

Seismic reflections

Oil market dynamics turn bearish

Five years or so ago, the peak oil theory was very much in vogue. Peak oil combined with surging demand in the developing world was supposed to lead to tight oil markets and a consequent upward spiral in prices. A rather different scenario is emerging, involving a much slacker near- to medium-term supply/demand balance and arguably a less bullish outlook for prices than consensus opinion expects. The key game changers are the deep malaise in the world economy, the shale oil revolution, advances in automotive technology and declining vehicle use in the OECD.

The malaise in the world economy

The most obvious reason for taking a more bearish view of oil markets is the deep malaise in the world economy reflecting de-leveraging, tightening financial sector regulation and widespread surplus capacity. For the foreseeable future, gone are the halcyon days when the world economy could grow by 4% pa plus. Assuming GDP growth of 3.0-3.5%, increases in oil demand will be limited to less than 1% and quite possibly more like 0.5%, bearing in mind structural factors such as improving vehicle fuel economy and tightening regulation in the use of vehicles. This would translate into demand gains in absolute terms of 0.5-0.9mmb/d, which we believe can be comfortably covered by non-OPEC sources and OPEC natural gas liquids. Planned increases in OPEC capacity driven by Iraq compound the issue of plentiful supplies.

The shale oil revolution

The shale revolution is now receiving belated recognition outside US oil industry circles as providing a highly significant new source of oil. OPEC, for example, has recently acknowledged its potential impact. Until now shale development has been very much a North American phenomenon. Shale oil production here is running at about 1.7mmb/d with perhaps 1.5mmb/d in the US and the rest in Canada. The vast bulk of this production has come on-stream within the past five years. US oil industry thinking is now that shale-oil development will boost US production by 2mmb/d between 2011 and mid-decade. We believe it is possible that North America will be self sufficient in petroleum by the early 2020s, bearing in mind falling consumption and the massive Alberta oil sands development projects. The key question now is to what extent the shale oil revolution can be replicated outside North America. From a geological perspective we would be optimistic on this front. Near term, shale oil development potential is particularly interesting in Argentina given the Neuquen Basin's outstanding geological prospectivity.

Vehicle fuel economy

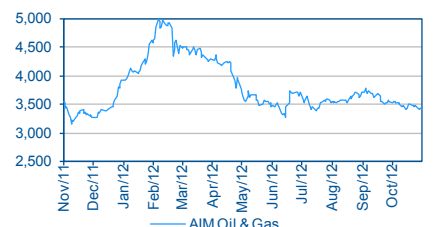
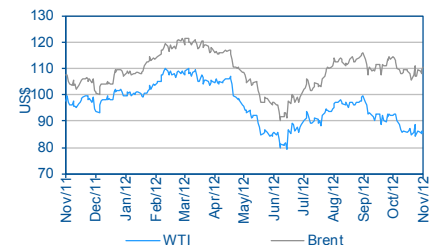
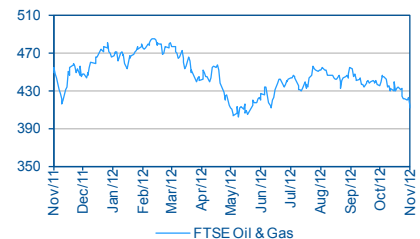
Light vehicle fuel economy is in the throes of radically improving in both North America and Europe driven by tightening regulation and technological advances in automotive technology. In the US the latest regulations call for fuel economy to be boosted by 42%



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between 2012 and 2016 and by a further 54% in the subsequent period to 2025. Europe is looking for similar gains.

Exhibit 1: Best and worst performers

		1 week			
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	202.1%	1	TETHYS PETROLEUM LTD	-19.4%
2	EGDON RESOURCES PLC	30.4%	2	HARDY OIL & GAS PLC	-14.3%
3	LENI GAS & OIL PLC	11.7%	3	ENEGI OIL PLC	-12.2%
4	MEDITERRANEAN OIL & GAS PLC	10.3%	4	ANTRIM ENERGY INC	-11.8%
5	INDUS GAS LTD	7.1%	5	BORDERS & SOUTHERN PETROLEUM	-10.8%

		1 month			
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	237.2%	1	FRONTERA RESOURCES CORP	-30.6%
2	LENI GAS & OIL PLC	230.9%	2	BANKERS PETROLEUM LTD	-24.7%
3	ASCENT RESOURCES PLC	34.6%	3	ENDEAVOUR INTERNATIONAL CORP	-24.1%
4	FORUM ENERGY PLC	32.9%	4	HARDY OIL & GAS PLC	-19.4%
5	EGDON RESOURCES PLC	23.7%	5	RANGE RESOURCES LTD	-18.6%

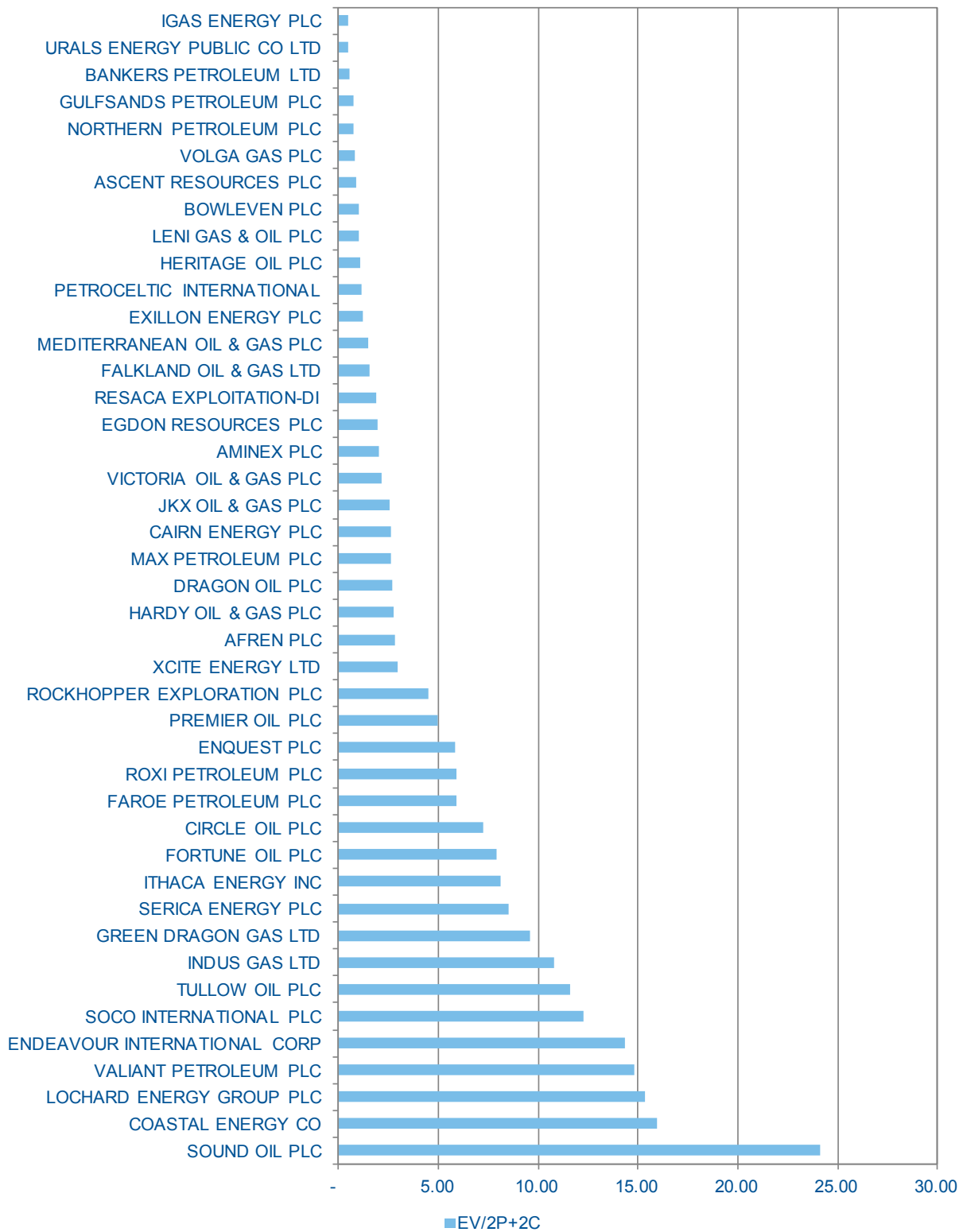
		3 months			
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	271.8%	1	CHARIOT OIL & GAS LTD	-76.6%
2	NIGHTHAWK ENERGY PLC	110.7%	2	RESACA EXPLOITATION-DI	-64.9%
3	SOUND OIL PLC	95.7%	3	GASOL PLC	-50.5%
4	LENI GAS & OIL PLC	95.6%	4	BAHAMAS PETROLEUM CO PLC	-45.6%
5	EUROPA OIL & GAS HOLDINGS	66.0%	5	FALKLAND OIL & GAS LTD	-35.8%

		6 months			
No.	Best performers	% change	No.	Worst performers	% change
1	PETREL RESOURCES PLC	237.2%	1	INDEPENDENT RESOURCES PLC	-73.6%
2	MEDITERRANEAN OIL & GAS PLC	118.2%	2	BORDERS & SOUTHERN PETROLEUM	-72.7%
3	AMERISUR RESOURCES PLC	104.5%	3	RESACA EXPLOITATION-DI	-65.8%
4	LENI GAS & OIL PLC	55.8%	4	CHARIOT OIL & GAS LTD	-65.4%
5	HERITAGE OIL PLC	52.1%	5	MAX PETROLEUM PLC	-63.5%

		1 year			
No.	Best performers	% change	No.	Worst performers	% change
1	AMERISUR RESOURCES PLC	256.9%	1	PETRONEFT RESOURCES PLC	-79.3%
2	PETREL RESOURCES PLC	163.6%	2	CHARIOT OIL & GAS LTD	-78.8%
3	NIGHTHAWK ENERGY PLC	102.5%	3	RESACA EXPLOITATION-DI	-76.4%
4	MEDITERRANEAN OIL & GAS PLC	81.1%	4	INDEPENDENT RESOURCES PLC	-73.6%
5	KEA PETROLEUM PLC	81.1%	5	MAX PETROLEUM PLC	-68.3%

Source: Bloomberg

Exhibit 2: EV/2P + 2C rankings



Source: Bloomberg, company releases, Edison Investment Research

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