ROLE OF CLEARING HOUSES AND FINANCIAL SERVICE PROVIDERS
DISCLAIMER

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Presentation Agenda

• Brief Introduction to INTL FCStone
• Why our services are needed in Europe
• Role we have played in risk management
• What services we provide in this space
• Profile of customers using these tools
• Challenges with Regulation
INTL FCStone: Some noteworthy points

- *FCStone originally established by 550 US grain co-ops*
- Merged with INTL in October 2009 to become INTL FCStone
- Now: over 20,000 commercial accounts, 32 offices worldwide, 1100+ employees
- Top 100 of Fortune 500 list of companies 2016
- No. 1 in OI for CBOT Corn futures and Kansas city wheat futures
- Top 5 in OI for CBOT soybeans and soyoil
- Top 5 in OI for NYMEX crude oil
INTL FCStone Dairy

- Purchased the No1 Risk manager in US – Downes O’Neill in 2007
- Involved in US Dairy markets since their inception
- Leading International Dairy Economists on staff
- Participant in much of the CME dairy product development
- Leading futures/option brokerage firm in Milk / Butter / Powders
- Establishment of the Cash Settled butter market
- First clearing member of the NZX
- Majority of trading volume on Eurex Dairy contracts
<table>
<thead>
<tr>
<th>Customers/Markets We Serve</th>
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<tbody>
<tr>
<td>Agriculture</td>
<td>Precious Metals</td>
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<tr>
<td>Energy</td>
<td>Base Metals</td>
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<tr>
<td>Softs</td>
<td>Food Service</td>
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<tr>
<td>Cotton/Textiles</td>
<td>Forest Products</td>
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<tr>
<td>Renewable Fuels</td>
<td>Merchant Services</td>
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<tr>
<td>Dairy</td>
<td>Livestock</td>
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<tr>
<td>Foreign Exchange</td>
<td>International Securities</td>
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</table>
32 offices | 1300 employees | 20,000 customers in more than 100 countries
Why Dairy Risk management in Europe
EU Dairy Market Price Volatility

- European Dairy Markets have become increasingly volatile due primarily to the reduction in price support mechanisms through the Common Agricultural Policy, namely:
  - Reduction in intervention levels
  - Phasing out of quotas
  - Reduction in trade tariffs

- Result is European market is increasingly influenced by world market prices

- Increased volatility has resulted in a requirement for many companies to more effectively manage their price exposures
EU Butter Price Percentage Change

% Price Change

-40% -30% -20% -10% 0% 10% 20% 30% 40% 50%

Jan 90 Jan 91 Jan 92 Jan 93 Jan 94 Jan 95 Jan 96 Jan 97 Jan 98 Jan 99 Jan 00

4 week % change 12 week % change

Source: DE/FR/NL Quotations
Reduction of price supports in the US market resulted in increased volatility.
Similar pattern in Europe?

European Butter

- EU Butter
- Intervention price (90%)
How to manage commodity volatility?

• Physical management
  – Procurement activities
    • Advance purchase
    • Storing or selling of inventories
    • Securing long term contracts with suppliers / customers

• Financial Management
  – Using futures markets to lock in a price
  – Using options to limit or cap exposure
  – Using options to create a floor or bottom on exposure
  – Using OTC markets to custom make financial products that meet your needs exactly.

• Using a combination of the strategies listed above!
Non Independent Risk Management is Difficult

Producers Want to Hedge When Prices are High (or expected to fall)

End Users Want to Hedge When Prices are Low (or expected to rise)

Milk Price History by Country
LTO EUR / 100 Kg: 4.2% Fat / 3.4% (crude) Protein
Hedging Theory

• Hedging is used to manage the effects of price volatility on businesses

• Hedging typically utilises financial markets to offset risks faced in your physical purchases and/or sales

\[
\text{Cash Market Losses (Gains)} = \text{Futures Contract Gains (Losses)}
\]
Manufacturer/Trader fixing the cost of Raw Materials when making sales contracts

<table>
<thead>
<tr>
<th></th>
<th>Cash/Physical</th>
<th>Futures</th>
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</thead>
<tbody>
<tr>
<td>SELL</td>
<td>硅1</td>
<td>硅2</td>
</tr>
<tr>
<td>BUY</td>
<td>硅2</td>
<td>硅1</td>
</tr>
<tr>
<td>Gain/Loss</td>
<td>Net Gain / Loss</td>
<td></td>
</tr>
</tbody>
</table>

(*) Cash/Physical and Futures represent different market strategies or positions related to raw materials. The numbers indicate different outcomes or market scenarios. The diagram illustrates the relationship and potential gains or losses between these strategies.
Hedge Example - Increasing Markets

<table>
<thead>
<tr>
<th></th>
<th>Cash/Physical</th>
<th>Futures</th>
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</thead>
<tbody>
<tr>
<td><strong>SELL</strong></td>
<td>€3800 + €50 margin</td>
<td>€4000</td>
</tr>
<tr>
<td><strong>BUY</strong></td>
<td>€4000</td>
<td>€3800</td>
</tr>
<tr>
<td><strong>Gain/Loss</strong></td>
<td>- €150</td>
<td>+ €200</td>
</tr>
</tbody>
</table>
## Hedge Example - Decreasing Markets

<table>
<thead>
<tr>
<th></th>
<th>Cash/Physical</th>
<th>Futures</th>
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<tbody>
<tr>
<td><strong>SELL</strong></td>
<td>€3800 + €50 Margin</td>
<td>€3600</td>
</tr>
<tr>
<td><strong>BUY</strong></td>
<td>€3600</td>
<td>€3800</td>
</tr>
<tr>
<td><strong>Gain/Loss</strong></td>
<td>+ €250</td>
<td>- €200</td>
</tr>
</tbody>
</table>
Risk Management Markets in Europe

Market Types

- Futures Exchanges
- Over the Counter (OTC) Markets
INTL FCStone Services

Futures Clearing and Brokerage

Risk Management Consultant

Market Intelligence

OTC Derivative Platform
INTL FCStone Dairy Services

1. Futures Clearing and Brokerage

2. OTC Derivative Platform

3. Market Intelligence

4. Consulting Services
1. Futures Clearing and Brokerage

• **Acting as Clearers on exchanges**
  - Providing access/accounts to commercial co’s
  - Making margin calls

• **Executing trades for clients**
  - Illiquid markets – finding buyers and sellers
EEX Dairy Trading Activity

EEX Dairy Futures Annual Cumulative Volume

As of EOD Thu, 03 Nov 2016 - Source EEX
EEX Dairy Trading Activity

EEX Dairy Futures Open Interest

As of EOD Thu, 03 Nov 2016 - Source EEX
2. OTC Derivative Platform

Innovative Solutions to meet the requirements of the markets

• European Asian Swaps trade 100-200% of the exchange traded volume

• Contracts traded
  • Monthly Average Butter Swaps
  • Monthly Average SMP Swaps
  • Milk Index Swaps (Butter/SMP indices)
  • Cheese Index Swaps (Butter / SMP Indices)

• 100% Back to back - No trading risk
3. Market Intelligence

Monthly Milk Collections

Thursday, 20 October 2016

- Combined milk production for the five major dairy exporters fell further in August, estimated at 23,679 million tonnes, down 1.34% on the 23,952 million tonnes produced in August 2015. The EU was the only one of the major producers to see an increase in production compared to last year, while NZ, Australia, and Argentina production were all lower.

- Cumulative collections for the five major dairy exporters for January to August are estimated at 182,225 million tonnes, 1.65% ahead of the same period last year, down from the 1.48% increase observed for January to July as the gap between this year’s production and last’s continues to narrow.

- EU production in August was estimated down 1.47% year on year, posting the third consecutive month that EU production has fallen behind the 2015 levels, but remains 1.80% ahead of the three year average for August collections.

- Just three of the EU top five milk producing countries saw milk collections remain ahead of 2015’s, one of which includes Spain for which there were no Eurostat data published in the previous year, and France where their decline in production from previous year’s levels is due to higher milk prices and an increase in feed grains prices. Milk production numbers may be subject to revision in the coming days when Eurostat data becomes available. Ireland and the Netherlands are the only other countries to see production up in August compared to last year.

- The UK again saw the biggest fall in production in August and is now joined by France, in terms of their cumulative collections for the year to August falling behind the same point last season with ANZAC and Faostat/Milk data pointing towards a more severe drop in production in September and October.

- Average EU milk fat content is estimated ahead of last year at 3.06% versus 3.02% a year earlier. Average EU protein content is also estimated up year on year at 0.21% versus 0.21% 12 months earlier.

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</thead>
<tbody>
<tr>
<td>EU Total</td>
<td>12,816</td>
<td>12,656</td>
<td>-1.27%</td>
<td>81,925</td>
<td>92,405</td>
<td>1.30%</td>
</tr>
<tr>
<td>Germany</td>
<td>2,729</td>
<td>2,670</td>
<td>-1.99%</td>
<td>18,775</td>
<td>19,347</td>
<td>3.07%</td>
</tr>
<tr>
<td>France</td>
<td>1,973</td>
<td>1,934</td>
<td>-1.88%</td>
<td>15,174</td>
<td>15,160</td>
<td>-0.09%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>1,347</td>
<td>1,202</td>
<td>4.32%</td>
<td>7,643</td>
<td>8,516</td>
<td>11.43%</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1,247</td>
<td>1,159</td>
<td>-7.07%</td>
<td>9,067</td>
<td>8,834</td>
<td>-2.90%</td>
</tr>
<tr>
<td>Poland</td>
<td>562</td>
<td>590</td>
<td>-1.24%</td>
<td>6,361</td>
<td>6,634</td>
<td>3.92%</td>
</tr>
<tr>
<td>Italy</td>
<td>853</td>
<td>833</td>
<td>-2.28%</td>
<td>6,246</td>
<td>6,533</td>
<td>1.53%</td>
</tr>
<tr>
<td>Ireland</td>
<td>734</td>
<td>727</td>
<td>1.62%</td>
<td>4,153</td>
<td>4,508</td>
<td>8.06%</td>
</tr>
<tr>
<td>Spain*</td>
<td>586</td>
<td>570</td>
<td>2.58%</td>
<td>3,980</td>
<td>4,075</td>
<td>2.29%</td>
</tr>
<tr>
<td>Denmark</td>
<td>461</td>
<td>455</td>
<td>-5.71%</td>
<td>3,057</td>
<td>3,177</td>
<td>3.92%</td>
</tr>
</tbody>
</table>

EU EEX Prices

Milk Production By Primary Global Producers

Thursday, 20 October 2016
4. Consulting Services

Recognised as leaders in Risk Management and regular consulting

Examples Include
• Standardized Consulting
  • Risk Management Analysis and Policy
  • Educational Programmes

Sample Once Off Consulting Projects
• Group of Dairy Co-ops: Development Dairy Index and risk management tools
• Global multi commodity cost modelling analysis
• Exchange’s- Advisory on the development of new Dairy contracts
• Co-op – Milk Price Modelling as part of internal 5 year strategic review
## Dairy Risk Management Education and Analysis Sample Programme

<table>
<thead>
<tr>
<th>Week</th>
<th>Presentation Series and Lessons</th>
<th>Parallel Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wk 1</td>
<td>Introduction to Dairy Futures and Hedging, Market Development and Challenges</td>
<td>Complete Account Opening Paperwork</td>
</tr>
<tr>
<td>Wk 2</td>
<td>Introduction to Exchanges, Clearing House, Brokers, Dairy Futures Contracts and Specifications</td>
<td>Market Information and Analysis</td>
</tr>
<tr>
<td>Wk 3</td>
<td>End User Hedge Examples and Strategies</td>
<td>Basis and Product Analysis</td>
</tr>
<tr>
<td>Wk 4</td>
<td>Monthly Global Dairy Market Outlook</td>
<td>Establish Internal Policies and Procedures</td>
</tr>
<tr>
<td>Wk 5</td>
<td>Margin and Cashflow Analysis</td>
<td>Establish a Test Trade</td>
</tr>
<tr>
<td>Wk 6</td>
<td>Basis Analysis and Strategies</td>
<td></td>
</tr>
<tr>
<td>Wk 7</td>
<td>Trader Hedge Scenarios and Examples</td>
<td></td>
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<tr>
<td>Wk 8</td>
<td>Monthly Global Dairy Market Outlook</td>
<td></td>
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<tr>
<td>Wk 9</td>
<td>Processor/Co-Op Hedge Examples and Strategies</td>
<td></td>
</tr>
<tr>
<td>Wk 10</td>
<td>Building Company Specific Risk Management Examples for the Company</td>
<td></td>
</tr>
<tr>
<td>Wk 11</td>
<td>Statistical Analysis - Correlation and Regression Analysis</td>
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<tr>
<td>Wk 12</td>
<td>In-House Working Session</td>
<td></td>
</tr>
<tr>
<td>Wk 13</td>
<td>Hedge Scenario's based on Specific Products and Markets</td>
<td></td>
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<tr>
<td>Wk 14</td>
<td>Guidelines on Establishing an Internal Risk Management Policy</td>
<td></td>
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<tr>
<td>Wk 15</td>
<td>Understanding Regulations and Compliance</td>
<td></td>
</tr>
<tr>
<td>Wk 16</td>
<td>Monthly Global Dairy Market Outlook</td>
<td></td>
</tr>
<tr>
<td>Wk 17</td>
<td>Guidelines on Establishing Internal Controls</td>
<td></td>
</tr>
<tr>
<td>Wk 18</td>
<td>Live Trading Platforms and Executing Sample Trades</td>
<td></td>
</tr>
<tr>
<td>Wk 19</td>
<td>Review Current Physical Position and Financial Market to Identify Hedging Opportunity</td>
<td></td>
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<tr>
<td>Wk 20</td>
<td>Monthly Global Dairy Market Outlook</td>
<td></td>
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<tr>
<td>Wk 21</td>
<td>Introduction to Options Contracts and Hedging Scenarios</td>
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<tr>
<td>Wk 22</td>
<td>Risk Modelling - Net Position Reports and VaR</td>
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<tr>
<td>Wk 23</td>
<td>Review Current Physical Position and Financial Market to Identify Hedging Opportunity</td>
<td></td>
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<tr>
<td>Wk 24</td>
<td>In-House Working Session</td>
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### Additional Resources

- **Brokerage and Trading Relationship**
- **Market Intelligence**
- **Integrated Risk Management Programme**
Our Customers

Diverse Portfolio of Leading Global Dairy and Food Companies

• Dairy Co-operatives-Farmers/Customers
• Dairy Processors
• End Users/Food Manufacturers
• Dairy Traders
Challenges with Regulation in developing markets in Europe
Regulatory concerns from our perspective

• Regulation being applied to commercial companies
• They are not banks!
• Just about aware of EMIR reporting
• Result in an uneven playfield favouring larger companies
• Excluding Farmers from accessing hedging market
• There is no systemic risk with these companies
• All firms are currently reporting through LEI numbers
• Why exclude these companies from hedging capability
Thank you!