SHIPPING MARKET REVIEW

OCTOBER 2012

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EXECUTIVE SUMMARY

THIS REPORT REVIEWS KEY DEVELOPMENTS IN SHIPPING MARKETS AND THE MAIN SHIPPING SEGMENTS DURING THE PERIOD FROM JANUARY 2012 TO SEPTEMBER 2012 AND INDICATES POSSIBLE FUTURE MARKET DIRECTIONS.

SHIPBUILDING

Shipyards' order cover continues to decline as more tonnage is being delivered than contracted. In 2012, the global order cover fell by 20% to 19 months. Only 30% of global yard capacity has been in demand during 2012 as 13 million cgt was contracted. Capacity has started to adjust. We estimate that 4% of the global yard capacity will close or at least become inactive in 2012. The remaining yards delivered on average 75% of the orders as scheduled during the period. While large yards delivered 96% of their orders, small and medium-sized yards struggled to meet their delivery schedules. In 2013 and 2014, many yards will be running out of orders. Small and medium-sized Chinese yards appear to be at the epicenter of the capacity adjustment process. We estimate that global yard capacity, by the end of 2014, could be back at the 2008-level. The impact on newbuilding prices could be profound. If capacity rather than marginal construction costs is to determine newbuilding prices, a return to the 2002-lows is a possibility. However, we argue that the marginal construction costs will represent a price floor above the 2002-low.

CONTAINER

Despite an oversupplied container market and weak fundamentals, box rates soared to a new all-time high in 2012. Market discipline, as well as low utilisation rates and slow steaming, have supported rates. Contracting activity suffered a severe slowdown during the first eight months of 2012. Low timecharter rates and a large excess yard capacity drove asset values downwards. Supply growth is expected to outpace demand growth in 2013. The outlook for the euro area remains uncertain and US economic growth remains weak. Market discipline as well as slow steaming combined with low utilisation rates are expected to continue to support box rates. The current market discipline may be tested over the coming years as oversupply continues to grow.

CRUDE TANKERS

A large and growing oversupply of tonnage continues to weigh down the crude tanker market. In August 2012, the Baltic Dirty Tanker Index dropped to levels not seen since the peak of the financial crisis. Newbuilding and secondhand prices declined accordingly. With freight rates in the doldrums, owners have kept contracting for new vessels to a minimum. The outlook for 2013 is dominated by the challenge of absorbing both the previous overhang of tonnage and another large inflow of vessels. The demand outlook is characterized by weak fundamentals combined with the increasing US crude oil production. The outlook remains negative. Accordingly, freight rates and asset values are expected to remain low in 2013.

PRODUCT TANKERS

The Baltic Clean Tanker Index descended deeper in 2012 as both weak fundamentals and an overhang of supply from previous years challenged the product tanker market. Newbuilding and secondhand prices remained subdued. Despite weak market conditions, some shipowners' regained their appetite for new vessels in 2012 in hope of an early recovery and the efficiency of more ECO-friendly ship designs. Economic fundamentals are projected to remain weak in 2013 and perhaps also in 2014. Distance-adjusted demand is expected to grow by 4% in 2013. Even though fleet growth is expected to be modest, the outlook for product tankers remains weak – at least until fundamentals improve.

CHEMICAL TANKERS

The chemical tanker market lost momentum in 2012 as demand failed to outpace supply growth. Demand growth was largely driven by Asian demand which is projected to increase

by 7% in 2012. With depressed freight markets, shipowners' appetite for new vessels seems to have evaporated. With few contracts and sales, asset values remained unchanged in 2012. In 2013, the gap between supply and demand is expected to narrow. Distance-adjusted demand is projected to grow by 4% in 2013, and the fleet is set to grow by another 2% as deliveries are set to level off. The narrowing of the gap between supply and demand might support rates and values in the short and medium term.

LPG TANKERS

The average Baltic LPG index reached a new all-time high in 2012 as Middle East exports and strong Asian demand supported the LPG market. Furthermore, lower commodity prices prompted many importers to stockpile, further supporting the LPG market. Firm market conditions have restored shipowners' appetite for new vessels. New LPG orders already amount to twice last year's orders. Accordingly, newbuilding and secondhand prices went slightly up. The outlook for LPG tankers is promising. Distance-adjusted demand is expected to exceed supply growth. As a result, rates are expected to remain firm in the short to medium term.

DRY BULK

The Baltic Dry Index descended deeper in 2012 as a large oversupply of vessels kept pulling rates downwards and in many cases vessels are currently operating below OPEX. Despite the large overcapacity in the dry bulk segment, the fleet is set to grow by another 13% in 2012 as deliveries are set to come out at a new record-high. Although scrapping activity continues at a very high level, it will not be enough to turn rates in the near future. Distance-adjusted demand is projected to grow by 6% in 2012. In 2013 and 2014, seaborne dry bulk demand is also expected to continue to show relatively strong growth. Even though scrapping is expected to continue at a high level in 2013 and contracting activity has been relatively modest recently, the outlook for the dry bulk market remains negative – at least for 2013 and probably well into 2014, especially for large vessels.

Accordingly, several ship segments are facing low freight rates, declining asset values and a short- to medium-term outlook where the risk of escalating overcapacity cannot be neglected. However, lessons from previous shipping cycles are that occasional spikes in freight rates do occur even in downward tending markets.

GENERAL REVIEW AND OUTLOOK

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GENERAL REVIEW AND OUTLOOK

THE WORLD FLEET HAS EXPANDED BY 36% FROM 2008 TO 2012, WHILE WORLD TRADE VOLUMES HAVE GROWN BY 9%. WHILE SUPPORTING GROWTH IN DEMAND, TRAVEL DISTANCES HAVE RECENTLY BEGUN TO SHORTEN.

WORLD DEMAND INDICATORS

GLOBAL DEMAND GROWTH HAS SLOWED, WITH ACTIVITY IN THE EURO AREA BEING PARTICULARLY WEAK. THE CHINESE ECONOMY IS SPUTTERING AS NEW GROWTH ENGINES ARE BEING INTRODUCED. WORLD TRADE VOLUMES HAVE INCREASED BY 2.5% DURING 2012.

WORLD TRADE VOLUMES INCREASING BY 2.5% IN 2012

World trade volumes have increased by 2% during the first eight months of 2012. According to the WTO, world trade volumes are expected to expand by 2.5% in 2012 (fig. 1). Such weak growth in world trade volumes was last seen in the aftermath of the 2008 credit crisis and in 2002 after the dot-com bubble. By comparison, the world fleet is expected to expand by 9% in 2012.

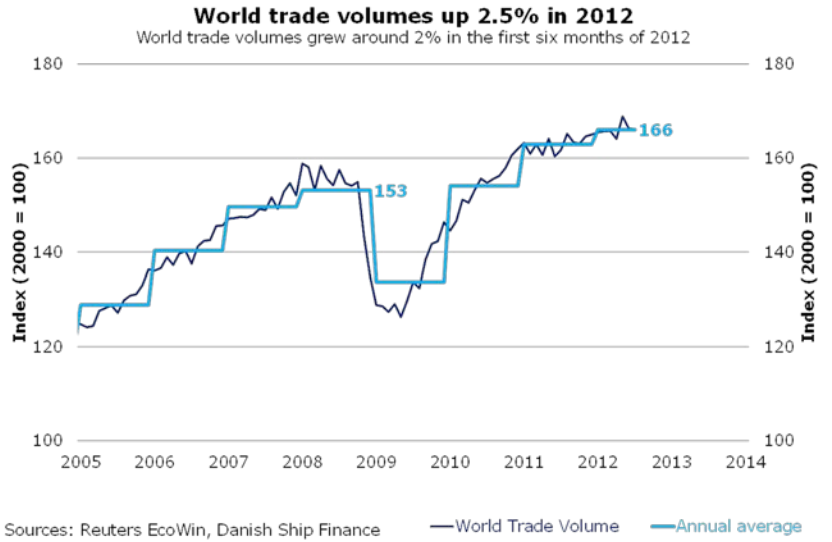
INDUSTRIAL PRODUCTION GOES LOCAL

World industrial production increased by 2% during the first eight months of 2012. While the industrial production in the advanced economies remained flat, emerging and developing economies, by contrast, advanced 4%. This development was primarily driven from Asia in general and China in particular. Industrial production in Latin America contracted 1% over the period (fig. 2).

CHINA DRIVING GLOBAL GROWTH BUT IS DECELERATING

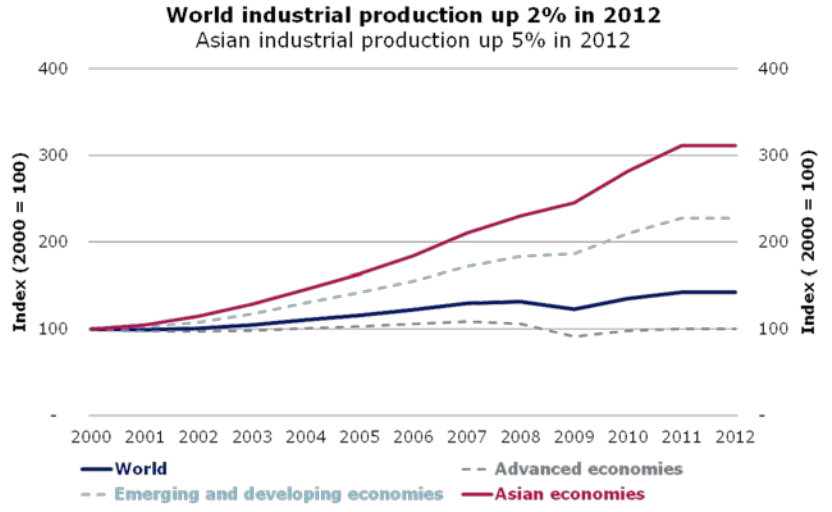
Since 2010, the global economy has been on a path to recovery, albeit a fragile one. Global growth has been driven – most notably, but not only – by China. The Chinese economy is now the world's second largest and a key driver of global growth. It amounts to 10-15% of global GDP and accounted for about one quarter of global GDP growth in 2011. The combination of a weaker global economic environment and tighter domestic policies slowed Chinese GDP growth from 10% in 2010 to 9% in 2011.

Figure GRO.1



Sources: Reuters EcoWin, Danish Ship Finance

Figure GRO.2



Sources: Reuters EcoWin, Danish Ship Finance

Weak growth in the Euro area and sluggish recovery in the USA constrained the contribution of net exports, as exports decelerated more rapidly than imports. Tighter domestic policy conditions dampened investment, particularly in infrastructure and real estate. By contrast, consumption growth remained robust as consumer confidence was sustained and household income continued to grow rapidly.

CHINA'S PATTERN OF ECONOMIC GROWTH IS CHANGING

What we have seen is the first apparent sign of a structural change in the Chinese growth pattern. The Chinese economy is in the midst of a gradual slowdown and structural changes are expected to gradually alter the rate and pattern of growth. So far, China's impressive growth has been investment-led and export oriented. However, the Chinese economy seems to have exhausted its gains from first-generation reforms and the absorption of imported technologies. As a result, the immediate gains from capital accumulation and labour reallocation are wearing off. Combined with a shrinking labour force due to population ageing, it seems inevitable that growth will slow. Consequently, the economy needs to rebalance towards consumption and services.

TRADE WILL BE A DRAG ON GROWTH IN 2012

External trade will likely be a drag on Chinese growth in 2012 as exports slow more than imports. The projected slowing of world trade growth from 6.6% in 2011 to 2.5% in 2012 would weigh on China's export growth.

EXTERNAL WEAKENING AND DOMESTIC TIGHTENING

China has not only become the world's second-largest import market; it is also its fastest-growing. Its strong demand for raw materials, advanced machinery, and consumer products has benefited developed and developing countries alike. However, global trade is set to soften further this year and remain relatively subdued thereafter. With Europe already in recession, high-income economies are expected to register more sluggish growth. In addition, the crisis is spreading, as growth is decelerating in most developing economies. As a result, world trade will remain weak in terms of volumes, affecting China's export-oriented economy.

CRISES DON'T STOP AT BORDERS

What we have seen is that crises don't stop at borders. The effect of a recession in one country spreads across borders – for example by reducing the demand for exports. Global demand growth has slowed, with activity in the euro area being particularly weak. IMF predicts that the *Advanced Economies* will grow modestly by around 1.5-2% in 2012 and 2013. That weakness reflects the effect of considerable headwinds, including the impact of the challenges facing the eurozone, tight credit and fiscal conditions and a squeeze on households' disposable incomes. *Emerging and Developing Economies* are projected to grow by 5-6% in 2012 and 2013, while China is expected to expand between 8% and 9% annually. In terms of seaborne demand, the big question is how China will keep its economy up to speed.

CHINESE FISCAL STIMULI OFFERS LITTLE DRY BULK DEMAND

Unlike many advanced economies, China still has room to support its decelerating economy through an expansive fiscal policy. While concerns about local government debt have risen, the general government balance sheet remains healthy. This fiscal space could be used to facilitate a soft landing and probably should be used if downside risks to growth were to heighten. However, fiscal stimulus measures that support consumption would have top priority. Relative to the previous episode of fiscal easing, the stimulus would ideally be less credit-driven, less local government-funded, and less infrastructure-oriented. Policy options to lift consumption would include targeted tax cuts (particularly consumption taxes and social contributions), social welfare spending (to provide support to those suffering as a result of the downturn) and other social expenditures (such as on education, healthcare and pensions). Such measures would also assist in promoting longer-term rebalancing of the drivers of economic growth. Unfortunately, China's new growth engines (i.e. consumption and service) are expected to contribute significantly less to world trade volumes than the old investment-led and export-oriented drivers.

MOST SHIP SEGMENTS ARE STRUGGLING TO ABSORB PREVIOUS YEARS' MASSIVE INFLOW OF TONNAGE AND THERE IS IN FACT MORE TONNAGE UNDERWAY. RATES AND VALUES ARE LOW IN THE MAIN SEGMENTS.

TRAVEL DISTANCES ARE GETTING SHORTER

The shifts in world industrial production – with production moving closer to consumers – are impacting global trade patterns. Crude tankers travel slightly shorter distances as higher North American oil production is reducing import volumes and distance-adjusted crude tanker demand. The Asian economies largely receive all their supplies from Asian refineries, which is why distance-adjusted product tanker demand is also weakening slightly. Intra-Asian container trades have expanded strongly in both volumes and travel distances during 2012. Container ships generally travel shorter distances. Travel distances for gas carriers and dry bulk vessels remain fairly stable.

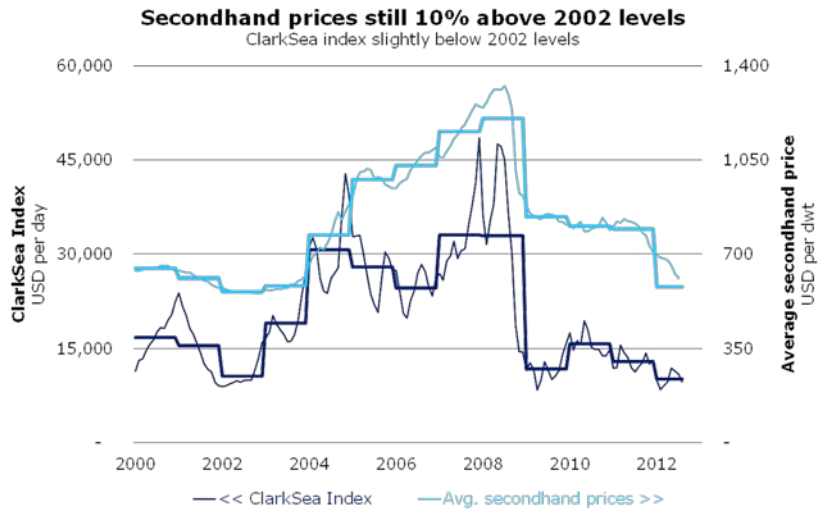
RATES ARE LOW

The shipping crisis deepened further during the first eight months of 2012: the growth in world trade volumes is unable to match the capacity expansion of the world fleet. Several but not all ship segments faced lower earnings during the period. The leading earnings index dropped 20% during the period (year-on-year) and has practically broken through the previous floor from 2002 (fig. 3). In several segments earnings are now flirting with or even failing to cover operating expenses.

BUNKER COSTS ARE HIGH

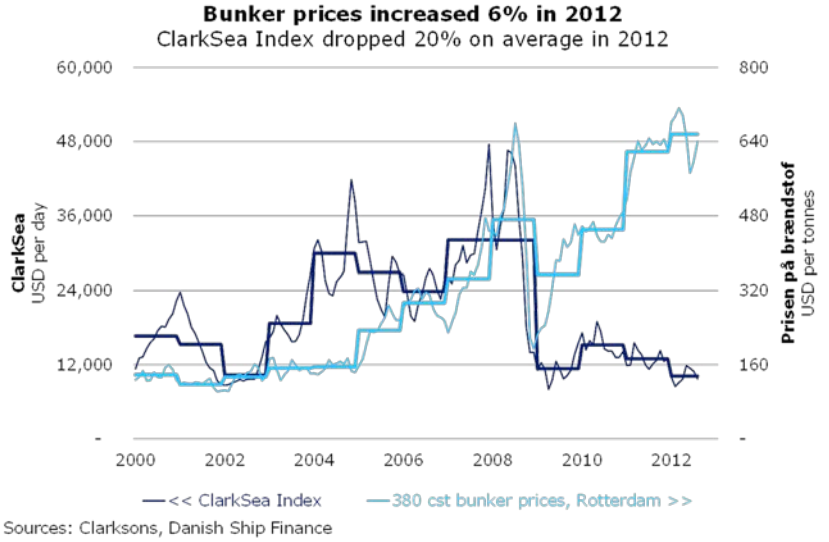
To make matters even more fragile, bunker costs are still very high. Compared to the record-high 2011-average, average bunker prices (380 cst, Rotterdam) grew by 6% during the first eight months of 2012 (fig. 4). Before drawing any conclusions, it is important to remember that not all shipowners are equally exposed to higher bunker costs. The individual exposure is subject to the business strategy and the risk profile of the owner.

Figure GRO.3



Sources: Clarksons, Danish Ship Finance

Figure GRO.4



Sources: Clarksons, Danish Ship Finance

ASSET VALUES APPROACHING THE RECORD LOW LEVELS OF 2002

Secondhand prices fell by an average of 27% during the first eight months of 2012 (year-on-year) and are approaching the record-low level of 2002 (fig. 3). The growing gap between supply and demand impacted not only short-term earnings but also the market expectations for medium- to long-term earnings potentials. Old vessels are impacted the most by short-term cuts in earnings while younger vessels tend to find some cover in the long-term upside potential.

LOW CONTRACTING ACTIVITY IN 2012

The combination of low freight rates, high bunker costs and continuing asset devaluations seems at last to have reduced owners' appetite for ordering new vessels. During the first eight months of 2012, 13 million cgt was contracted. Compared to an estimated yard capacity of 60 million cgt, we can conclude that only 30% of global yard capacity has been in demand during the first eight months of 2012. The situation is getting critical. The global order cover has on average come down to 19 months (fig. 5), but there are some large variations. Some yards have not won new orders in two or three years, while others have been able to attract new orders in both 2011 and 2012.

NEWBUILDING PRICES DOWN 9% IN 2012

The global orderbook has been declining since 2008 while global yard capacity peaked in 2010. To some extent, newbuilding prices reflect the yards' order cover (i.e. orderbook/yard capacity). Global yard capacity is, however, a simplified figure, as not all shipyards are capable of building all ship segments. Currently, we estimate that 70% (40 million cgt) of global yards by capacity (60 million cgt) are capable of building dry bulk vessels, while 40% are capable of building tankers, 30% are qualified to build containers or gas carriers, and less than one-third of the world's shipyards by global capacity compete for the highly specialised ship segments. This diversity is clearly illustrated by the diverse development in newbuilding prices. On average, newbuilding prices (per cgt) declined 9% during the first eight months of 2012 while – for example – newbuilding prices for dry bulk vessels dropped 12% and newbuilding prices for gas carriers remained fairly stable.

Figure GRO.5

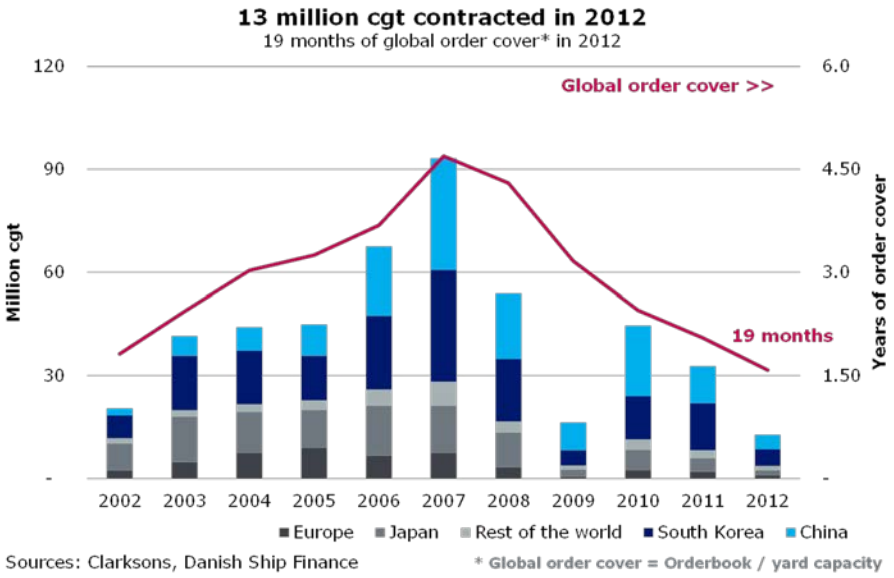
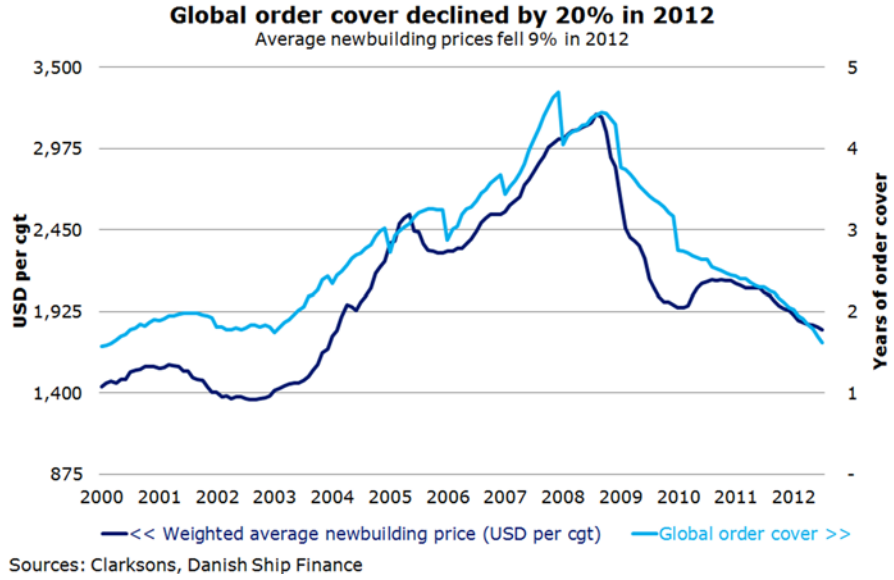


Figure GRO.6



LIMITED DOWNSIDE POTENTIAL IN NEWBUILDING PRICES

Average newbuilding prices have dropped more than 40% from their peak in 2008 but are still 35% above the previous low from 2002. The average order cover has now come down to 19 months and is therefore close to the rule-of-thumb construction period of 18 months for an average vessel (fig. 6). In this market, it is critical to consider whether the 2002-low represents the downside potential for current newbuilding prices. We argue that it does not. Not only have steel costs more than doubled from 2002 to 2012 other component costs, such as for main engines and wages, have also risen significantly. Consequently, we argue that there is relatively limited room for further cuts in newbuilding prices. Obviously, government supported shipyards could, on the other hand, decide temporarily to build ships at less than their marginal construction costs. In a scenario, where capacity rather than construction costs determine price developments, severe reductions in newbuilding prices could be the outcome of the massive glut of yard capacity.

AN OVERHANG OF SUPPLY URGES OWNERS TO SCRAP YOUNGER VESSELS

The world fleet has grown by 36% since 2008 while world demand volumes are up 9%. Consequently, several – but not all – ship segments are struggling to absorb an overhang of tonnage. In combination with the high bunker price and a relatively high scrap value, many owners have moved forward a decision to scrap their vessels. In the past, it was a rarity to scrap a vessel before its third special survey (15 years) but in today's weak market many owners have to consider the economics of paying for a third special survey and then trading the vessel – versus getting the vessel's scrap value.

SCRAPPING PICKING UP BY 37% IN 2012

Scrapping has picked up and the average age of vessels scrapped continues to decline. Nevertheless, we are surprised that the current market situation has not produced a larger spike in scrapping activity. 39 million dwt was scrapped during the first eight months of 2012. This represents a 40% increase in activity compared to the 2011-average but less than 3% of the world fleet. Of the vessels scrapped in 2012, 17% were less than 20 years old (fig. 7). A vessel scrapped early might represent a loss to the owner, but it contributes to the recovery of the segment and hence indirectly

Figure GRO.7

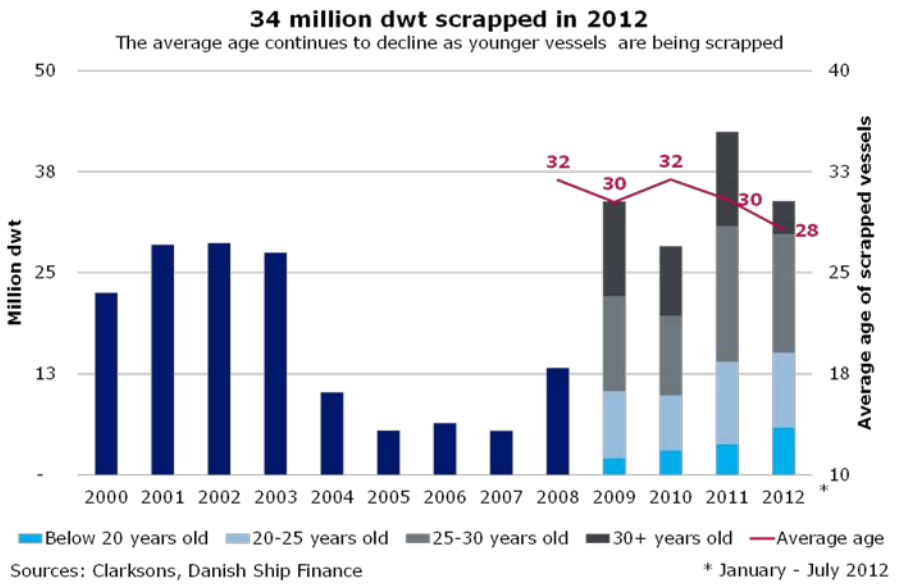
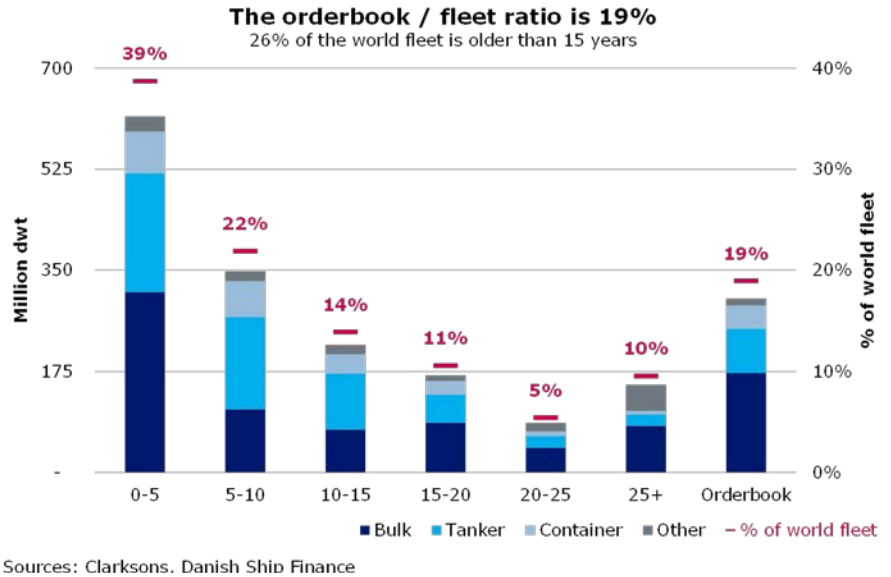


Figure GRO.8



supports the competition. This dilemma might explain why current scrapping activity is not accelerating and helping to restore balance between supply and demand.

26% OF THE WORLD FLEET IS OLDER THAN 15 YEARS

Nonetheless, looking at the age distribution of the world fleet, it seems there is still a considerable potential for early scrapping, at least to balance orderbook deliveries. Currently, 26% of the world fleet is older than 15 years compared to a nominal size of the orderbook of 19% of the fleet (fig. 8). However, there are great variations from one segment to the next. While the tanker and container fleets are relatively young, the bulk fleet is relatively old. The same is true for many of the more specialised ship segments. However, a look at a specific ship segment will reveal that current orderbooks mainly consist of large vessels while scrapping candidates are mostly smaller vessels. Consequently, balancing supply and demand will not be a walk in the park. Many owners will need to take considerable impairments on the book value of their assets if younger vessels are to be scrapped.

BLEAK OUTLOOK FOR THE GLOBAL YARD INDUSTRY

The outlook for the global yard industry is bleak and competition is mounting. Yards are trying to scale up their skills so that they can build *greener* ships or take on the competition for the more specialised vessels, such as offshore units or gas carriers. New designs are under development and are promising significant reductions of bunker consumption. The combination of lower newbuilding prices and improved bunker consumption persuades some owners to believe that they are doing a great deal. However, few ship segments can still absorb new vessels entering service without adding further pressure on rates and values. Clearly, owners' reasoning for placing new orders go somewhere between lower bunker consumption and low(er) newbuilding prices. Here, we believe it is important to raise the question: when can you conclude if a price paid is low or high? At the time of contracting or at the time the vessel is sold? If a segment is oversupplied it may be difficult to obtain the required return on the investment.

In general, we fear that a pick-up in newbuilding orders will harm both freight rates and asset values in the short to medium term, making it relatively difficult to achieve a return on the investment, not to mention the ability of some of the weaker shipowners' to service their debts.

YARD CAPACITY SET TO FALL

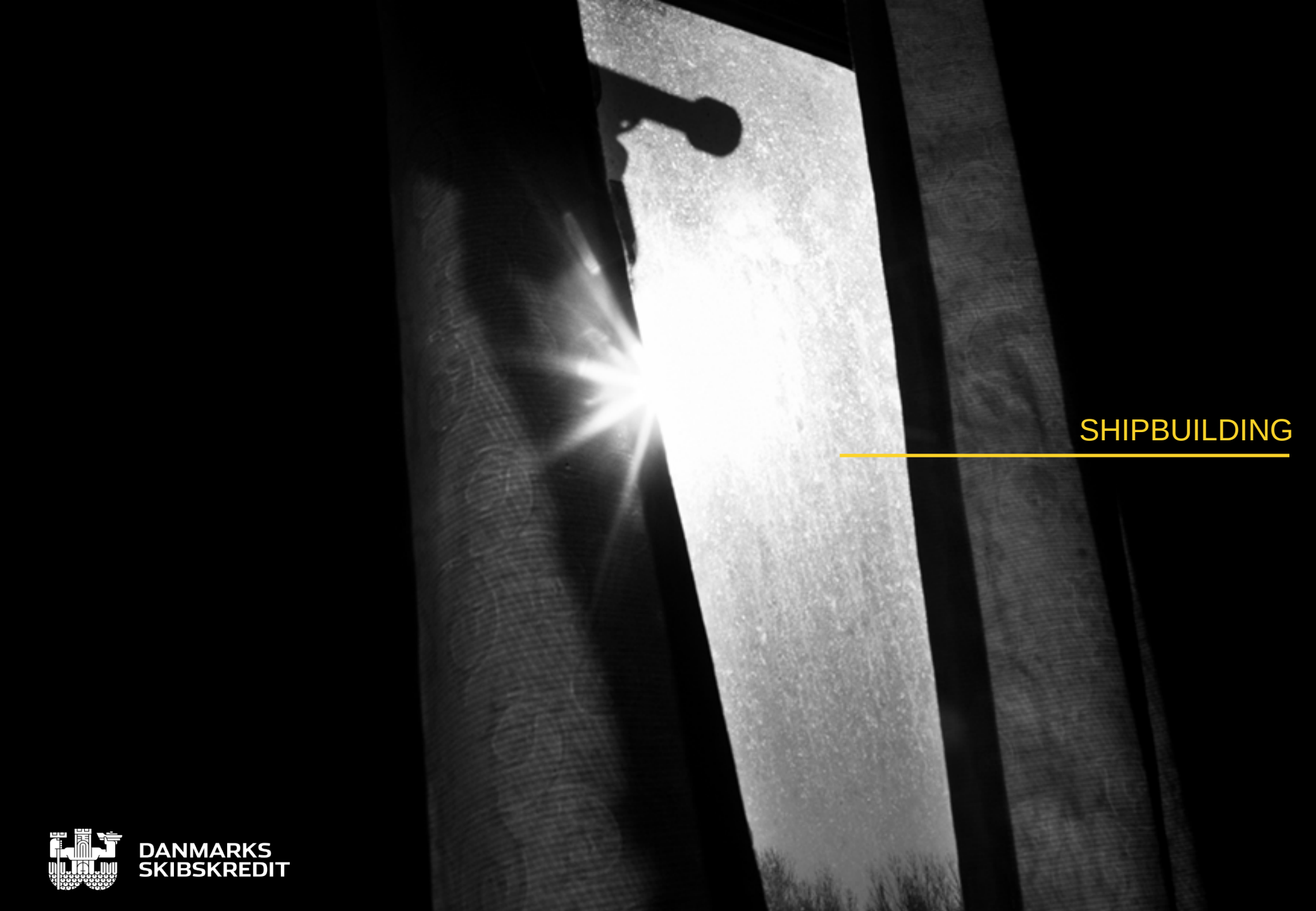
Clearly, a certain amount of new orders will be placed in the remaining months of 2012 and 2013, but we do not expect contracting activity to be strong enough to support the current yard capacity. We estimate that as much as 20% of current yard capacity will be in excess and might eventually be shut down. Small and medium-sized privately-owned Chinese yards appear to be at the epicenter of the capacity adjustment process. We estimate that, by the end of 2014, global yard capacity could be back at the 2008-level. On average, we forecast that newbuilding prices for less sophisticated vessels can decline by as much as 10-15% in 2013.

SHIP FINANCE INTO TURMOIL

Global ship financing has been hit hard by the financial market turmoil and, particularly, the European debt crisis. In combination with low freight rates, high bunker prices and declining asset values it seems inevitable that many – less creditworthy – owners will struggle to raise new debt. Shipowners' ability to take delivery of their newbuildings or to place new orders becomes highly constrained if access to debt markets is limited further. Therefore, for the remaining months of 2012 and 2013 we expect to see owners continue to struggle, postponing or cancelling newbuilding orders. Still, cash-rich and well-established owners and/or owners with access to Export Credit Agencies (ECAs) or similar might be able to do deals that may prove to be attractive in the long run.

OUTLOOK FOR 2012 AND BEYOND

We expect rates and asset values to remain low in 2013 although we see a potential for some short-lived spikes in freight rates.



SHIPBUILDING

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SHIPBUILDING

THE GLOBAL SHIPBUILDING INDUSTRY IS FACING A NEGATIVE OUTLOOK. THE ORDER COVER CONTINUES TO DECLINE AND A 20% REDUCTION IS EXPECTED IN GLOBAL YARD CAPACITY OVER THE NEXT THREE YEARS, MAINLY BECAUSE SMALL AND MEDIUM-SIZED YARDS WILL BECOME INACTIVE. HENCE, GLOBAL YARD CAPACITY WILL BE BACK AT THE 2008-LEVEL BY 2015.

NEWBUILDING PRICE

THE GLOBAL ORDER COVER HAS BEEN DECLINING FOR NEARLY 58 CONSECUTIVE MONTHS FROM 4.7 YEARS AT THE END OF 2007 TO 19 MONTHS IN 2012. NEWBUILDING PRICES, DOWN BY 9% IN 2012 ALONE, HAVE FOLLOWED SUIT.

NEWBUILDING PRICES DOWN BY 9% IN 2012

To some extent, newbuilding prices reflect yards' order cover (i.e. orderbook/yard capacity). Global yard capacity is, however, a simplified figure, as not all shipyards are capable of building all ship segments. This explains why newbuilding prices have developed differently from one ship segment to the next. In 2012, average newbuilding prices have fallen by 9%, but for dry bulk vessels they have dropped by 12% while for gas carriers they have remained fairly stable (fig. 1).

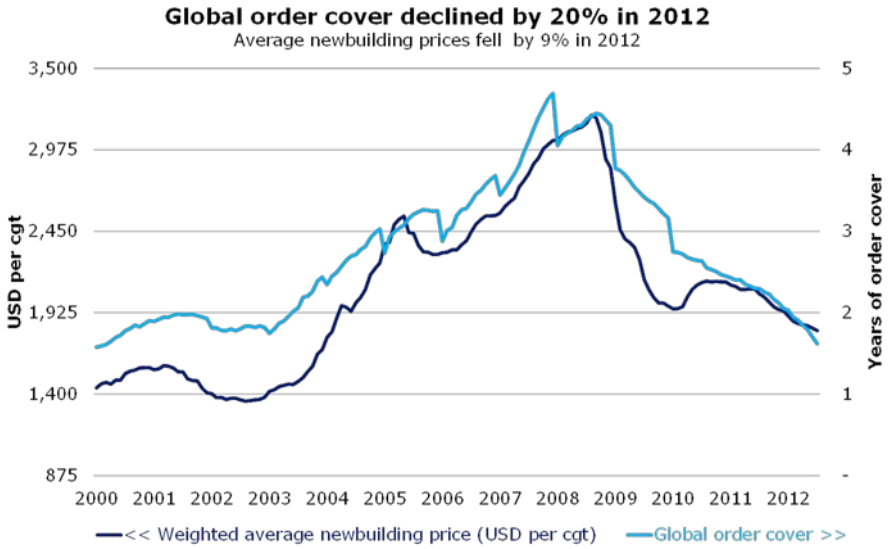
ORDER COVER DOWN BY 20% IN 2012

The global order cover fell by 20% to 19 months during the first eight months of 2012 (fig. 1). Yards delivered 34 million cgt whereas new orders of 13 million cgt were registered during the period. The order cover varies greatly among yards. Some yards have order cover four years ahead while others urgently need to secure new orders. Clearly, such variations put prices under pressure.

PRICE OF STEEL DOWN 13% IN 2012

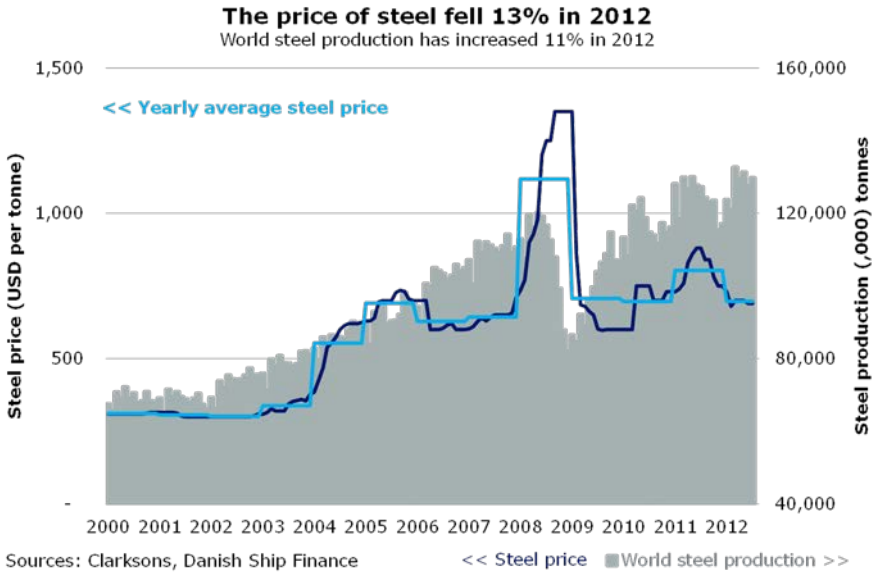
The price of steel declined by 13% in 2012 (fig. 2). Steel costs are a major component of the total costs of building a vessel. Generally, the more specialised a vessel is, the smaller the role of steel costs in the overall building costs. We argue that declining steel prices enables lower newbuilding prices and vice versa.

Figure SB.1



Sources: Clarksons, Danish Ship Finance

Figure SB.2



Sources: Clarksons, Danish Ship Finance

HISTORICALLY, SOUTH KOREA HAS BEEN THE LARGEST SHIPBUILDING NATION, BUT CHINA TOOK OVER THE POSITION IN 2010 WITH A PRODUCTION OF 21 MILLION CGT COMPARED TO SOUTH KOREA'S 18 MILLION CGT.

GLOBAL YARD CAPACITY EXPANDED 90% FROM 2005 TO 2010

Global yard capacity almost doubled from 2005 to 2010, from 32 million cgt to 63 million cgt. Primarily, Chinese and South Korean yard capacity has expanded during the period. The Chinese yard capacity more than trebled, increasing by 17 million cgt. The South Korean yard industry has nearly doubled its capacity, increasing by 8 million cgt. In the same period, Japanese and European yards expanded by 22% (1.9 million cgt) and 16% (1 million cgt), respectively (fig. 3).

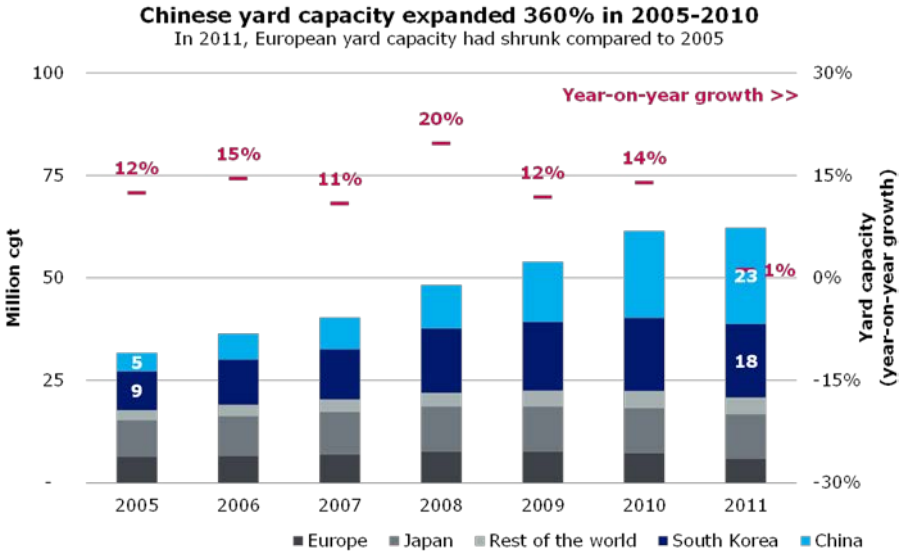
NEW CAPACITY OF 20 MILLION CGT OPENED BETWEEN 2005 AND 2010

A total of 275 yards with a combined capacity of 20 million cgt opened between 2005 and 2010. In China, some 150 new yards came on stream with a combined capacity of 15 million cgt. 70% of the capacity expansion was driven by small and medium-sized yards. Only six of the new yards had an annual capacity of more than 500,000 cgt. In South Korea, expansion, in cgt, was primarily driven by large yards, as a total of 13 South Korean yards with a combined capacity of 3 million cgt were established during the same period. Of this new capacity, 1.8 million cgt (63%) were yards with annual capacity of more than 500,000 cgt (fig. 4).

GLOBAL YARD CAPACITY STABLE FROM 2010 TO 2011

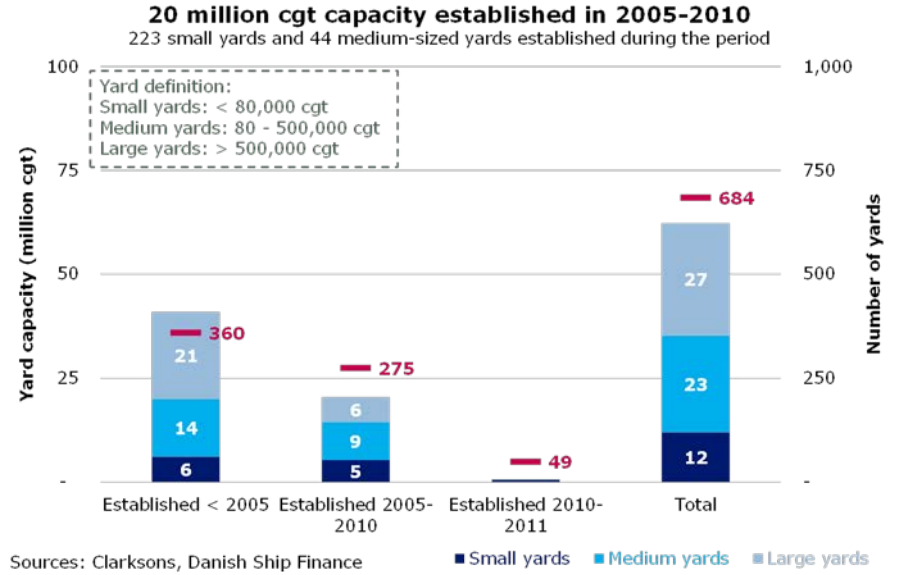
From 2010 to 2011, global yard capacity was almost unchanged. We estimate a minor increase of 1% (700,000 cgt). We estimate that global yard capacity was 62 million cgt at the end of 2011. However, the various shipbuilding countries developed differently. The Chinese yard industry continued to grow, adding 2 million cgt (10%) whereas European yard capacity contracted by 1.5 million cgt, corresponding to 20%. Other countries' yard capacity was more or less stable during 2011 (fig. 3).

Figure SB.3



Sources: Clarksons, Danish Ship Finance

Figure SB.4



Sources: Clarksons, Danish Ship Finance

CONTRACTING ACTIVITY SUFFERED A SEVERE SLOWDOWN IN 2012. GLOBAL ORDER COVER, IN DECLINE SINCE 2007, FELL BY 20% TO 19 MONTHS.

The combination of low freight rates, high bunker costs and continuing asset devaluations seems at last to have reduced owners' appetite for new vessels. Remarkably, orders placed in 2012 have increasingly been within the more specialised ship segments such as offshore supply units and gas carriers. South Korea has secured most of the specialised orders while Chinese yards continue to build mostly dry bulk and tankers.

CONTRACTING ACTIVITY DOWN 50% IN 2012

In the first eight months of 2012, 13 million cgt was contracted. This is half the capacity contracted during the same period of 2011. Compared to an estimated yard capacity of 62 million cgt, we can conclude that only 30% of annual global yard capacity was in demand during the first eight months of 2012. The low contracting activity has driven the order cover down to 19 months (fig. 5). The situation is getting critical: 138 of the 622 active yards – representing 35% of 2012 yard capacity - did not win a single new order during the first eight months of 2012. Some yards have not won any new orders for two or even three years.

SOUTH KOREA SECURED 40% OF NEW ORDERS

South Korean yards secured 4.6 million cgt of new orders during the first eight months of 2012 (fig. 6). South Korean yard capacity is estimated at 17 million cgt. Consequently, 41% (annualised) of South Korean capacity has been in demand during 2012. Large yards won 97% of orders placed in South Korea in 2012 to date.

CHINA ATTRACTED 36% OF ORDERS PLACED IN 2012

Chinese yards secured new orders of 4.2 million cgt during the first eight months of 2012 (fig. 6). Chinese yard capacity is estimated at 23 million cgt. Consequently, 28% (annualised) of Chinese yard capacity has been in demand during 2012. Medium-sized yards dominate the Chinese yard industry. 70% of new orders were placed at medium-sized yards. Large yards only secured 21% of the new orders.

Figure SB.5

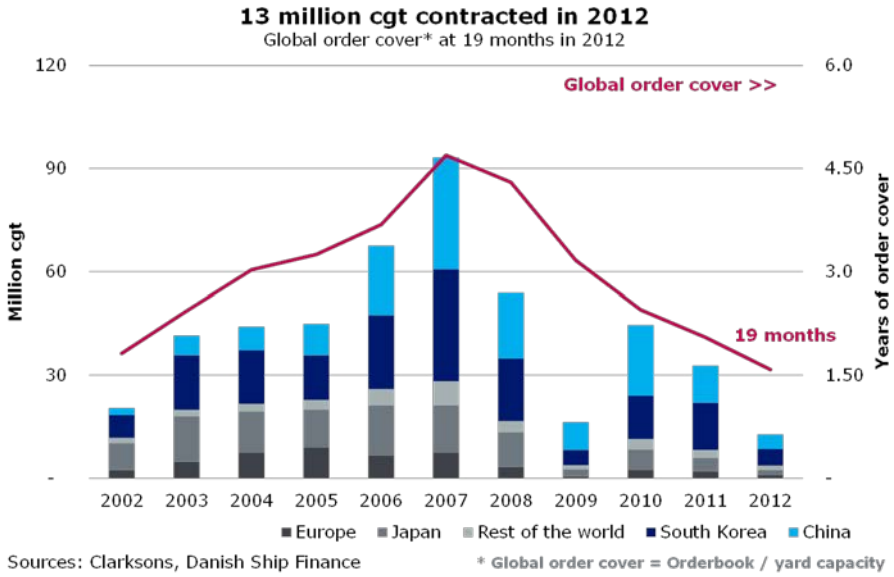
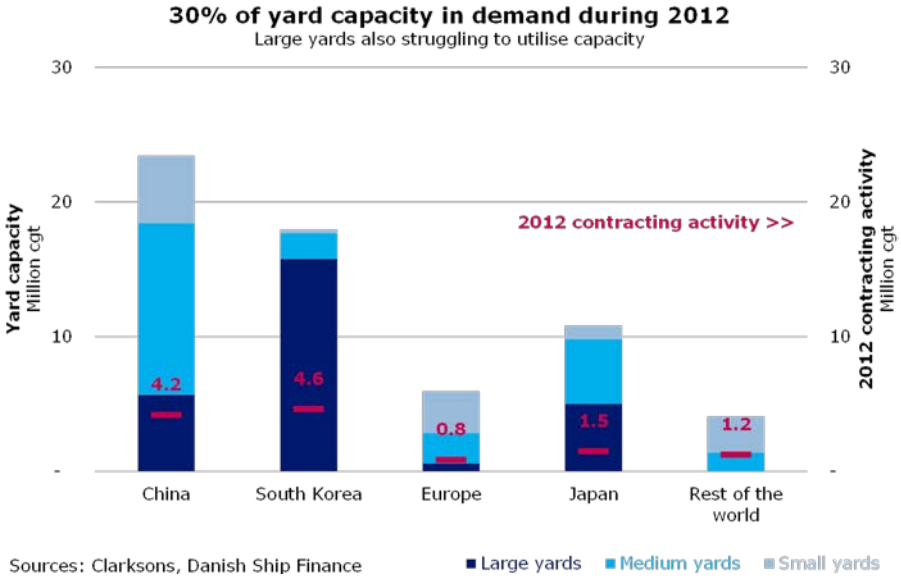


Figure SB.6



IN THE FIRST EIGHT MONTHS OF 2012, OWNERS HAVE TAKEN DELIVERY OF THE SAME NUMBER OF VESSELS AS THEY DID DURING THE FIRST EIGHT MONTHS OF 2011. WE HAD EXPECTED THAT THE SLUGGISH MARKET WOULD HAVE REDUCED THE INFLOW OF NEW VESSELS. STILL, 75% OF SCHEDULED DELIVERIES WERE BUILT. LARGE YARDS PERFORMED ALMOST ACCORDING TO SCHEDULE. EVERY SECOND VESSEL DELIVERED WAS A DRY BULK VESSEL.

35 MILLION CGT DELIVERED IN 2012

A total of 47 million cgt was scheduled for delivery in the first eight months of 2012. Firm orders represented 39 million cgt and 8 million cgt were purchase options. 35 million cgt (75%) were actually delivered (fig. 7). Of the remaining 12 million cgt, roughly 8 million cgt was postponed for later delivery while 4 million cgt was cancelled. The inflow of vessels is in line with the 2011 performance and only 4% below the record-high level of 2010.

LARGE YARDS DELIVERING 96 % OF THEIR ORDERBOOK

Large yards built almost half the capacity delivered during the first eight months of 2012. Large yards delivered 96% of their scheduled orders while medium-sized and small yards delivered only 72% and 55% respectively.

CHINA DELIVERING 14 MILLION CGT IN 2012

In the first eight months of 2012, China was expected to deliver 20 million cgt whereas 14 million cgt (70%) was actually delivered (fig. 7). Half the orderbook was scheduled to be built at medium-sized yards, while the large yards accounted for only 20%. The large yards delivered 80% of the scheduled orders while the medium-sized yards delivered slightly less. Small yards delivered 60% of the scheduled orders. Dry bulk vessels represented 70% of total deliveries from Chinese yards.

SOUTH KOREA DELIVERING 10 MILLION CGT IN 2012

South Korea was expected to deliver 11.5 million cgt whereas actual deliveries were 10.5 million cgt. In other words, 91% of scheduled deliveries were actually made (fig. 7). The large yards delivered according to schedule while the small and medium-sized yards failed to perform according to schedule.

Figure SB.7

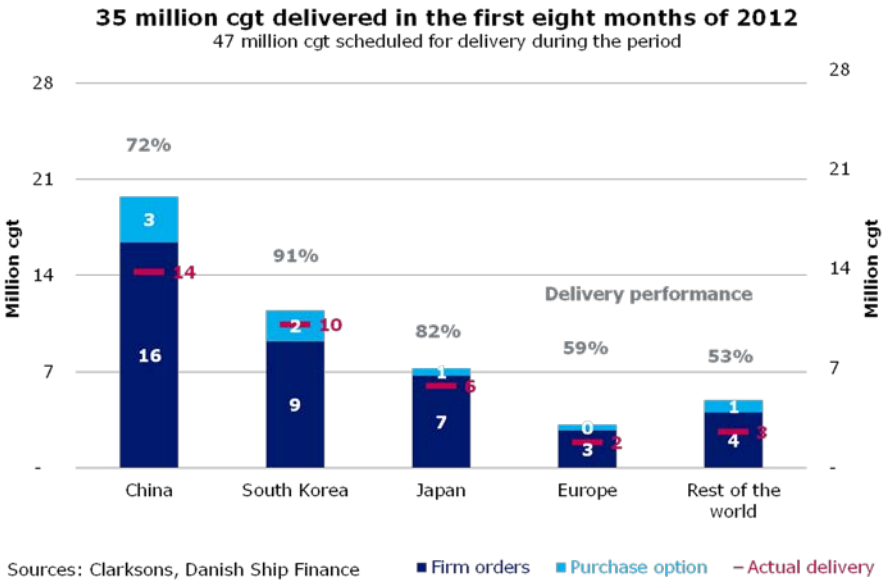
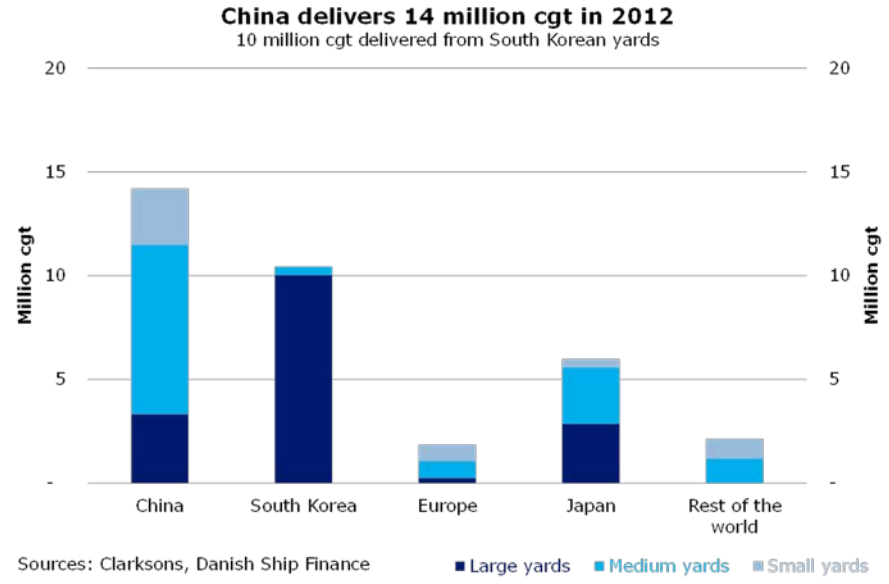


Figure SB.8



THE ORDERBOOK IS SHRINKING AND IS CURRENTLY AT THE MID-2005 LEVEL, WHILE GLOBAL YARD CAPACITY HAS ALMOST DOUBLED SINCE 2005. YARDS ARE UNDER PRESSURE TO SECURE NEW ORDERS. IN 2012, WE EXPECT 4% OF THE GLOBAL YARD CAPACITY TO CLOSE OR AT LEAST BECOME INACTIVE.

YARD CAPACITY POTENTIALLY REDUCED BY 2.7 MILLION CGT IN 2012

In 2011, global yard capacity was estimated at 62 million cgt. During 2012, yard capacity of 2.7 million cgt (142 yards) is expected to have become inactive. Our definition of inactive yards is yards without any deliveries during the year and an orderbook of zero. Deliveries from newly established yards in 2012 represent 1.2 million cgt. Consequently, we expect the active global yard capacity to be reduced by 1.5 million cgt to 61 million cgt in 2012 (fig. 9).

YARD CAPACITY OF 900,000 CGT IS BECOMING INACTIVE IN CHINA

The Chinese yard industry is facing great challenges. Few of the newly established yards have managed to attract new orders. In particular, 156 small yards are struggling, having secured new orders' equivalent to only 12% of their capacity during the first eight months of 2012. Clearly, some yards have a better order cover than others. We estimate that as many as 45 small yards – with a combined capacity of 900,000 cgt – have become inactive or will do so during 2012. In other words, we expect 4% of Chinese yard capacity to go out of business in 2012 (fig. 9).

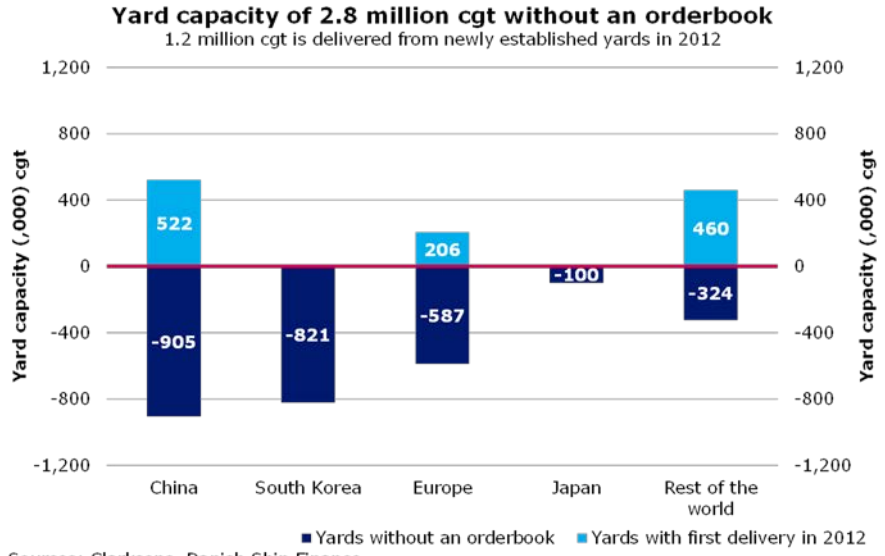
YARD CAPACITY OF 800,000 CGT TO TURN INACTIVE IN SOUTH KOREA

South Korean yards secured most of the new contracts in 2012, but with most orders going to the large yards. Many of the small and medium-sized yards failed to attract the attention of shipowners. We estimate that 5% of the South Korean yard capacity (800,000 cgt) will turn inactive in 2012 (fig. 9).

GLOBAL YARD UTILISATION OF 83% IN 2012

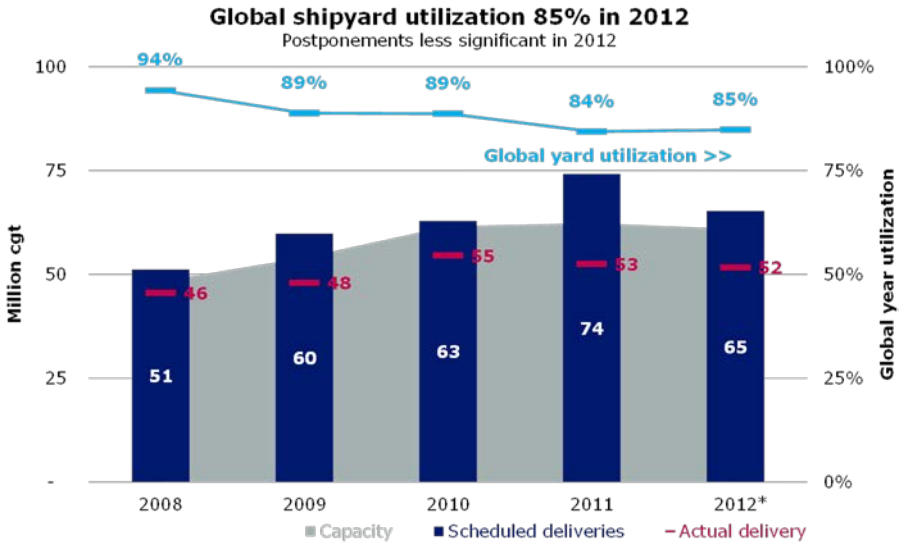
In Europe, Japan and the Rest of the world, yards with a combined capacity of up to 1 million cgt are expected to become inactive in 2012. Consequently, active global yard capacity is expected to be reduced by 1.5 million cgt in 2012. This means a slight increase in active global yard utilisation from 84% in 2011 to 85% in 2012 (fig. 10).

Figure SB.9



Sources: Clarksons, Danish Ship Finance

Figure SB.10



Sources: Clarksons, Danish Ship Finance

*2012 includes forecast of deliveries from Sep - Dec

A LARGE SHARE OF THE GLOBAL SHIPBUILDING INDUSTRY IS RUNNING OUT OF ORDERS AS THE ORDERBOOK IS SHRINKING. WE ESTIMATE THAT 9% OF GLOBAL SHIPBUILDING CAPACITY WILL CLOSE IN 2013. IN 2014, ANOTHER 11% OF THE YARD CAPACITY MAY CLOSE, IF CONTRACTING ACTIVITY REMAINS LOW.

The outlook for the global shipbuilding industry remains gloomy. The order cover continues to decline as contracting activity fails to balance deliveries and yard capacity adjusts slowly. However, the outlook varies greatly among builder countries and individual yards. Generally, large yards are more diversified in terms of building capabilities whereas small yards often specialise and therefore build a narrower range of ship types. As a result, large yards generally have a better order cover than small and, to some extent, medium-sized yards.

We estimate that the global order cover will drop from 19 months in August 2012 to 16 months in January 2013 and to an alarmingly low 12 months in January 2014. Clearly, new orders will be placed in 2013 and yard capacity may adjust more quickly than the 5.7 million cgt (9%) reduction we assume in our forecast, but the message seems clear: 2013 looks to be an extremely challenging year for the global yard industry in general, and for the Chinese yard industry in particular.

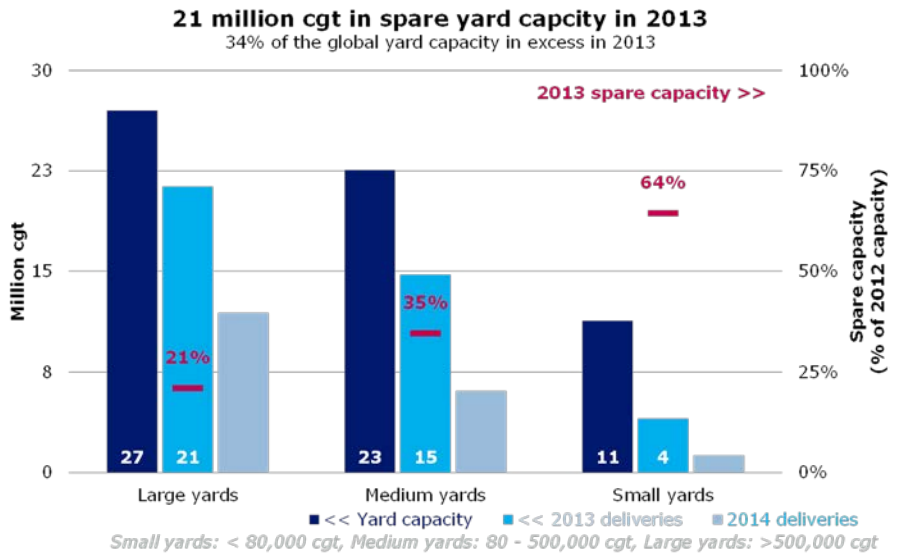
34% OF GLOBAL YARD CAPACITY IN EXCESS DURING 2013

With 40 million cgt in the orderbook for delivery in 2013 and an estimated 2012 yard capacity of 61 million cgt, the average yard will basically be employed for only eight months in 2013, unless capacity is adjusted or new orders are signed (for delivery in 2013). Large yards have a spare capacity of 21% while small yards are scheduled to run at an extremely low utilisation rate of less than 40% (fig. 11). Clearly, there are great variations. Some yards have an order cover of four years, but as an industry indicator it seems inevitable that capacity needs to adjust as quickly as possible.

40% OF GLOBAL SPARE YARD CAPACITY IS IN CHINA

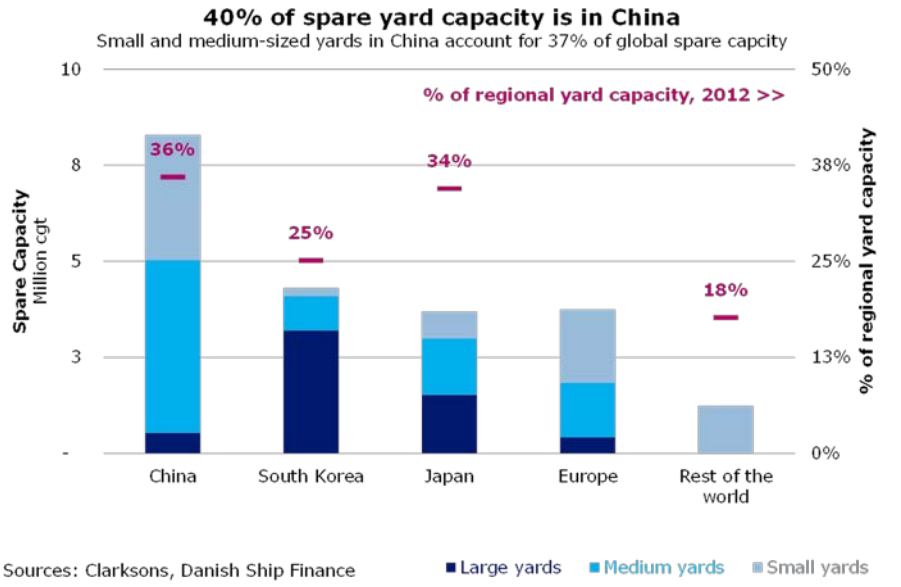
As discussed above, Chinese yard capacity has more than trebled from 2005 to 2011. In particular, small and medium-sized yards are struggling to fill their orderbooks. In 2013, Chinese yards will

Figure SB.11



Sources: Clarksons, Danish Ship Finance

Figure SB.12



Sources: Clarksons, Danish Ship Finance

account for 40% of global spare capacity (fig. 12). That means 36% of the Chinese yard capacity is expected to be idle in 2013 or expressed another way: on average, Chinese yards will run out of orders by August 2013. Spare capacity at small and medium-sized Chinese yards accounts for 37% of global spare capacity in 2013. The average small yard in China only has an order cover of four months in 2013, while the average medium-sized yard has an order cover of eight months.

SOUTH KOREA ACCOUNTS FOR 21% OF GLOBAL SPARE YARD CAPACITY

Large yards dominate the South Korean yard industry. More than 90% of the South Korean yard capacity is based at eight large yards. While these yards secured a large share of the 2011 and 2012 contracts it was not enough to utilise their capacity. In 2013, we estimate that they will have a spare capacity of 20%. This represents 15% of the global spare capacity in 2013. The 14 small and medium-sized yards in South Korea seem fairly well booked in 2013. Their spare yard capacity represents only 5% of global spare yard capacity in 2013 (fig. 12).

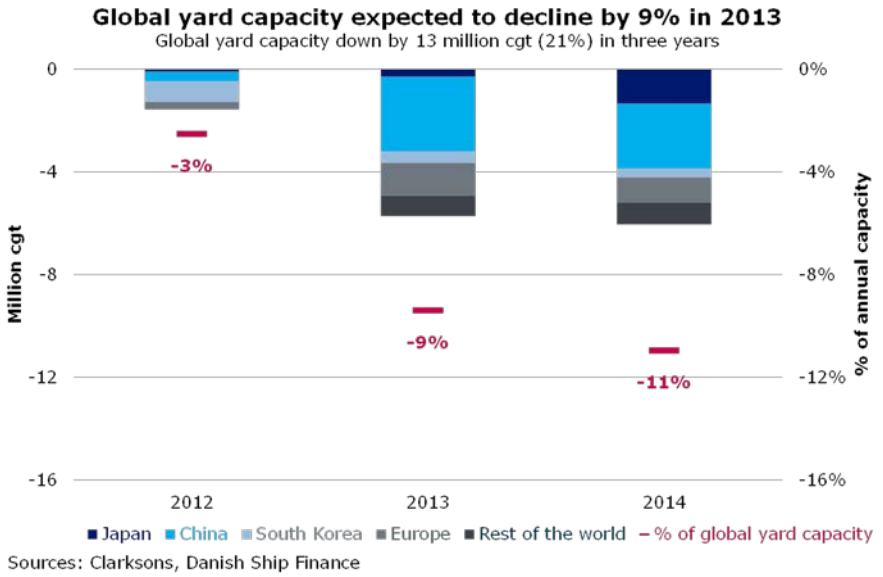
GLOBAL YARD CAPACITY DOWN BY 9% IN 2013

Traditionally, yard capacity adjustments have taken years to accomplish. However, we argue that small and some medium-sized privately-owned yards, in particular in China, might go out of business faster than previously seen. Our methodology, for predicting yard inactivity, which only takes individual yard orderbooks and annual delivery schedules into account, may be too simple. Recently, we have seen yard closures driven by financial problems rather than the order backlog. Nevertheless, we will continue to apply the current methodology. In 2013, we estimate that 5.7 million cgt could turn inactive and hence reduce active global yard capacity by 9% (fig. 13). Global yard capacity is expected to be reduced by an additional 6 million cgt in 2014. These estimations suggest that active global yard capacity will be reduced by 22% or 13 million cgt between 2012 and 2014, bringing global yard capacity back to the 2008-level.

GLOBAL YARD UTILISATION OF 85% IN 2013

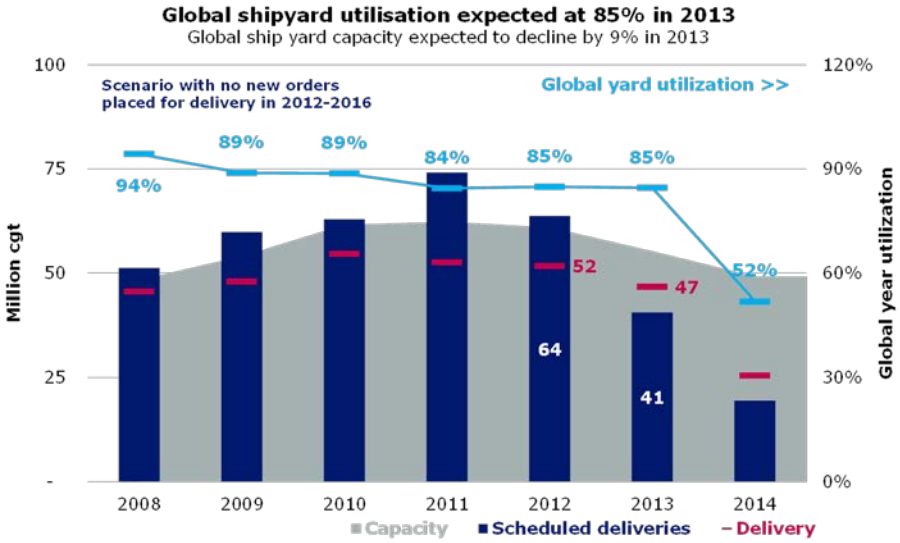
Orders scheduled for delivery in 2013 represent 40 million cgt. Adding postponements from 2011 and 2012, deliveries in 2013 are expected to reach 47 million cgt. With an expected yard capacity

Figure SB.13



Sources: Clarksons, Danish Ship Finance

Figure SB.14



Sources: Clarksons, Danish Ship Finance

reduction of 9% (to 55 million cgt), global yard utilisation is estimated to be relatively high at 85% in 2013 (fig. 14).

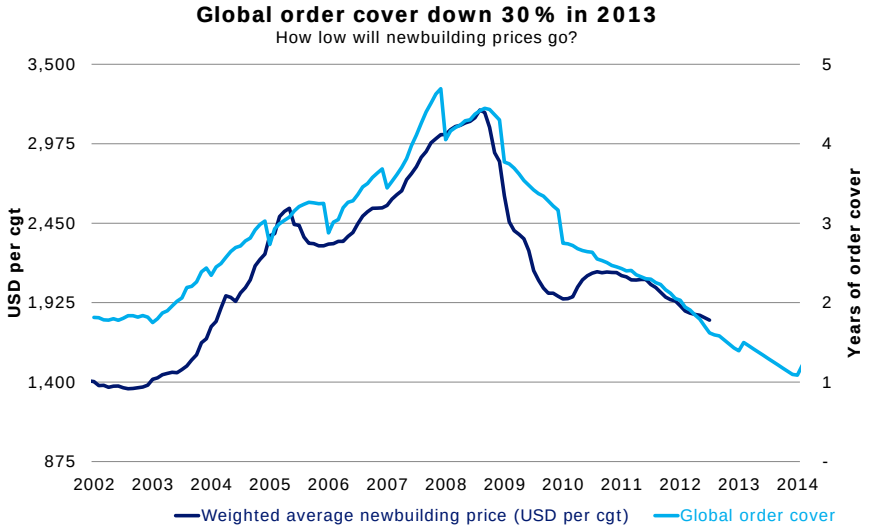
16 MILLION CGT TO BE CONTRACTED FOR DELIVERY IN 2014

The 2014 outlook is bleak: 20 million cgt is currently in the orderbook for delivery in 2014. Adding approximately 5 million cgt in potential postponements, 25 million cgt is now scheduled for delivery during the year. Global yard capacity is forecasted to decline to 49 million cgt by 2014. Consequently, yards need to secure an additional 16 million cgt in new orders for delivery in 2014 in order to maintain an 85% utilisation rate on the reduced yard capacity. To maintain an 85% utilisation rate on the current yard capacity, new orders of 26 million cgt will be needed for delivery in 2014, unless by 2014 yard capacity has been reduced relative to its current level. 26 million cgt is more than double the capacity contracted during the first eight months of 2012. One might consider which segments have the potential to absorb a large inflow of new tonnage over the next two years. The answer is: Not many. If annual deliveries do not level off considerably in 2014, the outlook for rates and values in most segments will depend almost entirely on young vessels being scrapped.

NEWBUILDING PRICES DOWN BY 10-15% IN 2013

The global orderbook has been declining since 2008 while global yard capacity peaked in 2010. Newbuilding prices do – to some extent – reflect the yards' order cover (i.e. orderbook/yard capacity). By January 2013, the order cover is estimated to have declined by another 3 months to 16 months. This could translate into a 5-10% reduction of newbuilding prices. By January 2014, the global order cover is predicted to average one year, based on our rather aggressive yard capacity adjustment assumptions, but there are large variations among individual yards. The global spare yard capacity is currently expected to peak at 48% in 2014. Clearly, new orders will be placed but we do not expect global yard utilisation to surpass 85% in 2014. Forecasting in the current market is subject to considerable uncertainty; however, we estimate that newbuilding volumes could decline by a further 10-15% in 2014. In this scenario, newbuilding prices are expected to bottom out in 2014 at USD 1,350 per cgt, fairly in line with the 2002-low.

Figure SB.15



Sources: Clarksons, Danish Ship Finance

It is critical to consider whether the 2002-low still represents the downside potential for current newbuilding prices. We argue that it does not. Not only have the steel cost more than doubled from 2002 to 2012, other component costs, such as for main engines, have also risen significantly. Consequently, we argue that the room for further newbuilding price reductions is limited to 10-15%. Obviously, government-supported shipyards could, on the other hand, decide temporarily to build ships for less than their marginal construction costs and hence potentially drive some newbuilding prices below construction costs. In a scenario where capacity rather than construction costs determine the price development, we might see a return to the low levels of 2002.

CONTAINER

DANMARKS
SKIBSKREDIT

CONTAINER

SUPPLY OUTGREW DEMAND BY 4 PERCENTAGE POINTS IN 2012 DUE TO WEAK EUROPEAN DEMAND. BOX RATES REACHED AN ALL-TIME HIGH IN 2012, WHILE SECONDHAND VALUES ARE AT ALL-TIME LOWS. A LARGE ORDERBOOK AND A FRAGILE DEMAND SCENARIO DOMINATE THE CONTAINER SEGMENT OUTLOOK.

FREIGHT RATES

LINERS' BATTLE FOR MARKET SHARE ENDED ABRUPTLY AT THE END OF 2011 AND MARKET DISCIPLINE RETURNED TO THE CONTAINER INDUSTRY. SUBSEQUENTLY, BOX RATES HAVE SOARED TO A NEW ALL-TIME HIGH, BUT LATELY THERE HAVE BEEN SIGNS OF RENEWED DECLINE. TIMECHARTER RATES HAVE BEEN VERY LOW ALL YEAR.

BOX RATES UP BY 19% IN 2012

When we last published our Shipping Market Review, box rates out of China had been falling almost constantly for a period of 17 months, reaching index 881 by December 2011. Since then, rates have soared and the composite index reached a new all-time high in May 2012 at index 1,336. Average box rates in 2012 are up by 18% (fig. 1).

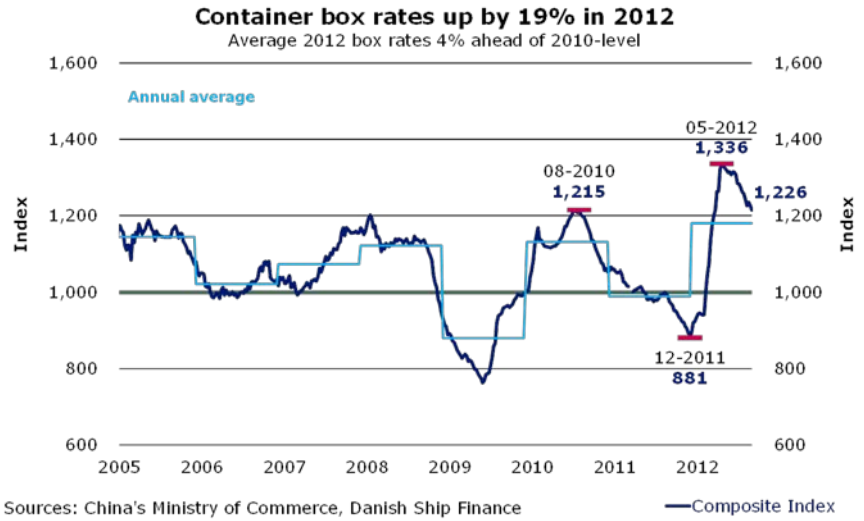
SHIFT IN MOMENTUM FROM MARKET SHARE TO EARNINGS

In 2011, most liners' earnings suffered as bunker cost increased by 40% while box rates dropped by 10% due to an intensifying battle for market share. At the beginning of 2012, the battle for market share ended very suddenly, and box rates climbed to a new all-time high. Since then, box rates have fallen by 8% to index 1,226 at the end of August 2012 (fig. 1). Whether this indicates a return to the battle for market share or an alignment due to weaker Christmas demand remains unclear. Thus, prospects for box rates are very uncertain.

TIMECHARTER RATES REMAINING LOW IN 2012

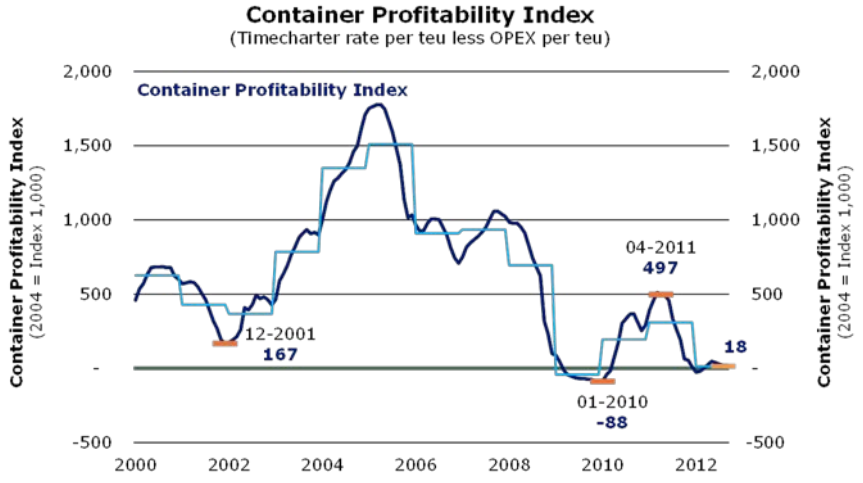
Timecharter periods have generally been shortening as liners have requested flexibility to adjust capacity to volatile demand. This has resulted in an idle fleet fluctuating in size but currently standing at 5-600,000 teu, or 3-4% of the fleet. The large volume of idle vessels has meant paltry timecharter rates throughout the year. Therefore, the container profitability index has barely stayed positive, down from index 497 in 2011 (fig. 2).

Figure CS.1

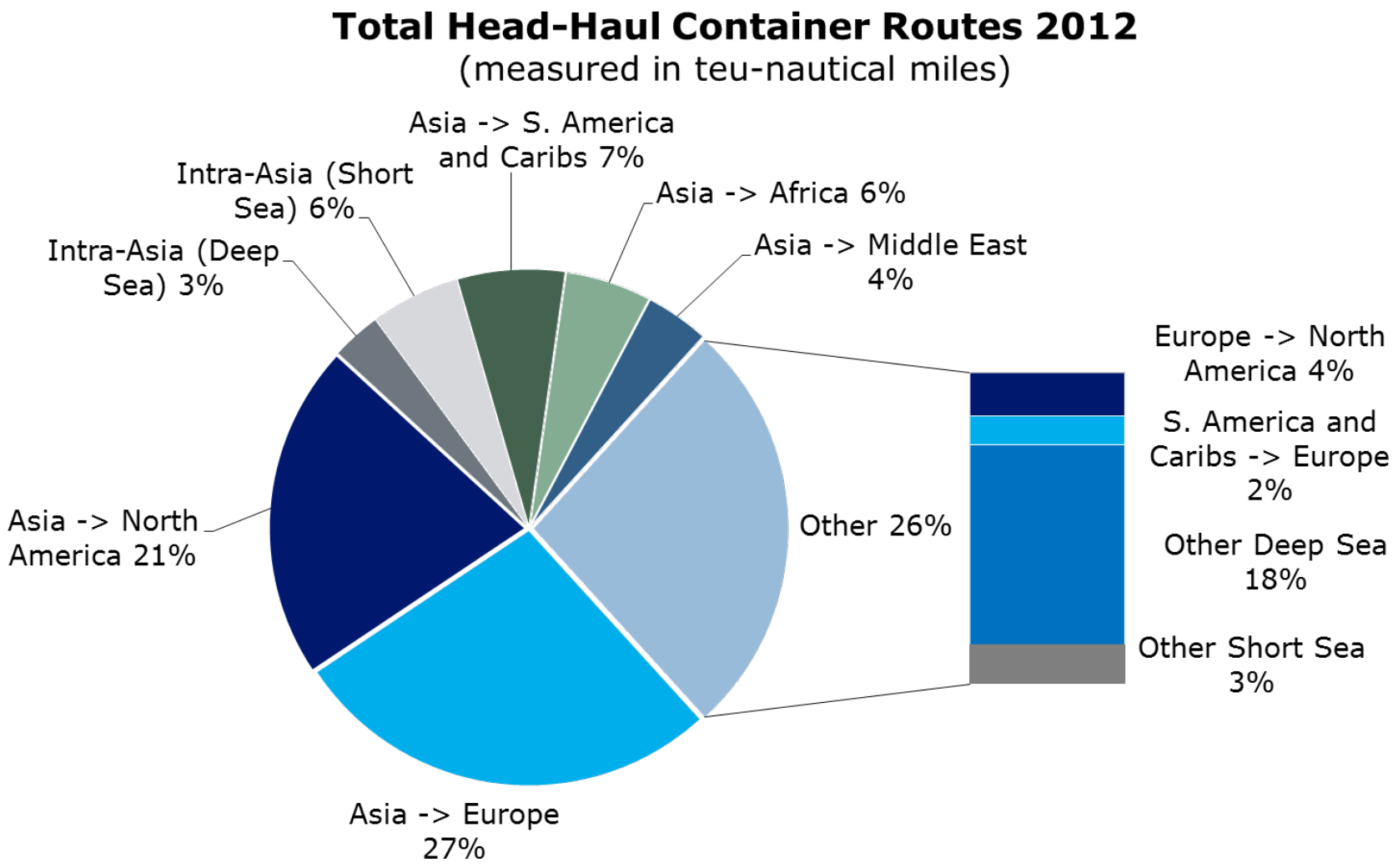


Sources: China's Ministry of Commerce, Danish Ship Finance

Figure CS.2



Sources: Clarksons, Danish Ship Finance



Sources: IHS Global Insight, Danish Ship Finance

SUPPLY AND DEMAND

THE CONTAINER FLEET EXPANDED BY 5% DURING THE FIRST EIGHT MONTHS OF 2012. DELIVERIES ARE DOMINATED BY LARGE POST-PANAMAX VESSELS BEING DEPLOYED ON THE ASIA-EUROPE TRADE LANE. GLOBAL DISTANCE-ADJUSTED HEAD-HAUL DEMAND IS SET TO GROW BY 4% IN 2012.

Since we last published Shipping Market Review, there has been a major operational re-structuring of the main trade lanes from Asia to Europe. The reason is the deployment of large vessels and liners' attempts to accommodate the new generation of vessels. This has led to a range of new services on the main East-West trade lanes and an intensifying cascading process pushing smaller tonnage through the route networks. Vessels above 10,000 teu (Super Post-Panamax) are also becoming more common on the transpacific trade lanes. The cascading process includes shifting Post-Panamax vessels of less than 8,000 teu to the North-South trade lanes. Continued use of slow steaming is affecting the effective supply of vessels – especially in the larger segments.

5% FLEET GROWTH IN THE FIRST EIGHT MONTHS OF 2012

The container fleet grew by 5% in the first eight months of 2012 as 950,000 teu (143 vessels) was delivered and 190,000 teu (103 vessels) was scrapped (fig. 4). At the end of August, the fleet stood at 5,100 vessels with a total capacity of 16.1 million teu.

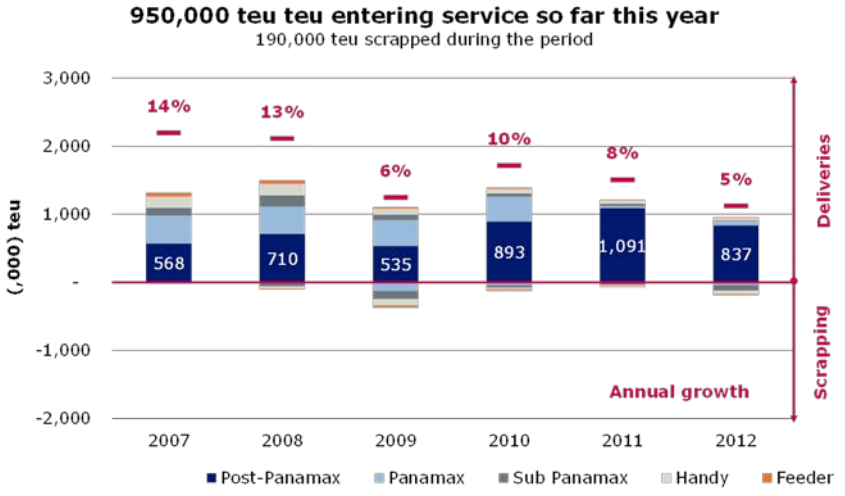
THE POST-PANAMAX FLEET GREW BY 830,000 TEU

Post-Panamax vessels represent 90% of delivered capacity this year, as 90 vessels with a total capacity of 840,000 teu were delivered in this segment. Super Post-Panamax vessels continue to represent a large share of total Post-Panamax deliveries. At the beginning of the year, the fleet consisted of 110 Super Post-Panamax vessels. In 2012, 43 new Super Post-Panamax vessels (541,000 teu) have been deployed (fig. 5). Consequently, the Post-Panamax segment grew by 830,000 teu, or 12%, and now represents close to 50% of the total container fleet (fig. 4).

NEGATIVE SUPPLY GROWTH IN SMALLER SEGMENTS

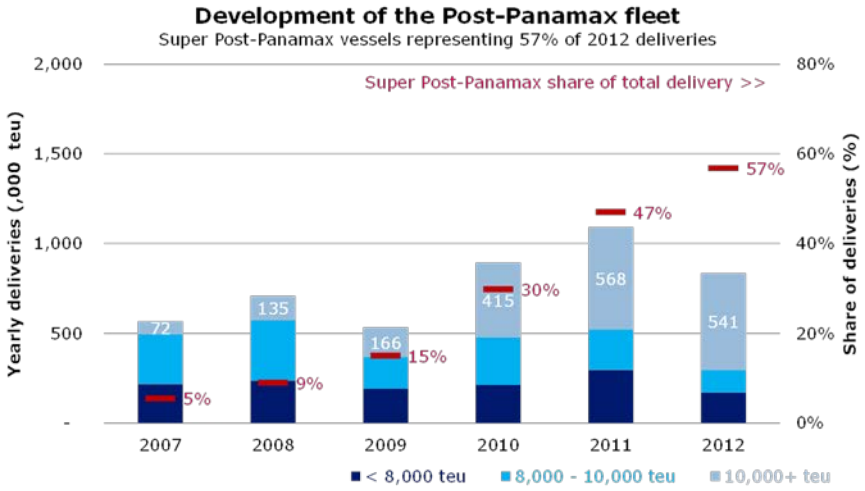
The Post-Panamax segment continues to grow at double-digit rates, but developments in the remaining segments vary quite a bit. The Panamax segment increased by 25,000 teu (0.6%) as 65,000 teu was delivered and 40,000 teu was scrapped. The other segments all experienced negative growth rates. The Sub-Panamax segment fell by 4% as

Figure CS.4



Sources: Clarksons, Danish Ship Finance

Figure CS.5



Sources: Clarksons, Danish Ship Finance

deliveries almost came to a standstill (8,000 teu) and 80,000 teu was scrapped. In the Handy segment 35,000 teu was delivered and 55,000 teu was scrapped.

CONTAINER DEMAND UP BY 4% IN 2012

Distance-adjusted head-haul container demand is set to grow by 4% in 2012 (fig. 7). In 2011, North American growth fell short of expectations, whereas European demand was stronger than expected. This time, the situation has reversed; North American demand is stronger than initially estimated and has therefore been revised upwards by 2.2 percentage points. European demand, however, appears to fall short of expectations, and has been revised downwards by 0.9 percentage point (fig. 6).

INTRA-ASIAN DEMAND UP BY 6% IN 2012

Intra-Asian head-haul demand was generally affected by lower European demand and is set to weaken from 9.5% in 2011 to 6% in 2012 (fig. 7). The slowdown in Intra-Asian demand is broadly based, but all countries continue to post positive growth figures nonetheless. The most significant slowdown is seen in Japan, as imports grew by only 0.9%. The main contributor to growth in Intra-Asian container traffic in 2012 is India. Indian imports from other Asian countries grew by 12% (17% in 2011).

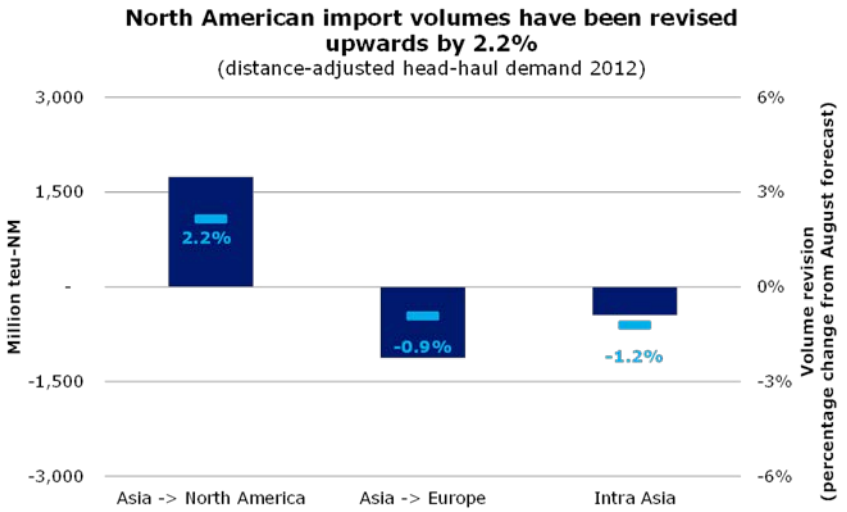
NORTH AMERICAN HEAD-HAUL DEMAND GREW BY 4.7% IN 2012

The North American economy has recovered faster than expected from the depths of 2011 and is expected to demonstrate robust growth in 2012. North American head-haul imports from Asia are expected to grow by 4.8% in 2012 (fig. 7).

EUROPEAN HEAD-HAUL DEMAND EXPECTED TO GROW BY 1.6% IN 2012

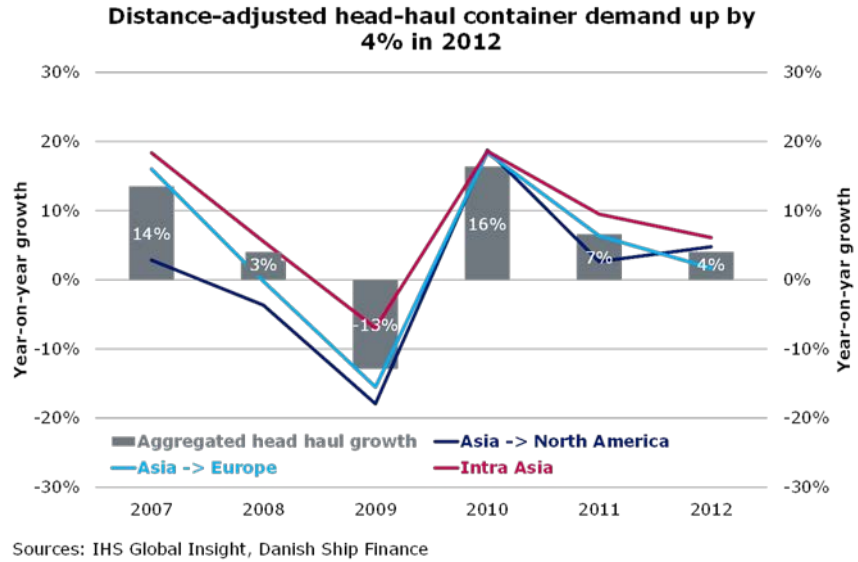
During recent years, owners' strategies of contracting large Post-Panamax vessels have primarily been with the objective of deploying the vessels on the main trade lanes between Asia and Europe. Virtually all Super Post-Panamax vessels have been deployed on these trade lanes. Since the recovery in the European economy has not yet materialized, it is not surprising that operators have sought new ways of finding employment for their vessels. The euro area is set to decline by 0.3% in 2012 as the political and financial uncertainty in southern Europe flared up again in the first half of 2012. This has also affected container volumes. Head-haul demand from Asia to Europe is set to grow by 1.7% in 2012 (fig. 7).

Figure CS.6



Sources: IHS Global Insight, Danish Ship Finance

Figure CS.7



Sources: IHS Global Insight, Danish Ship Finance

IN 2012, CONTRACTING ACTIVITY SLOWED TO A NEAR HALT. NEWBUILDING PRICES ARE AFFECTED BY OVERCAPACITY IN THE SHIPBUILDING INDUSTRY AND WERE DOWN BY 14% AT THE END OF AUGUST 2012. SECONDHAND VALUES HAVE DROPPED BY UP TO 40% SINCE 2011.

CONTRACTING DROPPED TO 260,000 TEU IN 2012

In 2011, 1.8 million teu was contracted in spite of considerable excess supply. In the first five months of 2012, contracting virtually came to a halt as only 16,000 teu was contracted. It therefore seemed as if the owners had for once displayed caution in relation to contracting tonnage. However, in June contracting climbed to 80,000 teu, as a line of Post-Panamax vessels (15 vessels) with a capacity between 5,000–5,100 teu was contracted. During the past two months contracting activity has remained at that level, as a total of 160,000 teu, including ten Super Post-Panamax vessels, was contracted in July and August. At the end of August, contracted capacity constituted 260,000 teu. The low level of contracting activity has led to a decline in average delivery times. In 2012, average delivery time was 28 months, which is a drop of two months from 2011 to 2012, and 13 months less than the highs of 2008 (fig. 8).

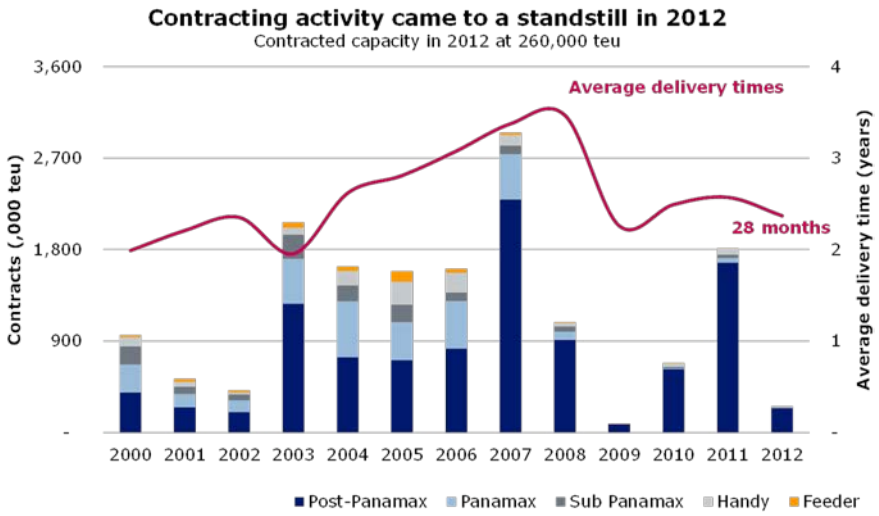
SECONDHAND VALUES DECLINING BY 40% IN 2012

Timecharter rates were close to break-even levels during 2012, and secondhand prices were driven down accordingly. Average secondhand prices declined by 40% in 2012 and are currently at all-time lows.

NEWBUILDING PRICES DECLINING BY 14% IN 2012

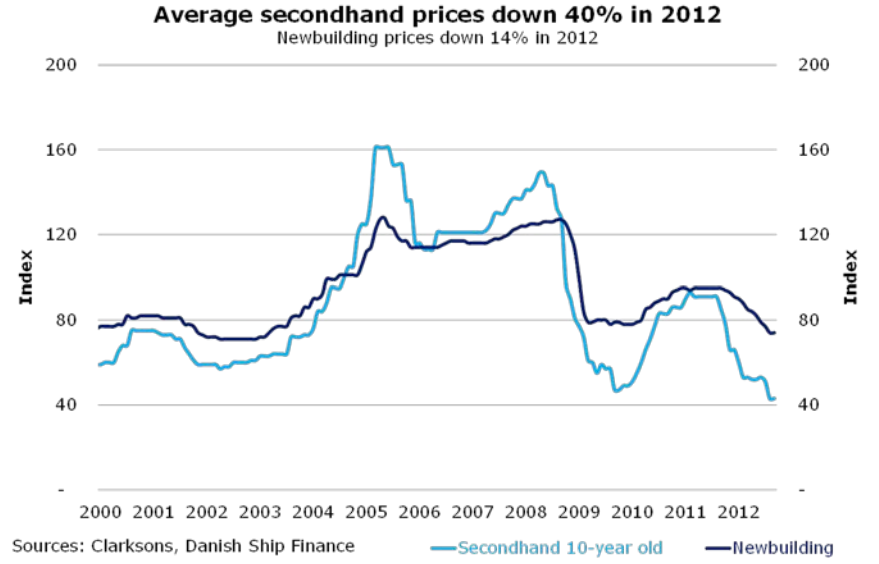
Container newbuilding prices are not immune to developments in the global shipbuilding industry, and container newbuilding prices dropped by 14% in 2012. However, newbuilding prices are associated with some uncertainty as a limited number of vessels have been contracted during the year. Nevertheless, the 5,000–5,100 teu vessels contracted from Chinese yards in 2012, listed at USD 43-45 million, have been reported as being near construction costs, indicating a low level of newbuilding prices.

Figure CS.8



Sources: Clarksons, Danish Ship Finance

Figure CS.9



Sources: Clarksons, Danish Ship Finance

DESPITE A ROBUST DEMAND SCENARIO THE SUPPLY/DEMAND BALANCE IS EXPECTED TO BE FURTHER SKEWED IN 2013. THE FLEET IS SET TO EXPAND BY A HISTORICALLY LARGE VOLUME OF TONNAGE DOMINATED BY POST-PANAMAX VESSELS. WE EXPECT MARKET DISCIPLINE TO BE TESTED DURING 2013.

In 2012, the fleet is expected to grow by 8% to stand at 16.6 million teu at the end of 2012. Consequently, the fleet has increased by 35% since 2008. By comparison, distance-adjusted head-haul demand has grown by 12% during the same period. Fleet growth has therefore exceeded demand by a factor of almost three.

It is primarily large vessels that have entered the fleet in recent years. This has led to a restructuring of the main trade lanes as large vessels have been launched on the main East-West trades. As a result, smaller Post-Panamax vessels (sub 8,000 teu) are pushed to other trade lanes causing a cascading effect throughout the route networks. This development is likely to continue in 2013, as supply growth is estimated to surpass demand growth by 3 percentage points. Super Post-Panamax vessels make up 40% of scheduled 2013 deliveries.

ORDERBOOK DECLINING BY 800,000 TEU IN 2012

The orderbook has declined by 19%, or 800,000 teu, since January 2012 to its lowest level since 2002 (22% of the fleet). In 2002, 1 million teu was on order, and the current order book is more than three times that volume. We therefore argue that a low orderbook/fleet ratio does not imply an end to the supply-side issues (fig. 10).

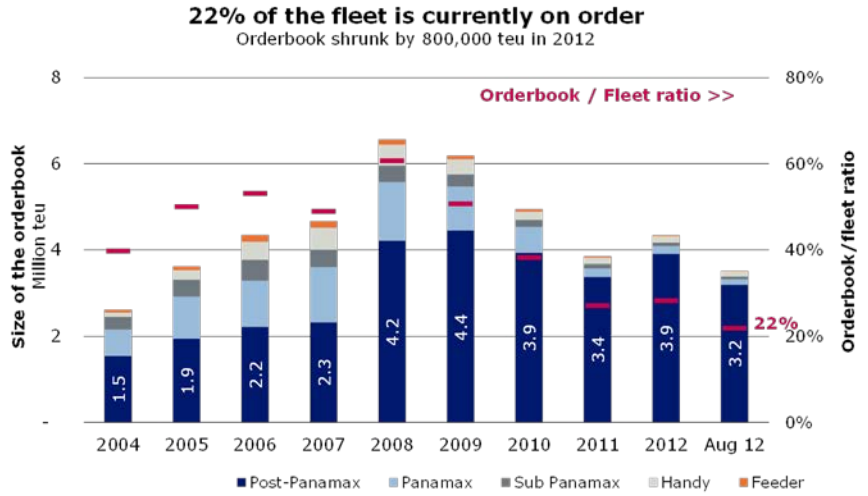
520,000 TEU EXPECTED TO ENTER THE FLEET FROM AUGUST TO DECEMBER

A total of 520,000 teu is scheduled for delivery during the rest of 2012. This will lead to an annual inflow of 1.5 million teu. We estimate that an additional 80,000 teu might be cancelled implying that the fleet will grow by 8% (1.2 million teu) in 2012 (fig. 11).

1.6 MILLION TEU EXPECTED TO ENTER THE FLEET IN 2013

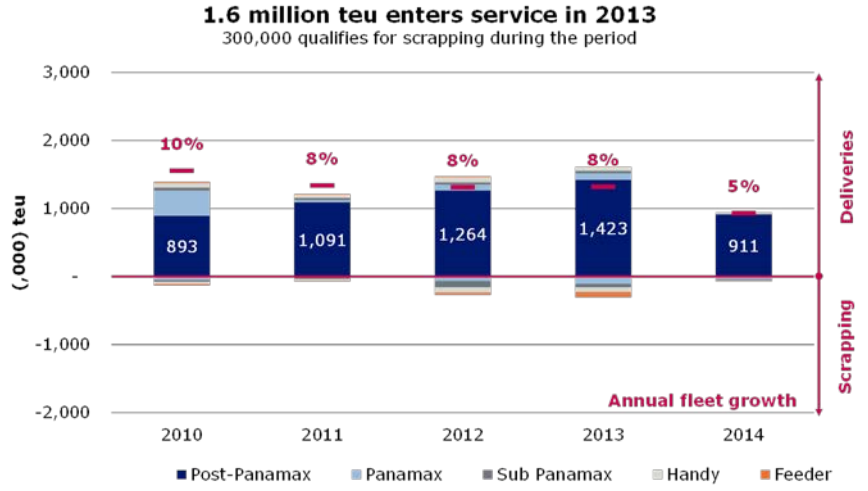
In 2013, 1.6 million teu is scheduled to enter the fleet. The massive inflow of Post-Panamax vessels is expected to continue as a record high 1.4 million teu is scheduled for delivery; hence, the segment will grow by 17%. The Panamax orderbook currently stands at 132,000 teu of which 20,000 teu is scheduled for delivery in the last four months of 2012. In the Sub-Panamax segment 40,000 teu is expected to be

Figure CS.10



Sources: Clarksons, Danish Ship Finance

Figure CS.11



Sources: Clarksons, Danish Ship Finance

delivered in 2013, 56,000 teu is expected in the Handy segment and 2,600 teu in the Feeder segment (fig. 11).

300,000 TEU QUALIFIES FOR SCRAPPING IN 2012

A total of 300,000 teu qualifies for scrapping in 2013 if all vessels older than 25 years are counted. The age structure of the container segment would indicate that primarily the smaller segments qualify for scrapping, since large vessels are generally younger than small vessels (fig. 11).

DEPLOYMENT OF VESSELS IN 2013

In 2012, operators shifted smaller Post-Panamax vessels (sub 8,000 teu) to other trade lanes including services to Africa, the US West Coast as well as South America. Deliveries in 2013 are expected to come out at 1.6 million teu. Of these, 1.4 million teu (88%) are Post-Panamax vessels - 600,000 teu are Super Post-Panamax vessels (fig. 12). These vessels will most likely be launched on the Asia to Europe trade lanes. We therefore project the restructuring/cascading process on the supply side will continue in 2013 and lead to increasing supply pressure on minor trade routes.

NORTH-SOUTH DEMAND GROWTH EXPECTED TO REMAIN STABLE AT 6%

The restructuring of the Asia to Europe trade lanes has led to larger tonnage being cascaded to North-South trades. Historically, growth on the major North-South trade lanes has been high and the demand forecast also points to a robust scenario. However, growth has slowed significantly in recent years and is expected to decline further from 11% in 2011 to 6% in 2012. In 2013, growth is expected to remain at 6%. Even though demand seems robust, we question whether growth is sufficient to absorb the inflow of larger tonnage (fig. 13).

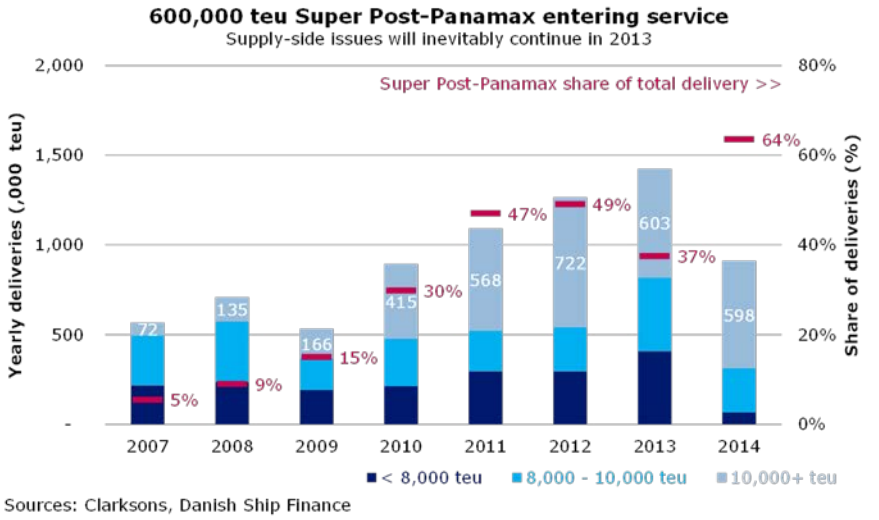
EUROPEAN DEMAND IN 2013 REMAINING UNCERTAIN

Distance-adjusted imports from Asia to Europe are expected to grow by 4% in 2013 (fig. 14). However, the situation in Europe is very uncertain. The debt crisis in the southern-periphery of Europe keeps stalling the European recovery and the IMF estimates the eurozone economy will contract by 0.3% in 2012. The GDP growth forecast for 2013 is 0.7%, yet most economic indicators are still negative and we therefore expect a fragile recovery.

TOTAL HEAD-HAUL CONTAINER DEMAND EXPECTED TO GROW BY 5% IN 2013

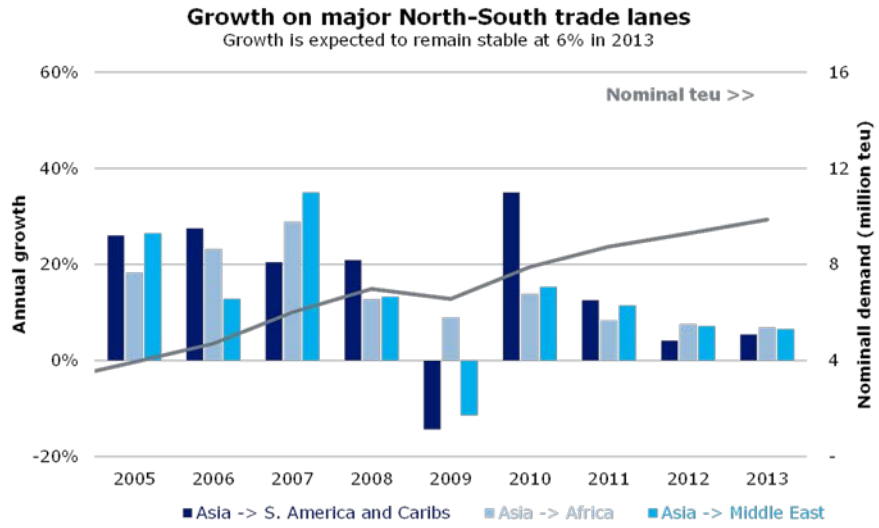
Total head-haul demand is expected to grow by 5% in 2013, which is one percentage point more than the 2012 growth rate (fig. 14). Growth

Figure CS.12



Sources: Clarksons, Danish Ship Finance

Figure CS.13



Sources: IHS Global Insight, Danish Ship Finance

is expected to be more or less balanced on all the major trade lanes. The main Asia to Europe and Asia to North America trade lanes are expected to grow by 4% and 5%, respectively. Intra-Asian demand growth seems to follow the patterns of western economies and is therefore also expected to increase from 6% in 2012 to 8% in 2013. However, a negative outcome for the European economy may cause a ripple effect throughout the global economy.

SPARE CAPACITY INCREASING BY 600,000 TEU IN 2012

Distance-adjusted head-haul demand seems robust and is expected to grow by 5%. However, this is not enough to absorb the massive inflow of tonnage. If no vessels are postponed or cancelled, fleet growth in 2013 is expected to be 8%. We therefore estimate that spare capacity, before taking supply cutting measures into account, will increase from 3.1 million teu in 2012 to 3.7 million teu in 2013 (fig. 15).

SLOW STEAMING CONTINUES TO REDUCE EFFECTIVE FLEET SUPPLY

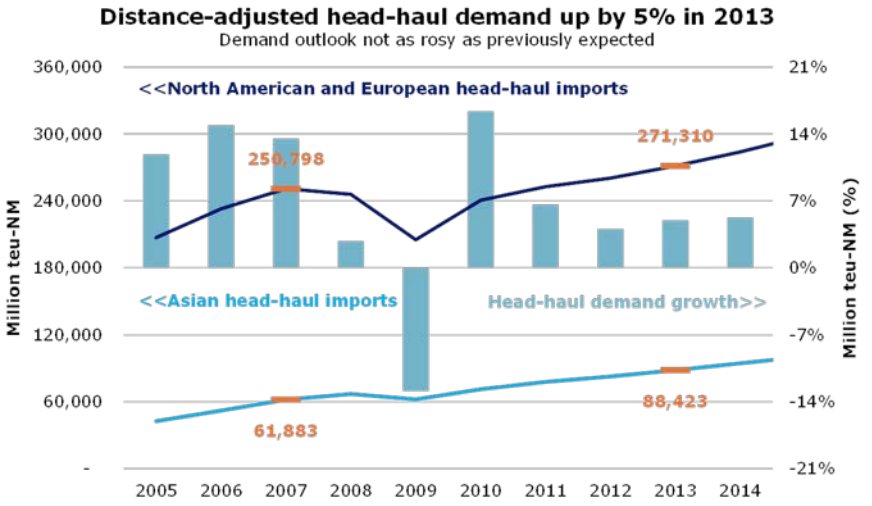
As long as overcapacity and high bunker costs continue to weigh on the container industry, the extensive use of slow steaming will most likely continue, thereby reducing effective fleet supply. Moreover, the low utilization rate in the industry may endure for the next few years.

RATES AND VALUES IN 2012

The container industry will remain challenged by the excess supply at least until the end of 2013, at which point deliveries will start to taper off for the first time in several years. However, even if supply and demand were to become better balanced after 2013, it may take a while before demand catches up with the massive inflow of tonnage. Further, the demand forecast is subject to considerable uncertainty. If demand fails to pick up, the recovery may not set in until well into 2015.

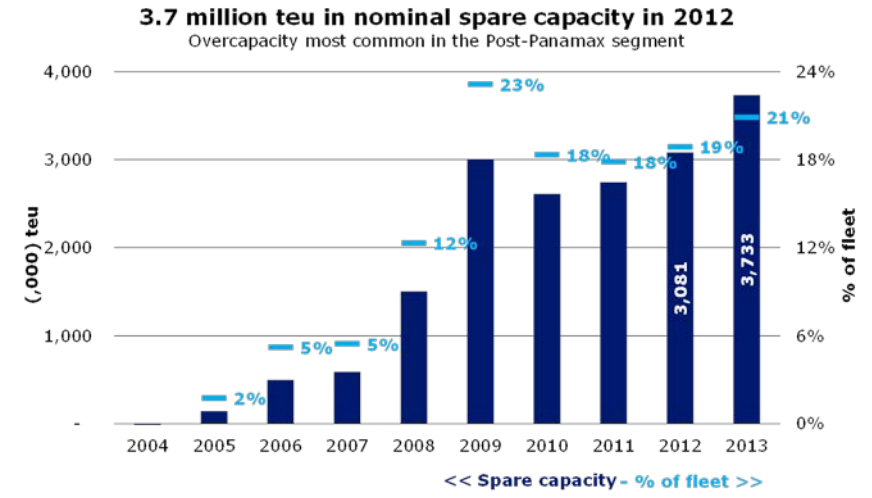
We believe that secondhand values have bottomed out and will therefore not decline significantly below current levels. Newbuilding prices, however, may drop further, as Chinese and South Korean yards could stage a price war due to overcapacity. In recent years, fundamentals have been set aside in determining box rates. It has rather been a question of the level of market discipline. As overcapacity is expected to increase in 2013, we expect the industry's market discipline to be tested, which may lead to increased volatility in box rates. However, we do not expect box rates to descend to the lows of 2011.

Figure CS.14

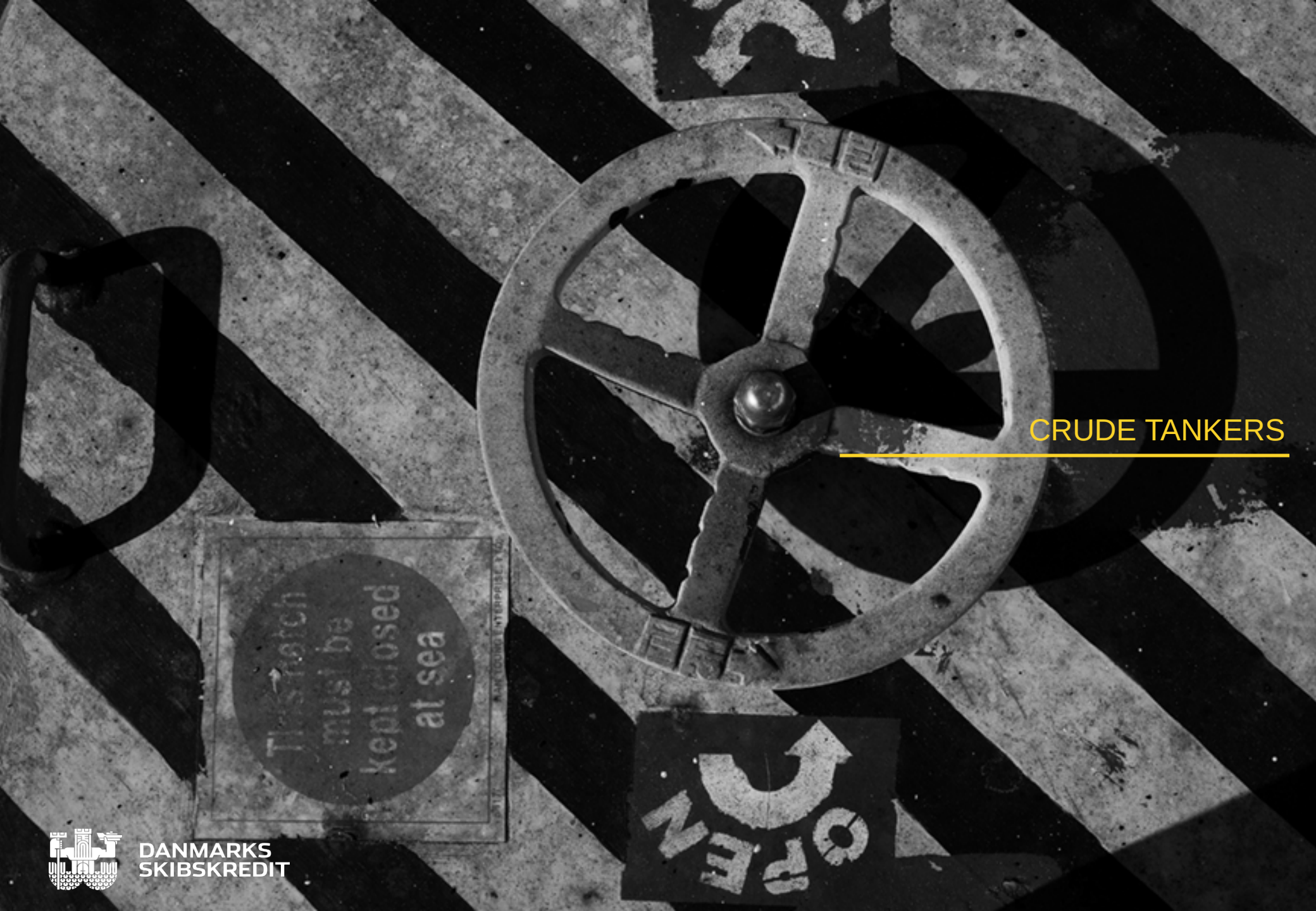


Sources: IHS Global Insight, Danish Ship Finance

Figure CS.15



Sources: IHS Global Insight, Clarksons, Danish Ship Finance



CRUDE TANKERS

DANMARKS SKIBSKREDIT

CRUDE TANKERS

MARKET CONDITIONS IN THE CRUDE TANKER MARKET ARE DETERIORATING. RATES ARE COMING UNDER PRESSURE FROM THE GROWING OVERSUPPLY OF TONNAGE. THE OUTLOOK IS EXPECTED TO BE SUPPLY DRIVEN AS FLEET GROWTH SURPASSES SEABORNE TRADE GROWTH.

FREIGHT RATES

THE YEAR 2012 BEGAN WITH SLIGHTLY UPWARD-TRENDING FREIGHT RATES, BUT BY AUGUST 2012, THE BALTIC DIRTY TANKER INDEX STOOD AT INDEX 616, DOWN SOME 25% FROM JANUARY 2012.

Overall, the crude tanker freight market persistently deteriorated during the first eight months of 2012. The year began with upward-trending rates supported by short-term factors such as Iranian sanctions, port delays and slow steaming. Gradually supply caught up with these short term factors and rates declined accordingly. However, slightly lower bunker prices provided some support for earnings during the period.

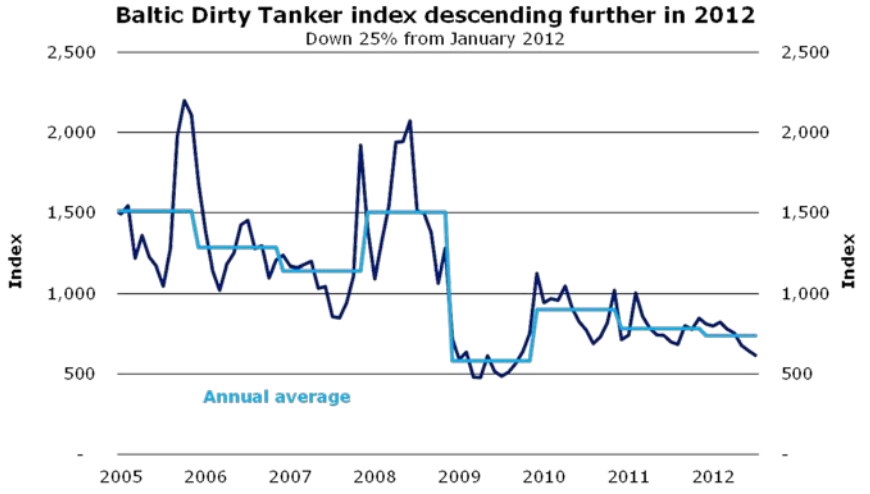
BALTIC DIRTY TANKER INDEX AT DEPRESSED LEVELS

During the first eight months of 2012 the Baltic Dirty tanker index fell 6% from an annual average of 783 in 2011 to 738 in 2012. At the end of August 2012, the monthly average stood at 616, down 12% year-on-year (fig. 1). Such levels have not been seen since mid-2009 when the financial crisis was at its peak. Back then, demand faltered, whereas today, the low rates are the result of the steady inflow of new vessels.

TIMECHARTER RATES ARE UP, BUT REMAIN LOW IN A HISTORICAL PERSPECTIVE

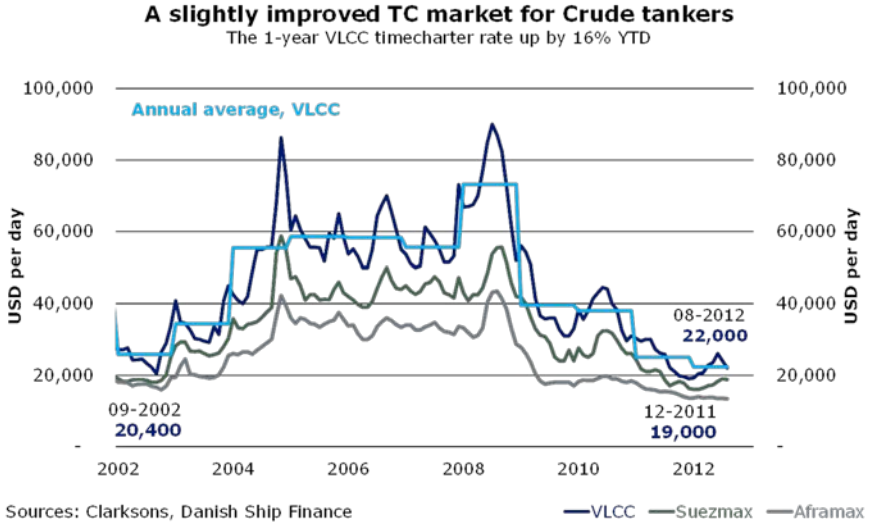
During the first eight months of 2012, average timecharter rates have increased from USD 19,000 per day in December 2011 to USD 22,000 per day in August 2012. The monthly average for the first eight months of 2012, stood at USD 22,000 per day, down 14% from the previous low, recorded in 2002 (fig. 2). Due to the current weak charter market, some activity has returned to the timecharter market, as current timecharter levels are attractive for locking in future rates. This indicates that market sentiments might be improving with the onset of winter in the northern hemisphere.

Figure T.1



Sources: Clarksons, Danish Ship Finance

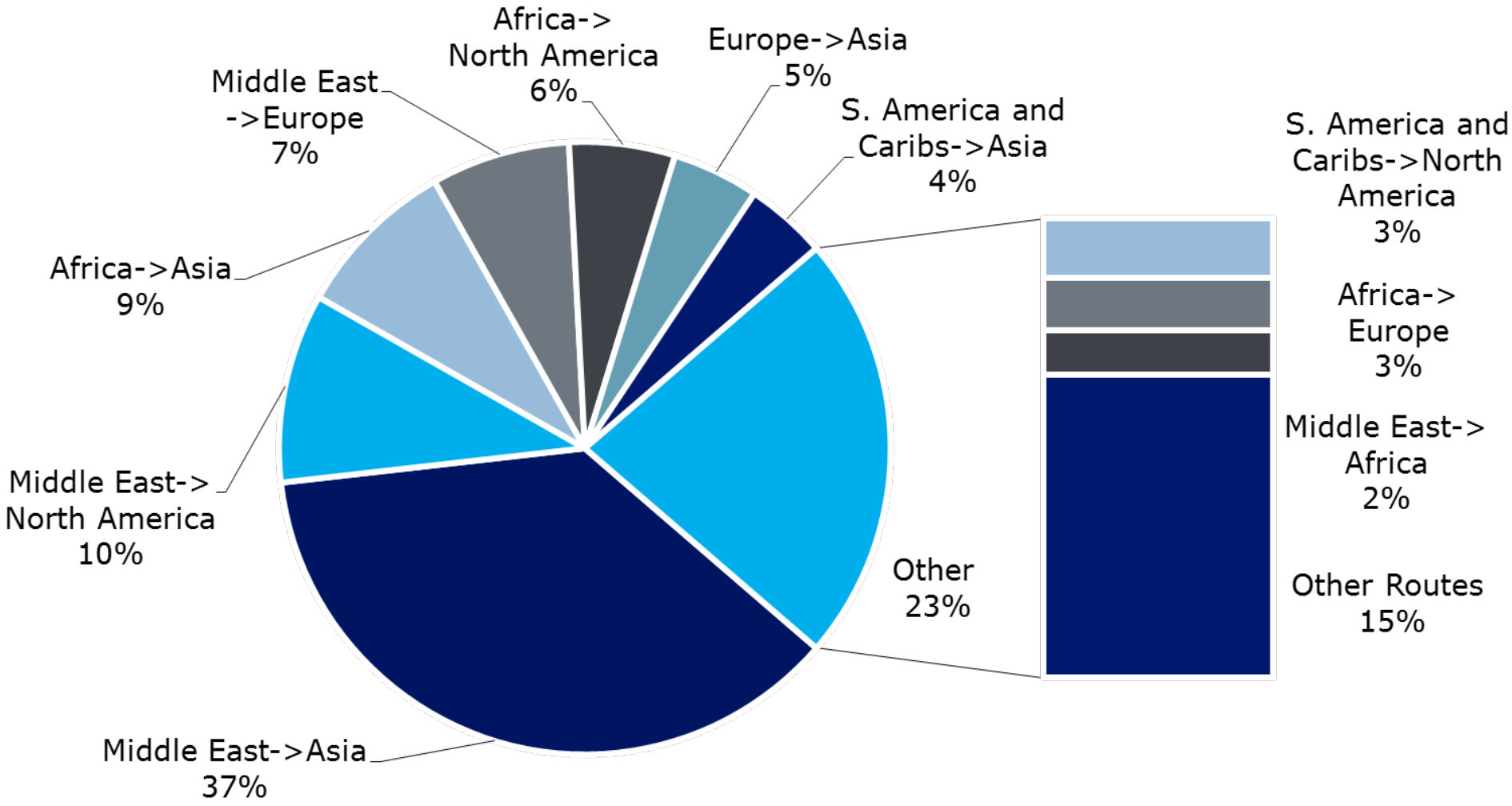
Figure T.2



Sources: Clarksons, Danish Ship Finance

Figure T.3

MAJOR FRONT-HAUL CRUDE TANKER ROUTES
(MEASURED IN BILLION TON-NAUTICAL MILES, 2011)



Sources: IHS Global Insight, Danish Ship Finance

THE CARGO CARRYING CAPACITY OF THE OIL TANKER FLEET GREW 3% DURING THE FIRST EIGHT MONTHS OF 2012 WHILE DISTANCE-ADJUSTED DEMAND GREW 6%. HEAVY POSTPONEMENT ACTIVITY EASED FLEET GROWTH. HOWEVER, DEMAND HAS NOT ABSORBED RECENT YEARS' STRONG FLEET GROWTH.

In January 2012, a total of 26 million dwt was scheduled for delivery during the first eight months of 2012, representing gross fleet growth of some 8% alone during the period.

THE OIL TANKER FLEET GREW 3% DURING THE FIRST EIGHT MONTHS OF 2012

The combination of cancellations, postponements and scrapping curbed fleet growth by 5 percentage points. During the first eight months of 2012, the supply of oil tanker tonnage grew 3% as 18 million dwt was launched and 6.2 million dwt was scrapped (fig. 4). Growth was not evenly distributed across segments: the Aframax fleet did not grow at all, while the VLCC and Suezmax fleet both expanded by 4%.

INCREASED POSTPONEMENT ACTIVITY HELPED TO CURB FLEET GROWTH

In the orderbook as of January 2012, a total of 38 million dwt was scheduled for delivery in 2012 of which a total of 26 million dwt was scheduled to reach the sea during the first eight months of the year (18 million dwt was delivered and about 7 million dwt was postponed for subsequent delivery). Our orderbook monitoring reveals that fewer orders were cancelled in 2012 than in 2011. Some 1 million dwt scheduled for delivery in 2012 was cancelled. Additional orders of 4.1 million dwt with a delivery date in 2013 or later was also cancelled during the first eight months of 2012. The pickup in cancellation activity for delivery beyond 2012 mainly involved the VLCC segment (fig. 5).

GROWING NUMBER OF DEMOLITIONS

As a result of the soft market conditions and the continuing inflow of new tonnage, scrapping activity has taken off during the first eight months of 2012 (compared to the same period in 2011). A total of 6 million dwt or 1% of the crude tanker fleet has been scrapped (6 million dwt in 2011) (fig. 4). Scrapping activity has been the highest in the Suezmax and Aframax segments. The number of tankers converted into other vessel types is dwindling; in recent years approximately 10 million dwt has been converted annually from tankers to for example dry bulk

Figure T.4

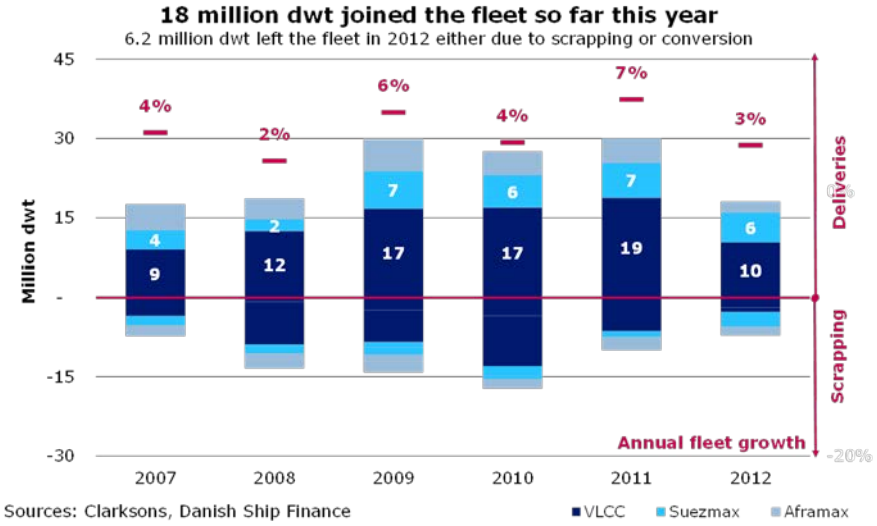
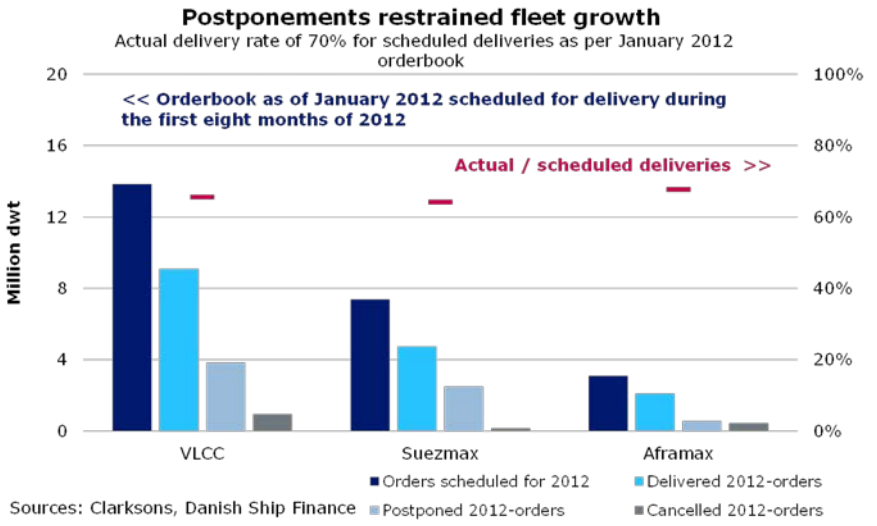


Figure T.5



vessels per year. Only 0.9 million dwt was converted into other types in the first eight months of 2012. The period when conversions helped to curb fleet growth seems to be over.

SEABORNE OIL TANKER TRADE GREW 6% IN 2012

Trade in seaborne crude oil expanded by 6% in 2012. Measured by volume, this is an increase of 118 million tonnes or slightly more than the 4% increase recorded in 2011 to 76 million tonnes. The 6% growth in 2012 is primarily driven by Asia in general and by China in particular. Europe and seaborne crude imports into the USA are declining (fig. 6).

OIL TANKER DEMAND STEMS FROM ASIA

Despite the sluggish conditions in the USA and the euro area, global oil demand has continued to grow in 2012. Global oil consumption increased by 1% driven by strong Asian demand. Oil consumption in OECD countries actually fell by 2%, while consumption in non-OECD countries has increased by 4% in 2012 to date. Once again, China was the single largest contributor to the increase in global oil demand. Chinese oil consumption was up by 5% during the first eight months of 2012. Oil consumption in China has risen by 33% from 2008 to 2012.

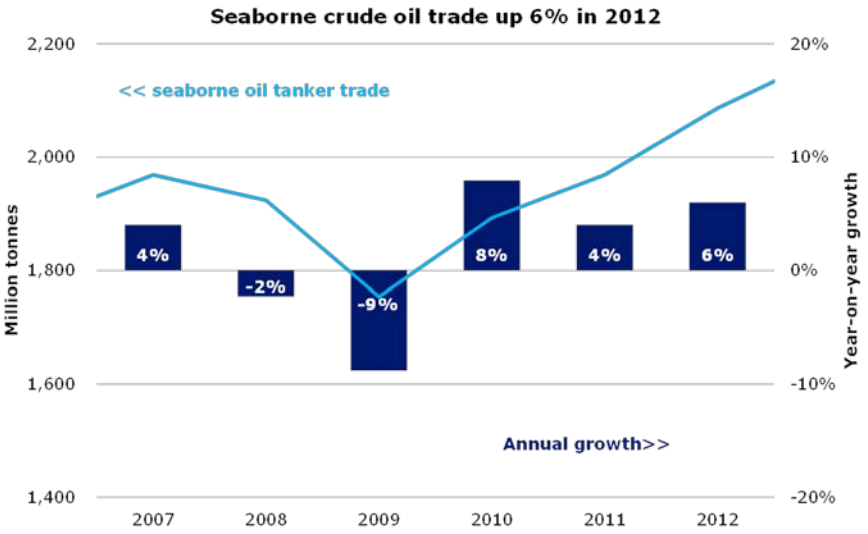
CHINESE CRUDE OIL IMPORTS REMAINING STRONG

China's oil imports continue to surge. China reached a new record-high in May 2012, importing 6.3 million barrels of crude oil per day (fig. 7). The new peak(up 18% compared with a year ago) is a reflection of China's increased stockpiling rather than of a rising domestic appetite and a stronger economic outlook. But for how long will China's stockpiling be able to mask tepid domestic oil demand and add positivity to the gloomy tanker market?

US IMPORT VOLUMES OF CRUDE OIL CONTINUES TO SLIDE

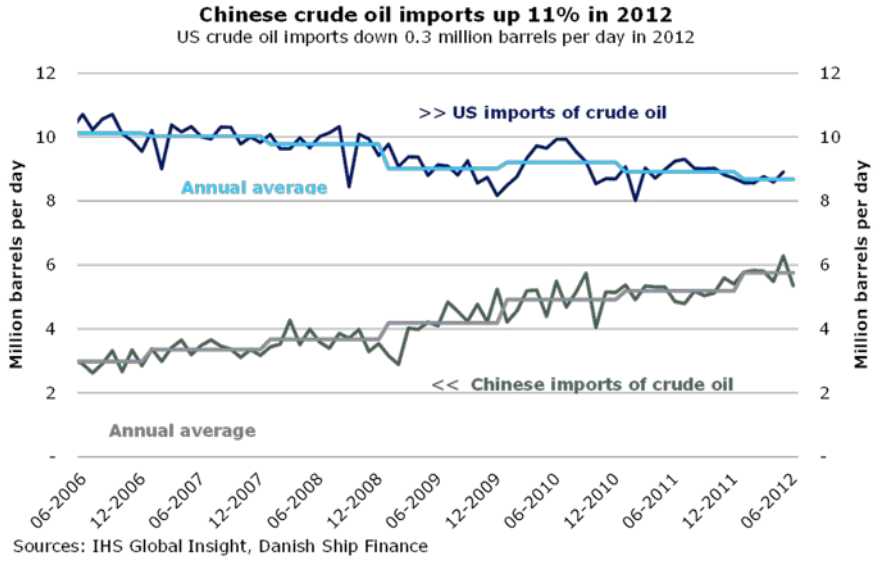
Seaborne crude oil imports to the USA are on the decline and have been so for the last couple of years. In 2007, US seaborne crude oil imports stood at 10 million barrels per day and the figure has declined ever since (fig. 7). In 2011, this figure had fallen to a little over 8.9 million barrels per day (fig. 7). This trend seems to be continuing in 2012, with average imports landing at 8.6 million barrels. The decline in US seaborne crude oil imports is a reflection of increased domestic supply, i.e. shale gas exploitation and increased imports from Canada through pipelines, rather than an indication of a steep decline in US oil consumption.

Figure T.6



Sources: IHS Global Insight, Danish Ship Finance

Figure T.7



Sources: IHS Global Insight, Danish Ship Finance

CRUDE TANKER TONNE-MILE DEMAND SLIGHTLY LOWER

The fact that Asian crude oil imports increased during the first eight months of 2012 meant that transported crude oil, on average, was carried over longer distances. One might mistakenly have thought that the decline in seaborne crude oil imports to the USA could have led to a drop in travel distances, but in fact the opposite is the case. Average travel distances on the remaining volumes actually increased as trading patterns have changed. The USA has been importing more oil from Saudi Arabia (+22%) while imports from Nigeria and Venezuela declined. Unfortunately, the increase in travel distances was not enough to offset the decline in volume. Taking changes in trade patterns into account, average world trading distances actually decreased slightly in 2012. Distance-adjusted demand is expected to grow by 5.7% in 2012 compared to 6% in 2011, led by China and India at increases of 7% and 8% respectively (fig. 8).

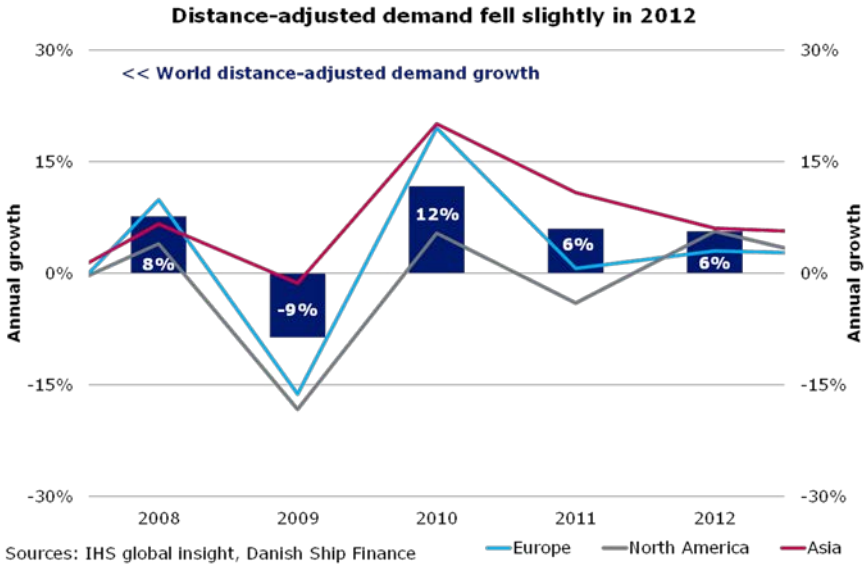
ANNUAL CHINESE CRUDE TONNE-MILE DEMAND CLOSING IN ON US LEVELS

China has become the second largest importer of crude oil, importing about 3 million barrels per day less than the USA. Distance-adjusted, China only generates 1% less than the USA in terms of ton-mile demand. Consequently, it won't be long before China overtakes the USA as the largest contributor to tonne-mile demand, even with the slowing rate of growth in its crude oil imports.

IMBALANCE BETWEEN DEMAND AND SUPPLY WORSENING

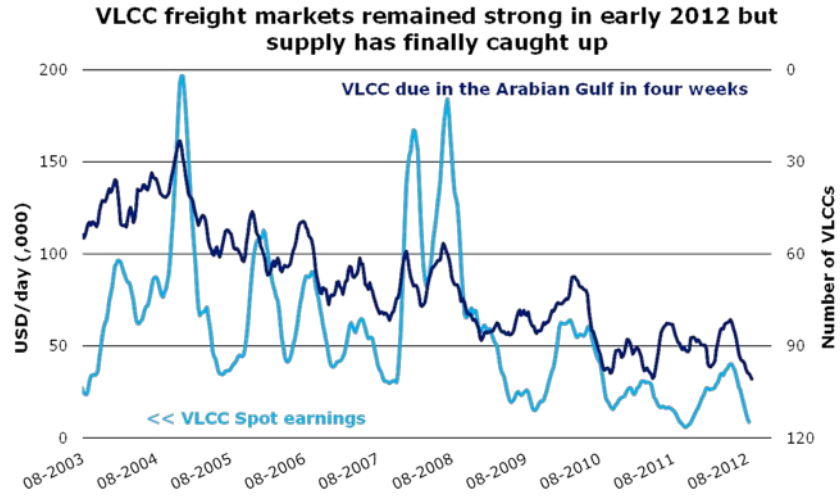
To sum up, the oil tanker market was clearly out of balance in 2012. Weak demand fundamentals, increasing domestic US oil production and the continued inflow of new tonnage sent freight rates tumbling. This is clearly summarised by the situation in the Arabian Gulf where the number of VLCCs available for cargo increased from an average of 93 in December 2011 to an average of 105 VLCCs in July 2012 (fig. 9).

Figure T.8



Sources: IHS global insight, Danish Ship Finance

Figure T.9



Sources: Clarksons, Danish Ship Finance

THE DETERIORATING OUTLOOK FOR THE OIL TANKER MARKET HAS KEPT SHIP VALUES DEPRESSED. SHIPOWNERS ARE FACING DIFFICULT TIMES AND ARE KEEPING CONTRACTING OF VESSELS TO A MINIMUM.

FEW NEW ORDERS PLACED IN 2012

Low freight rates coupled with oversupply and limited access to finance has kept contracting for newbuildings to a minimum (fig. 10). Only 3.1 million dwt was contracted during the first eight months of 2012, the lowest level in more than a decade. Contracts tended to be more in favour of VLCC vessels in 2012 than was the case last year. Aframax and Suezmax contracting activity has been reduced to a trickle with only 0.6 million dwt contracted during the first eight months of 2012 compared to 5.2 million dwt last year.

DELIVERY TIME APPROXIMATELY TWO YEARS

The scheduled average delivery time was at just over two years during first the eight months of 2012, slightly down compared to 2011 (fig. 10). The low level of average delivery time indicates that spare capacity at yards is increasing.

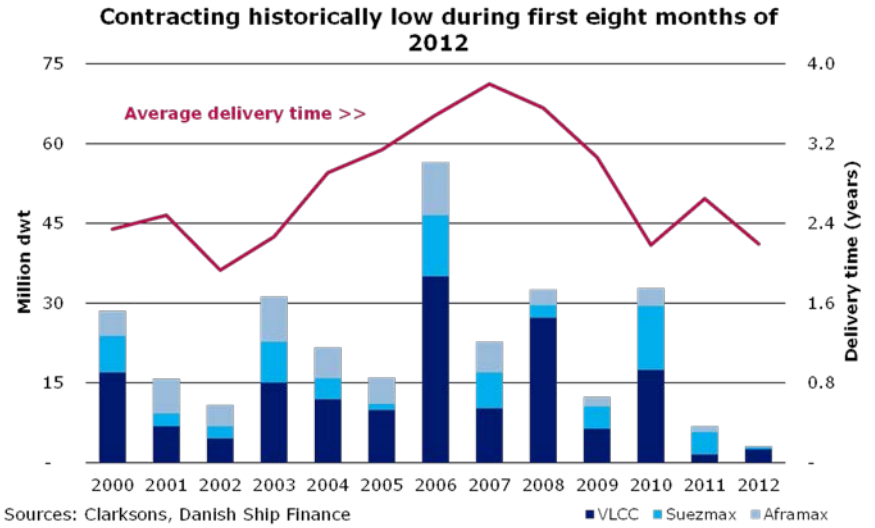
NEWBUILDING PRICES SLIGHTLY DOWN

Soft market conditions and the bleak outlook would normally drive prices further down, perhaps by more than reported; however, average oil tanker newbuilding prices fell by 5% during the first eight months of 2012 (fig. 11). With a declining orderbook and prospects of surplus yard capacity newbuilding prices might have been expected to drop even further. However, it appears that we have reached the level where input costs generally equal newbuilding prices.

FALLING SECONDHAND PRICES

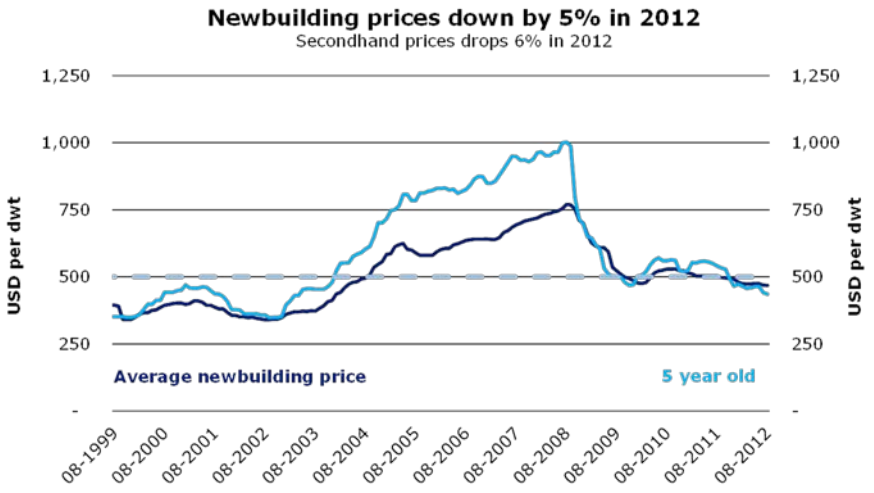
The deteriorating market conditions and the declining newbuilding prices have also pulled down the secondhand market. The average price for a 5–year-old oil tanker stood at USD 436 per dwt in August 2012, a decline of 6% for the year to date (fig. 11). Generally, older vessels have lost more in value than younger ones, as sending vessel to the scrap yards is becoming an increasingly attractive option.

Figure T.10



Sources: Clarksons, Danish Ship Finance

Figure T.11



Sources: Clarksons, Danish Ship Finance

THE OIL TANKER MARKET OUTLOOK IS CHARACTERISED BY A LARGE INFLOW OF NEW VESSELS AND WEAK FUNDAMENTALS. ACCORDINGLY, FREIGHT RATES ARE EXPECTED TO REMAIN DEPRESSED IN 2013. EVEN IF THE OIL TANKER SUPPLY GROWTH SLOWS IN 2013, THE NEAR-TERM OIL PROSPECTS WILL REMAIN MIRED IN UNCERTAINTY. FLEET UTILISATION AND EARNINGS ARE EXPECTED TO REMAIN LOW UNLESS THE GLOBAL ECONOMY REBOUNDS AND PROVIDES SUPPORT FOR STRONG OIL DEMAND.

Weak fundamentals and the overhang of tonnage combined with the relatively large orderbook dominate the outlook. In particular, declining US crude oil imports (due to increasing crude oil production) and the sustainability of China's insatiable thirst for crude poses the greatest challenge to oil tanker owners in 2013. As a result, owners might start considering the prospects of scrapping 15-year or even younger vessels.

MANY OIL TANKERS TO BE LAUNCHED IN 2012 AND 2013

By August 2012, the global orderbook for oil tankers stood at 47 million dwt (fig. 12). That is one new vessel scheduled to enter the fleet for each ten at sea, but the number varies considerably across segments. In the VLCC segment, almost two vessels are scheduled to enter the fleet each week for the rest of 2012. For 2013, the figure is down to one vessel per week. The orderbook fleet ratio is the highest for the two largest segments, VLCC and Suezmax, at 14% and 19% respectively, while the ratio is just below 5% for the Aframax segment.

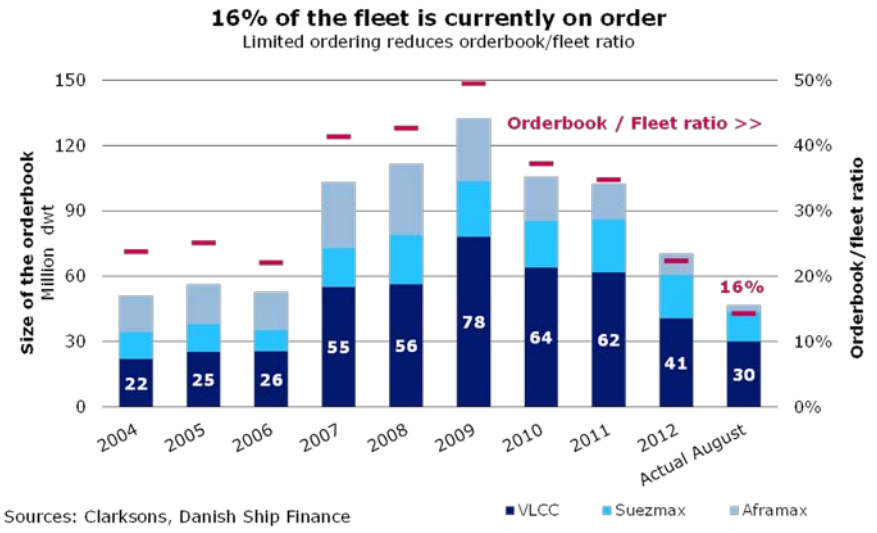
POSTPONEMENT WILL CURB FLEET GROWTH OVER THE NEXT YEARS

Assuming that the postponement activity of the first eight months of 2012 will continue for the remainder of 2012 and for 2013, we expect that some 3 million dwt will be postponed from 2012 and into 2013 and 4 million dwt will be postponed from 2013 into 2014 (fig. 14). Without postponement activity, fleet growth would have been 7% in 2013, or slightly above the 6% of 2012.

CANCELLATIONS MIGHT SHRINK THE ORDERBOOK IN 2013

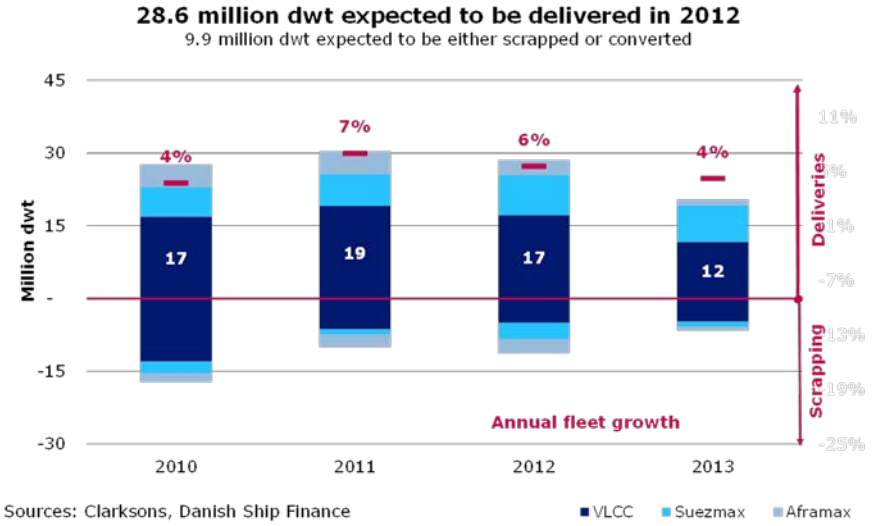
As already mentioned, cancellations have shrunk the orderbook by some 8% during the first eight months of 2012. Given the dire market conditions with no prospects of a rebound any time soon, we assume that cancellations will continue to shrink the orderbook. We estimate

Figure T.12



Sources: Clarksons, Danish Ship Finance

Figure T.13



Sources: Clarksons, Danish Ship Finance

that cancellations will reduce annual deliveries by 1 million dwt in 2012 and by another 2 million dwt in 2013.

YOUNGER VESSELS MIGHT NEED TO BE SCRAPPED

Almost two vessels are scheduled to enter the fleet per week in 2012 and the number is slightly lower for 2013. Combined with miserable earnings and high bunker prices, owners are facing unrelenting downward pressure on earnings as supply is quickly becoming too large to handle. In order to curb the massive inflow of vessels, owners have started to scrap younger vessels. We believe that owners will scrap vessels that are due for their fourth or even their third special survey in 2012 and 2013. In today's weak market, many owners' have to consider the economics of paying for a third special survey (4-5 million USD for a VLCC) at 15 years of age, and then trading the vessel versus the option of scrapping the vessel. In our opinion, scrapping may be an attractive option, because the breakeven point of trading an older vessel may lie well above what a vessel might fetch in the current market. We assume that 6.5 million dwt will leave the fleet in 2013 and for the last 4 months of 2012 we expect that an additional 4 million dwt will be scrapped.

4% FLEET GROWTH IN 2013

Taking the estimated levels of scrapping, postponements and cancellations into consideration, we estimate that net fleet growth will land at about 6% in 2012 (+6.5 million dwt for the remainder of 2012). In 2013, we expect that the growth rate will level off and that the fleet will increase by 4% (14 million dwt). However, even if this figure seems small, one has to remember that the annual entry of new tonnage is the fifth highest seen in the last fifteen years.

SEABORNE OIL TRADE GROWTH SLOWING

Growth in seaborne oil trade appears to slow down with growth rates similar to 2011. Total seaborne oil trade is set to expand by 5% (95 million tonnes) (fig. 14), the main growth driver once again being China and Asia, while Europe and North America are expected to remain subdued in 2013. Over the next few years, China is projected to become the fastest growing importer, while growth in the North American oil trade is expected to continue waning as domestic production is expected to pick-up (fig. 15). Considering the current instability in the world economy, the current forecast may well fall short of projections.

Figure T.14

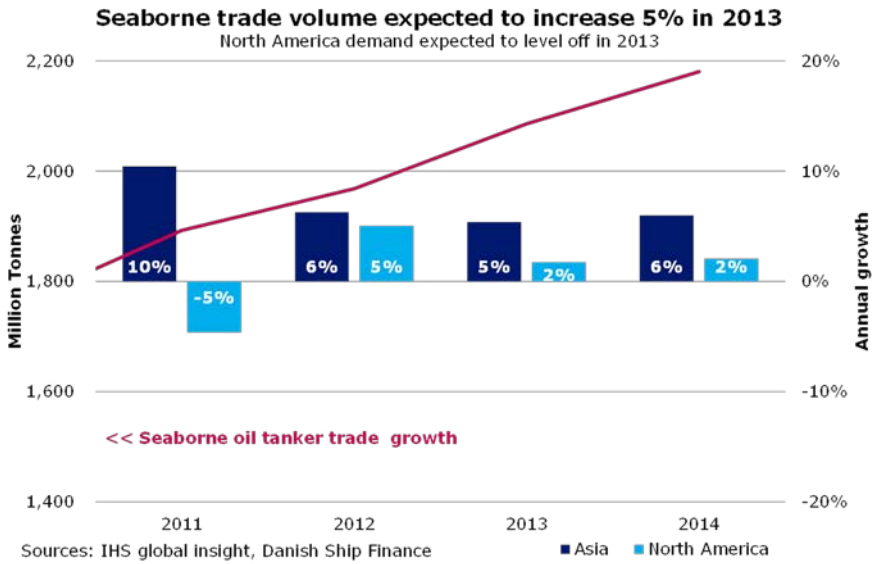
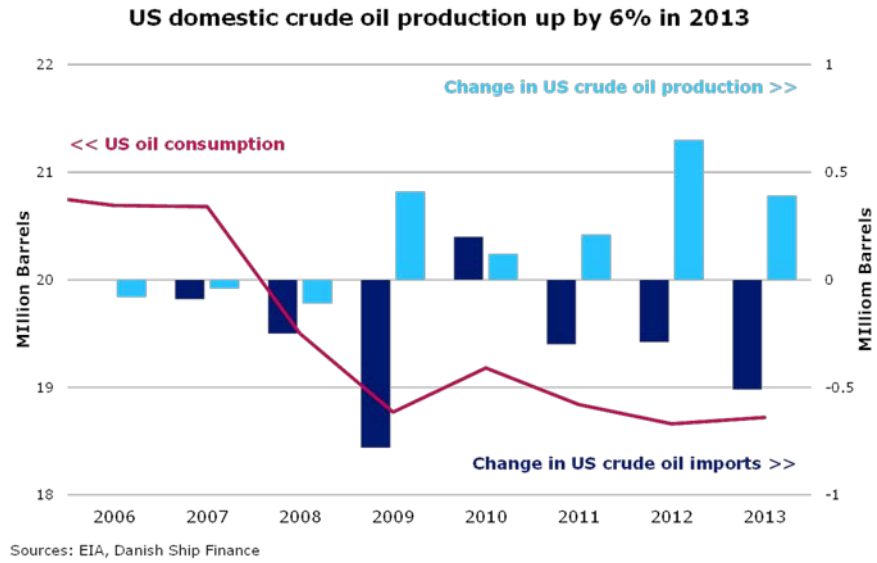


Figure T.15



CHINESE CRUDE OIL IMPORTS TRAVEL LONGER DISTANCES

The rapid growth in China's production of refined oil products and hence demand for crude oil imports has been a supportive feature of the crude tanker fleet for years now and this trend is expected to continue. Chinese oil imports are expected to increase by 0.5 million barrels per day in 2013 creating employment for ten VLCCs alone if the full increase is sourced from the Middle East. Lately, however, China has begun to import crude oil over even longer distances, and that could potentially lift distance-adjusted crude tanker demand considerably. Other countries such as India and South Korea are also expected to show healthy grow rates in 2013, as they are scheduled to open more refinery capacity.

US OIL PRODUCTION MAY HAVE DIRE CONSEQUENCES FOR CRUDE TANKERS

Growth in US domestic oil production is expected to continue offering grim perspectives for US crude oil import volumes. US oil production is set to increase by 0.4 million barrels per day in 2013 (fig. 15). Furthermore, US crude oil imports are expected to be sourced from nearby countries such as Venezuela and Mexico. This does not bode well for crude tanker demand. Translated into VLCC demand, this development alone could reduce VLCC demand by 2.5% annually.

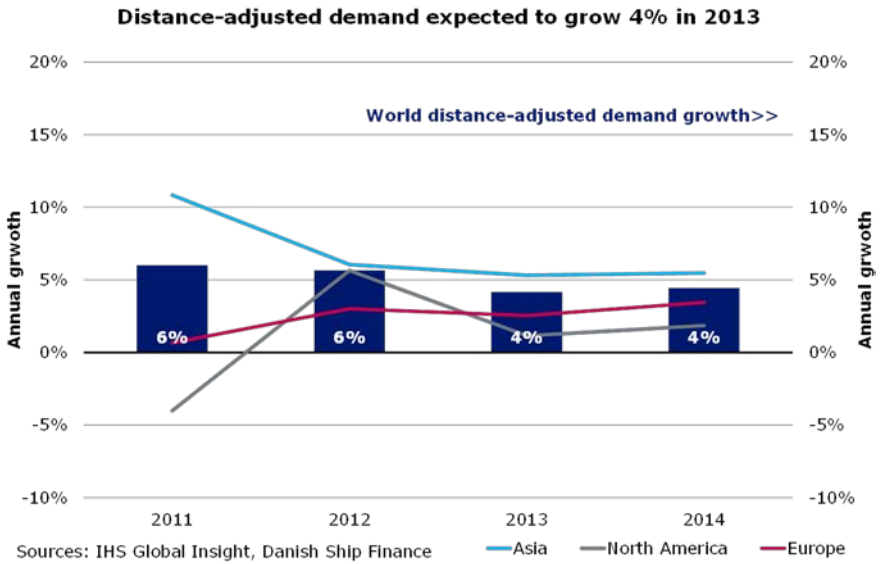
DISTANCE-ADJUSTED TRADE VOLUMES SLIGHTLY DOWN IN 2013

Asian crude oil imports are expected to increase by volume and to travel longer distances in 2013. However, the slump in European demand and the increasing domestic oil production in the USA will reduce average distance-adjusted crude tanker demand in 2013. Balancing the two factors, distance-adjusted crude trade demand is expected to grow by 4% in 2013 (fig. 16).

RATES WILL REMAIN LOW IN 2013

The outlook for crude tankers is bleak and rates are expected to remain low. However, we do expect temporary hikes such as from the winter season to have a positive effect on crude tanker demand, but with less intense and shorter-lived spikes than previously. However, owners can improve the situation by beginning to scrap even younger vessels at a faster pace than they are doing today. That would certainly help the market move towards a speedier recovery.

Figure T.16



PRODUCT TANKERS

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PRODUCT TANKERS

CONDITIONS IN THE PRODUCT TANKER MARKET ARE DETERIORATING. THE COMBINATION OF OVERSUPPLY CAUSED BY PREVIOUS YEARS' INFLOW OF TONNAGE AND WEAKENING FUNDAMENTALS IS KEEPING RATES DOWN. NEW ORDERING AND THE NEGATIVE ECONOMIC OUTLOOK HAS RAISED QUESTIONS ABOUT THE PRODUCT TANKER RECOVERY.

FREIGHT RATES

IN 2012, FREIGHT RATES HAVE BEEN DESCENDING TOWARDS THE LOWS OF 2009. BY AUGUST 2012, THE BALTIC CLEAN TANKER INDEX STOOD AT INDEX 581 - DOWN SOME 15% YEAR-ON-YEAR. HOWEVER, THE AVERAGE INDEX FOR THE YEAR IS STILL 25% ABOVE THE LOWS OF 2009.

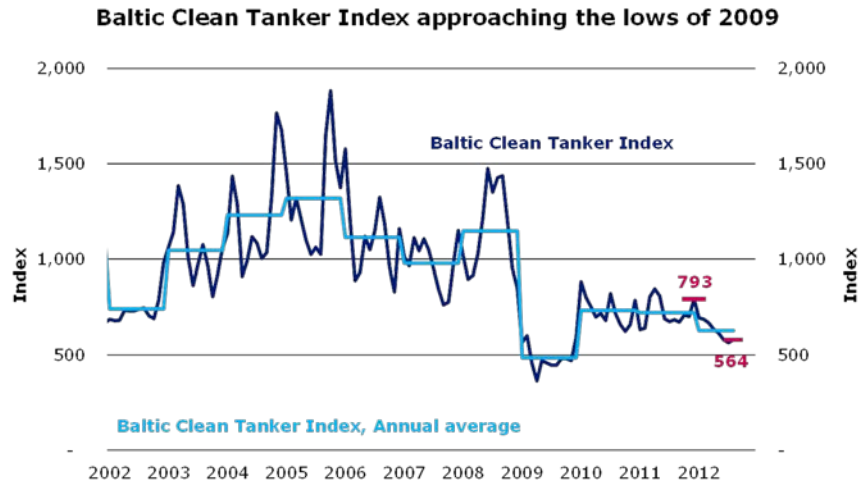
THE BALTIC CLEAN TANKER INDEX ON A PERSISTENT DECLINE IN 2012

The Baltic Clean Tanker Index dropped from a temporary spike at around index 800 in December 2011 to below index 700 at the end of January. An anticipated recovery in freight rates following the US driving season failed to materialise, and rates have since continued to descend deeper. The slump in rates is caused by weaker demand for gasoline and high refinery utilisation in USA as well as a large oversupply of vessels. High bunker prices are exacerbating the situation further. The average Baltic Clean Tanker Index for the full year 2012 is set to come out at around 600, down 15% from last year's annual average. By August 2012, the index fell to below 600 for the first time since December 2009, but the index is still 200 index points above the lows of April 2009. Even the hurricane season has failed to improve sentiments in the market (fig. 1).

OVERSUPPLY KEEPING CHARTER RATES DOWN

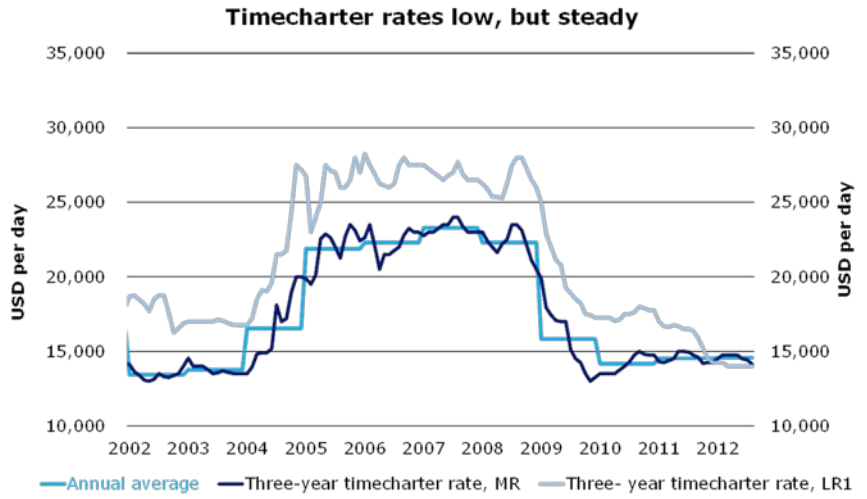
There is still no spillover effects from the weak spot market to timecharter rates. Timecharter rates have been stable, but at a very low level since the beginning of the year. Average timecharter rates fell 6% in 2012 from USD 15,300 per day in 2011 to USD 14,300 per day. The largest decline was seen in the larger vessel classes which declined 12% on average from 2011 to 2012. MR tanker timecharter rates are more or less unchanged from the levels seen in 2011. In 2012, activity in the timecharter market has mainly been directed at the MR segment as the current timecharter levels are attractive for locking in future rates (fig. 2)

Figure P.1



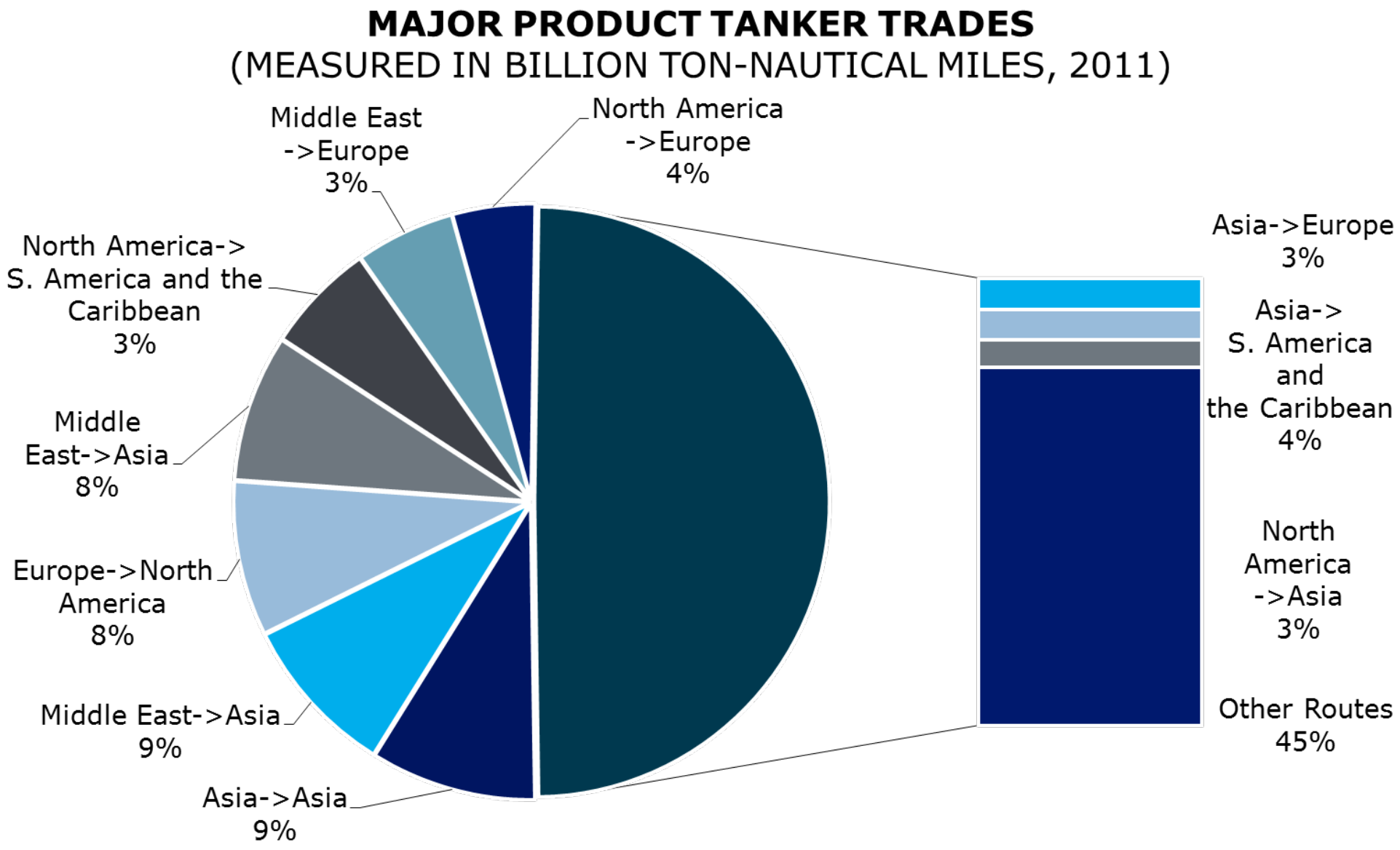
Sources: Clarksons, Danish Ship Finance

Figure P.2



Sources: Clarksons, Danish Ship Finance

Figure P.3


MAJOR PRODUCT TANKER TRADES
(MEASURED IN BILLION TON-NAUTICAL MILES, 2011)
Middle East ->Europe 3%
North America ->Europe 4%
North America-> S. America and the Caribbean 3%
Middle East->Asia 8%
Europe->North America 8%
Middle East->Asia 9%
Asia->Asia 9%
Asia->Europe 3%
Asia-> S. America and the Caribbean 4%
North America ->Asia 3%
Other Routes 45%
Sources: IHS Global Insight, Danish Ship Finance

THE PRODUCT TANKER MARKET REMAINED UNDER PRESSURE DURING THE FIRST EIGHT MONTHS OF 2012 AS ECONOMIC CONDITIONS CONTINUED TO DETERIORATE. THE PRODUCT TANKER FLEET GREW BY 1%, WHILE DISTANCE-ADJUSTED DEMAND INCREASED BY 3%. THE MANY POSTPONEMENTS CURBED FLEET GROWTH, BUT EVEN WITH THE MODEST FLEET GROWTH, THE OVERSUPPLY REMAINS A CHALLENGE TO THE PRODUCT TANKER MARKET.

2.5 MILLION DWT ADDED DURING THE FIRST EIGHT MONTHS OF 2012

During the first eight months of 2012, the fleet grew by 2.5 million dwt of new product tankers. For the first time, the LR2 segment was the largest contributor to total deliveries with 1.3 million dwt delivered. Meanwhile, MR tanker deliveries was the smallest contributor to total deliveries for the first time in decades, with only 0.7 million dwt delivered during the period, a decline of 70% compared to the same period last year (fig. 4).

DEMOLITIONS RUNNING SLOW DESPITE LOW EARNINGS

The relatively low levels of scrapping in 2011 seem to be repeated in 2012. Scrapping has been held at a moderate level during the first eight months of 2012 as only 1.3 million dwt (1% of fleet) was scrapped. Thus, the low freight rates have so far failed to push as much tonnage to the scrap yards as they did in 2009 and 2010 when low rates pushed 6 and 4 million dwt to the scrap yards. Although scrapping of LR2 tankers has doubled (0.7 million dwt) compared to last year, MR scrapping (0.4 million dwt) has been reduced to a trickle compared to last year's 1.4 million dwt (fig.4). The low number of demolitions in the MR segment might reflect owners' optimism about the future.

INCREASING NUMBER OF POSTPONEMENTS CURBING FLEET GROWTH

A large number of postponements have curbed fleet growth during the first eight months of 2012. In the January 2012 orderbook, a total of 8.3 million dwt was scheduled for delivery in 2012. Of these orders, a total of 5.1 million dwt was scheduled for launch during the first eight months of 2012, and 2.3 million dwt was rescheduled for later delivery. A total of 0.5 million dwt scheduled for delivery during the first eight months of 2012 was cancelled outright. As of August 2012, only 41% of the January orderbook had actually materialized (fig. 5).

Figure P.4

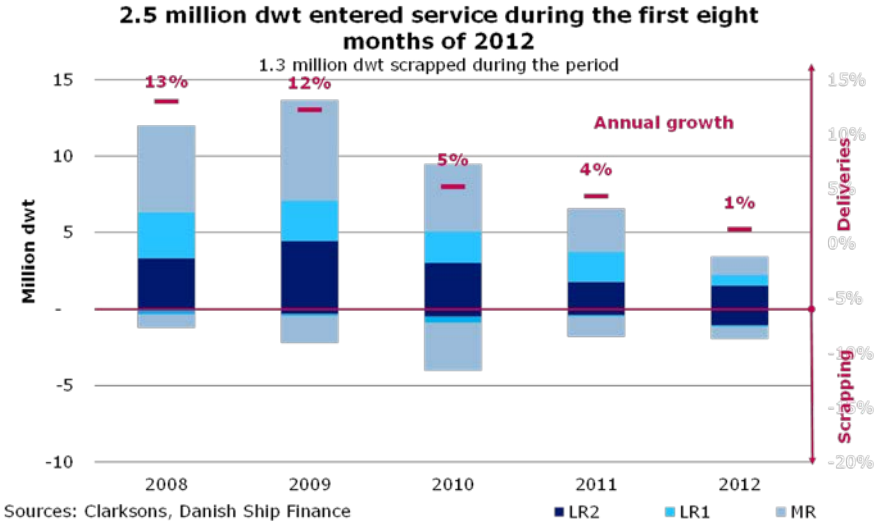
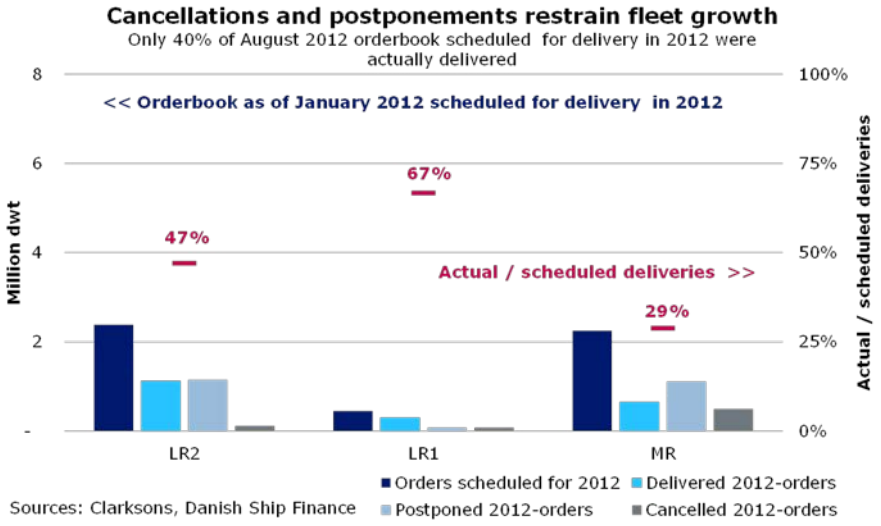


Figure P.5



THE PRODUCT TANKER FLEET GREW 1% IN THE FIRST EIGHT MONTHS OF 2012

Fleet growth is leveling off across the board. The product tanker fleet expanded 1% during the first eight months of 2012. Fleet growth was the highest in the LR1 segment at 2% in the first eight months of 2012 while LR2 growth landed at just below 2%. Growth in the MR segment came out at 0.5%, the lowest growth rate recorded since 2003 (fig. 4).

SEABORNE PRODUCT TANKER TRADE GREW 3% IN 2012

Trade in refined oil products expanded by 3% in 2012. Measured in volume terms, this is an increase of 28 million tonnes or approximately 600,000 barrels per day. This is only half the growth of 2011 when trade expanded by 54 million tonnes (7% annual growth). The 3% increase of 2012 is mainly a result of sluggish demand growth in the OECD area, whereas non-OECD economies still exhibit strong growth figures (fig. 6).

ASIA IS ONCE AGAIN THE MAIN DRIVER OF GROWTH

Not surprisingly, Asia was the main contributor to growth in product tanker demand in 2012. Asian oil product imports rose by 5% in 2012. In volume terms, this was an increase of 14 million tonnes or approximately half of the overall growth in the seaborne oil product trade growth in 2012. However, the troubles in the euro area and the sluggish US economy are starting to spill over to the Asian economies. China, for instance, is expected to experience a 13-year low in terms of economic growth this year. The slowdown in the Chinese construction industry and weaker demand for refined oil products for vehicles are causing falling demand. The combination of these two factors is reducing growth in Chinese imports of refined oil products in 2012 to a mere 1% - down from 12% last year (fig.6).

US OIL PRODUCT DEMAND STILL WEAK

North America, the second largest importing region of refined oil products, continues to show weak economic growth. Declining household incomes and relatively high gasoline prices have led US consumers to invest in more fuel-efficient vehicles and drive fewer miles. These factors combined have pushed US gasoline sales to the lowest level in a decade and hence reducing US imports of gasoline. US imports of gasoline have declined 17% in 2012 compared with the same period last year, hence bringing US gasoline import volumes back to 2000-levels. The contraction of demand was mainly fed by a decrease in supplies from Europe.

Figure P.6

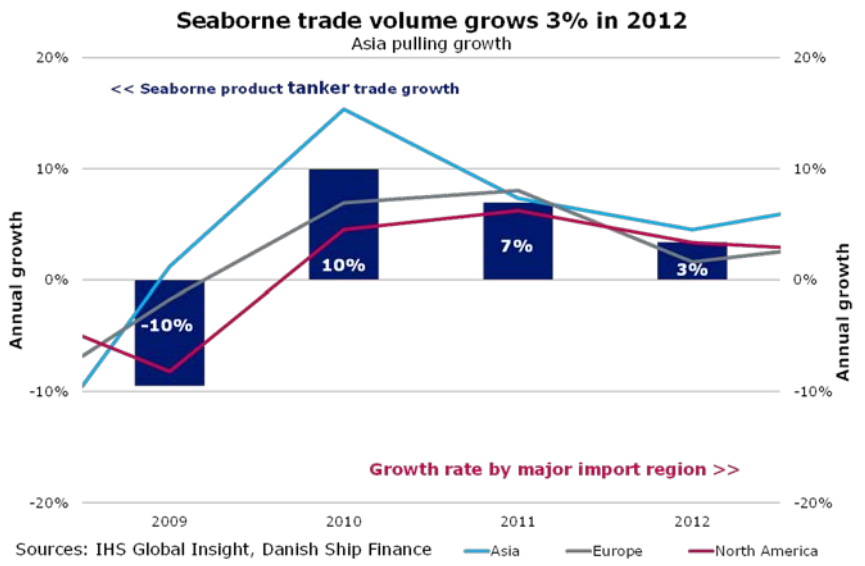
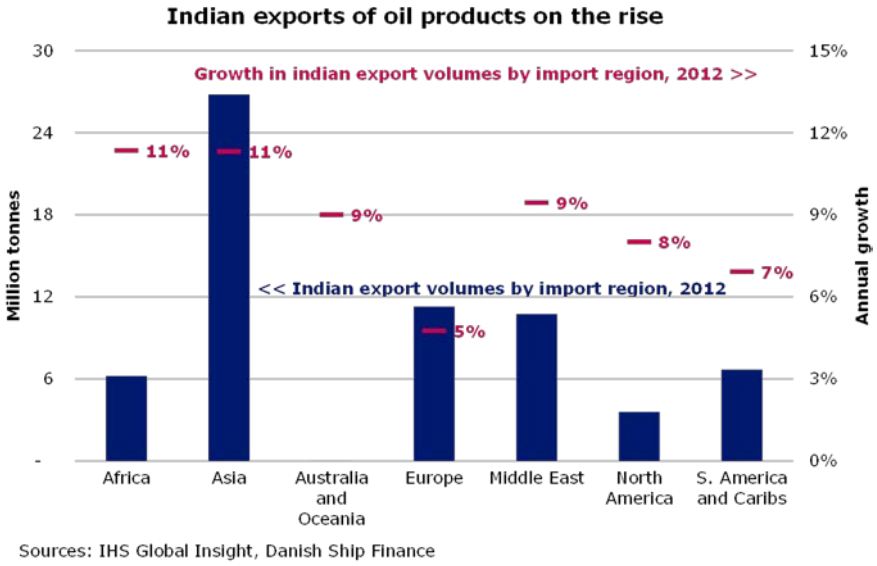


Figure P.7



INDIA BECOMING A MAJOR OIL PRODUCT EXPORTER

India's refinery capacity has been expanding since 2009 but planned expansions have not yet been fully implemented. India's refinery sector has expanded its capacity by 72% since 2009. Exports of oil products from India grew by 9% in 2012 (fig.7). Measured in volumes, this is an increase of 6 million tonnes - slightly higher than in 2011 when exports rose by 8.5% (5.5 million tonnes). The lion's share of the higher export volumes went to Asia, contributing significantly to growth in Asian imports. Volumes destined for Europe and North America increased by 5% and 8%, respectively. This should be seen in the light of low European refinery activity in 2012. This meant that the USA and Europe had to import oil products over longer distances.

US OIL PRODUCT EXPORTS HIT RECORD VOLUMES IN 2012

While US oil product imports declined in 2012, US export volumes soared and hit a record high in April. The rise in US oil product exports is a relatively new phenomenon, driven largely by surging demand from South America, as this region is becoming industrialised and is investing in infrastructure development. Without South America, the product tanker market in the Atlantic basin would have suffered even more. MR tankers, in particular, benefitted from this development, as the gasoline trade from Europe to the USA dropped. This trade is expected to gain in importance in the years to come.

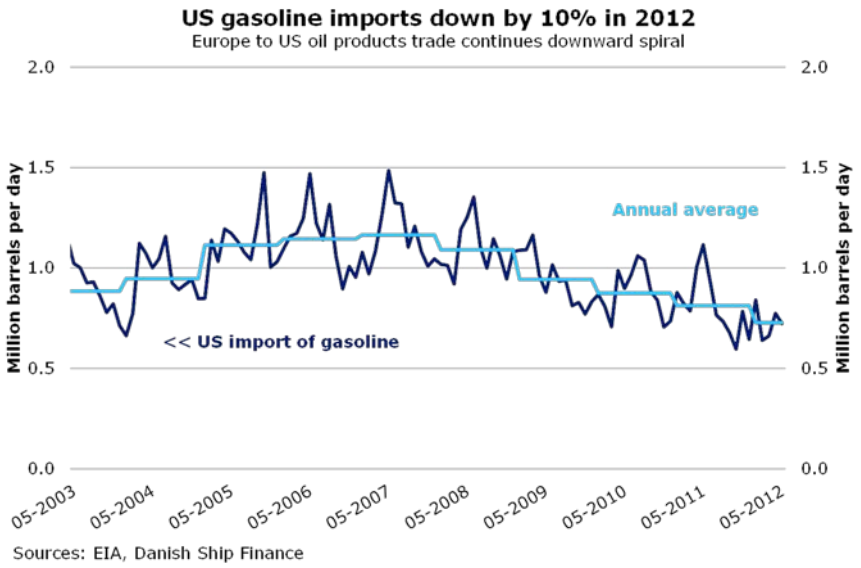
AVERAGE TRAVEL DISTANCES DECLINED IN 2012

Distance-adjusted demand is set to increase by almost 3% in 2012 (fig. 9). Asia remains the largest contributor to global distance-adjusted demand growth. However, as most of Asia's growth in oil product imports originates in Asia, this trade does not affect travel distances significantly. Declining import volumes to the USA resulted in shorter average travel distances, which in turn had an adverse impact on distance-adjusted demand growth.

THE PRODUCT TANKER MARKET IS STILL SUFFERING FROM OVERSUPPLY

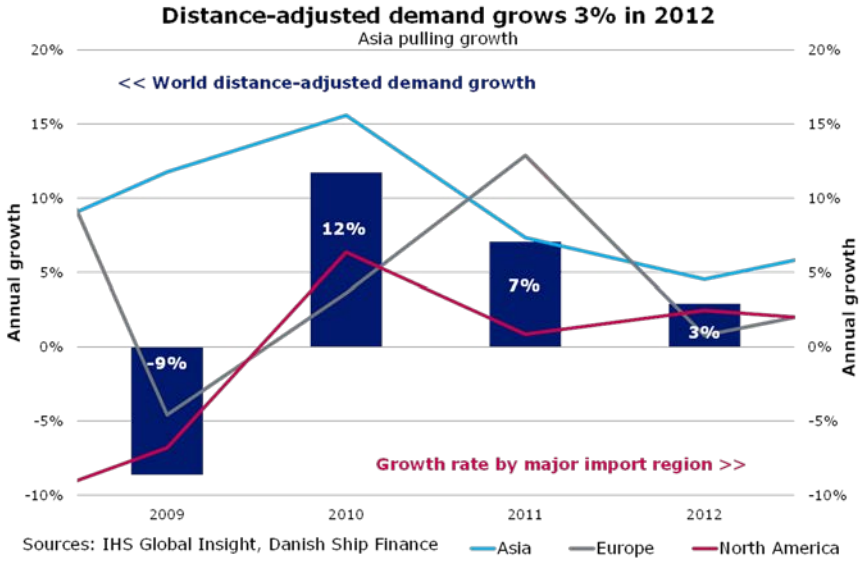
Although fleet growth was limited, the large excess supply from previous years combined with weakening fundamentals continues to keep rates in the doldrums. Increased postponement activity supported rates, but more scrapping is needed to balance supply and demand.

Figure P.8



Sources: EIA, Danish Ship Finance

Figure P.9



Sources: IHS Global Insight, Danish Ship Finance

AS THE BALANCE BETWEEN THE FLEET AND ORDERBOOK IMPROVES, SOME SHIPOWNERS HAVE RE-GAINED THEIR APPETITE FOR NEW VESSELS. SHIPOWNERS ARE PINNING THEIR HOPES ON AN EARLY RECOVERY AND ECO-FRIENDLY DESIGNS. LOW FREIGHT RATES AND EXCESS YARD CAPACITY HAVE PUSHED ASSET VALUES DOWN IN 2012.

MR ORDERING SPREE CONTINUES

Owners appetite for new vessels, and for MR tanker vessels in particular, recovered during the first eight months of 2012. A total of 3.4 million dwt was contracted, of which 2.3 million dwt was MR tanker tonnage. Contracting activity has been driven by owners' hopes of a market recovery and an appetite for more ECO-friendly and more fuel efficient designs than previously. Seen in a historical perspective, contracting activity remains moderate, but does the market really need more vessels? To our surprise, the harsh market conditions of 2009 seem to have faded from the owners' memories, even with the product tanker market still in the doldrums (fig. 10).

DELIVERY TIME INCREASING

The scheduled average delivery time was slightly above 2.5 years during the first eight months of 2012 (fig. 10). Shipowners seem to be opting for slightly longer delivery times in order to plan their delivery for better market conditions. Thus, even though yards had considerable excess capacity, average delivery times increased by four months from 2011 to 2012.

NEWBUILDING PRICES SLIGHTLY DOWN IN 2012

By August 2012, average newbuilding prices had fallen by 5% year-on-year (fig. 11). With a shrinking orderbook and prospects of excess yard capacity one might think that newbuilding prices would have dropped even further. However, it appears that some kind of floor beneath newbuilding prices has been reached – at least for the moment.

SECONDHAND PRICES DOWN 19% IN 2012

Negative cash flows - caused by the low freight rates – in combination with high scrap prices are making more owners cut their losses by selling for scrap thereby lowering average prices of secondhand vessels. By August 2012, these factors have pushed down average secondhand prices by more than 20% year-on-year (fig. 11). Especially, larger vessels have been hit hard by this development. Currently, a 5-year old LR1 tanker is traded at around USD 26 million, only 8% more than what MR tankers are trading for.

Figure P.10

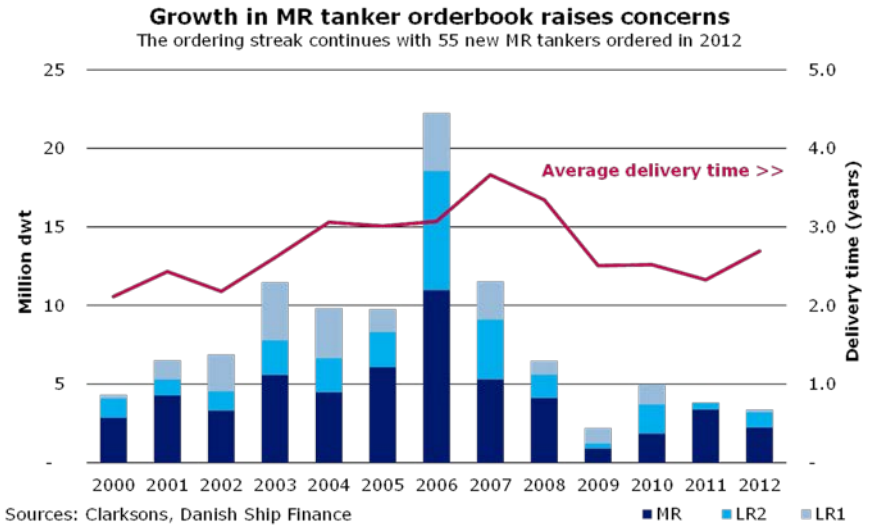
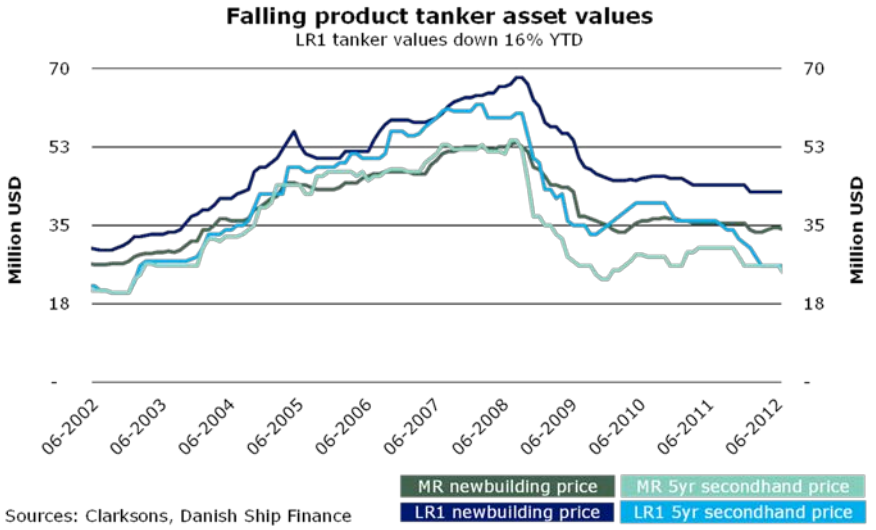


Figure P.11



OUTLOOK

THE PRODUCT TANKER MARKET IS EXPECTED TO CONTINUE TO SUFFER IN 2013 DUE TO THE ADVERSE ECONOMIC ENVIRONMENT AND THE RESULTING GLOBAL LOSS OF DEMAND FOR OIL PRODUCTS. THE MARKET IS STILL TROUBLED BY THE OVERHANG OF TONNAGE FROM PREVIOUS YEARS AND NEW ORDERING. A RECOVERY IS UNLIKELY BEFORE FUNDAMENTALS IMPROVE.

GROWTH IN PRODUCT TANKER ORDERBOOK RAISES CONCERNS

As of August 2012, the total orderbook stood at 11.8 million dwt. That means one vessel for each ten at sea is scheduled to for the coming years. Actually, the orderbook/fleet ratio is increasing as orders being placed are outgrowing deliveries. The bulk of orders consist of MR tankers which account for 64% of the total orderbook.

3.6 MILLION DWT SCHEDULED FOR DELIVERY IN 2012

With almost 3.4 million delivered so far this year, one might think that fleet growth would come to a halt this year. However, another 3.6 million dwt – or the equivalent of 29% of the August 2012 orderbook is still scheduled for delivery in the last four months of 2012. In 2013, another 5.4 million dwt is scheduled to join the fleet.

POSTPONEMENTS AND CANCELLATIONS SET TO INCREASE

The relatively high level of postponements is set to continue for some time. Taking the previous postponement activity into account, we estimate that as much as 1.5 million dwt will be postponed to 2013 in the last four months of this year and another 1.2 million dwt will be postponed from 2013 in 2014. Cancellations are also expected to reduce actual deliveries in the remainder of 2012 and in 2013. We predict that about 0.3 million dwt will be cancelled in the last four months of this year and that another 1 million dwt scheduled for delivery in 2013 will be cancelled. Consequently, 1.7 million dwt is expected to be delivered during the rest of 2012. Given these assumptions we expect that 4.6 million dwt will be delivered in 2013 (fig. 12).

SCRAPPING REMAINS A DARK HORSE IN 2013

As previously mentioned, low freight rates have not encouraged shipowners to send more ships to the scrapyards. Unfortunately, this tendency will most likely continue in 2013 even though the scrapping potential remains quite large. So even though almost 5% of the MR tanker fleet is older than 25 years, we do not expect scrapping to take

Figure P.12

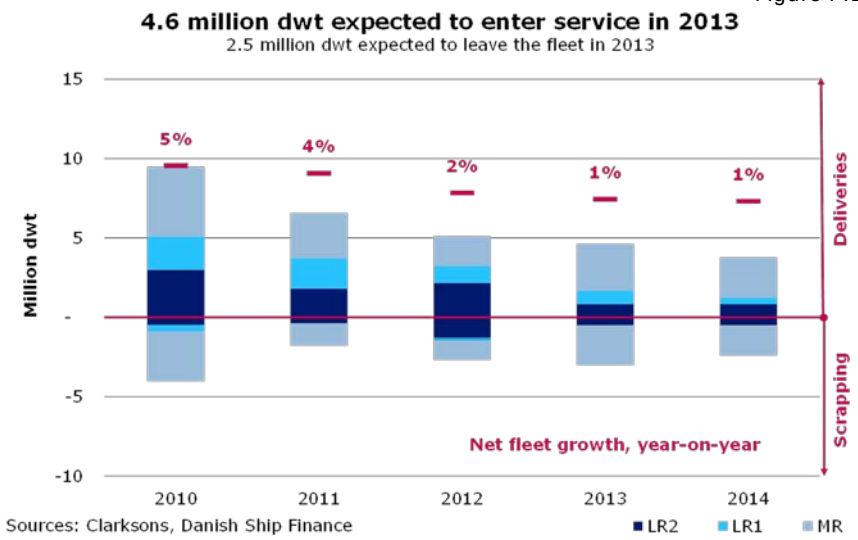
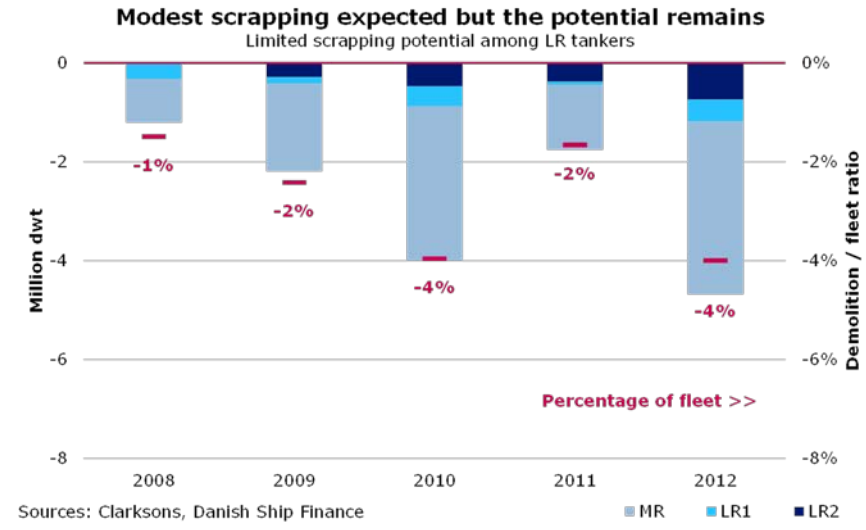


Figure P.13



off in the near future. We estimate that for the remainder of this year another 0.8 million dwt will be heading for the scrapyards, bringing total 2012 scrapping to 2.7 million dwt. For 2013, scrapping will reach almost 3 million dwt, an increase of 12% but significantly less than the 4.1 million dwt that left the fleet in 2012. However, these assumptions are obviously subject to uncertainty and the recent decline in scrap prices may encourage owners to keep their vessels at sea a little bit longer.

FLEET GROWTH EXPECTED TO REMAIN LOW IN 2013

Taking the estimated levels of scrapping, postponements and cancellations into consideration, we estimate that net fleet growth will reach 2% in 2012 (+1.6 million dwt for the rest of 2012). In 2013, we expect that growth will level off and that the fleet will expand by 1%. However, even if this growth figure seems small, one has to remember that the annual entry of tonnage will be almost unchanged from 2012.

OIL PRODUCT TRADE VOLUMES SET TO INCREASE BY 5% IN 2013

Growth in seaborne oil product trade appears to be picking up following a year of modest growth. Total seaborne oil product trade is set to increase by 5% (42 million tonnes) (fig. 14). Set to expand by 8%, Asian demand is expected to remain the largest contributor to growth in seaborne oil products. North American and European oil product demand is expected to stall in the years ahead as weak industrial activity and consumption of fuels in the transportation sector is set to remain weak.

EMERGING ECONOMIES DRIVING DEMAND FOR OIL PRODUCTS

Emerging economies in Asia are expected to expand their imports of refined products by 7% in 2013. Countries such as India, China and Indonesia are expected to report double-digit growth figures in 2013. Refined products, such as gasoline, diesel and naphtha consumed for industrial purposes provide an impetus for the growing consumption of refined products in the region. With demand from Europe and North America slowing and with demand for refined products closely tied to industrial production, powering fleets of commercial vehicles and factory generators, will these Asian emerging economies be able to pull demand by themselves? We doubt that demand for refined products can be driven to a high enough level by the Asian populations and the emergence of a new middle class – at least in the short to medium term. We estimate that spill-overs from North America and Europe will increase the probability of a slow-down in these countries, but we maintain our forecast of 7% as a likely high. However, growth in

Figure P.14

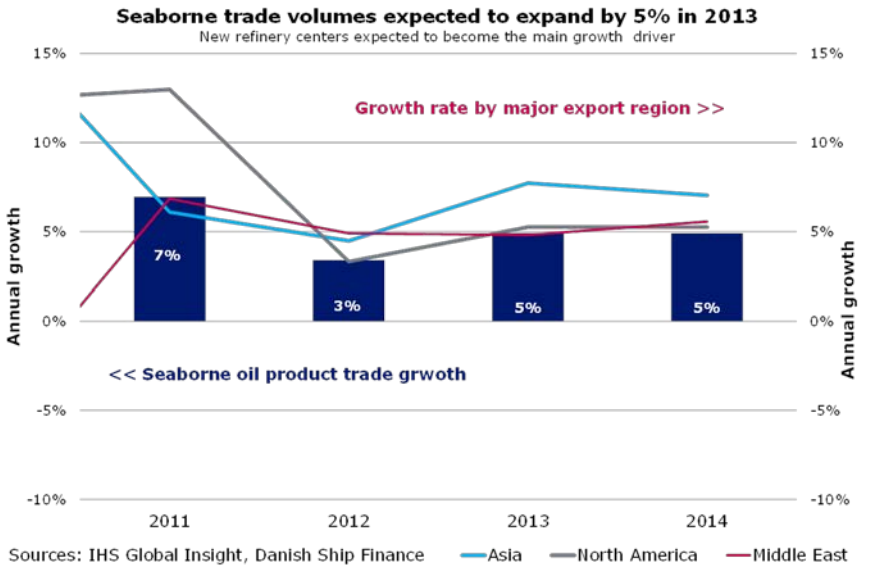
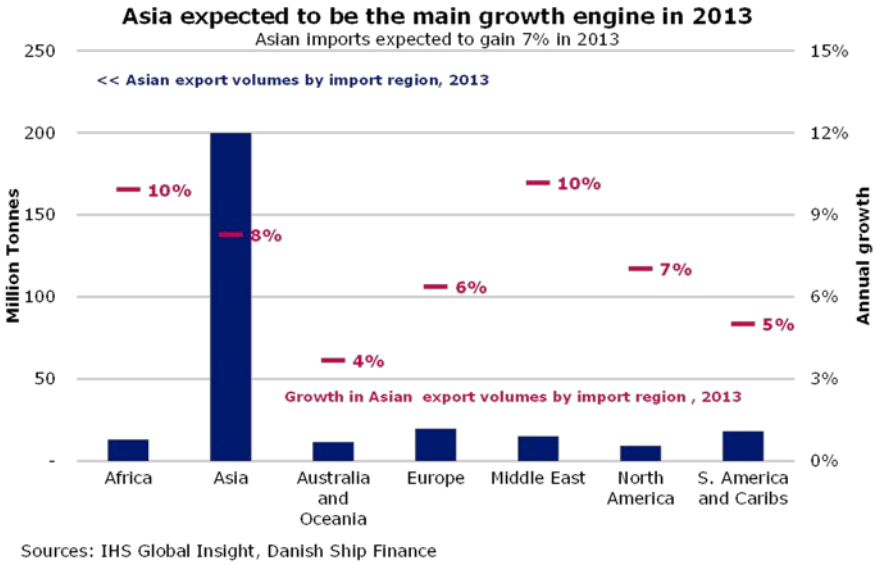


Figure P.15



demand for refined products in Asia will expectedly be in short-haul as most of the extra volumes are expected to come from increasing Intra-Asian trade (fig. 15). India, in particular, is expected to increase exports of refined products. Although Asian import volumes are growing, shorter travel distances will affect distance-adjusted demand adversely and will mainly benefit smaller vessels.

US IMPORT / EXPORT BALANCE ABOUT TO ALTER TRADING PATTERNS

Amid the continuing US oil product demand malaise, US oil product exports continue to show strong growth figures and the trend is poised to persist. The primary destinations of these volumes are expected to be in South America and Europe. The steady increase of US domestic crude oil production i.e. shale gas exploitation and rising pipeline deliveries will most likely allow US refineries to purchase cheap feedstock and support high refinery utilization rates. To a large extent, US exports will edge out European exports to both the USA and South America.

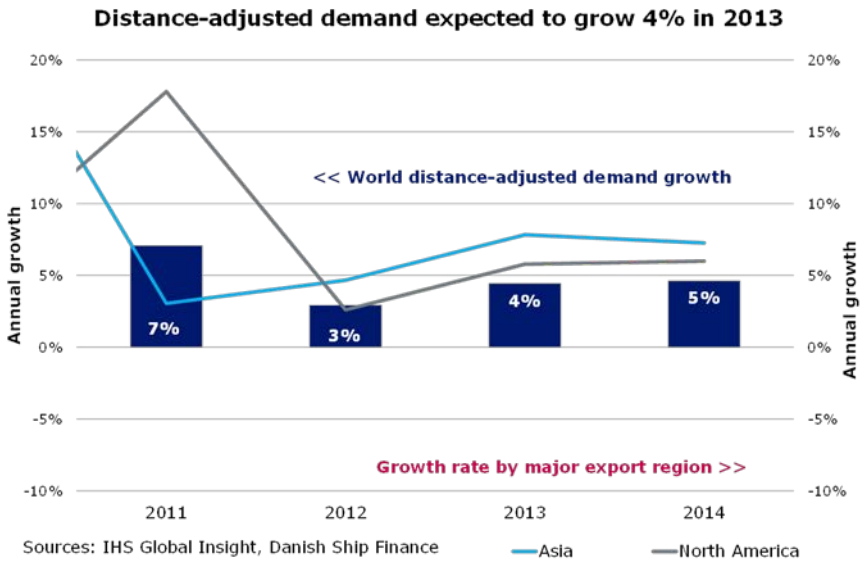
AVERAGE TRAVEL DISTANCES EXPECTED TO BE SLIGHTLY DOWN IN 2013

Asian imports of refined products are expected to be supplied through increasing intra-Asian trade, meaning that average travel distances will be slightly reduced. Furthermore, the slump in US imports of refined products is expected to reduce travel distances significantly. Although, increasing US exports of refined products will partly offset the decline in US imports, average travel distances are expected to decline in 2013. Distance-adjusted demand is projected to increase by 4% in 2013 – a 1 percentage point reduction compared with the growth in volume (fig. 16).

RATES AND VALUES EXPECTED TO REMAIN LOW IN 2013

The product tanker market is expected to stay low for the rest of 2012 and in 2013 although the oversupply of previous years is slowly being absorbed. Temporary spikes such as the winter season will have a positive effect on product tanker demand, but the spikes are expected to be less intense and of shorter duration than previously. However, demand is still struggling to regain the lost territory from the contraction of global refined product demand. A rebound of the product tanker market will require a dramatic improvement in fundamentals. Furthermore, the continuing ordering of new vessels brings a potential recovery of the product tanker market in jeopardy even if fundamentals were to improve.

Figure P.16



CHEMICAL TANKERS

DANMARKS SKIBSKREDIT

CHEMICAL TANKERS

CHEMICALS ARE TRAVELLING SHORTER DISTANCES, BUT THE GAP BETWEEN SUPPLY AND DEMAND SEEMS TO HAVE STABILISED. IN 2012, SUPPLY AND DISTANCE-ADJUSTED DEMAND ARE EXPECTED TO EXPAND IN TANDEM, GROWING BY 3%. IN 2013, MARKET CONDITIONS ARE EXPECTED TO IMPROVE AS FEW NEW VESSELS ARE SCHEDULED TO ENTER SERVICE.

FREIGHT RATES

CHEMICAL TANKER[1] SPOT RATES DECREASED DURING 2012. HOWEVER, THE ANNUAL AVERAGES ARE STILL RELATIVELY HIGH.

When we last published our Shipping Market Review, spot rates were record-high and expected to stay at a high level. The outlook was bright. The gap between supply and demand was expected to narrow. However, distance-adjusted demand failed to outpace supply growth. Consequently, spot rates have been trending downwards since the beginning of the year. In combination with a high, but slightly decreasing, bunker price, many owners are struggling to secure a positive cash flow.

DRAMATIC FALL IN ASIAN SPOT RATES

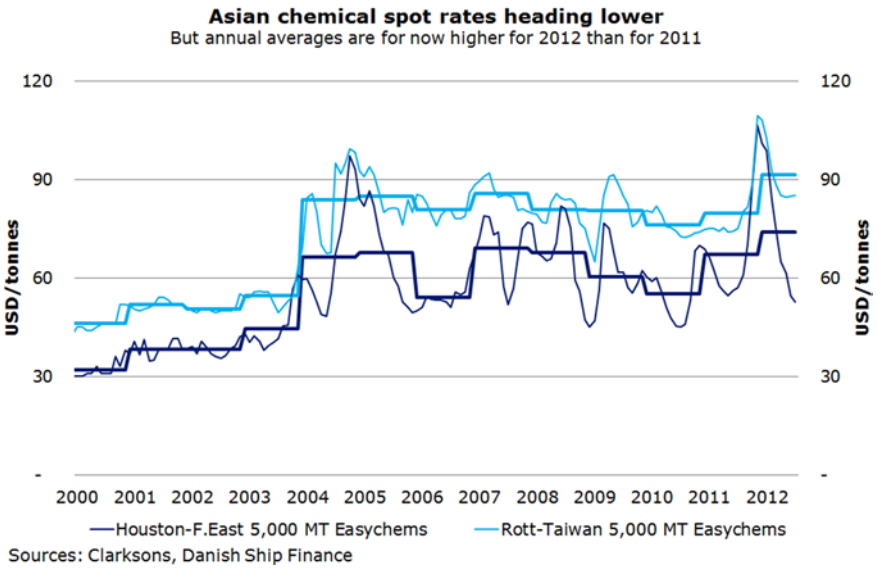
In August 2012, spot rates out of Houston bound for the Far East had fallen by 50% to USD 53 per tonne, while spot rates out of Rotterdam bound for Taiwan had fallen by 22% to USD 85 per tonne. However, the monthly averages of the two spot rates are still above the level of 2011 (fig. 1).

TRANSATLANTIC RATES STRUGGLING

In August 2012, the Houston-Rotterdam spot rates had dropped 23% from USD 60 per tonne in December 2011 to USD 46 per tonne, while the Rotterdam-Houston leg had fallen 5% from USD 47 per tonne to USD 45 per tonne (fig. 2).

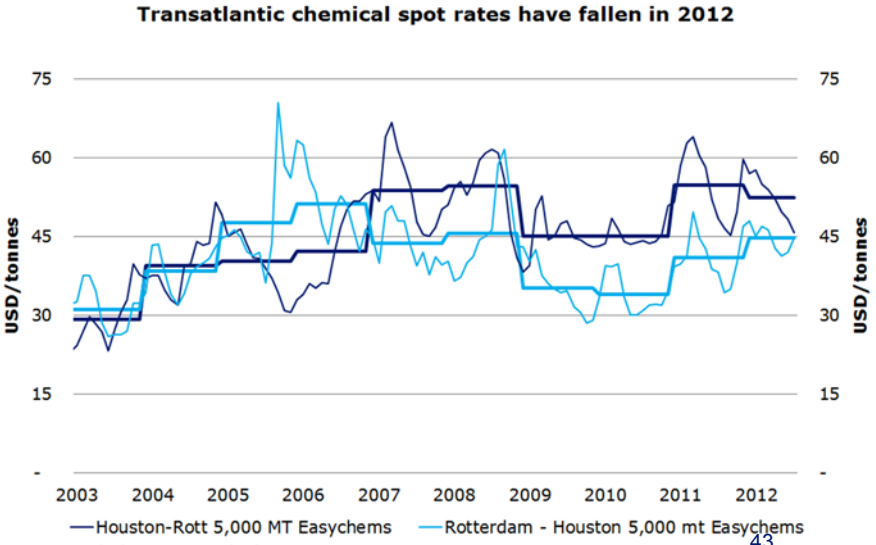
[1] Definition of chemical tanker: IMO I and IMO II tankers with stainless steel, zinc, epoxy or marineline coated tanks. We do not distinguish between parcel tankers and chemical tankers. According to this definition, the chemical fleet contains 2,700 vessels for 47,000,000 dwt in aggregate.

Figure CT.1



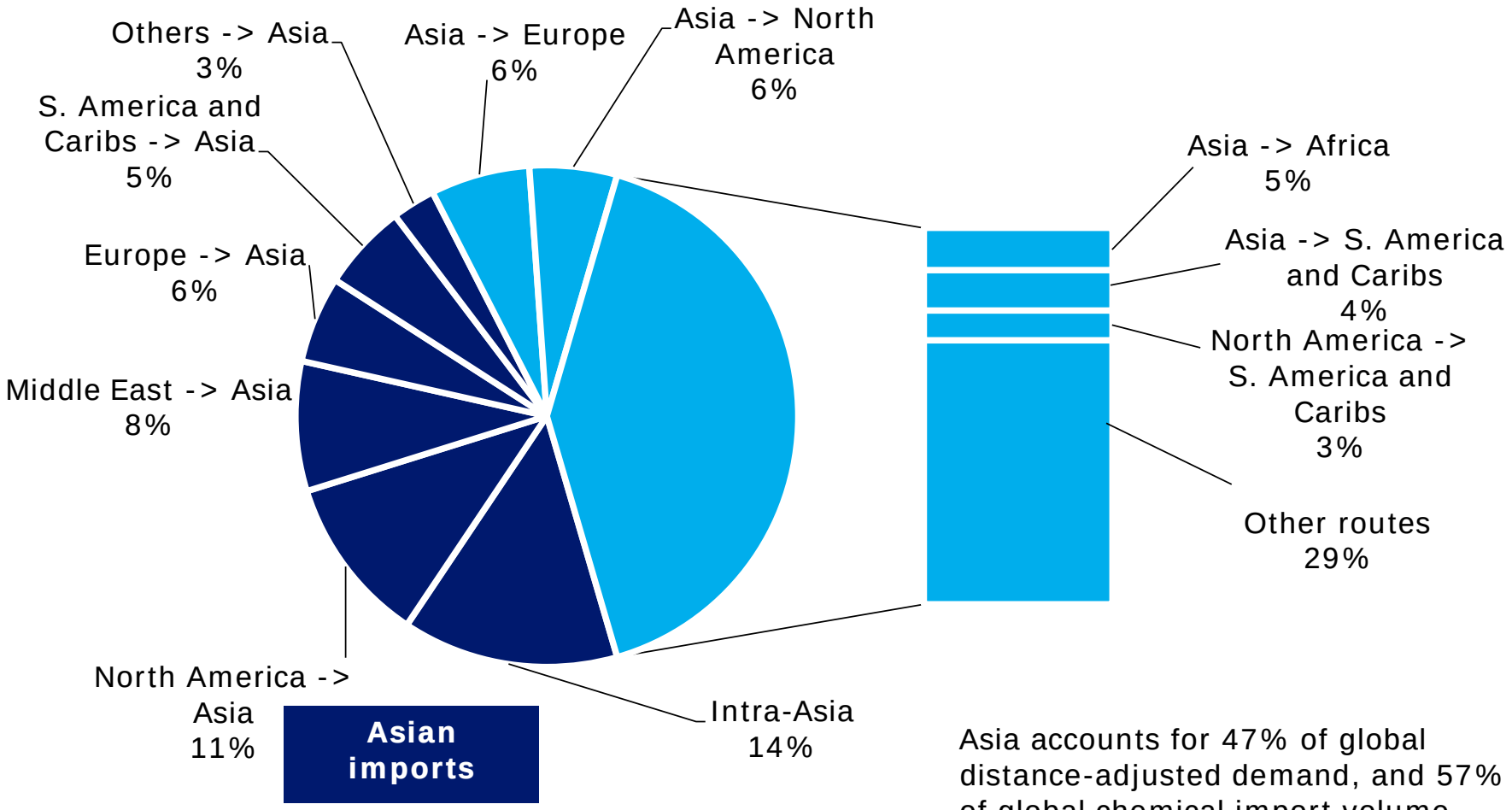
Sources: Clarksons, Danish Ship Finance

Figure CT.2



Sources: Clarksons, Danish Ship Finance

MAJOR CHEMICAL TANKER TRADES IN 2012
(MEASURED IN BILLION TON-NAUTICAL MILES)



Asia accounts for 47% of global distance-adjusted demand, and 57% of global chemical import volume.

Sources: IHS Global Insight; Danish Ship Finance

DELIVERIES ARE AT THE LOWEST LEVEL IN TEN YEARS AND SCRAPPING REMAINS RELATIVELY HIGH. THE CHEMICAL TANKER FLEET IS EXPECTED TO GROW BY 3% IN 2012. DISTANCE-ADJUSTED DEMAND IS ALSO EXPECTED TO INCREASE BY 3%, DRIVEN BY ASIAN DEMAND IN GENERAL AND BY CHINESE DEMAND IN PARTICULAR.

DELIVERIES AT LOWEST LEVEL IN TEN YEARS

Deliveries in the chemical tanker market continue to decrease. With 1.4 million dwt (3% of current fleet) entering service in the first eight months of 2012 (down 30% compared to the same period last year), this is the lowest entry of new capacity in ten years (fig.4).

PRIMARILY LESS SOPHISTICATED VESSELS DELIVERED

About 40% of the vessels delivered were highly specialized chemical tankers with either stainless steel or marineline coated tanks – the two types of coatings which can carry the widest range of chemical products. The remaining 60% were vessels with less sophisticated tanks coated either with zinc or epoxy.

FLEET GROWTH AT 3%

Compared to previous years, scrapping activity remains fairly high. Scrappings during the first eight months of 2012 amounted to 0.5 million dwt: two IMO I vessels and 20 IMO II vessels with an average scrapping age of 27 years. Consequently, the fleet expanded by only 3% during the period (fig. 4).

ONLY 49% OF EXPECTED DELIVERIES WERE ACTUALLY DELIVERED

Postponement and cancellation activity remained high during the first eight months of 2012. While 2.9 million dwt was expected to be delivered, actual deliveries amounted to just 1.4 million dwt (49%). One million dwt (37%) had been postponed and 0.4 million dwt (14%) may have been cancelled. The Deep Sea segment had the best delivery performance at 52% with 1 million dwt delivered. Once again, Short Sea had the worst performance with only 0.1 million dwt delivered (35%) (fig. 5). The low delivery performance may illustrate strong discipline among owners (trying to control the degree of oversupply), the yards' inability to deliver on time, or a lack of available finance, or perhaps a combination of all three.

Figure CT.4

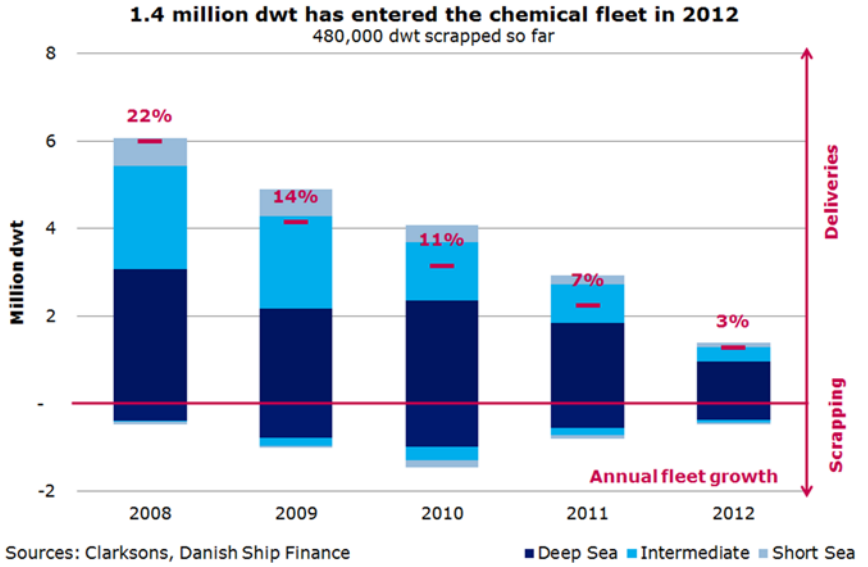
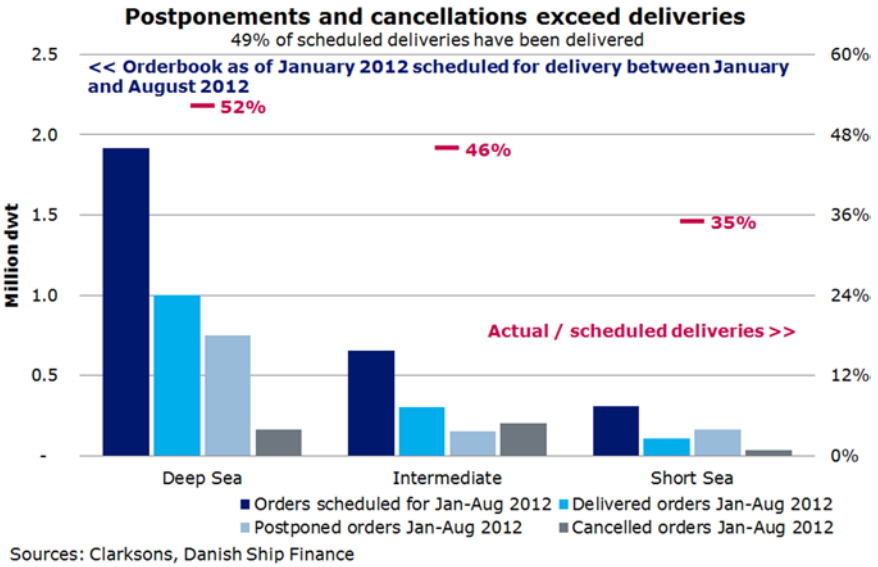


Figure CT.5



ORGANIC CHEMICALS DRIVING DEMAND

Organic chemicals is the most commonly transported type of chemicals, estimated to account for 48% of total chemical import volume and 43% of distance-adjusted demand. The distance-adjusted demand for organic chemicals is estimated to grow by 5% in 2012, while animal and vegetable oils and inorganic chemicals are expected to increase by 2% each.

TRAVEL DISTANCES GETTING SHORTER

Travel distances are getting shorter: Import volumes of chemicals are expected to rise by 4% (to 190 million tonnes), while distance-adjusted chemical tanker demand is predicted to increase by 3% in 2012 (fig. 6 and fig. 7). Changed trading patterns, with long-haul European and US exporters being replaced by short-haul Asian suppliers are the primary reason for shorter traveling distances (fig. 3). The trend is most evident for organic chemicals.

ASIA AND CHINA DOMINATING

Asian imports account for 57% of total seaborne chemical volumes while distance-adjusted Asian imports generate 47% of chemical tanker demand (fig. 3). Chinese demand for chemicals is the primary driver of Asian demand: China remains the world's largest importer of chemicals with imports estimated at 42 million tonnes in 2012. Chinese distance-adjusted demand is estimated to increase by 7% in 2012.

EUROPEAN DEMAND DECREASES

In 2012, Asian distance-adjusted demand for chemical tankers is expected to level off at 6%. This is mainly due to subdued demand in China. North America's and South America's distance-adjusted demand is expected to rise by 2% and 1% respectively. On the other hand, European distance-adjusted demand for chemical tankers is expected to drop by 1% in 2012 (fig 6.).

Figure CT.6

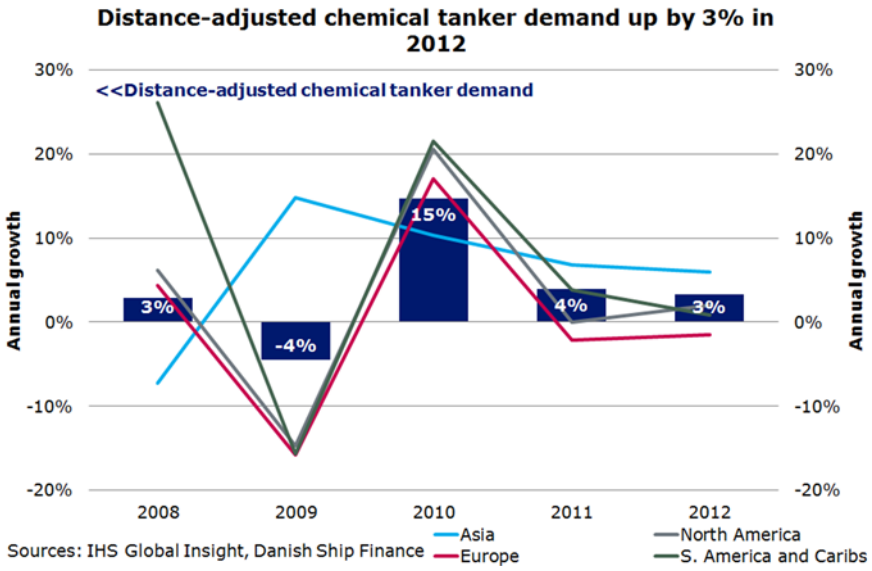
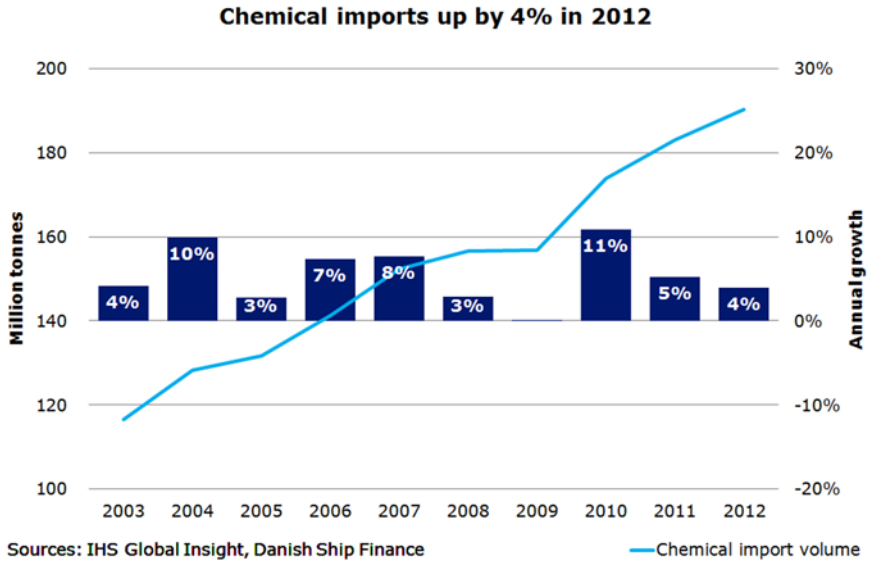


Figure CT.7



CONTRACTING ACTIVITY REMAINS IN THE DOLDRUMS WITH ONLY FIVE CONTRACTS SIGNED DURING THE FIRST EIGHT MONTHS OF 2012. NEWBUILDING AND SECONDHAND PRICES REMAIN UNCHANGED.

LOW CONTRACTING ACTIVITY CONTINUES

Contracting for the first eight months of 2012 has been historically low with only five contracts signed during the period. This means that the low contracting activity seems to persist in 2012. Four of the orders are deep sea chemical tankers with a capacity of 46,000 dwt, while the fifth one is a small short sea chemical tanker (fig. 8).

The low level of contracting activity should be seen in light of the heavy postponement activity and the fact that some orders placed back in 2006 and 2007 have still not been delivered. We are unable to determine whether this is an indication that owners are currently reluctant to take delivery of their vessels and therefore are working to postpone to later delivery dates or that yards are behind schedule. More likely, the low contracting activity could also reflect the tight credit situation. Average delivery time is estimated to be around two years for orders placed in 2012, which is the lowest level since 2003 (fig. 8).

UNCHANGED CHEMICAL TANKER VALUES

The low contracting and sales activity also makes it difficult to accurately assess the average asset values. Both the newbuilding price and the secondhand price shown in figure 9 are for a synthetic 35-37,000 dwt, IMO II, stainless steel chemical tanker. Asset values appear to be unchanged so far in 2012. The synthetic newbuilding price remains at USD 54 million and the average secondhand price at USD 39 million (fig. 9).

Figure CT.8

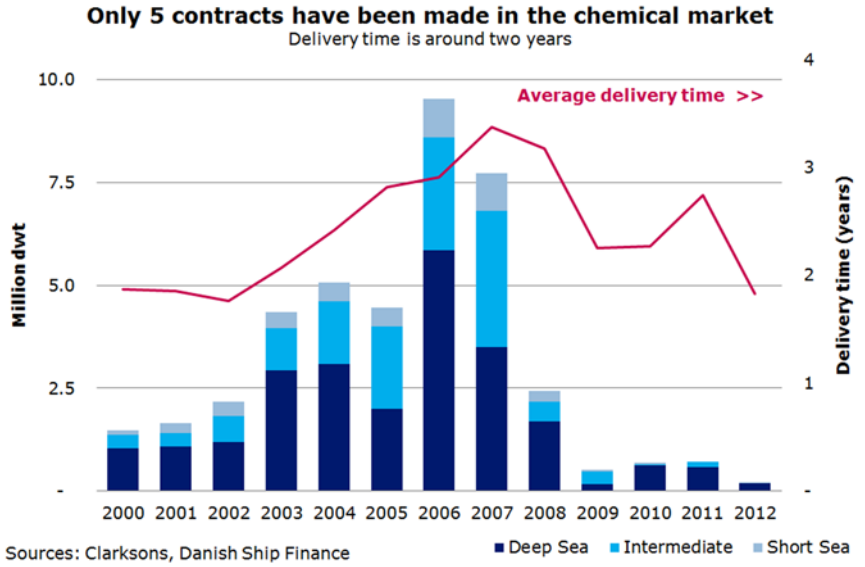
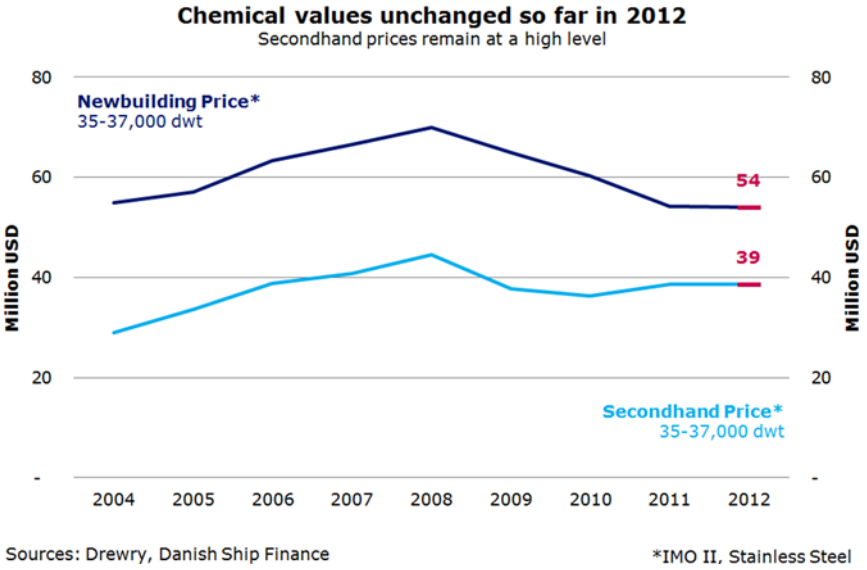


Figure CT.9



OVERCAPACITY IS EXPECTED TO LEVEL OFF OVER THE NEXT FEW YEARS. AN IMPROVED BALANCE BETWEEN SUPPLY AND DEMAND MIGHT SUPPORT FREIGHT RATES AND ASSET VALUES DURING THE REMAINING MONTHS OF 2012 AND 2013.

The chemical tanker market could potentially be on a path to recovery, albeit a fragile one. The supply side appears stable while more uncertainty attaches to the demand situation. The world economy is sputtering, but Chinese chemical imports have – so far – proven relatively robust, although recent short-term indicators point towards lower Chinese imports of chemicals. Based on a limited orderbook and – so far – low contracting activity, the gap between supply and demand is expected to narrow in 2013. On the other hand, shorter travel distances, a surge in contracting activity or lower demand volumes could easily jeopardise the potential. For now, however, we expect the market to start recovering during 2013.

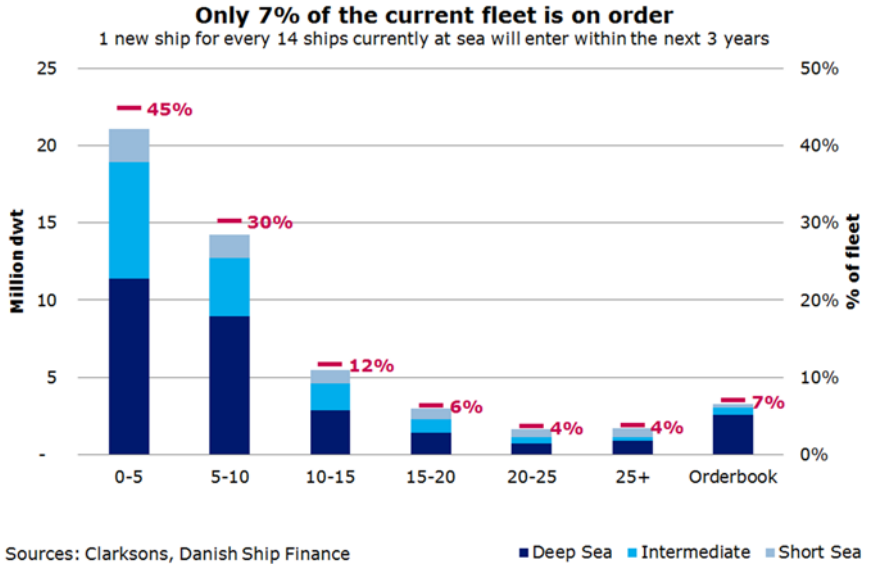
ORDERBOOK LOW AT 3 MILLION DWT

By September 2012 the chemical tanker fleet was 47.1 million dwt with new orders of 3.2 million dwt (7% of the fleet) scheduled to enter the fleet in a few years' time. Looking at the age distribution, 75% of the fleet is younger than 10 years, and only 4% of the fleet is older than 25 years (8% older than 20 years). Consequently, there is a limited potential for future scrapping (fig. 10).

DELIVERIES REMAIN AT A LOW LEVEL

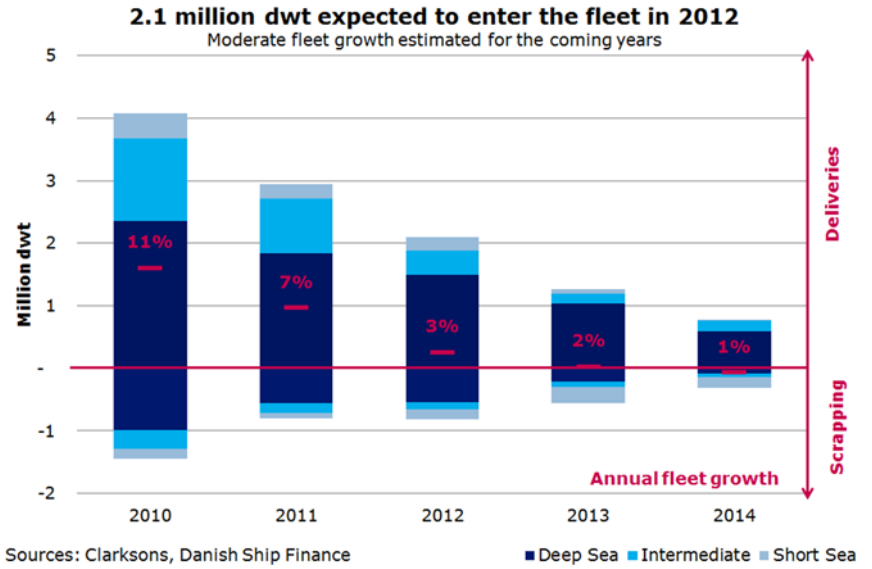
Half the orderbook (1.6 million dwt) is scheduled for delivery during the last four months of 2012. If these vessels are actually delivered, we see little hope for a market recovery in the short to medium term. However, considering the low delivery performance of the past eight months, we only expect 700,000 dwt to enter service during the last four months of 2012. 600,000 dwt has been postponed and is expected to be delivered in 2013, and the remaining 300,000 dwt is expected to be cancelled. The future delivery performance is expected to remain low. For 2013, we estimate that a total of 1.3 million dwt (2.1 million dwt in 2012) will enter the fleet in 2013 (fig. 11).

Figure CT.10



Sources: Clarksons, Danish Ship Finance

Figure CT.11



Sources: Clarksons, Danish Ship Finance

MODERATE FLEET GROWTH IN THE COMING YEARS

The chemical tanker fleet is young, so the scrapping potential of vessels older than 25 years is limited. In 2012, a total of 1.3 million dwt is older than 25 years, of which we expect 800,000 dwt to be scrapped. In 2013, 600,000 dwt is estimated to exit the fleet. Combining our scenario for deliveries and demolition we expect net fleet growth of 3% in 2012 and 2% in 2013 (fig. 11).

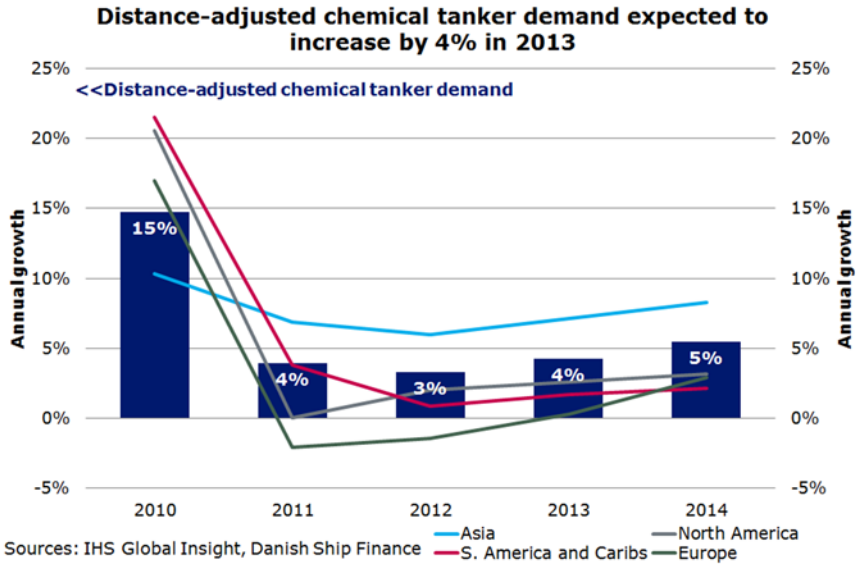
DEMAND EXPECTED TO RISE BY 4% IN 2013

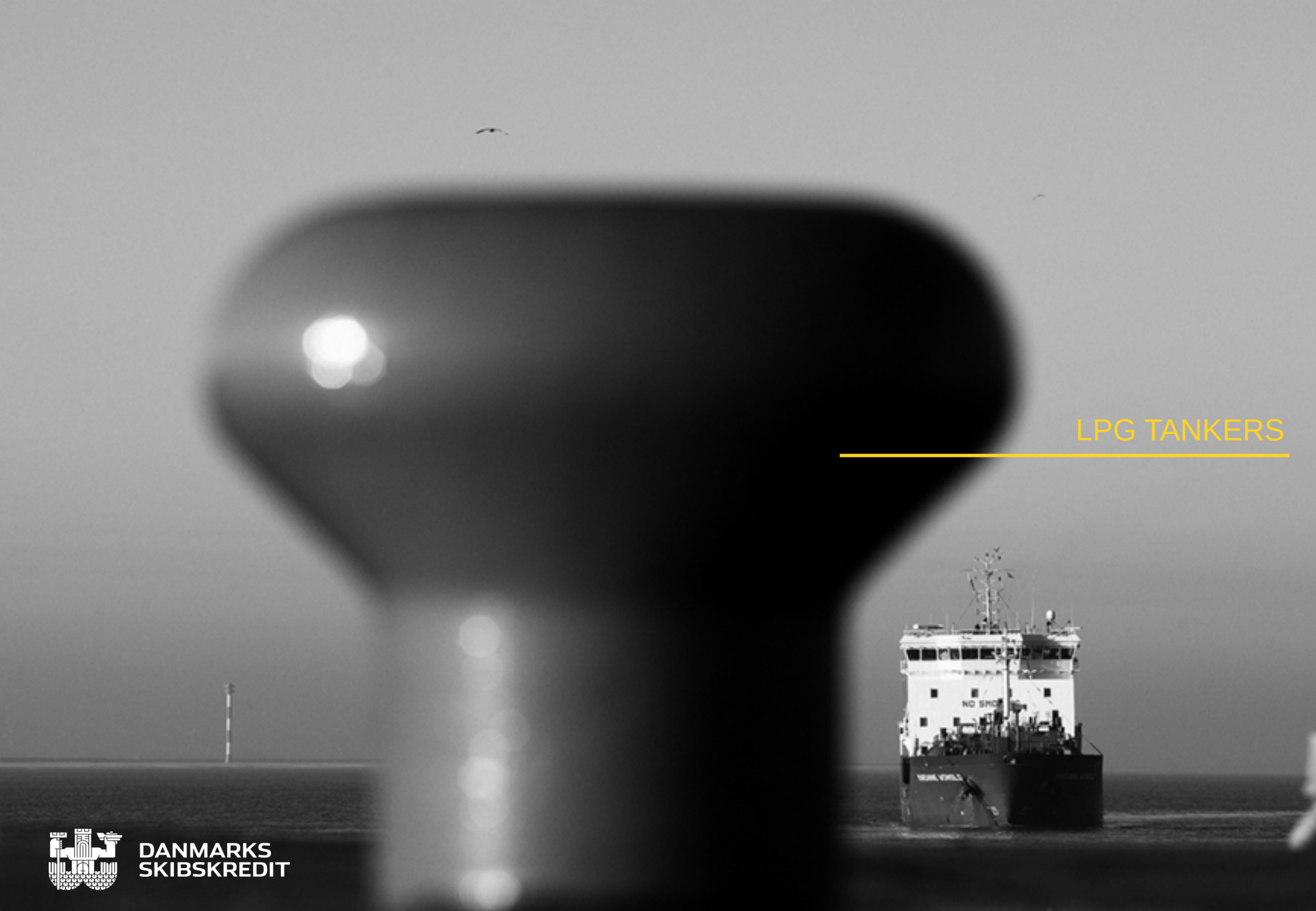
Distance-adjusted chemical tanker demand is expected to increase by 4% in 2013, still with Asia (China) as the main driver. However, import volumes are expected to increase by 5% indicating that the trend of smaller travel distances will continue. Asian distance-adjusted demand is estimated to increase by 7%, while the European demand is expected to remain constant. North American demand is expected to rise by 3% and South American demand is expected to rise by only 2% (fig. 12). Demand is expected to remain the strongest for organic chemicals, and distance-adjusted demand for organic chemicals is estimated to rise by 6% in 2013.

SUPPLY-DEMAND BALANCE IMPROVING

There is still a certain degree of overcapacity in the market for chemical tankers. The orderbook is low and few new contracts are being signed. Consequently, fleet growth is expected to remain low during the next few years. Demand is expected to grow faster than supply but this forecast is subject to considerable uncertainty. For now, we expect the supply and demand balance to improve in 2013.

Figure CT.12





LPG TANKERS

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LPG TANKERS

MIDDLE EAST EXPORTS AND STRONG ASIAN DEMAND KEPT THE MARKET AFLOAT – ESPECIALLY FOR THE LARGER VESSELS. LOWER PRICES FOR LPG COMMODITIES PROMPTED MANY IMPORTERS TO ACCUMULATE STOCKS. CONSEQUENTLY, MONTHLY AVERAGE RATES HAVE REACHED A NEW HIGH AND ASSET VALUES HAVE INCREASED SLIGHTLY. DEMAND FOR LPG IS EXPECTED TO BE ROBUST IN THE NEAR FUTURE AND COULD INCREASE WITH THE ONSET OF WINTER IN THE NORTHERN HEMISPHERE.

FREIGHT RATES

BY AUGUST 2012, THE BALTIC LPG INDEX STOOD AT INDEX 75, SLIGHTLY UP FROM A YEAR AGO. THE MONTHLY AVERAGE OF THE BALTIC LPG INDEX FOR THE YEAR-TO-DATE IS SET TO REACH A NEW ALL-TIME HIGH, UP 8% FROM THE PREVIOUS HIGH SET IN 2011.

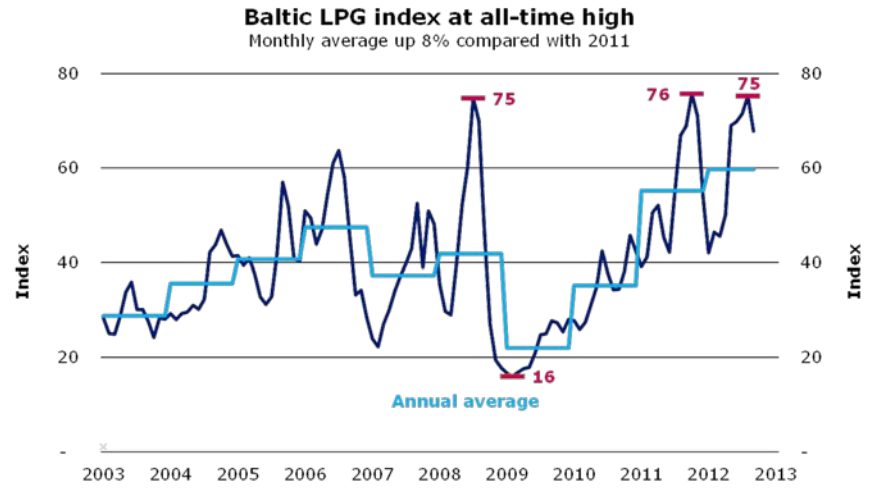
THE BALTIC LPG INDEX ASCENDING FURTHER IN 2012

The Baltic LPG index has so far increased 8% from a monthly average of 55 in 2011 to 60 in 2012 (fig. 1). 2012 began with a brief pause in demand as winter came to an end in the northern hemisphere and refinery turnarounds occurred in the major exporting regions. Rates have since gone up due to growing demand in Asia and to importers building up stocks in response to low prices for LPG commodities. At the end of August 2012, the daily observations of the Baltic LPG index hovered slightly above 75, only marginally lower than the all-time high of October 2011. September 2012 brought a brief seasonal lull, but rates are expected to improve with the coming of the winter season in the northern hemisphere.

WELL-BALANCED MARKET PUSHING CHARTER RATES HIGHER

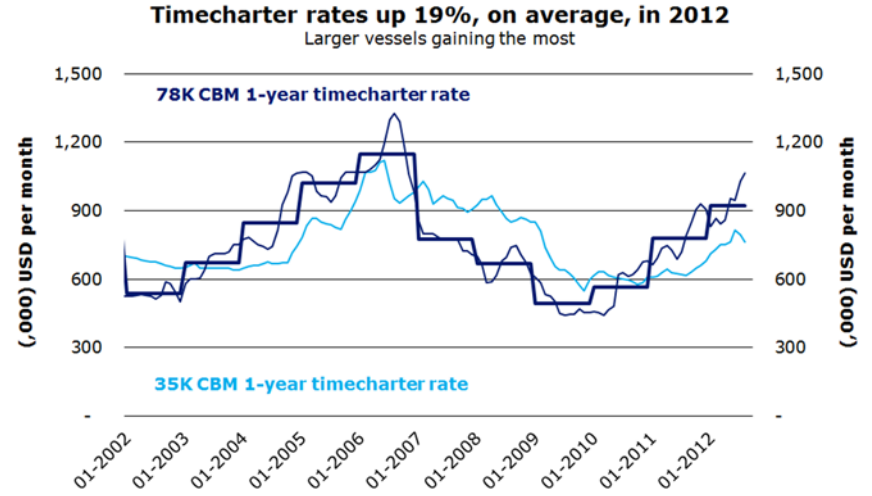
The limited growth of the LPG tanker fleet continues to push average charter rates higher. Average timecharter rates have increased from USD 830,000 per month in December 2011 to USD 930,000 per month in August 2012 (fig. 2). By the end of August 2012, the monthly average stood at USD 860,000 per month, up 19% from last year. However, the monthly average of 2012 is still 12% short of the golden period of 2005 to 2007. Current market conditions might generally bolster timecharter rates further.

Figure LPG.1



Sources: Reuters EcoWin, Danish Ship Finance

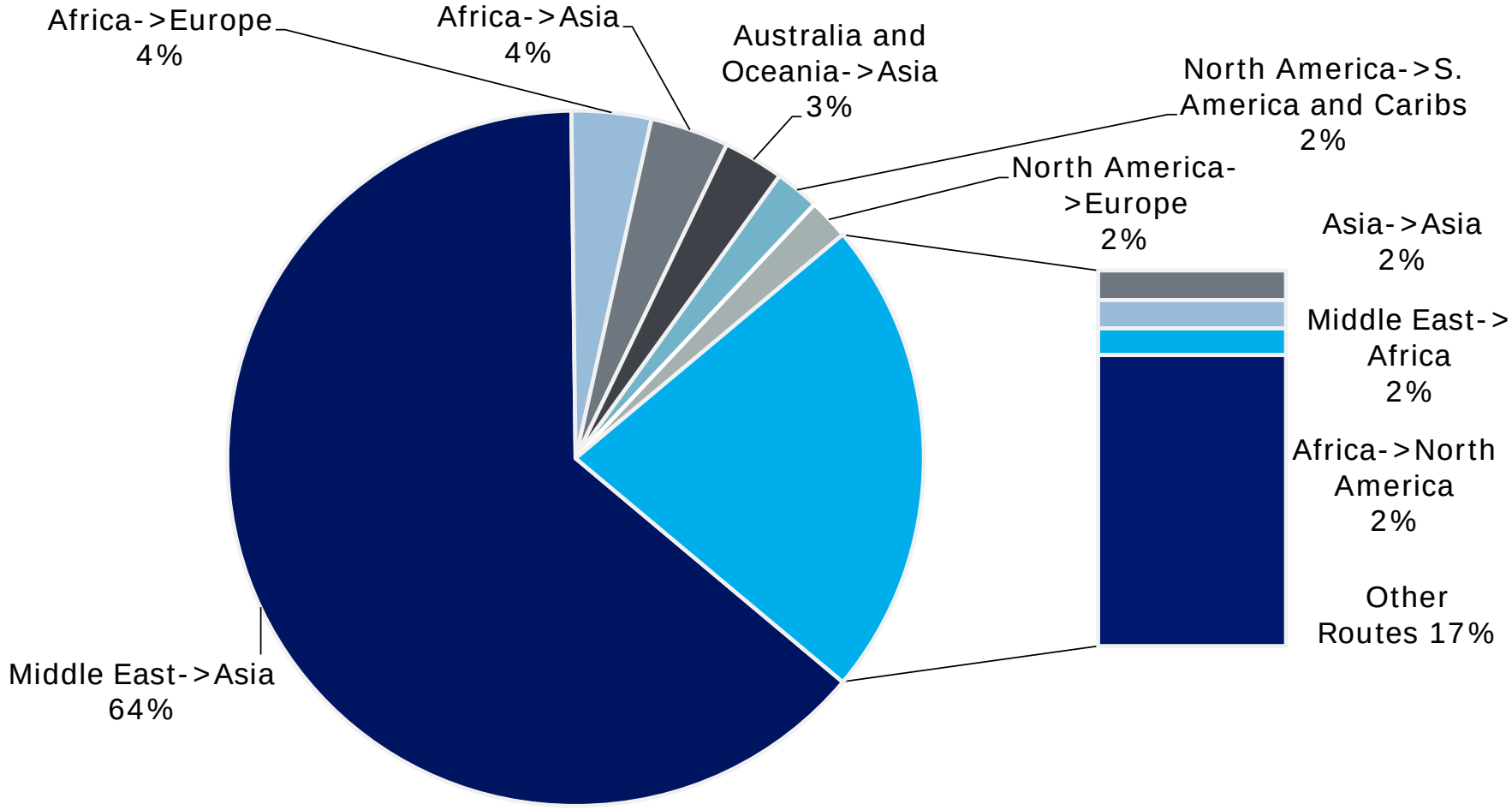
Figure LPG.2



Sources: Clarksons, Danish Ship Finance

Figure LPG.3

MAJOR LPG TRADES
(MEASURED IN MILLION TON-NAUTICAL MILES, 2011)



Sources: IHS Global Insight, Danish Ship Finance

LIMITED FLEET GROWTH AND INCREASING CONSUMPTION IN MANY DEVELOPING ECONOMIES SUPPORTED THE MARKET FOR LPG TANKERS IN 2012. AN ABUNDANT SUPPLY OF LPG FROM THE MIDDLE EAST AND RELATIVELY LOW GAS PRICES KEPT, IN PARTICULAR, THE LARGER VESSELS OCCUPIED.

HISTORICALLY LOW NUMBER OF VESSELS ENTERING THE FLEET

During the first eight months of 2012, a record low of 0.2 million Cu. M was delivered to the LPG tanker fleet (fig. 4). The small gas carrier segment was the largest contributor (0.1 million Cu. M) to total deliveries closely followed by VLGCs and MGCs. To find a similar low number of vessels entering the fleet one has to go all the way back to 1998 when total deliveries fell below 0.1 million Cu. M. The declining appetite for LPG tankers between 2008 and 2010 – and especially in 2009 – has now resulted in the lowest number of deliveries in more than a decade.

SCRAPPING ACTIVITY REDUCED TO A TRICKLE

The low scrapping activity of 2011 is set to be even lower in 2012. During the first eight months of 2012, only five vessels (0.03 million Cu. M) were sent to the scrapyards (fig. 4). Improving conditions in the LPG market have kept owners from sending vessels to the scrapyards even though steel prices remain relatively high. In 2012 to date, scrappings have been confined to small gas carriers in around the 30-year age bracket. Seen in a historical perspective, this is quite a low number that has not been seen since 2001 or the mid-nineties. However, the low number of demolitions is not a reflection that there are no candidates for scrapping among vessels in service. Actually, 6% of the current LPG tanker fleet is older than 25 years.

POSTPONEMENTS AND CANCELLATIONS DWINDLING

The number of deliveries dwindled during the first eight months of 2012. A total of 0.3 million Cu. M was scheduled to be delivered during the first eight months of 2012. The bulk of these orders was delivered, and only three small gas carriers were postponed for later delivery in 2012. A total of four vessels were cancelled during the period, but none of them would have affected fleet growth in 2012, as they were all scheduled for post-2012 delivery.

Figure LPG.4

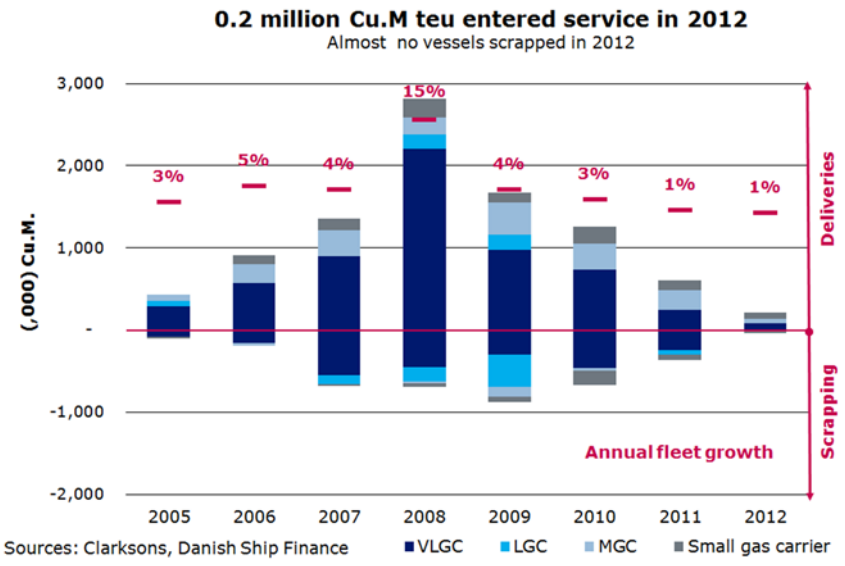
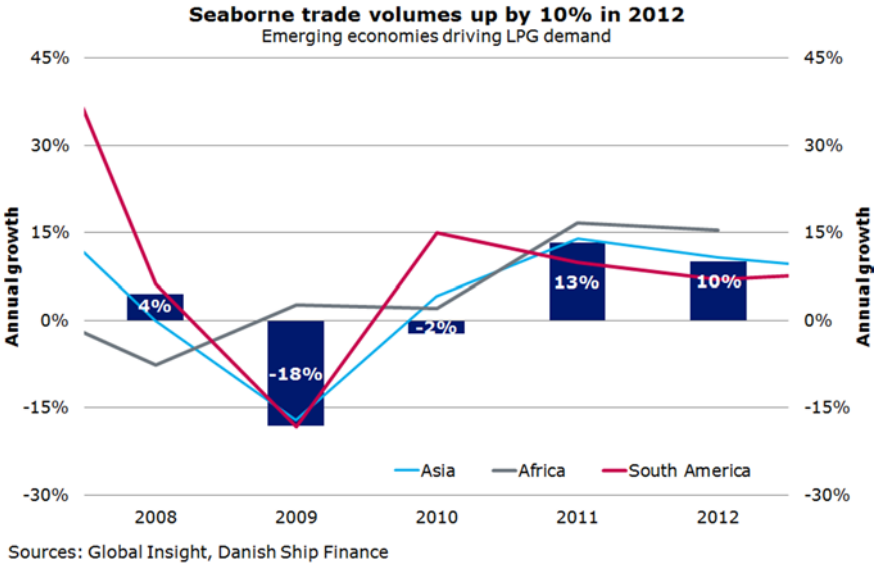


Figure LPG.5



LPG TANKER FLEET GREW 1% DURING THE FIRST EIGHT MONTHS OF 2012

The total LPG tanker fleet grew 1% during the first eight months of 2012 (fig. 4). Growth was mainly concentrated in the smaller segments (2%) while the larger segments are exhibiting little growth, if any at all.

SEABORNE LPG TRADE VOLUMES UP 10% IN 2012

Growth in seaborne LPG commodities has continued in 2012 at strong rates matching rates in 2011. Total seaborne LPG commodity trade is expected to be up by 10% in 2012 (fig. 5). The growth of 10% in 2012 is predominantly driven by the rise of emerging economies in Asia.

LPG DEMAND STEMS FROM EMERGING ECONOMIES IN ASIA

The increasing consumption in most emerging economies and the limited production capacity in these countries are expected to drive demand in 2012. Combined with the fact that prices for LPG products were relatively low, almost all of the importing nations seemed eager to fill up stocks. Asian imports are expected to rise by 12% in 2012 thereby contributing 90% of the growth rate in seaborne LPG trade.

THE MIDDLE EAST DRIVING EXPORT VOLUMES

The Middle East remained the main supplier of the higher Asian LPG imports. In 2012, LPG supply for Middle East exports is expected to increase by 12%, the single largest contributor to growth in total LPG exports (fig. 6). Nevertheless, growth in LPG production in the Middle East has slowed this year, largely because of the stagnant production of natural gas.

AVERAGE TRADING DISTANCES UNCHANGED IN 2012

The fact that increased volumes of LPG products were supplied by the Middle East meant that LPG products, on average, were carried over the same distances as in previous years. With no significant changes in trading distances the rate of growth in ton-mile demand did not bolster the seaborne LPG trade. Distance-adjusted demand is expected to expand by 10% in 2012 down from 13% in 2011 (fig. 7).

FURTHER TIGHTENING OF THE SUPPLY / DEMAND BALANCE

It has been an owners' market in 2012 to date. The Baltic LPG index reached a new monthly all-time high, up 8% from 2011. Abundant supply from the Middle East and the ever-growing consumption in emerging economies along with relatively low commodity prices kept especially the larger segments well-employed. In 2012, the larger vessels have benefitted the most from the improved market.

Figure LPG.6

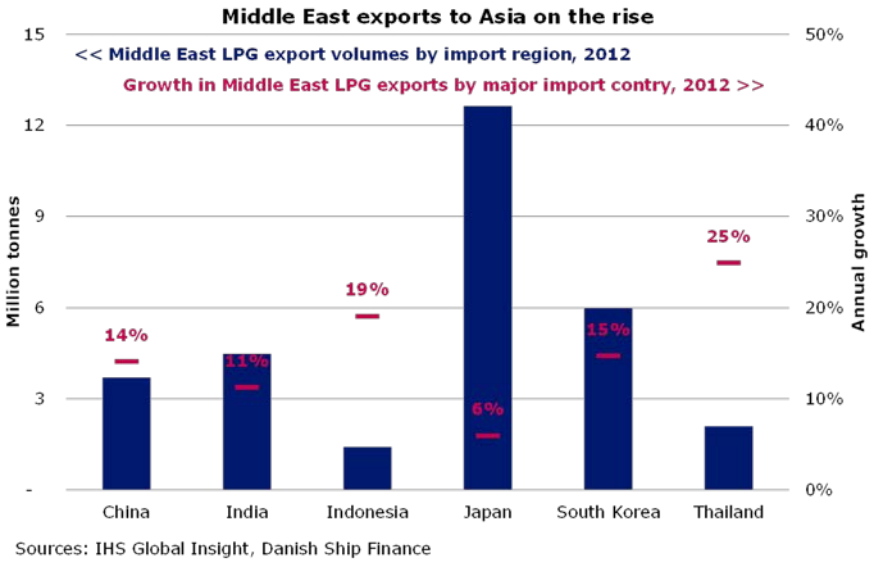
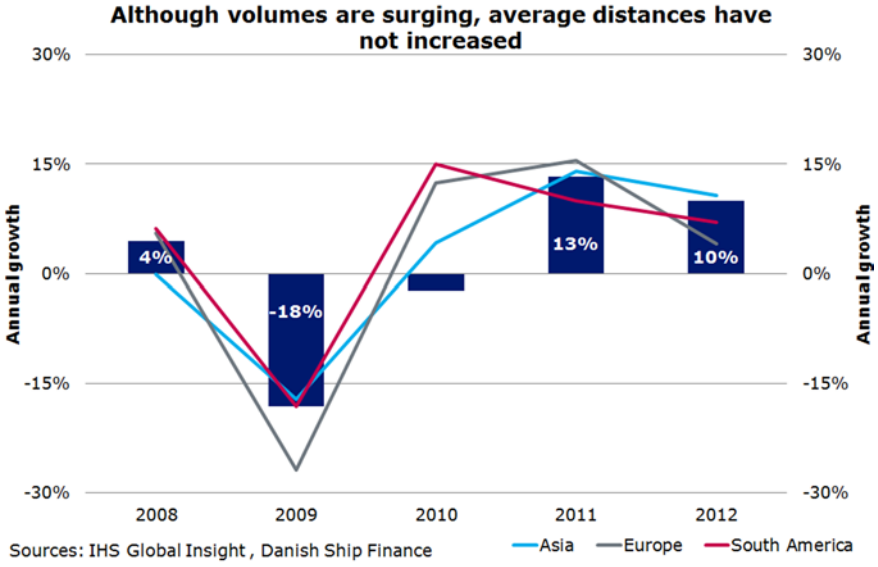


Figure LPG.7



STRONG CONTRACTING ACTIVITY WITHIN THE LARGER SEGMENTS AND THE NICHE BUSINESS OF BUILDING LPG VESSELS HAS SUPPORTED NEWBUILDING PRICES. SECONDHAND PRICES HAVE BENEFITTED FROM THE IMPROVED MARKET CONDITIONS.

LPG NEWBUILDING ORDERS ALREADY AT DOUBLE LAST YEAR'S LEVEL

The memory of the harsh conditions in the LPG market just a couple of years ago seems to be slowly fading from owners' memories. Owners' appetite for new tonnage – VLGCs in particular – took off during the first eight months of 2012. A total of 1.2 million Cu. M was contracted, of which 50% was VLGC tonnage (fig. 8). Clearly, owners are expecting that the ever-growing consumption of Asian economies as well as the abundant supply from the Middle East will continue for some time to come. Also, owners may benefit from the more ECO-friendly and fuel efficient designs. If rates and earnings remain high amid this period of high demand, a rush of new orders is not needed.

DELIVERY TIME OF AROUND TWO YEARS

Scheduled delivery times were still at just over two years during the first eight months of 2012, unchanged compared to 2011 (fig. 9). The short average delivery time is an indication that yards are getting more spare capacity and that, with market conditions expected to remain strong, owners are not opting for longer deliveries.

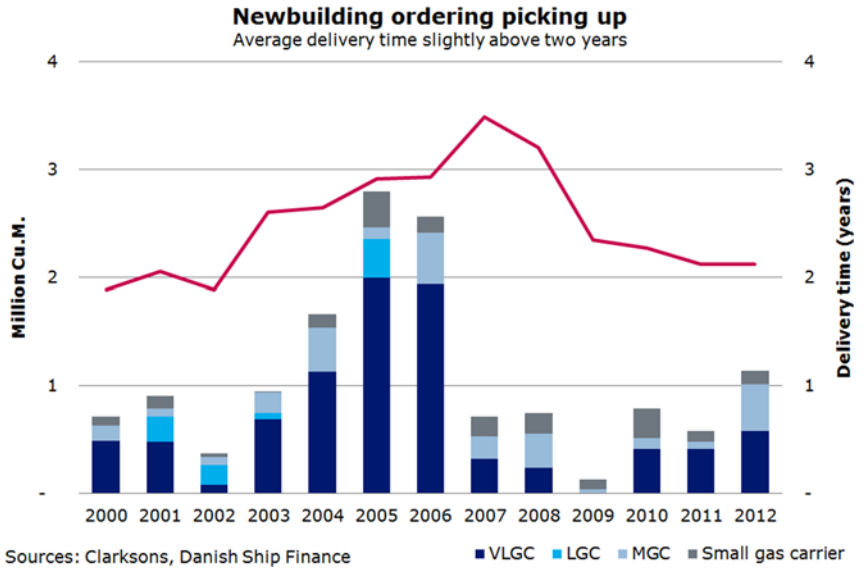
NEWBUILDING PRICES SLIGHTLY DOWN

Increasing newbuilding activity and the limited number of yards capable of building LPG tankers was not enough to prevent prices from falling; newbuilding prices declined 2% year-on-year (fig. 9). While prices of large vessel declined only marginally, there was a greater price fall for small vessels, because more yards were competing for these orders than for orders for large vessels.

SECONDHAND PRICES SLIGHTLY UP IN THE FIRST EIGHT MONTHS OF 2012

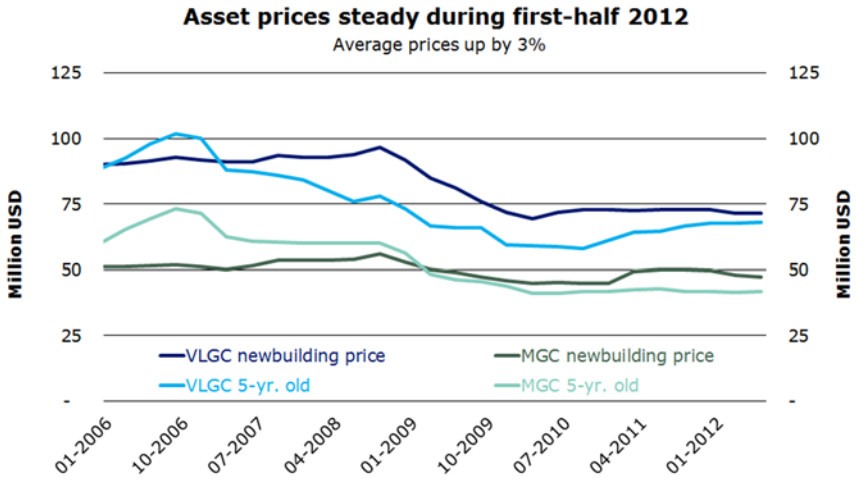
A strong LPG market and hence increasing freight rates have supported asset values. Secondhand prices have increased by 2% year-on-year as especially large vessels benefitted from the favourable market conditions. By August 2012, a 5-year old VLGC vessel could be purchased for around USD 68 million, while a 5-year MGC stood at USD 42 million.

Figure LPG.8



Sources: Clarksons, Danish Ship Finance

Figure LPG.9



Sources: Drewry, Danish Ship Finance

THE OUTLOOK FOR LPG TANKERS IS PROMISING. RATES WILL BE DEMAND-DRIVEN AS SEABORNE DEMAND IS EXPECTED TO OUTGROW THE FLEET. WE EXPECT FREIGHT RATES TO REMAIN ROBUST IN THE SHORT TO MEDIUM TERM.

THE LPG ORDERBOOK IS GROWING

At the end of August 2012, the aggregate orderbook contained a total of 2.4 million Cu. M, up some 50% from January (fig. 10). With a current fleet of 18.3 million Cu. M, the orderbook/fleet ratio (13%) does not look worrying. However, a new ordering boom could change this if the trend of the first eight months of 2012 continues, but ordering is still well below the dizzy heights of 2005. The bulk of the orderbook consist of VLGCs which account for some 60% of the entire orderbook. The majority of orders are scheduled to reach the sea in 2013.

FLEET GROWTH EXPECTED TO TAKE OFF IN 2013

Taking the estimated levels of scrapping and deliveries into consideration, we estimate that net fleet growth will land at about 1% in 2012 as new additions will be offset by scrapping (fig. 11). Should scrapping fall short of projections, estimated net fleet growth would land at about 2% for 2012. We expect that fleet growth will take off in 2013 and project a 7% increase for the year (1.2 million Cu. M). Fleet growth in 2013 will be the result of the large number of VLGC deliveries accounting for 75% of new vessels.

1.5 CU. M SCHEDULED FOR DELIVERY IN 2013

With only 0.2 million Cu. M scheduled for the remainder of 2012 cancellations and postponements are unlikely to have a major effect on fleet growth. A total of 1.5 million Cu. M is scheduled for delivery in 2013 (fig. 11). With demand for LPG expected to remain strong in 2013, we doubt that owners will opt for postponing or cancelling their orders to any great extent; quite the opposite of trends currently prevailing in the other shipping sectors.

MODEST SCRAPPING DESPITE GREAT POTENTIAL

With the prospects of rates remaining high for at least another year and taking the capacity of the LPG tanker fleet into account, we expect that the current relatively modest level of scrapping will persist for the remainder of 2012 and well into 2013. Considering the age structure of the current fleet, the vessels due for special surveys as well as the age

Figure LPG.10

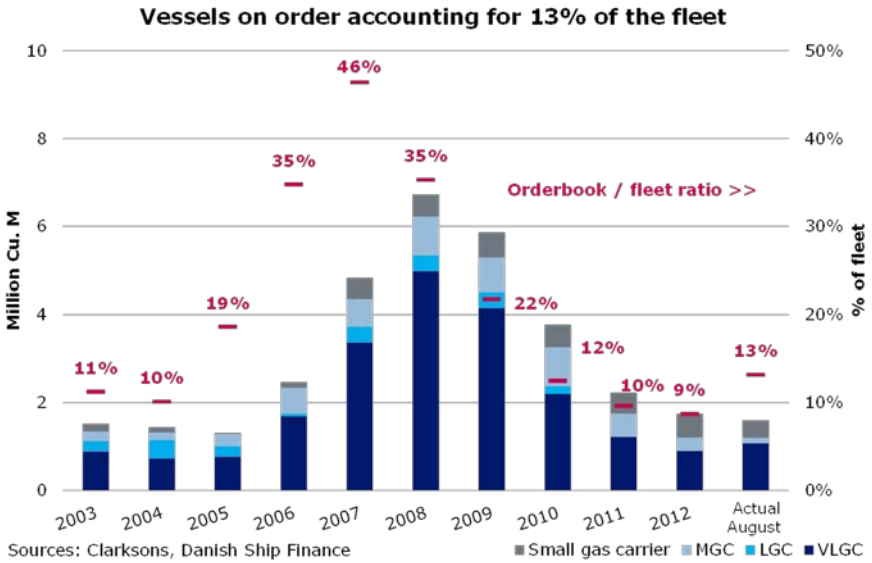
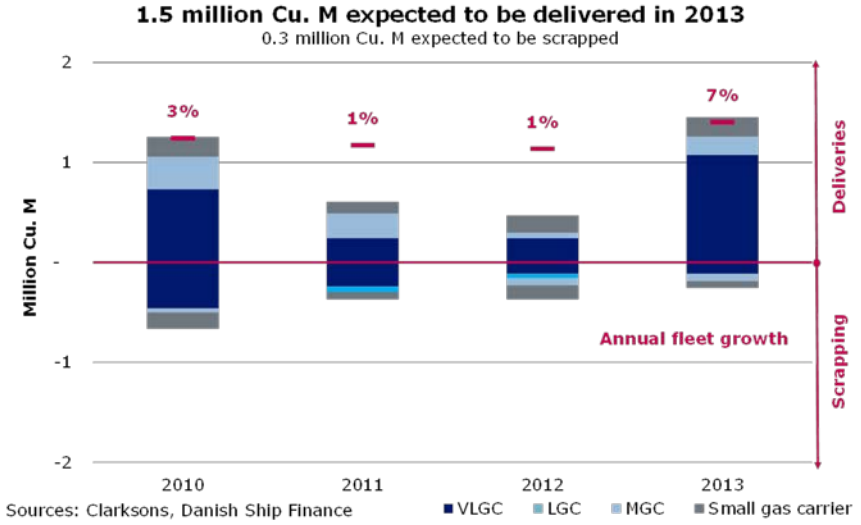


Figure LPG.11



structure of demolished vessels in previous years' buoyant markets, we do not expect more than 0.2 million Cu. M to be sent to the scrapyards during the rest of 2012. We project scrappings of 0.3 million Cu. M in 2013.

OVER-ORDERING MIGHT JEOPARDISE THE SUPPLY-DEMAND BALANCE

The recent surge in new orders for LPG vessels might ruin the delicate balance between supply and demand. As the rate of growth in LPG supply from the Middle East has nearly stalled, the uncertainty regarding the future LPG supply growth should keep owners cautious about ordering new vessels.

SEABORNE LPG TRADE EXPECTED TO STALL IN 2013

Growth in seaborne LPG trade is set to slow to growth rates of around 8% (5 million tonnes) - a reduction of 2 percentage points from 2012-levels (fig. 12). The main driver behind growth is once again Asia, but other regions such as South America and Africa are also showing strong growth figures albeit contributing very little in terms of volumes. Japan is expected to be the single largest importer measured in tonnes whereas Thailand and South Korea are competing for the position as the fastest growing importer.

ASIA DRIVES LPG DEMAND

Asian LPG import is expected to expand by 9% in 2013. Countries such as South Korea, China, Thailand and Indonesia are expected to show double-digit growth figures in 2013 (fig. 13). LPG consumed for cooking purposes provides an impetus for the growing consumption base for LPG demand in the region. Autogas consumption is also expected to gain popularity in major Asian cities for its ability to reduce smog. Another supportive factor for LPG consumption in Asia is the fact that Asia's petro-chemical industry – and South Korea's in particular - is converting cracking systems so propane can be used as a feedstock, and this should support LPG consumption further. The biggest threat to LPG consumption growth is the increasing use of town gas in Asia.

BATTLING PUBLIC HEALTH HAZARDS MIGHT BOOST LPG CONSUMPTION

A move to promote the use of LPG was provided by the World LPG Association in a campaign called 'Cooking for life'. Scheduled to run over the next five years, the campaign will promote LPG as a clean and safe cooking fuel, primarily in developing countries. According to the organisation around 3 billion people, many of whom live in India and China, still use biomass for cooking and heating purposes which may

Figure LPG.12

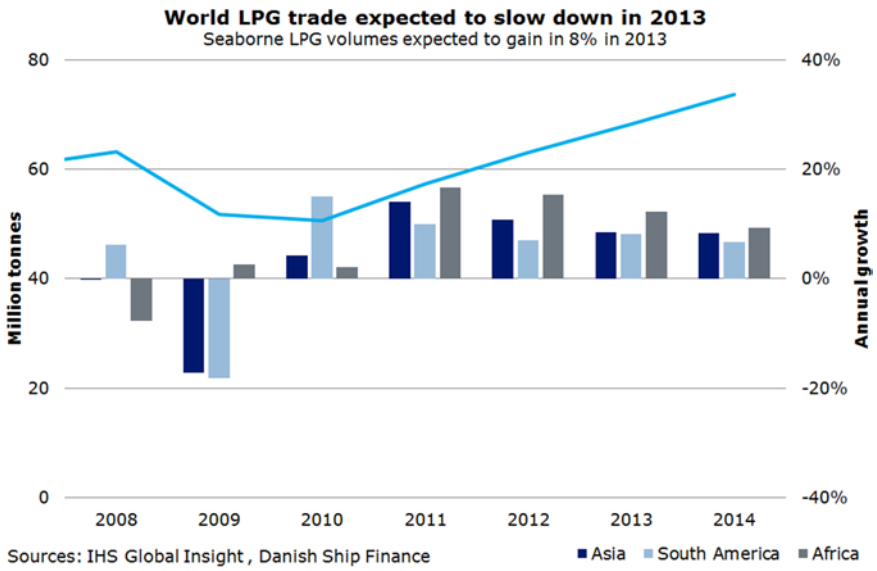
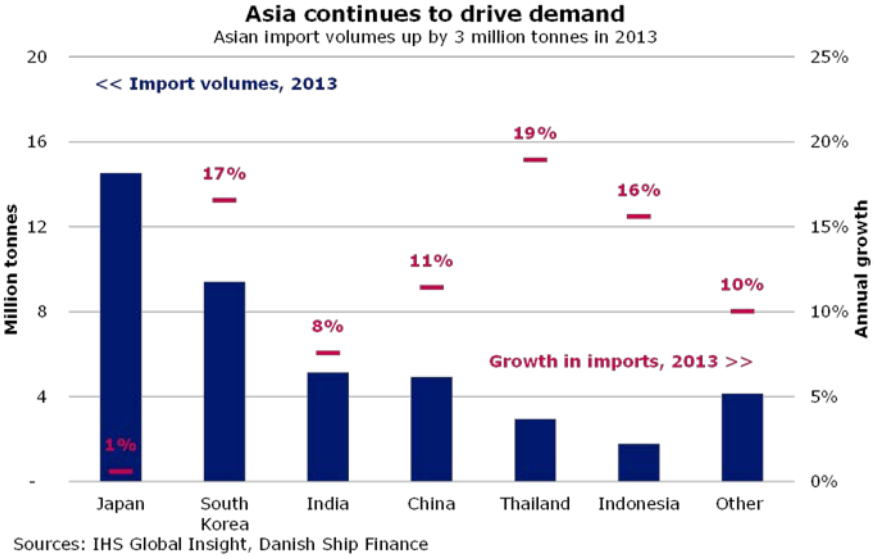


Figure LPG.13



lead to serious health hazards. Although, such a campaign will probably increase the consumption base for LPG in developing regions, it will most likely only provide support for the LPG tanker market in the medium to long term.

LPG EXPECTED TO BE SHIPPED FROM THE MIDDLE EAST

While Asia is driving global LPG demand growth almost single-handedly, supply of LPG is expected to originate in the Middle East. The Middle East will remain the largest supplier of LPG commodities for the Asian markets with exports to Asia projected at 35 million tonnes in 2013, an increase of 3 million tonnes over 2012 (fig. 14). Meanwhile, the rate of growth of LPG available for exports in the Middle East is expected to fall in the coming years as domestic consumption increases and production of associated gas declines.

DISTANCE-ADJUSTED DEMAND REMAINING UNCHANGED

With no significant changes in LPG trade patterns, demand is not further bolstered by distances. Altogether, distance-adjusted demand is expected to expand by 8% in 2013.

SHALE RESERVES LIKELY TO IMPACT THE LPG MARKET IN THE MEDIUM TERM

While growth rates in LPG supply in the Middle East are declining, in the medium to long term the USA might well emerge as a major supplier to Asia, and to Japan in particular. LPG production in the USA has been growing steadily in recent years largely due to the exploitation of shale gas. LPG production in the USA might already surpass demand and export from the country may be on the cards. However, the real impact on the LPG market will most likely remain on hold until the expansion of the Panama Canal is completed, which will reduce voyage time by twenty days. The rise of the USA as an exporter will be extremely positive for the LPG trade.

RATES TO REMAIN FIRM IN 2013

The current outlook for LPG tanker demand seems likely to continue supporting high freight rates in 2013. A mix of several factors such as an increasing consumption base in Asia along with the campaign for LPG as a cleaner and safer cooking fuel will result in increasing imports and hence increasing demand for LPG tankers. Furthermore, plenty of supply from the Middle East will keep vessels occupied. Market sentiment is expected to remain firm, largely on the back of strong demand and a tight vessel supply. But any over-ordering of new vessels could shatter this balance.

Figure LPG.14

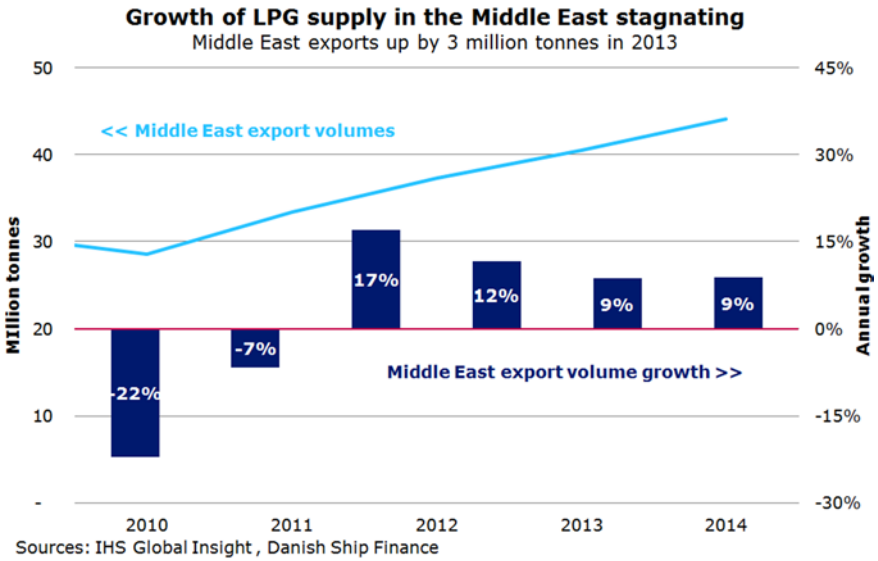
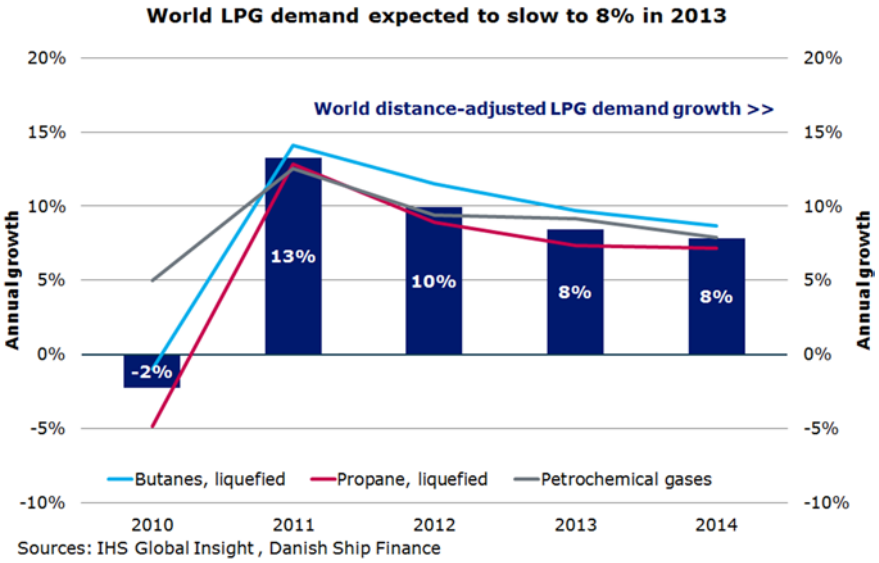


Figure LPG.15



DRY BULK

DANMARKS SKIBSKREDIT

DRY BULK

EARNINGS IN THE DRY BULK SEGMENT REMAIN UNDER PRESSURE. DRY BULK DEMAND IS LARGELY BACK ON TRACK AND OVERSUPPLY SEEMS TO BE THE MAIN FORCE KEEPING RATES DOWN

FREIGHT RATES

RATES IN THE DRY BULK MARKET DESCENDED DEEPER IN 2012. BOTH RATES AND CHARTER PERIODS REMAIN UNDER HEAVY PRESSURE AND IN MANY CASES VESSELS OPERATE BELOW OPEX.

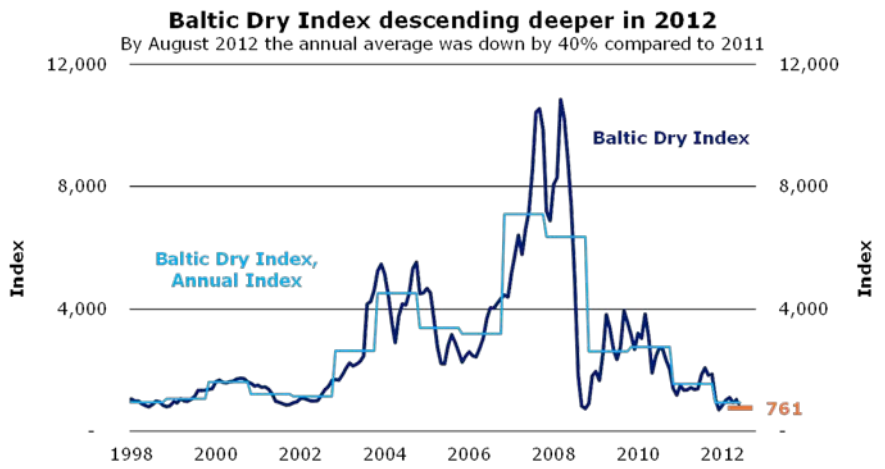
THE BALTIC DRY INDEX DESCENDING DEEPER IN 2012

A combination of large fleet growth and dwindling demand growth for raw materials continues to depress freight rates in the dry bulk segment. The Baltic Dry Index began 2012 with a sudden plunge as the index dropped from a temporal spike at around 1,900 in mid-December to less than 700 by the end of January. The index has so far failed to recover, and the usual spikes in the index are becoming decreasingly smaller. By August 2012, the index averaged 935 for the year running - the lowest since 1998 and alarmingly close to the record lows of 1986. The average Baltic Dry Index for the full year 2012 is set to come out below 1,000, down by some 40% from the annual average of 2011. Given the current market rates many vessels – especially in the larger segments - are now operating below OPEX.

OVERSUPPLY CONTINUES TO PUSH CHARTER RATES LOWER

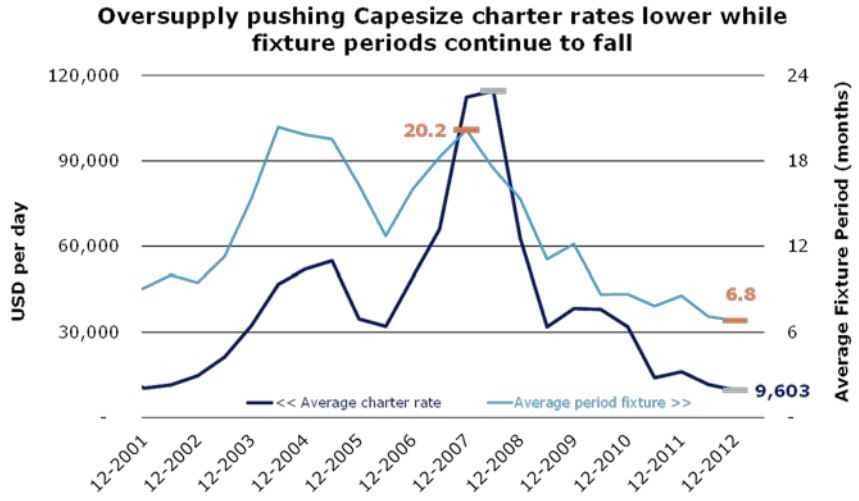
The unrelenting growth in the dry bulk fleet - and the Capesize fleet in particular - continues to push average charter rates lower. Average Capesize charter rates fell 26% in 2012 from USD 15,000 per day in 2011 to USD 11,000 per day. In the early months of second half of 2012 the average Capesize charter rate stood at USD 9,600 per day (fig. 2). Meanwhile, the large oversupply of vessels shortened average charter periods. The average fixture period stood at 6.8 months by August 2012. This was down from 8.2 months in 2011 and indicates that operators to some extent continue to believe that low rates will persist for some time still.

Figure DB.1



Sources: Reuters EcoWin, Danish Ship Finance

Figure DB.2

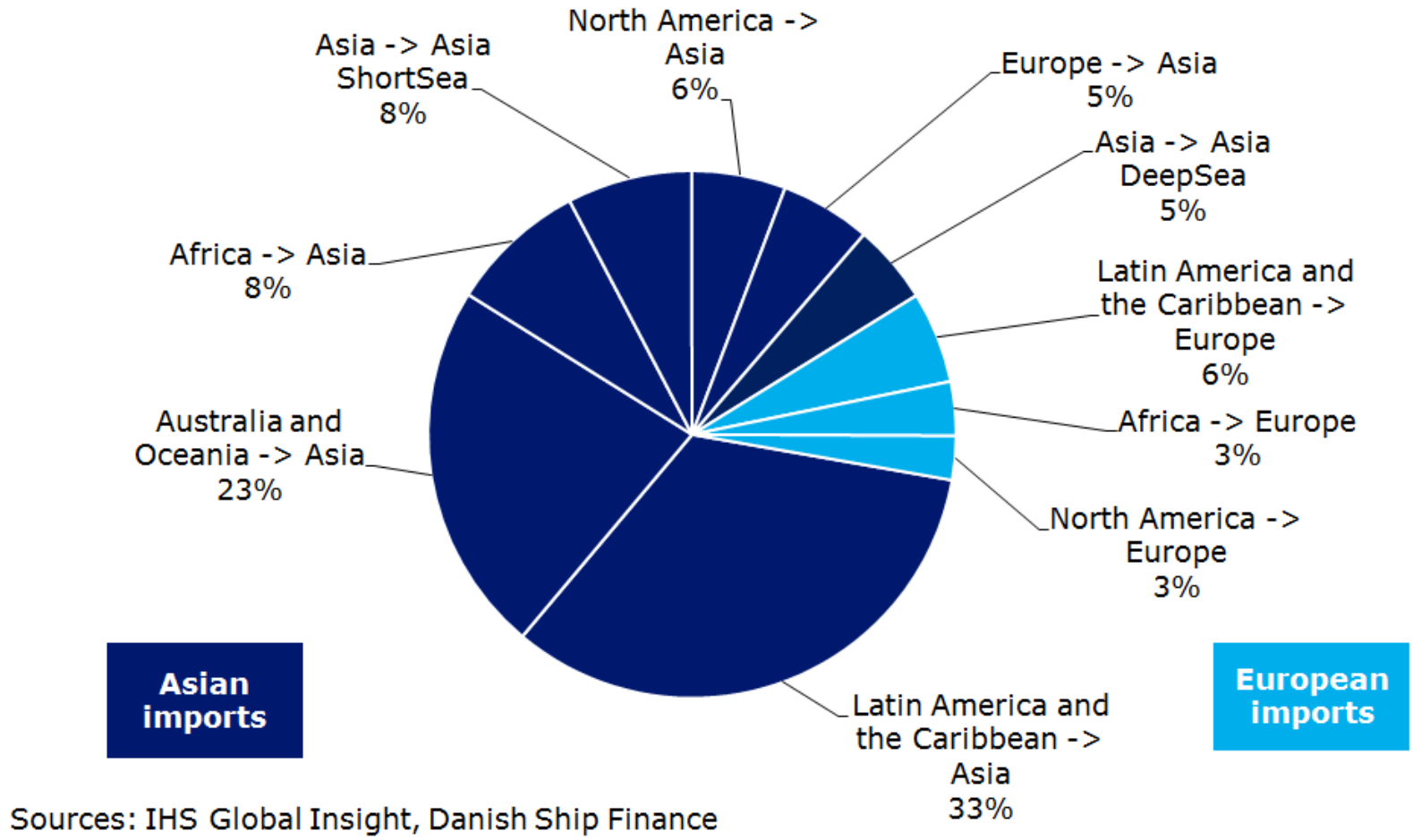


Sources: Clarksons, Danish Ship Finance

Figure DB.3

ASIAN DEMAND DOMINATES CAPESIZE DEMAND

TOP 10 FRONT-HAUL CAPESIZE ROUTES



Sources: IHS Global Insight, Danish Ship Finance

DISTANCE-ADJUSTED DEMAND SET TO GROW BY 6% IN 2012. DRY BULK CAPACITY INCREASED BY 8% DURING THE FIRST EIGHT MONTHS OF 2012. DESPITE HIGH SCRAPPING ACTIVITY OVERSUPPLY CONTINUES TO ACCUMULATE IN THE DRY BULK SECTOR.

74 MILLION DWT DELIVERED DURING THE FIRST EIGHT MONTHS OF 2012

During the first eight months of 2012 a record 74 million dwt was delivered to the dry bulk fleet. The Capesize segment remains the largest contributor to total deliveries with 33 million dwt (171 vessels) delivered. However, the increasing appetite for Panamax contracting which started in 2010 is now coming to the market and with a shrinking Capesize orderbook deliveries of Panamax vessels are now beginning to make up a larger share of overall deliveries (fig. 4).

21 MILLION DWT SCRAPPED DURING THE FIRST EIGHT MONTHS OF 2012

The record high scrapping of 2011 is set to be repeated in 2012. During the first eight months of 2012, 21 million dwt (3% of the fleet) was scrapped. The fall in rates has pushed more tonnage to the scrapyards than during the same period last year. Although scrapping continues to be the highest in the Capesize segment, activity is also seen to increase in the smaller segments (fig. 4).

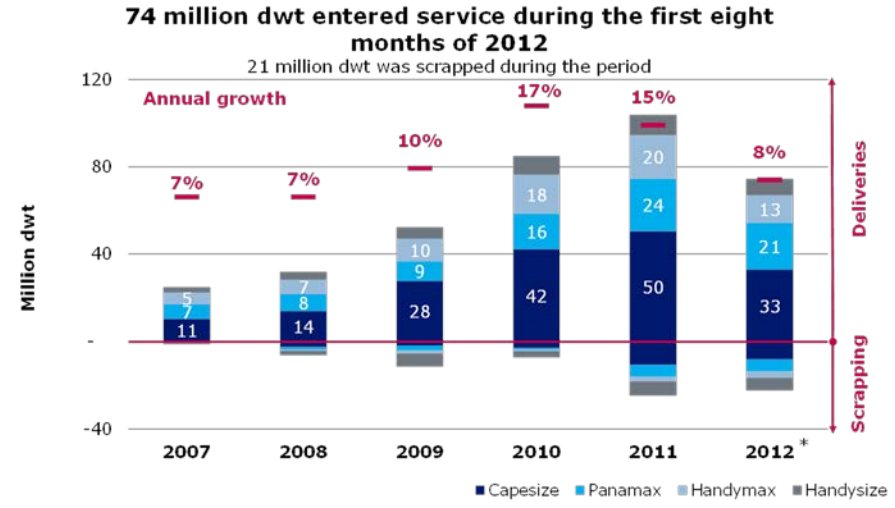
SCRAPPED VESSELS BECOME SIGNIFICANTLY YOUNGER

Vessels scrapped in 2012 were significantly younger than in previous years. In 2012, vessels were on average scrapped at the age of 28, a drop of more than two years when compared to vessels scrapped in 2011. In the Capesize segment scrapped vessels were only 23 years old on average – down from an average of 26 years in 2011. Even in the smaller segments, vessels scrapped in 2012 were on average about two years younger than vessels scrapped in 2011.

INCREASING NUMBER OF CANCELLATIONS CURBING FLEET GROWTH

A large number of cancellations and postponements have curbed fleet growth over the past eight months. In the orderbook as of January 2012 a total of 139 million dwt was scheduled for delivery in 2012. Of these orders, 65 million dwt was delivered during the first eight months of 2012 and another 22 million dwt was scheduled for delivery in September-December 2012. 35 million dwt was postponed for later delivery. Cancellations picked up in 2012 as a total of 17 million dwt

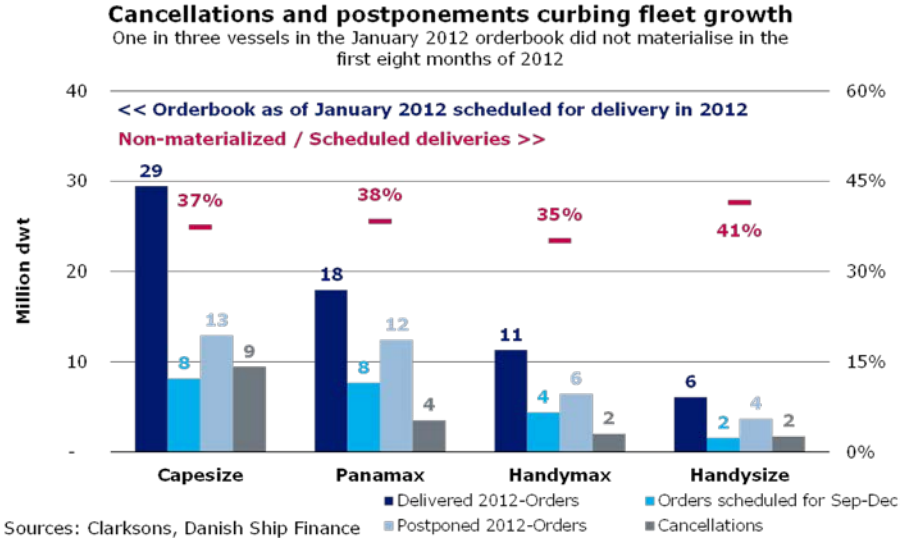
Figure DB.4



Sources: Clarksons, Danish Ship Finance

* January-August

Figure DB.5



Sources: Clarksons, Danish Ship Finance

(12% of the orderbook) was cancelled outright during the first eight months of the year. The pickup in cancellation activity has mainly involved the Capesize segment, whereas the smaller segments have seen a slight drop in cancellations compared to the second half of 2011. As of August 2012, 38% of the January 2012 orderbook had not materialised (fig. 5).

DRY BULK FLEET GREW 8% DURING THE FIRST EIGHT MONTHS OF 2012

The overall dry bulk fleet expanded by 8% during the first eight months of 2012. Fleet growth remained the highest in the Capesize and Panamax segments at 10% growth. The Handymax and the Handysize segments saw growth rates of 8% and 2% respectively.

SEABORNE DRY BULK TRADE SET TO GROW 6% IN 2012

Growth in seaborne dry bulk trade appears to continue in 2012 with growth rates similar to 2011. Total seaborne commodity trade is set to expand by 6% (231 million tonnes) (fig. 6). The growth rates of 2011 and 2012 seem to indicate a return to long-term growth in dry bulk commodity trade following the sudden halt in growth in the wake of the financial crisis and the subsequent rebound in 2010. The average annual growth in seaborne dry bulk trade over the past 15 years has been around 5%.

IRON ORE TRADE EXPANDING BY 8% IN 2012

Iron ore imports to China continue to be the single most important source of growth for the dry bulk segment. Total iron ore trade expanded 8% (111 million tonnes) in 2012 (fig. 6). Chinese investments in construction and infrastructure continued at fairly strong growth rates leading to relatively high growth rates in iron ore imports. Chinese imports of iron ore expanded by 8% (65 million tonnes) in 2012. Japanese imports have also contributed to seaborne iron ore demand as the rebuilding following last year's earthquake continued. Japanese iron ore demand expanded 9% (14 million tonnes) in 2012 (fig. 7).

COAL AND COKE DEMAND INCREASING BY 7% IN 2012

Growth in coal and coke demand is settling at somewhat lower levels than in 2010 and 2011 as growth has returned to normal. The coal and coke trade is set to expand by 7% (68 million tonnes) in 2012 down from the 11% (100 million tonnes) growth in 2011 (fig. 6). The declining growth rate is primarily attributed to waning

Figure DB.6

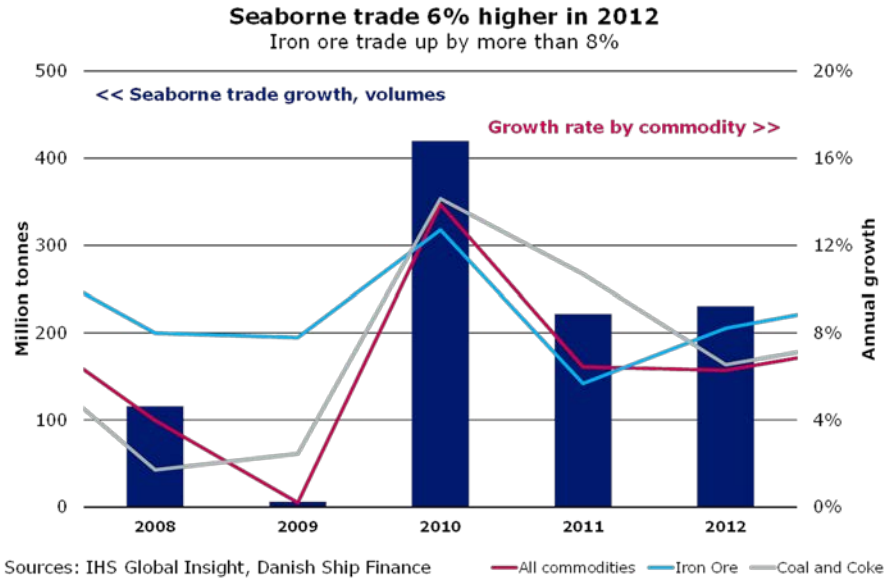
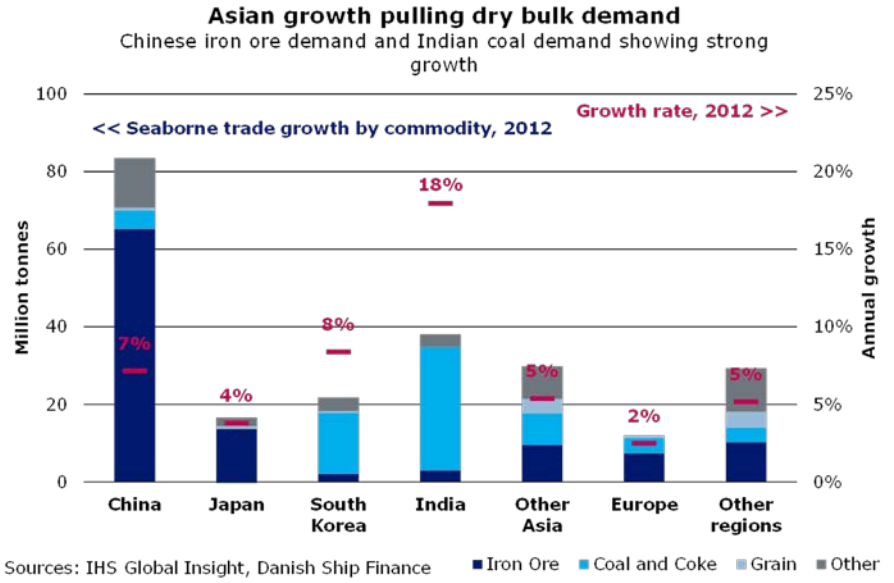


Figure DB.7



Chinese demand for seaborne thermal coal imports. Chinese demand for thermal coal is abating as growth in electricity production is gradually declining in response to a general slowdown in Chinese manufacturing. Indian demand for coal on the other hand is surging, up 23% (32 million tonnes) in 2012, yet slightly down from the 26% increase (29 million tonnes) in 2011. Thus, India is set to become the third-largest importer of coal in 2012 (fig. 7).

AVERAGE TRAVEL DISTANCES UNCHANGED IN 2012

Distance-adjusted demand is set to increase by 6% in 2012 (fig. 8). China remains the largest contributor to global distance-adjusted demand growth. However, as most of the growth in China's iron ore imports originates in Australia this trade does not add significantly to average travel distances. With almost all growth in coal imports to Asia sourced from Indonesia, average trading distances for Asian coal trades have been marginally reduced.

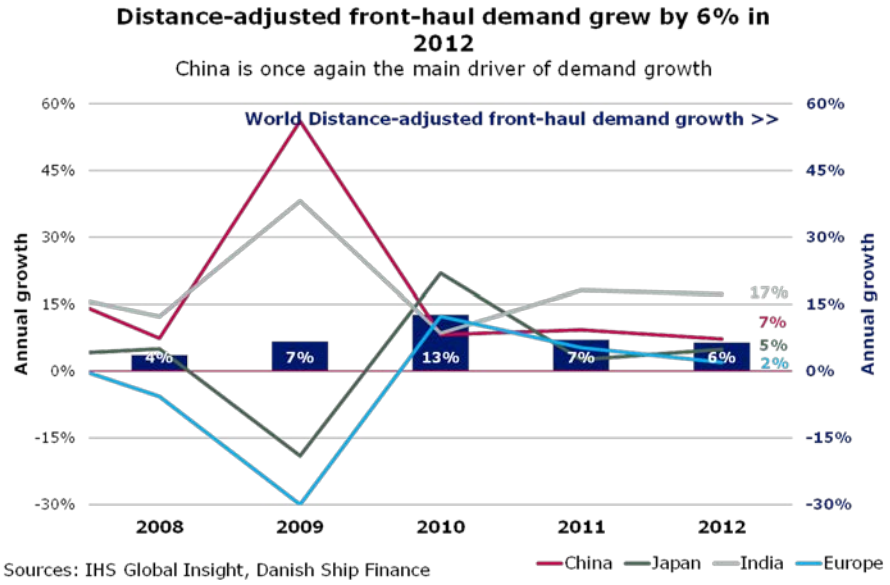
EASING PORT CONGESTION ADDS TO PRESSURE ON RATES

Expanding port capacity and improvements to port infrastructure have eased port congestion gradually over the past three years. However, disruptions to inland supply lines as well as weather-related disruptions continue to cause temporary spikes in port congestion. By August 2012, 6% of the total dry bulk fleet was occupied by port congestion. In the Capesize segment more than 10% of the fleet was occupied due to port congestion, whereas in the Panamax segment this applied to only 4% of the fleet (fig. 9). The majority of vessels occupied by port congestion are located off ports in Australia and China whereas Brazilian port congestion has generally been declining over the past couple of years.

LARGE EXCESS SUPPLY OF VESSELS KEEPING RATES UNDER PRESSURE

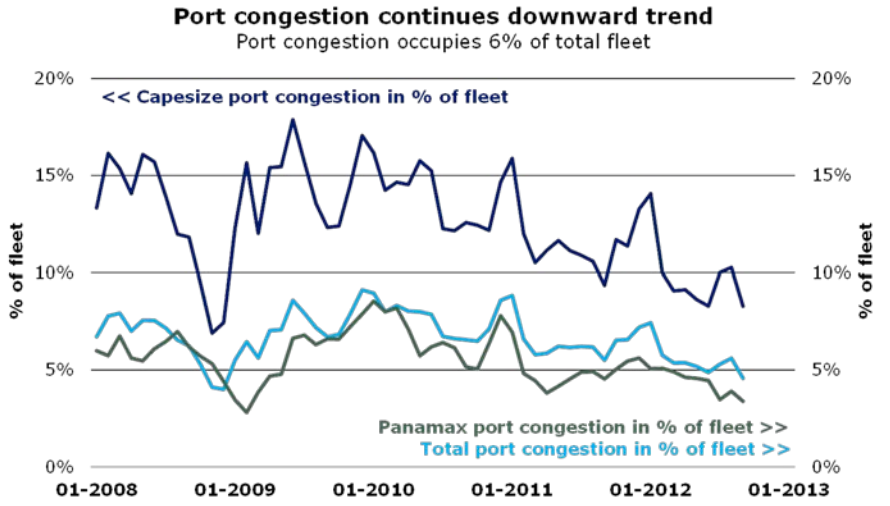
Although demand growth appears to be back on track following the financial crisis the large excess supply of vessels continues to keep rates under heavy pressure. Downward trending port congestion means that support for rates coming from this end will only be temporary. More scrapping is needed to balance supply with demand.

Figure DB.8



Sources: IHS Global Insight, Danish Ship Finance

Figure DB.9



Sources: Global Ports, Clarksons, Danish Ship Finance

CONTRACTING AND SHIP VALUES

SHIPOWNERS' APPETITE FOR NEW VESSELS FINALLY SEEMS TO BE ON THE RETREAT AS THE LARGE EXCESS SUPPLY OF VESSELS CONTINUES TO PULL FREIGHT RATES AND SHIP VALUES DOWN. INCREASINGLY, NEW CONTRACTS INVOLVE MORE FUEL-EFFICIENT VESSEL DESIGNS.

CONTRACTING DROPPED SIGNIFICANTLY IN 2012

Appetite for new vessels seems to be on the retreat in 2012 as owners struggle with low rates and large excess capacity (fig. 10). Only 12 million dwt was contracted during the first eight months of 2012. Appetite for new vessels continues to be directed mostly towards the Panamax segment where a total of 5 million dwt was contracted. Contracting of new vessels in 2012 seems to be directed towards more fuel-efficient vessels as owners strive to comply with the new IMO-rules for energy efficiency (EEDI) while at the same time trying to gain a comparative advantage over competitors operating older vessels.

AVERAGE DELIVERY TIME REMAINS LOW

Contractors are opting for slightly longer delivery times when placing new orders. Despite the low yard utilisation rates, average delivery time increased by approximately one month from 2011 to 2012 (fig. 10).

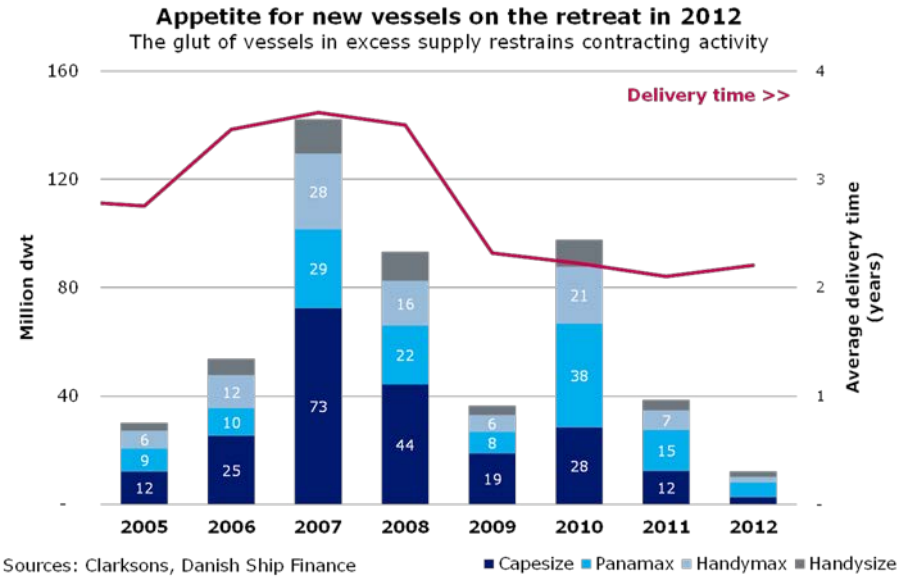
BY AUGUST 2012, NEWBUILDING PRICES DROPPED 14% YEAR-ON-YEAR

At the end of August 2012, average newbuilding prices had fallen by more than 14% year-on-year. The price of a new Capesize vessel is around USD 47 million, down 10% year-on-year, whereas a new Handysize vessel could be purchased for around USD 22 million, down 10% year-on-year (fig. 11). Panamax and Handymax newbuildings fell 15% and 17% respectively.

BY AUGUST 2012, SECONDHAND PRICES FELL 22% YEAR-ON-YEAR

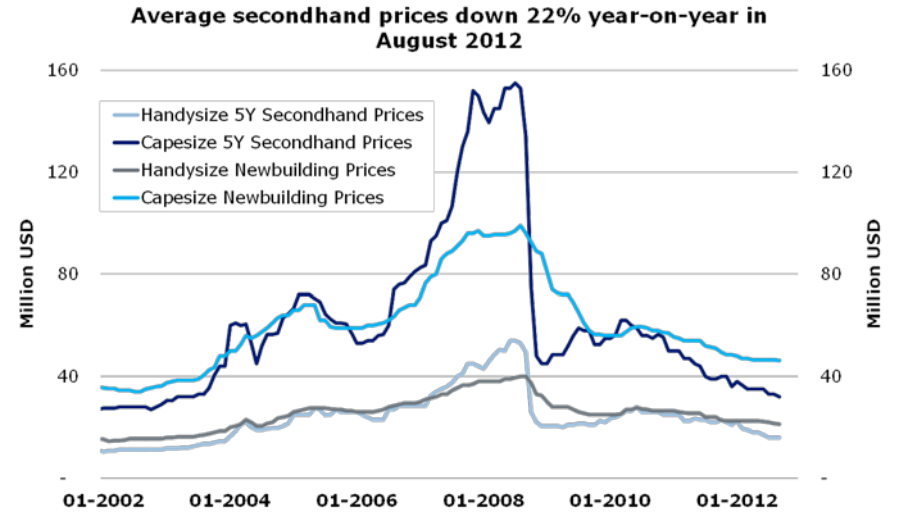
A combination of low rates and a high and rising excess fleet capacity is pushing secondhand prices lower. Also, falling scrap prices have lowered the floor in the market. At the end of August 2012, this unfavourable market development had led average secondhand prices to fall by more than 22% year-on-year. In August 2012, a 5-year old Capesize vessel could be purchased for around USD 33 million (down 15% year-on-year) while a 5-year old Handysize stood at USD 16 million (down 27% year-on year) (fig. 11).

Figure DB.10



Sources: Clarksons, Danish Ship Finance

Figure DB.11



Sources: Clarksons, Danish Ship Finance

OUTLOOK

SCRAPPING ACTIVITY IS EXPECTED TO REMAIN HIGH THROUGHOUT 2013 AND TO CURB FLEET GROWTH TO AROUND 3%. MEANWHILE, DISTANCE-ADJUSTED DRY BULK TRADE IS EXPECTED TO INCREASE BY 8%. HOWEVER, A LARGE OVERHANG OF EXCESS SUPPLY WILL CONTINUE TO SUPPRESS RATES.

135 MILLION DWT SCHEDULED FOR DELIVERY IN 2012

Although 74 million dwt had already been delivered by August, fleet growth is not about to come to a halt in 2012. Another 61 million dwt, or 9% of the August 2012 fleet, was still scheduled for delivery in the remaining four months of the year. Total scheduled deliveries for 2012 made up 22% of the fleet at the start of the year and thus 135 million dwt is scheduled to be added to the fleet in 2012 alone (fig. 12). Fleet growth is scheduled to be the highest in the Capesize segment which has 22 million dwt scheduled for delivery over the next four months.

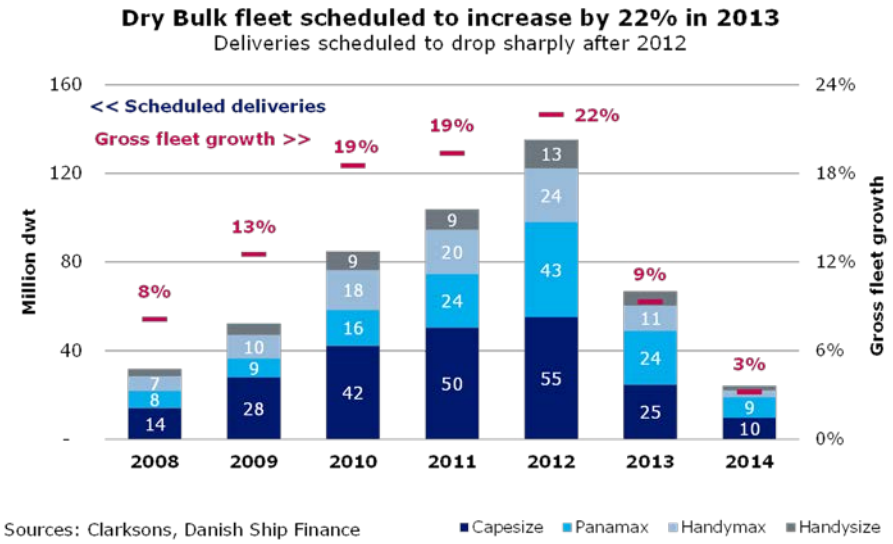
ONE NEW VESSEL SCHEDULED FOR EVERY FOUR AT SEA

As of August 2012, the total orderbook stood at 155 million dwt (fig.13). That means there is one new vessel scheduled to enter the fleet for each four vessels at sea. With about 40% of this orderbook still scheduled for 2012, deliveries are set to drop sharply in 2013. For 2013, 67 million dwt is scheduled to enter the fleet and another 24 million dwt is scheduled for 2014.

SCRAPPING ACTIVITY EXPECTED TO REMAIN HIGH IN 2013

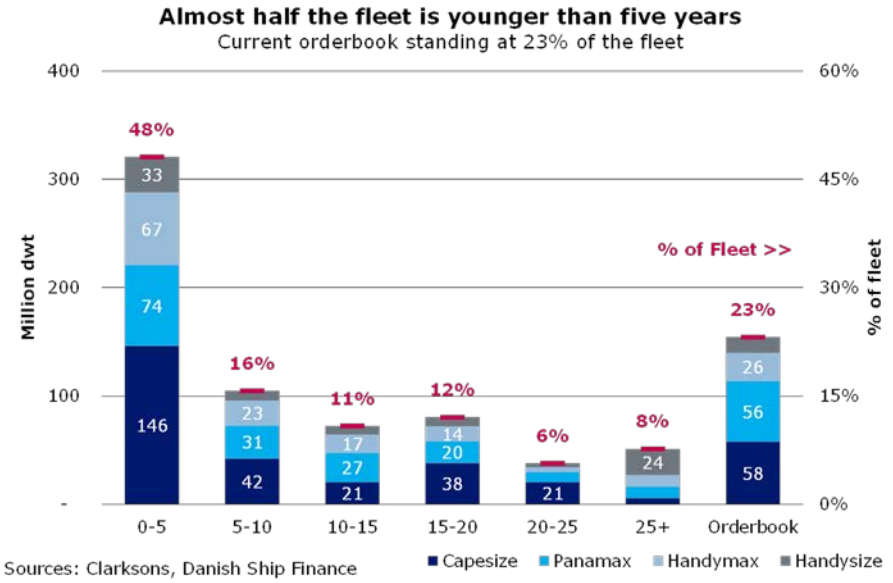
The high level of scrapping during the first eight months of 2012 is likely to continue for the rest of the year and well into 2013 (fig. 13). We expect the recent tendency for younger vessels to be scrapped to continue. We estimate that another 10 million dwt will be scrapped during the rest of 2012, bringing total scrapping in 2012 to 32 million dwt (5% of the fleet). In 2013, we estimate that scrapping will reach slightly less than 30 million dwt (fig. 14). These estimations are obviously subject to uncertainty and the recent fall in scrap prices may lead to a lower level of scrapping as there is less incentive to sell vessels for demolition. However, as the world economy continues to sputter, more vessels may become idle leading to even higher scrapping activity.

Figure DB.12



Sources: Clarksons, Danish Ship Finance

Figure DB.13



Sources: Clarksons, Danish Ship Finance

POSTPONEMENTS AND CANCELLATIONS SET TO CONTINUE IN 2013

The relatively high level of cancellations and postponements will probably continue for some time yet. Taking the low rates and previous cancellations into account, we estimate that as much as 6 million dwt will be cancelled in the last four months of this year and another 7 million dwt will be cancelled in 2013. Postponements are also likely to cushion the drop in deliveries. Continuing the postponement activity of recent years we project that 16 million dwt will be postponed from 2012 into 2013 and another 22 million will be postponed from 2013 and onwards. This will reduce expected deliveries for the remainder of 2012 to 39 million dwt. Given these expectations for postponements and cancellations we estimate that 54 million dwt will be delivered in 2013. That is only 52% of total deliveries of 2011 (fig. 14).

FLEET GROWTH EXPECTED TO STALL IN 2013

To summarise, we estimate that net fleet growth for 2012 will come out around 13% (81 million dwt) (fig. 14). In 2013, fleet growth is expected to stall albeit relative to a much larger fleet than previously. Measured in dwt, net fleet addition remains higher than the levels seen in 2009. Consequently, we estimate that the fleet will grow by 3% (24 million dwt) after another year of expected record high scrapping activity has curbed growth.

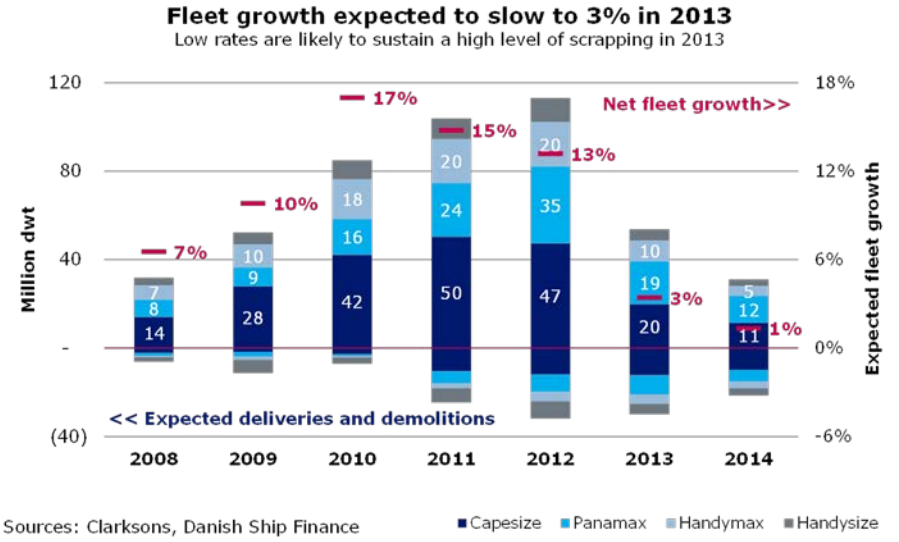
DISTANCE-ADJUSTED TRADE VOLUMES SET TO INCREASE BY 8% IN 2013

Distance-adjusted demand for dry bulk commodities is expected to increase by 8% in 2013. Chinese demand is expected to remain the largest contributor to total distance-adjusted demand growth as growth is set to increase to 9% in 2013. India's demand for raw materials is also set to contribute considerably to total growth. India's distance-adjusted demand is expected to increase by 18% in 2013 (fig. 15). From 2014 and onwards distance-adjusted demand is expected to settle somewhat with growth falling to about 5%.

DRY BULK TRADE EXPECTED UP BY A FIFTH OVER THE NEXT THREE YEARS

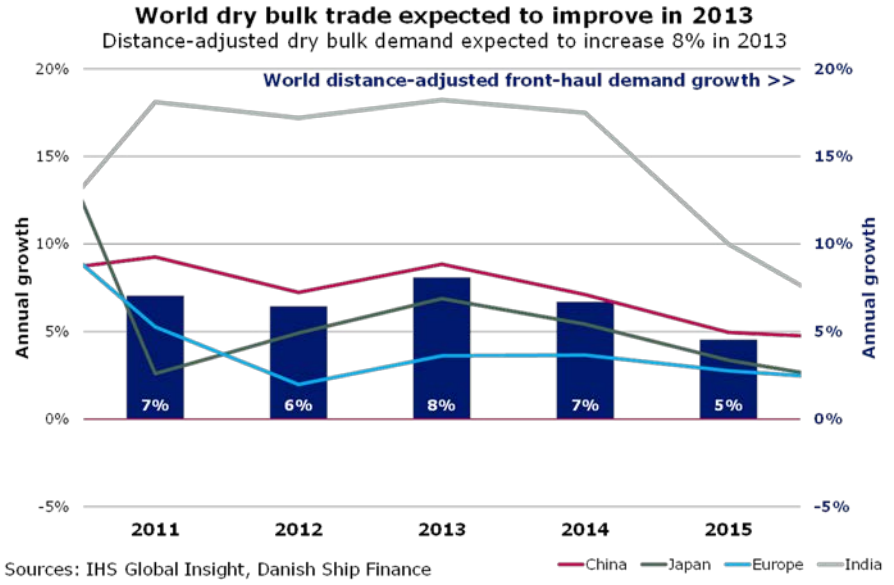
In the course of the next three years, trade in seaborne dry bulk commodities is expected to increase by 20% (fig. 16). China and India will remain the largest contributors to this trade. Chinese demand is expected to be driven mainly by iron ore imports which are expected to expand by 200 million tonnes over the next three years, an increase of 22% compared to 2012. Indian imports are driven by demand for steam coal to satisfy growing demand for

Figure DB.14



Sources: Clarksons, Danish Ship Finance

Figure DB.15



Sources: IHS Global Insight, Danish Ship Finance

electricity. India's demand for seaborne coal is expected to increase by 105 million tonnes, or by 62% over 2012.

AVERAGE DISTANCES MAY INCREASE ONLY SLIGHTLY

The large increase in Chinese iron ore imports is unlikely to be met by Australian exports alone and hence Brazil will probably be able to edge up its share of Chinese iron ore imports over the next couple of years. However, changes will be limited and are therefore unlikely to add any significant amount of mileage to average travel distances. Meanwhile, Indian demand for coal is likely to be met from Indonesia and to some extent Australia and South Africa. Hence, the projected expansion in this trade is not likely to be any sort of game changer when it comes to average travel distances. The overall effect on distance-adjusted demand of changes to trading patterns over the next three years is contributing around 1 percentage point. Thus, distance-adjusted dry bulk demand is expected to increase by 21% over the next three years.

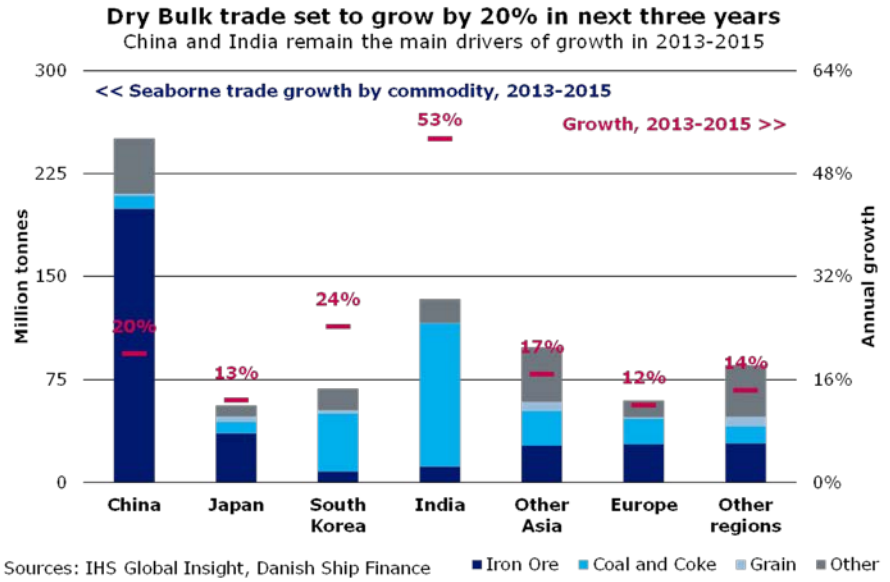
CAN CHINESE IRON ORE DEMAND GROWTH KEEP UP?

Chinese steel consumption per capita has increased at a remarkable pace over the past decade as investments in infrastructure and housing have taken off. Although Chinese steel consumption per capita remains well behind that of South Korea, it is beginning to match that of both Germany and Japan and it surpassed that of USA in 2008 (fig. 17). However, a deflating bubble in the real estate market and an on-going slowdown in the Chinese economy may have put Chinese iron ore demand somewhat ahead of the curve or perhaps even overshot its long-term potential. It remains to be seen whether Chinese steel consumption per capita has peaked, but shipowners should consider the fact that demand growth for iron ore may fall considerably.

RATES EXPECTED TO REMAIN LOW IN 2013

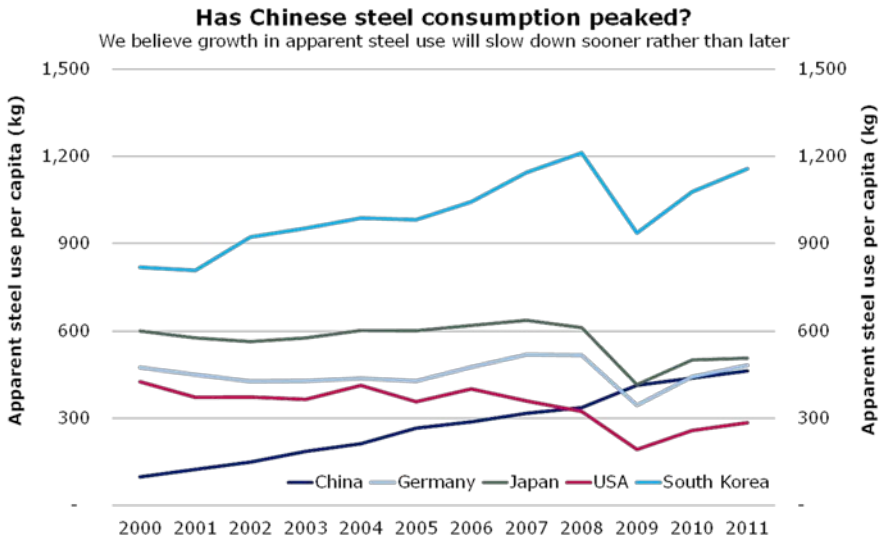
We believe rates are likely to remain low throughout 2012 and well into 2013. Although we estimate a record high level of scrapping and fleet growth of only 3% in 2013, this may not be enough to re-establish the balance between supply and demand before 2014. A large overhang of excess supply is still putting pressure on rates and even the healthy improvement in world trade may not be enough to turn the market around in 2013.

Figure DB.16



Sources: IHS Global Insight, Danish Ship Finance

Figure DB. 17



Sources: Reuters EcoWin, Danish Ship Finance

GLOSSARY

DANMARKS SKIBSKREDIT

Aframax:	Crude oil tanker or product tanker too large to pass through the Panama Canal and with a capacity of from 80,000 to 120,000 dwt.
Back-haul:	The leg of a trade route that has the lowest container volumes is often called 'back-haul, whereas the return leg is often referred to as 'head-haul'.
Barrel:	A volumetric unit measure for crude oil and petroleum products equivalent to 42 U.S. gallons, or approximately 159 litres.
BHP:	Break Horse Power. The amount of engine horsepower.
Brent:	Term used for crude oil from the North Sea. Brent oil is traded on the International Petroleum Exchange in London, and the price of Brent is used as a benchmark for several other types of European oil.
Bulk vessel:	Description of vessels transporting large cargo quantities, including coal, iron ore, steel, corn, gravel, oil, gas, etc.
Bunker:	Fuel for vessels.
Call on OPEC:	Defined as total global petroleum demand less non-OPEC supply less OPEC natural gas liquid supply.
Capesize:	Dry bulk carrier of more than approximately 100,000 dwt; too large to pass through the Panama Canal.
Cu.M:	Cubic Meter.
Ceu:	Car equivalent unit. Unit of measure indicating the car-carrying capacity of a vessel.
Cgt:	Compensated Gross Tonnage. International unit of measure that facilitates a comparison of different shipyards' production regardless of the types of vessel produced.
Chemical tanker:	DSF's definition: IMO I or IMO II tanker with stainless steel, zinc, epoxy or Marineline coated tanks.
Clarksons:	British ship brokering and research company. www.clarksons.net
Clean products:	Refers to light, refined oil products such as jet fuel, gasoline and naphtha.
CoA:	Contract of Affreightment. Contract between a shipping company and a shipper concerning the freight of a predetermined volume of goods within a given period of time and/or at given intervals.
Coating:	The internal coatings applied to the tanks of a product or chemical tanker. Coated tanks enable the ship to transport corrosive refined oil or chemical products and it facilitates extensive cleaning of the tanks, which may be required in the transportation of certain product types.
Deep sea:	Refers to trading routes longer than 3,000 nautical miles.
Deep Sea, chemical:	A chemical tanker larger than or equal to 20,000 dwt.
Dirty products:	Refers to heavy oils such as crude oil or refined oil products such as fuel oil, diesel oil or bunker oil.
Drewry:	Drewry Shipping Consultants Ltd. British shipping and transport research company. www.drewry.co.uk
Dwt:	Dead Weight Tons. Indication of a vessel's cargo carrying capacity (including bunkers, ballast, water and food supplies, crew and passengers).
Dynamic Positioning:	Special instruments on board that in conjunction with bow thrusters and main propellers enable a ship to position itself in a fixed position in relation to the seabed.
EIA:	Energy Information Administration. A subsidiary of the US Department of Energy. www.eia.doe.gov

E&P:	Exploration and Production.
Feeder:	Small container carrier with a capacity of less than 500 teu.
Feedermax:	Small container carrier with a capacity of 500-1000 teu.
FPSO:	Floating Production Storage Off-loading unit. Vessel used in the offshore industry to process and store oil from an underwater (sub-sea) installation.
Front-haul:	The leg of a trade route that has the highest cargo volumes is often called 'front-haul' whereas the return leg is often referred to as 'back-haul'.
Geared:	Indicates that a vessel is equipped with a crane or other lifting device.
Gearless:	Indicates that a vessel is not equipped with a crane or other lifting device.
Global order cover:	Global order is the global orderbook divided by annual yard capacity.
Gt:	Gross Tons. Unit of 100 cubic feet or 2,831 cubic meters, used in arriving at the calculation of gross tonnage.
Handy, container:	Container vessel of between 1,000-1,999 teu.
Handy, tank:	Crude oil tanker, product tanker or chemical tanker of between 10,000 and 25,000 dwt.
Handymax, dry cargo:	Dry bulk carrier of between approximately 40,000 and 60,000 dwt.
Handysize, dry cargo:	Dry bulk carrier of between approximately 10,000 and 40,000 dwt.
Head-haul:	The leg of a trade route that has the highest container volumes is often called 'head-haul, whereas the return leg is often referred to as 'back-haul'. On routes where there is a great trading volume mismatch between head-haul and back-haul, the head-haul demand will most often determine the freight rate level.
IEA:	International Energy Agency. A subsidiary of the OECD. www.iea.org
IHS Global Insight:	American economic consulting company. www.globalinsight.com
IMO:	International Maritime Organization. An organisation under the UN.
IMO I-III:	Quality grades for tankers for the permission to transport different chemical and oil products. IMO I are the most hazardous products, IMO III the least hazardous.
Inorganic chemicals:	A combination of chemical elements not containing carbon. The three most common inorganic chemicals are phosporic acid, sulphuric acid and caustic soda. Phosphoric acid and sulphuric acid are used in the fertilizer industry, whilst caustic soda is used in the aluminium industry. As these chemicals are corrosive to many metals, they are transported in stainless steel tanks.
Intermediate:	Medium-sized chemical carrier with a capacity of between 10,000 and 20,000 dwt.
LGC:	Large Gas Carrier. LPG ship with a capacity of between 40,000 and 60,000 Cu.M.
LPG vessels:	Liquefied Petroleum Gas. Vessels used to transport ammonia and liquid gases (ethane, ethylene, propane, propylene, butane, butylenes, isobutene and isobutylene). The gases are transported under pressure and/or refrigerated.
LR1, product tanker:	Long Range 1. Product tanker with the maximum dimensions for passing through the Panama Canal (width of 32.21 metres and length of 289.5 metres) of approximately 60,000-74,999 dwt.
LR2, product tanker:	Long Range 2. Product tanker too large to pass through the Panama Canal and larger than approximately 75,000 dwt.
Medium, tanker (MR):	Medium Range. Product tanker of between 10,000 and 60,000 dwt.

MGC:	Medium Gas Carrier. LPG ship with a capacity of between 20,000 and 40,000 Cu.M.
Multi-Purpose:	Dry bulk carrier with multiple applications, mainly as a feeder vessel or for special cargo.
Nautical Mile:	Distance unit measure of 1,852 meters, or 6,076.12 ft.
Offshore vessel:	Vessel serving the offshore oil industry.
OPEC:	Organisation of Petroleum Exporting Countries.
Organic chemicals:	Contain carbon and are also referred to as petrochemicals. Are used to produce virtually all products made from plastics or artificial fibres.
Panamax, container:	Container carrier with the maximum dimensions for passing through the Panama Canal (width of 32.21 metres, length of 291 metres) of approximately 3,000—5,100 teu.
Panamax, tanker:	Crude oil tanker or product tanker with the maximum dimensions for passing through the Panama Canal (width of 32.21 metres and length of 289.5 metres) of approximately 60,000—79,999 dwt.
Panamax, dry cargo:	Dry bulk vessel with the maximum dimensions for passing through the Panama Canal (width of 32.21 metres and length of 289.5 metres) of approximately 60,000—100,000 dwt.
Post-Panamax:	Container vessel of approximately 5,100-9,999 teu that is too large to pass through the Panama Canal.
Product tanker:	Tanker vessel with coated tanks used to transport refined oil products.
PSV:	Platform Supply Vessel. Offshore vessel serving the offshore oil installations.
Refinery turnarounds:	A planned, periodic shut down (total or partial) of a refinery process unit or plant to perform maintenance, overhaul and repair operations and to inspect, test and replace process materials and equipment.
Ro-Ro:	Roll On – Roll Off. Common description of vessels on which the cargo is rolled on board and ashore.
Short sea:	Refers to trading routes shorter than 3,000 nautical miles.
Short Sea, chemical:	Chemical tanker smaller than 10,000 dwt.
Small gas carrier:	LPG ship smaller than 20,000 Cu.M.
SSY:	Simpson Spence & Young, British ship brokering and research company. www.ssy.co.uk
Sub-Panamax	Container vessel of approximately 2,000-2,999 teu.
Suezmax:	Crude oil tanker with the maximum dimensions for passing through the Suez Canal (approximately 120,000—199,999 dwt.).
Super Post-Panamax:	Newest type of container vessel of approximately +10,000 teu.
TCE:	Time Charter Equivalent.
Teu:	Twenty Foot Equivalent Unit. Container with a length of 20 feet (about 6 metres) which forms the basis of describing the capacity of a container vessel.
Teu-knots:	Unit of measure that takes account of the speed of ships when estimating the actual supply of ships within a segment.
Teu-nautical mile:	Unit of measure indicating the volume of cargo, measured in teu, and how far it has been transported, measured in nautical miles.
Ton-nautical mile:	Unit of measure indicating the volume of cargo, measured in ton, and how far it has been transported, measured in nautical miles.
Tonnage:	Synonymous with “vessel”.
Town gas:	A mixture of gases produced by the distillation of bituminous coal and used for

	heating and lighting: consists mainly of hydrogen, methane, and carbon monoxide.
ULCC:	Ultra Large Crude Carrier. Crude oil tanker of more than 320,000 dwt.
Vegetable oils:	Oils derived from seeds of plants and used for both edible and industrial purposes.
VLCC:	Very Large Crude Carrier. Crude oil tanker of between approximately 200,000 and 320,000 dwt.
VLGC:	Very Large Gas Carrier. LPG ship with a capacity of more than 60,000 Cu.M.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