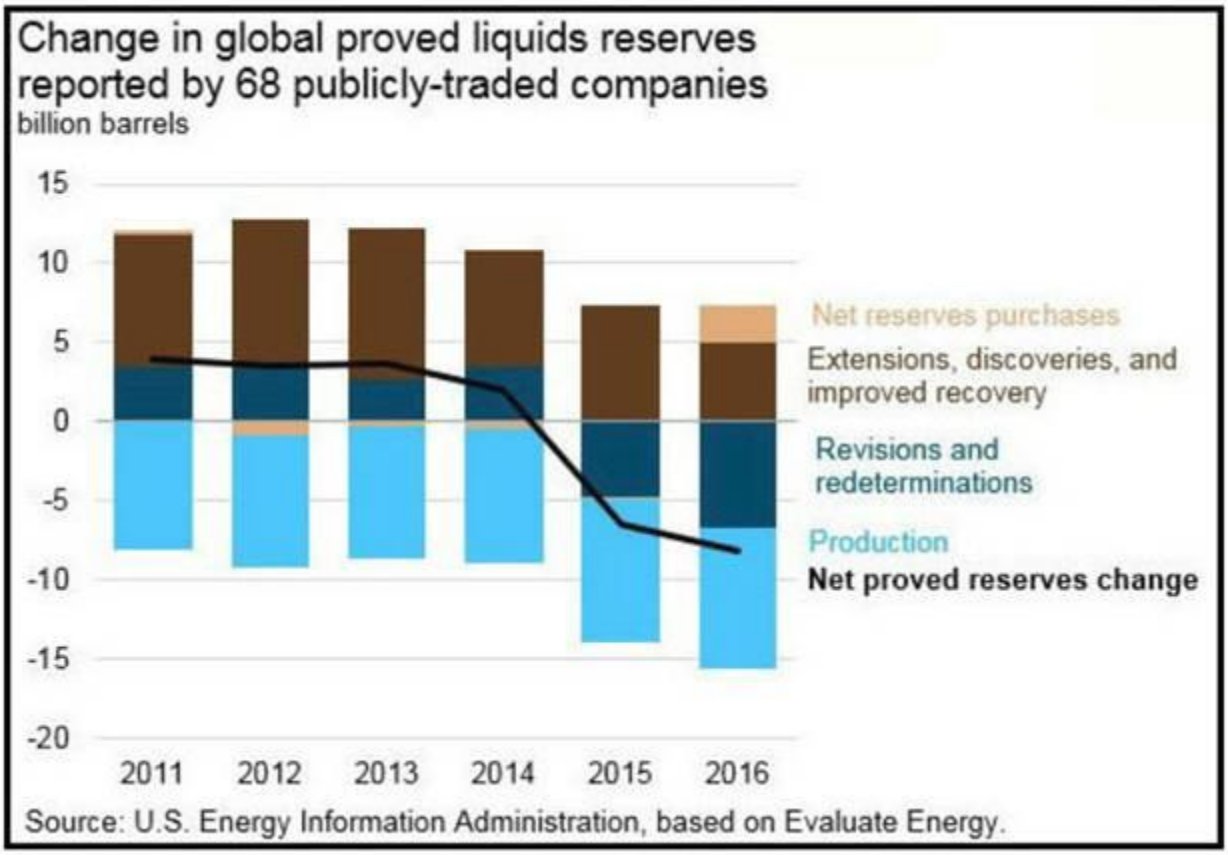
The Outlook: March 16, 2018

The oil business and its life-saving actions ahead.

It's not an easy chart for a Friday afternoon . . . but it is persuasive, indeed.



Pondering this chart, one analyst put it this way: "The major oil companies (and countries) are producing themselves right out of business." Of course that needs explaining.

Unlike manufacturing companies, or service companies, commodity companies must measure their remaining lifetimes, and let their investors know about it every year. The measurement is pretty simple: "How much oil (or copper, gold, iron, etc.) do we own today (stored anywhere from a mile underground in solid rock, to a mile underwater beneath the ocean floor.) At current oil prices, and at the rate we're sucking our oil out of the ground or the ocean floor, how long until we run out?"

That is intended to sound kind of frightening, because it <u>is</u> kind of frightening: to oil-company investors and CEO's alike. Manufacturing and service businesses don't have to worry about their sources of raw materials (well, not in a life-or-death way, at least.) Commodity companies measure how long they have left to live, by the sources and size of the raw materials they control. The chart captures how they try to keep living. "Production" (sucking oil out of the ground) drains their reserves. "Revisions and redeterminations" (good heavens!) guesses at how current global price levels add or subtract to companies' "recoverable" stocks of oil—because those stocks contain oil which ranges from "low hanging

fruit," easy and cheap to produce, to "giraffe-level fruit," harder and costlier to produce, hence making no business sense without much higher global oil prices. "Extensions, discoveries, and improved recovery" measure new oil field discoveries and technology's enhancement to the oil available from existing fields. Finally, the top item "Net reserves purchases", is not significant to the whole world, being what some companies buy from other companies.

Nope, not an easy chart. But the black line tells the story: since 2014, the oil industry has been producing sharply more oil than it discovers or "enhances." The industry's remaining years of life are falling.

As Outlook has often observed, the reason for this was easy to understand. In 2014 oil plunged, and companies had to cut their exploration-and-production spending very hard and very sharply, to limit the amount of money many of them were losing each day. But every single oil CEO knew they could not keep this up. They would absolutely have to begin spending again, to replace those shrinking reserves. It is indeed a frightening chart.

The oil-producing companies in which Outlook invests prepared for this with great speed and determination during the plunging years from 2014 – 2016. They sharply cut their costs of oil production, so that when they resumed spending to find more reserves, their earnings at lower global oil prices would more than cover such spending. Conoco's and Shell's actions during those years were highly effective, and both companies are making profits at $60 oil which would have been hard to imagine—for them or anyone else—even 3 years earlier. But the Outlook company which knows this chart backwards and forwards, because the need at which it points will be the rocket engine behind its growth, eventually, is Transocean: the global deepwater oil drilling king. There is no such thing as one chart or one sentence which ever tells the whole story, or paints the whole picture. But this chart comes pretty close, and the picture it paints is one which Outlook and its clients are likely to enjoy for years to come.

Outlook Capital Management, LLC
125 S. Wilke Road, Suite 200E
Arlington Heights, IL 60005
847-797-0600