

The Great Eastern Shipping Company Limited
Q2 FY12 Earnings Conference call
(November 14, 2011)

Moderator: Good afternoon ladies and gentlemen, thank you for standing by. Welcome to GE Shipping earnings call and declaration of its financial results for the second quarter ended September 30th 2011. At this moment all participants are in listen only mode. Later will conduct a question-and-answer session, At that time if you have a question please press '*' and '1'. I now hand the conference to Ms. Anjali Kumar, Head of Corporate Communications, at GE Shipping, to start the proceedings. Over to you Ms. Kumar.

Anjali Kumar: Good morning. Welcome to our Q2FY12 results conference call. We did announce our results on Friday so I hope you all have had enough time to go through it over the weekend. So instead of going through the results, we can directly start the Q&A sessions.

Moderator: We will now begin the Q&A session. We have the first question from Bhavin Gandhi from B&K Securities.

Bhavin Gandhi: Can you share with us the consolidated and standalone NAV number?

G. Shivakumar: The consolidated NAV is Rs. 448 per share and standalone is Rs. 329 per share.

Bhavin Gandhi: Why is the standalone NAV marginally lower as compared to the first quarter?

G. Shivakumar: The values of shipping assets have dropped during the quarter. The tanker values dropped by about 7% for tankers, whereas dry bulk values softened by around 10%.

Bhavin Gandhi: What was the thought process behind the cancellation of the MSV contract?

G. Shivakumar: It is just that we were not able to get a fix on the delivery of the vessel, so we decided that rather than wait, we cancel it.

Bhavin Gandhi: Have we booked any loss in the quarter because of that?

G. Shivakumar: No, we do not expect that there will be any loss from the cancellation.

Bhavin Gandhi: Can you share with us the segment wise utilization in your offshore fleet?

G. Shivakumar: On drilling of course it is 100% because both the rigs are on long term contract. In the supply vessel segment, PSVs are close to 95%, whereas AHTSVs are about 80%.

Bhavin Gandhi: What were the total number of operating days during the quarter for offshore?

G. Shivakumar: They were just over 1500 days.

Bhavin Gandhi: Can you provide the CWIP in the offshore and the shipping business?

G. Shivakumar: In the shipping business it is approximately \$160 mn and in the offshore business it is about \$65 mn.

Moderator: We have the next question from Mr. Vikram from Antique Stock Broking.

Vikram: Good afternoon sir, in the shipping CWIP which you said that \$160 million is it for the VLCC orders?

G. Shivakumar: That is correct.

Vikram: How are the payment agreements with the yard in case of 3 VLCCs?

G. Shivakumar: We have to pay the delivery installments on each of those that will be simultaneously with the receipt of the money from the buyers.

Vikram: Are we seeing any delays in the deliveries of the remaining orders in offshore business?

G. Shivakumar: There are some delivery delays including in the sister ship to this one which we cancelled but we are trying to find out when exactly the deliveries would be. We are working with the yard on that. But overall most of the assets are coming in according to schedule.

Vikram: How many vessels were dry docked during this quarter?

G. Shivakumar: We had three surveys during this quarter of which one was a full dry dock and two were surveys done without requirements for the dry dock, typically for younger assets.

Vikram: Any schedule for the coming quarters?

G. Shivakumar: In the next quarter we expect to have around 4-5 vessels dry docked.

Vikram: Do you have any open position on forex side?

G. Shivakumar: The forex hedging or the transactions that we do are hedges against our revenue inflows, so we do have some forward sold positions, which again reflect in our hedging reserves in the accounts..

Vikram: Are you looking at buying new assets or will wait for further correction in values?

G. Shivakumar: Not yet, we are not in the position where you feel it is a great buy. So I think it requires a further drop especially given the worsening market scenario.

Moderator: We have the next question from Mr. P Manoj from Mint.

P Manoj: In respect of canceling the MSV, you said that the delay is from the yard side. In such a situation have you got the money back from them?

G. Shivakumar: We will be getting back the money for the cancellation as per the term of the contract. We will be repayed the advance payment that we have made.

P Manoj: And how much is that?

G. Shivakumar: It is for the advance payments that we have made. We are not allowed to disclose the amount of money because it is the part of the contractual payment terms. But yes we will be receiving the payments that we have made so far.

P Manoj: The other vessel has also been delayed. So will you be looking at canceling that vessel?

G. Shivakumar: No, we are working with the yard to see what delivery schedules we can get out of that.

P Manoj: The government has allowed Indian ship owners to put armed guards on ships. Have you started putting armed guards on ships?

G. Shivakumar: No, we have not yet but it is something that we are looking at. Again, we are looking at a broader regulatory environment etc. so I think it will require a lot of consideration before one can do that.

Moderator: We have next question from Mr. Janaki Raman from Franklin Templeton.

Janaki Raman: The shipping business is going through a really tough time and if you strip off the effects of gains and the other income the EBIT turns out to be negative. How do you foresee the situation in coming quarters?

G. Shivakumar: I do not think that the EBIT is necessarily negative for all the companies, but yes broad conclusions are correct. The situation has not improved from the last quarter till now. And if anything the rates are lower on the dry bulk side. Also, we do not expect a great improvement in rates in the short term. Again having said that you would never know what happens as per the reports, the winters in the US have started a little early and you could have a sudden pickup in heating oil demand which will hopefully result in higher rates for tankers.

Janaki Raman: As per reports, the asset prices for large vessels have come down quite sharply. Have you seen the same thing happening in the smaller segments?

G. Shivakumar: The asset values in the smaller segments have been quite steady over the last year. They dropped quite a bit in the initial stages of the market fall which was in 2009. So on a year on year basis and they are probably down marginally or around the same level. What you heard about the large tankers is very true especially in the age range of 10 to 15 years where we have seen a dramatic drop in values by about 15 to 25%. It is not yet been seen on the very young fleet, say around 0-5 years.

Janaki Raman: When will the VLCC sale transaction happen?

G. Shivakumar: Two vessels are scheduled to be delivered in first quarter of next calendar year, that is between Jan to March 2012 and one vessel just after that, so its early next FY13.

Janaki Raman: So you will pay roughly about \$320 mn and in return will get cash flow of slightly less than that?

G. Shivakumar: That is correct.

Janaki Raman: Can you give me the cash position in both the shipping and the offshore business?

G. Shivakumar: The Shipping business has about Rs 2500 crs of cash. The offshore business has approximately Rs 500 crs of cash.

Janaki Raman: There has been an increase in the debt position in September 11 compared to March 11. Is it on account of any FX fluctuation or you have actually drawn more debt?

G. Shivakumar: We have drawn more debt. In shipping itself we have drawn about Rs 450 crs of additional debt.

Janaki Raman: Are you inclined to sell more shipping assets going forward?

G. Shivakumar: As a pure market call it is not a good time to sell. But as the ships get older, the tradability of the vessels is getting restricted. We are also seeing that the dry docking costs are quite astronomical these days. There are older ships that we might have to sell because their cost of maintenance is really high. So it will be a case to case scenario going forward

Janaki Raman: What is the update on the contract expiry of the second jack up with ONGC?

G. Shivakumar: The contract expires in Feb-March 2012. We are bidding into tenders and hopefully by December-January we will have something on that employment for that rig.

Moderator: We have the next question from Mr. K Ramachandran.

K Ramachandran: You have shown the revenue days from inchartered tonnage is zero whereas in the P&L you have expenditure for hire up of chartered ships. Can you explain please?

G. Shivakumar: If we hire the ship for one year or longer we take those as inchartered days. But when we incharter any ship for a specific voyage especially to fulfill the COA commitments, we do not show them under the incharter tonnage days.

Moderator: We have the next question from Mr. Varun Kejriwal from IDFC Securities.

Varun Kejriwal: Is cancellation an industry wide scenario and how do you see this phasing out?

G. Shivakumar: Cancellations may not really be an industry wide phenomenon. There may be some supply-chain constraints with some yards, but things have improved as compared to 2 years back, when we have seen large cancellations.

Varun Kejriwal: How about slippages in the deliveries?

G. Shivakumar: We are still running at about 40% slippage on dry bulk and approximately 25% slippage on tankers. So that has been quite consistent over the last couple of years.

Varun Kejriwal: Can you explain the interest cost accounting that you did in this quarter?

G. Shivakumar: The accounting standard says if you borrow in currency where the interest rates are lower than your currency it is assumed that the first little bit of depreciation which happens in your currency against that other currency in which you have borrowed it should go towards interest cost. So for example I am not saying we are borrowing in yen I'm just giving you an extreme example. If your rupee interest rates are at 10% and you have borrowed in Yen at 1% and assuming that the rupee will depreciate not more than 9%, the first 9% of depreciation in the year has to go towards the interest cost and the rest of the depreciation if there is any goes towards the capital. And since we borrow in dollars which is of course of lower interest rate currency than the rupee the same thing applies to us. So the first bit of depreciation whenever the rupee depreciates we will have this. We had this in a very small way in the first quarter and there was a 10-12 paisa move in rupee dollar but this time because there was an R.s 4 move it is much more dramatic number.

Moderator: We have a nice question from Mr. Chetan Kapoor from IDBI Capital.

Chetan Kapoor: What would be our foreign currency debt on the book as compared to last year as far as shipping and offshore?

G. Shivakumar: All the debt that we have is foreign-currency or foreign currency denominated.

Chetan Kapoor: Basically again going back to that borrowing cost issue so what is the amount of discretion what we have as far as that percentage what you're talking in up say 5% or 9% we are talking about?

G. Shivakumar: There is a little bit of discretion but we've try to keep it the way we have try to fix it to benchmark. So we fix it to the locally borrowing benchmark which is a AAA yield and then we'd take that against the actual rate at which we have borrowed and use that.

Chetan Kapoor: What kind of coverage do we have for the new vessels which will e coming in the offshore business?

G. Shivakumar: Currently, we have no coverage for them. We will be fixing these vessels a little prior to taking deliveries.

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

Ashish Jain: Why have the margins in the shipping business reduced on a sequential basis?

G. Shivakumar: We have a drop in revenue days and we have drop in the rates. We have an increase in the spot tonnages as well. We are now more than 55% running spot and if you are trying to see the translation from the top line into the EBITDA and wondering why it's not adding up, it is because the number of vessels operating the spot market has gone up. Spot days have gone up about 54.5% to 58% between Q1 and Q2 which results in direct higher operating expenses and higher fuel costs and therefore reduction in margins.

Ashish Jain: For calculating the NAV of the offshore business, how liquid is the asset market for these vessels?

G. Shivakumar: You are right. There are not that many transactions so it is more difficult to get a benchmark. So it is based on broker valuation

Ashish Jain: In your press release under the heading of 'Performance Review' you have made a statement saying that the impact of exchange difference was Rs35 crs on stand-alone basis. Is it possible to understand what's really driving that?

G. Shivakumar: There are 3-4 items, one is the interest cost which I explained earlier and how they get impacted by the rupee depreciation. Second is depreciation itself, a bit of loan revaluation goes into the interest cost, rest of it goes into the asset value, and then affects the depreciation expense. So we have a higher depreciation expense on account of this. On the other side we have dollar current assets which get revalued into the P&L that is like a debtors and working capital, and bank balances which get revalued and which have a positive impact when the rupee devalues. So, net of all that this is the impact on the P&L.

Moderator: We have next question from Mr. Nikhil Vora from IDFC.

Nikhil Vora: For the last couple of years we have seen freight rates really at the floor and literally at sub optimal levels for the industry in general. How come you have not yet seen lot of global

shipping companies go burst even right now given that most of them literally operating in the open environment? How should one really look at this and what should lead to a reversal in freight rates?

G. Shivakumar: Only one thing I will correct you on the outset it is not two years where you have seen consistently low freight rate. Early in 2010 we have saw \$50,000-\$60,000 plus on VLCCs. In 2010 we had very good average for dry bulk and you can see that from our TCY that we were averaging just under \$20,000 in the same quarter of last year which is now gone to about \$14,000. So last year was pretty dull for dry bulk ships due to large deliveries. Ordering activity has slowed down very considerably which is a good sign. Early this year we saw very large Korean company and big charter of dry bulk tonnage, Korea Lines filing for bankruptcy. We have seen smaller companies having difficulty. What had happened is, there are a lot of banks that have been wavering covenants and trying to do restructuring of loans which helped these companies to survive. It may not go on for much longer because banks themselves are facing pressure now own their asset quality. So that is something that might change substantially. The other thing is that these companies especially the ones which are focused on the spot market were making enough money to pay interest and you could think of doing a debt restructuring on the principal repayments or till early this year the equity markets were opened for issuance. So some of the companies which have listed for a long time were able to arrange equity money which helped them to tide over for some time. Now you have seen that the spot rates are so low that make basically make opex and you don't have anything left even for interest. Equity markets are closed and equity values have dropped so much that it just doesn't make sense to issue any equity at these levels. So we expect that there will be much more stress in the coming months.

Nikhil Vora: What will lead to a reversal in freight rate cycles?

G. Shivakumar: We will need to see at least a year like this of scrapping. If that continues that is younger vessels start getting scrapped then that will reduce the structural oversupply in the markets and that will lay a foundation for a turnaround but it is not going to happen very quickly. It will take at least another year of bad rates before you get a wholesale scrapping of let's say of a sub 20 years old tankers or bulk carriers. Even now there are people operating 20 to 25 year old bulk carriers. So on the demand side we really have nothing to complain about; demand has been pretty decent for ships. The problem is the supply and therefore the only thing that can save us really is that the supply gets rapidly shrunk by scrapping.

Moderator: We have next question from Mr. K Ramachandran.

K Ramachandran: I understand that most of your income comes in dollar or denominated in dollar so is it reasonable to assume that over a longer period over the next 3 months, we should get the full benefit of the recent sharp depreciation in rupee. So is it reasonable to assume that on a net basis you will stand to gain at least over these couple of quarters?

G. Shivakumar: Yes, on the net basis we will tend to again. But, the loan amount is about \$800 million equivalent the income which you get in quarter is not \$800, it is equivalent of \$80 million. So it does not match up in terms of depreciation or appreciation because the amounts are so different.

Moderator: We have next question from Mr. Romesh Jain from Quantum.

Romesh Jain: What is your take on the rig market, how is the outlook on the rig market?

G. Shivakumar: I will restrict myself to the jack-up rig market because that is the segment that we are most familiar with. That market seems to be fairly strong as activities are across all regions are picking up. Mexico is coming out with a tender for some 25 or 30 jack-up rigs and they have to do a big redevelopment of their giant oilfield where production is dropping off very rapidly. We believe that going further the jack up rates will remain stable going forward.

Romesh Jain: How do you see the supply coming in the rig market?

G. Shivakumar: Supply is not a big threat. The good thing about the rigs market is that there are not that many shipyards yards which can build these. There are only about 65 to 70 rigs on order which is less than 15% current jack-up rate fleet. Again there are probably 10 yards which can build rigs. Some of them just deliver one or two rigs in a year.

Romesh Jain: How do you see the contract prices ie values of the rigs going ahead?

G. Shivakumar: They should be firm, this is the market scenario, and we believe that those will remain stable. They have already gone up substantially in the last year or so. We have seen a huge amount of ordering take place between around this time last year and about March April this year. Many rigs have been ordered so values have gone up.

Romesh Jain: In terms of your contract on rigs, can you just let me know when the contracts are ending and around approximately what rates have been locked in for the contracts?

G. Shivakumar: I can't tell you the rate at which we locked in for the contracts because it is confidential but I can tell you when the contracts are ending. One rig has a five-year contract which ends in November 2014. We have one rig which is fixed on a three-year contract which will end in February-March next year. Third rig which will come in next year will go into five-year contract from there.

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

Anjali Kumar: Thank you very much for participating in this conference call. The transcript of this call will be put up on our website in few days.