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Outlook's oil group: good leaders, great stories.

Business stories are usually dull at first glance; but thrilling enough for anyone if we just take the trouble to dig deep. They're especially so if we imagine ourselves as CEO's: facing the pressure of total personal accountability for "fixing" whatever problems are haunting our companies at the moment. Outlook Capital Management has placed its clients' money most emphatically with 4 strong companies in the oil industry. Those companies' stories are fairly thrilling by anyone's standards so, at the risk of writing yet again about oil, let's take a quick look at them.

Our four champions have an interesting relationship with each other. Two of them—Conoco and Royal Dutch Shell—are at the front line of the war, so to speak, between global supply and demand for oil these past 5 years. When oil peaked around $109 in 2014, then plunged 75% to $27 by early 2016, the bosses at Conoco and Shell endured about 700 straight days of hell—which is literary license, but Outlook suspects both Shell's Mr. van Beurden and Conoco's Mr. Lance would privately tell us, "Yup. That's what it was."

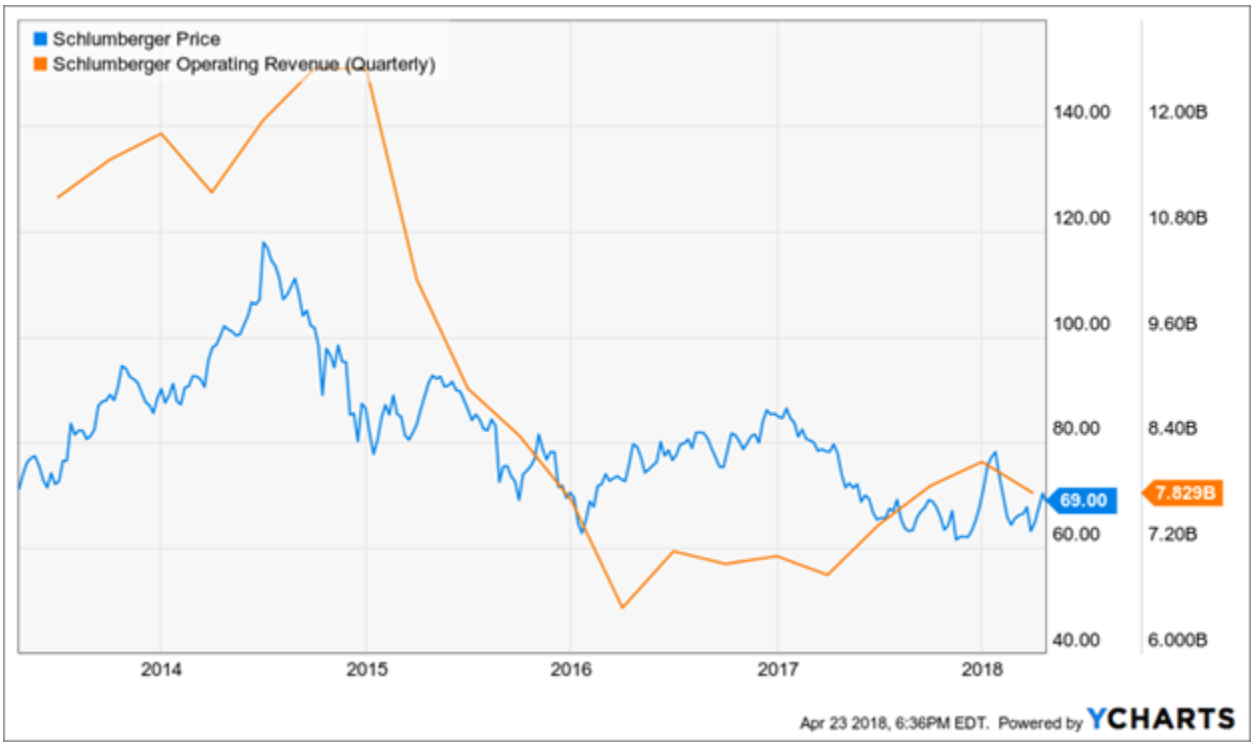
The two CEO's did what all capable leaders do when their companies run into serious trouble: first shore up the weaknesses, then rebuild for future growth. Conoco and Shell are mainly oil producers, whose earnings live and die with ups and downs in the global price of oil—which they cannot control in the slightest way. They both attacked two things with extreme speed: operating costs and debt. Shell (the stronger company when the plunge began) was highly effective. Conoco (somewhat weaker when the plunge began) was nothing short of spectacularly effective. By the end of that 700 days, both companies had made themselves able to operate profitably at global oil prices <u>50% lower</u> than when they began. There was a great deal of pain along the way: many laid off employees; valuable company assets sold to raise vital cash and cut debt; and more. But the speed with which Mr. van Beurden and Mr. Lance fixed their problems meant their companies could return to growth in a remarkably short time. Let's glance at their pictures.

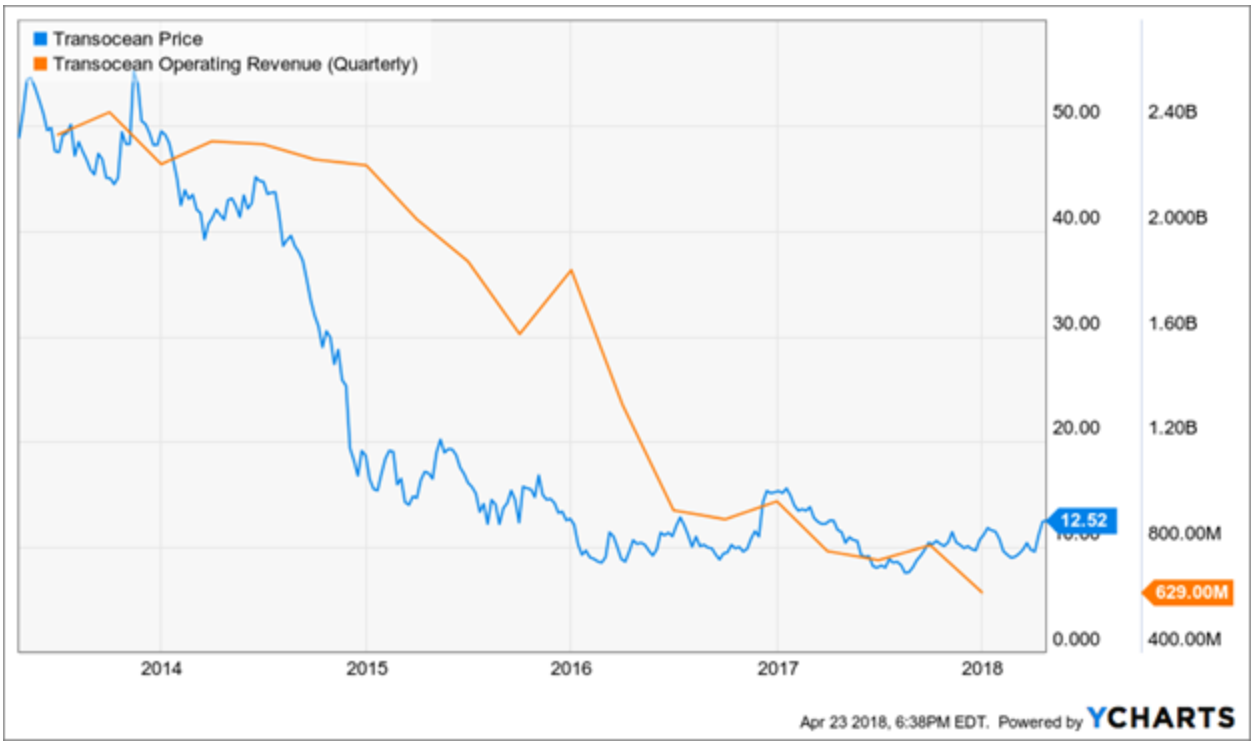
Blue are the stock prices—doing screaming cliff-dives if we ever saw one, from mid-2014; and orange are quarterly earnings—same cliff-dives. Looking closely at the far-right earnings figures, we can see that Shell's earnings plunged underwater but bubbled right back to the surface and climbed right out: staying

low, but positive, during most of the 700 days and their aftermath. Conoco's Mr. Lance had a darker nightmare to deal with, as earnings stayed underwater for 7 of the next 8 quarters—finally turning sharply positive as 2017 came to its close.

What might be on the minds of these two men, at this moment? Here's Outlook's guess: "Profits are positive, and finally beginning to accelerate in the right direction . . . and we would really like to keep them that way for another few quarters or years, even." There are exactly 2 factors which will determine whether they can, or not: global oil prices (not in their control); and capital spending on future oil discoveries and enhanced production (most definitely in their control.) Both CEO's have remarked that if they had their druthers, they'd be glad to keep capex under tight control until the year 2021 or so. Can they?

For the answer to that question, let's turn to our other 2 oil "champions:" Schlumberger and Transocean.





Schlumberger and Transocean aren't exactly in the front line of that oil supply/demand war—though they could show us all the battle scars anyone might wish, inflicted by oil's cliff-dive. They stand right behind companies like Shell and Conoco, selling them the services and equipment which those producers count as "capital spending." Whenever Mr. Lance and Mr. van Beurden decide that the consequences of holding down such spending have simply become too dangerous for their long-term health, they'll begin writing checks to Schlumberger (for a mountain of equipment needed to bring more oil from existing fields, and look for new ones) and to Transocean (for the use of its drill ships to find and enhance the production of oil in some of the world's harshest and deepest waters—where a lot of the globe's biggest untapped oil fields lie.)

For Schlumberger and Transocean, the orange lines are quarterly sales—the lifeblood of profits, of course. Schlumberger's sales reached their bottom two years ago, and have clawed their way up, handhold by handhold, ever since. Transocean gets the gold medal for enduring pain, however. Its orange line isn't cliff-diving anymore, but hasn't yet begun to inch its way up.

Outlook owns these 4 companies, like all our others, because regardless of nightmare plunges in orange lines, they have the strength to endure more if need be—quite a lot more, in fact. We own Conoco and Shell because in those endless wars between supply and demand, the one certainty is that after oil supply has won for a while, it will be demand's turn to win. That finally began to happen after 2016, very slowly . . . but demand's turn is likely to last a long time—much longer than the market's impatient speculators can imagine, or stand. We own Schlumberger and Transocean because Mr. van Beurden and Mr. Lance will have absolutely no choice, eventually: they must accelerate their capital spending, replacing used-up oil reserves, or their companies will have no future. They understand this perfectly; and Outlook suspects they also understand that their "2021" target for sustaining flat capex is much closer to wishful thinking than to hard planning.

No matter: they'll have a great deal of money with which to write those checks to Schlumberger and Transocean, as the global price of oil keeps grudgingly recognizing that, as always, supply sowed the seeds of its own destruction during that cliff-dive to $27, and thereafter. It is demand's turn in the saddle now, and Outlook thinks it will be there for a few years to come.

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