Aberdeen & Grampian Chamber of Commerce

Oil and Gas Survey

30th Survey: May 2019

Survey context

The oil and gas industry continue to face many uncertainties but five years on from the downturn the resilience of firms in the sector endures. Amid continued challenges, firms in the survey reported further rises in business confidence.

At the time of writing (April 2019), oil prices are at their highest level in six months, currently standing at $75/bbl.

The sector has responded to recent challenges, not least through driving efficiency improvements. Thirty new fields have come onstream since 2015 with an increase in oil production in 2018, up 9% on 2017 and the highest level since 2011.

Forecasts of future potential oil and gas levels from the UK offshore industry have also been revised upwards amid forecasts that 11.9 billion barrels could be extracted by 2050, up from the estimate of 8 billion from four years ago.

Outside of the energy sector, the wider outlook for the global economy looks more uncertain than it did just six months ago. Weakening growth in emerging markets – particularly China – and a general softening of confidence across most advanced economies have lowered growth forecasts for the next couple of years.

Here in the UK and Scotland, the immediate outlook continues to be shaped by the ongoing Brexit process. With the UK's exit from the EU now delayed until October, a further period of uncertainty is now guaranteed.

One of the implications of this uncertainty has been a weakening in business investment across the economy. Business investment in the UK fell throughout 2018, the first time that this has happened since the financial crisis.

It is therefore reassuring to see that companies in the oil and gas sector are forecasting growth in investment trends, with investment by North Sea operators and contractors continuing to pick-up after the downturn.

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Sponsor's foreword

The 30th Oil & Gas Survey, produced by the Aberdeen & Grampian Chamber of Commerce and sponsored by KPMG, continues to provide an enlightening data set which talks to optimism, hints at diversification and addresses the current and future human resource challenges of the industry.

The surveys that were undertaken from 2015 to 2017 chartered difficult waters for the UK Continental Shelf ('UKCS') and exploration and production related work was stagnant for that period of time. However, we have seen a gradual improvement in optimism through 2018. It is powerful to note that almost three quarters of firms are forecasting an increase in profits in 2019 and the results recorded the highest figure in this survey's history, indicating a rise in the value of UKCS production-related activity.

The 30th survey asked firms about their prospects in the year ahead, as well as the next three to five years, allowing us to assess trends in exploration and production, decommissioning and other related oil and gas extraction activities both in the UK and international markets. It is encouraging to note that 90% of firms said that they were optimistic about the long term future of Aberdeen as an energy hub. Contractors working in the UKCS are reporting healthy results and almost half of firms are working at or above optimum levels - the highest figure recorded in the survey since 2014.

Despite the UK's maturity as an oil and gas basin, some consider this to be a competitive advantage, with companies valuing the level of expertise, know-how and business infrastructure that exists within the region. They believe these attributes can and will play a significant role going forward as the focus on energy transition begins to gather pace. But if nearly 50% of respondents say that they need different capabilities to make different choices and have different outcomes, and many don't believe that the right skill-set exists amongst their employee population to manage this transition, we have a problem.

This latest survey suggests that greater investment is needed in the skills and abilities of our young people at school and university level to inspire them to work in this amazing industry. We don't need to look further afield to fix this; we can sort it domestically.

There certainly are, and will continue to be, many opportunities in a low carbon economy and some oil and gas companies may be successful in doing this. Yet the future is uncertain and the opportunities so diverse that there cannot be one single, or simple, answer.

Universities need to ensure that they make engineering and renewable energy courses more attractive and targeted towards the skills required to help students contribute meaningfully in a low carbon environment. Companies also need to realise that this is where the future lies. It's not to say that these courses don't develop individuals like this, but we do need the next generation of graduates to be inquisitive, challenging, and thought provoking – and if they ask better questions, they will help the industry to arrive at better answers.

Having had significant infrastructural investment throughout the down-turn, the North East of Scotland can and should build on this to secure its place as a regional centre of excellence. People will continue to be a key driver to maintain this position and investing in the skills that are needed sooner rather than later is vital to achieve future ambitions. Let's not miss this opportunity to remain a power-house of productivity.

Moray Barber
partner, KPMG

Chamber viewpoint

Welcome to the 30th edition of Aberdeen & Grampian Chamber of Commerce oil and gas survey, conducted in partnership with KPMG and supported by the Fraser of Allander Institute.

The research is fully independent and delivered as part of our commitment to provide Chamber members and the wider stakeholder community with the market insight and management information they need to make better informed business and investment decisions.

Although it's the longest running report of its kind in the UK, we regularly revise the survey to ensure we not only capture long-standing trend data but also explore current challenges and issues for the industry. For our 30th survey, we've looked to explore the potential effects of IR35 legislation, continued our investigation into payment terms in the industry, and looked at the future of Aberdeen as an all energy hub.

The results of the survey indicate more stability in terms of optimism and working levels. Although the net balance of contractor optimism in the sector has eased since the highs of the last survey, we have seen an increase in those reporting no change to their level of confidence (44% compared to 28% one year ago).

We're also seeing encouraging movement in the direction of investment spend both for the past year and expected spend over the next two years. This is particularly evident in investment to develop new markets, R&D and staff training. Naturally these demonstrate measurable indicators of growth intentions and future confidence in the sector.

The trend of businesses operating at or above optimum levels continues to steadily increase with 49% now reporting this to be the case; the highest level recorded since 2014.

In terms of employment, we're glad to report that 40% of firms have increased their total workforce in the past year and only 13% have reduced. Again, another positive sign that companies are seeing significant uplift not only in their current activity but also in their long-term future requirements.

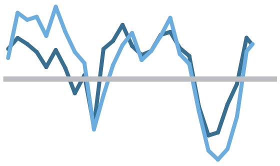
Although we found that 37% of firms report having no contractors, the changes to IR35 from April 2020 will encourage 14% of firms to consider reducing the number of contractors they recruit and 10% will look to convert contractors to permanent staff.

There is also good news in terms of production activity. A net of +36% of contractors expressed a rise in the value of production-related work in the North Sea compared to +20% a year ago, and a net of +49% anticipating a rise in the year ahead. This net of +36% is the highest balance we have recorded in this survey and the rising trend indicates a positive step in the right direction.

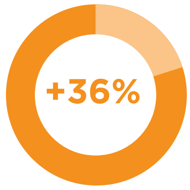
Finally, one key finding of note to us is the fact that 90% of firms are optimistic about the future of Aberdeen as an energy hub. One of our key aims here at the Chamber is to reinforce the fact that the North-east is a great place to live, work, study, visit, invest and do business. It's reassuring to see that so many energy firms in the region believe that the region has a positive future, and that it will continue to remain at the centre of the energy industry as we transition to a broader energy mix.

Shane Taylor,
research and policy manager

Key findings



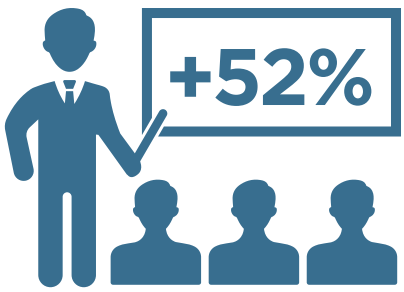
Contractors' confidence in the UKCS continued to improve with a positive net balance of +42%, although this has eased from the highs recorded in 2018 (+56% and +63%)



A net of +36% of contractors expressed a rise in the value of UKCS production-related activity, the highest net balance recorded in this survey

Optimism in the international oil and gas sector remains positive with a net balance of +49%, compared to the 10-year average of +28%

A net of

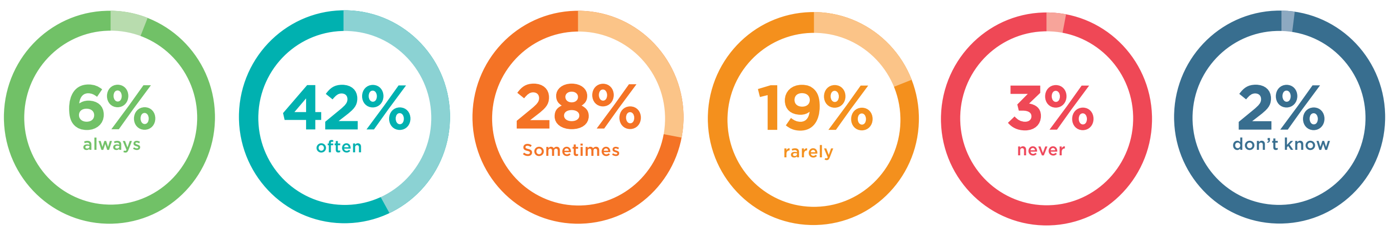


expect to increase investment spend in staff training over the next two years

49%

of contractors report working at or above optimum levels in the UKCS (the highest figure since Autumn 2014)

Firms were asked how frequently their customers adhered to their agreed payment terms:



40% of firms increased their total workforce in the past year while only **13%** reported decreasing their workforce

90% of firms are optimistic about the long-term future of Aberdeen as an oil and gas / energy hub

Contractors vacancy rate:

2.29 per 100 jobs

(up from 1.64 per 100 jobs six months ago)

72% of firms are forecasting an increase in profits in 2019

How has the level of collaboration among operators and contractors changed within the UKCS compared to three years ago?

- 23% better
- 53% no change
- 13% worse

45% of contractors report increasing investment spend in the UKCS in the past 12 months with only 7% reducing spend

A net of **+42%** of contractors recorded a rise in R&D investment in the past 12 months and a net of +49% expect a further rise over the next two years

47%

47% of firms either have started to use artificial intelligence or will do so in the next five years

Business optimism

United Kingdom Continental Shelf

It's now five years since the downturn in the oil price and the oil and gas sector continues to recover with firms in this latest survey reporting a further rise in business confidence. However, this recovery is yet to be felt across the whole of the industry. The downturn in 2015 and 2016 posed a significant challenge, not just for the oil and gas sector but also for the Scottish economy as a whole. Oil production from Scottish waters peaked in 1999, with natural gas production topping out in 2002. Since then, production levels for both fossil fuels have been on a sustained decline – although in recent years production has increased slightly. As the North Sea enters its mature phase of operation, with production more and more concentrated in smaller and harder to reach fields, the contribution of the industry to Scotland's overall economic footprint has fallen.

Furthermore the outlook for the sector is also being affected by the tangible sense of uncertainty, fuelled by the unstable political situation and challenging market conditions.

This latest survey reveals that business confidence among contractors continued to improve – however, the positive net balance of +42% has slipped back somewhat from its 2018 highs (+56% in Spring 2018 and +63% in the Autumn 2018 survey). This net balance is still well above the 10-year average net balance of +9%.

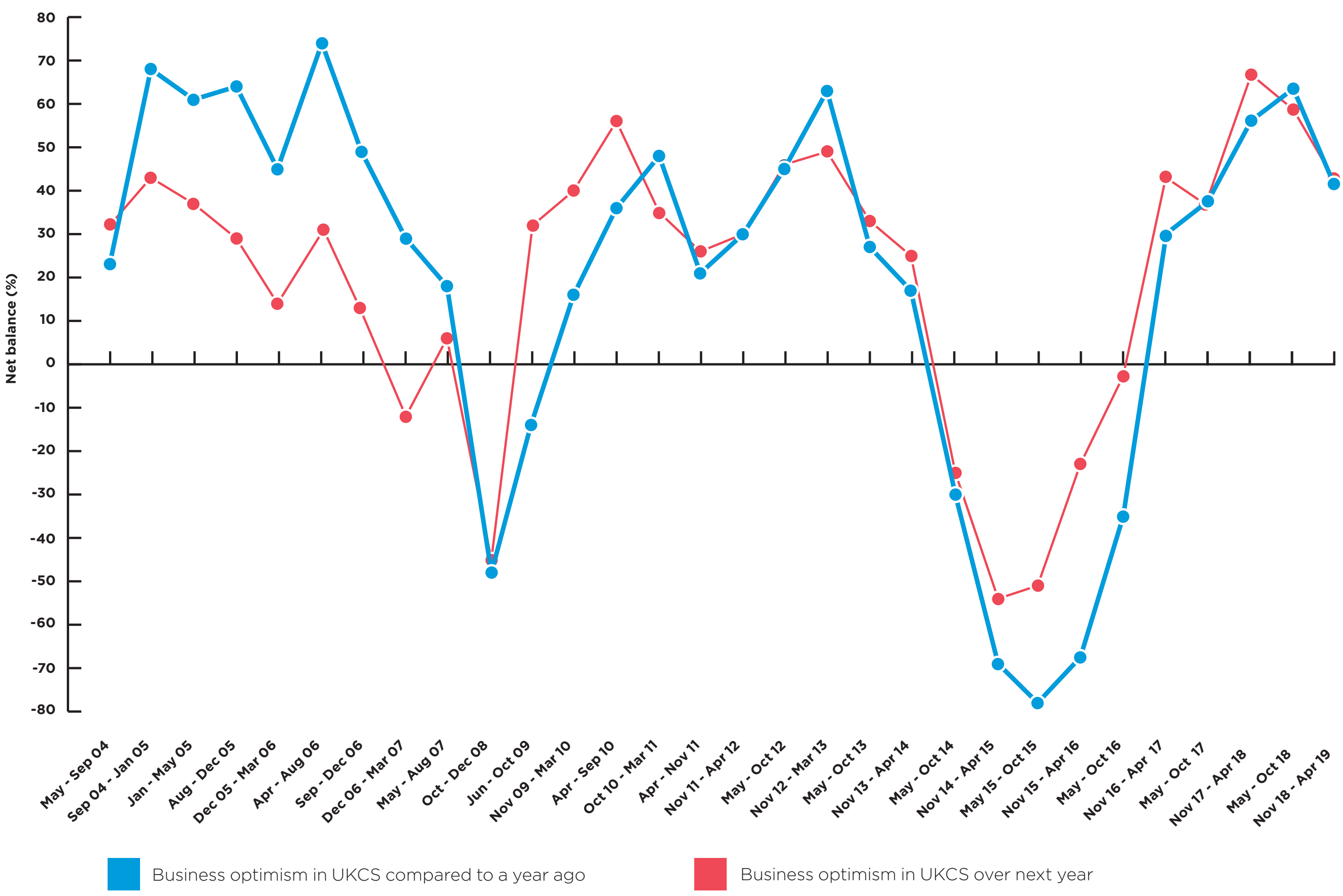
The net balance is the proportion of respondents reporting a rise minus those reporting a fall, therefore a positive net balance indicates an overall increase while a negative reading indicates an overall decline.

Unpicking the responses, we find that the trend does not in itself appear to signal a decline in business confidence. Instead, it is more likely due to an increase in the proportion of respondents showing little or no change from the previous high levels. In this survey a greater proportion of firms reported 'no change' to their confidence levels than in previous recent surveys; 44% compared to 31% in Survey 29 (Autumn 2018) and 28% in Survey 28 (Spring 2018).

Over the coming year contractors remain upbeat over their outlook for the UKCS area, half of respondents are confident that this upward trend will continue and only 7% are expecting the outlook to worsen.

Similarly, licensees and operators continued to report positive confidence levels and, looking to the year ahead, a net balance continue to remain confident about future prospects.

Figure 1 - Contractors: business confidence in UKCS (net balances)



International

In a similar pattern to UKCS activity, contractors remained relatively upbeat about their international activities with optimism trends for international activity remaining positive but easing compared to 2018 levels. On balance, firms continued to report and expect positive trends for both current optimism and for expected levels over the coming 12 months.

Between Autumn 2015 and Spring 2016, around half of contractors recorded declines in confidence regarding international work. However, in the three most recent surveys this has fallen to below 10%. Over the past 12 months, optimism in the international oil and gas sector increased for more than half of firms (54%) and a similar proportion (56%) are forecasting a further rise in confidence over the next 12 months.

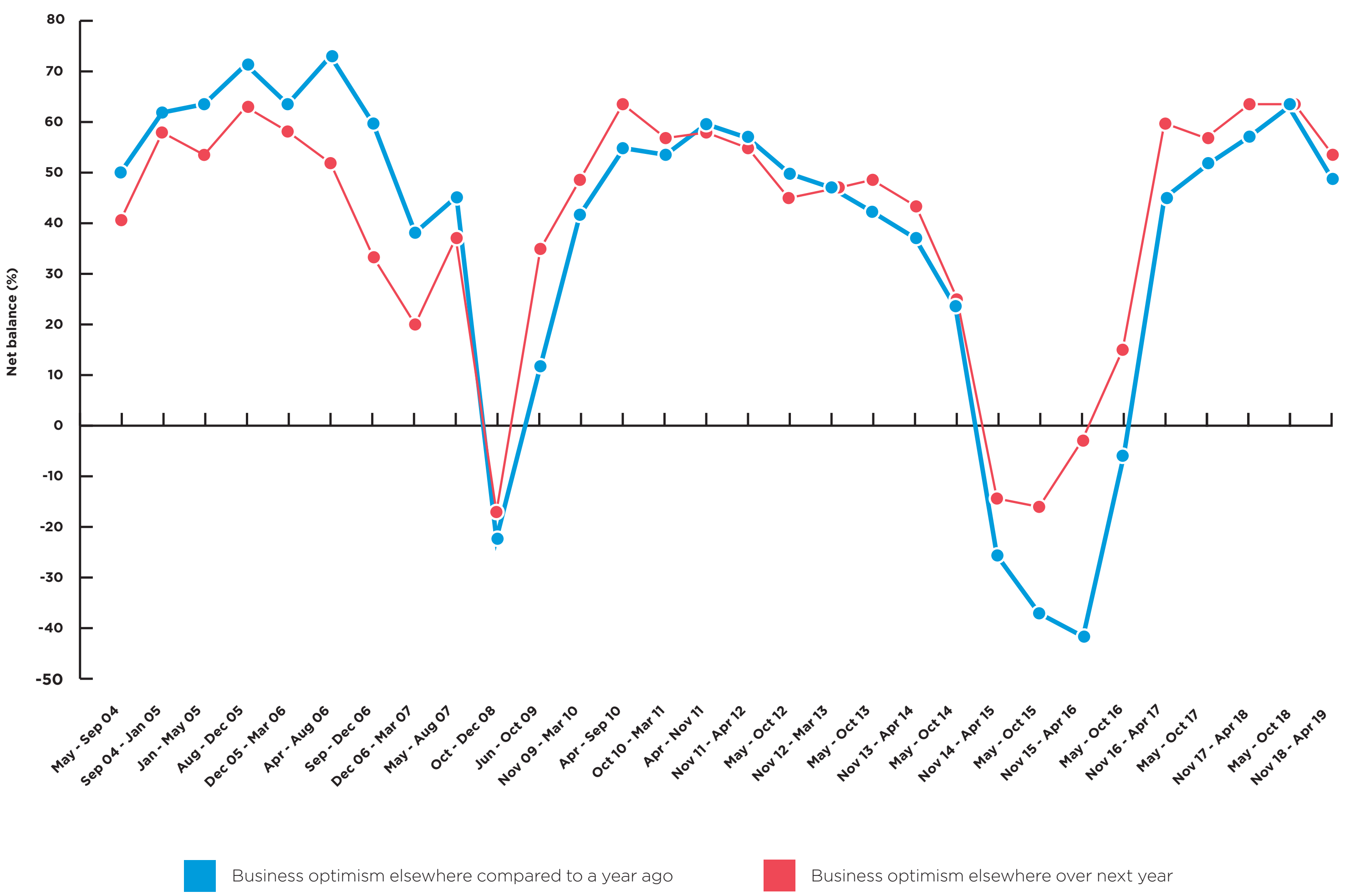
A net balance of +49% of contractors are more confident about their current international activities. Though down on the +64% recorded in the previous survey, it remains well above the 10-year average of +28%. Furthermore, a net of +54% are forecasting a rise over the coming 12-month period.

Akin to the trends in UKCS activity, licensees and operators once again recorded and expect a further rise in optimism around the oil and gas industry outside of the UKCS, though these positive trends eased.

As increasing exports forms a core pillar of the Vision 2035 strategy for the industry, it's encouraging to see that the sector is positive about the international outlook.

Chamber viewpoint

Figure 2: Contractors - business confidence in international markets (net balances)



Trends in business activity

Trends in business activity

Following on from confidence, we explore the specific activities of firms in this year and over future periods. Firstly, firms were asked questions concerning the actual and expected value of their organisation's work in the UKCS in production related work, decommissioning work and exploration activities (see Figures 3 and 4), and secondly they are also asked the same questions regarding their international activities.

Production related work

Through 2015 until the first half of 2017, contractors consistently reported net negative trends in the value of production-related work in the UKCS. However, over the past year and a half this trend has been improving and in this latest survey the net balance rose further to a net balance of +36% of contractors reporting an increase. This compares to a net of +28% in the Autumn 2018 report and +20% in the Spring 2018 survey. Any increase in activity is positive news for firms right across the supply chain. During the coming year more than half of contracting firms (54%) are forecasting a further increase in the value of production-related activities and only 5% are forecasting a decline (a net balance of +49%).

In relation to the value of production work outside the UKCS, fewer than 3% reported a decline and more than four in 10 (42%) reported an increase – a net balance of +39%. During the coming 12 month period more than half (54%) are expecting an increase and only 4% are expecting the value to decline.

A net balance of licensees/operators logged an increase in the value of their UKCS production related work and more than half expect no change to this value over the coming 12 months. With regard to the value of international production work, half of firms reported no change over the past 12 months and expect the same over the next 12, and around a fifth reported and expect a rise.

Figure 3 - Contractors - trends in UKCS activity in the last 12 months

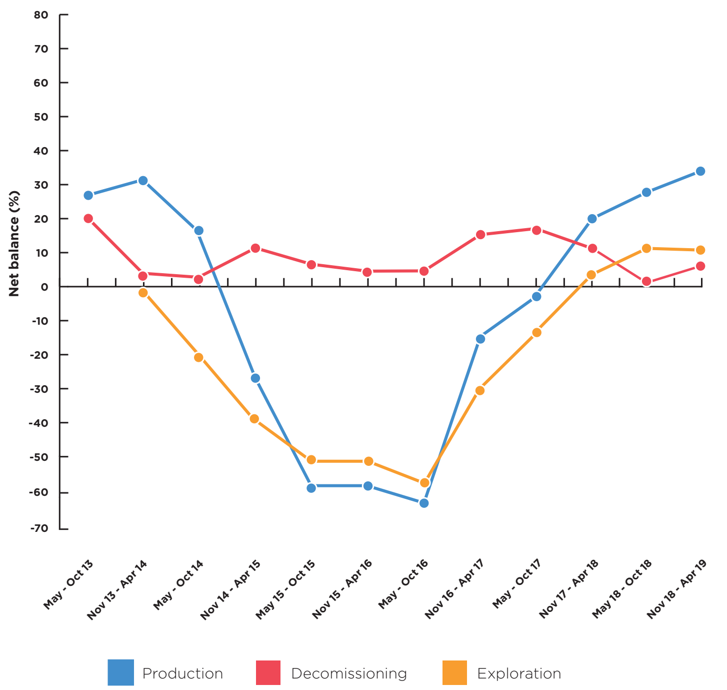
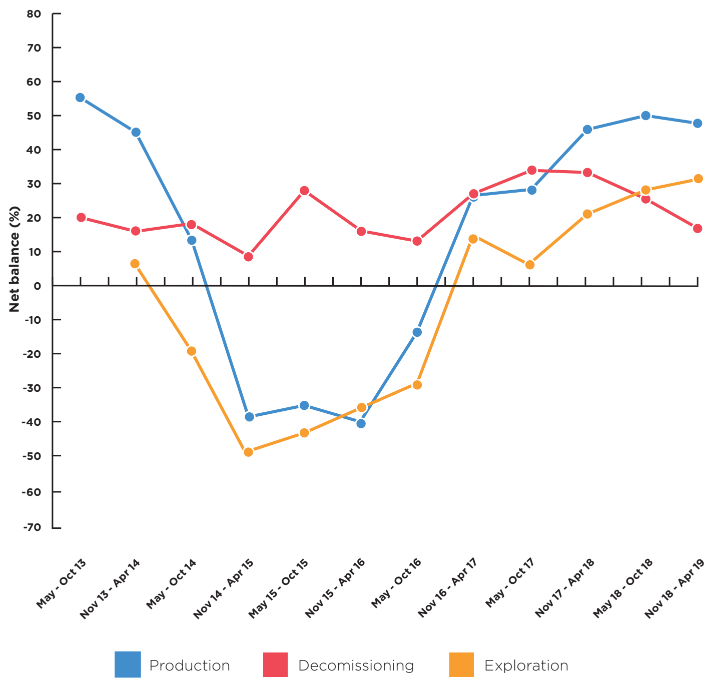


Figure 4 - Contractors – scheduled / expected trends in UKCS activity over the next 12 months



Decommissioning related activity

The oil and gas industry in the UK is changing and now decommissioning is taking its place alongside exploration and production activity. This survey asks firms about their decommissioning activity every six months and over time we can begin to look at the trajectory rather than the short term changes.

For respondents to our previous survey, the trend in the value of UKCS decommissioning-related activities eased to its lowest level since 2013. In the latest survey it increased a little to a net balance of +6% which is just two percentage points below the average net balance (since this question was introduced in 2013). Decommissioning activity was not relevant for almost 40% of firms. Of the remainder, 17% reported an increase in the value of the work, 11% reported a fall and 33% reported no change in the level of activity. Decommissioning activity is set to increase during the coming year with 28% of firms expecting an increase in the value of UKCS decommissioning work and fewer than 10% forecasting a decline in the value of such work.

A net balance of +16% of firms from the previous survey had expected a rise in international decommissioning-related activity and the outturn was slightly more modest at +6%. Over the course of the next year, a net of +12% anticipate a further increase.

Exploration related activity

The trend in the value of UKCS exploration-related work amongst contractors had been negative since Spring 2014 with the negative trend dipping to its lowest point in Autumn 2016. Since then it eased steadily though remained negative until the Spring 2018 survey where the outturn was positive (a net balance of +3%). Then in the previous survey a net balance of +11% of contractors recorded a rise and in this current survey remains largely unchanged at a net of +10%. During the coming 12 months the trend is expected to rise further with a net balance of +32% forecasting an increase in the value of UKCS exploration activity.

Similarly the value of international exploration work has, on balance, also been negative since Spring 2015 but turned positive in Spring 2018 when a net balance of +4% recorded an increase and rose further in this current survey to a net balance of +21%. A net balance of +38% of contractors are forecasting a rise over the coming year.

On balance, there was no net change in the trend in the value of UKCS exploration work for licensees/operators from the previous survey, however a net balance are now forecasting a rise.

Excluding seasonal factors, the trend in total international exploration work for licensees/operators improved in the six months to April 2019 however firms are anticipating a decline in overseas exploration work during the coming 12 month period.

Activity levels

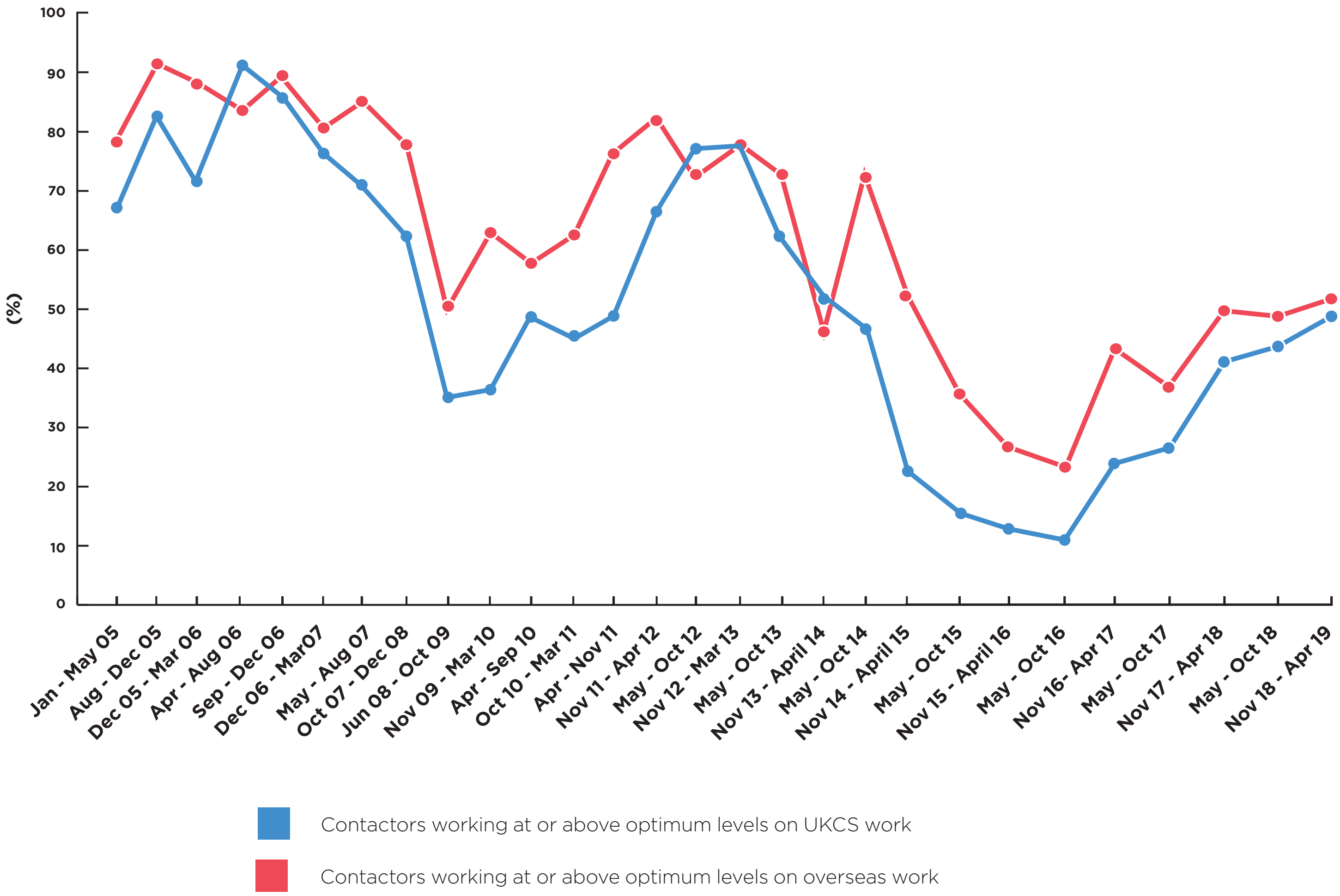
Figure 5 illustrates the percentage of contractors working at or above optimum levels over the period since the survey started in 2004.

The share of contractors working at, or above, optimum levels in their UKCS operations peaked at 79% in the Spring of 2013, it declined steadily over the three years until the May-October 2016 survey when it stood at 12% (the lowest figure since the survey began). Since then it has been rising steadily from 27% of contracting firms in Survey 27, then to 41% in Survey 28 and to 44% in the last survey. In this latest survey this figure has risen again to 49% reporting working at, or above optimum levels in their UKCS operations (the highest figure since May-October 2014).

In recent years global pressures have led to fewer firms reporting working at or above optimum levels in overseas markets, although since 2014 contractors have consistently reported stronger activity in their overseas portfolios compared to their UKCS portfolios. Once again this is evident in this latest survey with slightly more than half of contractor firms involved in overseas work working at or above optimum levels.

Trends in business activity

Figure 5: Percentage of contractors reporting working at or above optimum levels



Business trends

The survey also enquired about firms' expectations of involvement in specific activities over the medium term (defined in the survey as the next three to five years). The survey asks firms about their activities in decommissioning, renewables and unconventional oil and gas extraction.

Figure 6 shows contractors' expectations of greater involvement in decommissioning activity over the medium term. In the previous survey, a total of 74% reported that they were 'definitely' or 'possibly' likely to be more involved in decommissioning. In this most recent survey, this has risen slightly to 78%. We find:

- 26% (25% in the previous survey) reported they would definitely be more involved in decommissioning
- 52% (slightly higher than the 48% in the previous survey) reported they would possibly be more involved in decommissioning, the highest proportion since this question was added
- The proportion recording either that decommissioning activity is not relevant for them or that they were unlikely to or would not be involved decreased in this latest survey. In this latest survey it fell from 26% previously to 22%

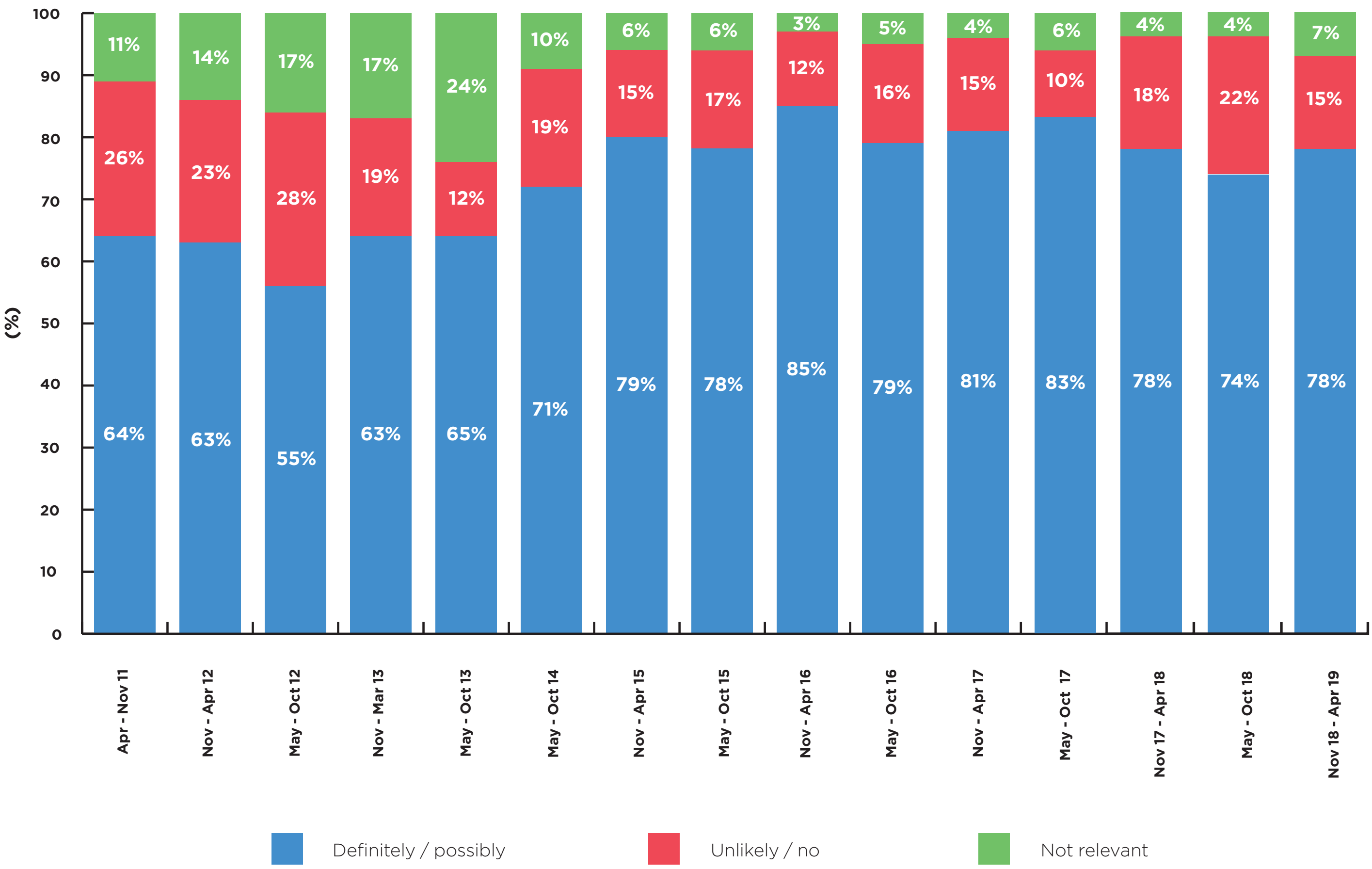
In Survey 24 (November-April 2016), we recorded the highest level of contractors reporting that they were definitely or possibly likely to become more involved in UKCS renewables work (63%), this declined to 53% in Survey 25 and has changed very little since then. It stood at 54% in Surveys 26 and 27, rose slightly in Survey 28 to 56% and increased only marginally in the last survey to 57%. In this survey, the proportion of firms indicating that their firms will likely be involved in UKCS renewables eased to 52% (20% indicating that their company will definitely be involved in renewable work and 32% that their company could potentially be involved). Involvement in UKCS renewables activity was not relevant to or not a consideration for more than half of licensees/operators.

The proportion of contractors expecting to either definitely (7%) or possibly (55%) be involved in UKCS unconventional oil and gas activity in the medium term fell from 68% in the previous survey to 62%. It follows therefore that the percentage of firms stating that they would be unlikely to be or definitely wouldn't move into unconventional areas in the UK increased, with the proportion rising from 32% to 38%.

With respect to unconventional activities outside of the UK, 62% of contractors (down from 67% in the previous survey) acknowledge the possibility that their firm could be more involved during the next three to five year period (11% stated they would definitely be involved and 51% noted a possible involvement). Over a third of firms stated that they would be unlikely to, or definitely wouldn't move into unconventional areas in international markets.

Fewer than half of licensees/operators expect to be involved in unconventional activities either in or outside of the UK.

Figure 6 - Contractors - Involvement in decommissioning activity in the next three to five years



Trends in business activity

Figure 7 - Contractors - involvement in renewables in the next three to five years

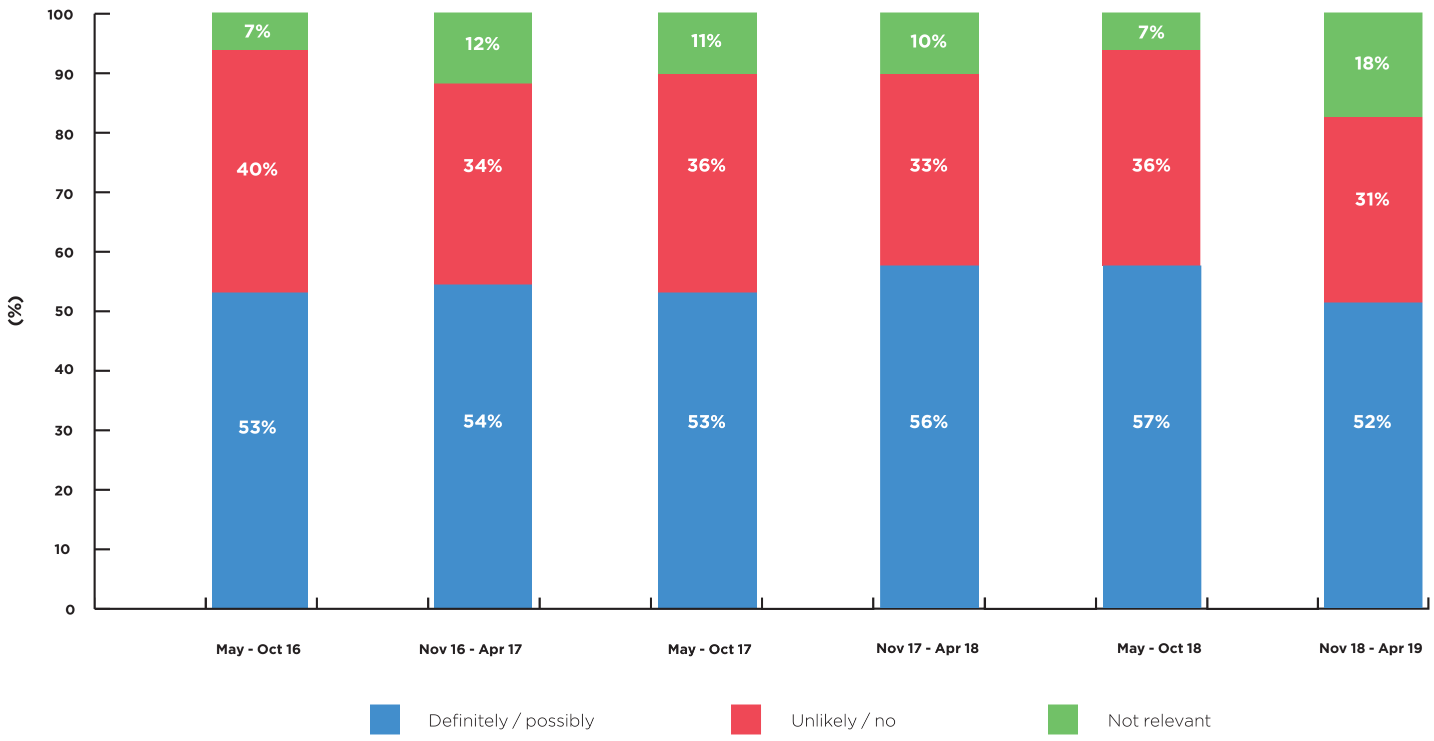
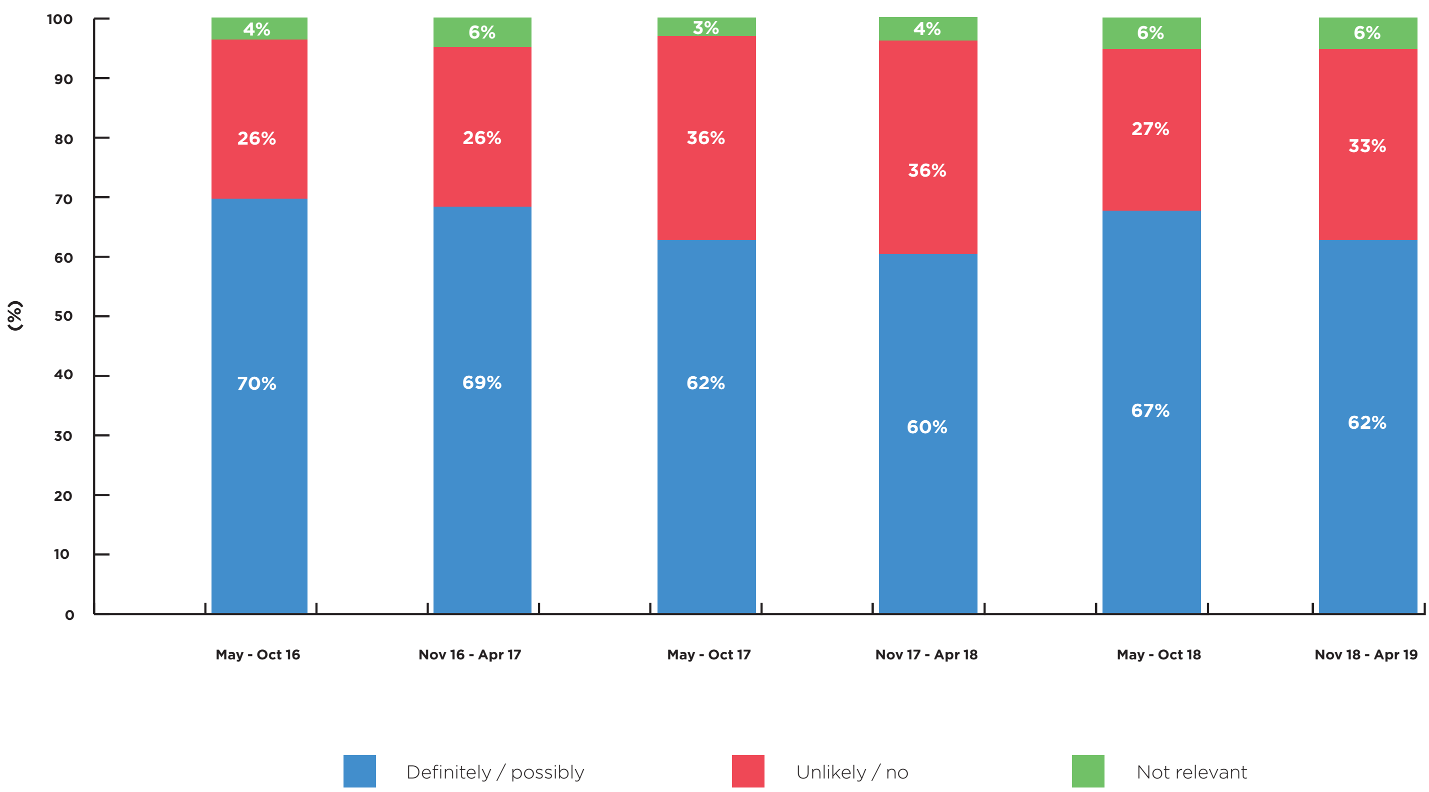


Figure 8 - Contractors - involvement in unconventional activity in the UK in the next three to five years



Employment changes

In their Workforce Report 2018, Oil and Gas UK estimated the number of jobs supported by the oil and gas industry across the UK to be more than 280,000 in 2018. The figure includes those directly employed by oil and gas companies and major contractors, as well as those from the wider supply chain and jobs supported by the on-spending of people employed in the sector. This current survey draws on responses for oil and gas operators and contractors who currently employ more than 42,000 employees.

We sought information on the current UK-based workforce for each firm, asking what has happened and what they expect to happen to their UK workforce (FTEs) in the next 12 months. In the 2017 survey, 11% of all firms increased their total workforce by more than 10%, then in the 2018 survey this rose to 21% and in this latest survey this rose further to 27%. During 2020, 19% of firms expect their total workforce to increase by more than 10%.

In this current survey around 40% increased their employment (FTEs) levels over the past year, 46% reported no change and 13% reported decreasing their workforce. During 2020, only 4% expect to reduce their workforce.

Vacancies

In Survey 21 (May-October 2014) we added a question on vacancies, noting the number of current vacancies in firms' UK activities.

In this latest survey we find that the vacancy rate (i.e. vacancies per 100 jobs) for operators/licensees has eased during the last six months and stands at 0.52 compared to 1.13 in the previous survey. The vacancy rate for contractors remains higher and has increased slightly from the 1.64 reported in the previous survey to 2.29.

"The survey suggests that greater investment is needed in the skills and abilities of our young people at school and university level to inspire them to work in the industry.

KPMG

Investment trends

Investment trends

Each Spring, the survey focuses on investment and research and development activity in the oil and gas sector. As the focus on investment was introduced in May 2005, we now have more than a decade of information on investment indicators for the sector, allowing 14 years of trends to be analysed. In this most recent survey we repeated questions about firms' scheduled investments in the UKCS, both in aggregate and broken down across different categories.

In this survey we explore trends in investment in the last 12 months and scheduled investment plans over the next two years.

In contrast to the wider UK economy, investment by North Sea operators and contractors continues to grow with firms in the oil and gas sector seemingly bucking the trend with respect to investment spend. On measures of investment spend, the overall picture is significantly more positive than in previous years, though it's worth bearing in mind that these increases follow very low levels through 2015 and 2016.

Business investment fell across the UK economy in 2018, whilst here in Scotland the latest Scottish Business Monitor and the Chamber of Commerce Quarterly Economic Indicator shows that firms are cutting back on new capital projects. Business investment has been weak since the financial crisis and latest figures show that business investment has fallen for four quarters in a row; and the data suggests that Scotland lags behind the UK.

For contractors, the net balance of total investment spend for the UKCS area in the last 12 months improved with more contractors increasing investment spend in the UKCS area (45%) than reducing spend (7%), while more than a third of contractors (36%) reported no change to their investment spend. Over the past three years, the proportion of firms reporting no change in their investment spend has been increasing. Nevertheless, this balance of +38% compares to a positive net balance of +9% one year ago and to a negative net balance of -22% two years ago.

The outlook for the next two years is even more positive. Significantly more contractors expect to increase investment (56%) than reduce (6%), while just over a quarter of contractors (28%) are forecasting no change to their investment spend.

Operators and licensees, on balance, also reported a rise in investment spend, however are not forecasting a further rise with 18% anticipating an increase and 18% expecting a fall.

Figure 9 shows the net balance between those contractors reporting an upward and those reporting a downward trend in each category of investment spending (i.e. the share of contractors reporting an increase in spending in

Figure 9 - Contractors - direction of investment spend in 2016-2018 and scheduled trend for 2019/20

Investment trends

this category minus the share of contractors reporting a decrease in spending). This reveals that the net balances for investment activity were positive in all categories (i.e. more contractors reported increasing than reducing spending in each of the categories). In the Spring 2017 survey, staff training, equipment maintenance and maintenance of infrastructure had been negative however in this latest survey, as in the previous survey, net rises in investment were reported across the board. Strong positive net balances were evident in research and development and in development of new markets.

The upward trend in research and development investment continued, rising to the highest net balance since 2006/07 and contractors are forecasting a further increase over the next two years. The trend in investment for developing new markets also continued to rise in this latest survey and here too a further rise is forecast.

In the 2016/17 Spring survey a net balance of -12% of contracting firms reported a reduction in the spend on equipment maintenance, then in the last survey a net balance of +11% was reported and now in this latest survey, in line with expectations, a net balance of +25% reported a rise. This trend is expected to rise again over the next 24-month period. Likewise, maintenance infrastructure spend declined for a net of -4% in the 2016/17 survey, rose to a net balance of +9% in the previous survey and rose once again in this latest survey for a net balance of +23% of contractors.

Operators also reported, on balance, flat investment trends for both equipment and infrastructure maintenance though a net balance are forecasting a rise in equipment maintenance investment.

Contractors have also reported a further increase in investment spend with respect to staff training. Throughout 2015 and 2016 investment in staff training was negative, then in the previous survey a net balance of +15% reported a rise. This has risen further in this current survey for a net balance of +23% of contractors. Operators and licensees unexpectedly reported a decline in investment spend for training though an increase is forecast.

R&D investment improved once again and the net balance now stands at the highest level since 2007. A net balance of +42% of contractors recorded a rise and a net of +49% expect a further rise.

Investment to reduce costs continued to rise for a net balance of contractors though the rising trend eased from a net of +28% in the last survey to a net of +27% in this current survey, though more than half of firms reported a level. Merger and acquisition investment spend, on balance, also increased and a further rise is forecast.

With regards to specific research and development activities undertaken by contractors, developing new equipment (61%), developing new services (54%), developing new processes (37%) and developing new software (31%) were once again the most commonly cited. Developing new equipment rose from 57% previously to 61% and developing new services rose from 34% in the last survey to 64% in this latest survey. Overall 13% and 10% of firms reported active involvement in decommissioning and renewables research respectively. Improving extraction processes and extraction yields were noted by 5% and 3%. Almost one in five firms reported no research and development activity.

In this survey we repeated the question designed to ascertain the extent to which firms used UK/EU funding or associated tax incentives for their research and development activity. The results indicate that slightly more than a third of all firms (35%) said that the availability of funding or tax incentives had influenced their company's decision to invest in research and development in the UK.

A quarter of firms in this survey (compared to 22% previously) have used UK or EU funding for research and development / new product development projects (e.g. funding from Scottish Enterprise, Highland and Islands Enterprise or Innovate UK). There was no change from the previous survey in the proportion of firms making use of UK tax incentives such as R&D Tax Credits and Allowances (33%). Less than half of firms (43%) indicated that they had not made use of any EU/UK funding or tax relief.

"Having had significant infrastructural investment throughout the down-turn, the North East of Scotland can and should build on this to secure its place as a regional centre of excellence.

KPMG

Figure 10 - Expected trends in investment spend by contractors (2011/12 to 2019/20)

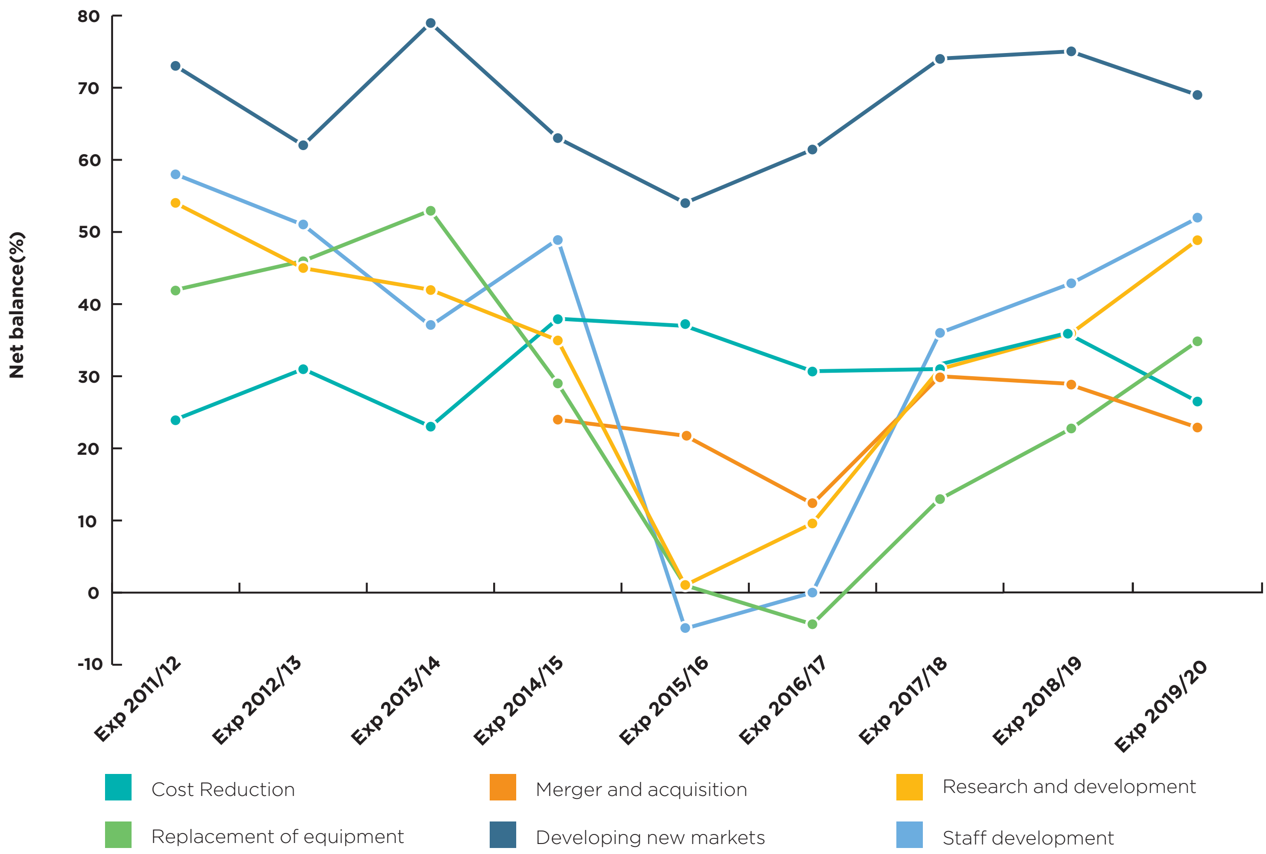


Figure 11 - Actual trends in investment by contractors, 2005 to 2018

Business constraints

Competitiveness and business constraints

This section explores the specific factors influencing UKCS activity and the actions firms are taking in order to retain a competitive advantage in the UKCS.

Since 2005, we have asked respondents to our Spring surveys to indicate (from a list) which factors they thought were most likely to limit their activity over the coming year in the UKCS and elsewhere. The list of factors has evolved slightly over time. The changing patterns of factors identified by contractors to be important for limiting their activity in the UKCS since 2005 are given in **Figures 12 to 15**.

The level of demand, once again is the most pressing concern for contractors, remaining a very important concern for the majority of contractors (71%), this is illustrated in **Figure 12**. Commodity prices on the other hand, while remaining a notable limiting factor the extent to which firms cite it as a very important factor, likely to constrain their activities, has been declining since 2015 and lessened again in this survey falling from 54% to 51%.

Figure 12 - The percentage of contractors reporting specific demand and economic factors as limiting UKCS activity

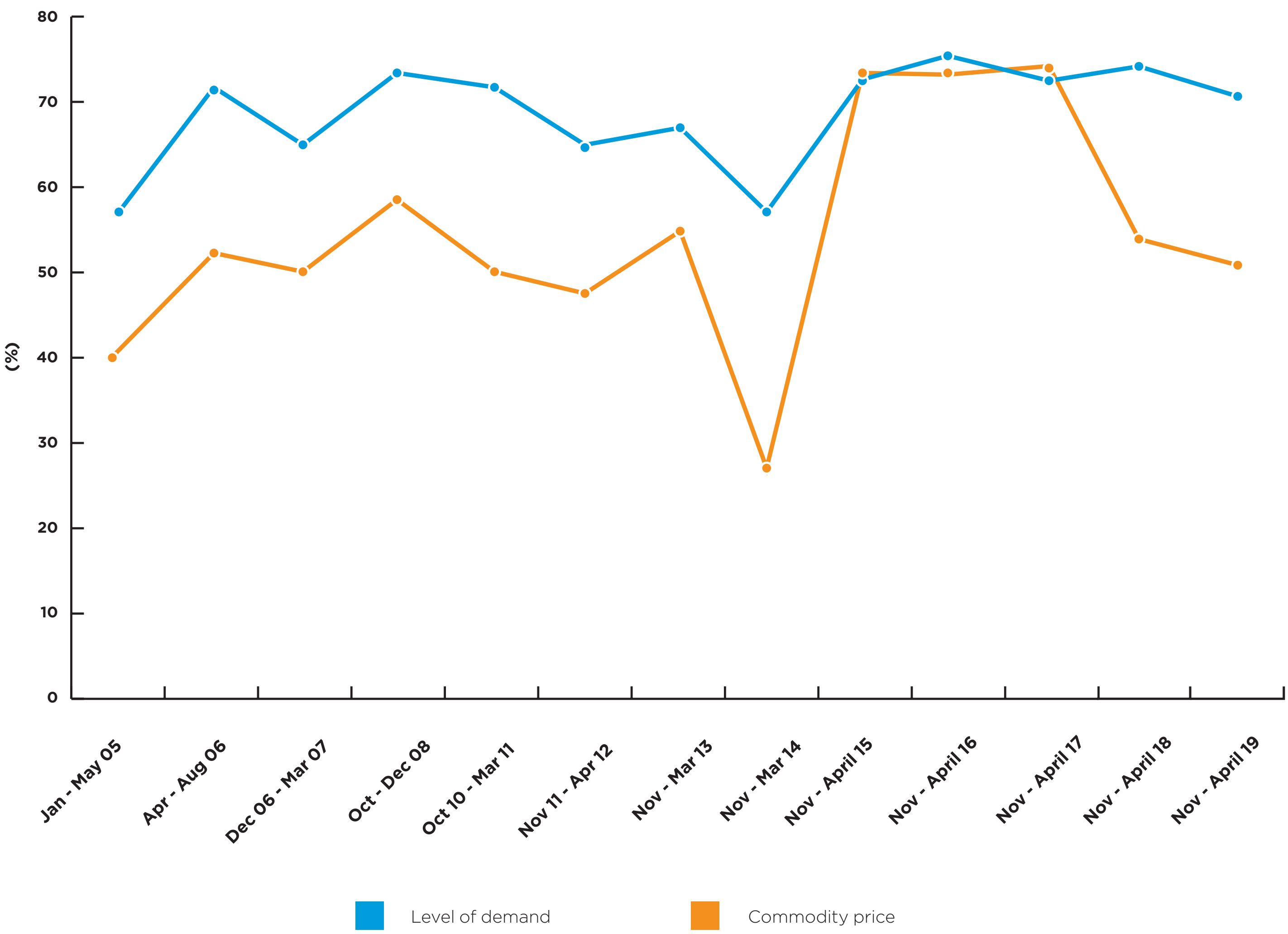
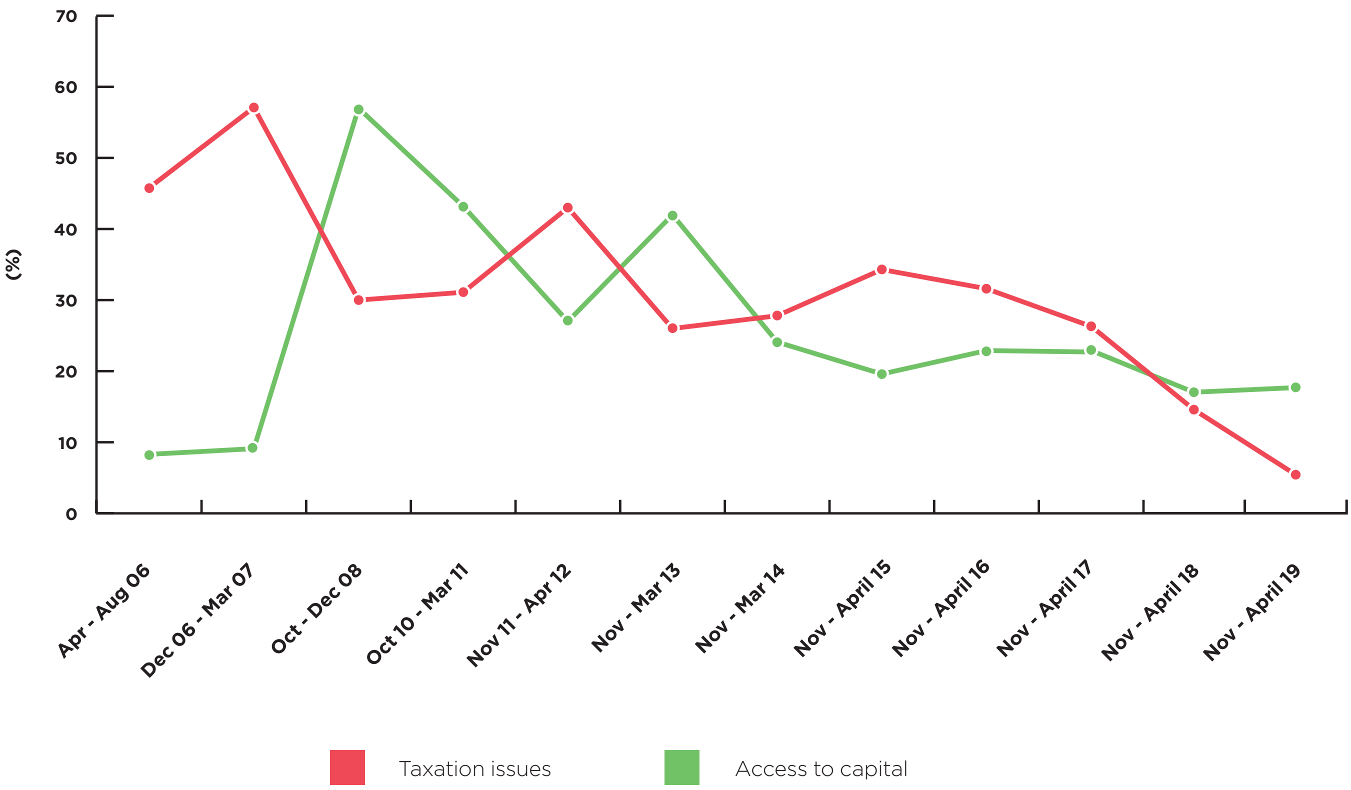


Figure 13 illustrates how the importance attached to taxation issues in limiting contractors' UKCS activity has been lessening since 2015. Two years ago, 26% of contractors cited it as a very important factor, this fell to 16% one year ago and has now fallen to 6% in this current survey. Similarly, concerns around access to capital have also been easing in recent years and is now a very important concern for just 18% of contractors compared to 23% two years ago.

Figure 13 – The percentage of contractors reporting specific cost and taxation factors as limiting UKCS activity



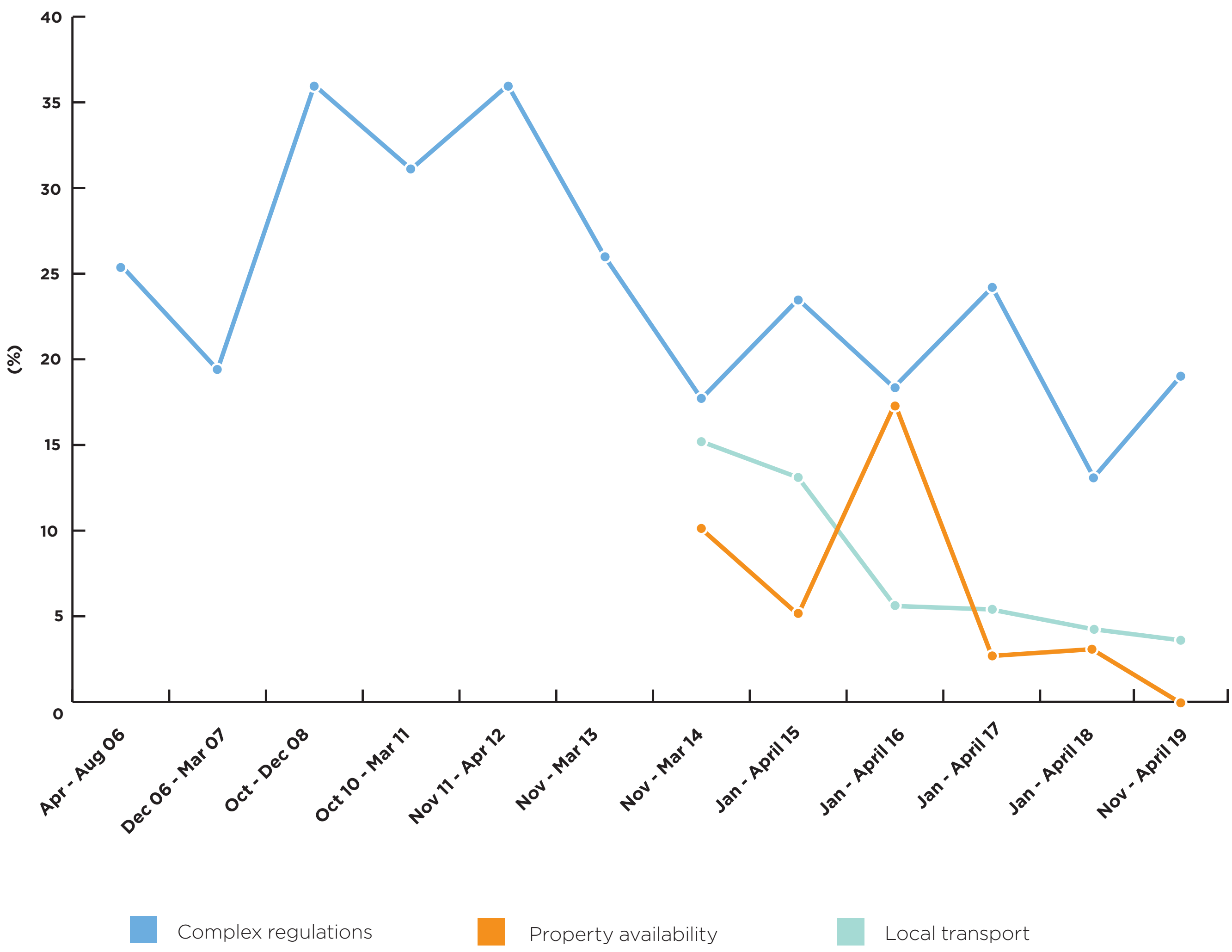
The extent to which skills remain, as a major constraint on firms' activities is shown in **Figure 14**. In this latest survey 43% of firms reported it as a very important factor, slightly down from a year ago when 46% cited skill shortages as a factor likely to limit activity. In recent years, alongside the fall in headcount reported by some firms, we found that skill shortages had eased as a constraint on firms' activities. However, it has increased over recent surveys and remains an important issue for firms seeking to expand in the future.

Figure 14 - The percentage of contractors reporting specific employment factors as limiting UKCS activity

Competitiveness and business constraints

The changing views of contractors on regulatory and infrastructure issues can be seen in **Figure 15**. Complex regulations rose in importance as a concern and 18% of contractors cite it as a factor likely to limit activity over the coming year compared to 13% previously. Once again local transport issues were cited by fewer than 5% of contractors, and are therefore not viewed as likely to limit activity. Ageing assets is rising in importance as a factor likely to limit business activity, rising to 30% compared to less than a fifth of firms a year ago.

Figure 15 - The percentage of contractors reporting specific infrastructural and regulatory factors as limiting UKCS activity



When asked to indicate the statement/category which most accurately described the majority of their customers' payment terms, just over a quarter (27%) claimed that they agreed to terms of 30 days or less and almost a further quarter (24%) reported terms of 31-40 days. 40% agreed to payment terms of between 41-70 days and fewer than 10% agreed on more than 70 days.

In relation to how frequently customers/suppliers were adhering to the agreed payment terms almost half (48%) said this was always/often. Just over a quarter of firms (28%) claimed payment terms were only sometimes adhered to, while almost a fifth (19%) said they were rarely adhered to.

Figure 16 - Firms' view on industry adherence to 30-day payment terms

Current industry challenges

> **Despite the UK's maturity as an oil and gas basin, many companies value the level of expertise, know-how and business infrastructure that exists within the region.**
>
> **KPMG**

Future planning

The changes to IR35 from April 2020 mean that businesses will be responsible for determining the employment status for tax of individuals providing their services via a limited company. The business/client will be liable for deciding whether contractors providing their services via a limited company should be treated as employed or self-employed for tax purposes, and either the business or an agency will be responsible for accounting for PAYE/NIC on payments to the limited company where required. With this in mind we asked firm what steps, if any, their business will be taking as a result of the new IR35 legislation changes.

The changes were not a relevant issue for 37% of firms who don't use contractors nevertheless 14% stated that these reforms will lead to them recruiting fewer contractors and 13% said they would look at changing their recruitment polices. One in 10 firms claim that they would look at converting contractors to employees and/or recruit new employees to replace contractors. Only 8% said they would attempt to negotiate additional costs with the supply chain and only 3% will look at potentially increasing contractor day rates.

Firms were asked to predict whether or not they were anticipating an increase in profit in 2019 compared to 2018. Encouragingly for the sector, 72% of firms anticipate an increase in their profits in 2019 compared to 2018. This is a significant increase from Autumn 2018 when 58% of firms were forecasting a profit rise compared to the previous year, and a slight increase from the 2018 Spring survey where 70% were anticipating a rise. However, in the Spring 2018 survey there were minimal differences between operators and contractors, whereas in this latest survey fewer licensees/operators are expecting an increase in profits in 2019 compared to 2018.

We then asked firms if, within the last two years, they had started to use artificial intelligence in their business. More than half of respondents (53%) to the survey stated that they do not use and have no plans to use artificial intelligence in the future. Only 14% already use artificial intelligence and 16% plan to within the next one to two years. A further 16% are expecting to introduce it within the next three to five years.

We introduced a question asking how the level of collaboration among operators and contractors has changed within the UKCS compared to three years ago. For more than half of companies there has been no change, however 23% felt that the level of collaboration was better compared to three years ago, with only 13% sensing that it had deteriorated.

We asked firms to indicate what best described their business' strategy and approach to energy transition. Just over a third (36%) claim to be actively diversifying their operations and seeking work outwith the oil and gas sector whereas 34% do not plan to change the level/proportion of their current non-oil and gas activity. For 15% of firms demand for their services/products is increasing organically in non-oil and gas projects.

We then went on to ask firms if they faced any barriers and challenges to diversification into other forms of energy. A third of firms stated that diversification was of no interest to them and was not part of their business plan. Of those firms that have considered potential diversification, the most commonly cited barrier centred around concerns of a lack of experience and skills within their organisation (43%). A number of firms reported financial barriers; the profitability and potential returns to investment of any diversifications is a potential barrier for 36% of responding firms, while 14% cited the limited access to capital and funding and a further 8% cited the high cost of research and development and also the limitations of the current technology. 19% are unwilling to diversify within the current political and regulatory environment.

Finally, we enquired as to how optimistic firms are about the long-term future of Aberdeen as an oil and gas / energy hub and somewhat reassuringly fewer than 10% reported being not at all optimistic. Almost 20% reported being extremely or very optimistic with a further 43% being moderately and 27% slightly optimistic. Fewer than 10% said they were not at all optimistic.

“

There's an incredible opportunity for Aberdeen to leverage its reputation in oil and gas and lead the energy transition. Some of the recent partnership projects, such as the launch of the National Decommissioning Centre, and the UK Government's recent statement of support regarding the Underwater Hub, supported by industry hubs such as the Oil and Gas Technology Centre, act as powerful statements of intent as the North-east looks to build our profile as a global leader in both the energy transition, and as a centre of excellence for subsea engineering.

Chamber viewpoint

Future planning

In the previous survey we introduced a question asking contractors what sectors the remaining proportion of their activities were if their business was not 100% in oil and gas activity. On average, 86% of contractors' business was in oil and gas activities (the same proportion reported in the last survey). They were then asked what percentage of their business they expect to be within oil and gas activities by 2025 and here the average fell to 77% (80% previously).

Looking in more detail, just under half of contractors (48%) reported that all of their business was in oil and gas with a further 32% saying that more than 80% of activity was oil and gas related, giving us a total of 80% currently reporting that more than 80% of their activity is in oil and gas. By 2025 just 60% of contractors expect more than 80% of their activity to be in oil and gas.

Percentage of business in oil and gas activities

%	2018	2019	Expected by 2025
100%	48%	48%	42%
80-99%	31%	32%	18%
50-79%	12%	10%	27%
0-49%	9%	9%	13%

The sectors outside of oil and gas that these contractors most commonly reported working in were renewables, other general engineering, and power generation. Often this work was a fairly marginal part of their activity as it accounted for less than 10% of their total activity for most respondents.

Appendix

The Oil and Gas Survey is conducted by the Aberdeen & Grampian Chamber of Commerce and the results analysed by Strathclyde University's Fraser of Allander Institute.

Methodology

The Aberdeen & Grampian Chamber of Commerce Oil and Gas Survey seeks evidence of changing trends and uses net balances as the principal survey statistic. Most questions of this nature ask the respondent to indicate whether the trend over the past four months and expected trend over the next 12 months is either 'up', 'level' or 'down'.

The net balance for such survey questions is defined as the number of 'up' responses minus the number of 'down' responses to each survey question. Hence a positive net balance indicates a rising trend, and a negative net balance a declining trend.

Generally the net balance can be expected to reflect the direction of change of the variable it purports to measure. Thus, for example, a positive net balance with respect to orders indicates that orders are rising. So typically the balance statistics are assessed by comparing them with growth rates, not levels of official data series [Treasury Bulletin Vol. 4 no. 2 Summer 1993]. 99 companies responded to the survey, representing a response rate of 10% of companies contacted.

We would like to thank all survey participants. Without your time and input we could not have delivered this research. Your continued support is invaluable to us in meeting our commitment to bring you independent and impartial insights into the key issues facing your business and the wider sector.

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About the Aberdeen & Grampian Chamber of Commerce team

Have you got a business question? Well the team at the Chamber can help you answer it. Our research team can support your business in a number of ways. We offer a bespoke approach which can be tailored to your individual organisation and objectives. We are currently delivering work for a number of members and over the last three years have completed over 100 commissions. We are here to help you and would be delighted to see if we can help solve your business challenges

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