# The Great Eastern Shipping Company Limited

**Q3 FY13 Earnings Conference call (February 08, 2013)**

**Moderator:** Good afternoon ladies and gentlemen, thank you for standing-by. Welcome to GE Shipping's Earning Call on declaration of its financial results for the quarter ended December 31st, 2012. I would now handover the conference over to Ms. Anjali Kumar, Head- Corporate Communications at GE Shipping to start the proceedings.

**Anjali Kumar:** Thank you. Good morning everybody. Welcome to our Q3FY13 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:** Good morning to all of you. As the results were out yesterday, I assume that you would have gone through the financial & market highlights which we disclose in our results press release. The NAV on a stand-alone basis as of 31st December 2012 was Rs. 249 a share and on consolidated basis was Rs. 429 a share. We can now start with the Q&A session.

**Moderator:** We have the first question from Bhavin Gandhi from B&K Securities.

**Bhavin Gandhi:** Can you help us understand why there was a sequential drop in profitability in the offshore segment. i.e Q3 over Q2?

**G. Shivakumar:** There was a profit on sale from one of the MSV that we sold in Q2 of about Rs.60 crs, whereas we did not had any profit on sale in Q3FY13. Also, we had a little bit of down time on one of our rig in Q3, where we had to do the intermediate survey. This was the main reason for the sequential drop in the profitability.

**Bhavin Gandhi:** Is this survey of the rig over?

**G. Shivakumar:** Yes, it was for a short while. It took about a week and was done in October-November.

**Bhavin Gandhi:** On the shipping side, the revenue days on a sequential basis were higher as you had the bunching up of spot days. So could it so happen that in the 4th quarter you might have lower revenue days as compared to Q3.

**G. Shivakumar:** Between Q3 and Q4 you could have lower revenue days but the nine-month run rate will more or less be sustained. Revenue days in Q3 were high because of the incoming-outgoing voyages, which may not be seen in Q4. If you take the general run rate of the three quarters I think it should be more or less around there in the Q4.

**Bhavin Gandhi:** Just wanted to check the status on the third-rig?

**G. Shivakumar:** She is now proceeding to the location. She will reach India in the next couple of days. So we hope she will be on hire sometime within the next week.

**Bhavin Gandhi:** What could be the mobilization costs that you have to incur on the rig?

**G. Shivakumar:** It depends upon the actual number of days. It also depends upon whether you do a dry or wet tow. The wet tow is basically when one or two anchor handlers actually tow the rig in water and the dry tow is when you load the rig on to a heavy lift vessel. The dry tow is much quicker but is also more expensive. Generally, bringing a rig from the Middle East to India might cost a little more than $1 mn on a wet tow.

**Bhavin Gandhi: T**here was also a contract cancellation which happened in January in offshore?

**G. Shivakumar:** No, the cancellation happened in the previous year. We got a refund along the interest and that income is booked in offshore.

**Bhavin Gandhi:** Is that the reason why sequentially the other income was higher for the quarter?

**G. Shivakumar:** That is correct.

**Bhavin Gandhi:** The commentary on the offshore side appears to be a pretty downbeat. Why is that so?

**G. Shivakumar:** Rates have not been very high for offshore vessels, especially for the lower end asset classes. Demand for Jackup rigs is pretty good but the two big growth areas i.e. Brazil and Australia which are also the two most expensive markets to operate in, are clearly witnessing a tapering off activity. Another thing is that a lot of new orders are still getting placed for offshore vessels. A lot of shipyards have moved towards building offshore vessels because they are not getting orders from bulk carriers or tankers. All in all the demand position is not looking very strong and the supply position unfortunately is going higher, which is causing a little bit of worry.

**Bhavin Gandhi:** The new orders which are placed recently will be delivered in the next couple of years. What is the current situation?

**G. Shivakumar:** You are right that the orders placed now will probably be delivered in 2014 and 2015. But the delivery position even for this year is pretty strong in both shipping and offshore. Close to 100 PSVs are expected to be delivered this year which is a pretty strong number especially considering that we do not have any phase out schedule. So a lot of it depends on commercial viability of existing vessels.

**Moderator:** We have the next question from Chetan Kapoor from IDBI Capital.

**Chetan Kapoor:** Will it be possible for you to share the fleet addition across various segments i.e. crude, product and dry bulk in CY12?

**Anjali Kumar:** On a gross basis we have seen 4.45% growth in crude, 1.72% in product and 10.35% in dry in CY12. The fleet addition numbers for 2013 also look pretty strong. For crude we see 9% fleet addition in CY13, 6% in product and about 15% for dry bulk. So the numbers are still quite alarmingly high. The scrapping numbers for CY12 have been 9.4 mn dwt for crude, 2.4 mn dwt for product and 33 mn dwt for dry.

**Chetan Kapoor:** According to your results commentary, it seems the Jackup rig charter rates have gone up, which goes against the argument that there has been a concern on the offshore front. Can you put some light on it?

**G. Shivakumar:** Yes, Jackup rig charter rates have been steadily going up since end of 2011, but are no way near the peak rates which they reached in 2007-2008. The fundamental difference between the Jackups and the offshore supply vessels is that there has been a real differentiation between old and new units in the drilling business however that is not happening in the vessel's business and therefore the modern drilling units have been getting a substantial premium in the charter rates against the old ones. The other thing is also that the supply of Jackup so far has not been very high. The order book of Jackups really kicks in from this year onwards, so we will have to see whether that has any impact in terms of the rates for contracts going forward. The thing on

Jackups is that we do not expect rates to go up very substantially from here because of the steady upward movement in the rates it has already witnessed.

**Chetan Kapoor:** I believe that one of a Jackup rig will be coming up for renewal this year? Do you have an option to renew it?

**G. Shivakumar:** No, we do not have an option, it is a contract which is coming up at the end of this calendar year. We are in discussions and have bid into some tenders. So far nothing has been finalized but there is certainly demand for new assets and hence employment is certainly not an issue.

**Chetan Kapoor:** **C**oming back to the shipping segment, what is the fleet addition in CY14?

**Anjali Kumar:** As of now**,** the gross fleet addition numbers certainly drop in CY14 as against CY134 and are sub 5% numbers in all categories. So that looks a little promising.

**Moderator:** We have a question is from Himanshu from M3 Investments?

**Himanshu:** I have two questions on offshore side. Are we seeing the new charter rates higher than the existing charter rates or the rates have softened? And the second question is on the Jackup rigs market. We are seeing Chinese shipyards building jackup rigs now. How cheap are these Jackup rigs compared to let us say Singapore or Middle East shipyards?

**G. Shivakumar:** The comparison on repricing of vessels depends upon where they were last priced. So if these vessels for instance were fixed last in end of 2009 for three years and they are going to be reprised now, they are certainly reprising lower. If they were fixed one-year ago sometime in the second half of 2011 and they are reprising now, they are certainly reprising higher. The markets were much higher in 2009 than today. So if you take today a base of 100, in 2009 they may have been 125-130 and in 2011 that might have gone down to 80 or 90. So markets are higher than one year ago but lower than three years ago. The important thing here is that utilization rates have gone up in some of the smaller anchor handling supply vessels as compared to 2011 levels.

Coming to your question with regard to the rigs, Chinese built rigs are certainly cheaper than Singapore built ones. It is not that they have been able to build very cheaply and this we have seen in shipping as well. The Chinese built new building contracts are not more than say 5 to 10% cheaper than an equivalent Korean built ship. Earlier, it used to get built mostly in Singapore. There was some little bit of supply coming in from the UAE and US. Now this is expanding to yards in China. So that is a little bit of concern because when those yards get into the business seriously then they start producing large volumes. So it is tough to say but as I mentioned with the rigs, the problem is the fact that there is addition supply capacity available rather than the price itself.

**Himanshu:** Is financing easier in Chinese shipyards because the Chinese government has been so aggressive. Are the payments terms much more easier as compared to Singapore?

**G. Shivakumar:** On the Jackups we have seen good payment terms from the shipyards. In some cases they are talking of even 90% on delivery.

**Anjali Kumar:** The difficult environment which shipping is facing in general, the same actually is not so applicable for the offshore market and therefore relatively they are in a much better space globally for funding..

**Himanshu:** When we say that 90% is the payment terms on the delivery, what would be the similar for Singapore yard? How much we have to pay at various stages?

**G. Shivakumar:** The normal rig building contractor in Singapore Yard would not be more than 20 or 30% on delivery, so 70 to 80% paid in stage payments.

**Moderator:** We have the next question from Vikram Suryavanshi from Antique Stock Broking

**Vikram Suryavanshi:** If on QoQ basis there has been good jump in our revenue days, is there any significant lower dry docking in this quarter?

**G. Shivakumar:** In Q3FY13 we had 20 days of dry docking as compared to about 60days in Q2Fy13.

**Vikram Suryavanshi:** We have good jump in our product tanker TCY. Will it continue?

**G. Shivakumar:** The market has been quite strong since then. It continues to be strong.

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

**Ashish Jain:** My question is on the consolidated NAV and the qoq uptake that we have seen. Is it because of better rates for offshore vessels?

**G. Shivakumar:** Actually it is not due to better prices for offshore vessels. The asset values are more or less the same. The impact is purely on account of the currency. One is the currency and the second is on account of operating earnings.

**Ashish Jain:** How would have currency benefit the quarter-on-quarter because?

**G. Shivakumar:** Last quarter we closed at Rs.52.88 and this quarter we closed at Rs.55. So let us just take one example of one vessel, the vessel valued at $30 million market value which has a loan of $20 million on it, so the $10 million of equity which was there in that vessel will be valued at Rs. 2 more now. That impacts the net asset value.

**Ashish Jain:** Given the kind of fleet addition you're talking about for the offshore industry, are we looking to increase our long-term charter for the support vessels?

**G. Shivakumar:** We have been looking to do some long-term charters. Again, it depends on what opportunities come up and the rates that come in. So if we have to give a large discount to take a long-term charter we are not really there to do it but yes, where the assets are vulnerable to adverse supply situation, we are looking to fix out. General principle in the vessel's market is to try to fix out for 1 to 3 years at least and so we're just following that throughout the cycle because we do not really dictate the tenure of the contract, it is the customer who dictates it.

**Ashish Jain:** Can you give some sense of where we are in terms of charters on our offshore vessels, basically asset class wise?

**G. Shivakumar:** I would not give specific numbers on earnings but typically you would on an anchor handler probably make somewhere around 15% return on equity at current charter rates. On the PSV you could still make a 20% plus return on it.

**Moderator:** We have the next question from Pankaj from Axis Mutual Fund.

**Pankaj:** I wanted to get some perspective from you on the shipping side in terms on the outlook on the freight market. What I essentially understand is there has been not much improvement on the freight rates except for some seasonality and fleet additions continue to remain at a high level. We have been expecting for a while now that this will lead to higher scrapping but somehow it seems that it is not happening at the pace what we have been expecting for the last couple of years. So if you could give some broader outlook in terms of how we are seeing things play out over the next 4 to 6 quarters?

**G. Shivakumar:** The outlook doesn't look very bright. It is the supply position which is causing the pain. In crude carriers it is about 9%, in product tanker it is about 6%, on dry bulk it is 15% to be delivered. We have seen accelerated scrapping last year which was an all time high for dry bulk. We saw close to 33 mn dwt get scrapped. Unfortunately that is still only 5% of the fleet. So you still have a 10% fleet growth for the year and the cargo growth is not 10%, which leads to poor markets. In CY12 also, we saw a 10% odd growth in the dry bulk market and even though cargo growth was pretty solid last year, we have seen rates gone down to really abysmal levels by end of the year. So in order to have some improvement in dry bulk you need to have an opposite situation which is may be 4%-5% fleet growth and 10% cargo growth. So it is difficult to see what could turn this around. On the crude tanker side, we also had US which is the biggest importer of crude reducing it imports very quickly which is down to 16 years lows because of their domestic shale oil production. Hence that market is also looking pretty bad. One bright spot is product tanker market, where the supply growth is not too high for this year, 6% and the fact that product movement has been pretty strong especially given that US refining capacity is doing well, refineries are exporting where they used to be importing.

**Pankaj:** So as far as dry bulk is concerned do you expect this year to be similar to last year?

**G. Shivakumar:** In terms of revenues, freight rates etc. yes, however that also provides opportunities for investment which is a different matter altogether. But in terms of freight rates, it is not going to be a great year.

**Pankaj:** Are we unlikely to see any significant improvement on the tanker side as well?

**G. Shivakumar:** Product tankers could do well and and generally the base seems to be a little higher now than it was two years ago for product tanker. But crude segment outlook looks weak.

**Pankaj:** The imports from US have reduced considerably. What implication does that have on our business?

**G. Shivakumar:** Considering that US import 5-6 mn bpd of crude and lot of it is long haul crude, it can have a huge impact on shipping at least for the crude tanker trade if it reduced significantly. Product trade not so much because they have already become net exporter of products. So that's not going to change adversely.

**Pankaj:** A few of the big LNG projects in Australia are either running far behind schedule or some of them have issues now with their viability. What implication does that have for both our businesses?

**G. Shivakumar:** Nothing really on the shipping business because we are not in the LNG carriage space. On the offshore business, yes, especially considering that we used to have an operation out of Australia, we had one vessel operating in Australia in the light construction business. We no longer have that vessel operating there but yes, it is a market that was expected to take in a lot of assets and it is being a disappointment to us. Projects that we thought were coming up in January or June of 2011 were still not seeing the light of day. So, yes, it is difficult and one of the reasons we hear is cost pressure because it is extremely expensive working in Australia. The costs really get built up and if US actually exports Shale gas than it is going to be very difficult for them to compete. On the offshore space, yes, it has a little bit of an impact because vessels that could be working in Australia are coming out and competing with us in other markets.

**Pankaj:** Finally, on this whole scrappage thing, somehow over the last two years we have been anticipating an accelerate scrappage but somehow it has been much lower than our expectations. Also, a lot of private equity players are putting in capital. So how does the whole thing play out and how we are thinking in terms of our asset purchase program in that context?

**G. Shivakumar:** You are absolutely right and it is concern for us as well. One of the things that was good about this down cycle was that you get opportunities to buy cheap if you have been saving up your money and if you not overextend yourself in the up cycle. So we were looking forward to some of the opportunities and as you pointed out, there is a lot of new money which has been coming into this business. That doesn't stop scrapping from happening but it just helps more new building orders placed. There are also these specific themes which these financial investors seem to be investing. One of the first scheme that came up was on the refined product space and therefore to invest in product tankers rather than crude tankers or bulk carriers. The latest theme is on eco-ships and all the benefits that go along with that. When you go into eco-ships you can only do that through the new building route because there are no existing eco-ships at least as of last year and therefore the new building order book is getting built up again specially on a product tankers side. So it is a concern, it's also keeping new building values from falling too much. Again the general word is that anyway it can't fall too much from here because yards are already making losses. Every week we see more orders being placed for vessels and not necessarily from financial investors, even shipping companies like us have been saving up their money for the bad markets, are placing orders.

**Pankaj:** **H**ow do we go about our vessel addition performance We have a vessel to be delivered in Q4FY15?

**G. Shivakumar:** We are trying to find pockets of value within the different segments that are there, trying to find where we can best deploy our cash, which segments are likely to perform and trying to get the best possible pricing on those contracts. That's what we're doing and not doing it in a huge way. Though, we believe that prices may not drop very much from these levels, we don't know whether they will be profitable at these charter rates. Hence we are doing small tickets of investments. The other thing is to wait and see if we really get cheap deals on the second hand market because there is a quite a bit of distress and the differential in values between a new building and say a 10 year old ship are very high now. You can get 10 year old ship for potentially 40% to 45% the cost of a new building vessels.

**Pankaj:** The inference that I am drawing is, as things stand probably in the next 3-4 quarters if at all we will restrict or add only a couple of vessels, not more than?

**G. Shivakumar:** Not a huge amount but I wouldn't say restrict or couple because you can do a new building contract. We have a couple of options on the contract that we have done already, so we could well exercise those options. It could well be 6-8 ships that we would buy, but it all depend on the value that we get. Again we are assessing and we have been assessing this for the last couple of years ever since the market value came down substantially from the high and whereever we find value we will be happy to invest. We would like to invest in the business except that we would like to do it at a value that make sense to us. So if we get those values next week we be there to transact next week because we have got a $600 million of cash and have leverage capacity.

**Pankaj:** I appreciate that but unfortunately the kind of disruption that we have been expecting is not happening for some reason or the other in the asset market?

**G. Shivakumar:** That is right, so as this stands today with today's prices, we are not going to do a huge amount of expansion but that could change next month if prices taken another step down, that is the only point I am making.

**Pankaj:** This new build we have contacted for a March '15 delivery, is that a signal in that sense that we think that the market are unlikely to improve until then and which is why we are contracting new builds for CY15?

**G. Shivakumar:** No, we could have squeezed it possibly to end of CY14 but we don't like taking deliveries in November-December because they become one-year-old when they are one-month old and that actually affects the value in the second-hand market. So it is just a very minor thing. The good yards have a solid order book at least for 12 to 18 months forward and therefore you will not get a delivery within 18 months generally from one of the top yards.

**Moderator:** We have a next question from Abhijeet Dey from BNP Paribas.

**Abhijeet Dey:** My question is regarding the offshore business. ONGC actually came out with a decision to reduce the age of the various offshore vessels that are eligible to participate in the tenders going ahead in various stages. So do you think this can make a change regarding the overall picture at least on the Indian water?

**G. Shivakumar:** Yes, the eligibility is maximum of 27 years. It is good for ONGC in the sense that at least one gets more modern vessels and the operations will be safer. It is not going to result in a great increase in rates for us i.e. rates for the service providers who have modern vessels and that also when there are enough modern vessels available. This is the point that we have been making all along. If there are safe modern vessels available then why take old vessels which are not as safe.

**Moderator:** We have a question from Suman Bhatt, an individual investor.

**Suman Bhatt:** Do you think asset prices have hit bottom or do you think they are still falling? The second question is on offshore side. You mentioned that the market outlook isn't looking great in terms of new build supplies. Will you be going slow on acquisitions on the offshore side?

**G. Shivakumar:** Coming to asset values, yes we have seen a substantial drop in asset values. In the last one year we have seen between 25% to 30% drop. Based on current earnings and based on the stress that we can see among the shipping fraternity, there is a possibility that these values could go lower. In some of the segments they have already at their historical lows. For instance in the product tankers or in the smaller crude carriers, they are at their historical lows. On the crude carrier segment there is a lot of stress and those are not yet at their historical lows. There is a possibility that they could go lower from the current levels. In drybulk also there is a huge amount of stress. So far we have not seen banks, lenders enforce and do fire sales of security ships that happened in the 80s and that really brought down the markets to very low. So far bank are held off from doing that for the last 3-4 years since the market went down. If that starts to happen in a big way then that will just be a downward spiral. So on the second-hand market you could well have cheaper prices on crude and dry bulk. On the new building markets, maybe there is not much scope for prices to fall. Currently none of the good yards have that kind of stress. A lot of the major yards also have the options to build other kinds of vessels like containers, drill ships etc.

**Suman Bhatt:** On the offshore side, will you be looking to add more assets?

**G. Shivakumar:** Standard vessels without a trade do not make a very good acquisition. If you can get a niche vessel for a particular trade or a requirement that your customer wants, then I think there is a value to that. Unlike shipping which is largely a commoditized business, offshore is very niche & specific business.

**Moderator:** We have a next question from Romil Jain from Quantum Advisors.

**Romil Jain:** How do you see scrapping in the offshore markets?

**G. Shivakumar:** Scrapping in supply vessels unfortunately goes completely unreported. In shipping you get details of every ship which has been scrapped. In the offshore market you may not even know about the vessels being removed from the market till maybe three years after it is been removed. They don't have a huge scrap value and therefore the scrapping is not a necessity. So what happens first is that they get stacked, basically they are parked in a place and they just wait for a market recovery and when they are parked you don't know whether they are being marketed or they just been parked. It's also the commercial requirements which will dictate whether an offshore vessel trades are not. So if all the customers in a particular region say that we will not take vessels more than 25 years old then that vessel is completely out. So even if there is two reasonable size customers who don't have any age restriction that vessel is always there to compete.

**Romil Jain:** Will the traditional ships go out of the market when these new eco design ships will start entering the market?

**G. Shivakumar:** No, the traditional ships will not go out of the system, they will just become less competitive and therefore they will be valued lower. So for instance if the fuel saving in a eco-ship is $2000 per day, you will get that priced into the differential between the price of an eco-ship and a non-eco-ship. The non-eco-ship will continue to trade, except that it will get a lower rate and because it is getting a lower rate it will get a lower price in the second-hand market.

**Romil Jain:** Can you provide the debt and cash numbers on standalone and consolidated basis?

**G. Shivakumar:** On a standalone basis, we have debt of Rs.3768 crs and cash of Rs.3261 crs. Whereas on the consolidated basis, we have debt of Rs.6620 crs and Rs.4139 crs of cash.

**Moderator:** We have a next question from Krishna Raj, individual investor.

**Krishna Raj:** My question is regards to the long-term outlook of LNG Shipping. The oil majors are forecasting that natural gas is going to be the largest growing fuel over the coming decades with concentrated supplies largely from US, Middle East & Australia. What are your views on the same?

**G. Shivakumar:** We do not own any LNG vessel and do not operate in that market. Buit we expect the market to grow in coming years. LNG as a fuel is a cheap & clean fuel. But we have a lot on existing new building orders for LNG ships which have been placed. Also, there is a big uncertainty factor which is whether the US will permit exports of gas or no.

**Krishna Raj:** Can we expect the Company to put money in buying LNG assets ?

**G. Shivakumar:** Currently we are not looking at deploying any asset in LNG.

**Moderator:** We have a next question from Bhavin Gandhi from B&K Securities.

**Bhavin Gandhi:** Will the offshore charter contract pricing in FY14 be more or less same as FY13?

**G. Shivakumar:** We do not give any guidance on the forward earnings, but one significant factor between the two years is that FY14 will have the full operating days of the additional rig.

**Bhavin Gandhi:** Would it be possible for you to comment that if the exchange rate remains at where they are what could be your realized loss by the year end on the foreign currency trancations?

**G. Shivakumar:** I do not have a number but it depends on the rates at which they have been forward sold and settled. This is basically the difference between the rates at which income and expenses have been booked and the rates at which the same have been realized in to Rupees.

**Moderator:** We have a next question from Himanshu from M3 Investments.

**Himanshu:** The average age of our Capesize, Panamax & Handysize dry bulk vessels is more than 15 years old. Are these vessels earning lower than the younger age vessels?

**G. Shivakumar:** Since the freight markets are so depressed, there is not much of a difference between what a 15 year old ship is earning and what the 2012 built ship is earning.

**Himanshu:** Is there any specific reason behind ordering a MR tanker? The order book in MR segment is also high as compared to LR segment? How do you read this?

**G. Shivakumar:** As you correctly pointed out, many MR tankers have been ordered as against LR tankers. The LR market was pretty subdued till recently. Again it is tough to put a number on the demand growth because that depends on the refined product trade which takes into account all kind of things including the price arbitrage between different regions. So yes, there is supply coming in of product tankers but we are quite positive on that business.

**Himanshu:** Is there a difference in long-term charter rates for an eco-ship and non-eco-ship?

**G. Shivakumar:** We do not have experience of our own on this but we have one listed player who operates eco-ships and who is very vocal about the advantages of those ships and they have been reporting that they are getting a substantial difference in the charter rate between an eco and a non-eco-ship.

**Moderator:** We have a next question from Chetan Kapoor from IDBI Capital, please go ahead.

**Chetan Kapoor:** What would be the price differential between a normal new building MR and an eco-designed MR tanker?

**G. Shivakumar:** Actually it is tough to say because yards are only building eco-ships now. There is nobody who is ordering non-eco ships now a days.

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

**Anjali Kumar:** Thank you very much for joining today. We will have the transcript of this call on our website in a couple of days.