Funding

Cash Flow and Cash

The Group's four main sources of funds are operating cash flows, secured loans, convertible bonds and equity. The major factors influencing future cash balances are operating cash flows, the purchase of vessels, and drawdown and repayment of borrowings.

As part of the ordinary activities of the Group, the Treasury function actively manages the cash and borrowings of the Group to ensure sufficient funds are available to meet our Group's commitments and an appropriate level of liquidity is maintained during different stages of the shipping cycle.

Over the long term, we aim to maintain a consolidated net gearing of no greater than 50% – defined as the ratio of net borrowings to net book value of owned vessels – which we believe is appropriate over all stages of the shipping cycle.

The information in this section as presented is adjusted for the implementation of HKFRS 16 "Leases" to give a better understanding of our underlying cash flow.

Key Developments in 1H 2019

- Our operating cash inflow inclusive of all long and short term charter-hire payments was US$72.2 million, as compared with US$72.1 million in the first half of 2018 and US$189.5 million in the full year 2018.
- In May 2019 we closed a new US$115.0 million syndicated 7-year reducing revolving credit facility secured against 10 unmortgaged vessels at an interest cost of LIBOR plus 1.35%.
- Our borrowings increased by US$36.6 million in the period after we drew down net US$91.8 million under our new committed loan facility while making net repayments of US$55.2 million of secured borrowings and revolving facilities.
- During the period we incurred capital expenditure of US$105.6 million in cash, of which:
  - (a) we paid US$66.4 million for one Handysize newbuilding resale and three secondhand Supramaxes which were delivered into our fleet in the first half of 2019 and a further two secondhand Supramaxes which delivered in July 2019; and
  - (b) we paid US$39.2 million for dry dockings, including the installation of ballast water treatment systems and scrubbers.
- In addition to the above cash payments for ships, we issued new shares equivalent to US$26.2 million to the ship sellers for two of the vessels that delivered in the period.

As at 30 June 2019:

- the Group's cash and deposits were US$313.8 million reflecting a 37% net gearing ratio;
- we have only one unmortgaged vessel; and
- our available committed banking facilities were fully drawn.

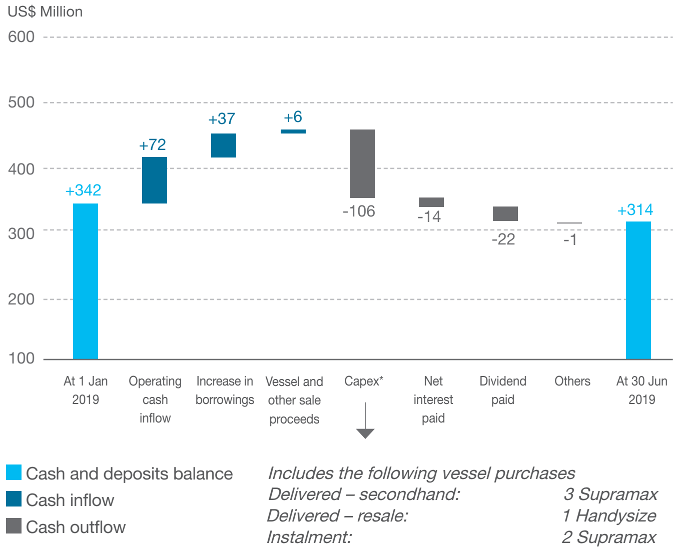
Treasury is permitted to invest in a range of cash and investment products subject to limits specified in the Group Treasury Manual. These include overnight and term deposits, money market funds, liquidity funds, certificates of deposit and structured notes.

Treasury enhances Group income by investing in a mix of financial products, based on the perceived balance of risk, return and liquidity. Cash, deposits and investment products are placed with a range of leading banks, mainly in Hong Kong.

The Group's cash and deposits at 30 June 2019 comprised US$311.4 million in United States Dollars and US$2.4 million in other currencies. They are primarily placed in liquid deposits of three months or less and saving accounts. This maintains liquidity to meet the Group's vessel purchase commitments and working capital needs.

During the first half of 2019, Treasury achieved a 2.9% return on the Group's cash.

Sources and Uses of Group Cash in 1H 2019



* excluding Capex of US$26.2 million funded by equity

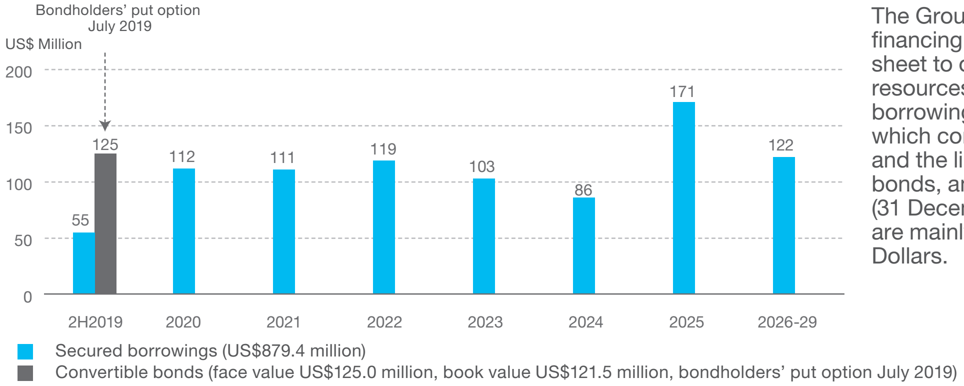
Cash, Deposits and Borrowings

The split of current and long-term cash, deposits and borrowings is analysed as follows:

US$ Million	30 Jun 2019	31 Dec 2018	Change
Cash and deposits	**313.8**	341.8	-8%
Current portion of long-term borrowings	**(232.0)**	(223.7)	
Long-term borrowings	**(768.9)**	(737.4)	
Total borrowings	**(1,000.9)**	(961.1)	-4%
Net borrowings	**(687.1)**	(619.3)	-11%
Net borrowings to shareholders' equity	**56%**	50%	
Net borrowings to net book value of owned vessels KPI	**37%**	34%	

Borrowings

Schedule of Repayments of Borrowings



The Group's Treasury function arranges financing by leveraging the Group's balance sheet to optimise the availability of cash resources of the Group. The aggregate borrowings of the Group at 30 June 2019, which comprised secured borrowings and the liability component of convertible bonds, amounted to US$1,000.9 million (31 December 2018: US$961.1 million) and are mainly denominated in United States Dollars.

Secured Borrowings – US$879.4 million (31 December 2018: US$840.9 million)

The overall increase in secured borrowings is mainly due to the drawdowns under our committed loan facilities, partially offset by scheduled loan amortisation. In the first half of 2019, we drew down all our remaining available committed loan facilities.

The Group monitors the loans-to-asset value requirements on its bank borrowings. If the market values of the Group's mortgaged assets fall below the level prescribed by our lenders, the Group may pledge additional cash or offer other additional collateral unless the banks offer waivers for technical breaches.

As at 30 June 2019:

- The Group's secured borrowings were secured by 112 vessels with a total net book value of US$1,802.4 million and an assignment of earnings and insurances in respect of these vessels.
- The Group was in compliance with all its loans-to-asset value requirements.

P/L impact:

An increase in interest to US$15.9 million (1H 2018: US$13.4 million) was mainly due to an increase in average secured borrowings to US$758.9 million (1H 2018: US$680.7 million).

Certain secured borrowings are subject to floating interest rates but the Group manages these exposures by using interest rate swap contracts.

Convertible Bonds – Liability Component is US$121.5 million (31 December 2018: US$120.2 million)

As at 30 June 2019 there remained the 3.25% p.a. coupon July 2021 convertible bonds with an outstanding principal of US$125.0 million and a prevailing conversion price of HK$2.96.

During the period, holders of our convertible bonds due in 2021 exercised their right to require the Group to redeem US$122.2 million of the convertible bonds at 100% of the principal amount on 3 July 2019. On the same day, the Group exercised the option to redeem all the remaining convertible bonds at 100% of the principal amount of US$2.8 million. Redemption and cancellation of the bonds will take place on 2 August 2019. The total redemption will be funded by the Group's cash reserves.

P/L impact:

The US$3.3 million (1H 2018: US$3.3 million) interest expense of the convertible bonds is calculated at an effective interest rate of 5.7% (1H 2018: 5.7%).

Finance Costs

US$ Million	Average interest rate P/L	Average interest rate Cash	Balance at 30 Jun 2019	Finance costs 1H2019	Finance costs 1H2018	(Increase)/ decrease
Secured borrowings (including realised interest rate swap costs)	4.2%	4.2%	879.4	**15.9**	13.4	(18%)
Convertible bonds (Note)	5.7%	3.3%	121.5	**3.3**	3.3	(2%)
	KPI 4.4%	KPI 4.0%	1,000.9	**19.2**	16.7	(15%)
Other finance charges				**0.6**	0.5	
Total finance costs				**19.8**	17.2	(16%)
Interest coverage (calculated as adjusted EBITDA divided by total finance costs)				KPI **4.0X**	5.8X	

Note: The convertible bonds have a P/L cost of US$3.3 million and a cash cost of US$2.0 million.

The KPIs on which management focuses to assess the cost of borrowings are average interest rates for different types of borrowings and the Group's interest coverage (see table above).

The Group aims to achieve a balance between floating and fixed interest rates on its long-term borrowings. This is adjusted from time to time, depending on the interest rate cycle, using interest rate swap contracts where appropriate. In the first half of 2019, all our interest rate swap contracts qualified for hedge accounting as cash flow hedges and US$0.3 million of interest rate swap contract income was realised. As at 30 June 2019, 62% (31 December 2018: 58%) of the Group's long-term borrowings were on fixed interest rates. As at 31 December 2019 and 2020, we expect about 54% and 48% respectively of the Group's existing long-term borrowings will be on fixed interest rates, assuming all revolving credit facilities are fully drawn.