Introduction

The Pacific Basin name has been synonymous with the international seaborne transportation of dry bulk commodities in Handysize bulk carriers since its original formation in 1987. The company that bears the Pacific Basin name today was established in 1998 and has continued to focus on the Handysize sector through its fleet of modern vessels of similar design in the 25,000–35,000 dwt range. The Group seeks to operate that fleet itself in a manner that provides the leading commodities companies of the Asia Pacific region with the most direct, reliable and flexible freight services whilst also increasing the Group's operational efficiency.

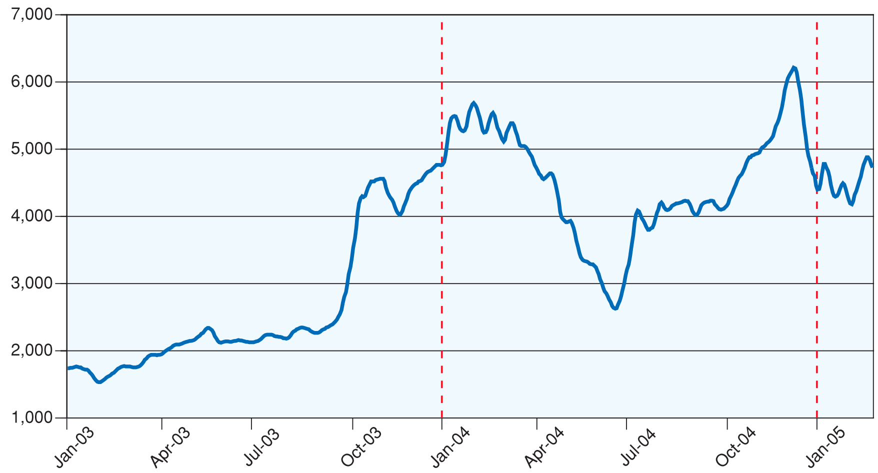
2004 marked a new chapter in Pacific Basin's history with its initial public offering ("IPO") on the main board of the Hong Kong Stock Exchange which was successfully completed in July. The IPO generated net proceeds to the Company of US$72 million, allowing further significant expansion of the fleet to meet the increasing demand for the freight services provided and in time to benefit from what is now proving to be a sustained and very robust dry bulk shipping market.

Market Review

The shipping industry as a whole experienced one of its strongest years ever in 2004. For the dry bulk sector in particular, this was in a large part driven by renewed economic growth and industrial expansion in Asian economies, in particular China where imports of primary dry bulk raw materials (iron ore and coal) grew by over 30%.

The dry bulk freight market started 2004 by continuing the rally that had commenced in the last quarter of the previous year, with the Baltic Dry Index ("BDI"), which tracks spot freight rates across larger dry bulk carriers, peaking at over 5,600 index points in February 2004. Throughout this period the demand for tonnage and the supply available to meet that demand were finely balanced. Demand from China for basic raw materials, especially iron ore, pushed rates higher and created significant port congestion in the iron ore and coal loading areas, particularly in Australia and Brazil. In the second quarter, the impact of China's economic slow-down measures reduced imports and decreased port congestion only slightly. Rates moderated as a result (the BDI dropped to 2,600) but this level was still above previous cyclical peaks since freight indices started in 1985, and continued to provide owners with favourable earnings.

Baltic Dry Index



(source: Bloomberg)

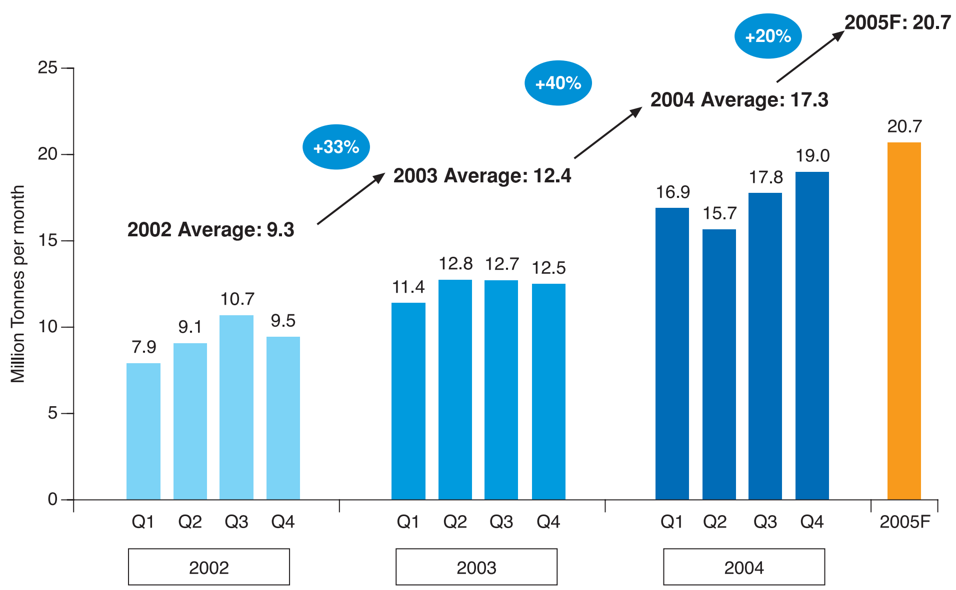
The moderation of rates was short-lived as China's pace of imports picked up again, creating a strong rally in the traditionally quieter summer months that was sustained well into the fourth quarter. With Chinese iron ore imports rising to a peak level of over 20 million tonnes in December and port congestion growing, the market was driven higher as the year end approached. The BDI posted 48 consecutive daily increases to reach a new record high of 6,208 in early December.

Handysize

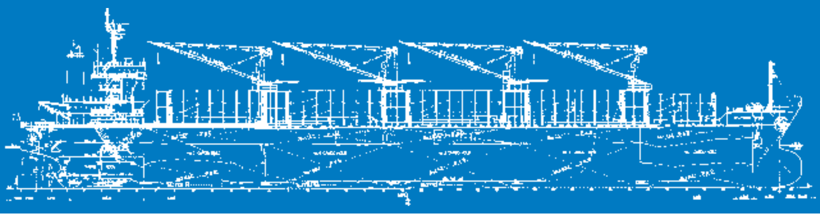
A similar pattern of strong and growing demand set against a tight and highly utilised supply base also provided very positive market conditions and rates in the Handysize sector. Spot rates remained above US$15,000 per day for most of the year and rates over US$20,000 were achievable for extended periods in the first and fourth quarters as all dry bulk sectors experienced demand-driven spikes in freight rates. These spikes occurred in February/March and again in November/December when the busy seasons traditionally associated with southern and northern hemisphere grain shipments naturally tightened market conditions. These conditions were exacerbated by China's burgeoning appetite for basic raw materials (iron ore in particular), a situation then worsened by port congestion that reduced the effective short-term supply base.

On the vessel supply side, newbuilding capacity constraints appear to limit the number of new ship deliveries for the foreseeable future, with only approximately 21% of current dry bulk fleet capacity on order for delivery over the next two to three years. With shipyards 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 Pacific Basin's 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 tonnage to postpone scrapping and to incur the considerably higher operating costs and off-hire associated with such vessels.

China's Iron Ore Imports



(source: Bloomberg/Clarkson Research Studies)



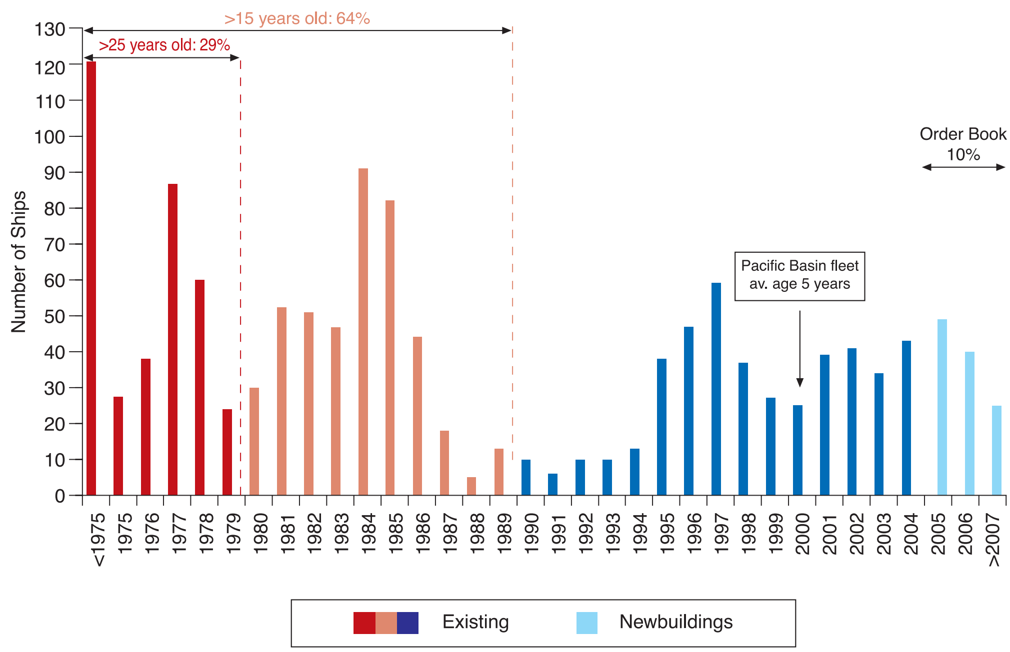
These market conditions have pushed vessel values higher. Prices for a five year old Handysize vessel and for a newbuilding vessel are both approximately 25–35% more expensive now than they were a year ago. For those companies with sizeable (and especially modern) fleets, this is obviously welcome news;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

Fleet Expansion and Development

As a result of the major expansion effected during 2004 and further additions so far this year, the Group continues to operate one of the largest fleets of modern Handysize vessels in the world. At the start of 2004, Pacific Basin operated a fleet of 18 vessels with an average age of four years, comprising 14 owned vessels and four vessels on long-term charters. The reorganisation that came into effect on 1 April 2004 in preparation for the Listing of the Group and the delivery of vessels under construction increased this to 26 vessels as at 30 April 2004. An additional four vessels and two newbuilding vessels were purchased conditional upon the completion of the Listing.

Despite the tight market conditions that characterised the sale and purchase market for most of the year, the proceeds from the IPO were successfully deployed with the purchase of another eight vessels from the secondhand market (of which seven delivered into the fleet before the year end), making Pacific Basin one of the most active buyers of modern Handysize tonnage during the year. This was achieved by making best use of the Group's long-term relationships and contacts in the industry to find opportunities not available to the market generally. These purchases combined with deliveries of a further three newbuildings took the Handysize fleet at year end to 40 vessels with an average age still below five years, comprising 33 owned and seven chartered vessels, with a further five newbuilding vessels under construction for delivery between June 2005 and November 2006. In addition, the Group owned one Handymax vessel, and had a further four Handysize vessels under management.

25,000–35,000 dwt Bulk Carrier Fleet Age Profile



(source: Clarkson Research Studies/Pacific Basin)

In September 2004 Pacific Basin took delivery of its first 53,600 dwt Handymax vessel which immediately commenced a long-term charter to a major Chinese shipping group (as described below, an agreement has since been entered into to sell this ship and to charter her back). The Group took delivery of a sister vessel, also on charter to the same Chinese charterer, in early January 2005, as well as a 28,600 dwt vessel built in 1997, which the Group had agreed to purchase in late 2004.

These deliveries bring the combined fleet today to 47 vessels with an average age of five years (Handysize: 34 owned, seven on long-term charters and four managed; Handymax: two owned).

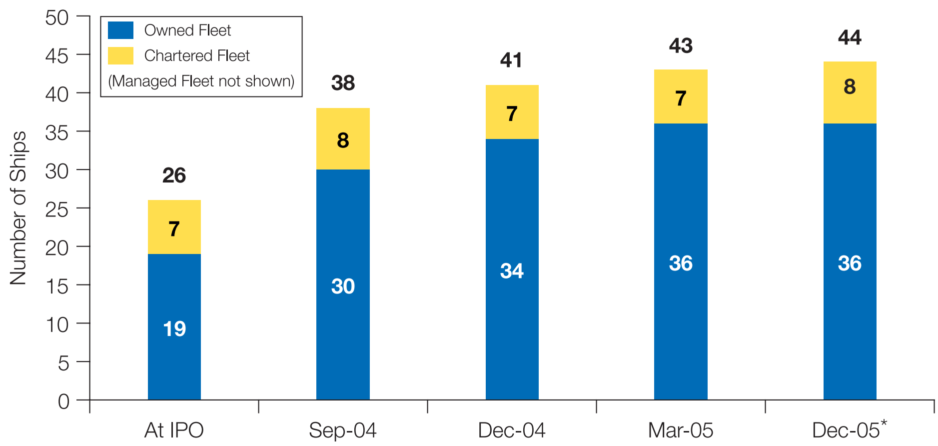
Additionally, since the end of 2004, the following transactions were entered into to develop and improve the Group's fleet configuration:

- The purchase of a 28,600 dwt vessel built in 1997, which is expected to be delivered during the second quarter of this year; and
- The sale of four vessels (two Handysize, one Handysize newbuilding and one Handymax) to be chartered 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 the Group's on-going fleet expansion programme. By chartering the vessels back for long periods at rates that are broadly similar to its cash cost of owning them, the Group maintains its scale and profitability. The 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.

Chartering and Cargo Operations

Pacific Basin continues to specialise in the transportation of a broad range of bulk commodities, with forestry products, cement, fertilisers, grain and steel remaining the most important. The Group's IHC pool has now established a market position and a reputation as the leading supplier in the Handysize sector of industrial freight services and supply chain management provided directly to the major commodity companies predominantly in the Pacific. This service is supported by a fleet of modern Handysize vessels, a comprehensive network of offices around the region and a team of dedicated and experienced industry professionals.

Pacific Basin Fleet Development



* *assumes vessels and newbuilding vessels are delivered as have been contractually committed but does not include potential additional fleet expansion*

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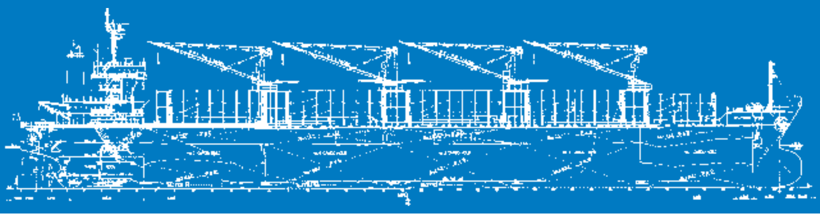
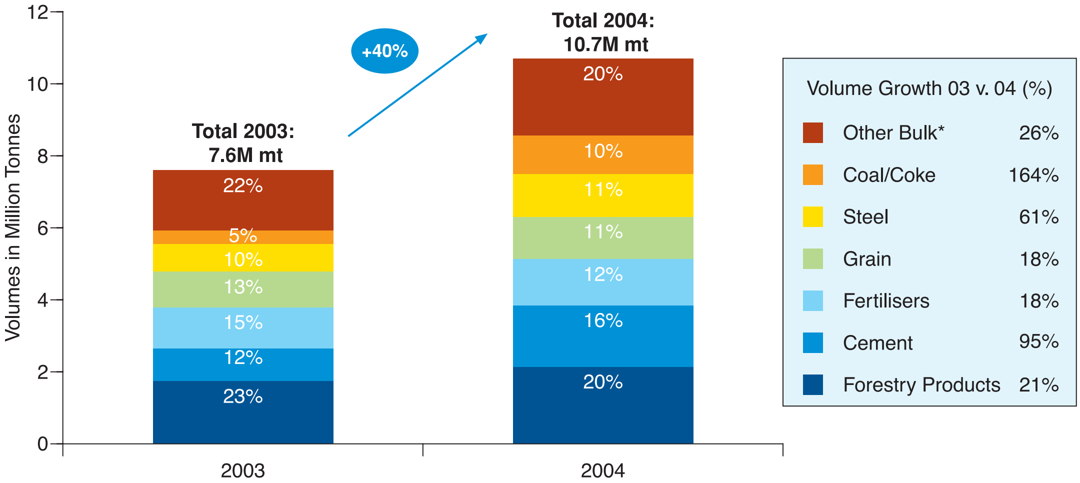


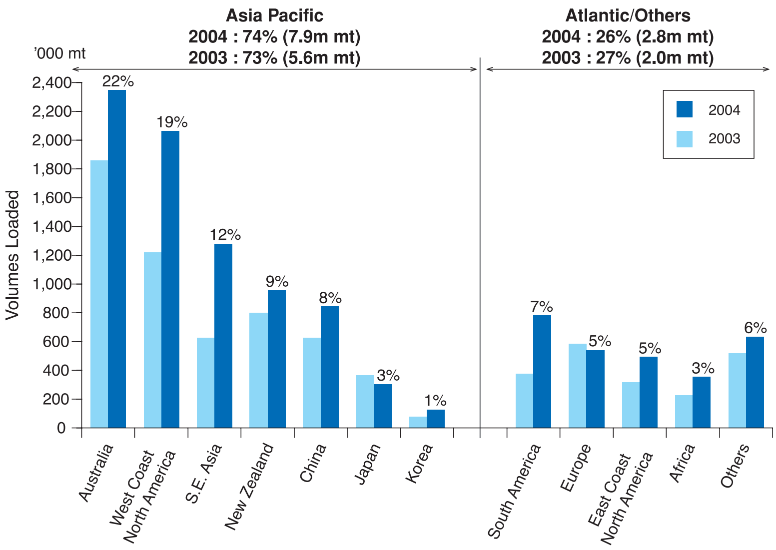
In 2004, IHC pool ships carried 10.7 million tonnes of cargo, an increase of 40% over the 7.6 million tonnes carried in 2003. Importantly, however, the Group's share of pool activity increased from approximately 60% in early 2004 to over 90% at the year end as the number and proportion of Pacific Basin owned and chartered ships entered into the pool expanded. Volumes of all commodities showed good increases with cement, steel, scrap and petcoke shipments particularly strong. These increases reflect stronger regional demand, both for imports and exports, particularly from China and the USA. The increase in the number of cement and steel cargoes carried into the USA was driven by strong domestic property construction, combined with an increase in IHC's share of inbound cement contracts. Growth in demand for the transportation of scrap and petcoke cargoes (used in the smelting process for steel production) has in part been driven by Chinese demand for steel products.

IHC Cargo Volumes



* *includes minerals, concentrates, agricultural products and other bulk products*

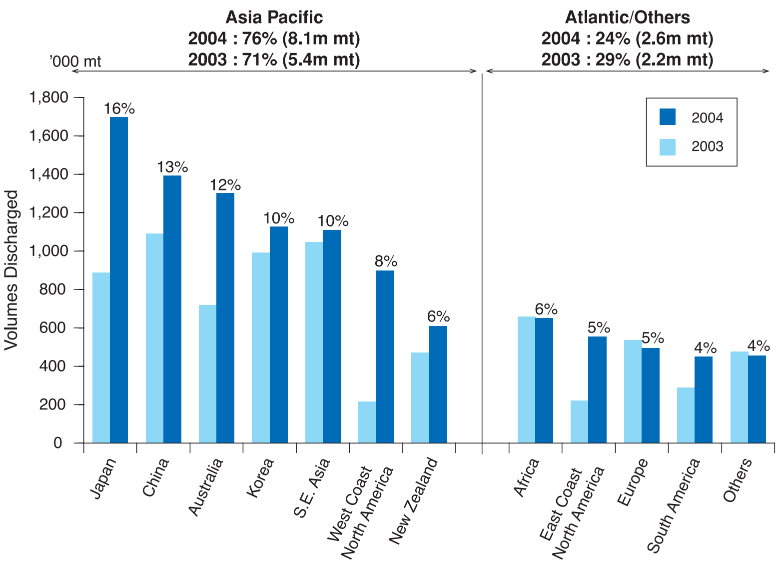
Major Load Areas



Cargoes for the key front haul trades are primarily loaded in Australia, New Zealand, the US west coast and Canada. These areas continue to be the most challenging for shipowners given the very high level of port state regulation, safety, environmental and other standards that are imposed and reinforce the need for the Group to have access to a fleet of modern, well-maintained vessels with experienced crew and strong shore-based local support. Whilst Australia continues to represent the Group's single largest loading area, volumes out of the west coast of North America showed particularly good growth driven primarily by exports of scrap steel, petcoke and fertilisers.

These front haul cargoes are delivered mainly to ports in Japan, China and South Korea. Whilst overall IHC cargo volumes increased by 40% over the year, volumes of cargo delivered into Japan almost doubled to 1.7 million tonnes, as a result of the Group's efforts to develop more cargo opportunities in Japan and bolstered in part by increased cargoes of coal during the country's nuclear power shut-down. China continues to be an important destination for the Group but accounts for less than one seventh of total cargo deliveries and therefore provides a significant growth opportunity going forward.

Major Discharge Areas



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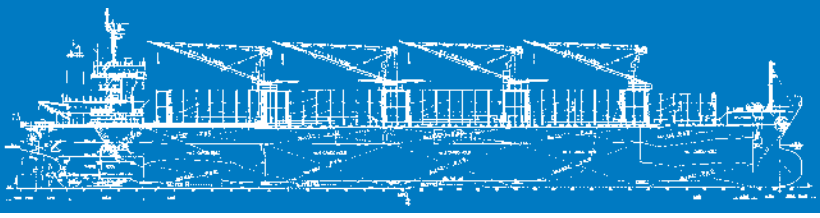


A key part of the Group's operating strategy is to secure back haul cargoes wherever these can be combined with front haul voyages on a profitable basis. Typical back haul cargoes in 2004 were cement, steel and fertilisers.

These voyages reposition vessels back in the prime front haul loading areas, thereby reducing the number of days in ballast, increasing overall asset utilisation and improving revenues as a result. Through the effective combination of front haul and back haul voyages, the Group's ships carry cargo most of the time. Successful triangulation of voyages, whilst maintaining acceptable levels of punctuality and and customer service, can only be achieved with a large standardised fleet of modern vessels to ensure a high level of operational and scheduling flexibility.

Reflecting this operating policy, the amount of cargo lifted in South East Asia doubled to 1.3 million tonnes, making it the third largest loading area during the year after Australia and the west coast of North America. At the discharge end, these back haul cargoes resulted in the delivery of some 1.3 million tonnes of cargo to Australia, behind only the deliveries to Japan and China. Deliveries to the west coast of North America tripled due to an increase in IHC's market share of the cement trade which lifted volumes to 0.9 million tonnes.

Although the Group's primary focus is on cargo movements in the Pacific, Atlantic-based activities also showed solid growth, with almost 2.8 million tonnes of cargo shipped, up from 2.0 million tonnes in 2003. In addition to being an important trading area in its own right, the Atlantic operations provide the Group with greater customer coverage and operational flexibility.

Through the IHC pool, the Group aims to deliver a high quality service tailored to the needs of its customers who rank amongst the leading commodities companies in the region. With a broad range of cargoes moved from, and delivered to, a wide variety of ports throughout the Pacific and Atlantic basins, the IHC pool has been successful in building a diversified customer list that comprises the leading commodities companies operating in these areas. The Group provided freight services to over 100 different companies in 2004, with the largest single customer accounting for only 7.1% of total Group revenues and the top ten accounting for only 36.9% of revenues.

The Group's commitment to customer service, flexibility and responsiveness is believed to have been a key factor contributing towards the expansion and strengthening of the Group's business relationship with the majority of these key customers in 2004.

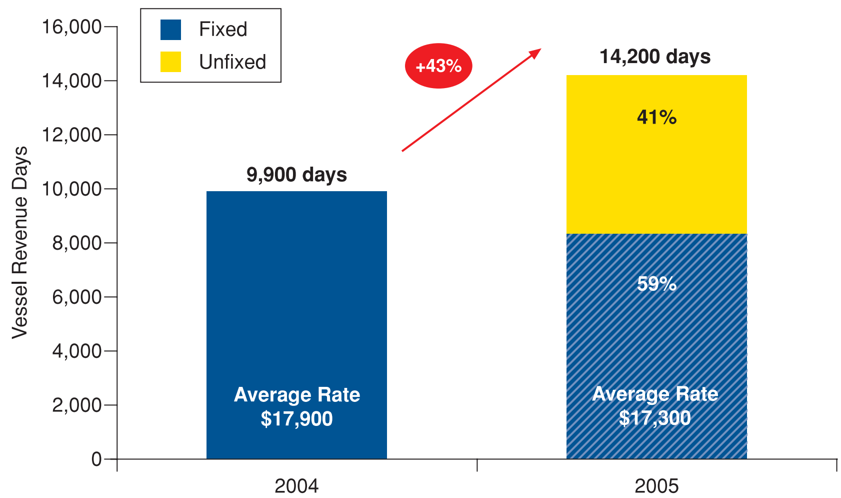
Revenue Generation and Employment Cover

The Group's operating strategy is to fix cargo contracts directly with shippers, rather than to time charter vessels out to other operators. By this approach the Group believes that it is able to improve the level of earnings achieved by its vessels through increased asset utilisation derived from the ability to link front haul and back haul voyages which reduces the amount of time spent ballasting. In 2004, the IHC pool was able to manage these scheduling and operating challenges to achieve a high level of asset utilisation thus reducing ballast days.

The Group seeks to arrange long-term cargo contracts for a significant proportion of its total fleet revenue days. The contracts are for multiple shipments at fixed rates to service the requirements of its customers, who are increasingly seeking to manage their exposure to freight costs by entering into such arrangements. This approach provides the Group with a reasonable level of certainty over its future revenue streams and provides its customers with a hedge against freight market fluctuations. The balance of fleet capacity is kept open to provide sufficient capacity to service customers' short-term freight requirements and to allow the Group to take advantage of spot market rates. This strategy allows the Group to achieve a high degree of stability in the average rates achieved by its vessels.

The Group's expected Handysize vessel revenue days for 2005 has increased to 14,200 from 9,900 in 2004 due to its fleet expansion in 2004 but before considering any further fleet expansion. By the end of February 2005, charter and cargo contract cover had been established for 59% of those 14,200 days in 2005 at an average rate of US$17,300 per day. This rate reflects the averaging of the basic contract rates in all existing front haul and back haul cargo contracts, including those that extend into 2006 and 2007, before execution premiums, i.e. it does not include any projected amount for future spot market fixtures or the benefits of enhanced asset utilisation to be achieved when contract cargoes are linked or are combined with other spot market fixtures to reduce the ballast content in these rates.

Handysize Fleet Employment Cover



Pacific Basin's two Handymaxes will provide a further 700 revenue days (2004: 100) which are 100% covered at US$8,450 per day. The Group 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 it holds over seven of the vessels in the chartered fleet.

Commercial and Technical Operations

Meeting the requirements of a diversified but demanding customer base requires the Group to strive for the highest standards of service at all times. To support this effort, the Group now has a comprehensive network of offices around the Pacific, with over 225 shore-based staff worldwide. During 2004, new offices were opened in Shanghai and Melbourne, with an office in Vancouver being opened in early January 2005 to supplement the key operational centres in Hong Kong and London and the regional office in Tokyo.

Hong Kong remains the key location for the Group and is the principal centre for all chartering, commercial and technical operations, as well as being the Group's head office and financial and administrative centre. Expansion of this office has continued throughout the year to support the growth of the business and the fleet. It now employs approximately 60% of the 225 shore-based personnel, necessitating the move to a larger office in March 2005 which allows all staff to be accommodated on one floor providing improved internal communication and enhanced overall efficiency.

Pacific Basin's London office relocated to a more central location during the year as it expanded to support the Group's growing presence in the Atlantic. It now employs 10 people and has full commercial and operational responsibility for vessels trading in the Atlantic.

The Shanghai office is Pacific Basin's fastest growing location and is an essential part of the Group's future development. This office has taken on the full technical management of ten of the Group's vessels and is likely to be the shore-based outlet for future fleet expansion. More significantly, however, the Shanghai office is also expected to be an important source of new business for the Group going forward. In the few months that this office has been operational Pacific Basin has already seen an increased flow of new business opportunities, with discussions underway, for example, on potential soya bean and coal contracts which it is hoped will lead to additional cargo volumes.

The newly established regional offices in Melbourne and Vancouver are both aimed at providing effective and local, same time zone support both to the Group's customers as well as to the Group's vessels when they are loading and discharging. Further offices in Singapore and Seoul support the Group's surveying and consulting services business, PacMarine Services.