



The Pay Zone

Jan 26th 2015

The Pay Zone: Oil Price Cairne, Faroe, Ithaca, Parkmead and others.....

WTI \$45.59 -72c, Brent \$48.79 +27c, Diff \$3.20 +99c, NG \$2.99 +15c

Oil price

The oil price had, by its own recent standards a fairly quiet week, Brent was only down \$1.38 whilst WTI fared a little worse after those awful inventory numbers to finish down \$3.54 over the period. This meant that having flirted with positive territory the differential has risen back to over \$3, those inventories are at long time highs. Cold weather in the States with ice and snow in the North East has had a modest effect on the natural gas price but stocks remain high and I would be surprised if the price went back up towards \$4 but you never know.

The Baker Hughes Rig count showed another big fall last week, 43 more units were lost taking the number to 1,633 which is down 287 in the last two months and at the lowest level since 2010. This week sees the start of the oil majors results season and whilst 4Q numbers will in most cases be dire, I suspect that it will be the statements and the cost-cutting that will attract most attention. Shell and ConocoPhillips are on Thursday with Chevron on Friday, in Shell's case their comparable quarter is with that of the profits warning last year so will actually show an increase y/y. For BvB, who was shocked into significant cost cutting then, it will be more of the same I suspect but maybe not as much as some other, we shall see.

Finally, the situation regarding fracking in the UK is facing yet more hurdles as the House of Commons Environmental Audit Committee is apparently calling for a moratorium and also some papers are suggesting that political groups in Scotland are also climbing aboard the bandwagon. The thought of job creation, local investment and profit sharing has been pushed aside by politicians ahead of a general election in which they are primarily look after number 1. The noise at one site, for which planning was vetoed was said to be as loud as a humming fridge' for householders and the refusal was not about the gas extraction but noise and traffic. There appears to be little listening to actual scientific facts here

The Bucket List

Long time readers will know that I don't put out new year share recommendations just for the sake of it, as a general rule I reiterate my preferred stocks and any changes of view. In the last few weeks, with the carnage in the sector, I have increasingly felt the need to take a fresh look at what stocks I like and why and if they need updating for the current situation. The result is The Bucket List which is intended to try and identify a group of companies that whilst badly hit by the crude price fall should weather the storm and, over the longer term, reward investors. The list includes stocks which have broad portfolios as well as those with more specific exposure to assets which might turn out to be a game changer, this is not intended to be entirely defensive. Attributes almost all companies share are good management, a generally strong financial position and in most cases asset values much higher than current share prices even at \$40 oil. Having said that, I am trying to balance in the list some risk as well as a degree of safety, it is meant to be a comfortable but exciting ride without too much fear of total value destruction.

The oil price as I have mentioned, has fallen since June of last year, starting with the ISIS invasion of Iraq and continuing through the Thanksgiving Opec meeting and is now over 50% lower than back then, at the moment I don't see any reason why things should change much as fundamentals remain weak. The supply and demand situation is still, and will remain out of balance until the Opec pricing policy has successfully taken enough crude off the market to make a difference, at that time a combination of less supply, and more demand created by cheaper prices might lead to a sharp pick up in the oil price. The oil price is no different to other commodities in that it always has cycles, they are rarely predictable and market participants usually overreact causing more long term damage. As we head into the reporting season it will be interesting to see how many projects are delayed or canned altogether and what guidance the CEO fraternity decide to honour us with. Last week I wrote about the head of Eni suggesting that Opec's actions may lead to \$200 oil in the long term, that may well be so but it will be made worse if majors junk a lot of big projects that will create shortages in the medium term. I believe that we are in U shaped scenario and that not until the end of this year will we start to see any light at the end of the tunnel and even then we may not recognise it when we see it. I



think that should supply dry up over the year we may lose as much as a million b/d by the 4th quarter, add that to a built in pick up in demand helped by cheaper crude oil and the situation looks more interesting. A 2.5m b/d swing is not out of the question and by then if Opec felt that the market had tightened sufficiently it could then cut production with enormous consequences, lack of investment would show through in no time.

So, the Bucket List is a mixed portfolio of shares that unless we are in an extended low oil price environment should produce some winners and hopefully not too many losers, if you think that we are in a Domesday scenario you shouldn't be investing in the sector at all. You will notice that there are no oil majors or service companies in this list, over the next weeks I will be addressing them all as they produce results as well as give us an idea of how they are set up to cope with the new low oil price world, indeed some may decide to take advantage of the situation.

In no particular order these are the shares I would consider looking at and if things change materially I will adjust accordingly, at the bottom of the list is a subs bench' of stocks that will come into play should various scenarios occur.

The heavyweight' end of the list is dominated by a quartet of companies that share the attributes mentioned above, they have good, balanced portfolios of assets some internationally, some in the North Sea. These are Premier (LON:PMO), Faroe (LON:FPM) , Ithaca (LON:IAE) and Parkmead (LON:PMG) all of whom have proactive management, sound financing and an ability to, to a large degree control their own destiny. Most have hedged well through the last few months and this has given them some protection, other degrees of protection can be seen in long term gas contracts held by Premier in Asia for example. Drilling programmes for all these companies offer plenty of upside through the year.

Cairn (LON:CNE) gets into the list as, in my view the Senegal discovery is a real opportunity to do what it has done before and change the company. The rest of the assets are good quality too and with plenty of cash it should be able to take advantage of significantly cheaper operating costs to press ahead and materially add value to the company. Staying in Africa this may well be the best chance in many years to make money in Bowleven (LON:BLVN), with the caveat that the deal is not yet totally done and dusted, the completion of the Lukoil/NewAge contract will leave the company with plenty of cash and some interesting wells to drill. If I see any signs of drift in the deal or in the end market for gas I would be ready to lock in any profits but at the moment subject to these points the idea works.

In this list I wanted to put in some stocks that have defensive merits but with exciting upside potential and the first that comes to mind is Sound Oil (LON:SOU). Whilst exposure to Italy wasn't always a good thing changes are being made and Sound looks to be in a good place being onshore and at present mainly gas oriented. Current production covers the running costs of the company and if Nervesa delivers then that gets better, at the moment gas prices in Italy are high and relatively very stable. But the upside potential at Sound is significant as in Badile they have a real potential company maker and that and other prospects such as Laura, Zibido and S.Maria Goretti are all capable of adding value. Sound is well funded and has strong support from major shareholder Continental and the outlook for the next 18 months is very appealing.

Staying onshore but in the US is Caza Oil & Gas (LON:CAZA) which has, for its size, one of the most valuable positions in the Bone Spring play which gives it flexibility and a strong competitive advantage. Also well hedged, Caza has already seen its costs falling and as its acreage is mainly held by production it has the ability to divert money to opportunities coming up, some of which have never been seen before in this play.

Amerisur (LON:AMER) remains a big favourite and when we hear the news that the new pipeline through Ecuador is up and running the economics of the business will be transformed. The Platanillo field gets better and better and I suspect will continue to provide success after success. Amerisur will be hoping for a good well result as it drills in Paraguay this year and readers will know that I think that this will also reward President Energy which has made the breakthrough in the country and will be watching the well with interest.

Whilst looking at companies that have exposure to high profile wells one mustn't overlook Pantheon Resources which is about to drill two wells in Texas that have the double advantage of possibly finding gas or at the deeper level, oil in the Woodbine. March 1st will see the renewal of drilling in the Falklands so one should watch both Rockhopper and FOGL, wells are to be drilled in both the North Basin and the South, should there be success for Premier and RKH then Sea Lion of course gets more attractive, even at these prices.

A company that had a high profile well last year was Hurricane Energy as it had success with its fractured basement play West of the Shetlands. The market combined oil price jitters with uncertainty of how the company was going to



fund the development and the shares fell after assessing the good news. With 100% stakes in the projects and a highly dynamic CEO the opportunities for Hurricane are not diminished by the weak oil price and the fact that the development can be moved more quickly than traditional finds make it look very attractive at these levels.

Only two more categories now and the first is to look at the potential for Genel and Gulf Keystone in Kurdistan. These stocks have had an additional bumpy ride as not only have they had the oil price to contend with but by being where they are they have a geo-political risk factor. Genel has not only Taq Taq and Tawke to give them massive increases in production this year but also have the gas development at Miran which I have always said is the jewel in the crown. The market is concerned about payments for their crude from the KRG but I believe that it is not in the interests of the Government not to pay them and in due course this will happen. Genel is a major beneficiary of Turkey's ongoing need for energy and with significant booked reserves of oil and gas should be on the shopping list of any cash-rich major as it is just too cheap in the long run. As for GKP it too must be looking very interesting at around 50p, at long last the company has hit the targets it set itself and although it too is awaiting payments for crude oil delivered it will also get paid. There is little doubt that once payments start becoming more regular the company can beef up its operation and will deliver value for shareholders. I think that GKP could easily get taken over as now it has started proper production from Shaikan and with modest pipeline connections can steadily increase its oil sales.

I have written about two special situations' in and around the energy sector and want to have a final mention of both Velocys and Alkane Energy in the bucket. Velocys is definitely in the long term camp but assuming there is a need to monetise stranded gas and that the small scale gas-to-liquids technology works which it does, then having supported it for a long time, its loyal shareholders will be rewarded. Alkane ticks the boxes for a number of reasons, it is a highly efficient producer of coal mine methane and it supplies the grid with much needed electricity, it too is a gas to power generator. Its power response sites can provide the grid with electricity and at rates well above the longer term contracted prices generating, as it were, higher profits.

Subs bench.

So that is the list for the time being, on the subs bench are waiting a number of companies who are dependent on political or similar events, IGas and Egdon will start to deliver when the initial furore over fracking and onshore drilling dies down probably after the election and should be observed. Similarly but many miles away, Andes Energia should come into focus more when the election process in Argentina becomes closer and more understandable. Also waiting for developments is Madagascar Oil & Gas which is attempting to get permission for its project there which should come through and is another long term one to watch. In time, Chariot Oil & Gas, as a fast follower' may have some appeal with respect to the Atlantic margin. Finally depending on timing it may be worth keeping an eye on NTOG as it too has interesting drilling later in the year.

And finally

The FA Cup at last got interesting and all those easy wins I glossed over didn't happen. With Chelski, Spurs, Saints and Noisy Neighbours all losing that has left tonight's draw looking more interesting. Man Who couldn't beat Cambridge either so Arsenal, the HubCap Stealers and West Ham must be the current favourites!

The FA Cup final falls on Steven Gerrard's birthday this year. Wouldn't it be a great present and a great send off if he could be there. I really hope someone buys him a ticket.

Andy Murray got through and plays to local favourite Nick Kyrgios tomorrow morning.

The European rugby finished the Group stages yesterday and the English sides did pretty well, Bath, Saints, Wasps and Sarries go through to the knockout stage with Racing Metro, Toulon, Clermont and Leinster.

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