THE AUSTRALIAN

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HD Rising **oil** price fuels stocks
BY Tim Treadgold
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LP An improving Australian dollar will also help investors

Oil is back as an investment option.

TD After two years in the sin bin, a strong price recovery and the start of takeover activity are indications that the revival could be sustainable.

If there are doubts they lie in the speed of the upturn and whether a higher **oil** price will trigger a surge in supply, preventing a rise far beyond the current level of almost $US50 a barrel and making it unlikely that there will be a return to the $US100/barrel (and more) enjoyed until mid-2014.

But, for Australian-based **oil** producers there is a second positive factor at work: a currency boost which is also being enjoyed by goldminers.

At the latest price for Brent quality **oil** of around $US49 a barrel and an exchange rate of something like US73c, **oil** in Australian dollars is trading at around $67 a barrel, well on the way back to its price in mid-2014, a time when the exchange rate was US94c and the local **oil** price was around $94/barrel.

The twin benefits of the **oil** price rising from its mid-January low of around $US27/barrel and the falling currency can be seen most clearly in the share prices of small-to-mid-tier **oil** and gas stocks such as Beach **Energy**, which has almost doubled from 35c on January 21 to latest sales at 69c.

The recovery is even more evident in another mid-tier **oil** and gas producer, AWE, which has risen by 160 per cent since mid-January.

With the dramatic move just a few days ago by local leader **Oil** Search to expand its influence in PNG, more merger and **acquisition** activity is expected in the **oil** sector.

McKinsey & **Company**, a management consultancy, suggested in a report to clients last week that "a deal deluge" typically follows an **oil**-price collapse.

Oil Search surprised the market with a clever move to buy US-listed InterOil for $US2.2 **billion** ($3bn).

The friendly scrip-deal with its PNG partner will give the Australian **company** expanded options in the global market.

It's worth noting the McKinsey report — issued before the **Oil** Search announcement — found that deals struck early in the recovery stage of a price crash "haven't always created value". **Oil**-market conditions today are said to be similar to those experienced in the last big **oil**-price slump between 1998 and 2000, a time when 25 deals of more than $US1bn each were undertaken in North America alone.

Three of those deals led to the birth of the current crop of super-major **oil** companies: when Exxon acquired Mobil, Chevron merged with Texaco, and BP bought Amoco.

Indeed in recent times we have already seen three major initiatives: ● Woodside tried but failed to **merge** with **Oil** Search.

● Beach has successfully acquired its smaller rival, Drillsearch. ● Santos, a perennial takeover target, has seen significant moves on its share register, with **Chinese** companies ENN Group and Hony Capital swapping an 11.7 per cent **stake** in the Adelaide-based **oil** and gas producer.

On the market Santos shares are up around 70 per cent from their mid-January low of $2.46 to latest sales at about $4.31.

The other leading Australian **oil** stocks, Woodside and **Oil** Search, have also risen from their low points, but with less conviction than Santos, Beach or AWE.

Woodside is up close to 15 per cent from $23.82 reached early last month to trade at $27, which is well short of its 12-month high of $36.94.

Oil Search is up about 25 per cent from $5.56 reached in mid-January to $6.60 or so — well short of its 12-month high of $8.36.

It's in the small-to-mid-tier sector that the effects of the rising **oil** price, falling dollar and the start of **M**&A action can best be seen, with AWE and Beach leading the way, followed by Senex.

What comes next will be interesting because the global **oil** market appears to be adjusting after a massive surge of supply caused by strong US shale-**oil** output and a refusal of the world's biggest **oil** producer, Saudi Arabia, to cut supply.

Goldman Sachs, an investment bank, has been forced to reverse its long-term bearish outlook for **oil**, telling clients in a research note published this month that the **oil** market has flipped from surplus to deficit.

Nonetheless, current forces affecting the market include: ● Supply cuts in countries such as Canada (wild fires destroying **oil**-production facilities).

● Trouble in Nigeria (terrorist activity).

● Social unrest in South America's key producer, Venezuela.

No wonder that positive view of the future **oil** price from Goldman Sachs came with a qualification.

Production outages in Canada and Nigeria will be resolved, which could mean that by the end of the year a small surplus might redevelop.

The Goldman Sachs view is that **oil** will settle in a band of $US45/barrel to $US50/barrel for the rest of 2016, and then rise slowly to around $US60/barrel by the late next year.

For Australia's big three players — Woodside, Santos and OilSearch (see graphic) that Goldman Sachs price prediction could be another significant positive.

If the Australian dollar is still in the range of US73c towards the end of next year (and some analysts think it will be lower) then at $US60/barrel the local **oil** price will be $82/barrel — within sight of the $94/barrel of two years ago.

No one is saying "rush back into the **oil** sector''; simply note the revival under way and the potential for a sustainable recovery, complete with **M**&A opportunities.Tim Treadgold is the resources correspondent on Eureka Report. This feature first appeared at www.eurekareport.com.au [http://www.eurekareport.com.au]

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