CHIEF EXECUTIVE'S INTERVIEW

Q Can you give more detail on the factors that affected profitability in 2005?

A China's oil imports soared over 40% in 2004, and VLCC rates, particularly on the Middle East – Asian routes we serve, consequently rose sharply. In 2005, however, there was an acute fall in the rise of imports of crude oil to China which on a net basis grew only 1.7% in 2005, according to the International Energy Agency (IEA), against growth of 41% in 2004. Although we noted in our outlook last year that a decline was expected, no one expected it to be as severe as it was.

Because of this, and other global factors, demand for VLCCs was quite soft, even in the last quarter of the year, which is usually the peak of the annual cycle. The expected spike in rates, which was markedly lower than that in 2004, went up much later and lasted very briefly. As a result, World Scale rates for the Middle-East to Japan routes, our key benchmark, dipped from an average of 150 in 2004 to an average of 104 in 2005.

The fall in VLCC rates was exacerbated by increased costs. Fuel oil prices rose on average 20% in 2005 over 2004, with increases as high as 50% in the fourth quarter, adding substantially to our cost of operations. So although our fleet had a larger average capacity, and generated higher revenues than in 2004, margins were lower than expected.

We also had to service our debt from March 2005 onwards, following the issuance of the US$400 million bond, whereas we only benefited partially during this period from the delivery of the tankers acquired with the proceeds. Depreciation has also increased substantially as we have grown our tanker fleet. Interest and depreciation expenses grew 310% to HK$558 million in 2005.

Overall, therefore, even though we saw increased revenues in all our businesses in 2005, this was offset by the increased fuel costs, higher interest and depreciation expenses. In fact, all of our businesses, including transportation, produced improved operating profit, so you can see the impact of the higher interest and depreciation costs.

Q Why do you remain positive on prospects for the year 2006?

A It is important to understand that the fall in oil imports to China in 2005 was not in any way due to less demand for oil. China's economy continued to grow very strongly, as it has done for many years now.

So why did 9% plus GDP growth not translate into double digit oil import growth, as it has done for the past decade? There are two reasons. Firstly the Chinese government held down retail fuel prices, which meant that the refiners in China were forced to operate at a loss. Naturally, they simply decided to refine a much lesser amount, and hence import as little crude oil as possible. This situation led to well-publicised fuel shortages across China and, ultimately, heavy government subsidies to refiners.

Secondly, China probably stockpiled crude in the final quarter of 2004. China does not make these figures public. But the International Energy Agency (IEA) calculates that this must have been the case, given than net crude imports were 45.2% higher than 2003 for the period, while refinery throughput increased by only 17.1%. So import demand was very strong in the September to December period of 2004, and by contrast comparatively weak in the same period of 2005 as stocks were drawn down.

> "So even if the market conditions are similar to 2005, we expect **higher earnings from our transportation business.**"

As we have said earlier, this situation appears to be now reversing. Having depleted stocks, there are good indication that China has resumed oil imports to a normal rate of growth. The IEA expects total demand in China to rise by 5.8% in 2006 against 2.5% in 2005. Since domestic production is likely to increase by no more than 2-3%, this implies low double digit growth for China's crude imports. This could be conservative. In announcing its latest five year plan, the Chinese government has stated its intention to liberalise fuel prices, a shift in policy which will boost refinery production over time. For the first quarter of 2006, China imported about 25% more crude than was imported during the same period last year.

Moreover, Asian oil import demand and hence VLCC rates are strongly linked to OPEC crude supply. OPEC crude supply has risen steadily from 28.6 million bpd in 2004 to 29.2 million bpd in 2005. We have seen figures for January and February at 29.6 million bpd and 29.8 million bpd respectively and there are a strong indication that supply would be maintained at above 29 million bpd to stabilise oil prices.

On the supply side, the global VLCC fleet grew by 32 vessels, or about 7.26% of capacity in 2005. For 2006, shipbrokers PF Bassoe estimate there will be 17 new deliveries representing a much smaller increase of around 3.59% of the global capacity at the start of the year.

However, the most important thing for Titan in 2006 is that we now have a much larger fleet that is all in place from the beginning of this year. And compared to 2005 when we were just expanding our fleet and not yet able to optimise, we are now able to operate our vessels more efficiently, with a much lower cost structure. So even if the market conditions are similar to 2005, we confidently expect higher earnings from our transportation business.

In addition, results from our other businesses should continue to improve. In storage, demand for our FSUs off Singapore is expected to remain strong. Additionally, two of the three major oil storage terminal projects in China that we have been developing in Nansha and Fujian, will see their first phases enter operation in the second half of this year and will begin to contribute, although modestly initially. Oil distribution is expanding and becoming more efficient. Having integrated the sizeable business we acquired from our controlling shareholder in late 2004, our oil supply bussiness is expected to see higher volumes and profit as well as generate additional transportation and storage businesses.

To sum up, we have confidence that 2006 will result in higher earnings on a much improved cost structure. This will be true even if World Scale rates don't improve over last year.

Q What plans do you have for each business in 2006?

A In transportation our focus will be on operational excellence for our expanded fleet of 13 VLCCs and the 15 product tankers. If there are attractive opportunities to upgrade our fleet, we will be doing so too, although we are in no hurry to acquire new vessels this year, having reached a comfortable size in 2005. We would also look into increasing our presence in the product tanker segment.

On storage, of course, we will continue with the construction of the three onshore facilities in China. We aim to open the first phase of Nansha, which involves 410,000 m^3 of fuel oil storage, in the third quarter, and Fujian, involving 90,000 m^3 of chemical and diesel storage, in the fourth quarter. We also expect to begin construction of the Yangshan facility near Shanghai before mid-2006, with a target completion of the 400,000 m^3 first phase by mid 2007. Given the very strong demand we are seeing at our FSU business, we may consider adding capacity in this area as well.

In distribution, we will focus on securing more term contracts in Singapore, and we will try to exploit synergies between the Singapore and Hong Kong operations.

In our supply operations, we will implement a new trading system and build our feedstock and fuel oil supply network, as well as blending capability. We will focus on improving the profitability of our supply operations by taking advantage of the synergy that exists between supply and our other businesses, such as shipping and storage. When operations start at the Nansha storage facility, we believe this will quickly begin to generate opportunities for the Group's other businesses as well.

Q What will CAPEX be in 2006 and how well funded are you?

A Capital expenditure is set to fall substantially in 2006 and we have only committed about HK$312 million (US$40 million) for our storage projects in China. We have no specific plans to buy VLCCs this year, unless an attractive opportunity comes along for us to upgrade our vessels.

Interest cover was satisfactory at 2 times for 2005, and it is rapidly improving. In 2005, we raised US$400 million in March, but most of the assets we purchased with the proceeds did not come on stream until much later in the year. For 2006, these assets are all operational and generating cash. Since our borrowings are all fixed rate, higher interest rates will not have any impact on our interest costs. We therefore expect interest cover to improve substantially.

Overall, we plan to conserve more cash this year and will look to increase our liquidity to take advantage of opportunities in the coming year and to consider lowering our gearing by paying down debts.

Q In the longer term, will attempts to reduce oil dependency affect Titan?

A If by long term you mean 50 years into the future, who knows? But for the foreseeable future, this is unlikely. According to the World Bank, the lower and middle income countries of Asia Pacific account for 52% of the world's population and 8% of global GDP. Yet Asia as a whole has only 3.5% of global proven oil reserves – down in fact from 5% ten years ago, according to BP. With countries such as China and India growing at more than 8% a year economically, and demand for cars, air travel, electric power and so on often growing even faster, the consumption of oil products is going to continue to rise, whatever governments do to encourage energy savings or alternative fuels. Indeed, the IEA points to US$3,000 per capita income levels as the point where demand really begins to soar. With millions of people in Asia entering this category each year, demand for oil could even accelerate.

> "When **operations start at the Nansha** storage facility, we believe this will quickly begin to **generate opportunities** for the Group's other businesses."