Oil Market Report – August 2010

Whilst oil prices followed a generally downward trend in August, the bigger news for UK fuel consumers was the proposed sale of yet another UK refinery. It is less than 3 years since Murphy Oil Corporation (aka Murco) took full control of the Milford Haven refinery, but the operation in Wales now joins Chevron (Texaco) Pembroke, Shell Stanlow and Total Immingham in facing the auctioneer's hammer. Add to that list, the closure of the Tees Refinery in 2009 and the exit of BP from UK refining in the last 5 years (selling both Grangemouth and Coryton refineries) and you have a refining industry in a serious state of crisis.

Why is it so tough for refiners and what does the future hold? Much can be pinned on the spectacular strategic mistakes made by refinery top brass in the early 90's – gasoline production capacity was maximised, just as demand for diesel was taking off. But the attached graph illustrates the more recent problems facing refiners, as available margins have crashed. Since January 2009, average gross profit per barrel of production has sat around the $5 – $10 mark and this puts most UK refineries into a loss-making position. Refinery revenues are of course high, but so are overheads. Monthly wages at circa £1.5m, annual energy costs of up to £10m (depending on energy recapture), quarterly jetty dues of £8m, monthly maintenance & repair at £1.5m, enormous depreciation bills, eye-watering capital projects and you have a rather unattractive business proposition.

With refining margins so weak (when will they recover? Who knows), there are not too many likely candidates to take these assets on and then take them forward. The major oil companies clearly won't and many of the potential suitors will steer clear, as long as refinery margins are so low. After all, why would the money-men of China, India and Russia take on ageing refineries, when products can just as easily be imported into the UK. Closures seem inevitable and of course, those refineries that can stay the course in this period of attrition will reap the rewards of limited supply and higher margins. But it could be pretty painful period of attrition and whether end-users of fuel will be so positive about such "rewards" is a different matter.