

# **VARUN SHIPPING COMPANY LIMITED**

## **ANNUAL REPORT**

**31<sup>ST</sup> MARCH 2014**

## Directors' Report

Your Directors have pleasure in presenting the Forty-second Annual Report together with the audited statements of account of the Company for the 18 months period ended 31<sup>st</sup> March, 2014.

	(Figures in millions of Rupees)	
	<b>18 months period ended 31.03.2014</b>	<b>18 months period ended 30.09.2012</b>
<b>PROFIT/LOSS BEFORE TAX</b>	(4,890.77)	377.27
Less: Provision for Taxation		
Current Tax	-	17.50
Short/(Excess) provision of Income-Tax for prior years written back	8.59	(23.88)
<b>PROFIT/LOSS AFTER TAX</b>	(4,899.96)	383.65
Add: Surplus brought forward from previous year	<b>1,239.40</b>	<b>942.92</b>
Amount available for appropriation	<b>(3,659.96)</b>	<b>1326.57</b>

In view of losses incurred by the Company, your Directors are unable to recommend any Dividend for Financial year under review

Freight and charter hire income for the 18 months period ended 31<sup>st</sup> March, 2014 was Rs.1753.15 million compared to Rs. 4655.02 million for the 18 months period ended 30<sup>th</sup> September, 2012. Profit before tax was Rs.(4890.77) million for the 18 months period ended 31<sup>st</sup> March, 2014 as against Rs. 377.27 million during the 18 months period ended 30<sup>th</sup> September, 2012. Net profit after tax was Rs. 4899.36 million for the 18 months period ended 31<sup>st</sup> March, 2014 as against Rs.383.65 million during the 18 months period ended 30<sup>th</sup> September, 2012.

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) & 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 to primarily pursue their individual growth strategies, thereby resulting in enhancement of business prospects and shareholder's value. The company has received approval of Hon'ble Bombay High Court for the said Scheme.

During the period under review, the company invested in the following wholly owned subsidiary companies:

Varun Global Private Limited and acquired 400,000 equity shares of Re.1 each. The existing subsidiary companies namely Varun Resources Pvt Ltd and Varun Global Pvt Ltd, were converted into public limited companies during the period under review.

Further, during the period under review your Company had invested in redeemable preference shares of Varun Asia Pte. Ltd., Singapore and Varun Cyprus Ltd, Cyprus. The details of investment made are mentioned in the attached financial statements.

### **Effect of 'Global Crisis' to Shipping industry**

Due to the global recession in shipping industry there was a downturn in the shipping business of your Company. This has led to lower capacity utilization and has adversely affected the operations of the Company. A combination of these factors has affected the liquidity of the Company and thereby facing problems in servicing the debt in timely manner. Further to this, the vessels are due for drydocking as it is mandatory requirement to drydock the vessels every two and half years. And hence are non operational till past more than a year resulting to a steep fall in the total operating income. Despite the loss of revenues, the Company was incurring fixed operating costs, including settlement of unpaid crew wages and seafarers repatriation. These fixed operating expenses in the form of employee cost, bunker cost and other fixed costs resulted to severe liquidity crisis to the Company and increase in the outstaying debts. Therefore in order for the Company to survive it was imperative to find the solution to service these huge debts. Further, the survival of the Company and resulting companies as result of the proposed demerger and merger, is very crucial as the shareholders of the Company will be receiving the shares of the resulting companies in exchange of their existing shareholding in the Company. If the Company is not revived then the shareholding value of the current shareholders of the Company will be completely eroded.

Therefore, with a view to revive the shipping business of the Company and the resulting Company namely Varun Resources Limited (VRL) and to enable VRL to survive, the Promoters (being the Yudhishtir D Khatau group) and the management together with our bankers (led by the State Bank of India) have decided to restructure the debts under the "Framework for Revitalising Distressed Assets in the Economy – Guidelines on Joint Lenders' Forum (JLF) and Corrective Action Plan (CAP)" issued by the Reserve Bank of India is vide its circular dated February 26, 2014, bearing number RBI/2013-14/503DBOD.BP.BC.No.97/ 21.04.132/2013-14, (hereinafter referred to as the "JLF Mechanism").

The various Joint Lenders Meetings held since 11.04.2014 based on the guidelines and RBI circulars on "Early Recognition of Financial Distress, Prompt, steps for Resolution and Fair Recovery for Lenders" under which the Reserve Bank of India has formulated the JLF Mechanism. The Joint Lenders Forum had decided to restructure the existing loan facilities and to provide incremental funding to the Company for revival of the business. The Bankers had appointed PwC, an independent agency to do Technical Evaluation Study to examine the viability of the business. Based on their viability report, forensic report and the subsequent clearance from Independent Evaluation Committee, it will be agreed by the joint lenders to restructure the account under JLF mechanism.

### **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 in the oil, gas and offshore support services sector.

According to market report, the steady relationship between the global GDP growth and sea-borne trade growth continued in 2014. According to the report of International Monetary Fund's April 2014, World Economic Outlook, looking ahead, global growth is projected to strengthen to 3.6 % in 2014 from 3% in 2013 and 3.9% in 2015. Growth is expected to increase to about 2.25% in 2014-15 in advanced economies, which is about 1% improvement compared with 2013. Main drivers are a reduction in fiscal tightening, except in Japan, and still highly accommodative monetary conditions. In emerging market and developing economies, growth is projected to pick up gradually from 4.7 % in 2013 to about 5% in 2014 and 5.25% in 2015. Growth will be helped by stronger external demand from advanced economies, but tighter financial conditions will dampen domestic demand growth.

According to the Market Report, the shipping market continues to face difficulty due to overcapacity and it is estimated that on an average there is about 25% more shipping capacity than demand. This overcapacity was created by over-enthusiastic ordering from 2004 to 2008 and again in 2013 as ship-owners attempt to build new, efficient and cheaper vessels to replace inefficient and obsolete older ships. The market for oil tankers is changing rapidly as global flows of oil are transformed by the advent of unconventional oil. United States of America's domestic crude oil production has displaced millions of barrels of crude oil imports. Some of that displaced crude oil is now refined closer to source in the Middle East and India, while some is shipped to a growing refining market in China. The change in oil trade has dampened demand growth for crude oil tankers, but has boosted demand growth for petroleum product tankers.

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 per cent 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.

#### **(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 4<sup>th</sup> 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 there are no separate reportable segments.

The Company together with its subsidiaries and associates, owns and/or operates a fleet of nine LPG carriers, including seven mid-size Gas Carriers (MGC's), one Large Gas Carrier (LGC). In the crude oil sector, as a ship manager, the Company operates three double hull Aframax crude oil tankers. In the offshore support services sector, as a ship manager, the company operates a fleet of five Anchor Handling Towing and Supply (AHTS) vessels.

(d) Outlook :

It is expected that 2014 will be another challenging year for world shipping markets. 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 conclusion, we foresee an oversupplied new building market in the coming year.

On the tanker markets, the supply side of the market, will be the biggest challenge as more fleet is scheduled to be delivered in the coming years. This will continue the downward pressure on fleet utilisation through 2014.

LPG demand growth has been strong in Asia and the Middle East and while Asia is the largest LPG consuming region, it is still expanding. The Middle East has become a significant LPG demand centre due to rapid expansion of petrochemical industry and continued growth in both residential and commercial sectors. Overall demand in Europe and North America is reasonably flat but could increase if price sensitive LPG supplies are available. Also, demand will continue to expand slowly in Latin America due to rising consumption in residential and commercial markets. In the LPG sector, the order book is balanced considering the increased LPG demand in Asia, Middle East and Latin America. It is therefore expected that the freight rates will remain firm.

On a global basis, OSV day rates and fleet utilization for OSVs are forecast to rise but will vary by asset and region.

(e) Risks and Concerns:

Shipping industry being global in nature is prone to several risks and uncertainties including international competition, state of global economy, marine mishaps and accidents, force majeure such as tsunami, floods, earthquakes, volcanic eruptions, etc., amendments in Government policies, rules and regulations, new regulatory compliances, port state control, increase

in financial costs, exchange rate fluctuations, changes in tax laws, acts of terrorism, wars, piracy, arrest of vessel by maritime claimants, shortage of qualified seafarers, global recession etc. Incidences of attack by pirates are still continuing. However, international forces including India are taking maximum measures to monitor and protect shipping companies.

The Company endeavours to counteract these risks by adopting certain measures like hedging its freight rates through long term time charter contracts and pool arrangements, complying with international ship management practices, and also insuring its vessels against various maritime risks with hull and machinery underwriters and Protection and Indemnity Clubs. The companies are also adopting "Best Management Practices" to counter piracy risks.

The Board of Directors periodically reviews and assesses the adequacy of risk assessment and minimisation procedures so that various risks can be assessed and minimised through well defined framework/procedures.

(f) Internal Control Systems and their adequacy :

The Company has proper and effective internal control systems commensurate with its size of operations in order to ensure that all systems and procedures are functioning satisfactorily. Internal audit function is carried out by the Chief Internal Auditor on a regular basis.

The Audit Committee of the Board of Directors regularly reviews the effectiveness and adequacy of the internal control systems to monitor due and proper implementation thereof and for due compliance with various applicable laws, rules and regulations, accounting standards and regulatory guidelines.

(g) Discussion on financial performance with respect to operational performance :

The details of the financial performance of the company have already been dealt with in the earlier part of the report.

(h) Human Resources :

The relations between the employees and the company remained cordial throughout the year. The committed shore based staff provides its prompt and efficient support and guidance to the floating staff on a continuous basis, which helps to maintain effective performance and operational efficiency at all times. The company continues to focus on safety and training and development of the employees.

(i) Social Responsibility:

As a socially responsible corporate citizen, the company continues to support a wide spectrum of community initiatives through NGOs as well as programmes for health, education and environment.

As required under Section 217(2AA) of the Companies Act, 1956, your Directors confirm to the best of their knowledge and belief that:

- i) in the preparation of the annual accounts, the applicable accounting standards have been followed;
- ii) the Directors have selected such accounting policies and applied them consistently and made judgements and estimates that are reasonable and prudent so as to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit or loss of the company for that period;
- iii) the Directors have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the Companies

Act, 1956 for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities; and

iv) the Directors have prepared the annual accounts on a going concern basis.

As required by the Listing Agreement with Stock Exchanges on which shares of the company are listed, a Report on Corporate Governance of the Company regarding compliance with Corporate Governance is attached to this report.

During the period Dr. A.K.Bhattacharya, Mr. C.M. Maniar and Mr. Khurshed M Thanawalla resigned from the directorship of the Company.

After the last Annual General Meeting, Ms. Armin Pardiwala was appointed as additional director. In terms of the provisions of the Companies Act she holds office until the date of the ensuing Annual General Meeting. Her appointment as ordinary Director of the Company is placed before the Members for consideration. The Board recommends the resolution for adoption by the members

Mr.Praveen Singh retires by rotation and being eligible, offer himself for re-appointment. Separate resolution is being proposed for his re-appointments.

You are requested to appoint Auditors of the company and fix their remuneration. The retiring Auditors Messrs. Sorab S. Engineer & Co. being eligible, offer themselves for re-appointment.

As required by Section 217(2A) of the Companies Act, 1956, read with Companies (Particulars of Employees) Rules, 1975, as amended, the names and other particulars of the employees are set out in the Annexure to the Directors' Report. However, as per the provisions of Section 219(1)(b)(iv) of the Companies Act, 1956, the Report and the Accounts are being sent to all shareholders of the company excluding the aforesaid information. Any shareholder interested in obtaining such particulars may write to the Secretarial Department at the registered office of the Company.

Your Directors express their thanks to all the officers of the Ministry of Shipping, Directorate General of Shipping, Ministry of Petroleum and Natural Gas, Indian Navy, Indian Coast Guard, Mercantile Marine Department, Class, oil companies and charterers for the valuable help and co-operation extended by them to the Company. Your Directors also thank the banks for their continued support to the Company. Your Directors also thank the shareholders of the Company for their sustained confidence reposed in the Company and its management. Last but not the least, your Directors express their deep appreciation for the sincere and hard work put in by the floating as well as the shore based officers and staff of the Company.

On behalf of the Board of Directors

**YUDHISHTHIR D. KHATAU**

*Chairman and Managing Director*

*Mumbai, 30<sup>th</sup> May 2014*

## CORPORATE GOVERNANCE REPORT

### 1. Company's Philosophy on Code of Governance

Corporate Governance is a combination of voluntary practices and compliance with laws and regulations leading to effective control and management of the Company. The Company believes that good corporate governance contemplates that corporate actions balance the interests of all stakeholders and satisfy the tests of accountability, transparency and fair play. The Company believes that all its operations and actions must be directed towards enhancing overall shareholder value.

### 2. Board of Directors

The composition of the Board of Directors, attendance of Board of Directors at Board Meetings and Annual General Meeting and other relevant details are given below:

Name of the Director	Category	No. of Board meetings attended	Attendance at the previous Annual General Meeting held on 04.02.2013	No. of other Directorships *	No. of memberships of other Board Committees **	No. of other Committees of which the Director is a Chairperson **
Mr.Yudhishthir D. Khatau	Promoter Executive	7	Present	15	Nil	Nil
Mr.C.M.Maniar***	Independent Non-Executive	4	Present	15	8	Nil
Mr.Praveen Singh	Independent Non-Executive	4	Present	1	Nil	Nil
Dr.A.K.Bhattacharya@	Independent Non-Executive	3	Present	Nil	Nil	Nil
Mr.Khurshed M. Thanawalla #	Independent Non-Executive	7	Present	11	4	2
Ms. Armin Pardiwala ^	Independent Non-Executive	4		4	Nil	Nil

\*Includes directorships in private limited companies, foreign companies and companies under Section 25 of the Companies Act, 1956, but excludes alternate directorships. Number of directorships is as at 31<sup>st</sup> March, 2014

\*\* Only covers membership/chairmanship of Audit Committee and Shareholders/Investors Grievance Committee.

\*\*\* Resigned from the directorship w.e.f 29<sup>th</sup> July, 2013

@ Resigned from the directorship w.e.f 10<sup>th</sup> May, 2013

# Resigned from the directorship w.e.f. 30<sup>th</sup> March, 2014

^ Appointed as Additional Director w.e.f. 29<sup>th</sup> July, 2013.

During the 18 months period ended 31<sup>st</sup> March, 2014, seven Board meetings were held on 29<sup>th</sup> November, 2012, 04<sup>th</sup> February, 2013, 10<sup>th</sup> May, 2013, 29<sup>th</sup> July, 2013, 14<sup>th</sup> August, 2013, 13<sup>th</sup> November, 2013 and 13<sup>th</sup> February, 2014.

### 3. Audit Committee

The terms of reference of the Audit Committee are given below:

- To have discussions with the auditors periodically about internal control systems, the scope of audit including the observations of the auditors and review the half yearly and annual financial statements before submission to the Board



and ensure compliance of internal control systems.

2. To oversee the Company's financial reporting process and the disclosure of its financial information to ensure that the financial statement is correct, sufficient and credible.
3. Recommending to the Board, the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees.
4. Approval of payment to statutory auditors for any other services rendered by the statutory auditors.
5. Reviewing, with the management, the annual financial statements before submission to the Board for approval, with particular reference to:
  - a) Matters required to be included in the Director's Responsibility Statement to be included in the Board's report in terms of clause (2AA) of Section 217 of the Companies Act, 1956.
  - b) Changes, if any, in accounting policies and practices and reasons for the same.
  - c) Major accounting entries involving estimates based on the exercise of judgement by management.
  - d) Significant adjustments made in the financial statements arising out of audit findings.
  - e) Compliance with listing and other legal requirements relating to financial statements.
  - f) Disclosure of any related party transactions.
  - g) Qualifications in the draft audit report.
6. Reviewing, with the management, the quarterly financial statements before submission to the Board for approval.
7. Reviewing, with the management, the statement of uses/application of funds raised through an issue (public issue, rights issue, preferential issue, etc.), the statement of funds utilized for purposes other than those stated in the offer document/prospectus/notice and the report submitted by the monitoring agency monitoring the utilization of proceeds of a public or rights issue, and making appropriate recommendations to the Board to take up steps in this matter.
8. Reviewing or approving all related party transactions to ensure they are conducted on an arm's length basis, that is, the transaction terms and prices are not more favourable to the related party than if they were transacted with a third party and will not be prejudicial to the interest of Company and its minority shareholders.
9. Reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems.
10. Reviewing the adequacy of internal audit function, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit.
11. Discussion with internal auditors on any significant findings and follow up there on.
12. Reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the Board.
13. Discussion with statutory auditors before the audit commences, about the nature and scope of audit as well as post-audit discussion to ascertain any area of concern.
14. To look into the reasons for substantial defaults in the payment to the depositors, debentureholders, shareholders (in case of non payment of declared dividends) and creditors.

15. To review :
- Management discussion and analysis of financial condition and results of operations;
  - Statement of significant related party transactions (as defined by the audit committee), submitted by management;
  - Management letters/letters of internal control weaknesses issued by the statutory auditors;
  - Internal audit reports relating to internal control weaknesses; and
  - The appointment, removal and terms of remuneration of the chief internal auditor.
16. To review the financial statements, in particular the investments made by the unlisted subsidiary company, if any.
17. To approve appointment of Chief Financial Officer (CFO) (i.e. the whole-time Finance Director or any other person heading the finance function or discharging that function) after assessing the qualifications, experience and background, etc. of the candidate.

The Audit Committee comprises of independent non-executive Directors namely Mr.Praveen Singh, Ms. Armin Pardiwala and Mr Khurshed M. Thanawalla (till 30<sup>th</sup> March 2014) and the members meet the requirements of clause 49 of the Listing Agreement. Mr.Praveen Singh is the Chairman of the Audit Committee. Ms Armin Pardiwala was appointed as member of the Audit Committee at the Board meeting held on 29<sup>th</sup> July, 2013.

During the 18 months period ended 31<sup>st</sup> March, 2014, six Audit Committee Meetings were held on 29<sup>th</sup> November, 2012, 04<sup>th</sup> February, 2013, 10<sup>th</sup> May, 2013, 14<sup>th</sup> August, 2013, 13<sup>th</sup> November, 2013 and 13<sup>th</sup> February, 2014.

Name of the Director	Category	No. of Audit Committee meetings attended
Mr.C.M.Maniar***	Independent Non-Executive	3
Mr.Praveen Singh	Independent Non-Executive	3
Dr.A.K.Bhattacharya@	Independent Non-Executive	2
Mr.Khurshed M. Thanawalla #	Independent Non-Executive	6
Ms. Armin Pardiwala ^	Independent Non-Executive	4

\*\*\* Resigned from the directorship w.e.f 29<sup>th</sup> July, 2013

@ Resigned from the directorship w.e.f 10<sup>th</sup> May, 2013

# Resigned from the directorship w.e.f. 30<sup>th</sup> March, 2014

^ Appointed as Additional Director w.e.f. 29<sup>th</sup> July, 2013

#### 4. **Remuneration Committee**

The Remuneration Committee comprises of independent non-executive Directors, namely, Mr.Praveen Singh, Mr Khurshed M. Thanawalla (till 30<sup>th</sup> March 2014) and Ms. Armin Pardiwala. The Chairman of the Committee is Mr.Praveen Singh. During the 18 months period ended 31<sup>st</sup> March, 2014 no Remuneration Committee meeting was held.

The Remuneration Committee inter-alia determines the company policy on specific remuneration package for Executive Directors including pension rights and any compensation payment.

The remuneration of the Executive Directors is decided by the Board of Directors based on the recommendation of the Remuneration Committee.

The Company has no pecuniary relationship or transactions with its non-executive Directors other than payment of sitting fees to them for attending Board and Committee meetings, payment of commission, if any, which has been approved by the