

2011 Windy City Summit

May 18, 2011

Making the Case for Risk Management

The Value in Risk Management



Table of Contents

Section	Overview	Page
1	Focus on Risk	1
2	What is risk?	5
3	The Value Proposition	9
4	Financial Risk Management Framework	12
5	Lessons Learned	21
6	Q&A	23
7	Speaker Contact	24

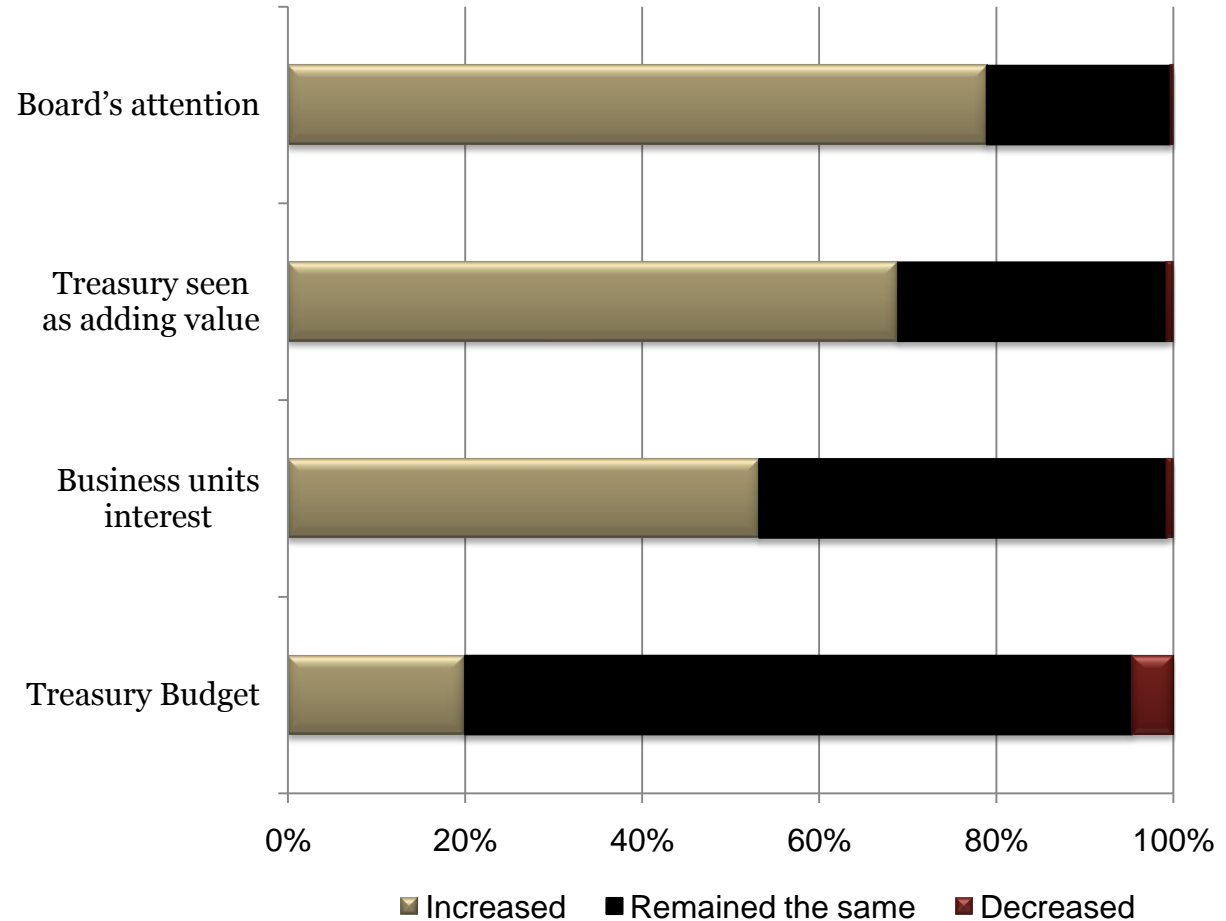
Section 1

Focus on Risk

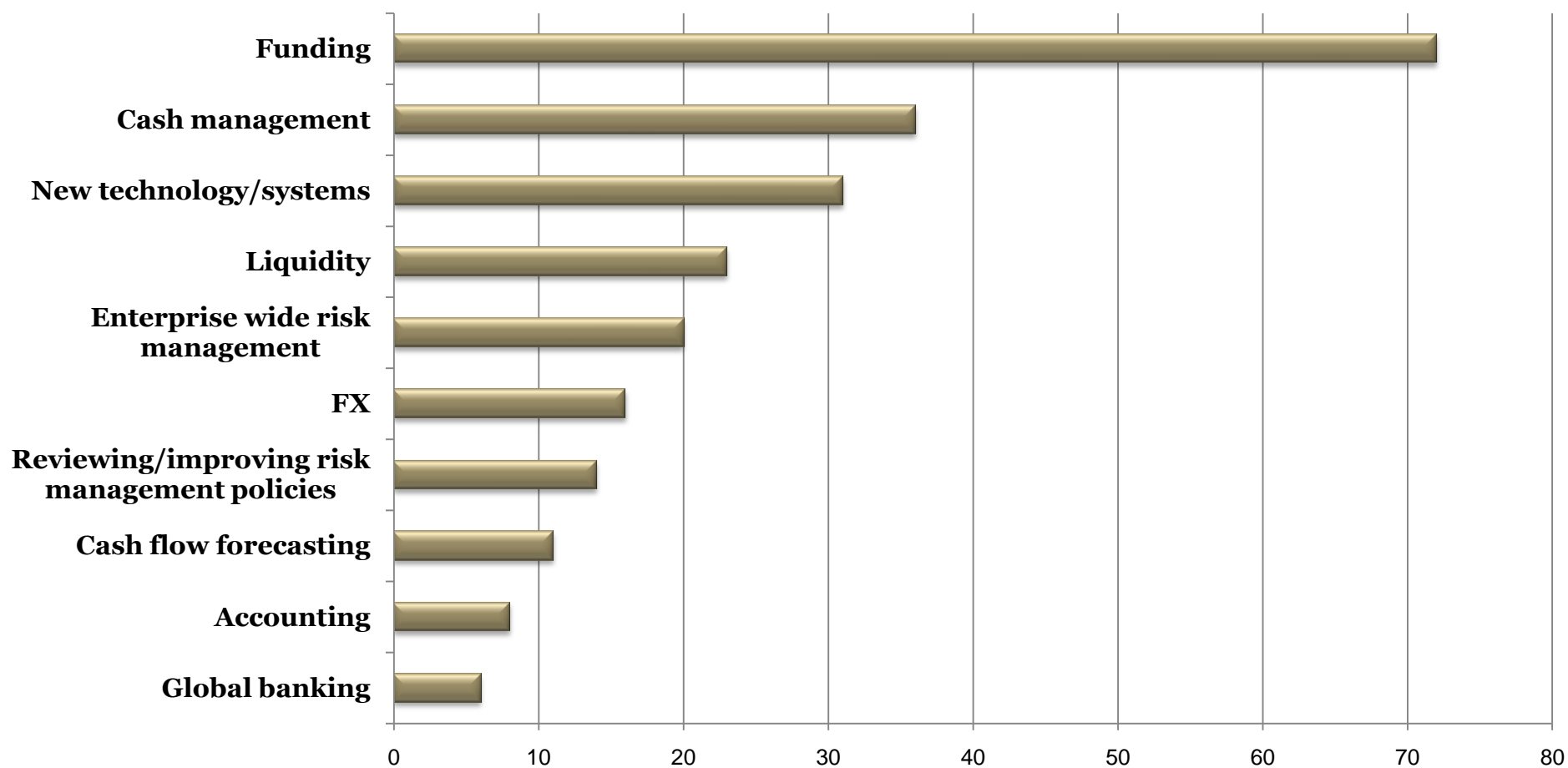
The crisis: increased visibility for treasury

"The Chinese use two brush strokes to write the word 'crisis'. One brush stroke stands for danger; the other for opportunity. In a crisis, be aware of the danger-but recognize the opportunity."

John F. Kennedy



The treasury agenda: focus on managing risk



Key drivers of focus on risk

External Pressure

- Changes in regulatory and reporting
- Access to liquidity/financing
- Intense investor and creditor scrutiny
- Uncertainty in FX, IR and commodity price environments
- Demand for more consistent and timely information
- Continued pressure to control operating costs

Internal Challenges

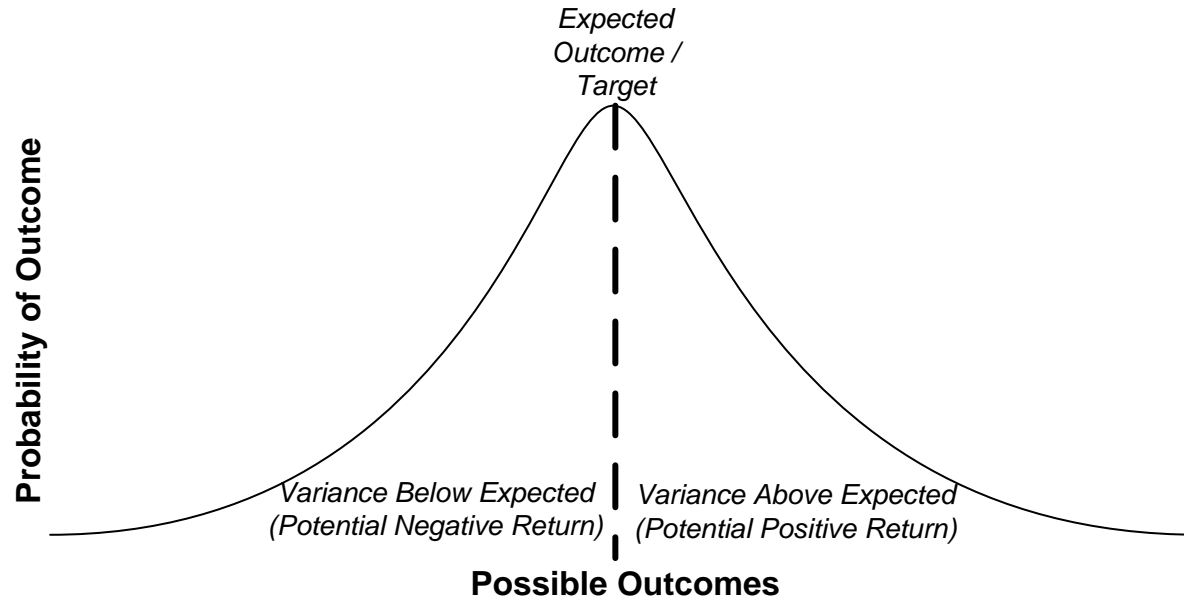
- Greater complexity, visibility and scope of Treasury function
- Increased Board and Sr. Management focus/scrutiny on Treasury activities
- Struggling to integrate and automate processes
- Limited personnel resources
- Pressure to maintain credit rating and access to capital markets
- Continued focus on controls and information security

Section 2

What is risk?

What is Risk?

- Exposure to uncertainty / variance to possible outcomes
- Typically viewed as potential for a negative impact
- Anything that impacts ability to meet business objectives / strategy



Risk management is a process to identify, assess, and manage risks to bring them to within acceptable levels.

Risks Can Come in Many Forms

Corporate Risks

Paid to Take

Paid to Manage

Paid to Mitigate

**Business/
Strategic**

**Market/
Financial**

Credit

Operational

Product, Market,
Sales, Competition,
Quality, Reputation

Foreign Exchange,
Liquidity, Interest
Rate, Commodity,
Energy

Country,
Counterparty,
Default, Spread
levels, Collateral,
Recovery,
Performance

Controls, Systems,
Data Quality,
Regulatory, Fraud,
Systems, Disaster

Market / Financial Risks

Foreign Currency

- Economic
- Translation
- Transaction

Commodity/ Energy

- Direct
- Indirect
- Basis

Interest Rate

- Financial Value
- Expense
- Income

Credit

- Counterparty
- Customer
- Supplier

Section 3

The Value Proposition

What Does Hedging Really Buy You?

Reduction in Volatility

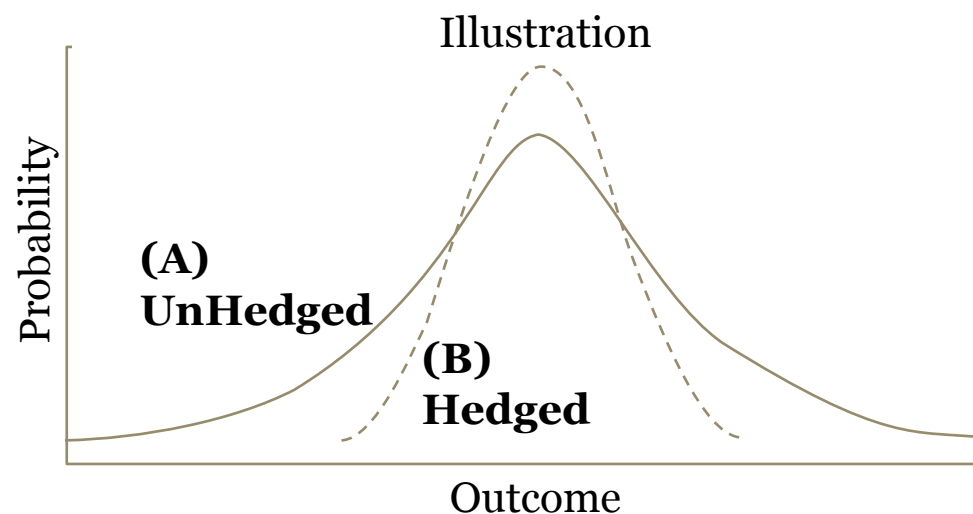
- Mitigate variability in expected outcome

Avoidance of Financial Distress

- Mitigate cash flow volatility
- *Gambler's Ruin*

Provides Predictability

- Allow management to plan
- Evaluate management's performance



Risk management should reduce the variance in possible outcomes, mitigating surprises.

How Does Hedging Impact Value?

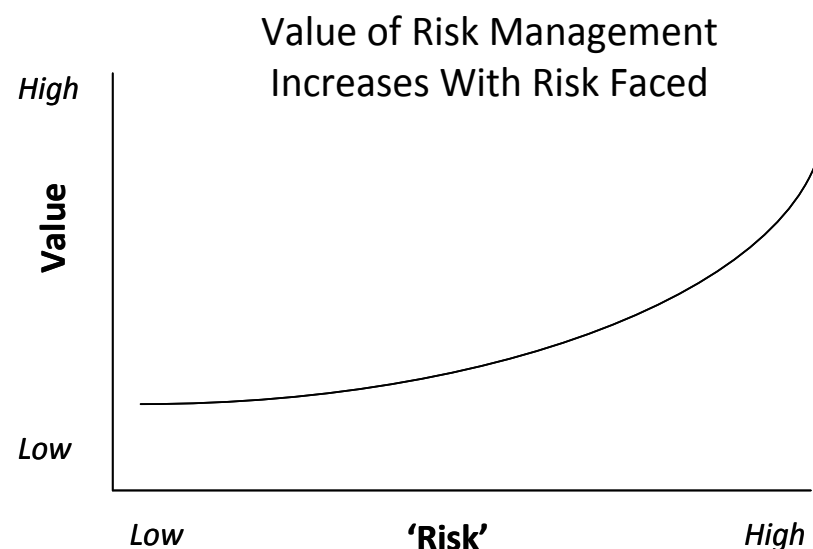
Risk management impacts value if it impacts the future cash flows of the business. Ultimately, hedging only buys you time, but there is value in that -

Value Drivers

- Financial Distress
- Predictability

Value Drivers Impact

- Capital structure decisions (debt vs. equity)
- Access to capital (timing)
- Cost of capital (liquidity reserves)
- Investment decisions (ability to grow)

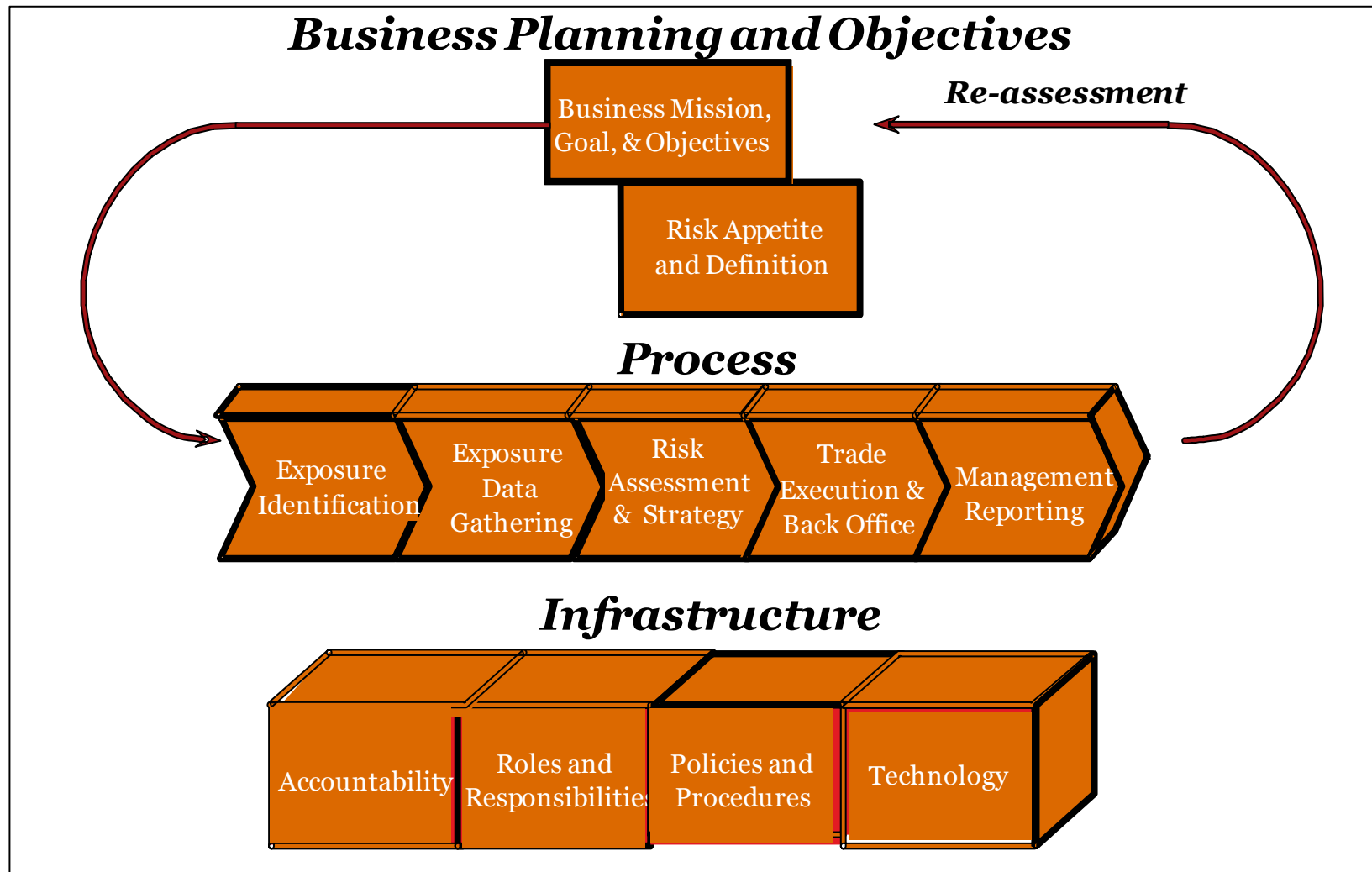


By managing its financial risks, a company can focus on its true sources for value generation.

Section 4

Financial Risk Management Framework

Risk Management Framework



Identify Exposures and Assess Impact

Understand Current Exposures

Key Activities

- Define financial risk exposures
- Define metrics for each exposure type
- Formulate initial view as to nature and magnitude of each exposure type
- Perform initial analysis of how exposures impact objectives

Develop Process

Key Activities

- Design exposure data gathering process
- Develop information sources
 - Use business units
 - Sales forecasts
 - Purchase history
- Assign accountability
 - Regular updates
 - Monitor expected forecast slippage

Assess Impact

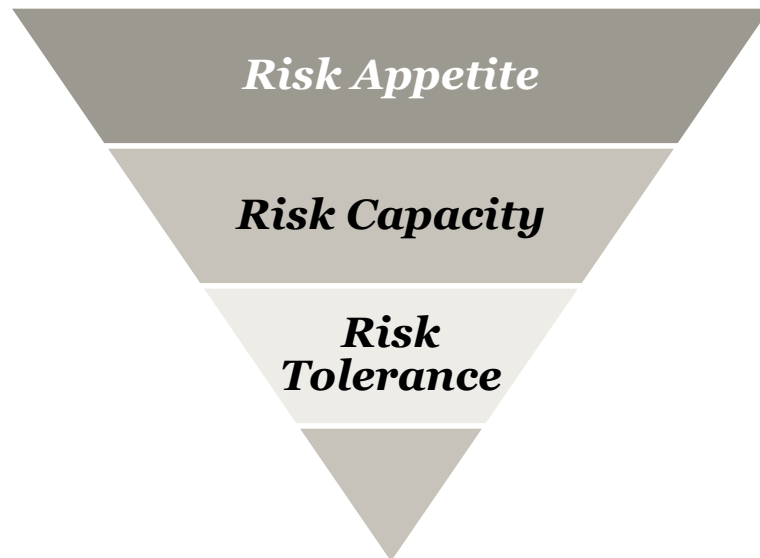
Key Activities

- Stress test exposure forecast, e.g. scenarios, VaR, CFaR, etc.
- Consider impact to strategy, operations, and investment decisions
- Consider interaction among risks
- Only residual risk is true exposure

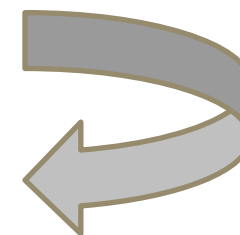
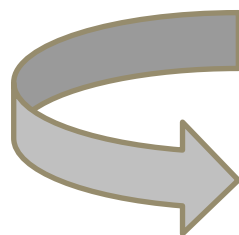
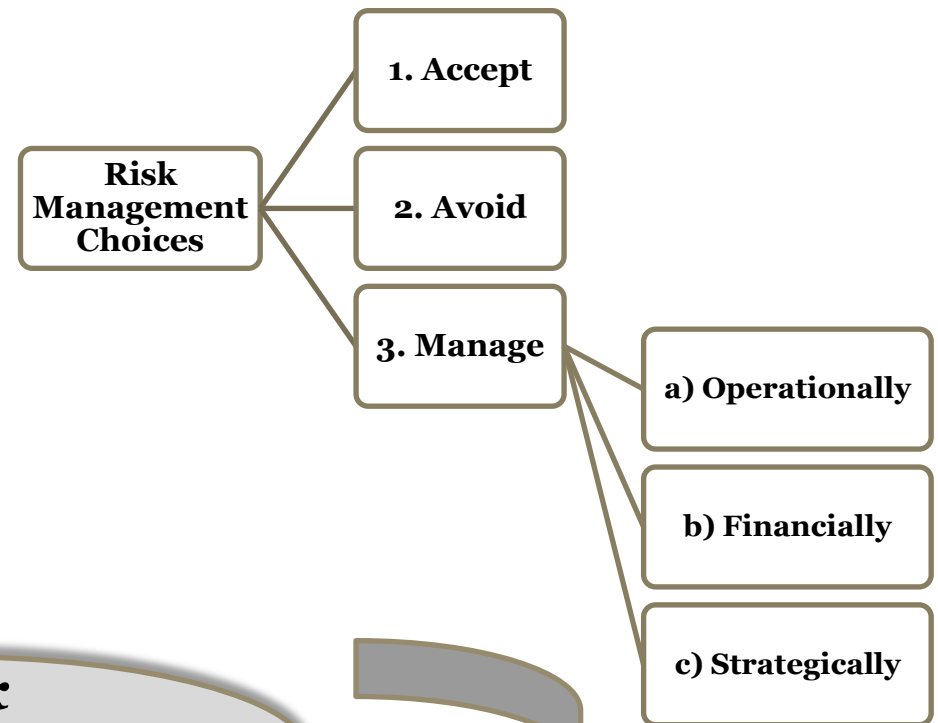
Defining Your Risk Management Objectives

Begins with evaluating your risk appetite and your choices regarding risk...

Based on your
stakeholders' risk appetite



Evaluate your choices for
managing the risk



Defining Your Risk Management Objectives

Quantify impact of risk based on defined objectives...

- Quantify and clearly articulate risk appetite –
 - The maximum acceptable negative earnings impact (quarterly, annually)
 - The maximum negative impact on cash flow that the Company can accept based on budget requirements, capital needs, and/or financial covenants
 - Include the cost of hedging (discount/premium to spot and/or premiums) incurred

- Establish and document clear objectives for the risk management program with specific metrics to measure performance -
 - Secure budgeted price or margin targets
 - Dampen volatility of financial results, e.g. EPS and/or cash flow, by X%
 - Maximize economic performance of business (e.g., gross margins)

- Performance measurement should highlight achievement of objectives
 - Avoid urge to focus on gains/losses of hedge portfolio, per se
 - Not a time for “Monday morning quarterbacking” of hedge decisions

The goal is to bring residual risk within risk tolerance levels

Parameters of a Risk Management Strategy

Exposure	What risks do I hedge?
Threshold	What is the minimum tolerable exposure level?
Horizon	How far out to I hedge?
Coverage levels	How much do I hedge?
Instrument	What instrument do I use?
Timing	When do I hedge?
Roles	Who decides?
Discretion	How do I consider the market?

In most cases, these parameters will naturally fall out of a robust risk assessment and conversation around objectives.

Develop a Risk Management Infrastructure

Internal controls ensure that risk management activities are being carried out, and without adding new risks...

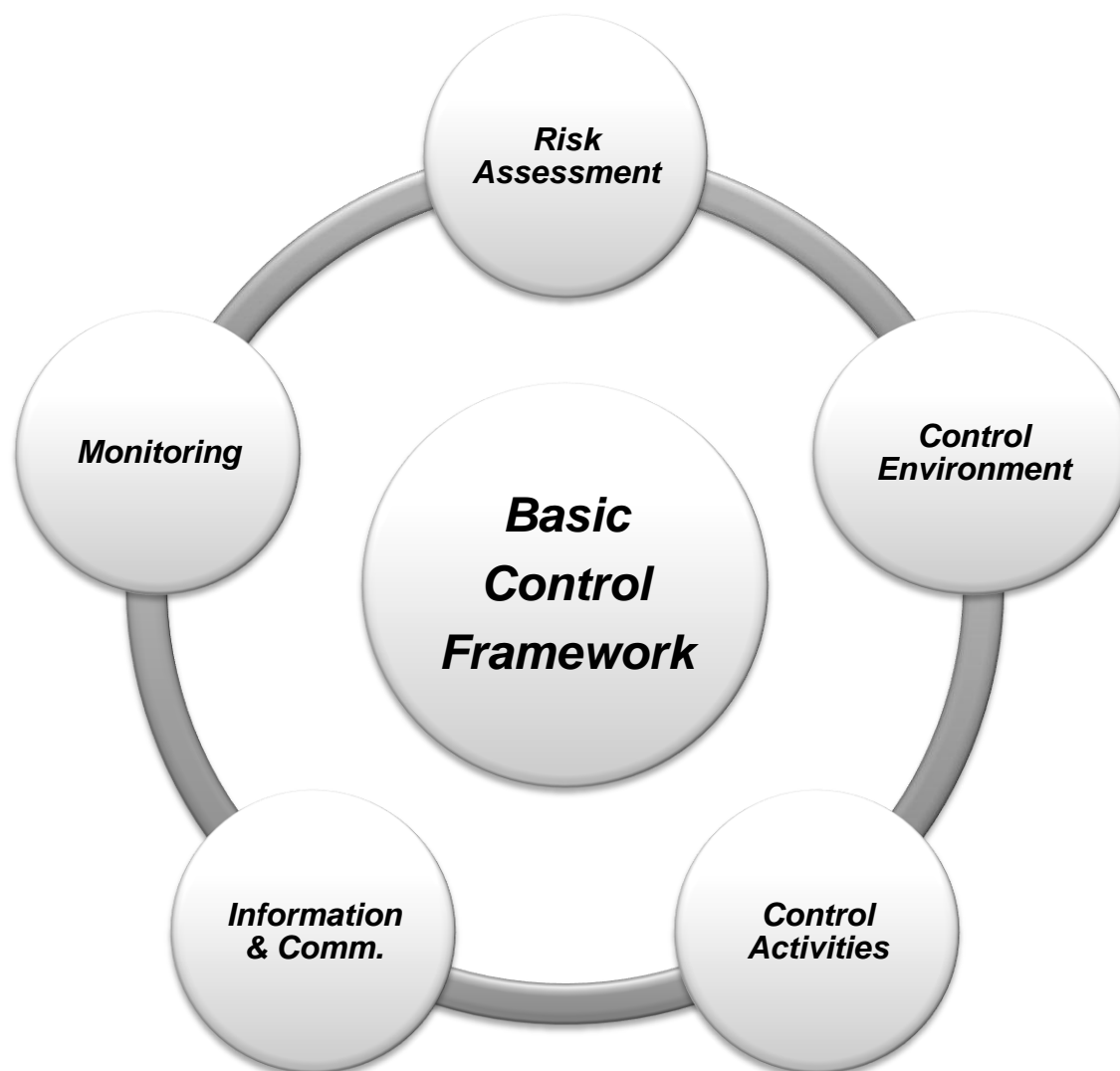
Two types of internal controls –

1. Preventive
2. Detective

Value of internal controls -

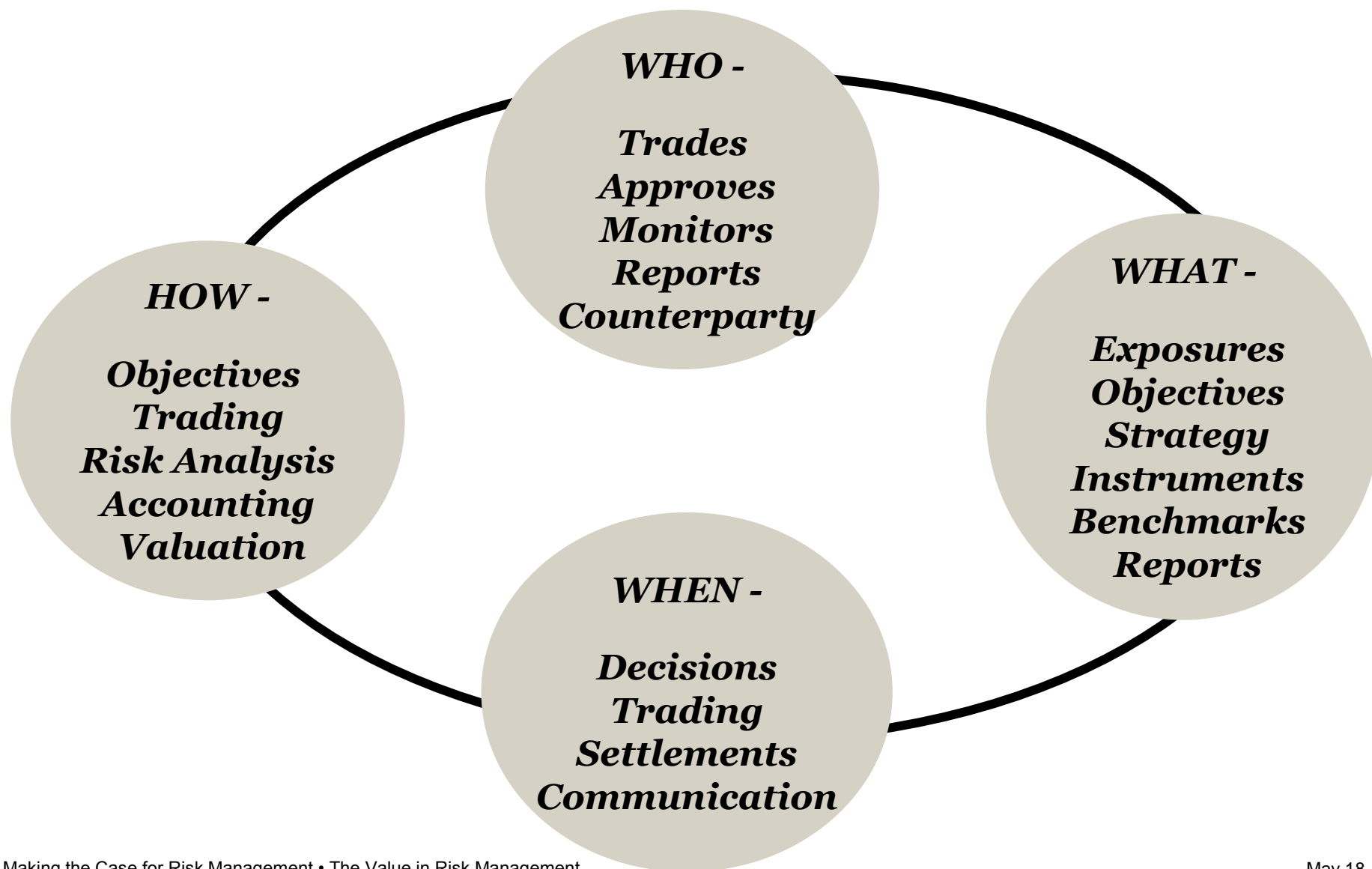
1. Disaster avoidance
2. Regulatory:
 - a) Sarbanes-Oxley
 - b) SEC
 - c) Hedge Accounting

Management reporting is a key element of control.



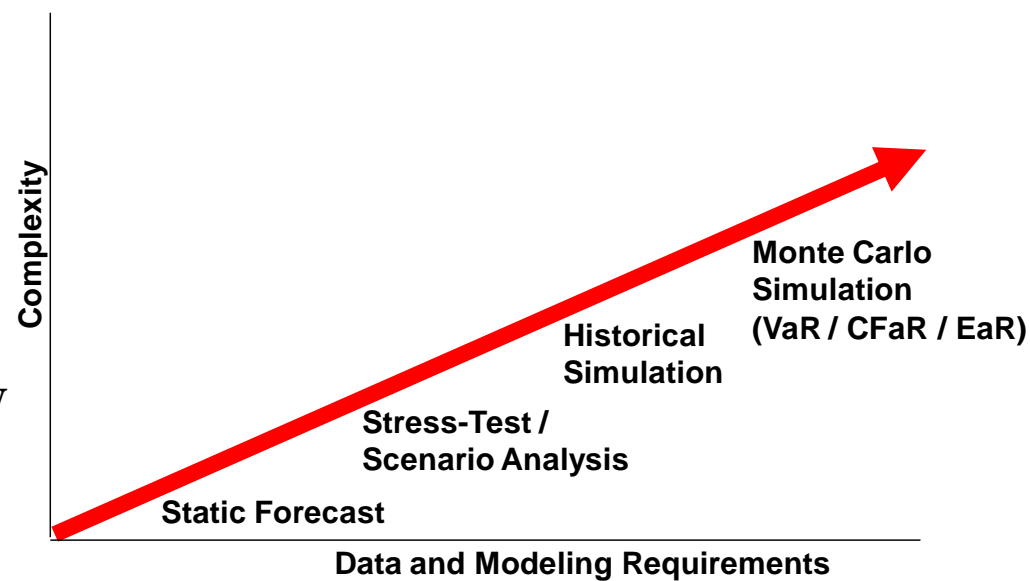
A Primary Internal Control is the Risk Management Policy

A policy outlines the following controls for risk management activities...



Risk Management Infrastructure Should be Supported by Technology

- Benefits of technology in financial risk management:
 - Greater control over information / data sources
 - Reduced manual error
- Improve controls over spreadsheet usage:
 - Catalog of files / version control
 - Limit access
 - Institute independent review / workflow
- Streamline / automate processes:
 - Valuation and accounting
 - Scenario analysis / Modeling
 - Track performance over time
 - Management reporting



Section 5

Lessons Learned

Avoid Potential Pitfalls of Ineffective Risk Management Approaches

- Paralysis by analysis
 - Sub-optimal controls
 - Management by committee
 - Lack of expertise
 - Too focused on price / market timing
- Poor communication
 - Head in the sand
 - Stop-start approach
 - Restrictive policy
 - Inadequate systems
 - Poor forecasts

1 Pitfall: Not managing risks – Inaction!

Section 6

Q&A

Section 7

Speaker Contact

About Your Speaker

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David Stowe is a manager in PwC's Financial Risk Management and Corporate Treasury Solutions practice. David assists clients on financial risk management issues, including interest rate, foreign currency, and commodity risks, as well as with general treasury management (banking, cash management, investments) and technology projects/solutions.

David has a broad and deep background in treasury, capital markets, and financial risk management. Prior to becoming a consultant, David held senior roles in treasury and financial risk management functions at Delta Air Lines as Director of cash management and financial risk where he managed Delta's global cash management operations and was responsible for both fuel price and foreign currency risk management.

David was also a Treasury Manager for The Home Depot, Inc. where he was responsible for general treasury, financial risk management, and investments. Additionally, he has worked for the Federal Reserve Bank in Atlanta in financial research, focusing on macro-economics and derivative security research, and was a quantitative analyst supporting fixed income and derivatives sales and trading for Merrill Lynch Capital Markets.

David has published articles and has presented at industry conferences on a wide array of issues in treasury, and risk management. He holds a BBA and an MS degree in Finance, and is a chartered financial analyst (CFA).

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