Pareto Project Finance AS

Pareto World Wide Shipping AS

4th quarter report 2011

Link: www.paretoprojectfinance.no/avdelinger/forvaltning/shippingfond

Executive Summary

NAV NOK 161/share

Subsequent to the merger with its sister company PWWS II and its underlying feeder companies, PWWS is now a company with net asset value of around NOK 1.3bn (NOK 161/share), one share class and 4,000 shareholders. With a contract backlog worth NOK 2.1bn and a significant overweight in offshore oil services, the company is well placed to weather the turbulent marked conditions at present.

Market Development

The contagious European debt crisis has made lending more expensive and forced the global shipping markets to continue its negative spiral. The global offshore oil services market continues to look healthy, but a lack of funding is presently reducing the growth rate and is limiting the potential to make transactions. On the other hand, this also creates opportunities for investments.

The Offshore Market

The underlying growth continues to be strong with the oil industry's investment levels for 2012 budgeted 10% up on 2011. Fundamentals are therefore good, although more restrictive banks, higher bond yields and a weaker equity pricing are having a dampening effect on activity growth, the ability to secure adequate project leverage and on transaction volumes.

The drilling and subsea markets appear to be in solid shape, with high activity growth in the coming years and a solid rise in asset prices already behind us. At the other end of the spectrum we find the seismic and supply vessel markets, which are still plagued by a degree of excess capacity, which will take another year to work off.

«The manager's focus on offshore oil services is paying dividends in a period with difficult financial markets»

The Shipping Market

Within shipping, the markets for commodity shipping (tankers and drybulk) continue their poor performance along with container shipping, while things are better within industrial shipping segments and outright solid within gas shipping, particularly LNG.

The structural overcapacity in the tanker and drybulk segments are being exacerbated by continued high newbuild orderbooks. The shipping lenders are toughening up, forcing owners to sell vessels. As a result, vessel values are on a negative spiral, which will take another few years to turn. Within industrial shipping segments, capacity growth is moderate, while demand is growing, implying improving utilization and dayrates.

Portfolio

PWWS has kept true to its strategy to focus on long term contracts and to seek exposure towards the global energy markets, rather than shipping.

PWWS now has 68% of its portfolio within offshore oil services and 91% of its portfolio secured on long term charters. The exposure towards shipping is primarily focused on industrial shipping segments, and 17% is towards LPG and chemicals transportation, which are reasonably healthy these days.

We will continue to maintain this exposure in the foreseeable future in an effort to preserve both capital and the ability to make dividend pay-outs to the shareholders.

We will continue to be opportunistic in terms of new investments and will primarily seek to exploit opportunities arising from forced, financially weak sellers, which present buyers with good underlying cash flow yields and asset appreciation potential, particularly when the projects are placed in markets with sound fundamentals. We've already seen a few such deals in 2011 and expect more during 2012.

Net Asset Value Development

Tougher banks and increased financing needs took its toll on the shipping values towards the end of the year, while offshore oil services and a strengthening USD contributed positively. The manager is quietly comfortable that the solid portfolio will be able to deliver good returns going forward. The portfolio has been de-risked and refined to this extent.

NAV development

The manager is pleased to report a positive development, despite very difficult financial markets and depressed shipping markets. NAV as of 31.12.2011 was NOK 161, up 3.9% on the previous NAV (30.09.2011) and up 2.5% for the year (IRR). The next NAV will be reported in the Q2'12 report.

NAV is up 3.5% since inception in 2006. This is an acceptable return considering that we have been through two financial crises and a near unprecedented melt down in the global shipping markets. In comparison, shipping stocks on the Oslo Stock Exchange are down 43% in the same period, while offshore oil service stocks are up 7%. The average of these two segments is a 19% negative return. Hence, on a relative basis, the returns are acceptable and are owed to an overweight on offshore oil services and a focus on long term contracts, rather than speculative asset plays.

As can be seen in the graph below, the estimated values of the charters, charter free values and cash in the projects constitute NOK 321 per share in PWWS. The debt in the projects make up NOK 191 per share, leaving a net position in the projects of NOK 131 per share. Cash, tax positions and cost provisions at the holding company net a positive NOK 31 and consequently a NAV per share of NOK 161.

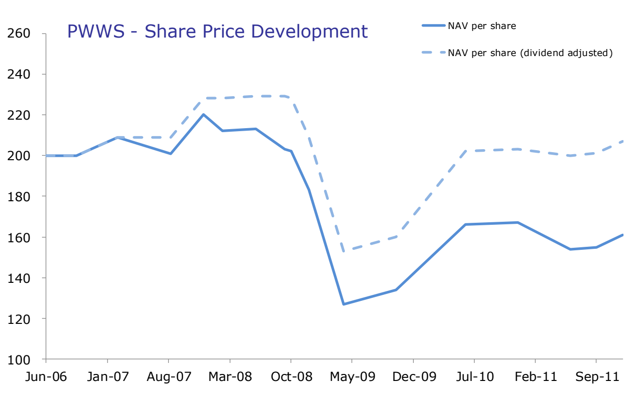
Direct yield

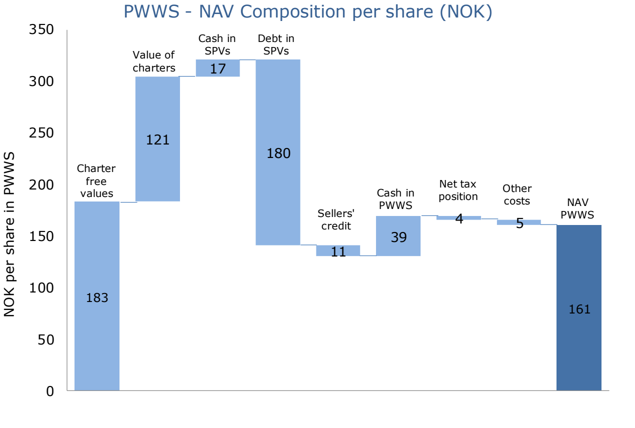
PWWS strives to make annual payments to its shareholders and such may come in the form of ordinary dividends, as well as repayment of capital. The last distribution was done in July 2011 as a NOK 10 per share repayment of capital. In total, PWWS has paid out NOK 286m to its shareholders since inception, which equals 23% of par value. PWWS expects the annual payments to investors to increase going forward.

	Last 3 mths	Last 6 mths	Last 12 mths	Last 24 mths	Since inception
PWWS	**3.9%**	**4.3%**	**2.4%**	**35.1%**	**3.5%**
Oslo Stock Exchange	10.5%	-8.6%	-12.5%	3.6%	0.8%
Shipping Index *	7.3%	-15.3%	-30.7%	-13.4%	-45.0%
Offshore Index **	18.2%	4.3%	3.6%	15.5%	18.2%

* Based on OSE203030 Marine

** Based on OSE101010 Energy Equipment & Service





Portfolio News

PWWS is invested in a broad range of shipping and offshore projects, which implies a significant diversification across different markets. This section provides an update on the quarter's most important newsflow related to the underlying investments and the portfolio.

Merger with PWWS II and the four feeder companies

The shareholders of the six involved companies approved the merger at EGMs on the 22nd and 23rd November 2011. The merger is expected to be effective primo/medio February 2012 after expiry of creditor notice periods. Subsequently, investors will own shares directly in PWWS.

The purpose of the merger is to create a larger and more powerful company with a simpler and more cost effective structure. The benefits are several:

- More efficient portfolio management
- Reduced costs for investors
- More efficient pricing of the company's shares
- More efficient use of capital buffers and provisions

The enclosed table shows the exchange ratio vs PWWS for the companies involved in the merger and the resulting NAV as of 31.12.2011 based on the NAV for PWWS combined.

B-Gas

The transaction was completed in November 2011 and the fleet is now trading under the new name of B-Gas. The company has 76% contract coverage for 2012 for 9 its semi-refrigerated vessels and 64% for its 5 pressurised vessels. The fleet is generally trading LPG products within Europe for oil companies, refineries, trading companies and chemical companies. The LPG market is in good shape with a very low orderbook.

Deep Sea Bergen Invest AS/KS AS Bergen Drillpart

DSBI repaid its USD 26.5m bond loan in December through a combination of cash at hand and a new bank loan of USD 10m from Pareto Bank. The bank loan has a term of 4.5 years, equal to the fixed contract term with Statoil on the rig. It is expected that DSBI will be able to make cash distributions to its shareholders from 2013 and onwards. KSASBD is debt free and makes semi-annual cash distributions with the same underlying asset exposure as DSBI.

Neptune Subsea IS

Both ships were delivered from the shipyard in Q4'11 according to revised terms with the shipyard. At the same time, Neptune Subsea entered into 5-year bareboat contracts for both vessels with Reef Subsea, a company owned by Hitec Vision Asset Solutions and Rieber Shipping. As part of the deal, Reef is to purchase a 25% stake in Neptune Subsea. The transactions are expected to close in Q1'12. As a result, this high-risk newbuilding project is now in the process of being transformed into a long-term contract project in a strong and growing subsea market.

Brøvig Stainless II DIS

Both ships have been delivered and have started 5-year bareboat contracts with Stolt Nielsen, which also has purchase options on both at the expiry of the contracts. This is expected to yield a positive return for investors. The alternative was to sell the vessels in a depressed shipping market, which would have resulted in a significant loss on the project.

Parbarge IS

African Offshore Services has taken over as charterer for the two barges, which continue on the same underlying contracts. The contract terms are slightly improved. The sellers' credit from Marine Subsea has been cancelled as a result of its bankruptcy, which further improves returns for investors in the project. Subsequent to an extraordinary debt repayment, this project is expected to produce significant cash distributions from 2012 and onwards.

MEJU

The jack-up was delivered from the yard in Q4'11 and a contract has been signed to sell the rig to PEMSA, a Mexican rig contractor at an undisclosed price. The transaction is expected to close in February.

	NAV 31-Dec-11	Last trade to date*	Last trade 31-Dec-11**	Tax value 31-Dec-11	Exch. ratio merger	Accumulated dividend
PWWS	161	126	110	73,58	1,0000	46,03
PWWS II	164	129	112	128,30	1,0192	14,00
PSK	76	60	52	36,21	0,4754	21,40
PSK II	73	58	50	59,01	0,4562	9,90
PPN SI	73	58	50	35,18	0,4574	17,95
OPT SI	74	58	51	35,54	0,4610	17,57

*Basis PSK NOK 60 on 27-Jan-12 **Basis PSK II NOK 50 on 21-Dec-11 ***Absolute since first equity infu

Portfolio News (continued)

Singapore Tankers

The company has agreed to revised terms with the charterer. In return, we have obtained better security for the charterer's purchase obligations at the end of the charterparty. The uncalled capital has also been increased at the request of the lenders to provide a buffer for potential future tax liabilities. Overall, this project has had a negative development during the year, but now looks to be past the worst.

Ross Handy II

This is the only dry bulk project in the portfolio. The final vessel in this project is now in the process of being scrapped and the project is expected to close during 2012. Subsequently, PWWS will have no exposure to dry bulk shipping. Despite the scrapping, this project has generated a good return for PWWS.

PSV Invest I

The first vessel was delivered in November 2011 and embarked on a 6-year contract with ConocoPhillips in Norway. The second vessel will deliver in March 2012 and will also go to ConocoPhillips on equal terms.

North Sea PSV

Financing has been secured to take delivery of the vessel, albeit at lower leverage than assumed, which has resulted in additional funding requirements for the equity holders. The vessel will deliver in February 2012 and has already secured its first contract in the North Sea spot market at a healthy day rate.

Volatile US dollar

Roughly 66% of NAV is exposed to the USD. The strengthening USD towards the end of the year had a positive effect on the reported NAV in NOK.

New investments

The Board and the Manager are actively seeking to optimize the portfolio and are particularly focusing on segments where the outlook is strong and where prices are impacted by financially distressed owners.

PWWS has invested NOK 54m in Q4'11 in the following two projects:

Offshore Accommodation

The project has bought three accommodation barges from Marine Subsea, which went belly-up in 2011. The barges are leased out on 10-year bare-boat charters to African Offshore Services at a competitive equity return. The barges have strong underlying contracts with major oil companies in West Africa. PWWS has a 15% stake.

Atlantic Gas

PWWS has a 30% stake in this project which has bought a 2002-built MGC (medium gas carrier) from GeoGas in a 2-year sale/lease-back deal. The LPG market is currently strong, with a promising demand outlook and a minimal orderbook. The company will be looking to trade or sell the vessel at the end of the charter party.

There have also been some follow up investments in existing projects, but these are more marginal.

Sale of projects

During Q4'11, PWWS sold its stake in Partankers IV for NOK 46m to the charterer and exited the VLCC segment completely. Due to the charter party, PWWS was able to obtain a vessel price roughly double that of the value of a similar, charter free vessel. Hence, despite a mark-down compared to the most recent valuation, this project generated double digit returns for PWWS while tanker values fell off a cliff. Subsequently, PWWS has no exposure to the crude tanker market.

Payments from projects

During Q4'11, PWWS received NOK 31m in cash distributions from projects (ex Partankers IV). During 2011 as a whole, PWWS received NOK 60m in payments from projects (ex Partankers IV). For 2012, the Manager expects a significant increase in cash distributions from projects.

This Quarter's Investment Review: B-Gas Ltd

B-Gas Ltd consists of a fleet of 9 semi-refrigerated and 5 pressurised LPG vessels. The fleet, including a marketing organisation, was bought from Camillo Eitzen in November 2011. The ambition is to develop the company further with various means of an exit possible.

As a result of its financial distress, Camillo Eitzen was forced to sell its fleet of small LPG vessels. B-Gas was set up to purchase this fleet, including its marketing organisation, which has a strong presence in the European market for marine LPG trade.

In the transaction, PWWS (39% stake) teamed up with Bergshav Management AS (51%) and Lorentzen Skibs AS (11%). The transaction closed in November 2011 and the fleet has since operated under its new name of B-Gas. The results so far have been satisfactory.

B-Gas trades in the European market for LPG, typically on longer volume contracts with major oil companies, refiners, trading companies and petrochemical companies. The small vessels are well suited to act as a "floating pipeline" to secure offtake of LPG, which is an associated product from petroleum production. Main clients are Statoil, ConocoPhillips, Repsol, Total, Shell, Bp, Preem, Vitol, among others.

The fleet of 9 SR vessels are relatively old, but in good shape and probably have another 10 years of trading life left. The fleet of 5 PR vessels are leased in on T/C contracts with purchase options, which will be considered if and when they are attractive.

The ambition is to use the solid cash flow from the fleet to invest in fleet renewal and growth to build a stronger franchise in the European LPG market, which is a well consolidated market with few competitors.

Overall, the LPG market is enjoying improved rates in line with increased volumes of petroleum production and a very low fleet growth. The orderbook for small LPG vessels is only 3% of the existing fleet, which also is old and in need for replenishment. The outlook for oil and natural gas production is good, meaning that there will be more LPG product to transport in the coming years.

Project start:	November 2011
Segment:	LPG
Contract:	Coa / TC 1-2 years
Charterer:	Various
Number of vessels:	9 + 5 (option)
Paid in equity:	NOK 54.0m
Last valuation:	NOK 58.5m

Contract Coverage	2011	2012	2013
Semi-Ref	94%	72%	19%
Pressurized	97%	64%	22%

Portfolio

The portfolio is robust with 91% contract coverage, of which 71% is on bareboat contracts with no technical risk. The portfolio is well diversified with 68% invested in offshore oil services and 32% within shipping. The largest segments are supply vessels, offshore drilling rigs, subsea vessels and product tankers. The secured contract backlog is NOK 2.1bn with an average contract length of 4.5 years.

Investments and capital

PWWS' portfolio consists of 28 projects that own stakes in 72 units. Its cash position as of 31.12.2011 was NOK 320m, of which around NOK 55m was reserved for follow-up investments in existing projects. The remaining capital will be used to make distributions to the shareholders, for potential additional capital requirements in existing projects, as well as to exploit new opportunities that may arise.

PWWS has a life cycle that expires 30. June 2014. It is expected that distributions to shareholders will increase towards that date. PWWS plans to provide shareholders with a full exit possibility at that time.

PWWS' portfolio is constantly evaluated to maximise returns for shareholders, while keeping risks at an adequate level. At present, the contract coverage is 91% and has a gross revenue value of NOK 2.1bn for PWWS. The average contract length is 4.5 years.

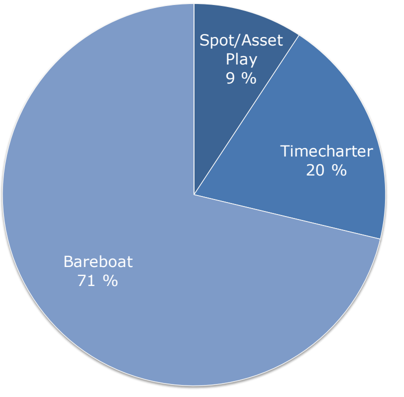
The backlog is spread across several large and solid counterparts and has an even exposure between offshore oil services, supply vessels and industrial shipping. Contracted revenues per year is also stable and is more than sufficient to cover all debt and operating cost commitments through 2014.

Overall, PWWS share of revenues and asset sales in the projects is expected to yield around NOK 4.8bn of income, while total debt and cost commitments amount to roughly NOK 2.8bn.

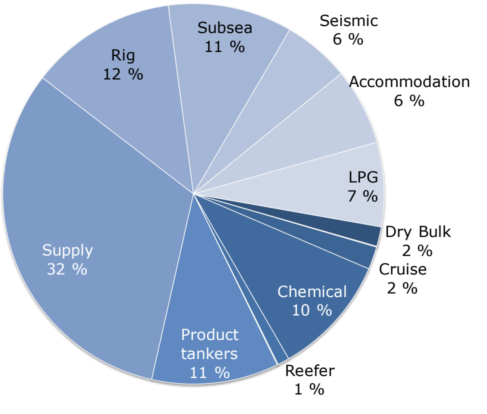
Financing situation in the projects

PWWS share of debt in the projects amounts to roughly NOK 1.5bn, implying an average project leverage just shy of 60%. This is healthy, considering the high contract coverage. The repayment schedule is evenly spread across the coming four years. Balloon payments are scheduled in line with project completions and resulting asset sales.

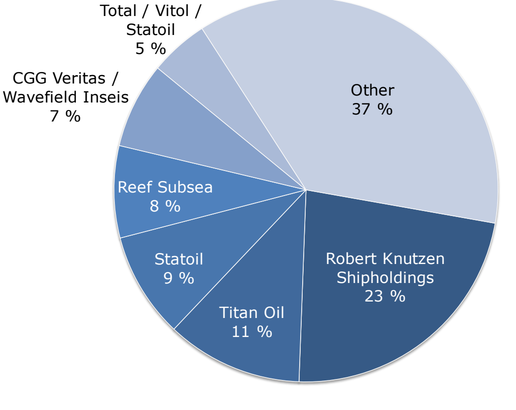
Charterparty Distribution



Segment Distribution



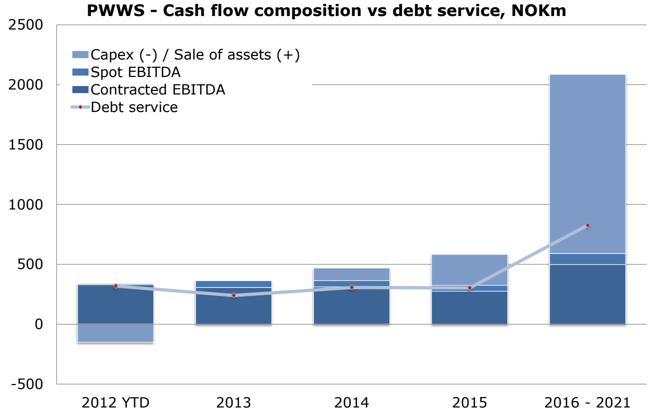
Charter hire backlog by counterpart



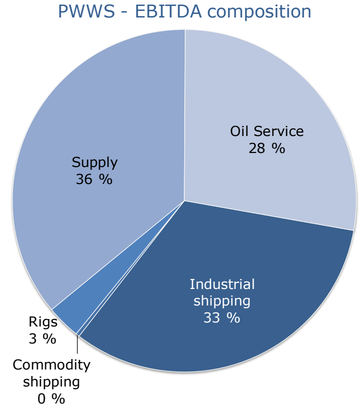
Portfolio (continued)

Project / company	Contract	Charterparty	Charterer	Proportion of NAV
Asian Offshore IS	Oct-18	Bareboat	Robert Knutzen Shipholdings Ltd.	8.7 %
Deep Sea Bergen Invest AS	Jun-16	Timecharter	Statoil	4.4 %
Singapore Tankers AS	Dec-18	Bareboat	Titan Oil Pte. Ltd.	10.9 %
Brøvig UBT AS		Spot/Asset play	N/A	0.2 %
Master and Commander IS	May-16	Bareboat	Wavefield Inseis ASA / CGG Veritas	4.7 %
Tor Cimbria RoRo KS	Oct-11	Timecharter	DFDS Tor Line	0.1 %
Pareefers II KS	Dec-11	Bareboat	Lavinia Corporation	1.0 %
Asian Offshore III IS	Sep-16	Bareboat	Robert Knutzen Shipholdings Ltd.	10.7 %
KS AS Bergen Drillpart	Jun-16	Timecharter	Statoil	5.5 %
Ross Handy II IS	Nov-12	Bareboat	Kristen Marine S.A.	0.4 %
River Cruise KS	Mar-16	Bareboat	Viking River Cruises S.A.	2.0 %
Parbulk II IS		Bareboat	N/A	1.3 %
Brøvig Stainless II DIS	Nov-16	Bareboat	Stolt Tankers B.V	1.6 %
Neptune Subsea IS	Feb-17	Bareboat	Reef Subsea	10.7 %
Parbarge IS	Jul-18	Bareboat	Marine Subsea AS	3.2 %
ParChem IS	Nov-18	Bareboat	Heung-A Shipping Ltd.	2.9 %
Parchem II IS	Aug-14	Bareboat	ECHEM	1.2 %
PSV Invest IS	Jan-18	Bareboat	ConocoPhillips	3.2 %
Berthea IS		Spot/Asset play		2.3 %
Bassdrill Ltd	Aug-15	Timecharter	Petrobras	0.4 %
PSV Invest II IS		Spot/Asset play		1.9 %
Lion AHTS IS		Spot/Asset play		0.6 %
NorthSea PSV IS		Spot/Asset play		0.4 %
B-Gas AS	Aug-12	Timecharter	Total / Vitol / Statoil	5.5 %
Lion AHTS II IS		Spot/Asset play		0.6 %
Partankers VI IS	Dec-15	Bareboat	STX Europe	2.2 %
Havila Shipping ASA	Apr-14	Timecharter		3.8 %
Offshore Accommodation IS	Dec-21	Bareboat	African Offshore Services	3.4 %
Atlantic Gas	Dec-13	Bareboat	Geogas Maritime SAS	1.8 %
Vestland Seismic IS	Sep-18	Bareboat	Albatross Shipping Ltd.	1.0 %
Bukit Timah Offshore DIS	Jul-20	Bareboat	Swiber Offshore Marine Pte.	1.3 %
Middle East Jackup Ltd		Spot/Asset play	N/A	2.2 %

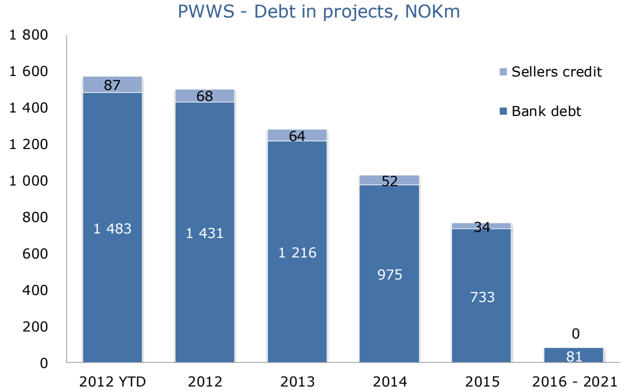
PWWS - Cash flow composition vs debt service, NOKm



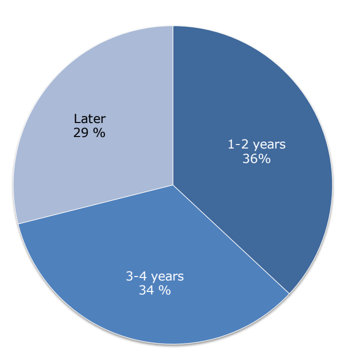
PWWS - EBITDA composition



PWWS - Debt in projects, NOKm



PWWS - Duration of contract backlog



Second Hand Market and Liquidity

As of 31.12.2011 PWWS had 8.2m shares outstanding. Pareto Project Finance AS (”PPF”) strives to facilitate an active second hand market for shares. The last trading price at the time of writing was NOK 126 per share. Investors who wish to buy or sell shares should contact their respective advisors.

Second hand market after merger

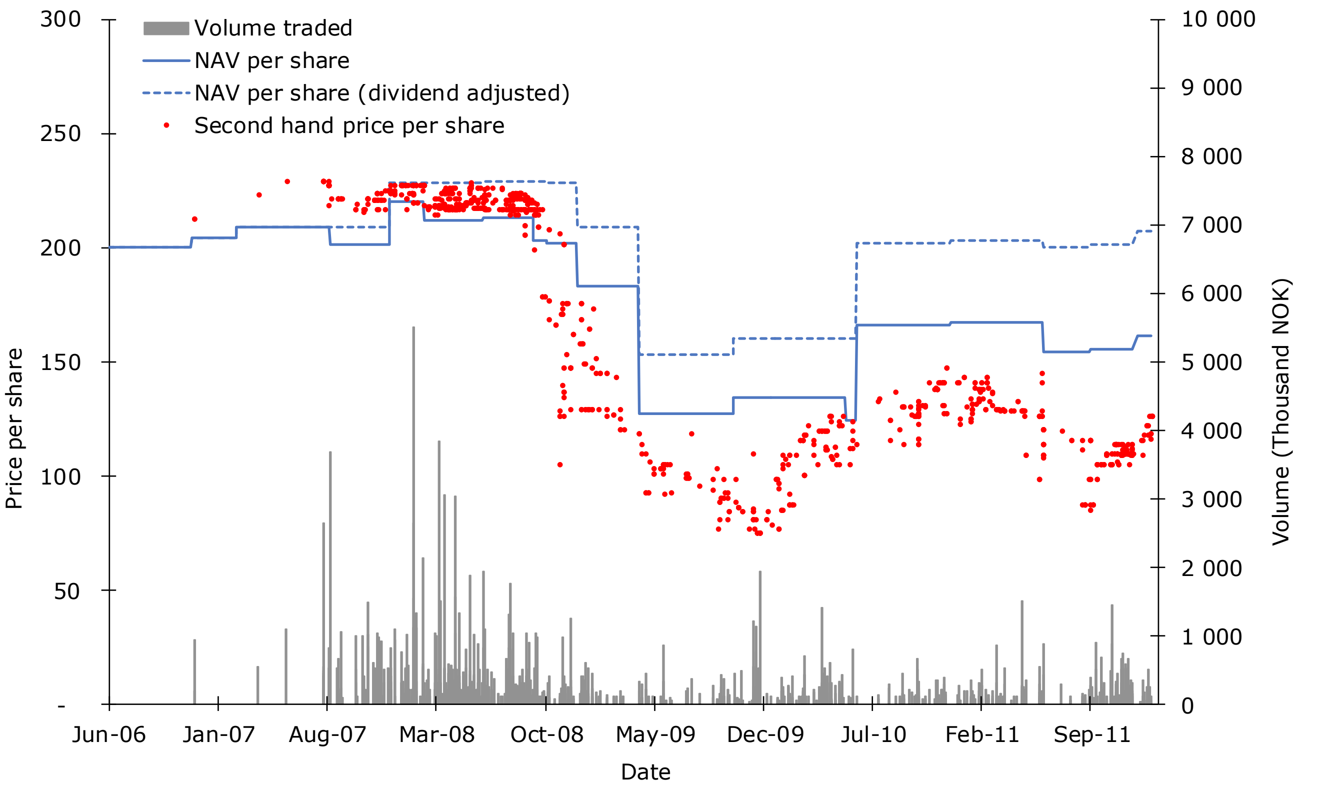
The company’s liquidity has primarily been second hand trades carried out in the largest feeder company, “Pareto Shippingkapital AS”. This company has around 1,750 shareholders and has for that reason experienced the most trades in the second hand market. The merger between PWWS, PWWS II and the four feeder companies is expected to be formally completed within the first half of February and the merged company will then have around 4,000 shareholders. The Fund Manager believes that this will have a positive effect with regards to liquidity and the number of shares traded. The traded share prices displayed in the table to the right and in the graph below have been calculated on the basis of implicit feeder trades, adjusted for the merger exchange ratio.

Discount to NAV

The shares have historically been trading at a discount to NAV of around 30 %. The trades that have been carried out over the last month have been done at a discount of around 23 %, hence the gap has been tightened slightly. The Fund Manager believes that a continued improvement in liquidity may close this gap further.

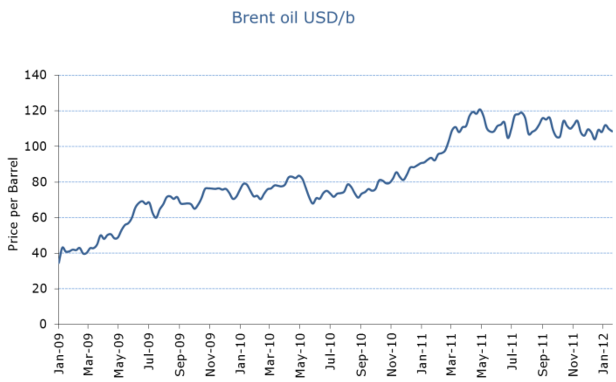
Date	Share price	No. of shares	Volume (NOK)
27.01.12	126	779	98 312
27.01.12	126	2 000	252 405
27.01.12	126	328	41 394
27.01.12	126	8 272	1 043 946
27.01.12	126	5 300	668 872

Number of trades since startup:	1 241
Volume traded since startup (NOK):	288 050 260
Average volume per trade (NOK):	232 111

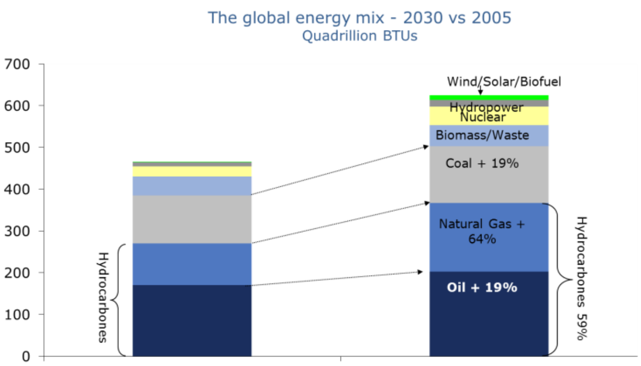


The Offshore Oil Services Market

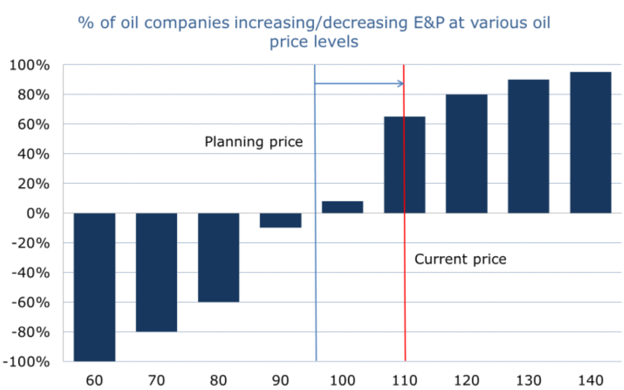
The outlook is positive with an oil price that has stabilised above USD 100/b and E&P spending budgets for 2012 showing 10% growth world wide over 2010. While the financial turmoil is having a dampening effect on growth, there's no denying the strong underlying momentum, which reflects the longer term energy needs of the world. This market is definitely part of a long term growth trend.



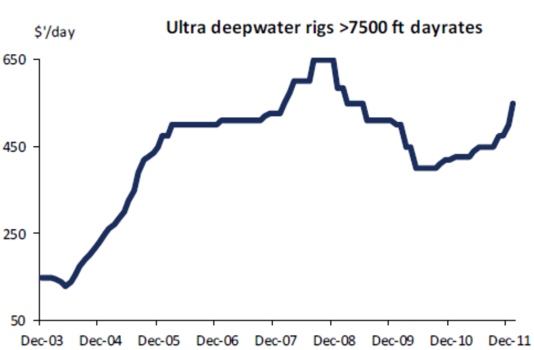
Source: EIA



Source: IEA



Source: Barclays Capital, PGS



Source: ODS-Petrodata, Pareto Securities

The oil market

The oil price (Brent) has stabilised above USD 100/b, despite the negative impact the European debt crisis has had on demand. However, the story of the oil market is not that of declining demand in mature economies, but that of growth in emerging economies. Non-OECD demand is expected to maintain a growth rate of 1.2-1.3 mb/d, despite the financial woes. These economies continue to grow and the energy use per capita is gradually heading towards the level seen in fully industrialised and mature economies.

The natural gas market

Natural gas is the world's second largest energy source, covering 25% of global energy demand. While global energy demand is expected to grow 30% in the next 20 years, natural gas demand is expected to grow twice as fast. The primary driver is electricity demand. A significant part of the global natural gas resources is found offshore, making it another positive driver for offshore oil services in the coming decades.

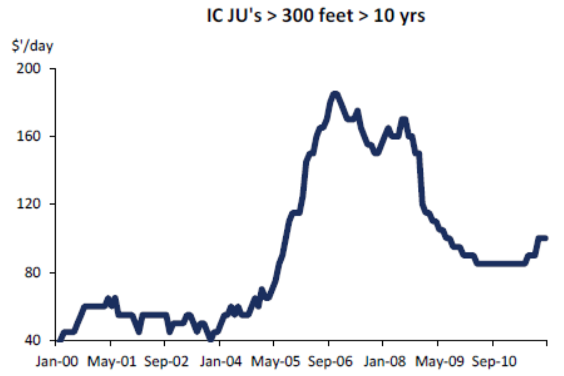
Both oil and natural gas are scarce resources, which are subject to a structural demand growth. Normally, this would dictate that prices should rise, and that is precisely what is happening. Globally, the oil industry expects to invest 10% more in oil and gas exploration and production in 2012 than it did in 2011. Interestingly, the plans are based on an oil price below USD 100/b for Brent. As can be seen to the left, there is upside potential if the oil price stays where it is now.

The market for floating drilling rigs

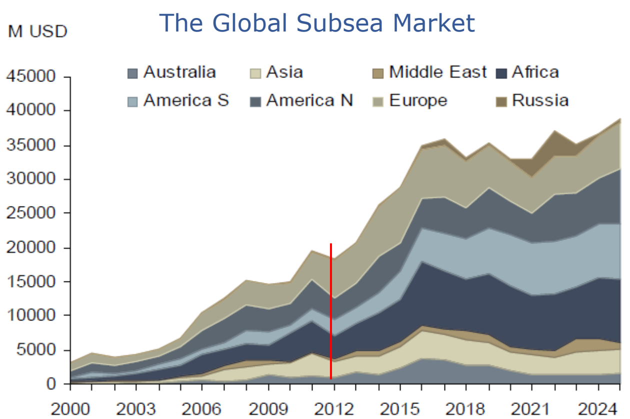
There is particular strength in the ultra deepwater markets, where dayrates have climbed from a low of USD 400k/d to the present level of USD 550k/d. While Brazil has been the talk of the town in the past few years, West Africa is perhaps the most interesting market right now. With 150 deepwater wells planned for each 2012 and 2013, rig demand could easily double in this region. East Africa is another upcoming area, where there have been some very large deepwater natural gas discoveries in recent years.

Finally, the large discoveries in the North and Barents Seas means Norway will be a hot market for high spec rigs in the coming decades. This means more work for the older rigs and a need for new capacity to manage the planned activity growth.

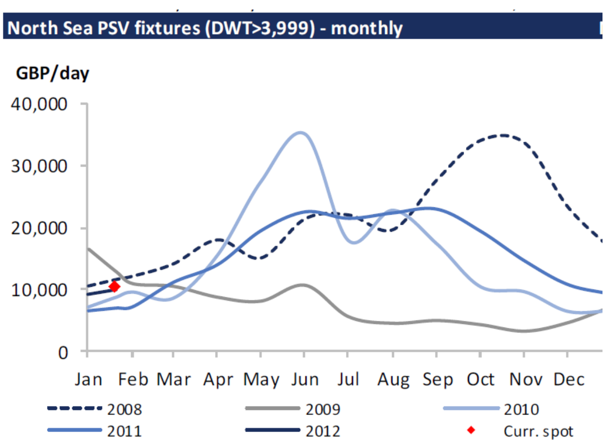
The Offshore Oil Services Market



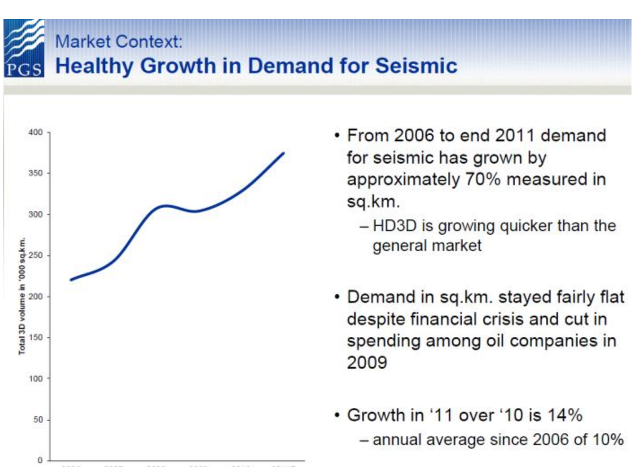
Source: ODS-Petrodata, Pareto Securities



Source: Rystad Energy, ABG Sundal Collier



Source: ODS-Petrodata, Pareto Securities



Source: PGS

Jack-up market

The jack-up markets are also continuing to improve. Perhaps the most interesting feature is that demand and dayrates for older units have staged a remarkable recovery. In some areas the markets are sold out, and we've seen some of the large US rig contractors reactivate stacked units against some very encouraging contracts.

Subsea

Demand in this market is the most visible of all, as it is primarily driven by the oil industry's field development and infrastructure plans, both which are subject to long planning horizons. The overall trend is that of more remote and more complex developments, which means increasing oil service intensity and an over proportional demand growth. The vessel markets have been plagued by the tail end of the previous newbuilding cycle, while demand is only now really set to pick up. We expect 2012 to be flat on 2011, but 2013 to represent a significant step-up.

Supply vessels

Demand is growing along with overall activity levels and is set for another boost when the current rig newbuilding order book starts delivering from 2012 and onwards. The outlook is better for large AHTS vessels due to a very limited order book. For PSVs, the order book is significant, particularly for large vessels, but it seems reasonable to expect a balanced market this year, perhaps with a better North Sea spot market season than last year. In the long term, the Norwegian market looks particularly encouraging on the back of the significant discoveries made last year. Potential tightness in the market will be exacerbated by rising deepwater rig activity, which will demand much the same capacity as that being used in Norway.

Seismic

In this market, too, the tail end of the previous newbuilding cycle has put a damper on utilization and dayrates, while demand has reached record levels. With the Gulf of Mexico now set for a full recovery, things look a lot better, particularly for high end vessels. A surge in exploration activity in Norway is also expected following the recent oil discoveries. Reportedly, dayrates for this year's summer season in the North Sea are showing decent gains. Market participants are also encouraged by a majority of the oil companies planning to raise exploration spending more than overall E&P spending, which is always a bullish signal for this industry. Don't expect 2012 to be a great year, but things definitely look better as we head towards 2013.

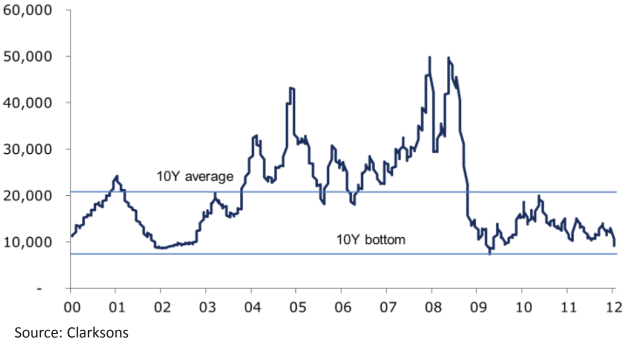
The Shipping Markets

The drybulk, container and tanker markets are outright dire, with a possible recovery still a few years down the road. Everybody is losing money, and high financing needs, falling ship values and tight banks are adding to the gloom. There are some bright spots, however, with LNG shipping booming, LPG shipping reasonably strong and chemical shipping at least at break-even levels.

Overall market

Overall shipping earnings are drifting back towards 10-year bottoms, driven by weak markets for commodity shipping, as well as container shipping. Unusually, this is not driven by a lack of demand as fixtures in both the dry bulk and tankers markets are at record high levels. No, it is driven by the overcapacity induced by the newbuilding spree of the past peak cycle. There are simply too many new ships coming into the market.

Clarksea Index, Overall vessel earnings $/d

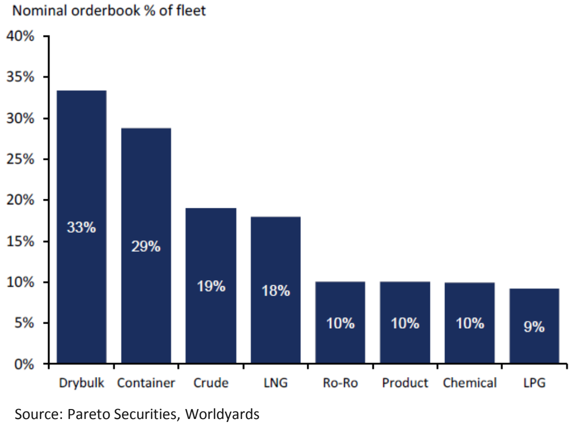


Source: Clarksons

Where's the money?

The problem is that the orderbooks are still so high that, even with robust demand growth, it will still take another two years or so before things start to turn in the worst affected markets. Annual demand growth is perhaps 8%-10% in the drybulk and container shipping markets, and around 3%-4% in the tanker markets. But that is not enough – look at the chart to the right.

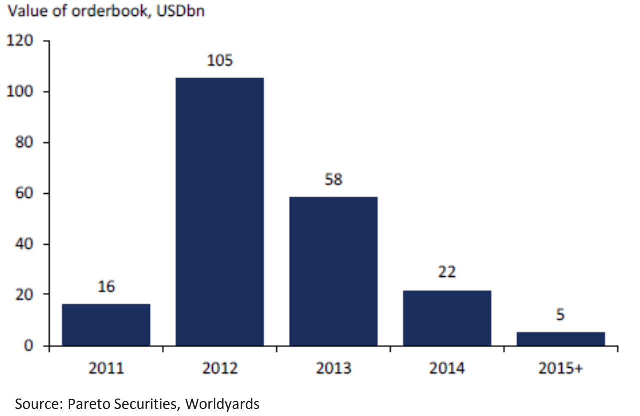
Nominal orderbook by segment



Source: Pareto Securities, Worldyards

But who's going to pay for all the new ships? The total value of the newbuilding orderbook is some USD 206bn. Assuming 30% down payment, that leaves more than USD 140 bn in financing to be arranged in order to take delivery of the ships. That's a tall order. No one's making money, so the owners don't have the cash. The number of lenders to shipping has declined, and those left are lending less than before. Moreover, with owners already having problems servicing existing debt, how can they convince the banks to lend them even more?

Cost of shipping newbuildings by year



Source: Pareto Securities, Worldyards

So, if the money to take delivery isn't there, will the newbuildings not be cancelled? Maybe so, but the problem is that once a shipyard has started building a ship, it gets finished. So, the ships may end up with the yards instead, but they will offload the ships into the market as soon as possible and will accept deep discounts. The yards will gradually also realise that they need new orders to keep the business ticking and will lower newbuilding prices towards variable costs.

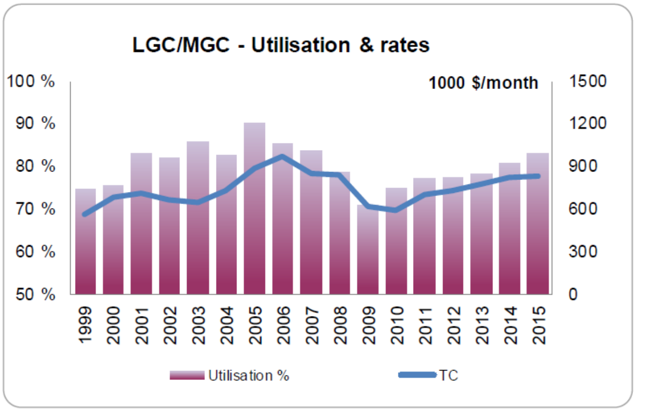
The result is a continous negative spiral in ship values. Existing ships are sold off to satisfy the banks. Resale prices plummet as nobody can afford paying for the newbuilds and newbuild prices fall as the yards attempt to fill up empty slots. At some point, things will become outrageously cheap and the time to invest will be there. But that is certainly not now.

The Shipping Markets

Where are the bright spots, and why should we invest in them?

LPG

The good thing about this market is that it is supply driven. LPG is a by-product of the production of oil and natural gas, which is rising. This puts more product on the market, which needs to be transported, as the production centres do not have adequate storage capacity. Thus, demand for LPG transportation is steadily rising at 3%-5% per year. At the same time, the newbuilding orderbook is low, particularly for the small and medium sized segments, where it is 5% or less of the existing fleet. Moreover, a significant part of the fleet is old, creating a replacement need. In sum, this is a healthy market with a robust outlook.

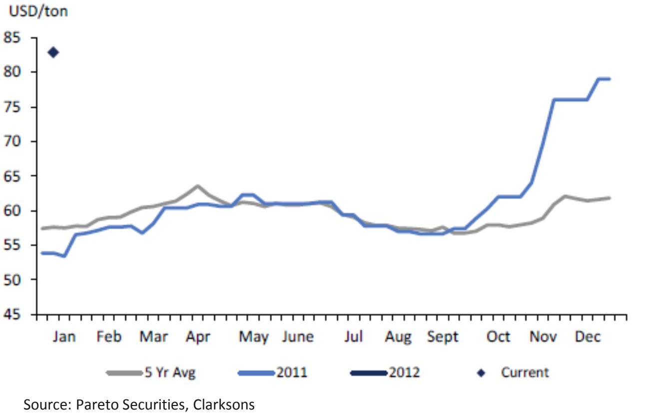


Source: Joachim Grieg & Co

Chemicals

Demand for chemical shipping is generally driven by global economic growth. For sure, this is negatively impacted by the debt crisis, but is still in a positive territory. What prevents this market from falling off a cliff like the crude tankers, is the fact that the newbuilding order book is small and the global fleet is old. There is limited capacity growth. Therefore, earnings are generally around break-even levels and are slowly improving. At some point in the next two years, utilization will have recovered sufficiently to drive rates and value upwards. In the meantime, it is possible to weather the storm without losing money.

Easychem rates average Transatlantic and F.East, 5.000 mt

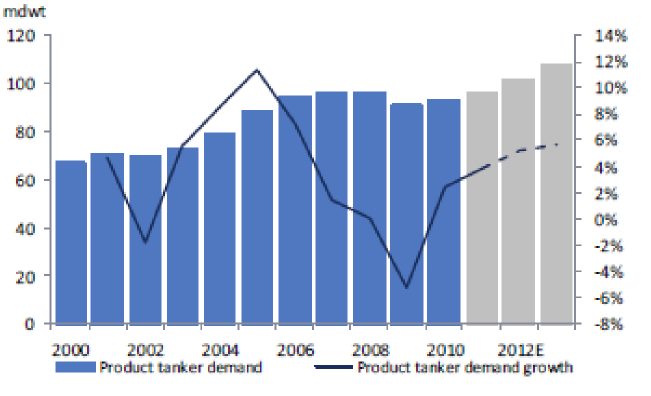


Source: Pareto Securities, Clarksons

Product tankers

This market has been under the weather for two years now, but has some structural drivers that make it a lot more promising than the market for crude tankers. Firstly, new refining capacity is now being built close to the oil producing centres, while refining capacity close to the consuming regions are being closed down. This increases transportation needs, implying an over proportional ton-mile increase relative to the growth in refining production. Secondly, declining US product demand means that US refiners have turned exporters, which creates additional transportation demand. Thirdly, the emergence of new refining regions in India and Brazil create more opportunities for arbitrage trade and the distances are increasing. Finally, the order book is just 10% of the existing fleet. With demand growth averaging around 4% per year, this market looks set to turn. John Fredriksen's recent order for 10 newbuild product tankers lends credibility to this view.

Product tanker demand estimates



Source: Pareto Securities

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