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DNORD.CO - Q3 2018 Dampskibsselskabet Norden A/S Earnings Call

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CONFERENCE CALL PARTICIPANTS

Keith Wallis

PRESENTATION

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

Thank you, and welcome to the presentation of NORDEN's third 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 have 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, the valuation of NORDEN and the business updates on our 2 Dry Cargo business units. Martin will then give you an update on the markets and our Tanker business. Finally, I will conclude with a few final words regarding the third quarter before we will open up for the usual Q&A session.

Please turn to Slide #4. Strong performance by the Dry Operator and the Dry Owner business units was outweighed by a historical weak product tanker market, and NORDEN realized an adjusted result for the period of minus \$12 million, corresponding to an EBIT of minus \$7 million. We maintain the expectations for the adjusted result for the year at 0 to \$30 million despite the poor tanker market. This is partly due to strong performance in the Dry Operator, where we expect a result for the fourth quarter that is substantially stronger than the \$2 million that we delivered in the third quarter. We have today also announced that we will initiate a share buyback program of \$10 million.

Next slide, please. Many shipping companies are evaluated and valued on the basis of NAV, net asset value. This represents the market value of the owned fleet and the financial position of the company. However, we do not believe this fully captures the value of NORDEN. We have a significant portfolio of time-charter contracts and long-term cargo contracts, which are not on the balance sheet. This portfolio adds significantly to the market exposure and can, in periods, represent a sizable addition to the owned fleet.

Additionally, we believe that NORDEN is able to generate value that goes beyond the usual NAV assessment through the Dry Operator. The Dry Operator is an ongoing business where the value can be evaluated on our ability to generate a margin and grow the activity levels.

Slide #7, please. The Dry Operator realized an adjusted result of \$2 million, which was an increase of \$4 million compared to the last year. In the third quarter, we usually have a larger share of our fleet carrying backhaul cargoes in preparation of grain excellent season in the fourth quarter. And we do believe we will continue to see seasonality in the Dry Operator results going forward.

Despite the strategy of a continued expansion of Dry Operator, NORDEN decided to temporarily reduce the number of chartered vessels in the third quarter to protect the value creation during the quarter and to optimize the positioning for the fourth quarter of 2018. As a consequence, the results for Dry Operator are expected to be significantly higher in the fourth quarter than in the third quarter.

Next slide, please. The healthy dry cargo market fundamentals continued during the quarter, and Dry Owner realized an adjusted result of \$4 million. Asset values and thereby, also the value of the overall Dry Owner portfolio have been fairly stable during the period and after significant gains over the last couple of years. It should be noted that the Dry Owner exposure to short-term rates is very limited in the coming quarters as most of the capacity has been covered. And now over to Martin for an update on the markets. Next slide, please.

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

Thank you, Jan. Dry Cargo spot rates continued their year-on-year improvements in Q3, although the pace is slowing. Panamax and Supramax rates were about 20% and 25% higher than in the same period last year, driven by a favorable combination of modest fleet growth and generally strong demand, supported by a healthy macroeconomic environment. The Chinese economy, which has been an important growth locomotive for Dry Cargo in the last few years, seems to be slowing. But so far, this is offset by stronger import demand in the rest of the world.

Next slide, please. We think the dry cargo markets will continue at healthy levels in 2019. Although the year-on-year improvements are likely to slow. Even though global economic growth looks to be decelerating slightly, we expect it to remain strong enough to provide good demand support. And coupled with Dry Cargo fleet growth of around 2% for 2019, the market is expected to be well balanced. The main risks we are seeing are a worse-than-expected slowdown in the global economy in general and the Chinese economy in particular. However, this is still not our base case. What is positive for the longer term is that vessel ordering remains very low. We count year-to-date new orders of less than 3% of the exit fleet, and the order book relative to the exit fleet is below 10%, which bodes well for the sustainability of the market balance.

Skip to Slide 12, please. Our Tanker business realized a quarterly adjusted net result of minus \$18 million, and the main driver of the poor results was a historically weak tanker market in Q3. In our 2 main vessel types, MR and Handysize, we realized cheesy ease of about \$10,350 and \$9,100 per day, respectively, which is the lowest we have seen for many years. Period rates did not fully reflect the weakness of the spot market. So we used that period rate premium to take some 6 months' coverage, especially for our east of Suez positions. And with recent rate improvements in the Atlantic, we do expect a stronger result in Q4 than in Q3.

Please turn to slide 13. The tanker market weakness seen during summer continued throughout Q3 and into the beginning of Q4. The market faced severe headwinds from a combination of price pressure from crude tanker competition and declining product imports in Asia, South America and the Middle East. Furthermore, high oil prices and a strong dollar team to be having a negative effect on overall oil demand, which feeds into product tanker demand.

Next slide, please. Looking ahead, we believe that after a very poor market in 2018, the tanker market will gradually start to improve from here. While all demand growth will probably still be subdued because of high oil prices and a slowing global economy. We believe that the negative effect from inventory draws will stop. In addition, the demand side, especially, in the second half of 2019, will get support from an increase in new refinery capacity coming on stream and the IMO 2020 sulphur regulation, which will have a significant and positive effect on product's trade.

On the supply side, we see limited remaining pressure from vessels exiting floating storage, and short-term fleet growth for product tankers remains in the area of 2% to 3% for 2019. So even though we still have some catching up to do in terms of moving off the current low utilization levels, we see good potential for better market fundamentals. And now back to Jan for a few final words.

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

We are on slide 16. Thank you, Martin. Let me just highlight the key messages here at the end. Since initiation 5 quarters ago, the Dry Operator has been focusing on 2 things: to build a strong performance track record, and increase the scale of the business. And we believe that we are well on our way on both of these ambitions. The value of the Dry Owner has increased considerably over the last couple of years, and we are constantly working to optimize the portfolio through new deals and adjustments of old.

While the tanker market currently is severely challenged, we have already begun to see improvements during the start of the fourth quarter with expectations of the continued improving market during 2019 at which NORDEN is well positioned for this in our Tanker portfolio. Additionally, we maintain the expectation that the IMO 2020 low sulfur regulation will have a large impact on the shipping industry, and we believe our investment in scrubbers will provide us with a competitive advantage. We are still looking profitable for the year, and we'll continue performance in the Dry Operator activity, a healthy dry cargo market and a tanker market with good potential, NORDEN is well positioned for the future. Next slide, please. And please remember that there are uncertainties related to any forward-looking statements.

Next slide, please. And this concludes our presentation. We will now open up for our Q&A session. Please await the conference host's instructions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) It appears there's no questions at this time. I'd like to pass the conference back to you.

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

Alright. Well, thank you very much for listening in, and thank you for your interest in NORDEN. Have a Good day. Thank you, and goodbye.

Operator

Pardon the interruption. There is just one question in the queue. Would you like to take this?

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

Yes, please.

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

Yes, please.

Operator

So this question comes from Keith Wallis from Fairplay.

Keith Wallis

In terms of dry bulk in the tanker market. So I mean, it seems to be -- for NORDEN, it seems to be a tale of 2 markets, sort of, paraphrasing Charles Dickens. I mean, in terms of the improvement, do you see any particular, sort of, specific locations that's going to drive the improvement in both sectors?

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

Well, I think in -- if we start with the tankers, then I think the first sign of life in the tanker market is what we are actually seeing right now on the bigger segments where crude tankers have already moved. And that will, in turn, have an impact on the power tanker markets. We've seen earlier this year -- we have seen some new billings, they come out in the market and take keen cargoes, and that was obviously very bad for the MRs. And we will also see LRs starting to switch from clean into dirty trades, if the currents or rate momentum on crude continues. So I think these are 2 of the elements that will help. Right now, we are seeing a very strong U.S. Gulf market for product tankers but not so much improvement in the rest of the world. So it's a very regional market right now on product tankers. In dry cargo, it goes bit with the grain seasons. We have had a fairly the slow grain season this year, not least because of the impacts of the trade wars, but that in turn should -- we should see a more busy season coming out now from South America later in Q1 when there should be a good number of shipments from Brazil to China on soybeans. So I think on that route, we have some expectations that things will pick up.

Keith Wallis

Okay. I mean is this also an issue about increased tonne mile demand? Or is it purely sort of general rise in demand generally?

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

I think on dry cargo, we expect a more muted demand growth in 2019. We have had some strong increases since 2016. We do think that general global economic activity will slow down a little bit in 2019. But on the other hand, in the dry cargo market, we are helped by a very low fleet growth. And actually, in '19, we expect slightly fewer new billings to deliver into the market than 2018. So overall, the market can actually live with a slightly slower demand development next year. But we expect a more to flat development in 2019 compared to the increases we have seen in 2018.

Keith Wallis

Okay. And on the tankers, you mentioned refinery expansion sort of coming on stream in 2019. Is that likely to lead to a change in trading patterns at all, given what the U.S. is doing and Iran and everything else?

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

Yes. So a lot of these refineries are coming in the Asia-Pacific region. And what we typically see is that just the addition of more refining capacity tends to add more regional trades. So not all the output from each refinery will be used domestically. And therefore it will tend to always spur added activity in the region where they come on stream.

Keith Wallis

Okay. I guess, one final -- just one final question. In terms of scrubbers, I mean, obviously, you've opted for scrubbers for your tankers, but not from looking at fleet list, not for dry bulk. Is there any reason for that?

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

No, we have actually invested both on dry and on tankers or for scrubbers. I know it's actually roughly a 50-50 split between dry and tankers.

Operator

There are no further questions in the queue.

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

All right. That concludes our presentation and Q&A for today. Thank you for your interest in NORDEN, and have a Good day. Thank you and goodbye.

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