PORTLAND MARKET REPORT

IN 2014, THE UK OIL & GAS INDUSTRY DIRECTLY AND INDIRECTLY SUPPORTED 450,000 JOBS IN THE UK

February update

In two separate Fuel Oil articles last year, Portland looked at both the Canadian oil sands and the biofuels industry to investigate how both these sectors were suffering because of low oil prices. Almost a year later and nothing has fundamentally changed for these two industries – prices remain low and most players are operating at negative margins. But despite this, both the oil sands and the biofuel industry continue to show resilience in the face of adversity. The oil sands have successfully managed to keep the oil flowing through innovative long-term contractual arrangements with US refineries and the biofuel producers have been enjoying high prices on their Renewable Transport Fuel Certificates. The "RTFCs" have offset the commercial pain in selling relatively expensive biofuels, when compared to lower priced straight-run petrol and diesel (neat biofuel costs circa 50 pence per litre (ppl), whilst neat petrol/diesel is trading around the 20ppl mark).

Unfortunately for another hard-hit sector – the UK offshore industry – such alleviating "good fortune" is in short-supply and the low oil price continues to generate unremitting doom and gloom. To some extent, the woes of the North Sea are purely part of the worldwide firestorm that is facing those involved in oil exploration. Consider some of the figures; Schlumberger and Haliburton – the two largest oil field service companies – have already laid off 55,000 jobs between them in the last 12 months and still further job cuts are expected. Investment by the oil majors is massively down; Exxon-Mobil have cut investment by $7.5bn for the coming 12 months, BP by $10bn, British Gas the same amount and Shell by $15bn. And the previous darling of the offshore industry – Brazil's Petrobras – currently being battered by both falling prices and corruption scandals, have announced an enormous $32bn reduction in capital expenditure for 2016.

Sadly though, there is more to the problems of the North Sea than just being a victim of the worldwide slump in oil prices. Rapidly declining production from ageing oil fields and a skilled workforce that is rapidly jumping ship to other parts of the world (or even other industries) sum up the problems faced. Equally, where new fields are being discovered in the North Sea, (Alvheim, Johan Svedrup), they tend to be located in Norwegian waters. The majority of British oil fields date back to the 1970s, meaning that increasingly difficult and innovative (read costly) exploration techniques are required to maintain satisfactory production yields. No amount of innovation however, can hide the fact that production in the UK North Sea has been declining since the late 1990s (when production peaked at 5m barrels per day), so that today less than 1m barrels per day (bpd) is being produced. That is a massive drop in a relatively short period of time and most tellingly, it is a reduction that has largely taken place in a high-price oil environment, that is, the decline started long before the current price crisis engulfing the industry. So arguably the current low oil price merely puts further pressure on an already ailing patient and is possibly simply going to hasten the inevitable end.

The catastrophe facing the UK offshore industry is also a catastrophe for the UK Treasury. In certain years, this traditional economic stalwart of UK plc, has accounted for almost 20% of all corporate tax raised in the UK and since the 1960s, it has generated over £300bn for the Exchequer. Having been as high as £10bn in 2010, tax revenue on UK Oil & Gas is expected to be only £150m this year, based on current oil price levels. That's a £9.85bn per annum drop in revenue for a Government that is still chasing the dream of reducing its deficit. Such low revenues would also by the way, blast a big hole in the spending plans of a newly created Scottish State, had they voted for independence in 2014 (particularly when you consider the current national budget of Scotland is circa $40bn). And then there are jobs. In 2014, the UK Oil & Gas industry directly and indirectly supported 450,000 jobs in the UK. Latest figures show a drop in employment of circa 75,000 across all offshore sectors – a figure much higher than the job losses being experienced in the UK steel industry, but news that has received considerably less fanfare.

These really are tough times for the upstream oil industry in the UK and with volumes below 1m bpd (vs 13m in USA, 10m in Saudi, 9m in Russia and even 1.5m in Norway), North Sea oil production in the UK could genuinely slip off the oil producing map. This would be huge news for Britain, but the emotional truth is that the loss of North Sea oil would make no odds to a world already drowning in over supply. If we can take any comfort in the situation, it is that the industry has survived low prices before and then come back stronger. Plus, Aberdeen is now a world leader in so many more areas than simply oil extraction. Centres of technical excellence abound in all things offshore, be they in wind-power, pipelines, cables, communications, seismic surveys, transportation and the grandest paradox of all – in rig decommissioning! In fact, if this is to be the beginning of the end for North Sea oil production, then the greatest projects arguably lie ahead, because decommissioning of oil rigs will require billions of pounds and years of work. As the first developed economic country to deal with large-scale rig decommissioning on a grand-scale, it would be entirely logical for this expertise to be successfully exported around the world. So let's not write off the granite men and women of Aberdeen just yet…

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For more pricing information, see page 22

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