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Geopolitics and the New Oil Environment

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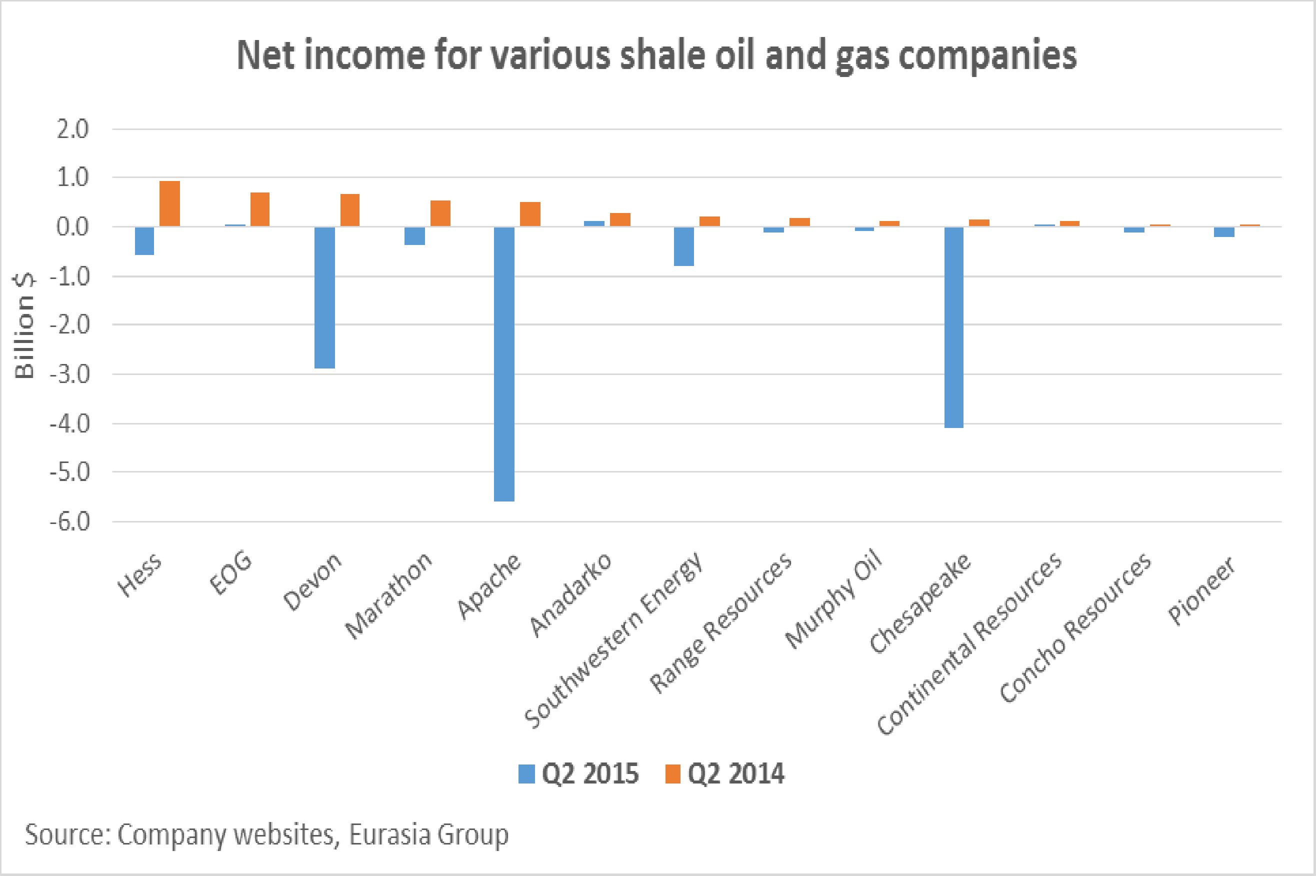
The “new normal:” Is $50/barrel here to stay?

- **Above $50/barrel**: non-OPEC production becomes profitable again, US rig count rises
- Saudis would probably be more aggressive in defending market share strategy

- **Below $50/barrel**, non-OPEC production continues to decline
- Project cancellations accelerates: global upstream is expected to decline by 20% yoy in 2015, and by another 3-8% in 2016

Capex and new projects fall victim to price collapse

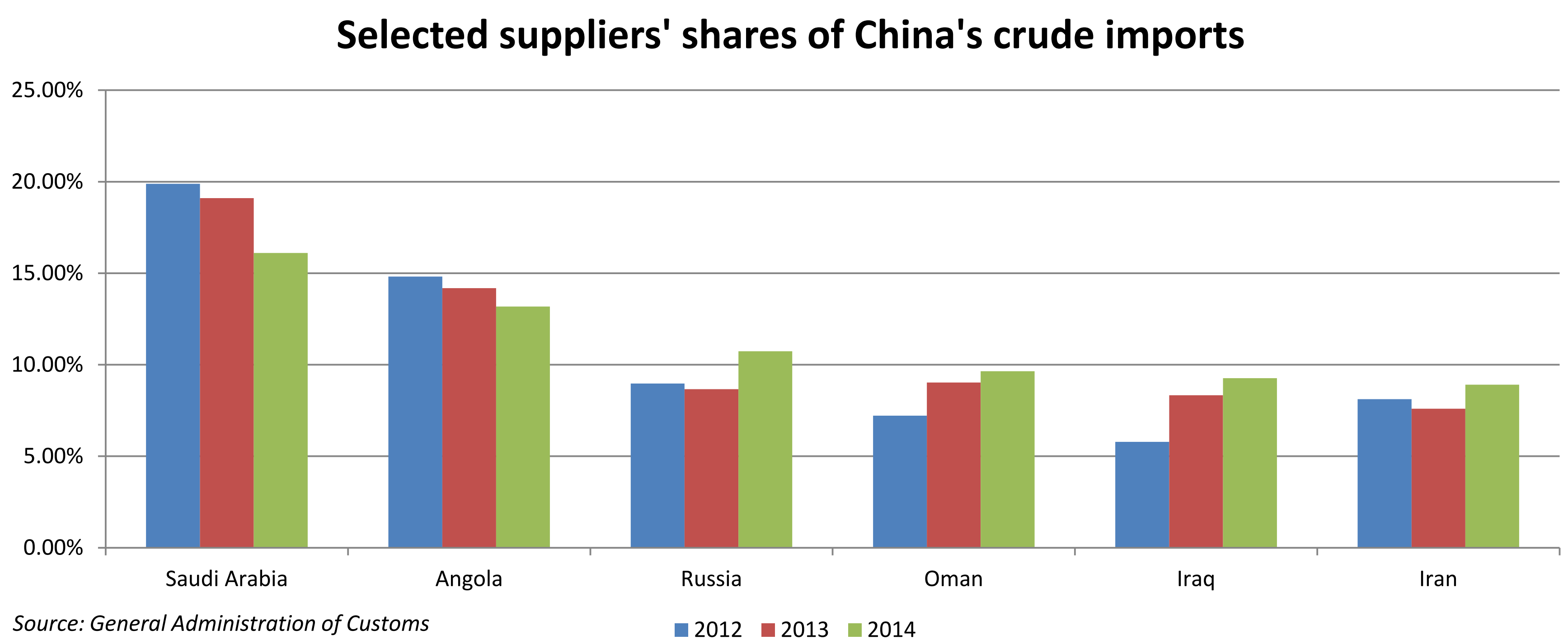
- Over $200bn of global new project spending has been delayed, postponed or cancelled
- Canada's oil sands taking largest hit: 40% decline in capital spending in oil & gas industry in 2015



- Shale producers reported losses of about $15 billion in Q2 2015 compared to profits of nearly $5 billion in Q2 2014
- US energy companies default rate has accelerate to 4.8%--highest level since 1999 and up from 3.3% in August

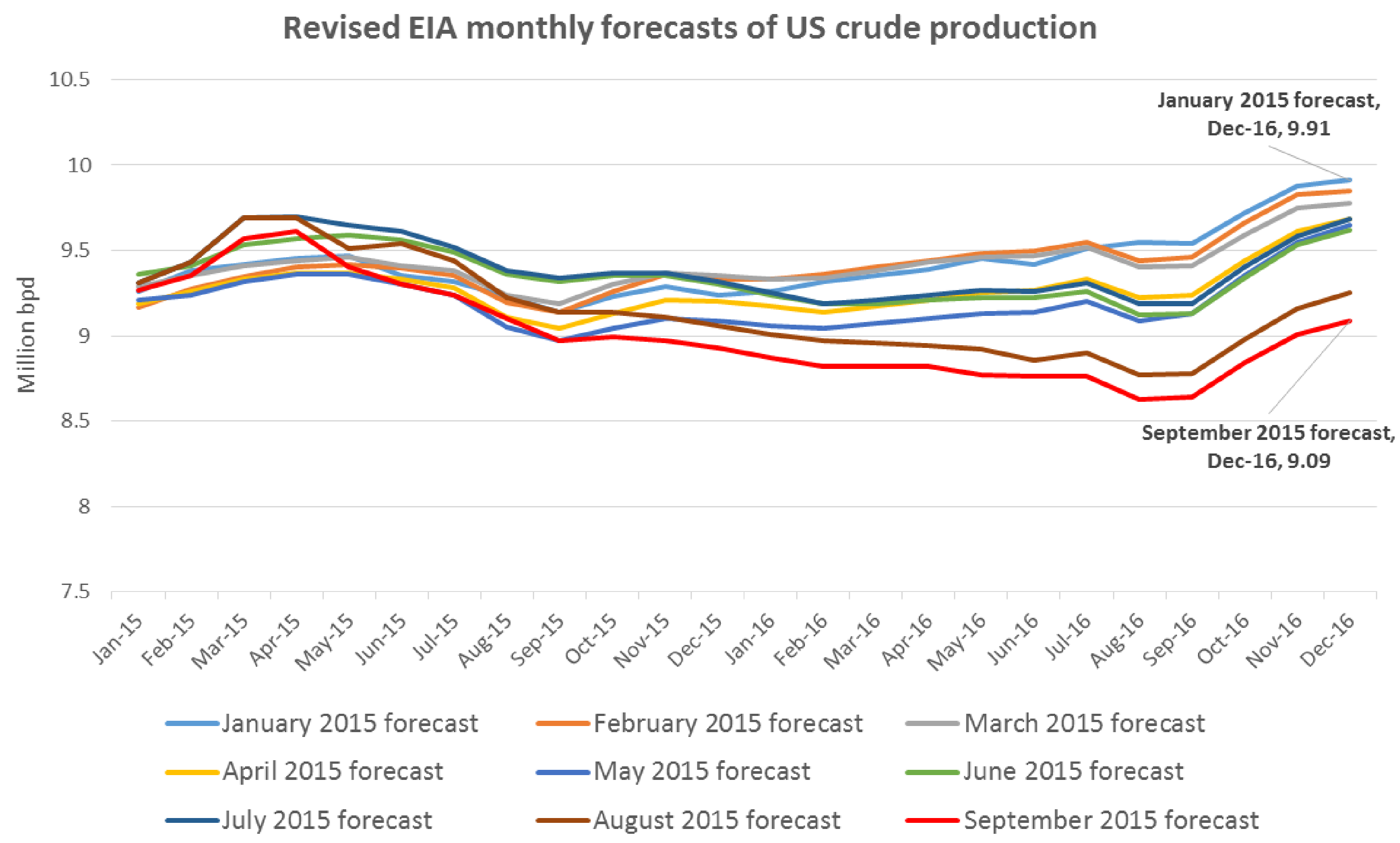
Saudi Arabia: strategy remains to protect market share

- No Saudi or core-OPEC group production restraint in 2015, belief is market will rebalance in 2016
- For Saudis, most rational path forward is to maintain production levels despite economic pressures



Source: General Administration of Customs

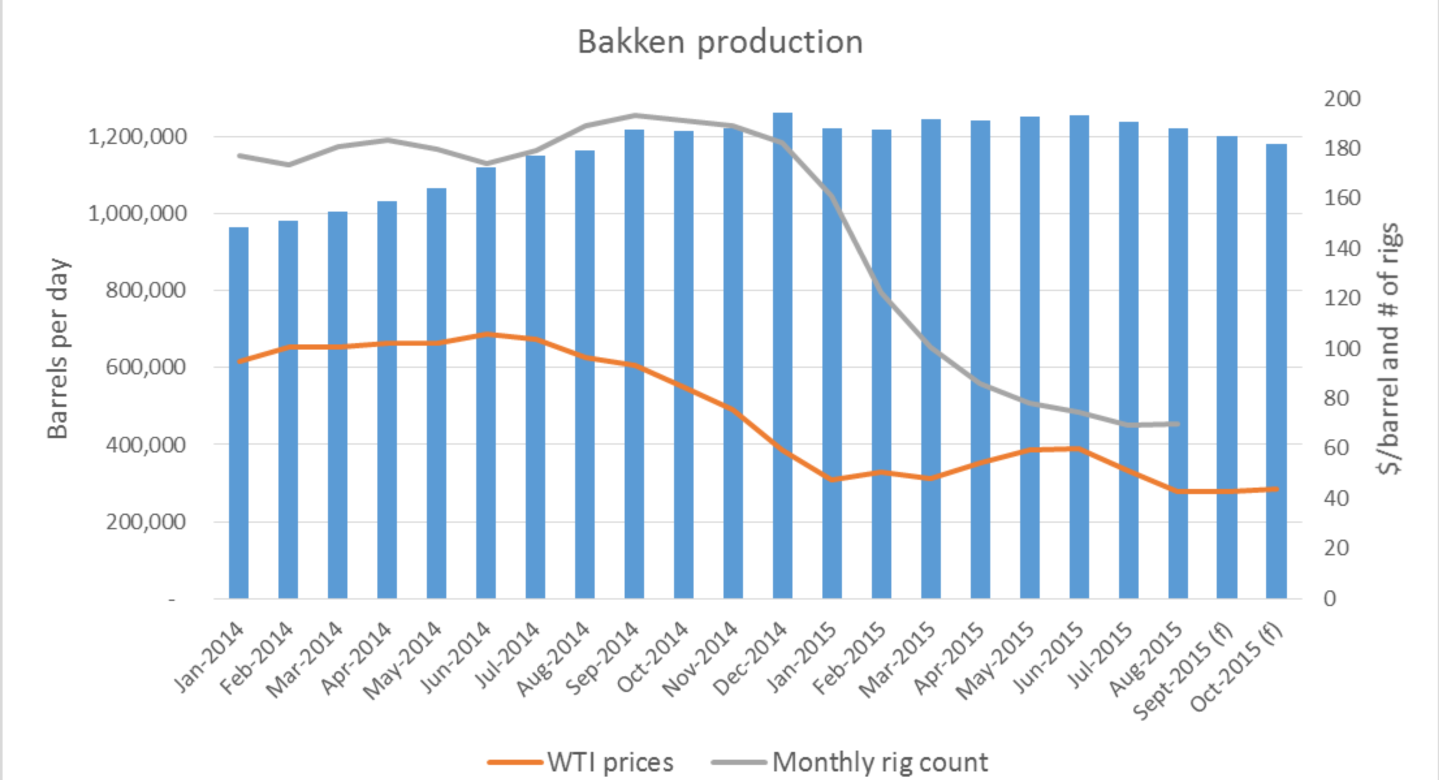
US supply remains "sticky": Declines in US production significant, but not enough to balance market in 2016



Source: EIA, STEO Jan-September 2015

US: not a marginal producer

- Low prices has spurred advances in technology, allowing producers to stay resilient (re-fracking wells, increased well productivity, advanced software)
- Other significant factors
  - Highgrading
  - "Fracklog" (backlog of uncompleted wells)
  - Service companies cutting costs

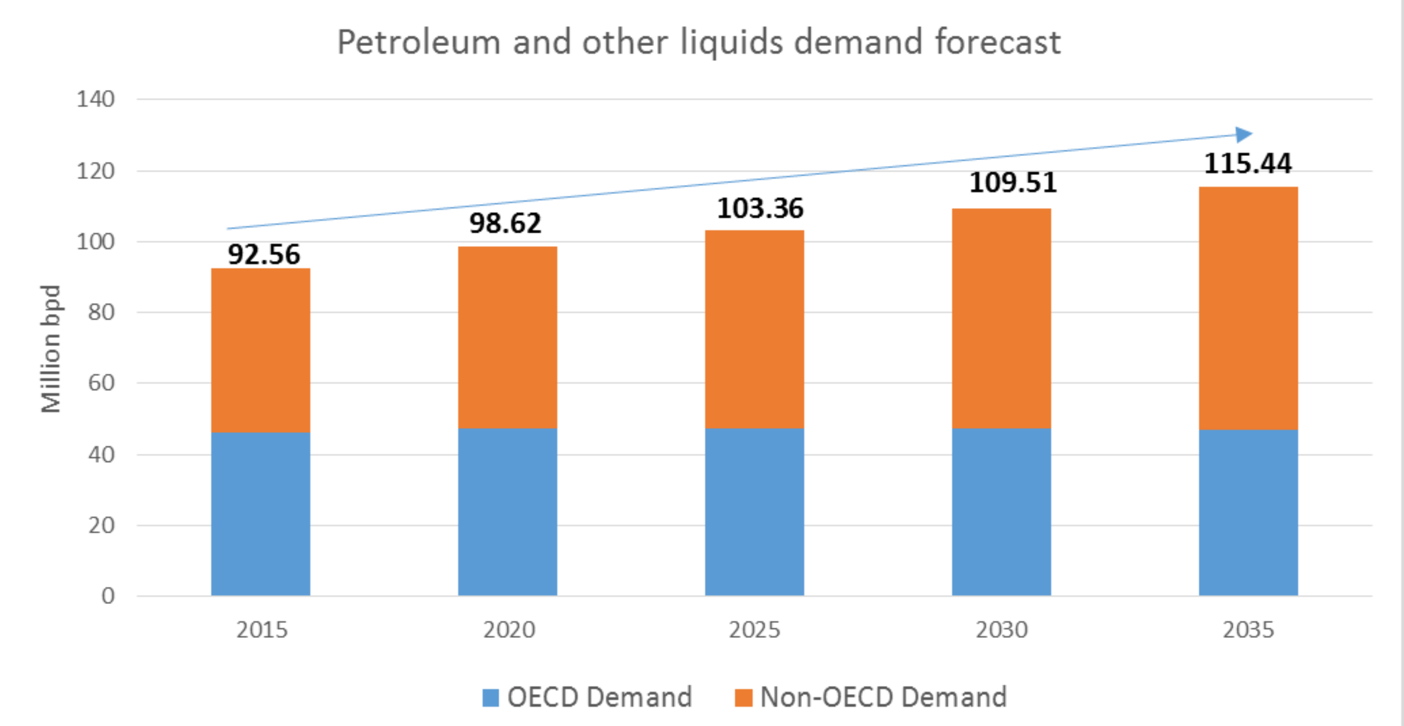


Source: EIA

Demand-led recovery more likely than collapse of supply

- Non-OPEC non-shale decline to underpin market rebalancing

- US and ‘income effect’: demand responding to low domestic gasoline prices
  - Gasoline consumption averaged 9.5 million bpd in August-the highest seasonal level since 2007
  - But this is not reversing long-term structural decline trend from efficiency measures



Source: EIA (AEO 2015, High resource case)

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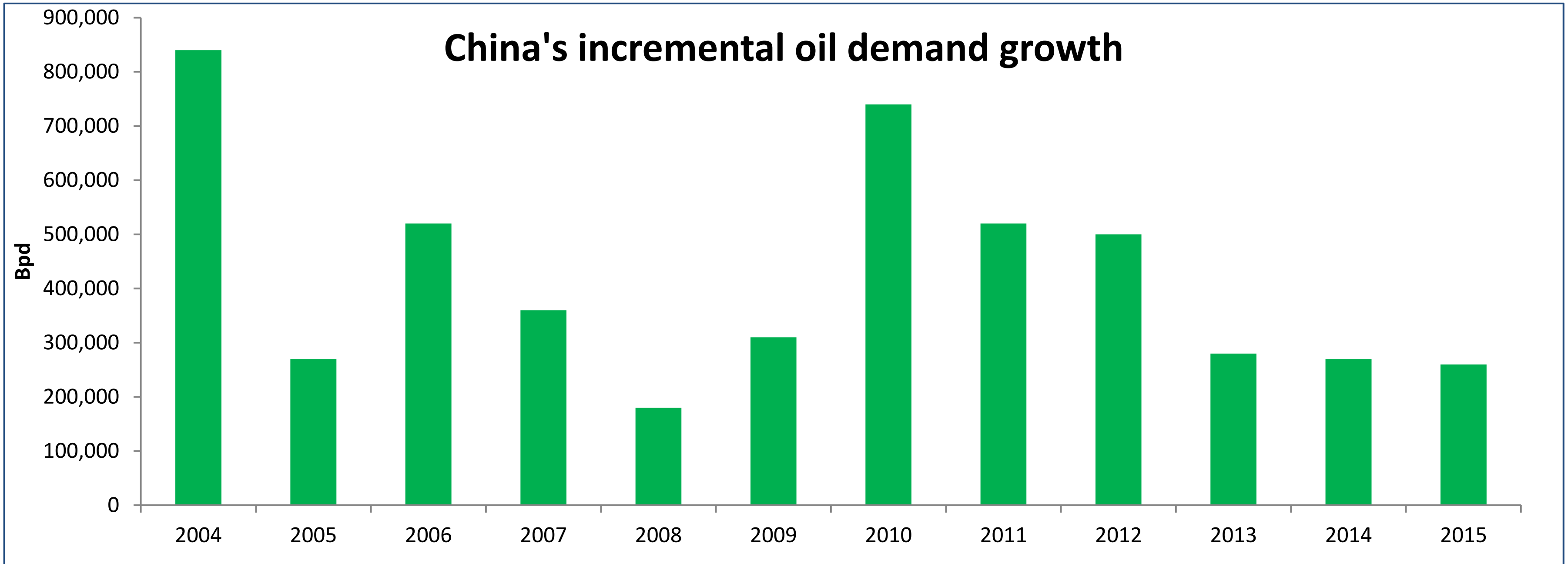
China: oil demand growing at a slower pace

- Slowing economic growth and resulting slowing appetite for commodities to continue
  - Slower demand means slower import growth and increased competition for market share in China
- State-set prices for diesel and gasoline will continue to limit impact of low oil prices on stimulating demand



Source: International Energy Agency

Rebalancing the market will take time

- Factors that would lead to market rebalancing:

Decreasing US and Non-OPEC production

Continued project cancellations

OPEC supply growth ending (not adding new capacity + decline rates of older fields)

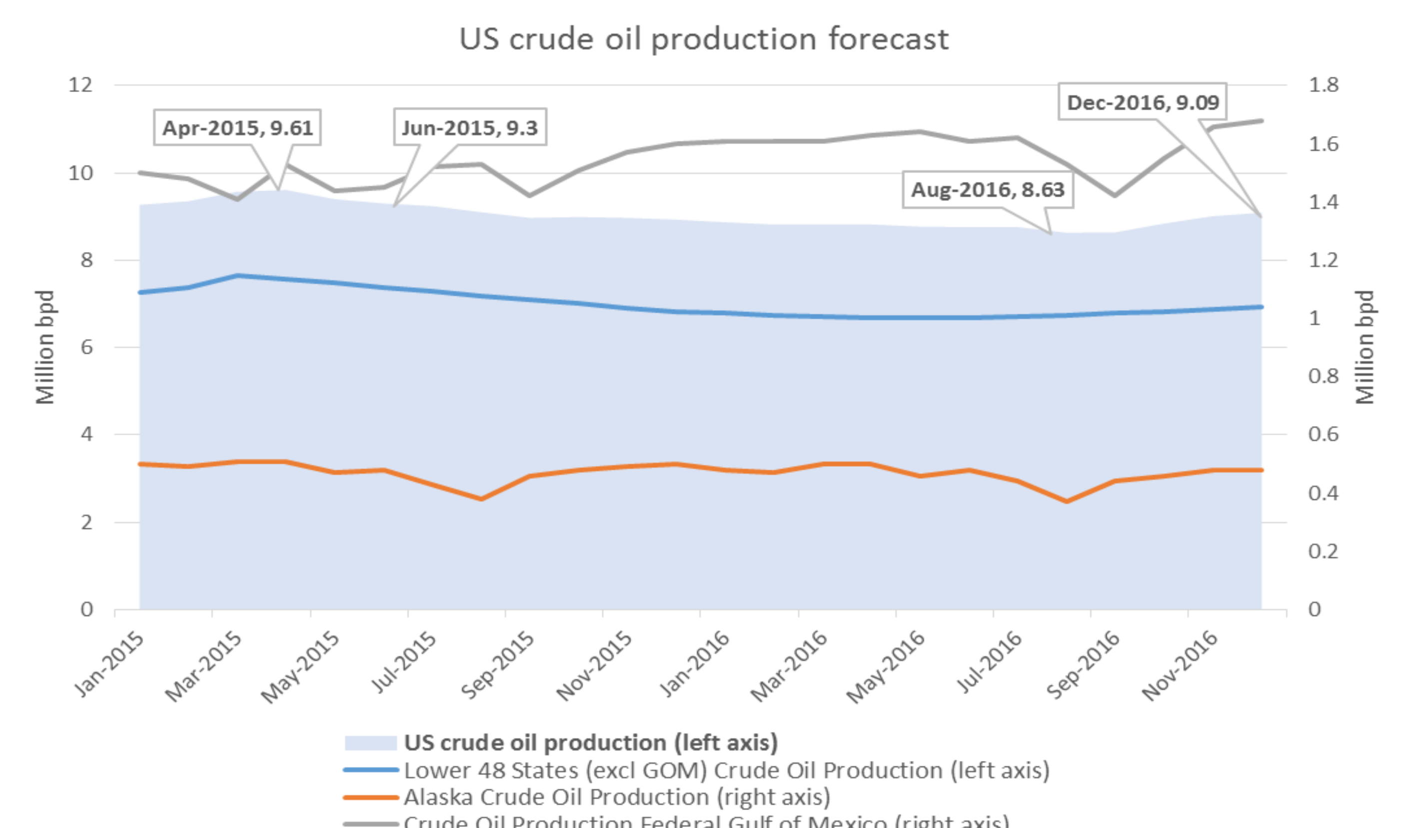
- Iraq/Saudi ends in 2015
- Iran ends in 2016

Global oil demand growth

US gasoline demand growth

2016: Where are oil prices heading?

- Likely to see average $50/barrel in 2016
- Non-OPEC supply is dropping, but OPEC is growing
- Geopolitical context remains structurally bearish
- Unlikely to see rebalancing (driven by incremental demand growth) until Q3 2017 at earliest



Source: EIA

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Thank you

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