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Half Year 2020 BW LPG Ltd Earnings Call

EVENT DATE/TIME: AUGUST 27, 2020 / 12:00PM GMT

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PRESENTATION

Operator

Ladies and gentlemen, welcome to BW LPG's Second Quarter 2020 Financial Results Presentation. We will begin shortly. You will be brought through the presentation by BW LPG's CEO, Anders Onarheim; CFO, Elaine Ong; and EVP Commercial, Niels Rigault. They will be pleased to address any questions after the presentation. (Operator Instructions)

Certain statements in this conference call may constitute forward-looking statements based upon management's current expectations, and include unknown and -- known and unknown risks, uncertainties and other factors, many of which BW LPG is unable to predict or control that may cause BW LPG's actual results, performance or plans to differ materially from any future results, performance or plans expressed or implied by such forward-looking statements. In addition, nothing in this conference call constitutes an offer to purchase or sell or a solicitation of an offer to purchase or sell any securities.

With that, I am now pleased to turn the call over to BW LPG CEO, Mr. Anders Onarheim. Please go ahead, sir.

Anders Onarheim ***BW LPG Limited - CEO & Director***

Thank you, and welcome to the presentation for our results for the second quarter 2020. As you heard, I'm here joined by our CFO, Elaine Ong; and our EVP Commercial, Niels Rigault. We appreciate your interest, and we'll take questions at the end of the call.

Let me start by saying that I'm very pleased with our 2Q results. Particularly when we take into account the circumstances. Both the COVID-19 and oil price disruptions, they put our entire organization to the test, both at land and at sea. Crude changes became a huge challenge, inspections were almost impossible to conduct, and the volatility in the market made it very difficult for the commercial team, in addition to adding work challenges like working for home, of course. I'm therefore very proud to lead such a competence and agility.

So if we go to the presentation, please go to the Slide 4, the highlights. At TCE rates on our VLGC fleet averaged $39,100 per day. This was generated net profit after tax of $62 million or an earnings per share of $0.45. With our continued strong financial performance in the second quarter, we have now achieved a year-to-date return on equity of 24%, and we have generated $300 million of free cash flow. We are also pleased to announce that we continue to return cash to our shareholders. The Board has declared a Q2 cash dividend of $0.50 per share amounted to $21 million. And with this dividend, we have year-to-date paid $0.35, which is about 34% of $1.03 in earnings per share that we had in first half. Our dividend policy remains to target a payout ratio of 50% on an annual basis. However, since we pay on a quarterly basis, the Board has found it prudent to pay out less than 50% for the first quarters. This, of course, leaves room for some upside in the last 2 quarters.

BW LPG, we are retrofitting the world's first LPG dual fuel engines on the BW Gemini and the BW Leo, and with this clearly taking the lead and advancing technology towards zero-carbon fuel propulsion. You can see the picture of the deck tanks ready for installation at the yard on the left side, so huge tanks. We continue to be fully committed to our 12 dual fuel engine conversions, given the substantial environmental benefits that this gives us. DNV has confirmed that installing new technology on existing vessels generates 97% less carbon emissions than the construction of a new vessel. This means that building in new vessels with LPG propulsion is hard to justify from an environmental perspective when you can actually convert. And we hope that the industry will follow our lead and upgrade the fleet rather than build new. We also hope that our customers will see and take advantage of this benefit when tendering for their longer-term chartering needs.

Finally, we have also started to collaborate with Hafnia, our affiliate company, on bunker procurement. Hafnia supports bunkering of over 450 ships, so they're a major player, bringing economic -- economies of scale and best-in-class bunkering logistics to our firm. As we also previously announced, we have concluded the sale and delivery of Berge Summit for a new owner for further trading. The sale has generated USD 9 million in liquidity and a net gain of $4 million. The successful completion of that transaction, I think, demonstrates our asset management strategy. We will continue to evaluate for investments and divestments in the quarters ahead. We now own an operator fleet of 46 modern VLGCs with an average age of 8.7 years.

Turning to Page 5, let me then review the key financials of the quarter. So in the second quarter, we positioned our fleet to capture the strong market in the first half of the quarter and protect ourselves with increased time charter coverage when the market hit bottom at the end of June. With our strong commercial and operating performance, we achieved a daily rate, as mentioned, of $39,100 for the VLGC segment. This allows us to continue to generate a strong return for our shareholders with return on capital employed of 12% and return on equity of 21% for the quarter. The annualized earnings yield, measured as EPS divided by our share price at quarter, was 58%. Our net leverage ratio decreased from 58% in the second quarter of last year to 46% in the second -- in the second quarter this year. This is a level we are very comfortable with. Once again, we have returned cash to shareholders, at the same time, significantly paid down our debt to a comfortable level.

Our EVP Commercial, Niels Rigault, now will take you through the market review and a commercial update. Niels?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

Thank you, Anders. Let me start with a summary of VLGC market outlook. We are currently witnessing a strong V-shape recovery in the VLGC market. At the start of Q2, we had a freight rates around $50,000 per day, but it declined sharply down to $10,000 at the end of the second quarter. Now in the middle of the third quarter, VLGC freight rates have recovered to a level we last saw at the beginning of Q2.

Looking forward into Q3, LPG production and export out of the U.S. are holding up well with the export at similar level to 2019, and inventory is still well above the 5-year average. LPG export out of the Middle East are up 17% or about 11 cargoes in August compared to the average export level from May to July, this as a result of OPEC gradually reducing their production cuts. For the medium term, meaning Q4 and '21, freight rates are also supported by inefficiencies from bunkering delays, crew changes and heavy dry dock schedule. In '21, we expect that over 20% of the fleets will be dry docked. We maintain a cautious view for '21, but highlight that a recovery to a higher oil and gas price environment would support a more positive outlook.

As you can see from Slide 8, traded LPG volume fell by 9% in the second quarter, but we have seen recovery in import demand in both Asia and Europe in the third quarter. The positive news in Q2 on the demand side is that China is back and have started to import LPG from the U.S. again; last time was in 2018.

At Slide 9, you will see EIA short-term energy outlook released in August. They still anticipate a growth in U.S. LPG export by 13% in 2020, but expects net exports to decline by 10% in '21, up from their April update, which was expected an 11% decline. The forecast is based on the WTI price of [$40s] (corrected by company after the call) for '21.

On the next 2 slides, we want to give you a better understanding of the LPG demand drivers. Global LPG demand is about 3x larger than the seaborne LPG trade. The LPG domestic production in Asia is not able to meet the rapid growth demand. Retail is the largest sector for the total LPG demand, consuming about half of all the produced LPG. At 2.1% compound annual growth that we have seen historically would equate to roughly 3 million tons of LPG additional demand per year or roughly 8 additional VLGCs a year. In addition to retail, LPG demand is also driven by the chemical and refinery sector.

On Slide 11, we saw that demand for LPG in China is driven as much by chemicals and refineries. In China alone, over 7 PDH projects are under construction and scheduled to come on stream from '20 to '23. The total propane requirement for these are estimated to be over 4 million tons per year.

Turning to Slide 12. The new building order book now stands at 11% of the current fleet with 2 new confirmed orders since our Q1 earnings release. 60% of the order book is the LPG propulsion. However, there are no reason to order new ships to make the fleet more efficient. More than 150 existing ships can be retrofitted. From an environmental standpoint, new builds do not justify the CO2 savings with a CO2 payback period of over 15 years contrary retrofits of only 6 months, think reuse.

Turning to Slide 14. Q2 was the quarter COVID-19 hit the VLGC sector. Total seaborne LPG trade decreased 9% year-on-year, mainly driven by decreased exports from the Middle East. OPEC+ started the historic production cuts in May. As such, LPG export from the Middle East dropped by 12%. Anticipating less cargoes out of the region, we position our vessels towards the U.S. and fixed only 10% of our fixture in the Middle East. U.S. export remained strong with volumes transported by VLGCs up 7% from the same period last year despite oil production reduction. The WTI oil price went negative in April, disrupting the VLGC trade. During this period, product services demonstrated its capabilities in supporting shipping performance by improving our commercial utilization.

European import demand came to a complete halt due to the lockdown measures. However, this was part offset by the increases in India and Brazil, with a sudden increase in import cost delays and discharged ports as many ships were stuck for weeks. The decrease in import demand resulted in an oversupply of fleets in the market and freight rates started to drop. We reduced the fleet capacity by flow streaming and sailing the longer route through the Cape of Good Hope instead of via the Panama Canal.

The collapse in VLGC freight rates at the end of June will impact our Q3 performance. For Q3, we have fixed about 80% of our fleet-wide available days at an average rate of about $27,000 per day basis discharge to discharge. However, the current strong rate environment will most likely translate to a higher earnings in Q4, making the third quarter a weaker quarter this year.

Slide 15 shows our strong performance of this quarter was driven by high utilization in combination with a well-positioned fleet that allow us to capture the strong spot market in the quarter.

Turning to Slide 16. In the second quarter, before the rates collapsed, we increased our time charter coverage from 16% to 25% for '20 and from 5% to 14% for '21. We have now covered our TC in exposure for '21 at a profit of $2 million.

With that, I will hand back to Anders, who will share some technical highlights. Thank you.

Anders Onarheim ***BW LPG Limited - CEO & Director***

Thank you, Niels. As mentioned, we continue to deliver a strong technical and operational performance in the quarter despite the challenges from the market due to COVID-19. Our planned dry docks and retrofittings remain largely on track and our final scrubber installation is scheduled for October this year. The retrofitting of BW Gemini and BW Leo with LPG dual fuel engines are commenced in August. Once completed, they will be the first vessels in water. With this pioneering technology, we could pave the way for ammonia propulsion and zero-carbon emissions down the road. I previously said that these conversions make sense, both from financial and environmental perspective. This is still the case. The fuel spread is still attractive, and we expect significant bunker savings with our retrofitter ships. Crew changes remain challenging, but we managed this well with contract overruns on declining trend. We have completed about 900 crew movements year-to-date. However, still 47 crew members are over 3 months delayed and 55 members are less than 3 months delayed for their crew change.

With that, let me turn it over to our CFO, Elaine Ong, who will take -- walk you through the financial position and results. Elaine?

Elaine Ong ***BW LPG Limited - CFO***

Thanks, Anders. Here on Page 20 is an overview of our income statement. Our TCE income was $149 million for the quarter and $311 million for the first half of this year. This is driven mainly by the strong TCE rates and a high fleet utilization of 97%. Included in our TCE income for the quarter is a positive $17 million relating to the effects of IFRS 15 on revenue, where since 1st of January 2018, spot voyages that straddled the quarter end have to be accounted for on a load to discharge basis. With rates picking up as we near the end of the third quarter, we expect IFRS 15 to have the opposite effect on our reported numbers for Q3. Vessel operating expenses came in at $7,100 per day for the quarter and $7,400 per day for the first half of the year. This is roughly in line with our expected run rate for this year.

Time charter high expense relates to 1 vessel with a charter period of less than 12 months. EBITDA came in at $113 million for the quarter and $239 million for the first half of the year, representing an EBITDA margin of 77%.

As previously highlighted, with effect from 1st of January 2020, we revised our vessel's useful life from 30 years to 25 years. The impact is an increase in depreciation of approximately $6 million per quarter. We also recognized a $4 million impairment charge on 2 time charter in contracts in this quarter. This is because their contracted rates were higher than forecasted earnings over the remaining lease periods. Profit after tax this quarter was $62 million or $0.45 per share. For the first half of 2020, our profit after tax was $143 million or $1.03 per share, yielding an annualized return on equity of 24%. The fair value changes this quarter include an approximate $2 million loss on our interest rate hedges and $3 million gain on our forward freight agreements and bunker hedges. These mark-to-market changes are deferred in equity, bringing our total comprehensive income for this quarter to just over $1 million.

Turning to Page 21. We provide a snapshot of our balance sheet and cash flow statement. Our vessels book values supported by broker valuations stood at $1.8 billion at the end of the quarter. Shareholders' equity was $1.2 billion or $8.39 per share. During the quarter, we generated $113 million of net cash from our operating activities and ended the quarter with $83 million of cash. Our $300 million revolving credit facility remains undrawn, giving us just under $400 million of available liquidity at quarter end.

Turning to Page 22. The strong cash flows generated over the last 12 months with minimal capital expenditures over the same period have allowed us to pay down debt, thereby reducing our leverage. Our net leverage ratio decreased by 12% over the last 12 months from 58% at the end of Q2 2019 to 46% at the end of this quarter. This is even after paying out $145 million in dividends for both 2019 and Q1 2020. This is made possible by our low operating cash breakeven of $20,500 per day for our own fleet and $21,600 per day when we include the time charter in vessels. Our all-in cash breakeven level for 2020 is $23,700 per day, which is the average TCE needed in 2020 to cover all our cash costs, including dry dockings and the equity portion of our CapEx upgrade.

Page 23 provides an overview of our liquidity and debt position. Our net debt position at the end of the quarter was $1.1 billion; of this only $13 million relates to our trade finance facilities for our cargo trading business and $215 million relates to lease liabilities under IFRS 16 on leases; the remaining $887 million in debt outstanding relates to our 5 term loans. We have no major balloon payments due in the next 5 years and only a small balloon payment of $47 million due in 2023 relating to our $150 million term loan. In May this year, we secured financing for the retrofitting of 5 dual fuel LPG propulsion engines. The existing $400 million facility at LIBOR plus 170 bps was increased by $38 million with all other terms unchanged. That gives us a bank financing that covers over 80% of our expected CapEx on these 5 vessels.

With this, I would like to hand the time back to Anders to conclude our presentation.

Anders Onarheim ***BW LPG Limited - CEO & Director***

Thank you, Elaine. If we then just turn to Page 25, I'll summarize then our earnings presentation. As stated, despite the challenges related to the COVID-19, we delivered another strong quarter, both commercially and operationally and generated earnings per share of $0.45 per share in the quarter and net profit after tax of USD 62 million. On the back of our strong earnings and taken into account our balance sheet, liquidity, CapEx and a cautious market outlook, the Board has declared a cash dividend for the second quarter of $0.15 per share amounting to $21 million. Combined with $0.20 dividend paid for Q1 2020, the dividend is 34% of year-to-date net profits. And at the share price this morning, this gives an annual dividend yield of about 25%. In fact, since our listing in 2013, our dividend policy has remained unchanged, with a target payout ratio of 50% of annual net profit after tax. With the dividend announced today, we have, since our IPO, declared 63% of accumulated earnings as dividends.

We are very excited and proud to have the first LPG dual fuel vessels soon ready for operations. I believe this clearly demonstrates our ESG commitment as a company. It's not enough to have a nice glossy paper with text only in the annual report. Action speaks larger than words.

Finally, I would like to provide a summary of our outlook on the VLGC market. Although the freight rates collapsed at the end of May, the market has shown a strong recovery towards the end of July. The rate has increased to around $50,000 per day, a level last seen in early May. Freight rate recovery is supported by recovering LPG exports, firming import demand from Europe and Asia, and significant reductions in fleet supply due to slow steaming of vessels and longer voyage routes from the U.S. to Asia via Cape of Good Hope. In the medium term, we see downward pressure on U.S. LPG supply following lower oil prices and a meaningful new build order book. This is partly offset by heavy dry dock schedule with over 40% of global fleet going to yards by end 2021, and recovery in Middle East LPG production as OPEC oil production gradually returns to precut levels. Again, we are conservative but we also think there is uncertainty out there, so we will stick to this view. But of course, we will maneuver as good as we can through what we think will be exciting but challenging times.

So with that, I'd like to thank you. And I'd like to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have the first question from the telephone line from the line of Anders Karlsen.

Anders Redigh Karlsen ***Danske Bank A/S, Research Division - Analyst***

Hello. Congrats on a good result. This is Anders from Danske. It's probably a question for you, Niels. What are you seeing in the U.S. right now in terms of exports? Because I mean, EIA has been fairly conservative in their approach towards 2021. And I assume that's part of what you're leading to when you're saying that '21 might be challenging. But could you give us some thought on what is happening in the U.S. right now.

Niels Rigault ***BW LPG Limited - EVP of Commercial***

Yes. I mean, yes, I've been very conservative. And also, as I mentioned during the presentation, the base WTI price they're using is [$40s] (corrected by company after the call), and right now it's more like $44. And we are also surprised that how many cargoes actually came out and are coming out right now. We also see that the rich gas areas are also pumping a lot of LPG. So things are going great. And I would say that there are more cargoes coming out. But yes, we are anticipating a reduction next year. But we'll see if the oil price continue to go up, then we'll probably see an increase.

Anders Redigh Karlsen ***Danske Bank A/S, Research Division - Analyst***

Okay. And then if you look to take additional cover, what levels could you -- is there any demand out there? And what levels can you, say, fix a year contract at the present time?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

Yes, there is demand. And right now, I would say that it's around $20,000, $28,000 per day.

Operator

We have the next question from the line of Lukas Daul from ABG.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

I was wondering, if you flip to Page 18 in your slide back, if you could help us reconcile the capital expenditures that you are sort of putting in place in your retrofit program. Because it says that you have spent so far $31 million on it, and that's not something we are able to reconcile with your cash flow statement. So maybe if you could help us with that.

Anders Onarheim ***BW LPG Limited - CEO & Director***

Elaine, will you take that?

Elaine Ong ***BW LPG Limited - CFO***

Sorry, Lukas, I didn't realize I was on mute. Thanks, Lukas, for your question. Basically, the $31 million is the expected expenditures for the retrofit this year, which we have financed, the 4 ships that will be. So it hasn't been entirely spent, so to speak.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. Okay. So that's something that will still sort of be paid out throughout the course of the year?

Elaine Ong ***BW LPG Limited - CFO***

That's correct.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. Okay. Okay. That makes sense. And then a couple of other things. You mentioned that one of the measures you have taken to sort of offset the market weakness was slow steaming, and I guess from some of your environmental KPIs in the appendix we could see that. But could you just ballpark sort of give us a figure of the average paid in the second quarter compared to the quarter before a year ago?

Anders Onarheim ***BW LPG Limited - CEO & Director***

Do you have those numbers, Niels?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

No, I don't have those numbers. The only thing I would say is that in Q2, we started to slow steam towards the end of Q2 when the market started to drop, so around mid-May, June. But...

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. And then Elaine, I mean you've been sort of having a very good OpEx numbers so far this year. But I was wondering whether there is kind of an impact of the COVID situation where maybe some of the stuff on the maintenance side, et cetera, needs to be sort of postponed. Is that a right assumption or is this sort of level something we should anticipate you to deliver going forward?

Elaine Ong ***BW LPG Limited - CFO***

Lukas, I think I mentioned earlier in the script that the levels that we're seeing for the first half of 2020 will be indicative of the run rate for the rest of this year.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. Okay. And then...

Elaine Ong ***BW LPG Limited - CFO***

So I think if you use that as a guide, that will be quite close.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. Fair enough. And you mentioned sort of the positive impact you've got on your TCE in the second quarter, I guess it was around $17 million, and that's going to reverse in the third? Is this going to fully reverse or partially, or how should we think about that?

Elaine Ong ***BW LPG Limited - CFO***

Well, I think it probably is going to partially reverse. It really depends -- I don't have the crystal ball at quarter end Q3 yet at this point in terms of where the positioning of the vessels are and what we would estimate as an accrual. But it's suffice to say that the $17 million that we saw at the end of the quarter -- that we report will reverse early in Q3, and then we will pick up some form of an offset. So I would say it should partially reverse at the least. And it also depends on how far along the freight rates improve compared to where we began, which is fairly low levels at the end of Q2.

Lukas Daul ***ABG Sundal Collier Holding ASA, Research Division - Analyst***

Okay. And then just finally, I mean, there have been a couple of secondhand sales in the recent months. And I would say that maybe the realized prices came in higher than what people would have anticipated. So my question is, what is that ought to, and do you see sort of potential for doing more similar transactions?

Anders Onarheim ***BW LPG Limited - CEO & Director***

I can start, Niels, and you can follow-up. I think we continue to evaluate our fleet and to see at what point is the right time to start renewing more. I think we are comfortable with the values we've seen. And I think -- so we will evaluate. But now our focus really is on renewing the part of our fleet where we are retrofitting. So -- but again, we will continue to look at this, and we have many discussions internally, and we have seen that there is some -- there are inquiries out there. Of course, one of the big challenges that's been now these past several months is that even though you can agree on something, getting both inspectors on board and just getting the details done, it's very difficult. Even though -- so generally, sales and completion takes much longer.

Operator

(Operator Instructions) There are no questions on the telephone lines at the moment, ma'am.

Iver Baatvik ***BW LPG Limited - Head of IR***

Let's take a question from the webcast. So this is from Petter Haugen from Kepler. He asks what's the extra cost of retrofitting at VLGC? And what the main cost elements are including offhire?

Anders Onarheim ***BW LPG Limited - CEO & Director***

I can start. I mean, I think the costs, we did discuss before, they are somewhere between $9 million and $10 million. That's the actual costs of retrofitting. And so that CapEx, it's pretty much equipment, it's about $6.5 million, GN engineering about $0.2 million, the yard cost is about $1.5 million, and then there's also built in some contingency. So -- and how many extra days, we have said that in total, we expect the retrofitting to take approximately between 50 and 60 days.

Iver Baatvik ***BW LPG Limited - Head of IR***

Okay. He also has a follow-up question, which is what does it take to convert from LPG to ammonia? And what is the expected cost of that?

Anders Onarheim ***BW LPG Limited - CEO & Director***

Yes. I think, of course, this is a big question. We have certainly seen, and we had a firm belief that it is not going to take big investment or big adjustment to go from the LPG propulsion to ammonia. So -- but the cost is still too early. We are still working on this, and we haven't closed dialogue with them. But it's still too early, I think, to give any concrete numbers. But again, this -- I'm being told by our clever engineers that this will not be a big investment.

Iver Baatvik ***BW LPG Limited - Head of IR***

Okay. I think there's no further questions on the webcast.

Operator

We have a question on the telephone line, sir. Would you like to proceed?

Iver Baatvik ***BW LPG Limited - Head of IR***

Yes. Let's go ahead and take question from the telephone line.

Operator

We have a question from the line of Eirik Haavaldsen.

Eirik Haavaldsen ***Pareto Securities, Research Division - Head of Research***

Yes, sorry for that. Just wanted to double check your Q3 guidance. When you say 80% of them or those days at $27,000, that's just -- your Q3 guidance refers only to spot days, right?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

It's fleet and wide.

Eirik Haavaldsen ***Pareto Securities, Research Division - Head of Research***

So including time charters?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

Yes.

Eirik Haavaldsen ***Pareto Securities, Research Division - Head of Research***

Good. Can you also then elaborate a little bit on where you've been booking ships for the past 2, 3 weeks?

Niels Rigault ***BW LPG Limited - EVP of Commercial***

Well, the market has really recovered as a V-shape. I mean, in June, it was down to $8,000 to $10,000 per day. And in August, we're talking slightly above $50,000, so -- and the market moved up in just -- from $10,000 to $40,000 plus in 2 weeks, so it's...

Operator

(Operator Instructions)

Anders Onarheim ***BW LPG Limited - CEO & Director***

Yes, I'm sorry. So well, it sounds like there are no more questions on here. So if that's the case, I'd just like to thank everybody for joining us for the call, and have a good day.

Operator

Thank you, sir. Ladies and gentlemen, we have come to the end of today's presentation. Thank you for attending BW LPG's Second Quarter 2020 Financial Results Presentation. More information on BW LPG is available online at www.bwlpg.com. Goodbye.