# POTEN TANKER OPINION

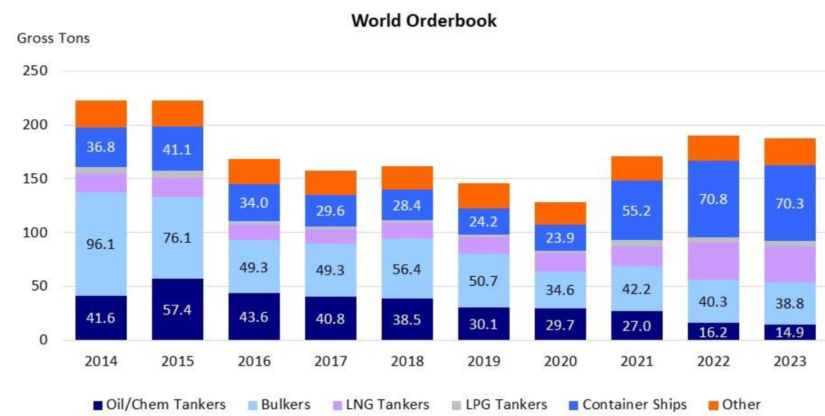
## Here We Go Again?

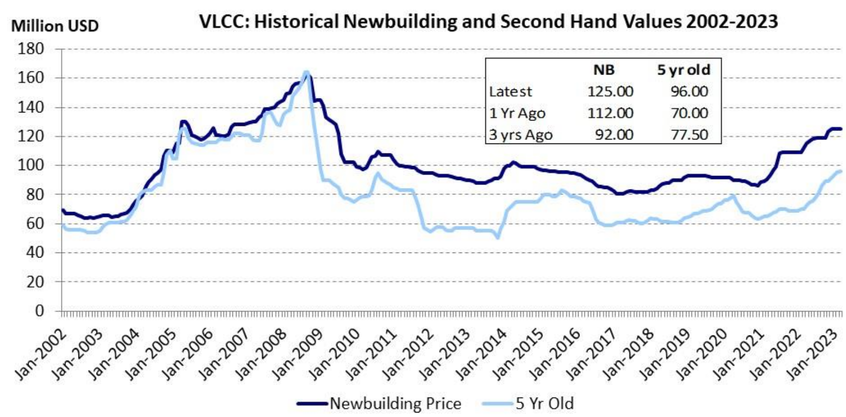
**Is interest in tanker newbuildings picking up?**

Despite the dramatic increase in rates and secondhand prices since the Russian invasion of Ukraine, the tanker orderbook has remained at historically low levels. Limited shipyard capacity, high newbuilding prices and the uncertainty around marine fuels in combination with tightening environmental regulations has so far prevented (or delayed?) the typical boom-bust cycle in tanker shipping. The limited orderbook and ageing fleet have given owners confidence about the freight market for the next two to three years. Has the time finally come for owners to return to the shipyards?

The tanker industry is highly fragmented and has low barriers to entry. It does not have a great track record of orderly capacity replacement. Tanker owners are frequently susceptible to herd mentality and order too many vessels when rates are high. The deliveries several year later will precipitate or contribute to the next downturn in rates. Large crude oil and product tankers have a typical lifespan of 20-25 year. Based on this, normal fleet replacement that would require that owners order 4-5% of the existing fleet every year. Accounting for 24 months delivery time and some demand growth, an orderbook of 10% of the fleet would therefore be reasonable. Unfortunately, this rarely happens. In good times new construction activity significantly exceeds the fleet's replacement requirements, usually followed by a lean period of very limited newbuilding interest. VLCC ordering over the last 20 years illustrates this phenomenon. The tanker market was strong in the early 2000s and the orderbook grew rapidly. By the end of 2008 (right before the global financial crisis) it peaked at 244 VLCCs, 48% of the fleet. It has moved up and down several times since. At the moment, we estimate the VLCC orderbook to be 26 vessels. The fleet is much larger than it was in 2008, and this represents only 2.9% of the VLCC fleet. The orderbook for the other tanker segments is also low: 1.8% for Suezmaxes; 5.4% for Aframax/LR2; 0% for Panamax/LR1; 2.6% for MRs and 0.4% for Handys.

Is such a low orderbook sustainable? The global pandemic was not kind to tanker owners and their earnings were low or negative in 2021. However, their fortunes turned around in 2022 and earnings rose rapidly. As shipowners accumulated cash, they started to pay off debt, bought back vessels that were on sale-lease backs and (public owners) increased their dividends. The potential for outsized earnings in the Russian trades encouraged new players to enter the market and scoop up secondhand vessels as ever-increasing prices, allowing traditional shipowners to dispose of their older tankers at significant premiums. Now many owners are sitting on a growing pile of cash, and they are evaluating what to do next.




Source: Poten & Partners

As this situation continues, it is likely that a number of these owners are looking at ordering newbuildings. True, newbuildings are expensive and the delivery time remains relatively long. On the other hand, secondhand vessels are very expensive too, if you can find them. There are very few modern secondhand vessels for sale. Newbuilding slots may become more readily available as the yards receive less container and LNG orders.

Financing is another factor that could impact owner decisions. Rapidly rising interest rates and a shrinking number of banks interested in traditional ship finance already made it more difficult and expensive to finance secondhand ships with a traditional mortgage. The recent turmoil in the international banking system will only make that more challenging. In contrast, funds to finance newbuildings are more accessible, in particular shipyard credit in combination with funding from Chinese and Korean Export-Import Banks.

We have already seen increased newbuilding activity in recent months. Several MRs, LR2s and Suezmaxes have been ordered this year. The quantities are still relatively modest, but as the confidence of owners grows, we expect to see more contracting. The earliest delivery dates are in 2025 and for large vessels, such as VLCCs owners will be looking at 2026. Most vessels are still equipped with conventional engines but an increasing share is LNG or dual-fuel ready.

Many of the large established players remain on the sidelines, but if history is a guide, this could change quickly. If some earlier slots become available at the right price, we expect there to be significant interest.