Midpoints, arbitrages and harbor rats prowling the docks

Contributed by

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Capital Link held its sixth Global Commodities, Energy and Freight Forum last week, which provided a broad overview of the shipping markets, with some insights along the way into regulatory and legal matters surrounding them. Though always well attended and excellent for networking, the wide spectrum of expert market views offered much food for thought (and grist for writers), but did not provided any precise guidance on market directions. After all, if we knew exactly what was going to happen, then…(readers can fill in the blanks).

An excellent overview of what might happen came at the end of the day. A panel of equity analysts was superbly moderated by Norton Rose Fulbright lawyer Brian Devine, following a triad of panels on drybulk, tankers and containers. Ultimately, shipping is an asset players' game- a point brought home in various ways during the forum. Mike Webber, equity analyst for Wells Fargo, reminded the audience that owners' successes, or not, in delivering earnings to share buyers depends on their market entry point, ie whether they acquired tonnage at attractive points in the market cycle. On the tanker panel, Bob Burke- from the very acquisitive Ridgebury tankers, expressed gratitude that his firm's purchases (mainly in the Suezmax size class) were consummated just prior to what has seemed to be an upward trajectory in the relevant sector. Noting that Ridgebury is backed by Riverstone, a prominent private equity fund, Burke said that PE gets in as the cycle cranks up, and then eases out- and capital markets take over, as the cycle gets past its midpoint.

Shares analyst Fotis Giannakoulis, from Morgan Stanley continued to voice a very cautious view on the product tanker markets. Mr. Giannakoulis is to be credited for taking a "let's see" approach even last year, when the marketplace was full of enthusiasm for MR tankers, even amidst an ordering binge in S. Korean yards, with a few Chinese and Japanese newbuilds thrown in for good measure. This year, in defining the main criterion for a healthy product tanker market, he said "…it will depend on product shipments in the Atlantic…".

This was consistent with the of tanker analyst Court Smith- who recently joined broker stalwart MJLF. Mr. Smith told the audience (at the same panel where Mr. Burke participated), "…the MR fundamentals don't look so good", and that "…we are not seeing U.S. exports driving the market." At this time in 2013, a year ago, the TC 14 Houston to ARA route was booming as middle distillate (diesel) was exported- hitting upside resistance around $18,000/day. Fast forward a year, when daily hires on the outbound run were equating to around $0/ day, according to Baltic Exchange calculations. Mr. Smith described the LR1 sector (larger tankers hauling products) as "doing much better." Analyst Jon Chappell, from Evercore, highlighted Tsakos Energy Navigation ("TNP") as his top stock pick, citing a shrinking vessel supply in the Suezmax and Aframax sectors. We should note that the tanker panel was superbly chaired by Jeff Goetz, Managing Director at Poten & Partners, which recently authored an excellent paper on potential disruptions in Aframax and VLCC trades if the ownership of the PDVSA refineries in Venezuela changes hands.

LNG, where firms like Dynagas participate, was touted heavily by the analysts. Morgan Stanley's Mr. Giannakoulis noted his firm's steadily increasing price targets on Golar LNG ("GLNG"), and opined that this company's "…new <FLNG> technology could be ground-breaking." Evercore's Jon Chappell, also very bullish on gas transporters, described the market for LNG spot fixtures as being "…a near term wreck…for the next 12 – 24 months...," but he pointed to strength later in the decade as liquefaction projects came on stream to soak up the present vessel supply bubble.

Views on the container sector dominated the conversations at the analyst session. Credit Suisse's Greg Lewis cited recent fixtures at what he called "substandard rates" by one listed owner of ships chartered to liner operators, and said, "…there's a reason why sentiment is bad…" Evercore's Mr. Chappell lamented the ongoing financial arbitrages in the sector, where the attractively priced debt that's available can finance vessels that are then placed on long-term charters at thin margins, He then offered that, with these dynamics…."we will never get to mid-cycle rates." Conversely, Mr. Giannakoulis, from Morgan Stanley, recommended Costamare ("CMRE")- exactly because it can arbitrage cheap finance against good charter rates. Wells Fargo's Mr. Webber talked about the box sector being "…a dangerous arms race from a shipping perspective…" and described the listed container stocks as "synthetic MLPs" (partnerships bought based on their yields). In the meantime, all eyes are on regulators who must pass judgment on a new set of alliances among the large carriers.

On the analyst panel, Credit Suisse's Mr. Lewis said that he likes the drybulk sector, and that it would bring about "…something special," but there was no clear definition of what was on offer. An earlier drybulk panel, moderated by Clarksons broker Douglas Newton (a newcomer to New York with Clarksons' beefed up presence) was searching hard for the anticipated Q4 jump upward. Mr. Newton was focusing on what I would call "$30K per day or bust" for Capesizes in Q4 2014- which starts in a week. In contrast, the panelists- from Euroseas, Pioneer Marine, Navios, and privately held Steelships, had their sights set further out beyond Oct-Nov-Dec 2014. With lower iron ore prices (around $81.50/tonne for nearby futures on the SGX) and lowering stockpiles of ore on the quays in China (according to "market sources" who prowl the docks), some folks are expecting a big uptick in the rates for Capesize bulk vessels. The swaps market, not always the best predictor, is looking for hires of $21,000/day in December 2014, on a composite of Capesize routes, influenced heavily by ore moves into China. Last year, exactly a year ago- this composite stood at $41,000/day, and in late December 2013 reached $39,000/day. But with the present hires at around $14,000/day, the "$30K crowd" will be watching closely for signs of a rebound.