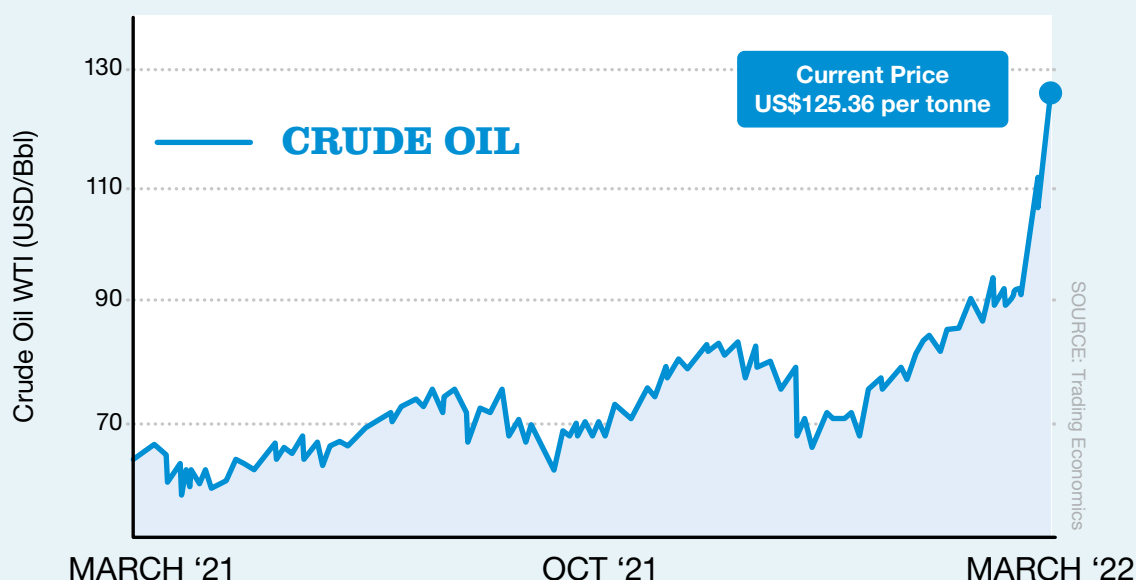


OIL ANALYSIS

Supply constraints emanating from the boycott on Russian product on top of increasing demand means that the oil price is getting squeezed. Under the Radar Report said it would go to US\$100 a barrel. We now think it will go much higher.

RUSSIA DRIVES OIL HIGHER

1 year price action for West Texas Intermediate Crude Oil.



RUSSIA OIL SANCTIONS DRIVE THE OIL PRICE HIGHER

Under the Radar Report has been taking the view for the past six months that the price outlook for oil was positive given declining oil project investment and exploration by the major oil producers in the face of renewable energy trends. At the same time, projections by the International Energy Agency (IEA) were pointing to global oil demand continuing to grow to higher levels until at least 2025. We had postulated that the oil price could rise to around the US\$100/barrel level.

The war in Ukraine and bans on oil exports from Russia has added another dimension to oil prices and this has big ramifications for inflation, global growth and international equity markets.

RUSSIA IS A BIG PLAYER

Russia is the world's third largest oil producer behind the US and Saudi Arabia*, with production of 10 million barrels a day. Half of this is exported, 60% to OECD countries in Europe, 20% to China. This is a significant in the context of global oil demand returning to pre-pandemic levels of 99.7 million barrels/day in the current year.*

This week oil futures touched US\$139/barrel on the ban on Russian oil exports to the US. At this stage, the ban does not appear to extend to exports of crude oil to Europe. The oil price has since retreated to around US\$125/barrel.

LIMITED GLOBAL PRODUCTION CAPACITY

The price rise reflects the difficulty of replacing Russian oil. OPEC produces 30 million barrels a day and have limited

spare capacity, due to reduced investment in recent years. While there is spare capacity in the US, particularly in oil shale production, producers have been giving priority to cash flow rather than drilling new wells.

RUSSIAN GAS

There are also concerns regarding Russian gas with the potential for reductions in supply into Europe very real, where it is used for heating. Changes in the energy mix could include increased oil consumption, further tightening the oil demand

supply balance or LNG imports. LNG supply contracts generally have price mechanisms linked to the oil price.

Under the Radar Report has backed **Karoon Energy (KAR)**, a pure oil play, as the best Australian company in the sector to gain exposure to the oil price. This has more than doubled since we recommended the stock in January 2021 at \$1.10. See our note on below. ■

*According to the International Oil Agency

KAROON ENERGY

Oil production

As we had hoped Karoon is benefiting from the double whammy of a higher oil price and rising production at its Bauna oil field in Brazil.

For 1H22, sales volume increased five-fold to 2.57 million producing US\$186.5m in revenues from five cargoes lifted at an oil price of US\$72.43/bbl (1H21 US\$47.31/bbl). Underlying EBITDA was US\$89.5m (1H21 US\$4.0m), while underlying NPAT was US\$21.1m.

Unit production costs US\$23.50/bbl were below expectations and contributed to a very strong operating cash flow of US\$83.9m. A highlight for the year was achieving 99% facilities uptime, reflective of maintenance ensuring the reliability of the vessel that handles the oil, the Bauna FPSO.

As a result of heightened oil price expectations, KAR recognised a material increase in the contingent consideration payable to Petrobras under the payment terms agreed in 2020 for the acquisition of the Bauna assets. This has resulted in a statutory net loss after tax of US\$97.7m for the half year. The company expects higher oil prices to generate additional cash flow to fund the higher Petrobras payments.

The group is expanding production in April, targeting an increase of 5-10k barrels of oil per day (bopd) at an estimated cost of US\$110-130m. After completion, drilling of two new development wells at Patola is scheduled with first production scheduled for early CY23 at an expected peak rate of over 10,000 bopd and estimated cost of US\$175-195m.

KAR's production for FY23 is expected to increase to 8-10 million barrels a year, more than double FY22. A material reduction in FY23 unit operating costs to US\$12-18/bbl is also expected (FY22 US\$28-30/bbl). ■

RADAR RATING: The best oil leverage on the ASX plus growth. Global events driving oil prices higher amid uncertainty and volatility, hence we think taking some risk of the table is necessary. TAKE PROFITS.

RADAR RATING TAKE \$\$\$ ▼
(DOWNGRADE FROM SPEC BUY)

ASX CODE KAR

CURRENT PRICE \$2.29

MARKET CAP \$1.28BN

DIVIDEND YIELD 0%*

**NET CASH US\$176M
(A\$245M)**



Data as at initial coverage

DATE 21 JANUARY 2021

PRICE \$1.10

*FY22 forecast 0 cents