



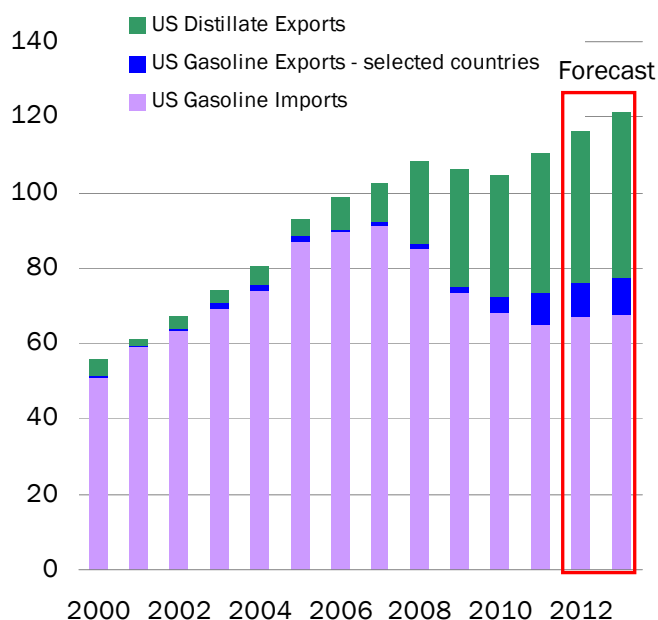
### No. 5 – MR2 ATLANTIC BASIN OUTLOOK FEBRUARY 24, 2012

The MR2 clean products trade in the Atlantic Basin provided a glimmer of positive market sentiment in 2011. Trade in the region was supported by a variety of factors that managed to absorb tanker capacity. These were the reduced refinery utilization on the US East Coast (PADD 1) and in Europe in the wake of declining demand, combined with the rising cost of crude imports and healthy economic activity in Latin America. Throughout the year, refiners on both sides of the Atlantic announced refinery closures, totaling roughly 1 million b/d of capacity due to persistently weak margins.

These factors have provided the foundation for a bullish outlook for MR2 trade in the region and have increased the frequency of reports regarding industry players making or considering investment in this vessel class. McQuilling Services believes that although in the short term this trade could be robust, long term prospects are limited by rising tanker supply, evolving trade routes and the currently low refinery operation levels.

Figure 1 provides our estimate of the region's MR2 demand based US import and export volumes of light and middle distillates.

**Figure 1 – Aggregate MR2 Demand**



Source: McQuilling Services

The prospects of increasing demand for exports on MR2 vessels out of the US are hinged on distillates.

Demand from Europe has been influenced by low refinery utilization rates that hovered around 80% of capacity last year. This boosted demand for back-haul TC2 distillate cargoes. It appears increasingly likely that Europe will enter a recession this year, further supporting these trade flows. However, in the long term utilization rates will rebound in Europe, boosting distillate output and reducing demand for US imports.

In the Southern Hemisphere, expanding economic activity, a poor sugar cane harvest and a lack of downstream capacity boosted import requirements from Latin America. Although this trend is likely to continue in the short-term, by 2016, the IEA anticipates that Latin America will have added approximately 1 million b/d of refining capacity and around 700,000 b/d of capacity upgrades. This will alter the region's petroleum product balance and slowly erode import volumes.

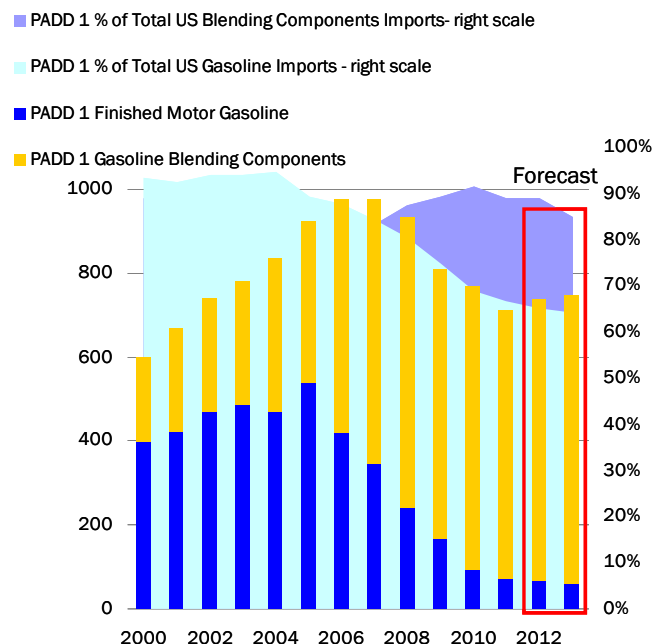
In the US market, PADD 1 represents the primary import hub for gasoline exports from Europe due to its high demand concentration. Between 2000 and 2010, PADD 1 absorbed roughly 90% of finished and unfinished gasoline imports (Figure 2). Unfinished gasoline is typically mixed with ethanol at blending stations, allowing a stable supply of the transportation fuel despite relatively weak regional refinery operations. Data from the US EIA shows that these import volumes of finished and unfinished gasoline rose by 6% between 2000 and 2007, peaking at 975,000 b/d, but have since posted an annual decrease of 7%. Given the rising automobile fleet efficiencies, combined with the shift to smaller automobiles and blending mandates, robust growth is unlikely to resume. Although there could be a slight uptick in the short-term, the potential uptick will likely be driven by refinery closures and will be limited by the already weak refinery throughput levels and ethanol blending.

Data from the US EIA supports this possibility as it reports that PADD 1 is operating at a utilization rate of 55% with an operable capacity of 1.6 million b/d. At the same time, gasoline production, which includes the blended (with ethanol) unfinished gasoline in PADD 1, has averaged 2.7 million b/d this year, with gross refinery inputs of almost 890,000 b/d. While demand for unfinished gasoline should provide a floor for MR2 vessel



demand, an uptick in consumption would likely result in refiners raising throughput levels, reducing sea-borne import requirements.

**Figure 2**  
**PADD 1 – Imports of Finished Gasoline and Gasoline Blending Components**



Source: McQuilling Services

Further pressure on MR2 ton-mile demand in the Atlantic Basin comes from rising import volumes of petroleum products from the West Coast of India to the East Coast of South America and the US via transit hubs in the Caribbean. Our proprietary data shows that in 2011, 19 and 24 vessels were fixed from the West Coast of India to the Bahamas and East Coast South America respectively. This compares to three cargoes sent to the Bahamas and seven to East Coast South America in 2009. These cargoes were carried on LR2 and LR1 tankers.

In the backdrop of these developments, we forecast that MR2 deliveries are set to rise. Our data shows that MR2 tanker net-fleet growth will total 72 vessels in 2012 and 2013 combined. The large number can be attributed to delayed deliveries from past orders but future orderbooks also hint at the threat of oversupply.

Over the next five years we expect that 177 MR2 tankers could be delivered into the market, which represents 20% of the current clean tanker fleet (Table 1).

**Table 1 – MR2 Tanker Orderbook Analysis 2012-2016**

MR2 Orderbook	Total Orderbook	% MR2 Orders	% 2012 CPP Fleet
177	348	51%	20%

Source: McQuilling Services

Given the current market conditions we anticipate that clean products trade between Europe, Latin America and the US will be relatively healthy in the next couple of years. However, looking further ahead, we expect demand for these vessels to lose ground to larger tonnage as refinery centers shift further afield. At the same time, economic uncertainty and reduced demand for transportation fuels should limit upside potential. Meanwhile, delayed deliveries and a robust orderbook have the potential to oversupply the market. These conclusions lead us to believe that market participants looking to profit from the current situation may want to consider a time charter to limit exposure.

For further forecasting on this trade and vessel class please ask us about our recently published 2012-2016 Tanker Market Outlook. This five year forecast provides analysis of future market trends, oil market fundamentals, asset markets and spot rate forecasts among other topics.

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