Roll Back Malaria and BCG: the Change Initiative

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Foreign exchange Risk

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- What does Rio Tinto regarding foriegn exchange risk?

Rio Tinto

- 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

- 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

Currency Exposure	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
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

Foreign Risk Management Plan

Three Main types of risk

- Transaction exposure
- Economic/operating exposure
- Translation exposure

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

Economic/ Operating Exposure

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

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.

Positives and negatives of Rio Tinto's risk management process

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.

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Risk management techniques

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- 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