TREASURY RESOURCES
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Using Interest Rate Derivatives to Minimize the Impact of Rising Interest Rates

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Presentation Overview

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- Interest Rate Swap
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- Swaption
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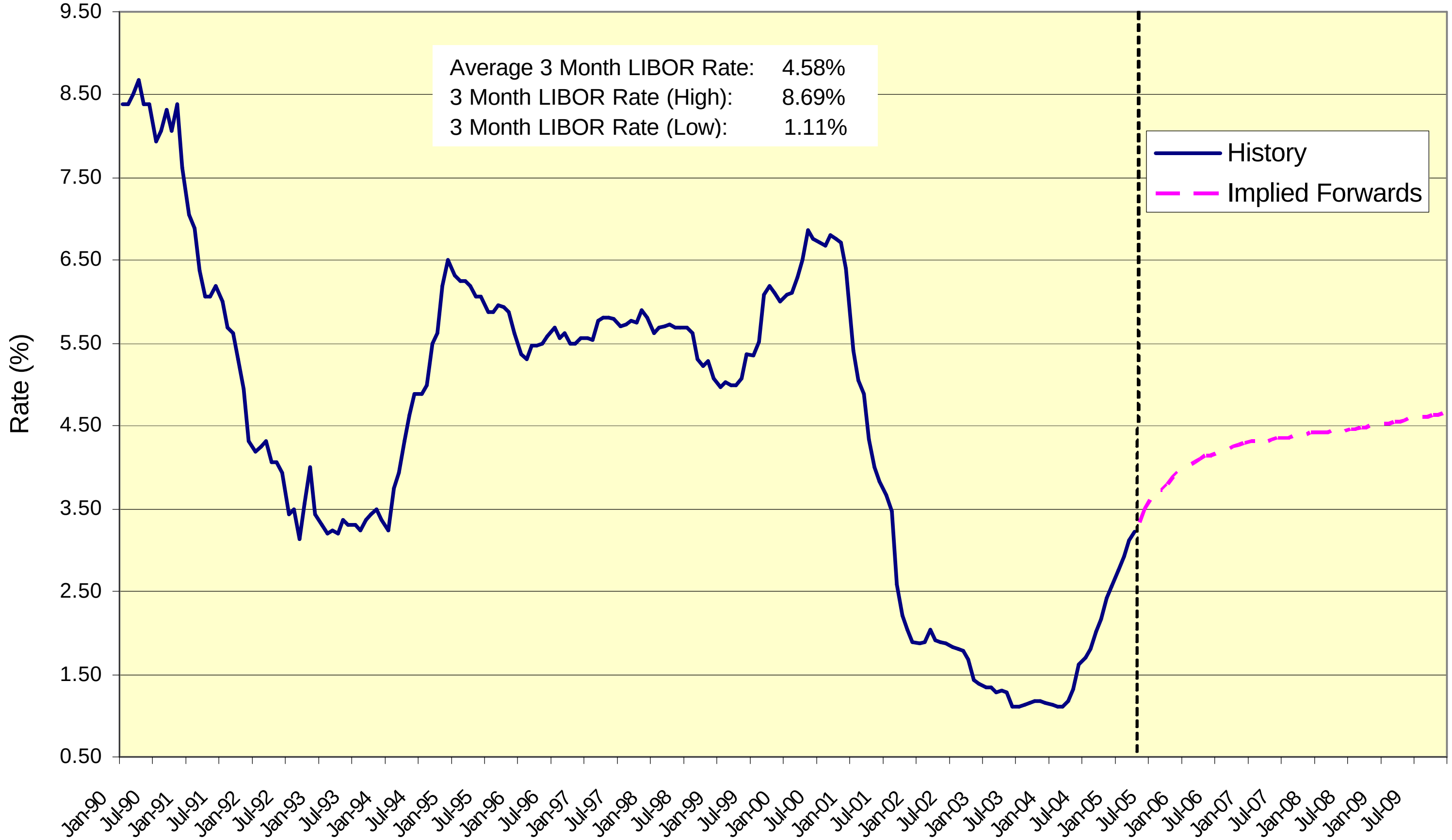
- Interest Rate Cap
- Interest Rate Collar
- Interest Rate Corridor
- Applications

Interest Rate Analysis

- Currently, one-month LIBOR is 3.09%, and three-month LIBOR is 3.29% (up from 1.10%, and 1.11% one year ago).
- At the May 3rd FOMC meeting, Federal Reserve policy makers raised the federal funds rate by a quarter-point to 3.00%. The Committee restated their plan to raise rates at a "measured" pace and mentioned that inflation risks are rising, stating “pressures on inflation have picked up in recent months and pricing power is more evident".
- The market (based on Eurodollar futures) is currently expecting three-month LIBOR to be at roughly 4.15% one year from now, and at roughly 4.35% in two years.

Three-month LIBOR: Past and Projected



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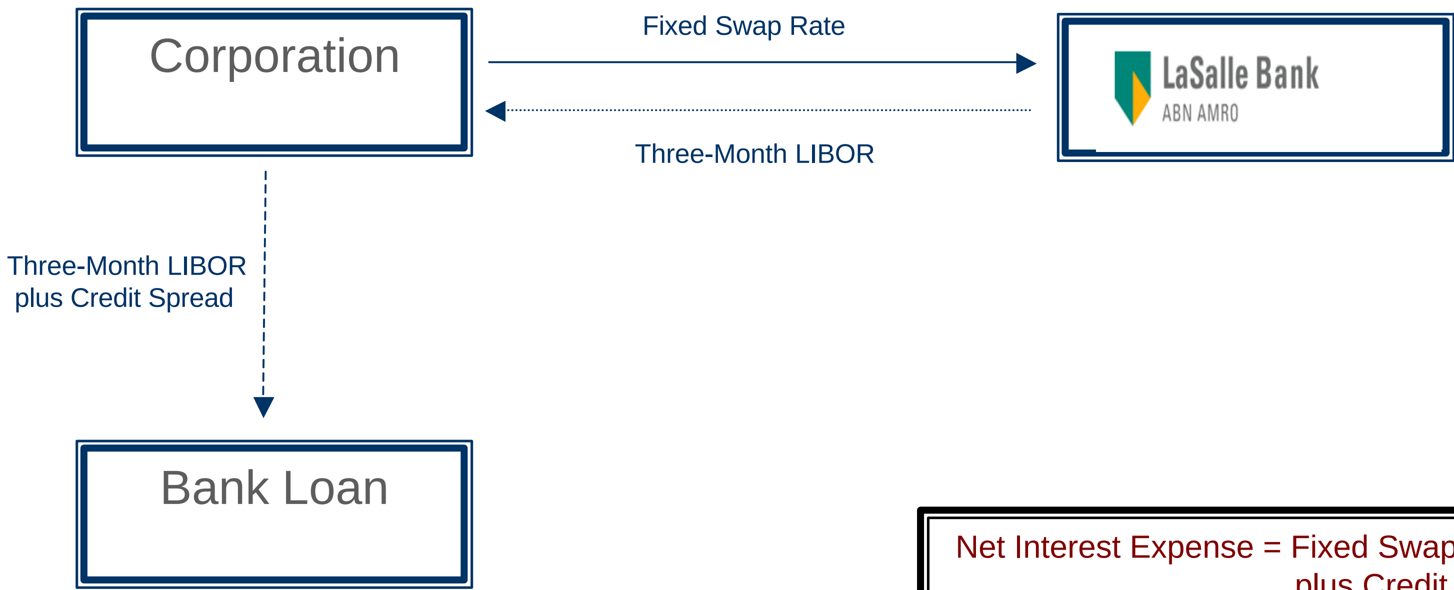
Interest Rate Swap

A contractual agreement between two parties in which the parties agree to exchange cash flows representing interest payments on an underlying notional principal amount for an agreed upon term.



Net Interest Expense = Fixed Swap Rate plus Credit Spread

Forward Start Interest Rate Swap

An interest rate swap that begins on a specific date in the future, but the fixed rate is set today.

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Swaption

Company has the right, *but not the obligation*, to pay fixed in an interest rate swap that begins on a specific date in the future, but the fixed rate is set today. Company pays a premium for this option.

Today

- Premium Due
- Determine Fixed Rate

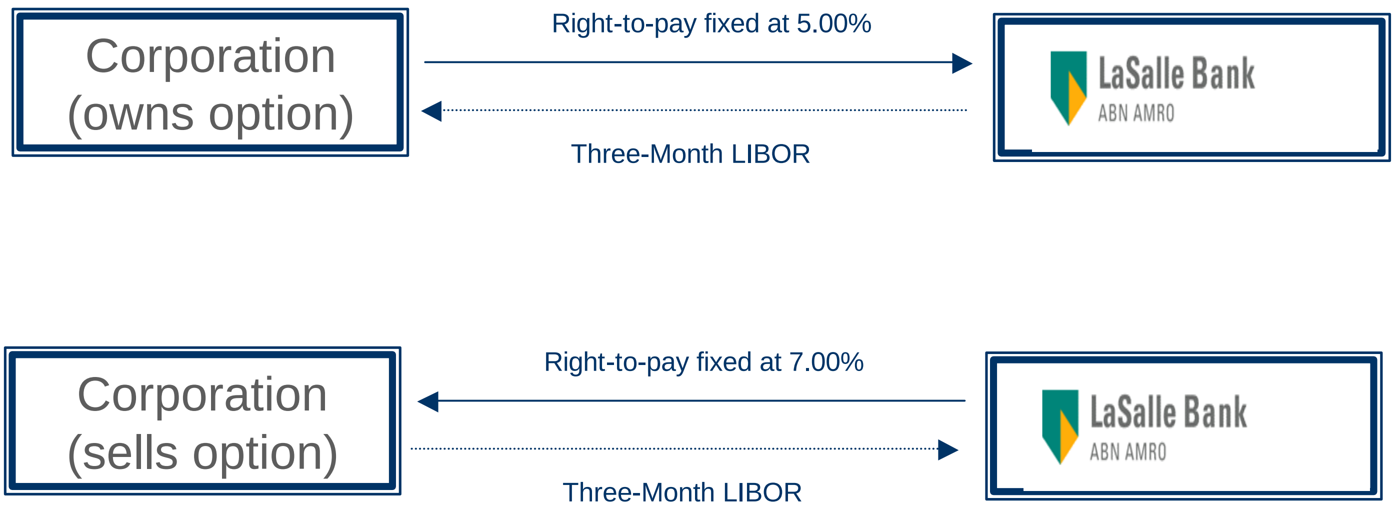
Swap Start Date

- Decide to enter into swap?

Swap End Date

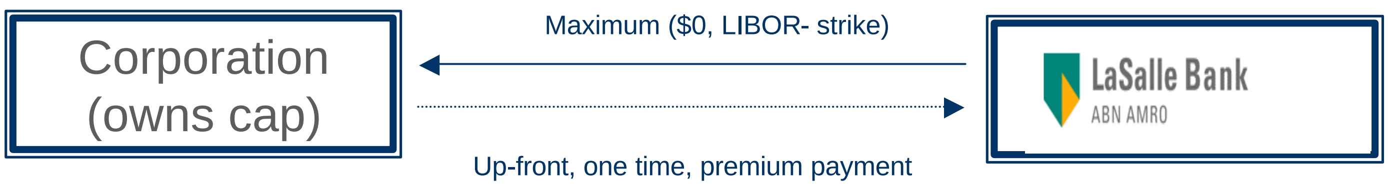
Swaption Corridor

Company buys a right-to-pay swaption, and sells a right-to-pay swaption with a higher strike. Company is limiting its protection to future increases in the swap rate. However, the company pays a lower net premium for this structure.



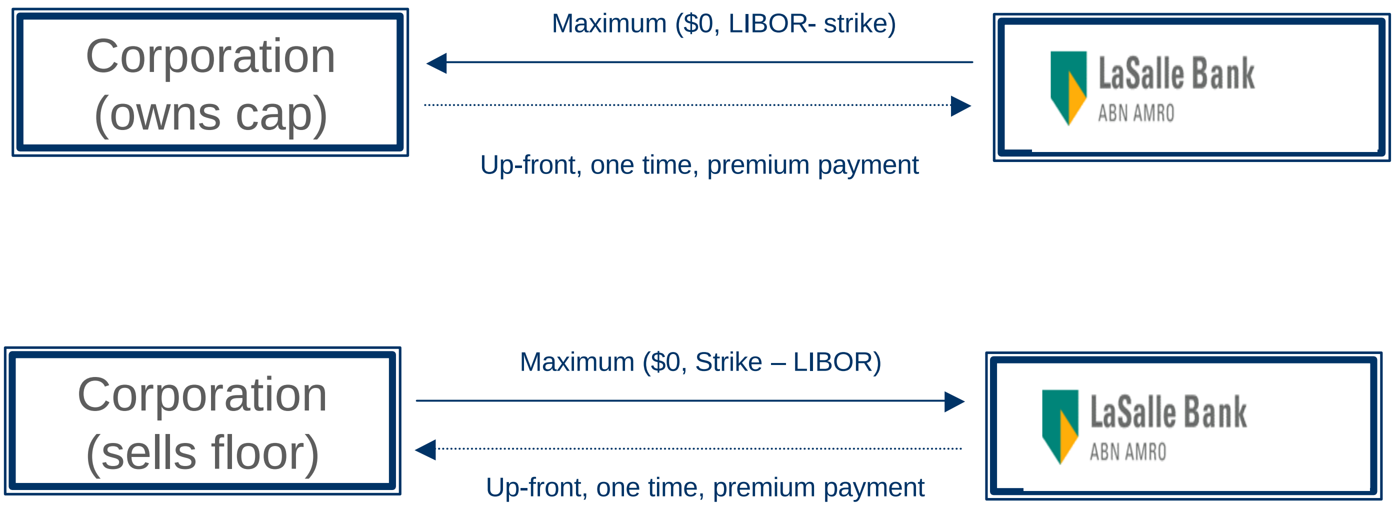
Interest Rate Cap

Company pays a premium in exchange for the right to receive a payment if LIBOR is set at a level greater than the strike rate.



Interest Rate Collar

Company purchases a cap and sells a floor to form a collar. The net premium can be reduced to zero by choosing the strike rates that allow for the cap and floor premiums to be equal.



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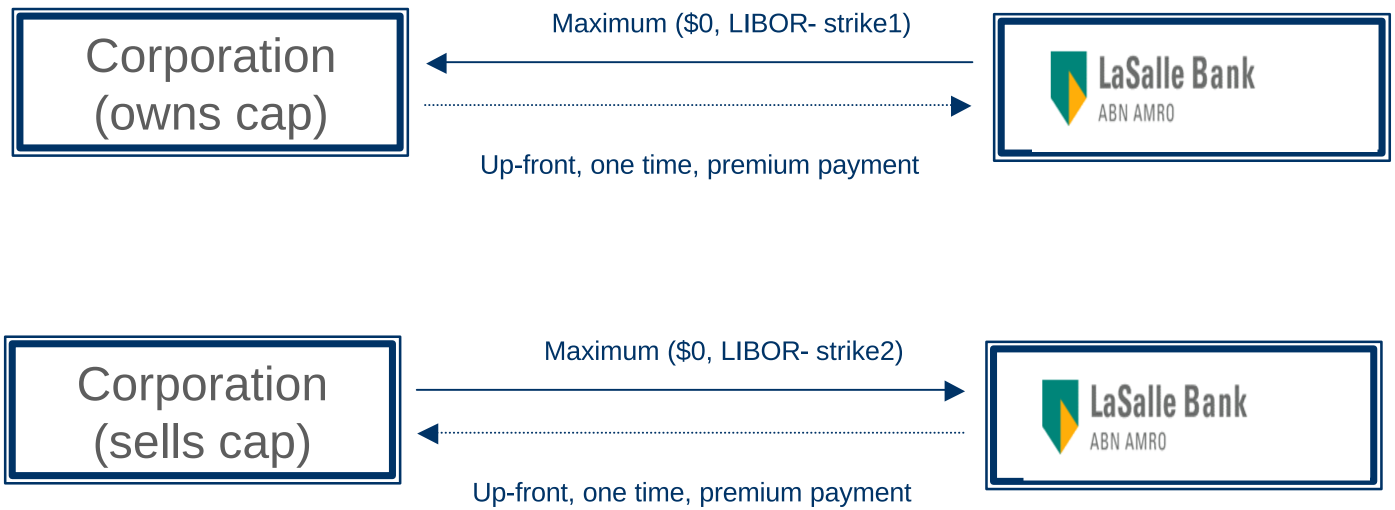
Interest Rate Corridor

Company buys a cap with a low strike and sells a cap with a higher strike. The company limits their benefit to increases in LIBOR above the higher strike. However, the company pays a lower net premium for this structure.



Strike1 is lower than strike2

Applications

- Attain financial goals

  The use of hedging instruments increases the certainty of cash flows which enhances a corporation ability to meet stated financial objectives, such as EPS, EBITDA, and ROE.

- Hedging a floating rate loan

  Interest rate swaps, caps and collars all place limits a corporation's exposure to increases in short term rates.

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Applications (continued)

- Pre-hedge future fixed rate financings

  Forward starting swaps are an effective tool to protect against an increase in interest rates prior to the issuance of fixed rate debt.

- Preserve cost of capital in a bidding situation

  The use of swaptions allows a corporation to place an upper bound on its cost of capital in situations where the need for financing is uncertain. Examples include acquisitions, and requirement to provide client financing with equipment sales.

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