The Outlook: July 7, 2017

ConocoPhillips in the Arena

ConocoPhillips: 5 Years

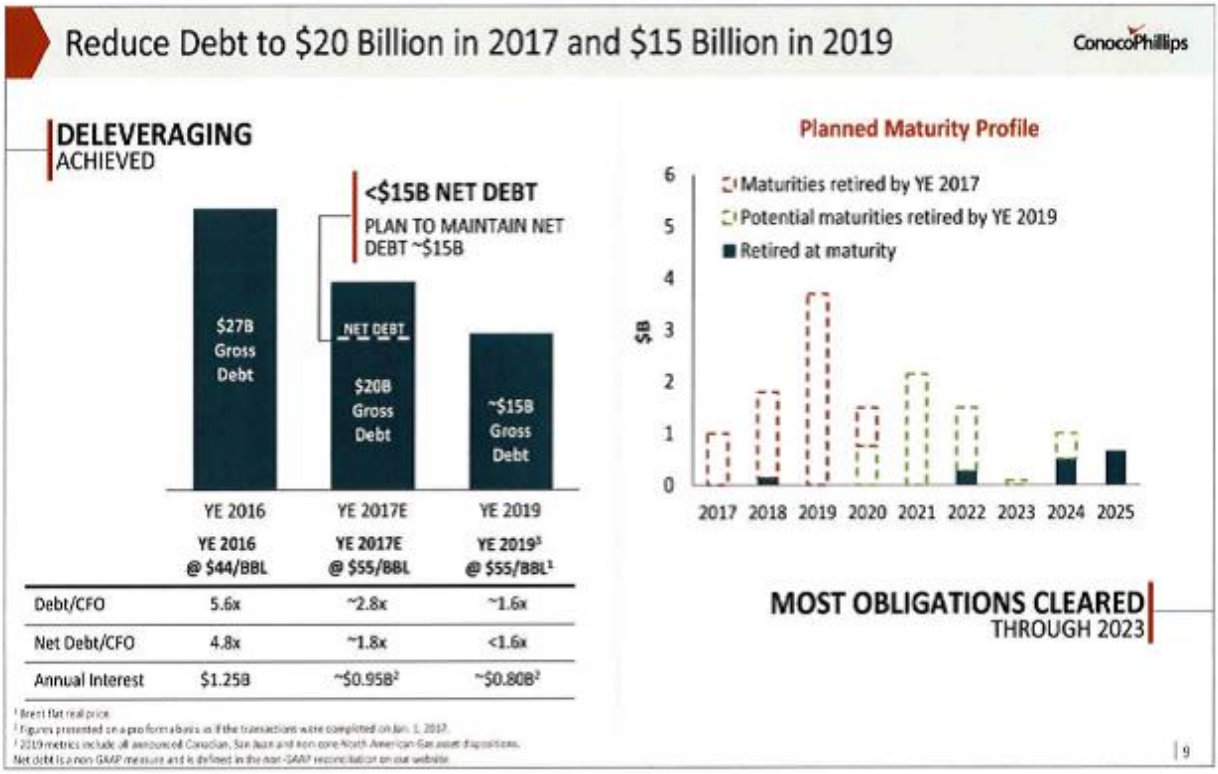
It was a normal day, today, for written opinions about the market:

- There were a great crowd of them.
- Pessimists outnumbered optimists by 5-to-1, very roughly.
- Whether bullish or bearish, all of them focused on each particular writer's idea of a clever way of looking at the market's "big picture:" particular statistics or indicators as powerful clues to whether the market is about to fall off a cliff (carrying with it our lives, our fortunes and our sacred honor), or might possibly spare us for another few weeks or months.

Outlook has remarked a few times that with investing as with everything else we humans do, what real people do when the chips are down is what matters most. It's somewhat easy to feel alone with this opinion. Very, very few commentators on the market—whether world famous professionals or obscure amateurs—talk or write as if they share Outlook's opinion. They never seem to give up searching for a clever method, looking at the market from the top down, to ensure they'll be on "the right side" of the next Bear or Bull Market.

One such article, today, was headlined something like "Commodities Are the Canary in the Coal Mine: Market Ready for Collapse." (There were several like that.) Another said something like, "Commodities at Historic Level of Undervaluation." (That was today's optimist—always in the minority.) Being written by clever people, both were interesting . . . but to Outlook, neither looked at "what matters most."

Let's glance that chart above, and we'll see what matters most. The blue line is the price of oil, falling off its cliff in 2014. The orange line is ConocoPhillips, falling with it. The red line is Conoco's dividend, plunging as well. And the circle is the last couple of years, during which Conoco's CEO, Ryan Lance, and his team managed their company through a frightening business downturn. They were "in the arena" and they have done extraordinarily well, with the chips down. The next picture tells the most spectacular part of their story.



Mr. Lance and his team cut Conoco's debt almost in half—in about one year. With near certainty, by 2019 the company will have erased nearly all debt coming due before the year 2024. In addition:

- Conoco's cost of oil production has fallen from $75 to something close to $45/barrel.
- A major part of its oil reserves now show a production cost of less than $35/barrel.
- Free cash flow is rising strongly, and looks likely for many years ahead to fund a growing dividend, growing share buyback, and constant annual capital spending of $5 billion.

“We don’t claim to know where oil’s price is going to be, but we know we must set up our company to not only survive but thrive in a $40 to $50 price environment. And today we’re generating free cash flow at those prices, and not many firms in our business can say that. Our goal is to deliver double-digit returns to our shareholders in this kind of tough environment . . . and better, whenever oil prices turn up again.” (Ryan Lance.)

Let’s glance up top, one more time. Free markets go through cycles. They do not stop going through cycles . . . because normal human behavior makes supply and demand change, whether the cycle is very high or very low. That blue line is one sharp down cycle indeed. “The cure for low prices is low prices,” and this will be no exception, regardless of the 5-to-1 majority of experts who might think it will. What really matters, though, for us investors, is whether the people on the spot at our companies have been standing and delivering under pressure. For Conoco the answer is a perfectly clear and emphatic “Yes!”

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