Alchemy, older vessels and new trades for tankers

Contributed by

Barry Parker

Barry Parker is a financial writer and analyst. His articles appear in a number of prominent maritime periodicals including Lloyds List, Fairplay, Seatrade, and Maritime Executive and Capital Link Shipping.

Last week, info provider Genscape revealed that a cargo of Alaskan North Slope (ANS) oil was on the water bound for South Korea, aboard the U.S. flag tanker Polar Discovery (owned by Conoco Phillips-“COP”), 141,000 dwt built 2003 at Avondale. The vessel has been loading oil from the North Slope (ANS) at Valdez for discharge at refineries along the U.S West Coast. But a funny thing happened on the way to….(Puget Sound, the Bay area, or even Long Beach)….the weakening oil market caused a realignment of prices for different crudes. While the industry is contemplating the impacts of shipping through the Arctic (some 45 years after the ice-breaking voyage of the tanker Manhattan from the north of Alaska to the U.S. east coast- pre pipeline), the COP vessel is steaming directly through the nexus of several important trends. First, the bigger context is that Alaska’s oil production has been shrinking; U.S. Department of Energy data shows the state’s annual production peaking in 1988 at 2 million barrels/day. By 2013, the figure had been cut by 75%, to around 0.5 million barrels/day.

According to RBN Energy, one of the go-to experts on the domestic U.S. oil markets, the narrowed spread of Brent (a good proxy for prices of oil that can be imported into the States) above WTI (the proxy for domestic grades) has opened the door for more imports into the U.S. West Coast ports. Flows from Alaska can suddenly attain better “economics” (ie a higher price) in Asian markets, so the vessel took a sharp right turn to South Korea. RBN says “So in the particular case of the recent ANS export cargo, we surmise that price is the primary issue for COP. In other words, with US prices and ANS premiums to WTI declining, COP is presumably getting a higher price from the South Korean buyer than they would at the US West Coast.”

Exports of U.S. produced crude oil have been largely limited to Canada, but one exemption to 1970’s era export bans allows ANS exports to Asian destinations- provided that they move on tankers built in the U.S. and operated under the U.S. flag (which implies that U.S. ownership is also in the mix). Previously, cargoes of Alaskan oil, transported to Valdez by pipeline, had been exported to South Korea in the mid 2000’s. According to a number of prominent analysts, notably Citibank’s Ed Morse, this cargo is part of a bigger wave (which also includes condensate cargoes), that will lift U.S. crude oil (or almost) exports to 1 million barrels/day over the next year. Ed Morse offered a terrific nautically themed observation, reprising vessels from an era pre-dating the Manhattan: “The Conoco cargo headed for South Korea markets the first sailing on what Citi expects to become an armada.” Morse suggested that: “Exports of ANS should reach sustainable levels of 100,000 barrels/day…” as others look for Asian market opportunities. That’s nearly one Suezmax tanker every week.

July 2014’s crude oil exports of approximately 400,000 barrels (mostly to Canada) was approaching a record level, dating back to 1957- according to analysts at Bloomberg. Looking into the future, RBN suggests that oil giant COP might be “…testing the waters in the belief that- in the long run- they will need to look at alternative markets for ANS in the belief that- in the long run- they will need to look at alternative markets for ANS…”

Tanker-watchers had been questioning how, exactly, U.S. tankers built specifically for the Alaska trade (such as the Polar fleet, and also a pair of new vessels recently delivered to Exxon Mobil) might be deployed. At least one set of suggestion, which must now be taken very seriously as refiners squawk about the non-availability of Jones Act vessels, would have such vessels hauling domestically produced oil in coastwise moves from Texas and Louisiana, and up to the Northeast. Another trend, maybe, is the C- word, “consolidation”, as existing Jones Act players have allied themselves with financial powerhouses and/ or repositioned themselves as financially minded companies. Some of the firepower could be harnessed to liberate million barrel ships from oilco ownership, maybe, besides the likely scale-building as fleets get combined. Emphasis on “maybe”.

Without giving specific recommendations here (we can leave that up to the Wall Streeters), I would agree with those who’ve expressed the view that internationally flagged million barrel vessels (and Aframaxes, as well) will probably be seeing more demand, at least for a while. Up until very recently, and spreads of foreign oil above domestic grades narrowed, the U.S. was significantly reducing imports, as U.S. production in the Lower 48 has soared by nearly 3 million barrels/day (a beneficiary of the “shale revolution”). As spreads have narrowed in 2014, the imports of crude oil have become more attractive into the U.S. have played a part in bringing the Suezmax market back to life. Storage related to price contango (weak nearby and stronger future prices), if it becomes a real trend, could provide further fuel here.

Then, going back to the refinery side, we have the concerns raised by another group of energy analysts, including Dallas-based Turner Mason, who expressed concerns about a glut (with low prices) of “light sweet” oil. With more domestic production in coming years, from places like Bakken and Eagle Ford fields- not perfectly suitable for U.S. refineries, in coming years, Turner Mason has talked about a “Day of Reckoning” for stranded light sweet oils.

Oil producers have been lobbying hard for repeal of the 1970’s export bans, to move some of the light sweet oils offshore, thereby keeping prices higher. The estimates of the future glut, approaching 1 million barrels/day several years out, are sized comparably with estimates of the “export Armada” now prophesied by Ed Morse. So maybe, just maybe, the Day of Reckoning might be avoided as barrels move abroad. And, of course, widening spreads could cover many sins- reducing the attractiveness of imports (sorry, Suezmax investors). Another part of these discussions, and without a definitive answer, is the investment in new oil processing infrastructure that would yield more value from the abundant new “shale” barrels to U.S. refineries. Splitters and splitters are examples of the new age alchemy in the oil patch.