Tug of war for oil sector looking to feast after famine

STAVANGER, Norway (Reuters) – After years of restraint since crude prices slumped in 2014, oil services companies are now at loggerheads with producers as they battle for what they see as a fair share of the sector recovery.

Oil industry suppliers say they have cut costs and prices to the bone and the recent rebound in crude justifies better rewards for anything from rigs to logistics and engineering services.

Their overtures have met with stubborn resistance from producers. But there are increasing signs that something has to give, including recent strikes at North Sea platforms.

“The cost savings that we have achieved over the past three years are not sustainable,” said Thierry Pilenko, Executive Chairman of TechnipFMC (FTI.N), one of the world’s biggest oil services groups.

“A rig that was once at $600,000 day is now at $150,000, which is not even cash breakeven," he added, referring to rig rental rates. "Cost inflation will come back … The drilling industry working below breakeven is not sustainable."

The oil market is cyclical by nature – if crude prices fall, so does investment and then output, which in turn drives up prices – and oil services companies ride the rollercoaster by using the upturns to raise their prices to offset the downturns.

Global exploration and production spending shot up by a quarter in 2005, fell 8 percent in 2009, jumped by about 12 percent two years later and then tanked by more than a fifth in 2016, according to data from consultancy firm Rystad Energy.

Consequently, average rig rates that were about $200,000 for a floating rig in 2005 more than doubled by 2012 and then fell to about $160,000 last year, Rystad said.

"It is still a feast or famine cycle," the CEO of oilfield services group Baker Hughes (BHGE.N), Lorenzo Simonelli, told an industry conference in the Norwegian oil capital of Stavanger.

After benchmark oil futures contracts LCOc1 slumped from more than $110 a barrel in 2014 to less than $30 in early 2016, oil producers cut spending drastically and promised shareholders that cost discipline was here to stay.

GRAPHIC – Boom and Bust Cycles of Oil Services Sector: tmsnrt.rs/2wppPke

Signs of rising rates have begun to emerge in the United States, but oil producers are loath to put the genie back in the bottle.

"There might be pressure on costs, but we will never forget what we have learned," Equinor Chief Executive Eldar Saetre told the Stavanger conference.

Indeed, Equinor’s announcement on Tuesday that it plans to drill 3,000 production and exploration wells off Norway during the next two decades came with a caveat.

“There is no room for cost inflation in those plans,” said Arne Sigve Nylund, head of Equinor’s Norwegian operations.

“We need to deliver at the same level we are now … I call on suppliers to work with us on how to deliver at the lowest possible cost.”

COLLABORATIVE APPROACH?

But with oil now trading around $75 a barrel, strikes at several of Total’s (TOTF.PA) North Sea offshore platforms are testimony to an industry wrestling with keeping efficiencies high and costs down.

The way contracts are structured between producers and services will be key to the future level of costs.

“There is a big dichotomy now. Some of the contractors are expecting to see price increases. They are almost saying ‘it’s my turn now’,” Luis Araujo, CEO of oil services company Aker Solutions (AKSOL.OL), said.

“I don’t buy into that. I think we should work together.”

Araujo pointed to clients such as Aker BP (AKERBP.OL) offering contracts more akin to “incentive schemes” than ways to squeeze margins.

“In the future, maybe suppliers are going to get paid by performance. So instead of getting paid by the daily rates, (you) will be paid by how many meters you can drill.”

Equinor’s Saetre put it even more succinctly at the Stavenger conference, with the words of U.S. rock star Bruce Springsteen emblazoned on the big screen: “Nobody wins unless everybody wins.”

But given oil producers’ own constraints, the message might not have trickled through quite yet.

“We have to be a bit cautious because the guys doing the presentations are the leaders. But then there is the next layer in line who are being educated to squeeze suppliers and not collaborate,” Araujo said.