Tanker Market Insight

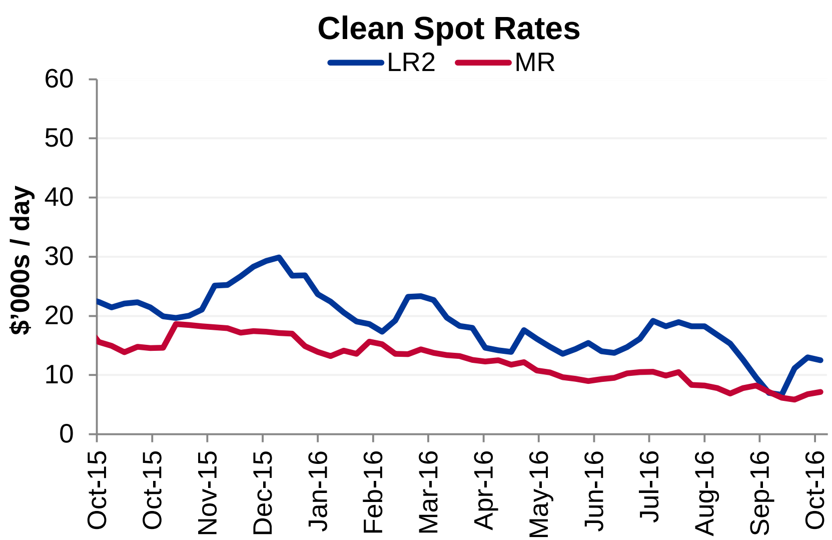
November 2016

Research Department, Strategic Development

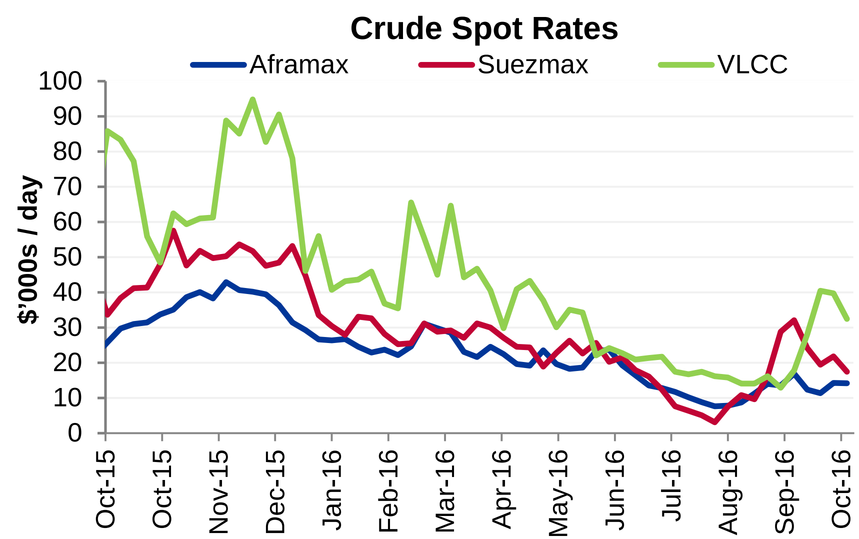
October review: VLCC rates rebounded strongly during October as record high exports out of the Middle East and rising Asian demand ahead of winter supported rates. Suezmax rates found some support from an increase in Nigerian exports, though rates for the month were little changed from September. The Pacific Aframax market saw some support from a ramp-up in imports by Asian refiners, though the Atlantic market remained under pressure. LR2 rates weakened during October and the near-term fundamentals for this sector continue to look extremely challenging.

November outlook: Winter market fundamentals should start to kick-in during November, with shorter daylight hours and deteriorating weather leading to an increase in vessel delays. Mid-size vessel demand should also find some support from rising Atlantic basin oil production, though disruptions could once again derail exports (see “Wild Cards” below). LR2 rates are expected to remain under pressure due to a lack of West-East naphtha arbitrage opportunities.

Wild cards: Piracy / terrorist activity appears to be on the increase off the coasts of Yemen and Somalia, which has the potential to threaten activity in key shipping lanes. A serious incident could cause vessels to avoid the region where possible, leading to longer voyages. Nigerian and Libyan production remain wildcards, with the recent bombing of the Forcados pipeline in Nigeria serving as a reminder that recent production gains could quickly be reversed.



Source: 90% of Clarksons



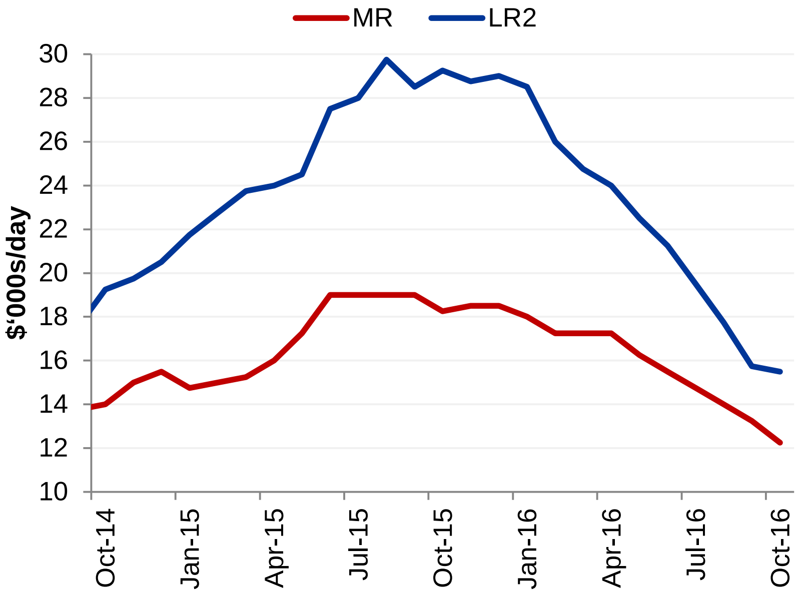
Source: 90% of Clarksons

Strong rebound in VLCC rates during Oct’16; mid-size rates found less support

Segment	Sept'16	Oct'16	October Review	November Outlook
	Spot Rates ($/day) Source: 90% Clarksons			
VLCC	15,000	35,175	Record high OPEC crude oil production and strong Asian demand supported VLCC rates during October. Iranian exports reached a record high 2.6 mb/d during the month while Iraqi and Saudi exports also remained elevated.	OPEC meets at the end of the month to try and decide on the mechanism for a production cut to 32.5 – 33.0 mb/d (vs. 34 mb/d currently). However, any such cut will not kick in until January, meaning high MEG exports should continue to support VLCC spot rates over the next couple of months.
Suezmax	19,500	20,750	An increase in Nigerian crude oil production, as crude streams that had previously been under force majeure came back online, gave support to Suezmax rates during October, though this support started to erode at the end of the month with news that the Forcados pipeline had been bombed.	The onset of weather delays through the Turkish Straits may add some positive impetus to Suezmax rates in November, though this could be balanced by renewed supply problems in Nigeria if the recent closure of the 200 kb/d Forcados pipeline turns into an extended outage.
Aframax (Pacific)	7,500	12,800	Pacific Aframax rates recovered from the extreme lows seen in September as rising demand from Asian refiners and a stronger VLCC market gave some support to rates.	Stronger oil demand heading into the winter months could give support to Pacific Aframax rates, though an excess supply of tonnage in the region my prevent rates from strengthening too much.
Aframax (Atlantic)	14,050	12,065	A significant strengthening in Caribs rates at the end of the month was not enough to offset weaker rates in the MED / UKC region, despite the resumption of Libyan crude oil exports from the port of Ras Lanuf. An excess of tonnage in the MED region was the main culprit.	The onset of weather delays in the Black Sea / MED and the Baltic, coupled with rising Libyan exports, could provide some support to Atlantic Aframax demand, though vessel supply in the region remains plentiful.
LR2	12,250	10,835	LR2 rates continue to move south as a combination of elevated fleet growth and a lack of West-East naphtha arbitrage opportunities put pressure on rates during the month.	LR2 rates are expected to remain weak during November as the West-East naphtha arbitrage remains closed and vessel supply remains plentiful due to the continued influx of newbuildings.

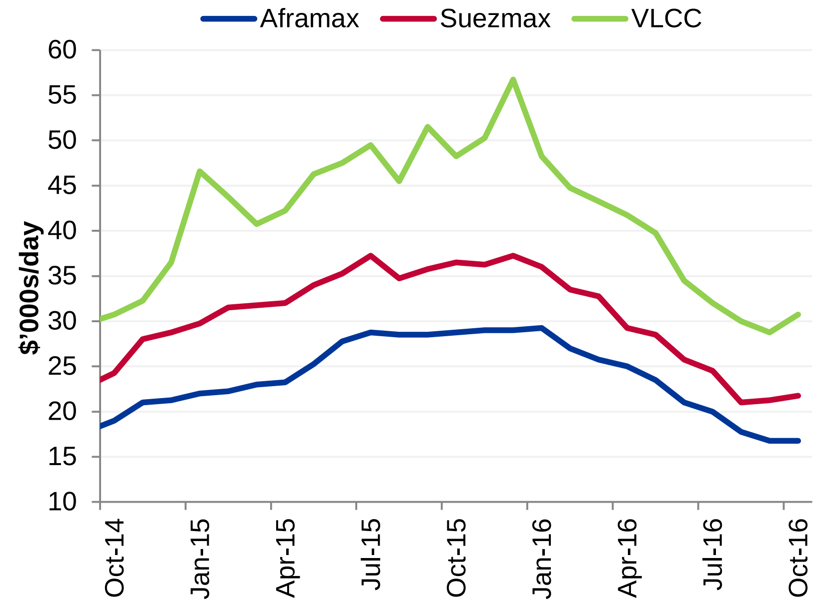
Normal Q4 seasonality, ongoing high oil supply to support rates in Nov'16

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)	
	Sept'16	Oct'16	Sept'16	Oct'16
VLCC	28,750	⬆ 30,750	29,250	⬆ 29,750
Suezmax	21,250	⬆ 21,750	22,500	⬇ 22,250
Aframax	16,750	16,750	18,000	18,000
LR2	15,750	⬇ 15,500	17,250	⬆ 17,500
MR	13,250	⬇ 12,250	14,500	⬇ 14,000

Source: Average of Clarksons, Braemar ACM, and Poten

Crude tanker TC rates stabilizing ahead of seasonally stronger winter market

S&P Activity

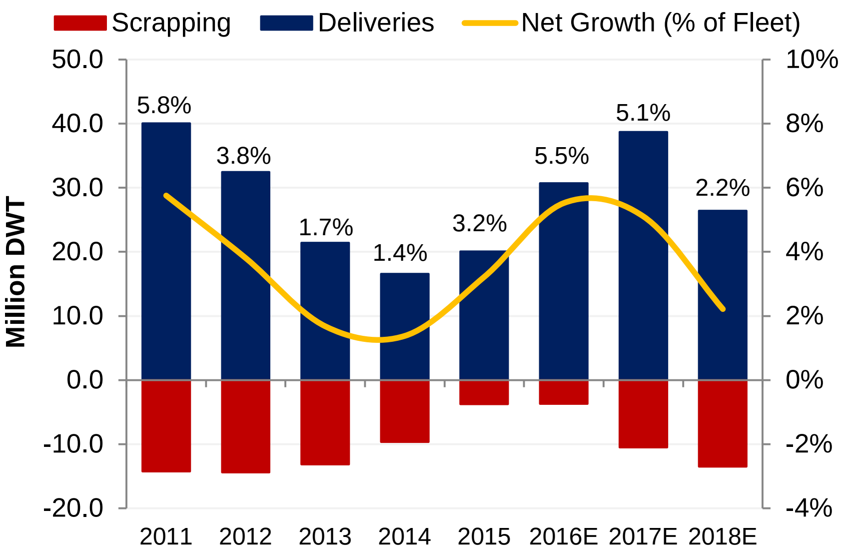
- Phoenix Energy (Greece) have reportedly sold a pair of 2011 and 2012 Hyundai built 105K DWT Aframaxes to Great Eastern, India for $57M enbloc. If confirmed, this would benchmark a 5 year old Aframax at $30M, which is 10% lower than previous guidance.
- The *Morning Glory VIII* (99k DWT/Onomichi/2002) was sold for $13M and the *Siena* (105k DWT/DSME/2002) was sold for $15M. Earlier in the year, the *Stresa* (105k DWT/DSME/2002) was sold for $19M, highlighting a 20% price fall in the last 6 months.
- Secondhand prices for tankers (modern and older) remain under pressure. As demonstrated from the above sales, new transactions have dropped prices by about 10%. Prices are approaching 2013 levels when we saw 5 year old Aframax prices in the region of $27M to $28M. Given the weaker freight market outlook for 2017, we could see secondhand values revert to levels last seen in 2013 over the coming months .

Asset Values (USD million)

	VLCC	Suezmax	Aframax	LR2	MR
NB	85.0	55.0	45.0	47.0	33.3
0	84.0 (-2.0)	55.0 (-2.0)	45.0 (-2.0)	49.0 (-1.0)	32.5 (-1.5)
5yr	60.0 (-2.0)	41.0 (-3.0)	30.0 (-2.5)	34.0 (-1.0)	22.0 (-1.0)
10yr	40.0 (-1.0)	29.0 (-2.5)	18.0 (-3.0)	18.0 (-3.0)	15.5 (-1.0)
15yr	24.0 (-2.0)	19.0 (-1.0)	15.0	15.0	10.0 (-1.0)

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

Total Tanker Fleet Growth



Source: Clarksons, internal estimates

Fleet Statistics

- The tanker fleet grew by 25.9 mdwt, or 4.9%, in the first 10 months of the year vs. growth of 16.3 mdwt, or 3.2%, in the whole of 2015.
- Tanker ordering picked up during October with orders for 16 tankers including 8 x Suezmaxes. Nevertheless, tanker ordering for 2016 as a whole remains extremely low at just 8.1 mdwt, on track for the lowest level of new orders in over 20 years.
- Tanker scrapping remains virtually non-existent with just one VLCC, one Suezmax and four Aframaxes sold for scrap in 2016-to-date.

Forecasted Fleet Growth by Size Range

	VLCC	Suezmax	Aframax	LR2	Panamax	MR
2016	6.3%	5.3%	2.7%	10.0%	4.8%	4.8%
2017	4.9%	7.4%	1.7%	7.7%	5.2%	4.3%
2018	3.2%	0.6%	0.4%	1.0%	2.9%	1.4%

Source: Clarksons, internal estimates

Secondhand prices remain under pressure and are approaching 2013 lows

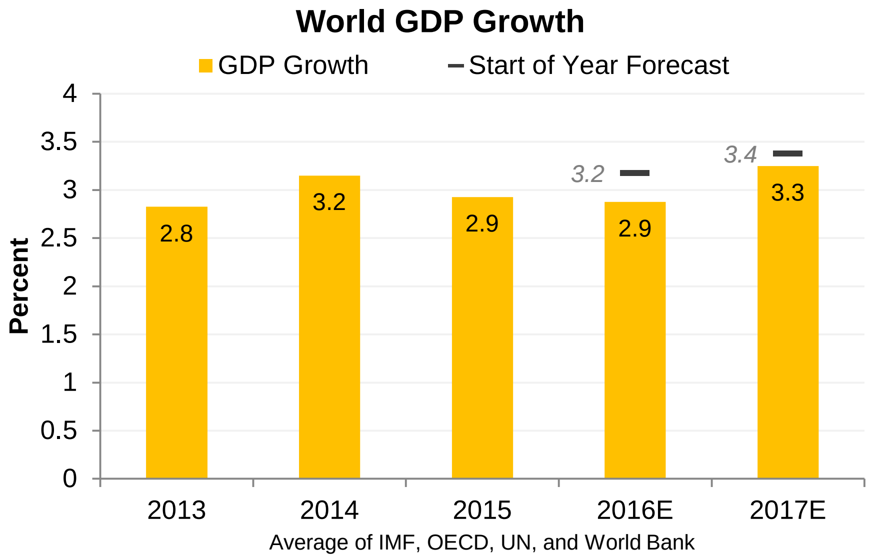
Economy Outlook

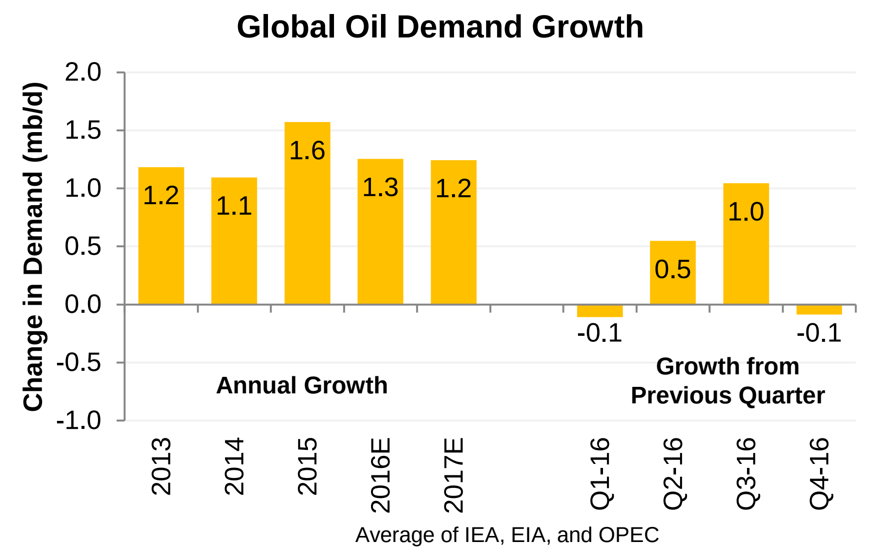
- While global economic growth in the first half of 2016 was exceptionally weak due to low growth in the US and Japan, growth is expected to pick up in the second half of 2016 and is forecast to gather momentum during 2017. Recent economic data shows that growth in Japan, Europe and China remains stable, and US growth was the strongest in 2 years in the third quarter of 2016.
- There have been no changes to global GDP forecasts since last month

USA	Growth in Q3 was the strongest in 2 years, coming in at an annualized rate of 2.9% and beating expectations.
Europe	Growth in Q3 was 1.4% annualized, which is similar to Q2. While growth remains weak, it shows that Brexit has so far not had the disastrous impacts that some had predicted.
Japan	Q3 growth is expected to be a fairly moderate 0.9% annualized, which is a slight increase from 0.7% in Q2.
China	China has reported three straight quarters of GDP growth at 6.7% GDP, meeting official annual targets of 6.5% – 7%.

Oil Demand Outlook

- The EIA has decreased their forecast of global oil demand growth to 1.3 mb/d in both 2016 and 2017. This follows a downward forecast revision by the IEA last month.
- According to the IEA, global oil demand growth continues to slow, dropping from a five-year high in Q3 2015 to a four-year low in Q3 2016 due to minimal OECD growth and a deceleration in China. The average of forecasts suggests that growth in Q4 2016 may remain relatively flat.



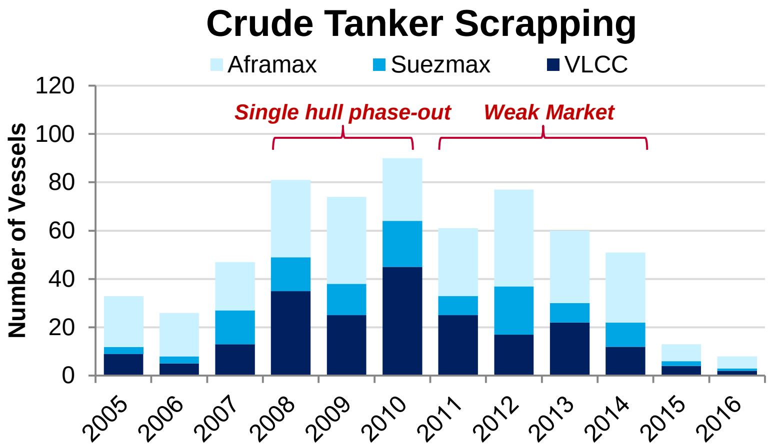


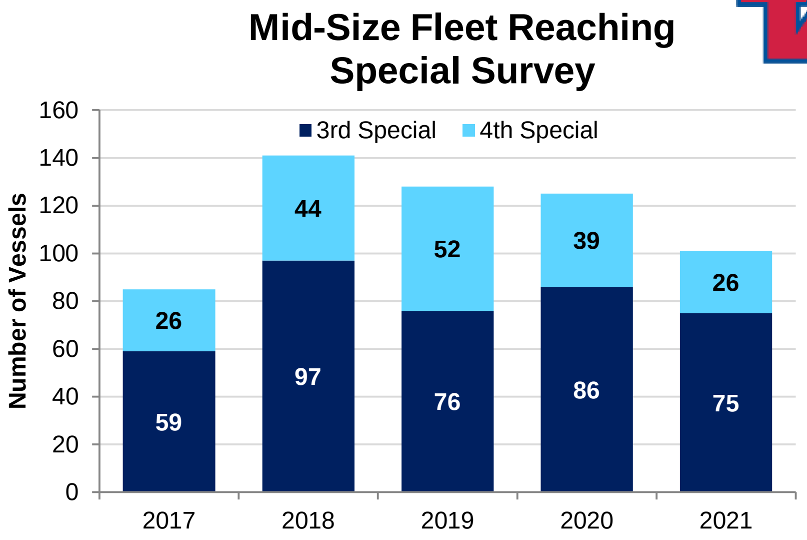
Further downward revisions to global oil demand growth

At the recently concluded MEPC meeting, the IMO threw the shipping markets a curveball by announcing that the new 0.5% global limit on sulphur emissions would come into force in 2020, and not 2025 as many had anticipated. This comes fresh on the heels of the IMO convention on ballast water, which finally gathered enough signatories in Sept'16 to be ratified, and which will enter into force in Sept'17.

For shipowners, these regulations present something of a headache. Owners must now decide on which ballast water treatment system to be installed in the coming years, a problem since no systems have been approved by the US Coast Guard (which, confusingly, has a different set of standards to the IMO). They now also have to consider whether to install a scrubber to deal with sulphur emissions after 2020, or whether to burn higher cost marine diesel oil.

All of which leaves Owners facing the prospect of more CAPEX spending in the coming years to be compliant with the regulations. But could these changes have a silver lining by encouraging the early scrapping of older tonnage?





A quick look back at history might offer some clues. As shown by the chart below, the tanker industry underwent a heavy period of scrapping in the period 2008-14 when almost 500 crude tankers exited the fleet. This was driven in large part by the phase-out of single hull tankers prior to 2010, and then by the extremely weak tanker market which followed the global financial crisis. Could the same happen in the coming years as new regulations come into force?

Looking at the age profile of the fleet, we certainly think there is scope for increased scrapping as a block of vessels approach their 3rd and 4th special survey dates in the coming years (see chart above). This is unlikely to happen in 2017 / 18, as there are mechanisms by which Owners can push out the installation date for ballast water systems, and the sulphur regulations do not take effect until 2020. But these decisions cannot be put off forever, which could set the market up for a strong end to the decade as higher scrapping leads to another period of low fleet growth.

Upcoming regulations may lead to a surge in scrapping later in the decade