THE EUROPEAN CONTRARIAN

November 11, 2022

Stolt-Nielsen Ltd

(BUY)

Price: NOK255.00
52-Week Range: NOK114.4 – NOK260.5
Shares Outstanding: 53.5 million
Market Capitalization: NOK13.6 billion ($1.3 billion)[1]

Ticker[2]: SNI NO
Dividend: $1.00
Yield: 4.0%

Data as of November 4, 2022

[1] One euro (NOK) is equivalent to $0.0978 as of November 4, 2022.
[2]The common shares of SNI NO trade on the Oslo Børs.

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Investment Thesis

Stolt-Nielsen (SNI NO) is one of the world's largest operators of chemical tankers, storage terminals for bulk-liquids, and container and transportation services for the door-to-door delivery of these products. The company also has a modest presence in aquaculture and has been making investments in the rapidly growing LNG industry. Rates for chemical tankers and containers are at highs not experienced in approximately 15 years, which has resulted in significant profits. While it is perhaps unsurprising that the market has not capitalized these earnings at a meaningful multiple, the current valuation severely underappreciates the near-term potential of the company. This valuation, combined with the growth potential of its LNG business and the moderate operating and balance sheet risk of the company, reflect an attractive investment opportunity. As such, shares of Stolt-Nielsen are recommended for purchase.

The company is currently valued at just 5x consensus earnings forecasts for the fiscal year ending November 2022, with run rate free cash flow representing a yield of 32%. The fundamentals of the market are supportive, with demand expected to grow slightly next year while the orderbook for new chemical tankers remains historically low. Because of this, analysts expect Stolt-Nielsen to increase earnings in 2023, with shares now trading at just 4.7x this estimate. Although it is difficult to pinpoint a proper multiple for what may turn out to be peak earnings, this valuation is too low when one considers that an additional five quarters at currently visible earnings potential (fourth quarter of 2022 plus all of 2023) could generate cash equal to nearly 40% of the market capitalization.

Stolt-Nielsen has been run by the founder and his family for more than six decades and has proven to be a well-managed company. The family's interests are aligned with common shareholders, as they hold over 55% of the stock, and they have run the company for the long term, making modest, incremental investments in growth without overburdening the balance sheet. Debt stands at $2.1 billion, or approximately 1.25x equity, and this could be repaid entirely within five years at run-rate earnings, which would eliminate $120 million of interest expense and add roughly $90 million to net income. For perspective, the company, though consistently profitable, earned less than $90 million in six of the last eight years. Put simply, the excess cash earned from a brief protraction of the current cycle could have a meaningful impact on profitability going forward.

Debt reduction is just one of numerous means by which the company can create shareholder value. It currently pays a 4% dividend and this distribution will likely increase. The company has been steadily expanding its fleet of tankers, its container business, and its storage capacity, while making additional investments in LNG, and, lastly, it has repurchased a modest number of shares in recent years. These factors all speak to Stolt-Nielsen's upside going forward, which, when combined with the additional margin of safety generated by the high level of free cash flow and the modest risk profile of the company, create an attractive long-term investment opportunity.

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Company Description

Stolt-Nielsen operates chemical tankers, provides storage facilities for bulk liquids and offers transportation and logistics services for bulk-liquid chemicals and food-grade products. Aquaculture and investments in the LNG industry also contribute modestly to the consolidated business. The company is incorporated in Bermuda, headquartered in London and trades on Norway's Oslo Børs. Stolt-Nielsen is majority-owned by Fiducia Ltd., which is a trust established for the Stolt-Nielsen family. Fiducia currently controls 55% of the common shares and has additional voting rights through the ownership of Founder's Shares. As of November 2021, Fiducia controlled a total of 64.8% of the voting rights.

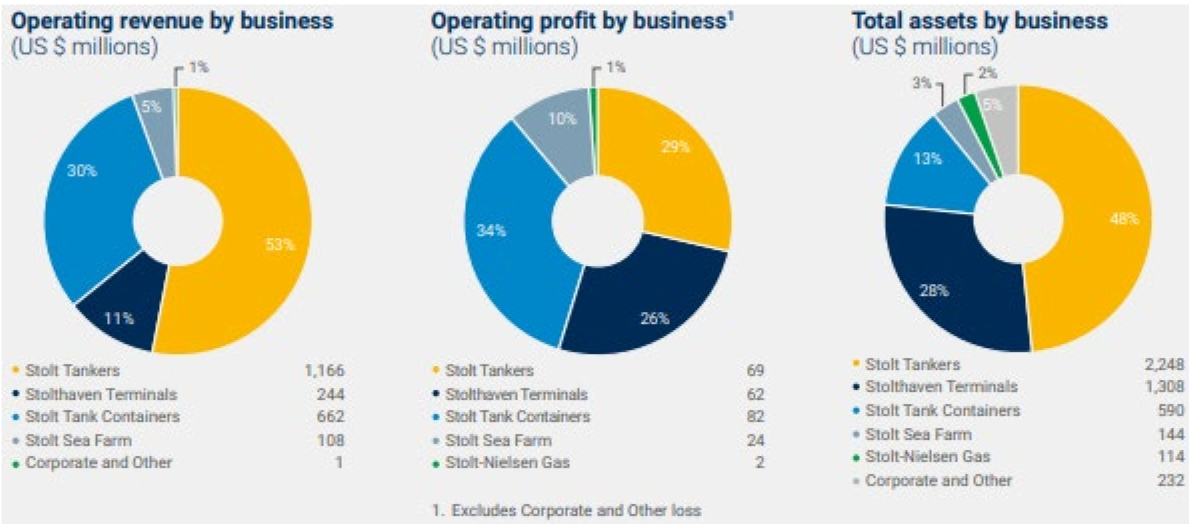
The company was founded in 1959 by Jacob Stolt-Nielsen with the purchase of the chemical tanker *Stolt Avance*. Mr. Stolt-Nielsen began his carrier as a ship broker in London, then moved to a firm in New York upon realizing that city was the center for the chemical tanker sector, just as the petrochemical industry started to flourish. He invented a process for shipping chemicals related to the manufacture of plastics and leveraged this into an ownership stake in a shipping venture before purchasing his own tanker. Within ten years, Stolt-Nielsen grew from having two other employees and one tanker to owning 11 tankers, operating an additional 21 vessels on time charter and having 150 employees with offices in New York, Oslo, Norway and Tokyo, Japan.

The company acquired its first bulk-liquid storage terminal in 1971, creating the segment that would become Stolthaven Terminals, which today operates 15 bulk-liquid terminals around the world. It began to develop its aquaculture business, Stolt Sea Farm, in the early 1970's and, in 1982, it founded Stolt Tank Containers as a transportation business to compliment the Stolt Tankers business. Stolt Tank Containers has grown to become the world's largest provider of door-to-door transportation services for bulk-liquid food-grade products and chemicals.

Jacob Stolt-Nielsen stepped down as CEO of the company in 2000, handing the reins to his son, Niels G. Stolt-Nielsen. The elder Stolt-Nielsen stayed on as Chairman until 2009. Niels Stolt-Nielsen has served as CEO for over 20 years, announcing his intention to step down from the role earlier this year. Upon finding a replacement for CEO, Mr. Stolt-Nielsen will serve as Chairman, replacing the current Chairman, Samual Cooperman, who has held the position since 2016.

As one can see from Exhibit 1, the tanker business continues to be a cornerstone of the company, with Stolt Tankers accounting for 53% of 2021 operating revenues and 29% of operating profit, while representing 48% of total assets. The exhibit also highlights the importance of the Stolthaven Terminals and Stolt Tank Containers businesses, which also contribute significantly to the company's profitability. Stolt Tank Containers is the second largest segment in terms of revenue at 30%, but the largest contributor to profitability at 34%. It also appears to generate the highest returns on invested capital, as the business accounts for only 13% of total assets. Stolthaven Terminals, on the other hand, is more capital intensive (28% of assets), but offers higher margins, accounting for 26% of operating profits on just 11% of revenues. The margins for the Stolt Sea Farm segment are also noteworthy, with the business contributing 10% of consolidated profits on just 5% of total revenues. Stolt-Nielsen Gas, which comprises LNG investments made primarily through joint ventures, has had a minimal impact on operating results to date. These segments are described in greater detail below.

Exhibit 1 Stolt-Nielsen: Breakdown of Revenues, Profits and Assets by Segment; 2021
($ in millions)



Source: Company reports.

Stolt Tankers is the leading operator of chemical tankers with a 164-vessel fleet. The deep sea segment comprises 83 vessels (52 of which are owned as of fiscal year ending November 2021), while the regional segment is serviced by 81 ships (25 of which are owned). The business provides for the safe, reliable transportation of bulk-liquid chemicals, edible oils, acids and clean petroleum products.

Stolthaven Terminals, the bulk-liquid storage services business, consists of 15 terminals throughout the world, totaling 4.9 million cubic meters of storage capacity as of November 2021. The terminals can handle chemicals, clean petroleum products, liquified petroleum gas, vegetable oils, biofuels and oleochemicals (chemical compounds derived natural fats and oils).

Stolt Tank Containers is comprised of 22 full-service depots and refurbishing facilities and a fleet of more than 43,500 tank containers. It is a leading provider of logistics and transport services for the door-to-door shipment of bulk-liquid chemicals and food-grade products.

Stolt Sea Farm is a land-based aquaculture business that consists of 14 farms. The business focuses primarily on the production of sole and turbot, with annual capacity of 1,570 tonnes and 5,700 tonnes, respectively. The segment sells 70% of its production to the foodservice industry, with the remaining 30% sold via retail. These clients are found in more than 30 different countries.

Stolt-Nielsen Gas is focused on making investments in the liquified natural gas ("LNG") industry. This segment owns 47.2% of Avenir LNG which is NOTC-listed (Norwegian Over-the-Counter), 8.3% of Odfjell SE (ODF NO), and 2.5% stakes in both Golar LNG (GLNG) and Cool Company Ltd. (COOL NO). It's most significant investment, Avenir, became fully operational just last year and the $2.1 million operating profit recorded in 2021 was due to an extraordinary gain on the sale of land of $3.2 million, which was partially offset by operating losses. The current market value of these investments totals approximately $200 million.

Stolt-Nielsen's financials are shown in Exhibit 2. As one can see, they are characterized by the volatility one might expect from a shipping company, although it is worth noting that the business was consistently profitable over the last nine years. It is also worth noting that revenues had not grown materially from 2014 through 2021 despite a ~10% increase in the tanker fleet and storage capacity and a ~30% increase in shipping containers.

Exhibit 2 Stolt-Nielsen: Historical Financial Results; 2014-2021, 9M 2021-2022
($ in millions)

	2014	2015	2016	2017	2018	2019	2020	2021	9M21	9M22
Revenues	2,137.9	1,983.7	1,879.9	1,997.1	2,125.5	2,032.1	1,955.1	2,181.1	1,588.0	2,039.3
EBITDA	389.5	468.2	465.9	458.9	451.8	436.0	482.2	529.2	379.1	526.6
Operating Profit	188.6	246.2	231.8	194.4	187.1	181.9	189.9	233.7	156.7	315.5
Profit Attributable to Shareholders	77.1	132.7	113.1	50.3	54.9	21.0	26.3	78.8	43.8	185.6
Vessels		144	150	155	155	155	152	158		
Containers		35,000	35,000	35,400	39,000	40,500	40,000	43,500		
Storage Capacity (millions of meters^3)		4.5	4.5	4.7	4.7	4.9	4.9	4.9		

Source: Company reports.

A breakdown of financial results by segment shows that while revenues for the container segment and, to a smaller extent, the aquaculture business have increased over time, the tanker business has been under some pressure for a period of years due to declining shipping rates. This has also impacted margins, with operating margins in 2021 less than half of what they were at their recent peak in 2016.

Rates improved materially in 2022, with other companies in this peer group noting that this year has been the best environment for chemical tankers since 2007. Margins through the first nine months of the year hit 11.7% in the tanker segment, which is the highest they have been in approximately seven years.

While the company has stated that the outlook for the chemical tanker industry is positive due to an expectation for demand growth in 2023 while supply is still constrained by a historically-low orderbook for newbuilds, it is difficult to know if rates will remain elevated for an extended period. As one will see, however, Stolt-Nielsen's valuation gives it no credit for its recent earnings, with market participants likely dismissing the current environment as unsustainable. While this may be true, the company has demonstrated the earnings power in a higher rate environment that will serve as its source of upside optionality over the long term. Over the short term, even just one additional year of elevated earnings could contribute meaningfully to shareholder returns.

Exhibit 3 Stolt-Nielsen: Financial Results by Segment; 2014-2021, 9M 2021-2022
($ in millions)

	2014	2015	2016	2017	2018	2019	2020	2021	9M21	9M22
Operating Revenue										
Stolt Tankers	1,259.7	1,136.7	1,060.9	1,158.5	1,219.2	1,147.9	1,113.1	1,165.6	857.8	1,084.7
Stolthaven Terminals	214.0	217.4	234.7	242.7	252.0	250.8	238.5	243.6	181.5	206.1
Stolt Tank Containers	539.6	510.3	475.7	512.7	551.1	528.6	520.6	662.4	471.0	666.2
Stolt Sea Farm	63.7	57.3	65.4	72.7	98.5	105.6	79.7	108.6	77.4	81.4
Corporate and Other	60.7	62.1	43.2	10.4	4.8	4.5	3.1	0.9	0.3	1.0
Total	**2,137.9**	**1,983.7**	**1,879.9**	**1,997.1**	**2,125.5**	**2,037.4**	**1,955.1**	**2,181.1**	**1,588.0**	**2,039.3**
Operating Profit										
Stolt Tankers	35.3	122.2	138.4	111.0	66.6	56.7	84.6	68.9	49.7	126.9
Stolthaven Terminals	64.7	38.9	53.0	54.2	76.4	69.0	68.8	62.3	53.8	68.4
Stolt Tank Containers	70.1	63.3	48.2	54.5	70.9	56.1	51.2	81.6	45.2	127.8
Stolt Sea Farm	(1.4)	0.4	14.1	3.5	13.0	0.9	(8.4)	24.4	13.1	18.1
Stolt-Nielsen Gas	0.0	0.0	0.0	0.0	(11.0)	(4.1)	(4.0)	2.1	0.3	(0.1)
Corporate and Other	20.0	21.3	(21.8)	(28.8)	(28.8)	(3.5)	(2.3)	(5.5)	(5.4)	(25.7)
Total	**188.6**	**246.2**	**231.8**	**194.4**	**187.1**	**175.1**	**189.9**	**233.7**	**156.7**	**315.5**
Operating Margin										
Stolt Tankers	2.8%	10.8%	13.0%	9.6%	5.5%	4.9%	7.6%	5.9%	5.8%	11.7%
Stolthaven Terminals	30.2%	17.9%	22.6%	22.3%	30.3%	27.5%	28.8%	25.6%	29.7%	33.2%
Stolt Tank Containers	13.0%	12.4%	10.1%	10.6%	12.9%	10.6%	9.8%	12.3%	9.6%	19.2%
Stolt Sea Farm	-2.2%	0.7%	21.5%	4.9%	13.2%	0.8%	-10.5%	22.5%	17.0%	22.2%
Stolt-Nielsen Gas	0.0%	0.0%	0.0%	0.0%	-229.9%	-91.6%	-128.0%	243.2%	93.7%	-13.2%
Corporate and Other	0.9%	1.1%	-1.2%	-1.4%	-1.4%	-0.2%	-0.1%	-0.3%	-0.3%	-1.3%
Total	**8.8%**	**12.4%**	**12.3%**	**9.7%**	**8.8%**	**8.6%**	**9.7%**	**10.7%**	**9.9%**	**15.5%**

Source: Company reports.

Valuation Analysis

Stolt-Nielsen's share price has been setting new 52-week highs and currently trades at levels last seen in 2005. However, the company trades at just 0.8x book value and, as shown in Exhibit 4, current valuation reflects an exceedingly modest multiple of both earnings and EBITDA. Please note that shares outstanding do not include common shares held in treasury, nor do they include Founder's Shares, as their only economic benefit is an insignificant $0.005 per share dividend. Earnings are reported net of this distribution.

Exhibit 4 Stolt-Nielsen: Current Valuation Metrics
(currency, as stated, in millions, shares in millions)

Share Price (11/4/2022)	NOK 255.00		
Shares Outstanding (millions)	53.5		
Market Capitalization	**NOK 13,648.6**		
NOK/USD Rate	0.0978		
Market Capitalization	**$1,334.83**		
Net Debt	$2,111.00		
Enterprise Value	**$3,445.83**		
2022E Earnings	268.5	2023E Earnings	283.2
Price/2022E Earnings	**5.0x**	**Price/2023E Earnings**	**4.7x**
2022E EBITDA	701.0	2023E EBITDA	718.4
EV/2022E EBITDA	**4.9x**	**EV/2023E EBITDA**	**4.8x**
Dividend	$1.00		
Dividend Yield	**4.0%**		

Source: Company reports, *Bloomberg*, *The European Contrarian* estimates.

As mentioned earlier, a lower earnings multiple is to be expected if profitability is considered to be unsustainably high. However, when one considers that free cash flow through the first nine months of 2022 indicates an annualized yield of 32% (see Exhibit 5), it only takes short bursts of peak cycle profitability to greatly reduce the payback period of an investment.

Exhibit 5 Stolt-Nielsen: Run Rate Free Cash Flow; 2022
($ in thousands, shares in millions)

	9M 2022
Cash Generated from Operations	**559,467**
Interest Paid	(87,285)
Debt Issuance Costs	(6,986)
Interest Received	2,348
Income Taxes (Paid) Received	(12,113)
Net Cash Generated from Operations	**455,431**
Capital Expenditures	(132,689)
Nine Month Free Cash Flow	**322,742**
Annualized Free Cash Flow	**430,323**
Market Capitalization	1,334,830
Esitmated Free Cash Flow Yield	**32.2%**

Source: Company reports, *Bloomberg*, *The European Contrarian* estimates.

Clearly, free cash flows at this level can meaningfully enhance shareholder value by financing asset purchases, returning cash through dividends or share repurchases, or paying down debt. Net debt of $2.1 billion, for instance, could be repaid within five years, thus generating an additional $120 million in pretax profit by eliminating interest expense. In fact, a single year of profitability on par with 2022, if used to pay down debt, would lower interest expense by approximately $25 million, which is on par with the total profits earned in some recent years.

If one were to assume Stolt-Nielsen reverted to the earnings potential experienced during the trough of the cycle (on par with the $21 million earned in 2019) but was able to pay off its debt and eliminate $120 million in interest expense (an estimated $90 million after tax), then earnings would be approximately $110 million. At a multiple of 12x this forecast, this would equal a market cap of $1.32 billion, which implies that the company should retain its current valuation even at the lowest point of the next cycle, thus limiting downside and creating a meaningful margin of safety.

Lastly, this valuation analysis does little to account for the company's investments in LNG, which are not currently reflected in earnings. The total market value of these investments is an estimated $200 million, and the sector is growing rapidly, but there has been minimal impact on Stolt-Nielsen's earnings to date. Adding these investments to a fair value estimate would have a negligible but positive impact on valuation, yet the upside optionality they provide is perhaps more significant.

Conclusion

Stolt-Nielsen operates in a unique subsector of the shipping industry. The demand for chemical tankers and bulk-liquid container shipping is very strong, and the company is benefitting from a strong rate environment, yet investors seem reluctant to give it credit for its current earnings strength, as the shares trade at just 5x and 4.7x the net income forecasts for 2022 and 2023, respectively. However, while it is reasonable to expect rates to decline at some point in the future, just one year of current earnings represents a free cash flow yield of over 30%, which significantly mitigates the downside risk of this investment.

The company has numerous levers by which it can use this cash to create value for equity holders, such as debt reduction, dividends, share repurchases, and investments in growth, particularly in LNG. This upside is compelling, while risks are mitigated by a strong management with significant equity ownership, an appropriate balance sheet and expansive free cash flow. Because of this, shares of Stolt-Nielsen are recommended for purchase.

Exhibit 6 Stolt-Nielsen: Consolidated Income Statement

($ in thousands)

	Notes	Three Months Ended August 31, 2022	Three Months Ended August 31, 2021	Nine Months Ended August 31, 2022	Nine Months Ended August 31, 2021
		(in thousands, except for per share amounts)			
Operating revenue	4	**$ 744,048**	$ 580,944	**$ 2,039,321**	$ 1,588,027
Operating expenses		**(504,784)**	(385,703)	**(1,367,996)**	(1,080,603)
		239,264	195,241	**671,325**	507,424
Depreciation and amortisation	4	**(72,428)**	(75,588)	**(211,009)**	(222,345)
Gross Profit		**166,836**	119,653	**460,316**	285,079
Share of profit of joint ventures and associates	4	**14,079**	11,780	**38,565**	30,560
Administrative and general expenses		**(67,155)**	(55,542)	**(185,959)**	(163,401)
(Loss) gain on disposal of assets, net		**(204)**	2,928	**1,585**	3,209
Other operating income		**530**	592	**3,430**	1,676
Other operating expense		**(2,228)**	(30)	**(2,394)**	(391)
Operating Profit		**111,858**	79,381	**315,543**	156,732
Non-Operating Income (Expense)					
Finance income		**1,050**	574	**2,344**	1,666
Finance expense on lease liabilities		**(2,661)**	(2,922)	**(7,673)**	(8,426)
Loss on early extinguishment of debt		—	—	**(11,149)**	—
Finance expense on debt		**(27,749)**	(28,095)	**(83,907)**	(87,785)
Foreign currency exchange loss, net		**(1,442)**	(2,682)	**(7,164)**	(640)
Other non-operating income (expense), net		**1,357**	(1,602)	**1,511**	(1,568)
Profit before Income Tax		**82,413**	44,654	**209,505**	59,979
Income tax expense		**(7,690)**	(11,191)	**(23,906)**	(16,193)
Net Profit		**$ 74,723**	$ 33,463	**$ 185,599**	$ 43,786
Earnings per Share:					
Net Profit					
Basic		**$ 1.40**	$ 0.63	**$ 3.47**	$ 0.82
Diluted		**$ 1.40**	$ 0.63	**$ 3.47**	$ 0.82

Source: Company reports.

Exhibit 7 Stolt-Nielsen: Consolidated Balance Sheet

($ in thousands)

	Notes	August 31, 2022	November 30, 2021
		(in thousands)	
ASSETS			
Current Assets			
Cash and cash equivalents		$ 234,367	$ 123,868
Restricted cash		98	6,096
Receivables		376,929	285,749
Insurance claim receivables		—	58,598
Inventories		5,168	6,986
Biological assets		48,304	50,344
Prepaid expenses		98,126	76,645
Derivative financial instruments	9	3,796	589
Income tax receivable		4,119	987
Other current assets		40,912	54,351
Total Current Assets		811,819	664,213
Property, plant and equipment	6	2,777,234	2,856,137
Right-of-use assets	6	219,494	203,048
Investments in and advances to joint ventures and associates		605,729	611,906
Investments in equity instruments	9	126,207	37,873
Deferred tax assets		4,152	9,238
Intangible assets and goodwill	6	34,765	38,967
Employee benefit assets		19,052	25,370
Derivative financial instruments	9	6,718	6,868
Insurance claim receivables	8	153,672	162,887
Other non-current assets		18,791	19,702
Total Non-Current Assets		3,965,814	3,971,996
Total Assets		$ 4,777,633	$ 4,636,209
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current Liabilities			
Short-term bank loans	7	$ —	$ 40,000
Current maturities of long-term debt	7	412,691	490,502
Current lease liabilities		53,953	43,473
Accounts payable		134,074	114,607
Accrued voyage expenses		72,074	51,328
Accrued expenses		238,104	197,904
Provisions		4,937	2,968
Income tax payable		18,467	12,534
Dividend payable	5	—	26,829
Derivative financial instruments	9	6,784	10,239
Other current liabilities		54,003	37,543
Total Current Liabilities		995,087	1,027,927
Long-term debt	7	1,705,853	1,695,142
Long-term lease liabilities		173,319	166,977
Deferred tax liabilities		74,356	68,025
Employee benefit obligations		22,490	31,720
Derivative financial instruments	9	7,885	7,938
Long-term provisions	8	154,673	164,126
Other non-current liabilities		1,157	1,425
Total Non-Current Liabilities		2,139,733	2,135,353
Total Liabilities		3,134,820	3,163,280
Shareholders' Equity			
Founder's shares	5	14	14
Common shares	5	58,524	58,524
Paid-in surplus		195,466	195,466
Retained earnings		1,743,658	1,584,978
Other components of equity		(243,798)	(255,002)
		1,753,864	1,583,980
Less – Treasury shares	5	(111,051)	(111,051)
Total Shareholders' Equity		1,642,813	1,472,929
Total Liabilities and Shareholders' Equity		$ 4,777,633	$ 4,636,209

Source: Company reports.

This report was produced by Horizon Kinetics ("HK"). The following persons employed by HK contributed to this report: Murray Stahl, Chairman, Steven Bregman, President, and Peter Doyle, Managing Director. HK is located at 470 Park Avenue South, New York, NY 10016. At the time of this report, there are no planned updates to the recommendations. To the extend HK has provided previous recommendations concerning the same issuer(s) during the preceding 12-month period, such recommendations do not differ from the recommendations contained here.

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