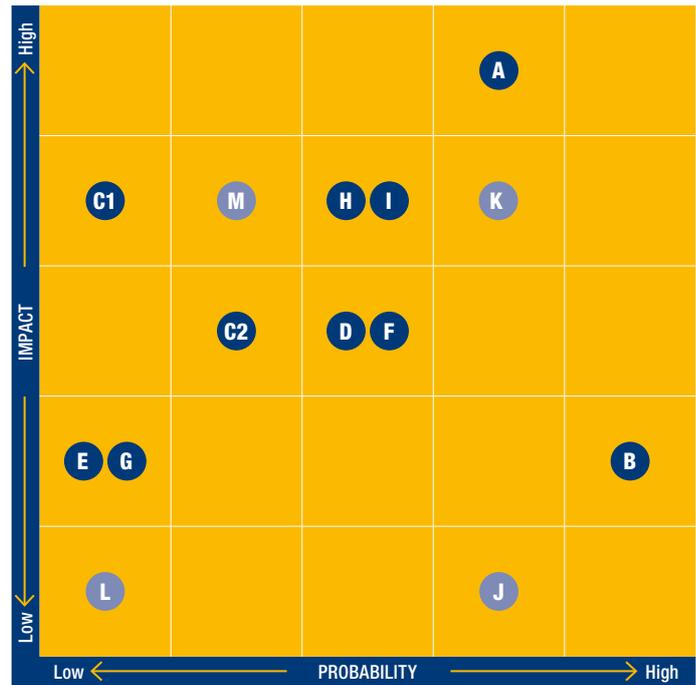


# BALANCE IN MANAGEMENT OF FINANCIAL AND OPERATIONAL RISKS

Rottneros is affected by the general business cycle, currency fluctuations and other company-specific environmental factors. The most important risks that affect the Group's capacity to achieve the objectives set are described in this section, as is the management of each risk. Rottneros is working to minimise risk through preventive work or, where this is not possible, by working with different kinds of hedging and insurance. Many of the risks shown below may have both a positive and negative impact on Rottneros. Work relating to risk is managed by the Board of Directors at an overall level and by the CEO and Group management at an operational level. The risk management process includes, among other things, strategic business planning, conducting an ongoing risk inventory, preventive maintenance work and investments, and financial hedging activities.



**Operational risk areas**

- A** Variations in pulp price
- B** Structural change
- C1** Access to raw material
- C2** Raw material prices
- D** Electricity prices
- E** Customer structure and customer credit
- F** Facilities
- G** Political decisions
- H** Sustainability and responsibility
- I** Environment

**Financial risk areas**

- J** Currency – balance exposure
- K** Currency – transaction exposure
- L** Interest rates
- M** Liquidity and refinancing

**SENSITIVITY ANALYSIS, 2016**

Type of risk	Change	Effect on annual profit after net financial items (SEK m)		
		2016	2015	Sensitivity
Pulp prices	USD 50/tonne	110	100	High
USD	SEK 0.50/USD	40	50	High
Electricity prices	SEK 0.10/kWh	25	25	High
Pulp wood prices	SEK 10/m <sup>3</sup>	15	15	Medium
Interest rate risk	1 percentage point	0	0	Low
Refinancing				Low
Credit risk				Low

Sensitivity calculations for each type of risk do not take into account the fact that actual changes will also affect other items. The effects of any hedging have not been taken into account, either.

## OPPORTUNITIES AND RISKS – OPERATIONAL

### RISK AREA

### RISK MANAGEMENT

#### A VARIATIONS IN PULP PRICE

PROBABILITY: 4 IMPACT: 5

'Pulp price risk' means the risk of changes in pulp prices having a negative impact on the consolidated income statement and balance sheet.

The pulp price is set in a global market and the price of Rottneros' products is dependent on how global demand for pulp products can be matched with the industry's production volume.

Variations in pulp price are seldom related to changes in Rottneros' costs and may thus generate major fluctuations in the result.

A high pulp price is positive for the result but may have a negative impact on potential sales volumes.

The setting of prices in the pulp market is governed by international price levels that depend on demand and the global economy.

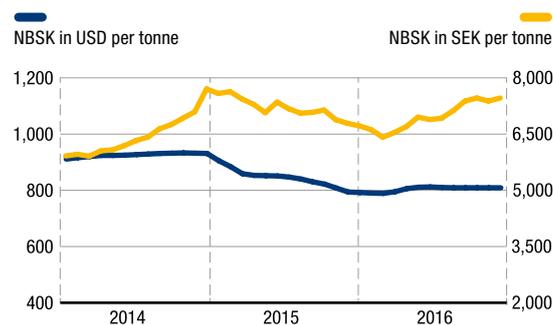
Pulp hedging is used when the price levels in long-term contracts are economically advantageous or when the market price is so low that further reductions may threaten the survival of the company. As a main rule, pulp prices are hedged in Swedish kronor.

Rottneros develops product segments that involve more added value and that can substitute mass products in the long term. The objective is to reduce dependency on the list price for market pulp and thereby mitigate fluctuations in profitability over a business cycle.

#### COMMENTS ON OUTCOME FOR 2016:

The Group had pulp hedging of 24,000 tonnes as of 31 December 2016, with a due date between January 2017 up to and including December 2017 at a price of SEK 7,150 per tonne.

#### PULP PRICES NBSK IN USD AND SEK



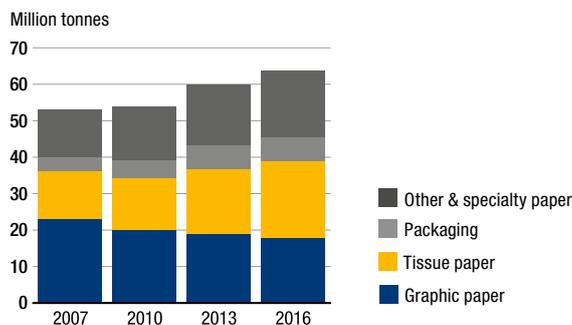
#### B STRUCTURAL CHANGE

PROBABILITY: 5 IMPACT: 2

Digitisation, globalisation and increased trade reduce demand for certain types of pulp and effect structural changes in the industry. Demand for newsprint and printing paper is weakening while demand for tissue paper, board and specialty paper is strengthening.

Rottneros has focussed on growth in product segments in which the company can add value through its knowledge and high-quality pulp, in order to manage structural change in the industry. The objective is to reduce dependency on the list price for market pulp and thereby mitigate fluctuations in profitability over a business cycle.

#### GLOBAL MARKET PULP CONSUMPTION PER APPLICATION



#### C1 ACCESS TO RAW MATERIAL

PROBABILITY: 1 IMPACT: 4

Pulp wood supplies are crucial for a pulp producer. Rottneros does not have any forests of its own and is therefore dependent on an optimal flow of pulp wood to its pulp mills. Deliveries and customer relations would be in jeopardy if Rottneros were to experience disruptions in the supply of pulp wood.

The Group ensures that it has a good, long-term relationship with the suppliers in the vicinity of each mill to safeguard access to pulp wood. Rottneros normally concludes agreements with major pulp wood suppliers for a period of between six and twenty-four months. Over the past year Rottneros has signed three-year contracts with the Group's largest suppliers of pulp wood. The Group has its own company in Latvia for supplies of pulp wood and chips in order to increase flexibility.

RISK AREA	RISK MANAGEMENT
<b>C2</b> RAW MATERIAL PRICES	PROBABILITY: <b>2</b> IMPACT: <b>3</b>

Price and price changes for pulp wood affect pulp producers. Higher prices for pulp wood have a negative impact on profit and Rottneros is unable to compensate for price increases on input goods.

The Group does not hedge against market price fluctuations, but long-term supply agreements provide some stability to prices. A price change of SEK 10 per m<sup>3</sup> will affect the Group's result by approximately SEK 15 million.

**COMMENTS ON OUTCOME FOR 2016:**

Rottneros raw material cost for the year amounted to SEK 580 (591) million, equivalent to 34 (33) per cent of net turnover.

<b>D</b> ELECTRICITY PRICES	PROBABILITY: <b>3</b> IMPACT: <b>3</b>
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Energy costs represent a substantial part of Rottneros' manufacturing costs. Increased energy prices may lead to increased production costs and have a negative impact on the Group's operating profit.

All electricity for the mills is purchased directly via the Nord Pool electricity exchange. Electricity prices are quoted in EUR. Future electricity prices are hedged in advance in SEK according to a set strategy to protect Rottneros' future electricity costs against major fluctuations and achieve a predictable electricity price.

The Board of Directors approves hedging levels based on proposals from senior management. The Board also approves new financial counterparties.

**NORD POOL ELECTRICITY PRICE (AREA SE3) IN SEK PER KWH**



**COMMENTS ON OUTCOME FOR 2016:**

The average price level for electricity on the Nord Pool exchange (area SE3) amounted to SEK 0.28 (0.21) per kWh for 2016.

At the end of December 2016, electricity was hedged corresponding to the percentage of forecast consumption specified in the table. The table shows the average price in SEK/kWh for all electricity hedging.

Year	Proportion hedged	SEK/kWh
2017	71%	<b>0.234</b>
2018	75%	<b>0.226</b>
2019	75%	<b>0.228</b>
2020	60%	<b>0.221</b>
2021	45%	<b>0.237</b>

<b>E</b> CUSTOMER STRUCTURE AND CUSTOMER CREDIT	PROBABILITY: <b>1</b> IMPACT: <b>2</b>
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A high dependency on a small number of major customers, industries or geographical markets may have a significant impact on revenue if a major customer or industry were to have problems.

Rottneros considers that the Group has a good diversification of commercial risk with over 100 customers, of which the ten largest together represent approximately 50 per cent of turnover. Printing paper customers account for approximately 25 per cent of revenue, which in the long term may constitute too high a proportion considering the long-term structural changes occurring in the market.

Geographically, the Rottneros Group is not dependent on the market in any particular country. Most of the Group's turnover is generated in Europe, where Germany, Italy and Sweden represent the largest markets.

Credit risk is managed at a Group level. Credit risk arises through cash and cash equivalents, derivative instruments and deposits at banks and financial institutions, and through credit exposures to customers.

With few exceptions, business risk relating to accounts receivable is insured through credit insurance with a ten per cent excess.

**COMMENTS ON OUTCOME FOR 2016:**

The Group has just over 100 customers and the maximum credit risk on outstanding accounts receivable amounted to SEK 33 million at the end of 2016 (10-15 per cent excess + any uninsured receivables).

93 (97) per cent of total outstanding accounts receivable were insured on 31 December 2016. Historically, the Group has only incurred small credit losses.

In 2016 the Group's largest customer accounted for 12 (11) per cent of turnover. No other customer accounts for more than 10 per cent of turnover.

## OPPORTUNITIES AND RISKS – OPERATIONAL

RISK AREA	RISK MANAGEMENT
<p><b>F FACILITIES</b></p> <p>Rottneros has two production facilities that conduct continuous production. Industrial injuries, machinery breakdowns, fires and other accidents may result in extended production shutdowns, damage to the facility and delivery problems.</p>	<p style="text-align: right;">PROBABILITY: 3    IMPACT: 3</p> <p>The management team conducts an annual review of the mills' maintenance needs for the coming years. This work includes identifying ongoing annual investments, investments in expansion and investments that aim to improve quality and safety.</p> <p>The Rottneros Group holds annual maintenance shutdowns to ensure a high and even rate of production. Maintenance shutdowns are carefully planned to minimise downtime. In addition, preventive maintenance is carried out regularly.</p> <p>Rottneros insures all of its facilities against property damage and business interruption and also has relevant liability insurance. The insurance companies conduct annual audits of the Group's facilities and make recommendations for improvements and reduction of risks.</p> <p>Rottneros also has a relatively low level of capital in fixed assets compared with the rest of the industry, which results in low depreciation and a low capital cost. Rottneros had machinery with a total book value of SEK 640 (515) million at the end of 2016. The replacement cost is much higher.</p> <p>Under Agenda 500, the Group's long-term industrial plan, Rottneros is making significant investments in facilities to increase capacity and strengthen competitiveness.</p> <p><b>COMMENTS ON OUTCOME FOR 2016:</b> In 2016, maintenance shutdowns were carried out during the third quarter at Rottneros Mill and during the fourth quarter at Vallvik Mill. Investments under Agenda 500 are progressing according to plan. Insurance is reviewed and procured annually.</p>
<p><b>G POLITICAL DECISIONS</b></p> <p>Political decisions may have a negative impact on production at the Group's pulp mills through changes in environmental legislation.</p>	<p style="text-align: right;">PROBABILITY: 1    IMPACT: 2</p> <p>Rottneros' exposure to political risks is considered to be limited.</p> <p>Rottneros runs its production in Sweden and sells most of its products to Sweden, the rest of Europe and the United States. These markets are stable democracies and the political risk of rapid changes to legislation, rules and regulations is relatively slight.</p> <p>Rottneros considers that there is always a risk of political decisions that raise the price or limit Rottneros' opportunities to produce pulp in some way or another. However, the Company considers this risk to be limited. Rottneros works to continuously improve the production process and the goal is that all investments in the mills will also benefit the environment.</p>
<p><b>H SUSTAINABILITY AND RESPONSIBILITY</b></p> <p>Inadequate responsibility relating to sustainability issues could harm trust in the Company and the brand, thereby having a negative impact on the Company's profitability.</p> <p>To achieve sustainable profitability and value creation Rottneros must simultaneously create value for those stakeholders who are affected by the Group's operations.</p> <p>See also the sustainability section on pages 28-35.</p>	<p style="text-align: right;">PROBABILITY: 3    IMPACT: 4</p> <p>Rottneros shall run its business responsibly with respect to the external and internal environment, society, our customers and suppliers, our shareholders and our employees. Trust in Rottneros as a responsible participant, supplier and employer strengthens our position in society and in the market, and promotes employee commitment. Rottneros communicates regularly with its stakeholders to maintain an open and positive relationship.</p> <p>Rottneros endeavours to make our products better, both from a quality and efficiency perspective, by understanding the customers' processes and product strategy. Environmental, social and economic factors are crucial to this success.</p> <p>The Group has a Code of Conduct describing how Rottneros and the Company's employees act in relation to the surrounding world and towards each other. The Code of Conduct defines Rottneros' social responsibility, ethical commitment and position in respect of gender equality and diversity issues, as well as the approach that Rottneros' employees should adopt on issues of principle importance.</p> <p>Employee well-being is an important part of Rottneros' success. The Group takes responsibility towards employees by promoting good health, environment and safety in the workplaces. Rottneros has a 'vision zero' approach to occupational injuries leading to sick leave.</p> <p><b>COMMENTS ON OUTCOME FOR 2016:</b> In 2016 9 (5) accidents occurred that resulted in a total of 62 (16) sick days.</p> <p>A new EU project, PULPACKTION, was launched in October 2016. The project will develop completely bio-based trays that use pulp and bio-based polymers instead of plastic or similar fossil-based solutions. In addition to project coordination, Rottneros is leading development areas within tray moulding and pulp development. The project, which will continue for four years, aims to contribute to more sustainable development in the packaging industry.</p>
<p><b>I ENVIRONMENT</b></p> <p>Rottneros' activities have an impact on the environment, which may entail environmental restoration costs.</p> <p>Extensive environmental legislation governs Rottneros' operational area, and its activities require permits that need to be renewed periodically.</p> <p>There is a risk of permits granted being exceeded, which may not only entail production restrictions or the need for investments, but also criminal penalties or the revocation of permits.</p> <p>There is also a risk of environmental legislation being amended, which may affect Rottneros' activities. No such changes are known at the current time. See also the environment section on pages 32-35.</p>	<p style="text-align: right;">PROBABILITY: 3    IMPACT: 4</p> <p>Good management of environmental issues represents a fundamental and important issue for the Board of Directors and corporate management, for which reason ongoing debriefing takes place monthly, half-yearly and annually.</p> <p>Both of the Group's mills have environmental management systems and are certified according to ISO 14001. The environmental management system includes well-established routines for follow-up, taking samples and dealing with deviations.</p> <p>The Group has a continuous sampling system with alarm functions linked to the mills' control systems to detect and prevent any infringements of applicable provisions and requirements. Random manual samples are taken in addition to this.</p> <p>All employees shall undergo environmental training in accordance with the Group's policy. Senior environmental staff within the Group undertake continuous professional training.</p> <p>Ongoing communications take place with county administrative boards and municipal authorities. Compliance consultation meetings are held with the county administrative board four times a year, to which the municipal authority is also invited to attend.</p> <p><b>COMMENTS ON OUTCOME FOR 2016:</b> In January 2016, Vallvik Mill was granted a new environmental permit, authorising the mill to produce 255,000 tonnes of sulphate pulp. The new permit ensures that Rottneros can continue to expand capacity in accordance with the provisions of the Group's long-term industrial plan Agenda 500. It is a comprehensive permit under the Environmental Code, which is associated with a number of conditions that are largely in line with the Company's view of the situation.</p> <p>As part of Agenda 500, the Board of Directors decided in 2016 that a new energy and emission-efficient biomass boiler would be installed at Rottneros Mill. The investment, totalling SEK 108 million, is expected to be commissioned around mid-2017. Following the investment, energy consumption at both mills will for all practical purposes be fossil-free.</p> <p>In 2016 the Board of Directors also decided as part of Agenda 500 that a new wash press would be installed at Vallvik Mill. This environmental investment of around SEK 45 million will significantly reduce the mill's COD emissions so that the production capacity can be expanded under the new environmental permit. The wash press will be installed during the maintenance shutdown in 2017.</p> <p>In February 2017 the Board of Directors decided to expand the purification plant at Rottneros Mill, within the scope of Agenda 500. The environmental investment of SEK 84 million is planned to be commissioned in 2018.</p>

## FINANCIAL RISK AREAS

The following describes the Rottneros Group's policies for managing financial risks.

Financial risks and other arrangements are described in Note 4.

The factors that have the greatest impact on the Group's result are associated with the price of pulp in USD, exchange rates, and pulp wood and electricity prices.

Financial risk is managed at Group level in accordance with guidelines defined in the Group's Financial Policy and approved annually by the Board of Directors.

The Board of Directors makes decisions on overall mandates and limits for restricting the Group's financial risk exposures and also makes decisions on all long-term financing.

The Board of Directors approves hedging levels based on proposals from senior management. The management continually assesses whether factors such as the USD rate, pulp price or electricity present attractive opportunities for strategic hedging. Financial hedging instruments are not used speculatively, but solely to hedge transactions and costings in accordance with the approved Financial Policy.

RISK AREA	RISK MANAGEMENT
<b>J CURRENCY – BALANCE EXPOSURE</b>	<b>PROBABILITY: 4 IMPACT: 1</b>

'Currency risk' means that currency rate changes may have a negative impact on the Group's future results, cash flows and values of assets and liabilities.

Rottneros' pulp mills and assets are 99 per cent in Sweden and other than the currency risk related to current account transactions, balance exposure is very low.

<b>K CURRENCY – TRANSACTION EXPOSURE</b>	<b>PROBABILITY: 4 IMPACT: 4</b>
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'Transaction exposure' is the risk of exchange rate fluctuations in export revenue and import costs having a negative impact on operating profit.

Most invoices are issued in USD, EUR and SEK. The Rottneros Group's assets and liabilities are valued in SEK. The fundamental principle is that the currency risk exposure that arises on outstanding accounts receivable shall be hedged, preferably by currency hedging or borrowing in currencies that correspond over time to the average accounts receivable for each currency. The purpose of hedging exchange rate risk is to reduce undesired and unanticipated effects of exchange rate fluctuations and minimise the negative impact on the Group's result. Our central finance function is responsible for proactively monitoring and managing the Group's exchange rate exposure and ensuring that actual risk exposure is identified and managed.

The Group applies a netting procedure so that all purchases and sales in each currency are netted and the net flow is hedged.

#### COMMENTS ON OUTCOME FOR 2016:

The underlying exposure to USD is high, while the direct inflow of USD (the real flow) corresponds to approximately 40 per cent and in EUR approximately 45 per cent. However, the impact of exchange rate fluctuations on indirect exposure is delayed, as the normal duration of a contract is between one and three months. As of 31 December 2016 Rottneros held currency hedges of USD 4.0 million and EUR 1.0 million.

<b>L INTEREST RATES</b>	<b>PROBABILITY: 1 IMPACT: 1</b>
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'Interest rate risk' comprises the exposure of the Group's financial assets and financial liabilities with a floating interest rate.

Rottneros' level of borrowing has remained low since 2009, when the Group was refinanced. The Group's borrowing is shown in Note 13 on page 69. The Group's low level of borrowing means that interest rate risk has primarily been limited to the return on cash and cash equivalents. In order to have an optimal capital structure, however, the Group's level of borrowing may be increased, which impacts interest rate risk relating to financial liabilities.

#### COMMENTS ON OUTCOME FOR 2016:

As of 31 December 2016 the Group had utilised SEK 14 million of its credit facilities. Cash and cash equivalents amounted to SEK 16 (169) million as of 31 December 2016.

In December 2016 Rottneros signed a debt financing agreement totalling SEK 120 million that will be used for investments in the Group's two mills within the Agenda 500 investment programme. The loans will be repaid within five years and have a variable interest rate. The loan terms include customary covenants such as net debt in relation to EBITDA, as well as the equity ratio and certain restrictions on dividend payments. These approved loans had not been used at year-end.

<b>M LIQUIDITY AND REFINANCING</b>	<b>PROBABILITY: 2 IMPACT: 4</b>
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There is a risk that Rottneros may not have sufficient liquidity to pay for running costs, or the Group not being granted credit.

The financing risk shall be minimised as far as possible by the due dates for loans and other credit facilities being well-diversified and evenly spread over time. Outstanding credit facilities shall be refinanced no later than three months before they fall due.

The Group's objective is for liquidity reserves to amount to at least ten per cent of the Group's 12-month rolling turnover and be available within 30 days. The Group continuously produces liquidity forecasts.

Rottneros' credit agreements are considered to be sufficient for normal operating and investment cash flow for the next few years. Both the liquidity and refinancing risks are therefore considered to be low at this time.

The Group shall maintain an optimal capital structure to keep capital costs down while ensuring that it is able to continue its activities.

The Group may take on new debt, change the dividend paid to shareholders, repay capital to shareholders, issue new shares or sell assets to reduce its debts in order to maintain or adjust its capital structure.

The Group assesses its capital on the basis of its debt/equity ratio. This key ratio is defined as net debt/cash as a percentage of shareholders' equity.

#### COMMENTS ON OUTCOME FOR 2016:

The Group's liquidity reserve at the end of 2016 amounted to 16% (19%) of turnover and the target is 'at least 10 per cent'.

The Group's debt/equity ratio amounted to 0% (-16%) at the end of 2016.

Group net cash at the end of 2016 amounted to SEK 2 (169) million.