Gas business shows signs of a revival in earnings

A number of recent charter deals indicate an upturn in the fortunes of gas carriers, particularly the larger vessels

Barry Parker

DURING the early November earnings season, Teekay LNG Partners reported its results for the third quarter. The company's name is a misnomer because its fleet includes a group of liquefied petroleum gas/multigas tankers and a clutch of conventional suezmaxes.

Because of the entity's partnership structure, its most significant figure is "distributable cash flow", which supports distributions to unit holders. Peter Evensen, the chief executive of the general partner (the entity actually managing the business, owned by Teekay Corp), attributed the increase in cash flow to "the steady growth in Teekay LNG's portfolio of long-term fixed-rate contracts".

The partnership's three LPG carriers on the water are fixed on long-term charters: one to Statoil for another five years and two to IM Skaugen with expiry dates in 2023-2024. Two 12,000 cu m multigas newbuildings with LNG capabilities will start 15-year charters back to IM Skaugen.

When these vessels are delivered next year, they will be dropped down from Teekay Corp to the partnership. Teekay has joined GATX (a long-time co-owner with IM Skaugen of ethylene carriers in the early 2000s and now of multigas vessels), as a financing partner for this Norwegian owner.

Optimism is creeping into the very large gas carrier sectors (vessels of 82,000 cu m plus). Recent reports have linked the LPG trader and time charter operator Petredec — partly owned by the National Shipping Company of Saudi Arabia — with a one-year renewal on a previous period fixture, and the shorter-term booking of a VLGC relet from another trader.

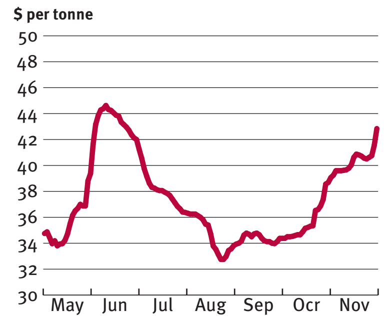
Recently, there has been runup in spot rates for the larger vessels. The cargo flows in the sector are opportunistic — often tied to the spread between the oil price and the value of finished or intermediate outputs where the LPG is a feedstock.

The Baltic Exchange index for the bigger LPG carriers on the Ras Tanura/Chiba route, which had peaked in mid-June at $44 per tonne before a summer slide, has been moving back up above $40 per tonne.

In recent weeks, crude prices for Middle East liftings have moved up on continued strength in the crack spreads in Asia. The prices of LPG (a byproduct of the refining process and separation of natural gas from crude at the production stage) have edged upward, as crude moved over $80 per barrel.

BALTIC EXCHANGE LPG

May 10, 2010 to November 10, 2010



Source: *Baltic Exchange*

It is not clear that the VLGC strength will continue. There is always a danger that charterers will pull back their cargoes if more expensive LPG becomes unattractive to receivers. Market sources estimate the charter hire on these large gas carriers at around $620,000 per month.

Unlike in the longhaul liquefied natural gas sector, long-term contracts are not the norm for vessels hauling LPG (propane and butane) along with refrigerated materials such as ethylene, propylene and ammonia).

Hires for smaller vessels, in European and Asian distributive trades, are sensitive to overall economic activity. European spot market activity was hit by French labour disruptions. As French refining returned to normal, rates for smaller coasters in the European trades turned sharply upwards. Brokers estimated the value of coastal traders at roughly $300,000 per month.

The paradigm of cash flow visibility, albeit for terms well short of 15 years, applies to the chartering strategies of companies seeking to please bankers, as well as investors.

StealthGas chief executive Harry Vafias was talking about "a strong and stable earnings stream for the foreseeable future" when he announced 10 period charters, ranging from six months (followed by an optional period) to five years.

Five of the charters, on fully pressurised vessels of 3,500 cu m-4,100 cu m now coming off previous charters, are bareboat deals. Mr Vafias pointed out that bareboat terms shifted the risk of operating cost increases to the charterer, described as "an international gas operator". StealthGas' largest charterers include Petredec, which is renewing its existing time charter on *Gas Shiruken*, a 5,000 cu m fully pressurised ship, and Vitol.

The increased term coverage is a mark of confidence by StealthGas, which had shown a willingness to increase its spot days to 80% during 2009 (compared with 95% in 2008). Stealthgas reports the time charter equivalent for the new charters to average $241,185 per month — suggesting that period rates are slightly discounted to the spot estimates. Backwardation of forward hires is a symptom of "good" freight markets- and another signal of improved nearby conditions.

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Besides the term chartering by Petredec and others, the sector has also seen long term thinking- in the form of investment activity. In late October, Camillo Eitzen announced it had completed the sale of a 40% share in Eitzen Ethylene Carriers (part of Eitzen Gas) for $15m to private investment company Jaccar Holdings. Jaccar is controlled by Jacques de Chateauvieux, best known as chairman of offshore specialist Bourbon.

Eitzen Gas' LPG/ethylene -capable fleet consists of eight wholly owned units of 10,387 cu m-11,758 cu m built between 1987 and 1992. Additionally, five newer semi-refrigerated units are managed for managing owner Solvang ASA and its partners.

The distinction between Jaccar, a private company, and the listed entity Bourbon is important. The latter has been selling its drybulk shipowning and operating business Setaf Saget. A group of 16 vessels was sold to Peter Georgiopoulos-controlled Genco Shipping & Trading for $545m earlier this year. Its ship chartering business has now been placed with a private company formed by Jean Louis Bottaro, a long-time Setaf employee. Bourbon will now be a pure player in offshore services, with a stated intention to invest $2bn in the sector.

Camillo Eitzen's capital restructuring has been ongoing and, in this context, the vessel sale to Jaccar makes sense. Divining the intentions of private equity investors such as Mr de Chateauvieux (who also has options to acquire a much larger stake in the ethelyne-capable fleet) requires some guesswork.

His move into the Asian-managed newly dubbed Eitzen Ethylene business is intriguing. The gas business is clearly on an upswing, but there is more: it could provide synergies with other portfolio components. Not the least of these is Chinese shipbuilder SinoPacific, where Jaccar has already ordered eight 12,000 cu m ethelyne suitable vessels.

The mission statement for Jaccar includes the goal of listing on financial markets, yet the future may offer a different flavour of 'exit' than simply a plain vanilla shipping initial public offering.

Historically, Jaccar has had close ties with Vietnam, including two funds for investing in local businesses.

Vietnam's efforts to develop a homegrown petrochemical business have gone through fits and starts. Two years ago, a company producing plastics-linked outputs, the Mylan Group in Tra Vinh, saw an investment by one of Mr de Chateauvieux's funds, the Vietnam Century Fund. As Jaccar and its funds continue to invest in Vietnam, a vertical integration component may be driving a shipping strategy.

The smaller semi-pressurised ships are not the only sector where investment flows are being driven by possible business strategies. Exmar has sold 50% stakes in two vessels, the 2002-built *Excalibur* and the LNG/regas vessel *Excelsior*, to the Teekay partnership.

Both are on 20-year fixed-rate time charters to Excelerate Energy, a terminal specialist and developer of the Energy Bridge concept, where vessels can discharge cargo in either a liquid or gaseous state (after regasification aboard the vessel).

At the outset, Exmar (which will keep the vessels' management) books a gain of around $50m and sees cash increased by $35m; the Teekay partnership assumes approximately $100m of related debt. As part of the payment package, Exmar will receive 1.1m partner units, worth another $35m to Exmar.

The LNG and related shipping businesses are expensive yet strategic to energy players. German utility RWE bought a 50% stake in Excelerate Energy in 2008, and the Energy Bridge concept figures prominently in the power producer's efforts to source new gas supplies in places such as Trinidad and West Africa.

In this sector, economies of scale are particularly applicable, because of high capital investment budgets and exacting technical and manning requirements.

In a low interest rate environment where investors are seeking yield, Teekay Offshore (which throws off just under 7%) has had no trouble raising equity this year. Mr Evensen, always careful in his choice of words, sung the praises of floating regasification and said: "The Exmar transaction also demonstrates the Partnership's ability to grow through direct third party acquisitions."

$620,000

Estimated charter hire on VLGCs

Recent US Federal Reserve actions suggest low rates will be around for a while, so high-yielding payers will likely continue to be attractive to investors.

A number of high-profile energy assets might fit into the Teekay stable if other owners are looking to rebalance their existing vessel portfolios. If a charterer had long-term interest, candidates might include the LNG vessel *Neo Energy*, a vessel that has never fitted in with owner Tsakos Energy Navigation's broader crude oil and products transport strategy. It is on a one-year charter expiring in June, 2011.

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Other attractive assets might come from Overseas Shipholding Group, which has recently consolidated management of its LNG activities into a broader company business unit — hardly a sign of corporate expansion in the sector.

OSG, with four 216,000 cu m Q-Flex vessels owned jointly with Nakilat, with lengthy bond-like contracts to QatarGas already in place (expiring 2032-2033), has been battered lately by the weakened spot tanker markets.

OSG is also a partner, with Euronav, in two double-hulled floating storage and offloading vessels *FSO Africa* and *FSO Asia* working for Maersk Oil Qatar on three-year deals. Noting the Euronav and Exmar connection (both still tied to the Saverys family), one must wonder whether a Teekay connection might not be in the offing. ■

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New impetus: VLGCs such as BW Gas' *BW Prince*, above, are enjoying rising spot rates, while Exmar has booked a $50m gain as well as a $35m cash injection from the sale to Teekay of a 50% stake in *Excelsior* and *Excalibur*, below.

Evensen: praising floating regasification.

De Chateauvieux: intriguing ethylene move.