Financing Commodity Trade Flows

Word Trade Organisation

Geneva, 28th September 2017

Jean-François Lambert

Financing Commodity Trade Flows

- Commodity supply chains are large and run deep: From Producers to Traders, to Processors. And beyond to end users.
- Financing is required all along the chains
  - ✓ Investment
  - ✓ Working Capital
  - ✓ Trade
  - ✓ Support to trade partners
- Besides Equity, financing is mainly provided by banks

Financing Commodity Trade Flows

- The pivot of the commodity supply chains are the Trading houses
- Trading Houses need liquidity as much as we need oxygen
  - ✓ Sourcing + Transportation + Storage +Transformation, multiply financing requirements, mostly short term
  - ✓ Hedging strategies deployment hinge on the availability of cash
  - ✓ Differentiating on the sourcing to secure the commodities
- Banks provide the bulk of that liquidity

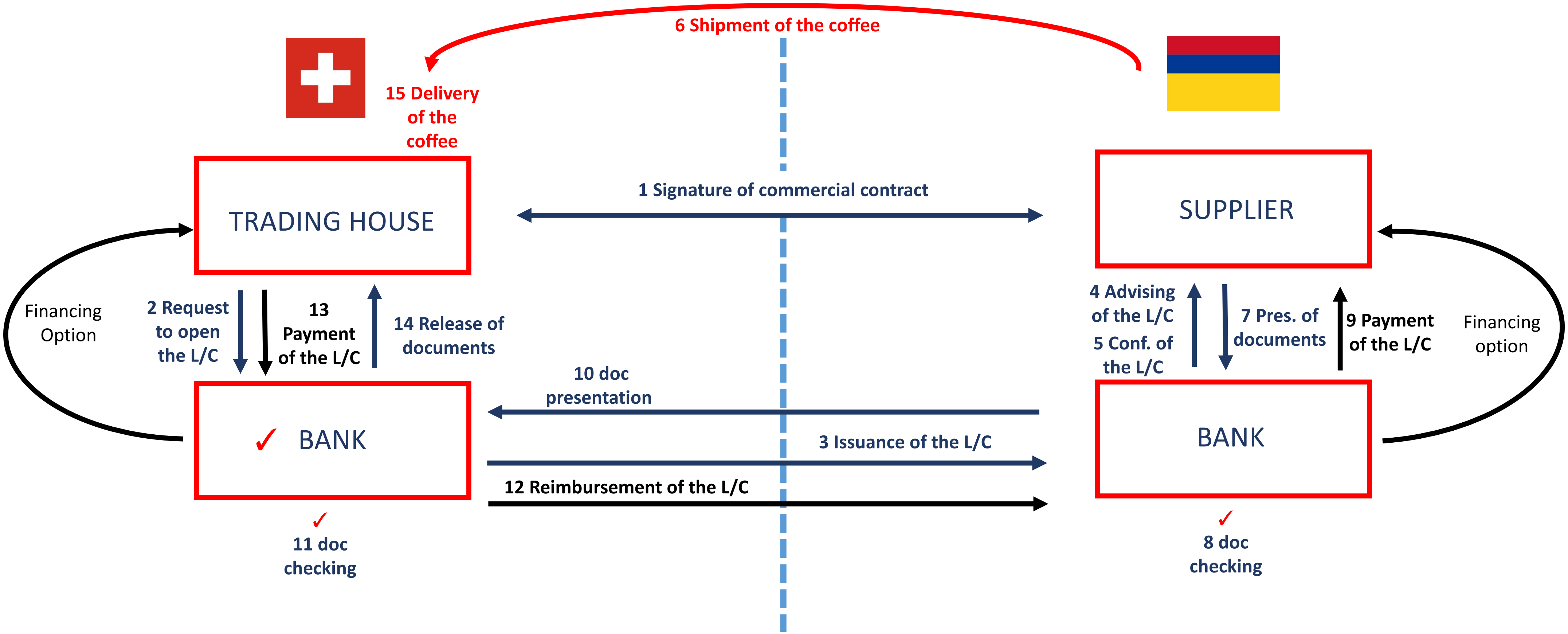
Example one : Typical Trade Financing

- A Trading House buys coffee from a producer located in Colombia to sell to a large European expresso maker.

- It will ask its bank to open a Letter of Credit in favour of the supplier on mutually agreed contractual terms

- How does this work?

Example one : Trade Financing



Benefits:

- For the supplier:
  - ✓the L/C will provide security on his future delivery
  - ✓It will allow him to secure financing locally

- For the Trading House:
  - ✓Payment of the L/C will be conditional to the fulfilment of the terms of the contract predicated on an agreed set of documents evidencing the trade

Benefits:

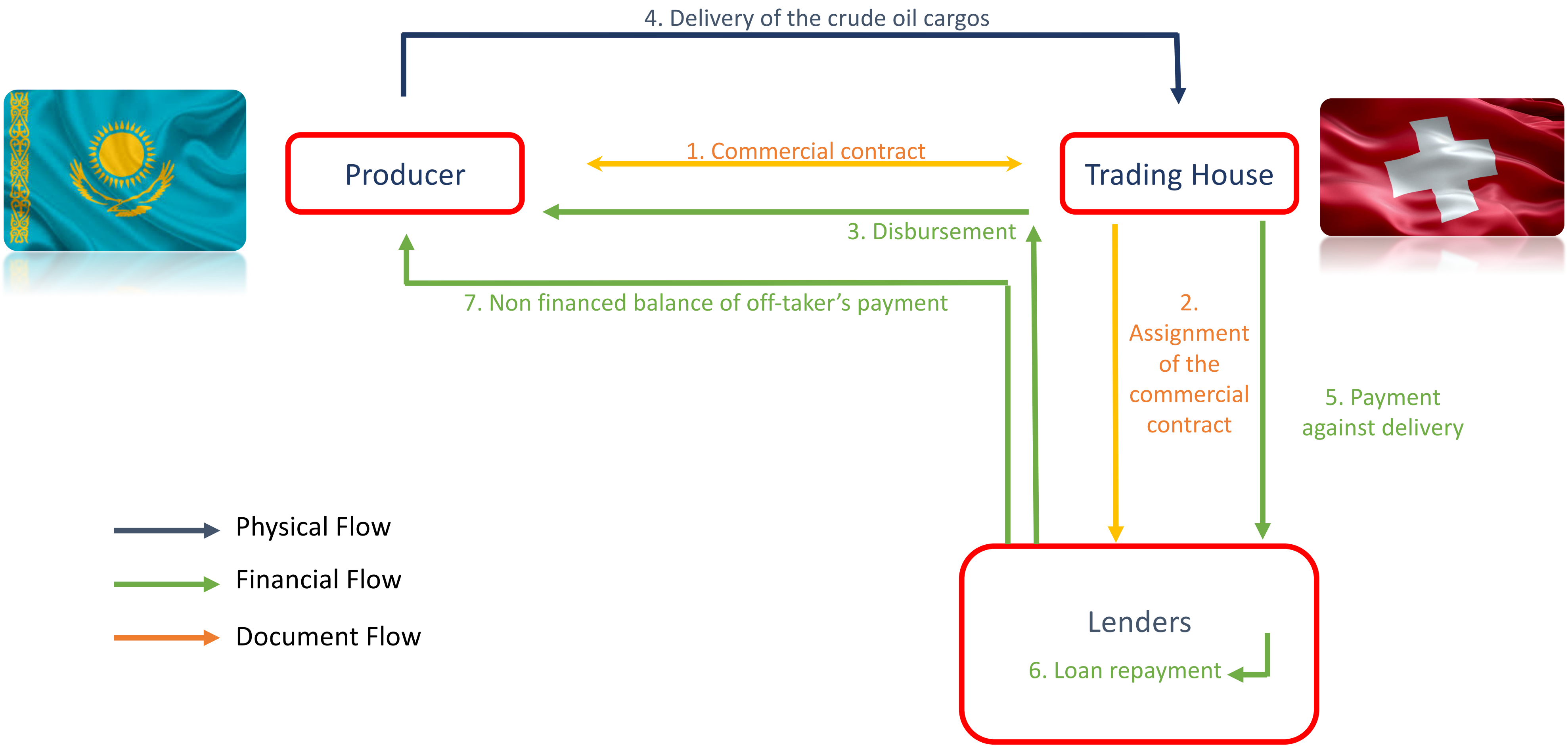
- For the Banks:
  - ✓The opening bank will keep the control over the goods until the trader pays or sell the coffee to its customer as agreed.
  - ✓The confirming bank will only guarantee the payment by the opening bank if agreed terms are fulfilled
  - ✓The beneficiary's bank (usually the confirming bank) will have a secured way out on its customer enabling it to finance the production process

A self liquidating instrument in nature, the Letter of Credit is recognised as a safe and reliable trade enabler

Example two: Pre-Payment

- A Trading House buys crude oil from a producer located in Kazakhstan
- It is willing to prepay part of his purchase predicated upon the signing of a long term contract
- How does this work?

Pre-Payment


4. Delivery of the crude oil cargos
Producer
1. Commercial contract
Trading House
3. Disbursement
7. Non financed balance of off-taker's payment
2. Assignment of the commercial contract
5. Payment against delivery
Lenders
6. Loan repayment
Physical Flow
Financial Flow
Document Flow

Benefits:

- For the supplier:
  - ✓The pre-payment will allow him to gather cheaper liquidity than from its local banks, on a longer term basis
  - ✓It will therefore be able to finance more effectively his investments

- For the Trading House:
  - ✓Pre-paying is a strong differentiating factor to secure long term supply
  - ✓It keeps the upper hand on the relationship with its supplier
  - ✓Its banks will provide the bulk of the required liquidity

Benefits:

- For the Banks:
  - ✓The Risk taken on the supplier is mitigated by the payment risk of the trading house
  - ✓The main risk is a performance risk (the ability of the supplier to produce and deliver the commodities

A perfect debt instrument to support a commodity supply chain as it dwells on the trade relationships between a buyer and its key supplier

Other forms of financing

- FX Market Lines
- Money Market lines
- Stock Financing
- Receivable Financing
- Working Capital financing
- Asset Financing

The Potential Challenges

- Derisking by Banks
- Inappropriate Basel regulatory framework for Commodity Financing
  - Insurance coverage
  - Stock financing
  - Performance risk
- Financial exclusion
- Cost to business (“Return on Effort”)