POTEN & PARTNERS

POTEN TANKER OPINION

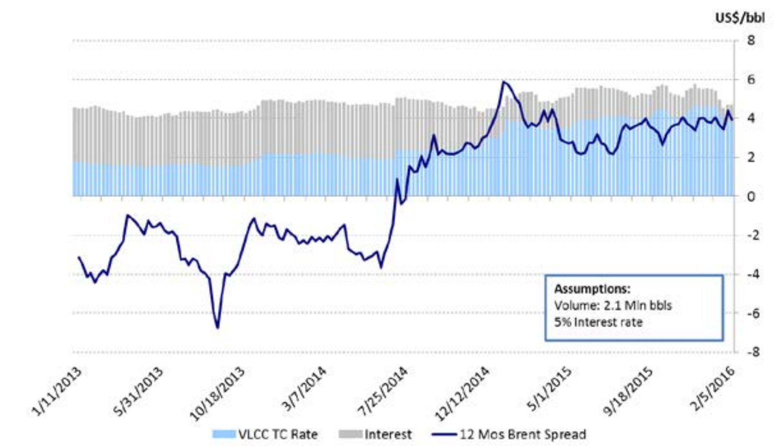
Do High Spreads Float All Boats?

Will increasing time spreads lead to increased floating storage?

In 2009 and 2010, the tanker market received a huge boost from the extra demand generated by floating storage. Floating storage was briefly back in vogue in early 2015. Despite the well documented "glut" of oil in world markets, storing the excess crude oil on tankers has decreased rather than increased over the last six months. The market was not there to make an arbitrage profit on the tanker storage play. However, in recent weeks, crude time spreads (the price difference between commodity prices in one period versus another period) have increased again, as the front of the market has fallen more than future prices. At the end of last week, reports surfaced that one of the trading companies put a number of VLCCs into floating storage. Is this the start of another floating storage boom or was this just a special deal?

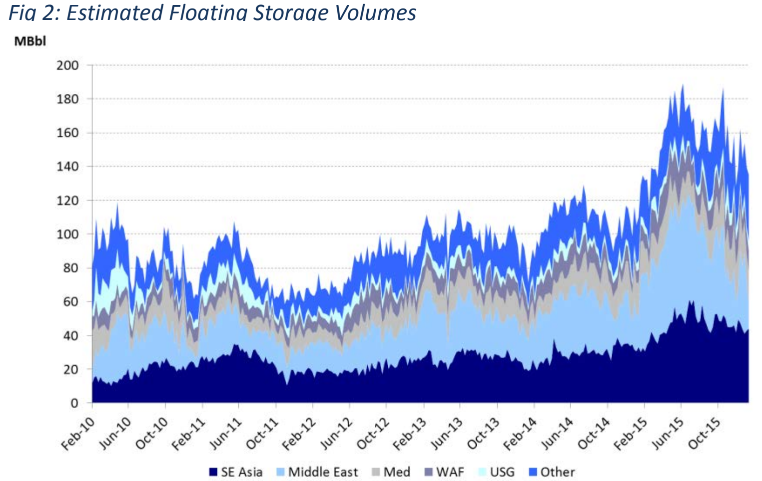
To make money using time spreads, traders buy physical crude oil, and sell crude futures to lock in a future price. They put the crude in storage tanks and wait for time to pass to sell the physical crude and unwind the hedge. The trader also needs to factor possible handling, insurance and capital costs into the equation. Land based storage is the preferred option as it is typically cheaper than floating storage in oil tankers. Currently, one year VLCC time charter rates are around $44,000 per day or about $0.65 per barrel per month for a volume of 2.1 million barrels. As time charter rates have declined and oil prices have weakened in recent months, the cost of floating storage has declined, while the contango (where future commodity prices are higher than current prices) has gradually increased (See figure 1).

Fig. 1: 6 Months Brent Spread vs TC Rate + Interest



Source: Bloomberg; Poten & Partners

Fig 2: Estimated Floating Storage Volumes



Source: Bloomberg

The lifting of the U.S. crude export ban has created potential opportunities for floating storage of U.S. produced oil. When oil could not be exported, a trader had very little flexibility on where the crude could be discharged and to have some flexibility it had to be stored on Jones Act tonnage, which was expensive (if it was available at all). Now that the ban has been lifted, international flag tankers can be used and once the oil is on the water, a trader can ship it to any refinery in the world, except U.S. refineries.

According to EIA data, during last week commercial crude oil inventories in PADD 3 reached 253 million barrels, a record level. Total commercial storage capacity in the region is 302 million barrels (excluding pipeline and field storage). However, this is a theoretical storage capacity as not every tank can be 100% full before operational inefficiencies start to come into play. International Energy Agency data shows that crude inventories in Europe and OECD Asia are also at very high levels compared to recent history. There are no reliable capacity statistics available for these countries so it is difficult to assess how much spare land based storage capacity is still available.

Bloomberg tracks tanker tonnage, using AIS data, that is used for storage and estimates the volume on-board based on the draught of the vessel (See Figure 2). This data seems to include short term storage but generally tracks Poten's observations. The graph shows that storage volumes have declined gradually in recent months. These figures include Iranian vessels that are used for storage and that start to be released slowly. According to Poten's analysis, 17 Iranian VLCCs are currently used for storage of crude and condensates. As the graph shows, the majority of the floating storage is currently located in South East Asia, mainly around Singapore and in the Middle East, which includes the Iranian storage.

So far, floating storage has not had a significant impact on the market, but it is one of the most significant wildcards that could swing tanker rates in the short-to medium term. Given the existing oversupply of crude in the oil market, in combination with limited remaining land-based storage capacity, any signal that traders and oil companies are starting to charter tankers to store crude oil (or products) will quickly and materially increase tanker rates.