Aramco and Reliance: Alliance Between Giants

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The deal

India’s Reliance Industries Ltd (RIL) announced at its 42nd annual general meeting that it had signed a letter of intent to sell a 20% stake in RIL’s chemicals, refining and fuel marketing (oil-to-chemicals [O2C]) business to Saudi Aramco in a deal valued at $15 billion. This deal includes RIL’s refining and petrochemical divisions, as well as its 51% stake in its joint fuel marketing venture with BP (RIL 2019). The remaining 49% stake in the fuel marketing business has been sold to BP for just under $1 billion. The crown jewel of this division is the 1.24 million barrels per day (MMb/d) Jamnagar refining complex (PPAC 2019), which consistently exceeded its nameplate capacity, with annual runs averaging 1.4 MMb/d since 2015 (PPAC 2019). The RIL-Aramco deal values RIL’s O2C business at $75 billion. This and other divestments RIL is planning are part of the company’s overall strategic objective to achieve zero-debt status by 2021 (RIL 2019). The current deal puts the value of RIL’s O2C business at nearly nine times earnings before interest taxes and amortization (EBITA) — a measure of the division’s operational profitability.

As part of the proposed deal, Aramco will also supply 500 thousand barrels per day (Kb/d) of Arabian crude oil to RIL’s Jamnagar refinery on a long-term basis (RIL 2019), though reportedly not at discounted rates (Economic Times 2019). RIL expects to conclude the deal by March 2020, with 50% of the money being paid at this time, another 25% in 2021, and the remaining 25% in 2022. Under the deal, an Aramco representative will hold the Chief Operating Officer position in the O2C business and a board seat in RIL (Economic Times 2019).

Figure 1: Structure of the deal.

<table>
<thead>
<tr>
<th>RIL (80%)</th>
<th>Aramco (20%)</th>
<th>BP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Refining</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemicals</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fuel marketing (51%)</td>
<td></td>
<td>Fuel marketing (49%)</td>
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<tr>
<td>0.5 MMb/d crude sale</td>
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Source: RIL (2019).

Implications

This deal is an alliance between two giants of the energy business. Aramco, with total revenue of $355.9 billion, is by far the world’s most profitable company and RIL, with $90 billion in revenue, is India’s largest by revenue and profitability. This would also be India’s largest foreign direct investment to date, overtaking BP’s $7.2 billion investment in RIL’s upstream business in 2011.
Securing the Indian market for Aramco

This initiative continues Aramco’s long-term strategy to increase its refining and petrochemical capacity, which is being achieved through a combination of projects and acquisitions. Other initiatives as part of this effort in 2019 have been its acquisition of 70% of SABIC’s shares (Saudi Aramco 2019), buying out Shell’s share in the Saudi Aramco Shell Refinery joint venture (Saudi Aramco 2019), and the memorandum of understanding to acquire a 9% stake in Zhejiang Petrochemical’s 800 Kb/d integrated refinery and petrochemical complex in Zhoushan, China (Saudi Aramco 2019). A refinery in India could also provide Aramco a base from which to export fuel to countries in Europe and the Americas.

It is also important for Saudi Arabia to protect its market share in this region as it locks in demand from the world’s third largest oil consumer (BP 2019). Asia has traditionally bought the bulk of its oil from the Middle East, but that has started to change since the United States (U.S.) House of Representatives lifted the ban on U.S. crude exports in 2015. Since then, U.S. exports to Asia have increased from 32.1 Kb/d in 2016 to 765 Kb/d in 2018 (BP 2019). During that period, Russia also increased its exports to Asia from 1.5 MMb/d to 1.9 MMb/d, while Saudi exports stagnated at 5 MMb/d. On the other side of the Suez, Saudi exports to the U.S. have steadily declined since peaking in 2012, with rising U.S. production reducing its import dependency. Thus, Saudi Arabia needs to secure customers in a market like India to continue to grow its oil exports. This increase in supply of 500 Kb/d to India is nearly as large as Saudi Arabia’s total exports to the U.S. in 2019.

**Figure 2:** Composition of India’s crude oil imports.

Source: (BP 2019) and the author’s calculations.
The RIL-Aramco deal will also allow Saudi Arabia to reclaim from Iraq the position of the top supplier of crude oil to India. Saudi Arabia, which used to be India’s largest crude oil supplier, lost this status to Iraq in 2017. Saudi crude oil exports to India fell to 0.79 MMb/d in 2018 from 0.81 MMb/d in 2016, even as India’s overall crude imports rose to 4.57 MMb/d from 4.26 MMb/d in the same period. These increased volumes imply that the share of Saudi crude in India’s crude imports could rise to 28%.

The importance of this deal is underscored by the International Energy Agency’s forecast that India will be the world’s fastest-growing oil consumer through 2040 to meet rapidly increasing demand from the transport sector and feedstock for the petrochemicals sector (IEA 2018). The growth in Indian crude imports of over 4% during 2017-2040 is expected to be more than twice as high as that of China, and would almost completely offset the decline in all of the OECD combined until 2040.

**Securing supplies for RIL**

Global oil prices have been volatile since the supply shocks from the U.S. shale revolution became a structural part of the oil market. The variability of the crude oil price of the Indian import basket has also increased since 2014-15 (PPAC 2019). There is thus a need for RIL and other Indian crude oil importers to mitigate the risks arising from the volatility in global oil prices and ensure uninterrupted supplies.

**Figure 3:** Coefficient of variation of the Indian basket’s crude oil prices.

Source: Author’s calculations based on PPAC (2019).
RIL expects that this partnership will insulate it from any future oil shocks and volatility in crude prices. Even in the absence of any discounts, a stable price regime, along with committed quantities, would reduce RIL’s risk. Crude supplies of 500 Kb/d represent about 40% of Jamnagar’s crude runs in 2018, significantly higher than the stake taken and twice as high as Aramco’s previous supplies (Wood Mackenzie 2019). These additional supplies would also help offset the decline in supplies from other heavy sour producers, namely Iran and Venezuela. According to RIL, “In the current volatile geopolitical world, where we can’t buy from Iran, Venezuela is in trouble. Here is someone sitting three and half days away, and they offer a bouquet of crude” (Livemint 2019).

**Sustainable financing of RIL’s growth strategy**

RIL has invested significantly in its refining and petrochemicals business over the past few years and expects this to significantly increase its efficiency. For instance, the complexity index of RIL’s Jamnagar integrated refinery has increased to 21.1, a remarkable jump of over 66% after the commissioning of integrated projects such as its refinery off-gas cracker, Para-Xylene expansion and petcoke gasifiers (RIL 2019). RIL’s 2018-19 annual report lays down its strategy for its O2C business going forward. It aims to increase its oil-to-chemicals ratio to more than 70% by gradually eliminating all road transportation fuels (gasoline, diesel) from Jamnagar’s refinery product slate. In the initial stage, the company aims to eliminate all refined products priced below crude for chemicals. Over time, with the increase in the use of electric vehicles globally and the consequent decline in demand for transport fuels, gasoline, alkylate and diesel will be purged, leaving only jet fuels and petrochemicals as outputs (RIL 2019).

![Figure 4: RIL’s net liabilities (June 2019) (billion US$).](source: Livemint 2019.)
This transformation aligns well with the growth in India’s polymer demand. India is the world’s fastest growing polymer market and the second largest only to China in Asia (BOBCAPS 2019). This growth is driven by rising disposable incomes, growth in the e-retail sector, and rising demand from infrastructure sectors. Polymer demand from newer applications, such as in the automobile and appliance sectors, is expected to add to this growth. Financing this transformation would entail setting up 40-45 metric tonnes per annum of petrochemical capacities at a capital expenditure of ~$30 billion over ten years (BOBCAPS 2019). Thus, a stake sale is imperative, considering RIL’s investment aspirations for its O2C strategy.

Another strategic objective of RIL is to become a zero-debt company by March 2021 (RIL 2019). In June 2019, RIL had a net liability of $36.9 billion, with the refining and petrochemicals business accounting for about $5.6 billion of this, according to analysts at Jefferies India (Livemint 2019). The Aramco investment reduces RIL’s current net liability by some 40%, excluding any new investments. RIL is also working toward carving out three independent companies from its different businesses, making itself a holding firm for these entities — O2C, Jio (in telecom) and retail.

Other forays

Both Aramco and RIL have other partnerships in India that seek to deepen their involvement in growing the Indian energy market.

By RIL

RIL has had a long-standing partnership with BP since 2011, when BP invested $7.2 billion for a 30% stake in a number of exploration and production blocks in India. Until now, this is the largest foreign direct investment in India. Going forward, RIL and BP are jointly investing $6 billion to monetize 3 trillion cubic feet of already discovered deepwater gas fields off the east coast of India. In addition, RIL is selling a 49% stake in its fuel retailing business to BP for just under $1 billion (RIL 2019).

By Aramco

Saudi Aramco has already committed to a stake in a 1.2 MMb/d downstream project being jointly built by the Indian Oil Corporation, Hindustan Petroleum Corporation and Bharat Petroleum Corporation, all Indian state-run refiners. Aramco and the Abu Dhabi National Oil Company (ADNOC) have signed an initial agreement to take a stake in this project. Aramco and ADNOC will supply half of the crude oil required for the proposed refinery due to be in place by 2025.

However, the project has faced delays in land acquisition and environmental clearances. These delays have also resulted in the project’s cost rising from $44 billion to $60 billion, perhaps prompting Aramco to look for alternative investment routes. With a downward revision in oil demand forecasts, it is also likely that the project capacity will be lowered. India currently has a refining capacity of just under 5 MMb/d and consumes 5.2 MMb/d (BP 2019).
Conclusions

The change in global oil trade patterns is likely to challenge incumbent exporters, especially in the Middle East. As energy demand centers move to the east, and growth is dominated by new and emerging markets such as India, Aramco will have to continue to move away from its traditional markets in the Atlantic basin to Asia. Here, the disruption to Iranian supply caused by the U.S. sanctions targeting the country and the decline in Venezuela’s production provide a window of opportunity for Aramco to capture a larger share of the Indian market. In this context, the proposed partnership with RIL in its O2C business is timely and should yield great value to Aramco. RIL also provides a stable entry point for Aramco and at a scale that would be able to offset declines elsewhere in global oil demand.
References


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