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TANKERS
INDUSTRY NOTE

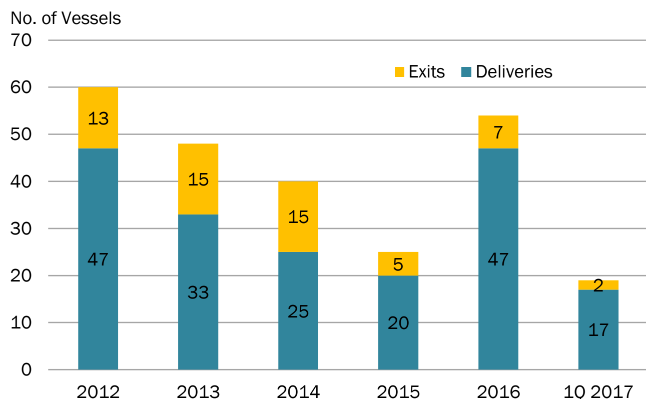
No. 10 – Balancing Act

April 28, 2017

In the first quarter of the year, the freight rates on the major VLCC benchmark trades we assess and track in our *Daily Tanker Market Rate Snapshot* were stuck in a downward spiral with limited upward swings. The weakness in rates can be attributed to a multitude of factors, the most influential being vessel supply.

Over the last five years, the VLCC fleet has experienced a tremendous growth spurt, expanding by 117 vessels (net) through the end of 2016. Another 17 ships have hit the water in the first quarter, while just two have exited the trading fleet – the *DHT Ann* for conversion and the *Varada Blessing* for demolition (Figure 1).

Figure 1 – Net Fleet Growth; 2012-1Q 2017



Source: McQuilling Services/Lloyd's Register Fairplay

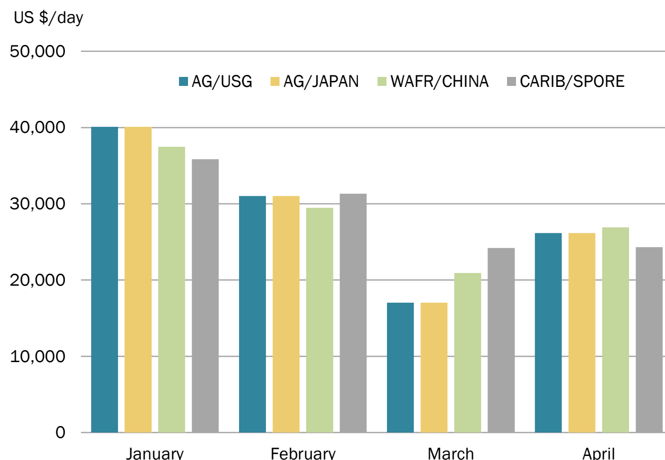
An increase in the number of newbuilding deliveries hasn't been the only factor that has led to an oversupply issue this year. Port delays and floating storage, which act as temporary supply reduction factors, have not been as prominent in 2017 as they were last year. By utilizing remotely-sensed position data (AIS) and our robust proprietary fleet management software, we are able to effectively monitor and track the global tanker fleet, including these market conditions.

In the Far East last year, discharge delays, which turned into short-term floating storage opportunities, were a topic of interest. Of particular significance was the backlog of tanker traffic at Qingdao in China, caused by teapot refiners' thirst for foreign crude oil. As an example, in February 2016, discharge delays for VLCC tankers nearly doubled, reaching as high as 28 days. Our analysis shows that every one additional day in port is equivalent to a tonnage reduction of 9-10 VLCCs. While this scenario would have been helpful to VLCC owners in the first quarter of the year, we have yet to see a situation of the same magnitude transpire. Both delays and floating storage have been minimal, allowing for well supplied position lists and more opportunity for charterers to put downward pressure on rates.

At the start of 2017, our time charter equivalent (TCE) assessment for AG/Japan was roughly US $53,500/day, while AG/USG was about US $25,500/day. In the Atlantic Basin, our assessment for WAFR/China was slightly excess US $48,000/day. The Caribbean/Singapore route commenced at US $36,100/day. This was the first and last time daily earnings were this high as week after week, rates steadily fell from these levels throughout 1Q 2017.

The month of March proved to be the bottom of the market, with TCE earnings, at points, reaching negative territory on the AG/USG route and as low as US $11,400/day on AG/Japan. The West Africa/China route fell over 60% from the start of the year to its lowest point of US $18,422/day at the end of March, while Carib/Singapore fell about US $10,000/day throughout the first quarter (Figure 2).

Figure 2 – VLCC TCE Earnings; 1Q 2017



Source: McQuilling Services

Rates began to find some strength in April on the back of sustained inquiry and resistance from owners to accept lower rates. Worldscale spot rates on the AG/Japan benchmark rose from WS 47.5 (TCE US $13,706/day) at

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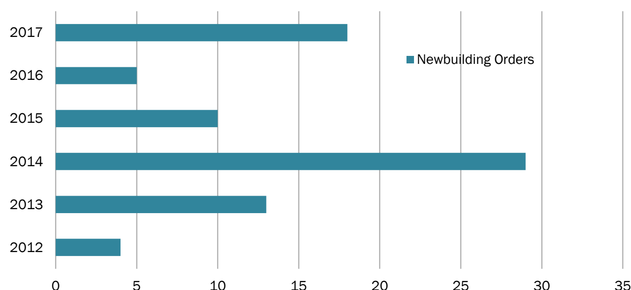
the start of April to a peak of WS 76 (US $35,796/day), an increase of 60%. Meanwhile, in the Atlantic Basin market, spot rates on the WAFR/China route climbed from WS 56 (TCE US $19,000/day) to a high of WS 73 (US $31,356/day). The rally didn't last long and rates have since abated as of the time of writing due to a swift repopulation of the tonnage list.

Despite mounting financial pressures being faced by VLCC owners in the spot market, the pace of scrapping has remained muted over the past few years. However, with demolition values on the rise and impending environmental regulations that will require costly upgrades to existing vessels, we expect to see an accelerated scrapping program begin this year and persist throughout our five-year forecast period.

In 2017, we forecast that 10 VLCCs will exit the trading fleet, followed by 23 in 2018 and an average of 34 ships per year in the outer years of our forecast cycle. Should an increase in tanker exits transpire, it would help to offset some of the fleet growth in recent years, especially as fewer vessels are anticipated to deliver from 2018-2021, despite a rather strong start to VLCC contracting this year.

VLCC newbuilding orders placed thus far in 2017 have caused some market participants to become weary about the future of this tanker segment. At the end of the first quarter, we captured 14 VLCC newbuilding orders placed by TMS Tankers, NS Lemos, DHT Holdings, Kyoei Tanker and the Angelicoussis group. Adding to this are the three orders reported by Shandong Landbridge and one option one by Neda Maritime in April, bringing the total to 18 orders, the highest level seen since 2014 (Figure 3).

Figure 3 – January-April Newbuilding Orders; 2012-2017

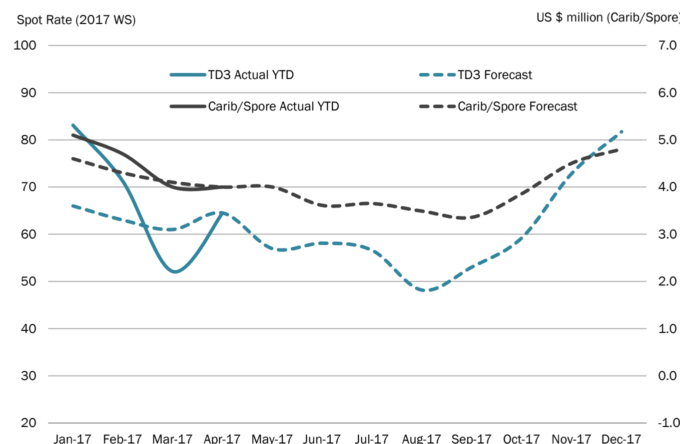


Source: McQuilling Services/Lloyd's Register Fairplay

Hyundai Merchant Marine has also signed a letter of intent with Daewoo Shipbuilding and Marine Engineering (DSME) for up to 10 VLCCs. Meanwhile, Sentek Marine recently emerged as having ordered up to four VLCCs from Hyundai Samho Heavy Industries.

We expect that weakness in rates will persist in the second quarter of the year, with TD3 averaging WS 57 and Carib/Spore US $3.7 million on a lumpsum basis (Figure 4). Of note, our original forecasts from the beginning of the year for TD1, TD3, TD15 and Carib/Spore have trended within 6% of actual market levels.

Figure 4 – TD3 and Carib/Spore Forecast



Source: McQuilling Services/Lloyd's Register Fairplay

Oversupply will continue to be a concern for this tanker segment in 2Q 2017 and the remainder of the year as we expect another 25-30 ships will join the trading fleet before 2018. While we forecast that 10 ships would exit the trading fleet in 2017, activity has been slow thus far. A notable increase in scrapping will need to transpire over the next eight months. Additional pressures will likely stem from Brazil failing to meet production expectations due to FPSO delays, creating less tanker demand than initially anticipated. In addition to this, a drawdown in currently high crude oil inventories could have a negative impact on cargo demand moving forward, as could a tightening in the WTI/Brent spread, pressuring long-haul US exports.

An in-depth view of these scenarios and our five-month rate forecasts will be published in our upcoming *May Interim Update*.

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