

Ref.: 2017-003

8 February 2017

**To : The President of the Stock Exchange of Thailand**

**Subject : The 4<sup>th</sup> Quarter of 2016 Management Discussion and Analysis (MD&A)**

### **Our Key Performance Indicators:**

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**The results**, audited by EY Office Ltd., show you the latest financial position of the Company. The earnings per day per ship during Q4 came in at USD 8,174, taking the annual figure to USD 6,476. Please take a look at the Market Segmentation report that shows you the relative performance of the PSL fleet's earnings per day per ship compared to the Index ships. In this quarter, daily operating costs were USD 4,510, which has taken the annual costs to USD 4,503 per day per ship, or lower than our target of USD 4,600 for the year and also lower than the actual of the previous year. The EBITDA was USD 9.21 million during Q4 and USD 17.94 million for the year. In Q4 we made a net loss of USD 3.34 million. The loss per share in Thai Baht stood at Baht 0.08 for this quarter and Baht 1.71 for the year. To put our annual loss for 2016 of USD 75.61 million into perspective, please keep in mind that the average BDI for this year at 673 was the lowest in history. We have given below the results of some of the other listed companies as a comparison.

<b>THE HARD FACTS</b>	<b>2015</b>	<b>2016</b>	<b>Q4 2015</b>	<b>Q4 2016</b>
<b>Highest Earnings per day per ship in USD</b>	15,000	15,000	15,000	15,000
<b>Average Earnings per day per ship in USD</b>	6,266	6,476	5,955	8,174
<b>Operating cost per day per ship in USD</b>	4,652	4,503	4,718	4,510
<b>EBITDA in million USD</b>	13.97	17.94	1.76	9.21
<b>Net Profit/(Loss) in million USD (excluding Exchange gain (loss) and Non-recurring items)</b>	(37.41)	(37.47)	(11.37)	(3.94)
<b>Net Profit/(Loss) in million USD</b>	(69.41)	(75.61)	(42.16)	(3.34)
<b>Earnings (Loss) Per Share (on adjusted number of shares) in Thai Baht (excluding Exchange gain (loss) and Non-recurring items)</b>	(0.82)	(0.85)	(0.26)	(0.09)
<b>Earnings (Loss) Per Share in Thai Baht</b>	(1.82)	(1.71)	(0.97)	(0.08)

**Awards and Accolades:** Precious Shipping won the ‘ASIA BEST EMPLOYER BRAND AWARD’ at the Asia Best Employer Brand Awards, 7<sup>th</sup> edition, 2016. We were nominated for the “Best Investor Relations Award” at the SET Awards 2016. We were classified as one of the companies with “Excellent” Corporate Governance for seven consecutive years from 2010 to 2016, by Thailand’s National CG Committee. We were the finalists for ‘The ClassNK Dry Bulk Operator of the Year’ at the Lloyd's List Asia Awards 2016. We were also the finalists for ‘The Bulk Ship Operator of the Year’ award at the IBJ Awards 2016.

**The Fleet Rejuvenation Plan,** started in 2012, has almost completed with 36 ships in the water as of 31 December 2016, two more Ultras (64K) still to come (one in April 2017, the other in early 2018) and one older small handy ship remains on our disposal list.

**Market Segmentation:** During Q4, the Baltic Handy Size Index (BHSI) averaged 481 points derived from the average Time Charter (TC) rate of USD 6,901. Compared to that, our Handies earned USD 8,864 and beat the BHSI TC rate by 28.45%. During Q4, the Baltic Supramax Index (BSI) averaged 795 points derived from the average Time Charter (TC) rate of USD 8,317. Compared to that, our Supramaxes earned USD 7,052 and underperformed the BSI TC rate by 15.21%. Our target has been to outperform both the indexes.

**The SET Opportunity Day** where PSL will be presenting will be held at the SET building at 1010 hours on Tuesday the 14<sup>th</sup> February 2017. We hope that many of you will attend this event where the Company will get a chance to thoroughly discuss the 2016 results and the prospects for 2017. For those of you who cannot attend physically, the SET [live web casts](#) the presentation giving you a chance to be present via the web.

**Ship Scrapping** has had a reasonable year with a total of 29.74 MDWT of ships being scrapped during 2016 across all sectors in the dry bulk market as compared to 32.09 MDWT in 2015. The existing age profile of the world fleet, together with low levels of the BDI, should result in the world dry bulk fleet growing at the slowest pace since the turn of the century with healthy scrapping expected in 2017/2018 due to the age profile as well as regulatory pressures that are around the corner. This will help redress the imbalance between supply and demand.

**Long Term versus short term Charters:** The long term charters already booked as of 31<sup>st</sup> December are shown in the chart below. As can be seen, our forward four year (2017 to 2020) rolling book is currently at the 16.75% level with a visible revenue stream of USD 126.9 million.

Year	2016	2017	2018	2019	2020
Total Available Days	14,746	13,409	13,861	13,870	13,908
Fixed T/C Days	2,562	2,555	2,240	2,190	2,196
%age Fixed T/C Days	17%	19%	16%	16%	16%
Av. T/C Rate/Day in USD	13,713	13,713	13,849	13,875	13,875
Contract value in million USD	35.1	35.0	31.0	30.4	30.5

It is our intention to continue to charter out our ships on long term period contracts whenever practical and economically viable.

### **BDI Developments:**

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Before making any forward looking statements, a few caveats. Firstly, logic in politics as well as the economy has been stood on its proverbial head making a mockery out of all predictions. Secondly, conflicting statements out of China indicate that policy changes, on matters that could have a disproportionate impact on the dry bulk markets, at times are one step forward and two steps back. Think of Coal mine working days and squashing of real estate and other asset bubbles in China just to name a few, very current and relevant, policy issues.

Demand has certainly been stronger than what anyone had anticipated at the start of 2016. China has been the stellar performer, and this has helped to drive time charter rates higher as the year has progressed. Having said that, if, and it is a big if, Chinese policy that has recently been reversed on the number of days Coal mines can work back to 330 days is changed once again to the 'new' policy of 276 working days in a year, then, and only then, will Coal imports into China continue to surprise on the upside during 2017. However, for the early part of 2017 the current reversal of this policy to the original 330 working days would increase domestic supply of coal and thereby reduce the dependence on coal imports till such time as policy is again, hopefully, changed back to the 'new' policy of 276 working days for Coal mines. This could result in lower coal imports into China in Q1 2017.

Then you have the onset of Chinese New Year with its traditional slowing down of demand coinciding with the January impact, when all delayed new building ships from October to December 2016 are delivered in January 2017, increasing the supply side significantly, and you could have the makings of the perfect storm for the BDI. We hope that the expected rate decline by these three factors - lowering of coal imports, Chinese New Year slowdown in demand and the January impact of additional ships entering the market - doesn't take the BDI back to the horrid levels that we experienced in the first two months of 2016.

Overall, 2017 will be similar to 2016 with a lower Q1 followed by improvements during the rest of the year PROVIDED ship owners scrap their older tonnage as quickly, and in as large numbers, as they did in H1 2016. If scrapping doesn't get off the back burner, then we may experience pain, not just in Q1, but during the whole of 2017. Any real sustained increase in demand coupled with marginal growth in supply would result in a sustainable time charter rates growth. Here are a couple of predictions from others on the BDI and 2017.

**The BDI had a wild year in 2016**, plunging to a record low of 290 points in February amid concerns that China's economy was headed for a hard landing, and then recovering as China moved to boost its economy by implementing stimulus programs. In addition, unexpected upside came from increased demand for coal imports as China cracked down on domestic production. While the recovery was volatile, the BDI closed the year just shy of 1000 points. The BDI's recovery has largely been a result of increased demand, but data also suggests that accelerating ship scrapping rates have contributed to the upside. A major drag on the BDI has been the oversupply of ships. The world is awash with ships because ship building accelerated during the last economic expansionary cycle, and these ships came online once the global economy cooled. Even though the global economy has, overall, improved, supply is still above demand, and with many ships competing for cargoes, hire rates remained depressed. As long as there is an overhang of ships the BDI has no hope of coming close to its record high of 11,793 reached in 2008. (Economic Calendar)

After the **Baltic Dry Index** touched record lows for several times this year, **2017 is set to be a better year for bulker owners**. With resilient Chinese imports of coal and iron ore, and strong grain and minor bulk trades globally, Clarksons predicted overall total seaborne dry bulk volume to grow 2% next year, the highest since 2014 if it materialises. However, scrapping volume is likely to decrease as freight rates improve, so net fleet growth will accelerate next year and oversupply worries will persist. (Lloyd's List)

As we head into 2017 there is every reason to be more optimistic about Dry Bulk prospects than at this time last year. Supply side concerns are starting to recede. On 1st January 2016 the order book for this year stood at 87mt, we believe only 48mt deadweight will actually deliver and with deletions likely to come in around 31mt, net growth in 2016 will be around 17mt. By contrast the order book for 2017 is about 50mt and should we see the same level of scrapping as in 2016, net fleet growth may be close to zero next year. If that is the case demand may exceed supply for the first time since 2008. Though the rate of iron ore growth continues to fall (2016: around 2.5%), coal has made a recovery in second half 2016 on increased Chinese demand whilst grain (shipments in 2016 increased by around 5%) and certain minor bulk trade has provided a real boost for the market. Increased bunker prices has arrested the increase in vessel speeds and acted as a brake on some ballasting whilst the imbalance in fleet supply between Atlantic/Pacific was manifested in November when rates in the Panamax sector in the Atlantic rose dramatically on the lack of available tonnage. This is indicative of a

market starting to come more into balance, so despite the usual negative influences on Q1, we are **reasonably optimistic that BDI in 2017 will outperform 2015/2016!** (Howe Robinson Research)

The early part of the year also brought us another unwelcome milestone: the Baltic Dry Index falling to an all time low of 290. Heavy demolition in the first half and better than expected Chinese trade helped later in the year – **fundamentals may be starting to turn but perhaps taking time to play out with bumps on the way.** (Clarksons)

## **Key Supply Side Developments:**

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**Supply Side developments** in the world bulker fleet makes for interesting reading. We started 2016 with 771.9 MDWT and have increased to 790.41 MDWT for a 2.4% net fleet growth during 2016. A further 7.3% (57.72 MDWT) is scheduled for delivery in 2017. If we were to apply a slippage factor of 50% (it was actually 47.5% in 2016) to these scheduled deliveries and further assume that scrapping reaches 30 MDWT (it was 29.74 MDWT in 2016) per annum we would be left with a net fleet growth of -0.14% (-1.14 MDWT) in 2017 and another -0.74% (-5.835 MDWT) in 2018. Net fleet growth is finally heading in the right direction.

**When do people scrap their ships?** When they are very old or when they are not so old BUT they do not make ends meet AND there doesn't appear any realistic prospect of that fact changing in the near future. The freight markets are therefore the single largest driver of ships to the scrap yards. The lower the freight markets the greater the number of ships ending up at the scrap yards. 2016 is the perfect example of this logic. Q1 was a disaster in terms of the market with the BDI touching a new historic low every day before bottoming out at 290 points in February. The Q1 total for scrapped ships was 13.83 MDWT, but as Q2 rates started to improve, scrapping took a sort of back seat with 'just' 8.68 MDWT reaching the breakers yards. This was followed by a very poor showing of 2.8 MDWT in Q3 with a marginally improved 3.43 MDWT in Q4 resulting in net supply of ships in the dry bulk space growing from 771.9 MDWT at the start of the year to an even higher number of 790.4 MDWT by the end of the year. But despite this growth in the supply side, the time charter rates during the year have risen from the ashes, just like Phoenix, to semi-reasonable levels by the end of the year. This suggests that supply demand balance is not that far away.

**Regulatory impacts** should see many more ships heading for the scrap yard in 2018. With the Ballast Water Management (BWM) convention coming into force on the 8th of September 2017, all existing ships will have to retrofit a BWM system in place by their next dry-dock after the 8th September 2017. Any ship that is older than 15 years of age would then become a Scrapping candidate when its next dry-dock comes due after the effective date as the cost benefit to retrofit an expensive, and as yet largely untried system, would be too great a risk to run. It will make the 'to scrap' decision easier. As at

the start of 2017 there are 114.94 MDWT or 14.54% of the existing dry bulk fleet that would be over 15 years of age and facing their next dry-docking after 8<sup>th</sup> September 2017 and become likely scrapping candidates.

Depending on your perspective, an overall 71% drop in ordering (total orders also hit a 35 year record low) is either cause for optimism or for further gloom! In fact, **only 113 yards took orders** (for vessels 1,000+ GT) in the year, compared to 345 in 2013, with tanker orders down 83% and bulkers down 46%. (Clarksons)

**Shipyards are likely to remain under pressure** during 2017, with Chinese shipyards now facing the added challenge of higher steel prices. However, this is good news for shipowners, as the lower orders aid the shipping market in its rebalancing act from the current vessel oversupply. (Banchemo Costa)

Analyst Chong Hui Ru of broker Banchemo Costa stated that we have already seen news this year of Chinese shipyards going bankrupt, with **estimates that half to three-quarters of the shipyards that China had in the peak years may have, or will be closed.** (TradeWinds)

The question is **how will owners react to the market conditions during 2017?** If the markets remain reasonably strong, then scrapping will slow down and that won't be good. If markets are bad, scrapping will be reasonably good in 2017. If that happens and 'forced' scrapping takes off due to the regulatory impact in 2018, we could have a few very interesting years ahead!

## **Key Demand Developments:**

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**The China Factor** continues to have a disproportionate impact on the dry bulk markets. **China's GDP growth numbers** have been slowing for an annual average of 6.7%. However, despite the macroeconomic numbers, **China's Iron Ore import**, according to preliminary Custom's data, was an astonishing 1,024.71 MMT in 2016 or about 7.5% higher than the 953.37 MMT in 2015! Volume of imported Iron Ore in China during 2017 is contingent on import pricing parity versus domestic production and transportation costs. Provisional **Chinese steel production** for 2016 was about 806.68 MMT or 0.8% more than the figure of 800.53 MMT in 2015. **China's Coal imports** totaled 255.67 MMT in 2016 or 25.2% higher than the 204.18 MMT imported in 2015! Coal imports are contingent on import pricing parity versus domestic coal production/transportation costs AND Government policy that has been, at first, reducing number of days that Coal mines can operate from 330 to 276 in April 2016 and, then increasing, back to 330 days in November 2016. In a country that currently produces and consumes some 3.7 BMT of Coal per annum even a small change in China's coal imports could have a significant impact on the Dry Bulk freight markets. **Chinese steel exports** have slowed marginally to 108.99 MMT in 2016 compared to the record busting 112.41

MMT in 2015 all of which is carried by geared ships from the Handy to the Ultramax sectors.

One issue that has continued to limit the ramping up of **Coal production in China** has been the wave of accidents at mines and what has become an almost routine loss of lives of Chinese coal miners. The wave of deaths, inspections, and temporary work stoppages are contributing to domestic coal production in China not rising to levels as high as the government desires. More accidents and worker deaths are in store for 2017, and this will likely **continue to put pressure on a ramp up in China's domestic coal production**. The latter months of 2016 saw China's thermal coal-derived electricity production grow year-on-year by 13%. With China seeing a shift in thermal coal-derived electricity generation growth recently, and with coal production growth still lagging, the near-term could easily see a pick-up in Chinese coal imports. This would help aid several segments of the dry bulk market. (Commodore Research)

A raft of data from **China** in coming weeks is expected to show **the world's second-largest economy carried solid momentum into 2017**, thanks to heavy government stimulus and a construction boom that breathed new life into its ailing smokestack industries. But Beijing's decision to double down on spending to meet its official growth target **may have come at a high price, as policymakers will have their hands full in 2017 trying to defuse financial risks** created by the explosive growth in debt. (Reuters)

**Interest rates in China** are already on an upward trend as the economy improves, People's Bank of China (PBOC) adviser Sheng Songcheng said. "The economy is improving so interest rates and prices will move in a positive direction. Under the right circumstances, if conditions allow, we can consider a rate hike." (Reuters)

**China will increase its targets for capacity cuts in steel and coal** in 2017, while extending its campaign against overcapacity to industries such as cement, glass, electrolytic aluminum and shipping. China has vowed to restructure its vast industries to tackle inefficiency and cut capacity overhangs, promising early this year to close around 500 MMT of coal capacity and 100 to 150 MMT of steel capacity in three to five years. The 2016 target for slashing outdated capacity - including 250 MMT in the coal sector and 45 MMT in iron and steel sector - has been finished ahead of schedule. (Reuters)

**China expects coal output and demand to increase** by 2020 even as it aims to cut 800 MMT of outdated capacity as the world's largest consumer of the fuel ramps up years-long efforts to tackle smog and make its manufacturing sector more efficient. Under its five-year plan for the coal sector, the National Development and Reform Commission (NDRC), the country's top economic planner, said it is targeting output of 3.9 BMT of coal in 2020, up from 3.75 BMT in 2015. Consumption will increase 3.5% to 4.1 BMT from 3.96 BMT over the same period, the NDRC said. (Reuters)

Chinese lending will stay very strong next year, and more records in consumer spending will be set. Recently released data showed Chinese consumer spending totaled approximately 3.1 trillion Yuan in November, which marked only the second time in history that spending climbed to 3 trillion Yuan or higher (the first time was in October). Overall, it is encouraging that each of the last two months have seen China's consumer spending exceed 3 trillion Yuan. **The outlook for the Chinese economy in 2017 remains very encouraging**, especially when compared with the rest of the world. (Commodore Research)

**Soybean imports into China** continue to rise though not at the same rate of growth seen in 2014/2015. However, with the domestic soybean harvest falling to 12 MMT and favourable crushing margins, we expect a strong finish to the year with annual imports perhaps reaching 84/85 MMT, as evidenced by increased chartering activity from both the North Pacific and the US Gulf during November. (Howe Robinson Research)

**China plans to reduce crude steel output** by 100 to 150 MMT by 2020 according to the ministry's 2016-2020 plan on upgrading the steel sector. China has already shut down steel plants with total capacity of over 90 MMT over the past five years. The National Development and Reform Commission said that the steel industry had completed its annual target of reducing production capacity by 45 MMT by the end of October 2016. (COSCO Steel & Coal China Market Newsletter)

**China aims to cap coal-fired power capacity** at 1,100 GW by 2020, 14.6% higher than the current ceiling, but accounting for less of the country's total power supply at 55%. The National Energy Administration (NEA) said China aimed to have 2,000 GW of electricity generating capacity by 2020, of which at least 320 GW would come from solar and wind power and 110 GW from natural gas. (COSCO Steel & Coal China Market Newsletter)

**China's housing market** is expected to cool in 2017 as government measures play a role in easing mortgage lending growth and dampening price rises, ratings agency Fitch said in its latest report. (COSCO Steel & Coal China Market Newsletter)

It is possible to understand the worries in the US electorate: the accumulated trade deficit versus China since 1985 will be about USD 4,274b at the end of this year. In order for the **US-China trade** to once again be balanced, the value of US imports from China would need to decrease by ~75%. If that is something Trump actually will aim for, consequences for shipping will be significant and probably hardest felt by container liners. (DNB Markets)

**China's economy** performed better than expected in 2016 **and its outsized influence on commodities** was evidenced in its efforts to reduce excess capacity in coal and steel — sending prices of those commodities through the roof. Commodities traders got more optimistic on the global economic outlook in December after the Federal Reserve decided



to raise interest rates for the first time in 2016 and indicated it would likely do so multiple more times in 2017. (Financial Post)

The **tougher environmental regulations** ratified in recent months, forcing more capex onto already cash-strapped shipowners, **are likely to increase scrapping**. Also, from forward prices it seems as if the new sulphur limit will double bunker prices three years from now, which again is likely to **reduce vessel speeds and take out ~10% of shipping supply**. Combined, this would limit supply growth, which along with very limited new ordering **lays a solid foundation for a strong cyclical upswing, if not another ‘super-cycle’**, we believe. (DNB Markets)

So what are the **implications of the IMO’s Marine Environment Protection Committee’s (MEPC) decision** to set the implementation date to reduce global sulphur content of bunker fuels to 0.5% from 2020, down from the existing 3.5% (outside existing emission control areas)? Shipowners now have a choice: install abatement technology (scrubbers), invest in new engines to burn alternative fuels (LNG) or burn compliant fuels (e.g. 0.5% Marine Gas Oil (MGO)). In the longer term, abatement technology and LNG may well become the dominant routes to compliance. Right now, scrubber technology remains in its infancy and the costs are high with some suggesting the cost could range from \$3-10 million depending on the size and type of vessel, as well as the ease of installation. Even if costs do fall over the coming years and the technology improves, such investment on older units will prove hard to recover. For younger units the economics might make more sense, particularly if the differential between high sulphur fuel oil (HSFO) and MGO widens. However, retrofitting scrubbers may not be technically straightforward, given the requirements for additional space and waste collection tanks. Equally operators will face costs associated with disposing of the hazardous waste created during the scrubbing process. (Gibsons)

It has remained advantageous to the dry bulk shipping market that **Indian hydropower production** this year has been coming in at the lowest level seen since 2012. Lower than normal rainfall has been putting pressure on hydropower production. Going forward, we continue to anticipate that India will be deriving a larger amount of its electricity from coal-derived generation. This will remain a positive issue for the dry bulk shipping market. In addition, it remains very positive that India’s overall electricity production has rebounded from last year’s decade-low growth level. (Commodore Research)

It would appear miners, who have been progressively reducing capital expenditure on development projects for some time now, are no longer operating their supply chains at maximum capacity. Seasonal factors aside, this could suggest that in the **future rates of growth in seaborne iron ore** will, from now on, be determined by consumption rather than supply side expansion. If this is the case, Q316 marks the beginning of a new era in seaborne iron ore trade, where the underlying trend growth rate will be sharply reduced and years in which there is negative growth will once again reappear. (Howe Robinson Research)

**India** will keep its wheat import tax unchanged at 10% as the private trade is expected to buy up to 3 MMT this year, the highest in a decade, a senior government source said. (Reuters)

In the first 10 months of 2016, **Vietnam** imported 11.7 MMT of coal, an increase of over 130% compared to the same period last year. Vietnam's strong coal import demand has benefited Australia and Russia in particular, for which coal shipments to Vietnam amounted to 3.7 MMT and 3.3 MMT respectively, an increase of 305% and 267% compared to the year ago period. Australia and Russia now account for 32% and 29% of Vietnam's Jan-Oct 2016 coal imports respectively, compared to 18% and 8% in 2014. While exports of Indonesian coal to Vietnam has also seen a 47% year-on-year increase for the Jan-Oct 2016 period to 2.3 MMT, they have been losing their edge in terms of market share. Indonesian coal now accounts for only 19% of Vietnam's coal imports, compared to a majority of 51% in 2014. (Banchemo Costa)

**Brazil's Vale** has inaugurated its biggest mining project ever, lowering costs in a cut-throat market and reasserting its place as the world's biggest iron ore producer. The S11D mine in the Amazonian state of Para will add 90 million tons of production when it reaches peak output in four years, lifting Vale over Australia's Rio Tinto, which had rivaled its output after years of stagnation. (Maritime Executive)

Yours Sincerely,

Precious Shipping Public Company Limited

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Khalid Hashim  
Managing Director