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OIL TRADING INDUSTRY FACES A MIDDLE EAST SHAKE-UP

- *Need to squeeze more value from every drop of crude is driving change*

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Middle East national oil companies are drilling deeper to extract every last drop of value from their barrels. Some of the world's biggest producers are increasingly focusing on extending the reach of their crude and products' trading arms in the first major shake-up for the industry since banks shut their commodities trading desks in the wake of the financial crisis, say experts.

Lower oil prices and the need to squeeze more value from every drop of crude to help support economic development are driving the shift, which has seen state-owned giants Adnoc and Saudi Aramco recently bulk up their trading units. The trend is set to be a major topic of discussion for industry executives and oil ministers attending this week's Middle East Petroleum & Gas Conference in Dubai.

"I would view this as a natural evolution of NOCs aiming to more fully monetise their crude oil supply," said Harry Tchilinguirian, global head of commodity markets strategy for investment bank BNP Paribas, who is scheduled to speak at the conference. "NOCs [are] looking to assume a greater role in the marketing of their oil products, and thus growing their trading teams."

Only a year ago during the same conference, Adnoc announced the formation of its own trading unit to further maximise value from its production. Adnoc is now hiring traders. Aramco Trading Company -- a unit of Saudi Aramco -- is also setting up an office in London this year after it opened a bureau in the bunker hub of Fujairah last December. Meanwhile, Iraq's state oil marketer is looking to open its first offices outside the country starting with Singapore.

The expansions come as NOCs invest heavily in the downstream sector, building complex refineries not only within their own borders but around the world. The investment splurge has made them bigger players in the global oil market, on both the crude and products sides.

Driving this trend is an economic imperative. Middle East state oil companies watched as traders like the late Marc Rich made a fortune on their production and helped to start commodities powerhouses such as Glencore in 1974. This all started to change when Oman began a joint venture with Vitol, the world's largest independent oil trader, in 2006 to focus on trading oil and products. Saudi Aramco set up its trading arm, Aramco Trading, in 2012.

The growing trading operations are enabling NOCs to better adapt to shifts in trade flows, as Middle East crude producers battle for market share in demand-hungry Asia. For example, a more robust trading arm might help Aramco source crude for its refineries in South Korea and China where it might not make sense to use crude from home.

"All these changes are creating new opportunities and value, which the trading arms of these companies can capture in principle, given their size," said Bassam Fattouh, who closely follows oil markets as director of the Oxford Institute of Energy Studies.

Saudi Arabia's Aramco, which last week disclosed it made \$111 billion in profits last year, has said it wants to become a top three global oil trader. The company has said it plans to be trading as much as 6 million barrels per day of crude by 2020 - 50 per cent higher than in 2018 - as it expands its downstream reach in Asia.

"Ten years ago major trading companies - which already had an important merchant role of their own - filled a giant gap left when banks exited commodities trading in the wake of the financial crises," said Dave Ernsberger, global head of energy pricing and co-head of global content at S&P Global Platts. "The determined push by NOCs into trading is the first major shake-up of the status quo in physical and paper trading since then. NOCs have built successful business of their own trading around their own natural positions, and by targeting trading spaces that remain somewhat under-occupied, like adding the back of curves in derivatives market. Many have started as JVs, but they are quickly emerging as full-on trading enterprises in their own right."

Iraq's state oil marketing body SOMO is planning to build out an active spot market for its crudes. In particular, SOMO is attempting to curb resales of its contracted volumes by term customers and corner the secondary market for Iraqi grades like Basrah Light and Heavy.

The UAE, meanwhile, has been investing heavily not only in the downstream sector but also in crude and products storage. UAE-based Brooge Petroleum & Gas Investment Co. -- which is considering a public listing of its shares -- is looking to add more oil storage capacity in Fujairah, betting that the eastern emirate on the Gulf of Oman will gain further prominence as a strategic bunkering and trading hub.

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