OIL PRICE WAR, A NEW AGE, & AN UNCERTAIN FUTURE

Vital Strategies
Management Consulting
Helping Businesses and their Leaders Succeed
August, 1990: Marine Fighter Attack Squadron 314 deploys for Operations Desert Shield and Desert Storm...
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Approximately 50% of the world’s proven oil supplies
Oil is the life blood of the global economy and therefore has the greatest strategic value of any resource on the planet...
Oil, Geostrategy, & Globalization

- Oil & the U.S. as Guarantor of Free Trade and Free Sea Lanes

- Bretton Woods: U.S. Commitments & Dominance
  - July 1944; Global monetary policy that encouraged and eventually guaranteed open markets in order to rebuild after WW II, and to build a world alliance against the Soviet Union
Oil Price War

- Up to a 73% drop in oil prices since July 2014
- Estimated $1.5+ trillion world-wide investment loss
- Large number of layoffs—500,000+ lost oilfield jobs
- Oilfield service company stocks down as much as 98%
- Oilfield service companies are seeing as much as a 40% rate reduction
- Distressed companies, debt issues, etc.
- Economic fallout for oilfield states – 17% of Texas Economy
- **2016 stock market volatility and weakness are a direct result**
- National average gasoline price has dropped from $3.67 in July 2014 to $2.04 on 26 Mar 2016; (a 44% reduction)
  - $20 billion+ saved by consumers
  - $180+ billion saved for U.S.
    - Approx. 0.2-0.5% GDP change for 2015
- Low energy prices have spurred growth in many industries
  - They have also somewhat mitigated economic slowdown for China, Europe, and other areas, thereby bolstering global economy
- We are at the cusp of significant M&A activity, increased investment in conventional production, and a possible consolidation of the industry
This Time It’s Different:  
*The U.S. Shale Oil Revolution*

- Over the past few years, U.S. shale oil technological advances have given a genuine outlook for U.S. energy independence and *caused a crippling drop in market share for OPEC (read Saudi Arabia)*
  - The U.S. is now the biggest total oil producer!
  - Of note, Saudi Arabia and the other Gulf States OPEC members have no known shale oil
U.S. Shale Oil: *This Changes Everything*

- The U.S. is uniquely positioned for shale oil development
  - Requires huge amounts of readily available capital ($6 to 12 million a well)
  - Highly skilled labor and continuously developing technology
  - A legal structure that rewards the land owners where drilling will take place
  - Pre-existing natural gas collection and distribution infrastructure (all shale oil wells also produce natural gas), and established industrial, transportation, and logistics infrastructure

✓ *Only the U.S. currently meets all of these criteria, and it is highly unlikely that shale will be effectively exploited anywhere else for a very long time*
OPEC, Market Share, & The Saudi Abdication From Price Setting

- During the June 2014 summit in Vienna, OPEC decided to continue production levels without adjustment
- During the follow-on 6 November 2014 OPEC meeting, Saudi Arabia effectively resigned from the role of PRICe setter
- So, de facto, the U.S. and specifically U.S. shale oil production has become the swing producer; two problems:
  - The U.S. can’t refine all the light, sweet, WTI crude we can produce
  - Heretofore, legislation has prevented the export of oil
- There had been some signs that OPEC was ready to “flinch,” but...
- The 4 Dec 15 meeting proved otherwise...
- So, now what?
OPEC’s (& Russia’s) Dilemma

- The question is, how long will the OPEC members hold out with oil prices below the required break-even point for their current national budgets?

<table>
<thead>
<tr>
<th>OPEC Member</th>
<th>National Budget Break Even Price</th>
<th>OPEC Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>$111</td>
<td>3.6%</td>
</tr>
<tr>
<td>Angola</td>
<td>$98</td>
<td>5.3%</td>
</tr>
<tr>
<td>Equator</td>
<td>$117</td>
<td>1.7%</td>
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<tr>
<td>Iran</td>
<td>$93</td>
<td>8.8%</td>
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<tr>
<td>Iraq</td>
<td>$71</td>
<td>12.0%</td>
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<tr>
<td>Kuwait</td>
<td>$47</td>
<td>9.0%</td>
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<tr>
<td>Libya</td>
<td>$215</td>
<td>9.0%</td>
</tr>
<tr>
<td>Nigeria</td>
<td>$119</td>
<td>6.3%</td>
</tr>
<tr>
<td>Qatar</td>
<td>$59</td>
<td>2.2%</td>
</tr>
<tr>
<td><strong>Saudi Arabia</strong></td>
<td><strong>$103</strong></td>
<td><strong>33.0%</strong></td>
</tr>
<tr>
<td>UAE</td>
<td>$73</td>
<td>9.2%</td>
</tr>
<tr>
<td>Venezuela</td>
<td>$121</td>
<td>7.9%</td>
</tr>
</tbody>
</table>

**Russia** $108

Source: Energy News by –Oil& Gas 360, Article and Analysis by Bloomberg. (June 5, 2015)
Possible Outcomes

• Natural progression of supply & demand
  ✓ Demand postulated to increase by 1 to 1.5 million barrels/day in 2016
  ✓ U.S. production to decrease by as much as 1 million barrels/day

• Russia and OPEC decide to reduce production
  ✓ Back to controlled pricing
  ✓ Until U.S. shale production increases

• Middle East tensions develop to a conflict
  ✓ All bets are off!

• **IN ALL CASES, U.S. PRODUCTION IN CONJUNCTION WITH CANADA AND MEXICO IS THE ONLY CAPABILITY TO SIGNIFICANTLY INCREASE GLOBAL PRODUCTION**
Possible Outcomes

• We are at the cusp of significant M&A activity and a probable consolidation of the industry
  ✓ Seeing an increase in investments in shallow production
  ✓ And, private equity is looking for deals in almost every sector of the industry

• The Spoilers—DEMAND MAY NOT INCREASE DUE TO:
  ✓ CHINA’S DECAYING ECONOMY
  ✓ TROUBLES IN EUROPE
  ✓ MARKET VOLATILITY
  ✓ DEMOGRAPHIC CHANGES
  ✓ OUR OWN DOMESTIC CHALLENGES
U.S. Policy: The Law of Unintended Consequences

- pulled out of Iraq and left it for Iran to take control
- reduced U.S. military forces, only to have the Taliban and now even ISIS taking control
- virtually abandoned Saudi Arabia by dealing with Iran
- left Assad in place while half-heartedly supporting rebels, making room for ISIS, and now allowing Russian interference
- caused the overthrow of Gaddafi, only to create another failed state; leaving it open for ISIS to enter

If you have not seen the film “13 HOURS,” YOU NEED TO

- the Nuclear deal, $150 billion...
- spreading and emboldened
SHALE OIL: A New Global Strategic Landscape

- A landscape that includes North American Energy Independence

- A Word On Demographics
Demographics: It’s a Numbers Issue

- **Good Demographics**
  + Mexico
  + India
  + Vietnam
  + Egypt
  + Jordan
  + Iraq
  + Turkey

- **Poor Demographics**
  - Japan
  - China
  - Russia
  - All of East Europe
  - All of West Europe (with the exception of some Nordic countries)

- Emerging Good
  - USA
The World in 2032: This also changes everything
Implications of Demographics

• Retiring U.S. Baby Boomers (born between 1949 and 1964) will start to reduce available capital within the next 5 years

• Baby Boomer business owner M&A requirement is about $10 trillion; current available funds equate to $535 billion (private equity overhang)
  ✓ A sense of urgency, and proper planning and preparation is the key for the baby boomer business owner—the window of opportunity is the next 3 to 5 years
A NEW AGE & AN UNCERTAIN FUTURE:
A New Global Strategic Landscape

- In uncertainty one can find both opportunities and challenges
MAJOR TAKEAWAYS

1. The U.S. shale oil revolution changes the entire global strategic picture and signals decades of potential North American energy independence.

2. The international environment has rarely been this unstable.

3. Global demographic changes need to be considered and will be a driver in global politics, security strategy, and economics for many decades.

4. We are in a great position relative to the rest of the world in terms of resources, demographics, economics, and our ability to exploit opportunities.

The world is entering into a new age – one of great challenges and great opportunities.

✓ IS YOUR BUSINESS READY TO EXPLOIT THE OPPORTUNITIES AND MITIGATE THE RISKS?
Comments & Questions

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A great plan builds the courage to execute

The struggle between overconfidence and timidity is timeless. A strong plan, well communicated and understood by all, can eliminate hesitation and build a bias to action in your teams.

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