SEB Commodity Research

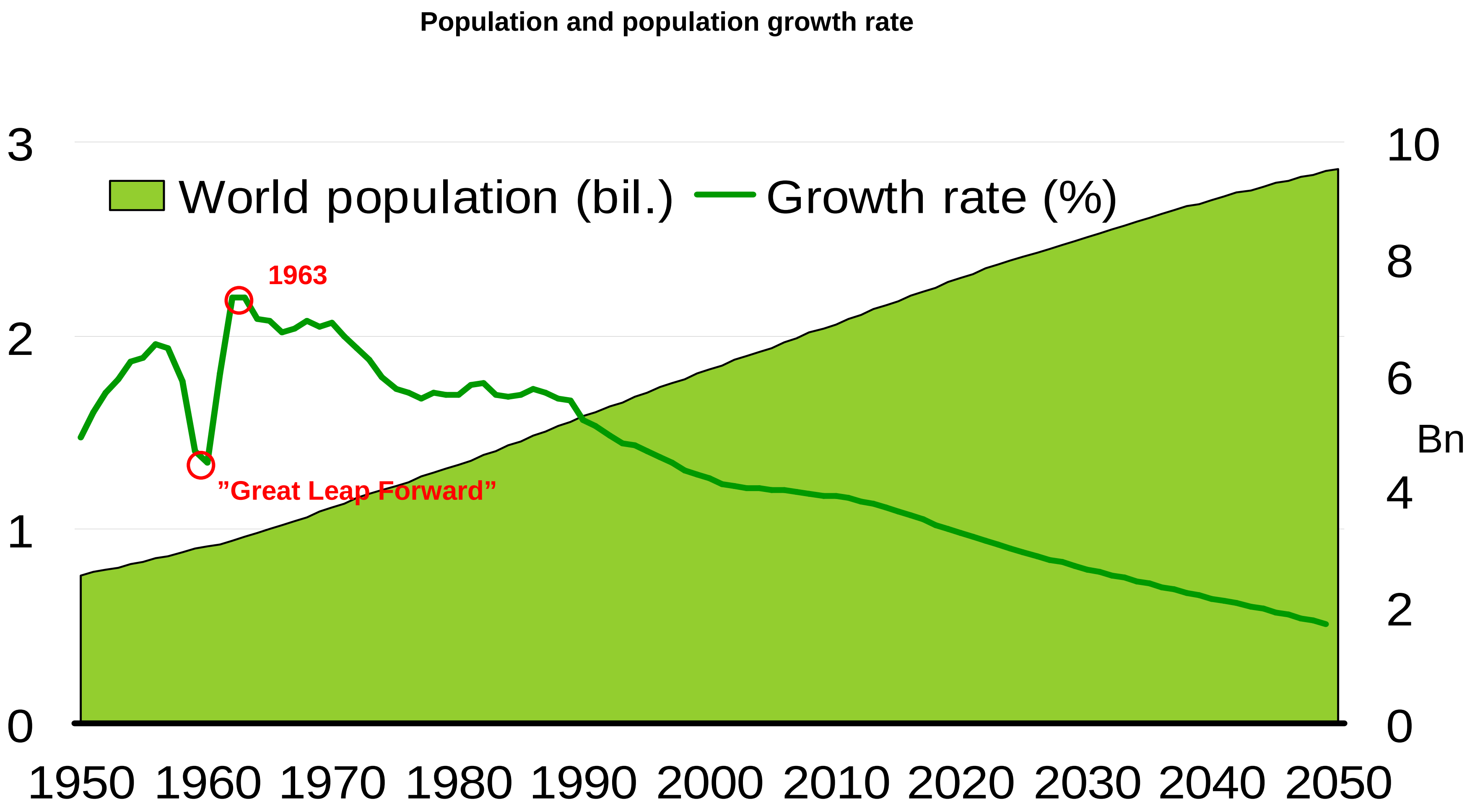
Bergforsk, 2011-05-04

Bjarne Schieldrop
Chief Analyst Commodities SEB
Bjarne.schieldrop@seb.no
+47 9248 9230

SEB and Commodities

- Commodities – an asset class
- Hedging of risk, securing margins
- Capital solutions, funding
- Access to instruments and markets
- Market insight

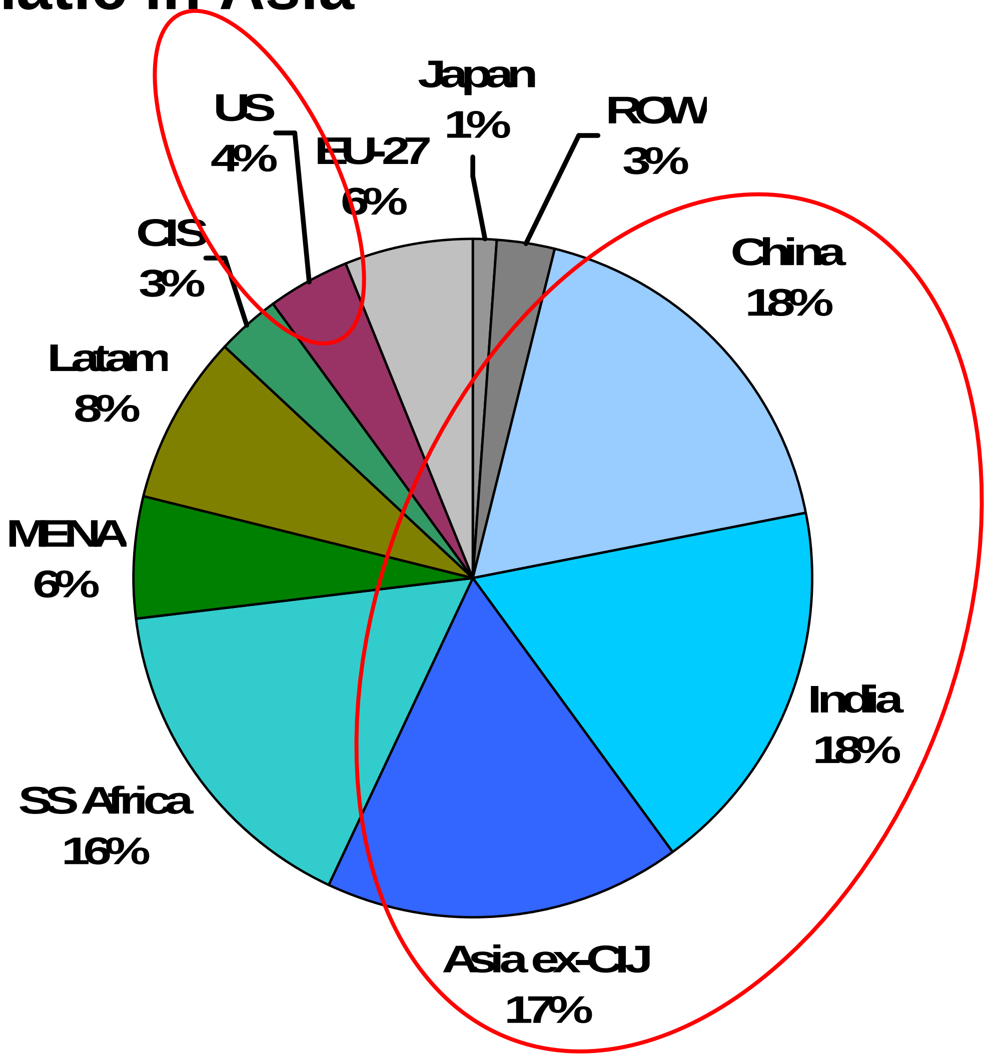
The big drama – 3x in 100 years
Global population



Source: *US Census Bureau, IMF, USDA*

World Population 2030

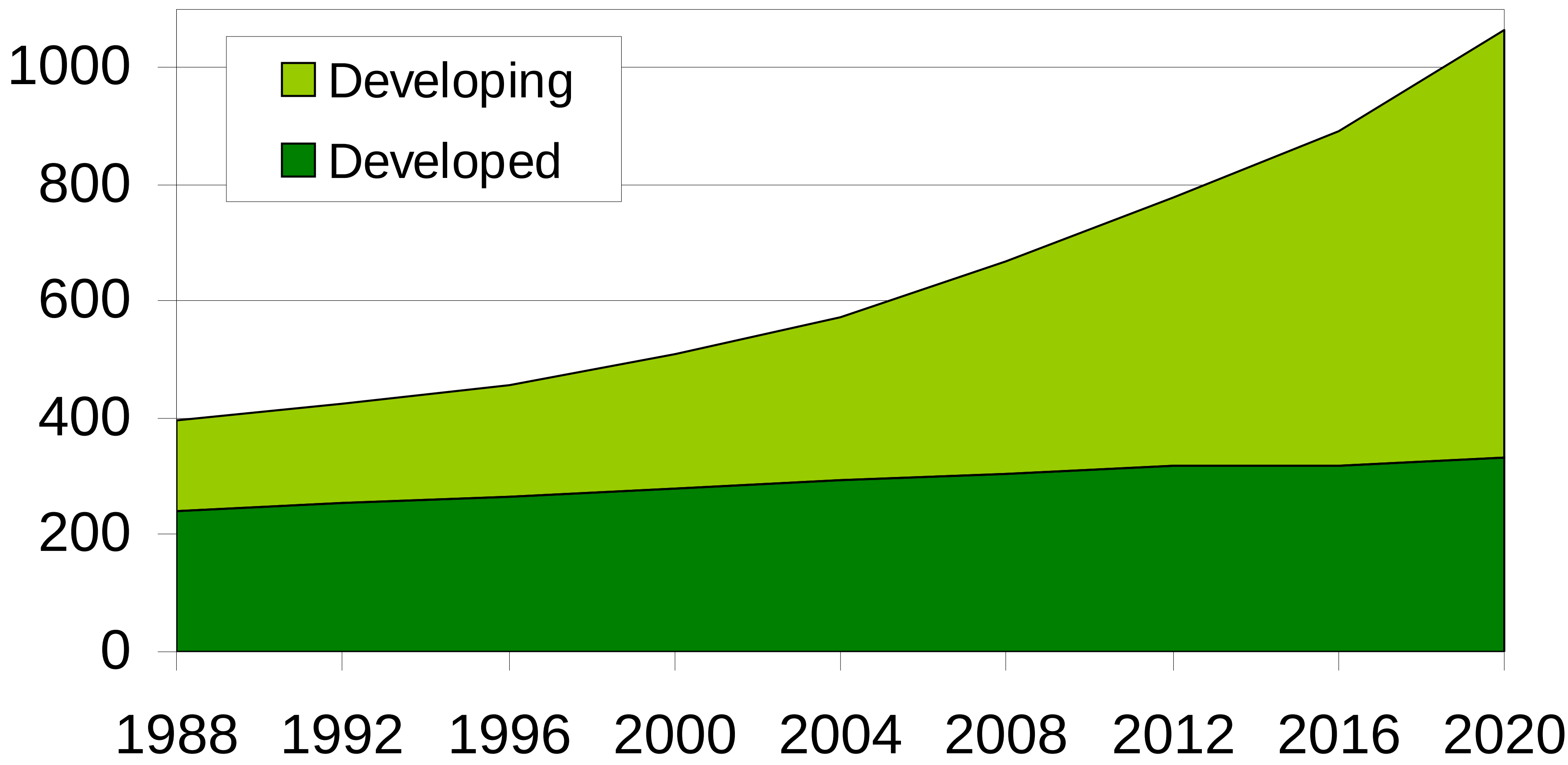
Most dramatic in Asia



Source: *UN*

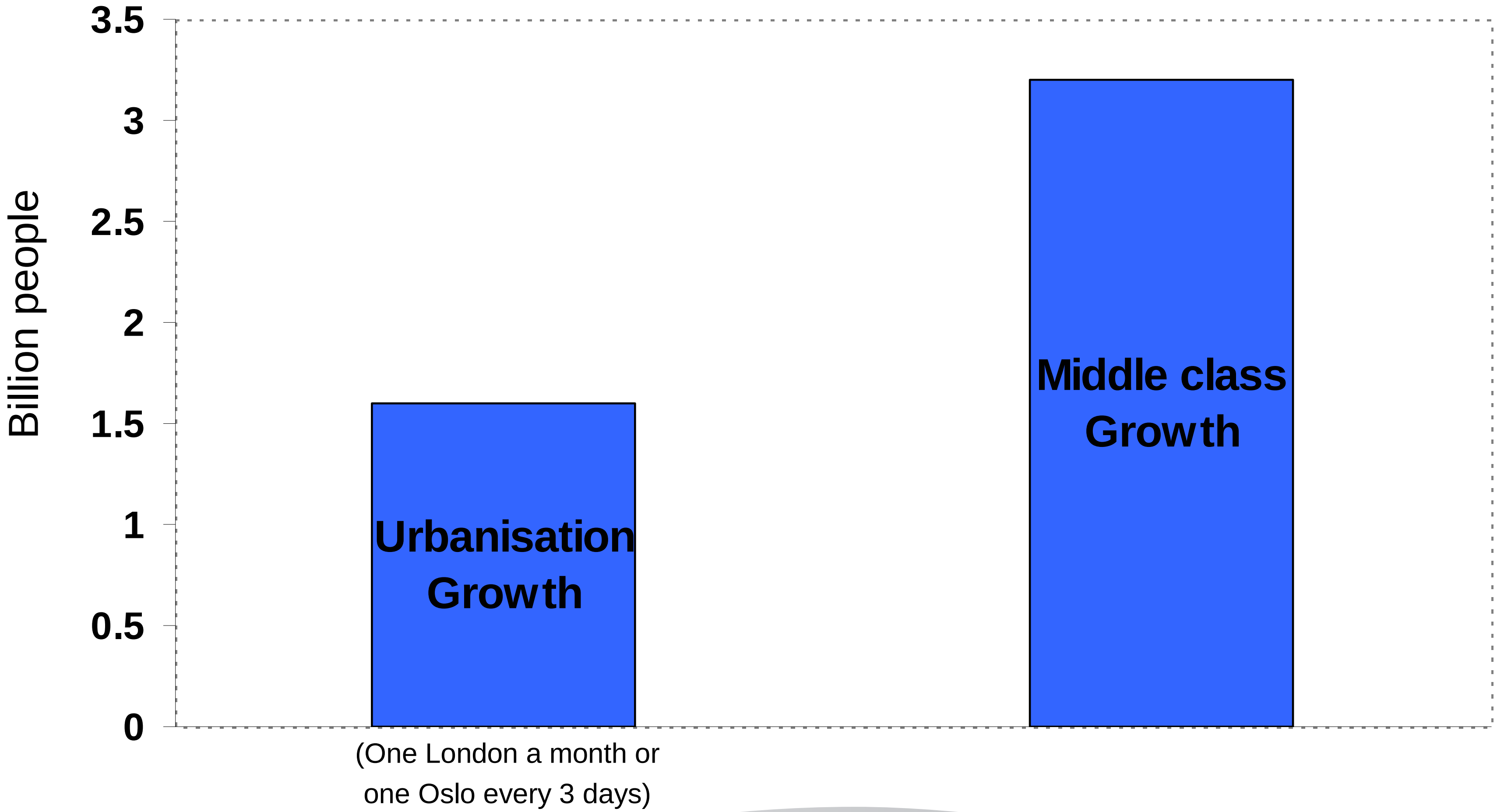
Emerging market middle class

Households with income > $ 20 000/year (in millions)



Source: *US Census Bureau, IMF, USDA*

Growth in Urbanisation and Middle class
2010 to 2030

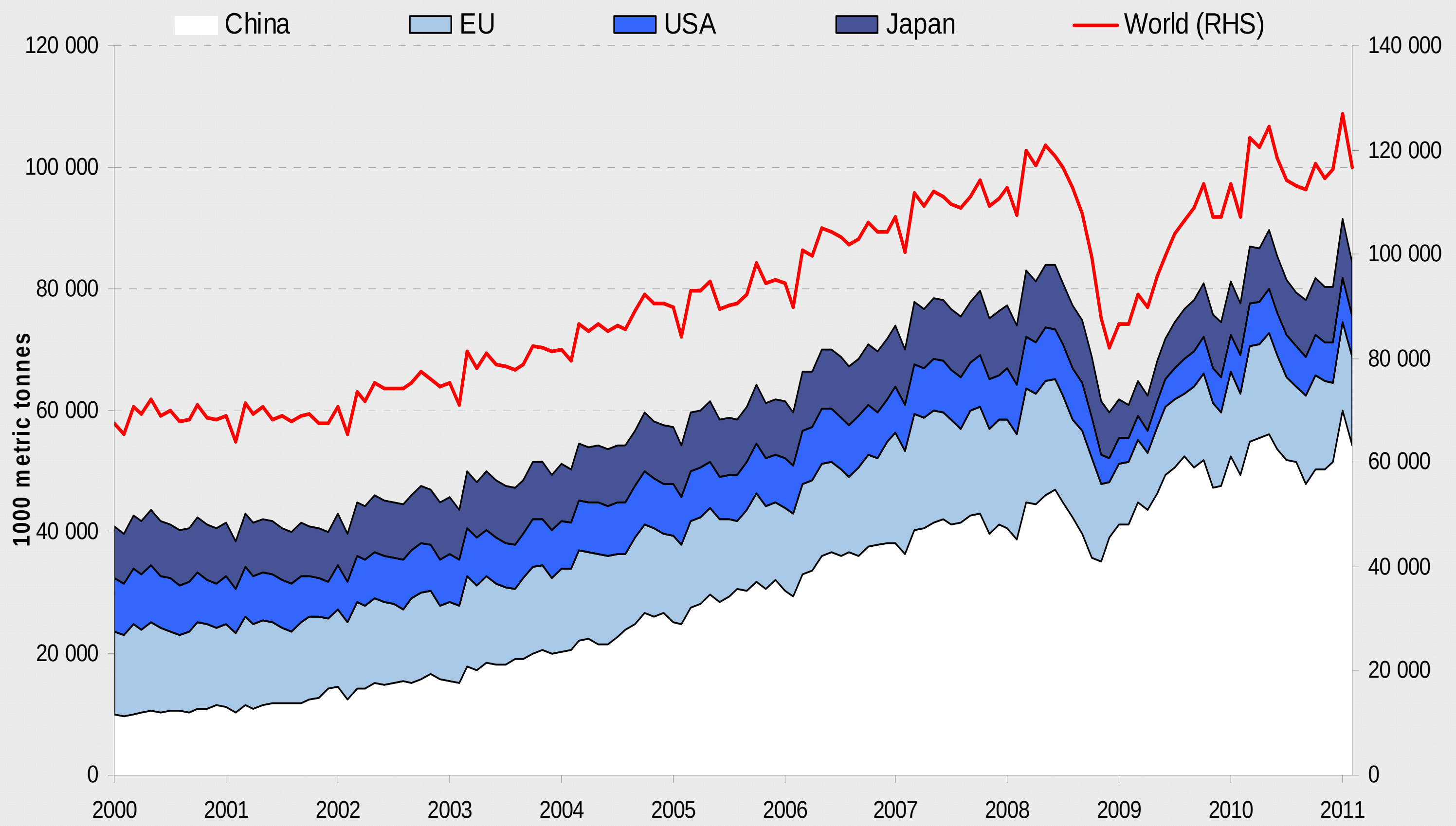


Emerging Markets

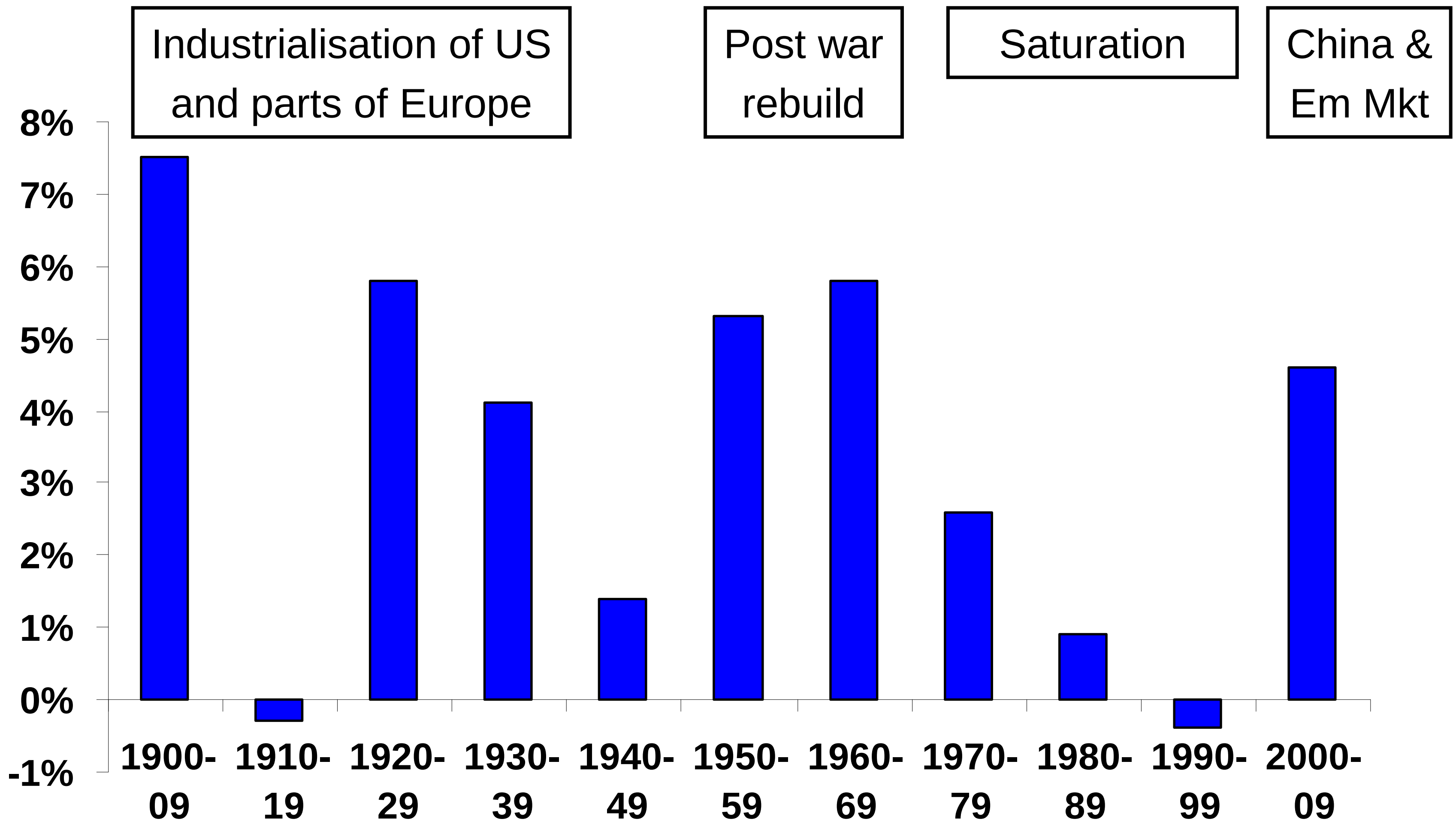
Industrialization, Infrastructure, Urbanization, Consumption

Crude Steel Production (Monthly)

..and all other metals grow proportiaonaly

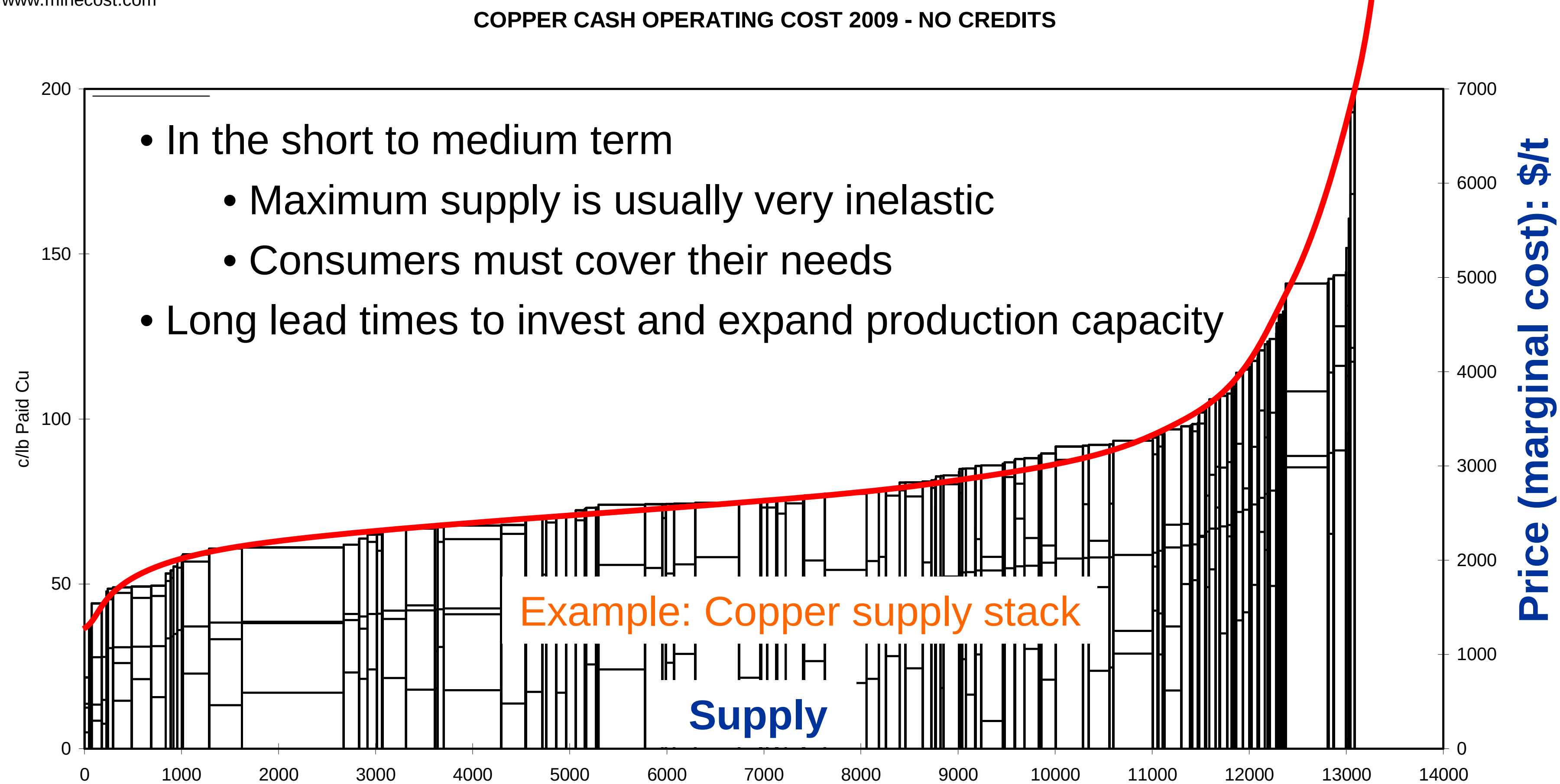


Global steel production growth



The exponential nature of commodity prices

SEB



(Production from all installations sorted from lowest to highest marginal cost)

Huge swings in Metals prices

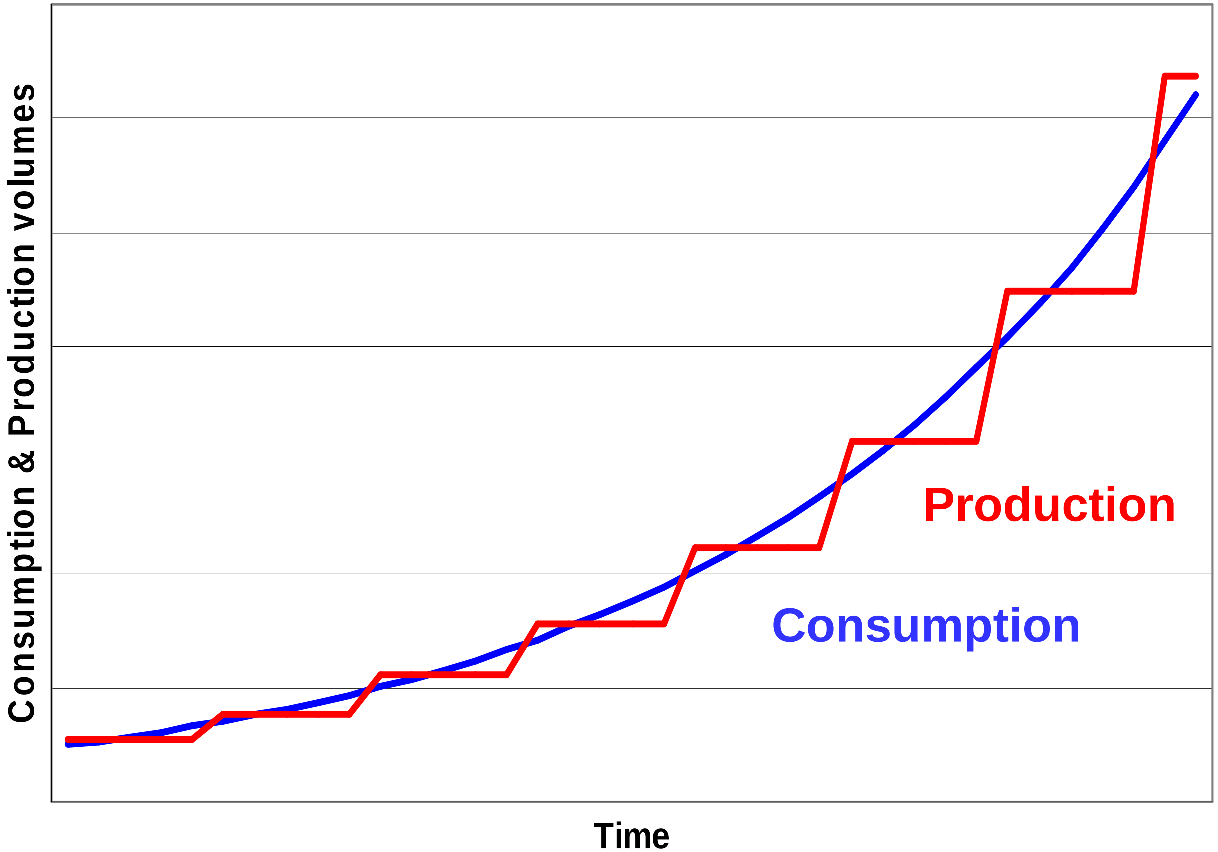
Higher risk profiles for commodity related companies

Source: Bloomberg CMIMPI Metals Index

Source: CMIMPI Ajdusted with USD Index 2001

Supply & Demand unsynchronized

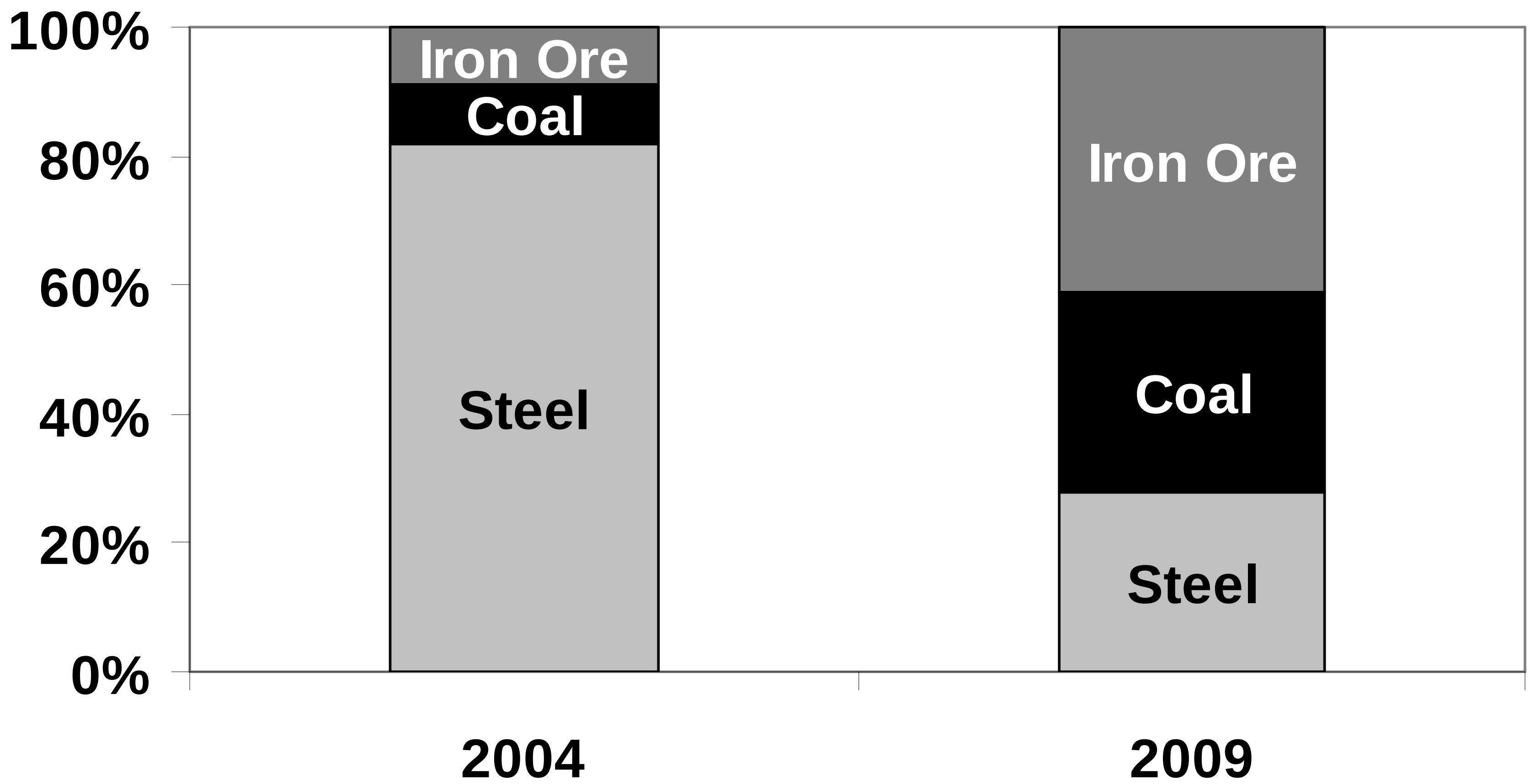
Strong demand growth – Stepwise supply growth



- Super cycle accelerating demand growth
- Commodities likely to experience more frequent high volatility periods

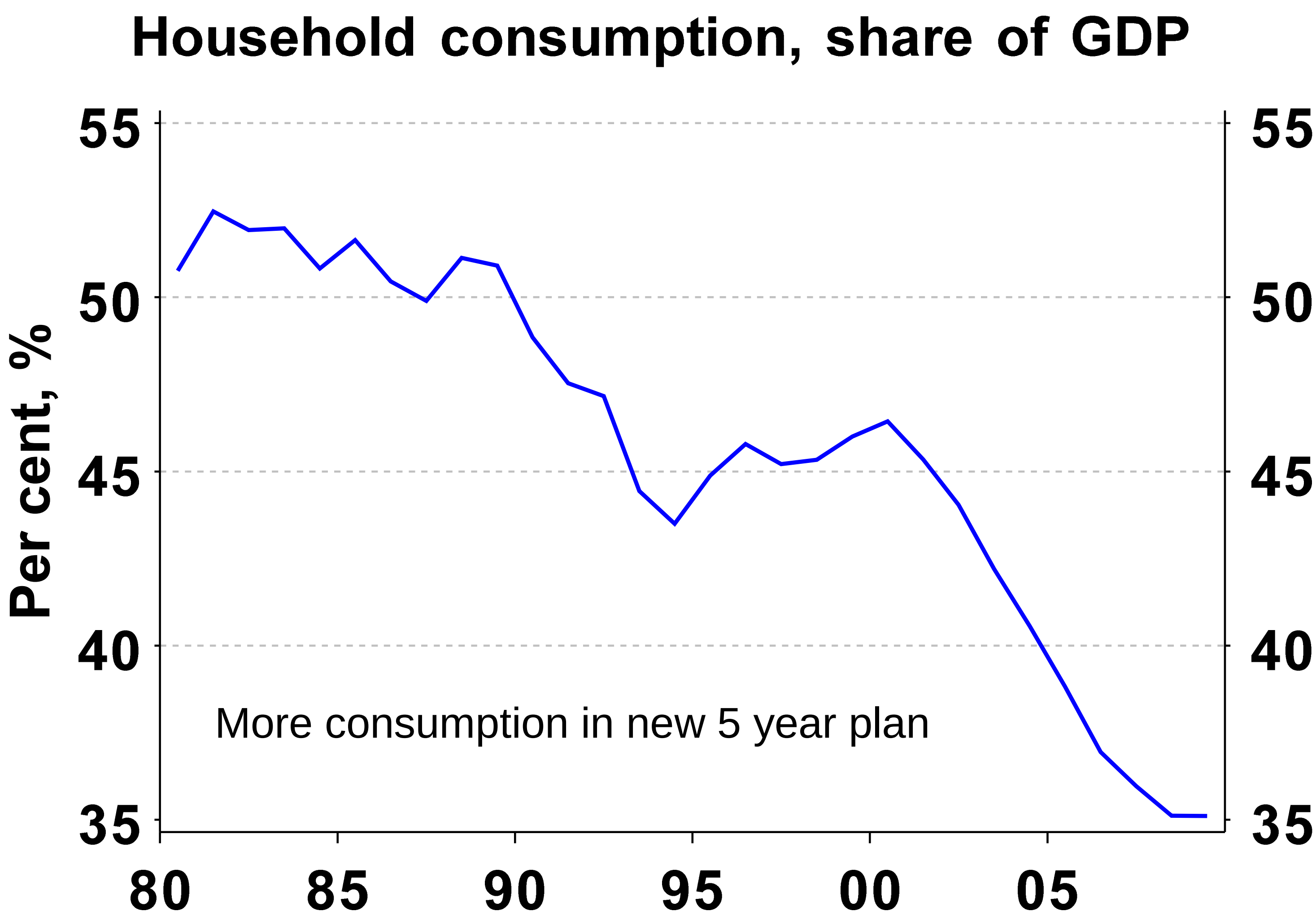
Profit splitt in Value Chain

Rappid changes, unpredictable future

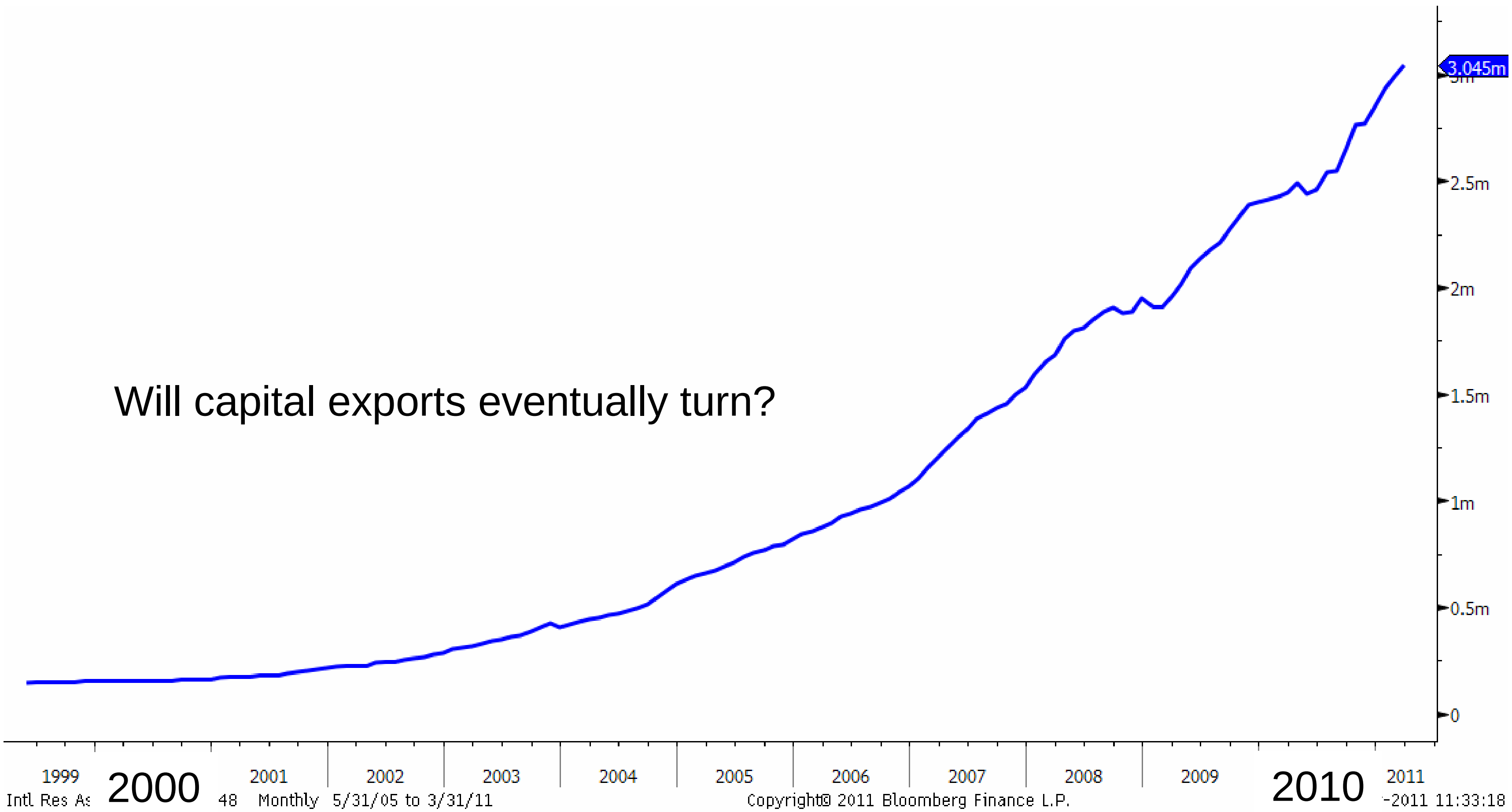


Source: Eurometal

China is not Crash proof



Chinese fx reserves = USD 3 Trillion

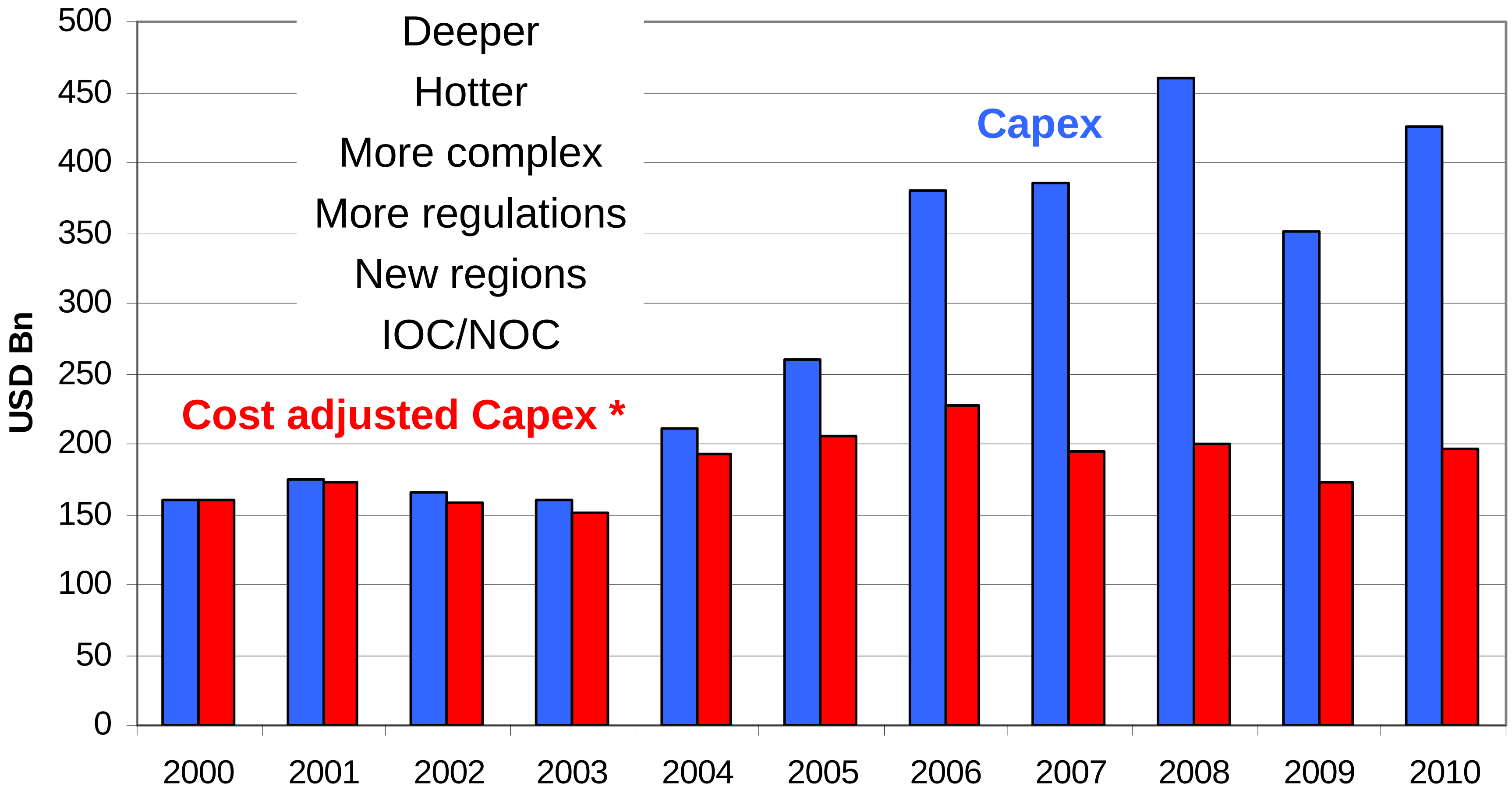


A Chinese property bubble?

Worrying, for more than just industrial metals

Capex Upstream Oil and Gas

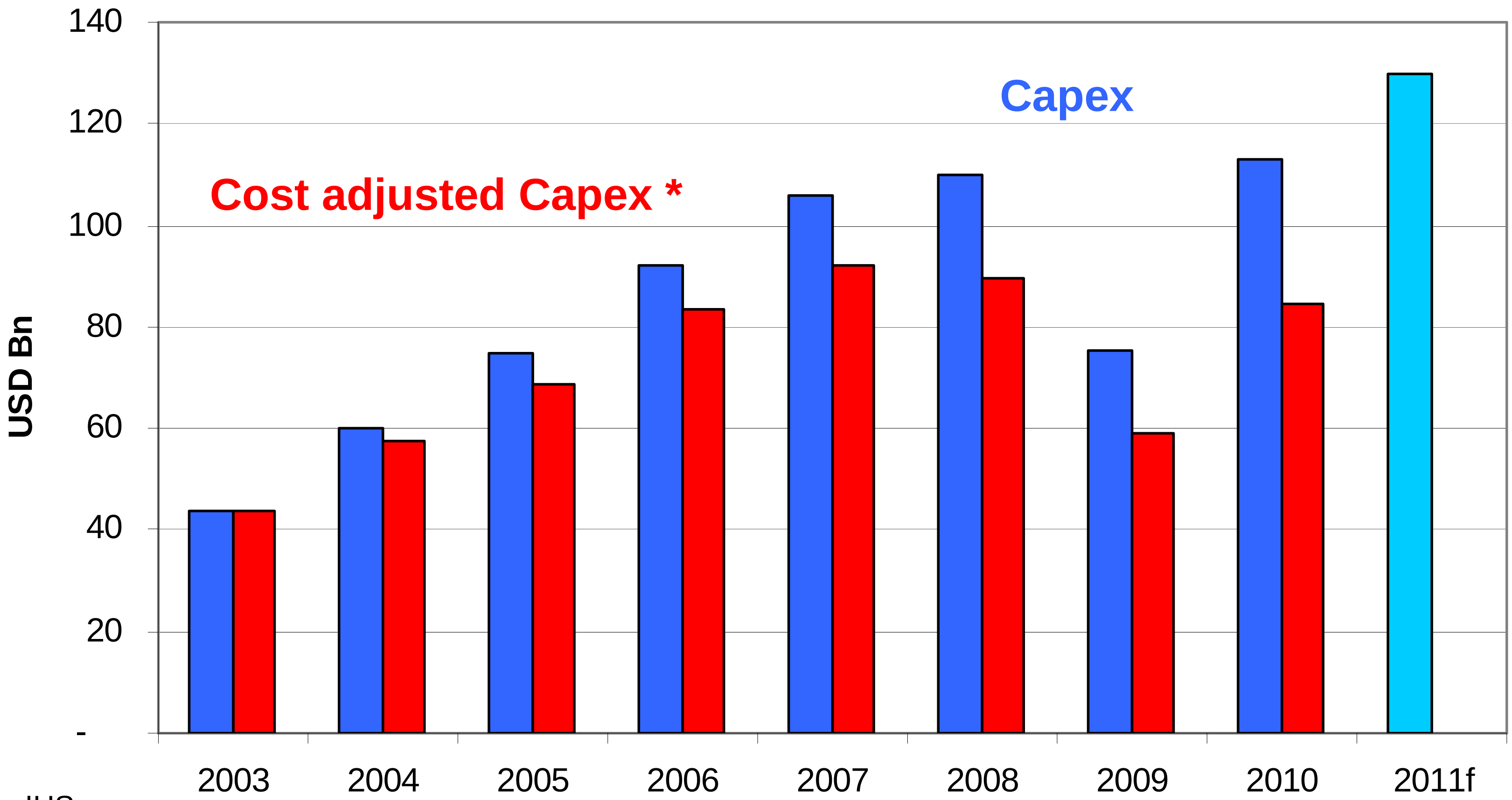
More money, but less bang per USD



Source: IHS, IEA, Morgan Stanley

*Adjusted with HIS upstream cost index, Yr 2000 = 100

Global Mining Capex



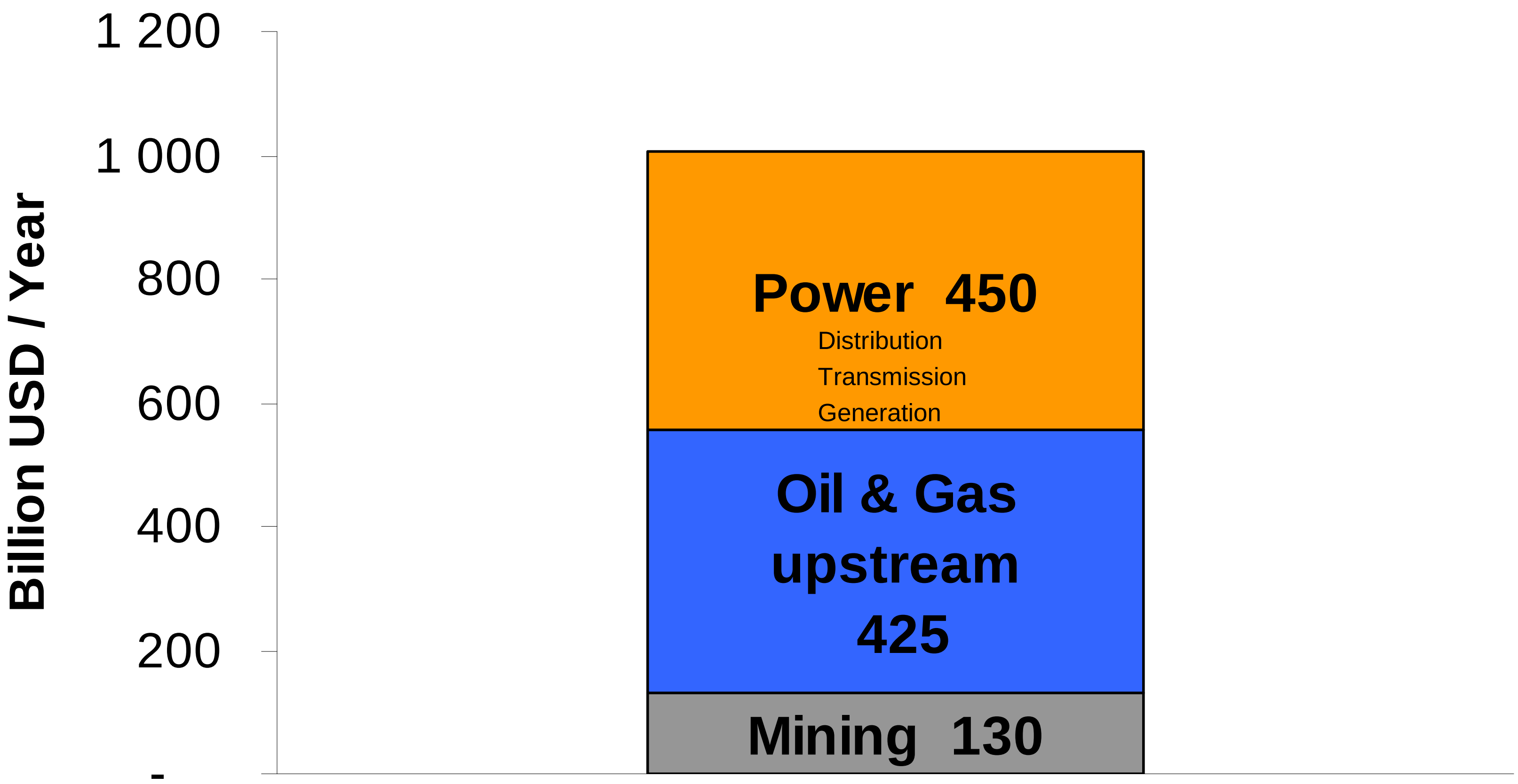
Source: IHS,

Source: McKinsey, Xstrata

* Adjusted Canadian Mine Cost Index MCS, Yr 2003 = 100

Commodity Capex per Year

Mining is the little one



Low borrowing rates coming to an end

10Y US Tresury yields heading down since 1980

Harder fight for capital

Higher risk profiles for commodity companies

SEB

- Declining ore grades
- More complex technology
- Deeper, hotter, new geographies
- Rising costs
- Environmental regulations
- End of long term prising agreements
- Huge price swings
- Chainging margin splits in value chain
- Higher risk, more uncertain returns
- Credit rating?
- Banks reaching sector lending limits

- **Necessary to access new sources of capital**

Unstable sources of supply

Region/ Nation	Political Stability	Regulatory Efficiency	Corruption Control
AFRICA			
Botswana	1	2	1
DR Congo	4	4	4
Ghana	3	2	2
Guinea	4	4	4
Madagascar	3	3	2
Namibia	1	2	2
South Africa	2	2	2
Zambia	2	3	3
Zimbabwe	4	4	4
ASIA			
Indonesia	4	3	3
Kazakhstan	2	3	4
Mongolia	2	3	3
Papua New Guinea	3	3	4
Philippines	4	2	3
Russia	2	3	4
Uzbekistan	4	4	4
LATIN AMERICA			
Argentina	3	3	3
Bolivia	4	4	3
Brazil	3	2	2
Chile	1	1	1
Mexico	4	2	3
Peru	4	2	3
Venezuela	4	4	4

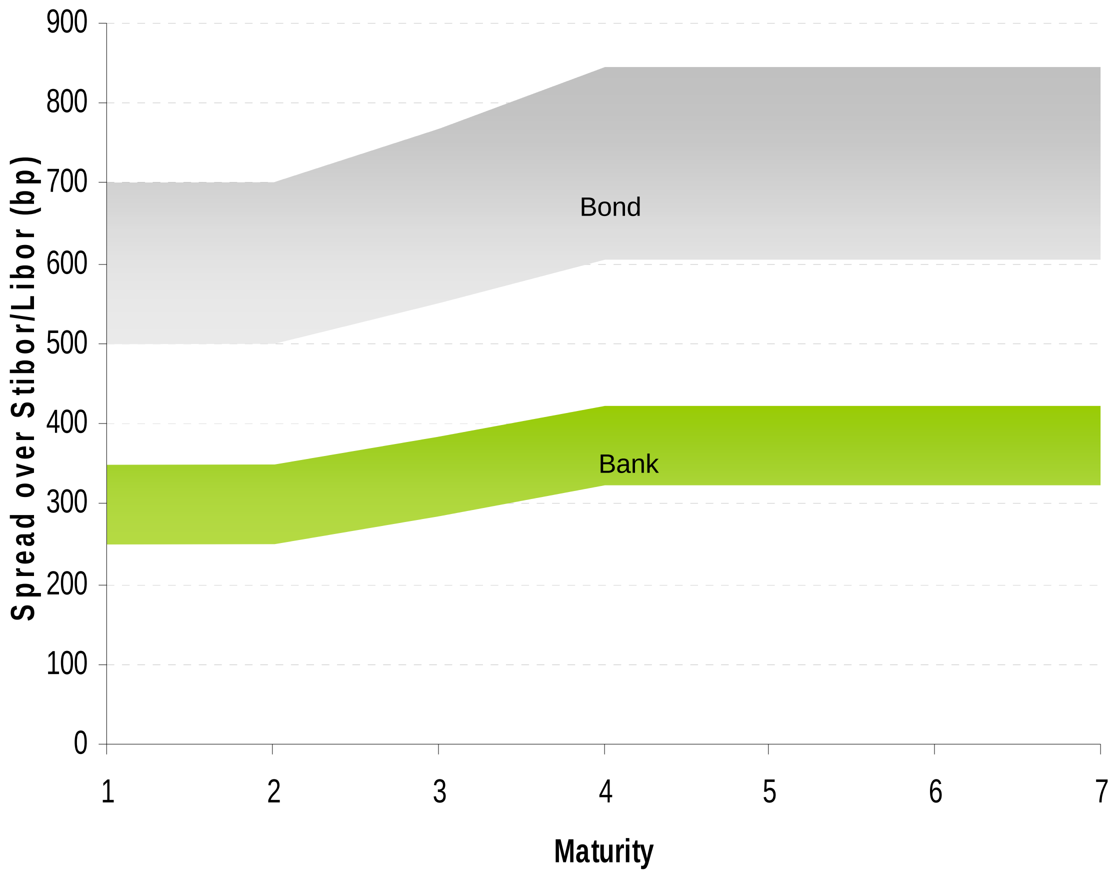
1 is best and 4 is worst

Source: World Bank 2009, Governance Measures

High Yield bonds – on of many sources

- Financing brown/greenfield development

Higher spreads than bank loans...

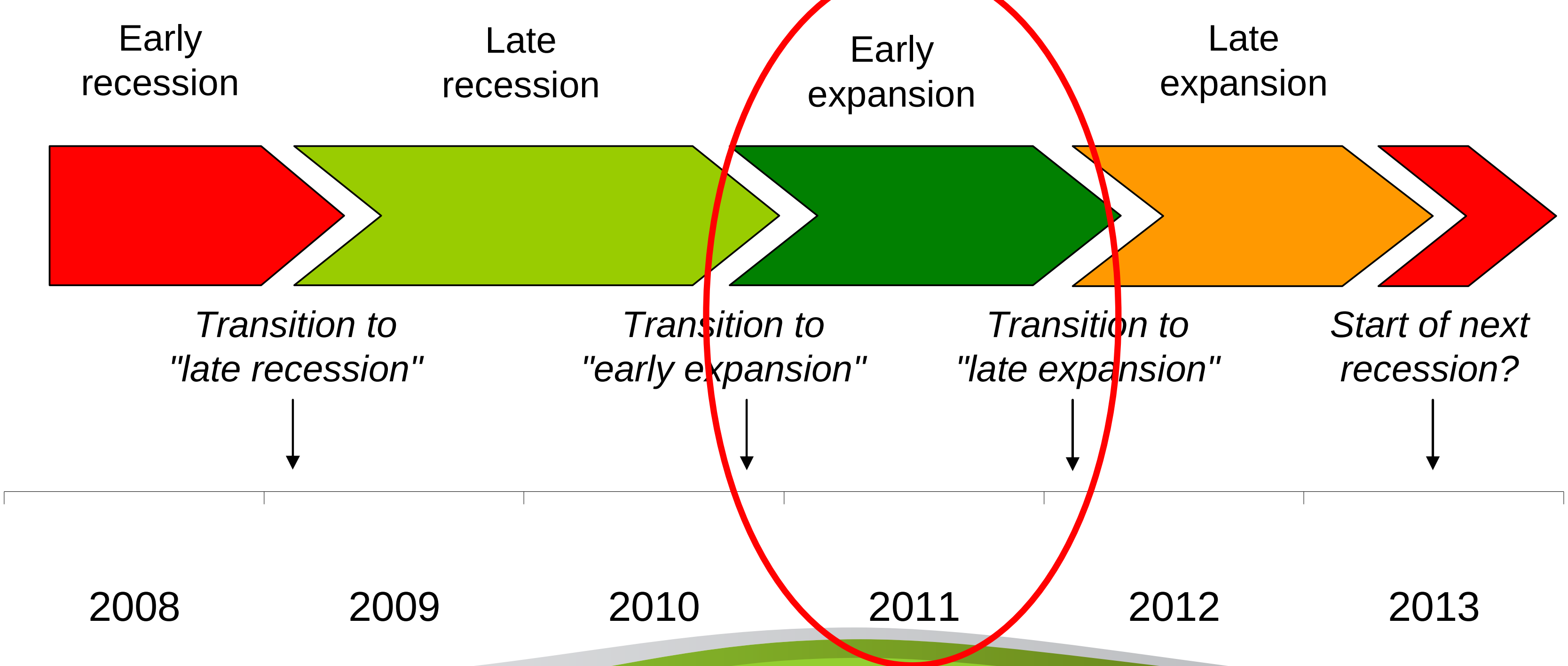


But bonds facilitate better cashflow than banks

- Later repayment of cashflows yield higher returns
- More flexible documentation
  - Less strict covenants
  - Higher loan-to-value
- More flexible drawdown
- A kind of subsitute for equity

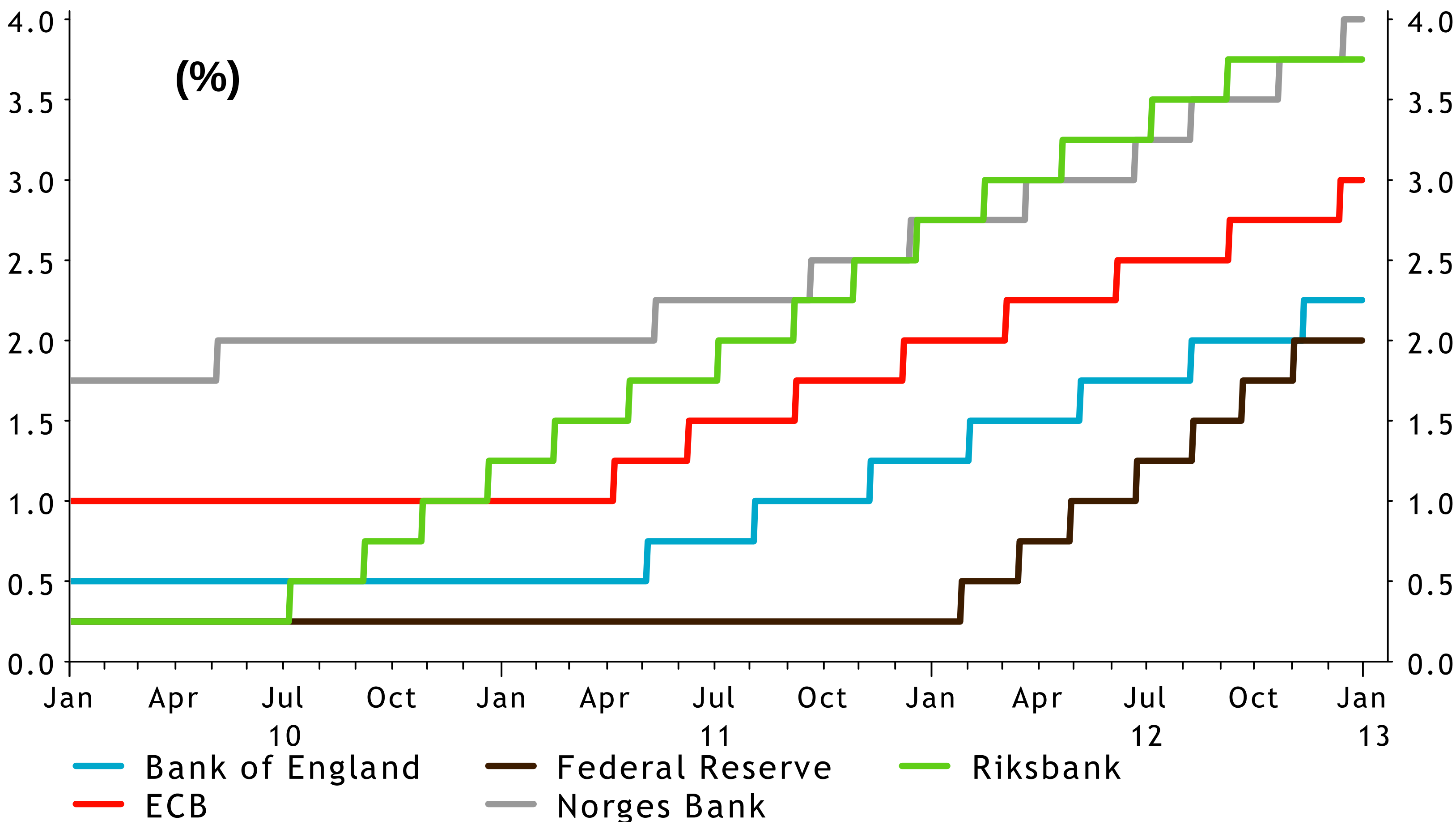
Strategic roadmap

Sub-trend return for stocks, bonds	*Above-trend return for both bonds and stocks*	*Cyclical bull market for stocks, rising yields*	*Above-trend returns for commodities, stocks*
Rate peak, inv curve	*Rate cuts, steeper curve*	*Rate trough, curve peak*	*Rate hikes, flatter curve*
Very high volatility	*Above-trend volatility*	*Very low volatility*	*Sub-trend volatility*
Defensive, large cap	*Early cyclical, small cap*	*Late cyclical, all cap*	*Yield sensitive, large cap*



Interest rate hikes are coming

ECB's dilemma: one size does not fit all



Source: SEB Economic Research

Outlook

SEB

	0-3M	4-6M	7-12M	
OVERALL	↗	↘	→	• High prices, long specs and uncertainty • Correction lower appears unavoidable
CRUDE OIL	↗	↘	→	• Risk skewed to the upside of $120/b in Q2 • So far only limited demand destruction
INDUSTRIAL METALS	→	→	↗	• Chinese soft vs. hard landing central • Short term risk skewed to the downside
PRECIOUS METALS	↗	→	↘	• Broad range of supportive factors for gold • Silver has rallied in retail hype
ARICULTURE	→	↘	↘	• Low inventories short term supportive • Demand destruction limiting upside

Disclaimer & Confidentiality notice

Τηε ινφορματιον ιν τηισ δοχυμεντ ηασ βεεν χομπιλεδ βψ ΣΕΒ Μερχηαντ Βανκινγ, α διϖισιον ωιτηιν Σκανδιναϖισκα Ενσκιλδα Βανκεν ΑΒ (πυβλ) (ΣΕΒ).

Οπινιονσ χονταινεδ ιν τηισ ρεπορτ ρεπρεσεντ τηε βανκ σ πρεσεντ οπινιον ονλψ ανδ αρε συβφεχτ το χηανγε ωιτηουτ νοτιχε. Αλλ ινφορματιον χονταινεδ ιν τηισ ρεπορτ ηασ βεεν χομπιλεδ ιν γοοδ φαιτη φρομ σουρχεσ βελιεϖεδ το βε ρελιαβλε. Ηοωεϖερ, νο ρεπρεσεντατιον ορ ωαρραντψ, εξπρεσσεδ ορ ιμπλιεδ, ισ μαδε ωιτη ρεσπεχτ το τηε χομπλετενεσσ ορ αχχυραχψ οφ ιτσ χοντεντσ ανδ τηε ινφορματιον ισ νοτ το βε ρελιεδ υπον ασ αυτηοριτατιϖε. Ανψονε χονσιδερινγ τακινγ αχτιονσ βασεδ υπον τηε χοντεντ οφ τηισ δοχυμεντ ισ υργεδ το βασε ηισ ορ ηερ ινϖεστμεντ δεχισιονσ υπον συχη ινϖεστιγατιονσ ασ ηε ορ σηε δεεμσ νεχεσσαρψ. Τηισ δοχυμεντ ισ βεινγ προϖιδεδ ασ ινφορματιον ονλψ, ανδ νο σπεχιφιχ αχτιονσ αρε βεινγ σολιχιτεδ ασ α ρεσυλτ οφ ιτ; το τηε εξτεντ περμιττεδ βψ λαω, νο λιαβιλιτψ ωηατσοεϖερ ισ αχχεπτεδ φορ ανψ διρεχτ ορ χονσεθυεντιαλ λοσσ αρισινγ φρομ υσε οφ τηισ δοχυμεντ ορ ιτσ χοντεντσ.

ΣΕΒ ισ α πυβλιχ χομπανψ ινχορπορατεδ ιν Στοχκηολμ, Σωεδεν, ωιτη λιμιτεδ λιαβιλιτψ. Ιτ ισ α παρτιχιπαντ ατ μαφορ Νορδιχ ανδ οτηερ Ευροπεαν Ρεγυλατεδ Μαρκετσ ανδ Μυλτιλατεραλ Τραδινγ Φαχιλιτιεσ (ασ ωελλ ασ σομε νον–Ευροπεαν εθυιϖαλεντ μαρκετσ) φορ τραδινγ ιν φινανχιαλ ινστρυμεντσ, συχη ασ μαρκετσ οπερατεδ βψ ΝΑΣΔΑΘ ΟΜΞ, ΝΨΣΕ Ευρονεξτ, Λονδον Στοχκ Εξχηανγε, Δευτσχηε Β)ρσε, Σωισσ Εξχηανγεσ, Τυρθυοισε ανδ Χηι–Ξ. ΣΕΒ ισ αυτηοριζεδ ανδ ρεγυλατεδ βψ Φινανσινσπεκτιονεν ιν Σωεδεν; ιτ ισ αυτηοριζεδ ανδ συβφεχτ το λιμιτεδ ρεγυλατιον βψ τηε Φινανχιαλ Σερϖιχεσ Αυτηοριτψ φορ τηε χονδυχτ οφ δεσιγνατεδ ινϖεστμεντ βυσινεσσ ιν τηε ΥΚ, ανδ ισ συβφεχτ το τηε προϖισιονσ οφ ρελεϖαντ ρεγυλατορσ ιν αλλ οτηερ φυρισδιχτιονσ ωηερε ΣΕΒ χονδυχτσ οπερατιονσ.