Prospects for the international oil companies and oil prices: Lower for longer?

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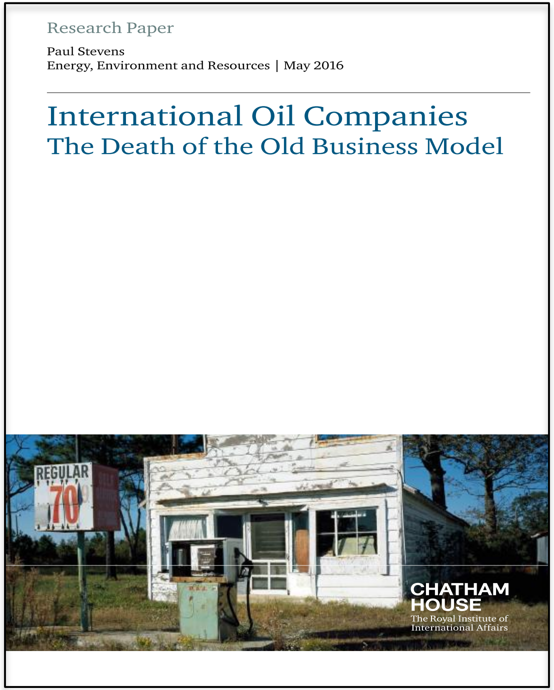
Presentation outline

- Problems created by ‘Trumpian Uncertainty”

- The International Oil Companies and the death of the old business model
  - What was the ‘old business model”?
  - Why has it been dying?
  - What solutions are possible?

- One option: Waiting for higher oil prices may prove disappointing: “lower for longer”?

- But beware Geo-politics?


Research Paper

Paul Stevens
Energy, Environment and Resources | May 2016

International Oil Companies
The Death of the Old Business Model

https://www.chathamhouse.org/publication/international-oil-companies-death-old-business-model

The IOCs and the death of the old business model

- **Four characteristics of 'the old business model'?**
  - Maximizing shareholder value
  - Maximizing bookable reserves
  - Minimizing cost based on 'outsourcing'
  - Using discount rates based on Capital Asset Pricing Model (CAPM)

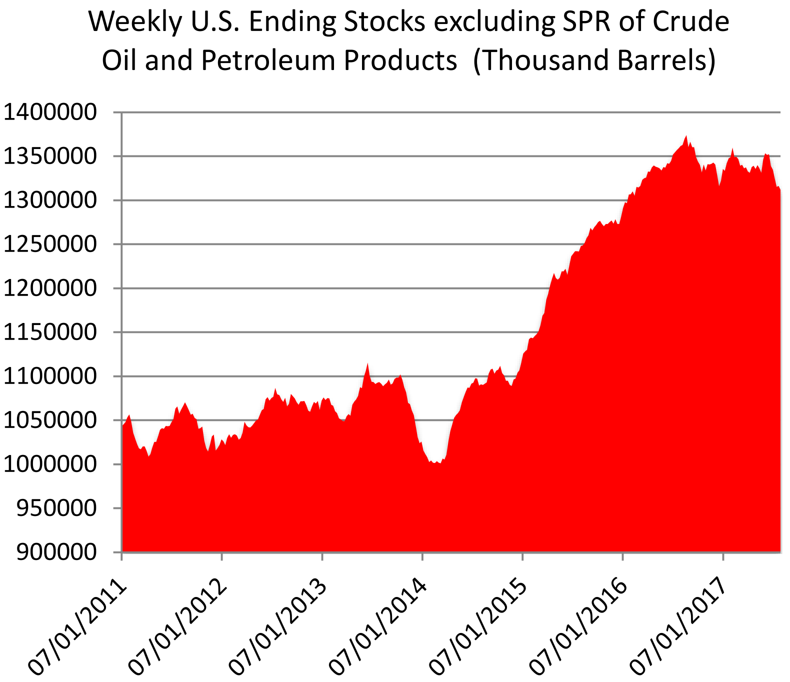
- **Why has it been dying?**
  - **Pre 1990s** = an industry of consensus in a world where the 'fallacy of composition rules'
  - **1990s**
    - Limited access to low cost reserves because of 'resource nationalism' plus increasingly progressive upstream fiscal systems
    - Outsourcing meant giving up much of their technological edge
    - The drag of the downstream
    - Attitudes to risk derived from CAPM
  - **Then compounded over the last 10 years**
    - Financial markets increasingly disillusioned with large, long-term, high risk projects
    - Issues to do with 'unburnable carbon' and 'the divest campaign'
    - Much lower oil prices – but beware "low" oil prices 1986-2004 Brent $33

What solutions are possible?

- They simply **die**!
- **Mega mergers**? – Competition authorities
- **Cut costs**? – Already trying since 2014
- **Slim down the balance sheets**? –Who will buy?
- **Diversification** into renewables? – Slim margins + Regulatory uncertainty + Very different business model
- **Hope** that, as part of a cycle, oil prices will recover? BUT ……

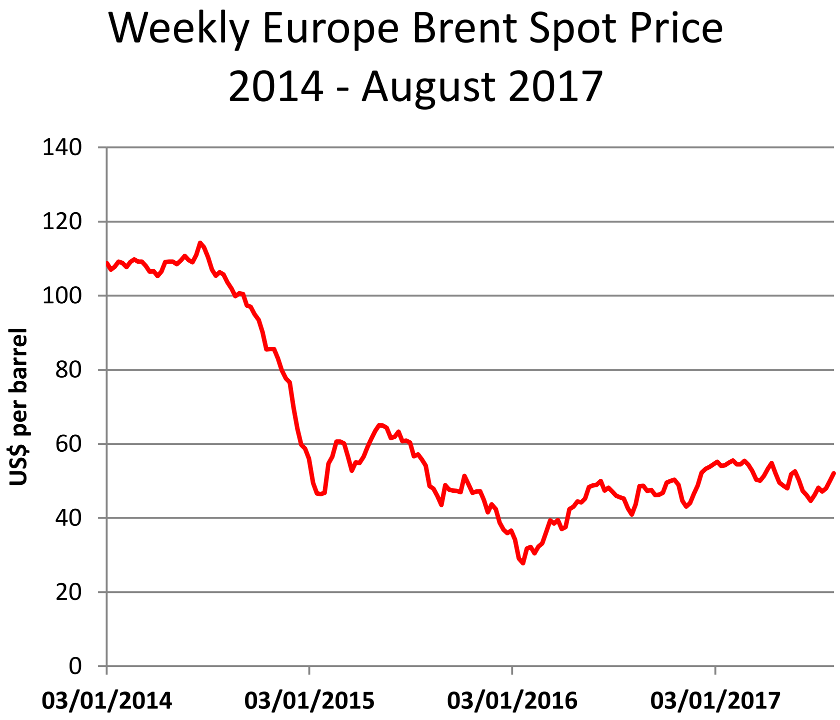
Current oil market: Oversupplied – see stocks!

- **December 2016 cut of 1.8 mbd too small**
  - September 2016 OPEC's target for January 29.8 mb/d. July 32.87 mb/d. Needed another 3 mb/d.
- **Nigeria and Libya excluded**
  - Increased by 520,000 b/d since November
- **Compliance worsening**
  - Iraq in July 120,000 b/d over quota
  - Kazakhstan agreed 20,000 b/d cut in 2017 currently increased by 140,000 b/d
- **Increased price elasticity of supply**
  - US increased 758,000 b/d (including NGls) since November. Forecast for 2018 increase 1.025 mb/d



Current oil market: Results of oversupply

- Price stuck below $55
- Potential collapse as ‘market balancing’ further delayed
- Existing price ceiling?
- Current OPEC deal until March 2018 – But then? …. assuming it last that long!



Current oil market: What are the options?

- **Do nothing hoping demand will come to the rescue?**
  - Widely differing views on demand for 2017. For Q2 IEA: demand>supply 660,000 b/d OPEC: supply>demand 710,000 b/d.
  - For 2018 IEA = 99.37 mb/d OPEC = 97.65 mb/d – difference = 1.72 mb/d

- **Further cuts/extension to the agreement?**
  - History of such agreements not encouraging – the longer the life the poorer the compliance

- **Saudi Arabia resumes its swing role**
  - Simply unsustainable - remember 1980-85

- **Wait for a coming supply crunch**
  - Possible because of lower upstream investment for conventional oil but ignores cost reductions (IEA 2014-6 upstream costs fallen 35%, 45% shale)
  - AND assumes growing future demand .... COP 21 and a possible recession?

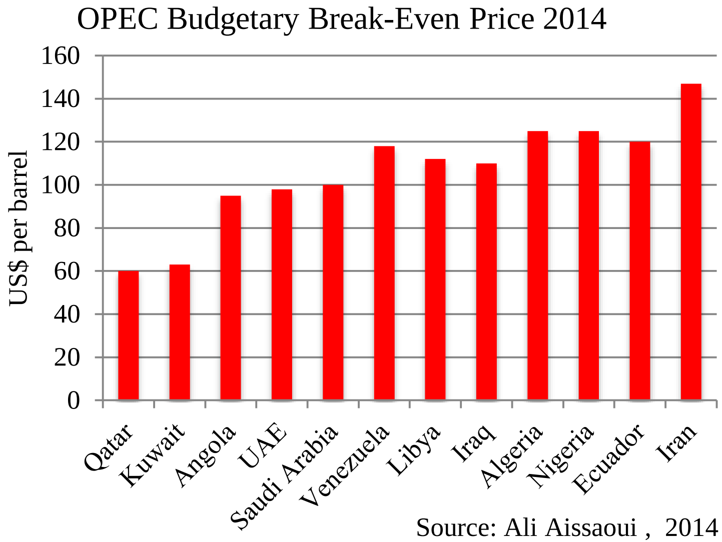
- **Or hope for a geo-political upset...**

Current oil market: Geo-political upsets?

- **Budget constraints causing internal conflict**
  - "There is a need for funds for the fiscal treasury". Carlos Perez, oil minister Ecuador as he reneged on the OPEC deal. Similar problems in Venezuela, Nigeria, Libya, Algeria etc. etc.

- **Problems in Saudi Arabia**
  - Economic pressures: reforms failing to deliver
  - Internal dissent from ISIS and unrest in the Eastern Province

- **"Trumpian uncertainty" and MENA**
  - MENA instability now similar to 1918: end of WWI and collapse of the Ottoman Empire.
  - **Two Trumpian issues:**
    - Iran
    - Jerusalem



Source: Ali Aissaoui , 2014

Trumpian impact in MENA
US policies and Iran

- Iran capable of creating **serious regional instability**
  - Some argue it is already doing so

- **Why would it?**: sanctions are off because of the JCPOA

- **BUT**
  - De facto many sanctions remain – Financial and against the IRGC – means serious barriers to increasing production.
  - Trump's threats to rip up the JCPOA – calmed by the "grown-ups" but still making very aggressive noises
  - **AND** Trump has created a new group to "assess" intelligence on Iran within the White House to bypass State/CIA/Pentagon. Remember G W Bush and 2002 ….

- Tempting for Iran to jump before they are pushed?

Trumpian impact in MENA
US policies to the Israeli-Palestinian problem?

- **Moving the US Embassy to Jerusalem**, possibly the most dangerous of Trump's election promises?

- **If carried out**, likely to lead to massive popular protests throughout MENA creating further regional instability
  - Threatens US supported regimes
  - Generate massive anti-US feelings and anti-US action
  - How would President Trump respond when the results of anti-US action begin to appear on Fox News?

Conclusions

- Oil prices likely to stay lower for longer than many expect although large uncertainties loom
- Geo-politics might increase the oil price and hence save the IOCs
- BUT if that happens, it would only be a temporary solution as another "oil shock" would prompt consumer governments to move away from oil

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