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Equity Research

WELLS FARGO SECURITIES

Corporate Governance Scorecard Volume II

Shipping, Equipment Leasing, & Marine MLPs

- **H216 Scorecard – New Rankings, But Idea Remains The Same.** Before we delve into our updated rankings, company specific changes, and feedback from our first Corporate Governance Scorecard, we want to reiterate the idea that underpins this entire exercise, which is that **we believe there is no longer a place in the public Shipping markets for companies that do not prioritize strong corporate governance and capital stewardship.** We continue to believe that risk premiums associated with poor governance/capital discipline can (and should) continue to widen, eventually pricing-out conflicted players and antiquated structures from the public markets.

- **The Basis For Optimism Is Sheer Terror – Oscar Wilde.** We've probably never been as optimistic about the long-term prospects for the sector as we are today. The quality of new entrants continues to improve, the public group is maturing, and while there are certainly growing pains associated with that process, we're encouraged by the influx of principled structures and management teams, either via recent IPOs (GLOG, ASC, EURN), reconfigured stalwarts like OSG and EGLE, and by proactive changes within some high-profile structures (Scorpio). We're certainly not expecting a pristine landscape overnight, but the idea that the priorities and standards in place during the sector's public infancy are somehow Shipping's *natural habitat* is just too pessimistic for us – and we think it runs contrary to pretty visible and meaningful momentum. Fundamentally, we also happen to think a dearth of new capital and the lack of a sustainable inflationary tailwind is gradually shifting the public sector's reliance on *sweeping asset trades* (a rising tide that lifts all boats) towards a more meaningful emphasis on margins, capital discipline, and returns – which we think should continue to favor stronger, more liquid corporate actors. Whether it be from an evolving sense of fiduciary duty, or the *sheer terror* of being ignored or priced out of the market, both paths of reason should lead public shipping companies toward the same outcome, which is what makes this such an easy trade for us to get behind.

- **Feedback, And A Few Words On *Intent*.** A subject like ***governance*** will always have several vantage points, particularly since it carries an array of connotations related to intent, fair dealing, and reputations – ideas we *generally* found to be held in high regard across the spectrum of our rankings. In fact, one of the most salient themes that emerged from the feedback was just how much value some of those that scored poorly place on their relationships with investors. Now, we certainly wouldn't call that idea universal, but we noted it to highlight that our scorecard doesn't measure intent, rather whether certain avenues *exist* that could misalign with shareholder interests, hopefully providing a baseline from which investors can dig deeper. To that point, we think strong governance helps *minimize* the need for investors to delve into those kinds of vagaries, for which they're almost constantly at an informational disadvantage. In short, we won't be evaluating or adjusting our quantitative factors for intent.

Superior Governance Translates To Outperformance:

- Companies with the ***strongest corporate governance*** scores (KEX, ASC, NVGS, TRTN, DHT, MATX, EURN, AVANCE, OSG, GLOG, TGH, NAT, LPG) ***outperformed*** the group by 29% on a 3-year basis and 35% since inception.

- Companies with the ***weakest corporate governance*** scores (DLNG, SSW, DSX, DCIX, ESEA, CPLP, SB, SALT, STNG, DAC, TNP, GASS, DRYS) have ***underperformed*** the group, by 20% on a 3-year basis and 44% since inception.

Michael Webber, CFA, Senior Analyst
(212) 214-8019
michael.webber@wellsfargo.com
Donald D. McLee, Associate Analyst
(212) 214-8029
donald.mclee@wellsfargo.com
Hillary Cacanando, CFA, CPA, Associate Analyst
(212) 214-8040
hillary.cacanando@wellsfargo.com
Donald Bogden, Associate Analyst
(212) 214-8037
donald.bogden@wellsfargo.com

Please see page 13 for rating definitions, important disclosures and required analyst certifications

All estimates/forecasts are as of 10/25/16 unless otherwise stated.

Table Of Contents

- **What Is The Wells Fargo Shipping Scorecard?** Our scorecard ranks the shipping universe on a number of Corporate Governance metrics (Page 9), with the ultimate goal of identifying high quality names based on those underlying factors – crystallizing a framework that has been core to our investment strategy and coverage, while also keeping conflicted companies/interests from relying on anonymity or indifference to perpetuate what's become a consistent headwind for the entire group.

- **Framework:** Our scores are based on a multi-factor model measuring Commercial Management (16.7%), Technical Management (16.7%), Sale & Purchase fees (16.7%), Related Party Transactions (16.7%), and Independent Board Membership (16.7%), which we detail later in the piece. In addition to those quantitative metrics (which make up 83.3% of the total score), we also include a subjective factor (16.7%) that attempts to capture the scale, scope, and context of risks that extend beyond the binary nature of the other data points (Pages 8-9).

- **Changes:** We've added 10 names to our scorecard (**TRTN, EGLE, HMLP, CKH, GSL, SFL, NM, GOGL, DLNG, DAC**) which brings the total to 52. Within our evolving framework, **a company's score and corresponding rank will represent a *rolling average of its current and previous scores*, which we believe will allow us to account for any ongoing changes to corporate structures without dismissing past performance.** Please see page 5 for an overview of potential (future) changes to our methodology.

The H216 Scorecard Results

Figure 1. Shipping Corporate Governance Scorecard Rankings – H216

H216 Corporate Governance Rankings (Rolling Avg)								
KEX	1		Quartile 1		SFL	27	*New*	Quartile 3
ASC	2				CKH	28	*New*	
NVGS	3				NAP	29		
TRTN	4	*New*			SDLP	30		
DHT	5				CAI	31		
MATX	6				NMM	32	↓	
EURN	7				RIGP	33		
AVANCE	8				GNRT	34		
OSG	9				GOGL	35	*New*	
GLOG	10	↑			KNOP	36		
TGH	11	↑			NNA	37	↓	
NAT	12				CMRE	38		
LPG	13				NM	39	*New*	
SBLK	14	↑	Quartile 2		DLNG	40	*New*	Quartile 4
EGLE	15	*New*			SSW	41		
BWLPG	16				DSX	42		
TK	17				DCIX	43		
TNK	18				ESEA	44		
GLNG	19	↓			CPLP	45		
HMLP	20	*New*			SB	46		
GLOP	21				SALT	47	↑	
GMLP	22				STNG	48	↑	
GSL	23	*New*			DAC	49	*New*	
TGP	24				TNP	50		
TOO	25				GASS	51		
FRO	26				DRYS	52		

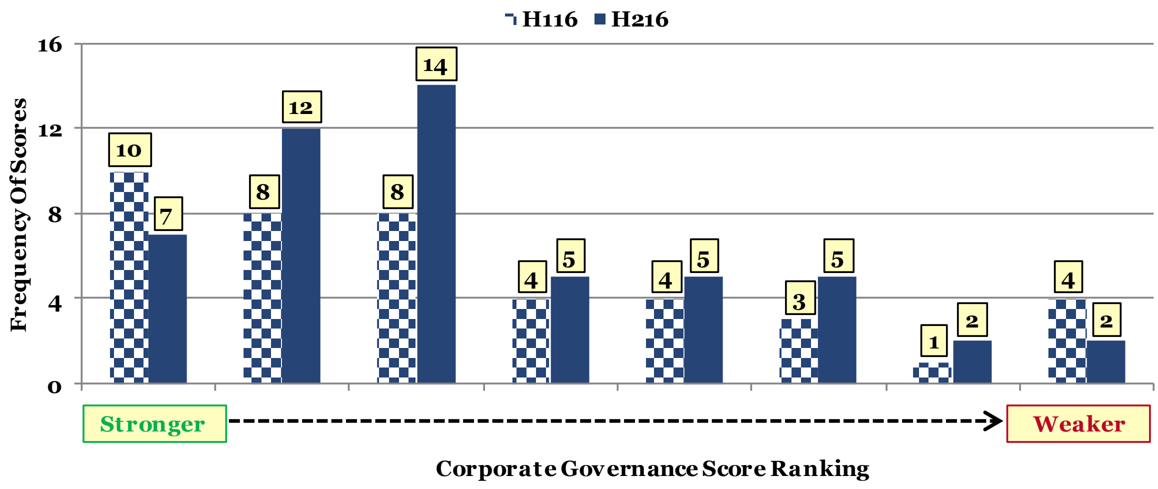
Source: Wells Fargo Securities, LLC estimates

Notes & Outliers

- The companies that had the **strongest** corporate governance scores within our framework were **KEX, ASC, NVGS, TRTN, DHT, MATX, EURN, AVANCE, OSG, GLOG, TGH, NAT,** and **LPG** as noted in Figure 1.
- The companies that had the **lowest** corporate governance scores within our model were **DLNG**, **SSW, DSX, DCIX, ESEA, CPLP, SB, SALT, STNG, DAC, TNP, GASS,** and **DRYS** as noted in Figure 1.
- Our subjective input factor reflects history, frequency, and context that is inherently limited by the other data points. We note that excluding our subjective factor (which carried an equal 17% weighting), the results would have been largely the same. In fact:
  - Excluding our **subjective factor**, 10 out of the 13 top quartile (best ranked) names would have been the same.
  - Excluding our **subjective factor**, 12 out of the 13 bottom quartile (worst ranked) names would have been the same.
- **Biggest Movers:** While our quartile populations were relatively consistent Q/Q, we note both **TGH** and **GLOG** moved up to Quartile 1 from Quartile 2, with **SBLK** moving up to Quartile 2 from the upper end of Quartile 4. We note **GLNG** moved to Quartile 2 from Quartile 1, while **SSW** slid from Quartile 3 to the top of Quartile 4. **STNG** and **SALT** had two of the largest improvements within their numerical scores (see below), and while their rolling average scores/ranks remained in Quartile 4, their isolated H216 results would have placed both in Quartile 3, which (absent any additional changes) is where they're currently trending (higher). We note the inclusion of 10 additional names contributed to some of the shifts in nominal rankings, along with the move towards a rolling average score.
- **STNG/SALT** have both begun to actively and tangibly address corporate governance concerns. On 9/29/16, Scorpio announced it amended its Administrative Services Agreement with Scorpio Ship Management (SSM) and Scorpio Commercial Management (SCM) which **1) eliminated the 1% sale and purchase fee, and 2) reduced the notice period to terminate the commercial/technical management agreements from 2 years to 3 months, with a fee equal to 3 months payable to SCM and SSM upon termination**. However, we note commercial/technical related third party agreements remain in place.
- **How Did Scorpio's Changes Impact Their Status Within Our Model? The elimination of the S&P fees helped their scores (below),** and from our perspective, we believe S&P fees (in general) are among the most dangerous within the industry, as they can potentially incentivize poor capital discipline, and there's inherently a long tail risk on those decisions, given that most Marine assets typically carry a 20-25 year useful life. While Scorpio has been among the most aggressive asset aggregators within the space (which, to be fair, was part of their initial mandate), the removal of those fees sends a message that the group is actively listening to investor dialogue. Both STNG and SALT moved up towards the middle of the 4th quartile (as opposed to firmly within the bottom of the group), **with their relative improvement in part hampered by the inclusion of its past scores** (weighing down its moving average). **On a standalone basis, Scorpio's new governance configuration would have placed both companies in Quartile 3, and we would expect them to continue moving higher as they log more history under the revised policies.**
- **CPLP's** score is hindered by the fact its C-Corp GP is private, which weighed on its overall ranking. While we believe its track record is mixed – it reset its IDRs, which we didn't like, and it converted its subordinated units early in February 2009, however the sponsor has also stepped up to support the MLP distribution (effectively giving it a charter subsidy at times) which was a positive, in our view. We should also note that CPLP maintains a S&P fee agreement on three of its legacy crude tankers (as part of its merger with Crude Carriers), which make up just 8.6% of their fleet. Given the binary nature of our model, should those fees be removed, CPLP would have moved closer to Quartile 3.
- **DLNG's** score was also weighed down by the fact that its GP is private, as well as its board composition, relative to the majority of the Marine MLP group.
- **CMRE's** score remains hindered by the existence of related party operating agreements (although it still maintains the highest score within the Containership group). We generally view CMRE as a solid operator, and have not seen anything to indicate its related party agreements have resulted in any loss of shareholder value. However, the simple fact that they exist continues to weigh on its ranking relative to where we would have placed them subjectively.

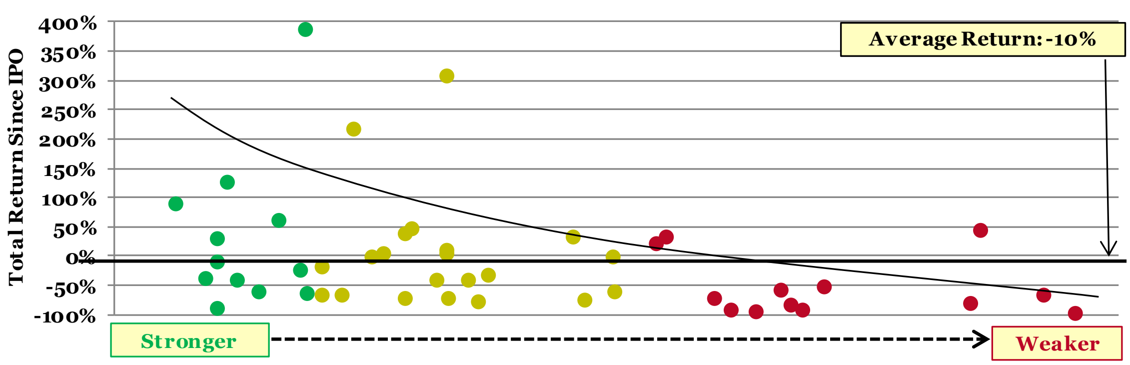
- **SB** also maintains a solid operational reputation; however the existence of related party structures and the binary nature of our model place a similar pressure on their score. In September 2016 Dr. Loukas Barmparis (currently serving as an SB President) and Christos Megalou were elected directors to hold office through 2019. Similarly to CMRE, on a purely subjective basis, we'd have ranked SB more highly.
- **SBLK** announced the appointment of Mr. Nikolaos Karellis to its Board of Directors in May 2016 (replacing Mr. Stelios Zavvos) who had been an independent director of SBLK. Additionally, SBLK announced it will not fill (temporarily) the seat vacated by Renee Kemp – reducing its board size to 8 directors.
- **NNA** has been in the news frequently over the past 8 months regarding a loan to its parent entity NM. NNA ultimately withdrew that loan, in reaction to a shareholder lawsuit and market feedback. Earlier this fall, NNA formalized a new loan to its parent entity (priced closer to market) with a broader collateral package. While we believe the ordeal has been a material headwind for the Navios group – and it's certainly reflected in our scorecard rankings, they previously enjoyed a better track record. We think repricing the loan was a step in the right direction; however there remains a (reasonable) argument to be made that no loan should have been made at all. Ultimately, we believe management has a high degree of conviction in the necessity of each Navios entity surviving the market's trough, and we don't expect this debate to completely subside anytime soon.
- **SSW's** score was weighed down by the S&P, financing, and other agreements in place at the management level, as well as other related party agreements.
- **GLOP** and **HMLP** were clustered at the top end of Marine MLP group scores by a relatively notable margin.
- **GLOG, TK, GLNG:** We note that given the nature of the relationships between GPs and MLPs, GPs tend to rank more highly within our model.
- **GMLP** may have had the most changing dynamics over the past 6 months, as GMLP 1) added an independent director, replacing former CEO Doug Arnell who stepped down on 9/16, 2) reset its IDRs in exchange for units, with the distribution threshold increased – the 25% tier threshold is now the minimum quarterly distribution (MQD) threshold, providing meaningful cushion for GMLP to raise distributions before the 50% split is triggered, but 3) saw (potentially systemic) contract issues around its recent Tundra dropdown, which has drawn meaningful skepticism from MLP investors around the timing and rationale for the dropdown all together. Net-net, GMLP's slid within our rankings, but remained towards the middle of Marine MLP pack and the broader group.
- **SDLP**'s score dropped in part due to the loss of an independent board member who has not been replaced.
- **RIGP**'s independent board membership declined as a non-independent director (SVP at Transocean Ltd) replaced an independent director in 5/2016. This will likely be the last quarter RIGP is included in our model, pending its previously announced merger with Transocean.
- We have included **TRTN** in our scorecard rankings following the completion of its merger with **TAL**, with **TRTN's** score ranking in our first quartile (among companies with the best corporate governance scores), while also standing out as our highest ranked Container company.
- Within the framework of our scorecard, subsidiaries or daughter companies suffer from having related party management agreements with their parent companies (although these agreements carry a lower relative weighting compared to agreements with private, related third parties in our model), which we believe technically presents an opportunity for conflict.

Figure 2. Corporate Governance Score Distributions



Source: Company filings, Bloomberg, Wells Fargo Securities, LLC estimates

Figure 3. Total Return Since IPO Vs. Scorecard Ranking



Note: Total returns for companies with pre-2002 IPOs (CKH, GLNG, TK, MATX, KEX) reflected from 2002 to date

Source: Company filings, Bloomberg, Wells Fargo Securities, LLC estimates

Feedback And Updated Thoughts

- **Updated Thoughts Around Our Scorecard & Methodology.** We received quite a bit of feedback on our initial Corporate Governance Scorecard in April. While there was nearly unanimous support for a quantitative breakdown of the sector's corporate governance, there were also several questions and suggestions around certain aspects of our methodology, which we've highlighted below. We've categorized these questions four ways: **(1) a debate over whether related party transactions are (in some cases) positive for shareholders**, **(2) how a company's history comes into play** (companies that have entered bankruptcy and reemerged with altered corporate structures can score well, despite that history – see OSG, EGLE), and **(3)** whether other factors should be incorporated, including **the level of insider ownership** (which can create a degree of alignment), etc. **(4) delving deeper into Board functionality, lines of sight, and independence** – which is something we plan to include in the future. We've addressed each of those points below, and continue to welcome feedback.

(1) Related Party Transactions – Should We Be Looking At The Underlying Merits Of Each Deal? **As it pertains to our scorecard, the answer is a very firm No.** Our scorecard is designed to evaluate and rank corporate governance issues within the space, and whether there are systemic avenues in place that *could* syphon away shareholder value. We've heard lots of justifications for related party deals (some of which are viable), but in the end, we believe they generally create a slippery slope for investors, along with an ambiguity around industry standards that weighs on valuations and investor confidence.

However it's worth noting that while we view solid Corporate Governance as a critical factor within our investment methodology, it remains *one* factor. We've seen instances where private vehicles or principals actually *subsidize* their public companies via related party transactions when liquidity is a major risk. In that situation (and most situations, frankly), those risks can be priced accordingly. However, within the context of our model and this scorecard, we believe consistency is paramount, *as it helps give a baseline to then actually price that risk.* If a related party deal *acts as a lifeline* and can be explained away to a point that it doesn't impact a stock's valuation or reputation, so be it (in *some* cases, a related party deal is a better option than insolvency). But it still happened, and we believe the onus is on the company to explain the merits to investors, how it got to that point, and to account for it.

(2) Company History – How To Account For It? Well, to get the obvious out of the way, we have to start somewhere. For the purposes of our model and scorecard, we generally try to attach the relevant company history to its management and board of Directors, rather than simply to the ticker. For example, if a company's management and board were to completely turnover tomorrow, events from 2014 would carry less weight with us than if the same management team/Board were running the company. In terms of *overall* scores, **we'll be using rolling average of current and previous scores, which we believe allows us to account for any ongoing changes to corporate governance structures without dismissing past performance**. We've yet to formally establish a term on that rolling average, but we'd expect a 2-3 year period.

(3) Insider Ownership – To Include, Or Not To Include? The idea of including management/board ownership has come up several times, and we find it interesting. While a case can certainly be made that a significant degree of insider ownership *generally* helps align the interest of management with shareholders, data around that is somewhat mixed. We have found studies supporting the idea, and others noting a deteriorating benefit when insider ownership is north of 5%. Ultimately, we tend to view insider ownership as being outside the bounds of what we're attempting to isolate with the scorecard. I.e., it's difficult to mandate or institutionalize a certain level of insider ownership. **Effectively, we tend to view the makeup of a company's shareholder base as a complimentary factor to solid corporate governance, rather than part of its foundation.**

(4) Board Functionality, Lines Of Sight, And Independence. Right now, our scorecard only measures the relative number of independent members, which doesn't provide much, in any depth into whether or not the board functions properly. Figuring out a way to quantifiably account for something like that is difficult, particularly in a way that is consistent across so many verticals. That said, we expect to focus on the separation of the Chairman/CEO positions, lines of sight between legal counsel/audit and the board, and (potentially) board turnover. We're still evaluating these parameters, but we generally expect board functionality to be the next factor added to our model.

Scorecard Rationale

- The purpose of the scorecard is to provide a baseline, comparable quantitative and qualitative corporate governance ranking across the Marine universe. We use a proprietary factor model built on six quantitative and qualitative inputs that places Marine names into quartile rankings (Quartile 1 being our highest ranking in the model). Our model is centered on measuring corporate governance controls, with (1) related-party technical and (2) commercial management fees, (3) S&P fees, (4) related-party transactions, and (5) the level of independent board membership is evaluated. We also add a subjective factor (6) to capture dynamics, context, or risks that are missed by the inherently binary aspect of some of our metrics. Our model creates a cumulative value, or ranking for each company in each category, and, for example, if a Marine stock scores poorly (Quartile 4), we believe the corporate governance profile of that name should probably receive extra scrutiny. Thus, an investor would need to price this lower degree of corporate governance (and associated risk) appropriately (i.e., pay a lower price/valuation). In contrast, we believe Quartile 1 Marine names are more likely to fetch a relative valuation premium based on higher underlying quality indicated by our scorecard.

How Should The Scorecard Be Used?

- We believe our scorecard can be used as a tool to help evaluate degrees of corporate governance across shipping sectors and individual companies. While there are obviously dozens of risk factors and fundamentals on both a company and an industry basis that go into making an investment decision, we believe corporate governance is too often either overlooked or mispriced. All else equal, we believe companies in Quartile 1 generally screen more favorably than the lower quartiles, presenting stronger governance standards than many of their peers. Our primary goal for this scorecard is to help clients better understand the varying degrees of governance risk across the shipping space, enabling investors to differentiate among investment alternatives, and provide a relative baseline for further work.

What It Is Not?

- Our corporate governance scorecard **is not** an indication that an investor should only invest in Quartile 1 Shipping companies, as we believe governance is one factor among several risks or fundamentals to be considered, along with a specific investor's risk appetite and investment goals. We note that industry dynamics (be it Tankers, LNG, Containers, etc.) play a very large role in our formal, cumulative ratings and investment process, and are not necessarily captured within the narrower scope of this scorecard.

Corporate Governance Quality & Equity Performance

- **Better Corporate Governance Has Led To Better Performance.** As noted in Figure 2, companies in **Quartile 1 have significantly outperformed** Quartiles 2-4, **with an average total return of negative 11% over the past 3-years**, compared to an **average 3-year total return of -49% for Quartiles 2-4** (vs. the 3-year total return for the S&P 500 of 21%). While we believe cyclical pressure has dampened those 3-year return totals across the board, we believe the **38% relative outperformance** reflects the general idea that higher degrees of corporate governance tend to lead to (or at least be consistently associated with) better returns.

Figure 4. Price, Performance, And Rating By Quartile Rank

October 2016 Shipping Corporate Governance Rankings

	Ticker	Rating	Price 10/24/16	% Total Return YTD	1 Year	3 Year	Since Inception/10-Year[1]
Quartile 1	KEX	Underperform	$58.98	15%	-7%	-34%	87%
	ASC	Outperform	$6.60	-44%	-41%	-42%	-43%
	NVGS	Market Perform	$7.30	-48%	-50%	-61%	26%
	TRTN	Not Rated	$12.81	-6%	-9%	-64%	-14%
	DHT	Market Perform	$4.36	-39%	-37%	4%	-92%
	MATX	Market Perform	$41.37	-3%	-9%	60%	122%
	EURN	Outperform	$8.10	-33%	-39%	79%	-43%
	AVANCE	Market Perform	$2.35	-82%	-79%	-66%	-65%
	OSG	Not Rated	$9.40	-40%	N/A	N/A	-41%
	GLOG	Market Perform	$16.85	113%	62%	27%	57%
	TGH	Market Perform	$7.40	-44%	-60%	-77%	-27%
	NAT	Not Rated	$9.55	-32%	-34%	54%	385%
	LPG	Market Perform	$6.28	-46%	-43%	N/A	-66%
	Average			***-22%***	***-29%***	***-11%***	***22%***
Quartile 2	SBLK	Not Rated	$4.55	54%	-58%	0%	0%
	EGLE	Not Rated	$4.42	-93%	-96%	-96%	-99%
	BWLPG	Market Perform	$3.05	-62%	-49%	N/A	-23%
	TK	Market Perform	$7.79	-16%	-75%	-80%	-70%
	TNK	Market Perform	$2.53	-59%	-66%	5%	-69%
	GLNG	Outperform	$24.03	53%	-18%	-26%	215%
	HMLP	Not Rated	$18.00	6%	27%	N/A	-4%
	GLOP	Outperform	$21.90	66%	31%	N/A	0%
	GMLP	Market Perform	$21.84	83%	44%	-8%	35%
	GSL	Not Rated	$1.39	-47%	-66%	-73%	-77%
	TGP	Outperform	$16.05	23%	-36%	-55%	43%
	TOO	Market Perform	$6.39	5%	-57%	-75%	-44%
	FRO	Market Perform	$7.56	-42%	-42%	0%	0%
	Average			***-2%***	***-36%***	***-41%***	***-7%***
Quartile 3	SFL	Not Rated	$13.81	-6%	-7%	20%	305%
	CKH	Not Rated	$58.84	14%	-6%	-38%	6%
	NAP	Market Perform	$11.74	11%	-12%	N/A	1%
	SDLP	Underperform	$3.46	18%	-60%	-83%	-76%
	CAI	Market Perform	$7.88	-18%	-18%	-67%	-45%
	NMM	Market Perform	$1.39	-53%	-81%	-87%	-81%
	RIGP	Market Perform	$11.80	55%	25%	N/A	-37%
	GNRT	Not Rated	$4.86	-46%	-55%	0%	0%
	GOGL	Not Rated	$3.64	-30%	-70%	-91%	-82%
	KNOP	Market Perform	$20.80	69%	33%	12%	28%
	NNA	Underperform	$1.40	-50%	-60%	-57%	-77%
	CMRE	Market Perform	$7.50	-21%	-43%	-47%	-3%
	NM	Not Rated	$1.20	-33%	-53%	-82%	-64%
	Average			***-7%***	***-31%***	***-47%***	***-10%***
Quartile 4	DLNG	Market Perform	$15.79	88%	28%	N/A	19%
	SSW	Market Perform	$12.74	-10%	-14%	-23%	31%
	DSX	Market Perform	$2.52	-42%	-62%	-80%	-76%
	DCIX	Underperform	$2.50	-56%	-73%	-91%	-96%
	ESEA	Market Perform	$1.78	-26%	-61%	-86%	-98%
	CPLP	Market Perform	$3.21	-36%	-44%	-51%	-62%
	SB	Not Rated	$1.38	74%	-54%	-80%	-87%
	SALT	Not Rated	$3.89	-60%	-77%	N/A	-97%
	STNG	Not Rated	$4.30	-39%	-48%	-53%	-57%
	DAC	Not Rated	$2.51	-56%	-59%	-35%	-85%
	TNP	Outperform	$4.92	-35%	-41%	5%	41%
	GASS	Market Perform	$3.26	-3%	-23%	-72%	-69%
	DRYS	Not Rated	$0.36	-98%	-98%	-100%	-100%
	Average			***-23%***	***-48%***	***-60%***	***-57%***
	S&P 500		**$2,139.84**	**-1%**	**3%**	**21%**	**86%**

Marine companies with top-tier corporate governance have Outperformed on a 1-year, 3-year and since inception basis

(1) 10-year performance used in lieu of since-inception data when applicable

Source: Capital IQ, Wells Fargo Securities, LLC

Corporate Governance Overview

- Within our Corporate Governance rankings, we have included several binary factors, which capture whether or not each company has **Related Party Commercial Management, Related Party Technical Management, Sale and Purchase (S&P) Fees,** and whether there's a history of **Related Party Transactions**. While the presence of any of these binary factors alone does not *necessarily* indicate a shareholder disadvantage, we believe they do represent a potential conflict of interest. While the frequent argument by those with related party fees has been that a high level of equity ownership within management or the company's sponsor counterbalances that risk (aligning them with other common shareholders on cost controls), we believe that argument is factually untrue, and often disingenuous. We believe some of these fee structures simply act as secondary dividends for ownership groups, and *even* if they are not (i.e. the fees are inline with comparable, third party fees) **it is simply not a risk equity holders should have to take**.

- Related party agreements are generally inherent within the GP/MLP structure as well, and those relationships are also penalized (albeit to a lesser degree) simply due to the fact that a semi-conflicted relationship exists. We think of it as capturing the lack of ultimate control that LP or subsidiary unitholders face. We generally penalize any related-party MLP arrangements that include a *privately* owned entity (GP or otherwise) more significantly – given limited visibility into both ends of a transaction.

- We have also included **Independent Board Membership** as a fifth factor, with a higher degree of independence amid a company's board of directors indicative of a higher overall level of corporate governance quality, in our opinion. We adjust those aggregate scores by a 6th **Subjective** factor where we attempt to incorporate additional company specific aspects not represented in our 5 primary corporate governance factors. We've given each of these factors equal weightings (as indicated below), with the cumulative Corporate Governance rankings summarized in Figure 3. Within our scorecard the higher ranked companies (GLOG, ASC, KEX) indicative of higher quality corporate governance, while the lower ranked companies (GASS, DRYS, etc.) have lower quality corporate governance, in our view.

    - **Corporate Governance Factor #1: Related Party Commercial Managers.** Commercial management covers the marketing, chartering, operations, and trading of vessels in the spot or time-charter market. While commercial management can be provided by wholly owned subsidiaries; it is common place in the industry for companies to outsource commercial management to third-party managers who charge a daily fee on a per vessel basis (with those fees ranging widely from $300 - $2,000/day across our Shipping universe). These management agreements can be with either public or private managers, which may be either related or unrelated parties, potentially creating conflicts of interest given the difficulty of comping the value of services within these arrangements. Commercial relationships with wholly owned subsidiaries or to unrelated third parties generally provide the least degree of potential conflicts of interest, while related party management presents higher potential risk for shareholders given those conflicts. Within related party commercial management structures, we believe the degree of the risks from conflicting interests are partially offset via public-to-public relationships given the greater degree of visibility on both ends of the agreement, while we view public-to-private related party arrangements as the least desirable. Additionally, given the presence of related party management relationships as an inherent aspect of the GP/MLP structure, our related party commercial management factor rankings are less punitive across the GP/MLP group so far as the arrangements are within the bounds of the typical GP/MLP relationship, and both entities are public.

    - **Corporate Governance Factor #2: Related Party Technical Managers.** Technical management includes providing vessel maintenance, arranging and supervising newbuilding construction, dry-docking, repairs, capital improvements, and maintaining vessel safety management systems. While technical management can be provided internally by wholly owned subsidiaries; it is common place in the industry for companies to outsource technical management to either related or unrelated third-party managers who charge a daily fee on a per vessel basis (with those fees ranging widely from $250 - $1,000/day across our Shipping universe). Relationships with wholly owned subsidiaries or to unrelated third parties generally provide the least degree of potential conflicts of interest, while related party management presents a higher degree of potential risk for shareholders. We believe the degree of the risks from conflicting interests are partially offset via public-to-public relationships given the greater degree of visibility on both ends of the agreement, while we view public-to-private related party arrangements as the least desirable. As with commercial management, the presence of related party management relationships is an inherent aspect of the GP/MLP structure, our related party factor rankings are less punitive across the GP/MLP group, and both entities are public.

- **Corporate Governance Factor #3: Sale And Purchase Fees.** Shipping companies often have Sale & Purchase fee arrangements, whereby management directly (or indirectly via a related third-party) receives a fee for any newbuild orders, asset sales, or purchases at the company level, with these S&P fees typically ranging from 1-1.25% of the total transaction value. We view the presence of these S&P fee arrangements as a major red flag, and a reflection of lower quality corporate governance given weaker alignment of shareholder and management interests. We believe S&P arrangements between related parties often incentivize investment decisions based on deal size and frequency, rather than returns.

- **Corporate Governance Factor #4: Related Party Transactions.** We also scrutinize related party transactions, as we believe they create similar (very significant) conflicts of interest for management, with the potential for transaction values to deviate from market prices given the incentives for premium valuations charged between the two parties (and higher risk). This most readily presents itself via acquisitions from private fleets or related entities, with a number of Dry Bulk, Tanker, and Containership owners acquiring or selling assets to their personal fleets. DRYS comes to mind, with DSX, TNP, and others all recently transacting with a private arm. This also includes real estate and other assets.

- **Corporate Governance Factor #5: Independent Board Membership.** We view board independence as a factor that is highly reflective of strong corporate governance controls. As such we believe it is important to differentiate between the varying levels of independent board membership across the shipping space. On average our universe had 67% independent board membership, although those figures are lumpy.

- **Corporate Governance Factor #6: Subjective.** For our final corporate governance scorecard factor, we assess factors that may be difficult to quantify amid our primary inputs, including history, context, and scale. This factor is given an equal relative weighting (17%) to our other 5 factors as we believe the binary nature of some of the data does not fully capture the risk.

Figure 5. Shipping Corporate Governance Scorecard Rankings (H216)

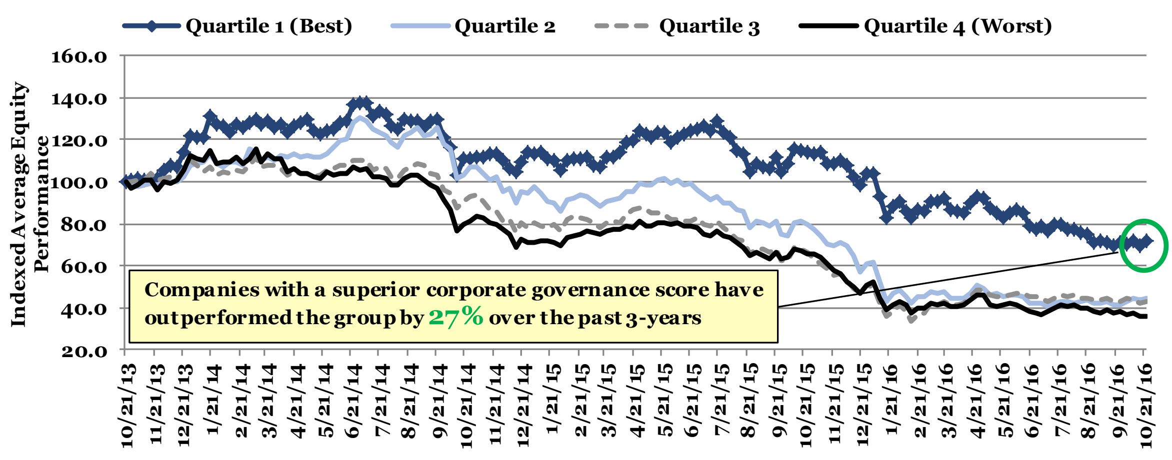
H216 Corporate Governance Rankings (Rolling Avg)

KEX	1		Quartile 1	SFL	27	*New*	Quartile 3
ASC	2			CKH	28	*New*	
NVGS	3			NAP	29		
TRTN	4	*New*		SDLP	30		
DHT	5			CAI	31		
MATX	6			NMM	32	↓	
EURN	7			RIGP	33		
AVANCE	8			GNRT	34		
OSG	9			GOGL	35	*New*	
GLOG	10	↑		KNOP	36		
TGH	11	↑		NNA	37	↓	
NAT	12			CMRE	38		
LPG	13			NM	39	*New*	
SBLK	14	↑	Quartile 2	DLNG	40	*New*	Quartile 4
EGLE	15	*New*		SSW	41		
BWLPG	16			DSX	42		
TK	17			DCIX	43		
TNK	18			ESEA	44		
GLNG	19	↓		CPLP	45		
HMLP	20	*New*		SB	46		
GLOP	21			SALT	47	↑	
GMLP	22			STNG	48	↑	
GSL	23	*New*		DAC	49	*New*	
TGP	24			TNP	50		
TOO	25			GASS	51		
FRO	26			DRYS	52		

Source: Wells Fargo Securities, LLC estimates

- **Stronger Corporate Governance Has Generally Been Associated With Stronger Returns.** As noted in Figure 6, our **Quartile 1 grouping** (KEX, ASC, NVGS, TRTN, DHT, MATX, EURN, AVANCE, OSG, GLOG, TGH, NAT, LPG), **generally outperforming our other quartile groupings** (down 23%), while our **Quartile 4 grouping** (were DLNG, SSW, DSX, DCIX, ESEA, CPLP, SB, SALT, STNG, DAC, TNP, GASS, and DRYS), which represents companies with the lowest degree of corporate governance amid our universe, **generally underperforming the other groups** (down 50%).

Figure 6. Average Equity Performance By Corporate Governance Quartile Ranking



Source: Capital IQ, Wells Fargo Securities, LLC

Ranking Methodology

Scorecard Step No.1: Rank Each Company According To The Fundamental Scorecard Factors

- First, we calculate a fundamental score for each shipping company based on our six-factor model, comparing relative degrees of corporate governance based on company data. The factors and weights are outlined in Figure 7 below.

Figure 7. Corporate Governance Scorecard Factors

	Corporate Governance Factor	Weight
Factor #1	Related Party Commercial Management	17%
Factor #2	Related Party Technical Management	17%
Factor #3	Sale And Purchase Fees	17%
Factor #4	Related Party Transactions	17%
Factor #5	Independent Board Membership	17%
Factor #6	Subjective	17%

Source: Wells Fargo Securities, LLC

Scorecard Step No. 2: Compile the Factor Score and Ranking

- With each company scored or ranked according to the corporate governance factors mentioned in Step No. 1, we then proceed to compile an overall corporate governance score, based on the associated weights noted in Figure 7 above. First, we rank each shipping company based on the overall corporate governance score (compiled based on our 6 factors.). Second, we separate the group into quartiles based on the overall scorecard ranking.

Appendix

- To further supplement our Corporate Governance rankings, we have provided a detailed summary of our factor inputs (Commercial/Technical Management, S&P fees, Related Party Transactions, Independent Board Membership and our Subjective factor) to an individual company level.

Figure 8. Company Specific Corporate Governance Overview

			Related Party				
Ticker	Sector	Quartile	Commercial Management Fees	Technical Management Fees	S&P Fees / Commissions	Asset Transactions	% Indep. Board Membership
TGH	Container	1	No	No	No	No	40%
CAI	Container	3	No	No	No	Yes	43%
CMRE	Container	3	Yes	Yes	No	No	40%
SSW	Container	4	No	No	Yes	Yes	63%
DCIX	Container	4	Yes	No	Yes	No	57%
TRTN	Container	1	No	No	No	No	78%
GSL	Container	2	No	No	No	No	33%
DAC	Container	4	Yes	Yes	Yes	Yes	67%
SBLK	Dry Bulk	2	No	No	No	No	88%
DSX	Dry Bulk	4	No	No	Yes	Yes	67%
ESEA	Dry Bulk	4	Yes	Yes	Yes	No	75%
SB	Dry Bulk	4	Yes	Yes	Yes	Yes	43%
SALT	Dry Bulk	4	Yes	Yes	No	Yes	71%
DRYS	Dry Bulk	4	Yes	Yes	Yes	Yes	67%
EGLE	Dry Bulk	2	No	No	No	No	71%
GOGL	Dry Bulk	3	No	Yes	No	Yes	60%
GLNG	GP	2	No	No	No	Yes	86%
GLOG	GP	1	No	No	No	No	50%
TK	GP	2	No	No	No	No	80%
NM	GP	3	No	No	No	Yes	57%
GLOP	MLP	2	Yes	Yes	No	Yes	57%
GMLP	MLP	2	Yes	Yes	No	Yes	86%
TGP	MLP	2	Yes	Yes	No	Yes	71%
TOO	MLP	2	Yes	Yes	No	Yes	67%
RIGP	MLP	3	Yes	Yes	No	Yes	57%
NAP	MLP	3	Yes	Yes	No	Yes	57%
NMM	MLP	3	Yes	Yes	No	Yes	57%
SDLP	MLP	3	Yes	Yes	No	Yes	80%
KNOP	MLP	3	Yes	Yes	No	Yes	86%
CPLP	MLP	4	Yes	Yes	Yes	Yes	50%
HMLP	MLP	2	Yes	Yes	No	Yes	71%
DLNG	MLP	4	Yes	Yes	No	Yes	40%
AVANCE	LPG	1	No	No	No	No	100%
NVGS	LPG	1	No	No	No	No	86%
LPG	LPG	1	No	No	No	No	71%
BWLPG	LPG	2	Yes	Yes	No	Yes	100%
GASS	LPG	4	Yes	Yes	Yes	Yes	60%
EURN	Tankers	1	No	No	No	No	90%
ASC	Tankers	1	No	No	No	No	88%
DHT	Tankers	1	No	No	No	No	100%
OSG	Tankers	1	No	No	No	No	90%
NAT	Tankers	1	No	No	No	No	67%
TNK	Tankers	2	No	No	No	Yes	67%
FRO	Tankers	2	No	No	No	Yes	67%
GNRT	Tankers	3	Yes	No	No	No	71%
NNA	Tankers	3	Yes	Yes	No	Yes	56%
TNP	Tankers	4	Yes	Yes	Yes	Yes	63%
STNG	Tankers	4	Yes	Yes	No	Yes	63%
SFL	Tankers	3	Yes	Yes	No	Yes	50%
CKH	US Marine	3	No	No	No	Yes	33%
KEX	US Marine	1	No	No	No	No	83%
MATX	US Marine	1	No	No	No	No	88%

Source: company filings, Wells Fargo Securities, LLC estimates

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