Energy Strategy
April 2018 Commentary

What more can I possibly say?

Oil is trading at a 3.5 year high. Missiles are flying over Riyadh. Global oil inventories continue to fall counter-seasonally and are headed to their lowest level in a decade by the end of this year. OPEC compliance consistently remains well over 100% and Saudi Arabia has indirectly endorsed an $80/bbl target (makes sense given their fiscal breakeven of ~$85/bbl). Venezuela is imploding before our eyes with production falling by 0.1MM Bbl/d per month (contributing to OPEC's production falling sequentially for 7 months now). President Trump has pulled the US out of the Iranian nuclear JCPOA threatening both Iranian exports (0.2-0.5MM Bbl/d over the next several months) and longer term production growth potential (0.5MM Bbl/d from the Azadegan and Yadavaran fields that will likely go unfunded by foreign investors). US producers continue to adhere to their pledge to constrain spending to within cash flow and redirect excess funds towards share buybacks and dividend increases thereby lowering their ability to ramp production while at the same time labour scarcity worsens and pressure pumping equipment availability slowly tightens. Oil demand growth is absolutely rocking with Q1 demand up 2.2MM Bbl/d YOY and is set to increase by ~1.8MM Bbl/d YOY. ***Did we mention that oil is trading at a 3.5 year high?!?. What more can possibly be said to convince investors that the turn is real and that the fundamentals for oil in the short, medium, and long term are overwhelmingly bullish???***

When we said on CNBC on December 31, 2015 that we thought oil was heading to $50/bbl within the next year many thought that we had started to celebrate New Year's Eve a little too early in the day (oil was trading at $37/bbl at the time). When we wrote in early 2017 that given our non-consensus view that the oil glut would be eliminated by YE'17 we thought WTI was heading to $60/bbl by the end of 2017 (oil was stuck in a $45-$50/bbl trading band due to the belief of limitless oil shale growth) accusations of "perma-bull" were thrown around. Early this year we wrote that given inventory trajectories we believed WTI would hit $70/bbl by YE'18 (we were too conservative!). So now, with oil trading above our $70/bbl call and making a 3.5 year high where do we see things headed?

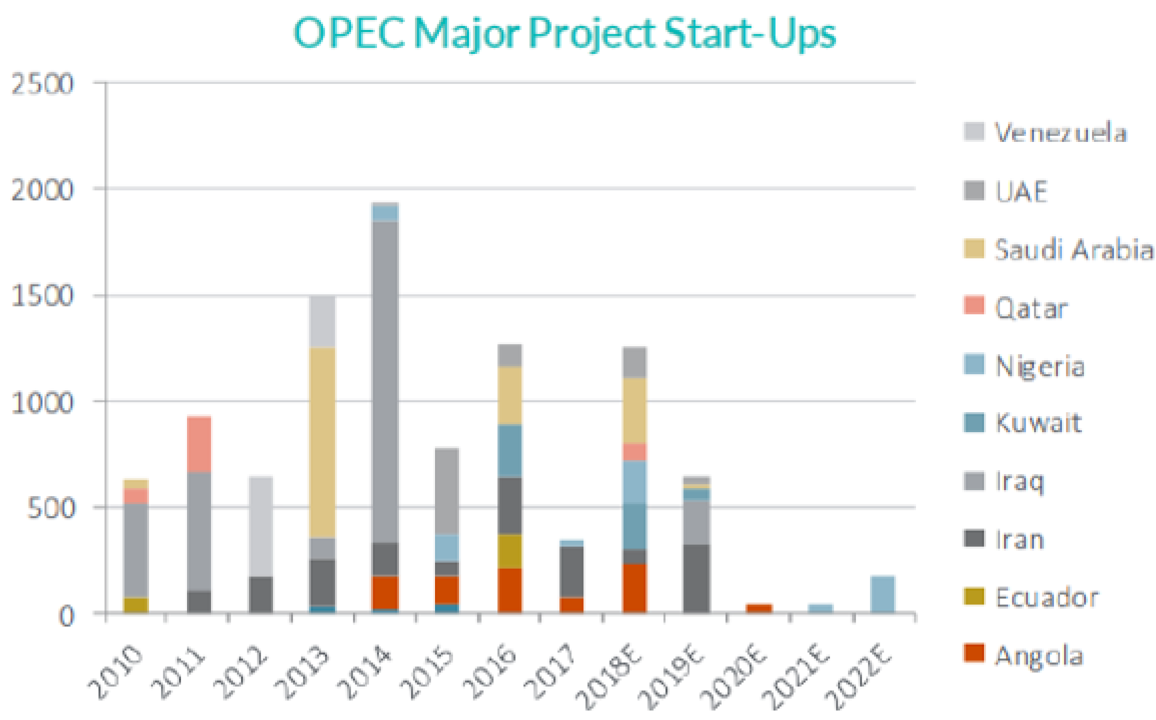
We strongly believe that oil is now in a multi-year bull market and is heading to $80/bbl in 2019 and over $100/bbl within the next several years.

Your first instinct upon reading this is likely "has he forgotten about OPEC shut-ins, US supply growth, electric cars, break even costs in the $50/bbl range, technological efficiency gains, etc...". History does repeat itself after all. The justification for this somewhat bold prediction (and 6 months ahead of consensus?) can be summarized in a previously published chart and we will expand on each line item:

Global Oil Balances	2018	2019	2020
Beginning of year undersupply	0.7	1.1	0.4
Add: Demand Growth	1.8	1.6	1.4
Total amount of required supply growth to reach balance	2.5	2.7	1.8
US Supply Growth	1.2	1.2	1.2
OPEC+Russia Supply Growth	0	1.2	0.3
Non-OPEC/US Supply Growth	0.2	-0.1	-0.4
Total estimated supply growth	1.4	2.3	1.2
End of year market balance	-1.1	-0.4	-0.7
Units: MM Bbl/d; Source: Ninepoint Partners			

The case for the multi-year oil bull market revolves around 4 basic tenets:

1) Due to the lack of investment on the part of OPEC during the dark days of $30/$40/$50 oil when social spending was overwhelmingly prioritized over upstream investment due to social appeasement necessities, OPEC has no major projects coming online between 2020-2022. Given the long-lead nature of these large projects (4-6 years) it corroborates the IEA's view that OPEC will only be able to grow oil production by 0.1MM Bbl/d per year to 2023. This production growth, which again comes from a collective 40% of global oil supply would equate to a stunningly low 6% of annual demand growth.



Source: Simmons, April 3, 2018

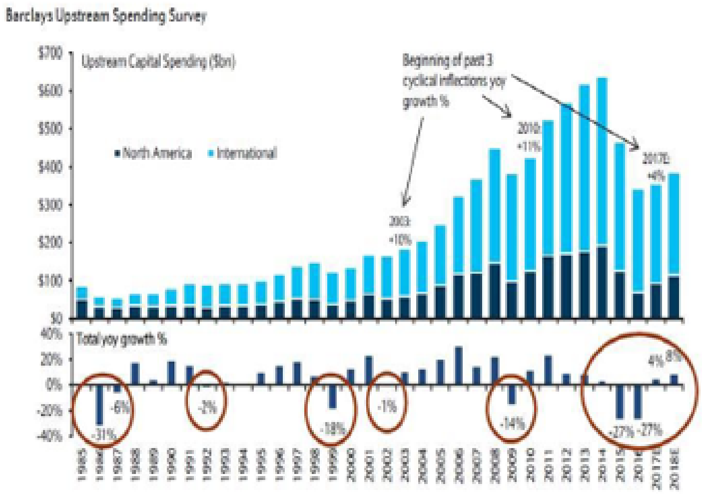
Further, due to the gamesmanship that occurred in early 2016 as OPEC was at the time considering a production freeze rather than an outright cut a significant portion of OPEC's curtailed/shut in production amounts to what we are calling "vapour barrels." By this we mean production growth that was artificially inflated with poor long-term production practices (ie. pulling on wells harder versus new drilling) that over the long run would have risked formation damage and longer term production potential. As can be seen below production within Iraq, Kuwait, Saudi Arabia, and the UAE magically rose by ~0.9MM Bbl/d in the first 6 months of 2016 as OPEC members were about to set the high water mark which would act as the individual members "freeze" allowance. Without the plan to establish a production ceiling this incremental 0.9MM Bbl/d of oil production likely never would have come to market. When one considers that while OPEC production is down 2.2MM Bbl/d from their high water mark (September 2016) involuntary cuts (ie. Venezuela) amount to 0.7MM Bbl/d (and climbing) and the vapour barrels (artificial production capacity) amounts to 0.9MM Bbl/d then the true amount of production that OPEC has to bring online when the expiry of their deal occurs amounts to only 0.6MM Bbl/d. In the context of 1.8MM Bbl/d of demand growth this spare capacity amounts to a meagre 4 months of demand growth. After that point due to the lack of investment OPEC can likely only grow by 0.1MM Bbl/d per year for the next 5 years and this ignores the potential for further "involuntary" curtailments from Venezuela, Iran, Libya, or Nigeria.

OPEC Monthly Production (MBpd)														
	Algeria	Angola	Ecuador	Iran	Iraq	Kuwait	Qatar	Saudi Arabia	U.A.E	Venezuela	OPEC Production ex. Libya and Nigeria	MOM Difference	Libya	Nigeria
Apr-18	990	1,500	520	3,750	4,430	2,700	610	9,900	2,860	1,550	28,810	-63	990	1,810
Mar-18	1,000	1,570	513	3,810	4,430	2,700	610	9,870	2,860	1,510	28,873	-150	990	1,850
Feb-18	1,040	1,600	513	3,830	4,430	2,700	620	9,880	2,800	1,610	29,023	-220	1,050	1,800
Jan-18	1,020	1,620	513	3,830	4,430	2,710	600	9,960	2,850	1,710	29,243	-107	980	1,800
Dec-17	1,030	1,640	520	3,800	4,420	2,690	610	9,950	2,880	1,810	29,350	-40	970	1,820
Nov-17	1,010	1,610	520	3,820	4,390	2,700	600	9,970	2,910	1,860	29,390	-130	1,000	1,750
Oct-17	1,020	1,710	530	3,810	4,350	2,750	570	10,010	2,910	1,860	29,520	-230	980	1,750
Sep-17	1,040	1,640	540	3,830	4,470	2,720	610	10,000	2,930	1,970	29,750	10	920	1,770
Aug-17	1,060	1,660	530	3,790	4,490	2,710	610	10,000	2,920	1,970	29,740	-40	890	1,750
Jul-17	1,060	1,680	530	3,790	4,500	2,700	610	10,030	2,910	1,970	29,780	60	1,010	1,710
Jun-17	1,060	1,670	530	3,760	4,480	2,710	620	10,020	2,900	1,970	29,720	240	840	1,750
May-17	1,040	1,630	530	3,760	4,420	2,710	620	9,930	2,860	1,980	29,480	-65	760	1,700
Apr-17	1,040	1,660	530	3,760	4,410	2,700	615	9,950	2,900	1,980	29,545	(40)	550	1,600
Mar-17	1,040	1,630	530	3,785	4,430	2,705	610	9,940	2,915	2,000	29,585	(150)	620	1,550
Feb-17	1,040	1,690	535	3,780	4,440	2,710	620	9,940	2,950	2,030	29,735	30	700	1,680
Jan-17	1,040	1,670	530	3,800	4,490	2,710	615	9,870	2,950	2,030	29,705	(1,095)	690	1,640
Dec-16	1,110	1,670	550	3,730	4,630	2,860	620	10,480	3,070	2,080	30,800	(170)	630	1,500
Nov-16	1,120	1,690	550	3,750	4,620	2,910	620	10,530	3,060	2,120	30,970	60	580	1,650
Oct-16	1,130	1,520	560	3,680	4,590	2,960	620	10,580	3,130	2,140	30,910	(150)	**520**	**1,600**
Sep-16	1,110	1,730	560	3,630	4,540	2,940	640	10,600	3,110	2,200	31,060	80	340	1,500
Aug-16	1,110	1,770	550	3,620	4,480	2,930	660	10,640	3,030	2,190	30,980	240	260	1,390
Jul-16	1,080	1,760	550	3,560	4,410	2,860	660	10,660	3,000	2,200	30,740	280	300	1,570
Jun-16	1,080	1,750	550	3,530	4,350	2,900	660	10,470	2,920	2,250	30,460	400	320	1,590
May-16	1,090	1,740	550	3,500	4,370	2,830	650	10,260	2,860	2,210	30,060	(10)	280	1,440
Apr-16	1,100	1,800	560	3,500	4,420	2,770	670	10,200	2,800	2,250	30,070	509	310	1,610
Mar-16	1,100	1,780	551	3,200	4,150	2,860	650	10,190	2,760	2,320	29,561	(52)	330	1,720
Feb-16	1,110	1,801	551	3,100	4,200	2,850	650	10,200	2,820	2,331	29,613	(128)	370	1,889
Jan-16	1,100	1,751	534	2,860	4,510	2,860	650	10,200	2,930	2,346	29,741		370	2,028
Avg. of first 6 months of 2016	1,097	1,770	549	3,282	4,333	2,845	655	10,253	2,848	2,285	29,918		330	1,713
First 6 month avg vs. peak month	13	(40)	11	348	207	95	(15)	347	262	(85)	1,143		10	(213)
Diff. now vs. peak month	(120)	(230)	(40)	120	(110)	(240)	(30)	(700)	(250)	(650)	(2,250)		650	350

Source: Bloomberg, Ninepoint Partners

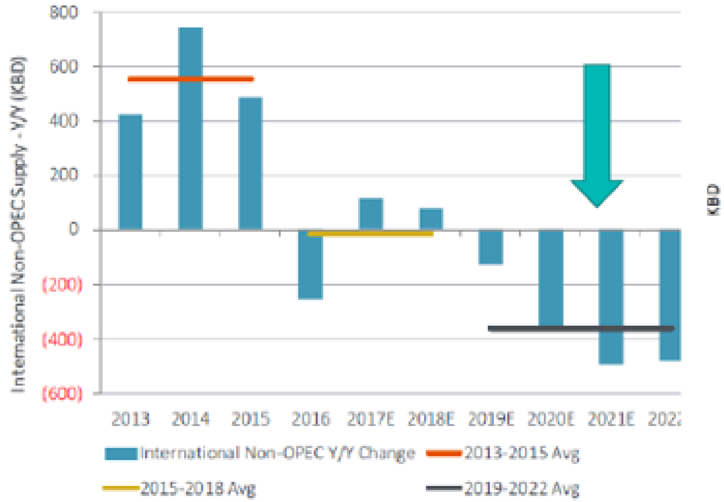
2) Similar to the coming trend within OPEC, Non-OPEC/US production is about to go into a multi-year decline beginning in 2019. The result of the largest collapse in the history of oil was the largest drop in spending in the history of the oil and gas business on long lead projects (Canadian oil sand projects, ultra deep water East Coast Africa, UK/Norwegian North Sea, sub-salt Brazil, etc). As these projects require many years of planning / engineering / spending / procurement / project execution cycle times run from 4 years to as high as 10. This means that even if oil were to spike to $1,000/Bbl today and the CEO of Royal Dutch Shell picked up the phone to authorize the construction of a new oilsand project or the initiation of a meaningful offshore project it would take at a minimum 4 years for the new project to result in incremental oil production. Non-OPEC/US production equates to 50% of global oil supply and this collective region has the complete inability to respond in a timely manner to either a price spike or a production shortage due to a political event within one of the many political hotspots within OPEC. Importantly the extended cycle time of non-OPEC/US production gives us confidence in the longevity of the oil bull market (hence the “multi-year” part).

Upstream Capital Spending ($MM)



Source: Barclays, December 14, 2017

International Non-OPEC Y/Y Change

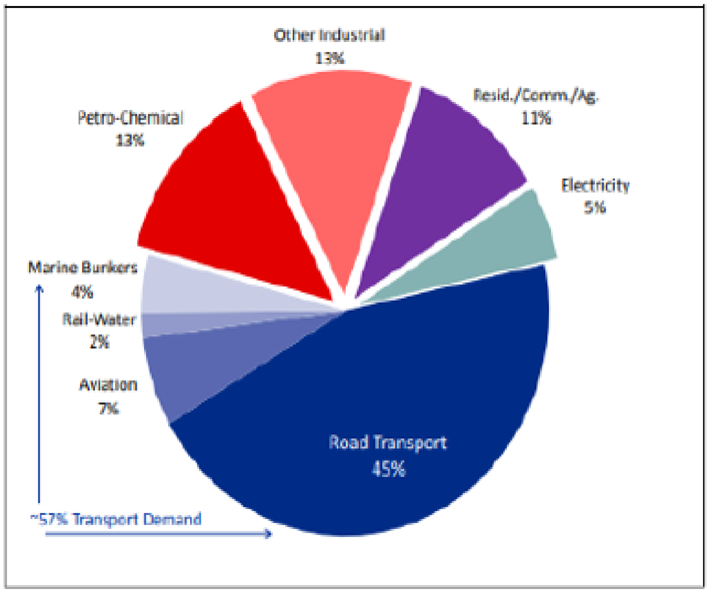


Source: Simmons, December 17 2017

3) US production (10% of global supply; US shale ~6%) while good is not good enough to offset the production growth stagnation/declines from the other 90% of global oil production as well as meet demand growth. Due to labour, equipment, and now pipeline constraints US production growth will be significantly less than what $70/bbl and $80/bbl oil would have historically resulted in. As well, and even more importantly, the change in the shareholder bases of many US E&PS from growth investors to value investors has resulted in compensation plans being much more aligned with generating positive rates of return on a full cycle basis as well as generating excess free cash flow to allow for shareholder returns (buybacks and dividends) versus the prior historical focus of growth for growth's sake. We all do what we get paid to do and as a result the incentive for CEO's to blow their brains out with excessive leverage or stock issuances in order to excessively grow has been eliminated. We believe as a result that annual US production growth will be constrained to ~ 1.2MM Bbl/d and some luminaries such as Mark Papa (former CEO of EOG and one of the most insightful and informed views on US shale production) believes that 2018 US production growth will be below 1.0MM Bbl/d with a falling pace in 2019 and beyond. In short, while 1.2MM Bbl/d (or less) of US supply growth is good it is not good enough to meet global demand growth nor offset the coming 0.3MM Bbl/d of net declines from OPEC and non-OPEC/US which amount to 90% of global supply.

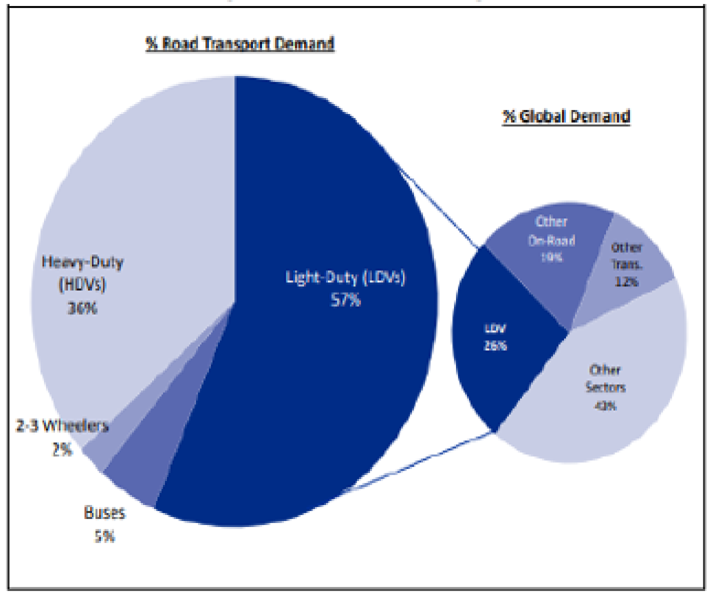
4) Demand continues to defy most oil bears expectations with Q1/2018 demand up a staggering 2.2MM Bbl/d. Despite the ever present though waning concern about electric car adoption we believe oil demand will continue to grow into the 2030's due to continued population growth and the urbanization of India. BMO wrote an excellent report on electric car adoption and estimates that cars only equate to 26% of total global oil demand. Therefore 74% of oil demand is much more sensitive to global economic growth rather than the ability of Tesla (and others) to hit production targets and meaningfully displace the internal combustion engine. Every 1MM EV's that are sold erodes demand growth by a paltry 14,000Bbl/d. In the context of 1.8MM Bbl/d of demand growth and annual internal combustion engine car sales of ~ 80MM each year even the most ardent cheerleaders of the electrification of the global passenger car fleet must admit that it will take several decades before critical scale is reached and for oil demand growth to be meaningfully impacted by EV's.

Global Oil Demand by Sector (%)



Source: OPEC, IEA, BMO Capital Markets

Road Transportation Oil Demand by Sub-Sector



Source: OPEC, IEA, BMO Capital Markets

To summarize, unless the world enters into a global depression and oil demand growth goes negative we cannot envision a scenario that derails our multi-year bull market thesis. In fact, we fully admit that the scenario we are forecasting cannot in reality come to pass. If inventory drawdowns of the magnitude that we are forecasting did occur then inventory levels at refineries would fall below minimum operational levels. What must therefore happen is for the rate of demand growth to be negatively impacted by a high enough oil price. If oil must act as a “demand killer” then a price in excess of $100/bbl is required in 2020 if one were to fully buy into the scenario that we put forth on the prior pages.

How then are we positioned for the multi-year bull market for oil? Our goal is to squeeze every dollar that we can out of the coming sentiment shift as consensus catches up to our views and be maximumally exposed to names that will benefit the most from a higher oil price. We are employing the Wayne Gretzky cliché of “skate to where the puck is going, not where it has been.” Money is actively exiting what has acted as bastions of safety over the past several years during the prior oil bear market (Suncor, midstreamers, pipelines, etc…) and is heading down cap in search of beta. We are already there. We were able to accumulate significant strategic positions in several midcap Canadian oil companies when sentiment was still poor. Today accumulating such positions would be extremely challenging. Some of our positions are up over 80% from when we started purchasing them but as a demonstration of how ridiculously oversold stocks were such names are still buys as we see 100+% upside in them from current levels.

	$70 EBITDA	EV/EBITDA	D/EBITDA	Target Multiple	Target Price	Upside	$80 EBITDA	EV/EBITDA	D/EBITDA	Target Multiple	Target Price	Upside
Company #1	$415	3.0	0.7	5.0	$3.47	86%	$564	2.2	0.5	5.0	$4.93	165%
Company #2	$2,275	3.4	0.9	6.0	$32.77	105%	$2,650	2.9	0.8	6.0	$39.10	145%
Company #3	$1,040	5.4	3.0	6.0	$10.44	28%	$1,455	3.8	2.2	6.0	$18.91	132%
Company #4	$742	4.1	2.2	5.0	$8.86	48%	$959	3.2	1.7	5.0	$13.44	125%
Company #5	$207	4.2	1.5	6.0	$28.18	67%	$252	3.4	1.2	6.0	$36.22	115%
Company #6	$2,804	3.5	1.5	5.0	$18.01	74%	$3,230	3.0	1.3	5.0	$21.91	112%
Company #7	$4,935	5.2	1.7	7.0	$21.27	51%	$6,281	4.1	1.3	7.0	$28.94	106%
Company #8	$239	3.6	1.0	6.0	$10.55	89%	$300	2.9	0.8	5.0	$11.13	99%
Company #9	$14,965	5.0	1.2	7.0	$70.46	52%	$18,528	4.1	1.0	7.0	$90.77	95%
Company #10	$1,432	4.8	1.0	6.0	$59.03	32%	$1,673	4.1	0.8	7.0	$84.50	90%
Company #11	$5,113	4.2	0.6	6.0	$27.42	51%	$6,115	3.5	0.5	6.0	$33.40	84%
Company #12	$289	3.6	0.6	5.0	$5.62	45%	$342	3.1	0.5	5.0	$6.78	74%
Company #13	$729	3.7	1.1	5.0	$21.47	52%	$824	3.2	0.9	5.0	$25.02	77%
Company #14	$1,093	4.6	1.1	6.0	$12.88	39%	$1,290	3.9	0.9	6.0	$15.72	70%
Company #15	$302	5.7	0.8	8.0	$12.12	46%	$342	5.1	0.7	8.0	$13.90	67%
Company #16	$3,585	5.6	1.1	7.0	$21.98	30%	$4,419	4.6	0.9	7.0	$28.04	66%
Company #17	$450	4.6	0.6	6.0	$10.43	36%	$534	3.9	0.5	6.0	$12.61	64%
Company #18	$16,492	5.8	0.8	7.0	$62.85	25%	$19,915	4.8	0.6	7.0	$77.47	54%
Company #19	$920	4.5	0.3	6.0	$21.25	37%	$1,018	4.0	0.3	6.0	$23.65	52%
Company #20	$6,137	6.0	0.5	7.0	$48.61	18%	$7,713	4.8	0.4	7.0	$62.00	50%
Company #21	$253	4.5	1.5	5.0	$1.76	18%	$299	3.8	1.3	5.0	$2.21	49%
Company #22	$347	5.2	0.7	6.0	$9.32	18%	$418	4.3	0.6	6.0	$11.49	45%
Company #23	$196	6.4	3.3	6.0	$0.94	-12%	$246	5.1	2.7	6.0	$1.48	38%
Company #24	$196	4.1	1.1	4.0	$2.42	-3%	$238	3.4	0.9	4.0	$3.14	26%
Company #25	$50	4.1	2.6	4.0	$1.38	-8%	$53	3.9	2.5	4.0	$1.62	8%
Company #26	$133	4.6	1.0	4.0	$1.19	-18%	$158	3.9	0.8	4.0	$1.49	3%
Company #27	$253	4.7	3.1	4.0	$0.94	-41%	$266	4.4	2.9	4.0	$1.15	-29%

Source: Ninepoint Partners

We have maximized the exposure of the Fund to consensus first believing in where oil is today ($70/bbl) and then to where we believe oil is heading ($80+/bbl) over the next several years. The dislocation between oil and oil stocks (since January 1, 2017 to now oil is up 29% in CAD$ terms and the S&P TSX Capped Energy Index is down 10%!) gives us a tremendous margin of safety as we see in many cases in excess of 50% upside just for oil stocks to catch up to where the price of oil already is let alone the upside we see in our $80+/bbl scenario:

Source: Bloomberg

In summary, we are in a multi-year bull market for oil. Sentiment is turning. Money is coming back to the space. Only a global depression can derail our thesis. Oil is already at a 3.5 year high. The dislocation between oil and oil stocks is the widest in history. Oil is up 29% over the past 16 months and some oil stocks are still down over 50% over the same time frame. We see 50% in oil stocks at today's oil price and over 100% in many cases if we are correct that we will see $80/bbl in the next year. The risk versus reward in the energy sector is the best that I have ever seen in my 15 year career.

Eric Nuttall
Senior Portfolio Manager
Ninepoint Energy Fund / Ninepoint Energy Opportunities Trust

COMPOUNDED RETURNS (%) AS AT APRIL 30, 2018

	1MTH	YTD	3MTH	6MTH	1YR	3YR	5YR	10YR	ANNUALIZED INCEPTION
Ninepoint Energy Fund, Series F[1]	13.5	-0.1	4.4	4.8	-6.0	-11.7	-0.6	-5.9	3.5
Ninepoint Energy Opportunities Trust	14.6	1.4	5.8	5.9	-7.1	-3.1	-1.4	-3.8	-27.9
S&P/TSX Capped Energy TR	12.3	3.9	8.3	4.2	4.1	-3.1	-1.4	-3.8	3.8†

[1] All returns and fund details are a) based on Series F units; b) net of fees; c) annualized if period is greater than one year; d) as at April 30, 2018; e) 2004 annual returns are from 04/15/04 to 12/31/04. The index is 100% S&P/TSX Capped Energy TRI and is computed by Ninepoint Partners LP based on publicly available index information.

† Since inception of Ninepoint Energy Fund

Ninepoint Partners LP: Toll Free: 1.866.299.9906. DEALER SERVICES: RBC Investor & Treasury Services: Tel: 416.955.5885; Toll Free: 1.877.874.0899