"The Great Eastern Shipping Company Limited Q4 FY17 Earnings Conference Call"

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MANAGEMENT: **MR. G. SHIVAKUMAR – CHIEF FINANCIAL OFFICER & EXECUTIVE DIRECTOR**
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Moderator: Good evening, Ladies and Gentlemen. Thank you for standing by. Welcome to GE Shipping's Earnings Conference Call on declaration of its financial results for the quarter ended 31st of March 2017. At this moment, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. At that time if you have a question, please press * and 1. I now hand the conference over to Ms. Anjali Kumar, Head of Corporate Communications at the Great Eastern Shipping Company Limited to start the proceedings. Over to you, Ms. Kumar.

Anjali Kumar: Thank you very much. Good afternoon, friends. I hope you have had time to go through our results. And before we start with the market commentary, our CFO – Mr. Shivakumar would like to make a few comments on the results.

G. Shivakumar: Hi. Good afternoon, everyone. And thank you for joining us this afternoon for this results conference call. And I hope you would have had some time to go through the results. I would like to elaborate on some of the significant accounting impacts that have taken effect under IndAS, which of course we have mentioned in the notes to our results but I thought we should discuss those further.

The first and biggest impact is with regards to the treatment of the fixed assets on transition. We have exercised the option of valuing them at fair value at the date of transition. So, wherever the market value was below the book value as on 1st April, 2015, they have been written down to market value. This has the effect of reducing the block of the assets and also of reducing our net-worth at the time of transition. The amount by which we have written down the value of our rigs and ships is approximately Rs. 2,000 crores between the two of them. It is about equally divided between the offshore business and the shipping business.

The second choice which does not have an impact on the net worth is with regard to the swaps that we have on our debentures which are issued in India. The hedge accounting treatment on those transactions has been discontinued, so any future change in MTM will affect the P&L, we have already seen that over the last four quarters where we have had these swings in the MTM which has affected the P&L. And in this year, you would have seen that there is a swing of about Rs. 300 crores on account of the change in MTM on those NCD swaps. This is unfortunately going to give rise to a lot more volatility in our quarterly results because this moves along with the currency and the interest rate curve. But we will have to live with it because this is the accounting treatment that is prescribed for us.

The other matter which is not an IndAS matter is that you would have noticed that we have taken an impairment in our P&L in the current quarter as well. This relates to some of our offshore supply vessels whose value has fallen quite precipitously in the last few quarters. We do not just take the market value in to account for the purpose of deciding on the impairments to go into the P&L, we also calculate what is called the value in use. This is just an NPV of the future expected cash flows based on the market outlook that we have. Here, along with the market value we take the day rates, the day rates that are getting fixed for charters have gone down to extremely low levels. And therefore, when we project these earnings, even the NPVs of future cash flows have gone down significantly, and that is why we have had to take a large impairment on our books, this is about Rs. 175 crores plus that we have taken in this quarter.

There is an element of judgment which we can exercise in this. We have opted to take a more conservative stand with regards to what we expect on future earnings. This is in keeping with our general philosophy of conservatism at the Great Eastern Group.

So, with those opening comments on the results for the quarter and year, I would like to pass the floor back to Anjali so that she can discuss what has happened to the markets.

Anjali Kumar: Thank you, sir. We will just start with the market commentary on the three sectors in shipping that we are in.

Starting with dry bulk**,** we saw that Q1 of the calendar had a good run for this sector and this was largely on account of China. The quarter started off with a huge surge in coal demand from China, and to add to that steel output was up, and it was up not just in China but it was up across the world. And this caused the huge increase in demand for both iron ore as well as the coking coal shipments. To add to that, sometime in the end of February or early March there was a huge disruption in Queensland, on account of floods and that caused a major disruption for the coking coal shipments from the principal supplier to the world. And this demand had to be replaced immediately and it got replaced by the US East Coast and Canada, which was again conversion into a very, very long haul trade. Grain shipments also picked from the East Coast of South America in this period. And so, as we can see most of these things were all extremely long haul in nature. We had some weather-related delays as well. So all of this had a reasonably positive impact on dry bulk and that is how we saw the rates surge up sometime in February and March of the quarter. Post the quarter, there has been some decline in prices and the indices, mainly because of slowing down of steel output now, grain season has also eased out. And to add to that, we have seen some huge chunk of new building deliveries which have taken place in the dry bulk, in fact, approx 18 million deadweight has got added in this quarter and very little scrapping, just about 4.4 million odd of scrapping has happened in the first four months of the year. So, that has once again put pressure on the rates and we have seen rates come off from the highs of March.

Coming down to the next sector, which is the crude tanker sector. Crude tanker markets have been just trending one way actually from the beginning of this year, and have been significantly lower in- fact from year-to-date. And the major reasons, of course, the OPEC decision came sometime in the end of last year, but the actual impact in terms of shipping started really in January and February of this year. So that impacted the quantum of cargos. And to add to that, floating storage capacity got released, and that again put the ships in oversupply position. Crude inventory levels were also high. And here too new building deliveries were almost 8.5 million deadweight, which is more than 2% of the world global fleet which got added in the quarter. So, all of that put together we have seen a one-way trend down in the crude market.

On the product side also markets have been lower, although a little less than crude, crude has had a much larger battering. But having said that, demand has been low at the endpoint and that caused product tankers' rates also to be low. There have been some tremendous stocks piled up, both in the east as well as in the west, and largely in the consuming regions basically, so no long-haul voyages are happening. People are buying from the nearest possible stored or piled up zone, so all very short haul voyages are taking place. There has also been a big disruption in the Middle East, there have been some Middle East splitters which have had outages/maintenances. And there has also been one of the very large refineries which had a fire, and therefore they too have had a forced outage. All of this put together has seen a big effect on the cargos coming out of the Middle East.

Again, on the supply side, additions have been about 1.5% to the world fleet, almost 2.6 million deadweight has got added on here.

So, that is as far as the shipping side goes. Coming to the offshore, unfortunately the bad run in the offshore continues and utilization levels continue to be low in both rigs as well as on vessels. Tenders have become really fewer and fewer worldwide. However, the good news is that at least in India we have got some new tenders coming in, that gives us hope. But globally because this number is still very low, there continues to be a huge pressure on rates.

G. Shivakumar: Every quarter for the last year and a half or so we have seen assets going from working into idling. In this quarter, at least we have seen that number as zero, so no new vessels have gone from being employed to idle. I am talking about the global fleet here. It is too early to say if that is a sign of a turnaround, but at least it is one indicator, and we will have to see if this sustains. So, let us wait and watch going forward. But as Anjali mentioned, the rates are under severe pressure because of where utilization levels are, people are focusing on getting contracts and willing to take much lower rates just in order to get the contracts.

One more topic that I thought I should mention is ordering. Dry bulk ordering has been quite low, in fact minimal. But the one slightly worrying trend which is emerging is that a lot of VLCC orders are getting placed, and when I say a lot, I am talking of about 12 which have already been placed in this year. And there seems to be enthusiasm to place these orders because prices have gone down significantly, which does not bode well for the market over the next two to three years, we would like the order books to keep coming off. The order book for dry bulk is already less than 10%. The order book for tankers, whether it is crude tankers or product tankers, maybe slightly above 10%. But we would like those order books to keep depleting, because that is one of the things that helps in getting a turnaround in the market.

Coming to our specific numbers, the net asset value for Great Eastern Shipping standalone is approximately Rs. 331 per share. The consolidated NAV, again we give a range because the values of the offshore assets are not very clearly ascertainable, is somewhere between Rs. 375 and Rs. 415 per share.

So with that, I think we will throw the floor open to questions. We are happy to discuss the results, market outlook, anything that you would like to discuss about the business. Thank you.

Moderator: Thank you, sir. Ladies and Gentlemen, we will now begin with the question-and-answer session. We have the first question from the line of Bhavin Gandhi from Batlivala & Karani Securities. Please go ahead.

Bhavin Gandhi: Sir, just firstly starting off with the offshore EBITDA numbers. So, there seems to be almost about Rs. 90 crores decline sequentially, so is this entirely explained by the rig idling or is there anything else?

G. Shivakumar: It is mostly the rig idling. We had a couple of vessels coming off contract as well.

Bhavin Gandhi: Okay. So sir, how many vessels were idling during the quarter and how many are idling now?

G. Shivakumar: So, we had at various times up to five vessels idling during the quarter. As it stands today, two vessels are idling.

Bhavin Gandhi: So rest have got deployed?

G. Shivakumar: Yes, the rest have got deployed on short-term contracts. So, it is between one month and six months contracts.

Bhavin Gandhi: And sir, Anjali ma'am mentioned about new tenders coming in India. So, is there any timeline on that one, in the second half of this year or so?

G. Shivakumar: We already have the tender out, so there has been a tender out for rigs, there has been a tender out for some vessels as well. So, these will get bid in, so the vessel tender closes in about 10 days' time and the rig tender closes in June, submissions are in June.

Bhavin Gandhi: And then the deployment starts to happen from when?

G. Shivakumar: It is 45 days after award for vessels and 180 days after award for rigs. So, you would typically expect that this will take a couple of months at least to award. So, basically you are talking about post monsoon on the West Coast, so sometime in October let us say.

Bhavin Gandhi: And sir, is it also possible to know how many rigs are being bid out for?

G. Shivakumar: I think it is eight, but I can just reconfirm that.

Bhavin Gandhi: And sir, just wanted to understand the impact that we have taken in the net worth on the fair value side. So if I understood it right we have taken about Rs. 1,000 crores impact on the offshore side and about Rs. 1,000 crores on the shipping side.

G. Shivakumar: That is correct.

Bhavin Gandhi: So, this Rs. 1000 crores seem to be a low number. I mean, if we add $1 billion in the fleet value on the offshore side, that seems to be like an 18% impact, I thought the impact was much higher or it was just up to March 31, 2016?

G. Shivakumar: Yes, this was based on the values of April 1, 2015. So while values had dropped by then, they have dropped significantly after that. So, we can only reflect it up to that date.

Bhavin Gandhi: And sir, if it is possible, can you just help us better understand the impact of forex variation on the P&L going forward, how one should look at it?

G. Shivakumar: Before anything else, it is eight rigs which the tender is out for, eight jack-up rigs. But coming to the forex, there are two opposite sides of impact that we have. So on one side we have liabilities of about $580 million, which is all the loans which are denominated in dollars, including the NCDs which are swapped into dollars. So, there you can take it and this is very rough, and just taking into account the forex impact and not assuming anything happening to the interest rate curve, because that also affects it. So for every Rs. 1 appreciation against $1, you would get Rs. 58 crore positive impact, and these are again rough numbers that I am giving here. On the other side in Great Eastern Shipping itself, we have a little over $300 million in cash and that is kept in actual dollar cash, where the same Rs. 1 appreciation would have a Rs. 30 crore negative impact. So net-net you have approximately a Rs. 25 crore to Rs. 30 crore positive impact for every Rs. 1 appreciation. Last year's MTM changes also had a large element of interest rate movements, but we cannot forecast those, what I have described to you is purely on exchange rate itself.

Moderator: Thank you. Our next question is from the line of Vikram Suryavanshi from PhillipCapital. Please go ahead.

Vikram Suryavanshi: Sir, basically, is there any change in age of vessels which are going for scrapping particularly in dry bulk compared to last year?

G. Shivakumar: No. Actually if there is a change in age, it is for the worse, in the sense that in the first quarter of last year we had 14 million deadweight scrapped. First quarter of this year you have, 4.5 million deadweight scrapped, in terms of the market mood. Last year you had 15-year-old vessels, I think even 14 year old vessels which were scrapped, this year the age is much higher, because earnings are higher, the general mood is positive.

Vikram Suryavanshi: And the eight jack-up rigs you are saying that is mainly by ONGC, the tender is for requirement of eight rigs that is what I understood.

G. Shivakumar: That is correct. It is an ONGC tender for eight rigs.

Vikram Suryavanshi: Okay. And how is the situation? Are we seeing improvement in support vessels as well apart from India and global market?

G. Shivakumar: You are saying in the global market or in the Indian market?

Vikram Suryavanshi: Support vessels in global market.

G. Shivakumar: Global market again is quite weak, so utilization is somewhere around 50%. Utilization meaning utilization on term contracts. Contracts are happening so far in the North Sea, but the rates are quite poor. We ourselves have landed some contracts, we have got a contract in South Africa. We landed a repeat contract in the Far East. So, there are contracts to be had, but not at very high rates. So for the good operators there are contracts, they have a chance to get some utilization; but again these contracts are few and far between. There is a lot of competition for them, so pricing is not very lucrative.

Vikram Suryavanshi: And I just missed the number in terms of scrapping you said in terms of tanker side, is there significant scrapping happening?

G. Shivakumar: Very little scrapping, less than 1 million deadweight of scrapping.

Vikram Suryavanshi: Both including product?

G. Shivakumar: Yes.

Moderator: Thank you. Our next question is from the line of Vaibhav Barjatya from HNI Investment. Please go ahead.

Vaibhav Barjatya: I just need one clarification. So, after this accounting changes that has happened, would it be fair to say that your assets will always be at market value or value in use, whichever is lower?

G. Shivakumar: No, that is only a one-time thing which was done, which is as of April 1, 2015. Now every quarter in shipping and every year for offshore, because the liquidity is different in offshore; we will see the market value, we will see the book value, we will also see the value in use; if necessary, we will take an impairment. So the higher of market value or the value in use, which is the NPV of future cash flows, will be taken for purpose of calculating impairment. So, if you have a ship which is in our books at 20, the market value is 15 and the value in use is 18, we will impair that ship to 18. If the value in use is 20, we will not impair that ship. It is not based purely on market value, that purely market value was only for the purpose of transition. We cannot do that on a quarterly basis because the market is quite volatile, we do not want to keep having these swings in our books.

Moderator: Thank you very much. Our next question is from the line of Parthiv Jyotsna from NVS Brokerage. Please go ahead.

Parthiv Jyotsna: I just have two questions. First, I would like to know what would be the average of freight charges for the shipping basically?

G. Shivakumar: Sorry. I did not get that question.

Parthiv Jyotsna: Yes, so I just need a rough average across like a ton average or something like that.

G. Shivakumar: So, we measure that on a day rate basis. So, that is in our press release, we can look at the crude tankers we have an average, which is given for the last quarter. So in this quarter we earned $20,897 on average across the crude tankers and for product tankers $15,800, across the bulk carriers $8,300.

Parthiv Jyotsna: And just a second question, how do you look as a company going forward say next year, year-and-a-half, two; just like a basic future outlook.

G. Shivakumar: So, dry bulk we think has bottomed out last year. The recovery part is likely to be there, first quarter was quite exciting because the volumes are very high, but that was unusually high. We expect a recovery in dry bulk, but maybe not as fast as we saw in the first quarter of this year. So, we should have gradual strengthening from here going forward. In tankers, whether it is crude tankers or product tankers, we believe that the market has not seen its worst point yet, maybe you will see that in this year or next year. After that it should recover because the supply of new ships will be lower and therefore you will have some recovery after that. In offshore, it is likely to get worse or stay at these levels for some time before it gets better. It is tough to call that recovery, it will depend on how the oil companies react. Hopefully we will get some stability in the oil price in the $50 to $60 per barrel range, and hopefully the oil companies will come back. But it is really tough to call that one. But we are not expecting a recovery in this year, maybe not in the next year either.

Moderator: Thank you very much. Our next question is from the line of Yash Matai from Vibrant Securities. Please go ahead.

Yash Matai: Sir, can you give me any guidance over how much crude carriers, product carriers are you going to add like in FY18 or like how much capacity addition will be happening in next year?

G. Shivakumar: No, we do not know how many ships we will be adding. We know that we have committed to add one product tanker, which will be delivered to us within the next month or two in this quarter, but that is what we have committed. We do not know if we will buy any further ships. It will depend on whether we get good ships and at what price we get them.

Anjali Kumar: So, we continue to look for opportunities in the three sectors that we are in, but it is difficult to say at this point what is it that will be finalized.

Yash Matai: But currently we are somehow at a very high in terms of deadweight, am I right now?

G. Shivakumar: We are at the highest that we have been in our life in terms of deadweight. Is that the question you are asking?

Yash Matai: Yes.

G. Shivakumar: That is right, we are at our highest ever deadweight.

Moderator: Thank you very much. Our next question is from the line of Jaykant Kasture from Dolat Capital. Please go ahead.

Jaykant Kasture: With the crude prices going down so like do you anticipate any losses, because there is high likelihood that you might not be getting tenders open for the rig orders?

G. Shivakumar: I take it you are talking about the offshore business.

Jaykant Kasture: Yes, that is right.

G. Shivakumar: The crude prices do not have such a straight correlation with rig utilization. Yes, they have gone down so the market has gone down because crude prices have been low, but I do not think it will react to this $3 to $5 change in the prices. It is not that it is stronger today than it was one year ago when it was $30 to $35 per barrel. So it does not move with those things, it is more on the mood and how they perceive the stability of the price going forward. In any case, in India the biggest player in the market among the customers is ONGC. I do not think they look at the short-term movements in the crude price to decide whether they are going to drill more wells, operate more platforms, etc. So, I do not think this is going to impact anybody, the fact that in the last one week it has gone down by $3 or $5.

Anjali Kumar: So in a sense it is more to do with the long-term trend in prices rather than the short-term.

Jaykant Kasture: No, but if in case in long term if prices go down to say like $30, $35 somewhere around that line?

Anjali Kumar: Yes, surely it will get impacted.

Jaykant Kasture: Then you see impact in that?

Jaykant Kasture: So, could you like give me a kind of percentage impact if possible?

G. Shivakumar: I do not think there is a number for it, if we were to give you a number, it would be just sheer guess work. There is no relationship or equation that we can put in place. But keep in mind that our home market is India, this is where all our rigs are today, this is where 70% of our vessel fleet is today. India is a place where there will be exploration and production for oil. We need to do more and more production of oil. ONGC has big plans. We do not think that this activity will go down to zero just because it is $30 a barrel. And therefore we think that there will be activity in the market, it is not that they will stop activity. At some point even at $30 per barrel and the longer it stays low, the more there will be a problem and the more it will bounce back strongly. This is what has happened and resulted in the big boom from 2003 to 2008. It stayed low for some time, therefore there was under investment and therefore when the demand suddenly picked up you found yourself caught short. This happens in all commodity markets, so it is not a permanent thing, and especially in our market. The national oil companies are going to keep drilling for oil and trying to produce more oil and gas.

Moderator: Thank you very much. Our next question is a follow-up question from the line of Bhavin Gandhi from Batlivala & Karani Securities. Please go ahead.

Bhavin Gandhi: Sir, just two more questions from my side. One is, if you can explain the sequential decline in other income in this quarter?

G. Shivakumar: It is the treasury income, so investments in debt mutual funds and interest rates move has an impact.

Bhavin Gandhi: **A**nd sir, how many OSVs will be coming out for idling this year?

G. Shivakumar: There are some which are working on short-term contracts.

Bhavin Gandhi: No, other than those which are not, other than ones which are on contract?

G. Shivakumar: There will be three or four additional ones for which we will have to find work in this year.

Moderator: Thank you very much. Our next question is from the line of Chintan Sheth from Sameeksha Capital. Please go ahead.

Chintan Sheth: Sir, in the press release when you mentioned the TCYs, that is time charter yields on our ships, is it basically for the time charter or which includes the spot market activity yields also on the average?

G. Shivakumar: Everything.

Anjali Kumar: So, it is a blend of both.

Chintan Sheth: Okay. So we can use it as a blend, right?

Anjali Kumar: Yes.

Chintan Sheth: And on the revenue share, I have been seeing this company very recently, if I see your revenue on the segmental side, total of the shipping and offshore revenue does not match with the consolidated net sales, why is that? So, when I say quarterly, we have posted segmental revenue of Rs. 875 crores this quarter and income from operation is Rs. 747 crores.

G. Shivakumar: Yes, this includes other income. The shipping will include other income in the shipping business.

Chintan Sheth: 622 includes the other income part?

G. Shivakumar: Yes, in the segmental reporting. The other income from the shipping company will be reported in the shipping segmental income.

Chintan Sheth: Okay. And from the standalone revenue, which is primarily the shipping side right or shipping business?

G. Shivakumar: Yes, that is right.

Chintan Sheth: In our consolidated segment, do we have any other ships in our subsidiaries or this shipping includes only standalone revenue only?

G. Shivakumar: We have one chartering subsidiary, but that is very minor, it is insignificant.

Chintan Sheth: Okay. So it is basically shipping plus other income?

G. Shivakumar: Yes.

Chintan Sheth: Okay. Standalone revenue plus other income which will add up.

G. Shivakumar: That is correct.

Chintan Sheth: Okay, sir. And on the fleet size, we are already at the historical high. So, you already mentioned in your comments that apart from the dry bulk most of tanker business has not seen the bottom yet and we have prepared ourselves for preemptively when the market is ready with more orders and more trade and transaction logistics basically. So, what is your view over the next three, four years, five years basically?

Chintan Sheth: Five years in terms of rates hovering around at what level?

G. Shivakumar: I cannot put a forecast on rates. But I think what I mentioned is directional, which is that last year was a bottom for dry bulk, this year and maybe first half of next year may be the bottom for the tanker business. I think that is all we can say because the rest of it, as I said earlier, is just guess work to put a number to the rates.

Chintan Sheth: Okay. And the book value right now with the adjustments and impairment revaluation, our book value will more or less equal to over NAV value, right?

G. Shivakumar: In standalone, it is more or less equal. In consolidated, it is significantly higher. So, the consolidated book value is about Rs. 480 per share while I mentioned that the consolidated net asset value is between Rs. 375 and Rs. 415.

Chintan Sheth: Because of the offshore basically.

G. Shivakumar: That is correct, yes. Because the offshore assets' market value is significantly below the book value, some of the assets.

Moderator: Thank you very much. Our next question is from the line of Giriraj Daga from KM Visaria Family Trust. Please go ahead.

Giriraj Daga: I have like two questions. First, will we have the NAV value for FY16 and FY15?

G. Shivakumar: In March 2016, I think it was Rs. 336. March 2015, I think it would have been around the same number, but I can tell you in a minute.

Giriraj Daga: They were all standalone operations, just to clarify?

G. Shivakumar: They are standalone. Last year we did not look at consolidated because it was even more difficult getting the offshore values. But this was on standalone basis.

Giriraj Daga: So, the consolidated not available on last year?

G. Shivakumar: Yes, the consolidated was not available last year. So, it has been around Rs. 336 last year and previous year around Rs. 320.

Giriraj Daga: And just on my next question, when I look at your deadweight at 3.75 million tons, you are talking of primarily both the markets, dry bulk as well as tanker, right?

G. Shivakumar: That is right, that is the full shipping fleet.

Giriraj Daga: How do you break this 3.75 million ton into the tanker and dry bulk?

G. Shivakumar: Probably 1.1 million - 1.2 million ton in dry bulk. So, about 30% dry bulk and 70% tankers.

Giriraj Daga: Normally the capesize is about 150,000 dead weight tonnes, right?

G. Shivakumar: 180,000 deadweight tonnes. Kamsarmax are 80,000 deadweight tonnes.

Giriraj Daga: And Supramax are 50,000 deadweight tonnes?

G. Shivakumar: Yes, 50,000 to 60,000 deadweight tonnes. So, we have about 1.1 million to 1.2 million deadweight in dry bulk.

Giriraj Daga: And the remaining in tankers?

G. Shivakumar: That is correct.

Moderator: Thank you. Our next question is from the line of Ashish Jain from Morgan Stanley. Please go ahead.

Ashish Jain: Sir, I just want to understand on this ONGC contracts, on regulatory terms how are we positioned versus global players, as in what advantage do we have, if any?

G. Shivakumar: A couple of advantages. The main advantages are with regard to the specification of the rigs, which include the footprint of the rig and the weight of it. So, it is the footprint and the weight. If we are standing next to a platform and drilling, we need to have a specific footprint which matches the rigs which have drilled there before. Only some designs of rigs can have those. So, you cannot bring in a new design rig which does not match that footprint. Second is, in a lot of these platform locations you also have a weight restriction of the rig, because the seabed can only take so much pressure, it is a slightly softer surface. Those are the two things which are technical, let us call it barriers to entry, or at least it makes it a little more difficult for somebody to enter here. The next thing is with regard to cost, and this is for any market, not just India. With regard to cost, because you need to have a local presence in order to operate, you cannot operate this remotely. This needs somebody on the ground here managing the drilling business and liaising with the customer on a day-to-day basis. And that involves costs of setting up an office here. So, that is one thing which especially if the market is as it is currently, which is a low margin scenario, that puts an additional burden. The other commercial factor is the mobilization cost that you put in. Again, these tenders which are out are for three year contracts, so you need to be mobilizing your rig, depends on where you are currently. If it is from the Middle East, maybe you will spend $2 million to come here. If you are in Southeast Asia, maybe it is $4 million to come here. Whatever that number is, I am just giving us some numbers as an example, they may not be the exact numbers now. So, you have to add that to your costs and see whether you will recover it over the period of the contract, because you do not know if you will get the next contract, right. That is one additional start-up cost that you have to get the business. While if we are here already that we are an incumbent sitting in position here. These are things that can discourage somebody from coming into a new market.

Ashish Jain: And sir, technically can you bid for two rigs in these contracts, because I guess one more is expiring in 2018?

G. Shivakumar: Yes, you can bid for two rigs.

Ashish Jain: Okay. Because the deployment will only happen in second half as you said.

G. Shivakumar: Yes, it will happen after the second half. So for instance if it is in June, it is not going to get decided before August. And let us say it gets decided in August, that is the earliest it can happen, that gives you up to February in order to mobilize it and our rig comes off contract around that time. So, we can technically bid the second rig.

Ashish Jain: Okay. But for the one which is already off contract so basically next three months is idling for that?

G. Shivakumar: That is correct. It is very likely to be idle.

Ashish Jain: But on the contrary, is there any chance that you can generate something on that in terms of revenue?

G. Shivakumar: We are always trying to find some work, but we have not got anything so far.

Moderator: Thank you. Our next question is a follow-up question from the line of Vaibhav Barjatya from HNI Investments. Please go ahead.

Vaibhav Barjatya: Just on this Rs. 2,000 crores adjustment to net worth, this was optional or it was compulsory to do this?

G. Shivakumar: It was optional.

Vaibhav Barjatya: So just to understand the management thinking better, why we have opted for this write-off and not otherwise?

G. Shivakumar: We thought that the book values of the ships should more accurately reflect their market values and since that option was there we thought that we should not have a net worth which is not a correct representation of what they are. Overall, we take a fairly conservative approach to all these things so where we can, we will do these write-downs. I mentioned earlier that this impairment which we took in offshore, we did not have to do it. We did not have to do it in the sense that because there is an element of management judgment which can come in, which is with regards to the future earnings that you expect. So if we say that we are going to earn what we earned as of 2011, 2012 which was a much higher rate than today, then there would be no impairment to be recognized. However, we take a conservative view on this, we do not think those rates are there to be earned today, obviously the market is different. And based on that, there is an impairment. So, we would like to take a conservative view with regard to all these things.

Vaibhav Barjatya: And going forward, so whatever will be the fluctuation that will come into P&L, right?

G. Shivakumar: No, the fluctuation do not necessarily come into the P&L. We are not going to revalue to market every quarter, I mentioned that earlier also. Every quarter we will measure for all the assets where the market value is less than the book value, we will test them to see if the NPV of future cash flows is higher than the book value. If that is also lower than the book value, then we will write it down. Otherwise this does not have to go into the P&L on a quarterly basis.

Vaibhav Barjatya: Okay. So going forward, it would be the test of impairment?

G. Shivakumar: Yes, you have to do the test of impairment so you have to write-down to either market value or value in use, which is basically NPV of future expected cash flows. If both of those are below, the higher of those is the value that you can take. If that is lower than the book value, then you have to take a write-down. If that is higher than the book value, there is no change to be recorded, you keep it at book value.

Moderator: Thank you very much. Our next question is from the line of Dhwanil Desai from Turtle Capital. Please go ahead.

Dhwanil Desai: Sir, I have two questions. One is, I want to understand in your experience how does the fixed asset behave during up-cycle and down-cycle both? Because what I observed is that during up-cycle, your fixed asset terms are around 0.5 times to 0.65x, around that range, and we have come down to around 0.3x level now.

G. Shivakumar: Sorry, I did not understand - how does what behave?

Dhwanil Desai: The fixed asset terms. What I am saying is the ratio of revenue to net block?

G. Shivakumar: Okay. That is not something that we follow at all.

Dhwanil Desai: So, is that an important parameter to look at or that is not a very relevant parameter?

G. Shivakumar: It is a significant parameter, yes, but not really an important one. No, I would not hazard a guess on it because we have not looked at it that way, because it would not be on a revenue basis, it will be more relevant on an EBITDA basis. And last year at this time, dry bulk you had zeroish EBITDA, you had a very marginal EBITDA, so your ratio was very high, though the asset values had collapsed also. In good markets, typically your ratio will be lower, and that is when your asset values are also extremely high. I would not really use it as a metric.

Dhwanil Desai: And second, sir, I just wanted to understand your thought process around the new capital allocation in terms of buying a ship or buying a vessel, whatever it may be. How do you look at in terms of the certain minimum threshold and do you look at the same way in terms of working out your basic IRRs and look at the cash flows and decide and what's the threshold that you work with?

G. Shivakumar: So, the threshold that we want to earn is at least 10% on total capital in dollar terms. So that is our threshold, that is what we would like to earn. When we look at a project, we see whether we think we can earn that, and this is on an IRR basis, this is not on a running yield basis, because that is quite rare. And so we look at that and we see under what scenario do we think can this 10% come through and do we think that scenario is likely to happen. So, if it means the scenario is that asset prices go up to 100%, only then we will make 10%, then we say okay that is not going to happen and therefore it does not make sense to do.

Dhwanil Desai: Okay. So, the important parameter here is IRR and not the ROC, is it right because then ROC…?

G. Shivakumar: That is correct because you make a lot of it from the appreciation or you lose a lot of money in the depreciation in the asset value.

Dhwanil Desai: Right. But I have been considering the way shipping rates behave and the volatility in that, but projecting cash flow is always a challenge, especially if you go far out. So, your estimation of IRR, do you have scenarios worked out and then most likely scenario up, I mean what is the thought process around fixing that uncertainty part around that return numbers that you have?

G. Shivakumar: Yes, so we do not do so much modeling as to create scenarios of the cash flows. But we look at a scenario where we think it is most likely to play out, and again we take a fairly conservative approach to this. We do not assume any very high numbers historically. We take at or below market averages for our projections.

Anjali Kumar: So, we take long-term averages when we take our cash flow projections.

Dhwanil Desai: Okay. So, the long-term average is of the typical realizations that you would have got from each segment?

G. Shivakumar: Sort of correct, yes. At or below, we take sometimes below the long-term averages as well based on what we think is likely to happen to the market, how it is likely to develop over the next few years.

Dhwanil Desai: And based on that if your expected IRR is more than 10%, then you go ahead and buy?

G. Shivakumar: That is correct.

Anjali Kumar: So, that is just one of the things that we do. I mean, other than that there are many more qualitative things that we also look at like what is the demand outlook for the particular commodity that this particular category of ship may carry, what is happening to the production, what is happening to the sourcing regions and where is the import happening from. So, a lot of that is also taken into consideration. So, the financial IRR modeling is just sort of the base level which is used.

Dhwanil Desai: Yes, I mean one thing is this will decide go or no-go. I mean if it is below 10% then probably some of the qualitative criteria may take a back seat or is it the other way round?

Anjali Kumar: Qualitative criteria are the main thing.

Moderator: Thank you. Our next question is from the line of Ashish Jain from Morgan Stanley. Please go ahead.

Ashish Jain: Sir, I just had one question. On dry bulk the optimism you have, is it from stronger production/demand in China or you think it is more about how the global trade is shaping up in terms of where the cargo is originating and that kind of stuff or is it a mix of both?

G. Shivakumar: So, first of all, if you have read some optimism in our words then I hope we have not given too much of optimism. Though the market has bottomed out, and we think we have seen the worst of it, we do not expect anything great to happen in dry bulk, we said that there is going to be a gradual recovery. But yes, we think that trade will continue to grow, we do not think it is a dire scenario where trade is going into negative growth. Trade will grow at a slow pace, we have a new normal of a slow pace of trade of growth, and with little blips in between like we had in the last quarter which is on an annualized basis probably a 3% trade growth. So, you will get these little blips where you can get back to decent levels of earnings. Yes, we will have, as I mentioned, trade growth, and because China is a significant driver of trade growth in dry bulk, we think that they will go along. They are not going to be growing 9% or 10% like they used to, but they will still be importing these commodities in a significant way. Their imports in the first quarter were increased by almost 40 million tons just in one quarter, which is on an annualized basis 3% plus trade growth, and that is just Chinese imports increasing. So, it will go up. So, the gradual recovery scenario we are talking about has two or three different things. One is supply growth slowing down, the order book is now down to below 10%, and there could be cancellations in that as well. There is trade demand being reasonably okay, it does not have to be a great number; but 2% - 3% is still good enough for a market recovery. So, that is a couple of things really which makes us, at least think that we have seen the worst of the dry bulk market and we should see a slow recovery going forward.

Moderator: Thank you. Our next question is from the line of Deepak Kapoor, an Individual Investor. Please go ahead.

Deepak Kapoor: Two quick questions. The first one is, just trying to understand your view on calendar year FY17 - FY18 this year, you think it will be a net-net addition in the dry bulk capacity?

G. Shivakumar: Yes, we think that there will be a net addition in dry bulk capacity, yes. But it will be a 2% to 3% fleet growth.

Deepak Kapoor: Okay. Second question I have is to understand…

G. Shivakumar: Sorry, were you asking about Great Eastern Shipping or the World fleet?

Deepak Kapoor: World fleet.

G. Shivakumar: Yes, so world fleet 2% to 3% in the next year or so.

Deepak Kapoor: So I have been trying to research on this industry and I came across some articles which said that when demand slows down shippers operate their ships at a slower speed to save on fuel, like slow steaming. And, so when prices become remunerative some capacity comes back just by ships traveling faster.

G. Shivakumar: That is correct. At least in theory, that is absolutely correct. If you model it and you look at the optimal speed at different fuel prices and freight rates, you will get a curve on what is the optimal speed at different freight rates and fuel prices. And obviously it will state that when you are earning more money, you should go faster. However, it does not always happen that way. We saw it in the tanker market in 2015. So between 2010 and 2014, probably the average speeds came down by 10% to 15%, probably closer to 10%. Which meant that effectively 10% of capacity had been taken up when speeds go down.

Deepak Kapoor: And that can come back?

G. Shivakumar: In theory that can come back at any time, but it did not come back because that would have killed the tanker market in 2015. So, you would have had basically two or three good months and then the market would have got killed because everybody came back to full speed. But it does not happen that much really. So, when people go into slow speed, they stay at slow speed for quite a long time. They do not go back into speeding in a hurry.

Deepak Kapoor: So even post-recovery, it is a gradual pickup.

G. Shivakumar: That is correct. It is only a gradual increase.

Deepak Kapoor: Okay. I have another question regarding the ballast water treatment system, I mean the regulation coming September onwards. What kind of impact will it have on GE, how many ships still need to be retrofitted, how many are already fitted?

G. Shivakumar: Only our new buildings have the ballast water treatment system, which is as of today six ships already have this fitted and everything else, which is 40 other ships will need to have this fitted, if they still need to operate in five years' time.

Deepak Kapoor: So, the average cost will be about $1 million?

G. Shivakumar: No, much less than that, we believe it is much less than that. So probably it is something between $0.5 million and $0.75 million, let's say, per ship. So, that is the cost. Now, when it is going to come into effect, we do not know. There are lots of options, which are being discussed by the regulators. So, that we will probably get to know within the next three months or so.

Anjali Kumar: Do our ships operate in US water?

G. Shivakumar: Yes, they do.

Deepak Kapoor: Because the US Coast Guard has not approved the ballast system yet from what I understand?

G. Shivakumar: Ballast water treatment system?

Deepak Kapoor: Yes.

G. Shivakumar: I think they have approved for now some two or three systems. So, that is what is causing uncertainty. So even if you want to comply, you do not know what to comply with. So all this uncertainty and therefore we do not think that it will come in a hurry, because then trade will just come to halt if you do not know what you are supposed to do. They have come in with a rule, but you do not know what you are supposed to do to comply with the rule.

Deepak Kapoor: Sir, the Indian Government's emphasis on coastal shipping inland waterways, does GE have any plans apart from getting into container shipping?

G. Shivakumar: Not really, there is enough for us to do in our businesses in dry bulk and tankers rather than thinking of getting into another. But just to clarify, we participate in a very significant way in the coastal shipping in India, whether it is movement of petroleum products or movement of dry bulk commodities. We have a big position here, so we have probably 25% - 30% of our fleet, which is operating in and around India, sometimes more also.

Deepak Kapoor: Because I thought that because even containership values are at historic lows?

G. Shivakumar: Yes, that is not our business really.

Deepak Kapoor: These asset values might be remunerated?

G. Shivakumar: Yes, it is just a very different business. They happen to be ships and they move from place to place, but it is a very different business from commodity shipping.

Deepak Kapoor: Last question on the fair value adjustment, these are going to be a balance sheet adjustments only?

G. Shivakumar: That is correct.

Deepak Kapoor: So what I see on the P&L statement the impairment charges, that is something different?

G. Shivakumar: Yes, the impairment tests that we have to do, that is on an ongoing basis, it will have to happen every accounting period.

Deepak Kapoor: Okay. So that is the only P&L item, but these fair value adjustments are balance sheet?

G. Shivakumar: That is right. And that balance sheet and that only happened at once when you did the transition from old Indian GAAP to IndAS.

Deepak Kapoor: **A**nd here onwards, it is largely impairment checks?

G. Shivakumar: That is correct.

Moderator: Thank you. Our next question is follow-up question from the line of Chintan Sheth from Sameeksha Capital. Please go ahead.

Chintan Sheth: Sir, wanted your view on the shipbuilding side. You mentioned that new building orders are down 10% and how are you seeing the shipbuilding industries performing basically?

G. Shivakumar: I do not know about their performance, I know that they are not getting too many orders. So now there have been a few orders which have been placed, I mentioned that VLCC's people have ordered some 12 - 13 VLCCs in the last few months. But the shipbuilding capacity will shrink over a period of time, it has already shrunk in the last four, five years, it will shrink further because there is less demand for ships to be added. It is as simple as that. It is good that it happens because that is again part of what will help the recovery of the shipping industry itself. So, over the medium-term we expect that shipbuilding capacity will keep shrinking.

Chintan Sheth: So what is the capacity right now, your estimate and what was it five years back?

G. Shivakumar: It is probably down 25% from five years ago, but it had more than doubled in the previous 10 years. So, it is going to keep coming down.

Chintan Sheth: That cycle also repeats, right, basically bankrupt and then they pop up?

G. Shivakumar: That is correct. That is like every other commodity business.

Chintan Sheth: But what is the lag period in the transition between these two phases? So right now we are having bottom of the cycle and they are facing trouble?

G. Shivakumar: This is a very long cycle, this takes 5 to 10 years to play out really. Because you need to build the capacity right, it is not like buying a ship. You can buy a ship and starting earning from tomorrow, if you had to setup, a shipyard, or reactivate a shipyard, an old shipyard, you need to get the people first, and you need to get all the equipment working. Then you need to have the designs, you need to have the technology, you need to be up to date with the technology to build the current type of ships. You may last built a ship five years ago, which is very different. We saw this in rig yards. A couple of yards which wanted to reactivate which had last built rigs 20 years before and it is very difficult to come back into the market. Of course that is an extreme case where they were trying to come back after 20 years gap.

Moderator: Thank you. Ladies and Gentlemen, that was the last question. I now hand the conference over to Ms. Anjali Kumar for closing comments. Over to you.

Anjali Kumar: Thank you very much. Thank you all for joining us on this call today. And as usual, the transcript will be uploaded in a couple of days' time. And meanwhile if you have any questions or doubts, you may easily reach out to us and we will be happy to answer them. Thank you so much and good day.

Moderator: Thank you very much. Ladies and Gentlemen, on behalf of the Great Eastern Shipping Company Limited, that concludes today's conference call. Thank you all for joining us. And you may now disconnect your lines.