



CHAIRMAN'S STATEMENT

Overview

We are pleased to present a satisfactory first set of annual results after a very significant year for the Group. We completed a successful reorganisation and listing on the Hong Kong Stock Exchange in July 2004 (the "Listing") and the capital we raised allowed us to undertake a substantial fleet expansion. This, in turn, enabled us to enlarge the scale of our business operations to meet the increasing demand from our customers for the freight services we provide. The freight market for dry bulk shipping was very strong, with owners and operators earning favourable rates.

The combined effect of the reorganisation and Listing, the expanded fleet, our business strategy and the level of the freight market is that the Group's profits for the year ended 31 December 2004 increased to US\$103.5 million from US\$22.7 million in 2003 on turnover of US\$234.3 million compared with US\$54.2 million in 2003. Basic earnings per share rose to 9.59 US cents (74.80 HK cents) compared with 2.85 US cents (22.23 HK cents) in 2003. By the end of the year, we operated 41 vessels (an average of 28 vessels during the

year), providing a total of just over 10,000 revenue days and achieving average daily revenue of almost US\$17,900 per vessel, compared with 15 vessels providing 5,500 revenue days at an average rate of US\$9,800 in 2003.

During the same period, our network of support offices was extended to improve our response to customers' requirements within their own time zones and provide greater operational support in our key cargo loading and discharging areas.

The number of Handysize revenue days for 2005 is now expected to be over 14,200, an increase of 43% before the planned further fleet expansion. With 59% of these revenue days already covered at an average rate of US\$17,300 per day and a healthy freight market, we remain confident that we can expect another year of strong growth.

Dividend

The Group's policy is to pay out by way of interim and final dividends not less than 50% of profits available for distribution in each financial year. For



2004, dividend payments are based on the results for the period from 1 June to 31 December 2004, because all retained earnings up to 31 May 2004 were paid out to shareholders of the Company prior to the reorganisation of the Group and the Listing.

In view of the above policy, the Board has recommended a final dividend of HK\$0.16 per share for the year ended 31 December 2004 to be paid on 6 May 2005 to the shareholders of the Company whose names appear on the register of members on 29 April 2005. When this proposed final dividend is aggregated with the mid-period interim dividend of HK\$0.08 per share declared on 13 December 2004, the total payout of HK\$0.24 per share represents 56% of the Group's profits for the seven months ended 31 December 2004. Our decision to recommend a total dividend above the 50% payout level is a reflection of the strength in the Group's performance, profits and cashflows, particularly in the final quarter of 2004, and our optimism given the strong start to the current year.

Market Review

There is no doubt that 2004 was an outstanding year for the industry as a whole, with the three principal sectors of shipping (container, tanker and dry bulk) each experiencing strong demand and constrained supply conditions, driving freight rates and vessel prices to historical highs. The dry bulk sector was in particular a beneficiary of economic growth and industrial expansion in Asian economies, especially in a number of the Group's main cargo delivery destinations, where the increase in consumption of primary raw materials created significant additional shipping requirements.

The demand for tonnage and the supply available to meet that demand were finely balanced and produced rates for Handysize vessels in excess of US\$15,000 in both the Pacific and Atlantic for most of the year. Additionally, the dry bulk freight market experienced two sharp rate spikes in the first and fourth quarters. These spikes were characteristic of market conditions where supply is unable to cope with incremental demand and it

was, perhaps, unsurprising that they occurred during the traditionally busy seasons associated with southern and northern hemisphere grain shipments, when the already tight market conditions were exacerbated by China's burgeoning appetite for basic raw materials, iron ore in particular.

On the newbuilding vessel supply side, capacity constraints appear to limit the number of deliveries for the foreseeable future, with the dry bulk sector having only 21% of current fleet capacity on order for delivery over the next two to three years. Shipyards are already virtually full for this period and, with only moderate assumptions about world and regional economic growth, this is unlikely to create any significant over-supply, the traditional cause of a downturn in shipping markets. For our sector (25,000–35,000 dwt), the order book represents only 10% of current fleet capacity. This means that, even if the rate of scrapping remains low, the world Handysize fleet (which already has an average age over 17 years and where 29% of the fleet is over 25 years old) is likely to grow older and less efficient. It is worth noting, however, that 2004 was the first year since 1997 that saw a net growth in the Handysize fleet (albeit by only 2.5%) as it became economically viable for owners of very old ships to postpone scrapping despite incurring the considerably higher operating costs and off-hire associated with such vessels.

These market conditions have pushed vessel values higher. Prices for a five year old Handysize vessel and for a newbuilding vessel are both approximately 25–35% more expensive now than they were a year ago. For those companies with sizeable (and especially modern) fleets, this is obviously welcome news; except that the prospects of buying additional vessels in the market have been limited. We have successfully utilised our long-term relationships, particularly in Japan, to find opportunities to add to our fleet expansion since last summer, despite these challenging market conditions.



Business Review

Through our International Handybulk Carriers ("IHC") pool we have established a market position and a reputation in our sector as the leading supplier of freight services provided directly to the major commodity companies predominantly in the Pacific. These services are backed by a fleet of modern vessels, a comprehensive network of offices around the region and a team of dedicated and experienced industry professionals. During 2004, approximately 75% of the cargo shipped by our fleet was loaded and discharged in the Pacific with the balance predominantly in the Atlantic and Mediterranean.

We specialise in shipping a broad range of bulk commodities, with forestry products, cement, fertilisers, steel and grain representing 70% of 10.7 million tonnes of cargoes carried by IHC pool vessels in 2004 (2003: 72% of 7.6 million tonnes). This is performed with the largest fleet of modern Handysize ships in the Pacific. At 31 December 2004, we had a fleet of 45 vessels, with an average age below five years, comprising 34 owned vessels (including one Handymax), seven vessels on long-term charters and four managed vessels. We also had on order six newbuilding vessels for delivery in 2005 and 2006 (five owned and one chartered). Further developments to the fleet since year-end are described in Fleet Developments below.

Our strategy of providing direct services to major commodity companies means we must be confident of our ability to load at ports where the regulatory environment is the most challenging. Modern ships and experienced local back-up are essential ingredients to the success of such an operation. These same ingredients are also essential at our main delivery destinations of Japan, China, Australia and South Korea. At both load and discharge ports, related infrastructure restrictions or natural geographical features frequently dictate that vessels not larger than Handysize must be used.

A modern, standardised fleet is also important to the securing of back haul cargoes which, when combined with front haul voyages, can be used to increase vessel utilisation and therefore improve the overall rates we earn. Through the effective combination of front haul and back haul voyages, we have successfully reduced our ballast time to achieve a high level of asset utilisation with our ships carrying cargo most of the time. Our success in securing back haul cargoes has resulted in Australia (our largest loading area) becoming our third largest discharge destination.

In tandem with our fleet expansion, we have in the last year opened new offices in Melbourne, Shanghai and Vancouver to provide local support for the main operational centres in Hong Kong and London, which have also expanded. Our shore-based staff now number some 225 employees, up from 175 on 30 June 2004.

Linking front haul and back haul voyages reduces the amount of time spent ballasting and we are continuously building a book of long-term cargo contracts to provide us with a reasonable level of certainty over, and stability in, our future revenue streams. As at 25 February 2005 (being the latest practicable date prior to this report), cargo and charter contract cover had been established for 59% of 2005's 14,200 Handysize vessel revenue days at an average rate of US\$17,300 per day. This number of vessel revenue days is before the planned additional fleet expansion. The cover rate reflects the averaging of the basic rates in all existing front haul and back haul cargo contracts, including those that extend into 2006 and 2007, plus spot fixtures already booked in the first two months' trading activities. It does not include any projected levels of future spot market fixtures or the benefits of enhanced vessel utilisation to be achieved when contract cargoes are combined, or other spot market fixtures are used, to reduce the ballast content in these rates.

Fleet Developments

Since the end of 2004, we have taken delivery of two further vessels bringing our fleet today to 47 vessels (Handysize: 34 owned, seven on long-term charters and four managed; Handymax: two owned) with an average age of five years:

- On 6 January 2005, we took delivery of the Xiamen Sky, our second 53,600 dwt Handymax newbuilding, which immediately commenced a long-term charter to a major Chinese shipping group;
- On 11 January 2005, we took delivery of the Citrus Island (now renamed Pitt Island), a 28,600 dwt vessel built in 1997, which we had agreed to purchase in late 2004;

Additionally, we have entered into the following transactions to develop and improve our fleet configuration:

- We have agreed to purchase a 28,600 dwt vessel built in 1997 at Imabari, which is to be renamed Castle Peak and is expected to be delivered during the second quarter of this year; and
- We have entered into agreements to sell four vessels (two Handysize, one Handysize newbuilding and one Handymax) and charter them back at attractively low rates, thereby retaining the operational control and profitability of these vessels. The combined effect of these sales is to eliminate US\$20.4 million of capital commitments on newbuilding vessel deliveries and, after repayment of debt of US\$34.6 million, release some US\$18.9 million of capital that can be redeployed to support our on-going fleet expansion programme. By chartering the vessels back for long periods at rates that are broadly similar to our cash cost of owning these vessels, we maintain our scale and profitability whilst benefiting from a degree of protection against operational and market risks of ownership. Our resulting vessel operating lease obligations will be US\$22.9

million in 2005, US\$68.9 million for the four years 2006 to 2009 and US\$29.4 million thereafter. The vessels involved are:

- (i) the Priory Bay, the oldest and smallest of the vessels in our owned fleet. We have chartered her back for two years, with an option for us to extend for a third year. The vessel is expected to deliver to her new owners in March 2005;
- (ii) the Mount Fisher, a 2002-built 28,500 dwt vessel. We have chartered her back for eight years, with options for us to extend for two further periods of one year each. We also hold an option to repurchase the vessel at any time after three years. Delivery is expected to occur in April 2005;
- (iii) Imabari hull number H507, a 28,000 dwt vessel due for delivery in November 2006. She will be chartered back for five years with options for us to extend the charter for two further years with a repurchase option from the end of the third year; and
- (iv) the Xiamen Sea, a 2004-built 53,600 dwt Handymax vessel. She will be chartered back by us on terms that match our outward long-term charter, thereby releasing the capital tied up for re-investment in more profitable vessels. We hold a repurchase option that can be exercised at the end of five years.

As a result of these transactions and assuming that the vessels deliver to their new owners as expected, our fleet will expand to 48 vessels (Handysize: 33 owned, nine on long-term charters and four managed; Handymax: one owned and one on long-term charter). Importantly our share of total IHC pool activity will increase further to over 90% and our 2005 Handysize revenue days will increase to 14,200, with 59% cover at US\$17,300 per day. The two Handymaxes will provide a further 700 revenue days (2004: 100) which are 100% covered at US\$8,450 per day. We



will still have five newbuilding vessels on order, with three to come into the owned fleet and two into the long-term chartered fleet as well as the purchase options that we hold over seven of the vessels in the chartered fleet.

Outlook and Prospects

2005 has started positively, reflecting the continuation of the very strong market for dry bulk vessels. Handysize market rates have remained above US\$20,000 per day, apart from a seasonal dip over Chinese New Year from which rates have since rebounded, and the demand outlook for bulk commodities and economic indicators in our main delivery destinations remain encouraging.

With shipyard orderbooks virtually full for the next two to three years, we have reason to be confident that there will be only modest newbuilding deliveries for our sector and manageable deliveries for dry bulk as a whole. The supply picture cannot deteriorate in the short term. Until we see a fundamental change, we believe that rates will continue to be healthy and supported at a higher base than has been the case historically. Additionally, until the short-term tightness between demand and supply is alleviated, the conditions for further rate spikes at times of peak demand remain in place.

Our strategy continues to be to focus on providing direct freight services to the world's leading commodity companies. The growth in demand from our customers and the cargo opportunities available to us clearly support continued development of our business in this niche sector. Meeting that growth through further capacity expansion will depend mostly on our ability to source additional newbuilding vessels and modern second hand tonnage which we believe we are better placed to do than most other Handysize owners.

As expected, our customer relationships with leading international commodity groups, our exceptionally modern fleet and the increasing visibility of our presence in Shanghai (and China

in general) are also giving us access to some interesting and potentially significant opportunities for long-term inbound and outward cargo contracts, using vessels other than Handysize. These include iron ore, steel, coal, soya bean and grain shipments and represent an exciting development for the Group which we hope will develop into an increasingly important part of our total activity.

In conclusion, with positive demand and supply fundamentals for the market, with our 2004 fleet expansion driving growth into 2005 and with good contract cover at attractive rates for this year and into 2006, we remain optimistic about the outlook for the dry bulk shipping market generally and for the prospects for our business in particular.

Finally, we look forward to the arrival of Mr. Richard Hext, who will be joining the management and the board as Deputy Chairman in early April, responsible for all of our commercial and operating activities. His experience in our industry and his depth of skills in all aspects of our business including long-term relationships with our customers are expected to bring a new dimension to the overall running of the Group and to its future success. Upon Mr. Hext's arrival, Mr. Simon Lee, whilst remaining as a non-executive director, will step down as Deputy Chairman. We wish to express our sincere thanks to him for the support, experience and counsel that he has provided to us in the past and we look forward to the benefits of his continuing involvement with, and service to, the Board.

Christopher R. Buttery
Chairman

Hong Kong, 1 March 2005

Pacific Basin Shipping Limited

Annual Report 2004

