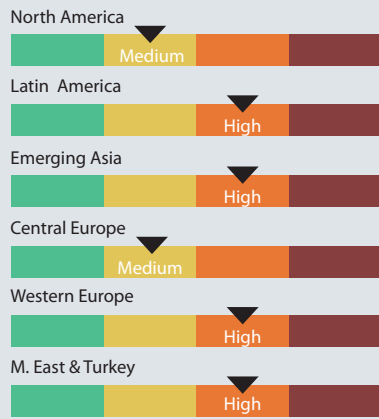


# ENERGY

## COFACE REGIONAL SECTOR RISK ASSESSMENT



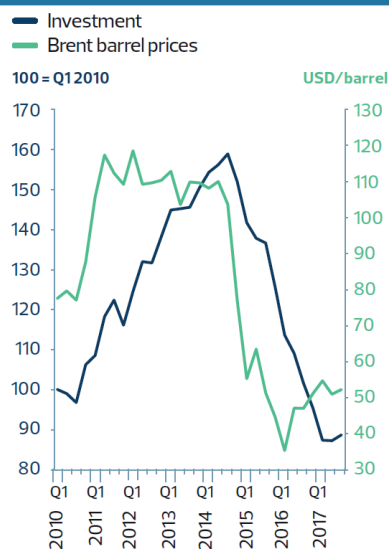
### + STRENGTHS

- Resilience to price fluctuations by leading diversified companies
- Expected high demand in 2018, linked to high growth worldwide
- Efforts by oil companies to streamline their production

### - WEAKNESSES

- High debt levels, especially among shale oil companies
- High volatility in crude oil prices
- Overcapacity of some oil & gas services companies

## TRENDS IN PETROL & GAS SECTOR INVESTMENTS



Source: Datastream, Coface

## RISK ASSESSMENT

The Organisation of Petroleum Exporting Countries (OPEC) and its partners - including Russia, the world's leading producer - extended the agreement to cap production for nine months through to December 2018. The declared goal is to reduce stocks to their five-year average, reducing production by 1.8 million barrels a day, or about 2% of production worldwide. This time, the agreement will include Libya and Nigeria, who should limit production to the highest 2017 level. As a result, Brent and "West Texas Intermediate" (WTI, the North American index also used as a benchmark for determining oil prices) reached high prices of USD 67 and USD 61 respectively in January 2018. The introduction of new-generation American pipelines, with improved capacity, should help close the USD 4 gap between Brent and WTI prices during the second half of 2018.

After reaching a record high in 2016, oil stocks remain very high (140 million barrels above the five-year average), but they are falling and should reach the five-year average during the second half of 2018. In addition, demand has been rising semester after semester, and bridged the gap with supply in the markets during 2017. Capital expenditure should rise slightly among the sector leaders (Chevron, ExxonMobil, Shell, Total, BP) operating over the entire value chain (exploration, production, refining, distribution), as they take advantage of their increased margins in 2017.

## DEMAND

According to the International Energy Agency (IEA), global demand for oil should reach about 98.9 million barrels per day in 2018, a slight rise of 1.3% compared to 2017 but well below the global economic growth of 3.7%. This trend highlights the increasingly efficient use of fossil fuels by the main consumer countries.

Demand in Europe is likely to be stagnant in 2018, at almost 15 million barrels/day. Consumption forecasts may be revised upwards if winter is harsher than the last two years, a scenario that seems probable. Refineries have taken advantage of the steep fall in oil prices since June 2014 to improve their margins (calculated using the NWE Brent cracking spread). However, crude prices still account for a significant proportion of their overall refining cost, up to 50%. In contrast, energy costs represent 28% of total expenditure for American refineries. The main effect of this will be to increase the vulnerability of European demand, which will be harder hit by price volatility. While recent years have been marked by a decline in European refinery capacity, the most recent investments (Total at Anvers, for example) show greater confidence in the future for the sector, especially for natural gas.

US demand for oil products should remain firm, with a 1% rise expected in 2018. Refinery margins should continue to stabilise, after reaching a peak of 29 dollars/barrel, following the hurricanes, which reduced supply due to the interruptions they caused. President D. Trump's tax reforms aimed at reducing corporate taxes will help the refineries. In addition, production capacity utilisation rates rose by 4 points in 2017 compared to 2016. This trend is explained by the combined effects of rising margins and an upturn in Brent oil prices, compared to WTI.

The rebalancing of the Chinese economy currently underway should lead to its growth slowing down in coming years. Coface is expecting real GDP growth in the Chinese economy of 6.5%, compared to 6.7% in 2017. As a result, Chinese energy consumption should grow slowly, by 2.7% according to the IEA. It is likely to import less oil and improve oil use efficiency. India will again be one of the main oil consumer countries in 2018, with a steep rise in demand (up 6.7% in 2018).

## SUPPLY

Despite the agreement, which is expected to freeze production levels in OPEC countries and Russia, supply should rise by 1% in 2018 to reach 100 million barrels/day, due to favourable prices for American shale oil producers. Capital expenditure forecasts (up 4.3% in 2018) in the sector are still insufficient and the oil & gas services companies will keep struggling.

According to the US Energy Information Administration (EIA), crude oil production in the USA should reach a record high of 10 million barrels/day in 2018. Shale oil players have managed to significantly lower their break-even point, as well as increasing productivity and reducing costs. The number of drill rigs in operation has doubled since mid-2016, reaching 915 (91% of which are horizontal drills). US production has been boosted by the increased productivity of the wells, although this remains well below levels reached in recent years. Another encouraging aspect is the decrease in bankruptcies in the exploration sector. According to international law firm Haynes and Boones, there were 64 in the first ten months of 2016 and just 20 in the same period of 2017. However, this has to be set against the fact that companies still have limited cash flow with total debt maturities in 2018 much higher than the previous year (115.8 billion, 172% higher). This could presage more bankruptcies in 2018. Prospects for shale oil investments will be limited by companies' financing requirements.

Western Europe has seen an upturn in the financial results of the leading companies, after a dismal 2016. The E&P segment has benefited from the higher Brent prices. The companies' slightly improved financial situation has helped boost prospects for European oil & gas services companies in 2018, which are dependent on investments. According to JPMorgan Chase & Co., in 2017 the average sectoral profit rose by 9% in Europe, vs. 6% in North America.

Chinese production should continue the downturn begun in 2016 and 2017, declining by 2.6% in 2018. This is due to a government industrial policy favouring natural gas. The government is thus seeking a gradual disengagement by privatising companies in the sector.

In Latin America, prospects for the sector were bolstered in 2017 by Brazil's return to growth, production from the Lula offshore field, and investments in the Libra field.