Tanker Market Insight

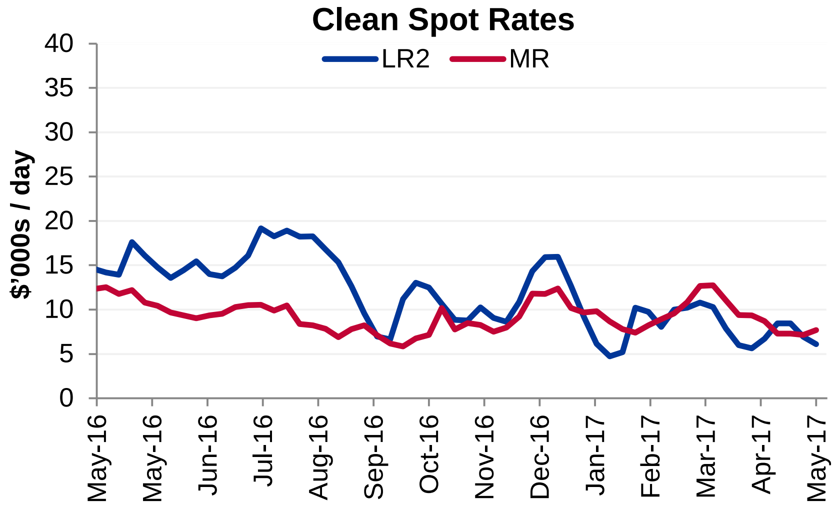
June 2017

Research Department, Strategic Development

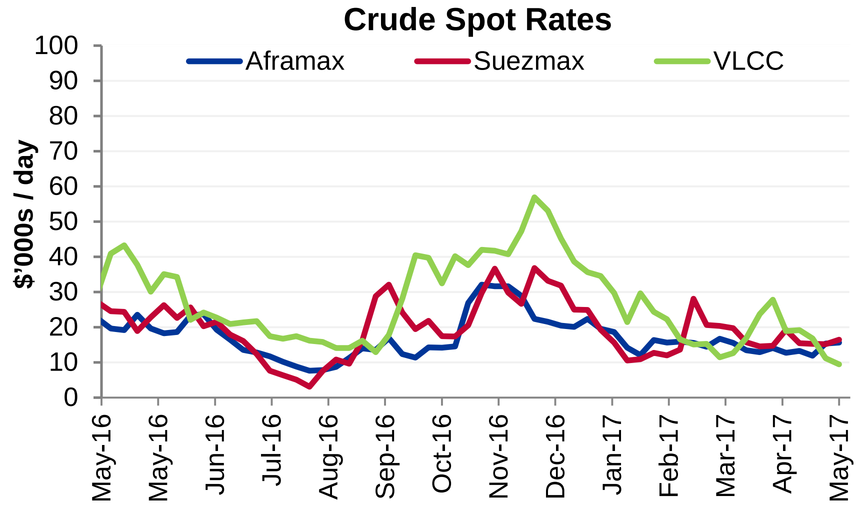
May review: OPEC announced in May that they would continue their output cuts through to March 2018. Both Libya and Nigeria increased production through the month, which provided some underlying support to the mid-sized tanker vessels, and the Suezmax sector in particular. However, the upside was capped as fleet growth across the large and mid-sized crude segments put downward pressure on rates during what is traditionally a soft period in the freight market. Despite rates coming up off the floor seen in April, LR2 demand in May remained muted as LPG remained the cheaper option as a petrochemical plant feedstock.

June outlook: Ongoing OPEC production cuts will continue to impact VLCC demand out of the AG as the Middle East continues to take the lead on supply reductions. Robust fleet growth, increased bunker costs, and seasonal declines in demand may also create softer rates in June. Suezmaxes may find some relief from the return of the Forcados terminal, while robust US crude oil exports could support Aframax demand in the Caribs market in the form of reverse lightering. LR demand is expected to remain muted as fewer cargoes are available from the AG to Japan, due in part to the recent diplomatic crisis between Qatar and other Middle East nations.

Wild cards: Saudi Arabia, Bahrain, Egypt and the UAE have cut diplomatic relations with Qatar over allegation of Qatar supporting terrorism and destabilizing the region. This has potential to create a major diplomatic crisis and impact the global production cut agreements. We discuss this issue on our Graph of the Month. Other wild cards include predictions that this year will see above-normal hurricane activity in the Atlantic. The National Oceanic and Atmospheric Administration has predicted 11-17 named storms, of which 5-9 could become hurricanes in 2017.



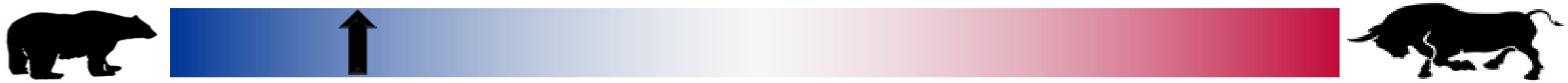
Source: 90% of Clarksons



Source: 90% of Clarksons

Fleet growth and OPEC cuts continue to put downward pressure on rates

Spot Market Review and Outlook

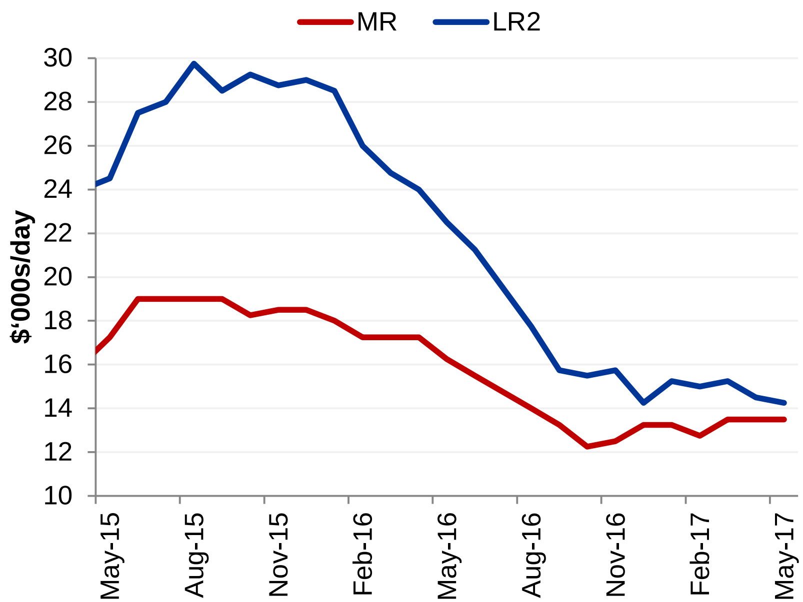


Segment	Apr'17	May'17	May Review	June Outlook
	Spot Rates ($/day) Source: 90% Clarksons			
VLCC	21,900	14,200	⬇ VLCC rates found a new floor as rates fell drastically during the second half of the month. The steep decline came as MEG export volumes caught up to production cuts, and was further compounded by continued high fleet growth and Chinese refinery maintenance.	⬌ Ongoing OPEC cuts are expected to keep rates from finding much upside in the near-term, though an increase in long-haul trade from the Atlantic to the Pacific could help offset some of the weakness. VLCC loadings out of the North Sea are expected to tick up in June, which will provide some additional support to rates.
Suezmax	16,100	15,600	⬌ Suezmax demand found some positive support from a combination of Nigeria's Forcados terminal returning to service (which creates demand for ~ 6 Suezmaxes / month) as well an uptick in Black Sea exports. However, strong fleet growth prevented rates from increasing.	⬇ Rates are expected to soften from May levels as the freight market enters a traditionally weak period for tanker demand. Ongoing high fleet growth and cuts to OPEC production will likely offset the upside felt from Atlantic to Pacific movements through the summer months.
Aframax (Pacific)	11,800	10,800	⬇ Rates came off during the month as Asian refinery maintenance commenced. High fleet growth and seasonal factors such as longer daylight hours / clear weather also put downward pressure on rates.	⬌ Rates are not expected to find much support as the market enters the expected seasonal dip in tanker demand. However, there is a chance some upside could be found if the fuel oil market improves, increasing cargos into Asia.
Aframax (Atlantic)	13,000	14,900	⬆ Rates found some upside as increased US exports supported reverse lightering in the Caribs market and the return of Libyan volumes supported activity in the Mediterranean.	⬌ Ongoing US crude exports and a continued recovery in Libyan oil production may provide some upside to rates, but this could be tempered by VLCCs poaching cargoes from the North Sea.
LR2	6,550	7,450	⬆ LR2s are being forced to ballast from the Far East to the AG as gasoil cargoes from Korea and Taiwan are being fixed on newbuildings instead. LPG prices remains low, keeping the West-East naphtha arbitrage closed.	⬌ We expect the West-East arbitrage to remain closed and for LPG to stay cheaper than naphtha during June, limiting demand for LR2s.

Rates expected to remain low as we enter the summer doldrums

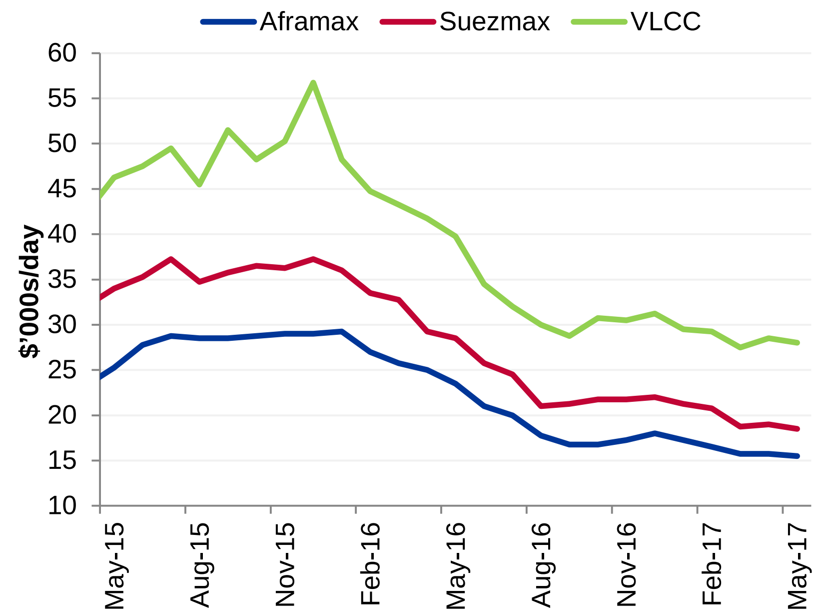
Time Charter Market

Clean 1 Year Time Charter Rates



Source: Average of Clarksons, Braemar ACM, and Poten

Crude 1 Year Time Charter Rates



Source: Average of Clarksons, Braemar ACM, and Poten

Broker Assessed Time Charter Rates

	1 year time charter rates ($/day)		3 year time charter rates ($/day)	
	Apr'17	May'17	Apr'17	May'17
VLCC	28,500	⬇28,000	29,500	⬇29,250
Suezmax	19,000	⬇18,500	21,500	21,500
Aframax	15,750	⬇15,500	17,000	17,000
LR2	14,500	⬇14,250	16,000	16,000
MR	13,500	13,500	14,250	14,250

Source: Average of Clarksons, Braemar ACM, and Poten

Time charter market continues to track the downward trend in spot rates

S&P Activity

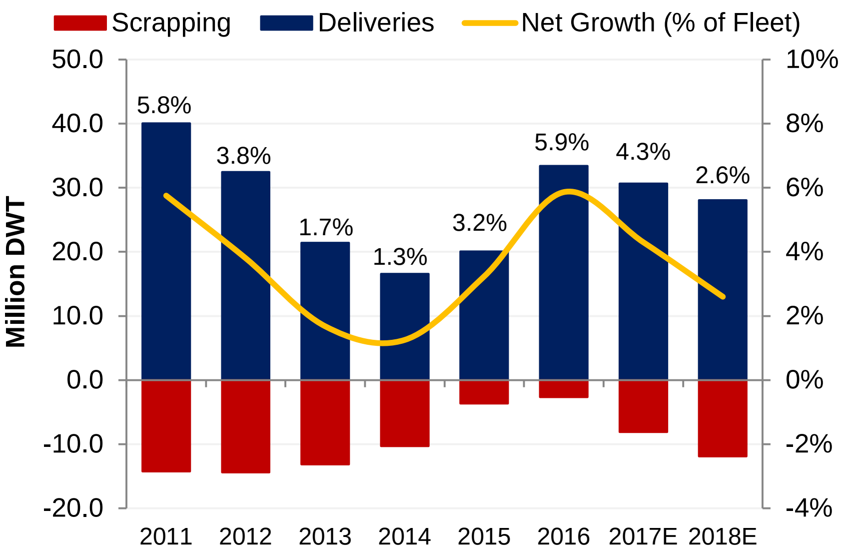
- Consolidation has been the theme of 1H-2017. After DHT bought BW's 11x VLCCs, Scorpio acquired Navig8 Product's 27 vessels for $1.145B in shares and cash. This was a premium to the broker assessed steel value of $1.105B. The combined entity will own 109 product tankers with an average age of 1.9 years. Scorpio will also issue $200M in equity, likely to bring the debt/equity ratio down from 75% to 60%
- Shortly after Scorpio's announcement, TNK and TIL announced a merger to form the largest US listed mid-size tanker owner. TIL shareholders will receive 3.3 TNK shares for every TIL share. The combined fleet will consist of 62 vessels with an asset base of $2.4B.
- Modern secondhand values have bottomed and are showing slight signs of strength. The Aframax *Nissos Santorini* (2012, Samsung) was sold for $30M with DD passed. Her sister ship, *Nissos Delos*, was sold in Feb-17 for $28.5M with DD due. Buying interest appears to be increasing, focused primarily on high-quality modern tonnage

Asset Values (USD million)

	VLCC	Suezmax	Aframax	LR2	MR
NB	80.5 (+0.5)	53.0	43.0	45.0	33.5 (+1.0)
0	85.0 (+3.0)	55.0 (+1.0)	45.0 (+1.0)	47.5 (+2.0)	35.0 (+1.0)
5yr	65.0 (+3.0)	42.5 (+0.5)	31.0 (+1.0)	33.0 (+2.0)	25.0 (+1.0)
10yr	42.0	27.5	20.0 (+1.0)	20.0 (+1.0)	17.0 (+1.0)
15yr	23.5 (+1.5)	15.0	12.0	12.0	10.0

Source: Clarksons
Note: values in brackets indicates change from last month

Total Tanker Fleet Growth



Source: Clarksons, internal estimates

Fleet Statistics

- The tanker fleet has grown by 16.2 mdwt since the start of the year, or 2.9%, driven by a heavy tanker delivery schedule and continued low levels of tanker scrapping .
- 23 VLCCs, 26 Suezmaxes, and 21 Aframax / LR2s have joined the fleet so far this year, while only 2 VLCCs , 2 Suezmaxes, and 6 Aframaxes have been scrapped.
- We estimate that the tanker fleet will grow by 4.3% in 2017 and by 2.6% in 2018, though uncertainty around upcoming regulations could change our outlook to the upside.

Forecasted Fleet Growth by Size Range

	VLCC	Suezmax	Aframax	LR2	Panamax	MR
2017	4.0%	8.4%	2.4%	6.4%	4.7%	3.2%
2018	4.2%	2.4%	2.1%	2.3%	2.8%	2.2%

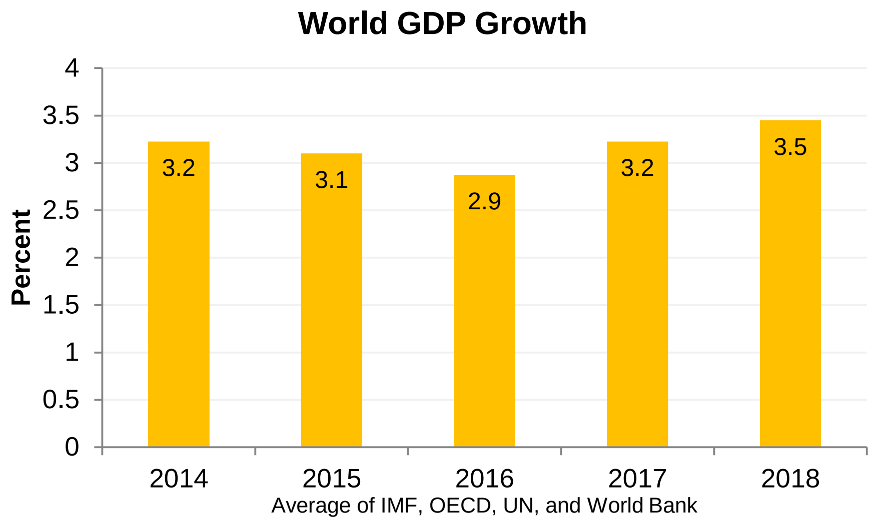
Source: Clarksons, internal estimates

Asset values remain fairly stable, suggesting a floor has been found

Economy Outlook

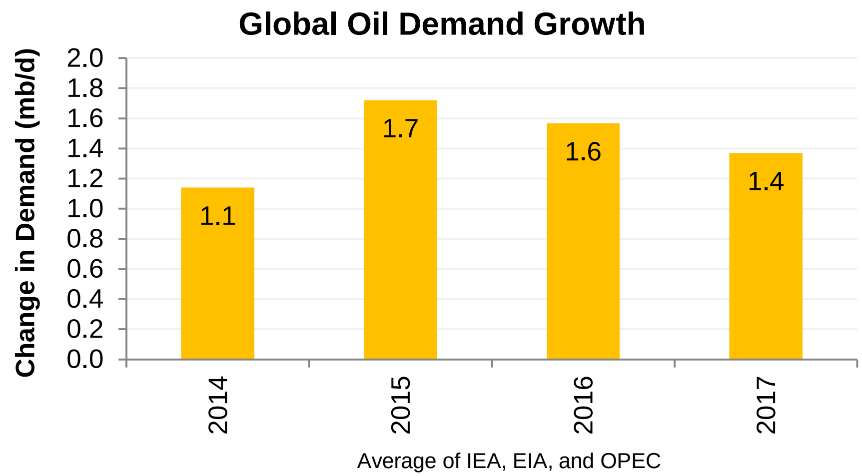
- The World Bank and UN released their newest economic forecasts, both of which emphasize improving global growth.
- According to the World Bank, “Global growth is firming, contributing to an improvement in confidence. A recovery in industrial activity has coincided with a pick-up in global trade, after two years of marked weakness”. As a result, and despite substantial policy uncertainty, global growth is projected to accelerate in 2017, and strengthen further in 2018-2019.

USA	World Bank expects growth to recover in 2017. Tax cuts and infrastructure spending could further increase growth in the short term, but could also lead to an increase in interest rates
Europe	Moderate growth occurred in early 2017, supported by manufacturing and exports. Unemployment fell in 2016, but remains high.
Japan	Growth has picked up in 2017, supported by exports. But, growth is expected to slow again to 1% or less in 2018 - 19.
China	GDP expanded by 6.7% in 2016. Steady growth has continued in early 2017, but is expected to slow to 6.5% in 2017 and 6.3% in 2018 – 19.



Oil Demand Outlook

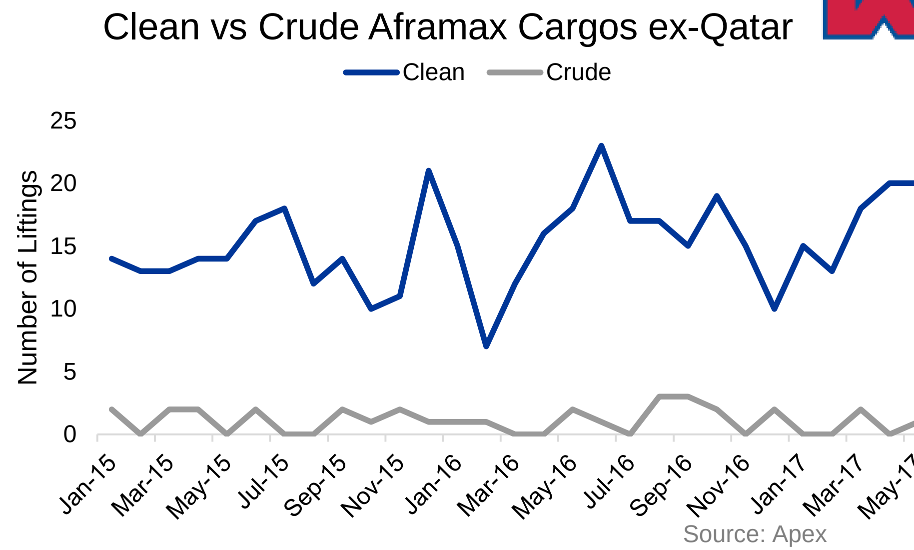
- Forecasts of global oil demand growth in 2017 are largely unchanged from last month.
- Crude oil prices increased to $54 / bbl in late May after Saudi Arabia announced their intent to extend OPEC supply cuts. However, prices fell below $50 / bbl again by early June.
- According to the EIA, global oil supply growth is expected to limit oil price increases in 2017, and the EIA has slightly increased their forecast of oil supply growth in 2017 from the US, Canada and Brazil.



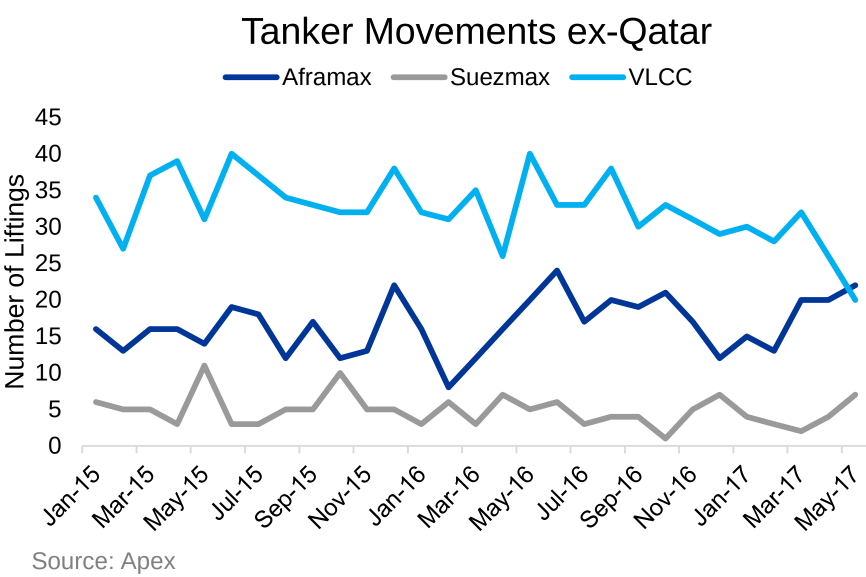
Global economic improvement, but minimal recovery in oil prices

On Monday June 5th, Saudi Arabia, Egypt, the United Arab Emirates, and Bahrain cut diplomatic ties with Qatar. According to Saudi's state news agency, the decision is due to Qatar's "embrace of various terrorist and sectarian groups aimed at destabilising the region," including the Muslim Brotherhood, al-Qaida, Islamic State, and groups supported by Iran. The decision was later supported by other countries including Yemen, parts of Libya, Mauritius, and the Maldives.

The countries said they would halt all land, air and sea traffic with Qatar, eject its diplomats, and order Qatari citizens to leave the Gulf states within 14 days. While this is not the first diplomatic dispute between Saudi Arabia and Qatar, it is more severe than past incidents. In 2014, Saudi Arabia, Bahrain, and the UAE withdrew their ambassadors from Qatar, but travel links were maintained and Qataris were not expelled



Although Qatar is an OPEC member state, its oil exports are relatively small. Qatar exported approximately 0.5 million barrels per day of crude in 2015, which is roughly 1% of global oil exports. All supplies were exported to the Asia Pacific region, and our view is that this trade is unlikely to be affected by the current dispute. Brent crude oil prices increased on news of the crisis, but fell throughout the rest of Monday and dropped to the lowest level in several weeks as global oil over-supply concerns outweighed concerns over Qatar.



While the overall impact is likely to be small, tanker rates could find support in the near-term if vessels that have recently called at Qatari ports are rejected by other Gulf region countries, and therefore re-routed to other destinations. Further, as the chart above notes, the lion's share of Qatari Aframax exports are clean cargos moving on LR2s. As a result, there is the potential for some chartering volatility to enter the market. Such volatility could provide some needed upside support for LR2 rates in the short term.