February update

Back in September 2010, Portland wrote about the problems facing European refiners, as high crude costs and ruinous refinery margins were strangling the industry. Unfortunately these dire warnings came to a head in January 2012, when Petroplus, Europe's biggest independent refiner (and owners of Coryton) had their $1bn credit line removed by the bank. Petroplus' share price immediately plummeted 40 % but more significantly, their ability to buy crude oil in sufficient volumes was removed.

Refineries without crude oil rarely function well (!), so Petroplus immediately shutdown three of its 5 European refineries – Petit Couronne in Northern France, Antwerp in Belgium and Cressier in Switzerland. Furthermore, production in the remaining two refineries – Coryton (UK) and Ingolstadt (Germany) – was reduced to circa half capacity.

Independent refiners v integrated operators

Whilst the predictably painful consequences of this fall-out will now be felt across Europe, Portland is left to wonder why another independent refining company has seemingly hit the skids. Just like Tosco before them in the USA, Petroplus hit the scene in a blaze of cash, with high value headline deals, aggressive acquisitions and seemingly no fear of taking on the big boys. Sadly and also like Tosco, Petroplus looks like it may not stand the test of time.

To understand why these independent refiners have not flourished, is to go back to the very basis of the original oil multinationals and their decision to have "integrated" operations. Integrated operations meant that the likes of Exxon, BP and Shell would have an "upstream" part of the business, that got the crude oil out of the ground, a "midstream" part that would refine that crude oil and a "downstream" part that would sell the crude oil, once it was refined. The basis behind this was an attempt to balance revenue and profits, irrespective of which way the oil price went. When crude oil prices were low, feedstocks for the refinery would be cheap and as a result, the ability to make higher margins on refined products much more significant. The opposite would be true when crude prices were high. Refinery feedstocks would be expensive and so margins tight. But during those periods, the integrated oil majors would still be happy because their crude oil (unrefined) would fetch much higher prices on the open market. Happy days!

So Petroplus' failure is arguably simple to understand; in short, they are not integrated. As crude oil prices have risen higher and higher, so refining margins have been squeezed relentlessly. With no crude oil to sell and only those squeezed refinery margins to rely on, Petroplus' cards were surely marked? Possibly yes, but more likely the problems for Petroplus were those of geography and the nature of the local European market – both of which were not on Petroplus' side.

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Even with high crude prices, refinery margins can still be attractive if the local market is robust enough to cope. Conoco clearly think so as they embark on their new "Phillips 66" venture, which is after all, a brand new standalone mid/downstream operation! Or look at the new Indian refineries or the refining hub of Singapore; these areas are not struggling with margin because demand for refined products is strong and accelerating. As long as demand for refined fuel increases, then refinery margins will be handsome. But in Europe (where all Petroplus refineries are located), demand for fuel is consistently falling year on year, as the effects are seen of energy efficiency, environmental legislation and more recently, the downturn in the economy. So unlike in Asia, where demand is running away from supply, European margins are generally rotten.

in Europe demand for fuel is consistently falling year on year

A final unpalatable truth is that the Petroplus group has been making eye-watering losses for quite some time and has always been a leveraged company with high levels of debt. In the end, the oil industry is no different to retail, banking or even national debt. When creditors get twitchy, they stop lending, cancel the IOU and ask for their money back…

For more pricing information, see page 30

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