WILSONS ADVISORY

Drilling Down on the Energy Sector Pullback

Our weekly view on Australian equities.

12 March 2025

The Crude Oil Price has Fallen to Multi-Year Lows

Oil has come under pressure this year due to the prospect of increased OPEC+ production, easing conflict in the Middle East, and concerns around the outlook for economic growth amidst escalating trade tensions.

On the supply side, OPEC+ announced in early March that it will proceed with unwinding its 2.2Mb/d in production cuts in April. This was in line with the group's plan, albeit market expectations were skewed towards another extension of the production cuts. The addition of new supply at a time when the global market is already in a small surplus has been a clear negative for the oil price.

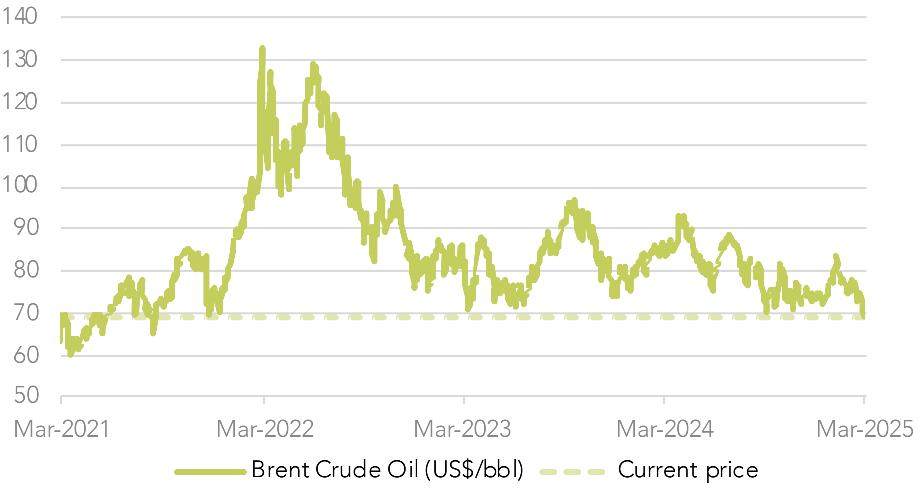
Easing conflict in the Middle East, with an Israel-Hamas ceasefire now in effect, has also driven a decline in the 'geopolitical risk premium' associated with the risk of oil supply shocks in the region.

On the demand side of the equation, the threat of US tariffs on imports from its major trading partners has fuelled concerns that an escalating trade war could meaningfully weigh on global economic activity, and hence energy demand over the medium-term.

Ongoing weakness in China's economy has also presented headwinds to global oil demand, which has not yet been met with a significant fiscal stimulus response.

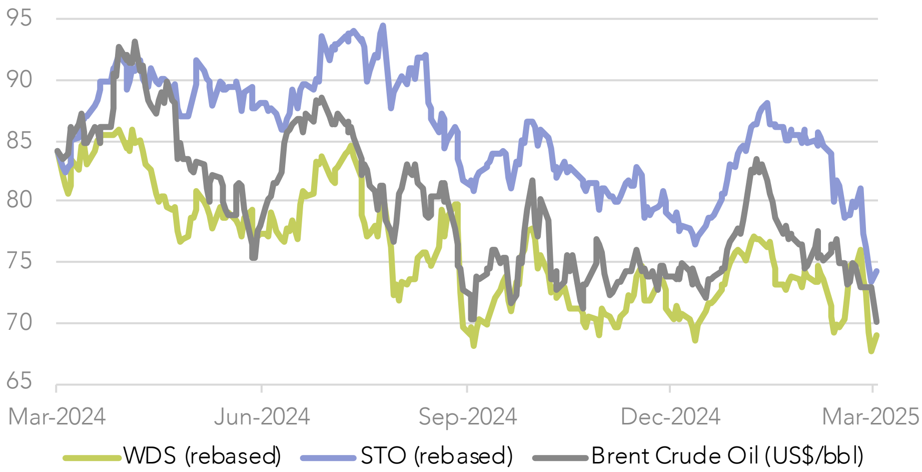
Unsurprisingly, in the context of the falling oil price, the energy sector has underperformed this year-to-date. While the major ASX oil and gas producers (Santos and Woodside) primarily produce LNG, the majority (~80%) of their earnings are indexed directly to the oil price. As such, this report is focussed on our near and long-term outlook for the oil price, and our preferred exposure, Santos.

Figure 1: The oil price has fallen to ~US$70/bbl



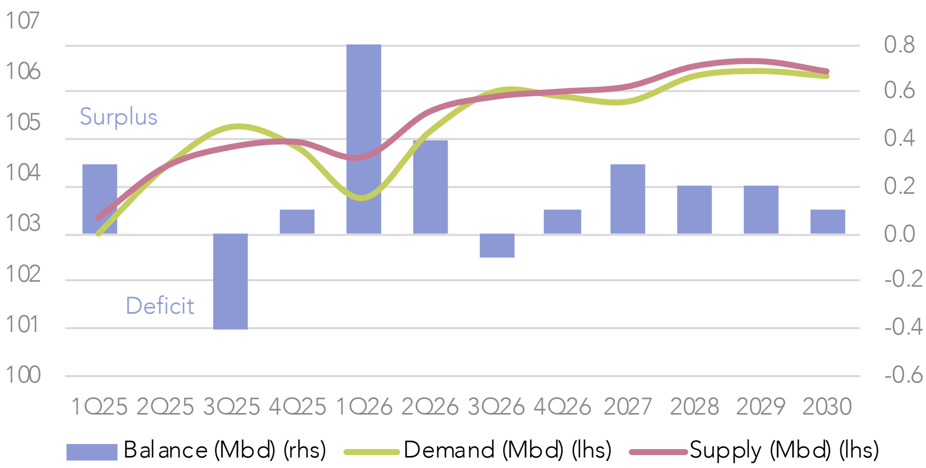
Source: Refinitiv, Wilsons Advisory.

Figure 2: The weaker oil price has weighed on ASX oil and gas producers



Source: Refinitiv, Wilsons Advisory.

Figure 3: The global oil market is currently in a small surplus



Source: IEA, Wilsons Advisory.

Risks to the Oil Price are Reasonably Balanced Over the Near Term

Overall, following the pullback this year to date, risks to the oil price are now balanced over the near-term.

While macro fears are currently weighing on sentiment towards energy markets, in our view these are more fear-based than evidence-based at this juncture.

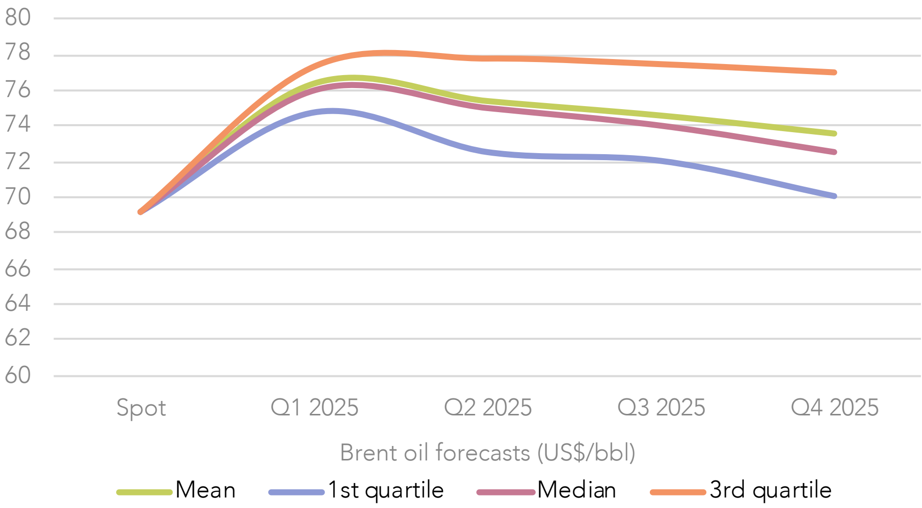
We see scope for the oil price to stabilise around US$70/bbl over the near-term, which has been a consistent support level over the last four years.

Consensus forecasts suggest oil will trade around ~US$75/bbl for the remainder of the 2025 calendar year.

The three key swing factors that underpin our our near term outlook for oil are:

1. Further extension of OPEC+ cuts? – while OPEC+ has reaffirmed its plans to gradually increase production by 2.5Mb/d from April (scheduled to take place over 18 months), it reserves the right to pause or reverse this unwind 'subject to market conditions'. We expect OPEC+ to be cautious in bringing back production, with the oil market already in a small surplus, which will affect the cartel's ability to maximise its revenues even with increased volumes. If OPEC+ pauses, this will provide support for the oil price.
2. Iran sanction risks – the key upside risk for oil in 2025 is the prospect that the Trump Administration will tighten sanctions on Iranian oil exports. This would provide support to the oil price and help to offset the impact of higher OPEC+ supply (should cuts not be extended). When sanctions were imposed in Trump's first administration, Iranian oil production fell from ~3.8Mb/d to ~2Mb/d, representing a meaningful hit to global supply (~1.8Mb/d out of ~100Mb/d globally).
3. Global growth pulse – recession tail risks have risen since Trump took office, which has weighed on the oil price. The potential for Trump's tariff threats to escalate into a full-scale trade war presents meaningful risks to global growth and hence energy demand. The direction of China's beleaguered economy will also be a key driver of demand, with China being the world's largest importer of the commodity. With only modest stimulus announced so far, we expect further stimulus to support China's economy and help counter the impact of tariffs.

Figure 4: The oil price is expected to stabilise around US$75/bbl



Source: Reuters commodity polls, Wilsons Advisory.

Will Trump's energy sector deregulation really drive greater US oil production?

President Trump has promised to expand US oil production by cutting regulatory red tape, including the Biden Administration's restrictions on oil and gas leases on federal lands, and increases in royalties and bond payments for producing oil and gas on federal lands.

Deregulation should facilitate more successful/quicker permitting on federal lands and will provide greater confidence to invest in US oil and gas projects. However, ultimately, the prospect of an increase in US oil and gas production will be primarily dictated by economics rather than policy.

For US producers to be incentivised to invest in new growth projects, the oil price will need to rise from current levels of ~US$70/bbl to underwrite a sufficient return on capital for most projects - irrespective of the improved regulatory environment.

Therefore, while Trump's policy tailwinds are incrementally positive for US producers, we don't expect them alone to 'move the needle' for US oil production (and hence oil prices). With that being said, Trump's energy policies have arguably de-risked US oil and gas projects (and selldown processes) that are already in the pipeline, including Santos' Alaskan oil project, Pikka (see below).

Remaining Constructive on Oil over the Long Term

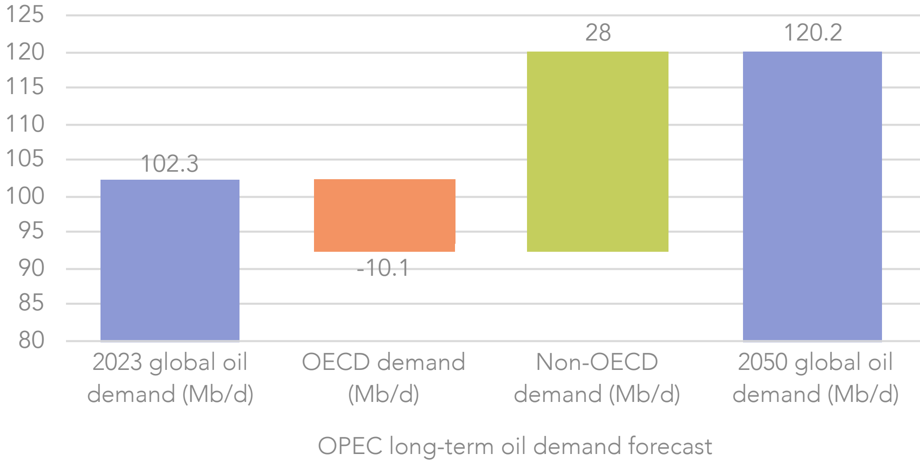
Leaving aside the near-term crosscurrents, our long-term view towards oil remains positive.

Despite the multi-decade challenges posed by the energy transition, we expect oil demand to grow until 2050 (in line with OPEC forecasts), as declining demand in OECD countries will be more than offset by growth in demand from non-OECD countries, driven by the economic development of Asia.

On the supply side of the equation, after driving a substantial ~10Mb/d lift in production in the last ~15 years (representing a ~10% increase to global supply), US shale production is expected to plateau over the next few years. This dynamic should support a relatively 'balanced' market, with OPEC+ likely to lift its production market share over the medium-term.

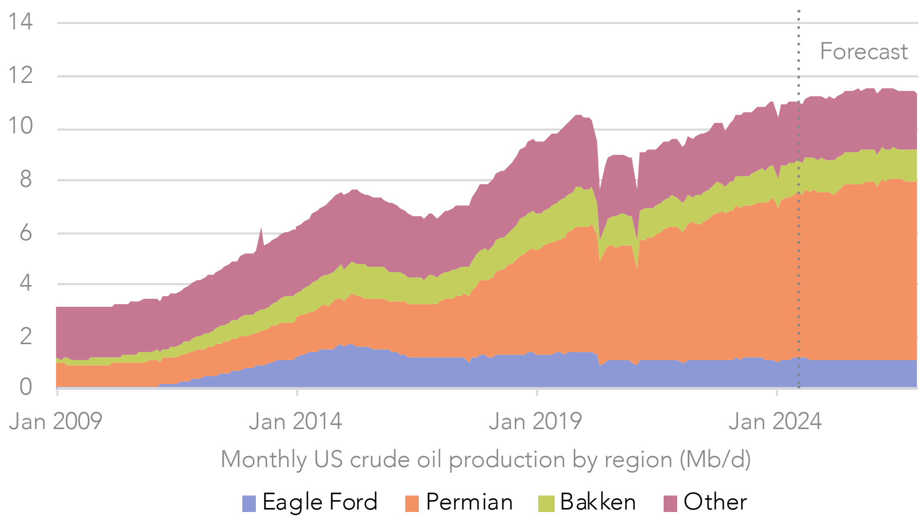
We expect this dynamic to give OPEC+ greater influence over the oil price across the medium-term, which is supportive of a long-term oil price of US$70-90/bbl.

Figure 5: Oil demand is expected to grow until 2050, driven by non-OECD countries



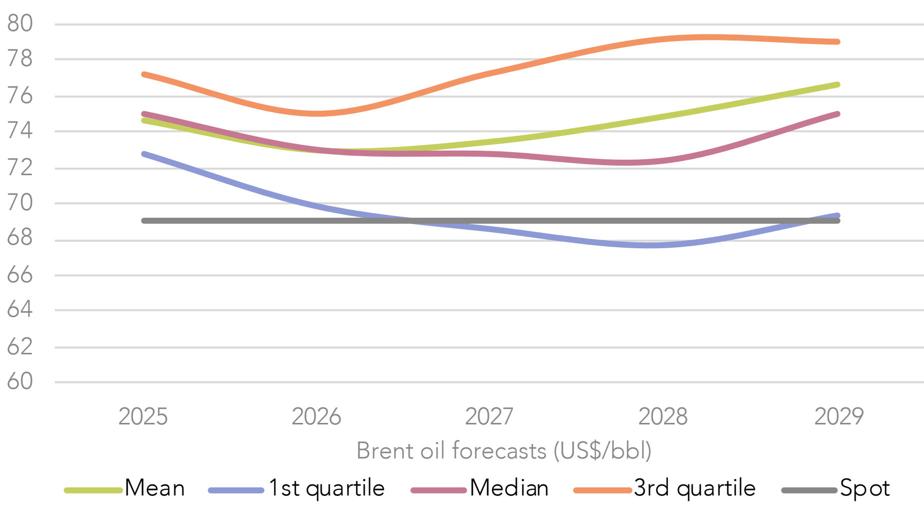
Source: OPEC, Wilsons Advisory.

Figure 6: US oil production is expected to plateau over the next few years



Source: U.S. Energy Information Administration, Short-Term Energy Outlook, February 2025; Wilsons Advisory.

Figure 7: Oil prices are expected to rise over the medium-term



Source: Reuters commodity polls, Wilsons Advisory.

Santos Remains our Preferred Energy Exposure

The Focus Portfolio remains modestly overweight the oil and gas sector, with our 5% sector weighting (solely in Santos) representing an 2% active weight compared to the ASX 300.

Santos (STO) remains the standout oil and gas exposure among the ASX large caps (compared to Woodside), given its attractive (and de-risked) production growth outlook, superior free cash flow profile, and disciplined approach to capital allocation (driving improving shareholder returns).

Santos' growth projects are nearing completion

Santos' two major growth projects - Barossa (North Australia, LNG) and Pikka (Alaska, Oil) - are now largely de-risked and progressing according to plan. Barossa is ~91% complete and on track for first gas in Q3 2025, while Pikka is ~76% complete and remains on track for first oil by mid-2026. These projects underpin Santos' consensus production CAGR of ~7% over 2024-2027.

Free cash flow build to underpin attractive shareholder returns

With the bulk of Santos' capex for Barossa and Pikka now complete and both projects set to come online soon, the company is on the brink of a significant step change in its free cash flows from late 2025.

In addition, Santos has also unveiled its plans to drive $100-150m in annual structural cost savings over the next 12-24 months, which should provide a further ballast to free cash flows.

In line with its improving free cash flow outlook, late last year management unveiled its new capital management framework, which will strengthen shareholder returns over the coming years.

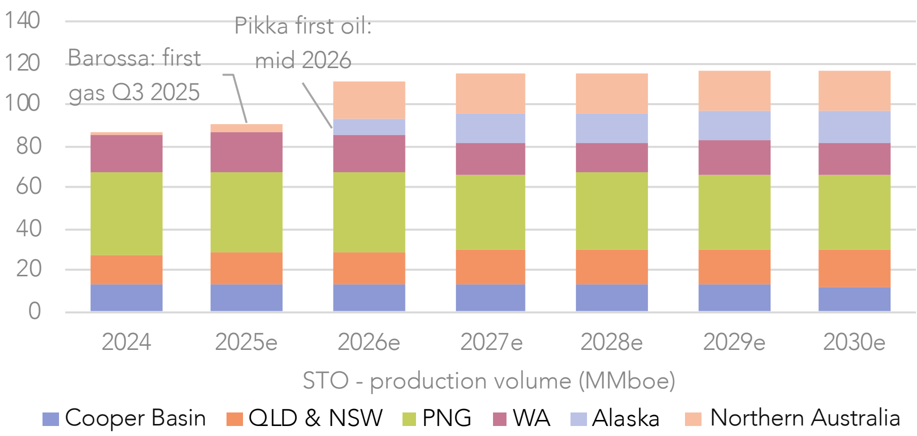
Under its new framework, Santos will return at least 60% of all-in free cash flows to shareholders from 2026 (vs 40% previously), The business has also committed to returning 100% of free cash flows once its gearing is below its target range of 15-25% (likely in ~2029 according to consensus).

Figure 8: Santos vs Woodside comparison table

	2024a	2025e	2026e	2027e	3yr CAGR
Production volume per day - oil equivalent (Mboe)					
Santos	238	253	292	295	7%
Woodside	530	493	474	504	-2%
Earnings per share (diluted) (US$cps)					
Santos	$0.37	$0.38	$0.50	$0.52	12%
Woodside	$1.51	$1.06	$0.79	$1.00	-13%
Capital expenditures (US$m)					
Santos	$2,428	$2,407	$2,085	$2,043	-6%
Woodside	$4,902	$6,310	$4,670	$4,715	-1%
Dividend yield					
Santos	-	4.7%	6.9%	7.8%	nm
Woodside	-	5.7%	4.4%	5.5%	nm
Free cash flow yield					
Santos	-	7.0%	14.4%	15.4%	nm
Woodside	-	1.5%	4.3%	5.8%	nm

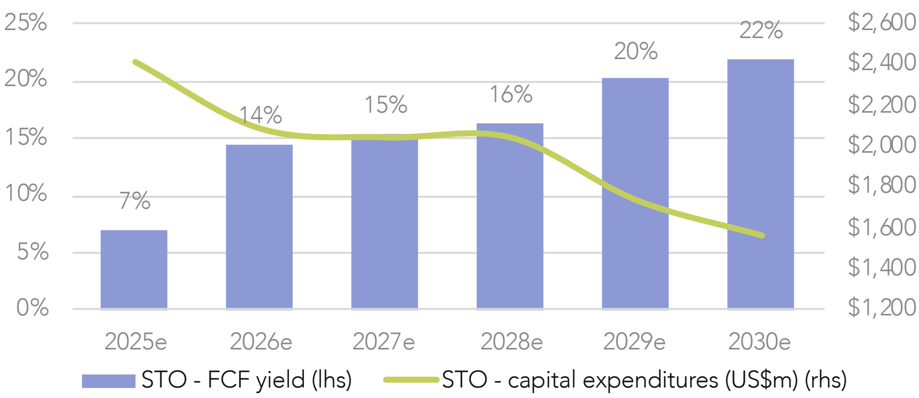
Source: Visible Alpha, Wilsons Advisory.

Figure 9: Santos will grow its production by ~24% over the next three years as Barossa and Pikka come online



Source: Visible Alpha, Wilsons Advisory.

Figure 10: Santos' free cash flows are set to inflect as production builds and capex eases



Source: Visible Alpha, Wilsons Advisory.

Figure 11: Pikka Phase 1

Selldown scenario analysis	
Assumed total project value (US$m)	**$4,500**
Santos % share	51%
Santos value (US$)	**$2,295**
Value of 50% selldown of Santos' stake (US$m)	$1,148
Value in AUD terms (at spot FX) (A$m)	$1,813
Scenario 1: special dividends	
Implied special dividends (US$cps)	$0.35
Value in AUD terms (at spot FX) (A$cps)	*$0.56*
Implied 'special dividend yield' % (at last close price)	9.2%
Scenario 2: share buyback	
Value of buyback (A$m)	$1,813
Santos market cap (A$m)	$19,811
% of shares bought back (at last close price)	9.2%

For illustrative purposes only. Data is based on the 10/3/2025 market close. Source: Refinitiv, Wilsons Advisory.

Trump 2.0 means Pikka selldown is back on the table

The Trump administration has been highly supportive of the Alaskan resources sector. The president has already signed an executive order that aims to unwind many of Biden's restrictions and ultimately boost Alaskan resources (and particularly oil and gas) development.

The regulatory/environmental tailwinds provided by the Trump Administration (alongside the natural de-risking of the project) have improved the likelihood that Santos can garner investor interest in its Pikka asset after first oil in mid-2026.

Santos has signalled it is likely to explore a partial selldown of its 51% stake in Pikka (our base case is up to 50% of its stake) to unlock capital for shareholder returns (special dividends or buybacks).

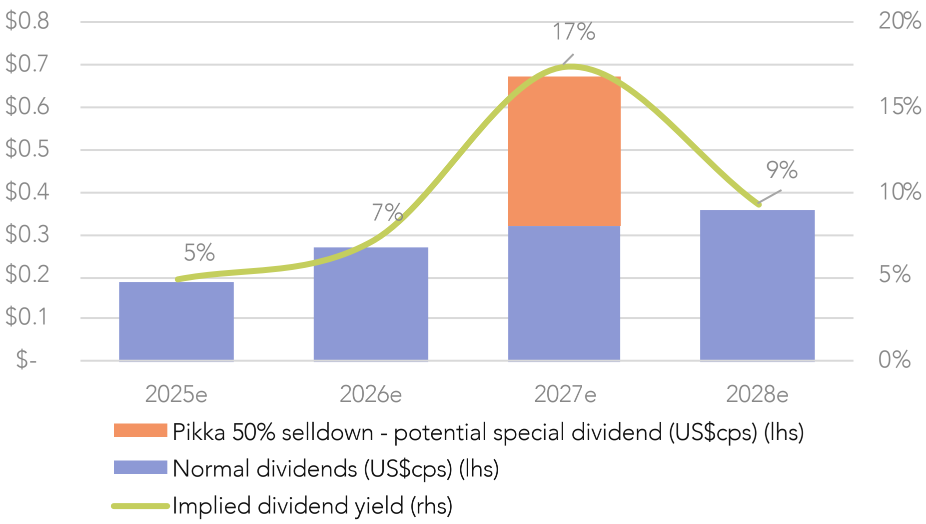
However, a complete sale of Santos' stake in Pikka is unlikely given this is a high quality, well located, long-life asset with significant strategic value as it diversifies its portfolio and will deliver strong cash flows for the group over the long-term.

As one of Alaska's largest oil projects, Pikka phase 1 will have a production capacity of 80,000 Bp/d and will generate an IRR of '20% or higher' at an assumed oil price US$75/bbl. Last year, the project was independently valued at ~US$4.5bn (Santos' 51% share: ~US$2.3bn).

Therefore, assuming Santos sells down half of its 51% stake in the project after first oil, this will liberate ~US$1.15bn of cash, which we expect will be used to fund capital returns to shareholders (via buybacks and/or special dividends), possibly as soon as FY26/7.

In figure 11 and figure 12 we have conducted a hypothetical analysis of the potential capital returns a Pikka selldown could generate.

Figure 12: A Pikka selldown could generate meaningful capital returns for Santos shareholders



For illustrative purposes only. Figure is based on the assumptions outlined in figure 9, and assumes Santos sells down 50% of its stake in Pikka shortly after first oil in mid-2026, and that the assumed proceeds are paid out via a special dividend in 2027. Source: Visible Alpha, Wilsons Advisory.

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