



POTEN TANKER OPINION

Retirement Planning

Can scrapping compensate for fleet growth?

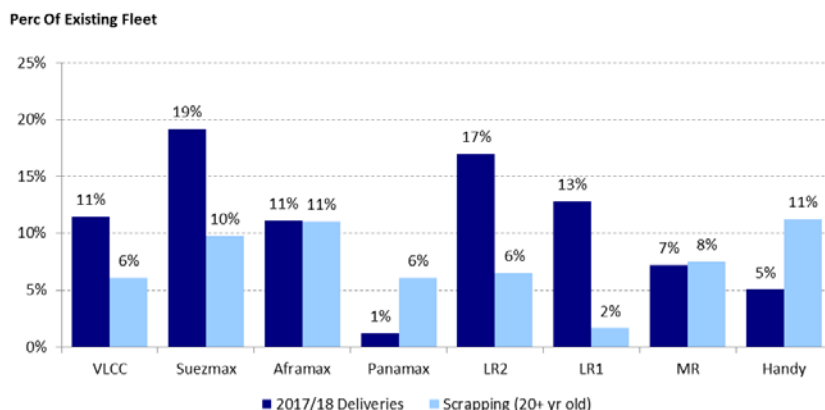
The age profile of the tanker fleet gives owners reason for concern. The orderbook for delivery in 2017 and 2018 ranges from a modest 5% of the existing fleet for Handy's to a whopping 19% for Suezmaxes. However, tanker markets do have a built-in balancing mechanism: scrapping. If the overcapacity in the market gets too high, rates will fall and scrapping will pick up to (eventually) bring the market back into balance (together with demand growth, off course). Given the orderbook, the consensus view of analysts is that the tanker market will experience ample supply growth in the coming years while the forecasts for tanker demand growth are rather subdued. Against this backdrop, what is the potential for a pickup in tanker demolition? Let's take a look at the pool of available candidates and their current employment.

First of all, what is the number of vessels which could be considered scrapping candidates in each of the segments? In recent years, tanker sales for scrap have been few and far between and the average age of tankers that are sold for demolition is well above 20 years. The most recent tanker that was sent to the breakers (in October), the VLCC MT Progress, was built in 1994. Before that, - in September - the 45,000 dwt MR product carrier MT Zeta was sold to buyers in Pakistan. This vessel was 28 years old (built in 1988).

For the purpose of this analysis, we will look at how many vessels would be scrapped over the next two years (through the end of 2018) if we used a fixed scrapping age of 20 years and how these numbers compare with the current orderbook for delivery in the same period. Figure 1 shows that – for most segments – the orderbook well exceeds scrapping under this scenario. The segments that appear the most worrisome are the VLCCs and Suezmaxes. Even under this relatively aggressive scrapping scenario (most tankers trade well beyond 20 years old), the scheduled deliveries in these segments are almost double the demolition numbers. The numbers for the large product tankers (LR1 and LR2) don't look encouraging either, but here we have to note that we need to review these segments in combination with their sister vessels in the crude trade (Aframax and Panamax). The Aframax crude tanker fleet will likely stop growing in the next few years, while the “dirty” Panamax segment is already shrinking as owners opt to build coated vessels to give themselves more trading flexibility and take advantage of the growth in long haul product movements.

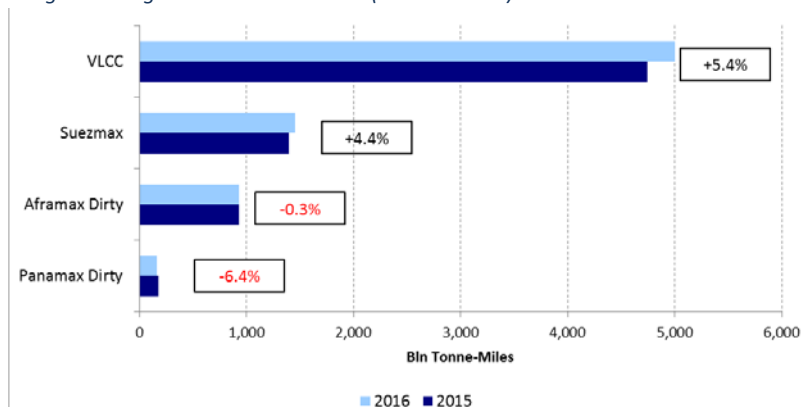
For MR and Handysize product tankers, the numbers look more encouraging, although it should be noted that a 20 year scrapping age is quite optimistic for these vessels. Smaller

Fig. 1: Deliveries vs Scrapping Potential



Source: Poten & Partners

Fig. 2: Change in Ton Mile Demand (2015 to 2016)



Source: Lloyds List Intelligence

product carriers typically trade well beyond 25 years of age.

How about the employment patterns of the older tonnage? Many of the older vessels are underutilized, have trading restrictions and/or are being used for floating storage. A freshly delivered newbuilding will be significantly more productive than the old vessel it replaces.

There is also demand growth that we need to consider. While we don't know what tanker demand growth will be in 2017 and 2018, we can take a look at developments in 2016 to date as an indication. Our analysis of the crude oil and dirty product trade shows ton mile demand growth of 4.2% year to date, a number that (if continued) will help defray the impact of the significant fleet growth. While we don't have the same data for the growth in all product sectors, expansion in ton mile demand for the LR1 and LR2 product carriers has been around 1.5-2% so far this year, well below the expected fleet expansion. The outlook for MR and Handysize product tankers appears brighter. The limited fleet growth in these segments will sow the seeds of a recovery in the coming years.

So, the expected fleet growth may not be as disastrous for the market as it appears at first glance, if we continue to experience healthy growth in tanker ton mile demand, and if scrapping will pick up in the next few years. These are obviously 'Big Ifs'. We will continue to follow the market closely to see whether these conditions are met. Stay tuned.