



**Rising Fortunes 3:
Examining growth in
the oil and gas industry.**

Welcome.

Welcome to Bank of Scotland's third annual oil and gas sector report; exploring the opportunities and challenges facing one of Scotland and the UK's biggest growth generators. Our two previous reports painted an optimistic picture and I am pleased that our 2014 research shows that confidence remains high.

The 100 companies surveyed for Rising Fortunes 3 have indicated that they plan to create almost 6,000 new jobs over the next two years. This is up from the 5,000 reported last year and if replicated across the industry would see tens of thousands of new jobs created. The findings of this survey are excellent news for the economy demonstrating the employment generating nature of the oil and gas industry.

Concerns around talent in the sector have also grown, with 38% naming a shortage of skills as the greatest challenge they'll face in the same period, up from one-third (33%) last year. However, we know that positive action is underway to address this shortfall, with new partnerships between higher education institutions and industry as well as the creation of new specialist apprenticeship schemes which we hope to see continue.

The results also demonstrate the global nature of the industry as more firms look to expand internationally and tap into the markets with the largest levels of recoverable reserves. 64% told us international expansion is a priority. Africa is the priority market for future investment with over a fifth (21%) targeting growth there while North America (17%) and the Middle East (18%) also remained key areas for investment.

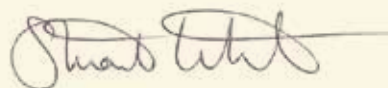
With 44% of income already generated internationally, this is not a new trend, but it does reflect the reach UK firms have as the industry benefits from the expertise gained in the challenging North Sea environment. Our client base mirrors this trend, and we have seen a significant increase in our support to the industry in recent years to facilitate international expansion and, as outlined in this year's report, we expect this trend to continue.

In addition, the survey found nearly half of all companies (48%) were moderately to intensely interested in diversifying into unconventional oil and gas, whilst nearly two-fifths (38%) had the same degree of interest in funding solutions for decommissioning activities. There was also substantial interest, amongst slightly more than a third (36%) in diversifying into renewables.

It is vitally important we keep pace with what is predicted to be a period of not just expansion but diversification. Bank of Scotland is committed to playing its part to ensure the UK and Scotland continue to make their mark in this key industry.



Stuart White
Area Director,
Aberdeen and
North of Scotland,
Bank of Scotland
Commercial Banking



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Thousands of jobs are expected in the oil and gas sector over the next two years. This section looks at where these jobs will come from.

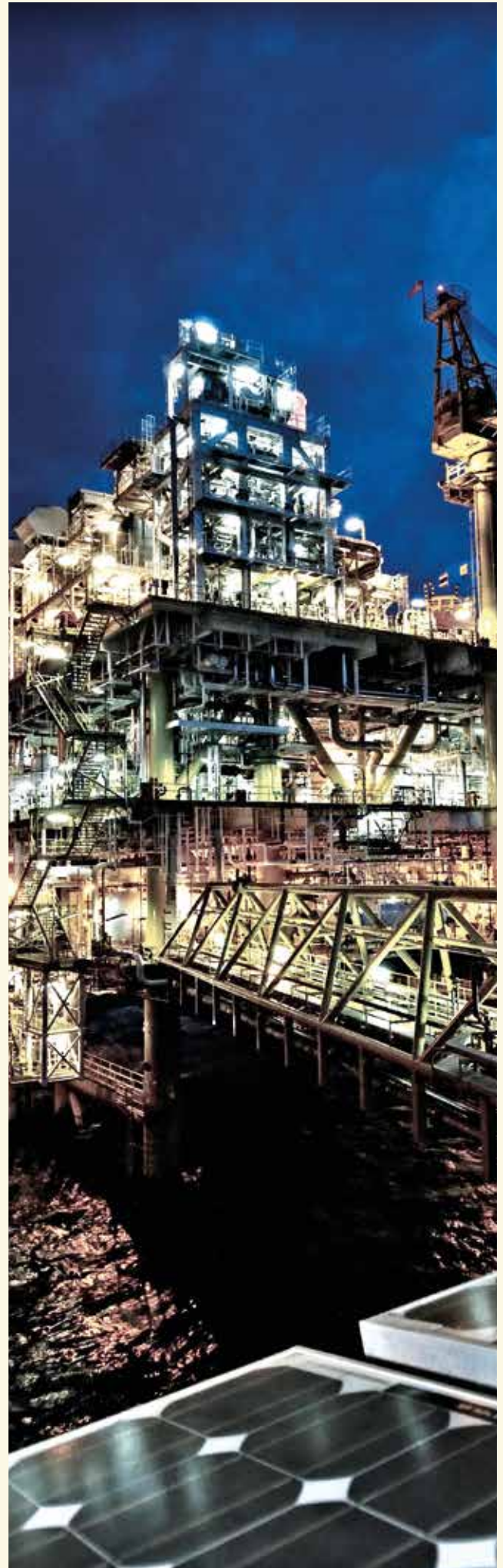
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Executive summary.

Seven out of ten UK oil and gas companies are planning growth in 2014-15, a slight reduction from growth expectations in 2013 (77% down to 69%), but still a substantial amount of growth. Expectations of growth by mergers and acquisitions are slightly down (11% down to 9%) as are expectations of organic growth (66% to 60%).

Suppliers of equipment and services are much more orientated towards growth (82% planning growth) than are exploration and production companies (72%) with companies in the North and Midlands of England most growth-orientated (83%), followed by companies in Scotland (72%) with firms in the South of England the least growth-orientated (66%).

All sizes of companies primarily rely on cash reserves or cash flow to finance growth and there has been marked growth in alternative sources of funds - trade and asset financing. Small companies are particularly averse to using debt.

The continent of Africa as a whole is now the most attractive location for overseas expansion for UK oil and gas companies, although traditional markets of America and Middle East still hold most attention. The rapid growth in conventional oil and gas discoveries in Africa, particularly East Africa, explain the continent's allure.

The proportion of companies relying on the North Sea for their growth is reducing, with the percentage of equipment and services suppliers not considering overseas growth particularly pronounced, down from 38% last year to 23% this year.

The survey indicates that about 39,000 jobs could be created by the UK oil and gas industry in 2014. Four times as many jobs are expected to be created by suppliers of equipment and services as by explorers and producers. Slightly more than half of the jobs are expected to be created by companies based in Scotland. Many of these jobs, perhaps about a third, will be located overseas. The survey also indicates that the industry could invest about £18.5bn in 2014, a slight reduction on 2013 investment levels. Comparison with

industry and analysts' forecast for UK investment suggest that about a third of this investment will be overseas.

Nearly half of all companies have some interest in diversifying into onshore shale and gas with a quarter of exploration and production companies showing keen interest. Two-fifths show moderate to keen interest in diversifying into renewables, and slightly more than a third are interested in finding funding for decommissioning.

Skills shortages are the biggest challenge facing the industry and the survey shows the problem is getting worse. This year, 38% named it as their biggest challenge, compared to 33% last year. Access to finance is still an issue, effecting suppliers of equipment and services more than explorers and producers.

Moving into new growth markets is seen as the biggest opportunity. Exploration and production companies are particularly keen to do that. Equipment and service suppliers see more opportunity in market diversification than do explorers and producers.

The mean forecast for the price per barrel of Brent crude this time next year was \$103.5, which puts the UK oil and gas industry at the higher end of the spectrum of forecast prices.

39,000

Jobs could be created by the UK oil and gas industry in 2014.

£18.5bn

The amount the industry could invest in 2014.

38%

of respondents named skills shortage as their biggest challenge.

Growth and finance plans.

Despite talk of the North Sea being in decline, a large majority of Britain's oil and gas executives (69%) see plenty of growth ahead.

This is, however, down on the 77% who predicted growth for their business last year. The fall is also in contrast to the rising optimism amongst leaders of the rest of Britain's onshore industry and commerce, which is now at a high not seen since the early 1990s¹. This seems odd. The steadily recovering UK and global economy which is causing rising consumer spending and business investment ought also to be pulling up the oil and gas sector. However, the North Sea is also affected by different factors which push more powerfully in the opposite direction. These include sharp rises in operation costs, up by 15.5% in 2013 with the number of fields with an average operating cost greater than £30 per barrel of oil equivalent (boe) doubling in the last year. Oil & Gas UK has also pointed to a challenging fiscal regime².

These pressures are having an effect. While Oil & Gas UK reported that ten new field developments costing £8bn and expected to recover 460 million boe, and 26 extensions of existing fields started in 2013, Chevron and Statoil separately postponed for a year investment decisions totalling £10bn on two fields with a combined 490 million boe recoverable³. Chevron said its Rosebank project did not "currently offer an economic value proposition" and Statoil said it wanted to "investigate the potential to make [its Bressay field] more cost effective⁴." And as the industry is global, there is obviously potential for the bigger independent oil companies, and indeed national oil corporations such as Statoil, to place their investment where it can earn a better return than may be available in the North Sea.

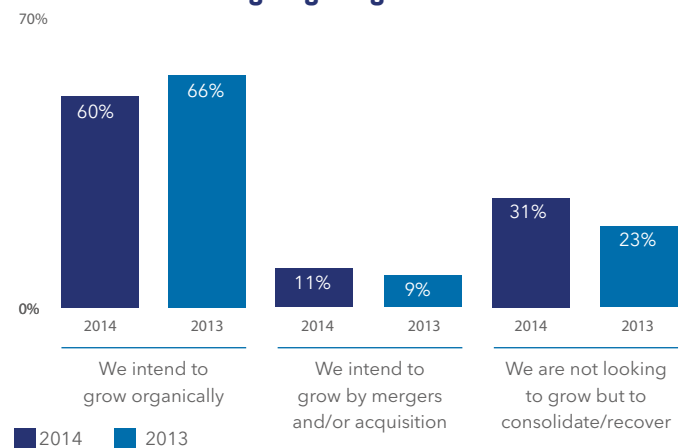
However, good news came from the Chancellor in his recent Budget statement with the announcement of a new allowance to be introduced for high pressure, high temperature (HPHT) fields. The announcement resulted in Maersk Oil and BG Group announcing that the HPHT allowance will help enable the development of two new projects, which will lead to investment of £6bn across new fields. The impression that costs are a major inhibitor is confirmed by the survey's finding that intentions to grow both by organic means and by mergers and acquisitions (M&A) have declined by an equal extent since last year.

Last year saw a big decline in M&A activity with European oil and gas transactions declining by 22% to 162, half of these in the North Sea. Nevertheless, upstream activity remained the most active market segment and accelerated in the second half of the year, which is promising for 2014⁵.

Also promising is the Wood Review of North Sea operations and regulatory regime, the final recommendations of which Sir Ian Wood believed "have the potential to deliver, at the low end, an additional 3-4 billion boe over the next 20 years, worth approximately £200bn to the UK's economy at today's prices⁶." The report was well received by both the industry and the government, so implementation might be expected soon.

Against this mixed background of threats to, and opportunities for, the North Sea - a picture which looks to be full of uncertainty also has clouds with silver linings - it is encouraging that seven out of ten firms see growth ahead. It isn't surprising, given that much of North Sea infrastructure is more than 30 years old, that firms engaged in inspection, repair and maintenance are the most optimistic with 89% of them stating organic growth intentions. And although there is universal acceptance that the oil in the North Sea yet to be discovered could be more difficult to extract, 60% of the exploration and production firms surveyed (just over a third of the sample) are focused on organic growth.

CHART 1.1: Harder going for growth



Companies based in the North and Midlands of England are the most optimistic (83% intending organic or M&A growth), followed by Scottish-based firms (72% intending growth), with those based in the South of England the least optimistic (67% intending growth). As in last year's survey, suppliers of equipment and services are much more orientated towards expansion (80% planning growth) than are explorers and producers (63% planning growth). But where last year's survey found that the bigger a company was, the more likely it was to have growth ambitions, this year's survey has found that expansion intentions are most probable amongst mid-sized firms. 94% of companies with a turnover of between £25-500m intended to grow, a proportion which fell to 80% amongst those turning over more than £500m, and dropped still further to 52% amongst those with a turnover of less than £25m.

The sources of funding the smaller companies intend to use to drive growth also varied. As a sector which has been cash-rich relative to other industrial sectors, nearly three-quarters of all companies habitually use either cash flow finance (38%) or cash reserves (33%). This is common to all sizes of firms, but smaller companies are more averse to using debt. Only 7% of enterprises with less than £25m turnover use debt, whereas 45% of companies with a mid-sized turnover do so. There has been a marked growth since last year in the proportion of companies using alternative to traditional forms of fund raising.

Last year's survey found only 3 per cent using trade finance (bank loans secured against firm orders often under-pinned by export credits). This year, 13 per cent of all firms used trade finance and the same proportion used asset finance (using balance sheet assets such as inventories to secure a loan). All sizes of companies used these means and they became particularly popular amongst large firms.

¹Lloyds Bank, Jan 2014. Business in Britain Available at: www.lloydsbankinggroup.com/globalassets/documents/media/business-research/bib_report_jan_2014.pdf ²Oil & Gas UK, February 2014. Activity Survey 2014,p3. Available at: www.oilandgasuk.co.uk/news/news.cfm/newsid/933 ³Oil & Gas UK, February 2014. Activity Survey 2014,p6. Available at: www.oilandgasuk.co.uk/news/news.cfm/newsid/933 ⁴Reuters, November 22, 2013. Chevron throws doubt on Rosebank North Sea development. Available at: www.reuters.com/article/2013/11/22/chevron-north-sea-idUSL5N0J73MH20131122 and Wall Street Journal Online, November 22, 2013. Statoil delays development of Bressay oil field. Available at: <http://online.wsj.com/article/BT-CO-20131122-703742.html> ⁵Ernst & Young, January 2014. Global Oil and Gas Transactions Review 2013, p34. Available at: [www.ey.com/Publication/vwLUAssets/Global_oil_and_gas_transactions_review_2013/\\$FILE/EY-Global_oil_and_gas_transactions_review_2013.pdf](http://www.ey.com/Publication/vwLUAssets/Global_oil_and_gas_transactions_review_2013/$FILE/EY-Global_oil_and_gas_transactions_review_2013.pdf) ⁶Sir Ian Wood, February 2014. UKCS: Maximising Recovery Review, Final Report, p7. Available at: www.woodreview.co.uk/documents/UKCS%20Maximising%20Recovery%20Review%20FINAL%202012%2020locked.pdf

CHART 1.2: Plans for growth

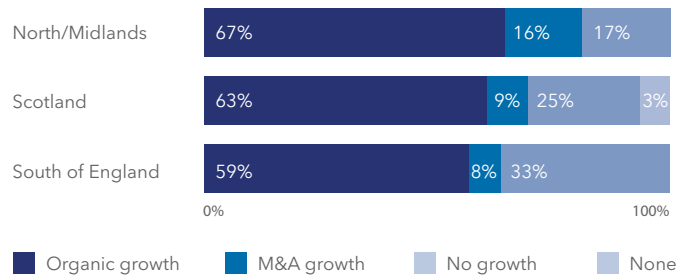


CHART 1.3: Suppliers of growth

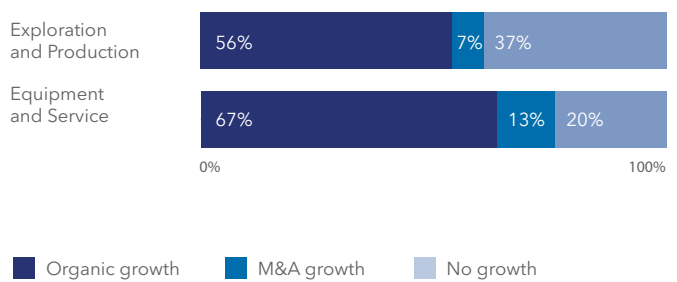


CHART 1.4: In the middle for growth

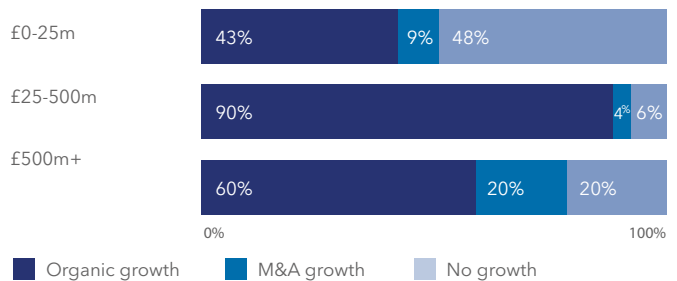
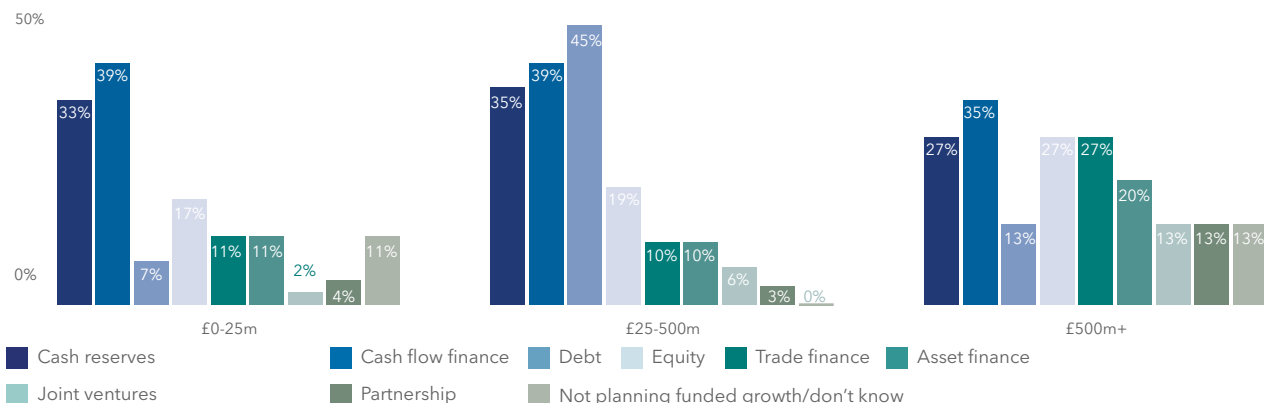


CHART 1.5: Drilling into cash reserves

Companies' normal growth finance sources by turnover



International expansion.

Africa looks to have become the new frontier for UK oil and gas companies. While well established markets in North America and the Middle East still top the priority lists for overseas growth, exploration and production companies give almost twice as many mentions for Africa as a whole⁷.

The reason is not hard to find. Analysis by Wood Mackenzie contends that these three regions, plus South America, have the largest recoverable conventional oil and gas reserves in the world.

The analysts identify 1.1 trillion barrels of technical reserves of which over half they classify as potentially economic. To the non-industry eye, it is rather startling to learn that Africa's reserves are well ahead of those in Russia and the Caspian basin and not far behind North America's. Both West and North Africa are fairly well-established oil and gas producing provinces, but discoveries are being regularly made off the West African coast and on and offshore of Egypt.

East Africa continues to make astonishing progress, accounting for close to half of the world's discoveries of conventional oil and gas in 2012. It is sufficiently attractive for investment to be reckoned as likely to increase 60% each year to reach \$7bn by 2018⁸. This is as much as is thought likely to be spent in the North Sea around that time⁹.

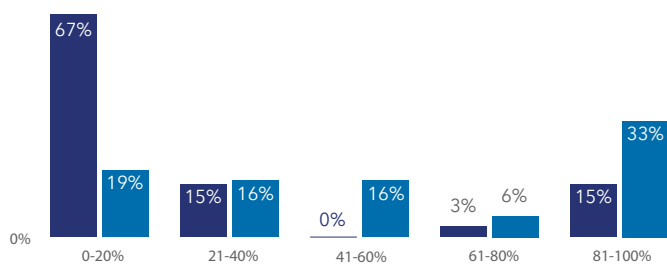
Undeveloped conventional technical reserves by value

(Source: Wood Mackenzie)

Region	Value
Middle East	\$185bn
Latin America	\$149bn
North America	\$132bn
Africa	\$125bn
Russia & Caspian	\$78bn
Asia Pacific	\$67bn
Europe	\$24bn

CHART 2.1: Home and away

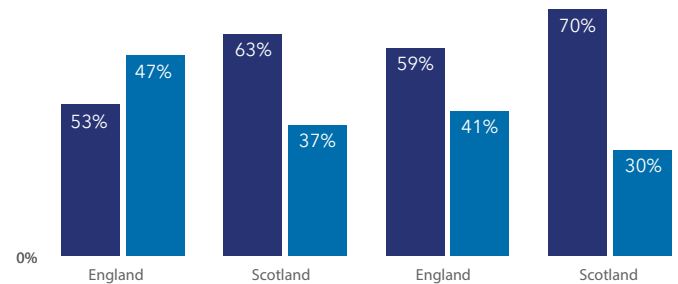
Percentage of company income derived from North Sea
100%



■ Companies based in England ■ Companies based in Scotland

CHART 2.2: Going more international

100%



■ Yes ■ No

⁷Wood Mackenzie, September 2013. One trillion barrels - the Global Potential of Undeveloped Discoveries. Available at: www.woodmacresearch.com/cgi-bin/wmprod/portal/corp/corpPressDetailOpen.jsp?pass=11542514 ⁸Wood Mackenzie, October 2013. Record levels of upstream development in East Africa will reach US\$7bn by 2018. Available at: www.woodmacresearch.com/cgi-bin/wmprod/portal/corp/corpPressDetailOpen.jsp?pass=11605457 ⁹UK Oil and Gas, February 2014. Activity Survey 2014. Available at: www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC040.pdf

The geographical pattern of interest in international expansion shown by producers and explorers broadly follows the picture of where the biggest undeveloped reserves are with some extra attention being paid to the UK's nearest overseas prospect - Norway. The foreign growth picture for equipment and services suppliers is similar to that, but with some distinctive variations. They have little interest in Norway, but much greater interest in South America and the Far East. This may be because exploration and production in these latter two regions tend to be dominated by national oil corporations which, while they have the resources and expertise to make discoveries, lack the specialised skills for offshore development and operations honed in the North Sea.

The global pattern of where the rewards are help to explain a shifting pattern of interest in international expansion by UK oil and gas companies. Increasing costs and complexity of oilfield discovery and development explain why 48% of exploration and production firms say they have not considered foreign growth in the last year but the increasingly limited, in global terms, prospects in the North Sea may be why the proportion not considering overseas growth in the next two years is slightly lower at 44%. The same pattern is evident amongst equipment and services suppliers - 38% did not expand abroad in the last year, but only 23% expect that to be the case in the next 24 months. These proportions are broadly similar across all sizes of firms, so it is not necessarily the case that bigger companies with access to more resources are more likely to be orientated to overseas growth. The sectoral division in intentions also shows up in a

North/South divide in terms of where companies have most of their existing operations. Companies based in Scotland, which have a high proportion of equipment and services suppliers, are much more dependent on the home market of the North Sea, with two fifths saying they get more than 60% of their turnover from the UKCS than those based in England, which are dominated by exploration and production companies. Scottish companies are much more orientated internationally, with two-thirds getting less than 10% of their income from the North Sea. Overall, a third of UK oil and gas companies get more than 70% of their income from the North Sea, while a third get more than 90% from international operations which emphasises the global nature of the business but also indicates a significant tail which is rooted in the home market.

This North/South difference, however, reverses in both recent activity in, and expectations of, international expansion. A higher proportion of Scottish companies have been involved in (63%), or expect to be engaged in (70%), international expansion than is the case with companies in England (53% and 59%). In last year's survey, 66% of executives surveyed said they intended to grow overseas. As 56% of companies in this year's sample said they had expanded internationally in the last year, this implies that five-sixths of intentions were turned into a reality. The proportion of intending overseas expansionists this year is exactly the same at 66% and if last year's rate of conversion of intentions into action applies, it amounts to a continuing shift in vision towards more distant horizons, with companies based in Scotland markedly more eager to reach out abroad.

CHART 2.3a: Going places

Where exploration and production companies are looking

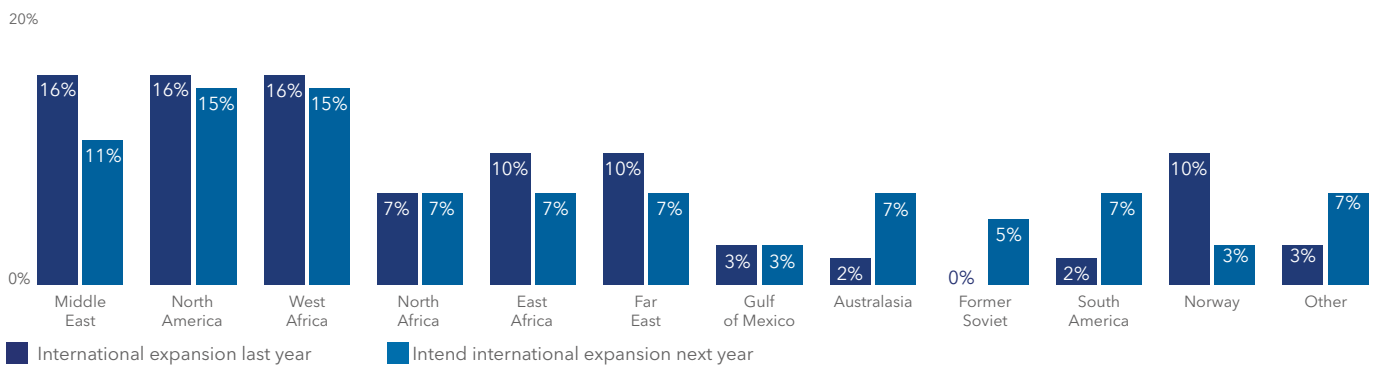
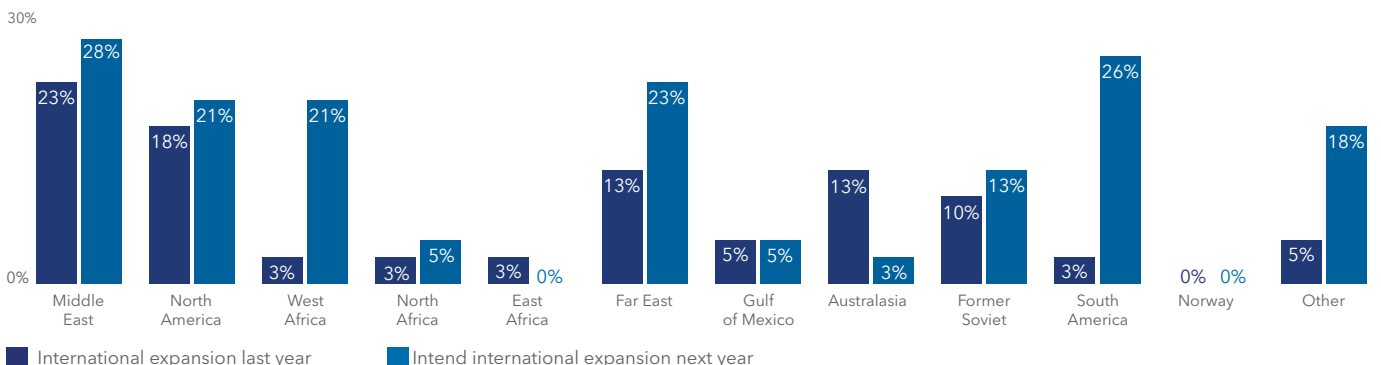


CHART 2.3b: Going places

Where equipment and services suppliers are looking



Job creation and investment.

Nearly 6,000 jobs could be created in the next two years by the 100 companies in this survey.

Four times as many jobs (4,748) are expected to be created by suppliers of equipment and services as by exploration and production firms (1,225). Slightly more of the total number of jobs expected to be created (5,973) are aimed to be created by firms based in Scotland (3,238) than by companies based in England (2,693), the remainder will come from companies outwith the UK. But because the sample has more Scottish-based companies in it than are located south of the border, companies based in England expect to be more job creative (81 per company) than those in Scotland (57 per company). The two companies which each expect to create more than 1,000 jobs are also large companies with turnovers of more than £500m, are located in the South of England, and are equipment and service suppliers.

The findings, which show an increase in expectations of job creation from last year when the firms surveyed expected to create 5,343 jobs, emphasise that the oil and gas sector is still a highly job creative business. Because most of the UK's oil and gas firms are clustered in North-East Scotland, Scotland should accrue most of the jobs benefit from expansion plans, but the North/South differential in job creativity also emphasises that the whole of the UK will benefit.

While a lot of these jobs will go to UK residents, it should also be emphasised that because much of the expansion is expected to take place outside the UK, many if not most of them will be located outside the UK. Nevertheless, the returns to UK-owned companies from the overseas investment and employment will also be a boost to the UK economy. Export sales from Scottish-based oil and gas companies have grown by an average of about 8% per year over the last five years, reaching a value of £8.2bn in 2011¹⁰.

CHART 3.1a: Making work

Expectations of job creation by exploration and production companies

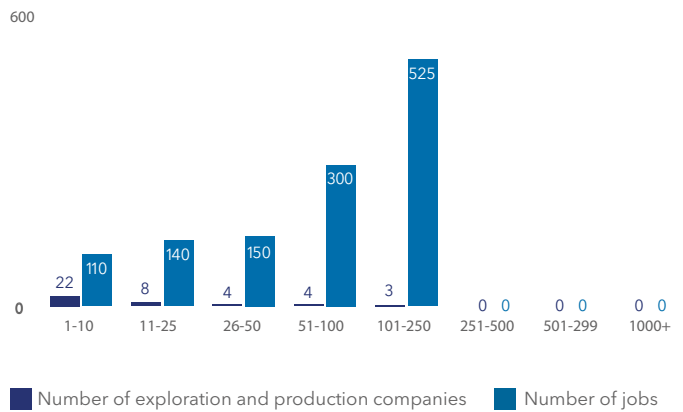
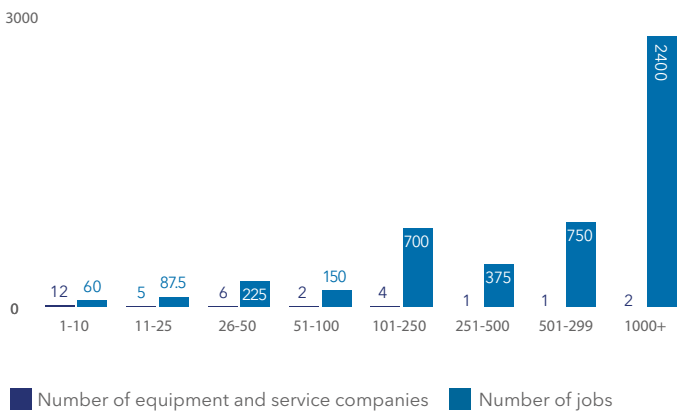


CHART 3.1b: Making work

Expectations of job creation by equipment and service suppliers



A slight scaling back of investment intentions from last year is indicated. This year, 65% of companies intend to keep their investment to the equivalent of less than 10% of their turnover compared to 55% which intended that investment level last year. And only one in ten companies expect to invest the equivalent of more than 90% of their turnover compared to one eighth last year.

But because the survey included 15 companies with annual turnovers of more than £500m, all of whom intended investment to some degree, the scale of spending is still extensive. The nature of the survey does not allow a precise figure to be calculated, but an indicative number is that about £2.7bn is thought likely to be invested by the firms surveyed, the lion's share (£1.9bn) being projected by the biggest companies. Scaled up to the size of the industry, the survey indicates that UK oil and gas firms intend to invest about £18.5bn. Expectations of investment in the UK Continental shelf in 2014 range from £11-13bn¹¹. So this survey indicates that about a third of the planned investment by UK companies will be overseas. Nevertheless, at a time when there is general agreement that an increase in business investment is needed to make the UK economic recovery more sustainable, the oil and gas sector certainly seems to be doing its bit to help.

¹⁰Scottish Development International/Scottish Council Development & Industry, May 2013. Survey of International Activity in the Oil and Gas Sector 2011-12. Available at: www.scdi.org.uk/news/214-scdi-scottish-enterprise-supporting-scotland-s-oil-gas-sector
¹¹UK Oil & Gas, Jan 2014. Activity survey 2014. Available at: www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC040.pdf and Wood Mackenzie, Jan 2014. UK Upstream Oil and Gas Review 2014. Summary available at: www.woodmac.com/public-media-centre/content/11814001

CHART 3.2: Producers and suppliers spending

Planned investment as percentage of turnover

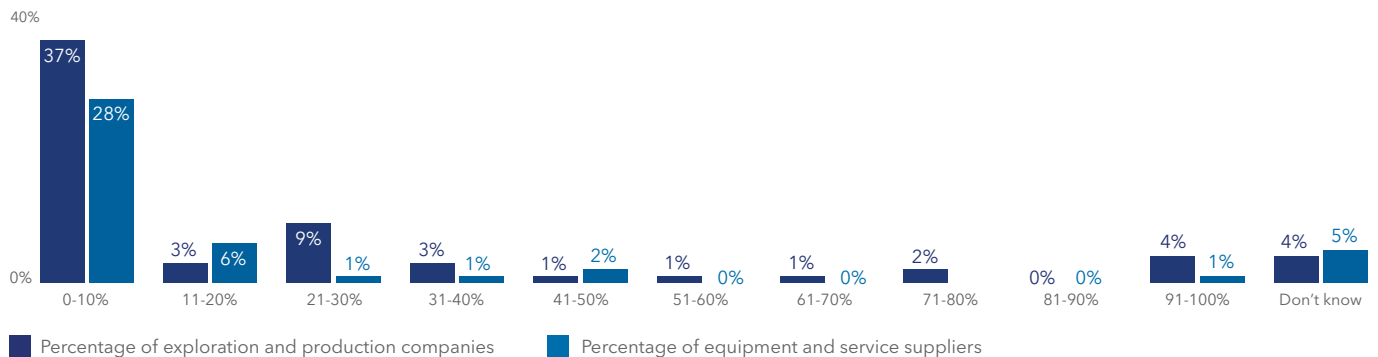


Chart 3.3a: Producers and suppliers spending

Number of companies

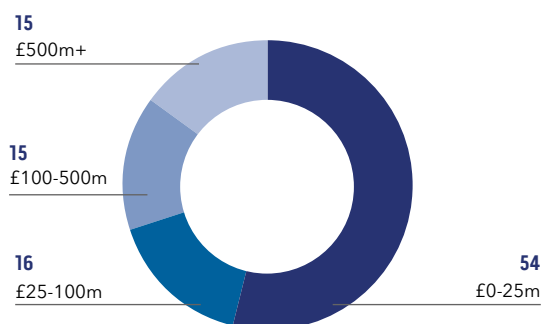
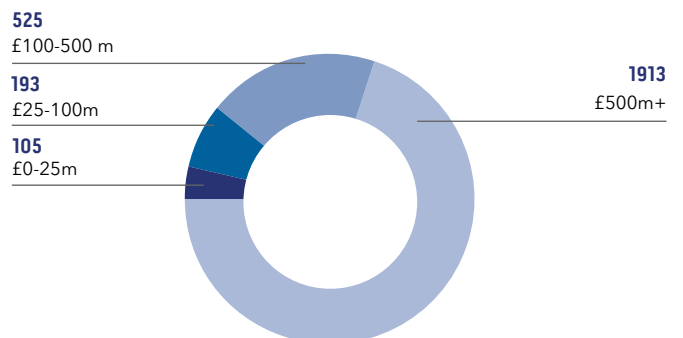


Chart 3.3b: Producers and suppliers spending

Approx total investment planned (£m)



Diversification.

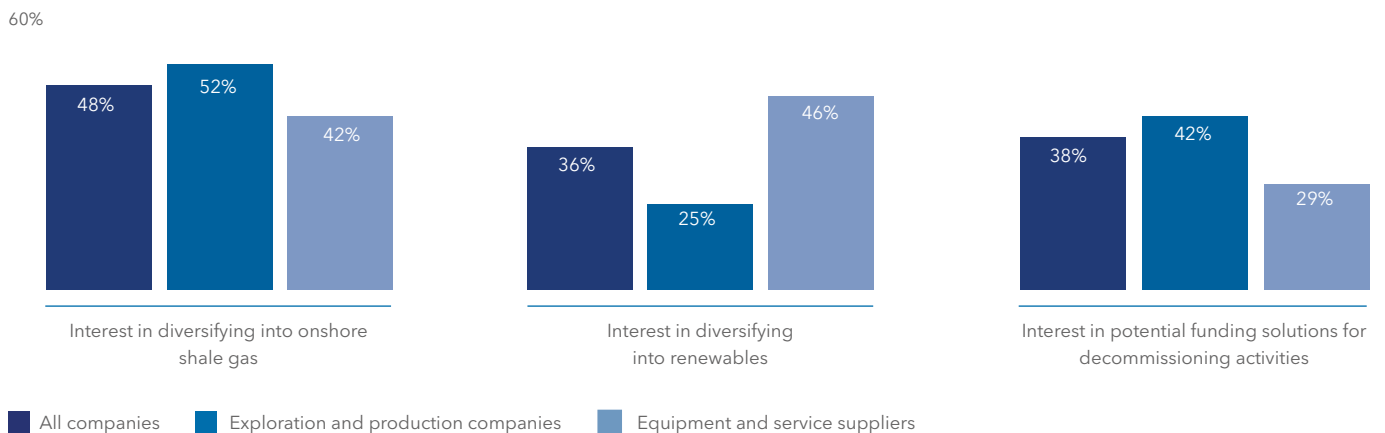
Diversifying into onshore shale gas remains the most attractive option for companies seeking to broaden their operations. Last year’s survey, which asked for a straight yes/no response in diversification, found that a fifth of all companies were interested in getting into shale gas.

This year’s survey aimed to get a better fix on the degree of interest by asking executives to rate their diversification interest on a scale of 0 to 10, where 0 equals no interest and 10 equates to being extremely interested. The survey found that nearly half of all companies (48%) were moderately to intensely interested in onshore shale gas, that nearly two-fifths (38%) had the same degree of interest in funding solutions for decommissioning activities, and there was least interest, but still substantial interest, amongst slightly more than a third (36%) in diversifying into renewables.

The prospect of shale gas providing a much cheaper source of fuel for electricity generation and source material for the chemicals industry has excited a lot of attention, particularly as it now has a proven track record in North America. The reductions in the cost of gas which have had substantial knock-on beneficial effects – reducing manufacturing costs, cutting the feedstock and energy bills in chemicals production, displacing coal in electricity generation (cutting carbon emissions) and reducing household and commercial bills – have spurred British politicians to encourage the same to happen this side of the Atlantic¹². The cost to industry of electricity per megawatt-hour in 2013 was \$67 in the US, an astonishing 50% discount on the price to industry in the UK of \$134 with a similar difference in costs to households¹³. The coalition government has already promised that the tax rate on a yet-to-be-determined portion of shale gas production will be 30% rather than the usual 62% rate. It has promised payments to communities close to shale gas production sites, presumably in an effort to reduce opposition¹⁴. Progress in tapping these unconventional hydrocarbons outside the US is, however, expected to be slow with most analysts reckoning that it will be 2020 before there is any substantial non-US production¹⁵.

CHART 4.1: Broadening the vision

Percentage with moderate to intense interest (4-10 on scale)



These pressures and expectations are reflected in a third of explorers and producers showing the keenest level of interest in diversifying into onshore shale gas (and 10% are already involved) against a fifth of equipment and services suppliers, for most of whom commercial opportunities will only arise when exploration turns into development, exhibiting the same degree of interest. The differing degree of interest in the two sectors of the oil and gas industry reverses on consideration of renewables. A quarter of equipment and services suppliers are keenly interested as are a fifth of explorers and producers. Perhaps because offshore wind has been slow to take off at a commercial scale in Scottish waters, 75% of companies based in Scotland show the lowest levels of interest, compared to 55% of those based south of the border.

Decommissioning continues to attract relatively low levels of interest, although 8% of companies are already working in the area. This may be because spending on decommissioning, although substantial at £900m in 2013, was only 4% of total North Sea expenditure. This should change by 2017 when decommissioning spending is forecast to be £1.7bn. Assuming operating spending, which escalated sharply in 2013, can be held at about £10bn a year, and with capital spending expected to be about £7bn, then the proportion of total North Sea spending that will go on decommissioning will rise to about 10%¹⁶.

This suggests that more companies will become involved, especially now that the UK government has provided harder guarantees of tax relief. But while there is tax money to be claimed back, securities to cover the cost of the work still have to be posted which can weigh heavily on a company's finances. So the question on interest in diversifying into decommissioning was altered from last year, when only 5% of all companies said they were interested, to cover the slightly different aspect of funding solutions for decommissioning work.

The assumption is that any company interested in decommissioning work will also be interested in funding to cover the upfront costs. The amount of interest being shown is still low though it is not surprising, given the nature of the work and tax reliefs at stake, that 25% of explorers and producers show the highest level of interest (7-10 on the scale) with 7% already working in the area. The high-level interest amongst equipment and service suppliers comes in at a lower 11% although 10% are already working in decommissioning.

CHART 4.2: Shale gas interest

Interest in diversifying into onshore shale gas on a scale of 0-10 where 0 is not at all interested and 10 is extremely interested

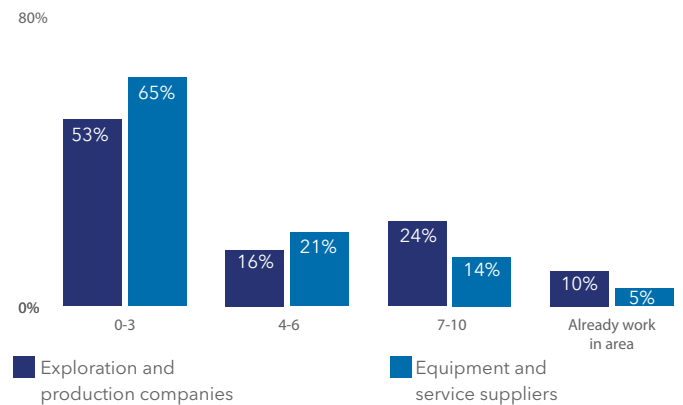


CHART 4.3: Renewable ambitions

Interest in diversifying into renewables, 0= no interest, 10= extremely interested

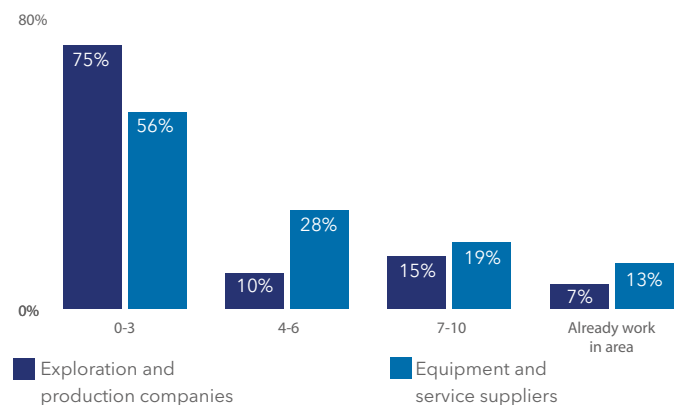
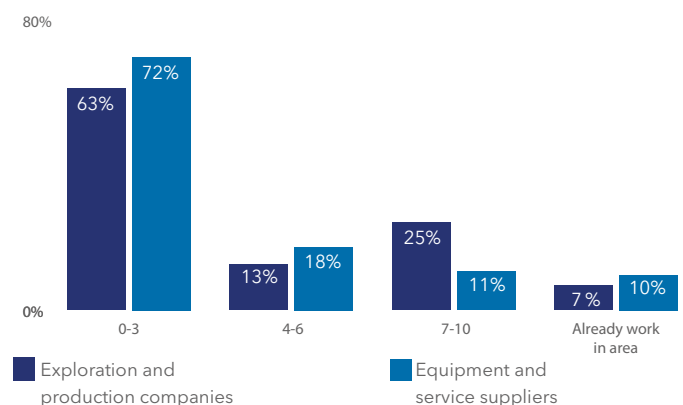


CHART 4.4: Funding the end game

Interest in potential funding solutions for decommissioning on a scale of 0-10 where 0 is not at all interested and 10 is extremely interested



¹²George Osborne, Chancellor of the Exchequer, 19 March 2014. Budget Speech. Available at: www.gov.uk/government/speeches/chancellor-george-osbornes-budget-2014-speech¹³International Energy Agency. Key World Energy Statistics 2013. Available at: www.iea.org/publications/freepublications/publication/KeyWorld2013.pdf¹⁴BBC News, 19 July 2013. 'Generous' tax breaks for shale gas industry outlined. Available at: www.bbc.co.uk/news/business-23368505¹⁵Standard Life Investments. Global Perspective, March 2014. Available at: www.standardlifeinvestments.com/GS_Perspective/getLatest.pdf#page=4&zoom=auto,0,393¹⁶UK Oil & Gas, February 2014. Activity Survey 2014. Available at: www.oilandgasuk.co.uk/cmsfiles/modules/publications/pdfs/EC040.pdf

Challenges and opportunities.

Skills shortages have become the bane of the UK oil and gas industry and this survey has found it is getting worse, not better. The number of companies reporting it as their major challenge has risen from 33% last year to 38% this year.

Equipment and services suppliers feel the greatest pressure with 46% saying it is their biggest headache, up from 37% last year. It is only slightly less of a problem for exploration and production companies – 33% say it is their biggest challenge – but at least that proportion has held steady since last year’s survey. The industry’s difficulty lies in recruiting the highly specialised skills it needs. The most acute shortages are for well drilling and operating engineers, subsea specialists, project engineers, health and safety specialists, and geoscientists. It needs a lot of other less specialist but still highly-skilled people as well. On one estimate, the industry needs to recruit about 12,000 people a year over the next decade to maintain a directly-employed workforce of 236,000, of whom 57,500 work offshore¹⁷. This does not look like a problem that is going to be resolved anytime soon.

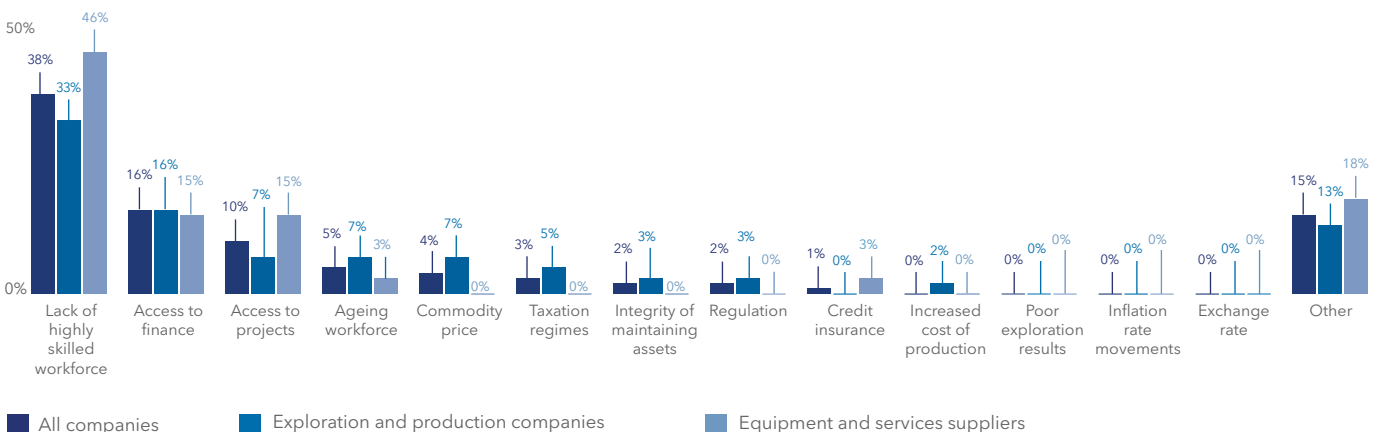
Mid-sized firms with turnovers of between £25-500m are particularly beset by this issue with 60% of them naming it as an issue. Amongst Scottish-based companies, 46% named it as their biggest challenge, reflecting their bias towards equipment and services suppliers.

Access to finance, identified by 16% as a current challenge, is still as big a problem as last year, when it was reported as a big issue by 17%. Perhaps because of perceptions by investors and lenders that current oil prices are relatively stable – Brent crude has ranged between \$100-115/barrel over the last year, the number of exploration and production sector companies naming access to finance as a big issue has halved from 31% last year to 16% this year. But the proportion of equipment and services firms reporting it as a problem has risen – up from 10% last year to 15% this year.

¹⁷Oilandgaspeople.com, May 2013. North Sea Oil and gas industry needs to recruit 120,000 new staff as retirement crisis looms. Available at: www.oilandgaspeople.com/news/719/north-sea-oil-and-gas-industry-needs-to-recruit-120000-new-staff-as-retirement-crisis-looms/%20may%202013/ Oil & Gas UK, July 2013. Economic Report 2013. Available at: www.oilandgasuk.co.uk/2013-economic-report.cfm

CHART 5.1: Skills gap

Perceived biggest challenges



Access to new projects within growth markets was the third most pressing issue – affecting companies of all sizes. It is a more pronounced problem for equipment and services businesses (identified by 15%) than for explorers and producers (7%). Taxation is slightly less salient than it was last year, identified by only 5% as a pressing problem. Indeed, commodity prices are also named by 7% of exploration and production firms as a prime concern, indicating a residual concern that prices might start dipping below \$100/barrel, a point where quite a few new field developments start to become less economically viable.

But that slight note of pessimism is more than counter-balanced by the 15% of all companies who see commodity prices as the biggest opportunity over the next 12 months, an outlook which is slightly more bullish amongst explorers and producers at 16%. Drilling companies were the most price optimistic of the sub-sectors in the survey with 21% of them seeing that as their biggest opportunity.

Moving into new growth markets, as last year, remains the biggest perceived opportunity, identified by 42 per cent, much the same as last year. But while far more equipment and service suppliers than explorers and producers were attracted by that as an opportunity last year, this year the position has reversed with 46 per cent of exploration and production companies seeing that as their major opportunity compared to 36 per cent of equipment and service suppliers. They, however, are more inclined to see market diversification (28%) as an opportunity than are exploration and production companies (13%).

Finally, the survey asked what executives expected the price of Brent crude to be in March 2015. \$110 was the most popular single price forecast, chosen by 26%, but the mean of all the price predictions was \$103.5. That puts North Sea company executives on the higher side amongst the main current price predictions.

CHART 5.2: Growing and diversifying

Perceived biggest opportunity

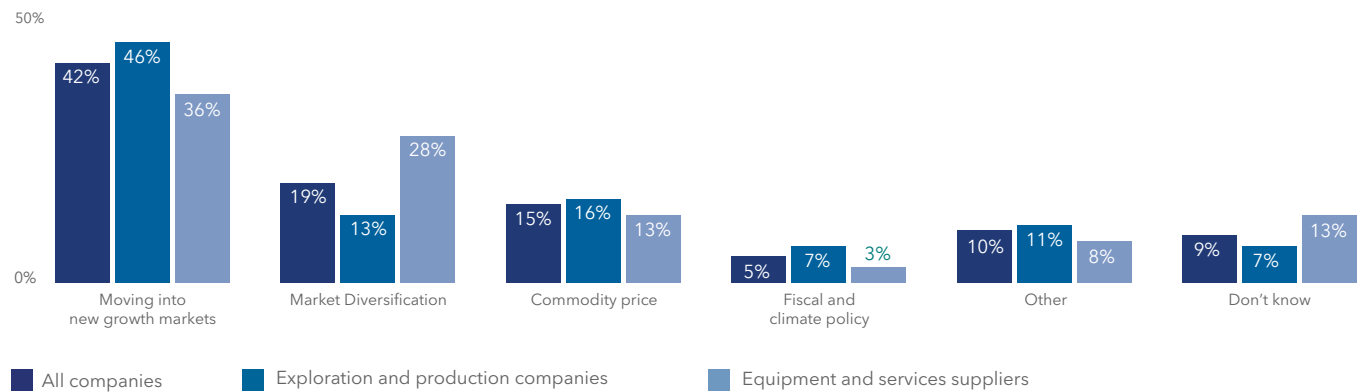
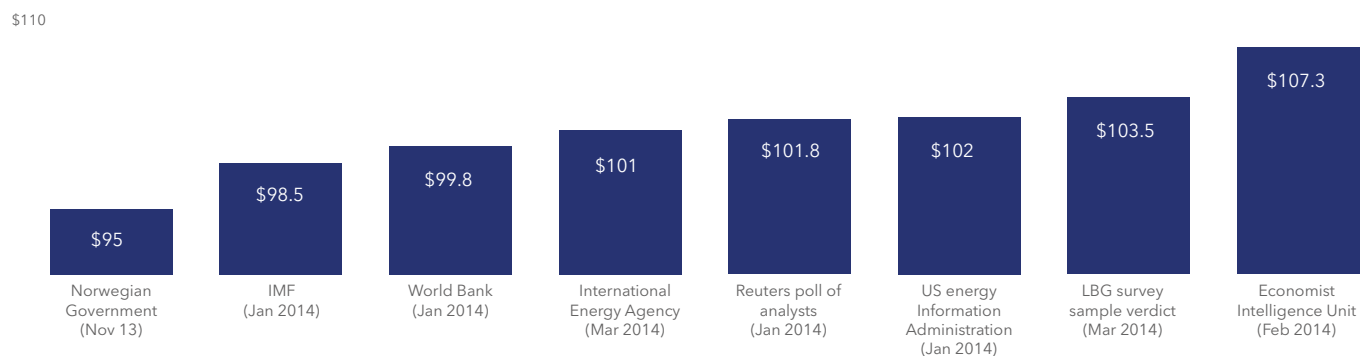


CHART 5.3: Reading the price numbers

Forecast for Brent crude price in 2015 (\$/barrel)



Scottish oil and gas businesses.

As one of Scotland's leading banks our teams are well placed to support the anticipated growth in the oil and gas sector by providing comprehensive financial services.

The range and depth of expertise across our Scottish teams is underpinned by many years of individual experience. Working alongside our local product specialists, we provide banking solutions tailored to your specific needs including:

- Trade finance
- Treasury and risk management services
- Bonds, guarantees and collections
- Structured finance solutions
- Cash management
- Asset finance

We are also providing access to reduced borrowing costs, through schemes such as Funding for Lending.

Methodology

Field research for this report was undertaken between 20th February and 6th March 2014 by the UK's largest independent market research consultancy BDRG Continental. To gather representative data from this diverse industry, a broad cross section of 100 UK businesses were interviewed spanning a range of size, location, and service type.

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