

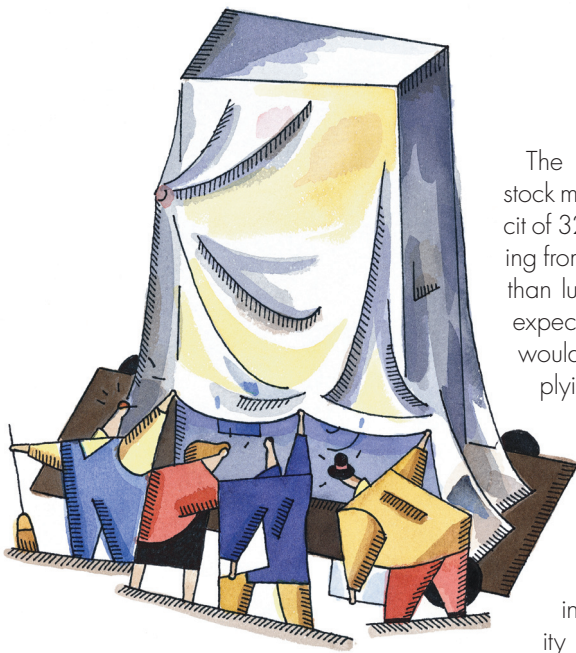
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WHAT ROLE FOR PEARL?

Shell May Keep its GTL Base Stocks

BY SCOTT GOULD
AND CHARLES MARTIN



The surrounding Middle Eastern base stock market is currently experiencing a deficit of 325,000 t/y. Though the quality coming from the Pearl plant will be much higher than lubricant companies require, the low expected cost of production and shipping would suggest that Shell may start by supplying the Middle East, covering the regional deficit, and then extend sales outward to neighboring areas until Pearl's output is consumed.

However, there are other dynamics to be considered: Shell's internal demand for higher quality base stocks, and the fact some regions – such as Europe – are currently thirsting for higher quality base stocks. We have framed several scenarios below to address the question of where Pearl's base stocks are most likely to go.

SCENARIO 1: THE LOCAL MARKET

Assume Shell chooses the most convenient option and looks for outlets within the Middle East and surrounding regions. This seems reasonable because these areas

need additional supply and because this approach would minimize transportation and logistical costs.

However, the supply gap in the Middle Eastern base stock market is focused more on lower quality fluids, such as Group I. Group III+ base stocks could be substituted into many Group I-formulated lubricants, and the higher viscosity index would allow blenders to reduce use of viscosity index improver, thereby saving costs. But a closer look reveals that the savings is small – roughly €1 per barrel. The limited benefit of using Group III+ in such applications would exert downward pressure on prices that the supplier could charge, seemingly negating the benefit of having customers in close proximity.

SCENARIO 2: TARGET EUROPE'S HIGH-VALUE MARKET

Alternatively, high-value markets in Western Europe may be an interesting option. Blenders and formulators in Europe are obtaining much of their higher quality base stock from Asia-Pacific countries. Sourcing from a closer producer would reduce shipping costs and shorten delivery times. In addition, there is speculation that Pearl's cost

When will it open, where will it go, and what impact will it have? Early next year, Shell is expected to ramp up production on the first train of the world's largest gas-to-liquids plant, a joint venture with Qatar Petroleum. Located in Ras Laffan, Qatar, Pearl will open with capacity to make 70,000 barrels per day of GTL material. Shell has said that will include capacity to make up to 15,000 b/d – or 690,000 metric tons per year – of API Group III+ base stocks.

structure will allow its base stocks to be sold in Europe – even including the cost of freight – at prices similar to those charged by local European Group III producers.

The issue for Shell then becomes convincing buyers that their Group III+ products are superior to what is already on the market. However, most blenders do not yet value the improved properties of GTL base stock over Group III. For example, current consensus in the market is that the zero sulfur levels in Group III+ offers little practical improvement over Group III's 5 parts per million sulfur content.

Many blenders respond to market pull established by end-use consumer demand, and it often takes an innovative company to create this demand through marketing campaigns that change perceptions of value. By selling a novel product to formulators that don't yet value Group III+ characteristics, Shell will be missing an opportunity to command a higher price by marketing directly to end-use consumers.

SCENARIO 3: FULFILLING INTERNAL DEMANDS

Shell is the world's leading marketer of finished lubricants, yet it still can strengthen its position by leveraging the performance characteristics of Group III+. With a 940,000-t/y deficit of internal base stock supply, Shell could seemingly soak up the entire first phase of Shell Pearl.

Additionally, Shell has recently rationalized plants in Petit Couronne, France, Hamburg and Montreal and is in the process of doing so with others in Harburg, Germany, and Stanlow, United Kingdom. This leads to speculation that Shell is planning for this new internal supply source from Pearl.

The Group III+ output from Pearl can help establish a new standard for high-quality base stocks with an improved synthetic lubricant line that belongs exclusively to Shell. Marketing the higher quality material themselves gives the company the ability to convey the added benefits of Group III+ directly to consumers rather than convincing

lubricant producers and blenders of its high value marketability.

Shell already has a history of working closely with original equipment manufacturers to establish innovative lubricant solutions and will most likely continue this tradition with their Group III+ material. Integrating their GTL products with OEM specifications will help the market place realize the full value of the base stocks. Shell already recognizes that Group II and Group III base stocks are becoming the norm in the industry, and, in order to be on the cutting edge, it must pioneer the development of innovative and superior products. The Pearl base stock slate is the perfect platform from which to implement such a strategy.

KLINE'S ASSESSMENT

After successful introduction, Kline believes Shell will start marketing Pearl base oils to other lubricant blenders, as OEMs are always more comfortable if more than one supplier can service their needs. This would make the next likely step to be the positioning of Shell's GTL base stocks as replacements for costlier polyalphaolefin in passenger car motor oil formulations and subsequently targeting 5W grades in heavy duty motor oils.

It's also worth remembering that auto manufacturing is moving to countries such as China and India, and that lubricant specifications in such places are leapfrogging. Shell's increased presence and interest in these two growth engines for the lubricants industry are also good indicators of Shell's interest and strategy regarding their GTL base stocks. ■

SCOTT GOULD is a manager in the Petroleum & Energy consulting practice at Kline & Company, a worldwide consulting and market research firm. He can be reached at Scott.Gould@klinegroup.com

CHARLES MARTIN is an energy consultant with Kline and can be reached at Charles.Martin@klinegroup.com Both are based at Kline's headquarters in Parsippany, New Jersey, U.S.