Event Update

Product tanker equities: The road ahead

06 September 2021

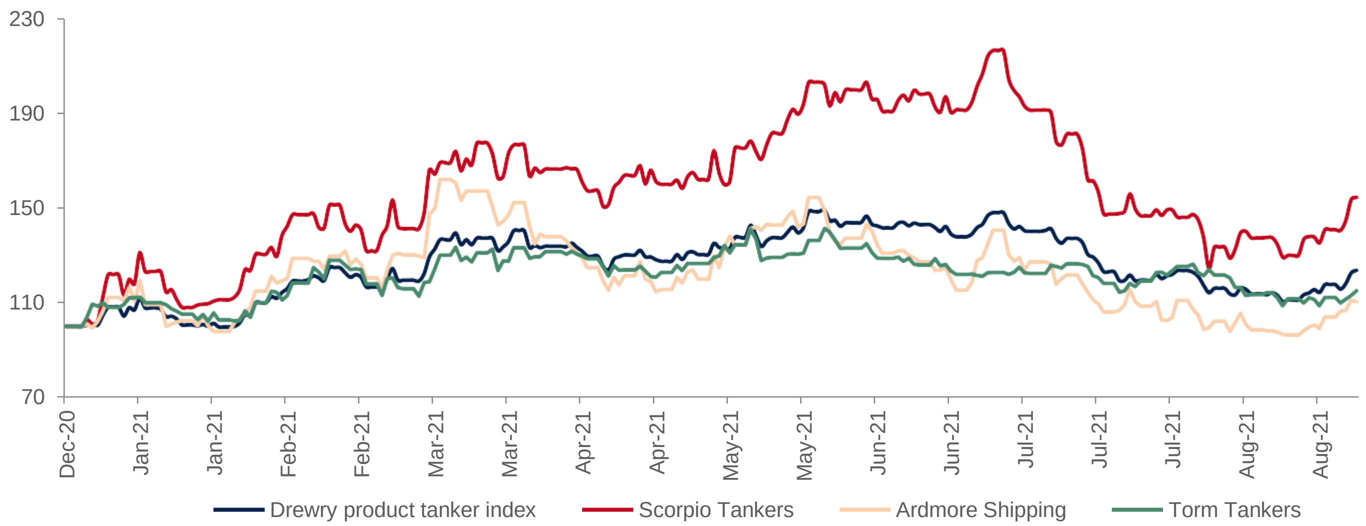
The product tanker shipping market has been volatile since April 2020 with rising Covid cases in several countries. Average product tanker earnings jumped by 97% MoM in April 2020 with average MR TCE rates surpassing USD 60,000pd and average LR2 spot TCE rates on TC1 Route (Ras Tanura-Yokohama) at USD 102,300pd. The supply-demand dynamics of product tankers changed dramatically in the following months as key crude oil producers and refineries adjusted their output and operations to prevent any further supply glut which also facilitated inventory drawdown in 2H20. Accordingly, spot TCE earnings were on a sharp decline across vessel classes in 2H20 and average product tanker earnings slumped by 85% between April and December 2020. MR TCE rates averaged USD 12,300pd and LR2 rates on TC1 averaged USD 11,400pd in December 2020.

Similarly, product tanker shipping stocks oscillated wildly in the first four months of 2020 marked by the initial decline, but thereafter posted gains in April 2020. However, capital gains in the initial months of the pandemic were not sustainable and stock prices soon declined to 52-week lows in 4Q20 – generally considered a seasonally strong period for the sector.

The volatile stock trend continued in 2021 with upside until June due to supporting trade and a downside thereafter, primarily driven by the re-emergence of Covid variants. Blockage of Suez Canal in late March and a ransomware cyberattack on the Colonial Pipeline on USEC in the first half of May also supported vessel earnings on some key routes which led to spikes in stock prices in 1H21.

The chart below shows the trend of three US-listed product tanker shipping stocks - Ardmore Shipping (ASC), Scorpio Tankers (STNG) and Torm PLC (TRMD). The stock prices of these companies are closer to the mid points of their 52-week highs with the latest financial results being the key driver. On 27 July, ASC reported its 2Q21 results, following which the stock remained range-bound between USD 3.15 and USD 3.65, in line with MR spot TCE rates in the past two months, but ASC's stock was 13% up over the past one month. STNG declared its 2Q21 results on 5 August which led to the 7% gain in the stock price on the next day. The company's stock moved up by 23% since it announced its 2Q21 financial results. TRMD posted its 2Q21 financial results on 10 August after which the company's stock price was stable, but over the past three weeks it has largely been declining.

Figure 1 Product tanker companies' stock price performance



Note: Indexed to 31 December 2020
Source: NYSE, DMFR

Product tanker equities: The road ahead

What could drive the product tanker stock prices?

1. Recovery in demand

Over the next couple of months, we do not rule out any decline in the stock prices of these companies on account of seasonal weakness and demand concerns amid rising Covid cases in major economies. However, we believe the worst is over for product tanker companies with the rollout of several vaccines and an increased vaccination drive supporting the uptrend in global oil consumption and trade.

The demand for gasoline, gasoil and naphtha is already close to the pre-pandemic levels, whereas that of jet fuel is still nearly 32% lower because of restrictions on international travel. We expect demand and trade of refined products including jet fuel to recover over the next 18 months due to vaccination drives, overall recovery in the global economy and easing restrictions on international air travel. OECD inventory of crude oil and refined products dropped below the pre-Covid 2015-19 average indicating very limited scope for further inventory drawdown. Accordingly, increasing consumption and trade of refined petroleum products are expected to support vessel earnings which will provide the much-needed push to product tanker shipping companies over the next one year.

2. Changing strategies

Ardmore Shipping (ASC) – New partnerships could be value accretive

a. Partnerships based on non-fossil fuel cargoes

Ardmore Shipping owns and operates a fleet of 19 MR and 6 Handy vessels which operate in product and chemical markets. In March, the company announced a new partnership with Carl Buettner and took the commercial management of four chemical tankers on behalf of the Bremen-based shipowner. The move has doubled the number of similar sized chemical tankers under ASC's management, leveraging the company's global platform and experience in the chemical and vegetable oil trades. The increasing focus on energy transition is driving greater demand for non-fossil cargoes. This move is aimed to cash in on the significant growth potential for more sustainable, non-fossil fuel cargoes that already account for 25% of ASC's business.

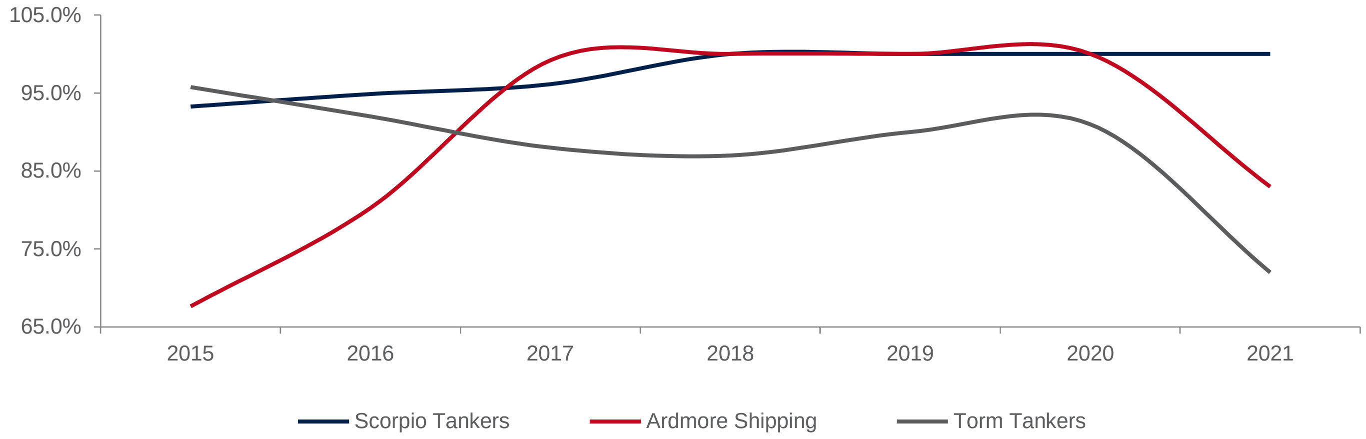
In June, ASC completed the formation of "e1 Marine" a joint venture with Element 1 Corporation and Maritime Partners LLC. Each partner owns 33.3% of the JV. Maritime Partners invested USD 40mn in perpetual preferred shares of ASC in two tranches. Additionally, ASC acquired a 10% equity stake in Element 1 Corporation in exchange for USD 4mn cash and 950,000 Ardmore's common shares at a total consideration of USD 11mn based on Ardmore's net asset value as of February 2021. The JV "e1 Marine" will be responsible for marketing, development, licensing and sale of Element 1's unique hydrogen generation systems for application in the marine industry including shipping, refrigerated containers, offshore energy, renewable energy, passenger and leisure, and certain port infrastructure and related applications.

Additionally, ASC entered into a contract with Lean Marine – a Swedish propulsion optimisation expert – to install the latter's FuelOpt propulsion optimisation technology across ASC's fleet after the success of the FuelOpt installation on MR Ardmore Sealion in 2020. ASC will complete installation of the system on all vessels in its fleet by end 2021. The system dynamically controls vessel propulsion based on set commands, matching the ships' propulsion power to the changing environmental conditions and eliminates costly variations in speed and output caused by human operational factors. FuelOpt installations will enhance the overall performance of ASC's fleet and help these vessels achieve more sustainable ship operations through lower fuel consumption and reduced emissions.

b. Transition from spot-only fleet to a mix of charter and spot

In 2Q21, 55% of ASC's fleet was deployed on East of Suez whereas the remaining 45% was operating on West of Suez. We expect the company to retain this ratio to maintain its presence in both markets. ASC's spot exposure moved up from 68% in 2015 to 100% in 2018 and thereafter remained at 100% until 2020, but for 2021, the company has locked in nearly 15.5% of its operating days on time charters. We expect the company to continue to explore attractive opportunities to lock in more vessels on time charter to improve its revenue visibility in the post-pandemic world.

Figure 2 **Spot exposure of product tanker companies**



Source: Company, DMFR

Table 1 **Ardmore's chartering strategy versus peers**

Company name	Charter type	2015	2016	2017	2018	2019	2020	2021
Ardmore Shipping	Time charter	32.4%	19.7%	0.8%	0.0%	0.0%	0.0%	15.5%
	Spot/pool	67.6%	80.3%	99.2%	100.0%	100.0%	100.0%	84.5%
Scorpio Tankers	Time charter	6.7%	5.1%	3.9%	4.0%	0.0%	0.0%	0.0%
	Spot/pool	93.3%	94.9%	96.1%	96.0%	100.0%	100.0%	100.0%
Torm Tankers	Time charter	4.2%	8.0%	12.0%	13.0%	10.0%	9.0%	28.0%
	Spot/pool	95.8%	92.0%	88.0%	87.0%	90.0%	91.0%	72.0%

Source: Company, DMFR

Scorpio Tankers (STNG)

a. Pool employment strategy

Scorpio Tankers (STNG), a leading product tanker company, has 131 wholly owned, finance leased or bareboat chartered-in tankers (42 LR2, 12 LR1, 63 MR and 14 Handymax), averaging 5.5 years. The company had very little exposure to the time charter market (6.7%) in 2015 which gradually reduced to no exposure in 2019. STNG is now operates its entire fleet in the spot market under various pools.

As of 6 September, all 130 on-the-water vessels in STNG's operating fleet operate in one of the Scorpio Pools. The company currently participates in four pools: Scorpio LR2 Pool, Scorpio LR1 Pool, Scorpio MR Pool and Scorpio Handymax Tanker Pool. These commercial pools offer customers greater flexibility and higher levels of service while helping STNG achieve scheduling efficiencies. The overall chartering mix of a company's fleet varies from time to time based on many factors including the management's view of the future market conditions. Although we do not rule out a few time charter fixtures by STNG in the near future, we believe the company will continue to focus on pool employment of most of its vessels in future as pool operations increase vessel utilisation and thereby revenues and profitability for vessel owners.

b. Scrubber investment will turn favourable with increase in fuel prices

STNG invested heavily on retrofitting scrubbers to its vessels. The company entered into agreements with third parties to purchase and install scrubbers on 98 vessels at a cost of USD 2.5mn per vessel. The company will finance scrubber installation through new loan facilities, increases in current loan facilities and working capital. Additionally, all 19 vessels acquired from Trafigura in 2019 were scrubber fitted upon acquisition. Although scrubber investment had lost its advantage in the beginning of 2020 because of reduced price differential between LSFO and HSFO, the rally in crude prices over the past nine months and increasing demand for shipping fuel, has taken the fuel price differential up to ~USD 100 per tonne making it an attractive investment for Scorpio Tankers. On 4 August, scrubber installation was completed on 98 vessels and the company aims to complete the installation on the remaining19 vessels by the beginning of 2022.

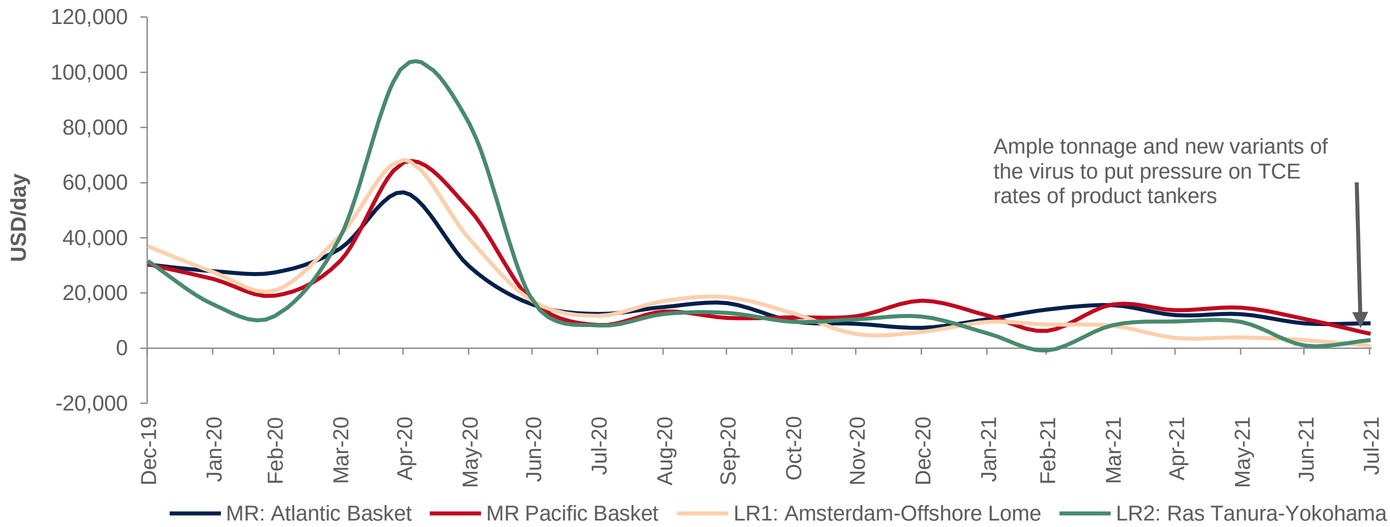
Torm PLC

a. Shifting focus on time charter contracts

Torm PLC (TRMD) is a Denmark-based product tanker shipping company that owns and operates a fleet of 85 (15 LR2, 9 LR1, 59 MR and 2 Handy) vessels. The main activity of the company is the transportation of refined petroleum products, such as gasoline, gasoil, jet fuel and naphtha, and occasionally dirty petroleum products, such as fuel oil. TRMD has an in-house operating and management platform for commercial, administrative and technical management of its vessels.

TRMD chartering mix indicates an average spot exposure of nearly 90% between 2015 and 2020. However, the company increased its exposure to time charter market in recent months and as of 10 August, 28% of its operating days for 2021 are locked on time charters. We expect the company to continue to lock in more vessels at attractive rates as and when such opportunities arise. The increasing exposure to time charter market will provide downside protection at a time when potential threats from new variants of Covid raise concerns on the pace of recovery in consumption and trade of refined products.

Figure 3 Timer charter equivalent rates of product tankers



Source: DMR, DMFR

b. Tilt towards scrubbers

TRMD plans to install scrubbers on 53 vessels, which account for nearly 62% of the company's fleet, to cash in on the benefits of the price differential between LSFO and HSFO. As of 10 August, the company has already completed the installation of scrubbers on 49 vessels and expects to complete the installation on the remaining four vessels by 1Q22. We believe these vessels will support the cash inflow for TRMD with increasing price differential on the back of higher crude oil prices and growing demand for shipping fuel.

Conclusion

The worst is over for the product tanker market, and we believe the market has bottomed out during late 2020 and early 2021. Barring jet fuel, the demand for gasoline, gasoil and naphtha is nearly close to their pre-pandemic levels. We expect the rollout of various vaccines and easing of restrictions to lead to higher consumption of cleaner fuel - supporting trade and earnings of product carriers. Additionally, refinery capacity of ~4.5 mbpd would be closed in 2020-21 in the net importing regions whereas new refining capacity of ~9.2 mbpd is expected to come online over the next five years. We believe refinery dislocation because of refinery closures in developed economies such as Europe, Australia and the US and upcoming export-oriented refineries in Asia and the Middle East will further support the tonne-mile demand of product tankers.

Disclaimer

Important information to recipients

Drewry Maritime Financial Research (DMFR) is the marketing name of Drewry Financial Research Services Ltd.

DFRS is incorporated in the UK and is authorised to provide investment advice in accordance with and pursuant to the UK Financial Services and Markets Act of 2000 (the "FSMA"). Drewry Financial Research Services Ltd is a wholly owned subsidiary of Drewry Shipping Consultants Holdings Limited, which as a group is focused on maritime research and advisory services.

Drewry Financial Research Services Ltd. is authorised by the Financial Conduct Authority (FCA).

Firm FCA Ref No - 572297

This email has been sent by Drewry Financial Research Services Ltd (DFRS or the "Company") solely for the DFRS clients who are qualified parties as per FSMA guidelines. Whilst the Company believes the information it uses for research is from sources believed to be reliable, the Company does not make any representation or warranty, express or implied, as to its accuracy, completeness, timeliness or correctness for any particular purpose. The opinions and estimates included herein reflect the analysts' views based on available information on the dates specified and these views may have changed without notice. Any recommendation contained herein does not have regard to the specific investment objectives, financial situation and the particular needs of any specific client. The information herein is published for clients only and is not to be taken in substitution for the exercise of judgement by the client, who should obtain separate legal or financial advice. The Company, or any of its related companies or any individuals connected with the Company, accepts no liability for any direct, special, indirect, consequential, incidental damages, or any other loss or damages of any kind arising from any use of the information herein (including any error, omission or misstatement herein, negligent or otherwise) or further communication thereof, even if the Company or any other person has been advised of the possibility thereof. The information herein is not to be construed as an offer or a solicitation of an offer to buy or sell any securities, futures, options or other financial instruments or to provide any investment advice or services. The Company and its associates, their directors, officers and employees may have positions or other interests in, and may effect transactions in, securities mentioned herein. DFRS does not seek to do business with any of the companies mentioned other than sell them these reports. However, other related parts of Drewry Shipping Consultants Holdings Limited may seek to provide "advisory services or the sale of other group research products" to companies mentioned in this report.

Drewry Maritime Financial Research
35-41 Folgate Street, London E1 6BX, United Kingdom
financialresearch@drewry.co.uk
Telephone: +44 20 7538 0191
Fax: +44 20 7987 9396

Event Update

Product tanker equities: The road ahead

06 September 2021

Jurisdictions

The distribution of this email is governed by the UK Financial Services and Markets Act of 2000 (the "FSMA") and is restricted to qualified parties as defined by the FSMA. The distribution of this email may be restricted by rules and regulations in certain jurisdictions. Persons into whose possession the email may come are required to inform themselves about and to comply with all applicable laws and regulations in force in any jurisdiction in or from which it invests or receives or possesses this email and must obtain any consent, approval or permission required under the laws and regulations in force in such jurisdiction.

For US Investors

Drewry Financial Research Services (DFRS or the "Company") is an independent research company and is not a registered investment adviser and is not acting as a broker dealer under any US federal or state securities laws. The Company does not provide individual investment advice or hold client money. As such, the Company is not required to be registered as an investment adviser.

Analyst certification

The research analyst(s) set out below certifies that a) all views expressed in this report accurately reflect his or her personal views about any and all of the securities or issuers and b) that no part of the analysts remuneration was, is, or will be directly or indirectly related to the specific implicit or explicit recommendations or views expressed by the research analyst(s) in this report.

Nikesh Shukla
Analyst – Tanker Shipping
nikesh@drewry.co.uk