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DNORD.CO - Q1 2018 Dampskibsselskabet Norden A/S Earnings Call

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## CORPORATE PARTICIPANTS

**Jan Rindbo** *Dampskibsselskabet Norden A/S - CEO*

**Martin Badsted** *Dampskibsselskabet Norden A/S - CFO*

## CONFERENCE CALL PARTICIPANTS

**Casper Blom** *ABG Sundal Collier Holding ASA, Research Division - Lead Analyst*

**Frans Hoyer** *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

## PRESENTATION

### Operator

Good day, and welcome to the interim report first quarter of 2018 conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Jan Rindbo, CEO. Please go ahead, sir.

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Thank you very much, and welcome to the presentation of NORDEN's first quarterly results for 2018. And thank you for dialing in. My name is Jan Rindbo, and I'm the CEO of NORDEN. CFO, Martin Badsted, and I will be presenting our results today.

I trust you've all found time to download the accompanying presentation available on our website. We will go through selected slides and we will refer to the specific slides as we go along.

Please note that this presentation and the following Q&A session will be recorded and made available on our website.

Slide #2, please. The agenda for today will be as follows: I will start by outlining the highlights of the quarter and our guidance for 2018. And Martin will then give you an update on the markets. Finally, I will conclude with a few final words regarding the first quarter and the outlook for the rest of 2018 before we would open up for the usual Q&A session.

Please turn to Slide #4, please. NORDEN has had a good start to 2018. The result in the first quarter was \$9 million, which is an improvement of \$8 million over the same quarter last year in spite of much smaller impact from reversal of provisions. The stronger result was mostly driven by improvements in the Dry Cargo market and continued value generation by Dry Operator, while the Tanker business was able to deliver a breakeven result in fairly poor market conditions.

Next slide, please. The market developed as expected throughout the first quarter, and we maintained the previously announced guidance for the 2018 full year result of \$10 million to \$50 million.

Dry Operator has started the year in line with expectations and is well positioned to continue to create value in the coming quarters. We continue to expect the Dry Cargo market will be higher on average than in 2017 and also believe the Tanker market will show signs of improvement during the second half of 2018.

Next slide, please. The Dry Operator continues to generate value through logistical optimization of the fleet and position-taking. In the first quarter of 2018, Dry Operator generated \$13 million in contribution margin, which gives an adjusted result for the period of \$3 million after all costs have been included. Dry operator generated profit while also investing in the positioning of vessels into a stronger seasonal second quarter market in the Atlantic. The positioning voyages were conducted towards the end of the first quarter and will generate profit in the second quarter of 2018. In the 9 months since being established, Dry Operator has generated a contribution margin of \$40 million, which corresponds to an adjusted net result of \$15 million. The daily margin, after all cost has been included, is just above \$200 on average for the full period. In the first quarter of 2018,



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our activity level was 5% higher than in the second half of 2017, and we believe there is an attractive potential to grow volumes in this business unit as well as improve the margins, and continued efforts along this path will be in focus for the remainder of 2018.

Next slide, please. In the first quarter of 2018, Dry Owner delivered a result of \$5 million in market conditions that were better compared to the same period last year. We continue to optimize the cyclical exposure of Dry Owner, and among other things, added a few time charter in-vessels with 2 to 3 years duration, including purchase and period optionality, and sold a Handysize vessel as well as an aging Supramax vessel. With the Dry Operator set out in place, Dry Owner has begun gradually relating its open-free capacity on fixed market rates to Dry Operator as opposed to fewer spot rates. This allows NORDEN's 1-year exposure to be managed by Dry Operator. As a result of this, Dry Owner coverage has increased to 67% by the end of the first quarter.

Next slide, please. Our Tanker business realized a quarterly adjusted result at breakeven level after outperforming the markets by more than \$800 per vessel day. The Tanker market continue to be under pressure, and there was no signs of the usual winter improvement due to high-supply growth in recent years and oil demand partly being satisfied by stock draws. We continue to focus on creating additional value through short-term business by utilizing the strong performance of the Norient Product Tanker Pool, covered with the chartering in of short-term-type chartered vessels. In the first quarter of 2018, we expanded the portfolio with almost 2,000 extra vessel days.

After the end of the first quarter, we have purchased 2 secondhand MRs as part of our objective to increase exposure to expected market improvements in the coming years.

Now over to Martin for a look at the market. Please turn to Slide #10.

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**Martin Badsted** - *Dampskibsselskabet Norden A/S - CFO*

Thank you. The -- despite the usual seasonal slowdown, Dry Cargo spot rates continued their year-on-year improvements. Overall, both Panamax and Supramax rates were about 30% higher than in Q1 last year, driven by a favorable combination of modest fleet growth and a strong volume growth for coal and minor bulks. A weak iron ore trade led to a rather subdued overall demand environment but that mainly hurt capesize rates.

Next slide, please. We think the Dry Cargo markets will continue to improve, even though global economic growth could be decelerating slightly. The lowest expected fleet growth in Dry Cargo for almost 20 years should provide the basis for continuation of the rate recovery. The main risks we're seeing are a slowdown in Chinese coal imports and potential headwinds from record-high iron ore stocks. But with the rest of the world still quite buoyant and very limited supply growth, the market is expected to be able to cope. And what is positive is also that we're seeing early indications that the uptake in ordering seen during 2017 has come to a standstill, which, if continued, would be positive for 2019 and possibly even 2020.

Next slide, please. Turning to the Tanker market. Spot rates had a really weak start to the year, with practically none of the usual winter market strength. Oil demand grew at a decent clip, but this did not translate into strong transportation growth since a lot of consumption came from storage. In addition, the supply overhang that has built as a result of the ordering binge in 2015 continues to haunt the market. The good thing is that weak rates are leading to an acceleration in scrapping, which is now contributing meaningfully to the supply-side adjustments that the market needs.

Next slide, please. Looking ahead, we believe that after a very poor start to the year, the Tanker market will improve in the second half. The global economic upswing is lending support to general oil demand, which is expected to grow by 1.5% this year. Oil stocks are coming down significantly, which means that a key downside is now largely behind us, although further destocking is required before it turns to real upside. In addition, refinery capacity seems to be getting tighter, which means that the impact of potential market disruptions could be bigger and longer than normal.

And finally, fleet growth, both for product tankers and the total tanker fleet, is declining quite substantially, both as a consequence of lower deliveries and finance grabbing. So even though we still have some catching up to do in terms of moving off current low utilization levels, we see good potential for better market fundamentals.

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And now back to Jan for a few final words. Please turn to Slide 15, please.

**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Thank you, Martin. The Dry Operator business unit continue to deliver a profitable performance in the first quarter, while still investing in positioning of vessels into the Atlantic, which we will benefit from in the second quarter. Dry Owner is well positioned to get the most out of the expected improvements in the Dry Cargo market, and we will focus on maximizing the value from the current portfolio. Our performance in Tankers continue to outperform the market even in an unusually weak winter market. And on this background, we continued the gradual buildup of T/C capacity. NORDEN is therefore well placed to benefit from the expected improvement in rates towards the end of the year. Lastly, we do expect market conditions to improve in both Dry Cargo and Tankers, and we will ensure that we make the most out of that in 2018 and beyond.

Next slide, please. And please remember that there are uncertainties related to any forward-looking statements. Next slide, please. And that concludes our presentation.

We are now opening up for our Q&A session. Please await the conference host's instructions.

## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) We will take our first question from Casper Blom from ABG.

**Casper Blom** - *ABG Sundal Collier Holding ASA, Research Division - Lead Analyst*

Just a quite simple question from my side. You talk about how you see a better market ahead actually in both segments, but still you decided to sell off a couple of vessels this quarter. What's the reasoning behind that? Why not hang on do it if you think the market is getting better?

**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Yes. Thank you for that question. Simple question. We'll try and give you a simple answer. The fact of the Dry Owner is that we continue to optimize the portfolio. So while we have sold some of our Handysize ships, which is a ship type that we want to exit on the ownership side, we've also taken delivery of number of new buildings in the Supramax size. And we've also taken some ships in on time charter for 2 to 3 years. And these ships that we're taking in also have both a period and purchase optionality. So actually when we look at the overall portfolio, despite the fact that we're selling some Handysize ships, which generally has lowest upside in a stronger market, then we actually feel we have a very good exposure to the -- to this expectation of a better Dry Cargo market, not just through the 22.5 ships that we own already, but also through the time charter portfolio that we have, including all the purchase and period options that we also have there.

**Casper Blom** - *ABG Sundal Collier Holding ASA, Research Division - Lead Analyst*

Okay. I would have argued that if you saw an upside ahead then why not wait, but fair enough. Then just the second question regarding the forming of the operating -- of the Operator business. It's obviously still early days, but are there sort of any specific learnings that you've sort of gotten so far that makes you want to adjust something so far or what's sort of the takeaway? Seems that if you're quite happy with the split of the dry bulk business.

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Yes. That's why we're actually very pleased with the performance of the Dry Operator business unit. We now have a 3 quarters of track record. And I think it's important here that we look at these results not in isolation for each quarter, but actually look at them together. And we can now see that over this 3 quarters that we're generating on average net profit margins of around \$200 a day or around \$5 million per quarter in net profits. So I would say, looking at our original expectations for this business unit, I would say that we're little bit ahead of what we actually thought we would achieve by this time. But we still see plenty of growth potential in this business unit. We have less than 3% market share, and this is very scalable part of our business that we think we can grow significantly in the coming years.

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**Operator**

We will take our next question from Frans Hoyer from Jyske Bank.

**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

My question on these lost provisions, \$10 million in the first quarter, and I believe you're looking to do \$5 million each of the following 3 quarters. Just wanted to understand, it sounds a bit sort of arbitrary how these -- the size of these reversals or taking to income. Could you confirm the numbers? And to what extent is this driven by the factors that are out of your hands and to what extent is this something you can decide for yourself?

**Jan Rindbo**  *Dampskibsselskabet Norden A/S - CEO*

Frans, so yes, we can confirm that the impact was \$10 million in Q1, and we're looking at the \$5 million in each of the next 3 quarters. Actually, of course, these are rounded numbers, so the exact numbers are little bit different from that. But that's, overall, the right figures here. So it's not -- I know maybe it seems arbitrary, but it certainly isn't. So it's really based on this whole value and use calculation that we've done previously. And you can say, so it's really the difference between the expected rates and the cost of the T/C higher when we did the value and use. So that is really the basis for it.

**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

So there isn't much uncertainty about the \$5 million per quarter for the rest of the year?

**Jan Rindbo**  *Dampskibsselskabet Norden A/S - CEO*

No.

**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

Okay. Second question on the IMO 2020 rules on -- how do you see that? I heard somebody else talking in a very glowing terms about the prospects around that event even well before 2020. I was wondering what your thoughts are on that issue?

**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Well, I think it depends a bit on what context those glowing remarks were made. But we think that some of the consequences here will be higher fuel costs, and that would indicate slower speeds for ships and that will take some capacity out of the market, which would be positive for the markets. That is probably more the case for Dry Cargo vessels, where we had a higher ability to adjust our speeds. Whereas on the Tankers, it's more driven by customer, so we have less flexibility to change the speeds there. But on the Tanker side, this could also lead to increased demand,

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where oil products are now more in -- you can say, in the wrong places and, therefore, needs to be transported by ship to different locations. So we could see both more arbitrage but also, just general more demand, more oil products that needs to be shifted around.

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**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

It sounds like -- how -- I mean what's the confidence level of that -- of the demand side in product tank? Would you say that's a pretty even thing? Or -- and could you then talk about the scale of the impact or the timing of both?

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Well, it's very, very hard. I mean there are a lot of uncertainties still related to this topic. So it is very hard to talk about the scale of this and what happened. And there are still, you can say, new things that are coming up here on this agenda all the time. So what could be 1 scenario here is that in the second half of 2019, more of these products will start to shift into spacious partnership places. And therefore, there will be this transportation demand already ahead of the 2020 rules. Another important scenario here -- another, I think, important scenario here is also that we may see a lot of extra demand towards the end of 2019, both actually in Dry Cargo and in Tankers, that maybe due to the higher fuel costs and maybe some more incentive for customers to actually ship their cargoes before the new rules are implemented. So that we could see a scenario where there will be an additional demand support in the second half of 2019. And then consequently, lower demand perhaps in the beginning of 2020. But there are just a lot of uncertainties still related to this whole topic.

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**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

Good. And that's because bunker is such an important part of operating cost and the price that customers pay for the transport?

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Absolutely. And if we are looking at \$200 to \$300 increase per tonne bunkers, I mean that is a substantial increase in the cost to our customers. And some of the cargoes that we are shipping are quite marginal, so it could also impact the trading patterns.

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**Frans Hoyer** - *Jyske Bank A/S, Research Division - Senior Analyst of Equities*

I mean the -- you might say that some of the cargo might not get shipped, but maybe that's being a little bit too negative?

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Well, it would mean that it is then shifting in favor of local, domestic supply.

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**Operator**

(Operator Instructions) It appears there are no further question. I would like to turn the conference back over to you. Thank you.

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**Jan Rindbo** - *Dampskibsselskabet Norden A/S - CEO*

Okay. Well, thank you very much for dialing in. And thank you for your interest in NORDEN. Have a good day. Thank you.



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## Operator

This concludes today's call. Thank you for your participation. You may now disconnect.

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