PHOTO: © FEDERICO CAPUTO | DREAMSTIME.COM

Trouble at the pumps

Higher fuel prices focus shipowners' attentions on bunker buying and hedging strategies, reports **Barry Parker**

Fuel prices have nearly doubled during the past year, making bunkers a truly burning issue for ship operators. A composite of prices for IFO-380, a grade used in many deepsea vessels, saw prices that were in the low $400's during Spring 2010 now priced up near $700/metric ton – reflecting the sharp rise in energy prices across the board.

As economic demand has recovered over the past 12 months, followed by the spreading of political uncertainty across the Middle East, crude oil prices have moved up to towards $125/barrel (basis Brent- with WTI discounted, at around $111/barrel), reflecting a two-year high. But unlike in 2009 there are fears this time that prices may not fall back down again in a hurry.

The New York-based shipping analyst at rating agency Standard & Poors, Ms. Funmi Afonja, told Seatrade: 'Exposure to fuel price risk at shipping companies differs widely; it depends on their portfolio of contracts. Some of the international listed companies have their ships out on time charters - so the exposure is passed on.' She explained further: 'Where we see exposure is where companies are doing spot business where the ship owner is responsible for fuel cost.'

Recent news items have fuel surcharges ratcheting upward, as carriers try to pass on increased costs, rather than absorb them. Where the carrier retains the responsibility for buying fuel (and also retains the risk of rising prices), successes have been mixed. Indeed, S&P, in a report on 'Top 10 Investor Questions for Global Shipping', noted that: '… even if fuel expenses can be managed to some extent through skillful use of hedging instruments and/or slow steaming, these strategies are less useful when oil prices stay high for a sustained period.'

Afonja points out that: 'Even with price risk management, there is still volatility in cash flows; the timing of hedging and surcharges may lag the actual expenditures.'

In the bulk shipping sector, contracts of affreightment (COAs), on voyage terms, may contain explicit cost escalators. S&P's Ms. Afonja (who follows companies including General Maritime Corporation, Overseas Shipholding Group, along with ACL and Kirby Corporation in the barging sector) talked to Seatrade at length about how previous oil price cycles have chastened ship and barge owners. She said: 'Generally, the shipping companies have gotten better; some older legacy contracts did not have fuel surcharges built in. They've learned their lessons- newer contracts usually contain escalation mechanisms.'

The S&P analyst – who follows ocean shipping groups General Maritime Corp and Overseas Shipholding Group, along with ACL and Kirby Corporation in the barging sector – relates how previous oil price cycles have chastened ship and barge owners. 'Generally, the carriers have gotten better; older legacy contracts did not

Spiralling bunker prices

Bunker fuel prices have yet to retreat since the start of this year as the market is charging towards the $700 per metric tonne (pmt) mark.

The price of Singapore 380 centistoke (cst) bunker fuel, Asia's benchmark grade, has spiked by 30% to about $680 pmt in the week ended 8 April from about $525 pmt in the week ended 10 January. This represents an average of 10% price hike a month for the past three months of this year.

The Rotterdam 380 cst bunker market paints a similar picture where the price soared from about $510 pmt in early January to slightly over $650 pmt during the first week of April.

Current price levels at key global bunkering ports are approximately $100 pmt shy of the historic high of $752 pmt recorded for Singapore 380 cst in July 2008 pre-Lehman crisis. Prices crashed to $198 pmt in December 2008 after the financial crisis hit in September.

The Singapore 380 cst price has since risen to $256-302 pmt by April 2009, further climbing to $470-497 pmt in April 2010 before touching an average of $680 pmt in the first week of April this year.

The intense volatility and unpredictability of the bunker market will only continue to haunt ship owners and operators.

By Lee Hong Liang

have fuel surcharges built in. They've learned their lessons – newer contracts usually contain escalation mechanisms,' she says.

Bunker swaps also provide protection. OSG, in describing its hedging, states: 'The Company enters into stand alone bunker swaps to protect the Company against future increases in fuel prices in the normal course of its International Crude Tankers lightering business, which includes a number of fixed rate Contracts of Affreightment ('COA'). During August 2010, the Company entered into an agreement with a counterparty to purchase 787 metric tons per month of fuel oil for $429.57 per metric ton. This contract settles on a net basis at the end of each calendar month from September 2010 through June 2011 based on the average daily closing prices, as quoted by the Baltic Exchange, of the commodity during each month.'

The Baltic, in computing time-charter equivalents from quoted WS rates, uses bunker prices supplied by Bunkerworld. At current fuel prices, OSG is booking gains of circa $150,000/month on this transaction.

As fuel prices go up, so does the need for derivatives. Jamie Sheldon,

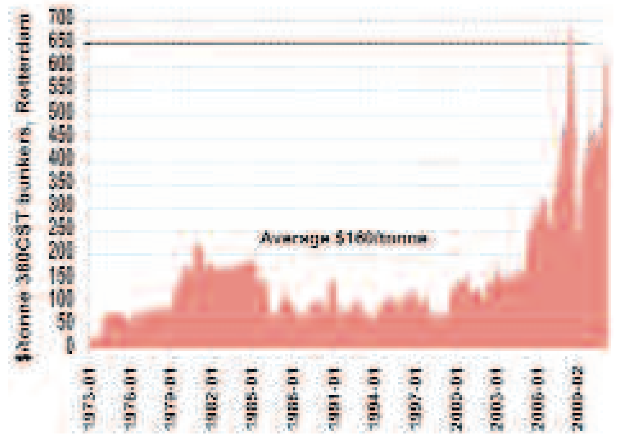
Fuel surcharges: a case study

For an example of how container lines are trying to pass on bunker price increases to customers, consider Horizon Lines, a US flag carrier linking the US mainland with Puerto Rico, Alaska, Hawaii, and, most recently, China. In late March, Horizon announced that bunker surcharges on its Jacksonville and Tampa runs to Puerto Rico would be $875 per container. The surcharges from Elizabeth (NJ) and Houston would be $965 and $1025 respectively. These numbers represent between 27% and 32% of overall revenue (net of fuel) per container, in 2010, of $3,229. Early April service announcements from Horizon showed that bunker surcharges in its Pacific trades would vary between 35% and 45%.

Horizon's recent financial reports reveal that fuel surcharges have been slow to catch up with its rising costs – the lag described by S&P's Afonja. The carrier's overall top line revenue from ongoing operations was roughly $1.2bn for its 2010 fiscal year, up $38m from the previous year. A complex variance analysis shows that the major contributor was a $41m increase in revenue from fuel surcharges.

However, in this case, the surcharges failed to fully compensate the carrier against fuel price increases – its reconciliation of cash flow changes shows a negative $12.6m item when comparing 2010 'fuel recovery' against the 2009.

BUNKER PRICES 1973-2011



from Veson Nautical, whose solutions include the IMOS6 Bunker Management module, tells Seatrade: 'High bunker costs and price volatility put margins at risk, so it's clear why more of our clients want an integrated view of their voyage activities and bunker swap positions. They need to understand their total bunker position to manage risk. IMOS supports this today.'

Owners performing spot business are often at the mercy of market conditions, which have a great impact on the ability of owners to deflect price increases towards their charterers. Again, S&P's shipping analyst offered some perspective, pointing out that: 'In the tanker market, you have overcapacity generally; as fuel prices spike up, the tanker rates are not going to move up in tandem. In a weak market, the owners simply don't have the pricing power to push fuel price increases entirely on to their customers.'

The analyst's views are underscored by a comment from Maersk regarding its liner business: 'The container shipping market significantly impacts Maersk Line's opportunities to be compensated for higher bunker prices with higher fuel surcharges, whereby the Bunker Adjustment Factor (BAF) ratio is affected by the general underlying market conditions.'

High fuel prices can also support a capital investment in bigger vessels with more economical propulsion systems. Maersk describes its new 18,000teu 'Triple-E' behemoths, to be delivered from 2013 onward, as being 35% more efficient than a 13,100teu vessel. Always innovative, Maersk has moved to a floating BAF, which protects the carrier with a market responsive surcharge that effectively allows the carrier to claw back more of the fuel price increases. ●