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Value Investor INSIGHT

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Tight Ship

While the oil tanker business today is in many ways firing on all cylinders, investor enthusiasm for oil tanker company stocks is sputtering at best. Masonry Capital's Mark Meulenberg explains why he sees opportunity in that disconnect.

When Mark Meulenberg prior to the pandemic contacted an old boss to ask his opinion on the oil-tanker industry, the response was short and to the point. "He knew the industry well, but said he'd been burned once too often and would never invest in another tanker company again," he says. "Value investor that I am, it made me think I might be on to something."

That something in mid-2020 turned into a basket of tanker stocks for Meulenberg's Masonry Capital, the contents of which today include **DHT Holdings, Euronav, Frontline, International Seaways and Scorpio Tankers** [*see table below*]. He believes the volatile, cyclical industry – now in an upcycle – has changed for the better, to an extent the market has refused to recognize.

Oil-tanker companies typically transport some combination of crude oil and refined oil products through a mix of ships, differentiated mainly by their capacity and range. While relative market rates paid by type of ship can vary, rates generally over time move in step and are influenced by oil prices and the supply and demand of shipping capacity. That's historically been a volatile cocktail, leading to big upcycles followed by crushing downturns.

Meulenberg's case that times have changed rests less on demand than supply. He generally believes oil demand as energy markets transition to a lower-carbon future will be more persistent than many expect, resulting in stable oil prices – with pressure to the upside – for many years. That will be a positive for tanker owners, he says, given the many constraints in place today on tanker supply.

One important supply constraint is regulatory: the International Maritime Organization has committed its members to targeted reductions in greenhouse gas emissions to 2050, but how those targets are to be met is still ill-defined. A likely avenue will be upgrades/changes to ship propulsion systems, but without defined requirements ship buyers are slow to greenlight new ships. Why order a $125 million tanker that takes more than three years to build if key specifications might change over the next few years?

Other factors are impacting supply as well. The financing environment for ships has significantly tightened, due mainly to higher interest rates and reticence on the part of lenders and private-equity investors to back fossil-fuel-related investments. Shipbuilder capacity is stretched, with high demand for container ships and LNG vessels pushing out average delivery times for tankers. The global shadow fleet of tankers transporting oil from places like Russia and Iran is taking supply out of the "sanctioned" tanker market.

Meulenberg also believes tanker-company managers – responding to shareholder demands – have shifted from chasing growth when the cycle is hot to more-disciplined capital allocation and an emphasis on directing current record-high cash flows to debt reduction, dividends and stock buybacks rather than buying new ships. "We think the earliest oversup-

Full Steam Ahead

If his optimism for the oil-tanker market pans out, Mark Meulenberg expects this basket of stocks to generate a high and rising stream of dividends and to benefit from multiple expansion as the underlying companies generate more sustainably positive financial results.

Company	Ticker	Stock Price	52-Week		Market Cap ($mil)	EPS (TTM)	P/E	Dividends (TTM)			
			Low	High				Regular	Special	Total	Yield
DHT Holdings	DHT	9.32	6.96	12.13	1,514	1.00	9.3	1.04	0.00	1.04	11.2%
Euronav	EURN	17.86	12.94	21.00	3,600	2.91	6.1	1.58	1.11	2.69	15.1%
Frontline	FRO	18.18	10.10	19.29	4,047	3.61	5.0	2.72	0.00	2.72	15.0%
International Seaways	INSW	44.42	28.63	53.25	2,172	13.26	3.3	0.60	5.68	6.28	14.1%
Scorpio Tankers	STNG	52.08	38.05	64.20	2,646	14.35	3.6	0.90	0.00	0.90	1.7%

Sources: Masonry Capital, company reports, other publicly available information ply could creep into the market is at least three years out," he says. "Even if companies lose discipline, there are plenty of reasons why they can't act on that."

With demand solid and supply in check, he expects good times in the industry to last much longer than the market seems to believe. His tanker-basket stocks mostly trade at 4-6x trailing earnings, with dividend yields – including regular and special payouts – mostly well above 10%. If his optimism pans out, he expects to collect a rising stream of dividends and eventually to benefit from multiple expansion as companies generate more sustainable results. Valuation multiples – both on earnings and book value – are historically low, he says, "and that's from a time when the business was arguably more cyclical and when company balance sheets were far less healthy than they are today." VII