



POTEN TANKER OPINION

Worldscale's (Not So) Flat Rates

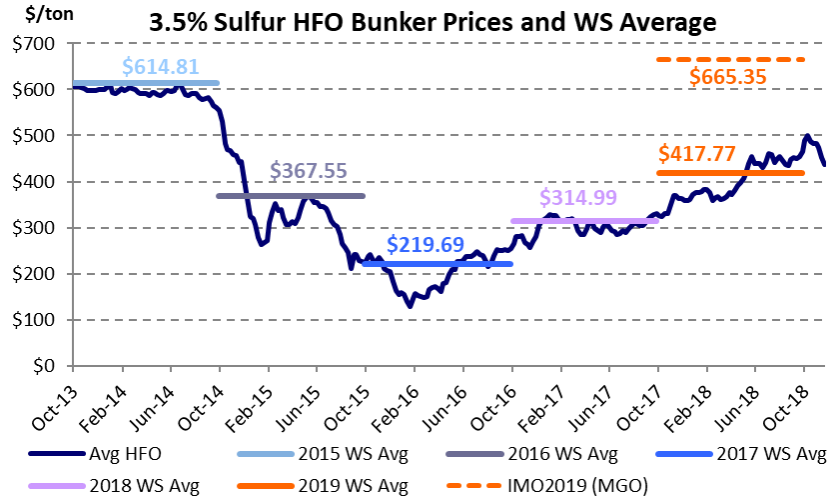
A preview of the bunker price impact on Worldscale flat rates

Worldscale is preparing to release its new flat rates for 2019. Just like last year, and for every year since the current Worldscale system was established some 50 years ago, the bunker prices are the biggest factor influencing the changes in flat rates from 2018 to 2019. Based on the increase in average fuel prices we expect flat rates to increase by 15-20%, a similar change to last year. The 2018/2019 change-over may be the last time that Worldscale uses the average price of 3.5% sulphur HFO bunkers in their calculation of flat rates. For 2020, Worldscale may want to base its freight calculations on the fuel that the vast majority of tankers will be using that year, i.e. low sulphur IMO 2020 compliant fuel. However, if it decides to go that route, Worldscale will face a problem: that fuel (and the associated pricing data) will probably not be widely available until the second half of next year. How will the Worldscale Association deal with this uncertainty?

A quick introduction to Worldscale: It refers to a system that attempts to equalize the net revenue of different voyages, allowing the cargo owner to change the destination of the cargo while giving the ship owner a daily return close to the originally negotiated voyage. Rate calculations are based on a standard vessel with a cargo intake of 75,000 tons and a daily consumption of 55 tons at a service speed of 14.5 knots. After subtracting bunker costs and port costs and accounting for steaming time and port days, the flat rate for the round-trip voyage is established so that the net earnings amount to \$12,000 per day.

The system traces its roots back to World War II and was originally developed to establish the freight costs for government-controlled tonnage when chartered out to oil companies on a voyage basis. After the government gave up control of the shipping industry in 1948, the industry had come to appreciate the freight rate tables and continued to calculate and publish similar schedules. In 1969 the shipping centres of London and New York joined forces and established a joint organisation to publish world-wide flat rates. At this point the adjustment changed to the current system of negotiated WS points which express the percentage of the flat rate that is applied to calculate the actual freight costs.

The voyage costs included in the calculation are port costs, canal costs and bunkers. Port and canal costs are typically a smaller component of the total voyage costs and relatively constant. Volatility is mainly caused by changes in bunker prices. Worldscale uses the average bunker costs from the beginning of October of the prior year to end September of the current year to establish the bunker cost assumptions for the calculations.



Sources: Ship&Bunker, Bunkerworld, Worldscale

Worldscale Bunker Prices and Flat Rate changes for Major Routes (2017=100)

		2017	2018	2019	IMO2019	Change		
						'17-'18	'18-'19	'18-IMO19
Bunker Prices used for Flat Rate:					0.1% MGO			
Avg 3.5% Sulfur HFO Price		219.69	314.99	417.77	665.35	+43%	+33%	+59%
From	To	2017	2018	2019 Est	IMO2019	'17-'18	'18-'19	'18-IMO19
Flat Rates (Indexed, 2017=100):								
Ras Tanura	Ningbo	100.0	118.5	141.2	195.4	+19%	+19%	+65%
Bonny	Philadelphia	100.0	118.0	140.5	186.1	+18%	+19%	+58%
Puerto La Cruz	Houston	100.0	101.1	118.3	145.5	+1%	+17%	+44%
Rotterdam	New York	100.0	113.1	136.4	152.8	+13%	+21%	+35%
Average:						+13%	+19%	+50%

Source: Worldscale, Poten & Partners

Bunker prices for the period 1 October 2017 – 30 September 2018 averaged \$418 per ton for 3.5% sulphur HFO, \$103 higher than bunker prices for the same period one year earlier. Based on this, flat rates will increase about 19% on average (see table). This is a similar increase as last year.

What could be the impact, if we assume that Worldscale will switch to low sulphur bunker fuel in its calculation? In the absence of data for 0.5% sulphur bunker fuel, we will use the 0.1% sulphur fuel as a proxy. As you would expect, the results are quite dramatic. The average of the 0.1% sulphur bunker prices that Worldscale uses for the ECA zones in 2019 is \$665 per ton. If this fuel was the basis for the calculation, average flat rates would jump by 50% next year. While this doesn't mean that freight rates would increase by the same amount (Worldscale rates may adjust), it does give an indication of the potential impact of the switch to low sulphur bunkers.

Worldscale has not reached a definitive agreement on whether, how and when to make the switch, but it is more likely than not that some type of low sulphur bunker fuel will become the de-facto standard in 2020. Charterers will look towards 2020 with some trepidation.