Longreach Energy Investments LLC

LONGREACH ENERGY

Monthly Report

July 2020

FIRM INFORMATION

Investment Manager
Longreach Alternatives Ltd
ABN 25 082 852 364
AFSL 246747

Sub-Advisor
Longreach Energy Holdings LLC
Delaware registered #565928

KEY INVESTMENT PERSONNEL

Andrew Sinclair
Principal – Commercial Director

Thomas Wagenhofer
Principal – Technical Director

CONTACT US

Longreach Alternatives Ltd
Level 13
1 Margaret Street
Sydney NSW 2000

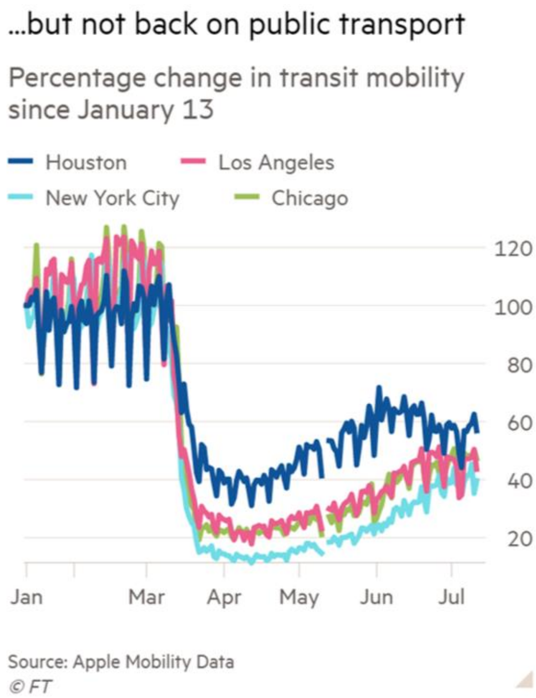
T+61 2 9135 0428
client.services@longreachalternatives.com

1. Market and Macro Industry Commentary

General Market Commentary

Despite the recent increases in Virus cases across much of the US, leading mobility indicators and oil and gas demand data continue to trend up.

Figure 1: US Driving and Transit Mobility (source Apple Mobility Data, via the FT)



The US Energy Information Administration (EIA) in its July Short Term Energy Outlook (STEO) forecasts that US motor gasoline consumption will average 8.3 million b/d in 2020, down 1.0 million b/d (or 10%) from 2019. The employment and economic activity growth trend expected in 2H20 is forecast to continue through 2021, increasing gasoline consumption to 9.1 million b/d for the year, about 2% lower than 2019.

EIA expects US jet fuel consumption in 2020 to be 31% lower than its 2019 average, a much larger percentage change than for gasoline and distillate (both down 10%). US jet fuel consumption fell to an estimated 660,000 b/d in 2Q20. EIA expects a rise to 1.4 million b/d in 4Q20. Jet fuel consumption is expected to continue rising through 2021 and average 1.5 million b/d for the year, about 12% lower than its 2019 average.

Figure 2: US Total Petroleum and Other Liquids Supplied 2015-2021 (source EIA)

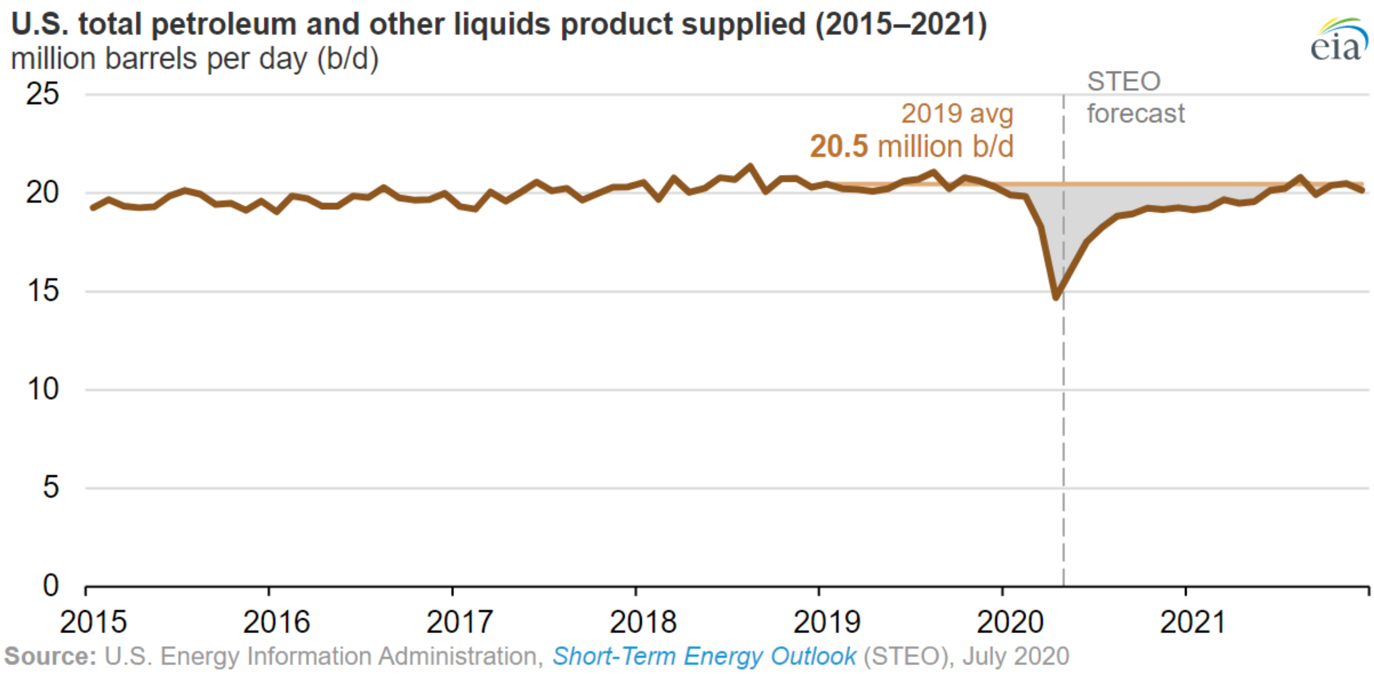
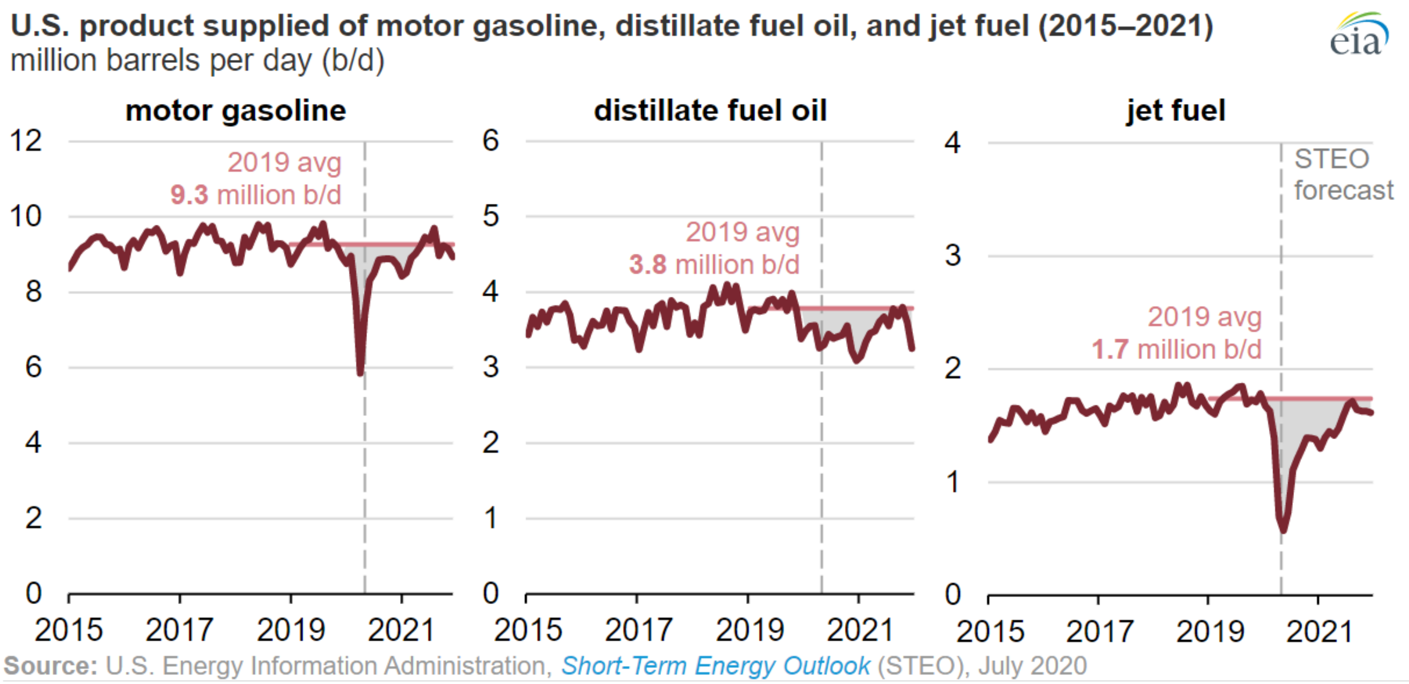


Figure 3: US Gasoline, Distillate and Jet Fuel Supplied 2015-2021 (source EIA)



Capital investment in the worldwide upstream industry has collapsed (Figure 4). This is entirely consistent with the severe fall in the number of rigs drilling for oil and gas in the US that we have observed in recent months (Figure 5).

Figure 4: Worldwide Upstream Oil and Gas Investment (source IEA, via Wall St Journal)

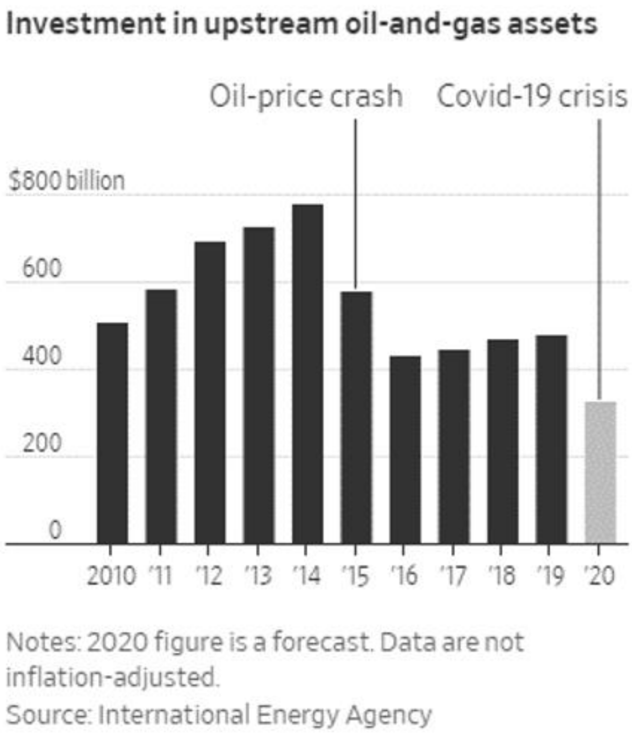
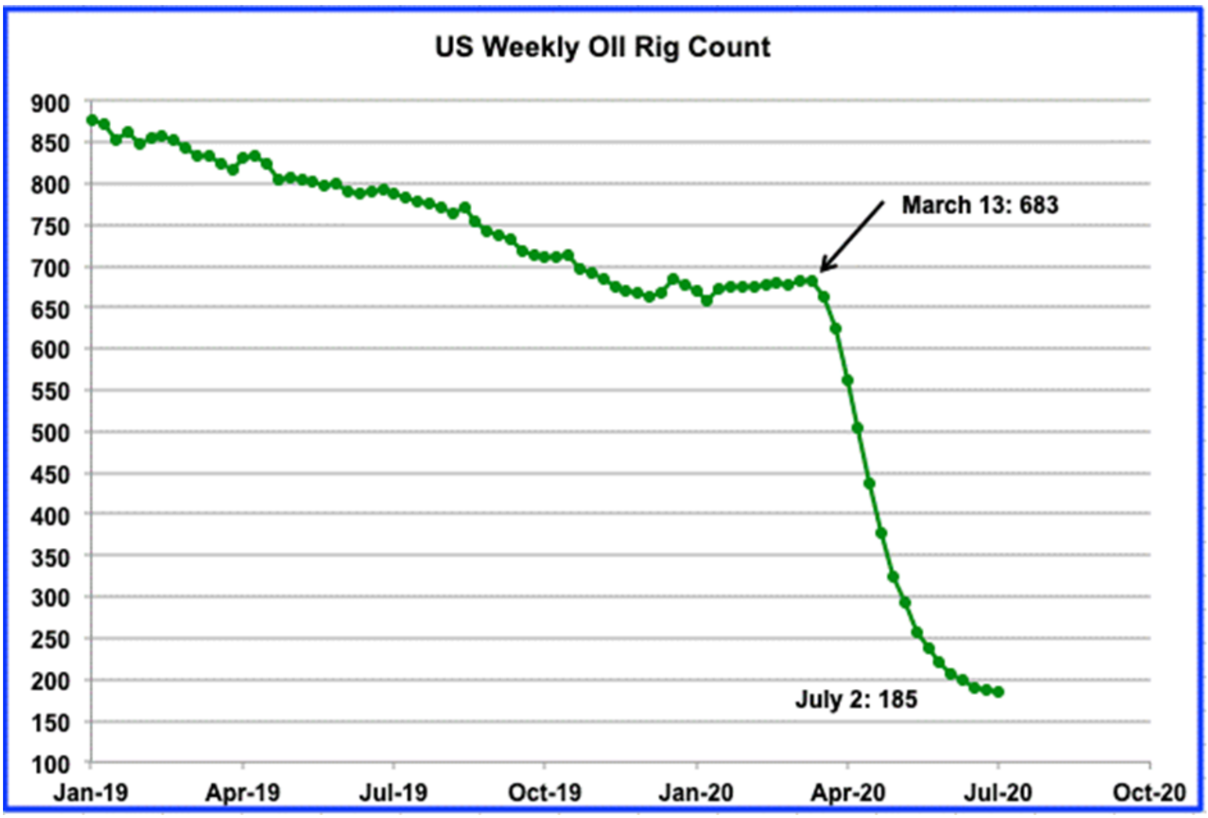
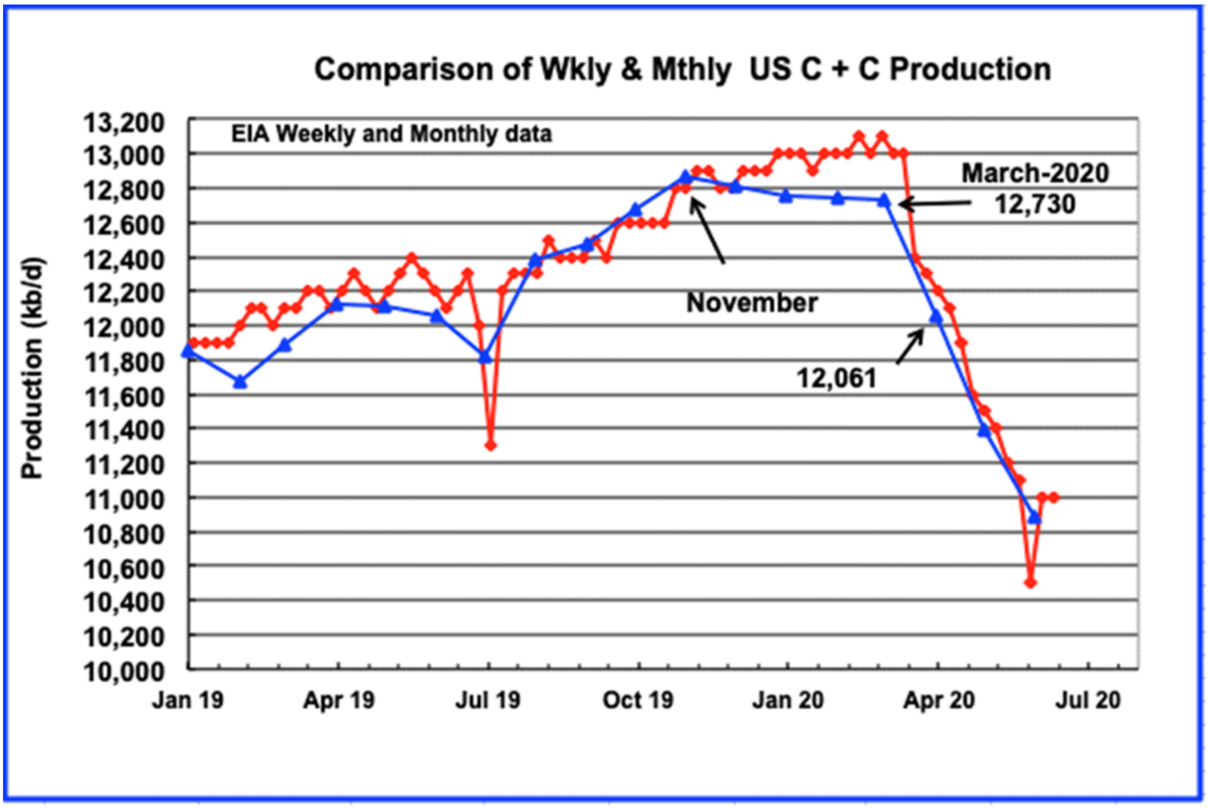


Figure 5: US Weekly Rig Count (source Baker Hughes)



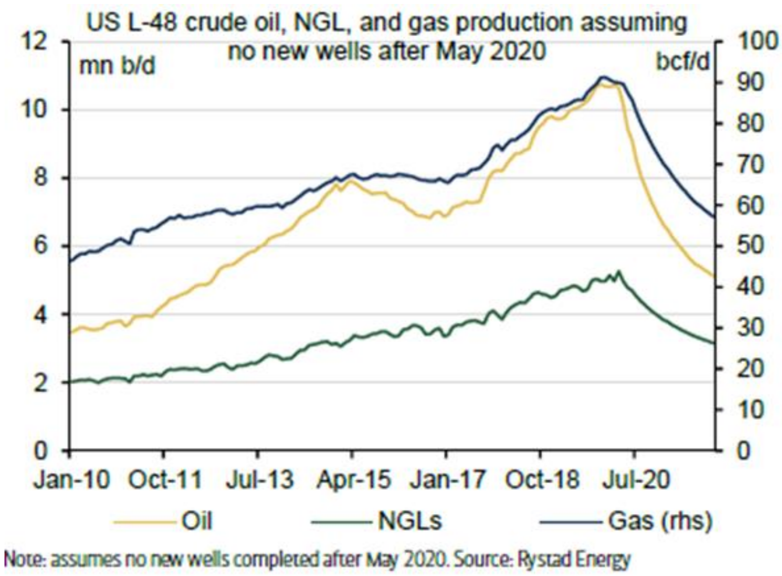
As the rig count falls, so does production.

Figure 6: US Crude Oil and Condensate Production (source EIA)



To highlight the impact of natural declines, Rystad Energy has calculated US Lower-48 production of oil, NGLs and gas assuming that no new wells are drilled after May 2020 (Figure 7).

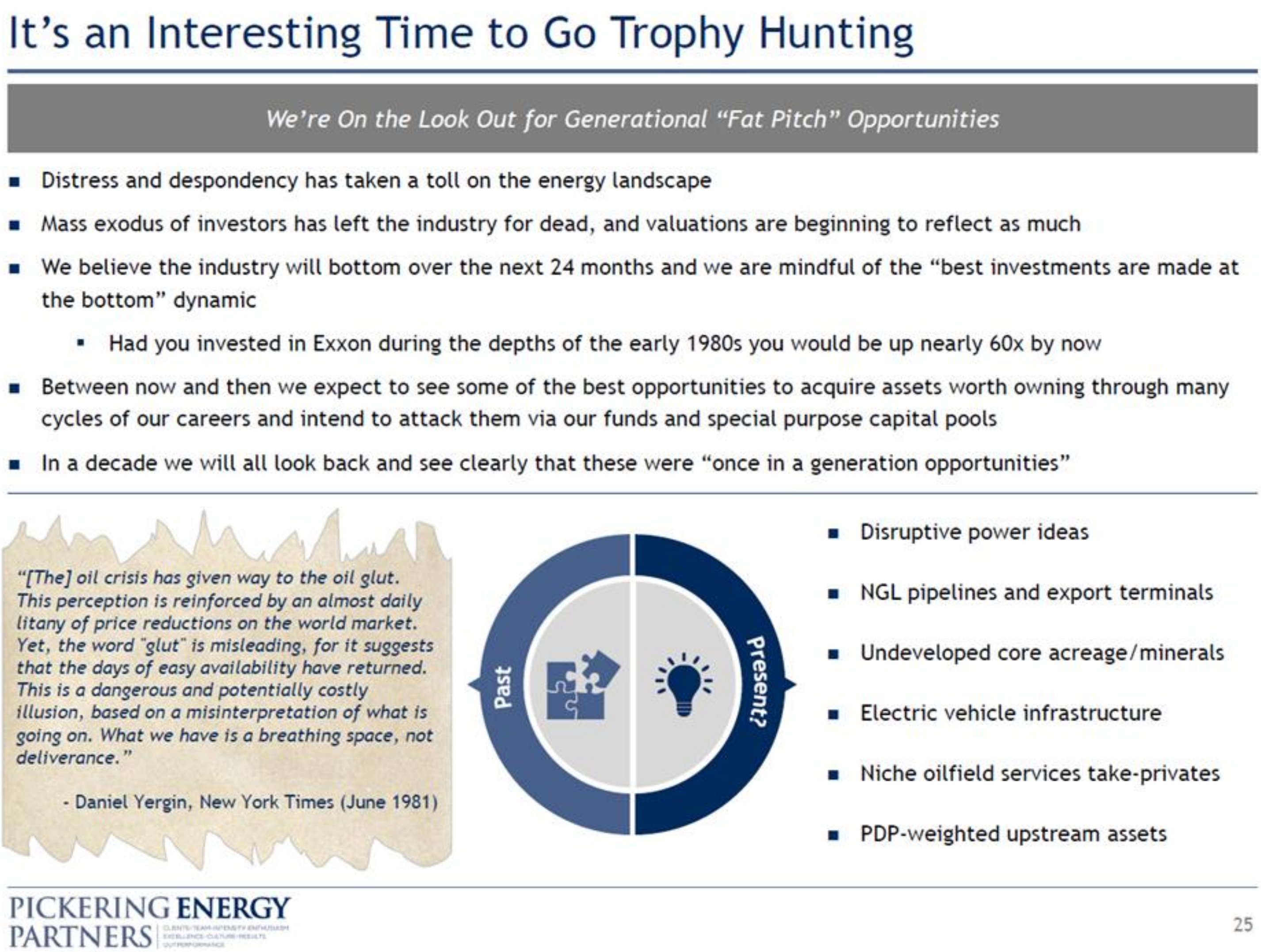
Figure 7: US L-48 Oil, NGL and Gas Production with No Wells after May 2020 (source Rystad Energy)



The base level demand for oil, NGLs and natural gas cannot be supplied from current producing wells. Investment is needed and for that investment to occur commodity prices must be high enough to deliver attractive returns.

As investors, we observe that the extreme cyclical downturn induced by a global health pandemic has provided what is likely to be a set of “once in a generation” investment opportunities. The factors are concisely presented in Figure 8, a slide borrowed from Pickering Energy Partners. The point about investment in Exxon in the early 1980s delivering approximately 60X if held to now, hardly the top of the cycle, is well made. Our focus is in undeveloped core acreage/minerals and PDP weighted upstream assets that can be acquired from distressed sellers at attractive valuations.

Figure 8: Time to go Trophy Hunting (source Pickering Energy Partners)



Gas Market

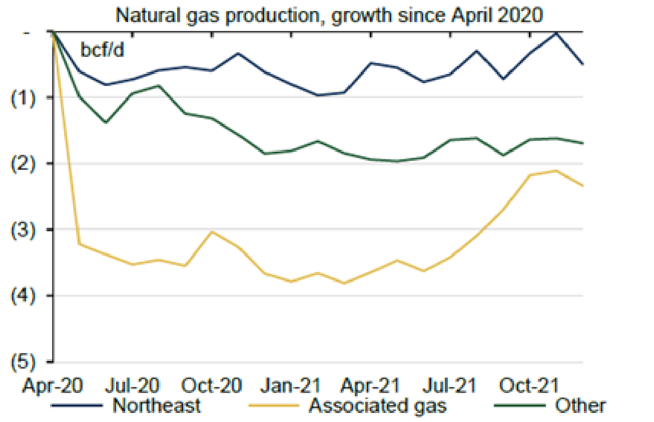
The prompt gas contract has increased approximately 30% in the last week and is now trading at $2.165/mcf. Calendar 2020 is up to $2.50 and 2021 to $2.766. On 30 July, the Jan ’21 contract broke $3/mmbtu. The increase has been driven by relatively high summer demand because of warm weather and price induced power switching from coal to gas, combined with continued declines in production.

Gas fired power generation reached record highs in mid-July topping the previous record of 45.46bcf/d. Platts projected that by the end of July gas power gen demand was likely to hit 47 bcf/d.

We expect that supply and demand fundamentals will continue to push prices higher over coming months. The Figures below from Bank of America summarise the current gas market dynamics.

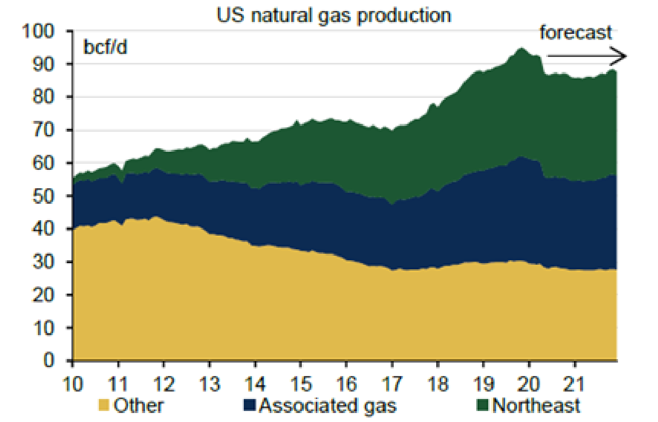
Figure 9: Bank of America Research Gas Market Analysis

Chart 7: Dry gas will continue to decline on weak gas prices, and wet gas will also show modest declines in 2H20 until gas prices recover in 2021



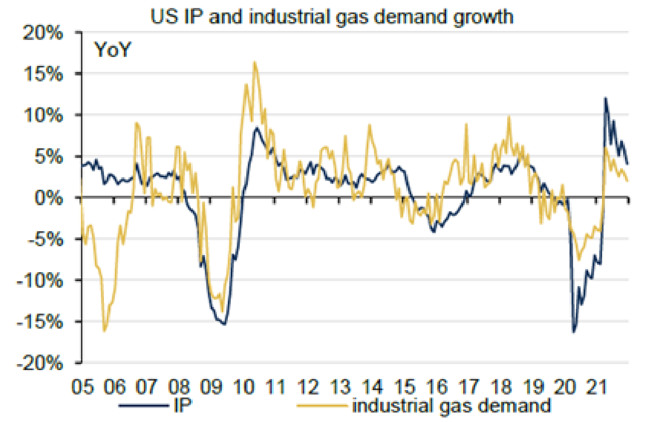
Source: BofA Global Research estimates

Chart 8: We have US nat gas production declining 2.1 bcf/d YoY in 2020 and 2.2 bcf/d in 2021, with 2H21 showing positive growth of 0.5 bcf/d



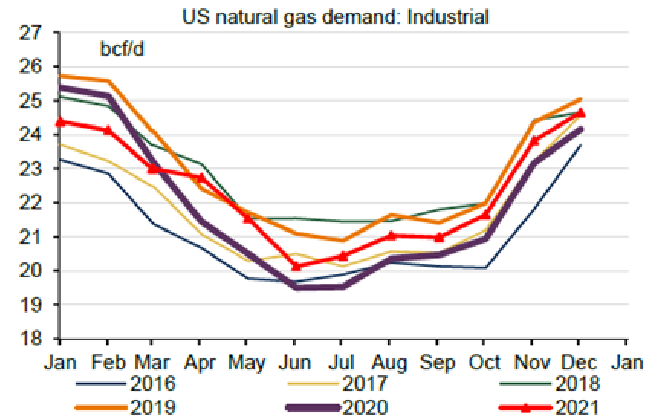
Source: EIA, BofA Global Research estimates

Chart 9: Industrial gas demand took a big hit from the Covid-19 lockdown in March and April, as factories temporarily closed



Source: Bloomberg, BofA Global Research

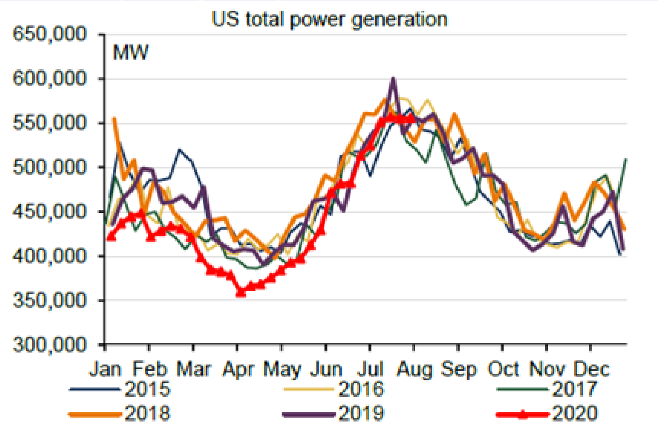
Chart 10: Early July we saw a small sequential pickup and expect the steepest YoY declines to be behind us, with continued recovery in 2H20



Source: EIA, BofA Glbal Research

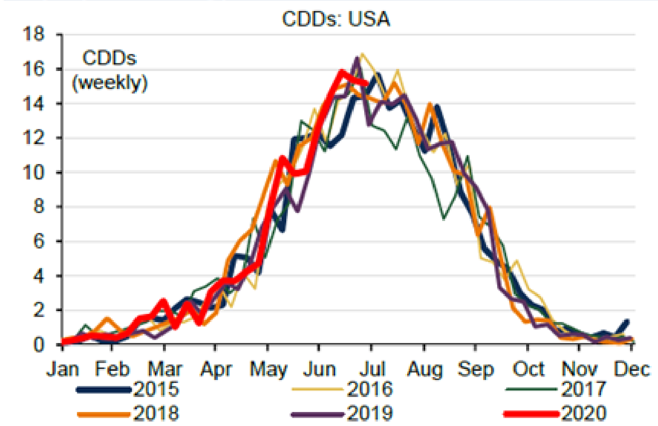
Power demand has rebounded strong from Covid-19, helped by a hot summer.

Chart 13: US power demand contracted by 11% YoY in April, but recovered to positive growth by June as lockdown was eased...



Source: Bloomberg

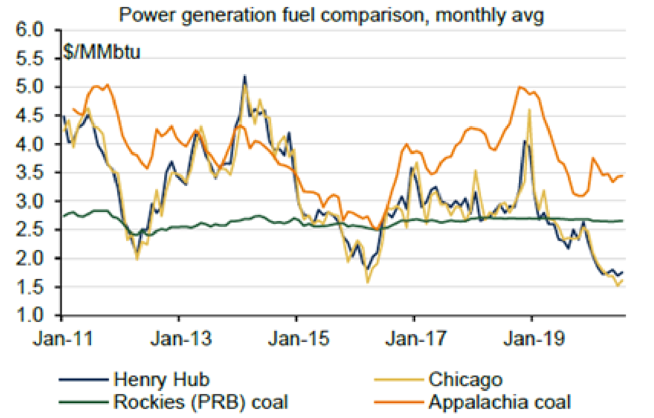
Chart 14: ...into the cooling season, with the hot weather in June and early July also boosting power demand



Source: Bloomberg

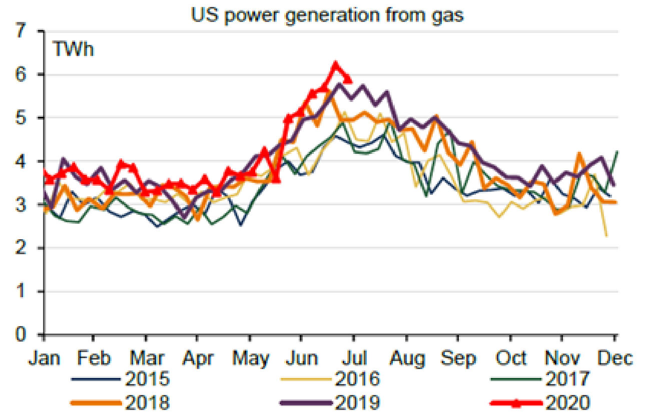
Gas burn is especially strong on maximum coal to gas switching.

Chart 15: Relative gas and coal prices, adjusted for efficiency in power generation, are at an all-time record low at the moment...



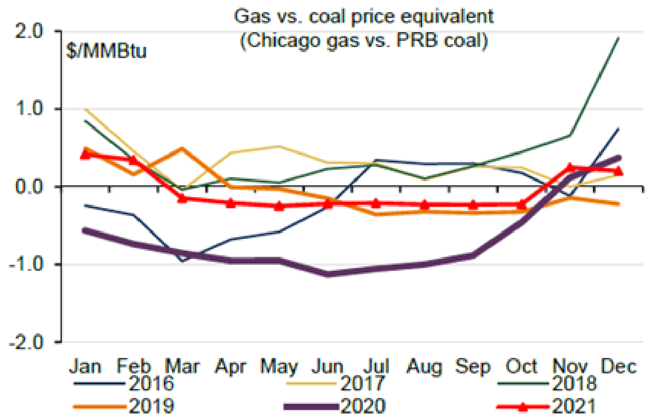
Source: Bloomberg, BofA Global Research

Chart 16: ...signaling maxing out of coal to gas switching, and thus gas demand in power generation hit an all-time record high in July



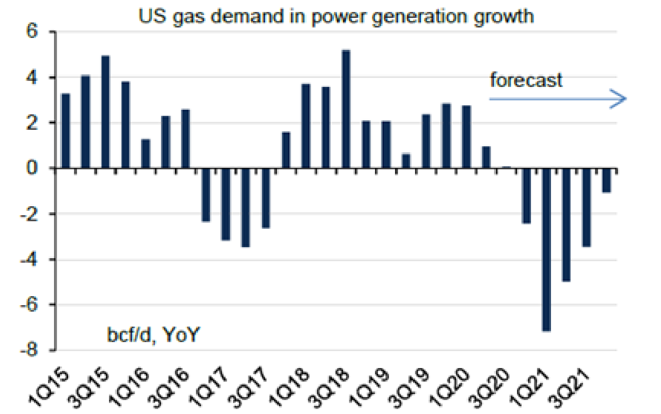
Source: Bloomberg

Chart 17: As soon as we are past the storage peak in late October, gas prices can rise, as partly already indicated by the forward curve



Source: EIA, BofA Global Research

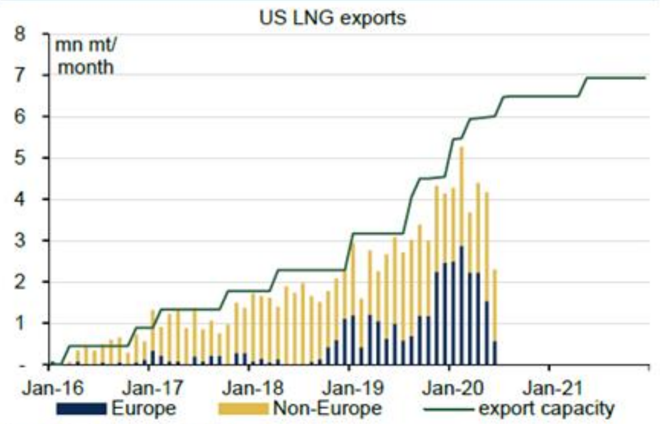
Chart 18: We expect gas burn to unwind from November onwards and then continue to contract into 2021 as the gas market tightens rapidly



Source: EIA, BofA Global Research

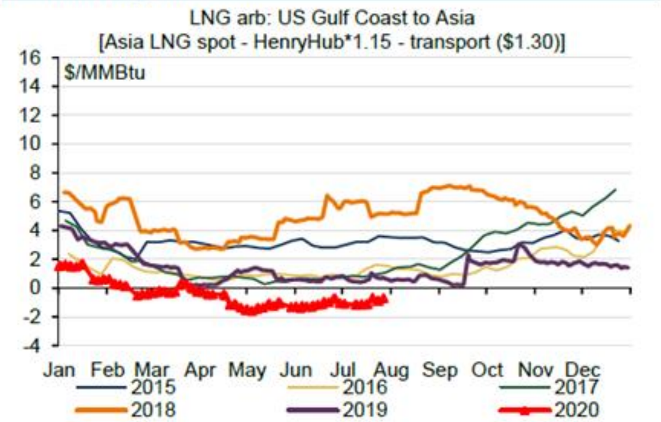
Bank of America Research also notes that demand for US LNG has been depressed all summer because of a global collapse in demand for liquid gas from both Europe and Asia. The LNG arb from US Gulf Coast to Asia closed in March and the arb to Europe has been closed since April.

Chart 19: The demand for US LNG has been depressed all summer



Source: Bloomberg, BofA Global Research

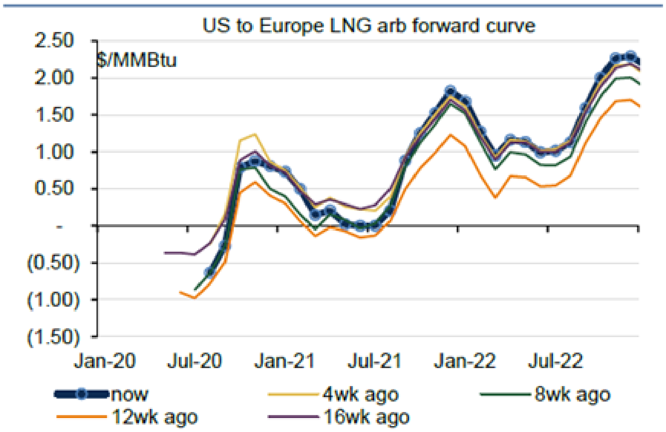
Chart 20: The LNG arb from US Gulf Coast to Asia closed in March and has been firmly closed since



Source: Bloomberg, BofA Global Research

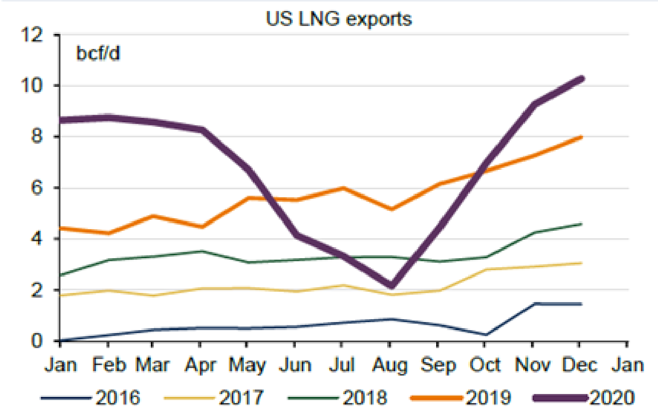
Current pricing has the LNG arb firmly in place by October and by November BofA expects US LNG exports to return to full capacity.

Chart 23: The arb to Europe is firmly open for October onwards on the forward curves for the winter...



Source: Bloomberg, BofA Global Research

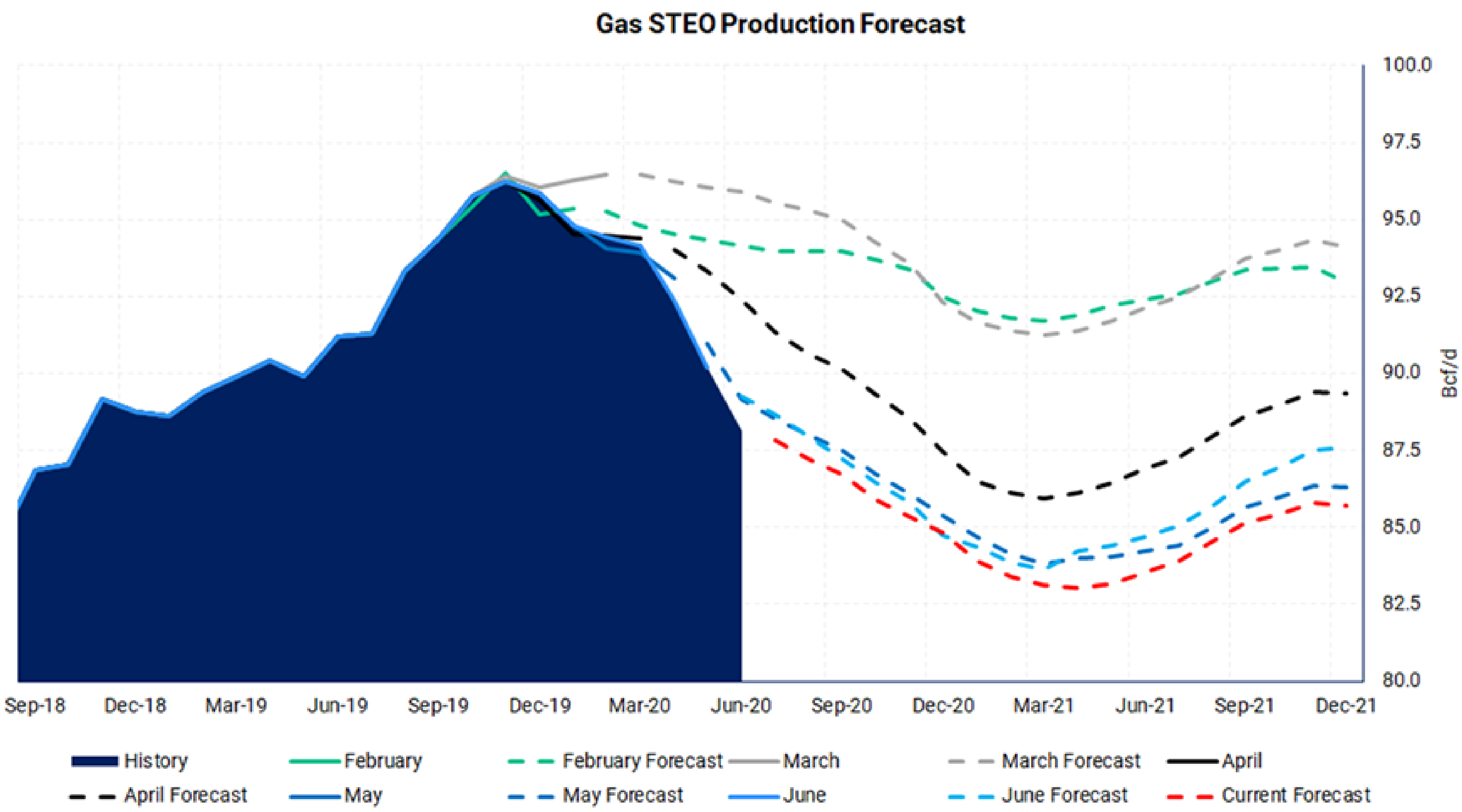
Chart 24: ...and by November, we expect US LNG exports to have ramped up close to full capacity and continuing to run at capacity through winter



Source: BofA Global Research estimates

Figure 10 shows the evolution of production forecasts within the EIA's monthly STEO reports.

Figure 10: Gas STEO Production Forecasts (source EIA via Aegis Energy)



Current forecasts to end Dec 2021 are approximately 10bcfd lower than those from February and March.

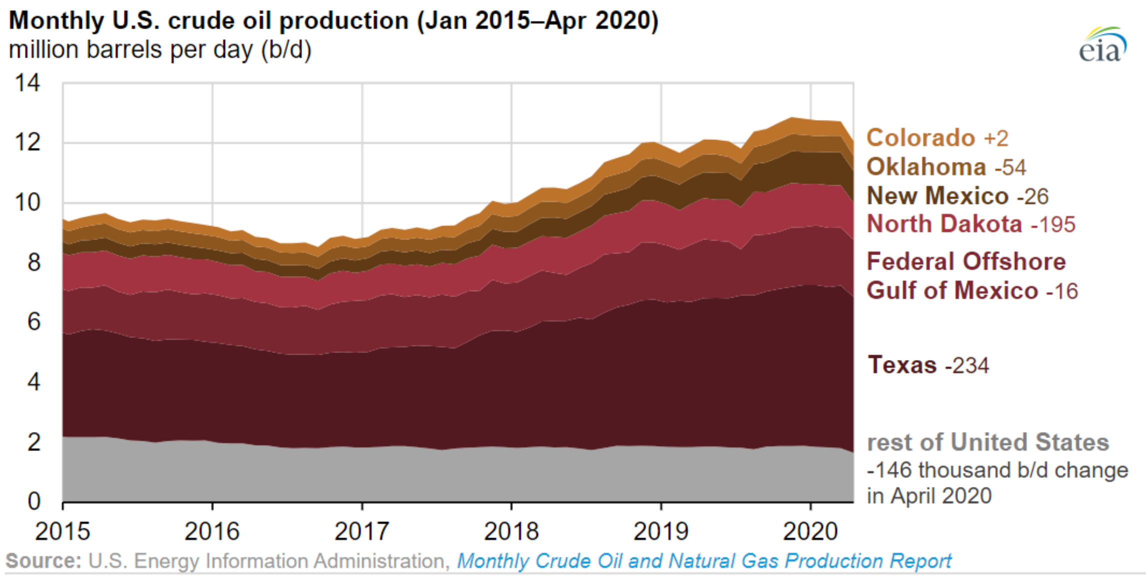
Oil Market

Prompt WTI was stable at approximately $41/bbl during July. Demand is continuing to trend up despite the surge in virus infections across the US slowing the pace of economic recovery. Bloomberg demand indicators as reported on 28 July:

- US refinery crude use: -17% y/y; +2.6% m/m
- Jet fuel demand: -41% y/y; +34% m/m
- Gasoline demand: -12% y/y; -0.7% m/m
- Vehicle miles on interstate highways: -14% y/y; unchanged m/m

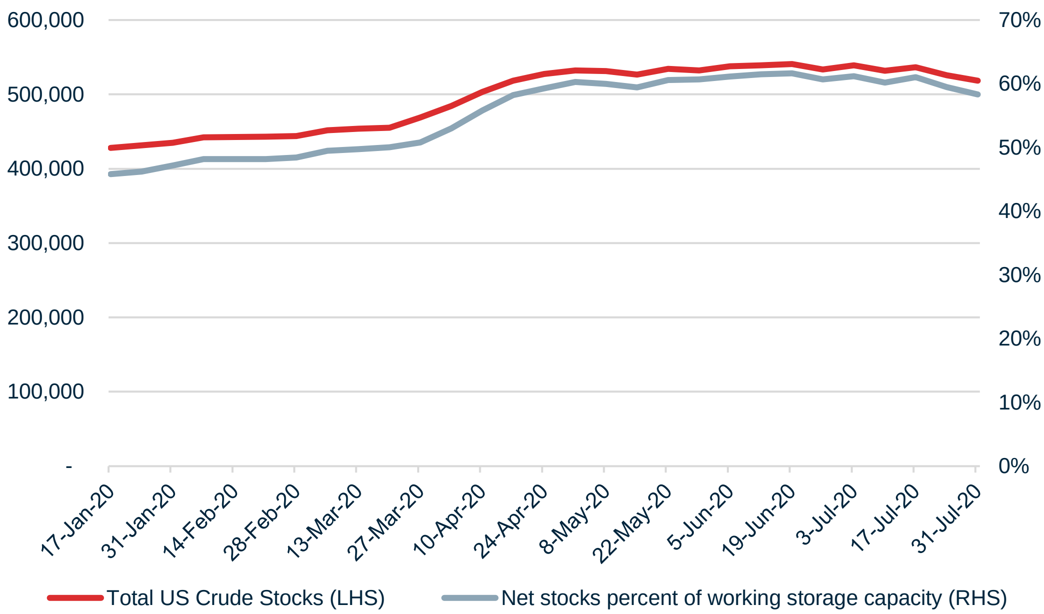
US production continues to fall (Figure 11). Most of the production temporarily shut-in due to low prices has now been restored. Declining US production is the result of the natural decline of currently producing wells, removing more production than is being added by new wells because of lower rig counts.

Figure 11: Monthly US Crude Production (source EIA)



Crude oil stocks in the US declined steady during July and now stand at 58% of capacity.

Figure 12: US Crude Stocks in 2020 (source EIA)

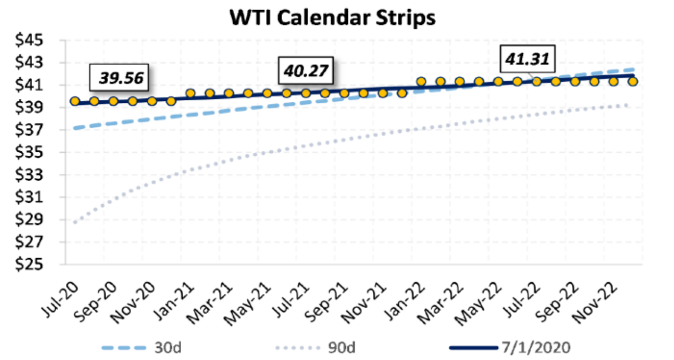


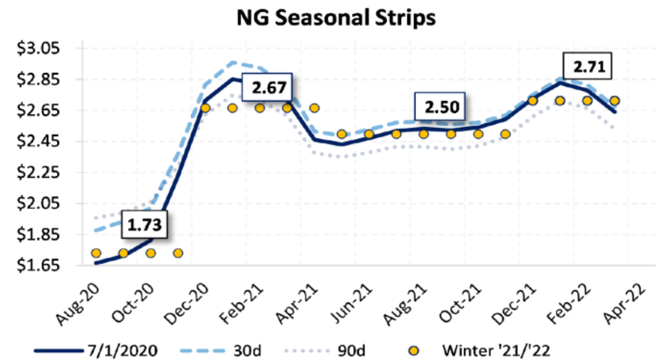
Longreach Energy Holdings LLC

LONGREACH ENERGY

Monthly Report

Gas and Oil Prices 1 July 2020





Swap Pricing

		Bal 20		Cal 21		Cal 22		Cal 23
NYMEX WTI Crude	$	39.56	$	40.27	$	41.31	$	42.42
ICE Brent Crude	$	41.65	$	43.28	$	45.21	$	46.88
Light Louisiana Sweet	$	40.90	$	41.81	$	42.62	$	43.83
TM Midland Differential	$	0.06	$	0.18	$	0.20		
NYMEX Natural Gas	$	2.03	$	2.60	$	2.43	$	2.37

Source: Bloomberg LP

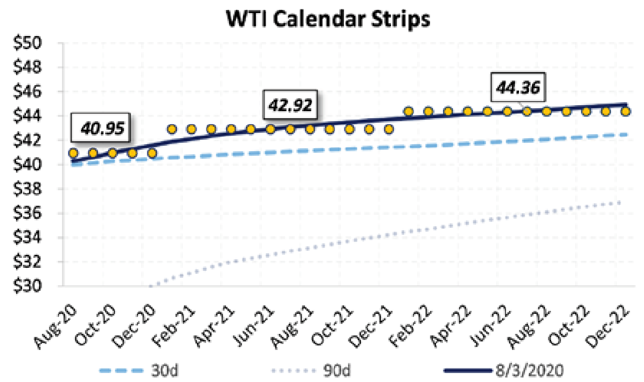
Note: Midland diff changed to TM computation Oct 1. All prices indicative only.

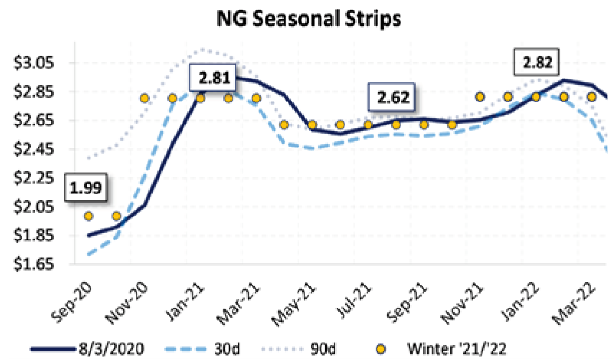
Natural Gas Basis

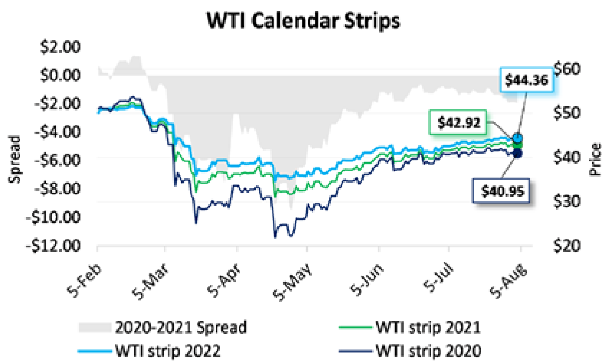
Location		Spot		Summer '20		Winter '20/'21		Summer '21
Henry Hub Fixed		$1.64		$1.81		$2.70		$2.51
MichCon	$	0.01	$	(0.16)	$	(0.16)	$	(0.23)
TETCO M3	$	(0.02)	$	(0.34)	$	1.02	$	(0.39)
NGPL-Midcon	$	(0.08)	$	(0.23)	$	(0.28)	$	(0.39)
NWRox	$	(0.16)	$	(0.28)	$	(0.27)	$	(0.54)
Dominion S	$	(0.19)	$	(0.48)	$	(0.39)	$	(0.50)
TETCO M2	$	(0.20)	$	(0.49)	$	(0.38)	$	(0.51)
Waha	$	(0.25)	$	(0.46)	$	(0.58)	$	(0.62)

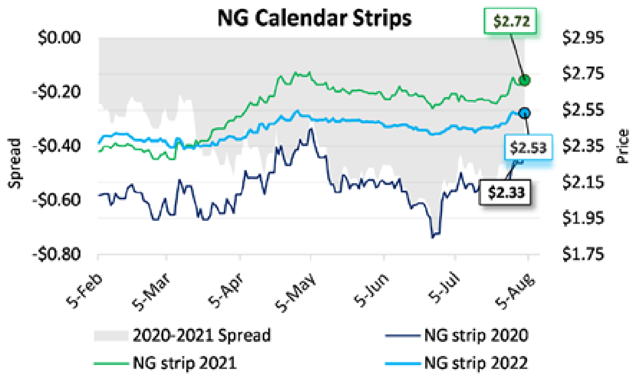
All prices as of close yesterday

Gas and Oil Prices 3 August 2020









Swap Pricing

		Bal 20		Cal 21		Cal 22		Cal 23
NYMEX WTI Crude	$	40.95	$	42.92	$	44.36	$	45.44
ICE Brent Crude	$	44.24	$	46.41	$	48.39	$	50.04
Light Louisiana Sweet	$	42.39	$	44.04	$	45.17	$	46.26
TM Midland Differential	$	0.09	$	0.38	$	0.50		
NYMEX Natural Gas	$	2.33	$	2.72	$	2.53	$	2.46

Source: Bloomberg LP

Note: Midland diff changed to TM computation Oct 1. All prices indicative only.

Natural Gas Basis

Location		Spot		Summer '20		Winter '20/'21		Summer '21
Henry Hub Fixed		$1.75		$1.88		$2.76		$2.60
NWRox	$	(0.05)	$	(0.29)	$	(0.24)	$	(0.40)
MichCon	$	(0.16)	$	(0.25)	$	(0.17)	$	(0.21)
NGPL-Midcon	$	(0.23)	$	(0.30)	$	(0.29)	$	(0.34)
TETCO M3	$	(0.24)	$	(0.47)	$	1.13	$	(0.35)
Dominion S	$	(0.57)	$	(0.74)	$	(0.45)	$	(0.52)
TETCO M2	$	(0.61)	$	(0.76)	$	(0.43)	$	(0.52)
Waha	$	(1.27)	$	(0.50)	$	(0.41)	$	(0.44)

All prices as of close yesterday