

Weekly Fundamental Market Report August 27-31, 2018

Market Update

PRODUCTS	8/27/18	8/28/18	8/29/18	8/30/18	8/31/18
WTI Crude Oil	69.97	68.53	69.51	70.25	69.80
Brent Crude Oil	74.41	75.95	77.14	77.77	77.42
Natural Gas	2.98	2.85	2.89	2.87	2.92

- [CME Group](#)

Headlines

North Dakota

- **Bakken buy illustrates trend.** [Williston Herald](#)
 - Buying into the Bakken isn't rocket science. It's just good economics. At least, that's what officials with U.S. Energy say about the company's \$17.8 million purchase of a non-operated interest in 67 wells concentrated in Williams and McKenzie County from APEG, an affiliate of APEG Energy II. The wells have proved reserves totaling 1.1 MMBOE, as well as 400 barrels of oil equivalent per day of current production across 1,600 net acres. "I think we like (the Bakken) for the same reason you see a lot of bigger companies still like it," said Ryan Smith, Chief Financial Officer for U.S. Energy Corporation. "There's a lot of oil in the Bakken. And it's a very business friendly environment". U.S. Energy is just the latest in large-sized acquisitions in the Bakken, and not even the largest. Whiting Oil and Gas, for example, purchased 54,833 net acres adjacent to existing properties they own in the East Missouri Breaks and Hidden Bench formations. Northern Oil and gas, meanwhile, spent \$100 million in cash and 56.37 million shares of common stock on 10,600 net acres. Smith said U.S. Energy, like many other oil companies, has been focused on lowering its debts as the downturn lifted. Now, however, they are ready to move into a growth phase. "The market, being basically oil prices in our world, has flattened enough and stayed around this price level enough to give people confidence in deploying capital," he said. And Bakken Boom 2.0 is better this time around, Smith added. Not only is there the Dakota Access pipeline, which has improved transportation economics for Bakken oil and gas, but the region as a whole has a lot more oil and infrastructure to support what's going on. "When people first started coming to the Bakken in numbers in 2010, 11 and 12, there really wasn't the (oil and gas) infrastructure there to support it," Smith said. "As people have stayed there longer, that support system is making developments more environmentally friendly, which makes everyone happy and has supported companies continuing to go there." Not only that, but there have been a lot of technological improvements that have helped further drive down costs and make the Bakken more economic, Smith pointed out. "It's more oil for cheaper," he said of the company's acquisition. "It's not rocket science." David Veltri, U.S. Energy's Chief Executive officer, said the purchase nearly doubles the company's existing production base. "(This is) in a highly economic area in which we have significant experience," he said. The assets are also highly complementary to what the company already owns in North Dakota, Veltri added. "The Transaction will add highly complementary assets to the Company's existing portfolio in North Dakota, with similar operators and development potential," he said. "The Company expects the Transaction will create additional opportunities for development and acreage swaps that would permit the Company to continue consolidating its leasehold position in the area. The transaction is being funded through a combination of cash, common and preferred stock, and the assumption of APEG's Commodity derivatives. The company

also plans to establish a new \$8.0 million revolving credit facility. Positive cash flow from existing operations and other strategic decisions will also be used to reduce borrowings under the new credit facility. The purchase further “builds shareholder value with the cooperation and support of our strategic partner, Angelus Private Equity Group (“Angelus”),” Veltri said. “In conjunction with Angelus, U.S. Energy has successfully restructured the Company’s balance sheet while adding desirable oil assets in a key area that we know well. These actions have set U.S. Energy on a stable path forward and have equipped the Company with the ability to evaluate and acquire assets that will ultimately deliver enhanced shareholder returns.” Closing the sale will depend on obtaining the required debt and equity financing. It also requires Nasdaq approval and the approval of company stockholders at a meeting scheduled for December. If completed, however, the transaction itself will have an effective date of July 1, 2018. Veltri indicated that U.S. Energy will continue to focus on acquisitions of assets that immediately increase production, revenue and cash flow for the company, as well as proactively enhancing, developing and drilling existing assets. U.S. Energy is an independent energy company focused on lease acquisition and development of oil and gas properties in the continental United States. They own acreage in the Williston Basin and South Texas.

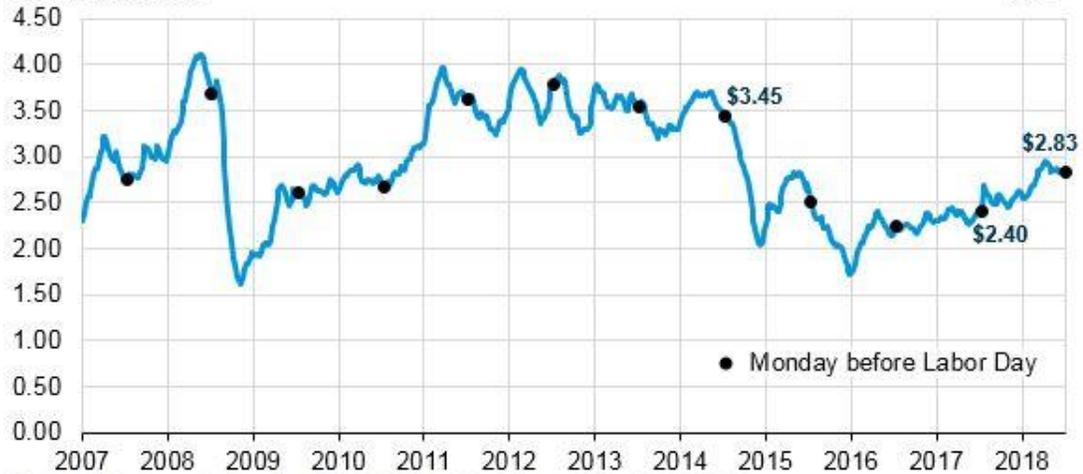
Domestic

- **U.S. retail gasoline prices heading into Labor Day weekend are highest in four years. [EIA](#)**
 - The U.S. average retail price for regular gasoline on August 27, 2018, was \$2.83 per gallon (gal), the highest price on the Monday before Labor Day since 2014, when it was \$3.45/gal. The 2018 price is 43 cents/gal higher than the same time last year. A higher North Sea Brent crude oil price—\$18 per barrel (b) higher than the price heading into Labor Day weekend last year and its highest level for this time of year since 2014—is the main driver of the increase in the gasoline price. Crude oil is the main input cost in the production of gasoline, and movements in the crude oil price—along with changes in gasoline market conditions—drive changes in wholesale and retail gasoline prices. EIA estimates that about two-thirds of the price of gasoline at the pump is attributable to the refinery acquisition cost of crude oil. Because a barrel of crude oil contains 42 gallons, each dollar per barrel of sustained price change in crude oil and gasoline wholesale margins translates to an average 2.4-cent-per-gallon change in petroleum product prices. When the price of crude oil increases, the price of wholesale gasoline adjusts to reflect the increased refinery input cost, other market factors being equal. The current higher crude oil price environment has coincided with a period of strong motor gasoline demand, which also puts upward pressure on prices. U.S. Federal Highway Administration data indicate that the cumulative miles driven in the United States through the first half of 2018 increased by 5.2 billion miles (0.3%) from the same period in 2017. Gasoline product supplied—a proxy EIA uses for consumption—in the first five months of 2018 averaged 9.2 million barrels per day, an increase of 0.2% compared with the same period last year. Although the year-over-year rate of increase was greater in the lower price environment of 2015 and 2016, U.S. gasoline consumption measured this way reached a record high in 2017, and recent consumption remains high compared with levels in previous years at this time. Retail gasoline prices vary significantly within the United States as a result of regional supply and demand balances, gasoline specification requirements, and taxes. The U.S. Gulf Coast—Petroleum Administration for Defense District (PADD) 3—typically has the lowest retail gasoline prices in the country because it has approximately half of U.S. refining capacity and produces more gasoline than it consumes. Through August 27, average Gulf Coast gasoline prices were 26 cents/gal lower than the national average, while West Coast (PADD 5) prices were 48 cents/gal higher. West Coast retail gasoline prices are often higher than the average U.S. price because of the region’s tight supply and demand balance, isolation from additional supply sources, and gasoline specifications that are more costly to manufacture. Since January 8, 2018, weekly West Coast regional gasoline prices have consistently exceeded \$3.00/gal. Although state-level gasoline taxes and fees in California and Washington each are nearly 50 cents/gal, state-level gasoline taxes and fees across PADD 5 average 29 cents/gal, which is less than a cent higher than the national average. U.S. regular gasoline prices averaged \$2.85/gal from April through August. Gasoline prices are often higher in summer months when gasoline demand is higher and when federal and state environmental regulations require the use of summer-grade gasoline, which is more expensive to manufacture. EIA expects that the monthly average price of U.S.

regular gasoline in 2018 peaked in May at \$2.90/gal and anticipates prices to remain relatively flat in the fourth quarter of this year.

Weekly U.S. average regular retail gasoline price (2007-2018)

dollars per gallon



Source: U.S. Energy Information Administration, *Gasoline and Diesel Fuel Update*

- **Crude rises to highest since July on sanction concerns. Reuters**
 - Oil prices rose on Thursday to the highest in more than a month, extending gains on growing evidence of disruptions to crude supply from Iran and Venezuela and after a fall in U.S. inventories. Brent crude oil LCOc1 rose 63 cents a barrel to settle at \$77.77. U.S. crude CLc1 settled 74 cents higher at \$70.25 a barrel, after earlier hitting a session high of \$70.50. Both contracts were at their highest in more than one month. A rally that started earlier in the day accelerated as U.S. crude rose above \$70 a barrel, and more speculators entered the market, said Bob Yawger, director of futures at Mizuho in New York. “There are pretty good tailwinds here that will keep people jumping on board,” he said. Brent’s wide premium to WTI is likely to encourage exports of U.S. crude, keeping U.S. inventories lower and boosting activity following weekly inventory data, he said. Brent has risen by almost 10 percent over the past two weeks on widespread perceptions that the global oil market is tightening and could run short in the next few months as U.S. sanctions restrict crude exports from Iran. “There are a lot of supportive factors here,” said John Kilduff, a partner at Again Capital Management in New York. In addition to support from geopolitical events, natural disasters could impact the market if a potential storm system currently off the coast of Africa strengthens and heads to the Gulf of Mexico, he said. “The oil market is once again tightening,” said Giovanni Staunovo, analyst at Swiss bank UBS in Zurich. “Iranian oil export declines are already visible well in advance of U.S. oil-related sanctions, which enter into force in November.” Iranian crude exports are likely to drop to a little more than 2 million barrels per day (bpd) in August, against a peak of 3.1 million bpd in April, as importers bow to American pressure to cut orders. The Organization of the Petroleum Exporting Countries, in which Iran is the third-biggest producer, will discuss in December whether it can compensate for a sudden drop in Iranian supply after sanctions start in November, the head of Iraq’s state oil marketer SOMO, Alaa al-Yasiri, said on Wednesday. Crude exports from crisis-struck OPEC member Venezuela have also fallen sharply, halving in recent years to about 1 million bpd. Official U.S. oil inventory data on Wednesday also helped the bullish trend. U.S. commercial crude inventories USOILC=ECB fell by a larger than expected 2.6 million barrels in the week to Aug. 24, to 405.79 million barrels, the Energy Information Administration said. U.S. production C-OUT-T-EIA was flat from the previous week’s record of 11 million bpd.

Oil and Gas Analysis

o Rotary Rig Count Summary

Location	Date	Week	+/-	Week Ago	+/-	Year Ago
United States	24-Aug-18	1044	-13	1057	104	940
	31-Aug-18	1048	4	1044	105	943
North Dakota	24-Aug-18	52	-4	56	0	52
	31-Aug-18	52	0	52	0	52
Canada	24-Aug-18	229	17	212	11	218
	31-Aug-18	228	-1	229	27	201
International	Jul-18	997	38	959	38	959

- Baker Hughes

o Weekly Petroleum Status Report

Stocks (Million Barrels)			
	Four Weeks Ending		
	8/24/2018	8/17/2018	8/25/2017
Crude Oil (Excluding SPR)	405.8	408.4	457.8
Motor Gasoline	232.8	234.3	229.9
Distillate Fuel Oil	130.0	130.8	149.2
All Other Oils	454.5	451.2	466.5
Crude Oil in SPR	660.0	660.0	678.9
Total	1,883.1	1,884.8	1,982.3

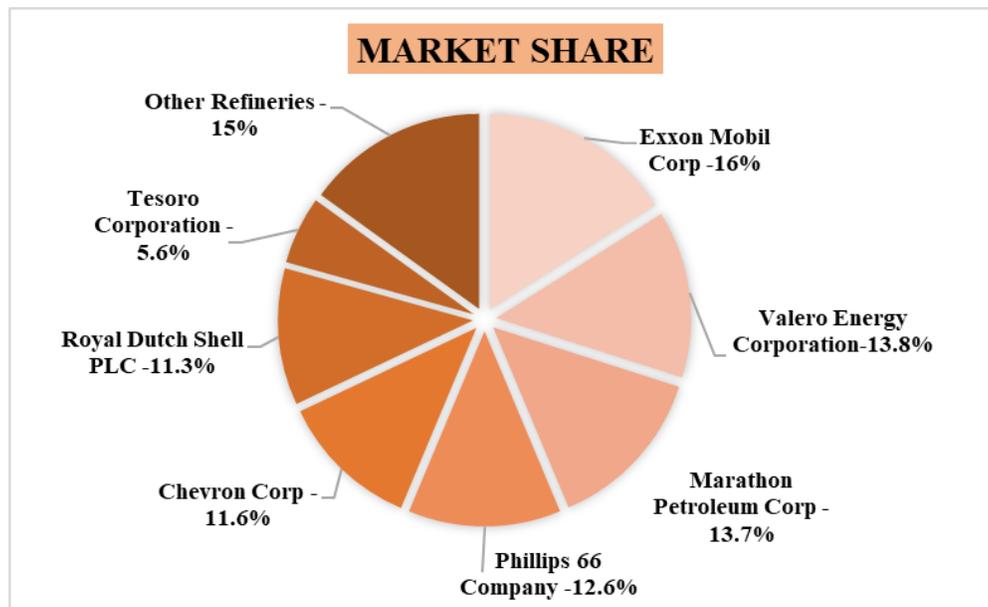
Products Supplied (Thousand Barrels per Day)			
	Four Weeks Ending		
	8/24/2018	8/17/2018	8/25/2017
Motor Gasoline	9,553	9,547	9,699
Distillate Fuel Oil	4,116	3,909	4,180
All Other Products	7,530	7,350	7,371
Total	21,198	20,807	21,249

Refinery Activity (Thousand Barrels per Day)			
	Four Weeks Ending		
	8/24/2018	8/17/2018	8/25/2017
Crude Oil Input to Refineries	17,759	17,738	17,581
Refinery Capacity Utilization	97.3	97.2	96.1
Motor Gasoline Production	10,134	10,195	10,379
Distillate Fuel Oil Production	5,295	5,289	5,185

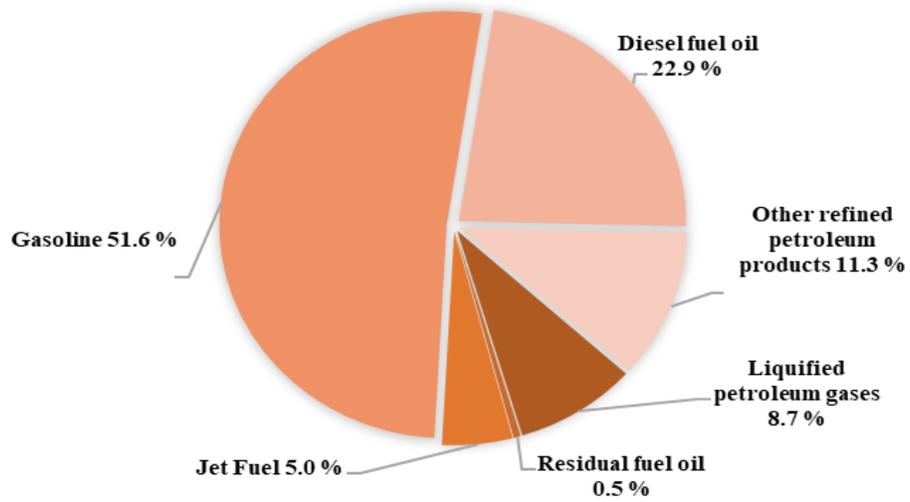
Net Imports (Thousand Barrels per Day)			
	Four Weeks Ending		
	8/24/2018	8/17/2018	8/25/2017
Crude Oil	6,393	6,576	7,290
Petroleum Products	-2,756	-2,895	-2,161
Total	3,638	3,681	5,130

- [EIA](#)

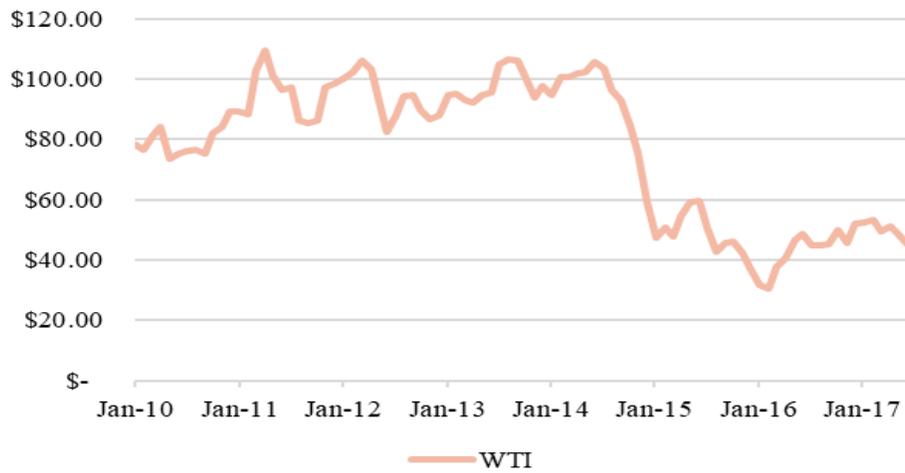
- **US Petroleum Refining at a Glance**



PRODUCTS AND SERVICES SEGMENTATION



WTI Monthly Spot Pricing



- [EIA](#)

o Key External Drivers

- o **World price of crude oil**
 - <http://markets.businessinsider.com/commodities/oil-price?type=wti>
- o **Demand from gasoline and petroleum bulk stations**
 - <https://www.reuters.com/article/us-usa-natgas-kemp/u-s-natural-gas-prices-rise-as-winter-stocks-look-tight-kemp-idUSKCN1BU1RK>
- o **GDP of mainland China**
 - <https://tradingeconomics.com/china/gdp>
- o **Trade-weighted index**
 - <https://www.investing.com/news/economy-news/top-5-things-to-know-in-the-market-on-friday-541066>
- o **Total vehicle miles**
 - <https://www.advisorperspectives.com/dshort/updates/2017/08/31/vehicle-miles-traveled-another-look-at-our-evolving-behavior>