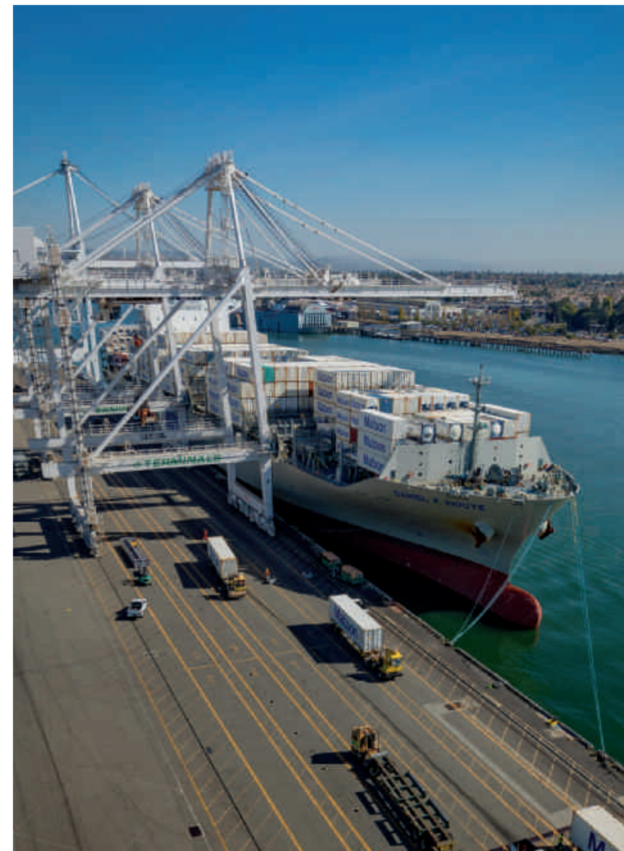
# TO OUR SHAREHOLDERS

On the water and over the road, Matson is a premier transporter of time-definite goods.

We have served the Pacific for 137 years with a relentless focus on exceptional customer service and on-time delivery. The cargo we carry sustains remote communities and businesses that rely on us as the lifeline to fulfill their supply chain needs. And as we expand our footprint and geographies through organic initiatives and acquisitions, we continue to be guided by two core tenets — *move freight better than anyone* and *grow shareholder value* through the timely and judicious allocation of capital. It is our DNA.

As asset and cash managers, the most important long-term financial metric to measure our performance is return on invested capital (ROIC). Since our company became public in 2012, our focus on ROIC has produced a nearly 2.6x increase in the book value per share, a compounded annual growth rate of 13.6%.[1] In the last few years, our ROIC has been reduced by the increase in debt that funded over $1 billion in multi-year vessel and infrastructure investments. We are now seeing the return on those investments materialize with each new vessel arrival and we will conclude this heavy investment cycle in the next few quarters. With new vessels and infrastructure in service by the end of 2020, we expect to realize $40 million in annual financial benefits,[2] and will realize a commensurate increase in ROIC from both higher earnings and lower debt levels.

In short, we are well positioned for the coming decade of service in the Pacific.



*Daniel K. Inouye* at SSAT terminal in Oakland.

[1]Book value per share defined as shareholders' equity divided by shares outstanding. Based on the 2019 shareholders' equity excluding the cumulative net positive adjustment of $154.0 million related to the Tax Cuts and Jobs Act of 2017. Including the adjustment, the compounded annual growth rate would be 16.9%.

[2]We expect $30 million in incremental financial benefits in 2020 compared to 2019 and expect $40 million in annual financial benefits in 2021 when compared to 2019. These benefits exclude the net effects of any changes in business activity in the tradelanes.

*R.J. Pfeiffer* pulling into Guam harbor.

## RECAP OF FISCAL YEAR 2019

Fiscal year 2019 was a busy transition period. We placed nearly $340 million of assets into service, took delivery of *Lurline*, our first Kanaloa Class vessel, and made substantial progress on the three key strategic priorities I laid out last year:

**1. Complete the Hawaii fleet renewal and renovation of Sand Island terminal**

In April, we placed into service the second Aloha Class vessel, *Kaimana Hila,* and in December we took delivery of *Lurline,* the first of two new "con-ro" vessels. With the delivery of *Lurline,* we closed a historic chapter of steamships in the active Matson fleet. Equally significant, in the first week of January 2020 our Hawaii tradelane service stepped down from ten vessels to nine. We expect to complete the newbuild program in the fourth quarter of 2020 upon delivery of *Matsonia.* Further, we responsibly recycled three steamships in 2019 and expect to dispose of the remaining three steamships in 2020 and 2021.

Shoreside, we installed three new gantry cranes and completed a number of electrical infrastructure upgrades at our Sand Island hub in Honolulu as part of a $60 million modernization project. We remain on track to have the major cost items complete by the end of 2020.

Our dual headhaul economics to and from China is unique in the industry, and our expedited service from Shanghai commands premium rates.

**2. Transition the fleet for IMO 2020 regulations**

I am proud to say that Matson's fleet was 100% IMO 2020 compliant on January 1, 2020, the International Maritime Organization fuel regulation's effective date. Our new vessel build program is instrumental in Matson meeting these new standards. In an effort to lower fuel costs and maintain the optionality in fuel consumption, we originally intended to install exhaust gas cleaning systems ("scrubbers") on three vessels. In May 2019, we expanded the program to six vessels given the compelling economics and the near-term fuel options available to us. As of this writing, we completed the installation of scrubbers on three of the six vessels in the program. We expect to conclude our scrubber program by the end of 2020 after which 8 of 12 vessels will have scrubbers in our active fleet servicing our core tradelanes. Based on current fuel spreads between high and low sulfur fuels, we continue to expect a relatively quick payback on these investments.

**3. De-lever the balance sheet**

We ended the year at a leverage level of 3.48x compared to 2.77x at the end of 2018.[3] The increase in debt was primarily due to progress payments on the last three new vessels and investments in the Sand Island infrastructure. We expect our debt level to peak in the first quarter this year, and shortly thereafter, we expect to begin de-levering our debt load, with a longer term targeted level in the "low-2s."

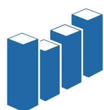
While significant corporate objectives were accomplished, our consolidated financial performance in 2019 fell short of our original expectations. This shortfall stemmed primarily from softer-than-expected volume in Hawaii and a lower contribution from SSAT, our terminal operations joint venture. The Hawaii tradelane contracted slightly due to a combination of negative population growth and lower aggregate tourism spending, which resulted in inventory de-stocking by retailers due to lower consumer demand.

The lower contribution from SSAT was largely a result of higher operating costs associated with the reorganization of the Seattle terminals, including the integration of a new and eighth terminal. Over the long-term, we

believe SSAT's interests in all of the container terminals in Seattle and one terminal in Tacoma will bring more volume and growth opportunities.

We had a solid contribution from our China service coming off an exceptional 2018. Our industry-leading expedited offering continues to resonate with customers, even with a volatile, tariff-driven backdrop that created "chaotic" conditions with blank sailings and U.S. West Coast port congestion.

An improving Alaska economy benefited both our Alaska tradelane service and Span Alaska, our freight forwarding business. Span Alaska's performance plus favorable contributions across most of our other logistics service lines powered our Logistics segment to an all-time high operating income.



We've invested nearly $700 million in Alaska over the past four years, which has led to diversified earnings streams while providing a platform for additional growth in the Pacific Northwest logistics corridor.

Our diverse portfolio of services and geographies continue to provide protection against episodic and potential secular earnings disruptions, while also providing a strong foundation for us to grow.

## SHAREHOLDER VALUE

In last year's CEO letter, I outlined how we think about allocating your capital to drive shareholder value. I will reiterate some of the key points from that letter, as well as provide updated thoughts as we enter the final year of our new build program and return to strong free cash flow generation.

Our priority for the use of cash is to fund necessary maintenance investments in our fleet, shoreside assets, and logistics operations. In 2020, we expect to exceed our annual maintenance capital expenditure target of approximately $50 million as we complete the remaining scrubber installations and Phase I work at Sand Island, but we expect to trend to the $50 million level thereafter.

Our four general uses of cash flow after funding maintenance capital are, in no particular order: invest in organic growth opportunities, reduce debt, return capital to shareholders, and acquire businesses.

- **Organic growth:** We continue to source organic growth opportunities that build upon our valuable Pacific network and U.S. West Coast franchises. To this end, in 2019 SSAT brought a new terminal in Seattle online and we deployed *Kaimana Hila* into the CLX service. *Kaimana Hila* is instructive of how fleet initiatives can be instrumental in both cost-saving and revenue enhancement efforts; her arrival relieved CLX vessels headed to dry-dock for scrubber installations, brought more capacity to the China tradelane to capitalize on volume during a seasonally strong second half period, and aligned capacity and demand in the Hawaii tradelane. With the arrival of our final vessel later this year, we will have even more capacity optionality to maximize revenues across our tradelanes. As one example, we are exploring adding additional capacity into the CLX service to meet long-term demand.
- **Reduce debt:** In the first quarter of 2020, we expect to hit our debt leverage peak in the "mid-3s" and our plan is to reduce our leverage to the target level of "low-2s" with at least 0.5x of deleveraging per annum. As we have indicated before, we are committed to maintaining investment-grade credit metrics and preserving our low-cost balance sheet, which we view as a competitive advantage.
- **Return capital to shareholders:** Since the 2012 separation, we have returned approximately $300 million to shareholders (approximately 17% of our current market capitalization[4]) in the form of dividends and

[3]Leverage defined as Total Debt divided by EBITDA as determined in accordance with our debt agreements. Total debt as of December 31, 2019 and December 31, 2018, was $958.4 million and $856.4 million, respectively. EBITDA, as defined in accordance with our debt agreements, as of December 31, 2019 and December 31, 2018, was $275.6 million and $309.4 million, respectively.

[4]Based on the diluted shared count and share price as of December 31, 2019.

*Hawaiian Merchant* departing San Francisco on its inaugural lift-on/lift-off container service (1958).

share repurchases. We have raised the quarterly dividend annually and we plan to continue growing the dividend in line with growth in cash flow. As we reduce debt toward our target leverage level, and in the absence of organic growth and acquisition opportunities, we will consider the return of excess cash to shareholders in the form of share repurchases and/or special dividends.

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- **Acquire businesses:** Although our primary focus the last few years has been on successfully executing the large investment projects, we have also spent considerable time looking at acquisition opportunities. In the past year, we conducted deep dives on a number of opportunities ranging in enterprise value from $30 milion to $250 million. With each opportunity, we applied the three core principles outlined last year in the CEO letter – the opportunity must: (i) have an enduring competitive advantage, (ii) be a good cultural fit and be strategic or complementary, and (iii) generate a cash-on-cash return in excess of 10% initially and have the ability to grow organically. Many of the opportunities we reviewed did not meet our hurdles on earnings quality and competitive positioning, some failed as a strategic fit, and others required too much follow-on capital to meet our return targets over time. We will remain disciplined in our approach and are not dissuaded in any way from looking at future opportunities.

  With that in mind, I want to reflect on three acquisitions, totaling over $700 million in aggregate capital deployed, that we have made since our public inception in 2012.

## A REVIEW OF OUR ACQUISITIONS TO DATE

In January 2013, we executed our first acquisition as a public company with the purchase of assets of Reef Shipping, a New Zealand-based company that served the South Pacific, for approximately $10 million. As I wrote in the 2012 CEO letter, the acquisition “met our criteria for operating in geographies and markets where delivery matters to ‘lifeline’ communities.” The launch of our SPX service out of Honolulu three years following this tuck-in acquisition offered a potential new value proposition for us. Unfortunately, the financial and operational burden of the remote SPX service and small addressable market detracted from what was strong operational performance. In short, we could not maintain

a cost-effective, reliable SPX service with small vessels over great distances. In 2019, we made the decision to end our own direct SPX shipping service and enter into vessel sharing agreements with Polynesia Lines and Maersk. We have not yet achieved our financial goal with this bite-sized investment, but we are confident that the vessel sharing arrangements will put us on an improved profitability path and allow for further profitable expansion in the region. More importantly, this acquisition taught us a valuable lesson about small markets and small vessels in the international trades.

In May 2015, we closed on the acquisition of Horizon Lines' Alaska operations for approximately $495 million. The Alaska tradelane represented a strategic complement to the Hawaii tradelane – a remote community dependent on a critical supply of recurring goods to residents and visitors. The biggest challenge with the acquisition was the integration. Our approach was to leverage IT, accounting, HR, customer service, and other operational platforms, which resulted in significant savings. The successful integration benefited from the strong cultural fit of the employees at Horizon Alaska with Matson. We underwrote the acquisition at a double-digit cash-on-cash return, which included one-time integration costs and an investment in containers, chassis, and scrubbers on three vessels. While we assumed a flat volume profile, we also modeled downside scenarios around the Alaska economy driven by a falling price of oil. Sure enough, in late 2015 Alaska experienced a pronounced economic slowdown, driven by a rapid contraction in oil prices to decade-lows that pressured oil exploration and production budgets, and led to a multi-year economic recession. We saw a nearly 10% decline in annual container volume from 2015 to the trough in 2017, which was the primary driver to falling short of our cash-on-cash return goal in the first few years of owning the business. Understanding cargo cycles and demand contraction as we do, we were undeterred by the initial volume performance. We view acquisitions for the impact to our business over decades, not years. We are now surpassing our return goals and remain confident we will meet or exceed our cash-on-cash goal in the first decade of owning the business. The acquisition was, and is, transformative to our business, providing another revenue stream and further diversification of our service and geography suite.

Following our acquisition of Horizon Alaska, we acquired Span Alaska in August 2016 for approximately $200 million. Span Alaska was our largest customer in the tradelane and the leading asset-light, less than container load freight forwarding operation to Alaska. Span Alaska built its reputation on a high-touch level of service for customers, a hallmark of the Matson brand. The company had a long-tenured and loyal employee base, and the culture fit right into the Matson

Since 2015, Operating Income in our Logistics group has nearly quintupled, propelled by organic growth and strategic investments.

2020 will usher in an era of significant free cash flow that provides flexibility to allocate capital to the highest risk-adjusted returns to create value for shareholders.

family. We acquired the business at an initial, high single-digits, cash-on-cash return level, excluding any vertical integration benefits to the Alaska tradelane operation and other operating synergies. Like Horizon Alaska, Span Alaska experienced challenging business conditions in 2017 as the recession in Alaska deepened. Volume came in lower than we originally projected, but Span Alaska's experienced management team exercised cost discipline and improved margins and hit our initial financial targets in the first year. As business conditions improved in 2018 and 2019, the cash-on-cash run rate was in the mid-teens. Needless to say, Span Alaska's success has been a meaningful driver of Matson Logistics' financial performance over the last three years.

With each acquisition we consider and transact, we are honing our M&A and integration skill sets, optimizing our network, leveraging our technology platform, and creating additional diversity and heft to our revenue and earnings streams.

## ONWARDS AND UPWARDS

For the last three years, we focused on allocating the cash flow from operations and borrowings to invest in four new vessels and key infrastructure. The magnitude of these multi-year investments without the commensurate profitability resulted in a depressed return on invested capital over this timeframe. However, an inflection upward in our ROIC is imminent as the vessel and infrastructure spending ends this year and we begin to see the financial benefits from these investments. 2020 will usher in an era of significant free cash flow that provides flexibility to allocate capital to the highest risk-adjusted returns to create value for shareholders.

As we enter the new decade, I am excited for the opportunities that lay ahead. We will continue to manage your company and capital for the long-term, ever mindful of the impact our financial and strategic decisions have on our role as a preeminent transporter of time-definite goods.

Sincerely,

Matt Cox
Chairman and Chief Executive Officer

February 28, 2020

*Lurline* pulling into Honolulu Harbor on its maiden voyage.