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POTEN TANKER OPINION

This Time it is Different

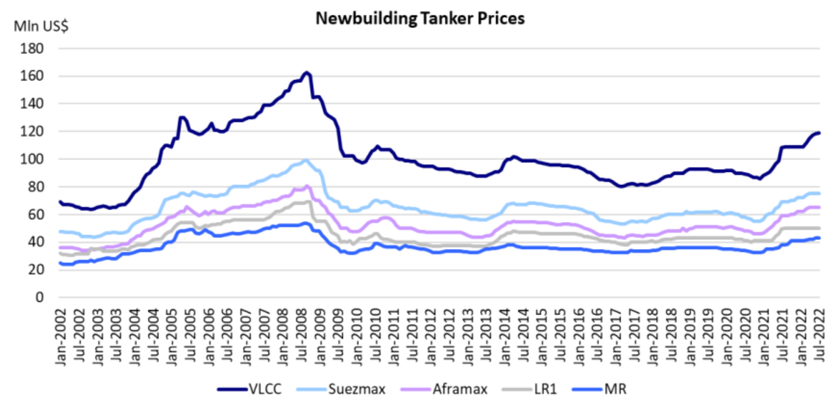
Asset prices are on the rise, flashbacks to 2004-2008?

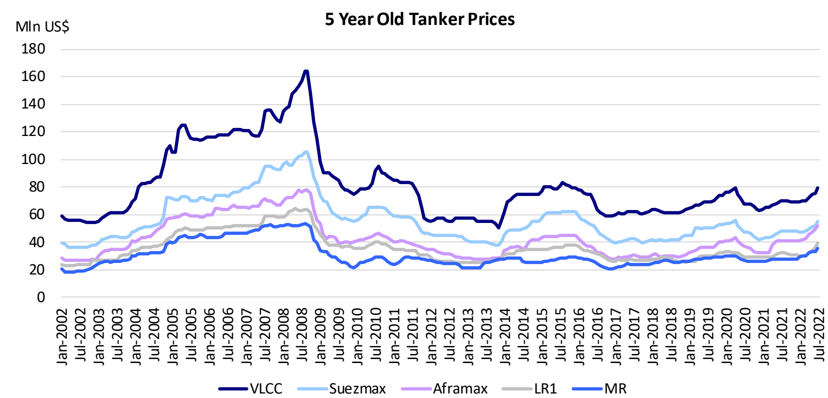
Tanker asset prices have been on a tear lately. VLCC newbuilding prices have increased from $88.4 million in January 2021, to $119 million this month, an increase of 35%. Secondhand prices have shown a similar trend. Over the same time period, prices for 5-year-old VLCCs are up 23% and 10-year old VLCCs 31%. The price developments in the other tanker segments, from Suezmaxes down to MRs mostly mirror those of the VLCCs. The last time asset prices increased like that was during the tanker "supercycle" from 2004-2008. As they say: "History doesn't repeat itself, but it rhymes." So, are there any similarities between now and then? Can we draw any conclusions from what happened then and apply them to today's market?

Let's highlight the differences first. The tanker supercycle of 2004-2008 was primarily driven by a combination of strong oil demand growth from China and (initially) tight tanker supply. After many years of mediocre returns and limited ordering, there was not a lot of spare shipyard capacity. The commodities boom of the supercycle supercharged all shipping segments simultaneously. Tankers, bulkers, containerships, LNG carriers and offshore were all booming at the same time. Strong demand and limited supply pushed up asset prices. Because of limited newbuilding capacity, delivery times started to stretch well beyond the normal 18 months to two years. VLCCs ordered in 2007 had a scheduled delivery date in 2011. Early deliveries were at a premium and prices for modern secondhand vessels approached and occasionally surpassed newbuilding prices. At the peak, in September 2008, a newbuilding VLCC cost $162.5 million for delivery towards the end of 2011. Poten assessed the price of a five-year-old secondhand VLCC at $164.25 million. Freight rates were so high that owners put a significant premium on prompt delivery.

The current situation is quite different in many respects, although there are some similarities. First the differences. We are not in a commodities supercycle driven by robust growth in demand. There is growth in demand for certain commodities (mainly as the world recovers from the pandemic) and prices have increased. However, supply restrictions and geopolitical events have more to do with it than sustained rapid demand growth. Economic expansion in China, the driver of the last cycle, has slowed dramatically. Compared to the first decade of this century, the current economic outlook is rather subdued.

Another significant difference is that the world is now very focused on addressing climate change and reducing global emissions, including from shipping. For tanker owners this means that the future of their business has become more uncertain (peak oil demand) and that investment decisions now need to incorporate choices around fuel and propulsion. None of these factors played a significant role when the previous generation of tankers were ordered 15-20 years ago. Vessels were pretty standard in terms of specifications and fuel consumption. The more fuel efficient "eco" design vessels only came into play 10 years ago.





Source: Poten & Partners

As we mentioned before, secondhand values actually surpassed newbuilding prices for a brief period in 2008. This is unlikely to happen during this cycle. As a result of higher steel prices and more expensive components, as well as environmental modifications such as scrubbers or dual fuel engines, newbuilding will likely remain more expensive than older secondhand units. So far, newbuilding prices have increased faster than secondhand values in the current cycle. However, this will likely change if rates continue to recover.

What are the commonalities between the two periods? First of all, similar to today, the market was in a recovery mode in 2003/2004. Initially, shipowners were cautious to see if the recovery would be sustainable, but when demand growth continued and freight rates remained high, owners started to expand and order new ships. Today, we are still in the early part of the cycle. The world is recovering from the pandemic, but there is a war raging in Europe and high commodity and food prices are fueling inflation and raising the specter of a global recession. However, if the global recovery continues, the war ends and rates remain strong, ordering will eventually resume. Shipowners are optimists and they will want to take advantage of a strong rate environment by expanding their fleet.

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