SPECIAL REPORT ON LATIN AMERICA

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Latin America Overview: New Decade, New Challenges

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2020: A MACROECONOMIC SCENARIO

Coronavirus causes disruption when economic recovery was badly needed

2019 was not a good year for Latin America's main economies: Brazil's GDP growth reached just 1.2% (IMF data), a pace that is not enough to catch up for the losses accumulated during the recent recession. In Mexico, industrial activity stagnated due to the regulatory uncertainty created by the López Obrador administration, as well as the back and forth over the new regional trade deal (USMCA, replacing NAFTA). Mexico's GDP actually contracted by 0.1% last year, the worst figure in the last decade, and the IMF's expectation, before the coronavirus crisis erupted, was just 1% growth during 2020. Finally, Argentina suffered from yet another turbulent year, with a presidential election, negative GDP growth of -3%, and a heavily devalued currency.

Chile also registered its worst GDP growth figure of the decade, with just 1.2% expansion following the unexpected social turmoil that upset the country during certain moments of 2019. Elsewhere in the region, Peru's economy expanded by 2.2%, its worst performance since 2009, while Colombia had a growth rate of 3%.

Overall, the picture was disappointing, and now that we are entering a new decade, the question is if the different countries in Latin America will be able to overcome the challenges that have made the last years so difficult. According to Rina Quijada, VP Business Development for Latin America at IHS Markit, the petrochemical business is linked to consumer spending in modern life, and therefore, demand for petrochemicals in 2020 should be slightly better than in 2019 in Latin America. In order to stay competitive, though, the industry will have to make sure there is enough feedstock available, in a timely manner and at reasonable costs.

Edison Terra, VP of the olefins and polyolefins unit of Braskem in South America, and president of the Latin America Petrochemical and Chemical Association (APLA), was optimistic about the feedstock situation, provided that governments support this development: "The region, mainly with Brazil and Argentina, has huge potential for growth in the petrochemical industry as there will be plenty of feedstock available. Brazil is already exploring opportunities in terms of pre-salt oil production, and the same will happen in Argentina with Vaca Muerta investments. Access to more competitive feedstock, however, will require policy changes, midstream investments, and infrastructural improvements in the region."

Edison Terra, President, APLA; VP Olefins and Polyolefins South America, Braskem

In a global world, integration makes sense for the sake of competitiveness. The different countries in Latin America should therefore explore the synergies available and invest in the needed infrastructure to make integration happen. Gas is a case in point. In Argentina it is so cheap that no-one wants to invest in gas production, while in Brazil gas is in short supply. "If YPF has to close wells in Argentina because it cannot sell the gas, that shale gas at US$ 3 per million BTU could be easily absorbed by the Brazilian market", affirmed Marcos De Marchi, CEO of Brazilian chemical producer Elekeiroz and director of APLA. "If we built a connection between Uruguaiana and Porto Alegre, that is today missing, we could have a good distribution of Argentinean gas, and that would be a win-win for all parties," he added.

Quijada of IHS Markit developed on this idea: "We need investment in infrastructure, midstream, pipelines, ports, terminals, and storage. In Mexico you have the infrastructure but you do not have the feedstock, so you have to import it. In Argentina you have the feedstock from Vaca Muerta, but you do not have the pipelines to take the product to areas of high local demand and exports."

SUSTAINABILITY

The industry is facing tougher questioning from the wider society regarding its sustainability efforts, whether in terms of curbing carbon emissions, reducing plastic waste or promoting circular economy initiatives. “The current environment is much more challenging for a company like ours, in terms of sustainability and innovation,” acknowledged Federico Veller, executive manager of chemicals at YPF, who also chaired the 39th Petrochemical Annual Meeting held by APLA in Buenos Aires in November 2019. “APLA has really put a lot of emphasis on sustainability and recycling issues,” Veller explained. “At the APLA Annual Meeting we could see first-hand how recycling is increasingly yielding results, be it for recycled shoes or street furniture. We also showcased the first Argentinean-made electric vehicle, and the importance of petrochemical products to make these products lighter and more efficient.”

At a company level, one of YPF’s objectives is to push the development of the industry using the resources of Vaca Muerta. Veller explained that, in order to do that, YPF has set up a technological center called Y-TEC.

Meanwhile, in Brazil Braskem is carrying out a significant amount of research and development with regards to the incorporation of post-consumption residues to the company’s portfolio. For that, the company has had to test its crackers to process feedstock produced out of the pyrolysis of plastic waste.

Beyond this, as part of its circular economy goals, Braskem started producing bio-based resins in 2010 and today has an annual production capacity of 200,000 mt/y of bio-based polyethylene. Stronger awareness about the importance of circular economy processes is driving demand: “We are seeing a much greater demand for our bio-based products, coming especially from Europe and Asia,” said Edison Terra of Braskem. This is why we are studying opportunities to expand the capacity of our green ethylene unit in Rio Grande do Sul.”

Also in Brazil, Elekeiroz, the only provider of oxo-alcohols in the region and a large player in plasticizers, is now producing green plasticizers using epoxidized soybean oil as feedstock at the Nexoleum 50-50 joint venture. While the general demand for chemical products is not growing, green plasticizers are being very well received by the market, according to Elekeiroz CEO Marcos de Marchi: “We are thinking of increasing capacity for green plasticizers thanks to stronger demand from shoe and toy manufacturers mainly, but also from producers of vinyl floor coverings.”

ARGENTINA

The stakes are high in Argentina as new president Alberto Fernández, in office since December 2019, needs to find a solution for the country’s enormous US$311 billion debt, including US$44 billion owed to the International Monetary Fund (IMF). Under these circumstances, 2020 will be challenging for all parties involved – and that includes the chemical industry.

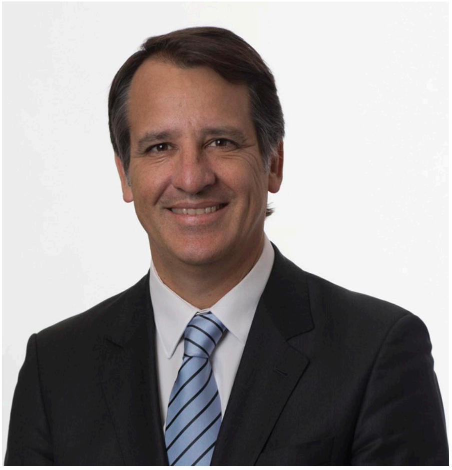
Notwithstanding the economic, political and now global coronavirus-related uncertainty, Argentina offers great potential for the industry. It is Latin America’s third largest economy and has a developed industrial base as well as an established petrochemical industry. YPF alone, for instance, has an annual capacity of 2.2 million tonnes (mt/y) including aromatics, solvents, specialties, methanol and 1.3 million mt/y of urea at its Profertil 50-50 joint venture with Nutrient. With this strong base, regional demand and the availability of feedstock from Vaca Muerta are poised to give a boost to the country's petrochemical capacity in the years to come.

Federico Veller, executive manager of chemicals at YPF, elaborated on the growth opportunities the company expects to capitalize on: "The Latin American market has a growing deficit of fertilizers, especially in Brazil. We currently have a project under evaluation to double production capacity at Profertil, and we expect to be able to take a final investment decision mid-2020."

Going up the value chain, all eyes are on the development of the Vaca Muerta hydrocarbon fields, but for the chemical industry to fully benefit from unconventionals, the macroeconomic situation needs to be tackled. According to Rina Quijada of IHS Markit: "If the economy does not improve, companies will not be able to obtain loans and invest, and development at Vaca Muerta is capital intensive."

Moreover, a strategy is needed to address issues such as the lack of infrastructure and the structural gas surplus in the country. Cheap gas may sound like a good thing for the chemical industry, but gas production needs to be sustainable, otherwise no-one will invest in it. "In the gas market, the balancing point will only be achieved when we have world-class capacity to export liquefied natural gas (LNG). This means 10 times the capacity we have today," explained Veller, who added that YPF is leading a project for the construction of a mega LNG plant in Argentina, with the vision of incorporating different players in a joint venture. "That is going to be fundamental for the petrochemical industry to take off in Argentina," Veller affirmed.

Not only Argentina, but also the wider region will reap the benefits of Vaca Muerta's resources, according to Sergio Marcondes, general manager of Braskem Argentina: "Regrettably, we are still not at the point where gas is available and supplied at competitive costs to the regional market. Once the government is able to establish the proper legislation and framework to develop the needed infrastructure, the whole region will have access to the excellent raw material from Vaca Muerta at very competitive prices."


Jorge Buckup, President Latin America, Univar

BRAZIL

While Argentina continues to face recession, Brazil is finally recovering, although very slowly and, by and large, the industry does not expect to engage in large expansion projects anytime soon considering that Brazil's idle capacity in the chemical industry is still estimated at 30%. Moreover, the coronavirus crisis is a huge bump on the road for 2020, although the country is in theory in a more solid macroeconomic position now, following the approval by the Senate of a landmark pension reform in October 2019.

Petrochemical giant Braskem, who has 29 industrial units in the country and sells two thirds of its global production in Brazil, is optimistic about the immediate future: "In 2019, our Brazilian market experienced a very small growth rate of approximately 2%. Fortunately, there are expectations and signs that necessary structural changes to the economy are being implemented," said Edison Terra, vice-president of the company's South American olefins and polyolefins unit.

Industry leaders from chemical distributors shared a similar expectation. Jorge Buckup, president for Latin America at Univar Solutions, said: "We look at Brazil's potential with cautious optimism. We believe that the reforms will eventually have a positive impact on the economy."

Jan Krueder, CEO of Química Anastacio, also believed the Brazilian economy is on the right track: "We are quite optimistic about Brazil and, despite the non-growing scenario, have had very positive results in the country over the last year. The interest rate decreased to 5% per year, the lowest in history, country risk declined by almost half, employment rate started to increase and the stock exchange hit historical records by the end of 2019."

For opportunities to transform into real business, however, Brazil needs to overcome some of the long-standing challenges it has suffered from in the past years. According to Marcos De Marchi, CEO of Elekeiroz, the three important issues that need to be addressed are feedstock, be it natural gas or naphtha, electricity rates and logistics. He explained: "We have the world's most expensive gas. We pay between US$10 and US$12 per million BTU, which is absurd when you consider than in Argentina they are closing down wells because they cannot sell the gas at a price of between US$2 and US$3 per million BTU."

In 2019, Brazil's National Petroleum Agency (ANP in Portuguese) announced structural changes to open up the country to new competitors, both in refining and also in the production and distribution of natural gas, which could significantly improve the playing field for chemical players. Speaking at the APLA Annual Meeting in Buenos Aires, the then head of ANP, Décio Oddone, anticipated a greater availability of gas that will facilitate the undertaking of new petrochemical ventures: "The additional opportunities in ethane, natural gas and propane will allow expansions in existing facilities, and, perhaps in the areas of Rio and Sao Paulo, a new cracker can be built to add to the existing capacity," he said. Oddone, however, left ANP in March, so it is not clear how these developments will unfold over 2020.

Besides, the country needs to close its massive infrastructure gap while also reforming certain logistics segments to increase competitiveness, namely cabotage. Marcos De Marchi said: "Today, to bring a product from Bahia to Sao Paulo, we need to use trucks at a cost of US$100/mt, when it could cost US$20 or US$30/mt if the cabotage segment was open to competition."

This year's Petrochemical Annual Meeting hosted by APLA, which marks its 40th edition, will take place in Sao Paulo between 7-10 November. APLA's president Edison Terra gave more details about the event: "At the Annual Meeting, approximately 300 companies are represented from 35 countries, and people use this opportunity to network and develop business. We are trying to share the future of the industry and its trends and increase the awareness of sustainability to foster sustainable practices and responsible care in the industry."

MEXICO

It is often perceived that elections bring uncertainty, but that once a government is in power and has a clear mandate ahead, the economy has a better chance of developing. Indeed, after López Obrador took power in December 2019, Fitch Ratings had a 2.1% growth prediction for Mexico in 2019, but that had to be revised downwards as the year progressed – the country ended with negative growth of -0.1%.

"Mexico is at a standstill, wait-and-see position", affirmed Rina Quijada of IHS Markit. "People are hesitant to invest because they have a lot of doubts about where the economy is going. Slower demand and flat GDP growth is hurting Mexico a lot."

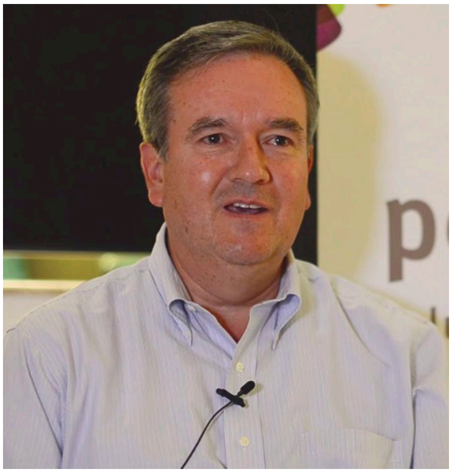
So, what are the structural problems hindering Mexico's growth? External reasons such as the renegotiation of the trade deal in North America, and a lower price of oil since 2015 add to internal problems such as the serious security issues that affect investment prospects and create heavy cost overburdens for companies. On the positive side, Mexico is such a large and diversified economy that chemical players who operate in many different segments are well prepared to navigate times of uncertainty.

Chemical specialties giant Evonik, for instance, has 17 active business lines in Mexico, and managed to expand sales by 15% in 2019, thanks to the consolidation of previous acquisitions and the company's relationships with global clients who are opening up operations in Mexico.

Martín Toscano, managing director of Evonik Industries de México, gave more details: "Agriculture is the fastest growing industry in Mexico, next to automotive. Mexican agriculture revolves around fruits and vegetables that have high added value and the potential to grow is large due to Mexico's extraordinary access to international markets. On the negative side, an area that was affected by uncertainty was pharmaceuticals. We are also looking forward to more stability in the sector of coatings and paints."

The renegotiation of the North American Free Trade Agreement (NAFTA), now called the United States-Mexico-Canada Agreement (USMCA), also created some turbulence. Toscano admitted that the automotive sector may be affected by the new trade deal, but said that adjusting to the regulatory framework should suffice for Mexican-based companies to sustain business projections.

Indeed, in the first half of 2019, Mexico actually became the United States' number one trading partner, surpassing Canada and China, but currently the coronavirus pandemic has brought a completely new scenario, in which it is very difficult to predict how the manufacturing industries will perform this year.



Eugenio Manzano, Executive Director, Pochteca

Going beyond the macroeconomic scenario, however, it is impossible to ignore some of the challenges that the country's chemical value chain is facing. Eugenio Manzano, executive director of Pochteca, a large chemical distributor with operations in Mexico, Brazil and Central America, said: "Mexico´s chemical industry accounted at one point for as much as 4% of GDP, but now it only represents 1.7%. Of the approximately US$45 billion chemical consumption, more than 60% is imported." Manzano added that the shortage of gas, ethane and methane negatively impacts the competitiveness of Mexico's chemical industry and many downstream industrial segments. "This situation, together with slow overall economic growth, represents a challenging environment for the coming years," he affirmed.

Manzano emphasized his desire that the current government be successful, acknowledging that the country is already seeing some improvements, namely bigger oil production and more oil processing in existing refineries. "However, the challenge is not minor since Pemex has a delicate financial situation and the existing facilities need a lot of investment to get them back to high operating rates," he concluded.

CHEMICAL DISTRIBUTION

The chemical distribution market continues to be dynamic despite sluggish market growth, and presents a combination of both global players, such as Univar Solutions and Brenntag, and regional companies for whom Latin America has always been their backyard, including Pochteca, GTM, Química Anastacio and Reno, among others. Over the last years, some of these players have engaged in significant M&A activity, expanding inorganically through acquisitions, and this process is far from being over.

"Latin America continues to have a very fragmented chemical distribution industry, with hundreds of small-regional players. The challenging economic environment, open borders, government regulations, economy of scale requirements to be competitive, e-commerce and digitization, and low commodity prices will all result in more mergers and acquisitions in our region," said Eugenio Manzano, executive director of Pochteca, adding that the Mexican-based company keeps its eyes open for any attractive growth opportunities that come across.

In challenging times like these, some companies are taking a more conservative approach. Reno S.A., a solvent-specialized distributor based in Chile and with sales operations in Peru and Argentina, has taken a deliberate decision to grow organically. "This ensures that our growth is sustainable and minimizes our exposure to management risks, because acquisitions can represent a loss of control. For this reason, we want to open operations in Colombia directly with our own office, and only after consolidating our presence in the Peruvian market," explained Claudio Gorichon, general manager of Reno S.A.

Entering new business segments and constantly incorporating new products is another strategy by regional distributors to ensure a stronger position both in front of clients and providers. Brazil's Química Anastacio, for example, believes the company has to be very agile, as explained by its CEO Jan Krueder: "We operate in 18 market segments and we see plenty of opportunities to continue growing. Currently we have around 1,000 products in our portfolio and will be incorporating approximately 10 new products per month moving forward."

Matthias Vorbeck, general manager of Anastacio Overseas, the firm's international trading arm, further explained: "During difficult times like these, a significant number of international companies leave the region in fear of losing profits. That represents an opportunity for us, to gain more market share and more relevance for our suppliers."

In parallel to exploring growth avenues, many players in the distribution segment have been increasingly leaning toward the more profitable specialty chemicals market, even though that has required extensive human resource, client relationship and cultural change efforts as specialties are a very different industry than commodities. Manzano of Pochteca highlighted that approximately 40% of the company's product line undergoes some value-adding process, for example.

U.S.-based Univar made a big move toward the specialty business with the acquisition of Nexeo Solutions. The new post-merger company, called Univar Solutions, has an important focus on specialty markets such as personal care, food, pharma and coatings, supported by a number of development laboratories called 'Solution Centers'. Especially in food, the company is working on R&D initiatives to bring more sustainable products to the market.

In Latin America the company has operations in Brazil, Mexico and Colombia, and covers the rest of the market through indent sales. "We have the opportunity to expand our footprint regionally, which will allow for business growth, either organically or through M&A," said Jorge Buckup, Univar Solutions' president Latin America. "Indeed, M&A is part of Univar Solution's strategy and we will continue to look for good opportunities. However, we are being more specific on what we want and which markets we want to invest in," he affirmed. ■

LOGISTICS

Logistics represents a significant portion of the activities of chemical distributors and having efficient solutions for warehousing and transportation is key for them. Pochteca, for instance, has 300,000 square meters of warehousing capacity, as well as its own tanks and railway terminals. However, the industry also needs specialized dedicated logistics providers, not just because of the region's significant infrastructure challenges.

Recognizing these particularities, German logistics solutions provider Leschaco has recently restructured to better serve the market offering a regional approach, rather than just country solutions. The company is a global freight forwarder and has a 5,000-strong fleet of tank containers. The leader in charge of the new structure, covering Leschaco's Brazil, Chile, Mexico and U.S. offices, is Martin Sack, regional head for the Americas: "With the current climate, our industry has to focus more and more on integrated solutions. It is not only transporting a freight from point A to point B, but covering the entire supply chain," he explained.

Trade flows are constantly shifting and this is even more the case in the context of international trade disputes, most notably between the U.S. and China. "We see that the world has a steady growth rate of about 2% per year, but the flow of these goods is the main challenge", emphasized Jarl Kåreson Hakvåg, shipbroker in charge of South America at Odfjell Tankers. "The trade war between the U.S. and China is disrupting the normal, direct flow between these two countries, so now you get different routes."

The logistics segment faces several important challenges, from the need to incorporate digitalization, to new regulations such as IMO 2020 and the region's lack of infrastructure. Fabiano Machion, general manager South America at Newport Tank, a tank container operator, elaborated on the flexibility ISO tanks can provide the different customers: "Latin America's logistics deficit creates high costs and makes some operations unfeasible. Some countries do not have high levels of awareness about the availability of ISO tanks, so it is our responsibility to educate the market."

With regard to the digitalization process, this has implications on several fronts, including efficiency, transport security and environmental performance. Leschaco, for instance, has created a separate fully-digital freight forwarding company called Logward. Martin Sack provided more details: "With Logward, customers can manage and control their supply chain on a cloud platform and the processing is the responsibility of third party logistics (3PL) providers such as Leschaco."

Commenting on the lessons learnt by the industry from cases such as the cyberattack suffered by Maersk in 2017, Hakvåg of Odfjell Tankers referred to both the security and efficiency aspects of new technologies. "In this industry you need a very strong setup and IT security. We have multifactor identification on our phones and our computers, and the office has firewall procedures. We are actually enthusiastic about going forward with digitalization – we even have a system mapping CO2 emissions so we can make changes to our vessels," he said, highlighting the strong efforts by shipping companies to comply with the new IMO 2020 regulations regarding fuel standards. ■