

Baltic Tankers Investor Indices

Author: Urs Dür, Zuoz Industrial LLC on behalf of The Baltic Exchange

Are tankers asset values justified? Not necessarily.

The Baltic Tanker Investor Indices (BTII) offer insights into the recent past and provide a snapshot of today's tanker markets (VLCC, Suezmax, Aframax and MR product tankers). Tanker asset values are currently very firm as, rather simply, the demand growth outlook has been exceeding the supply growth outlook. That said, the Baltic Tanker Health of Earnings Index (HEI) indicates that there should be some near-term pressure on asset values.

It's always about supply and demand

Crude and product tanker demand, according to Clarksons, was firm over 2023 with an estimated 3.2% demand growth and 7% tone-mile demand growth. The outlook for 2024 remains firm with an anticipated 3.4% demand growth and 4.4% tonne-mile demand growth¹.

Supply outlook dynamics are bullish for freight rates as well. Fleet growth was muted over 2023 and the orderbook remains historically low, at 6% of the fleet. While there has been more ordering over the second half of 2023, newbuilding prices are increasing with greater propulsion technology uncertainty, especially when one considers the 24-36 month lead time from order to actual delivery.

Furthermore, rather different from decades past, environmental regulations may constrict the speed, and thus supply, of older vessels in order to meet emissions requirements. Given that 33% of the crude tanker fleet and 34% of the product tanker fleet is over 15 years of age, we anticipate environmental requirements will further constrict supply in the coming years and be supportive of freight rates.

Finally, there is a (rather bad) wild card. The war in Ukraine has expanded tonne-mile demand for modern 'first-world' tankers. However, there is a nefarious element driving supply and demand dynamics, known as the 'Shadow Fleet'. This 'Dark Fleet' has expanded rapidly to skirt the Russian oil price cap (as a result of Russia's conflict with Ukraine) and is estimated to be hundreds of tankers in size. Indeed, in some size categories over 10% of the fleet is in the Shadow Fleet². The Shadow Fleet is believed to largely consist of older (15 years of age plus) Suezmax, Aframax, LR1 and MR2 tankers. Should the price cap on Russian oil become seriously enforced at some point, the size of the Shadow Fleet will be impacted and may change the supply dynamics in the near term.

¹ Clarksons Oil Tanker Trades and Outlook November 2023

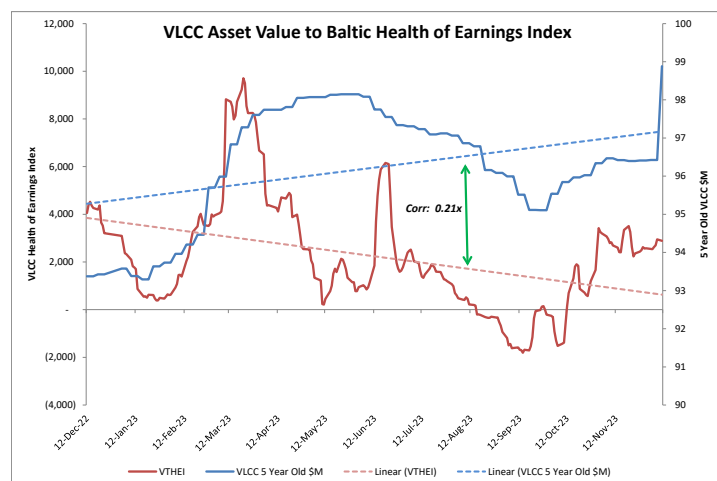
² Bloomberg, "Russia's Shadow Fleet", December 5th 2023

Health of earnings and asset values; opposite directions over the last 12 months

The Baltic Exchange publishes its Investor Indices to give a high-level view of historical data for decision makers' investment decisions. While the indices are not predictive, they offer trend insights.

In this edition, we compare tanker five-year-old asset values over the last 12 months in relationship to the Baltic Tanker Health of Earnings Indices (HEI). The HEI show the ratio of earnings against operating costs, with a negative number indicating that earnings are below operating costs. Notably, over the last 12 months in the four tanker classes covered by the Baltic Investor Indices (VLCC, Suezmax, Aframax and MR product tankers), asset values have been trending higher, while the health of earnings have trended lower.

VLCC HEI to asset values, trailing 12 months



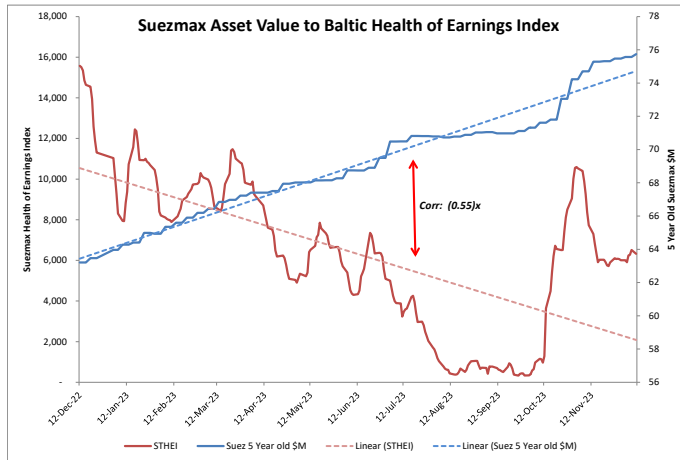
VLCC earnings have been rather volatile over the past 12 months, while asset values have trended higher with a pause during the autumn of 2023. There has been only a slight correlation between VLCC HEI and asset values at 0.21x.

In our view, VLCC asset values have stayed firm due to the sector's modest orderbook, that newer ships are being favored over 15-year-old-plus vessels and a firm demand outlook.

That said, over the trailing 12 months, VLCC spot earnings averaged \$23,400/day, which is well below the cash breakeven of a five-year-old VLCC of an estimated \$32,800/day³. The last year was not simple for a potential VLCC investor.

³ VLCC average 5 year old 2023 average price of \$96.2M, levered at 65%, 17 year profile, interest of 8.75%, OPEX of \$7,407/day and G&A of \$750/day is a cash breakeven of ~\$32,800/day

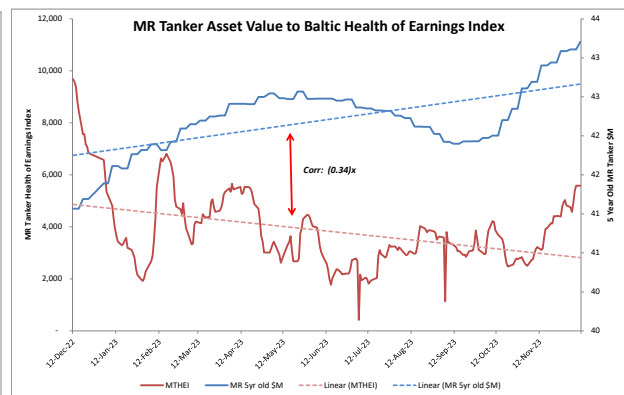
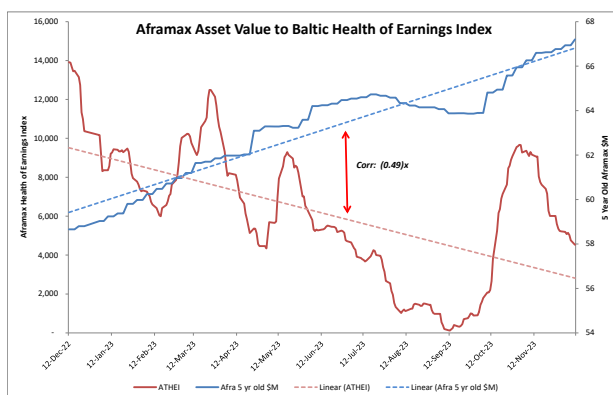
Suezmax HEI to asset values, trailing 12 months



Suezmax spot earnings have been historically firm for much of the year, averaging \$50,565/year. However, health of earnings has been softening: Suezmax spot rates averaged \$68,800/day from December 2022 to June 2023 but have only averaged only \$36,300/day over the last six months.

However, Suezmax asset values have only firmed over the last twelve months with a slight pause in the autumn of 2023. Similar factors apply to Suezmax values as to VLCC values above. Suezmax earnings and the impact of Shadow Fleet demand has also support asset values. However, the trendlines have been negatively correlated and that indicates some pressure on asset values at this time in our view.

Aframax and MR tankers also with negative HEI to asset values



Despite substantial bullish factors, some tanker asset value caution may be warranted

One year does not necessarily dictate a long-term trend. As we often note, shipping generally is deeply cyclical with often extreme volatility within the cycle. However, if asset values continue to trend upward, they will reach a level where the cash breakeven per vessel is not justified by the freight rates. This has occurred in the dry bulk sector recently and has made investment decisions in that sector rather challenging.

There are fundamental reasons to be bullish on tanker freight rates and asset values from strong demand to limited supply growth to expanding tonne-mile growth to restrictive emissions standards. However, with concerns that there may be a recession in the West in 2024, China facing real economic pressures that are not simple to resolve, the geo-political tension in the world remaining is very high with significant wars being waged and the Shadow Fleet offering a wild card, we believe some caution is warranted regarding tanker asset values, at least for the near term, with freight rates being softer in recent months.