

## **Product tankers: market review**

### **Mike Corkhill reviews market developments in the product tankers sector, with newbuilds of medium sized chemical tankers, able to accommodate a range of simple, commodity petrochemicals and refined petroleum products**

One year ago product tanker owners believed that the unexpected freight market boom was too good to last but today, that fatalism has given way to something bordering on optimism.

Product tanker owners are enjoying their current purple patch, buoyed by the same positive factors that are driving the tanker market in general - the strengthening US economy and burgeoning growth in China, underpinning the demand for energy.

#### **Shipbuilding**

With the charterer preference for modern ships now easily discernible in the tanker fixture lists, shipyard orderbooks are full-to-bursting.

Shipowners are struggling to provide the necessary tonnage in the face of the new European requirements calling for heavy oils to be carried in double hulls and single-hull tankers to be phased out sooner rather than later.

Newbuild prices are being driven upwards, as tanker owners fight for dwindling berth space at yards also trying to meet the escalating demand for container ships, bulk carriers and gas tankers.

If the returns enjoyed by product tanker operators in 2003 are anything to go by, meeting the increasing cost of a newbuilding should not be a problem.

The buoyancy in the tanker market last year was reflected not only in rising freight rates but also in the strong upward movement of tanker company share prices.

While product tanker owners did not achieve quite the same shares boost as that logged by some crude oil tanker operators, the banks are still queuing up to meet their capital requirements.

#### **Shipyard squeeze**

Few yards have benefited from the surge in product tanker orders as much as Hyundai Mipo Dockyard (HMD) and STX Shipbuilding in South Korea.

Both yards have specialised in the construction of 35-37,000 dwt (Handysize) product tankers, although 45,000 dwt (Handymax) tankers now also feature quite prominently in the orderbooks of both yards.

With shipowners seeking to provide their newbuildings with as much cargo-handling flexibility as possible, the so-called medium range (MR) product tankers of these sizes are invariably now also built as IMO 3 chemical tankers, able to accommodate a range of simple, commodity petrochemicals as well as refined petroleum products. Hyundai now has a total orderbook of 132 ships worth \$4bn, of which over 100 are product tankers. The pace of production is increasing rapidly, as evidenced by the fact that 34 of the ships were delivered in 2003.

Of the 100 ships that HMD has now completed since commencing newbuilding work in 1996, two-thirds have been product tankers. In January 2004 alone HMD secured orders for 22 ships worth \$750 million, equal to 44 per cent of the \$1.7 billion target budgeted by the yard for 2004. A total of 16 of these ships are MR product/chemical tankers. HMD expects to complete 40 vessels in each of the next two years.

#### **Large product tankers**

Larger product tankers figure much more strongly amongst HMD ships on order than those delivered.

Of the product tankers built to date at the Korean yard, all but a handful have been Handysize ships. In contrast, about 40 per cent of the product tankers on order are of the larger Handymax size.

The trend towards bigger product tankers is not limited to the HMD yard. It indicates a growing preference by shipowners worldwide for the flexibility offered by the greater cargo-carrying capacity even though, in general, the standard parcel sizes of clean petroleum products loaded at oil refineries have not noticeably increased. HMD is continuing to add new designs to its product tanker portfolio, including up to Panamax size. "We are now developing and marketing designs for product carriers of 19K, 27K, 32K, 35K, 37K, 47K, 53K and 70K in size," reports Seong W Jae of HMD.

The growing popularity of larger-sized tonnage with improved cargo-handling flexibility is also reflected in the fact that two-thirds of the Panamax tankers currently under construction worldwide are being built with coated cargo tanks and deepwell pumps. These features will enable them to participate in both the clean and dirty oil trades.

### **STX Shipbuilding**

STX Shipbuilding, formerly the Donghae yard, is stretched to capacity.

Although the yard has recently made breakthroughs in the container ship and LPG carrier sectors, over 75 per cent of the 60-plus ship orderbook is comprised of product tankers.

Valued at over \$2 billion, the STX orderbook is the 8th largest amongst shipbuilders worldwide.

Approximately 60 per cent of the tanker orderbook comprises Handymax product tankers of 46,000 dwt, 25 per cent Panamax tankers of 71,000 dwt and 15 per cent Handysize tankers of 35-37,000 dwt.

The tankers are able to carry simple chemicals as well as clean petroleum products. Although the yard has only one building berth, it is currently succeeding in continuing to improve its production performance.

Last year 20 ships were completed, while 24 deliveries are planned for this year and 30 in 2005.

However, due to a lack of available adjacent land, STX is approaching its limits.

Senior management is now giving thought to offers of land by two provincial governments in China for the purpose of setting up a second shipyard in the longer term.

A decision may be facilitated by the yard's changing ownership structure. In summer 2003 a fund managed by HSBC Private Equity Asia Ltd acquired a 15 per cent stake in the company for \$33.5 million, making it the first foreign investor in STX.

### **Pooled fleets**

The deep-sea product tanker trades are basically comprised of balancing movements, with ships supplying regional shortfalls of refined products.

The trades are directly impacted by the vagaries of global politics, economic performance, oil supply and demand fluctuations and the fortunes of alternative sources of energy.

Shipowners face a considerable challenge in providing the tonnage required to meet the needs of this volatile marketplace. One solution that has steadily gained ground over the years is the concept of pooled fleets. Commercial management of ships owned by a variety of owners is placed in the hands of a single operator.

The aim is to optimise fleet logistics, control costs and accommodate the full range of charterer requirements.

The pioneer of the pooling concept in the product tanker sector, Torm of Denmark, for example, currently manages three pools totalling 60 vessels owned by 14 different owners.

The participants are continuing to support the pooling approach with investments in newbuildings, to the extent that the aggregate fleet could be touching 100 ships in 2005.

Maersk Tankers is another Danish shipowner committed to pools, not least in the product tanker sector. The company manages a large pool of Handysize product tankers in the 27-37,000 dwt range, called the Handytankers Pool, and co-manages a pool of 110,000 dwt coated Aframaxes, also known as long range 2 (LR2) tankers. Product tanker pools are in the vanguard of providing modern, flexible tonnage to the market. In the wake of Erika and Prestige, the pools have benefited from the strong demand for this type of ship.

Maersk Tankers is making a full commitment to its two pools in terms of new ships. Over the past 12 months five new 35,000 dwt Handysize ships and one LR2 product tanker have been delivered to the shipowner.

In addition, the company's current newbuilding programme will boost the Maersk-owned fleet to more than 20 Handysize and 10 coated LR2s by 2006. The Danish shipowner is being provided with its newbuilding by Chinese shipyards, i.e.

Guangzhou Shipyard International and Dalian Shipyard are constructing 35,000 tonners, while the 110,000 dwt LR2s are being built at the Dalian New Shipyard.

D'Amico Tankers, Seaarland and Motia, other partners in the Handytankers Pool, have also contributed Handysize tankers to the fleet in recent years, boosting it to just under 50 vessels and making it the largest product tanker pool in the world. It is also a fleet with a very low average age.

### **Market prospects**

The tanker markets, including the product trades, are notoriously cyclical, with bust invariably following boom.

Because the boom periods always encourage large newbuilding programmes, there is an inevitability to the market collapses.

On this occasion the portents are especially gloomy, at least on paper. Over the next 30 months approximately 300 new Handysize and Handymax product tankers are due for delivery, equivalent to about 30 per cent of the existing medium range fleet in tonnage terms.

However, despite this full orderbook and the tradition of short-lived market booms giving way to plummeting freight rates, there is an underlying sense of optimism amongst product tanker owners that on this occasion the good times could last a little longer.

The high price of alternative sources of energy, most notably natural gas, means that the demand for gas oil as a power plant fuel and naphtha as a petrochemical feedstock continues to run high in the industrialised nations.

Furthermore, there is no sign of the Chinese economy cooling. China is now a net importer of crude oil and refined products to the extent of 2m barrels per day and this volume is increasing rapidly. Most market watchers do not expect to see a slowing of Chinese economic growth before the Beijing Olympics in 2008.

Such is the current scenario that there is a distinct possibility that not only will the product tanker sector absorb the current record orderbook without suffering the usual nose-diving freight rates, but also that it will need to maintain a healthy level of new ship ordering for some time yet.