Transcript of Q2 FY05 Conference Call held on October 29, 2004

Moderator: Good evening ladies and gentlemen. Welcome to the Great Eastern Shipping conference call on declaration of its second quarter results of FY, 2004-05. I would now like to hand over the conference over to Mr. Rajat Dutta.

Rajat: Thank you Pallavi. Good evening ladies and gentleman. Thank you for participating in the Quarter Call for the second quarter and the half year results for the financial year 2004-05.

I have with me Mr. Vijay Sheth and Mr. Bharat Sheth Managing Directors and Mr. Balan Wasudeo the CFO of the company.

May I now request Mr. Balan Wasudeo to enumerate the financial highlights.

Balan: Good evening ladies and gentleman. I have great pleasure in announcing the Q2 results of the company to you this evening.

Broadly, let me give a qualitative overview of what happened in Q2.

The main revenue drivers of the shipping and the offshore business were in positive mode. Capacity grew from 1.64 mn dwt in Q2 of last year to 2.8 mn dwt in September 2004, a rise of 70%. The revenue days increased by 29% from 2685 days to 3475 days.

Prime revenue drivers have been the spot earnings of our vessels particularly in the tankers. The capacity utilization of our offshore vessels also was at very good levels 90% and above in all sectors of the offshore business. The only small negative for this quarter was the unfortunate weather induced incident on one of our rigs “Badrinath” causing damage to equipment and for 68 days the rig was off hire.

Riding on these positives, the top-line for Q2 increased by 70% from Rs. 292 crores to Rs.497 crores. For practically the similar reasons on the H1-H1 comparison the top-line grew by 54%. The expense has also grown during the quarter, albeit not to the same extent, it has grown from Rs. 157 crores to Rs.253 crores, up 60%. Lot of this was directly related to the off hire of the rig that I just mentioned.

With the capacity growing by about 70%, direct operating expense under line 4C of the publication has seen more than 100% rise in expenses. This is largely due to the fact that lots of our vessels during this Quarter were on voyage charter fixtures. Since, the growth in expenditure was somewhat lower than the growth in top-line, there has been a tremendous boost to operating profits and operating margins. Operating profits increased by 95% from Rs. 125 crores in Q2 FY 03-04 to Rs.245 crores and a similar satisfactory growth of 62% on a H1-H1 basis. The point to be noted is that there was no gain on sale of ships during the Quarter under review unlike that of the corresponding quarter.

There was a rise in interest cost due to an increase in outstanding debt. Interest cost has grown up by 66% from Rs.10 crores to 17 crores in Q.

Depreciation charge also increased because of fleet additions. It is also to be noted that lot of ship acquisitions in the last 12 months have been older vessels and depreciation charge has been relatively higher. The profit before tax increased by about 102% in Q2 and about 48% on H1-H1 basis.

Coming to the provision for taxation, during Q1 of this financial year, we had provided taxation as per the normal tax basis- Income Tax Act 1961 provisions and deferred tax, which the industry was subjected to all these years. We had not taken the benefit of tonnage tax as the bill had not been enacted. Now we are happy to inform you that the tonnage tax regime is now been implemented. So, in Q2 we have given effect to the tonnage tax regime and hence reversed whatever was not required to be any more. We had provided deferred tax of Rs.14.75 crores in Q1 which is now been added back in Q2. So, on a full half year basis there is no deferred tax provision for the company. Considering this positive, the Net Profit from ordinary activities increase by 120% i.e from Rs.76 crores to Rs. 167 crores. After correcting for prior period adjustments the increase is still at very healthy levels a 109% growth from Rs.80 crores to Rs.167 crores. On the H basis from Rs.176 crores to Rs. 269 crores, a growth of 53%.

To briefly touch upon the segmental revenues. Growth in bottom-line has come largely from the shipping division because of the buoyant markets and also from fleet additions. But offshore has also performed very well with profits before tax and interest growing from Rs.20 crores to Rs.30 crores during the quarter under review.

You will notice gentleman that both in the Q and in the half year results, contribution under the accounting head “others” has been lower than earlier periods thereby improving the quality of earnings for the company in this Q and in the first half.

The capital employed has increased from Rs. 2900 crores to about Rs.3800 crores, an increase of about Rs.900 crores. The return on capital employed in the Q was about 20%. If somebody just does a little arithmetic one will see that on an incremental basis the Quarter gave about 48% return on incremental ROC. With that gentleman I close the presentation. I now hand over the mike to Mr. Vijay Sheth.

Vijay: Good evening everybody. Thank you very much Mr. Balan that was indeed a splendid presentation.

I would now take you through the offshore side of the business. Let us move on to slide 5 of the presentation.

During the last quarter the main drivers of oil and gas prices have been the demand coupled with concerns on supply apprehensions and therefore the oil companies have started increasing production in order to encash the price rally. This led to continuing redevelopment work globally. In India, ONGC the largest E&P operator has undertaken redevelopment of its Bombay high fields, which is expected to be completed by 2006. We understand that ONGC has already budgeted to spent large funds towards its redevelopment program. Other operators such as Reliance, Cairn, Hardy and others have also initiated such programmes. Now the operators have realised that their predominant focus on P needs to now shift towards the E part of the business. Therefore we will see a movement towards more and more exploratory activities in the foreseeable future. ONGC on its part has initiated the largest data acquisition program, and this we believe is the precursor for further dealing activities. Needless to add reserve accretion is an important and integral part of the E&P activity and oil companies will certainly need to focus on reserve accretion which will give a fillip to exploration activities.

India has become an important player in the E&P map of the world and certainly we expect that with NELP -V round the corner, more and more focus on the E&P activities will take place. Besides India, the Asian markets are also looking towards an improved level of activities.

The overall performance of the division, has been reasonably satisfactory barring the drilling rig Badrinath needed to be repaired due to weather down-time. The utilization across the OSV, the construction business and the harbour tugs was satisfactory with an average utilisation of around 85-90%. Of course, the quarter performance has been entirely due to the marine construction activity. Gal Constructor, our construction barge did a major job in the Middle-East contributing significantly to improved earnings of the division.

Moving on to slide no 6 of the presentation dealing with the outlook of the sector and the Company. As I mentioned a little while ago we are expecting that budgetary allocations towards the exploration part of the E & P equation will definitely see an increase.

In India, down stream companies have planned to increase their spending in E&P activities and major players like Cairn, Reliance, ONGC, Hardy etc.. are likely to spend anywhere between Rs. 7000-8000 crores annually both on exploration and development work in the next few years. Such an increased activity should lead to better utilization of offshore assets but with a time-lag.

Some of the assets belonging to GE Shipping have already been fixed and as you would have seen in the press release we have utilization running at about 50% and the revenue visibility of the division is for the balance 6 months is running at about Rs.105 crores. I think, with this we remain cautiously positive towards the sector and expect that things will shape itself out to better utilization in the coming quarters. Thank you very much, I now request Mr. Bharat Sheth my Co-Managing Director to run through the shipping presentation.

Bharat: Thank you Vijay and good evening to all the participants. For the July-September quarter, growth in oil demand was a spectacular 3.7% and as I have often said this would translate into close to a 7% demand for tanker tonnage. As many of you might be aware the spare capacity to meet the oil demand predominantly came from the Middle-East members of OPEC. This has lead to incremental tonne mile demand for ships. To give you some numbers 1% increase of incremental oil supply from the former Soviet Union translates into under a 1% growth in tanker demand, the same 1% increase from Middle-East members translates close to a 3% growth in tanker demand. It is therefore very important to recognize where the incremental oil is going to flow from.

The quarter shows 5% net growth in the tanker fleet but as I said the demand was running at 7% and therefore inspite of a strong tanker fleet growth during the quarter, over all balance for supply and demand continue to remain very tight which reflected into very strong freight markets. Also, there was very little scrapping that took place in the quarter.

Moving on to dry bulk, there has been a big run up in freight rates. Some of you will recollect that at the end of the first quarter there was almost 50% correction in earning due to a sudden slow down in China but most of this slow down was short lived it was really more an easy way of clearing inventories rather than an actual slow down in terms of demand. Thereafter there was a very strong demand for iron ore. In China steel production grew by about 20% and sea borne trade of iron ore over the quarter rose by about 11% and coal by around 4%. All this with a 4% net fleet growth saw demand for ships clearly exceeding the supply with the result there was a significant bounce back in dry bulk earnings.

Internal to the Company, the operating capacity of the division increased by 71% where as the revenue days increased by about 29%. This translated to about an extra 800 revenue days. The mismatch between an increase of revenue days of 29% and operating capacity increase of 71%, was because the incremental investment was in larger ships. More significantly, of the absolute increase of 800 days, 75% i.e. almost 600 days represented ships that were trading in the spot market and hence benefited from the improvement in the freight rates.

Turning to Slide 8 of the presentation, which gives the outlook for the balance two quarters, we believe going forward the supply and demand is going to remain extremely tight and this will significantly get accentuated in the subsequent quarters for 2 or 3 reasons. One, product inventory continues to remain very low particularly, in light of the fact that we are moving towards the winter. We understand that people are forecasting severe winter and with oil stocks running low in the United States, in Europe, we see a big move in a tonne mile demand. Secondly weather delays at this time of the year are a phenomenon, which causes severe logistic disruptions.

We have discussed this in the past, particularly so in some areas of the Black Sea and Mediterranean regions where night sailings are not permitted due to environmental issues. Currently weather delays are running at about 7-8 days. Last years we did see in the severest of the months, which was January and February, the delays went up to about 40 days and we all know what happened to the market then. The other important point to note and which is very much in favour of continuing strong tanker markets is that we are fast approaching the IMO deadline on scrapping of certain categories of ship. Now if you take the deliveries between now and March 2005, we believe there will be somewhere between 13 to 15 million dwt to be delivered and against it there is likely to be a mandatory scraping of somewhere between 15-19 million dwt. So, over the next 6 months we continue to remain in a situation where supply and demand continues to be very tight.

Moving on to the dry bulk trade, China has yesterday increased interest rates by a quarter percent and there is a lot of talk about China wanting to slow down the economy, though we aren’t seeing much of it as yet. It is clearly possible that China could move towards a soft-landing and we believe that if it moves towards a soft-landing while it may in the short term reduce the freight rate for dry bulk, the positive side of this is that it would mean a more sustainable strong freight market.

Steel demand we believe will continue to remain strong and this demand will continue to drive the demand for iron and ore as well as for coking coal. In addition with oil prices where they are

USD 50 - 51/ barrel, demand for steam coal will also continue to remain very strong.

Lets go back to our own fleet and what we have on the spot market for the next two quarters. Let me first concentrate on some of the business that we have already written for part of the current quarter, which is Q 3. Some of you might have access to the press release where we said that in quarter 2 our VLCCs earned an average of about USD 48,000/ day. As opposed to this currently our VLCC is averaging close to USD 90,000/ day and if the VLCC were open today we would be earning close to USD 1,50,000/day.

Our VLCCs next come up for fixtures in December 2004. Similar trend is seen in Suezmax where the Q2 average was at USD 34,000/day and basis the business that we have already committed for Q3 our Suezmax should average somewhere between USD 65000-70000/day. For Aframaxes our average rate for business done for quarter 3 is at about USD 36000 a day against USD 26000 a day for Q2.
We have a similar story for dry bulk where the market upmove that we saw in quarter 2 is going to start reflecting in earnings of quarter 3 and therefore for the 8 open vessels that we have we expect higher earnings for both the Handymax and Handysize ships. On the Handymax the average rates done so far for Q3 are upwards of USD 21000 a day and on the handy size in excess of USD 17,000 a day. In addition, there are 3 product tankers, which come off period charter rates into the open market in quarter 3 and quarter 4. Irrespective of whether we put them back on a period charter or trade them on the spot market, we should see significantly higher earnings from these ships as well. And therefore, to sum up, the outlook remains very positive for Q3 and Q4. However, we do expect volatility to continue due to the very tight supply demand position. So the slightest bit of negative news is going to magnify downwards and the slightest bit of positive news is going to exaggerate the market upwards. But overall, I would say that the next 6 months could best be summarized by saying that the freight markets will have a very strong and a firm undertone. And with these comments I pass the microphone on to Rajat.

Rajat: Let me now request Pallavi to put the floor open to questions.

Pallavi: Our first question comes from Mr. Pankaj Tanna from Magnum Equity.

Pankaj: Good evening Sir, congratulations on your fantastic result which were expected. I just wanted to know, if today we were to sell the Great Eastern Fleet en bloc, what would we be able to get in terms of the total fleet value vis-à-vis the book value?

Bharat: Well, let me just put it on a net asset value basis which would reflect the fleet and some of the other assets as well. As of 30th September we think our net asset value is some where between Rs.215-225 a share.

Moderator: Our next question comes from Mr. Vivek Banka from Bullseye Investment.

Vivek: Hello, good evening sir. I wanted to know that as the commodity peak is approaching and the freight rates on VLCCs are approaching USD 1,50,000/day, you have said difference between the spot and the long-term market is around 80% in favour of the spot market, which translates to a USD 70,000 per day in the longer-term market. So, I would like to know whether you are thinking of allocating a larger portion of the new ships towards the longer side of the market?

Bharat: At the moment the backwardation that we are seeing on the longer end of the market is simply too steep to the earnings on the spot market. So, until we see real signs of a downturn which we are not seeing at the moment we are unlikely to move in that direction and if I can just share with an example, a VLCC today on spot market could be earning close to USD 150,000 a day. If you were to fix that same VLCC for 3 years we are talking about numbers of somewhere between USD 40,000-45,000 a day and it is simply too steep a discount.

Moderator: Our next question comes from Ms. Shilpa Krishnan from Kotak.

Shilpa: I have a few questions the first one is for Mr. Vijay Sheth. You mentioned that the barge did very well and did a few jobs in the Middle-East and we understand that there is a considerable construction boom in the Middle-East. So, would it have made sense in retrospect to increase your assets on this particular segment like for example, barge or even the rigs especially as your rigs as well as your barge are ageing. And, what is your strategy going forward?

Vijay: Well we are consciously looking at various opportunities that are prevalent in the market place and we will look at expansion in these businesses selectively. The most volatile part of the offshore business is the construction business because it is totally a spot business. The offshore market being a tender driven business is largely driven by period work which could range from one well to one year or even three years. We may consider moving into a higher asset spectrum, (for example, into pipe-lay barges), considering the future potential and the risk-reward ratio.

Shilpa: How much would a barge or a rig cost today?

Vijay: Well, I guess it depends on the type of barge and the type of rig. For example, a second-hand cantilever jack up rig would cost from a low of about USD 60 million to a brand new one of about USD 120-125 million. If you went into the deep-water end of the drill ships, and semi-submersibles, they could be well over USD 200 million a piece. A pipe-lay barge would today be anywhere from a lower of about USD 20-22 million to even well over USD 100 million if you had the state of the art latest type of barge. We have not seriously evaluated ownership of a barge in recent times. We are looking at possible expansions in rigs if we think that the cost-benefit is justifiable.

Shilpa: Does ONGC have age specifications for the offshore fleet that it utilizes.

Vijay: Yes, they come out with tenders which specifies the asset profile. Depending on the configuration of the particular field and its characteristics, ONGC would draw up a fleet requirement.

Shilpa: I also wanted to know if your rigs are under any kind of risks on the acceptability front, going forward?

Vijay: I don't think so, both the rigs are right now operational. The drilling units are continuously upgraded. Even the hull is on a regular basis up graded and blasted and painted and subject to steel renewal. But the hull is incidental to drilling activities and all the drilling equipments are either upgraded, modified, replaced, refurbished or even new equipment is put on board. So it is a continuous ongoing process which takes place on a regular basis.

Shilpa: So how long the rigs continue to operate in your estimate?

Vijay: Well, it is very difficult to put a number on the age. For example, there are rigs which are of the late 60s and early 70s vintage which are in operation.

Moderator: Our next question comes from Mr. Binoy of Lion Bridge Technology.

Binoy: Congratulations on your excellent results. I have been very impressed. I would like to know where you see your fleet mix going in the future?

Bharat: At the moment it is approximately between 70-75% in shipping and the rest is in offshore. Going forward, I think, the ratio will broadly remain intact.

Moderator: We have our next participant Mr. Hemant Patel from Enam.

Hemant: What is the amount of debt as on date?

Balan: About Rs. 2000 crores.

Hemant: And for the full year you expect this to peak at this level?

Balan: Yes, it will probably be a little less.

Hemant: Considering your current order book and your continuing to buy secondhand assets, do you expect the debt levels to peak next year?

Bharat: No, the debt level will peak further down the curve because most of the deliveries are running from January 2005 to almost the end of 2007, which is when the last of the current orders come through. The debt level peaks a little later probably sometime in beginning 2006-07.

Hemant: What level are we expecting Sir?

Balan: We expect about Rs. 3000 crores. What is relevant is not the peak level of debt but the debt-equity ratio, which continues to be at conservative levels.

Vijay: We expect the debt-equity will be maintained around 1.25:1 or thereabouts.

Moderator: Our next next question comes from Mr. Anish Desai from ABN Amro.

Anish: Good evening and congratulations on good numbers. Could you give us a sense of what is going to be the supply over the next three years in the tanker market as well as the dry bulk market?

Bharat: The yards are almost full until the end of 2007 and some deals are now beginning to take place for 2008. If you look at the fleet growth projections and if you just take the mandatory scrapping and voluntary scrapping, we expect both dry bulk as well as the tanker fleet to grow at approximately between 4-5% per annum going forward.

Anish: Could you give us a separate number for tanker and dry bulk?

Bharat: For dry bulk the current fleet is 316.60 mn dwt and on tankers it is 318.70 mn dwt and if you take the total order book that runs through till the end of 2007 it is 62 million tons for dry bulk and 87 million tons for tankers.

Anish: And we are saying net addition is going to be around 15 million per annum. The other is, I understand that around 65% of the Great Eastern tanker fleet is single-hull and all single-hull tankers are to be scrapped by 2010, what would be the strategy for Great Eastern going forward, of course you have to replace the fleet but if you could give us a sense of what you are thinking?

Bharat: Actually 72% of our fleet is currently single-hull and 28% is double-hull. Going forward if you take all the new buildings in place we will be about 40% in double-hull and 60% in single-hull by 2007.

The IMO restriction of 2010, stipulates that various member states can decide whether to extend the date from 2010 upto 2015 or 25 years of age whichever is earlier. We understand that last week, Japan has announced its intention of permitting single-hull tankers to trade up to 2015. The Government of Singapore has officially now announced its stand of allowing single-hull tankers to trade upto 2015. Now, with Japan and Singapore having made such a move we believe that more and more countries particularly in Asia will continue to permit single-hull tankers to trade upto 2015.

Anish: What about, the loading ports, which would mainly be in the Middle East? Would they permit single-hull tanker post-2010?

Bharat: What they will do in 2010 is clearly not known but you have got to remember that Japan is a very important customer for Middle-East suppliers. No announcements have been made on the same by the middle-Eastern exporting countries, but if you ask me my judgment or call if Japan and Singapore has said that they would permit it then this is just bound to spread.

Anish: What would be the current cash on the balance sheet and what were the dry-docking days in Q2?

Bharat: The cash on the balance sheet is approximately Rs. 800 crores and as far as dry-docking is concerned we had 80 days in Q2.

Moderator: Our next question comes from Mr. Mohan from ABN Amro.

Mohan:If Singapore and Japan have agreed to extend single-hull tankers, and then would this impact the freight rates?

Bharat: As of now, 2010 is too far in the horizon for freight rates to be impacted. Nevertheless, this will have an impact on freight rates if at all only closer to the date i.e. 2010 as it will also be dependent on the state of the oil and gas demand and host of other factors.

Moderator: Our next question comes from Mr. Amit Mitra from Hindu Business Line.

Amit: On adoption of Tonnage Tax how much would be the savings for GE Shipping? Are you looking at acquiring more VLCCs? What are your company's plans on LNG shipping?

Bharat: The savings on adoption of Tonnage Tax is to tune of around Rs. 18 crores. As regards acquiring VLCCs, we are constantly eyeing opportunities both in the tankers as well as in the dry bulk markets subject to price acceptance. As regards LNG is concerned yes we would like to participate in the trade. We would wish to do it in partnership with existing players who have LNG expertise.

Moderator: We have our next participant Mr. Vivek Banka from Bullseye Investment.

Vivek: I would like to know about the long-term freight rate, which G E Shipping is looking at particularly for VLCCs?

Bharat: At this juncture, the decision to opt for long term trade is dependent on our internal perception of where we think the market is headed. As I has said in my presentation itself with the supply and the demand being very finely balanced it is very difficult for us today to contract for the long-term as current earnings are very strong. For the next 6 months we see markets to remain volatile and maybe one day you earn around USD 1,50,000/day and next day the market is at USD 1,00,000/day and in the third day it could be USD 2,00,000/day. All these are very strong numbers. As I said, the backwardation is too steep and we would tend to change our view for the long term provided either the backwardation curve or the forward deal curve goes up or the spot market comes down and we turn more pessimistic for the longer term then we could be wanting to fix our VLCC for a longer term but not otherwise.

Vivek:What would be the dry-docking days in Quarter 3?

Vijay: Quarter 3, we are expecting probably close to 150 days for shipping and for offshore it could be anywhere from about 50-60 days.

Moderator Our next question comes from Mr. Sandeep Nanda from SSKI.

Sandeep: On the incompleted voyage, we are aware that you don't recognize the revenue. So what would be the impact for this quarter on the top-line?

Bharat: This quarter we have had no impact on incomplete voyages, because if you look at the quantum of incomplete voyages that came into the quarter and you match it with the level of incomplete voyages that went out of the quarter, they are more or less balanced.

Sandeep: Your dead-weight tonnage has expanded by approximately 70%, whereas the top-line has also expanded by 70%. So what is happening to the realizations?

Bharat: The top-line in case of our businesses is to an extent influenced by how many vessels we have traded on voyage charters as opposed to time charters. And while the both the numbers could translate to a net equivalent earning, obviously if we have more vessels performing on voyage charter you tend to record a greater increase in top-line. Conversely, you could get an equivalent profit number from doing more and more tonnage on time charter, and would then have a reduced top-line but the same profit.

Sandeep: When is the VLCC due for dry-docking?

Bharat: We have two VLCCs. One of them is due in 2005 and still we haven’t decided whether in Q1 or Q2. The second VLCC is due for dry-docking in middle of March 2005. Now whether the dry-docking completes in Q4 FY 2004-05 or gets extended in Q1 FY 2005-06 is impossible to forecast.

Sandeep: When are the rigs due for re-pricing?

Vijay: While the Badrinath has a contract upto September 2006, we have just got a new 3 year contract for the Kedarnath starting from October 2005. Between the present contract and the new contract, Kedarnath needs to go for some refurbishment.

Moderator:Our next question comes from Mr. Navneet from Rare Enterprises.

Navneet: You have around Rs. 800 crores of cash. Rs.70 crores is what dividend you have declared, so you are sitting with Rs.730 crores net cash. Could you tell us about the utilization of this cash?

Bharat: As you are aware, we have a fairly extensive expansion program. We have an expansion of nearly about USD 350 million as we go into up for now upto September ’07. Apart from this, we are continuously evaluating second hand acquisition opportunities. We think that we need to sit on cash because it gives an opportunity to leverage ourselves to doing to act quickly.

Navneet: But my question was actually coming from a point that in the current quarter, you have already earned in excess of Rs.240 crores of cash.

Bharat: Yes, but that's reflected as part of the cash balance. Now, let me put it in an international perspective. If you were to take any reputed international company of our size, they normally have between 20-25% of the balance sheet size in cash. And in shipping, what is most important is to be able to sit on such cash levels, so that in the event of an opportunity presenting itself one could move quickly and aggressively. And therefore, if you look at our cash as a percentage or our balance sheet size it is broadly in line with the standard international practice.

Navneet: But to add to it Sir, your acquisition typically happens in 70:30 ratio. Which means that as you have Rs.700 crores cash, you can acquire assets worth around Rs.2200 crores. Are we looking at such investment numbers?

Vijay: USD 350 million as you will appreciate is close to about Rs.1800 crores.

Navneet: It is over a two year period Sir, What I am actually pointing to is that you will earn at least Rs.500 crores of cash in the next two quarters at the same level, I am not saying any increase or any decrease.

Bharat: When we bought the VLCC we had to move within 24 hours and we financed the acquisition entirely out of our cash reserve and that was in November 2003. Now, if you get such opportunities where you got to move fast and you just need the cash. But I think the point that you are raising is where can the company go particularly if these markets continue? We will continue to generate significant amount of cash, moving forward. At the same time, the way you are going to look at this cash is not that we want to invest it, unless we see either a strategic reason to get into particular business, or with an opportunity to provide superior rates of return. And in the interim there is a cost of holding on to the cash, but I think that's just in a sense, the longer term cost of trying to provide the superior return.

Navneet: Okay, I had another question regarding the increase in direct operating expenses. When I look at the direct operating expenses in relation to Q1, which was Rs. 67 crores, I see a huge increase is it partly because of the second VLCC addition also. Could you give us a breakup of these direct operating expenses, how they move?

Bharat: I think, we had more vessels in the spot market and trading voyage as opposed to having vessels on the spot market and trading time charter. So, as I explained to one of the earlier questions, when we have vessel on the spot market we either operate them on trip time or we operate them on voyage. And if you operate them on voyage then all the costs e.g. the bunker cost, port charges, canal dues and cargo charges everything comes on the owner.

Moderator: Our next question comes from Mr. Ketan Karani.

Ketan: First thing I wanted to know the average cost of debt what we are holding now as of date?

Balan: It's about 4%.

Ketan: If you see the EBIDTA margins of this quarter compared to the corresponding quarter, we have not grown much. That is of our last time we had a 46% EBDITA margin and now we have 49%. We are not creating too much value for our shareholders. Is it right way of looking at it? The amount of money we are investing, incremental have just earned 3% incremental EBIDTA margin.

Bharat: As explained by the CFO, if you look at returns on the incremental Rs.900 crores of capital employed, we have got a return on total capital of almost 48%.

Ketan: But this is only for a short-term period? What is for the long term?

Bharat: EBIDTA has nothing to do with whether a ship is fixed on a voyage or whether a ship is fixed on a trip time. So the more voyage charter you do, the EBIDTA is divided by a larger base number and hence the contraction in margins. It is no reflection on efficiency. It's just that if you are doing more voyage charters you have got a higher divisor, if you are doing more trip time charters, you have a lower divisor.

Ketan: On the cash that we are holding and the business strategy which we intend to follow? As the rates of almost every ship are at peak levels, has the replacement also gone up? Is it advisable then to acquire ships at such high values?

Bharat: Let me answer that in two stages. First, so far there has been no acquisition that Great Eastern has done at anywhere close to peak levels. If you look at any of the acquisition that either we have done on second hand or that we have done on our new building contract, we are significantly in money on both. As ship prices are high, we have to be more cautious. We recognize that we are eventually in a cyclical industry, and therefore there is every possibility at times that both asset values and earnings can come-off and they can come-off sharply and quickly and therefore whenever we invest, we do a lot of due diligence.

We take a call on the market to the best of our ability and so far at least all I can say is that, we seem to have got it right.

Ketan: I wanted to know how aggressive sellers would G E Shipping be and if not at the peak when will it sell the ships to unlock value?

Bharat: This is a good question and we ourselves recognize that these markets will turn down at some point of time. We have recently seen that markets behave very differently, just 6 months back, dry bulk asset values came down almost 25% in a span of 6 weeks and then they bounced back 30%. So, a correction today may not necessarily represent a secular trend. And until we are internally convinced about correction in asset prices translating into a secular correction we would probably not look at selling.

Ketan: As you have been in this business for almost over 5 decades and have been a player in the game of acquiring and selling of ships, I wanted to know at what time would G E Shipping become uncomfortable with the market? Is it possible to sustain this kind of levels?

Bharat: I think, decisions to sell cannot be only governed based on trend analysis alone. Lets say long term, if we believe that the VLCCs will have got to go back to averaging a world scale 60 points then even at that level companies make money on the ship, obviously they do not make the same amount of money that they make at world scale 200.

Ketan:But surely at such low world Scale points asset prices are also low.

Bharat: Yes, the asset prices are bound to reflect earnings potential but to what extent they would reflect will depend on whether market believes, it has just come down for the short-term it has come down for the next few or many quarters to come.

The other thing that is important to remember is that as a company we are in the business for the long-term and we cannot be simply driven by trying to capture profits today by selling assets sacrificing our service contract/understanding/relationships that we have developed and nurtured over years.

Also, we need to recognize that it is not Great Eastern’s business on a holistic basis just to trade in asset. Yes on the margin we do take opportunities and may be you might see some sale of ships but we can’t do it on a larger scale.

Moderator: Our next question comes from Ms. Shilpa from Kotak.

Shilpa: I have a question for Mr. Bharat Sheth. Sir, you were mentioning that VLCC spot rates are at USD 1,50,000/ day and for a 3-year time charter is around USD 40,000-45,000/day. At this point of time are you seeing in-chartering opportunities coming your way and if they do would you be accepting them?

Bharat: Well, we have managed to in-charter an Aframax crude tanker for a period of 11-15 months. We have just taken delivery about 2 weeks ago. We got it at a very competitive rate and it has made us a fair bit of money. At the same time, what we are finding increasingly difficult is the reluctance of one ship owner to give a ship necessarily to another ship owner. So whilst we continuously are in the in-chartering market today we are finding it difficult because the offer price that we receive is much higher than our bid price or the price we are willing to pay for a 2 –3 year time charter.

Shilpa: Okay, can you share with us some more numbers on the recent in-charter deal?

Bharat: We got the Aframax in the region of USD 20,000/ day and currently on the spot market the ship is earning close to USD 50,000/day.

Shilpa: Okay, got it. My second question to you is do you know what exactly is the government policy on the preference for Indian stake owners in LNG shipping? Have they spelt it out clearly and what exactly is there point of view and are oil majors okay with it?

Bharat: Well, Government Policy on LNG shipping nothing to do with oil majors. The LNG shipping policy talks about Indian participation and quite rightly so, to the extent of 26% in equity. I think, it is the right time for the Government of India because LNG is going to become significant source of energy in the future, and the participation of Indian shipping in the transportation of LNG is being encouraged rightfully.

Shilpa: Okay, but why do you think they have stipulated a 26% stake for an Indian shipping company?

Bharat: I agree though it is still a minority stake, it is with a view for Indian shipping companies to have management participation and be involved in various managerial decisions. I really think less than 26% would not give you the critical cut-off point.

Moderator: We have our next participant Ms. Aditi from B&K Securities.

Aditi: I would just like to know whether there was any one-time income from the sale of your fleet?

Vijay: No, not in this quarter.

Aditi: And anything like that for next quarter as in, if you are planning to dispose-off?

Bharat: We have contracted to sell a 1986 built crude oil tanker and on that there is a profit. I am not at liberty at this stage to mention the quantum of the profit, which will be recognized in Q 3 of this financial year as we expect to deliver the ship by the third week of December 2004.

Vijay: In addition, we have two offshore boats, which have already been delivered in the beginning of October 2004 month. So the deal is already consummated and it is all over, the profit thereon will be recorded in Q3.

Aditi: Any idea about how much will the profits on sale be?

Vijay: Well, as we have signed a confidentiality agreement with the buyers, it precludes us from saying anything about the profit on sale transactions. So, I am sorry, as much as I may like to reveal certain things, I may not be able to do so.

Moderator: We have our next participant Mr. Vivek Banka from Bullseye Investment.

Vivek: Sir, as you had mentioned earlier, your new tankers are coming up for spot market in December 2004. So, do we say that this now becomes the function of chance as to what would be the spot market rate at that point of time since spot market rates are varying from USD 1,00,000- 1,50,000/ day, the range is huge?

Bharat: Well, life itself is a function of chance, but having said that, as regards tankers let me clarify. It is not that every tanker that is earning between USD 1,00,000-1,50,000 a day. Both the Great Eastern VLCCs currently are operating on the spot market. They are next open in December 2004. Typically what happens is that you normally fix the vessels on the spot market about 3-3½ weeks prior to arrival at its load port. We would be looking at fixing the ship sometime in the third to the fourth week of November and therefore if the current market prevails over the next three weeks, on both the VLCCs we should start earning close to USD 1,50,000/day.

Vivek: Right, another question is as you had earlier said, the spread between the realization of the Q2 and Q3 in some cases it is more than double and in some cases it is more than 60-70%. So do we take for granted that Q3 results would be in excess of a 100% quarter-on-quarter increase in net profit?

Bharat: It is not our company practice to give revenue guidance or forecast on quarterly results. What we have shared with you in the Press Release and today's Quarter call are details basis charter parties that we have entered into currently for the vessels open to the spot market.

Moderator:Our next question comes from Mr. Harigeet from UTI Mutual Fund.

Harigeet: As the CFO mentioned there has been a 100% increase in direct operating expenses, but if I were to look at it as a proportion of the freight and demurrage income which is mainly the spot market income, it is still at 45% compared to say 57% for the same period last year. So can we actually expect to see this proportion going forward, increasing in the quarters coming in this year?

Bharat: The accounting head freight and demurrage income reflects voyage charter income. But a lot also depends on the extent of demurrage income in the overall freight and demurrage. For example, let us say due to congestion, a vessel is waiting at a port for 15 days and during those 15 days you have earned demurrage. Today as you can appreciate demurrage rates are extremely high, take a VLCC for example, demurrage is currently running at USD 1,00,000/day and let us say that if you had a waiting period of 10 days you would have a demurrage income of USD 1 mn and this tends to distort the picture at times.

Harigeet: So, does this mean that Rs.187 crores for the Q2 has a major component of demurrage income?

Bharat: It does not mean that. There is some demurrage income in that but there is not a significant amount.

Harigeet: Going forward can we expect operating expenses to be higher in the coming quarters as you will have more ships on the spot market?

Bharat: Yes, I think you will see both the accounting heads freight and demurrage as well as direct operating expenses higher due to assets operating on spot. Just to mention one more point part of the reason that direct operating expenses have gone up also because the bunker prices have gone up significantly.

Harigeet: Secondly my question pertains to the deferred tax, does the negative deferred tax represent a reversal of deferred tax provided in Q1 of this year?

Balan: Absolutely right, the H1 figures will come to nil.

Harigeet: Okay thirdly, what pertains to the stock and trade in your kind of business? A decrease of Rs.14 crores in this quarter;

Balan: We still have some properties leftover from our earlier division, which is slowly getting developed and sold, and as and when they get sold there is decrease in stock

Moderator:We have Mr. Shyam Sundar. Please go ahead with your question sir.

Shyam: Historically GE Shipping has a good buy back policy and looking at the conditions today it all looks very propitious to do a buy back where the stock price is quoting at discount of NAV. Also, you have a huge amount of cash and with declining interest rates, given your debt equity ratio can go up from the historical 1 to 1.25. So, given this condition are you looking at a buy back?

Vijay: There is nothing on the cards as we speak today obviously when we do any exercise like this you are sure to take the overall position on estimated expansions in various divisions and where the money can be utilized plus the discounts that stock price has to the NAV and you have to factor sustained stock price over a period and not the current stock price as of today. So, today as we speak that there is nothing on the cards to do a buy-back.

Shyam: Thank you.

Moderator: As there are no more questions, I would now like to hand over the conference to Mr. Rajat Dutta.

Rajat: I take this opportunity to thank all of you for participating into today's conference call. I hope we have been able to answer all your concerns and apprehensions on the industry and the company. The transcript of today Quarter Call would be available on our corporate website www.greatship.com. Thank you once again.

Moderator: Ladies and gentlemen, this concludes today's conference call.