

Energy Industry Trends Review

A large offshore oil rig is illuminated at night against a dark blue sky. The rig's complex structure, including cranes and platforms, is lit up with various lights, creating a stark contrast with the dark environment. The rig is supported by several large legs extending into the water.

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Editorial

Economic/industry outlook
Supply and demand levels, energy
prices

Changing energy trends
Refining, M&A, rig count

Company trends

• Consulting • Technology • Outsourcing

Editorial

Riding a roller coaster

Anyone watching crude oil market's performance between May and July 2009 could be forgiven for wearing a somewhat quizzical look.

The market started the period below \$60 a barrel, shot up toward \$73 in mid-June, went back down to the high \$50s by mid-July and was back up to the low \$70s at the end of July. This pattern of oil market movements included plus/minus \$4 swings each of the last two days of July. Up, down, up, down; how does anyone manage to run a high-performance business in the midst of all the volatility?

However, this volatility snapshot simply mirrors what has happened over the past year. What a difference a year makes. Back on July 11, 2008, crude oil hit the record price level of \$147 per barrel. Move one year forward and oil has declined in value by approximately 50 percent, but that is an improvement from the decline of more than 75 percent in January 2009. Indicators across the energy industry tell a similar story—the story of the economic downturn. From Asian liquefied natural gas spot prices to refining utilization rates, the number of active rigs to mergers and acquisition levels, there has been a rapid evolution. The industry has moved from a position of buoyancy to one in which firms across the board are increasingly challenged. Observers need to look no further than the second quarter of 2009 financial results for energy and oilfield services companies to see the impact. Firms have responded by launching initiatives to improve costs, operating models and asset portfolios.

One year might seem like a long time in some industries, but in an energy industry that has become accustomed to prolonged periods of steady returns

and long investment cycles, the amount of change and volatility has been an eye opener. Of course, the fact is that the energy industry already was undergoing a substantial amount of change even before the downturn hit. The rise of the national oil companies (NOCs), increasing levels of carbon and environmental legislation, oilfield services companies playing a larger role in industry development, a growing talent shortage and the "end of easy oil" are just a few examples of these pre-downturn changes. So, is the landscape all that different given the downturn?

The point is that the downturn may have helped accelerate the pace of change, positive and negative. As highlighted with the oil price movements, volatility/accelerated change might now be the normal state of affairs for the energy industry. Some analysts have mentioned the threat rising oil prices would have on an economic recovery—creating a potential boom-bust cycle. The chief economist of the International Energy Agency noted in a recent interview with the Independent newspaper that global oil production is likely to peak in 10 years, a decade earlier than many governments are estimating.¹ And, there is a chance that funding being funneled toward clean energy research actually accelerates the development of next-generation energy solutions.

So if accelerated change or volatility becomes more commonplace, how does a high-performance business manage through the volatility and change? Trying to keep up with every rise or fall is most likely a futile exercise

and can easily divert attention away from the bigger picture—delivering sustainable, long-term high performance. Accenture believes this is a time in which understanding key risks to businesses takes on even greater importance. What are the biggest risks? How likely are they to occur? What is their potential timing? What are the potential impacts? What are the potential opportunities? Companies are recognizing that a risk management program integrated across the operation—and embedded in the culture so everyone understands it—is not just a protective tool but even a competitive edge in an increasingly volatile and changing world. Equally, Accenture believes firms must ensure they have a solid platform from which to navigate through the changing environment. Companies should continue to assess their operating models, cost structures, asset portfolios and efficiency programs to help guarantee they are in the optimal position to robustly address a changing industry landscape.

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Trends snapshot

	May 2009	June 2009	July 2009
Economic	World economic growth is showing signs of recovery but, short term, is expected to decline by 1.4 percent in 2009. The main priority remains restoring financial sector health. ² Increasingly, there are concerns in the market that a more robust oil price might start to affect the global recovery going forward in 2009 and 2010.		
Oil supply	OPEC is generally adhering to its production cuts although the market continues to be oversupplied with good output levels from non-OPEC countries supporting production. The impact of high OPEC spare capacity and the fact that Saudi Arabia is currently capable of producing an additional 3 million-plus barrels/day within 90 days is intensifying pressure on the oil price. ³		
Oil demand	Demand growth is starting to recover in China and this is taken as a sign of an imminent, if weak, global recovery. Demand in OECD nations continues to struggle. 2010 is looking more promising but oil demand will depend on the rate of economic recovery in China and the United States.		
Oil price	The recovery in the oil price to more than \$70 per barrel this quarter has been led by a combination of increasing market confidence on the back of better demand forecasts and the impact of reduced OPEC output. Price volatility has been a frequent feature of the oil markets.		
Gas supply	Gas supplies are plentiful in all regions and the strong impact of liquefied natural gas (LNG) continues to be felt in all markets as it continues to effectively compete with both indigenous and pipeline supply. New supply projects under way are typically LNG-related or, if not, are aiming to enhance supply flexibility with alternatives. Drilling pullbacks and LNG production shut-ins remain in evidence.		
Gas demand	Gas demand continues to fall in Europe and the United States as demand from industrial users declines. The impact is to make the gas market very unpredictable, with suppliers concerned about the market conditions affecting the type and timing of their new projects, and buyers concerned about security of supply and pricing flexibility.		
Gas price	The lower oil price from earlier in 2009 has now manifested itself in the indexation terms in many gas contracts. Lower gas prices mean more gas is moving into storage as companies take advantage of the reduced price environment. In the United States, prices remain stubbornly low, with good supply from both LNG and new shale plays, maintaining downward pressure on prices.		
Refining	Refining margins for the second quarter of 2009 were volatile and show little uniformity, with some price spreads performing better than others. The trend toward maximizing complexity fell off this quarter as coking margins collapsed, demonstrating the value of flexibility in global refining portfolios. Heavy feedstock users suffered as upstream producers aimed to maximize the sales of higher-value light feedstock.		
M&A	The merger and acquisitions (M&A) market is showing real signs of recovery although buyers are proving choosy about the assets for which they are prepared to pay. Key regions and plays are driving activity such as West Africa, and shale plays in the United States and Australia. Reflecting poor current economic conditions, the United States generally is proving disappointing for M&A activity, particularly in the gas arena.		
Rig count	For the first time in several months, the number of US rigs—especially onshore gas rigs—has shown some sign of recovery from a long downward trend. Worldwide, the number of rigs in use has further decreased, indicating more uncertainty. Deepwater activity continues to be strong.		
Companies	Second quarter of 2009 oil company performance continues to decline. Executives are already tackling the most pressing problems—high costs and unpredictable cash flow. The oil price has more than halved from its 2008 record however costs have fallen at a slower pace. The result is that oil company cash flow is being eaten up by dividends and exploration, and many are having to increase debt or borrow to meet payments.		

Risk management: Achieving high performance with the right investment for the times

As abstract as a risk management strategy can sound, it urgently relates to events on the ground. No one knows that better than today's corporations. There is nothing abstract about financially endangered enterprises collapsing in near domino fashion, with reverberating consequences across the globe. Risk management comes to prominence on the corporate agenda because so much depends on it now.

The good news is that there are effective ways to identify, measure, monitor and report risk and make sure no limits are being breached. Risk management can be driven by compliance—or it can be visionary and manage risks in ever more integrated ways. Choosing the latter approach, a company can use risk management to create higher value in the business.

Always, effective risk management derives from the culture of the organization. With that culture understood, the chosen level of risk tolerance can be implemented company-wide. This can be a company where people know the limits. It can be a company that is venturesome, but it may choose to be incrementally so—assessing measurable results along the way. Processes and technology give a company's risk management a competitive edge. But at a fundamental level, getting the right risk culture to penetrate throughout the organization is one of the most valuable investments a company can make.

Accenture can help businesses on their journey to high performance through risk management. We can be with you anywhere on the continuum of risk management models. We can offer a team of people with deep global and industry experience—people who are pragmatic in their approach. We can offer professionals who can provide insight and guidance on how to put strategy and risk management together for a company—and make it work. We know how to help you use risk management to its fullest potential—and help move your company closer to achieving high performance.

Economic Outlook

Key trend—World economic growth is showing signs of recovery but, short term, is expected to decline by 1.4 percent in 2009. The main priority remains restoring financial sector health.⁴ Increasingly, there are concerns in the market that a more robust oil price might start to affect the global recovery going forward in 2009 and 2010.

Observation

More-developed countries continue to struggle more than emerging markets, although a few developed economies (such as France, Germany and Japan) have reported positive economic growth figures for the most recent calendar quarter. In emerging markets there are major regional differences, depending on strength of domestic demand, export dependence and the availability of a financial buffer generated through oil resources. China continues to look strong and is expected to overtake Germany as the world's largest exporter in 2009. Does this mean the recession is over or is this simply the lull before the next storm?

In a rush to latch onto any positive economic data, the markets have been advancing ahead, anticipating recovery only to fall back when unexpectedly weak economic indicators come through. This is one of the factors contributing to the volatility being witnessed in the markets. In addition, the specter of rising energy prices (oil has risen in value by 50 percent since January) could hamper recovery down the line if sentiment pushes prices up too quickly. Some analysts believe that the recent fall in energy prices has worked as an unofficial economic stimulus. If prices rise too high too fast, the "stimulus" may quickly disappear.

Oil supply

Key trend—Organization of Petroleum Exporting Countries (OPEC) is generally adhering to its production cuts although the market continues to be oversupplied with good output levels from non-OPEC countries supporting production. The impact of high OPEC

spare capacity and the fact that Saudi Arabia is currently capable of producing an additional 3 million-plus barrels/day within 90 days is intensifying pressure on the oil price.⁵

Observation

Global supply levels remain adequate given the current curtail in demand for oil. Even with the cuts in production by OPEC members, additional volumes have entered the market from places like Russia and Saudi Arabia as new production facilities come online. Debate continues to rage between those who think there is enough excess supply capacity in the market to meet the needs of a recovering global economy and those who believe that project delays due to the downturn mean the world will lack adequate supplies over the next two to five years. Much of the outcome will depend on how quickly demand resurfaces and whether the energy industry has timed its capacity investment properly to match anticipated rising demand levels.

Oil demand

Key trend—Demand growth is starting to recover in China and this is taken as a sign of an imminent, if weak, global recovery. Demand in OECD (Organisation for Economic Co-operation and Development) nations continues to struggle. The year 2010 is looking more promising but oil demand will depend on the rate of economic recovery in China and the United States.

Observation

Given the tentative signals of economic recovery, the signs of an upturn in global oil demand are equally tentative. Many emerging economies have taken advantage of lower prices to stockpile commodities, including oil. There is concern by some analysts that this stockpiling is coming to an end as storage capacity fills and that any upturn in demand for commodities may have been a temporary phenomenon. Real, sustained evidence of an economic recovery will be required to move the needle with respect to oil demand.

Oil prices

Key trend—The recovery in the oil price to more than \$70 per barrel this quarter has been led by a combination of increasing market confidence on the back of better demand forecasts and the impact of reduced OPEC output. Price volatility has been a frequent feature of the oil markets.

Observation

Volatility continues in the oil markets. While the general range of oil prices for the quarter has spanned from \$50/barrel to \$74/barrel, there has been a great deal of movement up and down within the range. Hopes about an economic recovery, combined with a long-term belief that supplies of oil may be under pressure, keep market traders intent on pushing the oil price toward the top end of the range rather than the bottom end. The danger is if oil prices rise too quickly, they could derail any economic recovery and the world may get pushed into cycles of economic upturns and downturns, feeding off of commodity inflation or deflation.

Gas supply

Key trend—Gas supplies are plentiful in all regions and the strong impact of liquefied natural gas (LNG) continues to be felt in all markets as it continues to effectively compete with both indigenous and pipeline supply. New supply projects under way are typically LNG-related or, if not, are aiming to enhance supply flexibility with alternatives. Drilling pullbacks and LNG production shut-ins remain in evidence.

Gas demand

Key trend—Gas demand continues to fall in both Europe and the United States as demand from industrial users declines. The impact is to make the gas market very unpredictable—with suppliers concerned about the market conditions affecting the type and timing of their new projects, and buyers concerned about security of supply and pricing flexibility.

Gas price

Key trend—The lower oil price from earlier in 2009 has now manifested itself in the indexation terms in many gas contracts. Lower gas prices mean more gas is moving into storage as companies take advantage of the reduced-price environment. In the United States, prices remain stubbornly low, with good supply from both LNG and new shale plays, maintaining downward pressure on prices.

Gas sector observations

From a supply perspective, gas markets are oversupplied. As with oil, demand for gas has not yet rebounded even in the face of some early signals of economic recovery. During 2009, gas production is expected to fall both in Europe and the United States. Suppliers are becoming increasingly concerned about how market conditions are affecting the type and timing of their new projects. From an LNG supply perspective, production issues have curtailed activity in

places like Nigeria and Angola. One geography bucking the trend is Australia. A number of recent gas-related deals have been finalized and new projects proposed. Australia is positioning itself to be a major gas player once recovery takes hold.

On the demand side, short-term gas demand in Asia, Europe and the United States remains depressed, due to lower power generation and industrial requirements. Gas purchasers are becoming more concerned about security of supply and pricing flexibility given current market conditions. However, gas demand is expected to rebound over the longer term. This is especially true in Europe, where a lack of domestically generated supply means a strong shift from gas exporter to gas importer. Asia equally should see a rise in demand as manufacturing comes back online once recovery ensues. At present, LNG buyers for their part continue to defer cargoes as allowed under their contract terms while some sellers are reducing

the amount of flexible LNG in their portfolios trying to find a market and are instead choosing to sell the gas under contract.

Gas prices are holding up in Europe but remain under pressure from the good supply outlook. From a US perspective, oversupply of gas combined with falling industrial demand is keeping gas prices depressed. Any strength in global LNG prices is being supplied by Asia where demand for gas in China and India remains solid though many Asian buyers continue to defer cargo deliveries. At the other extreme, concerns about low gas prices in the United States are prompting speculation regarding suppliers of associated gas reducing output, though with the oil price now more robust, most gas suppliers seem happy to take a hit on LNG prices to gain the return on the liquids production side.

Changing Energy Trends

Refining

Key trend—Refining margins for the second quarter of 2009 were volatile and show little uniformity with some price spreads performing better than others. The trend toward maximizing complexity fell off this quarter as coking margins collapsed, demonstrating the value of flexibility in global refining portfolios. Heavy feedstock users suffered as upstream producers aimed to maximize the sales of higher-value light feedstock.

Observation

Refining utilization remains low as weak demand and margins continue to drive down activity. From an OECD perspective, lower utilization rates could become a more permanent feature of the sector. This is dependent primarily on two factors—the impact of emissions legislation on ultimate OECD fuel consumption and the prevalence of larger, more complex non-OECD

refineries. Recent recovery in US refining utilization rates is likely to be temporary, helped by the summer driving season. Better demand forecasts in Asia for the remainder of 2009 are likely to contribute to throughput growth in the region.

Refining margins, given current product demand levels, continue to be under pressure but, as with the oil market, have shown increasing volatility. Refinery configurations, product yields and price variations all have contributed to the volatile nature of refining margins in different geographies with some margins rising while others fall.

Mergers and acquisitions

Key trend—The M&A market is showing real signs of recovery though buyers are proving choosy about the assets for which they are prepared to pay. Key regions and plays are driving activity, such as West Africa, and shale plays

in the United States and Australia. Reflecting poor current economic conditions, the United States generally is proving disappointing for M&A activity, particularly in the gas arena.

Observation

Second quarter M&A deals finally saw a real upswing as the rising oil price and better credit conditions filtered through to the market. While there has been an upturn in M&A, the market still remains greatly subdued in comparison to the previous few years. Regionally the United States, which has historically been a center of M&A activity, has been quite quiet. Instead, activity has picked up in places like Australia (especially, coal bed methane plays) and West Africa. Bidders are being more selective about the assets they are purchasing, with some assets failing to find a buyer even in the midst of much speculation. NOCs, while also taking a reflective

approach to acquisitions, have not been afraid to close some of the largest-value deals of the quarter. From an oilfield services perspective, some analysts predict that activity in the sector soon will increase with corporate buyers looking for strategic deals.

Rig count

Key trend—For the first time in several months, the number of US rigs—especially onshore gas rigs—has shown some sign of recovery from a long downward trend. Worldwide, the number of rigs in use has further decreased, indicating more uncertainty. Deepwater activity continues to be strong.

Observation

The second quarter of 2009 was characterized by an upward trend in US oil and gas rig activity and a slowing decrease in the number of worldwide rigs. The US trend may be upward but it is also nascent, reflecting the general pullback in production over the past year. Africa remains one of the more robust geographies for rig utilization, showing a small increase in the number of rigs deployed for oil production. Deepwater drilling rig activity, the segment that so far seems to have shunned the downturn, remains healthy but is seeing the impact of the downturn reflected in the form of lower rental rates.

Company Trends

Key trend—Second quarter of 2009 oil company performance continues to decline. Executives are already tackling the most pressing problems: high costs and unpredictable cash flow. The oil price has more than halved from its 2008 record; however, costs have fallen at a slower pace. The result is that oil company cash flow is being eaten up by dividends and exploration, and many are having to increase debt or borrow to meet payments.

Observation

Given the drop in oil and gas prices, it came as no surprise to industry commentators that second quarter 2009 company profits have declined. Most quarterly presentations were discussing how firms were approaching cutting costs. Many companies are still waiting for cost decreases to feed through the

supply chain and are frustrated at the lag when compared to the speed in the fall of oil and gas prices. This quarter saw particular challenges for some key NOC-dominated countries like Iraq, Nigeria and Brazil—all for differing geopolitical reasons. Most companies are sticking to the capital expenditure (CAPEX) plans they announced in early 2009 and as costs continue to come down, many are sitting more comfortably than a few months ago due to the fact that the oil price has rebounded somewhat. Going forward, analysts are watching both cash flows and gearing levels and assessing the impact these will have on dividend and CAPEX policies.

Endnotes

1 "Warning: oil supplies are running out fast," The Independent, August 3, 2009, via Factiva, © 2009 Independent & Media PLC.

2 "G8 grasps for exit strategy from costly economic rescue," Agence France Presse, July 9, 2009, via Factiva, © 2009 Independent & Media PLC.

3 © OECD/IEA, Oil Market Report, July 10, 2009, <http://omrpublic.iea.org/currentissues/full.pdf>

4 "G8 grasps for exit strategy from costly economic rescue," Agence France Presse, July 9, 2009, via Factiva, © 2009 Independent & Media PLC.

5 © OECD/IEA, Oil Market Report, July 10, 2009, <http://omrpublic.iea.org/currentissues/full.pdf>

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Combining unparalleled experience, comprehensive capabilities across all industries and business functions, and extensive research on the world's most successful companies, Accenture collaborates with clients to help them become high-performance businesses and governments. With approximately 177,000 people serving clients in over 120 countries, the company generated net revenues of US\$23.39 billion for the fiscal year ended Aug. 31, 2008.

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