

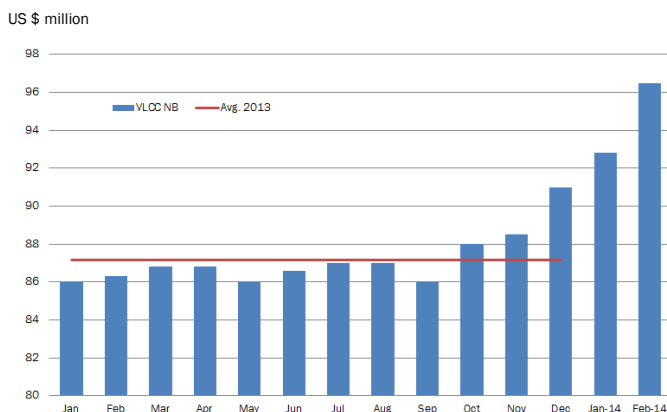


NO. 10 – ASSET CONTANGO? MARCH 5, 2014

In this note, we discuss observations of an asset contango market for VLCC assets. A contango market implies that prices of an asset will be higher in the future than today.

In the oil markets, a contango exists when future oil prices are expected to be higher than current prices. This event is typically illustrated through the futures market whereby prices for future delivery are more than the spot levels. In the VLCC asset market, we believe the recent rise of newbuilding prices compared to their five-year old peers may also be demonstrating a contango market.

Figure 1: Newbuilding Prices – VLCC

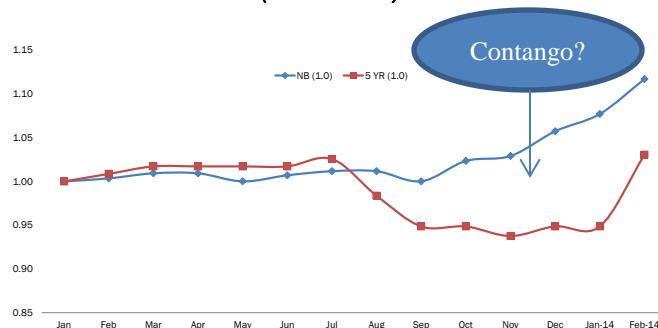


Source: McQuilling Services

Prices for VLCC newbuildings have been on an impressive upward swing the last few months after remaining relatively flat for most of 2013. The current price for a VLCC newbuild is approximately US \$97 million, a healthy US \$10 million more than the average price for 2013. At the same time, prices for five-year old vessels dipped during 2013 only to recover in the last couple months.

Newbuilding prices represent the futures market for asset buyers due to the required construction period, while five-year old asset values correspond with the spot market. In order to better understand the correlation, we display the asset price divergence by plotting the newbuilding and five-year value side-by-side with a starting base of 1.0 for each. By adjusting the base factor of 1.0 for the percentage increases/decreases on a monthly basis, we can clearly show the deviation that began in the summer of last year (Figure 2).

**Figure 2: 5-YR vs. N/B Asset Values
 Jan 2013 – Feb 2014 (1.0 – Base)**

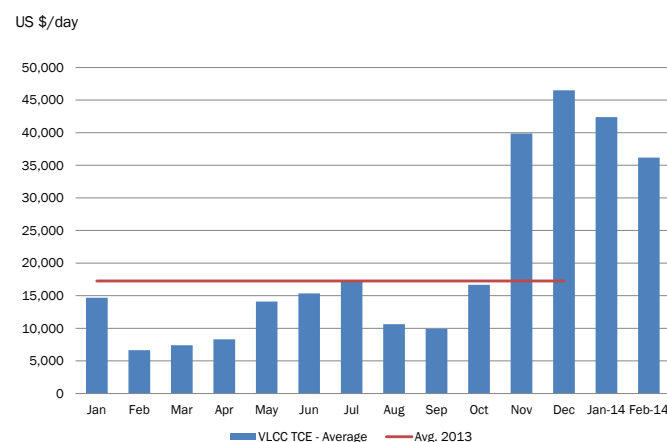


Source: McQuilling Services

While there may be several factors behind the uncoupling beginning in July, the implication is for improving crude transport markets in the long-run as compared to the short-term. Given the current deliveries scheduled for VLCCs this year (19) and in 2015 (32), we concur with this view, although rates have recently shown strength helping five-year old values accelerate in February of this year.

In Figure 3, we display the VLCC earnings during 2013 which may explain the weaker performance for five-year old vessel values for most of the year.

**Figure 3: TCE Earnings – VLCC
 Jan 2013 – Feb 2014 (US \$/day)**



Source: McQuilling Services

During the summer months, we witnessed a drop in TCE levels which was duly represented in the prices of five-year old vessels during the same period (Figure 2). However, sustained improvement in the TCE levels during the last

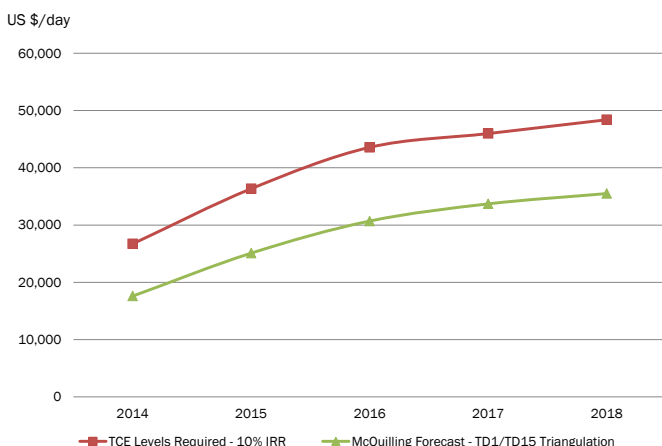


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four months provided initial support and a boost in values as displayed for February (Figure 2). Our outlook is consistent with the asset buying behavior just discussed, although in absolute terms, higher rates may be required.

In our recently published 2014-2018 Tanker Market Outlook, we used proprietary data to project the earnings for vessels across eight classes. While we expect earnings to be pressured this year, a gradual rebound should transpire.

**Figure 4: TCE Sensitivity – 10% Discount Rate
2014-2018**



Source: McQuilling Services

Using the current purchase price of a five-year old VLCC (US \$60 million) and our projected value for a ten-year old VLCC in 2018, we illustrate the required TCE rates for an owner to achieve a 10% IRR (Figure 4). If the market can sustain the momentum that began late last year, smiles may once again return to the faces of VLCC owners.

In conclusion, we highlight what may be an indication from the market that brighter days may be ahead for the crude tanker market, but probably not immediately. The recent contango development may be an early sign of an improving longer term trend. We remain cautious about the short-term fundamentals within the industry, particularly on the supply side, and continued ordering of new tonnage may reverse the sentiment at the back end of the forecast period.

2014-2018 TANKER MARKET OUTLOOK



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