



# PRICE RISK MANAGEMENT AS A MARGIN DRIVER FOR THE PULP AND PAPER BUSINESS

16th Day of Slovene Paper Industry  
21<sup>st</sup> November, 2012

*Making it possible*

## *PRICE RISK MANAGEMENT AS A MARGIN DRIVER FOR THE PULP AND PAPER BUSINESS*

- **Introduction to Nordea Bank**
- Why Price Risk Management?
- Pulp market outlook

# Nordea Bank- The largest financial services group in the Nordic & Baltic region

## ✓ 11 million customers

- 9 home markets
- Approx. 10.5 million personal customers
- 500,000 corporate customers, incl. Nordic Top 500

## ✓ Distribution power

- More than 1,000 locations in total
- 6.6 million Netbank customers

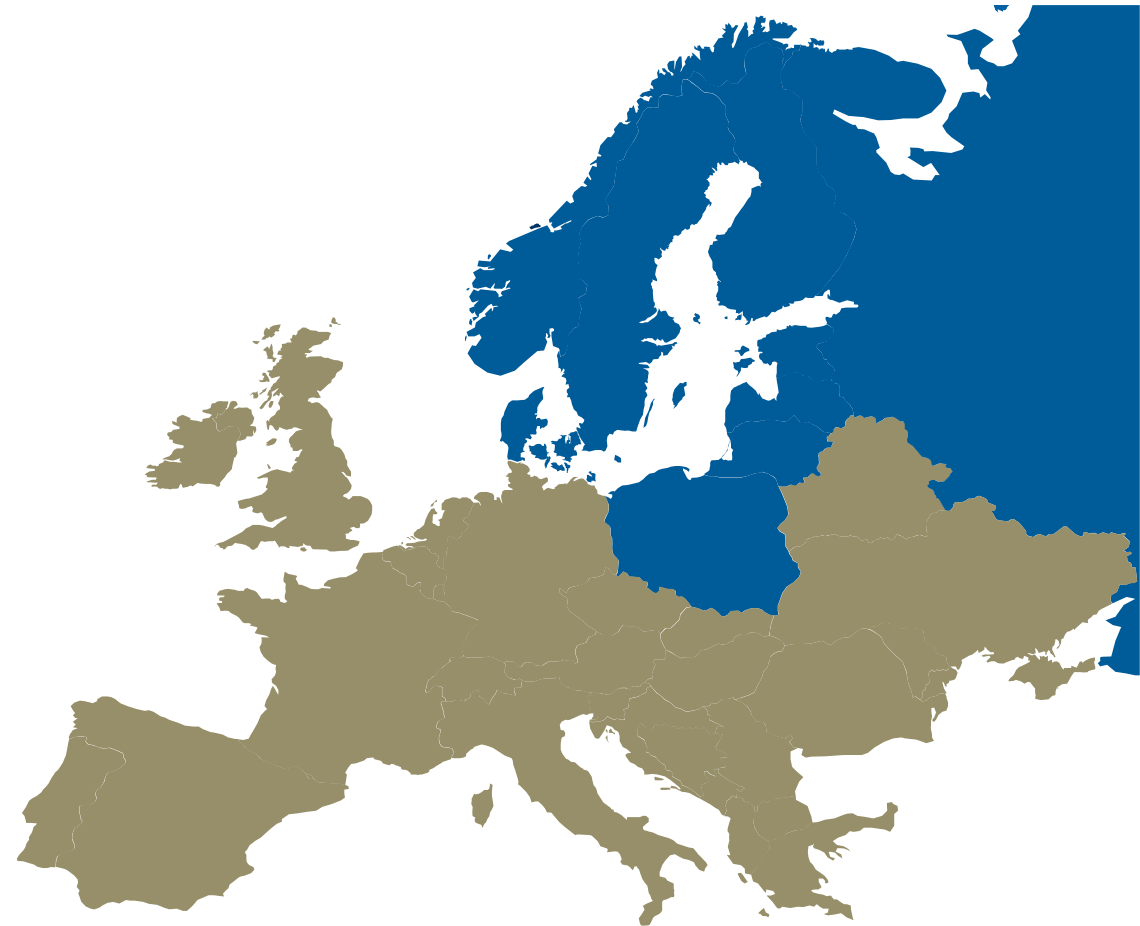
## ✓ Financial strength

- EUR 9,3bn in income (2011)
- EUR 709bn of assets
- EUR 27bn in equity capital
- AA credit rating
- Core Tier 1 capital ratio of 11.8%

## ✓ EUR ~28bn in market cap

- One of the largest Nordic corporations
- A top-10 European retail bank

### Nordea's home markets



# Market cap development

EURbn

2007		2008		2009		2010		2011		15 <sup>th</sup> August 2012	
1. Santander	92,5	1. Santander	54,0	1. Santander	95,2	1. Santander	66,0	1. Santander	50,3	1. Santander	53,3
2. Unicredit	75,9	2. BBVA	32,4	2. BNP Paribas	66,2	2. BNP Paribas	57,0	2. BNP Paribas	36,7	2. BNP Paribas	42,4
3. Intesa	68,8	3. Intesa	31,8	3. BBVA	47,7	3. Lloyds	52,2	3. BBVA	32,8	<b>3. Nordea</b>	<b>31,7</b>
4. BNP Paribas	67,2	4. BNP Paribas	27,6	4. Intesa	39,5	4. Barclays	37,2	4. Deutsche	27,3	4. BBVA	30,9
5. BBVA	62,8	5. Unicredit	23,3	5. Unicredit	39,3	5. Deutsche	36,3	5. Barclays	25,7	5. Lloyds	28,7
6. RBS	60,5	6. SocGen	20,9	6. Lloyds	36,3	6. BBVA	34,0	<b>6. Nordea</b>	<b>24,2</b>	6. Barclays	28,6
7. Deutsche	47,0	7. RBS	20,1	7. SocGen	36,2	<b>7. Nordea</b>	<b>32,8</b>	7. Lloyds	21,3	7. Deutsche	23,3
8. SocGen	46,1	8. Credit Agricole	17,8	8. Barclays	35,4	8. SocGen	30,0	8. Intesa	21,0	8. SHB	18,0
9. Barclays	45,3	9. Deutsche	16,0	9. Deutsche	30,8	9. Unicredit	29,9	9. RBS	14,3	9. Unicredit	17,2
10. Credit Agricole	38,5	10. Barclays	13,2	<b>10. Nordea</b>	<b>28,7</b>	10. RBS	26,7	10. SocGen	13,4	10. Intesa	17,2
11. Lloyds	36,3	<b>11. Nordea</b>	<b>13,0</b>	11. Credit Agricole	28,6	11. Intesa	25,7	11. SHB	12,7	11. RBS	17,0
12. KBC	34,1	12. Lloyds	11,1	12. RBS	18,5	12. Credit Agricole	22,8	12. Unicredit	12,4	12. SocGen	15,9
<b>13. Nordea</b>	<b>29,7</b>	13. KBC	7,6	13. SHB	12,4	13. DnB NOR	17,1	13. DNB	12,3	13. DNB	14,9
14. Danske	18,7	14. SHB	7,1	14. DnB NOR	12,3	14. SHB	14,9	14. Swedbank	11,6	14. Swedbank	13,8
15. Commerzbank	17,6	15. Erste	5,1	15. Danske	11,0	15. SEB	13,6	15. Credit Agricole	10,9	15. SEB	13,4
16. Erste	15,3	16. Commerzbank	5,1	16. KBC	10,9	16. Danske	13,4	16. SEB	9,9	16. Danske	12,7
17. DnB NOR	13,9	17. Danske	4,9	17. Erste	9,8	17. Erste	13,3	17. Danske	9,1	17. Credit Agricole	10,0
18. SHB	13,8	18. SEB	3,8	18. SEB	9,5	18. Swedbank	12,1	18. Commerzbank	6,7	18. Commerzbank	6,9
19. SEB	12,0	19. DnB NOR	3,7	19. Swedbank	8,0	19. KBC	9,1	19. Erste	5,3	19. KBC	6,5
20. Swedbank	10,0	20. Swedbank	3,1	20. Commerzbank	7,2	20. Commerzbank	7,0	20. KBC	3,5	20. Erste	6,1

Source: Datastream and UBS

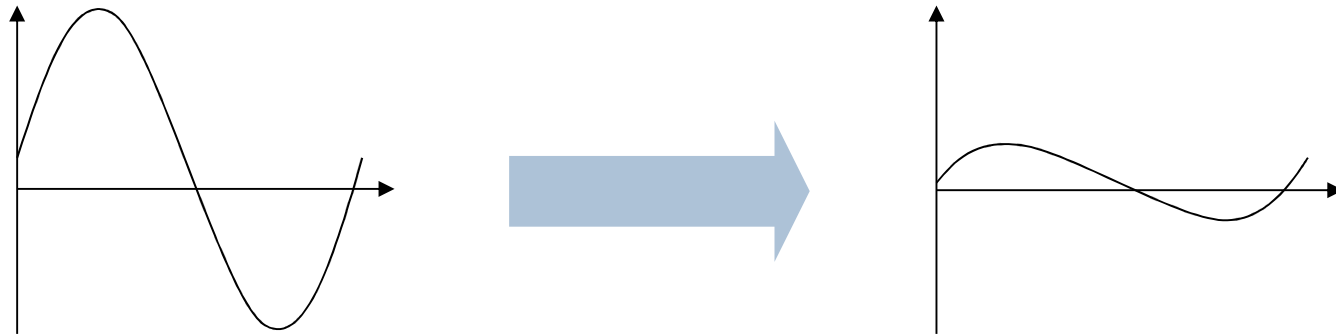
# Nordea's position in the pulp and paper market

- Nordea is a large lender to the pulp & paper industry.
- One of the best platforms in the industry for success
  - Nordea has a Pulp & Paper Expansion strategy to actively seek business globally
  - Most experienced team in the industry
- Global customer base leads to superior deal flows compared to other financial players
- Nordea (Merita-Nordbanken) has been involved in the P&P derivatives market since 1997, (i.e the start of pulp & paper derivatives market).
- The biggest financial participant in the world.
- Nordea is acting as a market-maker in the p&p derivatives market.
- Nordea has a risk mandate -> to take own risk positions.

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- **Why Price Risk Management?**
- Pulp market outlook

# Why price risk management



- Hedging increases predictability and stability of cash flows
- Hedging increases probability of profitability in every market environment
- Risk management enables corporates to concentrate on core business

The goal of price risk management is NOT:

- temporary minimization of e.g. costs
- trading gains

# Principle of financial price risk management

Price risk management and physical commodity transactions are separate

- Hedges are cash settled – no physical delivery
- Counterparty of hedging is Nordea – commodity counterparties as before and anonymous to Nordea

## Physical commodity purchases

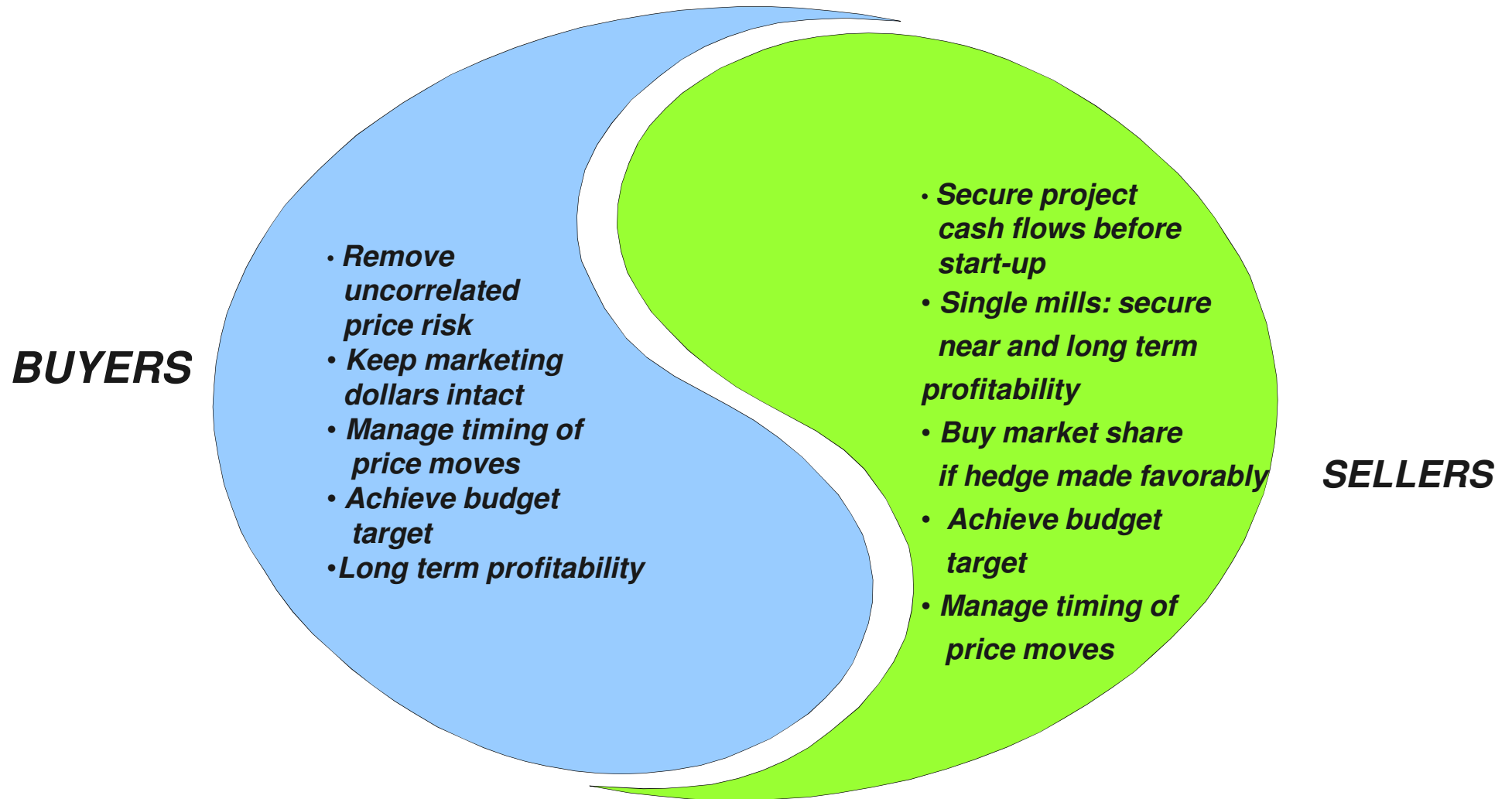
- Commodity/service is purchased from “physical counterparty”
- The price/rate in agreement is based on the **variable market price**
- Or price/rate of future purchases will be determined by prevailing market rates in the future

## Financial commodity hedge

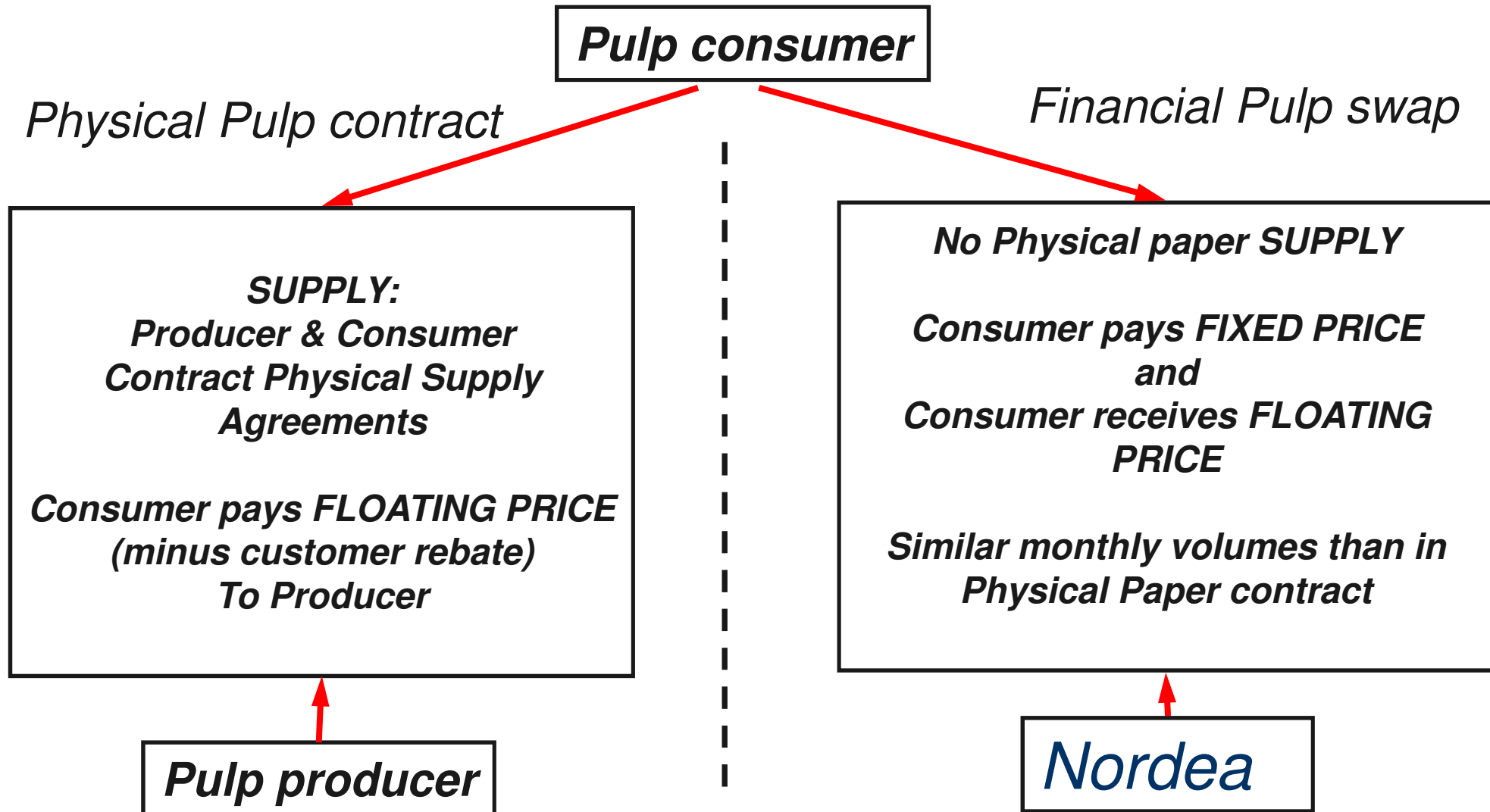
- Price risk is managed with commodity derivatives
- Cash flows from the hedge compensate for gains/losses resulting from price changes in the commodity market
- As a result the commodity price is fixed or otherwise hedged
- The derivatives contract is independent of the physical contracts



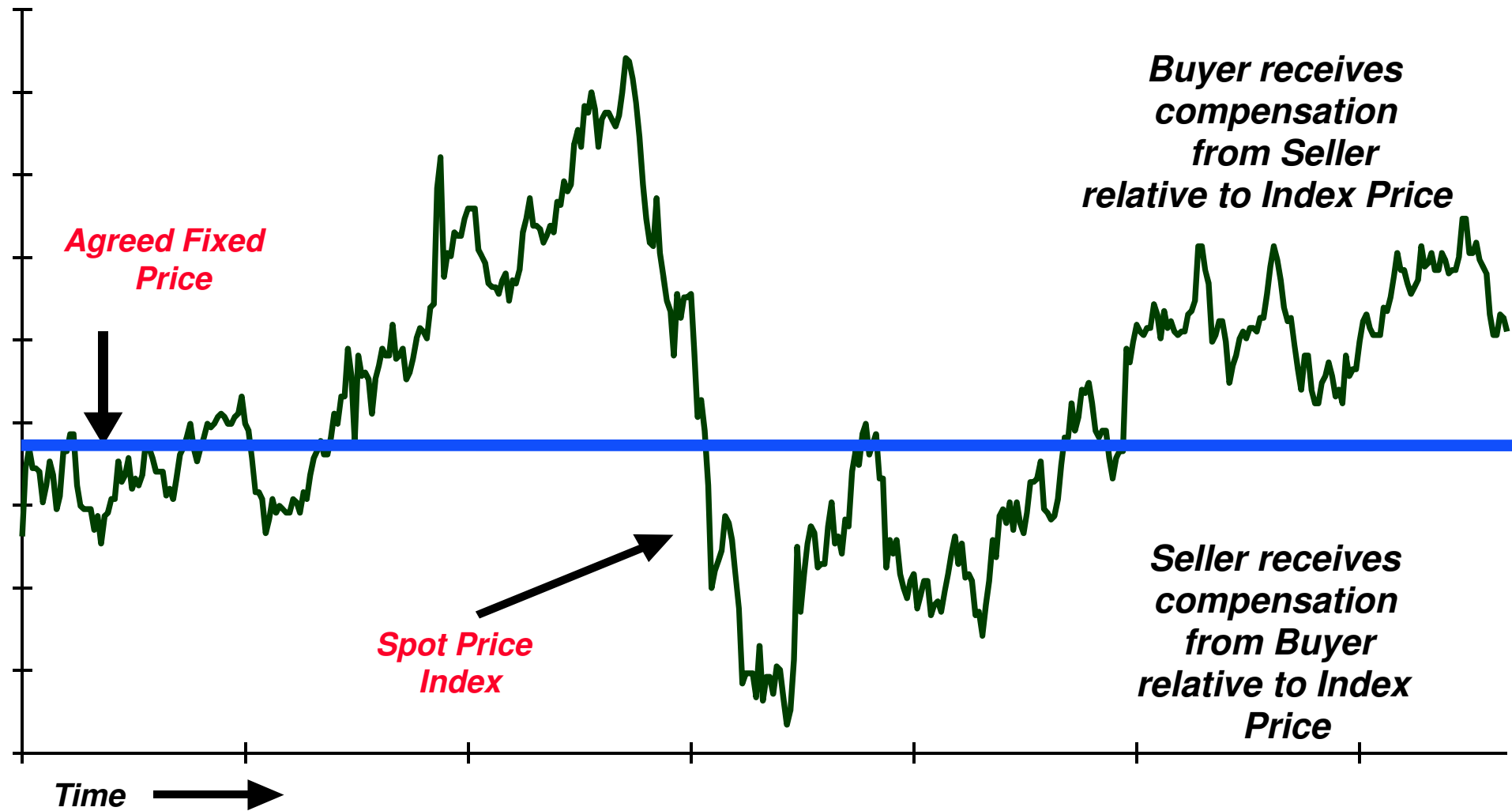
# Why Companies Hedge



# Separating Price From Physical Supply



## ***Price Swap --> A Fixed Price Arrangement***

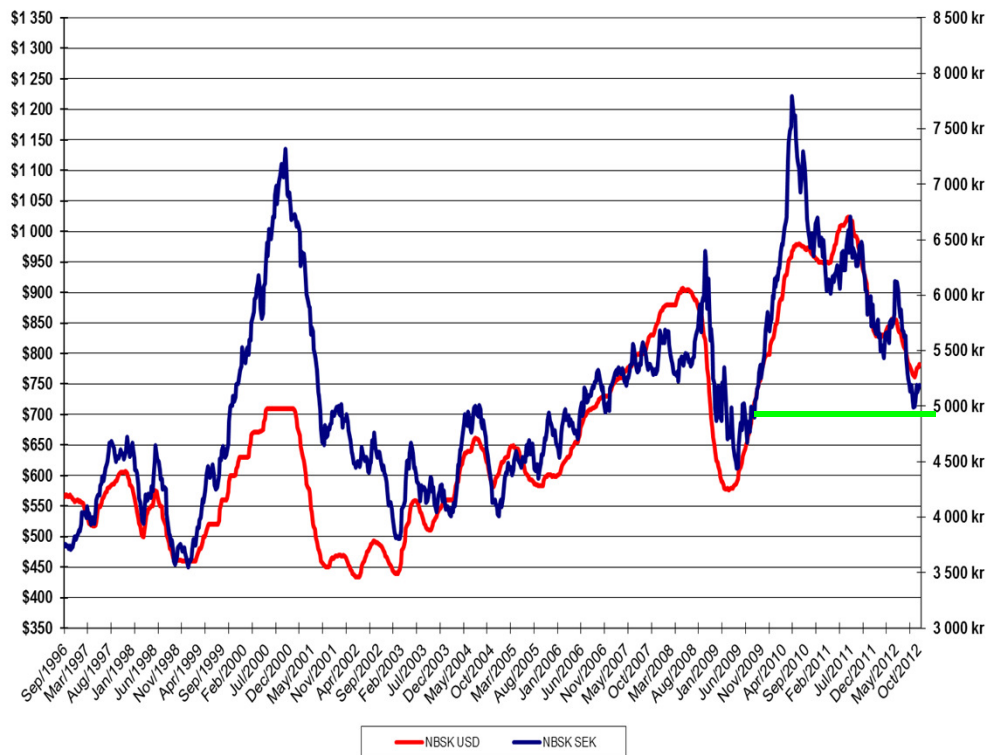


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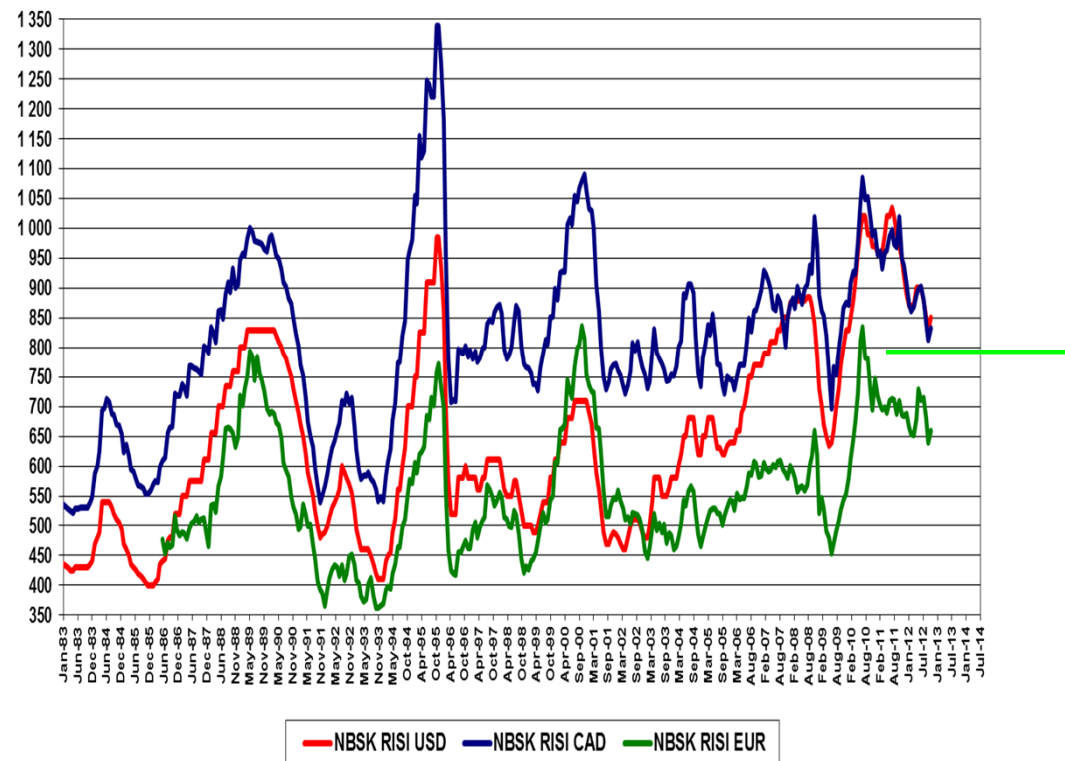
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- **Pulp market outlook**

NBSK prices are low for producers in SEK and CAD -> floor price reached

## NBSK PIX in SEK and in USD



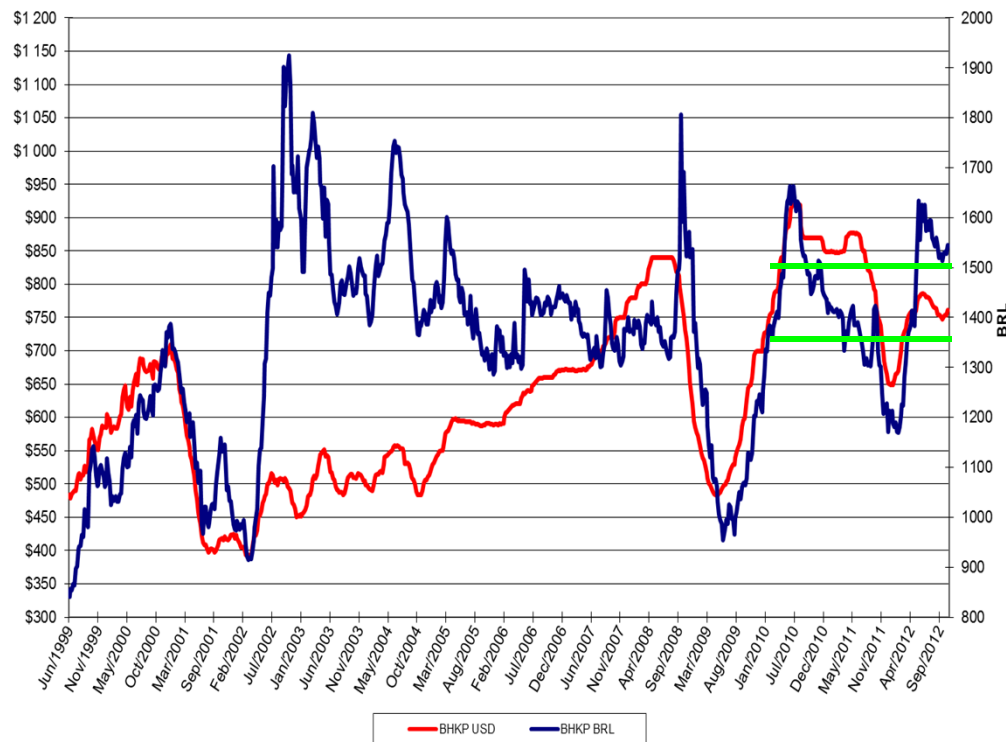
## NBSK RISI in CAD, USD and EUR



BHKP prices are low for producers in Brazil and especially for local Chinese producers  
-> floor price reached

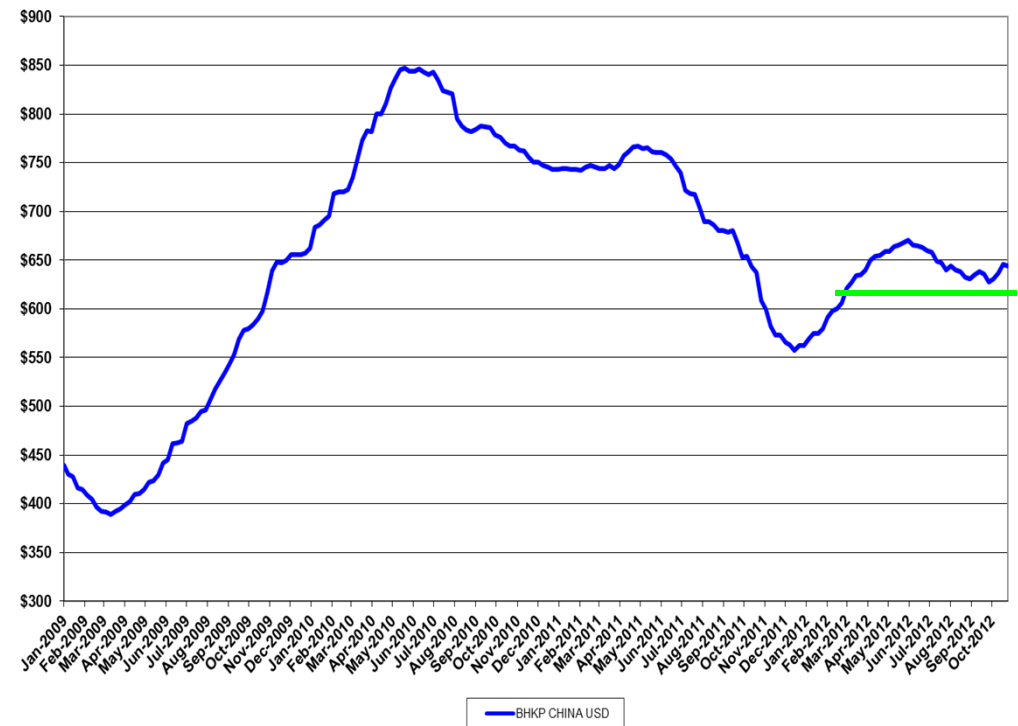
## BHKP PIX in BRL and in USD

Technical break-even level for BHKP pulp production in Brazil is in the \$700-\$720 list range including all costs (servicing debt).

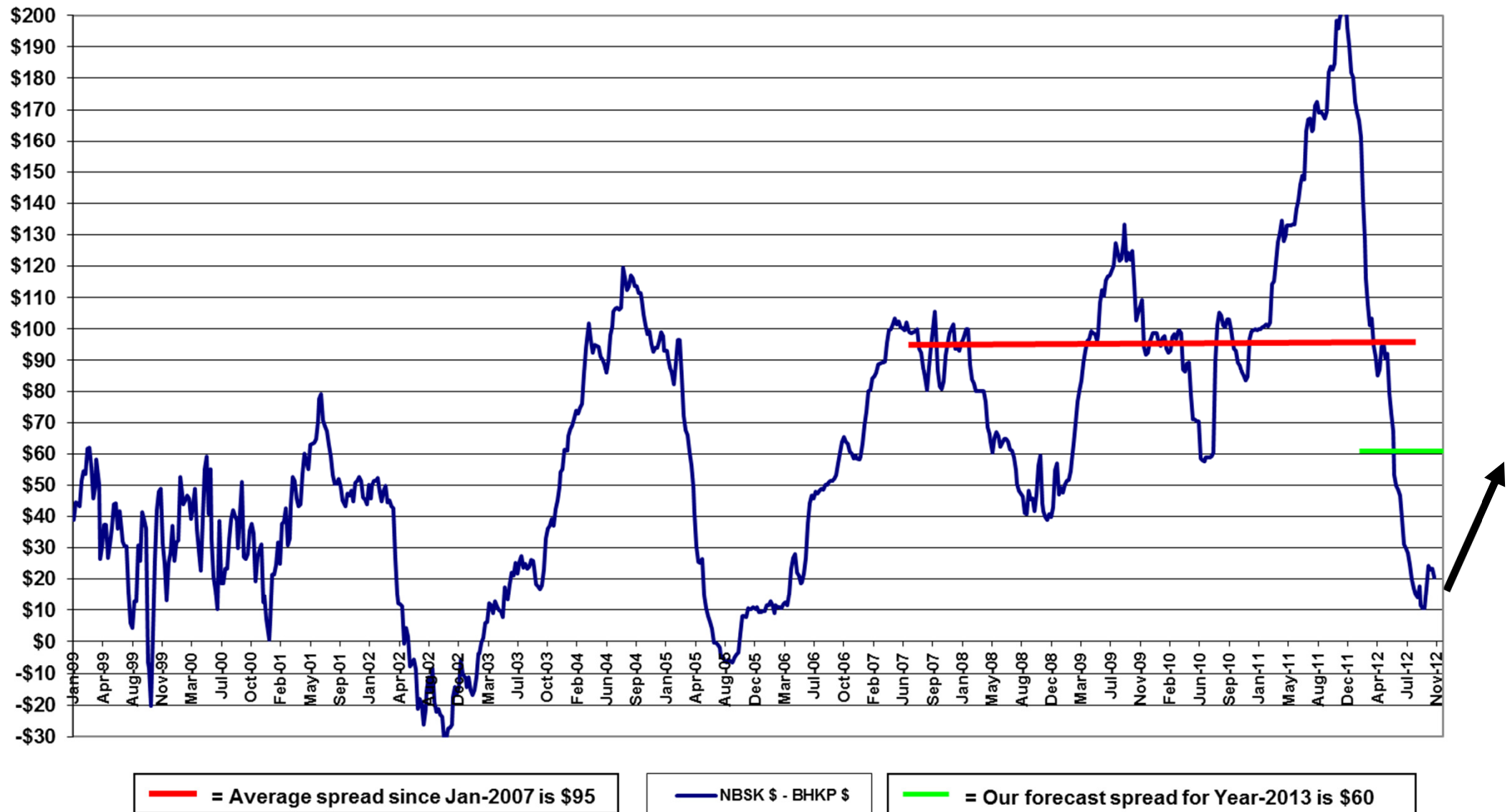


## BHKP PIX CHINA in USD

Technical break-even level for BHKP pulp production in China is in the \$600-\$620 net range



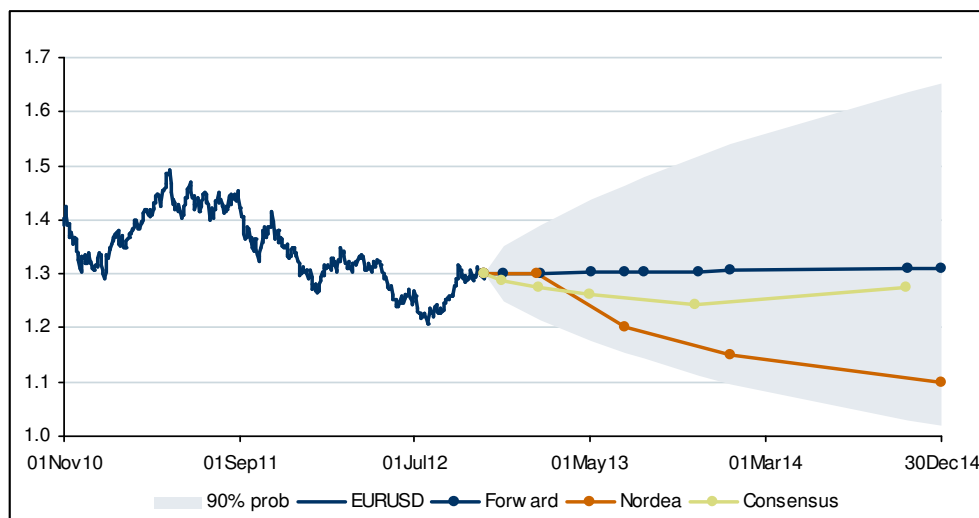
Spread price between NBSK PIX and BHKP PIX  
bottomed, likely heading back to about \$60



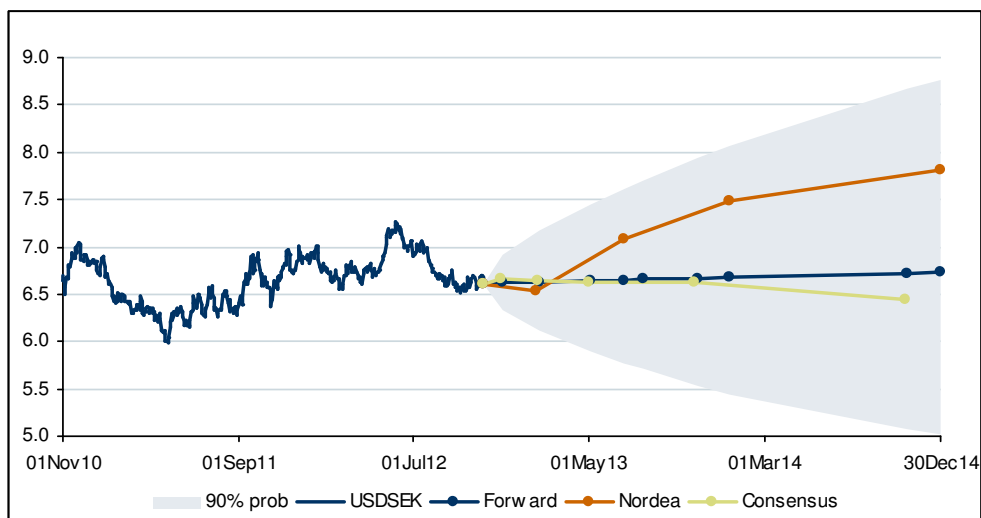
# Expecting stronger FX USD against Euro

## Note! Expecting weaker FX USD against CAD and BRL

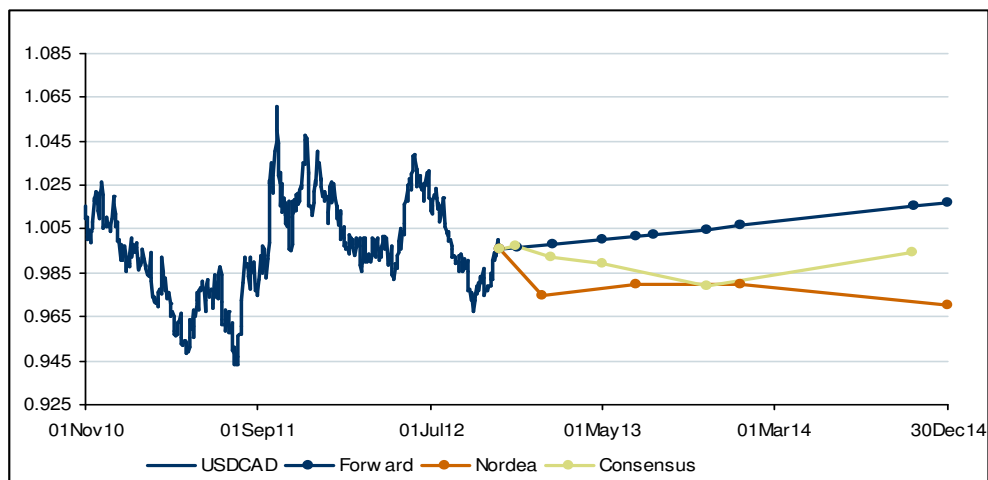
### FX EURUSD forecasts



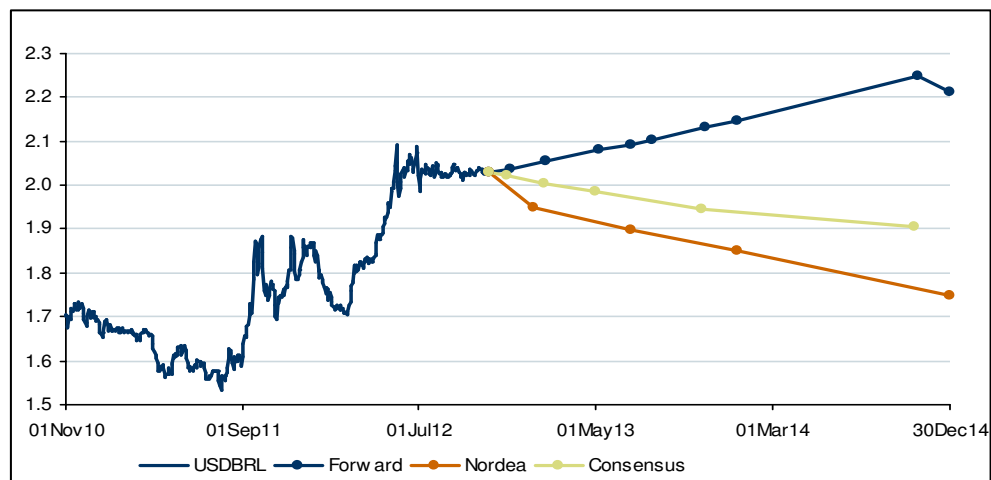
### FX USDSEK forecasts



### FX USDCAD forecasts

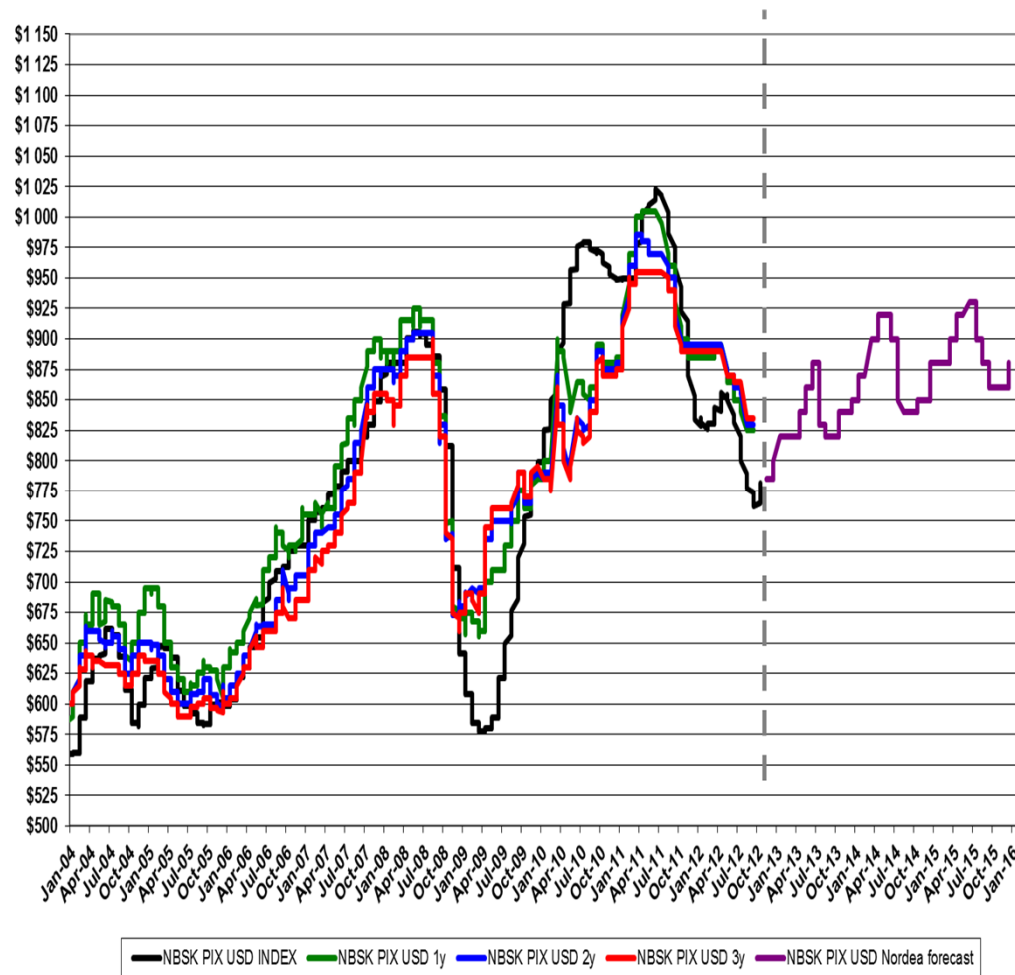


### FX USDBRL forecasts





# Historical development of NBSK swap offers and Nordea's pulp forecast



- Our forecast for Q4-12 is \$820
- Our forecast for Q1-13 is \$820
- Our forecast for Q2-13 is \$880
- Our forecast for Q3-13 is \$820
- Our forecast for Q4-13 is \$850

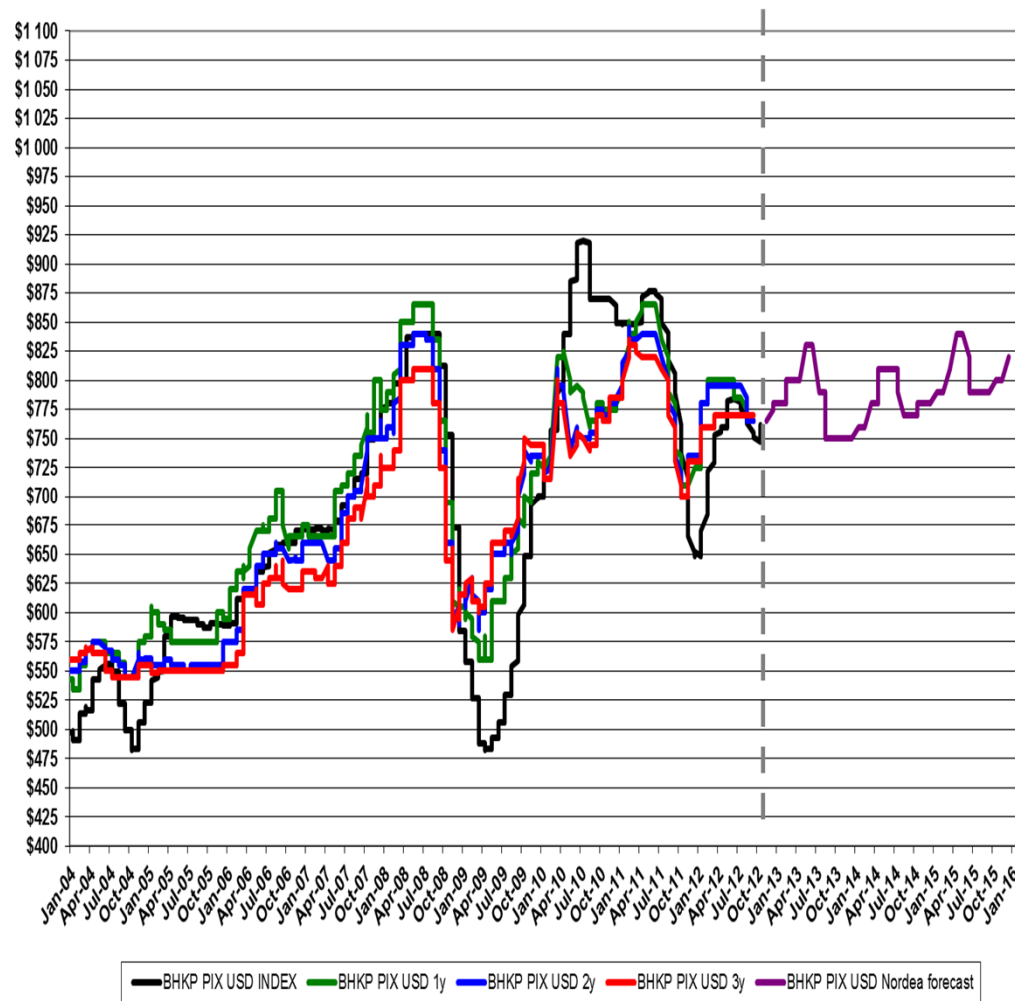
## *Market Drivers:*

\*Likely increases in corporate rebates inflating list prices

\*Potential integrated pulp flooding the market

\*Supply swings to specialty pulps

# Historical development of BHKP swap offers and Nordea's pulp forecast



- Our forecast for Q4-12 is \$780
- Our forecast for Q1-13 is \$800
- Our forecast for Q2-13 is \$830
- Our forecast for Q3-13 is \$750
- Our forecast for Q4-13 is \$750

## *Market Drivers:*

\*Likely increases in corporate rebates inflating list prices

\*Eldorado mill volumes will be consumed by higher demand from China -> no impact

\*From Q3 onwards weaker prices due to seasonal factors and additional supply (MdP, Oji Nantong)

\*Shutdown of JARI pulp mill (410k tons) in January-13

# Key drivers for pulp prices in coming years:

- **Discount inflation** - How large will they be and how much can be compensated onto list prices?
- **Economic inflation** – Central Banks to expand their inflation targets to tackle sovereign debts?
- **Cost inflation** – Wood, labour, chemicals, energy, water, logistics, capital, taxation, insurance etc.
- **Global Growth** - Sustainable Asian - & other Emerging market growth? Declining growth in mature economies?
- How will the **FX USD** perform in the next few years? Currency wars?
- What fate will certain **P & W papers** have in the mature markets – the same as newsprint?
- How many small domestic **high cost pulp mill closures in China**?
- How many of the **new paper mills in China** will be up and running according to scheduled start up?
- New pulp mills impact on the **supply / demand balance**?
- How much realistic **integrated capacity**, can turn into single line pulp mills in N. America & Europe?



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