Suez Canal Pricing Forecast 2005-2025

Pronóstico de Precios del Canal de Suez 2005-2025

R.K. Johns & Associates, Inc.

9 de noviembre de 2005

Contrato No. 158094

Resumen Ejecutivo

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FINAL REPORT

Prepared on behalf of:

The Autoridad Del Canal de Panama

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November 9, 2005

R.K. Johns & Associates Inc.

111 Broadway
New York, NY
10006
(212) 393-9697

Executive Summary

The Suez is a 100-mile long sea level Canal connecting the Red Sea to the Mediterranean Sea. It was opened for commercial ship traffic in 1869 and has been closed six times throughout its history, the longest outage occurring in 1967 when the Canal was shut for eight years.

The Canal was nationalized by the Egyptian government in 1956 and is managed and operated by the Suez Authority. Logically, the geographic advantage of the Canal is in vastly shortening a vessel's steaming time traveling in east-west directions as compared to having to take the circular route around Africa's Cape of Good Hope. By the Authority's calculations, the Canal saves 86% of the distance between the eastern Mediterranean Sea and Saudi Arabia and 23% of the distance between the Netherlands and Japan.

With the obvious exception of oil tankers, the Suez Canal has historically not been a significant trade route for the US. Today, about six out of every ten containership transits through the Suez involve the Asia/India – Europe trades. A small number of these services originating in the Indian subcontinent continue on to US ports after discharging in Europe.

While much has been said in the media about the "Suez option" for direct Asia – US trades, only one service by the Grand Alliance offers a roundtrip to the US East Coast via the Suez. Less than one percent of the cargo on this service originates in North Asia.

The advent of near-term Suez Canal services to the U.S. can be explained by the boom in shipbuilding – according to BRS-Alphaliner, in the next four years carriers are building twice as many post-Panamax ships (564) as they are Panamax vessels (242) and they need to be deployed quickly and profitably.

There are many "ifs" regarding new Suez services primarily related to timing. Carriers need to cascade vessels out of existing trades, but only when the even larger 7,000 and 8,000 TEU vessels are available. Second, the use of a post-Panamax vessel at US East Coast ports requires a level of "readiness" that most of these ports have not experienced. Carriers plan to call only two or three ports and they will need deep water, longer berths and more container yard space to accommodate the bigger ships.

Even more important, an Asia – US Suez service requires at least one or two more vessels to maintain a weekly rotation than a similar service via the Panama Canal. A 2005 confidential survey conducted by R. K. Johns & Associates for the Panama Canal indicated that container carriers plan to launch one new Suez

- US service in 2006 and three more in 2007, using vessels in the 5,500 to 6,500 TEU range.

The Suez Authority is not likely to offer these new US services any special considerations. Since 1987, the Authority has maintained a flexible pricing strategy defined to include rebates for various ship types and trade routes for which the Canal believes it faces a competitive alternative route. Rebates have historically been granted on specific voyages where the vessel calls a single load and discharge port. The exception has been LNG ships, where the Canal has attempted to competitively price its transits to capture the Qatar LNG export trade. The Suez Authority has not granted a rebate to containerships on any trade lane.

For the most recent fiscal year ended June 2005, Suez Canal revenue totaled $US 3.29 billion from 17,334 vessel transits. In the second half of 2005, Canal transits are growing seven percent, while revenue is advancing nearly twice as fast at thirteen percent – a clear indicator that ships continue to increase in size. Containerships account for just under 40% of the Canal's traffic and a slightly higher percentage of its net tonnage and revenues.

Containerships pay the highest fee per net tonnage category of vessels, approximately 10% more than oil tankers. The Suez Authority charges ships based on their volumetric cargo carrying capacity, which is closely related to the vessel's gross registered tonnage. To capture revenue for containers above-deck, the Canal maintains a surcharge on tolls based on the number of tiers of boxes. For example, an average sized Panamax containership with five tiers above-deck will pay a 10% surcharge on its net tonnage fee.

Canal toll rates were increased 3% in February 2005, the first general hike in fees in nine years. The increase was universal for all ship types. The Suez Authority has not adhered to any pattern in the timing or magnitude of previous increases. Carriers readily admit that they do not conduct an open dialogue with the Suez Authority regarding toll policy and that the Canal only provides a few months advance notice of fee changes.

An average Panamax containership (4,300 TEU) is now paying in tolls (excluding ancillary fees) about $US 56 per TEU per transit at full capacity. In comparison, a smaller containership (2,200 TEU), which is more prevalent on shorter Suez rotations such as the Middle East / India trade with the Mediterranean, is paying just under $US 174,000 per transit, which equals $US 80 per TEU of capacity. An 8,000 TEU vessel, the newest generation of post-Panamax ships being deployed in the Asia – Europe trades, will be charged nearly $US 400,000 per transit, or the equivalent of $US 50 per TEU.

However, given the dynamics of the import merchandise trade from Asia to the Europe and the US, most vessels operate at 90% capacity utilization, which effectively inflates the per TEU charge by ten percent.

Another factor creating volatility in Suez tolls is the fact that the Authority charges in “Special Drawing Rights” of the International Monetary Fund (SDR). Since the US dollar is the international standard currency for maritime transport, any fluctuation in the SDR/dollar rate will impact the calculation of the “effective” dollar toll charge. When the dollar looses value, as it has in the past few years, carriers effectively pay more per transit even if the toll rate in SDRs remains constant.

It is projected that the Suez Authority will not raise nominal toll fees before 2015. Canal traffic is strong and is forecast to expand at or above estimated world trade growth of 4% to 5% over the next decade. Higher oil prices have been a boon to tanker transits and the introduction of a large number of post-Panamax containerships is a plus for the Canal due to the growing trade between Europe, the Indian subcontinent and Asia. Assuming the dollar remains weak, the Canal is contributing two-fold to Egypt – higher revenue from traffic growth and more foreign currency. Since the Canal contributes 5% to 7% of the funds for government spending from its “surplus”, the government’s influence in promoting the need for toll increases should not be discounted. With the outlook for a stronger Egyptian economy and growth in Suez revenues, any government-mandated toll policy change seems unwarranted and unlikely.

By 2015, based on past practice, the Suez Authority is likely to raise tolls. This could also be the case again in 2025. Without access to the Canal’s financials or planning strategy, it is difficult to forecast the size of a rate hike. Again, based on historical precedent, a 5% increase is possible in both years.

Factoring in both the opportunity for cyclical changes in the SDR/dollar rate and the expectation of two nominal toll increases in 2015 and 2025, the average “effective” toll per TEU increases less than 2% per year over the 25-year forecast period.

