MONTHLY UPDATE

Shipping Sector

18 June 2008

Share Data

(%)	Absolute price performance 1m	3m	6m
Sensex	**(10.0)**	**6.0**	**(18.5)**
Great Eastern	(13.0)	16.2	(18.1)
Mercator	(4.2)	70.5	(30.4)
Varun	(10.2)	(4.6)	4.3
SCI	(6.4)	35.1	(1.2)
Chowgule	(4.4)	56.8	(18.8)
Essar	(27.9)	(23.7)	11.4

Firm markets

The tanker market firmed up in May, which was attributed to several factors such as the slowdown in vessel speeds, conversions to dry-bulk and usage of tankers for storage. The dry-bulk and LPG markets also remained firm in the month of May. Although tanker markets posted some weakness at the beginning of June, the market regained strength in the second week. The dry-bulk market has come off its peak in second week of June, which was attributed to the farmers' strike in Argentina and the reduction in coal movement in Australia.

B&K view

The dry-bulk market is expected to witness a slowdown post the Chinese Olympics given the sizable order book (~56% of the existing fleet). The tanker order book also remains sizeable (39% of the existing fleet) but appears less daunting given the large fleet of single-hull vessels which will have to go out by 2010. The demand supply remains finely balanced in the tanker segment and any disruption will lead to sharp volatility in rates. The charter rates will continue to remain range bound and the conversions and scrappings could be key determinants for this market.

Valuations

Company	Year ended	Standalone/ Consolidated	Reco	Price (Rs)	M-cap (Rs mn)	EPS (Rs)	PE Ratio (x)	EV/EBITDA (x)	RoCE (%)	RoE (%)
Great Eastern	FY10E	S	BUY	441	67,385	52.4	8.4	6.1	12.2	15.2
Mercator	FY10E	C	Outperformer	111	26,050	22.1	5	5	17.1	30.2
Varun	FY10E	S	Outperformer	73	10,800	17	4.3	4.3	12.9	24.2

Shipping portfolio NAVs

(Rs mn)	Reco	Fleet value*	Debt	Cash	NAV	Equity	NAV/Share (for shipping fleet)	CMP (Rs)	Premium/ (Discount) (%)
SCI	Not Rated	93,813	12,447	26,247	107,612	282	381	250	(34)
GESCO	BUY	79,059	24,900	13,500	67,659	157	431	441	2
Mercator	Outperformer	44,129	26,320	7,220	25,029	270	93	111	20

*Only value of existing fleet.

Market Overview

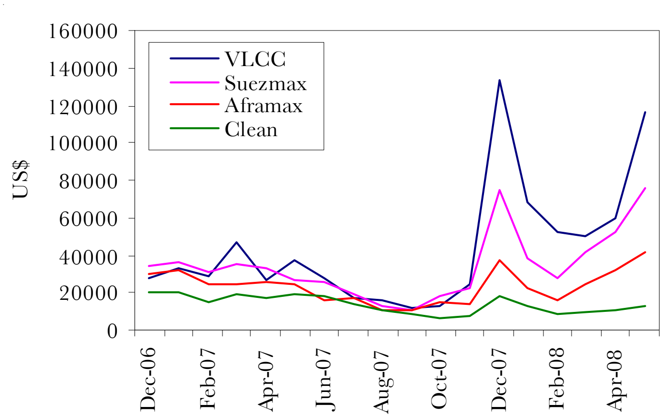
Tankers

The tanker markets touched their highs in May and then saw a brief period of correction in the first week of June, though they have started strengthening again in the second week of June. The unforeseen strength in crude tankers has been attributed to various practices, like the cutback in vessel speeds to reduce bunker consumption (a 1 knot reduction in the speed of VLCC tankers reduces tanker supply by about 10-20 vessels), conversions into dry-bulkers (~40 vessels in 2008) and the use of tankers for crude storage purposes by the Iranians. Another reason is that the difference in rates for double hull and single hull tankers has increased since the Hebei Spirit tanker accident. The asset prices also remained firm and VLCC rates increased by ~16% on a YoY basis.

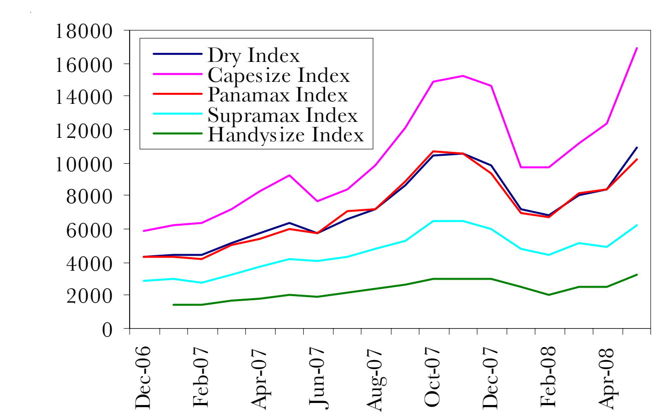
Dry-bulk

The rates remained firm for May, but reduced drastically in the second week of June. The fall is being ascribed, in part, to the Pacific rates decline arising out of the farmers' strike in Argentina, and the reduction in coal movement in Australia due to a rail derailment. The strength in May was ascribed to the tight demand-supply scenario, with a severe reduction in commodity stockpiles in the first quarter of the year. There was a fleet addition of 4.3 mn dwt in 1QCY08, compared to 6.2 mn dwt in 1QCY07. We expect the commodity demand to settle down with the onset of the Chinese Olympics. This**,** including the recent Chinese order to reduce the iron ore stockpiles at the ports**,** should moderate the demand for dry-bulk.

Tanker Charter Rates (monthly average)



Baltic Dry Index (monthly average)



Source: Great Eastern Shipping

Gas (LPG)

There was news of an accident at Kandla jetty, which left a some MGC vessels open in the month of May. The VLGC scenario improved in May and June. The record exports from the Middle East were partly responsible for this. Hence, an additional five new buildings are expected to be added to the market in next few months, which will be easily absorbed by the markets, looking at the recent conditions.

Special Focus

Shipbuilding under threat

The peak of the shipbuilding cycle is a clear threat to the new shipbuilding capacities coming up worldwide. What effect this could have on the asset prices, henceforth, is a point worth contemplating. The shipbuilding boom, which started from 2000 and saw record deliveries in 2007, acted as a builder's market. It is now that, we believe, it will transition into a buyers market.

We believe that in the downturn builders will start covering variable costs and ignore the sunk costs such as depreciation. The pricing in the shipbuilding industry, which is done on the basis of a mark-up, will now be facing a shrinkage in these mark-ups. We believe the yards in Japan and, to an extent in Korea, which work on thinner margins (5-6%), may be under greater threat than yards in China, India and Vietnam.

The major supply-side and demand-side factors affecting the shipbuilding industry are, hence:

Demand supply factors

Supply factors	Demand factors
Yards capacity	Shipping demand
Raw material prices	Replacement demand
Depreciating US$	Offshore demand

Supply factors

The yards' capacity is one of the bigger threats on the horizon. By the end of 2013, shipbuilding capability to deliver 73.5 CGT (compensated gross tonnage) will be available. Out of this, 14% capacity will lie in the greenfield yards, most of which are being set up in China.

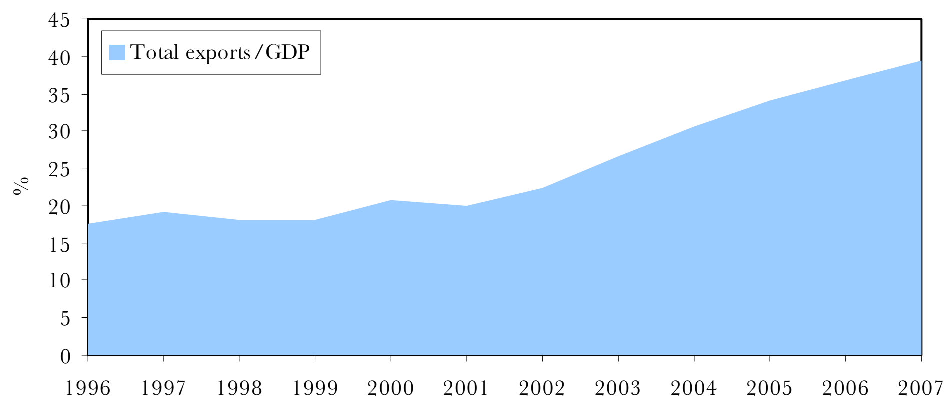
Raw material price inflation is the next biggest threat, with the price of the shipping steel plates moving up by 30% by the end of 2007 on a YoY basis. Though the impact on the yards will not be visible in the near term, as they contract for steel requirements on a back-to-back basis, steel suppliers are less likely to take this raw material price impact on themselves, in the longer run. Hence, the fixed price contracts which the yards enter into will not have anything 'fixed' about them.

The depreciating dollar affects more those countries which have in-house steel and equipment manufacturing capabilities. Hence, we expect this to affect countries like Japan and Korea, more than China or India.

Demand factors

Shipping demand, or the tonne mile demand, has seen drastic upheavals due to the increase in the tonnage, as well as the miles, part of the equation. China has been responsible for the dramatic increase in the tonnage trade increase, specifically in the iron ore trade, where it alone is responsible for ~50% of the iron ore imported. In the longer term we believe that the Chinese claim of being the "factory for the world" will be under threat in the high fuel cost scenario eating into the labour arbitrage.

China: total exports to GDP

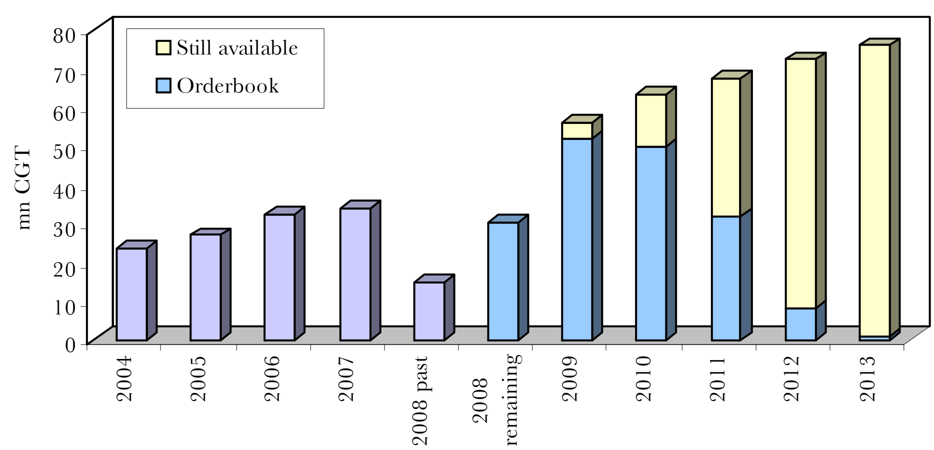


Source: Worldyards

Replacement demand arises due to aging of vessels and other regulatory requirements. We believe, in a middle ground that the MARPOL scrappings will happen over a period of time, until 2015. We believe that the orders given in the tanker segment have already factored in the expected scrapping demand.

Offshore demand, which has been a lifeline for the Indian shipbuilders, will continue to remain strong, though scalability in operations by presence in this field is questionable.

Worldwide shipbuilding order book vs. Still available yard capacity



Source: Worldyards

Overall, it will be an interesting time to watch out for, after 2010, as the shipbuilding industry will face a watershed by then. We may hence see a considerable decline in the new building prices.

News Synopsis

Industry News

- The Baltic Dry Index, a measure of shipping costs for commodities, posted its seventh consecutive decline as Argentine farmers intensified a three-month dispute that has disrupted grain shipments. The index slumped 227 points, or 2.4 %, to 9,419 points, according to the Baltic Exchange in London. That is the lowest since 30 April. It fell by the most ever, on 12 June and declined 17% last week. The drop may be levelling off, because goods such as grains and coal are cheaper on a delivered, or CIF, basis, which may spur vessel demand.
- Iran, OPEC's second-largest oil producer, has 15 tankers stationed in the Persian Gulf, capable of storing more than 30 mn barrels of crude, according to ship-tracking data compiled by Bloomberg. That compares with data compiled a week ago, which showed there were 14 such carriers. Iran, which had to use tankers for storage while its refinery customers carried out annual repair works, will start using the carriers for deliveries again, by mid-summer. It normally takes 24 to 28 hours to load a cargo and set sail.

Company News

- Mercator announced the delivery of a 2006 built double hull, very large crude carrier (VLCC) of 299,325 dwt.
- The Great Eastern Shipping Company Ltd. (G E Shipping) has contracted to sell its single hull general purpose (GP) product tanker, Jag Prayog. The 1982 built, 29,990 dwt vessel will be delivered to the buyers in the month of June 2008. The sale is in line with the company's strategy to modernise its tanker fleet.

Key stats...

Shipping weekly update

Shipping portfolio NAVs

(Rs mn)	Reco	Fleet value*	Debt	Cash	NAV	Equity	NAV per Share (for shipping fleet)	CMP (Rs)	Premium/ (Discount) (%)
SCI	Not Rated	93,813	12,447	26,247	107,612	282	381	250	(34)
GESCO	BUY	79,059	24,900	13,500	67,659	157	431	441	2
Mercator	Outperformer	44,129	26,320	7,220	25,029	270	93	111	20

*Only value of existing fleet.

Shipping fleet profile

Vessel type	SCI (Total DWT 4.62 mn)			GESCO (Total DWT 2.89 mn)			Mercator (Total DWT 1.7 mn)		
	Number	% of DWT	Age	Number	% of DWT	Age	Number	% of DWT	Age
Crude	30	72	16	12	53	7	9	63	16
Product	14	10	15	19	26	14	0	0	0
Dry Bulk	20	18	18	11	21	14	10	37	3
Total	64	100	16	42	100	12	19	100	9

Shipping trends

Asset price trends

	US$ mn		% change of current price from							
	Current		Apr 08 (1 month)		Feb 08 (3 month)		Nov 07 (6 month)		May 07 (1 Year)	
	NB	5 Year	NB	5 Year	NB	5 Year	NB	5 Year	NB	5Year
Crude										
VLCC	150	147	1.4	3.5	5.6	9.7	7.1	13.1	16.3	24.6
Suezmax	92	96	2.2	0.0	4.5	0.0	5.7	0.0	15.0	12.9
Aframax	72	72	1.4	0.0	4.3	2.9	4.3	7.5	9.1	7.5
Panamax	65	63	1.6	0.0	3.2	5.0	3.2	10.5	16.1	14.5
Product	51	52	0.0	0.0	(1.9)	2.0	(1.9)	(1.9)	8.5	6.1
Bulk Carriers										
Capesize	93	150	0.0	3.4	(2.1)	7.1	(1.1)	3.4	13.4	47.1
Panamax	52	89	0.0	7.2	0.0	8.5	0.0	1.1	23.8	53.4
Supramax	47	71	2.2	0.0	4.4	4.4	4.4	(5.3)	27.0	29.1

Source: Compass Maritime

Freight rates trends

		% change in the current TCY/Index from			
		Apr 08 (1 month)	Feb 08 (3 month)	Nov 07 (6month)	May 07 (1 Year)
Tankers rates					
VLCC	115,817	92.3	119.8	364.4	211.3
Suezmax	75,932	43.8	173.9	246.6	179.5
Aframax	42,010	32.0	158.9	196.2	73.7
Clean	12,731	16.3	43.1	63.1	(34.8)
Baltic Drybulk Indices					
Dry Index	10,918	29.8	59.7	3.4	70.5
Capesize	16,935	37.3	74.0	11.5	84.2
Panamax	10,203	21.6	52.1	(3.9)	69.6
Supramax	6,235	25.5	41.5	(4.6)	49.2
Handysize	3,243	29.4	55.6	6.7	55.6

Source: Great Eastern

Valuations

Company	Year ended	Standalone/ Consolidated	Reco	Price (Rs)	M-cap (Rs mn)	EPS (Rs)	PE Ratio (x)	EV/EBITDA (x)	RoCE (%)	RoE (%)
Great Eastern	FY10E	S	BUY	441	67,385	52.4	8.4	6.1	12.2	15.2
Mercator	FY10E	C	Outperformer	111	26,050	22.1	5	5	17.1	30.2
Varun	FY10E	S	Outperformer	73	10,800	17	4.3	4.3	12.9	24.2

Bhavin Gandhi
bhavin.gandhi@bksec.com
+91-22-4007 6224

Chetan Kapoor
chetan.kapoor@bksec.com
+91-22-4007 6226

Analyst Declaration: We, Bhavin Gandhi & Chetan Kapoor, hereby certify that the views expressed in this report accurately reflect our personal views about the subject securities and issuers. We also certify that no part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendation or view expressed in this report.

B&K Securities is the trading name of Batlivala & Karani Securities India Pvt. Ltd.

B&K Investment Ratings:

1. **BUY:** Potential upside of > +25% (absolute returns)
2. **OUTPERFORMER:** 0 to +25%
3. **UNDERPERFORMER:** 0 to -25%
4. **SELL:** Potential downside of < -25% (absolute returns)

B & K SECURITIES INDIA PRIVATE LTD.

Equity Research Division: 12/14, Brady House, 2nd Floor, Veer Nariman Road, Fort, Mumbai-400 001, India. Tel.: 91-22-4007 6000, Fax: 91-22-2287 2766/1136.

Registered Office: Room No. 3/4, 7 Lyons Range, Kolkata-700 001. Tel.: 91-033-2243 7902.

B&K Research is also available on Bloomberg <BNKI>, Thomson First Call & Investext.