

The Great Eastern Shipping Co. Ltd
Q1FY14 Results Conference call
(August 12, 2013)

Moderator: Good morning ladies and gentleman, thank you for standing by. Welcome to GE Shipping's earnings call on declaration of the financial results of the quarter-ended June 30th 2013. I now handover the conference to Ms. Anjali Kumar, Head of Corporate Communication at GE Shipping to start the proceedings.

Anjali Kumar: Good morning and welcome to the conference call. As the results were declared on Thursday last week, I am sure that all of you had enough time to go through it. I now handover the call to Mr. Shivakumar, our group CFO to start the proceedings.

Shivakumar: Hello everybody. I will start with the two numbers that we declare at the beginning of every conference call. As of 30th June 2013, the standalone net asset value (NAV) for the company was Rs. 277 per share and the consolidated NAV was Rs. 494 per share. Apart from these figures most of the information is available in the press release. Hence, we will throw the floor open for Q&A now.

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

Chetan Kapoor: First of all I would like to congratulate you on relatively good set of numbers in such a difficult environment. My first query is relating to the offshore segment. What would be the contract status of the three rigs we have?

Shivakumar: Out of the three rigs, one rig continues on the five years contract which started in end of 2009 and will go upto end of 2014. The second rig has a five years contract which started in February 2013. The third rig comes of contract in October-November 2013 this year and she has received a contract for 3 year period, which will start in end of this year and go on till end of 2016.

Chetan Kapoor: What kind of charter rates have we got for the new contract?

Shivakumar: It's slightly at lower rate than the previous contract. But that is purely due to difference in the tenure. The previous contract was for 18 months period, whereas this is for a three year period. So the headline rate is little lower than the previous rate.

Chetan Kapoor: What is the strategy behind placing new orders for dry bulk vessels at the shipyards? Are we expecting a recovery in the dry bulk charter rates?

Shivakumar: It is typically a call on the cycle. Though we are not able to see light at the end of the tunnel in the dry bulk sector, it is probably a question of time before we witness some recovery. Also, we are getting historically low prices for ordering ships and hence you might as well start ordering now. So that's the principal on which we have started looking to do some expansion.

Chetan Kapoor: So it's basically a call on the asset prices which you have taken right now?

Shivakumar: The call is not entirely on the asset prices but on the recovery cycle. The cycle will turn at some point in time. But it is extremely difficult to time that. Therefore we decided to make some investments now. The other thing is that these are the new breed of eco ships, the market that we would like to enter. So we thought it's a decent opportunity to get into that part of the market and with delivery coming two years down the road.

Moderator: We have our next question from Mr. Himanshu from M3 Investments.

Himanshu: The first question is on the product tanker side. This quarter's average product tanker TCY earnings are nearly 37% higher than the previous year. If we take out the gas carrier which was acquired last year, how much has product tanker TCYs moved?

Shivakumar: Overall, the product tanker earnings witnessed a steady improvement as compared to previous year. This was also supported by strong positioning of the fleet. I have been mentioning in the earlier calls that voyage completion and the kind of voyages that are done can affect individual quarters. So you can have exceptionally high or low numbers in individual quarters. But you need to take the broad message out that the market is stronger than it was in the previous year and that's what really matters.

Himanshu: Looking at your strategy of acquiring varied assets in shipping, are you assuming that all the segments will witness a recovery going forward? What would be the reason for being acquisitive on all the segments in shipping?

Shiva Kumar: We are not acquisitive on all the segments. If you would have noticed, we have not done anything on the crude segment. In fact, we have downsized in the last 2-3 years in the crude segment and not purchased anything. In case of product tankers and gas carriers, we are positive that the market fundamentals will keep rates reasonably healthy. Coming to the dry bulk segment, we don't yet see the turnaround coming and so we have placed new building orders which will come to us in two years time. We have made investments in products and LPG based on the market fundamental. Dry bulk is more counter cyclical call that we have made because its got beaten down substantially and so we would like to invest in that. We clearly see that the crude segment is not doing very well and we are not very positive about it and so we have made investments in the other parts of our business.

Himanshu: The product tanker order book is close to 15% of the world fleet and most of this will be of eco design, which all believe are efficient than the existing vessels. But we have recently contracted to purchase product tankers which are second hand. What is the rationale behind this second hand purchases?

Shivakumar: The eco versus a non-eco vessel is broadly a commercial differentiation. It means that you make some savings in your fuel cost when you are running an eco ship. This saving can be priced. It is not like a double hull versus not double hull concept, which has a regulatory angle to it. So if you are getting a sufficient discount on a non-eco ship vis-à-vis a eco ship, it is just a question of pricing. What happens is that shipyards takes away some of the benefit because of the pricing is little higher for an eco ship. So we are always looking at different types of assets and in relative pricing it seemed that these second hand vessels were a little better than what we would do with the new buildings. Also what happens is that when we get a second hand vessel, you get to participate in the strong market which is there currently, which you would not get if you went and order new ships that would come let say in two and half years time.

Himanshu: Are these eco ships far more environmental friendly?

Shivakumar: Yes they are because the fuel consumption is lower. There might be some charterers who would prefer to have those. But we haven't seen that happening, where there is a clear preference where they say we only want eco ships. That's purely because eco ships have not reached the critical size of the total fleet yet.

Himanshu: What is the total committed CAPEX for shipping business?

Shivakumar: Shipping business has a total committed CAPEX of around \$150mn.

Moderator: We have our next question from Mr. Prateek Poddar from ICICI Prudential.

Prateek Poddar: We have started to buy ships on one hand and are also going ahead with the buyback plan? Can you share your thoughts on this? Also what is your view on the asset market. Is it close to the bottom?

Shivakumar: Yes, asset prices are in the low part of the cycle, but have bounced a little bit from the bottom. They are probably up 10% from the beginning of this year. In case of product tankers they are probably up 15%-20% from the bottom. But yes, we would like to invest at this point in time. Apart from that we can also buy share in the existing fleet which is available at a discount and that's what we are doing via the buyback route. It is just that we have certain amount of cash and we have allocated some part of that towards buying the stock which is available at a discount to the underlying.

Prateek Poddar: You are a dollar long company and after the swap adjustments as well as the forward contracts you would still remain to be so?.

Shivakumar: In terms of balance sheet, yes and in terms of cash flows it depends on the market. It depends on what earnings we have.

Moderator: We have our next question from Bhavin Cheda from Enam Holdings.

Bhavin Cheda: What would be the CAPEX on the offshore side?

Shivakumar: We have no committed CAPEX on offshore side.

Bhavin Cheda: So the shipping CAPEX of \$150 mn would be spent till which date?

Shivakumar: This will be spent in the next two years.

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

Vikram: What will be the breakup of time & spot contracts of the shipping fleet?

Shivakumar: In Q1FY14 on a full fleet basis, we had 51% of the vessels on spot. In case of dry bulk it was 56% spot and in tankers it was close to 49%

Vikram: We have seen very good performance in the offshore side in terms of profitability. How have been the utilization levels and charter rates?

Shivakumar: Utilization levels continue to be good. In some of the segments we have seen the rates going up. So for instance, we are seeing high rates in the PSV segment now. In case of Jack up the markets are generally where they were about a year ago. But it is difficult to generalize the Jack up markets because they are very much regionalized. Anchor handlers continue to be remain weak, especially the smaller ones.

Vikram: How many drydocks were there in this quarter?

Shivakumar: We had five dry dockings in this quarter.

Moderator: We have our next question from Mr. Bhavin Gandhi from B&K Securities.

Bhavin Gandhi: What is the revenue visibility in the offshore segment especially in the support vessels going forward?

Shivakumar: A lot of it is fixed. We are broadly covered to the extent of around 70%-75% of our days for the remaining year and as I mentioned earlier, the only segment which is still struggling

is the small Anchor Handler segment. All other segments are doing quite well. There is a lot of demand for them and pricing is steadily moving up.

Bhavin Gandhi: If I remember correctly, in the last call, you mentioned that AHTSV segment has the smallest of the order book. Will that help the current situation?

Shivakumar: Correct, but this has been the case for few quarters now and unfortunately this supply side analysis has not helped very much. The important part is the demand scenario which is much difficult to estimate. In case of the PSVs the order book is very large but still the charter rates been growing at 8-10% for the last two years.

Bhavin Gandhi: As far as our contracts with ONGC are concerned, is there any measure by which ONGC would want to take some of the benefit of dollar/rupee movement?

Shivakumar: No, because it is an international competitive bidding process and people who bid include foreign bidders. It is a bid in a common currency which is dollar.

Moderator: Our next question comes from Mr. Ashish Jain from Morgan Stanley.

Ashish Jain: My first question is on the new building dry bulk orders. You have been mentioning that the current dry bulk earnings do not give a favorable return on earnings. Has the situation on the charter earnings changed now?

Shivakumar: We don't expect asset prices to fall further from the current levels. People are expecting some kind of market recovery by 2015 in the dry bulk segment. This is where we are trying to position ourselves for that recovery. Other option would be to purchase a second hand vessel, but the asset prices of modern dry bulk ships are up by 10-15% year to date.

Ashish Jain: Have we also seen recovery in charter rates as we have seen in the asset prices?

Shivakumar: No absolutely not. So that's the strange thing about this.

Ashish Jain: You mentioned that the jack-up market is much localized and rates vary from region to region. We have largely been India focused. Is that more to do with the business strategy or you think rates in India are higher?

Shivakumar: So far we have deployed only in India because it was our starting point i.e. when we entered the business and a home market as well. Over these years it has helped us to build that CV which will help us go abroad and market ourselves as a rig operator which we think we have now. So now we are in a position to go out and market our rigs overseas.

Ashish Jain: How many of our offshore assets are deployed in India?

Shivakumar: Out of 21 assets, 13 assets are deployed in Indian waters.

Moderator: We have our next question from Mr. Himanshu from M3 Investment.

Himanshu: You mentioned that the AHTV market is not performing well. Are our AHTSVs contributing to our EBIDTA?

Shivakumar: Yes certainly. They are contributing to our EBIDTA.

Moderator: We have our next question from Mr. Rajendra from IDFC.

Rajendra: What will be the consolidated revenue mix segment wise?

Shivakumar: The rigs are the ones which are earning the maximum among for all asset types. But then of course they also constitute the largest investment.

Rajendra: What is your outlook or guidance on the E&P status in India?

Shivakumar: E&P companies have lots of investment plans and these will eventually result in increase in requirement for offshore support assets. From the rise in flow of enquiries and tenders, we anticipate that the E&P activity will pick up.

Rajendra: You said that asset prices have slightly bounced from the bottom. How is the demand supply scenario currently shaped? Has the scrapping activity increased?

Shivakumar: Scrapping has come down in the recent past. Dry bulk scrapping in CY12 was about 32 mn dwt. This year has been lower so far and we are running at about 15 mn dwt for the first seven months of this calendar year. Also new ordering has been going up, especially on the product tanker side. On the financing side, there is new money coming in. There are couple of companies which have been successful in raising equity investing in capital markets. So public equity is coming in, private equity is coming in and people are placing a lot of orders and its happening in segments where the demand fundamentals are looking good. So the worry is that they may serve to depress those markets in the years to come. On dry bulk as well, the orders have been building up which is not a good sign because it's building up despite a pretty weak market and lower scrapping. So that's the little bit of our concern.

Moderator: We have a question from Mr. Rahul from Lucky Investments.

Rahul: I wanted to get a broad sense on what you make out of the US shale revolution and its impact on the oil tanker trade?

Shivakumar: It's already affected our markets. One market very negatively and two markets positively. The crude carrier market has been affected negatively because of increase in North American crude oil production and reduction in oil demand. The market which has been strong as a result of this is the product tanker market because the US refineries have become competitive especially with WTI pricing at a \$15-20 discount to Brent and shale oil reportedly getting priced at a further discount to WTI. So because it has been so competitive they have been able to export large quantities which have resulted in increase in product tanker movement. This is the reason why we have seen the MR product tankers doing so well in the last few quarters. The other offshoot is of LPG, which is another byproduct of the natural gas. Shale gas production increase has helped LPG market improve substantially.

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

Ashish Jain: Going by the orders that you have placed in the dry bulk segment, is it right to perceive that structurally you believe that dry bulk could recovery faster than crude?

Shivakumar: Yes that's seems to be the market consensus as well. The one big worry on crude is that of US shale production when you have such a long haul customer who is dropping imports than it's always a worry. So yes we probably would say that dry bulk could have slightly better demand fundamentals than crude oil.

Moderator: We have our next question from Mr. Chetan Kapoor from IDBI Capital.

Chetan Kapoor: Any particular asset class of the offshore segment does the Company want to expand?

Shivakumar: Nothing is finalized for now. It's a question of how much we want to invest and which market are we targeting.

Chetan Kapoor: Significant new deliveries of jackup rigs are expected to join in the second half of this calendar year? Will this affect the demand supply scenario? Will it affect the asset pricing?

Shivakumar: Around 14 jack-up rigs got delivered in the first half, whereas around 34 jack up rigs are expected to join in the second half. It is unlikely that we will hit that kind of run rate. So there will be some slippages. Coming to pricing, it's tough to get a drop in pricing from these levels because a large part of the cost of a jack-up rig is equipment related and there are not many suppliers or makers of these equipments worldwide.

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

Anjali Kumar: Thank you very much for joining us today. We will have the transcript of this call on our website in a couple of days. In case you have any more queries, please feel free to contact us.