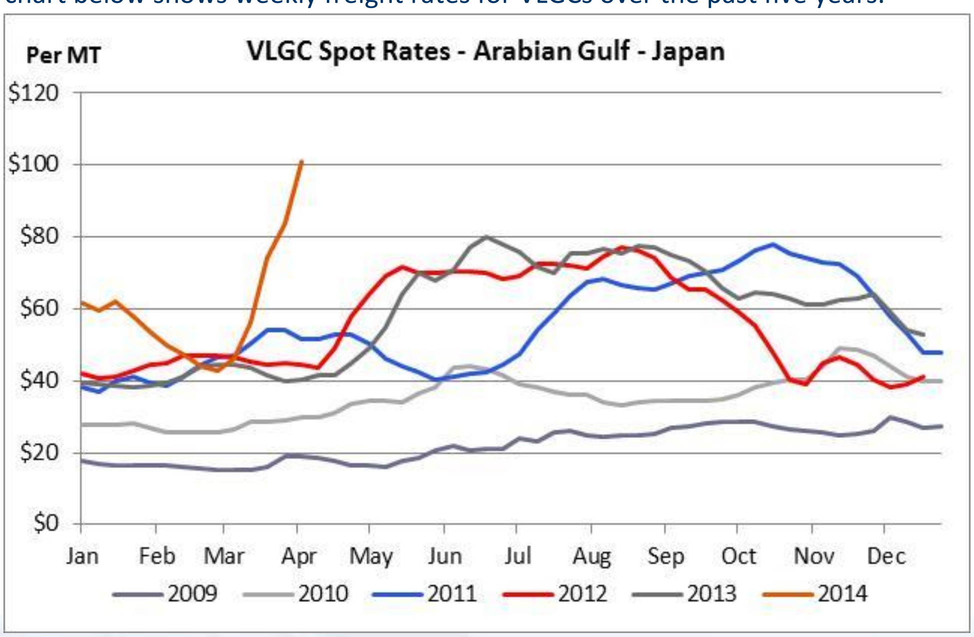
Liquefied Petroleum Gold

While the large crude oil tankers slip into what seems like a second quarter slumber, buzz continues to build around the liquefied petroleum gas (LPG) sector. Press headlines tout the recent success of LPG shipowners, many of whom are finally able to relish the fruits of their labor. Freight rates on the sector's the largest vessels, Very Large Gas Carriers (VLGCs) are in uncharted territory, topping $100 per metric ton this week on the benchmark Arabian Gulf to Japan trade. As the supply for LPG continues to grow with increased natural gas and crude oil production, incremental seaborne transportation requirements will mount. As with other shipping markets, oversupply concerns are omnipresent, but, for now, the near-term future for LPG shipowners appears to be graced by the Midas touch.

One key distinction between the LPG and crude oil tanker markets are the fundamental demand drivers. In its simplest form, the crude oil market is dictated by refiners who 'pull' forth supply. Since LPG is a byproduct of crude oil and natural gas extraction, supplies are 'pushed' into the market. LPGs, such as propane and butane, flow into a variety of applications in the retail market for cooking and heating or as petrochemical feedstocks depending on the price of substitutes, like naphtha.

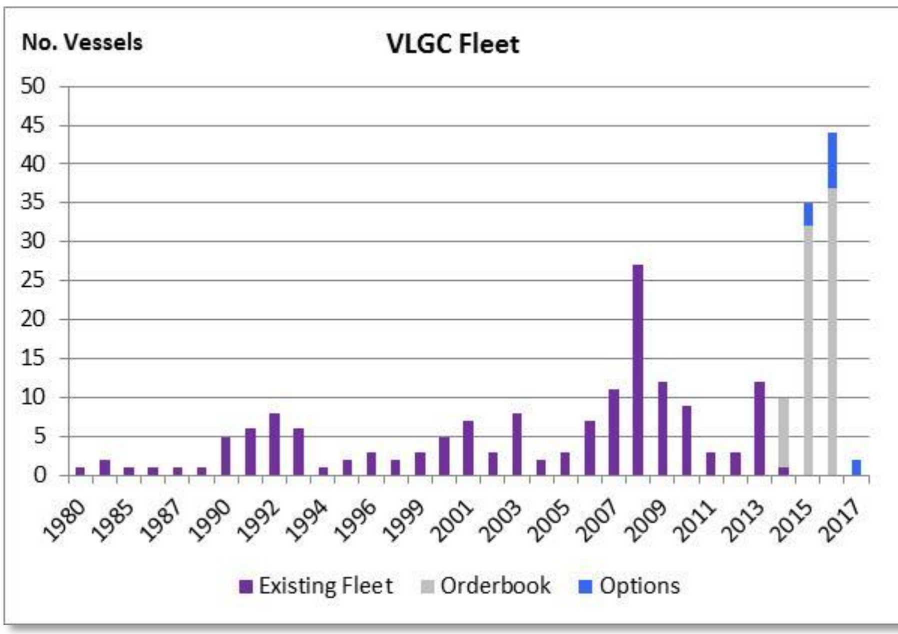
Although the price of the LPG itself is historically low, its transport is not. The chart below shows weekly freight rates for VLGCs over the past five years.



Source: Poten

Historically, the majority of LPG was supplied by the Middle East, but increased shale oil and gas production in the United States has contributed to supply length of LPG in the US Gulf Coast. Pushing the product into the great Asian sink significantly boosts ton-mile demand. In the past month alone, a dozen cargoes prompted a few lucky LPG carriers to embark on the 90-day round-trip voyage around Cape Horn since they are too large for Panama Canal transit. With US export volumes poised for continued growth, canal expansion delays only serve to compound ton-mile growth.

Although the demand for LPG shipping certainly has positive undertones, the VLGC fleet is facing a pretty steep orderbook relative to its existing size. The chart below shows the number of vessels by build year, along with the current orderbook through 2016. Today, the fleet is approximately 150 vessels.



Source: Poten

While the increase in freight rates is directly linked to the present shortage of vessels, those on the ownership side should be careful not to overcrowd this relatively small market. Like some other shipping sectors, robust freight rates have already drawn attention to this space from new market entrants, such as private equity and Wall Street.