Briefing on 1H2019 Annual Results Analyst Presentation

Time : 4:00 p.m.-5:00 p.m. 23 August 2019
Venue : Regus Conference Centre, 35/F Central Plaza, Hong Kong
Senior management present:

Vice Chairman, Executive Director and Chief Executive Officer	Yang Xianxiang
Executive Director and General Manager of Finance Center and Investment Center	Liu Kecheng
Executive Director, Directorate Secretary and General Manager of Operation Management Center	Xue Peng

Senior management made a review on company development, operation results and financial metrics for the first half year of 2019 (Refer to PPT as attached). And then a Q&A section was entered .

Q1 Please advise why ASP during Q2 grew decently and the guideline on ASP in future?

A（CEO）：The main driver was the increasing cost, including charter rate and bunker price which was declining just recently. Along with the rising price, bunker cost account for higher share of total cost through Q2.

Q2 How large is the spread between low sulphur oil and high sulphur one? And what was the incremental bunker cost brought by usage of low sulphur oil?

A（CEO）：There is still some uncertainty around low sulphur oil issue. Till now, we are still not going for scrubber solution. First of all, our vessels are typically small ones. Furthermore, the supply of low sulphur oil, to our judgement, will be sufficient enough to accommodate to demand. The current situation is the spread between prices of low sulphur and high sulphur is shrinking, from $150/ton two months ago to $110/ton at present. The main reason may be attributed to more supply of low sulphur oil. Vendors may have already figured out that demand of low sulphur oil will inevitably increase starting from next year. So they began increasing the production of low sulphur oil and changing the oil store facilities gradually. I'm afraid the price of low sulphur oil may even turn out to be lower than high sulphur ones and there will not be enough high sulphur fuel available on market. Vendors and consumers are both gambling such that we say it is hard to make prediction in advance. Based on current situation, our previous judgement has been proved correct. We have not installed any scrubber yet while some others do so. Such equipment installation cannot be finished over a short while.

A（Xuepeng）：Currently the low sulphur oil price is 30% higher than that of high sulphur ones. But the spread is shrinking. The low sulphur bunker, mostly burned as vessels entering ECA of China since the beginning of this year, made up 17% of the total bunker consumption over the first half year.

Q3 The company has been generous about dividend policy. Yet the first half year saw payout ratio increased one percentage. What is the reason behind it? And is it possible to increase it further?

A（CEO）：It would be value destructive if we do not pay out but retain profits which we are unable to invest to yield higher benefit than the fund cost. Then it makes sense to pay out more dividends. We target to keep the dividend payout ratio at 70% which has been maintained for past few years.

Q4 why is the spread between low sulphur oil (LSO) and high sulphur oil (HSO) shrinking? Is it mainly because of fewer HSO supply? Is this trend going to continue?

A（CEO）：I'm not quite sure about the reason why the spread is shrinking. From the angle of supply and demand, it is highly possible that the supply of LSO is not so tight, at least not as previously predicted. We are still trying to figure out the reason as there are so many factors to be examined. As far as we know, the production of Chinese oil was declining before but now increasing. I do not know why. But here is the guess. Oil produced in China contains lower sulphur. Then it may lose money if sold at the same price as other oil. But now it may sell at a higher price with profits which leads to higher production.

Q5 Please give some color on the performance of ASP, excluding the effect from increasing bunker price, for Japan related routes and Southeast Asian routes respectively?

A（CFO）：We do not have such statistics as our routes run through both North Asia and Southeast Asia regions with so many nations involved.

A（CEO）：Our pricing mechanism is complicated in a differential way, a cost-plus pricing in another word. So the fluctuation of market price may not be reflected by our revenue immediately.

Q6 Our freight rate and margins were both running at high level. Can we understand they are attributed to the contribution of our land based business?

A（CFO）：Since 2017, we have reorganized our report segments. Back at IPO, auditors divided our business into two segments of sea-based business and land-based business, simply based on accounting viewpoint. However we are doing business integrating sea and land. Better performance in the first half year was attributed more to sea-based business which included service provided from our sea section and land branches. Land-based business, say new-established container depot, recorded decent growth as well.

A（CEO）：Our freight forwarding business grew by 30%-40%.

Q7 Can we pass through all the additional cost if bunker price continues to rise in future？

A（CEO）：I believe so. And we did it before. We successfully passed through the extra cost even in 2017 and 2018 when the oil price fluctuated much more fierce than the present.

Q8 what is the impact on business in North Asia from Japan-Korea trade war?

A（CEO）：No significant impact. The trade war may exert influence on Korean shipping companies running routes between Japan and Korea. Our trade volume between Japan and Korea is so trivial that the influence be ignored.

Q9 What is the current position for Japan, Korea and Southeast Asia markets with trade volumes?

A（CEO）：Till now, the market is bottoming out in Q3. At the beginning of this year, all players were too optimistic about Southeast Asian markets. Everyone predicts more cargoes will flow between China and Southeast Asia with weaker US-China trade due to trade war between the two. Such speculation turns out wrong. Many players added more capacity which drove charter rate to rise. But the freight rates declined with indexes on freight rates in Southeast Asia having been plummeting recently. As a result, some players are retreating from certain routes. Market is recovering and freight rates are increasing.

Q10 As for dry bulk segment, the revenue increased and so did the profits. How did we make it while the market dry bulk rate dropped a lot？

A（CEO）：At the beginning of the year, spot rate of dry bulk was low. But we do not do business for short term but long run. We sign contracts for one or two years term. The difference between spot and long-term rates is huge. For example, BDI at present is 2000 and the spot rate for Panamax may be as high as 14000 or 16000 while the long-term rate may be only 11000. So BDI may not reflect individual company's profitability. We only play as shipowner to charter out dry bulk vessels without involving in operation.

Q11 What will be the influence from tariffs to be levied on 300 billion worth commodities imported into US from China?

A（CEO）：No direct influence on our business as we don't do US routes. Will there be more cargoes originally from China to go instead from other countries to US? Such transition will be difficult to make over a short period. It typically takes years to adjust supply chain. During the first half year, cargoes from Ho Chi Minh to US increased by more than 30% while Ho Chi Minh port's throughput only increased by 7%-8%. The first half year saw 20% up of cargoes from Thailand to US while Thailand's throughput declined.

Q12 We learned from management that we launched new product of Rail-sea transportation. How does this new product work together with your routes？Is it based on existing customers or new clients?

A（CEO）：This is a new product bringing incremental cargoes and we did not do it before. These cargoes are transported via trains from inland to ports with destination of both Japan, Korea and Southeast Asia, which is different from those cargoes are moved to ports by feeders sailing in Yangtze River or Pearl River or by trucks. We regard this new product promising. We signed a strategical cooperation agreement at Beijing in early July and many cargoes have been transacted immediately. Cargoes were transported from Japan and Southeast Asia to China by sea and then carried on rail. Except those sent by train to ports for loading, there is some comprehensive multi-transportation business. For instance, the cargoes was shipped from Russia to China and further relayed to Southeast Asia. And then we ship back-haul cargoes to China and they ride the rail back into Europe. In this way, we integrate the land road and sea road under Belt and Road Initiate. It is potent in strategical and substantive sense.

Q13 What's your guideline on capacity and CAPEX?

A（CEO）：Over the past two years when market hit the bottom, we placed a series of new ships orders. Starting from this September, we will take delivery of a total of 9 2400teu type new-built. We are lucky these new vessels will alleviate the current rising charter rates. Furthermore, we had deployed more capacity over our operation with additional short distance routes, such as Hong Kong- South China - Philippines, Hong Kong- South China - North Vietnam and Hong Kong-East Malaysia. There will be more new routes based on our established strategy.

A（Xuepeng）：There will be CAPEX about USD 70 million in second half year.

A（CFO）: Based on orders we placed, CAPEX is expected to be around USD 130 million in next year and USD 24 million in 2021

Q14 what's the incremental bank loans for?

A（CFO）：The incremental debts during the first half year are partly long-term loans for the delivery of 3 new vessels and partly short-term borrowings. Various currencies are involved in our settlement across regions which may result in arbitrage space in FX rates or interest rates. Despite abundance cash on hand, we tend to leverage bank loans to make settlement so that we could benefit from risk-less arbitrage with FX rates being fixed.

Q15 What's your guideline on volume? How can we trace your monthly volumes？

A（CEO）：We disclose our quarterly volumes. Since new routes are to be launched in future, the growth could be guaranteed. But we performed well during the first half year not simply relying on incremental volumes. Balanced trade flow contributed more. Outsiders may not be able to follow how the balance evolves. Take a single port on a route for instance. If both the export cargoes and import cargoes are 50teu, we could say it strikes the balance. Another scenario is that 100teu are exported while none is imported. Though 100teu are transported in both scenarios, profitability may vary significantly. So striking balance at every pot on the routes is vital to improve performance. More balance produces higher efficiency. We are able to increase efficiency as many pots on our routes are not balanced. Previously we carry 100teu to Vietnam with only 10teu for back-haul. Nowadays 100teu for head-haul and 110teu for back-haul. Simply focusing on more volumes is meaningless.

Q16 Do you have plan to buy back stocks?

A（CEO）：Not yet. Not many stocks on floating.

Q17 What is the current ratios about empty containers？

A（Xuepeng）：Our utilization rate currently runs about 70% which is slightly higher than the equivalent period in last year.

A（CEO）：Utilization rate does not necessarily represent the profitability. It is subject to ship size. Replacing 1000teu type ship with 2000teu type may influence the utilization rate. We are changing to bigger ships for many routes. Take one example. We used 1100teu ship to run route with Da Nang port to carry 1000teu cargoes before. Now we go for 1800teu type to carry 1500teu cargoes. No big change to utilization rate, but stronger profitability. Organizational capability is another driver for higher efficiency.

Q18 Please give more color on the reasons why the total Southeast Asia trade volume did not increase much?

A（CEO）：There were various reasons. First of all, it should be ascribed to cyclical reason. In 2017,markets were on up trend. Both economies and stock markets ran well in 2017 and went worse in 2018, which continued into 2019. Secondly, the domino effect by US-CN trade war makes everyone more cautious by reducing investment and inventory with less international trade around the globe. We observed that it used to take one week to call a port in Philippine while our vessels are now able to call the port as soon as it arrives. The reason was regarded less cargoes takes less time for terminal operation, i.e. to discharge and load. It is the same as what is happening is Thailand, Vietnam and Indonesia. My judgement is the downside market is close to its end. Market is getting better. Charter cost is increasing, with the rate for 4000Teu type ship now being around $15K/day versus about $7K/day two years ago. With the same vessel but incurred cost as twofold as before, how could you make profits? Without profits, the only option left (for competitors) is to retreat.