

Paul Bendy

Since 1997, Paul Bendy has been the Managing Director for Teekay Shipping Australia. Prior to this appointment, he was the Manager Shipping for both Caltex and Australian Petroleum since 1993. He has worked in many roles within the maritime and oil industries, from a sea-going engineer, engineer manager and then an operations manager within the Caltex refinery.

The Sydney office of Teekay Shipping is part of the global network to support the transport operations of Teekay's fleet of ships that trade around the globe. Teekay have a total of 98 ships, but with the merging of the BHPBilliton operation, the total is closer to 120 ships and a small fleet of tugboats.

Paul's prime role is to manage the Australian operations for Teekay Shipping Limited. The Australian offices of Teekay not only manage the Australian fleet, but also supports Teekay's international fleet while trading in the Australian and New Zealand region. This support is for both technical and operations. The functions of the Australian office include marine operations, technical, human resources, industrial relations, manning, payroll, purchasing, quality management and accounting.

Paul holds a First Class Marine Engineer's Certificate and is currently a director on several maritime related associations and several companies within the Teekay group. With his technical background, Paul likes to think he brings a very practical approach to managing Teekay's operations and with a keen sense of knowing what the needs are to improve the Australian maritime industry.

Trends in Tanker Shipping

The Independent Shipowner Perspective

Presented by
Paul Bendy, Teekay Shipping Australia

Slide 1:

Good morning ladies and gentlemen:

Slide 2:

A little less than 12 months ago, tanker owners were facing the strongest freight markets in over 25 years. In the third quarter of 2000 and in the early part of 2001 Clarkson's Shipping Intelligence Weekly had reported Aframax time-charters equivalent earnings of over \$60,000 US per day on some trade routes and they had also reported that a VLCC had reached the \$100,000 US per day milestone.

This was a far cry from the \$10,000 US per day that was averaged on the AG-East Aframax trade route in 1999, where tanker owners were operating below variable cost breakeven, and due to the weak market, ship values were plunging. This meant that many ship owners were in breach of minimum hull value covenants on bank loans where most owners had either painful discussions with their bank to buy themselves breathing room, or grasping at over priced refinancing options on the way down the slippery slope towards the brick wall.

But how did the tanker market get to these two extremes and in such a short period of time?

Slide 3:

Looking at some slides that we had put together for our Shareholders on the tanker supply and demand fundamentals, we can now see how we got into this mess as well as why we recovered so quickly. I thought I would kick off my comments today by sharing these with you.

The tanker business is driven by the balance between the demand for global oil transportation and the supply of shipping capacity. TCE rates are reflected in the balance between the two. Volatility in these rates is created in by rapid fluctuations in demand in response to changes in the world oil markets, while tanker supply responds much slower due to shipyard lead times. For the past 25 years the effect of these fluctuations has been cushioned by a surplus of tanker supply. This surplus, although difficult to measure, appears to have diminished significantly, causing a sharp increase in the volatility of tanker rates in 2000.

Looking first at the demand side, the first chart compares World Real GDP growth (in red) to oil demand growth (blue line, left axis), and oil production growth (green line) during the 1990s and year 2000. As you can see from this graph, oil consumption growth is a function of global economic growth. Oil consumption has been growing steadily, in fact, for the past 20 years.

Looking at the graph we see that world real GDP growth peaked in 1997 at 3.5%, then slowed in 1998 due to Asia. In 1999, the growth rate returned to the pre-Asia crisis level, with year 2000 paring even better. In Year 2001, things are not as bright on a global scale, but I will get to that later.

In the long run it is the demand (consumption) for oil that drives tanker demand. However because of seasonal variations in global oil inventories, the short term leading indicator of tanker demand is the level of global oil production.

In 1999, there was an unprecedented degree of disconnect between oil demand and oil production (green line) and was one of the reasons which led to the weak freight market. This was, of course, the effect of OPEC production cutbacks which resulted in a significant drawdown of world oil inventory levels. In 2000, OPEC increased production as a result of low inventory levels and escalating demand.

Slide 4:

Because of the distance leverage factor, the shift in incremental oil production growth away from the North Sea, where it was in the 1990s, to Middle East OPEC is very positive for tanker demand. This graph illustrates the close relationship between OPEC production and tanker rates which has developed over the past two years. The red line on this graph represents the average between AG/East and Caribs-US Gulf Aframax rates, which closely resembles the rates achieved by Teekay's tanker fleet. Because Middle East OPEC production has become such a key factor in the world's incremental oil supply situation AND because tanker rates are so highly levered to M/East OPEC production, it is not surprising that there is a strong correlation between tanker rates and OPEC production.

Three OPEC production cuts this year have reduced near-term tanker demand. However, present production is well below the level of typical global winter oil demand and, consequently, oil analysts are widely forecasting production increases later this year or if we do not get a production increases there will be a significant draw in world oil inventory levels.

Slide 5:

Turning now to tanker supply.

The "Erika" oil spill in December of 1999 quickly became a catalyst for the need to accelerate the phase-out of old, substandard tankers. In April of 2001 the International Maritime Organisation passed a legislation for the acceleration of the phase-out of the older 1970's - built tankers. Over the next five years, for the first time there will be enforced scrapping of a large number of tankers, regardless of the level of tanker rates. The pink bars to the right of the graph represent the new IMO phaseout schedule. During the next five years 82 mdwt or 28% of current world tanker fleet will be scrapped. It should be noted that these are the latest dates at which this tonnage has to leave the fleet. Many affected vessels will actually be scrapped in the 24 month period prior to their phase out date as they face maintenance expenditure hurdles, such as the 5th special survey, for example.

If you take the mandatory phaseout dates (ie: take the most pessimistic scrapping scenarios) and add the effect of typical annual growth world tanker demand, you will need very high newbuilding deliveries over a sustained 5-year period in order to prevent further tightening in the tanker supply/demand balance. Shipyard capacity will be a serious constraint during this 5-year period, as the yards are shifting production to gas carriers (a more profitable and faster growing sector), as well as building other kinds of ships, such as dry bulkers, container ships, passenger and cruise vessels. We believe that it is possible for the yards to build enough tankers to keep things in balance, BUT there is very little room for error: We could see supply squeezes for example, whenever OPEC steps up production suddenly, as they did on several occasions last year.

Slide 6:

Although tanker rates have come off their recent highs, and the world economy has slowed, we are still experiencing year over year increased oil demand. If you look at this chart you can see that first half production of this year is greater than last year and it has had a positive effect on tanker demand, which has resulted in higher earnings over the same period last year.

BUT.....

Slide 7:

So, does this mean the tanker business has reached the promised land of perpetual profitability? Unfortunately not, in my view. I'm not sure how the rest of you view this, but I for one tend to get nervous when there is nothing but blue sky above. Shipping, after all, has been a business in which one has never been allowed to be happy for very long.

While I would be ecstatic if I am proven wrong, I see no reason to conclude that the tanker business has suddenly ceased to be deeply cyclical. Over-ordering of tankers will eventually occur. The economic cycle will eventually turn. There will eventually be a market downturn, possibly a severe one. It may be 3 years or 5 years away, but it will occur.

Why am I already worrying about this now? Because despite today's euphoria, we tanker owners cannot earn our cost of capital by relying solely on the tanker cycle. Our fragmented industry has historically been a notorious destroyer of shareholder value for the average owner of tanker assets. More about this later.

Slide 8:

At Teekay, we often remind each other about the fact that our company is really in two distinctly different business; namely the highly cyclical asset owning business and the non-cyclical service business.

What I have just described in the first part of my comments today was of course related to our cyclical business. Because of its capital intensive nature, our asset business is the biggest single driver of our company's per ship-day topline, or revenues. Yet, the trade in the commodity of ship hulls is essentially an undifferentiated part of our business, in which anyone with enough money can participate. Since we do not conclude asset transactions very often, this is not the most time consuming part of our business.

We spend far more of our time thinking about the service and operating side of our business. There is a good reason for this: if you get it right, you can actually differentiate your company from others in the eyes of your customer. This is very significant.

On the next few slides, I will discuss how a shipowner might think about his service business as a means to build his franchise and, at the same time, enhance his bottom line.

Slide 9:

Running tankers is a risky business. Therefore, the first set of issues weighing on the mind of the shipowner revolves around the safe and competent running of his ships, including:

- long term availability and competency of crew
- ship quality and features
- maintenance policies
- safety practices
- emergency response preparedness
- quality control
- and overall ship management philosophy

The minimum standards in each of these areas are of course dictated by regulation and it requires a lot of work just to meet these standards. However, in my view it makes excellent business sense to go the extra mile and strive for the highest possible standard in these areas. In doing so, you help your customer minimize his risk. This should get you preferred supplier status, which in turn builds the value of your franchise as new business opportunities are created.

For example, at Teekay we know that when our ships call at a customer's terminal, the appearance of the ship reflects on our customer. A big part of the reason why we place such a high priority on the fabric maintenance of our ships is to assist our customer maintain a positive public image. In return, our satisfied customer rewards us with repeat business.

Slide 10:

Next on our mind is the area of customer service. Most owners talk about service, but many merely offer the minimum expected product. Service innovation and creativity are value added features that help our customer's bottom line. These might include:

- convenience
- flexibility
- consistency/predictability
- information
- and responsiveness

Offering operational scale is a great way to provide flexibility to the customer. The other day when I checked, I found that in 15-20% of Teekay's spot contracts with customers, we effect a substitution of the originally intended vessel before the loading date. These substitutions are typically necessitated by a change in the customer's loading program or by a delay to the original vessel on its prior voyage. Due to the size and homogenous nature of our fleet, our customers are

rarely forced into the inconvenience and cost of having to cancel a contract with Teekay at the last minute and look for another owner.

The use of the Internet will be an important tool in providing efficient and convenient customer service. Our industry must embrace the Internet, but information technology is merely one tool. Service organisations should have cross-functional teams organised around customer processes, and not functional teams. A responsive organisation structure staffed with empowered people is essential to being a true service company. This must be driven from the highest levels of the organisation.

The customer service aspect of our business has been under-prioritised for years. In tomorrow's world, you either add value or get out!

Slide 11:

The third big issue on the owner's mind is achieving his goals in risk management and customer service in the most cost efficient way. This issue is tackled by trying to build:

- higher vessel utilisation
- an effective organisation
- economies of scale
- IT systems
- and process efficiencies

This year Teekay will spend US\$10 million on continuous improvement initiatives and new infrastructure projects which will allow us to raise our quality of service further. Yet, due to significant economies of scale, our per ship day operating expenses and overhead costs are still expected to fall.

Scale and cost efficiency lay the foundation for providing a superior product at a competitive price.

Slide 12:

Today's customers in the tanker business are bigger, more focussed on their core oil business, more quality conscious and more sensitive to reputation risk. They increasingly expect their suppliers to deliver value, and to do so, suppliers must have significant resources, be it people, ships or capital. Consolidation in the tanker industry is beneficial for customers because it creates more capable suppliers. Customers want cost effective operators - they don't want cheap operators.

The highly fragmented tanker industry is gradually responding to this challenge. There is still a long way to go, but the pace of consolidation is quickening. We should fully expect to see the consolidation trend among shipping companies continue.

Owners should not pursue consolidation in the hope that it will lead to an erosion of the competitive nature of the tanker market. Even a substantially more consolidated industry will see

continued price competition. Owners will not have pricing power. Just look at the oil companies themselves for proof of this.

A consolidated market structure would see a greater number of financially healthy tanker companies who can deliver a quality product. Companies that are able to meet its customer's needs for flexible service will be rewarded with better profit margins. In turn, these companies will drive further consolidation through their financial strength.

Slide 13:

I promised I would get back to the subject of shareholder value destruction. Let me show you one of my favourite charts - favourite because it so clearly illustrates how consistently bad things have been in the industry and how badly consolidation is needed.

The chart shows the return on invested capital for three alternative investments during the 1990s. If you had invested in 3-month U.S. Treasury Bills (green line), you would have earned 4.7% on average. If you had been an investor in Teekay Shipping, your return would have been 7.1%. You would have beat the T-Bill return on a nominal basis, but not on a risk adjusted basis. And, if you had invested in Teekay's peer group of public bulk shipping companies, you would have managed only a 2.8% return!

If the largest, most professionally run companies in our industry cannot earn their cost of capital, what are the chances that smaller operators will survive?

How much longer should we expect investors to support the tanker industry if we don't deliver adequate returns.

Slide 14:

I said earlier that Teekay is in two businesses. Since Teekay did not manage to generate a sufficient return on capital over the past decade, let's look at how each of our businesses fared. Looking first at the asset owning business, in the early 1990s Teekay took delivery of a large number of newbuilding tankers ordered far too expensively. At the same time we were phasing out a number of old ships. As you can see from the green bars on the chart, our average invested capital per vessel almost doubled during the first half of the decade. Our net income TCE breakeven per ship day (the yellow dot line, right axis) rose from \$13,500 per day in 1991 to around \$16,000. This made it difficult to make a profit, even in a rising market. We were basically not disciplined enough in our asset business in the early 1990s. We invested unwisely when the price of ships was high.

In the second half of the 1990s, we were far more disciplined. By keeping our powder dry during the strong market in 1996-1998, we were able to make a major counter-cyclical move during the weak market in 1999, with the acquisition of Bona Shipping. The timing of this transaction reduced Teekay's net income breakeven considerably.

The good news is that if you get your asset purchases more right than wrong, on average through the shipping cycle, you are laying a solid foundation for profitability in the future. The bad news

is that no matter how good you are at timing such purchases, you cannot build a barrier against entry by others.

Slide 15:

This chart is a good way to describe the results of Teekay's service business in the 1990s. The chart compares Teekay's cash flow per ship day to that of our peer group. The Teekay advantage is the combined effect of asset utilisation, cost advantage, and strategic focus. If you get the service business right, you can build a franchise that consistently enhances profit margins. The stronger the franchise, the higher the margins. However, such margins are insufficient to overcome the effect of poorly timed asset acquisitions.

Slide 16:

So what is the difference at Teekay compared with many others who get into the tanker market? There are still many operators who believe that all you need to do is buy a bunch of ships and move as much cargo as you can get your hands on. I believe this sums up the strategic rationale used by many an opportunistic shipowner over the years.

This approach is no longer suitable. The only way to create long term shareholder value is to be good at both the asset business and the service business. Companies that succeed in both will drive the consolidation of our industry. In doing this they have a real chance of scaling the considerable barrier to achieve sustainable profitability in our business.

Thank you very much for listening.



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Teekay Shipping Australia

Maritime Law Association

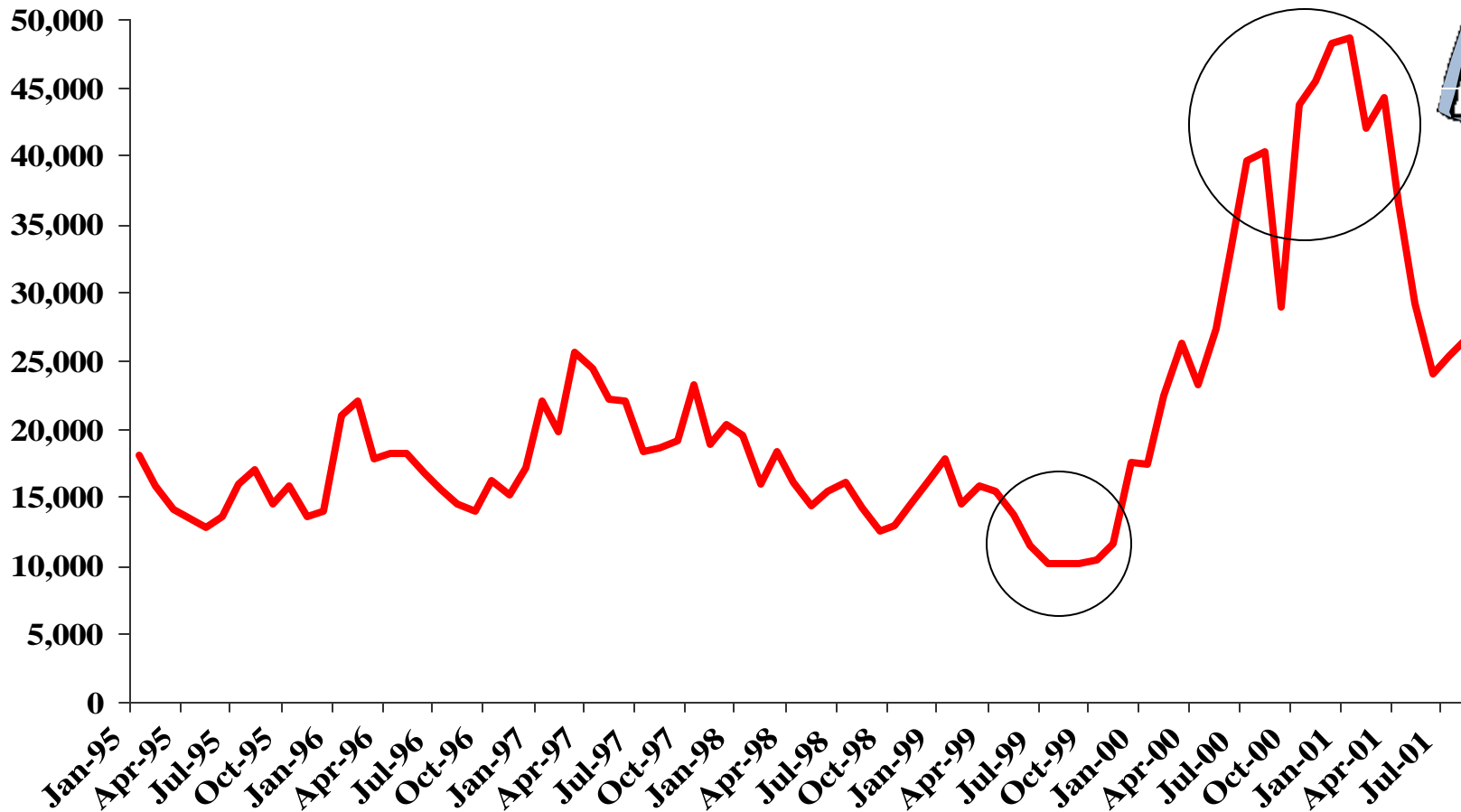
of Australia and New Zealand Limited

Conference October 2001

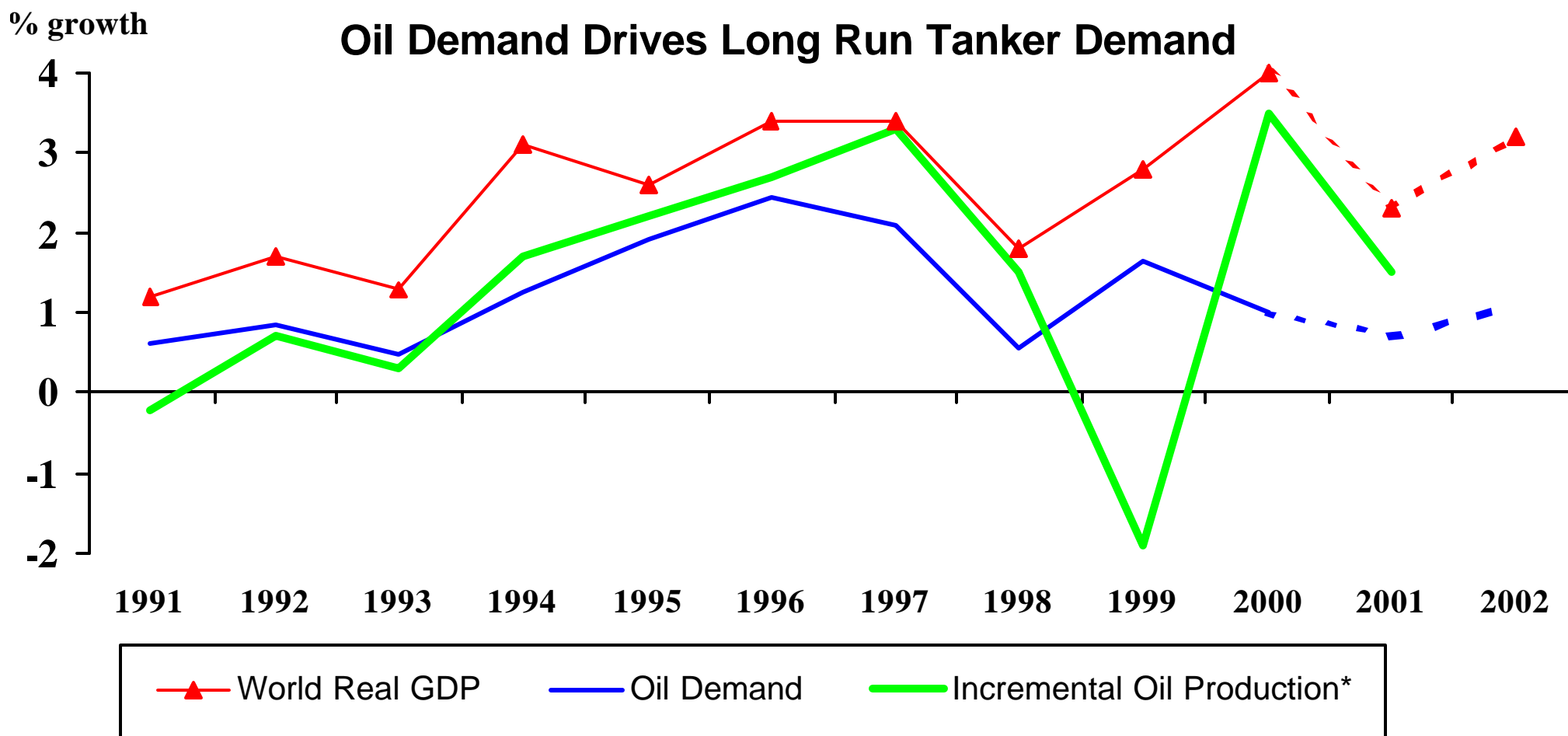
Aframax Average TCE Rates



TCE Per Ship Per Day (US\$)



GDP Growth vs. Oil Demand

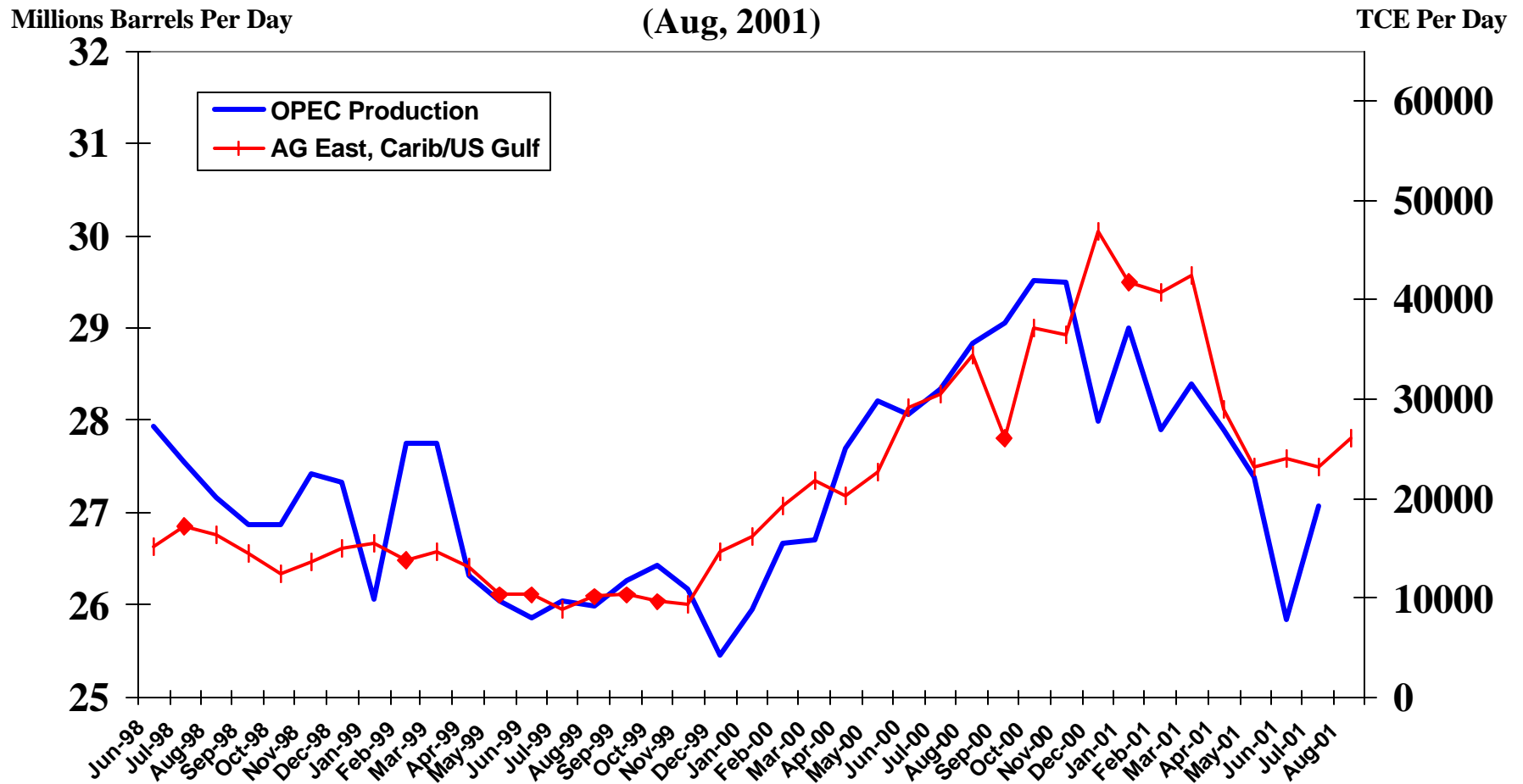


Source: IEA, Aug, 2001

* Consensus and oil consumption 2002 forecasts from ML report July, 2001

Incremental year-over-year oil production for 2001 based on first half 2001 production

OPEC Production vs Aframax Rates

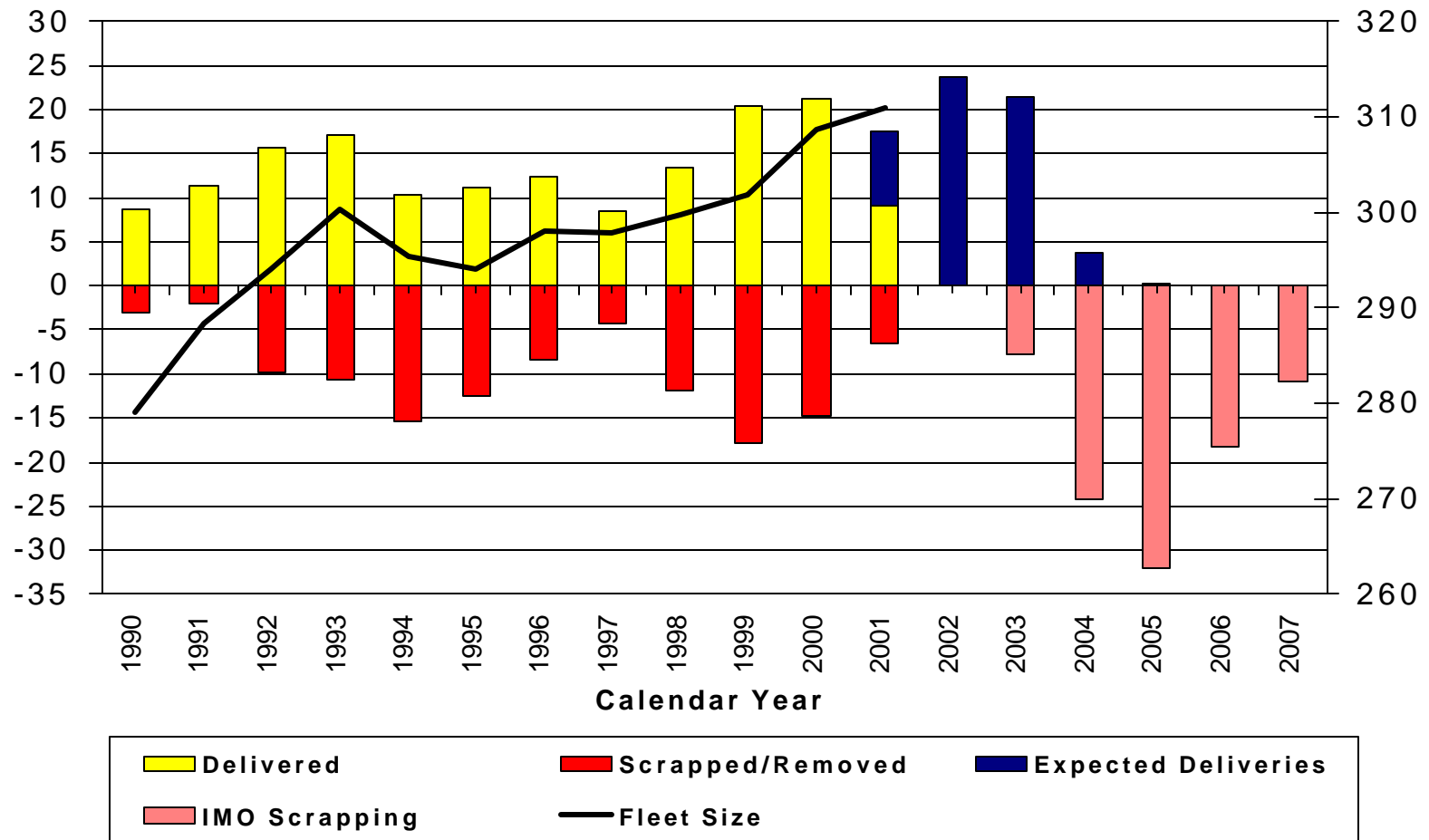


Source: International Energy Agency, Aug 13, 2001
Clarksons Aug 2001

World Tanker Fleet

Deliveries/Scrappings
(mdwt)

Fleet Size (mdwt)



Source: Clarkson World Shipyard Monitor 7/01
 '01 Scrapping/Deliveries is up to June 30, 2001

Off the Chart!



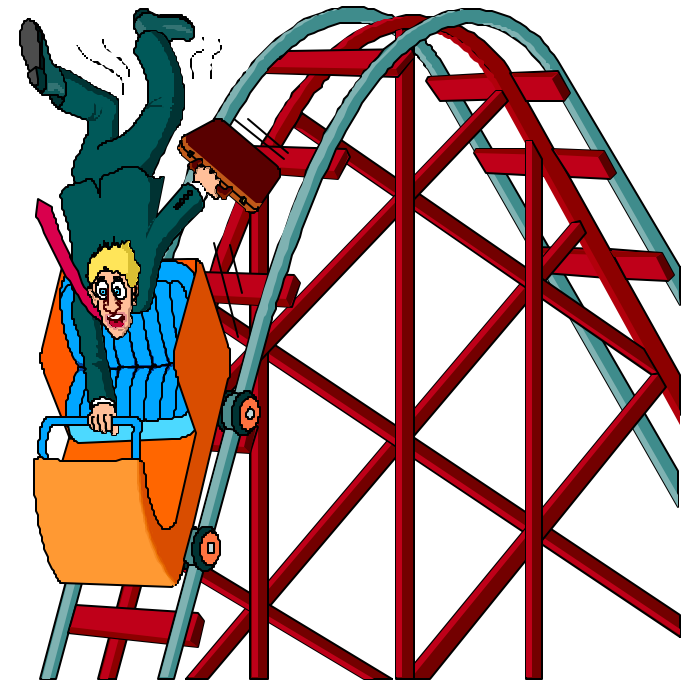
	OIL PRODUCTION ¹⁾		TANKER DEMAND ²⁾
	MBD	Change	Change
Jan-Jun, 2000	75,750	+1.52%	+ 2.3%
Jan-Jun, 2001	76,900		

	TANKER RATES (TCE/Day) ³⁾			
	Aframax	Suemax	VLCC	Change (avg)
Jan-Jun, 2000	\$25,358	\$31,764	\$36,921	+36%
Jan-Jun, 2001	\$37,181	\$41,720	\$48,440	

1) Source: IEA July 2001 2) Based on Fearnley ton/mile model 3) Source: Clarkson

...But don't sell your worry beads yet!

- Tanker market will remain cyclical in nature
- Basic barriers to entry remain low
- Market cycle alone will not stop
shareholder value destruction



One Company - Two Businesses...



**Asset Owning
Business**



**Service
Business**

1) Risk Management and Controls

Performing to the highest standards:

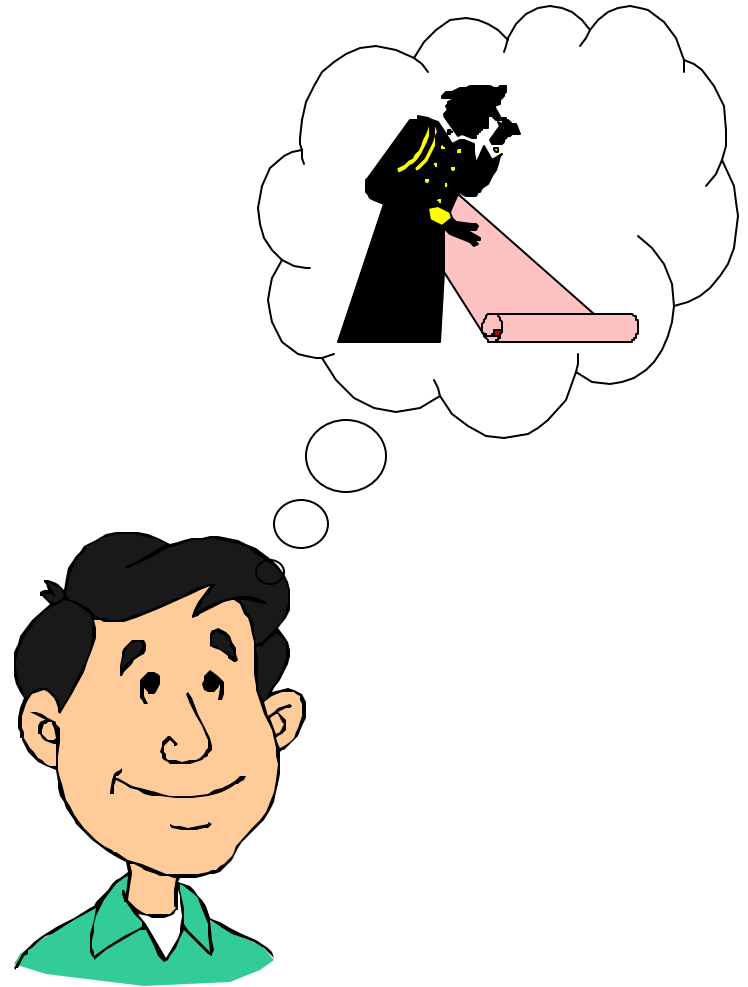
- Crew
 - Ship Quality
 - Maintenance
 - Safety
 - Emergency Response
 - Quality Control
 - Ship Management Philosophy
- ⇒ **Minimizes customer's risk**



2) Customer Service

Add value to your customer:

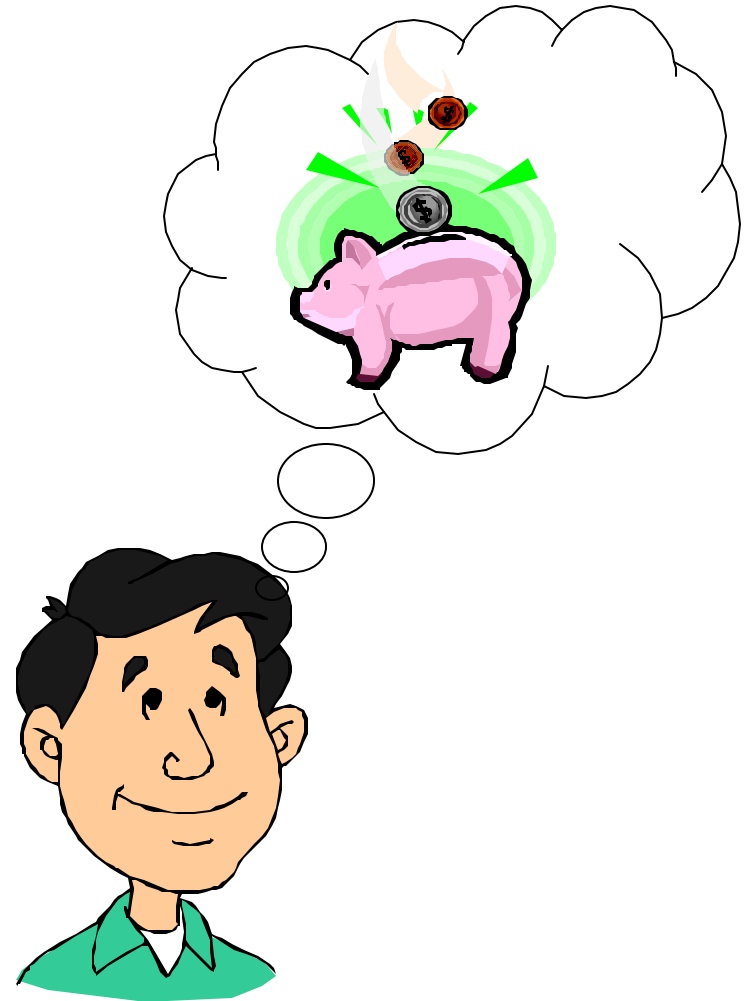
- Convenience
 - Flexibility
 - Consistency/Predictability
 - Information
 - Responsiveness
- ⇒ **Improves customer's bottom line**



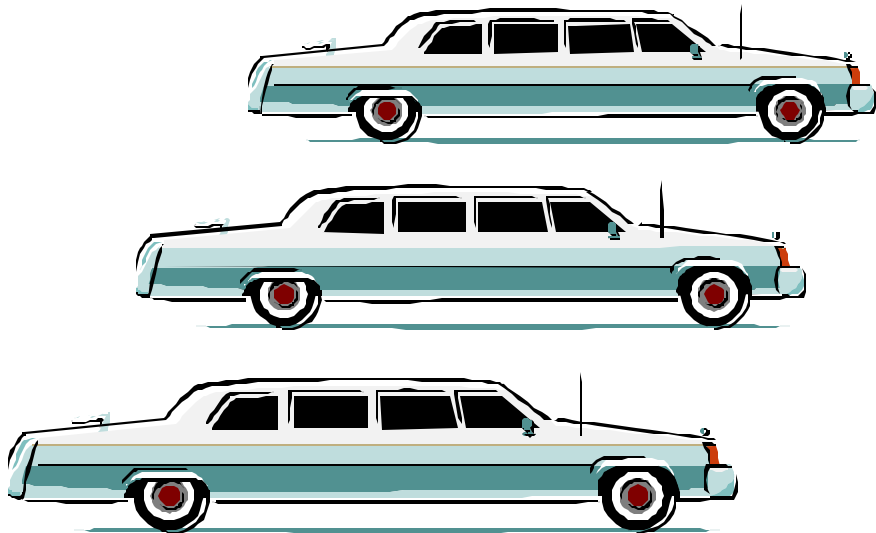
3) Cost Efficiency

Managing costs successfully:

- Vessel Utilization
 - Effective Organization
 - Economies of Scale
 - IT systems
 - Process Efficiencies
- ⇒ **Foundation for providing superior service at a competitive price**

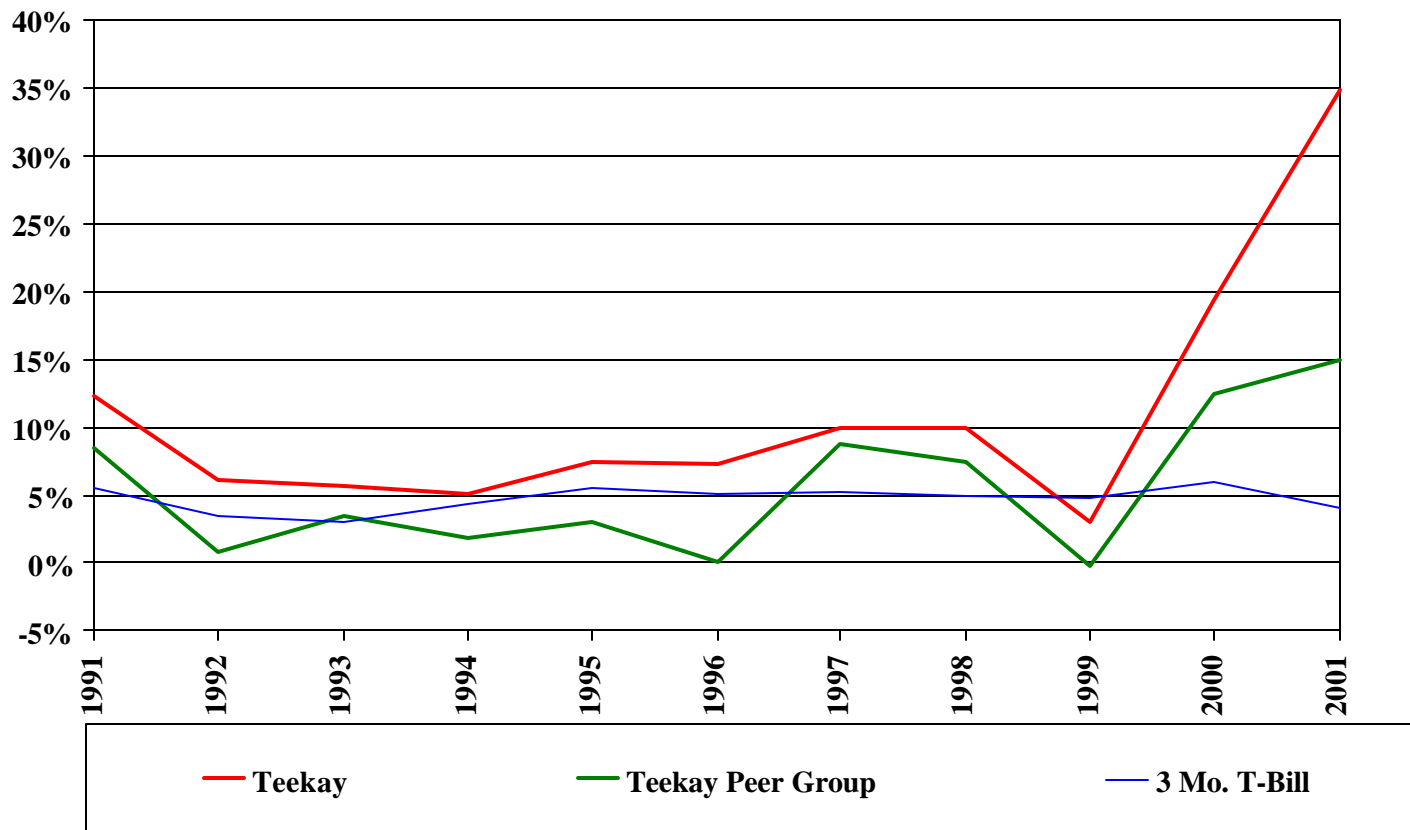


Consolidation: “cost effective” - not “cheap”



Poor Historical Returns on Invested Capital

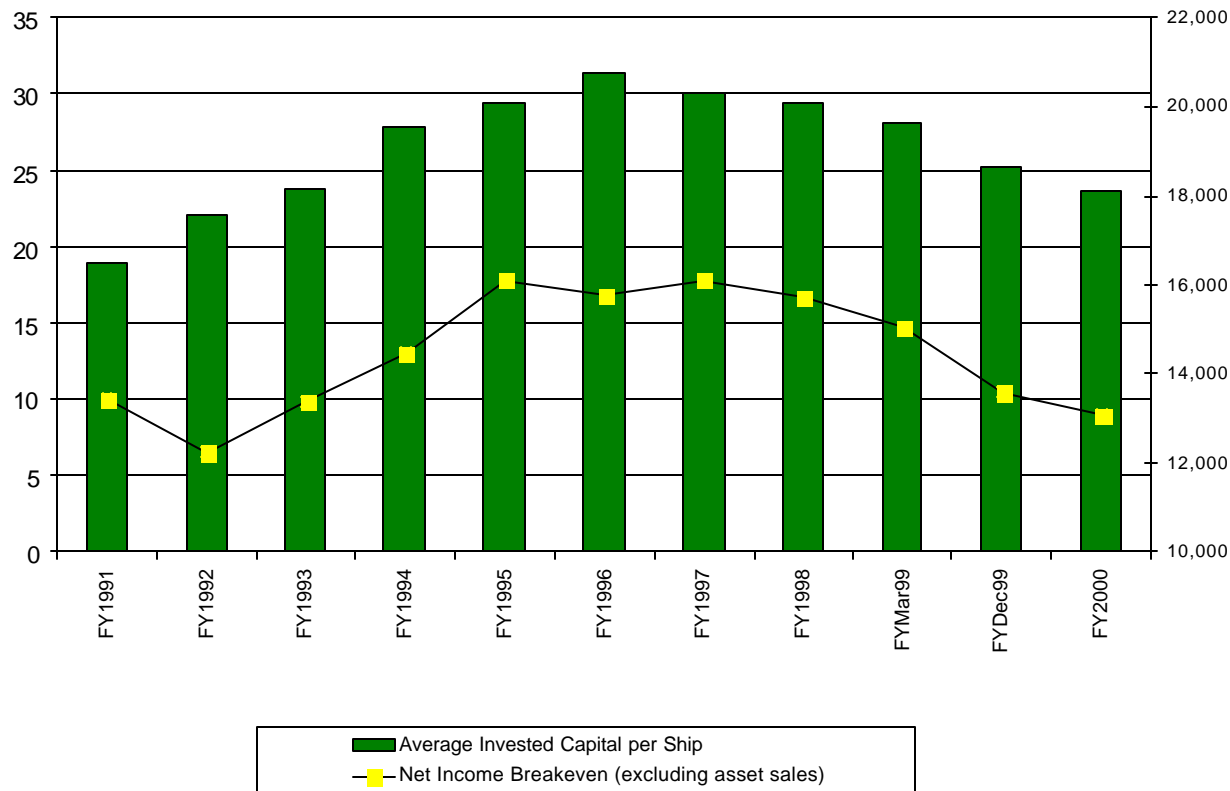
Return on Invested Capital



Learning a Lesson The Expensive Way

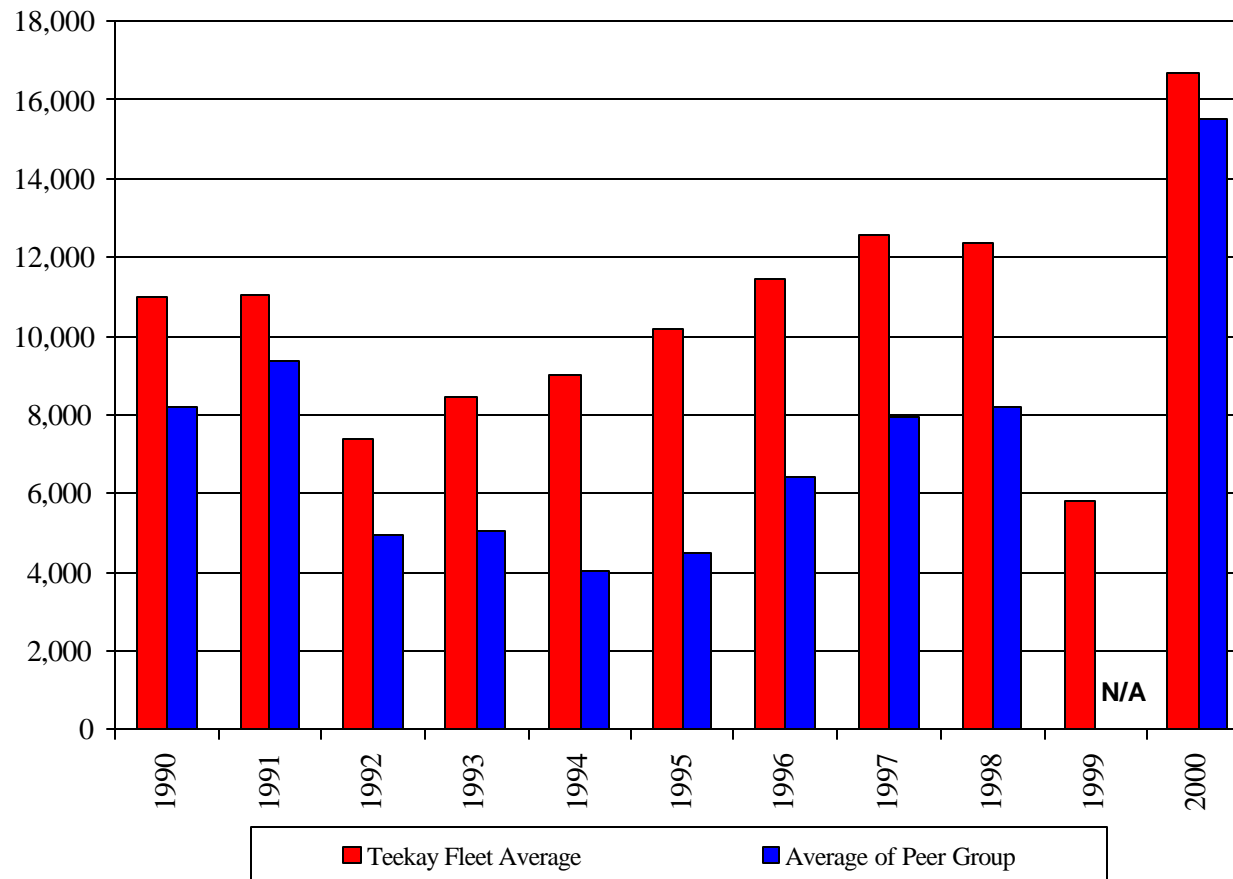
**Invested Capital Per Ship
(US\$ million)**

**Net Income Breakeven Per Day
(US\$)**



The Advantage of A Strong Franchise

Operating Cash Flow Per Ship Day
(US\$)



Fresh thinking needed!



**“Strategic Planning
at the Bendy household”**