REORDERING OF GLOBAL COMMODITIES MARKETS

• Implementation of Dodd Frank/Volcker Rule/EMIR
• Basel III capital rules punitive to commodities
• Loss of important bank counterparties impacts liquidity in futures and physical markets
• Huge turnover in senior staff from Banks to Trade Houses
• Reduction in risk capital for client risk management facilitation
• Bank credibility challenged by scandals in Fx, Libor and Gold Fixing
• Transition from OTC markets to futures and cleared product
• Regulators reign in HFT in futures markets
• Private Equity and Sovereign Wealth Funds increase interest in the sector
• Trade Houses increasingly push integrated model
BANKS EXIT OR REDUCE THEIR EXPOSURE TO COMMODITIES

Banks exit businesses because they are unprofitable

Regulatory bias against commodities (especially physical)

Key risks that banks face in the sector include:
- Regulatory risk
- Fines
- Headline risk

Cost of capital is higher than in traditional lines of business
- Market risk
- Credit risk
- Operational risk

Regulators exert a preference for the future/cleared model which competes with important OTC business for banks
BANK GLOBAL/SECTOR COMMODITIES REVENUE POOL

- 2009: 14.3
- 2010: 8.4
- 2011: 10.3
- 2012: 7.7
- 2013: 6.1

*Data provided by Coalition*
NEW TRENDS IN BANK STRATEGIES

Partial Exits - Morgan Stanley, Bank of America, JP Morgan, Goldman Sachs, Credit Suisse
Exits - Barclays & Deutsche Bank
Growth - BNP Paribas, CITI, Macquarie, BTG, HSBC
Regional Growth - Standard Bank, Standard Charter, Wells Fargo,
CIBC, RBC, Scotia Bank, Sberbank, ABN AMRO, CBA
## TRADING HOUSES FILL THE VOID

### Energy
- Glencore
- Trafigura
- Gunvor
- Mercuria
- Vitol
- Cargill
- Noble

### Agriculture
- Archer Daniels Midland
- Bunge
- Cargill
- Louis Dreyfus
- Glencore
- Mercuria
- Noble
- Wilmar
- Olam

### Metals
- Glencore
- Trafigura
- Noble
TRADING HOUSES FILL THE VOID

Advantages
- Fast decision making
- Willingness to use balance sheet
- Private ownership (most)
- Opaque structure
- Risk taking capabilities
- Light touch regulation
- Continue to invest in developing markets
- Investing in the integrated model
- No compensation restrictions

Disadvantages
- Opaque Structure
- Higher cost of capital
- Limited regulatory oversight
- Succession planning issues
- Anticipatory new regulation
- Exposure to global economic downturns
- Limited provider of risk management services
MARKET IMPACTS OF THE NEW TREND

Global dominance of trades houses adversely impacts the relationship of price makers to price takers

Reduction of liquidity in forward markets and physical markets

Increased cost of risk management to consumers and producers

Increased cost of balance sheet usage

Light regulatory regimes may allow trade houses a wide path to exercise market power

Ownership/control of strategic infrastructure causes increased prices volatility

Lack of market transparency in data

Pressure to use standardized exchange products increases basis risk for hedgers

Regulators create new TBTF institutions in the clearing houses

Banks reduced presence in physical market makes certain project finance deals undoable, has a direct impact on storage costs, security of supply (SPR) and increases end user costs
TRADE HOUSES TAKE CENTER STAGE

Oligopolistic pricing in physical market
Control over important infrastructure chokepoints
Hearsay reporting of prices to important industry pricing publication
Domination of physical commodity production and supply in developing markets
Controlling large market share in certain commodities
Trade Houses enter the Hedge Fund space
CHINA PARTICIPATES IN OPENING MARKETS

Chinese financial institutions become active in global commodity markets
• ICBC/Standard Bank, China Merchants Securities, GF Securities, BOCI

Chinese exchanges focus on global markets
• HKS – LME, SHFE – INA

China SOE’s buys stakes in global trading companies
• COFCO Noble (agriculture), COFCO Nidera (Agriculture)

Private Equity buys stakes in commodity traders and supply chains
• CIC- Noble, HOPU various

China (Shanghai) Free Trade Zone develops to grow international trading
• Global Companies register to use FTZ, SHFE locates INE in FTZ
GAME SET MATCH?

New Banks enter the market and fill the void in financial and physical products

- First quarter commodities earnings by banks indicate a recovery?
- New banks (along with certain incumbents) seize a growth opportunity

Trade house saturate markets with new hires and growing capital commitments

- Low volatility in major commodity markets spoil the party
- Commodity earnings stagnate causing retrenchment

Financial regulators relent, allow banks to have a presence in physical commodities and reduce the most onerous portions of regulation

- Loss of transparency, liquidity and competition impacts final rule making

Trade houses come under increase regulatory scrutiny

- Pressure from the global community forces Trade Houses to conform to bank like regulation and transparency
THE STRUGGLE BETWEEN PRICE MAKERS AND PRICE TAKERS WILL CONTINUE, HOWEVER MARKET FORCES WILL BRING THEM INTO BALANCE

1. “I have a suggestion for you. Raise your goddam fares twenty percent. I’ll raise mine the next mourning”. Crandall CEO American Airlines/ Putnam CEO Braniff Airlines

2. “Our business is moving molecules from point A to point B and managing the credit, market and operational risk associated with that. When there is more volatility people pay us more to do that”. Yusef Alireza CEO Noble

3. “A billion dollars isn’t what it used to be”. Nelson Bunker Hunt Investor