

biofuels

international

When a company is operating in a rapidly changing market, there is a real possibility that the most promising firms may fail – not because they lack the vision for a successful business, but because they have inadequate risk management procedures

Technology for a changing market

No-one could dispute the fact that operating ethanol and biodiesel companies brings risks as well as rewards.

Not only do companies have to manage the risks associated with traditional energy trading, they must also take into account the volatility and supply complexities in the agricultural commodities markets.

Management need to be able to factor in farm procurement, all transportation modes including vessel, rail, truck and blending and processing at the plant, marketing, and any additional logistical requirements. In addition to the specific difficulties presented by the biofuels market, there are also the challenges faced by any start-up company experiencing a period of rapid growth.

Given the global and volatile nature of the biofuels market, traders, risk managers and operations people in offices around the globe must have the ability to manage positions and exposure on a real-time basis.

Trading

In this environment the first rule is that paper-based systems and even spreadsheets are no longer adequate. Too many organisations rely on the spreadsheets they started out with long after the point when they should have been ditched. They look at the familiarity, flexibility and reporting capacity that individual users like, and fail to realise that what works for one trader will almost certainly not work for a team of

five, 10 or more.

That is because spreadsheets tend to be private tools, that are never synchronised across the organisation. They tend to fall apart when used as an enterprise tool because they are neither designed nor developed with the rigour of application development. The resultant material losses can be significant. Errors creep into formulae because of mistakes in formatting or incorrect links to other documents. In some instances, the error may actually be due to fraudulent activity on behalf of the spreadsheet developer and so it is often difficult to ensure data integrity.

What is required is an end-to-end specialist commodity trading and risk management system. It is not enough to have risk

management solely covering trading. Operational, regulatory, and counterparty risks must all be managed on a common platform. Given the interrelated and complex nature of the market, calculating exposure now requires an advanced solution, showing aggregated risk on a real-time basis.

The rapid expansion of the biofuels industry, coupled with its complex, interrelated and volatile nature, has accelerated the need to automate processes and manage risk. The question is no longer whether to automate commodity management, it is now when and how. ●

For more information:

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How biodiesel producer Vertical survived

International biodiesel and ethanol company Vertical has successfully ridden the wave of the rapidly expanding biofuels industry.

Formed in 2003, the company has grown from five to over 80 people in London, Brazil, Singapore, the US, and Geneva. Forecasts suggest that it will close 2008 with volumes in excess of half a million tonnes of biodiesel and close to a million tonnes of ethanol. The projected turnover for 2008 is \$1.1 billion.

The company has end-to-end customers so it sources raw material from the world's main production areas and sells the final product on to its end users in five continents as well as trading in biofuels. Its strategy has developed from simply buying and selling ethanol and biodiesel to adding value to the

end product and doing its own in-house blending.

With a fast-growing business operating in a complex, interrelated and volatile market, the company needed to establish the appropriate systems and processes to grow for its market-leading position.

'The first thing to do was to ensure we had watertight risk management processes,' says CFO, Gaurav Mehra. 'We restructured the finance team and put in place a group financial controller, treasurer, IT manager and risk manager. Then we started looking into the technology options available.'

The company decided to use a risk management and trading solution provided by US-based Triple Point Technology. Vertical chose Commodity XL because it could support the company's blending

operations, a key component of its processes, and integrate with SAP accounting system.

Having transferred its trading operations away from spreadsheets, Mehra's team has a real-time view of long and short term positions that are marked to market. Mehra can also see the VaR and SAP enables him to manage the company from both a risk and cash-flow perspective more effectively.

The reporting and chartered accounts have been harmonised with Vertical's main shareholder COSAN and accounts can be consolidated at the click of a button. The direct interface between SAP and Triple Point ensures that information from the trading book flows straight to SAP and automatically updates both the sales ledger and accounts receivable.