The Great Eastern Shipping Company Limited
Q1FY13 Conference call (August 10, 2012)

Moderator: Good evening ladies and gentlemen. Welcome to GE Shipping's earnings call on declaration of its financial results for the quarter ended June 30th, 2012. I now hand over the conference to Ms. Anjali Kumar, Head of Corporate Communications at GE Shipping to start the proceedings.

Anjali Kumar: Welcome to our Q1 results conference call. Before we start, let me give out the NAV details before we hand over the call to the CFO for Q&A session. The standalone shipping NAV at the end of Q1FY13 was Rs. 255 per share as against Rs 266 per share at end of Q4FY12 quarter. The consolidated NAV at end of Q1FY13 was Rs. 437 per share as against Rs 415 per share at end of Q4FY12. We can now start the Q&A session with our CFO.

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

Bhavin Gandhi: Can you explain the sequential decline in the EBIDTA in the offshore business.

G. Shivakumar: A 3 year contract on one of the rigs got over in early April and the rig had to go for a survey and after that it went on to another contract. The re-pricing has been slightly lower by 15% to 20%. So firstly, we had almost one month of offhire and the second effect was the lower re-pricing. Both these things affected the EBIDTA.

Bhavin Gandhi: If we also look at our revenue visibility for the balance part of FY13, it seems to have improved substantially in the crude and the product side. So are the time charter rates significantly better than what we saw in the previous quarters?

G. Shivakumar: Time charter rates have not improved significantly, but we decided to fix a couple of ships at reasonable rates for 3-5 years period. Some of these vessels were in the Aframax asset class where we did not had much presence in the spot market & hence we decided to put it on a time charter.

Bhavin Gandhi: Why was a sequential increase in depreciation on the shipping side?

G. Shivakumar: This is on account of exchange fluctuation. Part of it goes to the asset value and therefore the depreciation becomes higher.

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

Chetan Kapoor: Have we started seeing any improvement in asset prices? Secondly, how has been the scrapping activity in the tanker markets?

G. Shivakumar: We have not seen prices improving in any of the asset segments. Asset prices are flat or slightly down may be 5% to 10% in the last quarter. So that is what is happening on ship prices. Scrapping activity is continuing, but is still not a very significant number. On and off you see 16-17 year old ships getting scrapped but that are few and far between. So, unfortunately scrapping activity has not really picked up. The scrapping for the first half of the year is about 6.5 million dwt in tankers which is not a very large number.

Chetan Kapoor: Would it basically mean that the pain will be extended?

G. Shivakumar: Scrapping decision comes once in two-and-a-half years, when you have to spend money to renew the life of the ship by doing the dry docking and survey. So, for scrapping to take place in a large quantum, you need a sustained period of poor markets, which has still not take place. Especially in tankers, there have been months in which VLCCs have earned $25,000 to $30,000 keeping some hope for the owners to operate the vessel.

Moderator: We have next question from Mr. Raj Gandhi from Principle Mutual Fund..

Raj Gandhi: The shipping NAV of Rs 255 includes offshore investment at book?

G. Shivakumar: Right.

Raj Gandhi: So if I were to remove that then what is the pure shipping NAV?

G. Shivakumar: It is tough to do that because it is not a real world example as we have got liabilities against that. The investment in offshore accounts for about Rs.110 a share.

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

Abhishekh Ghosh: Could you give the Q1FY13 utilization for offshore segment-wise?

G. Shivakumar: Our utilization for PSVs were in excess 92%, AHTSVs at about 88%, MPSSVs around 80% and ROVSVs at about 86%

Moderator: We have our next question from Mr. Ravi Shenoy from Motilal Oswal.

Ravi Shenoy: Two queries, one is if you could explain your CAPEX? The other one is the asset joining schedule?

G. Shivakumar: We have a CAPEX of three assets in offshore which will be joining in the balance part of FY13. i.e. 2 vessels & 1 Jackup rig. We have bought one gas carrier in shipping which will join our fleet within the next couple of weeks. So that is all the CAPEX that we have.

Ravi Shenoy: Of this how much is pending?

G. Shivakumar: The amount remaining to be paid is about $140mn for all these assets.

Ravi Shenoy: Why is the revenue visibility low in the MPSSVs?

G. Shivakumar: That business has traditionally tended to be lower duration contracts and therefore visibility is poor. We have two of those vessels that are basically large

PSVs which can be used for specialized work. As they are not the standard PSVs they do not typically have contracts year round. That is why these vessels tend to operate on a short term contract of say three months, six months, sometimes even spot contracts which are 30 to 45 days and that is why the visibility on those is lower because of the nature of that market. Again if these are converted to become a construction support vessel there is a chance that they could have contracts ranging from 50 days for one small project to 5 year charters. But as large PSVs which is what they are functioning as now, the visibility will be much lower.

Ravi Shenoy: Why has the revenue visibility dipped on the ROVSVs as well?

G. Shivakumar: We currently have two vessels which are working in Brazil and we have another vessel which is also fixed there. But the vessels which are coming in, i.e which are being delivered in this year do not have contracts yet. So those days are all open days. That is why the visibility has declined.

Ravi Shenoy: What is the spot and time mix on the shipping side?

G. Shivakumar: On entire fleet we had around 53% on spot. In tankers we had about 44% on spot, whereas in dry bulk we had close to 78 on spot%.

Ravi Shenoy: How would that have been in the March quarter?

G. Shivakumar: Very similar numbers, so this has not changed much for the last 2 to 3 quarters.

Ravi Shenoy: In terms of debt, your net debt has come down considerably because there seems to be a buildup of cash. If you could explain how that cash will be used?

G. Shivakumar: Repayment of debt will happen through the normal operating cash flows. Cash is being accumulated not for repayment of debt but for new CAPEX.

Ravi Shenoy: What is the debt repayment schedule for the year?

G. Shivakumar: For the entire year, we will have close to $80mn of debt repayment for shipping and somewhat similar number for offshore.

Ravi Shenoy: On the debt side if you could provide FOREX debt number?

G. Shivakumar: It is all FOREX debt. It is all effectively US Dollar FOREX debt. We do not hedge the currency because that is a natural hedge, we get paid in Dollar so our cash flows are in Dollar and debt is in Dollar that is a natural hedge for us.

Moderator: We have our next question from Mr. Suman Bhat, an individual investor.

Suman Bhat: I wanted to know what are your CAPEX plan for the next year and beyond?

G. Shivakumar: As far as CAPEX is concerned, we do not have any commitment on the shipping side. The expectation was that the prices of assets would drop and that is what we have been waiting for and the assets values in some segments have fallen substantially in the last 12-18 months. So we are waiting for an opportune time to be able to identify good assets to purchase.

Suman Bhat: Do you see a further drop in asset prices or do you think it is kind of hit the bottom?

G. Shivakumar: We are not yet able to say with any confidence that they have hit bottom because there are a lot of factors ranging against them, starting with the kind of economic uncertainty and stress in the financial system. So it is difficult to say with any

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

Vikram Suryavanshi: We have some vessels in Australia. How have they performed in terms of earnings and profitability?

G. Shivakumar: We had one MPSSV in Australia. Now that vessel has come out of Australia and in fact she has been sold and delivered last week. So we are no longer in Australi, which has been a very high cost region to operate.

Vikram Suryavanshi: If you look at any other region outside India, do we have similar experience in terms of high cost or in terms of profitability or do we see that there are some regions which are lucrative?

G. Shivakumar: In most regions where the costs are high, the rates are high to compensate for those. The trick is to know at the time that you offer a rate what is the cost structure. The other region which is high in cost would probably be Brazil after Australia. Couple of the countries in Middle East are also higher in cost as compared in India. India is among the cheaper places to operate especially because you have Indian crew on board. Actually the manning cost goes up because you have to have local crew and in some of these regions though they have a thriving offshore oil industry they do not have enough trained people who are available and therefore they are very expensive.

Vikram Suryavanshi: How many vessels were dry docked in Q1FY13?

G. Shivakumar: We had six dry docks during the quarter which took 114 days.

Moderator: We have next question from Mr. Raj Gandhi from Principle Mutual Fund.

Raj Gandhi: How has the segmental ordering taken place in shipping segment?

G. Shivakumar: It has slowed down a little bit in bulk carriers and also in crude carriers but it has possibly remained the same or accelerated in product tankers. That seems to be the flavor of the month.

Raj Gandhi: What is driving this because we have not seen any improvement in the spot rates?

G. Shivakumar: It is being driven by expectations that a lot of the refineries in the Atlantic & Western Hemisphere will have to shut down because they are inefficient and built on old technology and they do not get environment clearances and therefore there will be lot more refined products moving there. The order book in the product segment is also smaller compare to the crude segment. .

Raj Gandhi: How much of a threat it is to the crude business because the ton mile impact will be hugely negative if crude starts moving a lot to Asia and then Asia to USA, Europe?

G. Shivakumar: Yes that is correct. Whatever happens in products will eat into the crude ton mile. It is difficult to estimate the impact. It's also probably a little overhyped as a theme for investment. The problem is that it has become very popular and therefore we have new investors who are getting into ordering product tankers.

Raj Gandhi: I think the yield is just about 4-5%. So are they happy with this kind of return because cost of funding has gone down?

G. Shivakumar: I do not want to speculate on that but I agree with the number that you have put on the yield. But they are ordering new ships. The other theme which is there is of new eco ships which basically will save 10% to 15% on the fuel costs. So all the order which are going in now are for those eco ships especially from the financial investors. So they expect that being a leader in ordering these will give them some kind of advantage.

Raj Gandhi: Is the low cost of funding driving these purchases?

G. Shivakumar: Yes, low of cost of funding is one thing. But the fact is that most ship owners are finding difficult to get funding. The amount of money available has just dropped dramatically and headlines of banks withdrawing from shipping portfolios have risen.

Raj Gandhi: What will be the LIBOR plus spread, for a ship owner?

G. Shivakumar: Depends on the company. For our credit we will probably get somewhere between 250 and 300 bps over LIBOR.

Moderator: The next question is from Mr. Krishna Raj, an individual investor.

Krishna Raj: My question is more related to the shipping side of the business. You had about Rs 2600 crs of cash last year and about Rs 3400 crs this year. So while in Rupee terms, it has moved by about 30%, in Dollar terms it is just moved by about 5%. I am sure the ship buying would be in Dollars, so the buying power of this cash has not really moved. So I just want to know how you think about this and is this something that you factor in when you think about how much cash you are going to hold?

G. Shivakumar: You are very right when you say that the buying power has not moved. That is unfortunate. Unfortunately, we cannot do anything about it. We try to protect our purchasing power by keeping some money in Dollars, but that is about all what we can do.

Krishna Raj: But you cannot enter into derivatives that protect the value of your Dollar?

G. Shivakumar: We can do that, so we do that from time to time. We are making all the efforts to protect our purchasing power and are very conscious of this problem.

Moderator: We have next question from Mr. Himanshu Upadhyay from M3 Investments.

Himanshu Upadhyay: My question is related to the hire of chartered ships? Why is that so?

G. Shivakumar: We incharter on a regular basis. The difference between the last year and the previous year is that we took a contract for carriage of crude and for that we needed to in-charter some ships and that is why we had those in-chartered days and hence its expenses.

Himanshu Upadhyay: Will this continue as an item or will it move? And how many ships are currently inchartered?

G. Shivakumar: It depends on the whether we get the contracts. For example, in 2010 and 2011 we did not succeed in winning that contract and therefore we did not have that. In 2011-2012 and 2012-2013 we do have the contract and therefore we have the in-chartered ships, so for this year we will have hire of chartered ships. There will be 1 to 2 ships on average throughout.

Himanshu Upadhyay: We have an inchartering company in Dubai. What is the status on that?

G. Shivakumar: That Company is still operating. But the inchartering activities have come down because the freight rates have declined & arbitrage to take an inchartered vessel does not arise. As it stands today there are no ships on charter on a long-term basis.

Moderator: We have our next question from Mr. Romil Jain from Quantum.

Romil Jain: How will you be placing the new offshore vessels which will be joining the fleet in FY!3?

G. Shivakumar: The rig which is to come in December/ January, already has a firm five year contract. The two other vessels which are coming in do not have contracts yet. But that market is doing well, and therefore we are fairly confident that we will be able to land contracts for those.

Romil Jain: Secondly, I just wanted to get a hang on the environmental norms that we have in the offshore sectors?

G. Shivakumar: There are no environmental norms as such in offshore. There are very stringent quality and safety checks in the oil field services businesses because these are very sensitive installations in the middle of sea. So it's very sensitive and its customers are extremely safety conscious because any accident could have a catastrophic consequences. So it is not very different for different regions but actually depends more on the customers own culture.

Romil Jain: Can you give the interest cost on your consolidated total debt?

G. Shivakumar: The average interest rate is somewhere between 5.25% and 5.5%.

Romil Jain: Can you give a general outlook may be from 2 to 3 years perspective on the shipping business?

Anjali Kumar: 2 to 3 years outlook in this environment is little difficult to give. But having said that from the way the order book is piled up, it looks like we will take some time to get out of this oversupply situation, especially on the bulk side. Therefore it is quite certain that for the next 1-1.5 years market will remain depressed. Beyond that I think we will have to closely watch how scrapping picks up.

Romil Jain: How has been the scrapping scenario?

Anjali Kumar: Scrapping has picked up significantly year to date. Already in six months we have seen about 26 mn dwt getting scrapped between tanker and dry bulk. But it is still a drop in the ocean when you see the huge order book that is there. Just to give you a perspective this 26 mn dwt for six months is compared to about 33 mn dwt in CY11.

Moderator: We have next question is from Himanshu Upadhyay from M3 Investments.

Himanshu Upadhyay: What is the outlook on the offshore business going forward?

G. Shivakumar: The offshore market is looking quite buoyant and that has been the case since early this year. It has not moved up much but the level of inquiries and level of contracts getting done are quite strong which also reflects in our visibility in the offshore side. There is not too much of an order book in the jackup rigs space, which could be around 15% of the current world fleet. Also, there is a huge amount of old fleet which needs to be replaced so orderbook is not much of a concern. So outlook is looking quite positive for the offshore business both in terms of the vessels as well as the rigs.

Himanshu Upadhyay: Are you confortable with the debt levels in offshore.

G. Shivakumar: We do not have a requirement to bring down the debt there. We are quite comfortable with that debt levels. So that's not one of our objectives or one of the stress points for us. They also have strong revenue visibility and very long-term contracts to support. In terms of capex, yes, the business looks quite good and looks lucrative to order in. But finally we will have to make a decision based on at current market values where you are close to the bottom in shipping whether it makes sense to invest their or invest in a market which is already may be in the top half of the pricing range in offshore. So that's something that we will have to decide. We are not ruling out either investing in shipping or in offshore but that's something which is not decided yet.

Himanshu Upadhyay: Just to understand the asset prices in this market. If the peak was 100 for jack up rig what could be the current prices and let's say the bottom was 50 for jack up rig in the last decade, what would be the current values?

G. Shivakumar: In jackup rigs, we are probably at 80 to 85. In vessels I would say we are probably 70% of the peak values**.**

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

Ashish Jain: Shipping NAV has gone down and our consol NAV has gone up. So is it that our offshore asset values have gone up?

G. Shivakumar: Not really. They have marginally gone up. But it is more a question of currency because they all denominated in dollars.

Ashish Jain: What would be the impact of currency?

G. Shivakumar: We are talking of Rs 50.88 vs Rs 55.62 , which is close to 9.3% change in currency itself. Values of vessels has dropped by 6 to 8% in the quarter.

Ashish Jain: What is the reason that you have gone ahead and put your aframax tanker on 3 to 5 year charter at subdued charter rates?

G. Shivakumar: Three year charter is not a bad rate. Of course it is lower than it used to be. We need to put away some vessels to reduce the level of risk & to get some visibility. Though we are not fixing a large portion of fleet, we take a strategic call about the segments that we need to have a spot market presence or otherwise. Where we don't necessarily need a spot market presence we fix out with good quality counterparty.

Ashish Jain: What percentage of our cost is dollar-denominated?

G. Shivakumar: Most of the operating expenses are linked to dollars in some way. But there is a little bit of lag. I'll just give you one example, the OEM suppliers of parts are all overseas and therefore that's all dollar-denominated or it could be Euro denominated. Dry dock expenses are to be paid in dollars because they are done overseas. Salaries paid for manning cost which constitutes maybe 55-60% of our overall operating expenses are paid in rupees but effectively fix based on a dollar rate. So around 85-90% of our operating expenses are link to dollar.

Moderator: Our next question from Mr. Chetan Kapoor from IDBI Capital.

Chetan Kapoor: The other income what has gone down on a YOY basis despite our cash increasing. So, what is the particular reason for that?

G. Shivakumar: It is a marginal change in some returns that we got from investments. Its typically a treasury item.

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

Ashish Jain: I just wanted to know the total revenue days in offshore business for the quarter?

G. Shivakumar: Offshore revenue days in Q1FY13 would be 1603. In Q4FY12, they were around 1800 days.

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

Bhavin Gandhi: On offshore side you said some long term charters have being tied up. Just wanted to understand what kind of returns we see on those contracts?

G. Shivakumar: We seen double digit returns on equity.

Bhavin Gandhi: If we look at the overall return ratios, they seem to be in the region of about 8% and if I strip out the rig returns, vessels returns are in the range of 4-5%.

G. Shivakumar: Definitely I agree that rig business has been more profitable then the vessels business. The reasons for that is at the rates were fixed in 2008 when market was much higher than it is now and therefore the realizations on that are much higher. In case of vessels, the utilizations and the rates were low especially the AHTSVs. They struggle quite a bit in the middle of last year and therefore the utilizations were pretty low.

Bhavin Gandhi: We have also seen some articles regarding some shipping companies complaining with ONGC policy of not having age restriction on vessels. Has there been any change as far as the ONGC's policy is concern?

G. Shivakumar: We have not yet got a tender which says that this is the age restriction which is there. So it is just a question of when it happens rather than whether it happens.

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

Ashish Jain: Is there any mix we targeting either in form of revenue mix or in terms of revenue days mix between the two businesses?

G. Shivakumar: We are not targeting in terms of revenue days or revenue mix. We would like to find most effective place to use it for where we earn the best returns and we do not have any constrains on the amount that we would like to put in to offshore or shipping.

Ashish Jain: So in that case in the current scenario, are we looking at buying more offshore vessel?.

G. Shivakumar: It is always tempting to buy the ones that is making money currently. We have seen that in shipping you make maximum returns when all hope is lost and you invested at that time. We bought ships in the 80's when there was a bad patch, some 20 ships in the space of two years and those ships served us very well for the next 20 years after that and made us a lot of money. So, that's one learning we had from the shipping business that only while making countercyclical investment you make decent money.

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

Anjali Kumar: Thank you everybody for being with us on the call. We will be uploading the transcript of the call on the website in a couple of days. If you have any other questions, you may please feel free to contact us any time. Thank you very much.