TANKERS – TIME`S UP

With rates having crashed amidst the expected Q1 lull https://harpooncapital.no/resources/SHIPPING%20MUSINGS.pdf and some brokers pitching the crude tanker names as shorts as the stocks/rates shark jaw develops, it is time to start getting involved again. From the long side. There has seldom been a better setup for the tanker industry and investors ought to pay attention. Having added BWLPG to the position list a couple of weeks ago, I add DHT and Scorpio this week.

The seasonal downturn has played out largely as expected, but with 3 notable exceptions:

1) VLCC rates looks to be bottoming out at a higher than expected level, not trading below $20k for q1 (a $30k drop from Q4 highs) with an average of $29k for the quarter as US exports almost doubled on Q118. With Clarksons reporting rates down 50% to $12k over the last week, below all-in breakevens for the industry, the trough is now in sight.
2) LNG rates came off more than expected seasonally, as El Nino took the peak off demand this winter, now trading below last year's levels.
3) LPG rates have picked up both sooner and stronger than expected on the heels of Mariner East 2.

Still, the stocks have refused to drop much during the seasonal slide, and even though the Asian refiners maintenance ramp will last another 6-8 weeks resulting in continued pressure on VL rates in particular, my own view is that the risk of missing out is now bigger than the risk of buying too early as every week brings us closer to the seasonal window shutting ahead of the 2H IMO 2020 ramp. Recent meetings with Scorpio Tankers, Frontline, BWLPG and Flex LNG have strengthened this view.

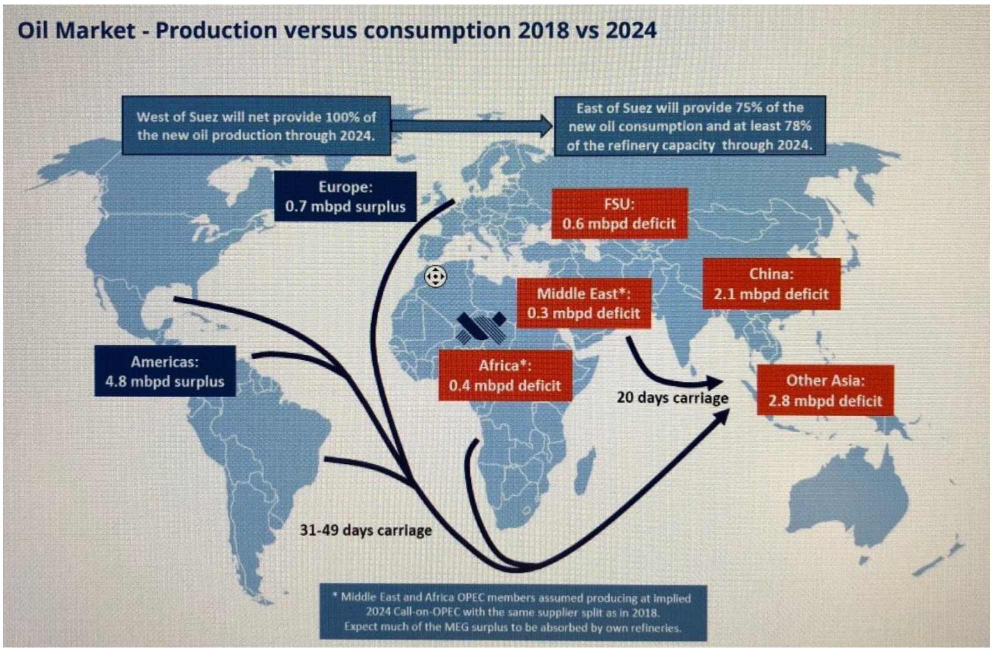
The timing argument is supported by the divergence between asset values and rates over the last few weeks, with Fearnleys taking up its estimate of tanker resale values by 4pc last week even as rates are down >40pc for the qtr. Maybe investors should consider adopting JF`s focus on asset prices rather than rates when timing the sector? Frontline and Scorpio Tankers NAV`s jumps almost 10pc as a consequence this week.

TANK

	P/NAV	**EV/GAV**
STNG	0,7	0,9
DHT	0,9	0,9
FRO	1,3	1,1

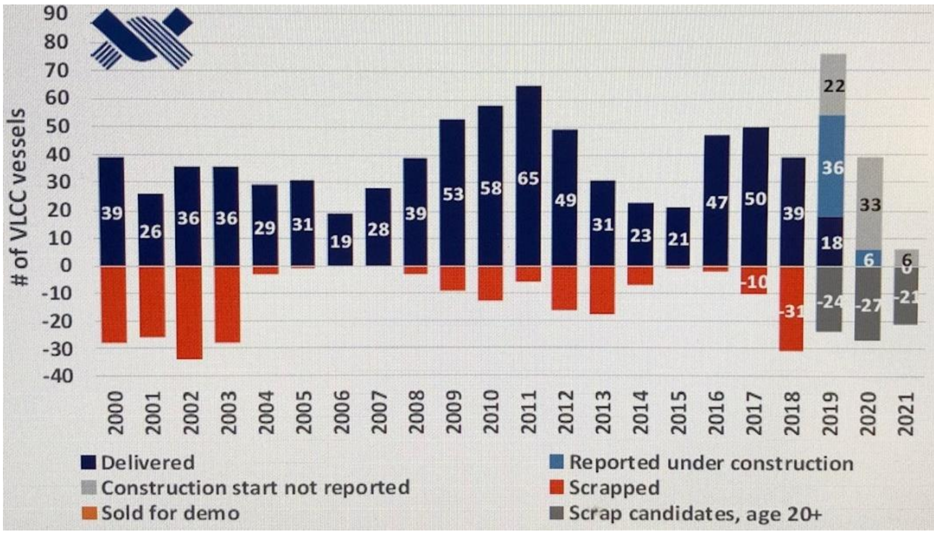
My preferred way to position for the upcoming tanker boom are the 3 names above, where Scorpio comes out on top as the quintessential IMO2020 play. But, first things first; following the refinery maintenance season crude needs to be moved first, kickstarting VL rates probably already this summer as the effects of the IMO 2020 regime starts in earnest with record volumes of crude runs ahead of the q4 extensive cleaning&bunkering operations currently being planned on non-scrubber vessels. DHT, FRO and EURN should be the first ones to benefit, with DHT on top due to pricing and scrubber exposure.

Also, the effect of changed trade flows (ie US to Asia) is here to stay as the booming US oil supply meets demand in Asia. The 1,2mbd or so growth in q1 has increased demand for VL`s by around 45 vessels. EIA forecasts US export of 7mbd by 2021. That means more than 180 extra VLCC`s assuming all goes to Asia, calculating from q1 19 demand – a cool 24pc of the VL fleet. As LOOP is the only loading alternative at the moment I don`t expect that to happen anytime soon, but dredging projects outside Galveston a.o are in progress and will certainly add capacity going forward. It will be interesting to see how this will play out in the 2H when the Saudis are likely to return with more volumes.



Source: Fearnleys

While some analysts still have concerns over the orderbook, I would take a different view as a consequence of IMO. As much as 5-6pc of the fleet will be out of service installing scrubbers, BWTS and cleaning tanks to handle compliant fuel in Q4. E.g; assuming all non-scrubber vessels are out for 5-7 days in Q4 cleaning tanks adds as much as 4pc to utilisation alone, according to calculations made by DNB. Of the 78 vessels due for delivery in 2019, this is enough to match the remaining deliveries considering 25 or so are already on the water. And then there is scrapping.. Going into 2020 more than 40 VL`s will be above 20yrs and will probably not make it through the next survey. In sum, supply does not seem to be much to worry about. On the contrary.



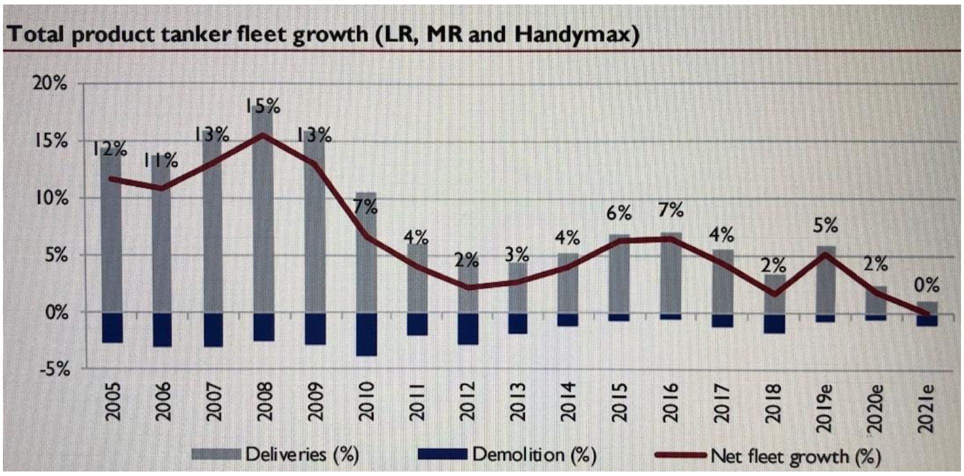
Source: Fearnleys

While JF`s focus is on the VL`s due to its much larger volatility and faster pay-off at peaks, I am thinking the product tankers will be the top performing segment in the coming upturn due to the increased demand from IMO 2020 through consumption and resultant trade volumes of MGO and LSFO blends. Scorpio e.g referred to some trades taking place already that they`ve never witnessed before (such as Australia to Norway). Back of envelope on VL`s vs product:

USD	**2008 peak**	**OPEX**	**CF**	**NB**	**Payback yrs**
VLCC	90kpd	9kbd	26m	91m	3,5
LR2	42kpd	7,5kpd	11m	51m	4,7

With demand for product tankers being fairly balanced already in Q1 with rates around $24k/day and an orderbook at it`s lowest level since 2000 effectively promising net fleet growth of zero as soon as next year, products looks like the IMO 2020 winner. How much demand will be up is anybody's guess given the complexity and multitude of trades, but doubling the last 20 yrs average of 3,7pc ought not to be especially aggressive. In sum, I would not be surprised to see rates overshoot on the 2008 high and, importantly, also on the 2008 relative vs VL`s. Rates back to the 2008 peak means approx $1,1bn in EBITDA on Scorpios own $1,5bn revenue number, implying 3,5 x EV/EBITDA and a P/E of 1,5x. Divi potential around $250m or 25% on current mrk cap. Every 10k/d on top of that adds a hefty $434m, easily paying back it`s EV in 2,5 years.

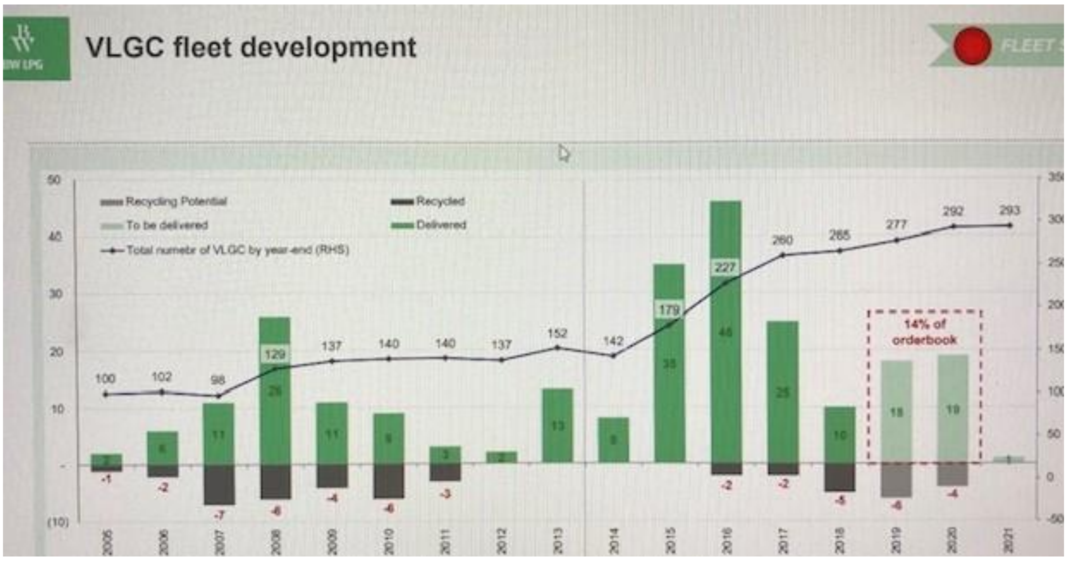
The elevated scrapping and increased refinery runs on the heels of IMO 2020 is just too good to ignore. A lot of investors are lining up to buy this in May/June as the seasonal weakness ends. I`d rather buy ahead of them. Pinpointing potential returns is a moving target depending on how high rates go; I wouldn`t sell a single stock in Scorpio below $40, DHT $8, FRO NOK90.



Source: Carnegie

LPG

With LPG rates up 200pc over the last month, the VLGC`s are returning cash to its owners for the first time in 3 years. This has coincided with the monthly number of cargoes from Marcus Hook going from 2-3 in the first couple of months this year to 8 in March helped by the start of the Mariner East 2 pipeline, with a potential 10/month if all LPG export. That ought to take the number of cargoes from the US up from 50+ per month to above 60, which ought to help balance the market in the near term. Further expansion of Targa and Enterprise will add to this in q2 and q3.



Source: BWLPG

With the order book coming down to a manageable 13% of the fleet, the LPG trade is thus beginning to look attractive again as the US shale boom secures further growth in volumes to the gas-starved Asian markets. Sure, the delivery boom in 2015-17 led to a an almost doubling of the VLGC fleet in a few years and effectively killed the profitability of the ship owners for a period, but that has been matched now by a 150pc increase in US export capacity. As US propane inventories are up more than 50pc from last year's levels and domestic demand is estimated to stay flat going forward while Far East prices are supported by the rally in Brent, , the arbitrage between Far East propane and Mount Belvieu may stay open, driving rates beyond the current industry cash breakeven of $20k+.

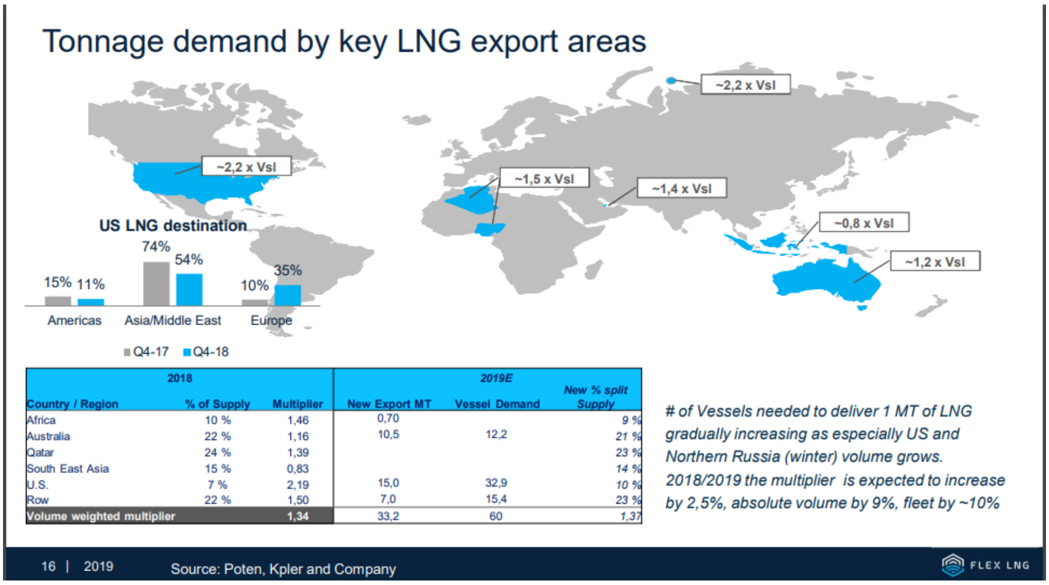
BWLPG NO at P/NAV 0.7 and EV/GAV of 0.9 is my preferred way to play. The runup to the summer market is more promising than we have seen in years. If owners manage to refrain from ordering much more now, the upside in rates further out is large, warranting more than a doubling in BWLPG based on asset values. Also, I like the Trade Finance operation recently set up, as it will allow the company to gain a better understanding of the economics facing the large traders while providing some optionality into both improving its own utilisation metrics and ability to play for the arbitrage economics. No reason for BW to be shy about it; returns for the pure shippers have been too low for too long.

While the stock is already up some since I included it in the position list a couple of weeks ago, the momentum in rates is on and I`d continue to buy at any price in the 30`s.

Source: Bloomberg

LNG

The LNG market this winter was all about a hefty run-up as especially China was scrambling to secure enough volumes ahead of the winter season, only to come crashing to the ground as El Nino took temperatures up to record highs, tempering Asian demand. As usual, investors seem to think that the current seasonal low will persist. That creates a buying opportunity as the relentless growth in Asian LNG demand continues with supply coming largely from the US.



2018			2019E		
Country / Region	% of Supply	Multiplier	New Export MT	Vessel Demand	New % split Supply
Africa	10 %	1,46	0,70		9 %
Australia	22 %	1,16	10,5	12,2	21 %
Qatar	24 %	1,39			23 %
South East Asia	15 %	0,83			14 %
U.S.	7 %	2,19	15,0	32,9	10 %
Row	22 %	1,50	7,0	15,4	23 %
Volume weighted multiplier		1,34	33,2	60	1,37

Source: Flex LNG

Meanwhile, Flex has spent the winter well, securing a 12mth time charter with a supermajor with a variable rate linked to spot. The best of both worlds, securing utilisation in a slow seasonal market while being exposed to spot as rates move up beginning Q3 when the Chinese are back. Furthermore, the company has filed for a NYSE listing. A promising move considering US investors propensity to price on yield. At $125k per day (200k briefly q4 19) there will be enough yield with a mrk cap/CF after interest of 1,5.

You`ve got 4 months until rates start moving again. Pay attention to the 116 level. Target 240-320.

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