Offshore Ultra-Deepwater O&G Development

The offshore O&G industry has traditionally faced numerous challenges, including higher operational costs, contractual difficulties and greater risk profiles, which have been exacerbated by lower global oil prices. Given the lengthy start-up time for offshore O&G projects, these constraints have tempered the short-term outlook for offshore crude oil production. The resulting reduction in supply will reduce margins for producers and suppliers, slow countries’ offshore development aims and dissuade rapid re-entry into the market. However, companies can weather these changes by implementing long-term strategies that hedge against downturns by maintaining liquidity in capital reserves and exploring the most economically-efficient offshore markets.

Despite cost saving measure such as cold stacking, shut-in stacking and contract modifications, offshore O&G is especially vulnerable to price changes. High per barrel break-even price for offshore operations and high start-up costs makes exposure greater to the drop in oil prices. Since 2015, low global oil prices have forced IOCs to decrease investments in offshore development to reign in capital expenditure on high-cost exploration and production. The longer oil remains at its current low level, significant shutdown and investment deferments will occur. It is estimated that from the beginning of the oil price decline in late 2014 to the end of 2015, $213 billion worth of deepwater investment has already been suspended around the world. Projections have stated that the effect of these delays will be a roughly 1.5 million bbl/d reduction in deepwater production and 500,000 bbl/d reduction in shallow water production by 2025.1

Cuts in exploration and production budgets are reducing interest in many foreign auctions. Recent auctions for offshore blocks have been disappointing for many nations which were previously seen as promising investment locations. In 2015, for example, Brazil sold only 37 of the 266 blocks it made available. There are opportunities for firms that still possess the liquidity to invest in countries offering more favorable terms (in order to incentivize companies to bid on blocks). Given these blocks require years of investments before becoming profitable, companies will need to plan on weathering the low oil price environment into 2017.

Market participants that are able to remain active in the sector will benefit from an oversupply of new rigs. With a multi-year average construction time, many offshore rigs under construction were contracted in an environment of higher oil prices, and some manufacturers even began to construct rigs in anticipation of future orders. Considering the overabundant supply of new rigs, rig day rates are likely to be depressed until the supply overhang is absorbed. In addition, declining rig utilization and supply costs will lower operation costs and provide incentives for rigs to stay in operation.

Emerging Offshore Opportunities

Over the past few decades, technological changes have accelerated the efficiency and capabilities of offshore exploration. These technological changes have helped increase the number of offshore discoveries, and today offshore production is approximately 27 MMboe/d, or 28 percent of the world’s total O&G production. Robust offshore
industries have developed in key O&G countries, including, but not limited to, the United States, Brazil, Canada, China, Indonesia, Malaysia, Mexico, and Norway. In addition to these established markets, there are several other countries that are interested in developing their offshore deposits, such as Guyana, Tanzania, Egypt, and Ireland, which could provide opportunities for U.S. O&G exporters to supply their expertise and their equipment.

In May 2015, ExxonMobil confirmed an offshore oil discovery, Liza-1, off the coast of the South American country of Guyana, which has been estimated to hold 700 million barrels of oil. At current prices, it would make the Liza-1 well worth around $40 billion, a significant find for Guyana, whose gross domestic product is a little more than $3 billion. However, there are two issues that remain: (1) the discovery was made in an area that is claimed by Venezuela; and (2) there is no established O&G industry or infrastructure in Guyana. ExxonMobil has stated that it will drill a second exploratory well and that it expects O&G production from Liza-1 by 2020.

Since 2010, there have been several natural gas offshore discoveries in southern Tanzania, which could allow Tanzania to become an important exporter of LNG in the coming years. In particular, discoveries by IOC partnerships are estimated at 16-17 Tcf and 22 Tcf of recoverable natural gas resources. However, there are several challenges that Tanzania faces in the development of its LNG industry, including significant fiscal and regulatory uncertainty, potential renegotiation of existing PSAs to increase the government's share, and the absence of a traditional O&G industry. Despite these hurdles, Tanzania has moved ahead with plans to build an onshore LNG plant near Lindi, in association with BG Group, Statoil, ExxonMobil and Ophir Energy. LNG production is expected in the early 2020s.

In 2015, the Italian company ENI confirmed the discovery of the “supergiant” Zohr natural gas field off the coast of Egypt, which could hold up to 30 Tcf of gas. At current prices, the gas could be worth about $100 billion. Egypt's O&G sector has become a more hospitable investment environment under the Sisi administration, which raised the low domestic fuel prices that previously deterred foreign investment in O&G production in Egypt. ENI plans to commence production at the Zohr field by the end of 2017. In addition to ENI, BP is also in the process of developing three offshore natural gas fields and intends to initiate production in 2017, with full-scale production reaching 1.2 Bcf per day.

In February 2016, the Irish government awarded 14 new licensing options that give companies access to offshore blocks for two years. Interest in Ireland’s offshore sector has heightened recently, with the most recent offshore licensing round receiving the most applications in its history. While Ireland remains a high risk and high cost country for O&G exploration and production, the significant amount of interest in the 2016 licensing round demonstrates that companies still see the potential for new O&G discoveries. The most recent discovery in offshore Ireland was the Barryroe field in the Celtic Sea discovered by Providence Resources in 2012. The Barryroe oil field could hold more than 1.6 billion barrels, but production is delayed as the company could not find partners to develop the field.

1 http://www.woodmac.com/media-centre/12530462