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The United States is Currently the Top Strategic Focus Area in the World For the Chemical Industry

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Could you give us an introduction to KPMG's Chemicals and Performance Technologies segment on a global level?

Mike Shannon (MS): We provide audit, tax and advisory services to the chemicals sector. KPMG has professionals in every major market worldwide focusing solely on providing services to our clients. Paul and I spend a lot of time travelling to different parts of the world to meet with our clients and to gain first-hand understanding of the sector.

Paul Harnick (PH): The energy practice within KPMG, of which the Chemicals and Performance Technologies segment is a part, is a strategic priority for the company. We are extremely strong in areas such as transfer pricing, international tax and tax optimization, while key areas of focus on the advisory side would be mergers and acquisitions; working capital optimization; cost reduction and process efficiency; and supply chain management. As a company, we perform external audit services for 32% of chemical companies around the world worth more than $1 billion, and we provide either tax or advisory services for the vast majority of the remainder.

What are the main differences between the chemical industry in the United States as it stands now versus other regions worldwide?

MS: The United States is now the number one strategic focus area in the world. Although China is bigger in terms of output, the focus is on the United States from a strategic and investment perspective. Although the sudden drop in the price of oil has somewhat levelled the playing field, the low price of natural gas means the United States is still the most cost-advantageous region for the production of chemicals outside of the Middle East. We are also seeing the return of manufacturing, taking advantage of cheaper raw materials.

PH: If you had asked us three years ago if we would ever see a world-scale commodity chemical plant being built in the United States again, we would have categorically said no. Our expectations for growth lay in the emerging markets of China, India, and Brazil, in that order. Now, although China remains at the top, India and Brazil have fallen off the list, to be replaced by the Association of South-East Nations (ASEAN) region in particular, and Europe. Brazil has been teetering on the brink of recession for the last 18 months, while India continues to be constrained by a lack of feedstock and very weak infrastructure. Both countries really struggle from a legislative standpoint, with Brazil in particular having one of the most complex tax regimes globally. As such, we are not seeing global chemical companies prioritize investment in either of these regions. Combined with the $135 billion worth of new capacity under construction in the United States, this is causing a fundamental shift in the world chemical marketplace.

Considering the chemical industry is now one of the strongest areas of the U.S. economy, what challenges does the uptick in production spell for companies themselves?

MS: The reality is that the U.S. economy will likely not be able to absorb all of the molecules coming out of the ground, and the United States will therefore have to increase its exports. The focus then rests on the form in which these molecules will be exported and the resilience of these distribution channels needs to be examined; the chemical industry has not needed to focus heavily on export procedures for the last 15 years so this will prove a significant challenge.

In the search for new end markets for the chemical industry, which industrial segments and geographies may prove able to absorb this extra capacity?

PH: There are a number of traditional end markets for chemical products, but we also need to look at what is happening in the automotive and construction industries, for example. The U.S. automotive industry is fairly strong at present, unlike its Chinese counterpart. More broadly, global mega trends tend to drive demand for chemical products, as does population growth and urbanization in emerging markets. Geographically, China continues to be a substantial end market for chemicals, despite its current woes. Many of our clients are looking at the ASEAN region as the next growth area; Indonesia for example has a potential 250 million consumers, while Vietnam has a low-cost manufacturing base and is benefitting from companies withdrawing their operations from China to take advantage of low wage rates.

MS: Even the traditional end markets for chemicals are undergoing change. Cars today require far more chemicals than 15 years ago, with for example carbon fiber replacing steel and plastics and other composites replacing aluminum. The transformation within those subsectors will have an extraordinary impact on the chemical industry. With urbanization, newer housing is more energy efficient and sustainable technologies are required. I would summarize the chemical industry as investing in advanced technologies that are changing the way we live.

The petrochemicals segment in particular is seeing a resurgence in the United States. How are the dynamics between low oil prices globally and high volumes of feedstocks playing out here?

PH: In the United States, the petrochemical industry is booming because of the low price of gas. Manufacturers are experiencing a boom period, although 2014 was really the outstanding year for profit generation. This will, however, have a severe detrimental impact on petrochemical production in Europe. Currently, the decline in the price per barrel of oil has contributed to a small but perceptible renaissance among European manufacturers; they remain cost disadvantaged to the United States, but less so than 12 months ago. Yet it remains to be seen how long oil prices remain at this level. In our recent webcast on the chemicals industry, we posed a variety of questions on current and future trends, including the mid-year 2016 outlook for oil prices clients were using in forecasting. Out of the more than 100 participants, there was a broadly 50/50 split between less than $50 and between $50 and $70 per barrel of oil.

What do the next few years hold for KPMG’s Chemicals and Performance Technologies segment?

PH: For KPMG, the next few years will inevitably see us tracking the changes in the industry. We are going to see some very exciting dynamics; companies have finally recovered from the downturn and have a huge amount of cash on their balance sheet, which they will need to strategically deploy. There is an ongoing cost focus in Europe, so global chemical companies will need to optimize costs and efficiencies in that regard. As the impact of the shale gas revolution starts to play out and new capacity comes online, there will be even greater challenges in finding markets for this product overseas and we should be seeing some big investments in supply chains. These are all areas where KPMG has world-class expertise and where we can help our clients overcome these challenges.

This interview was conducted by GBR as part of its research on the chemical industry in the United States, which will be published in February 2016. GBR's Industry Explorations report on the U.S. Pharmaceutical industry was published in October 2015 and can be accessed here. If you wish to participate, please contact Laura Brangwin at lbrangwin@gbreports.com