2022 Annual Results Presentation Transcript

23 February 2023

Speaker: Martin Fruergaard

Slide 1 – Introduction

Welcome ladies and gentlemen and thank you for attending Pacific Basin's 2022 Annual Results earnings call. My name is Martin Fruergaard, CEO of Pacific Basin, and I am joined by our CFO, Peter Schulz

Please turn to slide 3.

Slide 3 – OUR BEST UNDERLYING PROFIT EVER

I am pleased to report that in 2022, we achieved record underlying profit of US$715 million and EBITDA of US$935 million. Our net profit of US$702 million was our second-best ever, producing an excellent return on equity of 38%. Thanks to our strong cash flows, we were able to end the year with net cash of US$65.3 million, and we have available committed liquidity of US$615 million as at 31 December 2022.

Given the excellent performance of the Company in 2022, and our confidence in the longer-term fundamentals of the industry, the Board has recommended a final basic dividend of HK17 cents per share, consistent with our dividend policy of paying out at least 50% of net profits. Additionally, a final special dividend totalling HK9 cents per share will also be paid.

In total, the proposed final basic dividend and the proposed final special dividend amount to HK26 cents per share. When combined with the HK52 cents per share interim dividend distributed in August 2022, this represents 75% of our net profit for the full year. Our total 2022 interim and proposed annual dividends to be paid out to shareholders amount to US$525 million.

We continue to be committed to distributing excess cash to shareholders through dividends.

Please turn to slide 4.

Slide 4 – DRY BULK RATES HAVE BOTTOMED WITH SIGNS OF RECOVERY

In 2022, the dry bulk freight market saw an increase in average market freight rates during the first-half of the year due to high demand for minor bulk commodities. This was further supported by port-related congestion and limited new supply. However, the second-half saw a decrease in freight rates due to a variety of factors, including rising inflation and interest rates contributing to slower global growth, the Ukraine conflict restricting Black Sea grain exports, and lower construction activity and restrictive Covid policies impacting the Chinese economy.

Our Handysize and Supramax achieved net daily TCE earnings of US$23,430 and US$28,120 respectively, resulting in a total contribution of US$747 million before overheads.

2023 freight rates have started lower than those of 2022 as demand continues to be impacted by lower global economic activity and the typical seasonal weakness seen around Lunar New Year. Nevertheless, we are optimistic that rates have bottomed, and sentiment has improved as China resumes its reopening from Covid and the East Coast South American grain season begins.

Please turn to slide 5.

Slide 5 – STABLE DRY BULK LOADINGS – EXCEPT GRAIN

Global dry bulk loading volumes experienced a 2% year-on-year growth, mainly driven by an increase in the demand for minor bulks and coal. Minor bulk loadings rose 6% in 2022, with bauxite, forest products, and salt being the primary contributors. The second half of the year saw a 3% uptick in minor bulk loadings, with the main contributors being forest products, agribulk, and bauxite.

On the other hand, grain loadings were adversely affected by unfavourable weather conditions in major exporting countries, as well as limited grain exports from the Black Sea due to the Ukraine conflict.

Coal loadings rose 2% compared to the previous year, as countries in Europe, and notably India, sourced coal from non-Russian areas, such as the United States, Australia, Colombia, and South Africa.

Iron ore loadings decreased 1% due to seasonal weather in the first half of the year limiting cargo availability in Brazil and Australia, as well as reduced demand in China as domestic property construction slowed, and economic growth was negatively impacted by continued Covid mitigation controls.

Please turn to slide 6.

Slide 6 – FOLLOWING AN EXCEPTIONAL 2022 – 1Q' 2023 SHOULD SEE RATES BOTTOM

We delivered record daily TCE earnings, with our Handysize TCE rates in 2022 up 15%, while Supramax TCE rates were down 4% on average, compared to the same period last year.

We have covered 95% and 100% of our Handysize and Supramax vessel days in 1Q23 at US$13,460 and US$13,680 per day net respectively.

As mentioned in our third quarter trading update in October last year, we had been focused on optimising our short-term cover to maximise earnings over what is commonly a softer market during the northern hemisphere winter and Lunar New Year periods.

We have covered 46% and 68% of our Handysize and Supramax vessel days for 2023 at US$12,490 and US$13,310 per day net respectively.

Please note that our Supramax forward cover estimates excludes the scrubber benefit, which is currently about US$2,160 per day, across our Supramax vessels.

Please turn to slide 7.

Slide 7 – WE CONTINUE TO OUTPERFORM

For 2022, both our Handysize and our Supramax delivered an exceptional performance and we outperformed the indices by US$5,210 per day and US$7,080 per day respectively. Our performance continues to benefit from our diverse cargo and customer base and the close customer interaction facilitated by our extensive global office network.

It is worth noting that scrubbers fitted to our core Supramax vessels contributed US$2,510 per day to outperformance in 2022.

Handysize and Supramax vessels have outperformed the index over the last 5 and 6 quarters respectively.

Our operating activity generated US$56 million, equal to an average margin of US$2,840 net per day over 19,830 operating days. Although the margins fluctuated over this period, they stayed at historically high levels and our operating activity provides us with an ongoing opportunity to leverage Pacific Basin's commercial and operational expertise, as well as our global proximity to our customers, to generate additional income for the business.

In the second half of 2022, our operating performance and margins were negatively impacted by the higher cost of short-term time charters, especially for our Supramax vessels

Please turn to slide 8.

Slide 8 – HANDYSIZE – COSTS REDUCING TODAY

Our Handysize owned vessel costs increased mainly due to higher costs related to crew repatriation and other pandemic-related manning expenses. These cost increases moderated, and went into reverse, as China abandoned its zero-Covid policy

We have continued our efforts to diversify our seafarer recruitment, and are actively working to increase the proportion of Indian seafarers – which has also helped in reducing costs associated with repatriation over the period.

Higher depreciation over the period relates to the reversal of a vessel impairment of US$152 million at the end of 2021.

Please turn to slide 9.

Slide 9 – SUPRAMAX – CONTROLLING BLENDED COSTS

Our Supramax owned vessels experienced decreased depreciation, and finance costs for both our Handysize and Supramax vessels have continued to benefit from the decreased debt on our balance sheet. This has been particularly evident in light of the current rise in interest rates.

The long-term chartered vessel daily costs for our eight time chartered-in Supramax ships increased to US$16,590 due to the strong market conditions, which have resulted in higher charter costs overall. Three out of the eight long-term chartered vessels have scrubbers.

Despite the increase in costs on a small number of long-term chartered vessels, our blended Supramax costs remain controlled, and our owned vessels decreased costs by US$340 per day.

I will now hand you over to Peter who will present the financials, and I will be back afterwards with outlook and strategy summaries.

Speaker: Peter Schulz

Slide 11 – OUR BEST UNDERLYING PROFIT AND EBITDA EVER

Thank you very much Martin. Good afternoon ladies and gentlemen. Please turn to slide 11 were we set out our P&L in summary.

As you can see given our record daily TCE earnings, we generated our best results in both underlying profit and EBITDA, despite higher Handysize owned costs and higher Handysize and Supramax chartered costs – as Martin has explained.

Our G&A has increased mainly due to higher discretionary remuneration provisions given our result for the period.

Below underlying profit, our net profit was further improved by gains on vessel disposals, although offset by our hedging portfolio and incentive fees paid to bondholders for the early conversion of our Convertible Bond.

Please turn to slide 12.

Slide 12 – SIGNIFICANT SHAREHOLDER DISTRIBUTION

Our operating cash inflow for the year was US$874 million, inclusive of all long and short-term charter hire payments. This compares with the US$813 million in the full year 2021.

We had US$74 million in proceeds from the sale of seven smaller Handysize vessels which were sold and delivered in the period.

Capex spending remains well controlled, and for 2022 totalled US$85 million, of which we paid US$38.1 million for two second-hand Ultramax, and around US$47 million for dry dockings and Ballast Water Treatment Systems.

We expect capex expenditure for 2023 to be approximately US$60 million, predominately relating to dry dockings and Ballast Water Treatment Systems, and excluding any vessel purchases.

We paid US$72 million in incentivised conversion payments and various repurchases of our convertible bond – reducing the outstanding convertible bond to US$34.1 million.

US$716 million in dividend payments relates to the 2021 final Annual dividend of US$367.7 million paid in May 2022, and the 2022 Interim dividend of US$348.5 million paid in August 2022.

Please turn to slide 13

Slide 13 – STRENGTHENING BALANCE SHEET AND AVAILABLE LIQUIDITY

Despite significant shareholder distribution, we have continued to delever our balance sheet and we are today US$65.3 million net cash positive, while our committed liquidity is US$615 million.

The conversion offer and open market repurchase of our convertible bond was an important factor in this deleveraging exercise which is now largely complete.

Our goal going forward is to ensure that we maintain our strong available liquidity position for potential growth investments while still providing returns to our shareholders through dividends. As a testament to this strategy, we expect to pay 75% of 2022 profits through dividends.

I will now hand you back to Martin for his outlook and strategy slides.

Speaker: Martin Fruergaard

Thank you Peter,

Please turn to slide 15.

Slide 15 – DEMAND OUTLOOK: SENTIMENT IMPROVING – LONG TERM UPSIDE

Clarksons forecast a recovery in the market for 2023, with grains and coal set to be the major drivers. They anticipate a strong grain season in East Coast South America, which is expected to begin in the next couple of weeks, with additional support from Canada and Australia, despite a lower harvest of Ukrainian grains.

Food and energy security is expected to result in an increase in tonne-miles, as both commodities are sourced from further distances.

It is believed that dry bulk freight rates have bottomed, and that we will soon see an improvement in Chinese demand as workers return from Lunar New Year holidays, factories increase production, and China continues with its reopening.

In the longer-term we see upside demand from:

- China increasing its domestic and global trade, with a focus on economic growth through property, infrastructure and domestic construction
- Significant global infrastructure investments going forward – much of it driven by the green transition
- Continuous growth in emerging markets such as India and ASEAN region
- Geopolitical instability and increasing food and energy insecurity, which is likely to further drive tonne-mile demand for grain and coal

Please turn to slide 16

Slide 16 – LIMITED NEWBUILDING ORDERING – DESPITE RECORD RATES

We have continued to see that the long established relationship between dry bulk earnings and newbuilding contracting has been broken.

High newbuilding prices, and long delivery times of about three years has continued to discourage any significant new ship ordering. While, uncertainty around decarbonisation rules, technological limitations, and reduced life of older-technology ships have contributed to 2022 newbuild ordering being down 54% compared to 2021, and dry bulk orderbook now at 7.2% of total fleet.

While balance sheets have been repaired, we are seeing more companies like ourselves acting on short-term weakness in asset prices to acquire high-quality assets in the second hand markets. We continue to think that newbuilding order will remain limited as designs for zero-emission-capable vessels are developed over time.

Please turn to slide 17

Slide 17 – NET FLEET GROWTH REDUCING

Despite 2022 having even less scrapping than 2021, the global dry bulk fleet grew only 3.0% net during the year compared to 2.9% in 2021 mainly due to slowing newbuilding deliveries.

Vessel speeds have reduced in connection with lower TCE earnings and high bunker prices, and while capacity through increased vessel speeds is possible, we expect current and future decarbonisation rules to continue to limit vessel speeds over time.

Covid-related inefficiencies around the world, particularly in China have begun to be alleviated, and we have seen congestion in most major loading areas come back to more normalised levels.

We expect IMO 2023 regulations and the introduction of the European Union Emissions Trading System from 2024 will start forcing slower speeds and higher scrapping from 2024 at the earliest.

Clarksons has forecast scrapping of 1.6% and 2.2% of the fleet in 2023 and 2024 respectively.

These supply constraints, and limited scope for speeding up the global world fleet, provides structural long-term support for the dry bulk market.

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Slide 19 – STRATEGIC DIRECTION REMAINS UNCHANGED

Our strategy continues to remain unchanged, and at our core we will remain asset heavy, continuing to acquire – selectively and in a disciplined way – quality second-hand ships. We will continue to gradually sell our smaller, older ships when the time is right.

We have a world-class ship management team, and we are committed to keeping this function inhouse, with the ambition to further improve our safety and environmental performance, our cost competitiveness, and our service quality and reliability for our customers.

We will maintain our high level of services to our customers, while ensuring our crews are healthy and safe, and our vessels continue to operate safely and efficiently. We repeat again that we will not contract newbuildings until zero-emission-capable ships are available and commercially viable in our segments.

And, we will keep our balance sheet strong while distributing excess cash to shareholders.

Please turn to slide 20

Slide 20 – RESUMING OUR GROWTH STRATEGY

We remain committed to grow our Ultramax fleet and renewing our Handysize fleet, and during 2022 we acquired one Ultramax vessel, and one Supramax vessel which we expect to be delivered within February 2023, and one Ultramax vessel expected to be delivered in March 2023.

We currently own 115 Handysize and Supramax ships and, including chartered ships, we currently have approximately 240 ships on the water. In addition, we have eight vessels we purchased which we expect to be delivered during the first half 2023, which include six Ultramax, one Supramax, and one Handysize.

This return to growth is utilising our strong balance sheet to make counter-cyclical investments which we feel fit our longer-term strategy to continue to grow our fleet.

During 2022 asset prices approached historical highs which allowed us to sell some of our smaller, older Handysize ships, thereby crystallising value and further optimising our fleet to meet tightening environmental regulations.

In the year we sold and delivered seven Handysize vessels, while also selling one Ultramax vessel. We will continue to look for opportunities to divest these smaller older Handysize vessels depending on market conditions.

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Slide 21 – ON TRACK TO MEET OUR GHG REDUCTION GOALS

We will continue to trade our ships efficiently for high laden-to-ballast utilisation, and will constantly seek, assess and implement energy-efficient operating measures – including looking for collaborative solutions with our customers, tonnage providers, ports and other stakeholders.

As many of you are aware the IMO adopted global regulations came into effect from January 2023. We aspire for our ships to achieve an AER rating of “C” or better, but we will continue to prioritise EEOI with high laden-to-ballast utilisation, while managing our AER to ensure CII compliance.

We are preparing ourselves for shipping’s inclusion in the European Union Emissions Trading System (EU ETS), which is schedule for January 2024.

In addition to our initiatives to reduce the carbon intensity of our existing ships, we are collaborating and making preparations to achieve the longer-term goal of complete decarbonisation by transitioning to entirely new zero-emission-capable ships and fuels which are soon to become commercially available.

During the year, we committed to cooperate with Nihon Shipyard and Mitsui in investigating alternative green fuels and their availability, and to develop new zero-emission vessel designs and potentially invest in related bunkering infrastructure. Through our investigation we have concluded that green methanol is currently the most optimal fuel for the first generation of zero-emission vessels, and we are now collaborating with our partners to develop an efficient design for what we expect will be our first dual-fuel Ultramax ship able to run on either methanol or fuel oil. We should be ready to contract our first ZEV for delivery well ahead of our original 2030 target, and we believe that our example will help accelerate the transition to zero-emission shipping in our dry bulk sector.

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Slide 22 – WE ARE WELL POSITIONED FOR THE FUTURE

2022 was another exceptional year which has allowed us to further improve our balance sheet through a significant reduction in our debt, while also returning capital to shareholders.

We believe, the underlying demand and supply fundamentals of the minor bulk market will be supportive of rates that will allow us to generate steadier and more sustainable earnings over the long-term.

We continue to position the Company for a decarbonising future through initiatives to reduce the carbon intensity of our existing ships, while we maintain our focus to achieve our longer-term goal of complete decarbonisation. Our efforts in digitalisation, fleet optimisation, sustainability, and collaborating on the development of zero emission vessels and associated green fuels are all ways we continue to adapt to a more sustainable business strategy.

This end my update, but before going to Q&A, I would also like to thank our CFO Peter Schulz who will be leaving us in March 2023. We are incredibly grateful for Peter’s unwavering commitment and

dedication to our company over the years. His expertise and leadership have been instrumental in our success and growth. We wish him all the best and success in his future endeavours. Thank you, Peter!

And, as always, I would like to take this opportunity to thank all of our loyal and talented Pacific Basin seafarers and shore-based staff, as it is not without your commitment and professionalism that we can deliver these results and continue to improve our safety performance.

Ladies and gentlemen, I will now hand over to the operator who will open the lines 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. If you have any further questions, please direct them to our Investor Relations team who will be happy to answer.