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FOCUS ON
Oil & gas: a barrel half full

Produced by the Economic Analysis and Research

EXECUTIVE SUMMARY

- *A year ago the forecasts of crude oil prices dwelt steadily above 100 dollars a barrel (USD/bbl). If price has halved since, its value has not–at least not everywhere.* **Several countries, more or less known, offer better than ever opportunities for Italian companies in the industry, including SMEs**. *We have divided them into three groups, indicating risks and opportunities of each.*
- **Leading producers' group** *includes the USA and Saudi Arabia: the richest, developed, voracious markets. The Saudis have not yielded on OPEC quotas, while private U.S. firms have shown resilience in production despite the decreased number of wells. While the former is seeking to extend its leadership in petroleum products, the latter is looking with interest at new fields to become self-sufficient. We see opportunities in highly specialized segments along the entire chain: upstream, plastics, alternative energy sources.*
- **Those taking the plunge** *to break away from competition and become major players: Angola, Azerbaijan, Iran, Mexico and Oman. These countries are at a crossroads and will be among the most interesting destinations for both upstream and downstream in coming years; they possess important reserves for Italy too. We recommend them for valves and fittings, refining and enhanced oil recovery equipment.*
- **Dicey countries***, i.e. old acquaintances and new frontiers for the industry that express a high degree of risk but that might attract the attention of companies in coming years, with particular elements of opportunity that should be considered now, such as a local presence.*
- *A year ago* **the winning strategy** *to maximize profits was to increase production; now it is to produce efficiently. The role of SACE to provide* **credit insurance** *and a competitive financial offering is more essential than ever.*

THE AGE OF RIVALRY (AND GLUT)

Twelve months ago the projections on crude prices were consistently above 100 dollars a barrel (USD/bbl). The investments of the previous three years, with a break-even level of around 70 USD/b, were made to generate sizable profits. Petroleum was a precious resource around the globe, highly paid in every market and indispensable for economic growth. Today its price has halved and its availability almost been taken for granted.

This is not the first time oil prices have plummeted so drastically and suddenly. The characteristic of this decline is crude supply, which remains excessive due to the resilience of the small American shale producers – which has reduced the number of active wells by a third without affecting production – and Saudi Arabia, which has so far convinced OPEC not to tighten the tap and maintained its market share.

While investments cuts in new activities (-30pc worldwide) affect the medium term, the attractive price of crude encourages the accumulation of record-high inventories to feed importing countries if supplies suddenly decline, which may also delay upturns in prices. Unless some of the competitors grow tired, or some OPEC members are forced to relinquish their slice of the pie, 60 USD/bbl appears a reasonable "new normal" until 2020.

FIGURE 1. *Estimates of Brent prices in coming years, USD/bbl* [01]

	2015	2016	2018	2025
US Energy Information Administration (EIA)	61	70.5	79	91
Economist Intelligence Unit (EIU)	60	69	86	
Business Monitor International (BMI)	59	61	65	77
ICE Brent Futures (spot values Jun-Dec)	65/67	69/70	73/74	
Bloomberg Consensus	62	70		
S&P	62	68		
Citi Bank	65	68		
Goldman Sachs	58	62		
JP Morgan	62	72		
Barclays	60	68		
Bank of America Merrill Lynch	58	62		

[01] *Sources: US EIA, EIU, BMI, Thomson Reuters, Wall Street Journal. Data collected between July and August 2015*

In this context, the glut of crude oil is stressing rivalry between producers, weighing on less solid exporters' fundamentals (Nigeria, Russia, Venezuela), and accelerating the quest for efficiency, vertical integration and consolidation.

While oil price has halved, the same cannot be said for its value, because of its importance to producers, exporters and consumers and because it has proved once more cheaper than alternative sources (e.g. renewables, biofuels, etc.).

In the next few pages we present some opportunities in the sector and provide a few examples of how SACE can support the Italian value chain in new and "old" markets.

LEADING PRODUCERS

They are industry veterans whose strategic choices are redrawing the world energy map. They are market leaders with an established system and significant entry barriers, but they also represent the greatest opportunities in terms of scale (and potential demand).

USA: self-sufficiency at all costs

Export Opportunity Index 72/100

Since 2011, the United States has increased its production by over 1 million barrels a day, thanks to more efficient production techniques, which help keep the shale pioneers more or less afloat, and an energy policy that strives for autonomy at all costs. Shell obtained authorization from Obama to resume activities in the Chukchi Sea, north of Alaska, despite the environmental impact and the unforeseeable costs of the black gold rush in the Arctic. Oil reserves in that area (North Slope) equal or exceed those of the Bakken (23-24 billion barrels), the unconventional oil giant. “Cowboyistan” benefits not only from the powerful U.S. pipeline infrastructure but also from trains for transporting oil throughout the country. Self-sufficient production will avoid other expenses to protect U.S. energy interests around the globe. This approach will unveil several opportunities for Italian companies in **high-tech components, refining and petrochemicals, plastics machinery, and soil and water treatment.**

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Saudi Arabia: more than oil

Export Opportunity Index 85/100

Saudi Arabia, pivotal member of OPEC, encouraged cartel members to keep their output unchanged and fueled the price war: on the one hand, by offering discounts to counter the commercial penetration of other countries and the entrance of new competitors; on the other, by maintaining an ambiguous position toward the IS and effectively preventing producing countries like Iraq, Libya and Nigeria from expressing their potential in the international markets.

Low prices not only discourage exploration but also transformation. The country is at the center of the highest potential area in coming years: population growth, increased demand, and financial and energy availability are driving the development of **refineries and petrochemical plants**, as well as the production of **energy from renewable sources**. Oil products can therefore be supplied to the Middle East and Asian markets with higher margins and without the constraints of OPEC quotas on crude.

What SACE can do – a few examples

Company objective	Target country	Financial requirements	SACE Product	Amount	Duration
Supply valves to the petroleum industry	Saudi Arabia	Confirm letters of credit	Supplier Credit	€ 450,000	6 months
Supply components for building refineries and petrochemical plants	Saudi Arabia	Provide performance bonds	Guarantee Policy	€ 120,000	12 months
Increase the production of soil treatment equipment	USA	Expand lines of credit / Reduce the share of MLT risk assumed by banks	Financial Guarantee	€ 3 mn	60 months
Export inverters for solar energy production	USA	Short-term credit insurance and factoring	BT Export Development + Trade Finance	$ 9 mn	18 months

THOSE TAKING THE PLUNGE

The price war is destroying the ambitions of many emerging countries, stalled by cuts in state expenditure , the downsizing of state budgets and corruption scandals. A few are already reshaping their role, others are at a crossroads: whether to remain in the shadow of the "big guys" or head towards real change.

Angola: the other Brazil

Export Opportunity Index 61/100

With just under 2 million barrels/day of crude, Angola is competing with the Saudis as no. 1 supplier to China: a policy of aggressive pricing (and a fiscal target based 70pc on crude oil) has enabled Luanda to keep oil flowing despite the loss of U.S. demand. Fixed and floating offshore platforms have been operating since 1999 on a production-sharing basis with the national company. The government's objective is to keep the bar above 2 million bbl/day with a production cost of 30 dollars: here again, Italian companies might find interesting opportunities in providing technology and fittings for exploration and production (E&P), the search for industrial partners other than Chinese companies, which have acquired a dominant share of the production chain over the years, and expanding local refineries.

Azerbaijan: another hand in the great game

Export Opportunity Index 60/100

Baku is our country's no. 1 petroleum supplier: in 2014 we imported over 9 million tons (more than 67 million barrels) of crude oil at a cost of € 5.4 billion from this small country on the Caspian Sea. In May, Petronas, the Indonesian national company, took advantage of market sales to acquire 2.2 billion dollars in assets from Statoil and expand its upstream portfolio.

Our exports to Azerbaijan (some € 600 million) have tripled in the past five years based on machinery which still represents a quarter of Italian supplies: **taps and valves** alone generated over € 38 million in 2014. Competition with Russian gas, following cancellation of South Stream, will affect the energy policy of the area (and the EU in general) and may bolster demand for further **machinery.**

Iran: recovering lost time

Export Opportunity Index 48/100

In the past four years, Iranian petroleum exports almost halved (from 2.6 to 1.4 million bbl/day), and production declined by 17pc from the 4.4 million bbl/day in 2011. The European Union alone has reduced supplies by 600,000 bbl/day. Sixty percent of Iranian wells are over 60 years old, with crude recovery rates of 20-30pc from existing fields. The reduced volumes and the need to preserve social consensus have kept fiscal break-even well above 100 USD/bbl. Iranian crude has meanwhile been replaced with that of Saudi Arabia, the Emirates, and Kuwait. The reopening of trade, which should become effective for the petroleum sector in the first half of 2016, shall revive the industry, in need of equipment and structures to meet the challenge: in particular **valves, fittings, machinery and equipment** for the domestic transformation of petroleum and **enhanced oil recovery** technology.

Mexico: after 80 years of solitude, the private sector returns

Export Opportunity Index 67/100

With 2.8 million barrels a day, Mexico is the third-largest petroleum producer on the American continent: half of the volume is exported, but a quarter is reimported in the form of fuel. Extraction costs average 26 USD/bbl (18 for exploration and 8 for production), though reserves had declined by a third since 2005: energy reform, passed in August 2014 to reverse this trend, has ended the monopoly of national company, Pemex, which dated from 1938, and is beginning to reveal its potential. Today the country is one of the most promising areas on the planet: first tenders have started to assign offshore (shallow and deepwater) and onshore field concessions to private companies. The latter might prove the most attractive and coveted in the initial phases: the first tender calls received acceptable offers for only two of the 14 shallow water blocks. All healthy majors are in, singly or in consortium, even if they have assumed a more cautious attitude than expected so far. For this reason, entering the various segments of **E&P** now might be essential for seizing the greatest benefits from 2018 onward, as well as increasing the domestic capacity for hydrocarbon **refining and synthesis** with Pemex.

Oman: the free rider

Export Opportunity Index 60/100

Oman is the main producer of oil and gas in the Middle East that is not an OPEC member. In the past decade, it has improved its technology for recovering oil from wells, boosting addition production by 2pc per year. In coming years, it will try to follow the example of Saudi Arabia: maximum attention to upstream efficiency but also an effort to become a producer of refined products and plastics in one of the main crossroads of world commerce, the Strait of Hormuz. Here again, opportunities for suppliers of **enhanced oil recovery** systems, **machinery for the petrochemical industry** and the **production of solar and wind energy**.

What SACE can do – a few examples

Company objective	Target country	Financial requirements	SACE Product	Amount	Duration
Establish a commercial bridgehead in the country and participate in local commercial initiatives	Mexico	Expand lines of credit / Reduce the share of MLT risk assumed by banks	Financial Guarantee	€ 750,000	48 months
Furnish technologies for the automatic positioning of mobile offshore units	Angola	Offer customers extended payment terms	Supplier Credit	€ 1.8 mn	36 months
Export machinery/ plant for refining	Iran [02]	Equal the proposal of a competitor by offering a two-year prepayment period and payments extended to 84 months	Buyer Credit	€ 20 mn	10 years
Form an Azerbaijani company to market petroleum products in the country	Azerbaijan	Protect investments (and derived profits) from political events	Political Risk Insurance	€ 5 mn	48 months + possible extensions
Local use of a compact petroleum separation plant	Oman	Insure machinery against destruction	Supplier Credit	€ 250,000	7 months

[02] *Transactions only possible with banking counterparties outside the country and at conditions evaluated case by case. SWIFT messaging to/from the country will probably be restored after removal of the sanctions on the petroleum industry and will also depend on the counterparty involved.*

DICEY COUNTRIES: THE COIN INTO THE PIT

Thus far we have spoken of countries that have gained or maintained positions of strong market control or that are grappling with major changes. The following countries are our gambles, "old" and new frontiers of the industry: high-risk areas (current or potential) or imminent surprises?

Bolivia and Peru: from Mother Earth to the Pacific

Export Opportunity Index — BOLIVIA 47/100 — PERU 65/100

The production of gas in Bolivia has more than doubled in the past decade, surpassing better-known countries like Brazil, Kazakhstan and Kuwait, while in Peru it has increased thirteen-fold: the two countries together still account for 1pc of global production. La Paz, now the no. 1 exporter of gas and energy in the region, serves primarily Argentina and Brazil, but intends to lay a pipeline to the Pacific: it has signed an agreement with Lima to build it together. The gas pipeline will make it possible to develop processing plants in Peru and penetrate the Asian markets. The allegations of corruption in Brazil and the recent revocation of some tax benefits (“Oil Plus”) in Argentina may divert part of the expected investments in those countries to areas that are proving more stable and open to the private sector than expected.

Algeria: many bottlenecks, lots of gas

Export Opportunity Index 76/100

No. 8 producer and no. 4 exporter in the world, in 2005 it produced six times its gas requirement: the ratio halved since, while two-thirds of tax revenues continue to depend on the exports of hydrocarbons. The long-awaited enlargement of gas pipelines between Spain and France may free up eastward flows for both Spanish LNG and Algerian production: Paris, Madrid and Lisbon have shorted the time for debottlenecking the western coastline. There are several obstacles to lift: the attitude of the national company toward private interests, the succession to President Bouteflika, and EU energy policy. Pandora’s boxes bound to open in the country where our exports of capital equipment are growing faster than elsewhere in the Mediterranean.

Mozambique: too big to play?

Export Opportunity Index 49/100

Over 100 trillion cubic meters of gas reserves and expected investments of over 50 billion dollars, equal to three times the country's GDP. These are a few of the numbers challenging Mozambique in coming years: in the meantime, the OECD has downgraded the country score due to public debt approaching 100% of GDP.

Though the government does not quantify the country's resources, the volumes are too large to be left in the ground. The geographical location of the country is also highly favorable because it could allow several destination ports for its LNG, not only in the Far East but along the entire Atlantic coast. ENI's involvement in various local projects, and the high potential for SMEs in direct and indirect business, require a high focus on the country as a Southern gas hub.

What SACE can do – a few examples

Company objective	Target country	Financial requirements	SACE Product	Amount	Duration
Invest in a JV/special-purpose entity to build a plant	Bolivia	Protect from unfavorable legislation or transfer of profits	Political Risk Insurance	€ 7.5 mn	36 months + possible extensions
Furnish trucks to transport LNG to rural areas	Peru	Present a risk-free receivable to the bank to generate liquidity	Supplier Credit	€ 5.2 mn	48 months
Consolidate your presence in the supply of valves	Algeria	Match the payment conditions proposed by a competitor	Supplier Credit	€ 950,000	30 months
Open a local plant for assembly and maintenance	Mozambique	Increase MLT lines of credit	Financial Guarantee	€ 2 mn	48 months

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SO MANY OPPORTUNITIES, LITTLE CERTAINTY AND A PARTNER FOR COMPANIES

The rapid, impactful petroleum shock of 2014 left deep scars on the players involved and in many cases revealed the difference between strategic projects and spot initiatives: its substitution with renewable sources, the sustainability of highly complex projects, relatively intensive exploitation of existing resources, real demand and financial bubbles.

But Brent price also registered sudden, long-lasting increases since the '70s that perhaps have had a more profound impact on world economies. Will it happen again? We have read dozens of analyses in both senses. Will everything return as it was before? Here there is our say.

A year ago the winning strategy for scoring record margins was to increase production; today it is to produce efficiently. Managing and insuring risks, offering extended payment conditions, and enhancing cash flows along the whole supply chain have become factors that can significantly affect pricing. Never has it been more important to formulate a strategy commiserate with dimensions and ambitions and to find partners up to the challenge. At SACE we are ready to assist Italian companies to seize these opportunities.

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Export Opportunity Index - What is it?

SACE calculates the Index on a scale of 0 to 100 (where 100 represents the maximum opportunity).

Variable	Reference year	Source
Total value of Italian exports to the country	2014	ISTAT
Average growth rate of Italian exports to the country (note 1)	2011-2018	ISTAT + Oxford Economics forecasts
Concentration of imports by the country (note 2)	2013	United Nations
Italian share of the country's imports (note 3)	Latest available	UN Comtrade

NOTE

1) The period of average growth rate considered for Italian exports is: i) up to 2018 for countries for which SACE has projections (63 countries, included in the Export Report); ii) up to 2014 for the remaining countries;

2) The variable in question is the United Nations partner concentration of trade data on imports;

3) The score for Italy's share of the country's total imports is computed giving greater weight to intermediate market shares (between 2% and 4%), which indicate a good Italian presence and the potential for increasing our share.

In a minority of cases, referring to marginal countries, the score obtained was further adjusted by a qualitative factor to reflect political and economic events.