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Subsea production: More than just trees

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Steven R. Kopits

Ian Jones

Douglas-Westwood

In recent years, the subsea production equipment sector has developed in tandem with the offshore oil and gas business, and in particular with deepwater production. As the upstream business moves ever farther from shore, the need for high performance wet trees, controls, manifolds, and related equipment grows. As a consequence, subsea equipment is an increasingly important business line for production equipment manufacturers.

However, market measurement remains rudimentary as the subsea production equipment market is primarily tracked by the number of trees awarded. While such awards are disclosed by all manufacturers, tree counts fails to capture the range of activities in the segment, leading to potentially erroneous conclusions about the state of the business and its participants. As a consequence, the leading manufacturers in the business are disclosing progressively more information about their fast-growing subsea business. Not surprisingly, market leader FMC Technologies has led the way, commissioning Douglas-Westwood to prepare the first-ever assessment of manufacturers' market shares in dollar terms. The results are below.

High oil prices make deepwater production increasingly attractive, and the surge of oil prices from the middle of 2007 through the first half of 2008 drove the subsea business to record levels. Industry equipment orders, at their peak in 4Q 2007, exceeded \$3 billion. By early 2008, however, the market was correcting, with orders re-visiting levels more characteristic of early 2007. And the situation would go from bad to worse. As the financial crisis hit with full force in the second half of 2008, orders collapsed, falling by more than three-quarters to less than \$1 billion in the first quarter of 2009. While the drop was precipitous, the effect was perhaps more transient than might have been expected, and by 2Q 2009, life was beginning to return to the industry. Indeed, orders had recovered by the third quarter to more normal business levels.

At the company level, the market saw both continuity and change during the year. FMC Technologies recovered its top spot in orders by value in 2009, after running even with Cameron International in 2008. Notwithstanding Cameron's outstanding performance in trees in 2009 – during which it garnered 55% of all tree awards – its orders in value terms lagged FMC, with FMC and Cameron posting 35% and 26% respective market shares by value for the period. Cameron's loss of market share was GE's gain, and its VetcoGray division saw its share of orders rise to 20%, nearly double its level of a year earlier. Aker Solutions' subsea equipment business (which excludes the majority of its overall subsea business) suffered during the recession. The company rebounded in the third quarter with an estimated \$400 million in orders, closing the year with a market share of 12%, but with a comparatively lacklustre performance in subsea equipment overall.

Dril-Quip remains a small but respected player in the industry. While orders declined at the company during the recession – as they did for other manufacturers – Dril-Quip nevertheless posted a solid year, with orders estimated at \$400 million. It increased its competitiveness against the field, with market share for 2009 rising to 8% from 7% a year earlier.

Revenues: Buffered by backlog

During the recession, industry revenues fell by far less than orders, buffered by backlog conversions during the order drought at the end of 2008. Indeed, we estimate that revenues fell materially only for one quarter, in 1Q 2009, down about 10% from the previous quarter. However, performance soon recovered, and 4Q 2009 revenues were running at an all-time high.

FMC was, and remains, ahead in terms of revenues during the entire period under examination, with market share remaining in the 45-47% range and showing modest gains over time.

Our study shows Cameron and GE closely contesting second place in 2009, with 18% and 17% of the market, respectively. Aker Solutions lost ground in 2009, with share of industry revenues falling to 10%, from 13% two years earlier. Dril-Quip expanded both revenues and market share in 2009, with market share up to 6.4% and revenues increasing by 11%, the largest percentage growth in the peer group.

Douglas-Westwood estimates that every company, bar Cameron, posted record revenues for the year. And while Cameron's annual revenues came in a shade below 2008, its 4Q 2009 revenues beat any previous quarter by a comfortable margin.

Backlog: Bridging troubled times

Reflecting strong demand and limited production capacity, backlog grew steadily through 2007 to the middle of 2008. With the onset of the recession, orders collapsed and the industry began to work off backlog while keeping production and revenues relatively steady.

As a consequence, industry backlog declined from approximately \$8.3 billion in mid-2008 to \$6.6 billion at the end of 2Q 2009. However, 3Q 2009 saw a modest improvement of 2% in backlog, which recovered to \$6.8 billion. Backlog edged down in the last quarter of 2009, as inbound orders failed to keep pace with revenue growth.

For the first time, Cameron takes top spot in terms of backlog with a share of 40%, up from 27% at year-end 2008. FMC slides to second place in terms of backlog in the industry at 30%.

At 6%, Aker Solutions share of industry backlog has eased since year-end 2008, but is down by almost half since early 2007. GE backlog has varied at 12-15% of the market, most recently estimated at 14%, a modest improvement over 2008. Dril-Quip, the stealth player, continues its quiet climb, with backlog market share increasing by 1.5% over the past year. We estimate that both Dril-Quip and Cameron posted new records for backlog at year end.

Not so bad, and better looking forward

Considering the depths of the recession, the credit crunch, the collapse of oil demand, and the general climate of uncertainty, the subsea production and processing business has held up remarkably well. Revenues have held steady and, indeed, broken out to record levels. Orders are beginning to approach "normal" levels again. Backlog, although \$1.5 billion below its peak, has begun to recover and still represents 12 months revenue – a level which would have been quite acceptable in the first half of 2007. All things considered, the subsea segment has come through the recession in good shape.

The future looks better still. Douglas-Westwood believes 2010 will be a transition year with reasonable, but not exceptional, performance. However, like most analysts, we believe oil markets will begin to tighten by the end of the year, and oil demand growth will begin to outstrip supply again by 2011/2012. As prices climb and calm returns to the economy, expect the appetite for large offshore capex to improve, and with it, the prospects for subsea equipment manufacturers. After a tough year in 2009, the industry looks to regain momentum in 2010. The future looks bright.

About the authors

Steven R. Kopits heads the New York office of Douglas-Westwood, energy business consultants. Ian Jones covers subsea markets for the company in the United Kingdom.