



Ninepoint Energy Fund Market View

October 06, 2020

Will peak oil demand result in a lower [or higher] oil price?

Over the past quarter the oil price was relatively flat (up until last week) yet energy stocks sold off with the disconnect beginning in early September when BP published in their annual macro release several demand scenarios...2 of which had demand having already peaked which the media naturally ran with. In the following days an epic pile on of negative headlines ensued including California banning the internal combustion engine from new car sales by 2035, China reaching peak emissions in 2030, expansion of green/blue renewable diesel, hydrogen hype, etc. This all resulted in a mini buyers strike of energy stocks and when fears of a 2nd wave intensified there was no natural buying to support energy stocks from the risk-off tape. Today it feels like sentiment towards the sector is as low as it was in March when oil was in the \$20's. Despite improving fundamentals (demand normalizing and supply remaining constrained) we are suffering from a sentiment problem.

Investment Team



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Eric Nuttall @ericnuttall · Sep 30

Good riddance to a miserable quarter in which oil was flat yet energy stocks dived 16% due to an epic negative headline pile-on (BP peak demand, Cali, hydrogen, RDS, etc.). Q4 = vaccine news + inventory normalization to accelerate. Feels like both oil and sentiment are bottoming.

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Link- <https://twitter.com/ericnuttall/status/1311398466334138368?s=20>



Link- <https://twitter.com/ericnuttall/status/1311702904944889856?s=20>

What needs to happen for this to change and energy stocks to rerate? It is clear that the energy sector has been hit harder than any other sector this year and the reason is obvious: COVID-19 led to the largest demand shock in history and forced OPEC to remove a historic amount of production to avoid massive inventory builds. For now the focus remains on “weak” demand even though it has recovered to approximately 93MM Bbl/d...still down around 7% from pre COVID levels but significantly off the lows. Over the coming months, we remain optimistic that as fears of the 2nd wave fade (or at least we have visibility that governments are no longer willing nor able to shut down the economy like they did in March) and as progress towards a vaccine becomes more evident that the sector can begin to rerate. Further, demand should continue to normalize closer to 95-97MM Bbl/d resulting in “near” pre-COVID 19 conditions and with supply remaining depressed inventory draws (<https://twitter.com/ericnuttall/status/1311318631888936962?s=20>) should be additional evidence of a healing energy market.

Borrowing a line from Top Gun we view the sector as a “target rich environment”...everywhere we look we see stocks that we think can double, triple, or more with a slightly more constructive oil price. For example, we recently built a 6% weighting in a land driller which despite operating in the most difficult period in its history will still generate positive free cash flow this year. Using maintenance level activity in a \$50WTI world we see the company as having the ability to free cash flow its current market cap given the stock is down ~50% from when we last sold the position. We own natural gas names (~40% portfolio weight) that are trading at 20%-35%+ free cash flow yields using the strip price of natural gas and \$50WTI for their liquids production. We own small cap oil stocks trading at 38% free cash flow yields at \$50WTI where they could privatize themselves within

1.5 years at \$60WTI (where oil was pre-COVID 19). Valuations in the sector are incredibly compelling!!!

As I mentioned earlier, the sector faces a sentiment problem. We continue to believe that the oil price will recover to \$50-\$60 next year as demand continues to normalize (see <https://twitter.com/ericnuttall/status/1311730292135260178?s=20>) and supply remains constrained (see <https://twitter.com/ericnuttall/status/1310557910091608064?s=20> and <https://twitter.com/ericnuttall/status/1308050254139457538?s=20>).

What kind of upside is possible if we are correct in our call that oil is heading towards \$50 in early/mid 2021 and \$60 by late 2021? Using conservative trading multiples for each of our holdings the Fund has a targeted upside of 111%/201% at \$50/\$60WTI and given the average fund holding is down 53% from its 52 week high (likely in January) stocks need to double just to get back to where they were before COVID-19 hit. You can see below that of the 11 (blanked out) holdings they are trading at highly compelling free cash flow metrics (the average holding could privatize themselves from free cash flow within 3 years at \$50WTI...):

2021 FCF Yield @ \$50	2021 FCF Yield @ \$60	EV/CF @ \$50WTI	EV/CF @ \$60WI	EV/PDP	\$50/bbl target	\$50/bbl target	Weighted Return	\$60/bbl target
22%	42%	3.9	2.8	72%	\$5.03	107%	12%	\$7.98
21%	29%	3.5	3.0	124%	\$12.25	101%	11%	\$14.93
35%	87%	3.2	2.4	91%	\$1.64	130%	13%	\$3.10
60%	110%	5.8	3.5	66%	\$7.00	147%	15%	\$9.00
38%	65%	2.9	2.1	64%	\$3.79	165%	16%	\$5.75
33%	62%	2.6	1.9	68%	\$1.85	140%	14%	\$2.74
19%	24%	5.9	4.8	97%	\$5.93	66%	6%	\$7.40
12%	18%	3.9	3.3	133%	\$28.94	72%	6%	\$35.00
30%	55%	3.2	2.5	1.2	\$9.81	158%	9%	\$14.62
					\$1.50	63%	4%	\$2.00
49%	63%	3.2	2.9	66%	\$2.81	80%	4%	\$3.30
32%	55%	3.8	2.9	90%		111.9%	110.5%	

We aim to have a much more thorough discussion on what peak oil demand means, the likely pace of energy transition, probable supply shortages, and price scenarios out in the next few weeks but for now I would encourage you to follow me on Twitter (@ericnuttall) for frequent and timely updates as I intend to use it as my primary platform for keeping clients up-to-date (in addition to market updates via email)

Eric Nuttall

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NINEPOINT ENERGY FUND - COMPOUNDED RETURNS¹ AS OF SEPTEMBER 30, 2020
(SERIES F NPP008)

	1MTH	YTD	3MTH	6MTH	1YR	3YR	5YR	10YR	15YR	INC
FUND	-15.06	-52.33	-3.25	88.70	-45.34	-28.65	-18.84	-11.97	-8.74	-3.5
INDEX	-17.46	-53.65	-14.07	10.36	-49.93	-27.48	-14.47	-11.03	-7.52	-2.9

¹ All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at September 30, 2020; e) 2004 annual returns are from 04/15/04 to 12/31/04. The index is 100% S&P/TSX Capped Energy TRI and is computed by Ninepoint Partners LP based on publicly available index information.

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