The buoyant oil traders

Not everyone in the oil industry is licking their wounds

May 7th 2020

TIMING IS EVERYTHING. When the late Marc Rich, an infamous commodities trader, set out to prise open the Fort Knox world of oil trading in the early 1970s, he had little more to help him than family money, the proceeds from the sale of a colleague's car, and an address book full of contacts. But something momentous was happening. In the Middle East oil nationalism was stirring. Members of the Organisation of the Petroleum Exporting Countries were tearing up a post-war system in which Western oil companies, the so-called Seven Sisters, fixed the price of crude. An Arab oil embargo had pushed prices up to record levels. It was an ideal time for a renegade trader to go behind the backs of blue-chip producers, ship oil around the world on behalf of despots and sell it at market prices. With the motto "To make money out of other people's money", Rich created a business that was reliant on bank loans, secretive and controversial (he was indicted in 1983 for tax evasion and trading with Iran). It was also fabulously profitable.

Almost 50 years later, circumstances could not be more different. After a lousy year for oil producers in 2019, demand for petroleum has collapsed as a result of covid-19 lockdowns. Prices hit record lows. Oil is overflowing from storage tanks and sitting uselessly in supertankers. To constrain supply, producers are shutting down wells and cutting investment. Royal Dutch Shell, an Anglo-Dutch supermajor, has made a 66% cut to a dividend that was once as reliable as the tide on the Thames, onto which its London-based employees look out.

Yet away from the spotlight, the oil-trading operations of Glencore, a listed company founded by Rich, and private ones such as Vitol, Trafigura, Mercuria and Gunvor, are going strong. Last year they shipped more than 24m barrels a day, almost a quarter of world demand, generating turnover (including other commodities) of more than $700bn, as well as bumper profits. This year their winning streak is likely to continue. What makes these mavericks so resilient in an industry prone to boom and bust?

Again, it comes down to timing. As well as ferrying oil around the world, traders store it, taking advantage of differences between the "spot" price of the stuff now and the "futures" price days, weeks or months ahead. Unlike big oil producers, which plough fortunes underground in the hope of big pay-offs in years or decades from today, they hold oil—be it in transit or in storage—for short periods, earning tiny margins on each barrel and magnifying profits by shipping and blending huge volumes. Because the private ones are mostly owned by employees, they face no pressure to pay dividends if times are lean. And even when spot prices are low, they can make fortunes. According to Oliver Wyman, a consultancy, their most recent boom years coincided with the financial crisis of 2007-09 and the oil-price crash of 2014-15.

That is because they benefit from price volatility, rather than absolute price levels. In the turmoil of recent months, haywire markets have experienced an unusually steep "contango", a state of the market when the spot price is lower than the futures price (its opposite is "backwardation"). For those with storage, contango is a godsend. It enables you to buy oil cheaply, hold it and release it to the market when prices are higher. "It is like sailing with the wind in your back," says Jean-François Lambert, a trading consultant. Storage has been desperately scarce in recent months. In the heat of the crisis, shipowners took advantage to raise the price of tankers tenfold and demand ultra-long contracts. But thanks to good relations with the shipping industry and supportive banks, the traders were probably swift to get in ahead of the pack.

For all their similarities, they have intriguing differences. The most open of them is Trafigura, which alone publishes detailed annual accounts (as a measure of the wealth generated, its shareholders' equity last year was $6.5bn, split between management and 700 senior employees). It can count on $60bn in credit lines from 135 banks, and has introduced sophisticated data-crunching tools. It was quick to warn the markets of the lack of storage at the end of March, which suggests it was already well supplied with storage capacity by then. It is now bullish about a pickup in demand, and says low prices are working to force producers to reduce output. Hence the market is starting to rebalance. "Oil is coming back off the boats," says Ben Luckock, its co-head of oil trading.

Vitol, an even bigger trader, keeps a low profile and appears more cautious. It likes to think of itself as financially conservative and plays down talk of "bumper years". Its chief executive, Russell Hardy, sees a fragile recovery as lockdowns ease. "The worst is over," he told Reuters. But his mood is hardly bullish.

There is good reason for caution. The crisis has brought home the danger of collapse among indebted counterparties. Even before American oil prices plunged below zero on April 20th, Hin Leong, Singapore's largest home-grown oil-trading company, declared insolvency. In the aftermath the big traders quickly reassured banks that they were in no danger. Trafigura, with "adjusted" debt of about $5.3bn, sent a letter to banks explaining the market moves and saying that it had been able to minimise risks before April 20th.

Less renegade, less Rich?

Bigger challenges lie ahead. Large European producers, such as BP, Shell and Total, have become more aggressive traders in their own right, increasingly clawing back the ground they once surrendered. Middle

Eastern oil titans, such as Saudi Aramco, are also trying to muscle in. This could squeeze traders' margins in the long run. They also face heightened scrutiny over transparency, governance and climate change. Energy has always been a murky business; the pressure is mounting to make it less so. One day Trafigura and the others may be forced to move away from the black stuff. When precisely that will be is anyone's guess. Timing, yet again, will be everything.■

This article appeared in the Business section of the print edition under the headline "The mavericks of oil"