MEDIA SUMMARY: Analysis of the offshore oil and gas marine support sector

This document has been prepared as a summary of key findings from the Deloitte Access Economic report *Analysis of the offshore oil and gas marine support sector* (July 2013). This analysis was commissioned by a group of vessel companies represented by resource industry employer group AMMA (Australian Mines and Metals Association).

The report evaluates the economic environment facing vessel operator companies and assesses the implications of a subdued oil and gas industry on Australia's overall economy. With important industrial re-negotiations underway in the marine support sector, attention was paid to competitive pressures, cost and productivity issues.

In-line with the content layout of the report, this summary comprises four sections: 1) the macroeconomic context; 2) the oil and gas industry; 3) the offshore oil and gas marine support sector **(including key findings in the current EBA re-negotiations)**; and 4) potential implications for the Australian economy.

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About the offshore oil and gas maritime support sector (vessel operator companies):

- The 'marine support sector' refers to all vessel operator companies providing direct, critical support to about $115 billion worth of offshore oil and gas projects (primarily across WA, Qld, Vic and NT) .

- The offshore oil and gas marine support sector is estimated to employ approximately 2,500 staff directly to vessels, with another 10,000 staff in affiliated areas (Logistics Training Council, 2011) (p.18). The flow-on effects of these activities are enormous.

Some of the primary activities include:

- *Exploration phase:* seismic surveys, anchor handling tug supply (AHTS), platform supply and drilling.
- *Construction phase:* dredging, pipe-laying, supply and accommodation, barge navigation and towing.
- *Production phase:* platform support and servicing, transport and logistics,

Message: Without a competitive, productive and sustainable maritime support sector, Australia does not have an offshore oil and gas industry.

1) Macroeconomic context

Key Message: "The biggest driver of Australian economic growth in recent years is set to slow sharply. That will slow revenue in Australia's offshore oil and gas marine support sector and, with costs rising sharply, will affect the long term sustainability of the sector, (p. vi)."

- Since 2000, mining related capital expenditure (in Australia) has grown by 21% on average per annum. This has seen overall investment as a share of GDP double in the past 10 years, (p.4).

- The value of oil and gas projects (both under construction and in the pipeline) has more than doubled in five years. Large LNG projects will support the remaining rise in investment in the short term, (p.5).

- The resources boom has been the major systemic driver of the Australian economy in recent years. However, as resource extraction is expanding across the globe, supply has begun to catch up with demand. As a result, Deloitte Access Economics is of the view that the peak of the price phase has already passed, though Australia's terms of trade is expected to settle at a historically high level, (pp.3-4).

- Deloitte Access Economics' view sees mining investment peaking as a share of GDP within the next year; then declining to settle at around 5.5% of GDP by 2016; and falling further to around 4% of GDP by 2023, (p.9).

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- The consensus view from the major Australian banks tends to be more bearish, with expectations for a rapid fall in the value of capital projects in Australia leading up to 2015, (p.10).

- As the investment cycle peaks, the reward from Australia's enormous investment in resources is to be reaped from a sharp rise in net exports, which has been falling since 2000 in terms of contribution to GDP (p.5).

- In the past year, a fall in terms of trade and declining export prices has been illustrated by a squeeze on private business profitability. National accounts data shows wages and salaries of employees in Australia rose by 6% from 2011-2012, while gross operating surplus of private non-financial corporations fell by 4.5%, (p.7).

- This data is for Australia as a whole, but the point is also relevant in the offshore oil and gas marine support sector, where profitability has been under pressure for even longer (*see section 3 of this summary*), (p.8).

- While large LNG projects continue to dominate the investment program, the economic parameters underlying these and other mining investments are rapidly weakening. The Bureau of Resources and Energy Economics (BREE) believe that $150 billion of high value projects at the feasibility stage have been delayed or cancelled since April 2012, (p.9).

2) The oil and gas industry

Key Message: "The impact of a softer demand outlook, combined with the current cost pressures felt by operators, could significantly erode the business case underlying many of the proposed LNG developments scheduled to commence in Australia in the next few years. Maintaining the international competitiveness of the Australian market is critical to the ongoing viability of domestic industry, (p.14)."

- Australia possesses a world class oil and gas industry which significantly contributes to the nation's economic activity. Gas production has surged and this trend is expected to continue as existing oil reserves are depleted while recent and upcoming investments in LNG production is realised, (p.11).

- At present there are ten major oil and gas projects under construction, with a further nine in the pipeline. This investment activity – and the implications for the Australian economy – is significant. All involve offshore gas extraction and LNG production facilities and are worth a combined $115 billion, (p.12).

- Global demand for Australian gas output is expected to continue to grow to 2050 and Australia is well positioned to benefit from this growth, especially from Asia-Pacific markets, (p.13).

- However, risks are emerging which threaten the opportunities for Australia's oil and gas industry. Rising costs and regulatory hurdles face oil and gas firms as well as vessel operators in the downstream offshore oil and gas marine support sector (*see section 3 of this summary)*, (p.13).

- A number of the oil and gas projects now underway are enduring significant labour, capital and regulatory pressures, (p.14).

- When compared to the United States Gulf Coast, Australian construction inputs are more expensive and project management costs are greater. McKinsey (2013) estimates that a new Australian LNG project would have a cost of supply as much as 30% higher than a matching Canadian or East African project, (p.14).

- Price pressure is also growing alongside cost pressure, as the US, Qatar and Russia each build the potential to significantly increase the supply of gas to Asia, (p.14). The opening of the US market to LNG exports has resulted in about 20 applications currently with the US Department of Energy seeking export approval, (p.17).

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- The impact of a softer demand outlook, combined with the current cost pressures felt by operators, could significantly erode the business case underlying many of the proposed LNG developments scheduled to commence in Australia in the next few years, (p.14).

- The same issues also face investors and operators in the offshore oil and gas marine support sector, where global firms seek out markets which maximise their return on investment. Maintaining the international competitiveness of the Australian market is critical to the ongoing viability of domestic industry, (p.14).

3) The offshore oil and gas marine support sector

Key Message: "Strong wage growth combined with weakening profit margins over the past few years has left the offshore oil and gas marine support sector in a position where any significant, sustained growth in wages could threaten the ongoing viability of the sector, (p.26)."

- The offshore oil and gas marine support sector is estimated to employ approximately 2,500 staff directly to vessels, with another 10,000 staff in affiliated areas (Logistics Training Council, 2011) (p.18).

- The marine support sector is pivotal to the broader oil and gas industry with activities including seismic surveys, anchor handling tug supply (AHTS), platform supply and drilling (all exploration phase); dredging, pipe-laying, supply and accommodation, barge navigation and towing (all construction phase); and platform support and service vessels (extraction phase) (p.18).

- As with the broader oil and gas industry, labour costs in the offshore oil and gas marine support sector have increased substantially in recent years. The pace of wage growth in the sector has clearly been disproportionately greater than wage and price growth in the Australian economy overall, (pp.18-19).

- As an example, wages have almost doubled over the last decade for schedule 1 integrated ratings, and have increased by more than 70% for schedule 8 roles. In 2012, a schedule 8 integrated rating (construction) was earning almost $240,000 per year, while a schedule 1 integrated rating was earning in excess of $170,000 per year, (p.18).

- The strong pace of wage growth in the sector in recent years has also been accompanied by non-monetary employment conditions which restrict the capacity of employers to operate cost-effectively. These conditions are often unproductive and uncompetitive, and have implications for the wider economy, (p.20).

- Current EBA negotiations in the marine support sector include wage and conditions claims sought by unions that would impede productivity in the sector and restrict the flexibility with which firms can operate, reducing competitiveness and exacerbating an already high cost environment for domestic operators, (p.21).

- For such wage growth to be sustainable (MUA claim for 26% over four years + allowances increases), revenues must therefore grow at a similar rate. However revenue in the offshore oil and gas marine support sector has been under pressure. Further, revenue is expected to remain under pressure given the recent scaling back of investment activity, (p.21).

- Deloitte Access Economic undertook a survey of the pressures on Australia's vessel operator companies, finding that across 2008-09 and 2009-10 the sector's profits fell by 27% while at the same time wages costs grew by around 19%, (p.22).

- In the wider mining industry, wages growth has slowed as pressures on revenue and profits increase, but in the offshore oil and gas marine support sector, the gap between wages and profit growth continues to rise, (p.23).

- On a 'per vessel basis', both total expenses and wages have increased by around 40% since 2007-08, while revenue has increased by only 8%. Profit per vessel is now just half the level recorded in 2007-08, (p.24).

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- The wages contribution to expenses in the oil and gas marine support sector (>50%) is more akin to labour-dominated service industries such as education and training, which have far less revenue volatility, (p.25).
- Given current trends, it is clear that strong wage increases going forward will further erode the viability of the sector. Moreover, the challenges facing the sector mean that it is vital that vessel operators are able to manage their businesses flexibly, (p.27).
- Such a move would make it even more difficult for Australian-based vessel operators to compete with international rivals, and would place additional pressure on the oil and gas industry. Such a scenario would have significant implications for the Australian economy, and the offshore oil and gas maritime support sector, (p.27).

4) Potential implications for the Australian economy

Key Message: "Any outcome which constrained the operations of the wider oil and gas industry would therefore have implications for Australia's national prosperity overall. Not only would the economy forego significant investment and export activity, it would also see the delicate transition between the investment and net exports phase of the mining boom being pressured," (p.xii).

- The offshore oil and gas marine support sector is at the frontline of this transition (see above). Fumbling this transition would add to the risks associated with the impending structural change in the economy, hurting activity and employment growth as more people have to be reskilled in a shorter period of time, (p.xii).
- In 2011, the direct and indirect operations of the oil and gas industry represented some 2% of the Australian economy, with that share expected to rise considerably over time, (p.xii).
- Abandoning projects currently in the investment pipeline would have an immediate impact on the indirect contribution of the oil and gas industry. The construction sector would suffer from the loss of expected activity associated with large engineering developments, (p.29).
- Similarly, the manufacturing sector would forego revenue related to demand for machinery and equipment. Moreover, the downstream offshore oil and gas marine support sector would also clearly be affected by a slowdown in investment in the broader oil and gas industry, (p.29).
- Oil and gas investments currently represent a significant share of the Australian investment pipeline. Failure to convert a number of these plans to construction would see the end of the investment phase of the mining boom approach much more rapidly, (p.29).
- The effect of bringing forward the end of the investment phase of the resources boom, would likely cause unemployment to rise, as workers re-skill and other industries build up their capacity to take on more employees, (p.29).
- Relative cost pressures have pushed Australian projects back in the global development queue; that is a problem not merely for the Australian gas sector, but also for the Australian economy as a whole. Other things equal, that underscores the importance of cost control to the outlook for both this sector and for the wider Australian economy, (p.xiii).

Click here for the full Deloitte Access Economics report and for AMMA's accompanying media release.

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