

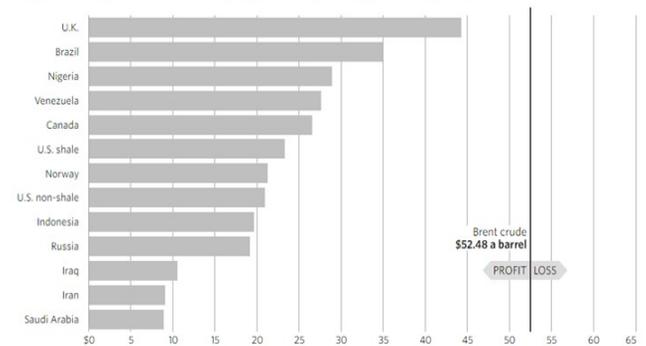
# Scenario analysis of the upcoming OPEC meeting

- OPEC is expected to announce an agreement of a production ceiling following their upcoming meeting November 30th.
- Russia has publicly stated that they intend to support and honor such an agreement
- Internal diverting agendas and historically poor results of previous attempts of capping the production leaves doubts in most analysts
- A rise in the oil price might benefit USA as much as the involved countries, to the Middle Eastern producers great dismay

Analysts	Contact Details
Ludvig Tingåker MSc. Finance Martin Holmquist MSc. Accounting & Finance	LINC – Lund University Finance society Tycho Brahes Väg 1 SE-220 07 LundSweden <a href="http://www.linclund.com">www.linclund.com</a>

## Cost of producing a barrel of oil and gas

Average cash cost to produce a barrel of oil or gas equivalent in 2016, based on data from March 2016.



Note: Brent crude price as of Oct. 11, 2016 at 12:32 p.m. BST.  
Source: Rystad Energy UCube

## Background

On September 28th the members of the oil cartel OPEC emerged from a meeting in Algeria and announced their common goal to execute a production ceiling on crude oil after their official meeting in Vienna on November 30th. The announcement came as a shock to the market, as OPEC had failed to agree on a production cut as early as June this year. The price of Brent crude oil increased by 5 % the same day as a consequence of the announcement and it continued to rise during the following week. The price level has recently seemingly stabilized at a level of \$52 per barrel while the market waits for any further indication on how the meeting next month might turn out.

## High Uncertainty

Uncertain times awaits the investors and industry dependents leading up to the meeting. The reason for this uncertainty can be found in a delicate balance act that OPEC is trying to execute. The main reason that previous

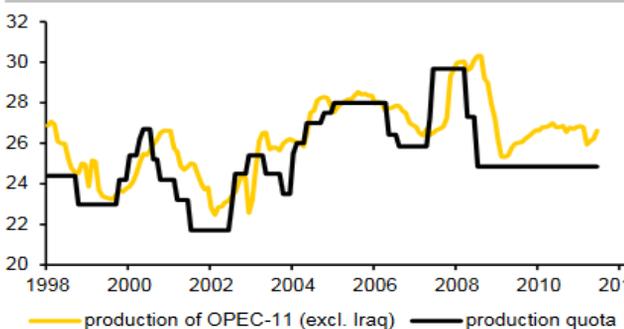
agreements between the OPEC members have fallen through is attributed to significant differences in the agendas the separate countries carry within the group. Venezuela is, while having the highest oil reserves of any nation, in the midst of the biggest economic meltdown in its existence due to falling oil prices. This because even though having vast oil reserves, the oil also is hard to obtain leading to high fixed costs for their oil industry, incentivising them to push for implementing a production cap for the members of OPEC expecting this will lead to higher oil prices. OPEC countries in the Middle East, however, have lower production costs and instead are afraid of losing market shares to the U.S. if prices rise above a certain threshold, which many cite as being around the \$60 per barrel mark.

Another factor to consider when evaluating the possible outcomes of the deal is whether or not Russia will support it. Russia is heavily dependent on its oil production, and would benefit from setting a cap on production following the previous years tumble of the Russian Ruble and economic recession. If Russia does not side with OPEC and maintain increasing production levels (already at post Soviet era high) the effect of a OPEC production cut might prove to be futile and prices might anew decline.

*"Given the propensity of OPEC and other producers to talk up prices, and the history of failed deals among OPEC and between OPEC and Russia, we would continue to treat the news somewhat carefully for the longer term"*

-Sberbank CIB

CHART 17: OPEC members have often "cheated"  
In millions of barrel a day



Source: Bloomberg, Commerzbank Research

Russian president Vladimir Putin announced on October 10th that Russia would indeed support OPEC, but only the following day Igor Sechin, CEO of Rosneft (the largest oil producer in Russia), said that Rosneft would not implement any production caps. It is easy to see that the two have different agendas where President Putin mainly is concerned about increasing the tax income of the state, while Sechin main focus is increasing production and would gladly accept the possibility of higher prices if offered. The historic record of OPEC not sticking to their agreed production caps is the main concern of Sechin. This is not an unfounded concern considering the graph presented on the previous page.

Where the cap itself will be set for the individual countries will also create discussion during the official meeting. These levels will be set based on previous production levels, but where these levers currently are is uncertain due to discrepancies between official numbers communicated directly from the countries, and the numbers produced by OPEC.

**Possible Scenarios**

We will present three potential outcomes of the OPEC meeting next month and discuss how they might affect the price of oil as well as who benefits from it.

**1. OPEC reaches an agreement on production cap and is supported by Russia.**

This scenario will increase the price on oil in the short run but also in the long run if the deal holds. The most prominent winners are the oil producers with high fixed costs who can start their production again and make profits as well as most other oil producing countries. Industries that might benefit from higher oil prices are renewable energy, recycling companies (due to higher prices on plastics) and insulation companies as heating becomes more expensive.

**2. OPEC reaches an agreement but non-OPEC members increase their production and the deal falls.**

This scenario will result in a price shock at first but later the price will return to today's prices as production rises in countries like the USA, Canada and China. The price will most likely stabilize at levels around the \$60 mark since the production costs of the recently mentioned countries will keep the price down.

**3. OPEC does not reach an agreement.**

Since the market already largely has priced in an agreement into the price of oil, the result of not reaching an agreement would be an initial price drop to the levels before the meeting in Algeria. The price level could possibly continue even lower in the long run. The winners of low oil price are industries and consumers in general as well as oil producers with lower costs. The losers will be producers with high fixed costs who are already taking a hit, such as Nigeria, Venezuela and U.S shale companies.

**Our prediction**

Taking all this into consideration, the short term effect of the meeting will result in scenario 2 being the most likely. It is to every involved party's benefit that a production cap is agreed in the short term and that the price is allowed to stabilize around the \$60 mark. It is the general consensus in the market that OPEC and Russia are committed to reaching an agreement. This will allow the US to start production to some degree which will prevent prices to rise further. Another indicator is that hedge funds are boosting their bullish bets on U.S. oil as expectations have increased during the recent weeks that non-OPEC countries will support OPEC in a joint output cut. In the long term OPEC has a long history of overproducing despite having set production goals, and if this happens, Russia will not hesitate to ramp up production. This could very well take several months to happen. The consequences of this long run scenario would be prices falling again when all countries increase their production again in order to not fall behind in the race for market shares.



## Disclaimer

---

### Ansvarsbegränsning

Dessa analyser, dokument och all annan information som härrör från LINC Research & Analysis (LINC R&A) är framställt i informationssyfte och är inte avsett att vara rådgivande. Informationen i analysen är baserad på källor, uppgifter och kunniga personer som LINC R&A bedömer som tillförlitliga. LINC R&A kan dock aldrig garantera riktigheten i informationen. Den framåtblickande informationen i analysen baseras på subjektiva bedömningar om framtiden, vilka alltid innehåller en osäkerhet och bör användas försiktigt. LINC R&A kan därför aldrig garantera att prognoser och framåtblickande estimat kommer att bli uppfyllda. Detta innebär att investeringsbeslut baserat på information från LINC R&A eller person med koppling till LINC R&A alltid fattas självständigt av investeraren. Varje investerare uppmanas att komplettera med ytterligare relevant material och information samt konsultera en finansiell rådgivare inför alla investeringsbeslut. LINC R&A frånsäger sig därmed allt ansvar för eventuell förlust eller skada av vad slag det än må vara som grundar sig på användandet av analyser, dokument och all annan information som härrör från LINC R&A.

### Intressekonflikter och opartiskhet

För att säkerställa LINC R&A's oberoende har LINC R&A inrättat interna regler, utöver detta så är alla analytiker skyldiga att redovisa alla eventuella intressekonflikter. Dessa har utformats för att säkerställa att Finansinspektionens föreskrifter och allmänna råd om investeringsrekommendationer riktade till allmänheten samt hantering av intressekonflikter (FFFS 2005:9) efterlevs.

### Bull and Bear- rekommendationer

Rekommendationerna i form av bull alternativt bear syftar till att förmedla en övergripande bild av LINC R&A's åsikt. Rekommendationerna är utarbetade genom noggranna processer bestående av kvalitativ och kvantitativ research och övervägning samt diskussion med andra analytiker.

### Definition Bull

Bull är en metafor för en positivt inställd vy på framtiden. Termen används för att beskriva de faktorer som talar för en positiv framtidsutveckling för bolaget.

### Definition Bear

Bear är en metafor för en pessimistisk inställd vy på framtiden. Termen används för att beskriva de faktorer som talar för en negativ framtidsutveckling för bolaget.

### Övrigt

LINC R&A har ej mottagit betalning eller annan ersättning för att göra analysen.

### Upphovsrätt

Denna analys är upphovsrättsskyddad enligt lag och är LINC R&A's egendom (© LINC R&A 2014-2016).