



# EY Partners Conference: strategic developments in the oil and gas sector

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## Introduction

Thank you very much and thank you for inviting me to take part in this event today.

I am honoured for several reasons. The first is that BP has a long relationship with EY – stretching back many decades.

And it is a relationship we value enormously.

EY's role as BP's auditor is relationship based on mutual respect that emerges through working together in a process of review, scrutiny and challenge.

Both our organizations have shown an ability to adapt and evolve, symbolised by the fact that neither BP nor EY are the names we were born with, so to speak.

Today I would like to share with you some thoughts about the world in which our industry operates and the possibilities for the next stage of its evolution.

We are operating in times of rapid change – geo-politically and macro-economically.

But this is nothing new.

Volatility has always been a backcloth for the industry.

Despite it, our industry has continued to deliver energy through two world wars, the Cold War, the oil shocks and nationalisations of the 1970s and the many conflicts and tensions of the 21st century to date.

Our task is not to avoid turbulence. That is impossible – but to operate effectively and predictably through difficult times.

As Dan Yergin wrote in *The Quest*, “There are many risks and dangers. The imperative is to anticipate them, prepare for them and ensure the resilience to respond.”

Resilience is the key word.

In my introductory remarks, I will frame our discussion by summarising the risks we face and the ways in which we seek to anticipate and respond to them.

I will divide my remarks into four areas:

- First, the geopolitical context;
- Second, the current context of the oil and gas markets;
- Third, the longer term industry context and the major shifts that are taking place;
- And finally, the priorities for a business operating in this setting – and specifically the priorities that we are pursuing in BP.

## **1. Geo-political context**

In terms of geo-politics, there are four elements that I would draw out with particular significance for our industry.

1.1 The first is the instability in parts of the Middle East. Alongside the war in Syria, Iraq remains divided – with violence in the north and calm in the south. In terms of the big oil producers, Saudi Arabia remains stable as do Kuwait and the UAE. Iraq is maintaining a high level of production. The Iranian nuclear situation remains unresolved.

1.2 The second element is uncertainty around European energy security. The EU uses around 15% of the world's oil and 13% of its gas. Yet its reserves amount to only 0.4% of the oil and 0.8% of the gas. Oil is accessed via the open global market. But gas is a real issue, with more than 30% imported from Russia. That has naturally raised a lot of questions but I think we sometimes see things through the wrong end of the telescope. We fear that energy supplies will be a victim of the tension when in fact the interdependence fostered by trade in energy is a force for stability. The EU started receiving Russia gas during the Cold War and the supply chain has survived ever since.

1.3 Third, we are witnessing the rebasing of China. In October, the IMF rated China the world's largest economy by purchasing power parity, overtaking the US. This is not so much a destination as a symbolic moment on a journey. China is seeking to drive multiple changes that will make it more than a statistical leader. It is driving for a balanced economy that is less dependent on manufacturing and western demand with more services and more domestic consumption. China is also showing a real determination to reduce the carbon intensity of its economy – with ambitious energy efficiency targets and world-leading investment in renewables. Recognising that

gas is a cleaner alternative to coal, China has also set a target to consume 420 billion cubic metres of gas by 2020 – the equivalent figure in 2000 was 25.

1.4 The corollary of China's journey is the US's transition from exceptionalism to isolationism. While the US was the undisputed world leader in many respects in the 20th century, it can no longer be seen as the city on a hill in many geo-political matters. It has become more reluctant to intervene in overseas conflicts. In energy, however, the US has made spectacular advances, thanks to the shale revolution. The US has enjoyed a perfect convergence of technology, land rights and infrastructure that have enabled it to look forward to the potential of energy self-sufficiency. Today, less than half America's oil is imported. And in gas it is close to self-sufficient. This may actually encourage a more introspective approach.

## **2. Oil and Gas markets context**

2.1 The first point here is the volatility in prices. None of us can be precise about the reasons though we can all see the expansion in supply – particularly in the US – at a time when the global struggle for growth has dampened demand. I hasten to add that anyone who has been in our business for a few decades regards volatility as normal. The last few years have seen prices plateau above \$100, but this has been the exception, not the rule. I certainly do not see lower prices as bad news. In fact, it could stimulate growth and enable the most competitive companies to stand out.

2.2 Demand for oil is set to be robust into the future. Oil is still the most used fuel in the world and our analysis suggests the internal combustion engine will still dominate the transport sector in 20 years' time – albeit with more efficient vehicles. We project that the net effect of these trends will be slow but steady growth in demand at about 0.8% a year. That is equivalent to at least another Saudi Arabia's worth of production by 2035.

2.3 Turning to gas, the first point to make is that while there is a global market and price for oil, gas is a tale of three continents. Since the shale revolution, the US has enjoyed prices under \$5 a unit, while Europe has typically had prices a little over \$10 and Asia as high as \$15 or more.

2.4 There are some signs of the dynamics of the gas market changing. The lower price in the US has led to gas displacing coal in power generation. But the coal has instead been exported to Europe. Meanwhile, the US is now looking to start exporting gas in the form of LNG. We expect demand for gas to grow at 1.9% annually in the next two decades. Gas power plants are generally cheaper to build than coal



equivalents – and they generate around half the carbon emissions. Our calculations indicate that a 1% shift from coal to gas in power generation would reduce carbon emissions as much as an 11% increase in renewables capacity.

### **3. Long-term context – secular shifts**

These developments are taking place against a background of a number of even more fundamental changes – secular shifts in the energy landscape.

3.1 The first of these shifts is the changing nature of demand for energy. We see global demand continuing to grow strongly over the next two decades. We do not expect the 50% growth of the past two decades, but we still anticipate growth of 40% and that is the equivalent of another US and another China in terms of consumption. That growth is almost all accounted for by the non-OECD world.

3.2 The second shift is that, even as demand continues to rise, the fear of supplies running out is receding rapidly. When I started in this industry in 1989, the world's proved reserves of oil amounted to around one trillion barrels. Since then we have consumed around 700 billion – but the reserves have grown to nearly 1.7 trillion. It is a similar story with gas. Already booked reserves represent enough oil and gas for more than 50 years of consumption at today's rates and we know there are many more resources out there. There are massive shale and tight oil and gas deposits, worldwide. There are the vast oil sands of Canada and heavy oil in Venezuela as well as the undiscovered resources of the Arctic. And these new resources may be outnumbered by the extra oil we can recover from already discovered fields due to new enhanced oil recovery techniques. Typically the industry has expected to recover only 35% of the oil in a field – but now we are looking at rates of around 60% in places such as Prudhoe Bay in Alaska.

3.3 A third secular shift is in the structure of the industry itself. International oil companies – or IOCs – once controlled the majority of the world's oil and gas reserves. After the wars and crises of the 1970s, national oil companies – or NOCs – took control of the lion's share of reserves and IOCs like BP were obliged to make their living at the new frontiers of the industry – such as deepwater and the development of unconventional oil and gas. It was a case of “innovate or perish”. However, now we are seeing a phase of synthesis when IOCs are increasingly working with partners in NOCs because our assets and capabilities complement each other. Projects such as the Southern Corridor – which involves seven countries and scores of companies – or Rumaila in Iraq, where we are working with an Iraqi NOC



and a Chinese one, Petrochina – exemplify the complex relationships now being formed between IOCs, NOCs, governments and customers.

3.4 The last tectonic shift is the game-changing role of technology. Since the 1990s, the sector has been transformed by a series of technological advances. 3D and 4D seismic imaging has enabled us to find previously invisible resources – notably deepwater oil fields hidden beneath salt canopies. Directional drilling and hydraulic fracturing have opened up previous stranded oil and gas. Enhanced oil recovery is driving a material shift in the proportion of oil we can expect to extract from any given field. And digital technologies are providing the ability to monitor and calibrate activities much more precisely, from drilling and production to refining and processing.

#### **4. Strategy and proposition**

Companies in our sector therefore face an environment rich in opportunities but also studded with challenges – not least the challenge of meeting investors' legitimate expectations.

Investors are looking at the scale of our capital investments and asking if they have been justified by the resulting cash flow and returns.

It is a fair challenge and we intend to answer it through our actions.

We can succeed in such an environment. We can create value. But to do so, we need to be strong, adaptable and resilient. What therefore are the pre-requisites for that combination of qualities?

4.1 First, and above all, we need to operate safely and reliably. That comes from systematic, disciplined operations.

4.2 Second, we need to drive value. That comes from having a strong portfolio where every asset and every product is of a high quality: upstream projects that deliver above average returns, downstream refineries that are well positioned and configured, premium fuels, advanced petrochemicals and lubricants – a portfolio that is good for all seasons. This goes hand-in-hand with capital discipline, because capital discipline is not simply a question of adhering to capital expenditure limits but of selecting the right projects to sanction from a range of opportunities. Indeed an EY report in August this year found that nearly two-thirds of megaprojects exceed their budgets and nearly three-quarters miss deadlines. Investors rightly want us to set capital limits and adhere to them.



4.3 Third, we need excellence in execution and operational efficiency to drive organic cash flow. This, like safety, proceeds from systematic operations. The two go together and this is the bedrock of resilience.

4.4 Fourth, we need a resilient financial framework. That means a robust balance sheet and conservative gearing. But it also means projects that can deliver value through cycles.

## **Conclusion**

That, in a nutshell, is the BP proposition.

The 10-point plan we launched in 2011 to re-set the business is on track to deliver as planned at the end of this year. At the end of 2014, we are on track to have both a better safety record and a better financial outcome than three years ago and to have achieved the increase in operating cash flow that we targeted.

While the 10-point plan will be completed, the essential proposition will remain as we believe it is the right one for the long term.

To summarise, we operate in a changing and challenging geo-political context. We are seeing major changes in the markets for oil and gas against a backdrop of secular shifts in demand, supply, industry structure and technology. But we believe we can thrive if we follow an agenda characterized by safety and reliability, a strong portfolio allied to capital discipline, excellence in execution and a strong financial framework.

It is an approach that has brought us through many challenges and enabled us and our partners to accomplish things that might not have seemed possible.

In 1994 we led the consortium that signed a contract with Azerbaijan, newly liberated from the Soviet Union and recovering from a war. This year we celebrated the 20th anniversary of that contract and the jobs, skills, revenues and progress it has brought to the people of that country.

In 1964 we were awarded our first licence to explore in the North Sea. This year we celebrated the 50th anniversary of our work there with a new discovery and new investments underway. And next year we'll celebrate the 100th anniversary of our international shipping business.



Our business and our industry has survived and succeeded by learning how to navigate through stormy waters and take opportunities that come wrapped in challenges.

Henry Kissinger once said “A diamond is a chunk of coal that made good under pressure.”

It is an apposite metaphor for our industry.

Thank you