



“The Great Eastern Shipping Company Limited Q2 FY 2019 Earnings Conference Call”

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COMMUNICATIONS**

Moderator:

Good Evening, Ladies and Gentlemen. Thank you for standing by. Welcome to The Great Eastern Shipping Earnings Call on the declaration of its financial results for the quarter ended September 30th, 2018. At this moment, all participant lines are in listen-only mode. Later, we will conduct a Question-and-Answer Session. At that time, if you have a question please press “*” and “1”. I now hand the conference over Mr. Shivakumar -- Group CFO to start the proceedings. Thank you. And over to you, Sir.

G. Shivakumar:

Hi, Good Afternoon, Everyone and Welcome to the Results Conference Call for Q2 FY 2018 - 2019. I trust you would have been through our Results and Press Release.

The main item of interest is that, as happened in the last quarter, the results have been swung by the movement in exchange rate during the quarter. While in Q1, the rupee depreciated by about Rs. 3.30. This quarter had seen a four rupee depreciation in the rupee versus the dollar. The results for the first half, therefore, include noncash charges of about Rs. 520 crores relating to exchange rates. The depreciation of the rupee is, of course, beneficial for our NAV since we have more dollar assets than dollar liabilities and this reflects in our net asset value. However, there has been a drop of about 4% in ship values, mainly in product tankers but also in bulk carriers. Net net, this has resulted in a drop in our standalone net asset value by about Rs. 8 per share to Rs. 352 per share. Offshore asset values have remained more or less static and some deals have been done for good quality modern assets. As a result, the has shown a narrower range for the rigs and therefore our NAV range has narrowed from 360 to 430 to about 397 to 420.

Coming to how the shipping markets have performed. Both crude and product markets have performed very badly in the period from April to September and that is reflected in our TCYs. This has basically been driven by poor refinery runs which have been low on the back of lower demand growth for end products. U.S. crude exports were the lone positive factor increasing by about 1 million barrels per day. But this was more than compensated by a drop in MEG exports.

Overall crude tanker demand was flat on a year-on-year basis during the first 9 months of calendar 2018 versus fleet growth on average of over 4%. This is again the first 9 months of this year versus the first 9 months of previous year, that is 2018 versus 2017. Therefore, rates have been very poor through the summer.

However, in this 9-month period which is between January and September, there has been a very marginal fleet growth in crude tankers, if at all. And this near zero growth situation is helping to absorb the excess supply overhang. We are glad to report that in October, rates have picked-up very significantly for crude tankers. The spot Suezmax is currently at over \$30,000 per day and on some routes above \$40,000 per day. VLCCs are trading above \$50,000 per day in the spot market currently and Aframaxs are probably in the \$25,000 per day range.

Coming to the product tanker market. Product demand was quite poor and the main increase in demand came from the consuming areas which means that there was very little demand growth for product tankers. So, consuming regions like China and India saw an increase in gasoil and diesel demand but this did not translate into the trade. And as a result, rates have been very poor, and they continue to be very poor. There is yet no sign of a turnaround in the market. The fleet growth in these assets has been about 2.5% in this 9-month period.

U.S. LPG exports have started picking up again and this may be a contributing factor to the market recovering somewhat in the last few months. We saw Q2 of this calendar year average VLGC spot rates going down to below \$10,000 a day and now they are more in the region of \$20,000 per day. Fleet growth so far this year in the 9 months has been zero.

The dry bulk trade into China has grown by about 13 million to 15 million metric tonnes during the 9-month period. And again, this is the 9 months over the similar same 9-month period in the previous year. There is a negative growth in iron ore imports into China, which is in the region of 10 million tonnes. But this is more than offset by an increase in coal and bauxite imports which are about 25 plus million tonnes. The fleet grew by about 2.5% in the 9-month period.

The order book stands at about 13% for crude tankers and at about 9% to 10% for dry bulk and product tankers. The offshore market continues to be challenged. Though it appears that at least the fall in rates has stopped, recent pricing points in the market indicate that there is an improvement of at least 20% to 30% from very low levels. And hopefully, the strength in oil prices will at some point in time translate to increased demand and therefore, some improvement in the rates. We currently have only one asset without a contract that is an 80-tonne Anchor Handling Tug Supply Vessel, and this is the same as it was in August when we had our last call.

One of the issues facing the industry in the next 15 months is the new IMO sulfur emission norm. In order to deal with this, we have decided to fit the exhaust gas cleaning system (which is colloquially called a scrubber) on 7 of our ships. These are our largest ships with the highest consumption and longest voyage time. And we expect that all these installations will be completed in calendar 2019 so we are ready for the new emission norms when they come in on 1st January 2020.

We continue to have a large spot exposure. And as I mentioned in the calls over the last few quarters, we have consciously tried not to fix out much of our capacity in the low markets because we have been expecting a turnaround and the time charter rates were very poor and were not adequately compensating us. Now we can start to see the benefits of it in the gas carrier market where the rates have recovered a little bit. But much more in the crude tanker

market where suddenly there has been a spike in the rates and having a large part of our 12 crude tanker spot is enabling us to take advantage of the increased freight rates.

So, with that, I will conclude my remarks. And we are happy to discuss these results and we welcome any questions from you.

Moderator: Thank you very much, sir. Ladies and Gentlemen, we will now begin the Question-and-Answer Session. We have our first question from the line of Chris Noronha, a shareholder. Please go ahead.

Chris Noronha: I was wondering if you can help me I was looking at your quarterly results and you mark-to-market the loss of Rs. 520 crores for the half-yearly, right, on derivative contracts? Could you elaborate on that? I am not able to understand when most of your income or revenue is in dollars, what is the problem?

G. Shivakumar: Yes, okay. I agree with you - There is no problem commercially. What we have done is that we have dollar assets and dollar income streams. And therefore, we match that off with dollar liabilities. Now we either take dollar loans directly or we take rupee loans and swap them into dollars. We have now created a dollar liability either naturally or synthetically. The accounting treatment specified for this is that any revaluation of the loan, if the loan goes up in value because of changes in exchange rates, has to be charged to the P & L. So, let us say we borrow \$100 million, a straight dollar loan and we borrowed it when the exchange rate was Rs. 65 to the dollar and it is now at Rs. 72.5 to the dollar that Rs. 7.5 difference in the loan has to be reflected somewhere. So, which works out on a \$100 million loan works out to Rs. 75 crores and now that Rs. 75 crores have to be reflected in the P&L as a loss on revaluation of foreign exchange. Under the earlier accounting standard we had the option to capitalize it to the cost of the asset. Under the new IndAS, it is not permitted. Now coming to derivatives, so that was when you just borrow dollars directly. Sometimes we borrow rupees because it is cheaper to do that and we also get longer tenure loans. We go into the rupee bond market in India and borrow rupees. But we also swap them into dollars because we do not want to keep a mismatch in the currency of our assets and our liabilities. So, when that happens the difference comes in as a derivative mark-to-market loss. It is essentially the same thing but it is a mark-to-market on the derivative because what we have done is effectively, we have sold those dollars forward at Rs. 65 in the same example that I was giving you. So, the same Rs. 7.5 has been recognized on those as well and it comes in as a derivative loss mark-to-market on the derivatives. There is no escape from this because all these have to be revalued in rupees when we are reporting. In commercial terms, there is no issue since we have used these dollar loans to buy dollar assets and those dollar assets have also got revalued. So, we used those \$100 million to buy \$100 million worth of dollar assets and those also have gone up in value in rupee terms from Rs. 650 crores to Rs. 725 crores because of the same revaluation because they are still denominated in dollars. However, in our books, they remain at the original cost. We do not

revalue our assets. And therefore, you only get one side of the impact. The positive side of the impact you get only in the net asset value because that is really showing the assets at the market value in rupee terms. So, when we have a weakening of the rupee, the P&L will take a hit.

Chris Noronha: Okay. In that case, if you encounter that the rupee is going to appreciate, right? In the first instance, I want to congratulate you on being one of the few firms which is marking to market quarterly.

G. Shivakumar: Okay, thank you. We don't deserve the credit, it is an accounting requirement.

Chris Noronha: I understand that. But if you look at whatever is going on in the Indian newspapers. But I want to congratulate you on that. But if the Indian rupee appreciates in that way next quarter you will hopefully...

G. Shivakumar: A positive impact, yes.

Chris Noronha: Have some sort of reverse effect or whatever the different mark-to-market.

G. Shivakumar: That is correct.

Chris Noronha: Okay. My second question relates to the CARE ratings issued a statement on your website and they say that based on that they have issued some sort of rating action. And they make comment there that the rating action factors in and I am reading out from the report factors in the deterioration in GE capital structure. Would you be kind enough to elaborate on that?

G. Shivakumar: Yes, sure. So, that is a factual statement in that our net debt as of 3 years ago was very marginal. So, the debt was slightly more than the amount of cash in our balance sheet. In the last 2.5 years and you would have seen since you have been observing us, we have done a lot of CAPEX and we have done a lot of borrowing to fund that and we have drawn down from our cash as well. This has resulted in an increase in our net debt and that is what they are referring to in this. So, that is the deterioration in the capital structure. We were close to zero net debt to equity, and we have gone up to almost 0.5 net debt to equity.

Moderator: Thank you, sir. We have the next question from the line of Aman Shah from Jeetay Investment. Please go ahead.

Aman Shah: Congratulations that our call on spot rate has actually now started turning when our sales are...

G. Shivakumar: Yes, we are now waiting for it to turn in our favor on product tankers also. That has not yet happened.

Aman Shah: Yes. So, my question was regarding the crude tanker market that we are seeing this steep recovery at what level should it be sustainable in your assessment? And what will be the tenure of this thing?

G. Shivakumar: Yes, so the honest answer to that is I do not know. So, and the reason I do not know is we still are not clear what has caused this we know that there have been more cargoes coming out of the AG, more crude tanker cargoes, VLCC cargoes, Suezmax cargoes, and therefore, there has been more movement. We do not know what has led to this sudden flurry of fixing, which has resulted in rates going up so much. We know that the fundamentals have been building up to it. But why it happened in October 2018 we have no idea, okay? What is the trigger for it? And without knowing what the trigger is we cannot tell you how long it will last. It may last through the winter, which is for the next 3 months to 4 months or it may be over in 2 weeks' time. So, all we can say is that the fundamentals have improved significantly over the last year or so where ships have got scrapped and therefore, the overhang of surplus capacity has got reduced. And while also celebrating the spot market as it is currently, we must sound a note of caution. There are a lot of VLCCs due for delivery next year. We have 65 plus VLCCs due for delivery next year, which is a very heavy delivery schedule. And so it is still going to be tough to have a sustained rally unless we have a lot of scrapping taking place and a big rebound in demand in the next few quarters. The one thing is that stocks have got drawn down and therefore, that may put some pressure onto people to import more and that could result in a significant amount of demand. We have been drawing, rather, we have been eating into inventories which can lead to future demand and so that is a possible positive factor which can come in. So, broadly, currently the fundamentals are quite aligned. But next year, there is a lot of crude tanker fleet growth which we should mention.

Aman Shah: Okay. My second question was related to the scrubber that we have installed in your 7 ships and balanced by this year and we will complete all installations you referred to.

G. Shivakumar: No, it is actually only 7 that we are going to install, we have taken a decision to install. They will all be installed by end of calendar 2019, not FY 2019.

Aman Shah: Okay.

G. Shivakumar: Yes, because the regulations kick in from 1st January, 2020.

Aman Shah: Correct. And what will be the CAPEX for this, if you can just...

G. Shivakumar: Okay. It should be somewhere in the region of \$20 million in all.

Moderator: Thank you, sir. We have the next question from the line of Vaibhav Barjatya from HNI Investments. Please go ahead.

Vaibhav Barjatya: I have 3 questions. So, one is on the if you can broadly explain the rationale of going for the scrubber and how it economically viable vis-à-vis the other option? And secondly, we have been hearing a lot about the impact on oil prices due to this IMO 2020 shift. If you can then broadly share your thoughts on that and whether it is going to impact essentially to the WTI and Brent? And okay, I think let us go with these two.

G. Shivakumar: Yes. Okay. First is on the economic rationale for the scrubbers. First let us go back to what this new regulation is. The new regulation restricts the amount of sulfur emissions from the exhaust gas of the ship to below 0.5%. Now in the standard fuel that shipping uses it goes up to 3.5% sulfur. So, the new regulation which kicks in from 1st January says that it has to be not more than 0.5%. Now you have a couple of choices here. You can use 0.5% fuel or you can continue to use 3.5% fuel but install a scrubber so that your emissions are less than 0.5%. The issue is that the high sulfur fuel oil is much cheaper than the low sulfur fuel and currently that spread is being quoted at about \$320 per tonne for 2020 and 2021. Now that is a traded market. So, the difference in price between marine gas oil i.e., low sulfur marine gas oil, and high sulfur fuel oil in 2020 is being quoted around \$320 per tonne. Now you just take the consumption of the ship and take the benefit of \$320 per tonne that is the benefit you get from installing the scrubber because you get to use the cheaper fuel. And that is where you get your payback. So, the payback comes from the amount of sailing time you have that is a factor because you have high consumption only when you sail. When you are standing, you do not have consumption, you have very marginal consumption of fuel and typically the bigger ships sail for more time. Also, the bigger ships have much more fuel consumption. The payback is a function of how many tonnes you burn per day while sailing and how many days you sail both of which lead to your total consumption for the year. This, therefore, works much better in bigger ships which sail for more days and so we are fitting this onto our biggest ships basically the large crude tankers where we are fitting these scrubbers. The larger ships are Suezmax, Aframax size vessel. So, let us just put some numbers, right? These are not our numbers but I am just putting you some numbers as an example. A typical Suezmax would use 9,000 tonnes to 10,000 tonnes of fuel in a year. Now, if you have a saving of about \$300 per tonne, you will end up at \$2.5 million to \$3 million of savings in a year. If you can get your scrubber in and again there are some times when you cannot use a scrubber so if you are in a port, you may not be allowed to use an open loop scrubber. If you are in some territorial waters, you may not be able to use an open loop scrubber, so you will have to discount that somewhat. But let us say, you have about \$2.5 million of savings on account of the lower fuel cost and your cost of fitting a scrubber is say \$4 million then you have got a payback period of less than 2 years. So, that is why it makes sense. Now this trade which is at \$320 maybe actually \$200 or it may be \$500. So, we do not know that number. But based on today's market expectation or where the forward market is, it seems to be at around \$320. So, that is where the economic rationale comes in.

Vaibhav Barjatya:

Okay, got it.

G. Shivakumar:

Okay? Now, coming to what can happen to oil price? That is completely dependent on how the refiners have prepared for IMO 2020. You have about 3.5 million barrels per day of high sulfur fuel oil which is consumed on a daily basis by the shipping industry. That is 3.5 million barrels per day of high sulfur fuel oil. Of this, you can assume that 15% to maybe 20% of the ships will continue to consume high sulfur fuel oil, okay because they have been fitted with scrubbers. Let us stretch it a little bit and say 1 million barrels per day of high sulfur fuel oil will continue to be consumed. That still leaves a gap of 2.5 million barrels which needs to be replaced with low sulfur oil. Now you need to find out whether there is enough low sulfur fuel oil, either fuel oil or gas oil marine gas oil, which is a middle distillate just like diesel. Is there enough of that to substitute for this high sulfur fuel oil? We do not know that because we do not know what the refiners are doing. Yes, people have announced investments and people have said that they will start producing low sulfur fuel oil, etc. But it still does not add up to the full 2.5 million barrels per day. You can do some yield switching between gasoline and middle distillate. So, you can shift from gasoline production in your refining stack and you may have a refining expert in-house who may be able to help you on this. But that may not be more than 1 million barrels per day. But you still have a gap of say 1 million to 1.5 million barrels per day of middle distillate which needs to be produced. Now if you had to produce 1 million barrels a day of middle distillate, your yield cannot be more than 50%. And when I say 50%, that is really at the outside, which means you have to process at least 2 million barrels per day additional of crude oil. Now, where is this additional crude oil coming from? And if you do not have that 2 million barrels per day of additional crude oil, you could have a higher crude oil price. All this assumes that the refiners have not invested in the upgrading capacity to reduce the output of high sulfur fuel oil and therefore, we have to process lots more of crude oil just to get this additional middle distillate or low sulfur fuel. But if the refiners have already invested in the coking capacity, hydrocracking capacity or desulfurization capacity, then you will not have a shortage of crude oil. So, that is the critical factor for you to know whether there is going to be an increase in the price of crude oil or not. So, the critical thing here just to recap is you need to know what the refineries have done and how they are preparing for IMO 2020. Under the scenario where they have not prepared enough, you can have a blowout in the prices of crude oil under that scenario. Otherwise, it will be business as usual.

Vaibhav Barjatya:

So, for the refinery, it would definitely be a function of what would be the investment and what would be the incremental price that they are getting on the....

G. Shivakumar:

That is correct and I have told that there is a big lead time for their investment 3 years to 5 years to set up a coker or hydrocracker. And there is a lot of investment, obviously and the lead time for making an investment is also a critical factor because the regulation date got announced a little over 2 years ago and people may not have believed it and invested because

we have had several postponements of the Ballast Water Treatment regulation. So, finally, we do not know what the refineries are going to do or have already done.

Vaibhav Barjatya: Sir, even if they have acted promptly you are saying 3 years to 5 years for the lead time then also there would be a there would be incremental demand for crude oil. Except it is going to take 3 years to 5 years to get the facilities in order?

G. Shivakumar: Yes, that is correct . So, we do not know whether they made that decision in 2016 or they are going to make it in 2018 or 2019. Again, that is why it is important to know what the refineries are doing. And if that additional crude oil is going to be required then what is going to happen to the crude tanker market because this crude will then be transported. Products will move as well. Okay, so that has a lot of implications, not just on the price of oil but also on what can happen to shipping markets, tanker markets.

Vaibhav Barjatya: Yes, I was coming to that. But yes, I think broadly got the sense and can I ask the third question or should I come back in the queue?

G. Shivakumar: No, you can ask your third question then.

Vaibhav Barjatya: Okay. Again, on this IMO 2020, what is your assessment, can it be really strictly implemented? Or there will be some of our low profile competitors who can take advantage of non-compliances, the cost advantage of noncompliance? And how this is implementation is going to work?

G. Shivakumar: Yes, it is an interesting point which we also keep thinking about. They have not yet worked out how the implementation and enforcement is going to happen. This will be decided in the MEPC meeting of IMO in 2019. So, by July next year, we will be clear as to how they are planning to enforce this. So, currently, it is uncertain. We will know next year, we will know next year, 6 months before the date, hopefully.

Moderator: Thank you, sir. We have the next question from the line of Bhavin Gandhi from B&K Securities. Please go ahead.

Bhavin Gandhi: Sir, firstly with spot exposure, when can we see you locking up some of this tonnage into the markets? We have already seen some improvement in rates happening now.

G. Shivakumar: Yes, Hi Bhavin. Yes, it is a little early. So, what happens is you get one good spot voyage and hopefully, we will enjoy a couple of good spot voyages and you have seen this because you have been looking at shipping for some time, it takes time for the spot rate improvement to start feeding through into the time charter rates. So, the first thing which happens is as soon as the spot rates improve owners stop giving the ship, offering ships for time charters or they just push the rates up by a few thousand dollars for charters. Charterers are still typically not

believing in the sustainability of the market and so they hold off from fixing too quickly on time charter. But if you have 2 months - 3 months of good spot markets then you will have a real pickup in the time charter rates. So, we will probably wait to fix but today voyages are getting done at \$40,000 a day for a Suemax and if we can lock in \$40,000 a day, I would say for 50 days, it writes down your average for the rest of the year because the time charter rates for a 1 year period are probably still in the \$20,000 - \$21,000 - \$22,000 kind of range and you know you have built up such a nice buffer that you can afford to take a much weaker market going forward and you retain the optionality for a market upside as well. So, we are not going to be in a hurry to fix. If we get a tempting enough rate, we will look at fixing. And yes, we have 12 crude tankers on the spot market so it will be nice to put away some of our capacity but we are not going to give it away cheap.

Bhavin Gandhi: Sure, sure. Sir, the second thing that I kind of could not understand is that despite the rupee depreciation, the NAV has gone down again. Which age profile have you seen because I could not see rates I mean asset prices coming off so much.

G. Shivakumar: We have seen bulk carriers come off quite significantly about 5% drop in our bulk carriers prices and product tankers. So, irrespective of age especially the Supramaxes have dropped in value. I think all the sub-capes have dropped in value, really, so Kamsarmaxes and Supramaxes. The product tankers have all dropped in value because the markets have been so terrible and I think people have been so disappointed by the way the markets have been during the summer. So, those have really suffered in their values.

Bhavin Gandhi: Sure. And sir, my third question, sorry to harp again on the IMO part this \$20 million CAPEX that you mentioned seems a little low from what we were guiding early, I thought it was closer to \$1.5 million to \$2 million a ship.

G. Shivakumar: No, so we are only doing 7 ships.

Bhavin Gandhi: So, this is only for the 7 ships that we are doing.

G. Shivakumar: We are only doing scrubber installation on 7 ships so far.

Bhavin Gandhi: Sure. And the other thing, again, so you already have commented on the regulatory aspect, etc. But I could not understand what changed I mean, what made you change your mind to go in for scrubbers? Because I always thought that we will wait out and see how the markets react to it. So, what is it that tilted because this forward curve that we are seeing, I believe was there earlier as well. So, what really changed your mind on that?

G. Shivakumar: The forward curve has probably widened a little bit over the last few months. But really, we looked at it quite deeply, we were actually doing a little bit of a techno-feasibility study on it. So, we got comfortable with that. We saw the forward prices. One option was to wait and

watch. But we also realized that the spread will not stay at high levels for very long because I mentioned earlier that refineries can look at doing investment and let us say, somebody has made his investment decision in 2017 or 2018 and that kicks in from 2021, let us say. That is less fuel oil oversupply and more gas oil supply which means that the spread will tend to narrow. More people fitting scrubbers, and more people will fit scrubbers when it comes to 2020 if they start seeing this price differential and then again the price spread will narrow between HFO and gas oil. And therefore, there is not going to be a huge period of big spreads. It is going to be I think a couple of years where you can really make money on this. And therefore, you need to get in early. And that is what prompted us to make the decision that we have booked those scrubbers and potentially the yard capacity also and get it done by 2019 itself. Again, so we have a fleet of 48 ships, right so among the things that we thought was we are not going to do it on all the ships. We are not going to do it on the small ships or the ones which do short voyages which is the Supramaxes, and the MRs. So, basically we chose the ships where you have a substantial safety margin in the sense that you get a payback which is pretty quick in fairly conservative circumstances, at a fairly conservative spread and that gave us the comfort to go and make these decisions. So, you may have seen this also, a lot of people have said that they are going to do this for Supramaxes, for MR tankers. It could possibly work under very optimistic conditions. We have not been able to make it work because it does not have enough margin of safety for us. And that is why we have chosen these ships only where we think we have a very reasonable chance to make our IRRs on the say about \$20 million investment that we make on these ships. So, it also helps us to compete with the eco-ships. We have five eco Kamsarmaxes and 1 eco MR but an eco non-scrubber ship say a Suezmax will probably have the same fuel cost as a non-eco scrubber fitted Suezmax. And therefore, we will be able to compete in that market better at a similar cost base by just putting in this additional small amount of CAPEX. That was another idea that we had on competitiveness in the market.

Bhavin Gandhi: Sure. And just one last thing from my side, we were hearing about Trump administration wanting to kind of delay this IMO thing and there were some talks about some relaxation on the compliance part. So, can you comment on those 2 aspects?

G. Shivakumar: The IMO had a meeting 2 weeks ago to discuss again the process of implementation of the new sulfur norms and ballast water, etc. the bottom line is there is going to be no delay to the implementation. There were some flag states that were looking to delay. But finally, the decision that has been made is that there will be no delay from 1st January, 2020.

Moderator: Thank you, sir. We have the next question from the line of Chaitanya Shah from Aditya Corporation. Please go ahead.

Chaitanya Shah: Sir, my first question is again regarding these IMO norms. Sir, according to your assessment do shipping companies across the world really have the balance sheet strength to comply with these norms by 2020?

- G. Shivakumar:** Yes, okay. It is tough, shipping companies have not made too much money in the last decade, so it is going to be a stretch for them. And that is why it is a little unfair to put the burden of this onto the shipping company at a time like this. However, there is funding available for a scrubber. A lot of the listed shipping companies have announced that they will raise 60% to 70% debt funding from shipping banks for funding these scrubbers. So, there is enough funding available. The point is that if you can get a payback of 2 years then you can always raise funding. If you can show that payback period, somebody will give you the funding for it. So, yes, they do not have the cash on their balance sheet but I think this is a bankable asset.
- Chaitanya Shah:** Okay, so but given the rising interest rate scenario and the ongoing liquidity squeeze that is going on across the global markets, do you think it is going to be much more difficult than previously thought of?
- G. Shivakumar:** It certainly has become more expensive to raise funding than before for a lot of companies, not for us. But again, it is a 2-year payback and banks are happy to lend to this because it also gives them some kind of eco or green, sort of tag to this funding. And therefore, funding is available, yes but you are asking should the burden be put on the shipping industry to do all this, to do this compliance with sulfur emission norms? Maybe not, maybe it should have been done at the refining level itself where they just do not produce high sulfur fuel. But that is a whole different discussion altogether. Once the rule has come into play, you have a choice either it can be CAPEX or it can be OPEX. You can have additional OPEX of \$300 per tonne of fuel or you can have CAPEX of USD3 – 5mn whatever, depending on the kind of ship that you have you have additional CAPEX. Now you have to make that choice, because that is what the regulation is.
- Chaitanya Shah:** Okay, sir. Sir, my basic intention of asking the question was if there is any way we can take given our balance sheet strength, can we take advantage of this situation in the next couple of years if say more if companies are not able to comply with these norms?
- G. Shivakumar:** Let us see. See, you do not have to comply with any norms. If you cannot invest in a scrubber, you have a higher fuel cost. Now the higher fuel cost may result in poor rates. But poor rates have existed for the last 6 months. Crude tankers including Suezmax and Aframax have made \$10,000 per day or less over the last 3 months to 6 months. So, it is not that the rates are going to go into negative territory then certainly, these ships will get scrapped. But it has to be seen in the context of what can happen to the tanker market itself. If the prices are very high and this results in additional crude processing as I mentioned earlier that means the demand for tankers has gone up, will go up and there will be a tightening in the market and they may still may be making a lot of money except that the difference will be the ship with a scrubber will make \$50,000 a day and the ship without the scrubber may make \$45,000 a day. That is all the difference might be. So, yes, obviously, we will look for opportunities. We have a pretty strong balance sheet. We will look for opportunities and we are always on the lookout for these. But

we do not really see that happening as of now. Let us see how the market plays out. If the market plays out that it gives us opportunities to invest or divest we will be there to take advantage of those.

Chaitanya Shah: All right. And so, my second question is a broad question about the dry bulk business that we have. Now, sir, the dry bulk business is significantly dependent on China, right? So, do we have any sort of risk management in the case that China slows down meaningfully? I mean, there is always going to be a limit to how much iron ore or coal or commodities in general that China can consume, right? So, what is your view on this?

G. Shivakumar: 15 years ago, we thought there must be a limit to how much coal, iron ore they can consume. But it has only gone up since then and year-on-year, it keeps going up. But even now, they are talking about a stimulus again to boost the economy. But your fundamental point is true that it is a China story. The dry bulk market is a China story. Now, what can happen to China? We do not know. The risk management for us is that bulk carriers constitute less than 30% of our fleet, okay? We can call that risk management, sometimes we fix on time charter, sometimes we have them on the spot market. Apart from that, you cannot do anything. If you are in the dry bulk market you are at the mercy of what happens to the Chinese economy. So, there is nothing really to be done there.

Chaitanya Shah: All right, sir. And for my last question, is regarding the time charter market. Sir, are crude tankers operating days gone up from 18% last quarter or 26% this quarter, according to your Press Release and the rates have essentially gone down. So, am I missing something over here or I mean, I just want your assessment of it.

G. Shivakumar: The operating days you said?

Chaitanya Shah: Yes, operating days.

G. Shivakumar: Yes so because we have fixed already some ships on voyages and long voyages so more of the days are getting covered and therefore, the percentage is going up. This is only until March. So, it is in the previous quarter that was for a 9-month period. This quarter, it is for a 6-month period but this number is always for the remaining FY.

Moderator: Thank you, sir. We have the next question from the line of Aadesh Mehta from Ambit Capital. Please go ahead.

Aadesh Mehta: Sir, what we see is in our P&L, the other expenses have grown pretty significantly at around Rs. 105 crores versus Rs. 60 something crores last year.

- G. Shivakumar:** Yes, we had some in chartered vessels. We took a short-term contract for an Indian customer for crude import into India and so we in chartered some ships to perform part of that contract, to lift some cargos.
- Aadesh Mehta:** Okay, sir. What could be the impact of this, sir?
- G. Shivakumar:** Nothing much really, it was a marginal positive in the results so a difference between in chartering and out chartering rate was a marginal positive but not a huge number either way.
- Aadesh Mehta:** Okay. Because the gap I am seeing is that of Rs. 36 crores.
- G. Shivakumar:** Yes. Sorry, you mean the impact of that? Yes, so this itself was Rs. 40 crores plus.
- Aadesh Mehta:** The in-chartering thing?
- G. Shivakumar:** That is correct, the delta in the in chartering, yes.
- Aadesh Mehta:** Okay. That is okay. So, ideally, if I am calculating the net income I should take that Rs. 40 crores in the gross revenues which you report and then put this as a part of your day rate expenses, right?
- G. Shivakumar:** That is correct, yes.
- Aadesh Mehta:** Okay. And sir, your presentation usually carries trends on scrapping, right? I am seeing that missing this time. So, sir, if you can throw some light on what kind of scrapping trends you have seen this quarter? Was it what they had been last quarter?
- G. Shivakumar:** Oh, so that is in our normal business outlook presentation not in a quarterly result presentation. But that will be there. So, we have that scrapping information, there is not much change in the last 3 months. So, crude tankers, we have seen 4% scrapping in YTD, in product tankers, 1%. So, it is not a huge amount of scrapping that is happening. In dry bulk, it is like 1%. Less than 1%, actually.
- Aadesh Mehta:** Yes, sir. So, sir, this would be this when you are saying YTD, it will be January to...
- G. Shivakumar:** Yes January to October.
- Aadesh Mehta:** January to October. So, on an annualized basis that can still go up to around 6%, if we expect this run rate...
- G. Shivakumar:** No, not 6%. So, crude tankers for 10 months is 4%.

- Aadesh Mehta:** For 10 months is 4%?
- G. Shivakumar:** Yes, so that is on an annualized basis that will go to 4.8%. But even that is unlikely to happen with the current spot market unless somebody has got a big survey coming up where they have dry dock a ship for \$5 million. So, unlikely they will go and scrap now because you can make a lot of money just by doing a couple of voyages in current markets.
- Aadesh Mehta:** Right. But sir, what we understand is that yes, the rates in spot markets have gone up. But that is usually the case during the winter season, right? So, how much of this rate increase do you think would be driven by seasonal factors versus say something changing, apart from seasonal factors?
- G. Shivakumar:** So, I do not think we have hit the winter impact.
- Aadesh Mehta:** Okay.
- Aadesh Mehta:** It is a little early maybe is the winter impact that typically happens in the first quarter of the calendar year. So, December onwards, let us say. It is a little early for that. Last year also we were expecting that there would be a seasonal impact but it was a very disappointing winter. In fact, the worst winter for tanker markets since 1990. So, sometimes these things do not work out. But this is not really the winter spike. There is a theory that it is because Iran cargoes are getting replaced by the U.S. or by Mexico and we can see a lot of cargoes coming out of there. But it is still not clear exactly what has resulted in the spike. But the fact is that with just 10 extra cargoes in a month this market can turn and I suspect that you have had not more than 10 extra cargoes in this month which has caused the market move.
- Aadesh Mehta:** Okay. And then sir, you mentioned earlier in the call that on a consolidated basis, your NAV would be now at around Rs. 397 to Rs. 420, right?
- G. Shivakumar:** That is correct.
- Aadesh Mehta:** Right, and your standalone NAV would be around...
- G. Shivakumar:** Rs. 352.
- Aadesh Mehta:** Right. So, that implies minimum your offshore NAV would be around Rs. 35 per share?
- G. Shivakumar:** Yes, Rs. 45, yes. Rs. 397, yes.
- Aadesh Mehta:** Yes, sorry, Rs. 45. And sir, what was this last quarter?



- G. Shivakumar:** So, we had a range, right. So, our range started at Rs. 360 and our standalone NAV was Rs. 361. So, we were more or less zero which means that it was at the lower end. So, it was Rs. 360 to Rs. 430. So, at the lower end of the range, it was basically zero adding to the NAV which means that it was at a cost. It does not mean that there is no equity value in the offshore business. What it means is that the equity value is equal to our investment in the offshore business. Because the standalone NAV takes the offshore business at cost.
- Aadesh Mehta:** So, should we interpret this that there has been some jump in your offshore NAV?
- G. Shivakumar:** Yes, there has been a jump. So, if you look at the range, so it was of Rs. 360 to Rs. 430, right? So, your midpoint of the range was somewhere around Rs. 395. Now what has happened is that the midpoint of your range has moved by about Rs. 15 to Rs. 410, okay? What has happened is that where you are getting and just as an example, where you are getting a valuation for a rig with a very wide range where you got a valuation of \$60 million to \$90 million as a valuation range for a rig from a broker, they are a little more confident about giving you a valuation now and that is coming down to \$75 million to \$85 million. Again, I am just giving you examples here. So, the lower end of the range has moved up because it is clear that there are buyers at certain prices. In this example which I am giving you, it is clear that there is a buyer at \$75 million. They were not sure of this earlier, but because there are transactions being done now, they pushed up the lower end of the range. However, the upper end of the range also has been moved down and that is why the range has narrowed and the upper end has come down from Rs. 430.
- Aadesh Mehta:** Right. So, sir, would it be fair to say then on a midpoint to midpoint basis you have actually seen at least 15% to 20% increase in your offshore NAV?
- G. Shivakumar:** Wait, where do we have a percentage increase? No, where do we have a percentage because I am really concerned about this percentage increase in the offshore NAV basically we have an Rs. 15 increase in the midpoint.
- Aadesh Mehta:** Okay, have you ever had Rs. 15 increase in the midpoint over the last 3 months?
- G. Shivakumar:** That has been contributed by rupee depreciation.
- Aadesh Mehta:** Of say around 6% - 7%.
- G. Shivakumar:** That is right but it has a significant impact. You have had a reduction in the shipping NAV. So, let us say, so the typical thing is offshore NAV addition accretion at the midpoint was a difference between Rs. 361 which was the standalone NAV and Rs. 395 which was the midpoint. So, that was Rs. 34 per share. Today, it is Rs. 352 which is standalone and Rs. 410 which is consolidated which is Rs. 58 per share. So, that movement has happened. So, that Rs. 34 has moved to Rs. 58.



- Aadesh Mehta:** So, that is actually a very good news actually for the offshore business.
- G. Shivakumar:** So, the critical thing is where does that start? So, this Rs. 34 per share originally, it is starting off from something like Rs. 100 per share. Okay? So, Rs. 134 has gone to Rs. 158. But yes, at least it is coming to your 15% type of number.
- Aadesh Mehta:** Okay. So, yes sir, so on a per share basis we have actually seen around Rs. 23 improvements. That is how a shareholder should see, right?
- Anjali Kumar:** Yes, Why Rs. 23?
- G. Shivakumar:** That, yes, the offshore contribution.
- Aadesh Mehta:** The differential on which your market cap would be around 6% to 7% impact.
- G. Shivakumar:** Yes, okay. Yes, that works, yes.
- Aadesh Mehta:** So, sir, my question then is...
- G. Shivakumar:** Remember a lot of it is also currency related. It is not just the asset value.
- Aadesh Mehta:** Yes, sir, I agree. But then if your offshore NAV has increased by 17% and the rupee has depreciated only by 7% at least we can believe that the 10% is the organic movement, right?
- G. Shivakumar:** Yes, you can do that on a rough basis, but again, it is because the valuation that 60 to 90 number has become 75 to 85, it is narrowing in that range. So, 60 to 90 had a midpoint of 75. 75 to 85 will have a midpoint of 80. But yes, 80 is a positive movement because at least now people are aware that there seems to be a floor. For good quality assets, there is a floor under the asset prices.
- Aadesh Mehta:** Yes, sir. So, sir, now my other question is when I see your P&L I still see impairment on certain assets sitting on your consolidated but not on your standalone P&L. So, I understand that to be for your offshore business.
- G. Shivakumar:** Yes.
- Aadesh Mehta:** So, why are we still seeing impairment in our offshore business assets?
- G. Shivakumar:** Yes, there is an impairment in one of the supply vessels. So, it was written down to market value in the impairment. Now what happens when you do a dry dock is that you capitalize it and add to the book value of the ship. Unfortunately, you have to write it down immediately to

market value. So, we just capitalized the dry dock and wrote it off immediately as an impairment.

Aadesh Mehta: Okay. So, all this adjustment would be there in your NAV also, right?

G. Shivakumar: Yes, they are all in NAV.

Aadesh Mehta: Okay, so we should rather choose to ignore this impairment?

G. Shivakumar: Impairment has already fed into the NAV. Any impairment is already factored in the NAV.

Aadesh Mehta: Yes, sir. Sir, my other question is, I know you have done a lot of techno-feasibility analysis. So, sir, what is your take on what could be the differential between a scrubber and a non-scrubber vessel in terms of time charter yield?

G. Shivakumar: So, we had one example. Yes, it is an interesting question and it is something that we look at also because we are going to invest and we need to know this. For a time-charter, you will not get full value. We have seen that in eco ships as well, in an eco versus non-eco ship. Let us say your cost advantage is \$2,000 per day on the fuel. Your charterer will not give you that \$2,000 per day advantage. The charterer will take away part of it. It may be 30% or 40% or 50%. But you should expect to give up a part of the advantage that you are getting which means that if you fit a scrubber on a ship and you give it on time charter, your payback will get stretched.

Aadesh Mehta: Right. So, okay. So, but then, say for a Suezmax, what could that differential be?

G. Shivakumar: Yes. So, let us just look at some numbers, right? 40 tonnes per day is the consumption of a Suezmax. Your typical sailing time should be about 60% okay? So, let us call it 24 tonnes per day just to make it easier. So, your consumption is about 9,000 tonnes per year, okay? So, if you have \$300 per tonne differential in the pricing, you have \$2.7 million. At \$2.7 million, you have about a \$7,000 to \$7,500 per day difference in the cost structure, correct?

Aadesh Mehta: Okay. Right.

G. Shivakumar: That will come to you completely if you operate the ship in the spot market, okay? However, the charter will ask for a part of it because they are giving you certainty because they are taking the risk on that spread of \$300 and they will ask for a part, a share of it because they are taking the risk on the differential in price and also, to ensure that you get high sulfur fuel oil, the cheaper fuel oil, to get the benefit. So, those are the numbers for a Suezmax. Again, if you take \$200 per day then your benefit has come down to \$4,500 per day to \$5,000 per day depending on what you take as a spread.

Aadesh Mehta: So, that is around 10% of the of the time charter yield which could be the differential?

- G. Shivakumar:** Yes, I do not know where we are going with this but yes, the time charter yield as of 2 months ago for a 1-year charter was probably 17 to 18. As of 3 years ago, was probably \$40,000. So...
- Aadesh Mehta:** Okay. So, I know it is very volatile. So, as the rates increase, so the incentive actually diminishes for time charter.
- G. Shivakumar:** Yes, there are a lot of factors which go into your fuel consumption - if your market is very strong, your fuel consumption may go up because you will go faster if your market is very strong. So, then if you go faster, right instead of 11 knots, you decide to go at 12.5 knots or 13 knots, you may land up with 50 tonnes of consumption which means that your benefits increase. So, it is a very complicated calculation we have used fairly conservative assumptions for it.
- Aadesh MehtaModerator:** Thank you, sir. We have the next question from the line of Neeraj Shah from MSD Partner. Please go ahead.
- Neeraj Shah:** Two questions. First one is, what is your view on the vessel scrapping as we approach the date of IMO regulations? Because as you mentioned, some of the smaller vessels, it does not make economic sense. But also the older vessels so how should we view the scrapping coming, say, in 2019?
- G. Shivakumar:** The sulfur emission norm which is coming in may not necessarily lead to a huge amount of scrapping. There is a different regulation which is kicking in and that could have a big impact on scrapping, which is the Ballast Water Treatment System. This is just a question of cost and cost can be passed on to the customer depending on how strong the market is. So, if you have a situation where the tanker market is very strong or the bulk carrier market is very strong, you can pass on the additional fuel cost to your customer, okay? So, this one is not critical. Yes, it is important if the market is weak and, let us say, a scrubber fitted ship or a modern ship is willing to take \$10,000 per day and that means that a less efficient ship without a scrubber has to work at zero then it will push you to scrap, yes. But that should be seen in the context of how the market is, actually because the most efficient ship is at \$50,000 and the less efficient one is at \$40,000 the less efficient ship will continue to operate and there is no need for them to scrap. But yes, it will add an element of reducing the competitiveness for an older less fuel-efficient vessel. The bigger one really is the Ballast Water Treatment System, which is compulsory. You have to install it, and for a large tanker it will cost you \$1.5 million - maybe \$2 million and that is something that you have to keep in mind because you do not get any benefit from that. When you install a scrubber, you get a cost saving. In a Ballast Water Treatment System, you are just spending that money to keep running. Then you have to think about whether it makes sense to spend that \$1.5 million extra at all. And that is something that could result in scrapping next year. One other impact which can happen, as a result of this change in the fuel norm, is that everybody starts using more expensive fuel. So, today's price

for high sulfur fuel oil is probably somewhere in the region of \$500 per tonne. The low sulfur fuel oil which is marine gas oil is probably \$750 per tonne. Your speed that you will operate at, your optimal speed in order to make the best yield on your ship will be slower at \$750 per tonne than it is at \$500 per tonne. Therefore, there is a natural inclination for people to slow down when they are using more expensive fuel. So, that is the impact that can come. And what happens when ships slowdown is that supply gets constrained and the market becomes tighter. That is one impact that could come from an increase in the price of fuel.

Neeraj Shah:

Okay, got it. And sir, just the second question is, on the availability of these scrubbers. I mean, we have read reports of a few of the larger manufacturers being sold out until 2020. So, I believe you would have already got the firm commitments for those 7 scrubbers that you plan to install. But for the industry, I mean, what percentage of fleets can operate with scrubbers?

G. Shivakumar:

Yes. Yes, your point on availability is correct. The big guys, the European manufacturers essentially are sort of full up at least until the end of 2019 some of them probably also for part of 2020. But I do not think people are full up all the way through 2020. And there are a few small manufacturers who still have capacity. So, there are smaller manufacturers who will provide it and people will go to these smaller manufacturers if they are keen enough to install a scrubber. The bigger constraint may be getting a yard slot to go and fit the scrubber. Because you need to go into a yard typically to go and do the last bit of piping at least for doing the scrubber fitment so that is another constraint which would come up in 2019. Yes and as far as the number of ships which can be fitted goes, typically this will get fitted on the bigger ships. We think maybe 5% of the overall fleet may get fitted and maybe 20% of the big ships, that is, Capesize, VLOC, VLCCs could end up fitted with scrubbers.

Moderator:

Thank you, sir. We have a follow-on question from the line of Chris Noronha, a shareholder. Please go ahead.

Chris Noronha:

Just wanted to make a general query to you. Over the last 2 years to 3 years, right you have expended CAPEX in acquiring ships of various capacities and in various market segments. Do you think that you now positioned yourself for the next 2 years to 3 years?

G. Shivakumar:

Yes, we think that we are close to the end of our CAPEX cycle. We do not see ourselves doing much more CAPEX from here. We have built a reasonable amount of capacity at a good price. The most important thing for us is that we got our ships in at a good price. We have funded them at a reasonable price as well and so we have sort of yes, we are happy with the amount of capacity that we have. We are not looking for too many more investment opportunities. Again, if good cheap ships are offered to us we will consider them on a deal-by-deal basis. But we are happy with what we have achieved over the last 2.5 years. In fact, you would have seen that we have been selling some bulk carriers.



- Chris Noronha:** I am sorry for interrupting, in terms of market segment, do you think that this many of ships will be able to deliver your services to what you want to do?
- G. Shivakumar:** Yes, we are fine with this. We wanted to build up an LPG fleet; we managed to get some good LPG ships. We bought 4 of them last year and this year. We bought some crude tankers in 2017, which we had not been able to do for the previous almost 10 years. So, I think we have built up a good quality fleet and we have got a good presence now in all the subsectors that we are operating in. So, we are happy with that.
- Chris Noronha:** Okay. Just one point in terms of CAPEX. Once again, I go back to the CARE rating document, do you have to spend additional CAPEX in the scrubber or effluent control?
- G. Shivakumar:** Yes. So, we have to do that.
- Chris Noronha:** CARE rating, what they make a comment is that it is a sensitive issue. It is a sensitive point of reference.
- G. Shivakumar:** Yes, that is correct. Yes, we mentioned that we need to spend about \$20 million for the scrubbers for these ships that we have committed to. For the Ballast Water Treatment System, it is going to happen over a fairly long period of time between next year and 2024. We need to spend that money that is going to be probably about \$30 million. But that is coming over a period of 4 years, really. So, that is over a much longer period of time frame.
- Chris Noronha:** So, presumably, that would meet the expectations of these rating agencies or whatever it is?
- G. Shivakumar:** Yes, the expectation will be met when cash flows become strong, I presume.
- Moderator:** Thank you very much, sir. We have the next question from the line of Aadesh Mehta from Ambit Capital. Please go ahead.
- Aadesh Mehta:** Just a short question. Sir, we see that our spot exposure to dry bulk is very high, it is around 74% of our revenue days. Are we expecting the dry bulk prices to go up from here also?
- G. Shivakumar:** You mean freight rates?
- Aadesh Mehta:** Yes, the freight rates.
- G. Shivakumar:** Yes, freight rates at least we do not expect them to come off much. So, we don't normally fix the Supramaxes on charter. So, that is 5 of our ships that we do not fix on charter at all out of our now to be 13 ships. It is only among the remaining ships, that is the cape size and the 7 remaining Kamsarmaxes that we will look at fixing on the charter. So, we will look at fixing them, if we get good rates, we will look at fixing them. Again, that is a market where we think

that the recovery is already in play and it is just a question of getting the right rate and we will get it.

Aadesh Mehta: Okay. So, we should actually expect this mix between spot and time to shift going forward at least in the dry bulk.

G. Shivakumar: Yes, at some point, if the charter rates go up, we will look to fix yes, this is not going to be a permanent thing. We will look to fix out when we will get a market opportunity, whenever we get much more remunerative rates. The rates are still above breakevens but when we get more remunerative rates, we will look at locking in some of our capacity, either by selling them or by fixing on time charter.

Moderator: Thank you, sir. We have the next question from the line of Vaibhav Barjatya from HNI Investments. Please go ahead.

Vaibhav Barjatya: Thanks for providing the follow-up. Just earlier in your initial remarks, you mentioned that iron ore imports in China have contracted when the coal imports have grown. So, just want to know why there is this difference in economy coal imports are going up, iron ore imports are going down. Do you have any views on that?

G. Shivakumar: You see the iron ore imports have gone down in a very marginal way actually. It is a 1% type of number and it could well be that, it is just a statistical blip. So, it is not too significant but coal going up seems to be slightly more of a trend. We have seen that over the last few quarters and that is an encouraging sign because something has to take up that slack. Iron ore, we are near max. Steel production, of course, is coming off in China. So, something has to take up that slack, there is so much coal a couple of billion tonnes of coal which are consumed in China. And some of it has to be imported at some point. Environmental regulations can easily change the picture here for coal. But yes, it is not a huge swing and it is not indicating anything dramatic going on in the Chinese steel market, really.

Vaibhav Barjatya: Okay. Got it and this might be a really silly question, but out of Brent and WTI which is high sulfur and which is low sulfur?

G. Shivakumar: Good question. And yes, you mentioned this question a little earlier. I am not very sure, but I think that it is Brent which is marginally higher, though both of them are on the lower end of the sulfur spectrum. But again, I am not sure of this and this is again a little bit from memory.

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



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November 02, 2018*

Anjali Kumar:

Thank you very much, everybody, for joining us. Today's call was exceptionally interesting and the transcript of this will be on our website in a couple of days. And for any other questions, please feel free to connect with us. Thank you, and have a good evening.

Moderator:

Thank you very much, ma'am. Ladies and Gentlemen, on behalf of Great Eastern Shipping, that concludes this conference. Thank you for joining us and you may now disconnect your lines.