

# Monthly NTA Statement

Investment Update as at 31 August 2019

## Performance Update

The Company's NTA decreased by -1.93% in August (from \$150.8m to \$147.8m). It was generally an ugly month for commodities and other risk assets as heightened rhetoric from both the US and China in their ongoing trade war increased global growth concerns and the potential for a recession. The MSCI Commodity Producers Index lost -8%, the S&P500 Energy Index lost -9% while the MSCI ACWI Metals and Mining Producers (ex-Gold) Index lost -11% in the worst month for commodities this year which saw a wipeout of 2019 year-to-date gains.

While our listed equities exposures performed better than broader gauges, our holdings were not immune from the sell-off. In particular, long positions in Shippers (-0.94%), Base Metals (-0.87%) and Soft Commodities (-0.85%) detracted while short positions in Iron Ore and Coal (+0.60%) delivered positive attribution along with Dual Listed Arbitrage (+0.30%) and longs in Precious Metals (+0.30%). The Company's Credit positions delivered +0.20% of attribution. The current gross exposure is ~80% and listed net exposure is ~40%.

## 10 Largest Long Equity Holdings

Teck Resources Ltd	TECKB CA
Worley Parsons Ltd	WOR AU
Yellow Cake PLC	YCA GB
Lundin Mining Group	LUN CA
Freeport-McMoRan	FCX US
DHT Holdings Inc	DHT US
Euronav	EURN US
Oz Minerals Ltd	OZL AU
Cornerstone Capital Resources	CGP CA
Gaslog Ltd	GLOG US

Source: Tribeca Investment Partners

## Key Details as at 31 August 2019

ASX Code	TGF
Listing Share Price	\$2.50
Share Price	\$2.04
Shares on Issue	63 million
Market Capitalisation	\$128.5 million
Listing Date	12 October 2018

## Net Tangible Assets (NTA) Per Share

NTA Pre-Tax	\$2.3078
NTA Post-Tax	\$2.3468

Source: Citco Fund Services

## Net Performance (Post-Tax)

1 Month	-1.93%
Financial YTD	-2.44%
Total Return Since Inception	-6.13%

## Oil Market

The oil market continues to be heavily influenced by macro sentiment with oil equities bearing the brunt. This is despite underlying fundamentals in oil supply providing pricing support which has seen WTI being sustained in the mid-\$50 per barrel. In fact, in recent weeks, a key indicator of physical tightness has begun to move aggressively higher for the first time since the OPEC-led oil sell-off, potentially signaling further price improvement through September. What is known as the front-month time spread, essentially the one-month forward market price less the spot price today, is showing a stronger backwardation (where today's price is materially higher than prices in the future for November delivery). This is traditionally a signal of a healthy oil market. Oil markets typically trade in backwardation when supply is tight. This is

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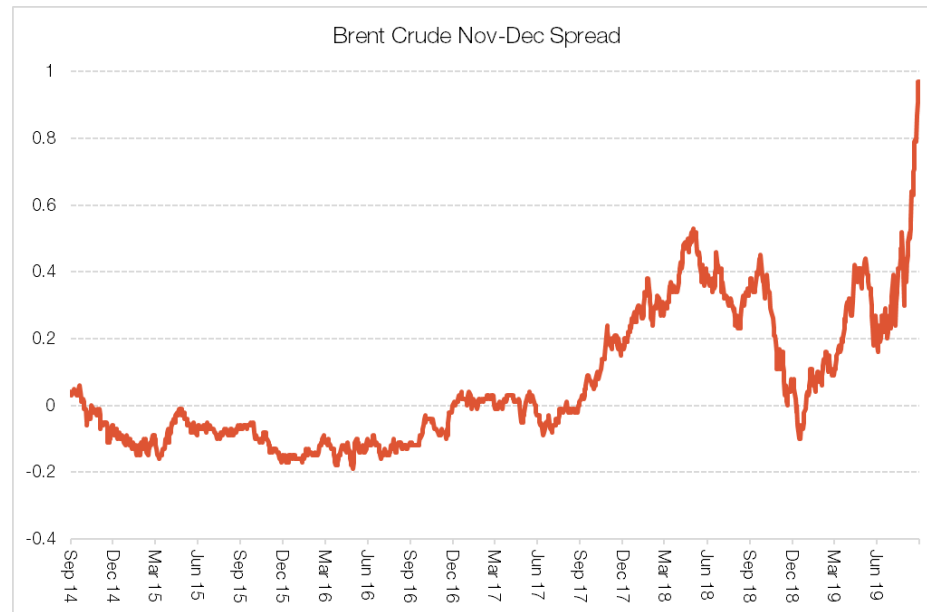
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illustrated below with one expert suggesting at a key Asian conference that, but for the trade war between China and the US, the physical market would price-in oil prices \$15/bbl higher than today.



Source: Bloomberg

In fact, this should be unsurprising when we consider the volumes that have been removed from the market over the past 12 months. The curtailments range from OPEC+ led cuts including Saudi Arabia and Russia; sanction-imposed production cuts for both Venezuela and Iran; and a material slowdown in US onshore production which had been the key winner of market share over the past two years. Natural field decline in large producing regions from Mexico to the North Sea also have contributed to the market tightness with capex budgets still constrained, albeit with some early signs of purse strings opening.

While demand growth forecasts have been reduced over the past 12 months since the trade war was launched by the Trump administration in late 2018, demand is still expected to grow by over 1 million barrels per day. Adding to the demand growth is the fact that IMO2020 will see a material increase in crude demand in order to meet the low sulphur fuel requirement. In the latest August Chinese trade statistics, consumption of crude continues to gather momentum. The upcoming opening of several major Chinese “mega refineries” highlights the developing economy’s desire for crude in order to feed their increasing demand for refined products including a growing petrochemical market. This is despite a drop-off in trade seen in other tradeable commodities.

It has been surprising in recent times that a strong, but admittedly later than expected, draw in observable inventories in the US in particular is not driving spot prices higher. It should be noted that inventories in the key OECD regions of the US, Japan, Singapore and Europe sit at 20 million barrels below the 5 year seasonal average and the August inventory draws of both crude and refined products averaged more than 7.2 million barrels per week of declines as consumption picked up. This level of consumption is significantly above the seasonal averages which is further confirmation of the above-mentioned tightness in the physical markets. We think that the IMO2020 impact on the market did have a negative impact upon Q2 demand as refinery turnarounds (their annual maintenance ahead of seasonal demand) were extended and destocking of certain products that are higher in sulphur occurred, reducing implied demand for crude, while stocking of low sulphur fuel products including diesel and gasoline, gave the appearance of weaker end-consumer demand.

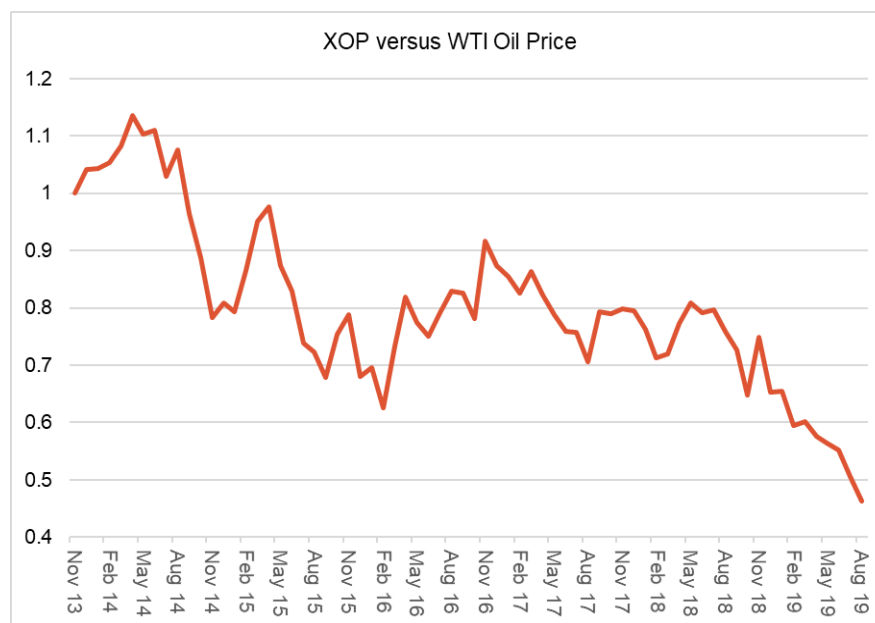
Looking forward into the second half of 2019 and to 2020, what has become apparent in oil markets is that growth for growth’s sake is no longer tolerated by investors. What this has meant for the independent producers of crude, the US E&Ps in particular, is increased discipline around spending. Capital budgets set at the start of the year are unable to be exceeded and companies need to look to repay debt as well as return capital to shareholders. The end result has been a material decline in the US onshore drilling rig count in spite of higher prices. It has also seen completion, or “frac crew”, declines while the companies themselves have started to reduce their inventories of “DUCs” (drilled but uncompleted) wells.

The reduction in DUCs in the near term means that production can hold up. However eventually this depletion of inventory either needs drilling to replenish this drawdown or it will lead to a decline in production in US onshore given the significant production decline rates in shale oil wells. All these factors combined suggest a supportive supply side environment for prices to move higher. The key question remains as to the impact of the US-China trade war and how it might impact demand. To date, the impact on oil demand has been somewhat negative but not nearly as significant as many market commentators would suggest.

### Oil and Oil Services Equities

The Company is currently net long 15% oil and oil services related equities. In recent months, there have been growing comments within the oil market that oil equities underperforming as equity is a better predictor of where the spot oil price is heading than the physical oil market. The evidence trotted out is usually cherry picked from an insufficient number of data points to have statistical meaning and is not borne out by reality. If this is truly the case, then oil equities should have materially outperformed the oil price since the 2015 lows in the commodity price. Since this time, the spot price of crude has nearly doubled. The equity basket of oil stocks, whether it be the large integrated names, or the independent E&P companies have performed poorly and, in many cases, seen a market de-rating.

Oil equities have continued to underperform in August despite the emergence of significant value and a stable price of oil. The XOP, the listed ETF of US oil producers (the E&Ps), continued to sell-off through the month despite recent results highlighting producer discipline and the emergence of free cashflow alongside growing capital returns. The XOP is at its lowest point versus the oil price in the ETF's history. Again, it must be remembered that the index is materially below where it traded when oil was in the low \$30s per barrel and usually you would see equities outperform the oil price as the commodity price rises.



Source: Bloomberg

As we have highlighted in the past, the sector is likely to see material consolidation in time, particularly with the opportunities around synergies and the emergence of large valuation differentials across small versus large companies, particular basins and balance sheet strength. There has been the emergence of M&A activity through the end of 2018 and into 2019, however, the investor response post transaction announcement has likely caused many to pause. Despite the transactions, by and large, making strong economic sense, investors have punished any company bold enough to take advantage of dislocations in the market on a valuation front.

Those E&Ps that have been brave enough to transact will, in time, be rewarded as the transaction is forgotten, and the strategic sense of the deals is reflected in the return profile of the business. To us, Encana is a case in point. The Newfield transaction was widely derided as diluting their Permian Basin assets. However, early cube drilling results out of the Anadarko Basin in Oklahoma have shown that the economics of this designed drilling and completion program is only marginally inferior to what is seen in the heart of the Permian. In addition, Encana has continued to outperform of synergies and capital returns versus the peer group via the \$1.3bn buyback. Despite this, post the late-2018

transaction, the company's share price is one third of that prior to the transaction. This is despite Newfield representing just 20% of the Encana net asset value (NAV).

With oil prices in the mid-to-high \$50s, oilfield service costs declining on lower activity, drilling efficiency still improving and capital discipline being shown by the sector, it now feels like we are late on the path for these stocks transitioning from growth to value. It is likely that through 2020, capital returns will materially increase across the group which will attract investors typically averse to the space. Given the peer group is trading on 3-3.5 times their operating cashflow, there is material upside as capital spending programs are pared back.

To us, this universe of equities, appear like the coal names from 2017 and 2018 where growth spending was cut, the commodity price was well above cashflow break-even and the equities were forced to return surplus capital to investors via dividends or buybacks. This led to a material outperformance of the peer group and helped to support coal prices above the marginal producer for longer.

### Schlumberger versus Haliburton

As a result of the above-mentioned capital discipline being exhibited by US shale producers which has seen a material decline in the onshore rig count, but more importantly a decline in frac crews who complete the wells, we initiated a short position in Haliburton. Haliburton is the largest US onshore oilfield services company that supplies frac crews and other well support services to the unconventional drillers. Given our expectation that capital budgets will not be revised upwards, we see further risks to forward market consensus earnings estimates.

At the same time, the international recovery in oilfield services looks to be seeing clear signs of improvement. This has explained our positioning in the early cycle engineering company Worley but has also led us to initiate a long position in the later cycle Schlumberger. We look at the pair trade of long international oil activity recovery versus declining US onshore growth through Schlumberger and Haliburton.

Regionally we are seeing increasing oil activity on the back of discoveries in Guyana but also increasing optimism around Brazil with the newly installed government. In addition, the Asia-Pacific region is seeing increased investment, some of which is in Australia targeting new LNG projects.

Heading into 2020, due to reduced oilfield service costs, overcapacity in rig and offshore service vehicle markets and improved efficiency, offshore break-evens have reduced materially and in many cases towards sub-\$50 Brent. In addition, natural field decline for many international oil producers sees production decline 10% per annum without the investment in new fields or brownfield tie-backs to existing infrastructure. This spending has been curtailed since 2015 and is now having a material effect on production, the case in point being the North Sea where spending had dried up until recently. Schlumberger will benefit to a greater extent than Haliburton as they are more skewed to international.

The positioning is consistent with our view around oilfield services and our equity holdings in both Worley and MMA Offshore. At the same time, we would note the OSX (PHLX Oil Service Sector Index), which is the oilfield services equivalent of the XOP (SPDR S&P Oil & Gas Exploration & Production ETF), has halved over the past 12 months. While that may suggest value is emerging, the issue we have identified in the US onshore service sector is the significant overcapacity in infrastructure that has emerged. As a result, oilfield service companies have been chasing work to utilize equipment which is potentially loss making from an economic basis but covers fixed costs. As a result, what looks like a low forward earnings multiple is in fact illusory and we would expect to see further negative earnings revisions.

It was not lost on us that early in September at a large US energy conference, Haliburton was forced to further downgrade their Q3 guidance. Meanwhile, at the same conference, Schlumberger was able to hold their guidance for the same quarter which vindicated our positioning. We would expect to see further downward guidance for Q4 2019 and for 2020 earnings, with the market estimating Haliburton's earnings will grow 12% at an EBITDA level in 2020 despite the deterioration in their core US onshore market where key lead indicators such as the onshore rig count and completion crew activity is in decline

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