Analysis of uk basic chemicals company

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BASIC CHEMICALS IN UK – ANALYSIS

HEADLINES

- The market size of basic chemicals in UK has declined to GBP12, 422 million recording a decline of 2. 6% in 2013 due to lower sales to manufacturers of plastic and synthetic rubber in primary form
- Reach regulation tightened in 2013 limiting competition of non-EU companies in UK
- Profit margin declines to a record low of 3% preventing production expansion in UK
- Shale gas remains an ace for basic chemicals producers in UK
- UK basic chemicals industry is matured. It is expected to grow at CAGR of 0. 7% during 2013-2019

MARKET TRENDS

- The market size of basic chemicals in UK has declined to GBP12, 422 million recording a decline of 2. 6% in 2013. Contraction of the industry was driven by falling revenues from plastics in primary forms, household cleaning and personal care, photochemicals and explosive, as well as pharmaceuticals segments.

- Purchases of basic chemicals by plastic in primary forms and synthetic rubber industry declined by 23% to GBP1, 360 million. The plastics industry in UK was having trouble competing with producers abroad as oversupply in the world settled-in. UK producers do not have access to cheap raw materials. Consequently, production of plastics and rubber in primary form declined by 23% in UK during 2013 negatively reflecting on revenues of basic chemical industry.
- Household cleaning and personal care producers reduced their purchases of basic chemicals by 15% in UK during 2013 as turnover of household cleaning and personal care products at constant prices declined by 5. 1%. Declining prices of specialty chemicals caused by increasing competition from China was the main reason of lower sales.
- Competition from abroad is limited by high infrastructure barriers for certain products. Currently ethylene production is concentrated in Grangemouth, Mossmorran and Wilton, UK and there is a network of 8 pipelines connecting major producers and consumers in UK. It is also proposed to connect ethylene network with Rotterdam. Potentially increasing imports if competition kicks-in.
- As of June, 2013 the regulation of chemicals in EU territory became stricter based on REACH (Registration, Evaluation, Authorisation and Restriction of Chemical substances) regulation. The requirement to register chemicals manufactured or intended to import into EU in quantities greater than 100 tons per year forces companies to register

within ECA (European Chemicals Agency). Registration within ECA results in higher costs as extensive research to confirm their safety is needed.

- Imports were pushed out as local producers were able to win-back their market share. Though market of basic chemicals in UK contracted by just 2. 6% during 2013 but imports of basic chemicals declined by 25%. Imports made 63% of the basic chemicals market in 2013 in comparison to 81% in 2012. Local producers were pushing out imports of hydrocarbons, oxygen-function compounds and other organic chemicals as their import declined by 31%.

PRODUCTION TRENDS

- Despite declining markets, production of basic chemicals was booming recording an 11% growth in 2013. The growth was driven by hydrocarbons, oxygen-function compounds and other organic chemicals expansion as the segment was winning back market share from imports.
- As competition in hydrocarbons, oxygen-function compounds and other organic chemicals got tense world-wide, domestic producers chose to compete in local market cutting down segment exports by 20% and total basic chemicals export by 17%.
- Cost pressure to the basic chemicals industry declined. Total costs related to basic chemicals increased by 12% in UK during. However, cost per unit of produce declined by 5% as turnover at constant prices increased by 17%.

- As production of hydrocarbons soared, costs related to refined petroleum products by 17% in 2013. The rise in costs in relation to growth in production at constant prices is related to increased share of basic chemicals manufactured from oil products as PPI of refined petroleum products decreased by 5%.
- Purchases of gas has increased by 21% due to 9. 4% rise in prices for industrial uses. Increase in production of hydrocarbons drove the purchases of gas upwards as well. The gas supply is well diversified with most of the gas coming from domestic supplies and Norway.
- Electricity costs increased by 20% in production of basic chemicals in UK during 2013. Mostly it was related to increased production in quantity though, electricity price rose by 2. 6% for industrial users in UK during 2013. UK's electricity generating capacities are outdated and plants one by one are turned off. Investments are increasing consequently raising electricity wholesale price.
- Despite an 11% growth in production, profits declined by 21% to GBP284 million in 2013. Profit margin has declined to a record low of 3% as producers were not able to cut costs at same amount as producer prices decreased by 5. 7% in 2013. Low profitability repelled new companies and prevents the industry from expansion in the next couple years.

COMPETITIVE LANDSCAPE

- Economies of scale is a major drive force in the industry. Though 27 companies with over 250 employees make less than 2% of companies in the industry, they generated 90% of turnover in 2013 as costs.

Largest companies in the industry were Ineos Group Ltd, BP Aromatics Ltd, BASF Plc, Air Products Group Ltd and Croda International Plc.

- Ineos Group Ltd, a UK-based subsidiary of Ineos AG, manufactures petrochemicals, specialty chemicals and oil products as polymers, chlorvinyls, ethanol, esters, ammonia and nitric acids, plastics, melamines, pnenols, oligomers, olefines, oxides and styrenics. The company sold its INEOS ChlorVinyls divission of chlorine business to 2M Group Ltd that operated in UK in August, 2013. Ineos Group also acquired a powerplant from Fortum in Grangemouth, UK in October, 2014 for GBP54 million.
- BP Aromatics Ltd is a UK-based subsidiary of BP Plc engaged in manufacture of purified terephthalic acid, acetic acid and olefins and derivatives that are derived from crude oil or natural gas. The company opened a brand-new bioethanol plant in Hull, UK in July, 2013 that cost GBP350 million.
- BASF Plc is a UK-based subsidiary of BASF SE. The company operates under 6 business segments: chemicals, plastics, performance products, functional solutions, agricultural as well as oil and gas. The chemicals segment is further divided into inorganics, petrochemicals and intermediates divisions. in January, 2013 the company completed acquisition of Pronova BioPharma. In 2014, the company sold its styrolution divission to Ineos as well as began building ammonia plant in Texas, US together with Yara.
- Air Products Group Ltd is a multinational subsidiary of Air Products & Chemicals Inc, which divides its busines into 4 divisions: gases, chemicals, equipment and services & solutions. Air Products Group Ltd

and Oman Oil Co have signed a joint venture that will provide full range of industrial gases in Oman in December, 2013.

- Croda International Plc is a multinational company engaged in manufacture of natural based speciality chemicals: consumer care which consists of global businesses in personal care, health care and crop care as well as Industrial Specialities which comprises home care, base oleochemicals, additives for polymers, polymers and coatings, lubricants and lubricant additives, and processed vegetable oils. The company has manufacturing facilities throughout the UK and mainland Europe, North and South America, India, Singapore, South Korea, Indonesia and Japan. Croda has invested GBP12 million in April, 2013 in new manufacturing facility in East Yorkshire, UK for processing specialty acrylic-based polymers. The company acquired Sipo to boost its presence in emerging markets in September, 2013.

PROSPECTS

- UK basic chemicals industry is matured. It is expected to grow at CAGR of 0. 7% during 2013-2019. The growth will be strongest in bases, gases and other inorganics of 2. 5% CAGR during same period. The growth will be hold back by increasing overproduction in world market.
- Prices of most basic chemicals will continue to be on decline in 2014. It is expected that the price of inorganic and organic chemicals will continue to decline in UK by up to 10% due to sluggish demand in EU and increasing oversupply globally in 2014. Meanwhile, organic chemicals prices should decline by up to 4% in France in 2014 as

production continues to increase in N. America with further rapid decline in 2015 as oil and gas prices collapse.

- Shale gas revolution in US is causing a major headache for UK basic chemicals producers as UK manufacturers have to pay up to 3 times more for gas than US producers. Consequently, producers in N. America are increasing production capacity and might further pressure prices of hydrocarbon-based chemicals down.
- UK shale gas reserves are estimated between 2. 8 and 39. 9 trillion cubic metres. Though it remains unclear how much of it is technical extractable. Exploration of shale gas and its extraction is a slow-going process in UK but if successful it could give a boost to basic chemicals market
- Electricity price most likely will continue to rise as demand of investment increases. Currently, the generation capacities and grid is outdated and a third of power plants are projected to be shut down by 2015. Consequently, investments and price of wholesale electricity should increase deteriorating UK industry’s competitiveness.
- Recent events in Ukraine and Russia pose little threat to supply of gases in UK as 73% of it is supplied by domestic production and Norway. Qatar supplies another 12% and only 15% of gas that is supplied by Belgium and Netherlands might be redirected from Russia. Though price issue remains if supply struggles in continental Europe, prices of gas might increase. However, supply issues in continental Europe could boost basic chemicals export from UK as producers in other countries might have to cut production.

- Tightening REACH regulation creates barriers of imports of mostly specialty chemicals as extensive and costly research is required before chemicals are approved by ECA for trade and use in EU. As EU companies tend to have higher market share they gain competitive advantage in distributing their overhead costs in comparison to non-EU producers.