Earnings Call Q2FY16 – November 9, 2015

Moderator: Good evening ladies and gentleman, thank you for standing by. Welcome to the GE Shipping earnings call on declaration of its financial results for the quarter end September 30th 2015. At this moment all the participants are in the listen only mode. Later we will conduct a question answer session. At that time if you have a question please press * and 1. I would now like to 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 Ms. Kumar.

Ms. Kumar: Thank you. Good afternoon friends, and welcome to the conference call for the Q2 results of our company which were out late evening on Friday, I hope all of you have had a chance to look at it. So I will directly hand it over to our CFO Mr. Shivakumar to start the proceedings and you may ask questions on it after that.

Mr. Shivakumar: Hi Good afternoon everyone and welcome to the results con call for Q2 FY16. First, I will take you through the happenings in the various markets that we operate in and then we will do some of the standard data and we will open the floor to questions. So let us start with the best part of the markets that we have been operating in, which is the product tanker markets and the crude tanker markets. We had very strong product tanker market in Q2 and we had continued strength in the crude tanker market. The crude tanker market was pretty strong in Q1 as well and that just continued through into Q2. The cause for this was the refining margins were very strong in the last quarter, resulting in the increased refinery runs which were up one and half million barrels a day over the previous quarter which is Q2 over Q1, and 2.6 million barrels a day over the corresponding quarter in the previous year. So as result, there were lot of products pushed out and what gets pushed out will have to be carried somewhere and therefore the product tankers had a lot of demand. The oil demand itself for 2015 has been devised upwards again to about 1.8 million barrels a day. But the main factor was not the demand, but the supply increase which was more than 3 million barrels a day and therefore the stock build has been about 1.5 million barrels a day of which about one million barrels a day can be seen in the OECD stocks which are declared much more frequently than the other stocks. Coming to the fleet, the crude fleet grew a little less than 2% in the 9 months period that is from January to September, while the product tanker fleet grew by 6% and if you recall this was always a concern for us and that the product tanker fleet and order book is very high. However, this fleet growth in product tanker was outweighed by very strong demand growth as I mentioned earlier which is because of the refining margins and strong demand for gasoline in the United States and the North America. Therefore, we had very strong earnings. The order book stands at about 19% for crude and 17% for products as of end of September and during this 9-month period ordering in crude tanker has been pretty strong, at about 7% of the current fleet and in product tankers it has been a little less than 5%. The dry bulk market continues to be very weak and while scrapping has been quite strong at about 24 million deadweight in the first 9 months of this year, and this has resulted in the next fleet growth of about 2.2% during the 9-month period, the demand growth has been much lower. In fact, it may not even be a positive. China has actually contributed a negative growth of about 40 million metric tons during the 9-month period which works out to - if you annualize - 1 to 1.5% of global trade which is difficult for others to compensate. One of the bright spots in the past few years has been Indian thermal coal imports which have been growing very steadily over the last 2-3 years but even those have leveled off now and they went into negative territory in the month of July and that continues up to October. So that is four continuous months of negative growth in Indian thermal coal imports. On the dry bulk side, while the ordering has almost stopped, the order book is still at 15% and therefore we need a lot scrapping to take place if the market has to get back in the balance. Coming to the new asset value, the standalone NAV has gone up from 341 as of June end to 367 as of September end and consolidated NAV has gone up from 536 to 565. There is no significant change in the valuation of the fleet, tankers are marginally up and bulks are marginally down. So it is mainly from the earnings of the quarter that the NAV has gone up. Offshore has been taken at similar levels to June but I must caution you here when doing the NAV estimates. Any number on valuation of any offshore asset, whether it is a supply vessel or a rig, it is just a guess work. The numbers which are given by the brokers are very wide so they give a range of valuations but even that wide range maybe wrong finally because there are no transactions happening and therefore it could be off by a factor of 10-15% easily or even more. And the one thing that we have noticed in recent week is that there is not much buying interest in any asset. Of course it is understandable for dry bulk and off shore because the markets are not doing well but even in tankers it doesn’t seem to be too much buying interest. Values have gone up but there is not huge amount of buying interest. So there are lots of ships that have been circulated for sale but not huge number of buyers in the current market levels. Maybe it is a liquidity issue to maybe it is that people don’t believe that markets can last for very long. In coming to the offshore market E&P spending is down about 25% this year and this is the worst recorded drop since 1986 .Utilization levels have also got crushed, working jack up units are down by 80 between June 2014 and June 2015. That’s about an 18% drop because of fleet is about 450, that’s an 18% drop and the number of working unit within the 12 months period the same number for

OSV is at about 300 units less are working between June 2014 and June 2015 . In the North Sea alone it is said that about a 100 units of supply vessels are idling. Coming to our business, we have three vessels coming out contract in this quarter, and two more in the next and of course we have a rig, the Greatdrill Chitra which is coming out of contract in the very end of Q4. So we are looking for business for those assets but contracts have been few and far between. Internationally for example Petrobras, which was again pulling in a lot of assets over the last few years, has not awarded even one contract reportedly in the whole of this calendar year. Then coming to dry docks, we had three dry docks in the first half of this year in shipping and we expect to have seven in the second half of this year and it is mainly bulk in the second half of this year. In off shore we had three dry docks in the first half and we expect to have two dry docks in the second half. Now we will be happy to take your questions. So I hand the floor to the moderator.

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

Mr. Gandhi: Good afternoon. Firstly if you can also comment on the gas markets and how they have been and how are we positioned in the gas carrier markets in terms of spot and time.

Mr. Shivakumar: Gas carrier markets have been extremely strong. Of course we have the ups and downs within the markets so currently the market is about 50-55,000 dollars a day on the spot. It has within the last three months seen $100,000 also. So as recently as two weeks ago, I think the rate was about 75-80,000 so it is seeing its ups and downs but it is really strong still even 55,000 is historically a very strong number. There is a concern about the number assets which are due to deliver, again this is driven mainly by the US LPG export as it has been for the last three years. So there is a big concern because you have lots of VLGCs being delivered just in the first quarter of next year. I think some 25 VLGCs are being delivered early next year, the first three to four months, so there is a little bit of concern around that of course there are also export capacities which are coming on stream early next year, early 2016. So some people are taking the positive view on it so much cargo coming into the market that all these ships will be absorbed and more. But again we have the one ship which is running on the spot market in any case. There is no point in taking too much of a view on it.

Mr. Gandhi: Sure. Second thing is I was noticing the operating cost in the offshore division and that seems to have gone down on a quarter on quarter basis. Then the credit is that every quarter from the first quarter to the last quarter the trend is upwards so is there anomaly there or is it a perfectly normal run rate that you are seeing.

Mr. Shivakumar: We are actually seeing, as a result of this market, some deflation in cost especially manning. So the big problem or the big area of increase in cost over the last four five years has been manning and that situation has eased dramatically and suddenly if you have out of the 18% less rigs which are working between mid 14 and mid 15 at least 50% of that will be cold stack. So that is less requirement for people. So the demand supply situation has eased dramatically and is why we are having benefits in our cost. We are also looking at ways to reduce our cost considering where the market is.

Mr. Gandhi: Sure. As you mentioned the offshore assets it is difficult to put a number to the asset value but when you are looking at your NAV calculations, it would be based on what you think the lower end of the guidance…

Mr. Shivakumar: It is to go towards the lower end of the guidance.

Mr. Gandhi: Thank you sir I will be back in the

Mr. Shivakumar: Just one more thing on the NAV, the offshore fleet is valued at about a billion dollars. So for every 10% variation you know what the number is? About 100 million dollars which is about Rs. 42-43 Rs.

Mr. Gandhi: Sure. Thank you so much.

Moderator: Thank you for your question. Participants, for any further questions please press * and 1. Next question from Mr. Pankaj Tanna Individual Investor. Please go ahead, sir.

Mr. Pankaj: Good Evening, I just wanted to check on your product tankers, you still expect this quarter to have a run rate of around $ 30,000.

Mr. Shivakumar: The markets have already come off from those levels not as strong, and that strength in the market has actually driven first from the Atlantic where the refining margins are very high. Gasoline demand in the US has set up during the driving season. So it has come off from that time? Yes.

Mr. Pankaj: Can we expect something between 20 and 25 from the next quarter or two.

Mr. Shivakumar: I won't guess a number on that but you know, we had about three four quarters ago we had a 20 number across the product tankers, so that includes the gas carrier by the way, so the pure product tankers, if you remove the gas carrier and just look at the product tankers excluding gas it will come normally somewhere between 24,000-25,000 dollars. That I don't think it is going to sustain. There are a lot of ships coming in and I don't see the demand staying at this level. We are already seeing lower numbers so we are definitely not at 24,000 spot in today's market. So it is definitely not going to stay there and I will be guessing if you put a number on what it is likely to be but I can only point towards where we were three four quarters ago which was $20,000 and you could well be lower than that also.

Mr. Pankaj: Gas carrier we are talking about the gas carrier LNG carrier or it is a…

Mr. Shivakumar: No it is an LPG carrier. So the markets are doing dramatically different, the LNG market is terrible and the LPG market is great.

Mr. Pankaj: That is what I was asking. Secondly I have seen your report, your MPSSV has got just to 13% coverage on the next half of the year. You are spotting it only or there are no long term contracts available for a ship like that.

Mr. Shivakumar: That is correct. It is not that we have too much choice in the matter, but if one of them has finished the contract in the last month or so and so she is standing by and the other one finishes the contract within the next month or so. So both of them, at these times we have no employment lined up for them.

Mr. Pankaj: Grim story on that ground.

Mr. Shivakumar: It is a pretty tough market. If you don't have employment it is quite a dire outlook.

Mr. Pankaj: As far as your fourth rig…I think three out of your four rigs have long term contracts and the fourth one is probably getting free sometime at the end of the quarter and you said, the hopes of getting…the ONGC I believe are out.

Mr. Shivakumar: So they have tenders out, we have bid in the tenders. So we hope to land some business there. That is our home market after all and we would be very happy to work here with ONGC.

Mr. Pankaj: That gets fixed the two thirds of our offshore will be in good hands.

Mr. Shivakumar: That is correct. This is a market in which you have to look to secure coverage.

Mr. Pankaj: I think it is great quarter and I think all the share holders appreciate the way you are operating. Considering when you look at other balance sheets, you get scared looking at them.

Mr. Shivakumar: Thank you very much.

Mr. Pankaj: Operating with net cash today and your dry bulk is definitely a great way that you are doing things. Anyway thanks a lot.

Mr. Shivakumar: Thank you very much.

Moderator: Thank you sir. Participants, for any further questions please press * and 1. Next question from Mr. Chris Noronha from IDG Management. Please go ahead, sir.

Mr. Naruna: Good evening to you, my name is Krish Naruna, I am calling you from overseas and I am a share holder. I just wanted to get some idea on two points, was the recent directive from the government of India to where the importers would have to use 50% of their imports using Indian vessels. Do you see that as a contributor increase in revenue this quarter or quarter going forward?

Mr. Shivakumar: We don't know what form it is going to take; it is a proposal which is there so you will have to see the fine print of this proposal. It is not going to be increase in revenue because I don't think that is going to be at a higher price than the market whenever it comes. And so we can employ as many ships as we actually have. So it is not going to be any great increase in revenue. We will see if it comes, even if it comes also it is not going to be a huge positive because our ships are all working. This actually comes very useful if the market is so bad that your ships are not working. So long story short, in this quarter certainly not because it is nowhere near as far as we know, it is no where being put into force.

Mr. Naruna: Okay. My second question relates to…there have been a lot of discussions in congress over here about permitting of exports of crude from United States to Asia and other countries. As you are aware the US has not been allowed to export crude for nearly going on 40 years. Is that in your opinion would result in the rates going up if it passes congress?

Mr. Shivakumar: Actually interesting question and the one which we have been grappling with for some time now. We still don't know whether it is positive or not because it depends on the trade patterns span out where they send the crude etcetera. So we will know when it happens till then it is all guess work we can make some…to me it is probably balance will be a positive whether it is a marginal positive or a big positive we don't know but we will have to see when it comes.

Mr. Naruna: Okay, thanks so much and congratulations on the good operations on this quarter and for the future.

Mr. Shivakumar: Okay thank you very much.

Moderator: Thank you sir. We have next question from Mr. Vikram Suryavanshi from Phillp Capital. Please go ahead, sir

Mr. Vikram: Good Evening sir and happy Diwali.

Mr. Shivakumar: Good Evening and happy Diwali to you too Vikram.

Mr. Vikram: Very good numbers sir, given the environment today. Can you just update us on what are the jackup rigs situation and how many new building rigs are expected and how are the rates compared to last year broadly for industry.

Mr. Shivakumar: The rates have dropped. First new building jackups, I think the order books just show about 125 or 130 jackups. Deliveries this year have been very low so we were supposed to have some 30 or 40 rigs delivered this year, I have the numbers somewhere and I think so far we have had about 15 rigs delivered, jackup rigs. So there are lots of delays, probably some of those rigs hopefully they will now be delivered at all because the market is so horrendous but the rigs still appear in the order books. So let us see what happens to those especially the ones that built in China which I think constitutes about 50% of the order book. Ordering has been very minimal, I think three or four rigs have been ordered in the last 9 months and most of those were just options that which were exercised. So that is on the order book and the delivery. With regards to rates, we have seen rates drop substantially so there is probably 30-40% drop in rates. In India we have seen price points for older jackups we haven't seen any pricing points for modern jackups but for older jackups we saw the pricing drop off by somewhere between 30-40% in recent tender. In South East Asia we heard but the problem is that you can't make out the exact because the cost structures are little different but there also I suspect somewhere between 25% drop in rates.

Mr. Vikram: And working fleet would be more than 600 are currently are…

Mr. Shivakumar: Working fleet is probably 350-360 currently. Maybe 330, this is as of June and lots of rigs have come off since then and not got new business.

Mr. Vikram: MPSSV is in Indian waters or it is home?

Mr. Shivakumar: This is all…one is in South East Asia and one is in Europe.

Mr. Vikram: So will be looking business nearby or it can be mobilized to other areas?

Mr. Shivakumar: It can be mobilized to other areas if we get business, these are not really Indian suitable assets because India requires slightly smaller assets and these are slightly more specialized for high tech work which is…there is not too much of a market here. So we will see, depending on the opportunity we may or may not mobilize into different areas. But they can be mobilized.

Mr. Vikram: Broadly the oil price increase would be the major trigger or there could be another area triggers for this industry to revive?

Mr. Shivakumar: This has to be oil price. That is one which can start of exploration all over again. And oil price trigger will come from…I don't think it is going to be demand, it has to be when supply drops off. That will take a couple of years to happen I think. At least a couple of years to happen because there is so much over supply in the market currently.

Mr. Vikram: In dry bulk, probably scrapping goes more than 30 million DWT per annum, will that be constrained on scrapping capacity or even more than 30-35 million ton can easily scrapped in a year.

Mr. Shivakumar: It can be scrapped, we have seen it done. Three years ago we saw 32 million, dead weight of dry bulk being scrapped in 2012. So it can be done. I don't think that there is a constraint on the amount of scrapping capacity. The problem is that the price is becoming lower now, in the beginning of the year the scrap price was almost 400. Today it is down to over 300 and it is not very lucrative and the demand for steel is also come off a bit. Which is of course driving the scrap price.

Mr. Vikram: Thank you sir.

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

Mr. Gandhi: Thank you for taking my question again. Sir ONGC had a call yesterday where they indicated that one of the jackup rigs have repriced downwards from 95,000 to 55,000. So is this a similar to our rig or this is the older rigs that we are talking about.

Mr. Shivakumar: This is older rigs.

Mr. Gandhi: So these are not modern rigs.

Mr. Shivakumar: I told you these are older rigs built in the 80s or maybe in the 70s. 30+ years basically. The price point which has dropped to somewhere around 35-40%.

Mr. Gandhi: As far as the age of the rigs are concerned, do you think there is scope for lot of older ones to get in support the market?

Mr. Shivakumar: I hope so but that will take some time I think because they have to come out of contract. The thing with rigs is different than with bulk areas - for instance you have a capesize vessel where even at $300 per ton, scrap price, you can probably land some 6 to 7 million dollars of scrap value. In rigs you don't get that much. Therefore, in comparison with the option of keeping it running…if they can get a contract, there is no way you are going to scrap it. If you are getting a contract at 55 because OPEX on these rigs will be 25 or so. So it is a nice ten million dollar EBITDA in a year and you will just keep it running because your scrap value will be much much less than that. Unless you don't get a contract, if you don't get a contract then you have to seriously think about scrapping cost and stuff like that and even then you will look at the option value of keeping it stacked because suddenly if the market goes up and can get back even to $55,000 a day. So it is going to take some time for that to play out. It took a long time in the last down cycle for that to happen. Of course in floaters you have seen it happening very quickly apparently 44 floaters have been identified for scrapping by the owners even in the last 12 months and that is a really quick adjustment to market conditions but somehow we are not seeing that in jackups or maybe that jackups owners are not such big listed companies and therefore they don't make the announcements. The cost of stacking a jackup is a little lower than cost stacking a floater. The hope of deep waters picking up is much much lower than the shallow water picking up again.

Mr. Gandhi: Sir given the fact that the coverage is much higher this year in the offshore market and will go down significantly for us into the next year, so how are you looking at capital allocation now, will you want to wait and see how the offshore market performs before you allocate any further capital be it in shipping or offshore or that will not be the case.

Mr. Shivakumar: Absolutely so we are going to be very cautious about putting more money into offshore. So we can buy or rather we think that if we can get a vessel with a contract attached. That would be useful to do but we should make sure that we are not cannibalizing our existing vessels business.

Mr. Gandhi: I was talking more on the company as such. Will it be an impediment to invest within the shipping markets as well so you wouldn't be investing shipping as well?

Mr. Shivakumar: I think we can manage, it is not done badly also…the balance sheet is pretty stress free so it is not too much of trouble it doesn't hamper the shipping expansions or whatever we want to do we can do, subject to certain limits of course we can't do a billion dollars. But it is not acting as a big handicap for us. Again the main thing in shipping expansion is that we are not seeing too much value.

Mr. Gandhi: What would be your picking order in shipping if at all?

Mr. Shivakumar: As it stands today, nothing is looking very exciting. Product tankers are not looking balanced because they have not gone up too much, bulk area is of a big worry because there just seems to be such a paradigm shift in the market asset values are now down to 20-25 year lows. Crude tankers have gone up 50% in the last 2-2.5 years so that is probably a little too much. Not too exciting maybe we can find some value in some small tankers until now. There are not that many bargains. I mentioned earlier, there are not too many buyers around, there are quite a few sellers but the price I guess a little high and the transactions are not happening in a big way.

Mr. Gandhi: Sure thank you so much.

Moderator: Thank you sir. Participants, for any further questions please press * and 1. Ladies and gentleman, if you have a question please press * and 1. There is no more questions madam.

Ms. Kumar: Thank you. Thank you to everybody for joining in and as usual, we will be putting up this transcript of this call on the website in a couple of days and obviously you are all free to call us and contact us from any clarification that you may have. Thank you very much for joining.