Siena Market Line
1st week of May 2015

Scorpio Bulkers Inc.

NYSE: SALT

Analyst: Kyle White
Sector: Industrials

BUY

Price Target: $3.46

Key Statistics as of 5/1/2015

Market Price:	
Industry:	$2.41
Market Cap:	$443.5 M
52-Week Range:	$1.30-9.46

Thesis Points:

- Bottoming in bulk goods shipping space means lift-off from current breakeven rates
- Newest, most modern fleet in industry will slowly come online over subsequent quarters, increasing revenues and driving down costs, improving margins
- Multiple catalysts

Company Description:

Scorpio Bulkers Inc., together with its subsidiaries, engages in the marine transportation of dry bulk commodities. Its fleet transports a range of major and minor bulk commodities, including ores, coal, grains, and fertilizers along worldwide shipping routes. As of April 02, 2015, the company owned eight vessels consisting of one Capesize, three Kamsarmax, and four Ultramax vessels; had time charters-in 13 dry bulk vessels comprised of one Handymax, one Ultramax, three Supramax, two Panamax, three Kamsarmax, and three Post-Panamax vessels; and contracted for 63 dry bulk vessels, which included 25 Ultramax, 20 Kamsarmax, and 18 Capesize vessels from shipyards in Japan, South Korea, China, and Romania. Scorpio Bulkers Inc. was founded in 2013 and is based in Monaco.

Thesis

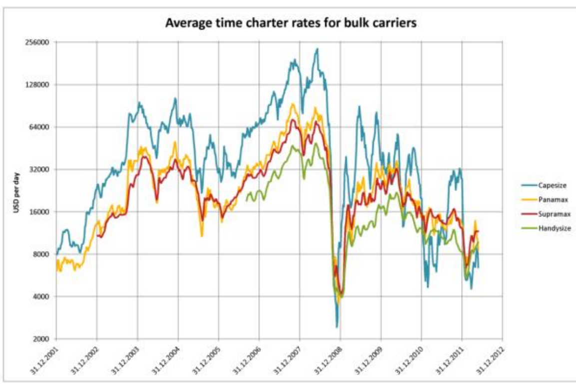
Scorpio Bulker Inc. is a relatively new company first having gone public in December of 2013. The inception of this company came at time when there was thought to be reprieve from the long-term bottoming of the market following the 2008 financial crisis, when global shipping virtually came to a standstill. Since the IPO, the stock price has fall 70%, and the market has simply counted the company out. What they aren't seeing is that the upswing for this beleaguered industry, (with a number of possible catalysts, some of which are occurring right now), is right around the corner. Combined with the revenues and cost savings that come from the most modern fleet in the industry and deep discounting compared to peers, we are looking at a company that has a distinct possibility to take flight, or perhaps more appropriately, become buoyant, very, very quickly.

Market Conditions in Bulk

One of the biggest investing faux pas is to constantly say "this time it will be different." If you look at the clinical definition of insanity and you find nearly the exact same definition. For the past 4 years this has been the thinking of bulk shipping industry. When we look at a chart of the BDIY or the Baltic Dry Index, which measures rates of maritime commodity shipping around the world, it can be seen just how bad things have gotten since 2008.

The index which opened up at 1000 in 1985 has largely traded above that mark over its 30 year history. Since 2008, it has struggled to surpass 900, let alone its initial watermark. For most of the index's history, as we can see, this wouldn't have been very surprising, for most of that time, economies were relatively isolated. Today though we are in the age of a global industrial economy, where maritime shipping is becoming increasingly important as a means to deliver necessary, market building goods and commodities. So why do we continue to see the worst market conditions in the 30 year history of the index, and more importantly what will get us the heck out of there? The explanation, as well as the savior for companies like Scorpio, is simple supply and demand economics, and it doesn't get more complicated then what you learned in the sophomore year at the university. Bulk shipping is no different than any other industry in terms of what they offer at the most basic level. What we have is supply (the number of ships in operation, worldwide) and demand (the need to use those ships to make…well shipments), and much like oil, the supply side is far in excess of what would drive a healthy market. In 2014 there roughly 50,000 ships of all kinds operating across the world's oceans 34% of which are bulk shippers alone. That's A LOT of ships, far too many in fact. With disappointing economics in China, as well as underwhelming data throughout India, Brazil and Russia, the global shipping industry has been beaten and bloodied. The commodities that once flooded into those markets such as iron, coal, grains, and other necessary products, have for the most part slowed to a trickle. On average, the past few years have shown that for every necessary shipment, there are 1.02 ships sitting around waiting to take them. That mean approximately 340 are doing absolutely nothing at any given time. This tends to be the result of shippers building when the getting is good and fleeing the market at the slightest notion of things getting hairy. The result of this building process? Well that's what charts are for!

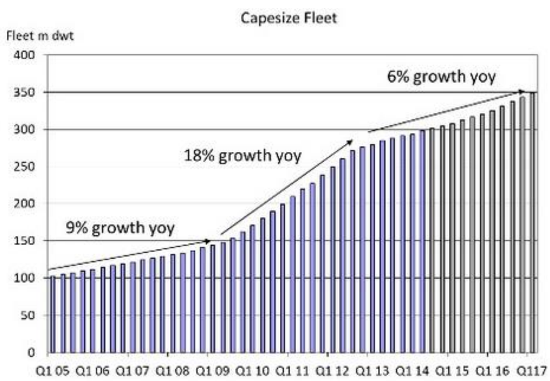
Source: Essence Securites



If the chart was extended up until today, we'd be seeing rates that typical just manage to cover operational expenditures. The reason these kinks haven't been ironed out earlier is that every time it looked as if conditions were improving, the bottom dropped out and the situation got worse, and very often much worse. This was the case for Scorpio. The launched in a year were for the most part; overheated fundamentals painted a rosy picture for a still troubled industry, bringing a brief sigh of relief, only to drag them further underwater. Scorpio's first foray into the market, and they got it completely wrong at the absolute wrong time…and equity investors got in the lifeboats and paddled away. There's a famous Warren Buffet philosophy floating around out there stating that you should be fearful when people are greedy and greedy when people are fearful. As the ultimate value investor, he might be on to something. Scorpio is no exception.

Catalysts Abound

Even the ocean isn't infinitely deep, but experiencing it as a human tends to throw everything out of proportion. As of May 1st 2015, the BDIY is at about half of its initial watermark. With 0 representing absolutely no global shipments, it not hard to imagine that things will get much worse, and eventually will get much better. Referring back to the chart on page two, in the better half of the 2000's the index traded well above 5000, ten times today's global shipping average. But what gets you there? The answer, any number of things. Starting with supply side first though, as it is the largest impactor on the economic success of the shipping industry as a whole. As mentioned earlier, there are a lot of ships out there right now, and the good times of a few years was pushing them out at an assembly line pace.



Source: SwissMarine Services SA

Harkening back to the supply/demand argument, too much supply equals low prices, low prices equal weak revenue streams, and all of that combined equals weaker companies. About this the market isn't wrong in its punishment of shipping stocks, but it has been slow to realize the efforts being undertaken to pacify the problem. According to research, new shipbuilding orders have dropped substantially for the first time in nearly 10 years, dropping from 342 orders in 2014 to a measly 23 orders projected for 2015, a drop off of 93%. Okay so shippers have finally started to realize that they've got to many ships, so what? There are still plenty of ships out there overcrowding the market. Well the one-two is that on top of not building more ships, shippers are actually scrapping ships at an increased rate (up to 4% of the current operating fleet as of 2014), and the average age of ships is coming down (23 years down to 20), meaning that shippers are willing to scrap early if it may restore balance to the market. In the very short term, these efforts may be enough to paint better pictures for respective balance sheets, pulling them out of their current discount. Supply side is beginning to lick its wounds, and maybe it'll be what does the trick, but it is likely that the market will have to offer more first. Coal and iron are two of biggest movers in the world by weight, and the good news is that source and use tend to be oceans away. Another key aspect of economics is that the person who can do something best, should be the one to do it. A less fastidious rule of economics is the person with the most utility, should be the one to receive a good. Well hallelujah, the markets are working, and in the favor of Scorpio because it just so happens that China and India have the most utility, and Australia and Brazil have the most skill (or maybe just the most, but from a shipping point, that's irrelevant.) The glutinous hunger of the world's fastest growing economies, while depressed momentarily (China more so than India), still have to make way for the exploding growth in consumption that we have still yet to see. It doesn't feel right to not fully explain the situation, so here's how the picture looks at least from a macroscopic view. While an uptick in either one of these commodity shipments is possible, there is a lot of policy work being done in China right now to substantially reduce their dependence on either. By 2030, China hopes to have reduced its current thermal generation capacity of 60%, down to a lower 20-30%. Hurray for the Earth, not for all of its inhabitants, especially the ones that ship commodities. India, which is far less developed than its neighbor does have considerably higher prospects in terms, having grown exponentially in its coal consumption. Both economies however depend on steel and iron ore, and increased commercial and residential building moving into the future could act as significant drivers in the near future. The supply side is going to bat for companies like Scorpio as well. Vale the largest producer of iron ore in Brazil has recently announced that the production of ore at its current low price, isn't sustainable moving into the future (yet they have recently opened a mine approximated to have 90 million metric tons of retrievable ore) meaning that prices will have to go up (little guys get crushed, reducing output.) The more valuable the goods being transported, the higher the charter rates for shipping companies. Last but not least, the government, always the stalwart friend of the blossoming company may step in and help shippers back to the path of prosperity. Laws and regulations, especially in developing economies, may soon make certain grades of coal and iron ore unfit for shipping and use, meaning that mining companies will rush to provide a higher quality product. Higher grade means higher cost (and how much coal and iron a country uses can't just be switched over night), meaning higher shipping rates are possible at least in the medium term.

Modern Fleet, Lower Costs, Higher Rates

So that's the macro view, the one that will likely benefit everyone; so why Scorpio? Low valuations could be one answer, but when you look at each and every peer in the industry group, the story is exactly the same; bad fundamentals, low price. Scorpio is no different here, revenues are a laughable $40 million dollars and operating profits are an enviable loss of $116 million. The balance sheet is leaking cash, equity is diluted, and debt will eventually find its way into the picture. Stack on top of this the largest new order book in the entire industry and the question of how they're going to pay for it and what do you have? Well…probably what would seem on any other day to be the makings of a short, but with much of the industry looking the exact same way, what are you going to do? Bet on the entire shipping industry collapsing? No! You put your chips down on the company that's going to come out swinging. The thing is we're looking at a company with the lowest proportion of debt in the entire industry, and on top of that, the newest most modern fleet afloat. Taken directly from the Office of Maritime Law, we can produce the following list in determining how to price a charter.

The issues that must be addressed are:
1.Revenue producing capacity of the vessel
2.Condition of the vessel
3. Age of the vessel
4. Design characteristics
5. The market in which it will operate
6. Supply and demand.

Knock off that list 5 and 6, they've already been discussed and they affect the entire industry, 1-4 are what specifically apply to Scorpio. The ships that Scorpio is looking to employee are some of the biggest, most efficient ships on Earth, and as a result they are able to produce more revenues in terms of being able to ship more goods on a trip-per-trip basis. So 1.) New ships will be bigger. 2.) Easier to talk about 3. As the average current age of Scorpio's owned fleet is 3 years old, which will be brought down as new ships come online, the age and maintenance structure of the company's ships is expected to be lower, at least in the near term than most of its competitors. 3.) Brand spanking new ships. Finally the improved design of the ships in terms of space use and efficiency should create more demand. Ships using newer technology save on fuel and maintenance costs, which are historically the largest portion of a company-in this-space's operating expenses. Over the course of the next two years Scorpion slated to produce 62 new ships, 52 of which are meant to be retained within the company, will have one of the largest, newest fleets in the industry, meaning that they will have competitive advantage in terms of cost as well as the attractiveness of the ships that they offer for buyers and sellers of commodities. A question that is frequently asked, and perhaps rightly worries the investing public is how exactly the company will pay for these ship that command an average price upward of $50 million. Management was right to admit that they missed the mark when they tried to time the market in 2013. They had over ordered for a market that simply wouldn't exist for them. However like good stewards of capital, they were able to take a bad situation and turn a bad situation into one that is slightly less bad.

	Vessel Name	Expected Delivery[2]	DWT	Shipyard[3]
	PRODUCT TANKERS AND KAMSARMAX VESSEL UNDER CONSTRUCTION—TO BE SOLD			
	LR2			
1	Hull S3120—TBN SBI Parejo	Q3–16	115,000	Sungdong
2	Hull S3121—TBN SBI Tuscamina	Q3–16	115,000	Sungdong
3	Hull H5023—TBN SBI Panatela	Q4–16	112,000	Daewoo
4	Hull H5024—TBN SBI Robusto	Q1–17	112,000	Daewoo
5	Hull H.5003—TBN SBI Macanudo	Q1–16	115,000	Daehan
6	Hull H.5004—TBN SBI Cuaba	Q2–16	115,000	Daehan
	LR1			
7	Hull S3122—TBN SBI Lonsdale	Q2–17	74,500	Sungdong
8	Hull S3123—TBN SBI Partagas	Q2–17	74,500	Sungdong
9	Hull S3124—TBN SBI Toro	Q3–17	74,500	Sungdong
	Kamsarmax			
10	Hull SS164—TBN SBI Salsa	Q3–15	81,000	Tsuneishi
	Total Product Tankers and Kamsarmax Vessel NB DWT		988,500	

Demonstrated above is a list of ships that Scorpio management was successfully able to convert into orders for other companies or smaller ships, which they were then able to sell on the market. Having been able to do this the company was able to take a significant portion of its cost load, and unload it on to someone, of course they don't get the ships, but the market is oversupplied anyway, right? Through shuffling around agreements with creditors, cutting down the length of charters, lower cost conversions, and the sale of the ships mentioned above, according to the company, just about 95% of the company's shipbuilding activities are financed. According to analyst estimates, which are very bullish (as the ever dutiful conservative, those estimates have been tapered down), the company's revenues are seen growing on average by 50% over the next five years. On top of this growth, the efficiency of owning ships over leasing them, coupled with the efficiencies of said ships, operating costs are expected to come down from their highs 172.4% YTD, to 60% by 2022, and below 100% by 2017. A massive improvement that the market should come to respect and buy into.

Making a Call

Macro factors are making the dry bulk industry cheap right now, some would say ludicrously. But as with all cyclical industries, the bad times do end, and seeing that we are in the worst of times, hopefully they will do so rather quickly. That being said, some companies are poised to do better in that brave new world on the other end of the tunnel. With new fleet advancements, along with the newest dry bulk fleet in the world, coupled with projected growing demand in Asia and developing economies, Scorpio Bulkers Inc. can be considered a buy. We're at the floor, and this building doesn't have a basement.

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1st week of May 2015

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Scorpio Bulkers Inc.	SALT	Analyst	Current Price	Intrinsic Value	Target Value	Divident Yield	Target Return	BULLISH
		Kyle White	$2.46	$2.57	$3.46	0%	1-y Return: 40.72%	

General Info

Sector	Industrials
Industry	Marine
Last Guidance	(Invalid Identifier)
Next earnings date	7/28/2015

Market Data

Enterprise value	$509.64
Market Capitalization	$224,790.42
Daily volume	7.72
Shares outstanding	180.47
Diluted shares outstanding	147.80
% shares held by institutions	77.53%
% shares held by insiders	0.00%
Short interest	4.15%
Days to cover short interest	4.15
52 week high	$9.46
52-week low	$1.30
5y Beta	0.00
6-month volatility	84.77%

Peers	Market Cap.
Diana Containerships Inc.	$189.90
Diana Shipping Inc.	$515.91
Paragon Shipping Inc.	$17.44
Baltic Trading Limited	$81.04
Box Ships Inc.	$28.11
Safe Bulkers, Inc.	$297.95
Goldenport Holdings, Inc.	$11.28
Euroseas, Ltd.	$41.72
Navios Maritime Partners L.P.	$1,116.49
Akcine Bendrove Lietuvos juru laivininkys	$1.33

Current Capital Structure

Total debt/market cap	47.90%
Cost of Borrowing	0.00%
Interest Coverage	213.59%
Altman Z	2.14
Debt Rating	AAA
Levered Beta	1.02
WACC (based on market value weights)	8.68%

Management

Professional	Title	Comp. FY1900	Comp. FY2013	Comp. FY2014
Lauro, Emanuele	Co-Founder, Chairman and Chi	$ -	$ -	$ -
Bugbee, Robert	Co-Founder, President and Dire	$ -	$ -	$ -
Baker, Hugh	Chief Financial Officer	$ -	$ -	$ -
Mackey, Cameron	Chief Operating Officer	$ -	$ -	$ -
Forgione, Luca	General Counsel	$ -	$ -	$ -
Kachelo, Anoushka	Secretary	$ -	$ -	$ -

10y-Median Performance

	SALT	Peers	Industry	All U.S. firms
Growth	#DIV/0!	5.8%	6.9%	7.4%
ROIC	-2.4%	5.1%	7.5%	14.3%
NOPLAT Margin		23.9%	9.2%	10.4%
REV./Invested Capital		21.5%	81.3%	137.4%
Excess Cash/Rev.	N/A	61.7%	13.5%	12.9%
Total Cash /Rev.	410.0%	61.7%	12.3%	15.2%
Unlevered Beta		1.02	0.74	0.95
TEV/REV	2.5x	5.0x	3.3x	2.5x
TEV/EBITA		23.9x	17.6x	13.1x
PE		17.1x	22.0x	23.5x
P/BV	0.7x	1.2x	2.2x	2.2x

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS
Last Quarter	-19.7%		
Last Quarter-1	-6.5%		
Last Quarter -2	-32.6%		
Last Quarter -3	-1.0%	0.0%	
Last Quarter -4	74.8%	0.0%	

Non-GAAP Adjustments in estimates computations

Operating Leases Capitalization	100%	Straightline	10 years
R&D Exp. Capitalization	100%	Straightline	10 years
Expl./Drilling Exp. Capitalization	0%	N/A	N/A
SG&A Capitalization	0%	N/A	N/A

Proforma Assumptions

Money market rate as of today	0.59%
Annual increase (decrease) in interest rates	0.1%
Yield Spread accelaration	1.2
Marginal Tax Rate	37.5%
Risk-Free rate	2.5%
Tobin's Q	194.74
Op. Cash/Rev.	2%
Growth in PPE	NPPE Growth follows Revenue Growth
Long term Growth	1.0%
Long term EBITDA Margin	40.0%
Long term NOPLAT Margin	20.0%
Long term ROIC	2.0%
Most recent Unlevered Beta	
Long term Unlevered Beta	0.74

$ -	Rev. Growth	Adj. Op. Cost/Rev	Invested Capital (Forecast)	NOPLAT Margin (Forecast)	ROIC (Forecast)	WACC (Forecast)
LTM		172.4%	$1,221.11	-48%	-1.8%	8.7%
NTM	98.3%	116.2%	$1,561.17	23%	2.3%	9.0%
NTM+1	100.0%	88.1%	$1,869.96	37%	5.1%	9.2%
NTM+2	37.7%	74.0%	$2,094.13	45%	6.7%	8.9%
NTM+3	19.4%	67.0%	$2,249.53	48%	7.6%	8.8%
NTM+4	10.2%	63.5%	$2,351.41	50%	8.0%	8.8%
NTM+5	5.6%	61.8%	$2,419.15	51%	8.2%	8.7%
NTM+6	3.3%	60.9%	$2,467.17	52%	8.3%	8.6%
NTM+7	2.1%	60.4%	$2,504.30	52%	8.3%	8.6%
NTM+8	1.6%	60.2%	$2,536.10	52%	8.3%	8.5%

Valuation

	Invested Capital x (ROIC-WACC)	Enterprise Value (UFCF Valuation only	Total Debt	Other claims	Equity Value	UDCF Valuation	Relative Valuation	Weighted Price Per Share
LTM	-$128.57	$926.20	$212.65	-$130.31	$843.87	$4.76	-$0.14	$3.53
NTM	-$103.81	$1,397.52	$354.79	$33.80	$1,008.93	$5.64	-$0.08	$4.21
NTM+1	-$77.21	$1,806.53	$663.58	$59.17	$1,083.77	$6.03	-$1.44	$4.16
NTM+2	-$45.49	$2,098.56	$885.58	$78.07	$1,134.91	$6.31	-$2.78	$4.03
NTM+3	-$28.22	$2,291.81	$1,030.14	$91.13	$1,170.53	$6.50	-$3.74	$3.94
NTM+4	-$18.70	$2,413.42	$1,113.39	$99.28	$1,200.74	$6.68	-$4.33	$3.93
NTM+5	-$13.42	$2,489.92	$1,157.86	$104.24	$1,227.83	$6.81	-$4.67	$3.94
NTM+6	-$9.51	$2,537.92	$1,179.70	$107.36	$1,250.86	$6.94	-$4.85	$3.99
NTM+7	-$7.37	$2,562.81	$1,188.55	$109.51	$1,264.74	$7.00	-$4.94	$4.02
NTM+8	-$80.38	$2,558.52	$1,190.38	$110.27	$1,257.86	$6.96	-$4.96	$3.98

Monte Carlo Simulation Assumptions

	Base	Stdev	Min	Max	Distribution
Revenue Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Op. Costs Variation	**0**	**10%**	**N/A**	**N/A**	**Normal**
Country Risk Premium	**6%**	**N/A**	**5%**	**7%**	**Triangular**
Long term Growth	**1%**	**N/A**	**#DIV/0!**	**#DIV/0!**	**Triangular**

Monte Carlo Simulation Results

	Intrinsic Value	1y-Target
Mean est.	$3.53	$4.21
σ(ε)	$0.32	$0.25
3 σ(ε) adjusted price	$2.57	$3.46
Current Price	$2.46	
Analysts' median est.		$3.65