

# Dealing with the downturn



REX FEATURES

# What should companies focus on during the recession, and what will the future look like? Europe's leading petrochemical executives discussed these topics at a high-level Roundtable

JOHN BAKER/BRUSSELS

THE SEVERE demand-led slump in the chemical sector is now in its seventh month. Chemical producers have reacted swiftly by tightening their focus on cash flow and reducing working capital. They also moved quickly to adjust inventories and match production output to the much lower levels of demand, idling plants, reducing working hours and cutting employee numbers.

The speed and decisiveness of the response marks a distinct contrast to previous troughs in the 1990s and early 2000s, when producers struggled to adjust, often too late. But with 2009 and even 2010 looking difficult in terms of demand, the fight really is on to minimize costs while maintaining the ability to benefit from an eventual upturn.

The impacts of the downturn and how companies are managing formed the main focus of the 2nd ICIS/Booz & Company CEO Roundtable on European Petrochemicals, held in Brussels in April. The first was held in March 2008, in very different market conditions.

Participants discussed what they are doing to adjust business operations to today's much reduced demand and wafer-thin margins. Discussion then turned to cover asset closures and optimization, restructuring and what measures European producers might take to ensure their longer-term sustainability.

There was broad agreement that those companies that entered the downturn with strong balance sheets and those which make intelligent decisions will emerge all the stronger post-2012. But that in the intervening period permanent plant and asset closures and a significant degree of restructuring are required.

Arno Knebelkamp, CEO of Germany-based vinyl producer VESTOLIT, led the way by stressing that his main focus at the moment is on "cash, cash and cash," a statement which elicited resounding agreement around the table.

"We are focusing on quick cash-generating initiatives, getting rid of inventory and reducing our fixed costs. We are also taking advantage of the labor flexibility mechanisms in Germany to adjust variable costs."

The sentiment was firmly supported by Boy Litjens, CEO of Netherlands-based plastics producer SABIC Europe, who noted that indeed "cash is king" in today's climate. SABIC, he indicated, had made some precautionary moves in Europe mid-last year, on the expectation of a supply-led downturn in the petrochemical sector, including cutting head-count and reducing capital expenditure.

"At the time people said we were overreacting, but now it seems wisely done."

SABIC has made further moves since demand really fell away in December, but as Litjens pointed out "we can't cut costs so much [as] to cover the gap – so we have continuous discussions on the balance of short-term cost-cutting and being able to take advantage of opportunities in the future."

The current aim is to limit the damage.



"We have to use all the tools at our disposal"

Just Jansz, LyondellBasell Industries

"There is now some demand, but margins are so thin we really wonder if we should continue to produce – you need to stay on top of it and we have weekly meetings to decide what plants to run."

Cash and financial discipline are also very important at US-based producer Dow Chemical, concurred Isidro Quiroga, commercial vice president for basic plastics in Europe, India, Middle East and Africa. "We are going through quite some downsizing, or right-sizing, including workforce reduction, asset closures, process optimization and divestments."

The industry reaction to the downturn is different this time, he explained. "We are taking action very early in the crisis." One of the reasons, he suggests, is that the sec-

## TAKING PART IN THE CEO ROUNDTABLE

- Just Jansz, president, technology business, LyondellBasell Industries
- Arno Knebelkamp, CEO, VESTOLIT
- Boy Litjens, CEO, SABIC Europe
- Isidro Quiroga, commercial vice president for basic plastics, Dow Europe & India, Middle East & Africa
- François Vleugels, formerly CEO, Unipetrol
- Richard Verity, vice president, energy & chemicals, Booz & Company
- Marcus Morawietz, vice president, chemicals, Booz & Company
- John Baker, global editor, custom publishing, ICIS

because of the wave of new capacities coming on stream in the Middle East. Although these have experienced some delays, for a multitude of reasons, their presence "has made us more prepared to take action."

On the question of managing through the downturn, Just Jansz, president of Netherlands-based LyondellBasell Industries' technology business, added that there is "no one silver bullet" to solve the problems. LyondellBasell, which has put its US operations and two EU-based holding companies into bankruptcy protection



"We really wonder if we should continue to produce"

Boy Litjens, SABIC Europe

(which it expects to exit before year end), is also, he noted cutting jobs and closing sites and offices.

"We have to use all the tools at our disposal – the priorities are for cost competitiveness and integration and to use our position in the Middle East to balance our global business."

Marcus Morawietz of global consulting firm Booz & Company noted that over the past quarter to half a year, chemical producers had taken the majority of actions and activities they need to create the focus on cash management.

"Actions are already agreed and in terms of restructuring, the mandates have been clearly given to the business divisions," he noted. "They now do need to be prepared

## WHEN CAN WE EXPECT AN UPTURN?

Do you want the bad news first? It could be that we will have to wait until 2013 for petrochemical performance to return to a healthy state. There was certainly a general consensus at the Roundtable that the current demand slump is unlikely to improve by any significant measure during this year.

“No significant plus on volumes for this year,” commented Knebelkamp, even with the economic stimulus packages being produced by the EU and member states. Litjens added that it was clear by April that the recovery was not coming just yet. But, he noted, there ought to be a recovery in demand by quarter four this year.

However, Jansz commented that 2010 could also pose problems in terms of supply/demand and “There is the likelihood that 2010 at least will be as difficult as 2009.” Vleugels was even more pessimistic: “The worst is still to come in Europe; I see the bottom by the end of the year with no significant upturn until mid- to end 2011.”

Even if the global economy and demand do pick up sooner rather than later, Europe’s petrochemical sector will have to grapple with a supply-led down cycle as material from delayed Middle East plants comes on stream in earnest in 2010 and 2011. “Even if demand returns,” said Quiroga, “supply will hold things back.”

A return to profitability will also be dependent on the direction crude oil takes over this period. In the longer term, noted Vleugels, if oil prices stay too low, there will be a significant cut in exploration. This means “that we will pay the bill over time when demand picks up again. We really need stable crude oil pricing, at a level that does not make us return to the roller-coaster crude oil pricing of last year. It is important to the petrochemical producers that oil prices recover their strength.”

A prolonged downturn would really sort the strong from the weak but also produce a strong upswing. As Litjens pointed out, if you are among the survivors by the time 2013–2014 comes around, the outlook could indeed be bright.

» for the upturn and will need to identify the right point to take the opportunities when the market comes back.”

## PRODUCTION PRIORITIES

However, the immediate priority for Europe’s petrochemicals producers is to balance production with demand and reduce inventories. The region has seen demand volumes down by as much as 30–40% since December.

But with integrated production, cutting output is not always easy. Knebelkamp made the point that with VESTOLIT’s operations being integrated into the Marl complex, it can’t just shut plants temporarily and adjust workforce accordingly.

Also, pointed out Francois Vleugels, who until recently was CEO of Unipetrol in the Czech Republic, it is just not feasible to simply shut down and start up large petrochemical units as and when product is needed, nor to run them below 70–75% of capacity. “You can



“Closures need to be made to clean up the asset base”

Francois Vleugels, formerly of Unipetrol

get into trouble running this low.”

A second issue is that with integrated production, there can be a push to make product from upstream. For example, “in Central and Eastern Europe, all the crackers are linked to refineries and these need to run to keep the balance with diesel. This is a danger zone in terms of margin squeeze in the [petrochemical] market.”

He believes the industry should focus on its competitive plants and close the less efficient units. “Closures need to be made to clean up the asset base. Now is an ideal opportunity – but if this is not done now there is little hope.”

This point too was wholeheartedly backed by the rest of the participants, although it was clear that closures are by no means a simple matter, due not only to integration of materials flows and integration of production, but also to government support for national assets that really ought to be closure candidates.

Knebelkamp pointed out that there are less efficient PVC plants in Europe are obviously getting government and federal support and that “this is a big concern for the industry.” Vleugels added that some

smaller cracker units in Eastern Europe were deserving of closure, but that if they did go, the effect on downstream units would be severe – again invoking the need for political discussions.

The same is true in principle in Western Europe, where permanent closure of ethylene capacity would create difficulties, given the close local integration with downstream units but poorer integration in terms of inter-site connections.

There was evident hesitancy around the table to accept that moves of this type were imminent, even given the current downturn. Nevertheless, it is clear that the poor performance at present will squeeze out underperforming assets, thus driving the consolidation that is required.

As Litjens explained, producers in Europe will have to focus closely on costs, and they need to ensure that their plants are at least in the 1st and 2nd quartiles in terms of performance. He also made the point that



“Companies have accepted and will manage the crisis”

Marcus Morawietz, Booz & Company

Europe should concentrate more on producing high-value-added products and leave the true bulk commodities to producers in the Middle East. “It is possible to produce the base polymers in the Middle East and focus on high-level products in Europe.”

This would, he acknowledged, require a high level of R&D and innovation in the region and a gradual restructuring of assets and mentality. If this route is not followed, he noted, “there will simply be no more investment in Europe as it will always be cheaper to produce in the Middle East.”

Jansz made the point that in one respect Europe is suited to follow the higher-value-added route, given that average plant sizes are relatively small. And Knebelkamp said that “you have to go to the added-value route as you can’t compete on cost alone.”

Individual plant closures may be hard enough to make, but consolidation and restructuring through merger and acquisition (M&A) activity will be an even more difficult process in today’s straightened financial conditions.

Although a shakeout is needed and companies will inevitably be looking at their »

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## CEO ROUNDTABLE

noncore businesses through portfolio management, the likelihood of buyers emerging looks remote. As Knebelkamp noted, that "there are not too many players with strong enough balance sheets around to drive the consolidation at the moment."

Producers and strategic buyers are too busy trying to minimize losses, while private equity buyers have limped out of the market and are looking at alternative ways to participate in



"We are going through quite some downsizing"

Isidro Quiroga, Dow Europe & IMEA

future given the demise of their debt-raising ability. Only the very cash-rich producers and sovereign funds may hold the potential to act.

Morawietz, however, advised that now is the time for executives to put more emphasis on strategic topics such as M&A and to assess how the sector landscape will change among competitors, customers and suppliers. "What are the opportunities for specific industry sectors as aged and nonperforming assets are taken out?" for example.

"We are seeing these topics starting

right now and we see this as a sign that the companies have accepted and will manage the crisis in terms of how to reduce costs." The key issue now is what comes next, and this, he noted, will depend very much on the length and depth of the crisis.

"We are clearly seeing lots of ideas for strategic activity but limited right now by shortage of cash." But in the long run, action will be taken, and ironically, the longer the



"We are focusing on quick cash-generating initiatives"

Arno Knebelkamp, VESTOLIT

downturn lasts, perhaps the better it will be for the sector, as more and more capacity is closed permanently.

The survivors will be those companies with plenty of cash and good-quality assets. These, said Litjens, really should now be balancing short-term cost cutting with longer term investment, to be ready to benefit from the upturn.

For more information on Booz & Company, go to [www.booz.com](http://www.booz.com)

## IDENTIFY YOUR STRATEGY

While the decline in demand and company performance has spurred prompt action, a good third of company CEOs and boards have little faith in the soundness of their strategies. And many are not sure of their strengths and weaknesses going into the recession.

These findings come from a turn-of-the-year survey by Booz & Company of 800 leading industrialists. Further findings, pointed out Richard Verity of Booz & Company, were that almost everyone agreed that the structure of their industry would alter as a result of the current crisis. "We are certainly at an inflection point and the next 12 months will define the winners and losers in the industry. This puts an extreme burden on CEOs at the present time."

But even where companies are secure in their strategy, many at the moment have little freedom to execute them. High financial leverage is holding many back, while for others the problem is low

liquidity. Such companies really will have to just ride out the storm.

Others are, however, still in good shape and these Verity terms the "industry shapers," with the ability to take advantage of the current situation, especially given the low valuations in the chemical sector right now.

But what should companies do? For the weaker positioned, Verity suggests they should be looking at cash preservation, noncore disposals and new sources of external funding. The stronger positioned should be looking at geographic and product expansion, investing in people and talent, and acquiring assets and companies. "They should be positioning themselves for growth after the crisis," said Verity.

In the meantime, all companies, he believes can benefit from reductions in working capital – and especially through inventory reduction – and enhanced performance on receivables.