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Export Infrastructure

Let's Go! Tanker Stocks Rip As Cosco Supply Catalysts Put Rates In Overdrive

Well, That Escalated Quickly…When we relaunched Tanker coverage at Webber R|A last week, our central theme was that **we were staring at the strongest Tanker market dynamics in a decade,** with US sanctions on two Cosco subsidiaries potentially adding an exogenous supply side shock to jumpstart a ramp in rates and profitability. Well a week later, Tanker rates are at 5-year highs…just like we drew it up! All kidding (and fortunate timing) aside, we haven't seen *this kind of rate upside* (both absolute level and velocity) in the better part of a decade, and it underscores just how tight the market can get when owners, charterers, and traders are this off-balance. Scrubber installations, Cosco sanctions, and the subsequent, pre-emptive *grey listing* of tonnage that may have "problematic charter history" by some majors have combined to give owners the kind of cycle-defining momentum that may have us look back on Q419/2020 in the same vain as '07-09. We remain buyers of the tanker group, specifically **EURN**, **DHT**, **FRO**, & **ASC**.

Why Are Tanker Rates Up? Charterers continue to avoid Cosco tankers, effectively removing/isolating ~5.4% of the VLCC fleet from most operations. Rates were already on the rise as refinery maintenance season winds down, IMO 2020 prep ramps, and ongoing scrubber retrofitting programs continue to take tonnage off the water. The additional sanctions-driven supply shock has sent rates, and equities, through the roof – since our 10/1 launch, our crude tanker coverage (**DHT**, **EURN**, **FRO** - all Outperform) is up ~**16**% while our product tanker coverage (**ASC** – Outperform) is up ~**24**%. Ordinarily, we'd pump the brakes a bit…but as the market inevitably begins to entertain the sustainability of this rare rally, we believe there are enough pieces of **exogenous* and structural support that Tanker equities may actually get the benefit of the doubt.

*Considering that the market typically keeps the Tanker names on a short leash, we think it's important that the primary catalysts for the group are coming from *outside* sources (IMO 2020/regulatory, Cosco Sanctions/geopolitical), as they may give the *long tanker trade* a bit more traction.

Cosco's Secrecy Adds A Dramatic Flare: It doesn't take much searching to conclude the makeup of Cosco Dalian's fleet is hazy at best. General consensus among trade press points to roughly **50** vessels directly tied to the two sanctioned entities, Cosco Shipping Tanker (Dalian) Co. and Cosco Shipping Tanker (Dalian) Seaman & Ship Management Co, but it's unclear what direct ownership looks like (Figure 1). Cosco Dalian owns 17 vessels (7 VLCCs, 1 Suezmax, 3 Aframaxes, 1 Handysize Chemical Tanker, and 5 Handysize LPG Carriers), however Cosco has not provided any clarification on the matter. Through all the murkiness, one thing is clear - the Cosco web is expansive/sticky and customers appear to be taking all steps necessary to avoid getting caught in it, and without clarification from Cosco as to which vessels have been blacklisted, those steps

...continued

seem to include avoiding all Cosco-related tankers - that's ~5.4% of the VLCC fleet (roughly equivalent to EURN's *entire* VLCC fleet) being sent to the penalty box (Figure 2).

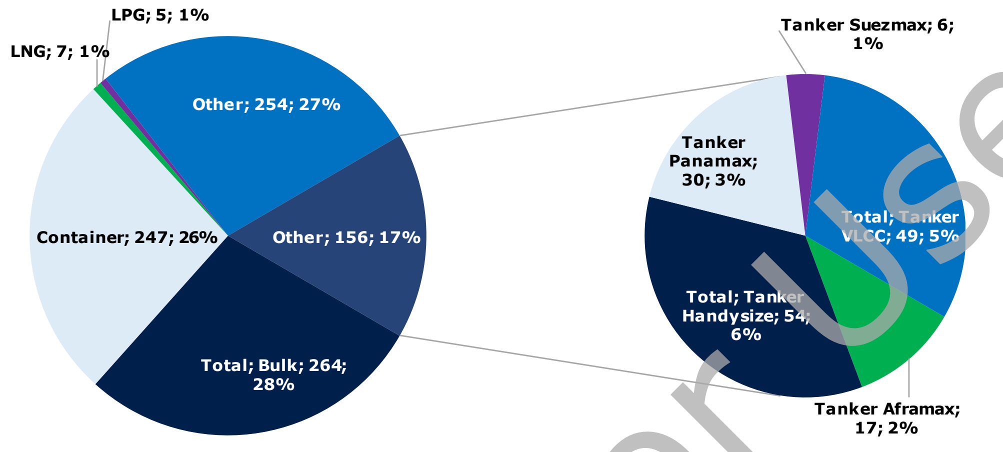
Crude Tanker Rates Reach 2015 Levels: VLCC time charter equivalent (TCE) rates ended the week at ~$86k/day (+71% w/w and +277% m/m), while this week Poten reported the MEG-Asia route broke $120k/day, which would surpass 2015 record levels. Suezmax and Aframax rates jumped so high we had to adjust the maximums on our charts for the first time in 5 years (Figures 3-7). Suezmax TCEs ended the week at ~$68k/day (+172% w/w and +326% m/m) while Aframax rates ended the week at ~$51k/day (+56% w/w and +182% m/m).

Product Tanker Rates Slightly Lagged: MR TCEs ended the week at ~$11k/day (+31% w/w but -6% m/m), with the volumes being somewhat capped by trailing refinery maintenance. We expect to see continued improvement in MR rates through Q4 as product inventories start to build, IMO 2020 tailwinds begin to take hold in crude/product tanker markets, and refinery maintenance slows through mid-October. We're also keeping an eye on LR2 conversions - our channel checks suggest 10-15 LR2s were converted from clean to dirty last week.

TGP In The Wrong Place At The Wrong Time: The counterpart in **TGP's** Yamal LNG JV is China LNG Shipping (CLNG), which is 50% owned by Cosco Dalian. While CLNG is not listed on the OFAC order, Cosco Dalian's 50% ownership qualifies CLNG and the Yamal LNG JV as "Blocked Persons" under OFAC rules. The long-term effects are still to be determined - but considering a capital commitment for 50% interest in 6 vessels at $350MM each, we expect "*what's happening with COSCO/Yamal?*" to dominate most of the **TGP** narrative this fall, even though given the dynamics, we're not expecting much commentary from the company until it's resolved (Teekay cancelled their 10/2 Investor Day).

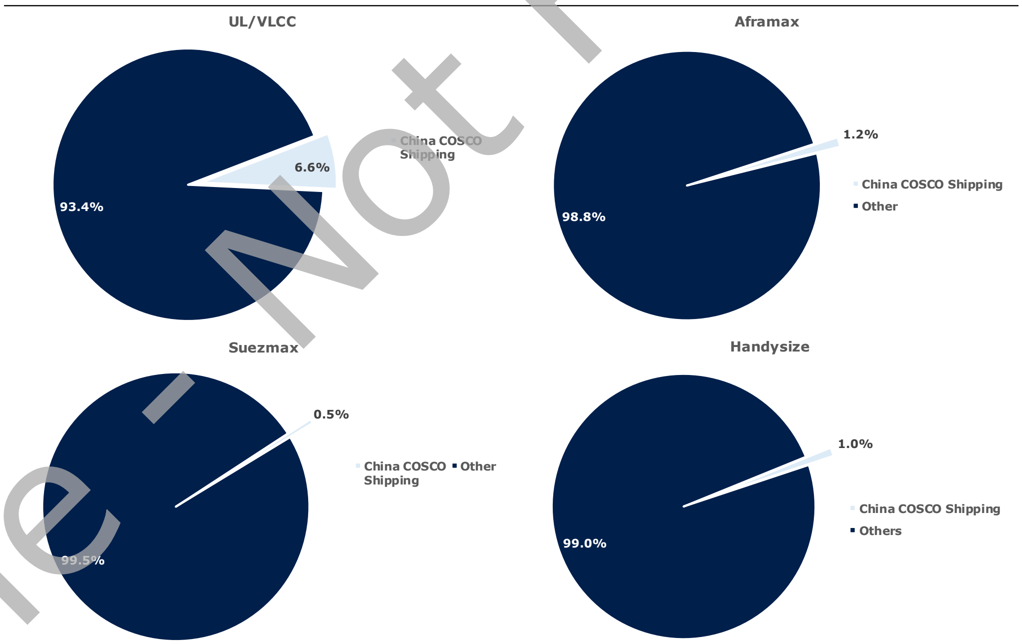
That said, we think there's probably a more workable solution (moving ownership stakes below the relevant threshold, etc.). The Chinese would be incentivized to keep that project and marine services on schedule, as it lessens its dependence on swing producers (US, etc.) for seasonal volumes, and given its ownership via state-owned entities (CNPC 20% and Silk Road Fund 9.9%). Our biggest concern is around the lending banks or shipyards (DSME) holding back funds/work until there's clarity – which could push back delivery services for the latter stages of the project. Novatek said even if the 5 Cosco/TGP Arc7 vessels are hit by US sanctions, it could still operate the Yamal LNG facility at full capacity via ship-to-ship transfers in Norway or NW Russia, but finding progress towards some sort of agreement is undoubtably the more desirable solution - CNPC recently pulled out of the South Pars gas field development project in Iran, but we think any impactful solution is more likely measured in months. We'll see…

Figure 1. Cosco Group Total Fleet Breakout



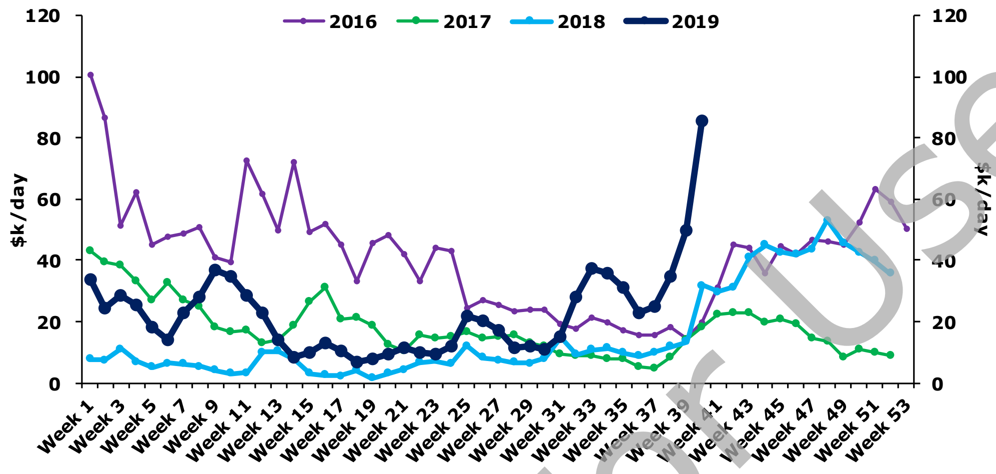
Source: Webber Research & Advisory, LLC, Clarksons

Figure 2. Cosco Group Ownership As % Of Total Fleet By Segment



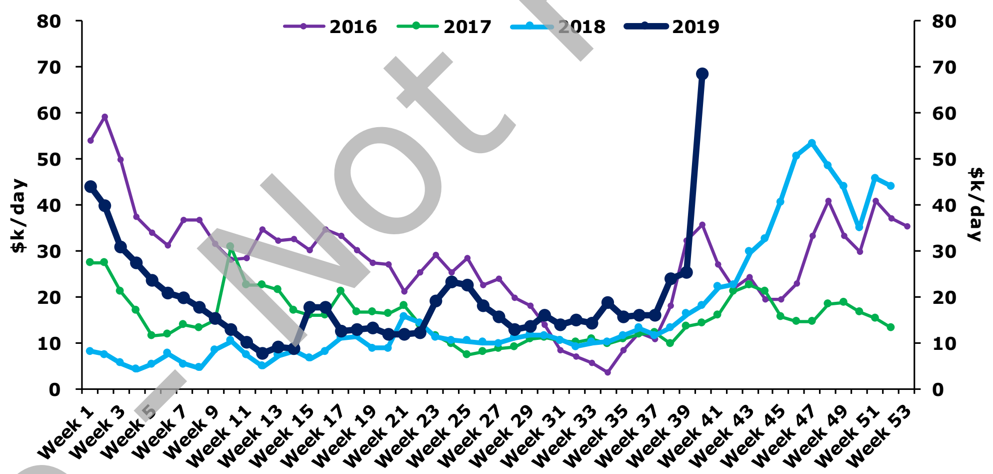
Source: Webber Research & Advisory, LLC, Clarksons

Figure 3. VLCC Average Earnings Modern (Selected Routes 2016-2019)



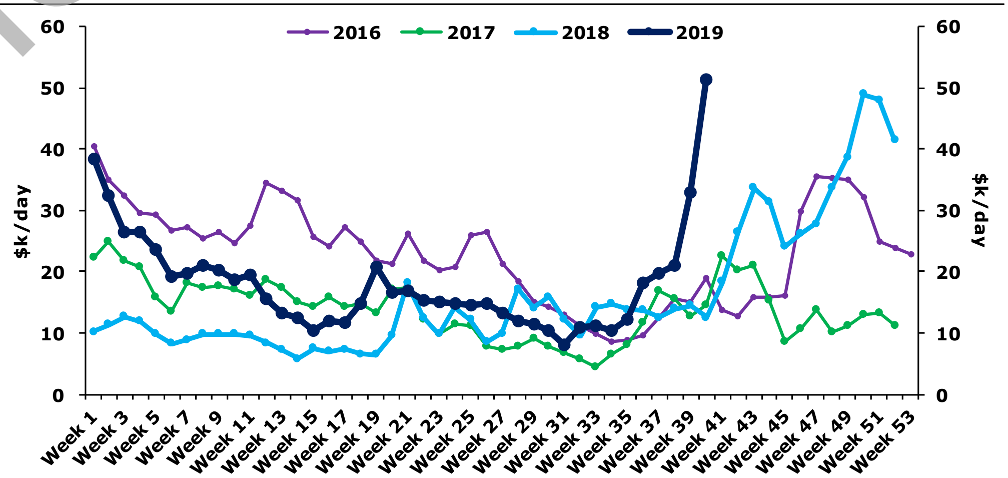
Source: Webber Research & Advisory, LLC, Clarksons

Figure 4. Suezmax Average Earnings Modern (Selected Routes 2016-2019)



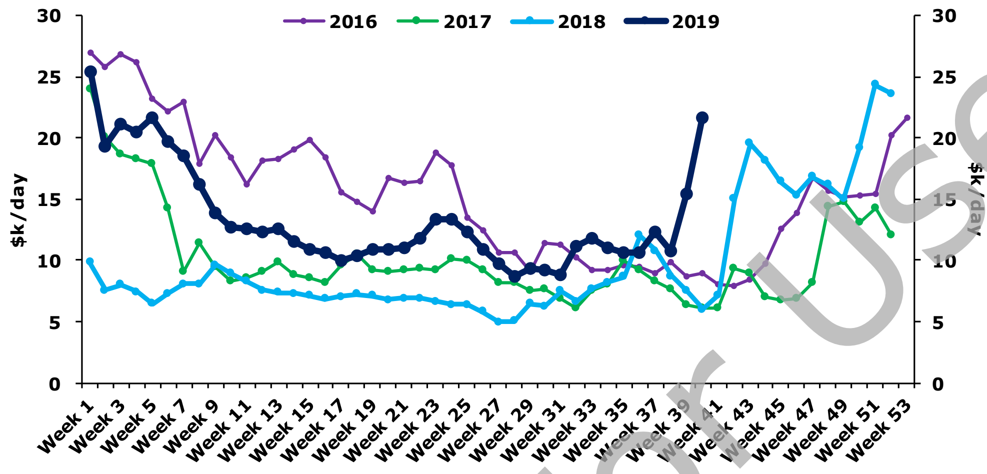
Source: Webber Research & Advisory, LLC, Clarksons

Figure 5. Aframax Average Earnings Modern (Selected Routes 2016-2019)



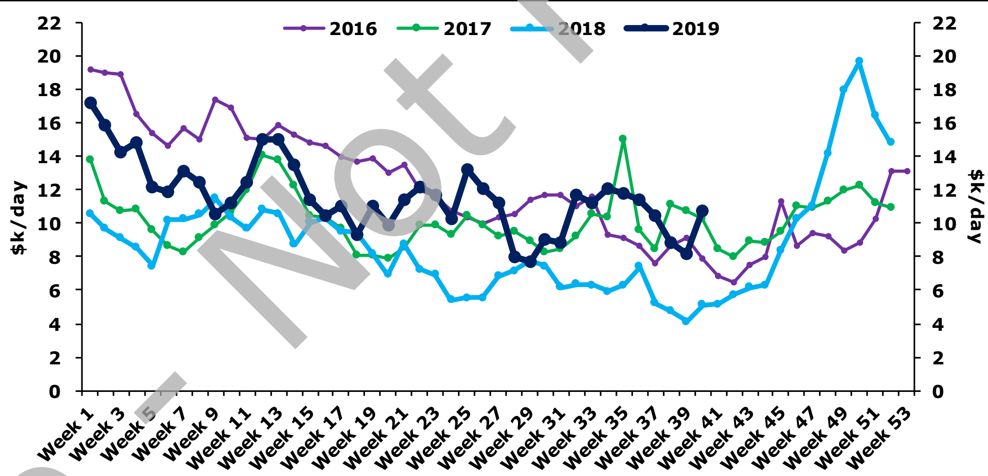
Source: Webber Research & Advisory, LLC, Clarksons

Figure 6. Panamax Average Earnings Modern (Selected Routes 2016-2019)



Source: Webber Research & Advisory, LLC, Clarksons

Figure 7. MR (Handymax) Average Earnings Modern (Selected Routes 2016-2019)



Source: Webber Research & Advisory, LLC, Clarksons

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