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Investment banks bet on physical markets (Translated by Crédit Agricole CIB)

CASE STUDY Financialization of commodities

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Investment banks are knitting partnerships with industrial companies and strengthening the links between trading and financing.

While their supremacy on commodity markets is still uncontested, Goldman Sachs, Barclays Capital and Morgan Stanley are faced with increasingly fierce competition. JPMorgan hopes to rapidly join the three global leaders by making a series of targeted acquisitions. It has just struck a decisive blow with the USD 1.7 billion takeover of the U.S. business of RBS Sempra, a joint venture between Sempra Energy and Royal Bank of Scotland. The deal includes the company's gas and electricity assets in Europe and its gold and metals assets globally with the exception of the United States. "JPMorgan's strategy is to cover the physical and financial aspects of commodities so as to have a platform offering the complete spectrum of services," says Catherine Flax, head of JPMorgan's commodities division for Europe, the Middle East and Africa (EMEA). The bank has said that it has increased its commodities-dedicated staff by 50% over the past two years.

Turning now to the Americas, the takeover of Bear Energy, within the context of the takeover of Bear Stearns in 2008, strengthened its presence in natural gas and electrical power operations in the United States. The purchase of UBS Commodities Canada, specialized in agriculture and energy, and of two smaller carbon emissions specialists, EcoSecurities and ClimateCare, contributed to extending its scope. JPMorgan is nonetheless still on the lookout for additional sources of growth: "We intend to focus on promising opportunities in agriculture. Our clients face a certain number of significant challenges including that of food security. We also intend to grow in the bio-fuel sector," adds Catherine Flax. It has been undergoing fast growth since the purchase of the Asian and European activities of Lehman Brothers at the end of 2008, and Nomura is on the offensive in the brokerage of physical goods (as opposed to derivatives), where investment banks are competing with traditional brokers like Trafigura and Armajaro. The Japanese bank has just bought the European natural gas and energy physical trading activities of Canada's Nexen. "We already had a dedicated operational platform for the financial trading of commodities, in particular through oil, metal and agricultural contracts," explains Jason Tudor, the head of commodities at Nomura for the EMEA region. "The acquisition of NEML [Nexen Energy Marketing London] provides us with an immediate presence in the physical market for commodities and is part of a strategy for future growth. We want to grow this business in order to become one of the five biggest players in the energy and gas sector in Europe over the next five years."

French banks are also betting on the physical energy market, the most significant segment ahead of metals and agricultural commodities. The acquisition of Fortis's Belgian and Luxembourg activities provided BNP Paribas with a physical trading capacity for gas and electricity in the United States, in Houston. "This acquisition gives us a nationwide dimension in the United States with a presence in practically all the U.S. states, not to mention Canada," says Amine Bel Hadj Soulami, global head of commodities derivatives at BNP Paribas. Société Générale also wants to bolster its presence in the U.S. oil sector, but not only that. "We want to be as close as possible to our clients. We are examining how to adapt our structures, for example by focusing our metals team around the existing unit in London, where the majority of our clients are," explains Federico Turegano, global head of natural resources and energy resources at SG CIB. "We are also studying the possibility of having a small team in Chicago to follow food and bio-fuels, since Chicago and the Midwest are major regional centers for soft commodities and bio-fuels in the United States." The bank could also benefit from the withdrawal of certain U.S. regional banks that have been hit by the financial crisis. On the other hand, it is more reserved with regard to its plans to start up trade finance operations in Geneva. With cross-selling elsewhere in Europe, SG CIB has opted for a model close to that of RBS Sempra, or for a partnership between Glencore and Credit Suisse, by creating two joint ventures: Gaselys with Gaz de France in 2001 and then Orbéo with the chemicals manufacturer Rhodia in 2006.

In order to gain a better knowledge of physical flows (see the expert opinion), CA CIB did the same thing last May with EDF Trading. "We will begin physical transactions in gas and electricity in Europe at the end of March," reveals Martin Fraenkel, global head of commodities for the Fixed Income division of CA CIB. Its joint venture with EDF Trading has been operating since November in financial products linked to gas and electricity in Europe and to coal worldwide. The unit has a staff of 10 in addition to the 70 front-office commodities professionals at CA CIB. Natixis has no plans to enter this market. For the moment it is betting on commodities financing and derivatives and favors cross-selling between units. In the fourth quarter of 2009, it opened a trading desk in New York dedicated to energy and metals. "Our French competitors have been present in this market for many years and have built up a corporate client base, a time-consuming process. For us, companies currently account for only around 30% of transactions, with the remainder coming from financial institutions and investors with which it is easier to develop relationships," explains Andy Gooch, global head of commodities for capital markets at Natixis with a staff of 73. Conversely, BNP Paribas is counting on increasing the share of institutional investors from 10% to 20% by 2012, instead of the 30% to 35% previously targeted (L'Agefi Hebdo of September 17, 2009). In two years, "we want to double the revenues from our commodities business," explains Amine Bel Hadj Soulami. According to our information, that means reaching USD 1 billion in derivatives. Société Générale continues to favor clients that produce and supply commodities. "We derive around 75% of our trading revenues from our corporate clients, a percentage expected to remain stable over the coming years," says Edouard Nevisaki, global head of commodities at SG CIB. In order to encourage cross-selling between the financing and trading room units, a year ago CA CIB created a structure overseeing all its activities dedicated to oil and gas. "We wanted to better coordinate our structured finance, capital markets and investment banking business lines while also relying on our client coverage teams and our 58 locations around the world," explains François Martin, head of this global energy group. Thanks to this organization and to a favorable context, revenues from oil and gas hedging products shot up by 50% in 2009, while those of the entire energy group were up by 38%. The next step for CA CIB and its competitors will be to develop investment banking business with commodities market players. BNP Paribas is

already up and running: “Over the past 18 months we have set up a team of around 40 senior bankers serving 350 large companies,” Lincoln Payton, global head of commodities at BNP Paribas, is pleased to report.

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