Quoted MR player outlines strategy

Perfect storms usually portend darkness- but the supply and demand situation for tankers in the refined product trades, while not yet at hurricane strength, is looking very bright.*

Unlike liner shipping, where bigger players can arguably exert limited pricing power, bulk shipping (including tankers) is a commodity business - where the intersection of supply (how much vessel capacity is available to haul cargoes) and demand (how many barrels are moving, where the barrels are moving and how long those trips take) determines the market clearing price.

Most industry observers are in agreement that the product tanker segment is moving towards undersupply - based mainly on the likelihood of minimal increases in future fleet capacity. For example, BIMCO said, in a recent report on tankers: "For oil product tankers, BIMCO expects the fleet growth to come down in 2016 and 2017, based on current orders and anticipate a continued slow uptake of new orders."

The future could be bright for Pyxis four MRs.

Looking at various numbers, we can see a situation where the orderbook for vessels is moving towards historically low levels as shipyards are experiencing turmoil and the finance picture for shipping becomes more challenging.

As of 15th March, 2016, Drewry estimated the MR2 orderbook (37,000 to 55,000 dwt) at a mere 8.2% of the existing worldwide fleet - which totalled 1,555 vessels totalling 71.9 mill dwt, excluding Jones Act vessels.

The vessel delivery schedules are spread out to 2019, but 87% of the MR2s are targeted for delivery by the end of 2017. However, Drewry suggested that delivery slippage may be a factor going forward. Thus, yearly fleet growth could be less than 3%, well below likely increases in yearly demand for product carriers. Also, when possible scrapping of older vessels is considered, the annual growth rate could be even lower.

On an investor conference call detailing 1Q16 results, a top executive at one of several listed refined products owners described the market situation as "as we go forward….you have a balanced market…so, any input into the demand is going to rip that market straight up…"

In language more mellifluous to economists and analytical types, Drewry detailed the demand in the sector of the recent annual report on Form 20-F filing from NASDAQ-quoted Pyxis Tankers, whose modern fleet of vessels transport refined products, as well as vegetable oil and certain chemicals.

Demand growth

Drewry described the demand for refined oil products - the lion's share being fuel oil, diesel, and gasoline - as having grown at a compounded annual rate of 2.7% from 2010 to 2015 (to an estimated 905 mill tonnes). Vegetable oils and chemicals, some of which are carried in the same tankers that haul refined products, grew by 3.4% during the same period- to 224 mill tonnes. Exports from Russia, India, China and the US grew even more dramatically during the same period, easily exceeding growth in world GNP, as reported by the IMF, which averaged 3.7% during this period.

Going forward, forecasters are cautious in their estimates of economic growth, but the demand side (based on tonnes moved and voyage length) shows promising signs. For example, Drewry anticipated that trades in refined products will see longer voyages - indeed, the average length of voyages for products increased steadily during the 2010-2015 period.

Drewry said: "In developed economies, such as Europe, refinery capacity is in decline and this trend is likely to continue as refinery development plans are concentrated in areas, such as Asia and the Middle East at or close to oil producing centres and where the new capacity coming

The Pyxis team enjoys being floated on Nasdaq.

on stream is export orientated."

Supply and demand analysts always get "into the weeds" when they consider further reductions in supply beyond slippage. Port congestion and the use of vessels for floating storage also have the impact of reducing the supply of vessels available to transport cargoes.

For the larger crude oil tankers, storage and congestion have affected the supply and demand balance since early 2015, as the impacts of falling oil prices led to opportunities for cargo owners. However, for the most part, these supply–reducing variables have not been present in the product tanker markets.

Contango factor

One exception was the dirty fuels markets in Singapore- where a contango (where the future price exceeds the current price) made such storage economically viable in 3Q15.

Price contango has more recently become a factor over a broader swathe of clean refined materials, such as diesel, gasoline and jet fuel.

One London-based broker and analyst, Gibsons, recently pointed out that recent strength in refining margins created incentives in northern Europe and the Mediterranean to build clean products inventories. Because of constraints in land-based storage capacity, excess cargoes were held on vessels (typically larger tankers), according to the broker.

Gibsons said that such storage has recently eased but "… with seasonal maintenance starting to subside, and heavy inbound diesel flows from all directions, including a VLCC from Asia, this respite is likely to be short lived." The broker also highlighted increasing clean storage in Singapore, which is symptomatic of the record stockpiles of light distillates in this oil refining and trading centre.

While storage of products on vessels makes for good reading, there are some important nuances to this aspect of the tanker market. Eddie Valentis, Pyxis Tankers CEO- with a fleet that includes four MRs, commented: "Designated storage of refined products has been limited - mainly diesel fuel temporarily stored on LR2s primarily in the UK/Cont. and West Africa. Currently, MR's are not being used as storage vessels."

However, there is substitutability across sizes, so tightness in one size class has the knock on effect of tightening up other sizes. Valentis picked up on this theme, saying: "Still, the storage of refined products on larger vessels takes supply out of the market, which is positive for the MR segment. The fundamental supply/demand outlook within the MR2 segment, the workhorse of the industry, looks very positive as we move into 2017 even without [exogenous] factors like contango and port congestion."

For the shipowner, a storage contract has the economic effect of fixing the daily hire for a lengthy period. While MRs are not typically engaged in storage- as Valentis explained above - companies can lock in cash flows through their chartering strategies. In the case of Pyxis, it has pursued a strategy of placing its four MRs on period charters, which reduces the volatility, and possible instability of earnings, from pursuing a pure spot market strategy.

It's difficult to predict the effect of floating storage of clean products with any precision, but we can say that companies like Pyxis Tankers will clearly benefit from this further contributor to supply tightness - if it transpires, and, perhaps, to the 'bright' perfect storm, or market 'rip' looming for this sector.

This article was written by Barry Parker of BDPL Consulting.

Fleet List

Name	Builder	Dwt	DOB	Charter
Pyxis Epsilon	**SPP**	**50,295**	**2015**	**Time**
Pyxis Theta	SPP	51,795	2013	Time
Pyxis Malou	SPP	50,667	2009	Time
Pyxis Delta	Hyundai	46,616	2006	Time
Northsea Alpha	Kejin	8,615	2010	Time
Northsea Beta	Kejin	8,647	2010	Spot

Source: Pyxis Tankers.