AN UPLIFT IN UPSTREAM CAPEX IS BECOMING A REALITY



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Whilst the world has been focusing on greener issues over the last decade, the sleeping giant of Oil & Gas (O&G) has taken a back seat, but continues to provide what is for now, and the foreseeable future, the world's most important commodity and source of energy. A recent Global Oil Outlook paper from Bloomberg, projects the aggregate demand for oil to peak by 2035, and decline by 10% to plateau by 2050. This decline is based on a move away from road fuel to electric vehicles, but the demand for jet fuel and chemical feedstocks is set to remain, if not grow.

In its August 2024 Global Outlook, ExxonMobil predicts that O&G will still make up more than 50% of the world's energy mix. Whilst its preeminence has faded, O&G remains critically important, although it will require more investment in readiness for the next 30 years or so. The International Energy Forum states in its June 2024 paper "Upstream Oil and Gas Investment Outlook":

"Annual upstream investment will need to increase by $135 billion to a total of $738 billion by 2030 to ensure adequate supplies. This estimate for 2030 is 15% higher than we assessed a year ago and 41% higher than assessed two years ago due primarily to rising costs and a stronger demand outlook. A cumulative $4.3 trillion will be needed between 2025 and 2030."

This, set against a backdrop of significant fluctuations in capital expenditure (CAPEX) experienced in the upstream and offshore energy sectors since 2015, can only be viewed as positive for the industry and its service providers, including insurers. This article examines the trends in CAPEX influenced by factors such as energy security initiatives led by national oil companies (NOCs) and strategic shifts by major oil corporations away from previously planned investments in renewable energy.

INTRODUCTION

The energy industry has witnessed dynamic changes over the past decade, marked by periods of investment expansion and contraction. Understanding these trends is crucial for stakeholders to navigate the evolving landscape effectively.

CAPEX TRENDS IN UPSTREAM & OFFSHORE ENERGY (2015–2030)

HISTORICAL OVERVIEW (2015–2020)

Between 2015 and 2020, the upstream and offshore energy sectors faced a downturn in CAPEX, primarily due to declining oil prices and a growing emphasis on renewable energy sources. This period saw reduced investments in new O&G projects, with companies exercising caution amid market uncertainties. The downturn has affected the talent pool across the industry, from oil companies and drilling and construction contractors to fabricators. A declining workload has seen experienced talent exit the industry in droves.

RESURGENCE AND PROJECTIONS (2021–2030)

A notable revival in CAPEX is observed from 2021 onwards and projections indicate sustained growth through 2030. This resurgence is driven by:

- **Increased Offshore Investments:** Research by Rystad Energy highlights that the offshore O&G sector is set for its highest growth in a decade, with $214 billion of new project investments lined up by 2025. Annual greenfield CAPEX surpassed $100 billion in 2022 and is expected to maintain this level, marking the first consecutive years of such investment since 2012 and 2013.
- **Regional Growth:** The Middle East is leading this offshore expansion, with countries like Saudi Arabia, Qatar and the UAE initiating large-scale projects. Offshore upstream spending in this region is projected to grow from $33 billion in 2023 to $41 billion in 2025. Similarly in South America (particularly Brazil and Guyana), the UK and Norway (in the North Sea) and Indonesia are going through an upstream investment phase.

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ROLE OF NOCS IN ENERGY SECURITY

NOCs are playing a pivotal role in ensuring energy security by ramping up investments in upstream and offshore projects. Their efforts are crucial in meeting the rising global demand for O&G, especially in the face of geopolitical tensions and supply chain disruptions. For instance, Middle Eastern NOCs are leveraging their vast resources and capital to outpace other producers, thereby securing a stable energy supply for both domestic and international markets.

STRATEGIC SHIFTS BY OIL MAJORS

Major oil companies are undergoing strategic realignments which impact CAPEX distribution:

- **Reassessment of Renewable Investments:** Companies like BP and Shell have scaled back their renewable energy investments. BP has announced a strategic shift to increase oil and gas production 60% by 2030 and reduce planned investments in low-carbon energy. Similarly, Shell aims to increase hydrocarbon production by around 1% annually through 2030, focusing on sustaining its oil and gas output.
- **Investor Influence:** Shareholders are exerting pressure on these companies to prioritise high-return assets. Elliott Management, a significant stakeholder in BP, has advocated for the company to divest from renewable projects, citing a lack of competitive scale and expertise in these areas.

IMPLICATIONS FOR THE ENERGY INDUSTRY

The reallocation of CAPEX towards traditional O&G projects has several implications:

- **Supply Chain Dynamics:** The increased investment is benefiting the offshore services market, with supply chain spending projected to grow by 16%. This growth encompasses offshore rigs, vessels, subsea equipment and floating production storage and offloading (FPSO) units.
- **Energy Transition Considerations:** While focusing on O&G, companies are also mindful of carbon emissions. Offshore production is considered one of the lower carbon-intensive methods of extracting hydrocarbons, aligning with efforts to reduce the overall carbon footprint.

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A PROMISING CONCLUSION

The upstream and offshore energy sectors are experiencing a significant upturn in CAPEX, driven by NOCs' commitment to energy security and strategic shifts by major oil companies. This trend is reshaping the investment landscape, with substantial implications for global energy supply, market dynamics and the ongoing energy transition.

THE ENERGY TRANSITION DILEMMA

Whilst the last decade has seen a decline or stalemate in upstream investment and a transition in part towards renewables, behind the scenes the insurance markets have been following suit and moving away from the sector.

Many of the large reinsurance and company markets have diversified from traditional O&G, as they did from coal 10 years ago. The Lloyds market has been affected similarly, with several historical sector leaders either exiting or curbing their enthusiasm for new projects or clients.

THE INSURANCE CLAIMS DILEMMA

With the downturn in upstream activity, the market claims teams and their service providers have pivoted to support the continuing power business, or the growing renewables lines of work. This, combined with the exit of historical leaders and the thinning out of legacy resource to focus on claims, leaves the industry shorthanded of experienced heads, aligned with the anticipated inexperienced upstream contractors.

BP HAS ANNOUNCED A STRATEGIC SHIFT TO INCREASE OIL AND GAS PRODUCTION 60% BY 2030 AND REDUCE PLANNED INVESTMENTS IN LOW-CARBON ENERGY.

OPPORTUNITIES

To mitigate the pending storm of losses arising from an upstream investment and development phase, insurers need to 'batten down the hatches' and control risks where possible. In a softening market, premium is at a premium and, tied to a threat of reducing deductibles, insurers' risk in this sector may be reaching the highest-ever levels. Construction costs are expected to increase due to the natural hang-up of COVID procurement and supply chain issues, combined with an increased demand for offshore vessels, in competition with offshore wind and the sudden upturn in O&G projects.

Insurers will need to ensure that every 'dot is crossed' in the contract certainty positions of the policy, check that MWS scope is fit for purpose, scrutinise schedules and be mindful of additional coverages clause limits.

Whilst these points will invariably assist in the post-loss environment, a capable and experienced loss adjuster is typically the best 'tool in the bag', with Integra being the sharpest tool to hand.

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