McQuilling Services, LLC
Marine Transport Advisors

Tankers

Market Update: Best Case Scenario?

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Highlights from our Tanker Market Outlook Mid-Cycle Update

We've reset our assumptions for our Tanker Market Outlook for the rest of 2009 and the balance of the forecast period through 2013. As such, we have taken an unconventional approach by evaluating and presenting what we believe would be the "best case scenario" for spot freight rates going forward rather than a "reference" or mid-point scenario. Our update is based on an extremely aggressive set of assumptions regarding tonnage supply--namely a 31% reduction in previous orderbook estimates and a complete removal of single-hull tonnage from the trading fleet in 2010.

Frankly, we believe these assumptions to be somewhat unrealistic but we did this to investigate an upper-bound to spot freight rate levels over the next few years given the weak tanker demand environment going forward. The results are quite interesting in that even with this set of aggressive assumptions; the tanker markets remain feeble in the face of fundamental tonnage oversupply (Table 1).

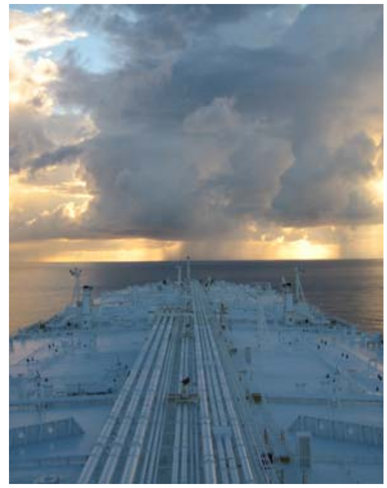
Table 1 – Average Projected TCE Revenues for Various Tanker Sectors *2010-2013, US$ Thousands*

VLCC TD1/3	Suez TD5	Afra TD9	Pana TD10	LR2 TC1	LR1 TC5	MR2 TC2/3	MR1 TC4
30.5	28.5	24.9	19.4	25.7	20.0	13.7	11.2

There is a building optimism that the global economy now seems to be beginning to emerge from the recession. The caveats are that it is not yet over and substantial risks to the downside continue to exist. Most anticipate a slower rather than faster recovery. The IMF expects a 1.4% contraction in global output in 2009 followed by a rebound in growth of 2.5% in 2010.

The IEA expects oil demand destruction of about 2.6 million barrels per day in 2009 from 2008 levels, followed by a recovery of 1.1 million barrels per day in 2010. Overall, world consumption is not expected to exceed 2008 levels again until 2012.

Spare supply capacity is substantial at the moment but it remains to be seen if the specter of constrained supply returns towards the back end of the forecast period as producers cut back on upstream investments and delay projects.



Overall dirty tanker demand was off 122 billion ton-miles or 1.3% through April of this year. The largest demand decline was measured in the VLCC sector where demand was off 110 billion ton-miles or 5.6%. Suezmax demand was down 4.5%. Numerous factors will limit growth in dirty tanker demand substantially during the remainder of the forecast period.

Results showed a slight increase of about 1.1% in total clean petroleum product volumes transported over the first four months of 2009 but total ton-miles increased 7% in this same timeframe, fueled by a significant shift in cargo volumes from regional trade to trades between regions.

Notwithstanding industry discussions regarding delivery delays, new additions to the trading fleet are roughly on track with expectations for 2009 year-to-date. On average deliveries are at 68%, slightly over our expectations for this point in the year (67%). Later in the forecast period the acute reduction in contracting new orders will likely reduce orderbook levels in the 2011-2013 timeframe.

While we had expected scrapping to accelerate in 2009, exits are curiously lagging behind expectations at 38% of planned removals for the year versus 67% expected.

Tonnage availability continues to be somewhat throttled by short-term supply factors such as floating storage although we accounted for this effect in our January assumptions for dirty tonnage. We missed the cues for CPP floating storage which we estimate has involved 20-30 LR1 and LR2 carriers as well as a few VLCCs.

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As of the writing of this note, tanker asset markets remain illiquid with scarce transaction volume and extremely limited financing supply. We believe this to be a short-lived phenomenon (1-2 years) but it weighs heavy as owners struggle to finance the orderbook of new construction. We believe the supply of funds will come from a variety of alternative sources, in addition to an increasing level of traditional bank financing over time. How the shipping finance industry re-forms itself through new debt products, ownership structures, operating agreements, collaborations and the like will be most interesting to observe.

On average the data seems to indicate that newbuilding prices have fallen about 16% or more across tanker sectors thus far in 2009 and second-hand values at least a quarter in value depending on the vessel's age.

Spot freight rate levels in the large tanker sectors have performed roughly as expected so far this year but levels are down drastically in the remaining clean and dirty sectors. In formulating the sector freight rate projections for 2009 we believe that the third and fourth quarters will remain depressed given the lack of dirty tanker demand and the overabundance of clean product tonnage, but that rates will recover somewhat from present lows.

This marketplace is affecting participants very differently with some quite able to sustain themselves for some time while others are moving closer to the precipice. As we stated in January, there will be numerous business opportunities that emerge during the course of 2009 as the less experienced, committed and able exit the sector.

McQuilling Services is pleased to announce the availability of our full 36-page "Mid-Cycle Update" to our 2009-2013 "Tanker Market Outlook." To join the industry as one of our Premium Service subscribers, please contact us for more details.

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