COMMERCIAL BANKING

Bank of Scotland Oil and Gas report

Executive Summary

BANK OF SCOTLAND

Introduction

This time last year, the UK's oil and gas sector was still reeling from an exceptionally challenging period, and many firms were still acting to counter the impact of an extended spell of depressed oil prices.

This year, the outlook for the oil and gas industry is one of cautious optimism. This year's survey of decision makers from more than 100 oil and gas businesses from Scotland, England and Wales, ranging from producers to firms in the supply chain, found a sector more positive than it has been in recent years.

There is evidence that the tide looks like it is starting to turn on employment in the North Sea and firms are planning for growth.

Of course, the last 12 months have seen some changes on the international stage. The UK's vote to leave the European Union (EU) and the election of Donald Trump as President of the United States of America could both have an impact on the energy industry.

But in the face of this uncertainty it is heartening to see some of the positive indicators that have emerged so far this year:

- In May, oil-producing nations agreed to extend production cuts for a further nine months, which should help bring further stability to markets.
- Domestically, the billion-barrel oil find in the Greater Lancaster Area, 60 miles west of Shetland – the largest undeveloped discovery on the UK continental shelf – is cause for great excitement.
- And the majority of firms that took part in our survey reported they are no longer planning to cut jobs to control costs and are more optimistic about recruiting in the coming 12 months.

This expression of confidence reflects an industry that appears to be turning a corner, with conditions for growth much more favourable than they have been in recent times.

It's clear that there are still potential challenges ahead, but at Bank of Scotland we remain committed to supporting the sector, which is fundamental to the UK economy.

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The year ahead

The difficult past few years for the industry, while not yet completely reversed, are starting to show signs of turning a corner.

This year the sector is cautiously optimistic, focused on meeting challenges, business growth and exploring new opportunities at home and abroad.

Business confidence is on the up. In 2016, the net balance of optimistic businesses (the number of firms that felt positive minus those that felt negative) was just 2%; it is now 39%. The change of mood is particularly striking amongst firms with turnovers of more than £750 million. Among this group, the net balance of optimistic firms was -33% in 2016 but has now jumped to 33%.

Growth is now on the agenda too. Last year, 49% of the sector was planning for growth over the coming 12 months, a figure that has grown to 58% in this year's survey.

This year, 70% of all companies said that the current business climate has presented opportunities outside of the UK.

75%

expect Brent Crude to reach $75-80 a barrel in 2019 or beyond

69%

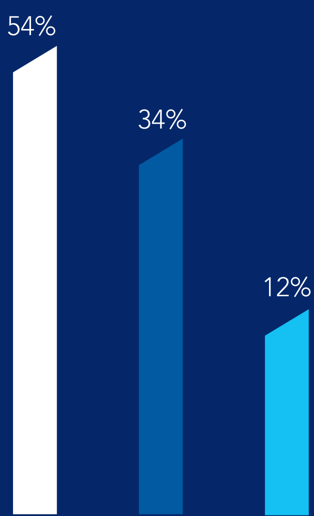
are confident they have done enough to survive the oil price decline

Has the current business climate presented new opportunities for your business in the UK?

Yes

No

Don't know



Opportunities and challenges

This year, even more firms are planning for growth, up from 49% in 2016 to 58%.

The most popular routes to growth are organic growth (27%), diversification of operations (22%) and mergers and acquisitions (9%).

With an increase in field development work expected in 2017, six out of ten (59%) firms see most opportunities in new contracts. The most common new contract opportunities include logistics (58%), supply chain (39%), engineering and fabrication (30%) and construction (27%).

The oil and gas reserves in the North Sea continue to represent one of the biggest opportunities for the industry.

More than nine in 10 (91%) firms said they expect to either maintain (69%) or increase (22%) their work on UK Continental Shelf (UKCS) projects in the next 12 months.

While there are opportunities for the sector, there are challenges on the horizon too.

Cost challenges: businesses say they are concerned about the increasing cost of production (48%), the value of sterling (44%), volatility of currency exchange rates (41%) and uncertainty because of the EU exit negotiations (35%).

They are planning to face these cost challenges by adopting new processes (68%), developing products (68%) and adopting new technology (67%).

Recruitment: 43% of firms saying uncertainty in the sector is putting people off entering the labour market.

26%

on average, firms expect growth of 26% of current turnover over the next year

29%

expect new opportunities in internationalisation

30%

of firms say the oil price decline has severely or quite badly affected their business over the past 12 months

14%

of firms are scaling back operational costs to improve profitability

Employment

While some companies are still making labour efficiencies, the survey found more people are now likely to be recruited into the sector than be made redundant.

The proportion of companies that expect to see a reduction in headcount over the next twelve months is down from 32% in 2016 to 19% this year.

This is a trend that looks set to continue in 2017 as 55% of companies expect to increase their overall headcount, nearly three times the 19% that forecast job cuts.

Asked in which sub-sectors job creation and cuts would occur, the most positive were engineering and fabrication, with a net gain of 17%, and equipment and supply rental with a net gain of 10% - likely reflecting the current wave of development activity.

The only negative areas were drilling, with a net loss of 12%, and subsea work, with a net loss of 5%.

26%

expect headcount to remain the same over the next twelve months

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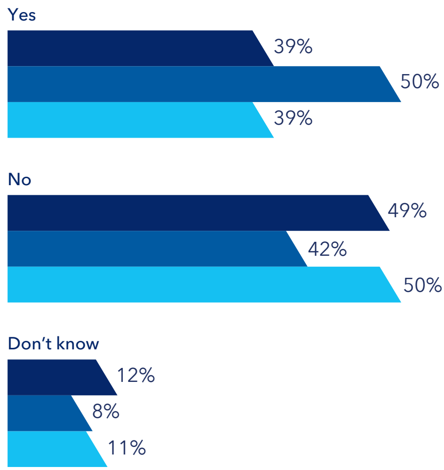
Will ongoing uncertainty impact on the talent/skills coming into the industry?

Up to £25m

Between £25m - £750m

More than £750m



International expansion

Despite the strong emphasis from businesses on pursing work in the UK, there are still profits to be made in overseas markets.

This year, 70% of all businesses said that the current business climate had presented opportunities outside the UK.

Popular types of overseas opportunities include new contracts (46%), new exporting opportunities (33%), diversification (33%), acquisitions (23%) and investment in new technology (15%).

Amongst large firms, with turnovers of more than £750m, the territories most commonly named as key markets for growth include South America (up from 22% to 33%), the Gulf of Mexico (up from 17% to 22%), and west Africa (up from 11% to 27%), in line with increased development activity levels there.

15%

expect to expand in the North Sea over the next 12-24 months

57%

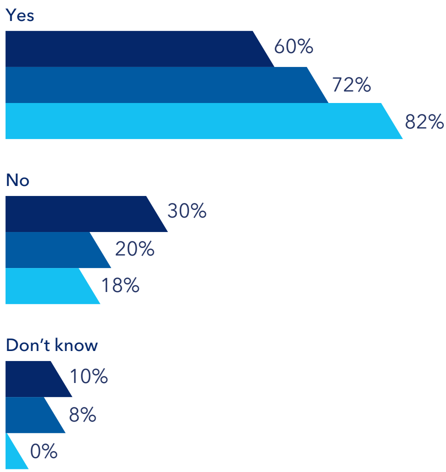
are interested in international expansion

Has the current business climate presented new opportunities for your business outside of the UK?

Up to £25m

Between £25m - £750m

More than £750m



Finance

Much of the financial stress that has afflicted North Sea companies since 2014 has eased.

The reduced financial stress is evident in the survey with calls for financial support reduced from 2016. The proportion of companies that said the UKCS needs more financial support has dropped from 45% to 36%.

Nevertheless, companies think more could be done. Asked to choose how the Scottish or UK governments could help either their business or the wider industry, two-fifths (42%) selected tax incentives and, with an eye to a post-EU UK, better trade deals (41%).

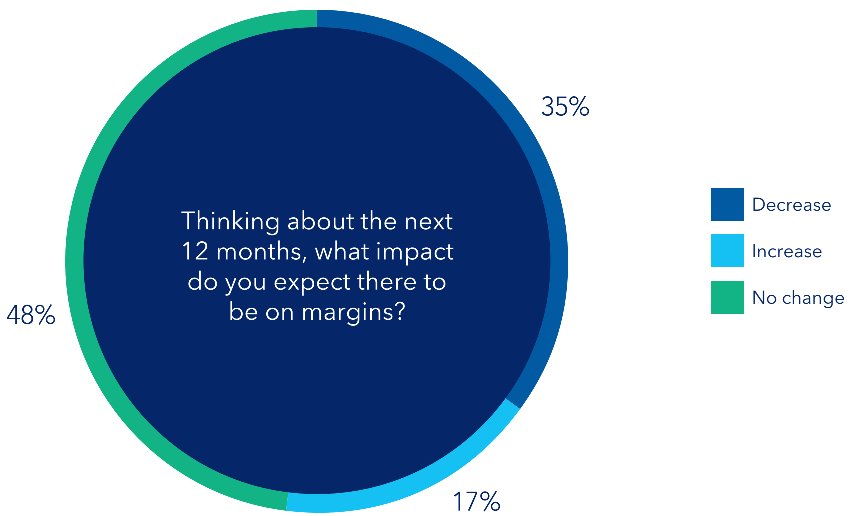
The turn toward optimism and the successes of independents such as Hurricane Energy, in what still is, after all, a risky industry in an uncertain world, suggests that a corner has been turned.

23%

need support in getting compliance for contract/ payment terms

69%

feel they have sufficient expertise to deal with the low-oil price environment



The support you need

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Methodology:
Field research for this report was undertaken in April and May 2017 by Coleman Parkes Research. To gather representative data, a cross section of 105 oil and gas businesses were interviewed. Companies ranged in size, from less than £25m, to between £25m and £750m, and more than £750m annual turnover.

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