

Quarterly Report

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Market Status

Overhang or in Balance?

The first two quarters of the 2002 obligation year have shown an encouraging trend towards consistent trading on t2e.

During August and September light but regular trading continued with prices remaining broadly steady, as indicated in the average price graph shown below. At that point it appeared to be accepted that the supply/demand balance would remain for the remainder of 2002, and stable prices resulted.

However trading during October became sporadic and consequently a price trend became difficult to discern.

Inevitably during the final quarter a number of reprocessors are entering the market. Many have excess tonnages to sell, probably following their completion of contracts with compliance schemes. Others have clearly held PRN tonnage back to the end of the year. Some sellers have seemed content to sell immediately at the best bid prices, rather than leave higher priced offers in the market. When they do, prices appear to soften.

However, many independent obligated companies traditionally enter the market at this time of year and it is common for them to pay prices on offer in order to meet their obligations with a minimum of delay. This can give the appearance of prices firming.

During October, t2e witnessed both phenomena and with spreads as wide as they were, it became difficult to gauge the prevailing sentiment in the market: Selling expectations remained at around £30 for most PRN classes, whilst buyers were looking to pay prices in the mid-£20 range. We saw trading at both ends of this range.

Exceptions so far have been in Aluminium and Glass. Aluminium trading has been thin (some 4,200 tonnes), with a wide fluctuation in traded price from £21.50 to £60.

The industry view, widely held earlier in the year, that Glass PRNs would be in short supply has changed following the recent High Court ruling regarding the seller obligation on drinks bottles. Nevertheless t2e has seen offers consistently in the £30s and trading in the £28-31 range although prices have declined a slightly during October.

With some 785,000 tonnes of PRNs unissued at the end of Q3 the question of whether the reprocessors have withheld too much tonnage too late into the year is gaining credence, although some of this could be the result of a natural "front loading" of tonnage ahead of documents being issued under compliance scheme contracts.

On the other hand the first half 2002 DEFRA figures suggested a generally balanced market in terms of supply and demand. The recently released third quarter figures represent the last scheduled indicator available to the market before the end of the year.

Whatever else these reveal, their release shows that there is a lot more purchasing to be done before the end of the compliance year.



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Managing Director's *Quarterly Report*

t2e has seen steady trading throughout the third quarter during which the price picture has been consistent. However, in mid-November as I write, prices have softened as speculation has increased about reprocessing figures.

The Agencies are to be congratulated on assimilating and disseminating this data but questions are being asked about whether this dissemination is swift enough to allow the market to adjust. Clear benefits can be identified from the implementation of a central register.

At the current levels, PRN prices have been extremely successful at increasing the levels of recovery and recycling. Almost more has been achieved in the first three quarters of 2002 than in the whole of 1998. Wood reprocessing and plastic exporting have maintained spectacular growth. Concerns continue to be expressed about whether overseas reprocessors are either *bona fide* or conducting environmental best practice. Nevertheless, until obligated industry devises a method of auditing reprocessors there will be no alternative to the current system.

Oversupply in 2002

The good news of increased reprocessing has been counter-balanced by a decrease in the reported obligation for 2002. This suggests that the market could be oversupplied in 2002 with substantial carry-forward to 2003. Our 2003 market will be opening on 2 December 2002.

The Minister's decision to maintain 2003 targets at 59 per cent recovery and 19 per cent material specific recycling has disappointed the market with reprocessors asking what incentives exist to further expand or even maintain current activities.

Equally exporters are suggesting that current levels are unsustainable if PRN prices drop significantly. With this uncertainty in the market many participants will welcome the opportunity to buy and sell PRNs three, six, nine and 12 months forward. t2e is currently in the final process of revising its rules to re-introduce forward contracts.

Review in 2004

The Minister has also warned players of a significant review in 2004. The key area of his concern appears to be that the regulations have not improved household recycling rates. This is surprising because improving household recycling rates was never one of the aims of the Regulation. At the RAGS conference in Perth presentations by Coy Smith, Materials for the Future Foundation, and Jack Maginnis, RDC Group, showed that landfill diversion targets, cost of landfill and lack of landfill space drive far more recycling of household waste than any product specific legislation. This combined with a more entrepreneurial approach by local authorities has been the basis of success in both the United States and Canada.

Elsewhere, negotiations continue within the EU. The UK still awaits fundamental outcomes such as revised recycling and recovery targets or the year in which compliance is to be achieved. Initial indications are that overall recovery targets may be lower than some European nations aspire to; recycling rates will be required to rise significantly both overall and in specific materials and it is unlikely that 2006 will be the compliance year.

New Advisory Committee Appointment

I welcome the appointment of the new Advisory Committee and wish the Chairman, John Turner, good fortune. The role will not be easy.

Many thanks to all those participants that have continued to support t2e and to those that are using it for the first time. Please let me or my team know if you have any suggested improvements on either the service that we provide or the enhanced information that we now provide on the website. Wishing you an enjoyable festive season.



Angus Macpherson
Managing Director



BRIDGING THE GAP BETWEEN BUYERS AND SELLERS

Forwards

Locking in - Prices

Cliff Laundon explains

The Environment Exchange will shortly re-introduce PRN forward contracts in addition to the current spot market. Although the forwards market may appear to be intimidating at first, it represents a invaluable additional tool for trading.

Key Features:

- PRNS can be traded on any day before expiration at an agreed price.
- Both parties lodge 10% deposits to secure the transaction.
- Interest is paid by the exchange on cash deposits
- Contracts do not have to be settled until expiration, a fixed date in the future.

Why should you consider using them?

Price certainty – for example, a major concern heard from t2e participants is that they do not know where prices will be later in the year. No one does, but nevertheless budgets have to be set and expenditure commitments made.

For a seller, a forward contract means he can pre-sell a given tonnage at a known price that will not change. He or she will know what price will be paid and when. There is no need to keep watching the market in order to re-evaluate what the PRN production is worth.

For a buyer the contract provides similar benefits - a pre-purchased tonnage with a known cash commitment at a known future date.

Efficiency

Trading forward offers efficiencies, over and above those of the spot market. Cash otherwise tied up in buying spot market PRNs can be better used elsewhere because the payment for PRNs under a forward contract is not required until later in the year.

Reprocessors do not have to wait until they are able to issue PRNs before they can trade. By using forwards they are able to ensure that PRNs realise revenues as soon as possible, without having to wait for favourable market conditions.

Deposits

Both buyer and seller lodge a 10 per cent deposit immediately after trading a forward contract. This is held by the Exchange until settlement, as a guarantee of performance. With a forward contract being tradable up to nine months before it reaches settlement, a party has to be confident that the other will perform the transaction, even if the market price moves against him. The deposit therefore ensures that the counterparty risk is kept to a minimum.

Traded forward contracts are similar to the supply contracts commonly used between compliance schemes and reprocessors. The features are essentially the same. Traded forwards, however add flexibility to security. The tonnage, settlement and price are subject to negotiation and can be customised to suit the requirements of both parties.

No single method of trading offers the complete answer. Combining the available methods in the right mix can give you the best chance of meeting your objectives in a way that is consistent with your propensity to the risks associated with each.

A brief comparison shows how to mix the advantages of each:

Bilateral contracts	Large volume contracts available, each with one counterparty. Single party performance risk.
Forward contracts	Smaller volumes available, with more than one counterparty. Deposits required for security.
Spot market	Price sensitive. Maximise favourable price movements when they occur. Subject to price and volume fluctuations.

