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Distribution and Marketing in the Downstream Oil Industry

- **The UK Downstream oil industry has undergone significant changes over the past three decades.**
- **These changes have been driven by strong competition that has delivered pre-tax pump prices that have been consistently the lowest amongst major EU countries.**
- **The sector has had to adjust to generally lower returns on capital employed, evidenced by mergers, rationalization of refining and distribution assets, withdrawal from the market and filling station closures.**
- **A healthy oil refining and marketing industry is a vital element of the nation's future security of supply and of competitively priced petroleum products.**

Background

Until the mid 1980s, the downstream oil sector was characterised by vertically integrated firms, which encompassed all oil related business activities, from crude exploration and production to refining, distribution and marketing.

For example, at its formation in 1979, UKPIA had 13 members, which included several companies that, due to merger or acquisition, do not exist today, such as Amoco, Burmah, Gulf Oil, Mobil, Petrofina and Phillips Petroleum.
UKPIA now has 9 members, several of whom have no crude exploration and production, whilst others are engaged in refining and wholesaling only - yet others have no direct involvement with the operation of petrol filling stations.

The downstream oil sector saw fairly dramatic change during the 1980s and 1990s. A key driver was supermarkets starting to offer road fuels at their bigger stores during the early '80s - they now command over 46% of total UK petrol and diesel sales.

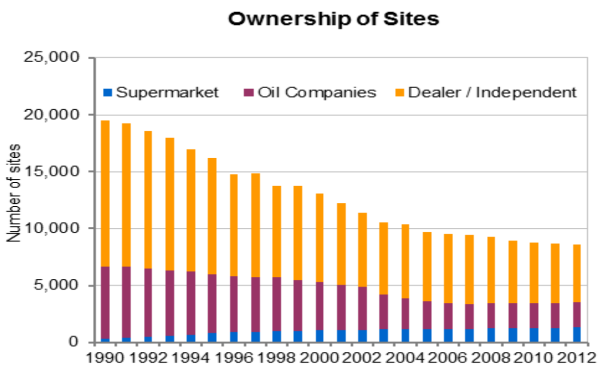

Figure 1: Ownership of Sites, 1990 – 2012
(Source: Experian Catalist 2006-2012 – EI Retail Marketing Survey 1994-2005)

The strong competition, over the last three decades, and lower return on capital employed on downstream refining and marketing activities have resulted in several company mergers and acquisitions as undertakings seek critical mass. This has inevitably resulted in a significant downsizing in oil company downstream organisations – far fewer staff and overheads, and closure/consolidation of assets such as oil storage terminals. The distribution of road transport fuels has been part of these structural changes, with delivery of fuel to service stations and commercial customers moving from oil company fleets to provision by specialist logistics companies, such as DHL, Wincanton, Hoyer, Suckling, Turners, Suttons and TDG.

Although several global oil companies still operate as vertically integrated businesses, the oil industry is now, more than ever, a multifaceted sector where the emergence of specialised independents, operating in all segments of the business, well reflects the increasingly competitive structure of the market in which they operate.

Downstream oil refining and marketing

Currently, the UK has the 4th largest refining capacity in the Western Europe and provides a resilient and flexible infrastructure system comprising of 7 operational refineries, extensive private and government pipelines carrying 30 million tonnes of fuel each year, 50 distribution terminals and 8,608 service stations.

However, UK oil refining and marketing remain a high volume/low margin, capital intensive business with below average returns on capital. Refineries operate between two international and liquid commodity markets: crude oil and the refined products. As each of these product streams has its own short term dynamics, with prices formed in international markets, the resultant spread between crude and petroleum product prices (which has to cover all associated costs of running a refinery and marketing business), is highly volatile and has traditionally translated in consistently low returns.

At a time when considerable levels of investment are required, this has added to the challenge of continuing to meet fuel demand in a safe, secure and affordable way, whilst conforming to ever more stringent environmental legislation. In the UK, 11 refineries have closed since 1979, 4 in the past 10 years – the latest being Petroplus's Coryton refinery in July 2012 - with 3 currently seeking buyers.

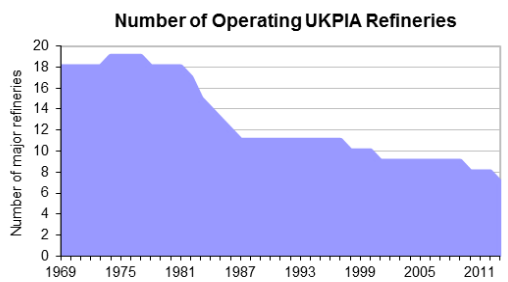

Figure 2: Number of refineries, 1969 – 2012
(Source: UKPIA)

These economic pressures have also been reflected in the high street, with the number of filling stations in the UK reducing dramatically from over 17,000 in 1994 to 8,608 at the end of 2012. Recently, around 420 filling stations on average have been closing each year and several oil majors have exited the retail market.

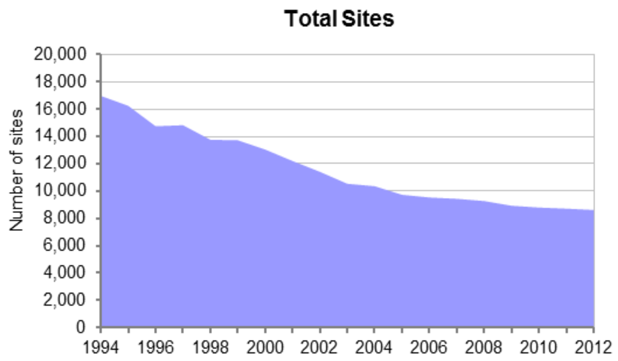

Figure 3: Retail site closures, 1980 – 2012
(Source: Experian Catalist 2006-2012 – EI Retail Marketing Survey 1994-2005)

Future challenges

The UK Downstream oil industry has undergone significant changes over the past three decades. These changes have been driven by strong competition that has delivered pre-tax pump prices that have been consistently the lowest amongst major EU countries.

UKPIA and its members believe strongly that a healthy, robust oil refining and marketing industry is a vital element of the nation's future security of supply and of competitively priced petroleum products (transport fuels, chemical feedstocks, heating oils, etc). They wish to continue working with the Government and all stakeholders to deliver this.

The challenge is to ensure that in the coming decades the UK continues to have access to affordable, secure supplies of the required oil products, as both sources of crude oil and consumer demand change. This can be achieved by importing more products (jet fuel and diesel) to meet demand, and exporting surplus products (petrol and fuel oil), so long as those markets remain available, or preferably by investing in UK refineries. UKPIA and its member companies believe that the challenges ahead will be best met with a strong domestic oil refining industry with close links to the European and global oil markets. For more information on issues affecting the refining industry in the UK, read 'A Perfect Storm': www.ukpia.com/publications

Conclusions.

The UK Downstream oil industry has undergone significant changes over the past three decades. These changes have been driven by strong competition that has delivered pre-tax pump prices that have been consistently the lowest amongst major EU countries. A healthy oil refining and marketing industry is a vital element of the nation's future security of supply and of competitively priced petroleum products.

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