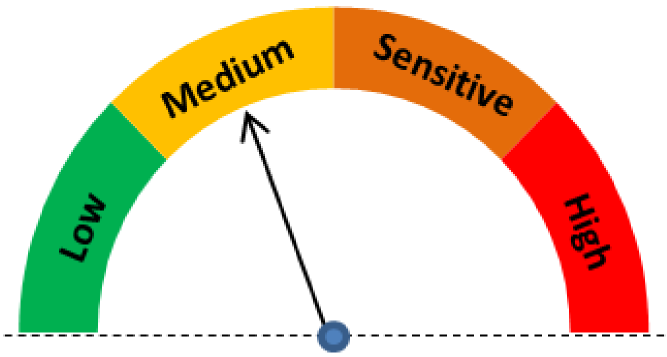
Euler Hermes Economic Research

Global Sector Report

ENERGY

Sector Risk Rating



What to Watch?

- Oil's impact on various segments and industries
- Risk of bankruptcies and defaults in U.S. high-yield sector given current low oil prices
- Iran's capacity to return to previous levels of oil exports, which would add to the global supply glut
- Chinese rebalancing weighing on increase in internal demand for petroleum products
- M&A opportunities poised to grow in 2016 boosted by very low valuations of oil sector assets

Pulling the plug on CAPEX appears to be the easiest way to address low oil price

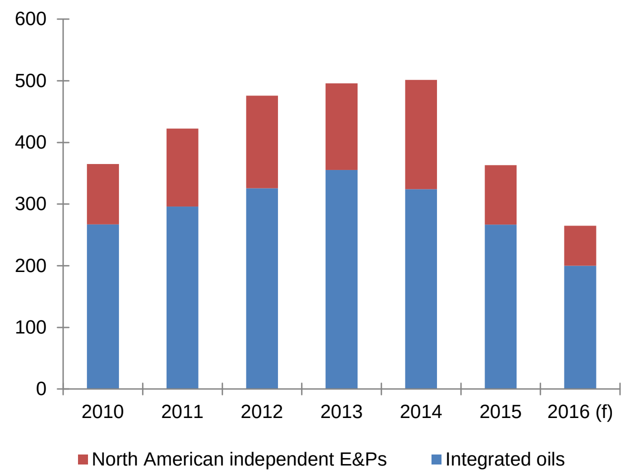
We expect investments in the exploration and production oil sector (or capital expenditures, aka CAPEX) to continue plunging in 2016, with a -25% fall, on the heels of a -28% dive in 2015. Delayed investment spending accounts for the equivalent of about 30bn barrels of oil reserves, and new investments are not due to come on stream before 2020 at least.

By postponing (if not cancelling) investment spending, oil companies have started to offset the impact of lower revenues and curb the fall in margins. The main culprits are Canadian oil sands projects, new U.S. shale oil wells, and high-cost deep water fields, especially those in Angola, Nigeria, the North Sea and the Gulf of Mexico.

A few oil players such as state-owned companies in GCC countries benefit from sovereign funds' large cash hoardings and might get away with long-term depressed oil prices. Although the underlying problem remains and the ongoing de-hoarding of cash cannot last forever, wealthy producers are still far away from running out of money. Thus, these countries can easily withstand this period of turmoil.

Considering Iran's looming return to the market, the question is: how long will oil prices remain low?

Total E&P spending in the oil industry (USD billion)



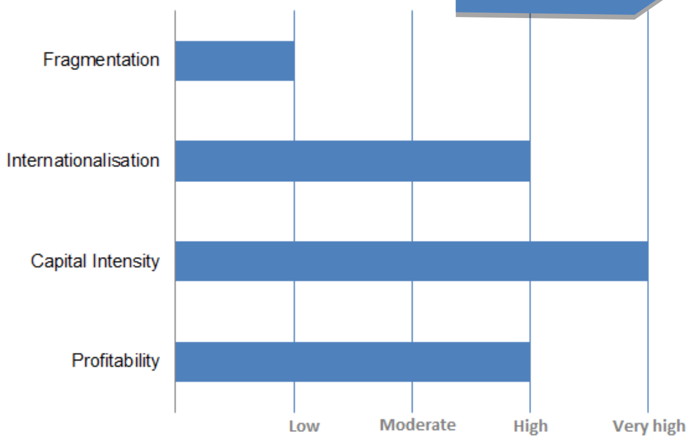
Sources: Bloomberg, Euler Hermes forecasts

Key Players

Country	Role	Sector Risk
United States	#1 producer	
China	#2 producer	
Japan	#3 producer	

ID Card

Sector Value:
6,822bn
USD



Strengths

- Emerging countries' rising demand causes a hike in power energy prices
- Electricity increasingly indispensable as a source of energy
- Oil is indispensable for all kinds of boats, planes or cars to be operating properly

Weaknesses

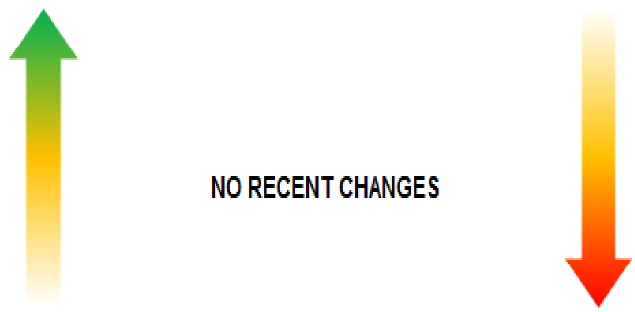
- Fossil fuels hit by the slowdown in Asia, especially China
- Environmental costs
- Rising awareness of coal and nuclear fallout
- Low oil prices curtailing further growth in renewable energies

Subsectors Insights

Coal: Still the dirtiest and most vilified fossil fuel, coal remains essential for electricity production in many countries including Japan, China, India and Germany.

Renewable sources: Although clean energy companies have been heavily subsidized especially across Europe, profitability has eluded most businesses. Low oil prices do not help the sub sector reach financial strength.

Recent Sector Risk Changes



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