The FT Global Summit 2018

As ever, The FT Global Commodity Summit which takes place every year in Lausanne, is the best possible forum to take stock of the commodity markets and get a chance to listen to and meet the most influential voices of the industry. The catch sentence written on the backdrop of the stage in the beautiful Beau-Rivage Palace was “The Start of a New Cycle”. Maybe a question mark should have been added at the end of the sentence for are we really on the cusp of a new cycle? Indeed, at the end of the one and half day summit, the impression was rather one of protracted transition out of challenging market conditions, with new trends building up, traditional trading patterns increasingly challenged, and, overall quite a lot of uncertainty. Not quite a clear-cut supercycle in the making!

Detailed comments have been written by the Financial Times journalists at the end of the summit[i] and I would advise the interested reader to refer to them. I will limit myself to a few observations on my take-away and a few notes taken during the discussions.

- **The economic backdrop**: If one element looks genuinely positive, it is the healthy state of the world economy. After many years when the world economic engine was sputtering post crisis, 2018 is seen as bringing very robust growth, in both the developed and developing world, for a second year in a row. Inflation is nowhere seen on the radar and a resilient growth environment should trigger a rise in investment and, eventually new productivity gains. This is of course good omen for overall commodity demand. Adding to this a weak dollar, so commodity prices

should be well supported. That is certainly the most compelling argument for a new positive cycle (without question mark).

- **China**: No one seemed worried about China during the summit. Of course, the concern about debt was mentioned but to be hastily brushed aside as by and large in domestic hands (the Japanese syndrome). China is normalising: demand for commodity still grows albeit at a lower rate than GDP. One Belt One Road or the BRI (Belt and Road Initiative) as it is now dubbed, is a formidable opportunity for what was a Middle Kingdom to extend its influence and clout: Xi's masterplan, if successful will exercise influence over 60pct of the world population and 30pct or the world GPB[ii]. But China is itself in a very important transition as it is focused on tackling its considerable environmental problems. Renewable energy will certainly develop faster in China than in many countries and in particular the Electric Vehicle market, thus fostering demand on several metals such as copper, nickel, cobalt interalia.

  China's influence on commodity markets is not to be demonstrated. But it may become even stronger over the next few years which I would illustrate by three examples:

  - As cobalt will likely get in high demand for EV's, the production out of DRC (over 50pct of the world's production) might end up totally in Chinese hands: Glencore's long-term deal with the Chinese battery maker, GEM is a case in point. Moreover, 80pct of cobalt sulphates and oxides used to make the cathodes for lithium-ion batteries are refined in China, when the remaining 20pct are refined in Finland but supplied by a DRV mine owned by China Molybdenum's control over mines in the DRC)[iii].
  - China produces 85pct of the world demand for rare-earth. A rather uncomfortable reliance for tech firms worldwide
  - China pragmatically acknowledged a few years ago that it can no longer be self-sufficient for its food and agri supply. With Cofco International, it is building a powerful procurement tool aiming at getting a better control on supply at origin whilst it will increasingly control a larger share of the supply at destination. How long before it disintermediates large agri traders by controlling the price formation to destination?

    Trade wars can take several shapes or forms and China's needs and priorities will no doubt increasingly clash with those of other economic juggernauts (Japan, US and Europe). This is not a worry today, but China's economic partners should be well advised to rethink their dependencies for strategic commodities.

- **Geopolitics**: The obvious uncertainty with clouds getting darker and bigger. The withdrawal of the Unites States from the world, which started under the Obama's administration, is accelerating under D. Trump, who's sole interest lies with America's . The American historical post-war responsibility on the world' stability is no longer a concern for his administration. Robert Kagan used to say that the US were from Mars and Europe from Venus[iv]. Mars does not intend to protect neither Venus, nor anymore else anymore, merely prioritising the US short-term economic interests. What consequences such vacuum could have, we do not know yet, but the recent decisions on tariffs do not bode well. A trade war could well be triggered if China and other targeted countries were to play a tit-for-tat game. A new stance on the Iranian nuclear deal would also create shockwaves around the world and incidentally prop up crude oil prices to forgotten highs. Volatility is good for commodity trading, but maybe not that kind of volatility. These looming geopolitical concerns are probably the main reason why, despite a strong economic backdrop, no one really believes in a new commodity super-cycle.

- **Commodity trading**: The days when trading commodities was about buying FoB and selling CIF are over. Trading commodities is about adding value on supply chains and to do this, trading houses need the financial power to acquire assets, from production to logistics to transformation and distribution. Unless a strong niche player, trading houses will need to get bigger to play the game. Traders had a difficult year in 2017 for two main reasons: the lack of volatility of commodity prices (notably in agri) and, in energy particularly, a painful change of market direction, from contango to backwardation. Only strong players, with the ability to trade large volumes and to create margins along the chains were able to generate satisfactory results (i.e. in line or little less than in 2016). The outlook for 2018 remains uncertain despite the strong economic environment: margins are difficult to find and a clear sense of direction is lacking so yield curves are not easy to play with, with the exception of some metals.

- **Strategy vs opportunism**: A fascinating debate across the spectrum during the summit: Traders all expressed their doubts and mistrust about long term strategic objectives: In an uncertain world, one need to be opportunistic, and certainly not stuck in strategic principles. To quote Glencore's Yvan Glasenberg – a trader cum producer; "at the right price I'd sell anything". Interestingly though, even miners expressed a slight uneasiness about long term strategic goals. Keeping the flexibility and the ability to take advantage of changing market conditions seemed to be the motto. This tells volume about the players' view of the current environment!

- **Mining:** Last year, miners rewarded their patient shareholders after 2015 and 2016. This year the rhyme is similar, but not quite: We need to optimise, to manage costs. And to invest wisely. But – and this is supports the transition year belief – nobody mentioned any significant growth project. Investments are limited to maintaining

the existing production capabilities. How long it will take before investors and analysts start to challenge the miners about this strategy as the need for metals is bound to grow in the next few years? A supply deficit is clearly in the making. Would the miners play scarcity to boost prices? Meanwhile cash is building up and miners don't want to "make any dumb move" as Anglo American's Cutifani put it. This is a game than the world is not going to afford very long, especially with the EV revolution coming. The miners' stance is likely to be rather different at the FT Global Commodity Summit next year…

Another thing is worth pondering: it could be described as the "Glencore effect". When Glencore and Xstrata merged, one of the first decision of the new CEO – Yvan Glasenberg – was to clearly delineate the responsibilities: to the Xstrata engineers, the management of the mining activities, to Glencore's teams everything else. The logic behind was simple: commodity traders will be more effective marketing and selling the Group's output than engineers. And it worked. So, what is the "Glencore effect"? Simply the fact that Glencore's competitors such as Anglo-American or BHP are endeavouring to create in-house trading activities, mirroring (or trying to) Glencore's model. Will that work? Time will tell but the odds are rather poor: trading is a culture that requires freedom and flexibility to play as many optionalities as possible, often beyond the house's longs. That is something traditional miners will struggle to accept.

- **Agri**: if there is a sector where traditional trading is challenged, this is agri. The efficiency of the world supply chains, the quality and quantity of crops over the past 5 years, the sophistication of the farmers and their ability to hoard when prices are not satisfactory, makes live of agri traders increasingly difficult. The 2017 results of large ABCD's such as LDC (Dreyfus) or Bunge evidence such difficulty. Waiting for the providential dislocation, only able to create a favourable trading environment looks increasingly like the Samuel Beckett's play "waiting for Godot" where Godot never arrives. Only large traders with a strong command of their supply chains and deep integration have a chance to thrive in such efficient environment. Alternatively, mid-size niche traders with deep expertise and control at origin and a perfect logistic are probably also sustainable if focussed on commodities where production is scattered and in the hands of small units (coffee, some cotton origins for instance). In grains and soybeans however only large producers cum traders will be able to make a difference. Consolidation is therefore likely, probably as soon as this year. Further partnerships with Cofco International, on the look for expertise at origin, would not be surprising either.

- **The most quoted commodities**:

    - Bunkering: The dislocation in bunkers (sulfur rate) effecting 2020. "it's happening"

- Uranium: no trust in a nuclear renaissance
- Copper: "supported on the supply side – potentially a copper crunch? The risk is on the demand side.
- "Watch Nickel and Cobalt (its cousin) and platinum for fuel cells and also vanadium ( for grid electricity storage – vanadium flow batteries)",Friedland – Ivanhoe
- On cobalt, automobile manufacturers building long term partnership to secure sourcing is urgent as China is about to secure the bulk of DRC supply. (Glencore LT contract with GEM).
- LNG (crunch on prod in 20 -21)
- Oil no clear upside and a backwarded market

## A few notes taken during the summit

1. McKenzie – BHO Billiton
   - History does not repeat itself, but it often rhymes (Mark Twain)
   - Commodities, the building blocks of modern life

2. Economy – Martin Wolf – Paul Horsnell
   - The world looks East: Developing Asia grows twice faster than the world (despite lower growth in China). Developing Asia is now half the world
   - Fundamentals are strong (growth will lead in a rise in investments and renewed productivity gains) as challenges (China's debt, inflation in the US, Protectionism, geopolitics)
   - Commodity sector. Not a quantum leap but views get more positive
   - China's demand for commodities is growing albeit at a lower rate than GDP. Normalisation?
   - Oil. The shale swing is not credible on the long run: Bullish on a 5 year horizon
   - Uranium: no trust in a nuclear renaissance

3. Energy Traders – Trafigura, Mercuria, Gunvor, CCI
   - Energy transition is beginning? But oil consumption will remain significant (2025 -2030)
   - Bigger will get bigger as trading conditions get more challenging
   - Mercuria: getting ready for less reliance on physical trading. Structuring, risk management and long-term investments in production (Vaca Muerte)
   - Less volatility in the market. Challenging trading conditions. Scale and Global footprint are paramount (Trafigura)

- Risk of disintermediation for traders as transparency increases (CCI)
- Need to maintain a disciplined capital allocation (CCI)
- LNG- strong opportunity for traders (Trafigura)
- Challenges (opportunity). The dislocation in bunkers (sulfur rate) effecting 2020. “it’s happening”

4. Mining – Freeports’ Adkerson , Ivanhoe Mines’s Friedland
    - Lesson learnt:
        - ✓ Better be opportunistic than strategic.
        - ✓ Danger of over leveraging “go into this thing with a strong balance sheet (Richard Adkerson, Chairman and CEO of Freeport)
    - Copper: “supported on the supply side – potentially a copper crunch? The risk (uncertainty) is on the demand side. (Adkerson)

5. “Watch Nickel and Cobalt (its cousin) and platinum for fuel cells and also vanadium (for grid electricity storage – vanadium flow batteries)”,Friedland – Ivanhoe
    - No worries on China (Friedland)
        - ✓ Population and urbanisation
        - ✓ Environmental concern: demand for alternative energy will thrive
        - ✓ Think of China’s scale
        - ✓ BRI
        - ✓ “Bet on copper”
    - Cobalt relies on DRC. Elections “47 pct of the population is going to vote”

6. Geopolitics (Charterhouse rules)
    - KSA: The model of MBS is Abu Dhabi’s MBZayed. A real change is taking place. MBS is supported internally, hence his ability to travel 3 weeks out of the country.
    - Qatar: Difficult to see how the emirate can get out of the hole.
    - Kazakhstan: Nazerbaiev succession is a concern
    - Russia:
        - ✓ Poutine is quite predictable.
        - ✓ Impossible to disentangle Russia from Europe (think about the gas)
        - ✓ Rosneft is a political tool

7. Glencore – Yvan Glasenberg
    - Listing was necessary to ensure growth
    - How to keep your shareholders as a successful private entity and most importantly renew them?
    - Private equity is not adapted: too demanding on return (25pct) for commodity business dynamics (too much leverage, volatility in revenue)
    - Lack of investment in mining: most of the investment are effected to maintain current production levels

- So far investors are satisfied with dividend priority and capital discipline. That will change.
- Copper crunch is possible
- On Agri. We would like to grow. This business relies on asset and infrastructure. Alliance with Canadian Pension funds to bring fire power
- Strategy vs opportunism: “At the right price, we would sell anything”. “I did not know one month ago I would buy a coal mine” (Hail creek from Rio Tinto in Queensland)
- On cobalt, automobile manufacturers building long term partnership to secure sourcing is urgent as China is about to secure the bulk of DRC supply. (Glencore LT contract with GEM).

8. Cofco International – Johnny Chi
    - “One Team, One Voice, One Dream”
    - Cofco Int will take care of its non Cofco shareholders (Temasek, StandChart and IFC), delivering value for money.
    - CI will be the sole procurer of COFCO
    - Need to build market share in destination markets (beyond China)
    - China should represent 1/4$^{th}$ of our global business
    - Need to build origination capabilities (South America, North America and Black Sea)
    - Increase partnership with farmers (disintermediate traders)
    - Sustainability is a core part of CI’s strategy.
    - On Partnerships: Even with our competitors

9. Agriculture Cargill, Summa Group, ADM
    - On Cofco: A competitor and a customer – Cargill
    - On disclocation: At last, some!
    - “From glut to volatility” - Cargill
    - Agri trading buying FOB selling CIF is dead - ADM
    - Traditional trading model is over: at origin, farmers apply storage strategy according to prices. The trader cannot create margin.
    - value has to be found all the way to the consumer. Starting with the farmers: digitalisation, Platforms, Analytics
    - On consolidation: Scale is increasingly important. Small players will struggle. “It has just started” - Cargill
    - Sustainable supply chains capabilities are out of reach to small players

10. LNG –Total G&P, Chenière Energy, Trafigura, LNG BP
    - Strong growth in 2017 strong trend in 2018
    - Over supply concerns did not materialize and won’t for the next 3-4 years

- LNG production is currently 300mt. 500mt required in 2030. Potential crunch time in 20-21. New project will be needed.
- New projects for Total. Supply from Papua New Guinea, demand in Myanmar and Ivory Coast (power)
- The market is between 2 places at the moment: Spot and LT contracts
- Total; to encourage investors, 80 pct of output lifted by shareholders in Yamal. Generate a stream of spot contracts
- Traf contract to secure longs with Chenière
- LNG vs Oil. Huge difference in scale:
  - ✓ Price is 30 pct logistic costs.
  - ✓ 2 cargos a week vs several cargos a day

11. Anglo American – Cutifani
    - Cost reduction: 30 to 40 pct in energy costs
    - Mining gets more chirurgical
    - Clamp down on investments: towards a more rationale behaviour. “don’t make dumb decisions”
    - Clear target of Net Debt to Ebitda

12. CFO’s - Vitol, Merucria, CCI, Trafigura
    - Barriers to entry grow (T). Margins are thinner (C).
    - There are margins to be found “. Volume alone does not make profits. You need infrastructure”. Need to capture margins over the whole supply chain. In all type of cycle (V)
    - Mercuria’s hybrid model
    - Vitol to focus on developing in emerging markets
    - Invest to “debottleneck the supply chains” (T)
    - The shift from Contango to Backwardation: “it is costly to manage the transition” (V)

13. Metals – M Chamberlain, chairman of LME
    - Work to put together Cobalt future contracts. To be launched in 2019
    - Complication arises from the fact the final counterparties are not LM members. So, no direct feed from the industry. (LME members ->OTC->final counterparties)

14. Oil Market- Trafigura, Repsol etc
    - Trafigura is one of the largest exporter of crude oil
    - The world moves toward a low sulfur environment
    - Growing importance of the petchem industry as a destination market for crude

- Refining: need to invest in conversion capacity. In Europe, need for sour crude than the US extralight one
- Shipping issue: Gasoil or scrubbers? The market is getting prepared albeit slowly; new vessels are equipped with scrubbers
- Shorter trades to deal with a complicated yield curve.

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[i] https://www.ft.com/content/5240ebc4-2dfa-11e8-9b4b-bc4b9f08f381
[ii] Nicolas Baverez in 'Violences et passions', page 44
[iii] The Economist march 24th, 2018 page 65
[iv] Robert Kagan in 'Paradise and Power', page 3