



# **WOUNDED BUT NOT SUNK: HOW COVID-19 IS DISRUPTING THE GLOBAL PETROCHEMICALS AND DOWNSTREAM INDUSTRIES**

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A company of **Allianz** 



**EULER HERMES**

# EXECUTIVE SUMMARY



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- The petrochemical industry prominence lays on providing essential raw materials to many manufacturing and conversion industries across many economic sectors.
- Many industries such as automotive, food packaging, construction and consumer products depends heavily on petrochemical feedstock. The industry is exposed to cyclical supply-demand conditions and prices, as the desire to exploit economies of scale encourage large and intensive investment to meet anticipated future demand.
- Hence, prices are normally based on a combination of production costs and supply demand dynamics on global exchanges.
- In 2019, significant capacity additions and slowing demand caused the industry value pool to decline. Sector was further impacted in 2020 due to COVID-19 pandemic

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# HOW COVID-19 IS AFFECTING THE GLOBAL PETROCHEMICAL AND DOWNSTREAM

The industry globally is classified into four key regions including North America, Europe, China, and Rest of the World.

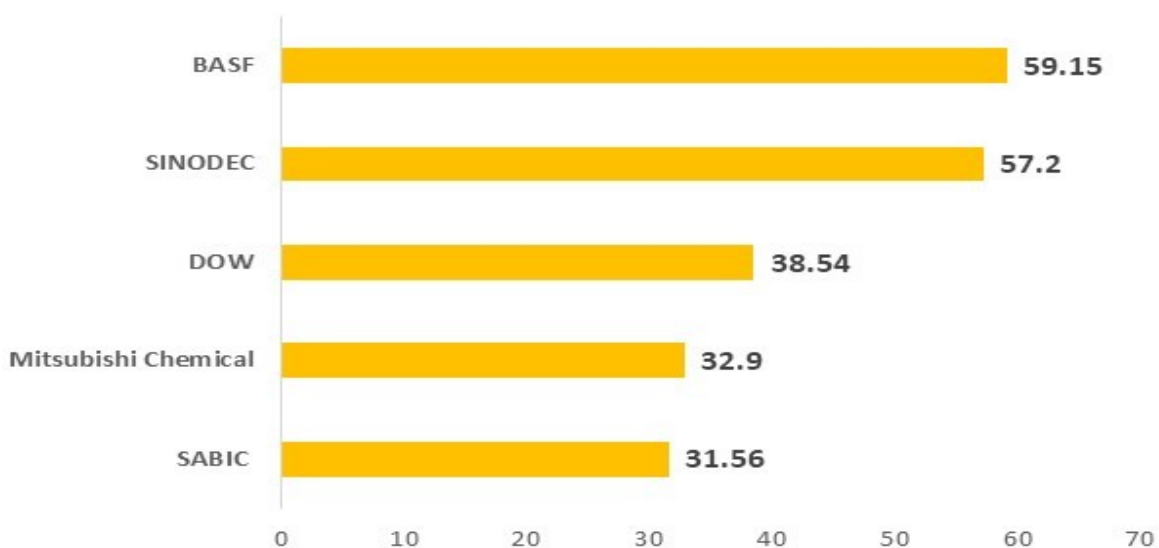
China has reduced the production output in H120 of petrochemicals as well as its downstream products due to limited inventory and a shortage of workforce.

The demand drop for oil and petrochemicals from China has resulted in a price decline of these products.

The US and European chemical prices remain under pressure from the falls in upstream costs and weaker demand, offset partly by firm demand into certain segments and a reduction in derivative imports.

However, visibility over short-term demand remains weak while social distancing measures remain in place and business and consumer confidence is low. China should continue to lead the way in the recovery while the US should reach its pre-crisis GDP levels end-2021. Europe will remain the laggard until 2022 after suffering a second wave.

**Figure 1: Top five chemical companies: World's largest by revenue in \$Bn (2020):**





# HOW COVID-19 IS AFFECTING THE GLOBAL PETROCHEMICALS AND DOWNSTREAM

Throughout recent years, the petrochemical industry was impacted significantly by a supply reduction of the global petrochemical manufacturing hubs while inventory is tied up.

In addition to feedstock price disruption triggered by oil price drop, [during 2020 COVID-19 pandemic, many countries implemented social and travel restrictions, which caused a further demand drop and declined in consumption of petrochemical products globally.](#)

Further decline in prices, earning and companies valuation led by falling oil prices. As per McKinsey Global Institute: 35% of the chemical industry's annual EBITDA could be at risk because of supply-chain disruptions, which affect the petrochemical production output.

The pandemic also forced the industry for a faster response to key consequences of this disruption: Oversupply and imbalances from supply chain disruptions and demand shocks, new competitive global dynamics as oil price collapse shift regional feedstock cost advantages, restructuring need and urgency to put purpose at the heart of the recovery plan and invest in green technology.

What measures taken by leading Petrochemicals undertake to mitigate and limit damages?

Companies struggled to manage the balance between implementing physical distancing measures and keep-ing plants running to provide necessary raw materials feeding relevant sectors through the pandemic.

The impact was reflected in the financial results of several petrochemical players from H1 2020. Hence, some industry leaders have cut operating and capital spending, renegotiated debt issuance and reduced its dividends.

# HOW COVID-19 IS AFFECTING THE GLOBAL PETROCHEMICALS AND DOWNSTREAM

## Level of impact and recovery trajectories by major petrochemical end users segments

The impact of COVID-19 on Global demand levels vary differently across Petrochemical end use sectors.

Some of the lost demand was offset and supported by a surge in demand from food packaging, and hygiene sectors.

However, it returned to pre-pandemic levels as consumer panic buying diminished.

While demand for construction with disparities within regions expected to recover by end of H121. Automotive industry and household equipment only by H2 21. An important segment Airlines expected to recover only by end of 2023 to pre-crisis level.

## Crude oil prices outlook

Petrochemical productions cost is largely dependent on oil prices and related products as the feedstock represents around 60% of the total production cost. Being a cost-based industry, the competitive advantage is to control such costs to ensure a fast recovery

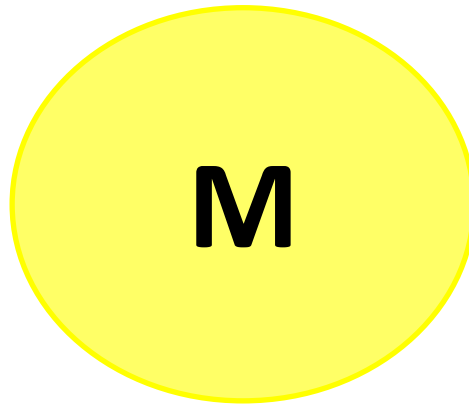
Brent crude oil prices closed the year 2020 by an average of \$39.68/b following the pandemic. 2021 average up to date is \$51.95/b. Currently, the general consensus among analysts and agencies is that oil prices will indeed see an upside in 2021 as above-average inventories will draw down with a global economic and oil demand recovery .

In conclusion, the necessary measures to respond to current economic conditions are cutting operating and capital spending, Renegotiating debt issuance and reducing dividends.

# PETROCHEMICALS SECTOR RISK RATING

Figure 2 : EH Global sector Color

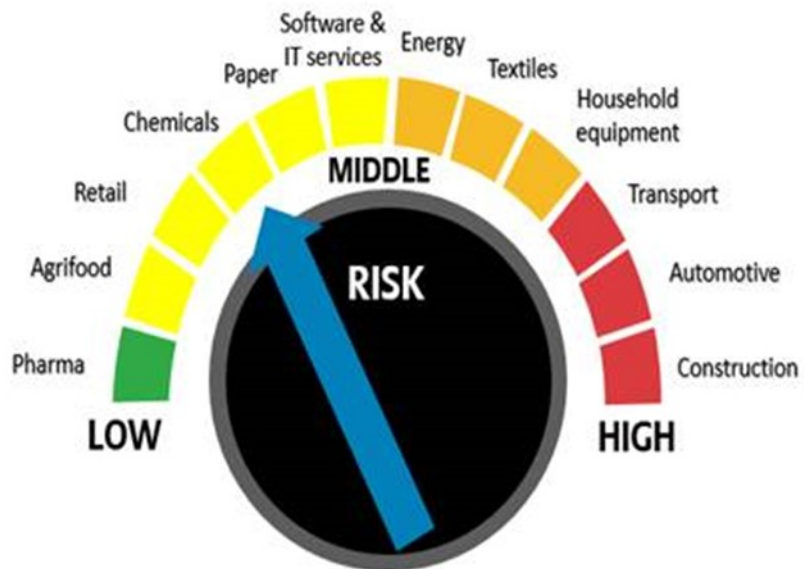
EH Global: Medium Risk



Sources: Euler Hermes, Economic research

Figure 3: EH Middle East sector Color

EH Middle East:  
Medium Risk



Sources: Euler Hermes, Economic research

# SECTOR DYNAMICS AND TRENDS

## FOCUS IN KSA

The Saudi petrochemical sector has grown to be one of the main pillars of the Saudi economy and played an important role in economy development with about 10.3% in country GDP in Q3 2020. In light of COVID-19 outbreak, sector reported a noticeable decline of 6.6% overall the year 2020.

Majority of dominating players are owned and supported by the Saudi Government with good cash position and adequate financing structure. The feed-stock prices for Saudi key players is heavily correlated to ARAMCO raw materials supply. In tandem with its core product "petroleum derivative", the local industry indicates slight improvement in average selling prices and demand, as the business activity evidenced improvement by falling COVID-19 case numbers in the fourth quarter of 2020, despite other major economies suffering a second wave.

Saudi producers enjoys a competitive edge compared with global producers suffering the rise in operating costs, the decline in the raw material margin and lower operating profits. Operational efficiency and economies of scale should ensure that Saudi Arabia retains an advantage over rivals during near future, given the challenging operating environment in the context of the pandemic.

**Profitability:** net profit range for the past five years is 9% on average. During 2020, profitability dropped significantly among players turning into losses of 8.7% on average. Sector Overall Revenues dropped by 26% on average for the past year 2020. Saudi Sector experts indicated this was triggered by lower oil prices, weak average selling price and the demand drop notably in Q2. Fortunately, both average selling prices and demand rebound since local authorities eased the restriction measures .

# SECTOR DYNAMICS AND TRENDS

## FOCUS IN KSA

In addition to the non-oil sector support from the government to increase the share of non-oil exports to non-oil GDP (32.7% in Oct. 2020) to reach 50% by 2030 as per the Saudi Vision.

**Financing:** The sector tends to be in healthy financial structure with an average of 2x liquidity in 2020. The industry enjoys high access to external borrowing from local financial institutions (Banks, SIDF, etc.) as majority of the key players are capital intensive with increasing leverage trend.

**Consolidation:** mergers between the major players and raise in capital are witnessed in the industry as per the latest acquisition events (SAFCO, SABIC and ARAMCO, SIIG & Petrochem). The objective is to achieve further improvements to efficiency and productivity to compensate for the loss of margins. The Saudi industry is expected to achieve around \$ 840 Mn profit in Q4 2020 following the supply-chain resilience and recovery post the pandemic.

**Saudization:** 12% localization in small enterprises or 45% in sizable entities is obligatory by Saudi regulations. The industry operates with an average of 70% localization and less than 13% non-technical labor. According to researches, every single job contributes to SAR 1.2 Mn country GDP, and creates other four job opportunities in the value chain. More essentially, launching Ministry of Industry & Mineral Resources to be separated from Ministry of Energy will enhance the petrochemical industry contribution in country GDP and increase employment of citizens by focusing on more expansion in the downstream chain; this would contribute to non-oil sector revenues and enhance an integrated structure of petrochemicals supply chains.

*Industry and ratio analysis were based on publicly available data of company's listed in Tadawul exchange for the period of 2020*



# SECTOR DYNAMICS AND TRENDS

## FOCUS IN KSA

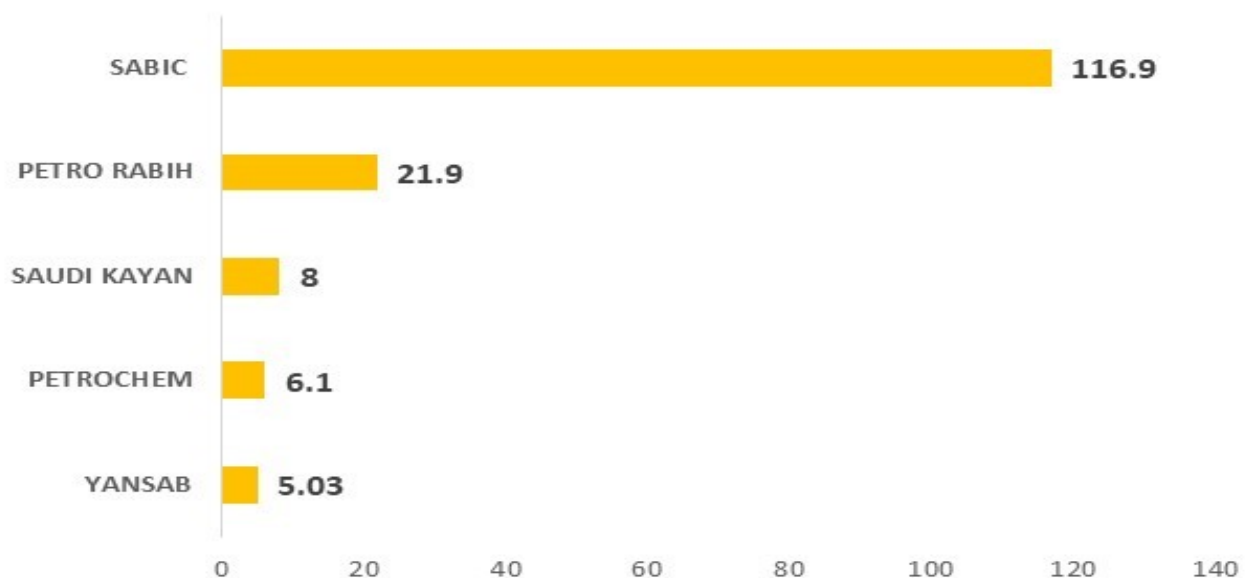
Figure 4: Examples of GCC key Players

Examples of Key Players in GCC	Country
<b>SABIC</b>	KSA
<b>Borouge</b>	UAE
<b>PIC</b>	Kuwait
<b>QAPCO</b>	Qatar
<b>OCTAL</b>	Oman
<b>OQ</b>	Oman
<b>GPIC</b>	Bahrain

Sources: Public information

The feedstock prices for Saudi key players is heavily correlated to ARAMCO raw materials supply

Figure 5: Top five chemical companies: KSA largest by revenue in SAR bn (2020)



Sources: Saudi Tadawul – for listed companies.

# PACKAGING INDUSTRY

## AN IMPORTANT END MARKET FOR THIS SECTOR IN KSA

Trade Credit Insurers are carrying a decent exposure on the mid supply chain level of the petrochemical sector, mainly the packaging industry. Packaging and plastic buyers had a low impact during the pandemic due to increased local demand from food packaging and plastic wrapping products. Such buyers had an on average 8% profitability margin.

The segment observed to have healthy financial structure with an average of 1.9x liquidity as well as good access to external borrowing from Saudi local banks. Balance sheet structure observed to be moderately leveraged at 134% on average.

There is an increment in the payment terms extended to suppliers to support the industry. Delay in payments noticed in Q3-Q4 2020 however, no adverse large claims reported during the peak pandemic period.

*Next sectorial note will focus on Petrochemicals end users with breakdown, segmentation and performances.*

The impact of COVID-19 on revenues and profitability levels varies differently across Petrochemical value chain, superior profitability levels on mid supply chain.

# RISK STANCE AND OUTLOOK

Majority of credit insurance exposure is concentrated on B2B business transactions for manufacturers and conversion industries, the highest limits are underwritten on the upstream and intermediates value chain of the industry.

The **payment terms within the industry ranges between 120-180 days**. Good cash flow trend observed on key players but systematic non-adverse delays in payment occurs from end customers due to market structural payment nature. Information on key market players is publicly available as majority are listed companies.

However, sourcing information on the downstream players and across second and third level of supply chain is a challenging task, local credit analysts expertise is required on the ground to obtain information from the market and arrange for direct contact to accurately assess their creditworthiness. Especially when credit insurance requests are large with high severity.

From its positive impact on job creation, to its significant contribution to GDP, and stimulating wider economic activity, the chemical industry is an integral contributor to economic prosperity in Saudi.

As regional producers look to diversify their product portfolio and invest in innovative new technologies, the industry will remain vital to global economy amid increased global uncertainty.

## FORWARD-LOOKING STATEMENTS

The statements contained herein may include prospects, statements of future expectations and other forward-looking statements that are based on management's current views and assumptions and involve known and unknown risks and uncertainties. Actual results, performance or events may differ materially from those expressed or implied in such forward-looking statements.

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