



POTEN TANKER OPINION

Breakup as Backup

What is the scrapping potential of the crude fleet?

Tanker owners are currently doing fairly well, certainly compared to their colleagues in the dry bulk market. However, history shows that such markets do not last forever and when the downturn comes, it is important that the supply side can respond quickly. The tanker orderbook is not excessively large in historical terms but still requires a sizable demand increase to maintain a balanced market in the coming years. Scrapping is the other variable that influences the supply side of the equation and the question is: What is the potential for scrapping to help balance the market in the coming years?

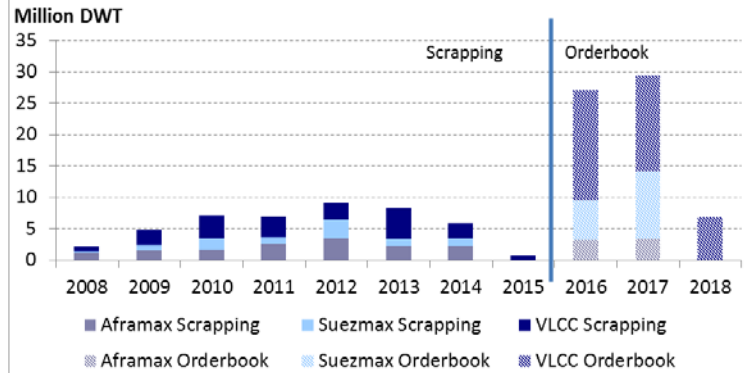
The tanker fleet is fairly modern, following the single hull phase out of the early 2000's and the ordering wave during the great commodity boom from 2004 to 2008. This is illustrated by relatively modest scrapping in the last several years (Fig 1).

There are an estimated 92 crude tankers of Aframax size and larger that will be 20 years and older by the end of the year. The current VLCC fleet consists of 653 vessels with an additional 128 (20% of the fleet) on order. 26 of the trading VLCCs will reach an age of 20 years or older by the end of this year and could be considered potential scrapping candidates in the coming years to offset the fleet growth. The Suezmax fleet consists of 426 tankers with 129 vessels (30%) on order but only 21 vessels were built prior to 1997. For Aframax, we are adding older coated tankers to the crude fleet as these vessels are more likely to be employed in the dirty trades as the economics of maintaining the coatings worsen, especially in a poor market. The Aframax fleet has 594 crude tankers and an orderbook of 92 vessels (15%). The number of Aframax tankers older than 20 years is about half the orderbook at 45 crude tankers including five coated tankers.

Ship owners will continue to trade vessels as long as they feel they can do so profitably. A major decision point is when the vessel needs to perform a special survey, typically when it reaches 20 years and again at 22.5 years and 25 years of age. The special survey of such older vessels often requires the investment of up to several million dollars in steel, coatings, etc., dependent on the condition of the vessel. When these special surveys come due during a poor market, owners are more likely to sell the vessel for demolition.

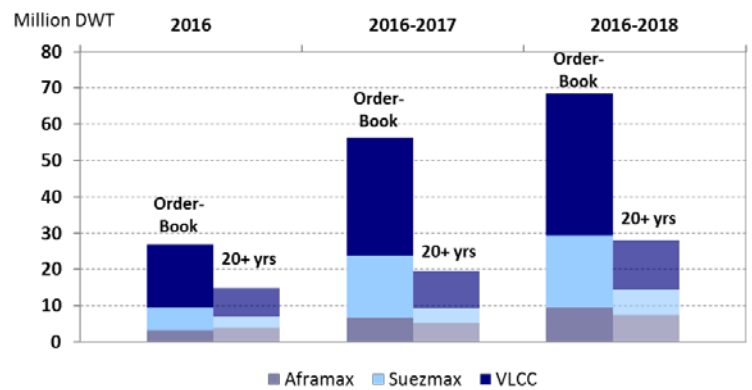
In order to assess the likelihood of tankers heading for the scrap yard, it is useful to examine the employment opportunities of such tonnage. AIS data shows that the vast majority of these vessels are trading East of Suez. With the exception of 8 PDV Marina Aframaxes, involved in Venezuelan

Fig. 1: Crude Tanker Orderbook Compared to Historical Scrapping



Source: Poten & Partners

Fig 2: Crude Tanker Orderbook Compared to Fleet Reaching 20 Years of Age



Source: Poten & Partners

crude trades, and some Eastern Mediterranean and Black Sea voyages, most of these vessels rarely show up in the Western hemisphere, where terminal operators are often stricter on age limitations. During the last couple of months, about 21 of these tankers were predominantly involved in Intra-Middle Eastern trades. Of the remaining tankers, 23 vessels have been trading predominantly from the Middle East to Asia, mainly India, China or Korea. Another 10 vessels were employed in Intra-Asian trades.

Another way to look at the data is to examine the special survey dates. Based on Q88 data and estimates, we project that 47 tankers will have a special survey due in 2016 and an additional 17 in 2017. In 2018, 23 tankers will have their next special survey (and likely some of the vessels with a survey in 2016). For four vessels, Q88 data states that their next surveys are in 2019 and later. If the market remains strong in 2016, most, if not all, of the scheduled tankers will undergo their special survey, and in the years thereafter, a smaller number will face the decision.

We forecast a continuation of the strong market for 2016, as high crude production will continue to require transportation and inefficiencies related to high oil inventories persist. After this year, we foresee weakening freight rates as deliveries increasingly affect tonnage supply and oil inventories start to wind down. Based on the profile of the fleet, it does not look like there are enough scrapping candidates to offset the deliveries and quickly support the rates.