Choose your partners

The interplay of petrochemical interests in Europe and the Middle East is set to increase as producers in both regions seek alliances for downstream investments

JOHN BAKER BRUSSELS

The dramatic events of the past two years have forced petrochemical producers in Europe and the Middle East to reevaluate some of the assumptions underlying how they see the sector developing.

The economic and financial crises in late 2008 and early 2009 had a big impact on producers in both regions. So too has the decline in ready availability of advantaged ethane feedstocks in the Middle East.

Leading industry executives met in Brussels in October to discuss how the two regions are responding to these changing circumstances at the third ICIS/Booz & Company CEO Roundtable on European Petrochemicals.

Optimism was evident from all participants on the business environment going forward. There was also agreement that there is plenty of scope for mutual development between leading Western and Middle East producers.

European players are seeking ways to capture the growth in global markets, offering their technology as a way to forge joint-venture partnerships, while Middle East companies are looking for strategic partners to help them expand downstream from their now well-established ethylene and first-line derivative asset base.

The move downstream is also being promoted by governments in the region, keen to create manufacturing jobs for their fast-growing, youthful populations.

Continuing with the strategy of focusing on greenfield ethane-fed cracker projects is mostly no longer an option for the Middle East. Producers there, especially in Saudi Arabia, are looking to drive more value from their assets through integration and optimization and from the wider feedstock slate they are increasingly being forced to consider.

Tom Crotty, group director of Switzerland-headquartered petrochemical producer INEOS, commented that the downturn had a big impact on the company, but that the measures it took in 2009 mean it is now well structured. "There were benefits from the downturn. It drove us to examine our cost base, which was low anyway, but it is surprising what pressure can do. We now have a lower cost base than in 2008, lower working capital and lower stock levels and are determined to hold on to this position now that there is an upturn."

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TOM CROTTY
Director, INEOS Group

Crotty believes the downturn has been positive for Europe by strengthening businesses for long-term survival. In the short term, things are looking stable, with petrochemical demand returning to underlying growth rates of 2–3%/year for commodity polymers, for instance.

"There will be a lot more scope for strategic developments and partnerships. We want to establish positions in China and the Middle East but for INEOS, being very EU- and US-focused, it is difficult to go it alone on developments here." However, he believes INEOS's strong technology base will be instrumental in attracting partnership opportunities.

Abdullah Bazid, in charge of strategy and planning at Saudi petrochemical major SABIC, noted that the downturn hit his company hard and led to restructuring in the US and Europe. A third of SABIC's sales are now outside Saudi Arabia, through its interests in Europe, North America and now China. But he too sees demand returning to normal patterns of growth.

"In the short term, attention in the Middle East is being focused on getting value out of what [assets] you have," commented Bazid, referring to the lack of major investments going forward on the grounds of high project costs and also limited feedstock availability.

He points to two objectives for the region: first, delivering on a number of specialty and performance products in partnerships chosen to deliver win-win situations; and second, to grow the local market for these materials in partnership with local companies.

In the longer term, the challenge is to come up with a business formula for a Middle East with limited or even no gas. In this case you should not look just at the Middle East but at the global scene, he said.

"If you invest without advantaged feedstocks, you might as well ask why not invest in other regions of the world. We [SABIC] will be in China and elsewhere. We will increasingly invest in other markets as we have to invest in added value."

DRIVING COMPETITIVE ADVANTAGE

In its home market, said Bazid, SABIC will drive competitive advantage through its gas feedstock and invest to make its assets even more competitive through energy reduction, deeper integration and plant optimization. These were built initially, he explains, "for a different energy game. Now we are looking at energy conservation and reductions in manpower costs." He believes better integration at SABIC's assets could cut costs by up to 20%.

Sahel al-Nazha, chief operating officer at Saudi Arabia's largest private chemical company, National Industrialisation Co. (TASNEE), agreed that there is a move to downstream investment in the Middle East.

"The region can be a workshop for European requirements. We have availability of material, workforce and infrastructure"

SALEH AL-NAZHA
President and chief operating officer, Tasnee

TASNEE, which already runs an ethylene complex and a large propane dehydrogenation/polypropylene (PP) unit, is looking to derive added value by moving downstream into acrylics and superabsorbent polymers, in partnership with Dow Chemical of the US and Germany's Evonik Industries, respectively.

"We need to get into products that bring added value and income to the country," he said, and which can help fight high unemployment in Saudi Arabia, especially among the fast-growing young population. "The biggest challenge for TASNEE is where can we benefit from our feedstocks and where we go from here."

DOWNSTREAM OPPORTUNITY

"I believe there is an opportunity again for Western players to get involved in Middle East partnerships and benefit one more time." But this time, explained Al-Nazha, it's not just about access to cheap feedstocks but also about gaining access to the local market and leveraging their technology base.

"The region can be a workshop for European requirements. We have availability of material, workforce and infrastructure and so offer an opportunity for investment. In China, things are going a little the other way, with tightening environmental requirements adding additional costs."

Ralf Kuhlmann, until recently head of base chemicals at Belgium-based ExxonMobil Chemical Europe and now with his own consultancy, stressed that producers need to take

PETROCHEMICALS **ANDREW HORNCASTLE** BOOZ & COMPANY, DUBAI

DIVERSE DEVELOPMENT IN THE MIDDLE EAST

FROM A Western perspective, viewers often do not realize Middle East countries are at different stages of evolution, each presenting different opportunities and risk profiles.

Saudi Arabia is the "heavyweight old guard" player trying to create breakaway growth strategies while dealing with cultural and governance constraints.

Abu Dhabi's "young entrepreneurial leadership" has charted a comprehensive vision for economic development and diversification and is working hard to implement. Qatar is the "small newcomer" learning from the others and developing a coherent growth vision and a credible implementation approach.

Iraq bears the potential to become a "reemerging heavyweight" because of a broader base of human and natural resources. Iran is a "trapped power" that could emerge to its former glory, but not without the risk of violent discontinuity.

Chemicals development in the Middle East now faces constraints from prevalent gas shortage and partial political pressures. However, there is an aspiration for extended value-chain coverage and stronger integration that opens up new opportunities for more value-added joint ventures. ■

a global approach in today's market. But when looking at partnerships, he advised that it was essential to define the value added in these deals and also the payback on both sides. "We need to see they are long-lasting partnerships and that they get value out of the chain."

Kuhlmann believes firms with established operations in Europe need to focus on three key areas: integration, energy efficiency and innovation. But even in the Middle East, as advantaged feedstocks disappear, there is a growing need to look at further efficiencies.

The petrochemical industry in Europe is, he added, still an integral part of the global business and needs to remain strong as it is the backbone of manufacturing industry in general in the region. But, he warned, it must address the question of how to make money at lower capacity utilization rates than previously the case.

"Rates of 90–92% cannot be guaranteed for the future, but it is feasible to make money at 85% operating rates. Even with the possible closure of 2m–3m tonnes/year of olefins capacity – which he admitted was a difficult task in Europe – these rates look set to be more likely the norm than not.

Bazid reinforced the point that older plants in Europe need to be closed. "Many assets date back to the 1960s and 1970s and we have to accept some are too old. SABIC is already looking at assets to close, but you have to come to really hard decisions and shut smaller units and build new efficient capacity – the challenge is always what is the return."

Crotty added that two factors combine to distort the situation in Europe: government interference that stops some capacity closing, and the fact that over the past year, smaller, heavier feed units have become more profitable due to the value of C4s and C6s produced. As a result, "decisions get postponed that would have otherwise been taken."

The current upswing in C4 values may well not be sustainable, as the next wave of global cracker projects swing back to heavier feedstocks, away from the C2 and C3-based crackers that have featured strongly recently. This shift back to naphtha cracking begins to open up the interesting question of where future plants might be situated.

GREATER REGIONALITY

As Bazid pointed out, if you go to cracking liquids and naphtha in the Middle East, it makes export business less profitable, which will lead to greater regionality in the market.

Richard Verity, a partner at global management consultancy Booz & Company added that "in the long term, beyond 2020, feedstock advantages might be less important. We could then imagine a world in which each of the main regions achieves a supply-demand balance using locally sourced product. In this scenario, Europe, for example, will continue to need a strong petrochemical base."

The loss of the gas advantage is also true as you move more to downstream products, Bazid pointed out, again creating implications for what products you decide to pursue and where these will be marketed. "This will be a challenge…. Local customers will still be relatively modest in number."

Al-Nazha added: "You have to be selective on the products you are making downstream." He too felt a lot of Middle East downstream production would still have to be export-oriented, but that gradually regional customers will become more numerous as industrial parks are created for local converters and customer industries.

This view was supported by Crotty, who said that INEOS is looking at both China and the Middle East for downstream investments. "If you have good technology you can get a good market position. A lot of the Middle East production will be export-oriented, while if you go to China, it will be for the local demand – INEOS will do both."

On opportunities for partnerships between European technology providers and Middle East producers looking to expand downstream, Bazid said there was a degree of complementarity in their aims. "The technology is there but how do we go about getting it right? Is it just about importing technology into the Middle East or do we go beyond this and try to set up global alliances? The challenge is to cut a win-win deal."

For Kuhlmann, an important issue is that these partnerships need to exchange best-in-class technology and not hold back the best as in the past. And for Al-Nazha, it is important that partners structure the deal so they are not competing in the same markets. This is especially the case in specialty products, he added.

But whatever the challenges, the Roundtable participants agreed that partnerships are the likely way forward. "There is an appetite in the West [for partnerships], commented Crotty. "The financial aspects are OK and there is still investment available for good projects, many of which will be cooperatives."

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ABDULLAH BAZID
Executive vice president,
corporate strategy and planning, SABIC

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RALF KUHLMANN
Industry management advisor,
Dr Kuhlmann International

TAKING PART IN THE ROUNDTABLE

- **Saleh al-Nazha**, president and chief operating officer, TASNEE
- **Abdullah Bazid**, executive vice president, corporate strategy and planning, SABIC
- **Tom Crotty**, director, INEOS Group
- **Ralf Kuhlmann**, proprietor, Dr Kuhlmann International

Also present

- **Richard Verity**, Booz & Company
- **Andrew Horncastle**, Booz & Company
- **John Baker**, ICIS

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