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OFFSHORE OUTLOOK BRIGHTENS

FORECASTS OF THE INDUSTRY'S IMMINENT DEMISE ARE GREATLY EXAGGERATED.

From negative $37 per barrel to nearly $70, the oil price recovery in recent months is buoying energy industry optimism for 2021. Last year, collapsing oil demand due to the pandemic and economic lockdowns raised questions about the industry's viability.

A price war between oil exporters Saudi Arabia and Russia needed the intervention of a U.S. president to save the oil industry from being crushed by soaring inventories. Despite this effort, activity came to a near standstill. Hundreds of thousands of jobs were lost. Bankruptcies soared, and gloom enveloped the industry.

Now, thoughts of $100 a barrel oil are floating in executives' heads. What's changed?

ROLLER-COASTER RIDE

The past 18 months marked one of the sharpest roller-coaster rides for the global oil industry since the mid-1980s. Then, the industry went from boom to bust in a matter of months, just like last year. Near-term, the industry faces continuing supply/demand and oil price questions: Will the pandemic again rear its ugly head and slam shut economic activity? In Europe, it seems to be happening.

Hydrocarbons' long-term challenge is a decarbonized world with less oil and gas needed. That reality would force structural changes on the industry. Such changes may be understood, but their timing is impossible to predict. However, prospects for a sunsetting industry are weighing on industry executives' views of the future, especially for those companies operating offshore that need long horizons for planning.

Offshore waters account for 70 percent of the world's surface, but importantly they contain many unexplored hydrocarbon basins. New technologies have cut the cost of finding and producing offshore petroleum, breathing life into the industry. In the Gulf of Mexico, oil prospects that needed prices of $60-$80 per barrel to be profitable are now viable at $40-$60.

Despite Gulf of Mexico and North Sea output falling last year, offshore oil still represents 30 percent of global supply and nearly the same share for natural gas. Over the past two decades, offshore natural gas production has grown nearly 50 percent as the cleaner-burning fuel helped create a world LNG market. The push for a low-carbon global economy further boosts LNG's prospects, prompting an active search for new offshore gas reserves.

"LOWER FOR LONGER"

In 2014, when Saudi Arabia stopped supporting OPEC oil prices, the collapse kicked off the "lower for longer" era. Initially, producing and service company executives expected a quick oil price rebound. When that didn't happen, they cut costs, reduced work and targeted low-cost projects.

This new era set back the anticipated offshore boom, which had kicked off in the late 2000s with $100 per barrel oil prices. The

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arrival of newbuild deepwater drilling rigs and offshore support vessels swelled fleets well beyond industry's reduced needs. Pricing was destroyed.

The offshore service industry plunged into a depression, which it's struggling to escape. Low commodity prices depressed customer spending, driving almost every offshore service company into bankruptcy protection while managers worked with creditors to restructure balance sheets and ownership interests.

As 2020 began, oil reached $60 per barrel, generating optimism that the era of low oil prices was ending. A budding offshore recovery spurred thoughts of meaningful activity increases. That optimism was dashed with the realization that a deadly virus was spreading rapidly across the world. Stopping economic activity appeared the only way to prevent the spread of the virus.

In a matter of weeks, the world grew to understand the critical role oil and gas plays in a functioning economy. Oil and gas provides the health products desperately needed – like face shields, masks, latex gloves and other personal protective equipment, all of which are made from plastic and other petrochemical derivatives.

When people and businesses ceased using petroleum, global oil inventories soared as producers were unable to shutter wells fast enough, let alone deal with the volume of oil in transit around the world. More supply than needed crashed oil prices – taking industry activity down, too. Between March and April, when lockdowns were instituted and pandemic fears were at their worst, global drilling activity dropped 23 percent. Fortunately, offshore drilling only slumped 6.5 percent, reflecting the long lead-times necessary for the sector's adjustment.

That long lead-time challenge is working in reverse this year. Last May, with oil futures rebounding from negative levels, land drilling recovered quickly. Offshore activity, however, continued declining until October, five months after land drilling bottomed.

Gulf of Mexico drilling did not follow the pattern of international offshore drilling as its rig count bottomed in June, having fallen by half. Today, the Gulf rig count has nearly fully returned to its January 2020 level, but the international count is only slowly recovering.

All aspects of offshore petroleum were impacted by last year's rig count decline. The sad part is that for every drilling rig and support and construction vessel idled, workers were discharged. Hiring workers to staff more offshore equipment will be a welcome change

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this year as more units go to work.

The pandemic's hit to energy markets extended to the LNG business in the U.S. Upwards of 120 cargoes of liquefied natural gas were cancelled as demand for gas-generated power fell and a second warm winter left foreign consumers with an abundance of supply and not needing new shipments. The LNG tide is turning, too.

SNAPBACK

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The snapback in oil and gas demand has forecasters bringing forward their dates for the return to pre-pandemic demand after previously predicting that would not happen for two to three more years.

Consultant Rystad Energy recently projected offshore project commitments will not only recover this year but may set a new record in the five-year period to 2025. They project almost 600 new projects with deepwater commitments enjoying the largest growth because their cost has now become much more competitive against greenfield continental shelf reserves. Offshore will still face a cost battle against onshore drilling, but the prospect of larger reserves and greater well productivity will influence final investment decisions.

Increasingly, the mature offshore basins – Gulf of Mexico and North Sea – face additional pressures, possibly slowing their recoveries. Higher costs from fewer and smaller hydrocarbon deposits must be balanced against the benefits of an existing extensive production infrastructure. But the greatest challenge facing producers is government attitudes toward fossil fuels. These pressures are greatest in the mature economies, ignoring the rewards exploiting offshore resources bring for coastal countries.

Signs of an improving offshore market are growing. A leading seismic survey company is reactivating vessels for work this summer. Exploration is critical for the future of offshore production. More seismic suggests more offshore drilling on the horizon. Drilling contractors are announcing new rig contracts. This is welcome news for all sectors of the offshore support industry.

Similarly, LNG demand is growing as colder weather across the Northern Hemi-

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sphere has depleted inventories. Not only does that mean more work for LNG tankers, but it drives the international search for gas.

CHALLENGES & OPPORTUNITIES

While energy forecasters struggle in predicting the pace of recovery, they all foresee greater demand. The complicating issue is assessing which pandemic-related behavioral changes will continue, limiting energy consumption growth. Furthermore, forecasters wrestle with the ESG and anti-fossil fuel measures that may curb oil and gas use.

"Environment, social and governance" are buzzwords reshaping management thinking. ESG influences investor willingness to provide capital to the industry as well as the pace of government initiatives to restrict fossil fuel use. For companies operating in the high-cost offshore sector, financial discipline and access to capital are critical. At the same time, lower offshore finding and development costs will allow the industry to tap resources in previously unexplored regions of the world.

Meanwhile, the offshore service industry has embarked on a new chapter – exploiting the oceans' wind energy. Although an established feature in U.K. and Danish waters, offshore wind farms are now sprouting in Asia and soon will provide electricity for the U.S. East Coast.

To date, offshore wind farms have been primarily installed in shallow waters, enabling them to be mounted on fixed structures embedded in the ocean floor. The move into deeper waters means turbines are placed on floating structures that must be anchored. Floating turbines cannot support the weight of winches to tighten their anchor lines, so anchoring them creates a new market for large anchor-handling oilfield support vessels.

BRIGHTER DAYS AHEAD?

The dark days for the offshore oil and gas industry are receding. Brighter days lie ahead. Even though offshore activity may not return to its past trajectory, or even to recent peak levels, surviving companies should be able to forge a profitable future.

Dark clouds predicting the eventual demise of fossil fuels hang over the industry's future, but the reality is that oil and gas, and their byproducts, will be needed for much longer than forecasts project. With large, highly prolific hydrocarbon deposits lying under the oceans of the world, the offshore industry will remain a key player.

***Mar**Ex*