Oil and gas industry overview

Naturally resourceful. A look at the top issues facing the oil and gas sector. Current oil price fluctuations unlikely to impact global industry trajectory.

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Continuing economic uncertainty, leading to a reduction in demand for oil and gas resources from the world's second largest economy continues to send shockwaves reverberating through the industry. The changing supply dynamics introduced by unconventionals, the geopolitical issues affecting certain key producers and consumer jurisdictions and the combined downward pressures on pricing currently provide a prevailing backdrop of industry uncertainty.

The cyclicality of the oil and gas industry is, however, unlikely to impact the long term global trajectory of the sector.

Nevertheless, the fluctuations presently being experienced may speed up certain trends that were already unfolding according to Deloitte's 2015 Oil and Gas Reality Check report.

This report outlines six of the major issues currently impacting the oil and gas industry (and the upstream market in particular).

These issues include an anticipated shift in supply-demand fundamentals, the emergence of new trading patterns, consideration of OPEC's role in the market, falling LNG prices, the long-term costs of complex projects and evolving dynamics between integrated oil companies (IOCs) and national oil companies (NOCs).

The report highlights the following key trends:

1. **Shift in supply-demand fundamentals**

Fluctuating industry dynamics are fuelling a power play between traditional and new oil suppliers.

For example, the United States continues to maintain its place as a major producer of both oil and gas, while historical energy trade patterns are shifting.

With the loss of the United States as an anchor market, the world's major oil suppliers are searching for new buyers.

2. **New trading patterns emerging**

As oil and gas supply and demand fundamentals continue to evolve, new global trade patterns are emerging. As a result, this could threaten OPEC's traditional position on global markets, although this is not a likely outcome in the short-term.

What is certain is that OPEC will be seeking new buyers as North America increasingly meets its own demand, and it may aim to pick up market share from Western Europe.

3. **OPEC: under pressure**

The OPEC organization currently supplies approximately 32% of the world's crude oil. However, OPEC's oil market share will fall by 5%[1] by 2018 as the supply of US tight oil picks up.

While that share may recover over the long term as supply patterns shift (particularly if US production flattens), OPEC will cede power in the interim.

4. **LNG prices: a buyer's market**

The price of LNG was once a model for stability, it is less so now. Until prices stabilize, natural gas will trade in more geographically proximate regions.

That means Australian LNG will likely retain its north/south advantage, providing supply to Singapore, Taiwan, Japan and South Korea. Conversely, North American producers have a more natural trading advantage with Europe.

The most cost efficient producers are the ones most likely to win global market share, especially as supply-demand economics kick in. This may ultimately give the United States (and perhaps Canada) a competitive advantage, as their break even points on LNG projects are typically lower

5. **Investing in innovation: the cost of complexity**

Capital spending is likely to fall off in the near term; however, megaprojects will still be required to meet long-term global energy demand.

To avoid the cost and time overruns that have typically characterized these projects, companies will likely want to explore a range of strategies, including pre-project planning, integrated project delivery, lean project management, modularization and talent management. They may also want to invest in advanced analytics to enable agile project monitoring and evaluation.

6. **National and integrated oil companies: evolving dynamics**

It is currently hard to foresee a future where IOCs don't play a pivotal role in oil and gas exploration and production.

Yet, in areas where the IOCs' traditional strengths are not required, it is possible to envision IOCs losing market share to large OFS players and to NOCs, particularly for non-technical projects.

To prevent this slow erosion, IOCs will need to guard against the instinct to engage in mass layoffs while commodity prices remain soft. While there is always room for heightened cost consciousness, IOCs may want to avoid putting themselves into a position where they lack the talent and momentum they need not only to ramp production back up once prices recover, but to maintain their edge in a shifting competitive landscape.

These issues facing the global industry impact upon the oil and gas industry in Kazakhstan to varying degrees. They should, however, also be considered alongside certain issues either specific to Kazakhstan or which are likely to have a more keenly felt impact upon the industry and its participants in Kazakhstan.

Downward cost pressures and relative capital scarcity amongst both super majors and more junior producers means that it is more crucial than ever for Kazakhstan to position itself as an attractive destination for such capital to be invested.

This means not just the general provision of a climate that enables investment but one where returns on capital can reach necessary levels such that investment decisions to direct capital to Kazakhstan rather than alternative projects and jurisdictions are facilitated.

Such improved returns on investment could be secured via a reform of the fiscal regime applicable to subsoil users and new projects. This reform continues to be campaigned for by producers, industry associations and professional advisors alike.

Certain elements of potential fiscal reform (such as a mooted replacement of VAT with a sales tax regime,) which could increase the cost base of Kazakhstan-based producers, will only serve so as to diminish available returns on capital and render Kazakhstan less attractive as a destination for oil and gas investments.

Today's oil and gas landscape is one where increasing numbers of alternative supply sources and investment opportunities compete for both limited demand and limited investment capital. Insofar as major further sources of supply (such as a sanction-relieved Iran) were to come fully into the competitive landscape then the ferocity of competition would only increase.

Accordingly, it is imperative that Kazakhstan mobilises all available state and commercial resources to maximise the agility and the competitiveness of its responses to the challenges facing the oil and gas industry in 2015.

[1] *OPEC's World Oil Outlook for 2014*