Capital Link Shipping
Weekly Markets Report

Oil and Water

Contributed by

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It's been a while since I discussed the U.S. energy situation- the Jones Act, oil exports and all that. In the interim, the price of oil (which had been in free-fall) hit a bottom and has bounced upward; many commodity people view it as a bear trap or "dead cat" type of a bounce. After moving down to the low $40/barrel region (basis NYMEX oil), the price has bounced up to above $60/barrel (with the Brent oil- a marker for many international prices) typically at a $7 - $/8 barrel premium. Oil traders are closely watching the stats; certain pundits have suggested that renewed production (a response to the "rebound") will quickly quash the recent gains. In the past month or so, the prices have leveled out; perhaps we've reached a new "equilibrium"- some $40/ barrel below the old level where the market seemed to balance.

Several items got me back in the U.S. oil market mood. First- the aspirations of the Overseas Shipholding Group (with hedge funds now at the helm) to re-list on the NYSE are a reminder of how powerful a cash flow engine that tankers built and flagged in the U.S. can be. While the foreign flag market- where OSG vessels trade mainly spot, is doing just fine, thank you, the U.S. portion of the fleet was earning $35,000/day (tug- barges) to $58,000/day (tankers)- for an average time charter equivalent (TCE) around $49,000/day.

Secondly, from my perch in south Florida where "watching the Jones Act go by" is an avocation of sorts, the tanker "EAGLE FORD" (an ex SeaRiver vessel built in the late 1970s for the Alaska trades, now managed by Seabulk) was whizzing by at around 17 knots (according to my AIS screen) on a voyage from the U.S. Gulf of Mexico up to the Northeastern U.S. High speeds are indicative of the higher hires that vessels receive- usually hauling crude oil from Corpus Christi/ Houston range (rather than from the pipeline at Valdez).

Then, a day later, the tanker "CHEMICAL PIONEER" came past- on the way to its anchorage for discharging at nearby Port Everglades. This vessel, a tanker with numerous small tanks, with separate pumps, for literally dozens of cargoes (what shipping guys of a certain age used to call "drugstore tankers"), is owned by privately held US Shipping Corp, based in Edison, NJ- in the process of re-working some $225 million of credit facilities. Last week, Standard & Poors (S &P) upgraded the corporate credit rating from "B-" to "B". The new credit, to be senior and secured, gets a B+. Not bad, considering that this company had also seen financial difficulties before the revival in the U.S. tanker marketplace. U.S. based companies are able to take advantage of the Term Loan B marketplace, where investors are able to participate in the loan. Basically, the new financing will lengthen the maturity on an existing Term Loan B from 2018 out to 2021.

Over the next five years, the prospects for the U.S. tanker fleet are good. In their commentary, S&P offered that "… Our stable outlook on U.S. Shipping reflects our expectation that the company will continue to benefit from improved charter rates due to the strong domestic coastwise liquid marine transportation industry…" Of course, there is some caution here- the company is relatively small (seven vessels, compared with two dozen controlled by OSG), and if things cool down, reduced cash flows on vessel re-chartering could be the result.

The Jones Act mandates that coastwise cargoes (such as those visible to me and other Florida ship-spotters) must move on vessels built in U.S. yards, be crewed by U.S. sailors, and be owned by U.S. citizens. Backed by incumbent vessel owners, a coalition of shipyards and others (like railroads), it has political longevity- with some of its provisions dating back to 1920. Yet, there is always a chance that even more powerful interests, notably Big Oil- which backs the export of U.S. crude oil, might trade away some parts of the Jones Act if and when the political horse- trading begins.

Last month, a big energy confab brought about discussions of a resumption of U.S. oil exports (banned since the mid 1970s), favored by the big producers and opposed by the big refiners (who benefit from cheap U.S. crude oil and enjoy a nice arb when exporting refined products). Alaska's Senator Lisa Murkowski (representing the oil producer point of view) noted that ""We're looking at a lot of our energy policies right now, and then added that "I don't think we should get all agitated and upset when there's an effort to look at the Jones Act." Murkowski, along with a legislator from North Dakota (another large oil producer) has introduced a bill that would allow crude exports in a big way- without an explicit link to the flag of the vessel.

To put things in perspective, the cost savings from substituting foreign flag tonnage for Jones Act compliant traders may be diminished if the foreign market remains strong. Number crunchers can make the comparisons come out any way that they want, but let's just say that international flag MR product-hauling tankers (approximately 50,000 dwt tons) earning $25,000/day close the price gap (U.S. versus foreign) substantially. Or consider that a small Suezmax tanker (a competitor for the vessel "EAGLE FORD" mentioned earlier- switched to the East Coast with a diminished Alaska trade) could require $40,000/day worth of spend. Again, cheaper than a U.S. bottom, but with a cost that still must be reckoned.

But, the shipping picture is going to be driven by the bigger companies, and bigger reach of the oil market. In a very low priced oil environment (say back down around $40/barrel), U.S. producers will see exports as an additional demand outlet- one which will raise prices off a bottom. In such an environment, it's possibly that refiners would seek reductions (real or illusory) in coastwise shipping costs. Conversely, if the oil Gods- motivated by geopolitical factors way beyond Bakken or Eagle Ford, Texas, bring about a move up north of $80/ barrel, then U.S producers will no longer be clamoring for exports (and the Jones Act will live to see many more days).