DME

Futures Insights

Issue 1

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Oman Crude Oil & DME

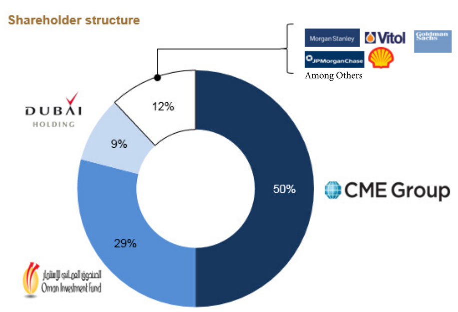
Oman crude oil has over the last decade established itself as the clear benchmark grade for the Middle East and Asian markets, with recognition coming in the form of DME launching its flagship Oman contract in 2007, while Oman has become the mainstay of the Dubai pricing mechanism.

Trading and risk management appetite is growing across Asia and as the world's only sour physical-delivery crude oil futures contract, Oman is emerging as the crude grade most likely to match the super benchmark status of Europe's Brent or the Americas' WTI – and become Asia's first true super benchmark in the commodities space.

The continuing futurization of oil markets and Asia's increasing reliance on Middle East crude has accelerated the need for a reliable sour crude futures contract, and Oman looks set to join Brent and WTI at the top table of commodities benchmarks.

DME

The DME was founded in 2006 and its flagship Oman contract launched in 2007. The world's largest futures exchange, CME Group, holds 50% equity in the DME, followed by the Oman Investment Fund (29%), Dubai Holding (9%) with a number of other strategic investors retaining the balance.



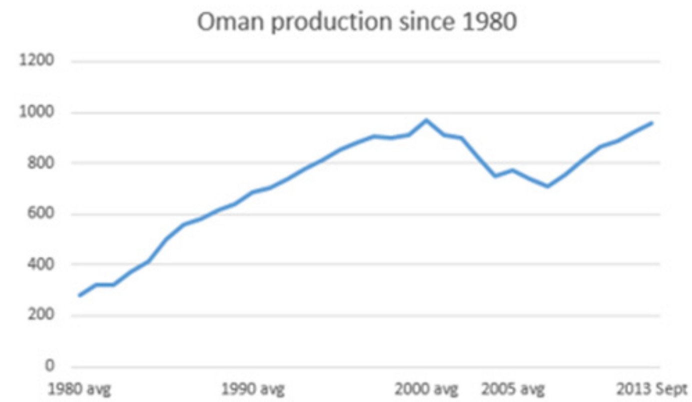
The DME is a fully regulated exchange, with Dubai's DFSA acting as the primary regulator, while clearing for the Oman contract is handled by CME Clearing, which is regulated by the CFTC in the US.

Oman Crude Oil

Oman has avoided the political upheavals that have affected parts of the Middle East in recent years, allowing the country to make great strides in boosting both crude oil production and exports – in particular bringing non-conventional crude reserves to market.

Oman's crude and condensate output moved above 950,000 b/d in the fourth quarter of 2013, marking a significant rise from 2007 production levels of just above 700,000 b/d. Oman typically exports around 750,000 b/d or around 45 cargoes every month (a figure more than double typical Forties crude oil production - which is the grade that almost exclusively sets the price of Dated Brent). With the increase in volumes, Oman production now matches the combined production of Brent, Forties, Oseberg and Ekofisk.

Oman had previously peaked at close to 1 million b/d at the turn of the century, and the country has two refineries typically processing just over 200,000 b/d of crude.



Petroleum Development of Oman (PDO) is responsible for 70% of Oman's oil production, which is turn is 60% owned by the Omani government, Shell (34%), Total (4%), and Portugal's Partex (2%). Other international companies with oil stakes include Occidental Petroleum, the largest single producer outside of PDO. BP, China's CNPC, Korea's KoGas, Spain's Repsol and the UAE's Mubadala Petroleum, are among the other equity holders.

Oman crude is exported as a single stream known as Oman Blend from the Mina al Fahal terminal. Oman also benefits from being outside of the Strait of Hormuz, which is considered by many to be vulnerable to geopolitical tensions, given its position as the world's busiest oil transport route.

In 2013, the Oman Oil Company (OOC) in partnership with Takamul Investment Company established a new company, Oman Tank Terminal Company (OTTCO), to build, own and operate a new oil terminal in Ras Markaz. This terminal aims to be the largest crude storage terminal in the Middle East region, and an export pipeline will eventually lead to Raz Markaz.

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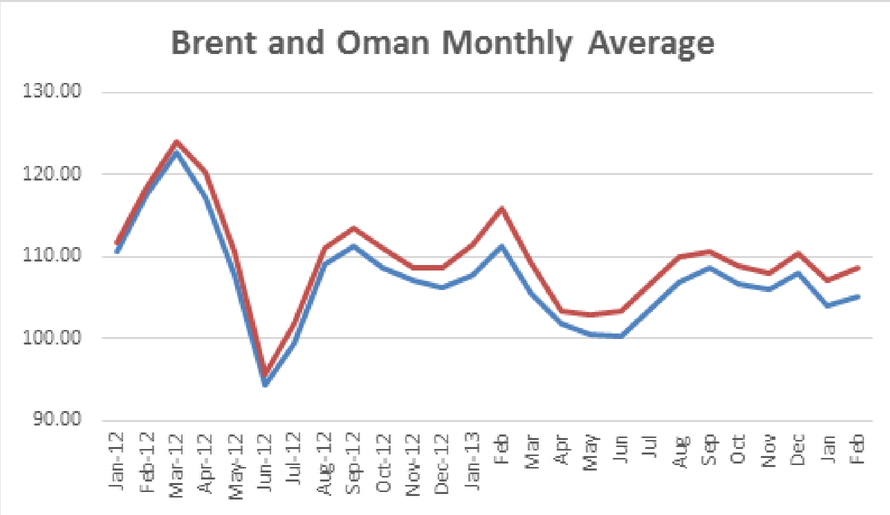
Price Relationship with WTI, Brent and Dubai

Since the Shale Oil Revolution in the US and oversupply in the Cushing storage hub, WTI tends to trade on its own localized fundamentals, so typically has a volatile relationship with Oman crude.



Although Oman arbitrage to the West is a rare occurrence these days, Oman and Brent typically have a strong correlation, with the Brent premium over Oman averaging around $2.40/bl over the last two years. The spread can go above $4.00/bl when the North Sea market is particularly tight, such as during times of maintenance, while the narrower end of the range will see Brent/Oman close in to around $1.00/bl.

As Oman typically sets the price of Dubai, the value of the two grades is usually very narrow, amounting to just a few cents/bl on most days. Occasionally the Oman/Dubai spread can widen, usually when Upper Zakum is the weakest of the three grades that are deliverable against Dubai (Oman and Dubai are the other two).

Upper Zakum typically falls below the value of Oman when the light end (gasoline, naphtha and LPG) crack is relatively weak, since Upper Zakum contains a higher yield of light ends than Oman. As Dubai is a reflection of the weakest grade out of the three, a lower Upper Zakum price will drag down the value of Dubai.

DME as a pricing mechanism.

In 2007, the Sultanate of Oman adopted the DME as its pricing reference, or Official Selling Price, a move that was later followed by the Dubai government.

DME Oman trades on a Month +2 basis, so for example in January the front-month contract is March. The OSP is established from a volume-weighted trading average between 1225-1230 Dubai time (1625-1630 Singapore). Correlation between traded volumes on DME and physical Dubai partials tends to be low, with DME volumes consistent regardless of the Dubai market.

Other Potential Benchmark Grades for the Middle East

Dubai: With the legacy benchmark down to just three or four cargoes per month, Dubai needs to be supplemented by other grades.

Upper Zakum: Excellent production potential, but the majority of the oil has destination restrictions, which makes it unsuitable for a benchmark grade.

Murban: Considered too light/sweet for a Middle East sour crude benchmark, although in volume and trading terms is a strong candidate.

Basra Light: While production levels and quality remain unstable, Iraqi crude is unlikely to be considered as a benchmark by the wider market.

Arab Medium and Arab Light: Destination restricted grades, so cannot be freely traded, which is essential for a benchmark grade

ESPO: Relatively low export volumes and quality not closely aligned with Middle East grades, which are the baseload for many Asia refiners.

2014 Performance Highlights:

Record Open Interest: **24,391** lots on 25th November 2013. Previous high was 23,429 lots on 26th March 2013

Record Volume Traded: **14,039** lots on 12 February 2014.

Record Window Volume: **6,511** lots on 26th February 2014.

Overall DME Record ADV: **10,764** lots in February 2014, previous high was 8,162 in Jan 2014

Record Physical Delivery: **16,770** in June for August 2013

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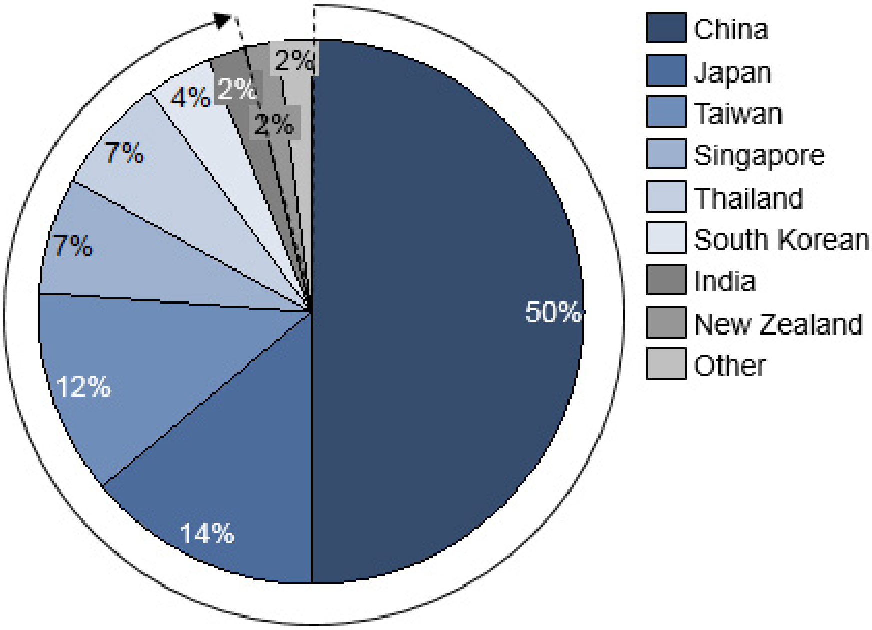
Oman delivery, destinations and quality

Physical delivery on the DME Oman contract ranges between 10 and 17 million barrels on expiry, making it the crude oil contract with the largest physical delivery in the world.

This typically represents between 50% and 75% of the total Oman export program.



China is the largest recipient of Oman crude, reflecting China's march towards the becoming the world's number one crude oil importer.

According to the Edinburgh-based analysts Wood Mackenzie, China will have an oil import bill of $500 billion by 2020 as its net imports surge to 9.2 million b/d by that time.

China also plans launch its own sour crude futures contract in 2014 and Oman is expected to be a major component of the contract. While China is the largest end-receiver of Oman Blend crude, Chinese companies account for under 10% of DME trading activity, as many third parties supply Oman crude to China.

The expansion of Oman crude production has led to a slightly heavier crude, which brings it closer into line with the quality of other significant crude streams in the Middle East, such as Saudi Arabia's Arab Medium and Iraq's Basra, making it an effective benchmark for the region.

Oman's most significant expansion in Oman Blend has been the Occidental-operated Mukhaizna field, which in 2012 reached 120,000 b/d production, — over 15 times higher than the production rate in September 2005, when Occidental assumed operation of the field.

The True Benchmark

With 6,000,000,000 barrels of Oman Crude Oil traded by March 2014, up to 75 participants, and a large network of members especially from the Asian landscape, DME Oman is the True Price Benchmark for Crude Oil in Asia.

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