



Will Oil Reach US\$100 Per Barrel?

Description

The latest missile strikes on Syria combined with declining oil output from Venezuela and the rising likelihood of Trump tearing up the nuclear deal with Iran have all worked to push crude markedly higher. The North American benchmark West Texas Intermediate (WTI) has gained 15% since the start of 2018 to be trading at over US\$66 per barrel, while Brent has broken through the US\$70 per barrier. This has sparked a flurry of claims that oil will move [progressively higher](#) over the course of 2018 and reach US\$100 per barrel before the end of the year.

If that were to occur, it would be a massive boon for beaten-down energy stocks, but there are a range of factors that could cap oil prices in coming months.

Now what?

Key among [the factors](#) weighing on higher crude is the sharp uptick in U.S. oil output. By the start of 2018, estimated U.S. oil production had reached its highest point since the U.S. Energy Information Administration started releasing this data. The rig count continues to climb, hitting 1,008 active oil rigs, which is its highest point since April 2015. That can be attributed to a renewed flurry of activity among U.S shale oil producers, which are determined to expand their oil output as rapidly as possible to cash in on higher prices.

Shale oil producers are also loosening the purse strings, boosting investment in many shale plays, including, most significantly, the Permian Basin, which some analysts claim has spare production that is only second to Saudi Arabia.

The so-called emerging supply constraints in the Middle East and among OPEC members are potentially overblown. Even if Trump reinstates sanctions against Iran, while it will curtail medium- to long-term oil growth, it won't have a sharp short-term impact on that nation's oil production. The market expects sanctions to shave 400,000-500,000 barrels daily off global supplies.

Nonetheless, there is every likelihood that European energy majors seeking to invest in Iran will seek waivers, meaning that some level of Iranian production growth will occur. French integrated energy major **Total S.A.** has noted that it will seek a waiver from U.S. sanctions if they are reinstated. It

appears that Venezuela's production declines have been priced in by analysts, and unless there is a significant deterioration in output, the ongoing collapse of Venezuela's oil industry will have little material effect on oil prices.

So what?

This isn't good news for an industry that has been waiting for almost four years for higher oil prices, but it also isn't all doom and gloom. The narrative for higher prices has some room to play out. While the upside for crude is capped, it is difficult to see it slipping below US\$60 per a barrel in coming months, because of rising geopolitical risks and renewed oil demand growth sparked by the global economic upswing that is currently underway.

That is good news for high-quality, low-cost drillers such as **Raging River Exploration Inc.** (TSX:RRX) and **Obsidian Energy Ltd.** ([TSX:OBE](#))([NYSE:OBE](#)). Both have failed to rally, plunging by 17% and 25%, respectively, since the start of 2018. That has created an opportunity to invest in drillers with higher-quality assets focused on steadily growing their light oil production.

Raging River has oil reserves of 107 million barrels, which have a net present value (NPV) of \$9.16 after applying a 10% discount. This is 49% higher than its last price, indicating just how much potential upside is available. The driller is focused on the production of light crude, which made up 87% of its production in 2017.

Obsidian's oil reserves of 131 million barrels, which are 50% weighted to light oil, have an NPV of \$2.63 per share, which is 92% greater than its market price.

Because both are focused on light as well as medium oil production, their earnings aren't as severely impacted by the considerable discount that is applied to Canadian heavy crude blend Western Canadian Select as pure heavy oil producers. That makes them far more attractive investments.

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