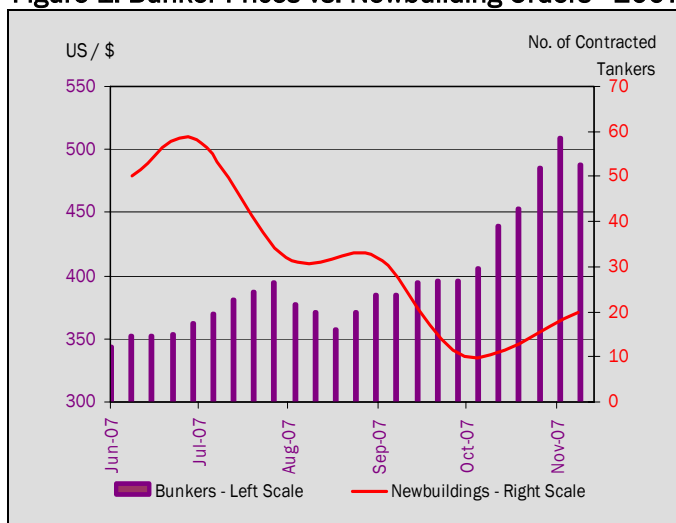




One year ago we published a monthly note in which we discussed decreasing bunker prices and their effect on tanker earnings. At the time, the price of IFO 380 decreased from US \$ 330 / ton to US \$290 / ton driving significant increases in spot voyage earnings. Presently, bunker prices are reaching US \$520 / ton, or US \$100 / ton increase from the previous month. This increase translates into substantially higher voyage costs across the five tanker sectors, coupled with decreasing investment activity in the marketplace.

The price of bunker fuel has been historically linked to the price of crude oil. On November 7, 2007 crude oil rose to above US \$98 a barrel, and in the same week bunker prices rose to their historical highs (Figure 1). Besides their linkage to the price of crude oil, bunker prices also have their own short term dynamics that cause price fluctuation on a port to port basis. In order to avoid regional price variations, we calculated an average bunker price from major world bunkering ports, and used the result in our calculations.

**Figure 1: Bunker Prices vs. Newbuilding Orders - 2007**



The cost of bunker fuel is one of main elements in the voyage cost calculation. Thus, its fluctuation directly impacts the vessel's earnings in the spot market. During the October, 2007 surge in bunker prices, newbuilding orders decreased sharply (Figure 1). We believe the reason

for such behavior lies among fundamental elements of a newbuilding project, where the price of bunkers plays a role. For instance, our standard calculation for contracting a newbuilding Aframax size tanker, priced at US \$72 million in today's market, requires a time charter equivalent of US \$ 31,800 per day to cover capital and operating costs (65% LTV financed and 7 year tenor). Also, Table 1 illustrates that an additional US \$ 4,200 per day is needed in the Aframax trades (in today's market) to compensate for the US \$100 dollar increase in bunker prices. From the project's financing perspective, the increasing price of bunker fuel causes a wider gap between the needed earnings and actual market performance. That gap creates a negative sentiment towards investing into new projects. Therefore, the reduced earnings result in decreased activity in respect to newbuilding orders.

**Table 1: Averaged TCE Earnings**

US \$	October 10th, 2007	November 10th, 2007	Loss in TCE Earnings
380 cst / ton	400	500	-
VLCC:	21,000	12,300	8,700
Suezmax:	33,200	27,700	5,500
Aframax:	22,400	18,200	4,200
Panamax:	18,300	14,700	3,600
MR:	11,700	8,800	2,900

\* Average bunker prices for world major bunkering ports.

Table 1 illustrates the difference in Time Charter Equivalent earnings, over the last month, due to a US \$100 increase in bunker prices. Such a high increase causes almost 50% cut in earnings on the VLCC trades. For instance, TD1 tanker route AG / USG produces a US \$4,200 per day in TCE earnings at WS 45 rate (October, 2007 average) and US \$500 / ton bunker price. The same route produces US \$13,021 in daily TCE earnings at WS 45 rate and US \$400 / ton bunkers.

As illustrated in the foregoing, earning levels in the tanker industry are dramatically affected by increased prices of bunkers. In this environment of elevated bunker costs, owners are trying to use different operating techniques, such as bunker hedging, to reduce their exposure to higher bunker prices. Still, the loss in earnings remains substantial.