VARUN

Varun Gas Infrastructure – GAS

Varun Asia – OIL

Varun Cyprus – OFFSHORE

Varun Management – SHIP MANAGEMENT

Change is the only constant

41st annual report
2011-2012

VARUN SHIPPING COMPANY LIMITED

Change is the only constant

Companies need to recognize changes in the environment and "*adjust their sails*" in order to meet the new challenges confronting them. Companies need to constantly change to bring about innovation, customer satisfaction, improved value and competitiveness.

Towards achieving this objective, Varun is in the process of re-organizing its businesses primarily to avail long term charters, meet customer and operational requirements as under:

Varun Gas Infrastructure – Gas

Varun Asia – Oil

Varun Cyprus – Offshore

Varun Management – Ship Management

Varun with a view to realign its existing businesses and increase focus on individual growth strategies of each business, proposes to rearrange its businesses by segregating its traditional Shipping Business, Ship Management and Shipping Investment Business into separate entities which would enable a better and focused approach to needs of growth and consolidation and would assist such entities to pursue their individual growth strategies, thereby resulting in enhancement of their business prospects and shareholder's value.

Varun Shipping Company Limited

Board of Directors

Mr. Yudhishthir D. Khatau
Chairman & Managing Director

Mr. C. M. Maniar

Mr. Praveen Singh

Dr. A. K. Bhattacharya

Mr. Khurshed M. Thanawalla

Ms. Manali Parekh
Vice president – Corporate Affairs,
Secretarial & Legal and Company Secretary

Registered Office

Laxmi Building,
6, Shoorji Vallabhdas Marg,
Ballard Estate,
Mumbai 400 001.

Auditors

Messrs Sorab S. Engineer & Co.,
Chartered Accountants,
Ismail Building,
381, Dr. D. Naoroji Road,
Mumbai 400 001.

Bankers

State Bank of India
Axis Bank Limited
ICICI Bank Limited
Bank of India

Registrars & Transfer Agents

Datamatics Financial Services Limited,
Plot No. A-16 & A-17, Part - B,
Crosslane, MIDC, Andheri (East),
Mumbai 400 093.

Contents

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.

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. Since then, the Company has become the largest owner of LPG carriers in India and has established a leadership position globally.

2005

In 2005, the Company diversified into transportation of crude oil with acquisition of two modern Aframax crude oil tankers. Since then, the Company acquired its third modern, double hull Aframax crude oil tanker in 2007.

2007

The Company acquired a Very Large Gas Carrier (VLGC), which is the largest LPG Carrier in the Indian fleet.

2007-09

In 2007, the Company acquired two modern highly sophisticated AHTS vessels. With the acquisition of three more large AHTS vessels in 2008 and 2009, Company established its leadership position in the large AHTS sector in the Asian region.

2012

- Consolidation of gas business in India under Varun Gas Infrastructure.
- Tankers owned under Varun Asia.
- Large AHTS vessels owned under Varun Cyprus.

Directors' Report

Your Directors have pleasure in presenting the Forty-first Annual Report together with the audited statements of account of the Company for the 18 months period ended 30th September, 2012.

(Figures in millions of Rupees)

	18 months period ended 30.09.2012	Previous Year ended 31.03.2011
PROFIT BEFORE TAX	**377.27**	168.22
Less: Provision for Taxation		
Current Tax	**17.50**	33.52
Excess provision of Income-tax for prior years written back	**(23.88)**	(12.78)
PROFIT AFTER TAX	**383.65**	147.48
Add: Surplus brought forward from previous year	**942.92**	934.92
Amount available for appropriation	**1,326.57**	1,082.40

Your Directors have recommended payment of dividend of ₹ 0.50 per equity share for the 18 months period ended 30th September, 2012, which will absorb ₹ 75.00 million. Additional amount of ₹ 12.17 million will be absorbed towards dividend distribution tax. After the above appropriations, your Directors propose to carry forward a balance of ₹ 1,239.40 million in the Profit and Loss Account.

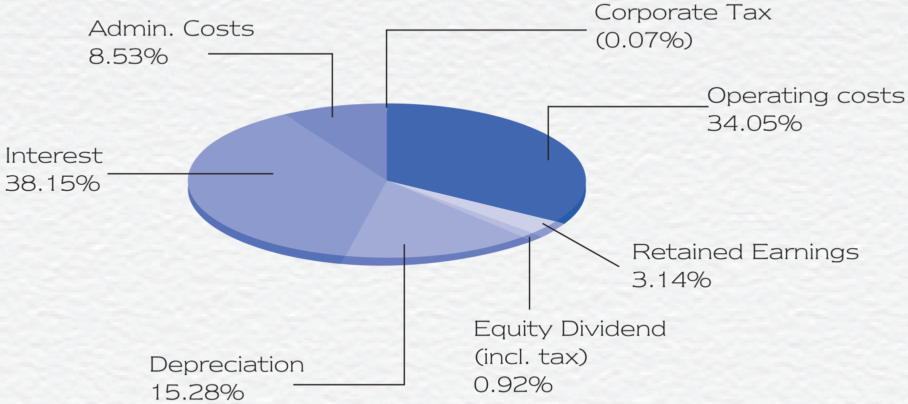
Freight and charter hire income for the 18 months period ended 30th September, 2012 was ₹ 4,655.02 million compared to ₹ 4,914.27 million for the year ended 31st March, 2011. Profit before tax was ₹ 375.27 million for the 18 months period ended 30th September, 2012 as against ₹ 168.22 million during the year ended 31st March, 2011. Net profit after tax was ₹ 383.65 million for the 18 months period ended 30th September, 2012 as against ₹ 147.48 million during the year ended 31st March, 2011.

During the 18 months period ended 30th September, 2012, Company sold its AHTS vessel Suvarna and Amba Bhargavi on Bareboat Charter cum Demise (BBCD) basis to Varun Cyprus Limited, Cyprus and Varun Asia Pte. Ltd., Singapore respectively and thereafter transferred the ownership of the vessels to the said companies. Further, the ownership of the vessels Amba Bhakti and Amba Bhavanee sold earlier on BBCD basis was transferred to Varun Asia Pte. Ltd., Singapore and the ownership of AHTS vessels Subhiksha and Sudaksha sold earlier on BBCD basis was transferred to Varun Cyprus Limited, Cyprus. The Company has also sold its AHTS vessels Subhadra and Suchandra to Varun Cyprus Limited. Due to flexibility of crewing under foreign flag and financing and fiscal benefits available to companies incorporated overseas, the subsidiaries/associate companies overseas have been able to obtain long-term low cost financing and long-term contracts/employment for the vessels acquired by them. The sale has also enabled the Company to reduce its debt from ₹ 27,036.5 million as on 31st March, 2011 to ₹13,434.7 million as on 30th September, 2012.

The Company together with its associates is the 5th largest in the world in terms of number of fully refrigerated LPG carriers and 7th largest in the world in terms of cbm, i.e. cargo carrying capacity under

DISTRIBUTION OF REVENUE / EXCHANGE GAIN

(₹ 9,449.40 Million)



10,000 + cbm category. The LPG carrier fleet presently owned and/or operated by the Company is the largest in India in terms of both fleet size and cargo carrying capacity.

With a view to realign businesses and increase focus on individual growth strategies of each business, the Company together with other companies has proposed to rearrange its businesses by segregating its traditional shipping business, ship management (technical and commercial management) and shipping investment business (presently confined to holding investment in group companies) into separate entities through a Composite Scheme of Arrangement and Amalgamation (the "Scheme") under the provisions of the Companies Act, 1956 thereby resulting in enhancement of business prospects and shareholder's value. The Company has received approval of Competition Commission of India and in-principle approvals from Bombay Stock Exchange Limited and National Stock Exchange of India Limited for the said Scheme. The necessary application has also been made to the Hon'ble High Court of Judicature at Bombay for approval of the said Scheme.

During the period under review, following companies became wholly owned subsidiary companies of the Company:

Varun Gas Infrastructure Limited - the Company holds 1,000,000 equity shares of ₹10 each.

Varun Global Private Limited - the Company holds 100,000 equity shares of ₹1 each.

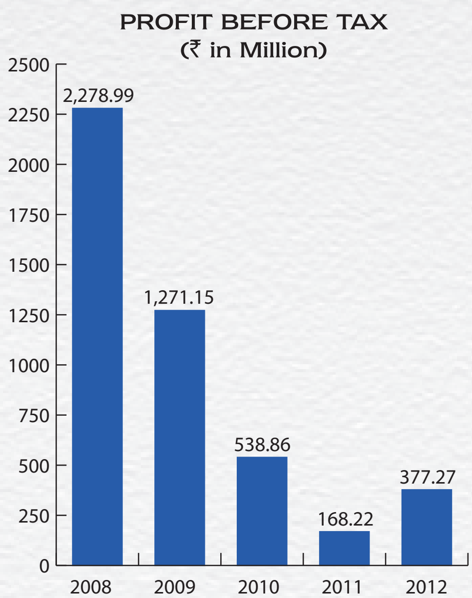
Varun Resources Private Limited - the Company holds 150,007,773 equity shares of ₹1 each.

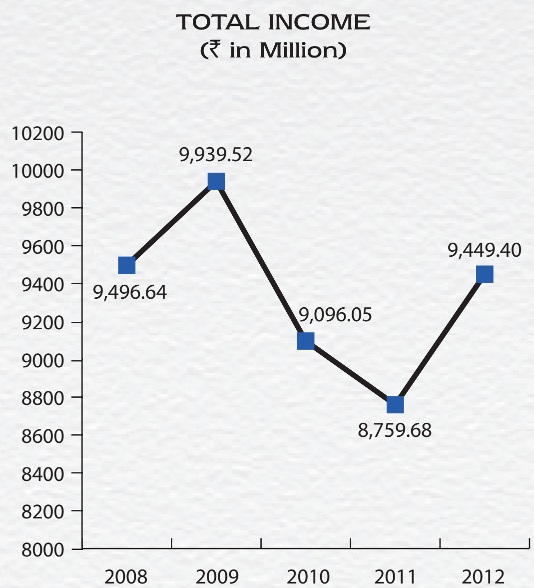
Further, Varun Asia Pte. Ltd., Singapore was a wholly owned subsidiary of the Company for the period from 3rd April, 2012 to 28th September, 2012 and is now an associate of the Company.

Further, Varun Cyprus Limited, Cyprus became a wholly owned subsidiary of the Company on 15th December, 2011 - the Company holds 1,000 equity shares of US$ 1 each.

The consolidated financial statements presented by the Company include financial information of its subsidiaries prepared in compliance with applicable Accounting Standards. The Ministry of Corporate Affairs, Government of India vide its Circular No. 51/12/2007-CL-III dated 8th February, 2011 has granted general exemption under Section 212(8) of the Companies Act, 1956 from attaching the balance sheet, profit and loss account and other documents of the subsidiary companies to the balance sheet of the Company, provided certain conditions are fulfilled. Accordingly, annual accounts of the subsidiary companies and the related detailed information will be made available to the Company and subsidiary companies' shareholders seeking such information at any point of time. The annual accounts of the subsidiary companies will also be kept for inspection by any shareholder at Company's Registered Office in Mumbai and that of the subsidiary companies concerned.

Details of subsidiaries of the Company are covered in this Annual Report.





Management Discussion and Analysis :

(a) Industry Structure and Development :

Transportation by sea is the leading and also most preferred mode of transportation the world over. The international shipping industry transports hydrocarbons and bulk commodities in wet bulk, dry bulk, liquefied gas, bulk chemicals and container sectors. Further, specialized vessels are also used to carry passengers, automobiles and project cargoes the world over. In addition thereto, offshore support vessels are used to provide services to offshore oil and gas exploration and production industry. The Company owns and/or operates a diversified fleet of 20 vessels, in the oil, gas and offshore support services sector.

According to Platou Report 2012, the steady relationship between the global GDP growth and sea-borne trade growth continued in 2011. Tonnage demand rose by 6.7 per cent compared to world GDP growth of 3.8 per cent. The respective figures were somewhat below observed long-term averages but broadly confirmed the 2:1 relationship between tonnage demand growth and GDP growth. However, had it not been for the strong increase in LNG volume, tonnage demand growth would have been weaker than expected based solely on the GDP vs. trade relationship. The main factor behind the slump in tonnage demand growth was the container trades which were hit hard by the weakness in the US and European economies. In addition, the continued strengthening of the Chinese yuan caused Chinese export growth to slow to 20 per cent from more than 30 per cent in 2010.

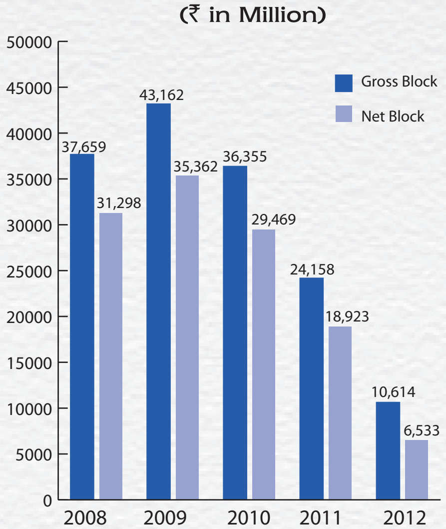
According to Platou Report 2012, the start of the year 2011 turned out to be a tough twelve months for the shipping industry overall. Market performance was weak, with the notable exception of LNG, despite relatively strong trade growth. With expectations for the world economy undergoing a marked shift to the negative and scheduled newbuilding deliveries still high for 2012, any meaningful increase in capacity utilisation will be hard to come by for the main segments.

Further, overall capacity utilisation of 84 per cent was above the very depressed level of 2009 and in line with the low levels seen at the start of the previous decade which was not a satisfactory time for shipping. Big differences among segments still exist.

According to Platou Report 2012, the year 2011 turned out to be one of the most volatile and eventful years ever for the global shipping environment. Three sets of events stand out; another financial crisis raised its head, the social upheaval in the Middle East (known as the Arab Spring) continued and, lastly, it was a major year for natural disasters with the two biggest – a tsunami and earthquake in Japan and the "flood of the century" in Australia, having a direct impact on shipping. While the effect of these disasters varied among segments, the overall impact was negative for world growth and hence for tonnage demand.

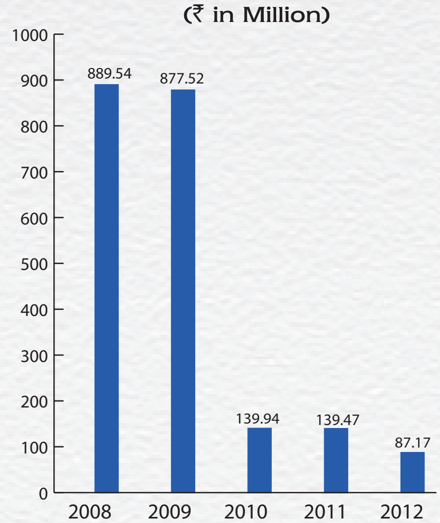
GROSS AND NET BLOCK

(₹ in Million)



EQUITY DIVIDEND

(₹ in Million)



High new building deliveries for the third year in a row continued to drive a large increase in fleet capacity. Total fleet growth came in at 8.2 per cent, the highest level in more than 20 years.

A marked slowdown in tonnage demand growth added to the tanker market's supply problems in 2012 and brought average freight rates down to the lowest level since 1994. Seaborne trade volume showed only marginal growth from the previous year. Fleet capacity continued its steady increase with a 6.2 per cent gain. Overall fleet utilisation fell by more than 3 percentage points to an estimated 83 per cent in the tanker market.

The dry bulk market weakened in 2011, average freight rates fell by more than 40 per cent with Capesize rates leading the way with a 50 per cent drop. A sharp jump in fleet capacity outweighed continued strong albeit volatile, tonnage demand, which grew at 10 per cent. Fleet capacity growth was massive, despite ongoing delays, slippage and cancellations. Net fleet growth topped 15 per cent, a modern day record. Fleet utilisation fell by 4 percentage points but at 88 per cent remained well above the low levels seen for tankers and containers.

Average freight rates for container vessels rose in 2011 but market performance was very uneven. Demand growth was only half of the previous year's sturdy pace, at 7.5 per cent. Fleet capacity added another 8.0 per cent resulting in a modest fall in capacity utilisation, keeping it below 80 per cent for the third straight year.

The LNG market had a fantastic year, in contrast to the rest of the industry. It is estimated that tonnage demand grew by more than 20 per cent while the active fleet increased only by 10 per cent. This led to a significant tightening of market fundamentals.

According to Platou Report 2012 in the year 2011 in the crude oil tanker market, fleet capacity continued its above-trend expansion but the real negative surprise was that seaborne trade growth slowed to a trickle, only a year after one of the strongest performance on record. Fleet utilisation thus moved significantly lower. VLCCs led the sharp drop in rates. Suezmaxes and Aframaxes also suffered, but rates did not fall as dramatically as for VLCCs. The seasonal upturn during the winter months was remarkably short and from the start of the second quarter and well into the fourth the market was exceptionally low for all segments.

LPG markets began a transition period in 2008. The year 2009 was the end of this beginning and start of a new era of sharply rising seaborne LPG supplies. The year 2012 has started seeing better utilisation of LPG vessels. Due to large expansion of Qatar Gas and Ras Gas LNG plants and establishment of new LNG export/import terminals, more LPG production and transportation is expected to take place during the times to come. Seaborne LPG supply is forecast to rise 47 percent to 83 mm t/year between 2008 and 2016. The growth a difference of 27 mm t/year of exports in 2016 v/s 2008 will alter the way LPG markets trade, changing trade dynamics and forcing product to new buyers.

According to Platou Report 2012, spending on oil and gas E & P accelerated further in 2011 and rose by an estimated 14 per cent, a very impressive figure considering that it came on top of robust double-digit growth in 2010. The sustained jump in oil prices to above $ 100 was an obvious catalyst. The demand for offshore support vessels (OSVs) in 2011 clearly benefited from significant increase in global offshore activity. The increase in offshore activity came on the back of rising oil prices and an estimated 14 per cent rise in global E&P spending. The rise in upstream investments produced growth across all the major drivers of OSV demand.

While day rates for large AHTS vessels generally increased in 2011, smaller sized vessels were left struggling to perform in many regions throughout the year.

Brazil was the epicentre of activity and increasing demand there attracted a number of AHTS vessels from other regions.

(b) Opportunities and Threats :

Indian flag ships have a "Right of First Refusal" for any cargo of Indian Public Sector Undertakings which are imported into India. This enables Indian companies to ensure better utilisation of its vessels in Indian trade.

India is the 4th largest consumer of LPG in the world after USA, China and Japan, but Indian LPG consumption per capita is very low compared to other countries. There is a tremendous growth prospect for LPG consumption/demand in India in future and total LPG demand is expected to grow at the rate of 8-9 per cent per annum. With vision 2015 of the Government of India, the Rajiv Gandhi Gramin Vitrak Yojna, LPG penetration in rural areas will improve.

The freight rates are mainly determined by the fine balance between future demand and supply of vessels and therefore may get adversely affected in case of mismatch between demand and supply of vessels over a period of time.

The Indian shipping industry continues to be burdened with several taxes such as service tax and withholding tax on interest which prevent healthy growth and development of shipping industry. In order to be globally competitive, it is essential that taxes are rationalised to ensure that Indian shipping companies are able to achieve a level playing field in the international arena.

Also, shortage of skilled and quality manpower due to continuous drifting of qualified seafarers to foreign shipping companies on account of peculiar tax provisions continues to be an area of grave concern for Indian shipping companies.

(c) Segment-wise Performance :

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

The Company together with its subsidiaries and associates, owns and/or operates a fleet of ten LPG carriers, including seven mid-size Gas Carriers (MGC's), one Large Gas Carrier (LGC) and two Very Large Gas Carriers (VLGC's), which have been deployed on a mix of time charters and spot charters with charterers such as Indian Oil Corporation Limited, Hindustan Petroleum Corporation Limited, Bharat Petroleum Corporation Limited, Reliance Industries Limited and Pertamina.

In the crude oil sector, as a ship manager, the Company operates three double hull Aframax crude oil tankers, which are placed in the Sigma Tanker Pool, trading globally. The benefit of working in the pool is that earnings of group of vessels owned by different owners are pooled together and distributed amongst various owners.

In the offshore support services sector, as a ship manager, the Company operates a fleet of five large Anchor Handling Towing and Supply (AHTS) vessels. The 3 large AHTS Vessels are on time charter to Petrobras, Brazil for a firm period of four years with four extension options of one year each. The other 2 large AHTS Vessels are on charter to Topaz Group in Caspian Sea for ultimate charter to BP Exploration (Caspian Sea) Limited for a period of two years with two extension options of one year each.

(d) Outlook :

There are encouraging signs that market mechanisms are being allowed to work and one may hope that a more balanced situation will emerge from 2013 onwards, world economy permitting.

One of the few bright spots for owners in 2011 has been the substantial reduction in the newbuilding order book. New orders fell by almost 20 per cent, with conventional shipping segments seeing a decline of more than 50 per cent. That has brought the overall order book down to around 20 percent of the fleet, in line with the long-term pre 2007 trend. Another year of relatively high deliveries and limited ordering should take the ratio below trend. This is positive for everyone involved because the first step towards a balanced market and adequate earnings begins with a manageable supply side.

It appears that 2012 is another challenging year for world shipping markets, in line with 2011.

According to Platou Report 2012, freight market in the three major shipping segments-tankers, bulk carriers and container ships is expected to be subdued. However, less demand from the major segments may result in higher focus on smaller, industrial segment.

Increasing focus on fuel efficiency and new regulations for new tonnage might help boost ordering activity, as shipyards respond by offering new, improved designs. Another factor that will affect the balance in the new building markets is the potential downsizing of the building capacity. In difficult time shipbuilders will have to close down facilities due to lack of employment, but historically this has proven to be a slow process. However, yards may adopt conventional ship building capacity to offshore capacity or even utilize their capacity for other means than shipbuilding.