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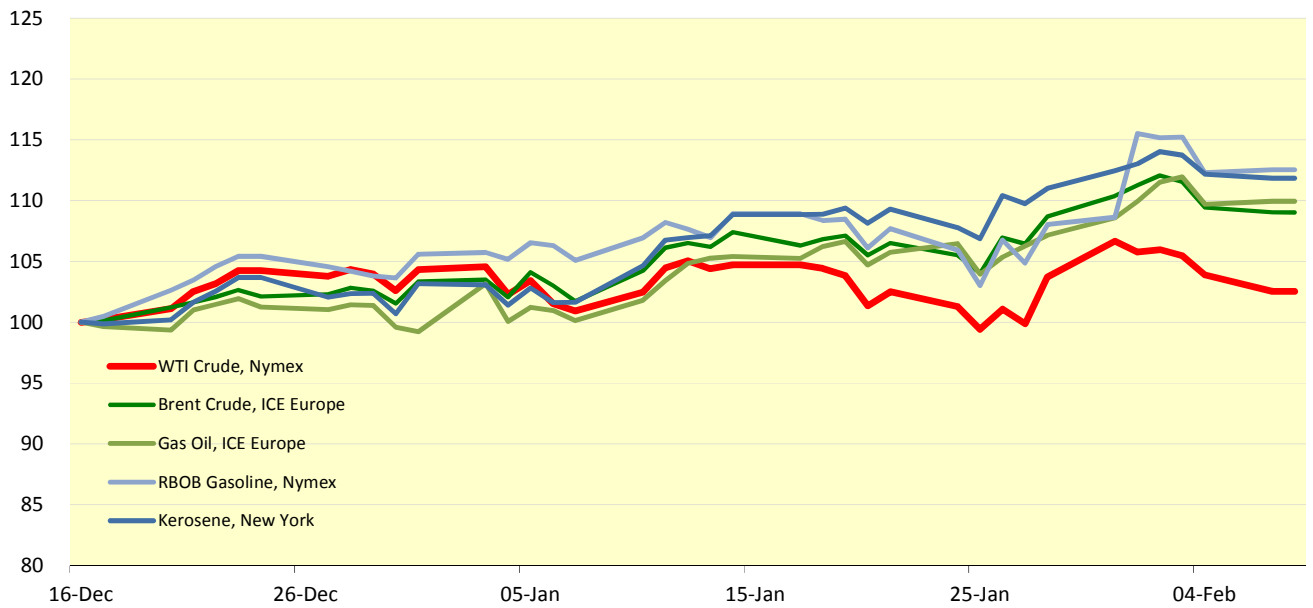
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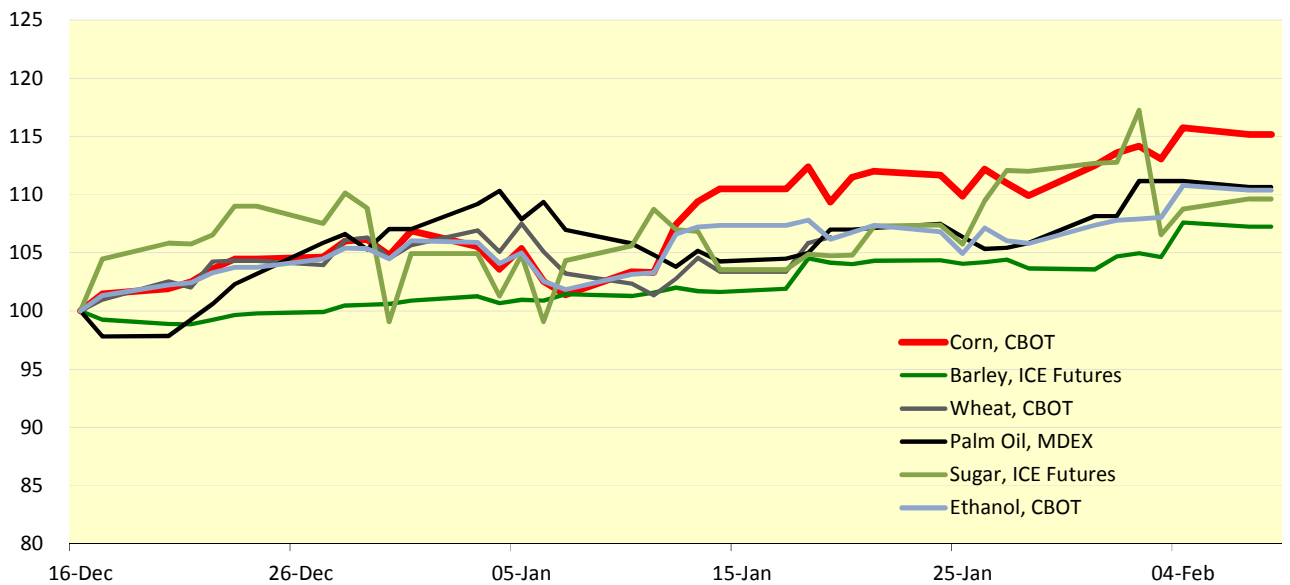
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Selected energy and crop prices, over past month: re-based to 100



Source: VM Group



Source: VM Group

Feature



Water as a peacemaker

By Paul Hannon

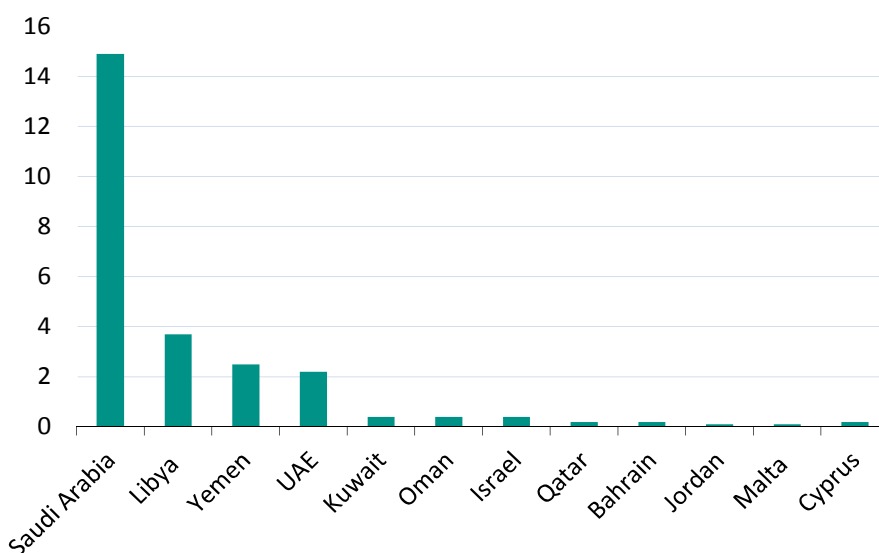
As urban growth soaks up precious water supplies, and climate change makes rainfall increasingly unpredictable, water shortages have become a potential source of political friction and even war. But hope is emerging that water assets can become much more wisely produced and managed, in an attempt to broker peace between those nations of the world where hostilities occur because of the lack of this resource.

Recent political turmoil in Tunisia and Egypt has called into question many assumptions about how politics in the region are conducted. As long-standing political factions are swept away or forced to confront different realities, there is evidence to show that a new stage in the region's history has been reached, and that the future is up for grabs. Against this background, the Strategic Foresight Group (SFG), a leading Mumbai-based policy research body with a long track record in Asia and the Middle East, unveiled a pertinent report entitled: *The Blue Peace: Rethinking Middle East Water*, which maintains that water

resources have the power to bring together countries that have traditionally been at odds with each other.

Covering the water and politics of seven countries – Lebanon, Jordan, Syria, Iraq, Turkey, Israel, and the Palestinian Territories – the *Blue Peace* report urges a major shift in how countries view their dwindling water resources. The report notes: “It is possible to anticipate conflict between countries due to disagreements over shared water resources... Indeed, conventional thinking about water in the Middle East tends to be pessimistic and alarmist. The challenge is to rethink water in the Middle East, to treat it as an opportunity for peace and development.”

Total freshwater shortfall km³/yr



Source: VM Group from World Water

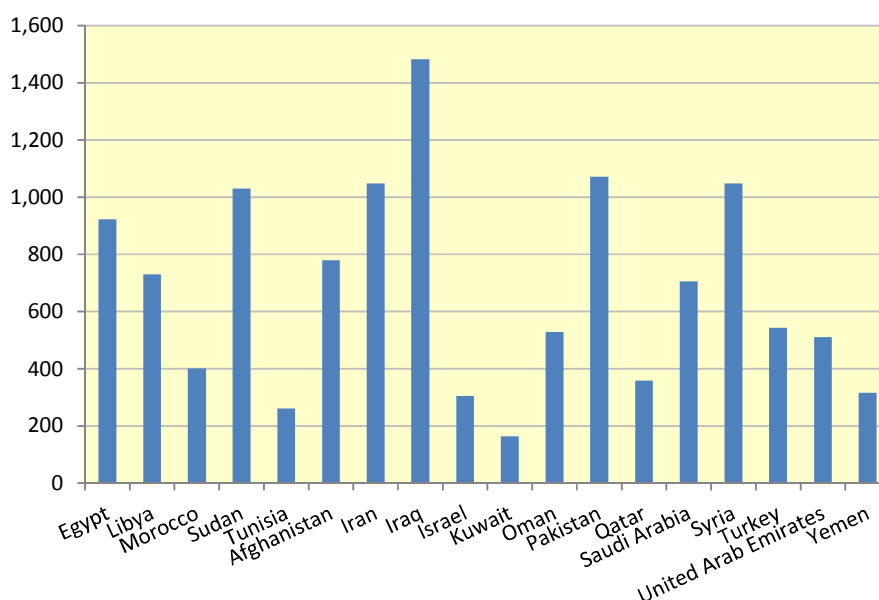
Turning things on their head

Rather than treating water assets on an individual basis and dividing them up piecemeal, the Strategic Foresight Group advocates a scaling-up of the view of water resources, calling for sustainable management of resources across several river basins and watersheds. Such a transnational approach to the thorny issue of water in the Middle East results from severe depletion of water reserves. Indeed, if anyone needs a textbook example of what “peak water” or “peak ecological water” looks like, they only have to examine the competing forces in the Middle East to see what it holds in store for us all. Peak ecological water, an expression coined by Pacific Institute water expert Peter Gleick, describes the point at which water withdrawals exceed the level of sustainability or, in other words, when an environment cannot generate enough good quality, easily

accessible, replenishable water. The key to avoiding this will be to use, price and manage water more carefully.

In some ways, irreparable damage has already been done to water assets in the Middle East. River flows in major rivers in the region have been depleted by between 50%-90% in the past 50 years, while the Jordan River has seen its flow drop by 90% since 1960, according to the SFG report. More specifically, it identifies the Palestinian Territories as particularly vulnerable to water shortages, citing the Mountain Aquifer, which feeds the West Bank, which has shrunk 7% since 1993, and the Western Galilee Aquifer, whose levels have dropped by 15%-20%.

Total freshwater withdrawal per capita m³/yr



Source: VM Group from World Water

Joint projects

Among the rivers that need early action, according to the authors of the report, are the Yarmouk River between Syria and Jordan, the El Kebir River between Syria and Lebanon, and the Orontes (Assi) River between Lebanon, Syria and Turkey. More specifically, the report urges the joint establishment of desalination plants by two or more countries, which would allow information exchanges between them, help ease the financing burden of such large-scale projects, and make it less likely that water infrastructure will be destroyed during times of conflict.

As for managing demand, countries in the Middle East are urged to introduce new tariff structures, modernise irrigation techniques, and retrofit much of the region's existing water

infrastructure. Given that water consumption rates in the region are forecast to surge by 50%-60% by 2020 (because of rapidly increasing populations), reducing water losses through delivery infrastructure becomes a major issue. Even in a modern American city like Chicago, water losses from water plant to user amount to 50%. The US as a whole allows 22bn litres of water to leak away every day.

Red Sea-Dead Sea project

A positive example of the type of transnational cooperation that is necessary in developing water assets in the Middle East is the Red Sea-Dead Sea Water Conveyance Study Programme, sometimes known as the Two Seas Canal Sea project. This scheme entails the pumping of 1bn cubic metres of Red Sea water annually into the Dead Sea, to raise its water level and provide drinking water from it through desalination. The technical complexity of this scheme, which has been the subject of four feasibility studies and numerous engineering reports by the World Bank, is further compounded by the traditional mutual political hostility between the main beneficiaries of the project – Israel, Jordan and the Palestinian Authority. The cost of the project will ultimately depend on the size of the power plant needed to pump the sea water – a minimum plant capacity of 250 MW is required – as well as the route of the canal network to transfer the water. Overall estimates range between \$3bn-\$10bn, but these may escalate substantially if the project is delayed.

No one said water politics were simple. Another example of how water has become the focal point of troubled African policymaking and economic growth is the distribution of water rights to the Nile River. Egypt has been locked in dispute with its upstream neighbours over water allocations, and continues to claim its annual 55.5bn cubic metres of water under its 1959 agreement with Sudan. Between them, Egypt and Sudan claim rights to 85% of the water flow in the Nile, leaving countries like Ethiopia, Uganda, Tanzania, Rwanda and Kenya seething at the inequity that continues to stem from European colonial decision-making of the past.

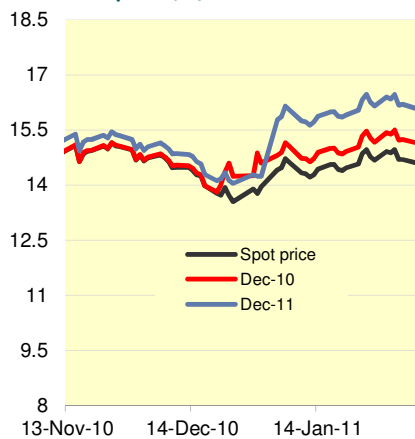
But subsequent to the recent election held in Sudan and the agreed secession of South Sudan in early February, as well as the current political uncertainty that is playing out over the future of Egyptian President Hosni Mubarak, there is even greater uncertainty about whether the region's political institutions are sufficiently aware or up to the job of delivering the type of stability that is needed for long-range planning of water resources. Asked about water allocation policy ahead of the South Sudan secession, Egyptian Water Resources and Irrigation Minister Mohamed Nasreddin Allam was quoted as saying: "The only difference if there is a division of Sudan would be a division of Sudan's quota between north and south, without encroaching on Egypt's quota."

Political dynamics

This business-as-usual approach may have to be a thing of the past. In assessing the likely change in outlook that politicians will have to embrace, Sundeep Waslekar, SFG president and principal author of the *Blue Peace* report, observed: "Relations between some countries in the broader region have undergone fundamental changes in the last two years. It would be naïve to assume that the political dynamics of 2011 will remain static until 2016 or 2021... and it would be useful to consider strategies that are not trapped in the existing political and environmental prism."

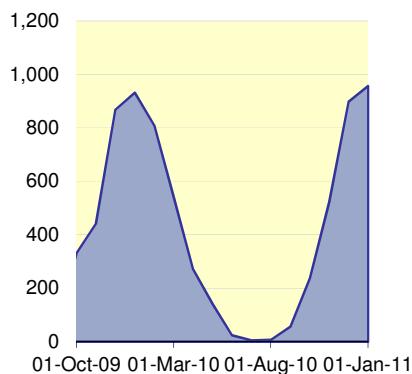
At a presentation of the report in Amman, Waslekar added: "The challenge is not addressing the water shortage in the Middle East, but addressing coexistence. Water is so central to life that any two countries in the 21st century with enough sustainable, clean and affordable water will have no motivation to go to war."

ECX carbon prices, €/t



Source: VM Group

United States, heating degree days



Source: VM Group

Climate

News

- **Feb 1:** Richard Sandor, chairman and founder of the Chicago Climate Exchange, forecast that either China or India would set up a cap-and-trade scheme before the US.
- **Jan 28:** New Zealand said it remains a net exporter of carbon credits.
- **Jan 27:** The percentage of people in the UK unconvinced about climate change almost doubled to 23% in the past year, according to a survey by the Office for National Statistics.
- **Jan 24:** The US government confirmed that its climate change special adviser Carol Browner would resign in Q1.
- **Jan 21:** Melting of the Greenland ice sheet reached a record high in 2010, according to research from the World Wide Fund for Nature.
- **Jan 19:** The European Commission temporarily closed its emissions trading scheme following detection of a fraud in which 2m carbon permits from the Czech carbon registry were stolen.
- **Jan 18:** Russia approved a further 18 Joint Implementation emission reduction projects.
- **Jan 13:** The European Union said it may tax energy resources to curb wasteful consumption and to support its strategy of low-carbon growth, according to the EU Climate Commissioner, Connie Hedegaard.
- **Jan 8:** Canadian scientists warned that the effects of global warming on polar ice caps could last for centuries, even if all greenhouse gas emissions were halted immediately.

Analysis

UK recession cuts emissions by 8.7%

The economic recession in the UK translated into an 8.7% drop in greenhouse gas (GHG) emissions in 2009, making it relatively easy for Britain to meet its climate change targets for the next five years, according to data released by the UK Department of Energy and Climate Change in early February. UK emissions for the six main GHGs covered by the Kyoto Protocol were 566.3 Mt carbon dioxide equivalent (MtCO₂e) compared with 620.5 MtCO₂e in 2008. The best performance was achieved by the UK energy supply sector, which accounted for 44% of the 54.2 MtCO₂e reduction. Total emissions from this sector were 11% lower. The business sector achieved an 11.8% (or 11.5 MtCO₂e) reduction in its GHG emissions, while the industrial processes sector, which includes the moribund construction industry, saw their GHG emissions fall 36% (by 6 MtCO₂e). Both transport (down 4.2% to 5.4 MtCO₂e) and the residential sector (5.8% lower at 4.8 MtCO₂e) posted relatively small reductions in their carbon emissions. The overall fall in emissions stems from a sharp fall in energy consumption in all areas, combined with an increase in the use of nuclear power rather than coal or natural gas for electricity generation. Emissions for UK agriculture were marginally lower at 49.5 MtCO₂e compared with 50 MtCO₂e in 2008 and 63 MtCO₂e in 1990. Most of the reduction in emissions from the agriculture sector related to lower methane levels, which were down to 18 MtCO₂e from 18.3 MtCO₂e in 2008. The latest data suggest that government-set targets of cutting 1990 emissions levels

by 35% by 2020 are achievable, although Chris Huhne, the energy and climate change secretary, said ministers were keeping up the pressure: "Yes, emissions were down in 2009 but so was the economy, so this is no time for back-slapping. A low-carbon approach has to be a vital part of kick starting and future-proofing our economy, getting us off the oil hook and onto long-term green growth."

S&P warning over California carbon scheme

US credit rating agency Standard & Poor's warned in mid-January that the cap-and-trade system that California plans to introduce next year may affect the long-term profitability of companies operating in the state, even though they will be allowed to pass on higher costs to their customers. The research report, titled *California Set to Launch Ambitious Cap-and-trade System as Federal Efforts on Pollution Control Falter*, analyses the likely impact of the proposed Global Warming Solutions Act and how the state's Air Resources Board is wrestling with how to distribute equitably the available carbon allowances among widely different power utilities.

Chinese jockey for position in carbon race

Officials in Jiangxi in eastern China revealed in late January they had lobbied Beijing to allow them to set up a local pilot carbon trading market. The move by Jiangxi follows similar approaches earlier in the month by Guangdong in southeast China to include a carbon-trading platform in its latest 2011-15 economic development plan. Beijing is expected to include a commitment to use "market mechanisms" to help cut carbon intensity rates in the final version of its national five-year plan, to be released next month, and the moves by the industrial regions are a form of jockeying for position ahead of a final decision. China has committed itself to cutting 2005 carbon intensity levels by 40%-45% by the end of 2020. Although it sees carbon trading as a way of meeting these targets, it expects to develop monitoring and verification protocols before pilot schemes are allowed to proceed.

Climate change debate returns to Himalayan glaciers

The trench warfare between both sides of the climate change debate took another turn for the worse in late January, with the publication in *Nature Geoscience* of a paper pointing out that some Himalayan glaciers are actually advancing rather than retreating, calling into doubt expert opinion on the influence of global warming. Published on 23 January, the paper, prepared by researchers from the University of California and the University of Potsdam, suggested that the factors in glacier movement in the Himalayas may not be restricted to climate, but may also embrace topography, and more specifically the amount of debris on the surface of a glacier. Although the research paper is understandably sprinkled with plenty of caveats, and the authors baldly state that there is not enough data

to reach a firm conclusion, it was seized upon by those doubting the existence of climate change in an attempt to argue that the whole global warming debate is a fraud. In the abstract of the paper, the authors point out that more than 65% of the monsoon-influenced glaciers they observed were retreating. They add that heavily debris-covered glaciers typically had stable fronts, and “debris-covered glaciers are common in the rugged central Himalayas, but they are almost absent in subdued landscapes on the Tibetan Plateau, where retreat rates are higher.” In contrast, more than half of the glaciers studied in the North-western Himalayas were either stable or advancing. The paper concludes: “Our study shows that there is no uniform response of Himalayan glaciers to climate change and highlights the importance of debris cover for understanding glacier retreat, an effect that has so far been neglected in predictions of future water availability or global sea level.”

Europe moves closer to carbon tax

The European Commission is fine-tuning plans to introduce a carbon tax on energy consumption in sectors outside Europe’s emissions trading scheme (ETS), according to taxation commissioner Algirdas Šemeta. The carbon tax proposals, expected within the next three months, may still include a system of border tax adjustment for carbon dioxide imports within the ETS. Šemeta told the European Parliament in mid-January that Brussels would continue to monitor the risk of carbon leakage – the process under which major polluters move beyond the EU to escape European carbon reduction targets – although the existing free allocation of allowances and access to international credits for ETS companies were, for the time being, sufficient measures to limit leakage rates.

Land

News

- **Feb 2:** Brazil hopes to have new regulations on foreign ownership of land within the next six months, according to agriculture minister Wagner Rossi.
- **Jan 25:** France announced plans to build a 600-turbine 3,000 MW windfarm off the coast of Brittany and Normandy at a cost of €10bn (\$13.6bn).
- **Jan 22:** An opinion poll revealed 84% of the British public was opposed to the privatisation of state-owned forests in England.
- **Jan 19:** Energy group BP forecast that solar, wind and geothermal power will account for 18% of energy growth over the next 20 years.
- **Jan 7:** Spanish renewable energy companies Gamesa and Iberdrola Ingenieria won a €20m contract to build a 13.6 MW windfarm at Ngong Hills, 30km southwest of Nairobi, Kenya.

Analysis

China expands forest area to 20%

China took centre stage at the United Nations Forum on Forests in early February, when it announced it had increased the country's total forest area by 20.5m hectares (50.6m acres), boosting the total national forest cover from 18.2% to 20.3%. Presenting the update to world foresters, Zhu Lieke, vice minister of the State Forestry Administration of China, said the pace of afforestation in China had accelerated, ecological conservation had been comprehensively enhanced, and "the shelter zone for safeguarding ecological security has basically come into being." Forest industries have undergone rapid development and played a critical role in improving livelihoods and eradicating poverty, Zhu said, adding that the output value of forest industries soared from 840bn yuan (\$128bn) in 2005 to 2,080bn yuan last year. Such a radical improvement has come at a major capital cost, however, with China stepping up the tempo of forestry investment to 298bn yuan during 2006-10, a rise of 80% over the previous five-year period.

Ethiopia offers huge tracts of land to overseas investors

Ethiopia has earmarked a further 3.6m hectares of agricultural land to overseas businesses, half of which is likely to go to investors from India, Ethiopian agriculture minister Tefera Derbew said on a visit to New Delhi in early February. Spurred on by the positive experience of offering 70-year leases to foreign investors, Ethiopia has attracted \$4.7bn worth of Indian investment in recent years, most of which has been channelled into the agricultural sector. Now the country wants to ratchet up that relationship, with Derbew claiming: "Indian investors are very welcome in Ethiopia." To date, 79% of the 307,000 hectares of land leased to domestic and overseas investors is held by Indian companies. Indian farming projects in Ethiopia include cotton, palm oil, rubber, oilseeds and

horticulture, while one Indian company is currently negotiating a lease on 100,000 hectares of land for sugarcane production. Derbew, who was on a three-day official visit to promote trade and investment from India, also put out the welcome mat for Indian construction groups, pointing out that Ethiopia had liberalised its policy on land allocation for major infrastructure projects such as roads and railways. The Ethiopian government has a target of building 2,000 km of railway tracks within five years.

Tonga development pact with China

The Chinese ambassador to the Southern Pacific island nation of Tonga was on hand in the capital Nuku'alofa in late January to sign a landmark two-year agricultural agreement that will see substantial improvements in Tonga's production of mushrooms, ducks and sweet potato powder. Worth Tongan Pa'Anga 1.6m (\$860,000), the new Agricultural Demo Farm Project entails the provision of five Chinese agri-technicians and an interpreter to train local farmers to build up their production and achieve larger economies of scale. The group will also provide technical assistance in building 10 methane-generating pits up until the end of 2012, when the pact expires. Tongan Ministry of Agriculture researcher Luseane Taufa said the project will have an impact on food and fuel imports by making noodles out of sweet potato for the first time, as well as reducing the amount of diesel that is imported to run the country's network of diesel generators. Tonga has a total population of 104,000 and annual GDP of \$750m. To date, it has relied heavily on cash crops like coconuts, vanilla beans, bananas, coffee beans and root crops, as well as remittances from the Tongan diaspora in Australia, New Zealand and the US. A substantial local Chinese business community has been established in recent years, and there are hopes that local fishing and tourist industries will be further developed.

Water

News

- **Feb 6:** Syria and Turkey laid a symbolic foundation stone for a dam on the Orontes River, pending final agreement on financing and water-sharing terms.
- **Jan 27:** Record low water levels at the 320 MW Mosul dam, the largest hydroelectric plant in Iraq, forced it to shut down.
- **Jan 26:** Brazilian environmental agency Ibama approved clearance of 588 acres of rainforest as the first step in construction of the controversial Belo Monte hydroelectric scheme.
- **Jan 18:** Low water levels and increased urban demand will result in significant power shortages in Vietnam during 2011, according to state power utility EVN.

Analysis

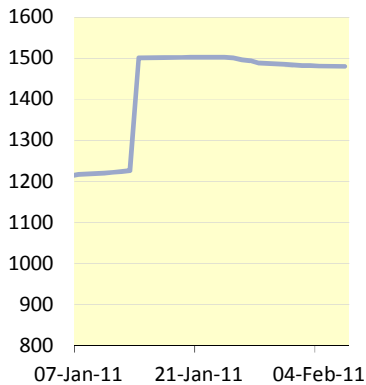
Chinese unveil new water conservation plan ...

China unveiled a far-reaching water management and conservation programme in late January, confirming that Beijing has finally acknowledged the serious water shortages in the country. The central thrust of the programme is to cap the amount of water used, then improve the efficiency of water use, and finally to reduce the amount of water pollution. Chen Lei, Minister of Water Resources, said that up to 80bn yuan (\$12.2bn) would be set aside to improve water conservation infrastructure. Average annual water use in China is 2,200 cubic metres per person, or about 28% of the world average.

... while Beijing rejects reports of water shortages

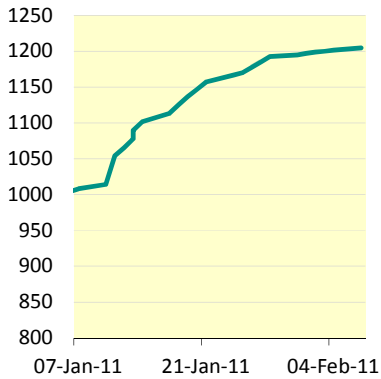
Just as the Chinese government was unveiling its multi-billion yuan water conservation plan, water officials in Beijing were rejecting reports that the long-running drought in the region had affected water supplies in the city. Beijing has had 12 years of drought and has now experienced its longest dry spell on record – more than 100 days without rain or snow. Most of the city's water reserves are replenished during the rainy summer months, but last year saw precipitation levels at about 25% of the norm. Despite the unusually dry weather, Beijing Water Authority officials denied reports that limits had been placed on water supplies in suburban areas. Figures from the authority show that total water consumption in 2010 was 3.57bn cubic metres, a rise of 20m cubic metres on 2009. For most of the past decade, Beijing has drawn water from its own underground reserves and from neighbouring regions to make up for any shortfall until the South-to-North water diversion scheme is completed in 2013. Urban folklore in Beijing recounts that water could be found 5 metres under street level in the 1960s, but now you would need to drill a further 10-15 metres before hitting water.

European biodiesel, RME, €/t



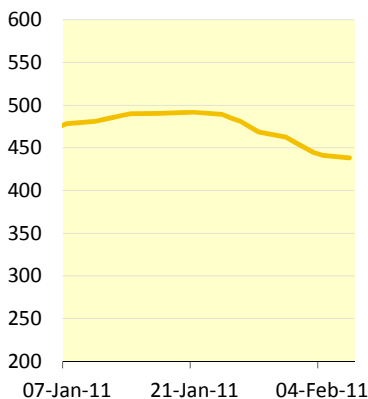
Source: VM Group

European biodiesel, FAME, €/t



Source: VM Group

Palm oil biodiesel, \$/t



Source: VM Group

Biofuels

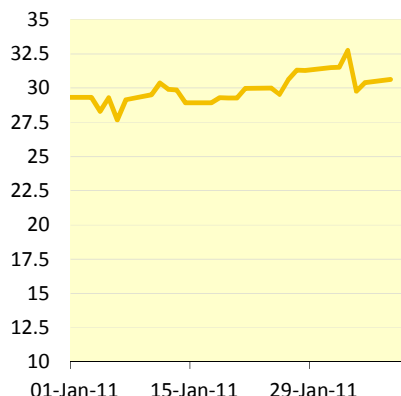
News

- **Feb 1:** French exports of ethanol to Spain doubled to 52.3m litres in the first 10 months of 2010.
- **Jan 28:** Finnish airline Finnair said it would postpone the use of renewable jet fuel on commercial flights because of cost and production issues.
- **Jan 28:** The European Commission awarded Swedish biotech company Chemrec a SKr500m (\$77m) grant to develop an industrial scale biofuel plant.
- **Jan 24:** Endicott Biofuels announced plans to build a 30m gallon/year biodiesel refinery for KMTex in Port Arthur, Texas.
- **Jan 24:** New York State energy officials said they had \$250m in funding available for biomass, wind, hydroelectric and other renewable energy projects.
- **Jan 21:** The US Environmental Protection Agency raised to 15% the amount of ethanol permitted for use in cars and light trucks built in 2001 and later.
- **Jan 21:** Danish biotech group Novozymes forecast the US biofuel industry would grow by 5% to 13.8bn gallons of ethanol in 2011.
- **Jan 20:** US soft drinks group PepsiCo announced plans to build two biomass power plants with a combined capacity of 3.4 MW at a cost of \$8m in the Philippines.
- **Jan 19:** Irish food group Greencore said growing sugar beet for ethanol production in Ireland was uneconomic and should be avoided.
- **Jan 18:** A Congolese rural development minister said agreement had been reached with a Chinese company, Greater Kingdom Group, to grow jatropha on 40,000 hectares of land in DR Congo.
- **Jan 17:** German oil trader Mabanft announced plans to begin trading wood pellets.

EU stresses need to streamline renewable energy effort

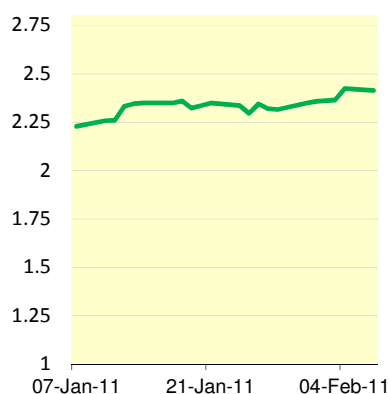
European Energy Commissioner Günther Oettinger said in late January that the current EU renewable energy targets are likely to be met, or even exceeded, if individual member states implement fully their national renewable policies and if financing for these schemes is improved. Presenting the European Commission with the latest assessment of renewable energy within the EU, Oettinger said that further cooperation between member states and better integration of renewable energy into the single European market were necessary, if annual cost savings of up to €10bn (\$13.6bn) were to be achieved. "We have to invest much more in renewable energy and we need smart, cost-effective financing. If member states work together and produce renewable energy where it costs less, companies and consumers and the tax payer will benefit from this." A key part of this will be a doubling of annual capital investment in renewable energy from the current €35bn to €70bn. Oettinger noted that while different financial instruments such as grants, loans, feed-in tariffs and certificate regimes are used across the EU, their management needs to be improved. "Investors need greater coherence, clarity and certainty," he said.

Sugar no.11, ICE Futures, cents/lb



Source: VM Group

Ethanol prices, CBOT, \$/gallon



Source: VM Group

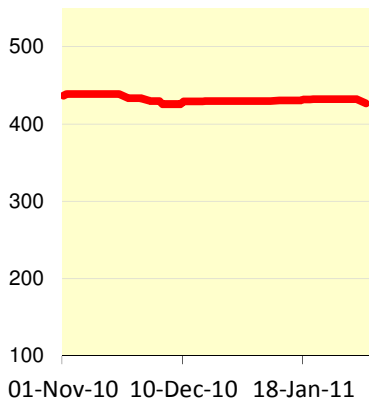
Argentina emerges as major force in biodiesel

Bad news for US biodiesel producers, who saw their world production ranking knocked down into fifth place by Argentina, according to a report produced in mid-January from Cader, the Argentine Chamber for Renewable Energy. The emergence of Argentina as a world player in biodiesel production gathered pace, with a 51% surge in output to 1.9m tonnes in 2010. Argentina is now ranked behind Germany, France and Brazil in biodiesel production and ahead of the US, where the industry remains largely fragmented. The bulk (65%) of Argentine biodiesel output is exported, mostly to Europe, but there are growing fears that the EU may block the import of foreign biofuels. This fear for Argentine producers of biodiesel is partially offset by growing domestic demand, underpinned by a government mandate for local oil companies to substitute 7% of their diesel production with biodiesel. This mandate is expected to be raised to 10% this year. Estimates of local biodiesel demand vary, but Cader suggests that the market can sustain 3.25 Mt, "which will exceed the supply available, creating a need for major investment in new biodiesel plants." Some of the Argentine biodiesel success lies in achieving large economies of scale, with an average plant production capacity of 108,000 tonnes each, compared with an average of 89,000 tonnes in Europe and 70,000 tonnes in Brazil. Argentine biodiesel production, concentrated mainly at nine plants in Sante Fe, is estimated to increase to 2.4 Mt when two new plants come online. These projects are being built by Cargill, with an annual 240,000 tonne plant capacity, and by Unitec Bio, with a projected output of 220,000 tonnes a year.

USDA gives \$405m support to biomass projects

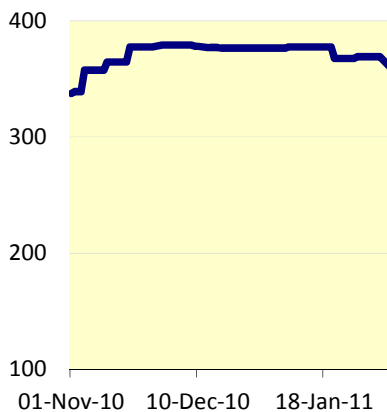
US Department of Agriculture Secretary Tom Vilsack threw a bushel-load of government finance at the American biofuel industry in late January, when he announced loan guarantees worth \$405m for three advanced biomass fuel projects. The bulk of the funding (\$250m) will go to a 55m gallon/year cellulosic ethanol plant in Alabama planned by Coskata. The plant, which has venture capital backing from Khosla Ventures, Blackstone and GM, relies on woody biomass as a feedstock. A further \$80m loan guarantee was approved for a 10m gallon/year plant proposed by Enerkem in Mississippi. The Enerkem project, which has already received a \$50m loan guarantee from the US Department of Energy, will use unsorted municipal waste as its feedstock. And finally, Ineos Bio received approval for a \$75m loan guarantee for its planned biorefinery in Florida, which will produce 8m gallons/year of cellulosic ethanol from citrus and wood waste.

World diammonium phosphate prices, \$/t



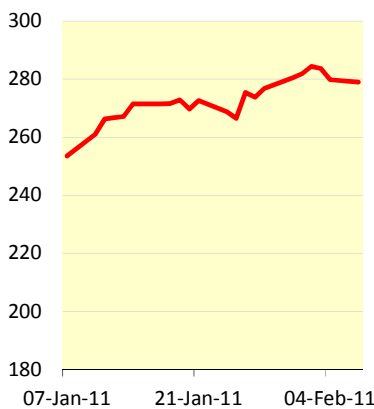
Source: VM Group

World urea prices, \$/t



Source: VM Group

Jet fuel kerosene, NY, cents/gallon



Source: VM Group

Input costs

News

- **Feb 4:** UK dairy farmers lose an annual £330m (\$533m), as milk production costs lag behind farmgate prices, according to the National Farmers' Union.
- **Feb 3:** The Argentine port of San Lorenzo reopened as talks started to resolve an eight-day strike, which had helped trigger a spike in world grain prices.
- **Feb 2:** South African port fees will rise by 4.5% from April, according to the Ports Regulator of South Africa.
- **Feb 1:** Farmland prices in England stalled in Q4 2010 but still finished 13% higher for the year, according to estate agents Knight Frank.
- **Jan 21:** Food price inflation in India dropped to an annualised rate of 15.5% in early January, compared with 18.6% for 2010 as a whole.
- **Jan 21:** The Canadian Farm Product Price Index showed a month-on-month fall of 2.1% to 110 in November 2010, with an 18.6% drop in the price of hogs, according to Statistics Canada.

Outlook

Bulk fertiliser prices rose in late January, in response to political uncertainties in North Africa and the Middle East, pushing US farmgate costs higher, according to the latest USDA data. Anhydrous ammonia, which had fetched an average of \$777/short ton (ST) in January was costing \$781/ST in early February. Urea and potash were also ahead by about \$4/ST at \$494/ST and \$569/ST respectively, while DAP picked up about \$7/ST to \$678/ST. Higher fuel costs reflected the rally in benchmark crude oils like West Texas Intermediate and Brent, and translated into a rise in farm diesel prices of about 12 cents to \$3.13/gallon during January.

Analysis

FAO Food Price Index hits fresh peak

High food prices and regime change in North Africa are becoming inextricably linked and, if officials at the UN Food and Agriculture Organization are to be believed, there is more bad news in store for everyone. The warning over higher food prices came on 3 February, when the FAO released its latest Food Price Index, a commodity basket that tracks monthly changes in global food prices, which reached a record high in both real and nominal terms for January. The January index surged 3.4% to 231 compared with December, and registered gains in all categories except meat. "The new figures clearly show that the upward pressure on world food prices is not abating," said FAO economist and grains expert Abdolreza Abbassian. "These high prices are likely to persist in the months to come. High food prices are of major concern especially for low-income food deficit countries that may face problems in financing food imports and for poor households which spend a large share of their income on food." More specifically, the January Cereal

Price index, a constituent of the broader food index, rose 3% from the December level, but is still 11% below its peak level of April 2008. The Oils/Fats Price Index gained 5.6% reflecting an increasingly tight supply and demand balance across the oilseeds complex, while the Dairy Price Index jumped 6.2% during January to 221, but is still 17% off its record high of November 2007. Meanwhile, tight global supplies pushed international sugar prices higher, resulting in a 5.4% rise in the Sugar Price Index to 420. As previously referred to, the only section of the overall index that remained steady, at 166, was the Meat Price Index. Declining meat prices in Europe – stemming from a feed contamination outbreak – were offset by a small increase in export prices from Brazil and the US. The FAO ended its latest food price summary on an upbeat note with Abbassian saying: “The only encouraging factor so far stems from a number of countries where – due to good harvests – domestic prices of some food staples remain low compared to world prices.”

Higher costs encourage US ranchers to cut national herd

High feed prices and improved slaughter prices for cattle have prompted American ranchers to trim back the size of the US national herd, according to the latest inventory report from the USDA, released in late January. The number of cattle and calves in the US on 1 January was 92.6m head, down 1% on the 93.9m recorded a year earlier, and represents the lowest cattle inventory in 52 years. The number of cows and heifers that have calved was 40m, down 500,000 head from last January. Beef cows, at 30.9m head, were down 2% from the year-ago level, while milk cows were up 1% at 9.1m head. The largest drop in numbers was in the beef replacement heifer class, which was down 5% to 5.2m head, while the number of cattle and calves on feed for slaughter in all feedlots rose 3% to 14m head. High market prices have encouraged cattle ranchers to sell their stock rather than hold them for breeding. The reduction in the availability of cattle later this year will result in higher retail prices for beef, which according to USDA estimates, will rise by between 2.5%-3.5% during 2011.

US grazing rates show broad increase

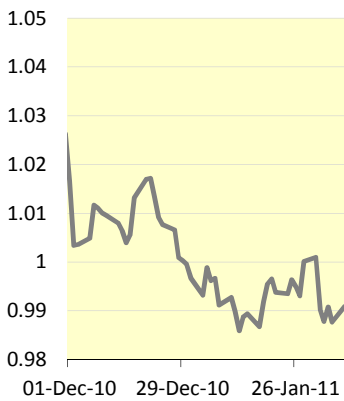
Just as US fertiliser and seed prices rose sharply last year, rates for grazing cattle also jumped, with some double-digit increases in western states, according to data released by the US Department of Agriculture (USDA) in late January. By the end of 2010, the most expensive US state in which to graze livestock was Nebraska, where the average monthly grazing fee was \$27.40 per head (/h), up \$0.90/h on the average for 2009. At the other end of the scale, Arizona remains the cheapest state in which to graze livestock, with a monthly cost of just \$11/h, up from \$10/h in 2009. Some of the worst inflation in grazing rates last year took place in Texas, where average monthly fees rose 16.9% (or \$1.90/h) to \$13.10/h, and in North Dakota where fees increased 14% (or \$2.30/h) to \$18.50/h. Some western US states, which have suffered water shortages, moved against this broadly higher trend, with monthly cattle grazing fees in California dropping from \$17.50/h

in 2009 to \$17/h last year, while Oregon rates dropped \$1.50/h to \$14/h in 2010. The overall increase in 17 western US states, where the bulk of US cattle grazing takes place, was 5.8% with monthly rates rising \$0.90/h to an average \$16.60/h.

Ciolo offers storage scheme to beleaguered pig farmers

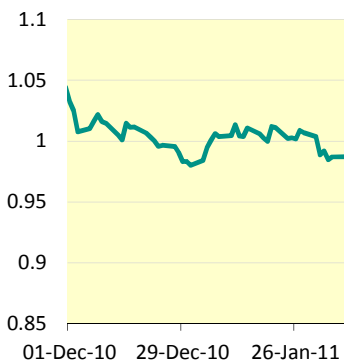
EU Agriculture Commissioner Dacian Ciolo unveiled funding plans in late January for a private storage aid scheme to help European pigmeat producers cope with a collapse in prices following the recent contamination of dioxin in animal feed. Market prices for pigs are currently about 10% below 2009 levels, meaning that producers sustain a loss of €25 (\$34) per animal. It is hoped that the storage scheme will allow producers some financial breathing space until market prices recover. Ciolo is aware that the sector has suffered financial hardship in recent years and that action is necessary to prevent widespread collapse in the pig farming industry.

\$/CAD (Canadian Dollar)



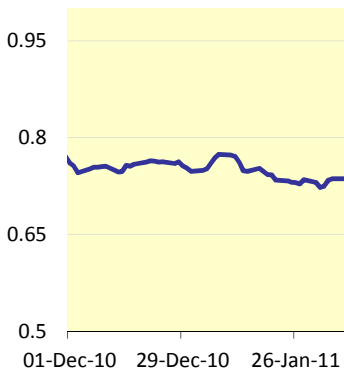
Source: VM Group

\$/AUD (Australian Dollar)



Source: VM Group

\$/€



Source: VM Group

Currencies & finance

News

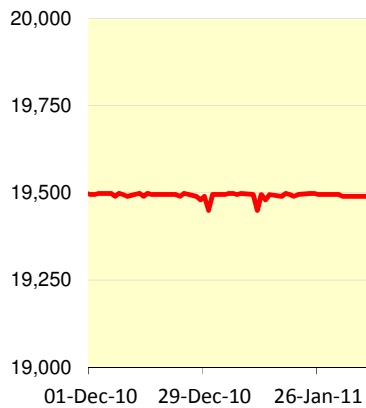
- **Feb 4:** Norwegian fertiliser group Yara warned of write-downs linked to financial irregularities at an Australian joint venture.
- **Feb 3:** US agri-supplier Dow AgroSciences posted a 4% rise in Q4 2010 pre-tax earnings to \$72m.
- **Feb 2:** Swiss food group Nestlé announced plans to build two new cereal and noodle factories outside Pretoria, South Africa, worth a total of R500m (\$69m).
- **Feb 2:** US agribusiness company Cargill announced plans to build a corn processing plant in Brazil, at a cost of 350m reais (\$210m). It also said it would buy the alcohol operations of Royal Nedalco in Europe for an undisclosed sum.
- **Feb 1:** US agribusiness company, Archer Daniels Midland, reported a 29% increase in Q2 2010 net earnings to \$732m.
- **Feb 1:** The Ivory Coast missed a \$29m interest payment on a \$2.3bn Eurobond.
- **Jan 31:** China Development Bank is prepared to invest up to \$10bn in mining and agricultural projects in Zimbabwe, according to Tapiwa Mashakada, Zimbabwe's minister of economic planning and investment promotion.
- **Jan 29:** International Finance Corporation, part of the World Bank, said it would invest \$300m developing agricultural projects in Ukraine later this year.
- **Jan 26:** US seasoning and spice group McCormick reported a 23% rise in net income to \$370.2m for the year to end-November 2010.
- **Jan 25:** US chemical group DuPont, which announced plans to buy Danish biotech group Danisco for \$5.8bn in early January, unveiled profits of \$3bn for fiscal 2010.
- **Jan 19:** Celanese Corp unveiled plans to build and operate two industrial ethanol plants in China with a combined output of 400,000 tonnes/year at a cost of \$300m.
- **Jan 18:** Finnish-Chilean pulp joint venture Montes del Plata announced plans to build a \$1.9bn pulp mill in Uruguay.
- **Jan 18:** US agribusiness group, Cargill, said it would spin off its 64%-owned Mosaic fertiliser and animal feed group, paving the way for a sale of the unit.
- **Jan 18:** Nestlé said it would invest SwFr160m (\$167m) expanding existing factories in Egypt that produce premium ice cream and soups.
- **Jan 13:** US coffee chain Starbucks announced plans to open its first outlets in India in a deal tied with coffee bean purchases from the Tata group

Analysis

Soros raises \$314m for South American venture

International investor George Soros raised \$314m in late January through the initial public offering (IPO) on the New York Stock Exchange of shares in Adecoagro, the South American agricommodity venture. Shares in the company were originally pitched to investors at between \$13-\$15, but underwriters trimmed the price to \$11-\$13 each and finally settled on an IPO price of just \$11. When Adecoagro debuted on 28 January, the

\$/VND (Vietnamese Dong)



Source: VM Group

\$/BRL (Brazilian Real)



Source: VM Group

\$/CNY (Chinese Yuan)



Source: VM Group

shares initially dropped to \$10.75 but finished the day at \$12, a rise of 9%. The company owns 287,000 hectares of land in South America valued at \$784m, split between 21 farms in Argentina, 15 in Brazil and two in Uruguay. In Argentina, it also owns and operates three rice processing-plants and has a dairy business built on 4,500 milking cows. In Brazil, it runs two coffee processing facilities, as well as two sugar and ethanol mills. It is this last category of business that Adecoagro wishes to expand with the proceeds of the IPO. The Luxembourg-based company is currently building a \$1bn sugar mill in Brazil, which it hopes to have operational by 2013. It still needs \$690m to fund the project, and will use \$230m of the recent fund raising for this and fund the balance out of cash flow and debt. The investment arm of the Qatar Investment Authority (QIA), which already owns 6.5% of Adecoagro, increased its holding in the company by subscribing to 25% of the IPO. Last October, QIA bought a 5% stake in Banco Santander's Brazilian unit for \$2.7bn.

New Chinese bidders emerge in Crafar soap opera

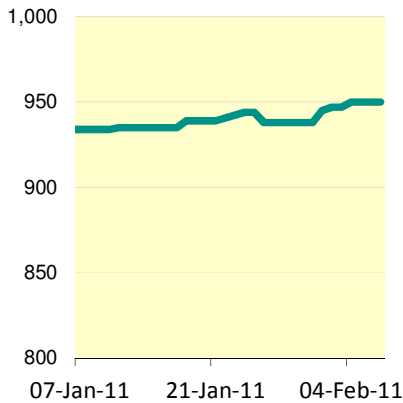
The long-running saga surrounding the troubled Crafar dairy business in New Zealand took another unexpected turn in late January, when the receivers for the business threw out one agreement with Chinese investors and unveiled a new deal with another Chinese company. Receivers KordaMentha said on 27 January that they had secured a new offer for the 16 North Island farms following the withdrawal of UBNZ Funds Management, whose bid failed to obtain government approval from the Overseas Investment Office (OIO). KordaMentha said the new offer, from Pengxin International, was the best offer they had and that the new bidders were planning to seek OIO approval for the deal in March. Shanghai-based Pengxin is a diversified investment company with overseas interests in biofuel crops, fisheries, farming and real estate development. It has total assets of about \$2bn and owns 650 hectares of sheep-rearing and arable farmland on Chongming Island near Shanghai as well as a further 930-hectare sheep farm in Shandong Province. The protracted uncertainty over the Crafar business, following its breaching of covenants on loans of about NZ\$200m (\$155.4m) in 2009, has triggered a debate in New Zealand on setting limits to the amount of land owned by foreign investors. The value of the failed UBNZ bid has been put at NZ\$200m, which would have cleared the loans due to Crafar's bankers.

Vietnam expects further boost from overseas remittances

Economic planners in Vietnam are counting on a 6% increase in remittances from overseas nationals this year to give a further boost to growth. Data revealed in January by the World Bank shows that economic development in Asia continues to rely heavily on remittances sent by nationals living abroad. The latest figures, published in *The Migration and Remittances Factbook 2011*, show Vietnam received remittances of \$7.2bn during 2010, which represents about 7% of the country's gross national product (GDP). In nominal terms China remains the largest recipient of cash from Chinese nationals living

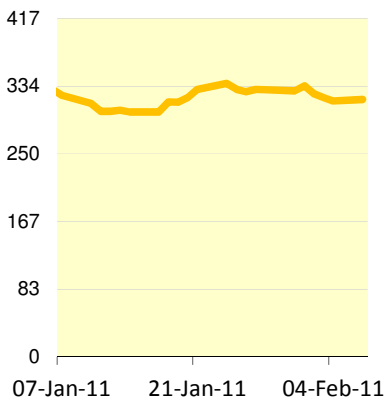
overseas. Chinese remittances amounted to \$51bn in 2010, far outstretching the \$21.3bn remitted to the Philippines. When viewed as a percentage of GDP, the impact of overseas remittances varies enormously, with remittances for Tonga accounting for 27.7% of its GDP and 22.3% for Samoa. Overseas remittances for China represent just 1% of its GDP.

Softwood pulp futures, CME \$/t



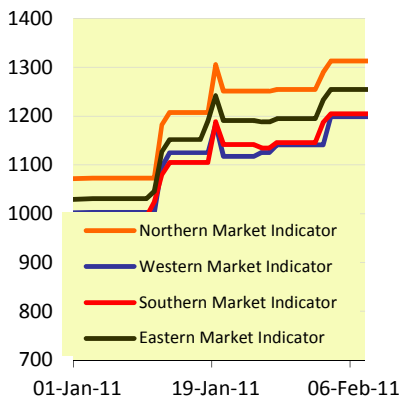
Source: VM Group

Lumber futures, CME, \$/mbf



Source: VM Group

World wool prices, Australian market indicators



Source: VM Group

Specialty markets

News

- **Feb 3:** Organic food sales in France rose 10% to €3.3bn (\$4.5bn) in 2010, according to the French industry body Agence Bio.
- **Feb 2:** The Uganda Floricultural Association said it was planning export trials of local flowers to European markets.
- **Jan 31:** Global consumption of fish hit an all-time high in 2009 of 145 Mt, or an average of 17 kg per person, according to the UN Food and Agriculture Organization.
- **Jan 27:** China has the potential to be a large importer of US-made alfalfa animal feed products such as alfalfa cubes, according to a USDA report.
- **Jan 26:** US consumer newsprint inventories rose 7% to 485,000 tonnes in December, according to the Pulp and Paper Products Council.
- **Jan 26:** Spanish researchers found that consumption of olive oil over a long period can help people avoid depression.

Analysis

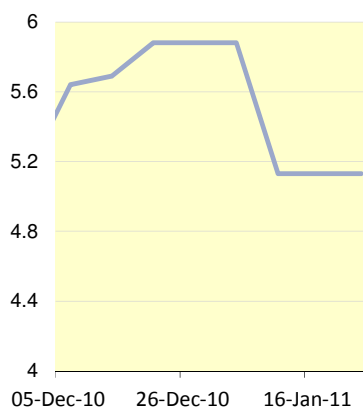
Wendy's/Arby's exports fast food brand to Argentina

US fast food chain Wendy's/Arby's International announced in late January another phase of its overseas expansion, with a plan to develop 50 Wendy's restaurants in Argentina over the next 10 years. The company reached agreement with Desarrollos Gastronomico, best known for its Havana Cafe quick service coffee chain throughout Argentina, to develop the US brand locally, with the first hamburger outlet slated to open in Buenos Aires later this year. Over the past 18 months, Wendy's/Arby's has reached development agreements with franchisees in the Middle East and North Africa, Singapore, Turkey, Russia and the Eastern Caribbean. It also hopes to expand into Japan, China and Brazil.

US targets Croatian pet food sector

Analysts at the USDA have advised US farmers to keep a keen eye on the Croatian pet food market, as the country's economic growth will open up opportunities that will allow more "distinct product segmentation." Their latest report on the market, published in late January, notes that Croatia is a net importer of pet food, with imports rising steadily from \$17.6m in 2002 to \$47.6m in 2009. The US share of this market is currently worth only about \$1m, but this could grow, as "many consumers are interested in healthy pet snacks and treats, especially those that are preservative-free and contain healthy ingredients such as fruit and cereals. Interest in functional products, such as those to promote dental hygiene, is also increasing." Hungary accounts for about 28% of Croatian pet food imports followed by Italy (20%) and Germany (11.5%).

Mohair prices, \$/pound

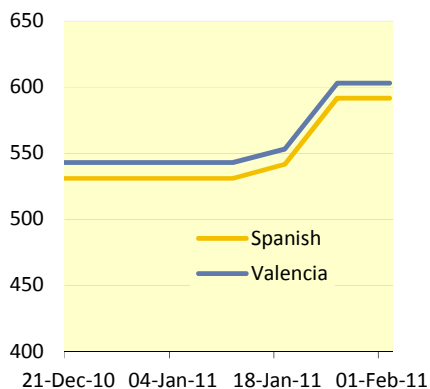


Source: VM Group

Chinese develop taste for French wine

Not content with just drinking fine French wine, the Chinese government has now decided to buy overseas vineyards, the most recent of which was the purchase announced in late January of the Château Viaud. The purchase, for an undisclosed sum, was conducted through state agri-conglomerate Cofco, and cements China's reputation as the largest export market for Bordeaux, with overall Chinese imports of French wine rising by 55% in 2009. Château Viaud consists of 20 hectares of prime vineyards and a substantial chateau residence, which is suitable for large-scale entertainment. The French deal is the second move by Cofco to import winemaking expertise. Last September it paid \$18m for the Chilean wine group Biscottes. By purchasing overseas vineyards, Cofco is hoping to develop its domestic business, which is dominated by its Great Wall brand of wine. Annual wine consumption in China runs to 1.1 litres per person, compared with an average of 23 litres in Western Europe.

Peanut prices, \$/t



Source: VM Group

Policy

News

- **Feb 3:** Ukraine said it will relax its grain export quotas by excluding corn from the restrictions it made in October.
- **Feb 3:** Puerto Rico faces an increasing scarcity of food over the next five years, the country's Farmers Association warned.
- **Feb 1:** Turkish animal feed producers were granted permission to use three types of genetically modified soybeans in feed, according to the Turkish Biosafety Commission.
- **Jan 31:** UK Agriculture Secretary Caroline Spelman called for substantial cuts in the EU Common Agricultural Policy budgets.
- **Jan 28:** Former EU agriculture commissioner Franz Fischler said he was a candidate to become Director General of the UN Food and Agriculture Organization.
- **Jan 24:** Korea imposed anti-dumping duties of up to 38% on eight Malaysian plywood producers for up to three years.
- **Jan 23:** Ivory Coast president-elect Alassane Ouattara called for a one-month suspension of cocoa exports, hoping to put pressure on incumbent Laurent Gbagbo to accept the results of the November elections.
- **Jan 21:** Ukraine and Serbia signed a five-year agreement on cooperation in agriculture.
- **Jan 18:** South Korea said it had culled 15% of its total pig and cattle herds to prevent the spread of foot-and-mouth disease.
- **Jan 18:** France called for an expanded role for the UN Food and Agriculture Organization in dealing with world food shortages.
- **Jan 16:** Algerian Prime Minister Ahmed Ouyahia instructed the state grain agency to speed up the importation of soft wheat and durum wheat.
- **Jan 13:** Costa Rica unveiled a new national policy on rice production aimed to support small farmers while reducing government support for the sector.
- **Jan 10:** Libya announced the removal of all taxes on staple foodstuffs and children's milk products.

Analysis

USDA gives twin victories to GM crop producers

Twin victories for the US biotechnology sector have paved the way for a fresh round of court challenges on the role of genetically modified (GM) crops in the US. A partial deregulation of GM sugar beet was announced on 4 February, when the US Department of Agriculture (USDA) said it would allow beet planting under closely monitored conditions to prevent potential pest risks. The spring planting is an interim measure until the department's Animal and Plant Health Inspection Service (APHIS) conducts a full environmental impact study. The sugar beet decision follows the USDA's ruling announced on 27 January that GM alfalfa could be planted without restrictions. The decision, again made by APHIS, means that doubt over the future of GM crops has been removed following a policy wobble by Agriculture Secretary Tom Vilsack in late December

when he hinted that the US biotech sector might be subjected to greater regulation and scrutiny. This would have had an immediate impact on the US farming sector, which is preparing for its spring planting, and a long-term impact on biotech seed producers like Monsanto. Announcing the GM alfalfa decision in January, Vilsack said that GM alfalfa “is as safe as traditionally bred alfalfa.” This view is not shared by some traditional farmers and organic crop producers, who fear cross-pollination by GM varieties. Andrew Kimbrell, executive director of the US Center for Food Safety, which has consistently challenged the USDA position on GM crops in the courts, said his organisation would take legal action to overturn the new ruling. Hoping to fend off the organic lobby, the USDA also announced it would set up studies and advisory groups to investigate how GM alfalfa might contaminate other crops. Wenonah Hauter, executive director of Washington-based consumer rights advocacy group Food & Water Watch, pointed out that: “these steps should have been taken before the agency decided to release this crop into the food supply, not after.” Let the court cases begin.

UK moves closer to accepting GM crops

Cultivation of genetically-modified crops should not be dismissed on moral or ethical grounds without a full examination of the facts, a new UK government report has advised, moving the British government closer to embracing GM crop production. Released in late January, the report, *The Future of Food and Farming: Challenges and choices for global sustainability*, concluded that with demand for food increasing as the world population grows, it is important to “fully exploit” the potential of GM technology as a means of intensifying food production. The report noted that investment in research on modern technologies is essential in the light of food demand in the coming decades, but also stressed that the human and environmental safety of any new technology needs to be rigorously established before its deployment. Furthermore, decisions about the acceptability of new technologies need to be made in the context of competing risks and the potential costs of not utilising new technology must be taken into account. Sir John Beddington, the UK Government’s chief scientific adviser, and a key contributor to the report, expressed his support for the use of GM crops as a means of addressing potential food shortages. He said: “If GM foods are shown to be safe, we should use them.”

Nigeria bans rice imports across land borders

Faced with a spiralling outbreak of rice smuggling into the country, the Nigerian government announced in late January a ban on rice imports through its land borders. From the start of February, rice imports were only allowed through the country’s seaports, raising the likelihood that government duties will be levied and collected. Rice currently attracts a 20% customs duty plus a 20% levy, both of which smugglers avoid with unmonitored illegal imports. Government officials confiscated more than 19,000 50kg bags

of rice in Nigeria's southwest region last year. With rice imports of more than 3.1m tonnes in 2009, Nigeria is the second largest importer of rice in the world.

Kansas City hosts conference on agroterrorism

In the six years since the first International Symposium on Agroterrorism (ISA) was held, the vulnerability of agriculture to terrorist action has moved up the political agenda. Held under the auspices of the Heart of America Joint Terrorism Task Force, in conjunction with the Kansas City Division of the FBI, the next conference, which is scheduled for late April, aims to improve intelligence gathering and dissemination, develop technical and tactical response strategies to potential attacks and raise the profile of the issue among government bodies around the world. Organisers of the latest ISA gathering in Kansas City, Missouri have stuck with their early marketing approach, stressing the message that "We can no longer take our food supply for granted." ISA defines agroterrorism as the unlawful use of force and violence against some component of agriculture to advance political or social objectives. It cites possible targets as livestock, crops, water supplies, grocery stores, farm workers, food processors and restaurants. With registration costing only \$395 per person, this heavily subsidised event includes breakfast and lunch over three conference days, plus admission to a gala barbecue banquet. Just in case any potential agroterrorist is thinking of turning up, FBI background checks will be made on all those attending the event.

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