



## ***Supporting Global Forest Industry with Financial Solutions***

**UTIPULP General Assembly  
Edinburgh**

April 15th, 2011



## ***Supporting Global Forest Industry with Financial Solutions – UTIPULP General Assembly***

### **Agenda**

- Nordea Bank – Strong bank with Forest Industry expertise
- Importance of Risk Management
  - Basics of hedging
- Pulp market outlook
  - Market view
  - Price scenarios

## Nordea – solid operations in nine markets

### Nordea's home markets



### 11 million customers

9 home markets  
Approximately 10 million personal customers  
750,000 corporates, including Nordic Top-500



### Distribution power

1,400 branches and 6.2 million e-banking customers



### Financial strength

EUR 9.3bn in income (2010)  
EUR 581bn of assets (2009)  
EUR 24.5bn in equity capital  
AA credit rating



### EUR 32bn in market cap

One of the largest Nordic corporations  
A top-10 European retail bank  
One of two Nordic Forbes 100 companies

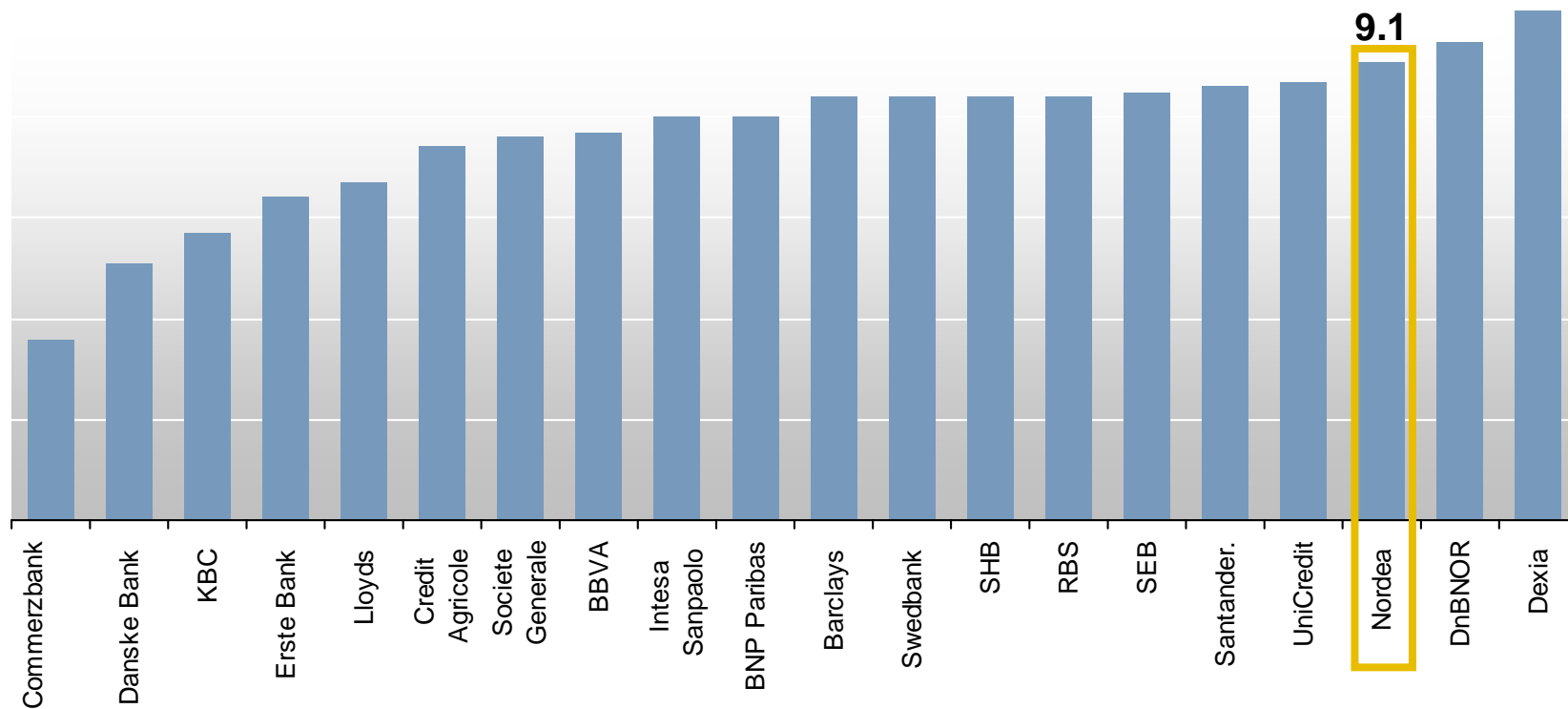
## Result highlights – strong performance in 2010

EURm	Q4/10	Q3/10	Chg %	Q4/09	Chg %	FY 10	FY 09	Chg %
Net interest income	1,365	1,310	4	1,299	5	5,159	5,281	-2
Net fee and commission income	618	525	18	463	33	2,156	1,693	27
Net result items at fair value	504	446	13	351	44	1,837	1,946	-6
Other income	20	82		45		182	153	
<b>Total income</b>	<b>2,507</b>	<b>2,363</b>	<b>6</b>	<b>2,158</b>	<b>16</b>	<b>9,334</b>	<b>9,073</b>	<b>3</b>
Staff costs	-675	-721	-6	-702	-4	-2,784	-2,724	2
<b>Total expenses</b>	<b>-1,270</b>	<b>-1,196</b>	<b>6</b>	<b>-1,219</b>	<b>4</b>	<b>-4,816</b>	<b>-4,512</b>	<b>7</b>
<b>Profit before loan losses</b>	<b>1,237</b>	<b>1,167</b>	<b>6</b>	<b>939</b>	<b>32</b>	<b>4,518</b>	<b>4,561</b>	<b>-1</b>
Net loan losses	-166	-207	-20	-347	-52	-879	-1,486	-41
<b>Operating profit</b>	<b>1,071</b>	<b>960</b>	<b>12</b>	<b>592</b>	<b>81</b>	<b>3,639</b>	<b>3,075</b>	<b>18</b>
<b>Net profit</b>	<b>770</b>	<b>711</b>	<b>8</b>	<b>447</b>	<b>72</b>	<b>2,663</b>	<b>2,318</b>	<b>15</b>
<b>Risk-adjusted profit</b>	<b>721</b>	<b>707</b>	<b>2</b>	<b>533</b>	<b>35</b>	<b>2,622</b>	<b>2,786</b>	<b>-6</b>

# Strong capital position

– compliant with proposed regulations

Nordea # 3 among European peers in Standard&Poor's Risk-adjusted capital (RAC) analysis



## Global Forest Industry Strategy

- Nordea has been banking the Nordic forest industry for over 100 years and therefore has a unique track record in the sector
- Nordea is one of the few banks with a global strategy in the sector, and is recognized globally for possessing in-depth knowledge and expertise in the sector
- Nordea has supported the gravitational shift from the traditional markets towards the new growth markets of Latin America and Asia:
  - pulp production to Southern hemisphere; fast growing plantations
  - paper production to low paper consumption per capita, and fibre deficient, countries
- Nordea introduced a global forest industry strategy in 2005 to grow the business beyond the Nordic region
- The strategy has been successfully implemented with an extensive number of relationships created in the Americas, Europe, Asia and Oceania
- International branches in Frankfurt, London, New York, Singapore and Shanghai. Representative offices in São Paulo and Beijing.

## Importance of Risk Management

- Risk management is a logical process or approach that seeks to eliminate or at least minimize the level of uncertainty associated with a business operation.
- Risk management is the process which aims to help organizations understand, evaluate and take action on all their risks with a view to increasing the probability of their success and reducing the likelihood of failure.

*“The fact is that one side thinks that the profits to be won outweigh the risks to be incurred, and the other side would rather avoid danger than accept an immediate loss.” -Thucydides (Ancient Greek philosopher)*

- Long-term end product sales prices should be matched (if possible) with a similar raw material price contract.

-> Less uncertainties, more predictability

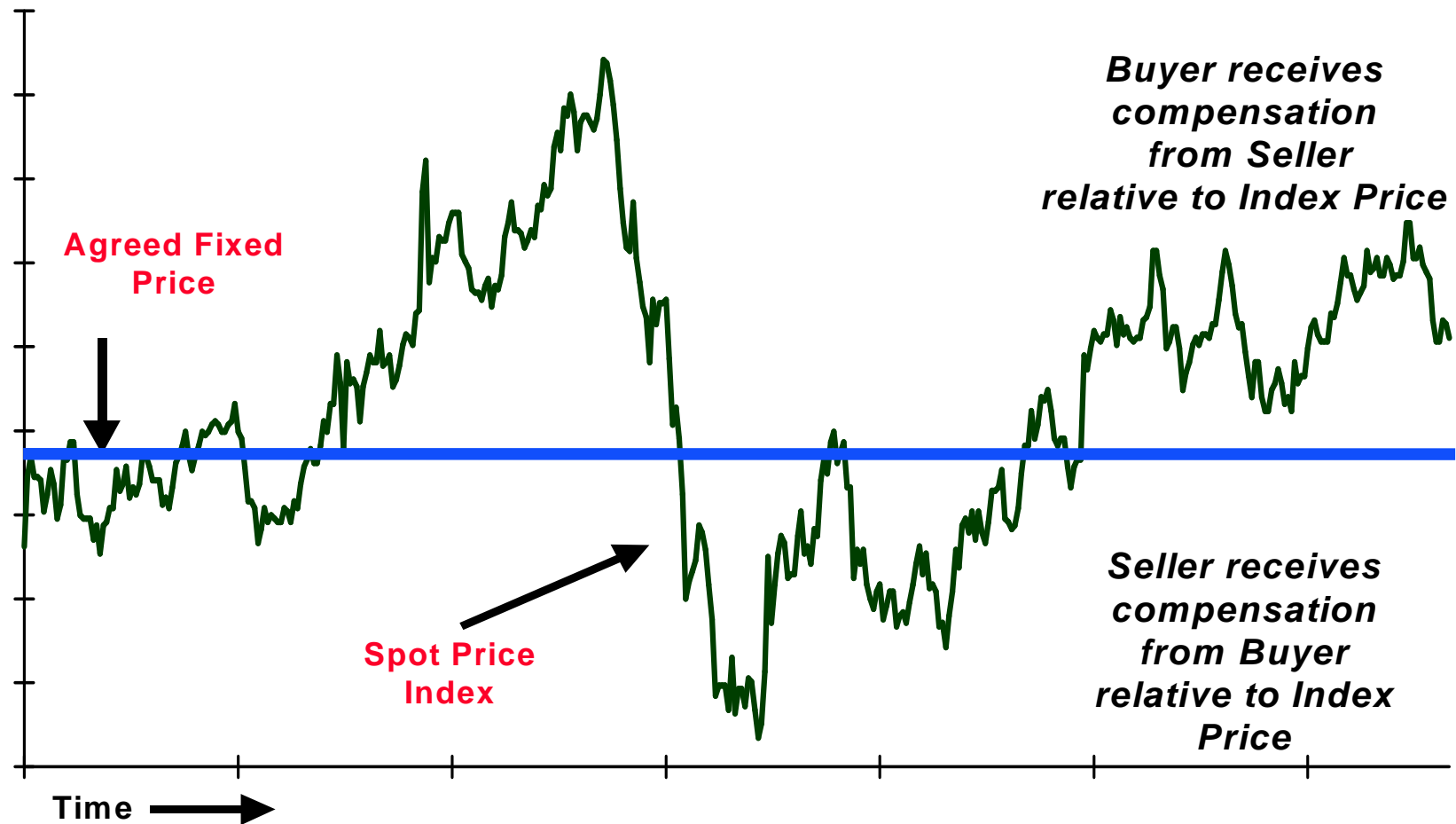
*“We took risks. We knew we took them. Things have come out against us. We have no cause for complaint.” –Robert Frost (American poet)*

# Price Hedging --> Financial Engineering --> A CONTROL TOOL

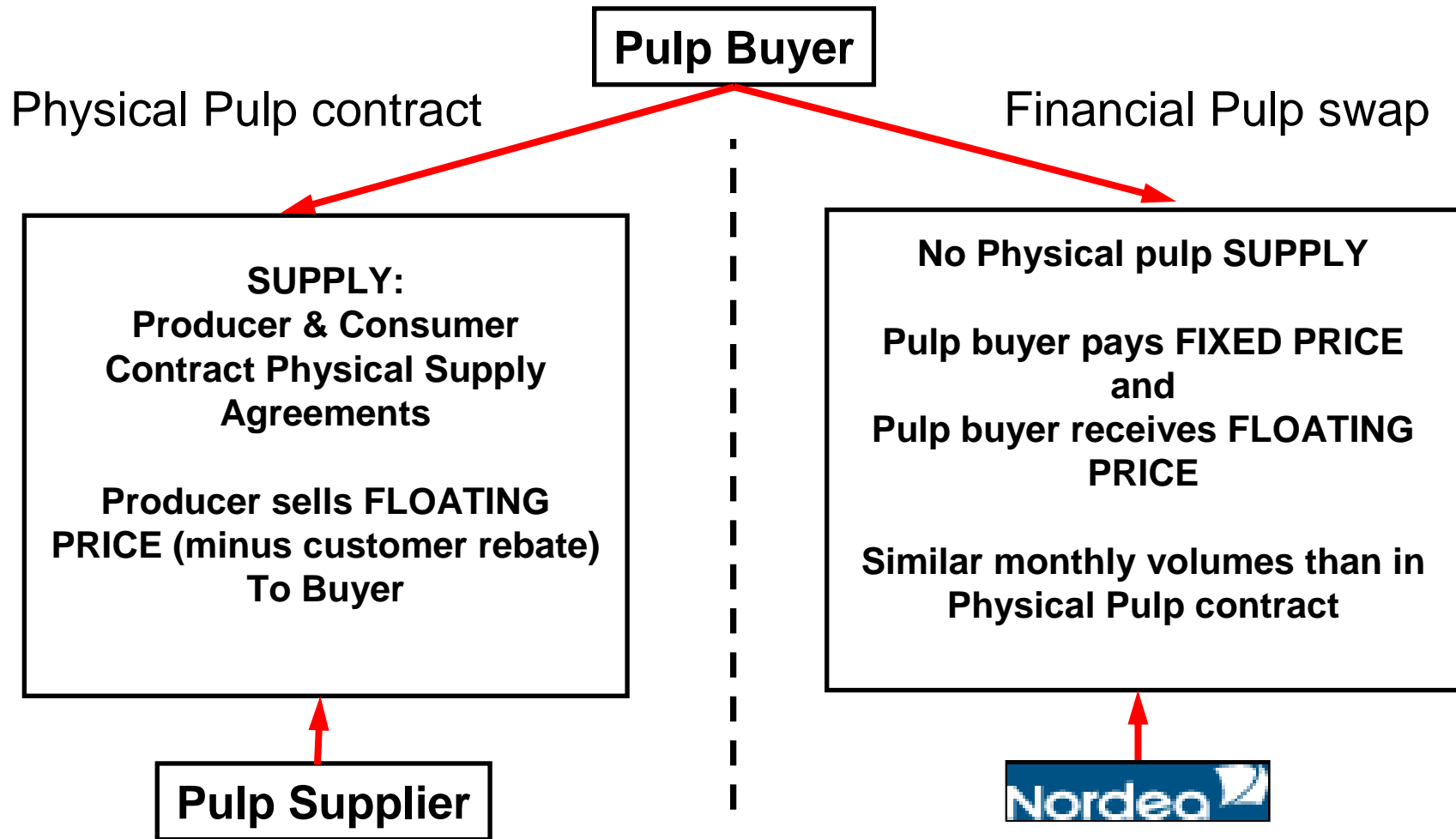
- **What is price Hedging?**
  - Using financial structures to replace *unknown* future prices with *known* future prices
  - Re-engineering transaction cash flows to a desired profile
  - Revenue (or cost) line becomes predictable
- **Cash-settled financial instruments based on fully enforceable ISDA contracts locking in price and volume terms against an index**
  - Focuses management to exert control over price and operations
  - Allows creative customer pricing solutions



## Price Swap --> A Fixed Price Arrangement

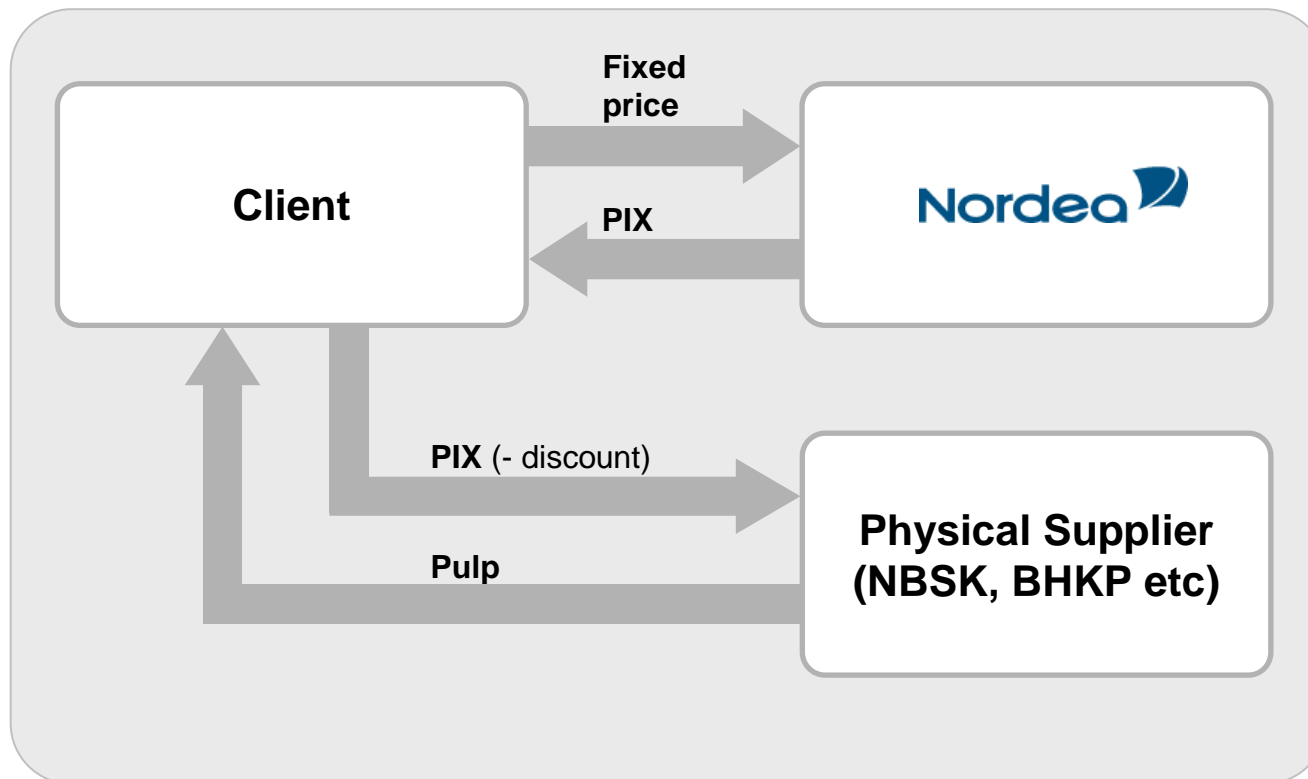


## Separating Price From Physical Deals (fully enforceable)

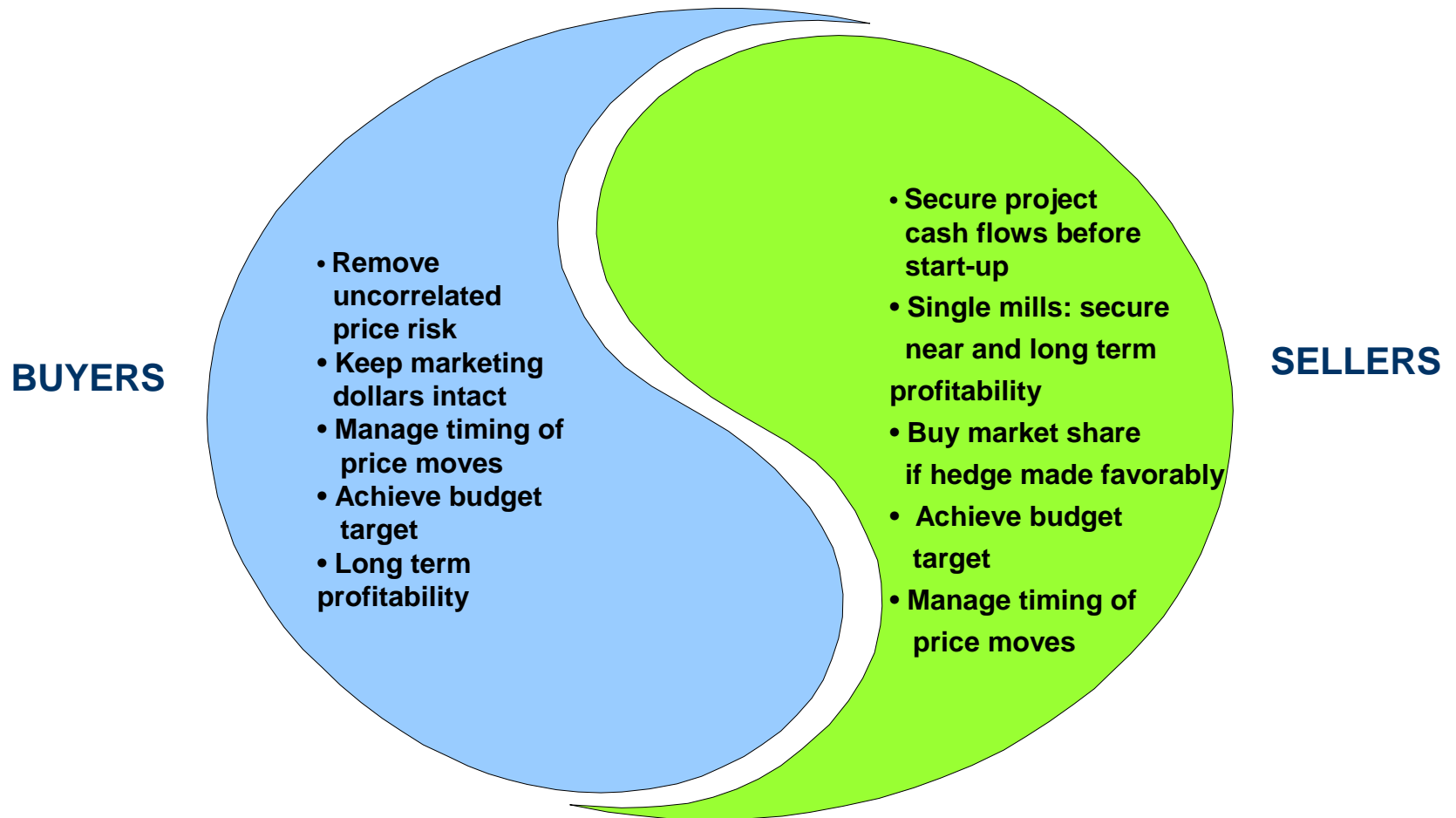


## Swap Illustration

- Financial transaction detached from the physical transaction



## Why Companies Hedge



## How Companies Hedge --> Approaches to Price Risk Management

- **“Rolling Forward”**
  - Consistently hedge on similar volumes & durations
  - Smooths out price movements
- **“Vision”**
  - Hedging based on future market development expectations
  - Putting to advantage superior market & industry knowledge
- **“Play the Numbers”**
  - Hedge based on perceived attractiveness of prices
  - Value based hedging, achieving better returns than the long-term targets
- **“Do Nothing”**
  - Price taker --> Speculator (running operations with floating costs / revenues)

## Basics of pulp hedging

- In general, European pulp swaps are tied to a PIX price index, North American swaps are tied to RISI index.
- PIX-index is published weekly at [www.foex.fi](http://www.foex.fi) by Foex Indexes Ltd
- Monthly average price calculated from the weekly index prices is used as a fixing price for the swap.
- RISI-index is published monthly at [www.risiinfo.com](http://www.risiinfo.com) by RISI
- This fixing price is then compared to the agreed contract price to settle month's payment.
- Fixing amount is then paid or received on the 5th business day of the following month. i.e. June fixing is paid on the 5th business day of July.
- Typical transaction volume is 500 – 3 000 tons/month.
- Most common tenor is 12 - 24 months, transactions possible from 6 months to 3 years period.

## Market Pulp volumes globally

- Total annual Market pulp volume is about 50 million tons of which 50% is Hardwood and 50% Softwood pulp.  
-> Value is roughly  $\$850 * 50 \text{ million} = \$42,500,000,000$ .
- Derivatives market size on pulp is about 8 million tons.  
-> Value is roughly  $\$850 * 8 \text{ million} = \$6,800,000,000$ .

As a comparison, the global aluminium production is about 42 million tons and the LME aluminium derivatives market volume is about 1,020 million tons annually. It's about 25 times the size of underlying market!

## What aspects you should consider? Are the pulp prices moving **up** or **down**?

### 1. Wood supply situation

- Competition from bioenergy & biofuel market; Environmental pressures from NGO's towards Indonesian wood supply; Depressed housing market in USA and Europe continues to shut down saw mills; Climate changes.

### 2. FX market

- Short term weakening USD against pulp producer currencies: CAD, SEK, EUR, BRL, CLP

### 3. Expectations of the general economic development

- Global economic growth stagnant

### 4. Capacity **increases/decreases** in the Pulp & Paper industry

- Mill conversions to Deinking and Fluff pulp

### 5. Inventory data, supply and demand information

- Very low (NBSK) to Normal (BHKP) inventories going to Q2-2011

### 6. Greater influence of China

- Over 2 million tons of new Tissue capacity coming on stream in 2011 – 2012.

### 7. Cost inflationary pressures

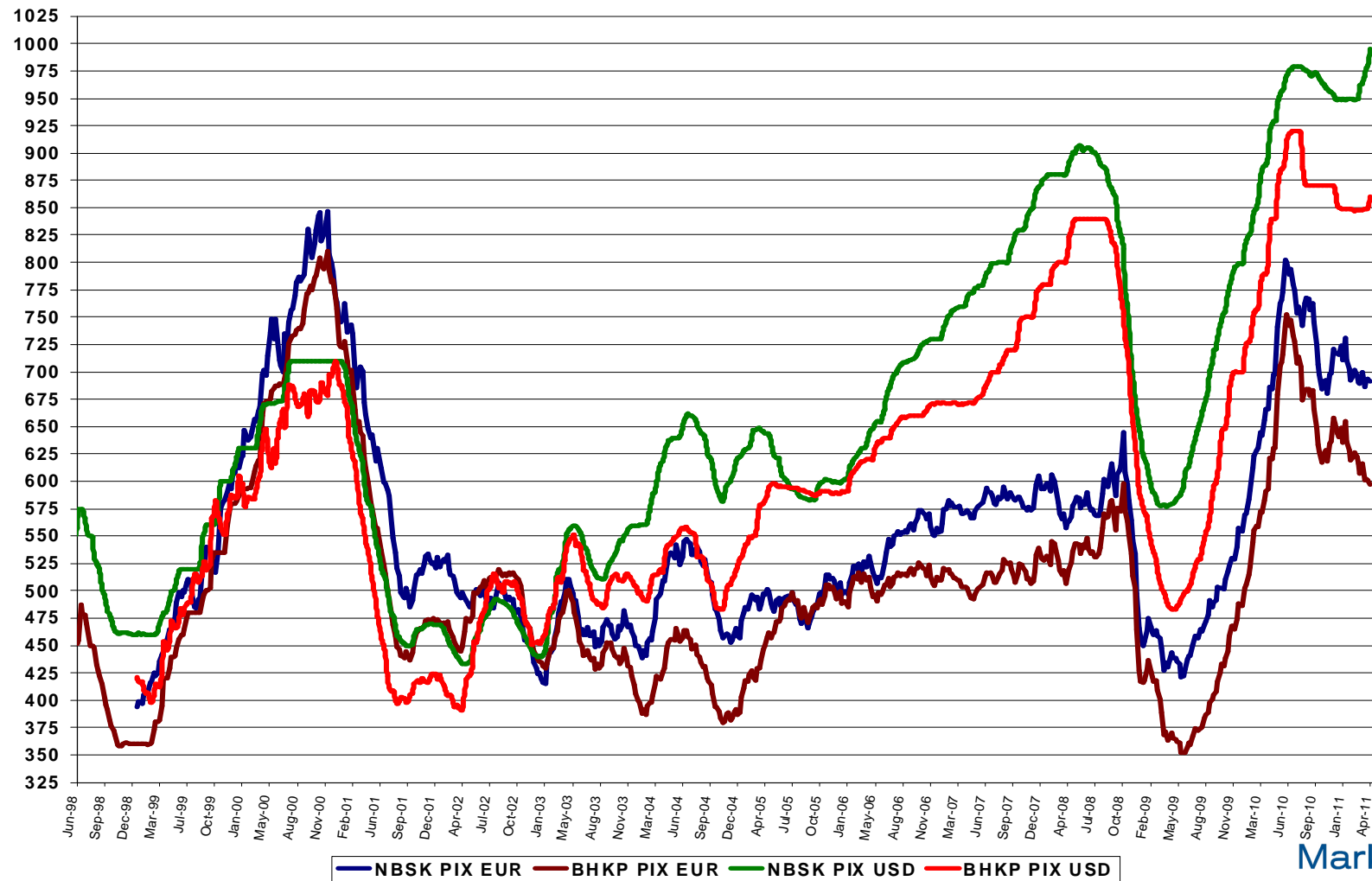


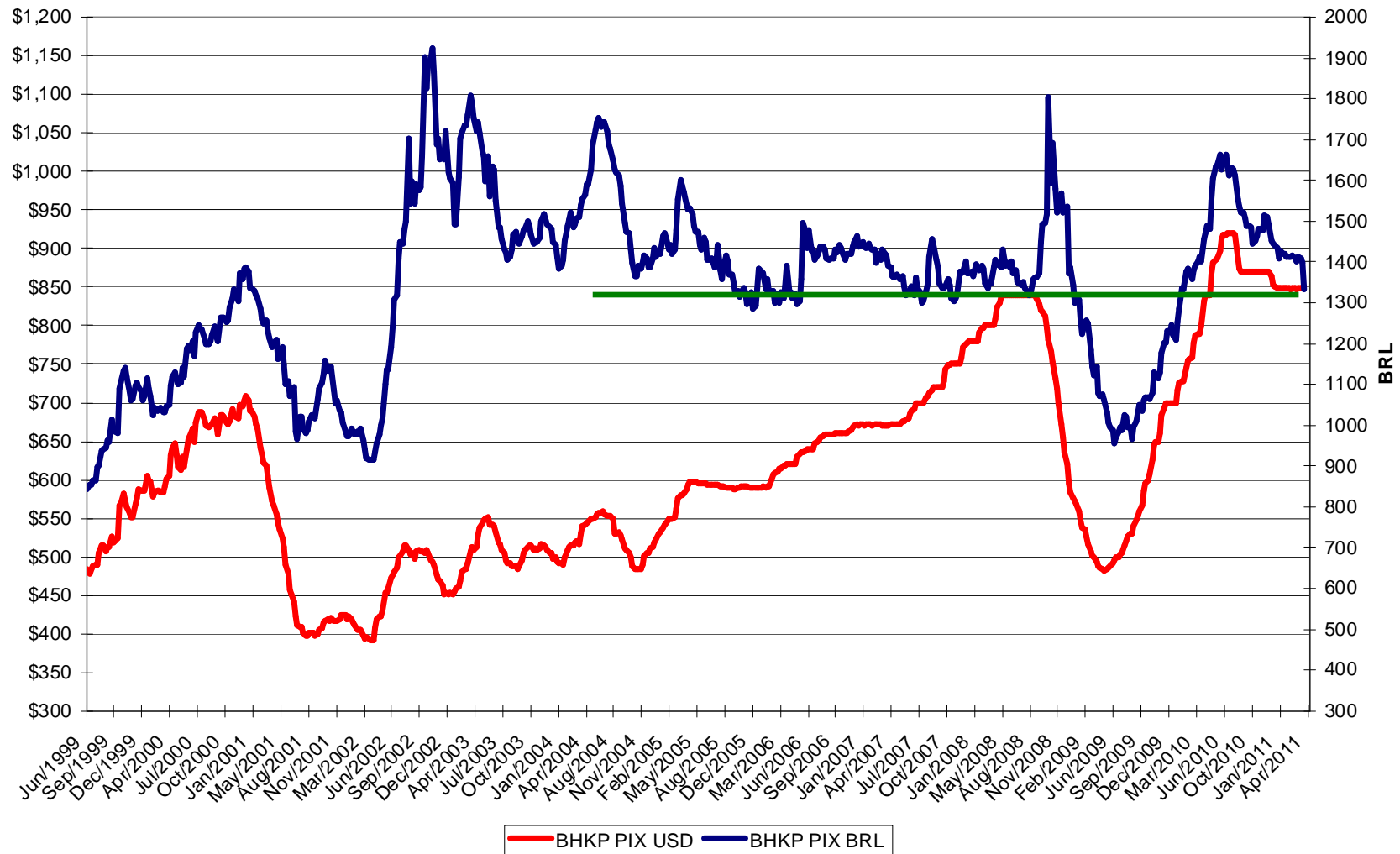
- Our pessimistic views have vanished due to the current FX levels (EUR/USD 1.4430, USD/CAD 0.9500, USD/BRL 1.5750, USD/SEK 6.2150, USD/CLP 470.00) and tightness of Pulp inventories. Wood costs as well as chemical costs increased in many regions during 2010 and beginning of 2011. In our analysis, other costs are also increasing such as; recycled paper, fuel and logistics. Taking these cost increases into account as well as structural changes on the supply side, the price floor of pulp has increased making the comparison to the historical average levels less viable.
- There is an announcement of \$30/ton price increase for both softwood and hardwood pulp for April deliveries. This will push the prices to \$1010 and \$880 respectively. The paper-grade pulp mill conversions to Fluff pulp and Dissolving pulp will keep the price momentum on during Q2. This is also the period of seasonal maintenance shut downs, thus keeping the inventory levels at normal for BHKP also.
- **By end of Q2-11, we are forecasting NBSK PIX to climb to \$1040 (+\$20) and BHKP PIX to \$880 (+\$20?).**
- **We are forecasting a small decrease in prices bringing NBSK PIX by end of Q3-11 to \$1000 and BHKP PIX by end of Q3-11 to \$850.**
- Our Q3 scenario is based on order books in Europe cooling down, continued paper market weakness in Asia, inventories building up with a somewhat stronger USD (below 1.35 against Euro). Should more than one of these scenario's not happen, the pricing correction is likely not going to materialize at all.
- Increasing demand and limited supply will start pushing pulp prices higher again from October 2011 onwards.
- **Our forecast for NBSK PIX by end of Q4-11 is \$1030 and BHKP PIX by end of Q4-11 is \$890.**
- **We are seeing strong market fundamentals continuing also during 2012, thus driving the pulp prices to \$1110 on the NBSK and to \$980 on the BHKP.**
- The world has entered a period of higher commodity prices and there is unfortunately almost no way back even to the levels we had in September 2009, examples below illustrate this:
  - \$70/barrel oil prices (currently \$124/barrel -> 77% increase),
  - \$6,500/ton Copper prices (currently \$9,850/ton -> 52% increase) or
  - \$700/ton NBSK pulp prices (currently \$980/ton -> 40% increase).

**We are expecting pulp prices to continue to move up due to:**

- 1) Supply/demand balance of pulp is favoring the price increases during next 2 years  
*-> marginal new supply (approx. 1 million) and 3,5 million tons of new global tissue capacity in 2011 - 12 are increasing demand.*
- 2) FX USD is weakening against producer currencies: EUR, CAD, SEK, BRL, CLP. Target within 9 months 1.45 - 1.50 against Euro.
- 3) Higher Oil & Chemical prices are increasing the cost inflationary pressure.
- 4) Conversions to fluff and dissolving pulp are tightening the pulp supply even further.
- 5) Paper price increases will likely be implemented as all the producers are in the same boat with cost pressure.
- 6) Wood costs are increasing as demand from energy companies is increasing the competition for wood.

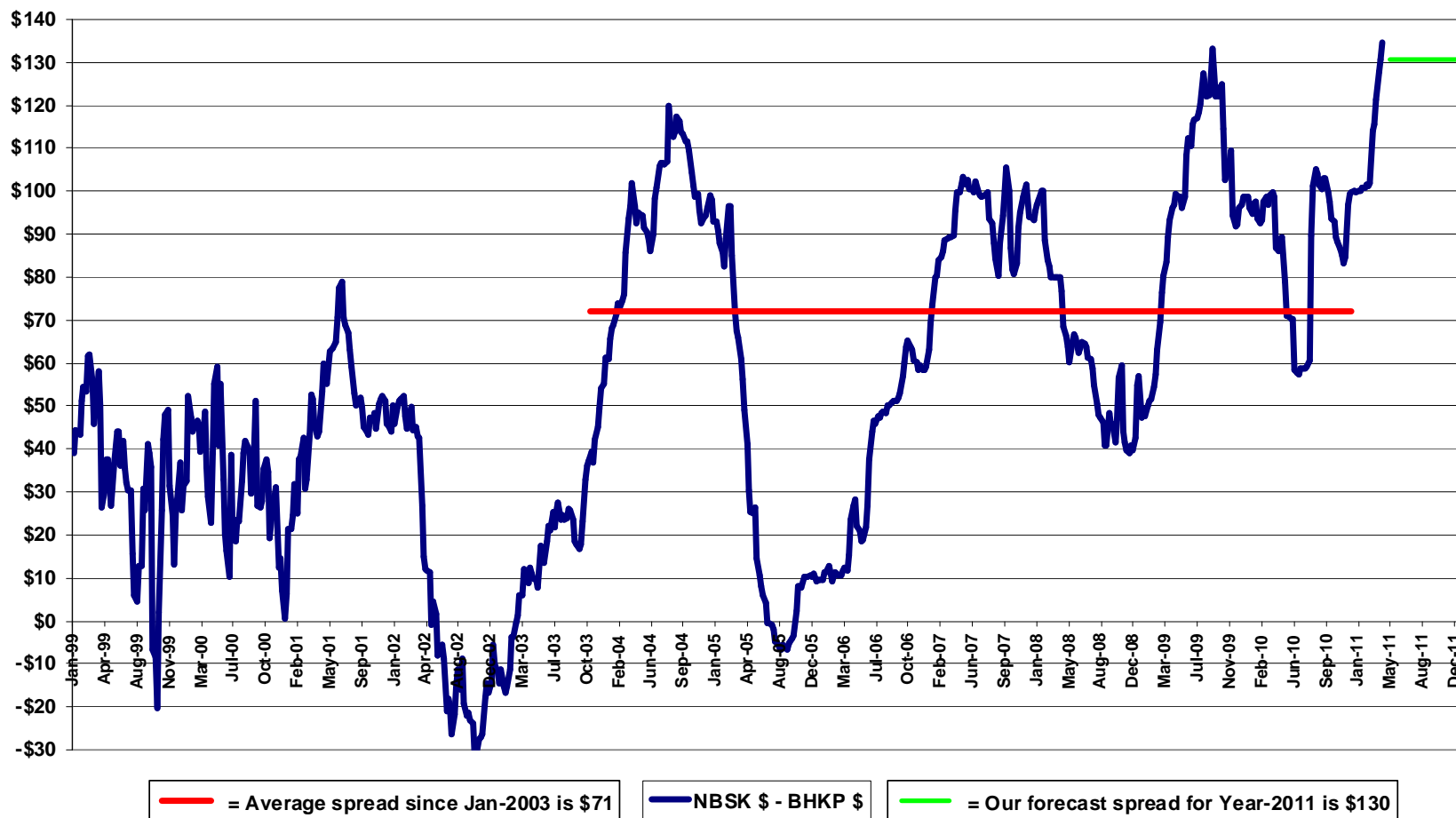
## Timeseries of NBSK PIX and BHKP PIX



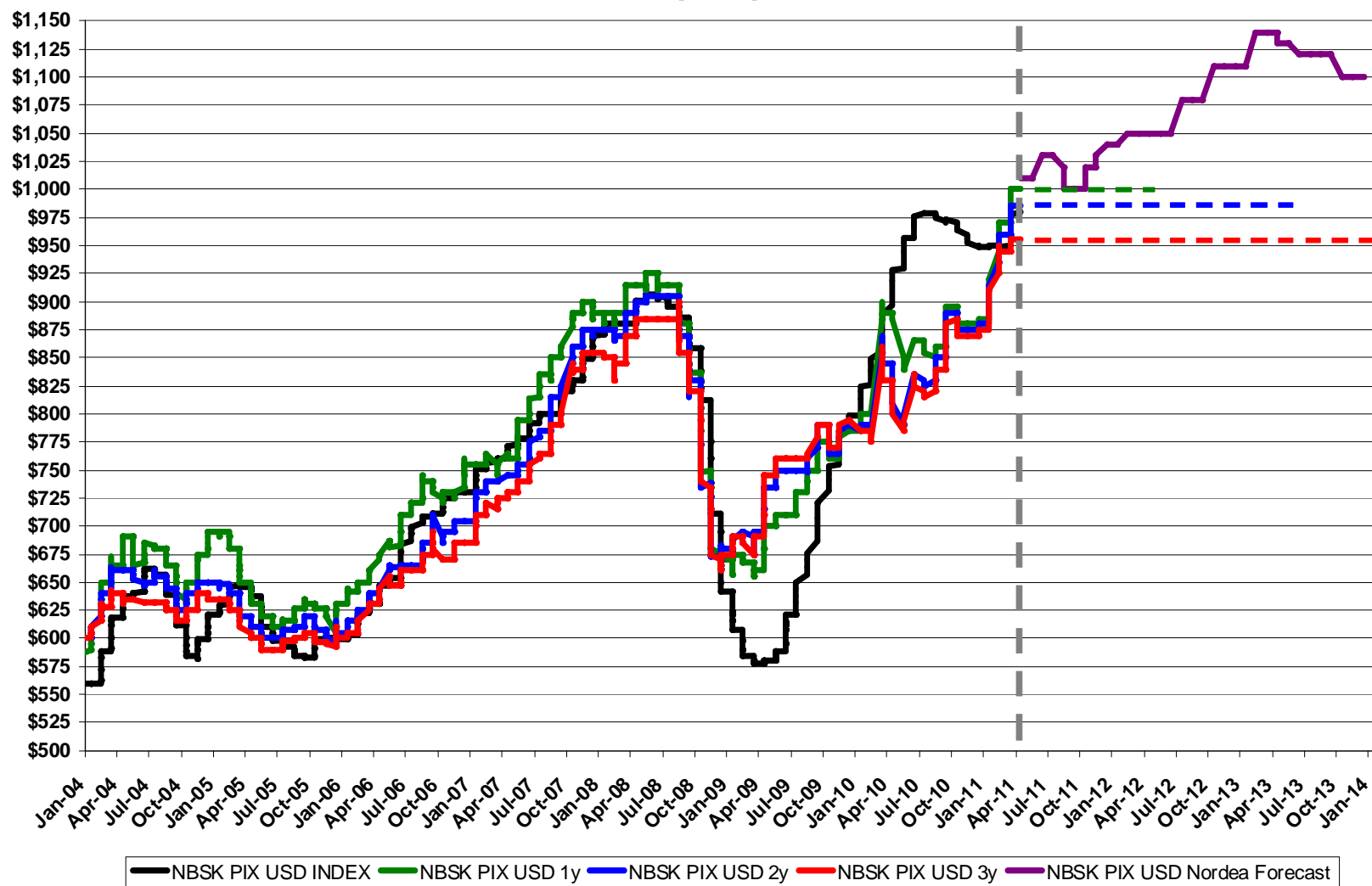


Hypothetically speaking a scenario with current BRL/USD rates and a 10% lower list price for BEK would make future pulp mills in Brazil questionable!

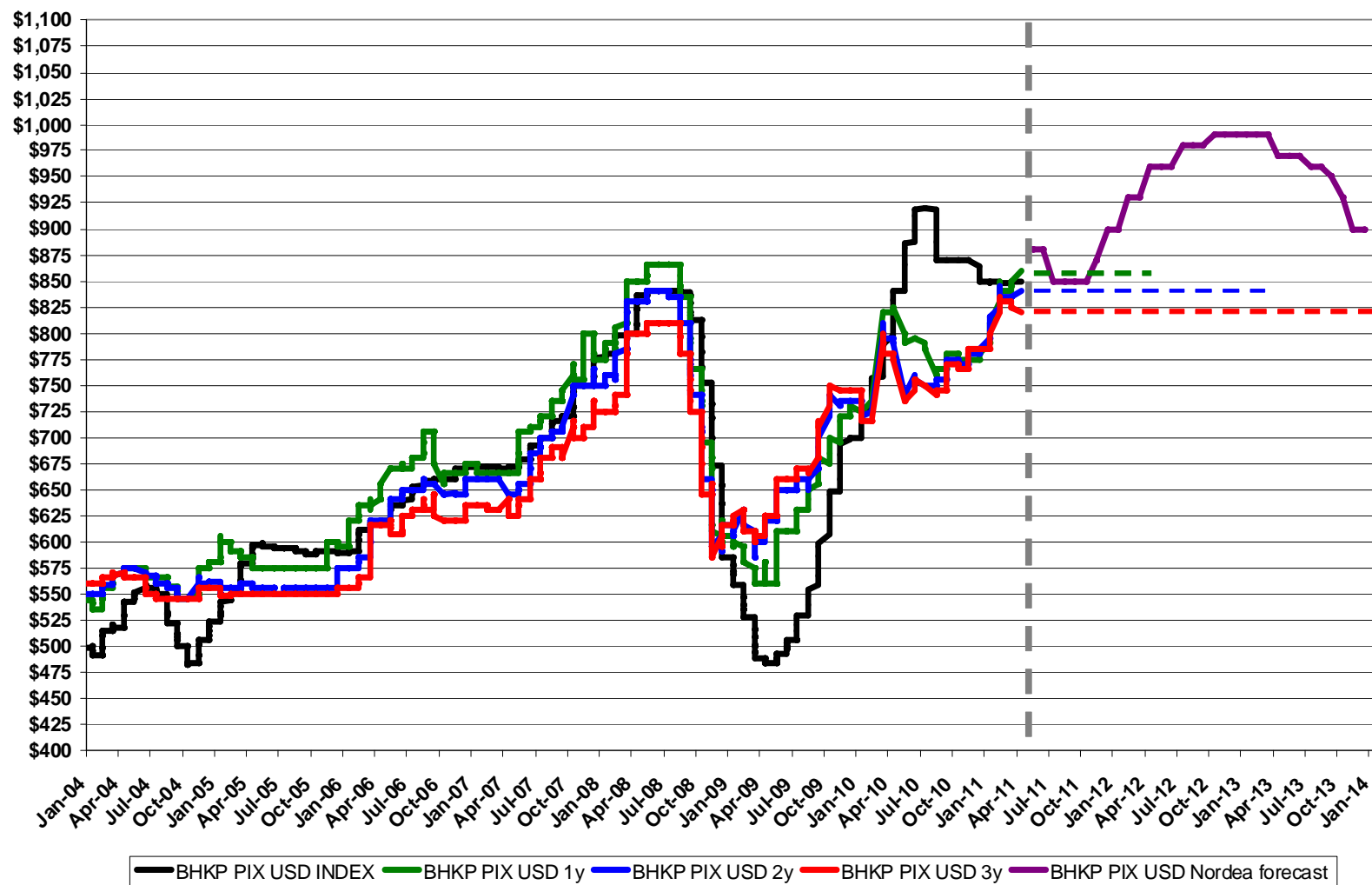
## Spread price timeseries of NBSK PIX and BHKP PIX



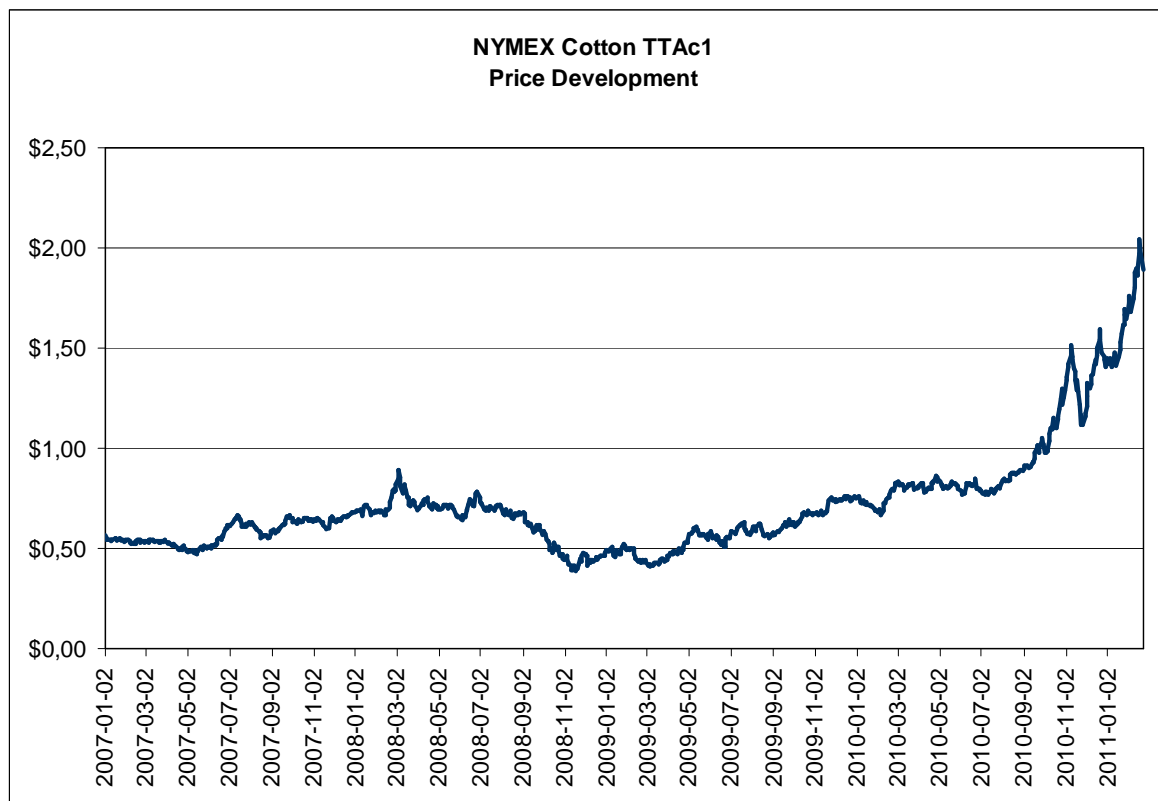
## Historical development of NBSK swap offers and Nordea's pulp forecast



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



## Pulp prices have been benefiting from recent cotton price rally



US farmers planted 30 % less cotton in 2007 from previous year in favor of growers planting corn & soybeans, especially for biofuels production.





## Top ten cotton producers — 2009

(480-pound bales)

	People's Republic of China	32.0 million bales
	India	23.5 million bales
	United States	12.4 million bales
	Pakistan	10.8 million bales
	Brazil	5.5 million bales
	Uzbekistan	4.4 million bales
	Australia	1.8 million bales
	Turkey	1.7 million bales
	Turkmenistan	1.1 million bales
	Syria	1.0 million bales

Source: National Cotton Council of America

### Factors that drive cotton price

**Grain prices:** Higher grain prices make them more attractive to cotton farmers, which leads to a decrease in cotton production. U.S. farmers planted 10.54 million acres of cotton in 2007, a 30 percent decrease from the previous year. More growers planted more corn and soybeans at the expense of cotton, especially for the production of biofuels

**Cottonseed prices:** Cottonseed is a byproduct of cotton production and is used in agriculture for animal feed and in the food industry to make cottonseed oil. Cottonseed production decreased in 2007 to 6.60 million tons, from 7.35 million the previous year, which helped to drive both cottonseed and cotton prices up.

**Climate:** Growing conditions vary from year to year and is a main driver for all crops, including cotton. In particular, droughts can have a devastating effect on crops and can lead to higher abandonment and prices. Nature is an unpredictable component of agriculture and the desire to smooth this risk is one of the reasons exchange traded funds exist.

**Synthetic fabrics:** Competing fibers such as polyester puts pressure on cotton demand. Many mills are shifting toward cotton/polyester blends, which are more durable and easier to maintain than pure cotton fabric. Polyester surpassed cotton as the most used fiber in 2003

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While we have opinions on almost any topic (just ask us), we acknowledge that our chances of *accurately* predicting the future are small, especially when it comes to the pulp market and the economy. Needless to say, we rather agree with Warren Buffett's advice that "it's better to be approximately right than precisely wrong."

Something we feel we are rather consistent with....

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