WEDF 2010

Finance Masterclass
–
Structured Trade Finance Techniques

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Typical Supply Chain - Finance Products

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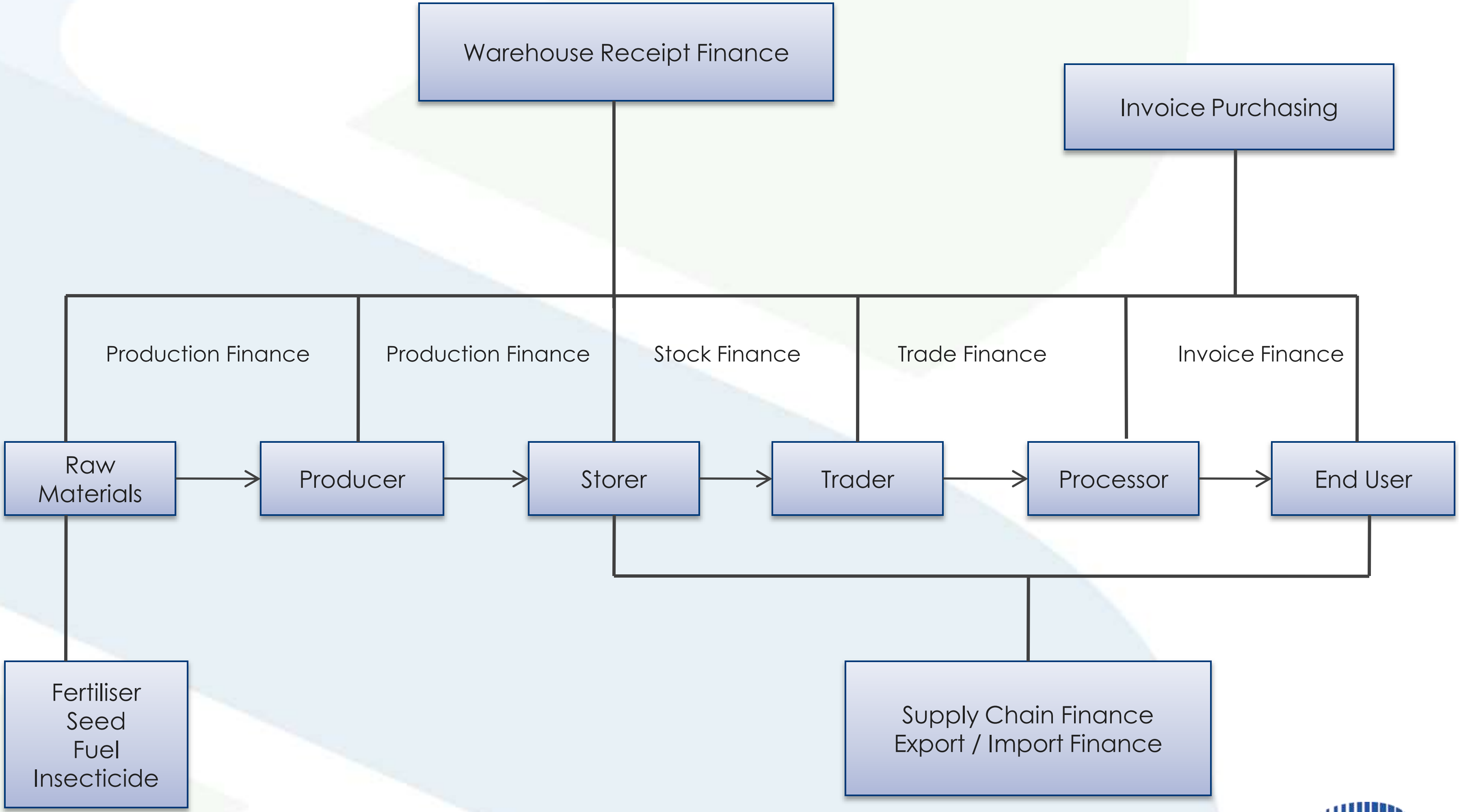

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Structured Commodity Finance Lender's Rationale

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- These financing products allow Lenders to focus on financing the commodity rather than financing the Trader against his balance sheet.
- The Finance Against Warehouse Receipt, Import & Export Products recognize both the intrinsic value of a commodity in storage, as well as the transferability of commodity ownership.
- The Lender will have improved control over the end to end application of working capital facilities in the clients business which improves the Lenders general risk profile.
- Basle II offers specific relaxation of Capital Reservation Requirements where a Lender can demonstrate the maintenance of exclusive, continuous and notorious control over the Collateral. This enables effective comparative lowering of the cost of lending (interest rates).

Structured Commodity Finance Lender's Rationale

Standard Chartered

- Lenders can improve the risk profile by placing more emphasis on tradable commodities as collateral rather than fixed assets. Plant and equipment that is either not in operation or located in inaccessible areas, offers less security than a freely tradable commodity.

- Collateral Control Companies such as ACE will help establish the Lender as a financier with technology and expertise to successfully mitigate risks associated with on-site storage and intrinsic value recognition of commodities throughout the full supply chain.

- The Lender will be able to service the growing number of clients who are constructing on-site storage facilities in Africa and other Emerging Markets and offering the commodities stored in them as collateral to Lenders

Structured Commodity Finance Client's Rationale

Standard Chartered

- Physical inventory may be held for a number of reasons:
  - Commodity prices are usually lowest during harvest time, this is when Traders and Producers may choose to purchase commodities without having end-buyers lined up.
  - Commodity processors prefer to take advantage of the lower prices at harvest time and build up physical stock positions to avoid shortages.
  - Where a Trader has entered into a FSA, the Trader may wish to hold the specified commodity early to take advantage of the price.
  - Improved control over the commodity in storage and guaranteed availability of the commodity at any point in time is now possible (Just in time inventory). Securing the commodity at a better price and improving marketability through a significant saving in transport costs since optimum quantities can be ordered.

Structured Commodity Finance Client's Rationale

Standard Chartered

- Auditors sanctioned this as off-balance sheet transactions since it can be treated as a true sale with optional repurchase.
- Allowing the client to gear his stock inventory and therefore utilise his balance sheet in a more efficient manner.
- Allows the client to settle his account at port of loading or higher up the supply chain which may translate into rebates from his suppliers.
- The Client can buy or sell large volumes of commodity anywhere in the world and guarantee availability of the commodity at any point in time.

Structured Commodity Finance Risk Matrix

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Commodity Risk

Quality

Weight

Quantity

Transport

Storage

Performance Risk

Credit / Price Risk

Insurance Risk

Admin Risk

Conventional Supply Chain Finance

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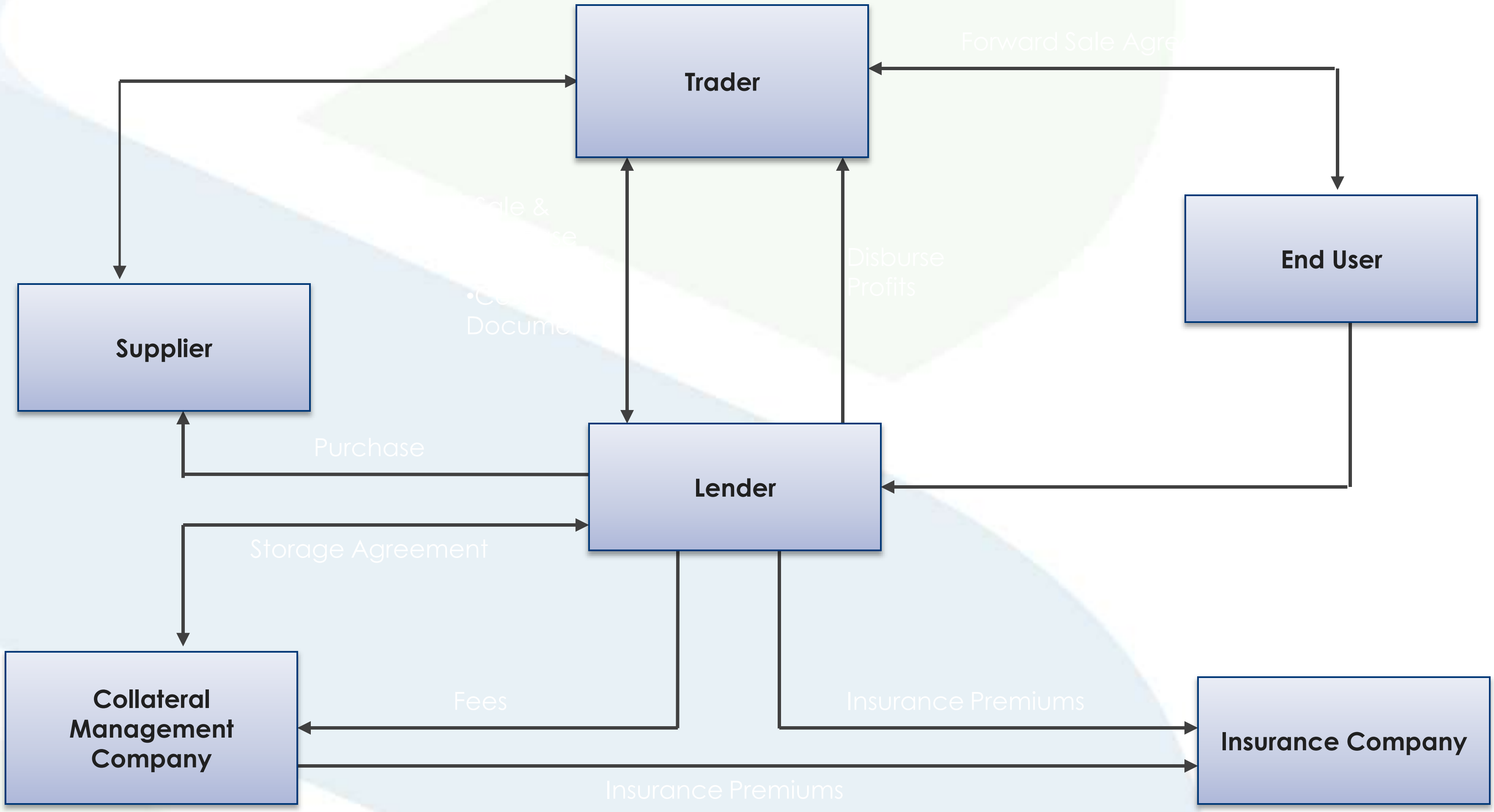

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Conventional Supply Chain Finance - Product Methodology

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- The Conventional Supply Chain Finance product focuses on financing back to back transactions.
- The product aims to finance transactions where the commodity trader has a matching purchase and sale order, but not necessarily the financial strength to execute the transaction.
- The product mainly relies on the financial strength of the buyer.

Conventional Supply Chain Finance - Implementation and Transaction Flow

A Trader in need of finance approaches the Lender with a proposed back to back transaction, in which he has identified a Supplier of a commodity backed by a matching order from a Buyer (Forward Sale Agreement).

- The maximum tenor is limited to 12 months to limit price risk and commodity risk.
- Only commodities stored in approved storage facilities will be financed.
- The Buyer is assessed by the Lender - credit limits are approved by Lenders Credit division.
- The forward sale agreement is an irrevocable agreement to purchase a stated quantity / quality of commodity supported by a warehouse receipt or a stock confirmation certificate which is ceded to the Lender.

Conventional Supply Chain Finance - Implementation and Transaction Flow

- The Lender pays the Supplier directly only after the stock confirmation certificates / warehouse receipts are registered in the Lender's name and a cession of the FSA is obtained.
- Stock Confirmation Certificates will only be accepted if issued by an approved Commodity Exchange Company.
- Warehouse receipts must be issued by an acceptable approved CMC.
- Rights under the Forward Sale Agreement are ceded to the Lender and the obligation to deliver the product purchased is delegated to the Lender.
- The cession and delegation allows the Lender to purchase the commodity from the Trader but continues to cover the Trader's rights and obligations under the FSA.
- Insurance over the commodity should be obtained by the Lender.

Conventional Supply Chain Finance - Implementation and Transaction Flow

- The Buyer signs a consent to the cession and delegation. They acknowledge that funds owed under the FSA will be paid into an account specified by the Lender.

- The Buyer acknowledges that they have no recourse to the Lender in the event of short delivery, non delivery or late delivery of the product.

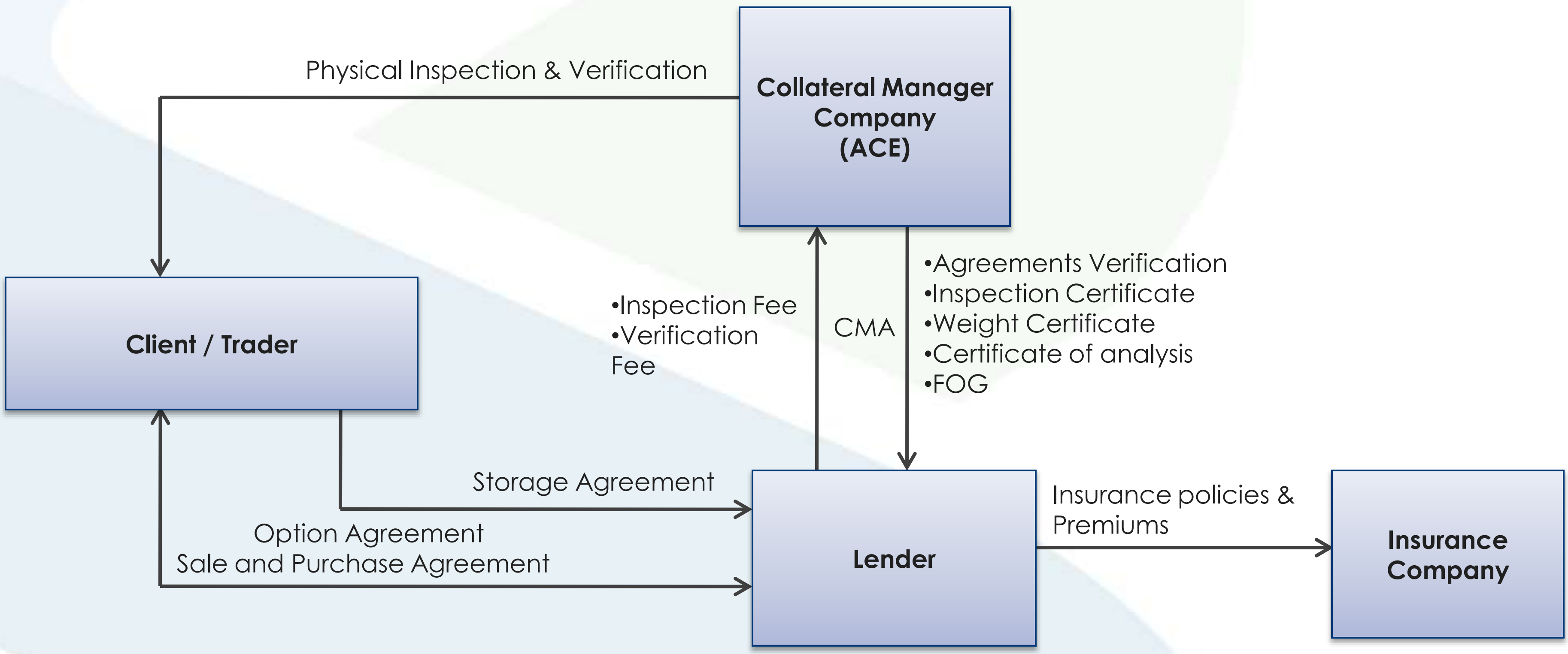
- The purchase price calculated is the discounted value of the future sale price. Interest rate fluctuations should be hedged by keeping a buffer – a minimum 3% is recommended.

- The warehouse receipts or stock confirmations cannot be released until cleared funds are received from the buyer.

- The Trader indemnifies the Lender regarding losses that may be suffered as a result of interest rate movements or any other reason, including but not limited to gross negligence or wilful default, whereby the Trader will have to reimburse the Lender.

- Funds are transferred to the Trader after deduction of costs, the Trader receives his profit less the Lender's costs.

Finance Against Warehouse Receipts



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Finance Against Warehouse Receipts – Product Methodology

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Warehouse Receipt Financing is a form of secured funding in which the client delivers legally valid documents of title to the lender that grant security or out right ownership of the commodity to the Lender.

- Warehouse Receipt Financing provides the Lender with the capability to finance related commodities in storage facilities that may be owned or leased by the client.
- Any commodity that is actively traded may be financed under WHRF.
- The commodity must be stored in an approved storage facility, managed by an independent CMC such as ACE for & on behalf of the Lenders.
- The structure necessitates that the CMC that issues the Warehouse Receipts, creates a legally independent storage facility.

Finance Against Warehouse Receipts – Product Methodology

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- A Warehouse Receipt is defined as an acknowledgement by a CMC to the Lender that certain goods have been safely received for storage and will be delivered on demand to the holder in accordance with the terms and conditions of the Warehouse Receipt.

- This is achieved by leasing the warehouse, obtaining a waiver of lien from the landlord, controlling movements in and out of the warehouse, and posting prominent signs giving public notice that the controlled area is operated by the CMC on behalf of the Lender.

- This allows the Lender to advance funds against commodities, evidenced by Warehouse Receipts that it is secured by a CMC and is being stored under the CMC's supervision in a pre-approved and clearly designated storage facility.

Finance Against Warehouse Receipts – Implementation and Transaction Flow

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A client in need of commodity finance is identified.

- The Lender will appoint a CMC to inspect and verify the designated storage facility for suitability of storage for the commodity to be financed. A site inspection certificate will be issued by the CMC.
- The CMC will enter into a Lease Agreement with the Landlord and obtain a Waiver of Lien over the commodity to be stored and financed in the leased facility. Copies of these will be submitted to Lender.
- The CMC will verify the quality and quantity of the commodity before issuing a Warehouse Receipt in favour of the Lender.

Finance Against Warehouse Receipts – Implementation and Transaction Flow

- The commodity value is determined by using the most relevant import or export parity price based on an international exchange (e.g. CBOT). A discount factor is applied to the price & basis in order to mitigate price risk.
- Interest rate fluctuations should be hedged by keeping a buffer – a minimum 3% is recommended.
- The Lender will finance the discounted value of the commodity.
- The advance made to the client may be secured either by the Lender taking outright ownership of the commodity or by way of taking a 1st security interest over the commodity

Finance Against Warehouse Receipts – Implementation and Transaction Flow

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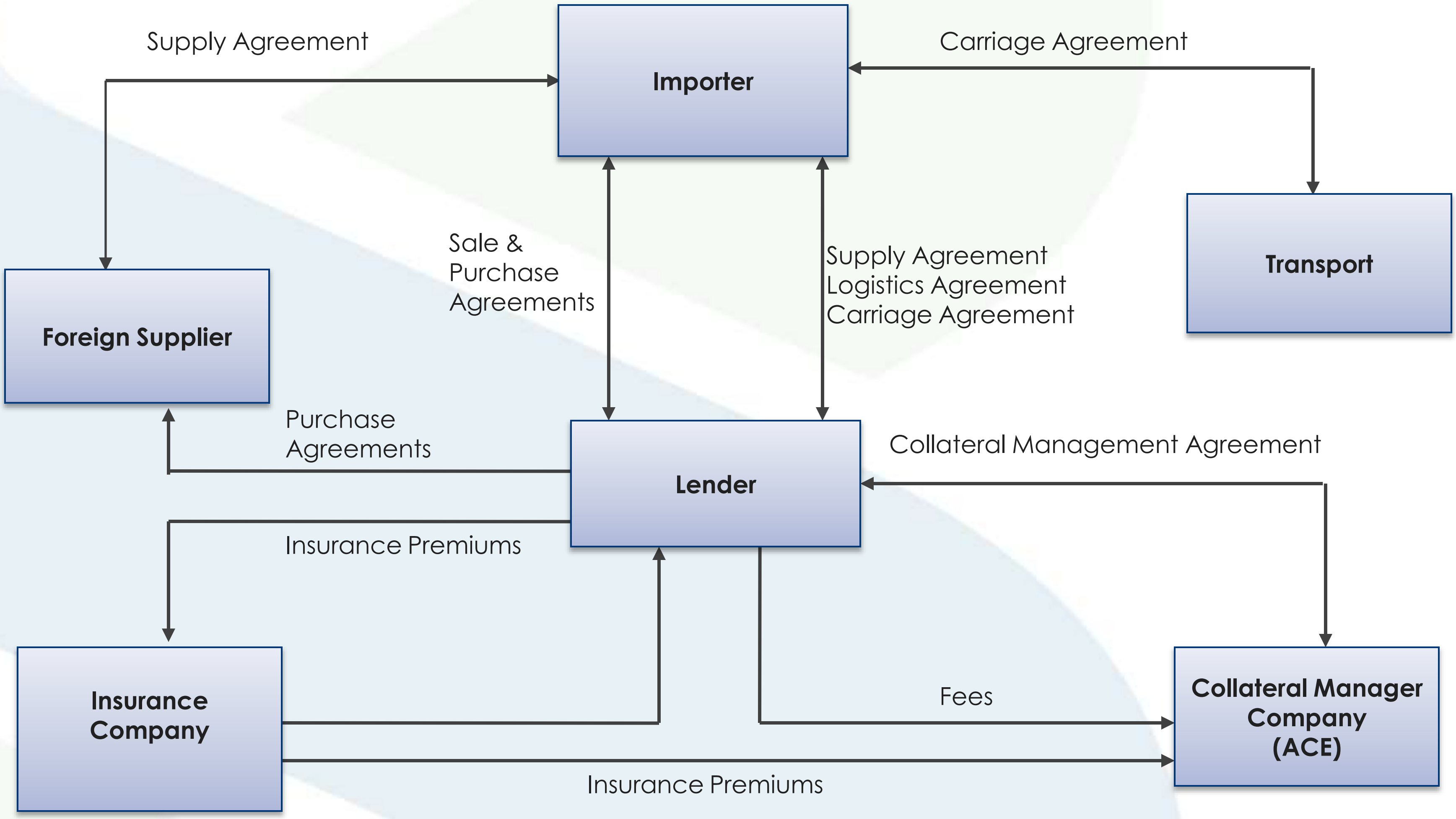
- The Lender will set Stop Losses usually at 90% of the commodity's import or export parity price. In case the stop loss level is breached the following options are available:

  1. The client will be required to margin that breach before noon the following day failing which it would be in default in terms of the agreements.
  2. The Lender may exercise its option to immediately sell the commodity in the open market and recover its advance should the breach not be rectified within the specified time allowed.

- The client may at any time notify the Lender of their intention to repurchase the commodity or repay the loan as per the terms in the agreements.

Import Finance



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Import Finance – Product Methodology

- Import Finance is an extension of the Warehouse Receipt Financing product, which caters for the shipping and transport legs involved in an import trade.

- As such, Import Finance caters for the financing of a trader which sources a commodity from various suppliers Internationally, ships and transports this into the importer's pre-approved warehouses.

Import Finance - Implementation and Transaction Flow

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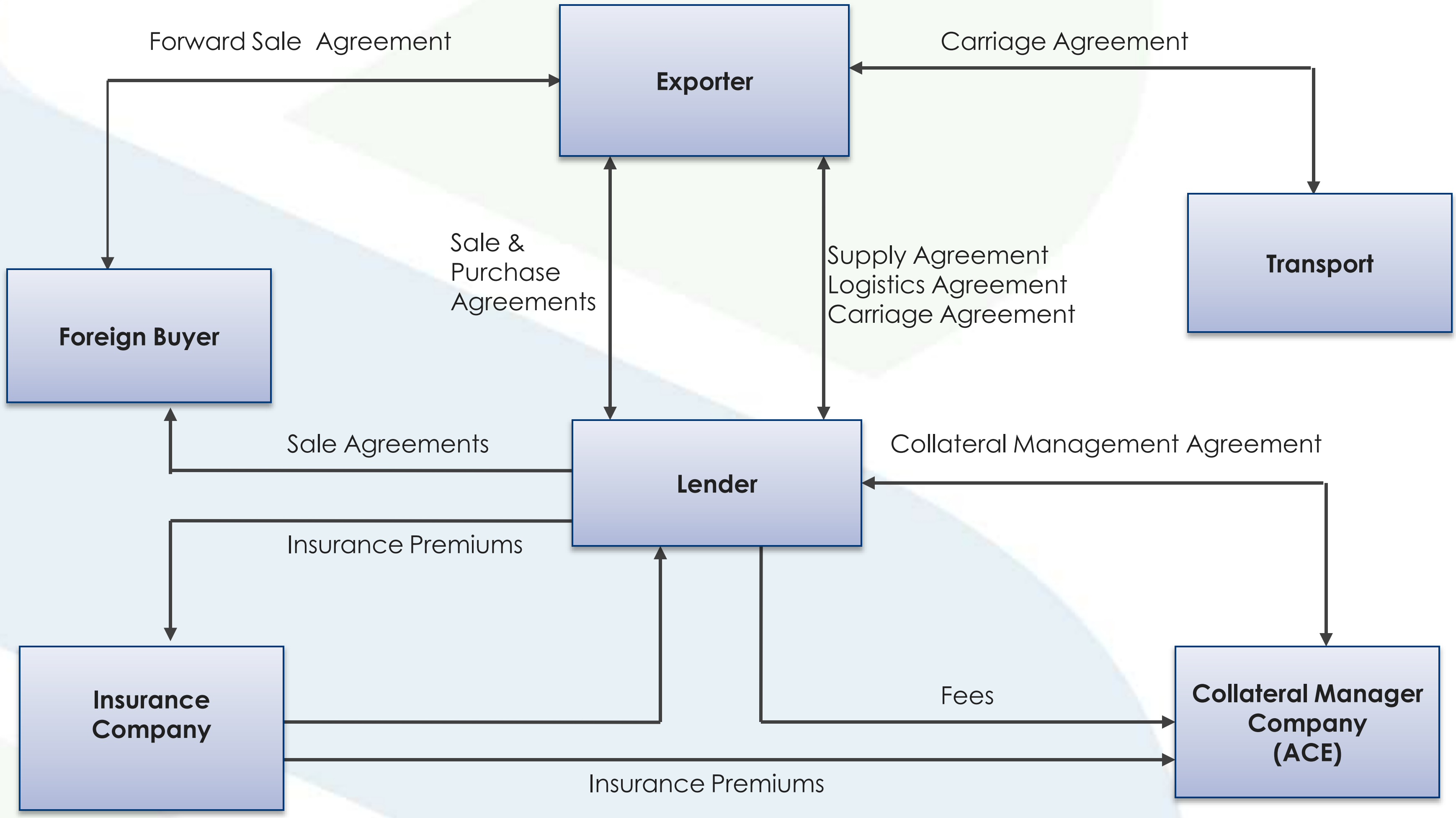
The Importer and Supplier will enter into a sale agreement.

- The agreement may require for the Importer's Bank to issue a Letter of Credit to the Suppliers Bank wherein payment conditions will be stipulated or the agreement will clearly note payment upon delivery of documents.
- The Importer will appoint a CMC to overlook the entire import process and inspect and verify the commodity at port of loading. A Load Survey Report and Quality and Weight Certificates will be issued by the CMC.
- The CMC will inspect and verify the designated storage facility for suitability of storage for the commodity to be imported. A site inspection certificate will be issued by the CMC.

Import Finance - Implementation and Transaction Flow

- The CMC will enter into a Lease Agreement with the Landlord and obtain a Waiver of Lien over the commodity to be stored and financed in the leased facility. Copies of these will be submitted to Lender.
- The CMC will be present at the port of discharge to verify quantity and condition of the stock on board the ship as well as monitoring the discharge process. A discharge survey report will be issued to the Lender.
- Upon final destination (In Warehouse) the CMC will verify the quality and quantity of the commodity before issuing a Warehouse Receipt in favour of the Lender.
- The Warehouse Receipt will be evidence of the type, grade, weight, quality and location of the commodity.
- The process flow for Import Financing then follows the exact route of the Warehouse Receipt Financing product.

Export Finance



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Export Finance – Product Methodology

- Export Finance is the extension of the Warehouse Receipt Financing product, which caters for the export, shipping and transport legs involved in an export trade.

- As such, export Finance caters for the financing of a trader which export commodities to various international buyers.

- Export Finance is the exact reverse of the Import product

Questions?

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