Shipowners urged to hedge against oil price spike

Many shipowners are still in denial about the imminent market shock as the IMO's low-sulphur rules take effect in January 1, 2020, say Enerjen founders. But the clock is ticking, as the switch to cleaner fuel will need to happen in the fourth quarter and hedging against the risk of a massive oil price hike should begin almost straightaway

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Shipping industry faces $100bn hit in worst-case scenario during the switch to low-sulphur fuels, say Enerjen Capital founders

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ENERJEN CAPITAL WANTS TO HELP SHIPPING COMPANIES TRANSITION TO CLEANER FUEL, WHILE MITIGATING THE FINANCIAL RISKS, SAYS STEPHEN SCHUELER.

THE global shipping industry could see fuel costs soar by as much as $100bn next year as new rules that drastically cut the sulphur content of fuel take effect.

That may be a worst-case scenario, but even a much lower figure would be devastating for some shipowners in a business where profit margins are notoriously slim.

So, are there any risk management opportunities and how would they work?

One company thinks it has an answer as the whole industry grapples with one of the biggest challenges it has ever faced.

Enerjen Capital has been set up by Stephen Schueler, a former chief commercial officer at Maersk and chief executive of Safmarine, who worked for Microsoft before joining the Danish group; Gus Majed, an oil trader and former partner of energy and commodities group Vitol, who co-founded its derivatives desks in London, Geneva and Singapore; and Jake Greenberg, former head of natural resources at Bank of America Merrill Lynch.

Backing them is an advisory board consisting of leading experts in the fields of oil and commodities trading, risk management and analytics.

To put the scale of the imminent market shock into context, Maersk — which operates the world's largest containership fleet — has already stated publicly that its fuel costs could potentially go up by some $2bn in 2020.

Smaller operators may find themselves paying an additional $100m-$200m or so as the oil markets adjust to the new clean fuel environment.

Container lines alone are forecast to face a $10bn hit, according to one recent estimate. Then there are bulkers, tankers, cruiseships, ferries, tugs and so on, all of which will have to comply from January 1, as there will be no delay or phase-in period.

The truth is, no one knows the exact sums involved, but the financial risks are potentially huge.

Yet even at this late stage, many shipping companies are ill-prepared for the violent price fluctuations that may engulf the oil markets as the International Maritime Organization's 2020 low-sulphur requirements become mandatory, say the Enerjen founders, who have developed a hedging vehicle that incorporates a basket of options and instruments.

Bought at the right time over the coming months, and taking advantage of current market conditions, collectively these should enable shipping companies to hedge against the anticipated IMO 2020-induced price spike.

Taking the four quadrant model of denial, anger, accept and commit, chief executive Mr Schueler believes that much of the shipping industry remains in denial, or is only just moving to the anger stage.

"While we are having a dialogue with shipowners, I feel we are helping them shift into the acceptance and commit stage," he says.

Even some of the big operators are not fully prepared as they weigh up the pros and cons of scrubbers, low-sulphur fuel or liquified natural gas — although the latter is largely for the future.

Shipping companies are not being asked by Enerjen to invest in some sort of hedge fund, but to become joint venture partners. Each will commit the sum of money they reckon could be at risk from higher fuel costs, after taking into account their position in scrubber technology, what they estimate could be recouped from their customers and their own in-house price forecasts.

"What we want to do is help shipping companies transition to cleaner fuel, while mitigating the financial risks," says Mr Schueler.

The global oil market will eventually correct to the new clean fuel environment, but the adjustment process is likely to be quite extreme in terms of price moves, predicts Mr Majed, Enerjen's chief information officer.

He anticipates a window of about year when there will be a massive supply-demand deficit, which is why it is important for partners to hedge their exposure. But with little in-house hedging expertise in most shipping companies, this is best outsourced to those who know how the oil markets work, says Enerjen.

The sums committed to the Enerjen programme are in effect an insurance policy against unpredictable fuel prices over the coming couple of years.

Now, though, with the clock ticking, Enerjen hopes to persuade shipping companies to participate in its Enerjen Capital IMO Green Note joint venture.

The fundamental message is that time is running out, and the deadline for adjusting to the new environment is not 11 months from now, but some time in the fourth quarter of 2019 when shipowners will have to start switching from heavy to clean fuels.

But a much more immediate date is looming for those who want to hedge against unpredictable and probably extreme oil price swings later this year. To take advantage of the currently low level of around $60.5 per barrel for Brent crude, hedging would need to start in the coming weeks.

“We will layer on the hedge in a systematic way month by month,” says Mr Greenberg, Enerjen’s chief commercial officer.

Consequently, Enerjen will close access to its IMO 2020 note at the end of February, by which time it hopes to have signed up a fair number of partner shipowners from across the industry.

“It’s really important that shipping companies have these hedges in place by the end of the third quarter, as the fourth quarter is when the industry will really start to draw down on these low sulphur products,” say the Enerjen partners.