Pacific Basin

2021 Annual Results Presentation Transcript

24 February 2021

Speaker: Martin Fruergaard

Slides 1-2 – Introduction

Welcome ladies and gentlemen, and thank you for attending Pacific Basin's 2021 Annual Results earnings call. My name is Martin Fruergaard, CEO of Pacific Basin, and I am joined on the line by our CFO, Peter Schulz who is currently in London.

Please turn to slide 3.

Slide 3 – Our Best Results Ever

In 2021, we saw the strongest dry bulk freight market since 2008 and generated our best results in our Company's 34-year history.

We made an underlying profit of US$698 million and a net profit of US$845 million, yielding an exceptionally strong return on equity of 58%.

Our results were positively impacted by a US$152 million reversal of the Handysize vessel impairment provision we took in 2020. The reversal was required because of the significantly improved dry bulk market which had driven up the market value of dry bulk vessels. The reversal does not impact our underlying profit, operating cash flows, EBITDA or available committed liquidity.

By the year end, we significantly strengthened our financial position with available committed liquidity increased to US$668 million and net gearing reduced to 7% - compared to 37% a year before.

In light of the extraordinary cash flow of last year and our robust balance sheet and positive outlook, the Board recommends a final basic dividend of 42 Hong Kong cents per share and an additional special dividend of 18 Hong Kong cents per share.

Combined with the 14 cents interim dividend distributed in August, the basic dividend represents 50% of our underlying profit consistent with our dividend policy.

Combined with the proposed special dividend of 18 cents, the total dividends for 2021 amount to 74 Hong Kong cents per share or around US$458 million in total, representing 66% of our underlying profit for the full year.

Our 2021 daily time-charter equivalent ("TCE") earnings averaged US$20,460 net for Handysize and US$29,350 net for Supramax, which is considerably higher than 2020.

Our strong results were also driven by our enlarged core fleet, with which we are well positioned for what we expect will be a continued strong dry bulk shipping market in 2022 and beyond.

Please turn to slide 4.

Slide 4 – Strongest Market in 13 Years

On the left of this slide, the dark blue lines show the strong upward trend in freight market earnings for most of 2021.

The annual average Handysize and Supramax freight market indices for 2021 were the highest ever, apart from the extraordinary years of 2007 and 2008.

Rates corrected downwards in the fourth quarter due to weaker industrial output in China and uncertainty over China's real estate market, steel production and energy curbs as well as the usual seasonal softening towards the end of the year.

However, rates were still at a strong level of around US$25,000 per day for both Handysize and Supramax at the end of the year.

On a tonne-mile basis, Clarksons estimates total dry bulk demand in 2021 was up 4% year on year.

On the right of the slide, we show Oceanbolt's indicative cargo loading volume data for each of the main dry bulk cargo sectors for a sense of what drove the market last year.

The volume of selected key minor bulks expanded 15%, due mainly to strong demand for construction materials such as cement and clinker, steels, aggregates and forest products.

The market also benefitted from stable, strong grain volumes which matched the exceptionally strong activity of the previous year.

The coal trade recovered strongly at 7% following a weak 2020 when coal exports were hard hit by lockdowns in key economies.

Iron ore volume growth at 2% was limited by cargo availability in Brazil and Australia and by Chinese steel output quotas in the second half of the year.

Please turn to slide 5.

Slide 5 – Growing Operational Leverage from Our Larger Owned Fleet

We quadrupled the carrying capacity of our owned fleet over the nine years prior to 2021, and we continued to grow our owned fleet last year.

We added 11 modern second-hand ships to our fleet during the year, including six large Supramaxes (commonly called "Ultramax") and five large Handysize ships, and we sold five of our smallest and oldest Handysize ships. We have since taken delivery of another modern Ultramax in January 2022.

We currently own 121 quality Handysize and Supramax ships that are well suited for our customers and trades and are generating very attractive returns. Including chartered ships, we currently have around 250 ships on the water.

Buying second-hand ships with prompt delivery in today's strong market remains a more attractive investment than contracting newbuildings from shipyards.

Our vessel purchasing has slowed in recent months and is expected to continue to be very selective as asset prices approach new historical highs. However, we remain committed to our fleet growth and renewal strategy longer term.

Please turn to slide 6.

Slide 6 – Outperformance Back on Track

Our average Supramax daily TCE earnings outperformed the Supramax spot market indices by about US$3,900, partly due to well-timed commercial positioning and to successful management of our 32 scrubber-fitted ships.

Our scrubber benefit is currently about US$1,200 per day, and we have so far recovered 67% of our original scrubber investment including realised bunker price spread hedges.

Our core Handysize TCE earnings lagged the index in the first three quarters of 2021, which is typical in a strongly rising freight market due to the lag between spot market fixtures and execution of voyages, and due to the effect of cargo contracts secured in earlier, weaker markets. However, we outperformed the Handysize index in the fourth quarter when the market correction in November allowed us to catch up.

Complementing our core business is our short-term operating activity, which generated significantly increased margins partly due to our decision to take in tonnage – particularly Supramax ships – early in the market recovery, and partly by leveraging our global network to combine ships and cargos for high laden utilisation.

Please turn to slide 7.

Slide 7 – Handysize– Overall Stable Costs

Our core fleet P&L break-even level (including G&A) was US$9,030 per day for Handysize and US$10,290 per day for Supramax in 2021. Our overheads, financing costs and vessel operating expenses remain well controlled and competitive.

However, ship operating expenses have increased for the entire shipping industry due mainly to more expensive crew travel, quarantine and other pandemic-related manning costs. This is reflected in the 13% increase in our Handysize opex.

The reversal of the vessel impairment provision will result in additional depreciation in 2022 and beyond, increasing blended vessel costs by approximately US$500 per vessel per day.

Please turn to slide 8.

Slide 8 – Supramax– Overall Stable Costs

Our Supramax core vessel blended costs were substantially unchanged year on year, with slight reductions in long-term charter costs, finance costs and depreciation largely offset by increased opex due to the industry's higher manning costs.

We remain cost conscious, but our main focus in today's strong rate environment is as always on safety and ensuring maximum utilisation of our vessels.

I 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 10 – Financial Results

Thank you very much Martin. Good afternoon ladies and gentlemen. Please turn to slide 10 were we set out our P&L in summary.

You can see how in the robust market of 2021 we generated significantly stronger performances from both our core business and operating activity to deliver our best underlying result ever.

You can also see how our net profit in 2021 is positively impacted by the write-back of the impairment we took in 2020.

Please turn to slide 11.

Slide 11 – Cash Flow in 2021

The operating cash flow for 2021 was US$813 million, inclusive of all long and short-term charter hire payments. This was significantly higher than 2020, and the second half 2021 cash flow was markedly stronger than the first half due to the rising market throughout most of the year.

Our borrowings decreased due to net repayments of US$323 million, partly offset by drawing down US$45 million on committed facilities.

Capex consisted of US$224 million which paid for six second-hand Ultramax and five second-hand Handysize vessels which delivered into our fleet in 2021, plus one more Ultramax that delivered in January 2022. It also included US$37 million for dry dockings and ballast water treatment systems. We docked 26 vessels in the year.

Please turn to slide 12.

Slide 12 – Strengthening Balance Sheet and Available Liquidity

As Martin has said, our net profit was positively impacted by a US$152 million write-back of the vessel impairment we took on our Handysize core fleet in June 2020. The reversal was required because of the significantly improved dry bulk market and the increase in ship values. It does not impact our underlying profit, operating cash flows, EBITDA or available committed liquidity.

Our strong operating cash flow significantly enhanced our financial position over the year, driving down our net gearing to 7% (compared to 37% a year before) and increasing our available committed liquidity to US$668 million by the year end.

We have the capital resources to continue our strategy of growing and renewing our fleet when we see attractive opportunities. Our capital allocation priorities will include:

a) de-levering our balance sheet in line with our amortisation profile;
b) maintaining a strong available liquidity position; and
c) distributing dividends to our shareholders in line with our stated policy – with special dividends possible should our liquidity merit it.

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

Speaker: Martin Fruergaard

Slide 14 – Favourable Demand Fundamentals

Please turn to slide 14.

We expect a continued strong dry bulk shipping market in 2022 and beyond, in part due to broad-based demand, especially for minor bulks and grain, supported by healthy economic growth with continued stimulus in many countries.

In January 2022, the IMF moderated its global GDP growth forecast to 4.4% in 2022 and 3.8% in 2023, largely reflecting markdowns in the US and Chinese economies due mainly to increasing US inflation and the retrenchment in China's real estate sector.

Despite this moderated GDP growth forecast, dry bulk demand growth is still expected to outpace supply growth in 2022 and more so in 2023.

Please turn to slide 15.

Slide 15 – Historically Low Orderbook

Despite some new ordering in the very strong market, we are optimistic that dry bulk supply will remain under control, giving further support to the dry bulk freight market in the longer term.

The dry bulk orderbook stands at 6.8% of the existing fleet, which is the smallest it has been in decades. The combined Handysize and Supramax orderbook is even lower at 5.6%, presenting the basis for continued low supply growth in the next few years.

We expect that new ship ordering will remain restrained, discouraged by:

a) uncertainty about the future fuels and technologies required to meet coming decarbonisation regulations;

b) the expectation that zero-emission ships will not be commercially viable for several years;

c) the high cost of newbuildings with a 2-3 year wait for delivery, when second-hand ships with prompt delivery represent more attractive investments; and

d) the shortage of shipyard capacity when berths are fully booked with orders for non-dry bulk ship types.

Based on Clarksons data, the global combined Handysize and Supramax fleet is estimated to grow by 2.5% in 2022 with very little scrapping taking place, and possibly start to shrink in 2023.

It is also worth noting that IMO and EU fuel-efficiency rules are likely to start forcing slower speeds from 2024 – and even accelerate the scrapping of the least efficient ships – which will further reduce supply.

Please turn to slide 16.

Slide 16 – January 2022 TCE Earnings Are Well Above 1Q 2021

Despite the usual seasonal weakness from November to the Lunar New Year, rates have been much higher than usual over the winter, and market activity has resumed with freight rates recovering as expected since early February – particularly in the Pacific.

Beneficial during the seasonally weaker start of the year, we commenced 2022 with a good level of cover for the first quarter.

In January 2022, we achieved actual Handysize and Supramax TCE rates of US$24,800 and US$30,600 per day net respectively, significantly outperforming market index rates of US$18,050 (tonnage-adjusted) and US$19,430 per day net respectively.

We have covered 48% and 64% of our Handysize and Supramax vessel days currently contracted for full year 2022 at US$19,550 and US$25,210 per day net respectively.

That leaves us with significant opportunity to add cargo fixtures to our book at what we expect will be stronger market spot rates in the months ahead.

Please turn to slide 18.

Slide 18 – Strategic Direction Remains Unchanged

Our established strategies remain substantially unchanged for 2022, although with some adjustment in how we execute them in the current strong market and for greater effectiveness.

We want to stay specialised in minor bulk and the ship types that we know so well, and want to maintain our customer and cargo focused business model and grow our scale.

At our core we will remain asset heavy and will continue our strategy over the long term of growing our Supramax fleet and renewing our Handysize fleet with quality second-hand ships.

We will continue to complement our core fleet with mainly short-term chartered ships.

We will also continue to gradually sell our smaller, older Handysize ships when the time is right, thereby crystallising value and further optimising our fleet to more easily meet tightening environmental regulations.

We will not contract newbuildings until zero-emission-ready ships are available and commercially viable in our segments.

We aim to always keep our balance sheet and liquidity strong.

And we want to be the industry leader on an earnings and cost per day basis.

There are also a few areas of special focus that we are attending to in the short term.

I want to ensure our teams are equipped and supported so that they can continue to deliver a quality service to our customers while maximising our earnings in the current strong market.

Safety, health and wellbeing are always a priority, especially during the challenging pandemic when crew-change restrictions and related complications take their toll on seafarers.

We are further enhancing our focus on optimising our environmental performance to ensure we meet or exceed the carbon efficiency compliance requirements of the IMO and potentially also other regional governments.

We are expanding our digitalisation programme with investments in new digital solutions to leverage our large amount of in-house data to optimise our business processes and interactions, and improve our decision-making, ultimately delivering additional value for our business and our customers.

Please turn to slide 19.

Slide 19 – On Track to Meet Our GHG Reduction Goals

The IMO adopted global regulations in June 2021 to drive improvements in the energy efficiency and carbon intensity of conventionally-fuelled existing ships. There will be much more about this in our Sustainability Report to be published in mid-March.

In short, the IMO's EEXI technical rules will cap maximum engine power limits for the majority of existing ships in the world, and their CII operational rules will require ships to become increasingly carbon efficient in the way they are operated, which will lead to gradually lower speeds from 2024 onwards.

Renewing our fleet with younger, larger, more efficient ships is an important part of our strategy to meet these carbon intensity reduction rules and help to achieve our industry's greenhouse gas 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. This will ensure that our existing ships running on conventional fuel oil can maintain sound Annual Efficiency Ratio (AER) ratings and continue to trade for the foreseeable future.

We target for our ships to achieve AER ratings of "C" or better from 2024 onwards.

In parallel, we are collaborating and making preparations to achieve the longer-term goal of complete decarbonisation by transitioning to entirely new zero-emission-ready ships and fuels.

With that in mind, in July 2021, we set ourselves a new target of Net Zero Emissions by 2050.

To achieve that goal, we target that our fleet will comprise only zero-emission vessels by 2050, and we will not contract newbuildings until zero-emission-ready ships are available and commercially viable in our segments and the appropriate refuelling infrastructure is being built out globally.

We have an outstanding in-house technical team and are actively involved in the industry-wide discussion about how shipping will decarbonise and meet the IMO's longer-term goals.

And it is comforting to know that, as the world decarbonises, we will continue to carry the non-fossil fuel commodities that will be the mainstay of future trade.

Please turn to slide 20.

Slide 20 – We are Well Positioned for 2022 and Beyond

We delivered our best results in our 34-year history and are recommending a full-year dividend pay-out of 66% of our underlying profit.

Forecast dry bulk demand growth is expected to outpace supply growth in 2022 – especially in our Handysize and Supramax segment – and more so in 2023.

We are well prepared to meet or exceed IMO's carbon intensity reduction rules, which are likely to start forcing slower speeds from 2024 – and even accelerate scrapping of the least efficient ships – which will reduce supply.

As always, we will be monitoring all risks and drivers of our market closely, ready to respond to changes. We have optionality in our fleet, and we are nimble.

The average age of our owned ships is 12 years which we consider ideal for optimising our return on capital while minimising residual value risk in the transition over time to zero-carbon technology vessels.

Our healthy balance sheet, large fleet and competitive cost structure position us well to thrive in the current strong market and continue to deliver high returns on equity and return cash to our shareholders.

We are experiencing a solid start to 2022 with seasonally low rates having bottomed in early February at much higher levels than in past years, and the freight market indices are now recovering with the Pacific market taking the lead.

The Atlantic is expected to soon benefit from the start of the South American grain season and, overall, we expect to see steady demand for commodities and tight fleet supply over much of this year.

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.