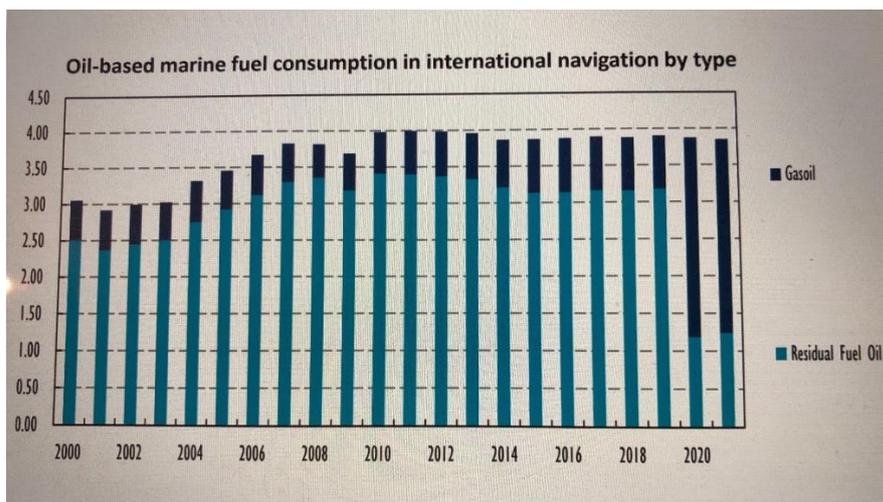


IMO2020

Being keen to hear updated views from this side of the pond, I attended a dinner with Norwegian shipping executives in Oslo on my return from Asia. The difference in views between West and East on the new IMO sulphur cap being implemented Jan 2020 is striking. Asian executives are generally of the opinion that it's the refiners job to secure availability of relevant fuel and that it's up to the clients to bear the cost if they want to reduce sulphur emissions (ie scrubbers). Western executives (Norway/US, at least) are far more forward leaning on the issue, thinking there could be tight supply of low sulphur fuel (<0,5% sulphur), thus scrambling to have scrubbers installed. The thinking is that the current \$250-300/mt spread between low sulphur MGO and HSFO will widen going into 2020 as MGO will be in demand while HSFO will approach coal parity as refiners will be left with an abundance of sulphur rich resid fuel. With scrubbers being «cheap» (anticipated payback between 0.5 and 1 year on current spreads depending on vessel type), the investment proposition in their mind is a no-brainer. A.o Star Bulkers is a strong advocate, having decided to retrofit their entire 115 vessel strong fleet with scrubbers.

Looking at IEA's report on the issue, one understands why. Marine fuel consumption constitutes around 3,8mb/d today, with low-sulphur gasoil approx 600kb/d. At current installation rate, scrubbers looks set to take approx 600kb/d. That leaves around 2,6mb of HFO looking for alternative demand.

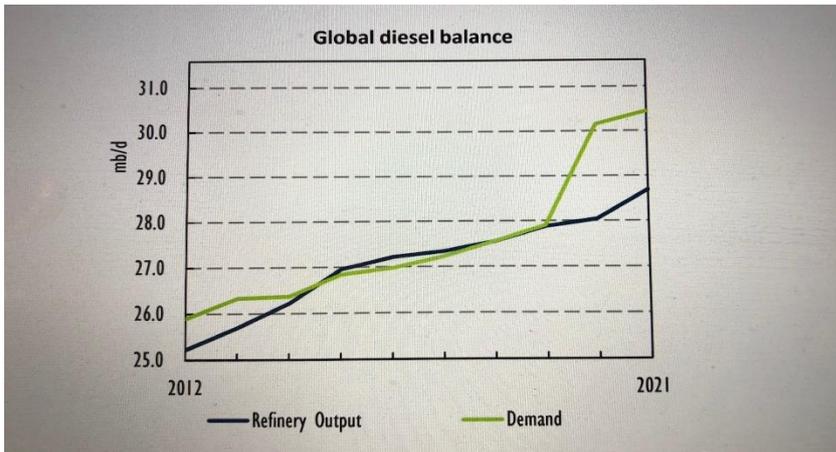


Source: IEA

The key question is: how much of the 2,6mb/d can be converted to (usable) blended fuel? IEA's own forecast (chart below) of total (not only marine use) refinery output lends credibility to the concerns Western shipping executives have. Some refiners, like Exxon and Shell, have recently announced availability of low sulphur fuels to be the same as HFO today. But that is not to say all refiners will. Or that the blended versions are indeed functionable. Reports on ships moving alongside to have their tanks cleaned following blended fuelling continues to pop up, and we know it will take time for the refiners to expand capacity.

The Harpoon Report

Hunting for value



Source: IEA

In short, based on IEA's numbers, there is a looming shortage of diesel come January 2020. The beauty of getting positioned now is that even if you think there is a risk the Asians may be right (they constitute the bigger buyers of marine fuel oil worldwide), very little is yet discounted. Neither in the products markets nor the shipping companies.



Source: Vistin Trading

The chart above is from Torbjørn Kjus in Vistin Trading. Torbjørn left his well-paid job as a top-ranked oil analyst with DNB in Oslo to pursue trading oil for Vistin ahead of the IMO 2020. That is called conviction. He is looking for the spread to widen significantly from here, and it may well be that Torbjørn is right in his call that we will see a 2008 replay of a diesel-driven rally in the oil market. I am thinking MGO/HFO well north of \$600/mt and Brent well into the triple digits. Very little seems discounted today, probably due to lack of liquidity out on the curve. Come Q1 2019 and I expect we'll see some more positioning here, giving a more representative picture on what to expect. Risk/reward looks unusually compelling, as little has been discounted and the upside looks very large.

Ways to play: the most straightforward exposures are found in commodities, e.g by going long MGO and short HFO and other spreads. The problem here is to find liquidity. Looking at the

The Harpoon Report

Hunting for value

shippers, a two tier market should develop between the have`s and the have not`s, with the have not`s probably forced to reduce speed as fuel costs rise. That will benefit the whole fleet. I would therefore be careful in taking the approach of some hedgies out there, in going long the scrubber-rich companies and short the have not`s. Rather, I`m looking for rates for the whole space to move up as slow-steaming sets in and more ships are found longside to install scrubbers, likely lifting all boats (pun not intended) and their respective equities. As the have`s will see an additional uplift on their scrubberinvestments, I`d go with these. I`ve calculated some potential NPV gains on some of the players following their scrubber decisions; suffice here to say that DHT, STNG and Hunter are my current favourite ways to play. Watch this space for additional ways to get exposure to the theme.

Oslo, 14102018

Ståle Rodahl.