



No. 22 – 2014 WORLDSCALE FLAT RATE FORECAST DECEMBER 11, 2013

Flat rates are issued by the Worldscale Association at the end of each year. These rates, which are given in values that represent the shipping cost per metric ton are provided in US dollars. Flat rates are a fundamental component in spot rate negotiations between owners and charterers. Spot rates are a gauge of the prompt tanker market, and represent a percentage of the flat rate, with the latter being equal to the nominal or 100% freight rate.

The Worldscale Association publishes more than 300,000 flat rates for various load/discharge points. The updated flat rates take effect at the start of each year. In an effort to assess the future developments of the market, McQuilling Services provides a forecast of Worldscale flat rates using the organization's "Basis of Calculation".

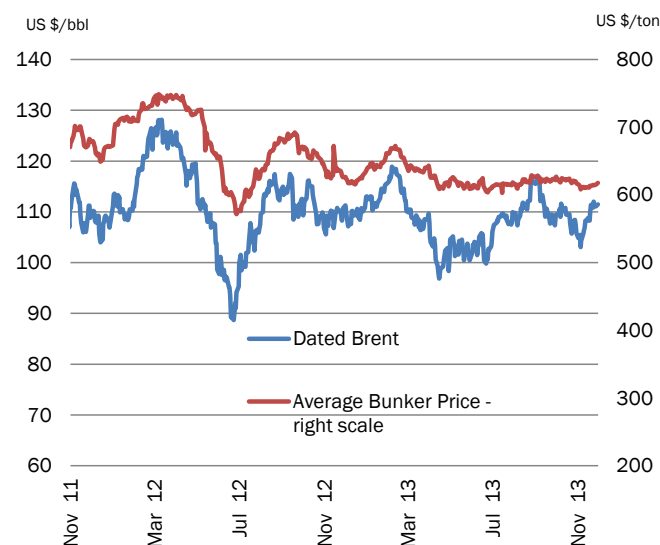
While the flat rates provided by Worldscale are applied to the entire spectrum of the world's vessels, the organization uses a constant total cargo capacity of 75,000 tons. This cargo capacity accounts for cargo plus stores, water and bunker fuels. A constant sailing speed of 14.5 knots, both laden and ballast is applied as are bunker consumption rates at sea and in port, load/discharge days are established and a fixed hire rate of US \$12,000/day is employed. To calculate the annual increase in port charges, we assume a rise of 5% on an annual basis. Our initial port costs are derived through industry relationships with international vessel agents.

The Worldscale Association releases a base bunker price to be used in this calculation that is an average of the fuel's price from October of the previous year to end-September of the current year. This is generally provided in the fourth quarter. The Worldscale Association reduced its base bunker price for HSFO 380-cst by about 8% from 2013 to 2014 from US \$686/ton to US \$632/ton. The base bunker price in 2013 was the highest level on record.

The price of crude oil has the strongest impact on the price of bunkers, which can be observed in Figure 1. We use the price of Dated Brent compared to our basket of bunker fuels as it is considered a global crude oil benchmark. Despite the reduction in bunker costs, it is clear that the relationship between Dated Brent and bunkers has become somewhat detached in recent years, primarily due to tighter supplies of bunkers as refiners upgrade units to reduce residual output.

Demand for bunkers would have been further eroded in 2013 as onshore users continued to increase consumption of natural gas. This development has been supported by lower natural gas prices on the back of increased production. Furthermore, elevated refinery maintenance and an uncertain freight market likely pressured demand from the tanker industry.

Figure 1: Dated Brent Spot & Bunker Prices



Source: Energy Information Administration & McQuilling Services

Despite this year's contraction, bunker prices have a higher upside potential by reduced supplies stemming from the previously mentioned rise in refinery conversion capacity, aimed to maximize the output of more high value petroleum products. According to data from JBC Energy, the global surplus of fuel oil was approximately 1 million b/d in 2008 and should fall to 300,000 b/d through 2018. These reduced supplies have contributed to the base bunker price increasing for 12 of the previous 17 years (Table 2).

McQuilling Services does not expect this trend to subside in the coming years and we are currently expecting a bunker price of US \$640/ton in 2014. Through 2018, we anticipate that bunker prices could rise to US \$690/ton. This upward movement will be driven by deepening global conversion capacity. Furthermore, as owners are faced with tightening emission regulations, the slow industry adoption of emission abatement technology could increase



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demand for HSFO. However, the previously mentioned lower cost of natural gas stemming from the change in market fundamentals should reduce demand from other industries and provide somewhat of a ceiling for bunker prices.

Table 2 provides our current assessment of the flat rates on selected benchmark routes. Overall, we expect the flat rate on these voyages to fall by an average of 4% compared to 2013. This contrasts to the 9% jump between 2012 and 2013. This was largely driven by the base bunker price declining 8% for the 2014 calculation.

Table 2: Historical/Estimated Worldscale Flat Rates and Bunker Prices

US\$/MT	TD1	TD3	TD5	TD9	TC1 / TC5	TC3 / TD10	Bunkers (US \$/ton)	% Change Bunkers
1998	18.41	11.26	8.79	4.42	11.04	4.11	108.75	
1999	16.99	10.4	8.18	4.15	10.19	3.85	82.75	-24%
2000	17.19	10.72	8.33	4.42	10.47	3.89	86.5	5%
2001	20.65	12.62	10.72	5.1	12.36	4.49	149.75	73%
2002	18.36	13.31	9.74	5.02	12.07	4.43	143.25	-4%
2003	20.03	12.15	10.16	4.97	11.92	4.38	138.5	-3%
2004	21.64	13.11	10.16	5.41	12.87	4.76	167.75	21%
2005	22.16	13.39	10.61	5.6	13.14	4.81	173	3%
2006	25.48	15.16	11.79	6.27	14.9	5.35	231.5	34%
2007	30.27	17.72	13.93	7.18	17.47	6.17	318.25	37%
2008	30.86	18.05	14.19	7.31	17.8	6.32	328.75	3%
2009	43.37	25	19.63	10.13	24.71	8.38	554.05	69%
2010	31.63	18.72	14.68	7.86	18.42	6.62	341.16	-38%
2011	38.41	22.51	17.67	9.25	22.19	7.78	467.48	37%
2012	46.31	26.95	21.05	10.76	26.65	9.21	606.56	30%
2013	50.75	29.4	23.01	10.94	29.1	10.06	686	13%
2014 est	49.60	28.98	22.17	10.80	27.80	9.32	632.44	-8%

Source: McQuilling Services, Worldscale Association

When determining how the rates will impact owners' earning, we examined TD3, the 260,000 ton trade from Ras Tanura to Chiba. With roughly 45% of global oil demand growth forecast to be derived from non-OECD Asia, this route is a key driver of oil markets.

The year-to-date spot average on this route has been WS 38.9 with a daily time charter equivalent (TCE) of US \$12,225/day. If we factor the reduced flat rate, our 2013 year-to-date spot rate rises slightly to 40.1 and the TCE increases to approximately US \$13,300/day. Despite this increase, it seems likely that owners will need to continue pushing spot rates higher in 2014, to break even and overcome financial pressures.

Some additional support for higher spot rates should also stem from forecasts that the global economy is recovering, supporting oil demand. In its latest Oil Market Report, the International Energy Agency stated that it expects demand growth to be 1.2 million b/d in 2013 and 2014 to 91.2 million b/d and 92.4 million b/d respectively. This is being supported by an improving economic outlook in the US.

Nevertheless, the availability of tonnage and the potential that some owners might increase speed could quickly eliminate any of these gains. As 2014 draws near, owners, especially of larger tonnage, will attempt to maintain the momentum of the current market. Lower flat rates will help them make their case, but ultimately, their fate will be controlled by the throttle.

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