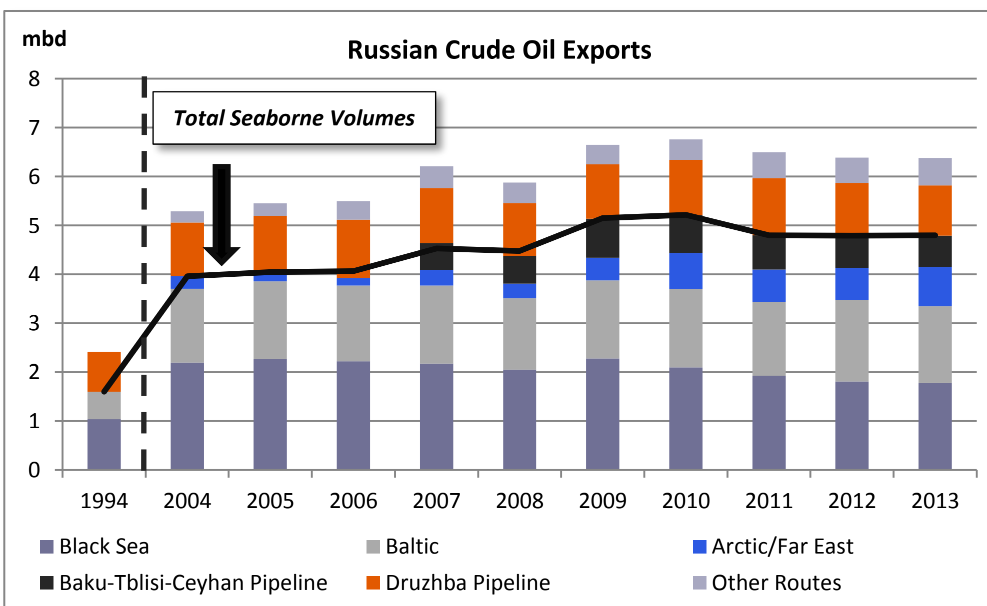
Ukraine in the Membrane

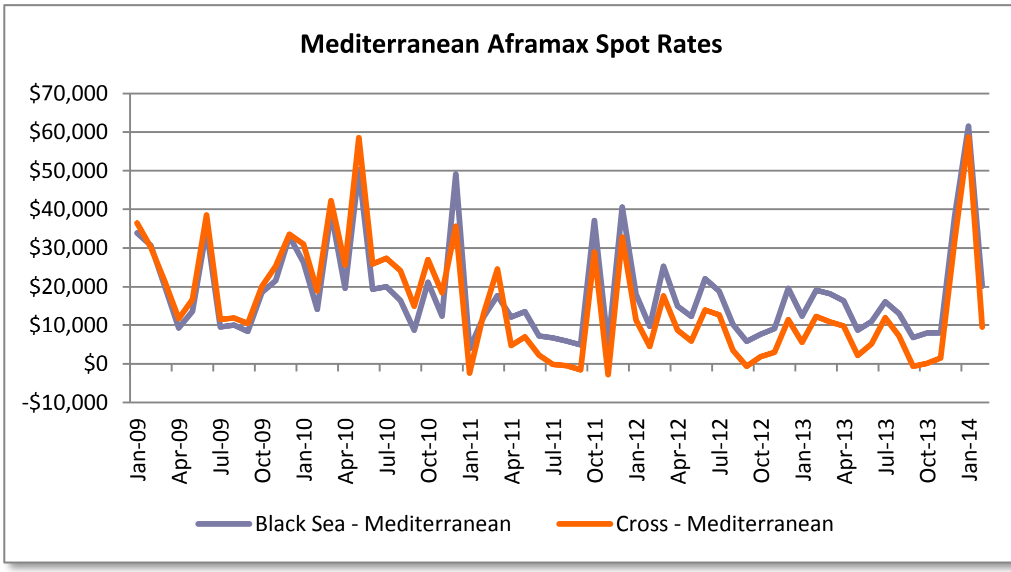
The recent developments in Ukraine serve as a stark reminder that crude oil and natural gas supply security for captive consumers are only as sure as their provider's next false move. Russia and Saudi Arabia regularly interchange positions as the world's largest oil producer, depending on OPEC production quotas, heightening market sensitivity to sabre-rattling of any sort. As tensions in Ukraine, Crimea and Russia mount, it is not yet clear the full extent to which the conflict will impact natural gas and oil supplies. To be sure, however, if trade barriers solidify, the ramifications for the oil and tanker markets will likely be significant.

Over the past decade, the tanker market has become more exposed to Russian production and exports. Total exports from Russia are 6.39 million barrels per day, an increase of 20% from 2004 volumes. The majority of Russian seaborne export volumes move from the Black Sea via the Turkish Straits. Over 1 million barrels per day are exported from the port of Novorossiysk alone. Half of these quantities end up in Europe. Should any of these export quantities be compromised, an equal draw on other Atlantic Basin sources would likely be required. Some have even posited the potential for US crude oil exports as a means of squeezing Russia's oil belt.



Source: IEA, Poten

Oil trade in the Mediterranean and the Black Sea is dominated by Aframax tankers and historically characterized by volatile charter rates. Transit through the Turkish Straits can be restricted by weather or shortened daylight hours in the winter, creating delays that trigger rate spikes. The chart below shows historical spot Aframax rates.



Source: Poten & Partners

As recently as February, daily earnings averaged upwards of $60,000 per day on the intra-Mediterranean trades. Current spot rates rates are significantly less, yielding time charter equivalents in the $10,000 to $15,000 per day range, demonstrating the volatility that persists in these regions.

Since Russian Urals crude oil flows from disparate export locations, anticipating price trends can be difficult for refiners purchasing the crude oil. Historically, Urals has traded at a discount to Brent due to differences in API and sulfur content, however the spread has collapsed to less than $0.85 per barrel during the last week, perhaps due to perceived future supply short-falls. Further upward pressure on Urals prices would suggest that other crude oil grades may become competitive in the European refining system. Replacement barrels from the Caribbean or West Africa would effectively lengthen ton-mile demand.

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