EYE ON ENERGY

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His fortnightly "Musings From the Oil Patch" is among the most widely read newsletters in the industry.

"THEY DON'T RING A BELL"

VIRUS CURVES HAVE FLATTENED AND ECONOMIES ARE SCRAPING BOTTOM. HAVE WE REACHED THE LOW POINT?

They don't ring a bell at market tops or bottoms. That's an old stock market expression, meaning it's only in hindsight that we know when the stock market peaks or bottoms. Today, the ringing bell we hear is signaling the re-opening of the global economy. It allows individual countries, believing they've been successful in their battle with the novel coronavirus COVID-19, to let citizens resume their pre-virus lives. Maybe we're marking a bottom.

Every country is at a different opening point. Those differences reflect when the virus was first contracted and how quickly it spread. Shuttering economies was designed to "flatten the curve" of the infection rate. The strategy gave healthcare workers the opportunity to deal with the sickest of the population without being overwhelmed and forced to play God by rationing care.

Almost everywhere, virus curves have flattened. However, the strategy morphed into a policy for stopping the virus entirely by limiting economic activity to the lowest level necessary to sustain life.

What we found with the "stop the virus" policy is that people's tolerance for being kept from work and confined to their homes or apartments was finite. Eight to ten weeks appears to be the limit. The most depressed and financially destitute are beginning to protest the extended shutdowns. The need to feed their families while being financially ruined is overwhelming the fear of getting sick. Besides, the young and healthy have proven to be less at risk of becoming seriously ill and potentially dying.

LOW POINT?

Today's bell-ringing signals we are economically and socially at a low point. Our frustrations are rising and our tolerance for lockdowns is ending. April will mark the worst month for oil demand destruction as cars didn't drive, planes didn't fly and ships didn't sail. As people barely left their homes except to shop for food and medicine, their vehicle efficiency went from miles-per-gallon to gallons-per-week.

Had the COVID-19 shutdowns been the only issue the energy industry had to confront, its financial pain could have been mitigated. Unfortunately, the COVID-19 explosion coincided with the onset of a market share war between two of the world's largest oil producers – Russia and Saudi Arabia.

The *mano-a-mano* battle to see which country could seize more market share from the other by boosting output and slashing prices did little but devastate the global oil and gas industry. The industry was knocked for a loop in dealing with collapsing oil demand, driving oil prices below well-operating costs. Forget any profits from drilling new wells!

The oil industry has been tested numerous times by collapsing oil prices. This time, however, marked the steepest oil price drop since the 1930s. Companies with strategies to grow by employing large amounts of debt quickly found themselves imperiled. Throwing people and projects overboard provided little help. Major law firm bankruptcy departments donned their firefighting garb and mobilized to assist financially-distressed energy companies. Usually, it meant helping them prepare for court-protected reorganizations.

As Warren Buffett is fond of saying, "When the tide goes out, we see who's swimming naked." Those naked swimmers are exposed now and will continue to be exposed for the balance of 2020. The energy wasteland is highlighted by how far even the best-managed and well-capitalized companies have seen their share prices drop. In many cases, those prices merely reflect options on the companies chances of surviving and climbing out of the abyss into which the industry has fallen.

More financially conservative companies are beginning to look around at the assets of distressed competitors. Since most of them won't survive in their current configuration, opportunities exist. How to separate an opportunity from garbage is the challenge. It means divining the industry's future and the economics necessary to grow.

"V," "U," "W" OR "L"?

If the April/May period marks the bottom for oil demand destruction, the question shifts to how the market will recover. Forecasters like to describe their predictions with letters. A "V"-shaped recovery suggests a sharp demand upturn after a sharp fall. The popular "U"-shape suggests continuing along at a cycle's low point before slowing heading higher. The more challenging shape is the "W" – a relatively sharp recovery following a sharp fall but then another sharp drop before a sustained rebound. The letter that scares executives, however, *There's little doubt we're now seeing sharp upturns in energy demand – primarily driven by people venturing from their homes and starting to live normal lives. Congestion and mobility data show countries and large cities in various stages of recovery from their vehicle traffic lows. Those increases are coinciding with greater air pollution – a sign of more vehicles on the roads.*

is the dreaded "L." It means demand never recovers from the abyss.

There's little doubt we're now seeing sharp upturns in energy demand – primarily driven by people venturing from their homes and starting to live normal lives. Congestion and mobility data show countries and large cities in various stages of recovery from their vehicle traffic lows. Those increases are coinciding with greater air pollution – a sign of more vehicles on the roads.

The number of airplane flights is also slowly growing, but that will necessitate a longer recovery period since airlines will be reluctant to add flights until passenger demand rises sufficiently to justify the additions. Airlines are the most challenged transportation mode for maintaining social distancing rules. Even if we never fly in center seats again, that still doesn't meet the six-foot distance rule as seats range from 25 to 35 inches wide.

The bigger problem is that airlines, due to their capital-intensive nature, need occupancy levels of 75 percent or better to break even. Even cutting passenger freebies – peanuts, meals and drinks – won't make a huge dent in their cost structures. Limiting seating capacity and requiring masks for everyone onboard are the first steps, but raising prices is likely the long-term fate of travelers.

A recent seaborne trade forecast by Martin Stopford of Clarkson Research suggests a 17-25 percent reduction long-term, partially driven by dislocated and revamped global supply chains – something the Trump Administration has been promoting for nearly its entire three years in office. The realization that most of America's health supplies and many popular drugs currently come from outside the country is pushing manufacturers to open plants at home.

IMPONDERABLES

The big questions for energy forecasters are the changes in working and living patterns that may emerge from the virus battle. Chinese congestion data show commuting traffic volumes have recovered to, and even surpassed, year-ago levels while weekend data shows people staying home. This confirms adjustments citizens are making after recovering their freedom.

Workers are returning to work but relying on driving themselves rather than using mass transit. The low weekend traffic means people are staying home and not partaking of events, restaurants and movie theaters. They're probably relying on electronic devices for their weekend entertainment and eating at home more. Will these patterns become permanent?

We're also seeing companies ac-

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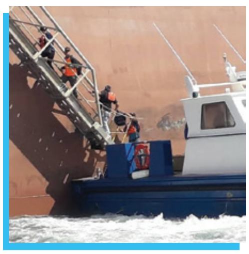


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> ***The big questions for energy forecasters are the changes in working and living patterns that may emerge from the virus battle. Chinese congestion data show commuting traffic volumes have recovered to, and even surpassed, year-ago levels while weekend data shows people staying home. This confirms adjustments citizens are making after recovering their freedom.***

knowledging that employees working from home have been as productive or, in some cases, more productive than working in offices. Will employees want to continue to work from home, especially if their children continue to participate in online schooling? What does this trend say about the future of offices and office space needs?

More open office layouts that facilitate social distancing may be needed in the future. However, video conference calls may become tedious if they're the only interactions workers experience. Quite possibly, workers will become infrequent office workers rather than be present every day.

Will migration from urban areas become more pronounced? If some of the cultural benefits of cities are limited by social distancing mandates and establishments are closing under financial pressures, we may see people opting to live where density doesn't contribute to the spread of illnesses. These sorts of trends will play into the dynamics for state and local government finances: How many tax dollars are lost versus the challenge of which services to provide and at what cost?

The imponderables of the pace of the economic recovery and its energy needs, both in how much and what kind, makes predicting the future perilous. The role of climate change policies in the economic recovery plans of governments will also play a role.

The uncertainty of the energy industry outlook is demonstrated in the comments of the CEOs of major oil companies. The heads of ExxonMobil and Chevron see the market returning to normal in the foreseeable future. To the contrary, the CEOs of BP, Shell and Total believe the world may have reached or passed peak oil demand. That puts pressure on them to remake their companies into meaningful renewable energy providers. The outlooks, however, are shaped by their different headquarter locations, customers and shareholders.

TILDE RECOVERY?

We expect an initial healthy oil and energy rebound, but then a slowing. We don't expect a return to pre-virus demand levels anytime soon. Our preferred recovery shape is the tilde: "~." Although looking something like a squashed "W," we believe the rolling peak and valley will be more likely our future. What we don't know is the height or depth of the peaks and valleys, or how long the tilde may last. The tilde is like ocean waves – they just keep coming.

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