

Transcript of the conference call held on January 30, 2004

Moderator: Welcome to the GE Shipping conference call. At this moment, all participants are in a listen-only mode. At that time if you have a question, please press *1. I would now like to turn the conference over to Mr. Rajat Dutta. Please go ahead, sir.

Rajat Dutta: Good afternoon ladies and gentlemen. Thank you for participating in the Quarter Call. We have with us Mr. Vijay Sheth and Mr. Bharat Sheth, Managing Directors of GE Shipping, and Mr. Balan Wasudeo, our Chief Financial Officer. May I now request Mr. Balan to take us through the financial highlights for the quarter and the nine months.

Balan Wasudeo: Good evening. It gives me great pleasure to join you today to discuss the results of the third quarter, ended December 31, 2003. This is the fourth consecutive quarter where we are reporting a performance far superior to the quarter corresponding to the previous year, but this quarter gives us particularly a high level of satisfaction for two reasons, one, of course, we have crossed the Rs. 100 crores mark on a quarter basis, which we feel is a very big milestone, and the quality of the performance has been exceptional, there has been a quantum jump at all levels of our P&L account as you may see, starting from the top line to the gross profit and the PAT, and all this profit has come from operations, and there have been no extraordinary profits either from sale of assets or anything else. The main drivers of this good performance have been partly, no doubt, the extraordinary market conditions of which you are all aware of, but also due to various timely actions taken by the Shipping division. To summarize the main drivers of this showing have been A), a very high revenue base in the shipping division, higher dry bulk earnings, and better capacity utilization of high-yielding drilling assets of the company.

Now, let me get down to the specifics. You will see a very healthy growth in operations, charter hire, as charter hire and freight rates grew by 43% in the quarter and 27% in nine months. This is largely because of the result of timely and large acquisitions made during the last calendar year. To put it in perspective, I will give you a few informative data. As on December 31, 2002, our total DWT was 1.21 mn dwt. It grew to 1.31 mn as on March 31, 2003. It further grew to 1.64 million DWT by September 2003, and gentlemen, it was 2.36 mn DWT as on December 31, 2003. As a result, the revenue base in this quarter was 3030 days as compared to 2381 days in the corresponding Q of 2002. All this combined to take the top line up by 43% in the quarter. The expenditure level, though they have grown to reflect the larger fleet size, was contained to a growth of 23% resulting in an improved gross margin. The gross margin in Q3 of FY03-04 was 48% as compared to a mere 40.4% in the corresponding quarter of the last year and as a result, the profit before interest, depreciation and tax, grew from Rs. 97 crores to Rs. 180 crores.

The increase of Rs. 83 crores is broadly explained by about Rs. 50 crores to Rs. 52 crores from the shipping side due to higher day-rates and higher tonnage, about Rs. 26 crores from offshore because of better capacity utilization and around Rs.5 crores from other miscellaneous income. There was a marginal growth of about 16% in the interest charge. This was due to the amount increased borrowings to fund growth in

tonnage. Depreciation charge has increased from Rs. 38 crores to Rs. 53 crores, again reflecting the tonnage growth and as a result of all this, the PAT grew to Rs. 110 crores, a 130% increase over the corresponding quarter of previous year of Rs. 47 crores. The PAT for the nine months was Rs. 286 crores compared to Rs. 132 crores, a 113% increase. The nine months' profit has exceeded the previous year's 12 months' profit & in spite of this tremendous growth in tonnage and revenue, our capital employed grew by only 24% and is just coming up to Rs. 33,000 crores. Understandably, this has resulted in a very healthy improvement in the return on capital. The nine months' return on equity is around 27-28%, up from what used to average around 18-20% in the previous years, and our return on capital employed is around 15%, both considered to be fairly healthy in the shipping sector. With this, I thank you for giving me a patient hearing and may ask Mr. Dutta to take over.

Rajat Dutta: Thank you Mr. Balan. May I request the participants to put in their questions.

Moderator: We have our first participant, Mr. Anirudh Datta of CLSA Mr. Datta, please go ahead with your question.

Anirudh Datta: Dry bulk rates have been very firm and have obviously been very good for your company as well as you have deployed most of your ships in the spot rate. Over the last few years you have focused more on the tanker business. Given the trends in dry bulk rate, do you see that you will acquire more dry bulk carriers.

Bharat Sheth: Most unlikely at the moment because what has happened as a consequence of the dry bulk rates having gone up, asset prices too have gone up a great deal and at these asset prices, we think that there is probably greater risk than reward in investment.

Anirudh Datta: What's your outlook, going forward, over the next 12 months? Do you believe that present rates growth on the dry bulk and the tankers' side will continue? Your VLCC carrier, has it been deployed on time charter or is it on spot market?

Bharat Sheth: The VLCC at the moment is on the spot market and is committed till some time in middle of March 2004, taking the full advantage of a very strong market. As far as how long this freight market could hold, I think it is very difficult. As you know, a lot of this is being driven by China and its difficult to predict about China getting derailed or China continuing the growth momentum, I think it is very, very difficult to assess. However, even if the markets do come off, I don't think they will come off very sharply. They may not hold at these numbers, but even if the market were to come off by 10, 20, 30% from these numbers, they are still very, very high numbers.

Anirudh Datta: Could you give us some sense of your capital expenditure plans next fiscal, given the fact that this year you had very aggressive additions to your fleet capacity?

Bharat Sheth: We have certain committed investments which were undertaken a couple of years ago, that is totaling approximately Rs.800 Crores, some of which will get delivered some time during 2004 and some of it will get delivered some time during 2005. As far as fresh investments are concerned, it is difficult to make any

commitments just now because asset values on the shipping side are extremely high, so it could be a lot slower than it was in 2003.

Moderator: We have our next participant, Mr. Anish Desai of HDFC Securities.

Anish Desai: At the end of the second quarter, you all did mention that you all have investments to the tune of Rs. 1050 crores in new builds could you give us some guidance on how much of this capex has been completed?

Bharat Sheth: We have got what is now left to come into the book is approximately Rs.800 Crores. So what has already come into our books is in the region of a Rs.1000-odd crores and there is another Rs.800 Crores that still needs to come in.

Anish Desai: And mostly in new builds?

Bharat Sheth: In the new buildings with deliveries spread over 2004 and 2005.

Anish Desai: Can we expect some more second-hand assets coming in?

Bharat Sheth: It is difficult to say because asset prices have gone up very, very sharply. Whilst we continue to look out for opportunities, unfortunately, we are not seeing those many and as you can imagine, in today's market there are too many buyers, but very few sellers.

Anish Desai: What would be the current debt on the books right now?

Bharat Sheth: About Rs. 1300 crores.

Anish Desai: What was the number of operating days lost because of dry-docking.

Bharat Sheth: About 93 days for the quarter.

Vijay Sheth: And offshore was about 15-20 days.

Anish Desai: Considering that obviously cash flows have improved significantly in the current financial year and considering where asset prices are right now, assuming that Great Eastern does not acquire any more assets, what does it plan to do with all this additional operating cash flow?

Bharat Sheth: Well, the point is that asset prices are strong at the moment but you know some of this cash might just have to wait in the wings, as we would call it, because it is possible that later in the year you might get other opportunities. So just at the moment, we may just have to sit on some cash.

Vijay Sheth: Not only that, there will be further investment opportunities for new building of vessels which may come into use over the next two-three years. So in a way of speaking, though we may have the cash available with us, we may commit to buying further capex during the year.

Anish Desai: All right. Just to probe a little more, these are obviously annual cash flows. So they would be recurring would you all be thinking of a buy back or of that sort?

Vijay Sheth: Nothing is on the cards right now, I mean, we have not even discussed it internally, very difficult to say anything right now.

Moderator: We have a next participant Mr. Rajaram of ICRA.

Mr. Rajaram: Good evening sir. I am a rating analyst with ICRA, I would like to find your views on the new IMO regulations which had been agreed upon. I would like to have your views on what impact this could have on freight rates in the near term and also on the residual life for your company's fleet?

Bharat Sheth: Yeah, well, what will happen is on Category-I vessels, of course, they have preponed the scrapping, so there is about 40 million dwt globally that needs to be scrapped by 2005, and far as Category-II vessels are concerned, I don't think it is right to say that the Category-II vessel is on a preponed scrapping progress. If anything, Category -I vessels have been given a little longer lease of life because they are leaving it to the state administration to determine individually as to how long these vessels can trade for. They have actually given a date of 2015. So Category-I they have preponed, Category-II they have not really preponed, they have given a little longer extension on life but each country will have to determine whether they want to call 2010 as the cutoff date or do they want to give an extra 1 year, extra 2 years etc. I think that is very far down the road.

As far as the impact is concerned, what will happen is, you know, globally everybody has been extremely concerned about this huge amount of new building tonnage that was going to be delivered this year and next year, some of that will get tempered because of this 40 million dwt that needs to be scrapped and therefore the net fleet growth could probably be somewhere in the 3-4% level. At one time, we were a little concerned that we were seeing a 6-7% net fleet growth, this could now become 3-4%. So if anything, it is going to swell the market, it is not going to negate it.

Mr. Rajaram: Okay, would you expect any upsides from this or is it just a negation of a possible downward pressure?

Bharat Sheth: I think any upside from now is sheer greed.

Mr. Rajaram: Okay, thank you.

Moderator: Thank you Mr. Rajaram. We have our next participant Mr. Chandresh of ARG Securities.

Mr. Chandresh: Hello, sir. Regarding this return on equity which was mentioned 28%. Have you worked out the figures separately for shipping and offshore division?

Balan Wasudeo: This is very difficult as we have a lot of common facilities. We have to look at overall company's

Mr. Chandresh: Okay, fine thank you.

Moderator: We have next participant Ms. Seema Shah of Way to Wealth.

Ms. Seema Shah: What would be the impact of the Sagarmala Project on the in-house shipping?

Vijay Sheth: Well we don't know, we need to see what exactly comes out. It could have some impact on our ports and terminal services area where we may see an increase in the port activity levels.

Moderator: We have our next participant, Mr. Arun of Reliance Mutual Funds.

Mr. Arun: We hear some unbelievable freight rates. How much do you think has been captured in your numbers so far?

Bharat Sheth: Well, it is difficult to give a percentage as to how much has been captured but we suspect a lot of the expansion that has been done was done in the quarter of October-December and a lot of deliveries staggered through in November-December. So I think the real impact of this will be felt in Q.4.

Mr. Arun: And what will be your sort of strategy to capture this in the coming quarters?

Bharat Sheth: Well, we are now running, most of the expansion that we have undertaken, in the spot market and so long as they run on the spot market they will be able to capture almost all of it. Only 2 ships out of the 11 that we have taken in the last 9 months have been fixed on period.

Mr. Arun: Going forward, you will consider locking it up for long term contracts?

Bharat Sheth: On the crude side where we now have 11 crude oil tankers, we have sufficient cover for 2005 and we are unlikely to go for more covers unless of course somebody pays us some very, very strong numbers. Because what we are seeing today, is a huge differential between spot market earnings and period earnings. I mean, to give you an example on the AFRAMAX tanker let us say the spot market if \$30,000 a day, the period rate for the same ship over 1 year would be say \$17 or \$18,000. So it is leaving too much money on the table.

Mr. Arun: Okay thank you.

Moderator: We have our next participant, Mr. Sachin Kasera of Pioneer.

Mr. Sachin Kasera: Congratulations, sir on the very good results. One question regarding your acquisition strategy. If we see in the current year, especially in the last 2 quarters you have gone greatly in terms of acquiring second hand assets whereas previously you were more focused on buying new vessels. So what has been the reason for this sudden change of strategy. Is it that the returns on second hand are much better than the first one, or was there some mismatch in terms of the fleet profile between first hand and second hand vessels.

Bharat Sheth: No, the real problem was that the shipyards were pretty full and any contract that we would have signed, let us say in the last 6 months, we would not

have been getting deliveries until early 2007. Whereas the benefit of buying the second hand was that you got deliveries within 25-30 days and you were able to capture most of the spot market increase, so we were very keen to go and acquire second hand ships because they just gave us opportunity to capture today's spot market.

The second thing is that we believe that what is important for our company is to continuously take a mix of newer ships and older ships because the newer ship would give you a longer trading life but they would obviously have a lower return on capital whereas the older ship give you a much bigger ticker on return on capital and we felt that a blend or a mix of both these would give us a better overall average than only new buildings or only second hand vessels.

Mr. Sachin Kasera: So sir have you not decided on some sort of broad range in which you would like to keep your ratio of second hand and new hand vessels?

Bharat Sheth: No we don't have a ratio I think it is more on wherever we see the opportunity. What has happened now is that second hand values have really risen very significantly. Let me give you some numbers; on the dry bulk it is up almost 70-80% in the last 12 months and in the last 1 month alone, second hand values are up about 10%. I mean that is just in the last 3 weeks. Now, therefore one might be forced to revert back to the new building markets and it just means that you don't get deliveries until 2007, or maybe even 2008.

Mr. Sachin Kasera: So that means that our new fleet acquisition program could probably go on a slow stream.

Bharat Sheth: It would certainly, it is unlikely to repeat what has been done in 2003. In 2003 the values had not really risen by very much, by very high numbers, they were more or less flat compared to 2002, but having risen 40-50% we would like to be a little cautious.

Mr. Sachin Kasera: You have primarily focused in terms of AFRAMAX. In the last quarter we brought one VLCC. But if we see the share of AFRAMAX in the crude is disproportionately high so do we, in going forward, focus more in terms of SUEZMAX or VLCC, or would we keep on building on AFRAMAX?

Bharat Sheth: No I think we just buy wherever we see the investment opportunity is right. I don't think we have consciously gone and built only AFRAMAXs or consciously you know only looking at SUEZMAXs because eventually we want to go in all 3 segments. Wherever we think is the right investment opportunity, that is where we focus on.

Mr. Sachin Kasera: There is a mention in the press that you are going in for International Ship and Port Facility Security. Do we attract a premium for it?

Bharat Sheth: No, no. This is the ISPS code which we have already successfully implemented on a couple of our ships. This is a statutory global requirement, and all ship owners have to comply with this code. You know this is protocol post 9/11 issue, for ports and ships' security and we will be well within the required deadline to achieve the status.

Mr. Sachin Kasera: Okay. What was the cash on balance sheet as on December?

Balan Wasudeo: About Rs.500 crores.

Moderator: We have our next participant, Mr. Anshul Trivedi of B&K Securities.

Mr. Anshul Trivedi: With regard to tanker freight rates. Where do you see tanker freights to go, and how are you taking care of such a situation?

Bharat Sheth: Well, first of all you can't take care of these situations because you know, these are just markets that will go up and will come down. But, what one is generally hoping is that China will continue powering this growth. Going forward China today consumes about 5½-6 million barrels of oil a day and people are expecting a 10% growth on this level of consumption. All this has got to come from sea-borne trade, because domestic production can satisfy this rise. So if you take 10%, and if that number is right, you are talking about an additional 600,000 barrels of oil a day, which when you translate on an annualized basis, is going to drive the demand for tanker tonnage. And in America US crude oil stocks are at a 28 year low. Now these are very low numbers and therefore, currently the refining is being diverted into heating oil. But what happens typically is, post April the US refiners start building up for the gasoline demand, to meet the driving season which normally begins in July-August. So we believe that the demand in America, could come out a little half a million or million barrels, but this year in general, the demand across the year will be higher than it was in 2003.

Mr. Anshul Trivedi: Regarding the older vessels, will you be looking at cashing in on the high rates which are available in second hand market, and if so, can you give us a number as to what proportion of the fleet would you be looking at, selling?

Bharat Sheth: No you know if you look at the older vessels, we still think that the cash flow that we are earning on the assets is disproportionately higher to the value of the assets. Because the assets being old, their values have not moved up in proportion to the cash flows. So for example, a 1 year cash flow can repay your entire ship out. So what is the point of selling it?

Mr. Anshul Trivedi: Very true. Now that spot rates are very high but at a time when you see them tapering off, I mean, stabilizing. So better thing would be to go in for booking yards for scrapping before that, because right now scrapping rates are very high. I guess they are around \$320.

Bharat Sheth: Now its \$350. The problem is by scrapping there is inability to get back into the market. Let's say some of the estimates are wrong and maybe China continues this pace of growth. And if the market remains strong an old ship even if we take \$350 on the light weight. We are talking about some of the older ship that we own are probably worth 2 or 3 million dollars. But the 2 or 3 million dollars you can make up in 6 months of earning. So it is too risky to just go and sell.

Anshul Trivedi: Till what period do you see freight rates to be buoyant. Because I believe are we correct in saying that until you see freight rates to be buoyant you not going for scrapping.

Bharat Sheth: We think that even vessels that we had originally floated to scrap, we would actually like to play a different strategy which is to spend on drydocking and try an extract even further life. Let us say a vessel that is due for scrapping is probably going to give the company 2 or 3 million dollars, so it is not a huge amount of money in terms of cash. By spending an additional million or 2 million dollars if you can extract additional life out of that assets and if the market remains strong, you could just make a lot, lot of money on that incremental 1 or 2 million dollars and the risk you are taking on that 1 or 2 million is much less than if you buy a second hand ship today where the risk could be anything close to 10, 15, 20 million dollars.

Moderator: We have our next participant Mr. Rakesh Jhunjunwala.

Rakesh Jhunjunwala: In your segment revenue you have given your other income has gone from Rs.36 crores to Rs.66 crone, what is this other income.

Balan Wasudeo: Are you referring to 9 months.

Rakesh Jhunjunwala: Yes.

Bharat Sheth: Yeah predominantly driven by property you know as we had some residual property on the de-merger of the real estate division. We have been quite successful in selling a lot more properties this year, so that has obviously helped reduce the block in real estate.

Rakesh Jhunjunwala: So there is no profit element in that.

Bharat Sheth: No, no. Virtually not. Then we had higher treasury of the cash balance our interest earning has been a little higher for 2003 as compared to 2002. These predominantly have been influential in the Rs.60 odd crores.

Rakesh Jhunjunwala: Is it right to conclude that next year your revenues should be, your shipping revenues should be 3 times of previous years revenues.

Bharat Sheth: It is very difficult to comment on this stage.

Rakesh Jhunjunwala: No no I think if the current freight rate remains your fleet has doubled and with your freight rate being above 2 or 2-2½ times, 3 times, 2002-03 even if you lock in long term you will lock in at increased freight rates.

Bharat Sheth: No what is happening today is that there is a huge differential between spot rates and long-term rates. To give you an example if you take the VLCC which best explains the story. The spot market is giving you an earnings of somewhere between 70 and 80,000 dollars a day. 1-year rate is probably still at \$30,000.

Rakesh Jhunjunwala: No, no I am referring to 2002-03 as your base.

Bharat Sheth: On the new building you see what we did was in order to continuously de-risk the model, the new buildings we locked in for up to 3 years. So those new buildings have been locked up till some time early 2006. With that risk virtually covered we built up only secondhand ships. Now the secondhand ships are

all as the moment running on the spot market. So one has much larger revenue base. Now obviously if the market remains the same as this year we will have a significantly high revenue growth next year.

Rakesh Jhunjunwala: Right so therefore I see you shipping division's revenue of Rs.710 crores for 2002-03. So easily your revenue for shipping in 2004-05 being what they are today should be around Rs.2200, Rs.2300 crores

Bharat Sheth: A lot will depend on what the rates locked in.

Rakesh Jhunjunwala: So I am saying if you take today's rates as the base freight rates.

Bharat Sheth: Yeah, I mean I do not have a precise number to tell you whether it will be 3 times or 2 times or whatever, but if you take today's rate it will be significantly high. The freight rates are not 2½-3 times across every segment. In certain segments the freight rate are of 50-60% the only segment where the freight rates have gone up about 3 times, is probably on the handy side bulk carriers. Where we have only 6 ships and out of the 6 ships, 2 vessel are due to be scrapped due to their age one in November in 2004 and the other one in March-April 2005. One more point is that if you take the entire product segment the rates have moved within only at 10% band and that too after a lag. So it is only in certain classes of assets. If you take the average of the crude it is probably up about 50%.

Rakesh Jhunjunwala: And other thing Sir, you have Rs.500 crores of cash and I think you add cash at Rs.180 crores a quarter, I think you should be able to fund your entire committed expansion with your own money.

Bharat Sheth: Yeah in fact some of the expansions that we have done in the 3rd quarter of this year is on cash basis. We haven't taken on incremental debt of the last few ships that we bought.

Rakesh Jhunjunwala: But then with such a improvement in your debt equity relations, your issue, should you not give any liberal dividends.

Bharat Sheth: I think the issue calls for a long debate on dividends and the point simply is that you know today may be you know it is looking like "surplus" cash, because we have continuously looking for investment opportunities and although as I said so earlier today asset value has gone up tremendously and maybe the investment opportunities may not come immediately. But I think if you take a medium-term horizon, I think this cash will provide very, very significant returns. We will also have repayment and you know there will be a stage payment on some of the new buildings that we have got, and it is possible that if we acquire additional tonnage we may utilise the cash. So I think the jury is still out on what will happen to the cash.

Moderator: We have our next participant, Mr. Ayaz Motiwala of Birla Mutual Fund.

Mr. Ayaz Motiwala: Sir, you were explaining the differential between the spot rate and the time charter. You threw a number where you said that the difference was

between \$17,000 and \$30,000 that is the kind of number you talked about. I could not figure out you know the typical spot deals are done at what period.

Bharat Sheth: No the typical spot deals you mean the duration of the spot deals. I would say anywhere between 20 up to 40 days. I mean when we say spot we refer to one particular voyage. And you know the example I gave you what for a VLC where the spot market is somewhere between \$70 and \$80,000 a day, but in the same ship I was to give on a period I would not really get much more than \$30,000. It could be \$31,000 \$32,000. But it won't be much more than that. But that is not to reflect what the spot market will do over the next 12 months. You see what is happening today, because of the trend in the market the bid offer spreads are wide, considerably wide.

Ayaz Motiwala: Understandably. Okay so just to build on that Sir, one of the meetings which I had some time back with your company you had explained as a policy you do about 65-70% on long contract. This was the stated policy at that point of time, in a normal shipping market, this is a very buoyant shipping market. So is that stated policy of doing long contracts upfront deals to catch the middle of the market rather than two extremes, does that remain and what's the change in the light of new tonnage acquisition and the market.

Bharat Sheth: I think in light of both tonnage acquisition and the market and probably the fact that asset values have risen considerably. We think we have already now reduced the long-term period and cover that may have to be 45% from 65-70% levels. So we have got a much greater exposure today to this spot market than we had some time ago. And partly it is not only driven by the very strong spot market but it also gives us the option if we want to sell any of the ships.

Ayaz Motiwala: Sir I am understanding it right what you are saying is that sorry this is a function of long contract getting over and deployed in spot and what have you done to additional tonnage additions.

Bharat Sheth: Yeah of the 11 ships, now 2 are in very long-term contract is going up to 3 year another 2 ships are for 1 year then there are 7 ships which are purely on the spot market. Spot market being defined as 20-40 days. The idea of doing this is that on the modern ship we want falls to secure a minimum level of profitability for the company because you know if the market whenever they do we will still be able to secure some strong results.

Ayaz Motiwala: Right so put that in perspective for us Sir in terms of number these 11 which you put in terms of and I believe you have crossed 2.5 million dwt now as a company could you give us a sense of numbers in terms of , just to get a sense of it, I know it is a very, you know difficult to model that in but just to understand the numbers.

Bharat Sheth: We have covered in the tankers 43% of revenue days for fiscal 2005, crude 44% and product 40% on the dry bulk, 24% is covered. But this is a dynamic number.

Ayaz Motiwala: Absolutely. And sir this in terms of tonnage would that be? could you put that in perspective for tanker and dry bulk.

Bharat Sheth: You know what is much more important is in terms of revenue days as opposed to in terms of tonnage because I could cover a 25,000 dead weight vessel for 1 year and if I cover my VLCC it makes a big difference.

Moderator: We have a next participant, Mr. Harigeet of UTI Mutual Fund.

Mr. Harigeet: Good afternoon sir. Congratulations on the very good numbers. Sir, this increase in the freight and demurrage income from Rs.63 crores to Rs.112 crores, would this be because we are operating in this spot market mainly because of the increase in the dry bulk rates, could that be a right explanation to derive from it?

Bharat Sheth: Yeah, absolutely correct. Because we have done many more voyages as compared to previous period.

Mr. Harigeet: Yeah and sir again the increase in direct operating expenses is it an offshoot of the same.

Bharat Sheth: Absolutely correct.

Mr. Harigeet: Sir just following on that, what is the feeling in the sector as such on the implication of tonnage tax? Sir, the fact that there is a vote on account and probably after the election there would be a budget. Now, what is the feel in the company and the industry if tonnage tax is going to be a reality in this particular year or 2005?

Bharat Sheth: Well, what we are being told at an industry level is that tonnage tax has been accepted as a concept and I think the law ministry is probably getting into the nitty-gritty of drafting. So we as an industry remain fairly confident that tonnage tax should come through whenever the budget is presented.

Mr. Harigeet: And sir, so what could be the kind of taxes that one look at, going forward, once tonnage tax becomes a reality for you?

Bharat Sheth: You know, we don't know what is the scale that is going to be recommended by the finance ministry for the tonnage tax. So it is very difficult to give a very precise answer. But if they go on the UK model, the tax rate should be approximately 2%. There is graded scale for tonnage, and the higher the scale you go up to, the lower the per ton cost, or lower the per ton revenue recognized. And then they just take the corporate rate of that. But I think average in the UK, under the tonnage tax regime, people are paying approximately 2% tax.

Moderator: We have our next participant, Mr. Mohan arswami from ABN Amro.

Mr. Mohan: On the offshore business, what has been the scenario in terms of the rates, particularly given that lot more finds on the crude and gas fields, has there been any buoyancy in the rate?

Vijay Sheth: Yeah, I mean there has been certain amount of improvement in the activity level, but you must not forget that there is a gestation period between the find and its actual production, I mean put on actual production mode. We have been fortunate this quarter because both our drilling rigs were fixed earlier in the year and

both of them worked throughout the Q.3 of fiscal 2004. As far as our offshore support vessels go, I think more or less the utilization has been quite satisfactory, between 80-85% for the quarter.

Mr. Mohan: Okay. On the shipping side, you mentioned that the operating days this quarter was slightly over 3000 days, given that most of the addition that happened towards the end of the quarter any ballpark number you would throw for the next quarter which can be the run rate for the year?

Bharat Sheth: We don't normally give any forecast as such for the Q4, revenue days for Q4 roughly will be 3200 days.

Moderator: We have our next participant, Mr. Ankit of Amit Nalin Security.

Mr. Ankit: Congratulations on very good set of numbers. What I wanted to know is like considering that it is difficult to forecast the shipping revenues in 2005-06, and going by the scenario that the current ratio of your shipping to offshore revenues 70:30, what do we expect it to be in the 2005-06.

Vijay Sheth: Difficult to say. Very, very difficult to say. Probably the same. Give or take a couple of percentage points.

Moderator: We have our next participant, Mr. Shrinivas of Imperial Investments.

Mr. Shrinivas: Just to take on the comment that you said on the VLCC, the difference between spot and long term, but you said the difference between the long term and spot rate does not really reflect the outlook for freight rates. Why do you say that?

Bharat Sheth: Well, you see what happens is that when, that the freight rates could come off that point nobody really knows. Let's just take last year, which is a known fact. Last year when the spot rate was at \$50,000 a day, the one-year period rates were at \$20,000. Now eventually if you take what the owner earned on the spot market between January and December of 2003, he probably made a net of about \$44,000-\$45,000 per day. So therefore it is not as if the person who was taking in the ship at \$20,000 per day. He would have made a loss of \$20,000 because there were no givers to him at \$20,000. The bid off spreads are so wide, I mean I would love to take a ship today at \$30,000 a day and give it out to somebody on the spot market at \$80,000 because that's the straight arbitrage. But the point is that those who want to take the ship, they are not really there to take the ships on a speculative basis but there are more people who need it for their own use and those people; they just don't want to go and pay, or you know pay close to today's spot rate; because rightly or wrongly, they say that you know the long-term average has been, you know, say the 5-year average has been \$30,000 a day, for example: These people are being forced to take vessels on the spot market. You see, what has happened is; globally oil companies used to have something like 40-50% of their transport requirements covered in under period charter, when the spreads were much less between spot and period. Today, what has happened is globally, I am giving you a global average, probably only 18-20% as of global requirement had been covered on long-term period. The balance 80% is by force being covered on the spot market and that is one of the reasons why we are getting this huge volatility in the market.

Mr. Shrinivas: But suppose I am a crude company and I am refusing to convert to long-term, does this mean that I am taking a call on spot rates?

Bharat Sheth: No, no, you might be willing. Let us say you are a crude company and say you came to somebody like Great Eastern to say that look I am willing to pay you \$30,000 per day. The point is, I would not be there to give you the ship at \$30,000; because I am earning \$80,000. Now you again come and tell me that I am there to pay you \$40,000 per day but I might still not give it you because immediately in the first 40 days, in one spot voyage, I am making straight \$1.6 million dollars more.

Mr. Shrinivas: So sir, that's what I am wondering why isn't that arbitrage that difference coming off. I mean I should be willing to offer you more than 30, right?

Bharat Sheth: You should be logically willing but you as an oil company would say that what has been the average for the last three years, or the average for the last five years. Now because of the volatility in the VLCC, for example, in 2002 the VLCCs were earning \$6000 a day. So you would be scared to take in a ship at \$30,000 per day because at \$30,000 per day if the market were to drop to \$6,000 per day you would be jammed. So, oil companies just find it very simple to say, look we will ride the market, why take too much cover if the market is strong, we will pay the rate, if the market is weak, we will pay, because oil companies, eight times or seven times out of ten are able to pass on the cost. I mean, if the refining margins are now up to \$6.5 they pay extra transportation costs on the crude but they are able to pass it on.

Mr. Shrinivas: Okay. Can you give a feel on how the average rate for your fleet has increased for crude product and dry bulk for the nine month period?

Bharat Sheth: I have got it for the three months if you would like?

Mr. Shrinivas: Okay.

Bharat Sheth: On crude, the average that Great Eastern, I mean what crude fleet has earned, basis voyages that are completed, has been about \$22,600 a day. On the product, we have earned an average of about \$18,500 per day, and on the gas carrier it has been the same at \$17,000 per day. On the dry bulk, the average earning has been about 13, 000.

Mr. Shrinivas: Can you break this up into what you have earned in long term and spot term?

Bharat Sheth: No this is a total that we have earned. But I will give you the difference. The crude carriers which are on period, which are on long-term, three year business, they are averaging somewhere between \$17,000 to \$19,000 per day. Now the same class of vessels on the spot market are today earning approximately \$30,000 a day.

Mr. Shrinivas: Okay. So would it be fair to say that 44% of your fleet is covered, say 44% of this fleet would earn about, definitely earn about 17,000-19,000 and the balance would earn whatever is spot rate?

Bharat Sheth: That is right.

Mr. Shrinivas: So if I just multiply that percentage, I would get the increase in realization for next year?

Bharat Sheth: Well, I really do not know what the spot rate will do next year. This 44% and 56% is also a moving target. You know, it is 44% today, but these numbers can change.

Mr. Shrinivas: Okay sir, can you give this figure for product and dry bulk too?

Bharat Sheth: Yeah on the dry bulk as you know we have 24% covered, it is covered at about \$13,000 a day on one ship and at \$19,000 a day on another ship. Now, on the spot market on comparable tonnage, we are earning at an average about \$22,000-\$25,000 a day. On the product tankers, the volatility has been much less at the moment, and really on the spot market in the product, it depends where you are geographically. To give you an example, today in the Pacific we have a product tanker which is earning us at an average \$17,000 a day. At the same time, we have an identical sister ship in the Atlantic; it is currently earning us \$35,000 a day. But you know, these things can change. Today, the Atlantic is stronger because the severe winter in America there is a big movement of heating oil. You know these things can change. Suddenly the arbitrage will open up East-to-West. Last year, for example the East was earning \$30,000 per day and the Atlantic was earning \$6,000 a day.

Mr. Shrinivas: Okay, you covered about 40% of your product fleet. What is the long term average there compared to \$18,500 per day that you did this quarter?

Bharat Sheth: It is about \$12,500 per day.

Mr. Shrinivas: Compared to \$18,500 per day that you get this quarter.

Bharat Sheth: Yeah compared to \$18,500 which is the market today but we have not gone and fixed anything at the moment at this \$18,500 per day levels, because we believe that the spot market will give us these returns, and we also believe that we seem to have sufficient cover at the moment and we are not interested in covering more at the moment.

Mr. Shrinivas: What is the typical coverage, these coverage ratios that you provided for '04-05. What were these for this year, at the start of this year?

Bharat Sheth: Oh, start of this year. I do not have the exact details, can I request Rajat to contact you?

Mr. Shrinivas: Sure, sure, thank you.

Moderator: Mr. Desai of HDFC.

Anish Desai: I think I just missed out on what is the outlook for the offshore division, is there as much excitement?

Vijay Sheth: Well, I think there is a lot of excitement, certainly, but we just have to see when the full thing takes off, because with NELP underway, the operators are definitely wanting to increase their exploratory activities and there have been recently quite interesting finds both by Cairn and Reliance. ONGC also a couple of days ago, had an interesting finding in Krishna-Godavari. All this is bound to increase the interest in India. ONGC is also increasing their activity levels by throwing open the marginal field development, which is an interesting facet of the business, where you are going to develop smaller fields which may just have marginal quantities of oil but that also will increase the number of players and the activity levels. So I think there is a lot of hope that things will definitely look up. Let's keep our fingers crossed. Finally, there is also the deep-water activity which you must have read about in the newspapers. Government of India has through ONGC earmarked about Rs.4,000-odd crores for the deep-water drilling activities, spread over the next 3 years. The first rig has already commenced operations, the second rig is coming sometime in February so she should start operations soon thereafter.

Anish Desai: Right, so considering that, you know, there is substantial demand, at least in the offshore rigs, you know, is there any potential for building capacity in this business. What are the asset prices like currently?

Vijay Sheth: Well, the asset prices are quite high, you must not forget that most of the drilling contractors are large American companies with serious resource capabilities. As far as the deep-water drilling rigs, the market is a little weaker in many ways but the asset prices there are quite significantly high, and there is a huge bid-offer spread, a willing buyer may be agreeing to pay \$150-\$200 million dollars. There are no sellers at these prices, so for these deep-water assets, the bid-offer spreads could be, maybe even close to 50 million dollars per rig, but these rigs could very easily drill beyond 7500 feet and you know, they are what is called dynamically positioned rigs. So they are quite expensive, very difficult to handle, and very technologically advanced to operate. So I mean, there is an opportunity if you have the right assets, I think, for employment but you just have to be a little bit more careful.

Moderator: We have our next participant, Mr. Navnit of Rare International.

Navnit: Why the product tanker TCY in Q3 are lower than that of Q2.

Bharat Sheth: I will tell you why, because in Q3 of last year, we had fixed some vessels in the 2001 market, at very high rate, so those vessels reflected earning in Q3 of last year. We were not able to secure the same rate.

Navnit: I am comparing with Q2. Q2 you had \$2,700 per day. It has fallen to \$12,300 per day.

Bharat Sheth: Again for the same reason, you know what happens is a lot of this works with a time lag. Now, if there were fixtures that were made let us say in Q4 or Q1 of '03, I mean, let us say, Q4 of '02 and Q1 of '03, they would reflect, even if they were on the spot market, they would reflect in the different averages of Q2. Let us say, I make a fixture today, it will reflect in the Q4 and let us say that today the spot market in the Atlantic, as I just said, is \$35,000 per day, so my Q4 may show 35 because it is at one fixture that has completed in the quarter. Now due to seasonality and other reasons, maybe Q1 FY05 is slightly weaker, but that does not

mean that it is on a secular downturn trend. It is just that you know it is to do with the seasonal variation.

Navnit: Okay. And the earning in dry bulk carriers, does it include mini bulk carriers, as well?

Bharat Sheth: No it does not include mini bulk carriers because those mini bulk carriers are earning at an average about \$1200-\$1300 dollars a day, so we just do not consider it in the equation.

Navnit: I had a suggestion that why don't you disclose offshore day rates as well.

Vijay Sheth: Well basically, the offshore business is largely tender driven and therefore from the point of the view of the company, you know, for confidentiality purposes, we believe that it is in the long-term interest of the shareholders that some of these things are not in public domain. Plus, you must not forget that the asset play or the number of assets working in offshore is significantly less as compared to shipping data. Shipping is a very well researched business. So to that extent there is also that part, and finally of course, in offshore there is nothing like a spot market in India at least. I mean, there may be an occasional OSV fix, largely because of the construction jobs that are conducted offshore India. So those are very few and far between and not representative.

Navnit: Okay. If I may ask, around at what rate the drilling units have been chartered, the Badrinath, I think, you did at the end of Q2?

Vijay Sheth: The Badrinath fixture is somewhere in the mid-30s.

Navnit: Okay.

Moderator: We have our next participant, Mr. Anshul Trivedi of Batliwala and Karani Securities.

Anshul Trivedi: As far as the HANDYMAX are concerned, a lot of activity has been seen over the last 2 months in the scrapping. So basically the thing is that the net addition of HANDYMAX has been negative, so do you actually see a situation again arising in the HANDYMAX section in which the freight rates are jumping up again.

Bharat Sheth: Well freight rates are, as you know, are extremely strong in the HANDYMAX segment. If you are talking about a fleet growth in 2004, we expect a fleet growth of approximately 5% on the HANDYMAX segment. You know, the markets are at extraordinarily high levels on HANDYMAX, what will happen, you know for the next 12 months is very, very difficult to answer just now. If China continues this momentum, there is no reason for this market to come down. If China gets derailed for any particular reason which you know, is very difficult to know why, but it can happen, I mean, the government there can suddenly decide to cool the economy off and these are factors beyond our control, then you could see a softening in the market.

Anshul Trivedi: No sir because, my query comes in from point of view because if you look at the dry bulk section, of the 931 ships that were taken off in the second

hand market, China took something like 80 ships whereas Greece picked out 286. But in case Germany, it picked up close to 100 ships which were all in the HANDYMAX segment, not all but 90% in the HANDYMAX section. So I mean, are you seeing a situation in which Europe is becoming increasingly interested in the HANDYMAX vessels?

Bharat Sheth: No what is that in Germany, the reason people are buying ships is because German government has given significant tax incentives to those people who are buying ships. So there are leasing companies that have been set up. They are buying ships but they are not running them as a ship owner, they are buying the ship, taking the benefits of the depreciation etc. but leasing them out. They own ships but they are owning them from a financing viewpoint.

Moderator: We have our next participant, Mr. Chandresh of ARG Securities.

Chandresh: Regarding this tonnage tax which you said is 2% of revenue or 2% of profit?

Vijay Sheth: Profit, profit.

Mr. Dutta: Yeah, I guess, most of the questions have been dealt with.

Moderator: Yes, Mr. Dutta. As there are no more questions, I would now like to hand over the conference to you Mr. Dutta. Over to you.

Mr. Dutta: Thank you once again to all the participants for spending time with us. We will be available for any other or further questions over e-mail. Can I request the closure of the conference. Thank you once again.

Moderator: Ladies and gentlemen, this concludes the conference for today. We thank you for your participation and using Tata Indicom's conferencing services. You may please disconnect your lines now. Thank you.