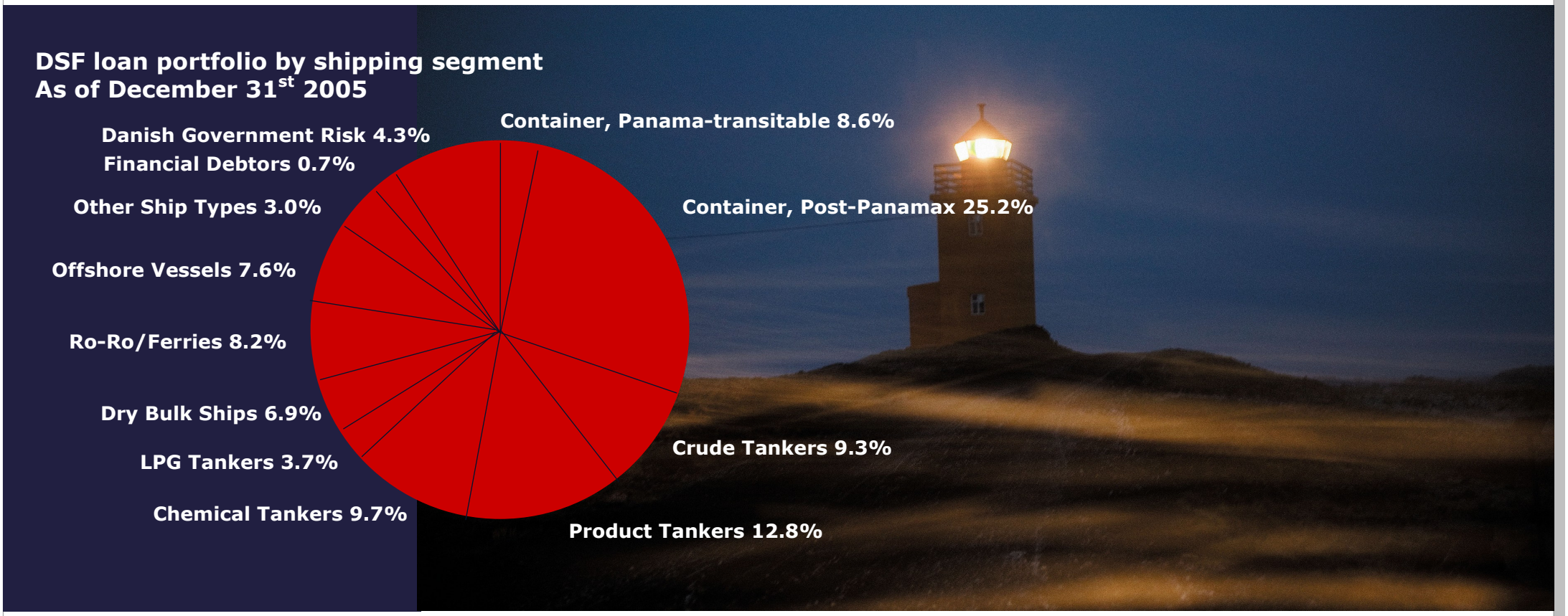
SHIPPING MARKET REVIEW – 2ND HALF 2005



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Danish Ship Finance

Please read carefully the disclaimer at the end of this report.

This report reviews the central developments in the period from July to December of 2005 for the main shipping segments in which Danish Ship Finance has exposure.

General Review & Outlook

The almost unrelenting price increases and freight rate improvements that have been prevalent in almost all shipping segments since 2003 received a definite shot at the bow by middle of 2005.

By 2nd quarter of 2005, newbuilding prices began a clear descent as contracting levels in most of the major ship segments fell to much lower levels. The effect on secondhand prices from falling newbuilding prices has so far been fairly mixed: Container and dry bulk ships have seen noticeable declines, whereas secondhand ship prices in the tanker segments largely held or even appreciated further.

The reality that most secondhand tanker prices have faired notably better actually appears quite surprising given that spot freight rates in the majority of the tanker segments displayed a distinct downward trend throughout most of the first three quarters of 2005. Furthermore, as much of the freight rate boom experienced in the tanker segments during the 4th quarter was largely caused by *temporary* factors stemming from the U.S. hurricane devastation, it appears even more surprising that secondhand tanker prices did not display clear declines during 2005. The simple answer to this puzzling conundrum may be that tanker ship owners and investors now carry a more positive outlook on the long-term future than they did a year ago – which is actually even more puzzling given expectations of a slowdown particularly in the U.S. economy.

In fact, both the IMF and OECD (and others) have cautioned that there is a growing risk of a far-reaching downside to their current economic outlooks. Increasing oil prices, a disproportional reliance on an already overheated housing market, and growing imbalances, including budget and trade deficits in key consuming economies, are all cause for great apprehension.

As these downside risks are largely concerning the consumption ability of U.S. private households, they are at least in the short to medium term mostly affecting the outlook for the container shipping segments which rely heavily on the U.S. containerized imports. But also the tankers and car carrier segments may be affected negatively in the longer run.

Although the general economic growth picture in 2006 and ahead lies to the downside some factors still speak in favour of robust freight markets during 2006 for at least a number of the shipping segments.

For the tanker and dry bulk segments, the likelihood of a demand boost largely depends upon the speed of transformation in the Chinese economy from an export and investment led economy to a consumption led economy.

To the extent that the Chinese economy is *not* slowing down its excessive investments in its steel manufacturing sector, the *dry bulk* segments are most likely to continue to experience abnormal demand growth and freight rates.

For the *tanker* segments, the developments in the Chinese economic transformation may act both ways. The massive demand and freight rate boost that the tanker segments saw during 2004 was to a very large extent driven by too little energy production capacity causing extensive power shortages throughout China. This led to a year-long boost in petroleum imports to cover the energy deficit, but as the Chinese energy capacity grew throughout 2005 its petroleum import demand receded proportionately. As 2006 is expected to see further improvements in the Chinese energy capacity, the need for petroleum in the energy production is thus, all other things being equal, expected to fall. The speed at which the net Chinese petroleum import demand will grow in 2006, thus largely depends upon the extent that the industrial production growth and private consumption growth can pick up the shortfall.

Conclusively, 2006 is expected to be yet another profitable year, but with freight rates probably somewhat lower than during 2005. As most ship prices do not fully incorporate the less optimistic outlook, they may most likely depreciate in 2006. Conversely, for some of the minor shipping segments there may still be upside left in both earnings and ship values ■

Executive Summary

- *Ship Building:* Prices continue downward as contracting activity slows considerably in almost all segments. Although most yards have a large backlog of orders, they need a significant pickup in contracting volumes to keep prices from falling.
- *Container Ships:* Noticeably falling charter rates and secondhand prices as the demand slowdown and fleet growth make their mark. Fleet utilization and consequently also freight rates may be severely tested in 2006-2007 as fleet growth reaches new records.
- *Crude Tankers:* Hurricanes caused a completely unexpected and unprecedented disturbance in the tanker markets, sending freight rates sky-high. For 2006, freight rates are expected to come somewhat down although there still may be some temporary upside left.
- *Product Tankers:* Hurricanes caused refineries to shut-down and the U.S. petroleum product imports to shoot skywards. Secondhand prices continue upwards as the near-term outlook is still largely positive.
- *Chemical Tankers:* Freight rates trend down but are still at very healthy levels. U.S. Gulf hurricanes temporarily both boost and depress freight rates. In 2006, fleet growth is expected to outgrow demand, although only to a limited extent.
- *LPG Tankers:* Continued freight rate improvements on top of already very high levels lead to higher newbuilding and secondhand prices. Conversely, contracting volumes slowed down, but from record levels. The outlook is favourable on still tight capacity.
- *Dry Bulk Ships:* The negative consequences of a global steel overproduction is beginning to be felt throughout the dry bulk sector, leading to de-stocking and falling freight rates. Earnings are still expected to remain at healthy levels, but much rests on China to behave well disciplined.
- *Car Carriers:* Tight charter market pushes charter rates further up, but newbuilding contracting activity and secondhand price rises slows down. A large orderbook may have an impact on charter rates but an ageing fleet may counteract a large drop in fleet utilization.
- *Ro-Ro/Ferries:* Passenger ferry companies still see stiff competition from low-budget airlines amid ever increasing fuel costs. In the future, costs are expected to stay high as new environmental regulations add to fuel costs and investment requirements.
- *Offshore Support Vessels:* Charter rates reached record levels as operators competed for vessels on the background of unusually high rig activity, prompting massive ordering and rising secondhand values. For 2006, the outlook remains optimistic as demand is expected to match supply.

Ship Building

Newbuilding prices continue downward as the contracting activity slows considerably in almost all segments. Although most yards currently have a large backlog of orders, they need a significant pickup in contracting volumes in order to keep prices from falling.

CONTRACTING PRICES

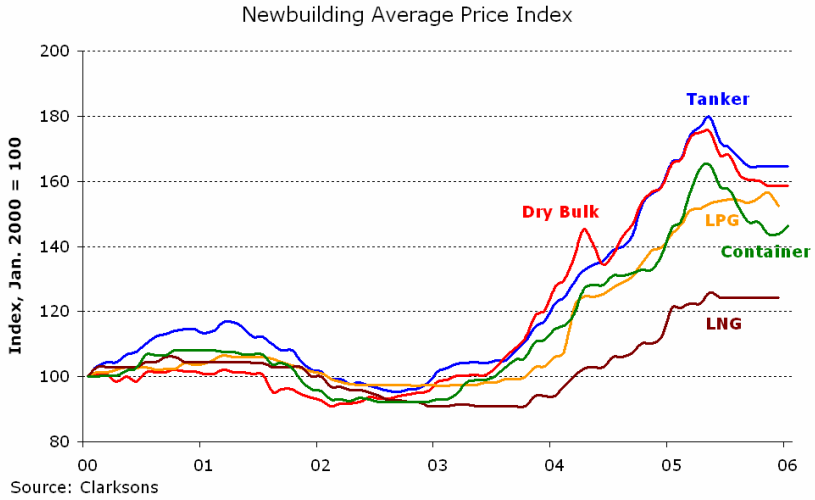
Controlled descent from record highs

Contracting prices are now on average at a level just slightly above the level 12 months ago but about 5% lower than the level 6 months ago. The downward movement since May is the first real reduction since the newbuilding rally began in late 2002 and so far looks more like a continuing trend rather than a mere correction.

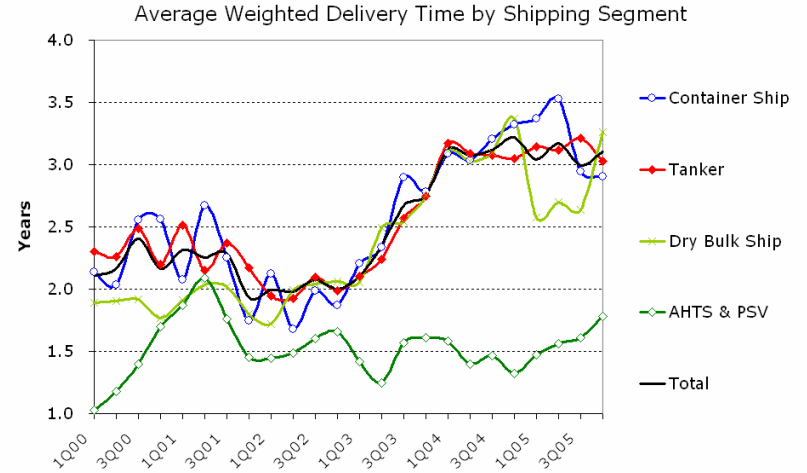
Only the ship types that have seen continued strong contracting activity, significantly improved freight rates, and/or exhibit an exceptionally long forward orderbook cover have been able to resist the downward price trend to a certain extent.

By contrast, the containership newbuilding prices have fallen relatively most as the contracting of new containerships almost ground to a halt in the second half of 2005, causing the average delivery period (from time of contract signing to delivery of ship) for containerships to be cut be more than 6 months (see blue line in the lower graph on the right).

Steel prices on thick ship plates have also begun to drift downward providing the yards with some manoeuvrability to lower newbuilding prices. In Japan and South Korea the yards have increasingly imported or are threatening to import lower-priced steel plates from China, thereby forcing the domestic steel mills to lower their prices. The price on steel for ship building has peaked later and relatively higher than other types of steel, partly because the production of ship plates has seen much less, if any, surplus production capacity. As the demand for ship plates is expected to continue to rise robustly in the next couple of years, ship steel plate prices may fall relatively less than other steel types where the Chinese surplus production capacity is much more prevalent.



Source: Clarksons



Source: DSF

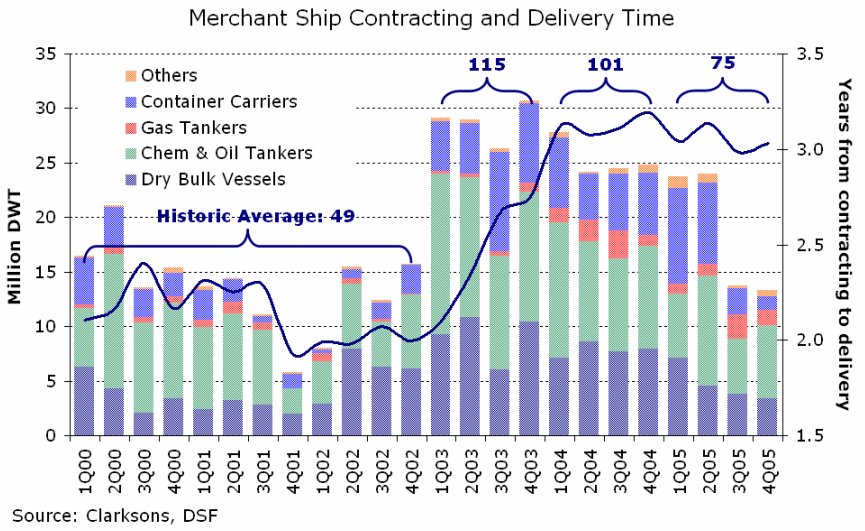
Abrupt and considerable contracting slowdown
Compared to around 48 million dwt contracted in the first half of 2005, the 27 million dwt contracted in the second half of 2005 represent a distinct shift in the shipowners' expectations of the future shipping demand and thus their willingness to accept record high contracting prices at record long delivery periods.

Particularly the containership owners have stepped hard on the brake by cutting their newbuilding orders by more than 75% from 1st half 2005 to 2nd half 2005.

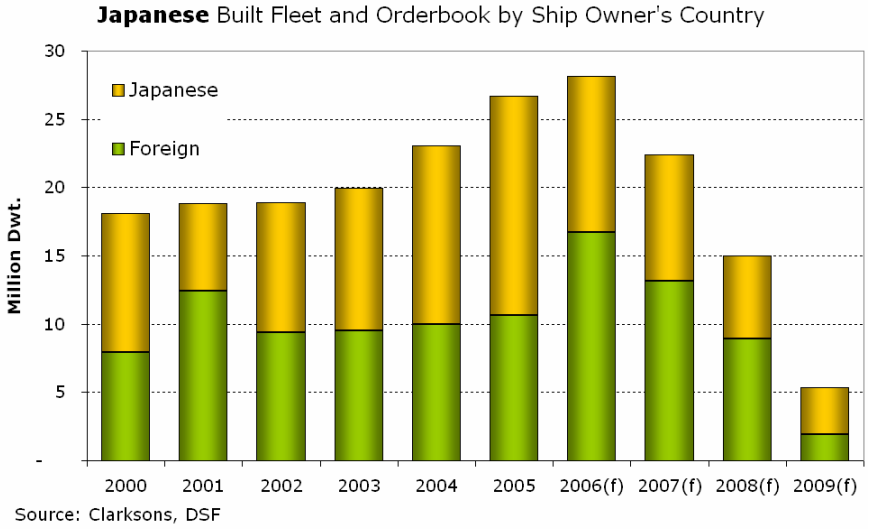
Despite the marked slowdown in contracting activity the current average delivery period of 3.1 years is still close to its all-time high of 3.3 years (see upper graph on right). This is possibly the main reason why contracting prices during the last 6 months have not fallen much more rapidly, than would otherwise have been expected from the much lower contracting activity.

By now most South Korean and Chinese yards are in a pretty comfortable situation with their orderbooks being almost full out to the latter part of 2008, thereby providing them with enough latitude to hold back on accepting new orders for a while without seriously compromising their income for the next couple of years (see the two upper graphs on page 7).

Conversely, Japanese yards may be in a less comfortable situation. From the official statistics from Clarksons, it appears that the Japanese yards may have free capacity of more than 19 million dwt in 2007-2008. To the casual observer, this would imply a considerable need for new orders so as to maintain profitable capacity utilization 2-3 years out. But, as the Japanese shipyards have a tendency not to officially register the orders of their domestic customers until a short time before delivery of the actual ship, some of the apparently free capacity may already be committed. But even when taking account of the Japanese habit of underreporting domestic orders, the extent of the apparently free capacity still seems excessive. Specifically, as depicted by the lower graph on the right, the foreign customers appear not to have contracted as much for 2007 and 2008 delivery as they have for



Source: Clarksons, DSF



Source: Clarksons, DSF

deliveries in earlier years. Thus despite the uncertainty regarding the real extent of the Japanese shipowners' orderbook at Japanese yards, the Japanese yards may be in a somewhat less comfortable position than their South Korean and Chinese competitors.

Please notice, that these possibly unreported orders is primarily for dry bulk and tanker building, implying that the future fleet growth in these two segments may indeed be much higher than indicated by the current official orderbook statistics.

In the greater European area the yards have secured the largest orderbook for a decade, although they still have free capacity for delivery as early as 2007 and 2008.

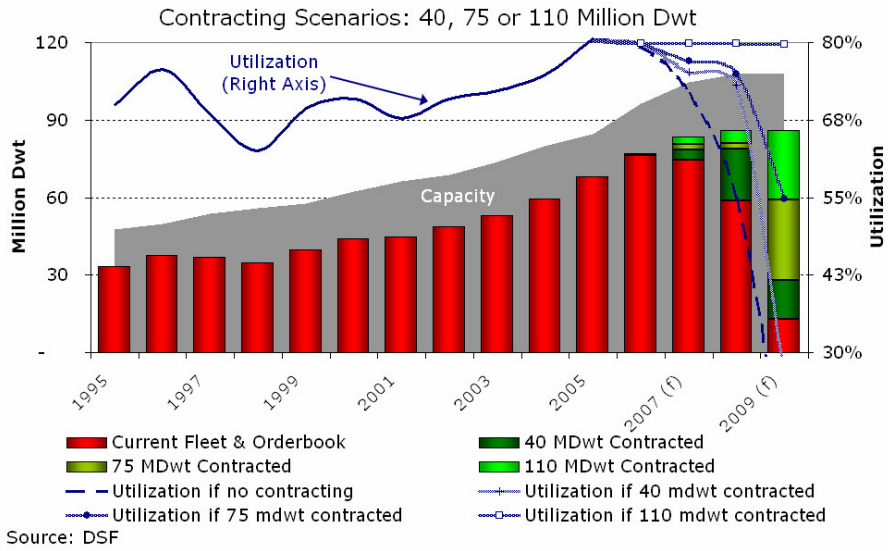
OUTLOOK

The competition toughens considerably, but no panic yet

Even when including the underreporting of the Japanese domestic shipbuilding orders, the global yard community needs a considerable volume of new orders during the coming 12 months. Excluding the approximately 15-20 million dwt of unreported or uncommitted Japanese orders, the other major shipbuilding regions need an extra 10-25 million dwt of contracts for the shipyards just to maintain their overall degree of utilization throughout 2008 (2 years out). But in order for the yards to keep their 3 year forward cover the yards need an additional 60-80 million dwt during the same 12 month period, adding up to a total requirement of at least 90 million dwt.

As all of 2005 has provided the yards with 75 million dwt and as the latest 6 months have provided only 27 million dwt of new orders, 90 million dwt may turn out to be exceptionally hard to achieve in the coming year given the currently very large orderbook, high newbuilding prices and wavering freight rates in most ship segments.

The amount of orders in 2006 is probably instead to lie somewhere in the region of 50-80 million dwt. Consequently by year-end 2006, the average delivery time may be reduced by 0.25-0.50 year from the current 3.1 years, thus leaving the shipyards



Source: DSF

not only with somewhat lower capacity utilization in future years but also a much shorter forward orderbook cover.

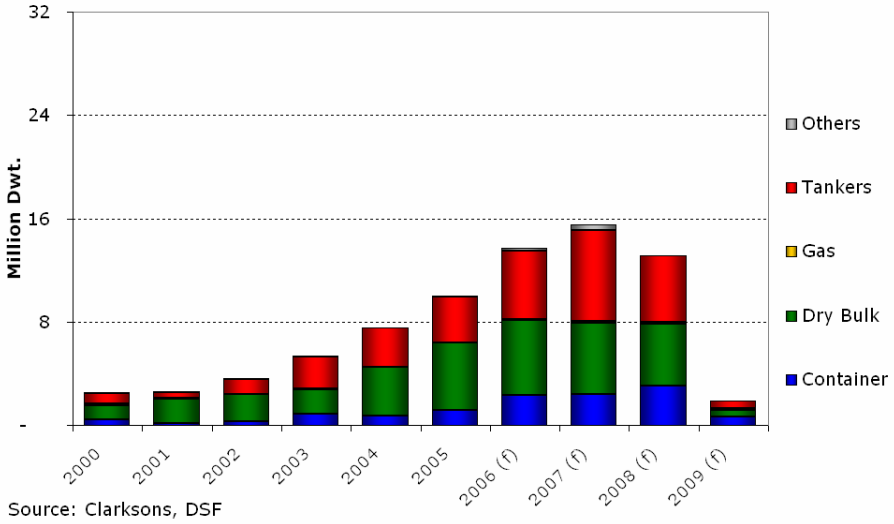
Although both the shipyard utilization and the forward orderbook cover are probably to descent from their record levels of 2005, both factors are in a historic perspective to remain at somewhat high levels for the foreseeable future. The urgency of securing new orders is thus *not* as outspoken as in the recession years of 2002 or 1998 and is indeed exceptionally different from the panic-years of the late 1980s. A noticeable negative pressure on contracting prices may thus not be present until the latter part of 2006 when the average delivery period is expected to have shortened considerably. Until then, there may even be scope for small upward movements if the freight markets perform well.

Conclusively, the competition to secure a full orderbook is expected to increase in coming years and the demand for newbuildings is expected to slow somewhat down. Irrespectively of the development for the steel plate prices, the contracting prices are thus expected to continue their decline ■

Current Fleet & Orderbook by Region of Build and Year of Delivery

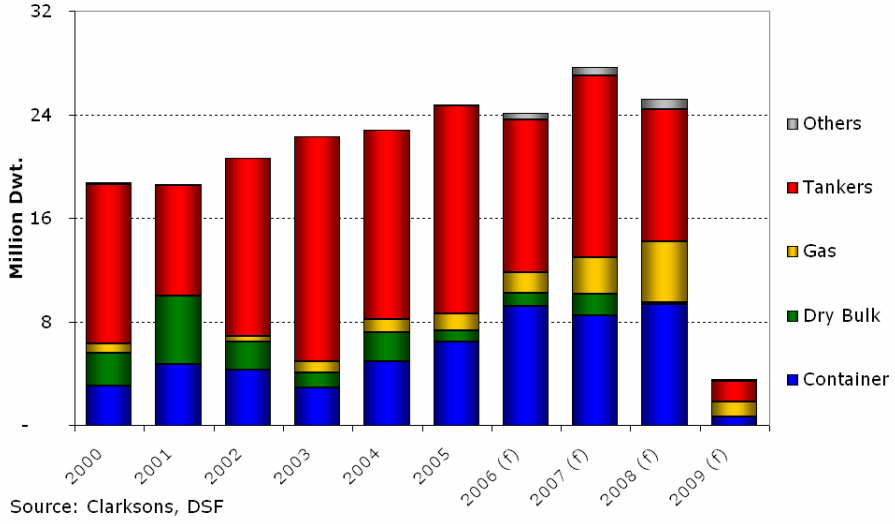
(Excludes allowances for possible slippage from scheduled delivery dates)

China



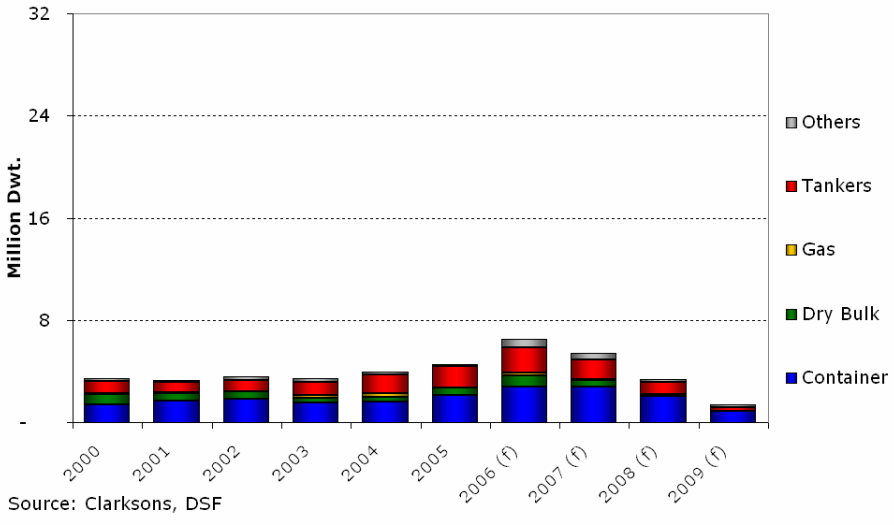
Source: Clarksons, DSF

South Korea



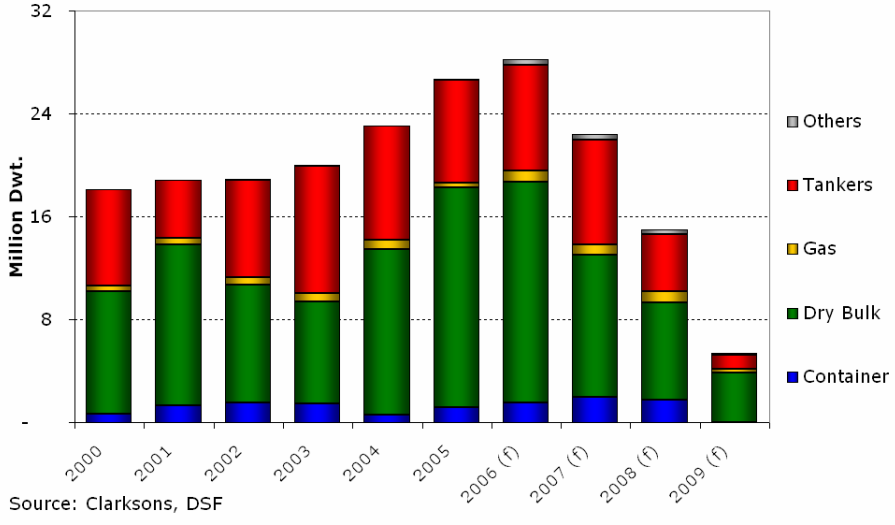
Source: Clarksons, DSF

Europe



Source: Clarksons, DSF

Japan



Source: Clarksons, DSF

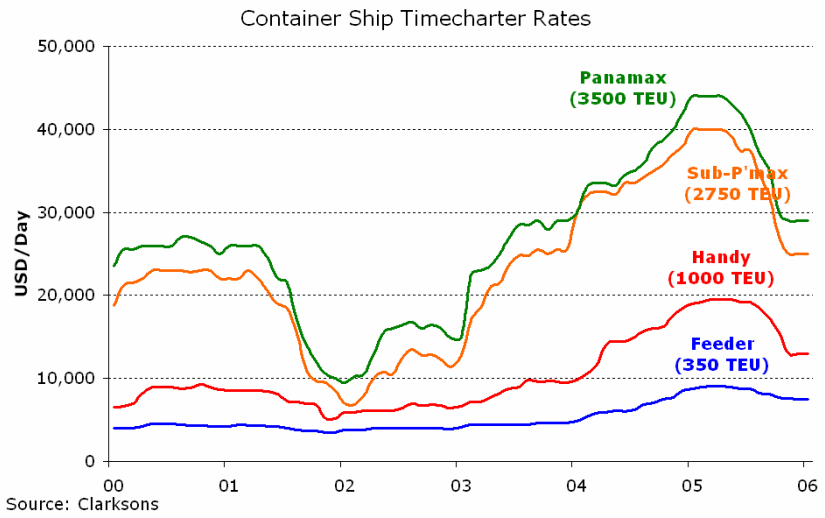
Container Ships

Noticeably falling charter rates and secondhand prices as the demand slowdown and fleet growth make their mark. Fleet utilization and consequently also freight rates may be severely tested in 2006-2007 as fleet growth reaches new records.

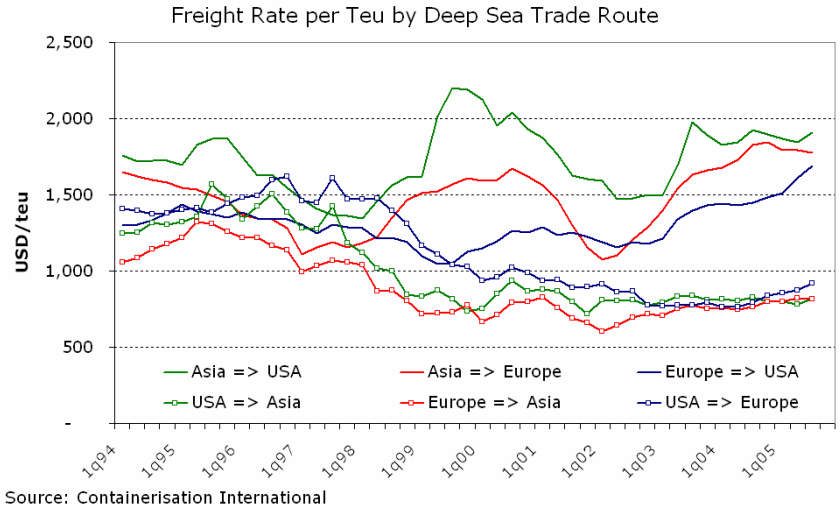
FREIGHT RATES

Tumbling T/C rates, but freight rates per box largely held up
The absolutely euphoric market expectations and timecharter rates prevalent just 7 months ago by now seem long forgotten. Since then, timecharter rates for the containerships on the charter markets (generally smaller than 4,000 teu) have shown a clear decrease of about 15-45%, with the medium-sizes of 1,500-2,000 teu having dropped the most and the smallest ships having fallen the least. Additionally, the charter-ship shipowners have been the victims of a significant shortening of the average charter period – from around 3 years by early 2005 to just 9-12 months by the end of 2005. But lately, the timecharter market seems to have found a temporary resistance level as the number of containerships free for charter in most containership segments is somewhat reduced, thus providing the shipowners with the upper hand at least for a while.

Contrary to the massive drop in timecharter rates, the freight rates that the liner-companies have been able to charge their customers per box were largely up or unchanged in the 3rd quarter of 2005, with the Transatlantic head-haul route from Europe to the U.S. fairing particularly well. But although the 3rd quarter numbers show contained downward price pressure, the preliminary figures for the 4th quarter are much less upbeat. According to the weekly figures published by the Shanghai Shipping Exchange, the freight rates per box on the large head-haul routes from China to Europe and North America have exhibited decreases of around 5-10% in the short period from early October to early January. The decreases may signify that the onslaught of newly built post-panamax containerships is beginning to have an observable effect on the competition among the liner-companies.

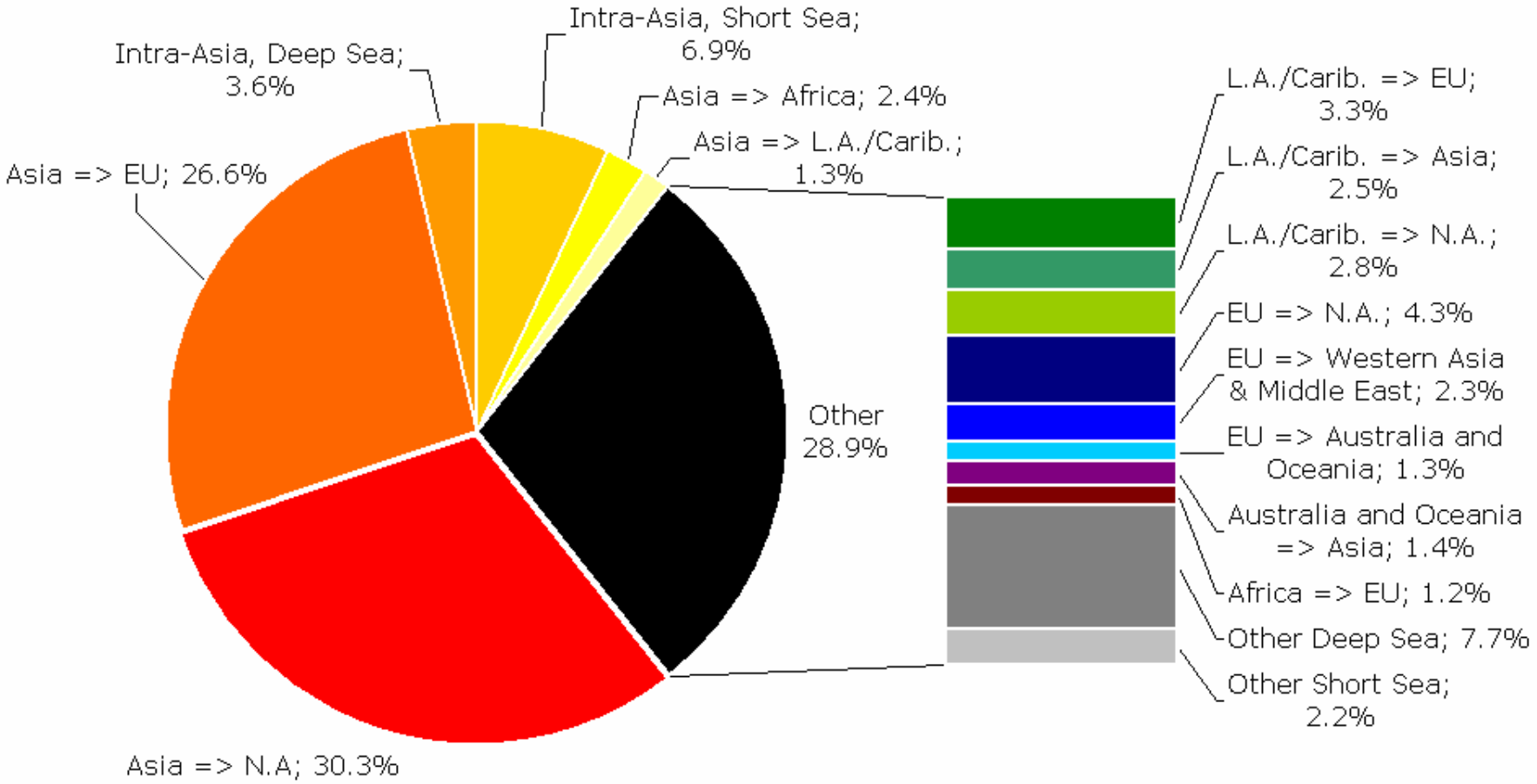


Source: Clarksons



Source: Containerisation International

Total **Head-haul** Container Ship Demand in 2005 by Route
(Measured by teu-Nautical Miles)



Source: DSF, Global Insight

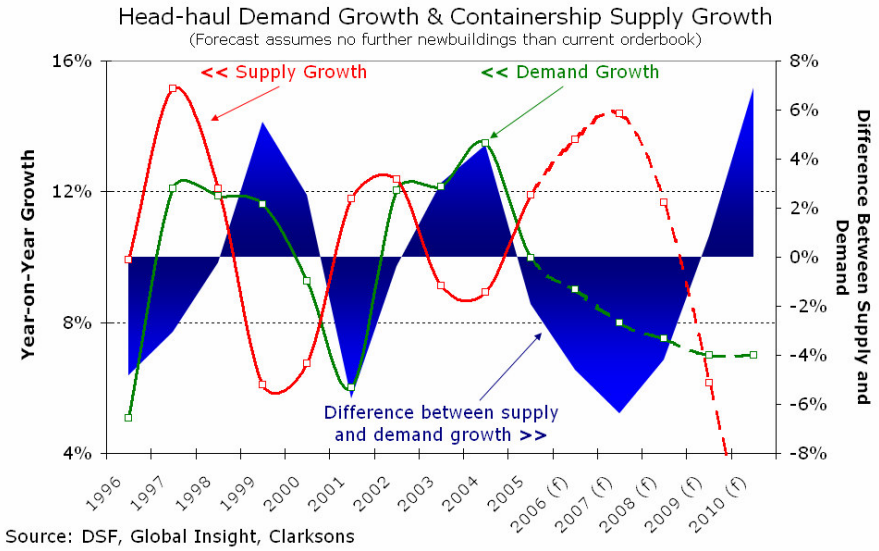
Lower trade growth, absent congestion and rapid fleet growth
The monthly figures on global port container handling, that are published by the British consultancy firm Drewry Shipping Consultants, have throughout the 2nd half of 2005 continued to depict a slowdown in the port handling growth rate, measured year-on-year.

Drewry estimates a growth rate in global container traffic of 10.8% for the first nine months of 2005, but the preliminary figures for port handling in the 4th quarter imply that total demand growth for the whole of 2005 may be somewhat less. For the whole of 2004, trade growth on the head-haul routes was a record 13.5%, implying that the "China boom" may indeed be fading out.

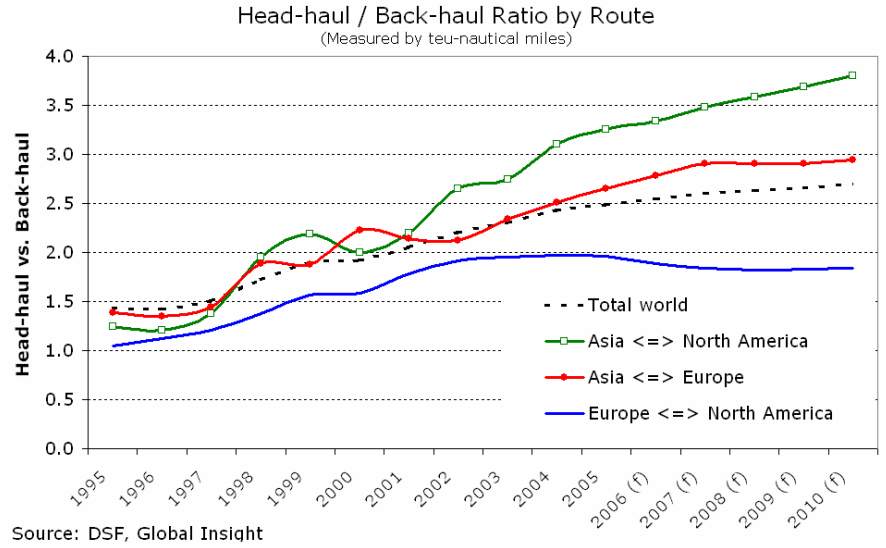
Unfortunately the slowdown in trade growth comes amid a distinct and long-lasting uptick in fleet growth. On the basis of own judgement and Clarkson figures, we estimate that the container- and multi-purpose fleet in 2005 grew almost 12% on a speed/efficiency-adjusted basis, causing a 1-1.5 %-point fall in the overall fleet utilization. Particularly the 2nd half 2005 fleet growth was high with 12.7% vs. 10.6% in the 1st half of 2005. In 2004, the fleet grew just 9% compared to a 13.5% growth in demand.

Further adding to the down-side pressure on fleet utilization and thus freight rates has been the absence of significant port congestion in 2005. In 2004, port congestion provided the liner companies with the psychological ammunition to raise freight rates further as a significant volume of ship capacity was held up in congested ports around the world.

In 2005, it seems as if the shippers have opted to send a part of their usual peak season cargo ahead of the peak season running from July to November in order to avoid having goods held up in ships, ports, terminals and trains. Consequently they may have boosted 2nd quarter growth to the detriment of 3rd and 4th quarter trade growth. Also, many ports have worked hard on improving efficiency at the dockside and further inland on road and train connections, thereby limiting port congestion further.



Source: DSF, Global Insight, Clarksons



Source: DSF, Global Insight

Moreover, the liner companies have in 2005 chosen to divert an increasing number of containerships to other ports than the heavily congested ports. Consequently major ports such as Long Beach and Los Angeles, USA have seen markedly lower import growth than in previous years.

Defying the trend of much lower trade growth were particularly the imports to Scandinavia, the Middle East and the Eastern European countries that were recently admitted to the EU. Unfortunately, their combined share of the total head-haul trade accounts for less than 9%, and their effect on overall fleet utilization is thus rather limited when the two major Asian head-haul routes to Europe and North America with a combined market share of around 57% slow markedly down.

CONTRACTING & SHIP VALUES

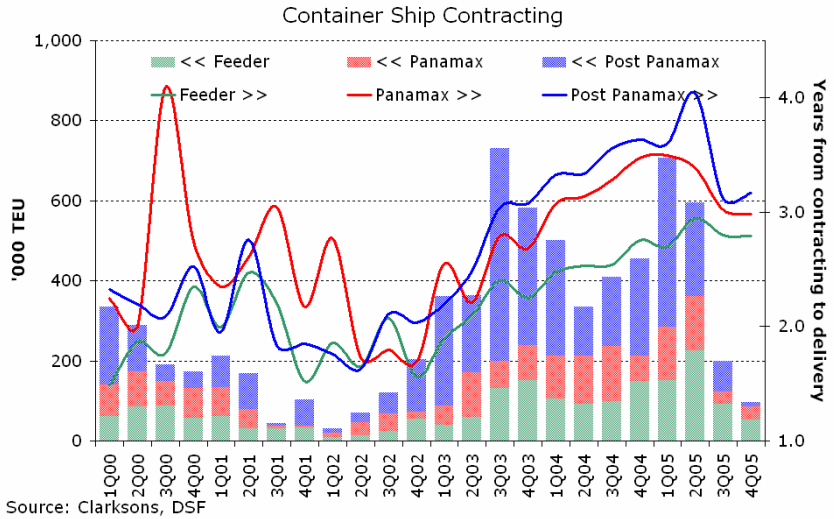
Almost complete stop to post-panamax contracting

The shipowners seem to have recognized that the containership orderbook may be too large in the face of a slowing trade growth in future years. Thus the contracting of new containerships during the 2nd half 2005 amounted to just around 100,000 teu, markedly down on the 1.3 million teu contracted during the previous 6 month period, according to data from Clarksons. Probably never before has the containership owners made such a distinct turnaround in such a short space of time.

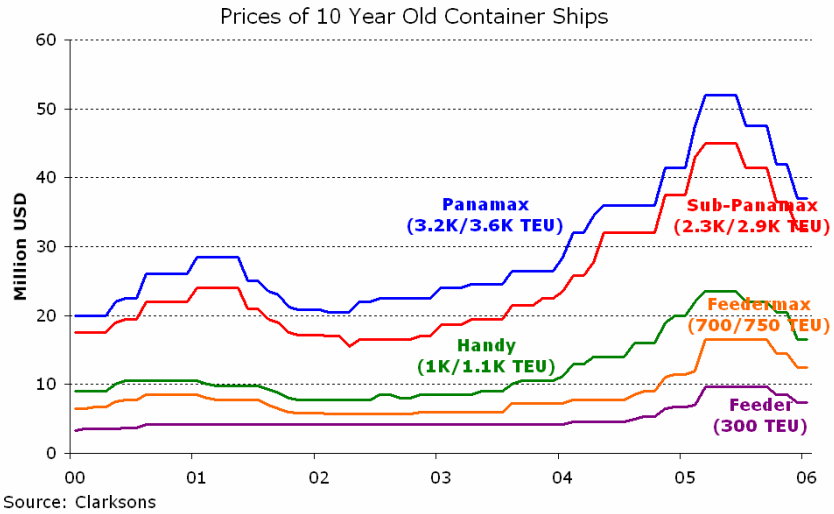
Particularly the contracting of post-panamax containerships ground to a halt, whereas the contracting of new ships for the much more elderly and scrap-likely feeder segment slowed justifiably less.

Despite the abrupt contracting slowdown, the orderbook still represents around 54% of the current fleet.

The effect of the falling timecharter rates and the sudden halt in contracting activity has been clearly visible on newbuilding and secondhand prices throughout the 2nd half of 2005. From June to December, the newbuilding prices have lost about 6% and the secondhand prices have lost 10-20%, although the secondhand prices are still largely up on the price levels prevalent 12 months ago, according to figures from Clarksons.



Source: Clarksons, DSF



Source: Clarksons

OUTLOOK

Long-term demand slowdown, two years of record fleet growth
Our container market outlook for the medium and longer term has not changed drastically from our outlook in the previous "Shipping Market Review". We thus advice you to read the previous report as supplement to this report.

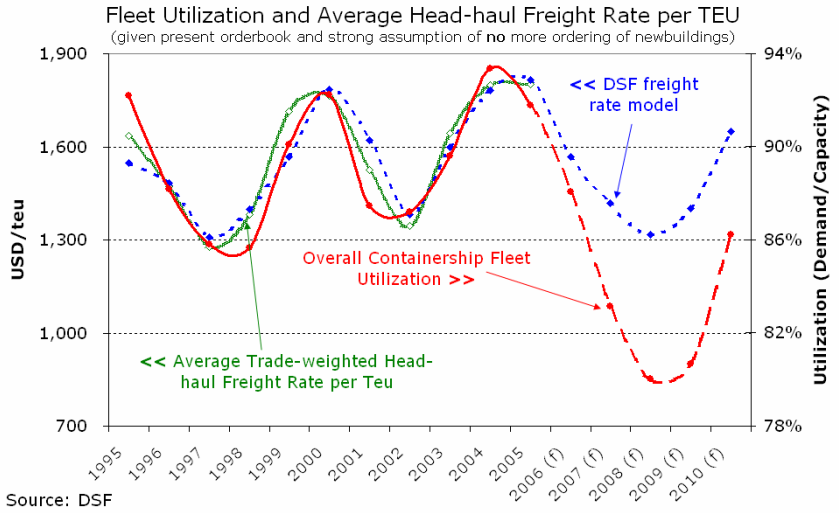
The outlook for the supply and demand balance still does not bode well for the future fleet utilization and freight rate levels.

In 2006, we expect total head-haul trade growth on a teu-nautical miles basis to average around 9% compared to an expected fleet growth of a record-high 13.6% (see upper graph on page 10), thus causing overall containership fleet utilization to drop by more than 4 %-points. This could lead to a drop in freight rates per box on the major head-haul routes by 10-15% from 2005 average levels.

But for box freight rates to drop by more than 10% in 2006, the market sentiment would have to deteriorate considerably which is regarded as rather unlikely given the outlook for world economic growth. Furthermore, prices tend to exhibit downside stickiness, preventing them from falling too quickly despite that the underlying supply-demand ratio warrants a greater price drop.

In the years following 2006, we expect total head-haul demand growth on a teu-nautical miles basis to continue down to about 7-8% annual growth. Unfortunately, the latest figures on the containership and multi-purpose orderbooks from Clarksons, combined with our own judgment on ship efficiency/speed, warn of yet another year of record fleet growth of a delivery-adjusted 14.4% in 2007, followed by 11.7% in 2008 and 6% in 2009. Given continued containership contracting, these already very high supply side growth rates will probably become even worse in coming years.

Consequently, fleet growth is expected to surpass demand growth by a very large margin for the next 2-3 years. Providing that our fleet growth calculations and expectations for demand growth are reasonably correct, it may lead to a never-before seen slump in fleet utilization in 2006 and 2007 which could have a direct



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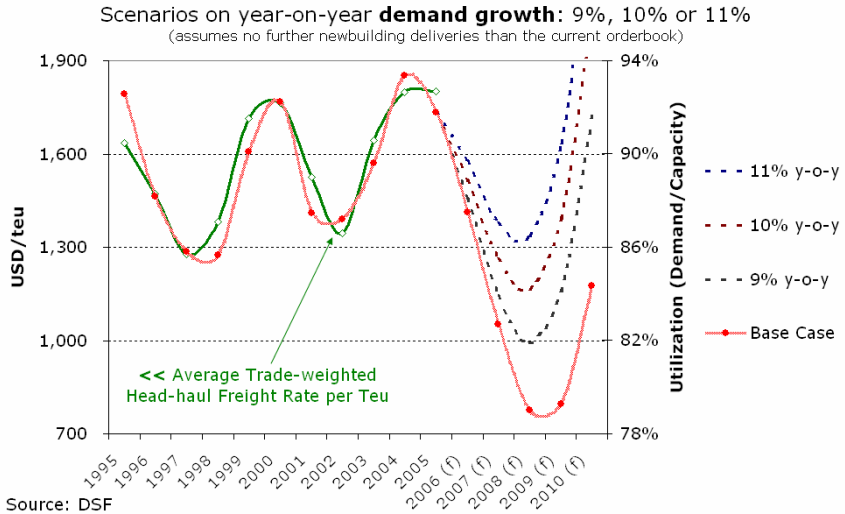


Source: DSF

impact on the liner companies' ability to maintain high freight rates and ship utilization for several years to come.

Although it appears that the short-term effect has been an increased quest for market share at the expense of freight rates, the recent series of consolidation among some of the largest liner companies may in the longer run have a dampening effect on the downward pressure on freight rates. On top of increased operating costs, a possible resurgence of port congestion and growing imbalances between head-haul and back-haul, the market consolidation may thus prevent freight rates from falling as low as implied by the dotted blue line in the upper graph on p. 12.

For the charter market in 2006, the number of ships available for hire is in the short term rather limited, particularly in the <1,500 teu and 3,000+ teu segments, and could thus set off a momentary mini-revival in the charter rates. But looking further ahead than 1q06, the availability of charter ships is clearly increasing with negative implications for charter rates. Also, the liner companies may already have covered most of their 2006 requirements with long-term charters or new-buildings and may only on a more limited basis require extra ships.

In 2006, the expected slowdown in trade growth first and foremost reflects a slowdown in consumption growth in most of the Western world, particularly caused by high(er) oil prices that reduce the business' and households' purchasing capability, and by stable or rising interest rates which cause real estate prices to slow down or even fall with direct effect on private consumption, and furthermore promotes higher savings rates. The interest rate induced slowdown is already clearly evident in the U.K, and in the U.S. the rising interest rates have by now caused a slowdown in the housing market which in turn may lead to lower import growth of containerized goods such as furniture, white goods, appliances, etc. for the newly acquired homes.

Furthermore, the boost to world container trade that China's accession to the WTO has originated in the period from 2002-2005, is believed already to have lost momentum and is expected to gradually loose momentum and significance in the years ahead.

In the short term though, the rebuilding following the two hurricanes, Katrina and Rita, may provide a short-lived surge in the housing market. Furthermore, the time that the wholesale goods spend in storage in the U.S. is currently at a historic low. Should the U.S. consumption growth continue strongly into the 2nd half of 2006, the retailers may thus momentarily have to boost their imports to build up inventories.

Also on the positive side in 2006, we do see upside potential particularly from the improving German and Japanese economies, although the Japanese containerized imports largely are on back-haul or short-sea routes and thus rather insignificant for the overall fleet utilization. Furthermore, the German upside potential may be short-lived, should the Euro appreciate considerably against the USD and thereby put an end to the export-led German upswing.

In the years following 2006, the expected continued slowdown in trade growth on the head-haul routes comes as a direct consequence of the slowdown in the housing market, and of the considerable U.S. imbalances in the form of record high trade deficits, current account deficits, federal budget deficits and very low national savings, which all have to be improved upon in the future with direct negative impact on consumption and import growth.

For years, the U.S. consumers have by living beyond means been the locomotive of global economic growth, but with them taking a breather, global containerized trade growth is unavoidably to slow down. Unfortunately, the lack of labour market reforms in the Euro zone on top of fragile U.S. import growth may prevent the European economies from being a serious contender for the role of global growth locomotive.

Conclusively, a head-haul demand growth of above 10% annually for the next 2-4 years is regarded as rather unlikely, and containership owners and builders may earlier than suspected have to adjust to this less than upbeat outlook ■

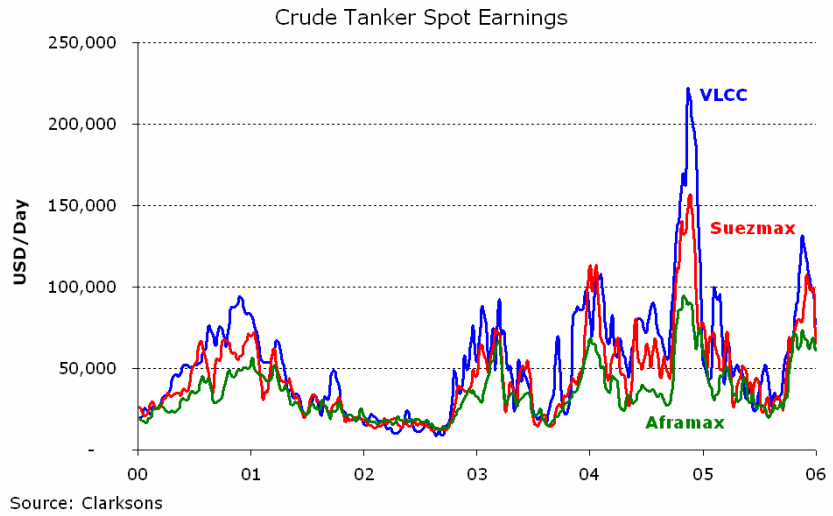
Crude Tankers

Hurricanes caused a completely unexpected and unprecedented disturbance in the tanker markets, sending freight rates sky-high. For 2006, freight rates are expected to come somewhat down although there still may be some temporary upside left.

FREIGHT RATES

Hurricanes boost 4th quarter earnings to very high levels
The 2nd half of 2005 turned out to be even more profitable than the 1st half of 2005, although average freight rates for the modern VLCCs of 95,600 USD/day in the 4th quarter of 2005 did not quite live up to 156,000 USD/day achieved in the 4th quarter the year before.

For all of 2005, the spot earnings of the modern VLCCs have averaged around 60.700 USD/day despite both the 2nd and 3rd quarter spot earnings averaging around 40,000 USD/day, according to Clarksons.



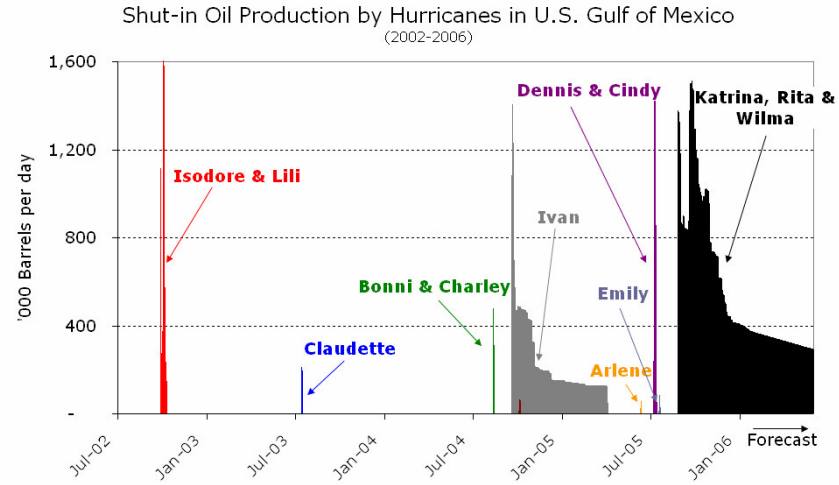
Source: Clarksons

SUPPLY & DEMAND

China reviving and hurricanes play havoc with tanker demand
Up until the end of September, when the devastation caused by the U.S. hurricanes started to have a real effect on the crude tanker markets, the spot earnings of the other crude tanker segments largely stayed at rather "low" levels. At least compared to the fantastic levels achieved in recent years.

Although the first hurricane Katrina hit the U.S. Gulf Coast a month earlier in late August 05, the crude tanker spot earnings did not react before the second hurricane Rita hit and it became obvious that the U.S. would probably need extra imports to make up for the lost oil production.

As depicted by the lower graph on the right, the impact on the oil producing facilities in the region of the three consecutive hurricanes is dramatically bigger and longer-lasting than any previous hurricane in the Gulf of Mexico. Consequently, in an



Source: MMS U.S. Department of the Interior, EIA U.S. Department of Energy

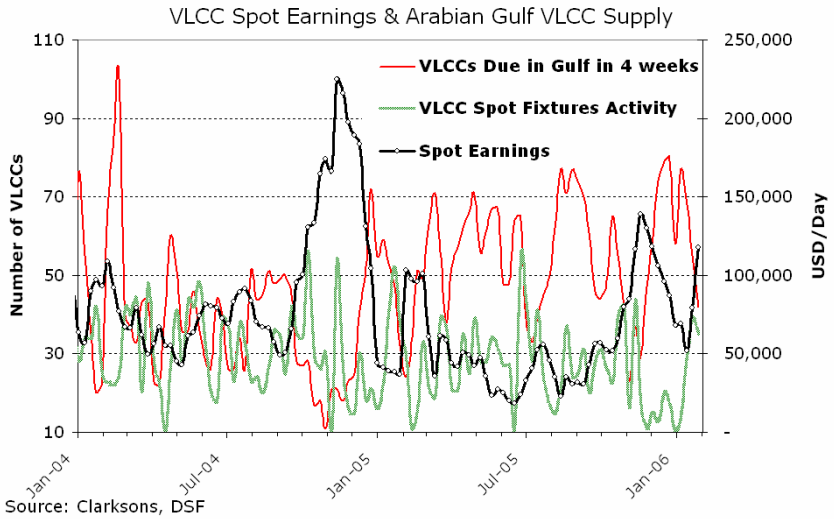
attempt to suppress the rising oil prices, the OECD countries decided to release oil from their strategic oil reserves, and the OPEC member countries decided to temporarily abandon their production quotas and pump out more oil. The temporary OPEC quota relaxation caused a short-lived spurt in fixture activity thereby shortly driving down the number of crude tankers available for charter in the Middle East Gulf (MEG) which subsequently caused spot freight rates to sky-rocket.

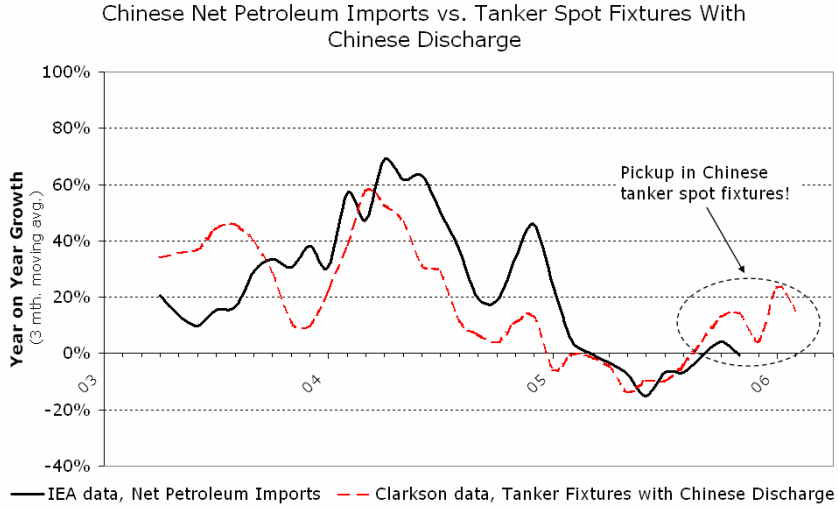
Following the short-lived spurt in fixture activity, the MEG fixture activity hit almost rock bottom throughout the following 1½ month despite the availability of crude tankers in the region increasing fast. Consequently spot freight rates dropped. The subsequent lack of MEG fixture activity bears evidence that (1) crude storage levels in the consuming countries are at relatively healthy levels, and (2) that refiners throughout the world have a hard time processing the heavy and sour crude oil that is mostly exported from the Middle East region thus limiting its export possibilities. In other crude oil exporting regions which are characterized by lighter and less sulphur rich crude oils (e.g. West Africa and North Sea), the fixture activity has been relatively more robust, thus supporting high freight rates for longer in these regions.

Underpinning the large increases in spot freight rates during 4q05 was a return to positive growth for the Chinese petroleum imports (see lower graph on the right). According to the IEA, Chinese net petroleum imports for the first 10 months of 2005 were 3.7% lower than the same period the year before, but by September 2005 the year-on-year growth turned positive. For the last two months of 2005 and for January 2006, the crude and product tanker fixture numbers seem to imply that the Chinese net petroleum import growth may have been even more positive.

The sudden change in China's import growth from a positive 43% for all of 2004 to a negative 3.7% for Jan-Oct. 2005 appears to be the result of several factors:

(1) The Chinese government has by artificially keeping the domestic prices of key petroleum products much below the world prices, encouraged Chinese exports, discouraged imports and





storage building, and depressed the use of fuel oil in power production during 2005. As the world crude oil price fell from its peak in late August, and as the Chinese government raised the domestic prices and increased the export tax, the price gap diminished causing a revival in the net import growth. Despite the recent changes, the Chinese domestic prices are still believed to be below world market prices, thus limiting the import incentives and the chances of a sustainable high import growth in the medium term.

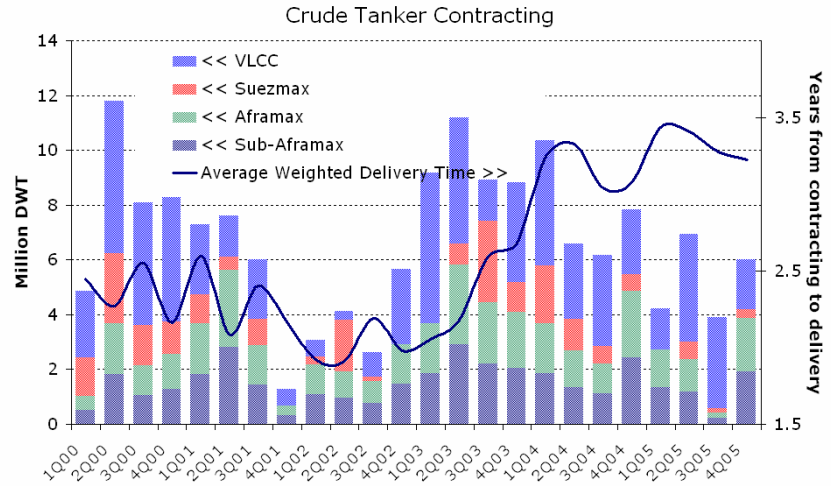
(2) Oil is typically an expensive fuel for power generation, and is consequently mostly used as a stop-gap source in power generation in periods of unexpected surges in power demand; which is exactly what happened during the 2004 boom. According to the IEA, the Chinese power capacity shortage was a record-high 35 GW during 2004. But in 2005, the shortage has reportedly declined to about 25 GW, causing the use of fuel oil in power generation to drop noticeably. For 2006, the power shortage is expected to drop even further to about 7-9 GW, and as other less costly fuels are put to use, the demand for oil in power production may recede further in coming years.

CONTRACTING & SHIP VALUES

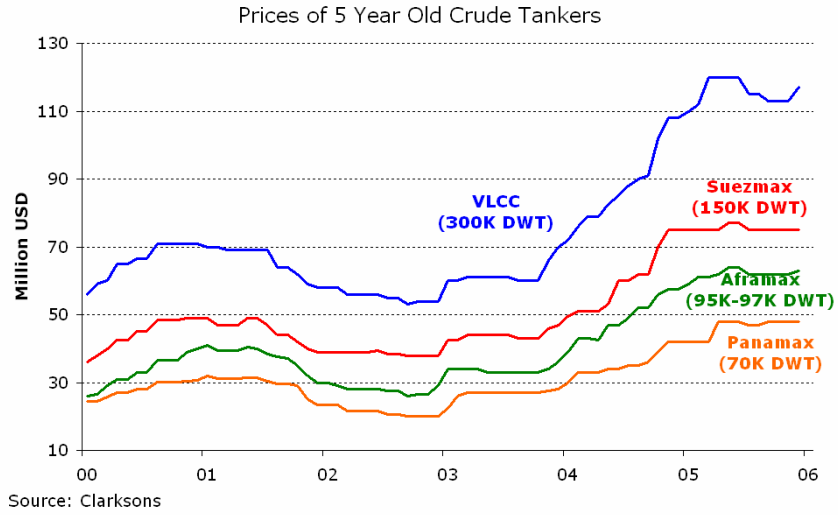
Slightly lower contracting, and secondhand prices held up
With around 8.1 million dwt contracted during the 2nd half of 2005 it is only slightly less then the 9 million dwt contracted during the previous 6 months. Although down, contracting levels are still reflecting rather optimistic demand expectations as the orderbook compared to the future fleet renewal requirements is reflecting above trend fleet growth for the next couple of years.

The reduction in ship contracting has since June 2005 led to a 3-6% reduction in the newbuilding prices for crude tankers. Year on year, the newbuilding prices are largely unchanged or 10% up.

Secondhand prices for modern double-hulled tankers are generally unchanged from 6 months ago, and 0-25% up on a year ago, according to data from Clarksons. Non-double-hulled ships have lost value since a year ago, but have seen a striking value revival in recent months.



Source: Clarksons, DSF



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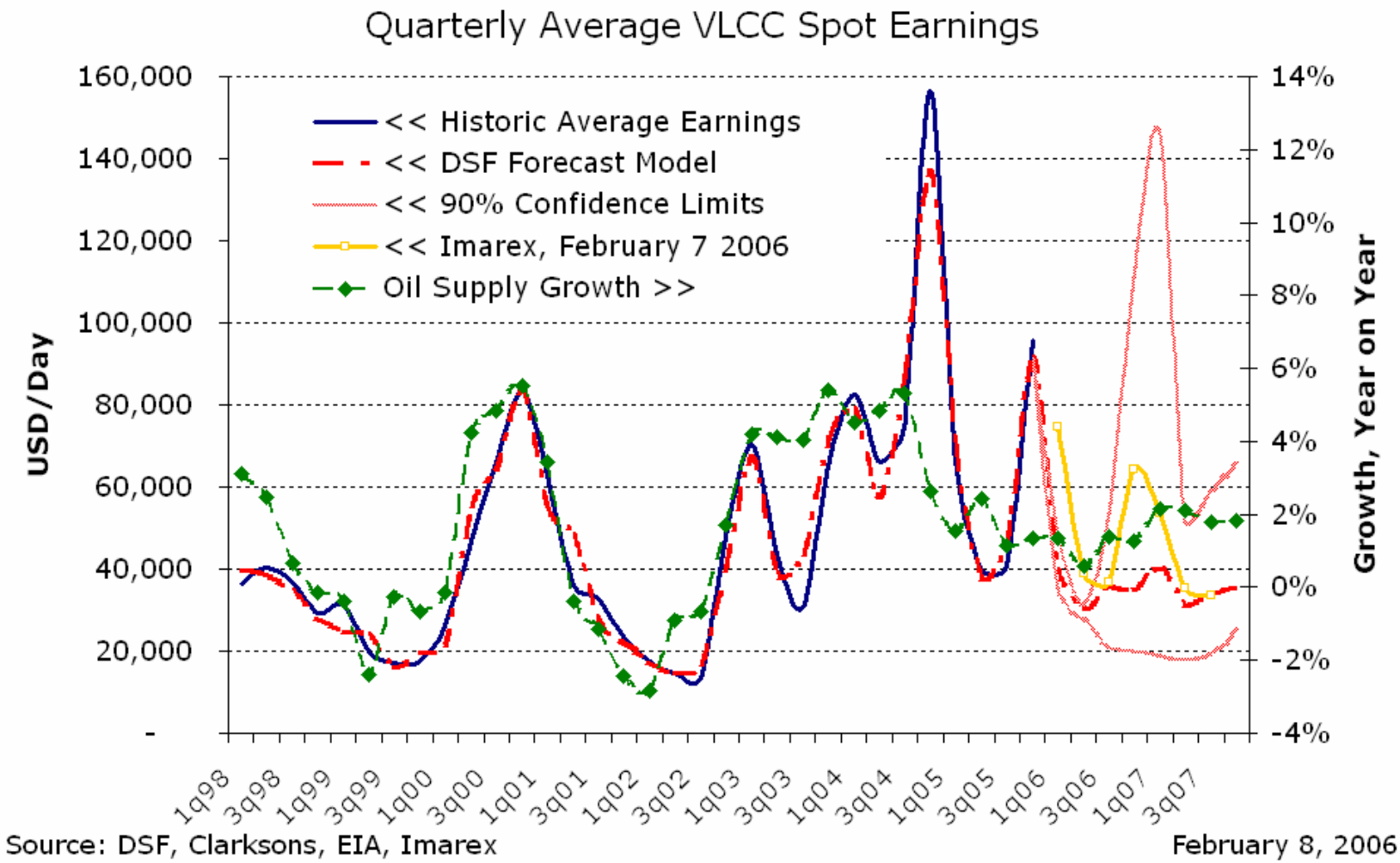


Average Spot Earnings of Modern VLCC, USD/day

Source\quarter	2004	2005	1q06	2q06	3q06	4q06	2006	1q07	2q07	3q07	4q07	2007
DSF Model	94,878	60,725	39,740	30,214	35,678	34,873	35,126	40,405	31,541	33,788	35,745	35,370
Imarex *			74,519	39,037	36,730	64,215	53,625	53,727	35,263	33,358	N/A	42,041

* Forward curve from the International Maritime Exchange as per February 7 2006. Average of routes TD3 (Ras Tanura - Chiba) and TD4 (Bonny - Loop). Grey shaded areas are actually realised historic spot earnings.

OUTLOOK

Lower freight rates, but still with an upside chance for 2006
Both the Energy Information Administration (EIA) of the U.S. Department of Energy and the International Energy Agency (IEA) of the OECD are predicting higher global petroleum demand growth in 2006 than 2005; 1.9% and 2.2% respectively. This is up from around 1.3-1.5% global demand growth in 2005.

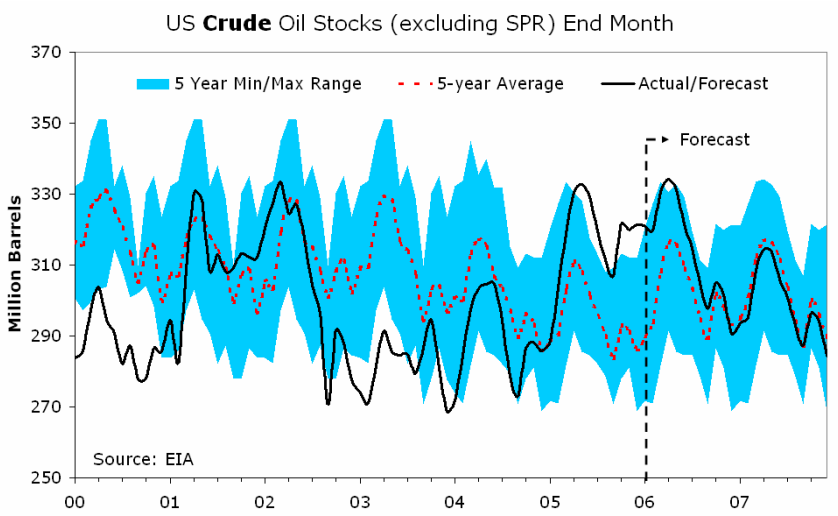
Intuitively, the relatively higher global demand growth in 2006 should translate into higher demand for oil tankers and thus somewhat higher freight rates in 2006 than in 2005 (all other things being equal).

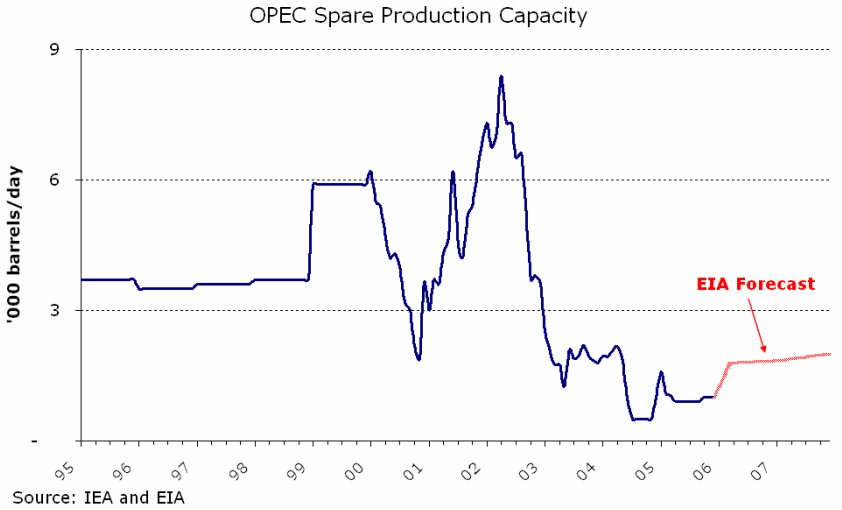
But counterintuitively, the growth in global oil *production* is with a growth between 1.6% and 2% not expected to be as high as the *demand* growth, which should remove some of the upside pressure on tanker freight rates. The relatively lesser oil *production* growth than oil *demand* growth comes as a result of the absolute level of oil production already being high enough to satisfy increased oil demand without necessitating a large draw on the oil storages.

But more importantly, if one takes account of the fact that a part of the growth in global oil production in 2006 is expected to come from a restoration of the shut-down U.S. production following the hurricanes, and thus not necessarily good for oil tanker demand, the global oil production growth net of U.S. oil supply disruptions actually turns out with growth of around 1.1% in 2006 compared to a rather higher 1.6% the year before.

Partly on account of the above issues, e.g. the IEA is expecting the call on OPEC in 2006 to be just 0.2 mbd (0.7%) higher than in 2005, which unfortunately should not speak well for the abilities of the VLCC ship owners to maintain spot freight rates at or above the levels obtained in 2005.

As our DSF Forecast Model (see graph and table on page 17) for the spot earnings of the modern VLCCs relies heavily on the short-term forecast from the EIA on global oil production (net of U.S. supply disruptions), the lower oil production growth expected during 2006 accordingly also implies lower freight rates than in 2005.





Notice that the farther out the model forecasts, the less reliable the results are, which is also implied by the widening confidence limits displayed in the graph. Also, pay particular attention to the fact that our forecast has *not* factored in the likelihood of yet another devastating hurricane season, a much colder winter, political uncertainty or civil unrest in the OPEC member states, or any other large and unpredictable event that could momentarily upset the tanker markets. Any such large event probably would put a significant upward pressure on freight rates, although only of temporary duration. *I.e. with the uncertainty following the U.S. hurricane devastation, the Nigerian attacks on oil pipelines and platforms, and the Iranians' intentions to revive their nuclear program all at play at the same time, freight rates during 1q06 in particular may indeed be much higher than predicted by our model.*

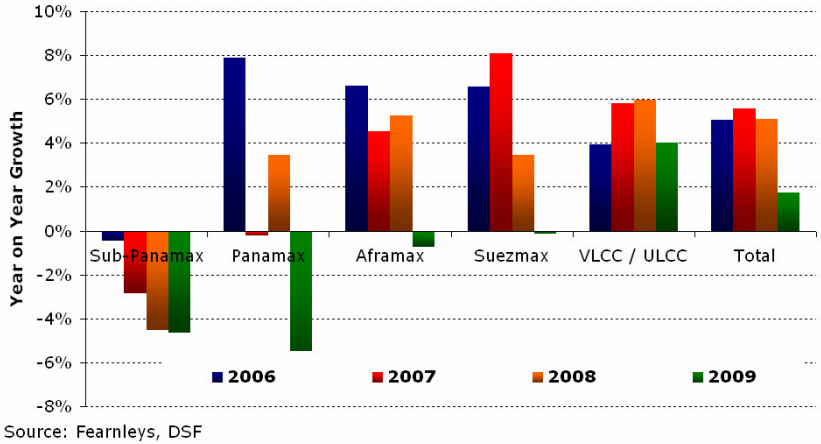
Moreover, as our model forecast is largely based on EIA's forecast on global oil production (net of U.S. supply disruptions), the crude tanker owners can take comfort in the fact that the EIA at least in one respect may have underestimated the oil supply growth in 2006. *Consequently our model's forecast for much of 2006 may also be too low.*

Depicted in the upper graph on the previous page, the EIA is for 2006 forecasting that the U.S. commercial crude oil stocks are to fall steadily down to their 5-year average level and remain there throughout 2007. This fall in crude oil stocks implies a lower need for imports and thus a lower demand for crude oil tankers in 2006 than would otherwise be the case.

The EIA is believed to support their forecast for lower crude oil storage levels on expectations that a higher OPEC spare production capacity (see lower graph on previous page) is to reduce the incentives and justifications for holding large stocks.

But, as the oil price increases caused by the uncertain situation in both Nigeria and Iran have recently exemplified, the justification for holding large stocks despite a slightly higher spare production capacity may indeed *not* be gone anytime soon. Furthermore, a generally higher petroleum demand necessitates holding bigger inventories.

Future crude tanker fleet growth given present orderbook and Marpol phase-out scheme



Source: Fearnleys, DSF

Instead we may see, not only the U.S. trying to increase its oil storages in 2006, but other OECD members, China and India also trying to boost inventories. In such a case, freight rates in 2006 may come much closer to the levels experienced in 2005.

For 2007, the forecast may prove too optimistic should the economic growth and henceforth petroleum demand growth in the U.S. and elsewhere begin to suffer as a result of the high oil prices, a contractionary monetary policy and a slowdown in the U.S. housing market.

Nonetheless, petroleum demand growth in particularly China and India is expected to remain robust which should keep global petroleum demand growth from falling into negative territory and thus provide some support to the crude tanker markets.

Regardless of the above highlighted uncertainties for the next two years, the considerable crude tanker orderbook, which is stretched out over an extended period, may signify a future fall in fleet utilization. Conclusively, the chances of a quick return to the very high spot earnings of 2003 or 2004 may become increasingly limited in future years ■

Product Tankers

Hurricanes caused refineries to shut-down and the U.S. petroleum product imports to shoot skywards. Secondhand prices continue upwards as the near-term outlook is still largely positive.

FREIGHT RATES

Yet another surprising 4th quarter as hurricanes ravage the U.S.
The downward trend which had been prevalent since late 2004, quickly and distinctly reversed as the first of the large hurricanes swept across the Gulf of Mexico and the southern states of the U.S. in late August, causing a massive and never-before seen devastation to the U.S. crude oil and gas infrastructure in the region. Subsequently, the spot freight rates jumped to similar or better levels than achieved during the 4th quarter of 2004.

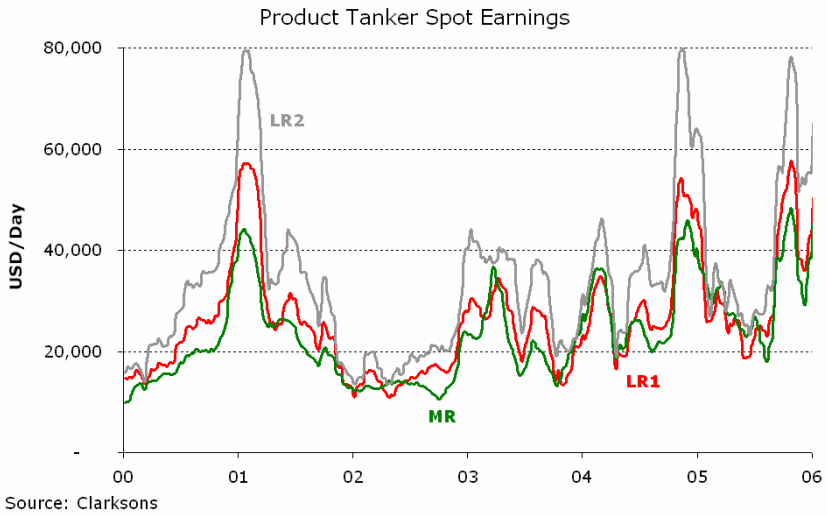
The timecharter rates are only slightly down on the record levels achieved in late 2004 or early 2005, implying continued optimistic expectations for the next 1-3 years.

SUPPLY & DEMAND

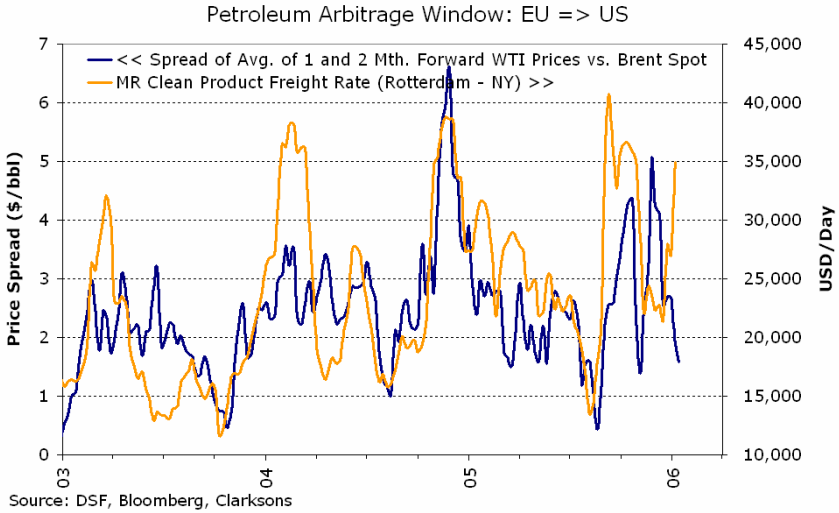
Hurricanes, hurricanes, hurricanes & not enough oil on stock
The repercussions of the most devastating Atlantic hurricane season in more than a decade overshadowed all other developments during the 2nd half of 2005 for the product tankers.

As a consequence of the devastations to a significant share of the U.S. refinery capacity and oil and gas production, on top of rather low inventories of both gasoline and distillates, the demand for imports of refined petroleum products sky-rocketed in the weeks and months following August.

Particularly the sudden shut-down of a large share of the U.S. refinery capacity led to a distinct spike in the refinery margins (petroleum product sales price minus crude oil purchasing costs and other production costs), which spurred a sudden opening of the arbitrage window between the U.S. and Europe (see blue line in lower graph on the right). Almost simultaneously, the freight



Source: Clarksons



Source: DSF, Bloomberg, Clarksons

rate for product tankers sailing between Europe and the U.S. shot dramatically skywards (see yellow line) as European refiners and oil traders jumped on the chance to export their products with a guaranteed profit.

Thus to make up for the shortfall in domestic production of refined petroleum products, the U.S. imports of gasoline rose by 18-20% in the 2nd half of 2005 compared to the corresponding period the year before. And for distillates (diesel, heating & fuel oil) the year-on-year growth in the 4th quarter of 2005 was an astonishing 25%.

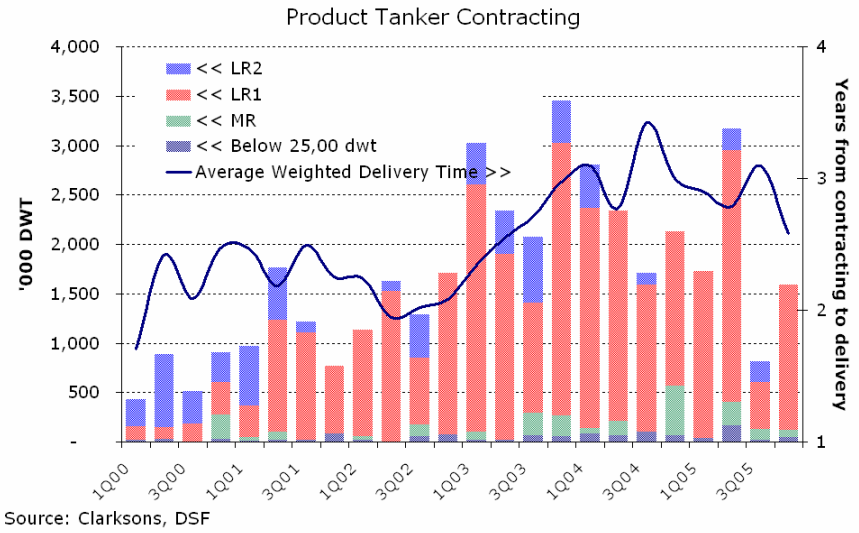
But for crude oil, the trend was distinctly different. On account of the shut-down refineries in the U.S. Gulf, temporarily closed tanker terminals, and most importantly because of already amply supplied crude oil storages, the imports of crude oil to the U.S. actually *fell* by up to 10% in 4q05, measured year-on-year. For that reason alone, the extent of the upturn in the *crude* tanker segments is actually quite surprising.

As the global refinery utilization was already running at close to maximum capacity, much of the imported petroleum products came from strategic and commercial storages around the world. E.g. the Japanese refiners increased their oil product exports in October by a reported 80%. This increase was partly due to Japan's contribution to the IEA/OECD emergency release plan.

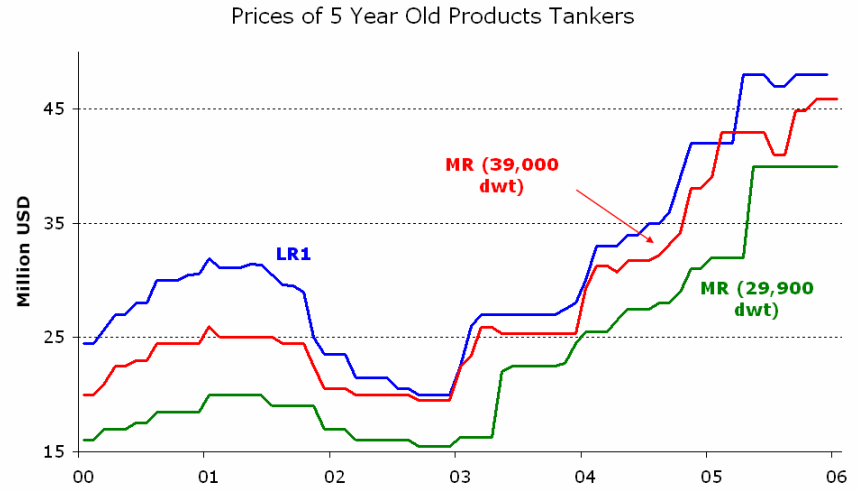
The subsequent boost to crude tanker freight rates may thus partly have come from the need to rebuild oil stock in the countries that contributed with refined petroleum products, and thus not necessarily from crude oil imports directly to the U.S.

CONTRACTING & SHIP VALUES

0-60% higher secondhand prices, but lower contracting
Contracting of new product tankers during the 2nd half of 2005 are more than cut in half from the newbuilding orders committed during the previous six months. For all of 2005, the product tanker contracting activity is about 20% down on 2004. The much lower contracting activity signifies a faltering belief in continued strong long-term demand growth and thus a deteriorating desire to commit at the currently high newbuilding price levels.



Source: Clarksons, DSF



Source: Clarksons

But somewhat counterintuitively, secondhand prices have continued upwards implying that earnings expectations are still extremely robust – at least for the near-term. Since six months ago, the secondhand prices of the younger and double-hulled product tankers have generally increased "only" 0-10%, whereas the elderly single-hulled product tankers have increased considerably more; 10-60%.

This diverging trend implies that the price differential between secondhand prices and newbuilding contracting prices has narrowed or even turned negative, reflecting that tankers with prompt availability are in high demand as opposed to ordering new tanker ships with delivery in 2.5-3 years time. I.e. under the strong assumption that secondhand prices were to remain at their currently elevated state, the current price differential implies that the likelihood of significantly falling newbuilding prices in the short to medium term is rather slim as just slightly lower newbuilding prices may spur a contracting revival.

But given the already large newbuilding orderbook and prospects of slowing demand growth, a word of caution should sound to those expecting further significant secondhand price rises or a long-lasting revival for the contracting activity.

OUTLOOK

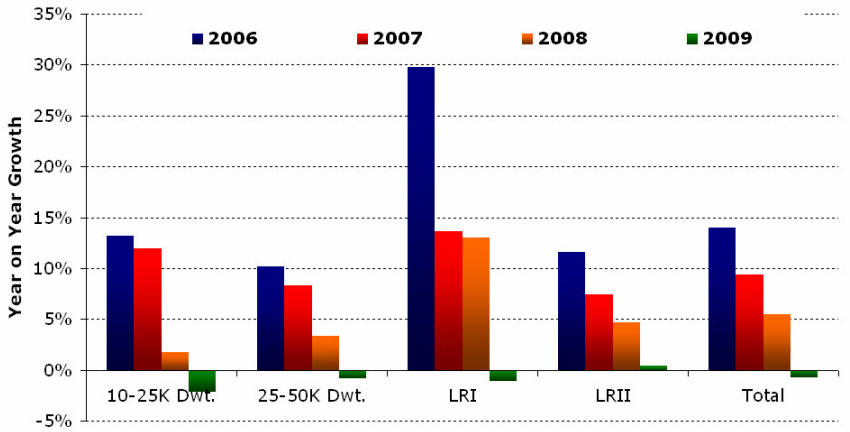
High fleet growth, but still robust demand

The one negative factor clouding the medium and longer-term outlook is the rather large orderbook which warns of high fleet growth in years to come. Even when taking account of the mandatory phase-out of single-hulled product tankers, fleet growth looks set to outpace demand in 2006 and in following years.

But at least in the short to medium term, the likelihood of still strong demand for the product tankers looks promising.

Particularly a rather heavy U.S. refinery maintenance schedule expected for the late winter and early spring may add upward pressure on U.S. import demand for refined oil products giving the product tankers a temporary boost. Conversely, the crude oil tankers may see comparatively less demand during the U.S.

Future product tanker fleet growth given present orderbook and Marpol phase-out scheme



Source: Fearnleys, DSF

refinery maintenance season as the crude oil inventories at present time are judged as more than adequate.

As the freight rate boom during 4q05 and 1q06 was almost entirely driven by the U.S. hurricane devastation, a similar freight rate boom is probably *not* to be expected for the '06/'07 fall and winter. Furthermore, should the U.S. gasoline and distillate inventories trend above their historical upper average range coupled with a mild winter in the Northern hemisphere, a mild Atlantic hurricane season and lower economic growth, any autumn or wintertime freight rate increase may be completely stifled. This goes for both the crude tankers and the product tankers.

Although demand growth in the longer run is expected to be down from the exhilarating demand growth experienced during the 2003-2005 boom, product tankers are in the long term expected to experience a relatively higher demand growth than the crude tankers, which ought to prevent the product tankers from experiencing very low earnings for longer periods at a time.

Furthermore, on account of the ongoing pickup in Chinese petroleum demand, the product tankers are set to benefit in both the short, medium and long term ■

Chemical Tankers

Freight rates trend down but are still at very healthy levels. U.S. Gulf hurricanes temporarily both boost and depress freight rates. In 2006, fleet growth is expected to outgrow demand, although only to a limited extent.

FREIGHT RATES

Trending down, but with a temporary hurricane boost
Over the first three quarters of the year, deep sea chemical spot freight rates generally trended downward but at still very healthy levels.

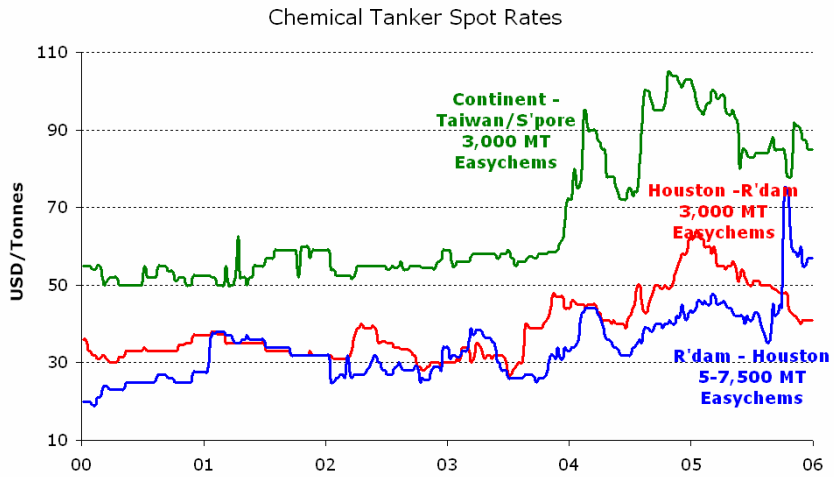
On most of the short sea intraregional routes, spot freight rates also decreased during the latter part of the year.

In the final quarter of 2005, the hurricanes hit the U.S Gulf Coast causing extensive shutdowns of chemical plants in the region. Consequently, the need for extra U.S. imports quickly forced spot freight rates significantly upwards as spare ship supply was scarce. Conversely, freight rates for U.S. exports fell commensurately as U.S. chemical exports slowed to a dribble.

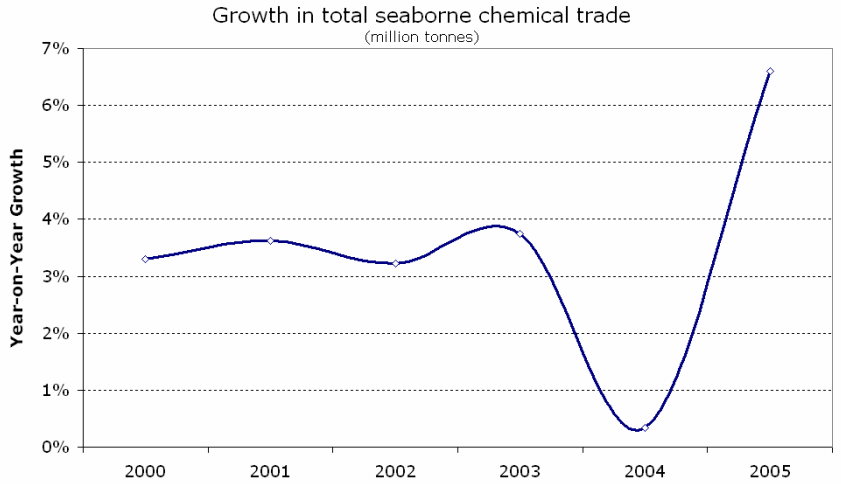
SUPPLY & DEMAND

U.S. imports boost coupled with an almost stop to exports
The momentary shutdown of U.S. chemical and petroleum refinery plants led to a sharp drop in exports at the same time as a momentary boost in imports.

Although the majority of the chemical plants were back in operation a few weeks after the hurricanes made landfall, export volumes did not pick up as the plants put priority to supplying domestic customers over exports. Furthermore, product prices in the U.S. had risen to levels that made them relatively uncompetitive for exports. Thus many end-users in e.g. Asia chose to source their products from less distant markets.



Source: Clarksons



Source: Drewry Shipping Consultants Ltd

In other trades there was the general tendency of a muted seasonal upturn in spot chartering activity. The lower spot activity was mainly a result of many owners and charterers having fixed their open positions well in advance, and that product prices were expected to fall thus leading some charterers to postpone their purchases.

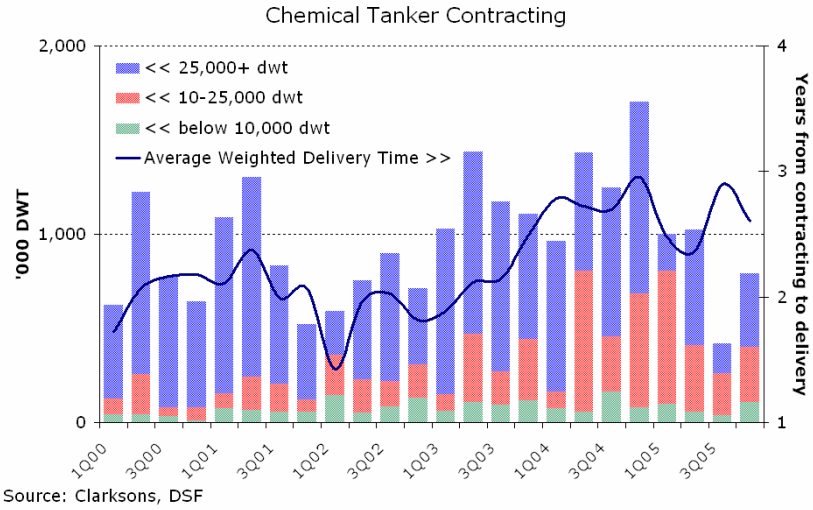
Furthermore, the spot freight rates on routes to Asia had throughout most of the year been hit by lower demand as particularly Chinese buyers needed less imports as their inventory levels were already somewhat sufficient in meeting demand.

CONTRACTING & SHIP VALUES

Lower contracting activity, slightly higher secondhand prices
Measured in dwt, overall contracting of chemical tankers during 2005 is according to Clarksons statistics down by about 40% from 2004. And although the 4th quarter did display a slight revival, contracting during the 2nd half of 2005 is nonetheless down by about 40% on the first half of 2005.

With regards to average delivery time there is a growing divergence between the coastal, the intermediate and the large deep sea chemical tankers. The small and intermediate chemical tankers typically have experienced constantly increasing delivery time throughout the last 12 months. Conversely, the deep sea chemical carriers appear to find it relatively easier to find available shipyard space as their average delivery time has come considerably down from above 3 years twelve months ago to around 2.7 years by now.

As newbuilding prices have come somewhat down since six months ago and as secondhand prices already in the first half of 2005 showed 10-15% increases, particularly the younger deep sea chemical carrier values have not appreciated much during the latest 6 months. Conversely, on account of the market value of older ships generally being much more determined by freight rates than they are determined by newbuilding price levels, particularly the elderly coastal chemical tankers have experienced much larger increases in the recent 6-month period.



Source: Clarksons, DSF

OUTLOOK

Fleet to outgrow demand but regulation may restrain rate fall
Given the large and still growing orderbook, chemical tanker supply is expected to outgrow demand in 2006 although the growth differential is not excessive. Consequently, the negative effect on freight rates is expected to be negligible, but may be amplified should the global economy slow markedly down.

Despite being a long time away, 2007 is expected to exhibit a recovery in freight rates as new IMO regulation may imply a tightened fleet utilization and thus less chance of depressed freight rates.

By January 1 2007 the reclassification of almost all chemical products, vegetable oils and animal fats into higher IMO classification grades is expected to come into force. Consequently, all IMO 2 tankers and a select part of the double-bottom IMO 3 tankers are expected see higher demand. Conversely, older and single-bottom IMO 3 chemical tankers and elderly product tankers may see less demand ■

LPG Tankers

Continued freight rate improvements on top of already very high levels lead to higher newbuilding and secondhand prices. Conversely, contracting volumes slowed down, but from record highs. The outlook is favourable on still tight capacity.

FREIGHT RATES

VLGC jitters, but other segments see sizeable improvements
For the Very Large Gas Carriers (60,000+ cbm) the second half of 2005 proved to be significantly more positive than the 1st half of 2005.

For the medium and smaller LPG tankers, freight rates improved throughout the entire year, ending the year at record levels.

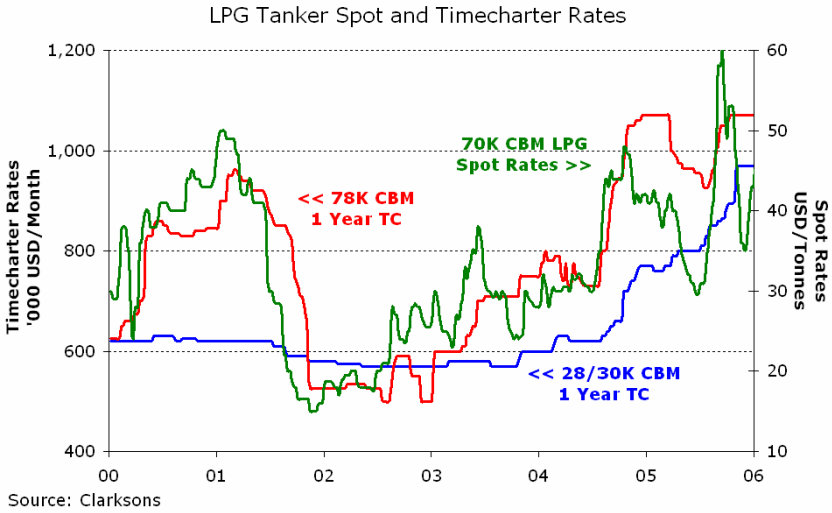
The very small coastal LPG carriers experienced slight setbacks during the 3rd quarter of 2005, although from relatively high levels, but regained its upward movement as autumn set in.

SUPPLY & DEMAND

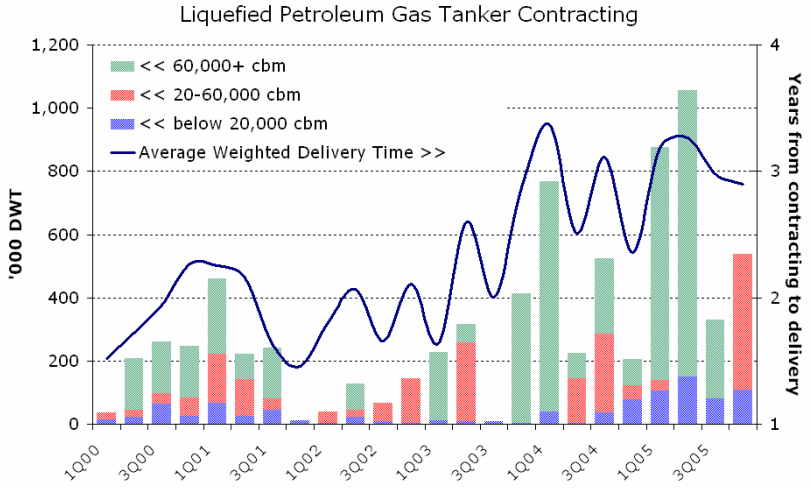
US import boost as hurricanes ravage
The fall in the large LPG carriers' spot earnings during the first half of 2005 was quickly reversed as the hurricanes swept across the Gulf of Mexico, subsequently led to large-scale import demand of LPG products to the U.S. For the period August-December of 2005 the U.S. propane/propylene imports were around 19% higher than the corresponding period in 2004, according to EIA data.

Despite falling domestic production of propane, the temporary increase in imports caused U.S. propane stocks to increase above their usual seasonal range. As the U.S. LPG production slowly returns to normal in coming months, the currently larger than usual product stocks may lead to lower than usual imports in 2006.

The rising freight rates and subsequently also rising ship prices have provided several LPG ship owners with the chance to dispose of non-core assets at a profitable price thereby leading to a natural consolidation within the LPG shipping industry.



Source: Clarksons



Source: Clarksons, DSF

CONTRACTING & SHIP VALUES

Slight contracting slowdown and 0-8% secondhand price rise
As the contracting of LPG ships dropped by 55% from 1st half to 2nd half, the absolute euphoric contracting activity displayed during the first half of 2005 did not seem to continue into the 2nd half despite much improved freight rates. Nonetheless, overall contracting during all of 2005 was 62% higher than in 2004.

As a result of the extremely high contracting volumes and continued strong improvements in the LPG freight markets during the last 6-12 months, the LPG newbuilding prices are the only newbuilding prices which have not displayed a pronounced tendency to fall in recent months.

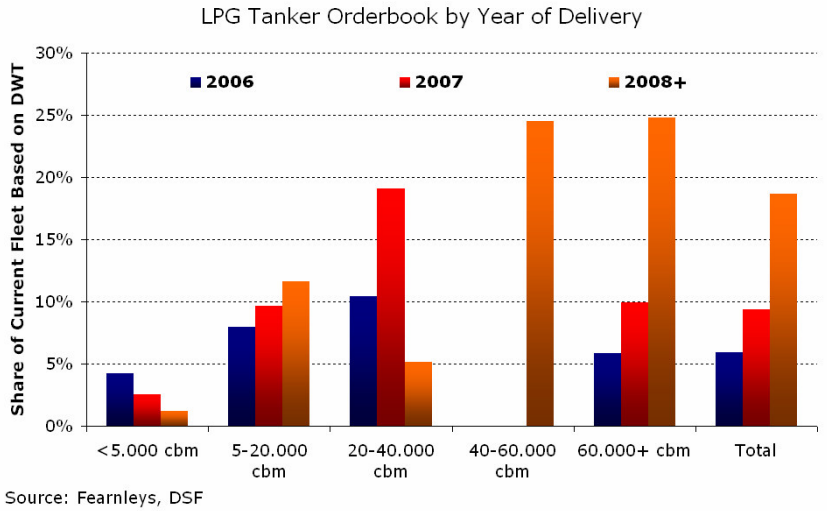
Somewhat counterintuitively, the higher freight rates and newbuilding prices appear *not* to have led to a similar improvement in secondhand prices. According to Fearnleys, most of the younger LPG ships have not appreciated in price during the last 6 months, although they are 10-30% above the level 12 months ago. Conversely, the older LPG ships have almost all displayed much higher price appreciation during the last 6 months.

OUTLOOK

Large orderbook, but old fleet and healthy demand growth
For the small and medium LPG segments, the fleet growth in 2006 looks somewhat high, but may be countered by increased scrapping of elderly ships. Conversely, the Large and Very Large Gas Carrier segments are expected to see none or very limited fleet growth in 2006, thus providing excellent potential for continued very high freight rates.

In the longer term, new deliveries in the VLGC segment in particular appears somewhat daunting, but actually represents almost the exact same capacity of the fleet which by 2007 is 25 years or older, and thus are likely to be scrapped in subsequent years.

LPG tanker demand growth in coming years is expected to remain healthy. Particularly, the planned increases in LPG production and export facilities in the Arabian Gulf are targeting LPG exports to



Source: Fearnleys, DSF

Asia, thus especially benefiting the larger LPG tankers. The expected high growth in the number of LNG liquefaction and exporting terminals is in future years particularly believed to provide extra demand for the LPG tankers. But given the high LPG fleet growth in coming years, the LNG projects will have to come on-stream as planned in order to properly absorb the growing LPG ship supply.

Although the above highlighted factors are generally expected to provide positive demand growth for the LPG tankers, there remains some uncertainty that some of the incremental LPG production in the Arabian Gulf is likely to stay in the region and thus not lead to the need for as much LPG tanker ship capacity as believed. According to *Argus LPG World* the region is suffering an acute shortage of gasoline which could potentially lead to construction of condensate (LPG) splitters as they typically yield 50% naphtha which is used in the production of gasoline.

Despite the uncertainties highlighted above, the tonnage utilization is expected to remain tight in the short run, but a potential slowdown in global economic growth may curb demand growth in the longer run ■

Dry Bulk Ships

The negative consequences of a global steel overproduction is beginning to be felt throughout the dry bulk sector, leading to de-stocking and falling freight rates. Earnings are still expected to remain at healthy levels, but much rests on China to behave well disciplined.

FREIGHT RATES

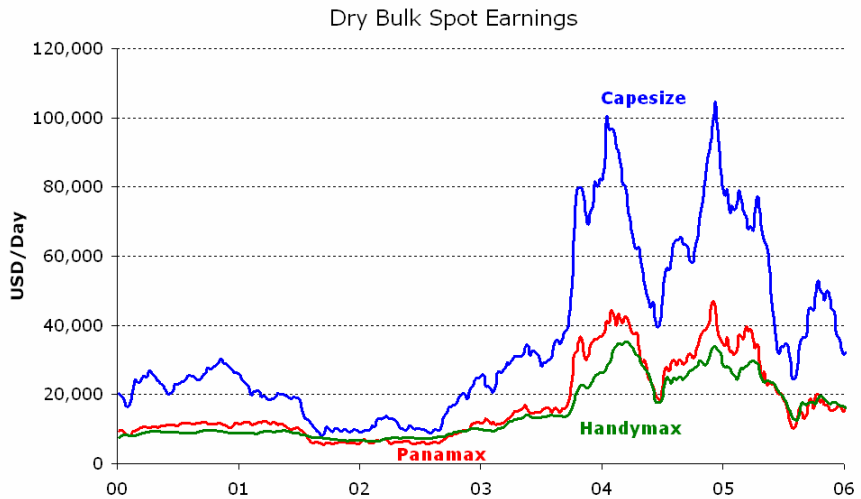
Correction on previous overreaction, followed by slowdown
The second half of 2005 began with freight rates across the board continuing their downward trend to reach levels that just a few months ago would have been regarded as unthinkable. But as the summer turned to autumn, dry bulk freight rates experienced a revival that lasted until late October, only to see freight rates once again turn significantly south as New Year approached.

The limited autumn revival in freight rates and the just as quick return to lower levels suggest that demand growth has indeed lost momentum in the 2nd half of 2005. Adding further impetus to the downward movement was particularly the receding port congestion which has triggered a quick release of ship capacity into the dry bulk markets (see lower graph on page 29).

SUPPLY & DEMAND

Congestion becomes less important as fleet outgrows demand
The lower freight rates during 2nd half 2005 are the result of the growth in particularly the iron ore trade slowing markedly down with a direct effect on the demand growth particularly for Capesize bulk ships.

According to preliminary figures from the British broker company SSY, Chinese imports of iron ore grew around 32% in 2005 compared to a much higher growth of around 40% the year before. But more importantly, other iron ore importing countries than China actually saw a net *decrease* of around 4% during 2005; down from a positive 2.3% growth the year before.



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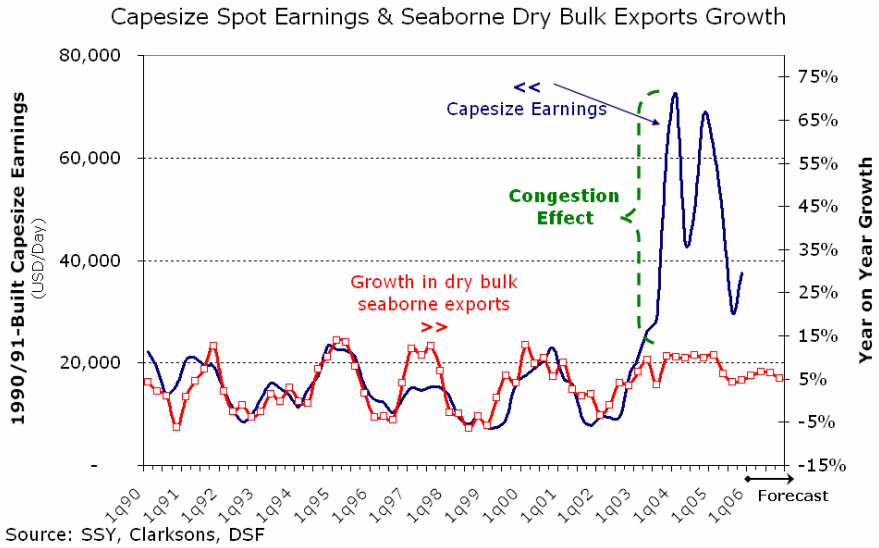
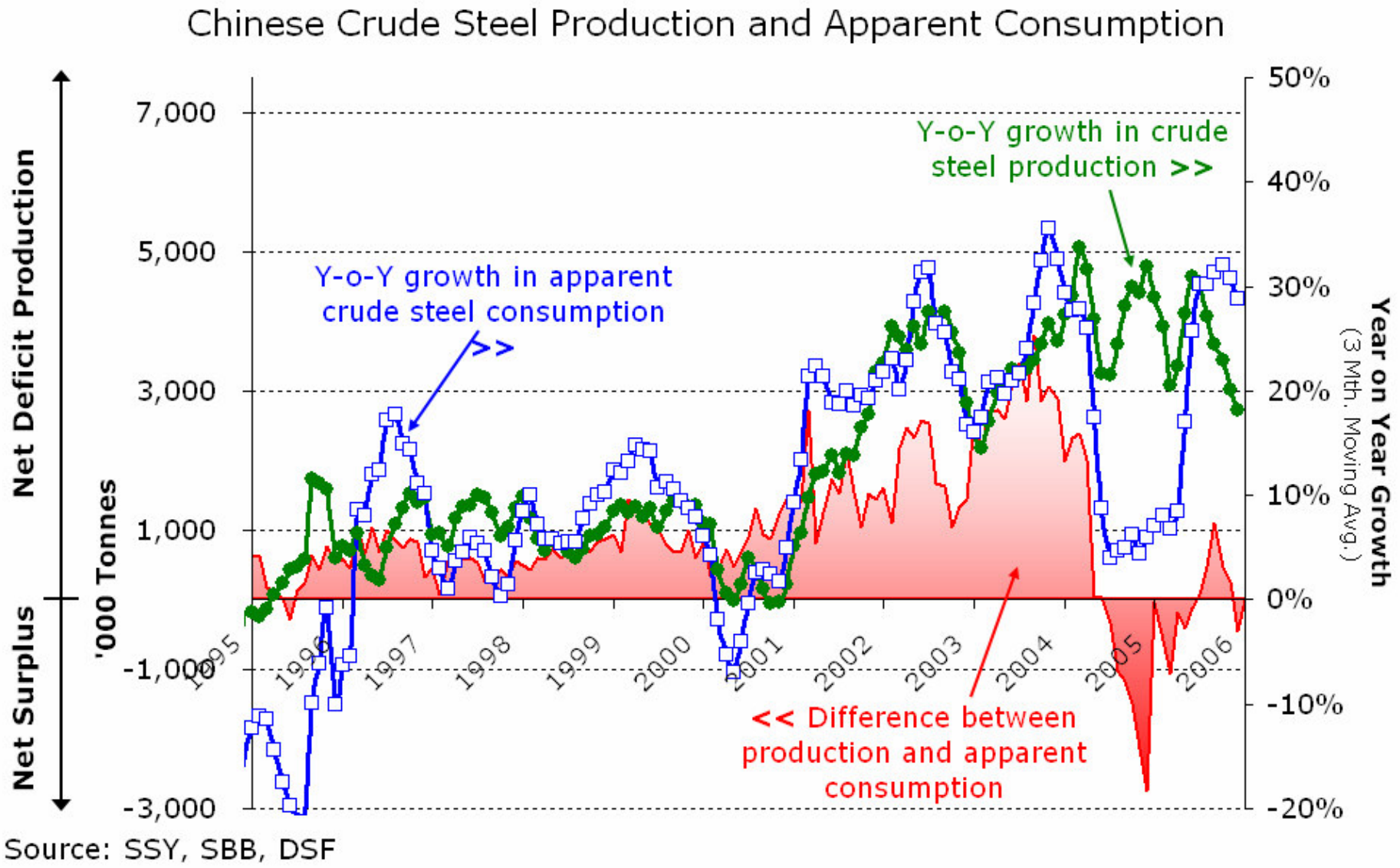


Source: SSY, Clarksons, DSF


Chinese Crude Steel Production and Apparent Consumption
Net Deficit Production
Net Surplus
'000 Tonnes
7,000
5,000
3,000
1,000
-1,000
-3,000
50%
40%
30%
20%
10%
0%
-10%
-20%
Year on Year Growth
(3 Mth. Moving Avg.)
Y-o-Y growth in crude steel production >>
Y-o-Y growth in apparent crude steel consumption >>
<< Difference between production and apparent consumption
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Source: SSY, SBB, DSF

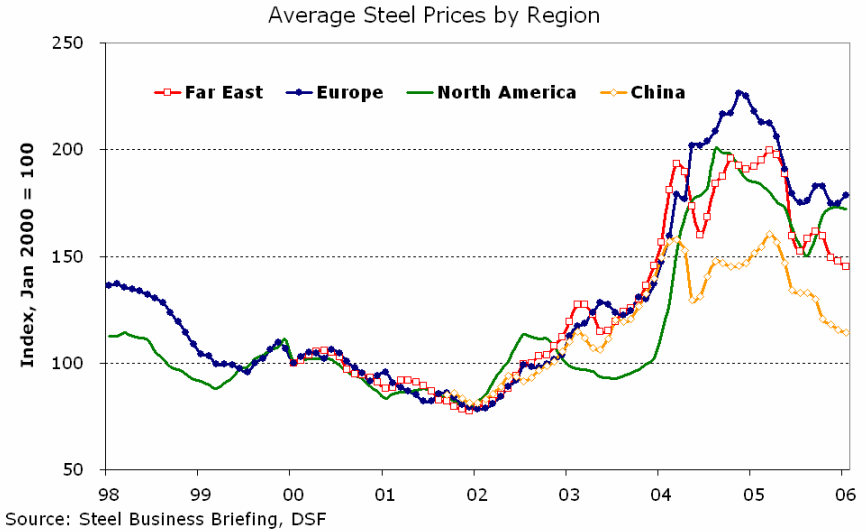
Consequently, China's share of total seaborne iron ore imports jumped from 33% in 2004 to above 40% in 2005. For the dry bulk markets and in particular for the Capesize segment, *China is thus an even larger factor than before in determining the dry bulk demand growth and freight rates*.

The lower Chinese import growth is mainly the result of China's crude steel production loosing momentum with an annual growth of around 23% in 2005 compared to an annual growth of 28% in 2004, according to the latest amended data from China's National Bureau of Statistics. The slowdown in China's iron ore imports is further amplified by an increasing Chinese production of iron ore, which grew by an astonishing 37% in 2005 – up from a growth of 12% the year before.

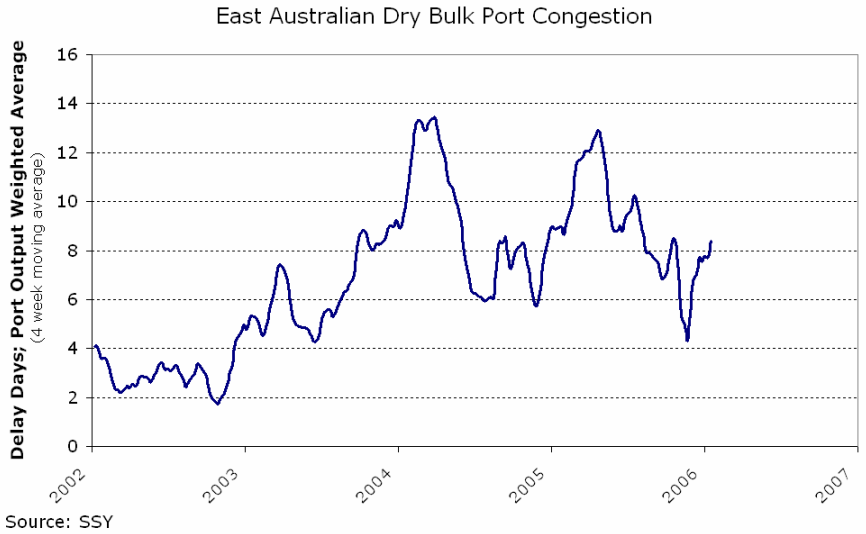
Despite the slowdown in steel production and a growth-spurt in steel consumption during the latter part of 2005 (see graph on previous page), the Chinese steel industry is to an increasing extent characterized by over-supply. Consequently, China has gone from being one of the world's largest steel importers just a few years ago to a net steel exporter by 2005. According to Steel Business Briefing (SBB), net Chinese steel imports in 2003, 2004 and 2005 were 34.6, 12.9 and -0.5 million tonnes, respectively.

The transformation from steel under-supply to steel over-supply has had a dramatic effect on steel prices in China (see upper graph on right), and subsequently on the Chinese steel mills' profitability. According to SBB, the steel industry's profitability for the period January to November grew by just 3.9% year on year, whereas the year on year growth in profitability for the period January to June was a much higher 36.1%, implying that profitability in the latter part of 2005 had fallen dramatically – if not turned negative.

So far, the Chinese steel over-supply has only to a limited extent reached outside China as the Chinese government has instigated several measures to prevent excessive steel exports. Nonetheless, particularly the other Asian countries have had to lower their steel prices to combat the potential threat from much cheaper Chinese imports. E.g. the Japanese shipyards have used the lower Chinese steel plate prices as leverage to force the large Japanese steel



Source: Steel Business Briefing, DSF



Source: SSY

mills to accept lower sales prices. Looking ahead, as dry bulk freight rates fall further and thus become less of an obstacle to trade, steel prices in regions further from China may start to show more distinct downward movement than experienced during 2005.

As depicted by the lower graph on page 27, by the lower graph on the previous page, and by the upper graph on the following page, port congestion has during the late 2003 boom and the 2004 rollercoaster been one of the key factors behind the developments in the freight markets. But as 2005 ran its course, port congestion seemed to diminish considerably in both Australia and China, thereby boosting the effective dry bulk fleet capacity and causing freight rates to fall to levels more supported by real fundamentals.

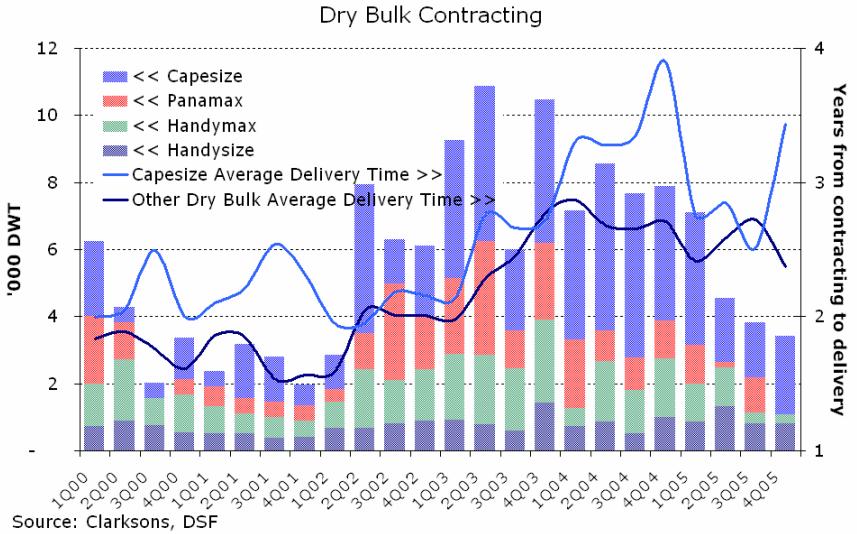
Following along from the seemingly direct relationship between freight rates and port congestion illustrated above, one should expect freight rates to shoot upwards in the future once port congestion returns in greater numbers. But during 2005 and into 2006, demand growth has been less than fleet growth thus creating a greater slack in the supply capacity than seen during 2004. Consequently, relatively more port congestion may be needed in the future to create the same upward pressure on freight rates than was previously necessary.

CONTRACTING & SHIP VALUES

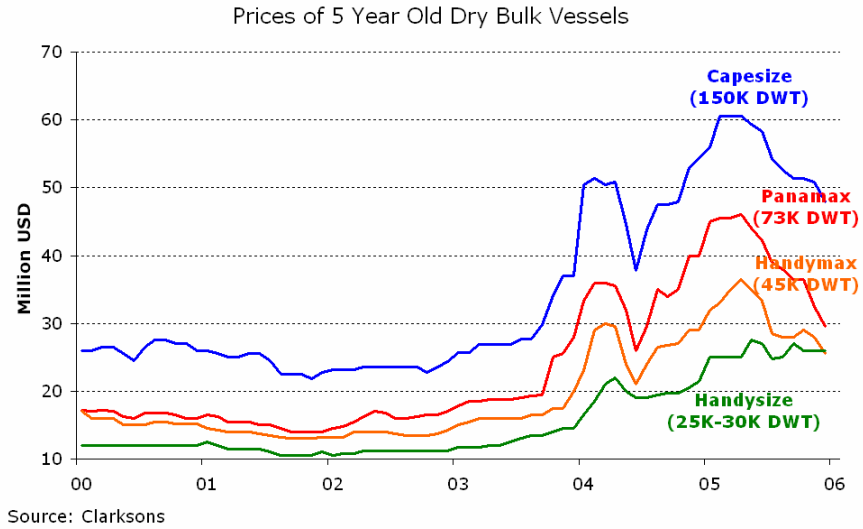
Prices continue down and contracting activity follows
Since the dry bulk secondhand prices peaked in April 2005, prices have on average dropped by 5-45% with the elderly ships decreasing the most and the younger Handymax ships barely budging.

In absence of a clear freight rate revival in the months to come, secondhand prices have probably further to fall before reaching levels that are more in line with the current freight rate levels.

The obviously lower freight rates have had just as obvious an effect on the contracting activity, with dry bulk contracting volumes during all of 2005 almost 39% lower than 2004. Moreover, the contracting volumes during the 2nd half 2005 are also about 39% lower than the previous 6-month period.



Source: Clarksons, DSF



Source: Clarksons

OUTLOOK

Slowdown at still very healthy levels, and a possible upturn
Predicting the freight markets has never been an easy task, and in these times of extreme volatility the task is definitely no easier. To help us guide us in deciding where freight rates are headed in the coming 11-12 months, we turn to two graphs in particular.

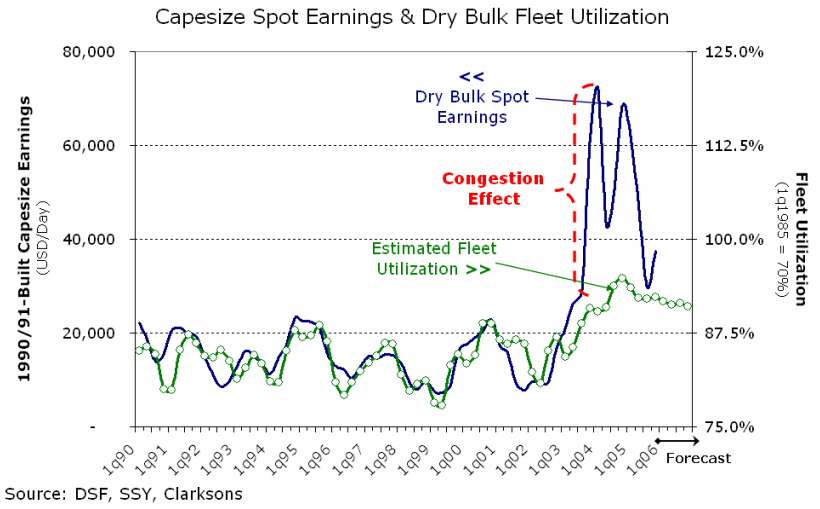
The first graph is the lower graph shown on page 27, depicting the relationship between dry bulk demand growth and quarterly average 150,000 dwt Capesize spot earnings. Although the relationship is only a very crude estimate, it implies that the 150,000 dwt Capesize average spot freight earnings are to lie somewhere in the region of 15-20,000 USD/day throughout the major part of 2006. I.e. spot freight rates have further to fall from their current level of around 22-23,000 USD/day.

The second graph is the upper graph shown on this page, depicting the relationship between an estimated fleet utilization (*ex*cluding any effect from port congestion) and the quarterly average 150,000 dwt Capesize spot earnings. Slightly different from the previous graph, this second graph implies that the spot earnings are to lie rather higher in the region of 25-30,000 USD/day throughout 2006. I.e. the spot freight rates may soon have reached a floor from which they will rise.

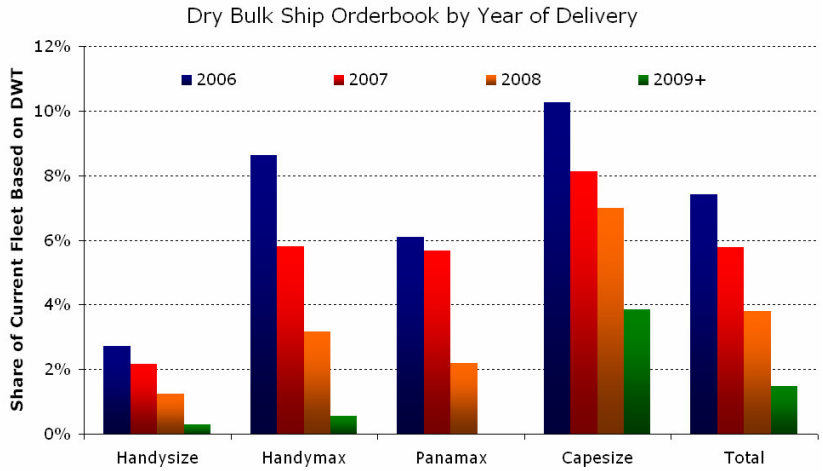
Probably, the reality is to turn out somewhere in between with rates of around 20-25,000 USD/day, which in historical terms are still deemed as very profitable levels.

But several issues may change the outlook in one or the other direction.

<u>On the upside</u>, the strong demand growth driven by China since 2003 has left the global raw materials industry in catch-up mode. As the easy export capacity expansions, including port upgrades, by now have been completed, further capacity growth may require considerably longer lead times and greater investment to keep up with demand growth. Consequently, there is a growing likelihood



Source: DSF, SSY, Clarksons



Source: Fearnleys, DSF

of renewed port congestion which could lay the groundwork for yet another freight rate rally.

Already now, the Australian ports are reporting increasing port congestion, and the Chinese iron ore ports are experiencing fast rising landside stockpiles of iron ore, temporarily amplifying port congestion and possibly leading to a boost in freight rates during the late winter and early spring. But as the summer approaches, the high stock levels may have to be brought back down, which on top of a fundamental slowdown in the Chinese steel manufacturing may lead to a deteriorating freight market later in the year.

Also bear in mind, that the slack in the dry bulk ship supply capacity may have grown to an extent at which port congestion is of less importance to the freight rate levels than was previously the case, meaning that any potential rally may be less pronounced.

Further on the upside, there is the probability that China may not be able to rein in the excessive growth in its domestic steel production, thereby temporarily leading to much higher iron ore imports than forecasted. However, this scenario has the potential of afterwards turning into a temporary dry bulk recession as the Chinese government would have to step even harder on the brake in order to avoid an entire industry from experiencing excessive financial losses.

To prevent this recession scenario from unfolding, the Chinese government has since early 2004 instigated several measures to curb steel capacity growth and steel consumption growth. As is evident from the blue line in the graph on page 28, the Chinese government did indeed succeed in temporarily slowing down *apparent consumption* growth, but has not had the same luck in curbing *production* growth, which is to the detriment of steel mills' profitability but to the benefit of dry bulk demand.

The difficulties in curbing steel production growth is made increasingly difficult by a surging Chinese trade surplus and still strong foreign direct investments (FDI) flowing into China. According to statistics from Steel Business Briefing and China's National Bureau of Statistics, the total capital funds sunk into steel fixed assets were about 26% higher than in 2004 which itself saw an investment growth of around 27%.

Speaking in favour of a future slowdown in the steel fixed asset investments, is an easing of the FDI growth rate following the change in the exchange rate regime in July, and due in part to a People's Bank of China policy of allowing foreign surpluses to partly spill over in bank liquidity in order to drive down domestic market interest rates, according to the World Bank. But unfortunately, this policy of boosting the domestic liquidity runs the risk of boosting credit growth which may lead to yet another unwanted investment upturn in industries already facing excess supply and depressed profit margins.

Thus to combat rising investments in steel production capacity, the Chinese government is not allowing any new mills to be constructed other than those already approved ahead of the new policy. But already now, 70 million tonnes/year of capacity is currently under construction, while a further 80m t/y is planned. Thus without the closure of an estimated 100m t/y of so-called backward, inefficient and/or polluting capacity, the Chinese steel capacity could grow to more than 490m t/y by early 2006 and much, much more in one or two years.

In 2005, the steel capacity was estimated at 470m t/y which corresponds to around 120m t/y of spare/unused capacity – i.e. around 75% capacity utilization. Consequentially, the stop to new mills is not necessarily a stop to further production growth as there is still a massive potential for steel production growth because the mills are far from hitting their physical upper limit on production.

Instead, we may have to rely on market forces to prevent excessive production growth and a hard landing for the Chinese steel industry and subsequently for dry bulk demand and freight rates. According to Steel Business Briefing, the largest Chinese steel mills are signalling a change in strategy for 2006; away from a volume and market share target to a focus on improving production efficiency and product quality. If true, it bodes well for a still strong dry bulk freight market in 2006, and more importantly a soft landing in the longer term ■

Car Carriers

Tight charter market pushes charter rates further up, but newbuilding contracting activity and secondhand price rises slows down. A large orderbook may have an impact on charter rates but an ageing fleet may counteract a large drop in fleet utilization.

Supply & Demand

Still tight ship charter market but rising operating costs
The market for pure car (and truck) carriers remains well balanced with only a very low number of charter contracts being settled as only few ships come available for charter. Consequently, charter rates have improved somewhat, although the rate of appreciation seems to be slowing down. The appreciation slowdown may not necessarily be a sign of pending weakness, but may merely be a sign of discounts in exchange for longer periods of hire.

The tight market persisted despite approximately 35 ships or 9% of capacity were added to the fleet during 2005. In 2006, around 43 ships or 10% of the current capacity are expected to be delivered from the yards.

The financial distress in the American car manufacturing industry does so far not seem to be profoundly affecting the seaborne car carrying business. In the longer run, it may actually lead to increased seaborne car trade as the foreign car manufacturers gain market share from their American competitors.

On the negative side, the car carrier operators have not been able to completely avoid increased operating costs from much higher bunker costs as much of the car carrying business is done on long-term customer contracts which not necessarily leave room for bunker adjustments.

Particularly the car carrier operators that have port calls at the U.S. west coast have found in increasingly difficult to increase capacity as the major ports in the region instead were focussed on the container business. Last year the container ports experienced major congestion affecting the entire operation of the ports. This year, the ports were consequently trying to avoid a repeat situation thereby squeezing the car carrier operators in the process, according to Lloyds List.

In the Mediterranean, and the Baltic the car carrier *feeder* operators have seen particularly strong demand growth as the tight capacity utilization on the deep sea routes has encouraged greater use of feeder services in order to make optimal use of the available ship capacity.

Contracting & Ship Values

Slight contracting slowdown and prices no longer rising
With a still large orderbook, high newbuilding contract prices and delivery as late as 2009, car carrier ship owners displayed growing apprehension with newbuilding orders dropping further from 2004's exceptionally strong activity.

During the last 6 months of 2005 secondhand prices barely moved, but are about 5-15% above a year-ago levels.

Outlook

Large orderbook, slowing demand growth but ageing fleet
Although the 10% capacity increase during 2006 may seem daunting, the current market is still so tight that any new ships are probably without disproportional effect on the charter market. Furthermore, the number of elderly ships leaves ample of room for scrapping once freight rates begin to show downward movement.

On the demand side, the growth rate is expected to slow down as particularly the North American car imports may be dented by a depreciating USD, reduced monetary stimuli, and high gasoline prices. Furthermore, the Chinese market is despite its vast potential not expected to provide large-scale car imports or exports as most of the cars are built domestically ■

Ro-Ro/Ferries

Passenger ferry companies still see stiff competition from low-budget airlines amid ever increasing fuel costs. In the future, fuel costs are expected to stay high as new environmental regulations add to costs and investment requirements.

Supply & Demand

Tough competition, rising costs, but still robust cargo growth
The general market for Ro-Ro and passenger ferries in Europe is somewhat unchanged from 2004. The saga of passenger ferries versus low-cost airlines continues, with passenger ferry companies heightening their efforts to diversify themselves away from direct competition with their airborne adversary.

In 2005 though, the bottom lines of the passenger ferry and ro-ro cargo companies suffered additionally by fast increasing bunker costs. As competition among the ship operators is still fierce, they have found it difficult to increase ticket prices to compensate.

Particularly in the Baltic Sea, the competition has had its victims with noticeably lower profits for some companies. In the North Sea / English Channel, the increasing competition has on the other hand led to a swap over between competitors of ship capacity and routes to avoid a destructive rate war.

On the bright side, the inclusion of new member states to the EU continues to provide robust cargo and passenger growth across the Baltic Sea, although the routes that run along the shoreline continue to experience weak cargo growth as reduced administrative burdens on road traffic customs procedures has led to a move of cargo away from the sea and onto the roads.

Contracting & Ship Values

Healthy contracting, slightly higher secondhand prices
Despite rising newbuilding prices, 2005 turned out as the year with the highest number of newbuilding contracts being signed in more than 5 years.

The higher number of newbuilding contracts is particularly the result of an overall prevalent lack of suitable and modern ro-ro tonnage, which has led to increased charter costs for the few ships that eventually did become free for charter.

Because of the higher newbuilding cost and higher charter rates, secondhand prices of modern tonnage has risen slightly since 6 months ago, but the volatility remains subdued compared to other ship types.

Outlook

Cost pressure and a continual move to Ro-Ro cargo
Despite fuel costs already making a large dent in operating profits the ferry companies cannot expect much relief anytime soon. On top of already elevated fuel cost the shipping companies sailing in the Baltic Sea can as per May 2006 expect further fuel cost hikes and high investment requirements from new EU regulation commanding the ships to cut sulphur dioxide emissions significantly. By November 2007, the North Sea and parts of the English Channel can expect the regulation to extend to their waters as well.

Adding to the woes, the passenger ferry companies on the routes to and from Sweden may see their revenues decrease in 2006, as a proposal from the Swedish government to halve domestic taxation on alcohol may reduce the number of passengers that travel by ferry to buy tax-free liquor.

Instead, the operators may continue their trend of focusing on pure cargo Ro-Ro services, but less and less on the passenger carrying ferry business.

As a continued high pressure on the road network within Europe is expected to lead to more cargo being moved by sea, and if a combined EU effort succeeds in reducing port costs, short sea Ro-Ro shipping within EU waters may, however, in coming years experience continual robust demand growth ■

Offshore Support Vessels

Charter rates reached record levels as operators competed for vessels on the background of unusually high rig activity, prompting massive ordering and rising secondhand values. For 2006, the outlook remains optimistic as demand is expected to match supply.

Freight Rates

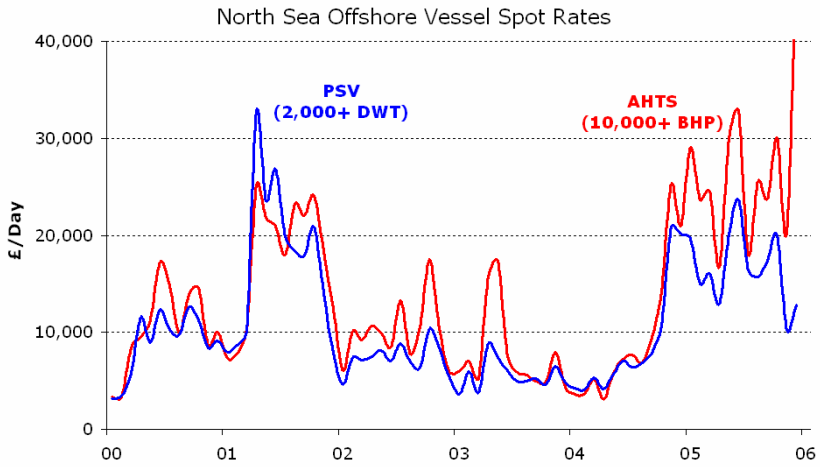
Charter rates on the rise all over the world
In the North Sea charter rates, although very volatile, stayed at very attractive levels all year. The market experienced short-lived drops in April due to unusually benign weather and in November due to lower than expected rig activity. However on both occasions the rates quickly picked up again and in December AHTS average monthly spot rates broke a new record with an average of GBP 48,000, according to Clarksons.

In the Gulf of Mexico (GoM) charter rates were already rising during the first half of 2005 due to increased rig activity. Then the GoM was struck by the hurricanes Katrina, Wilma and Rita and the extensive repair work required led to a surge in demand. Naturally this made charter rates rise even higher. However, the rates did not reach the same levels as in the North Sea.

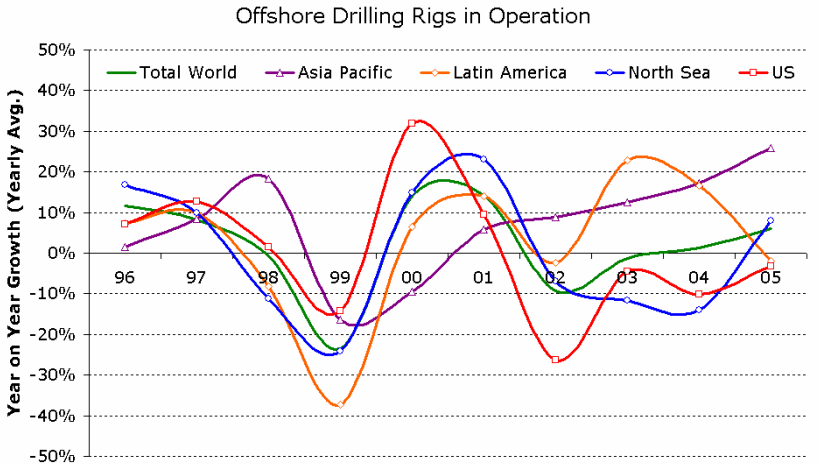
In other offshore drilling regions, demand and activity were also very healthy. Charter rates remained more stable although on a rising trend in most regions. Especially in the Asian pacific waters charter rates continued their upward climb as demand continued to show high growth and was able to absorb a considerable number of new deliveries.

Supply & Demand

Operators compete for vessels due to high E&P spending
With high expected oil demand, oil prices recently soaring above 60 $/barrel, and general consensus that oil prices are very unlikely to fall below 25 $/barrel in the future, the energy companies which



Source: Clarksons



Source: Baker Hughes Incorporated

explore for and produce oil and gas appear to finally have grown confident that even the relatively high-cost oilfields will turn a profit in future years. Consequently, the energy companies have boosted their Exploration & Production (E&P) budgets and many deepwater discoveries and marginal shallow water fields are now moving into development.

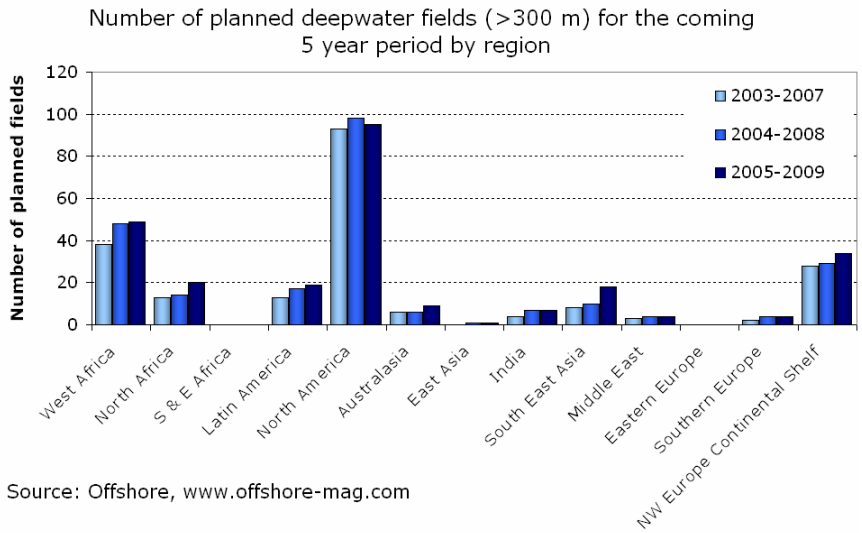
The increased confidence, not to mention balance sheets, was evident in the British 23rd licensing round of North Sea and Atlantic Margin licences, which during 2005 received the highest number of bids for offshore exploration blocks for more than 30 years.

Furthermore, the increased E&P spending has led to a worldwide increase in drilling activity and close to 100 % utilization of the world's drill ships, semi-submersibles and jackup rigs. As a consequence of this day rates for rigs have been on a steep incline.

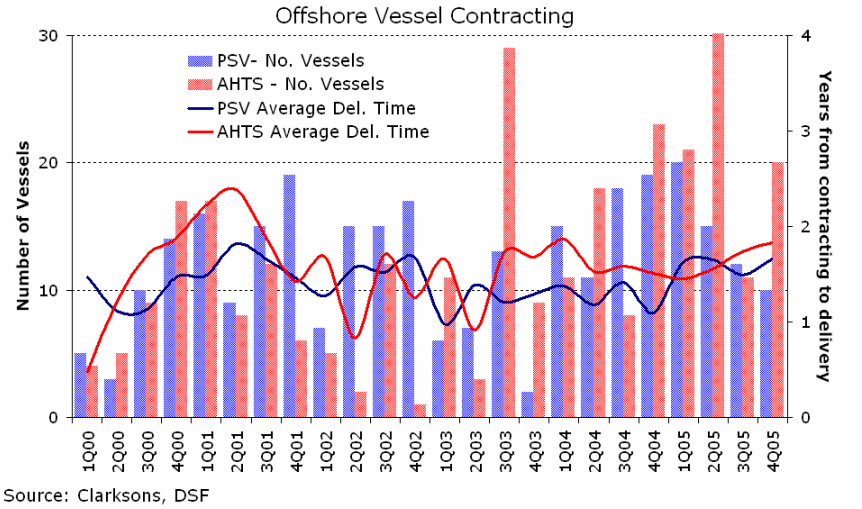
A higher number of rigs in operation is naturally followed by an increased demand for offshore support vessels and on top of this there was a considerable extra pull on the fleet due to the extensive survey and repair work following the hurricane wreckage in the GoM. Combine this with the high rig day rates which made any disruptions very expensive and rig operators and energy companies scrambled to acquire the necessary vessels for their drilling campaigns.

The large increase in rig utilization and day rates has led rig operators to remobilise cold stacked rigs and to put out a high number of orders for new rigs. As most of the ordered rigs are not expected to be delivered before 2007/2008, there are still concerns that there might be too few rigs in the short to medium term to provide work for the ever growing offshore vessel fleet.

However, the fact that the market was able to absorb the delivery of 61 AHTSs and 45 PSVs in 2005 without declining rates makes these concerns less pronounced. Nevertheless the possible lack of available offshore platforms may act as a momentary restriction on the demand for offshore support vessels in the medium term.



Source: Offshore, www.offshore-mag.com



Source: Clarksons, DSF

CONTRACTING & SHIP VALUES

Massive ordering and rising secondhand values
According to Clarksons figures, 83 AHTSs and 57 PSVs were ordered during 2005. This is the highest number of AHTSs ever contracted but a slight fall for PSVs relative to 2004. In total the 140 vessels presage a massive capacity increase for the offshore fleet in the future.

Despite healthy looking demand, the current orderbook appears rather large especially considering the high number of vessels that were already delivered in 2005. Consequently, the delivery of the ships may cause a negative pressure on charter rates.

The large increases in charter rates and longer delivery time for new vessels have led to a 20-30% increase in secondhand values compared to the average market values at the end of 2004.

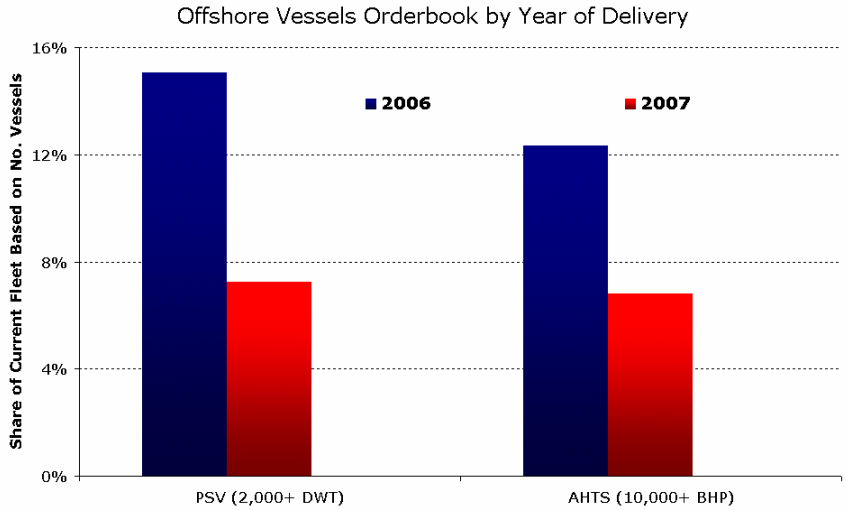
OUTLOOK

High charter rates expected to continue in 2006
Overall, 2005 has been a very profitable year for offshore support vessel owners and with soaring oil prices as well as E&P budgets, the outlook for 2006 appears quite optimistic.

The Norwegian and UK governments have put up a large number of blocks for their licensing rounds in 2005 and the interest was extraordinarily high. Furthermore by reopening the Barents Sea the basis for a sustained growth in activity in the North Sea and Barents Sea is present.

However the recent rise in the supplementary corporation tax on oil companies in the UK may hit investment as the tax rise may make certain projects unprofitable. Shell already announced it would cut its UK E&P program, while several other energy companies announced extraordinary budget reviews.

In the GoM, high demand due to full rig utilization and growth in deep water drilling may get a boost from additional demand from ongoing repair work. This work will probably not be finished before the middle or late 2nd quarter of 2006.



In other offshore exploration and production regions, the demand for offshore supply vessels is also growing strongly particularly led by the high prices of crude oil and by the strong growth in the number of LNG fields. Last but not least subsea spending is also expected to grow significantly especially in West Africa.

Thus most factors indicate a very good year for vessel owners. Risk factors are the recent tax rise in the UK and the large orderbook. While the U.K tax rise may reduce investments, the impact is not expected to be extensive as investments can be switched to other areas, and other North Sea regions still see high activity.

While the high orderbook is concerning, the recent remobilization of cold stacked rigs and the extra demand from repairs in GoM can probably match offshore vessel deliveries expected in 2006. From 2007, rig deliveries are expected to be relatively high providing the support vessels with incremental demand.

In conclusion, while we do not expect charter rates to soar even higher in 2006, they should continue at the high levels from last year and with very high levels of volatility ■

Glossary

Aframax: Crude oil tanker or product tanker too large to pass through the Panama Canal and below 120,000 dwt.

AHTS: Anchor Handling Tug Supply. Offshore vessel used for jobs such as the relocation of oil rigs and anchors of the oil rigs.

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 at 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, etc.

Bunker: Fuel for vessels.

Capesize: Dry bulk carrier of more than approximately 80,000 dwt; too large to pass through the Panama Canal.

Cbm: 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.

Clean products: Refers to light, refined oil products such as jet fuel, gasoline and naphtha.

CoA: Contract of Affreightment. Contract between shipping company and shipper concerning the freight of a predetermined volume of goods within a given period of time and/or at given intervals.

Dirty products: Refers to heavy oils such as crude oil or refined oil products such as fuel oil, diesel oil or bunker oil.

Dwt: Dead Weight Tons. Indication of a vessel's cargo carrying capacity (including bunkers, ballast, water and food supplies, crew and passengers).

Feeder: Small container carrier.

FPSO: Floating Production Storage Offloading unit. Vessel used in the offshore industry to process and store oil from an underwater (sub-sea) installation.

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.

Gt: Gross Tons. Unit of 100 cubic feet or 2.831 cubic meters, used in arriving at the calculation of gross tonnage.

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.

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.

Chemical tanker: Tanker with coated or stainless steel tanks (IMO I-III).

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 50,000—80,000 dwt.
LR2, product tanker:	Long Range 2. Product tanker too large to pass through the Panama Canal and larger than approximately 80,000 dwt.
Medium, tanker (MR):	Medium Range. Product tanker of between 25,000 and 50,000 dwt.
Multi-Purpose:	Dry bulk carrier with multiple applications, mainly as a feeder vessel or for special cargo.
Nautical Mile:	Distance unit measure of 1,582 meters, or 6,076.12 ft.
Offshore vessel:	Vessel serving the offshore oil industry.
OPEC:	Organisation of Petroleum Exporting Countries.
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—5,000 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 50,000—80,000 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—80,000 dwt.
PCC:	Pure Car Carrier. Car carrier built exclusively to transport passenger cars.
Post-Panamax:	Container vessel of approximately 4,000+ 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.
Ro-Ro:	Roll On – Roll Off. Common description of vessels on which the cargo is rolled on board and ashore.
Suezmax:	Crude oil tanker with the maximum dimensions for passing through the Suez Canal (approximately 120,000—200,000 dwt.).
TCE:	Time Charter Equivalent.
Teu:	Twenty Feet 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 the 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".
ULCC:	Ultra Large Crude Carrier. Crude oil tanker above 320,000 dwt.
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 capacity above 60,000 cbm.
WTI:	West Texas Intermediate. Oil price benchmark in the USA.

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