



# POTEN TANKER OPINION



## Demolition Derby

### Will scrapping hold the key to the tanker market recovery?

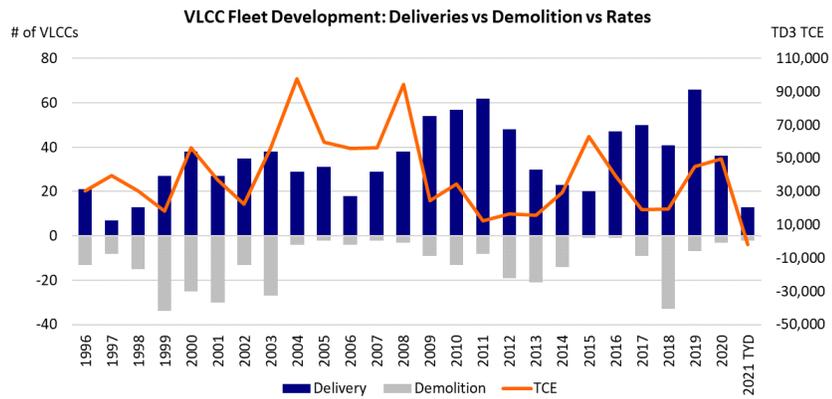
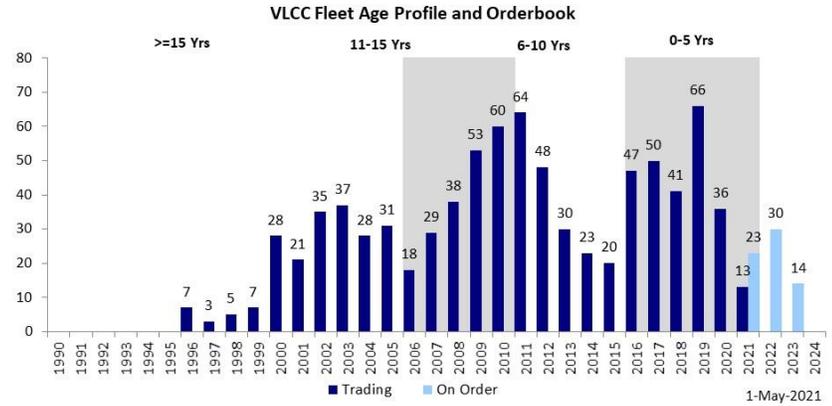
The tanker market has been in the doldrums since the summer of 2020. There are simply too many ships available for the limited number of cargoes that need to be shipped. While the main cause of the current crisis in the tanker market is unique, the crisis itself is not. The tanker market is cyclical, and we have seen periods of depressed rates many times in the past. While we are still dealing with the Covid-19 pandemic in many parts of the world, there are a growing number of areas where oil demand seems to have turned the corner (China, the United States and parts of Europe). However, this regional demand recovery remains tentative. It has not led to a material increase in seaborne oil flows and by itself will not drive tanker rates higher in the near future. For that to happen, we need adjustments to tanker supply as well. In the short-term, owners have a few levers that they can pull: slow steaming (effective, but temporary); delay scheduled deliveries and increase demolition. This week our focus will be on demolition.

Vessels have a limited lifespan and when they are commercially obsolete, they are headed for demolition. However, the timing of a vessels' commercial obsolescence is unpredictable. In good markets, when rates are high, owners are incentivized to keep their vessels in operation. They will spend money on maintenance and take their vessels through special surveys to extend their operating lives. In good markets, therefore, the average scrapping age increases. In bad markets, the opposite happens. Higher maintenance cost and fuel consumption make older vessels less competitive and low earnings forces owners to be very careful with their spending. In such a scenario, one would expect scrapping to ramp up quickly.

So far this year, demolition has not picked up significantly, despite historically low earnings, in particular for the large crude oil tankers. We will take a closer look at the VLCCs.

Starting with the age profile, some 71 VLCCs (8.5% of the fleet) will be 20 years old or older this year. Another 149 ships (17.8% of the VLCC fleet) are between 15 and 20 years old. This group of 220 vessels are the candidates to be scrapped in the coming years because some oil companies don't charter vessels older than 15 years, limiting their employment opportunities. This could push more vessels to the scrap yards. However, this has not happened so far. We suspect that there are a number of reasons for the dearth of demolition in the VLCC segment.

The first half of 2020 was highly profitable for tanker owners and despite their recent losses, many companies still have ample cash reserves and are not forced to scrap their vessels. This will change if the market does not improve. A second factor is the relatively healthy secondhand market.



Older vessels fetch good prices in the sale & purchase market and are sold for further trading rather than scrapped. A growing number of these vessels end up in the so-called "Rogue Armada", a group of vessels involved in the illicit transfer of Iranian crude oil and/or petroleum products. The U.S. lobby group United Against Nuclear Iran (UANI) has identified 114 vessels engaged in this trade, of which 23 are VLCCs. The growth of this fleet coincides with a 25% growth in Iranian crude oil production and exports since late 2020. These vessels earn premium rates by skirting U.S. sanctions against Iran. If the U.S. and Iran reach an agreement and sanctions are lifted, these "rogue" vessels will lose their raison d'être and could be prime scrapping candidates.

At the moment recycling capacity is restricted because scrapyards in India have ceased cutting operations due to the Covid-19 outbreak in the country. While scrap prices are high (reaching over \$500/ldt), that has seldom been a key driver for scrapping behavior.

Finally, scrapping behavior is heavily influenced by the market outlook of the shipowner. Despite the current dismal rate environment, tanker owners are generally bullish about the medium-term prospects as global oil demand recovers post pandemic. They do not want to miss the boat by scrapping their vessels too early.

So, in conclusion, shipowners have been reluctant to scrap their vessels so far this year for a variety of reasons, while external factors have played a role as well. What will happen with the Iran Nuclear Deal could be one of the most important wildcards in the tanker market in the coming months.