

Tanker sector report

Tanker peer group shares upgraded to BUY (HOLD)

12.02.2019

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Share prices in this note were correct as of 07:00 CET on 12 February 2019

CRUDE TANKER SECTOR

Conclusion We have upgraded our crude tanker peer stocks to **BUY (HOLD)**, and believe that, at an **EV/GAV of 0.8x**, OPEC output cuts are discounted, but **IMO 2020** is not. Ship prices are up in the past two months, as the one-year time-charter market starts to discount **IMO 2020**, with tanker stocks set to follow in our view.

What is new? **Tanker stocks upgraded to BUY**

Our analysis

VLCC rates are down to USD14k/day, from ~USD60k/day on 1 December, due in our view to OPEC output cuts. According to Energy Aspects, OPEC loadings fell 1.63mbpd in January MOM; we forecast a smaller decline in February, hence we believe the largest volume cut has already hit the tanker market.

Tanker stocks at an EV/GAV of 0.80x, implying a 20% decline in asset values... Our tanker peer group is now trading at EV/GAV of 0.80x, which implies a 20% decline in second-hand prices, far exceeding the average ~15% change in the value of a five-year old VLCC over the past eight OPEC output changes.

...but despite tanker rates tumbling, asset values are up over the past two months. Despite tanker rates tumbling since 1 December, the values of a 10-year old VLCC and Suezmax are up by ~10% and ~30%, respectively, in the same period.

Could it be different this time around due to IMO 2020? We believe that second-hand values are tightly correlated to the one-year TC market. Chartering a VLCC for one year today lets the charterer hold the ship throughout Q1 2020 (the first IMO quarter). Hence, from a one-year timecharter market perspective, the soft VLCC rate environment we expect for H1 2019 would month by month be offset by one additional month of 2020, hence the historical relationship between OPEC output changes and tanker rates might not hold this time due to IMO 2020.

Frontline back to a P/NAV of 0.9x, which has historically been a good entry point. We calculate Frontline's current NAV to be NOK48/share (NOK52 incl. scrubbers), which puts Frontline at a P/NAV of 0.88x (0.80x incl. scrubbers) for the first time since March 2018. Since January 2014, Frontline has traded below 1.0x NAV on four occasions; all marked a share price trough followed by a strong appreciation.

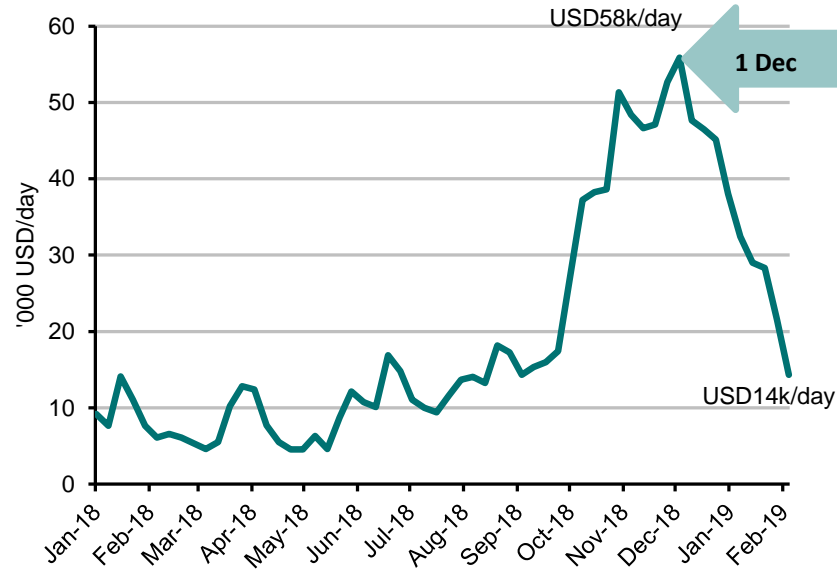
Rates set to bottom out in H1 (not the seasonally weak Q3) due to IMO disruptions. Our VLCC rate forecast (from our 30 November sector note) is unchanged at USD29k/day for 2019 (USD45k/day for Q4), USD41k/day for 2020 (USD50k/day in Q1), and USD43k/day for 2021. We expect supply growth of 2.9% in 2019 and 1.1% in 2020, and tonne-mile demand of 1.5% in 2019, and 4.4% in 2020, resulting in hybrid (50% conventional/50% speed adj.) utilisation of 83% for 2019e and 88% for 2020e. Historically, rates tend to bottom out in Q3, but due to our forecast of 1.7% lower supply growth YOY on IMO disruptions, we believe that rates are set to bottom out in H1 2019.

Valuation

We have upgraded our crude tanker peer stocks to BUY (HOLD), as we believe the risks we put forward in our 30 November 2018 downgrades are now discounted in equity values. Our small target price adjustments despite the recommendation upgrades are because our November downgrades were essentially a call on H1 weakness resulting from the impact of the OPEC cuts. Our target prices are USD7.5 for DHT (USD7.3), Euronav USD12.1 (unchanged), Frontline NOK69 (NOK67), Hunter Group NOK5.9 (unchanged), and Teekay Tankers USD2.0 (unchanged).

VLCC rates and tanker stocks down since 1 December 2018 on OPEC cut impact

VLCC rates peaked 1 December at ~USD60k/day and have declined to USD14k/day on OPEC output cuts....



...which has also led to sharp correction in tanker stocks and eroded past 12 months' gains (EURN, FRO, DHT index)

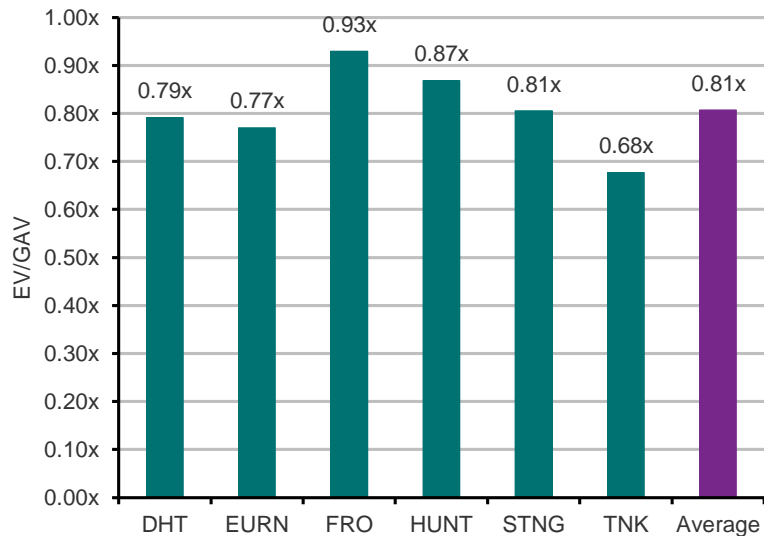


Source: DNB Markets (forecast), Clarksons (historical)

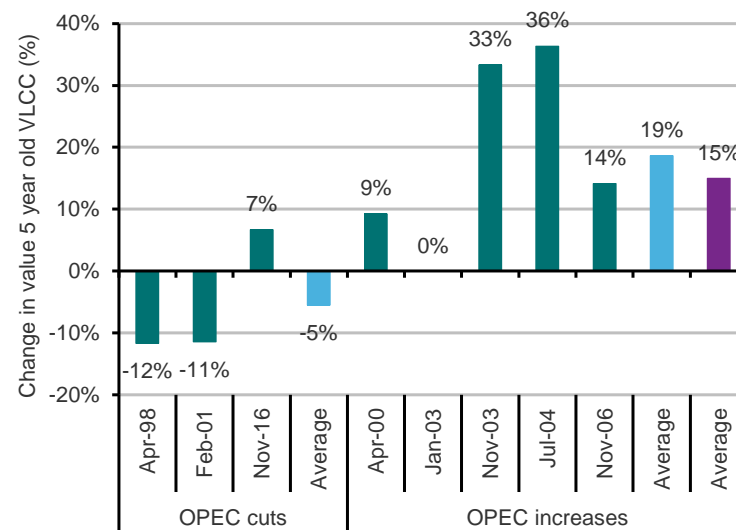
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OPEC cut discounted in equities, IMO not... (EV/GAV 0.8x today down from 1.0x 1 Dec-18)

Tanker peer group EV/GAV at ~0.81x (1.0x 30 Nov 18) implies that tanker stocks discount a ~20% decline in crude asset values...



...which by far exceeds the average ~15% change in the value of a 5 year old VLCC past eight OPEC output changes

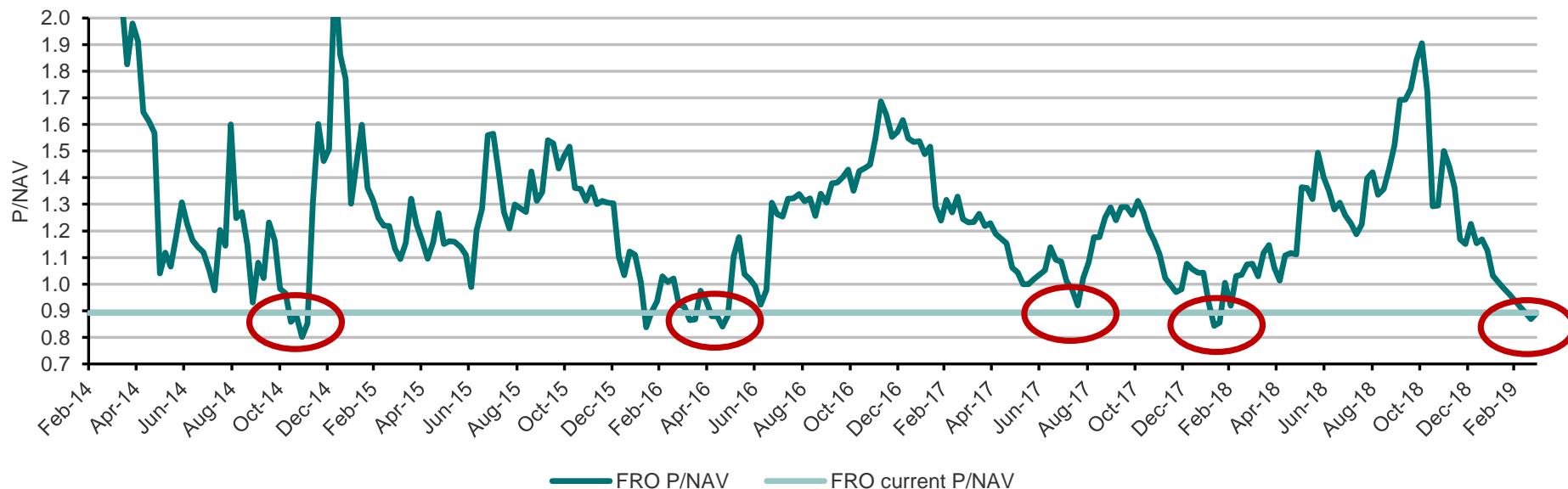


Source: DNB Markets (forecast), Clarksons (historical)

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Frontline back to P/NAV below 0.9x which has historically been a good entry point

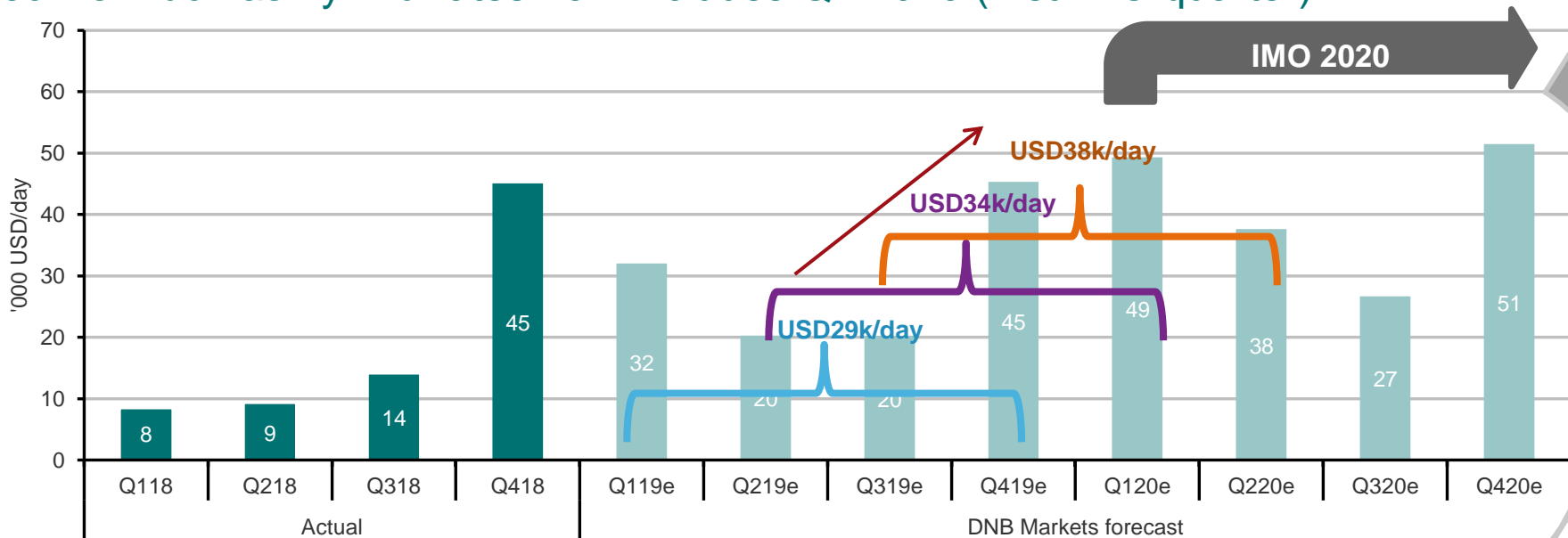
Frontline's current NAV NOK48/share (NOK52 incl. scrubber) which puts Frontline at P/NAV 0.88x (0.80x incl. scrubber) or below 0.9x for the first time since March 2018



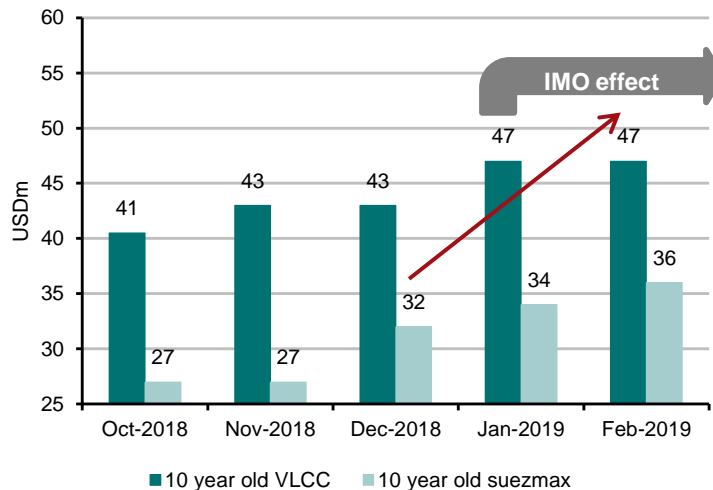
Source: DNB Markets (forecast), Clarksons (historical)

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VLCC secondhand prices correlates with 1 year timecharter rates which are unlikely to decline much as 1y fwd rates now includes Q1 2020 (first IMO quarter)...



IMO 2020 already having an impact on 10 year old VLCCs and Suezmax asset values which see values up past two months despite spot rates weakness short term



Source: DNB Markets (forecast), Clarksons (historical)

Recommendations, target prices and estimate changes (1:3)

Crude tanker peer group stocks upgraded to HOLD (BUY)

We have upgraded our crude tanker peer group stocks to BUY (from HOLD) as we argue the risks we put forward in our 30 November 2018 downgrade note are now discounted in equity values.

Our small target price adjustments despite the recommendation upgrades are because our November downgrades were essentially a call on H1 weakness resulting from the impact of the OPEC cuts.

Our target prices are based on our one year fwd NAV on USD107m VLCC resale prices, up from current USD95m today.

Changes to target prices and recommendations (%)

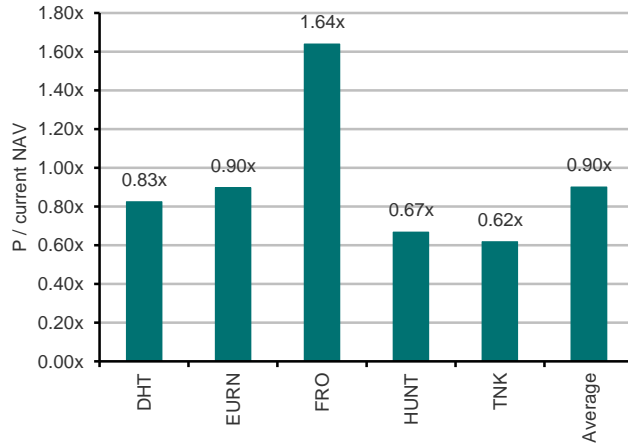
	DHT	EURN	FRO	HUNT	TNK
Recommendation (old)	HOLD	HOLD	HOLD	HOLD	HOLD
Recommendation (new)	BUY	BUY	BUY	BUY	BUY
Current share price	3.9	7.64	42.3	3.29	0.93
Target (old)	7.3	12.1	67	5.9	2.0
Target (new)	7.5	12.1	69	5.9	2.0
Changes to target (%)	3%	0%	3%	0%	0%
Upside to target (%)	92%	58%	63%	79%	115%

Source: DNB Markets (forecast)

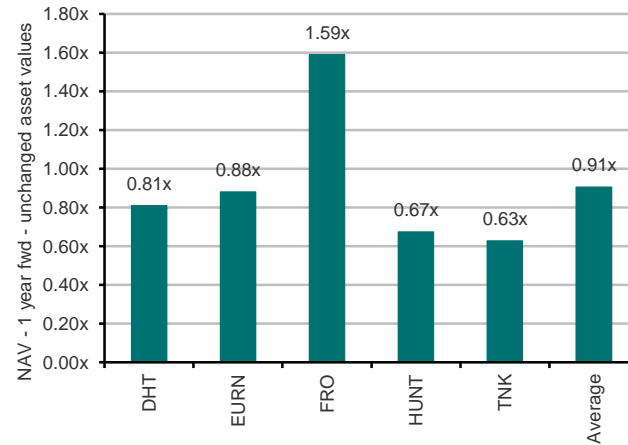
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Tanker valuation

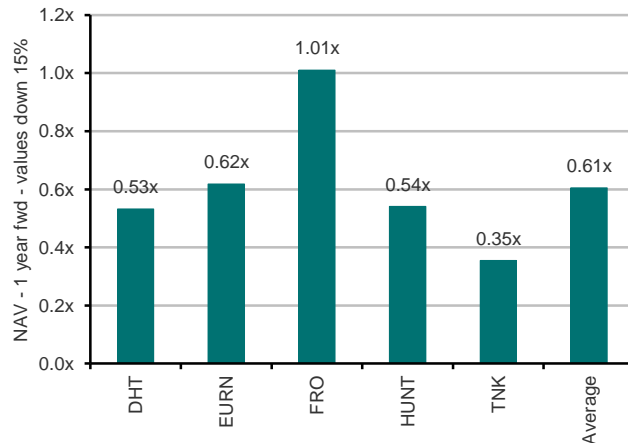
Price / current NAV



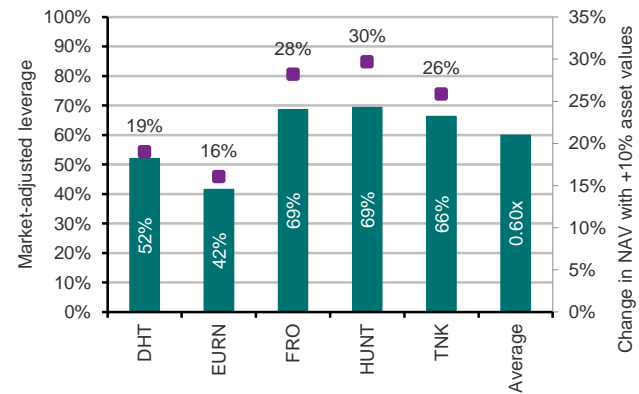
Price / 1 year fwd NAV - unchanged asset values



Price/1-year forward NAV –DNB asset value model



Market adjusted leverage and sensitivity to changes in asset values



Source: DNB Markets, USITC, Bloomberg (historical)

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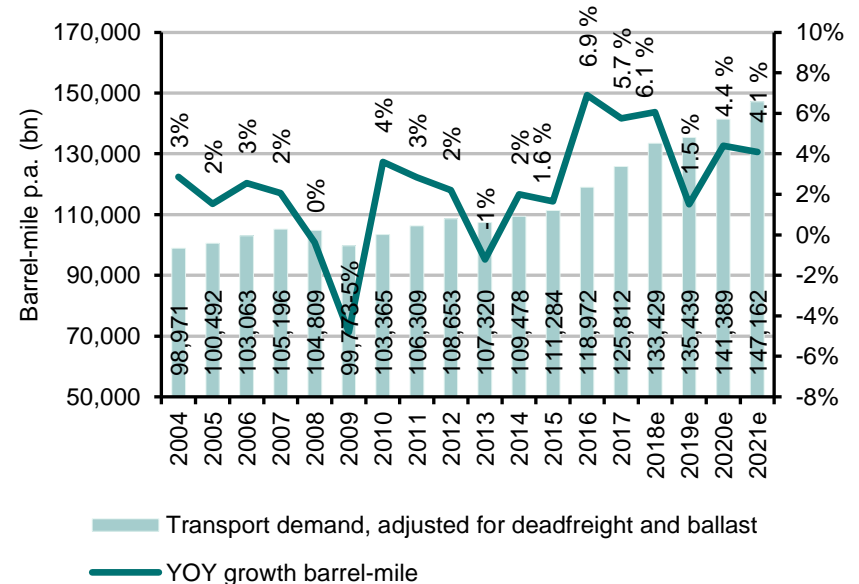
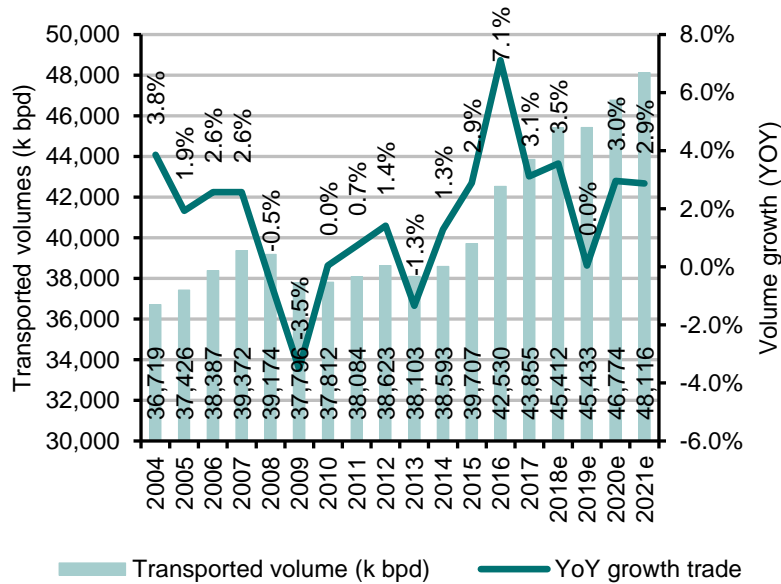
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Why positive to 2020e 1:6 – we forecast continued strong tanker tonne-mile demand after a weaker 2019

We forecast zero crude tanker volume growth in 2019e down from 3.5% in 2018 as OPEC is cutting production, before increasing to ~3% for 2020-2021e...

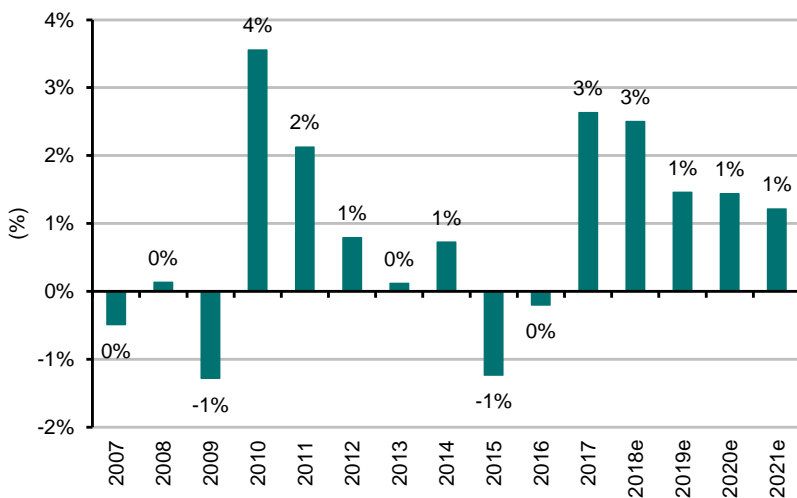
...but thanks to US export growth we end up with a 2019e tonne-mile of 1.5%, down from 6.1% in 2018e and we forecast 4.4% in 2020e and 4.1% in 2021e



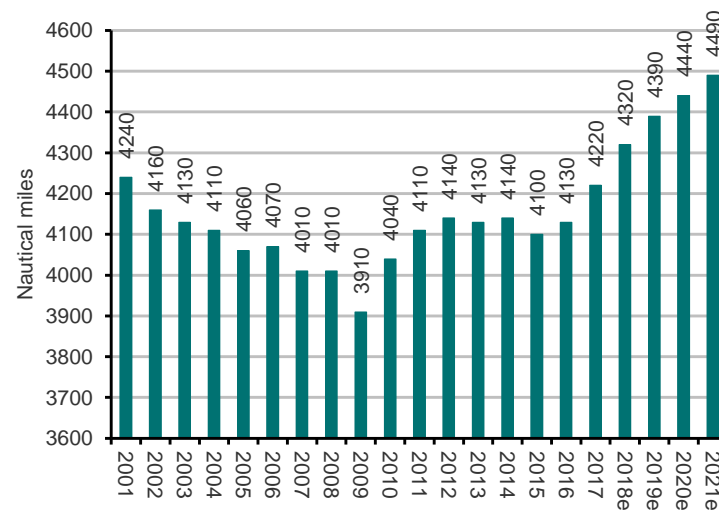
Source: DNB Markets, USITC, Bloomberg (historical)

Why positive to 2020e 2:6 – we forecast 2021e average export sailing distances to be 4% higher than in 2018e, explaining continued tonne-mile outperformance over volumes

We forecast tonne-mile to outperform trade growth due to ever increasing US crude exports...



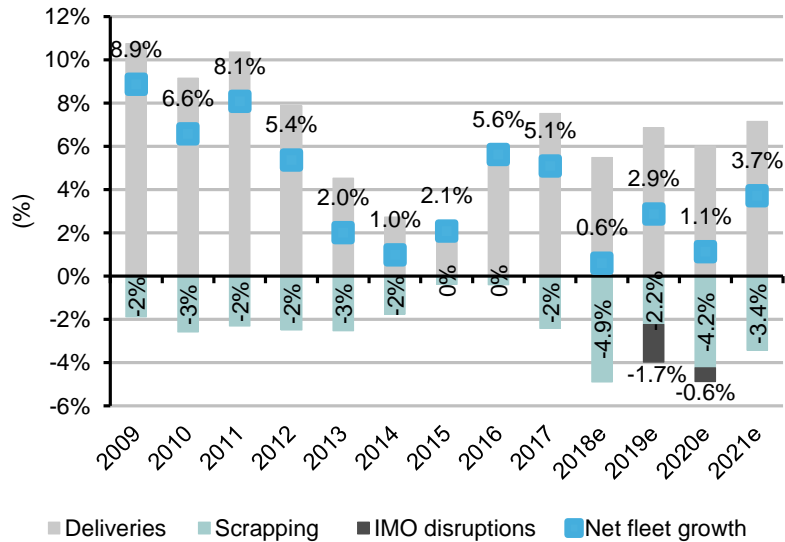
...which explains our continued belief in longer crude tanker export sailing distances (nautical miles)



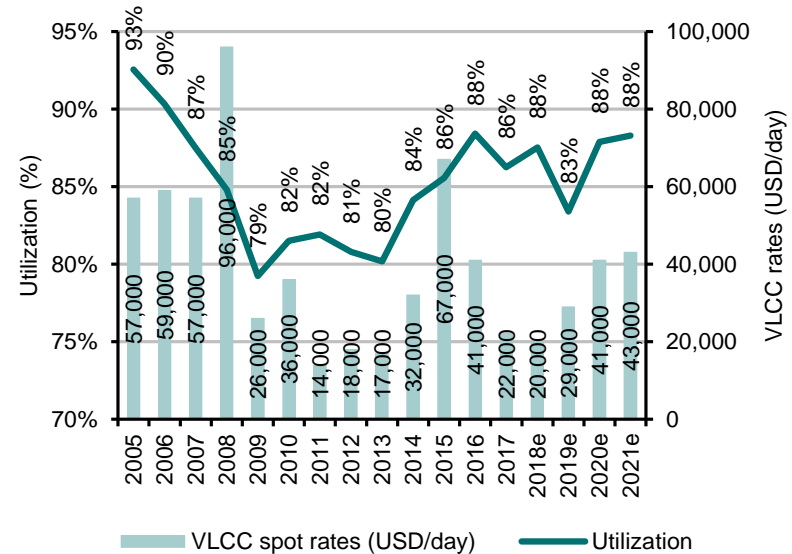
Source: DNB Markets, USITC, Bloomberg (historical)

Why positive to 2020e 3:6 – IMO disruptions and continued high scrapping would result in continued low fleet growth in our forecast period, but not as low as 2018 of 0.6%

We forecast fleet growth of 2.9% in 2019e, up from 0.6% in 2018e, net of IMO disruptions of 1.7% and scrapping of 2.2%, before decreasing to 1.1% in 2020e...



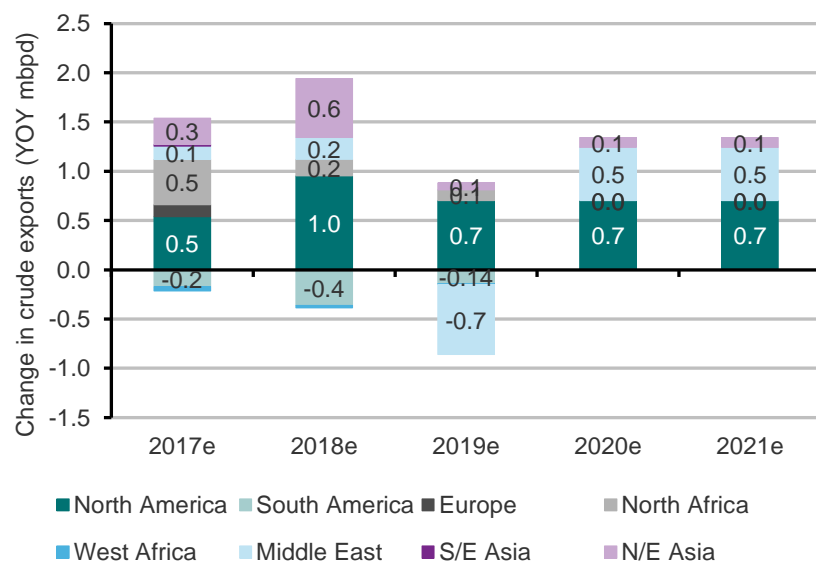
...which combined with a speed increase in the fleet, leads to a reduction in our hybrid tanker market utilization in 2019 from 2018, but a strong H2 2019 make us believe in higher rates YOY



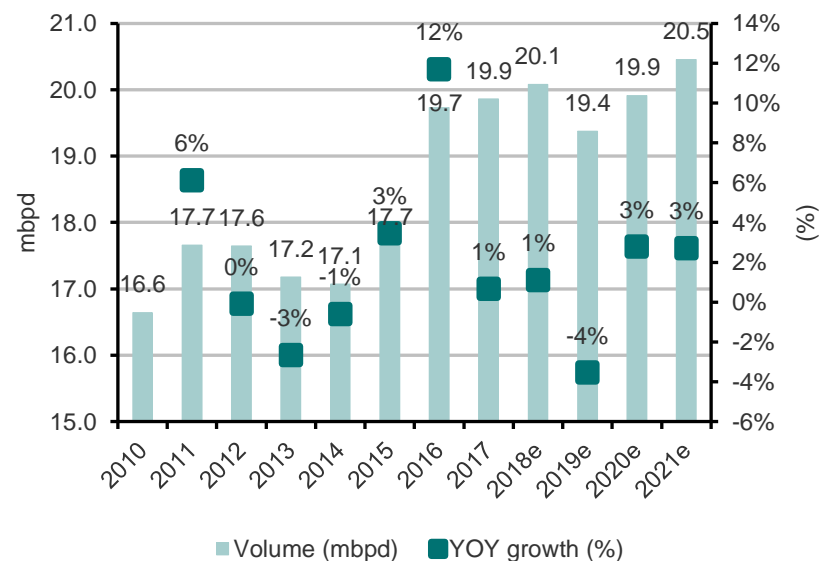
Source: DNB Markets, USITC, Bloomberg (historical)

Why positive to 2020e 4:6 – We forecast strong volume growth in the tanker market in 2020e and 2021e after 2019 (in which US volume growth would be offset by OPEC cuts)

We forecast US crude exports to grow by 0.7mbpd in 2019e which would be offset by a similar decline from Middle East as we expect OPEC to cut production



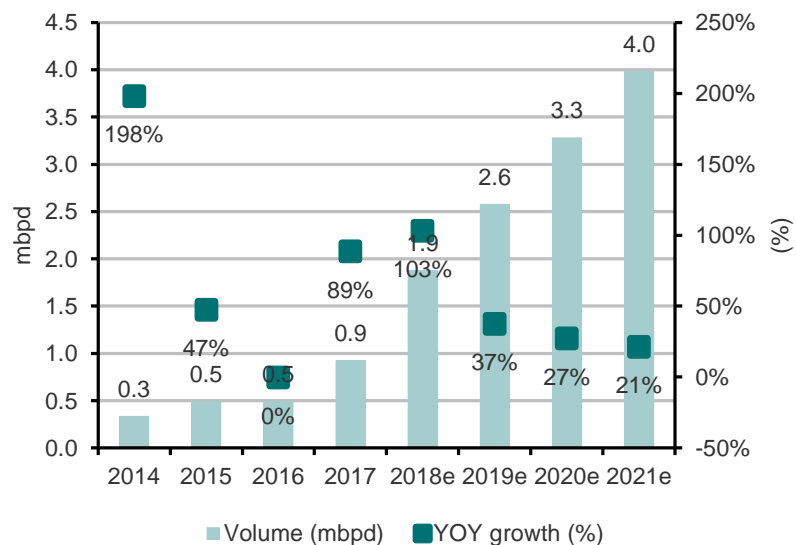
Middle East crude oil exports (mbpd) and YOY growth (%)



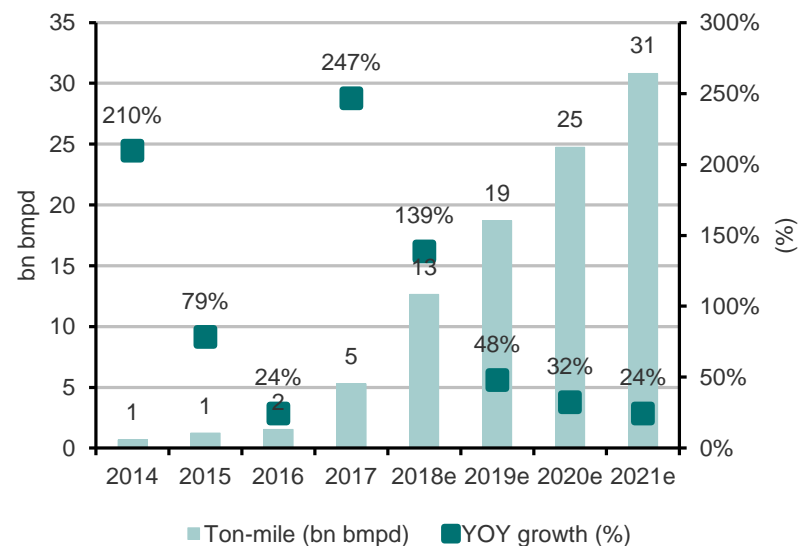
Source: DNB Markets, USITC, Bloomberg (historical)

Why positive to 2020e 5:6 – US crude exports to dominate both tanker volumes and tonne-mile demand with ~80% of incremental crude exports from 2019–2021, we forecast and incremental US laden tonne-mile demand to account for ~90% in the same period

US crude oil exports (mbpd) and YOY growth (%)



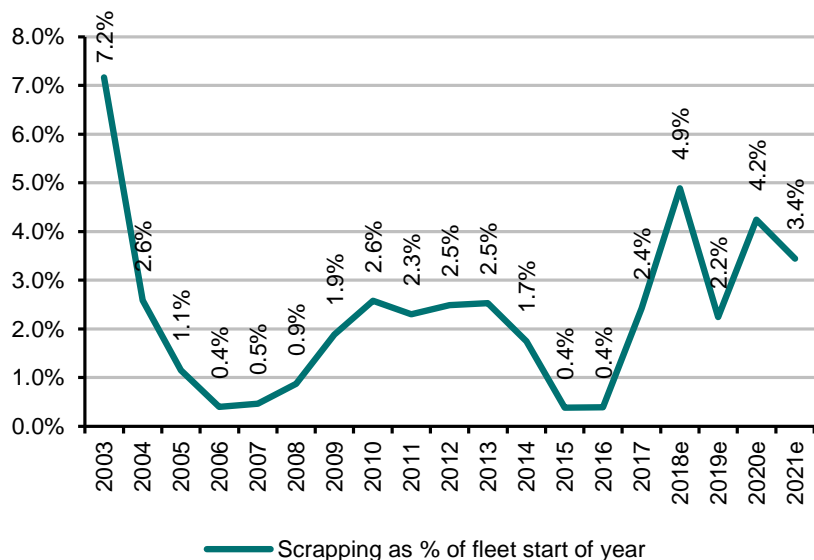
US crude oil ton-mile export (bn bmpd) and YOY growth (%)



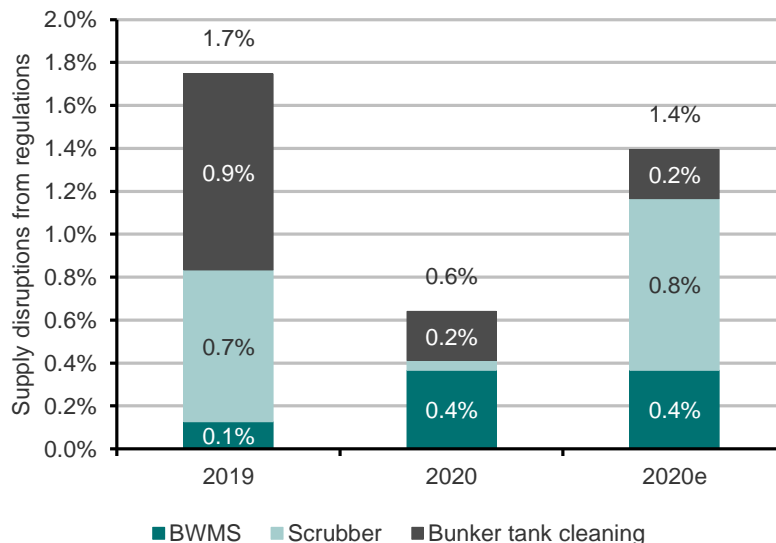
Source: DNB Markets, USITC, Bloomberg (historical)

Why positive to 2020e 6:6 – 2019 and 2020 supply growth would be impacted not only by high scrapping, but also by IMO supply disruptions (such as Ballast Water & scrubber installation and bunker tank cleaning – all resulting in off-hire)

Historical and forecasted scrapping by year (% of fleet)



Crude tank supply disruptions on current and DNB Markets' scrubber forecasts for 2020e



Source: DNB Markets, USITC, Bloomberg (historical)

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