OGUK

BUSINESS OUTLOOK 2021

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BUSINESS OUTLOOK 2021

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Foreword

This year's *Business Outlook* is published one year on from the first UK lockdown to prevent the spread of COVID-19. At that time, few could have envisaged the scale of the impact that the pandemic would have on all our lives. However, the success of the vaccination programme means that a more positive outlook is beginning to evolve for our industry, for the economy and for society as a whole.

Although necessary from a public health perspective, the shutdown of many parts of the global economy resulted in a dramatic collapse in oil demand, which fell to levels last seen more than 25 years ago, and a consequential plunge in oil prices. Combined with the initial failure of OPEC+ negotiations to bring balance to the market, the outcome was the lowest real-terms annual Brent price since 2003. Alongside pressure to balance sheets, companies have had to manage the challenges associated with ensuring safe offshore operations and risks to investments due to the pandemic.

Our report shows that whilst there are increasing signs that global energy demand will begin to slowly recover as economies unlock, most companies in our industry remain in a fragile state, with this downturn coming so soon after the previous one that impacted the global oil and gas sector. Thousands of UK jobs are likely to have been lost in the sector as a result of constrained operations, and the £3 billion of capital investment deferred from company plans in 2020 and 2021.

The impact of this on offshore activities is clear, with drilling activity falling by half and some of the lowest levels of new project approvals on record, as companies responded to the price collapse and reduced offshore personnel levels by around one-fifth to help manage COVID-19 exposure risk. Overall the industry spent 23 per cent less last year — a fall of some £3.4 billion.

The effects of the activity and expenditure reductions have been felt sharply in all parts of the sector and particularly severely by the supply chain. This is also a really challenging time for many of our people and their livelihoods, with unemployment rates increasing, especially in the regional oil and gas hubs across the UK. While the Job Retention Scheme has been very helpful, many businesses have still had to reduce their workforce numbers given the lack of short and longer-term activity in the sector.

The ability of our sector to recover, and its pace, remain an ongoing concern and therefore it is essential that we work closely with the UK and Scottish Governments and our regulators to build a sustainable recovery on the road to a net-zero future. This year is likely to remain highly challenging, as companies continue to navigate the operational issues associated with the pandemic, including the safe increase of offshore personnel levels, whilst repairing their finances. It will take time to see activity pick up as companies adapt to such unprecedented market challenges.

Nevertheless, there are some encouraging signs emerging that reflect the continued quality of opportunities on the UKCS. Investors are still being attracted, with close to £2 billion of new acquisitions taking place already this year. Moreover, the totality of reserves and resources being targeted on the UKCS has not been undermined by the downturn, despite the challenges faced by the industry.

We continue to provide the energy that fuels the economy and we should rightly be proud of the contribution and resilience of our key workers, who have safely sustained the delivery of secure and affordable energy throughout the pandemic. Oil and gas provide three-quarters of the UK's energy needs, and domestic production was enough to meet 70 per cent of UK demand last year. As we progress through the energy transition, it is expected that oil and gas will still need to provide more than half of total cumulative energy that will be consumed in the UK over the next three decades. Meeting as much of this demand as possible from domestic resources is the right thing to do from an environmental, economic and societal perspective.

In making the journey to a net-zero future, the sector has committed to ambitious emissions reduction targets in the recovery of oil and gas from the North Sea. In addition, the industry has a pivotal role to play in helping the wider economy decarbonise through the deployment of carbon capture and storage (CCUS) and hydrogen.

In the year when COP26 will highlight the opportunities and challenges we all face, it is clear that this industry can lead the way and do so sustainably and at pace.

The emerging North Sea Transition Deal is a catalyst for industry's plans to realise its full potential through the energy transition, as set out in Roadmap 2035. Under a new partnership with government, it will provide the framework to help unlock new investment, reduce emissions and importantly, create new employment and supply chain opportunities, building on the resources of the North Sea.

The sector continues to face huge challenges, but however difficult they are to overcome, they are surmountable. Through collective working and shared commitment from industry and government, with the North Sea Transition Deal at its core, we can build a sustainable recovery and help to deliver the climate change ambitions of the UK.

Deirdre Michie OBE
Chief Executive, OGUK

UK Oil and Gas Industry – Performance and Outlook

Oil market

The Brent spot price averaged $41.9/barrel (bbl) in 2020, around 35 per cent lower than the 2019 average of $64.3/bbl and 43 per cent below the average over the last 20 years ($73.9/bbl). This was the lowest real-terms Brent price since 2003. In addition, last year also saw some of the most volatile market conditions on record. The price spread within the year was over $61/bbl — almost three times higher than that of 2019 — with the spot price at one point falling below $10 and front-month futures below $20. This was mainly driven by a record fall in demand following COVID-19 restrictions, and uncertainty with regards to supply following the collapse of OPEC+ discussions in March.

There is greater optimism emerging around the forward price outlook, with significant gains towards the end of 2020 and into 2021. Prices during January and February 2021 averaged $58.5/bbl, increasing to above $70 in early March. This trend is mainly centred on expectations that the global vaccine roll-out will lead to continued demand recovery and a tighter supply balance. However, it is anticipated that the post-COVID demand growth trajectory will be slower than pre-pandemic expectations, and many scenarios suggest it may never return to 2019 levels. In line with this uncertainty, there are a wide range of views as to how the Brent price will develop throughout 2021, although most lie between the $55–65/bbl range.

Demand outlook

Global oil demand fell by nearly 9 million barrels per day (bpd) in 2020 to the lowest level since 2014, as countries took action to restrict the spread of COVID-19. These restrictions resulted in lower economic and industrial output and significantly reduced transport demand. In April 2020, demand levels were as much as 25 per cent down year on year, to rates last seen in 1995. Demand is expected to return to growth this year, with record year-on-year increases anticipated, although this will not be enough to mark a return to pre-pandemic levels. The International Energy Agency (IEA) forecasts demand of 97.7 million bpd, with a return to pre-pandemic rates unlikely until later in 2022.

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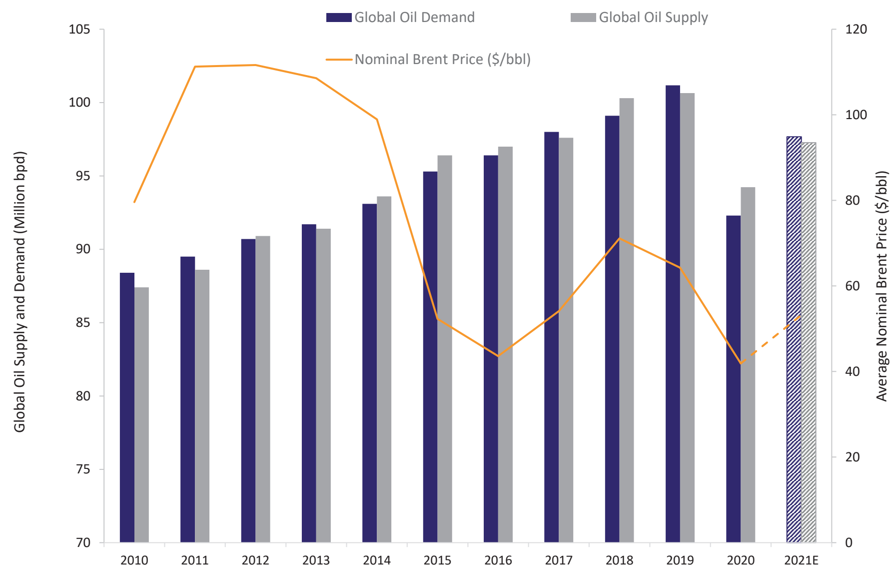
UK Oil and Gas Industry – Performance and Outlook (continued)

Supply outlook

Supply fell at a lower rate than demand last year, with a 6.4 million bpd decline — largely the result of cuts imposed by OPEC+ members and other major producers (including Norway). This led to significant oversupply in the market, especially during spring and early summer. The continued influence of OPEC+ decisions was underlined in early March this year when the bloc agreed to maintain production restrictions, leading to prices spiking above $70/bbl. The US Energy Information Administration (EIA) anticipates that global supply will increase to 97.3 million bpd this year, with a further rise to over 100 million bpd in 2022 — up from 94.2 million bpd in 2020. Yet concerns persist around the fall in investment and the ability of supplies to respond at the same rate as demand. This may lead to a tighter market and result in faster price growth.

Figure 1: Average Brent Price and Global Oil Supply and Demand



Source: IEA, EIA

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UK Oil and Gas Industry – Performance and Outlook (continued)

Gas market

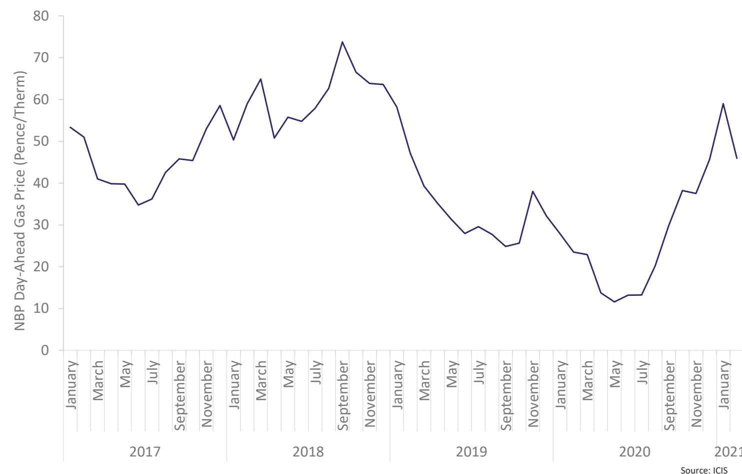
The NBP day-ahead gas price averaged 24.9 pence per therm (p/th) in 2020 — 28 per cent lower than 2019 prices (34.7p/th) and 46 per cent lower than the 20-year average (46p/th). This was the lowest real-terms annual average price since 2002. There has, however, been upward price movement towards the end of 2020 and into 2021, over and above what would normally be expected in seasonal swings.

OGUK estimates that UK gas use fell by around 7 per cent in 2020, mainly as a result of reduced industrial activity and demand within the service sector. Although this was affected by the pandemic, it marks a continuation of the generally declining demand profile in the UK, which has fallen by 22 per cent between 2000–19.

The evolution of UK gas supplies has also affected pricing, especially in late 2020 and early 2021. LNG imports in 2020 were in line with 2019 levels, however when combined with lower demand, its overall share has increased to 25 per cent, up from 23 per cent in 2019 and just 9 per cent in 2018 and 2017. This has increased the UK's exposure to the global gas market, which has acted to drive up domestic prices in recent months as rising demand and higher prices in East Asia have drawn more LNG supply shipments, impacting potential UK supply.

Maximising the proportion of UK demand that is met from domestic resources will help limit exposure to global trends and help to reduce overall carbon emissions, with domestic production having a lower footprint than LNG imports.

Figure 2: Monthly NBP Day-Ahead Gas Price



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Industry Sentiment

The extreme challenges and uncertain climate were reflected in levels of sentiment expressed by OGUK members in 2020. Although some signs of optimism were beginning to emerge in late 2020 and into Q1 2021, it is clear that this year will continue to be challenging for the industry.

Higher sentiment has mainly been driven by improved commodity prices and optimism that this could lead to increased cash generation and, subsequently, greater investment and activity levels. However, this trend remains fragile and OGUK believes it will take time for this to translate into new project approvals and fresh demand for the supply chain to meet. It is therefore unsurprising that sentiment levels expressed by E&P companies have been improving at a faster rate than those of contractors, though both remain low.

Figure 3: Business Sentiment Trends

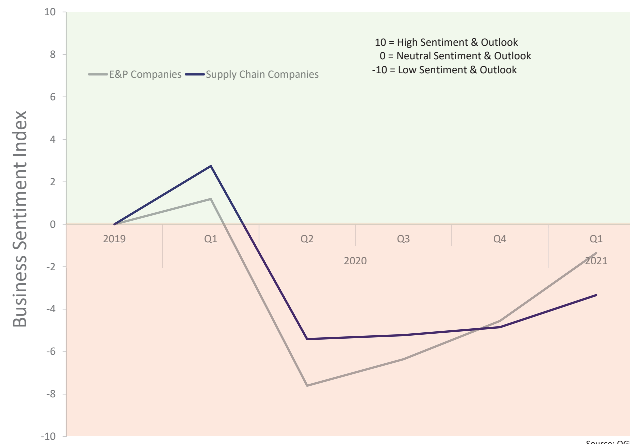
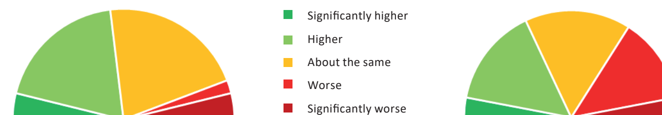


Figure 4: Supply Chain and E&P Sentiment



Source: OGUK

E&P Expenditure and Investment

£11.6 billion was spent on the development and operation of UKCS oil and gas resources and infrastructure in 2020. This is 23 per cent lower than in 2019 (£15 billion) and the lowest total expenditure since 2004 (in real terms), as E&P companies reduced activity and investment in response to COVID-19 safety and operational requirements and sought to conserve cash in unprecedented market conditions. OGUK anticipates that, although total expenditure will remain constrained in 2021, a slight increase is possible, with spend expected to be between £11.4–12.4 billion.

Despite the challenges faced by the sector, the Office for Budget Responsibility (OBR) forecasts that net production tax payments will still amount to £300 million in the financial year 2020–21, adding to contributions of more than £41 billion since 2010 and almost £360 billion since 1970 (in real terms). This tax take represents more than 55 per cent of the total cash flow generated from UKCS production to date. Looking forward, the industry is predicted to contribute a further £1.7 billion in net receipts to Treasury through to 2026.

The basin has continued to demonstrate that it is an attractive investment proposition to a range of investors. Data from Rystad Energy show that more than 600 million barrels of oil equivalent (boe) of potential resources were traded in 2020, with a value of over £1.5 billion, while over 1 billion boe was traded in 2019, at a value of almost £5 billion. So far in 2021, NEO Energy has acquired Zennor Petroleum and the majority of ExxonMobil's UKCS portfolio. In addition, EnQuest has acquired Suncor's stake in the Golden Eagle field, Waldorf Production has purchased Cairn Energy's stakes in the Catcher and Kraken fields and DNeX has significantly increased its shareholding of Ping Petroleum. These transactions represent almost £2 billion of trading activity and 330 million boe of potential resources.

Deals such as these have transformed the E&P investor landscape in the basin in recent years. OGUK expects this trend to continue, as a number of assets and prospects are actively being marketed to investors. Ensuring that resource opportunities are in the most appropriate ownership to increase their chance of progression is key to maximising the potential of the basin and providing new demand for the supply chain. Likewise, expectations of long-term stable regulatory and fiscal regimes are a prerequisite to attract inward investment.

E&P Expenditure and Investment (continued)

In total, around £725 billion has been spent by the industry (before tax) since 1970 and OGUK is aware of more than £150 billion of potential further spend in company plans over the next 20 years, two-thirds of which has the potential to be spent by 2030. This expenditure spans the full oil and gas lifecycle, from exploration through to decommissioning, and includes a range of development opportunities with varying probabilities of progression. Much of the remaining resource opportunities tend to be more technically and economically challenging than those which have already been realised. Resource prospects are generally smaller and more complex and the UKCS is now an increasingly marginal cost environment. However, there is real value to be captured across the industry if the correct frameworks are in place.

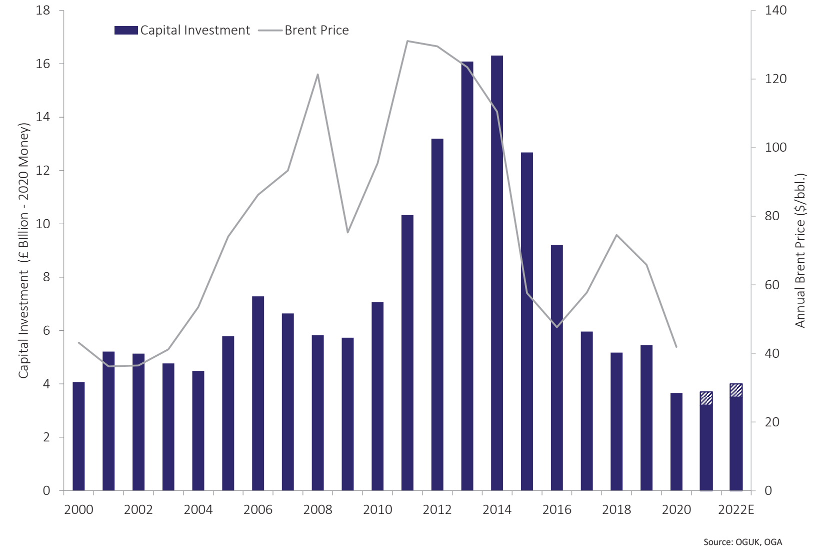
A loss of focus from governments on the importance of making the most of our indigenous resources, or any other barriers to business investment, could mean that this potential is lost without any wider economic or environmental benefit. It is important that this is recognised in the ongoing government review of the offshore oil and gas licensing regime. This is also important in the context of the transition to net zero — a strong domestic oil and gas industry is required as the foundation for companies to pivot their capabilities towards net zero over time. If the UK does not keep pace with other regions then it risks losing out on investment across the energy landscape, this could result in the loss of critical supply chain resources to areas where activity levels may be accelerating quicker.

Capital Investment

The level of capital invested in the basin typically follows commodity price trends, with periods of higher prices associated with the UKCS' ability to attract greater levels of investment. During such times companies benefit from greater levels of cash generation and look to sanction projects which may have more challenging economics at lower prices. Declines in investment have generally lagged the onset of price falls by 12–24 months, however the dramatic nature of the 2020 price crash coupled with the relatively low level of new investment approvals in recent years, has led to a sharper and faster investment decline.

Prior to the impact of the COVID-19 pandemic, with stable market conditions expected, it was anticipated that capital investment in 2020 would be in the region of £5–5.5 billion, similar to 2019 levels. However, this fell to £3.7 billion last year as a result of activity deferrals and cancellations — a decline of 33 per cent. An immediate rebound is not expected in 2021, and capital expenditure is anticipated to remain between £3.2–3.7 billion. Companies continue to face a range of pressures such as investor confidence, rebuilding balance sheets, challenges in safely increasing offshore personnel levels, changes to regulatory and policy frameworks and work to incorporate net zero considerations into projects.

Figure 5: Capital Investment versus Brent Crude Price



Capital Investment (continued)

OGUK now estimates that in the region of £3 billion of previously expected capital investment has been deferred in 2020 and 2021. It should be reminded that the impact on the UKCS is not unique, and the decline seen in 2020 was broadly in line with global trends, with the IEA estimating a global fall in oil and gas investments of around one-third.

Only two new projects were approved for development by the OGA in 2020 — Wintershall's Sillimanite field and IOG's SNS cluster development of the Blythe, Elgood and Southwark fields. The progression of these projects is a positive sign amidst challenging market conditions, although it should be noted that this level of annual project approvals is amongst record lows in the basin and will affect the near-term production outlook.

There are significant opportunities under consideration for approval in 2021 and 2022, many of which have been deferred from 2020. Combined, they would bring more than £5 billion of new investment, however their delivery remains contingent on the evolution of market conditions and continued support from all industry stakeholders and regulators. The progression of these projects could result in overall investment levels increasing to a potential £4 billion in 2022, and a forward profile of around £3 billion per year through to 2025 — slightly above pre-pandemic estimates and marking a modest recovery in activity levels.

These projects would bring important new prospects for supply chain companies and, positively, several have already issued early-stage tenders and requests for information and proposals, although the impact of this is unlikely to filter through to the supply chain until 2022–23. While commodity prices have increased, the challenges that E&P companies continue to face could limit the pace at which projects move forward as companies look to ensure new investments and balance sheets are as robust as possible in what will continue to be a capitally constrained environment. Greater levels of collaboration with supply chain partners can help find new solutions to project challenges and unlock opportunities and further value.

The investment landscape is evolving in line with the drive to net zero, affecting all sectors of the economy — including energy. The increasing focus on sustainable finance, and environmental, societal and corporate governance (ESG) reporting provides an opportunity for businesses across the sector to showcase how they are evolving their operations, strategies and business models in line with net zero. Continuing to be on the front foot in this regard can help the energy industry secure access to new sources of finance (see overleaf).

Future Investment Trends and Considerations

What is sustainable finance?

Sustainable finance is the process of taking due account of ESG factors when making investment decisions. The impact of this can lead to an increased focus on sustainable economic activities and projects. This is widely driven by the private sector, however in recent years there has been increased focus from the public sector and government to create platforms that enable the redirection of finance to key areas. OGUK expects this focus to continue to grow as per government policy and drivers.

What is ESG reporting?

There has been a growing focus from investors on reporting of ESG metrics and alignment with UN sustainable development goals. In particular, this has centred on environmental impacts of business operations in the context of net zero and the pandemic impact on social risks. Attention to ESG reporting has been driven by changing investor appetite in recent years and is an increasingly common element in many of the industry's financial reports.

What are the key trends in these areas?

For the sector, the focusing of investor expectations particularly regarding environmental factors creates an audience to showcase their ongoing commitments and progress towards emission reduction targets, outlined as part of Roadmap 2035. Whilst securing investment continues to be at the discretion of the investor, industry has been engaging in a cross-sector taskforce to produce a set of guidance on common metrics to suit user and issuer expectations.

In response to the growing sustainable finance appetite, significant growth has been seen in investment products such as green bonds, sustainability bonds and sustainability-linked bonds (GSS bonds). Moody's estimated that GSS bonds reached record levels in 2020, to $491 billion in issuances, with expectations of an increase to $650 billion in 2021. This growth has been attributable to a heightened focus on environmental and social risk, along with actions implemented by stock exchanges and an increased offering of green finance vehicles. In 2020, the London Stock Exchange also announced it would be recognising sustainability-linked bonds, suggesting this growth is set to continue over 2021 — particularly in the run-up to COP26.

This is echoed in the growth of the greening financial instruments on the market today, in particular sustainability-linked bonds (SLBs). SLBs which are issued by the International Capital Markets Association (ICMA) are a form of ESG-responsible bonds which include financial and structural features depending on the ability to meet pre-set ESG objectives. SLBs are regarded as a key step in elevating sustainability issues to the heart of the business ensuring sustainability is engrained in company strategy and economic growth. It is anticipated that these bonds will continue to grow in occurrence and value, as the focus on environmental and social factors grows.

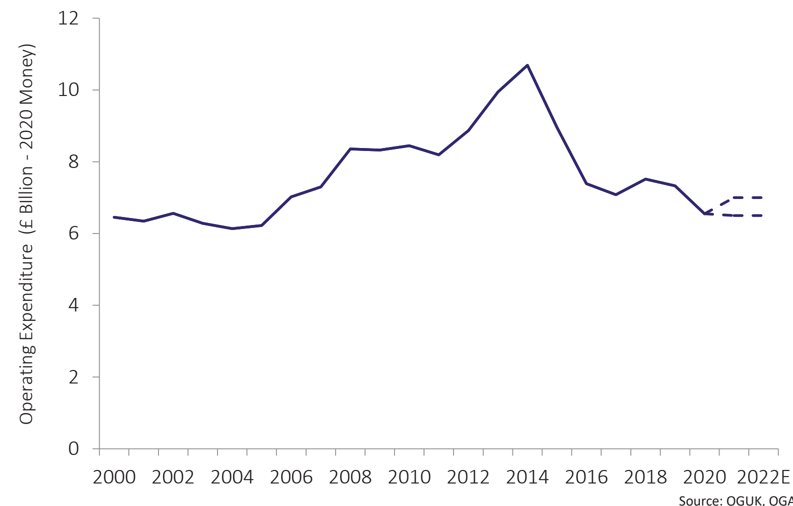
Operating Expenditure

There was a 10 per cent decline in operating expenditure in 2020 to £6.6 billion (compared with £7.3 billion in 2019), as companies deferred some offshore activities and reduced offshore personnel levels by around one-fifth to reduce COVID-19 exposure risk. It is anticipated that operating expenditure will remain in the region of £6.5–7 billion in 2021 and 2022.

The fall in expenditure pushed unit operating costs (UOCs) down to £11.15/bbl ($14.20) in 2020 — the lowest level since 2010. With Brent crude averaging roughly $42/bbl across the year, this is equivalent to over one-third of the per-barrel price, similar to that in 2016 and significantly higher than the last three years — demonstrating the increased cost challenge faced by E&P companies.

E&P companies are focused on sustaining improved UOCs, which have fallen by more than 50 per cent in dollar terms and 45 per cent in pounds since 2014. Maintaining the cost competitiveness of the basin is critical to attracting new investment to the UKCS and helping to unlock more marginal opportunities as the basin matures. An openness to embracing new technologies and new, innovative, ways of working across the industry will help with this.

Figure 6: UKCS Operating Expenditure



Source: OGUK, OGA

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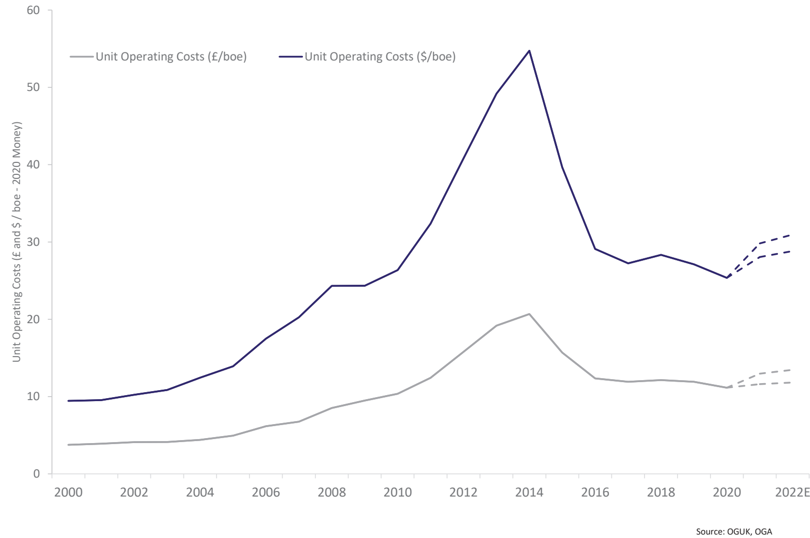
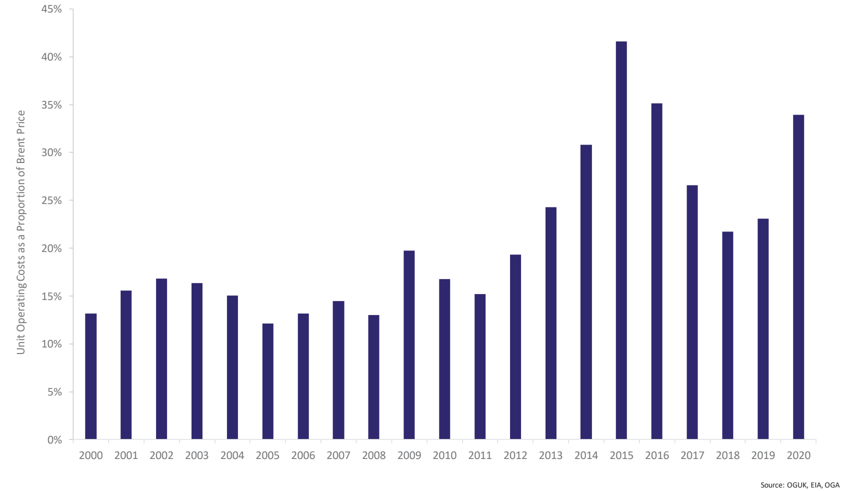
Operating Expenditure (continued)

Figure 7: Unit Operating Costs – Actual and as a Proportion of Oil Price



Source: OGUK, OGA



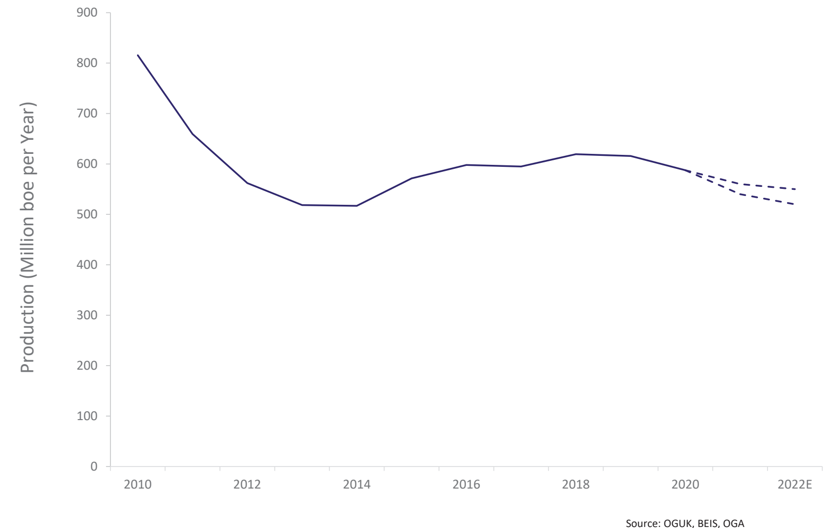
Source: OGUK, EIA, OGA

Production and Reserves

The industry produced just over 587 million boe in 2020 (1.61 million boepd), equivalent to an estimated 70 per cent of the UK's total oil and gas demand last year and more than 45 per cent of total energy demand.[1] Overall, production was 5 per cent lower than in 2019 (just under 616 million boe), with oil output falling by 7 per cent (from 403 to 375 million boe) while gas remained stable at a less than 1 per cent decline (from 213 to 212 million boe). This level of performance reinforces the resilience of the sector, given the scale of the challenges faced by offshore operations. Through the hard work and commitment of many people, the basin has continued to provide the UK with crucial energy security throughout the pandemic. At present, OGUK expects that production will decline further in 2021 and 2022, with a fall of between 5–7 per cent anticipated per year. This reflects lower levels of recent brownfield and greenfield investments and the anticipated impact of increased planned maintenance outages deferred from 2020, including that of the Forties Pipeline System in May and June.

It is likely that following recent increases, the basin is entering a period of longer-term production decline and a steady stream of investment in new fields is required to ensure the effective management of decline rates. Around one-third of production in 2020 came on-stream after 2015, while the wave of new production start-ups from investment commitments made earlier in the decade is now coming to an end.

Figure 8: UKCS Production Output



Source: OGUK, BEIS, OGA

[1] Final demand statistics not available at time of publication – OGUK estimates used for Q4 2020

Production and Reserves (continued)

OGUK expects that up to eight new fields will commence production in 2021. These projects have the potential to produce 250 million boe throughout their lives and peak output of around 130,000 boepd. However, lower rates of new investment in recent years will result in less production coming on stream in the upcoming period. New fields gaining regulatory approval in 2020 unlocked just under 40 million boe of new resources — less than one-third of approvals in 2019 and 85 per cent lower than 2018.

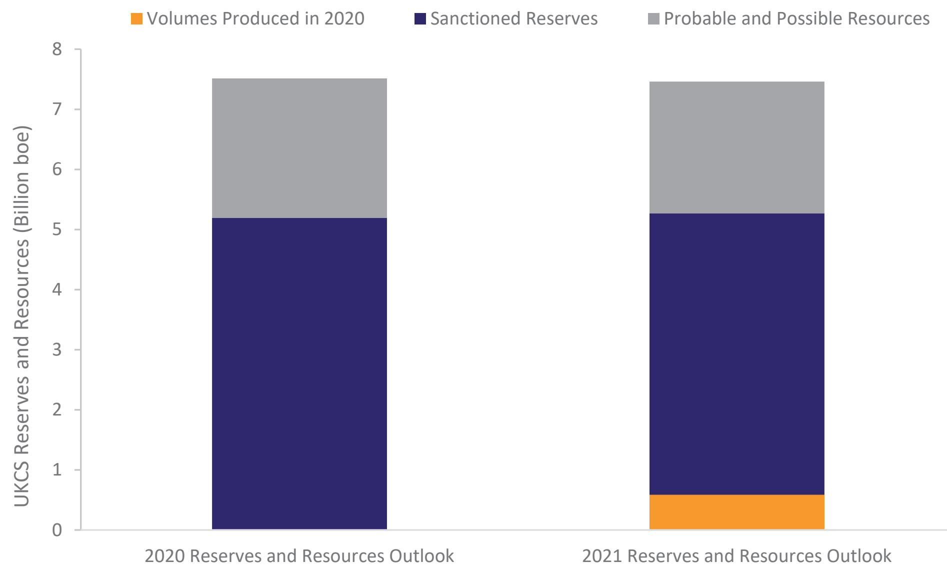
There are a range of opportunities being considered for investment approval in 2021 and 2022, but they are contingent on greater market stability and continued regulatory and government support. These projects could unlock in the region of 700 million boe over their life and therefore represent a significant opportunity to help manage the basin's production profile and contribute towards security of UK energy supplies, but it will be the middle of the decade before they begin to make a significant contribution to UKCS output.

Production and Reserves (continued)

Projects associated with almost 7 billion boe of reserves and resources were included in company plans at the beginning of this year, 2.2 billion of which are considered to be probable or possible developments. The volume of sanctioned reserves has decreased by around 520 million boe since the beginning of 2020, reflecting last year's production and the progression of some new greenfield and brownfield resources. While this highlights the lack of new project commitments in 2020, importantly, it also indicates that there has been no significant loss of potential resources from the basin, despite the challenges faced. Opportunities which were not progressed last year remain under consideration in company plans and it is therefore vital that all parts of the industry work constructively to ensure they go on to be developed.

OGUK is actively working alongside North Sea Transition Forum taskforces (previously called MER Taskforces) to promote increased resource progression activity and unlock additional value across the basin, in tandem with work by OGA and industry on area planning which is also having a positive impact on unlocking new resources.

Figure 9: UKCS Reserves and Resource Progression



Source: OGUK, OGA

Drilling and Wells Activity

Seventy-one wells began drilling on the UKCS in 2020 — half the levels seen in 2019 — as companies deferred and cancelled activities to preserve cash and reduce operational risk. The activity that took place included:

7 exploration wells

The lowest since 1965.

Nevertheless, there are reports of some successes in those which were drilled, including the Isabella well (operated by Total E&P)[2] and the Losgann well, operated by Apache in the Beryl areas.[3]

2 appraisal wells

The lowest since 1970.

This includes the much-anticipated appraisal of the CNOOC-operated Glengorm discovery, which at an estimated 250 million boe[4] was the largest UKCS discovery for a decade.

62 development wells operated by 14 companies

The lowest activity levels since 1976.

Half of these were sidetrack wells, in line with levels seen in 2018–19. However, this is significantly higher than between 2015–17 when 35 per cent of wells were sidetracks. This is evidence of fewer new development projects progressing in recent years and indicates that companies are looking to maximise field potential by making the most of available well slots.

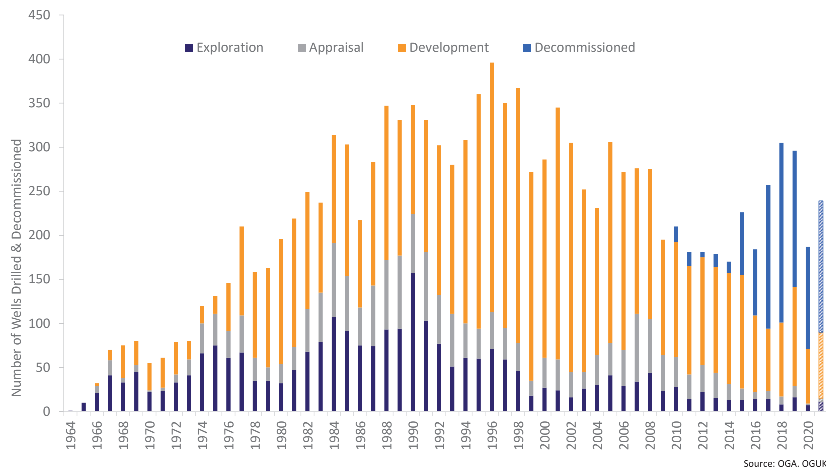
2 https://www.energyvoice.com/oilandgas/north-sea/268093/uk-exploration-record-low-westwood/

3 https://investor.apachecorp.com/static-files/5603ad3c-8ece-4742-9e48-899cf30a382a

4 https://www.total.com/media/news/press-releases/uk-total-announces-new-discovery-north-sea

Drilling and Wells Activity (continued)

Figure 10: UKCS Drilling and Wells Activity



OGUK expects to see a modest increase in activity in 2021, with a further potential pick up in 2022. This would include expectations of 70–80 development wells, 10–12 exploration wells and 3-5 appraisal wells this year — similar to levels seen in 2016–18. These wells include a wide range of exploration prospects, ranging from relatively small infrastructure-led prospects to some potentially high-impact opportunities. Continued high-quality exploration activity is crucial, particularly in providing new resource progression opportunities to support security of supply and providing new throughput to sustain the viability of infrastructure that may be required as part of future net-zero developments.

As outlined in OGUK's *Decommissioning Insight 2020*, around one-third of well decommissioning plans were deferred last year. Whilst a recovery will take time, OGUK also expects to see an increase in these activities this year. This is likely to be followed by a further increase in 2022 as companies return to deferred plans. It is possible, however, that companies may look to advance some existing plans which may have been deferred to 2022–23, given the prospect of increased cash generation from improved commodity prices and capacity in the supply chain to complete the work scopes.

Drilling and Wells Activity (continued)

Despite some prospects of some increase in activity levels, market conditions are likely to remain significantly challenging for drilling and wells contractor companies this year. Data from IHS Markit indicate that current levels of semi-submersible rigs working on the UKCS are amongst the lowest rates on record (36 per cent utilisation). The number of contracted jack-up rigs has been slightly higher (50 per cent utilisation), but remains at low levels, with a number of units both warm and cold stacked. Utilisation rates for these rigs have consistently trended below 80 per cent since 2015, having typically been upwards of 80 per cent prior to that. These trends are also reflected in lower contracted day-rates.

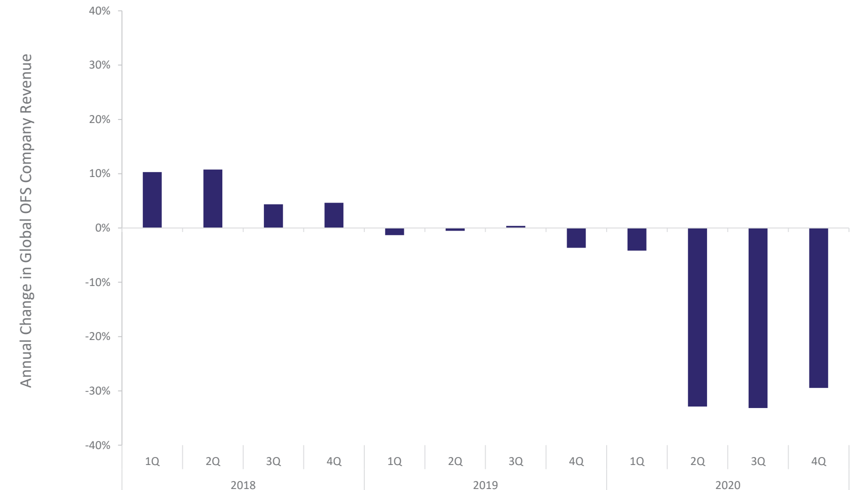
IHS does report a more optimistic rig outlook for 2022 as companies revisit work programs deferred during the pandemic, including well decommissioning campaigns, but the market will remain over-supplied. This is likely to lead to consolidation within the market as companies look to move some units to other regions or make decisions to scrap older assets.

Supply Chain Revenue and Margins

Activity deferrals and cancellations by operators, along with pressure to reduce costs, continue to have a significant impact on supply chain companies. Many companies invested in new resources and equipment pre-COVID with the anticipation of servicing projects which have subsequently not taken place and it will now take time for them to see a return on these investments. This is especially challenging for many companies given that overall revenue and margin levels had not yet recovered from the previous downturn. During previous periods of low price, many companies had been supported by new development projects which were already under way. However the relative lack of new project approvals in recent years mean that the impacts of this downturn are being felt even more strongly.

Rystad Energy reports that, globally, revenue levels were down as much as 33 per cent year on year in the second and third quarters of 2020. UK-specific data for 2020 is not yet available at the time of writing, however it would be expected to be representative of these global trends given the reductions in expenditure seen in the UK.

Figure 11: Global Oilfield Service Company Revenues



Source: Rystad Energy

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Supply Chain Revenue and Margins (continued)

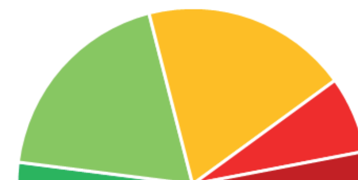
Within the UK sector, average EBITDA margins have also fallen, with EY reporting a near 40 per cent reduction between 2014-18 (most recently available data).[5] OGUK previously estimated that a stabilisation of margins was likely in 2019, but further reductions will have occurred in 2020. EBITDA margins are considered on an operating expense basis and do not include the costs of repaying capital expenses and other exceptional costs, therefore companies which are asset-based are likely to see lower, or even negative, cash flows. These positions leave companies with little or no ability to re-invest in their business and many have had to undergo financial restructuring to ensure business continuity — as experienced by a number of drilling contractors. Many companies have seen debt levels increase significantly, and several are due for refinancing in the coming 12 months. The results of this will provide an important marker of investor and financier sentiment towards oilfield service companies.

The relatively modest increase in new activities anticipated in 2021 suggests that it will continue to be a challenging period for many supply chain companies. 42 per cent of OGUK members report that they expect to see an increase in revenue in 2021, while 38 per cent anticipate remaining around the same as 2020. Of those who anticipate an increase, many indicate that this will still not mark a return to pre-pandemic levels, which were already significantly lower than those seen earlier in the decade.

[5] https://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/topics/oil-and-gas/oil-field-jan-2019/review_of_the_uk_oilfield_services_industry_january_2020.pdf

Figure 12: Supply Chain Company Revenue and Margin Expectations

2021 Revenue Expectations Compared with 2020



2021 Margin Expectations Compared with 2020

- Significantly higher
- Higher
- About the same
- Worse
- Significantly worse

Source: OGUK

Supply Chain Revenue and Margins (continued)

Fewer companies report that they expect margin rates to increase this year (20 per cent), and 28 per cent expect further declines. This reflects that many companies do not expect to see many recent cost reductions reversed in 2021, and some report having to absorb increases in their own cost base. This trend will not be sustainable and will likely result in increased rates of business failure and consolidation.

It is likely that the sector will see increased levels of acquisitions and consolidations as companies restart sales processes post-COVID. In March 2021 CHC announced an agreement to acquire Babcock's aviation business, while Expro and Franks International announced a merger of their businesses. Some examples of increased private equity-backed deals have also taken place recently, as in the case of ASCO and Vysus Group. Companies may also look to new acquisitions as an opportunity to gain an increased foothold into new energy areas.

A strong and well-resourced supply chain is a vital part of the UKCS value proposition to new investors. OGUK's 4-point Supply Chain Plan aims to introduce a more collaborative culture to sustain the sector while ensuring it transforms and readies itself to seize the all-energy opportunity. This includes:

- Exploring the *2020 UKCS Collaboration Survey* results to inform focus areas[6]
- Placing increased focus on the *Supply Chain Principles*[7]
- Developing and delivering tools to unlock a more collaborative culture
- Driving initiatives including the Efficiency Task Force,[8] OGUK's SME Forum and supporting the work of the Supply Chain & Exports Taskforce, including the payment performance initiative

Effective and constructive working throughout all areas of the industry will help unlock more opportunities, deliver greater value and create a more sustainable sector.

[6] https://oilandgasuk.co.uk/collaboration-report/
[7] https://oilandgasuk.co.uk/supplychainprinciples/
[8] https://oilandgasuk.co.uk/efficiency/

Industry Employment

In 2020, OGUK estimated that the level of direct and indirect employment supported by the industry could contract by 25,000 –30,000 based on anticipated investment and activity levels in 2020–21. OGUK believes that this remains a reasonable estimate, though it is still too early to make a full assessment of the impact of the downturn on the number of jobs that have been lost from the sector over the last year. There are a number of factors, such as the Job Retention Scheme (and its extension), which are helping to sustain jobs that would have otherwise been lost, resulting in some disconnect between levels of activity and investment and employment levels. OGUK will publish a more in-depth review of employment in our *Workforce Report* in Q2 2021, however there are some signs emerging from OGUK members, and from wider economic data, which give an indication of the industry landscape.

The Fraser of Allander Institute[9] has estimated that unemployment claim rates in Aberdeen and Aberdeenshire have increased by 136 per cent and 124 per cent respectively over the last year. This trend is also reflected in other oil and gas regional hubs, such as the north east of England, which has seen unemployment claimants rise by 40,000 and has an unemployment rate 1.4 percentage points above the national average.

Despite these rises, there are some tentative signs that 2021 could see greater stability in employment levels, though this will continue to be influenced by the development of market conditions. OGUK estimates that overall expenditure could see a marginal increase on 2021 levels and there is optimism around an increase in the level of offshore activity on the horizon. The ongoing work on the implementation of the Energy Services Agreement will also help to ensure that the industry is viewed as an attractive place to work.

This is also represented in data reported by the Office for National Statistics (ONS).[10] Between April and June 2020 it is estimated that the number of vacancies within the 'Mining & Quarrying' SIC code (of which the oil and gas industry accounts for the vast majority of economic activity) had fallen by 75 per cent year on year. Data for November 2020 to January 2021 shows a 47 per cent annual reduction. Although this demonstrates the continued challenges, it does show some sign of improvement. The emergence of new diversification and export opportunities will also help to support more jobs in time, supported by the North Sea Transition Deal (NSTD) aim of helping advance opportunities and support workers and businesses to transition into new work areas.

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[9] https://www.energyvoice.com/oilandgas/301924/economic-fallout-in-aberdeen-laid-bare/

[10] https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment/datasets/vacanciesbyindustryvacs02/current

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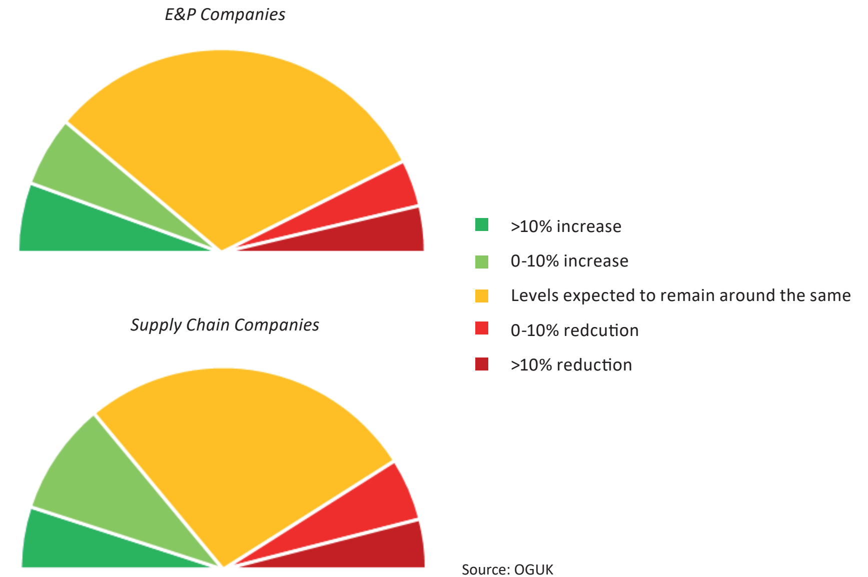
Industry Employment (continued)

Data provided by OGUK members show that the majority of companies (57 per cent) anticipate employment levels to remain around the same in 2021, with 26 per cent anticipating an increase and 17 per cent indicating that levels could fall further. This is a marked improvement on sentiment expressed in Q2 2020 when 52 per cent of contractors and 41 per cent of E&P companies noted that they were planning redundancies due to market and operational challenges.

Figure 13: Company Employment Expectations, 2021



Source: OGUK

Evolving Energy and Climate Landscape

The oil and gas industry, together with the wider energy sector, is adapting to a significant scale and pace of change to its policy and regulatory landscape as the UK aims to achieve net zero emissions and prepares to host the COP26 summit in November 2021. The industry supports the UK's climate aims and will play an important role in helping to deliver the solutions that are key to achieving them. These changes do, however, affect all parts of the sector and it will take time for companies to take account of the full implications on day-to-day operations, as well as longer-term strategies and business models.

As has been outlined, the role of the UK's oil and gas industry in providing secure and affordable energy remains fundamental. Oil and gas met an estimated 73 per cent of the UK's energy needs in 2020, with production from the UKCS providing around 70 per cent of this demand. Looking to the future, oil and gas will continue to have an important role in a net-zero society. In its 'Balanced Pathway' scenario, the Climate Change Committee (CCC) outlines that the UK will consume more than 17 billion boe through to 2050. This is more than half of the total cumulative energy expected to be used in the UK during this period and is an amount similar to higher-end estimates of the remaining UKCS resource potential.

To maintain secure and affordable energy supplies, it is crucial that the policy and regulatory landscape continues to support the industry in making the most of our indigenous resources — including the continued licensing of new acreage on the UKCS. This is good for both energy security and consumer affordability, and is important in helping to achieve the UK's ambitious climate objectives. Investment in oil and gas supports many of the capabilities that will provide an important part of the development of new net-zero solutions. Lower investment and activity levels create a risk that valuable capabilities will be damaged.

The NSTD can be an important catalyst for unlocking the full contribution that the industry can make to achieving net zero. It will help provide the framework to support the reduction of emissions from the production of oil and gas and advance investment in CCUS and hydrogen projects. The deal would also help ensure that as much of these new opportunities are seized by UK supply chain companies, and that there are clear employment pathways across the energy landscape. This will also help provide the foundation for continued growth into international export markets. It is important that the deal moves forward with pace and that it is ambitious, OGUK continues to work closely with the UK Government in agreeing this.

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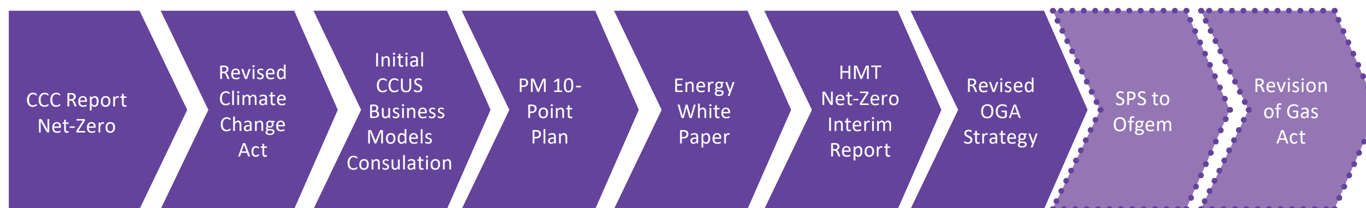
Realising New Energy Opportunities

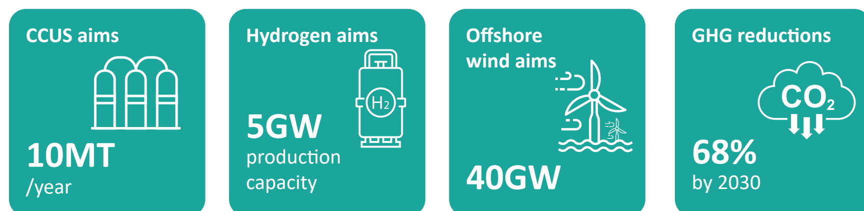
There are significant new opportunities beginning to emerge across the energy and emissions reduction landscape, in both the UK and around the world. The UK and Scottish governments have set ambitious targets surrounding the development of the carbon capture, use and storage (CCUS), hydrogen production and offshore wind industries — all of which are recognised by the CCC as crucial net-zero enablers. Companies within the oil and gas industry are already forming an important part of these developments and their role within this is set to continue to grow — with much of the investment, technologies and capabilities required being provided by traditionally viewed oil and gas companies.

Within the supply chain, 62 per cent of companies who responded to OGUK's Business Sentiment Survey reported that they provide goods and services which can help reduce their clients' carbon footprint, supporting the industry drive to reduce operational emissions by half by 2030 and become a net-zero basin by 2050. 82 per cent of supply companies also report that they plan to advance their diversification efforts over the next two years, as offshore renewables, CCUS, hydrogen and utilities are all identified as key new markets. There is significant opportunity across these areas, with the CCC estimating that investment in the energy sector may need to double to £50 billion per year to achieve net zero. In addition, many companies are applying their capabilities to non-energy sectors such as pharmaceuticals, defence and food and drink.



Realising New Energy Opportunities (continued)

Having committed to industry-wide targets of reducing operational emissions by 50 per cent by 2030, E&P companies, with the support of supply chain partners, are developing strategies to reduce their carbon footprint — including plans to fully or partly electrify offshore installations. Alongside this, many E&P groups are becoming increasingly integrated across the energy landscape in the UK. Total and bp were both awarded wind development licences off the coast of England and Wales by the Crown Estate in February,[11] while the much-anticipated ScotWind offshore wind licence acreage round — the first for a decade — is currently underway and expected to attract bids from OGUK members. These are in addition to development projects including Seagreen and Dogger Bank, which are both led by OGUK members.



OGUK members are also at the forefront of all of the most advanced net zero cluster projects around the UK, plans for which incorporate CCUS and hydrogen production. A final investment decision on Phase 1 of the Acorn project in the north east of Scotland is expected to made in late 2021 or early 2022, while the Northern Endurance Partnership is also moving forward. The latter is intended to provide the carbon transport and storage infrastructure for the associated Net Zero Teesside and Zero Carbon Humber projects.

The *Energy White Paper* outlined the clear need for projects like these to contribute towards net zero and the important role of oil and gas companies in the transition.[12] There are also a number of consultations ongoing, such as the approach to the sequencing of net zero cluster projects[13] which will help to put the frameworks in place to provide companies with the confidence to make major investment decisions. Securing the NSTD between industry and government will help advance the contribution that the industry can make in helping to achieve our net zero ambitions.

[11] https://www.thecrownestate.co.uk/en-gb/media-and-insights/news/2021-offshore-wind-leasing-round-4-signals-major-vote-of-confidence-in-the-uk-s-green-economy/
[12] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945899/201216_BEIS_EWP_Command_Paper_Accessible.pdf
[13] https://www.gov.uk/government/consultations/carbon-capture-usage-and-storage-market-engagement-on-cluster-sequencing

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