The Great Eastern Shipping Co.Ltd
Q4FY11 Investor/Analyst Conference Call
(May 9, 2011)

Moderator: Good evening ladies and gentlemen, thank you for standing by. Welcome to GE Shipping's investor call after declaration of its audited Financial Result for year ended March 31st 2011. I would now handover the conference to the Chief Financial Officer of the Company, Mr. G Shivakumar. Please go ahead sir.

G.Shivakumar: Good afternoon everyone and thank you for joining us on this conference call. You would have seen the results and the press release that we have put out with regards to the results and the outlook that is given for the market. We also have in the press release enclosed an analysis statement as we have been doing for the last few quarters. I would like to point out a couple of highlights and then will start the Q&A session. One of the primary item which was there in the results was relating to the impairment charge on the 3 VLCCs that are on order and which we have contacted to sell. Since the sale price is less than our cost we have decided to take the impairment on those assets in this year itself. This is a onetime impairment hit that we have taken in this quarter.
The second thing that I would like to put before you is that, we are now disclosing the NAV of the company on the consolidated basis, which includes the value of the offshore assets which have been mark to market in the same way that we mark to market the shipping asset. However it is with a caveat that the offshore market is not as liquid as a shipping market and the bid offers spreads are fairly wide and therefore there could be some variation with regard to the values of those assets. Based on our estimates the NAV per share of GE Shipping including the MTM on the offshore assets works out between Rs 420 and Rs 425 per-share.

Moderator: We have our first question from Mr. Chetan Kapoor from IDBI Capital.

Chetan Kapoor: Will it be possible to provide a breakup of the NAV between the shipping and offshore businesses?

G Shivakumar: The NAV of shipping business, including the investment in the offshore business is Rs 345 per share. So the remaining Rs 75 to Rs 80 comes from the MTM on the offshore assets.

Chetan Kapoor: So that means we have seen the fall in the NAV of the shipping fleet?

G Shivakumar: That's correct. The NAV declared at the end of the last Quarter was Rs 362.

Chetan Kapoor: During the quarter we had ordered couple of assets on the offshore side, one of them being the 350ft jack-up rig. Can you give us an idea why we have gone in for this kind of an acquisition?

G Shivakumar: Offshore business seems to be in good part of the cycle. It has recovered substantially from the market of 2009 and we have seen quite a bit of activity and inquiries for all kind of assets especially in drilling. Hence, we believe it's a good option for us to expand in that area.

Chetan Kapoor: But with utilization being in the range of around 65% to 70% for jack ups, do you believe that it will be improving in the future?

G Shivakumar: If you take utilization for jack-ups as a whole, it does not give a true representation. There are two very distinct groups of jack-ups which are there, those which will build in the 70s and 80s and there are those which were build in 2000s. Modern jack-up's utilization is in excess of 95% and for old jack ups the utilization as you mentioned is 60% to 65% and that's why we are very confident about these modern jack ups and that's why we have gone into the modern jack ups segment to build a new jack ups for ourselves. So old jack-ups are suffering with regards to utilization but modern jack ups are not. We are seeing lots of tenders, which are now coming out with an age restriction on the assets.

Chetan Kapoor: What is the logic behind acquiring the rig from Mercator and what kind of contract are we having on that?

G Shivakumar: The logic behind acquisition is the same as for ordering a new building rig. This deal is even more attractive because we had around one-year contract term remaining on it. Initially, this rig has a contract of 3 years of which 2 years have gone now. It is a rig that we have been working on for the last 2 years and extremely satisfied with its operation and therefore very happy to take it on our books.

Chetan Kapoor: Do you feel that there will be some recovery in the product tankers in the current financial year?

G Shivakumar: There is already a recovery seen on the product side as rates in the last few months are in excess of $15,000 per day. That's because of increase in the gasoline demand from US. The existing inventory for gasoline is low and they probably will have to import more to sustain the demand. On the supply side the product tanker's order book is less as compared to crude tankers. So we expect that supply also will not weigh too heavily on to the product tankers segment.

Moderator: We have our next question from Mr. Varun Kejriwal form IDFC Securities.

Varun Kehriwal: Wanted to get your thoughts on the VLCC impairment that we have taken. How are we looking at the shipping business? Are we expecting that VLCC business is going to remain extremely weak going forward and you would rather re-deploy the cash somewhere else or is there some other thinking behind this?

G Shivakumar: Yes, actually it is a part of re-deploying cash elsewhere. We thought that we should de-risk in some area and of course the outlook for the drilling business is currently looking much better than for crude carrier. So its part of pruning down our overall exposure while just re-jigging the portfolio to take into account assets which seems to have a slightly better outlook as of date.

Varun Kejriwal: Are you looking at using this cash from VLCC deal to effectively fund the new rig which you are expecting in FY 13 or is it also going to be used for additional assets?

G Shivakumar: It's more or less fungible; we had the cash even if we have not sold these VLCCs. We already had the cash to fund the rig. It's only keeping in mind the overall risk profile that we thought that we should prune down our exposure in one area at least since we are taking an exposure in another area. So the existing cash flows were sufficient to fund the rig and it was not a requirement that we had to sell. But it's part of our overall risk management that we decided to sell the VLCCs.

Varun Kejriwal: When will we receive the proceeds of this deal?

G Shivakumar: We will take the delivery of these VLCCs from the yard and then will deliver it to the new buyer. We will get the cash only between January 2012 and April 2012, in those four months.

Varun Kejriwal: How much have we already paid to the yard for these 3 vessels? cost?

G Shivakumar: We would have paid about 40% on average between the 3 of these VLCCs.

Varun Kejriwal: What is your outlook on the shipping freight rates? Have we already touched the bottom?

G Shivakumar: Based on current rates I will say that it is difficult for it to get much worse at least on the crude carrier segment. For instance if we take the VLCCs, currently they are running less than $5,000 a day on the spot market on the standard route. So it's tough to see it getting worst unless we were looking at lay up scenario but we don't see that happening. We expect that at some point there will be recovery in rates if only that there is still a substantial order book which is due to be delivered, which might get delayed to some extent. What will happen is as the rates stay low for a longer period of time, charterers will prefer modern ships rather than 1990 build tanker. Therefore scrapping of older vessels will start taking place which will lay the foundation for the recovery going forward.

Varun Kejriwal: How about the charter rates in the offshore segment. Do you expect those to remain firm?

G Shivakumar: Most broker reports seem to indicate that charter rates may firm up because of increasing demand the system. It may not go very much higher from it is currently but we don't expect a significant drop in rates from where we are. As mentioned earlier, lots of charterers are now starting to make a distinction between old assets and modern assets therefore we will have an edge in that market with all our assets being ultra modern.

Moderator: We have next question from Mr. Tejas from Barclays

Tejas: The operating expenses on Y-o-Y basis are seeing some dip. What has contributed to that? On a consolidated basis it has come down from Rs 553 crs to Rs 430 crs/

G Shivakumar: Lot of that is related to the bunker expenses which were the function of fleet which was operating on voyage charters and therefore that will vary substantially from quarter to quarter.

Tejas: We were hearing about a little bit of slowdown coming from China. Even the US recovery is not on track. Based on these scenarios, do you see further weakness in freight rates?

G Shivakumar: Yes we definitely see weakness in freight rates if China slows down to 7% because it is such a large importer of commodities either be it dry and wet. Adding to this is the sheer force to dry bulk supply which will get added to the system resulting in weakness in the dry bulk segment.

Moderator: We have next question from Mr. Rajesh from Karvy.

Rajesh: The numbers of the offshore business on the sequential basis seems to have improved. What is your view on the offshore market?

G Shivakumar: The rig which was inchartered came in on your books during this quarter and therefore the margins automatically improved because we no longer have to expense that bareboat charter which was being paid to the owner. Talking about the outlook, the comfort level form oil exploration is there when the oil price is above $70 to $75 which currently is well above that level and therefore we expect that activity levels in offshore segment will continue to remain high. On the other hand the order book is not huge for offshore assets and that's another factor which will help.

Rajesh: What will be the total investment in the offshore subsidiary be now?

G Shivakumar: GE Shipping’s investment in the offshore subsidiary is around Rs 1616 crs.

Rajesh: What is your weighted average cost of funds on the debt?

G Shivakumar: 4.7% is the total interest cost on our debt

Moderator: We have next question from Mr. Sachin form Lucky Securities.

Sachin: Since we booked a loss in the VLCC deal, are we expecting a significant correction in the asset prices and hence decided to have a stop loss or you expect to see a weak freight market for VLCC which would have forced you to run these assets at a lower IRR?

G Shivakumar: It’s actually neither of those; it's not that we are expecting the market will drop in the big way. As I mentioned earlier we're doing this as part of our portfolio re-allocation.

Sachin: Will there be more infusion in the offshore subsidiary?

G Shivakumar: They will require a little more investment. It depends on how their cash flows also pan out. But we don't expect that the investment will be more than $50 million to $70 million as of the current CAPEX.

Sachin: What is the overall announced CAPEX as on date and what is the equity component that is to be put in by the offshore business for that?

G Shivakumar: The total offshore CAPEX is little under for $450 million of which they have to put in around 30% in equity. So its around $130 million as equity component. They do have cash balances; however, we do as part of the risk management keep reasonable amount of cash for the un-contracted assets. They have some assets which are working in the spot market in the sub-sea business therefore have to keep some cash for those assets as well.

Sachin: What percentage of the equity part has been paid out?

G Shivakumar: Around 40% of the total equity component of the capex has been paid out.

Sachin: What would be their cash position after the fund infusion?

G Shivakumar: As of now they have an excess of $100 million in cash equivalent.

Sachin: What is the debt repayment every year for the next 2 to 3 years?

G Shivakumar: The debt repayment that they have is approximately $70 million per year.

Sachin: **W**hat would be the debt-equity that you would be comfortable for the offshore businesses?

G Shivakumar: Again it's not something that we look at in isolation. It depends on what kind of contracts they have. For instance if they have a large proportion of 3 to 5 years contract we will be comfortable with 1.75x to 2x debt-equity ratio. However, if the contract profile is lower, then we would be more comfortable with a 1.5x debt-equity ratio. Currently it stands at 1.75x.

Sachin: Do you expect asset prices in the shipping side to fall further?

G Shivakumar: We hope to see prices lower in the next few quarters on the dry bulk side. Low interest rates and ample liquidity in the markets has kept these prices high over the last couple of years. On dry bulk carriers we are seeing a gross addition of 20% this year based on the order book excluding slippages and then crude carriers we are seeing a little about 10%. Next year we are still seeing close to 10% in crude carriers and about 15% on the dry bulk side.
Sachin: But have we seen a significant slowdown in ordering in the 4 to 5 quarters?

G Shivakumar: Yes, in the last 3 to 4 quarters we have seen slowdown in the ordering. In the 1st quarter of CY 10 we saw large amount of ordering happen on the dry bulk side especially on the Panamax and Capesize segment but since then there has not be much ordering, a lot of the ordering in recent months has been on the large container ships side. Of course there are few orders here and there but it's quite marginal and therefore the order book for CY 13 is quite low at around 5% across the segments.

Moderator: We have next question from T Manoj from MINT.

T Manoj: I just wanted to understand, your de-risking from the main shipping side and focusing attention on the offshore business but at the same time you have full pull down from the IPO to the offshore business. Can you explain the logic behind that and whether you will be going into the market in the near future?

G Shivakumar: During the January-February period amid the volatile stock market it was just not conducive to go ahead with an IPO. In the meantime we had the business requirements where we had these 2 jack up rigs. We didn't want to hold up the business waiting for the financial markets to recover and therefore we decided to commit our own money into the business. The IPO is something that we are quite open to

T Manoj: Has the funding arrangement for both the rigs done?

G Shivakumar: The second hand rig that we bought was delivered to us in the first week on March and that rig has been funded at that time itself. We will have to raise debt funding for the new building rig that we have ordered. It's too early now because we have just paid the first installment and as and when required maybe 6 months or so down the road we will require to raise some debt.

T Manoj: On the main shipping side you have only two ships on order at the moment. After a long time your shipping thing is slightly off focus now for you. How long do you think you can look back at the main shipping sector in terms of buying assets?

G Shivakumar: We have the capacity to reinvest in the business and we will reinvest in the business at some point in time. But we have to be careful in making investments. Currently what has happened is that the asset values have been firm on account of the excessive liquidity and possibly the low interest rates. Therefore it doesn't seem to makes sense given the kind of earnings to invest in shipping business in a large way. It's not that we don't want to grow in shipping; we would like to grow in shipping but only at reasonable prices that can deliver a good return to our shareholders.

T Manoj: What is the mix of time and spot charters for the entire fleet?

G Shivakumar: At the end of the March quarter, approximately 47% of our overall fleet is on time charter and rest is on the spot market.

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

Bhavin: Why has the EBIT number of the offshore subsidiary declined marginally as compared to December quarter, even though we have taken the rig on our books?

G. Shivakumar: Two of our assets are mobilized for employment into a long-term contract in Brazil, one of the break-through that we have made in the last 6 months. They had to undergo refurbishment and also to be mobilized to Brazil. Lot of that expense has been debited in the last quarter and of course when they are undergoing refurbishment, they are not earning anything and therefore that is an expense which has come in.

Bhavin: Why has the coverage for AHTSVs been low at around 45 % for the balance part of the year?

G. Shivakumar: We would like that number to be significantly higher. It is just that less of them have gone on to long-term contracts. There have been fewer opportunities and therefore the coverage on that is less, but yes we would like it to be a higher number overall. We would like to have most of them on 1- to 3-year contracts.

Bhavin: Have you seen a correction in the new building asset market?

G. Shivakumar: We have not seen too many deals. Actually we have not seen any deals happening recently especially on the VLCCs. So there is not really any benchmark that we can use, nothing that we can remember in the last 3 months at least.

Moderator: We have next question from Mr. Vikram from Antique.

Vikram: The TCY rates for your crude carriers have performed better than the December quarter. Will these rates continue to remain same for the coming quarters?

G. Shivakumar: The TCY rates especially for the crude carriers improved in the fourth quarter as compared to third quarter of the financial year.

Vikram: What percentage of your crude carriers are in the spot market?

G. Shivakumar: Slightly more than 50% of our crude tankers operate in the spot market.

Vikram: How much scrapping has happened in this calendar year?

G. Shivakumar: In dry bulk, there have been a substantial amount of scrapping; almost 7 million deadweight. In crude carriers, it is about 1.7 million deadweight and on product tanker, it is 1 million deadweight .

Vikram: What would be the cash position in standalone business?

G. Shivakumar: Standalone cash position is around Rs2500 crs.

Moderator: We have next question from Mr. Aniruddha Basu from Reuters.

Aniruddha Basu: GE Shipping has done a few rounds of raising funds via bond issues. Are there any more plans of raising funds via bond issues?

G. Shivakumar: We have nothing planned. We have completed Rs200 crs of bond issues in the month of April. Currently there are no plans as of now.

Aniruddha Basu: By when do you plan to sell all three VLCCs and what is the price?

G. Shivakumar: They have already been sold. So the contract for sale has been entered into. They will be delivered to the buyers when we take delivery from the yard which will be between January 2012 and April 2012 and we cannot reveal the price at which we have sold them because of the confidentiality clause.

Aniruddha Basu: Are there any plans to dry dock any of your vessels in this quarter?

G. Shivakumar: Dry docking is a continual activity. We might have may be 4 to 5 dry docks in this quarter, but again this depends on the business requirements. So one or two here and there could happen.

Moderator: We have a next question from Mr. Kothari from Religare. .

Kothari: I wanted to know the capital work in progress and capital advances from the balance sheet date in standalone and consol?

G. Shivakumar: CWIP on consolidated and standalone basis is Rs1250 crs and Rs 1140 crs respectively

Kothari: I wanted to understand the segment revenue of offshore business. If I am right that includes Greatship India, GGOS, and GGES. But if we total it for this 3 companies for FY10 that comes to Rs985 crs against reported Rs763 crs for FY10 in the segmental revenue of the results. So what can attribute that difference to?

G. Shivakumar: There are internal company transactions there which have to get knocked out in the consolidation. So for instance, GGES has chartered its rig to Greatship India Limited and in the consolidation that transaction has to get knocked out.

Kothari: What is the balance charter time remaining for the 2 rigs?

G. Shivakumar: Greatdrill Chetna goes up to February-March next year so that is about 10-11 months remaining from now and Greatdrill Chitra goes up to October-November 2014. So that is almost 3.5 years remaining.

Moderator: We have next question from Mr. Mehta from BP Equities.

Mehta: Can you provide a percentage breakup between the rig revenue and offshore vessel revenues from the total income of offshore?

G. Shivakumar: Roughly it is 50% from rigs and 50% from supply vessels.

Moderator: We have next question from Mr. Janakiraman from Franklin.

Janakiraman: Now that the rig has become an owned asset, you will be paying depreciation on it. Over how many years will the rigs be depreciated?

G. Shivakumar: We will be paying both i.e. interest and depreciation on the rig. The rig will be depreciated over a period of 30 years.

Janakiraman: The capital employed in the offshore subsidiary is more or less equal to that of shipping business?

G. Shivakumar: The broad message you are giving is directionally correct, but they also have cash in their balance sheet. But yes it is getting close,

Janakiraman: The accretion of about Rs. 80 per share to the NAV is primarily coming from the Jack-ups or even the supply vessels are contributed to that?

G. Shivakumar: It is across the board. Broadly all the assets are valued at equal to or greater than the cost. Of course the Jack-up rigs because of their nature, their amount will be higher, but in terms of proportions, most of the assets add a substantial premium to what they reflected in our books. So it is not just Jack-ups which are at premium, it is also the offshore supply vessels.

Janakiraman: What would be the company's philosophy in terms of utilizing this cash balance?

G Shivakumar: We are waiting for opportunities. We would like to reinvest in shipping. But unfortunately so far the prices of assets have just not given us the opportunity. They are not reasonable enough for us to make any decent size investments. We have not seen prices come near to our buy zone.

Janakiraman: What if the asset prices continue to move ahead? Then how will be your strategy going forward?

G Shivakumar: I do not know how long that can sustain. It happened for the last year but I do not see how much longer it can sustain because there is difficulty. People are facing some difficulty. The cash flows from the assets are just not there and people who are stretched will have issues in meeting their repayment obligations. We believe that there will be pressure on asset prices going forward. It is only a question of 'when' rather than 'if' it will happen so we are waiting for that opportunity. Again we do not want to give up hope just before the market turns.

Janakiraman: If I compare the FY11 shipping segmental EBIT versus the effective capital employed you made about roughly 5% return on EBIT by capital employed. Does 2012 appears to be any better or it is going to be slightly worse than this?

G Shivakumar: Based on current markets I do not see it getting better. Some old charters have also come off. So I do not see it getting better from what we did in FY11.

Janakiraman: What is the consolidated cash balance?

G Shivakumar: The consolidated cash balance is around Rs3100 crs.

Moderator: We have next question from Mr. Bhavin Chheda from Enam Holdings.

Bhavin Chheda: Why has the offshore subsidiary's depreciation amount not changed on a quarter on quarter basis, even though we have taken delivery of the inchartered rig?

G Shivakumar: The rig has to be depreciated over a 3o-year period and this rig was only for one month in the year because we took delivery in the month of March. Therefore, the amount itself is not very large.

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

Ashish Jain: Can you share the revenue days of offshore subsidiary in FY11?

G Shivakumar: Revenue days of offshore subsidiary in FY11 were 5404 days.

Ashish Jain: In the earlier conference calls the management said that they are comfortable with a debt equity ratio of around 1x to 1.1 x. With that ratio already being touched, how do the things look going forward?

G Shivakumar: Actually it will vary for the two businesses. For example if GIL has a 50% spot market exposure they would not be very happy going more than 1x to 1.1x. But because Greatship has a much larger amount of coverage with certain cash flows, we would not mind going to a higher ratio. So even at 1.5x plus, we are quite comfortable.

Moderator: As there are no more questions I would like to hand over the conference to Mr. G. Shivakumar. Please go ahead sir.

G. Shivakumar: I thank you all for joining us on this call and as always we will upload the transcript of the call on our website. However, if you have any other queries, you are always welcome to, either call us, or send us an e-mail and we will be happy to answer your queries. Thanks again for joining.