GRANT'S

INTEREST RATE OBSERVER®

Vol. 32, No. 11c | Two Wall Street, New York, New York 10005 • www.grantspub.com | MAY 30, 2014

All ahead full

Shale gas continues to knock the world for a constructive and disruptive loop. A half-decade ago, few spared a thought for liquefied petroleum gas. Today, the United States is a growing net exporter of that shale-derived substance also known as propane or butane. Do you wonder who's building the ships to carry growing volumes of LPG from the U.S. Gulf Coast to energy- and feedstock-hungry customers in Japan, South Korea and China? Dorian LPG Ltd. (LPG on the New York Stock Exchange) is a promising new entrant in the field. In preview, we're bullish on it.

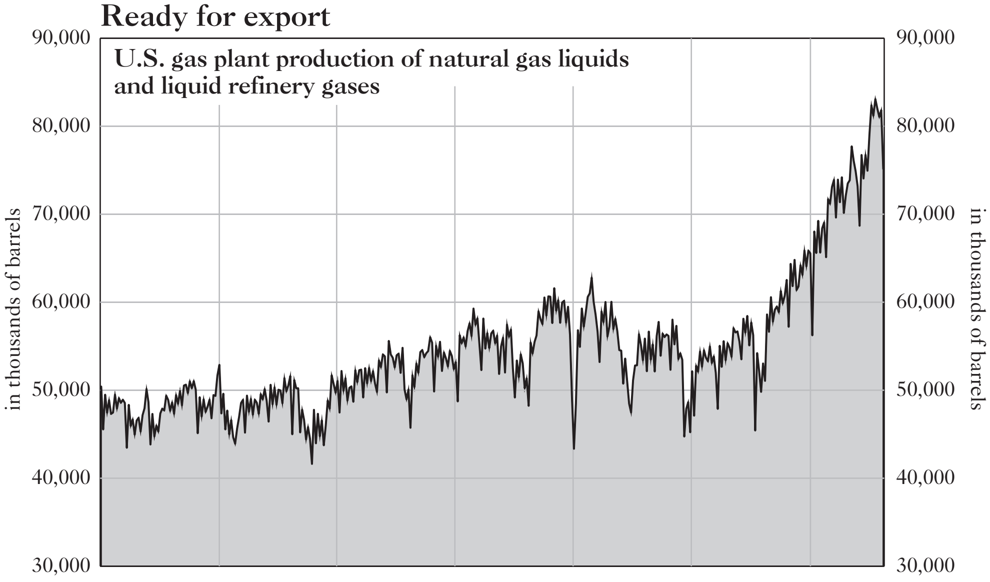
Dorian, which was organized 10 months ago, owns three ships of the VLGC type—for landlubbers, that's "very large gas carrier"—and has 19 more on order. Headquartered in Stamford, Conn., conservatively financed, incorporated in the Republic of the Marshall Islands (something to do with taxes) and launched through a series of private placements and strategic partnerships, Dorian took itself public a few weeks back. As you probably didn't notice, 7.3 million shares came into the world at $19 a piece. Let's just say there was no mistaking the Dorian IPO for the long-awaited debut of Alibaba Group Holding. Then, again, it isn't every start-up that attracts a takeover bid even before the date of its IPO (of which more below).

Dorian's strategy is to capitalize on the increasing demand for long-haul seaborne transportation of LPG. Thus, from the prospectus: "The growth in the United States of shale-derived oil and gas rich in natural gas liquids has contributed to a significant increase in the production of LPG. According to Poten & Partners, consultants, the U.S. is expected to become the largest LPG exporter in the world. LPG exports of 8.7 million metric tons in 2013 are expected to double by 2017 as a result of additional export projects from which supplies have already been committed to buyers. In addition, Middle East exports are expected to continue to grow and demand is anticipated to be concentrated in Japan, Korea and China, thereby requiring long-haul transport from both production hubs. U.S. export facilities recently built and under construction are principally oriented towards loading VLGCs, which are the primary vessel type used for U.S. exports. We believe that VLGCs represent the most cost-effective transportation for large LPG importers."

Not only does Dorian believe it, so do Enterprise Products Partners L.P. (EPD on the New York Stock Exchange), Targa Resources Partners L.P. (NGLS: NYSE) and Phillips 66 (PSX: NYSE). Each is building, or planning to build, or planning to add new capacity to serve the burgeoning LPG export market.

LPG is a mixture of propane and butane. Like ethane, it's a co-product of natural gas. You get it in the course of producing gas, whether you want it or not. Some do want LPG—upstate New Yorkers consume it by the bottleful to heat and cook. But demand for those homely purposes is necessarily slow growing. Enter here industrial demand from the rest of the world. "Propane is easy to ship and has a much higher value than ethane, thus making its export potentially highly economic," Jeffrey

Ready for export



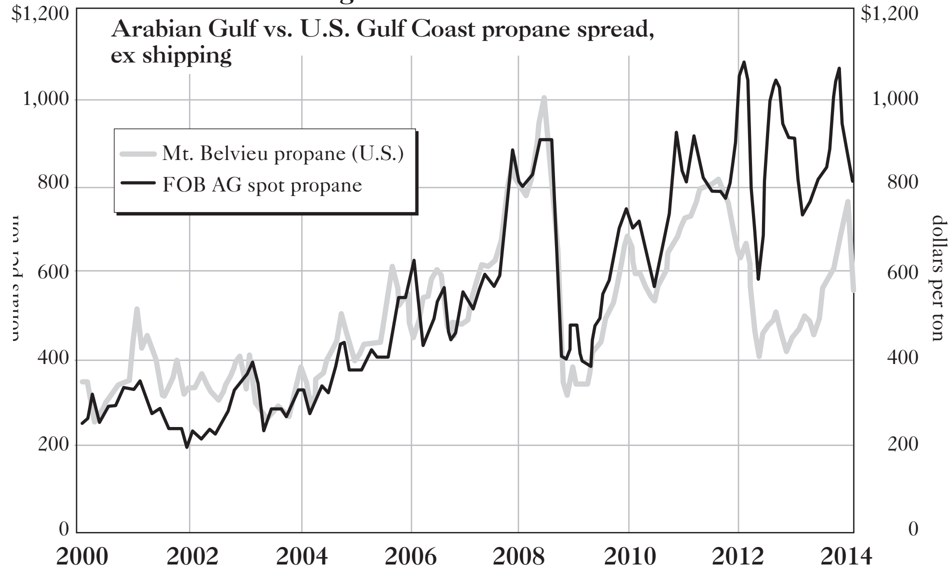
source: U.S. Energy Information Administration

Schwarz, a Dorian holder and co-founder of Metropolitan Capital Advisors, tells colleague David Peligal. "I don't expect much of an increase in domestic demand for propane. . . . The petrochemical producers are focused on ethane as the feedstock for their new production, so the increasing supplies of propane that we will see in the years ahead will likely be shipped overseas, and that is why I am optimistic that this bullish environment for the LPG shipping market has a nice runway ahead of it."

America may not be the only LPG exporter—it competes with the likes of Qatar, Saudi Arabia and the United Arab Emirates—but it is the low-cost exporter. Middle Eastern LPG commands an all-in price of $1,000 a ton or more in Japan, China or South Korea. American LPG is available for an all-in price of $700 to $800 a ton in the same Asian markets. According to Poten & Partners, as quoted in the prospectus, "Asian demand is expected to grow by 45% between 2013 and 2017 as petrochemical demand is expected to increase due to lower LPG prices from the West."

Elevated crude oil prices are a necessary, though not a sufficient condition, for Dorian's success. Naphtha, the world's favorite chemical feedstock, is derived from crude oil. LPG, very much a runner-up feedstock outside the United States, is (of course) derived from gas. "Historically," Schwarz observes, "the price of NGLs has been closely tied to the price of crude oil. In the U.S., that relationship has broken down in recent years as crude oil is a globally traded commodity, while natural gas and NGLs are U.S. domestic commodities. Crude oil prices have remained high, while the price of natural gas and NGLs have been driven down by the excess supply produced by the shale revolution. Even as propane and butane now make their way into international markets, the quantities are just too small to affect the demand and price of naphtha. Those pet-chems who can switch to propane as a feedstock will do so, meaning America's LPG exports will find a home, but probably without too much of an impact on the global price of LPG, which will retain its relationship to the price of naphtha. And this situation will continue as long as the price of crude oil remains strong." At crude prices much below $60 a barrel—assuming no movement in gas prices—LPG would likely struggle to compete.

America has the edge



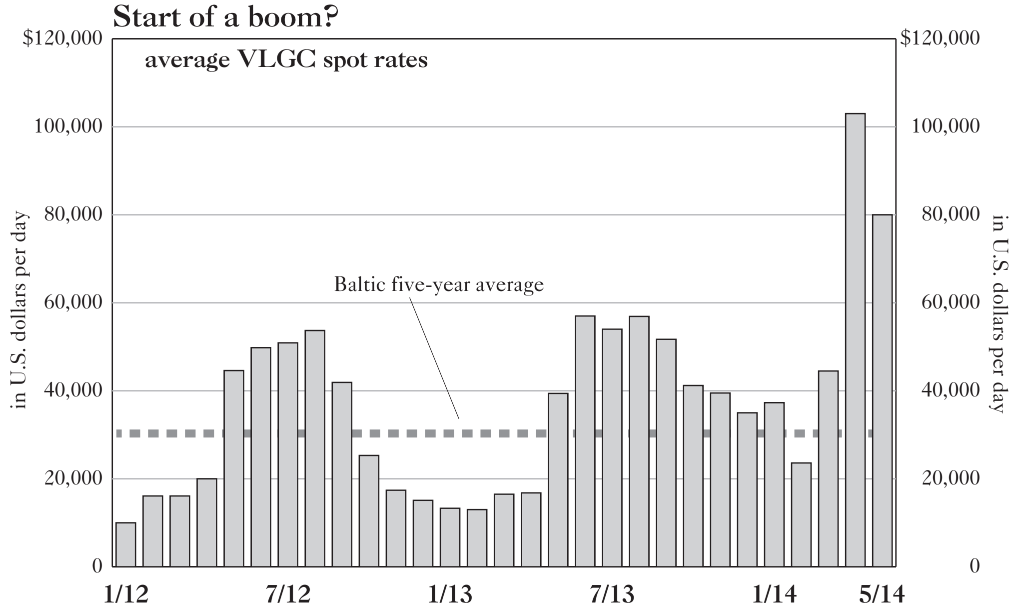
source: Poten & Partners

With 19 ships in the order books of a pair of South Korean yards (delivery dates range between July 2014 and January 2016), Dorian stands to become the owner of the newest and second-largest VLGC fleet. And a green fleet it promises to be: "ECO-design" is the theme, incorporating advanced fuel efficiency and emission-reducing technologies along with capacity to haul 84,000 cubic meters of LPG per vessel. Naturally, Dorian is not the only venture to spot the LPG opportunity, and thoughtful people will ask—though no one is yet in a position to answer—the cyclically recurring question in shipping, to wit: Will the supply of new vessels prove adequate, inadequate or grossly more than adequate for future demand?

"Given that an oversupply of ships may lead to a reduction in charter rates, vessel values and profitability," Peligal observes, "oversupply is one of two primary risks to the bullish thesis on Dorian—a collapse in crude oil prices being the other. The 78 VLGCs slated for worldwide delivery between 2014 and 2016 represent 49% of the existing VLGC fleet. A mitigating factor is that 20% of the existing VLGC fleet is over 20 years of age, and the oil majors will generally avoid chartering a vessel so long in the tooth.

"Avance Gas," Peligal continues, "listed in Oslo and one of the two major competitors to Dorian, is awaiting eight VLGCs under construction in a shipyard in Jiangnan, China. Just how the big oil companies will cotton to Chinese-made vessels remains to be seen. The fact is that Chinese yards are new to VLGC construction, and—in general—China's reputation for quality production falls well behind South Korea's. However the market may receive the made-in-China label, there is an underlying bullish consideration in the LPG-carrying segment of the shipping market. It is an extremely consolidated segment. The top 10 owners of VLGCs, with Oslo-based BW LPG being the largest player, possess 43% of the total capacity in service. And if you just look at BW, Dorian and Avance, they account for a major percentage of the out-year orders. Consequently, one would expect—the bulls would hope—that if the market appears to becoming saturated, some of the late-deferred deliveries, say in 2016, would get canceled."

Just how committed some in the business are to the benefits associated with concentrated ownership became apparent during a phone call Peligal placed on Monday to the president of Avance, Christian Andersen, in Oslo. Avance made a bid for Dorian five months ago and is still in hot pursuit, as Andersen told Peligal: "I've been clear that we would like to merge with Dorian. We gave them a merger offering in January, which they really didn't respond to. We have been chasing them through their board members and through their management to sit down and discuss a merger with us. And so far they have not been interested. I think it makes a lot of sense for us to combine those two



source: Pareto Securities, Clarksons Research Services

fleets. And this is important for us. But, of course, if they eventually decide that they are not interested to sit down with us, we will seek other opportunities for further consolidation."

With more than half of the 57.1 million outstanding shares in the hands of just four parties, Dorian can be viewed as a kind of a hybrid: private equity in substance, public equity in form. Thus, Scorpio Tankers (STNG: NYSE) owns 22.5% of the stock; Seacor Holdings (CKH: NYSE) has 16.4%; Dorian Holdings, the founders' group, has 9.9%; and Kensico Capital Management, a Greenwich-based hedge fund, owns 8%. Big Board turnover in Dorian shares amounts to only a couple of million dollars a day.

The caliber of the Dorian board of directors would seem to compensate, and then some, for the paucity of speculative excitement. Charles Fabrikant, age 69, executive chairman of the board of Seacor, a diversified collection of water-borne businesses (offshore marine supply, inland river services, dry cargo barges, liquid tank barges, shipping services), is one of the proven stewards of capital among the Dorian progenitors. (See for instance, "Patience of a saint" in the issue of *Grant's* dated Sept. 17, 2010.) Thus, from 1992 to 2013, Seacor's book value per share, with dividends included, grew at a compound annual rate of 13.4%; the Seacor share price, also with dividends included, compounded at an annual rate of 13.8%. Compare and contrast the S&P 500 Index over the same span of years. Counting dividends, the S&P delivered a 9.2% compound annual rate of return. To make Dorian a going concern, Seacor contributed both its capital and its shipbuilding contracts.

As the Street values the major LPG shipping companies, each trades in the neighborhood of seven times projected 2016 enterprise value to EBITDA (i.e., equity market cap plus net debt as a multiple of earnings before interest, taxes, depreciation and amortization). Avance, the fortunes of which are tied to the spot-leasing market, pays out 100% of its free cash flow to the shareholders. Dorian, too, will eventually pay a dividend, though not one so big as Avance's.

"Thus, with Dorian," Peligal observes, "you're betting on management's skill at allocating the earnings it doesn't pay out. We got a window into the way management thinks with its decision in February to commit two of the company's VLGCs to five-year time charter agreements with Royal Dutch Shell at rates of about $30,000 a day. The ink was hardly dry when the VLGC spot market exploded to over $100,000 a day. Rates have subsequently fallen back to $60,000, but you may wonder why Dorian would choose to commit these two ships (they will be ready later this year) to a fixed rate rather than to ride the buoyant spot market. There are a few reasons. One, $30,000 a day translates into a cash-on-cash return of 15% on the cost of the vessels. Two, it's probably not the worst idea to develop a relationship with Shell, a double-A credit. Three, at the end of the five years, you have a pair of ships that are 100% bankable—you can sell them into an MLP, you can do anything with them. Four, and possibly most important, there's nothing like scaling into a position. If you've got a large fleet in the wings, you take a couple of ships, you put them out, and you hope you're wrong and that the market goes up."

"Let's say," Peligal concludes, "that a strong cycle for LPG shipping takes place. What might Dorian conservatively earn in, say, 2017, the first year in which all 22 of the company's ships are expected to be afloat? If you assume day rates of $45,000, a utilization rate of 93% and modest capital spending (essentially, the fleet will be new), Dorian could earn $3.33 per share. Put a 10 times' multiple on it and you have a $33 share price. Of course, if VLGC day rates stay reasonably strong and the super profits' part of the cycle lasts longer than people expect, BW LPG and Avance Gas will benefit as well. Avance, as noted, is subject to the vicissitudes of the spot market; BW already has a big fleet on the water—so it has prompt, visible earnings—but it also has an older fleet. A bet on Dorian is a clear bet on the earnings power of its ships—and on the price of crude and on the demand for LPG as well as on a host of other things that we're probably not thinking of."

"Bet" is, indeed, the word. But we happen to like the people—and the odds.

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