IN CONFERENCE

Oil Tankers: The View from Energy Shipping Ltd.

This issue's "In Conference" is based on a speech by Nigel Dean, a senior shipbroker at Energy Shipping Ltd. (formerly ISIS Maritime Trading), at World Fuel Oil Summit VIII on May 21-23, 2015 in Athens. The summit was by hosted by the Public Power Corporation of Greece and organized by Axelrod Energy Projects.

This "In Conference" takes a look at developments in the tanker market over the past year or so. The impact of the fall in bunker prices is assessed. The change in tanker rates for various ship types is analyzed. Regional shipping requirements for refined products are also considered.

Drop in Bunker Fuel Prices

The dramatic fall in crude oil prices in 2014-15 and therefore bunker prices is having huge consequences for the tanker industry. The price of bunker fuel, the second most significant component of oil cargo freighting, has been halved. Shipowners, with the assistance of the Worldscale Association have taken most of the commercial benefit. Up until the end of the second quarter of 2014, returns on spot voyages were just about covering operational costs. By the end of first quarter 2015, the returns on shipping returns had doubled. For the first time since 2011, time charter rates are firming and vessel candidates are in short supply across all tanker sizes. With bunkers at half the price of a year ago, the turnover and opportunity cost for operators has diminished and a new confidence has entered the tanker industry with positive sentiment emanating from the large crude carrier owners as well as the smaller-vessel owners.

The Worldscale Association is mentioned because the flat rates of 2015 were calculated on the basis of the bunker prices of 2014 and although charterers make every effort to protect themselves, the scale is revised every year on January 1st at the peak of the Christmas and winter market. In May 2015, the cross-Med fuel market stood at WS 130. The rate of WS 130 was seen last year as well, but this year's income is substantially higher based on the revised Worldscale flat. The Worldscale Association was obliged to substantially revise the provision for reimbursing owners required to burn low sulfur bunker in the European and North American ECAs as the 2014 prices looked ridiculous in February 2015. In any event, charterers had already taken steps to negotiate their way out of this anomaly (namely, reducing ECA costs to laden voyage only or discounting the addition all together in some cases).

While VLCCs only play a backhaul role in fuel oil shipping (by moving fuel oil from the Continent or the Caribbean to the Far East), the sentiment among shipowners (perhaps most prominently in Piraeus), is strongly influenced by the big ships down to the smaller size ships, which carry most of the world's fuel oil (namely Panamax, Medium Range and Handysize). This does not mean that tanker hire rates have doubled – time-charter rates for the MR sector of $45-50,000 per day have firmed by $500/750 per day for a 12 month time-charter but MR operators are reporting daily incomes in excess of $24,000 per day, against the low to mid-teens of a year ago. Moreover, many new participants are feeling confident enough to seek time-charter tonnage while traditional long-term operators such as Navig8, ST Shipping & Transport (Glencore's shipping arm), Mansel (Vitol's tanker arm), and Trafigura are expanding their in-house tonnage lists.

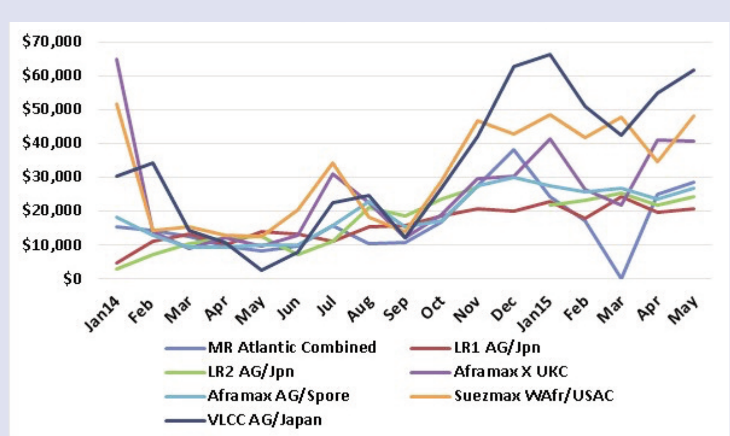
Thanks to the IMO, the world's seas and oceans are more protected than they used to be. All tanker ships moving oils are double hull with segregated ballast, and most with vapor recovery systems. The world's tanker fleet is mostly modern, with few ships in trade beyond 20 years of age. Even very well maintained larger tankers of 20 years are being moved to the scrapyards.

Spot Tanker Rates

A look at tanker rates is instructive. Other than Aframax cross-Med and Suezmax West Africa to US Atlantic Coast, tanker rates are higher than they were in January 2014. Overall the trend is increasing, particularly

for VLCCs (see the accompanying chart). The pattern is choppy, indicating an inherent volatility in rates; but is volatility increasing? Overall volatility from September 2014 to May 2015, as measured by the standard deviation, is up 26 percent from January to August, 2014 levels for all tanker types. For individual tanker types, MR Atlantic Combined and VLCC AG/Japan were up significantly, but with little change Aframax AG/Singapore, and with modest (10-15 percent) declines in LR1 AG/Japan and Suezmax WAF/US Atlantic Coast. However, there were significant declines close to 50 percent for LR2 AG/Japan and Aframax in UKC (North Sea).

SPOT MARKET $/DAY FOR VARIOUS TANKER TYPES



Source: Braemar ACM Shipbroking.

Largely hidden from view is the significant decline in bunker costs, which owners must pay for ships operating in the spot market. During the early months of 2014, IFO high sulfur bunker fuel 380 cSt at Rotterdam was $575 per metric ton. A ship consuming 50 metric tons per day of IFO on a sixty-day round-trip voyage, or 3,000 metric tons of bunkers, would have a fuel cost of $1,725,000. In May 2015, IFO bunkers cost $345 per ton for a total voyage fuel cost of $1,035,000, and thus a significant 60 percent savings. For ships fixed at the same Worldscale spot rate utilizing the 2014 and 2015 Worldscale published rates, which were not changed with regard to bunker costs, voyage profitability improved by the differential in bunker costs, or almost $700,000. This is a substantial difference. If a vessel does five voyages per year, then the savings are $3.5 million, which means $10,000 additional earning each day for a 350 operating days a year.

The spot market $/day rose from an average for all vessel types of $26,850 per day in January 2014 to $35,800 in May 2015, a 33 percent rise. Since owners in the spot market pay for bunkers, a rising $/day in face of falling bunker costs means that the profitability for owners has risen much more than 33 percent. This explains why some tanker owners are beginning to take an interest in the second hand market as their cash reserves are being built up by higher spot market earnings. The time charter market has not shown much of an increase, but fuel savings accrue to the benefit of the charterer, not the owner.

VLCCs

The collapse of crude prices in November 2014 had a short-lived but dramatic impact on the time-charter rates of the supertankers as charterers jumped to acquire crude storage to grasp an expected windfall profit from the volatility. VLCC rates leapt from $30,000 per day to $55,000 per day, with even a reported $60,000 per day. When the supply of VLCC's dried up, the charterers turned to Suezmaxes. With fewer vessels available, this rush was short lived and interest fell away as rates firmed. Indeed, many of the ships that were put on subjects were failed. The appetite for floating storage faded as crude prices fell further and the expected rebound was seen to be further and further down the road with the prevailing uncertainty to the outlook for 2015. At the time, one of the major oil companies spoke about the potential for crude prices to stay below $60 a barrel for three to four years ahead, a clearly unacceptable timescale for crude storage at inflated shipboard prices.

Some of the shipowners, who were keen to acquire VLCC tonnage two to three years ago, have begun to parade their vessels for sale in the hope of cashing in on growing asset values. This seems to show a surprisingly short-term view at a time when VLCC earnings are finally starting to cover some of the owners' capital costs. Provided the Saudis maintain relatively high production levels, Arabian Light will continue to be competitive in Europe, the Americas, and the Far East, keeping the VLCCs busy for the foreseeable

future. The willingness of VLCC owners to sell vessels should be seen as a retrenchment or a profit taking to ease leverage rather than a lack of faith in the VLCC market.

Smaller Tanker Types

During this past winter there were a few dramatic spikes in the Aframax and Suezmax markets, but they were short-lived. The effect of these spikes on market sentiment, however, was substantial. They proved that even with the new building programs of the past ten years, market demand has grown at such a pace that a shortfall in tanker supply can actually occur. This is great news for the hedge funds that have allowed the shipowners to keep the shipyards busy. Even if they hoped, they never expected such improved trading in such a short time scale.

Despite all the new tonnage, especially in the MR size, the new ships have been finding profitable employment. A year ago there was talk of layups, especially among the super tanker owners. Today, it is difficult to find a Suezmax or Aframax for time charter. A fresh hope has entered the sentiment of the owners' offices as they feel they are seeing the beginning of the long awaited recovery of the tanker market. The strengthened dollar has also been most beneficial to shipowners, especially those based in the Eurozone.

Transport of Refined Products

As a consequence of the rise in US crude production (and the controls on crude exports), there has been substantial growth of US refined products exports (especially the US Gulf and West Coast). A number of South American economies are hungry for product imports to supplement their own refining and to fuel their growing energy requirements. A number of South American countries (including Peru, Colombia, Ecuador, and Chile) have become regular recipients of the growing US oil products export trade.

The vast majority of these US export cargoes are moved by Panamax and MR vessels. The world is a smaller place than it used to be and many of the large operators maintain US Gulf and Singapore offices to service Pacific trading. Returns on these trades are good and until the Panama Canal widening is completed it remains an MR and Panamax (LR1) trade with shipping restrictions at aging terminals favoring the smaller sizes. Given the weakness of the summer cross-Med markets of recent years and the reduction of the trans-Atlantic gasoline trade, many MR vessels are beginning to find regular employment on the coasts of the Americas as backhauling to Europe becomes less interesting. On many occasions in the past 12 months the US Gulf to Europe trade has been firmer than the front-haul Europe to the US Gulf.

Economic growth in West Africa is also attracting attention and generating both local and bulk fuel supply trades. Despite the Ebola virus, West Africa is importing more refined products and the affected countries are keen to return to development once the disease is behind them. This is mostly a Panamax and MR trade, and it is clear that the Nigerian and Ghanaian refineries are not sufficient to meet the growing product supply requirement of this region.

For West Africa, most of the refined oils are sourced from Northwest Europe. Rotterdam to Lagos is a 30 day round trip for an oil tanker, so West African trade, like the Americas, makes a substantial impact on tonnage miles in the tanker industry. Last year, freight to Durban from the Mediterranean was in the area of $1.5 million. So far this year, with bunkers at half the price for 22 days steaming, freighting has been at similar numbers if not $100,000 higher, at a time when owners are enjoying a bunker bill at least $200,000 less than in May 2014.

East of Suez continues to be an unpopular destination for handy size, MR and Panamax tonnage; the sizes most active in fuel oil trades. While the Saudis and Kuwaitis maintain their regular exports of Aframax 80,000 mt fuel cargoes from the Red Sea and Mideast Gulf, most of which go into the Singapore bunker trade, only the imports of Egypt regularly pull Panamax and recently MR tonnage into the area to supply severely draft restricted outdated discharge terminals. Over the past five years, Indian refineries have been exporting handy size fuel cargoes, traditionally to Singapore but lately these cargoes have been mostly going into the Fujairah bunker market. Many owners have tried and tested these short haul trades.

Since 2010, short haul trades from east coast India to Bangladesh or Singapore regularly have traded at $400,000 for the 6-day voyage. This year, by contrast, rates are closer to $500,000, but bunkers are half the price. Perhaps the improved margins will attract more participants to the area. However, shipping fuel oil around the Indian Ocean continues to be problematic and all vessels ending in the Red Sea tend to ballast back through the Suez Canal to find Mediterranean or Black Sea load ports.

This past winter the Continent and Med trades offered good returns to fuel oil shippers. Despite an increased number of ice class tankers available these days, demand was firm and although no dramatic rate spikes, the returns deterred many shipowners from leaving the north during the winter months. The ship-to-ship lightering operations off Malta and Cyprus have now become regular features of the Mediterranean fuel oil business and although we have lost the significant Libyan export cargoes of late, two or three a month still manage to get out.

In the Turkish Straits, bad weather wreaked havoc, delaying transits especially for the Aframax and Suezmax ships where a 4-5 days delay was not unusual. This became frustrating for charterers with contractual laycans in the Russian load ports. Meanwhile, construction on a new bridge across the Turkish Straits has commenced forcing closure of the straits for a number of days in May and June 2015. Handy fuel oil shipments from Black Sea enjoyed freights in the WS 175/220 range throughout the winter period, with rates recently falling below WS 150.

Conclusion

In the Far Eastern shipyards, it has been reported that a switch is occurring from bulker orders to tankers and containerships. This seems to be the beginning of the end of the tanker crisis of 2009. It is often said that tanker shipping moves in seven year cycles. From the owners' perspective, it has been a long and challenging six years.

The big fleets which were in crisis last year seem to be coming through at last, shrugging off the threat of liquidation. The tanker market may not be exactly booming, but cash-rich tanker owners are buying second hand tonnage. Denmark-based Hafnia Tankers Copenhagen is feeling confident enough to approach the NY stock exchange for an IPO floatation and tanker prices are rising once again.

While a boost to the world economy, cheaper energy has already worked its magic for the shipping industry. No great boom in freight rates is expected, but freights have returned to levels which allow owners a return on capital investment. It would seem that the word "profit" can again be applied to the world oil tanker industry. ■