The Outlook: Nov. 30, 2017

Shell rebuilds: oil 33% lower . . . free cash flow 400% higher.

It's fairly shameless for us long-term investors to hang a 3-month chart on the wall, just because it's "Up!" so nicely and we happened to begin buying it back then . . . but let's glance at Royal Dutch Shell, anyway.

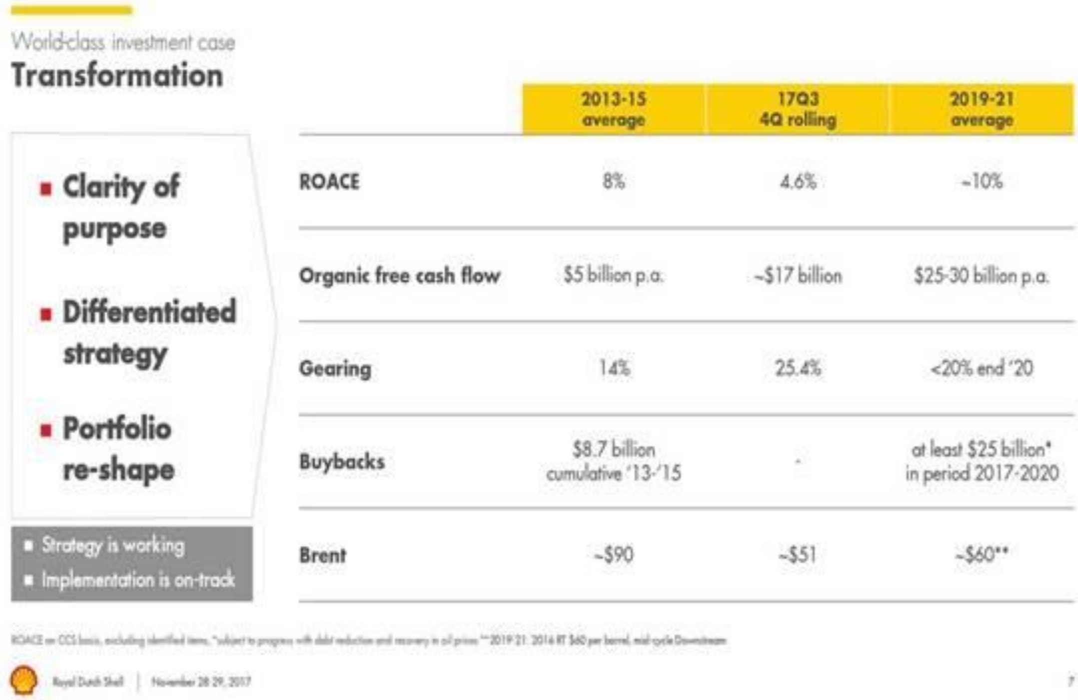
Royal Dutch Shell and Brent Crude Oil: 3 Months

The blue line is what we're cackling about—stock up 16%--and the orange line is the main engine behind it—global oil up 22%. We invested in Shell for 2 powerful reasons, about equal in importance:

- The near-certainty of strongly rising global oil prices, eventually.
- The admirable performance of Shell's boss (Ben van Beurden) and his people, in strengthening their company through what we call the "Valley of Death" when oil plunged.

Not long ago we noted Shell's purchase of a major deepwater-and-LNG producing company, BG, near the top of the oil market—the kind of thing which happens so often, even to the people who are as "inside" an industry as it's possible to be, that we humble investors might feel a little better about the Murphy's Law which quite often seems to tell us that whenever we buy something, it'll plunge the next day.

But as we've also noted too many times to count, what matters—in investments, in business and of course in life—is not whether we get knocked down (because we will, again and again) but how fast we get up, and how determined we are to beat whatever or whoever did the hammering. Shell's Mr. Beurden gave a talk, this week, about exactly what his team did. There is no word for it except "remarkable." Here is one picture which captures the essence of it.



	2013-15 average	17Q3 4Q rolling	2019-21 average
ROACE	8%	4.6%	~10%
Organic free cash flow	$5 billion p.a.	~$17 billion	$25-30 billion p.a.
Gearing	14%	25.4%	<20% end '20
Buybacks	$8.7 billion cumulative '13-'15	-	at least $25 billion* in period 2017-2020
Brent	~$90	~$51	~$60**

Start with the bottom row, which shows oil's price in 2013 – 2015, averaging $90/barrel. Then slide all the way right, where we see $60/barrel projected for 2019 – 2021. Next move up to Row 2—organic free cash flow—and notice that at $90/barrel, Shell only generated <u>$5 billion per year</u> in free cash flow. Slide right again, and blink. At $60/barrel, Mr. van Beurden tells us his company will be generating <u>$25 billion to $30 billion per year</u>. It isn't an idle promise. Shell already closing in on $20 billion.

Both Conoco (another Outlook core company) and Shell, through the Valley, told their people: "Our new motto is: "Lower Forever." We will build our company to thrive, even if oil stays lower, longer than any of us think possible." Both companies did that building by selling good assets (not their best, but good ones), by paying off big chunks of debt, and by cutting operating costs sharply indeed.

It's a familiar story to Outlook clients. The market flees from companies suffering through a Valley . . . and hands us startling bargains, if we understand what good people are able to rebuild, and that the laws of supply and demand always work, curing low oil (and other) prices in their own good time. That's exactly what is going on with Shell, Conoco, Schlumberger and Transocean. They are only beginning to climb out of their Valleys, and Outlook's opinion is that they won't be stopped.

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