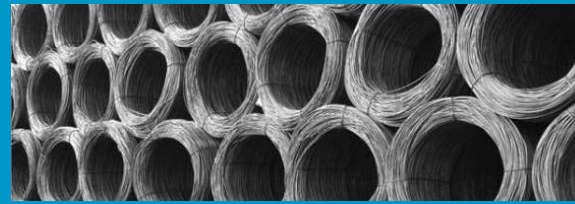
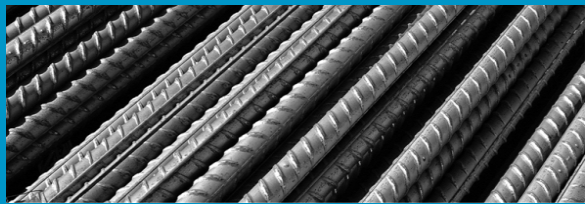


Getting started with steel derivatives – a simple plan



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Contents

Getting started with steel derivatives:

- Corporate considerations
- Operational considerations
- Practical considerations

Corporate consideration 1 - Exposure to Risk

- Low margins
- Volatile prices
- Contractual defaulting
- Counterparty risk
- Quality problems
- Logistical risk



We're all in the same boat

→ To do nothing is to speculate

Corporate consideration 2 – Speculation / Hedging

- Financial instruments: speculation tools?

Speculation or hedging – same tools

- Speculation Vs. hedging:

It's in the use of the tools rather than the tools themselves

- Speculator Vs. hedger:

It's in the inherent exposure

Corporate consideration 3 – Comparative Risk

1% change in price	Volatility	Bottom line impact	Financial hedging tools	Hedging
€/\$	9% p.a.*	\$ Significant	Yes	Yes
Steel Billets ex CIS	37% p.a.**	\$ Serious	Yes	Yes

* Monthly averages - 2000 to 2009

** Monthly CRU prices – 2000 to 2009

→ May prompt senior management to roll out focus on new risks...

Corporate consideration 4 – Risk v Reward



Achieving the best possible

Risk / Reward ratio

Not removing *all* risks

Operational consideration 1 – Basis Risk

- Not a perfect world: inevitably day-to-day changes in value of physical position will differ from changes in value of hedge (futures position) → **Imperfect hedge**
- Basis Risk is the measure of this imperfection
- Basis Risk is the price risk remaining after the hedge is in place
- Results in potential over/under-performance of the hedge
 - Inefficiency → Economic impact → Accounting impact

How to limit the effects of Basis Risk

- Understand it
- Constantly measure correlations between price changes
- Approach hedging as a dynamic activity
- Work to use the same index to price physical transactions and hedge them, as in more mature commodity markets

Operational consideration 2 – Be Prepared

THE 10 'COMMANDMENTS'

I
II
III
IV
V

- i. Review company's various exposures to steel and estimate "hedgeability"
- ii. Set risk management objectives
- iii. Obtain consensus among senior managers (commercial / financial)
- iv. Obtain board approval for hedging via financial instruments
- v. Establish a single focal point to put in place and manage hedging

Operational consideration 2 – Be Prepared

THE 10 ‘COMMANDMENTS’

VI
VII
VIII
IX
X

- vi. Determine hedging policy (limits, authorised “dealer”, authorised instruments, ...)
- vii. Set up control tools and allocate resources to guarantee actions are within parameters set by the hedging policy
- viii. Systematically value all hedges together with the physical transactions they are “offsetting”
- ix. Segregate “front-office” and “back-office” functions
- x. Ensure accounting is up to speed on IAS39 / FAS133 issues

Practical consideration 1 - Housekeeping

- Consider investing in basic information tools:
 - Independent market price feed
 - Auditable system to keep track of transactions and value of commitments

- Gather and disseminate internal information about physical commitments

- Take a realistic approach to the financial market (liquidity / settlement)

- Open an account with a broker....

Practical consideration 2 – Choosing a Broker

- Commitment to and understanding of the steel industry
- Financial strength and credit facility offered
- Market coverage (Exchanges, OTC)
- Geographical presence
- Access to or provision of liquidity (risk warehousing)
- Trade execution (Ring, Telephone, Electronic)
- Warrant trading
- Back-office quality (confirmation, disputes, ...)
- Commission rates
- Independent survey on client satisfactions

→ Derivatives is a regulated world - opening an account takes time

In summary...

The “experience-curve” process: *Where are you?*

