



Birmingham Futures Exchange

210 Olde Towne Road
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Steel Voucher Background

The following comments by Jonathan C. Putman, Chairman & CEO of Birmingham Futures Exchange, were published in the June 28, 2007 issue of the American Metal Market.

Prior to 2004, the lawnmower manufacturer with an annual contract with Wal-Mart, the automotive door panel provider with a model-year contract, and the contractor bidding on the construction of a new office complex all locked down their steel costs, either directly or indirectly, through long-term pricing agreements with steel mills.

This process began to unravel when hot-roll prices doubled in the first half of 2002 because the threat of 15-percent Section 201 import tariffs dried up the foreign steel pipeline. Steel mills gave back some purchase orders and failed to deliver others in an attempt to avoid missing out on the much-needed increase in revenues.

The death blow for contract pricing with a mill came when hot-roll prices tripled from the fall of 2003 to the fall of 2004 because of China's enormous increase in consumption. U.S. mills boldly added surcharges to their contract prices to achieve this dramatic price increase, all the while maintaining they had honored their original contract agreements. This caused enormous cost overruns for steel users committed to providing a fixed price product to their customers. Steel consolidation has given the mills the backbone to say that they will no longer bear the risk of long term price agreements without a built in adjustment for cost fluctuations.

The net result has been to leave steel users without a viable means to lock down total steel costs for extended periods. Steel hedging provides steel users the ability to offer fixed-price contracts to their customers. Utilizing futures for any other reason is not hedging, it is simply speculating on the part of the buyer, betting that they can out-guess the market. If your customers don't need their prices tied down, don't play in the futures market. Craig Bouchard, Wheeling-Pittsburgh Corp.'s vice chairman and president, is correct when he says, "There has to be an underlying piece of steel somewhere. The underlying component adds the tangible, measurable guts to a product that is traded across the world. And a synthetic can be manipulated with bad information. The synthetic, I don't think, will have the confidence with the real derivative players." This was most evident in November 2004, when CRU International Ltd. and Purchasing Magazine, two of the world's most respected steel indices, published hot-roll prices with a \$74-per-ton difference. This became a \$740,000 difference of opinion on a 10,000-ton hedge.



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The only way to avoid this problem is to base all transactions on only one index. This is essentially what the aluminum industry has done with the London Metal Exchange. Virtually all purchase prices are based on LME plus or minus some factor. That is why Nucor Corp. chairman, president and chief executive officer Dan DiMicco says steel futures will allow the financial markets to set steel prices rather than steel mills.

Lakshmi Mittal, ArcelorMittal's president and chief executive officer, is absolutely correct when he says that steel futures will not curb price volatility. They won't. They might even make it worse. They simply will allow users the opportunity to avoid the impact, plus or minus, of that volatility. That is a benefit worth pursuing.

This brief history highlights 3 critical issues that steel vouchers were designed to address:

1. Steel mills will no longer accept the risk of long term pricing
2. Steel mills do not want to give up their pricing power to an external index
3. Steel buyers need a method to hedge their price risk without basis risk

FCStone Agreement.

For the purpose of creating and implementing a Steel Voucher market, BFEX has signed a Letter of Intent with FCStone Trading, LLC ("FCStone") dated August 29, 2007 which states that FCStone will research, and if viable develop, a trading platform for Steel Vouchers. Such a platform is anticipated to include forward sales, options, and OTC swaps. If the trading platform is deemed to be viable, FCStone will develop a commercially reasonable method for posting such information about bids, offers, and trades. FCStone will evaluate a variety of distribution methods for providing the information to the marketplace, including but not limited to email and possibly an internet based continuously updated forward price curve. The development of said platform shall be subject to the rules and regulations of the Commodity Futures Trading Commission.

About FCStone Group, Inc.

FCStone Group, Inc., along with its affiliates, is an integrated commodity risk management company providing risk management consulting and transaction execution services to commercial commodity intermediaries, end-users and producers. The firm assists primarily middle market customers in optimizing their profit margins and mitigating exposure to commodity price risk. In addition to risk management consulting services, FCStone, LLC, operates one of the leading independent clearing and execution platforms for exchange-traded futures and options contracts. FCStone Group, Inc., serves more than 7,500 customers and in the 12 months ended May 31, 2007, executed 54.1 million derivative contracts in the exchange-traded and over-the-counter markets. In addition to renewable fuels, the FCStone Group companies work in all the major commodity areas including agriculture, energy, foods, forestry, and currency exchange. Headquartered in the Midwest, it has offices located throughout the world



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and is a clearing member of all major North American Futures exchanges. FCStone Group, Inc., trades on the NASDAQ Global Select Market under the symbol "FCSX."

Steel Voucher Definition.

A Steel Voucher is a prepaid coupon acceptable at the issuing mill in payment for a pound of base steel, including surcharges. Each producing mill defines base steel just as it always has done. Each mill negotiates extras for gage, width, quantity, chemistry, delivery, etc. which are paid for separately by the purchaser.

When a voucher is submitted to the mill through its account at FCStone, the voucher is immediately put back to the market and sold at the then current market price. This insures the mill that it receives the current spot price in cash to settle the invoice, regardless of the original sales price of the voucher.

Summary.

It is in the best interest of steel users to be able to limit their exposure to price fluctuations in the US domestic steel market through long term pricing commitments. Likewise, it is not perceived to be in the best interest of steel mills and their stockholders to assume this risk by offering these long term commitments.

Existing commodity and/or futures exchanges can provide an environment for long term pricing commitments if there exists a market price indicator for US domestic steel. This price indicator must provide a reasonable settlement mechanism and must take into account the fact that each producing mill has a unique product and a unique value. The producing mills must be able set their own prices and the price indicator must reflect the mill's prices for its unique products.

The utilization of Steel Vouchers as a proxy for finished steel, traded on a Steel Voucher Exchange, is the only viable mechanism for accomplishing all of the necessary requirements of a market price indicator for US domestic steel. It is the unique properties of the Steel Voucher that allows it to simultaneously provide fixed contract pricing for steel users and spot market prices for steel producers.

It is in the best interest of both steel users and steel mills to support the creation of a robust and viable steel futures market that utilizes this appropriate price mechanism.

Steel Mill Agreement.

Accordingly, Participating Steel Mills and BFEX agree as follows:

1. Participating Steel Mills will open a trading account with FCStone for the purpose of selling Steel Vouchers utilizing FCStone's Steel Voucher Trading platform in accordance with and subject to the rules and regulations of the Commodity Futures Trading Commission.
2. Participating Steel Mills will make an Initial Voucher Offering (IVO) of approximately 5% of Participating Steel Mills' projected annual sales volume by



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product. This IVO is currently projected to approximate 700,000 tons of sheet steel vouchers at \$600/ton for \$420 million.

3. Participating Steel Mills will make additional Voucher Offerings as needed to insure an adequate supply of vouchers to serve as the currency of the steel price hedging market, provided that these additional offerings do not dilute the market and cause the market value of said vouchers to fall below current Participating Steel Mills invoice prices.
4. Participating Steel Mills will accept vouchers as payment for the base price, including surcharges, of eligible steel invoices. Participating Steel Mills will add the necessary language to their order acknowledgements and invoices to inform their customers of the option to pay by voucher and clearly indicate the steps necessary to settle the invoice with vouchers. Participating Steel Mills will retain the right to disallow voucher redemption as a part of price negotiations with their customers, especially as it relates to long term pricing agreements.
5. BFEX will be responsible for enlisting additional steel mills to sell their vouchers on the FCStone platform to enhance the steel price discovery mechanism.
6. BFEX, together with FCStone, will be responsible for pursuing the creation of steel futures contracts denominated in steel vouchers, either individually or as a weighted index, with existing commodity exchanges.
7. BFEX will collect a royalty fee of one basis point (.0001) of the notional value of every steel voucher denominated transaction from the broker/exchange where the transaction takes place. This fee will apply as well to any and all futures contracts regardless of the exchange or broker involved.
 - a. While BFEX agrees to use all commercially reasonable efforts to negotiate this royalty fee, the parties acknowledge any royalty fee must be negotiated separately with any applicable exchange or broker.
 - b. BFEX will pay to Participating Steel Mills 50% of the gross royalty receipts collected on products denominated specifically in Participating Steel Mills vouchers.
 - c. BFEX will pay 50% of the gross royalty receipts collected on products denominated in a blend or average of multiple mill's vouchers to the participating mills, prorated based upon each mill's outstanding vouchers in the various products traded.

Steel Voucher Index.

The extreme volatility of steel prices over the last 25 years has created the need for a market mechanism that will allow steel producers and consumers to hedge their exposure to price fluctuations, allow long term investors in world wide commodities to participate in the metal's appreciation, and facilitate short term investor participation in an active market.

The BFEX Steel Voucher Exchange (SVE) is designed to provide vouchers from its member mills as a proxy for steel coils in the financial marketplace without the substantial costs of transportation, storage, and deterioration associated with alternative physical delivery mechanisms. End users will be able to select their specific mill of



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choice and have the steel produced to their exact specifications. In addition, hedge positions will enjoy excellent price correlation (100% correlation if final purchase is from the SVE mill).

These vouchers will accurately convey the current value of base metal at the individual SVE mills (including surcharges), because they can be used in lieu of cash for settling open invoices, thereby creating a guaranteed market made up of all the mill's active customers. If the voucher price should begin to fall below the current invoice price (including surcharges), these customers will begin to buy them for use in settling their open payables. This will apply upward price pressure until the voucher once again approaches current value. This market driven mechanism will also cause the voucher price to reflect the highest invoice prices, not the average. In addition to pricing differences, the variation in individual mill voucher values will also reflect the marketplace's evaluation of quality, location, and reliability of delivery.

It is the intention of BFEX and FCStone to publish a Steel Voucher Index based on the weighted average of all outstanding vouchers for the indicated product. This will yield a current market price for generic domestic steel. This price will be used to publish the Steel Voucher Index (SVI) providing the benchmark for US steel prices on a daily basis.

Steel Futures Based on the Steel Voucher Index.

The SVI is calculated by populating the deliverable of a 20 ton steel futures contract with the prorated weight, to the nearest pound, of all the participating mills for that product. The weights are then extended by the current voucher price to determine the total value of the 20 tons. This number is divided by 20 and rounded to the nearest penny for the current SVI value.

Steel Voucher Index for Hot Roll Steel								
Outstanding Steel Vouchers						Futures Contract		
Steel Company	Mill	Product	Capacity	5%	% of Total	40,000	\$/ton	\$/Contract
Bigco	City 1	HR	1,740,000	87,000	12.43%	4,971	592.00	1,471.42
	City 2	HR	2,080,000	104,000	14.86%	5,943	590.00	1,753.19
	City 3	HR	2,240,000	112,000	16.00%	6,400	588.00	1,881.60
	City 4	HR	2,400,000	120,000	17.14%	6,857	592.00	2,029.67
Midco	City 5	HR	2,200,000	110,000	15.71%	6,286	613.00	1,926.66
	City 6	HR	1,820,000	91,000	13.00%	5,200	615.00	1,599.00
Smallco	City 7	HR	1,520,000	76,000	10.86%	4,343	610.00	1,324.62
	Total		14,000,000	700,000	100.00%	40,000	600.00	11,986.15
						Weighted HR Steel Voucher Index \$/ton:		599.31

A short futures contract that goes to delivery will be required to deposit the 40,000 pounds of vouchers indicated in the index into the long's account. The long is free to convert the various mills' vouchers by simply selling the undesired ones and buying the preferred mill's vouchers. This will reintroduce basis risk to the long as the total pounds



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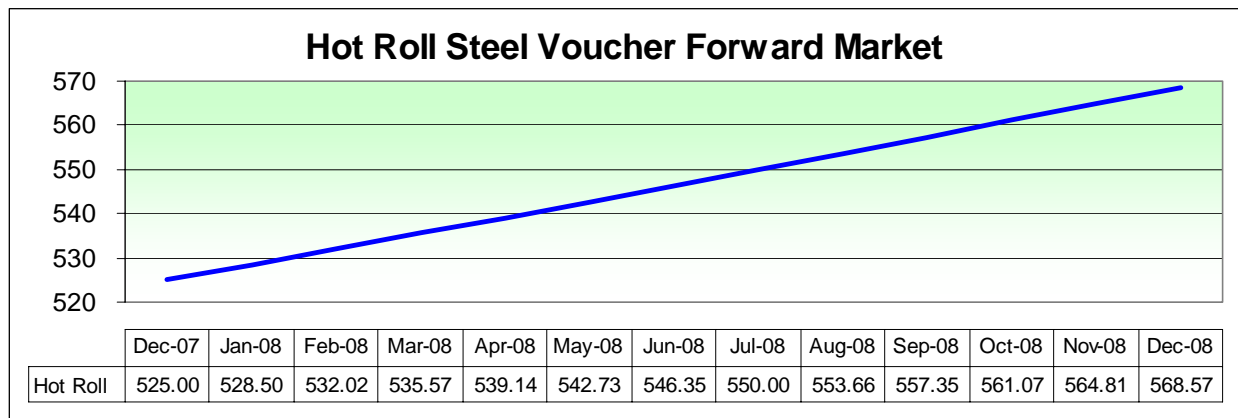
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will probably no longer equal 40,000. Because of this, steel hedgers may prefer to buy vouchers forward in the specific mill of choice.

Steel Voucher Forwards

The FCStone Steel Voucher Platform will offer forward sales of steel vouchers over an initial 24 month period. This will be a cost of carry market supported by the initial voucher offering of the participating mills. These transactions will require margining except in the case of a seller who deposits the actual vouchers in an FCStone escrow account. In addition to providing the necessary forward curve for marking to market, this forward market will provide the arbitrage opportunity needed to reconcile current and forward voucher prices with the components of the futures contract based on the Steel Voucher Index, thereby insuring continuous price discovery and conversion for the steel futures contract and the voucher deliverable and its direct connection to current steel prices.

Steel Price Hedging Examples Utilizing A Forward Voucher Market



All examples use the simulated data in the above chart.

Construction Project

Market Issue: Contractor wins a bid to build a new bridge. He used the voucher forward curve to estimate steel cost of \$542.73 a ton based on a May 2008 delivery. He must now lock in his cost and would prefer not to tie up his capital buying the vouchers today.

Voucher Solution: Contractor buys forward vouchers for May delivery at \$542.73 a ton to cover his projected cost and posts the required margin, which is only a fraction of the final purchase price. To avoid any potential basis risk (the difference between the voucher price and steel invoice) he decides to make the voucher mill his preferred supplier. When the steel is delivered in May he settles his forward voucher purchase for \$542.73 and pays his steel bill with vouchers. Whether steel prices rise or fall the contractor enjoys the budgeted steel cost and has avoided leaving his bottom line at risk due to increasing steel prices.