



Longreach Energy Holdings LLC

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

1. Market and Macro Industry Commentary

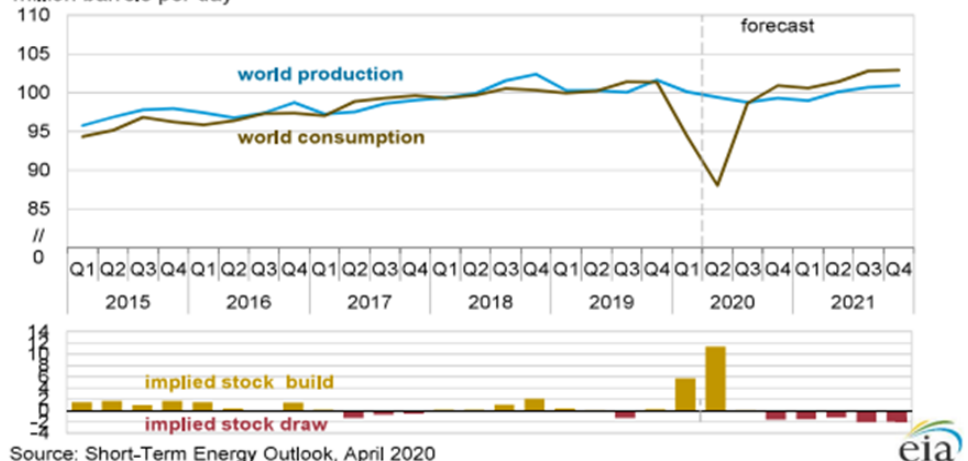
General Market Commentary

The changes wrought over the last four weeks are highlighted by fact that in early March the global oil market was still focused on prospective further production cuts by OPEC+ with talk of potential to reduce production by 1.5 million barrels per day (mbbl/d). The failure to agree any cuts, and Saudi Arabia's subsequent announcement that it would reduce its official selling price into Europe by \$8/bbl and increase production from 9.7mbbl/d to over 12mbbl/d, together with early Covid-19 related demand concerns, caused oil to drop by 31% on 8 March.

Today the world is to a large extent locked-down with minimisation of Covid-19 infections the apparent driver for all policy. Transportation fuel demand has collapsed as the world's population heeds instructions to stay at home and international (and domestic!) borders have closed. The US Energy Information Agency's (EIA) April Short-Term Energy Outlook highlights the hit to consumption.

Figure 1: Listed Gas E&P's Relative Performance (source EIA)

World liquid fuels production and consumption balance million barrels per day



The balance of March saw (very) high volatility with record falls and rises (for example 19 March saw oil prices rise by the most on record the day after a 24% fall). The market reacted on one hand to Covid-19 fallout and, on the other, to Central Bank policy responses and the prospect of coordinated action to reduce supply and prop-up demand with government purchases into strategic petroleum reserves. As this report is being written OPEC+ has announced a 9.7mbbl/d cut with other producers (including Canada, Brazil and US) expected to add at least 4mbbl/d of reductions. This, in the near term at least, has stabilised the forward curve although prompt is still weak. Approximately 14mbbl/d per day of production cuts, we have come a long way since the beginning of March.

CONTACT US

Longreach Alternatives Ltd

Level 13,
1 Margaret Street
Sydney NSW 2000

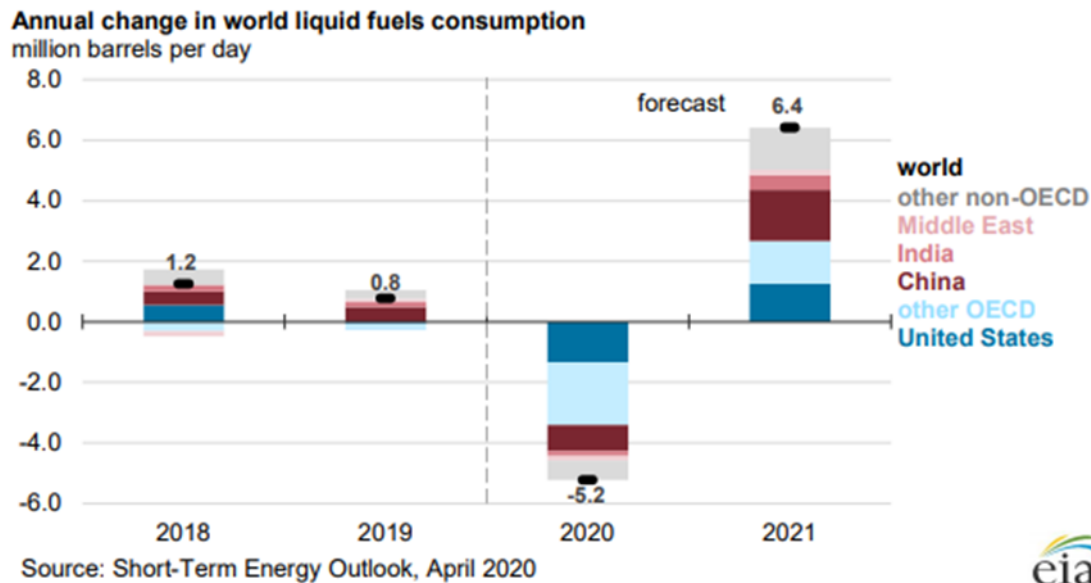
T+61 2 9135 0428

client.services@longreachalternatives.com



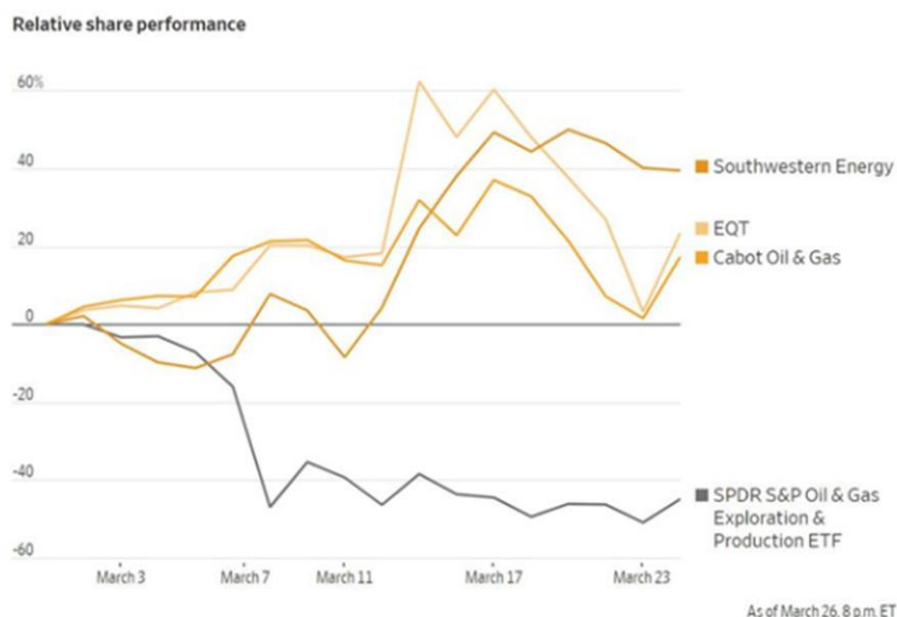
We believe that near term demand destruction will test storage capacity and that it is possible that in certain regions crude will have no buyer able to take supply and that we could see the prompt contract fall for short periods to below \$10/bbl. We see this as a particular risk over the next 2 quarters and are taking steps to protect our assets with appropriate hedging. Despite sharp moves in the prompt contract we do believe that the forward curve has stabilised, and that balance of probabilities indicates forward prices are more likely to move higher than fall as the world begins to emerge from Covid-19 lockdown. A strong demand rebound is forecast in 2021.

Figure 2: Annual Change in World Liquid Fuels Consumption (source EIA)



Happily, in times such as this the strong diversification benefits of natural gas become evident. For oil, during March the news and its accompanying market reaction, was overwhelmingly negative. For natural gas, things were much brighter. While there remains near term weakness in the prompt contract due to enduring effects of warm winter, the forward curve has increased with US 20/21 winter prices moving higher. The reaction of listed natural gas producers highlights the positive impact on the gas market from oil's collapse (see Figure 3). Factors driving this reaction are discussed in Gas Market below.

Figure 3: Listed Gas E&P's Relative Performance (source Wall St Journal)



Companies focused on gas drilling in the eastern US have seen a big rise in share prices relative to the broader oil and gas sector. Credit: Wall Street Journal



The reaction of the US upstream oil and gas industry to the oil price collapse has been swift – note that natural gas prices were already low and the capital reductions for gas focused drilling delivering prior period rig count reductions in gas basins (Figure 5). Announcements made during the month include:

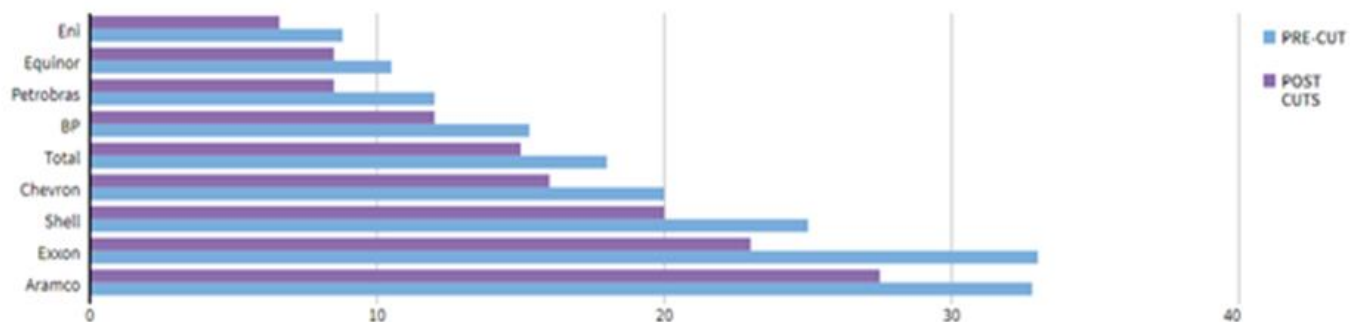
Company	Rig Reduction	% Capital Reduction	\$ Capital Reduction
Occidental			\$1,700m
Matador	3		
Marathon	5		
Apache		40%	\$670m
Devon		30%	
Murphy		35%	
Exxon		30%	\$10,000m
Concho		25%	\$900m
Pioneer	11	45%	\$1,300m
Hess			\$800m
ConocoPhillips			\$700m
Parsley			\$800m

Bank of America has collated cuts announced by global oil majors.

Figure 4: Oil Majors' 2020 Capex Cuts (source Bank of America)

Oil Majors' 2020 capex cuts

The world's top oil and gas companies have slashed spending plans following the oil price crash




In \$ bln
Company-provided figures (Aramco compares 2019 capex, Eni converted from euro)
Ron Bousso | REUTERS GRAPHICS

Rig counts show the impact of these decisions (see Figure 5). US land rigs falling 64 in a single week to 3 April, now a massive 361 fewer rigs working than this time last year (note date is in US format – m/d/yr). As has been highlighted in prior months' reports, this fall in rig counts will have material impact on supply and sets up for strong recovery in prices as the world eventually emerges from Covid-19 lock-down.



Figure 5: North American Rig Count (source Baker Hughes)

Baker Hughes rig count

Baker Hughes 

Rotary Rig Count
4/3/20

Location	Week	+/-	Week Ago	+/-	Year Ago
Land	646	-64	710	-354	1000
Inland Waters	0	0	0	-3	3
Offshore	18	0	18	-4	22
United States Total	664	-64	728	-361	1025
Gulf Of Mexico	18	0	18	-4	22
Canada	41	-13	54	-27	68
North America	705	-77	782	-388	1093
U.S. Breakout Information	This Week	+/-	Last Week	+/-	Year Ago
Oil	562	-62	624	-269	831
Gas	100	-2	102	-94	194
Miscellaneous	2	0	2	2	0
Directional	41	-6	47	-29	70
Horizontal	593	-60	653	-308	901
Vertical	30	2	28	-24	54

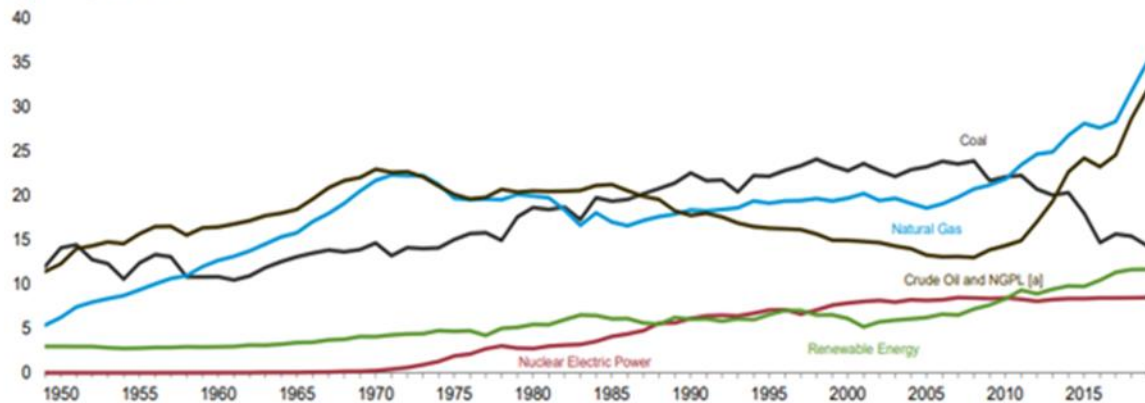
The EIA's March 2020 Monthly Energy Review has pre-Covid-19 energy production and supply trends. We believe that the patterns will be restored after this period of dislocation has passed and that natural gas and oil will remain essential contributors to energy supply for the foreseeable future. Key graphs are produced below.



Figure 6: US Primary Energy Production (source EIA)

Figure 1.2 Primary Energy Production
(Quadrillion Btu)

By Source, 1949–2019



By Source, Monthly

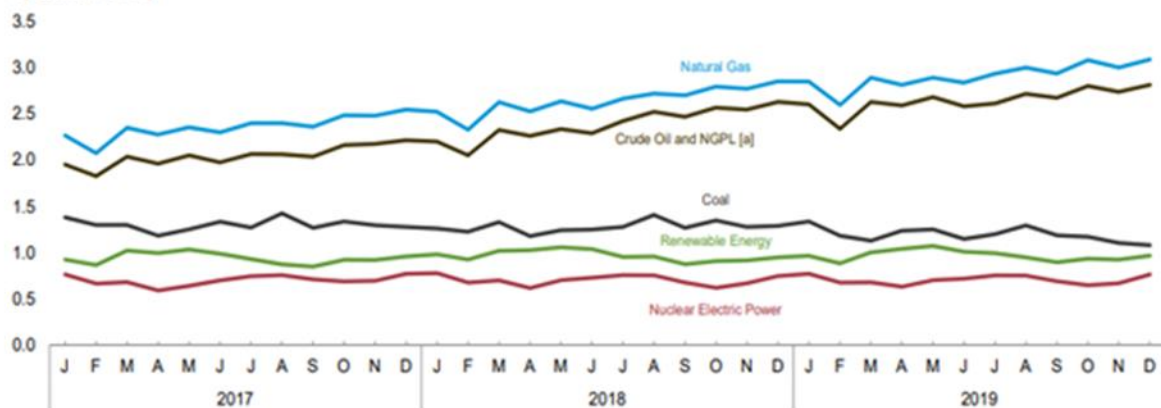
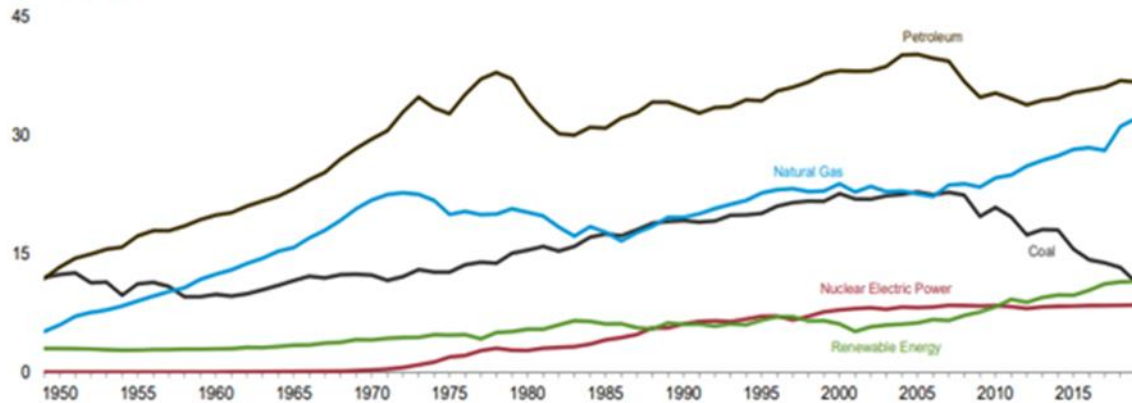




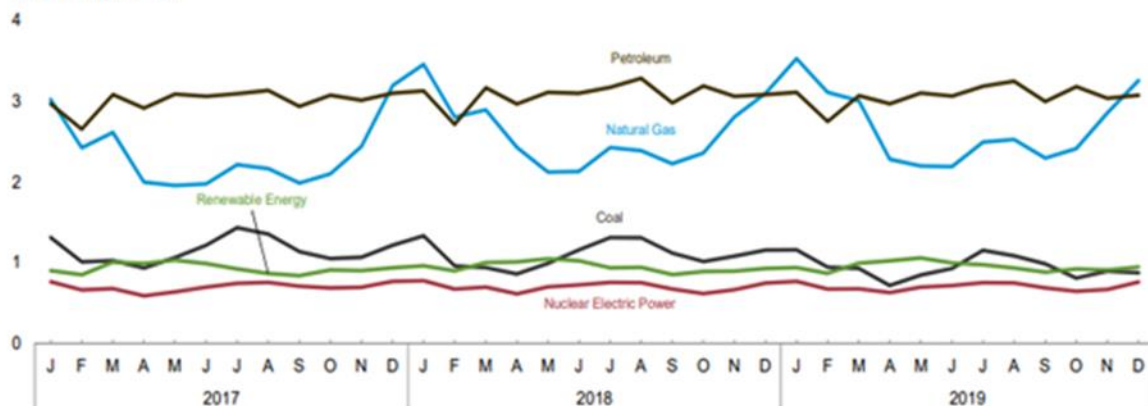
Figure 7: US Primary Energy Consumption (source EIA)

Figure 1.3 Primary Energy Consumption
(Quadrillion Btu)

By Source, [a] 1949–2019



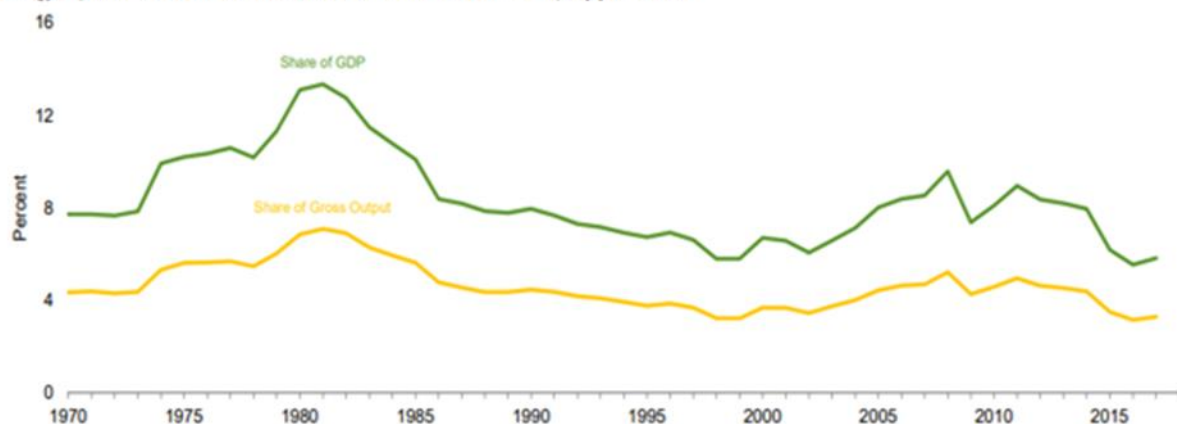
By Source, [a] Monthly



Gross energy production and consumption have grown, and will continue to grow, however the decreased unit-cost of energy has delivered significant benefits for the US economy, as a share of GDP energy expenditure continues to fall, providing more money for other things.

Figure 8: Energy Expenditure as Share of Gross Domestic Product and Gross Output (source EIA)

Energy Expenditures as Share of Gross Domestic Product and Gross Output, [b] 1970–2017





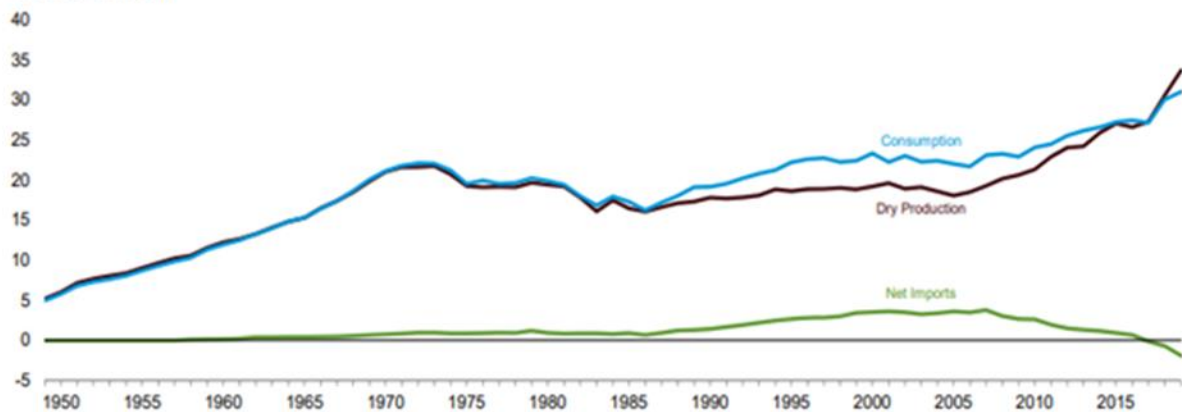
The growing role for natural gas in US energy supply as well as sector and seasonal demand factors are detailed in Figure 9.

Figure 9: Natural Gas Production and Consumption (in Trillion Cubic Feet, source EIA)

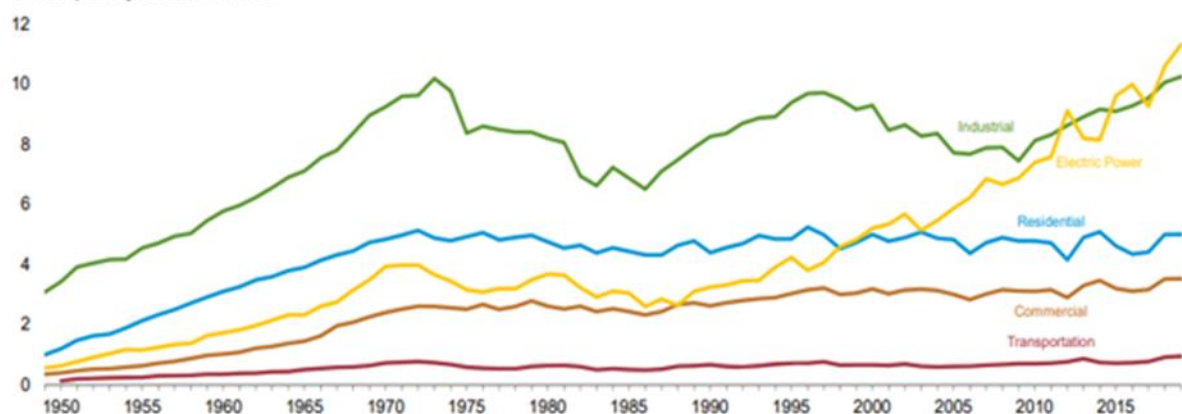
Figure 4.1 Natural Gas

(Trillion Cubic Feet)

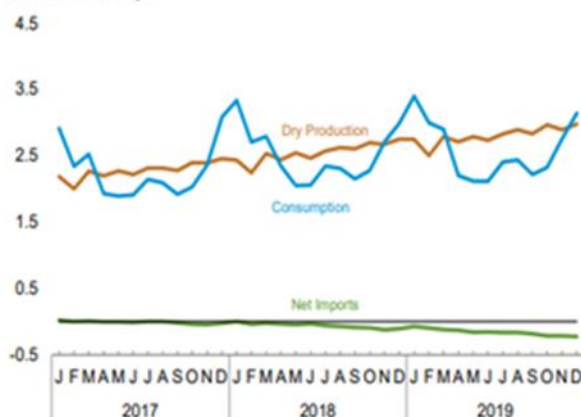
Overview, 1949–2019



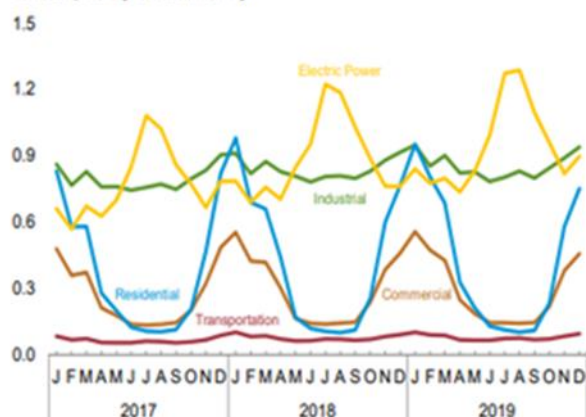
Consumption by Sector, 1949–2019



Overview, Monthly



Consumption by Sector, Monthly

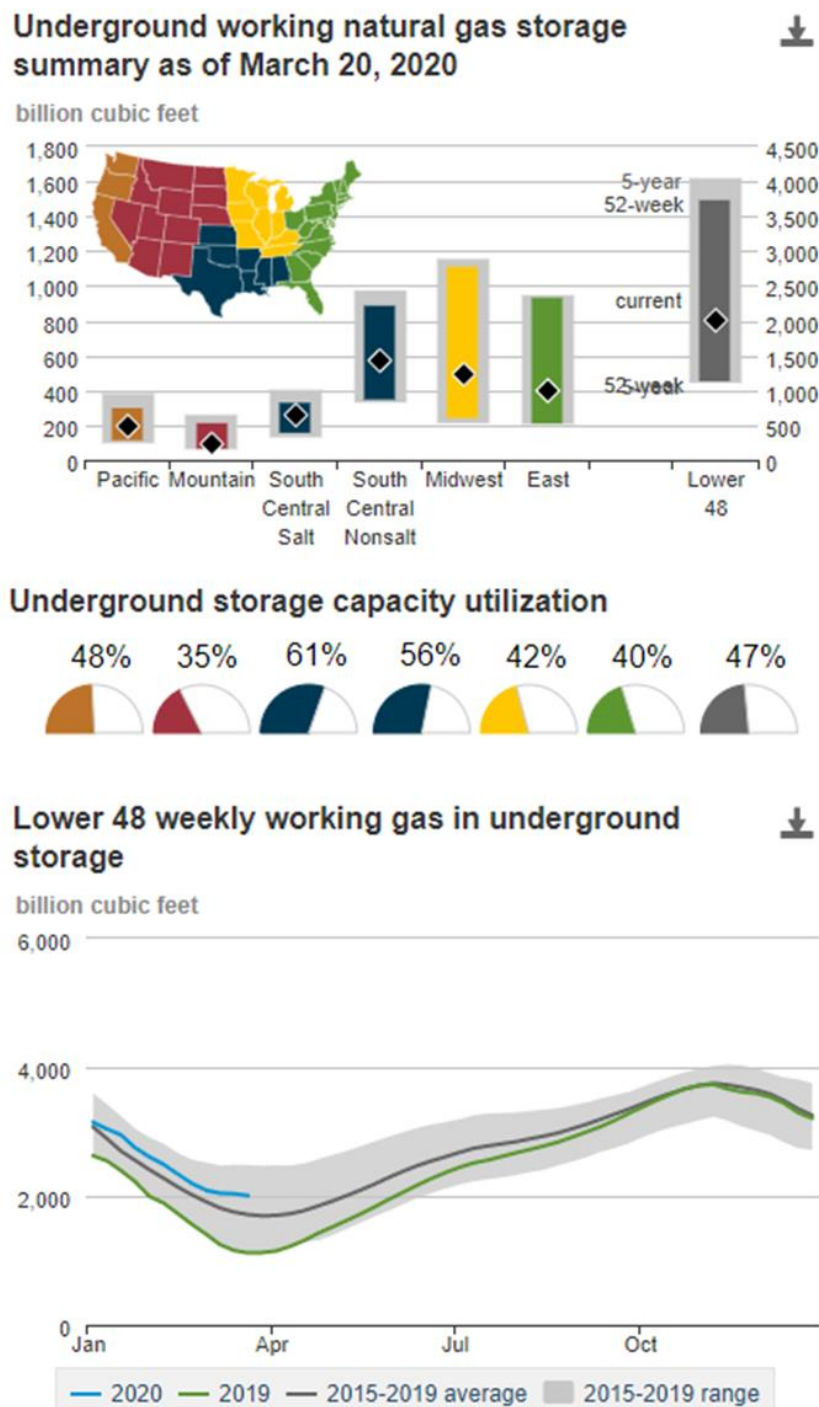


Gas Market

The production of natural gas from wells whose economic performance is determined by sale of oil (called Associated Gas) accounts for approximately 12% of US gas supply. The significant fall in drilling for oil, particularly in the Permian Basin, will deliver corresponding reduction in Associated Gas supply. This, together with previously discussed falls in rig-count, and consequently production, from Appalachia and other gas basins because of recent low prices, foreshadows an impending supply shortfall.

It is important to note the low transportation demand for natural gas (Figure 9). Resilient demand and large capacity in storage (Figure 10) mean that short-term dislocation we are seeing in the oil market does not apply to gas.

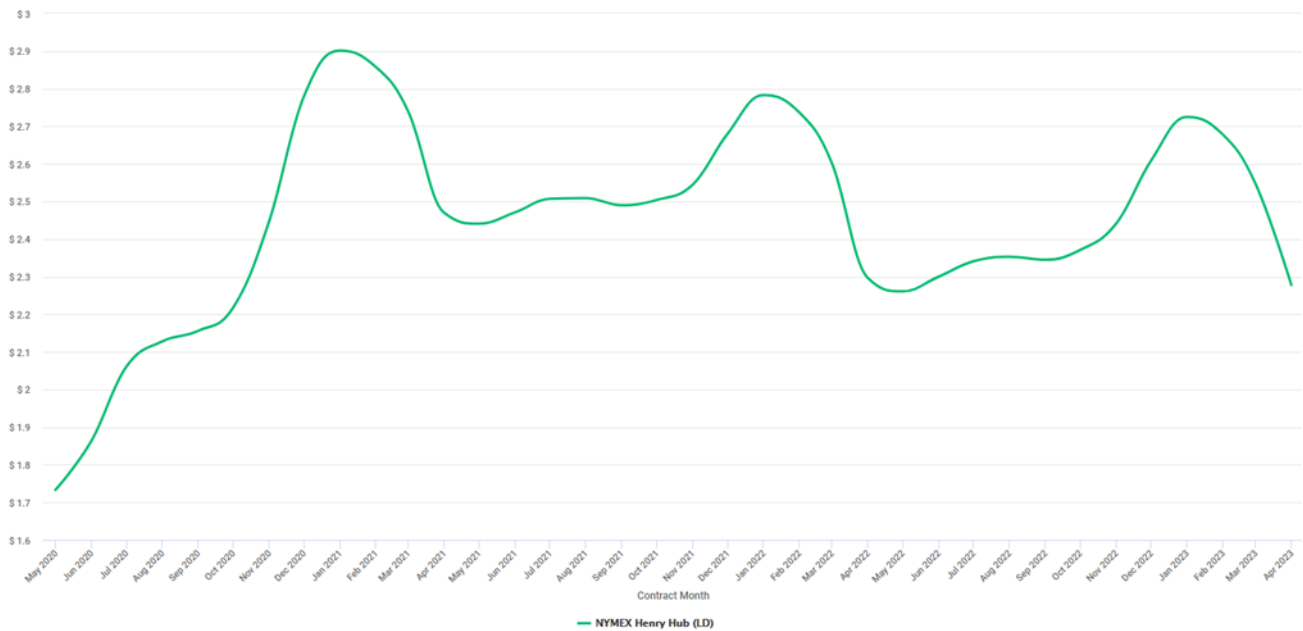
Figure 10: Natural Gas Storage Dashboard 26 March (source EIA)





A return to average winter temperatures in Q4 20 and Q1 21 could see significant storage withdrawals and a material tightening in the gas market. This could deliver material near term gas price spikes and is reflected in the increase in winter 20/21 Henry Hub contracts in recent days with the Dec 2020 contract now trading a little over \$2.90/mcf (Figure 11).

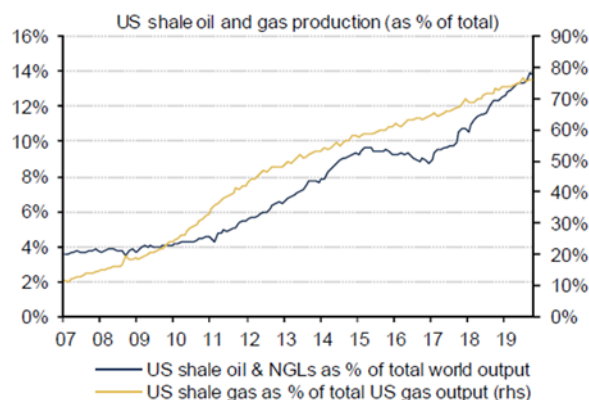
Figure 11: Natural Gas Strip at 13 April (source Aegis Energy)



The dominance of shale natural gas production in the US means that decline in drilling activity will see rapid fall in supply (Figure 12). This adds to risk of supply shortfalls into end of 2020 and beyond.

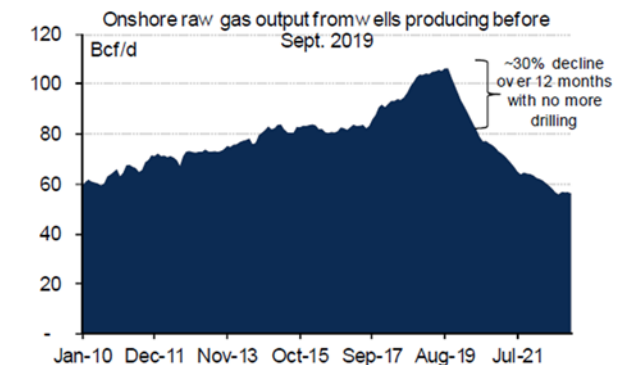
Figure 12: Natural Gas Supply (source Bank of America)

Shale now represents nearly 80% of US natural gas production...



Source: EIA, IEA

...and puts domestic production at risk of steep declines should producers ever step off this fast moving treadmill



Source: Rystad ShaleWell Cube

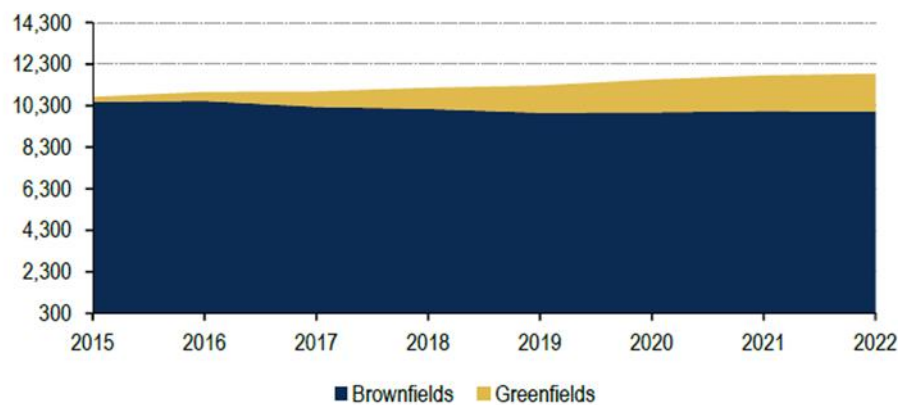


Oil Market

In the context of a, purported, supply war between Russia and Saudi Arabia and new promises from Russia to restrict its production, it is interesting to see Russia's historic performance. Despite promises to the contrary, Russia has never cut a barrel of production, see Figure 13. If history is a guide to the future it is likely that Russia will continue to maintain current production. How much this matters, remains to be seen.

Figure 13: Russian Oil Production (source Bank of America)

Chart 25: Russian oil production, kb/d

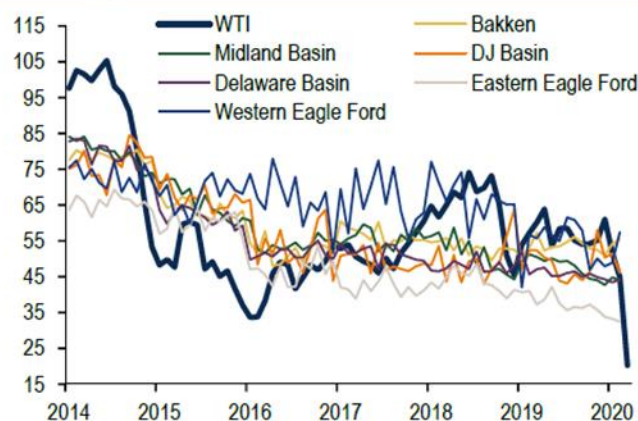


Source: BofA Global Research estimates, company report

The problems for the average producer across major oil basins is highlighted by Figure 14, current WTI prices do not support the drilling of an average well in any of the major shale basins. Note that these data are basin averages and there can be significant variation of performance within basins with high performing areas still offering attractive returns for new drilling. However, as evidenced by the average breakeven prices, these areas are relatively small.

Figure 14: Breakeven WTI Prices (source Bloomberg via Bank of America)

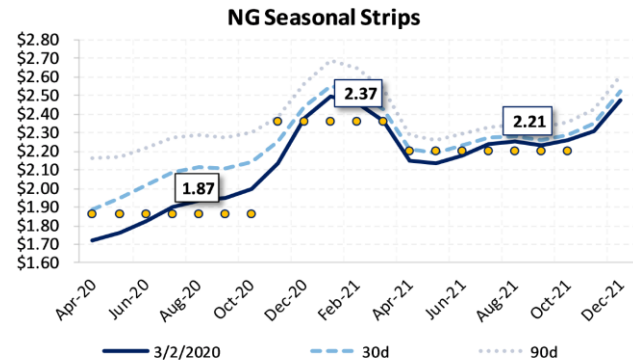
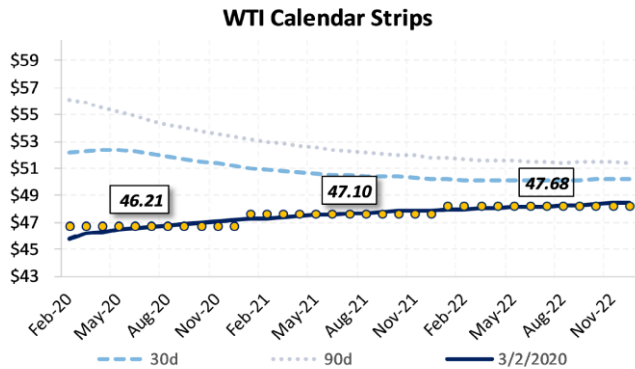
Chart 3: The current level of oil prices is below breakeven prices across US shale regions



Source: Bloomberg



Gas and Oil Prices 2 March 2020



Swap Pricing

		Bal 20	Cal 21	Cal 22	Cal 23
NYMEX WTI Crude	\$	46.21	\$ 47.10	\$ 47.68	\$ 48.25
ICE Brent Crude	\$	50.63	\$ 51.77	\$ 52.55	\$ 53.27
Light Louisiana Sweet	\$	49.18	\$ 49.90	\$ 50.37	\$ 50.98
TM Midland Differential	\$	1.36	\$ 1.28	\$ 1.25	
NYMEX Natural Gas	\$	1.96	\$ 2.30	\$ 2.39	\$ 2.44

Source: Bloomberg LP

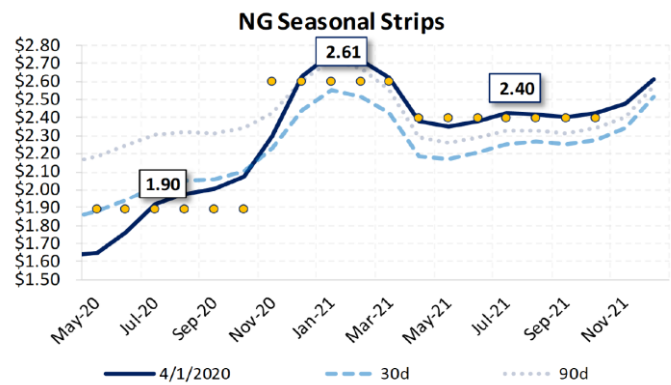
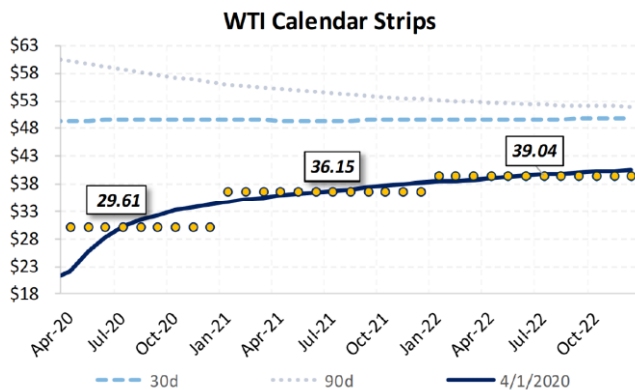
Note: Midland diff changed to TM computation Oct 1. All prices indicative only.

Natural Gas Basis

Location	Spot	Summer '20	Winter '20/'21	Summer '21
Henry Hub Fixed	\$1.79	\$1.85	\$2.34	\$2.19
MichCon	\$ (0.14)	\$ (0.23)	\$ (0.13)	\$ (0.19)
TETCO M3	\$ (0.24)	\$ (0.33)	\$ 1.04	\$ (0.32)
CIG	\$ (0.34)	\$ (0.55)	\$ (0.36)	\$ (0.62)
Dominion S	\$ (0.34)	\$ (0.44)	\$ (0.37)	\$ (0.43)
TETCO M2	\$ (0.35)	\$ (0.46)	\$ (0.36)	\$ (0.45)
NGPL-Midcon	\$ (0.42)	\$ (0.47)	\$ (0.38)	\$ (0.48)
Waha	\$ (1.59)	\$ (1.67)	\$ (1.54)	\$ (0.98)

All prices as of close yesterday

Gas and Oil Prices 1 April 2020



Swap Pricing

		Bal 20	Cal 21	Cal 22	Cal 23
NYMEX WTI Crude	\$	29.61	\$ 36.15	\$ 39.04	\$ 41.10
ICE Brent Crude	\$	33.41	\$ 39.98	\$ 43.30	\$ 45.93
Light Louisiana Sweet	\$	27.01	\$ 36.50	\$ 39.65	\$ 41.80
TM Midland Differential	\$	(2.48)	\$ (0.16)	\$ 0.20	
NYMEX Natural Gas	\$	2.04	\$ 2.50	\$ 2.41	\$ 2.41

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	\$1.71	\$1.89	\$2.59	\$2.38
MichCon	\$ (0.13)	\$ (0.29)	\$ (0.16)	\$ (0.20)
TETCO M3	\$ (0.19)	\$ (0.40)	\$ 0.98	\$ (0.37)
TETCO M2	\$ (0.30)	\$ (0.53)	\$ (0.41)	\$ (0.51)
Dominion S	\$ (0.32)	\$ (0.51)	\$ (0.42)	\$ (0.49)
CIG	\$ (0.51)	\$ (0.50)	\$ (0.35)	\$ (0.54)
NGPL-Midcon	\$ (0.74)	\$ (0.47)	\$ (0.40)	\$ (0.43)
Waha	\$ (1.48)	\$ (0.85)	\$ (0.75)	\$ (0.61)

All prices as of close yesterday