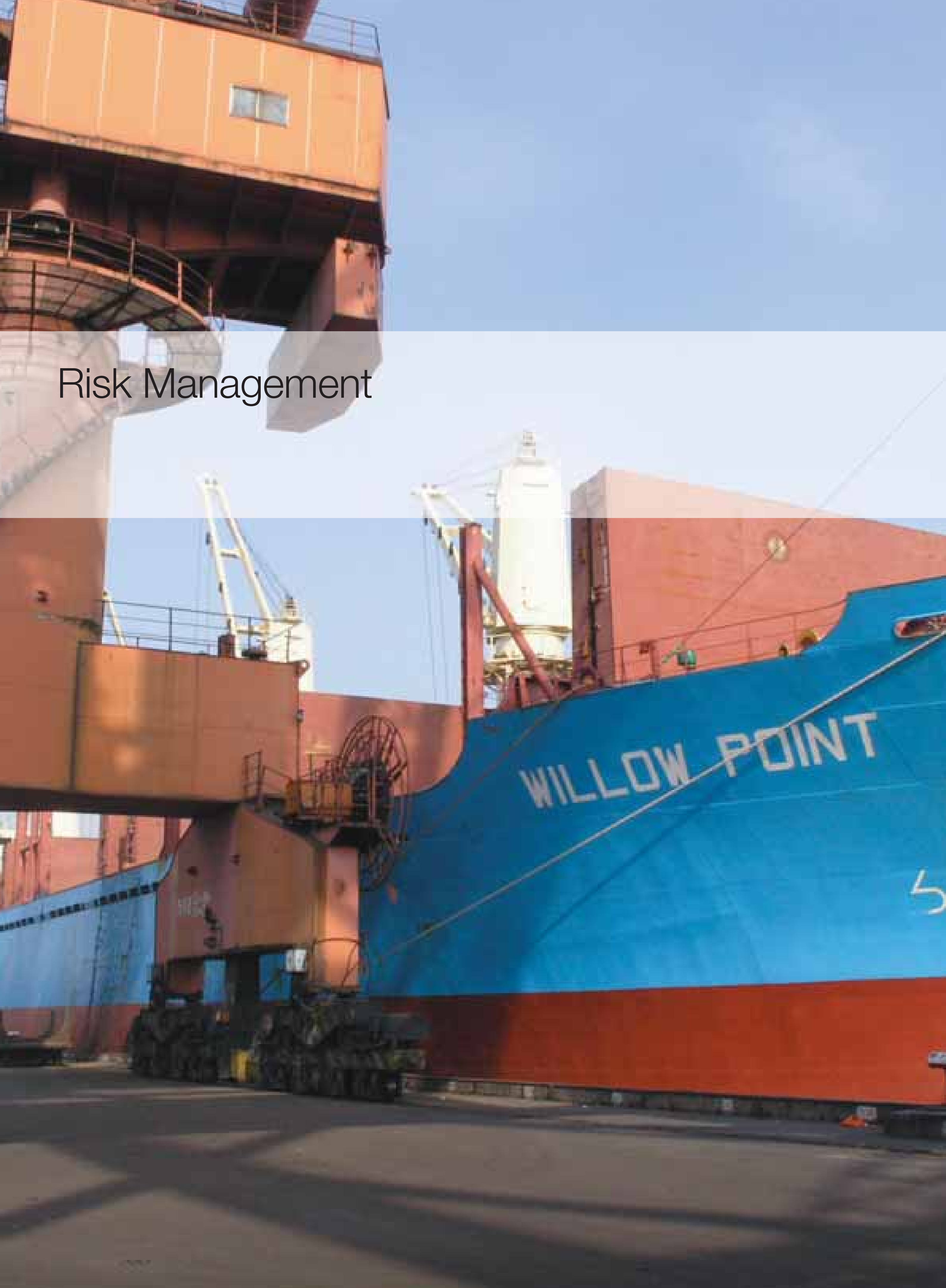
Risk Management



Pacific Basin's results are sensitive to a variety of risks. The Risk Management Committee, headed by the Company's Deputy Chief Executive Officer, actively identifies and reviews significant risks of the Group with the objective of minimising the sensitivity of the Group's earnings to those risks. The Group's approach to assessing and managing risks is further outlined in the Internal Controls section of the Corporate Governance Report. Risks to the Group can broadly be divided into commercial and others.

Commercial Risks

Earnings Volatility

Pacific Basin's operating revenue principally comprises income generated from voyages carried out by its fleet of vessels. Such income is highly dependent on prevailing market conditions, as reflected in freight rates.

Pacific Basin operates a large fleet of modern owned, chartered and managed handysize and handymax bulk vessels. By operating a significant pool of vessels all over the world, and through the careful matching of front haul and back haul cargoes, we are able to minimise ballast time, maximise vessel utilisation and achieve higher and more stable earnings than we would from a small regional operation.

Through long term cargo contracts, vessel utilisation is further improved and, more importantly, we reduce volatility in our achieved freight rates. Cargo contracts typically have a term of 12 months to 36 months. We rigorously measure and manage our coverage levels. At the end of February 2007, we had covered 65.8% of our 25,230 total handysize and handymax revenue days in 2007. Cargo contracts are fixed with a variety of international customers. Our diversified customer base prevents reliance on a single source of income and our top 15 customers account for around 36% of our turnover.

We complement our portfolio of contracts with limited use of outward time charters and Forward Freight Agreements ("FFAs") to further reduce volatility and our exposure to the prevailing freight market.

Use of Forward Freight Agreements ("FFAs")

The Group enters into FFAs on a limited basis as a method of hedging part of its forward freight exposure, where a ship is not yet booked with a 'physical' cargo contract or a physical cargo is not yet covered by a vessel commitment. FFAs normally run for a period of 3 months to 12 months. During the year ended 31 December 2006, the Group sold FFAs with a contract value of US$47.5 million and bought FFAs with a contract value of US$37.1 million.

The Board sets out policies under which the Group enters into FFAs. Day to day responsibility for monitoring adherence to the policy is delegated to the Executive Committee. The policy clearly defines authority levels and limits for hedging purposes, segregation of duties, access rights to the data base system and reporting requirements.

Volatility in Purchase and Selling Prices

Pacific Basin believes in the merits of being able to provide high quality handysize and handymax services to customers. In order to do so it is important to maintain a large and modern fleet through contracting newbuildings and through transactions in the second hand markets. As a result of these dealings, the Group takes risks in relation to changes in newbuilding prices and second hand values of vessels.

Senior management, through the sale and purchase and finance teams, evaluates sale or purchase opportunities which are then recommended either to the Board or to the Executive Committee depending on the size of the transactions. Decisions are based on relevant market information available to the Group and on estimates of the expected profit and residual value, so as to maximise our returns.

The Group evaluates the sale and charter back of vessels on terms which may also include options for the Group to repurchase the vessels at predetermined prices. Such sales carry the benefit of transferring the residual value risk of the vessel from Pacific Basin to a third party, whilst enabling the Group to maintain operational control over the vessels. In 2005 and 2006, we sold and chartered back a number of vessels for periods of between three and twelve years.

At the end of 2006, the Group had six handysize newbuildings on order at a Chinese yard and six at Japanese yards. The performance of the Chinese yard under the newbuilding contracts is guaranteed by a Chinese bank acceptable to the Group in the form of refund guarantees for payments made prior to delivery of the vessels. In Japan, the Group only contracts with leading Japanese shipyards.

In the case of second hand vessel transactions, the Group evaluates the credit worthiness of its counterparties. In addition, when selling ships, sales contracts have an industry standard 10% pre-delivery deposit as security for fulfilment of a buyer's obligation. When buying ships, the risk of non-delivery would be covered by arrest of the vessel in question.

Bunker Price Volatility

The Group hedges its expected future bunker requirement for each long term cargo contract in order to eliminate its exposure to future oil price fluctuations. Hedges are carried out via bunker swap contracts or bunker forward contracts. As at 31 December 2006, the Group had hedged all of its estimated bunker obligations under signed cargo contracts amounting to 112,000 metric tonnes for 2007, 22,000 metric tonnes for 2008 and 3,000 metric tonnes for 2009.

Credit Risk

The Group's credit risk primarily relates to its long term contract coverage including COAs, outward period charters and FFAs. The Group has limited credit risk as long term contracts are fixed with international customers with a primary focus on larger agricultural, industrial and mining companies with a successful track record and reputation.

It is industry practice that 95% to 100% of freight is paid upon completion of loading, with the balance paid after completion of discharge. The Group's losses from uncollected freight and charter-hire payments amounted to less than 0.2% of profit attributable to shareholders in 2006.

Other Risks

Inexperienced Sea Staff / Shore Based Staff in Ship Operations

The Group is heavily reliant on the quality of its sea and shore based staff to minimise the operational risk of grounding, collision, pollution or violation of Group and statutory regulations. Such events could result in financial losses through loss of hire, cost of vessel repairs, third party claims and penalties for statutory violations or from loss of reputation caused by delay and customer dissatisfaction.

To achieve a high standard of ship operation through good management systems, the Group has established the internal Pacific Basin Management System which observes the requirements of the mandatory ISM Code, the voluntary International Standards ISO 9001, ISO 14001 and OHSAS 18001. In addition to annual internal audits of the Group and its fleet, the Group is audited annually for compliance with the standards by external auditors, Lloyds Register of Shipping.

Pacific Basin ensures that sea staff are recruited from more than one country without placing undue reliance on one manning source. Other policies include pre-joining briefing and training of officers, on board training of crew by the Fleet Training Superintendents, the provision of training seminars and courses ashore for Masters and officers, training manning agents to ensure compliance of employment policies, and the provision of in-house training sessions and external seminars to shore based staff to keep them updated with industry and regulatory developments. An annual staff performance appraisal system is used to identify strengths and correct weaknesses in staff, and an incentive scheme is in place to encourage and retain employees.

Insurance Coverage

The inherent risks incident to the operation of vessels include sinking, collision, other marine disasters, environmental pollution, cargo and property damage and loss and business interruption. Any of these circumstances can cause loss to the Group. To minimise the likely financial consequences, the Group uses a range of insurance products, including hull and machinery, war risk, P&I cover, freight demurrage and defense cover, bunker insurance, charterers liability, purchaser interest, charters advance profit cover, ship owner liability and cargo liability cover. Insurances are only arranged with reputable underwriters. We use a group of 12 well-known international underwriters giving competitive premiums. The insured value of our fleet is not less than the vessels' market values. At the end of 2006 the aggregate value of hull and machinery insurance for our owned (US$1,172 million) and newbuilding (US$352 million) vessels combined with the value of hulls insured under purchasers interest insurance for our chartered vessels on operating leases (US$384 million), amounted to US$1.9 billion. Furthermore, the value of maximum loss of future earnings under purchasers interest insurance for our chartered vessels on operating leases amounted to US$44 million. Environmental cover is insured under P&I policies; for example oil pollution has coverage of up to US$1 billion per vessel per incident. A monthly review of the insured values is carried out to ensure coverage is adequate.

Interest Rate Risk

The Group's interest rate risks are associated with its interest bearing bank borrowings and finance lease liabilities. For interest bearing bank borrowings, we managed interest rate risks during the year by entering into interest rate swap contracts with the lending banks, giving an effective hedged interest rate of 5.87%. For finance lease liabilities, we pay fixed bareboat hire payments which are based on fixed interest rates over the life of the lease, giving an effective fixed interest rate of 6.75%.

Foreign Exchange Risk

The Group's functional currency is the United States Dollar as the majority of the transactions are carried out in this currency. The Group's exchange rate fluctuation risk is mainly in respect of the purchase of vessels in foreign currencies, principally Japanese Yen. To minimise the risk of currency fluctuation, at the time the vessel is contracted the Group hedges its future foreign currency payment installments to the shipyards by entering into forward foreign exchange contracts with our relationship banks that match the payment schedules of the construction of the vessel until delivery.

Typically these contracts range between two to three years depending on the length of the construction periods of the vessels, and our current furthest exposure is the third quarter of 2009. The total value of foreign exchange hedges in place at the year end is US$85 million (JPY 9 billion), related to three vessels contracted or authorised at the end of 2006.

Critical Software or System Failure

Certain software and systems are critical to the smooth operations of the Group's business. They include the database system which records all the Group's business activities, the electronic communication system and the financial accounting system. Their failure could have a severe negative impact on the business and earnings.

The maintenance and protection of software and systems, and the development and implementation policies, are carried out by the Group's IT department. They are responsible for the development of the Group's IT infrastructure in accordance with the Group's requirements and in particular the development and maintenance of anti-virus and firewall systems to protect our computer systems, servers, laptops and other fixed or portable computer devices from viruses, worms or similar hazards. The IT department also develops and maintains back-up systems including on-site and remote back-up facilities to ensure that, in the event of hardware/software failure or damage, systems can be recovered and made operational within four hours of a failure.