foreseeable future, in compliance with IMO's new EEXI and CII carbon-efficiency rules coming in 2023 and beyond.

If the Carbon Intensity Indicator were now in force, the vast majority of our vessels would have a "C" rating or higher. A few ships would rate lower than C mainly for operational reasons (such as dry docking, port congestion, or short voyages with long loading and discharging times), not because of any significant technical inefficiency.

In 2021, the global fleet's carbon efficiency has reduced somewhat as ships have accelerated to practically full speed to meet cargo demand despite higher fuel prices. That will be reversed in 2023 when the global fleet slows down to comply with IMO's new CII rules.

However, we at Pacific Basin remain largely on course to meet our current IMO-aligned target of a 40% improvement in carbon intensity by 2030, and our existing fleet will meet IMO requirements through continuous fleet renewal, energy-efficient operating measures and investments in fuel saving technologies. Our dedicated optimisation team will increasingly rely on digitisation for better efficiency decisions, while always looking for collaborative solutions with stakeholders, such as just-in-time arrivals, etc.

With an eye on the longer-term goal of complete decarbonisation, entirely new ship designs with zero emission propulsion systems are required. Pacific Basin supports the alignment of shipping with the Paris Agreement temperature goal and is committed to owning and operating only zero-emission vessels by 2050. We will not order "old technology" newbuildings. We will only order newbuilding vessels when zero-emission-ready vessels are available and commercially viable in our segments, and appropriate global refuelling infrastructure is being built out globally.

Please turn to slide 11.

**Slide 11 – Strategy Update**

Our strategic priorities remain unchanged.

We want to stay specialised in minor bulk and the ship types that we know so well, and stick to our cargo-focused, integrated owner-and-operator business model.

We currently own 120 Handysize and Supramax ships and, including chartered ships, we have over 260 ships overall.

We continue our fleet growth and renewal strategy, and will continue to look to sell some of our smaller, older Handysize ships as second-hand prices are strong, thereby crystallising value and further optimising our fleet to more easily meet tightening environmental regulations.

We are also making good progress on other special focus areas.

We are supporting our teams to ensure we continue to deliver a quality service to our customers while maximising our earnings in the current strong market.

We are doing our utmost to ensure our crews' wellbeing, and that our vessels continue to operate safely and efficiently despite restrictions that continue to make crew changes and repatriation very challenging during the ongoing pandemic.

We are enhancing our focus on our environmental performance optimisation.

And we are finding ways to further leverage the increasing amount of in-house data to improve our operational efficiency, cost and environmental performance, and ultimately to deliver additional value to our customers.

Please turn to slide 12.

**Slide 12 – We are Well Positioned for the Future**

So to recap, the dry bulk demand outlook is positive for the rest of this year and for 2022 and beyond, and we are optimistic that supply will remain under control, with the orderbook remaining at historically low levels.

With dry bulk ships now largely operating at full speed, supply cannot be further increased through speed, and IMO and EU fuel-efficiency rules will force slower speeds from 2023 which will reduce supply, giving further support to the dry bulk freight market in the longer term.

Potential threats to the dry bulk market include excessive new ship ordering, and electricity curbs and a housing construction slowdown in China, both of which we will continue to monitor closely. Please bear in mind that, in minor bulk, China is not the dominant market with only 11% of global Handysize discharge activity being in China, as you can see in slide 30 in the appendix.

Thanks to our much larger core fleet with substantially fixed costs and an increasing Supramax proportion, we have significant operational leverage with which to benefit from the current strong freight market.

We have an excellent fleet and team with which to meet decarbonisation rules while continuing to provide a seamless and world-class service to our customers, and we are committed to owning and operating only zero-emission vessels by 2050.

And, finally, our current attractive earnings, high return on equity and strong cash accumulation will enable us to return capital to our shareholders.

Before we move on to the Q&A, I also want to acknowledge our Pacific Basin colleagues at sea. The safety and wellbeing of our ships' crews is our key concern, especially during the pandemic when restrictions around the world continue to complicate crew changes and repatriation, often keeping seafarers at sea for longer than usual. Despite the hardships they face, our seagoing colleagues continue to demonstrate great loyalty, professionalism and attention to safe operating practices, resulting in good performance of our ships' voyages and our best ever safety KPIs in the year to date. We are very grateful for their remarkable support, and it is important to remind everyone how vital their contribution is to keeping the global economy going.

Ladies and gentlemen, that concludes our Trading Update presentation. Lines will now be opened for any questions you may have. Operator, over to you.

[Q&A]

I'd like to thank you again for joining us today and for your continued support of Pacific Basin.