BCP Research: Scorpio Tankers (STNG -/-/-) Bond Repurchases, Reaffirm Outright

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Summary: Scorpio Tankers (STNG), one of the world's largest oil product tanker issuers, continues to appear as an attractive "busted" convert. STNG repurchased US$52 mm face value of the 22s convert amt. out, roughly one fourth of the total since July. We suspect the positive near-term earnings prospects we have highlighted drove the bond repurchases. STNG's guidance for 3Q20 implies normalizing day rates to a 50% increase y/y, as well as potentially using the larger LR2/LR1 vessels for jet fuel storage at high day rates. We note 1Q20 day rates were already at multi-year highs at US$23k/d, with 2Q20 day rates spiking as covid-19 demand disruption caused E&P players to seek floating storage space given the limited land-based storage capacity. By contrast, vessel opex have remained flat. As a result, STNG's LTM EBITDA has increased to US$590 mm reducing net leverage to 4.9x. We note the estimated BBG consensus EBITDA estimate for 2020 is US$620 mm, essentially doubling the EBITDA recorded in 2019.

If tanker spot rates normalize at the expected 3Q20 day rates we estimate FCF could reach US$277 mm in 2020 – an implied 39% yield on the stock. A conservative 5.0x FCF multiple would imply 93% equity upside. Our estimated US$675 mm EBITDA for 2020 would be above current BBG consensus as well. Furthermore, we estimate STNG's fleet market value at US$4.5 bn per the reported long-term avg. sale price for five-year old second hand coated tankers. With total debt at US$3.0 bn (incl. leases and the US$151 mm convert), the implied equity value would be US$1.7 bn – 137% upside vs the current US$721 mm market cap. However, with the current share price at US$12.3, neither upside case would be sufficient to reach the convert's US$38/share strike price. As a result, we continue to see STNG 22s convert as "busted."

Our estimated STNG fleet value would be 148% of total debt (incl. the convert), sufficient to cover the senior bank debt and leases. Current FCF prospects are sufficient to amortize debt and fund the scheduled scrubber and drydock capex. If our expectations on day rates materialize, we suspect STNG leverage could decline to ~4x with potential to become a bankable credit. Despite the bonds rallying a couple points since our upgrade, we reaffirm our "Positive Outright" rating on STNG 22s as a HY bond trading at 8.0% mid-ytm at 93c with a "free" equity option.

Description	Coupon	Maturity	Amt Out (US$ MM)	Mid Price	Mid YTM	Conv. Price	STNG Price
STNG	3.00%	5/15/2022	151	92.50	7.96%	38.10	$12.30

** Prices sourced from BBG as of September 22, 2020*

- Please refer to our **"BCP Research: Scorpio Tankers (STNG -/-/-) Upgrading to Positive Outright"** note published August 7th for an overview of STNG
- On September 8, 2020 STNG announced that it had repurchased US$52 mm face value of the 22s converts at an 89c avg. price
  - Essentially repurchasing one fourth of the converts amt. out
- As highlighted by our short-term prospects, we suspect FCF generation enabled the bond repurchases:
  - Market demand is expected to outgrow fleet growth, as new build order book is currently at 7% of the total world tanker fleet
    - This would be the lower % on record, with the 10-yr average at 17% and the 5-yr average at 14%
    - Vessel values could continue to increase
  - Though 2Q20 had extraordinary high spot rates, spot rates were already at multi-year highs in 1Q20 increasing STNG's EBITDA and FCF generation
  - Assuming the issuer's day rate guidance for 3Q20, with spot rate increasing by 25% in 4Q20 (conservative given 4Q rates being historically around 50% higher vs 3Q)

        - We see EBITDA reaching US$675 mm for 2020, an implied 85% y/y growth and above the current US$620 mm BBG consensus estimate
        - FCF would be US$277 mm, sufficient to cover the scheduled scrubber and drydock capex
        - FCF would increase to US$343 mm in 2021 – assuming day rates stabilize at a mid-point 2H20
    - Our estimated US$277 mm in FCF would imply a 39% FCF yield on the current stock price
        - Assuming a conservative 5.0x FCF multiple, the market cap would increase to US$1.4 bn
        - An implied 93% upside vs the current US$721 mm market cap
        - Yet, the upside to US$23.76 per share would not be high enough to reach the US$38.10 conversion ratio
    - As a result, the 2022 convert would remain "busted" in our view as the common would remain out of the money
- Per the FY19 20-F, the long-term avg. sale price for 5-yr old coated product tanker vessels depend on its DWT
    - Our estimated market value for STNG's 127 owned and leased vessels would be US$4.5 bn
- After the bond repurchases, total debt (incl. leases and the convert) would be US$3.0 bn – an implied **148% coverage**
    - STNG equity would be US$1.7 bn should all vessels be sold at market, an implied 137% upside to the current US$721 mm market cap
    - Despite the stock upside to $29.18 per share, it would not be high enough to reach the US$38.10 conversion ratio
    - Furthermore, the book value of the vessels as of 2Q20 was US$4.9 bn – an implied **161 coverage** on STNG's total debt after the repurchases
- Per the above, we continue to see the convert attractive as a short-term bond option trading at 7.96% mid-ytm, including the "free" equity option
    - STNG's vessel values are sufficient to cover in full the US$3.0 bn total debt (incl. the US$151 mm convert)
    - Current TCE spot rates turn the issuer FCF positive, sufficient to cover the scheduled scrubber and drydock capex in 2020 and 2021
    - EBITDA leverage metrics would improve to 4.1x

STNG (US$ MM)	2Q20	Vessel Size	Avg. Sale Price (5-yr old Coated Vessel)	Est. Vessel Value
LR2	42	95k DWT	44	1,840
LR1	12	75k DWT	36	433
MR	60	45k DWT	31	1,848
Handymax	14	37k DWT	26	363
Total Vessels	**128**			**4,484**
Credit & Lease Financing	2,843			
Bonds	28			
Convert	151			
Total Debt	**3,022**			
Cash	251			
Current Market Cap.	**721**			
Current EV	**3,493**			
EV / LTM EBITDA	**5.9x**			
Est. Vessel Value / Total Debt	**148%**			
Est. Equity Value if Vessels Sold	**1,712**			
Est. Equity Upside	**137%**			
Vessel Book Value + Leased Assets	**4,855**			
Vessel Book Value / Total Debt	**161%**			

STNG (US$ MM)	FY17	FY18	FY19	1Q20	2Q20	3Q20 Est.	4Q20 Est.	FY20 Est.	FY21 Est.
LR2	142	189	261	99	180	86	108	473	388
LR1	21	47	66	22	39	24	30	116	108
MR	217	225	262	116	122	87	108	432	390
Handymax	79	83	103	43	34	19	24	121	88
Other Revenue & Voyage Expenses	46	36	6	0	0	0	0	0	0
TCE Revenue	**505**	**580**	**698**	**281**	**375**	**216**	**270**	**1,142**	**974**
EBITDA	**174**	**212**	**364**	**159**	**252**	**107**	**157**	**675**	**528**
Interest expense	(92)	(155)	(183)	(45)	(39)	(43)	(42)	(168)	(159)
Capex	(264)	(53)	(207)	(63)	(56)	(38)	(15)	(173)	(41)
Working capital	(17)	(13)	0	(75)	30	(7)	(4)	(56)	18
Tax expense	0	0	0	0	0	0	0	0	0
FCF	**(199)**	**(9)**	**(26)**	**(25)**	**186**	**20**	**97**	**279**	**346**
Debt Raised (Amortized)						(50)	(50)	(100)	(200)
Bonds Repurchased						(52)			
Bank Facilities & Leases	2,307	2,451	2,865	2,917	2,893	2,843	2,793	2,793	2,593
Bonds	111	111	54	54	28	28	28	28	28
Convertible Bonds	349	349	204	204	204	151	151	151	151
Total Debt	**2,767**	**2,910**	**3,122**	**3,174**	**3,124**	**3,022**	**2,972**	**2,972**	**2,772**
Cash	186	594	202	120	251	174	221	221	367
Net Debt	**2,581**	**2,317**	**2,920**	**3,055**	**2,874**	**2,848**	**2,751**	**2,751**	**2,406**
Gross Leverage	15.9x	13.7x	8.6x	20.0x	12.4x	28.2x	18.9x	4.4x	5.2x
Net Leverage	14.8x	10.9x	8.0x	19.2x	11.4x	26.5x	17.5x	4.1x	4.6x
Interest Coverage	1.9x	1.4x	2.0x	3.5x	6.4x	2.5x	3.8x	4.0x	3.3x
EBITDA Margin %	35%	37%	52%	57%	67%	50%	58%	59%	54%

Arturo Galindo
Investment Research Analyst
BCP Securities, LLC

Paseo de los Tamarindos No. 90 Torre Arcos
Torre 1, Piso 11, Oficina 11B
Bosques de las Lomas, México
Tel. +52 55 5025 5509
agalindo@bcpsecurities.com
www.bcpsecurities.com

Matias Castagnino, CFA
BCP Securities, LLC

Paseo de la Castellana, 91
28064 Madrid, Spain
+34 91 310 6980
mcastagnino@bcpsecurities.com
www.bcpsecurities.com

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"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

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“Market Overweight” – The spread of the bond to its similarly duration sovereign controller bond is expected to decrease over the next 3 – 6 months.

“Market Weight” – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

“Market Underweight” – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

“Not Rated” or no comment – Currently, the analyst does not have adequate conviction about the bond’s spread to its similarly duration sovereign controller bond over the next 3 – 6 months.

High Octane Universe
“Speculative Buy” – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

“Positive” – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the upside

“Neutral” – Bonds that in our view have an equity investment risk profile and we think risk/return is balanced

“Negative” – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the downside

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