

Lazard Insights Conference Call Series

Observations on Global Oil Markets: How Did We Get to \$90 Oil

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The Economist
March 6, 1999



What are the Experts Saying?

Dan Yergin, Chairman, Cambridge Energy Research Associates

October 30, 2007 – Dow Jones News

“oil market may be only one or two events away from \$100-plus oil,” adding they have become increasingly decoupled from the fundamentals of supply and demand.

“With prices over \$90 a barrel and strong anticipation of \$100, the oil market is showing signs of high fever, stoked by fears of clashes in the Middle East and resulting disruption of supply.”

“What we’re seeing in the oil market today is rooted more in the cauldrons of geopolitics and the impact of financial markets, expectations and psychology than in supply and demand, but these are real factors.”

OPEC Leader, Qatari Minister, TNK-BP Executive

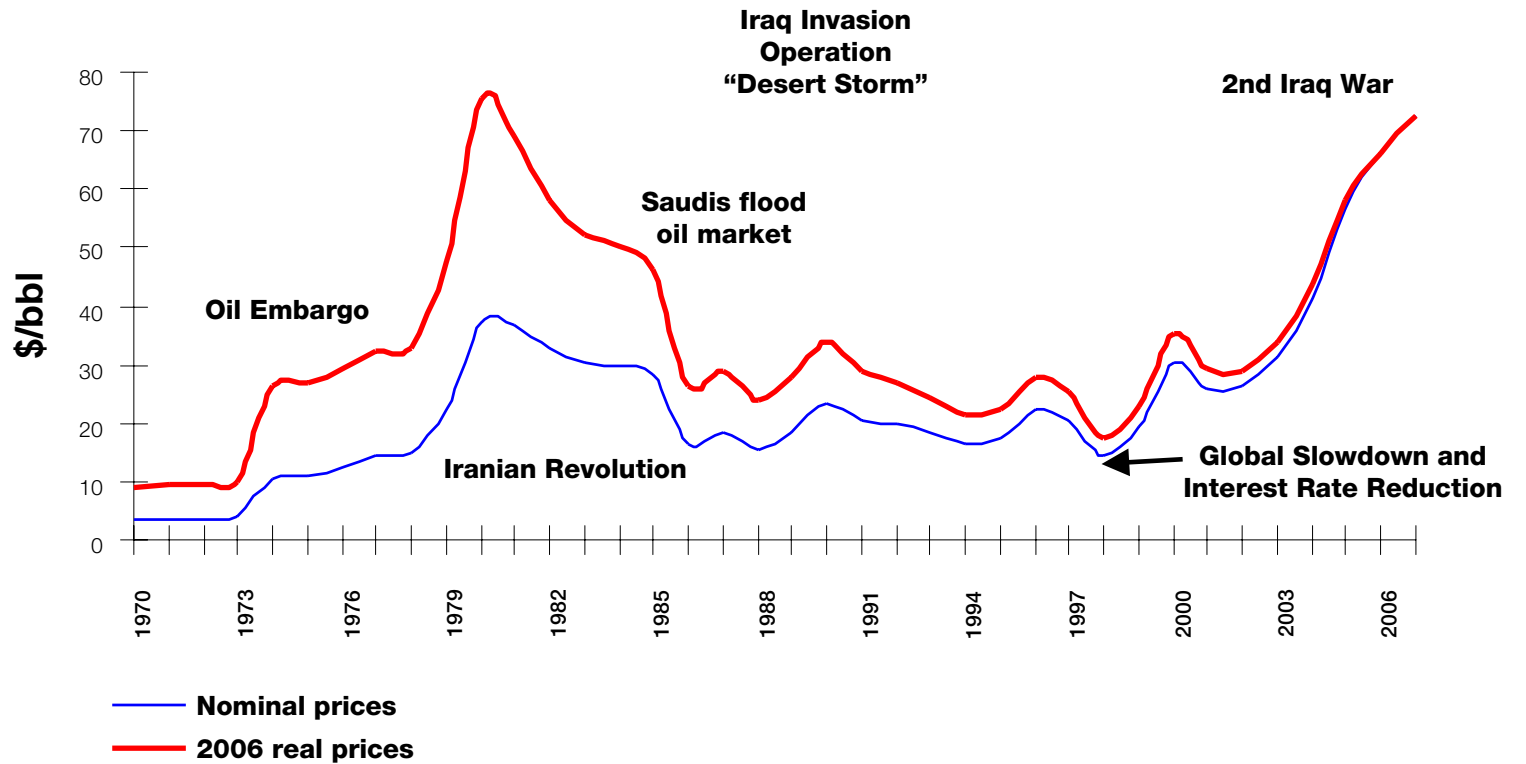
October 30, 2007 – New York Times

The president of OPEC said “Increasingly oil markets are being driven by forces beyond OPEC’s control, such as geopolitical events and the growing influence of financial investors.”

The Qatari energy minister...also heaped responsibility for the high price on a shortage of refining capacity.

Oil Price History

12 Month Rolling Average Price



Source: Credit Suisse

Not for public distribution.

What is the Right Oil Price?

(April, 2004 > December, 2007)

Near month futures price	\$35.00/BBL > ~\$88 (high ~\$98 @ Nov'07)
12-month futures strip price	\$31.65 > ~\$86-87 (high ~\$93 @ Nov'07)
Long-dated oil price (2012-2013)	\$27.35 > ~\$83-\$84 (high ~\$85 @ Nov'07)
5-year <i>trailing</i> average price	\$26.50 > ~\$53 (rising)
10-year <i>trailing</i> average price	\$22.50 > ~\$38 (rising)
Opec target price band	\$22-28 opec blend >>> \$50-70?
Investors' normalized price	\$20-25 (?) > \$50-65? W/upward bias

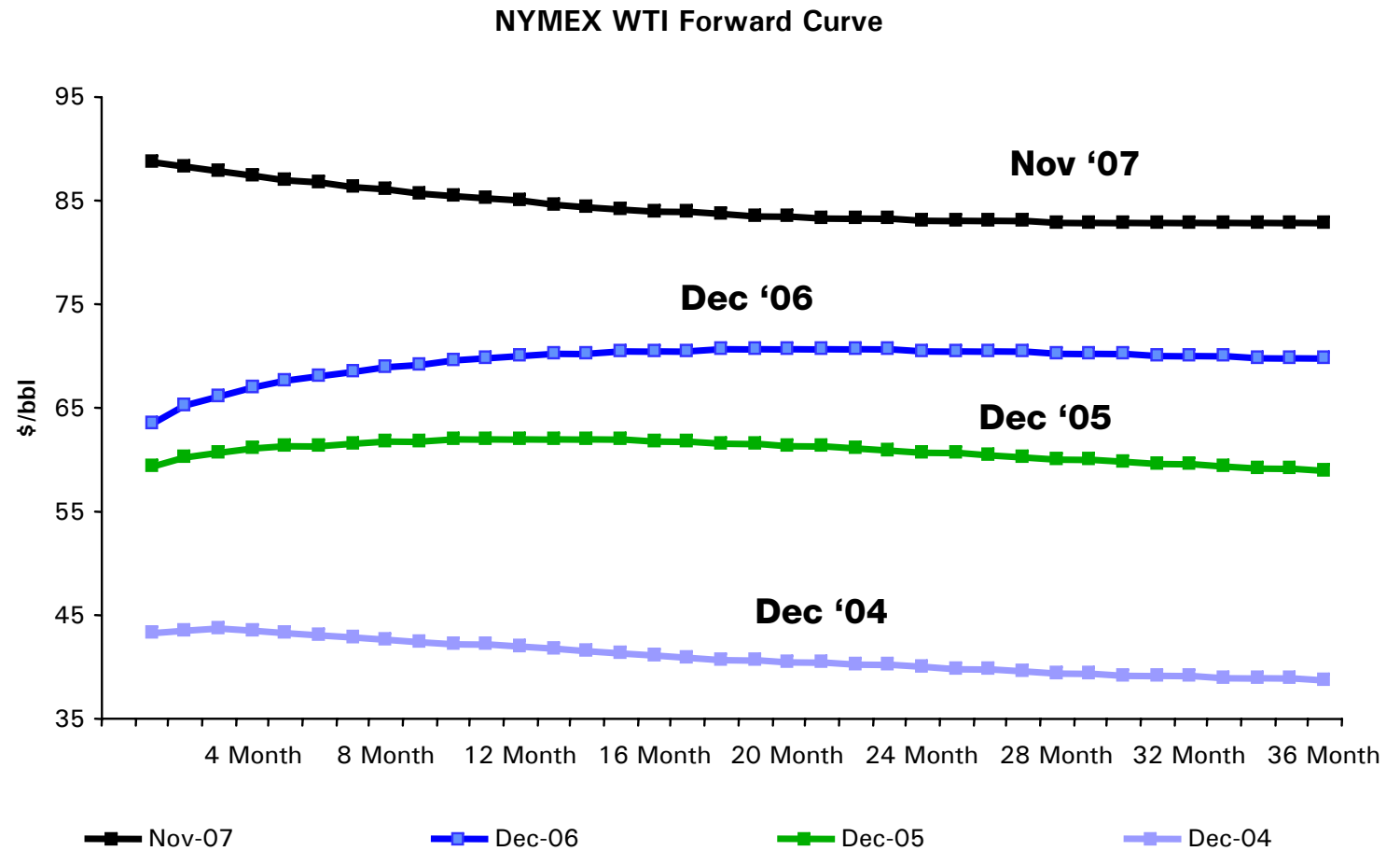
Futures market and investors shifting price expectations higher

Futures market view and reversion to the mean yield different views

SOURCE: NB: Consensus WTI oil prices for 2008 ~\$70.75/bbl and for 2009 ~\$66.75/bbl @ November 20

Futures market is often *not* a good predictor of future prices

Rising Price Expectations

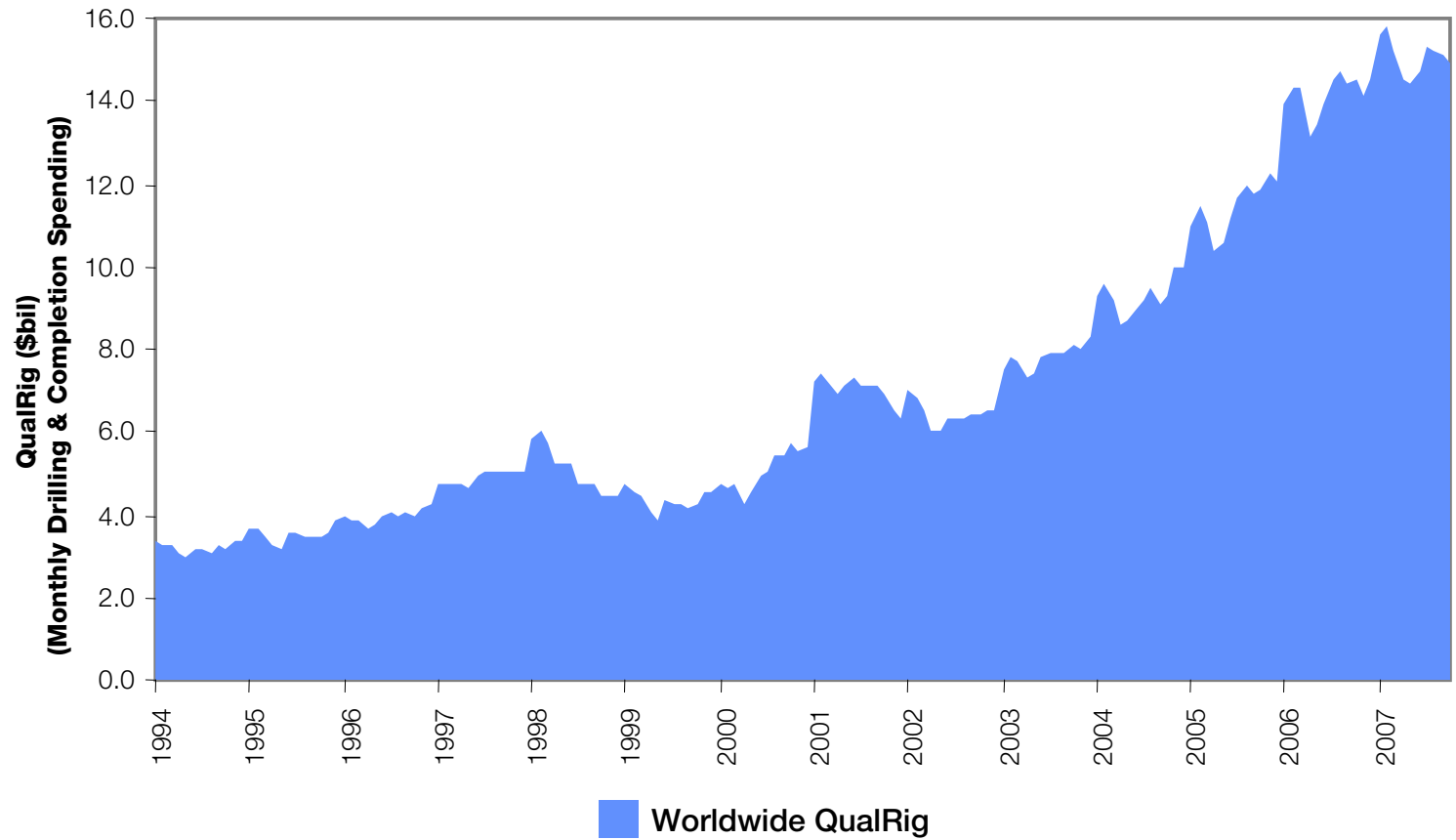


Source: Deutsche Bank

What Factors are Driving Current Oil Prices?

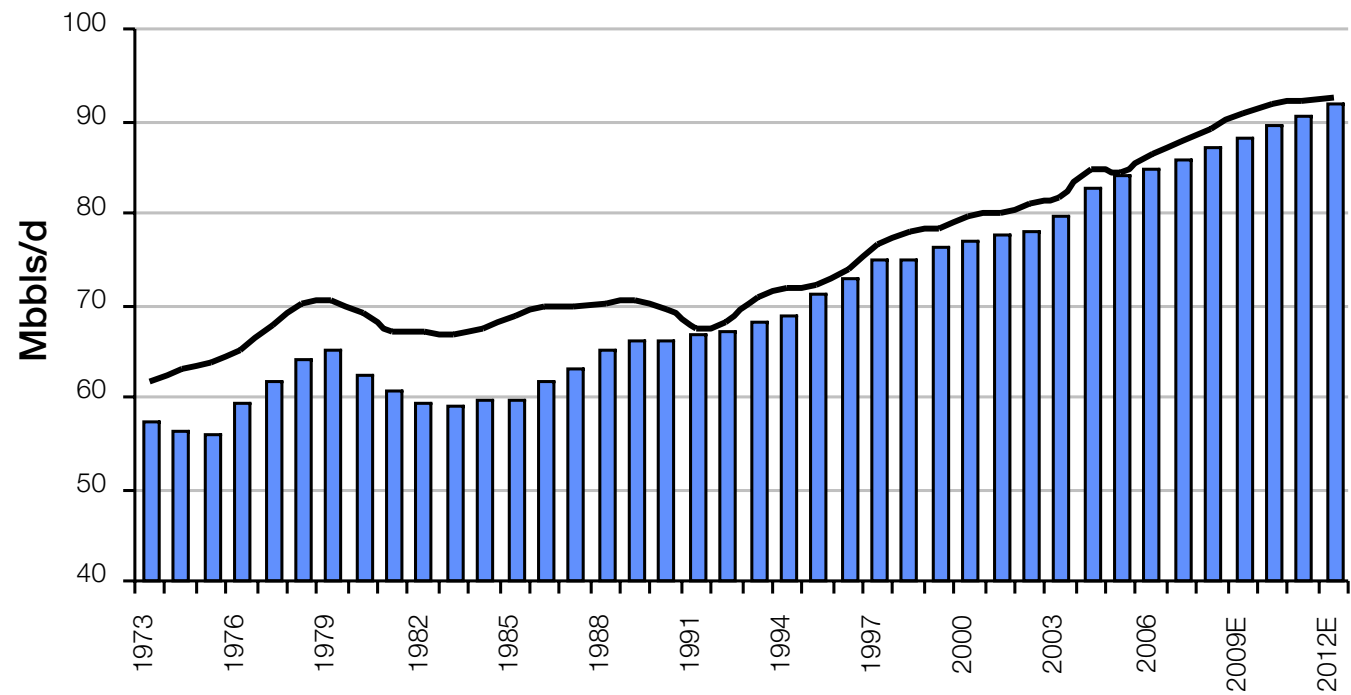
1. SUPPLY
2. DEMAND
3. SPARE CAPACITY
Concentrated in hands of a few OPEC producers, notably Saudi Arabia, Kuwait, UAE
4. RISING INDUSTRY COSTS
5. REFINING CAPACITY ISSUES
Insufficient conversion capacity, plus significant maintenance and reliability issues
6. INCREDIBLE SHRINKING U.S. \$
Oil is dollar-denominated; producers want higher price if paid in Dollars
7. GEOPOLITICAL RISK PREMIUMS
Hard to measure, but numerous hot spots
Nigeria, Venezuela, Iran, Iraq, Kazakhstan have featured in 2007
8. SPECULATIVE TRADING AND COMMODITY FUNDS
CFTC data shows net speculative long positions near record highs

Upstream Spending: Drilling & Completion



Source: Credit Suisse

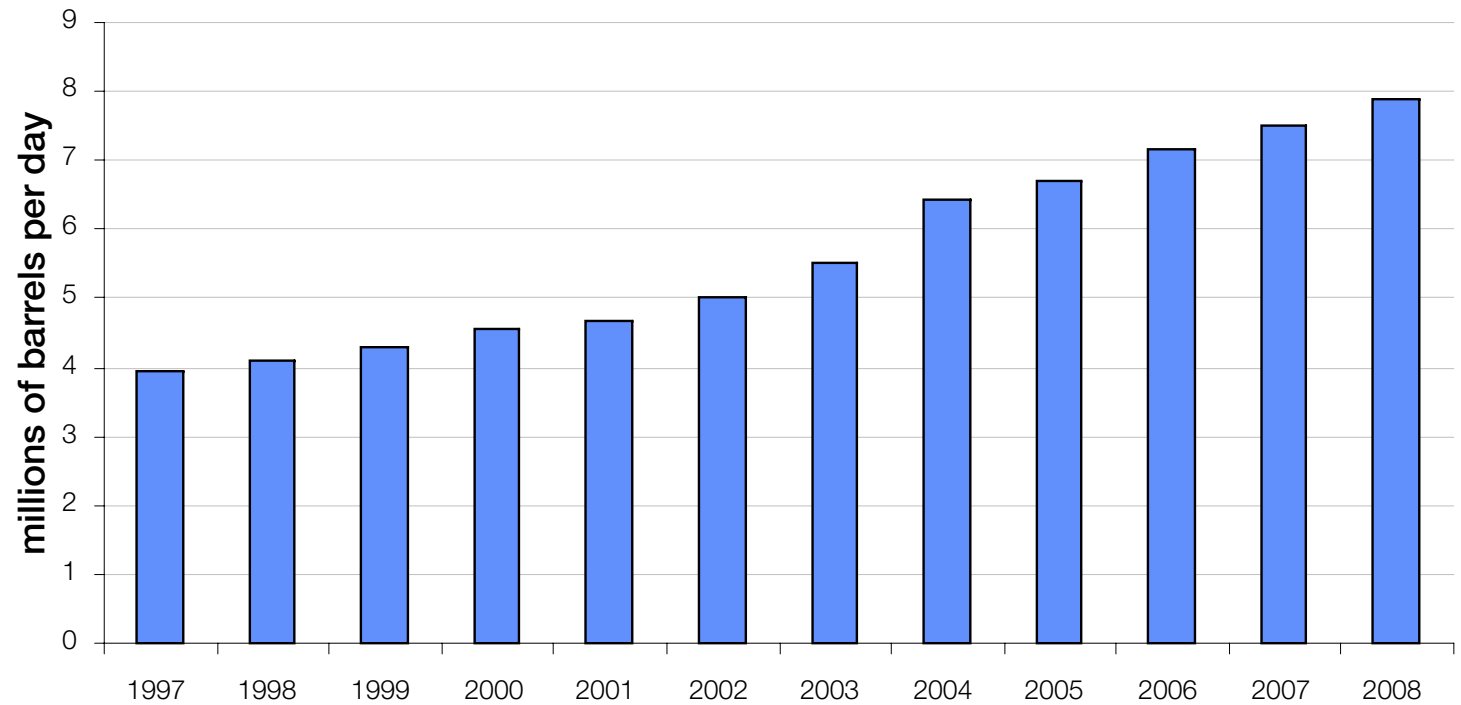
Oil Demand & Capacity



Source: UBS

■ Demand — Capacity

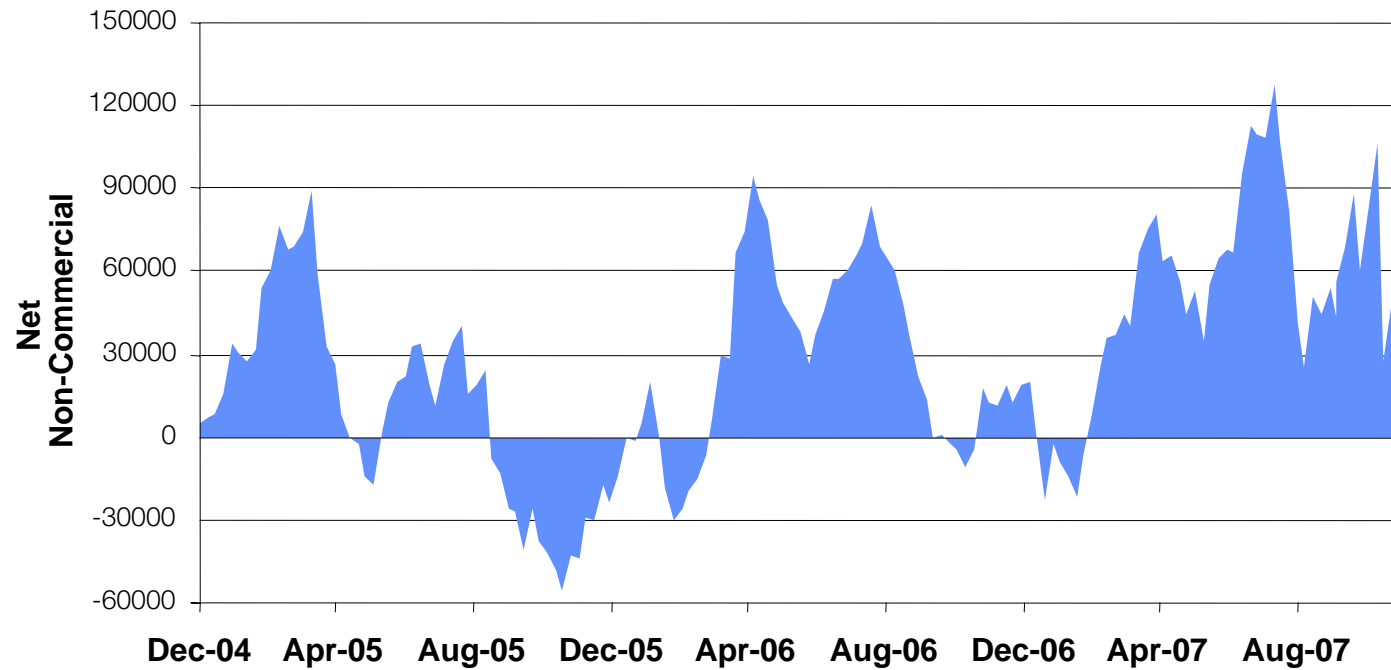
China Oil Demand (as reported) MBD



Source: Credit Suisse

Speculative Trading

CFTC Open Interest Contracts, Non-Commercial



Source: Citi

Challenges for the Oil Industry

- DEMAND IS ONCE AGAIN A PROMINENT NEAR-TERM CONCERN
 - To the surprise of many, global demand has remained resilient in face of high fuel prices
 - But, US housing and credit market issues increase probability of weaker economic growth
 - Separately, recent spike to \$90/bbl oil raises risk of price-induced demand hit

Weaker demand could point to looser markets and lower oil prices
- COSTS ARE RISING, AND FISCAL TERMS ARE LESS FRIENDLY
 - Rising production costs
 - Rising finding & development costs
 - Supply chain tightness: drilling rigs, services, engineering capacity, skilled personnel
 - Rising taxes & royalties: host governments are collecting more of the economic rent

Taken together, rising costs represent a growing worry for producers. Growing risk of cost overruns and delays on big projects. Additionally, growing risk of contract changes and expropriation.
- ACCESS TO RESOURCES IS DIFFICULT
 - **Access, capital investment and time required to bring new supply to market**

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