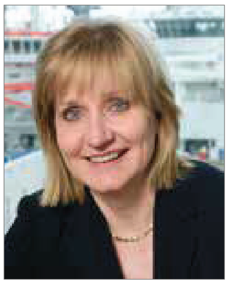
UKCS boosts competitiveness in response to investment challenge



By Deirdre Michie,
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Next year, the UK offshore oil and gas industry celebrates a significant anniversary. In March 1967, first gas landed from the West Sole field off the North Humberside coast, marking the beginning of 50 years of successful oil and gas production from the UK Continental Shelf (UKCS) and one of the country's greatest industrial stories.

The industry has demonstrated great enterprise over the intervening period, overcoming often major physical and economic challenges to recover 43 billion barrels of oil and gas from a hostile offshore environment which pushed innovation and the use of new technology to new frontiers. For over five decades, the sector's activities have attracted billions of pounds of investment to the UK, supporting hundreds of thousands of highly skilled jobs across the country. Development of the UKCS has underpinned the emergence of a world-class supply chain that exports goods and services around the globe. It has also contributed to the country's security of energy supply, currently producing half the UK's oil and gas needs and earning the Treasury billions of pounds in tax revenues – at the last count, a total of over £330 billion in today's money.

But today, the UK offshore oil and gas industry stands at a critical juncture. Appreciating an oil price in excess of US$100 per barrel, companies across the sector have since had to deal with a sharp drop to an average of US$41 per barrel this year. Capital investment in the basin is forecast to fall to around £9 billion in 2016 from its peak of £14.8 billion in 2014. There is very little drilling activity taking place and with expenditure rapidly declining few new development projects proceeding. The supply chain has been particularly impacted. Companies have suffered a decline in revenues of almost 30 per cent on average over the last two years; for some sectors the decline has been even greater. The personal impact has been great and the industry is expected to support 120,000 fewer jobs in 2016 than it did two years ago.

Industry drive to cut operating costs on rigs like these in Scotland's Cromarty Firth

The UK's decision to leave the European Union adds an additional dimension of complexity for many of our members in the already testing business environment. In the short term, we see three main challenges: distraction from managing our way through the downturn; a loss of positive influence over ongoing and future policy development in Brussels; and uncertainty, making it difficult for our members to make longer-term investment decisions. In addition, the ability to access the EU market for our goods and services could become more difficult, unless appropriate provisions are made to facilitate ongoing trade and maintain access to the energy market.

Yet, the industry's response to today's difficult market conditions demonstrates once again the measure of its tenacity. A year ago, many expected prices to recover in 2016. Twelve months on, the perception of future price growth has changed significantly and companies are now positioning themselves to survive and succeed in the "lower for longer" oil price environment.

Although both economic and political turbulence may not yet be over, Oil & Gas UK's recently-published Economic Report details the efforts that are being made by the industry in managing its way through the downturn, with a view to positioning itself to make the most of any potential upturn.

Sustainable cuts in costs

The industry's focus has increasingly turned towards delivering efficiency improvements. Oil & Gas UK's Efficiency Task Force (ETF) has acted as a catalyst to encourage a pan-industry review of business processes, standards, cultures and behaviours. The efficiency push by companies across the industry and the ETF have been key drivers behind the anticipated 45 per cent fall in unit costs from their peak of US$29.30 per barrel in 2014 to around US$16 per barrel this year. As the report illustrates, such significant gains would not have been realised through natural cost deflation alone, offering some reassurance about the sustainability of the improvement to the long-term health of the business. Lower unit costs have enabled some fields to continue operations that might have otherwise been uneconomic.

While some of the giant fields of the past, such as Brent, are now being decommissioned, there has not been as widespread a rush to cease production on the UKCS as might have otherwise been expected.

The recent improvement in UK production is testament to what can be achieved when the basin's competitiveness is addressed and attention is focused on unlocking new developments. Major production efficiency gains in existing assets, coupled with a raft of important oil and gas projects that have come on-stream over the past two years, resulted in a 10.4 per cent increase in production last year, the first upturn in 15 years – a trend forecast to continue in 2016.

There have also been fewer business failures than many expected, a tribute to the companies that have responded to the downturn by differentiating their value offering and diversifying both into new geographies and new products and services.

Looking ahead, many challenges still remain for this sector and the actions we are taking will help to determine the future of the industry. Provided cost and efficiency improvements continue and commodity prices hold up, revenues may begin to increase in 2017 across the supply chain.

However, we cannot expect a viable future if we fail to build on past investments. The lack of new development projects must be urgently addressed if we are to avoid a repeat of the sharp production decline that dominated the early part of this decade. While costs have fallen significantly, efficiency has increased, and the fiscal regime has been improved, many potential investors are unable to access the finance they require to develop assets.

The rate of exploration drilling has to improve and be more successful. This aim is being assisted by a £40 million government-funded acquisition of seismic data from areas around the Shetland Isles, South West Britain and in the Central North Sea. Encouraging all forms of drilling, including development, over the next 12 to 18 months will be vital for the industry's future. We must also begin to tap into the opportunities offered by the undeveloped small pools that have remained on the shelf for many years.

Maximising the economic recovery of the remaining barrels requires the continuation of a constructive and highly focused partnership between government, the industry, the Treasury and the Oil and Gas Authority. With a new industrial strategy forthcoming, the oil and gas supply chain must be recognised alongside the likes of the aviation, aerospace and automotive sectors as vital components of the UK economy.

With the right frameworks and market conditions, Oil & Gas UK believes that many more billion barrels may yet be recovered and that, with 50 years of history behind us, our industry story has still many chapters to unfold over the decades to come.