



Wealthpin **Pro**

OCTOBER 2023

MARKET OVERVIEW

Well, if things weren't already crazy enough, let's add another Middle Eastern war into the mix, shall we? We're following the situation closely here at Wealthpin HQ. So far, the markets have shrugged off any major side effects from the Israel-Palestine conflict. But how long this will last, no one knows.

Obviously, any disruption in such an important region will have global consequences. Arguably, one of the first industries to feel its effect will likely be maritime shipping. In this edition, we're going to explain a little more about how maritime shipping works, how the Israel-Palestine war could affect it, and then, we'll get to our pick for this month (hint: it's a shipping company).

So, let's dive in shall we?

TWO CHOKEPOINTS

If the Israeli conflict extends beyond its borders, two critical maritime chokepoints could be jeopardized: the Suez Canal, crucial for various commercial ships, including container vessels, and the Strait of Hormuz, integral for oil and gas transport.

The Suez Canal represents an "open choke point," meaning ships have alternative routes. In the event of a canal closure due to regional conflict (as happened in past conflicts involving Israel in 1956 and from 1967-1975), vessels could reroute around Africa. While this lengthens their journey, it reduces available vessel capacity, potentially driving shipping rates up.



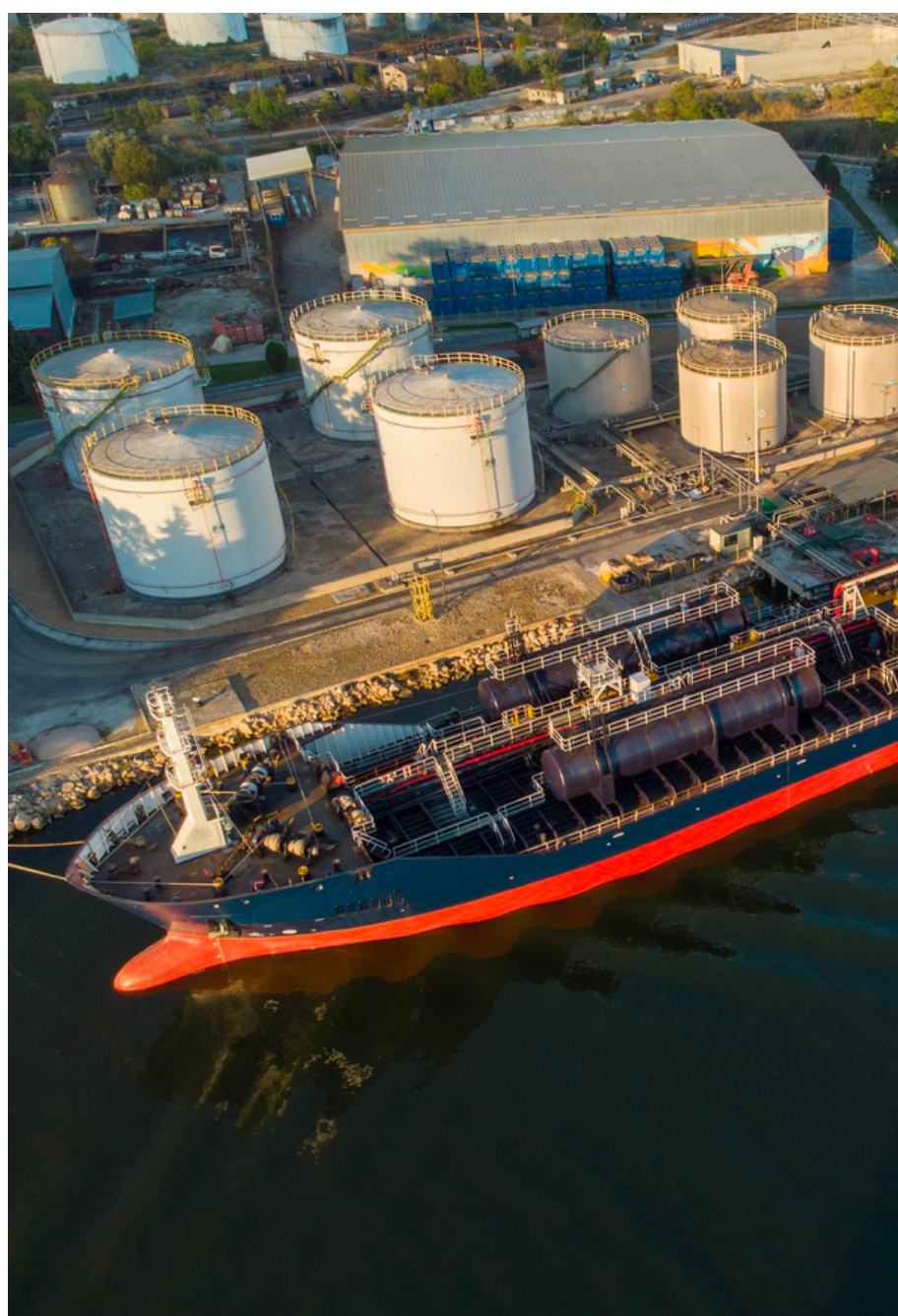
Israel doesn't command a large share of the container shipping market. Its primary ports, Ashdod and Haifa, manage a mere 0.4% of global throughput. According to Linerlytica, "the risk of major disruptions to the container trade flow through the Mediterranean region is currently minimal."

Zim (NYSE: ZIM), the world's tenth-largest ocean carrier headquartered in Haifa, acknowledged last Wednesday the possibility of service disruptions to Israel and the implementation of a war risk premium.

Zim anticipates that some of its staff may be summoned for military service, and the Israeli government holds a "golden share" in the company, guaranteeing governmental access to Zim's fleet "in times of emergency or for national security reasons." (This provision is not anticipated to affect market capacity significantly.)

The overarching concern for both container and dry bulk shipping, segments not severely impacted by the Israeli conflict, is their substantial exposure to the global economy's vitality.

CRUDE OIL SHIPPING



The Strait of Hormuz, unlike the Suez Canal, is a "closed choke point" — it offers no alternatives. The export of vast volumes of oil and gas hinges on the strait remaining accessible.

If vessels were required to avoid the Suez Canal, the demand for shipping, calculated in ton-miles (volume times distance), would benefit because the distance would increase while the volume stays stable. Conversely, a shutdown of the Strait of Hormuz would significantly reduce the volumes, negatively impacting ton-mile demand, as the loss of tons would outweigh the miles added from supplementary replacement volumes.

A more plausible short-term scenario for tankers involves the U.S. tightening its stance on Iranian exports, potentially benefiting mainstream tanker rates. Critics have accused the Biden administration of lax enforcement of sanctions against Iran, enabling Iran to capitalize on exports to China and thereby financially bolster Israel's adversaries.

LPG SHIPPING

Owners of VLGCs (very large gas carriers) might also witness a surge in freight rates.

VLGCs move LPG (propane and butane), competing with naphtha as a feedstock for Asian steam crackers. Rising oil prices due to the Middle Eastern conflict would escalate naphtha costs, rendering LPG more competitive, thus amplifying the demand for LPG imports in Asia and, by extension, VLGC transportation.



REFINED PRODUCTS SHIPPING

Currently, spot rates for product tankers — vessels transporting diesel, gasoline, and jet fuel — are surpassing typical levels for this season, and with inventories being low, the stage is set for the ongoing geopolitical crisis to further elevate rates throughout the winter.

LNG SHIPPING

In the meantime, nations importing LNG are keen on expanding their import facilities — specifically, floating storage and regasification units (FSRUs) — and seeking diversification in their supply sources. The conflict in the Middle East might compel countries to expedite these processes.

The upshot is an increased demand for FSRUs, thus bolstering rates for LNG carriers.

HOW TO PLAY IT

With all that considered, what's the best way to play this potential shipping boon? Well, for that, let's turn to our pick for this month.

TRADE IDEA:

SCORPIO TANKERS INC (NYSE: STNG)



PRICE AT PUBLICATION: **\$55.84**

MARKET CAP AT PUBLICATION: **\$2.76 BILLION**

52-WEEK RANGE: **\$40.34-\$64.20**

BACKGROUND AND OPERATIONS

Scorpio Tankers, established in 2009, has rapidly ascended to prominence in the global marine transportation industry, specifically in the refined oil products segment. With its strategic headquarters in Monaco and solidified by its presence on the New York Stock Exchange (NYSE), the company has carved out a substantial share of the market. Its competitive edge is sharpened by a contemporary fleet of 112 high-caliber vessels, boasting an impressively youthful average age of just 7.5 years, well below industry norms.

The diversity within Scorpio Tankers' fleet is notable: it encompasses 14 Handymax ships, 59 Medium Range (MR) tankers, and 39 Long Range 2 (LR2) tankers.

Time Chartered Out Vessels						
#	Vessel Name	Type	Year of Built	Duration	Daily Rate	Expiration
1	STI Memphis	MR	2014	Three Years	\$21,000	Jun-2025
2	STI Miracle	MR	2020	Three Years	\$21,000	Aug-2025
3	STI Magnetic	MR	2019	Three Years	\$23,000	Jul-2025
4	STI Marshall	MR	2019	Three Years	\$23,000	Jul-2025
5	STI Duchessa	MR	2014	Three Years	\$25,000	Oct-2025
6	STI Gratitude	LR2	2017	Three Years	\$28,000	May-2025
7	STI Gladiator	LR2	2017	Three Years	\$28,000	Jul-2025
8	STI Guide	LR2	2016	Three Years	\$28,000	Jul-2025
9	STI Guard	LR2	2016	Five Years	\$28,000	Jul-2027
10	STI Connaught	LR2	2015	Three Years	\$30,000	Aug-2025
11	STI Lombard	LR2	2015	Three Years	\$32,750	Sep-2025
12	STI Gauntlet	LR2	2017	Three Years	\$32,750	Nov-2025
13	STI Lavender	LR2	2019	Three Years	\$35,000	Dec-2025
14	STI Grace	LR2	2016	Three Years	\$37,500	Dec-2025
15	STI Jermyn	LR2	2016	Three Years	\$40,000	Apr-2026

(Scorpio Tankers Inc. Q2 Presentation)

DYNAMICS OF THE TANKER MARKET

The complexity of the oil shipping market cannot be overstated. Like we talked about above, it's a sector deeply interwoven with various global phenomena, including the intricacies of oil supply and demand, unforeseen geopolitical developments, and the ever-shifting terrain of the broader economic environment. Each factor holds substantial sway over the industry's configuration, directly impacting the spot rates associated with oil tankers.



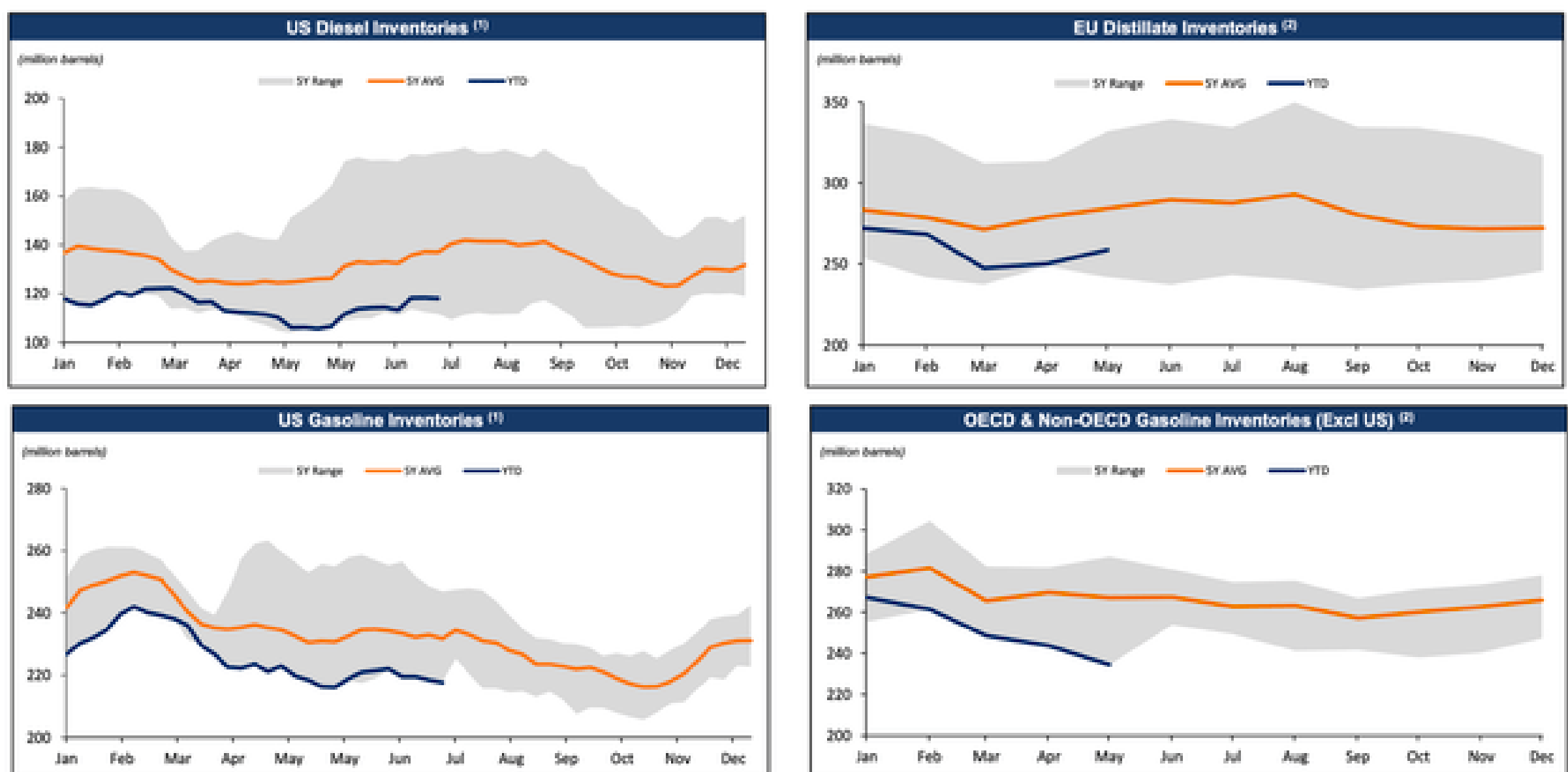
A crucial determinant of spot rates, which represent the immediate charter price of a tanker, is the status of global oil inventories. A scarcity in these inventories precipitates a heightened demand for immediate oil transport, catalyzing a sharp rise in spot rates. Conversely, abundant inventories signify reduced urgency for oil transport, thereby applying a downward force on spot rates.

THE CURRENT STATE OF OIL INVENTORIES AND STNG'S POSITION

At present, the global stage is set with relatively diminished oil inventories, a scenario contributing positively to an ascension in spot rates. This market condition favors entities like Scorpio Tankers, propelling them towards augmented revenues and enhanced profitability margins.

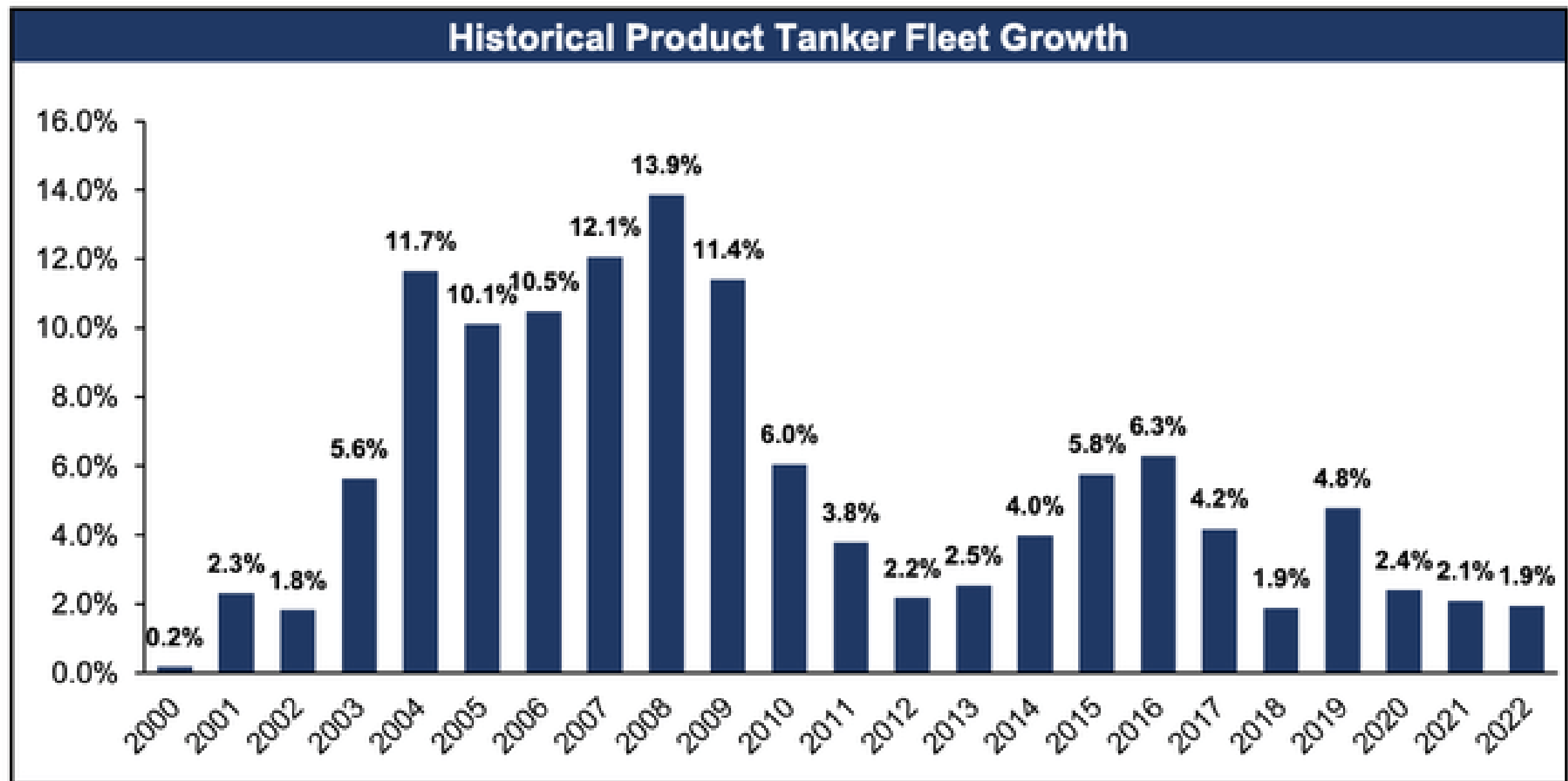


Global Inventories Remain Well Below Average



(Scorpio Tankers Inc. Q2 Presentation)

The broader context of 2023 has revealed a deceleration in tanker fleet growth, a trend deviating from historical patterns. High-interest rates, which inflate the financial burden of new ship construction, coupled with shipyards' preoccupation with diverse types of ships, are primary contributors to this slowdown.



(Scorpio Tankers Inc. Q2 Presentation)

For enterprises like STNG, with an emphasis on strategic leverage, these market conditions unveil lucrative prospects. Possessing a fleet that's both modern and efficient, they are strategically poised to exploit these market shifts to their advantage.

STNG'S FINANCIAL VIGOR

Despite recording a net income of \$132.4 million and an adjusted net income of \$133.3 million in Q2 2023, which marks a regression from the figures of Q2 2022, it's pivotal to interpret these numbers against the backdrop of overarching company performance and prevailing market conditions.

The oil shipping realm is notorious for its volatility, where rates and revenues are susceptible to dramatic swings induced by alterations in oil supply and demand, geopolitical oscillations, and macroeconomic variables. Navigating this tumultuous environment, STNG has showcased a formidable capability to not only withstand these market upheavals but also to carve out pathways for profit escalation.



Q2 2023 Highlights

Highlights
<p><i>Financial Results</i></p> <ul style="list-style-type: none"> • Adj EBITDA of \$235.2 million ⁽¹⁾ • Adj net income of \$133.3 million or \$2.51 basic and \$2.41 diluted earnings per share ⁽¹⁾ <p><i>Share Repurchases</i></p> <ul style="list-style-type: none"> • Since January 1, 2023, the Company repurchased 8.6 million shares for \$421.1 million <p><i>Dividend</i></p> <ul style="list-style-type: none"> • Quarterly dividend of \$0.25 per share <p><i>Significant Deleveraging</i></p> <ul style="list-style-type: none"> • Reduced indebtedness by \$241.2 million from March 31, 2023, through June 30, 2023 <p><i>Strong Liquidity Position</i></p> <ul style="list-style-type: none"> • Cash & cash equivalents of \$682.7 million as of July 31, 2023



¹⁾ Please see the explanation of Non-IFRS Measures in the Company's earnings release

(Scorpio Tankers Inc. Q2 Presentation)

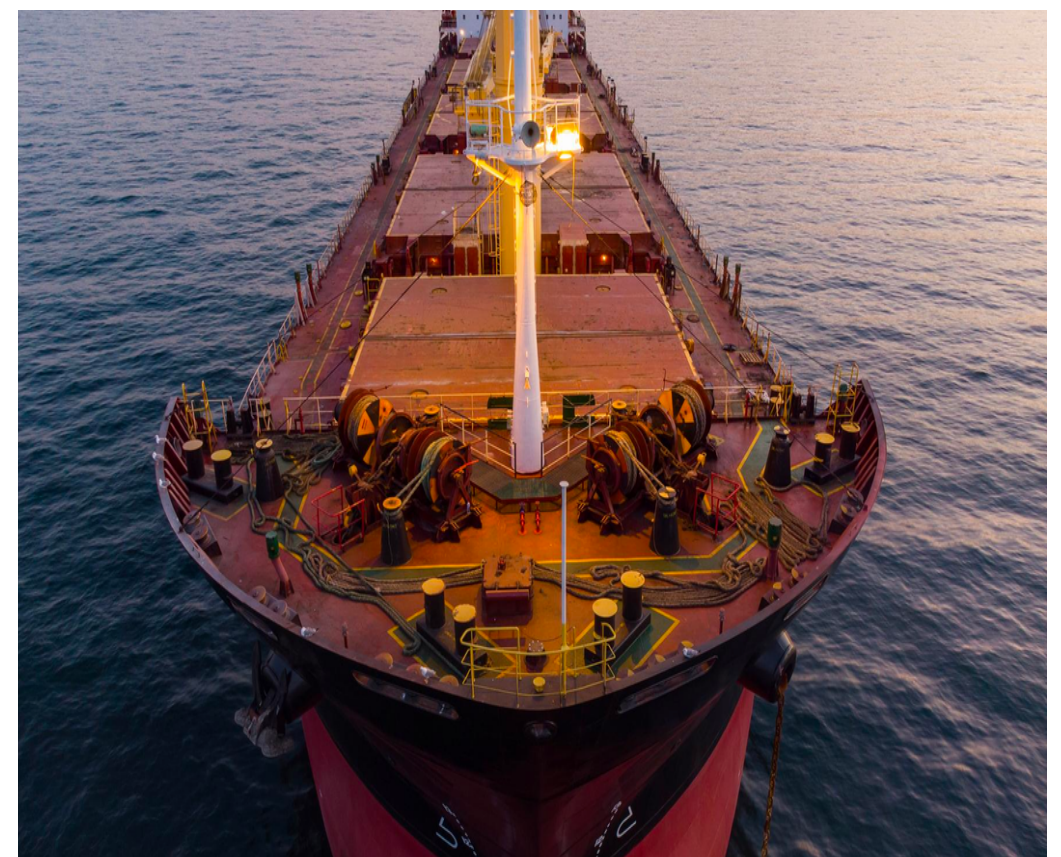
An examination of STNG's performance narrative for the first half of 2023 (H1 2023) illuminates a net income of \$325.6 million and an adjusted net income of \$328.9 million, figures that tower over their 2022 counterparts. This trajectory signals a robust uptrend in the company's profit-generating capacity. Moreover, the firm's resilience is manifest in its ability to sustain profitability in Q2 2023, despite a contraction in net income relative to Q2 2022. This resilience is indicative of STNG's adeptness at strategizing to mitigate risks and leverage opportunities, thus solidifying its foundation for prospective expansion.

STATE-OF-THE-ART VESSELS

In maritime shipping, especially concerning oil tankers, a company's fleet age plays a pivotal role. Oil tankers typically have an operational lifespan of 20 to 30 years, after which the expenses for upkeep and operations often surpass the vessel's profitability, prompting companies to decommission and supplant these aging ships.

Presently, the mean age of the global fleet is 11.7 years, serving as a critical reference point for juxtaposing the fleet ages of individual companies. A significantly lower fleet age compared to this average indicates that a company is utilizing more contemporary ships, usually resulting in operational and fiscal benefits.

Scorpio Tankers Inc. is noteworthy in this context, with a fleet exhibiting a Deadweight Tonnage weighted average build year of 2015. This datum is markedly below the global mean and also outperforms several of Scorpio's immediate rivals. For example, International Seaways (INSW) and Nordic American Tankers (NAT) have fleets with an average year of construction tracing back to 2011.



Additionally, some vessels within these competitors' fleets are nearing or have already exceeded their expected service years. This impending reality could precipitate considerable capital investments soon, as these firms might need to procure new ships to sustain their operational abilities.

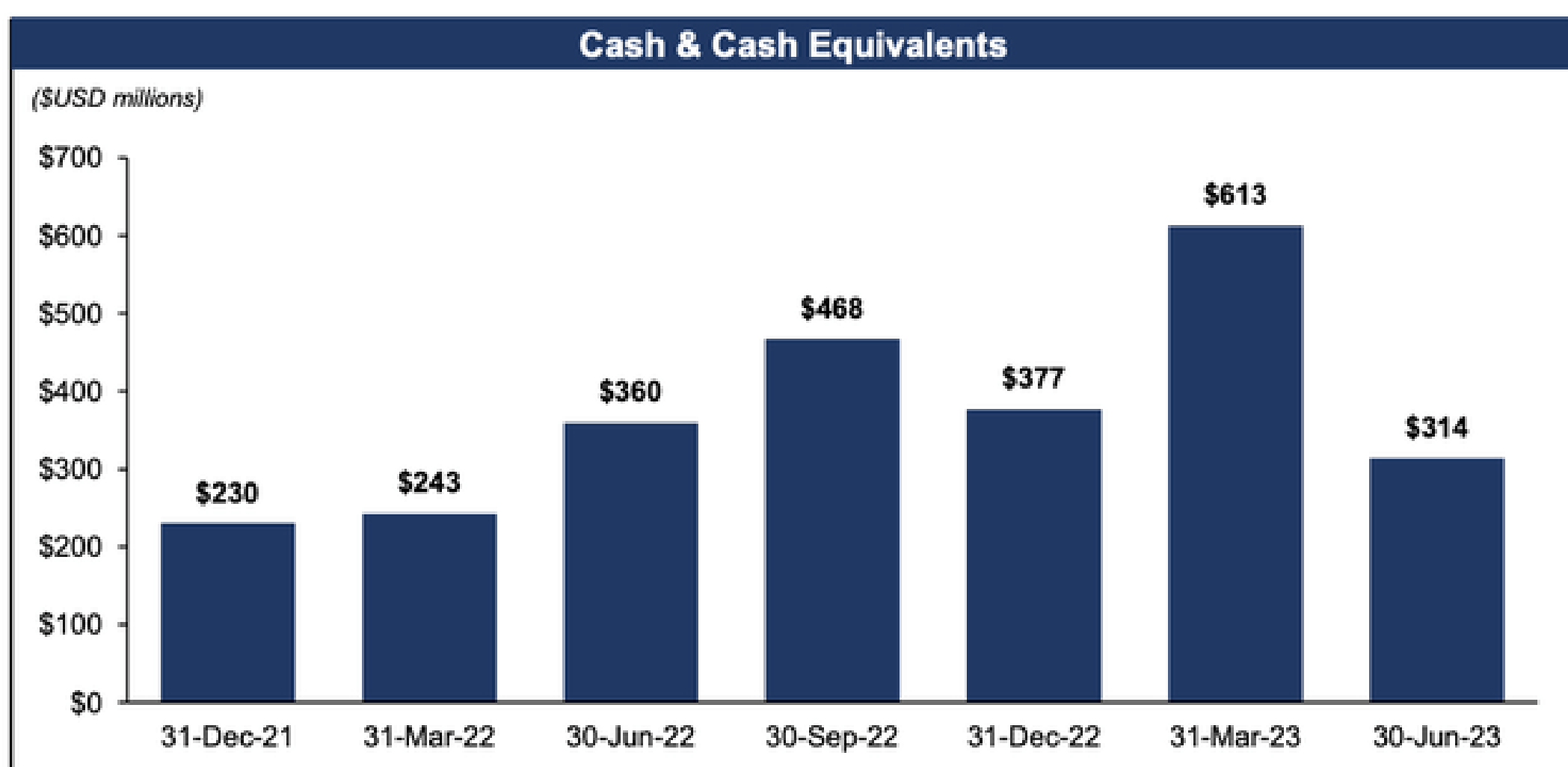
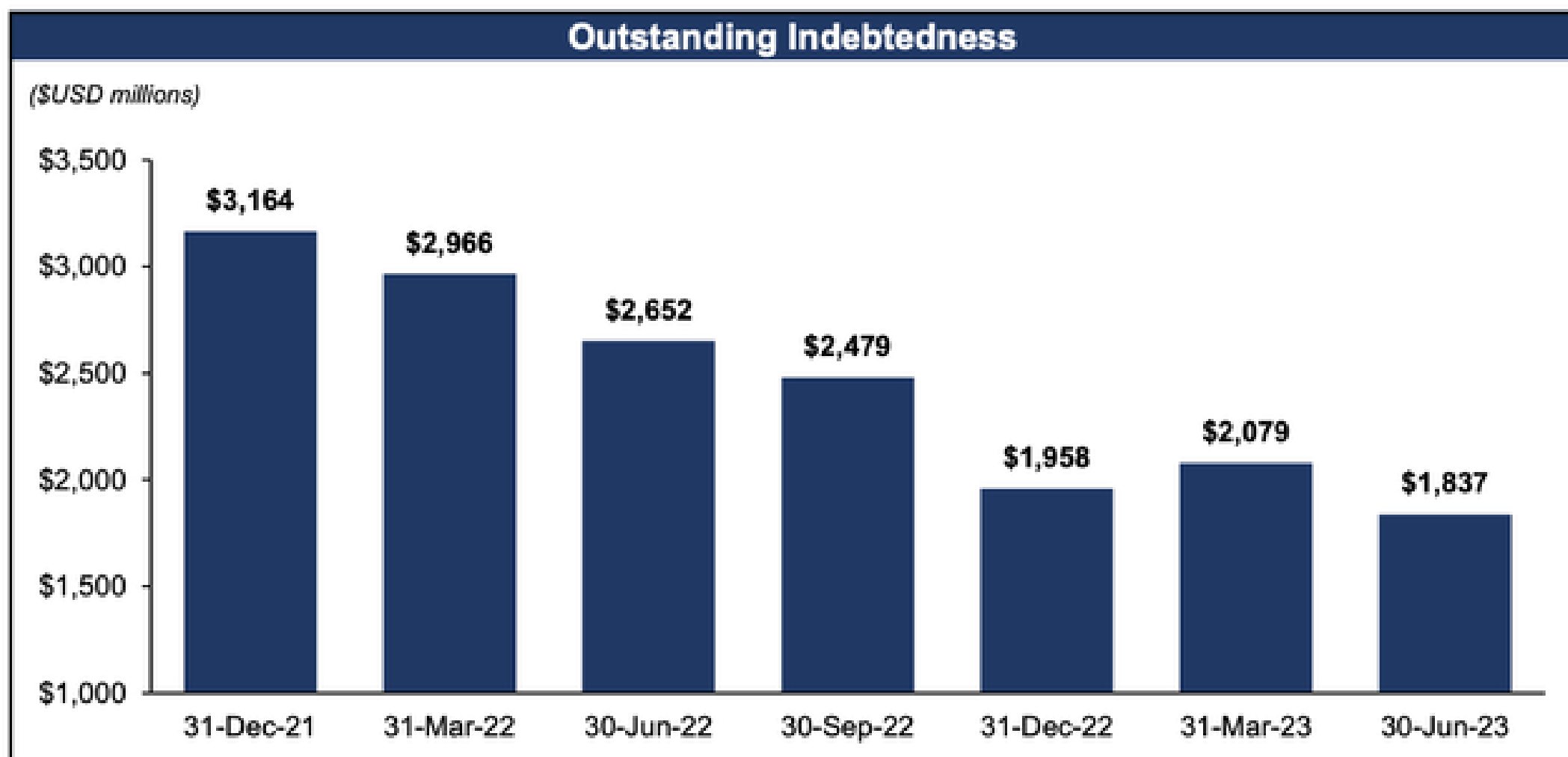
Conversely, the construction year of Scorpio's most senior vessel is 2012, indicating that none are nearing the end of their service life and many operate free of debt, with potential for several more decades of service. This positioning affords Scorpio a pronounced edge, enabling it to sidestep the hefty expenses tied to the procurement of new ships for an extended period.

The advantages of possessing a more recent fleet are not confined to evading the costs linked to older ship replacement. Newer fleets typically incur fewer maintenance expenses since state-of-the-art ships are less prone to require extensive overhauls. Furthermore, they're often characterized by enhanced fuel efficiency and compliance with the most recent safety and environmental standards. This compliance can foster cost reductions, streamline operations, and mitigate the regulatory risks often affiliated with older vessels.



STRATEGIC MANEUVERING OF DEBT:

In a display of financial astuteness, management has been dynamically orchestrating its debt profile through an amalgam of measures, encompassing lease repayments, debt curtailment, and the procurement of new financing arrangements. During Q2 2023, STNG enacted purchase options on a series of vessels previously tied to diverse lease agreements, a move that culminated in a substantial collective debt diminution of \$300.2 million.



(Scorpio Tankers Inc. Q2 Presentation)

This momentum was sustained in July 2023, with the exercise of purchase options on an additional six vessels, prompting a further debt contraction of \$143.6 million. The company also flagged its intention to exercise purchase options on an additional two vessels, an initiative projected to carve out an additional \$36.5 million in debt reduction by the culmination of Q3 2023. This sequence of actions illustrates a clear strategic inclination towards deleveraging, particularly steering away from costlier lease agreements.

Parallel to these debt mitigation endeavors, STNG has also fortified its financial structure with new financing accords. The company has successfully negotiated, or secured commitments for, three distinct credit facilities aggregating to

an upper limit of \$1.2 billion. The first facility, cemented in May 2023, drew \$117.4 million from a European bank. The second, consummated in July 2023, involved a term loan and revolving credit facility from a consortium of banks for up to \$1.0 billion. Upon fruition, \$440.6 million was drawn from this facility to finance 21 of the company's unencumbered vessels. The residual availability of this facility presents STNG with enhanced financial dexterity to navigate future ventures and strategic initiatives.

CHALLENGES AHEAD

Even with the anticipated decline in the Fleet Time Charter Equivalent (TCE) rate to \$26,210 from \$32,154 in the second quarter, the company's astute financial strategies and up-to-date fleet equip it robustly to steer through these obstacles. Prioritizing debt reduction and stock repurchases over dividend payments indicates a commitment to a long-term expansion plan that holds the promise of substantial investor returns.

The company's earnings are intricately linked to the dynamics of the global oil market, with any shift in oil demand or supply directly influencing its bottom line. This vulnerability to commodity prices signifies that a plunge in oil values could curtail the need for oil shipment, thereby diminishing Scorpio Tankers' revenues, a scenario acknowledged in their most recent earnings report.



Moreover, the company's considerable burden of debt, partly subjected to variable interest rates, introduces the peril of interest rate fluctuations. A hike in these rates could mean a sharp rise in Scorpio Tankers' interest obligations, impinging on its earnings and hampering debt serviceability. Additionally, it confronts regulatory uncertainties, given the maritime sector's adherence to a plethora of environmental and safety mandates. Regulatory shifts could impose significant capital outlays, adversely influencing Scorpio Tankers' fiscal health.

Operational hazards, intrinsic to maritime operations, encompass potential mishaps, piracy threats, and ecological catastrophes, all of which could inflict hefty expenses, tarnish the corporate image, and spawn legal repercussions. Lastly, the shipping sector's cyclical pattern, along with its vulnerability to worldwide economic trends, geopolitical occurrences, and alterations in maritime commerce trajectories, poses market instability for Scorpio Tankers. A recession in the shipping sphere could diminish the appetite for its offerings and exert a downward thrust on freight charges, potentially eroding revenue streams.

THE VALUATION

Considering the comprehensive data regarding dividends, financial statements, share repurchases, and prevailing favorable market conditions, the question arises: how do we determine STNG's value in relation to the broader market and its direct competitors?

In terms of dividends, STNG's trading is marginally above its 4-year average of 1.97%, with a projected forward rate of 2.11%. This yield is modest in comparison to its counterparts, more so when considering INSW's exceptional dividends that aren't reflected in the trailing twelve-month (TTM) or forward yield. However, STNG compensates with a conservative payout ratio. As the company concludes its debt reduction phase and perceives its stock price aligning with its Net Asset Value (NAV), it's plausible they will shift their emphasis towards enhancing dividends, rather than concentrating on share repurchases. It's presumed that the optimal NAV is likely in the range of \$52-\$55, with substantial share buybacks expected to persist below this threshold.

Examining the Price to Earnings (P/E) metric, Scorpio Tankers is notable, presenting a TTM P/E ratio of 3.27, the most competitive among its peer group. This is likely due to its comparatively elevated debt, as indicated by its Enterprise Value (EV) to Market Cap ratio. This specific ratio offers insight into the company's financial stance, incorporating debt, cash reserves, and market valuation.



STNG's upper-range position in this sector-specific ratio hints at a potentially weaker financial fortitude than that of rivals like INSW and DHT.

Nevertheless, STNG's prospects are encouraging. It's projected that through adept debt management and capitalizing on the sector-wide surge in earnings to augment its financial reserves, the company will achieve a more solid financial foundation. This enhanced fiscal stability is anticipated to empower the company to yield higher investor returns, triggering a disproportionate return trajectory, particularly if Spot Charter Rates maintain their high levels.

CONCLUSION

A new fleet, a solid balance sheet, competent leadership, and (unfortunately) geopolitical instability is all lining up to create perfect conditions for a boom time in maritime shipping. And Scorpio Tankers is one of the best ways to play that boom, in my opinion. Which is why we're adding it to the model portfolio.



To your wealth,
Alex Reid
Founder, Wealthpin Pro

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