

COMMODITY RISK, ITS MANAGEMENT & DISCLOSURES

FINANCIAL MARKETS

A mechanism that allows people to participate in trade.
Consisting of.....



CAPITAL MARKET

DEBT MARKET

MONEY MARKET

FOREX MARKET

COMMODITY MARKET

Foreign Exchange risk

Interest Rate risk

Commodity Price risk

Credit risk

Operational risk

Commodity Price risk

- Purchase cost vis-à-vis commitment on sales price
- Change in value of Inventory
- Counterparty risk

“Investors are demanding that management should control exposure to commodity risk & eliminate the effects of unfavorable market fluctuations on the bottom line”

- Jim Negus and Justin Ayre, KPMG LLP

To crystal-gaze
& rely on
forecasts

DO
NOTHING

Risk management for
improved operational and
decision making efficiency

COMMODITY RISK VS FOREX RISK....

Annualized Volatility for some of the Commodities Listed on MCX

FY	ALUMINIUM	COPPER	ZINC	CRUDEOIL	COTTON	SILVER	GOLD
2013-14	17.7%	18.2%	17.5%	21.9%	16.8%	30.0%	22.2%
2014-15	16.5%	18.1%	17.3%	29.6%	15.8%	23.7%	14.8%
2015-16	17.9%	20.4%	26.9%	44.3%	13.2%	21.6%	14.9%
2016-17	14.9%	19.8%	25.7%	34.5%	18.3%	20.3%	12.1%
2017-18	15.9%	17.3%	22.4%	24.1%	19.3%	14.6%	8.7%
2018-19	26.7%	18.6%	24.0%	32.8%	16.2%	14.8%	9.5%

Annualized Volatility for USD-INR

Period	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
Volatility	12.3%	5.5%	5.1%	4.2%	4.3%	6.9%

Data source: Bloomberg

Commodity price risks - volatility in commodities - greater than forex volatility

Jet Airways skids on fuel cost, posts Rs 1,297 crore loss in Q2

By Bureau | Updated: November 15, 2018 10:51 AM

Jet Airways' Q2 profit fell nearly 50% y-o-y, outpacing near 10% rise in revenue

Airlines may post steepest losses in a decade in FY19 owing to high fuel costs, falling rupee

Business Press Trust of India Nov 05, 2018 16:00:00 IST

Mumbai: Domestic airlines are projected to post their steepest losses in a decade in the fiscal year owing to higher aviation fuel costs and a falling rupee.

Business Line

BOMBSI 34,915.02 + 519.79 (1.49%)

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BNY Mellon digital tax competitiveness

Higher fuel costs, currency losses nudge domestic airlines deeper into red: Crisil

OUR BUREAU



Profit slides on higher fuel costs, rupee

Aircraft fuel expenses climbed 55.8 in the quarter, but expected to see better results in the coming quarters

C. Suresh Babu



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RISKS: COMMODITY PRICES IMPACTED BY MULTIPLE FORCES



Shifts in global economic power



Uncertain, divergent economic growth



Unpredictable fiscal, monetary policies, Fed moves



Growing social, political instability



Climate change

Demographic changes



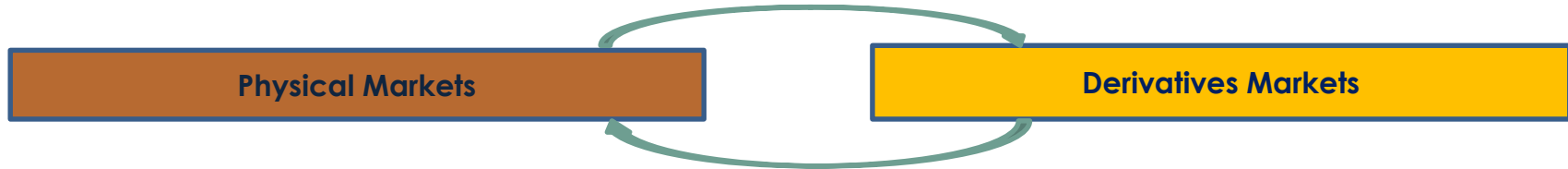
Technological innovations



Rapid urbanization



A derivative is a financial instrument whose price is derived from that of another asset, and the other asset is generally referred to as the '**underlying asset**', or sometimes just '**the underlying**'.



- Buying and selling of physical commodities
- Primary function is to enable availability of the commodity
- Involves producers, consumers, importers, exporters, processors

- Exists in parallel and enables physical market players to manage their price risks
- Forwards, Futures, Options
- Both exchange and OTC

- Taking a position in the futures market that is opposite to a position in the physical market
- Reduces or limits risks associated with unpredictable changes in price
- The objective behind this mechanism is to offset a loss in one market with a gain in another
- **Price lock-in**

WHAT NEEDS TO BE HEDGE & WHY TO HEDGE

RISKS TO THE INDUSTRIES

- Raw-material price volatility
- Stiff Competition
- Contractual inflexibility
- Rise in input price will erode margins
- Catastrophic Events - Tsunami, Hurricanes, Earthquakes, Terrorist Attacks etc.
- Safeguarding spot sales from fall in price



WHY TO HEDGE

- Reduces the impact of input price volatility
- Allows you to control costs
- Allows you to project costs and profits more accurately
- Protects business margins
- Allows to reduce the downside risk to business
- Lock-in specific price

- **Govt. of India**
 - Income tax benefits for hedging
 - Accounting standards – considers Hedge Accounting
- **Reserve Bank of India**
 - Liberalized access to overseas hedging markets
- **Securities and Exchange Board of India**
 - Strengthened RMS in domestic exchanges
 - Oversight over intermediaries

SEBI Listing Obligations and Disclosure Requirements Regulations, 2015 dt. Sep 2, 2015

- Require listed companies to disclose commodity price risks and commodity hedging activities in ARs,
- A key component of Corporate Governance Report.

- Studies (incl. by ICSI-CCGRT) of Annual Reports revealed:
 - About **40%** companies having exposure to commodity price movements did not make any mention of commodity price risk
 - About **50%** companies just mentioned about commodity price risks, but not in details
 - Proportion slightly better for foreign exchange risks

Study by MCX Research team of **FY2017-18** Annual Reports revealed:

- About **65%** companies with exposure to commodities among BSE top-500 listed companies disclosed commodity price risk or risk management.
- About **44%** of the disclosing companies had relatively good quality of disclosures

ISSUE OF NON-STANDARD FORMAT

RISK MANAGEMENT & DISCLOSURES: U.S. MARKET

- Disclosure mandatory for all risks
- Companies have discretion to choose :
 - *Tabular presentation*
 - *Value at Risk (VaR)* disclosures
 - *Sensitivity or "shock" analysis*

Market risk (amounts in millions)	31 December 20X0		20X1 Average		31 December 20X1	
Interest rate	\$ 12	\$ 10	\$ 13	\$ 11		
Currency	20	22	18	17		
Commodity	8	10	9	8		
Equity	6	3	4	5		
Effects of correlation and statistical combination techniques	(4)	(6)	(3)	(5)		
Entire trading account	\$ 42	\$ 39	\$ 41	\$ 36		

Microsoft Corporation: VaR disclosures

	Expected Maturity		Fair Value 12/31/xx
	20X1	20X2	
<i>(dollars in millions)</i>			
Futures contracts (short):			\$ 2.05
Contract volumes (5,000 barrels)	200	250	
Weighted-average price (per barrel)	\$ 19.45	\$ 19.54	
Contract amount (millions)	\$ 19.45	\$ 24.43	
	Expected Maturity		
	20X1	20X2	Fair Value 12/31/xx
<i>(dollars in millions)</i>			
Over the counter forward sales agreements			\$ 2.15
Contract volumes (5,000 barrels)	800	300	
Weighted-average price (per barrel)	\$ 19.52	\$ 19.60	
Contract amount (millions)	\$ 78.08	\$ 29.40	
Optional sales contracts			\$ 2.30
Contract volumes (5,000 barrels)	1,000	200	
Weighted-average price (per barrel)	\$ 19.53	\$ 19.61	
Contract amount (millions)	\$ 97.65	\$ 19.61	

Tyco International, Ltd.: Tabular

Derivative Instruments Held for Non-Trading Purposes The Company had derivative instruments in place to reduce the price risk associated with future production of 30 MMBbls of oil, 14 Bcf of natural gas, and 1 MMBbls of NGLs at December 31, 2015, with a net derivative asset position of \$273 million. Based on actual derivative contractual volumes, a 10% increase in underlying commodity prices would reduce the fair value of these derivatives by \$58 million, while a 10% decrease in underlying commodity prices would increase the fair value of these derivatives by \$44 million. However, any cash received or paid to settle these derivatives would be substantially offset by the sales value of production covered by the derivative instruments.

Anadarko Petroleum: Sensitivity or 'shock' analysis

As recommended by Corporate Governance Committee Report (Chairman - Shri Uday Kotak), **all listed entities** shall make the **disclosures in a prescribed format** as part of the **Corporate Governance Report in the Annual Report** under clause 9(n) of Part C of Schedule V.

Exposure of the listed entity to commodity and commodity risks faced by the entity throughout the year:

- a. Total exposure of the listed entity to commodities in INR
- b. Exposure of the listed entity to various commodities:

Commodity Name	Exposure in INR towards the particular commodity	Exposure in Quantity terms towards the particular commodity	% of such exposure hedged through commodity derivatives				Total
			Domestic market		International market		
			OTC	Exchange	OTC	Exchange	

- c. Commodity risks faced by the listed entity during the year and how they have been managed.



THANK YOU

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