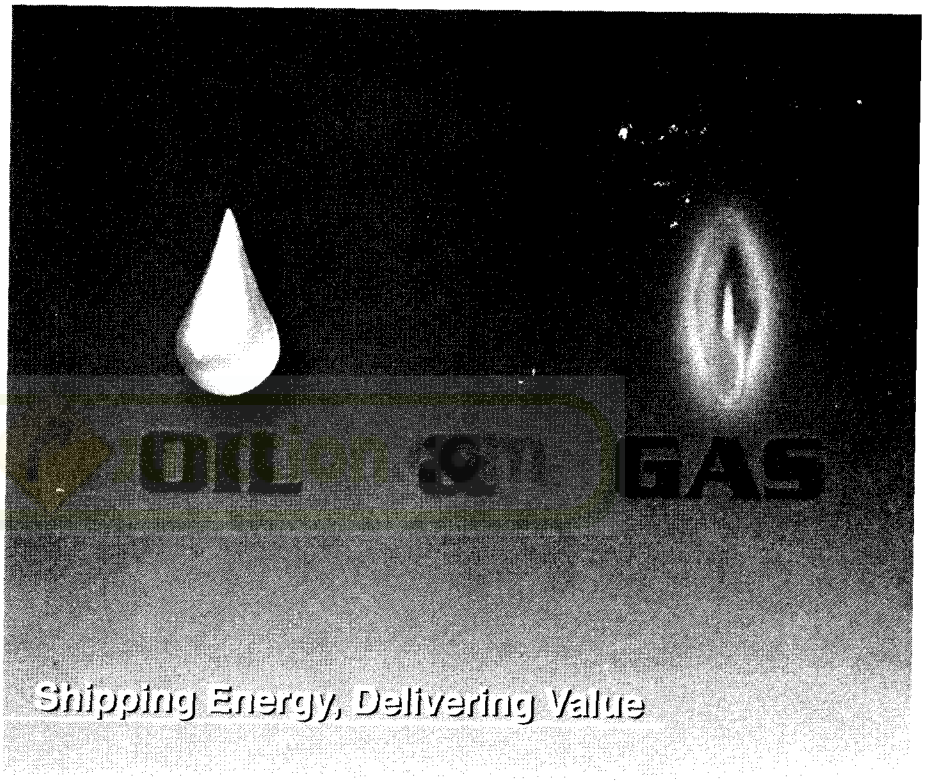
VARUN



35th annual report
2005-2006

VARUN SHIPPING COMPANY LIMITED

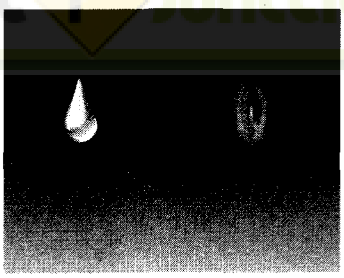
Shipping Energy, Delivering Value

Varun Shipping - a company that has chartered its course towards goals set in global horizons and has set sail to achieve them. With its diversified fleet of 19 vessels, it offers comprehensive shipping solutions in the hydrocarbon sector. Varun is the largest owner[1] of LPG tonnage in India and is internationally the second largest owner of tonnage in the mid-size, fully refrigerated, LPG carrier sector[2].

Anchored firmly in its mission of shipping energy and delivering value, Varun has enhanced its stakeholders value through growth, profitability and world-class performance. This also reflects in the fact that the company has received the award of "Fastest Expanding Indian Shipping Company", in 2006. The company has been making profits and paying dividends continuously since the last 22 years.

1. As at 31 December, 2005 Directorate General of Shipping, India website: www.dgshipping.nic.in

2. Letter dated 20 March, 2006 from Lorentzen & Stemoco AS.



The cover highlights Varun's area of specialization and the corporate focus – Oil and Gas. Varun primarily services the hydrocarbon sector, which includes the LPG, crude oil, petroleum products, and offshore sector.

The drop of oil signifies liquid cargoes comprising of crude oil and petroleum products which are transported by Varun. The gas flame symbolises Varun's leadership in Indian LPG shipping.

The dark background represents the vast expanse of sea – the arena of Varun's success. The light background signifies a clean, healthy and pollution free environment in which Varun operates its business and the expanse of opportunities, which Varun continues to explore on a continuous basis.

BOARD OF DIRECTORS	Mr. Dilip D. Khatau	Chairman
	Mr. Arun Mehta	Vice Chairman & Managing Director
	Mr. Yudhishthir D. Khatau	Managing Director
	Mrs. Rina D. Khatau	
	Mr. C. M. Maniar	
	Mr. Praveen Singh	
	Dr. A. K. Bhattacharya	
COMPANY SECRETARY	Ms. Manali Parekh	
BANKERS	State Bank of India Bank of India Bank of Baroda UTI Bank Limited	
AUDITORS	Messrs Sorab S. Engineer & Co., Chartered Accountants Ismail Building, 381, Dr. D. Naoroji Road, Mumbai 400 001.	
REGISTERED OFFICE	Laxmi Building, 6, Shoorji Vallabhdas Marg, Ballard Estate, Mumbai 400 001.	
REGISTRARS & TRANSFER AGENTS	MCS Limited Harmony, 1st Floor, Sector - 1, Khanda, New Panvel (West), Dist. Raigad 410 206.	

Corporate Landmarks

1973

The Company commenced operations
with the acquisition of one product tanker.

1983-84

The Company's first diversification programme-entered into support services for oil exploration with the acquisition of Anchor Handling and Towing Supply Vessels (AHTS).

1986

The Company's shares were listed on the Stock Exchanges and a Public Issue of Rs. 17.50 million raising Company's equity capital to Rs. 33.50 million.

1993

Second diversification programme-acquisition of two modern geared bulk carriers for dry cargo movement.

1995

The Company promoted a wholly owned subsidiary company in Singapore, VSC International Pte Ltd.

1996

The Company acquired its first LPG carrier making it the first private sector Indian company to commercially operate LPG carriers.

2005

The Group acquired its eleventh LPG carrier, as a result the Company now owns the largest LPG fleet in the country i.e. 76 per cent of the total LPG tonnage operating under Indian flag.

2005

The Company diversified into transportation of crude oil with acquisition of two modern Aframax crude oil tankers.

2006

"Fastest expanding Indian Shipping Company" award was conferred on the Company by The National Maritime Day Celebrations Committee.

Directors' Report

Your Directors have pleasure in presenting the Thirty-fifth Annual Report together with the audited statements of account of the Company for the year ended 31st March, 2006.

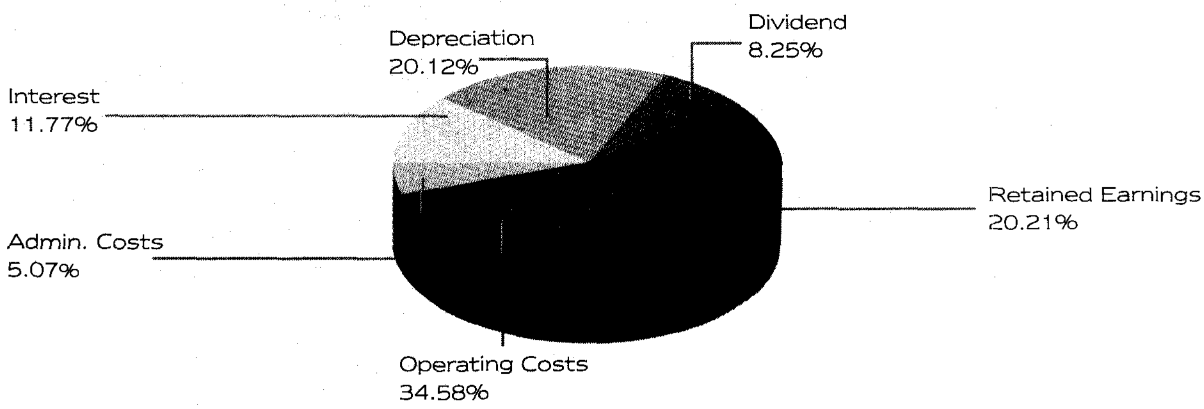
(Figures in millions of Rupees)

	Current Year ended 31.03.2006	Previous Year ended 31.03.2005
PROFIT BEFORE TAX	**1,833.71**	834.78
Less : Provision for Taxation		
Current Tax (includes Rs.4.57 million towards short provision for earlier years)	**13.20**	17.87
Fringe Benefit Tax	**11.60**	–
PROFIT AFTER TAX	**1,808.91**	816.91
Less : Transferred to Tonnage Tax Reserve under Section 115VT of the Income-tax Act, 1961	**370.00**	175.00
Add : Surplus brought forward from previous year	**185.99**	3.40
Amount available for appropriation	**1,624.90**	645.31

Out of the amount of Rs.1,624.90 million available for appropriation, your Directors propose to transfer an amount of Rs.257.10 million to General Reserve. The Directors recommend payment of final dividend of Rs.1.50 per equity share for the year ended 31st March, 2006 which together with two interim dividends totalling to Rs.3.00 per equity share declared and paid earlier for the year ended 31st March, 2006 aggregating to Rs.4.50 per equity share will absorb Rs.527.90 million and Rs.74.05 million towards dividend tax. During the year, an amount of Rs.40 million being the final 1/3rd redemption amount on 1,200,000 cumulative redeemable preference shares of the face value of Rs.100 each was paid. The Directors also recommend dividend of Rs.3.73 million on 1,200,000 cumulative redeemable preference shares, which dividend has already been paid as interim dividend during the year and on which dividend tax of Rs.0.52 million has been paid. After the above appropriations, your Directors propose to carry forward a balance of Rs.758.86 million in the Profit and Loss Account.

Income from operations was Rs.6,429.31 million compared to Rs.3,889.61 million for the year ended 31st March, 2005. Net profit after tax was Rs.1,808.91 million for the year ended 31st March, 2006 as against Rs.816.91 million during the preceding year. Increase in profit was due to continued buoyancy in freight rates for LPG carriers, expansion of Company's fleet and better utilization of Company's fleet during the year under review.

DISTRIBUTION OF REVENUE
(Rs. 6443 Million)



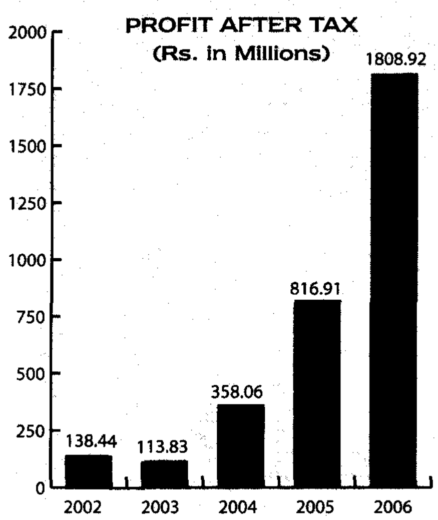
The Company continues to maintain its focus on the hydrocarbon sector. Towards this end, the Company after having acquired its eighth LPG carrier in April, 2005, acquired its ninth and tenth LPG carriers, namely, Maharshi Mahatreya in August, 2005 and Maharshi Krishnatreya in October, 2005 all three having a cargo carrying capacity of 35,559 cbm each respectively. With these acquisitions, the Company's present Indian LPG carrier fleet of 10 is the largest in India in terms of both fleet size and cargo carrying capacity of 260,715 dwt (319,960 m^3). It forms approximately 76 per cent of total LPG tonnage under Indian flag. In addition thereto, VSC International Pte Ltd. the Company's wholly owned subsidiary in Singapore also acquired one LPG carrier, Maharshi Bhavatreya in November, 2005 with cargo carrying capacity of 35,559 cbm. This ship is with the Company on bareboat charter with purchase option. Consequent to the said acquisitions, the group presently owns a fleet of 11 LPG carriers with cargo carrying capacity of 287,915 dwt (355,519 m^3).

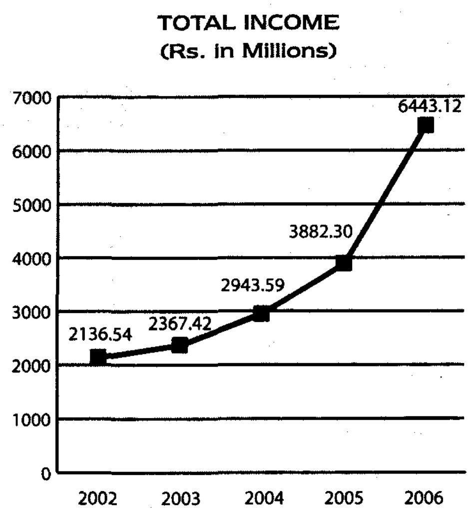
In order to strengthen its presence in the crude oil sector, the Company acquired its second modern double hull aframax crude oil tanker, Amba Bhakti in July, 2005 having cargo carrying capacity of 106,597 dwt. The vessel MT Hans Doot which was taken by the Company on bareboat charter cum demise basis was acquired by the Company in July, 2005.

Pursuant to a tender floated by Petronet LNG Limited (PLL), Exmar NV led consortium of which your Company was a member had submitted a bid and was short-listed by PLL for time chartering of one LNG tanker for 25 years. PLL had thereafter directed all the bidders to resubmit their price bids as the guidelines relating to LNG shipping were kept in abeyance. Based on the re-submitted bids, the LNG contract was awarded to another participating consortium.

As a result of the Company's strong acquisition programme during the year under review, the award of "Fastest Expanding Indian Shipping Company" was conferred on the Company by National Maritime Day Celebrations Committee formed by the Directorate General of Shipping, Ministry of Shipping, Road Transport and Highways, Government of India. Mr. Arun Mehta, Vice Chairman and Managing Director of the company was given the "Varuna Award" for his sustained and outstanding contribution to the shipping industry in India. Both the awards were given on 5th April, 2006, which is celebrated nationwide as India's National Maritime Day.

During the year under review, the Company issued and allotted 5,200,000 and 623,000 equity shares of Rs.10 each to Khatau International Limited and Mr. Arun Mehta, Vice Chairman & Managing Director of the Company respectively, pursuant to their exercise of option for conversion of 5,200,000 and 623,000 Optionally Fully Convertible Warrants (OFCWs) at Rs.32.09 per share. With the issue and allotment of the





said shares, the total issued equity share capital of the Company stands at 117,307,773 equity shares of Rs.10 each.

In order to raise additional funds for our fleet expansion programme, the Company proposes to issue Singapore Depository Shares (SDSs) in Singapore. The Company has in this connection filed the preliminary prospectus with Monetary Authority of Singapore on 31st March, 2006 and after complying with all requisite formalities, will consider issue of SDSs during the current financial year.

The Company has registered and opened a branch office in Singapore during the year under review and currently manages some of the Company's vessels from this branch.

Management Discussion and Analysis :

(a) Industry Structure and Development :

The international shipping industry transports hydrocarbons and bulk commodities in the wet, dry bulk, gas and chemical sectors by means of various vessels. The Company operates in above-mentioned sectors with a diverse mix of vessels. The Company also owns and operates vessels in offshore services sector.

The composition of the merchant shipping industry can be divided into 5 broad vessel classes namely :

(i) Tankers - Tankers are vessels designed to carry bulk liquids and are engaged in the carriage of liquids such as crude oil, refined petroleum products, chemicals, petro-chemicals and liquefied gases (LPG and LNG). Some examples of tankers are crude oil tankers, petroleum product tankers and gas carriers.

(ii) Bulk carriers – Bulk carriers are vessels designed to carry dry bulk cargo such as coal, iron ore, cement, food grains, etc.,

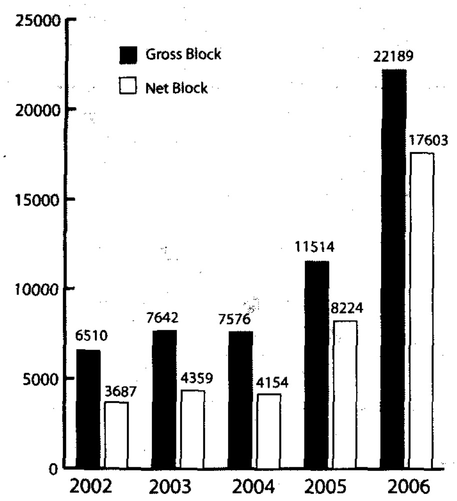
(iii) Other cargo ships – Other types of cargo ships include container ships and general or special cargo ships and carry dry non-bulk cargo such as vehicles, paper and pulp etc.

(iv) Passenger/cruise ships and ferries – Passenger or cruise ships and ferries are specially designed to carry passengers and/or vehicles.

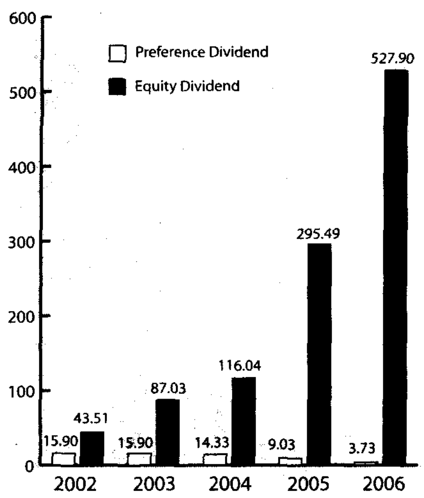
(v) Miscellaneous ships – Vessels that cater to the requirements of the offshore services industry as also all vessels that do not fall within the above categories.

The shipping industry is generally influenced by factors such as demand for the movement of cargoes, the resultant tonne-mile demand of vessels as well as the supply of vessels, economic growth trends

GROSS AND NET BLOCK
(Rs. in Millions)



DIVIDEND
(Rs. in Millions)



and heating fuel requirements based on weather conditions. The shipping industry has benefitted from the increase in demand for overseas seaborne trade driven by economic growth experienced by the Asia Pacific economies such as India and the Peoples Republic of China, in the recent past. It is also experiencing increased tonne-mile growth as a result of increasing shipments of finished goods over longer distances from the Asia Pacific region to the western hemisphere.

The demand for LPG has grown faster than the demand for world energy every year in the last decade. The main factors which drive LPG consumption are (i) overall economic growth (ii) LPG distribution infrastructure (iii) environmental incentives (iv) weather conditions and (v) natural gas availability.

According to Drewry Annual LPG Market Review and Forecast 2004-05, Asia is the most important LPG importing region accounting for 57.6 per cent of the seaborne trade in 2003. With a large proportion sourced from long haul destinations, such as the Middle East (and increasingly Africa and Europe), the region is even more important for gas carrier employment. Measured in terms of tonne-miles generated, Asia accounted as a destination for 80.5 per cent of global trade.

There was an increase in seaborne oil trade leading to an increase in tanker tonnage demand in crude oil and petroleum products sector. However, the fleet growth was also high. The average freight rates for crude carriers were down from 2004 to 2005 but still at second highest levels since 1970s.

There was an increase in seaborne dry bulk volumes in 2005 compared to 2004 resulting in an increase in tonnage demand in the dry bulk sector. However, an increase in the dry bulk fleet worldwide resulted in a drop in average freight rates for the year 2005 compared to the year 2004.

There is an increase in exploration and production activities in the offshore sector globally driven by high global crude oil prices. This has resulted in an increase in demand for shipping activities in the offshore sector. Exploration and production activities in India have increased over the years spurred by plans from the Indian Government to enhance domestic production of oil and gas.

(b) Opportunities and Threats :

The shipping industry in India has benefitted from an increase in demand for seaborne domestic and global trade as a result of overall growth of population in India and economic growth experienced by India and other parts of the world. According to Indian National Shipowners Association (INSA), Indian shipping transported approximately 13.8 per cent of the total overseas seaborne trade in 2003-2004. While India's trade volume continues to grow over the years, the Indian shipping fleet is ageing. As on 1st October, 2005, approximately 38 per cent of Indian flagged vessels were over 20 years old and approximately 19 per cent were between 15 and 19 years old. Although specialised vessels such as LPG carriers have a longer trading life of between 30 to 35 years, we expect most other vessels, which are more than 20 years of age to be scrapped over the next 5 years. The growing trade is expected to drive the demand for shipping and the scrapping of the ageing fleet is expected to reduce the supply of vessels. Therefore, the outlook for shipping in India appears to be positive and presents a good opportunity for existing Indian shipping companies to expand their fleet size and increase their market share.

Indian Government departments and Public Sector Undertakings (PSUs) are required by Government policy directing to import on FOB (free on board) or FAS (free alongside ship) basis in relation to cargoes owned or controlled by Indian Government. Further, under guidelines for chartering of foreign flag vessels, Indian flagged vessels are granted a "right of first refusal" in respect of charter of vessels by an Indian charterer. The collective effect of the policy and the guidelines is that Indian flagged vessels would have a right of first refusal with regard to significant import trade undertaken by Indian Government departments or PSUs.

The Indian Union Budget for the year 2006-2007 states that an investment of Rs.22,000 crores is expected in the next few years in the refinery sector alone. This is likely to lead to long term requirements in the import of crude oil and possible export of surplus refined petroleum products.

The shipping industry is highly competitive due to its global nature and is also increasingly regulated. Due to increase in quality requirements, there is likely to be shortage of skilled sea-going manpower.

(c) Segment-wise Performance :

The Company is engaged only in the business of shipping and there are no separate reportable segments.

The Company's LPG carriers are deployed on mix of voyage charter, time charter and pool arrangements.

In the crude oil and petroleum products sector, the Company has a fleet of 2 crude oil tankers and 3 product tankers. The 2 crude oil tankers are placed in the Sigma Tanker Pool, which trades globally, 1 product tanker is in a pool arrangement with the Heidmar Tanker Pool and the other two product tankers are employed on a mix of time and/or voyage charters.

The bulk carrier, MV Surya Kripa, is entered into pool arrangement with Bulkhandling Handymax AS of Norway.

In the offshore sector, the Company's 2 Anchor Handling Towing and Supply Vessels (AHTSs) are employed on time charter with Oil and Natural Gas Corporation Limited.

(d) Outlook :

LPG carriers are primarily used to transport LPG and ammonia. LPG due to its clean burning property is the most preferred fuel both for industrial and residential purposes. Forecasts of increased LPG production in association with numerous LNG projects are leading to increased orders of LPG vessels. One of the methods of producing LPG is by the treatment of natural gas to remove impurities. Natural gas comprises mainly of methane and small varying quantities of propane and butane (generally referred to as LPG), and ethane. Under the Kyoto Protocol (adopted in 1997 in Kyoto, Japan), greenhouse gases including methane (a key component of natural gas) are placed under restrictions in terms of flaring. Thus increasing amounts of natural gas will need to be processed rather than flared thereby leading to greater amounts of LPG being extracted from natural gas. As per the Drewry LPG Forecaster 4Q 2005, Quarterly Analysis of the LPG market, increased LPG production will see more LPG being shipped to the US Gulf with the Atlantic basin playing an increasingly important role in relation to the traditional Middle East-Far East trade that has dominated the VLGC market in the past and which should increase tonne-mile demand. The immediate prospects for fully-refrigerated vessels remain very good due to virtually no vessel supply side pressure in 2005 and only limited pressure in 2006. Given the positive outlook from the Indian and global LPG trade market, it appears that the LPG sector will continue to grow in tandem with the demand for LPG, in an environment with relatively stable freight rates. The Company is well positioned to benefit from the expected growth in demand for LPG both domestically and globally.

On the crude oil and products side, the Platou Report, 2006, indicates that well-known forecasters such as International Energy Agency (IEA) and Energy Information Administration of the US Department of Energy (EIA) predicted at the end of 2005 a growth in global oil consumption in 2006 of slightly more than 2 per cent or 1.7 million bpd with China and USA as the main drivers. EIA predicted oil consumption in the US to rise by 2.3 per cent and in China by 7 per cent. The Platou Report 2006 states that the trend in oil consumption will be the most decisive factor. Consensus forecasts for the world economy tell that 2006 will be another year of high economic growth. In combination with a possible moderate fall in oil prices, the report still expects oil consumption to show some strength and lead to a comfortable return on capital for shipowners in 2006.

Based on CRIS INFAC Refining and Marketing Annual Review, January 2005, it appears that India will continue to be a net importer of crude oil, natural gas and LPG and net exporter of refined petroleum products during the period up to 2008-09.