Capital Link
Topic: STAR BULK CONF.CALL
Moderator: Simos Spyrou
6 August 2020
3:00 p.m. GMT

OPERATOR: This is Conference # 1888217.

Operator: Thank you for standing by, ladies and gentlemen, and welcome to the Star Bulk Carriers Conference Call on the Second Quarter 2020 Financial Results.

We have with us Mr. Petros Pappas, Chief Executive Officer; Mr. Hamish Norton, President; Mr. Simos Spyrou and Mr. Christos Begleris, Chief Financial Officer of the company; and Nicos Rescos, Chief Operating Officer.

At this time all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session, at which time if you wish to ask a question please press star one on your telephone keypad and wait for your name to be announced.

I must advise you this conference is being recorded today.

We now pass the floor to one of your speakers, Mr. Christos Begleris. Please go ahead, sir.

Christos Begleris: It's actually Christos Begleris, co-CFO of Star Bulk Carriers Corp. And I would like to welcome you to the Star Bulk Carriers conference call regarding our financial results for the second quarter of 2020.

Before we begin, I kindly ask you to take a moment to read the safe harbor statement on slide number two of our presentation.

Today's presentation will focus on an overview of our second quarter results, our cash evolution during the second quarter, the liquidity enhancing measures that we are undertaking, our operational performance and the industry fundamentals before opening up for questions.

Let us now turn to slide number three of the presentation for a summary of our second quarter 2020 financial highlights. In the three months ending June 30, 2020, TCE revenues amounted $97.1 million, 4.8 percent higher than the $92.7 million for the same period in 2019. Adjusted EBITDA for the second quarter 2020 was $35.1 million versus $31.2 million in the second quarter 2019. Adjusted net loss for the second quarter amounting to $18.1 million or $0.19 loss per share versus $20.5 million adjusted net loss or $0.22 loss per share in the second quarter of 2019.

Our time charter equivalent rate during this quarter was $9,402 per vessel per day. Total cash today stands at $154 million, with total debt at approximately USD 1.6 billion.

Slide four graphically illustrates the changes in the company's cash balance during the second quarter. The company started the quarter with $131.3 million in cash and generated positive cash flow from operating activities of $23.4 million. After including debt proceeds and repayments, CapEx payments for scrubbers and ballast water treatment system installments, we arrived at a cash balance of $107.6 million at the end of the second quarter.

Given the current market volatility and overall uncertainty, we continue to take actions to protect the financial health of our company.

Slide five has an overview of our liquidity enhancing measures. One of our priorities has been to increase liquidity and strengthen our balance sheet through vessel refinancings. During July, we borrowed $173 million to refinance 15 vessels from four lenders, with net proceeds after repaying outstanding debt of $37.4 million.

As of today, we have secured additional commitments from four major banks and leasing houses to refinance 16 vessels, enhancing our liquidity by an additional $75 million to the cash figure that we show today. These transactions are expected to conclude during the second half of 2020.

Our current physical coverage for Q3 is approximately 60 percent at $12,145 per day, which includes estimated scrubber benefits. Our all-in breakeven cost is at $11,300 per day, including scrubber cost and debt service.

For the remaining of 2020, we have hedged the differential between HFO and VLSFO for 71,000 tons in the paper market for an average price of $232 per ton. Given the lower current market size of differential, these hedges are well in the money, providing a significant contribution to our bottom line.

In addition, we have taken advantage of the decrease in the LIBOR curve and have locked in 66 percent of our base rate exposure for approximately $1 billion of outstanding notional debt at an average fixed interest rate of 0.46 percent for an average maturity period of close to four years.

I will now pass the floor to our COO, Nicos Rescos, for an update on our operational performance.

Nicos Rescos: Thank you, Christos. Please turn to slide six, where we summarize our operational performance.

OpEx was a $4,027 per vessel per day for the second quarter of 2020 versus $3,939 per vessel per day for Q2 2019. Net cash G&A expenses were at $1,048 per vessel per day for the quarter versus $1,009 per vessel per day for the second quarter of 2019. The combination of our in-house management and the scale of the group enables us to provide our services at very competitive costs, complemented by excellent ship management capabilities, with Star Bulk consistently ranked among the top five ship managers evaluated by Rightship.

We're also currently number one amongst our listed peers in terms of Rightship rating. Our vessels have operated, largely uninterrupted during the second quarter despite the COVID-19 pandemic.

As of today, we have no remaining drydockings pending during 2020 for our fleet.

I will now pass the floor to our CEO, Petros Pappas, for a market update and his closing remarks.

Petros Alexandros Pappas: Thank you, Nicos. Please turn to slide seven for a brief update of supply.

During the first seven months of 2020, a total of 31.9 million deadweight was delivered and 9.1 million deadweight was sent to demolition, for a net fleet growth of 22.8 million deadweight or 2.6 percent. A total of just 6.1 million deadweight has been reported by Clarksons as firm orders, and the newbuilding order book has been reduced to a record low level of 7 percent of the fleet.

Year-to-date, the dry bulk steaming speed is estimated at 11.4 knots, down by just 0.4 percent to last year. However, a notable increase has been observed over the past month amid the sharp rebound in freight rates.

Following the peak of COVID-19-related lockdowns in April, shipyard deliveries and repairs have recently recovered to almost full capacity in Asia, while demolition activity also ramped up from June onwards.

Strong inefficiencies related to crude changes and quarantines at ports have led to a higher congestion and regional shortages of vessels. This is negative for operational costs and off-hires, but positive for the supply of vessels as it creates major inefficiencies.

Dry bulk fleet growth is projected to expand by approximately 3.3 percent during 2020, and under current trends could drop below 2 percent during 2021 to 2022.

Let's now turn to Slide 8 for a brief update of demand. According to Clarksons, total dry bulk trade during 2020 is estimated to decline by 4.5 percent, with COVID-19 the key factor behind the slump. With early second half having already shown signs of significant improvement, the projected decline is estimated to have concentrated on the first half of the year. A synchronized global economic stimulus, with China leading the recovery, is expected to expand trade activities during the second half of the year and into 2021.

Clarksons expects dry bulk trade to rebound in 2021 by 4.7 percent in tons and 5.5 percent in ton miles. This is versus below 2 percent growth in supply.

Iron ore trade during full year 2020 is projected to contract 0.4 percent in tons and to expand 0.3 percent in ton miles. Brazil exports decreased by 10.5 percent in the first half of 2020, negatively impacting Capesize ton miles.

During the second half of 2020, a recovery of Vale export is supported on the back of their production guidance of a minimum of 310 million tons, implying a 44 percent increase in export volumes through the first half of 2020.

Supportive to iron ore trade is the fact that China's crude steel and pig iron production have increased by 2.2 percent and 5.0 percent, respectively, during the first six months. May and June specifically registered record-high production figures, while steel mills profitability has reached a two-year high.

Iron ore inventories stand at low levels and will need to be restocked. However, steel production from the rest of the world continued to underperform by 11.8 percent during the first half, with most of the declines concentrated on the second quarter.

Coal trade during 2020 is projected to decline by 7.9 percent in tons and 8.8 percent in ton miles as the coronavirus strict import requirements, while high-cost Atlantic exports into Asia have been squeezed.

During the first half of 2020, China thermal electricity consumption contracted by 0.5 percent and domestic coal production and coal imports increased by 2.8 percent and 12.7 percent respectively. This combination clearly resulted in somewhat increased stocks. However, thermal electricity output increased by 6.5 percent year-on-year during Q2, slowing down the pace of inventory builds.

International thermal coal prices trade at a strong discount to Chinese coal at about 28 tons per ton but – $28 per ton. But the country's coal import restrictions policy continues to create some uncertainty.

India's thermal coal inventories at power plants increased by 17 million tons since last year, but they have been declining steadily from record high levels as of late. During 2020, grain and soybean trade is projected to increase by 4.6 percent in ton miles on the back of a sharp increase in Latin America soybean exports and the expected recovery in U.S. exports. China's grains demand is already emerging higher after the lockdowns, with the country's big population recovering following the African swine fever. The Phase 1 trade deal is expected to weigh positively on U.S soybean export volumes during Q4.

Minor bulk trade during 2020 is estimated to decline by approximately 7.1 percent. However, West Africa bauxite exports are projected to expand by 7 percent and will continue to generate ton miles for Capesize vessels. It is worth noting that Clarksons forecast minor bulk's trade to experience a 7.7 percent recovery during 2021.

Overall, with a record low order book and little environmentally related logic to order going forward, mounting fleet operating inefficiencies, rebounding consumer requirements affecting the minor bulks, increased liquidity injections in the economies worldwide and especially in infrastructure, Brazil strengthening iron ore exports and positive grain trade markets, the supply and demand balance looks bound to tighten during the next 18 to 30 months and barring any new black swan occurrences and for a major return of the coronavirus without a vaccine, or a potential resurgence of the U.S.-China trade war, the appropriate conditions are lining up for a strong dry bulk market. We're positive about the future, and we're positioning ourselves to take advantage of it.

Without taking any more of your time, I will now pass the floor over to the operator to answer any questions you may have.

Operator: Thank you, sir. Ladies and gentlemen, once again, if you do wish to ask a question please press star and one on your telephone keypad and wait for your name to be announced. If you wish to cancel the request, please press star two. Thank you.

Your first question comes from the line of Amit Mehrotra of Deutsche Bank.

Petros Alexandros Pappas: Amit, we cannot hear you.

Operator: Hello, sir. Would you please ask your question?

Amit Singh Mehrotra: Can you guys hear me now?

Christos Begleris: Yes.

Petros Alexandros Pappas: Yes, yes. We can hear you.

Amit Singh Mehrotra: I'm sorry about that. My headset must not be working. I wanted to ask about the operating cash flow in the quarter. Obviously, it was nicely positive. There just seems to be like a big working capital benefit in the quarter. I wanted to see if you can expand on that. What actually happened? And how much of that is sustainable or will unwind as we think about the back half?

Simos Spyrou: Amit, this is Simos. I assume that your question is relating to the cash that we are reporting today versus the cash balance that we reported three months ago on the call, the $154 million versus $106 million that we reported in May.

Amit Singh Mehrotra: No, no, not really. I mean the net income, if you add back depreciation, was still negative $9 million in the quarter, but you reported a positive operating cash balance of $23 million. So the implication is that the big working capital benefit.

Simos Spyrou: Correct. So this was basically an effect of managing our working capital and our payables. We have increased our liabilities per vessel during the quarter by almost $600,000 per vessel, which is close to $6 million, $6.5 million versus the previous quarter. And this has assisted in increasing the cash balance at the end of the quarter.

Amit Singh Mehrotra: Right. And so are those payables that stretched or...

Simos Spyrou: Exactly. Exactly.

Amit Singh Mehrotra: I just – do those unwind? I'm just trying to understand those – I mean cash flow is really important right now. I apologize for the nitty-gritty question. But do you expect that to unwind over the next six months? Or is this kind of performance achievable...

Simos Spyrou: We are managing the payables. So it's not – when you have under cash, it's not necessary to continue stretching the payables. So right now, we reported $154 million of cash as of yesterday. We are projecting to be – with the additional refinancings close to $230 million, $235 million end of the year. So if there is no need to stretch payables, we are not going to continue with aging. It was primarily during the second quarter when we hit the bottom of our free cash.

Christos Begleris: And just add to that, Amit, we started from a very low balance on working capital. So it was effectively a low-hanging fruit for us in order to manage cash. And the figure that we have stretched it to is not an exuberant figure. Therefore, we feel quite comfortable with where we are today.

Amit Singh Mehrotra: Yes. Yes. And I know it's a very nitty-gritty question. Maybe not that relevant in the grand scheme of things. But maybe we can pivot a little bit to the sale leasebacks, which are obviously more relevant. I mean the market has rebounded a lot. You guys have gotten good coverage. I always think about sale leasebacks as a little bit more of an expensive form of effectively debt financing.

Was that just a reflection of just how slow the market was prior to kind of the mid-June inflection, and you guys wanted to really protect yourself? Or is that just really...

Petros Alexandros Pappas: I mean Christos and Simos will explain, but these sale leasebacks were not expensive.

Christos Begleris: Yes. And let me expand on that. Basically, Amit, if you compare the interest cost on the debt that we are refinancing. If you compare the old interest cost compared to the new interest cost on the same base amount, the interest cost – the new interest cost is actually less than the old interest cost. So we're managing here to reduce our average margins, and we have much higher, competitively financed debt.

Now what is worth also saying is that we are taking, obviously, about $100 million of additional debt, which is extra proceeds for the company. But at the same time, we are lowering the interest cost and we are also having – we have negotiated a much better amortization profile for the new debt that we are taking over. And as a result, our annual overall interest service cost, including the debt principal repayment, is actually reduced by $10 million.

Amit Singh Mehrotra: Yes. OK. That's helpful. That's great. That's just great. So the last very couple of quick questions, and then I'll let go, let somebody else ask. But I guess the CapEx commitment really start to fall off as you progress over the next couple of quarters. So would you expect like the net debt reduction to accelerate? Of course, it's gone down on rates, but in terms of the cash calls?

And then you obviously mentioned the asset values taking a potential hit under COVID. Can you talk about where you think your LTV is today based on where the appraisals are? And what you see as kind of the scenario playing out and what's the potential increase in that LTV will be, you think?

Christos Begleris: So, I mean, on a net leverage basis, our LTV doesn't change, right, because we are effectively adding cash as well as...

Amit Singh Mehrotra: Yes. But the asset value – I'm talking about the asset value declining possibly. Where the asset values are today?

Christos Begleris: I mean we have not historically provided valuations of our feet, and we want to maintain doing so, if you don't mind. But leverage – I'll just say that leverage with the new debt effectively, with the new debt levels, is in the 60s on gross leverage compared to where valuations – valuations that we see today.

Amit Singh Mehrotra: So, it would be low 60s on a net basis?

Hamish Norton: No, growth. Growth. lower than that net.

Amit Singh Mehrotra: So net LTV will be I assume, on the (prior period).

Simos Spyrou: Probably.

Operator: Your next question comes from the line of Ben Nolan.

Tucker Colby Long: This is Tucker Long on for Ben Nolan. I had a couple of questions. First, given the weak market, are you guys considering any consolidation opportunities? I know you have in the past. And just wanted to get your color on – like your thoughts on that.

Hamish Norton: Yes. So I think last quarter, we told people that at that time, probably was not a good time for consolidation because everybody was very uncertain as to the future, and it was difficult to basically reach an agreement with anybody on a deal. And I think that has changed. I think people are getting more comfortable with the current situation and the future, getting more comfortable with how the world will react to COVID-19. And we would be very interested in consolidation opportunities that fit with our operations that did not increase our leverage.

We're not going to buy fleets for cash. And what you've seen us do in the past has not been to buy fleets for cash, but to use our share at net asset value. And if we have an opportunity to do that, we will look at it very seriously. And we would intend to make acquisitions in the dry bulk shipping market and not get into other markets at this time.

Tucker Colby Long: Yes, that makes sense. And then just a quick follow-up for modeling question. With the refis and the industries hedge, would you say the interest expense this quarter is kind of a more normalized level going forward? Or would that price tick back up moving forward?

Hamish Norton: I think you'll see that it's back up simply because we'll have more debt. But Christos and Simos, maybe you want to talk about that in more detail?

Christos Begleris: Yes. So interest basically increases given the larger debt amount by approximately ($2.5 million) per year. But the debt service overall, even much lower amortization is lower by $10 million a year.

Operator: And your next question comes from the line of Randy Giveans with Jefferies.

Randall Giveans: Can you provide a breakdown of the 3Q '20 quarter-to-date rates by asset class? Also, looking further ahead, clearly, iron ore trade is very strong and probably ramping up. Are you positioning your fleet to have more exposure to the Atlantic Basin as a result? And how do you compare kind of strong iron ore market with a more tempered outlook for coal?

Petros Alexandros Pappas: Randy, it's Petros. So Q3 coverage for – per asset class, is that the question?

Randall Giveans: Yes, that's the first part.

Petros Alexandros Pappas: Right. Our coverage for Q3 is about 60 percent at levels of low $12,000. Now we also have a little bit of FFA coverage, which gets it to 67 percent, 68 percent and – to a bit above $12,500. Now I don't remember by heart the coverage per sector. I think that we have more covered on the Kamsarmax side and less on the Cape. On the Cape, we are relatively – we are as sport as we can be because we're very positive about the next two quarters.

Randall Giveans: OK. And then to the second part in terms of positioning in the Atlantic and then iron ore versus coal.

Petros Alexandros Pappas: Well, this is a more complicated question. It has a lot to do with whether the vessels are AMSA-fitted or not, meaning whether they can go to Australia or not. And what is happening right now is that there is almost nowhere to disembark your crews. And therefore, you get a lot of people on board that are over 14 months. Actually, we have done a lot of work on that, but we'll tell you later.

This means that there are not enough vessels potentially or there won't be enough vessels to trade, and especially in Australia, this could get rates up in the Pacific. Vessels that cannot disembark crews and, by definition, cannot trade into Australia, will have to start ballasting towards South Africa or Brazil, et cetera. And that could actually lower – I mean make the market in the Atlantic easier for charters than the Pacific. We will see how it goes.

So we don't have a definite plan of going – of sending our vessels towards the Atlantic or the Pacific. We think that the Pacific will strengthen substantially going forward.

Randall Giveans: Got it. All right. Last question. Looking at your hedges, you (1,000) metric tons remaining in the back half 2020. You had 150,000 tons hedged as of last quarter. So does that mean you have not added any hedges for the fuel in recent months? And then on the other hedge, on your interest rate hedge, which is probably more impressive and important, what is your all-in weighted average interest rate now?

Christos Begleris: So Randy, to your first question, the answer is yes, affirmative. We have not added on the fuel spread hedge. It's the 14,000 per month that we have had since the beginning of 2020 effectively. And to your second question, we have averaged at a fixed base interest rate of 0.458 percent, so it's 45.8 bps for a notional of ($1.11 billion), which is about 67 percent of our current bank debt.

Simos Spyrou: And for what length?

Christos Begleris: And the average – weighted average maturity is four years.

Randall Giveans: Right. And I guess, inclusive of the margin, what's the weighted average interest rate?

Christos Begleris: So our average margin right now across the fleet is at – a bit below 2.5 percent. Therefore, the all-in interest cost is slightly lower than 3 percent.

Operator: And your next question comes from the line of Jay Mintzmyer of Value Investor's Edge.

J. Mintzmyer: So the first question I have, following up there with Randy's good questions, looking at your LIBOR swaps, very impressive. I don't think anyone can deny that. You did 66 percent. Is that sort of a max theoretical cap based on maturities and structure? Or is there a window to sort of fix the rest of that at these record low rates?

Hamish Norton: Well, we could fix more. But if you fix everything, and then you find yourself in a situation where you can pay down debt, you can get overswaps. And so we have to keep that in mind.

J. Mintzmyer: Certainly makes sense. So it sounds like a reasonable theoretical cap there.

Hamish Norton: Yes.

J. Mintzmyer: You did some sale leasebacks to open up liquidity. And I think that makes a lot of sense as you have a $100 million current account deficit heading into the next year. But it looks like you bridge most of that gap with the leasebacks. I think now you have $36 million total. If I'm counting – please correct me if that's wrong, that's about 1/3 the fleet.

What is sort of the reasonable level at which you would say like that's the most leasebacks we could do? Is it half the fleet? Is it 2/3 the fleet? What's sort of the cap there?

Hamish Norton: I mean, look, basically, we have – after all of the existing refinancing transactions closed, we have projected so much cash that we probably don't need any more. We're in a situation where we look out as far as we can see, and we don't have a cash problem at all. So I don't think we're going to be trying to do anything heroic here to add to our cash.

Christos Begleris: And if I may add, Jay, I mean theoretically, we could finance the entire fleet with sale and leasebacks because the types that we do are much lower leverage than what traditional sale and leaseback deals have been and at a much, much more competitive cost. However, we will not put all our eggs in one basket. Because we are effectively forging here relationships with all the major western shipping banks that are active right now, some American shipping banks like Citigroup, and then Chinese, both leading institutions as well as banks, which are major providers of capital, then Japanese sale and leaseback houses as well as banks, and then Taiwanese banks as well.

So five wise that we cast a wide net as far as our financiers are concerned. Because in times like this, which is a very difficult time to be talking about new ship financings, it really helps to have very good relationships across a wide spectrum of financiers.

J. Mintzmyer: It certainly makes sense, and it's good to hear that you feel like your cash runway is good. We wouldn't want to see similar peers have added new dilutive offerings or advance themselves into very speculative industries. So I'm glad you're not following that path.

Final question, kind of a repeat of what Randy was getting at. The Capesize, look, we had a spike in June, but it was kind of short-lived. Were you able to – would you fix anything on that? Or it sounds like you stayed mostly spot? And if you stay the spot, if you don't have the numbers now, is there any way you can follow-up maybe later with a new slide or something to provide segment guidance for those for Q3?

Petros Alexandros Pappas: Jay, it's Petros. Yes, we – the intention is to stay spot. We think that the Cape market will spike further in the – during the next five months. We see Brazil exporting probably 50 million tons or 55 million tons more than the first half of the year. If that is correct, then – and if that would be in addition to the Australian exports, that would mean that we would need 150 to 160 more capes to do the job.

If that is the case, and combined with all the inefficiencies that we are seeing in the market, like we have to deviate to ports and disembark the crews and wait for days. Sometimes, there are like – right now, there are like almost 70 bulkers in Manila waiting to disembark the crews. With all that, the additional tons and the inefficiencies in the market, we believe that – and more bauxite from West Africa, we believe we will be seeing a very strong market. So we will keep the fleet spot.

Operator: Thank you. There are no further questions at this time. Please continue. I would now like to hand the conference back over to your speakers today.

Petros Alexandros Pappas: Nothing more to add, operator. Thank you very much, and have a nice August to everyone that goes on vacation. And stay safe.

Operator: Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you all for participating. You may now disconnect.

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