

# Opportunities and Peril in Steel Futures

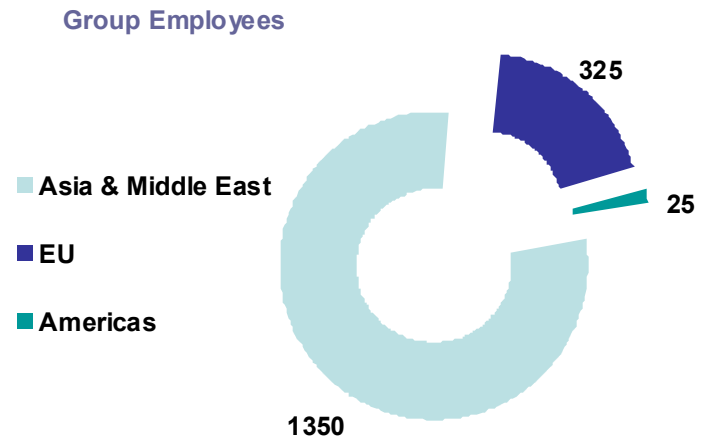
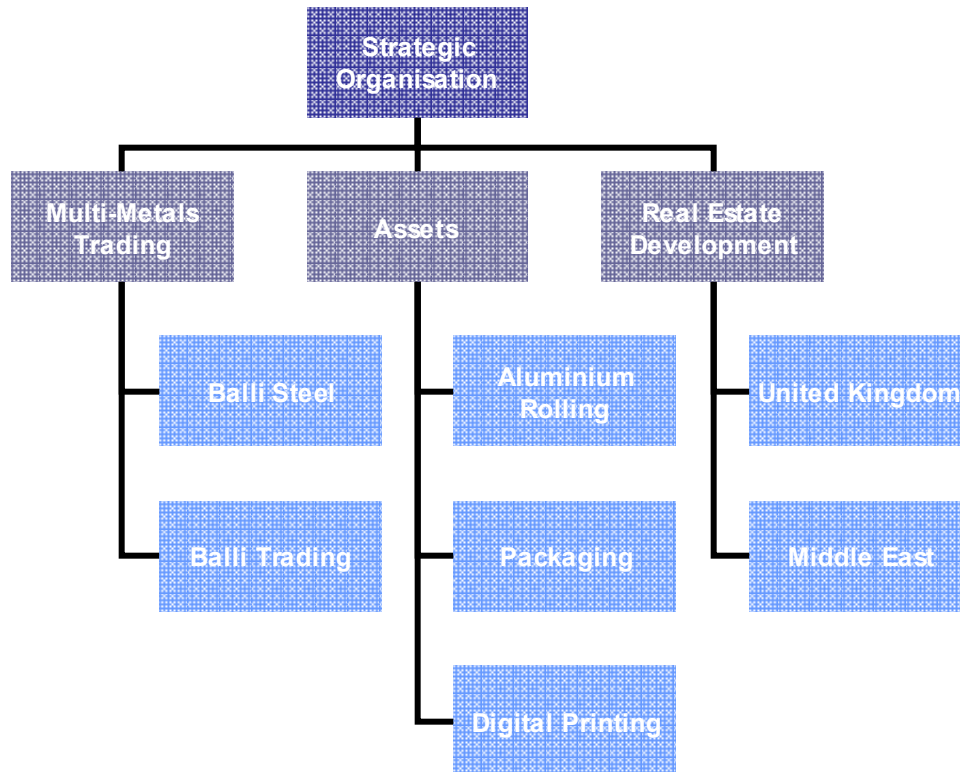
Nasser Alaghband

Steel Success Strategies XXII  
Paris - December, 2007



**BALLI**

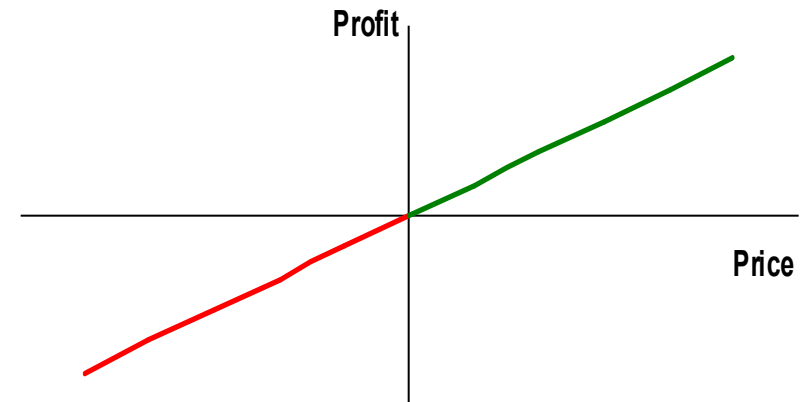
# Balli's Profile



**Balli Group is an independent multi-metals trader**

# Forward Contracts

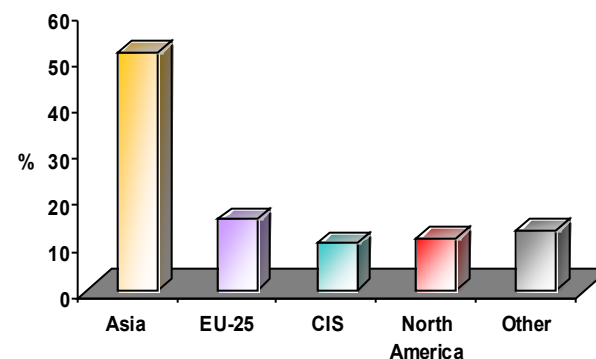
- A forward contract allows for the pricing at one point in time to be protected in the future
- The pricing of a forward contract depends on:
  - Forward Date
  - Interest Rates
  - Risk Assessment
  - Market Sentiment
  - Liquidity



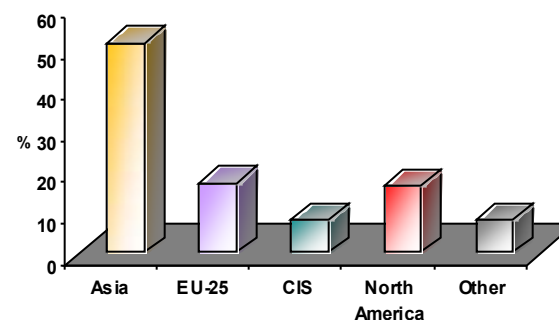
# The Case for Steel Futures

- Steel industry produces in excess of \$800 billion per year
- Positive growth outlook
- Growing demand for price risk management
- Established hedging platform for most metals

**World Steel Production by Region**



**World Steel Consumption by Region**



**Steel prominently lacking price risk management in the metals industry**



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www.balli.co.uk

# Cost Protection for Consumers

## Case Study: D1 Tower

- Estimated Rebar Requirement
  - 80 floors
  - 125 tonnes/floor
  - 15,000 tonnes

- Rebar Price

Jun 06	Dec 06	May 07	Dec 08
\$475	\$575	\$600	\$625

- If hedged at US\$475 /mt
- vs Dec 08 at US\$625 /mt
- Cost Variance: US\$2,250,000



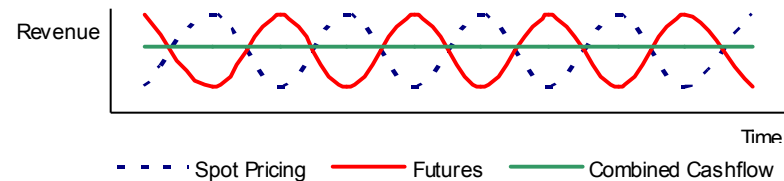
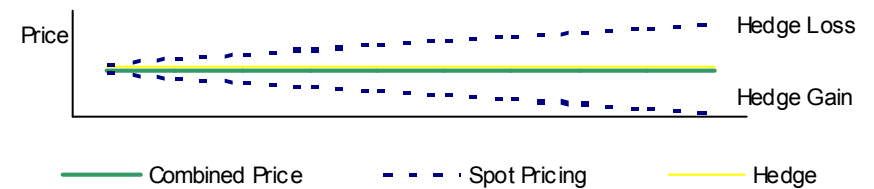
D1 Tower

- 80 floors
- 284 metres high
- \$180 Mln development

**Consumers can protect their budgeted costs**

# Opportunities for Producers

- Producers can fix prices forward and protect cash flow from price volatility
- Stable cash flows means lower risk, improved costs, and higher valuations, achieving improved long-term finance



**Producers can benefit from stable cash flows**

# Steel Futures Roadmap

- **DGCX – Dubai Gold & Commodities Exchange**
  - **Launched 2007**
  - Futures Contract – Rebar
- **LME – London Metals Exchange**
  - Launch 2008
  - Futures Contract – Billet
- **NYMEX – New York Mercantile Exchange**
  - Futures Contract – Hot Rolled & Cold Rolled Coil
- **SHFE – Shanghai Futures Exchange**
  - Announcement in coming months
  - Futures Contract – Wire Rods



# Will Steel Futures Develop Traction?

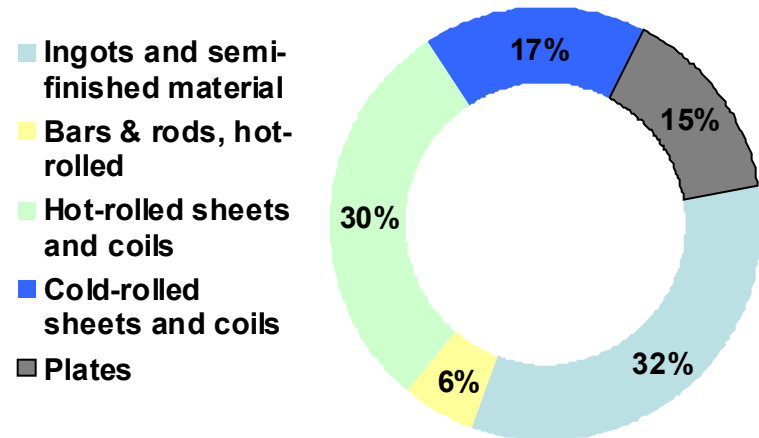
- Concerns raised against Steel Futures:
  - Steel is not a commodity
  - Steel futures will lead to volatility
  - Market liquidity



# Steel as a Commodity

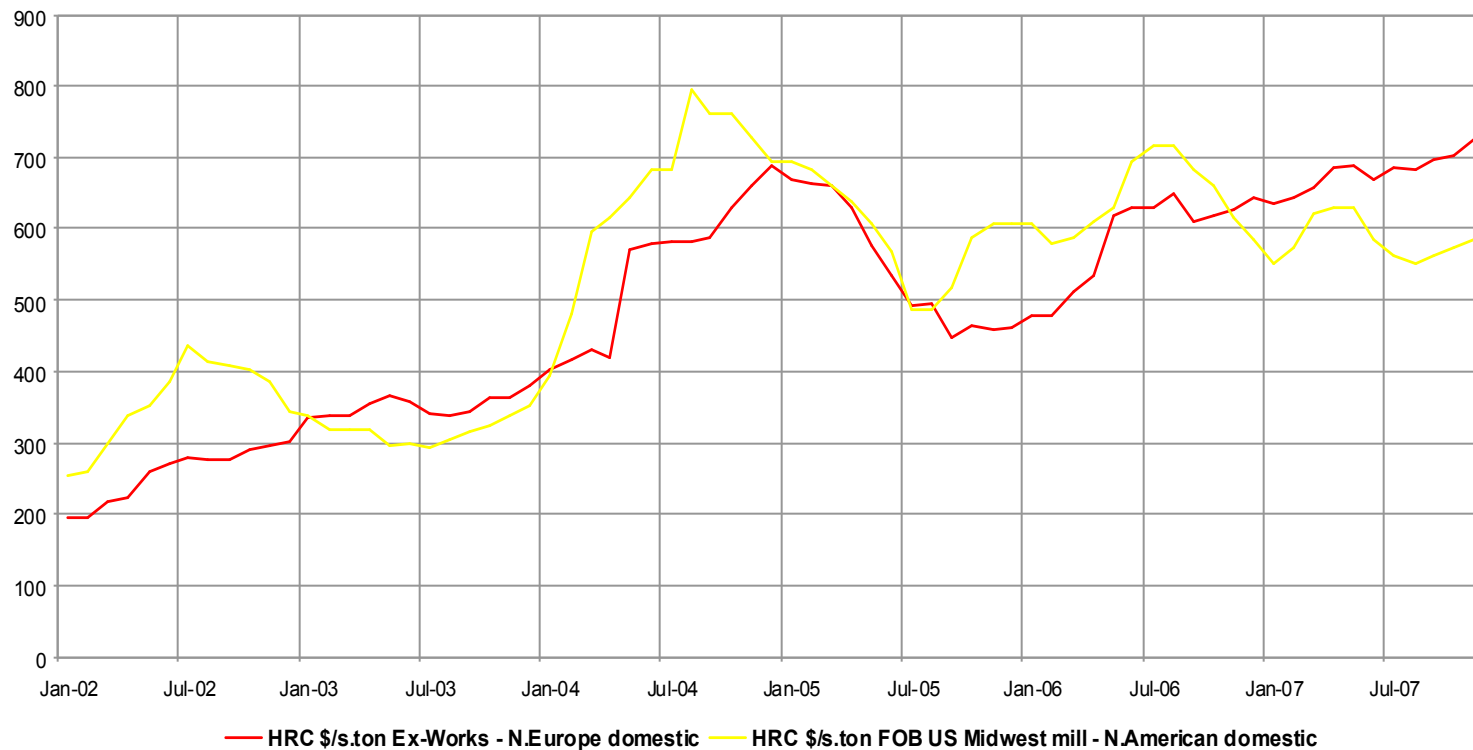
- The industry has chosen products closest to being a commodity:
  - **Billets**
  - **Rebars**
  - **Hot-rolled**
- Oil Futures have thrived as a hedging tool despite grade variations

World Steel Exports  
analysis by product - 2005



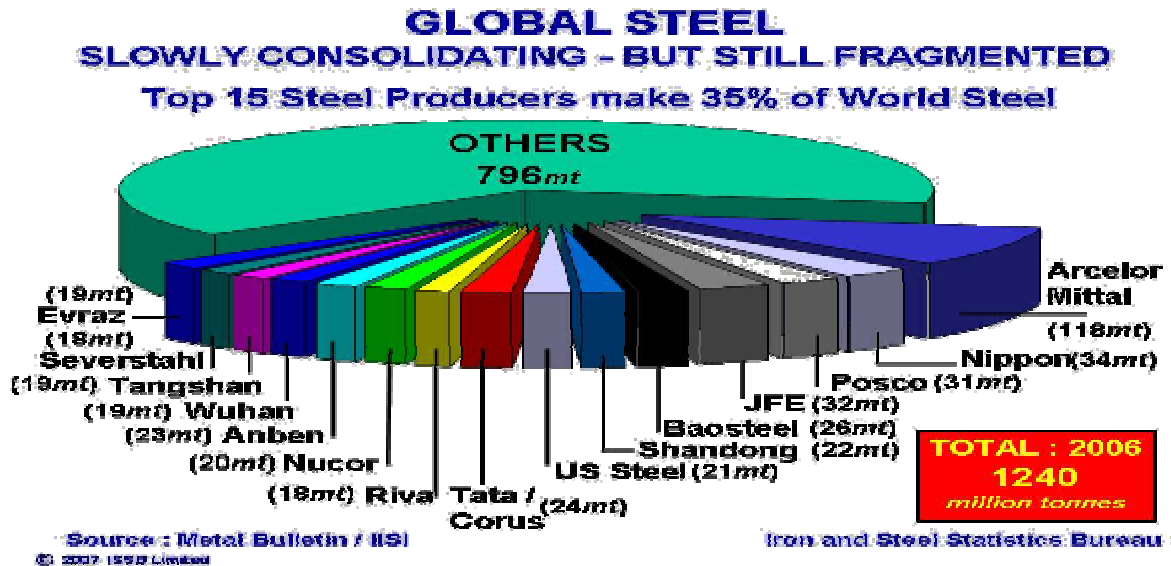
# Steel Futures Will Lead to Price Volatility

- Steel is already subject to significant volatility



# Does Consolidation Deal With Volatility?

- The industry is fragmented



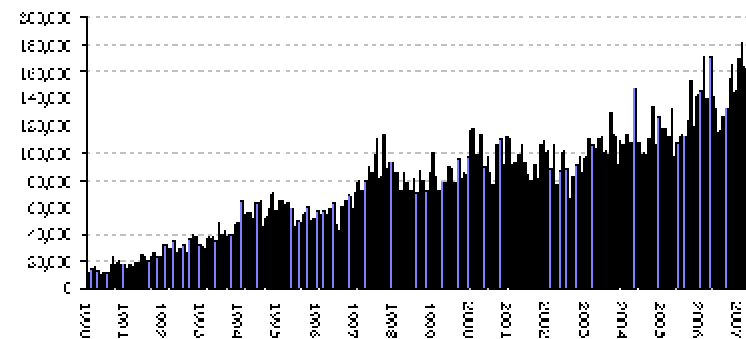
- Producers have no mechanism to offer risk mitigation to most customers



# Should Market Liquidity be a Concern?

- There will be a gradual liquidity increase during the initial years
- DGCX's promising start
- Financial community will play a key role in the speed of the Steel Futures liquidity build-up

LME Aluminium futures: monthly average daily turnover, contracts



2006 global primary aluminium production  
33.7 Mln tonnes

2006 LME futures and options approximately  
41.1 Mln lots or 1.0 Bln tonnes

30.5 times annual global production

Of which futures are approximately 89% and  
options 11%

**Further appetite for investment in exchange-traded funds tied to commodities will generate more interest in Steel Futures**

# Risk Management Preparation for Steel Futures

- Defining a unique strategy for your company
- Establishing robust IT systems to monitor the hedging operations
- Margin calls
- Market liquidity



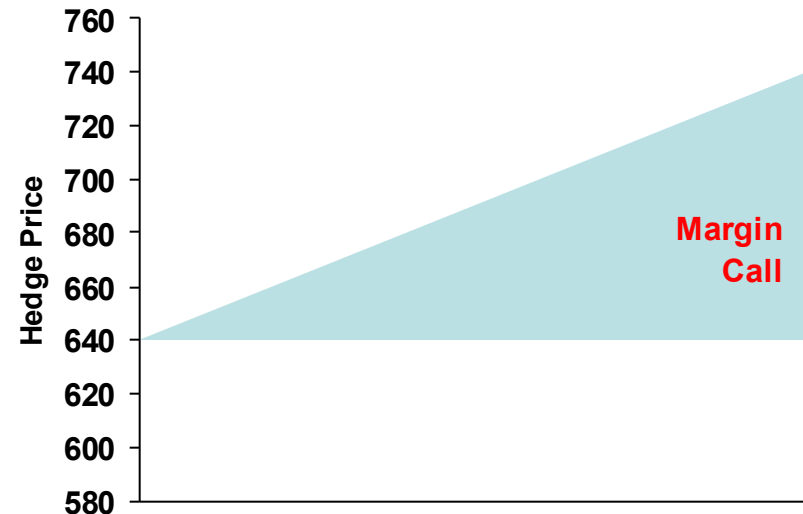
# Margin Calls and Cash-flow

- Cash-flow for initial margins
- Ready cash-flow for variation margins
- Margin calls must be settled promptly



# Case Study – Variation Margin Call

- 10,000 tonnes of steel debars
- Physical purchase contracted price \$620/MT
- Hedged sell at \$640/MT
- Price increases due to high demand to \$740/MT
- Variation margin credit line with broker of \$200,000
- Variation margin on trade \$1 million
- **Margin call of \$800,000**



# Scorecard from the Futures Industry to date

- Industry Interaction High
- Information Good
- Product Development Good
- Linkage To Market Trends High

