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No. 1 – Asset Markets: A Year in Review

January 10, 2014

Asset prices appear to have reached some equilibrium in 2013 after enduring a continuous downturn since 2009. Average annual composite tanker prices were down 0.42% year-on-year with mixed performances on a sector by sector basis. End of the year momentum could have set the stage for what may be the first positive year since 2008 registering a current 5% return based on January 2014 levels over 2013 averages. Table 1 illustrates current asset prices for the tanker market as of January 2014.

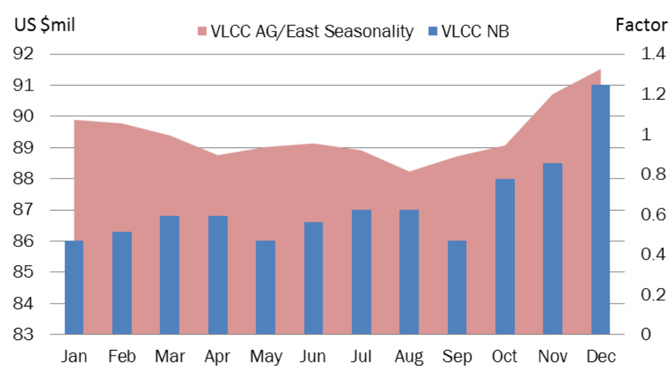
Table 1: Current Asset Prices
US $million, January 2014

	VLCC	SUEZ	AFRA	PANA/LR-1	MR
N/B	93	59	46	38	36
5 YR	55	39	28	26	28
10 YR	37	25	18	19	18
Demo	18	11	7	6	4

Source: McQuilling Services

VLCCs saw mixed results across newbuilds and second-hand tonnage year-on-year. Overall, the segment trended slightly downwards by 0.2% year-on-year using average annual prices.

Figure 1: VLCC Seasonality, *Jan-Dec*

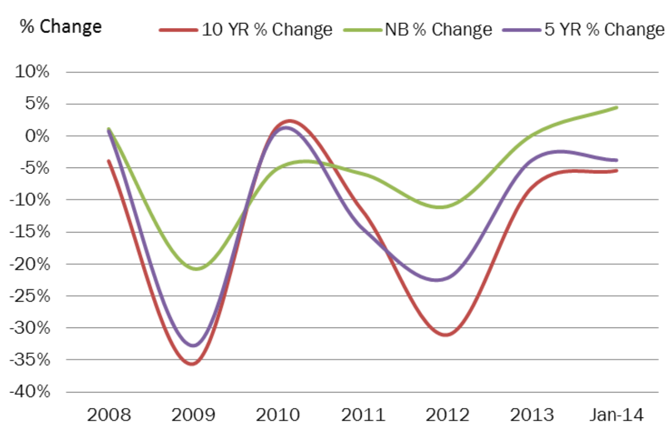


Source: McQuilling Services

The end of the year saw increased spot market activity and renewed optimism, which has supported asset prices heading into 2014. Current asset prices represent a 6% increase over 2013 average levels with newbuilds and 10-year secondhand tonnage increasing 6% and 16% respectively. In contrast, asset prices for five-year secondhand tonnage are down 4% from 2013 levels. Our proprietary seasonal ratios show the experiential adjustments in rates over the course of the year. Using a basis of one, we record the observed premium or discount on a monthly basis by using a multiplier factor. For example, a 30% increase in December rates from the annual average rates will indicate a 1.3 seasonal factor for December. As indicated in our previous industry note, a seasonal uptick and securing of tonnage ahead of the holidays traditionally helps to push up both spot rates and subsequently asset values in the latter half of the year. Figure 1 illustrates the relationship between the seasonality factor on the AG/East route and VLCC newbuild prices for 2013. Future expectations of spot rates based on ton-mile demand and tonnage availability, combined with access to financing and steel prices, are the basis for our five-year projection results in our upcoming 2014-2018 Tanker Market Outlook.

Asset prices for the Suezmax sector underperformed the industry average, registering a 4% drop in average annual prices year-on-year. Significant weakness was predominant in older secondhand tonnage as 10-year average annual Suezmax asset prices were down 8% year-on-year (12-13).

Figure 2: Suezmax Price Changes
2008-Jan 2014

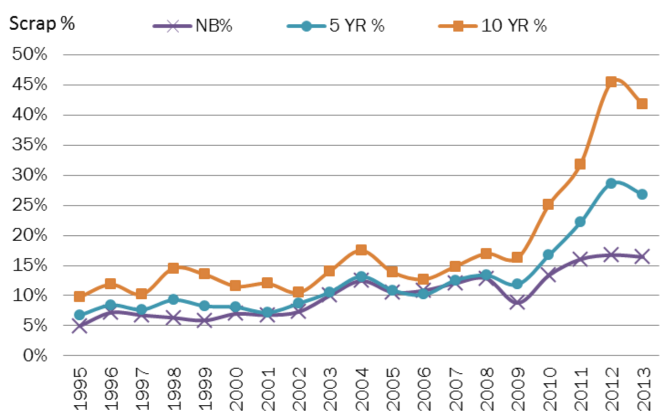


Source: McQuilling Services

Figure 2 illustrates the volatility in asset price changes for the Suezmax segment. Ten-year secondhand tonnage experienced the most negative volatility as compared with newbuilds and five-year old vessels. Terminal restrictions in West Africa, along with special survey costs, are the primary reasons for the poor performance. Older vessels will be more limited in their load and discharge options than their younger peers, decreasing the availability of demand for these vessels. Additionally, in a down market when newer tonnage is available at softer levels, potential buyers of older tonnage may be less willing to pay up for an older vessel due its second or third (and typically more expensive) special survey.

Average annual Aframax/LR2 prices remained flat year-on-year, recording a slight decrease of less than 1%, despite rate volatility throughout the year. Disruption in Libyan production pushed rates lower in the Mediterranean; however, a lack of available tonnage and weather disruption in the Carib/USG pushed rates significantly higher toward the end of the year. Similar to its peers, the Aframax class has seen scrap values, as a percentage of their market value, increase significantly over the last five-years.

Figure 3: Aframax Scrap Values as % of Market Values
1995-2013



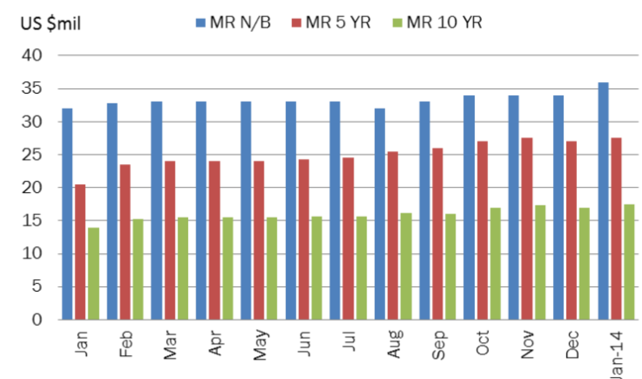
Source: McQuilling Services

The significant increase in percentage terms may be explained by higher steel prices, which have increased by approximately 25% over the last five-years due to improving demand, particularly from China. However, a movement towards historical trends would likely indicate a future increase in either asset prices, a decrease in the price of steel or some combination of the two. In the upcoming 2014-2018 Tanker Market Outlook, McQuilling incorporates steel prices in the model for asset price forecasting as we have established a very strong correlation using our proprietary quantitative analysis.

The Panamax/LR1 sector has shifted gears, with a focus on coated ships, as more than 80% of orders in the last five-years have been for LR1s. Our analysis shows LR1 fixtures for CPP cargoes out of the US Gulf almost doubled year-on-year, which enabled owners to benefit from economies of scale. Comparing current prices to 2013 average levels, we see positive growth of 7% highlighted by a 12% rise in 10-year secondhand tonnage. We examine the dynamics between ton-mile demand and the orderbook in our 2014-2018 Tanker Market Outlook. Our analysis indicates a dis-connect between current prices and market fundamentals.

Given the robust interest in the sector over the last two years, it should come as no surprise that the MR tanker class performed better than the rest of its peers, returning a 4% growth in average annual asset prices year-on-year. Looking at current prices compared to 2013 average levels, we see an increase of 10%. We have seen a massive move for MR tankers including a wave of public offerings and private equity investment into the space. Current newbuild prices are up 9% as compared to 2013 average levels.

Figure 4: MR Asset Prices
Jan 2013-Jan 2014



Source: McQuilling Services