Direct Commodity Investments

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NATIONAL BANK FINANCIAL GROUP

WAISC WEST 2013
World Alternative Investment Summit Canada

NBC Commodities

- **15-person Calgary-based team running both a client-driven and strategic trading operation**
- **Largest trader of financial energy derivatives among Canadian banks**
  - Collective team experience in excess of 250 years in the field of energy trading and risk management
  - strategic trading activities largely to support client-driven business
  - **Energy capabilities: crude oil, refined products, both physical and financial natural gas, coal**
    - OTC swaps and broad range of option/swaption structures
- Broad base of corporate flow hedging activity
  - **150+ transactional clients over the past 12 months**
    - **60% producers by client count (90 clients), 75% producers by volume**
    - Largest lender to the Canadian small-cap producer community, with solid participation in mid-size and large producer tiers as well
- Target market will always be participants in the Canadian market given lending base
  - **first Canadian bank providing WCS (Canadian heavy crude), Edm Sweet and NGL risk management structures**
    - **35 active clients on differentials over the past 12 months**
- **Well-received daily commentary circulated to over 2,000 people**
- **Trading desks provide the hedge for all the Horizons BetaPro commodity ETFs:**
  - Crude, natural gas, gold, silver, copper
- Broad contact with institutional investors, providing market updates and offensive/defensive direct commodity trade ideas
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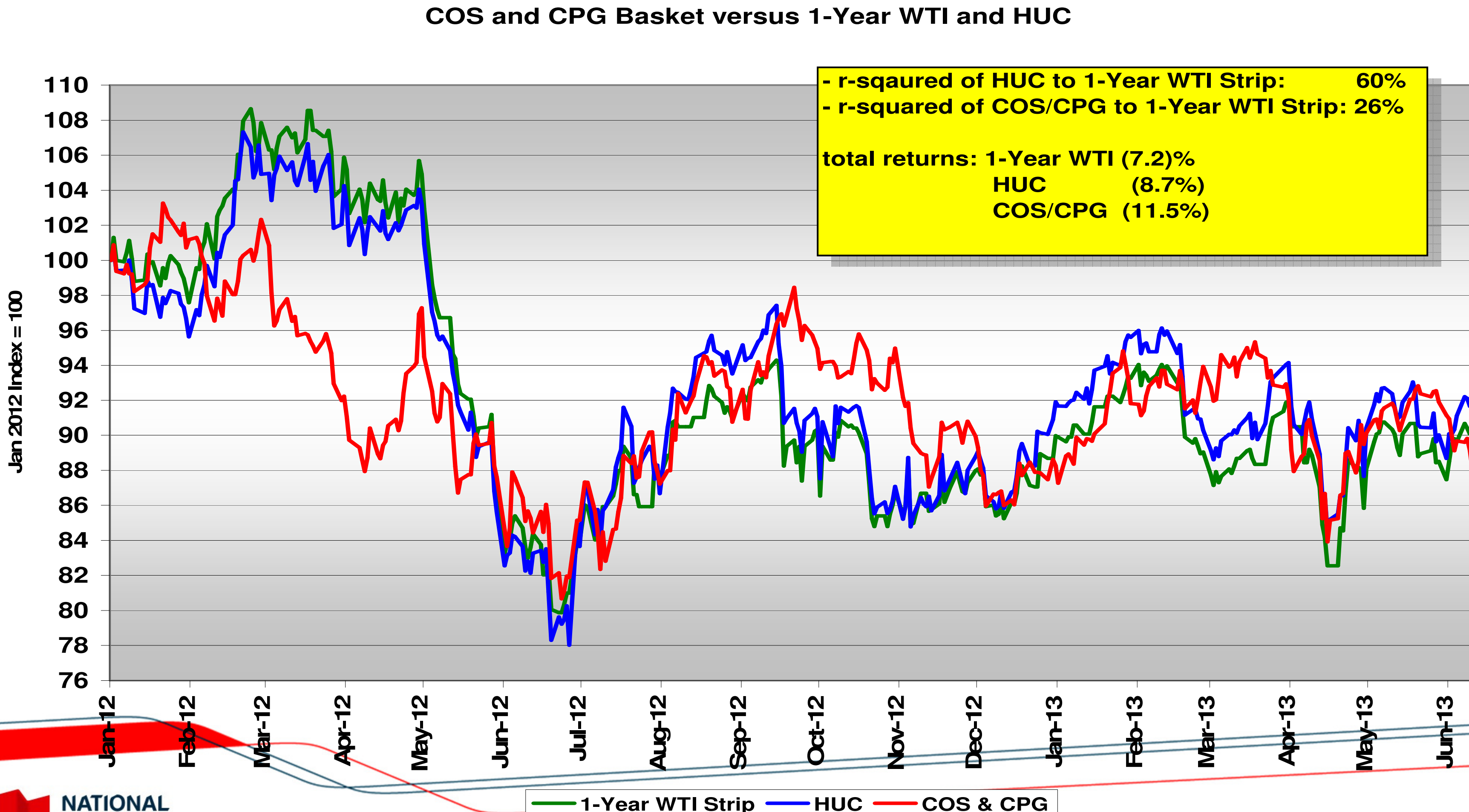
- **Work with retail distribution team to design commodity-linked structures**

Why Invest Directly in Commodities?

- Diversification vis-à-vis equity and bond holdings
- Inflationary hedge
  - Primary drivers for large institutions like Ontario Teachers' Pension Plan
- Capitalize on directional price views
- Capture perceived mispricing between equity and commodity markets
- Take advantage of structural market anomalies
- Hedge of existing investments
- Allows for structures that are tailor-made to the investor's view on commodity pricing relationships and the timing of any potential move

Directional Price Views

- Historically if investors had a strong view on a commodity price, buy equities of commodity producers
- Several problems with this approach based on the lack of correlation between equities and the commodity price:
  - Company-specific risks (BP and Deepwater Horizon)
  - Company hedging programmes
  - Influence of broad equity movements



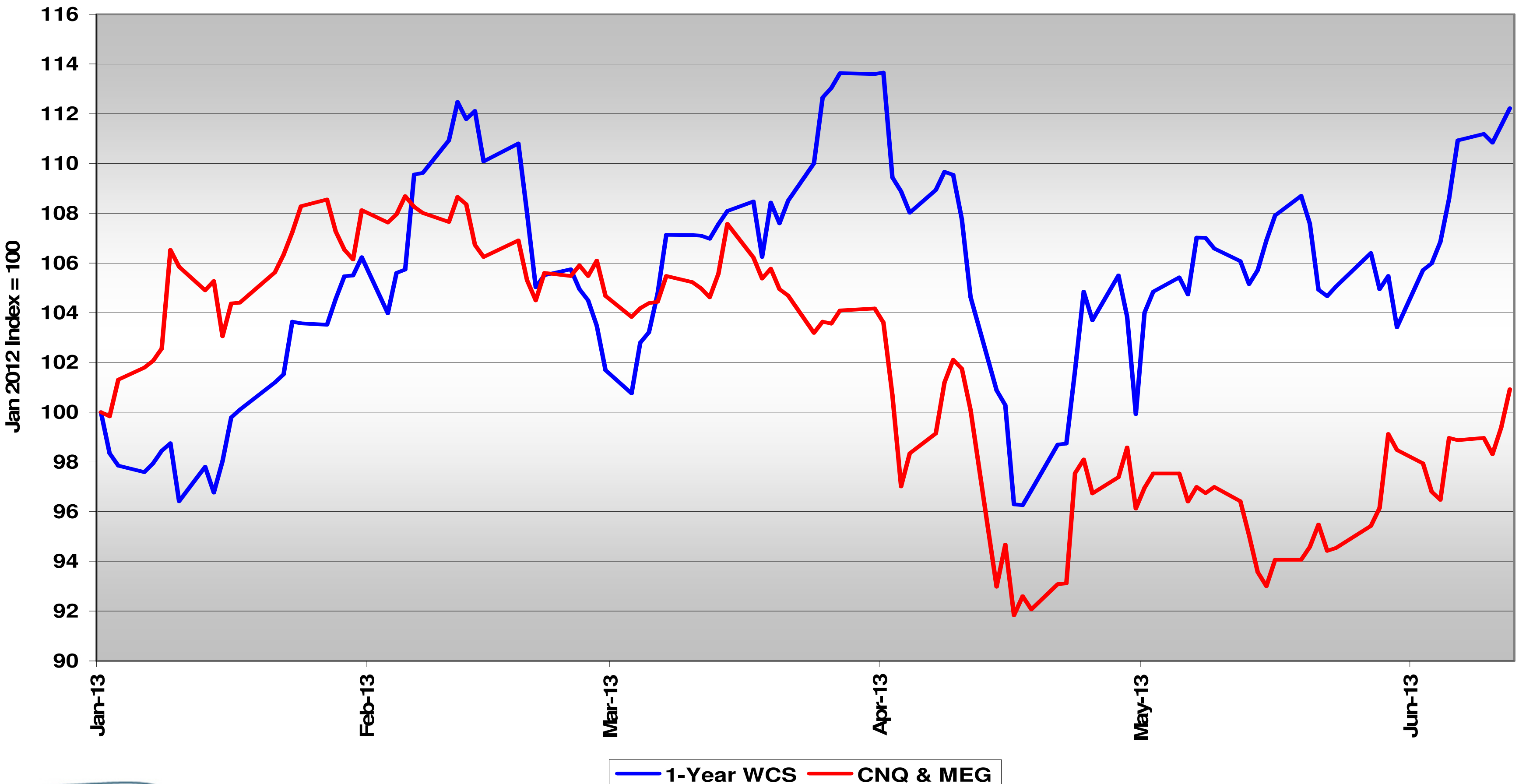
Commodity ETFs

- Direct plays on the underlying commodity
- E.g. Horizons energy ETFs
  - HOU, HOD, HNU, HND – 2X leverage to rolling prompt NYMEX WTI and natural gas futures contracts
  - HUC – single leverage tracking nearby Dec WTI contract rolling once a year in June to the second nearby Dec futures contract
  - HUN – single leverage tracking nearby Jan NYMEX natural gas contract rolling once a year in November to second nearby Jan futures contract
    - Both HUC and HUN were structured to minimize the adverse effect of contango (near-term forward market premium) on conventional spot-indexed commodity ETFs
  - HOY and HNY – single leverage NYMEX oil and gas ETFs with covered call yield component

Another Better Price Play and a Structural Market Anomaly

- Preponderance of producer selling of WCS (Cenovus, CNQ, Northern Blizzard, Twin Butte…)
- Interesting alternative way of playing the Keystone XL decision

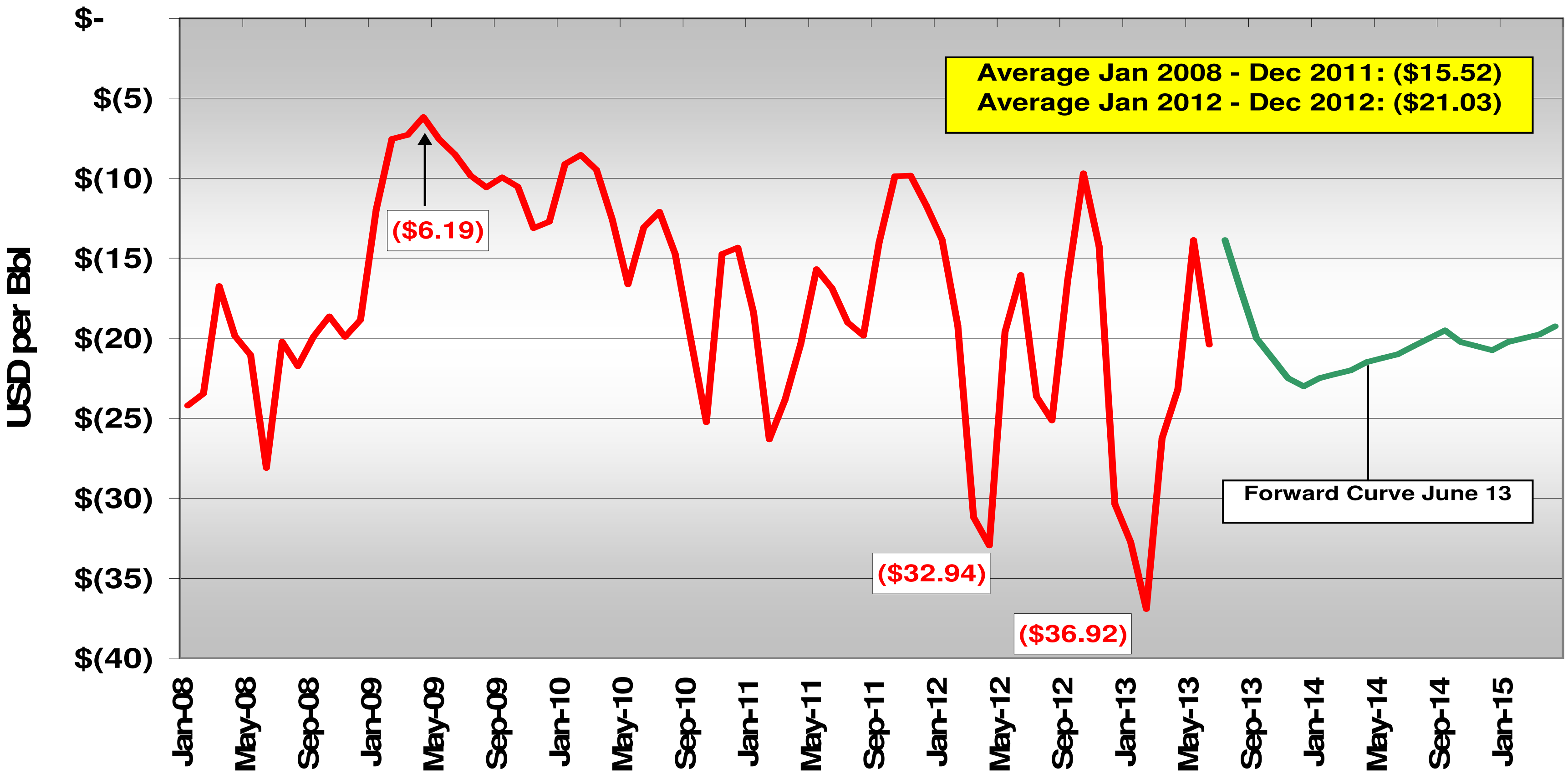
CNQ and MEG Basket versus 1-Year Western Canadian Select (WCS)



WCS Differential History and Forward Curve

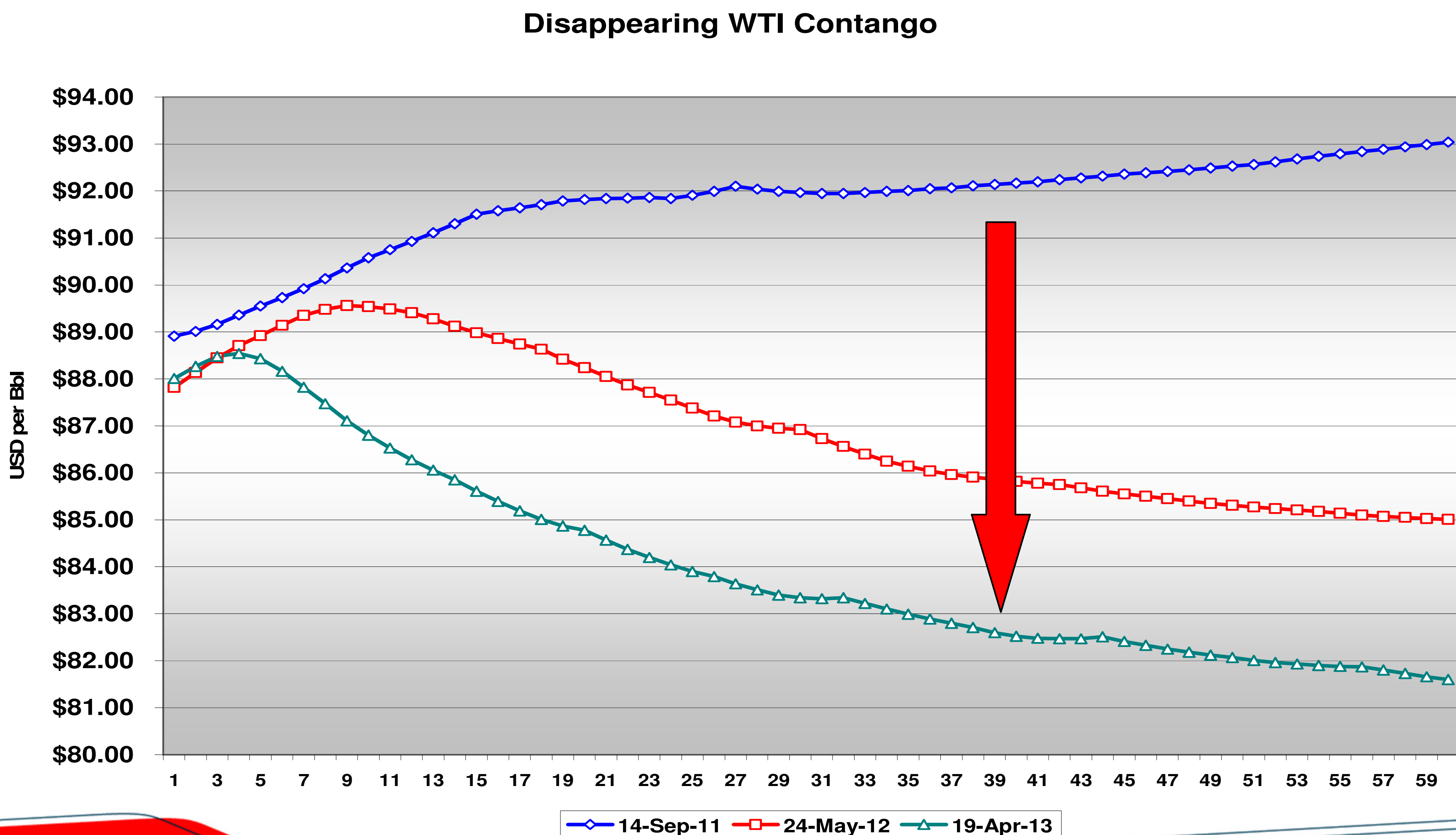
- Preponderance of producer selling of WCS (Cenovus, CNQ, Northern Blizzard, Twin Butte…)
- Interesting alternative way of playing the Keystone XL decision
- Investors as far away as Europe playing the WCS differential directly through the commodity market

WCS USD Heavy Crude Oil Monthly Actual and Forward WTI Basis



Another Structural Market Anomaly – Producer Hedging & Backwardation

- Shale producers have had two impacts on the forward curve:
  - North American production forecasts relaxing the concerns around future supply tightness
  - More aggressive hedging activity



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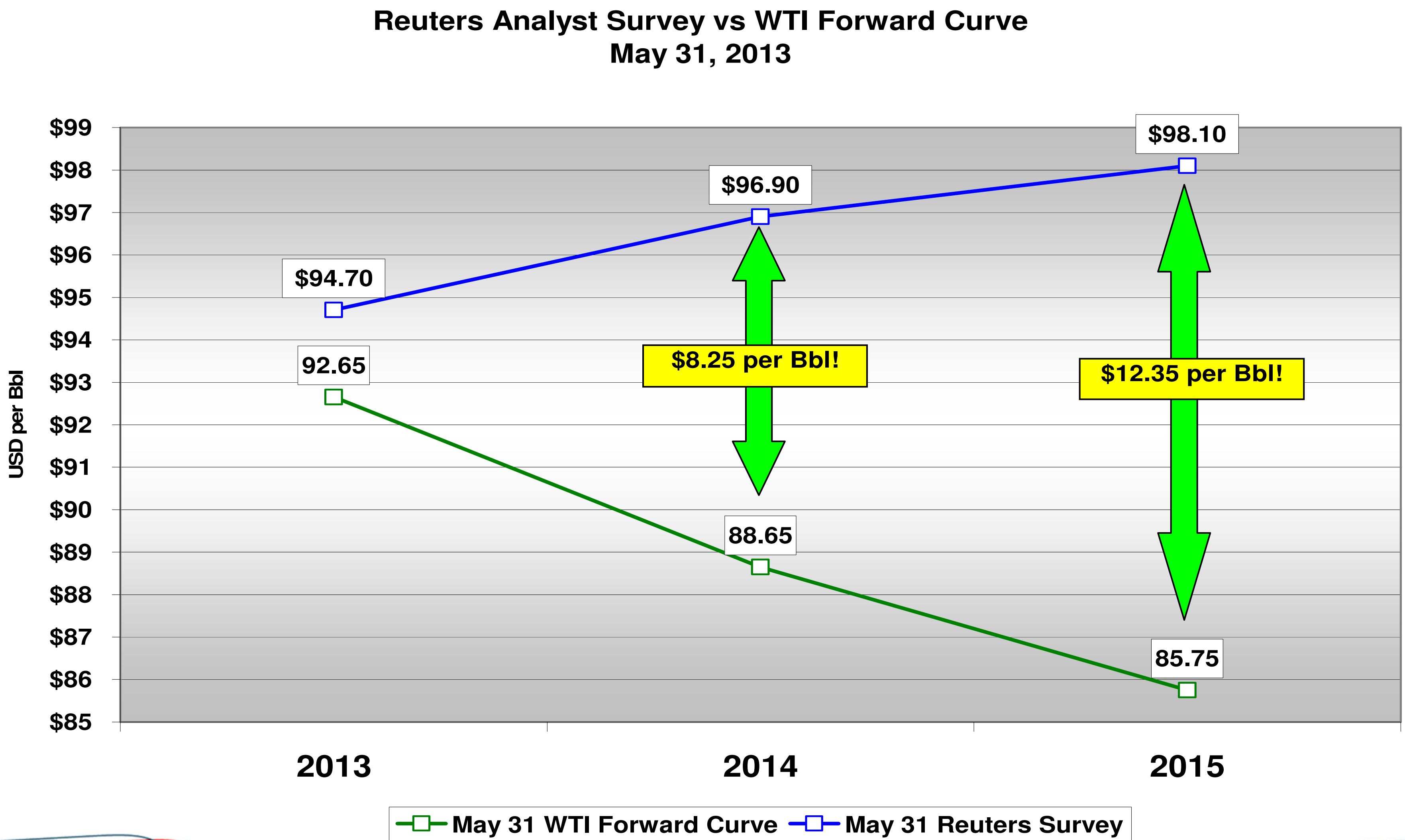
Another Structural Market Anomaly – Producer Hedging & Backwardation

- Forward curve trading at a material discount to average of 25+ oil analysts polled by Reuters at the end of May



Equity/Commodity Spread Trades

- Frequently we have instances where producer equities materially outperform or underperform the underlying commodity
- Creates opportunities for investors to establish spread trades between the commodity and a basket of producer equities
  - Buy the undervalued component and short the overvalued component
- Major institutional investor trade back in 2008 when oil pushed up to $140 and equities still reflecting more of a $100 oil price
  - Buy the producer equities and sell oil through a direct commodity play

Defensive Hedging of Equity Positions

- One might be long a producer equity because of favourable opinion of management team and long-term prospects
  - But there may be considerable concern about a short-term move lower in the company's principal commodity
- Direct commodity price hedges can be established to protect against an adverse commodity price move and its impact on the producer's revenues
  - Average price option strategies can be designed on an over-the-counter basis with a much lower premium than conventional European options on commodities

Types of Direct Commodity Investor Structures

- ETFs
- OTC swaps, options and spread trades
- Structured notes where coupon and/or principal repayment is tied to an underlying commodity price move
- Lots of flexibility to custom-design the product specifically to the client's price view and timing

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