

# THE MONTHLY RESEARCH CONFERENCE CALL

## ENERGY: SECTOR OUTLOOK AND INVESTMENT OPPORTUNITES



**MODERATOR**  
**Jim Kelleher, CFA**  
Director of Research

**Bill Selesky**  
Senior Energy Analyst

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61 Broadway • NYC, N.Y. 10006 • Telephone: (212) 425-7500

ARGUS RESEARCH COMPANY



# WHAT'S NEW AT ARGUS

## SEPTEMBER 2018

### ■ **New on the Argus Site: ETF Screening Tool**

- Enables clients to identify BUY/HOLD/SELLs on specific ETFs
- Allows screening by ratings categories and/or fund families
- Argus uses robust holdings-based approach to rate ETFs
- Future ETF research products to include model portfolios

### ■ **The Argus Semi-Annual Performance Review**

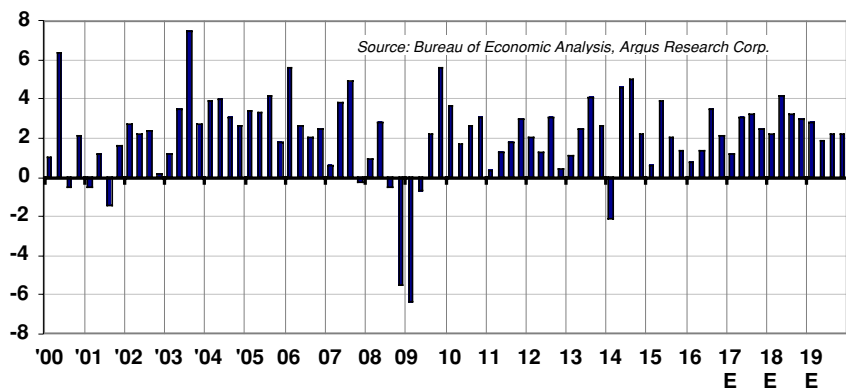
- We focus on providing full range of services, but...performance matters!
- Investars: Argus analyst/quant BUYs beat index on 1- thru 5-year basis
- Bloomberg BARR: Analysts ranked consistently in top 5
- Model Ports: Institutional, Growth, and G&I topping market on 1-year basis
- Focus List: median return 10.7% vs. 7.7% for S&P
- Our goal is high-quality research & high client returns

### ■ **Argus Quick Notes: Recent Weeks**

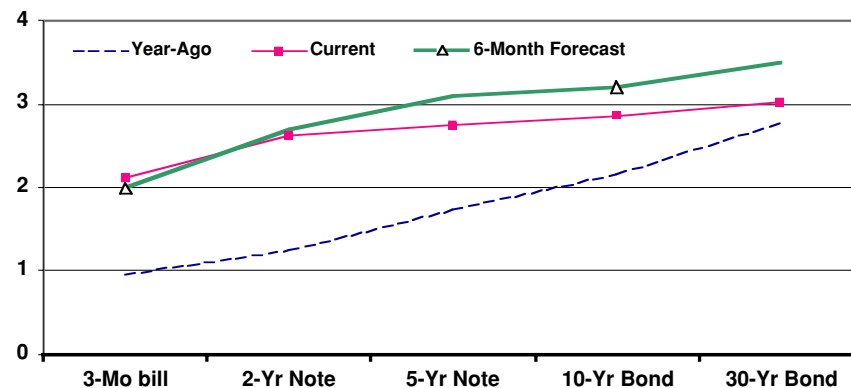
- Insiders & Argus like these stocks
- Momentum stocks
- Seeking High Yield

# MACRO FORECASTS

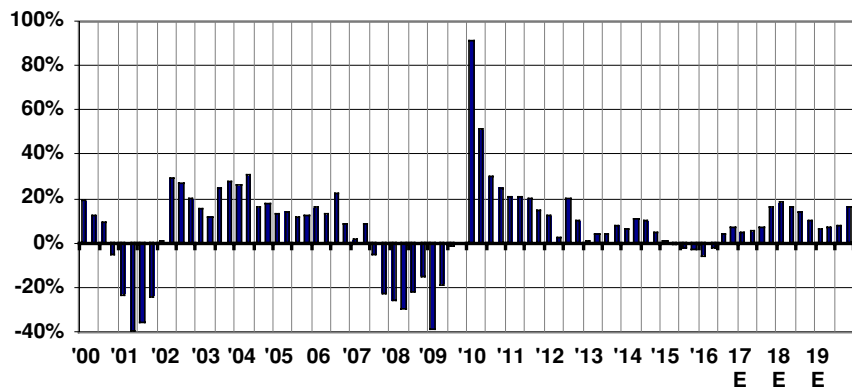
## REAL GDP W/FORECASTS (%)



## TREASURY YIELD CURVE (%)

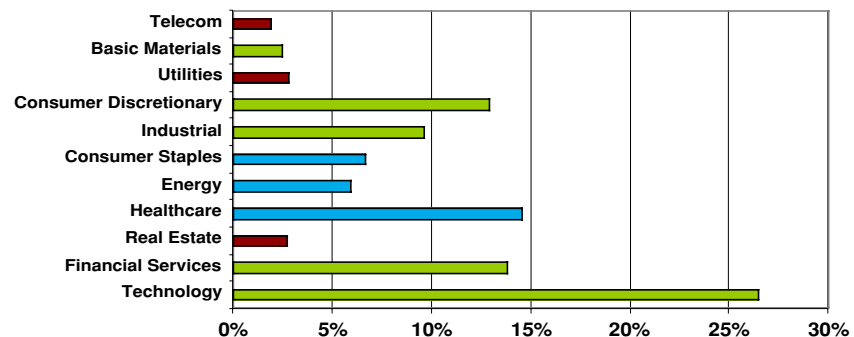


## S&P 500 QUARTERLY EARNINGS GROWTH



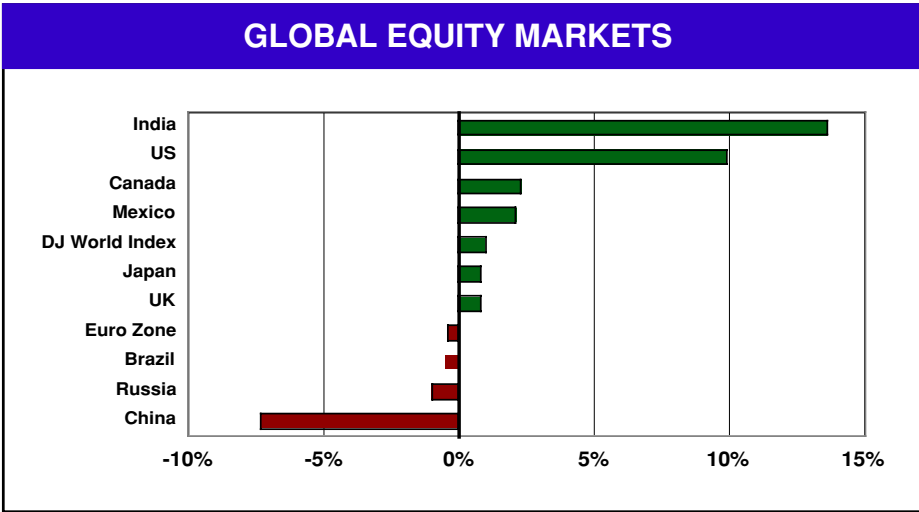
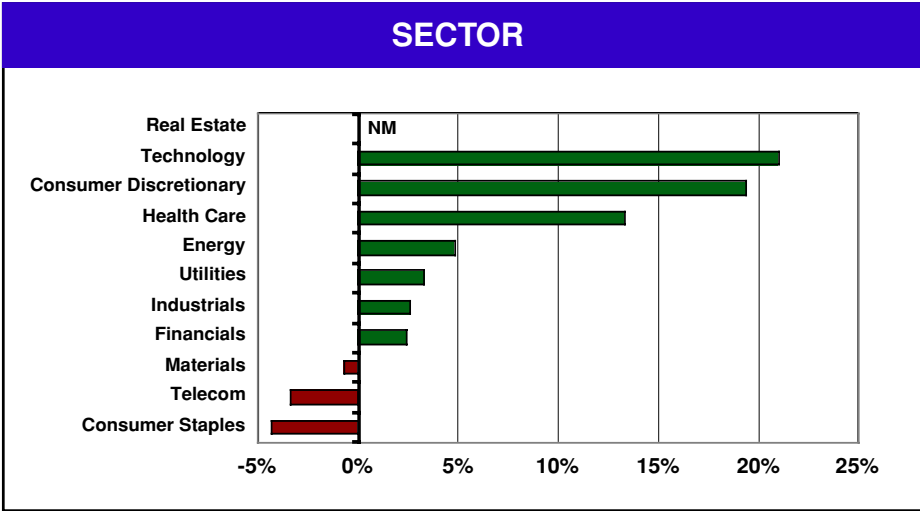
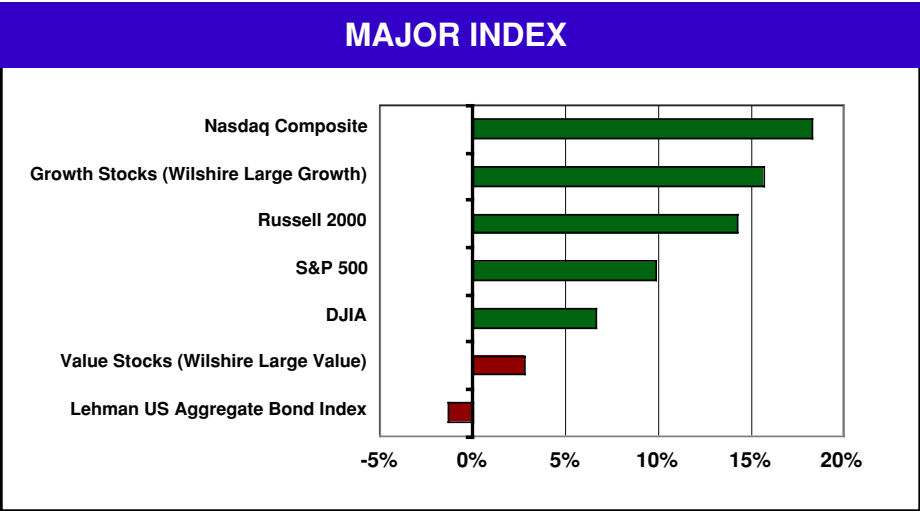
## MARKET SECTOR DISTRIBUTION - PERCENT OF S&P 500

Sectors in Green are Recommended Overweight; Blue are Marketweight; Red are Underweight



# MARKET PERFORMANCE

## DATA AS AUGUST 31, 2018



# OUTLOOK FOR ENERGY STOCKS

## ■ Our rating on the Energy Sector is currently Market-Weight

- The S&P 500 Energy Index has been the 4th best performing sector in 2018. The index is up 2.1% for the year, while in 2017, it was down 3.8%. The improvement is largely the result of strong global GDP growth, OPEC (and Russian) compliance with stated plans and crude oil inventories, which are in-line with 5-year averages. Crude oil currently sits at about \$70 per barrel (WTI).
- Second-quarter 2018 earnings (adjusted) for the Energy index were up, on average, 119% year-over-year, with the E&P and Refining sector showing the largest increases.
- The sector accounts for about 6% of the S&P 500. Over the past five years, this weight has ranged from about 7% to 13%.
- We forecast that West Texas Intermediate (WTI) will average \$65 per barrel in 2018, with an expected range of \$60-\$75 per barrel. Additionally, our Henry Hub natural gas price is \$2.75-\$3.05 per mmBtu. (midpoint of \$2.90 per mmBtu).
- The U.S. rig count for the week ending August 31, 2018 was 1,048 drill rigs, +105 rigs from 943 rigs on September 1, 2017.

# INTEGRATED OIL COMPANIES (IOC'S)

- **The IOC's (Super Majors) provide modest volume growth, but generate sizeable free cash flow for the dividend.**
- **Earnings results for the IOC's over the past 12 months have been significantly strong, and on average were up 115% from the prior year, largely due to an improvement in commodity prices.**
- **Specifically, Upstream businesses have benefited from higher y-o-y commodity prices and higher production rates; Downstream down y-o-y, due mostly to weaker refining margins (int'l side), adverse FX effects and higher operating expenses.**
- **Second-quarter 2018 results were tremendously strong, mostly attributable to higher y-o-y prices for crude oil, and NGLs. Global demand has remained solid and the IOC's continue to reduce capital spending and divest non-core assets.**
- **We prefer those IOC's with reasonable valuations, stable-to-higher production growth, falling capex budgets and a greater exposure to short-cycle (unconventional assets) investments. Also, a sustainable dividend program is a priority.**
- **Top Picks: Royal Dutch Shell (RDSA)**
- **Other stocks in coverage: XOM, BP, CVX**

# EXPLORATION & PRODUCTION (E&P)

- E&P's are the first link in the oil & gas supply chain; involves search and discovery and extraction of oil & gas reserves
- Profit performance for the E&P's over the past year has shown an incredible improvement, and on average are up 9-times year-over-year, as strength in North America has more than offset persistent weakness in Offshore and International markets
- Specifically, the onshore U.S. Land market has performed especially well, as shale-driven production in oil-rich basins like the Permian, Eagle Ford and Bakken has driven growth
- 2Q18 results easily beat Wall Street consensus, as higher commodity prices for crude oil and NGLs drove performance. In addition, long-cycle projects continue to be de-emphasized in favor of higher-return, shorter-cycle projects.
- We prefer those companies with under-levered balance sheets, a streamlined portfolio of assets and a deep drilling inventory, with low-cost extraction costs and growing cash flow trends.
- Top picks: EOG Resources (EOG), Apache (APA), ConocoPhillips (COP)
- Other stocks in coverage: DVN, MRO, NBL, APC, EGN, HES, OXY

# OILFIELD SERVICES & EQUIPMENT

- **This energy segment provides goods and services (drilling, testing, and transport) to oil & gas E&P companies.**
- **Earnings for the oilfield services and equipment industry (OFSE) since 2Q17 have shown continued improvement, and on average are up 88% y-o-y. Strength in North America has offset persistent weakness in Offshore and International markets**
- **Specifically, as oil prices have risen since the start of 2018, the E&P's (producers) continue to spend, although with oil price volatility, are now budgeting 15%-20% growth versus 30%-40% spending growth in 2017. That spend is still driving rig counts, utilization rates, and rig margins higher but at a slower pace**
- **2Q18 results easily beat Wall Street consensus, as materially higher sales, stronger pricing, better margins and higher rig utilization rates drove profits. In addition, former laggards such as the offshore and international end markets were beginning to experience an increase in sales.**
- **We prefer those firms with under-levered balance sheets with a global presence. We also favor companies with a growing market share and potential for meaningfully growing margins**
- **Top Picks: Halliburton (HAL) and National Oilwell Varco (NOV)**
- **Other stocks in coverage: BHGE, HP, SLB**



# REFINING

- **This segment refines crude oil into petroleum products such as diesel, gasoline and heating oils. Refiners make money from product margins and crude discounts.**
- **Earnings for the Refining group over the past 12 months, 2Q18 versus 2Q17, have shown a steady improvement, and on average are up 117% y-o-y. Strength was driven by stronger commodity prices and higher gross margins in the refining (and ethanol) segments.**
- **In particular, higher crude oil throughput generated stronger gasoline and distillate margins. Overall, the segment continued to experience strong operating income growth and high utilization rates, approaching a mid-90% rate.**
- **Profit results for 2Q18 were above expectations and 2H18 outlooks remained very positive. Maintenance programs are being accelerated and free cash flow is being directed towards dividend hikes and share repurchase programs.**
- **We recommend equity stocks that offer a reasonable valuation, pay a sustainable dividend and use cash flow for debt reduction and share repurchases. M&A in the sector a non-issue.**
- **Top Pick: Valero Energy (VLO)**
- **Other companies under coverage: HFC, PSX**

# TOP STOCK PICKS

- **INTEGRATED:**  
Royal Dutch Shell (RDSA)
- **E&P:**  
ConocoPhillips (COP), EOG Resources (EOG) & Apache (APA)
- **OILFIELD SERVICES & EQUIPMENT:**  
Halliburton (HAL) & National Oilwell Varco (NOV)
- **REFINING:**  
Valero Energy (VLO)

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