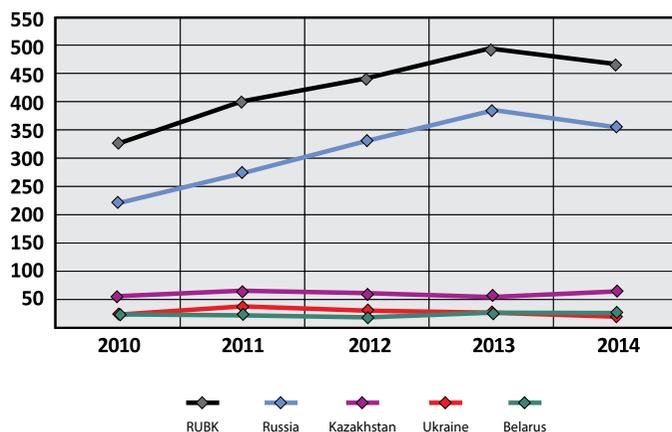


SUMMARY OF 2014 – NO MIRACLE HAPPENED

By Mikhail Usachev, Kirill Trusov

The plastic pipes market in RUBK (Russia, Ukraine, Belarus, Kazakhstan) showed a negative trend for the first time following continuous growth from 2010 to 2013, shrinking by 5% to 467.5 thousand tonnes. The major causes of the decline were a reduction in construction activity, a partial curtailing of investment programmes, and under-financing of ongoing renovation programmes. This was compounded by uncertainty in Ukraine which led to reciprocal sanctions and a sharp devaluation of the rouble

Pic. 1. PE pipe market of RUBK in 2010–2014, thousand tonnes



Annual performance of the Russian PE pipes market was disappointing. In 2014, Russia supplied 356,000 tonnes of PE pipes – an 8% reduction on the previous year. Consumption fell due to economic slowdown and a drop in the number of large infrastructure projects during the year. The situation in the PP and PVC pipes markets was not very optimistic either. PP pipes saw a repeat of the previous year's output at 121,000 tonnes; PVC pipes reached the 60,000 tonnes mark, an increase of just 1%.

The Ukrainian PE pipes market has been in turmoil for three years. It showed a negative trend from 2012 to 2014 and shrank overall by 41% (15,000 tonnes). In 2014 market volumes were down 18% to 22,000 tonnes. Due to the economic situation in Ukraine, the markets continued to shrink. The situation worsened for plastic pipe producers reliant on imported raw material as the 5% import duty for all grades of polymers took effect from February.

Consumption of plastic pipes in Belarus in 2014 did not show significant changes compared to the previous year and came to 25,000 tonnes. However, possible market growth opportunities were completely shattered due to the reduction in a number of large government investment projects.

The Kazakhstani market was the only one to show growth in 2014. Decreases in 2012–2013 were overcome and the Kazakh

PE pipes market grew by 16%. This growth was possible due to the implementation of a number of large government infrastructure projects. Kazakhstan is a bright example of successful government participation in infrastructure development. Unlike other countries, the government increased rather than reduced spending in spite of the crisis, in order to stimulate business. From 2015, Kazakhstan expected to invest around 3 billion dollars per year in the creation and modernisation of infrastructure. This will also influence the growth of PE pipes consumption.

The level of market development can be evaluated by assessing consumption of product per capita. Total plastic pipes consumption in RUBK in 2014 was 3.2 kg/person. Kazakhstan has been leading for several years, maintaining the level at 4.87 kg/person. Belarus is second at 3.90 kg/person, Russia is third with 3.75 kg/person and Ukraine is far behind at 0.74 kg/person.

RUBK plastic pipes market development is at a significantly lower level than that of Europe, Northern America and China. The consumption of plastic pipes per capita in Northern America and Europe is three times higher than in RUBK. Attention should be paid to the development of the Chinese market which has doubled the production of plastic pipes from 5.8 to more than 13 million tonnes in just over 4 years. This has almost reached European levels of 9–10 kg/person. Although there was a reduction in consumption in 2014, the plastic pipes market of RUBK does have potential for growth in the long run.

PE pipes market in Russia

In 2014 consumption of PE pipes in Russia reduced 8% due to many company and Government projects stopping or being postponed in light of the difficult economic and political situation. Large infrastructure projects, such as the Olympic Games in Sochi and APEC Summit in Vladivostok were lacking and the gas distribution development programme was stopped. Only strategically important projects like the Vostochny space-launch complex retained its investment.

Construction slowed significantly due to limited credit resources following the increased interest rate and economic sanctions. The Agency for Housing Mortgage Lending expected the mortgage market in 2015 (including government-backed schemes) to make 800 billion roubles. This is 56% less than in 2014 which saw record results of 1.76 trillion roubles. Clearly a significant drop would negatively impact the infrastructure construction rate.

The housing and utilities sector also experienced under-financing in utility networks renovation projects. The federal budget for this sector dropped by 28% to 62.2 billion roubles in 2014 and the sector entered a serious crisis situation. According to the Centre for Municipal Economy, over 44.9% of water and 40% of sewer pipelines required replacements in 2013. Only 1.5% of water and 0.4% of sewer pipelines are replaced every year instead of required 4%.

Forecasting PE pipe market volumes for 2015 is virtually impossible without any clear trends. The start of 2015 was not

positive. Consumption of pipe grades of PE in the first quarter was 32% lower compared to the same period in the previous year. Such a significant reduction in raw material consumption can only point to negative market dynamics in the future.

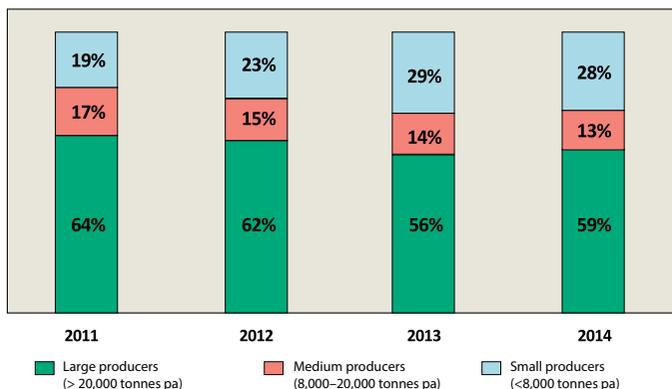
Output of PE pipes producers in 2014 was low at only 30–35% of production capacity whereas total capacity would see over a million tonnes of output.

Market share by volume amongst producers did not significantly change in 2014. The large producers slightly increased their share from 56% to 59% and the medium and small producers were 1–2% lower than in 2013. A worsening of the economy in 2015 will make it likely that the more financially resilient larger producers will be able to retain their market share.

There were some changes in PE pipe consumption. Pipe supply to the water industry – the largest market sector – went up by 65%. Pipes for gas pipelines had reduced in previous years from 26% in 2012 to 18% in 2014. The volume of gas pipes will continue to drop due to a partial suspension of the gas infrastructure development programme. The share of non-pressure pipes used for sewer pipelines, telecoms and drainage has increased in 2014 from 13% to 17%. This trend for non-pressure pipes will remain the same in 2015.

Pipe grades PE market in 2014

PE pipe producers have faced problems other than the drop in demand. In February 2014, there was an accident at Stavrolen,



Pic. 2. Market shares of PE pipes producers in Russia in 2011–2014.

the only producer of black-filled PE 80. The entire RUBK zone was left with only two local producers of pipe grade PE: Kazanorgsintez and Nizhnekamskneftekhim. In 2014, production of pipe grade PE in RUBK was 209,000 tonnes whilst consumption volume was 468,000 tonnes. This was a 55% shortfall of pipe grade PE – representing 256,000 tonnes – and had been building for a number of years. Kazanorgsintez and Nizhnekamskneftekhim benefitted from the shortage by significantly increasing prices for their products. According to the Marker Report, Kazanorgsintez made 6.1 billion roubles, a record high profit which was 2.85 times more than in 2013. Nizhnekamskneftekhim increased its net profit by 50.5% to 9.43 billion roubles.

The shortage was partially addressed by importing more expensive raw materials from Europe, Asia and Saudi Arabia. Other pipes are produced from less expensive non-pipe grade PE, however this is strictly prohibited, especially for use as pressure

pipes. Many companies were forced to lower their production costs and face tough price competition – and had no choice but to produce poor quality goods. This problem was dealt with in various ways. In Kazakhstan, for example, market participants created a self-regulatory organisation (SRO) to monitor rogue producers. The Association of PE Pipes Producers made a request to the Eurasian Economic Commission to apply zero import duties for black-filled PE. As a result, the EEC took the unprecedented decision to do so for Kazakhstan only for 2015, up to a volume of 100,000 tonnes. Perhaps only Kazakhstan is interested in good quality pipes?

In 2014, Russian home produced black-filled pipe PE supplied 55% of market demand, where 54% – PE 100, 1% – PE 80. The share of imported PE 100 grew from 15% in 2013 to 24% in 2014, which was also related to the shortage of PE in the domestic market.

The share of consumption of non-pipe grades of PE dropped to 19% which may be an indication of a reduction in counterfeit produce. The reduction of PE 80 share can be explained by the Stavrolen shutdown as well as consumer preference for PE 100 which is seen as a more efficient material.

In 2015, the situation for pipe grade PE in RUBK did not improve. Total production output for Kazanorgsintez and Nizhnekamskneftekhim shrank to 150–160 thousand tonnes, which will perpetuate the shortage. The pipe grade PE market should be more positive in 2016 however as Kazanorgsintez is planning to increase production output of pipe PE to 220 thousand tonnes. Stavrolen has also promised to introduce its own black-filled PE 100.

Prices and market trends for pipe grade PE

Local PE 100 producer prices were stable at 65,000–66,500 roubles per tonne in Q1 2014. Devaluation of the rouble at the beginning of the year meant imported raw material prices increased. European PE 100 producers increased prices from 76,000 to 85,000 roubles per tonne. Prices for pipe raw materials from Asia reached 81,000 roubles per tonne in March.

The accident at Stavrolen, along with seasonal demand increases in Q2, resulted in a significant price spike for pipe grade PE in Russia. Domestic producers of black-filled PE 100 increased their prices by 13,000 roubles per tonne to 80,000 roubles per tonne. At the same time, the price of imported PE 100 did not see a significant change, staying at 78,000–82,000 roubles per tonne during currency stabilisation. Price competition between imported and domestic raw materials intensified at the end of Q2.

Prices continued upwards during Q3 of 2014. Weighted average prices for PE 100 reached 80,000–85,000 per tonne amid high demand for PE pipes and the scheduled maintenance shutdowns at Kazanorgsintez and Nizhnekamskneftekhim. The prices for imported and domestic raw materials were almost the same.

Q4 of 2014 was a surprise for both the pipe grade PE market and the Russian economy as a whole. The prices for local raw materials reached their annual peak in November 2014 at 86,500 roubles per tonne before going down to 83,500 roubles per tonne as demand collapsed and the credit fund situation worsened. Double-slump of the rouble against the dollar made the prices for imported PE 100 pass 100 thousand roubles per tonne mark in December. Despite a significant decrease in oil prices, Asian raw materials reached 105,000 per tonne and

European PE 100 reached 115,000 per tonne.

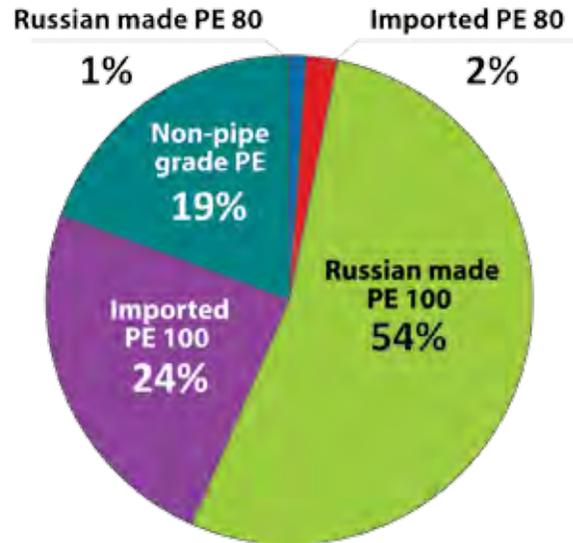
The weighted average prices for PE 100 at the beginning of 2015 were over 90,000 roubles per tonne. Local pipe grade PE producer prices did not increase significantly due to seasonal factors, only reaching 91,000 roubles per tonne in March 2015. However Asian producers of PE 100 showed record prices of 130,000 roubles per tonne. European prices significantly dropped to 96,000 roubles per tonne after the December spike due to the devaluation of the euro.

Import and Export of pipe grades PE

Increased demand for pipe grade PE, and the opportunity to sell products at an attractive price in Russia, ensured domestic producers stayed focused on the home market. Exports of pipe grade PE shrank by a third to 25,000 tonnes during 2014. Turkey, Ukraine and China became major consumers of Russian PE for pipes, bringing the total share to 81%. Kazanorgsintez covered 85% of total pipe PE exports; Gazpromneftekhim Salavat – 12%; and Nizhnekamskneftekhim – 3%.

Imports of pipe grade PE into Russia in 2014 was 1.5 times up to 94,000 tonnes. The first quarter of the year saw a serious drop in imports as the rouble devalued. Imports of pipe grade PE started to grow in Q2 and reached 15,000 tonnes in September. In Q4 imports decreased again due to the pressures of a seasonal drop in demand.

The supply geography of pipe grade PE in 2014 had seriously changed. Germany became the largest importer and increased its share from 15% to 41%. The share of Asian suppliers of PE was down and made up 47% due to a reduced supply from Korea, down to 16,500 tonnes. Thailand’s share remained the same as the previous year at 29%. Supply from Saudi Arabia sharply decreased to 6%, possibly due to the fact that European import duty for PE from the Persian Gulf was increased from 3.5% to 6.5%.



Pic. 3. Raw materials for PE pipes in Russia in 2014

Conclusion

With downward market trends, more expensive raw materials, and a devaluation of the national currency: this industry has never seen such a deep and prolonged crisis. However, each crisis must be treated as an opportunity. Difficult times force entrepreneurs to optimise business processes, enter new markets and create innovative products. Only effective and competitive companies can overcome the crisis – the rest will not survive. Sooner or later, the market will stabilise and growth will inevitably follow due to a built-up need for the construction and renovation of utility networks. The big question of course is when this will happen...

Pic. 4. Average prices for black-filled PE 100 trend, DDP Moscow, roubles per tonne including VAT, years 2012–2014.

