Capital Link Shipping
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IN THE NEWS

Opportunity for shipping MLPs- "…but we don't own the cargo!!!!!"

Contributed by

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Over the past few years, we've seen a new type of shipping investor- one who like the sector and wants some cash flow while waiting for a big uptick in asset values. Partnership structures, and- very specifically Master Limited Partnerships (or MLP's, with characteristics carefully defined by U.S. tax regulators), have offered investors opportunities to have their cake (in the form of periodic yield) and eat it too (in the form of a worthwhile terminal value). So, with this background, Capital Link's second annual Master Limited Partnership conference in New York, was incredibly worthwhile. The U.S. tax rules link MLP's- with their ability to pass through earnings but also tax deductions directly to investors (who own "partnership units). Rules allow the structure in extractive and natural resource businesses, mainly in the energy arena. Since the U.S. has been seeing what some observers have dubbed an "Energy Revolution", more MLPs have been created, and only standing room was available for most of the day.

The day was dominated by presentations about energy- upstream, downstream and midstream- with the latter bucket encompassing shipping of both raw materials and refined materials. Throughout the day, I heard various refrains on how the lowered oil prices have impacted the actual operations of partnerships; for transporters who don't own the cargoes, the answer should be: "It does not impact us- we just move the barrels or molecules". In most cases, with the exception of upstream entities- which actually pull hydrocarbons out of the ground and sell them, the refrain continued on with something like:"…we've been unfairly tarred with the $50 crude brush…". MLPs, being pass-through entities, have had cost-of-capital advantages. However, since the oil price plunge began in the second half of 2014, the advantage has dissipated. As yields on energy-related debt, particularly in the below investment grade portions of the market, have risen, so too have yields on energy-related MLPs.

In his lunchtime keynote speech, Mr. Kyri Loupis- who heads up the Energy & Infrastructure group within Goldman Sachs Asset Management, offered that: "The MLP sector <down 23% over the last six months > has clearly shown that commodity prices do matter, at least in the short or medium term." Happily, for those covered in pitch, the MLPs that have suffered the most are those "closest to the well" (ie upstream producers), suggesting that investors can differentiate a tiny bit, between the bad guys and the not so bad guys. But, still, moving farther away from the well, into infrastructure type MLPs, "…separating between perception and reality becomes a little more challenging", though "dislocation <unfairly attributing commodity risk> has created good entry points…"

Such considerations provide a useful segue into the LNG shipping panel, and the individual company presentations (in a smaller room upstairs- but also standing room only). Because gas movements have historically been tied to medium and long-term contracts, and Big Oil, the big movers of LNG (gas in a liquefied form), it's very naturally gravitated to the MLP structure. The panel, moderated by Clarkson Platou Securities' Matt Phillips included partnership entities tied to GasLog, Dynagas, GolarGas, and Hoegh- joined by a portfolio manager from Cohen & Steers- which offers funds that invest in MLPs.

Simple arithmetic suggest that prices for partnership units have fallen (as yields have been pushed higher), even though the freighting contracts continue- with ample cash flows to cover distributions. Put another way- that tarry brush alluded to by Mr. Lucas has unjustifiably drenched the LNG shipping sector.

"We consider these businesses to be floating pipelines….," is how Tyler Rosenlicht, from the funds provider, described the shipping MLPs, adding that "…we know them well…" Andrew Orekar, CEO of GasLog Partners LP, explained that the spot market for LNG shipping (where his firm does not participate) could see "…fewer opportunities…" when oil prices are low. Tony Lauritzen, the CEO of Dynagas LNG Partners LP stressed that, lower energy prices, overall, could stimulate demand and therefore could be a good thing. Graham Robjohns, CEO of Golar Gas Partners LLC characterized the business as being supply-led (ie liquefaction projects) and noted a nearby mis-match shown on charts presented by Matt Phillips, with vessel availability exceeding demand for vessels. Still, according to Phillips, for the most part- the LNG rates are healthy, albeit way down from the boom three years back. Panelist Richard Tyrrell, from Hoegh LNG Partners, talked about the dynamics of the U.S. export boom with gas likely going to more destinations- "…it's not all going to go to Japan…". The implication is that geographically disperesed infrastructure will be needed as they open up more markets- a good thing for the sector, overall, and certainly for the FSRU's which Hoegh LNG specializes in.

Looking to the future, what might we see? Tyler Rosenlicht, the Portfolio Manager, who talked about the importance of "…the longer duration of the fixed contracts…" and revealed a focus on "Who's your counterparty? How good are your assets?" and similar questions. He suggested that upcoming re-contractings might even see "a step-up in cash flows", meaning that long term rates would be improved. At one point, when discussing the overall context of vessels and terminals, he said: "We pay a premium for assets with access to water…" really because of the optionality of destinations.

From the panel, and from various snippets gleaned throughout the day, the financial landscape bodes well for additional maritime deals, with MLP's being, "a new pool of capital…" in the words of Tyler Rosenlicht. Nick Stillman, banker at Clarksons Platou, suggested that he would expect more registrations to be filed for shipping MLPs, saying "…it all depends on valuations…" but that right now, with such measures battered, the maritime MLP pipeline is temporarily dry. Optimism springs eternal- a pipeline (there we go again) of vessels with charters to "drop down", at an opportune moment, from the sponsor to an MLP is thought to be far more important than the oil or gas price.

In his lunch speech, GS's Mr. Loupis cited the work of researcher Ethan Bellamy (from RW Baird, a lead sponsor of the event), and suggested that, by and large, the marketplace did a poor job of differentiating which MLPS were directly impacted by their exposure to crude oil or refined products prices (and volumes) from those that were not. "But we don't own the cargo…" the shipping guys protested!