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DNORD.CO - Q3 2017 Dampskibsselskabet NORDEN A/S Earnings Call

EVENT DATE/TIME: NOVEMBER 09, 2017 / 2:30PM GMT



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CORPORATE PARTICIPANTS

Jan Rindbo Dampskibsselskabet NORDEN A/S - CEO

Martin Badsted Dampskibsselskabet NORDEN A/S - CFO

PRESENTATION

Operator

Good day, and welcome to the NORDEN Quarter Three 2017 Report Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to your CEO, Mr. Jan Rindbo. Please go ahead, sir.

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

Thank you very much. Welcome to the presentation of NORDEN's third quarter results for 2017. Thank you for calling in. My name is Jan Rindbo and I am the CEO of NORDEN. CFO Martin Badsted and I will be presenting our results today. I trust you have all found time to download the accompanying presentation available on our website. We will go through selected slides and we'll refer to the specific slide pages as we go along.

The agenda for today will be as follows. I will start by outlining the highlights of Q3, the key financial figures for the period and the strategy update. Martin will then give you our view on asset values and market conditions. Finally, I will conclude with our guidance for 2017 and we will open up for the usual Q&A session.

Please note that this presentation and the following Q&A session will be recorded and made available on our website. Slide 2, please.

In the third quarter of 2017, the adjusted net result is \$4 million which is a \$7 million increase compared to the second quarter of 2017. The dry cargo market continued its gradual improvement on the back of demand growth supported by the general improvements in the global economy. The tanker market has continued at low levels seen throughout 2017.

Q3 2017 was the first full quarter with the dry cargo department split into two distinct business units. The split enables NORDEN to act more focused as an operator and as an owner in the Dry Cargo market and thereby supports efforts to increase the value creation of the two business units. We will go through the split in details later on in the presentation.

We have raised the guidance range for 2017 to minus \$10 million to \$30 million. The adjustment is based on NORDEN being very well positioned to benefit from the recent improvement in the dry cargo market. Please turn to the next slide.

In Q3, we delivered the first positive quarterly dry cargo result in a couple of years. The market has continued to improve and contrary to the start of the year, NORDEN has been well positioned to benefit from the increasing market. A large part of this effect will, however, not show up before Q4 as Q3 has partly been used to position vessels into an increasing Atlantic market.

The tanker result was close to breakeven, which given the market conditions is quite satisfactory. The Norient Product Pool continues to outperform the spot market and NORDEN is also benefitting from coverage taken last year. Please turn to the next slide.

Q3 2017 marks a new beginning for NORDEN's dry cargo business. We have split the business in two units, a dry operator and a dry owner. The split enables us to act more focused as an operator and owner in the market and we see this transformation as an important step to increase both profitability and scale of our dry cargo business.

The objective of the dry operator is to create value through logistical optimization of vessels and cargos and taking short-term freight positions. The operator can position itself as either long or short and is thereby able to generate positive earnings under all market conditions. Scalability is key for this part of the business and we believe there is a significant growth potential.



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One of the drivers for enabling this value creation will be the continued development of our close customer relationships. The dry owner objective is to create value over a market cycle through timing, identification and appreciation of attractive deals on assets as well as long-term contracts on tonnage and cover. Next slide, please.

The dry owner will contain all the owned vessels as well as the long-term time charter-in contracts. In addition to this, the dry owner will also contain the cover effect from the long-term COAs. The capacity not covered by long-term contracts will then be transferred to the dry operator on market-based rates. This means that the impact of changes in the overall market levels will impact the dry owner, while the effect of our abilities in the short-term trading will be purely based in the dry operator.

The transformation is well underway and our external reporting will be transformed gradually in the 2017 annual report, and then there will be full separate P&Ls in the Q1 report in 2018. Next slide, please.

With the increased transparency, we can now see individual results of the dry operator and dry owner for the third quarter of 2017. At first glance, the dry operator result is not looking great with a loss of \$2 million after allocated administration costs and tax effects. But behind this result is the fact that we have positioned our vessels during the quarter into better paying regions which combined with a strengthening market means that we are capturing good value here in Q4. And this is one of the key drivers behind our raised expectations for the full year 2017.

On the dry owner part, we see the effect on the general improvements in the market. Furthermore, our long-term cargo coverage continue to underpin earnings and during the quarter, we have added a new long-term COA with Empemar to ship salt from Chile to the U.S. East Coast.

And now over to Martin for a closer look at the financial position and the markets. Turn to the next slide, please.

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

Thank you, Jan. NORDEN retains a balanced capital structure, so when comparing current market cap versus liabilities both on and off the balance sheet, our equity ratio is about 50%. We still have a strong liquidity position in excess of \$400 million including \$191 million of cash and \$225 million in unused debt facilities.

But along with a better market outlook and as we pay down time charter commitments and newbuilding installments, we are allowing our cash position to gradually normalize. Next slide, please.

Following a strong first half, asset values were broadly stable in both dry and tankers during Q3, however, with renewed optimism in dry cargo driven by a strong Q4, we also see a renewed upward pressure on vessel prices in that segment. The split of our owned fleet value is currently about 55% dry and 45% tankers, but if you include the TC fleet, actual market exposure is more like two-thirds dry and one-third tanker. Next slide, please.

Dry cargo fleet utilization continued to improve during the third quarter with demand up by 2.7% and slowing fleet growth. Demand is increasingly been driven by the rest of the world supported by global upswing and not just Chinese imports, although they are also holding up quite well.

It's worth noticing that global coal trade is now up 7% year-to-date based on broad-based import growth into both South Korea, Europe and China. The bauxite trade has also been very supportive after ramp-up of exports out of Guinea is adding healthy ton-miles. Next slide, please.

Looking into 2018, we believe the market is well positioned to improve further. We do expect demand growth to come down from the high levels in 2017, but supply growth is set to decelerate even more. So with 1.3% net supply growth expected for 2018, even small positive surprises on demand will feed into stronger rate levels.

In the very short term we see some downside in Q1, due to curtailment of heavy industry activity in China as they attempt to live up to local air quality standards. Beyond that, however, the continued global upswing should support healthy demand growth. Next slide, please.



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As expected, the third quarter turned out to be very challenging in product tankers and similar to the third quarter of 2016. Relatively high fleet growth continued and activity levels were subdued due to both seasonality and destocking. Hurricane Harvey did add some trading activity, but it was rather short lived and also had a flipside in the form of [order] cancellations. Next slide, please.

We believe the outlook for tankers has improved for a number of reasons. The global upswing is lending support to general oil demand which is expected to grow by 1.4% next year and then oil stocks have come down significantly, which means that a key downside is now behind us to a large extent. And then finally, our expectations for the total tanker fleet growth have come down recently. So even though we still have some catching up to do in terms of moving off current low utilization levels, there should be good potential for stronger and longer lasting spikes than we have seen for a while.

Now back to Jan for a look at our guidance and next slide, please.

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

Thank you, Martin. As mentioned earlier, we have raised the guidance level to adjust the net result in 2017 to minus \$10 million to \$30 million. In dry cargo, the increase in rates has continued and NORDEN has actively positioned vessels to benefit from a strong fourth quarter. Therefore, expectations for NORDEN's dry cargo segment are increased to minus \$10 million to \$15 million. Expectations for tankers are now to a range of 0 to \$15 million. Next slide, please.

And please remember that there are uncertainties related to any forward-looking statements. Next slide, please. This concludes our presentation. Now, we open up for the Q&A session. Please await the conference host instructions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have our first question from Frans Høyer from Jyske Bank. Please go ahead.

Frans Høyer - Jyske Bank - Analyst

You mentioned the growth potential in the operator part of the business. Could you give us some more idea of timing and scale of that growth? I guess you're talking about taking in -- or either short-term charters or at least increasing the fleet that you are operating?

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

Yes, but that is what we are looking at, increasing the short-term charter fleet. Now on the growth potential, our first priority has been to build up this platform, but the growth potential that we see comes from the fact that today even NORDEN as a large operator, we only have 2% to 3% market share and actually we think there's plenty of room for us to grow based on the customer demand that we are seeing. And therefore I don't think it's unrealistic to think that in the coming years that we can actually double the size of this fleet.

Frans Høyer - Jyske Bank - Analyst

By taking in other owners' tonnage to operate that for them?

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO



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That's right. It's a very liquid market and as long as we have good customer demand for what we do, I see no reason why we cannot grow our business. We have a good brand in the market. I certainly see customers willing and wanting to do more with NORDEN, but of course, first and foremost, we need to make this into a profitable part of our business, that is the first priority.

Frans Høyer - Jyske Bank - Analyst

Yes. I also have a question about the loss provisions that you are taking back into the P&L to the tune of \$85 million on an annual basis at the moment. And I guess at the end of the year there will be around \$100 million left of loss provisions in the balance sheet. And how does that taper off? Can you give me an idea of the tapering off timing and scale over the next couple of quarters or years?

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

Yes. So the majority of what is left is left for Q4 2017 and then for 2018 and that should only be a rather small part, call it \$25 million maybe in 2019.

Frans Høyer - Jyske Bank - Analyst

Got it, okay. I'll ask one more and get back in line. That is about the value of these very long-term contracts that you have landed both in terms of pellets and you mentioned a salt contract as well. Is there any surplus value in that over and above what's already reflected in vessel values?

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

Well, I would say that the long-term rates that we have achieved on these contracts, we don't comment on them so specifically, but they've been taking at rates that are above the spot market levels at that time and even at the current elevated rates that we're seeing here in the fourth quarter, they are still in the money so to speak.

Frans Høyer - Jyske Bank - Analyst Yes.

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

So they are -- I would say they are aligned, maybe a touch better than current -- what the current values would suggest.

Operator

(Operator Instructions) Mr. Høyer, please continue with your questions.

Frans Høyer - Jyske Bank - Analyst

Sorry, yes. I would like also to ask about, I mean the guidance range is still very wide for given that we only have a quarter left. Is that because you see so much volatility or uncertainty in the final quarter? Could you talk about the swing factors that you have in mind?

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO



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Well, I think that you're right of course, we are in the final quarter of the year, but we are still in very, very volatile markets and we still have open days obviously both in dry cargo and tankers. And as we can see also in the third quarter results of the dry operator, there can be times where we will open up the book again and maybe have ships that are positioning. So that brings some, you can say, increased uncertainty.

Frans Høyer - Jyske Bank - Analyst

Nothing in particular though that you sort of are prepared to absorb with this wide range?

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

No, I mean we're not expecting any extraordinary events or anything like that.

Frans Høyer - Jyske Bank - Analyst

Okay. I also wanted to ask you about -- so you mentioned that demand growth in dry bulk has been good. Do you say how much it has been or what you're expecting for the full year in dry bulk for 2017 and what you see for 2018? I mean, I'm talking market growth now.

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

Yes. So we do say that demand growth in Q3 was 2.7% and that year-to-date, demand growth has been 4.5% and so full year it should be -- it's on a declining trend, but it's still fairly strong also on a full year basis. We haven't commented specifically on really what we think it will be for 2018. So the key message for us is really that with supply growth being as low as 1.3%, it really is very likely that we will see a further strengthening of utilization overall.

Frans Høyer - Jyske Bank - Analyst

Okay. And then finally, I don't know if I'm doing something wrong here, but I calculate a net asset value in Danish Krone of 130 per share and I'm wondering whether that -- I noticed that you don't actually offer your own detailed calculation on that in the report. You haven't done for some time, but you do give us some of the building blocks to make the calculation. Is there something I'm missing here? I mean I just take the surplus value of newbuilds and so on of the fleet at the options value and divide or look at the surplus relative to book value and that's what I do. Is there some element there that I'm missing out?

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

I'm not sure. So what are you doing? You're taking the surplus value in the --

Frans Høyer - Jyske Bank - Analyst

The market value and I put that of the fleet including newbuilds. I deduct the book value as well as the outstanding installments in respect of the book value -- of the newbuilds and then I add the options.

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

Yes, but you are not adding any mark to market value of the time charter book or the coverage contracts that we have.



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Frans Høyer - Jyske Bank - Analyst

No, that's why -- I don't have the value, so I find that a bit theoretical. But, you know, that might be a major mistake, I don't know.

Martin Badsted - Dampskibsselskabet NORDEN A/S - CFO

Well, of course, the time charter book is fairly large in NORDEN as well as our contract coverage. You can actually find a schedule that indicates the number of days and the cash cost and cash earnings on that part of the portfolio. It's on our website. I think it's a little technical perhaps, so we can easily have a call afterwards.

Operator

As there are no further questions, I'd like to turn the call back to our speakers for any closing comments or remarks.

Jan Rindbo - Dampskibsselskabet NORDEN A/S - CEO

All right, thank you very much and thank you for your interest in NORDEN. Have a good day and goodbye.

Operator

Ladies and gentlemen, this concludes today's call. Thank you for your participation. You may now disconnect.

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