BCP Research: Scorpio Tankers (STNG -/-/-) 3Q20 Earnings- Maintain Outright

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Summary: Scorpio Tankers (STNG), one of the world's largest oil product tanker issuers, reported sound 3Q20 earnings. TCE revenue increased by 32% y/y on the weaker seasonal 3Q, as demand for larger LR2 and LR1 vessels remains for floating storage. EBITDA was 51% higher y/y as TCE revenue growth outpaced slightly higher vessel opex. Sequentially, EBITDA contracted as 2Q record day rates normalized and floating storage inventories began to unwind. FCF generation was US$72 mm due to WK contraction. During 3Q20, STNG repurchased about a quarter of the converts and is currently negotiating vessel refinancings to increase its liquidity by US$144 mm. The LTM net leverage improved to 4.6x.

As we had mentioned, STNG's short-term FCF prospects are enabling debt paydown and bond repurchases. LTM EBITDA is US$617 mm, well above last year's levels and the estimated BBG consensus for 2020. For reference, 3Q20's EBITDA was lower than our estimates due to lower TCE rates yet FCF was materially higher due to WK. We estimated FCF could reach US$277 mm in 2020 – an implied 43% yield on the stock. A conservative 5.0x FCF multiple would imply 117% equity upside. 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$3.1 bn (incl. leases and the US$151 mm convert), the implied equity value would be US$1.6 bn – 145% upside vs the current US$643 mm market cap. However, with the current share price at US$10.9, 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 145% 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 since our upgrade, we maintain our "Positive Outright" rating on STNG 22s as a HY bond trading at 6.7% mid-ytm at 95c 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	94.75	6.70%	38.10	$10.94

** Prices sourced from BBG as of November 10, 2020*

- 3Q20 TCE revenue increased by 32% y/y to US$177 mm, decreasing q/q due to the seasonal weaker 3Q's
  - LR2 revenue was 32% higher y/y at US$73 mm, as demand for larger vessels remains for floating storage contracts
  - MR revenue was 36% higher y/y at US$75 mm, despite stable TCE rates due to higher vessels operated after the Trafigura transaction
  - STNG's consolidated TCE was US$15k/day, 11% higher y/y due to higher LR2 and LR1 rates
- EBITDA increased by 51% y/y to US$82 mm, yet decreasing by 67% sequentially
  - Y/Y EBITDA growth was due to higher TCE revenue outpacing vessel opex increases
  - Sequentially, the contraction was due to normalizing TCE rates as record floating storage inventories began to unwind
  - As a result, the EBITDA margin expanded to 46% vs 41% in 3Q19
- FCF generation was US$72 mm, driven by lower drydock capex and WK contraction from A/R collection
- Total debt decreased to US$3,069 mm, with cash decreasing to US$218 mm
  - FCF was offset by debt paydown and US$19 mm in dividends and share buybacks
  - In September, STNG repurchased US$52 mm face value of the 22s converts at an 89c avg. price

    - The issuer has US$44 mm available credit lines and increased liquidity by US$64 mm trough vessel refinancings for 4Q20
- The LTM gross and net leverage ratios are 5.0x and 4.6x, respectively
- Recent highlights:
    - In September, the board approved up to US$250 mm in STNG securities repurchases, incl. the convert, bonds and the common
    - The issuer is in talks to increase liquidity by an additional US$75 mm from refinancing 11 vessels
- Link to results here

Thoughts on Convert

- As highlighted by our short-term prospects, strong FCF generation is enabling debt 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%
    - Though 2Q20 had record high spot rates, spot rates were already at multi-year highs in 1Q20 increasing STNG's EBITDA and FCF
    - 3Q20 TCE rates continued to increase y/y, yet it was to a lower level vs our estimates resulting in lower EBITDA
        - However, FCF was significantly higher due to better WK dynamics
    - For reference, we included our base case where we see EBITDA reaching US$675 mm for 2020
        - 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 43% 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 123% upside vs the current US$643 mm market cap
        - Yet, the upside to US$23.7 per share would not be high enough to reach the US$38.10 conversion ratio
        - The 2022 convert would remain "busted"
- 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
    - Total debt (incl. leases and the convert) stands at US$3.1 bn – an implied **145% coverage**
    - STNG equity would be US$1.6 bn should all vessels be sold at market, an implied 157% upside to the current US$625 mm market cap
    - Despite the stock upside, it would also not be sufficient to reach the conversion ratio
- Per the above, we continue to see the convert attractive as a short-term bond option trading at 6.70% mid-ytm, including the "free" equity option

- STNG's vessel values are sufficient to cover in full the US$3.1 bn total debt (incl. the US$151 mm convert)
  - For reference, the book value of the vessels as of 3Q20 was US$4.9 bn – an implied **158 coverage** on STNG's total debt
- 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)	3Q20	2Q20	3Q19	q/q	y/y
TCE Revenue	177	343	134	(49%)	32%
EBITDA	82	252	54	(67%)	51%
EBITDA margin	46%	73%	41%	-	-

STNG (US$ MM)	3Q20	2Q20	3Q19	q/q	y/y
Total Debt (incl. leases)	3,069	3,124	3,142	(2%)	(2%)
Cash & Equivalents	218	251	244	(13%)	(11%)
Net Debt	2,851	2,874	2,897	(1%)	(2%)
Total Debt / LQA EBITDA	9.3x	3.1x	14.4x	6.2x	-5.1x
Net Debt / LQA EBITDA	8.7x	2.9x	13.3x	5.8x	-4.6x

STNG (US$ MM)	3Q20	2Q20	3Q19	q/q	y/y
EBITDA	82	252	54	(67%)	51%
Interest paid (incl. leases)	(35)	(39)	(43)	10%	18%
Capex	(33)	(56)	(69)	42%	52%
Working capital	58	30	1	95%	-
Taxes paid	0	0	0	-	-
FCF	**72**	**186**	**(56)**	(61%)	-

STNG (US$ MM)	3Q20	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	59	45k DWT	31	1,817
Handymax	14	37k DWT	26	371
Total Vessels	**127**			**4,461**
Credit & Lease Financing	2,890			
Bonds	28			
Convert	151			
Total Debt	**3,069**			
Cash	218			
Current Market Cap.	**643**			
Current EV	**3,494**			
EV / LTM EBITDA	**5.7x**			
Est. Vessel Value / Total Debt	**145%**			
Est. Equity Value if Vessels Sold	**1,610**			
Est. Equity Upside	**150%**			
Vessel Book Value + Leased Assets	**4,864**			
Vessel Book Value / Total Debt	**158%**			

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%

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