Small is Beautiful, When it Comes to Tanker Companies

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"Small is beautiful", the title of a book which went on to become a tagline for the environmental movement that was burgeoning in the 1970's, has been applied by shipping journalists when product tankers - rather than behemoth crude oil tankers, are under discussion.


Image: credit BDP1 Consulting / Pyxis Tankers, Inc.

In a similar vein, we can apply it to the size of a maritime company putting its attentions on lower costs of operation. There's been extensive discussion of the virtues of bigger companies on the maritime conference circuit, and in the maritime media. The rise to prominence of the "big company" conversations is not surprising. Tanker and drybulk shipping successes are frequently synonymous with and really all about successes in the timing game. To win at timing, you need to be acquisitive; that's the strategy that some of the bigger boys are engaged in now. Sensibly, the packagers of companies have used weak markets to build up larger fleets, as they amalgamate second hand acquisitions, or large blocs of newbuilds that they've been able to pick up off at attractive prices. The messaging from many of those acquirers has taken on the slant of bigger being better and, further, that consolidation is king. Yet these arguments sometimes ignore the true nature of shipping's economies of scale. A micro-economic analysis of company cost structures shows, decidedly, that bigger does not always translate to lower operational costs per vessel.

As some of the bigger players have discovered, investors are not buying into the asset playing meme at this point. Instead, they are focusing on likely streams of earnings going forward. In a fragmented business (where all firms are essentially price takers) operational cost does matter, even where the market's strong hires are throwing off substantial free cash flows, as they were through early 2016.

In the realm of product tankers, one company which fits into the "Small is beautiful" categorization is Pyxis Tankers, Inc. which gained a Nasdaq listing (symbol "PXS") in late October, 2015. Its six-vessel fleet includes four MR tankers built in South Korean yards (three of which fit the "eco" description), and two short range tankers. All of the vessels are double-hulled, with an average age of under five years. All four of the MR's are on time charter, as is one of the two short range ships. Their cargoes include gasoline, jet fuel, naphtha and other refined petroleum products; the ships can also take organic chemicals and vegetable oils.

It's never quite possible to make purely "apples to apples" intercompany comparisons where U.S. listed tanker companies are concerned. But, in looking at a group of peer companies, we can get a feel for what's been happening in the MR product tanker sector, and show the cost advantages of a small company.

Starting with the top line, revenues will depend on the combination of spot (voyage by voyage) versus period chartering coverage, and the charter markets' term structures. In volatile markets like we are seeing presently, vessels in the spot trades have been earning more than more than ships engaged in the more predictable period time charter trades. For PXS's MR vessels (47,000 to 52,000 dwt), all on varying time charters, the average hire for 2016 Q1 is just shy of $17,100/day. This hire, currently in line with broker estimates of what a one year period time charter would bring, reflects the company's layered approach to managing its charter portfolio.

The spot markets tend to be highly volatile. One larger competitor, with several dozen MR vessels, saw its MR tankers- mainly in spot trades, net ting $24,655/day and $19,681/day in Q3 and Q4, respectively. Another peer, this one with 15 MR vessels, saw them earn TCEs of $24,269/day and $18,508/day in the respective Q3 and Q4 2015 - with trade mainly in spot employment. But spot trading is volatile; in early 2016, the Baltic Exchange was valuing the time charter equivalent on trans-Atlantic employment for MR tankers at below $15,000/day - this measure of spot earnings had stood above $25,000/day in late 2015. But rumblings persist regarding the floating storage of refined products, particularly in the ARA region, but these would likely go to the larger LR1's or LR2's.

The maxim of "Small is beautiful" is truly re-affirmed when we turning to the cost side of the income statement, taking a detailed view of the line items composing total operational daily cost. For PXS, "…we have a cost-competitive operating structure which is strategically and financially important to management and our shareholders," says company CEO Eddie Valentis.

Pyxis Tankers Inc. pays $425/ vessel / day for the services of an outside technical manager, and $325/vessel/day/ for commercial management- maintaining relationships with its world-class customer base of top traders and oil companies. With the company's small footprint, its daily G & A expense for each vessel (adjusted for non-cash components) is on the order of $1,080 - a few hundred dollars per day lower than the two peers. The daily operating expense for the eco-efficient MR tankers in the PXS fleet is estimated to be around $5,800/day (and around $6,200/day for eco-modified units). So PXS total daily cash operational cost is around $7,600/eco -efficient MR units, and $8,000/ eco-modified MR.

There's no denying that we've seen a robust market for crude oil tankers since late 2014. A number of analysts are suggesting that the product tankers, which strengthened during 2015, will actually have more staying power than the crude carrier sector - where there are fears of a boom in orders. The product sector, on the other hand, is seeing a historically low ratio of deadweight on order to total fleet size, currently 13.2% for MR's, according to Drewry, an expert consultant. With continually changing trade patterns- tied back to arbitrages in product pricing, and the continually evolving refinery picture, the spot rates have shown volatility as demonstrated above, which again puts the focus on keeping the costs down.

Cost numbers also defy exact comparisons, but a look at several peer companies shows PXS costs to be extraordinarily competitive. In Q4, 2015, daily operational expenses for modern eco-efficient MRs were led by PXS at $5,771, followed by ASC at $5,940 and STNG at $6,153. Technical management fees, paid to outside vessel managers, at the mid-sized peer came to $370/day in Q4 2015. Its commercial management is done internally, so we can't match up a precise per diem. However this peer's G&A expense (which would subsume the commercial component) worked back to just under $1,500/vessel/day in Q4 2015. The larger peer reported a large G & A number of nearly $1,300/vessel (adjusted for non-cash expenses) when spread over this company's large fleet of owned vessels. Add in technical fees of $685/day plus commercial of $325, this large competitor has management fees of over $1,000/vessel/day. The G&A expense of the much larger peer further illustrates the point that companies with smaller fleets can be far nimbler when it comes to income statement line items dealing with costs. Controlling costs may be the key to success in good times, and in bad.

by bdp1 Consulting Ltd.

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