

How Middle East war could impact global LNG, LPG shipping

An in-depth interview with Oystein Kalleklev, CEO of Flex LNG and Avance Gas

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The LNG carrier Flex Endeavour is chartered out through 2030. (Photo: Flex LNG)

War in the Middle East changes the geopolitical calculus for ocean shipping, compounding existing threats from Russia's invasion of Ukraine. Two of the top energy cargoes at risk in the Middle East are liquefied petroleum gas (LPG) — propane and butane — and liquefied natural gas (LNG).

What happens next in the Middle East will have major trade consequences for the U.S., the world's largest exporter of both LNG and LPG.

Oystein Kalleklev is the CEO of LNG shipping company Flex LNG (NYSE: [FLNG](#)) and LPG shipping company Avance Gas (Oslo: [AGAS](#)). The two companies he oversees have a combined market cap of \$2.56 billion.

FreightWaves conducted an in-depth interview with Kalleklev on Monday, covering the latest geopolitical issues faced by his fleets, his outlook on global LPG and LNG shipping fundamentals, and his views on shipping stocks.

This question-and-answer interview was edited for clarity and length.

Geopolitical risks escalate

FREIGHTWAVES: Both LNG and LPG shipping markets are heavily exposed to war in the Middle East. [There are two very different geopolitical scenarios here](#): one where fighting is contained in Israel and one where it escalates into a regional conflict that affects shipping via the Strait of Hormuz.

How do you see the “contained” scenario affecting markets for LNG cargoes transported by Flex LNG and LPG cargoes transported by the very large gas carriers (VLGCs) of Avance?

KALLEKLEV: The global LNG market is already so tight that just a minor ripple creates a lot of consequences. We saw prices for TTF [the Netherlands gas hub price] go up 40% to 50% last week. I think that’s a general risk premium. People are more worried.

The question on the VLGC side is whether the U.S. will crack down on Iran. That would disrupt volumes of Iranian LPG to China. China would need more LPG from places like the U.S. There hasn’t been any sign of the U.S. wanting to escalate this situation yet. That could be because Iran has been quite aggressive in the past by suddenly arresting crude tankers [when

shipping conflicts escalate]. It's kind of like putting your hand in a hornets' nest.

FREIGHTWAVES: Then there's the geopolitical escalation disaster scenario. This is not a black swan. It seems entirely possible that Israel will go after Hamas in Gaza, Iran will in some way retaliate and Israel will take some action against Iran. It seems entirely possible that this could close the Strait of Hormuz. Almost a third of the world's LNG and more than a third of the world's LPG transits this strait.

KALLEKLEV: I agree. It's certainly not implausible that if Hezbollah attacks from the north, there might be some type of retaliation by Israel against Iran. In such a situation you might have a closure of the Strait of Hormuz. All of the Qatari LNG volumes would be at risk, which would certainly be negative for the LNG market because a lot of volume would disappear.

Flex LNG doesn't really take many cargoes from Qatar and it has all of its ships on "hell or high water" charters. There would be a bigger risk for Avance, which is a spot shipping company, because it would affect the LPG volumes coming out of the Middle East.

But I just don't think you could have that kind of situation in the Strait of Hormuz for very long. These countries in the Middle East depend on these flows. Saudi Arabia needs \$80 or \$90 per barrel to balance its budget. Iran needs to export both oil and LPG to let its priests and military control the country. I believe there would be revolutions in the Middle East if the flows stopped for too long.

LPG shipping demand on the rise

FREIGHTWAVES: Even before the Israel-Hamas war, VLGC spot rates hit an all-time high of \$150,000 per day in September. They're now down to around \$100,000 per day — still very strong. Why have rates been historically high, unrelated to geopolitics?

KALLEKLEV: [The U.S. is producing more LPG](#). LPG inventories in the U.S. are basically at an all-time high. That is depressing the U.S. price [compared to prices in Asia], making the arbitrage to Asia super-strong. We've also seen an increase in LPG exports from the Middle East, despite OPEC cuts. And you have a good oil price environment so you have a good LPG arbitrage versus naphtha. [LPG competes with naphtha as a feedstock for Asian steam crackers. Higher oil prices lead to higher naphtha prices, making LPG more competitive, increasing VLGC demand to Asia]. At the same time, LPG has a good arbitrage versus other energy sources like LNG. And then, when you put Panama Canal congestion on top of all that, you get a really tight freight market.

FREIGHTWAVES: Panama Canal delays are making it harder for VLGCs to return to the U.S. Gulf from Asia within their appointed loading windows — their laycans — so VLGCs are taking the longer but more reliable route via the Suez Canal or Cape of Good Hope on their ballast (empty) legs. [That is reducing available ship capacity and pushing up rates](#). Are more VLGCs taking the longer route on their laden (full) legs to Asia, as well? That would make the market even tighter.

KALLEKLEV: With our VLGCs, we have more or less discontinued routing our ships through the Panama Canal on the ballast leg. Even if it looks like it will work on paper, and you expect waiting time at the canal of five days and you add in another three days as an extra cushion, you may get to the canal and end up waiting 14 days. You are not able to meet your laycan. You can ask the charterer for a new laycan, but if they don't agree, you've lost your cargo and you have to start all over again, and you end up waiting even more days when you arrive in the U.S. Gulf.

We do see more charterers [who control the route on the laden leg] routing around the Cape of Good Hope and avoiding the Panama Canal. They also need predictability. If they're sending a cargo to Asia, typically the price is good for a month. If they are not able to get to China before the end of the [scheduled] month, the price they get for the cargo could be lower.

LNG shipping rates normalize

FREIGHTWAVES: LNG shipping spot rates topped \$400,000 per day last winter — [the highest spot rates ever recorded by any ocean transport ships in history](#) — as a result of surging European demand following Russia's invasion of Ukraine and the sabotage of the Nord Stream pipelines. European gas inventories are now very high. What do you see for LNG shipping rates this winter?

KALLEKLEV: Last winter was of course crazy because of the war. Europe had to just buy anything it could in the spot market.



Flex

LNG and Avance Gas CEO Oystein Kalleklev. (Photo: Marine Money)

This winter is a much more benign market. The demand reduction for gas in Europe has been astonishing. Even after prices have come down, demand hasn't really bounced back. We've seen a lot less demand from both the European household and industrial sectors.

But even though storage is very high, Europe is still buying every spot cargo it can today so it does not entirely deplete its inventories coming out of this winter. So, I think the market will still be tight this winter, but I don't think you'll see the rate levels we saw last year.

Remember, cargo economics affects what people pay [for spot freight]. There are headlines today that gas is more expensive than oil. But in August 2022, gas was six times more expensive than oil. The cargo economics now [are nowhere close to what they were last season](#).

I think the \$200,000 [per day] we've seen on spot for modern tonnage this year is about the level we will be at. I don't think we'll see anything much more than that [current headline rates are around \$140,000 per day, according to Clarksons]. And if you told somebody spot rates would be \$200,000, everybody would be bullish about that in any year except 2022. When we fixed a ship at about \$200,000 in 2018, we went straight to the pub. When we fixed at about \$300,000 in 2022, we just went to a restaurant.

FREIGHTWAVES: LNG shipping is so different from other markets like crude tankers, product tankers, dry bulk and LPG. Those segments are heavily focused on spot rates. LNG shipping is almost entirely about long-term contracts. The \$400,000-plus-per-day LNG spot rates in late 2022 made for juicy headlines, but almost no one actually got them. Almost all LNG ships are on long-term contracts. Do you think this is a permanent market dynamic, given how expensive LNG ships are versus other vessels, thus the need for long-term charters to cover cash breakeven?

KALLEKLEV: Usually, when you get a spot market in LNG shipping, it's because markets are soft and people have no place to put their ships and they'd rather gamble in the spot market. As you mentioned, it's also about the price of the ships now. Cash breakeven on an LNG carrier can be \$50,000-\$60,000 per day, versus the low \$20,000s for a VLGC. It's much harder to trade an LNG carrier in the spot market when you have such a high cash breakeven because if you're in the spot market making zero because you're idling, you have some big bills to pay. Much bigger bills than in any other shipping segment.

Listing shares in New York vs. Oslo

FREIGHTWAVES: You're the CEO of two listed companies: Avance in Oslo and Flex LNG, listed in both the U.S. and Oslo. Flex LNG was originally listed only in Oslo. Why did you add a U.S. listing in 2019?

KALLEKLEV: I joined Flex in 2017 and we were already starting to think about the U.S. listing then. We changed our accounting from IFRS [International Financial Reporting Standards] to U.S. GAAP [generally accepted accounting principles] in January 2018 because most U.S. investors are more accustomed to U.S. GAAP than IFRS.

There were a couple of reasons we looked at listing in the U.S. One was that, back then, most of the big LNG shipping companies were in the U.S., not Oslo, so we thought we could get better pricing if we listed in the U.S.

Another was that we could see that the U.S. was growing to be on par with Australia and Qatar in LNG exports, so we thought: If we list in 2019, we're not allowed to raise equity in the U.S. for 12 months after we list, but 2020 would be good timing because there would be a lot of new U.S. volumes in the market, which would create more interest around the sector, and we could start fixing ships on long-term charters in 2020 and start paying good dividends.

Then COVID happened, which derailed our plans, although only for a year or so. The market came back in late 2020 and into 2021. We started fixing our ships on long-term charters and reorienting the company from being more asset-based to being a more dividend-paying company, which of course did wonders for our stock price.

We listed at \$11 per share. It went all the way down to \$4 during COVID and it has now gone to \$31, plus we've paid around \$8.20 in dividends. So, it's been a good voyage, even though it was a bit difficult in the beginning.

And today, more than 90% of Flex LNG's trading is in the U.S. So, if anything, the question is whether it makes sense to still be listed in Oslo.

FREIGHTWAVES: You mentioned that before Flex LNG listed in the U.S., most LNG shipping companies were listed here. [But most of those companies have since gone private](#): Teekay LNG, GasLog LNG Ltd., GasLog Partners, Hoegh LNG Partners. They all decided they were worth more private than public. Would Flex LNG be open to a take-private offer?

KALLEKLEV: Of course. Our work is to create as much possible value for our shareholders. If there is some private equity fund or infrastructure fund knocking on our door and willing to pay a price we think is attractive, we are not going to be putting in poison pills. Everything is for sale for the right price, although we are happy just being long-term shareholders and performing and paying out dividends.

FREIGHTWAVES: Oslo-listed shares of Avance Gas have performed incredibly well. They've more than doubled year to date. But the Norwegian kroner has been very volatile and has depreciated against the U.S. dollar, a negative for U.S. investors. Given your success with Flex LNG, why not seek a dual listing for Avance in the U.S., particularly given that one of your competitors, BW LPG (Oslo: [BWLPG](#)), is now going for a U.S. listing?

KALLEKLEV: I do get quite a lot of investors asking about a U.S. listing. But John [shipping tycoon John Fredriksen] owns 77% of Avance, compared to 43% to 44% of Flex LNG. The float [shares available to the public] in Avance is limited, not only in percentage but in dollar value. If we dual-list, there are a lot of costs involved. If we had a normal float and John owned a similar shareholding as he has in Flex, it could make sense. But it's really about the costs compared to the benefits and I'm not convinced, given the shareholding situation today, that it makes sense.

Retail investors and related parties

FREIGHTWAVES: In the 2000s, there was the hope that shipping would evolve to become a major sector for institutional investors. That all died out in the mid-2010s. And in the last few years, there's been a huge increase in retail investor interest. What do you think of the institutional-versus-retail investor split and how do you adjust your messaging as a result of that?

KALLEKLEV: Institutional shareholders have never really come back to shipping. The interest from institutional investors is actually surprisingly low. If you look at our shareholders, we do have institutional investors, but they're mostly index funds like Vanguard. They're index buyers, not some big institution taking a 5% bet on our stock.

Retail is becoming even more important. Last week, some lady on CNBC was shouting that she was very bullish on Flex LNG stock and we got a retail alert from our designated market maker that our retail volumes were 10 times normal. So, we can see that retail is now very important for shipping.

Retail investors typically follow the sector on platforms like Seeking Alpha or investor blogs or even just Twitter. We try to reach out to them more now with podcasts and investor presentations on YouTube. We're also more active on social media.

FREIGHTWAVES: Final question on shipping stocks: [Shipping equities have long been criticized for related-party transactions](#), whether they involve Greek sponsors of IPOs in the 2000s or the more recent case of [highly dilutive share offerings for vessel purchases by Greek micro-cap owners](#). Your companies are part of Norway's Fredriksen group. How does the group deal with concerns over related-party transactions?

KALLEKLEV: There are several problems out there with related parties. One is selling ships at inflated values [to the public entity by the private sponsor]. Another is skimming, by using fees, whether for management

services or commissions. We have always been very focused on not having any of this.

At the same time, we are dependent on running our companies efficiently. We have five publicly listed companies in the group in Oslo running about 250 ships [Flex LNG, Avance Gas, Frontline (NYSE: [FRO](#)), Golden Ocean (NASDAQ: [GOGL](#)) and Ship Finance International (NYSE: [SFL](#))]. What we don't want to do is duplicate administrative tasks.

So, we have very lean management teams and a shared services company, Front Ocean, that all five participating companies jointly own, which provides shared services such as legal, IT and insurance. Rather than hiring a lot of different people who are idle half the day, we pool those resources and get economies of scale.

The easiest way to look at this is to benchmark our costs versus our listed peers. For Avance, our average operating expenses are the lowest and our average general and administrative costs are by far the lowest.

It gets more complicated when you have related party transactions [for vessels]. When we do so, there is a very detailed overview so investors can drill down into that.

FREIGHTWAVES: The proof is that there are numerous shipping companies out there suffering from a "management discount." Their shares trade at a discount due to the reputation of their founders. But some of the Fredriksen companies, like Frontline, trade at a management premium.

KALLEKLEV: Yeah, it's called the "JF Premium." People know that if we do a transaction, it will be favorable to shareholders. It's a bit like Berkshire Hathaway — people know Warren Buffett will treat his shareholders in a friendly way. In our system, if you do anything to jeopardize that reputation, you are done for. You will not be able to work here.