

Oil Equities for 2021

Liz: Hi, Brian.

Brian Singer: Hi, Liz. Happy new year.

Liz: To you, too. So Goldman Sachs Research just hosted our annual global energy conference, which brings together investors and corporates from across the energy landscape. Just given what a challenging year know is for the oil markets in 2020, I imagine that was a big topic of conversation. Can you give us a sense of how things stand for the oil markets heading into 2021?

Brian Singer: Yeah, I may take you back actually to 2010 because there was a major increase in US oil production between 2010 and 2020. US oil production was about 5.5 million barrels a day in 2010. It went all the way up to almost 13 million barrels a day by the end of the decade. And a lot of the companies at our conference were the ones that were responsible for that growth.

Well, the growth in US oil production and the development of US shale was very helpful in terms of keeping a lid on US inflation. It was also helpful from a geopolitical perspective. What it didn't do is it didn't result in competitive corporate returns, earnings, and free cash flow for the companies responsible for that growth. And as a result, the investment community has pushed back on a lot of the energy players to either consolidate or improve their free cash flow profile by spending capital less aggressively and ultimately get to more competitive earnings.

Liz: And then 2020 brought its own challenges.

Brian Singer: It absolutely did because 2020 brought a surprise demand shock. And we've seen demand shock before, but this one was so significant that you couldn't just as producers stop drilling. You had to actually [UNINTEL] existing producing wells. And that's partly what caused the volatility in oil to ultimately, for a very short period of time, go below zero dollars a barrel.

While this was going on, though, and this understandably made headlines, at the same time, we actually saw corporate behavior improve. We saw more consolidation. We saw more companies say they're going to focus on free cash flow. We saw more companies

say they're going to spend capital less aggressively. But to a degree, some of that got overshadowed, again understandably, by the demand shock and ultimately questions over the timing of recovery.

Liz: So how do you think things might unfold in 2021?

Brian Singer: Yeah, we have a bullish view on 2021 both from an oil perspective and then also from an equity perspective, and that's because from a macro perspective we think oil demand recovers in 2021. And we think non OPEC supply does not. And we think that pushes up prices particularly as we move into the back half of 2022 when we really see a lot of that demand recovery.

And a lot of the comments at the conference that we had this week was supportive of that because producers really stuck to their more disciplined plans and said they're not necessarily going to be as responsive to higher prices at least for now.

Liz: So is it just shale, or are there other drivers of your bullish view?

Brian Singer: Well, beyond demand in shale there is another driver, and that's long lead time spending or lack of it and then ultimately growth coming from long lead time projects. Because for years now, really since 2015/2016, we've seen a shift to under investment in long lead time projects. And it hasn't had that much of an impact on the oil macro in oil prices, and it certainly didn't in the face of lower demand in 2020. But we think we're at the inflection where that's now going to be a much more noticeable driver of lower growth outside of OPEC on the supply side. And it's a big contributor we think to higher prices.

Liz: And what about OPEC's response?

Brian Singer: Yeah, we saw a surprise announcement this week that Saudi Arabia is going to be cutting production. And this did firm up near-term oil prices ultimately from an equities perspective, from a stock perspective. We think what's most important for the stocks to move higher and stay higher is to get to a point where the world needs OPEC production to increase. Now, that sounds counter-intuitive, but when the world needs more supply out of OPEC, that's when stocks can do well. And while that actually wasn't exactly this week's announcement, we see room for that to happen as the year

progresses and as demand improves. And that can send oil prices higher into 2022.

Liz: So overall looking into 2021, what are the most important things you'll be watching in the oil markets this year?

Brian Singer: Yeah, it's a great question, and I think there have really been four overhangs that have weighed on stock performance over the last year. And what's interesting is we think three out of the four of them are going to recede over the next nine months. The first overhang is short-term demand. The second overhang is Biden and the Biden administration policies and greater clarity there. The third is capital discipline and how producers will respond or not respond to higher prices. And the fourth is long-term demand.

Liz: So let's take those one by one. When it comes to demand for oil in 2021, what are you expecting specifically?

Brian Singer: So over the course of '21, by the end of 2021, we actually think we will almost fully recover to demand from back to 2019 levels. And that's an above consensus, that's an above consensus view. Now, in terms of when that has an impact on the stocks, we think the impact would actually start sooner rather than later. And really some of the catalyst for having greater confidence in short-term demand is when there's greater confidence in the vaccine and the vaccine being distributed and people feel more comfortable booking plane tickets for the second half of the year. So we think we can get some greater movement on that during the first half.

Liz: And what about the Biden administration? What are we expecting to see from an energy policy perspective?

Brian Singer: Well, there are a number of areas. It's certainly from a clean energy perspective there's a lot of confidence that we're going to see clean energy stimulus. And frankly, we have a bullish view, my colleagues have a bullish view on some of the clean energy and clean energy growth and clean energy stocks. That's actually more a function of lower costs and state policy than it is on a federal policy stimulus. But there's a lot of confidence that we could see that play out.

But from more of a traditional energy perspective, some of the key areas of focus are on access to federal land and permitting on federal land. And as well if there are any changes on the

taxation front. And at least from a federal land perspective, it is an overhang and it is a risk, but we think we can see some greater clarity with some of the pronouncements and speeches or policy discussions over the first half of the year.

Liz: You also mentioned that investors will be looking to see greater fiscal discipline from oil companies. How do you expect that to play out?

Brian Singer: Yeah, as we talked about earlier, this is a key area of focus for investors because there is not necessarily as much trust that the management, as prices move higher, will actually demonstrate discipline. I love the musical *Hamilton*, and there's a line in the musical *Hamilton* where George Washington tells Alexander Hamilton dying is easy, living is harder. And I think the corollary here is down cycle discipline is easy, up cycle discipline is harder. Investors are going to actually need to see prices move higher and see the producers stick to their lower reinvestment rate framework and not change behavior. We think that could potentially happen in the third quarter or by the third quarter of this year.

Liz: And what about the longer term declaration in oil demand?

Brian Singer: So this one we think is going to stay with us. We think, given energy transition and concerns, valid concerns about demand, growth in oil and decelerating over the course of the 2020s and some debate over when it declines, whether that's in the 2020s or in the 2030s, we think it's in the 2030s. That that is going to continue to weigh on how investors look at valuation.

Liz: So what does all this mean for valuation and portfolio positioning?

Brian Singer: So the normal playbook for a very bullish oil outlook that we have would be to own and to recommend companies that have weaker balance sheets and are higher beta. But given some of the dynamics that will likely lead to higher discount rates being applied to the group, our outlook for this year is beta within reason. This is a sector where there's been a fight for investibility. And we think there is now a fight for sustainability. And so for companies to really emerge as long-term winners in the space, we think they need to be sustainability leaders. And to demonstrate that, we have an L, an E, an A, and a D.

L is for leverage and having a strong balance sheet. E is earnings and having favorable competitive earnings, corporate returns, and free cash flow. A is for assets and asset sustainability being low on the cost curve and have an asset base that's reputable. And D is for decarbonization and being a participant in decarbonization, which is something that's not necessarily associated with traditional energy.

Liz: Thanks, Brian.

Recorded January 8, 2021

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