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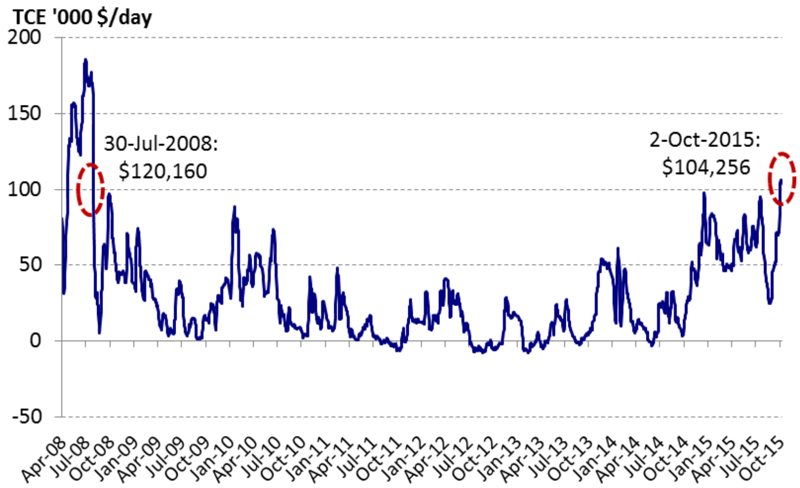
POTEN TANKER OPINION

This Time It Is Different

The VLCC market is hot again, but for different reasons

Late last week, time charter equivalents (TCE's), a measure of vessel's daily earnings exceeded the magical $100,000 per day mark for VLCC's. This brings back memories from the 2004 – 2008 "super-cycle", when this happened on a regular basis. In anticipation of these good times, a large publicly traded shipowner opened their presentation at the annual Marine Money Seminar in New York in June 2003 with a slide that defined a VLCC as a "Very Large Cash Creator". The last time that VLCC's reached $100,000 per day on the AG – East route (TD3 according to the Baltic Exchange) was on July 30, 2008, a little more than 7 years ago. So, is it in the words of Yankees legend Yogi Berra, "like déjà vu all over again"? Let's take a look at the circumstances and context that surround the current rate spike and compare them to the situation in 2008.

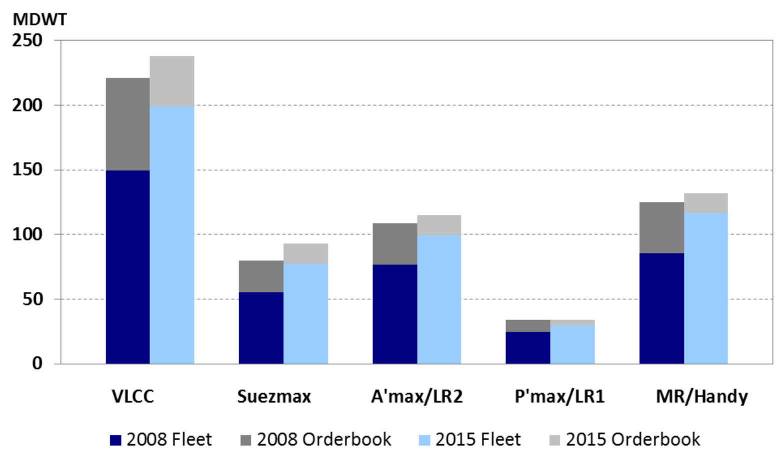
Fig 1: VLCC rates 2008 – 2015 (TD3, Arabian Gulf – Japan)



Source: Baltic Exchange

When the VLCC market was at $100,000 per day in July 2008, this was not as news-worthy as it is now. In the 5-year period from mid-2003 through mid-2008, rates for large crude tankers regularly breached this level and on occasion even reached much higher levels (like $250,000/day in November 2004 and even $300,000/day for one day in December 2007). As a matter of fact, the last time VLCC rates were $100,000, they hit this level on the way down, not on the way up (see Fig. 1). In contrast, the 5-year period (starting in October 2010) leading up to the current rate milestone has been very different. The tanker market went through a very difficult period following the global financial crisis as a result of a slowdown in oil demand combined with an abundance of shipping capacity. Rather than setting record highs, daily TCE's regularly reached rock-bottom and earnings even turned negative on occasion.

Fig. 2: Tanker Segment and Orderbook Comparison (2008 vs 2015)



Source: Poten & Partners

We know now that the market crashed in 2008/2009, but in the summer of 2008, this was not what most people were expecting. After many years of record earnings on the back of a booming world economy and amid very strong Chinese growth, investors were still in investment and expansion mode. They thought the party would never end. At the end of July 2008, the VLCC orderbook stood at 231 vessels, or 48%(!) of the existing fleet. Similarly, the Suezmax orderbook was at 45% of the existing fleet and the Aframax orderbook also exceeded 40% of the fleet (see Fig. 2). The high orderbook was not the result of discounted pricing by the shipyards. Since many shipping markets were booming at the same time and orders were flowing in from all directions, newbuilding prices were high and delivery times were long. As a result the high rate environment and positive sentiment, investors were willing to pay up to get a newbuilding resale or a secondhand vessel for prompt delivery. For example, a VLCC could be contracted in July 2008 for $159 million, while a newbuilding resale would cost $195 million (a $36 million premium). At $165 million, even a 5-year old vessel was more expensive than a newbuilding.

The situation is quite different now. One could argue that the market breached $100,000 per day on the way up, a trend which started in late 2013. However, market participants appear to be more uncertain about the long-term sustainability of these rates against the backdrop of a less robust global economy and a slowdown of growth in China. Current prices are significantly lower than in 2008, although, as a result of the healthy spot market, resale values are again assessed higher than newbuilding contract prices ($98 versus $95.5 million). The secondhand price for a 5-year old VLCC is assessed at $81 million (less than half the price in 2008). The orderbook levels are much lower as well.

Where do rates go from here? The consensus view is that the tanker market will probably remain strong well into 2016 because the world is awash in crude and needs tankers to move it around.