



NO. 3 – TANKER SUPPLY OUTLOOK

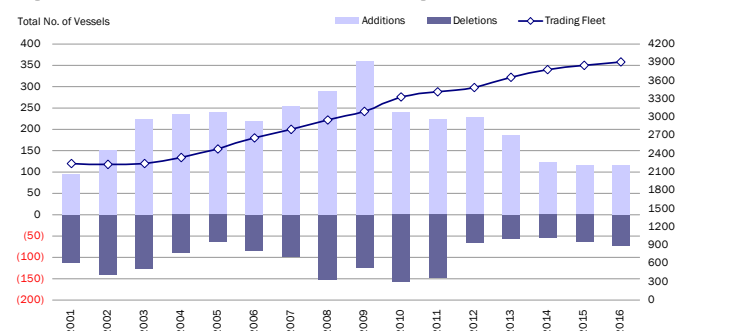
FEBRUARY 08, 2012

On the back of the continued weakness in the global economy, oil market disruptions and over capacity, tanker contracting fell to 109 last year, its lowest level since peaking in 2006. Given the current size of the fleet, which stands at 3,498 tankers above 27,500 dwt, contracting is expected to remain low in the short-term. The availability of loans to the shipping industry will remain limited in the current economic environment. This should help the market gradually return to balance as it should continue to limit new tanker orders.

Prior to making adjustments to represent delays and cancellations we recorded 562 vessels 27,500 dwt and above currently on order through 2014. This accounts for vessels that have a hull and an IMO number but omits deals listed as “reported”. Our process of forecasting slippage considers many factors. After determining what vessels will be delivered as IMO 1 or 2 we adjust the orderbook for delays and cancellations based on an internal assessment of the financial health of shipyards and owners. The final step in estimating fleet expansion compares the current orders in a given year to a fraction of the average placed between 2001 and 2011. We use the greater of the two to determine the number of deliveries that could materialize during the forecast period. Over the next five years we expect 767 tankers to be delivered into the market, which also includes ships delayed from previous years.

We forecast that 228 tankers will be delivered into the market in 2012. This represents a slippage of 35% based on the original-unadjusted orderbook. In the larger tanker classes we anticipate deliveries of 62 for VLCC and 43 for Suezmax. With the exception of the MR2 class, with an estimated 44 deliveries this year, supply increases should be less pronounced in smaller tanker classes. Relatively healthy freight rates have fueled MR2 market optimism for this class in recent years. The least pronounced supply growth should occur in the Panamax and MR1 classes with a respective 3 and 9 deliveries expected this year. The small orderbook is due to the increasing specialization of trades for which these tankers are used. Figure 1 illustrates additions, deletions and trading fleet inventory for all tanker classes. Note that through 2014 the tanker fleet will continue absorbing a high number of tankers before beginning to slow towards the end of our forecast period. Starting in 2014, we expect the delivery program to slow to roughly 125 vessels with this number continuing to shrink.

Figure 1: Total Fleet Inventory Changes *



Source: McQuilling Services

* These figures do not account for switching between clean and dirty trades on Aframax / LR2 and Panamax / LR1. They also do not account for other factors that reduce supply such as slow steaming, floating storage and port delays.

As bunker prices rise in an environment of tanker oversupply, upward spot rate movements are limited and owners have reduced sailing speeds to reduce fuel consumption. We have responded to this move by lowering our average fleet sailing speed by 1 knot to 13.5 realizing that some owners may be operating at speeds closer to 8-9 knots. As the sailing speed is reduced, the delivery of a cargo takes more time, reducing both the global and route specific availability of vessels. Table 1 provides the impact to the tanker fleet when operators reduce sailing speed by one knot. Other factors that will contribute to a reduction in tanker supply are port delays and demand for floating storage.

Table 1 - Number of Vessels for Each 1 Knot of Speed

	VLCC	SUEZ	AFRA	PANA	MR
Number of Vessels *	15-28	3-15	8-15	2-5	9-20

* Assuming speed reduction across fleet sector. Specific number depends on deployment assumptions

Source: McQuilling Services

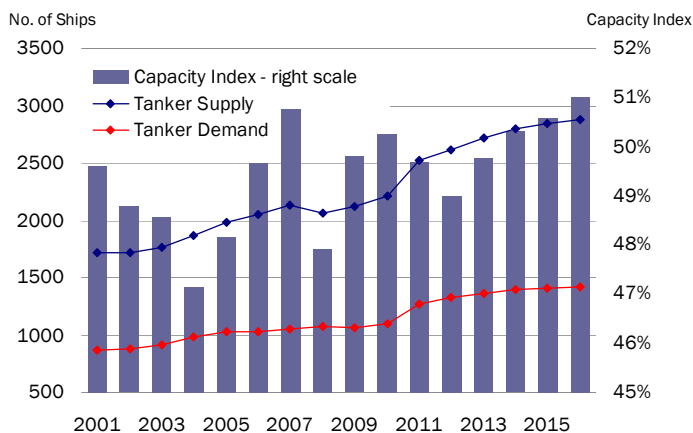
In recent years we observed demand to convert VLCCs into FPSO/FSO units. This has been influenced by robust demand from the expanding off-shore industries in South America, West Africa, the Gulf of Mexico, South East Asia and Australia / New Zealand. In previous editions of our Outlook, our exit profile had been strongly based on IMO regulations and special survey dates. Going forward, we



revised our estimates to account for conversion demand. Currently, we estimate that the off-shore sector will absorb 15 VLCCs per year for conversion to FPSO/FSO. Historically these have been single hull vessels but at the end of last year the *Chios* (301,824 dwt, 1993 built) and the *Arosa* (291,391 dwt, 1993 built) double hull vessels were sold into conversion for floating storage. This trend should continue and further help reduce fleet capacity.

Capturing the relationship of the factors that influence tonnage supply and their impact on demand in a specific period requires evaluating the effect of the fundamentals driving the market. In our 2012-2016 Tanker Market Outlook, we calculate the surplus or deficit of vessels by subtracting estimated demand from the average annual tanker inventory that is available for each vessel class. By normalizing this result we produce a capacity index to gauge the surplus or deficit of a specific tanker sector. In addition to the previously mentioned factors that absorb tanker capacity, the capacity index accounts for tanker supply reductions stemming from weather, maintenance, delays, dislocation, capacity reductions and availability reductions. Figure 2 provides the capacity index for the entire trading fleet. A discussion for the capacity index for each tanker class is also provided in the Tanker Market Outlook.

Figure 2: Capacity Index - Total Fleet



Source: McQuilling Services

In the coming years, the capacity index for the total fleet will continue to rise as deliveries will outpace deletions. In the short-term we see a rising capacity index in the LR1 class as a relatively strong delivery profile could pressure

fundamentals. The capacity index is also pressured as we currently forecast demand growth to be less pronounced during the out years. This factor could be adjusted upwards if the global economy regains its balance and returns to a growth trajectory. It is important to remember when looking at the capacity index that it is a tool to gauge the interaction of supply and demand and not an absolute indicator of expected market performance.

Looking forward, the tanker market will continue to be pressured by the combination of high tonnage availability combined with demand side pressure (see Industry Note No. 2). The McQuilling Services 2012-2016 Tanker Market Outlook provides a more detailed discussion tanker supply in addition to analysis of demand, asset markets and several other aspects impacting the industry. This report is currently available in PDF and hard copy formats.

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