

Market Review

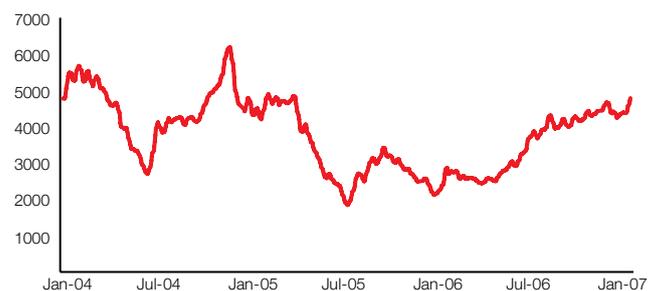




In 2006 the dry bulk shipping market surprised most industry experts, who had forecast a relatively weak year on the back of historically high new vessel deliveries. Once again, demand for bulk commodities, particularly iron ore, surpassed expectations and easily absorbed the supply of ships. This was clearly indicated by the Baltic Dry Index (“BDI”), which opened 2006 at 2438 points and climbed 80% to finish the year at 4397 points after a particularly impressive performance in the second half.

The BDI, which tracks spot rates for capesize, panamax, and handymax (but not handysize until January 2007) dry bulk carriers, got off to a quiet start in 2006 mainly due to iron ore supply shortages and, consequently, to lower capesize requirements compared to the very solid second half of 2005. Towards the end of the second quarter, however, it started to become apparent that robust demand for commodities, particularly cement and steel out of China, had absorbed the record volumes of newbuilding deliveries. The recovery gathered pace during the third quarter, traditionally a quiet period, indicating that the market had embarked on a new cyclical upturn.

The Baltic Exchange Dry Index

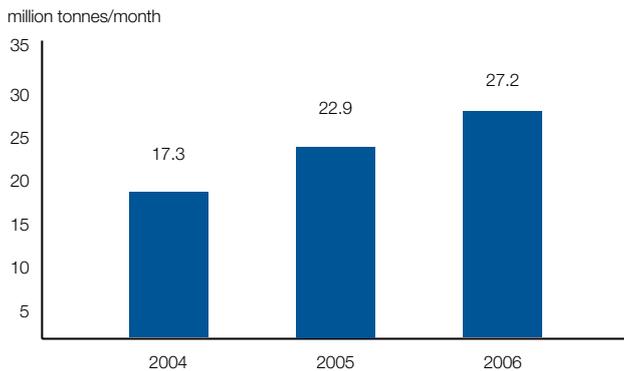


Source: The Baltic Exchange

One of the key drivers behind the rising need for dry bulk ships is the steel industry, which in 2006 achieved record world crude steel output of 1,240 million metric tonnes, an increase of 8.8% from 2005¹. Whilst China is leading the ramp-up in global production, realising year on year steel output growth of just under 18% in 2006¹, other major steel producing regions, such as the EU, CIS, North America, India, and Japan, also increased their production levels. This drove another outstanding year for shipments of iron ore, one of the

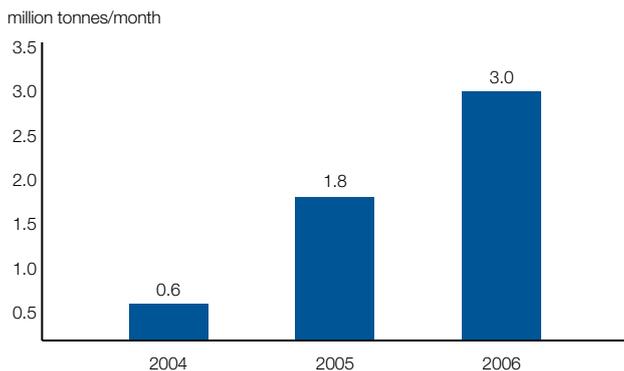
¹ Source: IISI

China's Iron Ore Imports



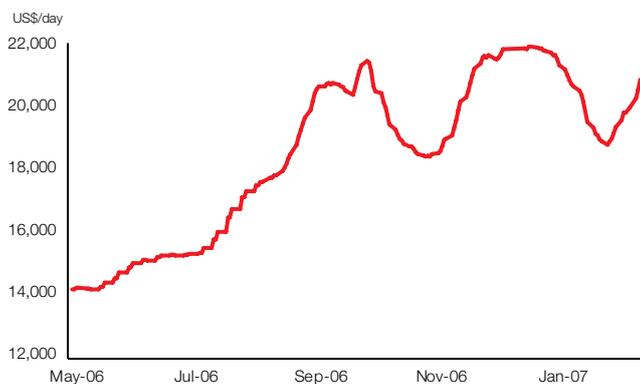
Source: Bloomberg LP

China's Cement Exports



Source: Bloomberg LP

The Baltic Exchange Handysize Index



Source: The Baltic Exchange

Note: net rate

most important commodities for dry bulk shipping. Another significant contributor to the strength of the dry bulk market was the fact that the majority of additional Chinese iron ore imports in 2006 was not supplied by Australia, already exporting at close to full capacity, but by Brazil. This has had significant tonne-mile implications, since two to three times as much shipping capacity is required to move the same volume of iron ore to China from Brazil as from Australia.

Other key dry bulk commodities also enjoyed vigorous demand in 2006, contributing to overall seaborne trade demand growth in 2006 of 5%-7% according to major shipbrokers. The actual figure is, however, increasingly difficult to calculate due partly to the tonne-mile factor already mentioned and partly to the growth of new trades which are not widely followed. For these reasons, we will be taking steps in 2007 to improve our in-house picture of overall dry bulk trade volumes.

The recovery of the capesize and panamax markets was preceded by improved handymax and handysize rates during the second quarter as a result of growing requirements for the so-called 'minor bulks' such as cement, steels and forest products with China, again, playing a key role both as major importer and exporter. Iron ore is the commodity that normally catches the headlines, but trade in a broad range of other cargoes has also expanded significantly in line with increased global GDP and industrial production. The alumina industry has been robust, supporting petcoke, bauxite and alumina shipments; demand for New Zealand timber has seen log exports to Asia and India climb, and the most visible minor bulk support has come from the cement trades in response to booming demand in the US and the Middle East. China has moved aggressively to fill a supply deficit and Chinese cement exports were up 63%² in 2006, absorbing much of the supply of new handymax vessels during the year.

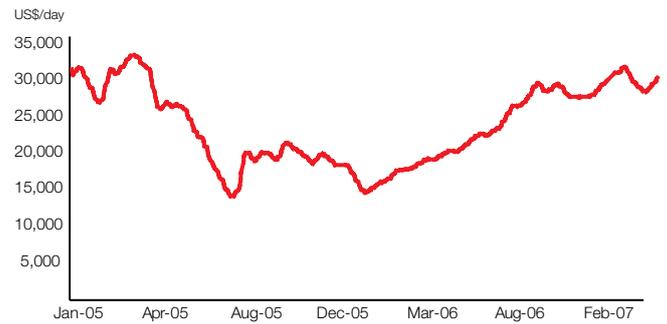
The handysize market developed in line with the general dry bulk market, except that the recovery in this sector started during the first quarter from a February spot market low of US\$11,000 per day to reach US\$13,000 per day by end March. The market recovery continued in the second quarter with the newly introduced Baltic Handysize Index ("BHSI") climbing to almost US\$15,000 per day net³ by the end of June. But it was in the third quarter that the market really accelerated, with the BHSI reaching US\$20,350 per day net by the end of September. After a long period of gains, the handysize market consolidated in the fourth quarter, but still managed to add another US\$1,000 per day; thus the BHSI ended the year at US\$21,350 per day net and as at 28 February stood at US\$20,447 per day net.

² Source: SSY

³ Net of 5% brokers' commissions included in the BHSI

On the handymax front, the Baltic Supramax Index (“BSI”) showed a little more volatility than the BHSI although the general trend was also in line with the BDI. A most interesting feature of handymax rates over 2006 was their upward advance on panamax rates, reflecting the greater operational versatility of geared handymax vessels and their increasing economic suitability for specific cargo sizes and types. The BSI closed 2006 at US\$28,563 per day net, up 64% on US\$17,384 at the beginning of the year, a rise driven mainly by Chinese steel and cement exports, and aided by increased congestion towards the end of the year. As at 28 February 2007, the BSI stood at US\$29,007 per day net.

The Baltic Exchange Supramax Index

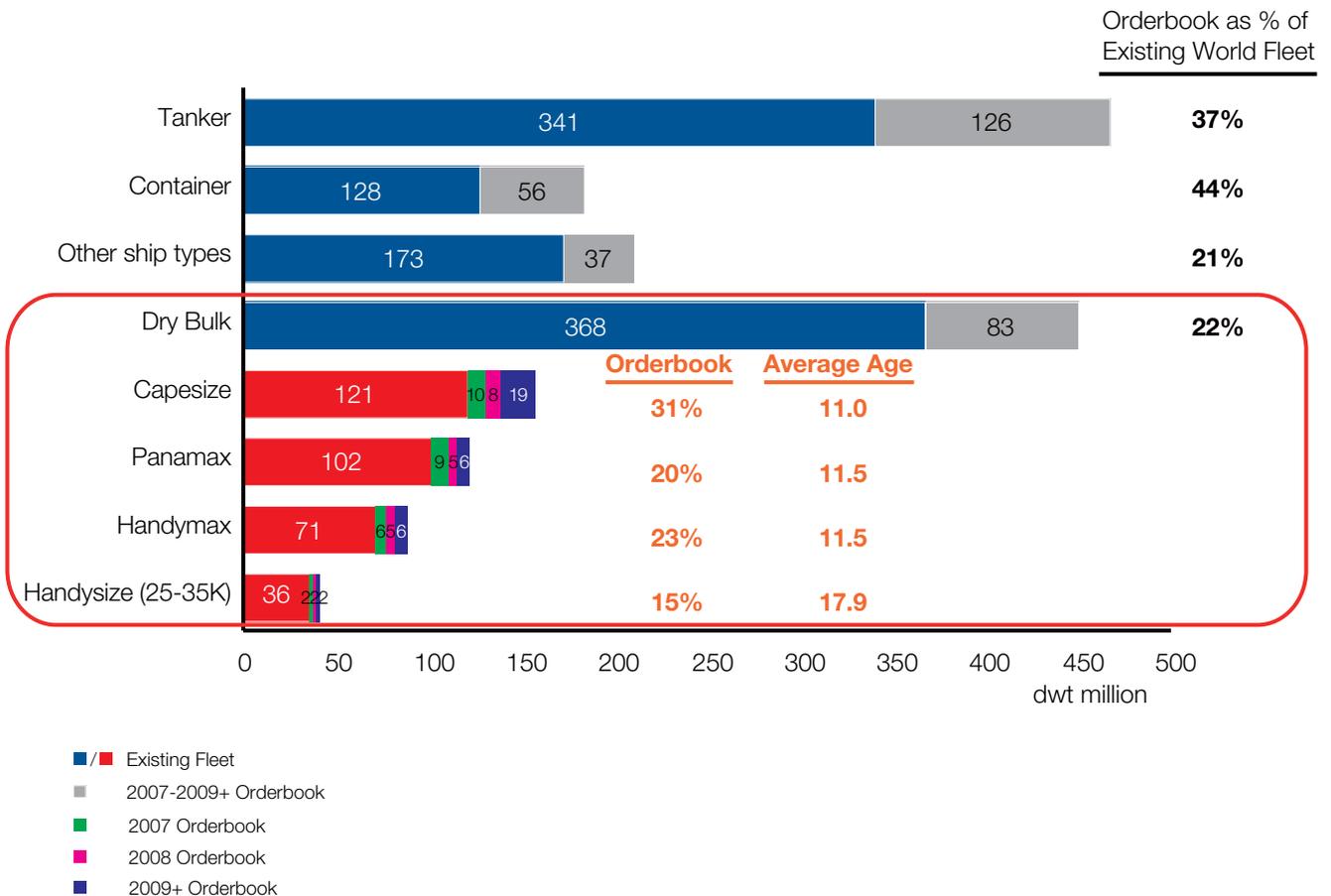


Source: The Baltic Exchange
Note: net rate

Vessel Supply: Orderbook, Scrapping, Asset Values⁴

The overall dry bulk fleet grew by 6.7% (deadweight basis) during 2006. This is lower than the year before, when the fleet expanded by 7.0%, but is still historically high. The handysize 25,000 to 35,000 deadweight fleet segment, in which Pacific Basin operates, saw year

Orderbook of World Fleet and Dry Bulk Sectors – January 2007



Source: Clarkson

⁴ Source: all fleet data from Clarkson

on year fleet growth of only 1.4%, much the lowest of all the dry bulk sectors. Shipyards continue to prefer building larger sized bulkers, tankers, and container vessels, the construction of which yields higher margins.

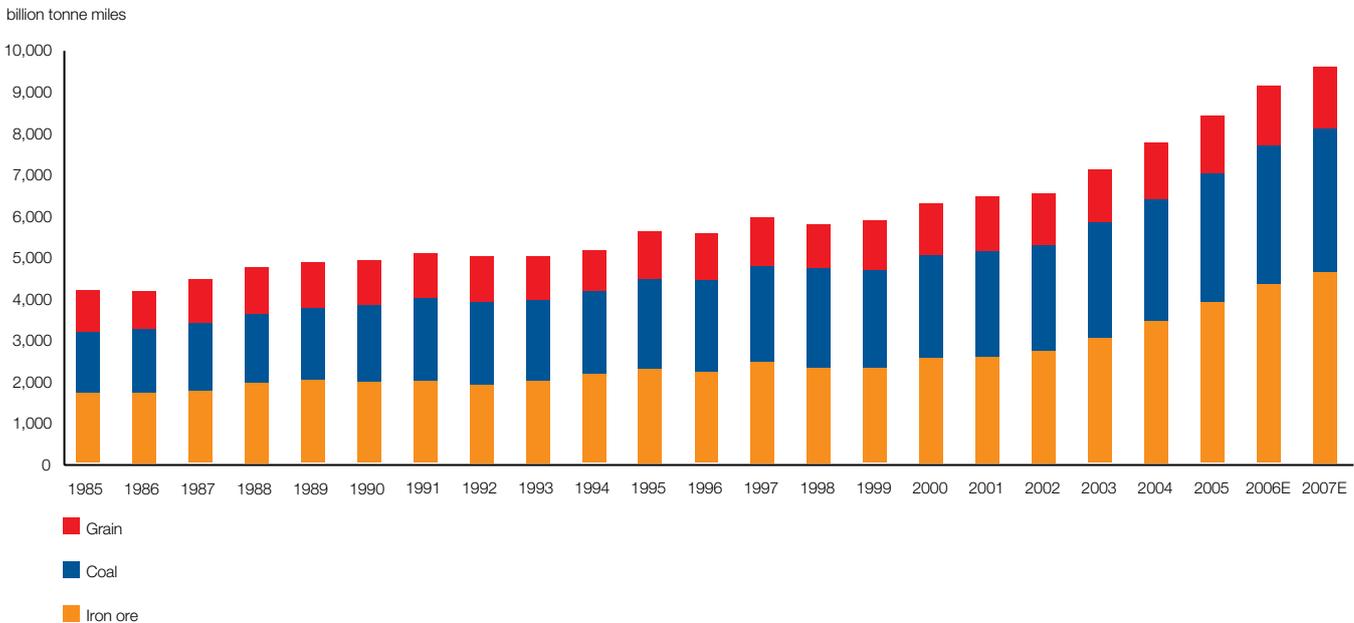
Yard deliveries of dry bulk vessels in 2006 at 25.7 million deadweight were higher than the year before (23.4 million deadweight), but higher scrapping at 1.9 million deadweight against 1.0 million deadweight in 2005 resulted in slightly lower fleet growth in 2006 than in 2005. Despite the high level of yard deliveries, the average age of the dry bulk fleet increased from 15.0 years to 15.1 years per vessel. This was seen also in the handysize sector where, by the end of 2006, the 25,000-35,000 deadweight segment had an average fleet age of 17.9 years per vessel, 0.3 years higher than one year earlier. Despite more new ships coming out of the yards and some increased scrapping, the dry bulk trades are increasingly dependent on older vessels operating beyond their normal economic lifespan.

Dry bulk scrapping in 2006 was almost twice the level of the year before but remains well below the natural replacement level. Scrapping was unevenly distributed, with over 75% taking place in the first half of the year and then reducing to a trickle as a result of improved freight rates during the second half.

Not unexpectedly, the contracting of newbuildings picked up pace during the second half of the year as freight rates rose. This resulted in the dry bulk orderbook increasing from 20% of the fleet in the middle of the year to over 22% at the end of 2006. Although in itself a high level it must be remembered that yards already had good forward cover, and so most of the ordering during the second half of 2006 is for delivery in 2010 and beyond. The handysize orderbook is lower at 15% due to the scarcity of yard capacity willing to contract smaller dry bulk ships.

Even when accounting for some orders not caught in the published orderbook statistics, deliveries for 2007 are not expected to be very different to last year. Deliveries for 2008 are estimated to be lower.

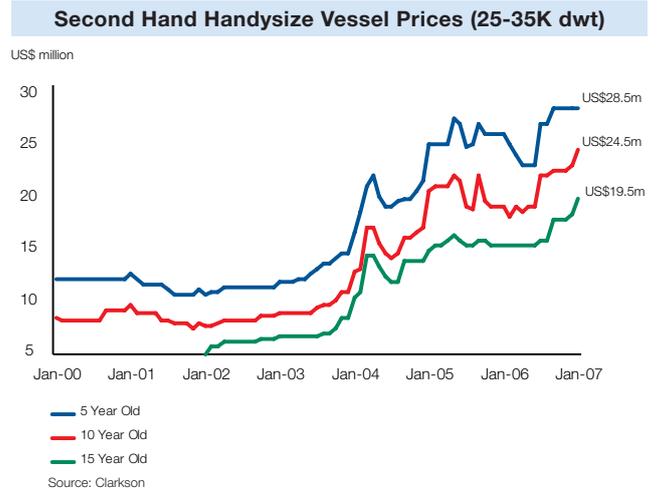
Global Trade in Major Bulks



Source: Fearnleys

Moreover, despite a high freight market and good earnings, an increasing number of the older ships will be forced to scrap. Fleet data indicates that about 26 million deadweight tonnes of dry bulk tonnage is over 27 years of age. This is equivalent to the entire dry bulk yard deliveries of 2006 and, although this will only disappear gradually, scrapping is expected to increase in 2007 and as a result to dampen supply growth from the new ships entering service. In the 25,000 to 35,000 deadweight tonne bracket, eight million deadweight tonnes – or 23% of the existing fleet – is aged 27 years or older, whereas the orderbook totals nearly six million deadweight tonnes, or 15% of the current fleet.

The weaker dry bulk market sentiment at the start of 2006 was reflected in ship values hitting a low point in February. On the back of improved prospects, prices for second hand ships began to climb, and by the start of the third quarter price levels had exceeded the previous all time highs set in the spring of 2005. Values continued to increase and by the end of the year prices for 5 year old handysize and handymax vessels were around 20%-30% higher than one year earlier according to Clarkson, although we put the rise at nearer 30%-40%.



Ageing Fleet Versus Orderbook – January 2007

