The Great Eastern Shipping Company Limited
FY'10 Earnings Conference Call
(May 24, 2010)

Moderator: Welcome to GE Shipping earnings call on declaration of its audited financial results for financial year ended March 31st, 2010. I would now hand over the conference to Mr. Shivakumar, CFO at GE Shipping to start proceedings. Over to you Mr. Shivakumar.

Shivakumar: On behalf of GE Shipping I welcome you all to the earnings call of the Q4-FY10 financial results. We have with us today our Deputy Chairman and Managing Director Mr. Bharat Sheth and the management team of GE Shipping. I will give a brief financial snapshot of Q4-FY10 financial performance of the company after which we will have a Q&A session.

As we had mentioned in our Q3 results con-call in January, the crude tanker markets had improved substantially from December onwards and this is expected to reflect in our earnings in Q4 and you will see from the Q4 press release that the average earnings of the crude fleet went up by more than $11,000 in Q3 and Q4. The average earnings in dry-bulk carriers are also higher during the quarter by about $3000 per day. While product tanker earnings remained quite subdued throughout the quarter finishing at average of about $1000 below the previous quarter.

Overall market earnings across all tanker classes were lower than the corresponding quarters in the previous year. If we remember the dry-bulk market had collapsed much earlier in 2008-2009 and the tanker markets only went down towards the end of FY09.

We will first compare the Q4 results with the Q3 results. As a result of improvement in the earnings, we had a better top-line. With no change in fleet during the Q4 quarter, operating expenses were largely unchanged except for some minor costs. Among the other expenses, once again we had a translation hit on account of the revaluation of foreign currency assets and liabilities which seems to be increasing with the volatility of the foreign exchange markets. As a result of the rupee-dollar exchange rate moving by about Rs.1.60 between end December and end of March, it resulted in a hit of Rs. 44 crs in our standalone profits for the Q4 quarter.

Despite this EBITDA moved up from Rs.132 crs to Rs.167 crs. There is no change in depreciation, whereas interest cost increased due to borrowings done between October and February this year.

Now comparing the results of Q4-FY10 with Q4-FY09 and stripping out the effective items like foreign currency translation and impairment, the operative results were actually quite similar.

Now coming to the balance sheet, we continued to be in a healthy position with a net worth of Rs 5371 crs and a gross debt of Rs.3668 crs. With balance of cash equivalents of about Rs 3450 crs, we have a net debt of just over Rs. 200 crs. We therefore believe that we are in a good position to take advantage of any opportunities that may be available. Our order book currently stands at 8 ships of a total value of US$577 mn of which we have already paid US$131 mn as on date. With some improvement in value of the ships, the NAV per shares stands at approximately Rs. 339 as compare to Rs. 303 when we last reported it for December 2009.
On a consolidated basis we have a total debt of Rs5370 crs giving us a consolidated debt-equity ratio of 0.92 and a consolidated net debt to equity ratio of about 0.25.

Before throwing the floor open to your queries, we have one request to make. You would have seen that our offshore oil field services subsidiary Greatship (India) Limited has filed a DRHP for its proposed IPO. We are not permitted to give out any information that is not in the DRHP. Therefore we will not be answering any questions relating to the offshore business whether it regards to the company, its financials, the general condition of the market, or outlook for the market and we therefore request you to restrict your questions to the shipping business and related factors. For any information on the offshore business we request you to refer to the DRHP which is a very detailed document.

Moderator: We have our first question from Amrit Mathur from Economic Times.

Amrit Mathur: We are hearing about the possible upturn in the tanker segment especially in crude segment for quite sometime but somehow it has not been reflected in the earnings?

Bharat Sheth: Q4'10 crude earnings were not much higher than previous quarter of last year but if you see in Q3 the average that we have achieved on the crude carriers was about $21000 per day and in Q4 we have averaged something in excess of $29000 per day. So it is quite a big improvement between Q3 and Q4. While there has been significant demand growth in China and India in absolute term, China and India are very small markets compared to the United States and Europe. So while we have seen huge demand growth in countries like China in particular a little lesser in India, it clearly gets swapped by any changes in demand growth in Europe and United States, simply on the volumes. US represents 25% of global oil demand and therefore a change in the US is lot more relevant than changes in China or India.

Amrit Mathur: When do you think will we actually start seeing actual Y-on-Y improvement in the freight rates?

Bharat Sheth: Y-on-Y improvement will depend on how the market behaves in the remaining period. And I think if your question is limited to oil demand I think a lot will also depend on what happens to the consumption of the refined products. I think that from the various events that are unfolding in front of us, European demand will be very subdued. The US demand is clearly improving but it is improving only in relation to a very low base that we saw in 2009.

Amrit Mathur: Could you give us how much of the tankers are fixed on time and on spot basis?

Bharat Sheth: If you take the rest of FY11, 58% is covered on the tanker segment. So 42% is exposed to the spot market.

Moderator: We have our next question from Ms. Swati Pandey from Reuters.

Swati Pandey: How many vessels do you plan to buy in FY11?

Bharat Sheth: Based on our committed CAPEX we are expecting the delivery of three vessels, two Supramax bulk carriers and one Kamsarmax bulk carrier. But one of these is coming in March 2011, so it could easily spill in to the next year.

Swati Pandey: What is your outlook for tanker segments in terms of freight rates?

Bharat Sheth: I think we will continue to see a lot of volatility as we have seen in the previous few months because everyday we are getting developments on what is happening at a macro level in Europe, in the United States. But can this have effect on India, China, Rest of Asia? The macro picture remains very hazy. So depending on how the macro picture unfolds, I think that will lead to the eventual unfolding whether it is a tanker market or dry-bulk market or any other market we are dealing.

Swati Pandey: Will it be correct to say that the worst is over for the shipping industry?

Bharat Sheth: I think it all hinges on what happens in Europe, Asia and America because if some people say that we are on the edge of a double dip then that will obviously affect earnings. If the worst of the global economic crises is behind us then I think it is fair to say that the worst of the shipping is behind us. But on the tanker side in particular we have a strong correlation to what happens to worst in economy.

Moderator: We have our next question from Mr. Avishek Agarwal from PUG Securities.

Avhishek Agarwal: There is a line item called as investments in your statements of assets and liabilities. The number has jumped from Rs302 crs to Rs2178 crs in this financial year on the consolidated basis, so what are these investments into?

Shivakumar: Most of our treasury investments were in bank deposits as of last year and end of previous year with banks no longer being so keen to take deposits in the low interest rates regime, the bulk of the investments are now kept in debt, liquid, and income funds and that is what reflected in investments.

Avhishek Agarwal: Regarding hire of chartered ships on a consolidated statement the cost is Rs. 132 crs. What is this cost attributed to because if I take your in-chartered tonnage that is showing nil in quarter 4 FY10.

Bharat Sheth: Last year we had a contract to carry crude oil from the Middle East to India for one of the Indian refiners and in order to perform that contract we had to in-charter various vessels. In the current year we do not have that contract and therefore you will see a big drop in quantum of in-charter.

Avhishek Agarwal: The employee's costs have come down to the tune of the 16% on a sequential basis at a consolidated level. In the third quarter do we pay any kind of bonuses to the employees? Is that one reason or is it because of some kind of cost cutting measures?

Shivakumar: It is a combination of both. There is also some accounting done where at the end of the year we do actual evaluation of the long term liability and based on that the costs are booked and in the first three quarters they are booked on an estimated basis and in the final quarter the adjustments are made based on the actual evaluation. This is the impact of that.

Moderator: We have our next question from Mr. Rajesh Ravi from PINC Research.

Ravi: What are the standalone figures for cash and debt?

G. Shivakumar: Rs. 3450 crs is cash and Rs. 3668 crs is the debt amount.

Ravi: What would be the total CAPEX that would be going in FY11 and FY12?

Bharat Sheth: In FY11 it is $135 mn, about $332 million in FY12 and $111mn in FY13. One VLCC out of the 3 is coming in FY13.

Ravi: What would be your view on the product tanker market?

Bharat Sheth: I think clean markets will probably remain subdued because that is much more a function of end consumer demand and looking at the developments taking place in Europe and the possible effects it should have on the United States. In the short term, short term meaning the next set of 6-8-12 months we think that average earnings that could be achieved on the clean tank sector will probably be relative subdued.

Moderator: We have our next question from Mr. Rohit Shimpi from SBI Mutual Funds.

Rohit Shimpi: How many of the crude tankers would be deployed in the spot?

Bharat Sheth: We have 7 crude oil tankers in the spot market.

Rohit Shimpi: That means you have contracted some assets this quarter. Last quarter we had some more assets on spot.

Bharat Sheth: No, if you remember one double-hull Suezmax of us was delivered in early part of the quarter in April. One Aframax tanker has secured a contract of an affreightment so in a sense while she is not on time charter, she is effectively hedged. Also one dry bulk ship are fixed. And this does not include a one Suezmax tanker, double hull which we operate in our wholly owned subsidiary but that also operates in the spot market.

Rohit Shimpi: How have the asset prices behaved? Have the prices of second hand assets moved up?

Bharat Sheth: Asset values have clearly gone up from the start of the year and that has reflected in our net asset value moving up from Rs.303 to Rs.339 and since April also we have seen asset values move up. That obviously will reflect in the net asset value which we will declare sometime in July when we next report our results. So these asset values are going up. I think they have been driven by the belief that the worst of the spot market is behind us and it is also being driven by the low interest rate regime which continues and there seems to be a little more demand from customers for taking charters for two years, three years even up to five years. I think it is a combination of various factors that is leading some of these asset values to go up. As far as we are concerned we are not looking at buying anything immediately because we still have $579 mn of committed expansion.

Moderator: We have our next question from Mr. Nikhil Vora from IDFC.

Nikhil Vora: How are you looking at the industry fleet addition for the current calendar year given the significant reduction that you saw in the last year? And second was on our own strategy whether we will continue to, if you had an option today to go in for new builds or would be looking at exiting some of our assets ship basically?

Bharat Sheth: Your first question was how we see the supply, if you take Jan to date on the dry bulk the supply has been running at somewhere in the region of 5% depending on the asset class and on the tanker which has been running at just under 3% again depending on the asset class. In both the tankers as well as the dry bulk I think we should see a slightly heavier delivery program in the second half as compared to the first half, more in dry bulk and a little less in tankers. So that is how the supply side will pan out.

Nikhil Vora: And it is just in sync with what broad estimates were till last year?

Bharat Sheth: The slippages that we are seeing in dry bulk are still running at about 40% to 45%. On tankers the slippages we are seeing are running at around 20% to 25%. Now, whilst the slippages will continue I think what will therefore happen is original delivery which was all contracted between 2009 and 2011 will spread between 2009 and 2013. And clearly because the earnings on the dry-bulk has surprise people on the upside we are now seeing greater enthusiasm for projects to be completed as opposed to earlier when the markets were in very bad shape.

Nikhil Vora: But you do expect the slippages to get arrested by the next couple of years.

Bharat Sheth: You see there is a physical limitation to what yards can do. So I think slippages could become a bit of a constant. More than slippages what we should be looking for is the complete cancellation. Slippages only differ but cancellations will decrease the pain.

Nikhil Vora: If you had not committed on the CAPEX for the next year, would you think the market is right now good enough to start looking at new builds or you think the markets are in terms of asset pricing good enough to look at some amount of exits?

Bharat Sheth: If we were starting with the zero capital expenditure commitment we probably would have gone to the second hand market for some shift and gone to the new building market for others. So for example if it was dry bulk we may have gone into the second hand market and acquired because you could today take advantage and lock up those vessels at a decent rate for two to three years. On the tankers we would have probably still gone to the new building market because the asset values probably have run up more than you can justify on immediate earnings.

Nikhil Vora: Do you think the worst in terms of cyclicality of rates are behind us now on both bulkers and tankers?

Bharat Sheth: You see cyclicality is something that we are not going to be able to shy away from. That is the nature of the business. I think whether the worst is behind us or not depends a lot on what eventually happens in the western economy. What we are seeing in parts of Europe spread to other parts of the world including some of the stronger economies like China and India then it is difficult to say that the worst is behind us.

Moderator: We have our next question from Mr. Bhavin Gandhi from B&K Securities.

Bhavin Gandhi: What is happening on the single hull regulation?

Bharat Sheth: I think scrapping will happen on the single hulls. Some of the vessels have already got scrapped, some more will get scrapped as we approach end of 2010. But we are clearly seeing that single hull vessels are finding it increasingly difficult to get employment. When the market becomes very tight, charters make some kind of concession and they will continue to deploy single hull vessels but as we move in 2010 these vessels will get harder to fix and eventually you will have to get scrapped. But so long as these vessels continue to earn above their operating cost which they all are today, the owner is going to prefer trading it as opposed to scrapping it.

Bhavin Gandhi: Based on what IEA has to say about the world oil demand in 2010 of 86.6 million barrels, if you were to stick to that number what kind of ton mile growth would we be seeing in the crude segment?

Bharat Sheth: I think the ton mile growth that we could see would probably be somewhere in the region of say 6% to 7%.

Bhavin Gandhi: What will be on the product side?

Bharat Sheth: It is difficult to talk on ton mile in product because it just continuously depends on the arbitrage opportunities that exist between different regions. Very often we get the same product being loaded and discharged in the same zone. Overall I think that we will see a relatively stronger crude oil market and a relatively weaker product market.

Moderator: We have our next question from Mr. Siddharth.

Mr. Siddharth: Now that GE Shipping has committed around Rs1200 odd crs in equity in Greatship, how are we as shareholder of the company to benefit from this IPO that you are coming out with?

Bharat Sheth: Well I think as far as the Great Eastern shareholders are concerned they will clearly benefit from the embedded value once that is realized on the successful listing of the oil & gas subsidiary.

Mr. Siddharth: Should not there be a demerger where we could directly get some shares in it?

Bharat Sheth: In the earlier case, it was a division and hence there was a degmerger. Greatship is already an independent company.

Moderator: We have our next question from Mr. Vishal Ajmera from Care Ratings.

Vishal Ajmera: I wanted to know the industry phenomenon as to what is the division between the single hull tankers and the double hull tankers in terms of percentage globally?

Bharat Sheth: About 90 odd percent of the tankers fleet should be double hull by now. And as I was telling one of the earlier participants is that some of the single hull vessels have gone into conversion process either into double hull or into dry bulk.

Vishal Ajmera: Is it like that the 10% of the single hull tanker fleet will be demolished or some will get scrapped by end of this year?

Bharat Sheth: No, much less because as I said part of it is already going into conversion projects.

Vishal Ajmera: In case if they get converted to dry bulk, which sort of ships are those?

Bharat Sheth: They are the larger ships, like recently we saw 5 VLCCs being converted from single hull. They have gone into a project to become large iron ore carriers for one of the iron ore companies out of Brazil. So these are the kinds of projects that are typically being undertaken.

Vishal Ajmera: What is the timeframe that is being taken by the yards for these conversions?

Bharat Sheth: It varies between 6 to 10 months.

Moderator: We have our next question from Mr. Jankiraman from Franklin Templeton.

Jankiraman: We have seen recovery in the tanker spot rates. Is it also visible in the contract rates?

Bharat Sheth: Yes, I would say it is also visible in the contract rates on the crude side, not so much on the clean product side.

Jankiraman: So have the contract rates come up to a level where you would be comfortable to lock in assets at current levels?

Bharat Sheth: We would not lock because, we believe that looking at our current net leverage, looking at the cash we are sitting on, looking at our overall exposure to the business we are quite happy to keep 40-odd percent of our tankers fleet exposed to the spot market because roughly if you take we have 4000 days exposed to the spot market, so every thousand dollars means almost four million dollars to the bottomline. And this is a business where markets can move $5,000 and $10,000 without too much of a difficulty. So we believe that we are financially strong enough to take the exposure and that is the best utilization of our money currently.

Jankiraman: So are you implying that at the current level there is more upside to be reached than downside risk?

Bharat Sheth: Yes, absolutely. There is more upside potential and less downside risk at current levels.

Jankiraman: You have also converted your Suezmax order into three VLCCs, does it reflect your perception that VLCC segment is much more profitable?

Bharat Sheth: I think we go. We did it for two reasons: (a) Great Eastern already had an exposure to Suezmaxes, whereas we had no exposures to VLCC (b) if you see there is an increasing trend where two of the largest growing economies India and China are doing the crude trades in VLCCs as opposed to Suezmax. The third reason is that VLCC has a greater volatility and therefore when the tanker market is strong, the earning differential between the Suezmax and the VLCC, favours the VLCC.

Jankiraman: Has the number of VLCC tankers that are right now used as storage carriers increased or decreased?

Bharat Sheth: That number has seen an increase over the last two to three months.

Jankiraman: Why has the contango on the crude forward curve increased?

Bharat Sheth: Partly due to the fact that Iran is now storing more of its crude which it is finding it difficult to sell in the international markets. So the Iranians have come in and taken up almost somewhere between 14 and 18 VLCC and then the rest of the VLCCs are booked due to the contango. The contango has come off. This varies, again every few weeks, every few months. The contango has obviously come up from where it used to be because it is a function not only of crude oil price but of interest rate and the rate at which you can secure ships. But if you take the sum total, the number of VLCCs in storage has gone up compared to three months curve.

Moderator: We have our next question from Ms. Nikita from Financial Express.

Ms. Nikita: Wanted to know the numbers for net debt, gross debt and debt to equity ratio for the company.

Bharat Sheth: We have a net debt of Rs214 crs as on 31st March, 2010, against an equity base of Rs5300 crs. The gross debt is Rs 3668 crs.

Moderator: We have our next question from Mr. Ashish Jain from Morgan Stanley.

Ashish Jain: What is the breakup between spot and chartered for both bulkers and tankers?

Bharat Sheth: Sorry breakup did you want?

Bharat Sheth: 58% of tankers and 50% of dry bulk days are covered for remaining FY11.

Ashish Jain: Is the increase in NAV from Rs300 to Rs339 largely driven by increase in assets prices or it also includes some incremental investments we might have done in GIL

Bharat Sheth: Investment in Greatship reflected as cost. The increase is basically because of two reasons, one is an improved values on various asset classes both second hand as well as our new building and secondly on increase in retained earnings for the quarter.

Ashish Jain: How is the increase in value for new ordered ships build into your NAV?

Shivakumar: While calculating NAV, we take into account the MTM on the new buildings. So we take a notional value for that.

Moderator: We have our next question from Mr. Paresh form Birla Sun Life Asset Management.

Paresh: At what price levels would we really be comfortable buying second hand vessels?

Bharat Sheth: We do not take the values of the earnings on individual basis but it is a combination of the two because you need to put that relationship right. At today's earnings we do not see value in doing a major acquisition or major commitment of capital towards purchase of assets. So we need to see either a drop in the value of vessels and across the sector it is not the same, so there are some segments where the values are already quite low and somewhere the values are relatively much higher. So there is no percentage that we can put across, but there has to be a substantial drop in the values of assets to justify purchase at these earning levels.

Paresh Khandelwal: Suppose these low earnings remain at the same levels for next two to three years and our cash goes on increasing further from here. If we don't buy then the return on equity would continue to remain at very low levels. So do we have any other plan as to do a buyback or something that we might just want to use? How do you think we would be placed over there?

Bharat Sheth: If we get into that situation where we really have to do some serious thinking on what to do with the cash because that is what you described is a scenario which we can call the worst case scenario where asset value will not come down and earnings do not go up. So then we will have to rethink at that time and see what our options are available with us

Paresh Khandelwal: Till last year at least our strategy was that we would probably become bigger in just one of the segments either in Aframaxes and Suezmaxes. What is the exact thought process behind the 2 Suezmax contracts getting changed to 3 VLCC orders?

Bharat Sheth: What we wanted to do is build in any one segment our meaningful presence in order to better obtain averages across different regions. What triggered our thought process first was, there is better relative pricing that we found on the VLCC contract vis-à-vis the existing Suezmax contract that we had. So that was the trigger point, but that was not the sole driver. We also saw an increasing trend that India and China are receiving more of the cargos on VLCC and we think that this trend will continue so that was the second driver in the VLCC. The third was that it was easier to build the Suezmax fleet or the Aframax fleet by taking in operating tonnage where as in the past we have taken into three Suezmax tankers as well as some Aframax tankers. It is very difficult to build a business model by in-chartering VLCCs because typical VLCC owners are reluctant to give out to non-oil companies the VLCCs on charter. So the third factor was that if you really needed to increase the Suezmax fleet, we could do by taking in inchartered tonnage. And the fourth driver was that since Great Eastern is sitting on high levels of cash, we found this as a sensible investment.

Paresh Khandelwal: Are we through with our selling process?

Bharat Sheth: Somewhere between 2 to 4 ships could be scrapped in FY11. Other than that we do not have any intention to sell anything outside the scrapping list.

Moderator: We have our next question from Mr. Vikram from Antique Stock Broking.

Vikram: How many vessels were in dry-docking for this quarter and what were the non-revenue days?

Bharat Sheth: We had one vessel that was dry-docked for a period of 33 days in Q4'10.

Moderator: Thank you for your question sir. As there are no more questions I would like to handover the conference to Mr. Shivakumar.

Shivakumar: Ladies and gentlemen this concludes today's earnings call. Thank you very much for your participation. The transcript of this call will be uploaded on our website for your future reference. Our corporate communications team will be glad to answer any of your other questions that you may have.