BOBCAPS
TRUST | INNOVATION | EXCELLENCE

OIL & GAS

18 February 2022

Expert call: Refining and shipping outlook

- **Current refining demand growth expectations may prove conservative, keeping refining and product markets tight**
- **Crude tightness to ease with pickup in OPEC and non-OPEC supply. Lifting of Iranian sanctions could significantly loosen crude market**
- **Tanker market poised for recovery from Q3CY22, supported by scrapping of old ships and sustainable demand recovery**

Kirtan Mehta, CFA
researchreport@bobcaps.in

We hosted Anoop Singh, Head and Principal Analyst, Tanker Research at Braemer ACM Shipbroking and Axel Siepmann, Managing Director of Braemar Naves. Key takeaways from the call:

IEA demand growth forecast for CY22 could turn out to be conservative: Post pandemic recovery in fuel demand (including for jet fuel) could surprise on the upside if we extrapolate the recovery seen in the US.

Real threat to long-term gasoline demand may be overhyped: A study of the US demand revival suggests that underlying behaviour is changing. Longer travel, longer commutes to office and increased use of SUVs are supportive of demand.

Iranian supply a risk for crude price: Illegitimate Iranian crude trade could potentially be of the order of 1mbpd and is transported via old tankers, which would otherwise have left the trading fleet. Upon lifting of sanctions, stored crude could immediately hit the market and further supply can potentially increase to 2-2.5mbpd.

Tanker market to turn strong within two years: Reduction in oversupply and improvement in demand should help the tanker market rebound by Q3CY22 and strengthen it by CY24/CY25. As Iranian storage trade comes to an end, the scrapping of older vessels will help improve utilisation levels. At least 8% of vessels are 20 years old and shipyards cannot deliver new tankers soon.

Tanker demand poised for strong recovery: Growth in non-OPEC supply will be positive for dirty tanker tonne miles. Crude flow from West to East of Suez is likely to grow by 2.6mbpd over the next 3-5 years. Similarly, refinery closures in OECD countries could increase demand for refined products from the Middle East, India and Far East by 1.5-2.0mbpd over the next five years. Long-haul flows for gasoil and naphtha are especially positive for LR2 (100kt ships) and MRs (<55kt).

Container congestion unlikely to materially ease this year: Meaningful reduction in container congestion, at either loading or discharge sites, looks unlikely.

Oil and refining

IEA demand growth forecast for CY22 could prove conservative

IEA expects demand for oil products to move 0.3mbpd above the pre-pandemic level in CY22. Post pandemic demand recovery (including jet fuel) could surprise on the upside if we extrapolate the revival seen in the US. Gasoline demand in the US has already returned to 2019 levels despite work mobility being 20% less. Strong gasoil demand through winter has reduced stocks below the average level. Petrochemical demand is also running 1mbpd above 2019 levels. With 2mbpd of capacity taken out of the western world over the past two years, the products market will likely remain tight.

Real threat to long-term gasoline demand may be overhyped

The ongoing US demand recovery suggests that underlying behaviour is changing. Improved vehicle fuel efficiency is giving rise to longer travel. Relocation of families to the suburbs is lengthening the commute to office. Faster growth of SUVs (alongside EVs) is also supportive of gasoline consumption.

Iranian supply a risk for crude price

Illegitimate Iranian crude trade could potentially be of the order of 1mbpd and is largely moved and stored on old tankers. Upon lifting of sanctions, supply can potentially increase to 2-2.5mbpd.

Shipping

Tanker market to turn strong within two years

Dirty and clean tanker markets are depressed due to oversupply as only 46% of the fleet was laden with cargo even at the peak in Dec'21. However, this is going to change as the industry scraps its older fleet as and when the storage trade for Iranian crude draws to an end – potentially this year with the lifting of Iranian sanctions. At least 8% of the current fleet is more than 20 years old and the order book is falling below replacement levels. Also, the industry will not be able to add new oil tankers soon as shipyards are busy with orders for container and LNG ships till at least end-CY24.

Asset prices may not follow the recovery in charter rates

While charter rates could recover on improving utilisation, asset prices may not see similar upsides, particularly for older vessels, mainly due to the risk emanating from transition to cleaner fuels. A positive view on demand recovery and firm steel prices has sustained asset values at cycle highs despite weak freight markets.

Tanker demand poised for strong recovery

Dirty tanker demand is likely to see a more sustainable recovery with pickup in OPEC and non-OPEC supply in H2CY22, as on-ground crude stocks hit minimum workable levels. Further, growth in non-OPEC supply will be positive for dirty tanker tonne miles. Crude flow from US to East of Suez is likely to grow by 2.6mbpd over the next 3-5 years.

On the other hand, refinery closures in OECD countries (close to 2mbpd over past two years) is positive for clean trade, which could increase by 1.5-2.0mbpd over the next five years. Long-haul flows for gasoil, jet fuel and naphtha are especially positive for LR2 (100kt ships) and MRs (<55kt ships).

Container congestion unlikely to materially ease this year

Meaningful reduction in container congestion, at either loading or discharge sites, looks unlikely. Also, the addition of new container ships will take time given that a bulk of the deliveries are scheduled only for CY23/CY24.

Potential acquisition/order window opening up for MR vessels

A potential optimal acquisition/order window for MR (medium-range) vessels for modern tonnage is opening up with hitherto under-investment in MR vessels and the likelihood of a market rebound by Q3CY22 latest.

While the long-term outlook on oil (and in turn tanker) markets points to an eventual decline in demand in all scenarios, limited supply (likely from under-investment on modern MR tankers as well as stronger regulatory forces which will make older assets inefficient) could lead to a sustained strong charter rate for the foreseeable future.

Disclaimer

Recommendation scale: Recommendations and Absolute returns (%) over 12 months

BUY – Expected return >+15%

HOLD – Expected return from -6% to +15%

SELL – Expected return <-6%

Note: Recommendation structure changed with effect from 21 June 2021

Our recommendation scale does not factor in short-term stock price volatility related to market fluctuations. Thus, our recommendations may not always be strictly in line with the recommendation scale as shown above.

Rating distribution

As of 31 January 2022, out of 115 rated stocks in the BOB Capital Markets Limited (BOBCAPS) coverage universe, 63 have BUY ratings, 32 have HOLD ratings, 5 are rated ADD*, 1 is rated REDUCE* and 14 are rated SELL. None of these companies have been investment banking clients in the last 12 months. (*Our ADD and REDUCE ratings are in the process of being migrated to the new recommendation structure.)

Analyst certification

The research analyst(s) authoring this report hereby certifies that (1) all of the views expressed in this research report accurately reflect his/her personal views about the subject company or companies and its or their securities, and (2) no part of his/her compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) in this report. Analysts are not registered as research analysts by FINRA and are not associated persons of BOBCAPS.

General disclaimers

BOBCAPS is engaged in the business of Institutional Stock Broking and Investment Banking. BOBCAPS is a member of the National Stock Exchange of India Limited and BSE Limited and is also a SEBI-registered Category I Merchant Banker. BOBCAPS is a wholly owned subsidiary of Bank of Baroda which has its various subsidiaries engaged in the businesses of stock broking, lending, asset management, life insurance, health insurance and wealth management, among others.

BOBCAPS's activities have neither been suspended nor has it defaulted with any stock exchange authority with whom it has been registered in the last five years. BOBCAPS has not been debarred from doing business by any stock exchange or SEBI or any other authority. No disciplinary action has been taken by any regulatory authority against BOBCAPS affecting its equity research analysis activities.

BOBCAPS has obtained registration as a Research Entity under SEBI (Research Analysts) Regulations, 2014, having registration No.: INH000000040 valid till 03 February 2025. BOBCAPS is also a SEBI-registered intermediary for the broking business having SEBI Single Registration Certificate No.: INZ000159332 dated 20 November 2017. BOBCAPS CIN Number: U65999MH1996GOI098009.

BOBCAPS prohibits its analysts, persons reporting to analysts, and members of their households from maintaining a financial interest in the securities or derivatives of any companies that the analysts cover. Additionally, BOBCAPS prohibits its analysts and persons reporting to analysts from serving as an officer, director, or advisory board member of any companies that the analysts cover.

Our salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to our clients that reflect opinions contrary to the opinions expressed herein, and our proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. In reviewing these materials, you should be aware that any or all of the foregoing, among other things, may give rise to real or potential conflicts of interest. Additionally, other important information regarding our relationships with the company or companies that are the subject of this material is provided herein.

This material should not be construed as an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. We are not soliciting any action based on this material. It is for the general information of BOBCAPS's clients. It does not constitute a personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual clients. Before acting on any advice or recommendation in this material, clients should consider whether it is suitable for their particular circumstances and, if necessary, seek professional advice.

The price and value of the investments referred to in this material and the income from them may go down as well as up, and investors may realize losses on any investments. Past performance is not a guide for future performance, future returns are not guaranteed and a loss of original capital may occur. BOBCAPS does not provide tax advice to its clients, and all investors are strongly advised to consult with their tax advisers regarding any potential investment in certain transactions — including those involving futures, options, and other derivatives as well as non-investment-grade securities —that give rise to substantial risk and are not suitable for all investors. The material is based on information that we consider reliable, but we do not represent that it is accurate or complete, and it should not be relied on as such. Opinions expressed are our current opinions as of the date appearing on this material only. We endeavour to update on a reasonable basis the information discussed in this material, but regulatory, compliance, or other reasons may prevent us from doing so.

We and our affiliates, officers, directors, and employees, including persons involved in the preparation or issuance of this material, may from time to time have "long" or "short" positions in, act as principal in, and buy or sell the securities or derivatives thereof of companies mentioned herein and may from time to time add to or dispose of any such securities (or investment). We and our affiliates may act as market makers or assume an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis, and may also perform or seek to perform investment banking or advisory services for or relating to these companies and may also be represented in the supervisory board or any other committee of these companies.

For the purpose of calculating whether BOBCAPS and its affiliates hold, beneficially own, or control, including the right to vote for directors, one per cent or more of the equity shares of the subject company, the holdings of the issuer of the research report is also included.

BOBCAPS and its non-US affiliates may, to the extent permissible under applicable laws, have acted on or used this research to the extent that it relates to non-US issuers, prior to or immediately following its publication. Foreign currency denominated securities are subject to fluctuations in exchange rates that could have an adverse effect on the value or price of or income derived from the investment. In addition, investors in securities such as ADRs, the value of which are influenced by foreign currencies, effectively assume currency risk. In addition, options involve risks and are not suitable for all investors. Please ensure that you have read and understood the Risk disclosure document before entering into any derivative transactions.

In the US, this material is only for Qualified Institutional Buyers as defined under rule 144(a) of the Securities Act, 1933. No part of this document may be distributed in Canada or used by private customers in the United Kingdom.

No part of this material may be (1) copied, photocopied, or duplicated in any form by any means or (2) redistributed without BOBCAPS's prior written consent.

Company-specific disclosures under SEBI (Research Analysts) Regulations, 2014

The research analyst(s) or his/her relatives do not have any material conflict of interest at the time of publication of this research report.

BOBCAPS or its research analyst(s) or his/her relatives do not have any financial interest in the subject company. BOBCAPS or its research analyst(s) or his/her relatives do not have actual/beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

The research analyst(s) has not received any compensation from the subject company in the past 12 months. Compensation of the research analyst(s) is not based on any specific merchant banking, investment banking or brokerage service transactions.

BOBCAPS or its research analyst(s) is not engaged in any market making activities for the subject company.

The research analyst(s) has not served as an officer, director or employee of the subject company.

BOBCAPS or its associates may have material conflict of interest at the time of publication of this research report.

BOBCAPS's associates may have financial interest in the subject company. BOBCAPS's associates may hold actual / beneficial ownership of one per cent or more securities in the subject company at the end of the month immediately preceding the date of publication of this report.

BOBCAPS or its associates may have managed or co-managed a public offering of securities for the subject company or may have been mandated by the subject company for any other assignment in the past 12 months.

BOBCAPS may have received compensation from the subject company in the past 12 months. BOBCAPS may from time to time solicit or perform investment banking services for the subject company. BOBCAPS or its associates may have received compensation from the subject company in the past 12 months for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory services in a merger or specific transaction. BOBCAPS or its associates may have received compensation for products or services other than investment banking or merchant banking or brokerage services from the subject company in the past 12 months.