"The Great Eastern Shipping Company Limited Earnings Conference Call"

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Moderator: Good evening, ladies and gentlemen. Thank you for standing by. Welcome to GE Shipping Earnings Conference Call on declaration of its financial results for the quarter ended and year ended March 31, 2019. At this moment, all participant lines are in the listen-only mode. Later, we will conduct a question-and-answer session. At that time, if you have a question, please press '*' and '1'. Should you need assistance during the conference call, please signal an operator by pressing '*' then '0' touchtone phone. Please note that this conference is being recorded. 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. Thank you and over to, Ms. Kumar.

Anjali Kumar: Thank you. Good evening, everybody. Thank you for logging-on to our call. I hope all of you have received the results which were out late evening yesterday. And you had enough time to go through it, so I would now hand over the call to our CFO – Mr. Shivakumar to take us through the proceedings.

G. Shivakumar: Good afternoon, everyone. And welcome. Let's go through the results. This year has been a wild ride for the profit and loss account, thanks to both exchange rate fluctuations and tanker market movements. And it reflects in the pattern of our results. Our profit loss account is affected by two major exposures, the spot tanker market and the dollar rupee exchange rate.

Let's look at tanker rates first, especially crude tankers. Our Press Release shows our average TCYs, in this you can see that the crude tankers earned less than $11,000 on average in H1 FY19. And almost doubled to $21,000 on average in H2. Product tanker TCYs also improved significantly from about $12,500 a day to about $15,800 per day, increase of more than 25%.

On currency, the rupee depreciated by more than Rs. 7 in H1 and then clawed back about Rs. 3 in the second half. The exchange rate impact for H1 was a negative Rs. 400 crores plus, and in H2 was a positive Rs. 300 crores. So overall, the P & L showed a loss in excess of Rs. 400 crores in the first half, and we pulled back most of it in the second half, ending with small loss of about Rs. 20 crores on a standalone basis for the full year.

This is the first standalone loss that we are declaring since 1984. However, the business actually did slightly better than it did in FY18, where we had a profit again due to some of the exchange rate impacts. Year-on-year crude and dry bulk TCYs FY19 were actually a little better than FY18. And product tanker TCYs were a little bit worse. So overall the business actually did a little better than in the previous year.

Now, looking at asset prices. During the quarter, bulker prices moved down between 5% and 10%, reflecting what is happening in the freight markets. Product tanker prices also dropped around 5% in the quarter. And on the other side, we saw crude tanker prices move up between 3% and 10%, and moving up more for the older ships. The general view on the outlook seems to be much more positive across the board for tankers. Our standalone net asset value moved up by about Rs. 7 per share to about Rs. 374, including offshore where asset values have remained unchanged, the consolidated NAV range remains in the Rs. 430 to Rs. 460 range.

Coming to how the freight markets have performed. Crude and product markets continue the strength of the previous quarter, but they weakened into the new financial year, that's into April. U.S. crude exports grew quite spectacularly in Q1 of 2019, increasing about 1.2 million barrels a day for the quarter year-on-year. While U.S. crude imports dropped by about 700,000 barrels per day, Chinese crude inputs grew by about the same number, about 800,000 barrels per day.

The crude tanker fleet grew by over 2% in the first quarter, much as we had anticipated. But rates remained strong because of the strong ton mile impact of U.S. crude oil exports. Current rates, however, are down to somewhere in the teens across the board. And Aframaxes are probably doing a little better than the larger size crude tankers.

With ordering slowing down significantly, the order book for crude tankers currently stands just over 10%. On the product tanker sector, the fleet has grown by about 1.5% during the quarter. But rates remain reasonable in the low to mid-teens. The order book stands at historically low level of about 7%.

The positive surprise for the quarter came from the LPG freight markets. Which saw VLGC rates going up from less than $10,000 per day in February to about $40,000 per day in April. Prices of LPG in Asia had moved up in line with crude oil prices, but the LPG prices in USA remained low. And this opened up the arbitrage trade. As a result, U.S. exports picked up significantly in the first four months of 2019, up 3 million tons year-on-year, an increase of 36%. Unfortunately, our VLGCs are on time charter, and so we are unable to take advantage of those rates. We have one MGC which is on the spot market, but the full effect hasn't come through to the MGC market yet.

The gas carrier fleet has grown by about 1% in the quarter, and the order book stands at around 11%. On the dry bulk side, the impact of the Vale accident is still being felt in the dry bulk freight market, especially in Capesizes. However, we still haven't felt the full impact because Brazilian miners seem to be drawing down from stocks to export. We expect net-net that Brazilian iron ore trade may drop by about 40 million tons overall in 2019.

We had some hopes that Australian mines may be able to compensate for some of this, but they themselves have faced some challenges with the weather affecting the export infrastructure. The fleet growth has not been as high as in the tanker business, at about 0.7% in Q1. And this sector has seen significantly more scrapping, and the run rate of scrapping is at about 1.5% to 2% for the full year.

The order book currently stands at 11.5% and the sector has seen some strong ordering activity for the larger sizes, backed by long-term contracts. Overall, we expect net fleet growth could be in the region of 2% to 3% for the dry bulk fleet.

The offshore market continues to be challenging, though the strength in oil prices hopefully should result in some improvements. We have obtained a long-term contract of five years for one of our PSVs in the Indian market. All our assets currently have contracts, of these assets one ROV support vessel, one 80-ton anchor handler and two MPSSVs have potential repricing in this FY. The spot market in the North Sea has picked up significantly and is currently paying in excess of $20,000 per day in the spot market. On the Jackup Rig side, all our assets have contracts. Our rig, Chitra, which came off contract, will go into her new contract in this month.

The market is taking its toll on the fleet. 40 Jackups were reported to have been removed from the fleet in calendar 2018, and a further four have been removed in 2019 till date.

As we reported earlier, we have sold our oldest VLGC, the Jag Vishnu, and we will be delivering her to the buyers this week.

In shipping, we continue to have a large spot exposure of close to 90% for this financial year, and we are keeping this open because we expect that there will be significant turmoil in the market in Q4 ahead of the IMO 2020 rule kicking in.

With that, I come to the end of my statement. And we are happy to take your questions and have a discussion on the market outlook.

Moderator: Thank you very much. We will begin the question-and-answer session. First question is from the line of Vaibhav Badjatia from HNI Investments. Please go ahead.

Vaibhav Badjatia: Just have one question. So, because of this Iran sanctions, Iran has threatened to close its waters. So just wanted to understand the impact on the industry and our company as such, if that eventually happens?

G. Shivakumar: So, for us specifically as a company, this doesn't make a difference because we were not trading Iran for many years now. On the industry, it should be overall positive, so long as that oil gets replaced. Now, if this gets replaced with U.S. crude oil, then it's good for ton mile demand, and that's good for the tanker market. If it gets replaced by Middle Eastern oil, then it's no change. So, overall, it's okay for the business we expect, if anything, it should have a positive impact. On the supply side, there are Iranian ships which will not be able to carry cargo now, and therefore those ships will go out of circulation. So that's how we see the impact of the Iran sanctions playing out.

Moderator: Thank you. The next question is from the line of Neerav Shah from GeeCee Investments. Please go ahead.

Neerav Shah: A few questions, sir. Firstly, for the vessels where we are not installing scrubbers, what is the docking schedule for them, where they will go for the cleaning of fuel tank so that we can come to know the revenue loss for each quarter if you already have that schedule? And generally, on the industry front, I mean, say more than 97% - 98% of the vessels are not installing scrubbers. So how much of that supply will it be taken away from the market? Because the panic will happen, I mean, all the companies will try and postpone as much as possible this schedule, so how do you see that even playing out in terms of how the rates will behave?

G. Shivakumar: Okay, interesting questions. Thank you. The first thing I want to clarify is that the ships which don't have scrubber installations don't need to go for a docking. Basically, you have to clean your fuel tanks which have the residue of high sulfur fuel oil and prepare them to now take low sulfur fuel oil, which may be heavy fuel oil or it can be gas oil. That cleaning has to be done and that can be done on the run while afloat. Some cases the position of the tanks may not permit this to be done on the run, and therefore the ship may have to stand in one place while it's getting done. But in no case do you actually need to go into a dock in order to do the cleaning. The maximum that can happen is that you have to take a few days off-hire in order to do this. So, we have three to four tanks on every single ship, the schedule will be that you start cleaning your tanks. Now, what are we looking to optimize? We are trying to maximize our capability to use high sulfur fuel oil till the last possible day, that is 31st of December, because low sulfur fuel or gas oil costs more. And therefore we will try to keep the cleaning of the tanks till the last possible moment. Again, we will have to keep practical considerations here because you may be in the middle of the ocean when you have to change fuels on 31st of December and you can't do that switchover suddenly. So we will clean our tanks one by one. We will start doing that probably from June, July, and depending on whether we are near a convenient port, etc, because ,once you finish cleaning all your tanks you have to discharge the residue which is being cleaned out of your tank -that has to go out somewhere. So, we are scheduling it and we will do that over the period of six months, starting from June

Neerav Shah: Okay. So, the vessels which are clean, say in July or August, the re-pricing will not happen, I mean, that you will have to take a hit for that time period?

G. Shivakumar: Let's just take an example of one ship. There are four tanks on the ship, the total capacity -- and I am going to just oversimplify it a little bit. So there are four tanks on a ship, each with 500 tons capacity. Okay, so what we will do, and just as an example, is you clean out two of the tanks and then you run with only two tanks, so you have reduced your fuel capacity by 1,000 tons. Or you clean out one tank in June, one tank in July-August, one tank in September, one tank in November. Or we may even say we will clean three tanks up to end of December and till 31st of December you use from that one remaining dirty tank, you keep using the dirty fuel oil, the old fuel oil. And then on 1st of January we switch over seamlessly to the other three tanks and start using the compliant fuel, and clean the last tank at a convenient time later. So that's how it will work, really. We will do it slowly because the moment we clean all four tanks then we are committed to taking the more expensive fuel. And we can't do that because it's just too expensive, it's $200 or 250 dollars extra that you have to pay per ton. And these ships consume a minimum of 20 to 30 tons.

Neerav Shah: Got it. So, typically, this particular event will not have any impact on the rates?

G. Shivakumar: There will be some. I mentioned you had to go out and discharge that sludge which you have, at some point you have to go and do that, you have to find a reception facility which will do that. Sometime you need to do your cleaning, you may decide to stop at one place and do your cleaning, it may take two, three, four days to do the cleaning. There will be an inefficiency associated with the changeover of the fuel, or cleaning.

Neerav Shah: Okay, thanks for that. And coming to the second question, sir, on the offshore business. When did the contract end for one rig in Q4, which month or which dates specifically?

G. Shivakumar: I don't have the exact date, in end of March.

Neerav Shah: Sir, I am looking at the performance of the subsidiary and it seems that there is either one-off expenditure, I mean, because you have already operated that for the entire quarter. So, any one-off in that subsidiary?

G. Shivakumar: No, not really. We had some expenditure going on to a new contract, a PSV contract in India. We had some expenditure for getting those vessels ready because they needed some specialized equipment. But that was about it. But that's not a huge amount.

Neerav Shah: Because the operating profit is on a sequential basis is coming to Rs. 123 crores to somewhere around Rs. 90 crores.

G. Shivakumar: See, what has happened is also that the OPEX has come down significantly over the last few years. And now a little bit of those, that gain is going out, the market, as offshore market picks up a little bit, it is starting to tighten slightly. But I think more than that, it's the new contract expenditure which we did for the vessels.

Moderator: Thank you. Ladies and gentlemen, we would request you to restrict your questions to three at a time. If you have a follow up question, we would request you to come back and queue. Thank you. The next question is from the line of Hardik Shah from Max Life Insurance. Please go ahead.

Hardik Shah: Sir, my question is regarding the debt. So, the consolidated debt is around Rs. 6,000-odd crores. What would be the repayment schedule like?

G. Shivakumar: In this year on a consolidated basis we have to pay about $210 million dollars, which is about Rs. 1,500 crores.

Hardik Shah: And the Rs. 1,000 crores NCD approval that you have taken, is this for refinance or is there some CAPEX that is planned?

G. Shivakumar: Currently there is no planned CAPEX in terms of acquiring vessels. However, we have some CAPEX of installing, we have some expenditure for installing scrubbers on our vessels.

Hardik Shah: Right. But what quantum would that be?

G. Shivakumar: That is actually $20 million. So, the NCD approval is basically an enabling approval, in case something comes up. As of now we have no plans for spending that money.

Hardik Shah: Any plan or strategy to deleverage?

G. Shivakumar: In principle, yes, we want to deleverage from these levels. We went up very significantly in leverage in the last three years as you would have seen, and our intention is to bring it down.

Hardik Shah: Just final question on the vessel that you are planning to sell, when are the cash flows and approximate cash flows, what would it be?

G. Shivakumar: We can't mention what the cash flow is.

Hardik Shah: When is the deadline?

G. Shivakumar: Delivery date is this week.

Hardik Shah: And that would be used for, again, the debt or regular purpose?

G. Shivakumar: So it just goes into the pool, there is no debt which has to be repaid against that.

Moderator: Thank you. The next question is from the line of Chaitanya Shah from Aditya Corporation. Please go ahead.

Chaitanya Shah: Sir, my question is regarding the acquisitions that we have done over the past two, four years. What is the return on capital threshold that we have for these acquisitions? Do we have an internal number of any sort?

G. Shivakumar: Yes, our target is between 10% and 15% minimum.

Chaitanya Shah: So that is the return on capital or return on equity?

G. Shivakumar: Capital, full capital.

Chaitanya Shah: Okay. Sir, so I just have one question regarding that. I am seeing your 2018 annual report and it seems that the impairment that you have taken on the assets in 2018, you mentioned that the discounted rate used in measuring the value of 6.5%. I was just trying to understand the difference between your required rate and why the discount rate, where there is such a significant difference?

G. Shivakumar: That's the cost of capital, that's based on our measurement of the cost of capital. The target return is a little different from that.

Chaitanya Shah: Okay. So, when you sort of measure your NAV, I can assume you sort of used 6.5% to 7% to measure that NAV?

G. Shivakumar: NAV Meaning?

Chaitanya Shah: The 430 to 460 **G. Shivakumar:** No, that is based on the broker assessment of the value of the ship in the market. So there is no discounted cash flow in that. This is based on a pure broker certificate, saying this asset, the entire list of assets this is what we think they are worth in the market, current market price. It is not a discounting of future cash flows. So current market price, that's all.

Chaitanya Shah: Okay. And what was the CAPEX done this year? Because I am seeing an entry of around Rs. 500 crores in your cash flow from investing number And I don't see any change in the number of assets that you have. So just want to understand.

G. Shivakumar: Okay, so we sold two assets in the year, we sold one bulk carrier, our oldest bulk carrier. And we sold another bulk carrier which is 2011 built. But we bought two very modern gas carriers, 10 and 12 year old gas carriers. And the amount is very different. We change ships, so the number of ships in the fleet remains more or less the same. But we actually changed the fleet itself. The total sales was less than $30 million. The CAPEX was 90 plus million $

Moderator: Thank you. The next question is from the line of Vikram Suryavanshi from Phillip Capital. Please go ahead.

Vikram Suryavanshi: Sir, can you share the NAV number for standalone and consolidated, I missed that number.

G. Shivakumar: So standalone is 374, and consol is between 430 and 460. Again, because they give a range for the valuations of the offshore assets.

Vikram Suryavanshi: And I just also missed basically the fleet growth in crude carrier.

G. Shivakumar: Crude carriers actually have been quite strong in the first quarter. It's a little over 2%. It is not annualized, just absolute growth.

Vikram Suryavanshi: Okay. And sir on the shipping side I just wanted, because if you look at our TCY numbers are broadly same on QoQ basis, particularly in tanker and product. And even if you look at the revenue days or capacity wise, but I think operating cost structure seems to be much higher, so there any dry docking or are we seeing even shipping side also the cost structure getting increased?

G. Shivakumar: Some of these things are provided for at the end of the year. Some of the payments are provided for, are estimated and provided for at the end of the year, including some manning costs. So, that has an impact normally in Q4. We are not seeing any great cost pressures. Dry docking actually does not reflect in this because it's capitalized. So we are not seeing real cost pressures in shipping. But this typically happens, Q4 generally sees a little bit of bunching of costs on the manning side.

Vikram Suryavanshi: And how is the utilization rate for offshore support vessels and Jackup rigs for the industry?

G. Shivakumar: Industry, on term contracts, the Jackup rig international market is running at 62%, which was 57% in 2017. Including spot contracts, it's at about 66% to 67%, it is again according to market reports. Offshore vessels on term contracts remain below 50%, unfortunately.

Moderator: Thank you. The next question is from the line of Jeet Gala from Centra Advisors. Please go ahead.

Jeet Gala: Sir, just wanted to ask one question, regarding the average age of the crude fleet what we have right now is approximately 13.6 years. So with IMO 2020 coming into picture so basically what is the kind of the age of the fleet are we looking at to maintain before we enter 2020? So, are we looking to reduce the average age of ships or are we comfortable at 13.6?

G. Shivakumar: We are quite comfortable at 13.6.And the age doesn't really matter for this IMO 2020 business. So, what is IMO 2020? It is going to lead you, push you towards more expensive fuel, if you don't have a scrubber. And the reason why age sometimes matters there is, your eco ships which are built 2014/15 and later, typically have a lower fuel consumption. So between a ship which was built in 2012 and a ship which was built in 2015, there could be a 5% to 10% difference in fuel consumption, and therefore that penalty which you have for using higher cost fuel is less for an eco ship. That's where the age comes in. Otherwise the age does not matter at all.

Jeet Gala: So even the transition of getting into IMO 2020, it really doesn't matter out there? I mean, whether it be a 10-year-old ship or a 15 year old ship?

G. Shivakumar: So,long as you are non-eco, it doesn't matter whether you are built in 2013 or 2008 or 2005. So that's the critical thing really. Of course, your customer acceptance based on your age is always a factor. But that's irrespective of IMO 2020 or not. We are currently running three Suezmaxes which are built in 2000. So long as you maintain them to good quality, because every time you go to a loading terminal, Middle East most likely, they check your ship. If you are able to pass those stringent tests, you will be accepted. So they don't look at the age. Okay, to the extent to saying, this is a 19-year-old ship, let us look at it more closely. They will look at it and they will inspect the ship keeping that in mind. And they will be more stringent in their tests. But if you pass that, you have no issue at all, because your customer is accepting you, because you are clearing the customers' quality test. It is more difficult for a 19 year old ship than for a nine year old ship, that's the only point that you have to think about. We are able to run those ships well and have them acceptable to all our customers.

Moderator: Thank you. The next question is from the line of Saket Kapoor from Kapoor & Co. Please go ahead.

Saket Kapoor: Sir firstly, what is the net – how much cash are we holding on as on 31st March?

G. Shivakumar: In the Group we have about $500 million, Rs. 3,500 crores in cash.

Saket Kapoor: And what is the borrowing?

G. Shivakumar: Borrowing is about Rs. 6,000 crores.

Saket Kapoor: Sir, if I look at your balance sheet part, okay, it is on the consolidated level that you are mentioning, we don't have the balance sheet for the consolidated level?

G. Shivakumar: We have it, its there.

Saket Kapoor: Sir, what I was trying – and what is our cost of funds?

G. Shivakumar: So, our debt – you mean our cost of debt?

Saket Kapoor: Yes, cost of debt.

G. Shivakumar: I think cost of debt currently in dollar terms is running at below 5% consolidated, probably closer to 4.5%.

Saket Kapoor: 4.5%?

G. Shivakumar: That's right.

Saket Kapoor: Sir, going forward for the investing community, what are the key triggers for the shipping industry in totality? How are you seeing the global trade shaping up? What are the factors that are going to play out in this age of de-globalization? What should be -- which are the key areas where you people are keeping a key eye on it?

G. Shivakumar: So the critical thing to watch out for in the next 12 months is the impact of IMO 2020. Globalization stuff is fine, it's affecting the dry bulk market, and it's putting pressure on the dry bulk market whenever there are these trade wars between U.S. and China. But critically we have IMO 2020 transition coming up, and we think that that could be a big factor. Now, how the refining industry and the oil industry have adapted and prepared for IMO 2020 is going to be a critical thing. So that's really the factor that we are looking for in the next 12 months. It could be a trigger for a market recovery. Already the tanker market is significantly better this year than it was at the same time last year. So, from a layperson or general investor point of view, I suppose, you need to keep track of what is happening with regard to IMO 2020, whether there is actually a shortage of fuel for ships. That's the only thing that I would say that is a critical factor, whether the refining industry needs to run extra in order to produce this. The other factor, irrespective of IMO2020 is what is happening to U.S. crude oil exports. So, that is a very big positive for the crude tanker market specially. That's very good for ton mile demand for crude tankers, because it moves very long distances when it is being exported from the U.S., since typically is being exported to Asia.

Saket Kapoor: And sir for the benefit of all investors, if you would summarize this IMO 2020 part, I am not quite conversant. I can Google it out, but if in a gist if you can explain it.

G. Shivakumar: I will give you a one minute summary. The fuel which is used by ships traditionally is high sulfur fuel oil, it is permitted to be up to 3.5% sulfur content. From 1st January, 2020, it has been mandated by the International Maritime Organization that you can only use 0.5% sulfur fuel. Now, whether there is enough 0.5% fuel being produced by the refining industry, and therefore, whether more crude oil has to be processed in order to produce the same amount of fuel, whether there will be surplus of 3.5% fuel which has to be stored on ships, whether higher cost fuel will make ships run more slowly, and therefore, tighten the supply of ships. Those are the factors that could affect the market by end of this year and early next year. Basically, it is a transition from one kind of fuel to another, which has a lower sulfur content, which could lead to a disruption in the oil market.

Saket Kapoor: So it is now the work for the refinery only to get themselves aligned? Because we people in the shipping industry can't do anything about it, it is it is a refinery upgradation only that will be processing and resulting in lower sulfur content?

G. Shivakumar: That's right. So in the shipping industry you can fit a scrubber, but if you haven't done it so far it's already too late, because there's a lead time for the equipment and fitment. So, basically, it's now up to the refiners and the traders to produce that new fuel, the compliant fuel.

Saket Kapoor: Okay, and we having the scrubber installed, we can mitigate that percentage by using the same, that is what you are saying?

G. Shivakumar: So we can use the old fuel, that's what it means, the cheaper fuel.

Saket Kapoor: But the surplus then will go down with use of scrubber, that is what you are trying to say?

G. Shivakumar: That is correct. So then we will be able to comply if we use a scrubber.

Saket Kapoor: And as per your understanding, how much of these ships that are there currently have been installed with this scrubber part?

G. Shivakumar: I think we should take this offline because this has been covered on some calls before, so maybe if you can call into us then we will have a long discussion and explain thus scenario to you.

Saket Kapoor: Last point, if you could give more understanding of the offshore market, what should we read into rig counts that are been published by the U.S. department?

G. Shivakumar: The rig count which is published by them typically focuses on the land rigs. We haven't yet seen a big increase in the number of offshore rigs which are being utilized. The E&P budgets, offshore exploration production budgets, hopefully this year will go up, that is what has been forecast. If that happens, hopefully more rigs will be employed. We are already seeing that a lot of rigs are getting removed from the market, we expect that the market should at least gradually tighten going forward. And hopefully, we will have a recovery. We have already seen a recovery in supply vessel rates. I mentioned that the North Sea currently in the spot market is paying about $20,000 a day for large PSVs, at least as of last week. So there is potentially a recovery, gradual recovery, which can happen.

Saket Kapoor: Sir, the reasons for removal of rigs, are they due for dry docking, or maintenance or what is the reason for the removal of the rigs, I could not get the point?

G. Shivakumar: People have got tired of spending money on them and there is no revenue coming, and you have to spend a lot of money to keep a rig, to hold on to a rig.

Saket Kapoor: Because sir, Government of India is trying to extract, trying to extract more and more oil that are available in the fields. And so will that lead to somewhat any change in this market or is it a very nascent one if we compare on a global scale?

G. Shivakumar: I think I will have to request you to either go back in the queue, because there are a lot of questions. We can take this offline as well and have a long discussion on this. But because everybody else is waiting, we can discuss it separately.

Moderator: Thank you. We move to the next question, which is from the line of Arjun Sengar from Reliance Mutual Fund. Please go ahead.

Arjun Sengar: Sir, just about this IMO 2020. I understand that there can be a supply disruption which can turn out sometime in Q4. But I just wanted to explore the other possibility, which is that, like you said, you will after your higher cost fuel which would increase your operating costs. Is it possible that you are actually worse off after IMO 2020? Is that a possibility?

G. Shivakumar: So, let's go through these operating costs thing. See, typically fuel cost is a pass through. But let's keep that aside. Now, what happens when fuel costs increase? So, every voyage that we do we do a calculation, what is the optimal speed. Let me just take an example of a voyage. We have committed to you that we will bring your cargo from Middle East to Mumbai and charge you $10 per ton. All costs are on our account, including fuel costs. So, when that happens, the fuel cost is ours. Now we are trying to reduce the fuel cost in order to increase our profitability on this voyage. Now, how do you reduce the fuel cost, by sailing slower. And the way it reduces your fuel cost is, and I am just giving you numbers as an example, you reduce your speed by 5% your fuel cost goes down by much more than 5%, it goes down by 10%. Therefore, your time is increasing by 5%, but your cost is going down by 10%. And therefore, you make more money on a per day basis by reducing the cost. Okay. So this is the voyage calculation that we do every time we fix a voyage. Now, this depends on a couple of things. One and most important, is the price of fuel. The breakeven point. So for every voyage we are calculating the best speed at which you do it to maximize the day rate. At $400 per ton, which is today's price of high sulfur fuel oil, the speed may be 12.5 knots, okay? If we do the same calculation of that voyage at $600 per ton, that optimal speed will be 11.5 knots. And therefore, what happens is, everybody goes slower in order to maximize their earnings. What happens when everybody goes slower? The supply of ships gets constrained. And therefore, it will actually be a positive for the market, it is likely to be a positive for the market. Are you following me on this?

Arjun Sengar: Understood.

G. Shivakumar: And therefore, the entire industry, so the entire shipping fleet effectively shrinks because everybody who owns a ship, who is running it in the spot market does the same calculation.

Anjali Kumar: And this will not only going to impact us, but the whole shipping industry.

Moderator: Thank you. The next question is from the line of Raja Kumar, an individual investor. Please go ahead.

Raja Kumar: So my question is on the credit rating for the outstanding debt. So, I saw in 2018 your credit rating has been probably, from AAA stable it has become AAA negative. So, I just want to know, given the turmoil that is happening in the market today, is there a stress test the company is done, given that the IMO compliance is also going to kick-off? And I think one of the rationale that is mentioned in the case of a downgrade was, they have mentioned that they wanted to see how the company is able to go through the IMO compliance in 2020? Because that is going to kind of impact you further up.

G. Shivakumar: Yes. Good evening and thank you for your question. So, we didn't catch most of it, but your question was whether the IMO is actually a negative because it's been mentioned as one of the factors in the downgrade, is that correct?

Raja Kumar: Yes, that's correct.

G. Shivakumar: Yes. So, it is mentioned as a factor because we have to do some CAPEX in order to comply. So, between all the ships in our fleet, the 47 ships which we will have as of end of this week, the total CAPEX that we are expecting to put into our fleet is about $20 million for the scrubbers, and for the non-scrubber ships $6 million to $7 million, it's not capex, it is just some minor equipment changes that we have to make. So it's not much, we are talking of Rs. 180 crores to Rs. 200 crores. So, it's not a huge amount of capex that has to be done, but on the margin it's one of the factors, and that's why they have put it there.

Raja Kumar: Okay. So it not a material item, if you are just Rs. 180 crores so I am kind of surprised why you have listed that as one of the reasons to look out for in the future years to see if the company is able to compliant to.

G. Shivakumar: Yes, on the margin, what they felt was that on the margin it adds to pressures, sort of. We sort of agree with you, but yes, it is some money. On a balance sheet of our size, not really significant, but yes.

Raja Kumar: Sir, just to lead on the same point. I mean, is there any stress test the company has done? Because you said the market is going to be volatile in Q4 of 2019, have you done any stress test in terms of how bad things can go and the implication that it will have on your ratings?

G. Shivakumar: Thank you for the question. This is an interesting one, and it's something that we have been doing for the last seven or eight years actually. So, we actually have a stress test which we do every quarter. We keep cash on our balance sheet providing for stress. We keep cash on our balance sheet assuming the next three years, will earn as per the worst three year period that we have seen in the last 25 years, and every single ship will earn those rates. And then we keep the cash to ensure that we are able to go through that market of every ship earning the worst rates of the last 25 years without having financial stress. So, that cash is always kept on the balance sheet, and that's why we even today have $325 million on Great Eastern Shipping standalone balance sheet.

So we do that stress test all the time, and that is one of the things which enables us to ride out bad markets like this when there's financial distress all over the world in shipping companies.

Raja Kumar: Great. Just on the same point, so if cash, I am sure this cash is not lying idle on a checking account, you must be deploying it in money market or some kind of instrument, right? So I just want to know are there any, I mean given that many companies have ILFS kind of exposure, just want to know is this money kept in a very safe instrument where we are not having any exposure?

G. Shivakumar: Yes, we have no credit losses in our treasury.

Raja Kumar: I mean, you don't anticipate anything in the future as well?

Anjali Kumar: More than two-thirds of it is in bank deposits.

Moderator: Thank you. The next question is from the lineups and this Sanjeev Pandya from Pankti Group. Please go ahead.

Sanjeev Pandya: Thank you for taking my question. Sir, three quarters back we had talked about an investment hypothesis where I had mentioned three elements to the investment hypothesis. One was that scrappage is expected to accelerate because of the secular down cycles in the industry. Second is that crude might start to get perceived as a sort of a sunset industry, given an oncoming disruption in the usage of oil itself. And therefore, what happens to crude tankers? The third was bankability, given that roughly 70% of the shipping companies were sort of bankrupt, what happens to them? And more important, what happens to the last man standing when the cycle takes off? So, would you like to review these three elements, the demand-supply balance, has scrappage really played out in the last year or in the period going forward. How are you seeing scrappage segment by segment, how is it expected to be change? Because this I think will be the most important factor in turning the cycle. That is one. And two, crude being…

G. Shivakumar: Yes, being a sunset industry. And third was on being last man standing.

Sanjeev Pandya: Being last man standing, which is basically the bankability, the supply of equity to this sector should have by now come down to zero, I mean, at least the supply of shall we say mature money which can come in at very low yields that supply should have come down to zero. So, would you like to review the entire environment in the context of these three factors?

G. Shivakumar: Yes. Okay. Thank you for your question. The first one is the easy one. Scrapping has happened, it happens when markets are very weak. So, in the first half of last year we saw a lot of crude tanker scrapping. However, from September onwards the crude tankers have been making very decent numbers. And therefore, scrapping has come to almost a standstill. Bulk carriers have started, last year was minimal scrapping, but now because the markets have been so weak, we have seen a little bit of scrapping picking up in the last two to three months. In the tankers…

Sanjeev Pandya: And moving forward, sir?

G. Shivakumar: Yes, in tankers, we expect that the scrapping will not be a great amount because the general market outlook has become fairly positive, considering that this year so far has been better than previous year, than 2018. And everybody has got the same positive view of what IMO 2020 can do for the tanker market, okay? Therefore, we are not expecting scrapping, at least in this year to be a major factor, unless the markets -- so unless you see six months of really weak crude tanker market, it is unlikely that we will see a big pickup in scrapping. And that is not our base case of having very weak crude tanker markets, for six months at least, because by September-October you will start having the impact of IMO 2020 preparations coming in. So that is on scrapping. Maybe in a couple of years as a lot of ships got built between 2000 and 2008, those ships will turn 20 years old in a couple of years' times. All those ships will become scrapping candidates and that could happen. But in this year, we don't see it as a big factor.

Coming to the second one, which is about crude oil being a sunset industry? That is very much in the future. As it stands today, the market is what it is. Crude oil prices are high, demand for crude oil is there, the demand supply balance for crude oil is quite tight, and that's why we are at $70 plus/minus a few dollars. So, that is something which may happen 10 years down the line. We need to think about it three to five years down the line. For now, the market for crude oil tankers is strong. And that is what matters to us. The market for drilling for crude oil may become strong at $65.

Sanjeev Pandya: No, no, I mean, this is a trend which we noticed in other sunset industries. I mean, just please say yes or no whether this is also applicable? Let's take say jute or halogen lighting or some sunset industry where demand is tapering off and it is visible. What we have seen usually happen is that there is disproportionate profitability to the leftover assets. So, whoever is last man standing with already some cost in, let's say, a crude tanker today is going to see disproportionate profitability, because demand will not taper off in the manner anticipated. So, given that for a new ship order you would have a 20 years horizon, I am assuming, by you I mean the entire industry. Shouldn't there be a tapering off of new tanker orders given the outlook for oil?

G. Shivakumar: Yes, so the outlook for oil which you talk about and you spoke about couple of other industries, we are not experts in those industries. And people give these forecasts about oil demand collapsing and dropping by 50% and 70% in the next 5, 10, 15, years, whatever that number is. These are things which make headlines. But we don't think the reality will be anywhere near that. Because your transportation fuels will not be replaced in such a hurry, your cars will not be replaced in such a hurry. So, it is not going to happen to the extent that we think it is. Maybe in 25 years time you could see oil demand dropping very significantly from the hundred million barrels a day. But it is unlikely to happen in the next 5-10. So oil demand is still on its way up, there is nothing -- what is the factor that is going to bring oil demand down next year as compared to this year, unless we are talking of a global recession. If there is a demand drop due to a global recession because of an economic event, then it can happen, otherwise we don't see a drop in crude oil demand in a business as usual scenario. That's the factor that we just like to put here. What you are saying may be valid five years down the road. Also, when we look at crude tankers, again, remember that the crude tanker you are ordering today will stay alive till 2040. However, the crude tankers which are in the market today, which were built in 2000 or 1998 will not be alive in 2025. So those will be removed. When you add this vessel into the fleet this vessel is going to be the one which is the only one, which will still be sailing in 2040. And therefore, even if the market has dropped or the demand has dropped by 90% that vessel will still be operating, as you know, like the last man standing. So, for making that investment all we need is 5 to 10 years of cash flow visibility. We are not looking at what will be the earnings in year 2040. I am talking about general ship owners, we take a slightly more short-term approach to these things. If we can make money in a five year period, we are happy to make the investment. So, to sum up: the market is not dying, the crude oil market, the tanker market is not on its way down in terms of the size of the market. We can have poor earnings because there are too many ships, or short-term blips in demand, but it is not on a structural downturn, yet. Every year demand grows for crude oil, for oil products. So that is on that one factor. And therefore, five years down the line, it may be a proper discussion to have.

Now, coming to the issue of whether money is available? Money is available because people are taking a very positive view of IMO 2020. The market is uniformly positive, all analysts are positive about the tanker markets, at least for IMO 2020. And therefore money is available today for doing these deals. Again, it is not available to everybody, but it is available to the better players in the market. So, when there is a good story people will make money available, and that is what we found over a period of time. Yes, the private equity money has gone because they have burnt their fingers, but there are always new investors who are coming in and funding. So, because the outlook is looking so positive and because we had this positive surprise over the winter of 2018, people are putting money back into the markets. All the international shipping stocks have gone up, tanker stocks have gone up 20%, 30%, 40% in the last three months or so. So money is there coming into shipping equities.

Moderator: Thank you. We will move to the next question, which is from the line of group Dhruv Jain from Ambit Capital. Please go ahead.

Dhruv Jain: Sir, just had one question. So in 2018 annual report we saw that there are some non-current investments in some tanker companies that you guys have made. Just wanted to know if you guys continue to hold that investment? And also, what was the rationale for the same during last year?

G. Shivakumar: Okay, this was done by our subsidiary in Sharjah. It is a trading subsidiary which was in the chartering business. They used to be in the in-chartering businesses, so they used to charter-in and charter-out. So they had a positive view on the tanker market and they were unable to get any deals in the chartering market. And therefore, they decided to use this as a proxy for those transactions. They said we need to go long on the market because we are positive on it. And so they said we will go long by buying these equities. So that was their rationale.

Dhruv Jain: And sir, do we continue to hold these shares?

G. Shivakumar: Yes, substantially most of them are being held.

Moderator: Thank you. The next question is from the line of Chaitanya Shah from Aditya Corporation. Please go ahead.

Chaitanya Shah: Hello, sir. Sir, my question is on the offshore business. What I have understood is after lot of quarters you sounded a bit positive on the offshore business. Now, what I want to ask is, if the rates go up in the offshore business, how are we going to take advantage of it, because most of our fleet I see is already in time charter, so just want to understand that?

G. Shivakumar: Yes, you are right. It is something that concerns us as well. So we don't yet see that big recovery happening. But yes, we need to provide to know that if the market suddenly goes up we have some capability to capitalize on it. So, currently, we have one anchor handler, one ROV support vessel and two M-class vessels, which are our best ships, which could come up for re-pricing in this year. And the advantage with those two MPSSVs, the M-class vessels is that they are the best vessels in our fleet in terms of the spec. And those could be open for fixing in the market. More importantly, our rigs keep coming up for re-pricing because we have contracts getting over in a staggered way. We had one rig which came off contract this year. We have one rig coming off contract early next year. We have two rigs coming off contract two years from now. So we have pricing points every year for rigs and the big impact actually comes from the rigs. So, if the market goes up in the next tender, then you will see it in our next pricing. So, every year we do one repricing. In shipping, if we saw a very weak market, we would say that we will keep all our assets spot, so we have 85% to 90% spot exposure. In offshore, you can't do that because the customer decides for what tenure they want the asset. So if the customer says I want your rig on a three year contract, it's a three year contract, you can either take the contract or you can just sit idle. And that's what we are doing, really. We would take the three year contract because we prefer that to sitting idle. And because we have staggered ends of contracts, we have a pricing every year. And so if the market goes up we will ride it on the way up.

Chaitanya Shah: Okay. And sir my next question was on the dividends that you declared. Now, this is a scenario which I think, I mean, we have declared close to Rs. 96 crores of dividend payout. Now, this is a hypothetical question. I mean, we have the balance sheet strength to declare, even double the dividend, I mean, Rs. 10 dividend or a Rs. 11 dividend, it would have hardly affected the balance sheet given the payout is just Rs. 100 crores and we have close to Rs. 3,500 of cash. I mean, I just want to understand how you sort of came at this number? And going forward if you don't do more CAPEX going forward, then do you think that the dividend payout will increase in the coming years?

G. Shivakumar: So a couple of things. One is, yes, we paid a dividend this year. And because the year was a bad one in terms of our P&L we reduced the dividend. We have a commitment to trying to smooth out the dividend flows to shareholders and not to pass on the volatility of the shipping markets to the shareholders. We try to smooth it out a little bit. Yes, we do have cash and 3,500 is on a consolidated basis, in a standalone balance sheet we have about Rs. 2,250 to 2,300 crores. And so we can afford to pay out more. However, I was explaining to an earlier participant, we also have our risk model, we want to keep cash. We have a fairly positive outlook on the market, but we also have a lot of repayments in this year. And we have some CAPEX that we have to do for the scrubbers. And therefore, we are keeping our money in reserve. If the market turns out the way we hope it will turn out where there is a strong banker market, then certainly dividend can be, additional dividend can be paid out. You saw the dividend payout in 2015-16, which was our last big year where we had a much higher dividend. And therefore, if we have higher free cash flows we will certainly look at paying more dividend.

As to your question on why 5,40 and not some other number? There is no science to it, it is just a number that the Board felt is right. They thought that it could be appropriate.

Chaitanya Shah: All right, sir. And sir this is my last question, going forward will it be safe to assume that the CAPEX intensity going forward in the next five years would be lesser than the intensity you had in the last four or five years?

G. Shivakumar: It depends on the opportunity, we didn't expect the CAPEX intensity of FY17, frankly. It is just that the market gave us opportunities and we decided to take advantage. We got good quality assets cheap, and we decided to go out and buy them. If that happens again next year, we will do that. So we are a shipping company in the shipping business, if we get opportunities to invest at prices which are attractive, we will go and do that.

Moderator: Thank you. Next question is from the line of Ketan Kharani, an individual investor. Please go ahead.

Ketan Kharani: Good evening, sir. The question is on the IMO 2020 again, a lot was talked about it today. So, I just wish to know how GE Shipping is prepared to sail through this IMO 2020 thing? I mean, in terms scrubbers, how many scrubbers that we have already installed and how many ships? I think the portfolio of our ships is around 48, correct me if I'm wrong. So, out of those, how many scrubbers, out of so many ships how many scrubbers have been installed? And how many of them you plan to go through the cleaning method and just be with it?

G. Shivakumar: Yes. So we have 48 ships currently, we have contracted to sell one which will be delivered out in this week. So we will have 47 ships. Of the 47 ships, we have decided to fit seven with scrubbers. The first of those is being installed as we speak, the testing will happen shortly in the next week or two. The others will be installed from August onwards, the other six. So that is where we are on the scrubbers. On the other 40 vessels where we don't have scrubbers, the transition plan is that we just clean the tanks and prepare them for using compliant fuel, which is low sulfur fuel. So there is nothing major to do on the other ships, except that you have to plan out the cleaning very carefully, you have to test out various different kinds of fuels, because these are new products which are available in the market. We have to test them out and see whether they are compatible and whether they are safe for our engines, so which we are doing. And that's about it. So long as it is planned well and scheduled well, it should not be an issue at all.

Ketan Kharani: So, the takeaway would be like installing a scrubber, the capital invested on installing a scrubber is expensive, then running it on the lower cleaner thing and spending higher amount on the fuel charges?

G. Shivakumar: It depends on the ship, actually. So we are doing the scrubber installation on the ships which have a higher fuel consumption. The fuel consumption is a function, one, on the size of the ship, and the length of the voyages. So basically, you consume fuel only when you are sailing from one point to another, you don't consume much fuel when you are standing at the port waiting to discharge or actually discharging or loading cargo. So, the bigger ships typically tend to have longer voyages and have a much higher consumption of fuel. So those are the ones where it makes sense. Like every capital investment decision, we set ourselves a target for a return because this is approximately $3 million investment on every ship where we put a scrubber. So we said, if we are investing $3 million or whatever that number is, we need to make a return on that money also. And only these seven ships are able to pass that test. And therefore we decided, there are other ships which are sort of border line, but these are the ships which were able to pass that test. And we have a safety margin which we keep in all these things, because we want to ensure that we make that return.

Ketan Kharani: Okay. So typically what is the timeline that the cost of scrubber will be recovered?

G. Shivakumar: We have targeted a payback period within two and a half years. We don't think that the differential in fuel prices will last for more than three years, that is, a significant differential in fuel prices.

Ketan Kharani: Okay. Sir, another question, oil is an important commodity, the oil prices effect a lot of, has a lot of effect on the freight rates and everything. So, any outlook on the oil for next two or three quarters?

G. Shivakumar: Okay. Your guess is as good as mine. But we think that oil should be tightening, the supply is fairly tight. And as we go closer to IMO 2020 to end of this year, we think that there will be a progressive tightening in the oil market, especially with Iran sanctions, etc, kicking in. We don't think that that there is that much excess supply in the market to take care of these things. Venezuela itself has dropped off significantly because of the sanctions. So maybe a progressive tightening in the oil demand supply balance.

Moderator: Thank you. The next question from the lineup and Bhavin Gandhi from B&K Securities. Please go ahead.

Bhavin Gandhi: Sir, if you can just comment on the dry bulk market, how should we look at it now? When do you think these volumes can get replaced, the lost volumes can get replaced?

G. Shivakumar: These lost volumes are looking tough this year. So net-net we are looking at about 40 million tons lost to the market this year. We were hoping that Australia would come in at some point. But it seems that that's also going to be difficult. Hopefully, this thing in Brazil gets sorted out and that volume comes back at some point. If it does manage to come back then you will get a really sharp bounce in the second half of this year. But we are not hopeful, because every day you get, today again we got news that two mines have been shut again. So, again, the news flow is very confusing, so it's tough. But generally, I think it is going to be a negative picture, as it stands today. Again, every day the news changes coming out of Brazil. But as it stands, it looks like (-40) is the balance for the year in terms of Iron Ore trade.

Bhavin Gandhi: Sure. And just one more thing, if one wants to look at the forward curves of the differential between diesel and FO beyond January 2020, it is not showing a sharp pick up. Any specific reason you would attribute to that?

G. Shivakumar: It is at running at about 275 for calendar 2020, between HSFO and MGO. This is based on Singapore pricing, right, so that is the benchmark. Today's Singapore pricing differential is about $200. So it is up from $200 to $275, $280, all the way up to Cal 22 it is above $200. Even Cal 22 at today's prices is somewhere around $220, $225. And Cal 21 is somewhere in the $240 to $250 range. So it's above today's levels. And it's still a decent differential to have. I think it still justifies the scrubber if we can get $200 differential for three years.

Bhavin Gandhi: Alright. So that three year pay back that you mentioned can be justified by this $275 differential is what you are saying?

G. Shivakumar: Yes, absolutely. And, yes, it will justify the scrubber investment. So long as you can get it done by 1st January. Again, so every month that lose on that is obviously a reduction from your payback. And you will get a payback and you will get a return also in the first three years itself.

Bhavin Gandhi: Sure. And just one final thing on that IMO, I am not little clear on this part. So this thought on the open and closed loop scrubbers, how does it make a difference, if you can just help me out with that?

G. Shivakumar: Basically, what an open loop scrubber does is that it keeps circulating water through the scrubber. And you just keep pumping it out into the ocean. The closed loop scrubber does not, it is what it says, it is a closed loop, it goes back into a tank, now the alkalinity of that water has got reduced because you have you have sulfur dioxide in water, and therefore it become more acidic. You dose it with caustic soda to reduce the acidity or to increase the alkalinity, and then you keep recirculating it. That's a closed loop scrubber, it's much more expensive to do and you need a lot of storage for that and you take up space on your ship. So very few closed loop scrubbers are being used, except I think in a few cruise ships or maybe some car carriers. So, 95% plus of all the scrubbers which are being installed are either open loop or what they call hybrid where you can convert it to a closed loop, but practically it's not going to be converted to a closed loop. Now, the problem with a lot of ports have is that you are basically discharging wash water into the ocean.Let's say you come to go to Singapore and you are discharging or loading there. And because you are using a scrubber you are going to pump water with higher sulfur content overboard. They are saying, you can't do that in our waters, you can do that on the open sea but not in our waters. While doing our payback calculations we have taken this into account, we have assumed that you will not be allowed to use the scrubber in any port in the world. We started off with the assumption that no port will accept your running an open loop scrubber in it. It is likely that it will happen that way also.

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

Anjali Kumar: Thank you, everybody, for this wonderful question-and-answer session. And, as usual, we will have the transcript of this in about two to three days. Please do feel free to reach out to us if you have any other queries. Thank you.

Moderator: Thank you. On behalf of the Greatest Eastern Shipping Company Limited, that concludes this conference. Thank you for joining us. And you may now disconnect your lines.