

Managing Zinc Price Risk on the LME

11th Asia Pacific General Galvanizing Conference

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Bangkok, 25 July 2019



SETTING THE GLOBAL STANDARD



Agenda

Section	Title
1.	Overview of the LME
2.	Zinc - recent developments
3.	Zn price risk management

Overview of the LME

The LME is the leading global venue for metal market participants to manage their price risk

LME is the leading global exchange in all non-ferrous metals

In 2018, the LME traded in excess of

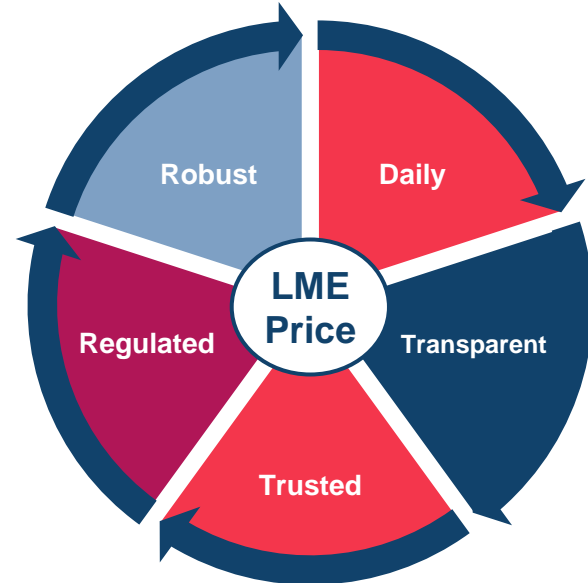
185 million lots

\$15 trillion notional value

4.1 billion tonnes

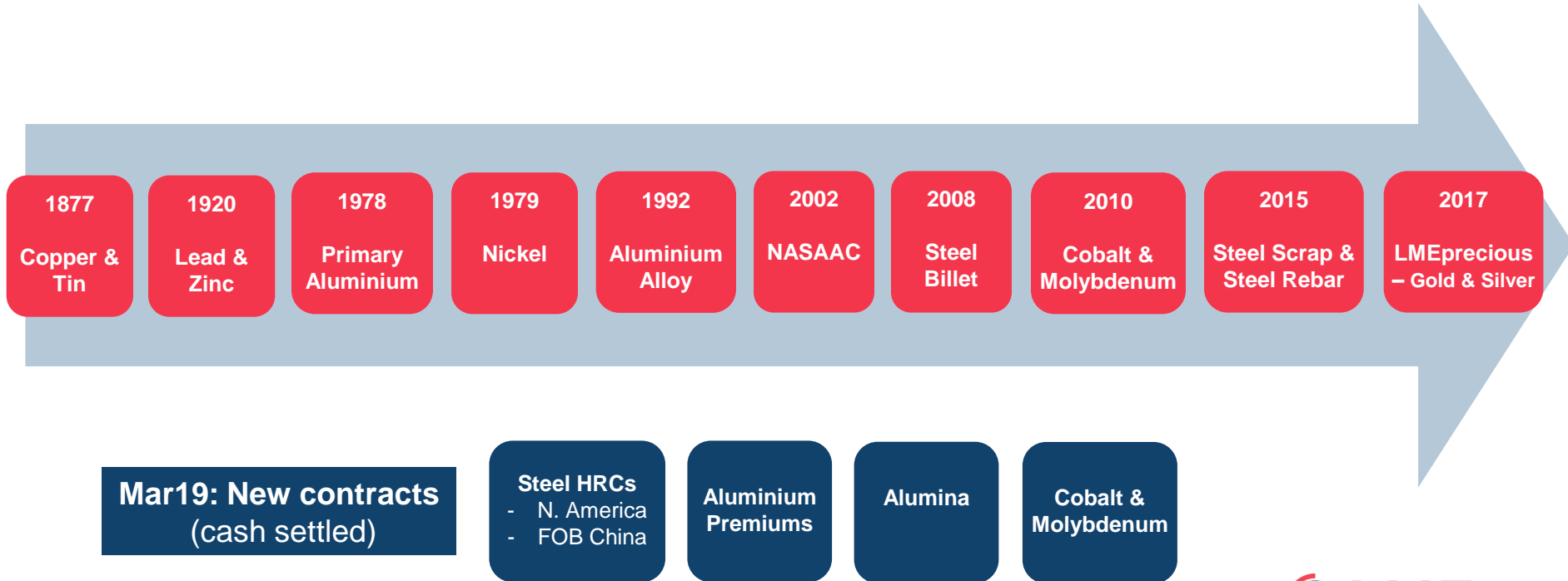
This equates to an average daily turnover of 730k lots

LME provides market leading pricing of futures contracts



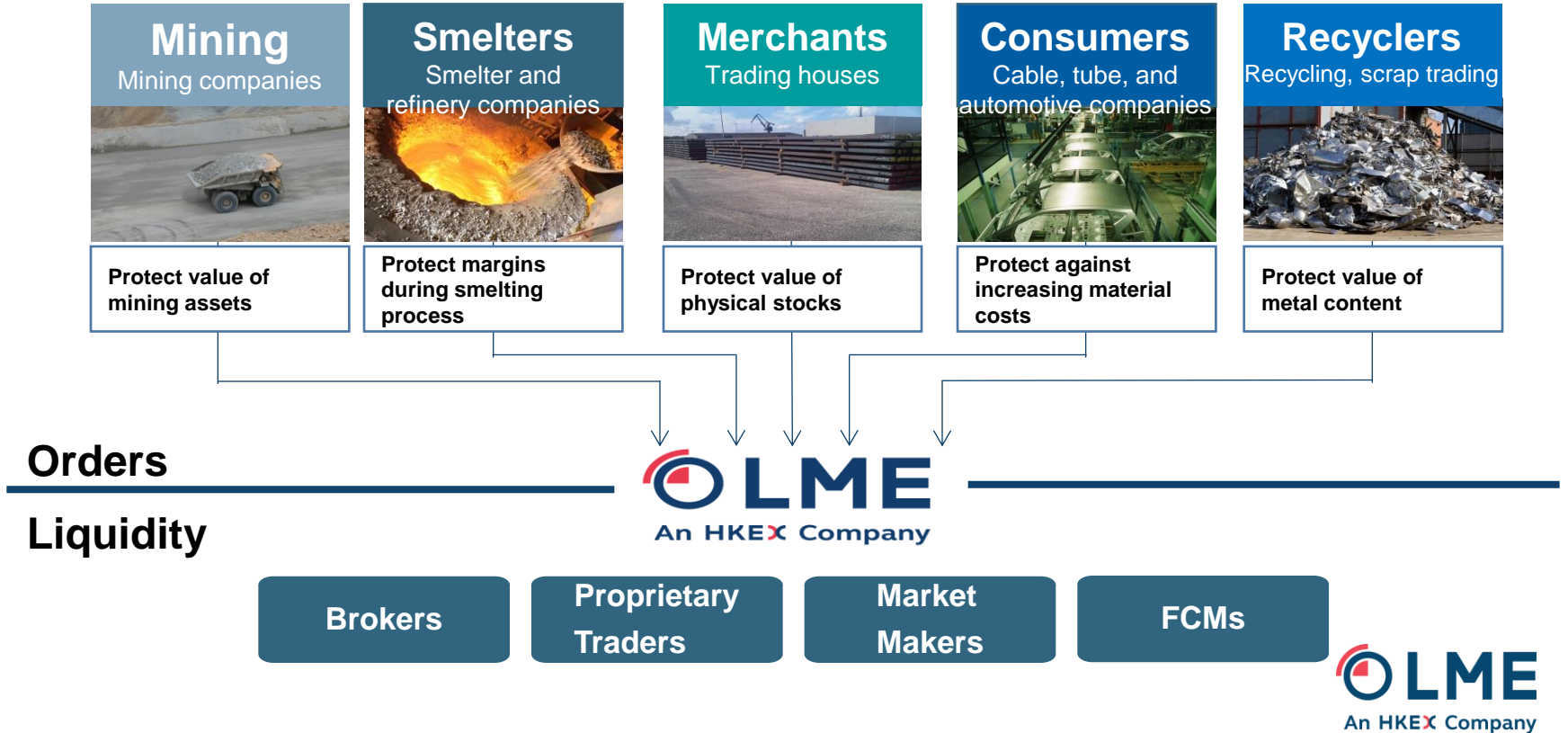
The LME metals

New contracts have been added to the initial copper and tin contracts over the over the past ~100 years...

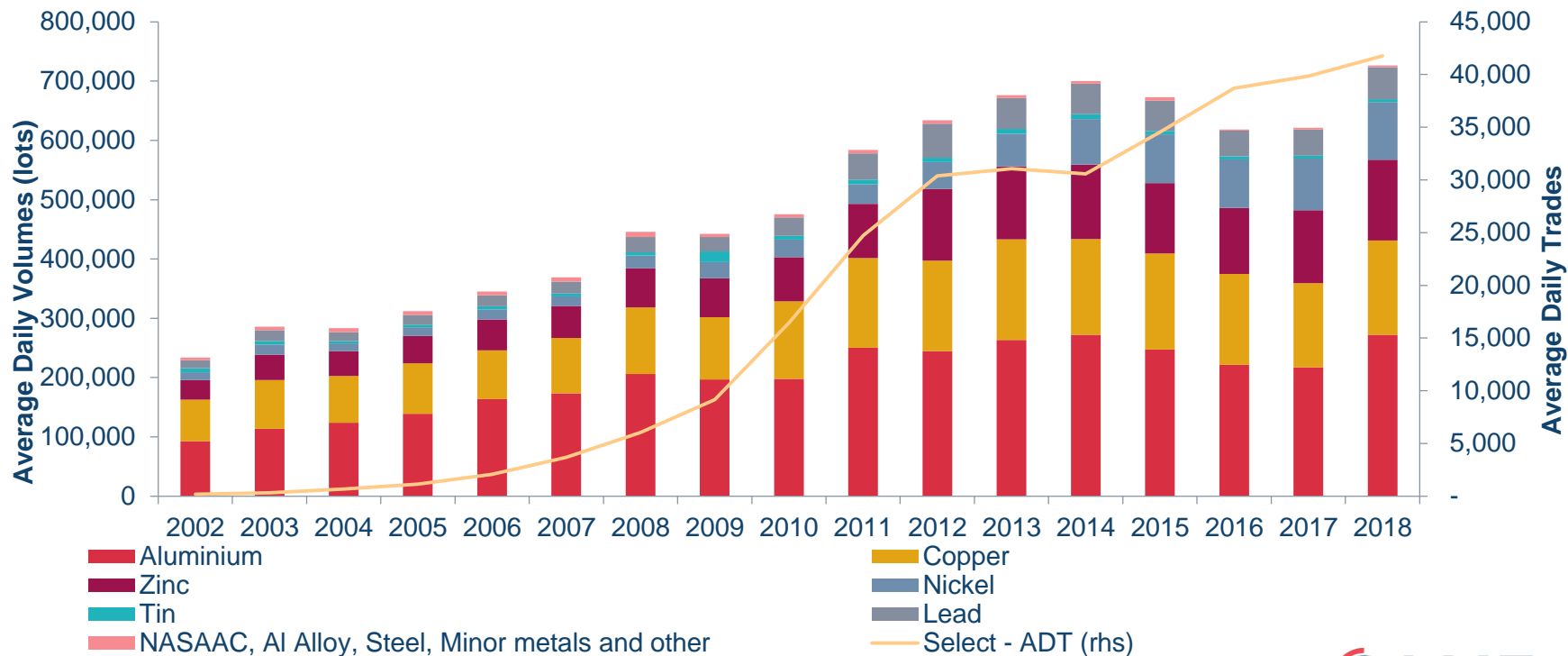


Customer Coverage

Users come from all stages of the metals value chain + financial market makers and investors

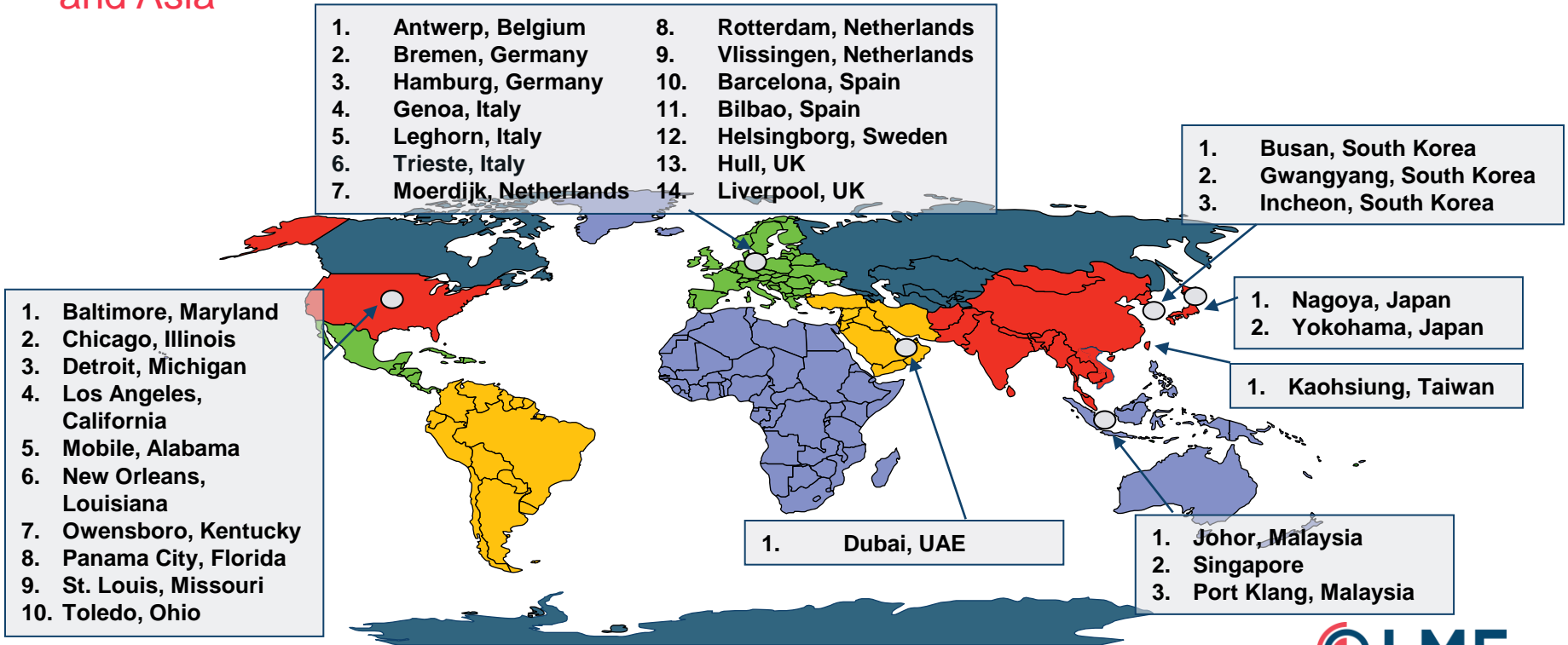


LME Average Daily Volumes 2002 - 2018



Warehouse Locations

Over 500 LME-approved warehouses in 33 locations across the USA, Europe and Asia

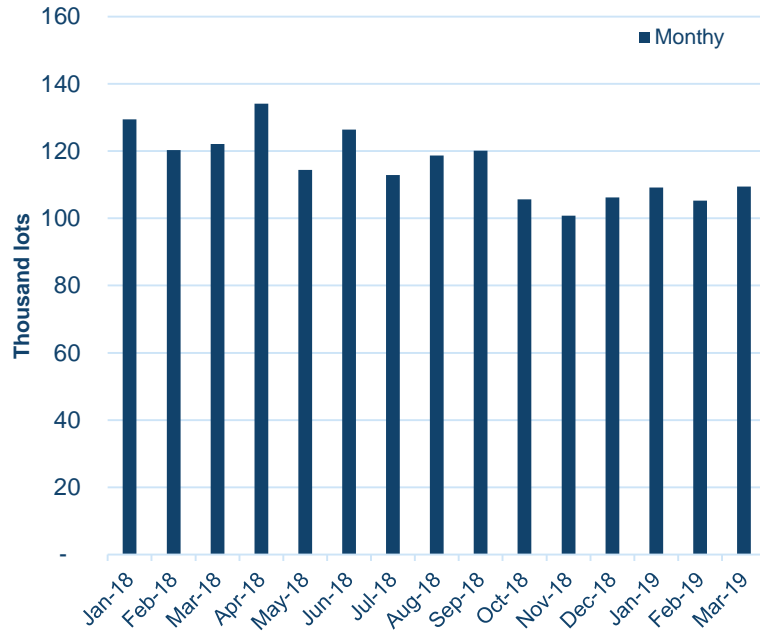


Zinc - recent developments

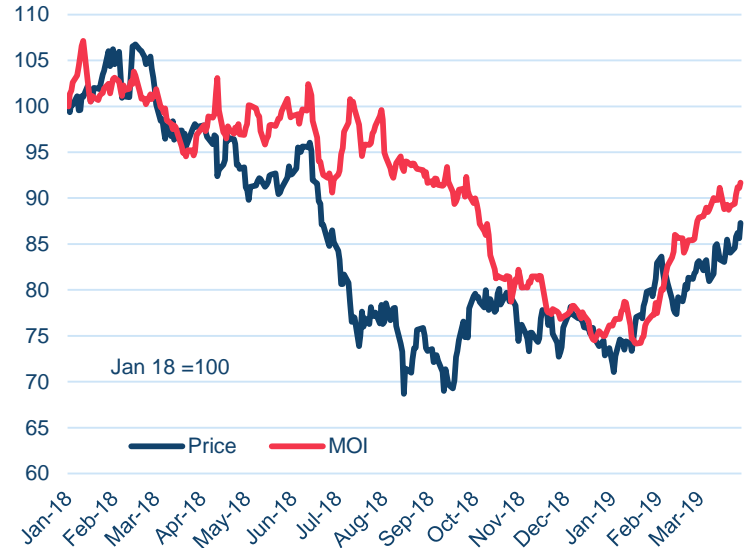
Price and Open Interest

Open interest developing similarly, prices going opposite directions

Average Daily Volume



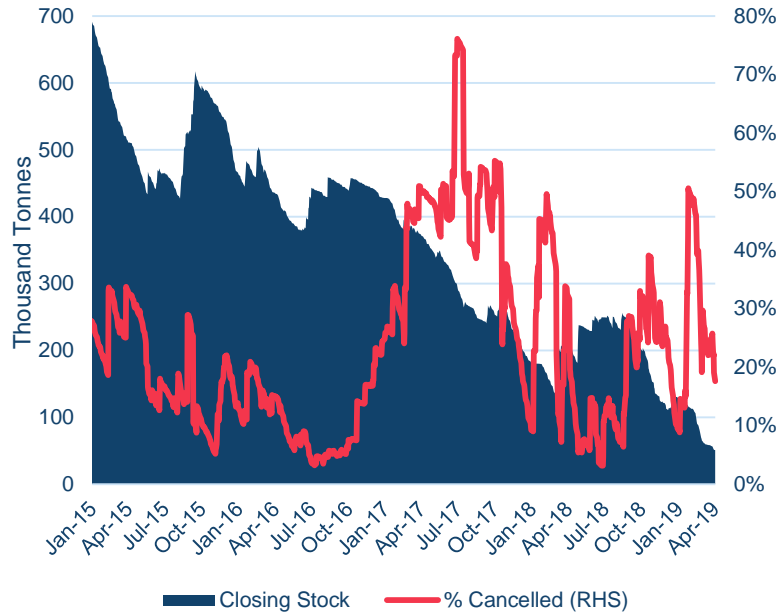
Open Interest



Source: LME. ADV excluding UNAs.

Zinc exchange stocks

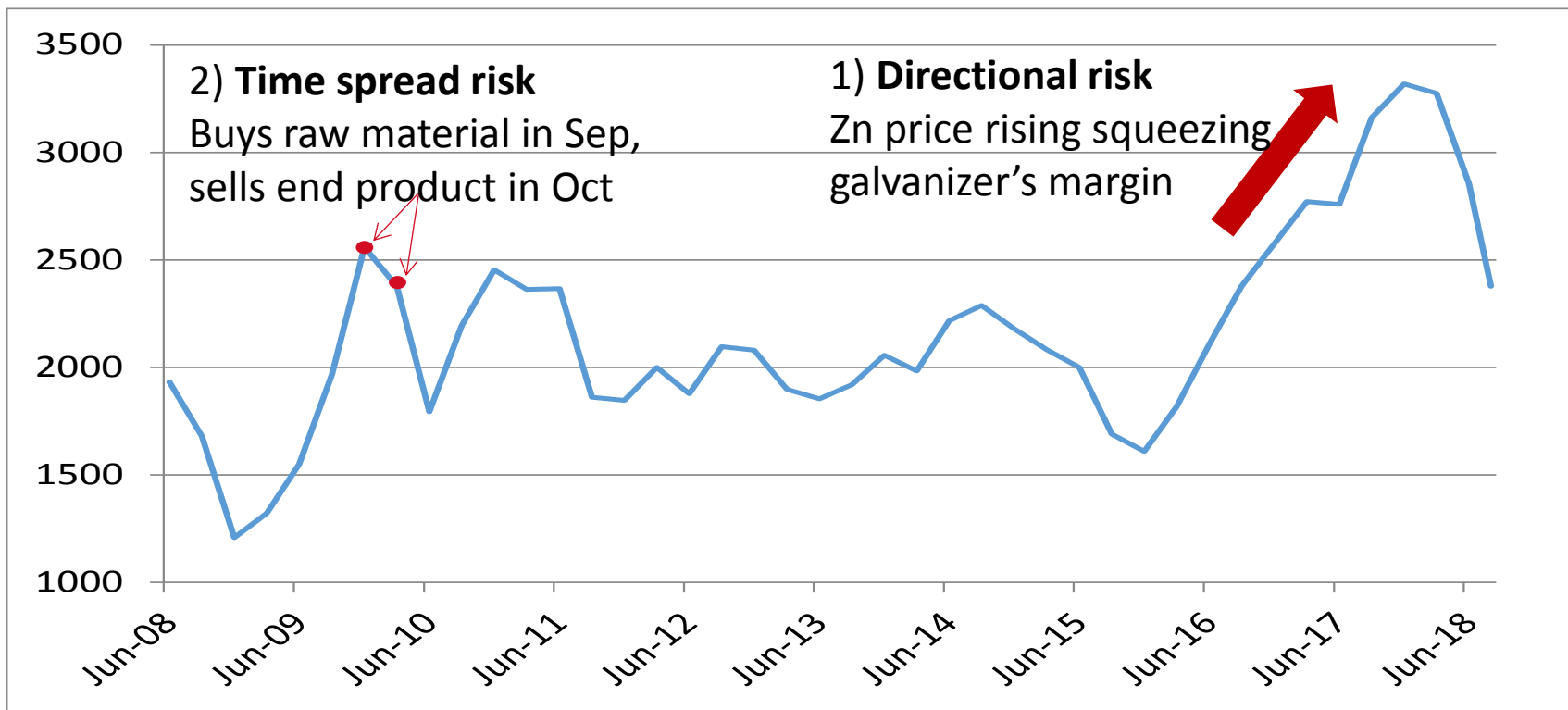
Zinc



Source: LME

Zinc price risk management

Looking back on zinc...



Source: LME

What are Futures and how do they work?

A future is an agreement to buy or sell a **specified asset (material)** of a **standard quantity** on a **fixed date** at a **price agreed today**

- Futures are paper instruments for price risk management
- No change to physical contracts
- Hedging reduces exposure to price risk
- Futures enhance pricing flexibility

What is Hedging?

Hedging

Establishing a position in a commodity futures market (LME) which is equal and opposite to a risk on a physical market.

- Protects against adverse price movements
- Locks in an agreed profit margin
- Protects inventory value

Hedging as a form of ***Insurance*** (*protection*).

Typical Scenarios

Case 1

You are a galvanizer and you are selling forward at a fixed price. You are short of physical material because you have sold before buying.

What are your options?

1. *Do nothing*; price of Zn rises, cost of purchase rises
2. *Buy now and hold the material*; use up working capital and incurring storage expenses
3. *Buy forward a LME Future*; hedge your exposure at a fraction of the cost of holding physical material

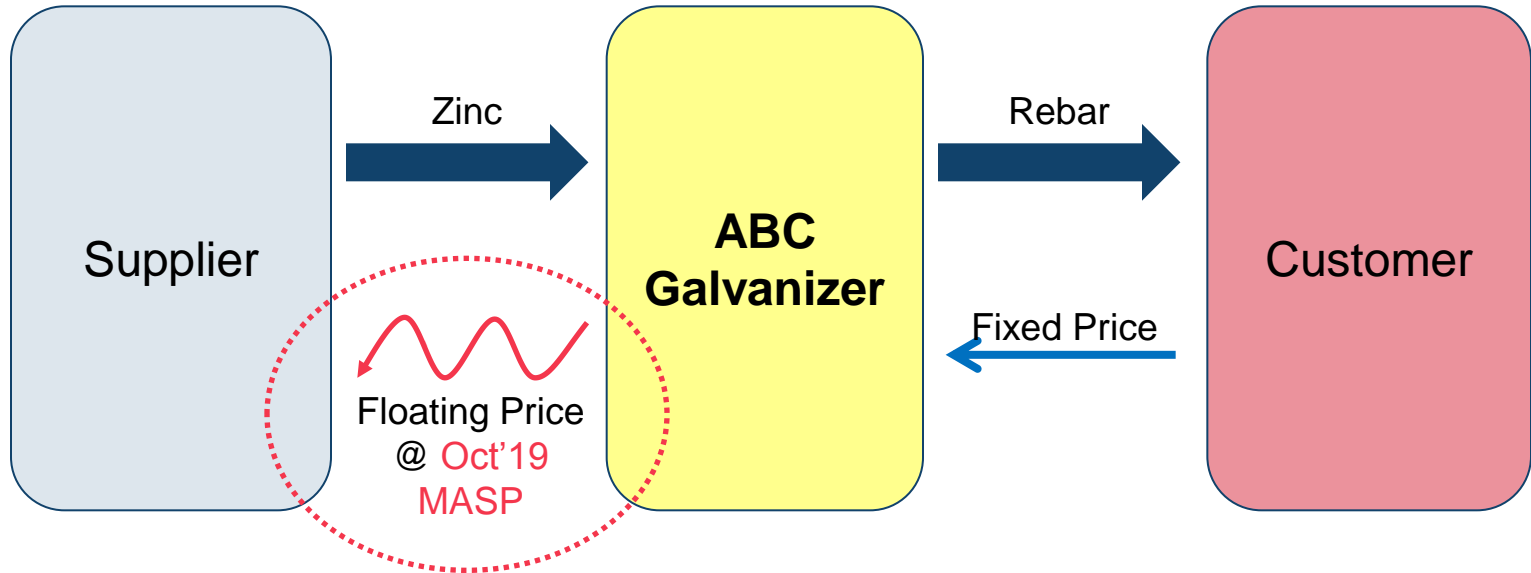
Benefits

1. Lock-in a forward purchase price
2. Accurate budgeting for raw material requirement costs
3. Increased ability to commit to future sales prices

Hedging Example (Fixing cost of raw materials)

ABC Galvanizer Ltd.

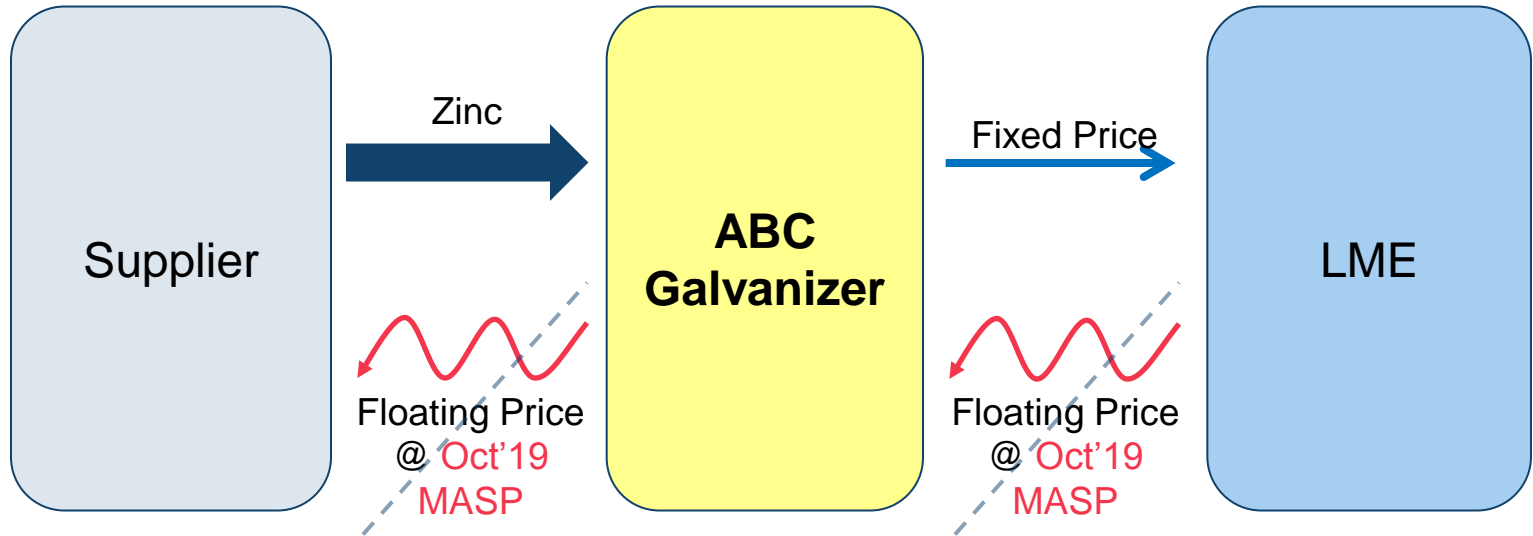
What is the risk?



Hedging Example (Fixing cost of raw materials)

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What is the risk?

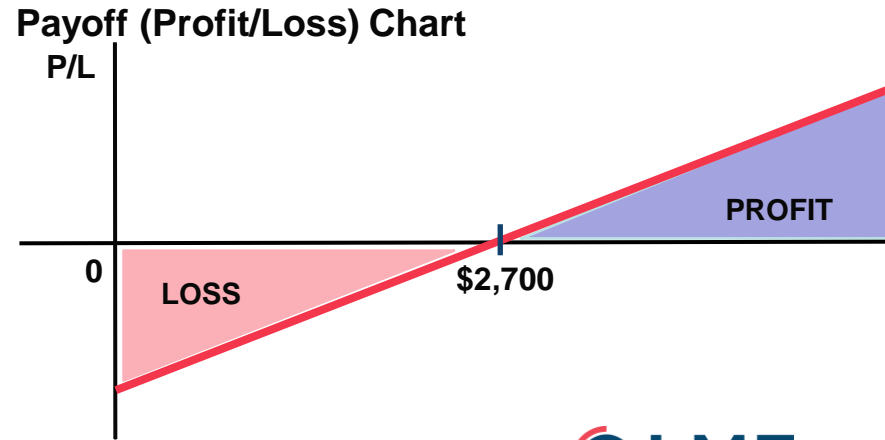
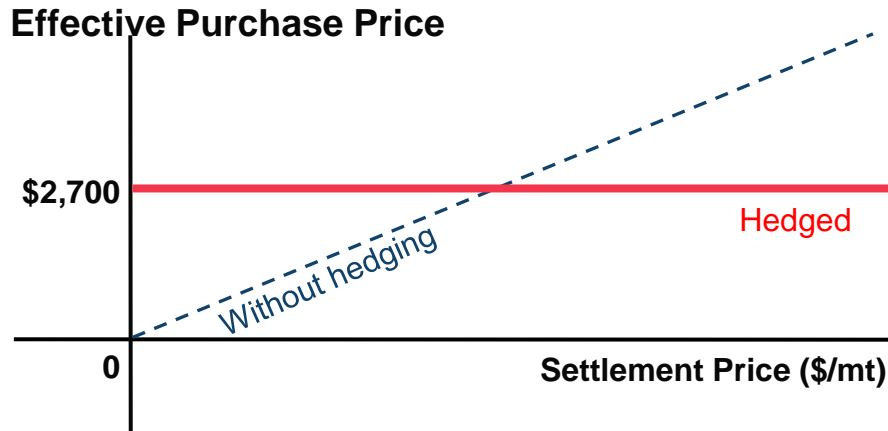


Hedging Example (Fixing cost of raw materials)

ABC Galvanizer Ltd.

Benefits

- ABC Galvanizer is able to lock in a fixed purchase price of Zn
- Protects profit margin



Common Hedging Opportunities

- Cost of raw material (buying price)
- Sales revenue (selling price)
- Inventory hedging
- Time-spread risk (Traders)
- Financing scheme (e.g. Repo)
- Pricing flexibility (Fixed-to-Float, Float-to-Fixed)

Using futures to enhance price flexibility



Consider this...

Market is bullish and prices are expected to rise.

Pricing preference?

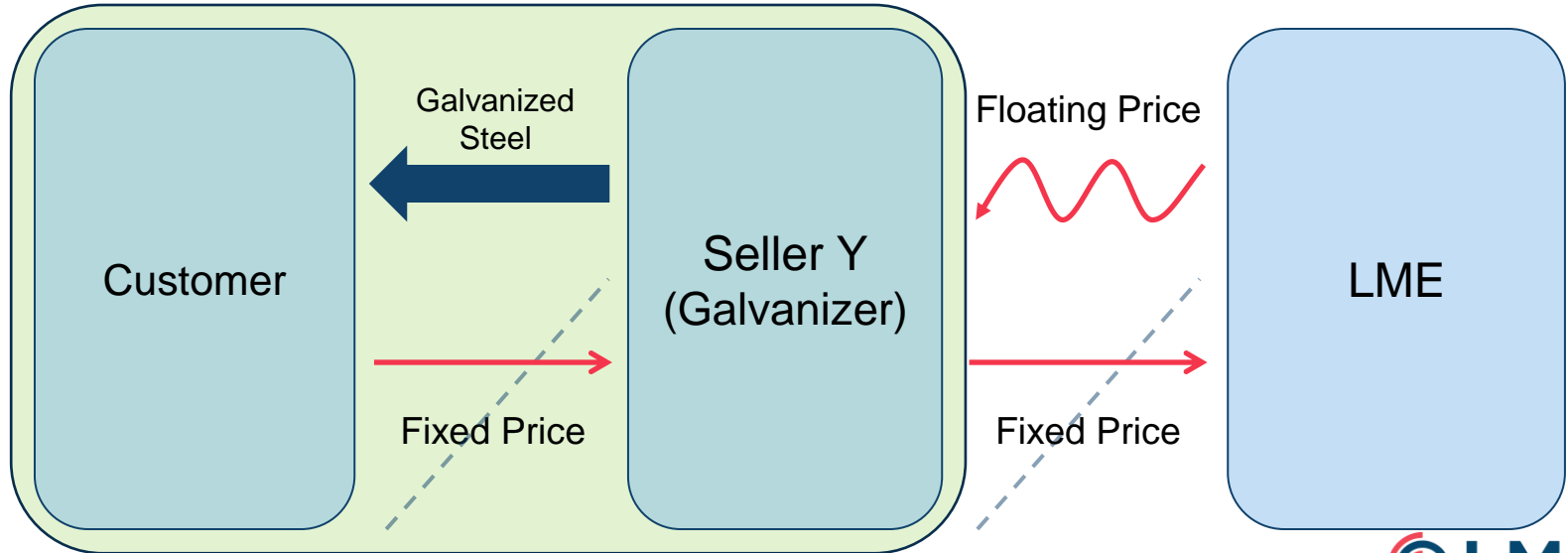
- *Seller* – Floating Price
- *Buyer* – Fixed Price

Benefits

1. Pricing flexibility; ability to offer Fixed or Floating sales price
2. Maintain your pricing preference
3. Keep customers happy! 😊

Using futures to enhance price flexibility

- Customer wants to buy at Fixed price
- Seller Y wants exposure to Floating price
- Seller Y can **Buy LME futures** to convert Fixed price to Floating price



Physical transaction

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