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The Lubricant Distributor's Voice

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The Flipside to the Downslide in Lubricant Prices

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While price decreases were big news in the lubricants business in January 2015, there is an important back story about the higher cost and prices of some synthetics that needs to be told.

Price decreases started in 2015 when Chevron was the first to announce a general decrease in lubricant prices. Shell, ExxonMobil, Phillips 66, Valvoline, Castrol, Petro-Canada and others soon followed. The decreases were not a surprise to most lubricant marketers. In fact, many in the business anticipated decrease announcements in December 2014. This is because the price of crude was plummeting in the 4th quarter, base oil prices were dropping in response, and the highly visible price of gasoline was reaching levels not seen in years. With that, in the views of many lubricant marketers and end users, the pressure was on for majors and independents to respond accordingly by decreasing lubricant prices. And although it took a month longer than some expected, lubricant manufacturers did respond by announcing price decreases in January 2015. Most of these decreases, with effective dates in January and February, were in the area of 3 to 4%, which translates to roughly \$0.35 to \$0.45 a gallon.

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But... an important point that may have been lost in the frenzy of the price decrease announcements is that not all lubricants are made from the same types of base oils. Because of this, while the industry was announcing decreases and price easing in white oils, API Group I, II and III, little notice was being made of continuing increases in Group IV (PAO) and Group V base fluids. As a result, while the prices of many lubricants were decreasing, the cost of lubricants made from Group IV (PAO) and Group V base fluids was on the rise.

One example is seen in the price of PAO which recently increased by close to 4%. Another is seen in the price of PAGs which marched up nearly every quarter in 2014. Adding to this are the ongoing increases in the price of nearly all types of esters.

So how is it that when the price of API Group I, II and III base stocks are decreasing and driving the price of many lubricants down that the cost of PAO and esters are increasing which in turn is driving the price of some synthetics lubricants up?

Part of the answer starts with an understanding that demand for PAO is increasing and supply is comparatively tight. Where many counted PAO out over a decade ago when Group III made its debut as a "synthetic," demand for PAO for use in motor oils has increased to meet emission and fuel standards and regulations driving the movement towards higher performance lubricants with lower viscosities. This has resulted in increased demand for low viscosity PAOs.

While demand has increased, planned Normal Alpha Olefins (NAO) outages have had a negative impact on short-term supply of NAO feedstocks. As a result, PAOs have been on allocation worldwide for the better part of the past three years. Although plant de-bottlenecking has helped to elevate some of the shortfall in supply, supply continues to come up short of the growing demand for PAO.

And then there are the esters.

In general petroleum-derived products tend to follow crude prices, but for synthetic esters a different set of criteria govern the movement of the raw materials.



Synthetic ester raw materials closely track the movement of chemical feedstocks such as ethylene, propylene, butylene, and other specialized chemicals such as fatty acids. These raw materials, some of which are derived from crude oils and others from plant sources, have been on a rapid upward trajectory for the past two plus years. This has been driven by supply-

demand conditions, with annual increases in high double digits, and cumulative increases approaching 40% over this period. Only recently have these increases moderated, but they are still climbing at a slower pace, in mid-single digits. Some of the specialized raw materials remain in tight supply with continued tightness for the foreseeable future. Much of this is coming from the suppliers of these specialized chemicals, and it is unlikely there will be significant decreases in the costs of these raw materials in 2015.

In addition to upward price pressure from the higher cost of the raw materials, increased demand for esters is also putting pressure on prices. Increasing use of esters in Food Grade applications and the need to use these stocks in applications requiring ever increasing higher temperature performance further enhances their value where there are fewer alternatives and once again demand may exceed supply leading to higher pricing. The so called "True" synthetic lubricants utilizing Group IV and higher quality base fluids may not require as many additives as petroleum counterparts, but many of these additives are increasing in costs and not decreasing as crude prices are doing.

So at the end of the day, whereas some might conclude that the price of all lubricants should decrease when the price of crude drops like a rock, there is more to the story when speaking about the cost and price of some synthetic lubricants. This is because the raw materials required to make some synthetics are distantly or not at all connected to the price of crude.

The end result is that when a buyer is expecting lower lubricant prices due to significant drops in the price of crude, it's important to understand that not all lubricants are made from the same raw materials. Now, more than ever, price increases need to be justified and customers are expecting full documentation on the driving factors behind those increases. At the same time margins will suffer for those blenders that have customers that will simply not accept increases.

Never before have blenders of high-performance synthetic industrial lubricants had to look so carefully at their formulations to see where they might be able to find some savings to preserve those margins and not have a negative effect on lubricant performance.