



# LME Steel Billet Futures

Developing price risk management tools for the steel industry

## The LME and risk management for the steel Industry

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LONDON METAL EXCHANGE

[www.lme.com](http://www.lme.com)



# The London Metal Exchange

- Introduction to LME
- Contract specifications
- How can you use the contract?

Hedging scenario

# The London Metal Exchange

- The world's leading non-ferrous exchange
- Annual turnover \$8.1 trillion (2006)
  - This equates to approximately: US\$ 677 Billion per month or US\$ 34 Billion per day
- >95% of all non-ferrous metals futures trading is through the LME
- 95% turnover is from outside the UK

**130 Years of experience providing price risk management tools to the metals industry**



**LONDON METAL EXCHANGE**

# Primary Role of LME

Pricing

Hedging

Terminal Market

Delivery

Price Convergence

London Metal Exchange



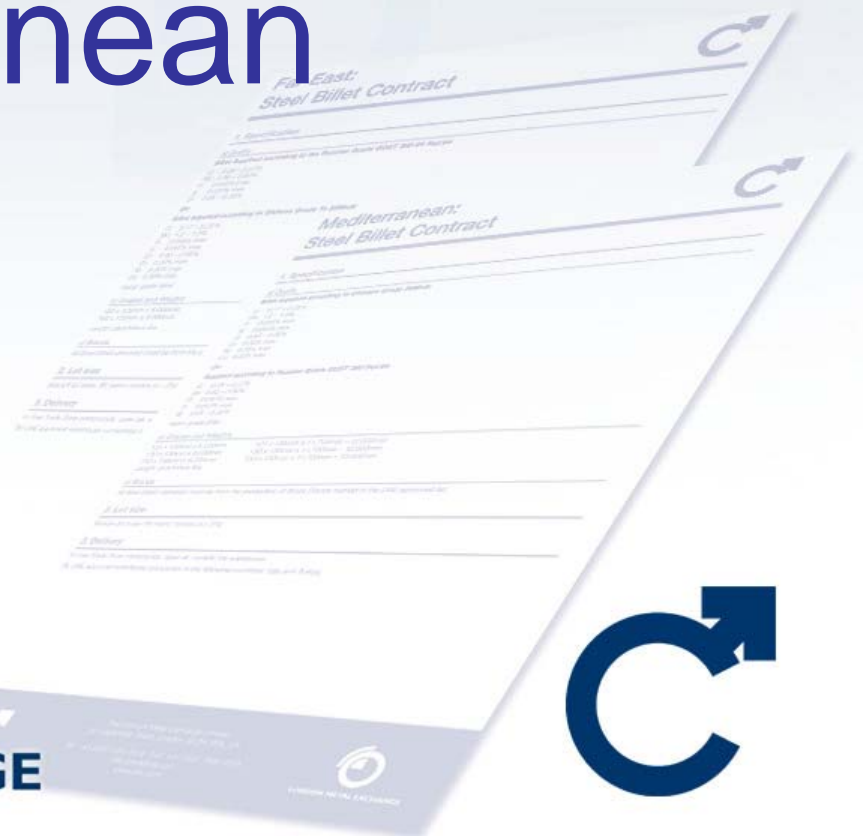


# LME Billet Specification

Two regional contracts:

Mediterranean

Far East



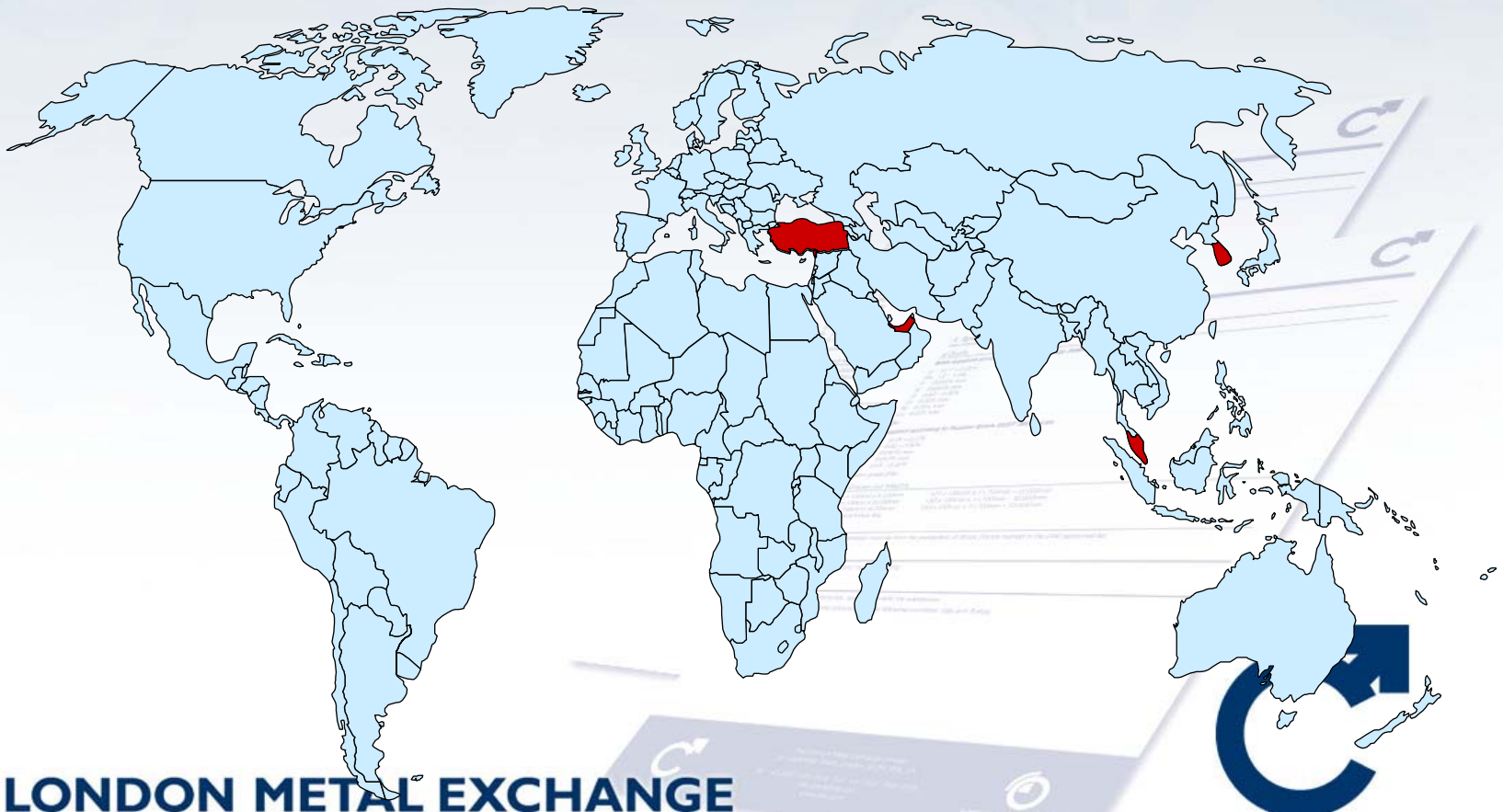


# LME Billet Specification

The current proposed delivery locations are:

Mediterranean: **TURKEY**  
**DUBAI**

Far East: **SOUTH KOREA**  
**MALAYSIA**



# LME Billet Specification

The current specifications are:

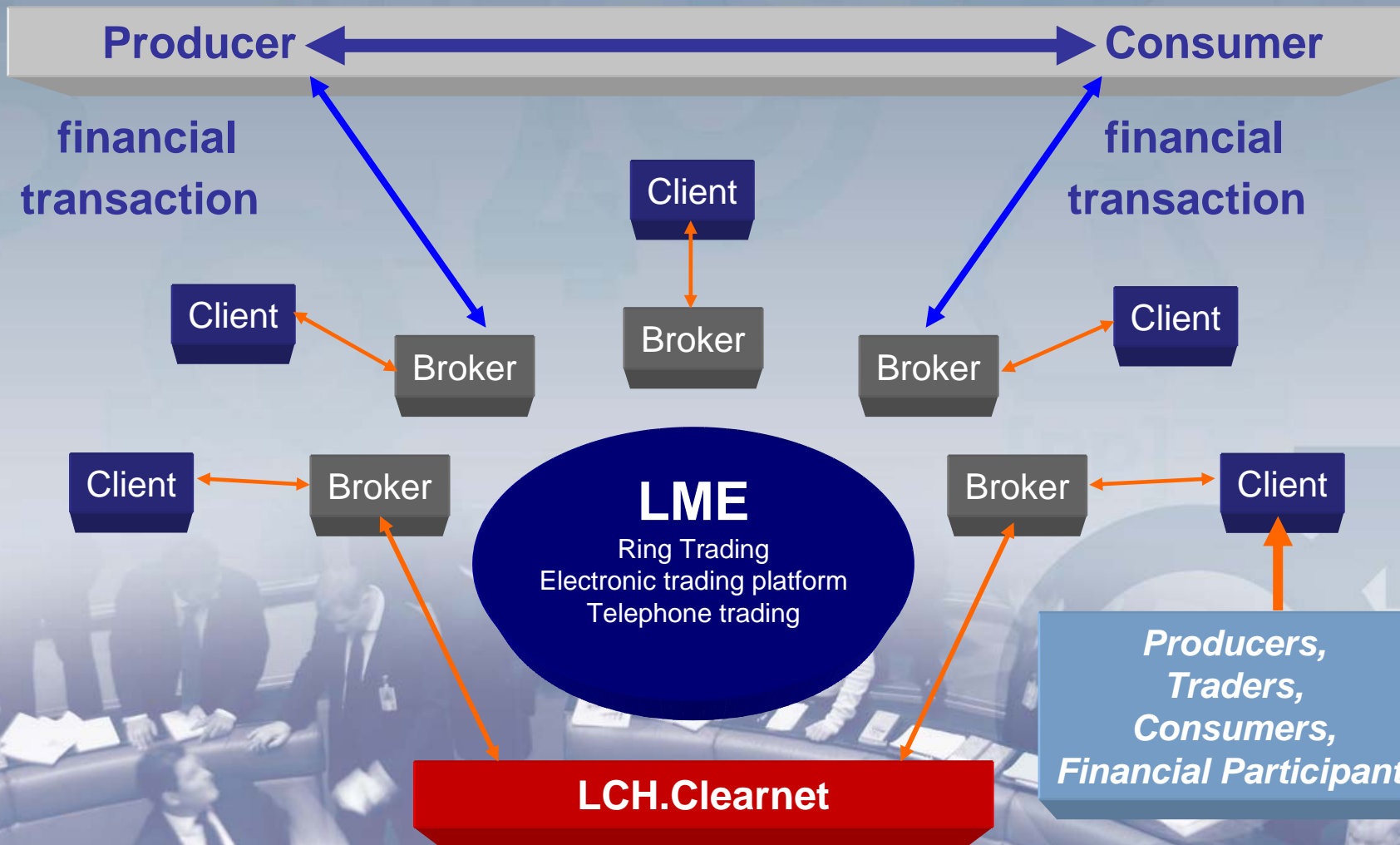
- GOST 380-94 Grade 5sp/ps
- GOST 380-94 Grade 3sp/ps
- GB 20MnSi
- GB Q235
- ASTM A615/A; 615M-07 Grade 60
- BS4449: 2005





# Trading on the LME

## Physical transaction



London Metal Exchange

# Hedging scenario

Physical enquiry for fixed price sales of steel billet.



Physical enquiry for fixed price sales of steel billet

**Scenario: You have a customer making an enquiry to buy billet at fixed price on a monthly basis.**



Physical enquiry for fixed price sales of steel billet

**Your customer wants to buy  
5000/mt each month for a 6  
month period.**

**LONDON METAL EXCHANGE**



Physical enquiry for fixed price sales of steel billet

**Freight is going to cost \$50/mt  
to deliver the billet to your  
customer.**



Physical enquiry for fixed price sales of steel billet

**Your premium will be \$15/mt.**

**This includes the “added value”  
of your billet above the LME  
futures price.**



## Physical enquiry for fixed price sales of steel billet

In order to offer your quote to your customer -  
We now need to get the LME price – this will  
then be used as a benchmark to calculate  
your overall price.

**You telephone your broker, they indicate  
that the LME price for the period is  
\$505/mt.**



## Physical enquiry for fixed price sales of steel billet

This is how to calculate the price for your customer.

$$\begin{array}{r} \text{LME} \\ \text{Price} \\ \$505/\text{mt} \end{array} + \begin{array}{r} \$15/\text{mt} \\ \text{Premium} \end{array} + \begin{array}{r} \$50/\text{mt} \\ \text{Freight} \end{array} = \$570/\text{mt}$$

This means that the price which you can offer to your customer is \$570/mt.



## Physical enquiry for fixed price sales of steel billet

Let's assume your customer is happy with the price  
- \$570/mt.

To protect yourself against price volatility, you now  
need to hedge on the LME.

This is done by “mirroring” the deal which you have  
just agreed with your customer.

In this case you need to buy 5000 mt per month of LME  
futures at \$505/mt.



Physical enquiry for fixed price sales of steel billet

You ask your broker for a two-way market for 5000/mt per month of billet for the 12 month period.

The broker quotes the price \$495/mt - \$505/mt.

You tell your broker that you will buy 5000 mt per month at the offer price of \$505/mt.



Physical enquiry for fixed price sales of steel billet

**To be able to look at the financial outcome, we now need to move forward in time.**



Physical enquiry for fixed price sales of steel billet

**It is now January**

**You are “long” 5,000 mt of futures for January at \$505.**

**This is the 5,000 mt which you bought last year.**

**This position needs to be sold, therefore, you need to telephone your broker.**



Physical enquiry for fixed price sales of steel billet

You ask your broker for a two-way market for 5000 mt for January.

The broker quotes the price \$525 - \$530.

You tell your broker that you will SELL 5000 mt for January at the bid price of \$525/mt



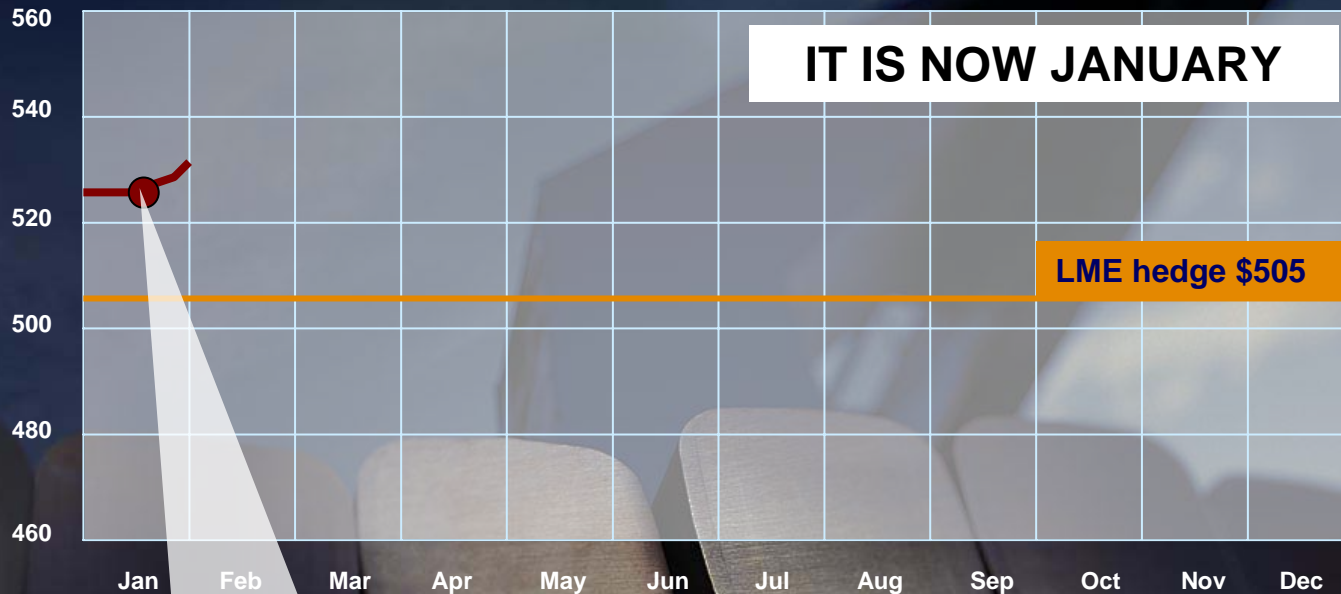
Physical enquiry for fixed price sales of steel billet

**Lets take a look at a financial summary of what you have done on the LME and what you have done in the physical market.**



# Physical enquiry for fixed price sales of steel billet

January OUTCOME – LME Price \$525 /mt



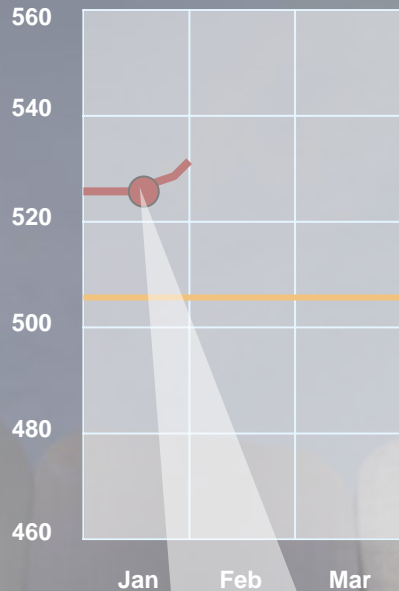
The January price has risen to \$525 /mt



# LME Futures and Physical position - SUMMARY

Physical en

January OUTC



The January price has risen to \$525 /mt

## LME FUTURES

## PHYSICAL

Bought 5,000 mt LME billet futures at \$505/mt for January

Sold 5,000 mt of billet to customer for \$570 for delivery this month (January)

Sold 5,000 mt LME billet futures at \$525/mt for January

Deliver 5,000 mt billet to customer who pays \$570/mt

Physical market price has also risen \$20, therefore, had you not sold at a prior agreed fixed price you would have sold at this higher price  
Physical "Loss" = \$20.

LME profit:  $\$525 - \$505 = \$20$

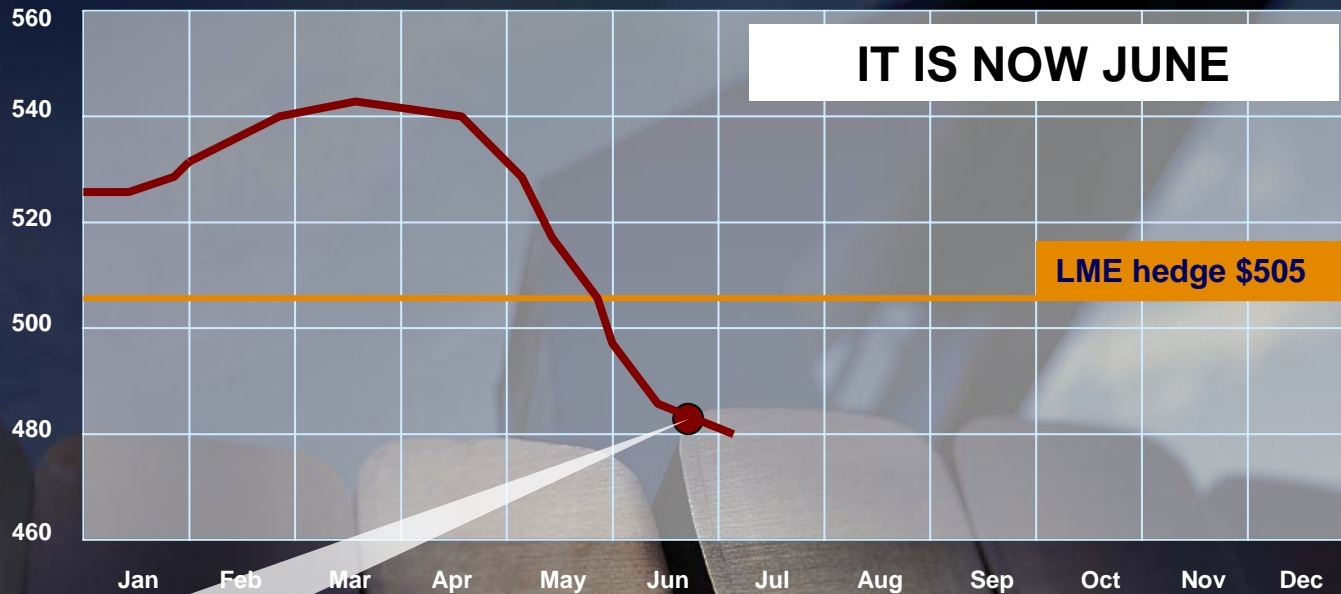
Physical "Loss" = \$20

The \$20 profit achieved on the LME trade has compensated for the "loss" of profit on the physical side

THE \$15/mt PREMIUM IS ALSO REALISED

## Physical enquiry for fixed price sales of steel billet

June OUTCOME – LME Price \$483/mt



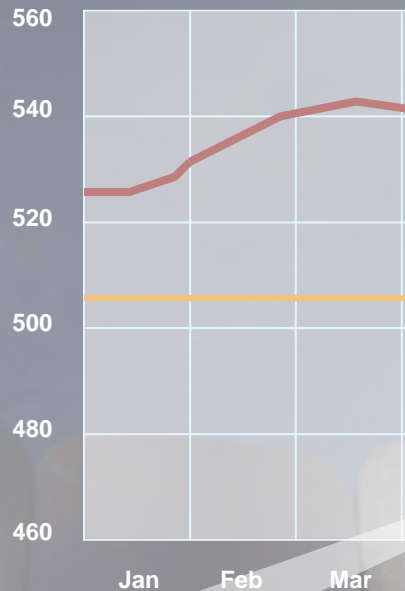
The June price has dropped to \$483/mt



# LME Futures and Physical position - SUMMARY

Physical end

June OUTCOM



The June price has dropped to \$483/mt

## LME FUTURES

## PHYSICAL

Bought 5,000 mt LME billet futures at \$505/mt for June

Sold 5,000 mt of billet to customer for \$570 for delivery this month (June)

Sold 5,000 mt LME billet futures at \$483/mt for June

Deliver 5,000 mt billet to customer who pays \$570/mt

Physical market price has also fallen \$22, therefore, had you not sold at a prior agreed fixed price you would have sold at this lower price.

LME loss: \$483 - \$505 = \$22

Physical "Profit" = \$22

The \$22 loss on the LME trade has been compensated for by the profit on the physical side



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Developing price risk management tools for the steel industry

## Launching 28 April 2008

Select and inter-office telephone markets will be available from 25 February 2008



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