The Great Eastern Shipping Company Limited
Q4 2013 Earnings Conference Call
May 6, 2013

Moderator: Good evening, ladies and gentlemen. Welcome to GE Shipping's earnings call on declaration of its financial results for the quarter ended Mar'31, 2013. I now hand over the conference to Ms. Anjali Kumar – Head of Corporate Communications at GE Shipping to start the proceedings.

Anjali Kumar: Good evening everybody. Welcome to our Q4FY13 results conference call. We have our CFO, Mr. G. Shivakumar who will take us through the results and then we can start the Q&A session.

G. Shivakumar: Hi, good evening and welcome to our conference call. We assume that you would have got some time to go through the results. The Net asset value on a standalone basis as of 31st Mar'13 was Rs.248 per share and on a consolidated basis it was Rs.433 per share. I leave the floor open for questions now.

Moderator: The first question is of Mr. Bhavin Gandhi from B&K Securities.

Bhavin: If you can start off with giving us the number of days for which the new rig was operational during the quarter and mobilization charges if any, which were booked?

G. Shivakumar: We took delivery of the rig around 17th Jan'13 and it went on hire in the middle of Feb'13. So it operated for about 45 days in the fourth quarter. Mobilization cost would be about $2 million.

Bhavin: If we look at the y-o-y EBIDTA performance of the offshore business, we are not seeing any major improvement. Any significant reason for that?

G. Shivakumar: There are some repricings which have happened at a lower rate. On the drilling side, we had one rig pricing which was done at a lower rate and has not compensated by the new rig coming in. It makes a big impact just on the rate differential on the pricing. Apart from that there has been also some cost increases. The new ships which have come in have added to the bottom line but that is not enough to compensate for the drop in the drilling rig repricing.

Moderator: The next question is of Mr. Vikram from Antique Stock Broking.

Vikram: Can you explain the impairment cost of Rs 31 crs on certain assets?

G. Shivakumar: We had purchased some cranes and helideck to put into our vessels which were constructed for the subsea business. We have cancelled those vessels. We can put them on to our other vessels if we require them to be in subsea mode but currently we have no requirement. So we have taken an impairment charge on those equipments

Vikram: Are there any higher incomplete voyage days in this quarter?

G. Shivakumar: No, we don't have that swing factor in the 4th quarter.

Vikram: How has been the scrapping scenario in tanker segment? Are many younger assets getting scrapped?

G. Shivakumar: The average scrapping age for larger vessels especially for large crude carriers is around 20 years, whereas it will be around 24-25 years for smaller vessels. Also, the other factor which comes into this is that the smaller vessels which are the product tankers are doing much better i.e. on the charter rates front as compared to crude tankers. So there is not much of an incentive to scrap the vessels unless there is some regulatory issue. So average age of scrapping has not come down significantly in the last few months.

Vikram: In terms of million dwt, how is the scrapping happening in dry bulk and tanker side?

G. Shivakumar: In the first three months of this calendar year, we are going along at a little lower than last year's run rate. So we have less than 2 mn dwt of crude carriers scrapped in Q1CY13 versus about 9 mn which was scrapped in full last year. In dry bulk, we have had about 7.5-8 mn scrapped versus 33 mn dwt in CY12. In product tankers, scrapping has been quite low. Its only about 0.5 mn dwt scrapped in the first 3 months of this year. As I mentioned, the product tanker market is doing very well so there is no need or incentive to scrap any ships.

Vikram: Are we seeing good amount of slippages in a new order delivery?

G. Shivakumar: Slippages are continuing. We are seeing yards which are facing financial stress and therefore not delivering ships. So you have about 40% plus slippage in dry bulk and 30% plus slippage in tankers. That continues so far. But again that is something which has not changed very substantially. We do not know whether these are cancellations or just delays. There is now a very good possibility that a lot of these are actually cancellations and that the order book is not as much as made out to be from the headline news.

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

Chetan Kapoor: My question is regarding the rig repricings? If I am not wrong, we have repricings due this year and next year.

G. Shivakumar: We have 2 rigs which are coming for repricing in the next 2 years. One rig is due for repricing at the end of this calendar year. The other rig which was priced in 2008 comes off contract in end of calendar year 2014.

Chetan Kapoor: How are the charter rates in the offshore business? Are we seeing any softening in the pricings?

G. Shivakumar: It depends on the individual segment. The smaller vessel segment especially the PSVs has a large order book and therefore there is a little bit of a glut and pressure on the rates. On small anchor handling tug supply vessels like the one that we have which is 7,000 hp and about 80-85 tonnes Bollard Pull, the order book is not very high; however, the existing fleet is too large and hence the rates are little subdued. It is not expected that they will go down much from here, but we do not see the rates to pick up substantially. Also the existing fleet of this smaller asset classes is very old and a lot of those are early 80s built. So we have a lot of replacement demand and phasing out of older assets could help to revive the charter market. In case of larger vessels, the charter market is firm and if these assets have added capabilities of doing complex jobs like ROV support then you get a decent premium in the charter rates as these kind of vessels are not easily available in the market.

Chetan Kapoor: As far as your view on the product tanker side is concerned, what is the likely expectation on the charter rates in FY14 and '15?

G. Shivakumar: I would not venture a guess on the charter rates, but the general outlook for product tankers trade is positive. Again, it is a function of two-three things; one is that the trade has gone up in a big way and it has been shaken up by the US on back of shale boom which has turned it to a net product exporter. Also, in the past the new supply has been fairly low for product tankers. However, going forward, if we have large orders placed in this segment which has been the recent trend, there could be some pressure on the charter rates. But for now, product tanker segment is the one bright spot in the commodity shipping market.

Moderator: The next question is from Sanjay Doshi from Reliance Mutual Fund.

Sanjay Doshi: I wanted to have your comments on the asset prices. Last quarter, you mentioned that we need further correction in asset prices for the Company to become active. Have you seen any movement there?

G. Shivakumar: We have seen some uptick in the product tanker segment because there is quite a bit of money which is waiting to come in and buy assets. Majority of the listed players of Europe and the US seem to be under significant stress but privately owned shipping companies seem to have substantial amount of cash. That's so because every time a good asset comes into the market it gets snapped up pretty quickly. So there are a lot of buyers waiting for good assets. The product tankers values went up between 3-10% during the quarter, whereas on the rest of the assets classes, values are down maybe 1-5%.

Sanjay Doshi: And do we stand that we may not be active at these prices or has the business outlook improved for us to look at some opportunities though there has not been any significant price correction or asset correction?

G. Shivakumar: We are always on the lookout for value buying and keep on evaluating opportunities. Even if we may not be at the absolute bottom in terms of prices, but one thing is for sure is that we are in a bottom third or bottom quartile of the market. So we are always assessing purchase opportunities and as and when something comes along which looks tempting, we will buy. We are also looking at whether we can do some new buildings also.

Sanjay Doshi: Can you share more light in terms of any capital which has been committed over the next one year for asset purchase and the segments that you will be more happy to look forward to?

G. Shivakumar: Currently, we only have one capital commitment, which is for one product tanker, which will come in about 2 years time. So there is only one installment payment which has to go within the next one year, but that is about it. So it is not a huge CAPEX commitment. We are always evaluating opportunities but as of now the only commitment is this one vessel.

Sanjay Doshi: But would we be comfortable with around $600-700 mn if need be to look forward to asset purchase?

G. Shivakumar: I would not get into a number but yes, the affordability is certainly there, I do not know if it will extend to $600 million but yes, the affordability is certainly there.

Sanjay Doshi: On the global shipping market, has there been any significant shift from players in Japan because of the currency movement? Have you seen pricing being aggressive from those areas?

G. Shivakumar: The significant effect of the Yen movement is two-fold. One is that Japanese owners could not afford to sell ships because they would have to book a large loss on the sale when the Yen was at 80 to a dollar. Now that it is close to 100 to a dollar they can afford to sell more. So you see a few more Japanese second hand ships coming into the market. The second impact is on yard pricing. Yards were completely outpriced because of the strength of the currency, and that disadvantage has got nullified to a large extent. So they are becoming a little competitive again. So those are the two impacts really.

Moderator: The next question is from the line of Pallavi from HT Media.

Pallavi: Your offshore business has compensated for the underperformance of shipping business for some time now. In your outlook, for the offshore business, you are saying that excessive capacity addition in the coming years could cause some concern on utilizations and rates going forward. So I just wanted to understand the impact, if you could elaborate more on this and give me some outlook on the offshore business and whether it will continue to sort of compensate for the underperformance of shipping in future?

G. Shivakumar: Yes, as I mentioned there are some areas in offshore where there is a little bit of weakness. For example, if you take a plain vanilla mid-sized PSV of 3,000 deadweight, that part of the market is not very strong. However, in the larger sizes and in the jackup rig market which form the large part of our business, the market continues to be quite strong and very profitable.

Pallavi: So what is your outlook on the shipping business then? Are you expecting rates to improve in the next?

G. Shivakumar: The product tanker market is already at a very decent level. So, that market will continue to be strong is our prognosis. On dry bulk, the supply overhang is quite worrying. People are calling for a recovery by 2014. So we expect maybe a year before the recovery. On the crude tanker market, it seems a little more structural change because of changing trade patterns. We will have to wait and see how the trade evolves.

Moderator: The next question is from Rohit from SBI Mutual Fund.

Rohit: Are you seeing any different routes coming up which can compensate for such a big player as US cutting imports?

G. Shivakumar: In the last four years, they have reduced crude oil imports by 4 mn barrels a day and nobody can compensate that kind of trade. So, that is why we are seeing this weak market. China, of course is continuing to import, China is continuing to import from as far a field as Venezuela, West Africa, which is the longest run. So that is a little bit of compensation, but it is not enough. Rest of the world cannot grow 4 mn barrels in this period. So that is why you will find the crude market so weak in the last year or two.

Rohit: So what is your strategy on asset acquisition in this segment then? Is it something which you would probably do last of all?

G. Shivakumar: Possibly, yes. As of now, we do not believe that the asset values have priced in the outlook for that business. So we are not there to acquire assets in the crude. It is not just the business being good or not, because of the cycle. The cycle will reach a point where crude carriers' prices get hammered to the levels where they are attractive. At that point, we will not mind buying crude carriers. It is not that we have written off the segment. All we are saying is current asset values do not make sense because of the outlook for that business. But, in principle, we do not have an attachment to saying that crude has to be the bigger segment or biggest business.

Moderator: The next question is from Himanshu Upadhyay from M3 Investment.

Himanshu: My question is on the jackup rig market. How have been the charter rates off late? Also how have the asset values moved in that sector? Last time we had discussed that Chinese shipyards were getting aggressive in this market. Has that impacted the other shipyards?

G. Shivakumar: Earnings outlook has been stable from last few months. Again, the problem is that it is very difficult to compare two fixtures which are done because of different cost structures. It is a very localized business and local costs are not really comparable. So if you have a fixture in Indonesia at let us say 100 and you have another fixture in Malaysia at 90 and another fixture in India at 80. It might well turn out that the Indian fixture is the best of the lot because the operating expenses, tax structure, etc. But broadly the market seems to be improving. It has been strong for quite some time now, maybe a year or more, and it seems to be improving slightly.

With regard to Chinese yards, they have not been aggressive in dropping prices, but have been lenient in the payment and financing terms. However, it has not forced the Singaporean builders who are the market leaders to drop their prices. In the last six months those prices must have gone higher rather than lower because of the demand for those rigs.

Himanshu: Are charter rates on the supply vessels also been softer as compared to a year?

G. Shivakumar: Over the year, day rates may be slightly lower by 5-10%. Again, rates have come down for plain vanilla assets and not for slightly more advanced and capable assets. For the more advanced vessels, the rates have gone up because there is a shortage of those assets. Asset values may have come off slightly but not very much. For the older assets, yes, they would have come off substantially, but for modern assets it's a very marginal drop.

Himanshu: What are your views on the next round of capital investment in the shipping business? Will you be investing there?

G. Shivakumar: We are almost at the bottom of the cycle and therefore it makes little more sense to invest in shipping.

Himanshu: What is the main reason for large orders still placed for the larger assets in shipping like capsizes?

G. Shivakumar: Basically, people are saying that I have got cash, I have to invest in and I am in the shipping business. As I said we are in the bottom quartile. The new building order for a capsize at the peak was maybe $100 million and today you can get that at $45-50 million. People say that how much lower can it go and at some time it will again go back to

$100 million mark and then will I make a lot of money. It is a fairly simplistic view to take but that is how you do in a cyclical business and that is how people make money. Basically, that is a temptation. Also, if you place an order now, it will get delivered 2 years down the line and hence you need not worry about the terrible charter rates in the short term and hope that by the time the ship comes the market has recovered.

Moderator: The next question is from Ashish Jain from Morgan Stanley.

Ashish Jain: My first question was on the offshore business. If I look at the segmental results, the offshore margins seem to have dropped quite significantly quarter-on-quarter. So, what is really driving that in the segmental numbers?

G. Shivakumar: One is that we had the rig delivered to us in January. She went on hire in mid-Feb. So all the expenses related to the mobilization of the rig got added in this fourth quarter. We also had a couple of dry docks during this quarter on the offshore side

Ashish Jain: Where would be the jackup rates today?

G. Shivakumar: The last rate which was fixed in India for a long term contract was in early 2012 which actually is only a representative fixture. But if you take our own fixture which happened in late 2011 that was probably 25% lower than the rate of 2008.

Ashish Jain: And that is a realistic number to look at even today?

G. Shivakumar: No, I do not think so. The market is stronger than it was in 2011. But we are nowhere near the highs of 2008 yet.

Moderator: The next question is from of Krishna Raj, an individual Investor.

Krishna Raj: My question is related to the shipping side of the business. In fact, I was expecting an impairment charge on the shipping side and I will just run through my reasoning. If you look at the statement of assets and liabilities that has been put out, the fixed assets have been carried at about Rs.300 per share. You said the NAV was Rs.248 and that included the Greatship investment at cost. This investment at cost is about Rs.120 a share. So that leaves about Rs.128 a share for the rest of the balance sheet and you are practically carrying no debt on the shipping side of the business and the current assets and the current liabilities more or less square off except for your short term provisions, which I think probably not included in the NAV. So that leaves me with a back-of-the-envelope calculation of about Rs.300 odd per share is the book value of the vessels and the vessels are almost half their age, the average age is 9.6 years. So I wanted to just understand if my reasoning is right and what is your reasons for not impairing the shipping side of the business?

G. Shivakumar: We will come to the calculation that you have done a little later. The average age of the vessel does not really make a difference. When in the boom, you could have had a 20-year ship and still would have had a wonderful value for that. But, basically the point that you are making is correct and you can see it from our net asset value calculation itself. If you just see it from a difference between the book value per share and the NAV per share, you will find that we are substantially lower. The only difference in those two calculations is that the shipping assets or all the assets are mark-to-market in the NAV calculations, while in the book value calculation, they are taken in as per book value.

Therefore, there is certainly a negative in the market value of the shipping fleet vis-à-vis the book value of the shipping fleet.

But however, the way we do the impairment is like this. The accounting standard says that, you take the market value of the asset versus the book value of the asset. Now, the market value is lower than book value, the way it is now. You need to test the asset for impairment. And when you test for impairment, you also have to not just take the market value of the asset, because then most of your accounts would just be changes in the market value of your assets and these are not assets which are trading assets, in the sense that you expect just trade in and order that. They are held for the purpose of earning cash flows. So the next test which you have to do is to see what is the expected benefit that I derive from holding this asset. That means you project the cash flows that you expect from that asset over the remaining life of the asset, discounted back at your weighted average cost of capital and then you arrive at a value.

Let us say for example, a book value of Rs.100 for a specific asset. You have a market value of Rs.70 for that same asset. So you have a shortfall of Rs.30 and now you do a projection of the expected cash flows. The expected cash flows the way we project is that we will take the last 10 years average earnings of that class of asset. We do not just take that 10-year average earnings. For the first 3 years we apply the current 3-year time charter rate. So we take the full impact of a weak spot market or a weak prompt market. Then for the next 4 years, we take the long-term averages and beyond that period, for the remaining life, we discount that further by 15%, and then we arrive at the net present value of the cash flows from that asset.

Now, in the case that I mentioned let us say that this lands up at Rs.110. So now you have the book value of the asset as Rs.100, market value is Rs.70 and the value in use of that cash generating unit is Rs.110. Now, there is no scope for taking an impairment charge on that asset based on the projections that have been made for the asset. We have used the same benchmark since 2008-09 for assessing the value of the assets. So if you arrive at a number of Rs95 from the cash flows in the same example, we would be taking an impairment of Rs.100 minus Rs.95 which is Rs.5. However, as it stands today and the test that we have done on 31st March 2013, none of our assets have required to take impairment based on the projections.

Krishna Raj: In current liabilities under short-term provisions you have about Rs.800 crores, should I understand that most of it is mark-to-market on cash flow hedges, the provisions for mark-to-market on cash flow hedges?

G. Shivakumar: Yes, you are absolutely correct.

Krishna Raj: So I was assuming that this would decline over time. So if you can throw some light on the nature of how it moves over time that will be really helpful?

G. Shivakumar: We have borrowings in rupees which are swapped into dollars. Since we are a dollar base business, we have swapped those into dollars and there is a mark-to-market on this, a negative mark-to-market on this. The mark-to-market comes not just from the rupee/dollar swap but also from the interest rate swap because we have swapped them into fixed rate dollars. Therefore, there is a negative mark-to-market on those transactions. These will stay on our balance sheet till such time these borrowings are repaid which is starting in 2018.

Krishna Raj: You do not take the short-term provisions while calculating your NAV, right?

G. Shivakumar: No, we take them into it. The way we calculate the NAV is we take the entire balance sheet. All we do is replace book value of fixed assets with the market value, and then the shareholder funds is a balancing figure.

Krishna Raj: Although you earned Rs.146 crores as profit after tax, the shareholders fund has dropped by Rs.130 crores. So I should understand the balancing figure is a change in the cash flow hedges that goes to equity.

G. Shivakumar: Yes, large part of it will be that.

Moderator: As there are no more questions, I would like to hand over the call to Ms. Anjali Kumar.

Anjali Kumar: Thank you very much for joining us today. We will have the transcript of this call on our website in a couple of days. In case you have any more queries, please feel free to contact us.