Baltic Tanker Investor Indices

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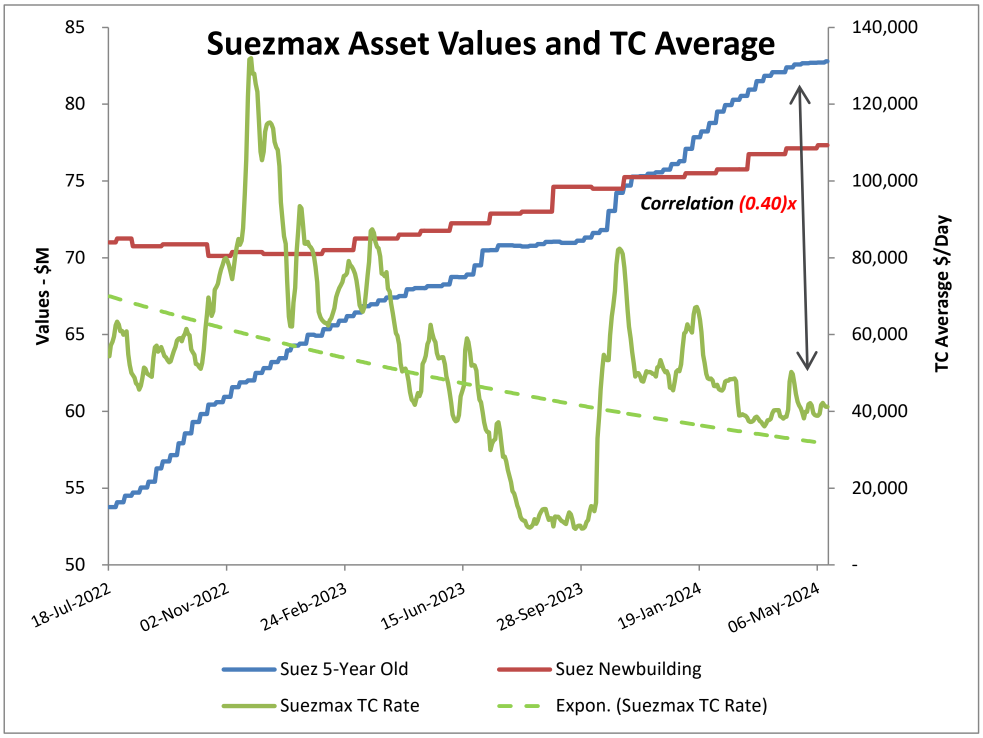
Déjà vu, all over again: More Suezmax newbuilding orders neigh

Famed New York Yankees manager Yogi Berra famously said, “Its déjà vu all over again.” In another one of his famous “Yogi’isms”, Berra also famously said, “When you come to a fork in the road, take it.” In that regard, tankers, specifically Suezmaxes, appear to be repeating history and the decisions are hard to commit to.

As most all know, shipping has historically suffered deep cyclicality often beginning and ending with extremely firm markets on either end of a very long trough. Tanker markets have been historically firm in recent years, coinciding with a historically low orderbook in 2022; a technological revolution regarding emissions, propulsion and propulsion options; and an ageing fleet with some of that fleet deployed in the “Dark Fleet” carrying sanctioned Russian and Iranian oil. Secondhand tanker asset values have inflated rather aggressively over the last two years, moving up at a faster rate than freight rates. In some cases, five-year-old vessels are markedly more expensive than a newbuild order. That is not a common condition. In our view, this market environment may lead to an over-ordering of tankers, something strong markets have spurred in the past. As ships are long-lived assets, long-term oversupply may become a reality again relatively soon. So is history repeating itself?

Five-year-old Suezmax values make newbuild prices attractive …

For crude tankers, the above conditions appear to be most pronounced in the Suezmax sector. The Baltic Exchange uses an average of the TD6 (Black Sea to Mediterranean) and TD20 (West Africa to Continent) for their weighted average Baltic Suezmax timecharter equivalent (TCE), which, while still at healthy levels today, on balance has decreased over the last two years. In addition, over the last two years, the Baltic Tanker Investor Indices five-year-old Suezmax values have increased markedly and the correlation between freight rates and five-year-old asset values is negative at -0.40x. Unusually, a five-year-old Suezmax tanker value today is 7.1% above the estimated newbuild order value - historically a five-year-old Suezmax is typically valued well below a newbuild order.



With the 10-year Baltic weighted average TCE at $27,747/day, on the surface, the newbuild appears the better option if one is willing to wait. With the Suezmax newbuild value at $77.3 million, we estimate that, once delivered in an assumed 2.5 years, the first-year cash breakeven daily TCE will be approximately $26,000/day, with at least positive cash flow against the average TCE achieved over the last 10 years.[1] To compare, today's five-year old Suezmax value is $82.8 million and we estimate that its first-year cash breakeven TCE is $30,200[2], with a negative cash flow to average 10 year TCE rates.

Importantly, when one considers book value – yes, depreciation impacts equity – in 2029 the now 10-year old secondhand Suezmax purchased in 2024 will have a book value of $57.8 million and annual depreciation of $5.0 million while the much more modern 2.5-year-old newbuild order will be on the books for $42.5 million with annual depreciation of $3.5 million, an annual difference of $1.5 million per year in, non-cash, net income in favor if the newbuild. It stands to reason that we believe many companies would like that net income.[3]

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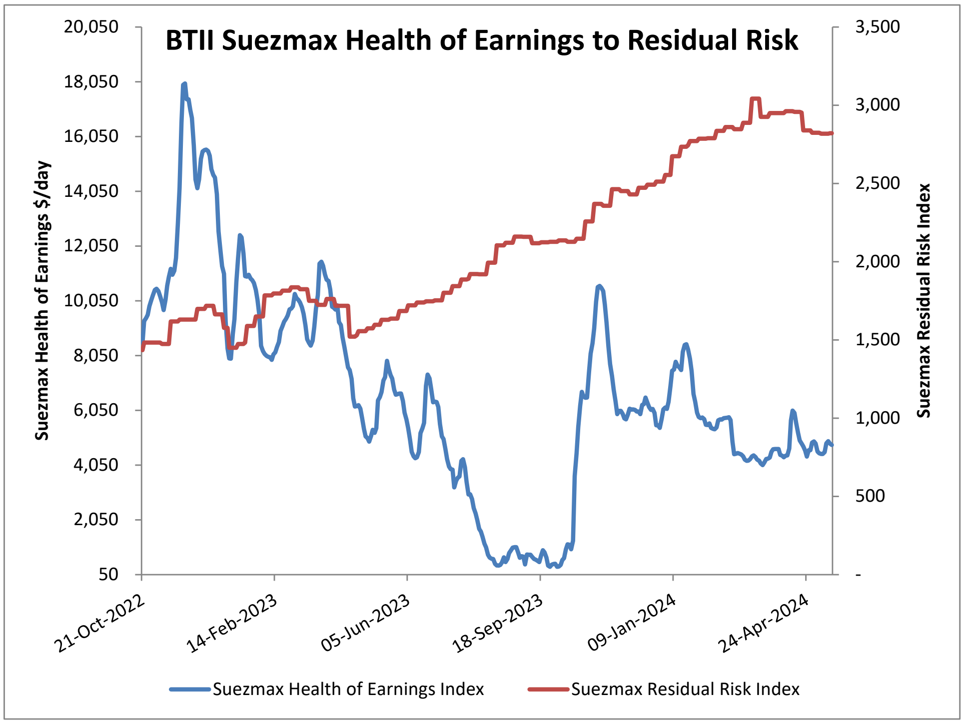
[1] Assumes purchase price of $77.3 million, levered at 65%, 20-year loan profile, 8.75% interest, OPEX and G&A of about $7,800 day.
[2] Assumes purchase price of $82.8 million, levered at 65%, 15-year loan profile, 8.75% interest, OPEX and G&A of about $7,800 day.
[3] Depreciation assumes acquisition value less 23,000 lightweight tons of steel at $350/ton with a 20 year usable life.



...but ordering a Suezmax newbuild is not that simple a decision.

Looking at the Suezmax fleet metrics, about 31% of the Suezmax tanker fleet is 15 years old or older while the orderbook is at 14% of the fleet capacity. Historically the Suezmax fleet orderbook has averaged about 20% of the fleet and the current orderbook only replaces about 46% of the ageing fleet. That being said, the 14% on order is far higher than the 28-year-low orderbook of about 2.5% seen in the summer of 2022.[4] In addition, newbuild ships should be more efficient and may have better optimized deadweight capacity. On top of that, a significant, though unknown precisely, number of the fleet over 15 years of age is in the "Dark Fleet", trading sanctioned Iranian and Russian Oil to China, further assisting, somewhat artificially, freight rates and asset values for modern ships.

A bird in hand is still a compelling argument. For the last two years the Baltic Suezmax weighted average TCE was $50,900/day and for the last three years it has averaged $37,900/day. These rates are well above the 10-year average of $27,800/day and well above our above noted cash breakeven for a five-year-old Suezmax of $30,200/day. Bulls will still consider that it will take time for newbuilds to deliver and begin to bring rates down consistently, as such the strong cashflows anticipated over the next 30 months will significantly de-lever the acquisition of a five year-old today.

Further to waiting the 30 months from order to delivery, newbuilding today means complex decisions regarding propulsion options. Dual-fuel options can be costly and not necessarily proven over the long term. Environmental and emissions restrictions may change and may be phased-in over the

[4] Clarksons

newbuilding period, not impacting today's fleet, but impacting something ordered today for delivery in 2026-27.

With a currently growing orderbook, current freight rates and technological decisions cloud a Suezmax newbuild decision that otherwise looks good on paper. Despite these factors, the Suezmax newbuild order remains attractive and the orderbook will likely continue to grow, with history possibly repeating itself.