

NAVIGATOR

WESTSHORE'S MONTHLY NORTH SEA REPORT

April 2015 Issue: 44

Nothing surer than death and taxes

Will the latest UK budget see the death of the North Sea?

WHY CERTS?

Westshore's Jørgen Knudsen investigates the craze for certification



WESTSHORE

SHIPBROKERS AS

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“Doing more for less”

As we edge closer to the summer months the offshore industry has responded to the turmoil resulting from the oil price plummet in one of two ways. Cautiously waiting to see whether the storm can be ridden out with minimal disruption, or choosing to take action – to varying degrees of severity. In the North Sea further job cuts have been announced which is of little surprise given the cost-cutting climate, in addition to billions of pounds of assets being put up for sale. The focus on slashing overheads, in combination with the news from the UK government on tax cuts, have led some to speculate over a sooner than expected recovery. Will explorers seize the chance to drill cheaply while they can? 2016 is beginning to show signs of the year where more can be done for less....



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AVERAGE SPOT MARKET RATE AHTS



 **60.4%**

Average AHTS utilisation in February

 **62.4%**

Average PSV utilisation in February

	feb 14	mar 14	feb 15	mar 15
Number of supply spot fixtures	68	68	102	93
Number of AHTS fixtures	66	64	76	72

 **28**

Number of rig moves in March. (March 2014 - 20)

 **25**

Number of rig moves in February. (February 2014 - 24)



It's been a tough month on the spot market as the high points grew further apart and didn't reach anywhere near the heights they have in the past. Activity levels have been high as some charterers divert attention from the term market where they will be locked into a contract and turn towards short-term spot market solutions. The trouble is of course the vast over supply. The number of rig moves per month has consistently been up every month on last year's figures and for supply work the stream of requirements has been 27.5% higher Q1 2015 than Q1 2014. But the number of vessels competing for jobs has resulted in utilization for PSVs falling to the lowest average levels in the past six years. High numbers of vessels were being bid in for cargo requirements and rates began to teeter over the sub-GBP3K mark.

Lay ups of course are becoming an increasing feature. In Norway crew from a laid-up vessel are paid off temporarily for the first three months at which point labour regulation states the decision must be taken by the ship owner to 'permanently' lay off crew or return the vessel to operation. With some Norwegian vessels now heading towards the three month mark, vessels in temporary lay up may return to the market should owners decide. Meanwhile we have a handful of newbuilds set to enter the market in the next few months, not a great time to be seeking work for the first time. Rates have historically picked up as we head into April and May but with market confidence this low, any significant hike would be quite unexpected.

“BOLD AND IMMEDIATE ACTION” FOR **UK** OIL AND GAS

On March 18 George Osborne, UK Chancellor of the Exchequer, delivered the 2015 Budget – for the UK oil and gas industry which is on the brink of sink or swim there were high hopes.

The beleaguered UK sector has shown a steady decline in oil production since the late 90s at around 5 -10% annually although this has accelerated greatly in the last couple of years. This coupled with huge increments in costs has sunk UK oil and gas into deep water with one report claiming only two in five UK fields are now profitable. Sir Ian Wood, founder of the Wood Group and one of the UK's most eminent oil businessmen said pre-budget that this could be a watershed moment for the industry. Literally make or break.

The four key points affecting the UK oil industry were in general widely received. Firstly the previously over-complicated tax regime affecting fields in different ways dependent on size would be scrapped and a more transparent, simplified regime would be established. This has been met with approval from industry heads who said the current regime discouraged investment.

A budget of GBP 200 million is to be used for new seismic surveys for under explored areas of the UK sector. Whilst this is a positive for the seismic industry and may encourage some companies to take up exploration activities, for some this was seen as a drop in the ocean. 200 million will only go so far and there remains huge areas still unexplored, where do you start and how much will actually be revealed with that size of a budget? Moreover the only way of really proving if there's oil is to go out and actually drill. Something that will only be done if the right economics (and regulatory regime) is behind the exploration programme.

There will always be some that wanted more, but on large the announced tax reductions were commended. The Petroleum Revenue Tax is to be reduced from 50% to 35%. This is specifically aimed at targeting ageing or brownfield production and halting the move towards decommissioning too soon. This change will take effect next year and effectively reverses the tax hike that was implemented in the 2011 budget when oil prices were much higher.

The highly controversial Supplementary Charge is to drop to 20% from 30% and will be backdated to January 2015. This charge had steadily increased by the current UK government so the drop effectively takes the level back to where it was five years ago. Bearing in mind that while other UK businesses now face a 20% corporation tax, the oil industry is hit with 30% PLUS the supplementary charge – does this really show a commitment to saving the industry?

However I go back to my earlier point of the depressing statistic of only two in five UK fields actually being profitable and remind the good reader that for profits to be taxed there needs to be just that – profit.

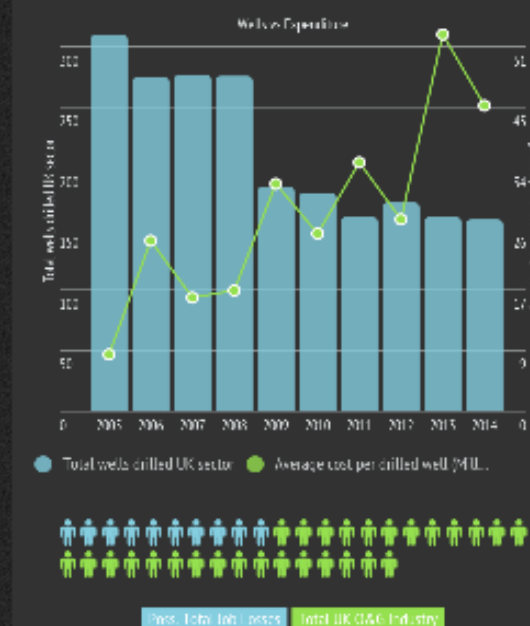
UK TAX CHANGES

15%
Reduction in Petroleum Revenue Tax

10%
Reduction in Supplementary Charge backdated to January

£200 million
Allocation for seismic surveys in unexplored areas of UK

15%
Predicted boost in oil production as a result of tax changes say OBR



“Unless we get this right we will lose a huge amount to the UK economy and the UK will be the loser.”

Sir Ian Wood

£ **£**
2400000000
600000000
Dec 2014 estimate March 2015 estimate

Crude oil production 1990-2014

The Chancellor told of how the changes in tax are expected to boost oil production by 15% according to the Office for Budget Responsibility. In addition an expected GBP 4bn of investment was expected as a result of the more attractive fiscal regime. The OBR, taking into account the drop in oil price and production, has dropped its estimates on oil receipts for 2016-2017 to 600m GBP down from 2.4bn GBP. This is something several oil nations will be facing as estimates are revised and a far bleaker outlook is accepted. Though these measures will take time to take effect it is highly unlikely they will halt the decline of North Sea oil and gas, merely change the playing field for some time to come.

While times of economic boom encourages steady growth and cautious change, that's not what we are surrounded by now. Fundamental change and complete overhaul is needed to secure a long term survival for UK energy needs and North-east job security.

MARKET NEWS

Island Offshore has agreed to delay all newbuilds under construction at Vard bar one. The Island Clipper is set to deliver from the yard in April 2015 and will do so on schedule. Aside from Clipper Island has three PSVs and one CSV which will now be delayed by on average six months. In its quarterly statement Island said that this will help improve short term cash flow for the company.

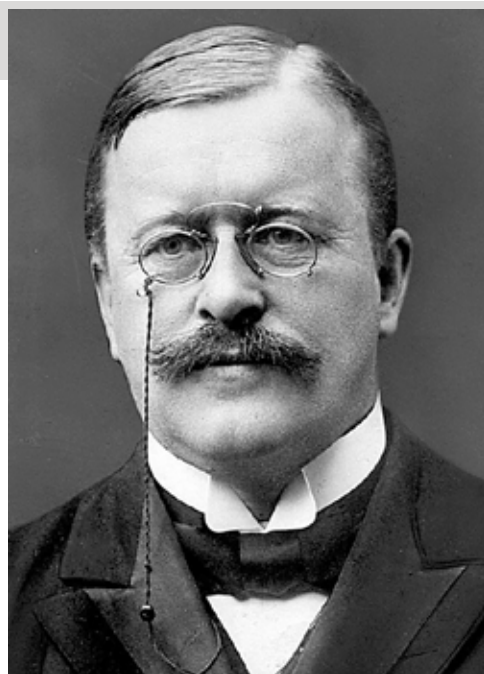
Boa has inked a deal to construct an IMR vessel at Noryards. Bucking the no-newbuild trend, Boa has signed up for one with an option for two further vessels. Former Bergen Group, Noryards was sold in 2013 to Ukrainian oligarch Kostjantin Zjevago. Zjevago is said to have been personally involved in the project and established a joint venture for the vessel between Boa and Calexco (Zjevago's company). Boa will assume two thirds of the equity while Calexco will have one third. The vessel will cost some NOK 700m and is set for delivery Q1 2017. Boa will charter the vessel to its US company on a five year charter on delivery.

Two PSVs under construction at Vard in Vietnam for an affiliate of German ER Offshore have been cancelled. The PSVs were to be owned by a KG scheme which has filed for insolvency, the rising strength of the dollar blamed as one reason for collapse. Tradewinds reported that a source close to ER said "If they took delivery of these units, they would basically be at least 20% above the market or even more, so it is better for them to lose their 10% instalment,". The KG structure of ownership is something common to ER Offshore where although the company would give no confirmation how many of its 13 vessels were owned under similar structure, the majority are believed to be so. KG is similar to the Norwegian KS schemes. of staff will be kept on including UK Managing Director John Maxwell.



CASTBERG POSTPONED

The development decision for Statoil's Johan Castberg field located in the Barents Sea is to be postponed until Q4 2017. The field holds an estimated 450 – 660 million boe. The decision to delay the project is as a result of the falling oil price and Statoil's focus on placing investment and resource on fast-track projects where value can be created over shorter time frames. The Snorre 2040 extension project met a similar fate with a decision now expected Q4 2016. Snorre is one of the fields with the largest remaining oil resources on the NCS. The subsurface is complex, and major investments will be required to produce the resources, Statoil said.



SONGA TRYM IN UK

Semi Songa Trym is set to head for UK waters end of April for a two well programme for Statoil. Meanwhile a handful of new rig requirements have surfaced over the past month for short durations. This has unfortunately been the increasing trend for rig tendering activity which has all but ground to a halt with the short one to two well programmes grabbing headlines that would have otherwise been of low interest 18 months ago. Full run down on the drilling market can be found in our Market Forecast.

TOMMELITEN ALPHA SHELVED

ConocoPhillips is reported to have cancelled its Tommeliten Alpha project in the Norwegian Sector. The US major considered re-using the topsides of the discarded Huldra platform, but is now said to have put the project on hold. Discovered in 1977 the field has lain dormant for decades but in 2014 a tieback to Ekofisk was planned.



STACKED, SCRAPPED AND TRANSFORMED

Plans to scrap some North Sea stalwarts came this month as rig owners struggle to find work in a market with decreasing demand and vast over supply. Transocean Legend, Transocean Rather and GSF Arctic III will head to scrappers yards this quarter while Ocean Valiant is currently undergoing modification into an accommodation platform for use at Premier Oil's Solan Phase III field.



WINTERSHALL SEEKS SEMI FOR MARIA

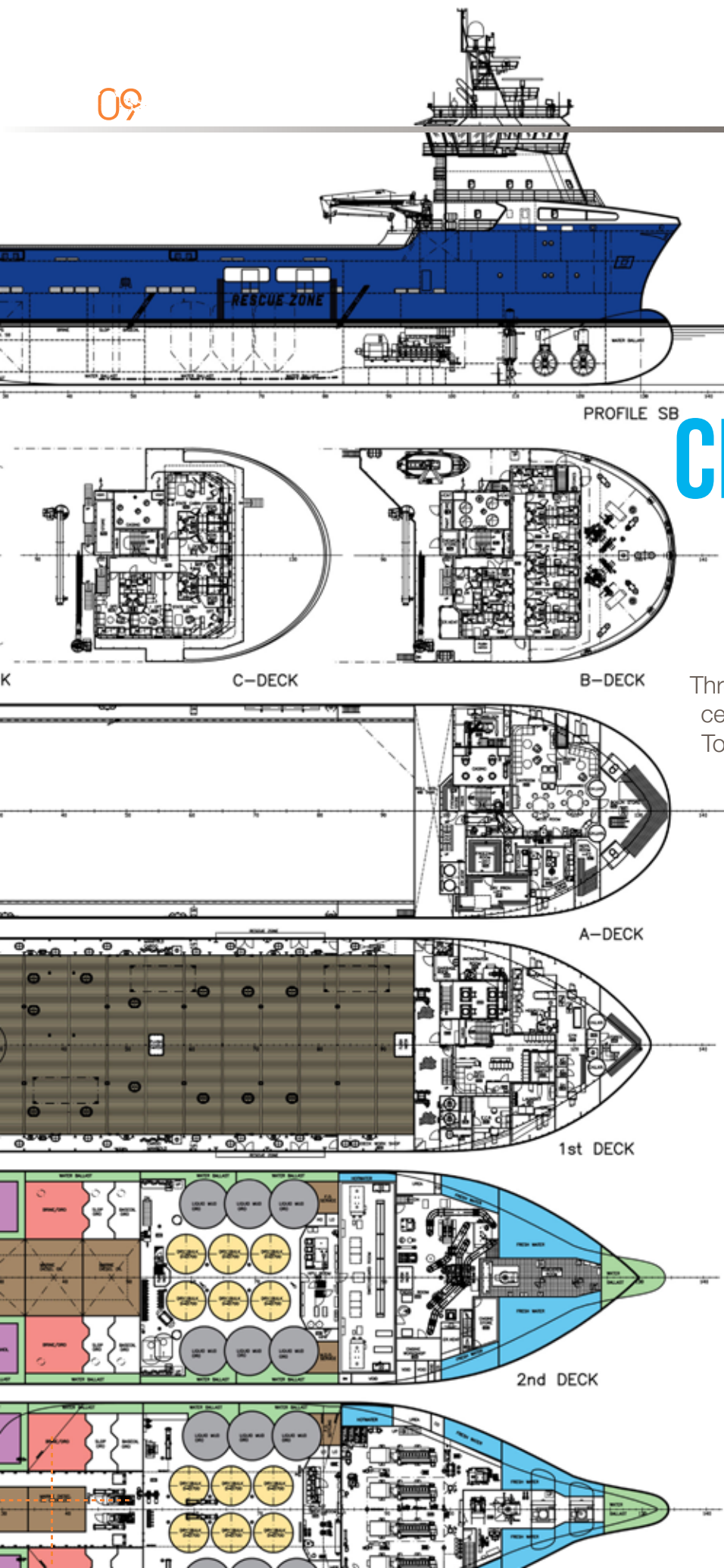
Wintershall's Maria project now appears to be back on the agenda following months of uncertainty over oil price and increasing costs. Wintershall is seeking a semi to drill six wells (550 – 600 days) commencing in the second half of 2016 at the Maria field.



ASSET SALES GALORE

Several North Sea operators have announced plans to sell off assets. Total is looking to shed its 80% stake in Laggan-Tormore field which is located West of Shetland. The sale of its Frigg pipeline may also be on the cards. Chevron announced plans to increase asset sales by 50% to nearly 10bn and that it would be delaying the Claire Ridge project in the UK sector by a year. Shell kicked off a 9bn asset sale early last year when it put the Anasuria, Nelson and Sean fields up for sale. While talk of mergers and acquisitions was the hot topic at the start of the crisis the reality that has transpired is that few if any have money to purchase or acquire entire companies, sale of individual assets has instead dominated the headlines.





CERTS MAKE A DIFFERENCE

Three years ago A PSV with valid water & fuel certs stood out from the crowd in Aberdeen. Today, you stand out if you don't have them.

BY JØRGEN WELDE KNUDSEN

The water used offshore typically originates from one potable water source and has multiple applications, including health, hygiene and industrial processes. Failures in segregation or back-flow systems can contaminate an entire supply, which could disrupt production and have serious health consequences for personnel. Similar risk is connected to the fuel taken onboard offshore locations. To minimize this risk, charterers are now increasing their focus on both water and fuel certificates when entering the market for supply duties. We estimate that around 30 % of the supply requirements out of Aberdeen now require water and/or fuel certificates.

Water certificates are divided into three main areas of testing; microbiology, hydrocarbon and legionella. The certificates are valid for three months from sampling date and it takes around 12-14 days from sampling date to receiving the certificates. This process can be speeded up to some degree, but conclusive testing requires at least seven – 10 days. The Maritime Safety Forum sets guidelines which are for most charterers, maximum limits for approval of tanks. If results are found to exceed set guidelines, owners are recommended to take action to decrease values before retesting. Fuel certificates on the other

hand are valid for six months from sampling date; however several charterers are now using three months as their limit of validity. Owners have reacted to charterers increased focus on certificates, and we estimate that 70% of the spot PSV fleet trading out of Aberdeen is certified for water and 40% for fuel.

**“
IN TODAY'S MARKET,
WHEN CHARTERERS
HAVE 20+ PSVS
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CERTIFICATES
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DECISIVE FACTOR
”**

A recurring issue however is that owners are struggling to take new tests in time and they end up waiting on replacements while current certs have expired. We would recommend all owners keep a high focus on this.

The high cost of maintaining valid certs has been cited by some owners as the reason for

not taking them. The cost for testing and certifying a water/fuel tank is approx. GBP 100 per tank. A large PSV typically holds 10 fresh water tanks and four fuel oil tanks. To keep the vessel's water tanks certified throughout the year will cost owners around GBP 12000 a year, or about NOK 145000. Testing the vessel's fuel tanks would cost owners approx. GBP 1000 for testing two times a year, however we recommend testing fuel tanks every three months due to the relative low cost and charterer's view on validity on certs. So to sum it up, the cost of keeping a large PSV up to date on both water and fuel certs throughout the year will be approx. GBP 14000 or about NOK 169000.

Charterers are increasing focus on using certified vessels in their operations, and the cost of keeping a vessel certified is relatively limited. We are experiencing first-hand the value of water and fuel certificates, as certified vessels are often prioritized by charterers. Particularly in today's market, when charterers have 20+ PSVs to choose from, water and fuel certificates is often a decisive factor.

Certificates make a difference – get them and keep them up to date!

THE DRILLING MARKET



Cost escalation was all too evident in the drilling industry long before the oil price crash. Cut backs were creeping in several months before the price of a barrel was beginning to wobble, but the combination of the two has had a catastrophic effect on the drilling market. The share price of nearly all the major rig owners has tumbled, Transocean down nearly 60% from a year ago, ENSCO 57% down, Seadrill down 61% and Hercules Offshore over 90% fall in share value. The CEO of Hercules said last year, «If our customers get cold, we get pneumonia».

As with the offshore supply segment, over supply contributes a significant chunk of the problem. The total global fleet of floaters and jackups today stands at around 850 units, a further 220 are set to deliver before end of 2020. Of this 430 units were built in the 80s or before. In previous downturns scrapping is considered but rarely materializes. This time may be different as many of the largest rig owners have announced plans to scrap even UDW units. However taking all market conditions into account (oil price, future demand and total supply) we can say that between 160 – 200 units would need to go before any meaningful effect would be felt. Only a small fraction of this has been thus far announced.

Of the new units set to deliver in the coming years most are being built in South East Asia. While negotiations are ongoing to delay these units, many will still be built. The region could become a graveyard of idle rigs in years to come as the cost of mobilization proves too much for owners. In addition the emergence of several Chinese yards, building rigs on spec with little or no rig building experience, will prove to be a costly exercise. Many offered extremely attractive payment terms, just 5-10% down payment. Given the option of taking delivery of an expensive piece of kit you will struggle to find work for, walking away from your 10% down payment will suddenly seem increasingly viable. In this instance we will likely see these rigs contracted to a Chinese operating company established solely to take delivery of the rigs.

A lot was said about potential M&A activity during this downturn, but as most rig owners are similarly up to their eyes, few if any are in a position to buy anything. The sale of individual assets may be seen periodically in the months to come but acquisition of whole companies – as was modus operandi of Transocean previously, will unlikely be seen.

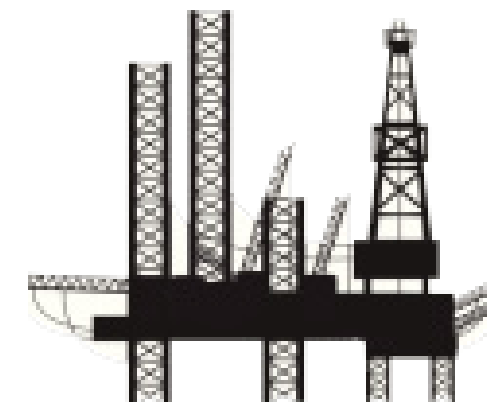
In addition to the over-supply of rigs, tendering activity has really dried up. Shorter, one to two well contracts are hitting the headlines that 18 months ago would have barely have raised an eyebrow. On a global basis the number of idle rigs grown every week. By the end of 2015 10 – 14 semis are expected to be idle in the North Sea and a further 10 jackups. In addition to this is sublet availability, for which practically everything is available. Approach an operator about a rig on contract for a potential sublet charter; expect to get your hand bitten off.

As you might expect rates have tumbled. An early 2014 fixture for a semi in North Sea waters would come in at around USD 430-500K, the market

is now around USD 200 – 225K. Interestingly however OPEX for such a unit comes in at around USD 85 – 90 for UK waters, USD 170 – 180 in Norway so there is a margin there for those able to secure the work.

With a floundering oil price the world's deep water basins of West Africa and Latin America have question marks hovering over them. The deeper the water, the more complex the environment the more marginal the field becomes and with an oil price at current levels few will be bold (or stupid?) enough to embark on new projects. For the rig owners this makes for dire reading as so much effort and investment has been ploughed into UDW segment over the past decade.

As much as I'd like to round this off on a positive note, a short-term pick up in oil price seems unlikely, 2017 is being touted as the soonest that a recovery can be expected. By which point we will have found out who will manage to swim and who will unfortunately sunk.



OFFSHORE EWEA COPENHAGEN 2015

This month industry heads gathered in Copenhagen to meet and discuss the latest developments in offshore wind. The EWEA Offshore Conference, held every second year at differing European cities, sets the stage for professionals at all stages of the industry to see the latest developments in offshore wind.

Westshore's Offshore Wind Manager, Roger Holden, gives us his key take-aways from the event.

- We are now approaching an offshore capacity of 10GW in Europe distributed through 11 European countries.
- Between 60 – 80GW is expected by 2030
- The new parks will be located further from land (40 – 50m+) which will require different SOVs than in use today
- China is an upcoming market with plans for 10GW capacity within the next five years
- USA is expected to focus efforts on land-based WTG operations and so will not feature as a major player in the next five years at least.
- As with oil and gas, cost awareness now playing increasing focus. This is taking the form of Low interest expenses, larger WTG, smarter and more efficient tendering and installation procedures.
- European Wind Organisation is working with EU towards a WTG renewable platform where politicians will create a framework for pricing and regulation in order to attract investors to offshore wind.



