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China tanker shipping and shipbuilding

Washington wants more tankers, but who will take the risk?

Infrastructure, Industrials & Transport

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We reiterate OW on CSET (1138 HK) following the sharp correction in tanker equities, driven by softer spot freight rates, renewed Middle Eastern hostilities and uncertainty over Washington's plans to bring sanctioned tankers into compliant trading. Since October 14, CSET-H and CMES-A have fallen 20.8% and 17.8%, respectively, significantly underperforming the HSI (-1.3%) and CSI 300 (-1.4%). Yet Oman-China VLCC spot earnings have declined 8%, while one-year time-charter assessments increased 11% WoW to US$303.5k/day. We believe the market is pricing in potential supply additions before any have materialized. While U.S. Energy Secretary Chris Wright's reported 19 October comments outline a more credible route for sanctioned tankers to return, three hurdles remain, in our view: (1) **Limited suitable capacity:** Kpler estimates that only ~24 sanctioned VLCCs currently meet age and ownership criteria for mainstream trading. (2) **Uncertain investment economics:** A 20-year-old VLCC recently sold for US$117mn, versus US$131mn for a newbuilding, while refurbishment and limited earnings visibility complicate investment decisions. (3) **Persistent operational risks:** Additional vessels would not eliminate attacks around Hormuz or congestion at Oman ship-to-ship (STS) locations. We see limited evidence of meaningful near-term capacity additions and would accumulate CSET-H on dips.

- **What changed? Washington is exploring a route for sanctioned tankers to re-enter mainstream trading.** Reuters reported on 15 October that the U.S. was considering allowing previously sanctioned vessels to transport non-sanctioned oil. On 19 October, Secretary Wright provided further details, according to Bloomberg, saying the administration is working with investors interested in purchasing and refurbishing idled sanctioned tankers. He suggested the initiative could eventually add dozens or hundreds of vessels to the compliant fleet. However, no individual vessel approvals, completed conversions or deployment timetable have been confirmed. The potential supply addition therefore remains, in our view, a proposal rather than available capacity.
- **The potential VLCC supply addition is far smaller than the headline suggests.** Gibson estimates that 878 tankers are sanctioned globally, of which 325 fall within the OFAC-only pool, including 153 VLCCs. However, 70% of OFAC-listed tankers are at least 20 years old, reflecting the shadow fleet's reliance on aging vessels that have gradually exited mainstream trading. Many also face technical or ownership restrictions. Kpler estimates that only ~24 VLCCs currently meet age and ownership criteria for returning to compliant trade, particularly after excluding Iranian state-linked vessels. Although refurbishment and legitimate ownership transfers could eventually expand this pool, regulatory permission does not immediately create commercially usable capacity.
- **Who will fund the conversions?** The 20-year-old VLCC *Vadin* was reportedly sold for US$117mn earlier this month, vs. US$60.5mn earlier this

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year, compared with approximately US$131mn for a newbuilding. Assuming illustrative refurbishment costs of US$3-10mn, investment at *Vadin*-equivalent pricing would reach US$120-127mn, or 92-97% of a newbuild price. However, *Vadin* was not sanctioned, and idled shadow-fleet vessels could be acquired at substantial discounts. The challenge is that actively employed shadow-fleet owners have little incentive to sell cheaply while benefiting from elevated freight earnings, while idle or damaged vessels may require extensive repairs. With limited visibility on earnings beyond the current conflict and subsequent inventory rebuilding, we question how many investors would commit substantial capital without attractive purchase prices.

- **Re-entry has happened before, but scaling it is another matter.** Sinokor acquired three VLCCs previously involved in Iranian or Venezuelan shadow trades earlier this year, demonstrating that vessels with such trading histories can return to mainstream ownership. However, none was individually sanctioned at the time of acquisition. Secretary Wright's reported proposal involves currently sanctioned vessels that may require ownership changes, refurbishment, insurance and classification approval. Suitable repair-yard availability could also delay deployment. Sinokor provides a precedent for selective reentry, not evidence that large-scale conversions can be completed quickly.
- **The immediate constraints remain Hormuz security and Oman congestion.** The shortage of effective tanker capacity reflects the risks of operating inside Hormuz and delays at offshore transfer locations, rather than simply insufficient vessel numbers. Clarksons estimates Gulf of Oman STS volumes at 11–12mn bpd over the past two weeks, down from 12–13mn bpd previously but still roughly twice early-September levels. Vitol confirms that producers continue paying elevated freight and conflict risk premiums to move oil through Hormuz. Investors purchasing and refurbishing older VLCCs must decide whether exceptional shuttle earnings compensate for the risk of damage or loss in a conflict zone. Additional vessels would also have limited benefit if offshore transfer capacity remains constrained. Conversely, further attacks could disrupt cargo flows, adding another source of uncertainty.
- **CSET – Highlighting the disconnect between equity prices and freight earnings.** Since the first shadow fleet news, Oman–China VLCC TCE has fallen 8% to approximately US$790k/day, versus declines of 12% for West Africa–China to US $640k/day and 15% for U.S. Gulf China to US$515k/day. The larger Atlantic corrections also reflect expensive transportation: our estimates put freight to China at approximately **US$18/bbl from Oman, versus US$31/bbl from West Africa and US $35/bbl from the U.S. Gulf**. Oman remains 43–49% cheaper in freight terms, supporting its attractiveness to Asian refiners. Meanwhile, VLCC time-charter assessments have strengthened despite spot weakness, with one-year rates rising 11% WoW to US$303.5k/day and two-year rates increasing 36% to US$188.5k/day. We acknowledge slower spot chartering activity, but see little evidence of an equivalent deterioration in medium-term tanker earnings. We reiterate OW and would accumulate on dips.
- **Songfa (603268 CH) – Conversion risks are longer-term, not an immediate cancellation trigger.** Tankers account for approximately 33% of Songfa's orderbook, while our data show that the global VLCC orderbook has reached 32.8% of the existing fleet, versus 13.2% a year ago. Large-scale conversions could eventually add capacity alongside scheduled newbuilding deliveries, increasing pressure on future tanker orders. However, the U.S. program has yet to deliver confirmed capacity additions, and existing shipbuilding contracts involve advance payments and contractual obligations. We see limited basis for assuming widespread cancellations from Secretary Wright's reported comments alone, while recognizing that a prolonged freight downturn would increase risks to future contracting.

Can shadow-fleet conversion work commercially?

Acquisition economics – A trade-off between price and vessel condition. The shadow fleet has historically absorbed older tankers leaving mainstream trading, particularly as they approach stricter age-related charterer requirements. The most attractive conversion candidates would be technically sound vessels available at discounted prices. However, these may be difficult to acquire cheaply if their current owners are generating substantial cash flow. Conversely, long-idled or damaged vessels may be available at lower prices but require greater expenditure and longer periods out of service.

At a hypothetical US$120mn total investment, assuming US$25k/day operating costs and 330 earning days annually, simple cash payback would take approximately 4.8 years at US$100k/day TCE, versus 2.9 years at US$150k/day. These calculations exclude financing, taxes, future drydockings and residual value. For a 20-year-old VLCC, the remaining commercially acceptable life makes the timing of payback particularly important. The US$3–10mn refurbishment range is illustrative rather than a verified cost estimate for a sanctioned vessel.

The remaining freight cycle – Strong near-term earnings, uncertain long-term returns. Current VLCC earnings reflect exceptional conflict conditions, including offshore transfers, longer voyages, elevated insurance costs and restricted vessel movements. These conditions may persist while the conflict continues, while replenishment of depleted commercial and strategic oil inventories could provide further support after tensions ease.

However, the duration of any replenishment cycle remains uncertain. Our data show the global VLCC orderbook at 32.8% of the existing fleet, up 19.6ppt YoY, with deliveries spread over several years. Investors purchasing aging vessels at elevated prices must therefore weigh exceptional near-term earnings against potentially lower freight rates as shipping conditions normalize and newbuildings enter service.

Execution – Government authorization is only one step. Returning currently sanctioned vessels to mainstream trading requires legitimate ownership transfers, repairs where necessary, classification surveys, valid registration, insurance and charterer acceptance. U.S. authorization would not automatically override applicable EU/UK restrictions.

Our industry checks suggest suitable repair facilities are already heavily utilized, although we have not established a global shortage of VLCC-capable drydock slots. Access to appropriate repair capacity could nevertheless affect the timing of conversions, adding to the delay between policy approval and actual commercial availability.

Middle East conflict – Supporting freight, but also threatening cargo volumes. Renewed attacks on commercial shipping and Saudi energy infrastructure have increased investor uncertainty alongside Washington's proposed conversion program. Security risks restrict the number of vessels willing to enter Hormuz, sustain conflict risk premiums and prolong transportation inefficiencies. However, attacks severe

enough to interrupt oil exports could also reduce the cargo volumes available to ship.

Vitol reports that Middle Eastern Gulf high-sulfur fuel oil exports remain at least 800k tonnes/month below February levels, while interruptions to Saudi crude exports have prompted some North Asian refiners to substitute fuel oil for crude feedstock. We therefore distinguish between security risks that increase shipping demand through inefficiencies and attacks that materially reduce oil exports. The latter would present a more significant threat to our constructive tanker outlook.

Policy objectives versus commercial returns – A potential mismatch. Washington wants additional tanker capacity to increase oil exports and lower freight costs. Private investors, however, need sufficiently strong earnings to justify acquiring and refurbishing aging vessels. If the program succeeds in expanding compliant supply and reducing freight rates, it could also weaken the returns underpinning those investments.

Conversions may still be attractive where technically sound vessels can be purchased at substantial discounts and returned to service quickly. Nevertheless, we question whether enough such opportunities exist to achieve the scale envisioned by Washington without favorable acquisition prices or other incentives.

What would change our view? Confirmed acquisitions of suitable sanctioned VLCCs, completed refurbishment, commercial insurance and actual deployment into compliant long-haul trades would demonstrate meaningful progress. We would also reassess our outlook if security conditions improve and Oman STS congestion declines materially without corresponding cargo growth, releasing effective tanker capacity independently of the conversion program.

Investment conclusion. Secretary Wright has reportedly outlined a more credible route for sanctioned vessels to enter mainstream trading, but the scale and timing of additional capacity remain uncertain. The equity market has already begun pricing future supply additions, even as current freight earnings remain exceptionally high.

We reiterate OW on CSET-H and would accumulate on dips. Washington has an incentive to bring more tankers into service, but investors must still acquire suitable vessels at attractive prices, restore them to compliant standards and earn sufficient returns before the exceptional freight cycle normalizes.

Also read:

- China tanker shipping and shipbuilding: Out of the shadows, but not into the mainstream — buy on dips (15 Oct)
- China tanker shipping: The curious case of easing congestion and rising tanker rates (4 Oct)
- China tanker shipping: Cargo flows remain intact, shipping stays inefficient, buy CSET on dips (24 Sep)
- China Tanker Shipping: Cargoes survive renewed fighting; upside risk to VLCC TCE assumptions (17 Sep)

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- COSCO Shipping Energy Transport (1138.HK/600026.SH): 2Q26 earnings review and briefing takeaways　Management validates the tanker bull case; raising TCE forecasts and PTs (28 Aug)
- China Tanker Shipping: The chicken-and-egg flips: More barrels, more ships; turning slightly more constructive on tankers, stay OW on CSET (24 Aug)

