PICKERING ENERGY PARTNERS, INC.

Quick Hit Research Note

Crude Oil Observations or Confessions of a Fundamental Analyst in a Speculative Market

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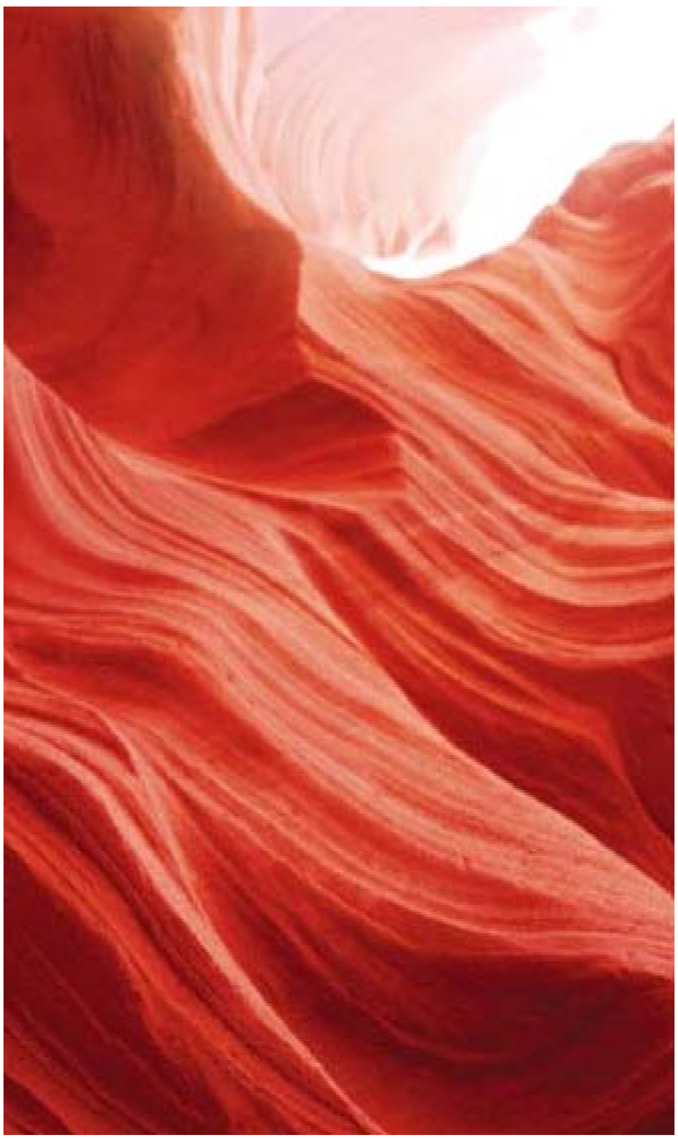


Summary

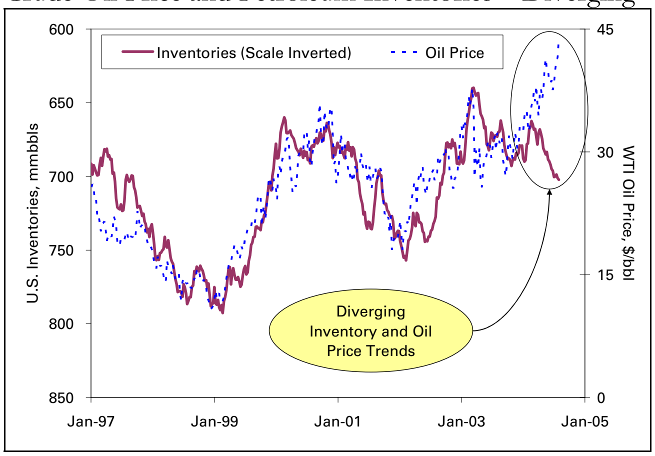
- **The Crude Oil Markets Are Adequately Supplied**: Several indicators that we monitor closely 1) inventories, 2) imports, 3) tanker rates, and 4) crude oil differentials suggest that the current crude oil market is adequately supplied…even though oil prices remain at record high levels.
- **'Other' Factors Are Driving The Markets** : The persistent high crude oil price confirms that the market is discounting a supply disruption (Iraq, Venezuela, Russia, etc.) *and/or* continued robust demand growth (exceeding non-OPEC supply growth) putting more pressure on limited excess capacity.
- **OPEC in a Box:** OPEC/Saudi Arabia can only influence the physical markets with extra barrels, and currently have no sway over the sentiment of financial markets. It is somewhat dangerous for OPEC to add more barrels to a market that is adequately supplied, yet failure to do so may allow crude oil prices to run even higher, increasing the risk of cycle-killing negative demand impacts.
- **Near Term Direction A Coin Toss:** With 'other' factors driving the oil markets, analyzing crude oil prices is a study in chaos theory…any direction is possible in the short term.
- **Robust Price Threatens Longevity:** The link between price and demand is obvious, but the magnitude is unclear. The toughest question is the most important…will the oil price go high enough to cause negative demand impacts to short circuit the cycle?

IMPORTANT DISCLOSURES ON PAGE 4 OF THIS REPORT

Inventories

- The well developed relationship between crude oil inventories and oil prices continues to diverge.
- Combined U.S. crude oil and refined product inventories have built substantially since the beginning of the year, yet oil prices have continued to rise.

Crude Oil Price and Petroleum Inventories – Diverging

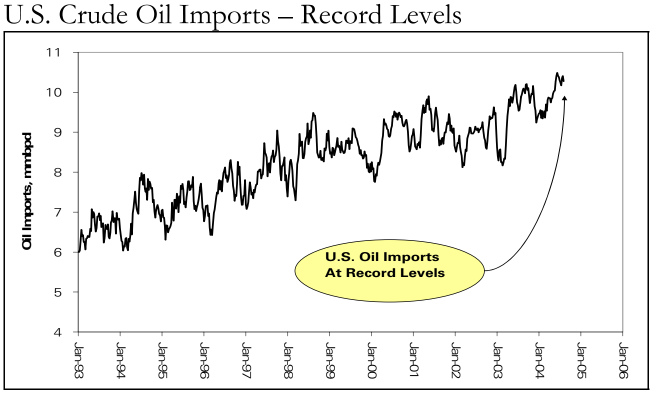


Sources: DOE, Bloomberg, Pickering Energy Partners, Inc.

Crude Oil Imports

- U.S. crude oil imports are at record levels. The past 10 weeks have seen imports 5% above year ago levels.
- Rising (and record) crude oil imports suggest that there are incremental barrels currently in the marketplace.

U.S. Crude Oil Imports – Record Levels

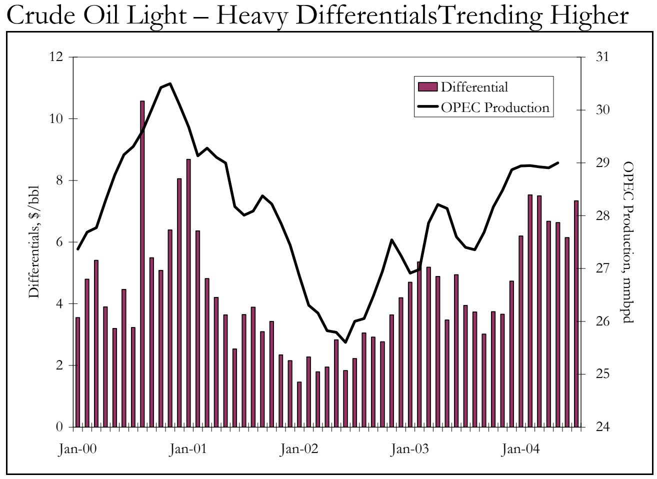


Sources: DOE, Bloomberg, Pickering Energy Partners, Inc.

Oil Price Differentials

- The incremental barrel of OPEC oil is typically heavy and/or sour. As OPEC adjusts its production, the last barrels added are heavy and sour.
- A thirsty oil market would willingly soak up the OPEC heavy barrels in a heartbeat, keeping historical differentials intact.
- However, the differential between light oil (West Texas Intermediate) and heavy oil (Arab Heavy) has grown over the past six months. Amply supplied crude oil markets have to be cajoled into buying the incremental barrel.

Crude Oil Light – Heavy DifferentialsTrending Higher

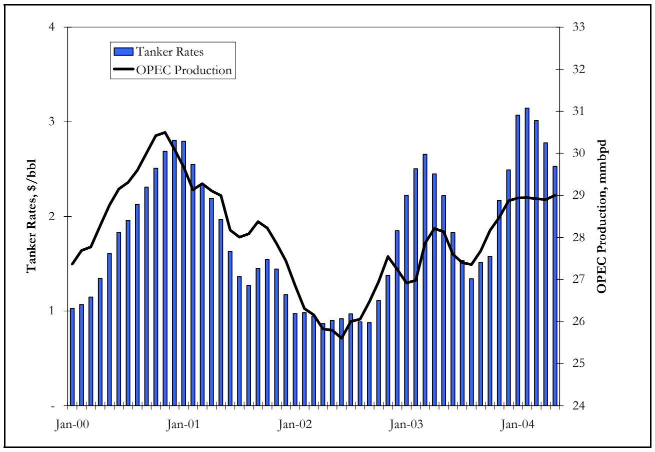


Note: WTI less Arab Heavy; Source: Bloomberg

Tanker Rates

- Tanker rates from the Persian Gulf to the US Gulf of Mexico show a decent long term relationship with OPEC production.
- Tanker rates over the past six months are at/near record highs, confirming high OPEC production and record U.S. imports.

OPEC Production and Tanker Rates

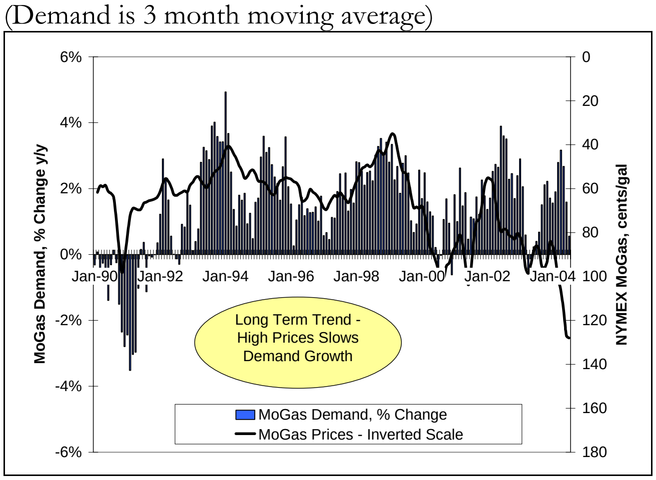


Note: Both data series are 3 month moving averages
Sources: Bloomberg, IEA, DOE, and Pickering Energy Partners, Inc.

Demand

- The following graph shows the long-term trend of motor gasoline demand and NYMEX gasoline prices. As gasoline prices increase (price scale is inverted), demand growth slows. Thus, as oil and gas prices move higher, we become increasingly nervous regarding demand growth.

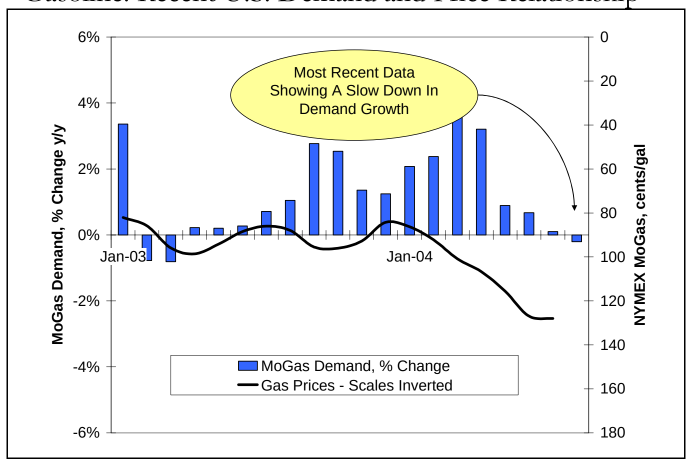
Gasoline: Long Term U.S. Demand and Price Relationship (Demand is 3 month moving average)



Sources: DOE, Bloomberg, Pickering Energy Partners, Inc.

- Real time demand is difficult to measure. However, the most recent data points show gasoline demand has begun to decline y/y as price has risen dramatically (note the inverted scale for gasoline prices).

Gasoline: Recent U.S. Demand and Price Relationship



Sources: DOE, Bloomberg, Pickering Energy Partners, Inc.

- U.S. motor gasoline consumption is 9 mmbpd and accounts for 11% of global oil consumption. *Is stagnant US gasoline consumption a leading indicator of broader energy demand*?

Conclusions

Crude markets are adequately supplied based on inventory trends. Tanker rates, crude oil differentials, and record US oil imports are confirming data points. Crude oil markets are a geopolitical spectator sport *for the time being* and should be played only by those with firm opinions on global supply disruptions and oil demand elasticity. Using Texas vernacular, one has to have "a little extra below the belt" to saddle up to the crude oil markets. Fundamentals argue for lower prices, but this broken record has been playing for some time. On a fundamental basis, our price outlook remains unapologetically unchanged at $30 to $35/bbl.

Analyst Certification:
I, David Pursell, do hereby certify that, to the best of my knowledge, the views and opinions in this research report accurately reflect my personal views about the company and its securities. I have not nor will not receive direct or indirect compensation in return for expressing specific recommendations or viewpoints in this report.

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