

Malaysia:

Rich Pickings with Little Risk

This report was compiled by Global Business Reports after meeting with many of the key players in Malaysia's chemical industry. It looks at efforts to add value to Malaysia's considerable resources, find new markets for an export-driven economy and maintain a responsible approach to manufacturing. Authors are Tom Daly, Daniel Kaye and Naomi Sutorius-Lavoie.

Since its formation in 1963, which brought together the newly independent states of Malaya, Singapore, as well as Sabah and Sarawak on the island of Borneo, Malaysia has worked hard at restructuring its economy from an agro-based to an industrialized economy.

Under British rule, large-scale tin and rubber production had been developed but by the 1960s, unemployment was high and the Malaysian government set about developing labor-intensive industries, since manufacturing then accounted for only 8% of GDP. The structural change the country's economy has undergone is reflected in the fact that the manufacturing sector today constitutes around 31% of GDP and unemployment is at 3.9%. Whereas Malaysia relied heavily on commodities for export in the past, today approximately 80% of exports are manufactured products.

After a dip in 2005, when GDP growth slowed and inflation rates reached their second highest level in almost seven years, forecasts for 2006 are optimistic and Malaysia remains an excellent place to do business for a number of reasons. There are abundant natural resources, including oil and natural gas -the feedstocks for a well developed petrochemical industry. In addition, Malaysia's landscape is dotted with oil palm plantations, making it the world's largest producer and exporter of palm oil. Production of crude palm oil (CPO) was at around the 15 million tonne mark for 2005, accounting for 48% of production worldwide. The abundance of palm oil in Malaysia has attracted the major players in the oleochemicals market, who are present among Malaysia's 48 oleochemical refineries, most of which are concentrated in the southern state of Johor.

The country has a global share in excess of 20% of the oleochemicals market, as well as being the leading exporter of basic oleochemicals, such as fatty acids, glycerin and soap noodles, in the world.



Stepping Stone

Yet resources alone are not enough to attract such a high level of foreign investment. A stable political climate, fronted by Prime Minister Abdullah Ahmad Badawi, is complemented by a legal system familiar at least to other Commonwealth states. MIDA (Malaysian Industrial Development Authority) enforces no caps on the level of foreign equity injected into manufacturing based projects. The workforce is, on the whole, well-educated and easily trainable and labor costs are yet to rocket as they did in Singapore, which became an independent republic back in 1965.

Malaysia's ethnic diversity (indigenous Malays make up 58% of the population, 24% is Chinese and 8% Indian) presents a somewhat unique advantage. Not only does such a society encourage a tolerant attitude towards foreigners, it also makes communication in English more or less a necessity. The language is used as a lingua franca between the various ethnic groups when the official national language Bahasa Malaysia is not spoken. In addition, having



sizeable Chinese and Indian communities will open doors for doing business in the economic powerhouses of the future, China and India, while a common religion links Malays to the Muslim world.

Foreign investors have been able to take advantage of Malaysia's good infrastructure and strategic location in Asia with several important sea ports. The Straits of Malacca, linking the Indian and Pacific Oceans, ranks among the busiest shipping lanes in the world, as well as providing the shortest route between China, India and Indonesia – three of the world's most populous countries. The size of the Malaysian market is not one of the country's key draws and investors have to

turn their attention towards export.

This is apparent with the Boston-based Cabot Corporation's plant in Port Dickson, the only carbon black plant in Malaysia with an operating capacity of some 80,000 tpy. "This last year, we have expanded our plant here with the intention of becoming an export plant," says James Rice, Managing Director of Cabot Malaysia. "Traditionally, 85% of our business has been here in Malaysia – and if we make it here we can sell it. But we want to cut that share down to 50-60%. Obviously, we'll use global and regional group logistics to avoid competing with other Cabot businesses around the world."

In the short-term, he says, the main focus of company's expansion strategy is to support the establishment of Cabot businesses outside of Malaysia. "Cabot Malaysia's big initial export thrust will be into China. Cabot is currently building a second plant there. We are shipping material to this plant so that when it comes on-stream, it will start with a market already established. After that, we'll have markets in Thailand, Vietnam and Japan to serve."



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Responsible Actions

It was in the early 1970s that foreign investment began to drive Malaysian industries, with the government keen to stamp out unemployment with the promotion of labor-intensive industries. Electronics and textiles were the two initial targets but by the 1980s the strategy had shifted towards developing the country's rubber, oil, gas and palm oil resources. This represented a great opportunity for foreign investors but the benefits have certainly been mutual. The multinational presence has brought in managerial expertise, modern manufacturing technology and strong marketing networks. In addition, it ultimately led to the initiative of which today's Malaysian chemical industry is most proud: the Responsible Care program.

Started by the Chemical Industries Council of Malaysia (CICM) in 1994 with considerable impetus from chemical professionals with a multinational background, Responsible Care is taken very seriously in Malaysia today, especially with regard to the sustainability of crops. The initiative is designed to encourage companies to improve their health and safety standards and environmental policies, and is marked by an annual awards scheme. The list of signatories to the program is still dominated by multinationals, though it is hoped that many of the SMEs will come on board later in 2006. Though not keen to fork out and make the necessary investments to comply with Responsible Care standards, smaller companies will have to make changes if they wish to do business with the larger players. One means of encouraging further SME-participation has been the introduction of a mentor-disciple program, where a large company will sponsor a smaller counterpart in an effort to improve industry standards.

Fuelling the Economy

Whilst Malaysia undertook to promote labor-intensive industries after independence, the challenge it faces today is to compensate for the level of investment it is losing out on to China and India. Other Asian countries with emerging economies are certainly also a threat. None of this detracts, however, from Malaysia's natural resources, of which other countries are feeling the squeeze. If Malaysia is to enjoy previous rates of climb back up to its 7% GDP growth rate, it must export globally and add value to its resources in order to achieve higher margins.



One much-hyped method of adding value to palm oil is the production of biodiesel, a renewable fuel for use in diesel engines. Though very much still in the early stages of development, biodiesel has so much potential for export (in particular to the European Union) and profit-margins that the Malaysian government has adopted a national biofuel policy aiming to secure a 10% global market share for Malaysia in years to come.

Another key driver is the gradual lowering of import duties on the Chinese market. A WTO-member since 2001 China is already a big importer of Malaysian palm oil and this is set to rise with the advent of biodiesel. Meanwhile, Malaysia's petrochemicals exports to China went from \$43 million in 1995 to \$1.6 billion in 2004. And today, of course, the coming into effect of the ASEAN Free Trade Area (AFTA) five years ahead of schedule in 2003 effectively presents companies with a single market of 530 million people.

Aside from biodiesel, the emphasis for the development of the chemical industry in Malaysia will be on adding value to its existing petrochemical and oleochemical products.



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Over 10% of Malaysia's total land area consists of oil palm plantations.

Oleochemicals Seeds of Success

Malaysia's abundance of palm oil has made the country into an oleochemicals hub. Now, the same looks set to happen with biodiesel.

It is difficult to avoid palm oil around the world. An edible oil, it has been an essential source of nutrition for thousands of years. In modern life, it is used in cooking oils and margarines, as an important raw material for various manufacturing industries, including pharmaceuticals, cosmetics and detergents. Now palm oil is well on the way to making another global impact, this time as a feedstock for the much-hyped biodiesel.

Over 10% of Malaysia's total land area consists of oil palm plantations. The state of Sabah alone accounts for around 15% of global palm oil production. Nationally, production of crude palm oil (CPO) reached 15 million tonnes in 2005, up from 14 million tonnes in 2004 and giving Malaysia a leading 48% share of global production. Its nearest competitor is Indonesia, where several Malaysian companies are currently seeking to expand their operations.

One group with such a strategy is Felda Holdings, the commercial arm of the state-owned Federal Land and Development Authority (Felda). The company manages over 400,000 hectares of palm plantation, and in 2005 postponed a proposed stock market listing because "the timing wasn't right," according to Raja Datuk Sharifuddin Abidin, a Felda Holdings board member. "We wanted to modernize and improve our performance first."

The company openly admits that its smaller private sector competitors have

gained ground over the past decade; "global production standards are rising but also there is a realization that we have been standing still for some time. We used to grow by 20,000-30,000 hectares by getting new land from the government etc, but a time came in the 1990s when there was no more land for the government to give us. So now we are in the next phase. The key is to increase productivity and yield as other private operators have done. The standard yield is around 20-25 tonnes per hectare per year, but we think that 35-38 tonnes is possible with better moisture management."

Malaysia's large cultivated area, for a crop that is statistically by some distance the most efficient oil crop in the world and is unique in yielding two different oils from the same fruit (palm oil and palm kernel oil), naturally caught the interest of the key players in the global oleochemicals business seeking a good raw materials base, including Cognis, Akzo Nobel, Uniqema and Procter & Gamble. With production reaching the 2 million tonnes mark in 2005, Malaysia's oleochemicals manufacturers account for roughly 25% of the world's natural fatty alcohol and fatty acids.

The multinational presence in Malaysia's oleochemicals business gained momentum in the 1980s. Akzo Nobel came to Malaysia in 1987 and acquired 50% of the equity of an oleochemicals business then owned by Malaysian company Lam Soon, a plantations owner and producer of cooking oil. In a recent move, Lam Soon again took complete control of its oleochemicals joint venture with Akzo Nobel and is said to be interested in acquiring Akzo Nobel's other oleochemical facility in Emmerich, Germany.

Though it may seem a surprise for a European company to be divesting its interests in such an important sector, the move is certainly indicative of the

emergence of plantation companies as a dominant force in oleochemicals. Kuala Lumpur Kepong (KLK) and Golden Hope Plantations are prime examples of this.

Golden Hope entered into a joint venture with Henkel in 1984 to build an oleochemicals plant near Klang and recently bought a 50% stake in the global oleochemicals business of Cognis. Though many of Cognis Oleochemicals' customers are traditionally multinational companies located in Europe and the US, the move reflects the growing demand on the oleochemicals market in Asia, which is, after all, where more than half the global capacity is to be found in light of the proximity to raw material sources, namely palm and coconut oils.

With many plantation companies jumping on the oleochemicals bandwagon, CEO Raymond Yap believes Cognis is fortunate to have a partner (Golden Hope) who can offer good synergies: "The integration makes a lot of sense for both parties but what is more critical for us is that we get a plantation company partner which has a long-term perspective of the business. They are willing to support strategic investments and prepared to take a longer-term view of the business versus a very short-term approach, which is not really healthy for this type of industry."

Here Yap refers to what he calls a "commodity-based approach" where plantation companies, in particular, initially concentrate on building capacities and then worry about the market later. "The chemical industry is very different," claims Yap. "The cycles and the supply and demand balance are so important, the timing of investment is so crucial, knowing your market, knowing what drives growth in the industry, rather than just building capacity and putting it into some kind of a pool and hoping somehow the market will find its pricing and the demand and supply will sort themselves out. However, plantation companies are fast learning the idiosyncrasy of the chemical industry."

Indeed there have been concerns at over-capacities in the palm oil and oleochemical industries. Palm oil stock reached an unprecedented level of 1.5 million tonnes last year, so while production increased, the average price of CPO fell in 2005 to RM 1,400 (\$378) per tonne compared to RM 1,610 (\$435) the previous year. The export value of processed palm oil and oleochemical products both fell in 2005.

Enter the Dragon

There have been a couple of different reactions to the drop in prices and the need to become more cost-effective. G. C. Tan, Managing Director of Akzo Nobel Oleochemicals, points to a “logical move downstream” into oleochemical derivatives but is also keen to take advantage of growing export markets, planning a 30% capacity increase over the next five years. “The industry is facing some restructuring,” claims Tan, “with more players coming in, particularly in China, where there is a big market for basic oleochemicals.”

With most Malaysia-based companies increasing their capacities in some form or another, could there be a danger of supply exceeding demand? The strategy of investing in China has both advocates and skeptics. The market’s potential is undoubted but with China becoming more self-sufficient in oleochemical production and import duties set to gradually come down this year, there are those who question whether investments in China, such as that of KLK-subsiary Palm-Oleo,

are actually worthwhile.

Tan Sri Datuk Dr. Yusof Basiron of the Malaysian Palm Oil Promotion Council (MPOPC) is not surprised at Palm-Oleo’s strategy: “China is now an international player, backed by a very strong home market but with the capacity to trade back with the rest of the world.

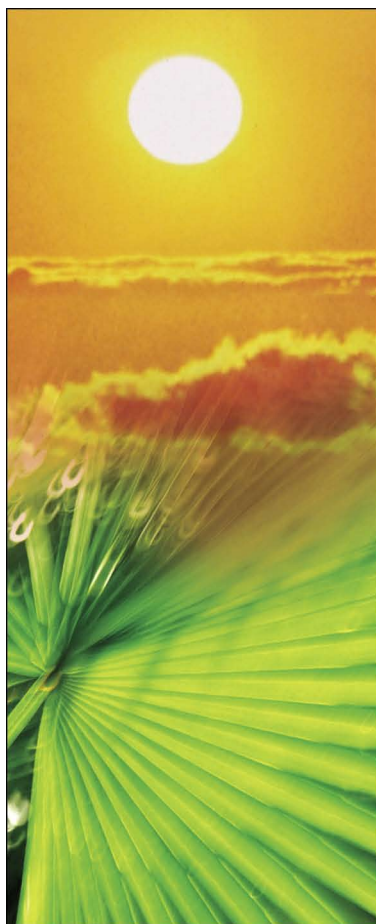
With most Malaysia-based companies increasing their capacities in some form or another, could there be a danger of supply exceeding demand?

It is now becoming a super processing center that can go big on capacities without the risk of being too small. If a Malaysian supplier uses this vehicle to take advantage of China’s size and then hopefully gets some of the products to the utilizing channels, some can be re-exported to the rest of the world. That is a very convenient

business model.”

While restrictions on China’s palm oil imports are being relaxed this year, India continues to be a difficult export market because of the import duties it imposes. The price-depression effect this has on Malaysian palm oil is worsened by the fact that India uses the import duty revenue to subsidize its own local oil production.

Besides the good prospects China is offering, there are two further driving factors today which can cancel out what Tan Sri calls the Indian “negative leverage model” and are managing to sustain pricing, when in the past all might have seemed gloomy. The first is the Trans Fatty Acid (TFA) labeling issue in the United States. Research has linked TFA with high cholesterol levels and heart disease, and as of January 1 2006 its content must be displayed on foods and dietary supplements sold in the US. This has led to manufacturers reforming their applications to have more palm content. The other driving factor is the advent of biodiesel, a renewable fuel made from organically derived oils for use in diesel engines.



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A Fuel for the Future

In August 2005 Plantation Industries and Commodities Minister Peter Chin outlined a National Biofuel Policy to promote the use of palm-oil based biofuel as a new energy source for the domestic transportation and industrial sectors, as well as for export. The biofuel technology developed by the Malaysian Palm Oil Board (MPOB) would also be commercialized. The Policy gives a mandate for the blending of processed palm oil with petroleum diesel, where 5% of the content is biodiesel and 95% petroleum diesel, to be known as B5 and used in Malaysia from 2007. The palm oil component in the blend is expected to increase in the future.

For Datuk Karunakaran, Director-General of the Malaysian Industrial Development Authority (MIDA), biodiesel is “a new opportunity that was not there five years ago and we want to capitalize on it.” Aiming to secure a 10% share of the global biodiesel market for Malaysia, MIDA has already approved Malaysian and foreign companies to build biodiesel plants and is seeing a lot more interest. Companies are keen to convert palm oil into biodiesel because it can be sold for twice the price of the current value of palm oil, earning a 100% profit margin. The adoption of the Policy is expected to require 500,000 tonnes of palm oil per year, which would lead to a welcome reduction in palm oil stock.

MPOB started campaigning for the development of the biodiesel industry halfway through last year and entered into three separate joint-venture biodiesel projects (with Golden Hope, FIMA Group and Carotino), which will see the building of three plants, each with a 60,000-tonne annual capacity. Tan Sri Datuk Dr. Yusuf Basiron, who spent fourteen years as Director-General of MPOB, believes that government involvement was key to waking people's interest: “When the world saw MPOB providing the financial support to construct biodiesel plants, as a government commitment, like a venture capitalist supporting A, B and C to come up with their plants with 50% of the financing coming from us, it started to take notice, especially the banking world. They thought, “If MPOB has already signed off RM 60-70 million (\$16-19 million) worth of plant construction, there must be positive outcomes about biodiesel potential.”



“Plantation companies are fast learning the idiosyncrasy of the chemical industry,” says Mr. Raymod Yap of Cognis Oleochemicals.



“We have gone into the biodiesel market in a much bigger way,” says David Ho - MD of Hovid and Carotech

Quick off the Mark

One early biodiesel success story is that of biotechnology firm Carotech, a subsidiary of pharmaceutical company Hovid, which retains a 55% stake. As the first company to plant in the world to commercially extract tocotrienols and carotene from palm oil, using a patented process, Carotech achieved another first recently when its CaroDiesel fuel became the first biodiesel stock on the Bursa Malaysia. At the time of writing its shares were trading at RM 0.615 (\$0.17).

Historically a phytonutrients business, biodiesel has thrust Carotech into the limelight but Managing Director David Ho insists the company's business model has not changed: “We are still very much very focusing on the extraction of carotenoids and tocotrienol but at the same time in our extraction process we actually change the oil into methyl esters. In the past we sold the methyl esters to the oleochemical industry but now because of the demand for biodiesel, we have gone into the biodiesel market in a much bigger way.”

Even ten years ago, Ho knew biodiesel was a potential application for methyl esters. The problem was a lack of interest, since palm oil prices were high and gas prices nowhere near today's level. Now that the timing and prices are right, Ho plans to capitalize with a RM 9.7 million (\$2.6 million) purchase of land at its base in Perak to enhance its biodiesel production facility with a new RM 100 million (\$27 million) plant. This will mean an increase in daily capacity to 345 tonnes from the present 45 tonnes on completion in the next eighteen months.

Of course, with many plants only at design or construction phase, it will be

a couple of years before the projected 1.4 million tonne national capacity comes online and the real key players on Malaysia's biodiesel market emerge. In Europe, however, there is a strict legislative deadline (2010) by which time 5.75% of all automotive fuel must be from renewable sources. Such a commitment and doubts that Europe can meet the requirements on its own, has prompted Malaysian companies providing the raw material source to seize this opportunity and race to supplement insufficient production in the EU. Carotech, however, is also looking to identify potential Asian markets, especially the Japanese market, in case European ones come under protection.

As well as competing with oleochemicals for raw materials, which will no doubt drive prices higher, biodiesel harms the oleochemicals industry in another way, as Raymond Yap of Cognis Oleochemicals points out: “Biodiesel impacts on us very significantly because one of the by-products to come out of biodiesel is glycerin and this is a very important oleochemical product. Because of the huge capacity and the generation of a huge amount of biodiesel, this has really depressed glycerin prices. So from a valuable product, a product that is highly profitable for the oleochemical industry, glycerin has become a low-value by-product.”

The time has certainly come for B5 biodiesel and environmentalists will welcome the reduction in greenhouse gas emissions it will bring about. Further down the line it remains to be seen how much palm oil can be taken away from the food industry and whether fuelling stations, most of which are operated by the petroleum oil industry, are willing to accept fuels with higher biofuel content.



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Petrochemicals Plenty in Reserve

The recent rapid development of the petrochemical sector in Malaysia, owing to abundant reserves, good infrastructure and cost-competitiveness has been the catalyst for downstream plastics processing in the country. There is now a very active campaign to secure further petrochemical feedstocks.

As of January 2005, Malaysia had 3.8 billion barrels of crude oil reserves and 87 trillion cubic feet of natural gas, giving it oil and gas world rankings of 27th and 13th respectively. Some of the world's petroleum giants have been present in Malaysia for over a hundred years. The first recorded oil find was made in Sarawak in 1882, while on Peninsular Malaysia, the first oil field was not discovered until 1971. The government had little control of the petroleum industry

at this stage. Only after the outbreak of the Arab-Israeli conflict in 1973, when the OPEC states put a stop on shipments to countries supporting Israel, and the ensuing energy crisis did Malaysia see fit to safeguard the development of its petroleum industry. The Petroleum Act in 1974 brought about the formation of a national oil company which would be granted exclusive rights to exploring and obtaining petroleum both onshore and offshore in Malaysia.

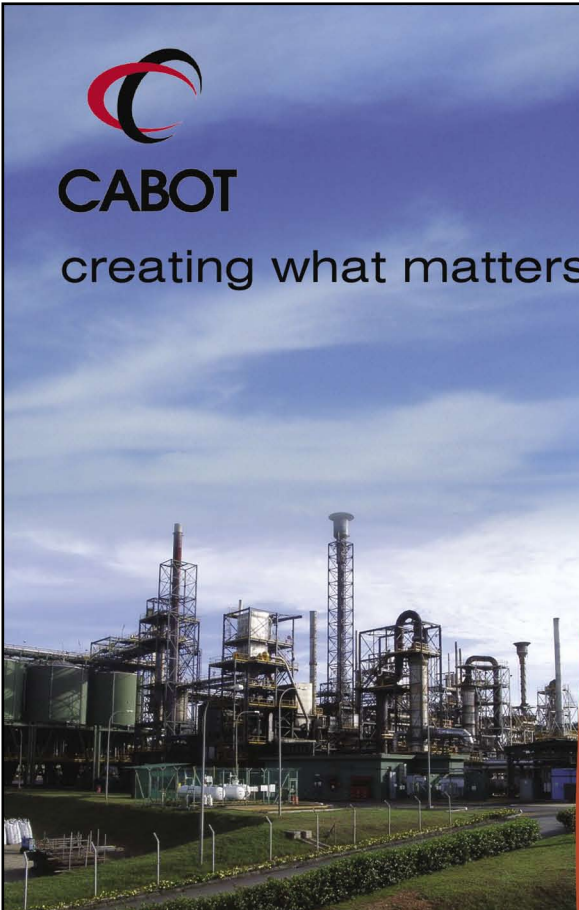
Petroleum Nasional Berhad or PETRONAS as it is commonly known, is making Malaysia a regional petrochemical hub with its Peninsular Gas Utilization (PGU) project, a trans-peninsular pipeline which channels gas to industries around the country. This has given PETRONAS the opportunity to embark on various gas-based petrochemical projects with its joint venture partners, high-profile names such as BASF, Shell and ExxonMobil.


PETRONAS has been very proactive in moving to secure future supply through partnerships with ASEAN (Association of Southeast Asian Nation) member states. The group has an agreement with Indonesian counterpart PERTAMINA to

purchase 1.8 trillion cubic feet of gas by 2021. Additional supplies will come from the Malaysia-Thailand Joint Development Area in the lower part of the Gulf of Thailand, the ASEAN Gas Grid project and the state of Sarawak on the island of Borneo, which is thought to have over 50% of Malaysia's natural gas reserves. PETRONAS made a gas discovery in offshore Sarawak as recently as October 2005.



The development of the industry is nothing if not well planned. Inter-plant synergies have been promoted to maximize productivity, something which has seen the emergence of integrated petrochemical complexes (IPCs) in industrial zones such as Kertih in Terengannu, Gebeng in Pahang, and Pasir Gudang in Johor.

A major investor in the latter zone, and one of the largest direct buyers of feedstocks from the major energy companies in Malaysia, is Titan Chemicals Corporation, which, as the second largest polyolefins producer in South-East Asia, is in turn supplying downstream plastics manufacturers in an industry responsible for much of the world's plastic bags, films and bottles.





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Right Place at the Right Time

As part of Malaysia's ongoing industrial development program, Titan was set up in 1989 by Datuk T.T. Chao, whose Chao Group operate Houston-based Westlake Chemical Corporation, in a joint venture with Permodalan Nasional Berhad (PNB), a government-backed investment institution. Last year Titan became the first petrochemicals company to be listed on the Bursa Malaysia and current CEO Donald M. Condon Jr is adamant that Asia is very much the centre of the plastics world at the moment.

"In our industry Asia is where you would like to be. This is where the growth is, where plastics are still being accepted. Whatever number you predict for China or Asian growth, you can multiply that by 1.2 or 1.3 and that will be plastics growth for the next five or ten years."

Such a positive outlook for the Asian plastics market did not seem likely just a couple of years ago. Condon, who was named Malaysian CEO of the Year for 2005, saw tremendous potential upon his arrival at Titan but first had to weather what he terms 'the perfect storm' - the turbulent period from 2001 to 2003 after the Asian financial crisis. The Asian economic tigers, having invested heavily in petrochemicals, were left stunned.

The market, however, has made a



"Asia is where the growth is, where plastics are still being accepted," says Donald Condon - CEO of Titan Chemicals.

recovery to match the resurgence of Titan. Having faced RM 4 billion (\$1.08 billion) in debts, Condon attributes Titan's remarkable turnaround to "an internal focus on cutting costs, improving the fundamentals of the business and the products." Always confident that supply and demand would come back into balance, Condon is now targeting a 20% capacity increase by the second half of 2007, to be achieved through a RM 600 million (\$162 million) investment program in Johor.

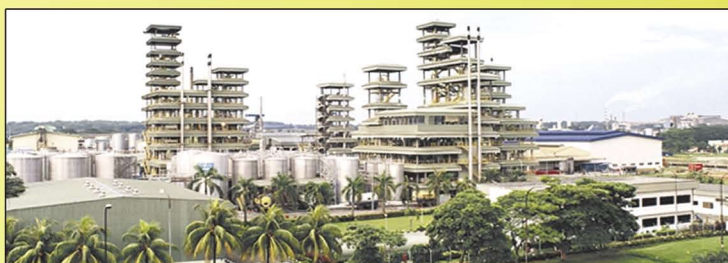
This will make essentially three additions to Titan's business. Firstly, it will see the construction of Malaysia's first butadiene extraction unit to serve the synthetic rubber market and downstream manufacturing. This is a move the government has been

keen on for some time, since Malaysian companies have traditionally had to import butadiene. Secondly, the OCT (Olefins Conversion Technology) process or metathesis will be brought in to produce more propylene from naphtha, and, thirdly, from this 115,000 tpy propylene capacity expansion, Titan will be able to produce an extra 130,000 tpy of polypropylene, which it has long wanted to account for a larger share of its business.

Though the Malaysian market has grown for Titan ever single year since it has been on the market, the relatively small population of Malaysia inevitably leads to covetous glances towards not only China but other high-population countries in the region such as Indonesia, the Philippines and Vietnam, which actually have higher growth rates than China for plastics.



With petrochemical feedstock supply looking very secure, the challenge for Malaysia's petrochemicals industry is indeed to strengthen its position in the more populous overseas markets. If it can continue to produce high-quality polymers at competitive prices, it will do exactly that.



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Distribution

Asian Gateway

The new wave of economic development in Asia is both an opportunity and a threat for Malaysian chemical distributors

With the establishment of a modern, medium-sized local chemical industry situated at the hub of one of the world's key shipping routes, Malaysia is often touted as an emerging trading post for distributors looking to capitalize on the boost to regional trade expected to arise from strong demand conditions in China and surrounding Asia. Accessible, with a strong road and port network, good communication infrastructure and a relatively transparent regulatory environment, the outlook seems good. So what are the distribution sector's prospects?

Despite a good deal of bullish sentiment, Malaysia's progress towards becoming a dominant regional export hub might be somewhat less spectacular than optimists would like. The world's second largest container port – in Singapore – is situated on its doorstep and offers massive competition. Despite having economies of similar size, Singapore's single port handled 21.3 million Twenty-foot Equivalent Units (TEUs) of total container throughput in 2004, more than 4 times the amount handled by



Malaysia's largest port in Klang and nearly double the 11.3 million TEUs handled by all of Malaysia's 11 main ports combined.

Trade in chemicals specifically (excluding petroleum) made up around 10% of all of cargo throughput in Malaysia's ports in 2004 – and more than half of that came from the loading and unloading of palm oil. One of the country's key pieces of infrastructure is at Kuantan, a multi-purpose deep sea port facing the South China Sea that serves as an export base for the neighboring east coast corridor petrochemical industry, home to companies such as BP-Amoco Chemical, BASF-Petronas Chemical and Eastman Chemical.

At home, the chemical distribution sector has, by and large, enjoyed a bull run over the past decade, mirroring the country's strong industrial progress. "Our Malaysia office has been one of best performers in the group in recent years in terms of revenue and profitability," says W.C. Teoh, Executive Director of the Singapore-headquartered distribution company Worldwide Resins and Chemicals (WRC), who operate offices across Asia, including in Taiwan, Thailand, Vietnam and China. "Our revenue was up 26% in 2004 from 2003, compared to 15% for the group as a whole," says Teoh, whose company is also market leaders in the local supply of epoxy resins. A key ingredient of WRC's success, he says, has been the ability of manufacturers to source products cheaply from abroad. "Malaysia is a very free market, which has assisted the industry's growth," he says. "There are no import duties, aside from on those products that are available locally such as titanium dioxide. And there is no VAT, either."

There is a flip side, however. Those same liberal trade and investment policies have helped a number of international distributors – such as Connell Brothers and Thor Specialties – establish themselves. The extra competition has seen the market mature and put downward pressure on profit margins. "Having reached a certain stage in its development, competition amongst distributors in Malaysia is fairly intense," says Teoh. "Product quality and prices are now quite similar across competitors, so the key is to have good relationships with customers and to focus on quality of service."

But now the industry looks set to confront a new, equally potent challenge. Far from providing fresh impetus for local distributors, low-cost manufacturing operations in China and elsewhere have begun to damage the local end-user consumer product industries that Malaysian distributors have often depended upon. "End users



A Vital Link between Manufacturers and End Users Worldwide

The WWRC Group is a leading distributor of chemicals and plastics in South-East Asia and the Greater China Area. The group operates its own offices and warehouses in Singapore, Malaysia, Taiwan, Thailand, China, Hong Kong and Indonesia. WWRC mainly serves to the paint and coatings, ink, adhesives, plastics, rubber, electronics, composites, resins and other related industries.

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– electronics and electrical assemblers – are increasingly moving away from Malaysia, so that is a threat to our business.”

The Malaysian market may experience a period of dislocation while adjusting to new demand conditions. “The result of the shifts in the patterns of demand is that Malaysia is now really a saturated market – especially for many bulk chemicals,” says Dato’ Peter Tan, CEO of Kong Long Huat Chemicals (KLH), one of Malaysia’s largest traders of inorganic chemicals. “Chemicals business growth has slowed to 5-8% per year, compared to 10, 15 or 20% 10 years ago. In order to grow at those sorts of rates, we have to go overseas. So we’re now looking at regionalization – we’ve established a representative office in Vietnam and have a JV in Thailand.”

The chemical distribution sector has, by and large, enjoyed a bull run over the past decade, mirroring the country’s strong industrial progress.

Exports are also the immediate strategy for industrial chemicals distributor Akashi. Managing Director Tang Pian Nam says that his company’s partnerships with multinationals (formerly Arco, currently Bayer) for distribution of polyurethanes on the Malaysian market are becoming a thing of the past. Instead, the company has moved both upstream and downstream, concentrating on its own manufacturing (of silicone emulsions and polyurethane systems) and logistics services. “We are trying to move forward in the



future and have a presence in the niche markets. Of course we are aware we need to get out of Malaysia because in the past our focus was mainly within Malaysia and recently we have started to look at other ASEAN markets.”

“We do not see distribution as a long-term business for us. There is still a niche market in distribution if we focus on chemicals which require special storage or containment but in general distribution the margins are getting thinner and it is getting very competitive, so you need to work on an economy of scale. Therefore the strategy for us is to work on services and manufacturing, where



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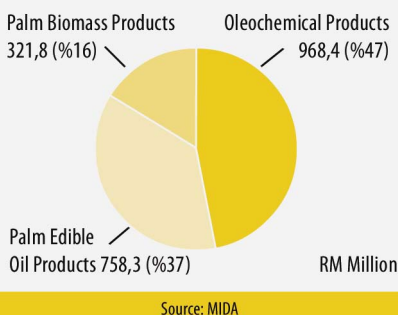
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the margins are fair.”

With distribution margins disappearing, low-cost China is a blessing as well as a curse. Tan says that 60% of KLH's products are currently sourced from China, where they are available much cheaper than elsewhere. Teoh explains that in the past year, he has begun to follow a similar strategy. “It's become a survival factor for us. Some of the products of our European or American principals lost out to Chinese competitors, so it's an important way for us to improve our competitiveness.”

The same goes for Behn Meyer, one of Malaysia's longest-established suppliers of crop protection, fertilizer and specialty chemicals products. “We can't ignore the fact that Chinese and Indian products are very competitively priced and of an increasingly consistent quality,” says Managing Director Tay Kin Bee. “We are sourcing from these countries, re-branding the produce and distributing them under our own name. They include soya protein products and manganese oxide for animal feed. In fact, we even source potato products from Inner Mongolia. There's no need to go to Shanghai.” In other words,

Investments in Projects Approved in the Oil Palm Products Industry by Sub-Sector, 2005



the portion of Malaysian industry that survives the wave of low-cost competition from overseas is likely to be better served than before.

The more widespread such innovations are, the easier it will be for Malaysia to adapt to the shifting trading environment. Indeed, as the impact of growth in other parts of emerging Asia continues to work its way through Malaysia's chemical distribution networks, improvements in both product range and service are unlikely to end there.

Useful Contacts in Malaysia

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This report has been compiled by:

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Akashi is fast becoming a leading regional business of the Malaysian Chemical Industry by distributing cost-effective, high quality products and services to customers, subscribing to “Responsible Care” standards of excellence, diversifying its markets and exporting abroad. It aims to manufacture, market and trade chemical products for the benefit of customers, suppliers, employees, shareholders, stakeholders and the community.

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