Developments in Oil Products' markets

The most important external factors affecting the result of the Oil Products reporting segment are the price differential between petroleum products and crude oil and between Brent crude from the North Sea and Russian Export Blend (REB), and the USD/EUR exchange rate.

Demand for petroleum products continued to grow

Global demand for petroleum products continued to rise during 2013, despite uncertainty surrounding economic growth, by around 1% for the second year in succession. Gasoline demand growth was focused on developing countries. Demand for diesel in Europe softened, as a result of the challenging economic situation and lower industrial demand for energy and transport. Low capacity utilization rates at European refineries led to a higher diesel shortfall in Europe, creating a stronger market for diesel compared to other key product segments.

Crude prices impacted by the state of the world economy and geopolitical uncertainty

Continuing uncertainties in the world economy and geopolitical tensions in oil-producing countries were the main drivers in the oil market during 2013. Brent traded in the USD 100–120/bbl range, peaking in early February, when it reached USD 120/bbl, before weakening in the lead-up to the summer as new concerns related to the international economy and future growth prospects in China drove the price close to USD 100/bbl.

Following some positive signs in the international economy, combined with political unrest in Syria and strikes that reduced Libyan crude oil exports, crude trended up during the late summer and early fall towards USD 120/bbl. As the strikes ended in Libya and negotiations between Iran and Western countries pointed to the possibility of a future easing of crude export sanctions, crude prices returned to USD 105–110/bbl, ending the year at around USD 110/bbl. The increasing production of tight oil in the US limited crude price increases and resulted in narrower differentials between lighter and heavier crudes.

The price differential between Russian Export Blend (REB) and Brent averaged USD –1/bbl in 2013, which was slightly narrower than in 2012. The differential widened significantly during the spring on the back of higher crude prices and the refinery maintenance season before narrowing and reaching even positive differential levels in the late summer when delayed maintenance at Russian refineries and the strikes in Libya reduced oil exports. The refinery maintenance season in the fall and the end of the strikes in Libya saw the price differential widen again, approaching around USD –2/bbl. With the ending of the maintenance season, the differential narrowed towards USD –1–1.5/bbl, where it stood at the end of the year.

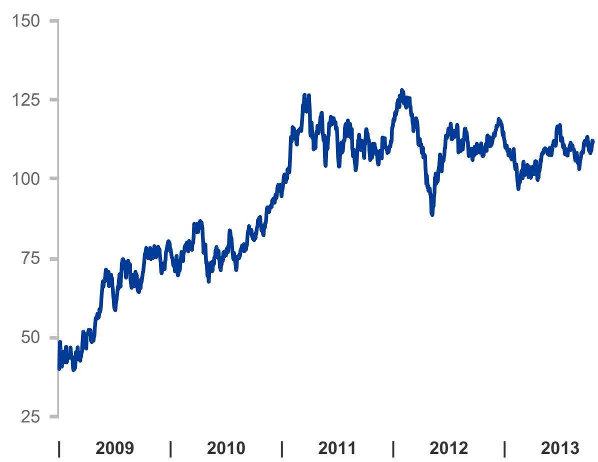
The structural changes under way in the European refinery sector favor advanced refiners such as Neste Oil that are able to meet today's statutory requirements and react flexibly to changing market conditions.

Fluctuating refining margins

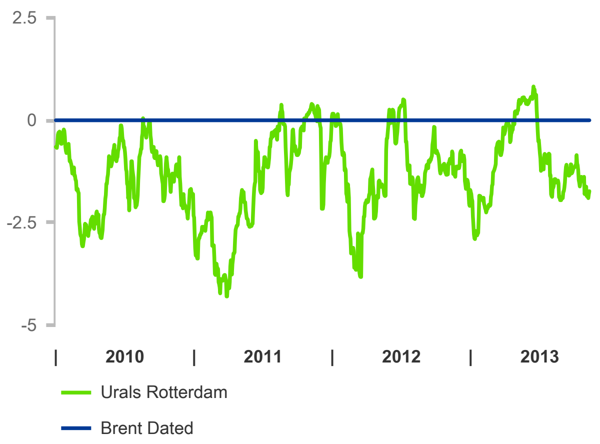
Refining margins in Europe were volatile and clearly weaker on average than in 2012. Margins during the first quarter were strong, as gasoline margins were unseasonably high due to refinery outages and relatively low gasoline inventories. After a strong start to the year, refining margins experienced growing pressure in the second half as new capacity was ramped up in the Middle East and Asia. High diesel exports from the US to Europe also pushed European refining margins down, to such an extent that many refiners were forced to make economic run cuts. Margins were lowest at the end of the year after the fall maintenance season.

Middle distillates were again the strongest part of the barrel. Gasoline margins were seasonally low during the early part of the first quarter and the fourth quarter, but were strong from the spring until the early fall. Fuel oil margins were strong during the first half of the year, but weakened significantly during the second half.

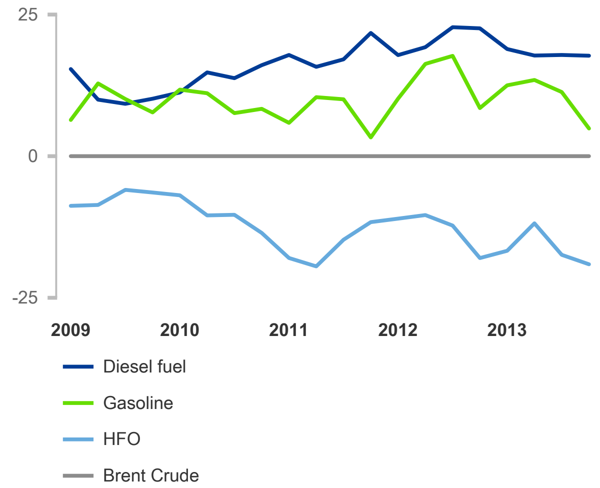
Crude oil price, USD/bbl



Price differention between Urals and Brent Dated, USD/bbl



Price differential between main petroleum products compared to Brent Crude, USD/bbl



Base oil market remains challenging

The challenging market situation facing premium-quality Group III base oil continued during 2013, primarily because of the extensive supply of these products. The recovery in the world economy suppors demand for Group III products, as does the increasing shift to premium-quality base oil around the world. Neste Oil's Group III base oil increased its share in the main markets of Europe and Americas, thanks to successful sales work, despite the tough competitive situation there. Neste Oil's goal in 2014 will be to further grow its market share, although the overall market for Group III base oil is expected to remain challenging.

A changing competitive environment

Neste Oil is a small oil company by international standards, and has concentrated on premium-quality fuels and extending its middle distillates capacity, particularly diesel. The Porvoo refinery is one of the most advanced in Europe and Neste Oil has a leading position on its home markets around the Baltic.

Neste Oil’s main competitors comprise other advanced refiners in Northwest Europe and global export refiners. The latter include Russian refiners focusing on improving the quality of their output, together with refiners in the Middle East and Asia that have invested in modern capacity in recent years.

Russia is continuing to modernize its refining capacity, encouraged by tax changes introduced there in 2011 aimed at increasing investments in crude production and improving the country’s refining base.

Average capacity utilization rates at European refineries during 2013 were below 80% and resulted from slow demand growth and overcapacity. Uncompetitive refineries in Europe and along the US East Coast will probably continue to be shuttered as a result of the worldwide growth in refining capacity. Tougher environmental legislation in Europe will also affect the restructuring of the refining sector, which is expected to favor advanced refiners, such as Neste Oil, that can respond to new legislative requirements and react flexibly to changing market conditions.

Neste Oil has become one of the world’s leading suppliers of base oil. Producers in Asia and the Middle East that have recently increased their production capacity are key competitors for Neste Oil in this area.