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No. 2 – 2014 - 2018 Tanker Market Outlook

January 23, 2014

Macro Context

Throughout 2013, the global economy faced several challenges that exerted pressure on the recovery from 2009's financial crisis. These were the continuation of low GDP expansions throughout most countries in Europe, a US government shutdown, reduced activity in some emerging economies and geopolitical tensions, especially in the Middle East.

As we start 2014, signs of a recovery are starting to emerge. On the back of lower energy costs, the US economy is set to grow and unemployment levels have been falling. The International Monetary Fund forecasts a US GDP growth of 2.6% in 2014, up one percentage point from 2013. Although Europe continues to struggle, some key economies appear to have bottomed out, while periphery economies could start benefiting from the tough reforms that have been put into place in recent years.

Although growth levels will not be as robust as past years, emerging economies will expand by 5.1% this year. This will be led by China at 7.3% and followed by India at 5.1%. This foundation should help keep oil demand growth elevated with the IEA projecting an average annual increase of approximately 1.1 million b/d throughout the forecast period.

Tanker Profile

The imbalance of tanker supply in relation to ton-mile demand will have an impact on spot rates. While 2012 saw deliveries and deletions under/over our projections by 20%, history was unable to repeat itself. Although tanker deliveries from yards were less than expected in 2013, the same was true in regard to vessels being taken out of the trading fleet.

In parallel to this, new tanker contracting in 2013 rose to 392, which was the highest level since 2007. This was led by a wide margin for MR2 vessel orders (223 orders), which continues to cement our belief that clean tanker rates are in store for a supply driven contraction. This reality will gradually emerge as previous years' orders deliver from yards, especially in 2015 and 2016. Our concerns are also supported by our finding that the average age of the MR2 trading fleet, omitting IMO 1 and 2 classifications, is approximately 10 years old. As these new tankers are added to the trading fleet, rate pressure could be exerted across the spectrum.

New tanker contracting was relatively limited for the other tanker classes, although interest in VLCCs rose to the highest level since 2010. While this can be viewed in a somewhat bearish context, several of these orders appear questionable due the owners and yards associated with them.

Over the next 12 months, and throughout the forecast period, the pace of fleet trimming will play a vital role in fundamentals. This, in turn, will be driven by charterer vetting requirements, technical restrictions at major load/discharge ports and trading economics. For the larger tanker classes, owners could lay the foundation for a meaningful shift in market fundamentals by sending vessels over 15 years old to the breakers.

This abundance of tonnage is somewhat masked by the continued and wide spread utilization of slow steaming. The other factor exacerbating the oversupply of tonnage is owners' employment of voyage triangulation. This practice reduces the amount of vessels required to meet global demand as one vessel effectively moves two cargoes. We have provided two forecasts for triangulated routes in this year's report in order reflect the current operating environment.

Demand for floating storage should remain subdued as market participants appear fixated on developments in North America. Despite these headlines, an often overlooked fact is, that since 2005, global oil supplies have only increased by a net of 1 million b/d (JBC Energy). This sets the stage for the potential for a tighter supply situation.

Despite the current rally that is present in some tanker sectors, we believe that rates are likely to be pressured in 2014. This is primarily driven by limited demand growth and an abundance of supply.

Asset and Finance Markets

The European banking community will undergo asset quality reviews from regulators as part of the new Basel III guidelines that will come into effect in 2014. We remain cautious about traditional financing options that will be available to owners prior to this review. We have already witnessed the exit of major lenders from the industry while other players are reducing exposure and implementing more strict lending parameters. The increased capital ratio requirements that will need to be met by banks as part of Basel III may result in further asset sales including non-performing loans on vessels. In this regard, we have seen private equity investors return to the industry including OakTree Capital and Third Point. These companies have been active acquiring distressed loan portfolios.

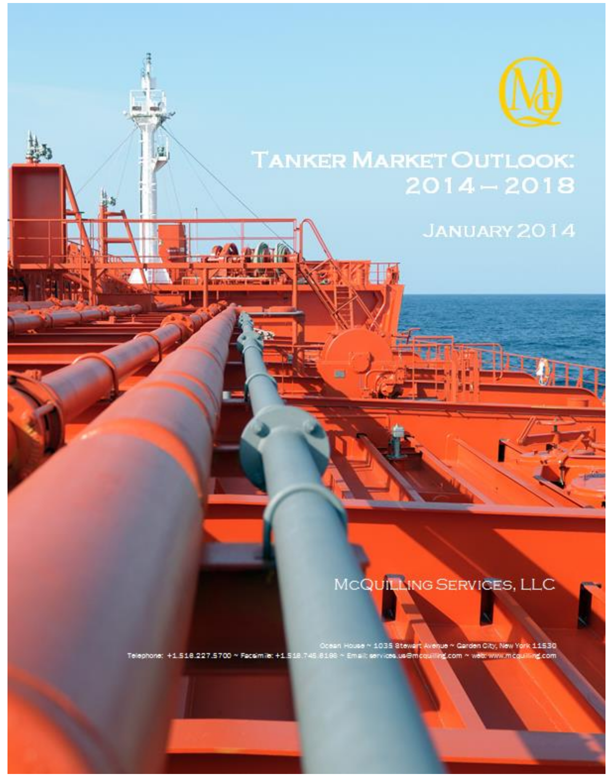
During 2013, asset prices appear to have reached an equilibrium. Newbuilding prices declined by 1.8%, while secondhand vessels remained flat. Investor interest returned to the industry with private equity contributing approximately US $4.7 billion in capital. An area of particular interest for investors remains in the MR2 product tanker segment which saw prices increase by 3.6% on average, with secondhand vessels appreciating by 5% year-on-year.

Asset Forecast

Utilizing an enhanced asset price forecasting model, combined with experiential adjustments, we project modest strength for VLCCs and a weaker asset value environment for the Suezmax and Aframax sectors. For the clean product tankers, we are less optimistic due to the current projection regarding an oversupply together with a strong MR2 delivery in the short-term.

Our investment analysis for the full range of tankers indicated that prices for vessels are overvalued, assuming a 10% discount rate. Additionally, at current prices, owners and investors would require significant increases in our forecasted TCE levels in order to break-even on an investment.

As we begin 2014 the tanker market appears to have the sentiment of the market in its favor. Several tanker classes are seeing robust earnings that have been driven by a host of factors from weather delays to vessel dislocation. Although this is a welcome development for owners that have recorded heavy losses in recent years, our analysis of market fundamentals lead us to believe that the rally will struggle to maintain its trajectory.



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