Our vision is to ensure the UK Continental Shelf becomes the most attractive mature oil and gas province in the world with which to do business.

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Foreword

The global spread of the Coronavirus is having a devastating impact on people and their loved ones as well as our established way of life, our businesses and our economy.

As a sector only just beginning to emerge from one of the worst downturns in its history, our findings show its position is now paper thin and we have significant concerns about the resilience of our supply chain especially, to absorb further pressure.

The most dramatic fall in oil price in almost 30 years and the remaining market uncertainty will undoubtedly impact investment decisions. In the short, medium and longer term, serious questions remain for governments as to how we can protect the sector which is a vital part of the UK’s critical infrastructure and so ensure the UK can continue to enjoy secure and affordable energy today and in the coming weeks and months and as we transition to a lower-carbon future.

Protecting this industry now is also essential to meeting our net-zero aspirations, with any loss of capabilities in our energy regions, businesses, jobs, skills and infrastructure diminishing our ability to either lead from the front, or potentially to follow, in providing the net-zero solutions the UK and the world will need.

As our report shows, we now face a situation where E&P production revenues could be almost half the level of just two years ago, despite the same level of output. This trend is unsustainable for many and without intervention could lead to the loss of businesses, jobs and skills anchored in the UK.

As the leading representative body for the sector, OGUK is proud to champion an industry renowned for its ability to innovate and adapt in extraordinary times. However, coming so soon after the previous downturn and with no certainty as to how long these difficult times will last, governments and regulators should be in no doubt that this challenge has many dimensions, and this industry will need sustained and targeted support if it is to weather the storm.

Deirdre Michie
Chief Executive
OGUK
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The UK oil and gas industry makes an important economic contribution across the UK.

Roadmap 2035 outlines how the sector can help ensure that the UK continues to benefit from a secure energy supply alongside an affordable, responsible and managed transition to net zero. This will only be achieved through a joined-up approach across government, regulators and industry.

The industry's production operations are responsible for around 3% of the UK's total greenhouse gas emissions.

Effective stewardship of the industry will ensure that it continues to provide wide-ranging economic benefits and that companies remain anchored in the UK to support the energy transition.

The industry's people, skills and resources will be an important part of meeting net zero.

Remaining competitive is key. The focus and support of government is vital.

Supporting the development of CCUS and hydrogen.

Investing in renewable energy sources.

The industry is an important asset for the UK – helping fuel the economy.

Supporting 270,000 jobs across the UK.

Paying £350 billion over the last 50 years and more than £1.1 billion in taxes in each of the last two years.

Adding £15 billion to the value of the UK economy.

Reducing the UK's energy import dependency.

Supporting the UK economy now and in a net zero future.

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Government and industry need to progress proposals for a sector deal, at pace. This will help ensure that companies are able to sustain their operations now and prosper in the years to come.
Brent averaged $64.3 per barrel (bbl) last year and has seen a general downward trend since late 2019. Falling global demand as a result of the continued spread of Coronavirus (COVID-19) had lowered prices to around $50/bbl in late February. This marked decline in demand was then compounded by a significant increase in supply as constraints within OPEC+ countries were removed — leading Saudi Arabia and Russia, amongst others, to increase output. This ‘perfect storm’ in the market resulted in prices falling below $30/bbl on 16 March, a fall of over 55 per cent since the beginning of 2020 and the lowest price since early 2016.

At the time of writing, it is unclear how long prices will remain at this level, given the uncertainty over the continued impact of Coronavirus on demand and the length of time OPEC+ countries are able to withstand low prices. Brent futures prices currently remain below $40/bbl for the majority of 2020 and below $45 in 2021, demonstrating the cautious outlook in the market. Whilst some past downturns have seen a relatively quick recovery, such as in 2008, others have resulted in a more prolonged period of low prices, such as from 1985 onwards.

The US Energy Information Administration (EIA) now forecasts that Brent will average around $43/bbl this year — $18 lower than its previous estimate — with other banks and agencies outlining the potential for a lower annual average (potentially as low as $35/bbl). This price environment will cause significant cash flow and investment challenges for all areas of the UK industry, the full implications of which are still being considered.
Oil Market Dynamics

The continued spread of the Coronavirus has impacted the global economy significantly. In early March the International Monetary Fund (IMF) reported that growth expectations in 2020 would now be lower than the 2019 rate of 2.9 per cent, with the potential for further downward revision. The OECD base case is now 2.4 per cent but also outlines that the impact of Coronavirus could ultimately cut growth rates by half this year (to 1.5 per cent). This would represent the slowest rate of growth since 2009.

Consequently, the International Energy Agency (IEA) has slashed its oil demand forecast for 2020 — indicating that it now expects the first annual decline in oil demand since 2009. First-quarter demand is expected to be around 2.5 million barrels per day (bpd) lower than last year and the IEA low case outlines the potential for demand to be at least 730,000 bpd lower across the full year. This drop in demand resulted in a fall in Brent to below $50/bbl in late February — before the further impact of an increase in supply.

Throughout 2019 and early 2020 OPEC+ countries had already restricted output by 1.7 million bpd in order to bring equilibrium to the market, prior to the impact of Coronavirus on demand. This action was crucial in supporting prices at more than $60/bbl and it had been anticipated that further constraints would be put in place to counter the recent demand fall. The failure to reach agreement and subsequent collapse of existing supply restrictions mean that OPEC+ countries are now free to increase supply from the start of April. There are expectations that supply from these countries could increase by around 4 million bpd — potentially resulting in an unprecedented differential between supply and demand of 5–6 million bpd in early Q2. These unique market conditions resulted in the most severe price decline since that seen during the Gulf War in 1991.
Commodity Markets: Gas

The UK’s day-ahead National Balancing Point (NBP) gas price has now been on a downward trajectory for more than a year, reflecting global trends. Prices averaged 34.7 pence per therm (p/th) in 2019, and more than halved from over 60 p/th at the start of the year to less than 30 p/th by the close of the year. This average was 42 per cent down on 2018 (60.3 p/th) and 30 per cent below the ten-year average of 49.3 p/th.

The trend has continued in the first few months of 2020, with prices averaging 25 p/th through to mid-March, having reached a low of just over 20 p/th in mid-February. The ongoing decline has been the result of shifting supply and demand dynamics in the market and has resulted in real challenges to gas operations across the basin.

The average NBP gas price was 35 p/th in 2019 – the lowest average for over a decade. NBP gas prices fell by 50% during 2019 and hit a low of 20 p/th in early 2020.

Source: ICIS Heren
Gas Market Dynamics

UK gas demand fell by 2 billion cubic metres (bcm) in 2019 — a decrease of 3.9 per cent — and is now 22 per cent lower than ten years ago. This trend is the result of various factors, primarily improved energy efficiency and changing energy use patterns.

Following a significant increase in gas demand for electricity generation in 2016 to offset declines in the use of coal, gas use in power generation has declined. In 2019, electricity generated from gas decreased by 2 per cent and is now 10 per cent lower than 2016. This has been offset by an increase in generation from renewable sources including wind, solar, hydro and bioenergy. Renewable output grew by 13 per cent in 2019 alone and is now more than four times greater than in 2010.

The UK benefits from a strong and increasingly diversified gas supply, including volumes flowing from domestic production, interconnectors with continental Europe and increasing LNG shipments from around the world.

Although there was a small decline in UK gas production in 2019, domestic supply was enough to meet 51 per cent of national demand. However, around 20 per cent of the produced volumes were exported, mainly to Belgium and the Republic of Ireland (totalling more than 90 per cent of exports), and the remainder used domestically. Remaining UK demand was met by pipeline imports from Norway, via interconnectors (mainly from the Netherlands), and LNG shipments.

Growing flexibility in the market — mainly provided by the increase in LNG availability — have fundamentally changed the dynamics of the UK gas market. The increasingly physical linkages and exposure to other international gas price markers are applying significant downward pressure.

In the short term, given ample volumes of continental gas and LNG imports, it is likely that the UK market will continue to be oversupplied, which will act to keep prices relatively low.
What Does the Commodity Price Environment Mean for the UKCS?

The current commodity price environment will pose significant challenges across the UK offshore oil and gas industry. Lower prices will affect the revenues of all companies, further stretch balance sheets and impact investment rates.

It will be important to take time to fully understand how the current dynamic will unfold, however E&P companies are evaluating all options to preserve cash and sustain their operations — including activity deferrals and cancellations. It is also important to note that each company will be in a different position depending on their own operations and financial structure.

The impact will be felt by supply chain companies almost immediately as the lower-than-anticipated levels of activity start to take effect. This comes at a time when many areas of the supply chain are already facing fundamental financial challenges, in light of significantly reduced revenue and margins in recent years. There is limited scope for many companies to absorb further cost reductions.

It is important the industry stakeholders, including government and regulators, understand the severity of the challenges industry is facing and support the steps taken to maintain the viability of businesses and operations.

This industry is essential to providing secure and affordable energy now and, with the right stewardship, will continue to do this in the decades to come. This can be achieved whilst supporting the drive to net-zero greenhouse gas emissions through the industry’s skills and resources.
Cash Flow and Profitability

The reductions in commodity prices will affect E&P company revenue and spending plans. OGUK had previously anticipated that expenditure levels in 2020 would be in line with those in recent years, and the long-term average for the basin, at around £15 billion (in 2019 money); however, these plans are now under intense scrutiny by all companies.

Production in 2018 and 2019 was effectively level at around 618 million barrels of oil equivalent (boe), with a range of 600-610 million boe anticipated for 2020. Even so, revenues generated from stable rates of production have varied considerably. OGUK estimates that UKCS production revenue was over £28 billion in 2018, falling to around £24.5 billion last year. Based on a longer-term Brent price of $40 and NBP gas price of 25 p/th, it is estimated that revenue would be just over £15 billion this year — a decline approaching 50 per cent in just two years. This figure will vary depending on how the price dynamic unfolds in the coming months.

It is feasible that this year will see the UKCS experience negative cash flow for only the third time in the 40 years since the basin first saw positive cash generation. At $40/bbl and 25 p/th, OGUK expects that the UKCS would effectively be cash-flow neutral — i.e. revenue and expenditure are at similar levels. If Brent averaged $35 then the basin would fall into a negative cash flow position of around £1.2 billion. Wood Mackenzie estimates that a prolonged $35 price could mean a global fall in cash generation of $380 billion (£290 million) this year.

E&P companies will look to reduce and delay expenditure, investment and activities to mitigate the commodity price risk and maintain positive cash flow. Access to finance will also be constrained as investors review the market outlook and await commodity price recovery.
**Operating Costs**

The UKCS has seen significant improvement in its competitiveness, efficiency and productivity in recent years. These improvements will help performance, but the industry remains significantly challenged on a number of fronts.

Across the UKCS overall, unit operating costs (UOCs) averaged $15.2/boe (£12.50) in 2019. This compares with 2014 when average UOCs were $32/boe (or £20/boe) — a greater than 50 per cent improvement in US Dollar terms.

OGUK estimates that around 85 per cent of assets which produced at least 1 million boe last year have UOCs under $40/boe, compared with two-thirds in 2014, demonstrating the improved efficiency of E&P companies. The highest-cost asset in this group is now around $64/boe, compared with more than $100/boe in 2014.

The improved cost profile has been achieved through reductions in operating expenditure and increased production — last year the UK industry produced 20 per cent more, at a 30 per cent lower cost than in 2014. It is likely that operating costs will be reduced further this year as all expenditure comes under increased scrutiny.
Capital Investment
Total capital investment last year was almost £5.5 billion — similar to 2017 and 2018. This is in line with the long-term average, in real terms, over the last two decades (not including 2011–15, which reflected an unsustainable level of investment and a period of low capital efficiency).

OGUK expects that capital investment will be lower in 2020, with £4–4.5 billion anticipated (a 20–30 per cent decrease). This reflects expected activity deferrals, as most projects which are not yet fully committed are likely to be re-evaluated. However, there is an element of uncertainty with this outlook as companies continue to evaluate the longevity and impact of the price crash.

OGUK had anticipated that there would be an increase in new field investment approvals this year, with up to 10 projects progressed, representing £5 billion of investment and up to 500 million boe of reserves. This level of new investment approvals is no longer likely. Companies will be looking to preserve cash as long as possible and will take an increasingly conservative approach to new approvals. Although companies take a long-term market view, the majority of these projects will be too expensive to pass investment hurdles at current price levels.

Some projects may still manage to attract some limited investment, especially if prices recover to some degree, but investors are likely to watch how the market dynamic unfolds before making any significant commitments.

This trend will be reflected around the globe, with Rystad Energy estimating that at least $100 billion (£76 billion) is likely to be stripped from E&P company budgets this year, with the potential for this to grow depending on market developments.
Drilling Activity

Along with investments in new capital projects, OGUK now anticipates a reduction in drilling activity this year. At a $60–65 price range OGUK had expected the number of wells drilled to be in a similar range to 2019. However, based on recent experience, it is conceivable this could be down more than one-third, reflecting the reductions seen in 2015–16 and signalling a return to record-low levels. Coupled with this, OGUK would also expect the rate of well decommissioning to slow. Companies may place increased attention on lower-cost activities which maximise the potential of existing well stock, such as well interventions to safeguard, restore or increase production rates.

It is likely that drilling activities which are not firm commitments with contracts in place will be delayed or cancelled, and it is possible that some contracted activity may also come under pressure.

As well as reducing the rate at which reserves are progressed through to production, this will have a significant impact on supply chain companies, with many drilling contractors still feeling the effect of a period of lower activity and day rates in recent years. Rystad Energy estimates that global demand for mobile drilling rigs could fall by a further 15 per cent this year.
Production: Helping Meet UK Energy Needs

The UK produced almost 1.7 million boepd (618 million boe) last year — the same level as 2018 and 20 per cent higher than 2014. This was the equivalent of 51 per cent of UK gas demand and 74 per cent of demand for oil products. Along with significant improvements in production efficiency, the turnaround in production has been underpinned by a series of new investments coming on stream. More than 40 new fields have commenced production since 2014, with these fields accounting for around one-third of production last year.

OGUK expects that production will be in the range of 600–610 million boe in 2020. However, lower levels of investment and drilling activity now will affect the level of new production coming onstream in the near future.

There is still significant resource opportunity to unlock, with 6.6 billion boe in company plans through to 2035, as well as further additions through recent exploration successes. However, in the current environment very few projects will receive investment approval, until companies have a clearer understanding of the longer term market dynamic.
Supply Chain

Following significant reductions between 2014–16, revenues and margins across the supply chain have remained relatively flat and OGUK had expected a similar outturn in 2020. This financial position has already stretched balance sheets to unsustainable levels in many cases, with companies facing common challenges in their ability to service increasing debt levels whilst investing in new capabilities. The anticipated further reduction in activity levels and increased cost pressures will place further strain on the finances of supply chain companies — however, the full extent of the impact remains to be seen. Demand levels will return, but this may take time. The wider impact of the Coronavirus outbreak will also be felt as companies may find it more difficult to source goods from, and export to, the global market.

Rystad Energy estimates that, at a global level, total oilfield services revenues could fall by 8 per cent if Brent averages $40/bbl, or 15 per cent if prices fall to an average of $30/bbl. A more prolonged period of lower prices will also cause a negative impact on revenues in 2021. It is likely that many areas of the supply chain would struggle to absorb additional and sustained cost and activity reductions of this level. OGUK will also be closely monitoring any impact on employment across the sector, given its close relationship with levels of activity and investment.

The current combination of commodity prices and the wider impact of the Coronavirus mean that the sector is all the more exposed. This is likely to result in a higher number of consolidations and insolvencies in the market. Access to finance across the industry in the coming months will be crucial. It is important that the government works closely with our industry, as with others, to help weather the current pressures to ensure that they do not result in permanent damage to the UK’s capabilities.

These capabilities are crucial in providing energy security now and will continue to be so as the UK moves towards net zero. Government and industry must work at pace in the coming months to secure a sector deal that ensures our supply chain can sustain their businesses and capabilities today and prosper in years to come. The companies in this sector form an important part in positioning the UK as a world leader in CCS and hydrogen. If these capabilities are lost then the country risks missing out to other nations on this crucial opportunity.

The information that forms the basis of this report is provided by our members from across the industry, uniquely positioning us to set out the business outlook for the whole sector.