29-Aug-2019

BW LPG Ltd. (BWLPG.NO)

Q2 2019 Earnings Call

CORPORATE PARTICIPANTS

Martin Ackermann
Chief Executive Officer, BW LPG Ltd.

Elaine Ong
Chief Financial Officer, BW LPG Ltd.

Iver Baatvik
Head of Investor Relations, BW LPG Ltd.

Martin Ackermann
Chief Executive Officer, BW LPG Ltd.

Welcome to BW LPG Second Quarter 2019 Financial Results Presentation. We will begin shortly. Thank you very much. Welcome to the presentation of BW LPG's Results for the Second Quarter of 2019, the financial period ending 30th of June. I'm joined by our CFO, Elaine Ong, as always, and we appreciate your interest and we will take questions at the end of the call.

The Baltic Index for VLGCs went up significantly by 129% in the second quarter of 2019 compared to the previous quarter, averaging at $49.8 per ton or $34,300 per day. VLGC freight rates started to recover since the end of the first quarter, and the positive momentum continued in the second quarter. In Q2, U.S. domestic LPG consumption has dropped to seasonally low levels and U.S. production remained strong. Consequently, U.S. exports reached the highest in history, driving up the VLGC utilization rate. In addition, the Gulf Coast LPG export terminal capacity was tight in the second quarter and U.S. LPG inventory was kept very high. Together with low domestic consumption, U.S. LPG prices were on the downward pressures, supported by the arbitrage and freight recoveries.

If you turn to Slide 4, we'll review the highlights of the quarter. In the second quarter, we generated TCE income of $111 million based on daily rates of $27,500 for the VLGC segment, with VLGC contract coverage of 14% and a total contract coverage of 14%. EBITDA came in at 40 -- $75 million, a strong EBITDA margin of 68%, and we generated a profit margin of 23% or a gain of $26 million for the quarter or $0.19 per share. This gives an annualized return on equity of 11% for the second quarter.

On the back of a strong second quarter, the Board has declared an interim cash dividend of $0.10 per share, amounting to USD 13.9 million. With the positive market outlook and strong balance sheet, we are proud to again be able to return cash to our shareholders.

I'll now turn to Slide 5 for an overview of our commercial performance. In the second quarter, TCE rates on our VLGC fleet averaged at $27,500 per day including offhire and $28,200 per day excluding offhire. Our commercial utilization was 94%, reflecting a 6% waiting time on the fleet. Excluding waiting time, our VLGC spot earnings came in at $31,200 per day compared to the Baltic spot market index of $34,300 per day. Including waiting time, our VLGC spot market earnings came in at $29,000 per day.

Turning to Slide 6 to summarize our outlook on the VLGC market. In line with our forecast, VLGC freight market started to recover since the end of the first quarter and the positive momentum has continued into the third quarter. This is supported by U.S. LPG production and terminal growth. We expect the expansion of enterprise export terminals in September 2019 to ease the tightness in the U.S. Gulf Coast export terminal capacity that support high U.S. export and VLGC fleet utilization in the near term. The growth in LPG export is well supported by strong demand for imports, mostly driven by the petrochemical sector from the Far East and regional sectors from emerging markets in Asia such as India and Indonesia. As such, we expect the strong market demand for VLGCs will increase, giving a positive freight outlook for the remainder of 2019 and 2020. However, increased demand will in part be offset by a high level of newbuild deliveries.

Turning to Slide 7, here we provide an update and snapshot of the EIA's outlook for LPG balances in the U.S. Because of increased production and flat domestic consumption, 2019 U.S. LPG net exports remained strong. In its latest forecast, EIA has revised the 2019 U.S. LPG net export growth, up by 4.8% and2019 net export is estimated to reach 36 million tons, a growth of 18.4% from 2018. Related EIA U.S. LPG inventories levels stand at 94.2 million barrels, which is close to the all-time high levels we saw in 2015 and 2016 as 32% higher year-over-year. For 2020, U.S. LPG production is expected to further grow by 4.2%, while domestic consumption is expected to grow marginally at 0.1%, resulting in a net export growth of 14.1%. Net export is estimated to reach 41 million tons in 2020.

On Slide 8, we provide an overview of seaborne LPG trade in the second quarter of 2019. Global total seaborne LPG trade grew by 6% year-over-year, driven by strong export from North America supported by increased demand from China, South Korea and Japan. Chinese total LPG imports reached 4.8 million tons, which is up 9% year-over-year. As the U.S. and China have not reached the conclusion of the trade negotiations, China continues to import its LPG from the Middle East and growing shares of North American exports to China were rerouted to Japan and South Korea. Retail demand from India fell slightly in the second quarter with total LPG imports falling by 3% to 3 million tons, mostly because India was clearing the built up inventory from the pre-election stockpiling that we saw during the first quarter. However, year-to-date, Indian LPG imports have reached 6.4 million tons, which is 10% higher year-over-year.

On the export side, North American LPG exports reached 10.7 million tons, which is up 34% year-over-year. North American LPG exports via VLGC reached 9.3 million tons, which is the highest in history, up 39% year-over-year.

The markets Marcus Hook Mariner East 2 expansion projects was completed with an average of approximately 9 VLGCs per month. This was partly offset by Middle Eastern exports that were down by 15% year-over-year to 8.8 million tons. Exports from all major exporters fell and Iranian LPG exports fell by 14% year-over-year to 1.2 million tons because of sanctions. In July 2019, the OPEC+ allies have agreed to extend the production cost until March 2020 to mitigate falling oil prices amid soaring production from the U.S.

On Slide 9, we see that the global fleet of VLGC stands 275 vessels as of 30th July 2019, but the 10 ships were delivered in the first half of the year. The current order book to fleet ratio stands at 13% with 8 more expected to be delivered in the remainder of 2019, 19 in 2020 and 10 in 2021. If we look at the start of 2020, 45% of the fleet will be less than 5 years old, so the global VLGC fleet is very modern. We have identified 30 VLGC recycling candidates from '19 to '21, which will leave the net growth in number of vessels to 8.7%, assuming no more newbuild orders. The recycling candidates are identified based on the historical recycling age of VLGCs, which is 28 years old and the nature of the ownership and contract commitments of the vessels. Of course, recycling decisions will be highly determined by freight rates.

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

Elaine Ong
Chief Financial Officer, BW LPG Ltd

Thanks, Martin. Starting with our income statement on Slide 10, operating revenue was $176 million in Q2 '19, while royalty expenses went up to $65 million due to higher bunker expenses and higher fleet utilization. Our TCE income for the quarter was $111 million compared to $61 million in Q2 '18. This is mainly due to higher VLGC freight earnings with the recovery of the market. EBITDA came in at $75 million, a strong margin of 68%.

In the second quarter, our new product services division lifted 2 VLGC cargoes out of the U.S. As a result, we recorded a net gain of $0.5 million, comprising the net settlement of physical cargo, buy and sell of contracts and the corresponding commodity derivatives. Even though we are pleased to see a net gain from the commodity contracts, our goal for product services is a more streamlined commercial management of our vessels resulting in a higher utilization of our fleet.

As stated in our last earnings release, we adopted the new IFRS 16 on leases with effect from 1st Jan 2019. With this, our 5 charter-in contracts with more than 12 months duration have been capitalized on our balance sheet. While our 3 charter-in contracts, which expired within the next 12 months, will continue to be reported as charter hire expenses. As such, our charter hire expenses for the quarter declined to $4 million. The expenses related to the other 5 charter contracts with greater than 12 months expiry are now recorded under operating cost, depreciation and interest expenses. The net impact relating to the capitalization of these longer-term charter contracts is a decrease of $0.7 million in profit for Q2.

Taking all this into consideration, our profit after tax in the second quarter was $26 million or a profit of $0.19 per share. The Board has declared an interim cash dividend of $0.10 per share amounting to $13.9 million. The dividend will be payable on or about 13th September to the shareholders on record as of

4th September, implying shares will trade ex-dividend from 3rd September. The dividend will be accounted for in our third quarter financial results. Including the dividend announced today, BW LPG has, since our full listing in 2013, paid out $3.71 per share. This is over 80% of our accumulated net profits per share of $4.62 for the same period.

Turning to Slide 11, we provide the snapshot of our balance sheet and cash flow position. The adoption of IFRS 16 resulted in leases with expiry greater than 12 months being capitalized onto the balance sheet. The impact on the balance sheet was that right of these assets as part of total noncurrent asset increased by $157 million and total current -- noncurrent liabilities and total current liabilities increased by $129 million and $31 million, respectively. Net cash provided by operating activities was $38 million as the VLGC market recovers. And we ended the quarter with cash and cash equivalents of $50 million.

Turning to Slide 12, our net debt position was at $1.3 billion as of 30th June 2019. Total liquidity, consisting of available cash and undrawn facilities, was $177 million. After the refinancing that was announced on the 22nd of May this year, we currently have the following 5 debt facilities: a $400 million ECA facility with $313 million outstanding; a $221 million ECA facility with $176 million outstanding; a third ECA financing at $290 million with $248 million outstanding; we also have a $150 million terminal facility with $127 million outstanding; and lastly, the new $458 million facility signed in May this year included a $258 million term loan with $255 million outstanding and a $200 million revolving credit line with $75 million outstanding. We will have no other debt maturities before the $150 million term loan matures in 2023.

With that, I'd like to hand it back to Martin to conclude our presentation.

Martin Ackermann
Chief Executive Officer, BW LPG Ltd.

Thank you, Elaine. So if you please turn to Slide 13, then I will summarize our earnings presentation. We generated a gain per share of $0.19 in the quarter on TCE income of $111 million or an -- and an EBITDA of $75 million or a strong EBITDA margin of 68%. We generated a gain of $26 million for the quarter or $0.19 per share.

During the quarter, BW LPG signed a new 7-year, $458 million senior secured facility to replace the $800 million facility maturing in the fourth quarter of 2020. The refinancing will lower the company's cost of debt and our cash breakeven levels. And on the back of the strong second quarter, our positive market outlook and a strong balance sheet, the Board declared an interim cash dividend of USD 0.10 per share. Including this dividend, BW LPG have returned more than 80% of its accumulated net profit, showing the strong commitment to return cash to shareholders.

In the short term, we expect continued high U.S. LPG export to support the strong rates and we maintain our downward view on Middle Eastern exports due to the core sanctions on Iran and extension on OPEC+ production cuts. We expect that increased demand from VLGCs from growing exports will be in part be offset by a high level of newbuild deliveries and constraint from more people ordering ships.

In conclusion, we have a positive freight outlook for the second half of 2019 and 2020. And at the current market rate, we generate an excess of $1 million of cash per day. In the longer term, we maintain our view of sustained U.S. LPG production growth and no further newbuilding orders remain key to a balanced VLGC market.

With that, we would like to open up for questions.

QUESTIONS AND ANSWERS

Anders Redigh Karlsen, *Danske Bank Markets Equity Research*

I was wondering in terms of your commercial performance in Q2, you are weaker than your closest peers. Is there any reason for it? Or can you elaborate a little bit around that?

Martin Ackermann, *BW LPG Limited - CEO*

Anders, and thanks for calling in, and you put your finger in it right away. Even though our real life spot rates of $31,200 is below what we'd normally expect, I would say it's in line with at least 1 of our peers. And normally, the Baltic with a trade for the 1 month's lag is a good indicator of market spot earnings. And however, due to the steep increase that we saw in rates during the quarter, the real life spot rates for second quarter was below this. And as we put in our presentation, you can see that the Baltic lagging 1 month came in at $34,300 for the second quarter. If you lag that for 1 more week, the Baltic actually drops to $31,000, which is in line with our spot earnings and slightly above 1 of our peers in their spot and slightly below another 1 of our peers in their spot. So we think it's mostly because the market was rising somewhat roughly from the first to the second quarter as we see this lagging behind in general.

Anders Redigh Karlsen, *Danske Bank Markets Equity Research - Analyst*

Okay. It's pretty much what I thought. You gave some guidance very quickly around on your second half expectations on net results, can you just repeat that?

Anders Redigh Karlsen, *Danske Bank Markets Equity Research - Analyst*

You kind of gave some guidance, it sounded like on your second half expectations on net profit. Can you repeat that?

Martin Ackermann, *BW LPG Limited - CEO*

Yes. I didn't give guidance on our net profit but I was giving, a slight bit of guidance by saying that at the current market levels, we are generating slightly in excess of $1 million per day. In cash, not net profit, So we just talked about cash generation. So of course, we're right now in a quite positive market.

I think also one comment I can add to your previous question on spot market rates, we've seen for probably more than 6 continuous quarters that on average, the West premium to the Baltic has been higher, I mean, thereby the premium than the East. And for the second quarter, we saw that reverse. So say on ballpark, the East was on average, during the quarter, approximately $5,000 per TCE -- in TCE per day higher than the West and that has reversed again into the third quarter. So of course, it depends on -- your spot performance is quite dependent on whether more or less of your fleet is in the East or in the West. We have 52% of our fleet in the East during the quarter. And of course, another factor is also if you, for example, have your contracts take to the Baltic, if they're floating on the Baltic, then you will get for this quarter, at least paid out with the premium that the East was trading over the West.

Anders Redigh Karlsen, *Danske Bank Markets Equity Research - Analyst*

Okay. In terms of your positioning towards Q3, you say that [net that you provide, none have] come up again, but can you say anything about your [fix] reposition when you enter the quarter? Was it part on rates were very strong? Or have you been averaging through the quarter?

Martin Ackermann, *BW LPG Limited - CEO*

Yes. I prefer not to give a very detailed answer on that, but we are at the current stage, at what we consider ourselves, in a comfortable position.

Operator

And next question is from Eirik Haavaldsen from Pareto Securities.

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

On the time charters, just to try to understand the rate on your time charters in the second quarter, which was a bit lower than what you previously guided but the rest of the year and the number of days and so on is pretty unchanged, is there something that happened there because the realized rate is so low?

Martin Ackermann, *BW LPG Limited - CEO*

Eirik, let me just -- no, I mean, there's no formality that it's -- what number are you referring to specifically now, sorry?

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

Your Q2 time charter TCE rate of $23,030 versus the rest of the year guidance of $27,000 I believe you gave rest of the year guidance in the high -- almost $27,000 at the Q1 release but it's minor, it's not important. I just wanted to know if there was something abnormal there?

Martin Ackermann, *BW LPG Limited - CEO*

Nothing abnormal to report. We came in with $23,000 right? That for, 14% of the fleet.

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

And just to clarify, Martin, the rest of the year guidance, on the 2020 guidance, which in terms of coverage days is unchanged from Q1. There have been rumors that you have fixed some ships recently. Is it -- is this guidance as of Q2? Or coverage as of this date?

Martin Ackermann, *BW LPG Limited - CEO*

The table that you see on Page 16 reflects our coverage at the end of Q2. But I would say we have deliberately reduced our coverage to the current level, and we have 14% year-to-date and 11% for the rest of the year. And as you can see, we guide only 4% into 2020. So of course, we're open for contracts but still, we are -- we have not been willing to lock in, let's call it shorter-term time charters, giving the way what we think will be, as I also say on the call, a strong market for the next 18 months.

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

Okay. And then I have two more questions, please. So one is related to the $0.5 million of a gain on the commodity trading part. Can you just focus through how that works precisely? Is this 1 cargo that you essentially lifted and a profit of say, $10 a ton then? Or how does it work? And do you hedge that exposure? How much is it really related to subsidy gain?

Martin Ackermann, *BW LPG Limited - CEO*

So I was just looking into the time charter, just to get back to that. We have did have 1 TCE that expired during the quarter. So when you compare Q1 to Q2, that's probably why you've seen that slight reduction in earnings in second quarter because the -- at this time, it has been expired. It was making around $30,000 per day and that obviously brought down the number to $23,000.

To your question on our product services, as we said all along, we've done -- we don't take any flat price exposure, we hedge the position. As soon as we buy the cargo, we hedge the size of the position so we don't have any or minimal exposure to product prices. So that's the way we're thinking about this. This is -- it's again, it's only a service to improve the utilization or to take advantage of when we have ships that our clients can't use or to basically reduce our waiting days. And just to be clear, we did 2 cargoes during the quarter, not just 1.

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

Okay. And finally, one for Elaine, maybe on -- you're sending a pretty clear message on the dividend today and in the second half. And obviously, from the third quarter, your cash flow is going to be substantially higher than now. And with say, $30 million in normalized debt repayments, should we assume that this sort of $50 million cash level is the way you would like to be? And that all excess cash beyond debt repayments and some CapEx, et cetera, will be paid out? Or will you be building cash or paying down revolvers? Or how should we really model your intentions here on the dividend, given the current market prospects?

Elaine Ong, *BW LPG Limited - CFO*

Well Eirik, I think first of all, I think all those what you kind have said our possibilities how we use our cash, ideally, as you know, our leverage over the past challenging 2.5 years have creeped up. So one of the key goals would be to try and reduce that over a period of time as we build up cash. And as our Board has demonstrated this quarter of also a strong desire to return some of that positive profit back to the -- our shareholders. I think you can also expect the dividend coming and then obviously, we have to meet all of our capital requirements.

So I think it's going to be a combination of that. And it really depends on kind of the prioritizing which one comes first as the cash has been built up. But if we do foresee a strong market in the next little while, I think you can assume a good chance that a combination of all of the above will happen.

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

So it's fair to assume that the 2 or at least the revolver can be paid down pretty quickly at the current markets?

Elaine Ong, *BW LPG Limited - CFO*

I think that's safe to assume and that process has already started for us in Q3. And probably, just also to remind you that our dividend policy, that has not seen much dividend in recent years, is 50% of [untouched]. So that's also a guided policy. So I think we will use the combination of that, you'd probably not going to be too far off.

Operator

(Operator Instructions) And there are currently one -- we have one question just being registered at the moment. That is Nick Linnane from Sefton

Nick Linnane, *Sefton Place Advisors - Portfolio Manager*

Do you have any view at the moment on whether U.S. exports are constrained by terminal capacity or by demand? So basically, do you expect exports just to ramp up in line with the expansion of terminal capacities as those come online? Or do you think that it's constrained on the demand side?

Martin Ackermann, *BW LPG Limited - CEO*

Thanks for calling in, Nick. I think the short answer to that is we were close to maxing out terminal capacity here recently. But with expansions that we're now seeing at enterprise, we don't see any issues with terminal capacity constraints with the expansions that we've seen both with enterprise, with Targa, with Mariner East, et cetera.

In terms of whether demand is a restriction, we don't see that, to be honest. It certainly looks that the market generally for LPG is supply-driven. And with the current pricing of LPG, it seems like there's no shortage of demand for the product, and we see that happening going forward as well. I also talked through about through the call, we see general positiveness across Asia, both North and South East Asia, India and so forth.

Nick Linnane, *Sefton Place Advisors - Portfolio Manager*

Okay. So just as a follow-up, could you talk a bit about your view on the tightening of each of the expansions you mentioned and how quickly you expect them to ramp up, whether do you kind of get the increase in stated capacity kind of within a very short period of time? Or if it takes 3 to 6 months to ramp up the terminals?

Martin Ackermann, *BW LPG Limited - CEO*

Yes. I might not have the full overview for the core, but I mean, I can give you some flavor of it. We have enterprise that we expect to complete in late September 2019, and that should be adding about 175,000 barrels per day, which in tons is about 5.3 million tons per year, or maybe easier to think about that it's approximately 10 additional or incremental VLGC cargoes of capacity per month. So that's going to enable enterprise to load both butane and propane simultaneously and keep very high level of export for their terminal alone. And then they have a second expansion, which we understand is scheduled to complete in the third quarter of 2020, and that expansion will increase the LPG loading capacity by another 15 -- let's call it 15 VLGC cargoes of capacity per month. So when both these expansions are completed, enterprise nameplate capacity will be more than 1.1 million barrels per day or approximately 33 million barrels per day, the equivalent of 63 VLGCs per month. So that's by far the largest of the terminals.

Then we have Targa, which has a nameplate capacity of nearly 20 million tons per year or about 37, 38 VLGCs capacity per month, and they are expected to expand the terminal in [Calida Park] by -- be this third quarter of next year. So after that expansion, they should have an LPG export capacity somewhere between 11 million to 15 million barrels per month or say -- let's say, 22 to 27 or 28 VLGC cargoes of capacity per month. So those are the big ones.

The Mariner East, the first one was completed, but the 2X pipeline is still under construction. They had this delay on the pipeline, which we understand has now -- have been sorted and the -- I expect it to complete this by the late 2019. So we don't model that in before first quarter of next year. And that pipeline has a nameplate capacity of 250,000 barrels per day but I think maybe we can do that offline if you have questions to that. But I don't think they have announced how much LPG and how much ethane is going through the line at this point. Those are sort of the highlights I can give you.

Nick Linnane, *Sefton Place Advisors - Portfolio Manager*

Do you, for enterprise, if it completes like [10 months], Do you get kind of the extra 10 cargoes by October or by November? Or what sort of your sense to how quickly that comes?

Martin Ackermann, *BW LPG Limited - CEO*

I'm sorry, I'm not...

Nick Linnane, *Sefton Place Advisors - Portfolio Manager*

Whether there's a ramp-up period or not . So if they completed in like, September and they actually have to operate at that rate from October? Or does it take a couple of months?

Martin Ackermann, *BW LPG Limited - CEO*

No. No, once they're ready, they're ready and then it will come straight off the manifold, so then it's just a matter of them selling it. And the positive thing is, of course, that, that's -- the fact that there is so much capacity coming online is likely to keep a downward pressure on terminal prices. And we still see, as I also mentioned, ample LPG production and a very positive outlook in terms of production outlook, a very moderate outlook on domestic LPG consumption in the U.S., so that should also keep a relative pressure on LPG pricing. So if we're seeing both terminal prices and LPG prices on a downward trend, that ought to give us a positive outlook on freight in the short, medium term.

Operator

And there are currently no further questions registered so I'll hand the call back to the speakers. Please go ahead.

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

Yes. Hello. Then we'll take one question from the webcast there. It's from Santiago Domingo. It says could you give us more color on IMO 2020? What approach are you taking there? And how do you think it's going to impact the freight rate?

Martin Ackermann, *BW LPG Limited - CEO*

Thank you, Santiago, for calling in. I think, well, IMO 2020 is of course, a big thing looming over the industry and we're a bit preparing for a long time on that. We -- our -- I think our general view is that fundamentally, the oil price that we will see or the fuel oil prices will be absorbed over fuel in the freight rates over -- at least over the medium to long term. Short term, we might see some turbulence in the market, and we are recovering that through a mix of having a few ships with scrubbers. We have our strong focus on LPG propulsion, where we have the first ship ready in the second quarter of next year. And with LPG prices where they are at the moment, that looks like a very unfavorable decision but of course, the CapEx there is significant. And then we have done some financial hedges to cover our positions for next year. So we are taking sort of a mixed approach to the market developments of next year, and we feel confident that we are able to handle that.

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

Okay. Then there's no further questions from the web. So I'll hand it over to the operator.

Operator

Thank you. So no further questions registered on the telephone lines either. So yes, I'll hand it back to the main speakers. Please go ahead.

Martin Ackermann, *BW LPG Limited - CEO*

All right. Well, thank you very much for calling in, and thank you for showing your interest in our calls. As you can tell, we have a relative upbeat outlook, and we think we have an interesting period ahead. So thank you for your support, and thank you for being a shareholder in BW LPG.