Great Eastern Shipping
Investors/Earnings Conference Call
(August 12, 2014)

Moderator: Good evening ladies & gentlemen. Thank you for standing by. Welcome to GE Shipping Earnings Call on declaration of its financial results for the quarter ended June 30th, 2014. At this moment all participants are in a listen-only mode. Later we will conduct a question & answer session. At that time if you have a question please press * and 1. I now hand over the conference to Ms. Anjali Kumar – Head of Corporate Communications at the Great Eastern Shipping Company Limited to start the proceedings. Over to you Ma'am.

Anjali Kumar: Good evening friends. Welcome to the conference call for our first quarter results which we announced earlier this afternoon. I hope all of you have managed to get a copy of the results by now and have gone through it. I now hand over the conference to our Group CFO – Mr. G Shivakumar who will take you through the key features of the results and thereafter we throw the floor open to questions.

G Shivakumar: Hi and good afternoon to everybody. First we will take a look at what happened in the markets over the last quarter and so first we will look at the Dry Bulk markets. The Dry Bulk markets saw a pretty good trade growth, so a lot of iron ore imports, iron ore is the most important commodity for us and specially iron ore imports into China. That went up by more than 70 mn tons in the first half of this calendar year, which is in itself a very strong number showing some replacement demand for domestically produced iron ore. However the bad news is that most of that incremental iron ore came from Australia. About 60 mn tons came from Australia which is a short haul and only 10 mn tons came from Brazil, which is a very long haul and therefore it did not have too much of a ton mile impact on demand. With regard to fleet growth of dry bulk we are having a fleet growth of about 5% annualized in business, so about 2.5% in the first half. Coming back to the demand side, we also had a bit of negative factor in demand which came from the Indonesian ban on nickel and bauxite ore exports. Just the Chinese imports of these two commodities went down by between 20 mn tons and 25 mn tons in the first half because of the ban on exporting unprocessed nickel and bauxite ore and that served as a pretty big negative specially for the smaller sized vessels, the Panamax and Handymax, Supramax vessels. So as a result of which we have had a very weak second quarter of calendar 2014, especially for the smaller sized vessels. So Panamax and Supramax typically stayed below $10,000 through the quarter. Now coming to crude and product tankers – the crude fleet growth was more or less zero during the first half of the year as we had expected and I think we mentioned it on a couple of quarterly calls now. We are expecting very low fleet growth on the crude carrier side for this year and the next week. We do not think we will see more than 1% fleet growth in both the years. So as a result of that we have seen markets somewhat volatile, so for instance for a Suezmax from being about $10,000 a day going up all the way to about $25,000 to $30,000 a day. You get these little spikes because the market is reasonably tight. It is not so tight as to move the base up convincingly to say $20,000 a day but it still shows that the market is not over-supplied by a great margin. On the product tanker side unfortunately the fleet growth has been about 2% to 2.5% for the first half which translates to about 4.5% annualized for the year, which somehow we were expecting demand to be reasonably strong and it has been. Rates have been somewhat disappointing in Q2 of the calendar year that is our Q1 of the financial results. So that is reflected in our TC wise and so vis-à-vis last year Q1 FY14 our crude carriers have done better, dry bulk have done better. But product tankers have done a little worse. Now coming to our specific results we will just go through some of the standard questions that we have. So we had three dry docks in shipping completed during the quarter and we had a couple that started in June and spilled over into Q2 and which will therefore be accounted in Q2. Overall, we will have four to five dry docks completing in Q1. In offshore we had two completed dry docks in Q1. Again we have a couple of spillovers so we expect to have three complete dry docks in Q2. As far as asset values are concerned, in shipping, we had a drop of about 5% to 6% quarter in the shipping fleet. In offshore the values were more or less flat between March and June. The net asset value ended at about Rs. 326 per share on a standalone basis i.e. taking into account the investment in Great Shipping at cost and when we revalue all the assets of Great Ship, the net asset value was about Rs. 560 per share. Now looking at what the future holds, the order book for dry bulk is about 22% still. The first half saw quite strong ordering. We saw 35 mn dead weight ordered in the first half which had slowed down, so the pace has slowed down a little bit. We had about a little over 20 mn ordered in the first quarter of the year and in the second quarter it was about 12 mn to 13 mn dead weight ordered. In crude in the first half we saw about 10 mn dead weight ordered, which is about 3% of the existing fleet and this also had slowed down from about 6 mn dead weight in the first quarter to about 4 mn dead weight in the second quarter. The crude order book stands at about 10% to 11%. In product tankers the order book stands at close to 20%, a little over 16%. The ordering was about 3.8 mn dead weight which is about 3% of the existing fleet and this also has slowed down in the last few months to a pace of about – there was ordering of about 1 mn dead weight in the last quarter. So now that we covered all the standard data that we look at, we will throw the floor open to questions and we will like to discuss the outlook with you.

Moderator: Ladies & gentlemen we will now begin the question and answer session. If you have a question please press * and 1 on your push button phone and await your turn to ask the question when guided by the facilitator. We have first question from Mr. Bhavin Gandhi from B&K Securities, please go ahead sir.

Bhavin Gandhi: Sir just wanted to check regarding one of the notes that was mentioned in the notes to accounts regarding this repayment of preference shares. So does this impact in any which ways the NAV number that we have reported?

G Shivakumar: No it does not impact. Oh, it impacts the net asset value for Great Eastern Shipping but on a consolidated basis it does not make a difference, yeah but in a very small way by Re. 1 or so.

Bhavin Gandhi: Sir just wanted to take your sense in terms of the NAV numbers. Firstly, just wanted to check how do you perceive asset values now, I mean do you think there is room for further correction in both shipping and offshore markets? And then I will come back to the second part of the question.

G Shivakumar: Yeah, we will have to see asset values in relation to what is happening on the freight markets. Crude carriers, the freight markets are giving hope and therefore it is unlikely that the asset values will come off in any significant way. May be the older vintage vessels, may be 15-16-year-old vessels could drop in value, may be an 18-year-old vessel could drop in value but for the more modern vessels, and by modern I am talking of 10 years or below, it does not look like they are going down in value, in fact in the last quarter they have probably gone up slightly in value. So that is one thing on crude and that is purely because of the way the freight market is behaving because it is giving hope of recovery. And considering that the next year and half has very few deliveries there is a hope that there could be some tightening on the supply-demand side. With regard to product tankers we have already had quite a bit of a fall probably 10% in the last quarter on slightly older assets, older meaning 5 years and above assets. So there has been a drop of may be 10% or so in the last quarter. Again there could be some fall that is an area where there are a lot of new buildings coming in for an MR Tanker for instance and you could have a situation where the validity of the pricing of the older ships goes down quicker than for a new building eco-ship. We do not think that will necessarily happen. There is already a pretty wide gap in that valuation. So we do not think that there is going to be that much of a difference between the depreciation of an old ship vis-à-vis a new building. So the new buildings have not gone down much. New buildings have probably gone down by may be 5% or so in the last six months for a resale. Coming to dry bulk, the older dry bulk ships have probably dropped by 10%, may be even 15% in the last three months. The market peak was probably in March-April. Since then they probably dropped 10% or 15% and these are older ships meaning about 10 to 15-yeat-old ships. On the modern end it is a lot less. New buildings there has been no drop, may be a 3% drop in the price of a resale, may be a 5% drop. But dry bulks somehow, the modern end is holding up across the board but the older vessels are suffering a little bit where the freight markets are weak. So that is on the asset values and then you had another question on -

Bhavin Gandhi: On the offshore side also how do you see asset values?

G Shivakumar: Offshore side again it is tough to put a number. Now the asset values again as I mentioned it couple of times before when we discussed the net asset value including offshore. It is tough to really assess the value of these vessels because so few of them get traded. So you could suddenly have a mid-sized PSV being sold at $20 mn for instance. So two year old mid-sized PSV and you might see another PSV of a similar vintage being traded at $26 mn and it could just be the difference in the spec, the yard where it is built or the country where it is built. So it could be an origin built or a Fareast built PSV with different specs. So it is tough to see, I think we have had a little bit of a correction in asset prices, probably a 5% correction in asset prices over the last year. May be 10, again it is anybody's guess what that number is but it is tough to put a number on that because it is not such a commoditized market. But the one thing which is sure is that pricing seems to be a little bit under pressure because of so many deliveries coming in. So specifically in PSVs I think the fleet will probably grow 8% or 9% this year. So there are a lot of vessels which are there, which are getting delivered and there are a few which are idling, not ours thankfully and that is going to result in a little bit of pricing pressure. So far we have not seen any desperate seller dropping the price but it could happen if this goes on for much more time. As far as rigs are concerned there are lots of rigs delivering but we have not seen any transactions of rigs happening at lower levels. So that is even less liquid than supply vessels. So tough to call that part.

Bhavin Gandhi: The second part is slightly hypothetical. I do not how much you would be able to help me out here but just wanted to know in your sense the NAV values that we are likely to see. I mean we are generating about Rs. 20 of cash every quarter but the NAV accretion has not been of a similar rate because the asset prices have corrected. And also what tends to happen, I mean this happened last year third quarter also where the vintage changed because the calendar year changed. So there was an impact on that side also. So do you think the NAV accretion will continue to be lower than the cash accretion that is happening in the business going forward?

G Shivakumar: In shipping I do not see that there is that much room for asset values to fall. There is yes, we are a bit above the lows of last year, the lows of probably across all the segments between end of 2012 and middle of 2013. So we are probably 15% above those levels. So yes, you can drop that much. We are depreciating the assets in any case and if you have bought the assets at close to current market values, so equivalent market values. Let us say today the market value for a 10-year-old ship is $50 mn and if you bought the new ship at $30 mn then your depreciation is taking care of your year change. So I do not expect too much of an issue there. But your depreciation will be real, so it will not be to the extent. Yes, if your question is - can your full depreciation come into the net asset value growth - that will be tough because for that you will need an actual an increase in the benchmark prices. So if the market is flat and there is no increase in benchmark prices, I do not think we will get the full cash EPS impact into the net asset value.

Bhavin Gandhi: And sir the second part of my question was on the Capex side. So what is the Capex number for FY15 and FY16 likely to be?

G Shivakumar: So the Capex numbers again we have the same Capex that we had a while ago, so we have 5-6 vessels to be delivered in FY16 and FY17. That is the bulk areas and one product anchor, all new building and which is a total of about $180 mn. And we have the one rig which is about $200 mn which is to be delivered in this financial year, hopefully by the end of this financial year.

Bhavin Gandhi: Sir roughly it would be 50-50, this year and next or --

G Shivakumar: No, this year is half of the entire group Capex, then 25%-25% between FY16 and FY17. At very end of this year so it is almost an FY16 kind of delivery.

Bhavin Gandhi: And the current quarter EBITDA of the offshore business which from the back of the envelop number looks like Rs. 260 for the offshore business EBITDA except for the downtime that you might have in the fourth quarter of this year for the rig, do you think this number is sustainable or do you think there will be other repricing which will also come through?

G Shivakumar: We had some timing differences. I do not think that number is sustainable. We had some timing differences on OPEX. Typically the first quarter tends to be a little light on OPEX and which then catches up in the later part of the year. So OPEX will tend to be higher, i.e. maintenance OPEX obviously not the manning cost which is sort of evenly spread through the year. So you will find that expenses will tend to go up in the next three quarters. Just to correct you the downtime on the rig is expected to be in Q3 not in Q4.

Moderator: We have our next question from Mr. Vikram Suryavanshi from Philip Capital, please go ahead.

Vikram Suryavanshi: Sir just wanted to know on the rig in terms of delivery do you have any ballpark number that how many rigs are expected to come?

G Shivakumar: We are expecting the total order book for rigs is about a 120, possibly now 125, you keep saying orders for these rigs. And they are sort of evenly spread out. So next year you could have about, 45 rigs scheduled to deliver. This year second half you probably have a 20 plus number schedule to deliver. We do not think all of them will deliver as per schedule. There are a lot of first time yards here but eventually these rigs will come. They may come a few months late or a few quarters late but they will come. But generally you can assume about 40 rigs per year as a delivery.

Vikram Suryavanshi: Okay. And I know it is very difficult to understand scrapping in rigs because of refurbishment and all that but it is very difficult to understand then though deliveries are there what kind of rigs can go out of the system? Do we see anything apart from the age anything happening in terms of policy changes or something else, the old age can go out of a system?

G Shivakumar: There are a lot of international charters who ask for modern rigs only, but there are still little pockets including India where old rigs are accepted. So they will find a hope in these markets where they are expected. However those will become less and less as time goes along and customers realize the efficiency benefits and safety benefits of a modern rig. So it is particularly difficult. They will not get scrapped. You are right, they do not get scrapped, they just get stacked so they go from hot stack to cold stack and it is just the option value that if the market goes up suddenly you can reactivate those rigs and make a lot of money. And that is why people do not scrap these.

Vikram Suryavanshi: And in India for ONGC and other companies do we have preference for Indian rigs or is there any duty for if foreign players come to India and bid for ONGC or something?

G Shivakumar: There is a preference for Indian bidders so an Indian operator who bids a rig to ONGC gets a preference over a foreign operator who bids to ONGC subject to certain conditions on local content. So there is preference that way. The duty is not based on the ownership but on where the rig was located last. So if it is physically being imported into India the duty treatment for a foreign operator and an Indian operator are the same.

Vikram Suryavanshi: So the last location would be for –

G Shivakumar: Yes.

Moderator: We have our next question from Mr. Ashish Jain, Morgan Stanley, please go ahead.

Ashish Jain: My question is on the offshore side what has led to such a sharp expansion in markets if I just do consol minus standalone on a quarter on quarter basis?

G Shivakumar: This is Q1 versus Q4? And you are looking at EBITDA margins, right?

Ashish Jain: Yes.

G Shivakumar: Yeah, so we had some one-offs. I think we discussed with them last time that we had a few one-offs and that is why last quarter actually our margins were a little low. Last quarter also we had the rig survey which was completed in January. So first of all she had about 15-16 days in January which a non-earning period and they she had to also incur expenses during that period. So the margins for last quarter were weak mainly because of the rig and we had some more expenses. Again, I was just mentioning to Bhavin about the expenditure for OPEX. Typically it starts off low in Q1 of the year and ends up high towards the end of the year. So OPEX tends to be higher in Q4 of every financial year. So those are the reasons really. So this quarter is a little higher than normal, Q4 is lower than normal.

Ashish Jain: So sir then these margins at least for this September quarter and also should be sustainable basically is that –

G Shivakumar: So you will have operating expenses starting to go up from this quarter onwards.

Ashish Jain: Because of write-offs.

G Shivakumar: No, not just write-offs, the running OPEX itself will go up from this quarter. It is likely to go up from this quarter because of the trend that we have seen over the last few years.

Ashish Jain: Just to understand this, is this some kind of seasonality in – condition hedge?

G Shivakumar: No, no, it is just a budget cycle because you had a budget in the previous year so there is quite a bit of work that gets done in Q4 in the budget and the procurement. And therefore you do not need to do as much in the next quarter. So it is just to do with the budget cycle more than anything else.

Ashish Jain: And sir secondly on the operating coverage days which you have given for the shipping fleet, I think we are pretty much at lows in terms of what we would have seen anytime in the past in terms of 41% base cover for crude and 29% for dry bulk. So is that more in line with how we are seeing the leaps today and as in we would get into more longer term contracts at more efforts. Because normally we have said that 50-50 is what we would want to maintain between a particular spot and a charter but this is quite a big deviation in my view.

Ashish Jain: Yeah, that is right. So we have been like this actually for some time now, for the last couple of quarters at least. And basically you are right, it is because the rates are so low that it is not worth fixing at all. So we look at time charters as part of our risk management process and if you are fixing out a really low point in the market where you are not getting much of earnings at all then there is no point fixing it. That safety net is just not worth it. So if we see the market, if we get a bump in the market then we probably look at fixing more assets. But at the current market we not really inclined to. The other thing is that we do not have exposure, so we do not have much of a Capex. We have not expanded much really and since the balance sheet is light we thought that we should take this risk on running the ships, running more ships port. We have also seen in the last couple of years that running the ships spot has outperformed period rigs. If you have the skill to trade the ship well and so we are just backing that as well.

Moderator: We have our next question from Shri Somujit Banerjee from ICICI Securities, please go ahead.

Somujit Banerjee: Sir in this quarter we see a significant decline in the interest cost. Can you please explain that sir?

G Shivakumar: Yeah, this is vis-à-vis Q4 again I presume you are talking about. This is Q4, right?

Somujit Banerjee: Yeah, Q4 as well as last year also sir.

G Shivakumar: Okay, one is vis-à-vis Q4 is because we had some re-financings in Q4, so Q4 was naturally high. We did some re-financings in our offshore business and the way we treat the upfront cost is that we spread it over the life of the loan. This time we cut-short the life of the loan and repaid the loan in advance. So we took a hit of whatever was the remaining amortized upfront cost and we did the refinancing so that it was taken in Q4. Now coming to Q1 versus Q1 it is just a function of the repayments that we have done. In the last year or so net we would have paid about 120, so our debt itself would have gone down by about 12% to 14% in dollar terms and therefore the total interest cost has gone down to that extent.

Somujit Banerjee: Okay, so what is your current cost of debt?

G Shivakumar: Between the two companies I would put it about 4.5%.

Somujit Banerjee: Okay. And sir depreciation I assume that we are going to follow this rate given the change in company's act.

G Shivakumar: Which rate? What is it?

Somujit Banerjee: The depreciation amount has come down sir.

G Shivakumar: Yeah, that is right, so that is something which will continue over the next foreseeable future. This impact is not a one-time impact, 15.8 crores.

Somujit Banerjee: And sir secondly what I understand the own tonnage base, revenue base has come down on a YoY basis. So is that due to dry docking thing sir?

G Shivakumar: Yeah, there is the sale which happened in the month of May. So that impact would be there. So we had a few sales which have happened in the meantime. So it is a combination. Last year we did a couple of sales, a couple of purchases and then we did one sale in May this year as well and again 90 days is a very minor differential year.

Somujit Banerjee: And sir secondly just wanted to understand, subsequent to the quarter you are selling one VLGC and again we are taking delivery also of another VLGC. So what is the rationale sir just trying to understand that?

G Shivakumar: The rationale is that the transactions are done at two different points in time. The purchase we did in August-September last year it was a forward delivery so we took delivery of that vessel which contacted last year. In the meantime the market has gone up so we had the opportunity to lock in a profit, so we have sold the other VLGC, which is slightly older. It is 4-years older than the one that we have. So since it is an older one we have decided to sell that one.

Somujit Banerjee: And sir finally with GAIL taking out some order regarding LNG ships and all, do we see GE shipping capturing such kind of a business?

G Shivakumar: We are not currently considering it. The conditions seem a little difficult to meet to we are not currently considering that they have some conditions about – as you have to bid three vessels. So that is going to be a little big for us and there is also a requirement for an Indian built vessel so we will have to look at all those things carefully. As it stands today it looks difficult.

Moderator: We have our next question from Mr. N K Kurup from Hindu Business Line, please go ahead sir.

N K Kurup: This is part of the just question he asked about the sale of this gas carrier, I wanted to know that the procedures being taken into account the current quarter?

G Shivakumar: No, this deal is going to be executed in the second half of this financial year. So it is been sold but it will be delivered in the second half.

N K Kurup: And is it possible to say what would be the sales proceed?

G Shivakumar: No, we do not give details of sales proceeds or profit on sales.

N K Kurup: So earlier you said the net debt if the company has benefited.

G Shivakumar: Oh certainly we have benefited on that market because the prices have gone up since we bought that ship.

N K Kurup: And one more question about what is the overall outlook for the tanker market in the coming quarter?

G Shivakumar: Coming quarter is a tough one. July we saw a little bit of a spike in the crude carrier markets, which seems to have subsided now. So this quarter seems not a bad one for crude carriers. Product tankers are more or less where they were, so there is not much excitement in product tankers. There seems to be a little more hope about the crude carrier market because of the very low deliveries for which we are seeing.

Moderator: We have a question from Ms. Jinit from B&K Securities, please go ahead.

Jinit: Last quarter you had mentioned that there are couple of OSVs that are coming up for repricing on the first half, so I just wanted to check if the repricing was done at similar rates to last year or was there any downward movement there?

G Shivakumar: Actually there are two which have got repriced so far and one of them was repriced lower and one was repriced higher, so no conclusions to be drawn from that one.

Jinit: And sir just a broad outlook on rates?

G Shivakumar: The trend is slightly lower on this. The one which got repriced higher was for a specialized job. So that is where vessels are making good money. For plain vanilla supply jobs the rates are not high.

Jinit: We are expecting 6 more repricing for the balance of the year.

G Shivakumar: So we will have 5 more repricing in the balance of vessels and one of rig.

Jinit: And sir speaking of the rig, has it been contracted now?

G Shivakumar: No, it has not yet contracted. We have been into two tenders. One long term tender and one one-year tender, so we are awaiting the results. Hopefully we will have that sometime within the next few weeks.

Jinit: And sir just a broad outlook on the offshore supply vessel market, particular to ESE?

G Shivakumar: Okay, it is broad and this is going to be a very macro outlook which I will give you. Basically offshore E&P spending looks like it is going to grow by not more than 2%. There is one outlier research outfit which is calling it for it to grow by may be 6% to 8% but the consensus seems to be 2% to 3% growth in E&P spending growth.

Jinit: And this as compared to last year would be how much?

G Shivakumar: The last three years have been in excess of 10% including one year where I think we had 12% or 13%. So that is just reported in perspective. And again vis-à-vis that we have supply vessel growth which will be 5% to 6% at least. It will be about 5% to 6%, not more than that actually because anchor handlers are not growing much. So PSVs will grow close to 10% but supply vessels overall will probably grow 5%, little more than that. So generally the market looks slightly over-supplied. So we are expecting rates to hang around where they are currently or start trending a little lower but not much lower from here. Generally rates tend to be sticky around these levels. They do not go down too much unless the market is massively oversupplied.

Moderator: We have our next question from Dipen Shankar IDBI Capital, please go ahead.

Dipen Shankar: Just want to understand overall the demand scenario outlook for dry bulk considering the improving demand from China or so.

G Shivakumar: Yeah, that demand scenario for dry bulk is basically there are 2-3 things and good that we can discuss this. I know it has already gone up in a big way in the first half, 70 mn tons additional being imported. The second half we are likely to see much more Brazil cargoes and this is a seasonality thing. So we will see much more Brazilian cargoes coming in which results in much better ton mile than when you see an Australian cargo being lifted to China. So that is one positive that we will have. On a slightly more long term, the domestic iron ore in China as mentioned in the past is extremely lower quality and is not cost-efficient. Especially when you consider that the price of iron ore is somewhere around $90 it is very difficult to justify using domestic iron ore with 20% FE quality when the prices are around $90 per ton for international quality for 63% FE contain iron ore. So therefore we expect to see some replacement demand for international iron ore, and there is a lot of iron ore capacity coming on street in Australia, in Brazil and in Africa. And we think that if the ore is produced it will be consumed. It will be exported and it will go and the main consumer of this anyway on the margin is China. And therefore it will move and if it moves then its demand for dry bulk vessels. So that is on iron ore which is a major commodity. Coal, we think India might be a big driver. China seems to be having some issues with regard to pollution and they seem to be having a lot of hydropower this year. So we do not know how their thermal coal demand will pan out but India seems to be growing quite well in terms of coal import demand. So that is likely to keep coal demand at a reasonable level. The other commodity, major commodity is rain and we have had a disappointing first half of rain. The second half is likely to be better. The US harvest is likely to be good and that will again move to Asia and so we expect that to provide some demand push as well. So overall the demand seems to be okay. The problem is the supply and you have a lot of ships which are coming in. The growth still continues at an annualized rate of about 5% and scrapping has not yet picked up. Scrapping in the first six months has been not more than 6mn or 7 mn dead weight. So we need scrapping to happen before we can really have a pick up in race.

Dipen Shankar: So overall so we are expecting a demand growth in the range of 4% to 6% per se for a year?

G Shivakumar: That is correct.

Dipen Shankar: So we are expecting the rates to pick up from these levels.

G Shivakumar: Yeah, because the rates really are terrible so we expect that they should improve from here.

Moderator: We have our next question from Chirag Gandhi from Principal Mutual Fund, please go ahead sir.

Chirag Gandhi: Any new ordering that you would be looking to do from here on based on the view on the markets?

G Shivakumar: Again, its purely a function of the price and if we can get – we would like to get some new so-called eco-ships. We would like to get them but finally it is going to be a function of the price. We make a comparison every time between an existing buying and existing ship and doing fuel efficiency improvements on that. So we have done that on quite a few of our vessels. You can retrofit some of the stuff which gives you the fuel economy and we have done that quite successfully. So when we make a choice of whether to buy a new ship or an existing ship, we look at that and we look at all the numbers. And we are always doing a relative value on this.

Chirag Gandhi: But based on where asset prices are today you do not see any reordering?

G Shivakumar: No, not really. Okay, the asset prices are not bad actually. The problem that we have is that the order book has built up so much that it is causing some uncertainties. So this time last year the dry bulk order book was very decent. So we had not too much of a worry about the dry bulk order book. However after the market strengthened starting from July-August, people just went crazy and ordered. So in the last 12 months, so between July and June, about 80 mn dead weight have been ordered, or probably 90 mn dead weight of dry bulk ships have been ordered and which will put a lot of pressure in the next couple of years on the rates. So that is a constant worry that we have because you order a ship now, you get it in 2-3 years time and it comes into a market where everybody has ordered ships. So that is a little bit of a concern for us. So till this supply side gets sorted and I do not know what can sort out the supply side given that it is driven by liquidity, it is driven by people wanting to invest. So I do not see how we can deal with it.

Chirag Gandhi: Coming to the E&P spend that you are referring to, so within let us say the broad category shallow, deep water or something, anything looking good in that sense or it is across the board cut down in Capex?

G Shivakumar: It is actually good that you asked that question. We have had probably a sharper correction for deep water rigs than shallow water rigs so far. They probably attract the maximum capex. So that is where we have had some cuts and we have had a 25-30% drop in rates based on some fixtures. So there seems to be some pressure there. But logically it would seem that when they had to make cuts they would make cuts to the most expensive end of it. Also in shallow water remember that most of the drilling is production drilling. So your marginal cost of extraction is much lower than for a deep water. In deep water you are actually doing exploration in a lot of cases. So your uncertainty regarding the payoff from it is much higher. But when you are doing a production drilling with a jack-up rig on a platform then you know that there is a well there, there is a field there and you know that there is oil there and you just have to find an easy way to get it out. So the breakeven on that is much-much lower than for a new field.

Chirag Gandhi: And when you say the 25-30% drop in new fixtures, is it only on floaters and those deep water vessels or even ultrahigh spec jack-ups are seeing such corrections?

G Shivakumar: No, this is only for the floaters, for a new drill ship.

Chirag Gandhi: So as of now the high-specification jack-ups have just seen about 5-10% correction.

G Shivakumar: The high-specification jack-ups yes, probably seen something like a 5-10% correction. In the international markets may be not even that, yeah may be a 5-10% it is possible. It is tough to compare them but yes, I would go with a marginal correction.

Chirag Gandhi: And will it soon catch up or whether it is going to be a flattish kind of outlook?

G Shivakumar: I do not think. See the drill ships started off much more profitable than jack-ups so the starting point of say before this drop, drill ships were more profitable than jack-ups were on a pure capital invested to EBITDA basis. So it is probably a catch up already which has happened.

Chirag Gandhi: And how does domestic market see? You are seeing some rates correction there as well, right on domestic offshore segment.

G Shivakumar: Domestic offshore it has not corrected too much. There is a lot of demand and there are tenders coming out and tenders are going by without getting the number of vessels that are required probably because we are not able to find the market clearing rate or people are not able to get the clearing rate for other customer. So there is a shortage of assets here and we keep having roll-overs of requirements. This has happened in rigs from a year ago. This is happening in vessels all the time. So that is a requirement and I think if the market settles at a correct hearing rate we will have the vessels to meet that requirement. So rates are pretty low. They are not dropping further. So they are pretty low. They are still profitable but not as much as they should be.

Chirag Gandhi: Just interestingly it is an open option thing, so let us say if you have an asset line there, tenders are going without vessels. As in why do not somebody just bid it up and see if ONGC accepts it then go through in that sense.

G Shivakumar: Yeah, I think people are sort of guided by the history when it has not happened that full international market clearing rate is paid. So that is where people do not really bid with great enthusiasm. You are absolutely right that they should just bid because you have nothing to lose but basically people say that I will just go and market it as it is.

Moderator: We have a question from Mr. Ashish Jain from Morgan Stanley, please go ahead sir.

Ashish Jain: Shiv, I just had one question on the supply side while the order book is so strong, are we seeing any challenges from the yard side on the deliveries which may lead to better rates than what we might be thinking today?

G Shivakumar: You mean where they are not able to deliver on time and you are referring to which specific shipping or offshore rigs?

Ashish Jain: Shipping side.

G Shivakumar: Not really. There will be, in fact our best case assumes that there will be at least 10% to 15% slippage, may be 20% slippage. So even with that you will have a 5% growth probably – 4% to 5% growth in the fleet and currently it is running at 2.5% for the first half so you are running at 5% run-rate for the year. So may be when you get closer to it, see a lot of people have ordered ships on speculation, a lot of people have done it with raising money from the public or private equity markets but you could well find some weaker players having difficulty taking delivery because they are not able to get the financial closure. But even if that happens, somebody will take delivery of those ships and we have seen that happening including for VLCCs where the yard themselves or the buyer defaulted and the yard put them out for sale, nobody bought them because the market was looking so bad about two years ago and the yard themselves ran the ship and they gave it to somebody for commercial management and they ran the ship. So finally the bottom line is that ship is delivered and it competes. So we do not have much hope of that huge cancellations happening and therefore that is not something that we would bank on.

Moderator: Sir there are no more questions in the queue.

Anjali Kumar: Thank you ladies & gentlemen for joining us on the call today. As usual the transcript of this call will be on our website in a couple of days and obviously feel free to call our team any time you with or any time you have a query. Good day to you.

Moderator: Ladies & gentlemen this concludes the conference for today. We thank you for your participation and for using Tata Docomo Conferencing Service. You can please disconnect the lines now. Thank you and have a pleasant evening.