Market Update: Oil & Gas – July 2015

Brought to you by the KPMG Global Energy Institute

Oil & gas markets: monthly roundup

Oil price benchmarks traded lower in June and early July as both fundamental and technical indicators combined to paint a bleak picture for global oil prices. On the fundamental side, over-production by OPEC, an increase in US oil stocks and a rise in US rig counts supported the notion of an over-supplied market. Chinese demand meanwhile was also seen to be slowing as crude oil imports reduced to US$55.73 billion during the Jan-May period, almost 50 percent lower than the same period last year.[1]

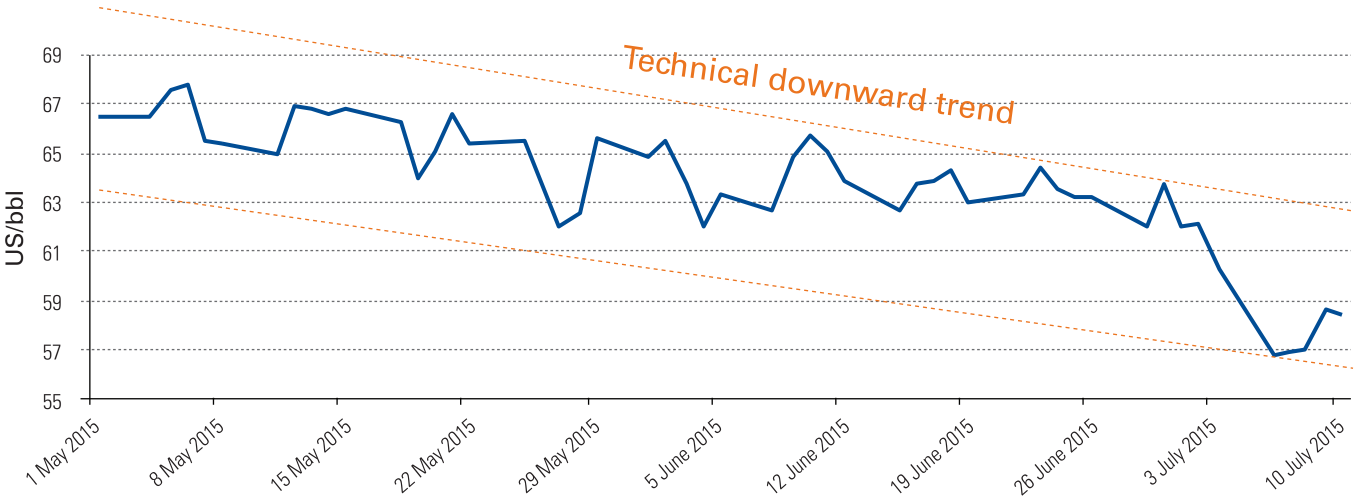
The technical picture also provided little comfort as an emerging medium-term downtrend became more entrenched – and a 20 percent fall since May has seen a return to a bear market.

On July 6th, oil prices sunk to a near 3-month low. The ICE Brent futures contract sunk to intraday low of US$55.1/bbl, while the US NYMEX WTI benchmark fell to US$50.58/bbl.

M&A activity

The global M&A market in the oil and gas sector appears to be slowly recovering from the sluggish start seen in Q1 2015, according to data published by IHS. Global deal value in Q2 2015 was estimated at approximately US$190 billion, a 34 percent y-o-y rise. However, the number of deals reported was significantly below 2014 levels, down 41 percent compared with same quarter last year. The disparity in deal value and deal count was attributable to the Shell-BG merger which accounted for around 70 percent of the total deal value for the upstream sector. Upstream M&A activity was estimated at US$120 billion for Q2 2015. Mid-steam M&A activity was also a significant contributor to deal value in Q2 2015, accounting for almost one-third of the total at around US$60 billion.

ICE Brent: May – July 2015

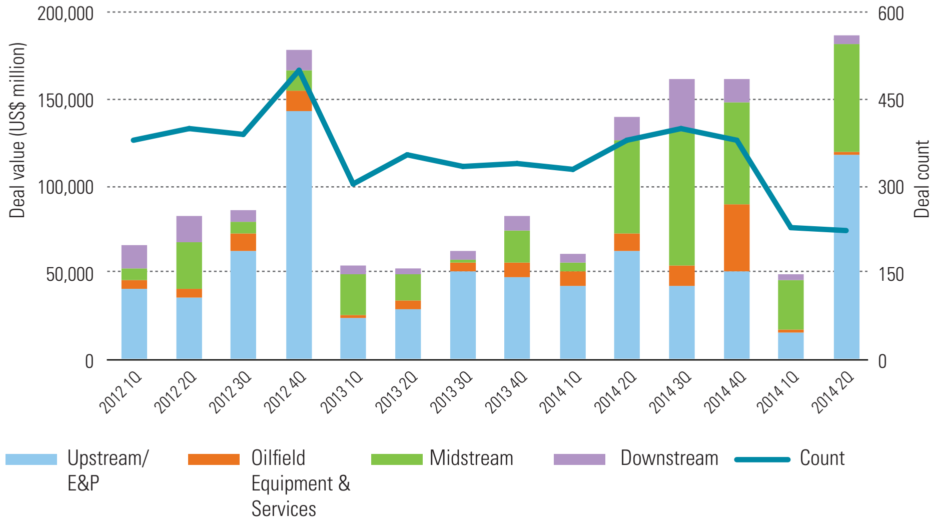


Price source: Bloomberg

[1] "20 major import products and top 5 countries/regions," China Trade Research website, accessed July 2015

The low volume M&A activity of 2015 is a far cry from the high-value, high-volume activity seen in 2014 – where the oil and gas sector recorded its highest ever annual deal value of US$523 billion, more than double 2013 levels. During this period unconventional reserves and resources enjoyed an 80 percent rise in acquisition spending. However, plunging oil prices since November 2014 has disturbed momentum in the M&A market and made potential buyers and sellers more selective with their M&A activities. Despite the uncertainty around oil price, cash-rich companies with strong balance sheets and opportunistic parties will continue to closely monitor acquisition opportunities within this sector – as many upstream players remain vulnerable with oil trading below US$70/bbl.

M&A Deal Value



Source: IHS

Supply side headlines

- Global surplus crude oil production capacity averaged 1.7 million barrels per day (mb/d) in May and June, 0.4 mb/d lower compared to last year (OPEC)[2]
- US refinery capacity reached 18 mb/d – based on increases in both capacity and utilization – helped accommodate increases in the US crude oil production (EIA)[3]
- Non-OPEC oil supply in 2015 is projected to grow by 0.68 mb/d, in line with the previous forecast and below last year's strong growth of 2.17 mb/d. (OPEC)[4]
- Global petroleum and other liquids production averaged 95.7 mb/d in May and June 2015, growing by 3.1 mb/d compared to last year (EIA)[5]

Demand side headlines

- Global oil demand is expected to grow at 1.18 mb/d in 2015, marginally higher than the previous year's growth of 0.96 mb/d (OPEC)[6]
- Global petroleum and other liquids consumption in May and June 2015 averaged 92.9 mb/d, 1.5 mb/d higher compared to last year (EIA)[7]
- Total oil consumption is expected to pick up pace in second half of 2015, leading to a total oil demand of 92.50 mb/d for 2015. (OPEC)[8]

Analyst estimates: oil

Analysts continue to present mixed views on oil price forecasts. A backlog of uncompleted wells has prompted some analysts to maintain high forecasts, whilst others expect US supply to grow and exert downward pressure on prices.

Brent (US$/bbl)	2015	2016	2017	2018
May Average	60.7	70.5	81.1	85.9
June Average	62.0	69.8	80.2	85.1
May Median	60.0	70.0	80.0	80.0
June Median	61.8	70.0	80.0	80.0
Number of estimates	19	17	11	7

Source: based on a poll of 19 external energy market analysts

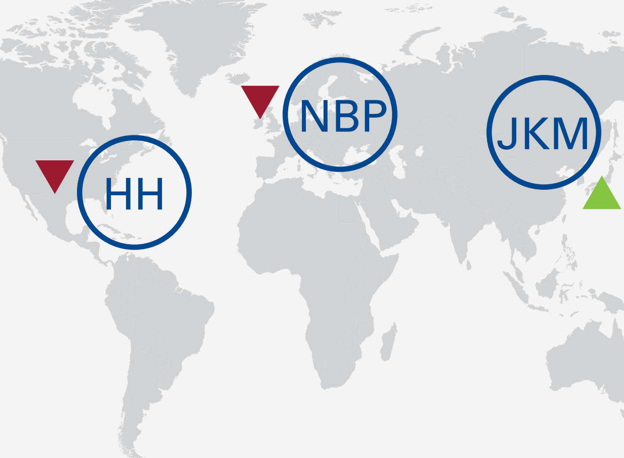
2 "Monthly Oil Market Report," OPEC website, accessed July 2015
3 U.S. refinery capacity reaches 18 million barrels per day", EIA website, accessed July 2015
4 "Monthly Oil Market Report," OPEC website, accessed July 2015
5 "The Availability and Price of Petroleum and Petroleum Products Produced in Countries Other Than Iran", EIA website, accessed July 2015
6 "Monthly Oil Market Report," OPEC website, accessed July 2015
7 "The Availability and Price of Petroleum and Petroleum Products Produced in Countries Other Than Iran", EIA website, accessed July 2015
8 "Monthly Oil Market Report," OPEC website, accessed July 2015

Gas markets: monthly roundup

Industry benchmarks

UK

ICE UK Natural Gas Futures, dipped 1.2 percent month-on-month to 42.62 pence per therm (p/th) as warm weather along with ample supply led to lower UK demand for gas. (Source: ICE)[10]



US

Natural gas prices at the Henry Hub delivery point declined 7 cents for the month of June, averaging at US$2.78/ MMBtu compared with US$2.85/MMBtu in May. A drop in gas production in Northeast (owning to maintenance and construction in the Marcellus area) during May and June contributed to US gas production averaging 78.2 billion cubic feet per day (Bdf/d) in June, down 1.2 Bcf/d from April level. The EIA expects Henry Hub prices to average US$2.97/MMBtu in 2015 and US$3.31/MMBtu in 2016 supported by consumption growth in industrial and electric power sectors. (Source: EIA)[9]

Japan

The Platts Japan Korea Marker (JKM) for July deliveries averaged US$7.60/MMBtu, up 6.7 percent month-on-month but down 41.3 percent year-on-year. The increased demand from Asian power utilities in the usually high-demand summer season helped push prices higher for the month. Buyers from Taiwan and Japan entered the spot market to buy several cargoes, however, the majority of demand for July delivery LNG came from India, one of the premium markets in the Asia Pacific basin – as spot cargo prices continue to offer better value than longer term contracts[11]

Analyst estimates: gas

Analysts continued to lower Henry Hub price forecasts for 2015 as robust supply growth continues to outstrip demand. However, longer-term forecasts are pricing-in a decelerating supply growth, as falling rig counts could threaten medium and longer term supply.

Henry Hub (US$/MMBtu)	2015	2016	2017	2018
May Average	3.1	3.5	4.0	4.1
June Average	2.9	3.5	4.0	4.3
May Median	3.0	3.4	4.0	4.1
June Median	2.9	3.5	4.0	4.4
Number of estimates	17	17	10	5

Source: based on a poll of 17 external energy market analysts

9 "Henry Hub Natural Gas Spot Prices," EIA website, accessed June 2015; "Short-Term Energy Outlook," EIA website, accessed July 2015
10 "ICE UK Natural Gas Futures #1 (M1)," Quandl website, accessed July 2015
11 "Publishing and Periodical Companies; Platts JKM(TM) for July-Delivered LNG Plunged 41.3 percent from Year Ago on Poor Demand," Jounal of India, 30 June 2015, via Factiva, accessed July 2015

A global insight

Points of view from KPMG's Oil & Gas subject matter experts

UK

George Johnson
Executive Advisor, Oil & Gas
KPMG in the UK
T: +44 7879 498872
E: george.johnson@kpmg.co.uk

Trepidation in the crude oil market

"Fundamentally, there's little to suggest the market is due for an upside correction anytime soon. Oil supply remains plentiful and the constant threat of more barrels entering the market (from Iran) is placing a virtual cap on prices. Adding to this bearish sentiment is the emerging technical downtrend which could engender further selling pressures – as speculative players may seek to capitalize through short position taking. Further price decay could see some of the more vulnerable upstream players in the industry reaching for the taps."

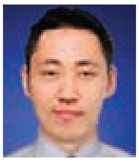
US

Thomas G Ruck
Manager Advisory, Oil & Gas
KPMG in the US
T: +1 713 855 2399
E: truck@kpmg.com

Fundamentals remain bearish

"Oil fundamentals continue to weigh on prompt prices. Despite some recent small declines in US crude production, crude supply should continue to exceed demand by as much as 2 million barrels per day globally for the balance of this year (per recent IEA update). This supply imbalance needs to be cleared before crude prices can sustain any increases. The term structure of crude prices should shift into steeper contango as well once inventories begin to increase. Refinery utilization and crack spreads, meanwhile, remain the one bright spot in the oil patch. Crack spreads remain well above average levels for East, Gulf and West Coast refiners. Even Northwest Europe cracks are above average for this time of year. However, cracks will likely begin to decline as product demand tapers off into the fall."

ASEAN

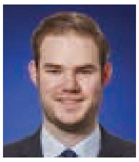


Oliver Hsieh
Associate Director, Commodity & Energy Risk Management for ASEAN
KPMG in Singapore
T: +65 6411 8037
E: oliverhsieh@kpmg.com.sg

All eyes are on China

"Much time and ink has been spent discussing the slow-moving car crash that is the Greek economy; however within Asia this week, the turmoil within the Chinese equity market has seen Beijing taking drastic measures to regain control. In years past, through their iron-fisted approach, Beijing has maintained a calm this-is-all-under-control facade. This round of market interventions however breaks that guise. As the region's bellwether for industrial and economic activity, China's intervention paints a very bearish picture for energy demand. Expect markets to remain volatile with weakness and caution being the prevalent themes, at least until trade restrictions are lifted."

Switzerland



Christian Kurz
Deputy Head Regulatory & Risk Management, Commodities Trading
KPMG in Switzerland
T: +41 58 249 65 76
E: ckurz@kpmg.com

Technical picture turns bearish

"The medium-term price trend has turned bearish once again. Momentum indicators have rolled-over and the long-term moving average is still in decline. Aside from the oil market fundamentals, the latest price action appears to have been influenced by the recent developments around Greece and the stock market crash in China. Short-term, Brent prices have reached oversold level (on the relative strength index), which could lead to a short-term consolidation phase. We could see some price support at US$55/bbl, however, if we dip below this level, a further price decline to US$45-50/bbl cannot be ruled out."

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