<u>The Outlook: Nov. 3, 2017</u>

Nerve, in the arena: Transocean.

Two months ago, Outlook made an emphatic judgment about the great long-term value in the oil sector, and backed it up with an emphatic amount of client (and Outlook) money. The most interesting (or possibly "breathtaking") of our new companies is Transocean, which rents deepwater oil-drilling ships to the world's oil exploration-and-production companies. A picture always helps.

Transocean's "Deepwater Invictus"

An Outlook golden rule is, roughly, "Get interested in a company when the market hates and fears it, and its operating business is trying to claw its way out of the Valley of Death, so to speak." Hard times sometimes kill companies; but they usually bring out the very best in its people . . . and that "best" is often downright remarkable. Let's see if we can describe Transocean's hard times in a few bullet point, after glancing at its 10-year picture.

- Blue is the stock price: down 95% from $170 to $7, until the past few weeks. Orange is quarterly sales, down 76% from 3.3 billion to $800 million. We've seen a fairly astounding Bull Market during most of those 10 years. Transocean just might be near some kind of world record for the worst sustained Bull Market performance in history. It's not easy to find 10-year charts which look like that, these days.

- Transocean operates 49 rigs. Half of them are idle.

- The other half have been renting—until recently—in the neighborhood of $150,000 per day. Only 3 years ago, when oil was at $115/barrel, the going "dayrate" for such rig rentals was $450,000 to $600,000 per day.

- Half or more of Transocean's active rigs (being rented) are still under contracts paying $450,000 - $500,000 per day . . . but when those contracts expire over the coming few years, their rates will plummet toward that $150,000 number, or else zero if nobody wants them at all.

- Also until quite recently, Transocean's customers (mostly major oil companies) have been making their own history, slashing capital spending on exploration-and-production by 80%, or so, from their 2014 levels . . . and sustaining that "Valley of Death" for Transocean for a historically unprecedented three years.

So we might all agree that "Valley of Death" is not exaggeration, when it comes to the hard times which should theoretically be bringing out the best in Transocean's leaders and people.

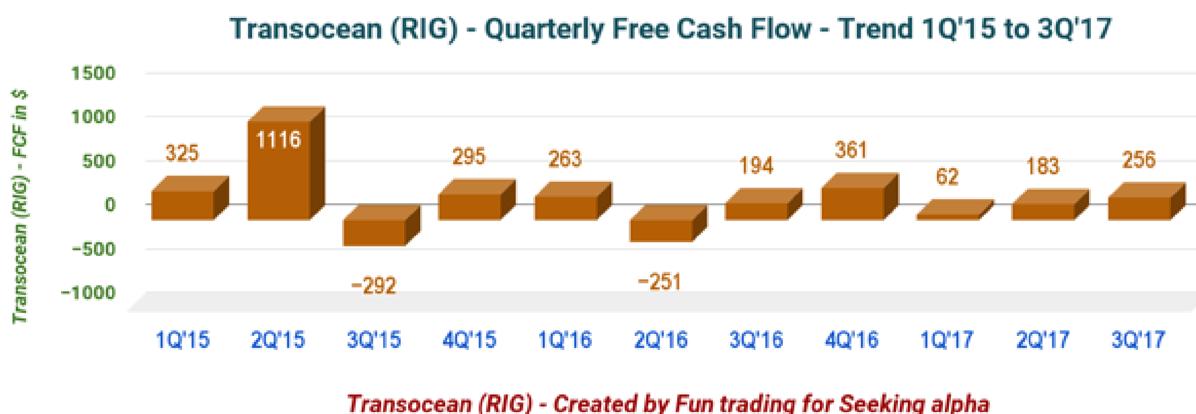
In Outlook's opinion, there is no "theoretically" about it. Transocean has done very well indeed.

- Cash on hand is $2.7 billion—at the very high end of Transocean's history.

- Debt maturities are not significant until 2022, and the company is sure of extending that multi-year string of "no cash challenges" until 2025 or so, by this time in 2018.

- Transocean's backlog of "rental contracts in place" is the best in the industry, by a long shot, at $13.5 billion dollars.

Those 3 items can be summed up in one phrase: "cash flow breathing room." As Outlook has noted a few times, companies which operate in cyclical industries simply have to accept a roller-coaster business life. They will be hurt when the roller-coaster swoops down. But if they're run by experienced, wise people, their down cycles simply inflict pain—rather than threatening their lives—which always comes down to having the cash to pay your bills, no matter how surprisingly long the "Valley of Death" stretches out. Here's a quick look at Transocean's free cash flow in this Valley.



There are one or two more things Transocean's people have done:

- Scrapped old (and even moderately aging) drillships. When a company like Transocean scraps a ship, it gets something in the range of 2 or 3 cents on the dollar of the ship's original purchase price. Ouch. But it also gets to stop spending considerable volumes of money keeping those ships fit for future service during what they call "warm stacking" (get it up and running in a few days or weeks) or "cold stacking" (longer.) Transocean's leaders have been ruthless about cutting their fleet down to only the best, most modern ships in the industry—which will command the highest rental rates whenever that cycle turns up again.

- The best comes last. A few months ago Transocean bought a Norwegian drill-ship firm, Songa, adding 7 or 8 modern rigs to the fleet—almost all of which were in active service under fairly long rental contracts. All of them—like Transocean's other 49 rigs—fall into exactly one category: "deepwater and harsh-environment drill rigs." Those are the most expensive rigs to rent, because they drill in the toughest ocean environments. Hence they were also the first kind of rigs cancelled by the world's big oil companies, when oil began its awful plunge in 2014 . . . and they'll probably be the last kind of rigs aggressively sought out again, when the oil upturn has been underway for long enough to convince the "big oils" that it will last.

Yes . . . that took some nerve, didn't it? Transocean's CEO, Jeremy Thigpen, looked at the carnage all 'round him, and calmly doubled his bet on the future of Transocean's fundamental business. As Outlook has remarked a few times, the critics talk and complain . . . but those in the arena act, and commit their lives, fortunes and sacred honor, so to speak, to making sure their actions pay off for the owners of their companies, which is us. Let's close with a glance at Transocean's market voyage, these past two months.

That kind of picture is nothing but fun . . . but doesn't mean much. Years mean something; months do not. So let us glance up top once more, at the 10-year picture. Transocean might never get to $3.3 billion in sales again . . . but Outlook is willing to bet a lot that they'll get back to $2 billion and possibly a good deal more. When they were last around $2 billion, Transocean traded around $50—which would be a noticeable improvement on today's $11. But as usual with well-run cyclical companies, Transocean's operating costs per dollar of sales will be sharply lower than ever before, as those sales finally head back up again—hence earnings will be sharply higher. This company has given itself a great deal of "breathing room" in which to endure more of its Valley of Death, if need be. Maybe it will have to endure more . . . but it will climb out of the Valley, and it will be worthwhile for us to have kept it company while it endured.

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