



## Downstream oil industry profitability

- The main driver for higher pump prices in the UK and globally is the price of crude oil and the impact this has on the price of refined products such as petrol, diesel and jet fuel.
- Historically, a combination of good supply infrastructure, open markets and strong competition in the UK has kept pre-tax prices of petrol and diesel amongst the lowest in the EU.
- Refining/marketing companies that are UKPIA members have below average return on capital employed. Their aggregated average return for the period between 2001 to 2006 was 8%, well below the average return for the manufacturing and service sectors.
- NW Europe refining margins have recovered from very low levels to an average of US\$5 per barrel over the last 5 years but remain highly volatile.
- UK refineries will require further substantial investment in the future to meet changing crude oil source and consumer demand patterns, the need for cleaner fuels and tighter environmental standards. A stable fiscal and investment climate will be crucial to attracting this investment to the UK.

### Background

The price of crude oil and the resultant impact on fuel prices is a subject that attracts a lot of debate, particularly against the background of high crude prices that have persisted for the last four years, Brent blend reaching a peak of \$147 per barrel in July 2008.

With some integrated oil companies reporting increased earnings as a result of these higher prices, there have been calls in some quarters for a 'windfall tax' levy. However, UK oil and gas producers are already highly taxed on their profits, with the tax yield automatically increasing with higher prices.

### Oil industry overview

The oil industry is a complex and diverse global business, comprised of a varied mix of national oil companies - often state owned or controlled, integrated international oil companies with upstream and downstream activities; refining

companies; oil storage and distribution companies; fuel marketing companies and a range of traders, shippers, suppliers and specialist service providers involved with most stages of the business.

Upstream oil exploration and production in particular is a high risk and complex activity, requiring huge investment in finding and bringing on stream new sources of oil without any guarantee of success. International oil companies' earnings should be viewed in this context, which is underlined by the International Energy Agency's estimate that \$3 trillion of investment will be required in the next 25 years to meet projected future oil and gas demand, most of this focused on finding new sources of oil and gas.

### Downstream oil refining and marketing

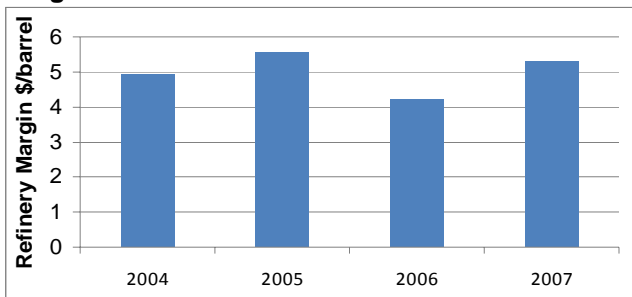
UKPIA's member companies in the UK reflect in part this diversity, some being subsidiaries of large integrated international oil companies with international exploration, refining and marketing interests, others being specialised refining companies with no fuel marketing interests or some with marketing interests only.

## Downstream profitability in the UK

Refining/marketing companies that are UKPIA members have below average return on capital employed. Their aggregated average return for the last five years to the end of 2006 was 8%, well below the average return for the manufacturing and service sectors. (Source UKPIA Statistical Review 2008).

Oil refining remains a capital intensive business. Although gross returns for NW Europe refineries have improved in the last four years to an average of \$5 per barrel, higher prices for crude oil and other feedstocks have increased volatility.

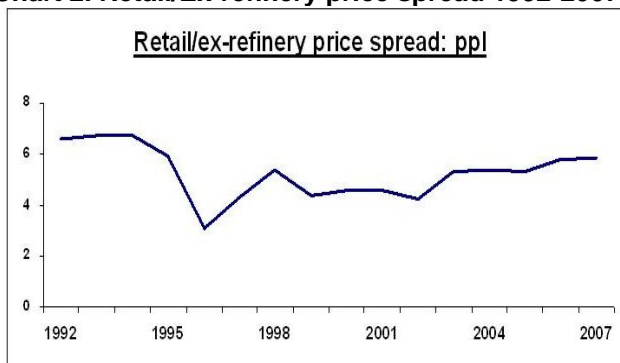
**Chart 1. Average NW Europe Gross Refining Margins**



Source: BP Statistical Review 2008

For those companies with UK fuel marketing activities, particularly retail forecourts, over the last fifteen years this has become increasingly a high volume low margin business, characterized by strong competition. This is evidenced by the fairly flat trend in the difference between the ex refinery wholesale price of petrol and diesel and the pre-tax forecourt pump price (see Chart 2 below) which has ranged between 5-6pence per litre over the last four years.

**Chart 2. Retail/Ex-refinery price spread 1992-2007**



Source: Wood Mackenzie OPAL

The UK road fuels market has grown very little in volume terms and the low profitability is reflected in the rate of closure of filling stations - an average 600 per year until recently. This background has also prompted some companies to exit the UK market and in addition to filling station closures, two refineries have closed in the last eleven years.

The main driver for higher pump prices in the UK and globally has been the higher price of crude oil and the impact this has had on the price of refined products such as petrol, diesel and jet fuel.

Supplying companies are not profiting at the expense of consumers. A combination of good supply infrastructure, open markets and strong competition in the UK has kept pre-tax retail prices of petrol and diesel amongst the lowest in the EU over the last decade.

## Future challenges

UK refineries will require further substantial investment in the future. UKPIA 's 2006 report 'Meeting our energy needs: The Future of UK Oil Refining' outlines the growing imbalance in UK refinery output, as well as many current and future major challenges, such as the overall balance and trade-off between product quality and product mix, new specifications, future demand patterns, types of crude oil and meeting environmental objectives.

In addition, a joint industry/Government study, the 'Review of UK Oil Refining Capacity' by Wood Mackenzie, which examined many of these issues, was published in May 2007.

A stable fiscal and investment climate, to help underpin long-term investment decisions, will be crucial to attracting this investment to the UK.

## Conclusions.

UKPIA member companies make an average return on capital below that of other sectors. Those companies with upstream activities have reported increased earnings linked to higher crude oil prices but fuel supplying companies are not profiting at the expense of consumers. A combination of good supply infrastructure, open markets and strong competition in the UK has kept pre-tax retail prices of petrol and diesel amongst the lowest in the EU. A stable fiscal and investment climate, to help underpin long-term investment decisions, will be crucial to attracting refinery investment to the UK.

For information on 'Upstream Oil Industry Profitability' [please click here](#) (or visit [www.oilandgasuk.co.uk/issues/economic](http://www.oilandgasuk.co.uk/issues/economic))

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