The 2020 FT Commodities Global Summit

Two weeks ago, the first virtual FT Commodity Global Summit took place. However successful the summit was – attendance was counted in thousands rather than hundreds, one cannot help having a weird feeling after 3 packed days of first-class panels and interviews. No Beau-Rivage Hotel in Lausanne and its wonderful view, no cocktail parties in the garden overlooking lake Leman, just oneself in front of a computer screen. Yet, the three-day summit delivered on its promises and the FT team did a first-class job in lining up the leaders in the industry and ensuring the audience gets a comprehensive picture of the commodity world and the challenges it faces.

This year's theme was the climate crisis and its consequences. However, the backdrop of the covid-19 pandemic and the recession it triggered in many parts of the world could not be brushed away as a temporary blip, for it has created one of the biggest shocks of demand since decades.

As ever, The FT and other medias have provided a thorough account of the discussions, but in case you missed them, here after are my personal take-aways from the 3 days exchanges.

1. **Get green or else.** If only one thing was made crystal clear throughout the summit, it is that across industries, across sectors, across supply chains, displaying a convincing ESG strategy toward building a 'greener' business environment is no

longer an option. It has become a strategic imperative and beware the one who does not take this seriously. Stakeholders i.e. investors, banks, customers, suppliers (whether of goods or services), not forgetting employees, will soon no longer be in a position to keep supporting a business plan or a strategy which lacks a clear and strong drive towards more transparency, sustainability in its wider sense and of course a positive impact on the environment. It is fascinating to witness how fast things have changed. A couple of years ago, articulating an ESG stance was seen as a positive move but one buying time and underpinning good communication. No anymore: the call for the society at large is such that no company can afford not to have a compelling ESG and CSR plan at the heart of its strategy. This has far reaching consequences in the world of commodities and raw materials and most of the debates and discussions reflected the challenge for all players.

- **Emission reduction for all**. Commodity Trading houses, whether privately owned or publicly listed, in agri, metals or in energy sectors must demonstrate proper behaviour. All have been communicating on carbon emission reduction objective. Scope 1 (direct emissions) or scope 2 (indirect caused by energy consumption) for now. This is however probably just a hors d'oeuvre. Soon they will also be accounted for their indirect responsibility on scope 3 emissions (upstream and downstream processes). In other words, trading houses and even those with a limited involvement in upstream or downstream industrial process are likely to be treated like any industrial companies when it comes to their environmental responsibility.

- **Can trading houses ride this wave?** The answer is not easy and varies from a sector to another.

    - In agri for instance, the plan is rather straightforward: obtaining full traceability warranting total compliance on every supply chains. Nobody is there yet but progress has been made. LDC for instance indicated that they were able to trace 100pct of their direct purchase of soy in Brazil and demonstrate they are not relying on illegal deforested lands. But what about indirect purchases? Cargill candidly explained that although 96pct of their Brazilian soy supplychains were deforestation free, they were under huge negative pressure about the remaining 4pct and were getting bad press because of that. Purchasing seems to bring as much as reputational responsibility than producing.
    - In metals, the focus is on copper, nickel, lithium, cobalt because of their contribution in the energy transition notably in the transportation sector. But what about other metals, iron and coal? And what about the responsibility in sourcing from mines that are not ESG compliant? What about the energy used in extraction? Any mine relying on fossil fuels to provide for its energy needs will need to move into renewables when possible. If not possible, will it eventually be under pressure to close down? Not immediately so, but soon enough as the owners might find themselves short of financing support if no transition strategy is in place. Same with water supply and tailings treatment. Trading houses, at least for their larger trade flows will be accounted for their suppliers' ESG goals.

    - It is of course in the energy sector that the challenge looks particularly tough. To-date trading renewables is simply not profitable. Is there anything to trade by the way? The business model relies on fossil-fuel trading, and in that respect the new commodity, LNG remains a fossil fuel and therefore does not bring a significant credit to either producers or traders. For large energy trading houses therefore, the choice is limited: invest (i.e. buy assets, therefore dilute the trading model) in renewables and move into renewable power trading. Such is the choice made by Trafigura, Vitol – Mercuria was ahead of all thanks to its purchase of the JP Morgan Power business a few years ago. What about refineries? They will have to focus on bio fuels, says Gunvor.

- **Yet we are talking about transition.** In other words, the commodity trading world , whilst no longer in denial that business models are bound to evolve, advocate they have some time ahead to plan inevitable changes and adjustments. In the meantime, existing business should not be threatened. This makes sense of course, but under the condition that a clear roadmap is drawn and communicated about. Many discussions hovered therefore around the timing of the transition. A few weeks ago, BP in its 2020 Energy Outlook advocated that in its three scenarios it has envisaged (rapid, net-zero and even business as usual) the share of fossil fuel in primary energy had started to decrease with a peak-oil demand having already occurred. Whilst all players agreed on the inevitable decline, most of them and particularly the leaders of the large oil trading houses, were in polite disagreement with the BP stance. Oil demand they said, will start to decline within 10 years but certainly not immediately. Were they in denial as the consequence for their business of a quick drop would be daunting if not life threatening? Maybe, but more convincingly, most argued that the reliance of our economies on oil was such that an accelerated trend was simply not realistic. The 100 mio barrel-per-day oil consumption level is here to last for the coming 10 years said in unison the CEO of Vitol, Gunvor and Mercuria. That is a valid point especially for oil. But what about coal consumption? It will become increasingly difficult for commodity houses to trade thermal coal and this justifies the development of LNG trading.

- **Banking in 2020: get greener for finance.** A very powerful tool to convince the commodity world to embrace the energy transition and be at the forefront of the ESG fight is to put pressure on finance. Banks are therefore now clearly tasked by the society at large to make wiser choice when it comes to lending and this goes beyond mere credit risk. What is financed, who is financed is now increasingly subject to scrutiny and covenants linked to environmental impact and footprint. The conference showed this is no longer aspirational or directed toward coal or deforestation. Several revolving credit facilities now include green covenants on emission reduction scope 1 and 2 for instance, or safety on production sites. Quite telling: a bank was represented by its Global Head of Green and Sustainable Finance, not by the Global Head of Commodity and Structured Trade Finance… Times are changing.

2. **Oil outlook.** Beyond the longer-term questions about the energy transition, the outlook for oil in the next two years was much discussed. 2020 has been a very good year for most large oil trading houses, even those which were caught on the wrong foot at the beginning of the year such as Vitol. The combination of a high volatility and steep contango is the perfect formula for record trading profits. Already Trafigura which fiscal year closes at the end of September, hinted at such nice performance (probably nuanced by the more challenging profitability of its industrial assets).

   - **Demand**. The yield curve is less attractive now (contango play is barely lucrative, says Trafigura). More crucially, questions over the rebound on the demand side do not find easy answers amid the lingering covid-19 pandemic. (will there be demand for the oil accumulated during the contango?) Demand has slackened this year by 8mbpd said Fatih Birol for IEA. The question is how long will it take to come back? IEA is quite ambiguous about that with a very political agenda (we are not OPEC best friends anymore and we embrace the future. Emissions have declined and we have collectively to do the utmost, so they do not come back to pre-covid levels). Traders have naturally a more direct vested interest and believe it should take more than a year to see demand back in the 100mio bpd level.

     With the restart of several economies after the ebbing of the first covid wave, Baker-Mackenzie forecasts demand to grow over the 4th quarter of 2020, but certainly not close to pre-covid levels. Yet it should be strong enough to rebalance the market somehow.

     On the longer-run, as Pierre Andurand put it "it is hard to see oil demand falling off a cliff. He therefore anticipated a demand plateau for the next few years (until 2027-30) and then a decline, with EV gathering momentum and the energy transition in full bloom. Put on the spot, the oil hedge fund star, together with Ben Luckock, the Co-Head of Oil trading at Trafigura and Ann-Louise Hittle VP Macro oil at Backer Mackenzie made the following predictions on the demand outlook:

In mbpd	Dec 20	Dec 21	Dec 25	Dec 2030
P.A.	95	c100	104	98
B.L.	<95	c100	100	100
AL.H	95	c100	100	103

     The trump card will of course be the availability of a covid vaccine which could rapidly boost oil demand by 5/6 mbpd.

   - **Supply.** Uncertainty does not limit to demand levels. It is also huge on the supply side. Short term, the market is clearly over supplied vs tepid demand levels with additional uncertainty around Libya returning to the market, as well as doubts about the OPEC-NOPEC production cut agreement. On the short run, OPEC has been praised for the good job done in managing prices and it is expected that supply stays as it is for several months, awaiting demand to gather some strength. The consensus is that OPEC/NOPEC should leave production levels unchanged. Too much supply and price would sink to unsustainable level for many producers. More restrictions could drive prices up to the point that many could be keen to take advantage, like some OPEC struggling members Or, of course, the US shale producers, which for now are in a restructuring / rationalisation mode. Inevitably, the market would become oversupplied and a price war between conventional and tight oil producers would follow.

On the longer-run, things are even more complicated: If prices do not climb back at least towards the 50$ level, many producing countries will face significant economic problems and potentially social unrest. On the other hand as Rosneft stated, (but this was echoed by many) the level of under investment in the oil production industry is massive. In 2020, exploration spending dropped 4-fold since the peak of 2014 to below 20bn dollars. This could create bottlenecks on the supply side and thus justify the prediction that whilst absolute level of oil prices are likely to remain stable, we might witness rather high volatility before the oil demand starts to structurally fall. A bonanza for oil traders…

- **What does this all mean for oil price?** The short-term outlook consensus seems to be around stability this year. Vitol's CEO anticipates a prolonged 40 to 50$ pbl level (in 2021) whereas Jeremy Weir, factoring in a potential 3rd Covid wave not only do not see prices rallying but in fact possibly drifting further in the next 6 months, addingas a caveat that the evolution of the US dollar will definitely have an effect. The clearer predictions regarding Brent were made by Pierre Andurand, Ben Luckock, and Ann-Louise Hittle:

	Dec 2020	Dec 2021
P.A.	35	50
B.L.	30.5	45
AL.H	-	60

Still these spot prices do not necessarily reflect the potential volatility on a daily basis mainly caused by uncertainty on the supply side.

3. **Finance: the shadow of Singapore.** This year's fraud scandals and bankruptcies in Singapore were present in every discussion around technology, the financing of the sector and the commitment of banks to keep supporting it.

- **Could technology help?** Blockchains, trade repositories will definitively add value and banks will be promoting these technologies to fight their worst nightmare: frauds. The consensus amongst the CFO's of the largest commodity houses is clear: what happened in Singapore will accelerate the adoption of these new technologies. The concern, as expressed by Vitol is that the market is far away from embracing global standards, and therefore it might get worse before it gets better with more inefficiencies to be expected. Maybe so, but as the CFO of Trafigura pragmatically pointed it out, one must start somewhere, and it is imperative that the legal system embraces the progress of digitalisation and adds legal value to electronic bills of lading for instance. Can technology help? Definitely, said Vitol's CFO but business is all about good decision making, i.e. very human.

- **What about banks?** By and large banks will keep supporting their fittest customers and many amongst banks and Trading houses mentioned “a flight to quality”. More fundamentally the transparency of the relationship between banks and their customers never appeared as crucial as it is now. Trust is about understanding and information sharing. Large banks pulling out is no good news, and epitomizes the slim profitability of commodity finance vs the perceived risks. Most banks have been reassessing their portfolios, the structure of the financing, and inevitably the pricing. Citi’s Global Head of Commodity & Energy hinted at “robust conversations”, whilst the Natexis representative admitted the bank had gone through a sector wide portfolio review, leading to selective reductions of exposures.

  Is this affecting the large trading houses present at the summit? None admitted it, but CFOs all agreed that the market needed more participants rather than fewer to support commodity trading. The good news is that the current level of prices means that the financing needs are not stretched. It is expected though that even for large trading houses, banks will be more attracted to support trade cycles and current assets than to increase their participation in RCFs. When one of the CFOs answered a question about banks, she said that they had been particularly supporting “to finance storage” i.e. the contango play. Typically, this is a form of secured financing on assets… Q.E.D[1].?

4. Other interesting points.

- **LNG**. A few years ago, LNG was hailed at the new commodity and a bright future for LNG trading was foreseen by everyone. But LNG has not delivered, and particularly so this year when demand felt by 3 to 5 MT btu and demand represents 70pct of last year’s. Prices are much too low, and profitability is slim if existent. Still, most specialists insisted on the importance of LNG, especially as a quid pro quo for coal or in the shipping industry to replace the dirty fuel oil. However, where the debate got most interesting is that gas is a fossil fuel and therefore may not be seen as viable on the long term as the world engulfs itself in an (hazardous?) accelerated energy transition process towards net zero emission goals. In that context would the huge investments required to ensure the transition out of coal be ever profitable? Will they still be financed by the banking sector, itself under pressure to direct money to the righteous?

- **Hydrogen.** The big winner this year. From shipping to other forms of transportation, hydrogen was hailed as the most promising source of clean energy. The question is of course through which mean on production. Natural gas? Not very compliant! The cleanest for of hydrogen would be the one produced using renewables like solar and wind… Arguably clean but in the meantime we might have to resolve ourselves to make use of an almost illimited resource on earth: gaz…

[1] *Quod Erat Demonstrandum*

- **China.** No commodity conference could be held without China being mentioned. It has this year, first and foremost because the world growth is more than ever driven by the sharp and sustained rebound of the Chinese economy and demand for anything like soy, oil or metals remains very strong and supports the whole commodity complex. Nobody demonstrated China's importance, better than the Chairman of Glencore, Tony Hayward: "When Glencore is competing in Africa for access, we do not bump into Rio Tinto or BHP. We bump into Chinese companies. Who is our biggest customer? China is. When we merged Glencore with Xstrata, which regulator intervened to say we want some changes here? The Chinese regulator. What happened when we made the remedies to allow the transaction to conclude? We sold a copper mine. Who did we sell it to? A Chinese company". Fascinating demonstration of the acute awareness of China of its dependency on global resources and its systematic endeavours to get access to them. As concluded by Tony Hayward, "this has been going on for a couple of decades and I do not anticipate that changing".

- **Restructuring.** Two interesting keynotes from Agri traders and two different views. On the one hand, Greg Heckman the new CEO of Bunge (listed in the NYSE) was keen to hail the potential benefit of bringing back the organisation under one roof, when hitherto, business lines were managed in a decentralised fashion. One global platform for a global footprint. Greg Heckman seemed quite comfortable about the support of its key investors on his strategy. On the other hand, Sunny Verghese, the CEO of OLAM (listed in Singapore) is advocating the opposite model whereby the business is being split into two subsidiaries, one focused on food ingredients and the other on "global agri-business" aiming at attracting different investors. The common denominator for both groups has been a rather unattractive performance in the past few years and disappointed investors. Let's see if such opposite strategy can create value for them in a post-covid world.

JFL
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