

Mayo Clinic: The 2020 Initiative

TheCasesolutions.com



TheCasesolutions.com



Foreign exchange Risk

TheCasesolutions.com

- What does Rio Tinto regarding foreign exchange risk?

Rio Tinto

TheCasesolutions.com

- British-Australian multinational metals and mining corporation with headquarters in London, United Kingdom.
- The company has operations on six continents but is mainly concentrated in Australia and Canada

Risk management at Rio Tinto

TheCasesolutions.com

- Groups earnings, shareholders equity and cash flows influenced by a wide variety of currencies due to geographical dispersion.
- US dollar is main currency
- Generally invest and borrow on floating interest rates. As main currencies rise and fall with commodity prices, offering a natural hedge.

At 31 December 2013

Gains/(losses) associated with 10% strengthening of the US dollar

	Closing exchange rate US cents	Effect on net earnings US\$m	Of which amount impacting underlying earnings US\$m	Impact directly on equity US\$m
Currency Exposure				
Australian dollar	89	(1,442)	21	20
Canadian dollar	94	(3,077)	30	–
South African rand	12	(4)	1	2
Euro	138	372	(22)	6
New Zealand dollar	82	51	–	–

At 31 December 2012 restated

Gains/(losses) associated with 10% strengthening of the US dollar

TheCasesolutions.com

Foreign Risk Management Plan

Three Main types of risk

- Transaction exposure
- Economic/operating exposure
- Translation exposure

TheCasesolutions.com

Transaction exposure

- The risk that currency exchange rates will change between the start of a deal and the end.
- Reducing transaction exposure
 - Forward contracts
 - Futures contracts
 - Money market hedge
 - Options
- Locking in vs. not locking in

Translation exposure

- Financial statement produced by foreign subsidiaries.
- For Rio Tinto
 - Many overseas assets
 - When currency depreciates against home currency, asset prices and cashflow drops.
- Theoretically:
 - Hold all assets in home currency
- Balance sheet hedging of net assets.

Economic/ Operating Exposure

- The result of unexpected currency fluctuations affecting a company's market value and future cash flows.
- If a currency depreciates it can purchase less decreasing supply and therefore commodity prices.
- Difficult to reduce risk as by nature it is an unexpected change.
 - Exchange rate swaps
 - Market
 - Pricing

Positives and negatives of Rio Tinto's risk management process

TheCasesolutions.com

Positives:

- As Rio Tinto does not actively currency hedge it keeps administrative costs low, and enables them to benefit from upwards swings in the market.
- As they have a fluid approach to risk management it allows them to be more interactive and take things on a case-by-case approach. This is beneficial as it gives their Risk management team lots of experience in different incidents.
- Currency risk management does not increase cash flow, in reality consumes cash flow. Thus by not regularly engaging in the practice Rio Tinto can save that cost.
- It is not theoretically possible to outguess the market. And when the market returns to equilibrium the expected net present value of hedging is zero.

Negatives:

- By not hedging and making cash flows known, it makes it more difficult to predict future cash flows. This may affect future investment opportunities
- By not reducing the risk associated with cash flows, management increases the chance that cash inflows will not be sufficient to keep the company out of financial distress.

Risk management techniques

TheCasesolutions.com

- Does not believe in active currency hedging
- Reviews exposure on a regular basis
- Utilizes currency protection where it deems appropriate
 - Aquisitions
 - Disposal
 - Tax
 - Dividends
- Example of money market hedge

Money market hedge example

Financials table for The Hershey Company

Company: Hershey Company
Reporting currency: US dollar (USD) or US dollar (USD)

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company

Company: Hershey Company