November 27, 2018

Explanation by the CEO of Ocean Network Express Pte. Ltd. and Major Q&A

[Introduction]

Good afternoon everybody. My name is Jeremy Nixon and I'm the CEO of Ocean Network Express. Thank you very much for coming here today. What we hope to achieve today is to give you some insights into the current trading performance of ONE and some of the current market developments. In terms of the agenda, we have identified five areas. The main focus will be on 3, 4, and 5 which are probably more in line with your expectations.

1. Corporate Overview

So, in terms of the corporate overview, I'm sure you are very much aware of the history and background of the three Japanese shipping companies—NYK, MOL, and K Line—and their decision to essentially carve out their liner divisions to create a new company in terms of ONE. Those three companies previously in terms of scale and size in the market were the 11th, 14th, and 16th largest liner carriers in the container market. By combining together, we now have a scale of over a million TEUs, actually 1.5 million TEUs, which today on this particular graph we have put ONE at number 6. In reality we are really tied for 5th with Hapag-Lloyd because of another two-three vessels to come out of the yard in the next few months.

You can see that the logic behind this was to get scale and to be able to get to a larger place in terms of global reach. And, that was very much in line with the tremendous consolidation that's gone on in the industry, particularly since the Lehman Shock, where we saw many other carriers coming together. So, essentially in the space of three years we went from 19 carriers down to 12 carriers today.

We have our holding company here in Japan, which is 31% owned by K Line, 31% by MOL, and 38% by NYK. And then, we have the operating company, where I'm based with my fellow director Yamaga-san here today down in Singapore. And the operating company in Singapore oversees the total global operation in 120 countries of the world. As you remember, US$3 billion worth of balance sheet was created. The business domain is very much pure line of shipping full container loads end to end. And we plan to bring in some of the terminals that were previously under the three Japanese shareholders to bring those eventually onto the balance sheet of ONE. That development is still an onward discussion going on between the shareholders and the holding company today with an envisaged target date of sometime in the fourth quarter of 2018 business year.

Moving on in terms of the overall scale and size, 120 countries in the world, 125 services a week. We are truly a global container shipping company but with a particularly strong focus on the trans-Pacific trade, where we are one of the top three players, and a strong player also in the intra-Asia markets. As I said already, the holding company in Tokyo, operating company in Singapore and regional headquarters based in Hong Kong, Singapore, London, Richmond, Virginia in the USA, and Sao Paulo, Brazil to oversee the countries.

2. Corporate Strategy

In terms of our strategy, I think you could see that most strategy is built around whether it's a cost leadership approach or a niche approach or a differentiated strategy approach. And, I would say that whilst we remain a global carrier, we are not going to directly compete with the top three major container shipping companies, the mega carriers who have significant cost leadership. And at the same time, we are not a niche carrier either. We are a global carrier which has a differentiated strategy which will strongly focus into particularly the trans-Pacific and the intra-Asia markets, but has good coverage of Africa, Latin America, Oceania, Europe, and the transatlantic markets as well.

The key difference is that we are one single brand, so our offering to the customers in all 120 countries, ONE, is the brand. We can serve the customer with the same systems, the same management team, and the same contracting procedure whereas some of our competitors still have regional brands where they break up their offering into sometimes two or even three competing brands on the same network but under different brand ownership.

We are very much focused on “THE Alliance” product, which is our dominant consortia position, particularly on the east-west trades where we look to leverage our scale further by working with consortia partners as in Yang Ming and Hapag-Lloyd. And, of course, we want to maintain a strong focus on IT and innovation and particularly in the digitalization area and a true focus on customer service delivery excellence to ensure that we have that premium quality in the markets, which is always something that we associate with the three previous Japanese legacy companies.

Our core values outwardly are based around quality, reliability, innovation, and customer satisfaction and to support that inwardly, we need to have good team work, lean and agile organization, application of best practices wherever possible, and a very challenging, thought-provoking and innovative management team. That should translate in due course into a premium offering in terms of reliability, customer satisfaction, quality, and innovation as we have discussed.

Coming through to the consortia side of our business, in the container shipping market we are allowed to work operationally with our competitors to provide a common network where we integrate our ships around a common set of services or loops and where we then allocate that service back out to the individual brands, which then compete commercially. The significant change that has happened here since 2001 is we have seen a market which had previously around 20 carriers operating across seven different consortia groupings now in 2018 we’re down to just nine carriers operating around just three consortia groupings.

So, THE Alliance is our consortia that we work with. It includes Hapag-Lloyd, which is a major European company as you are aware, who has grown organically, but also acquired CP Ships, CSAV, and more recently UASC; Yang Ming, an Asia-based company which is a well-established player in the east-west market; and of course ONE, based now in Singapore. Collectively, we operate 34 services a week in the east-west trades. We actually have our global service center where we coordinate all the activity in Singapore very near to the ONE GHQ office.

3. FY18 1H result and whole year forecast

That’s by way of background and introduction to the company and some of the scale and size that we have. What I would like to do now is to take you through our most recent announcement, which was back on the 31st of October, where we disclosed our forward guidance for 2018, to give you some further background behind that and give you some prognosis as to where we are against those targets and objectives.

This is the slide that we showed previously, which indicated the first-half loss of US$311 million and a projected second-half forecast of US$289 million loss combined to create an overall projection of minus US$600 million for the full year. In terms of the second half, as you are probably aware, in the container shipping market, the second half traditionally is a weaker period in terms of volumes than the first half. The second half includes both the Chinese holidays in the first 2 weeks of October and Chinese New Year as well as the end-year seasonal markets associated with the calendar New

Year and Christmas in the North American and European markets. We have reflected that obviously with our volume projections as we will explain.

Okay, if we go through to the actual integration itself, and this is quite a busy slide, but I want to explain this to you in more detail to give you some insight on how the integration took place and what were the operational challenges we faced and particularly what we refer to as the teething issues that we incurred in the first quarter of our financial year. So really our planning started all the way back in early 2017 and our original objective was to achieve a regulatory filing sometime in July 2017.

So, if we look at this slide here we have the actual start of the live bookings for the new company taking place in February. But back here in July 2017 was when we were hoping to get the regulatory clearance, which would then allow us to plan all the various offices, set up all the tax implications for 120 countries, get our IT systems up and running, put all our initial data load information, set up our EDI connections, etc., select our staff, and bring them over largely ready so that when we went live with the bookings from February 2018 we could be safe with the operation from April 2018. So this is where we started to take the export bookings planned, and this is when we actually start to load the physical containers on to the ships.

The reality was that the regulatory calendar got delayed and with the DOJ in North America we didn't actually get clearance until the 31st of October. So that gave us just November, December, and January to prepare the organization globally to go live with the bookings from the beginning of February 2018. That was a very tight window in hindsight.

Secondly, during this process, what is happening here is that the export bookings are ramping up with the new company but the old company is still maintained. And the old company will continue to take export bookings right up until April. And then, from this particular date, which we call Day 1, the old company then stops taking bookings and we start to operationally handle all the export bookings in terms of the operation as ONE. It still takes some time for the legacy companies to come to an end because the legacy companies, K Line, MOL, and NYK, will still be receiving import containers after April right through up until July and even into early August.

So, during this period here, essentially we are four brands in the market. The three legacy plus one, the new company. But in terms of manpower resources we are still the original three companies, where we have taken some of the staff away from the legacy companies and brought them over to ONE to help us through this period. This is really the crunch point of the peak in terms of managing the transition of a company.

Because of the tighter regulatory time window we didn't have as many resources as we needed initially to be able to set up all our IT systems and get everything working perfectly. We didn't have an IT problem. We had a resource issue and a data load-up issue. And, you could say that really at the end of the day our three main challenges were to do with the staff resources, not having enough staff resources at ONE particularly during that startup period in February, March, and April. Secondly, that in the staff familiarization, we ended up using one of the legacy company's IT systems so two-thirds of the staff were reasonably new to the IT system we were going to use. Of course, we were planning to train them, and we did. We did a lot of training work but the time window we had for the training was compressed by the fact that on the regulatory side we were not allowed to start mingling, combining staff, or crossing to ONE until we had got the clearance in November.

And then lastly, our business is a very data-rich business. We have over 45,000 different customers. We do over 80,000 EDI datasets a day. We need to have very good core quality data in our system. And to do that we have to upload a lot of files and information and we got a little bit delayed on that. So that, I could say, is really the key reason why we had the teething issues back in

April, May, and June.

Of course, we worked very hard to recover the situation. And the management team and all of our staff globally were working seven days a week 24/7. We brought in a lot of additional resources, particularly on the offshore side, back office side, to stabilize the operation. And, quite quickly during July we managed to do that. So we got through the very difficult times and effectively were able to resolve the issue.

When we came through into the 2nd quarter, we had fixed the stabilization issue. We were hitting stable service delivery quality with our customers. And therefore, we were much more optimistic about the outlook for the second half of the year. We would estimate that those teething issues probably cost us around about US$400 million in loss contribution and additional equipment imbalance. That was really our key difficulty during that first quarter and into the second quarter.

4. Market outlook in FY18/19

Moving on, how do we see the markets? I will come back to explain how we expect to further improve the bottom line and our outlook for 2019 with some of the countermeasures we are going to deliver. But I think it's important that we also just look at the context of the current business environment. Overall, in terms of supply and demand, we see a reasonably balanced position now. In 2018, we originally forecasted about 6% on the supply side, about 6% on the demand side. We have some changes, particularly on the trans-Pacific, which I will explain. And in terms of 2019, at the moment we are projecting about 4% growth both on the demand side and the supply side. So overall it's a relatively benign and stable market in terms of supply and demand.

In 2018, this is a pictorial view of the container trades. And it shows the flows of the different trade lanes. The thicker the flow, the more volume that's moving. The numbers in the boxes and the round circles relate to overall trade growth on those projected trades. At the moment, this data was put together on the basis of October's data. So it doesn't include November and December. Back then in October we were looking at about 4.6% global growth. We think actually it's going to be more towards 5% to 5.5% by the end of the year because of the situation of the trans-Pacific trade, where we have seen a really sudden acceleration in the U.S. imports coming particularly from China, where that 4% number at the moment is probably tracking close almost to double digit figures particularly during November, very significant.

Overall, as I say, supply and demand seem to be reasonably stable and freight rates in the second and third quarters and particularly the second quarter have generally showed a reasonable amount of stability with some peaking in the trans-Pacific trade due to the tariff issue, which we mentioned earlier on.

On the supply slide, the idle fleet now is down to only 1%. As ONE, our fleet is fully employed and the overall charter market now has a limited amount of chartered vessels available for now and for next year. Also, what's quite healthy is the forward orderbook, where it's really fallen now to the lowest levels we have seen for over 10 years now, where just less than 11% of the total orderbook is actually produced. So, that has really come down significantly as you can see from this diagram. That shows that there isn't a large over-ordering splurge going on in the industry and bodes quite well for the next two to three years.

Key issues in terms of uncertainty at the moment, referred earlier on to the U.S.-China trade war. The second one is Brexit, but I would say that it's a relatively small issue because the U.K. at the end of the day – 50% of the U.K.'s trade is with Continental Europe and that's largely not a container trade so we see limited impact. And, of course, the bunker price has some key sensitivity on the bottom line.

Taking the trade war first, there are really three types of potential outcome of the hiking of the tariffs in terms of China and the USA. One outcome could be that there is no change actually in overall sourcing patterns and simply that the tariff cost leads to an increasing cost which may lead to some increase in final cost through to the consumer, which may have some slight negative drag on demand, so that's scenario one. And that is certainly the case for those commodities which cannot be easily transferred to different sourcing areas.

Item two is where certain U.S. importers may decide to scale-down the amount of sourcing they do from China. That is actually quite challenging because today 61% of all imports into the USA from Asia are actually already coming from China, only 6% from Vietnam, 4% from Japan and pretty much all the other countries after that at 2% or 3% in terms of overall size and scale. So China is extremely significant in sourcing for the U.S. markets. And their ability to change that has quite a lot of restrictions in 2019.

The third one is in terms of moving production from China into the U.S. market. Frankly, we don't see any anecdotal evidence of that going on at the moment, whereas you could say in the other direction we are seeing some of that happening with the automotive industry, with BMW's recent decision to move X5 production from Charleston in North Carolina into China and also the Tesla decision to build a new plant in Shanghai to move production out of the U.S. So in the automotive industry we see some impact but it's mostly westbound.

From ONE's standpoint, we have less sensitivity to the China-U.S. market. The overall market is as I said 61% from China. We are only about 52% because we have more exposure and involvement with the Japan market and particularly with Southeast Asia and the Indian subcontinent. And similarly, in the westbound trade all of the USA's exports to Asia, 40% of those go to China. In our case, only 20% of our exports from the USA actually go to China. So we have a relatively smaller risk in that area.

The fuel cost issue has a huge impact obviously on the global economy at the moment and all the forward forecasts as to where we are going on fuel prices. But clearly, the developments in the last three to four weeks have been quite interesting and quite significant. Frankly, for a liner shipping company that is consuming today about 4.6 million tons of fuel oil a year, any reduction in the fuel price has a positive impact. We predicted a forward forecast price of about US$466 per ton for the second half of 2018. The price today is now down to about US$420. So we have to be a little bit careful. We cannot just say automatically that they are coming in at lower prices than we expected. Because our consumption, particularly during October and November, is related to what the price we stemmed the bunkers at earlier which would have been at the higher price. But clearly, if we continue to see a lower fuel price, particularly during January, February, and March, that would have some upside for us.

I know that we need to just close out very soon to give you your full time on the questions and answers. I'm not going to tell too much on the issue of 2020 IMO Fuel other than to say it's coming. We will have to change over our fuel types. This is an industry requirement and our planning is progressing well in that direction.

We also saw quite a lot of terminal congestion, particularly during August, September, and October. We had 27 site typhoons through Asia and that had an impact across the industry. And we are working towards 2019 to try and build more resilience into our network.

Lastly, I would like to bring us on to our overall projections and where we are heading as ONE. Frankly, it's too early in terms of forward guidance to change that prognosis at the moment. However, what we can say is that in terms of the stabilization and recovery teething issues that we had, we would estimate that about US$400 million was the adverse impact of that. And, we don't expect to suffer that problem again going forward. Our customers are satisfied with the product we are giving them. And every day that goes by we are recovering, pretty much getting back to our original market share as the original 3J companies. So, that's positive.

5. Turnaround Strategy

What I would like to do though is to give you a little bit more insight on what we term Group 1 and Group 2. So Group 1 are changes that we are making at the moment, positive changes to improve our second-half performance for 2018. And Group 2 are changes that we are making in the planning stage in 2018 to get ready for 2019 deployment. We list those here and I will go into a little bit more detail now.

In terms of this particular slide, the key thing during the rest of 2018 is to ensure that we do recover our liftings. And I would say that our dominant leg liftings have recovered pretty substantially. We are now and have been in a largely full ship situation during September and leading into October despite the seasonality. And we have been really focusing much more on the backhaul or non-dominant areas. And one of the challenges we found was that while we recovered quickly on our service delivery on the dominant side, it took longer on the backhaul. Because on the backhaul trades, the customer has more choice of carriers, more space availability, and more equipment availability. But we are now heavily focused on trans-Pacific westbound, Europe eastbound, and inter Asia trades. I would say that the recovery there is going in a very positive direction. And we are tracking at the levels that we need to achieve to ensure as a minimum that we achieve the second-half forecast.

We have also tightened up on our detention and demurrage collections and our invoicing processes. And as you can see here, we have made a noticeable improvement on our load factor performance. You can see that on the trans-Pacific trade we are now at 97% on the headhaul and on the Europe trade we are at 95% on the headhaul, just slowing down a little bit now on a seasonality basis. On the backhaul, we are at 38% on the trans-Pacific. The trade is heavily imbalanced, so for every three containers coming into North America about one container is going out. So, the imbalance ratio is about 2.5 to 3 to 1. We are pushing up towards a 38%-40%. We are pretty much getting there now in terms of imbalance – ensuring that we are optimal in terms of our market share. And we have pretty much recovered our market share now on the trans-Pacific westbound trade.

Europe eastbound trade, again on the backhaul, the trade is less imbalanced so actually we can achieve a higher load factor, with vessels about 60% utilization. Intra-Asia has been more challenging, quite frankly. We are up to about 88% on the headhaul and about 83% on the backhaul, heading in the right direction. These are the levels that we have actually factored into our second-half forecast. So any upside on this would be upside on our forward results.

Then, we have our Group 2, which is focused very much on improvements for next year. The key one is product optimization, network change. As I mentioned earlier on, we operate about 125 services a week. This is our opportunity to readjust our network on a global basis, rationalize some loops, upscale some ship sizes, optimize some ports, remove some ports, add some ports to get some higher yield cargo, and also build into that some fuel saving in terms of optimizing the larger ship sizes, and improve some of our feeder networks for a hub and spoke structure.

We are making good progress. We have engaged very early on with our taskforce team working with our consortium partners to prepare the ground for some quite significant improvements in terms of our fixed cost deployment from April 2019. We are also working on and planning for our cargo negotiations, our customer negotiations, and our cargo portfolio. Yes, of course, we will be trying to seek freight rate increases in a number of markets. But at the same time we will be looking at the yield of the current cargo we are covering and try to improve the port pair mix, some of the mix between shipper-controlled and consignee-controlled cargo, and some of the routing effect cargo. We will also try to enhance some of the surcharges that we recover from our customers. And really a critical component is to bring in a floating fuel surcharge into our forward contracts starting from January when the new contract starts, particularly for the big international players and then from April with our Japanese customers and from May with our trans-Pacific customers. So we are at a good planning stage there to do that.

Lastly, let me just close out with where we are on the synergies. When we put together this integration, we were planning to achieve just over US$1 billion in synergy savings on an annualized basis. We expected to be able to achieve that on an annualized basis after three years and in the first year to achieve 60% of those savings. Actually, we now are projecting to hit about 75% of those synergy savings. They are made up of three components.

The first one is the variable cost. This is with all our vendor contracts really, the individual tariffs that we had with each of our individual vendors. We re-negotiated all of our contracts moving them from 3J contracts to ONE contracts from the beginning of April 2018. So the variable cost reduction of US$430 million for the rail, truck, feeder, terminal, and equipment has largely been achieved in line with our original projections.

Secondly, in terms of our fixed cost overheads, particularly our IT costs, rationalization in the organization, the reduction in the number of offices globally, and the amount of staff that we need, particularly in our offshore centers. We know how much it cost us in our legacy days. We know how much it's costing us now. And, I would say that we are largely on track with these overheads cost savings.

Lastly, in terms of the fixed cost savings in our network and the bunker saving and product rationalizing, we did make a number of improvements in 2018 when we launched in April. But we have some more significant changes to make and improvements to make, particularly in 2019 so we would see more operational cost savings. We have achieved some in 2018, but we will see more coming in 2019 as I alluded to earlier on.

I would just like to formally close out the presentation and hand the floor back to the MC and yourselves for questions and answers. My colleague Yamaga-san and I will try and respond as efficiently as we can. Thank you.

Questions and Answers

Q1) About utilization on the Asia-North America Westbound trade, it improved to 38%, but I think this is pretty low compared to the pre-integration level. So please tell us how long you think it will take to recover to nearly 60%, where it was before the integration.

A1) The utilization on the Asia-North America Westbound trade has already recovered to a level that puts us among the top three, which is quite close to the numerics when each of the three Japanese companies was operating its own containership business. Our only concern is the impact of U.S.-China trade friction. We may see some volume to China away. But, because we have a lot of services to Japan, to Korea and to Southeast Asia I feel that we can reasonably recover that volume in other destinations.

Q2) Synergy from the integration will achieve over 70% of the three-year plan during this fiscal year. Do you think you have any more room for additional realization of synergies?

A2) Synergy from the integration is appearing steadily, mainly in reductions in variable costs, and general and administrative expenses. We assume that 75% of US$1,050 million, which is our synergy effect target, will appear during the first fiscal year. We set our target for synergy by ship allocation and efficiency of operational costs, with modest numerics in comparison with other items, because we made minimal changes in routes for the first fiscal year in consideration of the impacts on customers. Therefore, we think there are opportunities in this area to create a significant synergistic effect after FY2019. We need to negotiate and reach agreement with our alliance partners to restructure routes, and we have already started this process.

Q3) The business performance outlook was revised to a significant downturn as a result of the teething problems immediately after the launch of services. Was it in part a problem with ONE's management?—please tell us your viewpoint.

A3) ONE's management thoroughly grasped the background and effect of the teething problems immediately after the launch of services. As evidence, we swiftly launched the global task team in May and took the actions necessary to recover and stabilize service quality. On the other hand, while steadily implementing operational troubleshooting, we were slightly optimistic, particularly on the Asia – North America westbound trade, on the assumption that customers would smoothly return to ONE in response to the troubleshooting. We would like to express our apology for this point.

Q4) You explained that the impact of the teething problems immediately after the launch of services was US$400 million, and this is a transient loss. I want to confirm that you actually have confidence to achieve business performance along with the numerics set out in the business plan at the beginning of the fiscal year.

A4) Among the factors behind the teething problems immediately after the launch of service was were a lack of familiarity with the IT system and a shortage of personnel. These problems have already been resolved, and we don't see any problems in operations. In addition, we can expect to improve earnings by restructuring routes and reducing fuel consumption, measures we plan to execute soon. Of course, this may be affected by the business environment from FY2019, but basically we have a positive outlook on improvement of ONE's earnings.

Q5) ONE is a containership company positioned the world's top 5, but I think the reality is that ONE's competitiveness falls short of the top companies because its scale is still far behind the leaders. Please tell us how you plan to address this issue. Also, please tell us your views about further restructuring from mid- and long-term viewpoints.

A5) ONE's scale is on the level of 1.5 million TEUs, and in fact lower than Maersk, which is a 4 million TEUs and CMA-CGM with 3 million TEUs. However, ONE holds larger shares than they do on Asia-North America and Intra Asia routes. In addition, together with the partners in the consortia, ONE jointly allocates 20,000 TEU ultra-large containerships on the Asia-Europe routes and 14,000 TEU ships on the Asia-North America routes as the competitors. So through our consortia model and our focus on two or three big trades, our competitiveness is very similar to the competitors. The economies of scale by building bigger ships in the industry are running out now in terms of restrictions of terminals and ports. Furthermore, supply chain needs to look at frequency not just pure slot cost. Therefore, we think ONE can compete with the top companies in the industry.

With regard to restructuring in the industry, we think the first stage should be winding down, with restructuring to nine major companies. The top companies in the industry already hold a nearly 30% share on the major routes. And we recognize that further restructuring may cause problems with competition laws.

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