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Foreword

The Scottish Enterprise Energy Team recognised the need for Scottish oil & gas companies to develop sustainable business in international markets many years ago, and has provided strategic advice and assistance in support of this ambition ever since.

With this came a need to reliably measure international activity at regular intervals in order to monitor industry progress, and, importantly, to assess the effectiveness of the support being provided by Scottish Enterprise and Scottish Development International.

This report is the result of a long term partnership between the Scottish Enterprise Energy Team and the Scottish Council for Development and Industry (SCDI) which, we believe, provides the most reliable assessment of international oil & gas activity available. Since the start of the survey in 1997, SCDI has adopted a consistent methodology to carry out the survey on our behalf, giving rise to confidence in the data, and in particular in the annual trends demonstrated in the report.

It is particularly pleasing to note that this 2005/2006 survey demonstrates that the Scottish oil & gas supply chain has again sustained its annual growth, reaching sales in global markets of £3.754 billion. Combined with sales in the domestic market, this means that Scottish businesses have now reached annual sales of £11.67 billion.

This report and analysis is prepared on behalf of Scottish Enterprise by the Scottish Council for Development and Industry, and it follows therefore that the views and recommendations made in the report may not all necessarily reflect the views of Scottish Enterprise.

I hope this important survey will be a valuable source of reference to Scottish businesses and partner organisations, and that it reinforces the very significant contribution of our oil & gas businesses to the Scottish economy.

Brian Nixon
Director of Energy, Scottish Enterprise

SURVEY OF INTERNATIONAL ACTIVITY IN THE OIL AND GAS SECTOR 2005/2006

Summary of Study Results

Total Oil and Gas supply chain sales from the Scottish market have increased by 16% to reach a record £11.67 billion.

Direct Exports from Scottish based operations have increased by 2% and are valued at £1,898 million in 2005.

International sales derived via Subsidiary Companies are valued at £1,856 million, up 3.5% compared to 2004.

In 2005 total international sales are estimated at £3.75 billion, 2.7% higher than in 2004.

Provision of General Services to the Oil and Gas industry accounts for 72% of total international sales, followed by the provision of Products/Equipment/Materials at 15%.

A quarter of total international sales are derived from the North American markets with the African region accounting for 15% and Eastern Europe 7%.

Exports into Eastern Europe have grown by 22.3% since 2004.

The top 5 international markets are the United States, Nigeria, Russia, Azerbaijan and China.

86% of total international sales are accounted for by large companies with 250 plus employees.

A rapid rise in activity in the domestic UKCS market has been recorded with sales rising by 23.6% compared to 2004 levels. This is the largest increase recorded since the survey commenced.

Background

The Scottish Council for Development and Industry (SCDI) has been involved in undertaking research into export performance from Scotland since 1961. The focus of this initial research was to measure the level and value of manufactured goods which were sold outwith the United Kingdom's borders and which were produced from within Scotland. With the emergence of a growing service based economy and the ongoing impact of exports of Primary Goods, such as fish, minerals, oil and gas, this ultimately led to the production of a single export research document covering the primary, manufacturing and service sectors. This was produced annually by SCDI until 2003 when the statistical gap was filled by central government figures produced by the Scottish Executive.

SCDI had long been conscious that contained within the above export survey was much information which would act as a starting point in measuring the level of international activity being undertaken within the Oil & Gas industry in Scotland. As it became clear that the skills and knowledge base of the UKCS supply chain was eminently exportable, more of a focus was taken by both the public and private sectors in enabling the internationalising of the industry. In collaboration with Scottish Enterprise, SCDI looked at what could be done to monitor and measure the extent to which this global approach to sales was impacting upon the Scottish-based supply chain.

The upshot of this collaboration was the decision in 2000 by SCDI and Scottish Enterprise to work closely together to undertake the inaugural survey of international activity in the oil and gas sector. This was done with a view to providing an ongoing measurement of Scotland's success in this internationalisation process. This latest document represents the seventh in-depth survey which has been carried out and aims to provide updated data for the year 2005. The main focus of this research is to measure the export activity undertaken by the supply base associated with the oil & gas industry. This is principally because the international activity of the service/supply base represents the key client group that is being encouraged by Government and others to develop overseas markets. As well as international markets many oil and gas supply companies are also diversifying into non oil markets and this research aims to measure the extent of this diversification and also to examine what are the key non oil sectors being targeted.

The survey research into the service/supply base was undertaken in such a way as to try and distinguish between differing types of international activity. Hence questions were posed which enabled companies to distinguish between direct export activity, where the product or service was supplied/managed from Scotland, and where the product or service was supplied/managed via an overseas located subsidiary organisation.

Although the response rate and sample size will, to a certain extent, alter each year the survey is undertaken, SCDI employs a methodology which allow us to measure growth rates which are then applied to each annual set of data. Given that great care is taken to ensure that responses are received from all the key industry players this enables us to have confidence that these published figures represent an accurate picture of the trends taking place within the oil and gas sector.

This approach by Scottish Enterprise and SCDI was also spurred on by an understanding that the development of this international dimension is vital to sustaining ongoing employment levels in Scotland beyond the productive life of the UKCS. However, it is very clear that the UKCS sector itself will continue to be a major, albeit slowly declining, source of revenue and employment for at least another 30 years, although forecasting history would suggest that this is likely to be an underestimate.

International Activity in the Service/Supply Base

International Sales

The survey defined international sales as a combination of direct exports and sales delivered via overseas owned subsidiaries. The first part of this section examines the level of direct export activity undertaken by the service/supply base, the second element looks at the activity within overseas owned subsidiaries and lastly the combined results of these are examined to give a total picture.

It was clear that many businesses which supplied the oil and gas industry would not necessarily have this as the sole end market for their products or services. Thus the survey research asked companies to give an indication of total export activity and also to estimate the proportion of such revenues that were derived through sales to end user customers in the oil and gas sector. In addition the companies who responded to the survey were categorised into four main business or product areas to help define from what segment of the service/supply industry the greatest activity levels were generated. These category areas are defined below: See Appendix A on Page 22 for more information.

Business Category 1	Product/Equipment/Materials
Business Category 2	Bulk Materials
Business Category 3	Services
Business Category 4	Engineering/Procurement/Construction/Installation

(i) Export Values

This section looks at directly generated export revenues where the product or service is supplied/managed from Scotland. The results of the research are presented in Table 1.

Table 1. Scottish Service/Supply Direct Exports 2003 - 2005
(£m current prices)

	Exports			Exports to Oil & Gas Sector		
	2003	2004	2005	2003	2004	2005
BUSINESS CATEGORY						
(1) Prod/Equip/Materials	472.1	442.7	415.0	429.5	404.5	377.5
(2) Bulk Materials	226.7	227.8	216.3	226.7	228.3	208.7
(3) Services	968.6	1,049.8	1,201.3	840.5	905.0	1,041.7
(4) Eng./Proc/Constr/Install	108.6	323.3	269.7	108.6	323.3	269.7
TOTAL	**£1,776.0**	**£2,043.6**	**£2,102.3**	**£1,605.3**	**£1,861.1**	**£1,897.6**

Writing in last year's survey the volatility of the oil and gas sector was highlighted as representing an ongoing challenge for the industry. The price variations affect differing oil provinces in different ways, but the fact that in relative terms the UKCS is a high cost area for exploration and production makes it particularly vulnerable during periods of low oil price. This fact, plus the commitment of many companies to globalise their business out of a Scottish location, has been a major driver behind the steady growth in international activity from the supply chain on which this survey has reported for the past six years.

From the sub $10 oil price depths of the late 1990s a recovery and stability in price has been witnessed in the early part of the new millennium. However in the past three years a major upturn in prices has occurred and has to a large extent been sustained. There are many reasons for this and global conflicts have undoubtedly contributed to this, particularly in relation to the Middle East. A flexing of muscle by Russia in relation to gas supplies and some short term gas supply issues facing the UK have all helped create a market feeling of insecurity as regards energy supplies. Combined with the ever growing demand from the rapidly expanding Chinese and Indian economies, there is no shortage of upward pressure on the price of both oil and gas.

International Activity in the Service/Supply Base

These latest survey figures relate to the calendar year 2005, a year in which the price of Brent Crude climbed from around $45/bbl to peak at over $67/bbl in early autumn before finishing the year around $58/bbl. 2006 is not covered by the research in this document, but the price of Brent Crude peaked even higher this year reaching close to $80/bbl in the late summer before ending the year around $58/bbl. This period of relatively high oil price has made the UKCS reserves much more attractive to the oil companies and this has led to a sustained and significant upturn in UKCS activity over the past two to three years. This has simply heightened the focus on the resource constraints, labour and equipment, which face the UK's oil industry supply chain in attempting to undertake all the projects which are now economically viable.

Turning to the results of the 2005 survey the latest data shows a further increase in the value of direct exports from the oil and gas supply chain, although at a lower rate than in recent years. Exports into the oil and gas sector show an increase of 2%, rising from £1,861m in 2004 to reach £1,898m in 2005. This compares with increases of 15.9% in the last survey, 18.3% the year before and 27.5% the year before that. As direct exports are handled directly out of Scotland it seems possible that the slowdown in growth rate can at least be partly explained by the upturn in UKCS activity.

Overall direct exports, that is those which include non oil and gas derived sales, have also shown an increase, this time of 2.9%, up from £2,044m in 2004 to £2,102m in 2005. This compares with 15.1% growth the previous year.

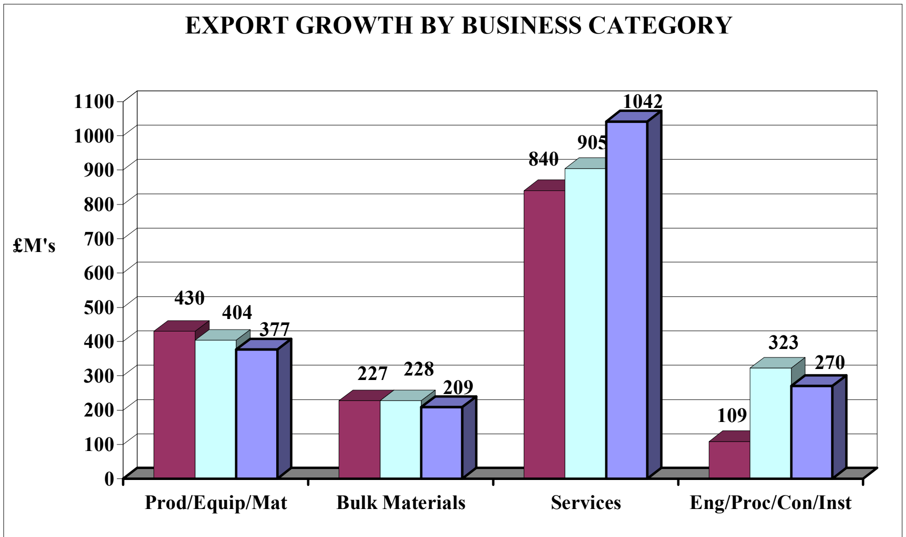

Figure 1

The information presented in Figure 1 illustrates the sectoral breakdown of direct exports into the oil and gas sector. Interestingly actual sales growth is recorded only in the export of Services with the other business categories showing value declines of the order of £20-£50m. The export of Services remains by far and away the most significant business category and this has seen a continued strong growth in direct exports, with an increase of 15.1% reported, meaning that direct services exports have topped the £1 billion level for the first time in the survey's history.

International Activity in the Service/Supply Base

As Figure 2 illustrates the direct export of Services now accounts for well over half of total exports, with the modest export decline in the other three business categories meaning that they all take a reduced percentage share of the total compared to 2004.

% SHARE OF 2005 EXPORTS BY BUSINESS CATEGORY

(2004 % Share in Brackets)

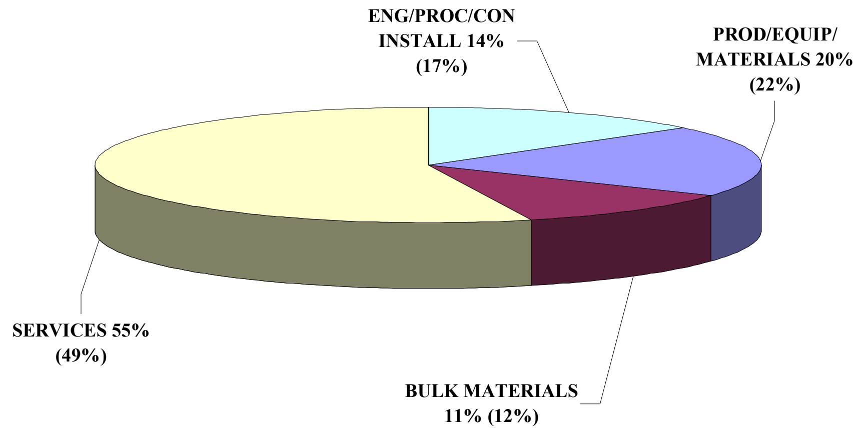

Figure 2

International Activity in the Service/Supply Base

(ii) Overseas Subsidiary Values

This section looks at international sales generated via overseas owned subsidiaries which although they may operate in a largely autonomous fashion ultimately report back to a Scottish based headquarters. The results of the research are presented in Table 2.

Table 2. Overseas Subsidiary Sales 2003 - 2005 (£m current prices)

	Sales			Sales to Oil & Gas Sector		
	2003	2004	2005	2003	2004	2005
BUSINESS CATEGORY						
(1) Prod/Equip/Materials	148.0	162.3	212.4	116.4	132.3	168.5
(2) Bulk Materials	16.0	6.3	11.8	15.4	6.3	11.8
(3) Services	1,647.2	1,713.3	1,870.0	1,525.7	1,529.2	1,675.7
(4) Eng./Proc/Constr/Install	130.7	125.2	0.0	130.7	125.2	0.0
TOTAL	**£1,941.9**	**£2,007.1**	**£2,094.2**	**£1,788.2**	**£1,793.0**	**£1,856.0**

Since the survey's inception one of its key features has been to monitor not only the growth in direct exports from Scotland, but also the level of activity undertaken by overseas subsidiary operations which report to a Scottish headquarters. Recent surveys have recorded rapid growth in the level of international sales via subsidiary operations. This increase continued in last year's survey but with a much reduced rate of growth and this set of latest results for 2005 follows the 2004 trend i.e. growth but at a slower rate.

Examining sales from subsidiaries into the end customer oil and gas market, we can see that these have grown from £1,793m in 2004 to reach £1,856m in 2005, a rise of 3.5%. For the second year in succession this means that the level of direct exports from Scottish based companies into the oil and gas market is higher than that being delivered via subsidiary operations, albeit by only £41.5m. Overall exports via subsidiaries have witnessed marginally stronger growth, rising 4.3% to reach £2.1 billion.

In terms of subsidiary company activity the massive influence of the Services business category is once again vividly shown by the data in Table 2. Sales of £1,676m equates to some 90.3% of all sales activity delivered via subsidiary operations, an increase on the 85.2% share noted in last year's research. In addition to the Services category, Product/Equipment/Materials and Bulk Materials show growth in subsidiary sales, whilst the Engineering/Procurement category figures decline to zero in 2005. This Business category is dominated by major companies delivering large scale projects often of a subsea construction nature. The fact that zero sales data is recorded for the 2005 period is unlikely to reflect zero business, but is more a reflection of the longer lead times in delivering and invoicing the major projects which this sector handles.

The latest survey showed a further small decline in the number of companies responding who were delivering sales through an overseas subsidiary operation in 2005. This stood at 38 compared with 45 in 2004 and 52 in 2003. In contrast the number of country markets in which overseas subsidiary sales was being undertaken has tended to show an increase in recent years. It remains SCDI's view that the trend which has seen a large increase in activity delivered via subsidiary operations is likely to continue, driven by a need for local content and market access.

International Activity in the Service/Supply Base

(iii) Total International Activity

Summarising the previous two sections this element of the report combines both categories of international activity and presents a total picture for the level of internationally derived sales from the Scottish oil and gas industry. The results of the research are presented in Table 3.

Table 3. Total International Sales 2003- 2005 (£m current prices)

	Sales			Sales to Oil & Gas Sector		
	2003	2004	2005	2003	2004	2005
BUSINESS CATEGORY						
(1) Prod/Equip/Materials	620.1	605.0	627.4	545.9	536.8	546.0
(2) Bulk Materials	242.7	234.1	228.1	242.1	234.6	220.5
(3) Services	2,615.8	2,763.1	3,071.3	2,366.2	2,434.2	2,717.4
(4) Eng./Proc/Constr/Install	239.3	448.5	269.7	239.3	448.5	269.7
TOTAL	**£3,717.9**	**£4,050.7**	**£4,196.5**	**£3,393.5**	**£3,654.1**	**£3,753.6**

The results in Table 3 emphasise the growth shown in Tables 1 and 2. Total international sales to oil and gas customers have now reached £3,753.6m, a rise of 2.7% compared with 2004 and 10.6% compared with the 2003 figure. Total sales, including those to non oil and gas customers, have risen by 3.6% and 12.9% over the equivalent periods.

Decline is noted in the Engineering/Procurement category and Bulk Materials with a modest increase recorded in the Production/Equipment/Materials category. However, as previously mentioned the principal driver for growth continues to be in the export of Services, whether direct or via subsidiaries.

Figure 3 clearly shows the ongoing strength of international sales of Services and also illustrates the relative volatility of sales in the high contract value Engineering/Procurement business category over the last three years.

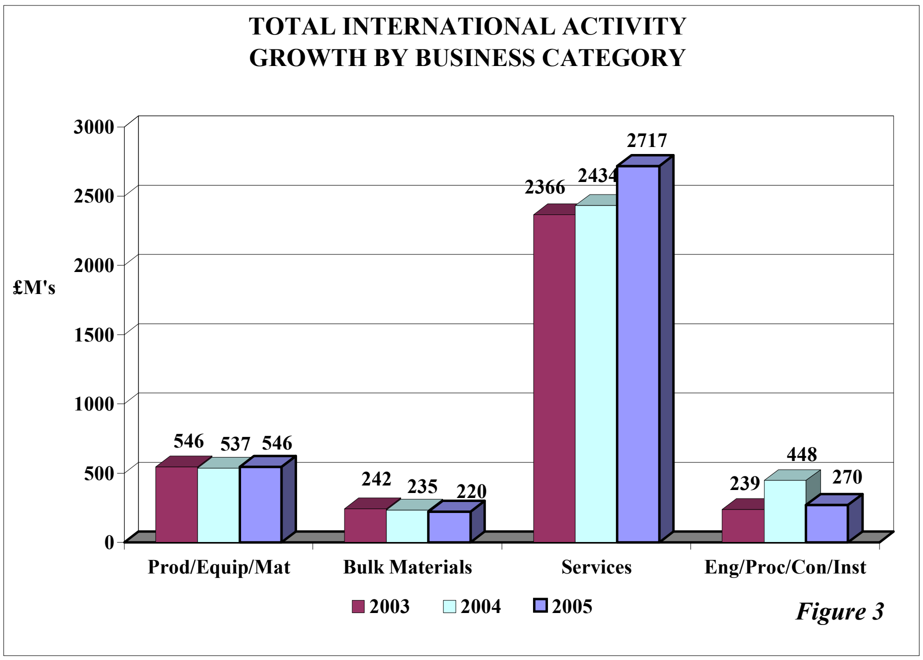

Figure 3

International Activity in the Service/Supply Base

The continued dominance of sales from the Services category is once more emphasised in Figure 4, where its share has risen to 72% of total international sales. However, it is worth a reminder that when the 2002 data was released the Services category actually accounted for 76% of the total. As is expected, the decline in subsidiary sales from the Engineering/Procurement category results in a fall in its share from 12% to 7%. The relative share of sales accounted for by Bulk Materials and Product/Equipment/Materials is unchanged over the past four years, despite some slight up and down movement in actual sales value terms.

% SHARE OF 2005 TOTAL INTERNATIONAL ACTIVITY BY BUSINESS CATEGORY
(2004 % Share in Brackets)

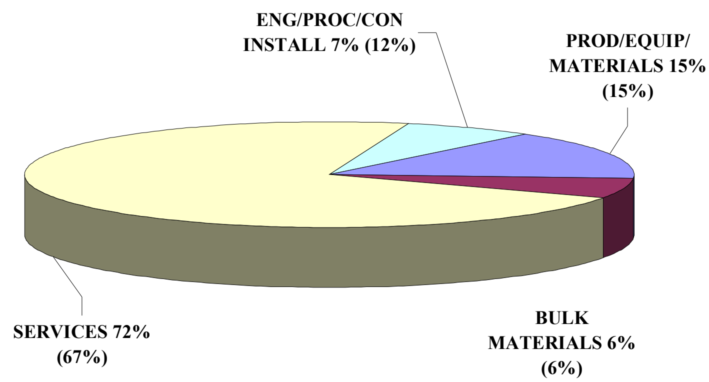

Figure 4

In our summary to the industry sector data presented in last year's report the following observation was made.

"It is possible that the relatively stable oil price of 2002/2003 has seen companies confident enough to invest in the UKCS more than overseas. Given that 2004 and now 2005 has seen an ongoing rise in the price of oil it is possible that this theory would see an even greater shift of management time and investment decisions focusing on the UKCS. Whether this will happen remains to be seen. One of the key issues is a lack of resource, both in terms of manpower and equipment to deliver all the projects which become viable at a high oil price. How this issue is addressed will have a major bearing on to what extent and where future export growth occurs."

The statistical evidence for 2005 presented in this latest survey would tend to reinforce some of the thoughts presented in the above paragraph. The oil price during 2006 has been even higher on average than during 2005 and there is much anecdotal evidence, in a Scottish context, to show that the Scottish-based oil and gas supply chain is extremely stretched in manpower and equipment resource terms in handling the volume of UKCS business at present. Next year's survey may well confirm the feeling that the focus has to some extent switched from export back to domestic market opportunities. This is not a surprise as international opportunities are often more challenging and require greater management resource to deliver than their domestic counterparts. However, from a long term Scottish perspective it is vital that our supply chain continues to be active in the international markets and to compete and enhance our reputation abroad. This strategy will ultimately sustain the industry and anchor many key jobs here in Scotland for a longer timescale than a purely domestic approach. Manpower, or lack of, remains a significant constraint and it is vital that the oil and gas sector redoubles its efforts to attract more young people into its fold. By growing the manpower resource the Scottish based supply chain can then begin to operate successfully domestically and internationally in tandem.

Market Analysis of International Activity in the Service/Supply Base

In addition to measuring the level of international sales a further rationale for undertaking the research was to accurately gauge what overseas markets were the principal targets for international activity. Over time it is hoped that this can be measured in such a manner that will allow trends to be monitored which will assist in the targeting of export assistance and other measures aimed at encouraging the growth of overseas sales.

In responding to the survey, companies were asked to give details of their sales in overseas markets and to indicate whether the sales revenue was generated by direct export activity or via an overseas subsidiary. In addition companies were again asked to distinguish between sales to oil and gas industry customers and general sales outwith this sector. The data presented is for 2005 only and covers only sales to oil and gas end user customers.

Geographic Analysis

Initially the responses are broken down at a broad geographic level to give an indication of the principal market regions in which activity is concentrated. Table 4 examines the level of total international sales activity on a geographic region basis and breaks this down into direct sales and overseas subsidiary sales.

Table 4. Destination of International Sales by Geographic Region in 2005 (£m Current Prices)

	Direct Export	Overseas Subsidiary	Total International
North America	35	918	953
Africa	440	127	567
Asia Pacific	134	157	291
Eastern Europe	117	146	263
Middle East	62	139	201
Latin America	25	176	201
European Union (EU)	161	27	188
Western Europe (excl. EU)	43	40	83
Australasia	2	77	79
Unallocated	878	49	927
TOTAL	**£1,897.6m**	**£1,856.0m**	**£3,753.6m**

NB See Appendix A on page 22 for more details of geographic region definitions.

Once again the North American market is by far the most significant market for international activity. In overall terms sales into the market increased from £868m in 2004 to £953m in 2005, a rise of 9.8%. Although subject to variation, the split between direct exports and those sales delivered via subsidiaries into North America is the starkest in the history of the survey, with £918m of the £953m total (96%) being derived via subsidiary companies.

Houston in Texas is of course a major global centre for oil and gas and ultimately is where many key international investment decisions are made. Hence, as well as opportunities on Houston's doorstep, namely offshore Gulf of Mexico, it is a vital location for many businesses in terms of accessing other international contracts. Scotland was not slow at recognising this and for many years a major trade delegation has attended the annual Offshore Technology Conference (OTC) in the Texas City. As the Scottish supply chain has matured and expanded, the first port of call for many on the international expansion trail has been Houston. As this survey shows over the years, North America has always been the main export focus and in the last seven years an increasing element of this has been the establishment of North American subsidiaries. There is little doubt this trend will continue and in overall terms it seems probable that sales into North America in 2006 may well have broken the £1 billion barrier.

Market Analysis of International Activity in the Service/Supply Base

The relative share of total international sales taken by the differing geographic regions is shown in Figure 5.

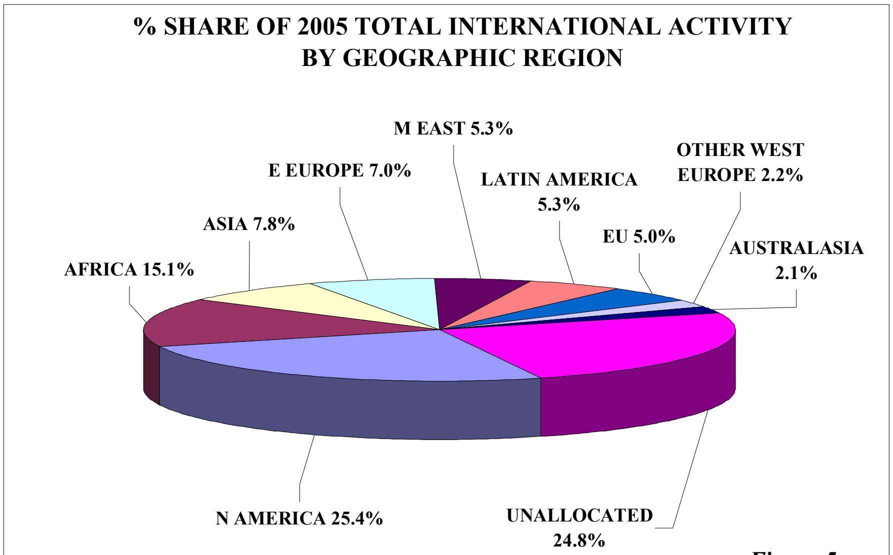

Figure 5

Figure 5 shows that North America now accounts for over a quarter of total international sales, compared with 23.8% in 2004.

Over the previous two years, and particularly in 2003, there had been substantial growth in business done in the African region. This latest set of results does not see a similar surge but it does record maintenance of recent export levels and even a small increase on top of this. Total international sales into Africa were recorded at £567m in 2005, compared with £554m in 2004 and £357m in 2003. Major global oil discoveries or the "elephant fields" as they are often referred to in the industry have been found in recent years off the West Africa coast and are being developed. Clearly this presents opportunities to Scottish companies and this is enhanced by the fact that many supply companies, whether Scottish or internationally owned, often manage West Africa out of a Scottish usually Aberdeen based office. However, the region is not without its challenges and operating in the area can often be difficult due to the political climate in many of the countries. Recent kidnappings of oil personnel from an Aberdeen-based contractor only serve to emphasise this. As such, activity in the region does tend to be dominated by the major operators and contractors and direct market opportunities for the small and medium scale business are limited.

Elsewhere activity in the Asia Pacific region has bounced back and sales are now valued at £291m compared with £228m in 2004. Here there is a fairly even mix of activity being undertaken by direct sales and via subsidiary operations. Eastern Europe has continued its steady growth and now takes £263m in exports from Scotland compared with £215m in 2004. As was noted last year this represents a pretty consistent upward trend of sales into the area both direct and through subsidiaries.

Looking at the other key geographic markets there has been a small decline in trade with the Middle East and likewise with Australasia, although the latter is mainly due to disposal of a previously Scottish owned subsidiary. Sales into Latin American markets are also down compared with 2004, standing at £201m in 2005 as opposed to £256m in 2004. Here sales via subsidiary businesses have held up well with the decline being principally due to a sharp fall in direct exports. On the European front there is mixed set of figures with international sales into the EU markets on the rise and to the European, non EU markets, a decline is recorded.

Market Analysis of International Activity in the Service/Supply Base

Country Analysis

Table 5 provides a more detailed analysis of the country markets in which the Scottish oil and gas service/supply base is trading. These figures again relate solely to sales from the industry to oil and gas end user customers.

Table 5. Destination of International Sales by Country Market in 2005 (£m Current Prices)

		Direct Export	Overseas Subsidiary	Total International
(1)	United States	31	884	915
(2)	Nigeria	151	34	185
(3)	Russia	99	56	155
(4)	Azerbaijan	13	89	102
(5)	China	67	29	96
(6)	Norway	43	40	83
(7)	Netherlands	78	2	80
(8)	Australia	2	77	79
(9)	France	73	0	73
(10)	Venezuela	3	69	72
(11)	Mauritania	68	0	68
(12)	Angola	68	0	68
(13)	Iran	29	35	64
(14)	Egypt	54	0	54
(15)	Equatorial Guinea	12	35	47
(16)	Arab Emirates	10	35	45
(17)	Libya	14	30	44
(18)	Saudi Arabia	10	31	41
(19)	Ivory Coast	38	3	41
(20)	Colombia	0	39	39
(21)	Canada	5	34	39
(22)	Brazil	20	17	37
(23)	Oman	1	35	36
(24)	Thailand	1	33	34
(25)	Argentina	0	31	31
(26)	Pakistan	1	30	31
(27)	Brunei	0	30	30
(28)	India	25	1	26
(29)	Singapore	26	0	26
(30)	South Africa	0	25	25
OTHER NAMED MARKETS		73.9	84.6	158.5
UNSPECIFIED MARKETS		881.6	47.5	929.1
TOTAL		**£1,897.6m**	**£1,856.0m**	**£3,753.6m**

The position of the North American region as top destination for Scottish supply chain companies is of course predicated on the massively dominant position of the United States as the top individual country market. As mentioned previously the hub of decision making based around Houston and the desire for Scotland's companies to establish subsidiary bases in this area is undoubtedly the main reason why the USA is so dominant.

After a slight decrease in sales into the USA in 2004 the increase in exports recorded in 2005 re-establishes the pattern which has been evident since this survey was first undertaken in 1999. Namely one of strong growth and a general switch to doing business via subsidiary companies as opposed to directly out of Scotland. In statistical terms 2005 saw a 13.9% rise in sales into the USA, rising from £803m in 2004 to reach £915m in 2005. Trade with Canada declined from £65m to £39m during the same period.

Market Analysis of International Activity in the Service/Supply Base

After North America and the substantial USA driven growth, the next major geographic region in sales terms is Africa. The results in Table 5 show a number of key African markets appearing in the Top 30 export destinations and although there are some market by market fluctuations on a year on year basis, the overall trend is towards sales growth into many of these key oil provinces. Foremost amongst these is Nigeria where sales have once again risen substantially, up from £111m in 2004 to £185m in 2005. This equates to an increase of almost 67% and puts Nigeria into the position of being Scotland's oil and gas industry supply chain's second top international market. It is also worth noting that at present the majority of this trade with Nigeria, 82%, takes the form of direct exports. In a less challenging environment, in terms of its political stability and security, it seems likely that by now, after seven years of consistent growth in trade with the market, a tendency to establish subsidiary operations would have been more advanced. That this is not the case, not only in Nigeria but also in key other African markets, is a reflection of how difficult many of these places are to undertake business.

Looking at some of the other key African markets we can see that sales into Angola have risen once more, up from £38m to £68m. In Equatorial Guinea sales are up from £32m in 2004 to £47m in 2005 and appearing in Table 5 for the first time is Mauritania where exports of £68m are recorded. On the other hand compared to 2004 a major decline in sales into Egypt is noted, down from £179m to £54m in 2005 with the Ivory Coast, Libya and South Africa also showing more modest falls. It is worth repeating that there can be considerable year on year variation in sales levels into the different country markets depending on the nature and scale of the projects involved. Whilst this is true globally it is often particularly the case in Africa where due to the difficult working environment Scottish involvement tends to be via the major contracting firms and at the higher value end of the scale.

The consistent upward trend in sales into Eastern Europe has been sustained in 2005 and this has been driven by rising sales into both Russia and Azerbaijan during the period. Russia is now Scotland's third most important market and exports have increased by 35% in 2005, up from £120m in 2004 to stand at £185m in 2005. As for Azerbaijan there has been an increase from £81m in 2004 to £102m in 2005 making it the fourth top destination for our international oil and gas supply chain sales. As ever there is a degree of fluctuation and sales into Kazakhstan have dipped from £12m to £3m. Despite this it is clear that the opportunities in key Eastern European markets offer further potential to Scottish industry assuming that market access does not become restricted in any way by protectionist policies.

Nearer to home a varied picture emerges with sales into the EU markets increasing compared with 2004, mainly due to an increase in exports to the Netherlands. The level of sales into Non EU markets, in effect Norway, has fallen back from 2004 levels and is now valued at £83m compared with £152m in 2004. This is perhaps surprising but as noted last year may reflect the impact of the pan North Sea management model on how business is actually being delivered across the wider region.

Strong growth into the Asia Pacific markets has also been a feature of the 2005 results and Table 5 again provides some more detail on what the key drivers have been. The principal reason has been a strong recovery in sales into China. It is fair to say that the exports into China have been volatile over the years and 2004 witnessed a decline to £52m from a 2003 figure of £106m. These latest results show a recovery to £96m making it the fifth most important market for 2005. Other Asian markets which have grown in the past year include India and Singapore, with the flip side being that decreases in sales into Thailand and Brunei are recorded.

The position of Latin America has declined again although the market picture varies considerably. Sales to Brazil are down from £106m to £37m and exports to Trinidad & Tobago have also reduced such that it no longer appears in Scotland's top 30 markets. Modest growth though has been seen in other country markets with exports to Venezuela up from £55m to £72m; Columbia up from £27m to £39m and Argentina up from £24m to £31m.

Market Analysis of International Activity in the Service/Supply Base

The Middle East has also recorded a small overall decline in its intake of Scottish exports. Iran is still the most important market in the Middle East for supply chain exports with £64m of Scottish sales in 2005, down marginally from £66m in 2004. There are also drops in sales into the Arab Emirates, £50m to £45m and Oman, £50m to £36m and in contrast an increase to Saudi Arabia where sales have risen from £37m to £41m.

Figures 6-8 graphically illustrate the key markets for Scottish based oil and gas supply/service companies.

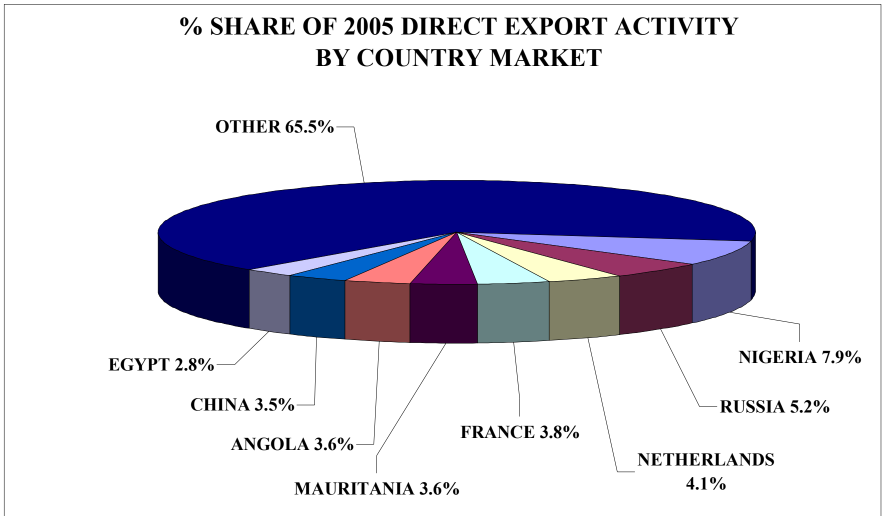

Figure 6

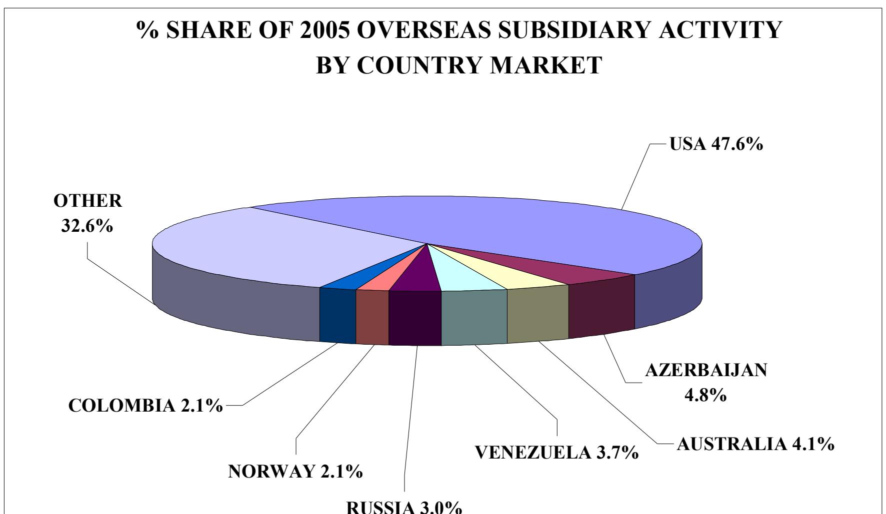

Figure 7

For direct exports Nigeria is currently the top market for Scottish firms with almost 8% of the total being destined for this key West African market. Indeed the significance of West African markets for direct export trade is further emphasised by the 3.6% share taken by Mauritania and a similar share being accounted for by Angola. In contrast none of these markets are amongst the key locations for establishing overseas trading subsidiaries.

Market Analysis of International Activity in the Service/Supply Base

Taking a position of overwhelming dominance here is the United States which, whilst no longer featuring as one of the top markets for direct exports, accounts for a 47.6% share of subsidiary sales. The Eastern European markets of Russia and Azerbaijan also show a tendency to an increasing proportion of sales being delivered via subsidiaries.

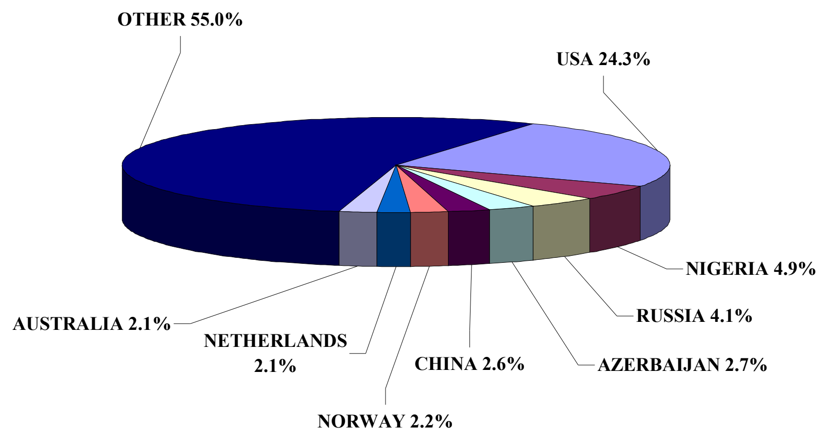

Figure 8

As illustrated in Figure 8, in overall terms the United States accounts for just under a quarter of all international sales from Scotland's supply chain, which compares with 22% in 2004.

There are of course a large number of smaller markets outside the top eight shown above which contribute to the remaining 55% share. The 2005 results show that some 75 different country markets across the globe were targeted by Scottish oil and gas supply chain exporters in 2005, with overseas subsidiary activity being recorded in 38 different markets. This diversity of activity reflects well on our supply chain and is a clear indication of the extent to which globalisation has occurred in recent years. The trend seems likely to continue although it is important for the industry's long term future that management resource remains focused on maintaining and building this activity, even when domestic opportunities are plentiful as at present.

Active Exporting in the Scottish Service/Supply Base

The definition of an active exporter is a company which generates more than 15% of its turnover through export sales. The data generated by the survey allows us to measure the number of active exporters in the sample and to compare the 2003, 2004 and 2005 data. For the purposes of this analysis export activity has been defined as international activity, that is the sales figures for direct export and via subsidiaries are counted as equally valid.

Table 6 details the results within different export turnover bands.

Table 6. Active Exporting in the Scottish Service/Supply Base

% Turnover Derived Internationally	No of Companies 2003	2004	2005	% Change 2004-05
76-100	15	18	19	+6
51-75	28	29	33	+14
26-50	44	38	27	-29
15-25	28	20	16	-20
TOTAL	**115**	**105**	**95**	**-9**

Like last year the results present a mixed picture. Once more at the top end of the scale there is an increase in the number of companies who are exporting greater than 50% of their turnover, whilst at the lower end there has been a reduction in the numbers exporting between 15% and 50% of turnover. In numeric terms the results often vary depending on the number of responses to the survey each year. Taking this into account we can say that there continues to be an increasing proportion of survey respondents who export more than 50% of their total turnover. In the 2005 survey this has risen to 55% of all respondents compared with 52% in 2004 and fewer than 50% in 2003.

It is too early to make firm conclusions on trends but the results suggest that those businesses which have been proactive in getting into international markets and who now have this international dimension as a well established part of their business model are succeeding in growing globally. For other companies where the international business is a lesser part of their sales, the refocusing on domestic opportunities may well be resulting in an accelerated decline in the proportion of turnover being generated outwith the UK.

Small and Large Exporters

The statistics in Table 7 were derived by estimating the proportion of sales accounted for by SMEs (i.e. those with up to 249 employees) and large companies (250 plus employees). This enables the relative contributions of small and large companies to be assessed.

Table 7. Relative Contributions of SME and Large Companies - 2005

	SME Company Share (%)	Large Company Share (%)
Direct Exports	21	79
Subsidiary	10	90
Total International Sales	14	86

This is the third year of the survey in which SCDI has provided a breakdown by company size of the sales totals presented in Tables 1, 2 and 3. Although the results have shown some variations over the past three years there is actually a fairly consistent picture emerging in terms of the relative contributions of small and large businesses to the international sales pattern.

With regard to direct export performance there is no change in the proportions accounted for by SMEs and Large firms compared with 2004. However, for subsidiary sales the SME proportion has actually increased marginally from 9% in 2004 to 10% in 2005. As a result the overall share of total international sales accounted for by SMEs has reached 14%, or £525.5m in 2005.

United Kingdom Activity in the Service/Supply Base

Domestic Sales

Although not a core part of the survey, which principally was designed to measure international sales activity, respondents were asked to indicate the value of their domestic sales i.e. sales within the United Kingdom marketplace. A breakdown of these results is given in Table 8 and Figure 9 illustrates the changes within the four main business categories as defined below:

Business Category 1	Product/Equipment/Materials
Business Category 2	Bulk Materials
Business Category 3	Services
Business Category 4	Engineering/Procurement/Construction/Installation

Once again businesses were asked to indicate their total domestic sales but then also to define the proportion of these which were sold to end user customers in the oil and gas industries. It is these latter estimates which are focused on.

Table 8. Scottish Service/Supply Sales to the UK Domestic Market 2003 - 2005 (£m current prices)

	Total Sales			Sales to Oil & Gas Sector		
	2003	2004	2005	2003	2004	2005
BUSINESS CATEGORY						
(1) Prod/Equip/Materials	803.0	826.1	938.6	649.5	663.6	777.7
(2) Bulk Materials	527.1	504.8	574.8	502.3	421.8	512.4
(3) Services	5,589.6	5,279.3	6,497.3	4,543.5	4,471.3	5,517.1
(4) Eng./Proc/Constr/Install	884.0	956.1	1,215.8	785.5	849.6	1,109.3
TOTAL	**£7,803.7**	**£7,566.3**	**£9,226.5**	**£6,480.8**	**£6,406.3**	**£7,916.5**

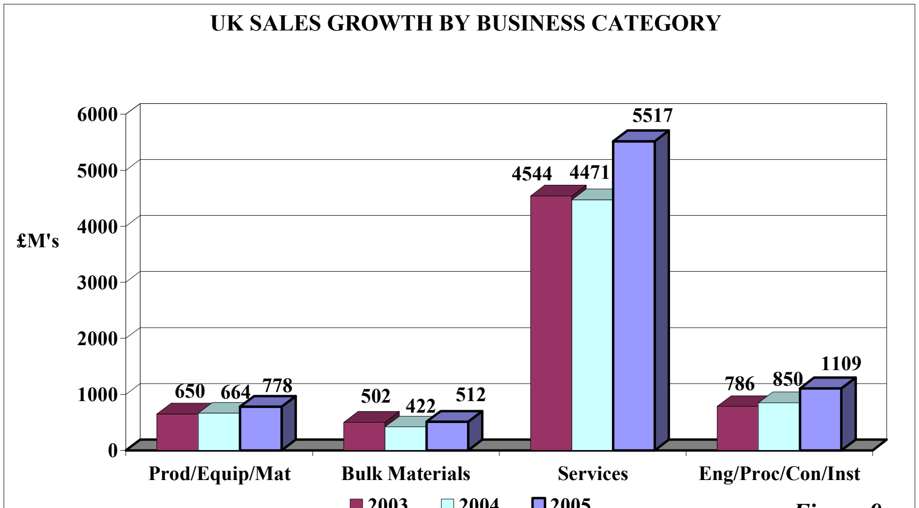

Figure 9

Last year's survey surprisingly reported a small decline in the level of sales being undertaken by the supply chain into the UKCS. The rising oil price in 2004 had led to expectations that an immediate upturn in UKCS activity would follow, however this was not the case. In attempting to rationalise this it was thought that project lead time may well be the reason for no sales increase and that with 2005 recording an even higher average oil price last year's survey speculated that we would see an increase in UKCS activity when results were being reported in this current survey.

United Kingdom Activity in the Service/Supply Base

As Table 8 and Figure 9 illustrate this has indeed been the case. In total terms UKCS sales have risen from £6,406m in 2004 to reach £7,916m in 2005, a rise of 23.6% over the period. At an industry sector level there have been increases in all four Business categories with the largest increase in value emanating from the dominant Services category where a rise of £1,046m or 23.4% is recorded. In percentage terms the greatest growth is seen in the Engineering/Procurement sector, which of course witnessed an export deline. Domestically though, sales from this sector have risen by 30.6% in the 2004 to 2005 period, with the growth in subsea industry sales undoubtedly being a key factor in this domestic rise. In the other two sectors Product/Equipment/Materials increased sales by £114.1m or 17.2% and the Bulk Materials sector rose by £90.6m or 21.4%.

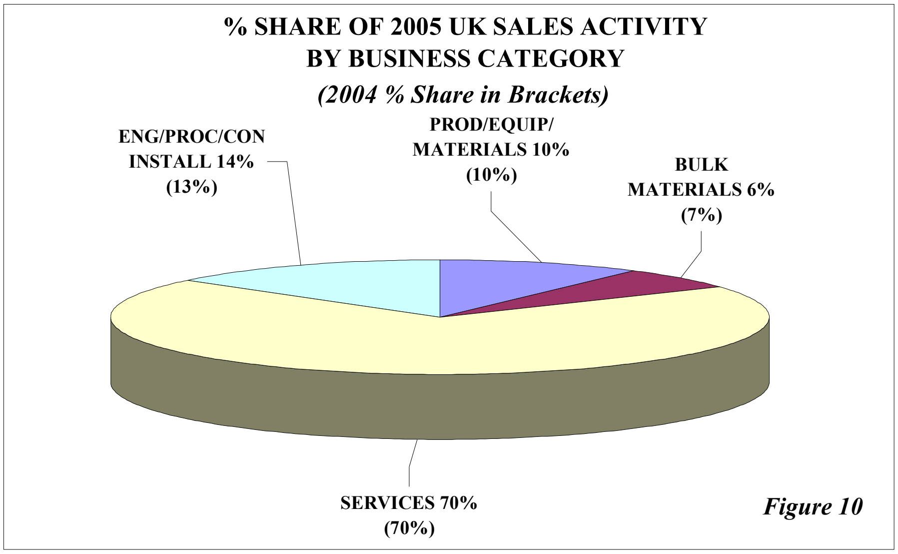

Figure 10

Figure 10 shows the share of UKCS sales taken by the four Business categories. There is little change from the 2004 proportions reflecting the strong across the board rises in domestic activity.

Anticipating the trend for 2006 is difficult. On the positive side oil prices have again been high and unless there is an unanticipated dramatic slump in price during the final calendar month of 2006, the 2006 average price will have been higher than in 2005. The 23rd Licensing Round results announced in late 2005 showed strong interest in the UKCS, and although the results of the 24th Round have not been released at the time of writing, a positive response from the industry is expected. On the downside costs continue to rise and semi-submersible drilling rigs in 2006 are now being charged at six times the day rate they were in 2004. Combined with the previously mentioned manpower constraints it is difficult to predict whether there is capacity in the UKCS to significantly grow domestic sales in the coming years. SCDI would re-iterate its view that international growth is also long term critical and it is to be hoped that the industry can successfully balance the resource requirements needed to maintain activity on both fronts.

International and Domestic Market Sales Comparisons

Having carried out the survey for a number of years, SCDI considered it valuable to take a closer look at the relative trends in international and domestic sales since 1998. Whilst the growth in international activity is welcome, is it actually substituting for a decline in the UKCS market or is it part of a wider growth picture?

Table 9 below details the overall Total International sales figures and Domestic sales data between 1998 and 2005, as well as the sum of these. Figure 11 illustrates the growth trend in these same categories again over the seven year period.

Table 9. International and Domestic Market Sales 1998 - 2005 (£m current prices)

	1998	1999	2000	2001	2002	2003	2004	2005
International	1,669	1,246	1,888	2,199	2,716	3,394	3,654	3754
Domestic	4,186	4,979	5,107	5,599	5,965	6,481	6,406	7916
Total	**5,855**	**6,225**	**6,995**	**7,798**	**8,681**	**9,875**	**10,060**	**11,670**
International % Share	28.5%	20.0%	27.0%	28.2%	31.3%	34.4%	36.3%	32.2%

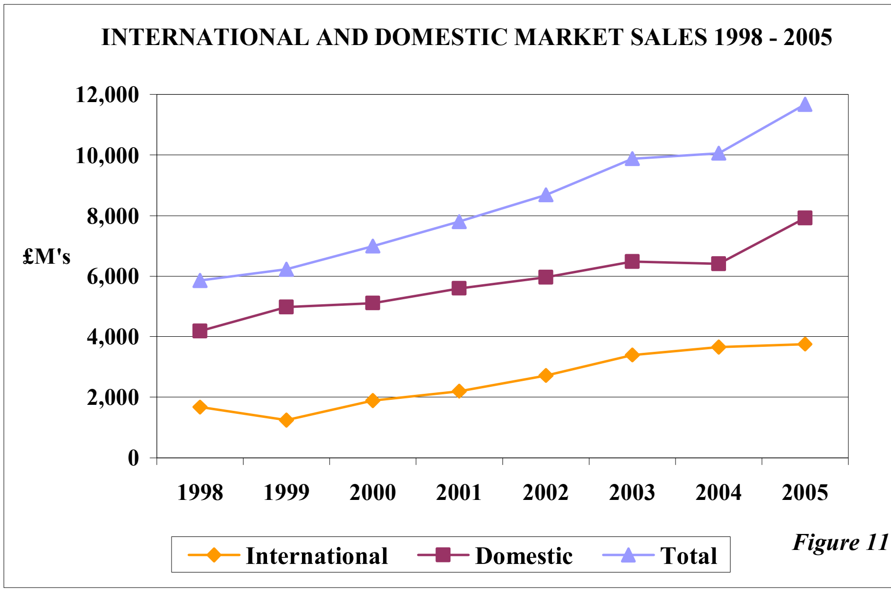

Figure 11

As Figure 11 shows this latest set of results reports the sharpest upward trend in domestic activity since the survey was initiated. This combined with the modest growth in international sales means a dip in the proportion of total sales which have gone overseas for the first time since the 1999 figures. Nonetheless it remains substantial at 32.2%.

In total value terms sales, which breached the £10 billion barrier for the first time in the 2004 survey, have now gone well beyond that to stand at £11.6 billion in 2005. This equates to growth of 150% since the research was first carried out in 1997. The equivalent growth figures for domestic and international growth over the same period are 121% and 248%.

Assuming adequate resources are available to pursue a fair proportion of the many opportunities which exist in the domestic and global oil and gas sector we should see a continued upward trend in the lines in Figure 11.

Sector Diversification

The 2002 survey incorporated an additional question which aimed to focus on the extent to which companies traditionally selling into the oil and gas sector were beginning to diversify their business. In truth the response to this was patchy and although the data generated enough information to give an indication of what other key sectors were being targeted, it was the intention to build on that in subsequent surveys. A more precise definition of the question, whose fundamental aim was to record the level of sales into non oil & gas end market sectors has since helped generate an improved response. Table 10 summarises the information received in 2005.

Table 10. Scottish Service/Supply Trading with Non Oil & Gas Sectors 2005

BUSINESS SECTOR	**VALUE (£m)**
Defence	£17.3m
Non Oil & Gas Energy	£298.1m
Non Oil & Gas Engineering	£21.7m
Industrial Equipment, Materials and Services	£31.6m
Other	£86.0m
TOTAL	**£454.7m**

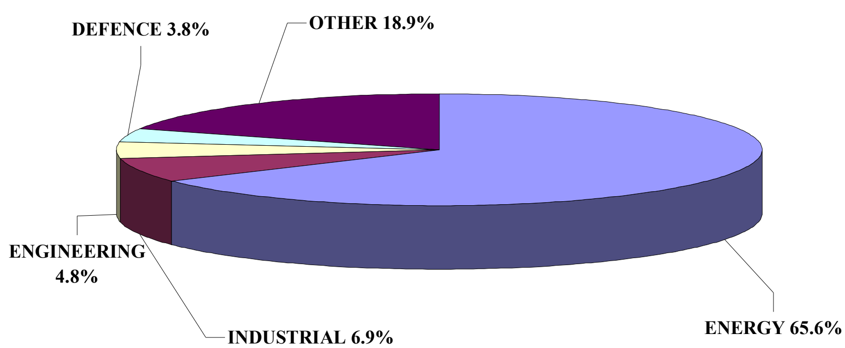

Figure 12

The latest data shows a recorded value total of £454.7m in diversification sales in 2005, compared with £481.4m in 2004 and £701m in 2003. It is difficult to make year on year comparisons, particularly as this is not the core element of the survey research, nonetheless a few observations can be made. The fact that the value has decreased again can increasingly be seen as being reflective of a buoyant domestic and global oil and gas sector. A case of the supply chain devoting more resource to core business and less to broadening out their business base into other target industry markets. It is difficult to be too hard and fast on this being the reason for sales decline, but if it were, it would again be of some concern from a long term perspective, in that sector diversification and international diversification is undoubtedly critical to long term job retention in Scotland.

The latest figures show an increasing proportion of sales into the Non Oil and Gas Energy category – principally renewables, but also power generation. In 2005, 65.6% of sales were into this market sector as opposed to 46.4% in 2004 and 24% in 2003. Even more significant are the value results which show that in 2005 £298m of business was done in the sector compared with £223m in 2004. The other three specified sectors all have a lower percentage share and this also refllects a decrease in sales value into them compared with the 2004 results.

Sector Diversification

While Table 10 and Figure 12 show the principal non oil markets the detailed results indicate a considerable diversity of sectors being targeted. These include Transport Services, Agriculture/Food sector and various strands of the public sector from local government to the NHS.

Conclusions

Once again the sole focus of the study is the key client group of the Oil and Gas Service/Supply chain. The main aim of the study was to continue measuring the degree to which it is beginning to develop international opportunities based on the expertise it has gained in the UKCS. In addition the survey took the chance to measure the level of domestic sales being generated by the same Service/Supply base and also looked at the extent of diversification into non oil and gas end user markets. This is the seventh time the research has been carried out and it further adds to the data set which over a period of time should reflect the trends in internationalisation and also oil price impact on sales.

Summarising the results it is clear that international growth has continued during 2005 but as for 2004 this is at a slower pace than in recent years. The value of total international sales is up from £3,654.1m to £3,753.6m during the period. However, in 2005 this growth has come from both direct exports, as well as sales via subsidiaries, albeit at modest levels in both cases. The major difference being reported in this current survey is the sharp rise in sales into the domestic or UKCS market. This follows on from a small decline reported in the 2004 research and a previous period of steady rises. The 2005 results show a much more substantial 23.6% hike in UKCS business an increase of over £1.5 billion compared with 2004, equating to 2005 domestic sales of £7,916.5m. This sharp increase means that the combined domestic and international total sales value, which for the first time broke the £10 billion barrier in 2004, now stands at £11.67 billion.

In terms of markets the North America region, and in particular the United States, remains the major destination for international activity by Scotland's supply chain. The most significant feature of the 2004 survey was the increasing importance of the African region both in terms of direct exports and subsidiary sales. This trend, principally with regard to direct exports, has been sustained in 2005 and the Eastern European markets have also continued to demonstrate a growth in importance to Scottish exporters.

Looking ahead the positive signs for the oil and gas sector continue to outweigh the negative ones. In a Scottish context these survey results and the developments which have occurred in 2006 all point to an extremely buoyant sector. Many of the large operating and contracting companies have all made significant investment decisions in their Scottish operations. Foremost amongst these are initiatives such as major new office complexes in Aberdeen for BP, Shell, Subsea 7, Acergy and Halliburton ESG as well as Chevron's decision to locate a global research and development facility in the city. Scotland's largest Management Buy Out of the year saw the creation of Production Services Network (PSN) from part of Halliburton's Kellogg Brown & Root (KBR) business, creating significant new Scottish headquartered oil and gas company. There is little doubt that global energy needs will continue to drive strong demand for oil and gas and that Scotland PLC can play a long term and significant part both locally and internationally in satisfying this need.

In last year's report SCDI stated that ***"On the labour market side it is to be hoped that some of the new initiatives planned to increase the attractiveness of the industry; to train more technicians/graduates and in overall terms to lower the UK oil and gas sector age profile, are this time backed by sufficient and consistent investment from the major industry players both at Operator and Contractor level to deliver real and lasting improvements".*** Whilst much remains to be done and long term commitment means exactly that, there are some positive signs that this time the industry has got the message about the need for consistent investment in bringing on new people and not solely relying on a recycling of the same core labour group leading to an upward wage spiral.

Ending briefly on a political note SCDI considers it vital that the UK Government maintains fiscal stability for the industry and is sensitive enough to ensure that its tax policies encourage investment in a mature oil and gas basin. Should the oil price show a

Conclusions

significant decline at any stage in the next few years, this will be a critical test of the UK Government's commitment to the UKCS. The growth in the global economy, driven by China and India, combined with major instability in some of the key oil producing provinces has raised the profile and significance of energy policy to a level it has not seen in recent years. At the time of writing the UK Government's energy portfolio is held by a Cabinet Minister for the first time in many years. This is positive but even better would be a dedicated Energy Minister with a cabinet seat. With 2007 likely to see a new Prime Minister in place at a UK level it is vital that Government support for the industry is enhanced during this period and not diminished.

Appendix A

Geographic Region Definitions

Region	Main Markets
North America	United States, Canada
Western Europe (Excl' EU)	Norway, Faeroes, Switzerland
Latin America	Brazil, Mexico, Columbia, Venezuela, Trinidad, Argentina
European Union	Denmark, Netherlands, France, Germany, Italy
Eastern Europe	Russia, Azerbaijan, Kazakhstan
Middle East	Iran, Qatar, Saudi Arabia, UAE, Oman, Syria
Africa	Egypt, Ivory Coast, Nigeria, Equatorial Guinea, Angola, Libya
Asia Pacific	Singapore, Vietnam, Brunei, China, Indonesia, Malaysia, Thailand
Australasia	Australia, New Zealand

Business Category Definitions

1.Products/Equipment/Materials

Pumps, drilling equipment, computers, wellhead equipment, ROVs, Instrumentation/Process Control Equipment.

2.Bulk Materials

Chemicals, Valves, Building Materials, Plastic/Composites

3.Services

Surveying, Logistics, Certification, Repair/Maintenance, Drilling Services, Diving, Testing/Inspection, Seismic Services.

4.Multidiscipline

Engineering, Procurement, Construction, Installation, Commissioning. (Platforms, Subsea, Pipelines etc)

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