Baltic Tanker Investor Indices

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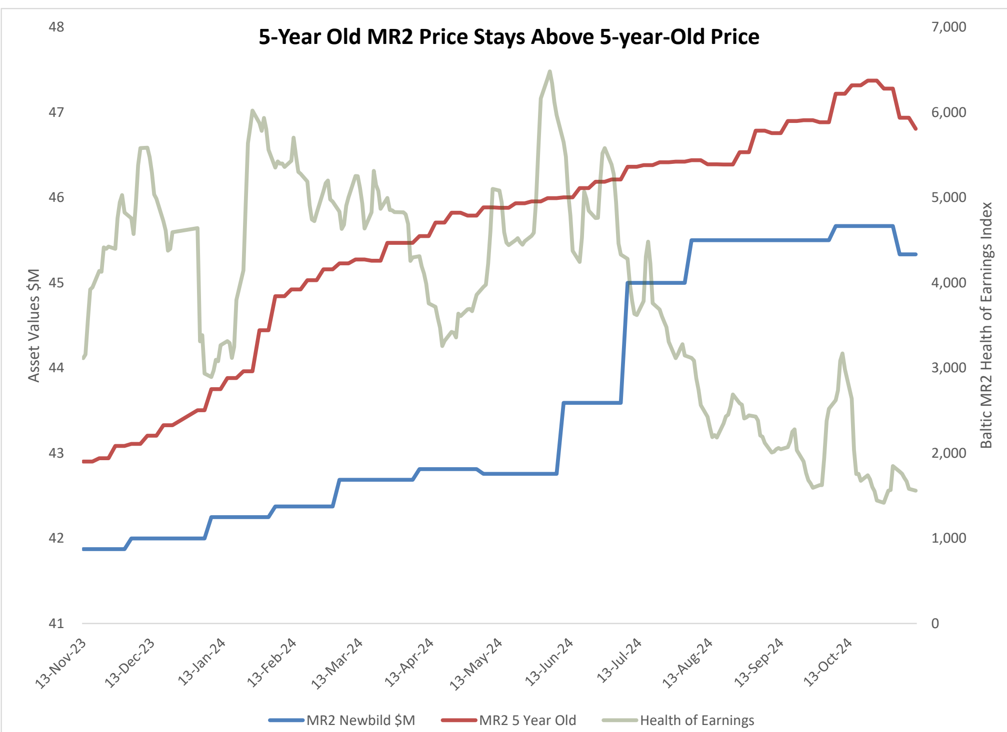
Product Tankers: A Bird in Hand Has Value…with Variables

We believe the product tanker market will stay relatively firm for some time, but there appears to be some downward pressure on asset values. The MR market has been strong over the last few years as demand has been exceeding supply, although this appears to be changing. In addition, market strength has been supported by tonne-mile expansion due to disruptions in the Red Sea and the dynamics surrounding Russian exports. Finally, the change in the US Administration, its relationship with energy production, and its relationship with China offer wide-ranging variables.

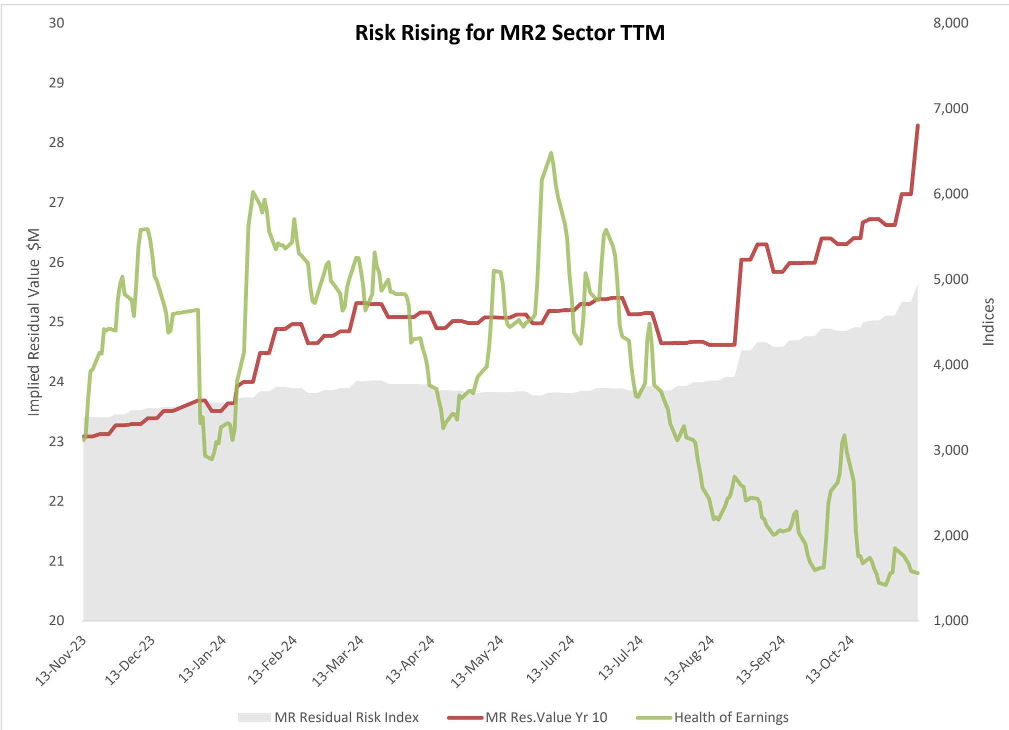
Investors appear to anticipate that the near-term MR2 market over next few years should remain strong. This is evidenced by the relationship of MR2 newbuild prices to five-year-old MR2 prices. While the Baltic Health of Earnings Index[1] is strong, investors would rather pay for a ship today ("a bird in hand") rather than pay for a newbuilding and have to wait, facing many uncertainties.



[1] The Baltic Exchange publishes the Baltic Health of Earnings index on every trading day for each major cargo vessel type. It shows the ratio of earnings against cost with a negative number indicating that earnings are below operating costs. The Health of Earnings Index is highly correlated to freight rates, however takes in to account increases in OPEX over time.

MRs: What We Think We Understand About Supply and Demand

On the strength of product tanker markets and values, more ship ordering has occurred. From a historically modest orderbook seen in 2021, the orderbook has grown substantially. Some may argue that the orderbook of today appears to be close to historical averages, however deliveries are expected to exceed global demand growth over 2025-26. This should put some pressure on freight rates and increase risk to today's values. As shown below, this relationship may have already begun to manifest itself. The Baltic MR Residual Value Index[2], which measures the implied residual value of a 10-year-old MR after a five-year charter, has been rising, but the implied five-year time charter freight rates have been softening. As a result, the Baltic Residual Risk Index[3] has also been rising.



On the demand side, there are tangible demand factors that are supportive of tonne-mile demand expansion, but those factors could conceivably dissipate in the coming years. The incoming Trump Administration is anticipated to be very tough on Iran, which might alleviate the violence in the Red Sea, opening the region to more seaborne traffic and, in-turn, softening tonne-mile demand growth. It is also possible that the war in Ukraine comes to some solution in the coming years, with one of

[2] Baltic MR Residual Value Index: The residual value is calculated by taking the written down cost of a 5-year-old vessel and deducting the net earnings from a five-year timecharter. The net earnings are calculated by taking the earnings from a five-year timecharter with 5% brokerage commission paid and deducting the operating costs over the 5-year period adjusted for 5% inflation year on year. A year of earnings is assumed to be 360 days whereas a year of operating costs is assumed to be a full calendar year (365 days).
[3] Baltic MR Residual Risk Index: Residual risk is the ratio of the residual value of the MR Product Carrier against the recycling value. If the residual value is lower than the recycling value the index will be negative, indicating a lower risk of the investment.

the elements to broker peace being the slow lifting of restrictions on Russian petroleum exports, releasing some of the shadow fleet and softening the market.

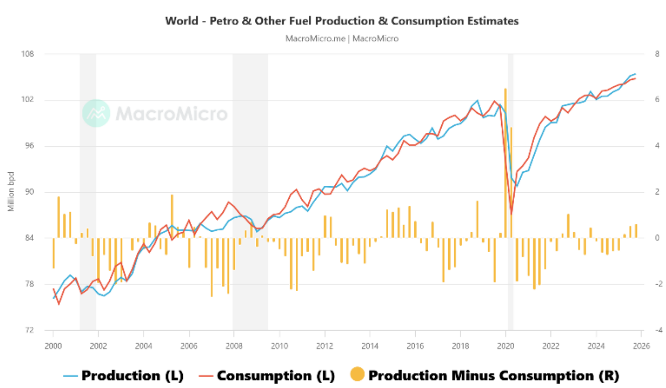
Then there are product demand factors that have yet to evolve. Firstly, we expect that Chinese stimulus will be substantially influenced by its trade relationship with the US and China's imports of relatively cheap Iranian crude oil could be curtailed as the Trump Administration appears poised to be very tough on Iran and China.

Secondly, President-elect Trump has repeatedly stated the best way to combat US inflation is to bring the cost of energy down and one can expect that US domestic oil production may grow substantially over the next four years, possibly impacting tanker trade patterns. In addition to completing the Keystone Pipeline that was halted by the Biden Administration, we would not be surprised to see the Trump Administration investing in - and quite possibly be supportive of expanding - the ageing US refining infrastructure.

Freight Rates Have Justified Values

Over the last 12 months, spot MR freight rates have averaged about $32,150/day and the implied Baltic MR five-year time charter averaged about $19,800/day. If one were to purchase a five-year-old MR today, we estimate the cash breakeven would be about $18,400/day.[4] The spot rates of the last year more clearly justify today's asset values, but even the five-year time charter (which admittedly are far and few between) rate makes sense from a cash perspective. Despite the above noted supply/demand pressures and uncertainties, investors see the cash results of today.

Refined product demand growth is still expected to be firm in the coming years and it takes time for newbuilds to come online. There will be seasonal factors that support demand and some of the variable demand factors may become enhanced in the coming years while others may dissipate. In the end, we expect the value of a modern MR on the water will exceed the value of a newbuild order over the coming quarters.



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[4] Cash breakeven is computed as OPEX, plus G&A expense, debt amortization, interest and fees. On a five-year-old MR we assume 65% leverage with a 17-year profile, SOFR of 4.60% Margin of 3%. Increasing asset values offset by a declining SOFR has led to the 15% increase in cash breakevens

[5] USEIA and MacroMicro