September 10, 2015
Robert W. Lamond

Business Notes

Oil Price Collapse 2014 (Part 6)

"Beggar thy Neighbour"

Capitulation approaches

WTI $ 45.94
Brent $ 49.42
Dow Industrials 16,400
US 10 Year 2.18 %

US Oil Rigs – 662
Bakken - 72
Eagle Ford - 93
Permian - 253

Overview

Our thesis in the past year has been that the huge rise in U.S. and Canadian oil production, without any production constraints, led to the drop in oil prices. (Invisible hand strikes again!) OPEC production has remained in the 31 to 33 million barrels per day range since 2004, with U.S. production rapidly increasing, by 4 million barrels per day from 2011 until now. This flood of new U.S. oil, with Canada, effectively overwhelmed the market and caused the recent major break in oil prices.

Current Summary

At present, it appears that both privately owned and state-owned energy companies are pumping at "beggar thy neighbour" maximum rates, even at low oil prices, in order to maximize revenues and survive. This state of affairs cannot persist for a lengthy period as inevitable insolvencies, both corporate and national, will ensue.

Encouraging signs currently include: the decline of U.S. oil production, the recovery of WTI oil prices from the recent low, the continued low level of U.S. and worldwide oil-targeted drilling, and finally the first cautious announcement from Saudi Arabia that stakeholders should attempt to target 'fair' oil prices.

As a result of enduring low oil prices for almost 9 months now, the capitulation stage should be fast approaching where outside debt holders step in to prevent companies from drilling themselves into oblivion.

Amazingly, at the time of writing, Continental and Whiting, both active Bakken producers, announced that for 2015 they were "living within cashflow". That must mean the missionaries have finally arrived!

Recent Events:

Drilling Rigs:

U.S. oil-targeted rigs have now dropped to 662 from the cyclical high of over 1600 and, despite a slight pickup in the second quarter, drilling levels continue to decline. Key shale oil plays such as the Bakken, and Eagleford are at cyclical lows, while the Permian has picked up somewhat.

Industry analysis suggests that very few horizontal oil wells are economic at current oil prices. Hence, rigs presently in operation must be related to lease retention, term rig contracts, retention of quality rigs, or drilling programs which are "set in stone".

There do seem to be a number of exuberant announcements of high productivity wells in some of the shale plays. One must assume that they are the result of identifying the sweetest spots in core area saturation drilling programs, using the largest fracs available.

U.S. Production:

At last, the E.I.A. has revised its numbers and instituted a new data gathering methodology. This now shows that U.S. daily production peaked in March 2015 at over 9.6 million barrels, and has since declined to 9.1 million barrels.

Both North Dakota and Texas production levels appear to be declining slower than other regions, probably a result of completing part of the frac log inventory which is quite large in each of those plays. The recent drop in oil prices, however, will likely have slowed this completion activity.

In summary, overall U.S. production will continue its inexorable decline until oil prices recover.

U.S. oil inventories

The growth of U.S. oil inventories posed a problem due to their steady rise during a period of U.S. production weakness. As now confirmed by the E.I.A. numbers, increased storage volumes were not solely created by U.S. oil production. Despite the prophets of doom, Cushing tanks are not overflowing and Cushing and general U.S. oil inventories are slowly declining.

Oil Demand

E.I.A. statistics suggest a steady increase in U.S. demand. More detailed analysis of gasoline usage also indicates that, due to low gasoline prices, mileage driven and gasoline demand has increased markedly.

With the U.S., Chinese and other international economies slowly expanding, one would anticipate that oil demand will steadily increase due to current low energy prices. Indeed, world demand has reportedly increased to over 93 million barrels per day at present.

Outlook

In looking back over the past year, it appears we are now reaching the capitulation stage during which the cumulative effect of low prices results in a number of financial catastrophes. After almost a year in the trenches, many energy companies are becoming exhausted, failures are more common and deeply discounted equity or bond issues are prevalent. Industry layoffs are widespread especially in the service industry sector, the bottom of the "food chain". There are still not very many optimists around!

However, with the world economy still in a growth mode and with producers lacking no incentives to increase production (other than mere survival!), we should now be past the bottom of this cycle, with the ensuing recovery likely to follow a normal upward zigzag course.

Conclusion

Thanks for everyone's interest and comments. Most people have been kind enough not to mention the last downward spike in oil prices contradicting my optimistic outlook.

I remind everyone that our weekly and monthly oil graphs are prepared on a regular basis and are available on Tuscany's website (www.tuscanyenergy.com).

Best Regards,

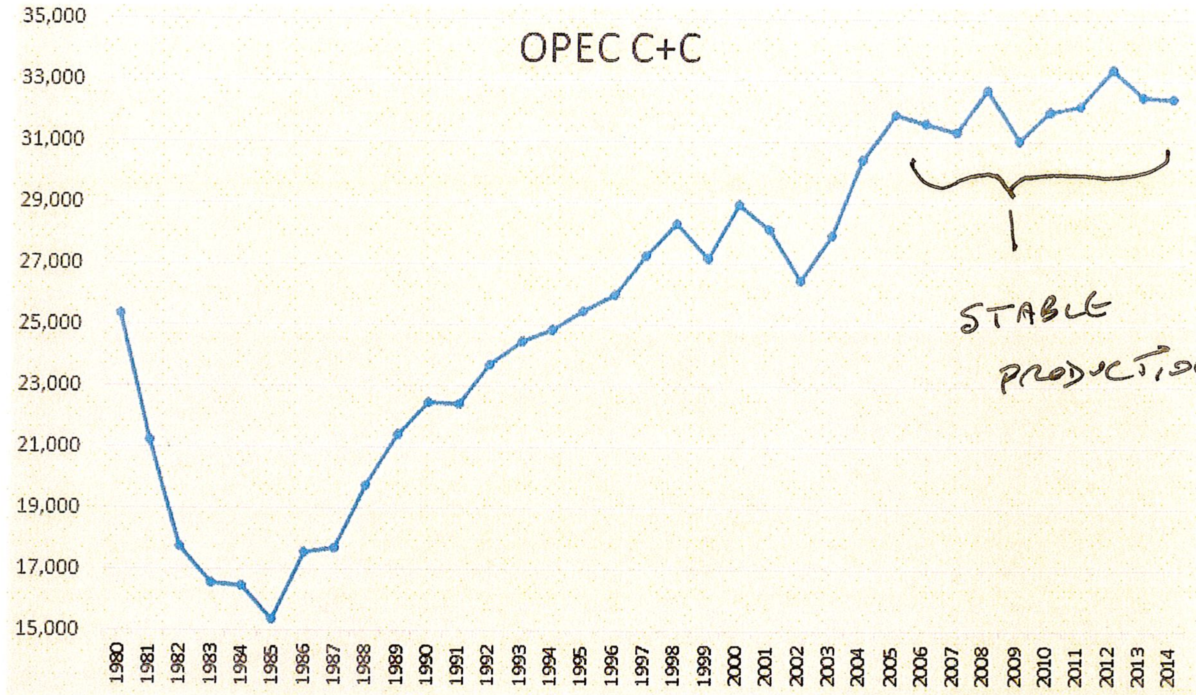
Bob

Robert W. Lamond

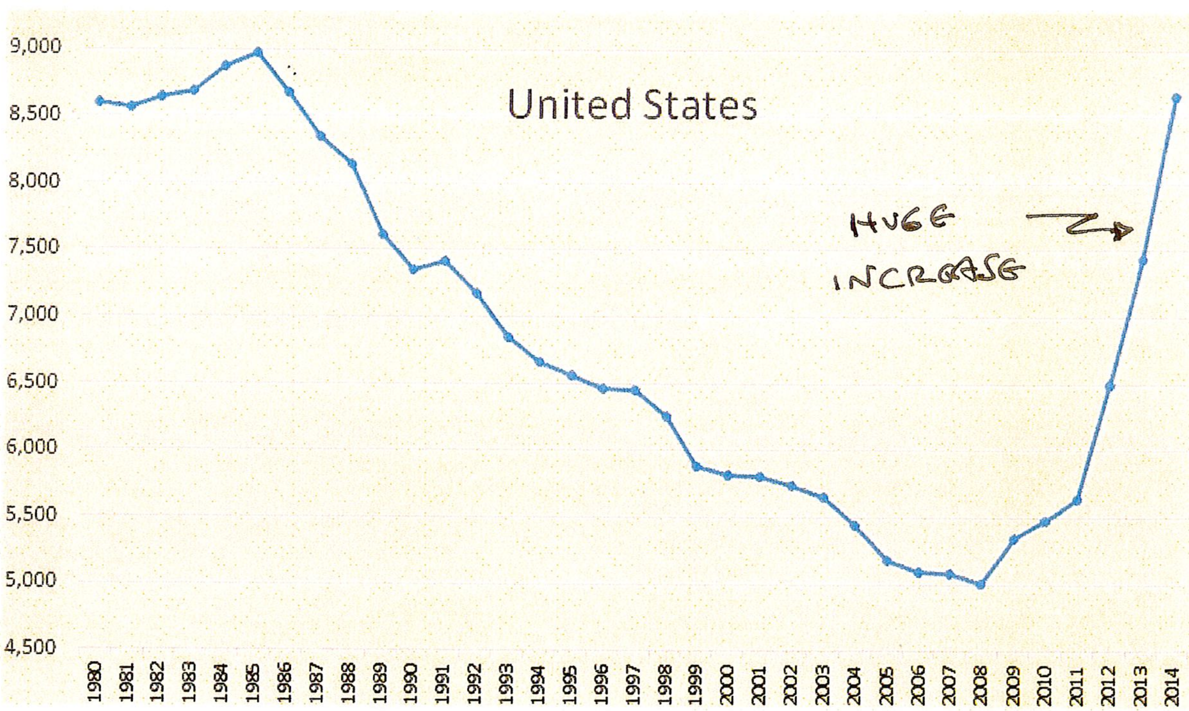
9/SEPT/15

OIL PRODUCTION

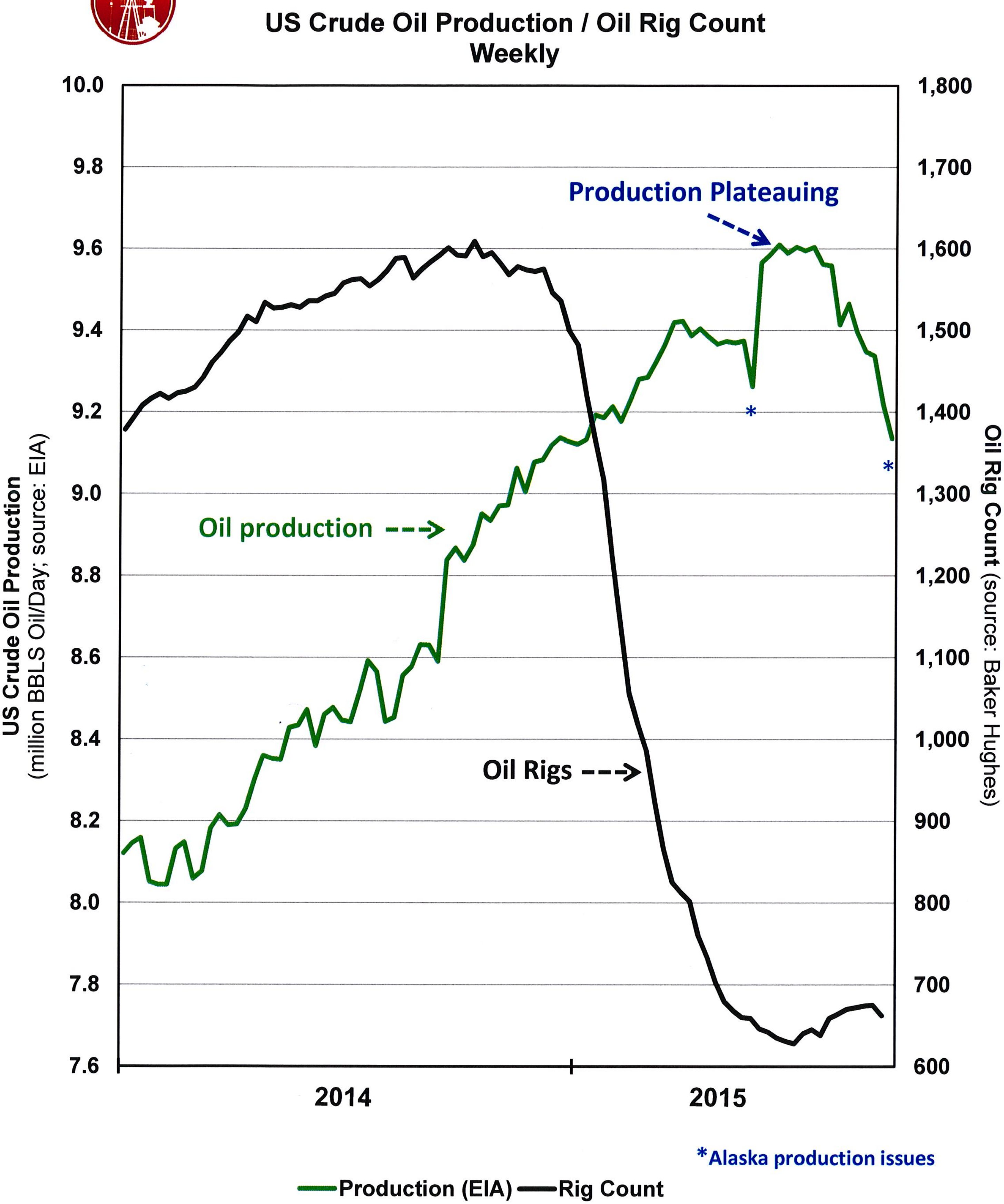
OPEC



← PEAK



10-Sep-2015



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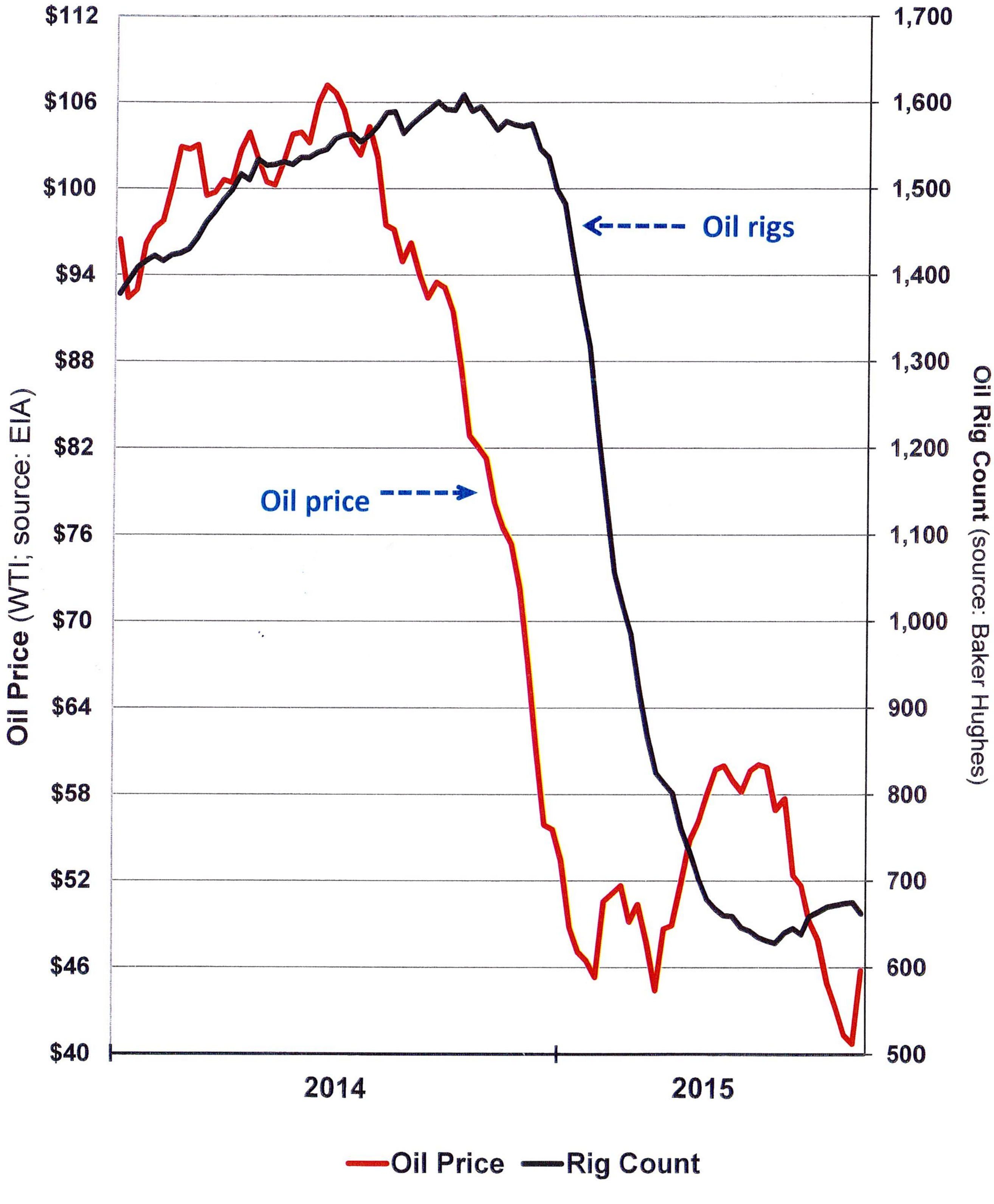
8-Sep-2015

US Crude Oil Price / Oil Rig Count
Weekly



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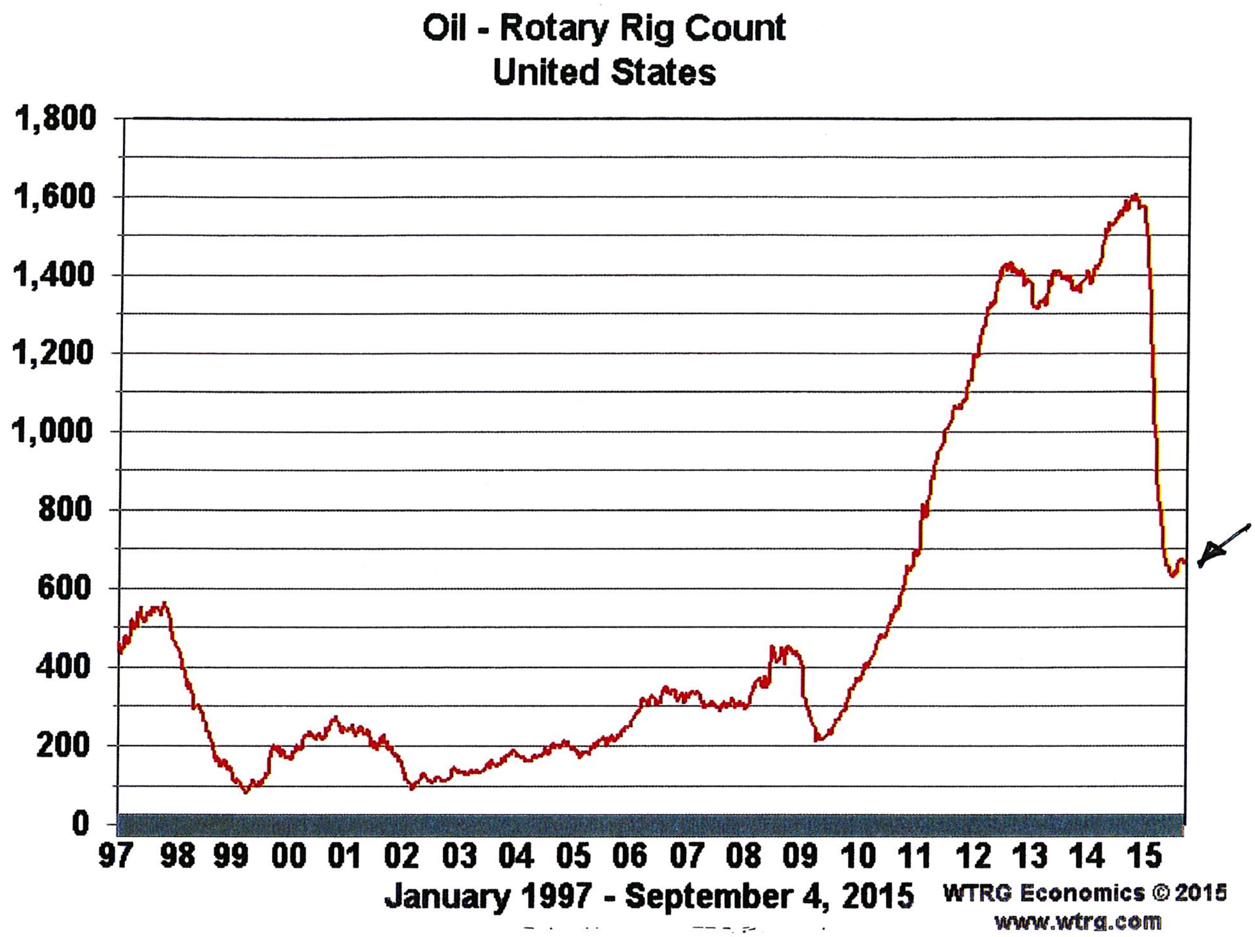
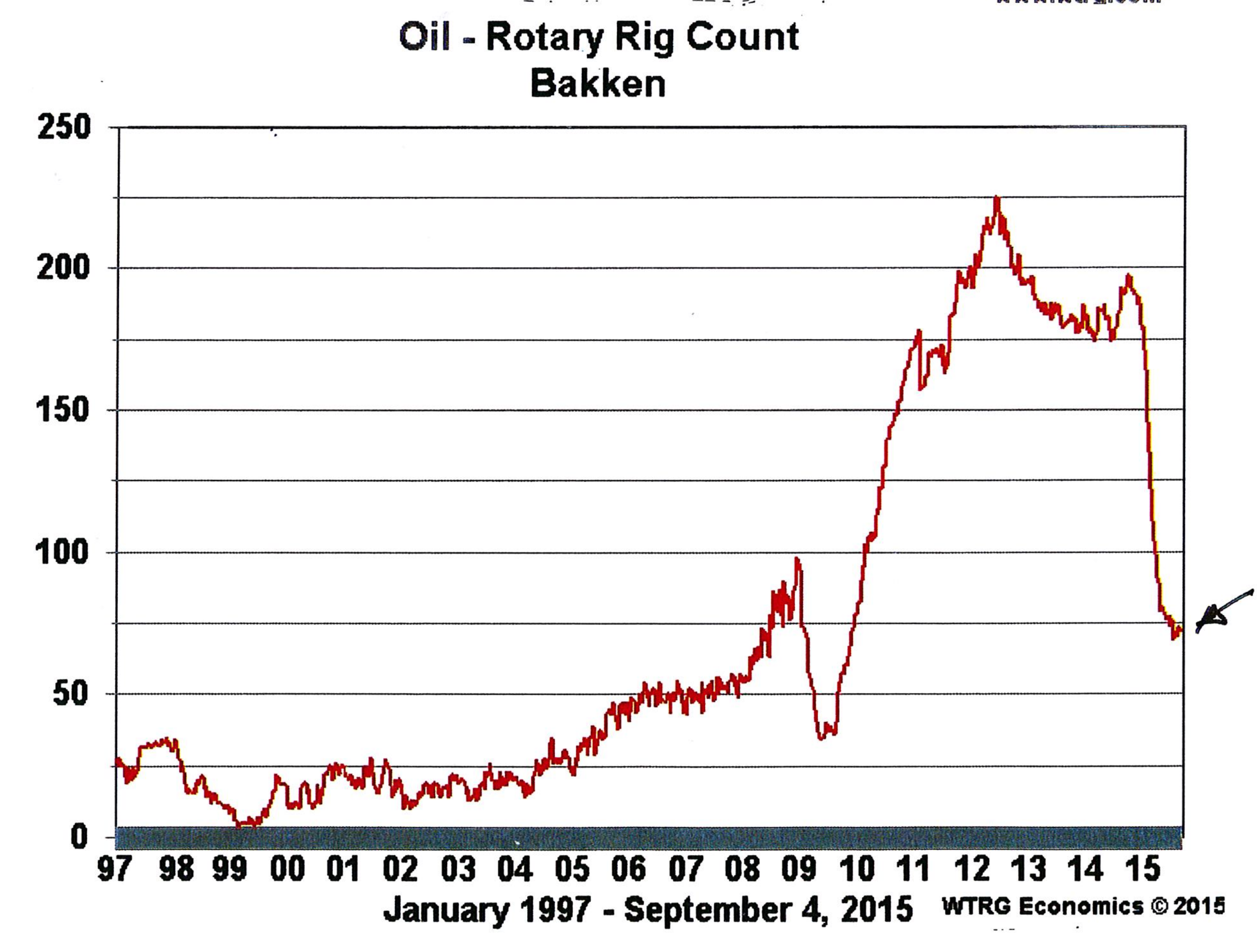
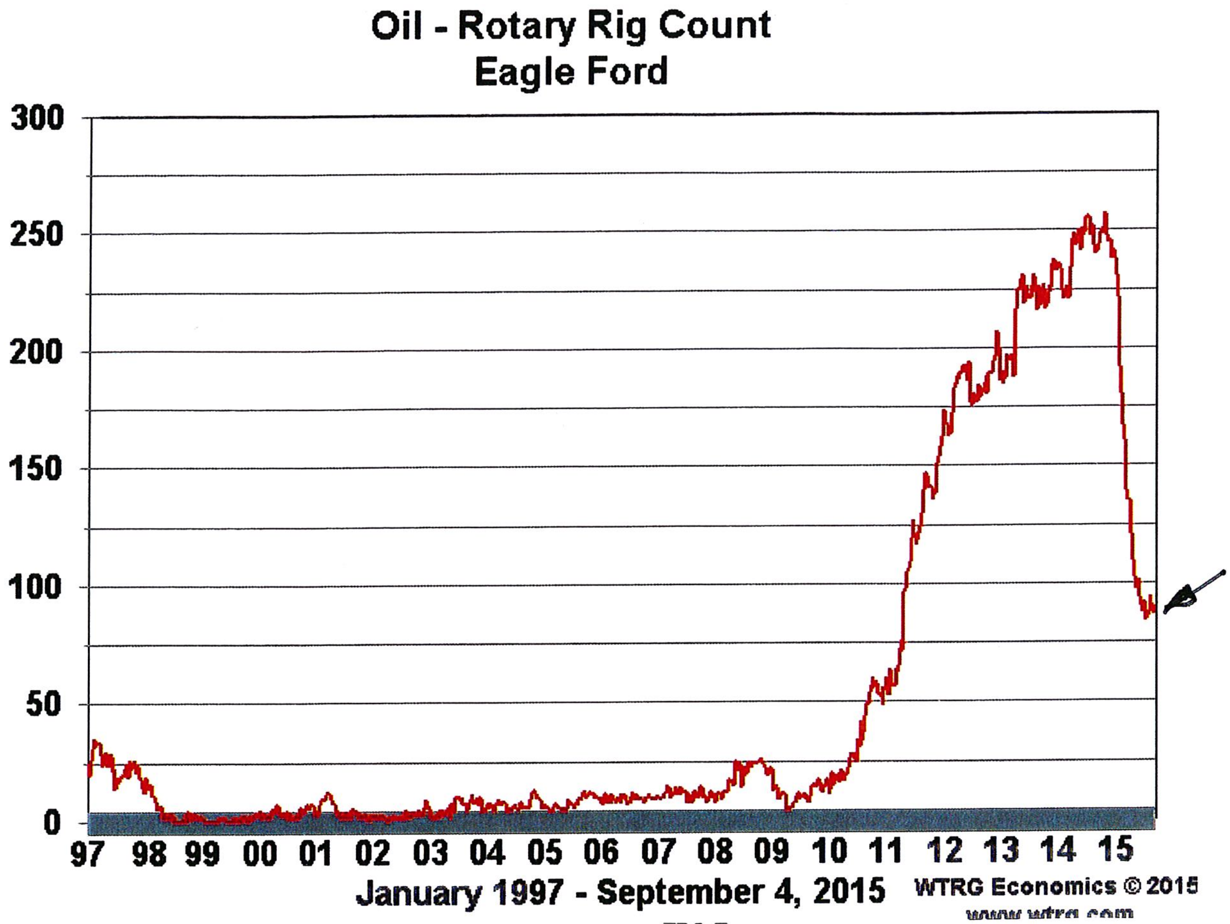


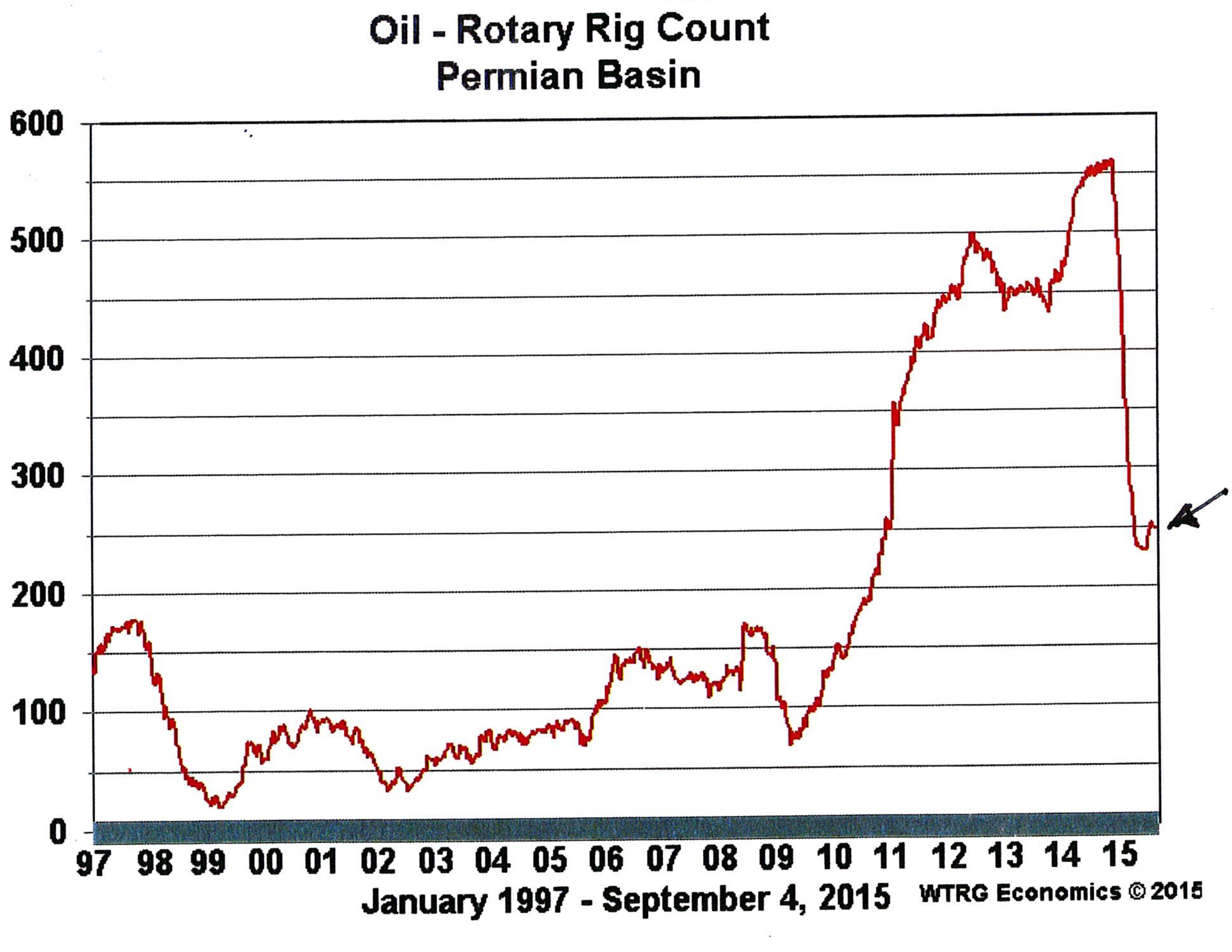
Oil - Rotary Rig Count
United States
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15
January 1997 - September 4, 2015
WTRG Economics © 2015
www.wtrg.com



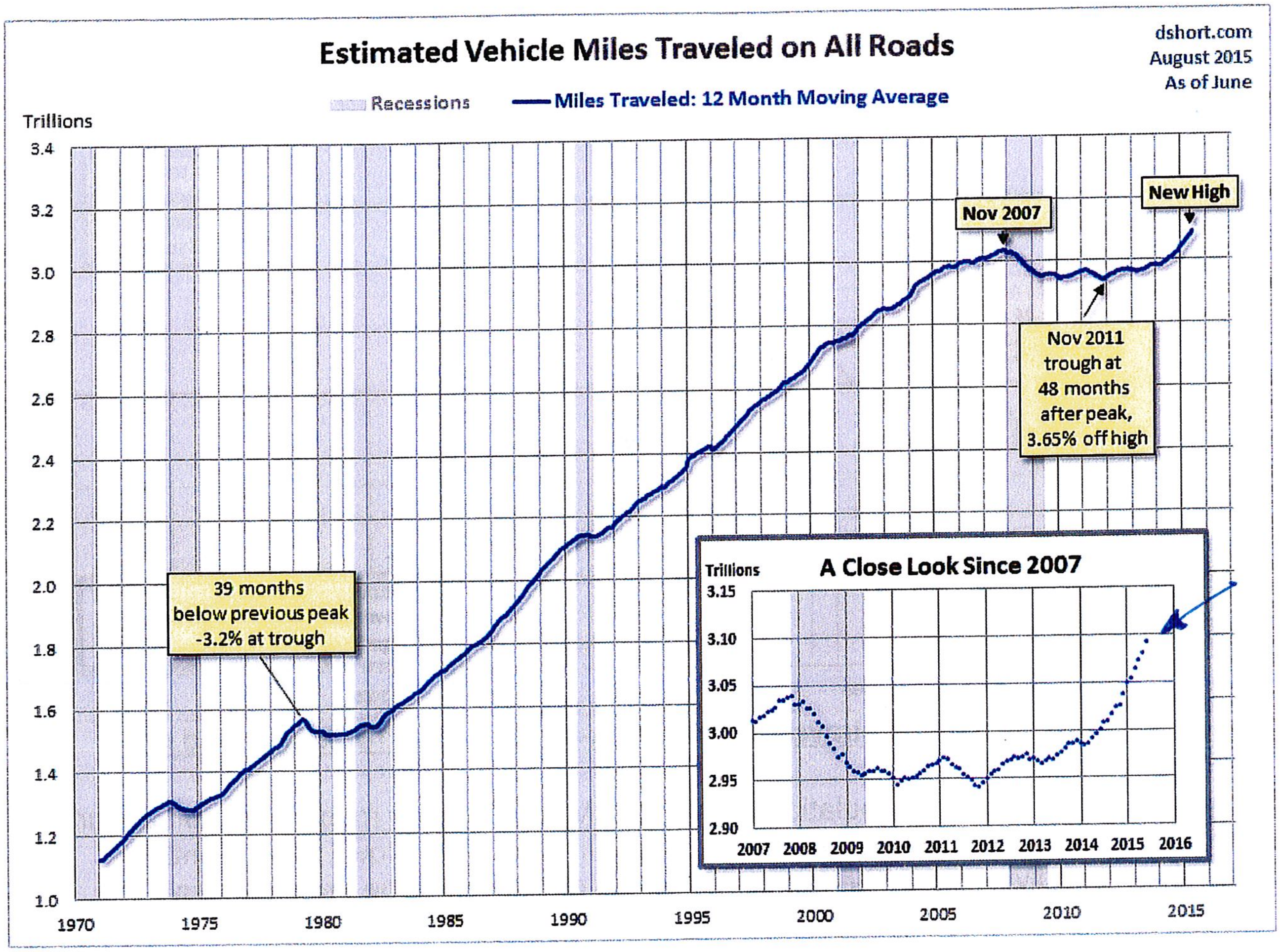
Oil - Rotary Rig Count
Bakken
250
200
150
100
50
0
97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15
January 1997 - September 4, 2015
WTRG Economics © 2015



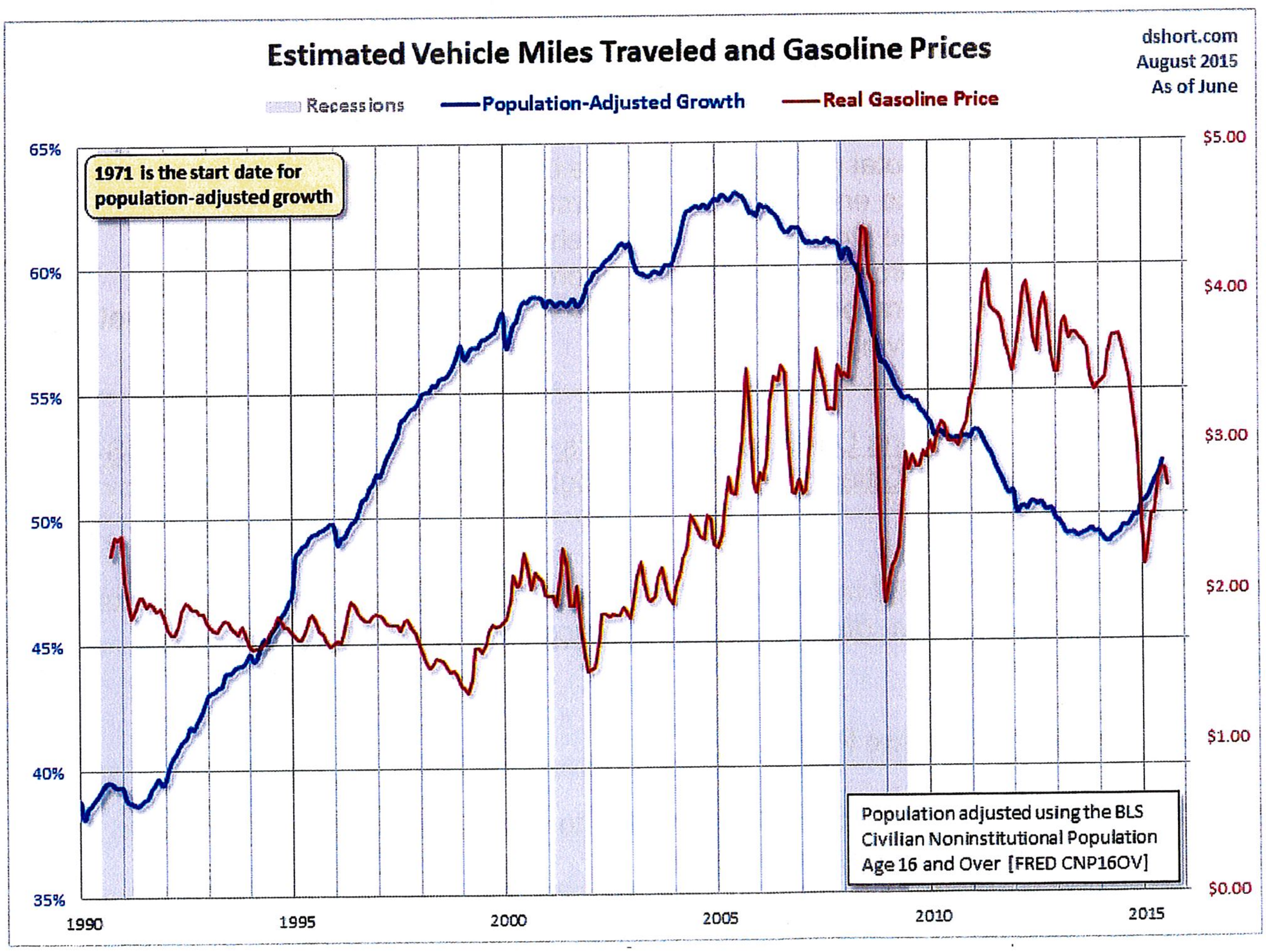
Oil - Rotary Rig Count
Eagle Ford
300
250
200
150
100
50
0
97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15
January 1997 - September 4, 2015
WTRG Economics © 2015



Oil - Rotary Rig Count
Permian Basin
600
500
400
300
200
100
0
97 98 99 00 01 02 03 04 05 06 07 08 09 10 11 12 13 14 15
January 1997 - September 4, 2015
WTRG Economics © 2015



Estimated Vehicle Miles Traveled on All Roads
dshort.com
August 2015
As of June
Recessions
Miles Traveled: 12 Month Moving Average
Trillions
3.4
3.2
3.0
2.8
2.6
2.4
2.2
2.0
1.8
1.6
1.4
1.2
1.0
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
Nov 2007
New High
Nov 2011
trough at
48 months
after peak,
3.65% off high
39 months
below previous peak
-3.2% at trough
Trillions
A Close Look Since 2007
3.15
3.10
3.05
3.00
2.95
2.90
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016



Estimated Vehicle Miles Traveled and Gasoline Prices
dshort.com
August 2015
As of June
Recessions
Population-Adjusted Growth
Real Gasoline Price
1971 is the start date for
population-adjusted growth
65%
60%
55%
50%
45%
40%
35%
$5.00
$4.00
$3.00
$2.00
$1.00
$0.00
1990
1995
2000
2005
2010
2015
Population adjusted using the BLS
Civilian Noninstitutional Population
Age 16 and Over [FRED CNP16OV]

Oklahoma City-based Continental Resources reduces drilling operations budget again

By ADAM WILMOTH The Oklahoman | Posted: Wednesday, September 9, 2015 10:55 am

OKLAHOMA CITY - Continental Resources Inc. executives Tuesday cut the company's drilling budget again as oil prices continue to weigh on the oil and natural gas industry.

The Oklahoma City-based oil and natural gas producer said it will spend $300 million to $350 million less than the $2.7 billion it planned for this year's budget. The company said it is cutting its rig count in North Dakota to eight, down from 10 previously.

"While we do not believe today's low commodity prices are sustainable long term, we are committed to living within cash flow until they recover," CEO Harold Hamm said in a statement. "We are reducing capital expenditures to protect our balance sheet and to preserve the value of our world-class assets until commodity prices improve."

Continental in December cut its 2015 budget by more than 40 percent from its earlier guidance of $4.6 billion.

Click here to link to the article at NewsOK. Some stories require an Oklahoman subscription to read.

Bonds | Wed Sep 9, 2015 11:47am EDT

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BRIEF-Whiting Petroleum CEO says plans to operate within cash flow for 2016

SEPT 9

Whiting Petroleum Corp

* CEO Jim Volker says plans to operate within cash flow in 2016

* CEO says expects to maintain $3.5 billion borrowing base even after October loan redetermination process

* CEO on $3.5 billion borrowing base capacity: 'We don't intend to use it'

* CEO says Redtail Niobrara shale assets have production potential of 100,000 barrels of oil equivalent/day

* CEO says believes company 'leading the charge' in oil industry on capital budget cuts

* CEO says prefers to pay down debt instead of buying back stock

* CEO says Bakken differential could fall from around $8/barrel to about $5 if WTI oil prices stay near current levels Source text for Eikon: Further company coverage: (Reporting By Ernest Scheyder)