FAR Limited

June 2018

The Oil Patch

Barry FitzGerald

Long-dated impact on demand from EVs:

The electric vehicle revolution is the most disruptive event in the global car industry since Henry Ford's Model T hit the roads in the early 1900s.

Quite rightly, the media is infatuated with the story, but claims it means the death of oil is a gross exaggeration.

Sales of EVs currently account for only 1.1% of annual global sales (1.14m EVs were sold in 2017). And according to the International Energy Agency's latest "Global EV Outlook 2018,'' EV's currently number 3m out of a global car and truck fleet approaching 1.5bn.

The IEA is forecasting EV fleet numbers to grow to 125m units by 2030, or 220m if the world gets aggressive on promoting EV uptake, as is the case in Norway where EV's now have a 40% market share.

As a rough rule of thumb, 100m EVs displace 1.8 million barrels of oil a day. So, take the IEA's 125m EV units estimate by 2030, and the oil displacement becomes 2.25m b/d. If oil demand was not growing, that would be a problem.

But it is. The IEA forecasts growth from 99.3m b/d in 2018 to 105 m b/d by 2040 with demand from the petrochemical, aviation and shipping sectors picking up the slack from the rise of EVs.

Having said that, EVs undoubtedly represent an emerging demand challenge for oil, with the IEA demand forecast of 105m b/d by 2040 implying growth well below the historical annual growth trend of 1m b/d.

However, it is worth remembering that supplying circa 100m b/d day in, day out, requires a massive exploration and development commitment to replace existing oilfields which on average, decline by 3% and 4% annually.

OPEC's "gradual" increase checks prices:

The recovery in oil prices has been checked by moves by Saudi Arabia and Russia to push OPEC to increase output after 18 months of supply curbs.

The push will come at a meeting of energy ministers from OPEC countries in Vienna on June 22-23, with a "gradual'' increase in supply expected.

The escalating trade war between the US and China has not helped oil's cause, with China considering retaliatory tariffs on its annual US oil import bill of $US8 billion.

The combination of OPEC supply increases and the US-China trade battle was enough to pull oil prices back sharply by mid-June.

The global benchmark Brent had fallen from $US79.28/bbl a month earlier to $US73.44/bbl, and WTI was down from $US71.55/bbl to $US65.06/bbl.

Despite the price retracement, Brent remains up strongly from its price in July last year of $46.53/bbl while WTI is up from $US42.70/bbl.

The International Energy Agency said in its June oil market report that it suspects that Middle East OPEC countries could increase production in fairly short order by about 1.1m b/d, and there could be more output from Russia on top of the increase already built into its 2019 non-OPEC supply numbers.

"However, even if the Iran/Venezuela supply gap (possibly as much as 1.5m b/d by the end of next year) is plugged, the market will be finely balanced next year, and vulnerable to prices rising higher in the event of further disruption,'' the IEA said.

Under investment to feed long-term recovery:

Despite the volatility in oil prices, Morgan Stanley has argued that the Australian energy sector is in the early stages of a long-term recovery.

It was more than wishful thinking too, with the investment bank saying energy cycles typically play out in years, not months.

"Although oil prices and energy equities have done well recently, it is less than 12 months since the cyclical lows of mid-2017."

"Previous cycles have gone on for much longer and importantly industry fundamentals are improving.''

"To be clear, oil prices will likely retain volatility, but arguably much of the significant downside risk has reduced while upside risk remains given underinvestment across the industry since 2014 combined with strong demand,'' Morgan Stanley said.

Exploration gets smarter:

Global expenditure on conventional exploration and appraisal wells in 2018 is likely to remain 60% below the 2014 peak at $US37 billion, according to leading industry consultant Wood Mackenzie.

But there is good news in the bad, with WoodMac saying exploration is actually performing better now than when oil prices were more than $US100/bbl.

Vice president of global exploration for WoodMac, Andrew Latham, said that for the first time in a decade, the industry actually created rather than destroyed value in 2017.

Even so, the newly efficient exploration industry that emerged from oil's price shakedown, is finding less oil and gas.

WoodMac forecast that annual new field resources are likely to be around 15 billion barrels of oil equivalent in 2018 compared with the 20-30 billion boe long run average.

Dr Latham said that as was the case throughout the downturn, the best discoveries will come from newly-proven plays and frontiers, with more than half of all volumes again being found in deepwater.

"With with budgets likely to remain tight, prospects with less than a one in ten chance of success are unlikely to be drilled. We'll be watching many wells around the world with potential to open new plays or add large volumes,'' he said.

His "wells to watch'' list did not include any Australian wells. But upcoming well by ASX-listed FAR (Gambia) made the list.

For more information please contact:

FAR Limited
Level 17, 530 Collins Street
Melbourne VIC 3000 Australia

T: +61 3 9618 2550
F: +61 3 9620 5200
E: info@far.com.au

far.com.au