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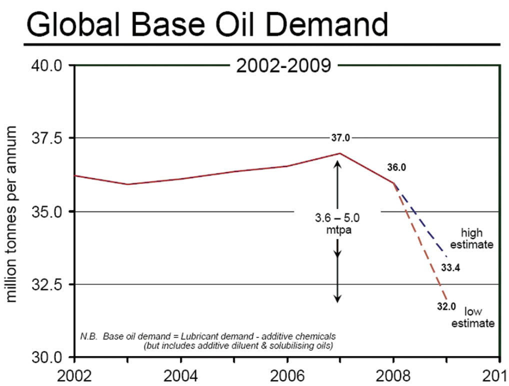
2009: The year in review and a brief look forward

Steve Ames, Managing Director of SBA Consulting reflects on what was a difficult year for many in the lubricants industry. He pointed out that perhaps his comments about 'difficult' was somewhat of an understatement of the realities for both end-users in industry and on the impact that the global recession has had on the lubricant supply industry. He also provided a brief 'look forward' and conceded that it will be more difficult than reporting history. He does see some of the signs of a slow recovery – more about that later.

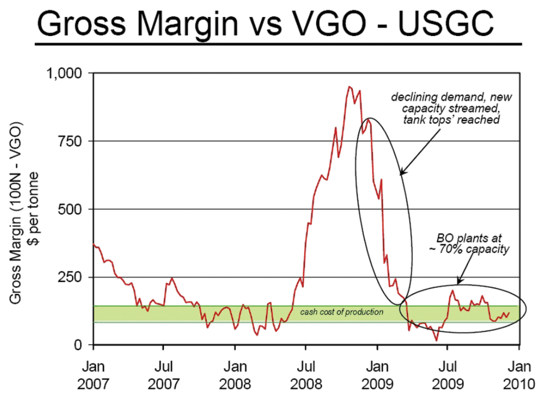
DEMAND

In 2009 demand for both base oils and finished lubricants declined by around 7 – 11 % and this followed on from the circa 3% decline experienced in 2008. Overall the lubricant supply industry has seen a reduction in volume of some 4 to 5 million tonnes per annum (mtpa) since 2007. This means that lubricant supply tonnages were the lowest recorded for more than 25 years. Another significant impact on Group I refining was European legislation that forced the replacement of aromatic extracts by lower toxicity products such as naphthenics and treated distillate aromatic extracts (TDAE) now used in tyre production. Although the legislation was European based, its impact was global.



SUPPLY ECONOMICS

Base oil supply was also impacted by the continuing decline in margins of the refinery fuel operations, crude slate changes, production run cuts and idled refineries and processes - these produced an overall global operating performance of about 70% for base oil refineries. The impact of these declining margins on pricing and profitability was such that base oil production provided little help to overall refinery economic performance.



Early in 2009 many refineries reached tank tops and subsequent action taken to reduce production influenced lower production output figures.

REFINERIES FOR SALE

More worrying was that 7 refineries with 2.5 mtpa of base oils capacity were put up for sale, some of this number remain unsold and may be closed, whilst other refineries have been or may be sold.

These movements probably reflect the base oil refinery margin pessimism. Sunoco Tulsa (and Sinclair Tulsa) was sold to Holly Corp and the marriage of the two refineries undertaken by Holly Corp provided synergies that should help keep the 490 ktpa Group I base oil plant operating. Agip's Livorno refinery was offered for sale in Feb 2009, this refinery normally produced 550 ktpa Group I, but we believe no acceptable offers have been received. Six Shell refineries were offered for sale during 2009 – 3 with base oils: Harburg (180 ktpa of Group I and 150 ktpa naphthenics), Stanlow (230 ktpa of Group I) and Montreal East (140 ktpa of Group I). In 1Q2009 Colas agreed to buy the 330 ktpa Group I SR Dunkerque base oil refinery from ExxonMobil & Total. Colas will operate it as a 300 ktpa bitumen plant as part of the deal. The deal is expected to be finalised in mid-2010, with possible base oil offtake agreements. Valero's Paulsboro refinery was put on the block in Jan 2010 and included a 590 ktpa Group I base oil plant.

Over capacity and poor margins had also taken their toll, already one base oil refinery has closed and three other closures were announced for 2010 / 11. The detail of these are: Puralube (Baufield subsidiary) closed the 80 ktpa Group I re-refining