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## MARKET FOCUS

## VLCC fleet count may fall in 2008

The big-tanker market is being pulled in 'opposite directions'.

Geoff Garfield

London

The VLCC fleet may end 2008 with fewer vessels than it started with, as the sector enters a period that could see big swings in owners' fortunes.

German-Dutch transport bank DVB says the market is being pulled in opposite directions by potentially large numbers of ships being converted into bulkers and the huge volume of newbuildings for delivery.

A trawl through sale-and-purchase (S&P) reports, class records, company statements and tanker-tracking systems has identified 24 VLCCs that were removed from the market in 2007 and up to 51 that might exit in 2008 for conversion.

With 47 newbuildings stemmed for delivery in 2008, the VLCC fleet may finish this year with a lesser tally, says DVB's Research & Strategic Planning Division. A shortage of VLCCs in 2008 may develop, it adds.

"The emergence of the conversion alternative has brought about the potential for considerable changes to industry fundamentals," said the bank in its latest VLCC Market Outlook.

Coinciding with DVB's report, Cosco Shipyard Group confirmed 18 conversion contracts worth \$250m, including that of 15 single-hull tankers into ore carriers/bulkers for completion in 2008.

Until now, hectic tanker ordering during the past two to three years had raised expectations of fleet growth outpacing demand.

In fact, the fleet will expand by 0.5% in dwt terms even if all single-hull conversion candidates leave. But this still lags far behind demand growth, expected at between 2% and 2.5%.

DVB is careful, however, to highlight the fact that if owners of these older tankers get "cold feet" and cancel or postpone their plans because the dry-bulk markets fail to recover from the recent big falls, many VLCCs, acquired at high prices, are likely to continue trading wet.

The bank describes the VLCC



DVB: Reporting on the VLCC market

Photo: Dr Peters

market as having finished 2007 with a "bang", only to see freight rates lose more than 60% in the first three weeks of 2008.

It says financial turmoil and pricing structures in oil futures suggest the sector will continue to soften through the first quarter of 2008. Later in the year, low crude-oil inventories and increasing Opec production might spur higher demand.

DVB adds that the connection between pricing structures in the futures market and VLCC freight rates was prevalent last year.

Look further back and tanker earnings have been driven during the past three years, at least in part, by oil prices trading in "contango", where the spot price is lower than that for futures contracts.

It encourages stock building by refineries, while traders see an opportunity to speculate on near-term price rises.

The opposite situation — "backwardation" — means the price for oil is higher in the spot market than for future delivery. It encourages refineries to draw on storage, limiting demand for tankers.

Last July, the oil price moved into backwardation and as the spread between spot and futures kept increasing, freight rates fell to their lowest levels since August 2003. In December, however, Saudi Arabia offered bigger discounts to US customers for immediate delivery and the oil spread dropped to nearly zero and "VLCC freight rates ricocheted from their lows", says DVB.

Since then, the oil price has moved deeper into backwardation again, forcing VLCC freight rates lower for the first quarter of 2008.

Meanwhile, the bank comments on the build-up of available tonnage with, on 18 January, more than 100 VLCCs expected in the Middle East Gulf over the following four-week period.

Paris-based broker Barry Rogliano Salles says in its latest Tanker Newsletter, published after DVB's report, that the 30-day ship-availability index stands at 121. It describes it as "bitter pill for owners to swallow".

With the oil price in backwardation, there is little incentive for stock building, says DVB. Similarly, refineries in China, where retail prices are controlled by the government, are reluctant to import expensive crude and sustain losses.

Looking further ahead, the bank says that in contrast to a potential tonnage shortfall caused

**Barry Rogliano Salles: The broker says the 30-day ship-availability index stands at 121 — which it describes it as "bitter pill for owners to swallow".**

by conversions in 2008, a record 58 VLCC newbuildings will be delivered in 2009 but only an estimated eight will be removed from the fleet. Fleet growth in dwt terms will be nearly 11%, exerting downward pressure on freight rates.

A "second wave of deliveries will hit the markets in 2010", when another 50 new VLCCs are

expected to come into service.

On the positive side, the market could regain balance if all non-double-hull vessels are removed from the oil trade in 2010 under the phase-out schedule. DVB assumes 74 single-hull VLCCs will still be in the fleet at the beginning of 2010.

If it happens, the fleet will reduce 3.2% from 533 to 509 vessels. Assuming 2% annual growth in VLCC demand, the build-up of surplus tonnage in 2009 could quickly be absorbed, says DVB.

Although the bank is sceptical about all remaining non-double-hull ships being pulled from the market in 2010, it says the *Hebei Spirit* accident in South Korea has raised the chances of accelerated removal.

The recent French court ruling on the *Erika* accident in 1999 has also "opened the possibility for local interests to sue charterers for economic and environmental damage following an oil spill, adding to the odds that are stacking up against continued use of SH tankers".

DVB, which uses both its own and other data from various sources, calculates a VLCC fleet growth of 2.8% in 2010.

Conditions will slowly improve as the record deliveries of 2009 and 2010 are absorbed by the market, it says. Only 29 new VLCCs were ordered in 2007 and owners, because of higher borrowing costs, might in future focus on financing the existing orderbook rather than contracting new vessels or declaring options.

Revolt



Bjørn Aar Grødem, Administration Coordinator

Some years are more iconic than others, and 1968 was one of them.

- Racial riots in Washington, student revolts in France, the assassination of Robert F. Kennedy, Bob Beamon's legendary long jump at the Summer Olympics in Mexico City, the Cold War, Flower Power. What a year?

- It was an interesting year - for better or worse, but at the time we did not give much thought to what was happening in the world around us. I was mainly occupied with my new career in shipping that year.

The first reports of oil on the Norwegian shelf came on 9 October 1968, and that changed the entire business.

- Everything has changed. We, for instance, purchased an enormous electronic calculator for the office. It cost the tremendous amount of NOK 18,000 and could only do elementary arithmetic, but at the time it was a revolution.

Many other changes have come about over the past 40 years?

- You can say that again. Today, everything is done on computers, e-mail keeps us in touch with the world, we carry the phones in our pockets, and banks hand out calculators for free. All this is fine, of course, but none of it will change the fact that it's all about people.



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