The Austin Group Energy, LP

STATE OF THE ENERGY MARKET: Late 2016 - Early 2017

The 2014 Saudi strategy of continuing production in the face of low demand growth has failed. For the last 20+ years Saudi Arabia has acted as the regulator of the world crude oil price; pumping more to keep global crude prices from over-heating and cutting production to cool price spikes during periods of slowing demand. They were tired of rampant cheating on the part of their OPEC partners and concerned about the growth of production in the US as a result of Fracking. So, to "preserve their market share" in global production, the Saudis continued to pump in the face of slow demand growth with a resulting plunge in oil and natural gas prices to about 25% of their former peaks (from $104/bbl. to $28/bbl.)

While the price has subsequently risen into the mid-$40s, the cost to Saudi Arabia has been profound resulting in cuts to payments to their citizenry and a tremendous squeeze on their treasury. There have been discussions of the Saudis selling debt instruments to raise money and the costs to the other OPEC members have been ruinous.

They have recently approached their OPEC membership with a plan to make modest cuts to production (while allowing those countries that would cheat anyway to continue to produce at capacity) in the hopes that this would dry up the surplus glut and allow the price to rise in the future. But, ironically, the increases in productively from recent technological innovations, forced on the industry due to low energy prices over the last few years, means that producers ability to respond with more production in the face of rising prices will likely prevent those prices from getting back to the levels that existed prior to the Fall of 2014.

Last year we also noted the high levels of leverage for the upstream producers and midstream aggregators and predicted that there would be substantial bankruptcies. While our predictions came to pass (*90 North American oil and gas producers have filed for bankruptcy since the beginning of 2015, (including Chapter 7, 11, 15, and Canadian cases) and involve approximately $66.5 billion in cumulative secured and unsecured debt*) it has not been quite as bad as we feared. Many companies have been able to restructure their debts and continue to pump as much as they can to provide sufficient revenue (even at a loss) to service that debt.

So, while Goldman Sachs said earlier this year that they expect that the period of "cheap oil" is over and that oil prices will stabilize over $50/barrel later this year and into 2017, what they are really talking about is a reduction in the world crude glut, more than a tremendous increase in demand.

From the standpoint of consumers though this has been a boon in the form of low gasoline prices, low cost feed-stocks for petrochemical companies and low cost fuel for power companies that have converted from coal to natural gas production.

RESULT:

The price of crude oil and natural gas will stay low for the foreseeable future *(through 2017)* and the upstream and mid-stream companies will be focused on lowering costs and creating new efficiencies. Engineers with state-of-the-art skills in the newest reservoir, production or stimulation technologies will be in demand. At the corporate level, the processes of acquisition, divestiture and financial restructuring will continue so there will be a need for people with experience in finance and M&A. Trading, marketing and origination roles are always available for individuals with a history of strong profitability, as are opportunities for successful business development people. And, with all this uncertainty, many companies focus on risk management so there will be opportunities for individuals with RM application knowledge, especially with regard to ERM expansion and implementation.