1.2. INDUSTRY OVERVIEW

1.2.1. Global market trends

Historically, the international tanker market has been characterised by marked cyclicity and a large amplitude of fluctuations in freight rates due to changes in tonnage supply and demand.

Demand for tanker transportation is affected by a number of factors, including supply and demand for crude oil and oil products, the availability of refining capacity, the economic situation in global and regional markets, the distances over which oil and petroleum products are transported, and competition from other modes of transport.

Supply in the tanker market is also affected by a number of factors, including the pace and quantities of new ship deliveries, old tonnage disposal rate, conversion of existing fleet, and changes in industry regulation.

Oil market

Since the beginning of 2018 the price structure in the oil markets has remained in backwardation[1], which negatively affected the demand for oil tankers for both floating storage and arbitrage shipments over long distances. The policy pursued by OPEC and the largest producers in an attempt to reduce crude oil inventory levels was effective. In February 2018, inventories almost reached the average level for the last five years. Nevertheless, the rate of inventory reduction was, apparently, lower than previously expected, which led to the oil production cap deal being extended until the end of 2018. The output reduction reached 140% in the first quarter, which meant an actual cut in OPEC production by 2.4 million barrels per day against the 1.8 million envisaged by the agreement.

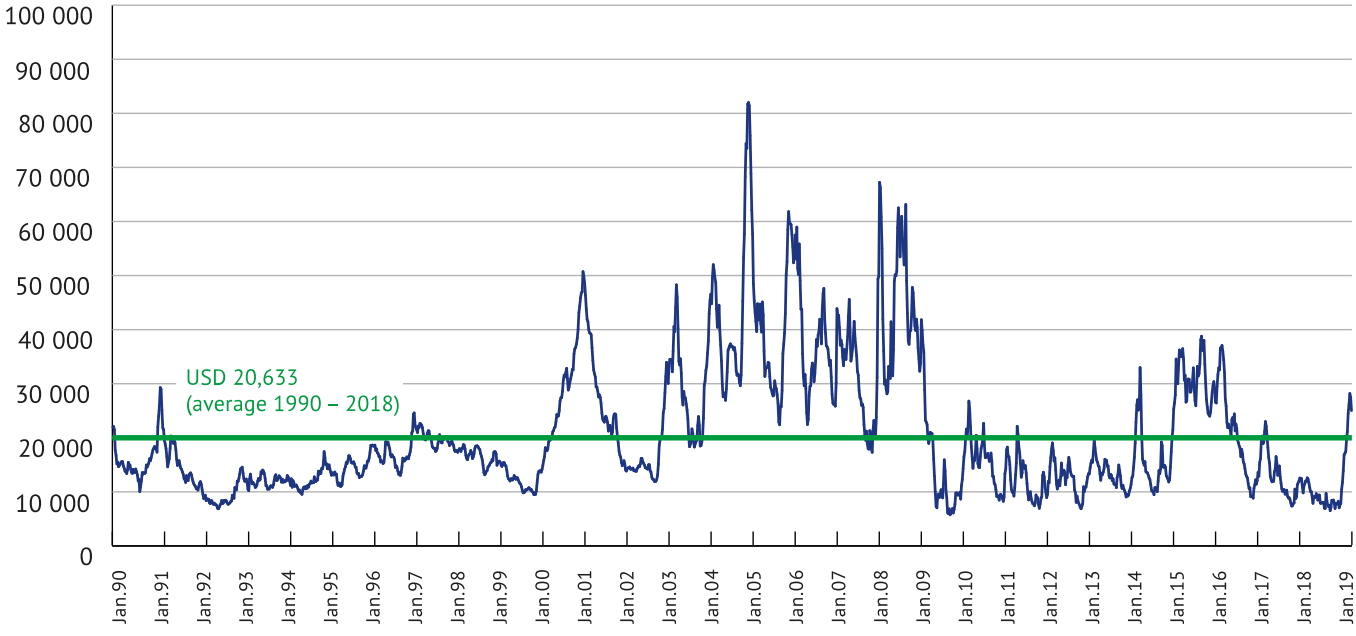
On the back of positive macroeconomic indicators in the USA, China and other largest economies, which prompted an upward revision in global economic growth forecasts, and a tangible result in maintaining oil supply discipline since the early 2018, oil prices have been increasing steadily, with Brent crude reaching US$75-80 per barrel in 2Q and 3Q 2018. In June 2018, OPEC countries reached an agreement to gradually increase oil production by 1 million barrels a day. As soon as in June, there emerged trends towards an increase in the number of oil cargoes in the market and cautious optimism regarding improvement of the situation in the freight market by the end of the year.

Oil prices were rising during the third quarter and at the beginning of the fourth quarter. As a result, the average monthly Brent crude price in October amounted to US$81.03 a barrel. Concerns about potential disruptions in oil deliveries due to the renewal of U.S. sanctions against Iran from the beginning of October were one of the major price growth factors. However, due to the entry of additional oil into the market, the lack of a significant reduction in Iranian exports and an increase in the risk of deceleration in the Chinese economy in 2019, oil prices fell in November and remained at US$55-65 per barrel during 4Q 2018. The futures price structure shifted to contango[2] from time to time.

Tanker market

2018 proved to be a second consecutive challenging year for the tanker industry, with trading conditions remaining extremely difficult and the spot rates well below their historical averages. Tanker markets hit the lowest level on average since 1992.

Dynamics of the value of the ClarkSea Index[3] (USD per day)



1. See the Glossary.
2. See the Glossary.
3. See the Glossary.

Despite the positive trends of 4Q, in 2018 the value of the ClarkSea Index amounted to USD 11,216 per day (the lowest value of the index was recorded in 1992 at USD 8,983 per day).

No improvements were seen in the tanker markets during the period from December to September 2018. In addition to a decrease in demand for oil transportation due to OPEC countries exceeding their production cut targets (the actual cut in production in 1H 2018 was about 2.4 million barrels per day), the rates of new ship deliveries from shipbuilding yards were high in 1H 2018, including due to ship delivery deadlines previously agreed between shipbuilder and shipowners who suffered losses having been brought forward from 2017. The rates for VLCC, Suezmax and Aframax crude oil vessels during the period from December to September 2018 were on average 35-65% lower than average rates in 2017, and 50-60% lower than in 9M 2017. For LR2, LR1 and MR product vessels, the rates were at the 2017 level.

There was, however, a visible rebound in freight rates in the Q4 2018. Largely thanks to an increase in oil production by OPEC countries and Russia following the decision to revise the oil production cap deal and amid the seasonal increase in demand for transportation of oil and petroleum products, tanker markets grew significantly, and in December the rates reached the level seen at the end of 2015.

A positive factor that contributed to achieving a balance between the supply and demand for tankers by the end of 2018 was an increase in activity in the scrap market in the first quarter. Due to low freight rates and high metal prices, 25 VLCC vessels and 21 Aframax vessels were sold for scrapping during 2018. The pace of new ship deliveries has decreased since the beginning of 3Q 2018, which is one of the factors necessary to achieve a balance in tanker markets.

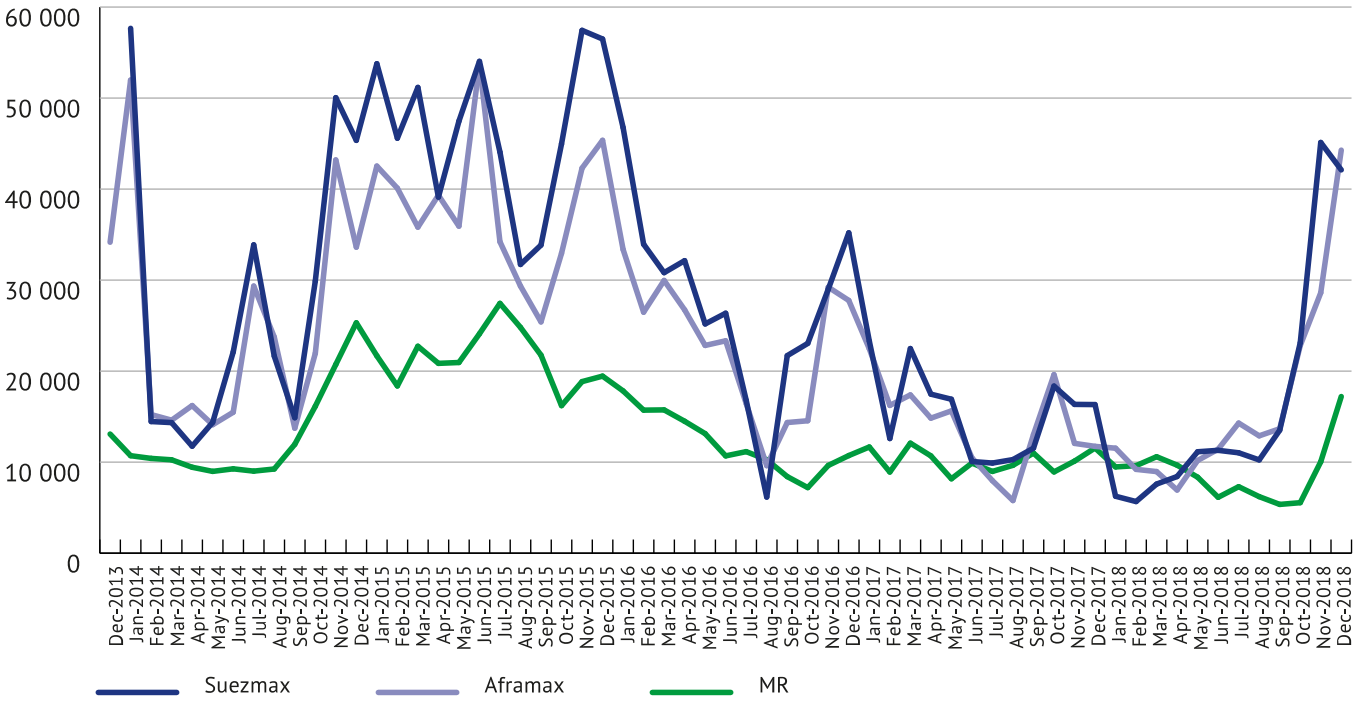
On average, only Suezmax and Aframax tankers showed a slight improvement in 2018 compared to 2017, while average rates for other tanker categories declined.

Weighted average spot TCE (USD per day)

Vessel size category	2018	2017[1]	Difference
VLCC tankers	15,561	17,794	-12.55%
Suezmax tankers	16,466	15,436	6.67%
Aframax tankers	16,175	13,873	16.59%
MR product carriers	8,750	10,213	-14.32%
Handysize product tankers	5,029	6,734	-25.32%

Source: Clarksons

Dynamics of spot tanker freight rates (USD per day)



Source: Clarksons

In the time charter market, rates were declining during 2018, but in the fourth quarter the decline was compensated for by dynamics of spot rates.

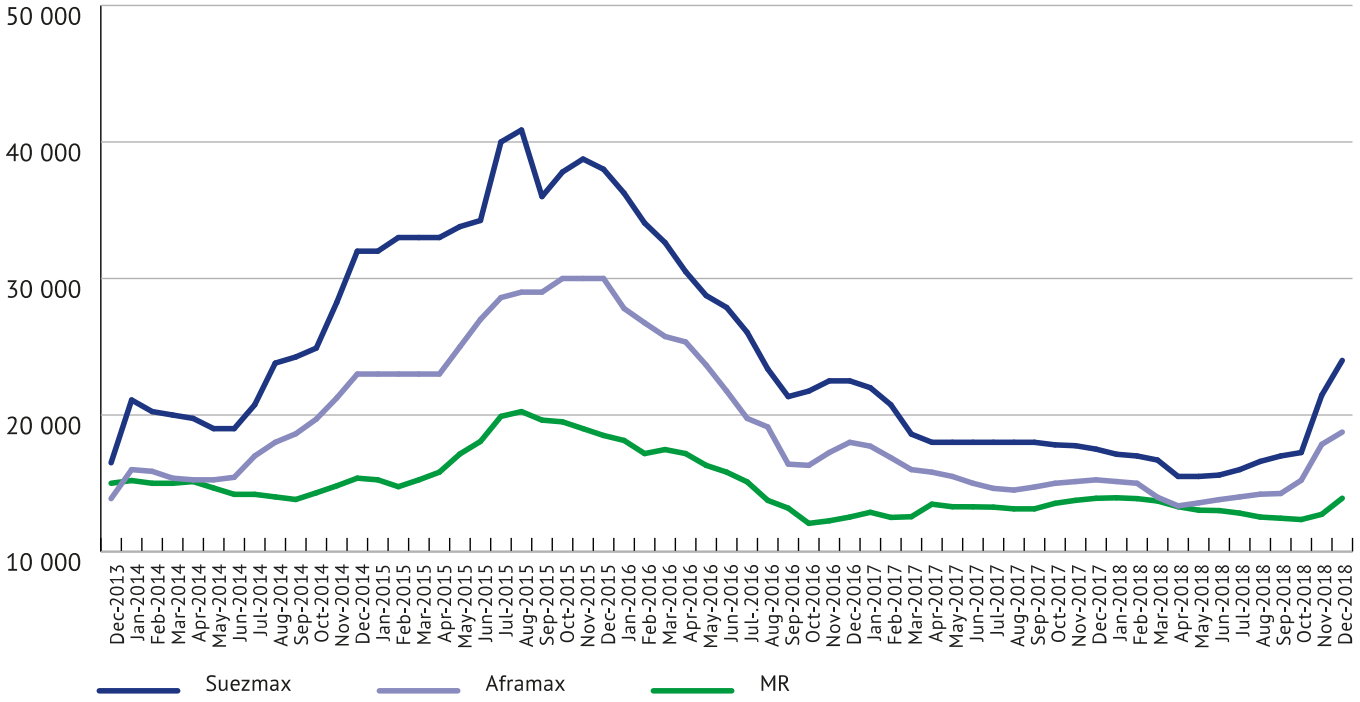
1. Clarksons Research Services data for 2017 as of 31 December 2018 were updated in comparison with similar data as of 31 December 2017.

Weighted average one-year time charter rates (USD per day)

Vessel size category	2018	2017[1]	Difference
VLCC tankers	22,899	27,084	-15.45%
Suezmax tankers	17,486	18,495	-5.46%
Aframax tankers	14,925	15,490	-3.65%
Product carriers (dark petroleum products)	12,962	13,077	-0.88%
Product carriers (light petroleum products)	11,572	11,430	1.24%

Source: Clarksons

Dynamics of tanker time charter rates (USD per day)



Source: Clarksons

New build and S&P market

Activity in the second-hand tanker market was declining at the beginning of the year, but the demand for vessels recovered beginning from the second quarter and for the full year increased by 19.35% compared to 2017, with 333 deals (total deadweight: 32,596 thousand tonnes, total value: USD4,956 million) against 279 deals in 2017 (total deadweight: 27,838 thousand tonnes, total value: USD5,586 million). A significant factor in the initial decline in buyers' interest in tonnage, apart from low freight rates, was the uncertainty regarding the impact of the approaching entry into force of the 0.5% cap on sulphur content in bunker fuel from 2020 and the need to factor in investments in ballast water treatment systems that must necessarily be installed on vessels during dock repairs after September 2019. Meanwhile, due to the same factors, prices for second-hand tonnage decreased significantly in 2018, which in turn attracted buyers to the market after the first quarter.

Prices in the tanker sale and purchase market dropped by 20-25%. Prices for bulk carriers stagnated following growth in 2017.

1. Clarksons Research Services data for 2017 as of 31 December 2018 were updated in comparison with similar data as of 31 December 2017.

Activity in the second-hand tanker market

Indicator	2018	2017[1]	Difference
Number of vessels sold (units)	333	279	19.35%
Total deadweight of sold ships ('000 tonnes)	32,596	27,838	17.09%
Total value of sales (USD million)	4,956	5,586	-11.28%

Source: Clarksons

At the end of 2017 and during 2018, the demand and orders for new vessels increased multiply compared to stagnation in the shipbuilding market in 2016 and 1H 2017. The segments of container ships and LNG carriers accounted for the major part of orders in 2018. The number of orders for both tanker and dry cargo fleet also increased significantly due to the reasonable expectation that the bottom in prices for new ships had been passed. The value of orders for new ships has increased by about 15% since the beginning of 2018 due to the stabilisation of demand for contracts and an increase in metal prices and exchange rates of currencies used by Far East shipbuilders.

Dynamics of the number of new ship orders

Type of vessel	2018	2017[2]	Difference
Crude oil and product tankers	169	262	-35.50%
Chemical tankers	35	72	-51.39%
LPG carriers	41	27	51.85%
LNG carriers	76	18	322.22%
Total	321	379	-15.30%

Source: Clarksons

1.2.2. Competitive position

Main competitors of Sovcomflot Group in core business areas are:
- Fredriksen Group, Cyprus;
- Teekay Corporation, Canada;
- Euronav N.V., Belgium;
- Knutsen OAS Shipping, Norway;
- China COSCO Shipping, China;
- Mitsui O.S.K. Lines, Japan;
- Dynacom Tankers, Greece;
- Scorpio Group, Monaco
- Torm A/S, Denmark
- Minerva Marine, Greece;
- BW Group, Bermuda
- Tsakos Group, Greece;
- MISC, Malaysia.

The Group's share of the freight market does not exceed 1%. Any change in this indicator over the past three years is considered immaterial (less than 0.01%) due to the high degree of fragmentation on the tanker transportation market and the continued presence of a significant number of operators, estimated in total at about 3,200 (including approximately 200 companies with a fleet of 10 or more tankers).

According to Clarksons, at the end of the reporting period Sovcomflot Group held the following positions in global shipowner rankings:

Parameter	Global ranking
Arctic shuttle tanker fleet	1
Ice-class tanker fleet	1
Aframax tanker fleet	1
Fleet of multifunctional icebreaking vessels	1
Size of tanker fleet	3
Shuttle tanker fleet	3
Ice-class LNG tanker fleet	5
Product tanker fleet	6

No. 1
IN THE WORLD

Arctic shuttle tanker fleet
Ice-class tanker fleet
Aframax tanker fleet
Fleet of multifunctional icebreaking vessels

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