Commodity Price Risk Hedging Policy

Chiho Environmental Group Limited

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Preamble:

The most important business risk within the Group arises from price changes related to commodities. Hence, the management of commodity price risks is essential to our risk management.

1 Background

The company generates revenue mainly from the sale of products after we process mixed metal scraps.

Our profit is the margin between:

Purchase cost of mixed metals on market price
+ processing costs
= Costs of production

Recovering (i.e.: yield) of mixed materials
x Quantity (ie: tonnage) of the recycled scrap products
x with market price
= Revenue

The pricing of (i) mixed metals scrap and (ii) the recycled metal products follows generally the movement of the Commodity Market on those established exchanges such as the London Metal Exchange ("**LME**"), New York Commodities Exchange ("**COMEX, CME** Group") and the Shanghai Futures Exchange (**"SHFE").** The correlation between the exchanges and the mixed metals scrap / recycled metal products will be checked on a regular basis.

Any price movement during our processing time will affect the profit/loss of our operations.

2 Calculation of Risk Position

The scope of this Policy covers all the Group's legal entities, including its subsidiaries and affiliates.

To cover part of the open risk with **synthetic** trades (hedging instrument) we need to calculate the risk exposure first. A uniform way of risk evaluation to determine the Group´s position is essential. Hence, information need to be provided to support a **Commodity Risk Manager**, who will perform calculation on risk position as follows:

- Details of the daily purchases and sales
- Monthly stock/ inventory on hand (including Inventory in our warehouse, materials on ships, materials in Custom's yard, etc.)
- Contract and stock detailed with the approximated yield of metal from each type of scrap product. (i.e. the expected recovery)

+ Plus: Open purchase contract with fixed price
+ Plus: Materials on ship with fixed price
+ Plus: Materials in Custom clearance with fixed price
+ Plus: Materials in front of release
+ Plus: Mixed scrap in our yard (inventory)

+ Plus: Finish products in our warehouse (inventory for sale)
+ Plus: Buy back temporal sales (Synthetic) (buy LME minus Discount at arrival of the Ship)*
+ Plus: Purchase Futures from an Exchange (Synthetic)
+ Plus: Purchase Call-Options (Synthetic)
= **LONG** Position in price risk

- Minus: Physical sales with price for delivery forward
- Minus: Sales **temporal*** (Synthetic) (Sell LME minus discount at departure of the ship)
- Minus: Sales to an Exchange (Synthetic)
- Minus: Purchase of Put-Options (Synthetic)
= **SHORT** Position in price risk

LONG minus SHORT = Open Risk Position (in tonnage)
SHORT divided LONG = Risk Coverage (in percent %) = **Hedge Quote**

*(*Temporal sale: After loading on ship, we sell basis LME minus a discount. When the shipment arrives at the destination port, we buy the scrap back with LME minus another discount. The company therefore is not subject to any price risk during the voyage/ shipping period.)*

3 Procedure

On daily basis, the Commodity Risk Manager gathers the NEW Purchase and Sales Contracts information with details in excel form. The Purchase Manager and the Sale Manager of a reporting unit are responsible for data correctness and timely delivery of the requested information.

On monthly basis, the Commodity Risk Manager gathers all the OPEN Purchase and Sales Contracts with details in excel form. The Purchase Manager and the Sale Manager of a reporting unit are responsible for the data correctness and timely delivery of the requested information.

On monthly basis the Commodity Risk Manager getting all inventory figures including goods in transit from Finance and the Purchase Manager.

The Commodity Risk Manager (or his designate) summarizes the information above and reports 2 key data daily to the Members of the Pricing Committee: (i) Open Risk Position in Tonnage and (ii) Risk Coverage in Percent.

Based on the market situation, the Pricing Committee gives each key commodity a range of target for the maximum Open Risk Position in tonnage and Risk Coverage in Percent (Hedge Quote). This resolution has to be forwarded to the Risk Manager for implementation.

4 Instruments

The Risk Manager executes the hedging for the risk as a whole ("Marco Hedge"). The Risk Manager is delegated to reduce our OPEN Position (i.e.: Exposure) by using the following Instruments:

- Futures contracts based on LME, COMEX, SHFE
- OTC Futures contracts based on LME, COMEX, SHFE, TSI (Ferro), Platts. (and other reputable Index to be agreed by the Pricing Committee).
- Temporal Sales to be agreed by the Pricing Committee

- Buying Options to be agreed by the Pricing Committee. However, closing them by selling these Options is allowed by the Risk Manager.
- Selling Options (and their closing subsequently) to be agreed by the Pricing Committee.
- Using other kind of instruments have to be discussed and approved by the Pricing Committee.

5 Objectives

Given of our business incurs a LONG position. Physical and synthetic instruments (with the following orders of preference) are only allowed to reduce our risk. It is strictly forbidden to increase our exposure by synthetic trades.

1. Physical Sales (preferred)
2. Temporal Sales
3. Futures
4. Options

On daily basis, the Commodity Risk Manager should manage to meet the Hedge Quote target instructed by the Pricing Committee.

We will trade futures contracts only in the organised markets. Our hedging partners could be either Brokers or Bankers with good credit ratings. The ratings have to be checked one time a year.

Only the "Board of Directors" are allowed to open new hedging accounts with Broker or Banks. The Pricing Committee is delegated to source and contact new partners.

The Pricing Committee will nominate authorized Traders who will place orders with brokers (see the trader list on last page).

To avoid OVER HEDGE, the Pricing Committee will give a **maximum** target of Hedge Quote up to **90%.** *(Notes: A 100% full hedge is not necessary because there are always some variances of yield % of metals in the scrap metal purchase and sales contracts)*

If the Risk Manager is not able to fulfil the Hedge Quote, he has to inform the Pricing Committee immediately.

6 Responsibilities

Interdisciplinary approach with continuous communication among various parties is an important success factor.

Board of Directors

- Implementation of the overall risk strategy
- Definition of the overall maximum risk position
- Open new broker accounts

Pricing Committee

- Implementation of the overall risk strategy

- Definition of the overall maximum risk position
- Option Strategy
- Risk Strategy
- Regular meeting/ telephone conference (minimum on a monthly basis) or at short notice in case of significant market changes
- Definition of the group-wide maximum risk within the divisions copper, ferrous, aluminium scrap, aluminium ingots
- Distribution of the meeting Minutes to the Board of Directors
- Work out proposal for trading and risk strategy
- Nominate authorized traders for execution of hedging trade
- Review the Risk Position or Exposure reports on a regular basis

Department Heads of Purchase and Sales

- Implement the approved risk strategy in each subsidiary
- Responsible for reporting data timely and accurately, administrating and extracting them from the inventory control system
- Each regional business unit (or sub-group or subsidiary or trading team) has to nominate a person as its **Position Manager**
- The Position Manager designated by the Department Heads should be the persons in the Department to receive immediate notification of purchasing and sales contracts concluded and final allocation of the different commodities of materials. The Position Manager should also be responsible for the accuracy of the data submitted to the Risk Manager.

7. Broker accounts / Broker lines

The usage of the broker's facility lines depends on (i) the physical trading volume that needs to be hedged and (ii) the span-margin (Initial Margin) which is published by the LME on a regular basis. Hence, the broker's lines need to be sufficiently sized to avoid potential margin calls. In addition, at least 2 broker accounts should be in place for price comparison whenever possible.

8. Synthetic broker transaction

Strategy:

- Synthetic broker transactions are to be exclusively used in order to reduce the physical risk position and the commodity price risk.
- Micro-hedges strategy is possible on single contract/ aggregate volume.
- In all cases the volume of the broker transactions must not exceed the volume of the underlying physical transactions. In addition, the volume has to meet the target of the Hedge Quote (i.e.: no over-hedge).
- We do not trade "Proxy" Hedges. We stay with our underlying commodity.
- The hedging contract should have the same period (year's quarter) as the physical transactions.
- Profits/losses from the hedging transactions should be realized in the same period (year's quarter) like the profits/losses from the physical contracts.
- An extension/rolling of hedging contract is possible in case of delays within the physical contract.
- Carries based on original contract price need to be approved by the Pricing Committee.

The overall risk position must not be increased by hedging transactions. Therefore, the following transactions are prohibited:

- Synthetic contracts (LME or OTC) without any physical underlying
- Hedging transactions with a volume exceeded the normal business.

Type of hedging transaction:

For normal hedging, we only use Futures contracts based on LME or OTC. Any other type of hedging transactions (like using options and other structured products) is not allowed before approval of the Pricing Committee.

Basic rules for conclusion and documentation of hedging transactions:

I. The 4–Eye principal (i.e.: segregation of duties between preparer and reviewer) must be followed at the closing / opening of each hedging transaction.

II. Some details between the physical/ underlying assets position and synthetic hedging transaction (via LME or OTC, for example) with the be crossed checked regularly, says for every 3 months:
   - Market prices
   - Expiry dates
   - Volume or quantity required

III. Based on the II above, the valuation of the physical position will be built.

Authorized persons:

Transaction only can be traded by authorized persons with the relevant experience. These people are specified by the Pricing Committee within the account opening and account administration process. The number of authorized people has to be kept on a very restricted basis at all times.

An overview of all brokers should be in place, and the authorized persons must be available at any time.

Transaction for subsidiaries and third parties:

The authorized persons should be entitled to arrange hedging transaction for subsidiaries. Basis for the transactions is the signing of a framework agreement between the two parties. The hedging transactions need to be documented in time and in a comprehensible way for later independent review.

Transactions for third parties are generally not allowed. Exceptions need to be approved by the Pricing Committee.

9. Information undertakings

The following need to be reported promptly to the Pricing Committee

- Cancellation of a hedging line
- Transactions which are not covered by the guideline
- Transactions which had been settled by non-authorized persons

Contacts:

Board of Directors

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Pricing Committee

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