The bin-Salman Interview – What Does It Mean?

Does the MBS statements suggest that an output freeze will not take place or were the statements meant for a domestic audience?

Is it important enough to reduce our short term price target?

Torbjørn Kjus – April 6 - 2016

Content

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The bin-Salman Interview – What Does It Mean?

- Does the MBS statement suggest that an output freeze will not take place or were the statements meant for a domestic audience?

- In a long interview with Bloomberg in Riyadh one week ago the Saudi Arabian Deputy Crown Prince, Muhammad bin-Salman (MBS) cast doubt over the outcome of the April 17th meeting that is scheduled to take place in Doha. The meeting is meant to limit the downside in oil prices through a production freeze deal between OPEC and non-OPEC producers. According to a Reuters piece from last week, 12 countries have so far confirmed their participation in the meeting. These countries are: Algeria, Bahrain, Ecuador, Indonesia, Kuwait, Nigeria, Oman, Qatar, Russia, Saudi Arabia, Venezuela and the UAE. More official confirmations are on the way from countries which have already confirmed verbally that they will attend, according to Qatar's Energy minister.

- The announcement of this meeting has been very supportive for the oil price as it led to a large short covering by financial players, since a deal to freeze production should limit the potential downside in oil prices. Now with the statements by MBS in the Bloomberg interview last week, the outcome of this freeze deal is much more uncertain. In the interview MBS said that Saudi Arabia will only freeze output if Iran and other major producers do so. If all countries agree to freeze production, we're ready," MBS said . "If there is anyone that decides to raise their production, then we will not reject any opportunity that knocks on our door." This stands in contrast to prior statements from the Saudi Oil Ministry and from Russia which had suggested that a freeze deal could happen without any commitment from Iran. The market took this statement very negatively for the oil market because Iran has made no indications that they will join the freeze deal and even if they did, most analysts would probably doubt that production from Iran would be frozen anyway.

- If Saudi Arabia indeed see any chance that a freeze deal cannot be accomplished then it is relevant to ask the purpose of even arranging the meeting. If a meeting is held and Saudi does not accept a deal without Iran participating then we believe a deal will not happen and if a meeting is held without a successful deal, then the oil price may drop quite significantly on that kind of news. Would that be in Saudi Arabia's interest. Would MBS like to see a lower price again to inflict even more pain on the other global oil producers and hence set the stage for higher prices later? It seems odd that MBS is not coordinated with the oil ministry in this issue, but could his statement have been meant for domestic politics? And is it not very strange if MBS in the last minute should undermine the Russian effort to achieve this now famous freeze deal? Is this a negotiating trick to achieve something in return from the Russians vs Iran in Syria or other places?

- The problem with this statement from MBS is that he outranks everyone else in Saudi when it comes to economic policy as he heads the newly formed Economic Council. This implies that if he actually means what he is saying here, there will be no production freeze deal in Doha, because we are confident that Iran will not take part in any production freeze deal. Before this statement by MBS we were 90% certain that there would be a production freeze deal coming out of the Doha meeting, because why hold this meeting if a freeze is not already agreed? It would, as described above, send the oil price in tailspin if a meeting was arranged and ended up with no agreement. After the MBS statements we see the chances for a freeze deal meaningfully reduced, maybe down to 50%.

- If the meeting to hold the freeze deal in Doha is cancelled or if it is held without a successful outcome we would reduce our short term (3-month) price target for Brent which is currently 45 $/b. We would however not do anything with out 6-month target of 55 $/b and our 12-month target for 65 $/b. Our 24-month target (currently 70 $/b) on the other hand may be adjusted slightly higher due to the extra damage that may be inflicted to the supply side of a potential revisit to 25-35 dollar oil prices.

- On Monday this week the Russian Energy Minister Alexander Novak however stated that "Russia can conduct extra talks with Saudi Arabia on oil output freeze before the meeting in Doha on April 17th". Novak also stated that he is confident that an agreement will take place. This suggest that maybe the statements from MBS in the Bloomberg interview last week may have been meant for his domestic audience. Also the Kuwait OPEC governor Nawal Al-Fuzaia said on April 5 that there are indications that oil producing countries in both OPEC and non-OPEC are poised to agree on a production freeze to January levels. This statement seemed to give the market some restated confidence that there could still be a freeze deal in the Doha meeting on April 17th. But nonetheless the MBS interview last week has added a lot more uncertainty to the April 17th meeting than what the oil market would prefer.

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The Saudi Royal Family (Source Wikipedia)

Abdul Aziz (Ibn Saud)
- King: 1902-1953
- Founded Saudi Arabia in 1932
- 22 wives (4 at a time)
- 45 sons of which 6 have been kings

King Saud
- King: 1953-1964
- Forced out

King Faisal
- King: 1964-1975
- Killed

King Khalid
- King: 1975-1982
- Heart Attack

King Fahad
- King: 1982-2005
- Stroke

King Abdullah
- King: 2005-2015
- Regent since 1995
- Unifying and popular
- 6 sons

King Salman
- 80 years old
- Full brother of King Fahad
- 25th son of Ibn Saud
- Well regarded
- Trusted mediator
- Had a stroke in 2010
- Pro economic reforms
- , but slow for social reasons
- Has 11 sons

Crown Prince Sultan
- Died 23.10.2011

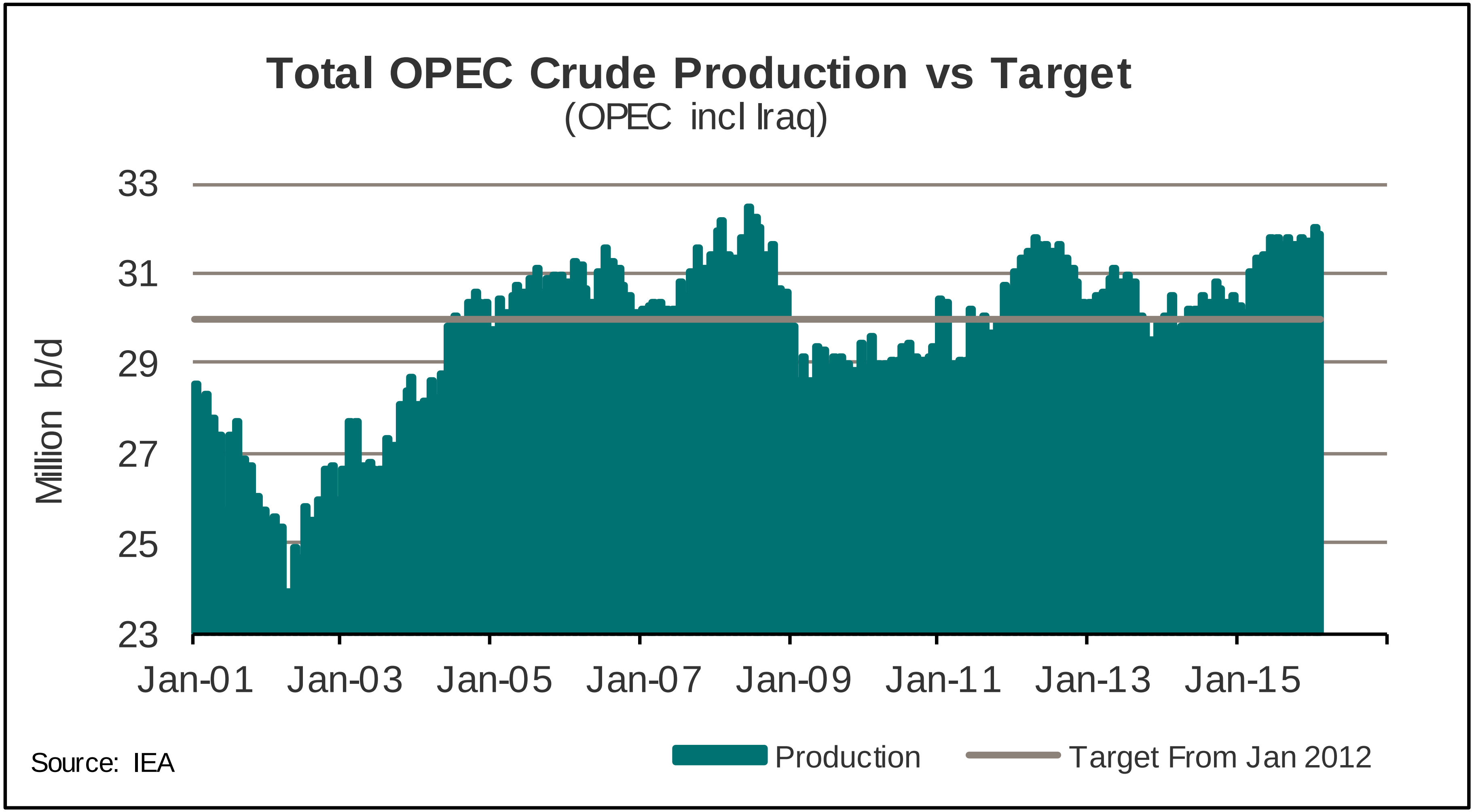
Crown Prince Nayef
- Ultra conservative
- 23rd son of Ibn Saud
- Full brother of King Fahad
- Died 16.06.2012

Former Crown Prince Muqrin
- Relieved from his position April 2015

New Crown Prince bin Nayef
- 55 years old, son of late Crown Prince Nayef
- Educated in the US - Political Science
- The most pro-American Saudi minister
- First successor from the third generation

New Deputy Crown Prince Mohammad bin Salman
- 30 years old
- Son of King Salman
- Defence minister from January 2015
- Head of Economic council - January 2015

OPEC - Production & Target



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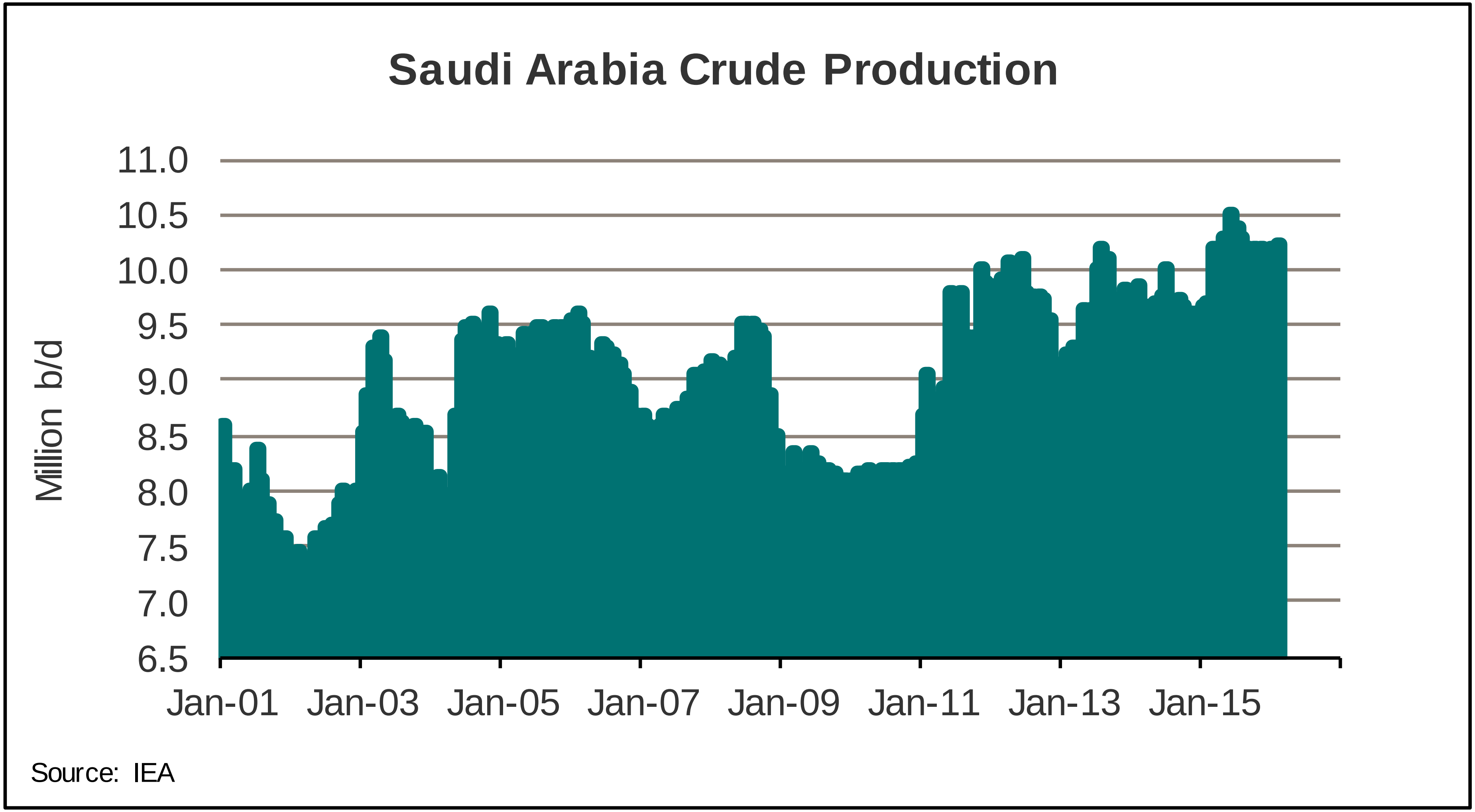
Saudi Arabia - Production



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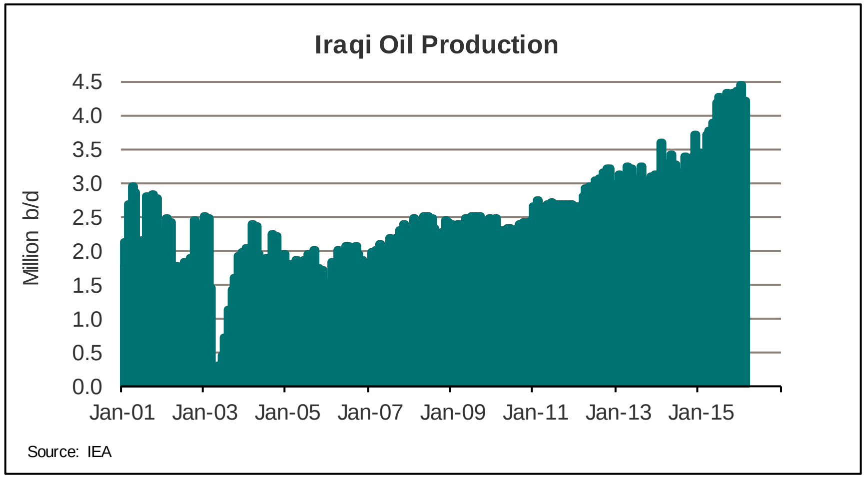
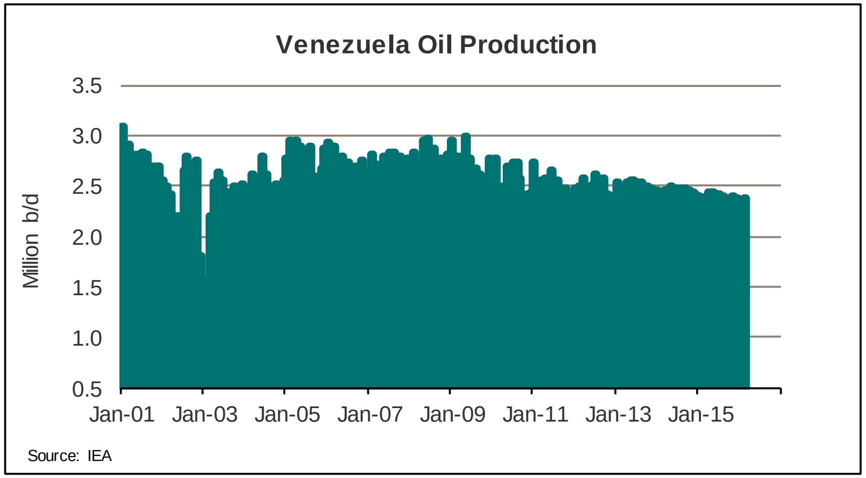
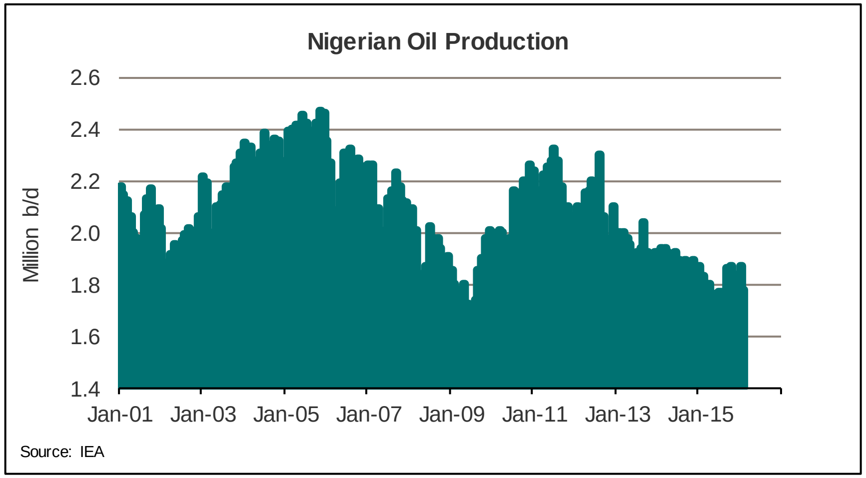
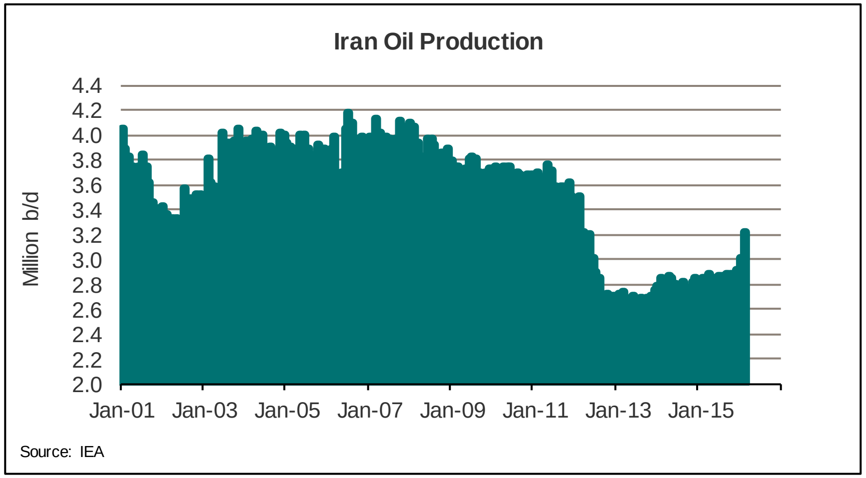
Production In Selected OPEC Members









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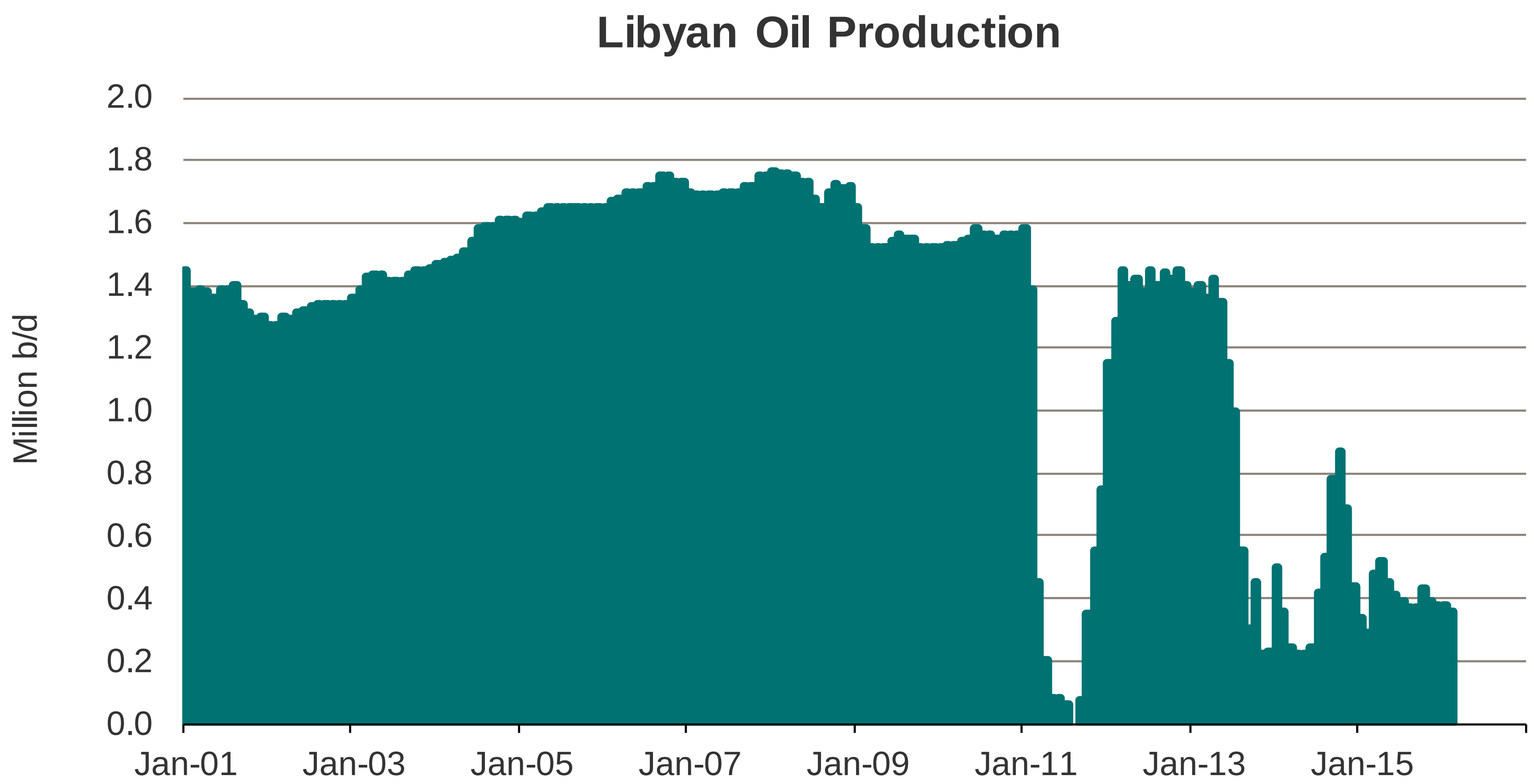
Libyan Production



Source: IEA

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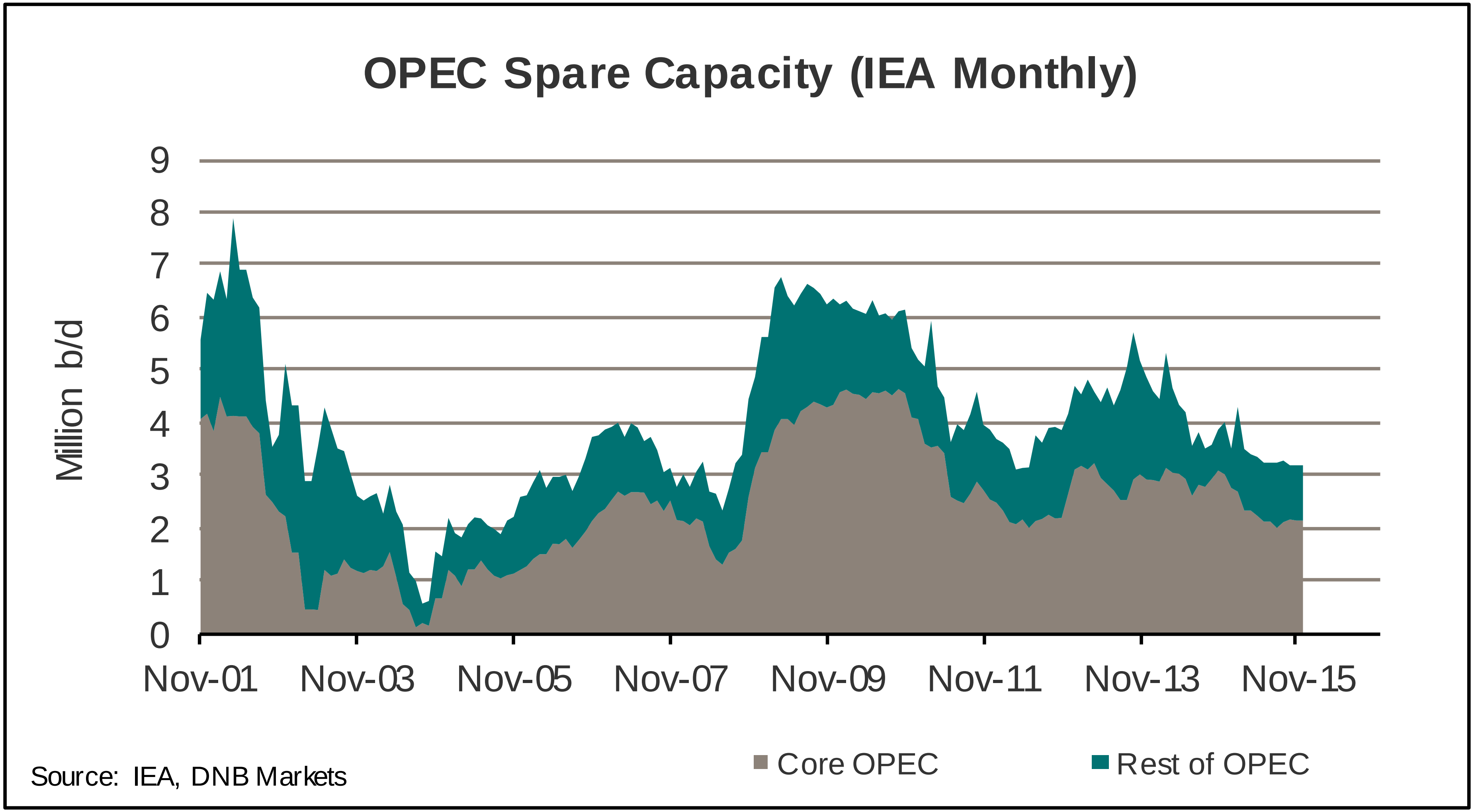
OPEC Spare Capacity



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Source: IEA Monthly Oil Market Reports

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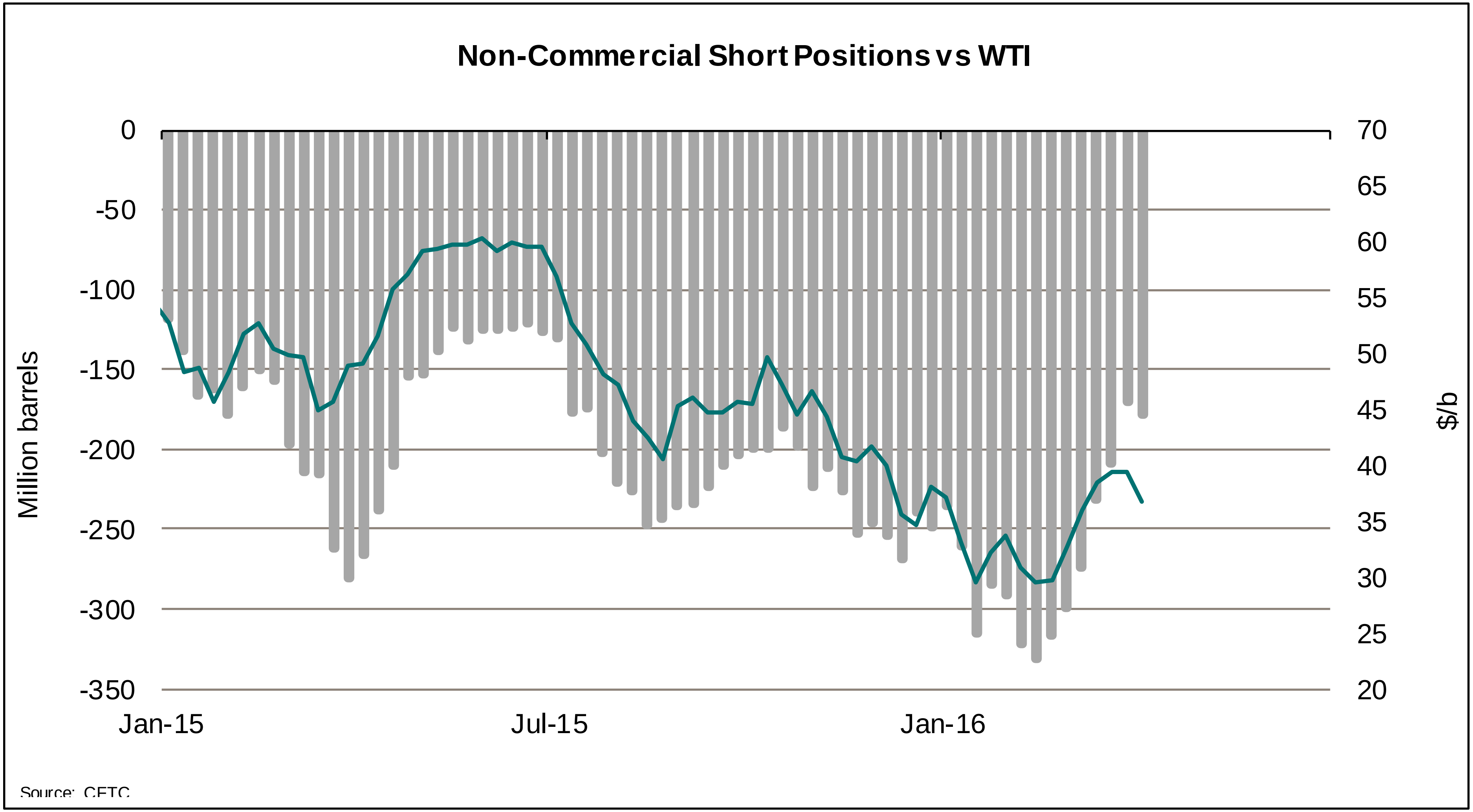
Short Sellers Have Been In Command For WTI Lately

- Recently the short positions in WTI have been covered, contributing to higher prices



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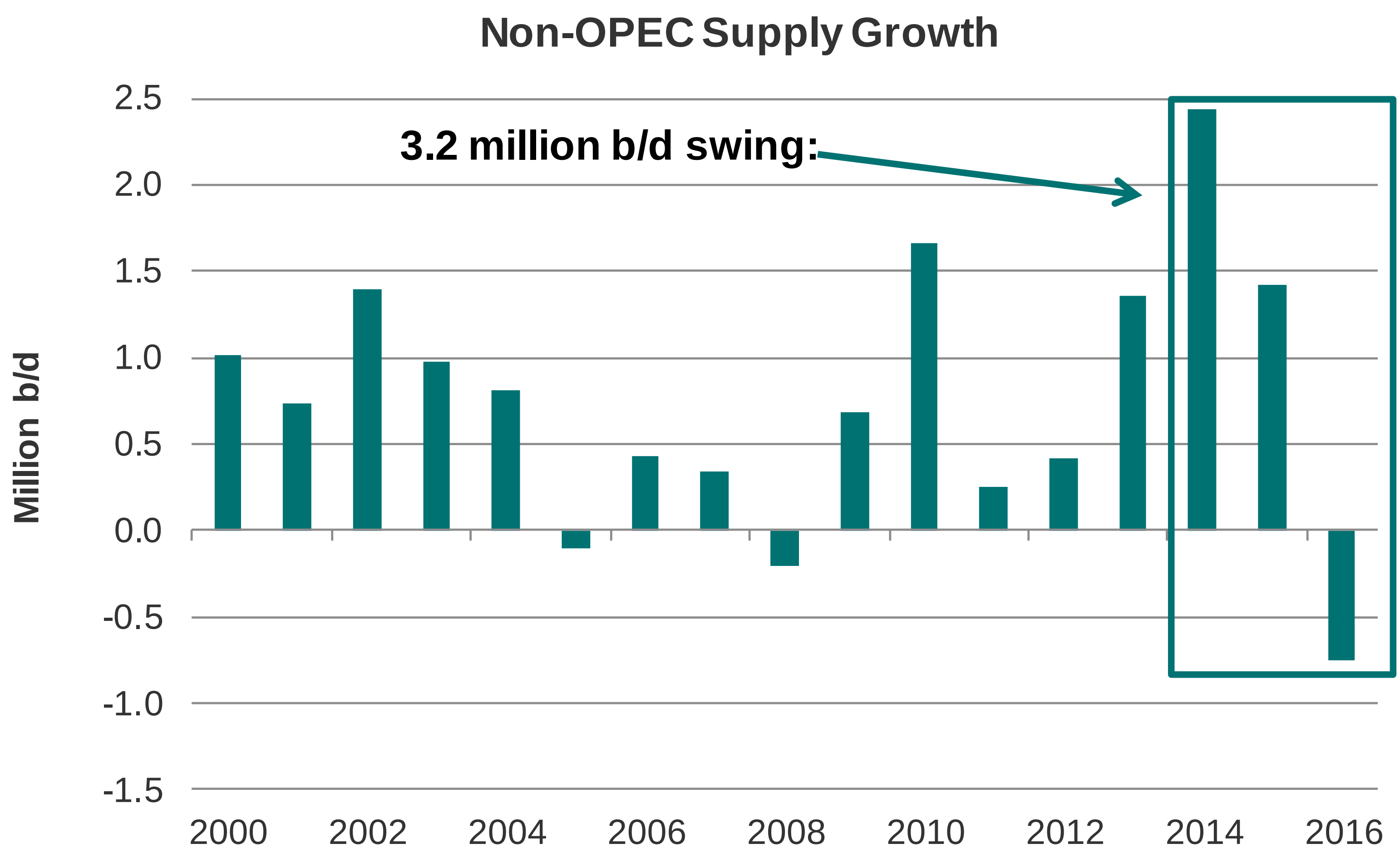
No Doubt That It Is The Supply Side That Is More Important

- OPECs market share policy is leading to a swing of 3.2 million b/d of non-OPEC supply growth from 2014 to 2016



Source: IEA

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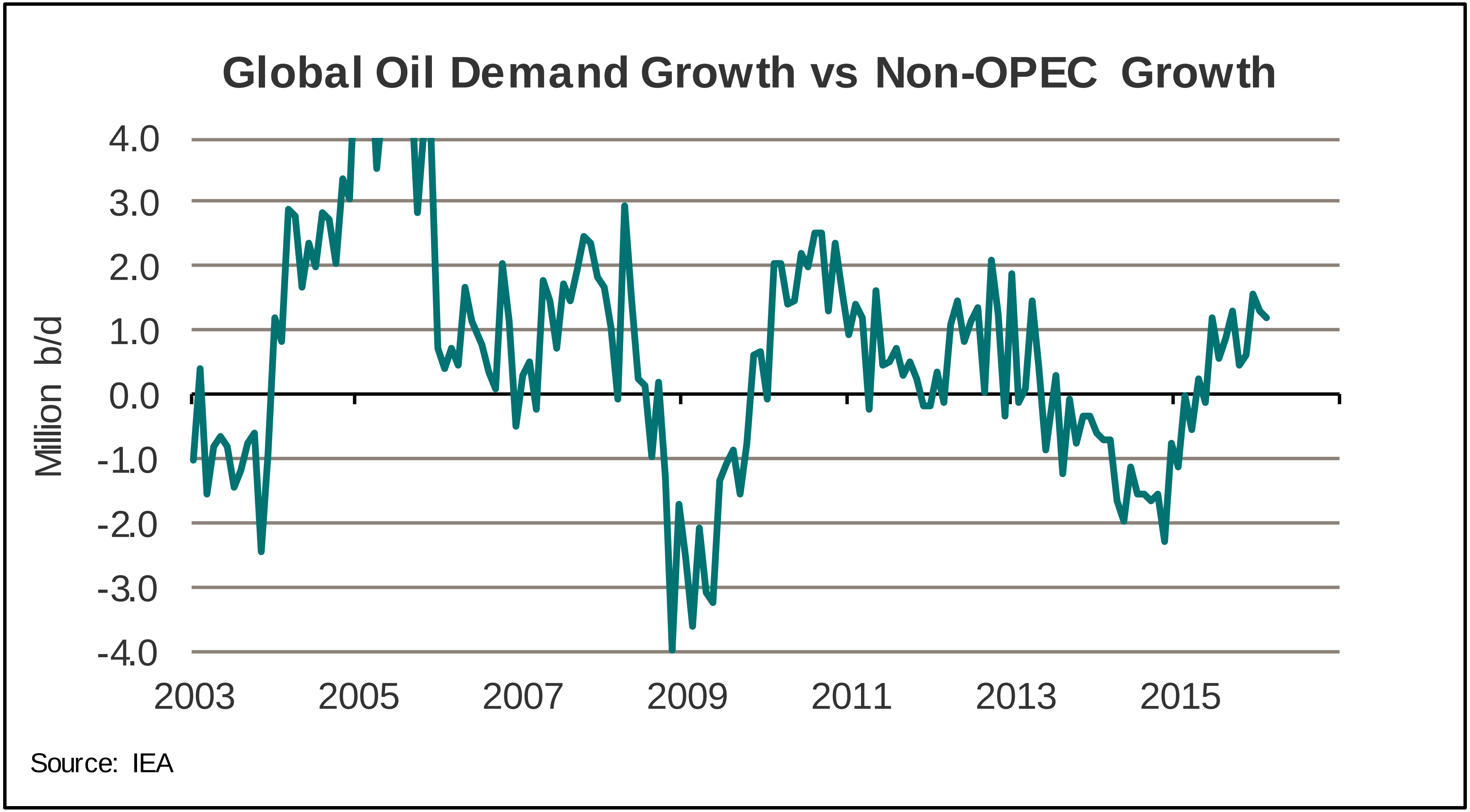
Changes In The Supply-Demand Balance Are Happening

- The price is doing its magic. If demand keeps on growing more than non-OPEC supply we need more and more from OPEC



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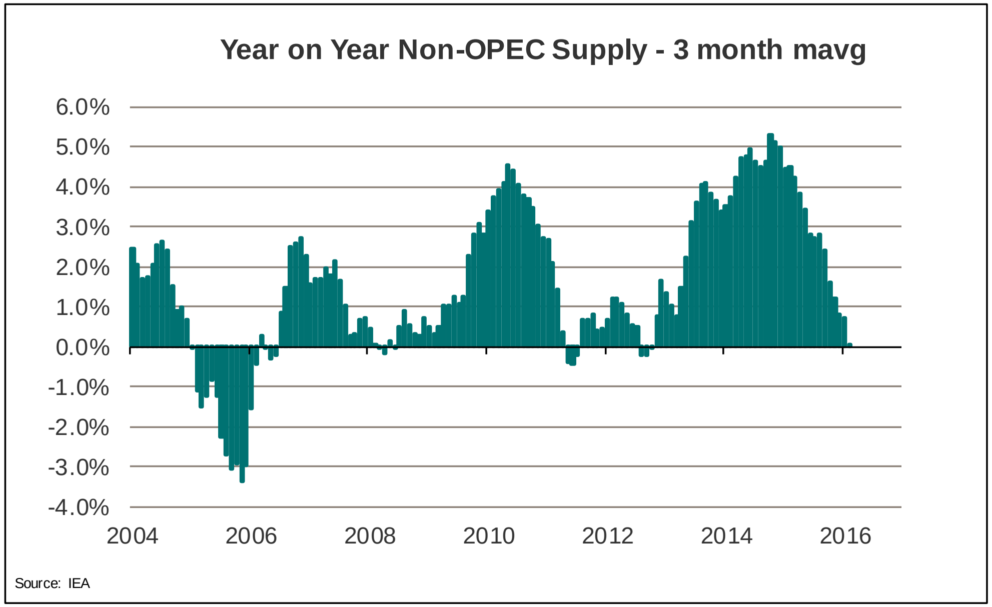
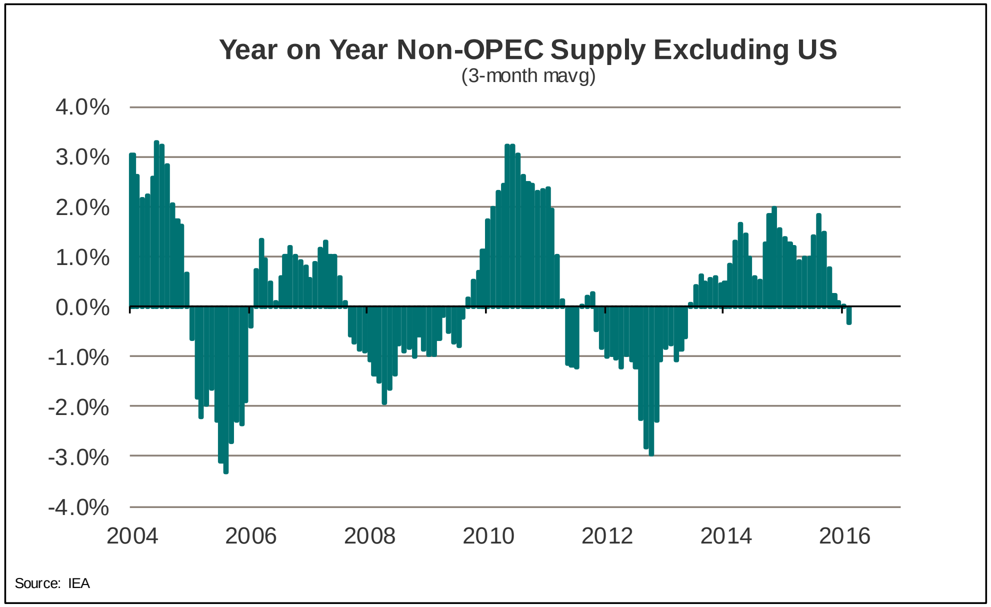
No Growth In Non-OPEC Anymore

- Despite continued growth in Russia





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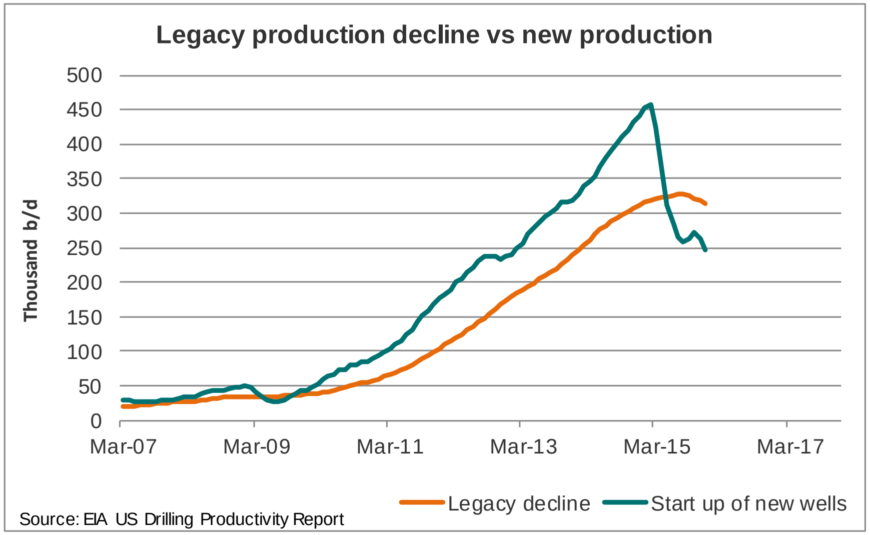
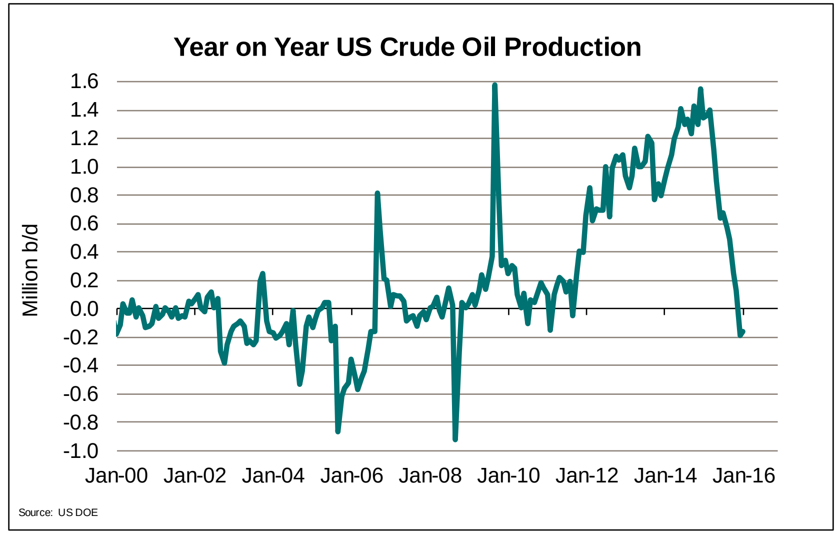
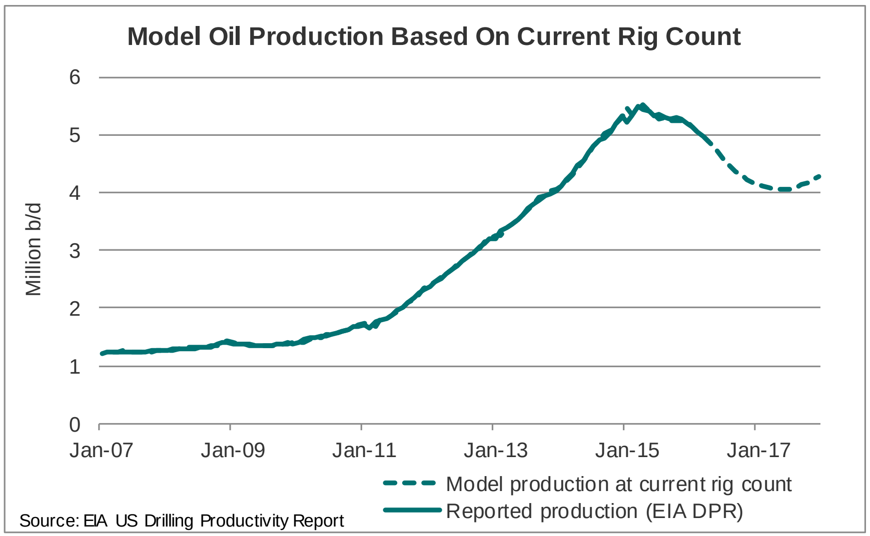
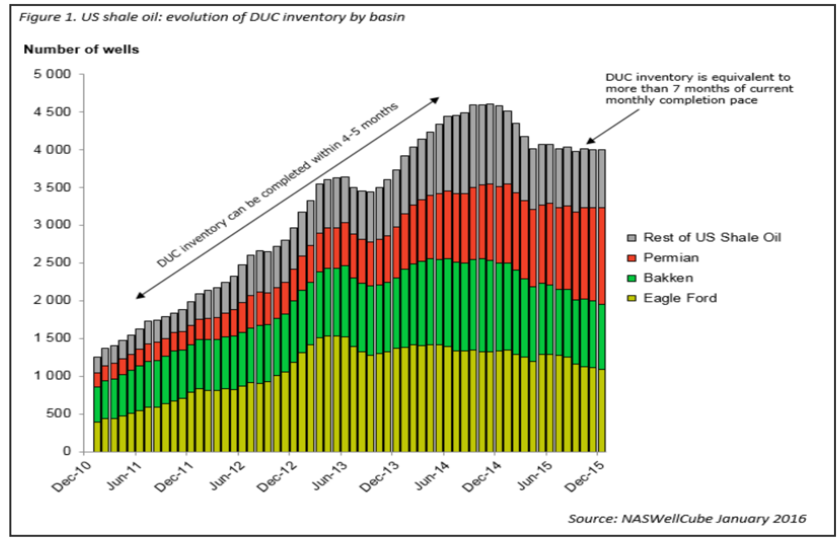
Shale Production Has Started To Drop

- And with the current rig count production is set to drop to 4 mbd in the key 7 shale regions??









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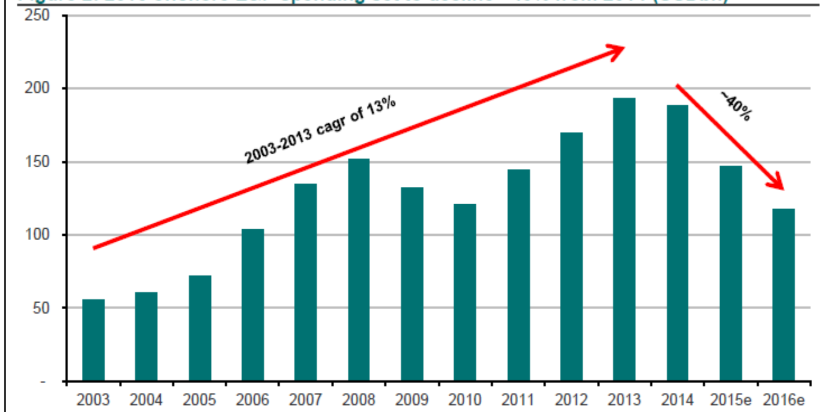
Enormous Cuts In Global Oil Spending Will Continue in 2016

- This sets the stage for lower production/lower production growth in the future

Peer group	2015 upstream E&D capex (US$M)	2016 upstream E&D capex (US$M)	y-o-y change in upstream E&D capex (US$M)	y-o-y change in upstream E&D capex (%)
MLP	210	70	- 140	-67%
NOC	64,715	51,612	- 13,103	-20%
Mid/Small-Cap	48,088	29,193	- 18,895	-39%
Major	147,194	119,090	- 28,104	-19%
Large-Cap	79,861	47,603	- 32,258	-40%
	340,068	**247,568**	**- 92,500**	**-27%**

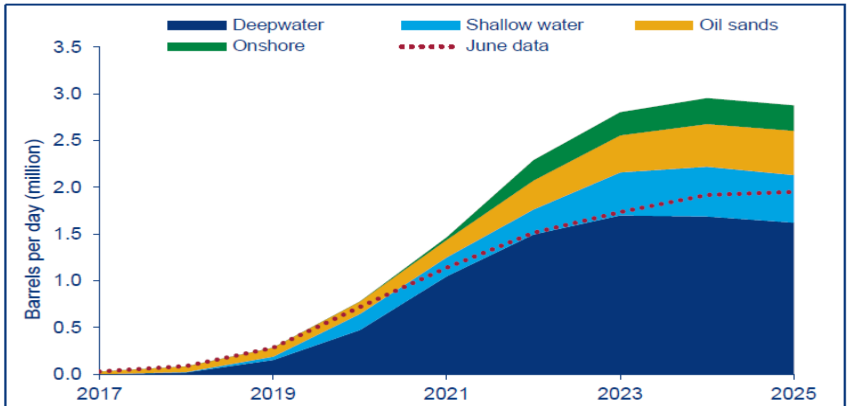
Source: Wood Mackenzie, company announcements 124 companies

Figure 2: 2016 offshore E&P spending set to decline ~40% from 2014 (USDbn)



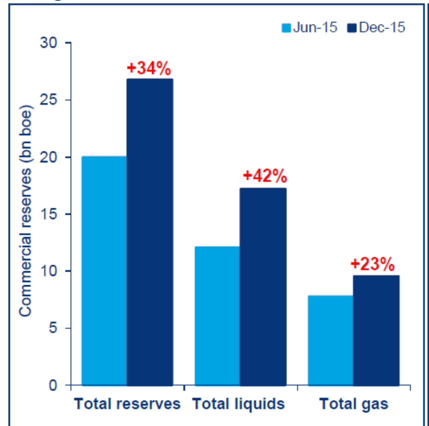
Source: Companies, DNB Markets

Liquids production impacted by project FID delays



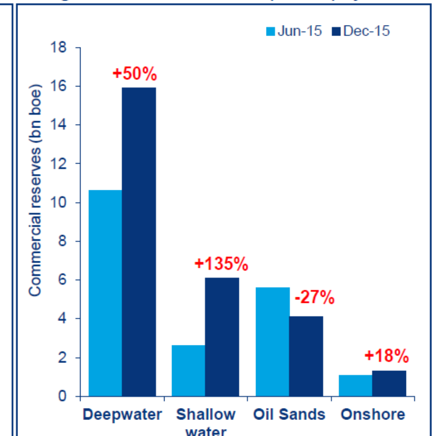
Source: Wood Mackenzie's Upstream Data Tool

Changes in total deferred reserves since June



Source: Wood Mackenzie

Changes in deferred reserves (bn boe) by theme



Source: Wood Mackenzie

Shell's decision to axe a Canadian project shows extent of the downturn

ft.com > companies > energy >

Unusually — and in contrast to the $200bn-plus of future spending shelved by energy companies since last year's crude price collapse — work on Carmon Creek was well under way. This was no flight of fancy. Shell had already taken the decision to invest: it was clearing the site, procuring major equipment, building accommodation for staff, and starting work on wells.

ConocoPhillips to exit deepwater exploration by 2017

Oct 29 2015, 15:25 ET | About: ConocoPhillips (COP) | By: Carl Surran, SA News Editor

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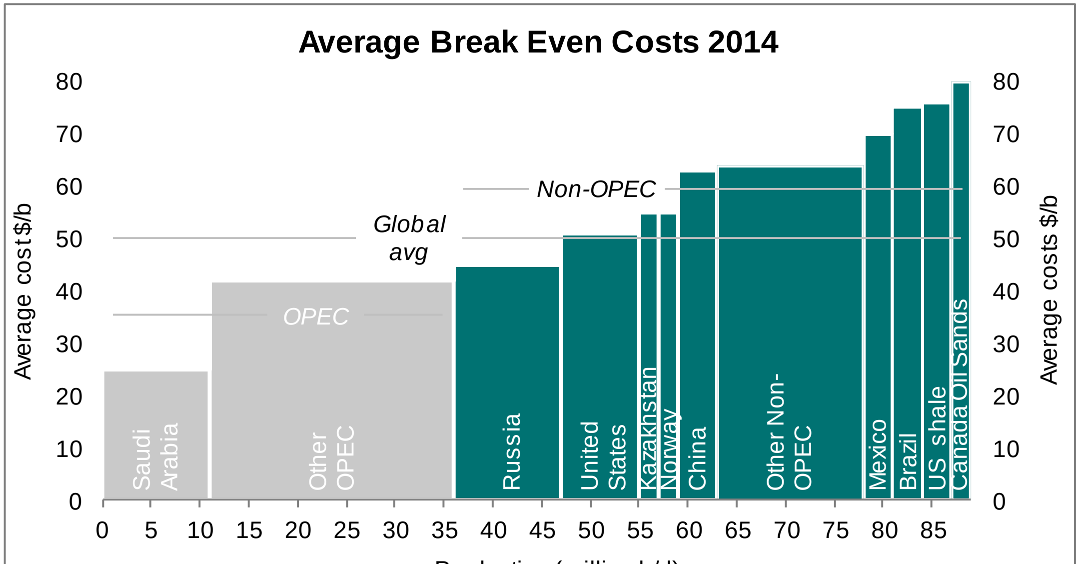
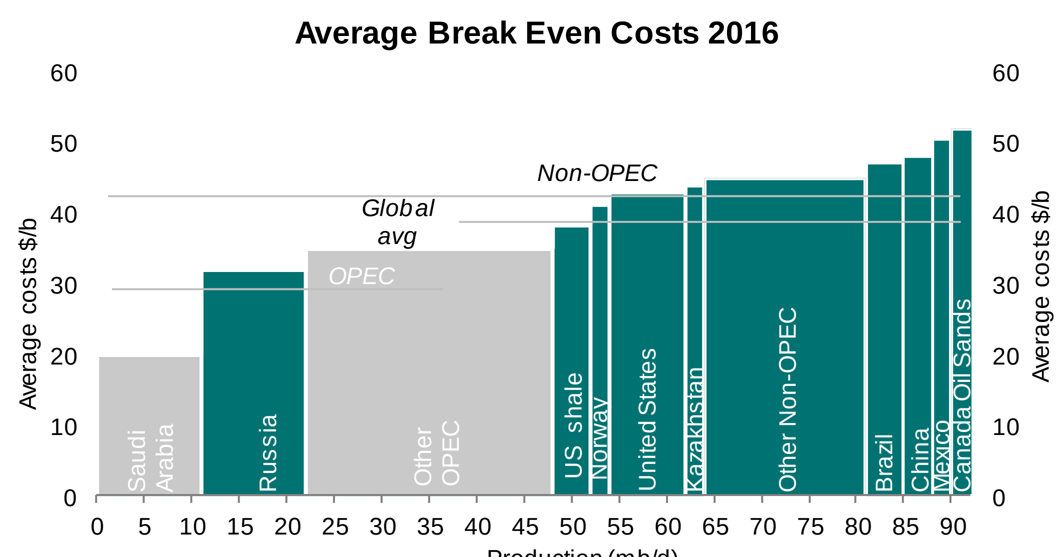
Break Even Costs On Average Down 20% Since 2014

- Global average was 50 $/b in 2014 when oil prices were 100 $/b plus, now the average is 40 $/b



Source: Company Reports, Energy Aspects



Source: Company Reports, Energy Aspects

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Strong Price Response To Demand In Key Countries

- Total oil demand growth up from 0.9 mbd to 1.8 mbd in 2015, YoY demand growth still decent

Demand change in %	Change 2011	Change 2012	Change 2013	Change 2014	Change 2015	YoY Last 3 mts	2016 YTD Chg:	Forecast 2016
North America (Canada, Mexico)	1.4 %	0.8 %	-0.7 %	-1.4 %	-1.9 %	-1.8 %	-1.7 %	-1.9 %
US	-1.1 %	-2.4 %	2.5 %	0.8 %	1.5 %	0.3 %	0.2 %	1.7 %
OECD Europe	-3.1 %	-2.8 %	-1.5 %	-1.2 %	2.0 %	0.7 %	-0.4 %	-0.1 %
Australia, New Zealand, Japan, Korea, Chile	0.3 %	4.1 %	-1.3 %	-2.5 %	-0.2 %	-2.5 %	-2.4 %	-2.1 %
Europe/Africa Med & FSU	3.8 %	1.5 %	0.1 %	3.5 %	0.4 %	2.8 %	3.8 %	1.5 %
Middle East AG excl. Iran and Saudi	3.3 %	7.5 %	3.1 %	-1.0 %	2.5 %	3.9 %	3.6 %	3.1 %
Iran	0.5 %	2.2 %	2.4 %	-0.6 %	-3.6 %	1.7 %	3.5 %	3.1 %
Saudi Arabia	4.4 %	6.8 %	-0.3 %	5.9 %	4.6 %	3.0 %	1.4 %	1.1 %
Asia Pacific/East Africa excl. China and India	2.8 %	2.9 %	4.5 %	2.5 %	3.8 %	4.5 %	4.2 %	4.0 %
China	4.5 %	4.4 %	3.6 %	3.4 %	5.8 %	2.4 %	2.5 %	2.6 %
India	5.1 %	5.1 %	1.3 %	2.0 %	5.7 %	8.4 %	8.9 %	8.1 %
West Africa	3.5 %	4.2 %	4.3 %	-0.6 %	1.4 %	1.5 %	1.3 %	1.0 %
Latin America (excl. Mexico)	2.2 %	4.2 %	2.4 %	2.4 %	-0.7 %	-2.0 %	-2.1 %	-2.4 %
Total World	**0.9 %**	**1.3 %**	**1.3 %**	**1.0 %**	**1.9 %**	**1.3 %**	**1.1 %**	**1.3 %**

Demand change in Million b/d	Change 2011	Change 2012	Change 2013	Change 2014	Change 2015	YoY Last 3 mts	2016 YTD Chg:	Forecast 2016
North America (Canada, Mexico)	63	34	-38	-63	-86	-79	-74	-83
US	-227	-457	472	147	292	59	44	333
Europe	-474	-413	-215	-168	265	99	-58	-22
Australia, New Zealand, Japan, Korea	32	332	-115	-210	-21	-230	-225	-163
Total OECD	**-606**	**-505**	**104**	**-295**	**451**	**-151**	**-312**	**65**
Europe/Africa Med & FSU	273	113	10	267	29	217	290	109
Middle East AG excl. Iran and Saudi	76	173	79	-29	64	98	89	81
Iran	10	40	35	-16	-68	30	63	57
Saudi Arabia	115	192	-17	177	144	90	40	26
Asia Pacific/East Africa excl. China and India	223	236	381	221	346	410	390	379
China	400	422	345	352	616	269	274	296
India	169	175	47	75	213	329	351	330
West Africa	42	53	56	-11	19	20	18	16
Latin America (excl. Mexico)	135	262	153	160	-49	-133	-137	-173
Total Non-OECD	**1,441**	**1,666**	**1,089**	**1,196**	**1,315**	**1,330**	**1,378**	**1,120**
North America	-164	-423	435	84	207	-20	-30	250
Europe/Africa Med & FSU	-201	-301	-206	99	295	316	233	87
Middle East AG/Asia Pacific/East Africa	1,024	1,570	755	570	1,294	997	983	1,006
Middle East AG	201	405	98	132	140	218	192	164
Asia Pacific/East Africa	824	1,165	657	438	1,154	778	791	842
West Africa	42	53	56	-11	19	20	18	16
Latin America (excl. Mexico)	135	262	153	160	-49	-133	-137	-173
Total World	**835**	**1,161**	**1,193**	**901**	**1,765**	**1,180**	**1,067**	**1,185**

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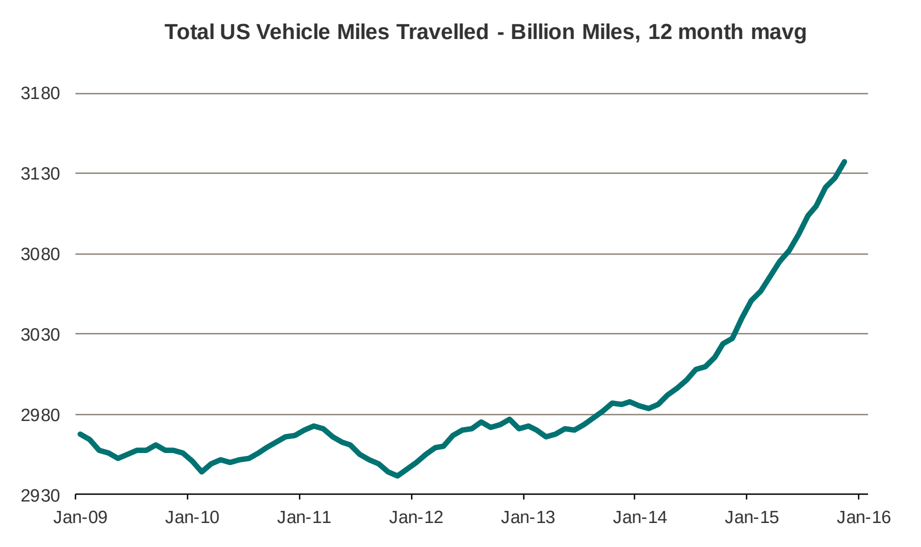
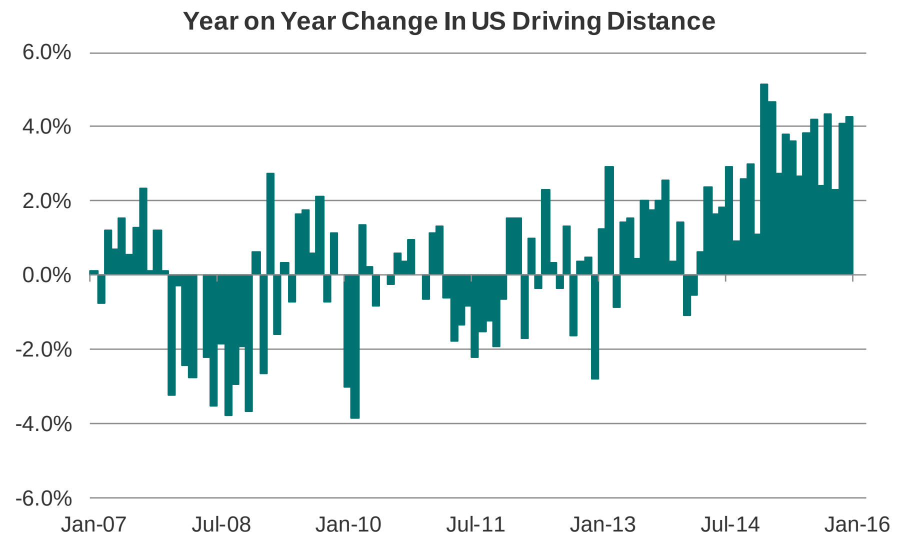
Driving Distance On The Rise As Gasoline Prices Drop

- Lower oil prices are incentivizing more driving



Source: US Federal Highway Administration - Traffic volumes collected from 4000 roadside monitoring stations across the US, published with a two-month delay



Source: US Federal Highway Administration - Traffic volumes collected from 4000 roadside monitoring stations across the US, published with a two-month delay

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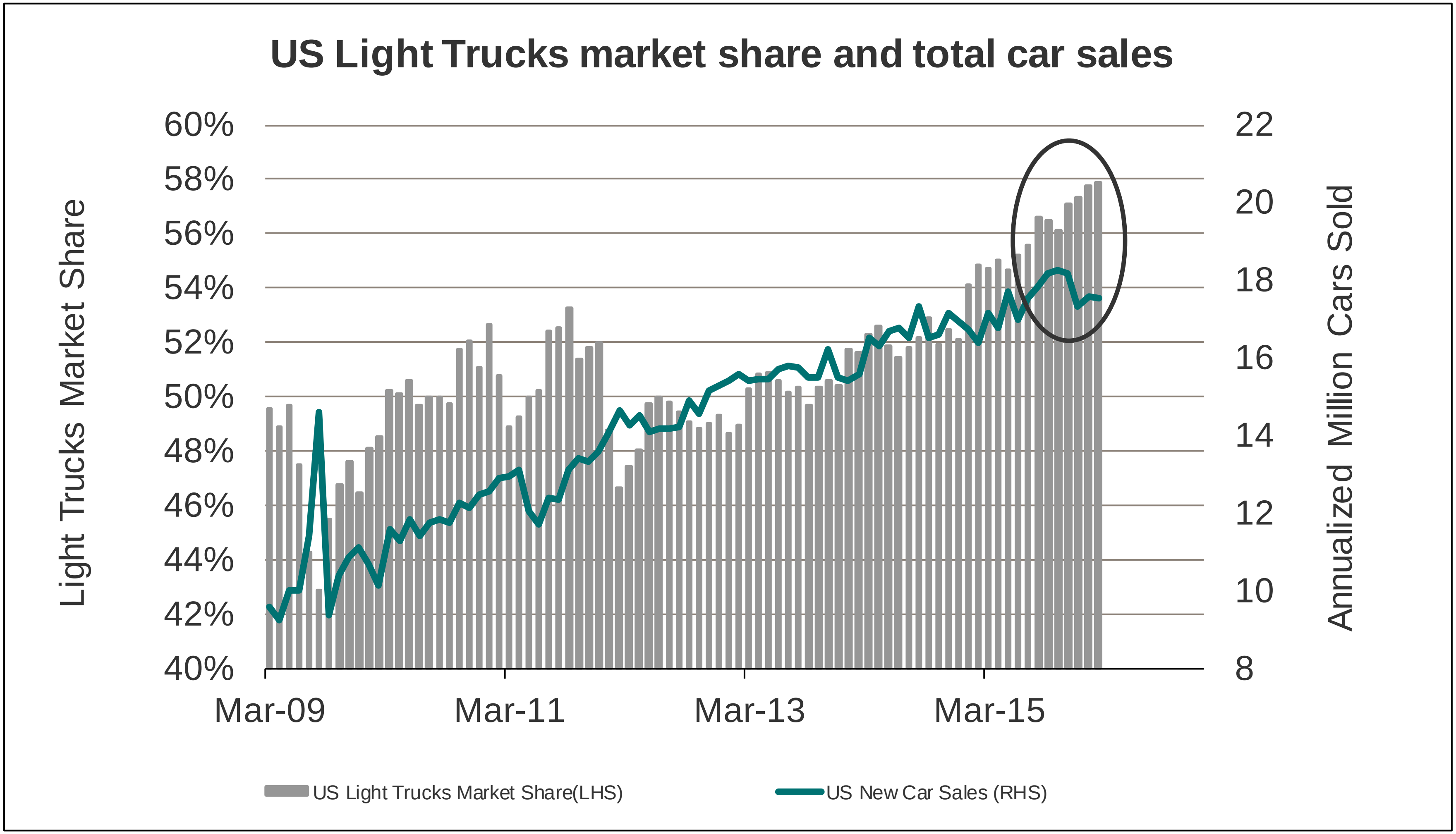
US SUV Market Share Expanding Again



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Fundamental Balances DNB Markets vs IEA, OPEC, EIA

DNB Markets World Oil Supply-Demand Balance:	2010	Change	2011	Change	2012	Change	2013	Change	2014	Change	2015	Change	2016	Change	2017
OECD Demand	47.0	-0.6	46.4	-0.5	45.9	0.1	46.0	-0.3	45.7	0.5	46.2	0.1	46.2	-0.2	46.0
Non-OECD Demand	41.7	1.4	43.1	1.7	44.8	1.1	45.9	1.2	47.1	1.3	48.4	1.1	49.5	1.0	50.6
Total Demand	**88.7**	**0.8**	**89.6**	**1.2**	**90.7**	**1.2**	**91.9**	**0.9**	**92.8**	**1.8**	**94.6**	**1.2**	**95.8**	**0.8**	**96.6**
Non-OPEC Supply	50.0	0.2	50.2	0.4	50.6	1.2	51.8	2.3	54.1	1.4	55.4	-1.1	54.4	-0.7	53.7
OPEC NGL's and non-conventional oil	5.7	0.4	6.0	0.3	6.4	0.0	6.3	0.2	6.5	0.2	6.7	0.1	6.8	0.2	7.0
Global Biofuels	1.8	0.0	1.8	0.0	1.9	0.2	2.0	0.2	2.2	0.1	2.3	0.1	2.4	0.1	2.4
Total Non-OPEC supply	**57.5**	**0.6**	**58.1**	**0.8**	**58.9**	**1.3**	**60.2**	**2.6**	**62.8**	**1.6**	**64.4**	**-0.9**	**63.5**	**-0.4**	**63.1**
Call on OPEC crude (and stocks)	**31.3**	**0.2**	**31.5**	**0.4**	**31.9**	**-0.1**	**31.7**	**-1.7**	**30.0**	**0.2**	**30.2**	**2.1**	**32.3**	**1.2**	**33.5**
OPEC Crude Oil Supply	30.0	0.7	30.7	1.4	32.1	-0.9	31.2	-0.2	31.0	1.1	32.0	0.9	32.9	0.2	33.1
Implied World Oil Stock Change	**-1.3**		**-0.8**		**0.2**		**-0.6**		**0.9**		**1.8**		**0.6**		**-0.4**

IEA World Oil Supply-Demand Balance (March 2016):	2010	Change	2011	Change	2012	Change	2013	Change	2014	Change	2015	Change	2016	Change	2017
OECD Demand	47.0	-0.6	46.4	-0.5	45.9	0.1	46.0	-0.3	45.7	0.5	46.2	0.0	46.2		
Non-OECD Demand	41.7	1.4	43.1	1.7	44.8	1.1	45.9	1.2	47.1	1.3	48.4	1.2	49.6		
Total Demand	**88.7**	**0.8**	**89.6**	**1.2**	**90.7**	**1.2**	**91.9**	**0.9**	**92.8**	**1.8**	**94.6**	**1.2**	**95.7**		
Non-OPEC Supply	50.0	0.2	50.2	0.4	50.6	1.2	51.8	2.3	54.1	1.4	55.4	-0.8	54.6		
OPEC NGL's and non-conventional oil	5.7	0.4	6.0	0.3	6.4	0.0	6.3	0.2	6.5	0.2	6.7	0.2	6.9		
Global Biofuels	1.8	0.0	1.8	0.0	1.9	0.2	2.0	0.2	2.2	0.1	2.3	0.1	2.4		
Total Non-OPEC supply	**57.5**	**0.6**	**58.1**	**0.8**	**58.9**	**1.3**	**60.2**	**2.6**	**62.8**	**1.6**	**64.4**	**-0.6**	**63.8**		
Call on OPEC crude (and stocks)	**31.3**	**0.2**	**31.5**	**0.4**	**31.9**	**-0.1**	**31.7**	**-1.7**	**30.0**	**0.2**	**30.2**	**1.7**	**31.9**		
OPEC Crude Oil Supply	30.0	0.7	30.7	1.4	32.1	-0.9	31.2	-0.2	31.0	1.1	32.0	0.9	32.9		
Implied World Oil Stock Change	**-1.3**		**-0.8**		**0.2**		**-0.6**		**0.9**		**1.8**		**1.0**		

OPEC World Oil Supply-Demand Balance (Feb 2016):	2010	Change	2011	Change	2012	Change	2013	Change	2014	Change	2015	Change	2016	Change	2017
OECD Demand	47.0	-0.6	46.4	-0.5	45.9	0.1	46.0	-0.2	45.8	0.5	46.3	0.1	46.4		
Non-OECD Demand	40.3	1.5	41.8	1.4	43.2	1.2	44.4	1.2	45.6	1.1	46.7	1.1	47.8		
Total Demand	**87.3**	**0.9**	**88.2**	**0.9**	**89.1**	**1.3**	**90.4**	**1.0**	**91.4**	**1.6**	**93.0**	**1.2**	**94.2**		
Non-OPEC Supply (Incl all Biofuel)	52.4	0.0	52.4	-0.5	51.9	1.5	53.4	2.3	55.7	1.3	57.0	-0.7	56.3		
OPEC NGL's and non-conventional oil	5.0	0.4	5.4	0.3	5.7	0.1	5.8	0.2	6.0	0.1	6.1	0.2	6.3		
Total Non-OPEC supply	**57.4**	**0.4**	**57.8**	**-0.2**	**57.6**	**1.6**	**59.2**	**2.5**	**61.7**	**1.4**	**63.1**	**-0.5**	**62.6**		
Call on OPEC crude (and stocks)	**29.9**	**0.5**	**30.4**	**1.1**	**31.5**	**-0.3**	**31.2**	**-1.5**	**29.7**	**0.2**	**29.9**	**1.7**	**31.6**		
OPEC Crude Oil Supply	30.0	0.7	30.7	1.4	32.1	-0.9	31.2	-0.2	31.0	1.1	32.0	0.9	32.9		
Implied World Oil Stock Change	**0.1**		**0.3**		**0.6**		**0.0**		**1.3**		**2.1**		**1.3**		

EIA World Oil Supply-Demand balance (Feb 2016):	2010	Change	2011	Change	2012	Change	2013	Change	2014	Change	2015	Change	2016	Change	2017
OECD Demand	46.1	-0.3	45.8	0.1	45.9	0.2	46.1	-0.3	45.8	0.6	46.3	0.2	46.5	0.3	46.9
Non-OECD Demand	41.0	1.5	42.5	0.8	43.3	1.2	44.4	2.3	46.7	0.8	47.5	1.0	48.5	1.1	49.6
Total Demand	**87.1**	**1.2**	**88.3**	**0.9**	**89.2**	**1.3**	**90.5**	**2.0**	**92.4**	**1.3**	**93.8**	**1.2**	**95.0**	**1.5**	**96.5**
Non-OPEC Supply (Incl all Biofuel)	51.8	0.2	52.0	0.7	52.7	1.5	54.1	2.8	56.9	0.5	57.4	-0.6	56.9	-0.2	56.7
OPEC NGL's and non-conventional oil	5.5	-0.3	5.3	0.5	5.8	0.4	6.1	0.1	6.3	0.3	6.6	0.3	6.9	0.3	7.2
Total Non-OPEC supply	**57.3**	**-0.1**	**57.2**	**1.2**	**58.4**	**1.8**	**60.2**	**2.9**	**63.2**	**0.8**	**64.0**	**-0.3**	**63.8**	**0.1**	**63.9**
Call on OPEC crude (and stocks)	**29.8**	**1.3**	**31.1**	**-0.3**	**30.8**	**-0.5**	**30.2**	**-1.0**	**29.3**	**0.5**	**29.8**	**1.5**	**31.3**	**1.3**	**32.6**
OPEC Crude Oil Supply	30.0	0.7	30.7	1.4	32.1	-0.9	31.2	-0.2	31.0	1.1	32.0	0.9	32.9	0.2	33.1
Implied World Oil Stock Change	**0.2**		**-0.4**		**1.3**		**0.9**		**1.7**		**2.3**		**1.7**		**0.5**

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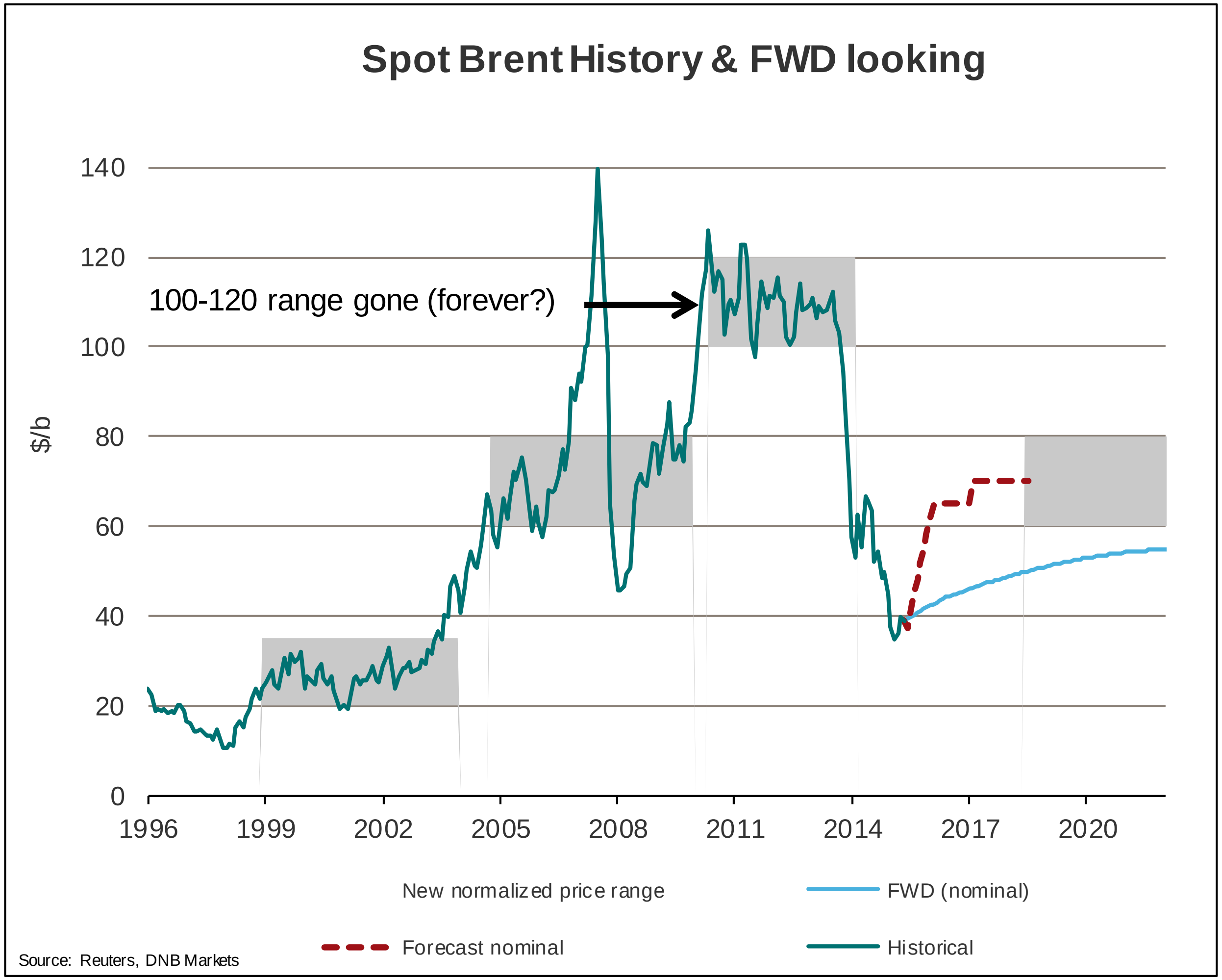
Long Term Oil Price Forecast

(The forecast is for the rolling 1st month ICE Brent future contract)

	Historical Nominal $/b
2001	24.4
2002	25.0
2003	28.8
2004	38.3
2005	54.5
2006	65.1
2007	72.4
2008	97.3
2009	61.7
2010	79.5
2011	111.3
2012	111.7
2013	108.7
2014	99.5
2015	53.6
	Price target Nominal $/b
3 months	45
6 months	55
12 months	65
24 months	70
2019-2023	60-80



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