LION CAO

ASSET MANAGEMENT

Maritime Industry Update

March 28, 2012

On March 19, Lion Cao attended Capital Link's *6th Annual Invest in Shipping Conference* at The Metropolitan Club in New York, and we have prepared a summary of the conference topics below. We thought it would be of interest to share some of our takeaways from both the event and our own research on the market conditions for private equity investment in the maritime sector.

The *Invest in Shipping c*onference is an investor-focused event held every year in New York, and gives investors the opportunity to hear from and discuss relevant issues with influential executives of U.S. and foreign listed shipping companies, analysts, financiers and market experts. Topics discussed at the conference included macroeconomic issues that are shaping and transforming international shipping today. Some of the notable panelists included Jeffrey Pribor, CFO – General Maritime Corporation, George Economou, CEO – DryShips (NASDAQ: DRYS), Ocean Rig (NASDAQ: ORIG); Erik Helberg, CEO – RS Platou Markets, AS; Paul Leland, CEO – AMA Capital Partners and George Saroglou, COO – Tsakos Energy Navigation (NYSE: TNP). In addition, we also connected with a few of Lion Cao's contacts in the sector, including Peter Schaerf, Managing Director at AMA Capital Partners, Elliot Etheridge, Managing Director and Head of Marine Transportation Investment Banking at Dahlman Rose & Co, and Jay Rodin, Capital Markets Chairman at Brock Capital Partners.

Our attendance at *Invest in Shipping* was just one of the many efforts we have been making to explore and evaluate opportunities in the maritime space. We believe that the current market dynamics present very compelling investment opportunities for long-term, patient investors. The extended poor performance in the bulker and tanker markets have pushed vessel values to new lows and the banks appear to finally be getting tired of broken covenants and concessions to debtors. A major theme of the conference, and one that we had recognized ourselves, is that opportunities to purchase assets at significant discounts are very likely to arise within the next 6 to 18 months.

Overall Macroeconomic Situation

ABN-AMRO's Nick Kounis, Head of Macro Research and Group Economics started the conference with a discussion on the Global Economy and World Trade.

Mr. Kounis sees the world in the midst of a recovery, albeit one that will be slow and drawn out, and not without its bumps in the road. The industry continues to face headwinds in the form of risks relating to sovereign debt, high oil prices related to the Iranian situation, and unclear regulation in the capital markets. Kounis expects further restructuring from Greece, as even at best case following the recent round, Greek debt service would still be at 120% of GDP for 2012. More action is needed on the part of European politicians. During his discussion, Kounis had a great slide of Merkel pointing at Sarkozy who was pointing at Monti who was holding his hands out as if to say "what do you want me to do?" Kounis indicated that we can expect to see more bailouts and restructurings as the cost for these would be far lower than those associated with the disaster that would follow the breakup of the Euro. Deleveraging and "fiscal fundamentalism" will lead to slow growth in Europe for the foreseeable future.

Kounis was encouraging about the prospects for US growth as the US has been showing better numbers recently. Kounis predicted that unemployment should slacken due to job growth, but mostly due to aging out of the baby boomer population. In Asia he predicted moderate growth (China to continue at 7.5-8% and the surrounding nations at similar levels to last year).

Dry Bulk

Ben Nolan of Knight Capital Group headed the panel on Bulkers.

Demand

Demand is not the issue in the dry bulk market as global demand remains quite strong. In dry-bulk, the largest demand driver continues to be moving commodities into China, especially iron ore. The Chinese urbanization push is expected to last well into the next decade, keeping growth at 7.5% or above and keeping steel prices high. Chinese iron ore quality is very poor, so imports will continue. Currently more than 60% of iron ore imports go to China, accounting for 30% of global bulk shipping demand.

Additionally South America and South East Asia continue to have high iron ore demand. In Argentina and Indonesia demand is steady at 9%. Additionally, Japanese coal imports are expected to continue rising as a result of the shutdown of its nuclear plants.

Supply

The issue in bulk shipping continues to be supply as ships ordered during the spike in the market continue to be delivered. Delivery slippage was somewhere between 30% and 35% for 2011 and is expected to continue at 30% or slightly higher for 2012. Record scrapping was recorded in 2011 and is expected to increase, possibly even double this year as aging tonnage becomes less and less valuable in the face of dry-docking expenses and low rates (more than 5M dwt was taken out of the water already this year). Unfortunately, even record scrapping will not affect the market as 100M dwt is expected to hit the water in 2012. Analysts are predicting that it will take two more years for a correction in supply to take place.

In good news, the Chinese have taken account of the long term trends and will not over-promote construction to keep yards open and producing new ships. They will instead shut down or convert yards to serve other purposes such as green energy. Fifty percent fewer orders have been placed in Chinese yards vs. last year.

One interesting development has been the clear advantage of the Japanese-built "eco-ships". The Japanese ships being built now have advances in propellers, hull design, motors, and especially drive shafts that will allow them to save an average of 15% on fuel costs without slow steaming. These ships can cost up to $5M more per vessel than normal bulkers, but can offer significant savings, especially in the face of crude increases. Ben expects the Japanese to have the edge in technology for another two years at least, and that the advantages will not contribute to pushing out of the older fleet unless rates continue to remain low for more than 20 months. As he said, "if rates come up, then everyone's ships will sail; those with these ships will just make better margins." Should rates remain depressed for long enough though, the savings offered by these ships will be more and more attractive. The Korean yards are focusing more on LNG and Offshore and less on eco ships.

Vessel Class Distinction

During the craze of ordering in 2005 – 2008, perceived economies of scale led to proportionate over-ordering of larger asset classes. As such, capesize vessels have suffered the most from the downturn and will continue to do so as more have been delivered and remain on the order book than the smaller classes. Smaller vessels should perform well over time, but should rates shift significantly higher, large vessels will do well again for the same reason they were originally ordered. Cape rates will remain the most volatile.

Tankers

A clear separation has developed between the tanker categories, significantly favoring carriers of refined products over crude. The crude tanker market continues to suffer from the same self-inflicted supply-side crisis as the bulker market, while product tankers have seen steady business and positive numbers. Analysts and ship owners were mixed about demand, but the one consensus was that the current uptick for crude tankers is not a structural recovery, but a short term blip created by a flood of chartering by Vela in Saudi Arabia in the face of sanctions and possible fighting. Every analyst and ship owner is excited about product carriers over crude oil tankers, especially as the US begins to produce more oil from fracking and shale deposits, curtailing US crude demand from foreign producers.

Product Tankers

Product tankers have outperformed crude for a full year. The industry has seen a 10% increase in tonnage supply to the global fleet, and all of that new capacity has been absorbed. In 2010, 120 new ships were delivered, and in 2011, 80 ships were delivered, with no slack in demand. Product tankers have not been forced to slow steam, instead delivering as soon as possible. US demand for crude oil is currently at a 10-year low while demand for product is at a 10-year high. Adding to the attractiveness of the product market is the closing of US refineries and the opening of new refineries further away from the major demand sources, thereby increasing potential ton-mileage. The major theme for analysts was that if product has shown this kind of growth before the refinery shift and at low GDP growth, then structurally it must be improving, and there should be plenty of further growth potential.

Crude Tankers

Crude is still very much tied to global GDP which has not grown enough to fill the supply ordered in the 2005 – 2008 over-ordering. Ton mileage has shifted somewhat as lower crude demand in the US is being replaced with routes from Africa to China. Chinese demand is up to 5.90b barrels/year from 5.16b barrels/year last year. China accounted for 35% of VLCC ton mile demand in 2011. That figure has risen to 42% this year as fewer cargoes have come into China from the Middle East and more have arrived from Africa, South America and the Caribbean. China may be building its strategic petroleum reserve and may ramp up demand if it thinks Iran can be a real problem. Chinese oil companies have been looking to Canada's oil sands which may provide further ton mileage in the future, though this is still uncertain. In any case, China's urbanization will certainly play a major part in creating demand for crude.

Slippage on crude tankers seems to be around 20% (vs. a historical 10%). What drives crude demand? GDP growth in the US, further growth in China, or contango (which previously tied up 15% of the supply and drove up rates significantly) can all play major roles. Scrapping has been seen of VLCC's, but not enough to right-size supply. Scrapping is always welcome but not realistic as the sole supply lever even though steel prices should remain high for the foreseeable future. Scrapping will happen on an individual basis and will generally be done by owners who are dealing with a completely depreciated asset.

LNG

Conference participants were quite bullish on the LNG market. Maritime transport remains the major bottleneck in the natural gas infrastructure and logistics chain, and one that major players are looking to remove. The LNG shipping industry remains relatively small; in fact, Clarksons lists the global fleet at only 373 vessels at an average age of 10.5 years. The world orderbook now stands at just over 70 vessels. Newbuilding deliveries prior to 2014 will be limited due to few orders being placed in the period 2008 to 2010.

Asian demand is predicted to double in the next 5 years from 50M tons to 100M tons. Global demand for gas is forecast by the Energy Information administration to increase by 50% by 2035. In response to the short supply and huge demand, John Fredricksen's Golar has seen its stock up almost 200% in a year. Golar currently operates a fleet of 9 vessels and just recently signed up for two 162,000-cbm LNG carriers at an estimated cost of $200Meach, bringing their total orderbook since the beginning of 2011 to 12 vessels. Day rates for LNG ships have been averaging $100,000/day and climbed to almost $200,000/day, and long-term charters of up to 3 years have been booked recently at $140,000/day. Both LNG carriers and Floating Storage and Regasification Units (FSRUs) are in short supply. Korean yards are heavily focused on building and converting existing ships into these. The orderbook at the moment seems to be below projected demand (but that can be a dangerous trap to get into!).

Offshore

Conference panelists, including George Economou (CEO of Ocean Rig), Simen Lieungh (CEO of Odfjell Drilling) and Tor Olav Troim (VP and Director of Seadrill), were all very optimistic about the offshore drilling sector. . Rigs are currently commanding $650,000 per day for 2 years with options at $690,000 to continue for 2 additional years. All three deepwater operators were fairly confident that they would see $700,000 day rates within the next two years. Contract terms have recently been extended from less than a year to almost 5 years, which is essentially how long it would take to pay one of these down.

All agreed that there is no way to significantly affect supply before 2014. At the moment, there are only 3 yards in Korea who can deliver the requisite capabilities for a rig at the proper cost, and it will be at least 3 years before China has the ability to match the Koreans. Currently these yards are maxed out at 25 Ultra-Deep Water (UDW) rigs per year. Within 5 years 20% of the deepwater fleet will be 40 years old or older. Newbuilding prices are projected to remain where they are as Korean yards seek to keep working during the major downturn in the overall orderbook, and counterparty risk is seriously low due to those parties being the wealthiest companies in the world. LTV ratios are available at 50%, to 60% to even 70% in some cases.

Jackup rigs were also encouraging though the supply-side risk is significantly higher as they are far cheaper and easier to produce.

Bank Financing/Capital Markets/Alternative Financing

Not surprisingly, bank financing is readily available for LNG and Offshore, and is available for chemical tankers as well at more conservative LTVs. Offshore offers very strong fundamentals in the form of high demand and very low counterparty risk. High growth in these sectors with strong projected cash flows for the next two to three to even five years means banks are very willing to lend against these assets. As indicated above, LTV has been as high as 70% for DPW rigs. As Evan Cohen of DVB said, "we've been limited less by capital and liquidity than by hours in the day!"

In Tankers and Bulkers, underwriting is trending down due to capital requirements from Basel III. Syndication has proven difficult due to differing lending requirements by separate institutions in various nations and balance sheet situations. New loans have proven difficult in general but are still available to asset purchasers with strong balance sheets and good counterparties. Smaller club deals have proven to the most flexible during difficult times such as these.

Interestingly, banks have been turning more aggressive with foreclosures, a trend which is expected to continue as low rates restrict cash available to operators. Banks have been making serious concessions for over a year and see the trend continuing. Banks have tried to avoid foreclosures to keep from taking assets on to their balance sheets and thereby forcing them to raise capital to meet new government requirements, but are seeing losses pile up and are beginning to change their tune. These capital requirements bode well for cash rich investors as banks will seek to sell these assets quickly to avoid raising more cash. Deals are already starting to appear and will be coming down the pike at an increasing rate. Analysts believe that these deals will start to pile up within the next 6 to 18 months and may come in a serious rush.

Capital markets are seeing a similar trend. Bonds are generally available in the three growth sectors and excessively expensive for tankers and bulkers. IPO's are expected to follow suit: based in Bermuda with executive offices in Monaco, Greek owned GasLog Ltd. (GLOG) has scheduled a $400 million initial IPO with a market capitalization of $1.071 billion at a price range mid-point of $17 for Friday, March 30, 2012. This is to follow three other public offerings including Golar's IPO and a follow-on from Teekay LNG for $350M. At least two more are expected to launch this year.

Alternative financing from private capital is where most groups not involved in LNG or Offshore are turning now. There were a large number of private equity investors in attendance at the conference and most analysts, especially Ben Nolan, mentioned that they had been speaking to numerous groups representing private capital. Institutional investors have been looking at the space as well and are looking to deploy soon.

Restructuring/Chapter 11

Jeff Pribor, CFO of GMR, was a panelist for the restructuring panel along with Paul Leland, CEO of AMA Capital Partners. All the panelists complimented Jeff's efforts, noting that the CFO position at a company in the midst of a Chapter 11 is one of the most difficult in the world, and that Chapter11 is rarely, if ever, what a company wants to do and rather is a necessity.

The overarching theme of both panels was that given proper prior planning and strong advisors on both the legal and financial side, a Chapter.11 refinancing can often be the best course of action. Jeff was obviously limited in what he could say, but the group around him was enthusiastic about GMR's Chapter 11 proceedings, indicating that they had made all the right preparations for the process.

Overall Impressions

Our overall impressions from the conference were quite positive, especially for patient private equity investors. Bunkers and Crude Tankers will be a sector where great deals will be available in the next 6 to 18 months.

Growth in the other sectors is also quite compelling. LNG is still a rather small market in comparison, but with new E&P technology and amazing finds here in North America, cheap supply is set to grow. Demand in Asia will continue to rise as China requires more energy and Japan replaces its nuclear plants with efficient and relatively clean natural gas. Removing the bottleneck in the logistics chain is sure to produce great returns for early investors, and is a sector definitely worth considering. Due to the huge upfront capital requirements and limited shipyard production capabilities, UDW E&P still presents a large enough barrier to entry to remain attractive for at least the next three years. The same energy story in Asia is set to influence this game.

Each market presents its own challenges, but entry points seem ideal for those with available cash. We continue to see this as a great time to be private equity investors in the maritime sector with dry powder.