# Business of oilfield chemicals to diversify under pressure from Chinese suppliers

**Oil production restrictions under OPEC+ agreements have affected not only the Russian vertically integrated oil companies, but also the players in related industries. In particular, low oil prices have pushed down the budgets of oil companies, and made them revise costs and cut orders for well services and oilfield chemicals. CREON Group surveyed the leading market experts to learn when a recovery can be expected in the drilling and oilfield chemicals segment.**

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In 2019, Russian oil companies drilled 1.1 million meters of exploratory wells, 6.4% more than a year earlier. At the same time, production drilling that had been on the rise in recent years, has now decreased by 1.2% to 27.3 million m. The reduction in oil production and consumption caused by the OPEC+ agreement and the COVID-19 pandemic forced oil producers to shut down existing wells and stop new drilling, as well as to cease geological and technical explorations including hydraulic fracturing.

The oilfield services industry has always been sensitive to market fluctuations, and the tough year of 2020 could lead to series of bankruptcies, according to industry participants surveyed by the CREON Group. "All types of oilfield services will be affected to some extent. In absolute figures the oilfield services were hit by falling oil prices more than other sectors as it is the most expensive and capital-intensive business. The demand for drilling and related oilfield services has decreased and will continue to decline. I suppose that due to falling oil prices the overall decline in oilfield service orders will be 30% to 50%", says Zamir Abdullayev, head of PNG Drilling Company.

Manufacturers of reagents for the oil and gas industry have not yet felt the consequences of the crisis: "In March and June we did not see any decline: our services are contracted and we are fulfilling our current commitments", says a major producer of drilling chemicals. - Now we see a slight drop in volumes, but it's natural since sales of chemicals and drilling reagents are always lower in summer. We are more concerned with oil companies possibly starting to revise production volumes and shutting down marginal wells, or even rejecting or postponing complicated and expensive projects such as hard-to-recover reserves at the Bazhenov suite. Perhaps, the crisis will have a delayed effect on us."

## Cheaper Chinese solutions

The Russian oilfield services market has been under sanctions for several years, and the comeback of European and American suppliers is not expected anytime soon. Therefore, Russian companies are using either their own products or what the Chinese have to offer. According to the experts, about 20-25% of the Russian drilling chemicals market belonged to products from China before 2020, with low quality products at an attractive price. In the current situation, many Russian companies are forced to switch to Chinese suppliers even more. "Chinese chemicals are putting much pressure on the Russian reagent market for drilling and well service. The situation when companies are switching to the cheapest solutions has been gaining momentum since long. And in many ways, it was created by the oil producers: they built a tender system that targets the lowest possible price without taking into account the economic efficiency of more expensive and high-quality products", the industry expert comments.

## State aid

According to projections of the Russian Ministry of Energy, the oilfield service companies may lose 30% to 40% of their orders volume this year. "The oilfield services are important segment of oil and gas industry;

today it generates about 1.5 trillion rubles of revenue and employs over 150 000 people", said Russian energy minister Alexander Novak in May at a meeting with president Vladimir Putin devoted to the development of the fuel and energy complex. "We believe that it is important to create conditions for the continuation of well drilling activities even at a time when this is not needed. To do so it is necessary to provide financing for well drilling without shutting down the wells, so that the production can be restarted when needed in future", the minister underlined.

In the nearest future, the Ministry of Energy plans to introduce a program to support industry through government orders, subsidies for development and implementation of advanced technologies. The federal budget will support companies that were forced to shut down marginal wells through providing soft loans in the amount of 400 billion rubles. It is expected that these measures will allow oil companies to drill up to 3,000 wells that will remain in reserve for better times, until the OPEC+ deal expires in April 2022.

**Time to reformat the market**

The ongoing crisis is a good opportunity to rebuild the Russian oilfield services market, following the pattern of the global majors that diversified their business while losing up to 70% of capitalization. "As the business of large international companies like Schlumberger, Halliburton and Baker Hughes is bringing losses, they can significantly reduce or even completely shut down drilling and exploration, keeping only chemicals production, modeling and geophysics divisions", comments one of the largest oilfield service players in the markets of Russia and the CIS.

Experts interviewed by the CREON Group believe that the oilfield services market will recover no earlier than 2023, once inefficient and technologically lagging companies have left the business. "Despite the recovery in oil prices, it will take months before all segments of the supply chain restore consistent revenue growth", says the source in the industry, stressing that when the market recovers, operators will rather choose projects with a flexible budget and with potential increase in production, and also high-yield investments with a short payback period. "The well service segment will be first to recover compared to other services, but the oil service industry as a whole will possibly have to wait until 2023, when the demand for services may get back to the 2019 level", considers the expert.

"Unlike large oil companies, the Russian drilling chemicals market is run by small and medium-sized businesses. And while the oil giants will survive even with losses imposed by OPEC+ deal commitments, the service companies will face difficult times. In this situation the government should pay closer attention to support oilfield services", concludes **Sandjar Turgunov**, General Manager of CREON Energy.

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*Well Service and Oilfield Chemicals 2020 Conference in Moscow, on September 11, 2020 (Program and registration).*